

# FOCUS ON WATER



Annual Report and Accounts 2007

SEVERN

TRENT

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## Cautionary statement

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', '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.

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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).

## Severn Trent Plc

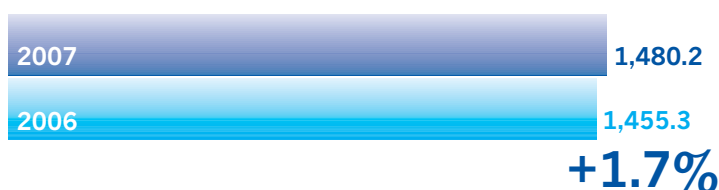
Severn Trent Plc is a public limited company listed on the London Stock Exchange and registered in England and Wales with company number 2366619. This is the Annual Report and Accounts for the year ended 31 March 2007.

More information on Severn Trent Plc can be found on our website at [www.severntrent.com](http://www.severntrent.com)

# FOCUSED ACTIVITIES

- > special dividend of £575 million paid to shareholders in October 2006
- > improved balance sheet efficiency following payment of special dividend
- > no dilution of dividend per share as a result of Biffa demerger
- > sale of non core activities, including US Laboratories, Aquafin and Property
- > overhead costs to fall by £6-10 million over next 12 months
- > gearing to move to 60% of Regulated Capital Value
- > dividends to increase by 3% above inflation to 2010

## Group turnover £m



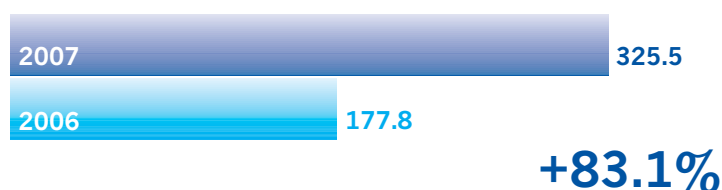
## Group profit\* £m



## Final dividend pence



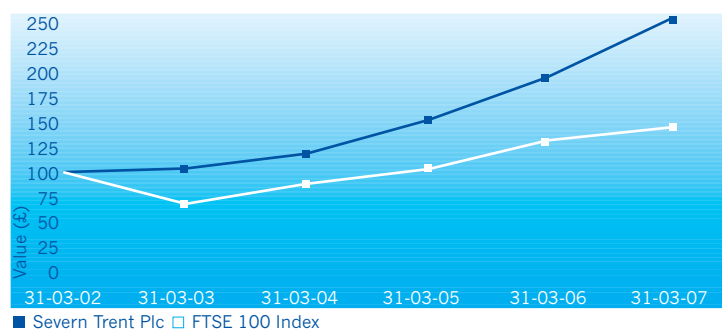
## Group profit before tax £m



## Earnings\* per share pence



## Total shareholder return



This graph shows the value at 31 March 2007, of £100 invested in Severn Trent on 31 March 2002 compared with the value of £100 invested in the FTSE 100 Index. The other points plotted are the values at intervening financial year ends.

## What we do

Severn Trent Plc is a FTSE 100 group focused on water. It serves over 3.7 million household and business customers in England and Wales and provides water and waste water solutions in the UK and overseas.

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Group turnover

**£1,480.2m**

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8,372 employees

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# OUR INDUSTRY

The water industry in England and Wales invests more than £3 billion a year and employs over 27,000 people. There are ten water and sewerage companies in England and Wales and sixteen water supply companies. Severn Trent Plc is the second largest water company listed on the London Stock Exchange.

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### Coverage



Severn Trent Water's region stretches from mid Wales to Rutland and from the Bristol Channel to the Humber. We deliver nearly 2 billion litres of water a day to homes and businesses through 46,000 km of pipes. A further 54,000 km of sewers take waste water away to over 1,000 sewage works.

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### The regulatory framework

Ofwat sets annual price limits for each water company. The current price limits were set in 2004 for the period 2005-10 (the 'AMP4' period). They will next be set in 2009.

Each water company has to submit an annual return (the 'June Return') to Ofwat covering its activities. This is the primary source of regulatory information and enables Ofwat to monitor and compare the performance of the companies.

Water quality in England and Wales is regulated by the Drinking Water Inspectorate; river pollution and flooding is regulated by the Environment Agency.



# SEVERN TRENT WATER

## Turnover

£1218.1m

80.3%

of group turnover

5,289 employees

Severn Trent Water provides high quality water and sewerage services to over 3.7 million household and business customers, in England and mid Wales.

## Key strengths

- > lower tariff levels compared to other water companies
- > drinking water and waste water quality significantly above average
- > strong management team with clear and focused strategy
- > sustained commitment to corporate responsibility

For further information visit [www.stwater.co.uk](http://www.stwater.co.uk)

# WATER TECHNOLOGIES AND SERVICES

## Turnover

£288.9m

19.0%

of group turnover

2,984 employees

Water Technologies and Services is one of the world's leading suppliers of water and waste water treatment solutions. Headquartered in the US, it has a growing presence in the Middle East, Europe and Asia. It has three main businesses: Water Purification, Operating Services and Analytical Services.

## Key strengths

- > strong brand recognition
- > market leadership in disinfection, filtration and arsenic removal – all growing markets
- > continually expanding product and technology base
- > good track record of organic growth and cost control

For further information visit [www.severntrentservices.com](http://www.severntrentservices.com)



# DRIVING HIGHER STANDARDS



**Sir John Egan**  
Chairman

I am pleased to report on a year of significant restructuring for the Severn Trent group of companies which allows us to implement our **focus on water** business strategy.

I am pleased to report on a year of significant restructuring for the Severn Trent group of companies which allows us to implement our **focus on water** business strategy.

In June 2006 the board announced its intention to restructure Severn Trent. Biffa Plc was successfully demerged on 9 October 2006, the sale of Severn Trent Property was completed on 6 November 2006 and the sale of US Laboratories was concluded at the end of December 2006.

In addition, group balance sheet efficiency has been improved by the payment on 20 October 2006 of a £575 million special dividend to shareholders.

As previously announced, the board intends to maintain group debt at around the target 60% of regulated capital value, and to continue to increase dividends by 3% above the rate of inflation at least up to 2010, the remainder of the regulatory review period.

The current market capitalisation of the smaller and focused Severn Trent at £3.5 billion is greater than it was at the end of 2004. Shareholders have received a demerged Biffa worth £1.1 billion and have received a special dividend of £575 million.

Severn Trent Water's customers' top priority is the safety and reliability of their drinking water and we have a strong track record on this. We have consistently achieved 99.9% compliance with water quality standards since 1997, which represents one of the best compliance records in our industry.

Over and above these basic requirements, management is developing detailed plans for fundamental improvements across all areas of the business as outlined in the review by our Group Chief Executive, Colin Matthews.

### Group results

Overall, Severn Trent has delivered a positive performance in 2006/07, with group profit from continuing operations before tax, IAS 39 fair value adjustments and exceptional items at £252 million and group profit from continuing operations before tax was £325.5 million, an increase of 83.1%.

In line with our declared policy, the board is proposing a final dividend of 38.68 pence (31.97 pence) to be paid on 3 August 2007. This would give a total dividend for the year, excluding the special dividend paid on 20 October 2006, of 61.45 pence per ordinary share, an increase of 20.2%.

### Corporate responsibility

When I was invited to join the Severn Trent Plc board and became its Chairman I did not know the full extent of the challenges which the board and new incoming management team were to uncover and the immense commitment of time and energy which has been needed to manage these issues.

There is no point in dwelling unduly on the 2000 to 2004 era to apportion blame or responsibility as this does not help customers or shareholders.

There is, however, every point in me stating here on behalf of the board and management team that we have already accepted the responsibility for making things right.

I believe that you will see from the considerable work outlined in this annual report what we have achieved so far – and the considerable work that we are determined still to do.

We are waiting to learn from Ofwat and the Serious Fraud Office the conclusion of investigations into reporting irregularities made to Ofwat by Severn Trent Water.

We are continuing to co-operate fully to restore confidence in Severn Trent Water going forward and we acknowledge that further amends may be made to customers, depending on the outcome of the investigations.

In response to Ofwat's interim report of March 2006 concerning allegations of false reporting made against Severn Trent Water in 2004, we have already credited customer accounts and altered bills appropriately for subsequent years.

We have taken and will continue to take, all actions we think appropriate to ensure the maintenance of both high ethical and professional standards and resilient and effective controls throughout our companies.

Our new strategy on corporate responsibility (CR) is to support the new management team's drive for excellence by achieving high standards on a range of CR issues.

Those issues include: climate change; the local environment; engagement with local communities; health and safety; business ethics, diversity and investing in people. Further details of our CR strategy, values and action plans are set out on the Severn Trent website ([www.severntrent.com](http://www.severntrent.com)).

To be effective, a company's CR strategy must be fully integrated with its core business planning. The strategic and organisational change that took place within Severn Trent in 2006/07 has reinforced this.

As described later in this Annual Report, Severn Trent Water has determined 20 critical success factors and adopted 20 KPIs, by which it will measure performance and set targets. Many of these indicators link directly to Severn Trent Water's CR strategy – for example, the KPIs on health and safety, leakage, net energy use, pollution incidents and employee motivation. This ensures that CR is entrenched at the very core of Severn Trent's activities.

In addition, Severn Trent's Corporate Responsibility Committee, a board committee, has introduced a more structured approach to reviewing all areas of our CR performance.

Take climate change for example. This has risen up the political and public agenda in 2006/07. We welcome this. Severn Trent Water has been engaged in planning for the changing climate for a number of years. We have built a leading reputation in this area with key stakeholders such as the Carbon Trust.

Severn Trent Water's work on climate change focuses on two main aspects: mitigating our impact on climate change, and adapting to it. In turn, mitigation has two main aspects: energy efficiency initiatives and in-house renewable energy production, primarily biogas combined heat and power (CHP). The effects of our work in both these areas are reflected in our KPI on net energy use.

#### Board, management and staff

The board of Severn Trent Plc continually reviews its management plans to ensure orderly succession and continuity of leadership.

After a year of great strategic change, Chief Executive Colin Matthews is reshaping the group to focus on water aided by Tony Wray, Managing Director of Severn Trent Water, who is concentrating on improving Severn Trent Water day to day operations. As the priority switches more and more to implementing the improvement plans announced by Mr Matthews, the two roles will combine.

The board therefore wishes to provide clarity and confidence to customers, employees and shareholders that there will be a smooth leadership transition in due course from Mr Matthews to Mr Wray particularly now that detailed preparations are underway to achieve an appropriate regulatory settlement for 2010 to 2015.

It is expected that the consideration of the two roles into one leading to the appointment of Mr Wray as Chief Executive and the retirement of Mr Matthews from the board and the company will take place around the end of 2007.

Martin Bettington, Managing Director of Biffa Plc, stood down from Severn Trent Plc when Biffa was demerged in October. I thank him for his tremendous contribution to Severn Trent in helping to grow Biffa to the point where it is now an independent FTSE 250 company valued at more than £1 billion.

Marisa Cassoni stood down from the board in October after 5 years as a non-executive director. I thank her for her contribution, particularly her membership of the Audit, Remuneration and Nominations Committees.

Rachel Brydon Jannetta stood down from the board in December 2006 on completion of the sale of the US Laboratories, our US analytical environmental testing firm, to TestAmerica Holdings. As President and CEO of Severn Trent Laboratories, she made a significant contribution to Severn Trent during her 11 years with the company and the last two years on the board during a period of significant change.

As part of our strategy of focusing on water, all the current executive and non-executive directors of Severn Trent Plc now hold similar positions on the board of Severn Trent Water Limited. Since March 2007 the boards of directors of Severn Trent Plc and Severn Trent Water Limited have been identical.

We have carried out rigorous board effectiveness reviews with the help of independent consultants, which have generated a number of actions to secure improvements to board performance.

I would also like to pay a special tribute to our committed staff whose performance in a year of exceptional challenge and change has been outstanding, ensuring we continue to achieve our business goals.

#### Investment proposition

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 sustained strong financial returns to shareholders.

#### Outlook

The outlook for the coming year is one of significant improvement, with our plans indicating that we will meet the Ofwat determination for operating costs in 2007/08. This improvement is driven by the fall in energy prices (with prices now fixed for 2007/08, our total energy costs will be around £17 million lower than 2006/07), and the delivery of efficiency savings of £5 million through the implementation of our improvement plans.

Our plans encompass the medium and longer term, in some cases extending beyond the end of the current AMP4 period. Delivering sustained improvement will result in cost efficiencies being realised, but will necessitate investment to succeed.

With the exception of any unforeseen variation in commodity prices (principally energy), 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 outperformance against the Ofwat determination for operating costs, without affecting our ability to deliver the 6% efficiency on the capital programme.

# ACHIEVING GREATER EFFICIENCY



A handwritten signature in blue ink that reads "Colin Matthews".

**Colin Matthews**  
Group Chief  
Executive

The successful transformation of the group into a focused water company has enabled the senior executive team to devote a substantial amount of its time to operational improvement in our core water business.

### Introduction

We believe that to satisfy our customers and be cost effective we must raise professional standards across the entire business. Other industries have demonstrated that higher quality and continuous improvement leads to lower costs.

There is every reason why Severn Trent in particular and the water industry in general, can do the same. This is the best, probably the only way, to satisfy customers, regulators, employees and shareholders.

Safety is a prime example of the principle we are pursuing. Our performance improved in the year, which is welcome, but we can make more progress. The skills and attention to detail which achieve higher standards of safety are the same as those we need to improve our environmental impact.

Moreover, as we achieve higher safety standards our operations will become more cost effective. There is no trade off between higher standards and profits – they are closely aligned.

### Operational improvement

With the demerger of Biffa and the sale of the US Laboratories completed by the end of 2006, the group's senior executive team has concentrated on operational improvement.

The group already has clear strengths – for example, Severn Trent Water's consistent attainment of high water quality standards. In order to satisfy our customers and deliver continuing growth for shareholders, we need to improve continuously in all areas.

Therefore, in 2006/07 we examined every aspect of Severn Trent Water's current performance. We benchmarked it against companies in the water and sewerage sector and also in other sectors. We identified major opportunities for improvement and we drew up detailed action plans for achieving those improvements.

We have identified 20 critical success factors against which we will measure our performance and progress. We have chosen these with great care, because they represent what we believe are the key concerns for customers, regulators, employees and shareholders. These 20 factors will be represented by 20 KPIs. In all but two cases, we have defined our actual performance based on our benchmarking exercise and we propose to use these as a basis for assessing our performance going forward. For each indicator, we will set ourselves ambitious targets for the coming years, and have drawn up action plans for achieving them. Some improvements will be effected relatively quickly; others are longer term, going beyond the current AMP4 period.

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 expect to reduce our recurring overhead costs by between £6 million and £10 million over the coming 12 months.

Over the next five years, we expect staffing levels (permanent and agency) in Severn Trent Water to be reduced by around 600 posts. Our plans indicate around 130 of this total being achieved in the financial year 2007/08. We expect to incur around £24 million of restructuring costs over the remaining three years of the AMP4 period, with around £8 million being incurred in 2007/08.



We have changed the divisional structure. In place of our previous 'functional' structure, which had distinct teams working on planning, engineering and operations, we have created integrated teams, one focused on clean water, one focused on waste water and one focused on customer relations.

Like the integration of Plc and Water teams, this new structure will raise standards and drive greater efficiency. It also aligns the organisation with the processes that matter to our customers.

In the following pages of this report, we describe those KPIs and our current position on them. In future years, we will continue to measure and report progress against the targets for each indicator.

### Safety

At Severn Trent health and safety is vitally important to us as a company. In 2006/07 (ex Biffa, Property and US laboratories) our health and safety performance was 24% better than the previous year: there were 7.1 RIDDOR incidents per 1,000 employees, compared to 9.3 in 2005/06. We reached our target for the year, but the figures are still too high. We aim to improve continuously in this area.

We devote huge attention to health and safety for two reasons. It is vitally important at a very personal level, because every safety incident and every day lost has a human impact. But it is also critical at business level. The skills and attention to detail that achieve higher safety standards are the same as those that achieve higher operational and environmental standards and productivity.

Therefore, as our operations achieve higher safety standards, they will also achieve greater operational efficiency. Far from trading off higher safety standards against profit goals, we pursue both together.

### Our stakeholders' priorities

I have said that the KPIs represent the key concerns for our stakeholders. In 2006/07 two concerns in particular have dominated our relations with many stakeholders: leakage and customer service.

Our leakage increased in the prior year 2005/06. As we announced in this last year, 2006/07, we devoted greater resources to leakage management. We employed more people, invested in new leak detection technology, fixed 37,000 leaks, 8,000 more than the previous year and invested almost £20 million more than the previous year. This effort has reduced our leakage this year but it was not until the month of March 2007 that we attained a monthly level of leakage commensurate with our Ofwat annual target. Therefore, notwithstanding this reduction, we believe that we will not attain the annual average target level of leakage.

We have kept Ofwat fully informed of our progress and we are in the process of finalising and verifying our leakage data for submission in our annual June Return, which will be submitted in a few weeks. In due course we will be discussing with Ofwat our ongoing plans and commitments to maintain our progress in reducing leakage.

Reducing leakage will remain a priority in 2007/08 and we are determined to maintain the good progress we have made in the second half of 2006/07. We are in a good position going into this new year.

On customer service too, I am pleased to report good progress. We recruited and trained more staff and fixed problems with our IT billing system. Again, by the end of this year, this work was showing encouraging results. In the last quarter of the financial year, we were once again approaching the levels of service that our customers and regulators expect from us.

### Water Technologies and Services

This business now comprises our Water Purification, Operating Services and UK Laboratories businesses. It produced good results in 2006/07.

We made a number of disposals in the 2006/07 financial year, and one acquisition following the year end. We sold our stake in Aquafin NV to the Flemish government for £29.6 million. We also sold our Pipeline Products and Services assets to ADS LLC and we sold our Aztec instrumentation product line to ABB Limited. On 11 May 2007, we acquired the assets of United Kingdom based Quay Technologies Limited for £1.9 million plus potential additional consideration of up to £5.1 million tied to future earnings. Quay Technologies Limited manufactures a proprietary ultraviolet technology for use in water and waste water disinfection.

These transactions enable us to concentrate on our core strengths, and on higher margin and higher growth areas. We have a twofold strategy for achieving organic growth in these areas. First, we are expanding our existing technologies into new geographical markets and secondly, we are taking new technologies into our existing markets.

### Outlook

In 2007/08 we expect to make good progress in Severn Trent Water on the AMP4 contract and on our own improvement plans. We have demanding targets in our capital programme, in water and waste quality, in customer service and in other areas. We intend to achieve those targets cost effectively, providing value for our shareholders.

We also have to invest to meet longer term targets: the requirements of the Water Framework Directive; the challenges of adapting to climate change and reducing our own carbon footprint.

The investment in reaching those targets, in process improvements and in higher standards will go hand in hand with operational efficiency and improvement. So as we implement those investments for the AMP4 period and beyond, we are confident they will lead to higher levels of customer satisfaction as well as strong financial performance.

The provision of water and waste water services requires operational and investment planning over the long term. We are working with internal experts and external stakeholders to identify and understand the key challenges we face over the next 25 years, ranging from obvious ones like climate change and carbon footprinting, to more industry specific ones like separation of surface water or catchment degradation and the impact they could have on our assets and their ability to deliver the service customers expect. This work will establish the context for our short and medium term planning processes and also inform our Strategic Direction statement for Ofwat by the end of this calendar year. We will continually update this long term planning process in future years.

# FOCUS ON WATER

## OUR STRATEGY IN PRACTICE

Our strategy takes into account the needs of many different stakeholders. Our plans for higher standards will help us satisfy the expectations of all the different groups. For example, greater operational efficiency will help us keep charges to customers low, meet our regulators' standards and targets, create a safe and motivating environment for our employees, and produce good returns for shareholders.

**Our goal is to have highest standards, lowest charges and great people.** Phase one of achieving that goal was to restructure the group so we could focus on water. With that done, we have moved into phase two – the drive to achieve higher standards and continuous improvement in all we do.

Higher  
standards

Continuous  
improvement

Greater  
efficiency

## MEASURING OUR PERFORMANCE

### Radical plans for improvement

Over and beyond these basic requirements, management is fully engaged in implementing plans for fundamental improvement across all areas of the business. The successful execution of these improvement activities will radically change our business over a period of years.

We have already effected organisational improvements. In addition to the integration of the head office and Severn Trent Water Executive teams we have changed the divisional structure in Severn Trent Water. In place of our previous 'functional' structure, which had distinct teams working on planning, engineering and operations, we have created integrated teams, one focused on clean water, one focused on waste water and one focused on customer relations. This new structure is designed to raise standards and drive greater efficiency. It also aligns the organisation with the processes that matter to our customers.

During 2006/07 we examined every aspect of Severn Trent Water's current performance. We benchmarked it against companies in the water and sewerage sector, and also in other sectors. The benchmarking 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.

We have identified 20 critical success factors against which we will measure our performance and progress. We have chosen these indicators with great care, because they represent what we believe are the key concerns for our customers, regulators, employees and shareholders. These 20 factors will be represented by 20 KPIs. In all but two cases, we have defined our actual performance based on our benchmarking exercise and we propose to use these as a basis for assessing our performance going forward. Two KPIs are new (first time job resolution and capital process quality) and we need time to assess our current performance and define our objectives. For all other KPIs, we have shown where our starting point is on a relative scale based on the results of our benchmarking exercise.

For each indicator, we have set ourselves ambitious targets for the coming years, and drawn up action plans for achieving them. Some improvements will be effected relatively quickly and easily; others are longer term, going beyond the current AMP4 period.

The table on the next page sets out our actual performance for the period under review. Based on our benchmarking exercise, our performance is shown in one of three categories, of what we consider to be lower quartile performance, upper quartile performance or median (representing 2nd and 3rd quartile performance).



## Key performance indicators

Key area	Objective	Basis	Measure	Performance		
				Lower quartile	Median	Upper quartile
Employee	Provide a safe working environment	MAT	Lost time incidents per 100,000 hrs worked <sup>1</sup>			0.50
	Develop a confident and productive workforce	Annual Survey	Employee motivation <sup>2</sup>			76%
Customer	Provide a high quality product	MAA	Water quality (mean zonal compliance) <sup>3,4</sup>			99.98%
	Quality interaction with the customer	MAT	Customer written complaints per 1,000 properties <sup>3</sup>	19.06		
		MAT	First time call resolution for billing % <sup>5</sup>			80%
		MAT	Unplanned interruptions per 1,000 properties <sup>3</sup>	6.95		
	Provide a high standard of operational service		Properties at risk of low pressure per 1,000 properties <sup>3,6</sup>			0.09
			First time job resolution <sup>7</sup>	To be determined		
	Development of a sustainable service		Performance against regulatory obligations <sup>5,8</sup>		26%	
Financial	Asset base enhancement	MAT	Capex (gross) vs final determination <sup>3,9</sup>			2.7%
			Capital process quality <sup>7</sup>	To be determined		
	Manage trade debt		Debtor days <sup>6,9</sup>		37.5	
	Management of cost base	MAT	Opex vs final determination £m <sup>9</sup>	479.1		
		MAT	Cost to serve per property £ <sup>10</sup>		226.93	
Environment	Minimise environmental impact	MAT	Pollution incidents per 1,000 properties <sup>3,4</sup>		0.08	
		MAT	Sewer flooding – other causes per 1,000 properties <sup>3</sup>		0.16	
		MAT	Sewage treatment works – breach of consents <sup>3</sup>			0.00%
	Optimise use of resources	MAA	Raw water storage <sup>5,6</sup>			90%
		MAT	Net energy use Kwh/MI <sup>5</sup>		618	
			Leakage MI/d – current DMA <sup>11</sup>	446		
Notes: All measures are for the period to 31 March 2007, except as stated. MAT = Moving Annual total MAA = Moving Annual Average 1 Actual performance across all employees and agency staff. 2 Performance based on annual all employee survey and quarterly survey of 10% of permanent employees. 3 As reported in June Return to Ofwat. Performance figures are provisional at this stage as the June Return will be submitted to Ofwat on 15 June 2007. 4 Measure for calendar year to 31 December 2006.			5 Actual performance based on internal data. 6 Measure as at 31 March 2007. 7 Measure and relative performance to be determined. 8 Measure for quarter ended 31 March 2007. 9 Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2007. 10 Actual performance based on audited UK GAAP financial statements and regulatory accounts for the year ended 31 March 2007. 11 DMA leakage performance measured monthly. Month of March 2007 DMA performance disclosed in table above. Annual measure is MLE leakage the calculation of which has not been completed as at 5 June 2007.			

For a number of KPIs, we have only commenced capturing the data and measuring our performance during the current financial year and therefore corresponding amounts for the previous financial year are not available.

For others, the corresponding amounts are available and these are as follows;

> Water quality	99.95%
> Customer written complaints	10.04
> Unplanned interruptions	4.5
> Properties at risk of low pressure	0.10
> Capex vs. final determination	6%
> Debtor days	31.76
> Opex vs. final determination	£446.5m
> Cost to serve per property	£219.56
> Pollution incidents	0.11
> Sewer flooding incidents	0.14
> Sewage treatment works breach of consents	0.31%

It is not statistically realistic to expect any company to be at the top of every single league table, but nevertheless, we aim 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 target to move with it.

We will report on these measures in future results announcements.

# WATER AND SEWERAGE

## Performance

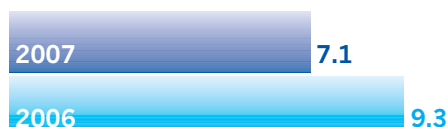
	2007 £m	2006 £m
Turnover	1,218.1	1,150.9
Profit*	413.0	400.4

\*Before interest, tax and exceptional items (see note 5)

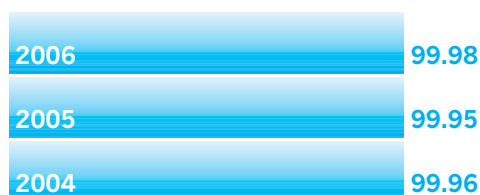
Turnover in Water and Sewerage increased by 5.8% in 2006/07, to £1,218.1 million. Sales prices increased by 6.58% (including inflation) from 1 April 2006. The price rise represented the 7.23% increase allowed by Ofwat, less a 0.65% voluntary abatement of K, previously announced in 2005/06.

Profit before interest, tax and exceptional items (PBIT) was up by 3.1% on the previous year, to £413.0 million as the higher turnover was partially offset by cost increases described opposite.

## Health and safety – RIDDORS per 1,000 employees



## Water quality %



**Tony Wray**  
Managing Director  
Severn Trent Water

## Financial performance

Turnover in Water and Sewerage increased by 5.8% in 2006/07, to £1,218.1 million. Sales prices increased by 6.58% (including inflation) from 1 April 2006. The price rise represented the 7.23% increase allowed by Ofwat, less a 0.65% voluntary abatement of K, previously announced in 2005/06.

Profit before interest, tax and exceptional items (PBIT) was up by 3.1% on the previous year, to £413.0 million. A number of factors impacted PBIT. They included increased energy costs of £23.5 million caused by rising prices; other increases net of efficiencies in our cost base of £17.4 million; increase in infrastructure renewals expenditure of £3.6 million and an increase in depreciation charges of £10.1 million reflecting the growing asset base.

The KPIs covered in the Group Chief Executive's review are referred to here to provide further detail on their use in driving our performance improvements.

## Our asset base

During the financial year, we invested £103 million (£98m net of grants received) in maintaining our infrastructure network. Capital expenditure, excluding spending on infrastructure maintenance, was £399 million. Gross capital expenditure (including infrastructure maintenance expenditure) was £502 million.

One KPI, capex (gross) vs final determination, measures our performance on managing the financial aspects of the delivery of our investment programme. This measures the percentage variance between our capital expenditure and Ofwat's final determination for AMP4. This assesses one aspect of performance against our objective of delivering services to our customers at the lowest costs. Other KPIs (most notably the capital process quality measure) will assess our delivery of high quality services.

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

## Our cost base

We recognise that managing our operating costs is a key component in our success. We continued the work started in 2005/06, including process improvement leading to reducing employee numbers and removing management layers.

Two KPIs measure our performance on managing costs. The first measures the variance between our latest formal forecast of operating costs and Ofwat's Final Determination for AMP4.

The second indicator is the total cost (including operating costs, depreciation, infrastructure renewals and third party costs) associated with serving each customer property.

### Meeting our customers' expectations

Our customers' top priority is the safety and reliability of their drinking water supply and we have a strong track record. We have consistently achieved 99.9% compliance with water quality standards set by the Drinking Water Inspectorate (DWI) since 1997, which represents one of the best compliance records in our industry.

Water companies and regulators measure water quality in a number of ways. Our water quality KPI is based on 'mean zonal compliance'. This is an overall measure used by the DWI which measures the extent to which samples taken at customers' taps comply with all the requirements of the Water Supply (Water Quality) Regulations 2000.

The DWI's performance tables for the 2006 calendar year, which are based on more than 500,000 tests from samples of Severn Trent Water, showed that we achieved 99.98% mean zonal compliance. This is an improvement on our previous year's performance.

During 2006/07 we delivered a number of programmes designed to maintain and improve water quality. They included schemes to secure compliance with mandatory standards for cryptosporidium and nitrate reduction. In addition we carried out an extensive and targeted mains cleaning programme to improve the aesthetic quality of the water we supply.

We are continuing to develop drinking water safety plans for our treatment works and our investment programme for water quality in 2007/08 includes further mains cleaning, more nitrate reduction schemes and lead removal schemes. This will ensure we maintain our high levels of water quality throughout our distribution system.

For water supply to our customers, our KPIs are Ofwat's DG2 risk of low pressure and DG3 unplanned interruptions to supply.

On unplanned interruptions to supply, Ofwat deemed our performance 'good' in 2005/06. However, our figures deteriorated in 2006/07, primarily because of five operational events in the summer of 2006. This year, using the DG3 definition, around 36,100 properties experienced unplanned interruptions to supply, compared to around 15,200 in 2005/06. This represents 1.07% of the properties connected to our network, compared to 0.45% in 2005/06. We have put in place an action plan to improve performance, focusing on our network assets, our processes for responding to problems with water supply and our contingency planning for events such as power outages.

We continued our performance on low pressure in 2006/07, with 314 properties across our entire region at risk of experiencing poor pressure at year end, compared to 313 properties in 2005/06. This represents less than 0.01% of the properties we serve.

During 2007/08 we will install several thousand fixed pressure loggers which will provide much better data on our network enabling us to improve our performance further.

The flooding of a home or property with raw sewage, is viewed by most people as one of the most unpleasant problems our customers may endure. Overall, for the first two years of the AMP4 programme, we have been ahead of our Ofwat target in this area. We will continue working to achieve a net reduction year on year in the number of properties at risk of flooding from sewers. Our programme of works to reduce permanently the risk of internal and external flooding will benefit an estimated 1,600 properties, dependent upon the rate of discoveries of new properties experiencing flooding and being added to our registers.

In terms of the number of actual sewer flooding incidents, our 2006/07 figures are slightly up on those for 2005/06. Changes in weather patterns, with increased numbers of storms have been one of the contributing factors to increases in flooding.

Our sewer flooding KPI aims to reduce the number of incidents from blockages, sewer collapses etc over the next five years. There are two main routes for achieving this reduction. One will be the completion of schemes already underway, such as the £14 million scheme to alleviate flooding in Kenilworth. The second is solutions such as routine sewer cleansing programmes to prevent sewers from blocking.

### Interacting with customers

In addition to receiving excellent operational services from us, our customers expect to interact with us in a satisfactory way. If they have a query about billing, they expect it to be resolved on their first call. If they write to us, they expect a quick response to their letter. It is already well documented that we have not reached high enough customer service standards in recent years.

In June 2006, Ofwat issued a notice under S22A (4) of the Water Industry Act, stating its intention to fine Severn Trent Water for failure to meet customer service standards under the Guaranteed Standards Scheme (GSS) for water companies. The notice covered performance since June 2005. In addition, we are still working and fully co-operating with Ofwat and Ernst & Young LLP on their independent investigations into customer service performance and misreporting which includes performance prior to June 2005. We await the conclusions of those investigations and details of the financial penalties that will be imposed on us.

In June 2006 Ofwat also issued a notice under section 203 of the Water Industry Act requiring further information to be provided about the misreporting of data and our performance against DG standards and the GSS scheme. Data for these areas has been provided to Ofwat going back as far as 1995 and we have answered their detailed questions. Our final response was submitted on 31 January 2007. We anticipate that Ofwat will respond with a further S22A notice of intention to impose a penalty for misreporting of data since June 2005.

In the meantime, we have done much to improve current customer service standards. Many of the customer service failures of 2005/06 were due to the introduction of a major new IT system (TARGET) for billing customers. We acknowledge that, when introducing that system, we underestimated the amount of training required to transfer our contact centre operators to the new system. We also underestimated the extent to which any major new IT system is prone to problems.



# Performance review

## Water and Sewerage continued

During the second half of 2005/06 and the start of 2006/07, these problems were increasingly apparent to us, our customers and to Ofwat. In July 2006, the Consumer Council for Water (CCW) issued a report showing that complaints about Severn Trent Water increased by 54% during the six months from October 2005 to March 2006. Their report for the period April 2006 to March 2007 showed a further rise in complaints of 36%. In 2006/07 we began work on an action plan to fix IT problems, to recruit 70 additional staff in our billing division and to extend the training given to contact centre operators.

The results of that work now show steady improvements. Customer service performance in the first eight months of 2006/07 remained unsatisfactory while figures for the final four months, as a result of the action plan, were starting to show improvement.

For customer service performance the first KPI is written customer complaints per 1,000 properties. This is a new measure for 2006/07. In previous years we have tracked DG7, a measure of the response to written complaints. DG7 performance in 2006/07 was 99.76% compared with 88.7% in 2005/06. Against the new measure, our quarter three performance was 25.9 (complaints per 1,000 properties), recovering to 17.5 in the last quarter, giving performance in the year of 19.06. Whilst both the quality and timeliness of responses have improved in the year, continuing issues on answering phone calls caused customers to write in and complain.

Our second KPI on customer service is first time call resolution for billing contact, which shows the proportion of calls resolved at that point. As well as giving the best standard of service to customers, first time call resolution is also the most cost effective for us. This is again a new measure and whilst we have calculated performance for 2006/07 at 80%, this measure was not tracked in management reports in the course of the year. During 2006/07 the focus has been on ensuring compliance with Ofwat's DG6 (the number of billing contacts received during the report year and the time taken to respond to them) standards and improving the quality of call response.

The training and competency programme for billing staff will continue in 2007/08 and beyond. Our goal in 2007/08 is to sustain the improvements we are now seeing, so we once again meet industry standards in this area. Beyond that, we will set ourselves higher aspirations of being an industry leader in customer service.

Interaction with customers is not just about how we perform in terms of specific figures and measures. It is also about fitting in with different customers' ways of life and giving them flexibility in how they contact us. So, in 2006/07 we redeveloped our website ([www.stwater.co.uk](http://www.stwater.co.uk)) in order to give customers self service options for dealing with us. Transactions such as requesting a meter or telling us about a change of address can now be done online 24 hours a day, seven days a week (24/7), whereas previously customers had to telephone our contact centre.

The other main area of customer interaction relates to our operational water and waste water services. We completed a reorganisation of this process in 2006/07 with the closure of our two 24/7 regional operational management centres. We have established a new 24/7 customer operations service centre at Coventry in the heart of our operational area. All customer contacts related to water and waste water matters are handled alongside and as part of, our operational management capability. This enables us to diagnose operational failures more effectively and promptly and also allows us to use our remote monitoring systems to keep our customer contact teams better informed thus providing a higher standard of service on operational matters. We are working on improving process efficiency to increase customer satisfaction in order to deliver first time job resolution for field and network problems.

We are encouraged that in the first six month period since establishing the new centre (October 2006 to March 2007) we have improved by 13% to 72% the number of customers who, through our service delivery survey, have told us we have met or exceeded their expectations. We are confident that these results demonstrate we can make further sustainable improvements to operational customer service in 2007/08 and beyond.

Our New Connections department manages, from application to delivery, the connection of customers to water and waste water services. In 2006/07 we have worked closely with developers and customers to understand how we can improve our service to them and make interaction with us easier. Consequently, we have changed our organisation design, introduced new web based applications and improved our performance on water service connections completed within 21 working days from 45% to 81%. We are aiming to build on these improvements through 2007/08.

We also have customers who, on receipt of a bill, either cannot or will not pay. This directly impacts our trade debtors and our financial performance. We have therefore introduced the debtor days KPI as the measure by which our performance will be tracked and benchmarked.

Assuming that our year on year billing and collection performance for each of our various income streams remains constant, we would expect our debtor days to increase on an annual basis by approximately two days. This is due to the continued impact of customers switching from the unmeasured to measured basis of charge. As measured bills are sent to customers throughout the year, there will inevitably be a number of recently issued bills that remain unpaid at year end. The number of water meters we installed increased by over 65,500 in 2006/07.

Our debtor days performance has deteriorated from 31 days in 2005/06 to 37 days in 2006/07. This deterioration is above the two day expected increase described above and has been driven by operational performance issues within our billing and collection processes.

We intend to position ourselves within the upper quartile of industry performance by 2011/12. This is to be delivered through a stepped performance improvement in our billing and collection activities. In particular, we will improve the performance of our billing contact centre, reduce our current work in progress backlogs and introduce further billing system improvements.

### Developing a sustainable service for customers

Serving customers also means looking after their long term interests as well as their immediate concerns. Our main aim is to ensure that we are maintaining the serviceability of our assets. This means carrying out the work necessary to make sure their water and sewerage systems deliver reliable service in the future for customers and the environment. It takes into consideration aspects like the condition and deterioration of a company's above ground and below ground water and sewerage assets. The most recent Ofwat assessment shows that we have a stable serviceability across our asset base.

### Improving the delivery of our capital programme

We will aim continuously to improve the delivery of our capital programme. We are in the process of developing a KPI that will measure the quality of our Capex delivery.

The AMP4 contract for 2005-10 includes a capital investment programme of approximately £2.7 billion. This includes:

- > more than £400 million on maintaining water supplies
- > £150 million on improving drinking water quality
- > around £850 million on maintaining and improving river quality
- > more than £350 million improving sewers and dealing with sewer flooding, and
- > more than £260 million to reduce leakage

In the two years to date we have mobilised 2,852 projects of which 1,616 have been completed. We have invested just short of £200 million on our water production and distribution service with the focus on improving levels of service to customers, upgrading our treatment works and distribution network. We have invested over £250 million on sewerage services, with a focus on repairing our aging sewers, maintaining and upgrading our sewage treatment works to meet tighter quality standard and we are exploring ways of exploiting our by products to generate electricity. In addition we have invested £50 million on our support services to improve customer service and business services.

This year capital expenditure, net of grants and contributions, excluding spending on infrastructure maintenance of £98 million, was £365 million for the year. Adjusting for the changes to the programme, to be agreed with Ofwat through the change control process and for timing, differences, we are on track to deliver approximately 6% efficiencies over and above the final determination. This has been largely driven by the use of better technologies, better designs and greater delivery efficiency. It is still early days in AMP4, but we aim to maintain similar outperformance over the rest of AMP4.

### Protecting the environment

The local environment is especially important for a water company. How we abstract water, how we manage waste water discharges, how we operate over 1,000 sewage treatment sites, how we operate our 54,000km of sewerage network and how we manage resources all have a huge potential impact on the local environment. We have a responsibility to minimise that environmental impact and to optimise our use of resources.

The seriousness with which we take that responsibility is reflected in our KPIs. Five separate indicators are linked to environmental performance. They are: breach of consents at sewage treatment works; pollution incidents; raw water storage; net energy use and leakage. In addition to measuring our environmental impact, all five indicators provide a sharp insight into our operational performance.

### Minimising our environmental impact

One of our KPIs in this area measures our compliance with the discharge consents for our sewage treatment works. We have a good history of performance in this area, although a poorly performing sewage works at Stratford-upon-Avon reduced our overall performance figures for 2005 (based on calendar year). In 2006 with that specific problem remedied, our compliance levels were excellent and we achieved a compliance rate of over 99.99%. This level of compliance is amongst the best to be found in the industry.

Another KPI which relates to our environmental impact is the number of pollution incidents; more specifically the number of Environment Agency reported category 1, 2 and 3 pollution incidents. The total number of such pollution incidents was 530 in 2006 calendar year, which was lower than 2005 but still too high. Of the total recorded, two were of the most severe in category 1, and eight were category 2. This performance is comparable with the industry averages using the 2005 data.

Within the total number of pollution incidents, 98% (520) were category 3 incidents which are classified as having a very limited and localised environmental impact. This particular aspect of performance was similar to our 2005 performance (519), placing us in the lower quartile for the industry. We have taken positive steps to make significant improvements in developing an action plan to deliver pollution reductions during the current year and through to the end of the current AMP period. The plan is linked to our proactive and reactive work on the sewerage network. Whilst we only have the first quarter performance for 2007 the results are encouraging, showing a decrease of almost 35% for category 3 incidents compared to the first quarter of March 2006.

We have also instigated a number of projects which include initiatives to raise customer awareness around the impact of depositing fats, oils and greases into the sewerage system. Significant numbers of our sewer blockages are caused by fat build up which in turn contribute to the number of pollution incidents and floodings. We have a plan to educate customers about the potential problems of pouring fat down sinks and drains, part of which is the offer of the provision and distribution of free 'fat traps'. These are small containers to hold cooled fat for easy disposal with household waste. We raised awareness of this initiative through our Source magazine which accompanied all of our annual bills distributed in February and March 2007.

Across the region we have a number of large scale construction and upgrade projects at a number of sewage treatment works. These upgrades are already underway, as part of our AMP4 capital programme and when completed will result in environmental improvements. We are pleased to report that work is currently on schedule.

# Performance review

## Water and Sewerage continued

### Optimising our use of resources

Our water supplies are fundamental to our business. Our KPI on raw water storage compares the percentage of raw water available at our reservoirs against our three year rolling average.

In 2006/07 our raw water storage levels were good despite a dry summer. We did not impose a hosepipe ban during the year, and storage levels at year end were normal for the time of year.

### Net energy use

Our KPI on net energy use measures how much energy (net of renewable energy generated by us) we consume per megalitre of water or waste water treated. Since energy costs are a major element of our cost base – and were especially so in 2006/07 following price rises, managing energy usage also enables us to manage costs. In addition, managing energy consumption is an essential element in mitigating our environmental impact.

In 2006/07 we continued to manage our net energy consumption in two principal ways. First, we maintained our renewable energy production at around 155,000 MWh, this represents 16% of total electricity used.

Secondly, we manage net energy consumption through energy efficiency programmes. In 2006/07 we completed on schedule site energy reviews of our top 407 sites that account for 85% of Severn Trent Water's electricity use. The review has resulted in individual Site Energy Management Plans for 330 sites that include local actions to improve plant/process optimisation and identify potential 'spend to save' opportunities. The review has identified generic approaches required to manage energy on the remaining sites; we believe these plans will enable us to save approximately 10,000 MWh of electricity during 2007/08.

In forthcoming years, implementation of regulations such as the Urban Wastewater Directive and the Water Framework Directive will increase our energy requirements. In order to offset that, we plan to expand our renewable energy production even further. We are planning a number of new opportunities and will continue to work on this in 2007/08 and beyond. In addition to extending our current CHP biogas production, the opportunities we are planning include: biomass energy crops, micro generation, wind turbines and extending hydro power.

### Leakage

This has been a priority for us in 2006/07. We returned disappointing results in 2005/06 and consequently increased our focus on and investment in, leakage control. We employed more people in this area, invested in new technology and in 2006/07 found and fixed 37,000 leaks, 8,000 more than the previous year.

This effort has reduced our leakage this year but it was not until the month of March 2007 that we attained a monthly level of leakage commensurate with our Ofwat annual target. Therefore, notwithstanding this reduction, we believe that we will not attain the annual average target level of leakage. We have kept Ofwat fully informed of our progress and we are in the process of finalising and verifying our leakage data for submission in our annual June Return, which will be submitted in a few weeks.

The largest single element of our investment in leakage management is incurred in our mains renewal programme. The Ofwat Determination for AMP4 assumed around £184 million of expenditure over 5 years (in nominal terms). We have already invested around £85 million in the first two years and we expect to invest a total of around £231 million, some 26% more than assumed in the Determination, over the whole AMP4 period on mains renewals alone.

Reducing leakage will remain a priority in 2007/08 and we are determined to maintain the good progress we have made in the second half of 2006/07. We are in a good position going into this new year.

Promoting the efficient use of water is important to us. During 2006/07 we continued to adopt a twin track approach for promoting the efficient use of water with our customers. This included the promotion and distribution of water saving devices, together with education and the provision of advice to raise awareness of the need to use water wisely.

In the report year we have recorded increases in the distribution and installation of cistern displacement devices, our self audit guides and water butts. We increased distribution of cistern displacement devices by 45,622 (47%) and installation by 65,838 (144%). Self audit guide distribution increased by 15,278 (21%) and water butt distribution by 123 (2%). In addition, the number of pupils attending our education centres in 2006/07 increased by 3,332 (15%). We have enhanced our education programme, and commenced three trial projects including a household water efficiency trial, school water efficiency trial and a local government partnership investigating opportunities to promote water efficiency.

CCW research shows that there is still much work to be done to ensure our customers are sufficiently engaged with the issue and can make use of the tools and technology that we make available. Throughout 2007/08 we will continue our efforts to influence the attitudes of our customers through focused education and awareness activities. In addition we will continue to build our knowledge of the savings associated with water efficiency activities to ensure that future plans provide us with cost effective savings.

### Creating a great place to work

We have stressed repeatedly that health and safety is a key priority for us. At the business level, it is also an important indicator of quality at the workplace level, the physical well being of our employees is paramount.

In line with our KPI on health and safety, we reported a 20% reduction in the RIDDOR accident rate per 1,000 employees in 2006/07. This was an improvement on our performance from the previous year. In 2007/08 and beyond, we will aim to improve further on our safety performance and have therefore moved our performance measure from RIDDORs to the more demanding measure of lost time incidents (LTIs).

For the current year we are targeting a 15% reduction in LTIs. This is a broader measure than the measure we used previously as it includes all injuries that result in time off work, not just the serious longer term injuries.

Behavioural change and individual engagement are important aspects of improving safety and general business performance. We encourage our employees to share and debate their ideas about safety, and to put these ideas into practice. Towards the end of 2005/06 we began to develop a safety management system called SUSAs (Safe and Unsafe Acts). This is a one to one work based observation and discussion process in which SUSAs trained managers talk regularly with their team members about the way in which they and their team do their job.

By the end of March 2007, over 80% of managers had received SUSAs training. The remaining 20% will receive the training in 2007/08 and there will also be a rolling programme to give SUSAs training to new managers. The target is also for each manager to have at least one SUSAs discussion every week.

A second major initiative to improve safety performance is a safety process review of all of our water and waste water sites. A survey is being carried out at each site, with a target completion date of April 2008. Each survey generates an action plan, with some improvements being made immediately and larger improvements being incorporated into our capital investment plan.

As well as completing the safety process review, our plans for 2007/08 include setting up a new technical operational function. This team will independently assess the quality of our operations against technical and safety best practice. The objective is to bring continuous improvement to our technical and operational activities and reporting.

The engagement and skills of our workforce are vital ingredients in making us a leader in our industry. We also need to benchmark that engagement rather than simply talking about it in abstract terms. We have therefore introduced a KPI on employee motivation. Previously, we used to run an annual employee survey; we have now moved to a quarterly survey of 500 randomly selected employees, as well as the annual survey of all staff. This gives us an ongoing measure of staff morale and motivation, which we can also benchmark against other organisations.

#### **Outlook**

In the first two years of the AMP4 contract, we have made good progress on the targets set by Ofwat. Maintaining this progress will govern our activities for 2007/08 and beyond. In order to meet our efficiency targets, we will continue to control operating costs, make process improvements, and manage our capital programme. We will also continue our work to improve leakage and customer service performance.

Our ability to achieve significant operational improvements in 2007/08 and to achieve our AMP4 targets will be boosted by the introduction of our 20 KPIs. They give us clear year by year targets, as well as establishing robust action and improvement plans for achieving them. This will assist both internal and external scrutiny of our activities and deliver our strategy of focus on water.

# WATER TECHNOLOGIES AND SERVICES

## Performance

	2007 £m	2006 £m
Turnover	<b>288.9</b>	299.8
Profit*	<b>19.7</b>	17.1

\*Before interest, tax and exceptional items (see note 5)

After adjusting for the disposal of the Pipeline Services business and the impact of exchange rate fluctuations, turnover in Water Technologies and Services was £292.6 million in 2006/07, up 2.4% on 2005/06 (see below). Turnover in the US businesses was up by 4% above 2005/06, while turnover originating from business units outside the US was essentially even with last year.

Profit before interest, tax and exceptional items was £19.7 million, an increase of 15.2%. This was mainly achieved through greater operating efficiency.

	2007 £m	2006 £m
Turnover	<b>288.9</b>	299.8
Pipeline Services	<b>(5.1)</b>	(14.0)
	<b>283.8</b>	285.8
Exchange rate impact	<b>8.8</b>	–
	<b>292.6</b>	285.8
Growth	<b>2.4%</b>	

## Health and safety RIDDOR incidents



**Len Graziano**  
President and  
Chief Executive Officer  
Water Technologies and  
Services

Severn Trent's Water Technology and Services business is a leading global supplier of water and waste water treatment solutions. It comprises three main groups: Water Purification, Operating Services and Analytical Services. The first two groups are marketed as Severn Trent Services, while Analytical Services takes in the UK Laboratories business.

We operate at the forefront of new water technology. We are leaders in our chosen markets of disinfection, filtration, arsenic removal, and in the UK environmental testing services. We are also a leading provider of contract operating services for water and waste water plants.

## Strategy

Our growth strategy is to focus on our core strengths. Therefore, we made a number of disposals in the 2006/07 financial year. We sold our Pipeline Products and Services assets to ADS LLC. At year end we sold our Aztec instrumentation product line to ABB Limited. We also sold our stake in Aquafin NV to the Flemish government for £29.6 million.

These disposals leave us free to concentrate on our core strengths and on higher margin, higher growth areas. We have a twofold strategy for achieving organic growth in these areas. First, we are expanding our existing technologies into new geographical markets and secondly, we are taking new technologies into our existing markets.

In order to achieve the first of these, we are extending our global sales and distribution network outside the US. This emphasis is reflected in our new order volume for Water Purification products increasing slightly above 13% year over year in 2006/07. As regards new technologies, we acquired a proprietary ultraviolet (UV) technology, Quay Technologies in May 2007. This will enhance our position in the growing global water and waste water disinfection treatment market.

The other aspect of our strategy for delivering good returns to shareholders remains unchanged from previous years. That is, we continue to focus on cost control, operational efficiency and safety improvements. We believe the connections between these three aspects are extremely strong, health and safety improvements go hand in hand with greater operational efficiency, which itself goes hand in hand with cost control.

We are therefore pleased to report a much improved health and safety performance in 2006/07. The number of RIDDOR incidents was down by over 55% on 2005/06.



## Water Purification

The Water Purification division's turnover rose by 4.5% to £106 million and profit before interest and tax increased by 39% on the previous year.

Within this division, Metering Services was a very positive story. In the UK, demand for domestic water meters is increasing, leading to good growth in our figures for meter installations and meter supply.

The Water Purification division is product oriented and new technology is therefore important. Metering Services leads the industry in solid state electronic metering of domestic premises. We further developed our position in 2006 with the design and launch of a new concentric SmartMeter, which is suitable for outdoor installation (our existing meters were primarily for indoor use). The new meter also has the capability to help leak detection, clearly an important part of the UK strategy for water management.

In early 2007 our SM150 and SM250 SmartMeters were the first domestic electronic powered water meters to be approved under the new European Union Measuring Instruments Directive (MID). This will open up the whole European Market to our products for the first time.

The arsenic removal market continues to grow in the US and we have two strong product offerings: Bayoxide® E33 is a proprietary granular ferric oxide medium and Bayoxide® E33P is a proprietary pelletized ferric oxide medium developed by LANXESS for use in Severn Trent Services SORB 33® and SORB 33® APU arsenic removal systems. Bayoxide® has been permitted for use by environmental agencies in 24 states in the US, more than any other arsenic removal technology.

Outside the US, we continued to win new contracts in the Middle East, including supplying on site sodium hypochlorite generation systems to the Abu Dhabi Water and Electricity Authority (ADWEA) and a large electrochlorination contract in Qatar. We also won a deep bed filtration contract with a municipality in China and a contract in the UK to supply Southern Water with filtration equipment for four new waste water treatment facilities.

## Operating Services

This division comprises our Contract Operations business, which carries out operating and maintenance contracts in the US, and our International group, which provides operating management and consultancy services in Europe and the developing world. These services include the Coast to Coast Water (C2C) joint venture. This 25 year, £1 billion Private Finance Initiative contract with the UK Ministry of Defence started in March 2005 and serves some 1,500 sites throughout the country.

At the start of the year, the Contract Operations market in the US was relatively soft. However, demand picked up, driven by municipalities' and governments' need to comply with regulation and to improve the performance of water and waste water plants.

Turnover in Operating Services for the year was up 1% to £146 million and profit before interest and tax improved 4%.

In terms of contract wins, a highlight was the renewal of our US\$72 million contract with the Florida Governmental Utility Authority for five years. Under the revised contract, we will operate and maintain four water and wastewater systems for five years, with an additional five year extension option.

## Analytical Services

Year over year, Severn Trent Laboratories UK's (STL) turnover was £32.5 million, up 1%. As a result of the organisation's continued cost efficiency programmes, profit was up 15% on the previous year.

During the financial year, STL was successfully awarded new contracts with both Welsh Water and Severn Trent Water for five and three years respectively. In June it won a contract to sample and monitor endocrine disrupting compounds for the National Environment Agency Demonstration Programme. This is being conducted in England and Wales in conjunction with the UK Government and the Water Industry. STL also saw continued success in the waste water, waste and land markets and growth in our applied research and radiochemistry capabilities.

## Outlook

Looking ahead, we believe the market outlook for us is generally positive.

There are opportunities in our target Water Purification markets for electro chlorination, on site sodium hypochlorite generation, arsenic removal, and tertiary treatment services. In particular there are good opportunities for us to take our existing technology into new geographical areas. We will continue to focus on selected countries in the Middle East and in 2007/08 we plan to open a direct sales and service office in the United Arab Emirates.

We will also target growth in Asia and Europe. Developments like the EU MID approval for our SmartMeter products will create growth opportunities in 2007/08 and beyond.

There are good commercial opportunities ahead in ballast water treatment, driven by new International Maritime Organisation regulations. Severn Trent De Nora's Balpure system for treating ballast water has a patent pending in the US and was the first commercial system to be selected for testing by the US Coast Guard and the US Environmental Protection Agency.

In the Operating Services business, we plan to achieve growth through geographical expansion, both in the US and internationally, especially in Europe and particularly in the UK non regulated water sector and in Italy.

In Analytical Services, our twin focus will be on utilities and on the commercial sector. The utilities sector remains important to us, but we believe there are higher growth opportunities in the commercial sector. Our existing analytical expertise and reputation in the utilities sector are directly relevant to those commercial opportunities. So we are well equipped to grow that side of the business.

In all three areas, we will maintain our cost control and efficiency programmes.

# THE HEART OF OUR BUSINESS

Severn Trent Plc's decision to focus on water also shifted the focus of our corporate responsibility (CR) strategy in 2006/07. Our new strategy on CR is to support the company's drive for excellence by achieving the highest standards on a range of CR subject areas.

Those subjects include: health and safety; climate change; the local environment; engagement with local communities; business ethics; diversity; and investing in people. Further details of our CR strategy, values and action plans are set out on the Severn Trent website ([www.severntrent.com](http://www.severntrent.com)).

Indicators presented in this CR section have been independently verified by the external consultants Acona as part of our CR verification programme.

**Putting CR at the heart of the business**

To be effective, a company's CR strategy must be fully integrated with its core business planning. The strategic and organisational change that took place within Severn Trent in 2006/07 has reinforced this.

As we describe elsewhere in this Annual Report, Severn Trent Water has adopted 20 KPIs by which it will measure performance and set targets. Many of these indicators link directly to the company's CR strategy for example, the KPIs on health and safety, leakage, net energy use, pollution incidents and employee motivation. This ensures that CR is at the very core of Severn Trent Water's activities. Additional CR objectives have been set to ensure focus across all other elements of our CR strategy. Water Technologies and Services has adopted quarterly CR KPIs in the areas of health and safety, climate change, the supply chain and business ethics focusing on its core business.

In addition, the company's Corporate Responsibility Committee, which now meets bimonthly, has introduced a more structured approach to reviewing all areas of our CR performance through the new KPI's and objectives.

As several of our core CR issues now appear in the company's new KPIs, our progress on them in 2006/07 has already been described earlier in this report, in the Performance Review. Below we look at other CR subject areas that have been important to Severn Trent's activities and focus in 2006/07.

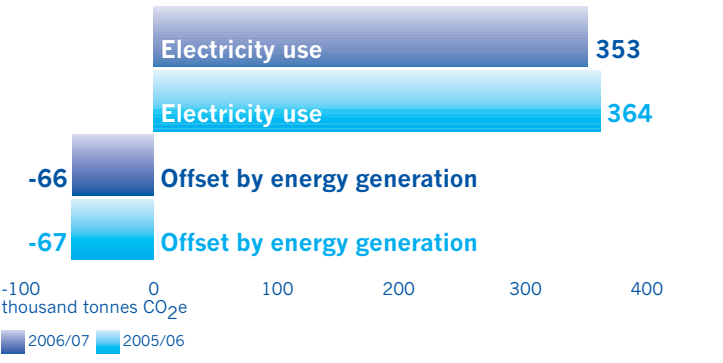
**Environment**

We welcome that climate change has risen up the political and public agenda in 2006/07. Severn Trent Water has been engaged in planning for a changing climate for a number of years. We have built a leading reputation in this area with key stakeholders such as the Carbon Trust. In 2005, we published the Carbon Management report supported by the Carbon Trust. This year we have worked on updating this to take into account the changes within the business.

Our work on climate change focuses on two main aspects: mitigating our impact on climate change; and adapting to it. In turn, mitigation has two main aspects: energy efficiency initiatives; and in-house renewable energy production, primarily biogas CHP. The effects of our work in both these areas are reflected in our KPI on net energy use.

Our work on climate change adaptation involves trying to assess how climate change might impact Severn Trent Water's operations and strategic development. Water supply and sewer flooding are two areas of particular importance.

Key greenhouse gas emissions – Severn Trent Water



Our Water Resources Plan, sets out our water resources investment programme until 2010 and presents a 25 year development plan to 2030. Whilst we have committed to delivering a 17 Ml/d reduction in leakage over the AMP4 period, our analysis to 2030 shows there is a potential need for new strategic water resource developments and further leakage reductions to counter the effects of climate change on the supply/demand balance for water. We therefore aim to carry out work during AMP4 and AMP5 to understand better the climate change impacts and to plan longer term feasibility studies that will ensure water supply to our customers at least cost to them, whilst still considering the longer term social and environmental impact of future increased water abstraction. A key part of this process will be to continue to reduce demand and promote water efficiency.

**Workplace**

Over the past two years we have written much about our work to strengthen our internal business culture and ethics. This work continued in 2006/07 making Severn Trent a more open and transparent culture, where there are no barriers to evaluating performance, whether good or bad.

By the end of March 2007, over 550 Severn Trent Water senior and middle managers had attended a training workshop on ethical decision making. We designed this programme with the help of the Institute of Business Ethics. It gives managers a set of principles and tools to deal with ethical challenges in their day to day work. The next phase is to extend the training across the organisation, to reach all employees.

Water Technologies and Services has also implemented a business ethics training program. Employees worldwide attended 'Ethical Behaviour at Work' training which included the Code of Conduct, Business Ethics and Whistleblowing. US staff were in addition involved in 'Fair Treatment' training focusing on maintaining an appropriate workplace.

Another mechanism for improving our business is strengthening the training we give to new managers. In Severn Trent Water we are now taking a more individual approach to new manager development and in addition to an induction 'Stepping Into Management', there are a variety of modules for managers new to their role.

### Our employees

Our most important obligation to our employees is to ensure their safety and this is covered in the KPIs. We also have other obligations to our workforce. They include: promoting diversity, investing in training, promoting work life balance; and enabling participation in our employee share ownership schemes.

Severn Trent Water launched an important development scheme in 2006/07. Developing Talent is a structured and inclusive two year development programme for people with high potential in the early stages of their career. Unlike its predecessor, the old graduate scheme, our new programme is now open to current employees, graduates and non graduates as well as externally recruited graduates.

We extended the 2006 apprenticeship recruitment campaign and saw 1,000 applications for 40 roles. The apprentices chosen joined 49 other trainees in distribution and sewerage who began their development programmes earlier in the year. Some of them will be the first in the UK to earn qualifications under the proposed Water Apprenticeship Framework.

In Water Technologies and Services a training program has been specially designed to identify 'tomorrow's technical experts'. Successful applicants receive a personal development plan and time to develop technical capabilities.

A diverse workforce is important to the success of the company and we promote this in our working practices. There is always scope to improve our diversity performance and our measures to do this include: monitoring diversity profiles; targeted recruitment initiatives; diversity awareness training; and benchmarking our policies and practices against best practice organisations. Water Technologies and Services programs such as Affirmative Action in North America ensure that managers have a diverse applicant pool.

Severn Trent Water has positive working relationships with recognised trade unions. Regular meetings with trade unions provide opportunities for ongoing dialogue and enhancement of their understanding of the issues facing our business.

### Marketplace

Severn Trent Water has been working to develop its supply chain assessment processes in 2005/06 and 2006/07. Significant contractors/suppliers have been required for some years to provide information on their health and safety performance and their environmental qualifications and performance. In 2006 we recognised a need to build on that. Therefore, in 2006/07 Severn Trent Water began developing a new standardised risk based approach to supply chain assessment, focusing not just on health and safety and environment, but also on human rights, bribery and corruption. We have been working with Nottingham Trent University in the development of a Supply Chain Diploma in Management Studies a first in the Utility sector. The course participants represent all areas of the supply chain, both internal and external.

### Group health and safety

## 24% improvement in RIDDOR\* incident rate

	Per 1,000 employees
2006/07	7.1
2005/06	9.3

\*RIDDOR – Reportable Injuries, Diseases and Dangerous Occurrences Regulations

### Community

Severn Trent Water's relationship with the regional community is another facet of our CR strategy. Our engagement with the community takes several forms: community investment, community liaison; and educational initiatives.

Our community investment programme focuses on three areas: the natural environment, education; and health and well being. We continued our work with nine partner charities that operate at a local and international level.

We also made a substantial grant to the Severn Trent Trust Fund, as in previous years. This independent charity was established in 1997 to help customers in genuine financial difficulty apply for help with paying water and other utility bills. The trust fund helps customers to become good payers. Our annual funding of the trust is £3.6 million per year.

Our education programme aims to raise awareness of the importance of water and water efficiency. We have continued two main initiatives: our educational centres and BeSmart, an education programme which teaches school children about water efficiency. In 2006/07 over 25,000 children visited our educational centres, while 46 schools took part in BeSmart.

Independent research into the two initiatives, commissioned in 2006/07, shows that both are successful in promoting the health aspects of drinking water and the importance of water efficiency. 'It is clear that children that have direct experience of a Severn Trent Water education initiative are more engaged, active and vocal about their water behaviours,' concluded the researchers.

During the year, the BeSmart programme won a West Midlands Business in the Community Big Tick award for investing in young people. It also won a Utility Week award for best community initiative.

# Financial review



**Michael McKeon**  
Group Finance  
Director

## Financial highlights

	2007	2006	% change
Turnover* (£m)	<b>1,480.2</b>	1,455.3	1.7
Profit* before interest, tax and exceptionals (£m)	<b>405.3</b>	393.0	3.1
Profit* before interest and tax (£m)	<b>430.0</b>	377.3	14.0
Profit* before tax, exceptionals and IAS 39 (£m)	<b>252.0</b>	230.2	9.5
Profit* before tax (£m)	<b>325.5</b>	177.8	83.1
Earnings* per share before exceptionals, IAS 39 and deferred tax (p)	<b>82.4</b>	71.4	15.4
Earnings* per share (p)	<b>106.1</b>	52.9	100.6
Final dividend (p)	<b>38.68</b>	31.97	21.0
Interim dividend (p)	<b>22.77</b>	19.16	18.8
Total dividend for the year (p)	<b>61.45</b>	51.13	20.2
Total rebased dividend	<b>61.45</b>	57.00	7.8

\*From continuing operations

### Group results

Group turnover from continuing operations was £1,480.2 million (£1,455.3 million), an increase of 1.7% over last year. The growth in turnover was mainly due to the price increases in Severn Trent Water and organic growth in the Water Purification business partially offset by the disposal of a small business (Pipeline Services) and a reduction in activity in the other businesses.

Group profit from continuing operations before interest, tax and exceptional items was up 3.1% to £405.3 million (£393 million). Beyond the net increase in turnover, the factors affecting profit before interest and tax were cost increases in Water and Sewerage partially offset by margin growth in Water Technologies and Services. There was a net exceptional gain of £24.7 million (exceptional charge of £15.7 million) – see below. Group profit from continuing operations before interest and tax was £430.0 million (£377.3 million).

### Water and Sewerage

Turnover in Water and Sewerage increased by 5.8% in 2006/07 to £1,218.1 million. Sales prices increased by 6.58% (including inflation) from 1 April 2006. The price rise represented the 7.23% increase allowed by Ofwat, less a 0.65% voluntary abatement previously announced in 2005/06.

Profit before interest, tax and exceptional items was up by 3.1% on the previous year to £413.0 million. Beyond the increase in turnover a number of factors affected profit before interest, tax and exceptional items, principally: an increase in energy costs of £24 million, other increases, net of efficiencies, in our cost base of £17.4 million, increase in infrastructure renewals expenditure of £3.6 million and an increase in depreciation charges of £10.1 million reflecting the growing asset base.

### Financial highlights

During the financial year, Severn Trent Water invested £502 million in fixed assets and maintaining its infrastructure network. Included in this total was net infrastructure maintenance expenditure of £98.0 million.

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

### Water Technologies and Services

Turnover in Water Technologies and Services was £288.9 million in 2006/07, down 3.6% on 2005/06. As set out in the table below, adjusting for the effect of the sale of a small business (Pipeline Services) and removing the impact of changing exchange rates, turnover rose by 2.4% to £292.6 million. On the same basis, turnover in the US was up by 4%. Turnover in the UK and rest of the world was up by around 3.1% through continued organic growth. Around 43% of Water Technologies and Services' turnover arose from customers in the USA.

	31 March 2007 £m	31 March 2006 £m
Turnover	288.9	299.8
Pipeline Services	(5.1)	(14.0)
	283.8	285.8
Exchange rate impact	8.8	–
	292.6	285.8

Water Technologies and Services' profit before interest, tax and exceptional items increased by 15.2% to £19.7 million. The improvement mainly arises from improved margins across all principal businesses. The impact of changing exchange rates was immaterial.

### Corporate and Other

Other Businesses' turnover was down 82.6% to £10.3 million. Corporate and Other incurred a loss before interest tax and exceptional items of £26.3 million (loss of £25.7 million).

### Interest and tax

After net interest charges of £153.8 million (£163.9 million) and share of results of associates and joint ventures of £0.5 million (£1.1 million), group profit from continuing operations before tax, exceptional items and IAS 39 fair value adjustments increased by 9.5% to £252.0 million (£230.2 million). Group profit from continuing operations before tax was £325.5 million (£177.8 million).

The total tax charge for the year was £76.9 million (£54.2 million) of which current tax represented £58.5 million (£61.5 million) and deferred tax £18.4 million (credit of £7.3 million). Profit for the period from continuing operations was £248.6 million (£123.6 million).

The effective rate of current tax on continuing businesses, excluding prior year charges and exceptional items, calculated on profit before tax, exceptional items and IAS 39 fair value adjustments was 27% (28.7%). The decrease in effective rate is a result of a lower level of disallowable expenditure. Going forward we expect the effective current tax rate for 2007/08 to be in the range of 25% to 28%.

### Discontinued operations

Discontinued operations generated a profit before tax and exceptional items of £59.6 million (£88.2 million). After tax charges of £15.2 million (credit of £11.2 million) and net exceptional charges of £24.4 million (£nil), net profit attributable to discontinued operations was £20 million (£99.4 million).

### Earnings per share

Basic earnings per share from continuing and discontinued operations were 114.7 pence (95.9 pence). Adjusted basic earnings per share (before exceptional items, IAS 39 fair value adjustments and deferred tax) were 82.4 pence (71.4 pence), an increase of 15.4%.

### Exceptional items

There was a net exceptional gain, on continuing operations, in the year to 31 March 2007 of £24.7 million (exceptional charge of £15.7 million) which comprised:

- > a charge of £14.9 million in Severn Trent Water arising from a programme to restructure and realign the business (£11.9 million write off of decommissioned assets and £3.0 million restructuring costs);
- > demerger and related costs of £16.7 million (including £7.8 million arising from the settlement of pension obligations); and
- > profit on disposal of property and businesses of £56.3 million, comprising:
  - profit of £36.2 million arising from the disposal of properties in Severn Trent Water;
  - profit on disposal of Aquafin NV of £14.7 million; and
  - profit of £5.4 million from the disposal of Severn Trent Property and other property assets in Severn Trent Plc.

There were net exceptional charges of £24.4 million (£nil) on discontinued operations, which comprised:

- > profit on disposal of Biffa Belgium of £9.5 million,
- > a charge of £31.5 million arising from the impairment of goodwill relating to US Laboratories; and
- > loss on disposal of US Laboratories of £2.4 million

### Capital structure and dividend policy

During the year the group reviewed its capital structure and its dividend policy in the light of the transformation of its business structure and the focus on water strategy. The greater longer term clarity provided by this strategy enabled the group to declare its intention to raise gearing, as defined by net debt to regulated capital value (net debt/RCV), to 60%. Leading directly from this decision, a special dividend of £575 million was paid on 20 October 2006. The tighter focus of this new strategy also allowed the group to declare a new dividend policy to raise dividends by 3% above RPI inflation through to the end of the current AMP period – 31 March 2010.



# Financial review continued

## Cash flow

	Continuing £m	Discontinued £m	2007 £m	2006 £m
Cash generated from operations	486.5	87.5	<b>574.0</b>	758.9
Net capital expenditure	(317.7)	(33.8)	<b>(351.5)</b>	(395.9)
Net interest paid	(157.8)	1.4	<b>(156.4)</b>	(180.1)
Tax paid	(29.6)	(6.4)	<b>(36.0)</b>	(68.3)
Other cash flows	0.8	0.4	<b>1.2</b>	(0.2)
Free cash flow	(17.8)	49.1	<b>31.3</b>	114.4
Dividends	(739.5)	–	<b>(739.5)</b>	(234.3)
Acquisitions and disposals	138.0	–	<b>138.0</b>	1.3
Financing	10.0	–	<b>10.0</b>	11.6
Change in net debt from cash flows	(609.3)	49.1	<b>(560.2)</b>	(107.0)

Operating activities generated a net cash inflow of £574.0 million (£758.9 million). Movements in working capital along with the demerger of Biffa Plc on 9 October 2006, sale of Biffa Belgium, the US Laboratories and the Property businesses have resulted in lower group operating cash flows compared with the previous year. Capital expenditure net of grants and proceeds from asset sales (principally surplus properties) £62.2 million (£8.4 million) was £351.5million (£395.9 million). Net interest paid decreased to £156.4 million (£180.1 million) due to the timing of interest payments on finance leases. Tax payments also fell compared with the prior year to £36.0 million (£68.3 million) due to refunds received relating to tax paid in prior years. Dividends paid, including the special dividend of £575 million, amounted to £739.5 million (£234.3 million). After the receipt of £10.0 million from share options exercised (£11.6 million) and other cash inflows of £1.2 million (outflow of £0.2 million) net debt increased by £560.2 million (£107.0 million) from cash flows.

Net debt at 31 March 2006 was £3,127.6 million (£2,961.1 million). Year end balance sheet gearing is 73.3% (60.9%). Net debt, expressed as a percentage of 31 March 2007 Regulatory Capital Value ("RCV") was 56.4% (56.8%), based on RCV at 31 March 2007 of £5,546 million (£5,209 million). The group's net interest charge, excluding IAS 39 fair value adjustments, was covered 4.2 times (3.8 times) by profit before interest, tax, depreciation and exceptional items, and 2.6 times (2.3 times) by profit before interest tax and exceptionals.

## 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 undertaken for the STPS and another scheme, the Severn Trent Senior Staff Pension Scheme (SSPS), as at 31 March 2004.

On the demerger of Biffa Plc the company entered into an agreement with that company and the trustees of the STPS, the SSPS and the UK Waste Pension Scheme (UKWPS) whereby the assets and liabilities relating to Biffa Plc employees in the STPS and the SSPS would be transferred to the UKWPS with effect from 31 March 2007. The net deficit relating to Biffa employees at the demerger date was £39 million. This has been included in the net assets that formed the dividend in specie on demerger. The reduction in the deficit between the demerger date and 31 March 2007 has been treated as an exceptional loss on settlement of £7.8 million.

On an IAS19 basis, the estimated net position (before deferred tax) of all of the group's defined benefit pension schemes was a deficit of £135.1 million as at 31 March 2007. This compares with a deficit of £221.9 million as at 31 March 2006. The movement in the deficit arose as a result of:

- > Additional contributions made during the year of £83 million;
- > Net deficit of £31.2 million transferred to Biffa Plc as a result of the demerger;
- > Strengthening the actuarial assumption relating to longevity, which increased the deficit by £60 million, offset by an increase in the discount rate which reduced the actuarial value of liabilities by £61.7 million;
- > Service cost in excess of normal contributions of £27.2 million resulting from part of the 2006/07 normal contributions having been prepaid in 2005/06; and
- > Other actuarial losses of £1.9 million

Total cash contributions to the schemes in the year were £97.4 million (£105.2 million).

The key actuarial assumptions utilised in the valuation were:

	2007	2006
Discount rate	<b>5.4%</b>	4.9%
Inflation	<b>3.0%</b>	2.7%
Expected return on equities	<b>8.25%</b>	8.0%
Life expectancy at age 65		
For current pensioners		
Men (years)	<b>19.2</b>	18.3
Women (years)	<b>22.1</b>	21.0
For future pensioners currently aged 45		
Men (years)	<b>19.9</b>	18.9
Women (years)	<b>23.0</b>	21.8

On an IAS19 basis, the funding level has improved from around 86% at 31 March 2006 to around 91% at 31 March 2007.

As at 31 March 2007 the group's defined benefit pension schemes had total assets of approximately £1,365 million, (£1,403 million).

Further details of the group's pension position are contained in note 28 to the accounts.

#### Dividends

An interim dividend of 22.77p (19.16p) was paid on 24 January 2007. The board is recommending the payment of a final dividend of 38.68p (31.97p) to make a total dividend, excluding the special dividend, of 61.45p (51.13p). Following the demerger of Biffa Plc and the share consolidation that followed, the dividend for the year ended 31 March 2006 was rebased to 57p per share. The total dividend proposed for the year ended 31 March 2007 represents growth of 7.8% on the rebased dividend, in line with the board's previously announced policy.

#### Treasury management

The group's treasury affairs are managed centrally and in accordance with its Treasury Procedures Manual and Policy Statement. The treasury operation's primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in interest and (to a lesser extent) currency rates and counterparty credit risk. Its activities are subject to a set of controls commensurate with the magnitude of the borrowings and investments under its management. The board determines matters of treasury policy and its approval is required for certain treasury transactions.

It is the group's strategy to access a broad range of sources of finance to obtain both the quantum required and the lowest cost compatible with the need for continued availability.

The group uses financial derivatives solely for the purposes of managing risk associated with financing its normal business activities. The group does not hold or issue derivative financial instruments for financial trading purposes. The group uses a limited number of currency swaps and interest rate swaps to redenominate external borrowings into the currencies and interest rate coupon required for group purposes.

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 2007, interest rates for some 68% of the group's net debt of £3,127.6 million were so fixed, at a weighted average interest rate of 5.7% for a weighted average period of 13.5 years. This policy has been implemented by entering into a portfolio of long dated interest rate swaps that hedge the group's economic exposure to changes in interest rates. However, these swaps are not designated to particular liabilities and hence do not meet the criteria for hedge accounting under IAS 39. Consequently the swaps are revalued at each balance sheet date and the change in fair value is taken to the income statement as a finance cost. In the year ended 31 March 2007 £52.7 m was credited (£31.5m charged) to net finance costs in respect of such fair value movements.

The group's business does not involve significant exposure to foreign exchange transactions. Cross currency swaps are employed to exchange foreign currency borrowings for sterling. The group also has investments in various assets denominated in foreign currencies, principally the US dollar and the euro. The group's current policy is to hedge an element of the currency translation risk associated with certain foreign currency denominated assets.

The long term credit ratings of Severn Trent Plc and Severn Trent Water Limited are:

Long term ratings	Severn Trent Water Limited	Severn Trent Plc
Moody's	A2	A3
Standard & Poor's	A	A-

Further details of the group's borrowings, investments and financial instruments are contained in note 20 to the accounts.

#### Accounting policies and presentation of the financial statements

The Group's financial statements are prepared in accordance with International Financial Reporting Standards that have been ratified by the European Union. There have been no changes in accounting policies during the year ended 31 March 2007.

Following the demerger of Biffa Plc and the disposal of US Laboratories the comparative figures have been restated to reclassify these businesses as discontinued operations. Biffa Belgium, which was also sold during the year, was already classified as a discontinued operation in the previous year since it was held for sale at the previous year end. Severn Trent Property and the former associated company Aquafin NV do not meet the definition of discontinued operations in IFRS 5 and hence are included in continuing operations although they too were sold during the year.

#### Exchange rates

Approximately 2% of the group's profit before interest, tax and exceptional items and 2% of its operating assets are denominated in US dollars. The trading results of overseas subsidiaries are translated to sterling at the average rate of exchange ruling during the year and their net assets are translated at the closing rate on the balance sheet date.

#### Supplementary information

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



**Michael McKeon**  
Group Finance Director

# Board of directors

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4



## **1 Sir John Egan** MSc (Econ) BSc (67)\*

Sir John Egan joined the board in October 2004 and became Chairman on 1 January 2005. He is a director of Warwick Castle Park Trust Ltd and was, until recently, Chairman of Inchcape plc and Harrison Lovegrove & Co Ltd. Sir John worked in the motor industry until 1990 at General Motors, Massey Ferguson and British Leyland, rising to become Chairman and Chief Executive of Jaguar plc. He was Chief Executive of BAA plc from 1990 to 1999 and Chairman of MEPC from 1998 to 2000. He was also President of the Confederation of British Industry from 2002 to 2004. Sir John was knighted in the Queen's Birthday Honours List in 1986. He is a deputy lieutenant of the County of Warwickshire and from September 2007, Chancellor of Coventry University.

## **2 Colin Matthews** MA CEng MBA (51)

Mr Matthews joined the board in October 2003, becoming Group Chief Executive on 1 February 2005. He is a non-executive director of Mondi Ltd and Mondi Plc, currently part of Anglo American Plc. He is a Chartered Engineer and worked for the (American) General Electric Company and then for British Airways, first as Director of Engineering, then as Director of Technical Operations, responsible for all aircraft maintenance, IT and procurement. Mr Matthews was Group Managing Director of Transco from 2001 to 2002 and then CEO of Hays Plc from 2002 to 2004.

## **3 Michael McKeon** MA CA (50)

Mr McKeon joined the board on 13 December 2005 as Group Finance Director. Prior to that, he was Group Finance Director of the buildings materials group Novar Plc. Mr McKeon worked for Rolls Royce Plc from 1997 to 2000 in various senior roles including Finance Director of the Aerospace Group. He has extensive international business experience, having worked overseas for CarnaudMetalbox, Elf Atochem and Price Waterhouse. Mr McKeon is a Chartered Accountant and a Member of the Institute of Chartered Accountants of Scotland.

## **4 Tony Wray** BSc(Hons) (45)

Mr Wray joined the board in March 2005. He is Managing Director of Severn Trent Water Ltd. Prior to that, he was Director of Networks at Eircom, the Republic of Ireland's telephone operator. He joined British Gas in 1983 and held various managerial positions before becoming Head of Asset Management. In 2000 he moved to Transco, first as Director of Asset Management, then as National Operations Director, before being appointed to implement the merger integration of Lattice (Transco) and National Grid Group into National Grid Transco.

## **5 John Smith** FCCA Hon. FRIBA (49)\*

Mr Smith joined the board in November 2003. He is currently Chief Executive of BBC Worldwide and has held various other senior positions within the BBC since joining in 1989 including: Finance Director from 1996 to 2006; Director of Finance, Property and Business Affairs from 2000 to 2004; and Chief Operating Officer until 2005. Mr Smith has held a non-executive directorship with Vickers Plc, was a member of the advisory board of Zurich Financial Services UK and was a director of the Royal Television Society. He also served for three years on the Accounting Standards Board until November 2004.

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#### 6 Martin Houston BSc MSc DIC (49)\*

Mr Houston joined the board in September 2003. He is Executive Vice President and Managing Director of BG Group's North American, Caribbean and Global Liquefied Natural Gas business, and a member of their Group Executive Committee. He joined BG Group in 1983 and has held a number of technical and commercial roles with a predominantly international focus. He is a fellow of the Geological Society of London.

#### 7 Richard Davey (58)\*

Mr Davey joined the board on 1 January 2006. He is non-executive Chairman of London Capital Holdings Plc and a non-executive director of Yorkshire Building Society and Amlin Plc. He also served as a non-executive director of Freeserve Plc from 1999 to 2001 and of Scottish Widows Fund and Life Assurance Society from 1996 to 2000. The majority of Mr Davey's executive career was spent in investment banking at N M Rothschild & Sons where he served in various roles including Head of Investment Banking. Prior to that, he worked at various organisations including Merrill Lynch International Limited and Exco International Plc.

#### 8 Bernard Bulkin, BS PhD FRSC FRSA FIE (65)\*

Dr Bulkin joined the board on 1 January 2006. He is Chairman of AEA Technology Plc, Chairman of Swedish company Chemrec AB and a non-executive director of Accelergy Corporation in California. He is also a Venture Partner at Vantage Point, an international venture capital firm and a Commissioner on the UK Sustainable Development Commission. In 2003 he retired as Chief Scientist at BP Plc, where he had worked for eighteen years.

\*Non-executive director

Membership of board and management committees is as detailed below:

#### Board committees

##### Audit Committee

J B Smith (Chairman)  
B Bulkin  
R H Davey  
F B Smith (Secretary)

##### Remuneration Committee

R H Davey (Chairman)  
B Bulkin  
Sir John Egan  
M J Houston  
F B Smith (Secretary)

##### Nominations Committee

Sir John Egan (Chairman)  
B Bulkin (c)  
R H Davey (c)  
M J Houston  
C S Matthews  
J B Smith (c)  
F B Smith (Secretary)

(c) = Core Members

#### Corporate Responsibility Committee

B Bulkin (Chairman)  
Sir John Egan  
C S Matthews  
F B Smith (Secretary)

#### Management committee Executive Committee

C S Matthews (Chairman)  
A Ballance  
C J Ford  
P J Gavan  
L F Graziano  
M J Kane  
R S Martin  
M J E McKeon  
J C O'Sullivan  
A J Richmond  
S C Smedley  
A P Smith  
F B Smith  
J van den Arend Schmidt  
A P Wray

#### Senior independent non-executive director

R H Davey

#### Group General Counsel and Company Secretary

F B Smith

# Directors' report

The directors present their report, together with the audited financial statements of the group for the year ended 31 March 2007.

## Principal activity

The principal activity of the group is the supply of water and the treatment and disposal of sewage.

Details of the principal joint venture, associated and subsidiary undertakings of the group at 31 March 2007 appear in notes 18, 19 and 41 to the financial statements on pages 67, 68 and 88.

## Business review

The Chairman's statement, the Group Chief Executive's review and the report and performance reviews for the group's main businesses on pages 4 to 23 provide detailed information relating to the group and its strategy, the operation of its businesses, and the results and financial position for the year ended 31 March 2007.

Details of the principal risks and uncertainties facing the group are set out in the corporate governance report on page 33.

All of the above are incorporated by reference in (and shall be deemed to form part of) this report.

## Research and development

Expenditure on research and development including amounts capitalised as tangible fixed assets related to research and development, amounted to £4.2 million (2006: £5.4 million).

## Treasury management

The disclosures required under the EU Fair Value Directive in relation to the use of financial instruments by the company are set out in note 20 to the accounts on page 69.

## Post balance sheet events

Details of post balance sheet events are set out in note 39 to the group financial statements.

## Dividends

An interim dividend of 22.77 pence per ordinary share was paid on 24 January 2007. The directors recommend a final dividend of 38.68 pence per ordinary share to be paid on 3 August 2007 to shareholders on the register on 29 June 2007. This would bring the total dividend for 2006/07, excluding the special dividend paid on 20 October 2006, to 61.45 pence per ordinary share (2006: 51.13p). The payment of the final dividend is subject to shareholder approval at the Annual General Meeting.

## Directors and their interests

Details of changes to the board during the year and of the directors offering themselves for reappointment at the Annual General Meeting are set out on pages 29 and 31 respectively.

Details of directors' service contracts are set out in the directors' remuneration report on page 40.

The interests of the directors in the shares of the company are shown on pages 42 and 43.

Biographies of the directors currently serving on the board are set out on pages 24 and 25.

## Directors' responsibilities statement

The directors are responsible for preparing the financial statements. The directors have chosen to prepare the financial statements for the group in accordance with International Financial Reporting Standards (IFRS) and for the company in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of IFRS financial statements, International Accounting Standard 1 requires that the financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. Directors are also required to: properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's performance; and prepare the financial statements on a going concern basis unless, having assessed the ability of the company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or have no realistic alternative but to do so.

In the case of UK GAAP financial statements, the directors are required to prepare financial statements for each financial year that 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 the financial statements, the directors are required to: select suitable accounting policies and then apply them consistently; make judgements and estimates that are reasonable and prudent; state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for ensuring that the company keeps proper accounting records which disclose, with reasonable accuracy, at any time, the financial position of the company. The directors are also responsible for: safeguarding the assets of the company and the group; taking reasonable steps for the prevention and detection of fraud and other irregularities; the preparation of the report of the directors and the directors' remuneration report which comply with the requirements of the Companies Act 1985; and ensuring the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Directors indemnities

The company's Articles of Association provide that directors of the company shall be indemnified by the company against any costs incurred by them in carrying out their duties including defending any proceedings brought against them arising out of their positions as directors in which they are acquitted or judgement is given in their favour or relief from any liability is granted to them by the court.



### Supplier payment policy

Individual operating companies within the group are responsible for establishing appropriate policies with regard to the payment of their suppliers. The companies agree terms and conditions under which business transactions with suppliers are conducted. It is group policy that provided a supplier is complying with the relevant terms and conditions, including the prompt and complete submission of all specified documentation, payment will be made in accordance with agreed terms. It is also group policy to ensure that suppliers know the terms on which payment will take place when business is agreed. Details of supplier payment policies can be obtained from the individual companies at the addresses shown in note 41 to the financial statements on page 88. Trade creditors for the company at the year end are estimated as representing 11 days' purchases (2006: nil days' purchases).

### Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £277,476 (2006: £487,422). The company focuses on the development of long term partnerships with charities close to its major sites which reflect the three core aims of promoting the natural environment, education and building communities. The company is also committed to supporting WaterAid, the UK's only major charity dedicated to providing safe domestic water and sanitation to the world's poorest people.

The company's policy is not to make any donations to political parties. However, the Political Parties Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part XA of the Companies Act 1985) requires certain types of expenditure on political events to be preapproved by shareholders. At the 2006 Annual General Meeting, shareholders gave the company authorities to cover such expenditure until the 2009 Annual General Meeting. Pursuant to those authorities, during the year ended 31 March 2007 the group incurred costs of £nil (2006: £6,000).

### Substantial shareholdings

As at 5 June 2007 the company had been notified under the Disclosure and Transparency Rules of the following major shareholdings:

	Number of ordinary shares of 97 <sup>1</sup> / <sub>4</sub> p each	%
Barclays plc	8,412,304	3.61
Legal & General	8,235,812	3.53
Investment Management Limited		

### Share capital

The company was given authority at its Annual General Meeting in 2006 to make market purchases of ordinary shares up to a maximum number of 34,909,675 shares. Similar authority will again be sought from shareholders at this year's Annual General Meeting. No market purchases were made by the company during the year ended 31 March 2007.

Details of movements in share capital are shown in note 30 to the financial statements on page 80.

### Employees

The average number of employees within the group is shown in note 9 to the financial statements on page 60.

Severn Trent operates a non discriminatory employment policy and full and fair consideration is given to applications for employment by disabled persons where they have the appropriate skills and abilities. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training adjustments are made. It is the policy of the group that the training, career development and promotion opportunities of disabled persons should, as far as possible, be identical to that of other employees.

The group actively encourages employee involvement and consultation and places emphasis on keeping its employees informed of its activity and financial performance by way of briefings and publication to staff of all relevant information and corporate announcements. The Severn Trent Sharesave Scheme, an all employee SAYE plan, is offered by the group on an annual basis and helps to develop employees' interest in the company's performance.

Further details of arrangements relating to employee involvement are described in the corporate responsibility report on pages 18 to 19.

### Auditors

In the case of each of the persons who are directors of the company at the date when this report was approved:

- > so far as each of the directors is aware, there is no relevant audit information of which the company's auditors are unaware; and
- > each of the directors has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Relevant audit information means information needed by the company's auditors in connection with preparing their report.

This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

Deloitte & Touche LLP has indicated its willingness to continue as auditors, accordingly a resolution to reappoint them will be proposed at this year's Annual General Meeting.

The reappointment of Deloitte & Touche LLP has been approved by the Audit Committee, who will also be responsible for determining their audit fee on behalf of the directors.

### Accounts of Severn Trent Water Limited

Regulatory accounts for Severn Trent Water Limited are prepared and sent to the Water Services Regulatory Authority. A copy of these accounts will be available from the website of Severn Trent Water Limited ([www.stwater.co.uk](http://www.stwater.co.uk)) or on written request to the Company Secretary (at the address given on the back cover). There is no charge for this publication.

# Directors' report continued

## Going concern

The board has a reasonable expectation that the group and the company have adequate resources to continue in operational existence for the foreseeable future. Accordingly the financial statements set out on pages 45 to 88 and 90 to 98 have been prepared on the going concern basis.

## Annual General Meeting

The Annual General Meeting of the company will be held at the National Motorcycle Museum, Coventry Road, Bickenhill, Solihull, West Midlands B92 0EJ at 11.00am on Tuesday 24 July 2007. The notice convening the meeting, together with details of the business to be considered and explanatory notes for each resolution, is distributed separately to shareholders. It is also available on the company's website: [www.severntrent.com](http://www.severntrent.com)

By order of the board

## Fiona Smith

Group General Counsel and Company Secretary  
5 June 2007

## Corporate governance

During the year, and as part of our strategy of focusing on water, all the current executive and non-executive directors of Severn Trent Plc were appointed to similar positions on Severn Trent Water Limited. Since March 2007 the boards of directors of Severn Trent Plc and Severn Trent Water Limited have been identical.

Severn Trent attaches great significance to the maintenance of good corporate governance procedures and adherence to best practice recognising that they play their part in creating a framework which can provide increased benefits for shareholders.

## Compliance statement

This report describes how Severn Trent has applied the principles of good corporate governance as set out in Section 1 of the Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003 (the "Combined Code"). Apart from the matter detailed below the company has complied throughout the financial year ended 31 March 2007 with all of the Combined Code provisions. During the year, the company decided to take advantage of the relaxations that will be permitted by the updated version of the Combined Code issued by the Financial Reporting Council in June 2006 for reporting years starting on or after 1 November 2006. Accordingly, Sir John Egan was appointed to the Remuneration Committee on 3 November 2006.

## The board

### Board structure

The board consists of a non-executive Chairman, three executive directors and four non-executive directors. In accordance with the Combined Code, separate individuals, Sir John Egan and Colin Matthews, are appointed to the positions of Chairman and Group Chief Executive respectively. Richard Davey is the senior independent non-executive director.

The board has reviewed the status of the non-executive directors and considers them all to be independent in character and judgement and within the definition of this term in the Combined Code. The test of independence is not appropriate in relation to the Chairman.

The Chairman and the non-executive directors contribute external expertise and experience in areas of importance to the group such as corporate finance, general finance, corporate strategy, environmental matters, general management and corporate governance. They also provide independent challenge and rigour to the board's deliberations.

Collectively, the board is satisfied it has all of the necessary skills, experience and qualities to lead the company.

## Directors and their interests

The names and biographies of the directors currently serving on the board are set out on page 24. The following also served as directors during the year:

- > Martin Flower retired from the board as a non-executive director on 10 June 2006;
- > Marisa Cassoni retired from the board as a non-executive director on 6 October 2006;
- > Martin Bettington retired from the board as an executive director on 6 October 2006; and
- > Rachel Brydon Jannetta retired from the board as an executive director on 29 December 2006

The training needs of all directors are kept under review and appropriate training identified as part of a continuing process.

Details of the directors' service agreements, emoluments, the interests of directors and their immediate families in the shares of the company and in awards or options over such shares granted under the company's Long Term Incentive Plans and Sharesave Scheme are shown in the directors' remuneration report on pages 34 to 43.

## Operation of the board

The board has ultimate responsibility for ensuring that the company is properly managed and achieves the strategic objectives it sets. It has an agreed schedule of matters reserved to it, which includes setting long term strategic and business objectives, overseeing the company's internal control systems and ensuring that appropriate resources are in place to enable the company to meet its objectives.

The board meets at least ten times in each calendar year and convenes additional meetings as and when required. Details of the number of board and committee meetings and the attendance of the directors at those meetings are shown on page 31.

The Chairman has prime responsibility for the effective workings of the board and agrees the agenda in consultation with the Group Chief Executive and Company Secretary. Papers, including minutes of board committees held since the previous board meeting and reports from each of the executive directors responsible for the group's operating businesses or key central functions, are circulated in advance of each meeting. In addition to the board meetings, the Chairman meets with the non-executive directors without the executive directors present. The non-executive directors, led by the senior independent non-executive director, also have an annual meeting where there is an opportunity for them to meet without the Chairman to appraise the Chairman's performance.

The Group Chief Executive is responsible for the executive management of all of the group's businesses and for implementing board strategy and policy within approved budgets and timescales. The Group Chief Executive is supported by the Executive Committee. Membership of the Executive Committee is shown on page 25 and comprises the executive directors and senior managers responsible for key central and operational functions.

Procedures are in place which allow directors to take independent professional advice in the course of their duties and all directors have access to the advice and services of the Company Secretary. Where a director has a concern over any unresolved business he is entitled to require the Company Secretary to minute that concern. Should he later resign over this issue, the Chairman will bring it to the attention of the board.

Severn Trent purchases directors and officers' liability and indemnity insurance to cover its directors and officers against the costs of defending themselves in civil proceedings taken against them in that capacity and in respect of damages resulting from the unsuccessful defence of any proceedings.

## Board committees

The board has established an effective committee structure to assist in the discharge of its responsibilities. The terms of reference of the Audit, Remuneration and Nominations Committees (the “Principal Committees”) comply with the provisions of the Combined Code and are available for inspection on the company’s website ([www.severntrent.com](http://www.severntrent.com)) or may be obtained on written request from the Company Secretary at the address given on the back cover.

Each of the Principal Committees has reviewed its effectiveness and terms of reference during the year and any necessary actions have been identified and reported to the board.

The membership of all board committees is set out on page 25.

## Audit Committee

The Audit Committee is chaired by John Smith. Its membership comprises Bernard Bulkin and Richard Davey. Only independent non-executive directors may serve on the committee. John Smith has been identified by the board as having recent and relevant financial experience.

The committee meets with the group’s external auditors (the “Auditors”) at least four times a year. By invitation of the committee other individuals such as the Chairman, Group Chief Executive, Group Finance Director and Group Director of Internal Audit will normally be in attendance for all or part of those meetings. The committee and the Auditors also hold separate meetings without the attendance of executive management.

In their assessment of the independence of the Auditors, the committee receives annually in writing details of relationships between the Auditors and the group, which may bear on the Auditors’ independence and receives confirmation that they are independent of the group as required by International Auditing Standard 260.

The committee annually approves the level of the Auditors’ fees in respect of the audit of the financial statements of the group and its subsidiaries at the same time as considering the adequacy of the Auditors’ proposed audit plan.

A formal policy, which includes fee limits, has been adopted for non audit services. Any material project work where fees payable to the Auditors are likely to exceed £100,000 must be approved by the Audit Committee. Where fees are expected to exceed £500,000 the project work would normally be the subject of a competitive selection process. The level of non audit services provided by the Auditors and the associated fees are considered annually by the committee, in the context of the Auditors’ independence, as part of the committee’s review of the adequacy and objectivity of the audit process. An analysis of fees payable to the Auditors in respect of audit and non audit services is provided on page 59.

It is the group’s policy to seek rotation of the Auditors’ principal engagement partner as a matter of course every five years and of other key members of the audit team, where deemed appropriate by the Audit Committee.

The Audit Committee has, throughout the year, monitored the integrity of the financial statements together with the company’s formal announcements relating to its financial performance, paying particular attention to significant reporting judgements contained therein.

The Audit Committee has reviewed risk management and the effectiveness of the system of internal control during the year ended 31 March 2007 and has reported to the board on the outcome of this review.

The effectiveness of the group’s internal audit function has been reviewed by the Audit Committee.

The Audit Committee reviews annually the group’s formal whistle blowing policy that deals with allegations from employees relating to breaches of the group’s Code of Business Principles and Conduct.

## Remuneration Committee

The Remuneration Committee is chaired by Richard Davey. The other members of the Committee are Bernard Bulkin, Sir John Egan and Martin Houston. Only independent, non-executive directors, and the Chairman, who was considered independent on appointment, may serve on the committee. Sir John Egan was appointed to the committee on 3 November 2006. The Group Chief Executive also attends Remuneration Committee meetings at the invitation of the Remuneration Committee Chairman. The committee will normally meet at least four times a year.

The Remuneration Committee determines, on behalf of the board, the Severn Trent policy on the remuneration of executive directors and the Chairman of the board, and is consulted by the Group Chief Executive regarding remuneration for a number of the group’s senior executives.

Further information on the activities of the Remuneration Committee is given in the directors’ remuneration report on pages 34 to 43.

The directors’ remuneration report also describes how the principles of the Combined Code are applied in respect of remuneration matters and includes a statement on the company’s policy on directors’ and senior executives’ remuneration, benefits, share scheme entitlements and pension arrangements.

A resolution to approve the directors’ remuneration report will be proposed at the Annual General Meeting.

### Nominations Committee

The Nominations Committee is chaired by Sir John Egan and its members are the Group Chief Executive and all non-executive directors. The committee's core members are Bernard Bulkin, Richard Davey and John Smith. All other non-executive directors will attend meetings subject to their availability. Other executive directors, senior management and external advisors may be invited to attend meetings as considered appropriate. The Nominations Committee has responsibility for considering the size, structure and composition of the board of the company, retirements and appointments of additional and replacement directors, succession planning and making recommendations so as to maintain an appropriate balance of skills and experience on the board. The committee meets at least three times a year.

No board appointments were made during the year.

### Corporate Responsibility Committee

The Corporate Responsibility Committee is chaired by Bernard Bulkin and its members are Sir John Egan and Colin Matthews. Other executive directors and senior management involved with managing businesses or formulating policies within the group are regularly invited to attend committee meetings. The committee's main responsibility is to develop, review and promote policies to further the group's environmental values in its business, workplace and community engagement activities. The committee's terms of reference may be viewed on the company's website ([www.severntrent.com](http://www.severntrent.com)). Details of the group's corporate responsibility activities may be found on pages 18 to 19.

### Meetings

Details of the board and Principal Committees' meetings attended by each director during the year are as follows:

	Plc board	Audit	Remuneration	Nominations
Number of Meetings	13	6	7	5
Sir John Egan <sup>5</sup>	13	–	2	5
M J Bettington <sup>1</sup>	8	–	–	–
R S Brydon Jannetta <sup>2</sup>	9	–	–	–
B Bulkin <sup>6</sup>	11	5	3	5
M L Cassoni <sup>3</sup>	6	3	3	1
R H Davey	11	6	6	5
M C Flower <sup>4</sup>	2	–	2	2
M J Houston	12	–	7	5
C S Matthews	13	–	–	–
M J E McKeon	13	–	–	–
J B Smith	13	6	–	5
A P Wray	13	–	–	–

1 – Resigned 6/10/06

2 – Resigned 29/12/06

3 – Resigned 6/10/06

4 – Resigned 10/6/06

5 – Appointed Remuneration Committee 3/11/06

6 – Appointed Remuneration Committee 3/11/06

### Directors' interests in contracts

No director had a material interest at any time during the year in any contract of significance, other than a service contract as shown in the directors' remuneration report on page 40, with the company or any of its subsidiary undertakings.

### Remuneration

The directors' remuneration report, which includes a statement on the company's policy on directors' and senior executives' remuneration, is set out on pages 34 to 43.

### Reappointment

The company's Articles of Association require all directors to submit themselves for reappointment at least every three years. This provision also ensures that, as a minimum, one third of the board of directors, together with any director appointed since the last Annual General Meeting, retires each year and, if eligible and so desires, stands for reappointment at the Annual General Meeting. Directors retire on the basis of their length of service since their last election.

Sir John Egan and Tony Wray are the directors retiring by rotation and offer themselves for reappointment.

The Nomination Committee has formally reviewed the performance, contribution and commitment of each of the retiring directors and has recommended their reappointment to the board.

### Performance and effectiveness reviews

During the year the board, with the help of an outside facilitator, carried out a formal evaluation of its performance and that of its committees as well as the individual performance of directors. Each director and the Company Secretary answered a questionnaire on his/her perception of the composition, operation and effectiveness of the board and its committees and on the performance of the Chairmen of the board and principal committees as well as individual directors. In addition they were interviewed by the facilitator to explore certain issues in greater depth and to identify areas requiring improvement. Finally the process reviewed progress against actions identified in last year's review. The conclusion of the evaluation was discussed in detail by the board.



# Corporate governance report continued

## Shareholders

### Relations with shareholders

The board recognises the importance of representing and promoting the interests of its shareholders and that it is accountable to shareholders for the performance and activities of the company.

The annual report and accounts is the principal means of communicating with shareholders. The company's website ([www.severntrent.com](http://www.severntrent.com)) contains complete versions of such reports along with other information relevant to shareholders.

In respect of the company's Annual General Meeting the board encourages shareholders to attend and exercise their right to vote. The notice of meeting and related papers are sent to shareholders at least 20 working days before the meeting. Separate resolutions are proposed on each substantially separate issue. Details of the proxy votes for and against each resolution and the number of abstentions are indicated after the result of the vote on a show of hands.

Shareholders are given the opportunity to meet with the board before and after the Annual General Meeting. Presentations are made on the group's activities and performance prior to the formal business of the meeting. Shareholders have the opportunity to ask questions of the board and present their views. The chairmen of the Audit, Remuneration and Nominations Committees, together with all other directors will normally attend the Annual General Meeting.

The company announces its results on a half yearly basis. Presentations are made to analysts and shareholders following the release of the interim and year end results. The Group Chief Executive and Group Finance Director meet shareholders during the year. The Chairman and, if appropriate, the senior independent non-executive director are available to meet shareholders if required. The board receives written feedback following meetings with institutional shareholders.

## Internal control

### Internal control and risk management

The board has overall responsibility for the group's system of internal control and for reviewing its effectiveness.

The board reviews the effectiveness of the system of internal control, including financial, operational, compliance and risk management, at least annually in accordance with the requirements of the Combined Code and the guidance set out within it. The system of internal control is reviewed for effectiveness and adequacy.

Such systems can only provide reasonable and not absolute assurance against material misstatement or loss, as they are designed to manage rather than eliminate the risk of failure to achieve business objectives.

The board reviews risk management and the effectiveness of the system of internal control through the Audit Committee. The board also keep under review ways in which to enhance the control and audit arrangements in the group. The Audit Committee receives reports every six months from the Group Chief Executive on the significant risks faced by the group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary. Any significant control weaknesses that have been identified as requiring remedy are also reported to the Audit Committee. The Auditors also report on significant control issues to this

committee. The Internal Audit department provides objective assurance and advice on risk management and control.

The board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks faced by the group, have been in place for the year to 31 March 2007 and up to the date of the approval of the Annual Report.

Key elements of the group's processes and procedures are: an organisation structure with clear lines of accountability; regular, structured reviews of business risk by senior management; a scheme of delegated authority; pre-approval of plans, budgets and significant investments; monthly reporting and monitoring of financial results, regulatory compliance and other key business measures; and independent assurance provided by both internal and external auditors.

Work continues to review and improve the system of internal controls across the group. Any controls weaknesses identified have action plans to remedy them and those plans are monitored by the Audit Committee and management team.

### Principal risks

Through its business operations the group is exposed to a number of commercial risks and uncertainties which could have a material impact on our businesses, financial condition, operations and reputation, as well as the value and liquidity of our securities. Not all of these factors are within our control and, in addition, other factors besides those listed below may have an adverse effect on the group.

#### **Changes in law or regulation in the countries and types of business in which we operate could have an adverse effect on our business and operations.**

Regulatory decisions in relation to our businesses, e.g. on whether licences or approvals to operate are renewed, whether market developments have been satisfactorily implemented, on the level of permitted revenues for our businesses, whether there has been any breach of the terms of a licence or an approval, could have an adverse impact on the results of our operations, cash flows, financial condition of our businesses and the ability to develop those businesses in the future.

#### **The results of our operations depend on a number of factors relating to business performance, including the ability to outperform regulatory targets and deliver anticipated cost and efficiency savings.**

Earnings from our regulated water business will be affected by our ability to meet or better our regulatory targets set by Ofwat, the Environment Agency, Drinking Water Inspectorate and other regulators. To meet these targets, we must continue to improve management processes and operational performance. In addition, earnings from a regulated business also depend on meeting service quality standards set by regulators. To meet these standards we must improve service reliability and customer service. If we do not meet these targets and standards, both our results and our reputation may be adversely affected and fines could be imposed.

#### **Various government environmental protection and health and safety laws and regulations govern our businesses.**

These laws and regulations establish, amongst other things, standards for drinking water and discharges into the environment which affect our operations. In addition, our businesses are required to obtain various environmental permissions from regulatory agencies for their operation. Environmental laws and regulations are complex and change frequently. These laws and their enforcement have tended to become more stringent over time, both in relation to their requirements and in the levels of proof required to demonstrate compliance. While we believe we have taken account of the future capital and operating expenditure necessary to achieve and maintain compliance with current and foreseeable changes in laws and regulations, it is possible that new or stricter standards could be imposed or current interpretation of existing legislation amended, which will increase the group's operating costs or capital expenditure by requiring changes and modifications to its operations in order to comply with any new environmental laws and regulations.

#### **The failure of our assets or our inability to carry out critical operations could have a significant impact on our financial position and our reputation.**

We may suffer a major failure in our assets which could arise from a failure to deliver the capital investment programme for our businesses or to maintain the health of our systems. Any failure could cause us to be in breach of a licence or approval and even incidents that do not amount to a breach could result in adverse regulatory action and financial consequences, as well as harming our reputation. Severn Trent Water's regulated business controls and operates water and sewerage networks and undertakes maintenance of the associated assets with the objective of providing a continuous service. The failure of a key asset could cause a significant interruption to the supply of services, which may have an adverse effect on the group's operating results or financial position. In addition water supplies may, inter alia, be subject to contamination from the development of naturally occurring compounds and pollution from man made sources and these may have an adverse effect on our operating results or financial position. The group could also be held liable for human exposure to hazardous substances or other environmental damage.

In addition, we are subject to other risks which are largely outside our control, such as the energy costs, impact of climate change, weather or unlawful acts or third parties, including terrorist attacks, sabotage or other international acts which may also physically damage our business or otherwise significantly affect corporate activities and, as a consequence, affect the results of our operations and our financial position.

#### **External factors could affect the group's pension schemes and adversely impact on our financial position.**

Pension assets and liabilities (pre tax) of £1,364.6 million and £1,499.7 million are held in the group's balance sheet as at 31 March 2007. Movements in equity markets, interest rates and life expectancy could materially affect the level of surpluses and deficits in the schemes and could prompt the need for the group to make additional pension contributions in the future. The key assumptions used to value our pension liabilities are set out in note 28 on page 77.

#### **The group's financial position and business results could be adversely affected if its existing funding arrangements are materially altered.**

The main risks faced by the group in its treasury operations relate to material external changes to current arrangements. In the debt markets, factors such as borrowing restrictions or changes to credit ratings could mean we were unable to finance ourselves or be forced to pay too high a price for that finance. In terms of our borrowings a proportion is subject to variable interest rates and any increase in those rates could increase our borrowing costs. In addition we undertake financial transactions with a number of institutions and we could suffer a financial loss if any of those counterparts were to fail.

# Directors' remuneration report

This report provides the information required by the Directors' Remuneration Report Regulations 2002. It also describes how the principles of the Financial Reporting Council's Combined Code on Corporate Governance (the 'Combined Code') are applied by the company in relation to directors' remuneration and sets out the remuneration policy for the year ended 31 March 2007 and subject to ongoing review, the current and forthcoming financial years.

## Remuneration Committee

The Remuneration Committee determines, on behalf of the board, the company's policy on the remuneration of executive directors and the Chairman of the board. The committee determines the total remuneration packages and contractual terms and conditions for these individuals. The committee is also consulted on the remuneration policy for the next band of senior executives. The policy framework for remunerating all senior executives is consistent with the approach taken for executive directors.

The committee is comprised exclusively of independent non-executive directors of the company, with the exception of Sir John Egan, the company Chairman who was independent on his appointment to the board. The members of the committee during the year were:

- > Richard Davey (Chairman from 11/06/06)
- > Martin Flower (Chairman until 10/06/06)
- > Bernard Bulkin (from 03/11/06)
- > Marisa Cassoni (until 06/10/06)
- > Sir John Egan (from 03/11/06)
- > Martin Houston

With the exception of Sir John Egan, the committee members have no personal financial interest, other than as shareholders, in the matters to be decided. As stated above, as company Chairman, Sir John Egan's fees are set by the committee and Sir John Egan is not party to this discussion. The constitution and operation of the committee comply with the Combined Code except that Sir John Egan's appointment to the committee was made in advance of the appropriate reporting period (as disclosed in the Corporate Governance Report on page 29). In setting performance related remuneration, the committee has regard to the provisions set out in Schedule A to the Combined Code.

## Advisers

To ensure that the company's remuneration practices are market competitive, the committee has access to detailed external research on market data and trends from experienced specialist consultants.

The committee has received material advice from New Bridge Street Consultants LLP which have been appointed by the committee for the purpose of providing this advice. New Bridge Street Consultants LLP, the principal adviser to the committee, has not provided any other services to the company.

The Chairman of the board, (prior to his appointment to the Committee), the Group Chief Executive and the Group Human Resources Director, Andy Smith (until 31 January 2007) and Sally Smedley (from 12 February 2007), also attended some meetings to provide advice and respond to specific questions. Such attendances specifically excluded any matter concerning their own remuneration. The Company Secretary acts as secretary to the committee.

The committee's terms of reference can be viewed on the company's website at [www.severntrent.com](http://www.severntrent.com) or requested from the Company Secretary (at the address on the back cover). The terms of appointment for New Bridge Street Consultants LLP are also available on request from the Company Secretary.

## Remuneration policy

The company's continuing remuneration policy for executive directors is to provide remuneration in a form and amount which will attract, retain, motivate and reward high calibre individuals. The remuneration package is based on the following principles:

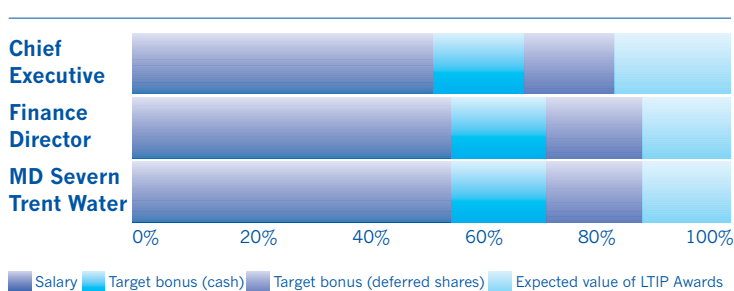
- > Incentives are aligned with the interests of shareholders and seek to reward the creation of long term value;
- > Reward elements are designed to reinforce the link between performance and reward. Performance related elements should form a significant proportion of the total remuneration package and typically comprise at least 50% of total remuneration, if paid at the maximum;
- > The total remuneration package for on target performance should be fully competitive, but not excessive, in the relevant market;
- > Packages are structured flexibly to meet critical resource needs and retain key executives.

Each year, the committee reviews the remuneration policy for executive directors and other senior executives, taking into account both the external market and the company's strategic objectives over the short and the medium term. In respect of 2007/8, as outlined in greater detail later in this report, the committee has particularly focussed on the balance of variable remuneration and the split between short term and longer term targets.

As a consequence, whilst the committee is satisfied with the appropriateness of the overall quantum of rewards available, it has decided that, at least in respect of 2007/8, an increased weighting should be placed on the annual bonus (with the compulsory deferral of a proportion of bonus), with a corresponding reduction in the LTIP award to be made. The reason for this rebalancing reflects the company's stated objective of improving operating efficiencies via the identification of clear, focused KPIs which the committee believes can best be set and measured over 12 month periods.

### Total remuneration package

The chart below shows the expected values of salary, bonus and long term incentives for target performance for the executive directors. The committee considers the mix between fixed and performance pay to be appropriate.



### Personal shareholdings

The company operates shareholding guidelines under which executive directors are expected to build and maintain a minimum holding of shares in the company. The Group Chief Executive is expected to build and maintain a holding of shares to the value of 1.5 x base salary and other executive directors 1 x base salary. Executive directors are expected to retain at least half of the shares they receive through the Long Term Incentive Plans or other share based plans until they meet the guideline holdings within five years. If insufficient shares are awarded within five years then this timescale will be extended.

Through a variety of share schemes, all employees are encouraged to hold shares in the company.

### External directorships

Executive directors are encouraged to take on external non-executive directorships, though normally only one other FTSE 100 appointment. In order to avoid any conflicts of interest, all such appointments are subject to the approval of the Nominations Committee. Executive directors are normally only permitted to retain the fees arising from one such appointment. None of the executive directors currently hold any such appointments.

### Chairman and other non-executive directors

The remuneration policy for non-executive directors, other than the Chairman, is determined by the board, within the limits set out in the Articles of Association.

During the year, Sir John Egan was paid fees of £230,000 for his role as Chairman. This included £34,500 paid in the form of shares. Sir John is provided with a company car, but does not participate in any of the company's pension arrangements, share or bonus schemes.

Until retiring from the board on 10 June 2006, Martin Flower received fees of £19,300 for his role as Deputy Chairman. He did not participate in any of the company's pension arrangements, share or bonus schemes nor received benefits in kind. His fees included the premiums for chairing the Remuneration Committee and being the senior independent non-executive director.

Remuneration for non-executive directors, other than the Chairman, comprises an annual fee for acting as a non-executive director of the company and additional fees for acting as:

- > Chairman of a board committee (£15,000 p.a. for the Audit and Remuneration Committees and £10,000 p.a. for the Corporate Responsibility Committee);
- > Member of a board committee who is not the chairman of that committee (£3,000 p.a. per committee other than for the Nominations Committee for which no fee is paid);
- > Senior independent non-executive director (£10,000 p.a.).

The company Chairman does not receive any additional fees for committee memberships.

Save for John Smith, whose total fees are paid directly to his employer, non-executive directors receive 90% of their total fees in cash and the remaining 10% is used to purchase shares in the company. A similar arrangement is in place for the Chairman but with 85% of fees paid in cash and 15% used to buy shares in the company. The Chairman and non-executive directors are expected to retain those shares for the duration of their appointment with the company. Non-executive directors are not eligible to participate in share or bonus schemes nor is any pension provision made.

The non-executive directors do not have service contracts or consultancy agreements with any group company, but they do have letters of appointment.

# Directors' remuneration report continued

## Remuneration arrangements for executive directors

The remuneration arrangements for executive directors comprise the following elements:

- > Base salary and benefits;
- > Annual bonus plan;
- > Long Term Incentive Plans;
- > Post retirement benefits.

Details of each of the above elements are as follows:

### Base salaries and benefits

Base salaries are a fixed cash sum payable monthly. The company's policy is to set the salary for each executive director having regard to the market median for similar roles in publicly quoted companies of a comparable size and, so far as practical, undertaking similar activities. Salaries for individual directors are reviewed annually by the remuneration committee. From 2007 the remuneration committee agreed that salary increases will take effect from 1 July in line with the rest of the business. Salaries are set with reference to individual performance, experience and contribution, together with developments in the relevant employment market and internal relativities.

Executive directors' salaries have recently been reviewed for the financial year 2007/08. They are as follows:

Director	Salary wef July 07	Increase
Colin Matthews	£580,000	3.6%
Michael McKeon	£400,000	8.1%
Tony Wray	£300,000	9.1%

The increase for the Group Chief Executive reflects general inflation as well as the market rate, whilst Tony Wray received a larger increase to reflect his progression within his role. Michael McKeon joined the company in December 2005 and, consistent with the company's approach for new appointments, did not receive an increase last year. He has therefore been awarded a larger than normal increase for 2007, reflecting a recognition of his contribution, his development with the role and the time elapsed since joining the company.

In 2006/07 there were eight executives immediately below board level who were paid salaries of between £150,000 and £250,000 per annum.

Salary £000	Number of Executives
150-200	3
201-250	5

The non salary benefits for executive directors comprise the use of company car or allowance, fuel, private medical insurance, life assurance and an incapacity benefits scheme. Private medical insurance and some other benefits may be flexed under the company's flexible benefits scheme. As they are flexing within the same value of overall package, their individual choices are not reflected in the table of directors' emoluments on page 41.

## Annual bonus plan 2006/07

Executive directors are eligible for annual bonuses to encourage improved performance, with financial and non financial targets established by the committee to align executive directors' interests with shareholders. In 2006/07 financial targets comprised profitability (plus return on capital employed for Martin Bettington and operational cashflow for Tony Wray). Non financial targets comprised the achievement of personal objectives and specific targets relating to health and safety performance. Following the publication of last year's report, the bonus arrangements for Tony Wray were amended to bring them in line with the other senior managers in Severn Trent Water and his non financial targets include operational performance and customer service measures.

Given the prime importance which the board and the committee place on health and safety issues, the indicative bonus was adjusted by a multiplier based on health and safety performance. This could lead to an increase or a reduction but, in all cases, was subject to the overall bonus maximum.

The maximum bonus potential and target composition for executive directors for 2006/07 is shown below:

Director	Financial	Non financial	Max bonus value
Colin Matthews	53%	27%	80%
Michael McKeon	47%	23%	70%
Tony Wray	28%	42%	70%
Martin Bettington	100%	50%	150%
Rachel Brydon Jannetta	100%	50%	150%

The actual bonuses awarded by the committee for the year ended 31 March 2007 are shown in the table of directors' emoluments on page 41. The following table shows how the split of the bonuses paid in respect of the year ended 31 March 2007 related to the targets set at the start of the year:

	Achieved Financial	Achieved Non financial	Multiplier	Total bonus paid
Colin Matthews	53%	21.6%	1.0	74.6%
Michael McKeon	47%	19.0%	1.0	66.0%
Tony Wray	10.2%	10.9%	1.0	21.1%
Martin Bettington	n/a	n/a	n/a	n/a
Rachel Brydon Jannetta	78.3%	50%	n/a	128.3%

Martin Bettington left on the demerger of Biffa and, as disclosed in last year's report, his maximum bonus potential for 2006/07 was 150% reflecting his not participating in the company's LTIP during the year. The bonus award was not crystallised at demerger.

Rachel Brydon Jannetta left at the date of the sale of the US Laboratories business on 29 December 2006 and, as disclosed last year, her bonus potential for 2006/07 was 150% of salary. Her bonus award was calculated at the date of sale and the value of her bonus award was 96% of base salary (being 128.3% reduced on a prorated basis for the period that she worked; 78.3% related to achievement of financial targets, whilst 50% was awarded for achievement of non financial targets, including health and safety performance.).



It is not the committee's policy to award transaction related bonuses. No transaction related bonuses were paid to any executive director linked to the successful demerger of Biffa or the disposal of any business.

Annual bonus payments are not taken into account in calculating executive directors' pension entitlements.

#### Annual bonus plan 2007/08

As noted above, the committee has recently undertaken a review of the balance of performance related remuneration for the executive directors. As a result the committee concluded that, over the next 2-3 years, it is important for the executive directors to be focussed on the achievement of specific strategic goals from year to year, which will be closely linked to the company's 20 KPIs and intended to create a strong focus on the creation of operational efficiencies.

Consequently, for the 2007/8 financial year, the annual bonus opportunity for all the executive directors has been increased to 120% of salary. For the achievement of target performance, 60% of salary will be earned compared with 35% in 2006/07 for executive directors other than the Chief Executive. However, as explained above this increase reflects a reweighting of performance pay from longer term measures to more targeted annual measures and does not reflect a material increase in total target pay.

Colin Matthews' package is amended to reflect the fact that he is leaving the company. His annual bonus maximum for 2007/08 will be 150% however, he will not be invited to participate in the 2007 LTIP. He will be set specific personal targets. This approach is consistent with that taken previously for Rachel Brydon Jannetta and Martin Bettington.

Director	Bonus Max	% salary for on target performance
Colin Matthews	150%	75%
Michael McKeon	120%	60%
Tony Wray	120%	60%

In addition, 50% of any bonus paid (with the exception of Colin Matthews) will be deferred into shares to be held for three years following payment and subject to continued employment unless the committee determines it is appropriate to release the shares in 'good leaver' cases.

The bonus outturn will operate on a balanced scorecard of measures, based on the KPIs outlined earlier. All of the targets are considered by the board to have an impact on the longer term financial performance of the company and a number of them are reported to the Regulator.

The health and safety multiplier will not operate in respect of 2007/8 although the committee reserves the discretion to reduce (but not increase) bonus payments if health and safety targets are not fully met or if the company's overall financial performance is not felt to warrant the indicative level of bonus.

Consistent with the latest developments in institutional guidelines, the rules of the annual bonus plan now provide that the committee may reclaim some or all of the after tax part of any bonuses awarded to executive directors if it subsequently transpires that the bonus calculation was based on calculations which are subsequently demonstrated to be materially incorrect.

#### Long term incentives

At the 2005 Annual General Meeting, shareholders approved the introduction of the Long Term Incentive Plan 2005 (LTIP 2005), which replaced the 1997 Long Term Incentive Plan. Under the LTIP 2005, annual conditional awards of performance shares may be made to executive directors and senior staff, up to an annual maximum limit of shares worth 125% of base salary.

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price. Awards will normally vest as soon as the committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

#### 2005 LTIP award

In respect of the 2005 award, 50% will be triggered if the company's Total Shareholder Return (TSR) performance is at the median or above relative to the following group of water and waste companies and other selected FTSE 100 'high'yield' stocks as follows:

AWG	Pennon Group
BOC Group	Rentokil Initial
BT Group	Scottish & Newcastle
Diageo	Scottish & Southern Energy
Kelda	Scottish Power
National Grid	Shanks Group
Northumbrian Water	Unilever
Pearson	United Utilities

So far in the performance period AWG and BOC group have both delisted. The committee has agreed that their TSR performance will be substituted with that of Compass group and Centrica respectively (the next highest yield companies in the FTSE 100) with each replacement being effective from the dates that the original companies delisted.

The remaining 50% of the 2005 awards will be triggered subject to the satisfaction of group Economic Profit (EP) targets. As explained in previous years, due to the commercial sensitivity of the EP targets, these have not been precisely disclosed. However, the committee confirms that the minimum threshold level of vesting in respect of the water business over the five year cycle will not be lower than that implied in the most recent Ofwat determination. For the 2005 awards, EP is calculated by reference to a post tax rate of return of 7.5%.

For executives below board level in the non water businesses, 25% of their LTIP awards are dependent upon the TSR target and 75% of their awards are set by reference to EP targets.

#### 2006 LTIP award

In 2006 the Group Chief Executive received an award of shares worth 125% of base salary with other executive directors receiving up to 100% (other than Martin Bettington and Rachel Brydon Jannetta who, as explained previously, did not receive any award in 2006).

Michael McKeon was also entitled to an LTIP award over 36,405 shares on joining the company as part of the terms negotiated at that time. These shares were awarded at the same time as the normal 2006 grant and, as the aggregate award size exceeded 125% of base salary in a financial year, were made pursuant to the exemption to the Listing Rules in chapter 9.4.2. All terms were identical to the terms of the normal 2006 LTIP award and the committee confirms that such award was felt to be necessary to facilitate the recruitment of Mr McKeon and to honour commitments made to him on recruitment.

# Directors' remuneration report continued

Vesting of the 2006 awards is wholly dependent on a TSR target over a fixed three year period beginning on 1 April 2006. There is no retesting of the condition.

This condition was chosen because the committee considered TSR to be the most appropriate means of aligning the interests of the executives with investors through generating superior shareholder returns, particularly in view of the significant restructuring which occurred during 2006.

For median TSR levels of performance, 25% of that part of the award will vest and, for upper quartile TSR levels of performance, 100% of that part of the award will vest. Vesting between 25% and 100% will be on a straight line basis between ranking points. In addition, for awards to vest, the committee must be satisfied that the company's TSR is reflective of the company's underlying performance.

The TSR comparator group for 2006 awards comprises water companies and FTSE 100 high yield companies (excluding financial and retail companies or other sectors which might result in an undue bias in the sample). 'High yield' was defined as companies which had an average gross yield that was greater than base rate minus 1% in the calendar month preceding 1 April 2006 and their use as comparators recognises the fact that, at least in part, shareholders choose to invest in the company for the dividend income it produces.

After the end of the performance period, the TSR performance condition will be measured and independently verified by New Bridge Street Consultants LLP on behalf of the committee.

The comparator group companies for the 2006 LTIP award are:

AWG	Pennon Group
BT Group	Rentokil Initial
Centrica	Scottish & Newcastle
Compass	Scottish & Southern Energy
Kelda	Scottish Power
National Grid	United Utilities
Northumbrian Water	

For the 2006 award, where comparator group companies have been delisted during the course of the performance period, the "proceeds" of that sale will be reinvested in another company selected from an agreed list of high yield organisations.

During the performance period, AWG have delisted and therefore will be replaced in the comparator group by Unilever from the date of AWG's delisting.

### 2007 LTIP award

As outlined in the policy section above, the committee reviewed the balance of variable pay for 2007/8, and it has concluded that, whilst it does not wish to materially alter the overall quantum of remuneration for the executive directors, it wishes to rebalance performance more towards focussed, short term targets. Accordingly, it is the committee's intention to make LTIP awards of 50% of salary to Michael McKeon and Tony Wray in 2007. As previously stated, Colin Matthews will not be invited to participate in the 2007 scheme.

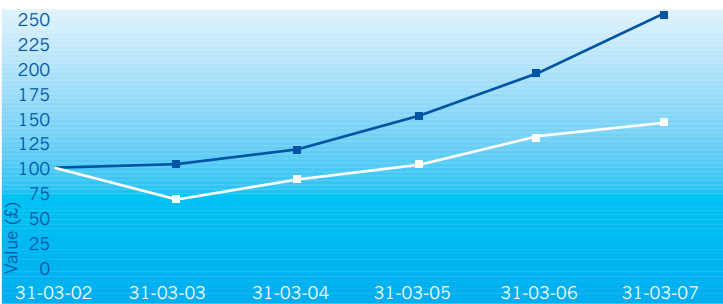
In view of the fact that (i) there has been considerable consolidation amongst UK listed utilities companies and (ii) the restructuring of the Group has largely been completed, the committee has reviewed the performance conditions that will apply to the award to be made in 2007.

The vesting of awards will be subject to TSR, measured relative to those companies ranked 51-150 in the FTSE by market capitalisation (excluding investment trusts). This is felt to be the most suitable comparator group since the number of comparable regulated utilities against which to compare the company's performance is now too small to enable meaningful analysis. The performance measures remain unchanged with 25% of awards vesting at median performance, and 100% vesting for performance in the upper quartile.

### Performance graph

This graph shows the value, by 31 March 2007, of £100 invested in Severn Trent Plc on 31 March 2002 compared with the value of £100 invested in the FTSE 100 Index. The FTSE 100 was chosen as the comparator because the company is a constituent of that index.

### Total shareholder return



This graph shows the value, at 31 March 2007, of £100 invested in Severn Trent on 31 March 2002 compared with the value of £100 invested in the FTSE 100 Index. The other points plotted are the values at intervening financial year ends.

### All employee share plans

The company offers an all employee SAYE plan on an annual basis and periodically reviews the use of other all employee incentive vehicles.

Details of the company's shares that are held in trust on behalf of participants of certain of the employee share schemes are given on page 81. In respect of the LTIPs, the company's policy is to purchase, and hold in trust, 50% of the total number of shares that could potentially vest from all outstanding LTIP awards. The requirement to purchase shares is calculated, and carried out, shortly after each annual award.

In respect of awards made under the company's Share Incentive Plan, all the shares taken up by employees at each invitation are purchased and placed in trust immediately.

The company grants SAYE options over unissued shares, always operating within the dilution limits contained in the scheme rules.

The committee is satisfied that the overall dilution limits provide sufficient headroom for all the company's share schemes.

### Post retirement benefits

Of the current executive directors, Colin Matthews and Tony Wray participate in the Senior Staff Pension Scheme (as did Martin Bettington prior to the demerger of Biffa). The scheme is a funded HMRC registered final salary occupational pension scheme which provides:

- > A normal retirement age of 60 years;
- > An overall pension at normal retirement age of two thirds of final pensionable salary, which for executive directors is defined as base salary only, subject to the completion of 20 years' pensionable service;
- > Life cover of 4 x pensionable earnings;
- > A pension payable in the event of retirement on grounds of ill health;
- > A dependant's pension on death of two thirds of the member's pension.

Colin Matthews and Tony Wray participate up to the level of the scheme specific earnings cap ("the Cap") which in 2006/07 was £108,600. They are provided with a cash supplement in lieu of pension entitlement above the Cap at 40% of their respective salaries.

Members' contributions are payable at the rate of 6% of pensionable earnings. Early retirement is available after the age of 50 with the consent of the company. Any pension would be subject to a reduction that the Trustee considers appropriate, acting on actuarial advice, to reflect the expected longer payment of the pension. In the event of incapacity, early retirement is available on an unreduced basis allowing for pensionable service to age 60.

Under the Trust Deed and Rules, pensions in payment in excess of any Guaranteed Minimum Pension are guaranteed to increase in line with price inflation subject to a maximum of 5% each year. In the calculation of individual cash equivalent transfer values, allowance is made for such increases.

As disclosed in last year's remuneration report, the company reviewed its pension policy for directors and employees as a result of the Pensions Act 2004, Finance Act 2004 and the results of the triennial valuation of two of its main schemes during 2004. As a result of this review, new executives are offered an allowance, expressed as a percentage of base salary, to fund their own pension provision. The individual is able to choose whether the allowance is paid to the company's registered defined contribution scheme, taken as cash or paid to a personal pension arrangement. This reflects the wish of the committee to remove future exposure to defined benefit schemes for senior executives.

The new arrangements apply to Michael McKeon at 40% of base salary.

### Directors' service agreements and letters of appointment

A model service contract was approved by the committee in 2004. All current executive directors have signed the model contract and, accordingly, service agreements for all executive directors have notice periods of 12 months from either party. They also provide for a maximum damages payment in the case of redundancy or termination in breach of the agreement by the company of up to 175% of base salary which was calculated as a conservative pre-estimate of the value of salary, fixed benefits and on target bonus.

The reference to 175% is a cap and any damages payments will not be made automatically but will be subject to both phasing and mitigation unless, in the circumstances, the committee considers it appropriate to achieve a clean break through payment of a lump sum in which case it will require some discount for early payment. Contracts also permit the committee to take into account a view of the extent of poor performance on the part of the executive director. Any payment will not include amounts in respect of awards which have been made under the company's LTIPs over which the committee retains discretion. There are no specific contractual payments or benefits which would be triggered in the event of a change in control of the company. The committee believes that the contracts provide as much scope as is feasible to protect the interests of shareholders when negotiating a termination, at which time it would address the duty of mitigation.

The service contract for Rachel Brydon Jannetta, who was based in the US and employed by a US subsidiary, was in the same format as for other executive directors but modified to reflect prevailing US employment legislation.

The details relating to Colin Matthews' termination package have not yet been agreed.

# Directors' remuneration report continued

The dates of the current executive directors' agreements, the dates on which their appointments became effective and the current expiry dates of their agreements are as follows:

Executive directors	Date of agreement	Effective date	Expiry date
Colin Matthews	3 June 2004	6 September 2004	Terminable on 12 months' notice
Michael McKeon	6 December 2005	13 December 2005	Terminable on 12 months' notice
Tony Wray	19 January 2005	7 March 2005	Terminable on 12 months' notice

Tony Wray is the subject of reappointment as executive director at the forthcoming AGM.

Details for the executive directors who ceased to serve on the board during the year are as follows:

Executive director	Date of agreement	Effective date	Expiry date
Martin Bettington	10 June 2004	10 June 2004	Terminated on 6 October 2006
Rachel Brydon Jannetta	30 June 2004	1 September 2004	Terminated on 29 December 2006

Rachel Brydon Jannetta left the Board on 29 December 2006 on the disposal of the US Laboratories business. During the sale process notice of termination of her contract of employment was served, triggering the termination payment provision in her contract of 1.75 times base salary, an amount of \$673,750. In accordance with her contract, it was agreed that the termination payment would be made in twelve monthly instalments with the proviso that any income she received from alternative employment would be deducted from the payment. Mrs Brydon Jannetta has subsequently accepted a role within HIG Capital and therefore the salary payments she receives from them are being deducted from the termination payments in mitigation of the loss.

Mrs Brydon Jannetta also received a bonus of \$288,750 for the period from 1 April 2006 to 29 December 2006, the details of which are shown on page 36.

The committee agreed that the LTIP award made to Mrs Brydon Jannetta on 5 September 2005 at a share price of £9.75 should vest on completion of the sale, subject to achievement of performance conditions and time prorating. The 2005 award vested on 2 March 2007 to the extent that 49.7% of the shares, being 3,944 shares with a market value of £13.89 each, were released to Mrs Brydon Jannetta.

Mr Martin Bettington transferred with Biffa on the demerger and received no payment by way of compensation for loss of office. The committee agreed that the LTIP award made to Mr Bettington on 5 September 2005 at a share price of £9.75 should vest on demerger, subject to achievement of performance conditions and time prorating. The 2005 award vested on 1 December 2006 to the extent that 59.76% of the shares, being 13,944 shares with a market value of £14.55 each, were released to Mr Bettington.

In both cases the 2004 award lapsed as the performance conditions were not met.

In respect of the Chairman and current non-executive directors, the dates on which their appointments took effect and the current expiry dates are as follows:

Chairman and non-executive directors	Initial appointment	Current appointment	Current expiry date*
Sir John Egan	1 October 2004	1 October 2004	31 December 2007
Bernard Bulkin	1 January 2006	1 January 2006	31 December 2008
Richard Davey	1 January 2006	1 January 2006	31 December 2008
Martin Houston	1 September 2003	1 September 2006	31 August 2009
John Smith	3 November 2003	3 November 2006	2 November 2009

\*Subject to the requirements of the company's Articles of Association for the reappointment of directors at Annual General Meetings.

Details for the non-executive directors who retired from the board during the year are as follows:

Non-executive directors	Initial appointment	Last appointment	Date retired
Martin Flower	11 June 1996	11 June 2005	10 June 2006
Marisa Cassoni	1 September 2001	1 September 2004	6 October 2006

It is the normal practice of the company for non-executive directors to serve three three year terms. Non-executive directors have no right to compensation on the early termination of their appointments.

The text and tables that follow comprise the auditable part of the directors' remuneration report, being the information required by Part 3 of Schedule 7A to the Companies Act 1985.

## Directors' emoluments

	Basic salary and fees <sup>1</sup>				Annual bonus £000	Other <sup>3</sup> £000	Total	Total
	Cash £000	Shares £000	Total £000	BLKs <sup>2</sup> £000			2006/07 £000	2005/06 £000
<b>Chairman and other non-executive directors</b>								
Sir John Egan (Chairman)	195.5	34.5	230.0	26.4	–	–	256.4	217.6
Bernard Bulkin	45.9	5.1	51.0	–	–	–	51.0	8.3
Marisa Cassoni	21.5	2.3	23.8	–	–	–	23.8	39.1
Richard Davey	57.4	6.4	63.8	–	–	0.9	64.7	8.3
Martin Flower	19.3	–	19.3	–	–	3.3	22.6	101.2
Martin Houston	38.7	4.3	43.0	–	–	–	43.0	34.0
John Smith <sup>4</sup>	55.0	–	55.0	–	–	–	55.0	40.0
<b>Executive directors</b>								
Martin Bettington	167.9	–	167.9	11.5	–	68.7	248.1	409.7
Rachel Brydon Jannetta	149.8	–	149.8	3.0	152.5	109.5	414.8	330.7
Colin Matthews	557.3	–	557.3	13.3	417.8	213.7	1,202.1	973.8
Michael McKeon	370.0	–	370.0	9.1	244.1	81.5	704.7	264.9
Tony Wray	272.3	–	272.3	19.5	57.9	70.2	419.9	415.3
	1,950.6	52.6	2,003.2	82.8	872.3	547.8	3,506.1	2,842.9

1 Included within fees for the non-executive directors are amounts to be received by way of shares rather than cash to encourage participation in line with corporate governance best practice. The gross value of the shares is recorded in the table above. Non-executive directors who were either appointed or retired during the year received a time apportioned award. The number of shares received by each director was:

	Ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p each	Ordinary shares of 65 <sup>5</sup> / <sub>19</sub> p each
Sir John Egan	746	757
Marisa Cassoni	–	98
Martin Houston	90	91
Bernard Bulkin	154	128
Richard Davey	188	167

2 Benefits in kind received by Sir John Egan comprise the use of a company car. Benefits in kind for executive directors comprise the use of a company car, fuel, private medical insurance, life assurance and an incapacity benefits scheme.

3 Other emoluments include: expenses chargeable to income tax, allowances in lieu of a company car, travel allowances, relocation expenses, telephone allowances, payments made under the group's flexible benefit arrangements and amounts paid in lieu of pension contributions. Included in other emoluments are:

> Martin Flower – expenses chargeable to income tax £3,271.

> Richard Davey – expenses chargeable to income tax £946.

> Martin Bettington – amounts received in lieu of pension contributions £67,167 and flexible benefits payments £1,583.

> Rachel Brydon Jannetta – amounts received in lieu of pension contributions £59,422, termination payment £47,057 and allowance in lieu of company car £3,034.

> Colin Matthews – amounts received in lieu of pension contributions £180,560, allowance in lieu of company car £18,000, travel allowance £15,000 and telephone allowance £113.

> Tony Wray – amounts received in lieu of pension contributions £66,560 and flexible benefits payments £3,616.

> Michael McKeon – allowance in lieu of company car £15,000, relocation expenses £60,061 and other expenses chargeable to income tax £6,469.

4 John Smith's total fees are paid directly to his employer.

## Directors' pension provisions

The disclosure of pension benefits is made under the requirements of the Listing Rules of the UK Listing Authority (the "Rules") and also the requirements of the Directors' Remuneration Report Regulations 2002 (the "Regulations"). These are shown in separate tables below.

The Rules require information to cover the period during which a director was a board member, whilst the Regulations require information to cover the financial year. The information below sets out the disclosures required by the Regulations:

	Service completed in years (including transferred in service credits)	Accrued pension at 31.03.07 £pa	Increase in accrued pension during the year £pa	Increase in accrued pension during the year (net of inflation) <sup>1</sup> £pa	Transfer value of accrued pension at 31.03.07 £000	Transfer value of accrued pension at 31.03.06 £000	Increase/(decrease) in transfer value over the year, net of directors' contributions £000
Martin Bettington	24	166,827	112	(5,890)	2,547.8	2,381.3	166.5
Colin Matthews	2	9,293	3,790	3,592	114.6	62.3	45.8
Tony Wray	2	7,488	3,739	3,604	67.3	31.2	29.7



# Directors' remuneration report continued

The information below sets out the disclosures required by the Rules:

	Accrued pension at 31.03.07 £pa	Increase in accrued pension during the year £pa	Increase in accrued pension during the year (net of inflation) <sup>1</sup> £pa	Transfer value of increase in accrued benefits net of directors' contributions <sup>2</sup> £000
Martin Bettington	166,827	112	(5,890)	1.7
Colin Matthews	9,293	3,790	3,592	40.2
Tony Wray	7,488	3,739	3,604	27.1

1 Inflation over the year is measured by reference to the increase in the retail price index between March 2006 and March 2007, or the earlier date of leaving.

2 The transfer values have been calculated in accordance with Actuarial Guidance Note GN11 published by the Institute of Actuaries and Faculty of Actuaries.

The pensions shown above will be provided through the Severn Trent Senior Staff Pension Scheme, the Severn Trent Supplemental Pension Scheme and the Severn Trent Pension Scheme.

Contributions amounting to £148,000 were paid to a defined contribution scheme in respect of Michael McKeon.

The directors of the company at 31 March 2007 and their beneficial interests in the shares of the company were as follows:

## i) Beneficial holdings

	At 1 April 2006 Number of ordinary shares of 65 <sup>5</sup> / <sub>19</sub> p each	At 6 October 2006 Number of ordinary shares of 65 <sup>5</sup> / <sub>19</sub> p each	At 9 October 2006 Number of ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p each	At 31 March 2007 Number of ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p each	At 31 June 2007 Number of ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p each
<b>Chairman and other non-executive directors</b>					
Sir John Egan (Chairman)	7,288	8,045	5,363	6,109	6,109
Bernard Bulkin	–	128	85	239	239
Richard Davey	–	167	111	299	299
Martin Houston	1,403	1,494	996	1,086	1,086
John Smith	–	–	–	–	–
<b>Executive directors</b>					
Colin Matthews	1,059	1,078	717	717	717
Michael McKeon	–	–	–	–	–
Tony Wray	–	–	–	–	–

Following the Extraordinary General Meeting held on 6 October 2006, Severn Trent Plc's ordinary shares of 65<sup>5</sup>/<sub>19</sub>p each were consolidated into ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each, on 9 October 2006, on the basis of 2 new shares for every 3 old shares held.

Colin Matthews, Tony Wray and Michael McKeon have further interests in the company's ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each by virtue of having received contingent awards of shares under the Severn Trent Plc Long Term Incentive Plan as follows: Colin Matthews on 15 December 2004, 5 September 2005 and 19 June 2006; Tony Wray on 5 September 2005 and 19 June 2006; and Michael McKeon on 19 June 2006. Further details regarding Michael McKeon's contingent awards are set out on page 37.

The LTIP operates on a three year rolling basis. The Severn Trent Employee Share Ownership Trust is operated in conjunction with the LTIP. Awards do not vest until they have been held in trust for three years and specific performance criteria have been satisfied.

Executive directors have a technical interest in 771,717 shares held by the Employee Share Ownership Trust.

The details of the performance criteria are explained on pages 37 and 38 of the remuneration report. The individual interests, for the above named directors and for the directors who left during the year, which represent the maximum aggregate number of shares to which each individual could become entitled, are as follows:

	At 1 April 2006 or subsequent date of appointment Number of ordinary shares of 65 <sup>5</sup> / <sub>19</sub> p each	Awards vested during year	Market price at time of vesting (p)	Gain on vesting (£000)	Awards lapsed during year	Awarded during year	Market price at time of 2006 award (p)	At 31 March 2007 or earlier date of leaving Number of ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p each
Martin Bettington	77,465	(13,944)	1455	202.9	(63,521)	–	–	Nil
Rachel Brydon Jannetta	46,022	(3,944)	1389	54.8	(42,078)	–	–	Nil
Colin Matthews	105,933	–	–	–	–	56,980	1178	162,913
Michael McKeon	–	–	–	–	–	66,523	1178	66,523
Tony Wray	17,948	–	–	–	–	22,385	1178	40,333

The awards that lapsed during the year were those that were awarded to Martin Bettington and Rachel Brydon Jannetta on 13 August 2003, 15 December 2004 and the non vesting balance of 5 September 2005.

The performance period for allocations of shares made in 2004 ended on 31 March 2007. The Remuneration Committee has subsequently determined, based on the company's Total Shareholder Return and Economic Profit Targets over the three year performance period, that participants are not entitled to any vesting of their awards. The 2004 contingent awards of shares are included in the table above.

The 2006 awards were made on 19 June 2006, but are not included in the table above.

No further awards have been made under the LTIP as at 5 June 2007.

## ii) Options over ordinary shares

	At the start of the year or subsequent date of appointment (No. of shares)	Exercised during the year (No. of shares)	Cancelled during the year (No. of shares)	Granted during the year (No. of shares)	At the end of the year or earlier date of leaving (No. of shares)	Year of grant of option	Exercise price (p)	Date from which exercisable	Expiry date
<b>Sharesave<sup>1</sup></b>									
Michael McKeon	–	–	–	1,499	1,499	2007	1172	May 2014	Oct 2014
Tony Wray	1,136	–	–	–	1,136	2006	823	May 2009	Oct 2009

1 The executive directors, in common with all eligible UK employees of the group, are entitled to participate in the company's Inland Revenue approved Sharesave Scheme.

The terms and conditions applicable to these options are those provided in that scheme. The options have no performance conditions as such conditions are not permitted by legislation.

2 No executive share options in respect of executive directors were granted or lapsed during the year. At 31 March 2007 there were 30 other executives participating in the group's Share Option Scheme (2006: 145).

3 At the close of business on 31 March 2007 the mid market price of the company's shares was 1,434p (31 March 2006: 1,117p) and the range during the year was 1,106p to 1,493p.

4 On 9 October 2006 Severn Trent Plc's ordinary shares of 65<sup>5</sup>/<sub>19</sub>p each were consolidated into ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each. No adjustment was made to the shares awarded under the LTIP or granted under the Sharesave Scheme. LTIP awards will vest over ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each and Sharesave Options will be exercised over ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each.

Other than the lapse of the 2004 LTIP award, there has been no further change in directors' interests between 31 March 2007 and the date of this report.

Signed on behalf of the board who approved the directors' remuneration report on 5 June 2007.

**Richard Davey**

Chairman of the Remuneration Committee

# Independent auditors' report to the members of Severn Trent Plc

We have audited the group financial statements of Severn Trent Plc for the year ended 31 March 2007 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expense and the related notes 1 to 41. These group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

We have reported separately on the parent company financial statements of Severn Trent Plc for the year ended 31 March 2007.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the directors' remuneration report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

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

We report to you our opinion as to whether the group financial statements give a true and fair view, whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the directors' remuneration report described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the group financial statements. The information given in the directors' report includes that specific information presented in the chairman's statement, the group chief executive's review and the performance review that is cross referred from the business review section of the directors' report.

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

We review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

## Basis of audit opinion

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

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

## Opinion

In our opinion:

- > the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2007 and of its profit for the year then ended;
- > the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- > the part of the directors' remuneration report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- > the information given in the directors' report is consistent with the group financial statements.

## Deloitte & Touche LLP

Chartered Accountants and Registered Auditors  
London, UK  
5 June 2007

# Consolidated income statement

## For the year ended 31 March 2007

	Notes	2007 £m	2006 (restated) £m
<b>Turnover</b>	5,6	<b>1,480.2</b>	1,455.3
Operating costs before exceptional items		<b>(1,074.9)</b>	(1,062.3)
Exceptional restructuring costs and termination of operations	8	<b>(14.9)</b>	(7.9)
Exceptional demerger costs	8	<b>(16.7)</b>	(7.8)
<b>Total operating costs</b>	7	<b>(1,106.5)</b>	(1,078.0)
Exceptional profit on disposal of property and businesses	8	<b>56.3</b>	–
Profit before interest, tax and exceptional items		<b>405.3</b>	393.0
Exceptional items	8	<b>24.7</b>	(15.7)
<b>Profit before interest and tax</b>		<b>430.0</b>	377.3
Finance income	10	<b>86.3</b>	72.9
Finance costs	10	<b>(240.1)</b>	(236.8)
Net finance costs before fair value movements on treasury instruments		<b>(153.8)</b>	(163.9)
Fair value movements on treasury instruments	10	<b>48.8</b>	(36.7)
Total net finance costs	10	<b>(105.0)</b>	(200.6)
Share of results of associates and joint ventures		<b>0.5</b>	1.1
Profit before tax, fair value movements on treasury instruments and exceptional items		<b>252.0</b>	230.2
Exceptional items	8	<b>24.7</b>	(15.7)
Fair value movements on treasury instruments	10	<b>48.8</b>	(36.7)
<b>Profit on ordinary activities before taxation</b>		<b>325.5</b>	177.8
Taxation on profit on ordinary activities – current tax	11	<b>(58.5)</b>	(61.5)
– deferred tax	11	<b>(18.4)</b>	7.3
Total taxation	11	<b>(76.9)</b>	(54.2)
<b>Profit for the period from continuing operations</b>		<b>248.6</b>	123.6
<b>Discontinued operations</b>			
Profit for the period from discontinued operations	12	<b>20.0</b>	99.4
<b>Profit for the period</b>		<b>268.6</b>	223.0
<b>Attributable to:</b>			
Equity holders of the company		<b>267.1</b>	221.6
Equity minority interests		<b>1.5</b>	1.4
		<b>268.6</b>	223.0
<b>Earnings per share (pence)</b>			
From continuing operations			
Basic	14	<b>106.1</b>	52.9
Diluted	14	<b>105.1</b>	52.4
From continuing and discontinued operations			
Basic	14	<b>114.7</b>	95.9
Diluted	14	<b>113.6</b>	95.1

# Consolidated balance sheet

## At 31 March 2007

	Notes	2007 £m	2006 £m
<b>Non current assets</b>			
Goodwill	15	49.1	506.3
Other intangible assets	16	101.2	112.4
Property, plant and equipment	17	5,521.1	5,743.1
Interests in joint ventures	18	0.5	9.7
Interests in associates	19	3.4	19.6
Derivative financial instruments	20	6.6	3.7
Available for sale financial assets	21	0.2	0.5
		<b>5,682.1</b>	6,395.3
<b>Current assets</b>			
Inventory	22	22.4	54.4
Trade and other receivables	23	387.1	481.5
Derivative financial instruments	20	14.1	10.8
Cash and cash equivalents	24	143.2	142.6
		<b>566.8</b>	689.3
Assets held for sale		–	41.5
<b>Total assets</b>		<b>6,248.9</b>	7,126.1
<b>Current liabilities</b>			
Borrowings	25	(631.8)	(808.2)
Derivative financial instruments	20	(67.1)	(114.4)
Trade and other payables	26	(405.1)	(540.6)
Current income tax liabilities		(59.0)	(48.8)
Provisions for other liabilities and charges	29	(6.7)	(30.1)
Liabilities directly associated with assets classified as held for sale		–	(28.5)
		<b>(1,169.7)</b>	(1,570.6)
<b>Non current liabilities</b>			
Borrowings	25	(2,639.0)	(2,295.5)
Derivative financial instruments	20	(56.2)	(30.1)
Trade and other payables	26	(188.3)	(158.7)
Deferred tax liabilities	27	(891.1)	(870.2)
Retirement benefit obligations	28	(135.1)	(221.9)
Provisions for other liabilities and charges	29	(32.2)	(80.1)
		<b>(3,941.9)</b>	(3,656.5)
<b>Total liabilities</b>		<b>(5,111.6)</b>	(5,227.1)
<b>Net assets</b>		<b>1,137.3</b>	1,899.0
<b>Capital and reserves attributable to the company's equity shareholders</b>			
Called up share capital	30	228.3	227.2
Share premium account	31	57.5	48.6
Other reserves	32	419.0	432.4
Retained earnings	33	429.4	1,188.2
<b>Equity attributable to the company's equity shareholders</b>		<b>1,134.2</b>	1,896.4
Minority interests	33	3.1	2.6
<b>Total equity</b>	33	<b>1,137.3</b>	1,899.0

Signed on behalf of the board who approved the accounts on 5 June 2007.



**Sir John Egan**  
Chairman



**Michael McKeon**  
Group Finance Director



# Consolidated cash flow statement

## For the year ended 31 March 2007

	Notes	2007 £m	2006 £m
Cash generated from operations	36	574.0	758.9
Interest paid		(148.6)	(139.4)
Interest element of finance lease rental payments		(20.2)	(45.1)
Tax paid		(36.0)	(68.3)
<b>Net cash generated from operating activities</b>		<b>369.2</b>	<b>506.1</b>
<b>Investing activities</b>			
Interest received		12.4	4.4
Dividends received from associates and joint ventures		1.5	2.7
Net loans advanced to associates and joint ventures		0.5	(2.3)
Net cash inflow from available for sale fixed asset investments		0.2	0.2
Acquisition of subsidiaries net of cash acquired		–	(0.3)
Cash demerged with Biffa Plc	35	(21.9)	–
Proceeds on disposal of subsidiaries net of cash disposed	35	130.6	1.6
Proceeds on disposal of associate net of costs		29.3	–
Proceeds on disposal of property, plant and equipment		62.2	8.4
Purchases of intangible assets		(21.5)	(29.6)
Purchases of property, plant and equipment		(427.2)	(407.5)
Contributions and grants received		35.0	32.8
<b>Net cash used in investing activities</b>		<b>198.9</b>	<b>(389.6)</b>
<b>Financing activities</b>			
Dividends paid to shareholders of the parent		(739.5)	(234.3)
Dividends paid to minority interests		(1.0)	(0.8)
Repayments of borrowings		(789.9)	(500.2)
Receipts from sale and lease back transactions		–	170.2
Repayment of obligations under finance leases		(34.6)	(167.7)
New loans raised		1,418.4	648.8
Issue of shares		10.0	11.6
<b>Net cash used in financing activities</b>		<b>(136.6)</b>	<b>(72.4)</b>
Increase in cash and cash equivalents		33.7	44.1
Net cash and cash equivalents at beginning of the period		110.4	64.4
Effect of foreign exchange rates		(1.0)	1.9
<b>Net cash and cash equivalents at the end of the period</b>	36	<b>143.1</b>	<b>110.4</b>
Net cash and cash equivalents comprise:			
Cash and cash equivalents	36	143.2	142.6
Bank overdrafts	36	(0.1)	(32.2)
<b>Net cash and cash equivalents at the end of the period</b>	36	<b>143.1</b>	<b>110.4</b>

# Consolidated statement of recognised income and expense

## For the year ended 31 March 2007

	2007 £m	2006 (restated) £m
Exchange movement on translation of overseas results and net assets	(25.5)	21.6
Exchange differences on hedges of net investment	6.4	(5.3)
Tax on exchange differences on foreign currency hedging	(1.9)	1.8
Gains on cash flow hedges taken to equity	6.2	0.3
Deferred tax on gains on cash flow hedges taken to equity	(1.8)	(0.1)
Actuarial (losses)/gains on defined benefit pension schemes	(14.3)	26.3
Deferred tax on actuarial losses/gains	4.3	(8.0)
<b>Net (expense)/income recognised directly in equity</b>	<b>(26.6)</b>	<b>36.6</b>
<b>Transfers</b>		
Amounts on cash flow hedges transferred to the income statement in the period	4.6	4.5
Deferred tax on transfers to income statement	(1.4)	(1.3)
	<b>3.2</b>	<b>3.2</b>
<b>Profit for the period</b>	<b>268.6</b>	<b>223.0</b>
<b>Total recognised income for the period</b>	<b>245.2</b>	<b>262.8</b>
<b>Attributable to:</b>		
Equity shareholders of the company	243.7	261.4
Minority interests	1.5	1.4
	<b>245.2</b>	<b>262.8</b>

# Notes to the group financial statements

## 1 General information

The Severn Trent group has a number of operations. These are described in the segmental analysis in note 5.

Severn Trent Plc is a company incorporated and domiciled in the United Kingdom. The address of its registered office is shown on the back of the cover of the annual report and accounts.

Severn Trent Plc is listed on the London Stock Exchange.

## 2 Accounting policies

### a) 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 2007 and those parts of the Companies Act 1985 applicable to companies reporting under IFRS as adopted by the European Union.

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.

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 comparative figures for the income statement have been restated to reclassify Biffa Plc and US Laboratories as discontinued operations following their demerger and disposal respectively.

### b) Basis of consolidation

The financial statements include the results of Severn Trent Plc and its subsidiaries, joint ventures and associated undertakings.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since that date. Losses attributable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

The results of subsidiaries, joint ventures and associated undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the group has the power to control a subsidiary. The results of joint venture undertakings are accounted for on an equity basis where the company exercised joint control under a contractual arrangement. The results of associates are accounted for on an equity basis where the company holding is 20% or more or the company has the power to exercise significant influence.

All intra group transactions, balances, income and expenses are eliminated on consolidation.

### c) Revenue recognition

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

Revenue is not recognised until the service has been provided to the customer, or the goods to which the sale relates have either been despatched to the customer or, where they are held on the customer's behalf, title has passed to the customer.

In respect of long term contracts, revenue is recognised based on the value of work carried out during the year with reference to the total sales value and the stage of completion of these contracts.

Turnover includes an estimate of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable. Dividend income from investments is recognised when the shareholders' rights to receive payment have been established. Interest and dividend income are included in finance income.

### d) Segmental reporting

Each of the group's business and geographical segments provide services that are subject to risks and returns that are different from those of the other business segments.

# Notes to the group financial statements continued

## e) Property, plant and equipment

Property, plant and equipment comprises:

### i) Infrastructure assets

Infrastructure assets are included at cost (or deemed cost on transition to IFRS) less accumulated depreciation. The costs of day to day servicing of infrastructure components are recognised in the income statement as they arise. Where it is probable that the money spent will cause future economic benefits to flow to the group, then costs are capitalised. Infrastructure assets are depreciated over their useful economic lives, which are as follows:

	Years
Impounding reservoirs	250
Raw water aqueducts	250
Mains	80-150
Sewers	150-200

### ii) Landfill sites

Landfill sites are included within land and buildings at cost less accumulated depreciation.

The cost of landfill sites includes the cost of acquiring, developing and engineering sites, but does not include interest. The cost of the asset is depreciated over the estimated life of the site on the basis of the usage of void space.

Following the demerger of Biffa Plc the group no longer holds landfill sites.

### iii) Other assets

Other assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated over their estimated economic lives to their residual value, which are principally as follows:

	Years
Buildings	30-80
Fixed plant and equipment	2-40
Vehicles and mobile plant	2-15

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

Interest costs of debt raised to finance new property, plant and equipment are not included within the cost of those fixed assets, but are expensed to the income statement as they arise.

## f) Leased assets

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the lower of the fair value of the leased asset or the present value of the minimum lease payments is capitalised as an asset with a corresponding liability representing the obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor and the finance charge being written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

Where assets are financed by leasing arrangements where substantially all the risks and rewards of ownership remain with the lessor, these are classified as operating leases. Rental costs arising under operating leases are expensed on a straight line basis over the term of the lease. Leases of land are normally treated as operating leases, unless ownership is transferred at the end of the lease.

## g) Grants and contributions

Grants and contributions received in respect of non-current assets, including charges made for new connections to the water and sewerage networks, are treated as deferred income and released to the income statement over the useful economic life of those assets.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in the income statement in the period that they become receivable.

## h) Impairment of non current assets

If the recoverable amount of goodwill, an item of property, plant and equipment, or any other non current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the assets in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash generating unit or asset.

The discount rate used is based on the group's cost of capital adjusted for the risk profiles of individual businesses.

Goodwill is tested for impairment annually. Impairment reviews are also carried out if there is some indication that an impairment may have occurred, or, where otherwise required, to ensure that non current assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the income statement.

**i) Investments**

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as held for trading or available for sale are measured at fair value, with gains or losses recognised in income or equity respectively. When an available for sale investment is disposed of, or impaired, the gain or loss previously recognised in equity is taken to the income statement.

Other investments are classified as held to maturity when the group has the positive intention and ability to hold to maturity. Investments held for an undefined period are excluded from this classification. Such investments (and those held to maturity) are subsequently measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the income statement.

**j) Inventory**

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

Development land and properties are included at the lower of cost and net realisable value. Cost includes the cost of acquiring and developing the sites. The net realisable value of development land is based upon its value as a serviced site, after taking account of the cost of providing infrastructure services.

Following the disposal of Severn Trent Property the group no longer holds development land or properties.

**k) Cash and cash equivalents**

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition and include cash and balances at central banks, treasury bills and other eligible bills, loans and certificates of deposit. Cash and cash equivalents also include overdrafts repayable on demand.

**l) Provisions**

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

- > Landfill restoration costs: Provision for the cost of restoring landfill sites is made over the operational life of each landfill site and charged to the income statement on the basis of the usage of void space. Following the demerger of Biffa Plc the group no longer holds provisions for landfill costs.
- > Environmental control and aftercare costs: Environmental control and aftercare costs are incurred over the operational life of each landfill site and may be incurred for a considerable period thereafter. Provision for all such costs is made over the operational life of the site and charged to the income statement on the basis of the usage of void space. Material environmental control and aftercare costs are discounted by applying an appropriate discount rate.
- > Insurance: Provision is made for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's independent insurance advisers.

**m) Pension costs**

The group operates both defined benefit and defined contribution pension schemes.

Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency 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 included in operating costs. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other finance income or cost.

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 recognised income and expense.

Costs of defined contribution pension schemes are charged to the income statement in the period in which they fall due.

**n) Foreign currency**

The results of overseas subsidiary and associated undertakings are translated into the presentational currency of the group, sterling, using average rates of exchange ruling during the year.

The net investments in overseas subsidiary and associated undertakings are translated into sterling at the rates of exchange ruling at the year end. Exchange differences thus arising are treated as movements in equity. On disposal of a foreign currency denominated subsidiary, the deferred cumulative amount recognised in equity since 1 April 2004 relating to that entity is recognised in the income statement under the transitional rule of IFRS 1.

Exchange differences arising in respect of foreign exchange instruments taken out as hedges of overseas investments are also treated as movements in equity to the extent that the hedge is effective (see note 20).

All other foreign currency denominated assets and liabilities of the company and its subsidiary undertakings are translated into the relevant functional currency at the rates of exchange ruling at the year end. Any exchange differences so arising are dealt with through the income statement. Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. All profits and losses on exchange arising during the year are dealt with through the income statement.



# Notes to the group financial statements continued

## **o) Research and development**

Research expenditure is expensed when it is incurred. Development expenditure is capitalised and written off over its expected useful economic life where the following criteria are met:

- > An asset is created that can be identified;
- > It is probable that the asset created will generate future economic benefits; and
- > The development cost can be measured reliably.

Expenditure on property, plant and equipment relating to research and development projects is capitalised and written off over the expected useful life of those assets.

## **p) Taxation**

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full, using the liability method, on taxable 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 to utilise it. Deferred taxation is measured on a non discounted basis using the tax rates and laws that have then been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred tax liability is settled.

## **q) Goodwill**

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Goodwill arising on acquisition of subsidiaries is included in intangible assets, whilst goodwill arising on acquisition of associates is included in investments in associates. If an acquisition gives rise to negative goodwill this is credited directly to the income statement. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill arising on all acquisitions prior to 1 April 1998 was written off to reserves under UK GAAP and remains eliminated against reserves. Purchased goodwill arising on acquisitions after 31 March 1998 is treated as an intangible fixed asset.

Goodwill is tested for impairment in accordance with the policy set out above and carried at cost less accumulated impairment losses. Goodwill is allocated to the cash generating unit that derives benefit from the goodwill for impairment testing purposes.

Where goodwill forms part of a cash generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of that operation when determining the gain or loss on disposal of the operation.

## **r) Intangible non current assets**

Intangible assets acquired separately are capitalised at cost and when acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, the historical cost model is applied to intangible assets. Amortisation charged on assets with finite lives is taken to the income statement through operating expenses.

Finite life intangible assets are amortised on a straight line basis over their estimated useful economic lives as follows:

	Years
Software	3-10
Other assets	2-20

Intangible assets are reviewed for impairment where indicators of impairment exist.

## **s) Trade receivables**

Trade receivables are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that the asset is impaired, where it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

## **t) Financial instruments**

### **i) Debt instruments**

All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date, with gains or losses being recognised in the income statement (see below).

Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

### **ii) Derivative financial instruments and hedging activities**

The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently remeasured at fair value at the balance sheet date. The fair value of cross currency swaps, interest rate swaps and forward currency contracts is calculated by reference to market exchange rates and interest rates at the period end.

In relation to fair value hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument is taken to the income statement where the effective portion of the hedge will offset the gain or loss on the hedged item (see above).

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that 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 recycled through the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

Forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations and to the extent that they are designated and effective as net investment hedges are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to the income statement.

For derivatives that do not qualify for hedge accounting, gains or losses are taken directly to the income statement in the period.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that date any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs, or transferred to the income statement if the forecast transaction is no longer expected to occur.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in the income statement.

#### **u) Share based payments**

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

The fair value of employee services is determined by reference to the fair value of the awards granted calculated using an appropriate pricing model, excluding the impact of any non market vesting conditions. The number of awards that are expected to vest takes into account non market vesting conditions including, where appropriate, continuing employment by the group. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non market condition.

#### **v) Pre-contract costs**

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

#### **w) Discontinued operations and assets held for sale**

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year, then the disposal group is deemed as held for sale. The disposal group is measured at the lower of the carrying amount and fair value less costs to sell.

Where a group of assets, which comprises operations that can be clearly distinguished operationally and for financial reporting purposes from the rest of the group (a component), has been disposed of or classified as held for sale and it

- > represents a separate major line of business or geographical area of operations; or
- > is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- > is a subsidiary acquired exclusively with a view to resale

then the component is classified as a discontinued operation.

Non current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

#### **x) Purchase of own shares**

The group balance sheet incorporates the shares held by the Severn Trent Employee Share Ownership Trust (the Trust) and which have not vested unconditionally by the balance sheet date. These are shown as a deduction from shareholders' funds until such time as they vest.

#### **y) Trade payables**

Trade payables are initially measured at fair value and are subsequently measured at amortised cost, using the effective interest rate method.

#### **z) Exceptional items**

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view.

# Notes to the group financial statements continued

## 3 New accounting policies and future requirements

The following statements have been issued by the International Accounting Standards Board and are likely to affect future financial statements.

International Financial Reporting Standard 7 'Financial instruments: Disclosures' (IFRS 7) was issued in August 2005 and is required to be implemented by Severn Trent from 1 April 2007. The standard incorporates the disclosure requirements of IAS 32, which it supersedes and adds further quantitative and qualitative disclosures in relation to financial instruments.

International Financial Reporting Standard 8 'Operating Segments' (IFRS 8) was issued in November 2006 and is required to be implemented by Severn Trent from 1 April 2009. The standard requires identification of operating segments based on internal reports that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and assess its performance. The impact of the standard on Severn Trent's financial statements is not expected to be significant since the group's segmental reporting already closely reflects reports regularly reviewed by the Chief Executive and the board.

IFRIC 11 "Group and Treasury Share Transactions" was issued in November 2006. The interpretation addresses accounting for share based payments in the separate financial statements of the parent company and its subsidiaries. As such it is not applicable to the consolidated financial statements of Severn Trent Plc.

IFRIC 12 "Service Concession Arrangements" was issued in November 2006 and is required to be implemented by Severn Trent from 1 April 2008. The interpretation draws a distinction between two types of services concession arrangement; those where the operator receives a financial asset, specifically an unconditional contractual right to receive cash or another financial asset from a government body in return for constructing or upgrading a public sector asset; and those where the operator receives an intangible asset, the right to charge for the use of the public sector asset that it constructs or upgrades. The interpretation will be applicable to the group's contracts with the UK Ministry of Defence ("MoD") and is expected to result in the recognition of both a financial asset in respect of the right to receive cash in return for upgrading the MoD assets and an intangible asset arising from the right to provide water and sewerage services.

IAS 23 (revised) was issued in March 2007 and is required to be implemented by Severn Trent from 1 April 2009. The revision to the standard removes the option of immediately recognising as an expense borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for use or sale. Such costs are therefore required to be capitalised as part of the cost of the asset. The revised standard will require Severn Trent to change its existing policy and is likely to result in a proportion of borrowing costs that are currently expensed being capitalised in property plant and equipment or intangible assets. The costs will then be amortised over the expected useful lives of the relevant assets.

The directors assess that the other standards and interpretations issued but not yet effective are not applicable to the group.

## 4 Significant accounting judgments and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group is required to make certain judgments, estimates and assumptions that it believes are reasonable based on the information available. The more significant judgments and key assumptions and sources of estimation uncertainty are summarised below:

### (a) Goodwill impairment

Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units ("CGU") to which goodwill has been allocated. The value in use calculation requires the group to estimate the future cash flows expected to arise from the CGU and a suitable discount rate to calculate present value. Details of the assumptions used are set out in note 15 to the financial statements.

### (b) Depreciation and carrying amounts of property plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2 (e).

### (c) Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, salary and pension increases, investment returns and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 28 to the financial statements.

### (d) Tax provisions

Assessing the outcome of uncertain tax positions requires judgments to be made regarding the result of negotiations with and enquiries from tax authorities in a number of jurisdictions. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

## 5 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.

### Corporate and Other

Following the sale of Severn Trent Property and other property interests, the sole remaining other business is the group's corporate insurance company. Henceforth this is reported together with unallocated corporate costs as Corporate and Other in the segmental analysis. All prior year numbers have been restated for comparative purposes.

The group is also organised into geographical regions, UK, US and Europe. Geographical information is classified by the location of the principal operations of each business unit.

#### a) Primary reporting format – business segment

	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
<b>2007</b>					
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 8)	21.3	14.7	(11.3)	–	24.7
<b>Profit before interest and tax</b>	<b>434.3</b>	<b>34.4</b>	<b>(37.6)</b>	<b>(1.1)</b>	<b>430.0</b>
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					(105.0)
Profit before tax					325.5
Tax					(76.9)
Profit from continuing operations					248.6
Profit from discontinued operations (note 12)					20.0
<b>Profit for the period</b>					<b>268.6</b>

#### Discontinued operations include:

	Waste Management £m	US Laboratories £m	Eliminations £m	Total £m
External sales	401.0	94.4	–	495.4
Inter segment sales	3.9	1.7	(5.6)	–
<b>Total sales</b>	<b>404.9</b>	<b>96.1</b>	<b>(5.6)</b>	<b>495.4</b>
Profit before interest, tax and exceptional items	51.2	8.0	–	59.2
Exceptional items (note 8)	–	(31.5)	–	(31.5)
Share of results of associates and joint ventures	0.5	–	–	0.5
<b>Segment result</b>	<b>51.7</b>	<b>(23.5)</b>	<b>–</b>	<b>28.2</b>

# Notes to the group financial statements continued

## a) Primary reporting format – business segment (continued)

2006	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
External sales	1,148.5	277.0	29.8	–	1,455.3
Inter segment sales	2.4	22.8	29.5	(54.7)	–
<b>Total sales</b>	<b>1,150.9</b>	<b>299.8</b>	<b>59.3</b>	<b>(54.7)</b>	<b>1,455.3</b>
Profit before interest, tax and exceptional items	400.4	17.1	(25.7)	1.2	393.0
Exceptional items (note 8)	(4.8)	–	(10.9)	–	(15.7)
<b>Profit before interest and tax</b>	<b>395.6</b>	<b>17.1</b>	<b>(36.6)</b>	<b>1.2</b>	<b>377.3</b>
Share of results of associates and joint ventures	–	1.6	(0.5)	–	1.1
<b>Segment result</b>	<b>395.6</b>	<b>18.7</b>	<b>(37.1)</b>	<b>1.2</b>	<b>378.4</b>
Total net finance costs					(200.6)
Profit before tax					177.8
Tax					(54.2)
Profit from continuing operations					123.6
Profit from discontinued operations (note 12)					99.4
<b>Profit for the period</b>					<b>223.0</b>

## Discontinued operations include:

	Waste Management £m	US Laboratories £m	Eliminations £m	Total £m
External sales	764.1	134.0	–	898.1
Inter segment sales	6.6	0.8	(7.4)	–
<b>Total sales</b>	<b>770.7</b>	<b>134.8</b>	<b>(7.4)</b>	<b>898.1</b>
Profit before interest, tax and exceptional items	85.2	5.9	–	91.1
Share of results of associates and joint ventures	1.0	–	–	1.0
<b>Segment result</b>	<b>86.2</b>	<b>5.9</b>	<b>–</b>	<b>92.1</b>

## Other segment items are:

2007	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
Capital expenditure	399.5	6.1	–	(4.3)	401.3
Depreciation and amortisation	241.2	6.6	0.3	(3.5)	244.6

2006	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
Capital expenditure	335.6	6.7	0.2	(3.3)	339.2
Depreciation and amortisation	219.7	6.7	4.0	(4.2)	226.2



The segment assets and liabilities are as follows:

	Water and Sewerage £m	Water Technologies and Services £m	Eliminations £m	Unallocated Corporate and Other £m	Consolidated £m
<b>2007</b>					
<b>Assets</b>					
Segment assets	5,894.7	225.5	(16.9)	141.7	6,245.0
Interests in associates and joint ventures	0.5	3.4	–	–	3.9
	5,895.2	228.9	(16.9)	141.7	6,248.9
Group total assets					6,248.9
<b>Liabilities</b>					
Segment liabilities	(618.7)	(66.3)	–	(4,426.6)	(5,111.6)
Group total liabilities					(5,111.6)
<b>2006</b>					
<b>Assets</b>					
Segment assets	5,671.6	241.3	161.0	(15.9)	6,058.0
Interests in associates and joint ventures	0.4	19.7	8.6	–	28.7
	5,672.0	261.0	169.6	(15.9)	6,086.7
Assets relating to discontinued operations					1,039.4
Group total assets					7,126.1
<b>Liabilities</b>					
Segment liabilities	(653.8)	(77.6)	(4,245.2)	–	(4,976.6)
Liabilities relating to discontinued operations					(250.5)
Group total liabilities					(5,227.1)

Assets relating to discontinued operations includes interests in associates and joint ventures amounting to £0.6m.

Segment assets comprise goodwill and other intangible assets, property, plant and equipment, inventories, derivatives designated as hedges for future transactions, receivables and operating cash. Deferred taxation, investments and derivatives designated as hedges of borrowings are all included in unallocated corporate assets.

Segment liabilities comprise operating liabilities. Taxation and corporate borrowings and related hedging derivatives are all included in unallocated corporate liabilities.

# Notes to the group financial statements continued

The entire Waste Management segment has been divested and its results are included in discontinued operations in 2006/07. The comparative figures have been restated to reflect the current year classification. Following the disposal of the US Laboratories business, which is also included in discontinued operations in both years, the former Water Purification and Operating Services and Laboratories segments have been reclassified. The UK Laboratories business, which formerly was included in the Laboratories segment, is now included in the Water Technologies and Services segment. Prior year figures have been restated to reflect the new classification as follows:

	Water purification and operating services (as previously stated) £m	UK Laboratories £m	Eliminations £m	Water technologies and services (restated) £m
Turnover	267.8	32.0	–	299.8
Profit before interest, tax and exceptional items	12.0	5.1	–	17.1
Exceptional items	–	–	–	–
Profit before interest and tax	12.0	5.1	–	17.1
Share of results of associates and joint ventures	1.6	–	–	1.6
<b>Segment result</b>	<b>13.6</b>	<b>5.1</b>	<b>–</b>	<b>18.7</b>
Segment assets	234.0	25.7	(18.4)	241.3
Interests in associates and joint ventures	19.7	–	–	19.7
	<b>253.7</b>	<b>25.7</b>	<b>(18.4)</b>	<b>261.0</b>
<b>Segment liabilities</b>	<b>(65.8)</b>	<b>(8.2)</b>	<b>(3.6)</b>	<b>(77.6)</b>

## b) Secondary reporting format – geographical segments

The group's turnover from continuing operations analysed by geographical market (by destination) was as follows:

	Continuing activities		Discontinued activities	
	2007 £m	2006 £m	2007 £m	2006 £m
<b>Turnover</b>				
UK	<b>1,288.8</b>	1,253.2	<b>387.0</b>	705.7
US	<b>124.1</b>	140.2	<b>94.3</b>	134.0
Europe	<b>33.4</b>	36.8	<b>14.1</b>	58.4
Other	<b>33.9</b>	25.1	–	–
	<b>1,480.2</b>	1,455.3	<b>495.4</b>	898.1

The carrying amount of the group's assets and additions to property plant and equipment analysed by the geographical area in which the assets are located was as follows:

	Total assets based on location		Capital expenditure	
	2007 £m	2006 £m	2007 £m	2006 £m
UK	<b>6,103.1</b>	5,953.6	<b>398.3</b>	334.9
US	<b>58.6</b>	67.2	<b>3.0</b>	4.3
Europe	<b>87.2</b>	65.9	–	–
	<b>6,248.9</b>	6,086.7	<b>401.3</b>	339.2
Assets relating to discontinued activities	–	1,039.4	<b>39.0</b>	87.6
	<b>6,248.9</b>	7,126.1	<b>440.3</b>	426.8

## 6 Revenue

	2007 £m	2006 (restated) £m
Water and sewerage services	<b>1,209.3</b>	1,137.7
Other services	<b>217.7</b>	243.6
Sales of goods	<b>59.5</b>	62.9
Revenue from long term contracts	<b>30.8</b>	65.9
Eliminations	<b>(37.1)</b>	(54.8)
<b>Total turnover</b>	<b>1,480.2</b>	1,455.3
Interest receivable (note 10)	<b>5.7</b>	2.3
Revenue from discontinued operations	<b>502.8</b>	900.0
<b>Total revenue</b>	<b>1,988.7</b>	2,357.6

## 7 Operating costs

	2007 £m	2006 (restated) £m
Wages and salaries (including exceptional restructuring costs £3.0 million (2006: £4.8 million))	245.0	253.8
Social security costs	17.3	20.0
Pension costs (including exceptional settlement on demerger £7.8 million (2006: nil))	46.8	31.2
<b>Total employee costs</b>	<b>309.1</b>	<b>305.0</b>
Power	61.7	38.7
Raw materials and consumables	103.3	105.1
Rates	57.3	56.5
Impairment of trade debtors	22.7	25.0
Service charges	27.6	27.5
Depreciation of property, plant and equipment	203.9	198.5
Exceptional write off of decommissioned plant	11.9	–
Amortisation of intangible fixed assets	28.8	27.7
Hired and contracted services	129.4	143.1
Operating lease rentals		
– land and buildings	4.8	5.3
– other	3.1	2.9
Hire of plant and machinery	5.4	4.0
Research and development expenditure	4.2	3.9
Profit on disposal of fixed assets	(0.7)	(2.9)
Foreign exchange gains	(0.2)	(0.1)
Water and Sewerage infrastructure maintenance expenditure	98.1	94.5
Exceptional demerger costs	8.9	7.8
Other operating costs	107.6	111.4
	<b>1,186.9</b>	<b>1,153.9</b>
Release from deferred income	(3.5)	(4.6)
Own work capitalised	(76.9)	(71.3)
<b>Total operating costs</b>	<b>1,106.5</b>	<b>1,078.0</b>

Operating costs include £31.6 million (2006: £15.7 million) of exceptional costs. Further details are given in note 8. The pension costs shown above include current and past service costs. Other pension costs (interest costs, expected returns on assets and actuarial gains and losses) are included in finance costs and the statement of recognised income and expense.

During the year the following fees were charged by the auditors in respect of continuing and discontinued activities:

	2007 £m	2006 £m
Fees payable to the company's auditors for the audit of the company's annual accounts	0.2	0.1
Fees payable to the company's auditors and their associates for other services to the group		
– The audit of the company's subsidiaries pursuant to legislation	0.5	1.0
<b>Total audit fees</b>	<b>0.7</b>	<b>1.1</b>
– Other services pursuant to legislation	0.1	–
– Tax services	–	0.2
– Other services	0.3	0.8
<b>Total non audit fees</b>	<b>0.4</b>	<b>1.0</b>

Other services comprises controls reviews £0.1 million and various other services £0.2 million (2006: forensic accounting services £0.3 million, controls reviews £0.3 million and various other services in total £0.2 million).

Details of directors' remuneration are set out in the remuneration report on pages 41 to 43.

# Notes to the group financial statements continued

## 8 Exceptional items

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.

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 down of decommissioned assets £11.9 million and redundancy costs £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.

A net exceptional charge of £15.7 million arose in the year ending 31 March 2006. This comprised:

An exceptional restructuring charge of £7.9 million arose comprising:

- > £4.8 million arising in Severn Trent Water as a result of costs associated with a redundancy programme undertaken to meet AMP4 efficiency targets; and
- > a net £3.1 million arising in Systems relating to the cessation of trading with external customers and disposal of the Worksuite and CIS operations.

£7.8 million of costs arose relating to the demerger of Biffa and other strategic reviews undertaken.

## 9 Employee numbers

Average number of employees (including executive directors) during the year (full time equivalent):

	2007 Number	2006 (restated) Number
By type of business:		
Water and Sewerage	5,289	5,188
Water Technologies and Services	2,984	2,966
Other Businesses and Corporate	99	350
Continuing operations	8,372	8,504
Discontinued operations	4,089	7,808
	12,461	16,312

## 10 Net finance costs

	2007 £m	2006 (restated) £m
<b>Investment income</b>		
Interest receivable on bank deposits	5.4	1.3
Expected return on defined benefit scheme assets	80.6	70.6
Other financial income	0.3	1.0
	86.3	72.9
<b>Finance costs</b>		
Interest on bank loans and overdrafts	(28.4)	(24.5)
Interest on other loans	(122.6)	(120.7)
Interest on finance leases	(20.2)	(22.8)
Total borrowing costs	(171.2)	(168.0)
Interest cost on defined benefit obligations	(67.5)	(66.9)
Other financial expenses	(1.4)	(1.9)
Total finance costs	(240.1)	(236.8)
Fair value movements on treasury instruments	48.8	(36.7)
<b>Net finance costs</b>	<b>(105.0)</b>	<b>(200.6)</b>

Fair value movements on treasury instruments comprise:

Net gain/(loss) on debt and swaps in fair value hedges	0.7	(0.7)
Gain/(loss) arising on revaluation of derivatives not in designated hedge accounting relationships	52.7	(31.5)
Fair value losses on cash flow hedges transferred from equity	(4.6)	(4.5)

<b>Fair value movements on treasury instruments</b>	<b>48.8</b>	<b>(36.7)</b>
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## 11 Taxation

### a) Analysis of tax charge in the year

	2007 £m	2006 (restated) £m
<b>Current tax</b>		
Continuing operations		
Current year at 30%	67.9	75.8
Prior year at 30%	(9.4)	(14.3)
Total current tax relating to continuing operations	58.5	61.5
Current tax relating to discontinued operations	9.2	(12.7)
<b>Total current tax</b>	<b>67.7</b>	<b>48.8</b>
<b>Deferred tax</b>		
Continuing operations		
Origination and reversal of temporary differences – current year	35.0	(0.5)
Origination and reversal of temporary differences – prior year	(16.6)	(6.8)
Total deferred tax relating to continuing operations	18.4	(7.3)
Deferred tax relating to discontinued operations	6.0	1.5
<b>Total deferred tax</b>	<b>24.4</b>	<b>(5.8)</b>
Total tax charge relating to continuing operations	76.9	54.2
Total tax charge relating to discontinued operations	15.2	(11.2)
<b>Total tax charge</b>	<b>92.1</b>	<b>43.0</b>

### b) Factors affecting the tax charge in the year

The tax expense for the current year is lower than the standard rate of corporation tax in the UK (2007 and 2006: 30%). The differences are explained below:

	2007 £m	2006 £m
Profit on ordinary activities before tax:		
Continuing operations	325.5	177.8
Discontinued operations	35.2	88.2
	<b>360.7</b>	<b>266.0</b>
Tax at the standard rate of corporation tax in the UK (2007 and 2006: 30%)	108.2	79.8
Tax effect of share of results of associates and joint ventures	0.1	0.3
Tax effect of expenditure not deductible in determining taxable profit	5.9	14.9
Effect of different rates of tax in overseas jurisdictions	(0.6)	(1.3)
Adjustments in respect of prior years	(21.5)	(50.7)
<b>Total tax charge</b>	<b>92.1</b>	<b>43.0</b>

The adjustments in respect of prior years arose as a result of agreeing open computations with the relevant tax authorities and, in 2007, the recognition of a deferred tax asset of £7.7 million for previously unrecognised tax losses in the USA.

### c) Tax charged directly to equity

In addition to the amount charged to the income statement, the following amounts of tax have been charged directly to equity:

	2007 £m	2006 £m
<b>Current tax</b>		
Tax on exchange differences on foreign currency hedging	1.9	(1.8)
<b>Total current tax charged directly to equity</b>	<b>1.9</b>	<b>(1.8)</b>
<b>Deferred tax</b>		
Tax on actuarial losses/gains	(4.3)	8.0
Tax on cash flow hedging	3.2	1.4
Tax on share based payments	(0.6)	(0.8)
<b>Total deferred tax charged directly to equity</b>	<b>(1.7)</b>	<b>8.6</b>



# Notes to the group financial statements continued

## 12 Discontinued operations

Pursuant to the Group's strategy to focus on water the following transactions took place during the year:

On 30 June 2006 the Group completed the sale of Biffa Belgium to Veolia Proprete SA for net consideration of £23.7 million;

On 6 October 2006 the Group completed the de-merger of Biffa Plc; and

On 29 December 2006 the Group completed the sale of Severn Trent Laboratories Inc. to TestAmerica Holdings Inc. for net consideration of £77.1 million.

### a) Profit from discontinued operations

	2007 £m	2006 (restated) £m
Turnover	495.4	898.1
Operating costs	(436.2)	(807.0)
Profit before interest, tax and exceptional items	59.2	91.1
Net finance costs	(0.1)	(3.9)
Share of joint ventures and associates	0.5	1.0
Profit before tax and exceptional items	59.6	88.2
Tax	(15.2)	11.2
<b>Profit after tax</b>	<b>44.4</b>	<b>99.4</b>
Exceptional impairment of goodwill	(31.5)	–
Exceptional gain on disposal of discontinued operations	7.1	–
Attributable tax expense	–	–
<b>Net profit attributable to discontinued operations</b>	<b>20.0</b>	<b>99.4</b>

### b) Cash flows from discontinued operations

	2007 £m	2006 (restated) £m
Net cash flows from operating activities	75.3	138.6
Net cash flows from investing activities	(26.2)	(83.5)
Net cash flows from financing activities	331.7	(9.3)
	<b>380.8</b>	<b>45.8</b>

### c) Earnings per share from discontinued operations

	2007			2006		
	Earnings £m	Weighted average number of shares m	Per share amount pence	Earnings (restated) £m	Weighted average number of shares (restated) m	Per share amount (restated) pence
Basic earnings per share from discontinued operations	20.0	232.9	8.6	99.4	231.0	43.0
Diluted earnings per share from discontinued operations	20.0	235.1	8.5	99.4	233.0	42.7

## 13 Dividends

Amounts recognised as distributions to equity holders in the period:

	2007		2006	
	Pence per share	£m	Pence per share	£m
Final dividend for the year ended 31 March 2006/2005	31.97	111.4	30.30	104.8
Interim dividend for the year ended 31 March 2007/2006	22.77	52.9	19.16	66.5
Special dividend for the year ended 31 March 2007	165.00	575.2	–	–
	<b>219.74</b>	<b>739.5</b>	<b>49.46</b>	<b>171.3</b>
<b>Proposed final dividend for the year ended 31 March 2007</b>	<b>38.68</b>	<b>90.3</b>		

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.

On the demerger of Biffa Plc the ordinary share capital of the company was consolidated with the intention that the share price of Severn Trent Plc shares would be similar before and after the demerger. Two new Severn Trent shares were issued for every three old Severn Trent shares held. The per share amounts disclosed above in respect of dividends declared before the consolidation are the amounts that were declared on the shares in issue at the time. They have not been restated for the share consolidation.

## 14 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 year, 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 year.

Basic and diluted earnings per share from continuing operations are calculated on the basis of profit from continuing operations attributable to the equity holders of the company. The weighted average number of shares for the year ended 31 March 2006 has been restated to reflect the 2 for 3 share consolidation that was approved at the extraordinary general meeting on 6 October 2006.

### From continuing operations:

	2007			2006		
	Earnings	Weighted average number of shares	Per share amount	Earnings (restated)	Weighted average number of shares (restated)	Per share amount (restated)
	£m	m	pence	£m	m	pence
Basic earnings per share	247.1	232.9	106.1	122.2	231.0	52.9
Effect of dilutive options	–	2.2	(1.0)	–	2.0	(0.5)
Diluted earnings per share	247.1	235.1	105.1	122.2	233.0	52.4

### From continuing and discontinued operations:

	2007			2006		
	Earnings	Weighted average number of shares	Per share amount	Earnings (restated)	Weighted average number of shares (restated)	Per share amount (restated)
	£m	m	pence	£m	m	pence
Basic earnings per share	267.1	232.9	114.7	221.6	231.0	95.9
Effect of dilutive options	–	2.2	(1.1)	–	2.0	(0.8)
Diluted earnings per share	267.1	235.1	113.6	221.6	233.0	95.1

### Supplementary earnings per share

Supplementary adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, fair value movements on treasury instruments and exceptional items in both 2007 and 2006. The directors consider that the supplementary figures provide a useful additional indicator of performance.

### From continuing operations:

	2007			2006		
	Earnings	Weighted average number of shares	Per share amount	Earnings (restated)	Weighted average number of shares (restated)	Per share amount (restated)
	£m	m	pence	£m	m	pence
Basic earnings per share	247.1	232.9	106.1	122.2	231.0	52.9
Effect of:						
Exceptional restructuring costs and termination of operations	14.9	–	6.4	7.9	–	3.4
Exceptional demerger and related costs	16.7	–	7.2	7.8	–	3.4
Exceptional profit on disposal of property and businesses	(56.3)	–	(24.2)	–	–	–
Current tax related to exceptional items at 30%	–	–	–	(2.4)	–	(1.0)
Fair value movements on treasury instruments	(48.8)	–	(21.0)	36.7	–	15.9
Deferred tax	18.4	–	7.9	(7.3)	–	(3.2)
<b>Adjusted earnings per share before exceptional items, fair value movements on treasury instruments and deferred tax</b>	<b>192.0</b>	<b>232.9</b>	<b>82.4</b>	<b>164.9</b>	<b>231.0</b>	<b>71.4</b>

# Notes to the group financial statements continued

## 14 Earnings per share continued

	Earnings £m	2007 Weighted average number of shares m	Per share amount pence	Earnings (restated) £m	2006 Weighted average number of shares (restated) m	Per share amount (restated) pence
<b>From continuing operations:</b>						
Diluted earnings per share	247.1	235.1	105.1	122.2	233.0	52.4
Effect of:						
Exceptional restructuring costs and termination of operations	14.9	–	6.3	7.9	–	3.4
Exceptional demerger and related costs	16.7	–	7.1	7.8	–	3.3
Exceptional profit on disposal of property and businesses	(56.3)	–	(23.9)	–	–	–
Current tax related to exceptional items at 30%	–	–	–	(2.4)	–	(1.0)
Fair value movements on treasury instruments	(48.8)	–	(20.8)	36.7	–	15.8
Deferred tax	18.4	–	7.8	(7.3)	–	(3.1)
<b>Adjusted diluted earnings per share before exceptional items, fair value movements on treasury instruments and deferred tax</b>	<b>192.0</b>	<b>235.1</b>	<b>81.6</b>	<b>164.9</b>	<b>233.0</b>	<b>70.8</b>

## 15 Goodwill

	2007 £m	2006 £m
Cost and net book value		
At 1 April	506.3	499.1
Acquisition of businesses	–	0.1
Impairment of US Laboratories (see below)	(31.5)	–
Disposal of subsidiaries	(414.1)	(0.1)
Additions	–	1.4
Adjustment to consideration on acquisitions in prior years	(0.3)	–
Classified as held for sale	–	(2.1)
Exchange adjustments	(11.3)	7.9
At 31 March	49.1	506.3

### Goodwill impairment tests

Goodwill is allocated to the group's cash generating units (CGUs) identified according to country of operation and business segment.

A summary of the goodwill allocation by CGU is presented below:

	2007 £m	2006 £m
<b>Water Technologies and Services</b>		
Water Purification US	21.0	23.8
Contract Operations US	9.6	10.8
UK Services	0.2	0.2
UK Laboratories	12.0	12.3
Services Italy	6.3	6.4
	49.1	53.5
<b>Discontinued Operations</b>		
Biffa UK	–	390.5
US Laboratories	–	62.3
	49.1	506.3

The recoverable amount of a CGU is determined using value in use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five year period. Cash flows beyond the five year period are extrapolated using an estimated nominal growth rate stated below. The growth rate does not exceed the long term average growth rate for the economy in which the CGU operates.

	Nominal growth rate 2007 %	2006 %	Discount rate 2007 %	2006 %
Water Technologies and Services	3.0	3.0	11.5	11.0

These assumptions have been used for the analysis of each CGU within the business segment. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the segment.

On 4 September 2006, the group agreed to sell its US Laboratories business to TestAmerica Holdings Inc for £77.1 million. This resulted in an impairment of £31.5 million in the goodwill relating to the US Laboratories business, which was recognised in the group's interim financial statements. This transaction was completed on 29 December 2006 (see note 35).

## 16 Intangible assets

	Computer software £m	Other assets £m	Total £m
<b>Cost</b>			
At 1 April 2005	204.2	29.2	233.4
Acquired in business combination	–	0.1	0.1
Additions	27.8	1.2	29.0
Disposals	(14.6)	(1.5)	(16.1)
Classified as held for sale	(1.3)	(0.3)	(1.6)
Reclassifications and transfer	(3.7)	(9.4)	(13.1)
Exchange adjustments	0.1	0.6	0.7
At 1 April 2006	212.5	19.9	232.4
Additions	20.3	1.2	21.5
Disposals	(9.2)	(0.1)	(9.3)
Disposal of subsidiaries	(2.4)	(3.6)	(6.0)
Exchange adjustments	(0.2)	(0.6)	(0.8)
<b>At 31 March 2007</b>	<b>221.0</b>	<b>16.8</b>	<b>237.8</b>
<b>Amortisation</b>			
At 1 April 2005	(98.1)	(9.5)	(107.6)
Amortisation for year	(27.5)	(1.8)	(29.3)
Disposals	14.0	1.3	15.3
Classified as held for sale	1.2	0.2	1.4
Reclassifications and transfer	2.0	(1.4)	0.6
Exchange adjustments	(0.1)	(0.3)	(0.4)
At 1 April 2006	(108.5)	(11.5)	(120.0)
Amortisation for year	(27.8)	(1.6)	(29.4)
Disposals	8.3	–	8.3
Disposal of subsidiaries	1.4	2.7	4.1
Exchange adjustments	0.1	0.3	0.4
<b>At 31 March 2007</b>	<b>(126.5)</b>	<b>(10.1)</b>	<b>(136.6)</b>
<b>Net book value</b>			
<b>At 31 March 2007</b>	<b>94.5</b>	<b>6.7</b>	<b>101.2</b>
At 31 March 2006	104.0	8.4	112.4

Other assets primarily comprise capitalised development costs, brands and patents.

Intangible assets include internally generated software of £108.8 million (2006: £112.4 million). Additions during the year totalled £4.7 million (2006: £25.4 million).

# Notes to the group financial statements continued

## 17 Property, plant and equipment

	Land and Buildings £m	Infra- structure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
<b>Cost</b>					
At 1 April 2005	2,246.3	3,609.3	2,677.9	65.1	8,598.6
Acquisition of businesses	–	–	0.1	–	0.1
Additions	101.1	80.9	205.2	10.6	397.8
Disposals	(5.7)	(0.6)	(68.6)	(13.2)	(88.1)
Reclassifications and transfers	23.1	–	(19.8)	–	3.3
Classified as held for sale	(18.2)	–	(62.8)	–	(81.0)
Exchange adjustments	2.4	–	6.6	1.0	10.0
At 1 April 2006	2,349.0	3,689.6	2,738.6	63.5	8,840.7
Additions	107.4	98.3	213.7	8.0	427.4
Disposals	(19.7)	(1.4)	(68.8)	(13.0)	(102.9)
Disposal/demerger of subsidiaries	(370.2)	–	(364.4)	–	(734.6)
Exchange adjustments	(3.9)	–	(11.7)	(0.3)	(15.9)
<b>At 31 March 2007</b>	<b>2,062.6</b>	<b>3,786.5</b>	<b>2,507.4</b>	<b>58.2</b>	<b>8,414.7</b>
<b>Depreciation</b>					
At 1 April 2005	(731.6)	(958.4)	(1,238.2)	(31.0)	(2,959.2)
Charge for year	(63.7)	(20.5)	(176.2)	(7.5)	(267.9)
Disposals	5.6	0.6	68.6	11.2	86.0
Reclassifications and transfers	(10.0)	–	2.4	–	(7.6)
Classified as held for sale	14.3	–	44.0	–	58.3
Exchange adjustments	(1.0)	–	(5.6)	(0.6)	(7.2)
At 1 April 2006	(786.4)	(978.3)	(1,305.0)	(27.9)	(3,097.6)
Charge for year	(59.6)	(21.3)	(166.0)	(7.6)	(254.5)
Disposals	13.3	1.4	55.3	11.3	81.3
Disposal/demerger of subsidiaries	186.3	–	178.1	–	364.4
Exchange adjustments	3.2	–	9.6	–	12.8
<b>At 31 March 2007</b>	<b>(643.2)</b>	<b>(998.2)</b>	<b>(1,228.0)</b>	<b>(24.2)</b>	<b>(2,893.6)</b>
<b>Net book value</b>					
<b>At 31 March 2007</b>	<b>1,419.4</b>	<b>2,788.3</b>	<b>1,279.4</b>	<b>34.0</b>	<b>5,521.1</b>
At 31 March 2006	1,562.6	2,711.3	1,433.6	35.6	5,743.1

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases.

	Land and Buildings £m	Infra- structure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
<b>Net book value</b>					
<b>At 31 March 2007</b>	<b>–</b>	<b>127.2</b>	<b>185.1</b>	<b>–</b>	<b>312.3</b>
At 31 March 2006	19.3	127.2	232.9	–	379.4

Fixed plant and equipment includes £180.3 million (2005: £225.3 million in respect of assets in the course of construction for which no depreciation is charged).



## 18 Interests in joint ventures

	2007 £m	2006 £m
<b>Group's share of:</b>		
Long term assets	0.1	0.9
Current assets	0.9	4.2
Current liabilities	(0.6)	(7.1)
Long term liabilities	-	-
Amounts due from joint ventures	0.1	11.7
	0.5	9.7
<b>Group's share of:</b>		
Turnover	1.6	2.9
Operating costs	(1.1)	(1.9)
Operating profit	0.5	1.0
Finance costs	(0.2)	(0.4)
Profit before tax	0.3	0.6
Tax	(0.1)	(0.1)
Profit after tax	0.2	0.5

The joint venture has no significant contingent liabilities to which the group is exposed and the group does not have any significant contingent liabilities in relation to its interests in the joint venture. The group has no capital commitments in relation to its interests in the joint venture.

Particulars of the group's joint venture undertaking at 31 March 2007 are:

	Nature of business	Percentage of share capital held	A ordinary shares of £1	B ordinary shares of £1
Cognica Limited	Asset Management	50%	100,000*	100,000

\*Held by the group

The country of incorporation and main operation of the joint venture is Great Britain and it is registered in England and Wales.

# Notes to the group financial statements continued

## 19 Interests in associates

	2007 £m	2006 £m
At 1 April	19.6	16.3
Additions	–	3.0
Disposals	(15.0)	–
Share of profits	0.9	1.6
Dividends receivable	(1.5)	(1.5)
Other movements	(0.6)	0.2
At 31 March	3.4	19.6

Group's share of:

Total assets	14.6	330.9
Total liabilities	(11.2)	(311.3)
	3.4	19.6

Turnover	24.6	41.9
Profit before tax	0.9	1.6

On 7 July 2006 the group sold its interest in Aquafin NV to the Flemish Government for approximately £29.6 million.

The associate company has no significant contingent liabilities to which the group is exposed and the group does not have any significant contingent liabilities in relation to its interest in the associate. The group has no capital commitments in relation to its interests in the associate.

The associate at 31 March 2007 was:

	Equity interest	Percentage of share capital held	Nature of business
S.I.I. Societa Consortile per Azioni	19,536,000 of £1	25%	Water and sewerage

The country of incorporation and main operation is Italy.

## 20 Financial instruments

The group's policies in respect of foreign currency and interest rate risk management and the related use of financial instruments, which form part of these financial statements, are set out below.

### a) Financial liabilities analysed by currency and interest rate after taking account of various currency and interest rate swaps entered into by the group

#### At 31 March 2007

Currency	2007 Total £m	Non-interest bearing liabilities £m	Floating interest rate £m	Fixed rate borrowings		
				Fixed interest rate £m	Weighted average interest rate %	Weighted average period for which interest is fixed Years
Sterling	3,295.2	26.1	1,110.6	2,158.5	5.7	13.5
Euro	8.5	6.8	1.7	–		
US dollar	2.9	2.9	–	–		
<b>Total financial liabilities at 31 March 2007</b>	<b>3,306.6</b>	<b>35.8</b>	<b>1,112.3</b>	<b>2,158.5</b>		

#### At 31 March 2006

Currency	2006 Total £m	Non-interest bearing liabilities £m	Floating interest rate £m	Fixed rate borrowings		
				Fixed interest rate £m	Weighted average interest rate %	Weighted average period for which interest is fixed Years
Sterling	3,112.9	43.6	941.7	2,127.6	5.7	14.6
Euro	36.4	6.7	29.7	–		
US dollar	13.8	9.1	4.7	–		
<b>Total financial liabilities at 31 March 2006</b>	<b>3,163.1</b>	<b>59.4</b>	<b>976.1</b>	<b>2,127.6</b>		

Non-interest bearing liabilities relate to onerous contracts and trade payables. The weighted average period to maturity of the onerous contracts is 4.6 years (1.5 years). Trade payables are all due in under 1 year.

Included in the fixed rate debt above, the group has entered into a number of forward start accruing interest rate swaps. These had an initial notional value of £19.6 million and commence accruing notional value between 31 March 2007 and 2032. The maximum notional value of these swaps is £135.0 million. These swaps are floating to fixed and bear fixed interest at between 5.32% and 5.52%.

The group has also entered into £236.0 million of forward start interest rate swaps (floating to fixed) that commence between May 2007 and May 2009. These swaps all terminate in 2010. These interest rate swaps bear interest between 4.54% and 4.87%.

Floating rate sterling denominated borrowings bear interest based on LIBOR, whilst euro denominated borrowings bear interest based on EURIBOR and dollar borrowings bear interest based on dollar LIBOR.

### b) Investments in interest earning assets analysed by currency after taking account of various currency swaps entered into by the group

Currency	2007 £m	2006 £m
Sterling deposits	100.0	87.8
Sterling cash at bank	43.2	54.8
	<b>143.2</b>	<b>142.6</b>

Sterling assets receive interest based on LIBID.

Of the total £143.2 million interest earning assets, there is £49.6 million of cash held on short term deposit as security for external insurance, as part of Derwent's reinsurance obligations. In addition, Severn Trent Water has a total of £1.9 million on short term deposit as security for self insurance obligations.

# Notes to the group financial statements continued

## c) Monetary assets and liabilities by currency, excluding the functional currency

### At 31 March 2007

	US dollar £m	Net foreign currency Euro £m	monetary assets Other £m	Total £m
<b>Functional currency of operation</b>				
Sterling	0.2	1.0	–	1.2

### At 31 March 2006

	US dollar £m	Net foreign currency Euro £m	monetary assets Other £m	Total £m
<b>Functional currency of operation</b>				
Sterling	5.7	0.7	–	6.4

Net currency gains/(losses) arising from monetary assets/(liabilities) not in the functional currency of an operation are recognised in its income statement. Those arising from the translation of US dollar and euro functional currency financial statements into sterling are recognised in the statement of recognised income and expense.

## d) Financial liabilities analysed by maturity date

	Overdrafts £m	Loans payable by instalments any of which are payable after five years £m	Other repayment terms £m	Finance leases £m	Other financial liabilities £m	<b>2007 Total £m</b>	2006 Total £m
Current financial liabilities	0.1	1.7	597.3	32.7	33.3	<b>665.1</b>	866.6
Financial liabilities due after one year:							
Between one and two years	–	–	213.7	40.9	0.3	<b>254.9</b>	164.5
Between two and five years	–	–	190.6	105.6	0.6	<b>296.8</b>	554.3
After more than five years	–	35.5	1,823.4	229.3	1.6	<b>2,089.8</b>	1,577.7
Non current financial liabilities	–	35.5	2,227.7	375.8	2.5	<b>2,641.5</b>	2,296.5
	0.1	37.2	2,825.0	408.5	35.8	<b>3,306.6</b>	3,163.1

£461.0 million of funding instruments contain certain financial covenants, breach of which can trigger early repayment.

**e) Borrowing facilities**

The group has the following undrawn committed borrowing facilities available (all at floating rates).

	2007 £m	2006 £m
Expiring within one year	–	–
Expiring in more than one, but not more than two years	–	–
Expiring in more than two, but not more than five years	500.0	500.0
	<b>500.0</b>	<b>500.0</b>

In addition, the group has a committed facility of £80 million (2006: £80.0 million), of which up to £60 million may be drawn in the form of money market borrowings and the balance not utilised by such drawings may be drawn as overdraft. The amount undrawn at the year end was £47.2 million (2006: £nil).

**f) Derivative contracts**

	Assets £m	2007 Liabilities £m	Assets £m	2006 Liabilities £m
Cross currency swaps – hedges of net investment	–	–	–	–
Cross currency swaps – fair value hedges	3.1	(65.3)	3.1	(37.0)
Cross currency swaps – not qualifying for hedge accounting	1.2	–	3.9	–
Interest rate swaps – cash flow hedges	3.9	(0.5)	0.6	(3.0)
Interest rate swaps – not qualifying for hedge accounting	12.5	(57.5)	6.9	(104.5)
<b>Total</b>	<b>20.7</b>	<b>(123.3)</b>	<b>14.5</b>	<b>(144.5)</b>
Less non-current portion				
Cross currency swap – fair value hedges	2.7	(55.7)	3.1	(27.1)
Interest rate swap – cashflow hedges	3.9	(0.5)	0.6	(3.0)
<b>Total</b>	<b>6.6</b>	<b>(56.2)</b>	<b>3.7</b>	<b>(30.1)</b>
<b>Current portion</b>	<b>14.1</b>	<b>(67.1)</b>	<b>10.8</b>	<b>(114.4)</b>

**Interest rate swaps**

The notional principal amounts of the outstanding interest rate swaps contracts at 31 March 2007 was £1,273 million (2006: £1,232 million). The fixed interest rates vary from 4.38% to 6.45%. The main floating rate is LIBOR.

Included within this are interest rate swaps with a notional value of £1,432 million (2006: £850 million) which do not qualify for hedge accounting. The group has an ongoing debt requirement and these swaps aim to fix the interest rates paid on a portfolio of variable debt of various terms. As it is not possible to specifically match these swaps to individual debt instruments, they do not qualify for hedge accounting.

**Cross currency swaps**

The notional principal amounts of the outstanding cross currency swap contracts at 31 March 2007 was £491.3 million (2006: £467.6 million). These swap a variety of currencies into sterling.

**Hedge of net investments in foreign entities**

During the year the group held a US dollar cross currency swap that was designated as a hedge of net investment in the group's US subsidiaries. The swap matured in January 2007 and was not replaced. The foreign exchange gain of £6.4 million (2006: loss of £5.3 million) was recognised in hedging reserves in shareholders' equity.

# Notes to the group financial statements continued

## g) Fair values of financial instruments

Financial instruments by category:

### Asset/(liability)

	2007		2006	
	Book value £m	Fair value £m	Book value £m	Fair value £m
<b>Primary financial instruments held or issued to finance the group's operations</b>				
Trade receivables	181.3	181.3	302.6	302.6
Short-term deposits	100.0	100.0	87.8	87.8
Cash at bank and in hand	43.2	43.2	54.8	54.8
Borrowings falling due within one year	(631.8)	(603.6)	(808.2)	(791.2)
Borrowings falling due after more than one year	(2,639.0)	(2,572.2)	(2,295.5)	(2,468.6)
Provisions for onerous contracts	(3.1)	(3.1)	(2.2)	(2.2)
Trade payables	(32.7)	(32.7)	(57.3)	(57.3)
<b>Derivative financial instruments held to manage the currency and interest rate profile</b>				
Interest rate swaps and similar instruments	(41.6)	(41.6)	(100.0)	(100.0)
Currency instrument – cross currency swaps	(61.0)	(61.0)	(30.0)	(30.0)
Total net financial liabilities	(3,084.7)	(2,989.7)	(2,848.0)	(3,004.1)
<b>Other long term assets</b>				
Other fixed asset investments	0.2	0.2	0.5	0.5

Where available, market rates have been used to determine fair values. When market prices are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

## h) Financial risk factors

The group's activities expose it to a variety of financial risks: market risk (including currency risk), credit risk, liquidity risk and interest rate risk. The group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the group's financial performance. The group uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central treasury department (Group Treasury) under policies approved by the board of directors. Group Treasury identifies, evaluates and hedges financial risks in close co-operation with the group's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and the investment of surplus funds.

### (i) Market risk

The group operates internationally and is exposed to foreign exchange risk arising from net investments in foreign operations, primarily with respect to the US dollar and the euro. In addition, the group has a significant value of foreign currency debt, primarily in US dollars, yen and euros.

Foreign exchange risk arises when transactions are denominated in a currency that is not the entity's functional currency. To manage the foreign exchange risk arising from foreign currency debt the group enters into cross currency swaps with external parties.

External foreign exchange contracts are designated at group level and company level as hedges of foreign exchange risk on specific assets, liabilities or future transactions on a gross basis.

The group's risk management policy is to hedge 100% of all foreign currency denominated debt.

The group has certain investments in foreign operations whose net assets are exposed to foreign currency translation risk. Currency exposure arising from the net assets of the group's foreign operations is managed through borrowings and forward foreign exchange contracts denominated in the relevant foreign currencies.

### (ii) Credit risk

Operationally, the group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history, other than in Severn Trent Water Limited, whose operating licence obliges it to continue to supply domestic customers even in cases where bills are not paid.

For financing purposes, derivative counterparties and cash transactions are limited to high credit quality financial institutions. The group has policies that limit the amount of credit exposure to any one financial institution.

### (iii) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash balances and the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Due to the dynamic nature of the underlying businesses, Group Treasury aims to maintain flexibility in funding by keeping committed credit lines available.

### (iv) Cash flow and fair value interest rate risk

The group's income and operating cash flows are substantially independent of changes in market interest rates.

The group's interest rate risk arises from long term borrowings. Borrowings issued at variable rates expose the group to cash flow interest rate risk. Borrowings issued at fixed rates expose the group to fair value interest rate risk. Group policy is to maintain over 50% of its borrowings in fixed rate instruments. At 31 March 2007 some 69% of the group's net debt was fixed.



The group manages its cash flow interest rate risk by using floating to fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Under the terms of the interest rate swaps, the group agrees with other parties to exchange, at specified intervals (mainly semi annually), the difference between fixed contract and floating rate interest rates calculated by reference to the agreed notional principal amounts. The group has entered into a series of long dated interest rate swaps to hedge future debt. Economically these act to fix floating rate debt within the group, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a credit of £52.7 million (2006: charge of £31.5 million) in the income statement.

#### i) Fair value estimation

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

The fair value of financial instruments that are not traded in an active market (for example, over the counter derivatives) is determined by using valuation techniques. The group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Estimated discounted cash flows are used to determine fair value for the debt. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using quoted forward exchange rates at the balance sheet date.

The nominal 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 group for similar financial instruments.

#### 21 Available for sale financial assets

	2007 £m	2006 £m
Investments in unquoted equity instruments	0.2	0.5

The fair values of the unquoted equity instruments cannot be measured reliably since there is no active market in the instruments. Hence the investments are held at cost. It is not possible to determine a range of estimates within which the fair values are highly likely to lie.

#### 22 Inventory

	2007 £m	2006 £m
Inventory and work in progress	22.4	34.1
Development land and properties	–	20.3
	22.4	54.4

Following the disposal of Severn Trent Property the group no longer holds development land and properties.

# Notes to the group financial statements continued

## 23 Trade and other receivables

	2007 £m	2006 £m
Trade receivables	256.0	372.7
Less provision for impairment of receivables	(74.7)	(70.1)
Trade receivables – net	181.3	302.6
Receivables from related parties	0.3	0.3
Corporation tax recoverable	–	0.1
Other amounts receivable	37.8	12.1
Prepayments and accrued income	167.7	166.4
	387.1	481.5

The carrying values of trade and other receivables are reasonable approximations of their fair values.

There is no concentration of credit risk with respect to trade receivables.

Prepayments include £8.2 million (2006: £9.6 million) in respect of amounts due from customers for contract work.

## 24 Cash and cash equivalents

	2007 £m	2006 £m
Cash at bank and in hand	43.2	54.8
Short term bank deposits	100.0	87.8
	143.2	142.6

Of the £100.0 million of short term bank deposits, £51.5 million is not available for use by the group. Further details are given in note 20 (b).

Cash and bank overdrafts include the following for the purposes of the cash flow statement:

	2007 £m	2006 £m
Cash and cash equivalents	143.2	142.6
Bank overdrafts (note 25)	(0.1)	(32.2)
	143.1	110.4

**25 Borrowings**

	2007 £m	2006 £m
Bank overdrafts	0.1	32.2
Bank loans	462.6	381.4
Other loans	2,399.6	2,201.3
Obligations under finance leases	408.5	488.8
<b>Borrowings</b>	<b>3,270.8</b>	<b>3,103.7</b>

	2007 £m	2006 £m
The borrowings are repayable as follows:		
On demand or within one year (included in current liabilities)	631.8	808.2
In the second year	254.6	163.6
In the third to fifth years inclusive	296.2	554.2
After five years	2,088.2	1,577.7
Included in non current liabilities	2,639.0	2,295.5
	<b>3,270.8</b>	<b>3,103.7</b>

The group's borrowings are denominated in the following currencies after taking account of cross currency swaps:

	2007 £m	2006 £m
Sterling	3,269.1	3,069.4
Euro	1.7	29.6
US dollar	–	4.7
	<b>3,270.8</b>	<b>3,103.7</b>

The fair values of the group's borrowings were:

	2007 £m	2006 £m
Bank overdrafts	0.1	32.2
Bank loans	429.7	358.7
Other loans	2,170.1	2,380.1
Obligations under finance leases	408.5	488.8
	<b>3,008.4</b>	<b>3,259.8</b>

Fair values are based on expected future cash flows discounted using LIBOR forward interest rates related to the expected timing of payments.

Fixed debt has a weighted average interest rate of 5.7% (2006: 5.7%) for a weighted average period of 13.5 years (2006: 14.6 years).

Further details of bank facilities are given in note 20.

Obligations under finance leases are as follows:

	2007 £m	2006 £m
Gross obligations under finance leases	588.2	721.6
Less future finance charges	(179.7)	(232.8)
<b>Present value of lease obligations</b>	<b>408.5</b>	<b>488.8</b>

The remaining terms of finance leases ranged from 4 to 25 years at 31 March 2007. Interest terms are set at the inception of the lease, no leases (2006: 3.4%) were at fixed interest rates. The weighted average effective rate payable on fixed rate leases was 4.3% in 2006. The lease obligations are secured against the related assets. The fair value of the finance lease obligations is not significantly different from their carrying value.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restrictions on dividend payments, additional debt or further leasing.

# Notes to the group financial statements continued

## 26 Trade and other payables

	2007 £m	2006 £m
<b>Current liabilities</b>		
Trade payables	32.7	57.3
Social security and other taxes	6.7	47.9
Other payables	34.2	39.3
Accruals and deferred income	331.5	396.1
	<b>405.1</b>	<b>540.6</b>
<b>Non current liabilities</b>		
Deferred income	183.0	151.5
Other payables	–	2.7
Accrued expenses	5.3	4.5
	<b>188.3</b>	<b>158.7</b>

The directors consider that the carrying value of trade payables is not materially different from their fair values.

Accruals and deferred income includes £2.5 million (2006: £3.1 million) in respect of amounts due to customers for contract work.

## 27 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the group and movements thereon during the current and prior reporting period.

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Tax losses £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2005	921.3	(95.5)	(1.2)	(21.2)	63.5	866.9
Charge/(credit) to income	10.2	20.9	0.1	(11.0)	(26.0)	(5.8)
Charge/(credit) to equity	–	8.0	–	1.4	(0.8)	8.6
Acquisitions/disposals	0.1	–	–	–	–	0.1
Assets held for sale	–	–	1.0	–	–	1.0
Exchange differences	–	–	–	–	(0.6)	(0.6)
At 1 April 2006	931.6	(66.6)	(0.1)	(30.8)	36.1	870.2
Charge/(credit) to income	(8.4)	17.7	(8.6)	14.7	9.0	24.4
Charge/(credit) to equity	–	(4.3)	–	3.2	(0.6)	(1.7)
Acquisitions/disposals	(3.5)	12.6	0.7	–	(12.3)	(2.5)
Exchange differences	(0.1)	–	0.3	–	0.5	0.7
<b>At 31 March 2007</b>	<b>919.6</b>	<b>(40.6)</b>	<b>(7.7)</b>	<b>(12.9)</b>	<b>32.7</b>	<b>891.1</b>

Certain deferred tax assets and liabilities have been offset. The offset amounts are as follows:

	2007 £m	2006 £m
Deferred tax asset to be recovered after more than 12 months	(44.8)	(68.9)
Deferred tax asset to be recovered within 12 months	(4.7)	(3.0)
	<b>(49.5)</b>	<b>(71.9)</b>
Deferred tax liability to be recovered after more than 12 months	937.8	932.8
Deferred tax liability to be recovered within 12 months	2.8	9.3
	<b>940.6</b>	<b>942.1</b>
	<b>891.1</b>	<b>870.2</b>

In addition to the amounts disclosed above, at the balance sheet date the group had unused tax losses of £4.9 million (2006: £33.3 million) available for offset against future profits. No asset has been recognised for these losses since it is not probable that there will be sufficient taxable profit available against which the losses can be utilised.

The Chancellor's budget announced proposed changes to the future rate of corporation tax and industrial buildings allowances that, if enacted in the Finance Act, will impact the deferred tax pension and future tax charges. The group is currently assessing the likely impact of these changes.

## 28 Retirement benefit schemes

### Defined benefit schemes

The group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit schemes are funded to cover future salary and pension increases and their assets are held in separate funds administered by trustees. A formal actuarial valuation of each scheme is carried out at regular intervals by an independent professionally qualified actuary. Under the defined benefit schemes, members are entitled to retirement benefits calculated as a proportion (varying between one thirtieth and one eightieth for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years salary in the last ten years of employment. The final salary sections of all of the pension schemes listed below are closed to new entrants and the age profile of scheme participants is expected to rise and hence service costs are also expected to rise in the future.

The UK defined benefit schemes and the date of their last formal actuarial valuation are as follows:

UK defined benefit scheme	Date of last formal actuarial valuation
Severn Trent Pension Scheme ("STPS")*	31 March 2004
Severn Trent Senior Staff Pension Scheme ("SSPS")	31 March 2004
Severn Trent Water Mirror Image Pension Scheme	31 March 2006

\* The STPS is by far the largest of the group's UK defined benefit schemes.

On the demerger of Biffa Plc the company entered into an agreement with that company and the trustees of the STPS, the SSPS and the UK Waste Pension Scheme ("UKWPS") whereby the assets and liabilities relating to Biffa Plc employees in the STPS and the SSPS would be transferred to the UKWPS with effect from 31 March 2007. The group has no continuing responsibility for the UKWPS following this agreement. The net deficit relating to Biffa Plc employees at the demerger date was £39 million. This has been included in the net assets that formed the dividend in specie on demerger. The reduction in the deficit between the demerger date and 31 March 2007 has been treated as an exceptional loss on settlement of £7.8 million.

The group has an obligation to pay pension to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £7.5 million (2006: £11.5 million) is included in the retirement benefit obligation.

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2007	2006
Price inflation	3.0%	2.7%
Salary increases	4.5%	4.2%
Pension increases in payment and deferment	3.0%	2.7%
Discount rate	5.4%	4.9%
Longevity at age 65 for pensioners retiring now		
– men (years)	19.2	18.3
– women (years)	22.1	21.0
Longevity at age 65 for pensioners retiring in 20 years		
– men (years)	19.9	18.9
– women (years)	23.0	21.8

# Notes to the group financial statements continued

Amounts recognised in the income statement in respect of these defined benefit schemes are as follows:

	2007 £m	2006 £m
<b>Amounts charged to operating costs</b>		
Current service cost	(41.1)	(38.9)
Past service cost	(0.4)	(0.8)
Exceptional settlement	(7.8)	–
	<b>(49.3)</b>	<b>(39.7)</b>
<b>Amounts charged to net finance costs</b>		
Interest cost	(73.0)	(75.4)
Expected return on scheme assets	87.0	79.2
	<b>14.0</b>	<b>3.8</b>
<b>Total amount charged to the income statement</b>	<b>(35.3)</b>	<b>(35.9)</b>

Actuarial gains and losses have been reported in the statement of recognised income and expense.

The amount included in the balance sheet arising from the group's obligations under defined benefit schemes is as follows:

	2007 £m	2006 £m
Present value of defined benefit obligations – funded schemes	(1,492.2)	(1,613.3)
Total fair value of assets	1,364.6	1,402.9
	<b>(127.6)</b>	<b>(210.4)</b>
Present value of defined benefit obligations – unfunded schemes	(7.5)	(11.5)
<b>Liability recognised in the balance sheet</b>	<b>(135.1)</b>	<b>(221.9)</b>

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

	2007 £m	2006 £m
At 1 April	1,624.8	1,394.4
Service cost	41.5	39.7
Exceptional loss on settlement	7.8	–
Interest cost	73.0	75.4
Contributions from scheme members	7.5	10.6
Liabilities transferred to Biffa Plc	(201.5)	–
Actuarial losses recognised in the statement of recognised income and expense	3.7	152.8
Benefits paid	(57.1)	(48.1)
<b>At 31 March</b>	<b>1,499.7</b>	<b>1,624.8</b>

Movements in the fair value of the scheme assets were as follows:

	2007 £m	2006 £m
At 1 April	1,402.9	1,076.9
Expected return on scheme assets	87.0	79.2
Contributions from the sponsoring companies	97.4	105.2
Contributions from scheme members	7.5	10.6
Assets transferred to Biffa Plc	(162.5)	–
Actuarial gains and losses recognised in the statement of recognised income and expense	(10.6)	179.1
Benefits paid	(57.1)	(48.1)
<b>At 31 March</b>	<b>1,364.6</b>	<b>1,402.9</b>



The analysis of the assets in the schemes and the expected rates of return were:

	Expected return	2007 Fair value of assets £m	Expected return	2006 Fair value of assets £m
Equities	8.25%	811.5	8.00%	907.5
Gilts	4.65%	248.5	4.17%	261.7
Corporate bonds	5.40%	103.2	4.40%	63.5
Property	6.55%	86.3	6.20%	81.4
Cash	5.25%	115.1	3.70%	88.8
Total fair value of assets		1,364.6		1,402.9

The expected rate of return on scheme assets is based on market expectations at the beginning of the period for returns over the life of the benefit obligation. For gilts and corporate bonds the expected rates of return are based on market yields at the balance sheet date. For equities, an equity risk premium has been added to the gilt rate.

The actual return on scheme assets was £76.4 million (2006: £258.3 million).

The estimated amount of contributions expected to be paid to the schemes during the year ending 31 March 2008 is £47 million.

The history of actual and expected performance of pension scheme assets and liabilities is:

	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligations	(1,499.7)	(1,624.8)	(1,394.4)
Fair value of scheme assets	1,364.6	1,402.9	1,076.9
Deficit in the schemes	(135.1)	(221.9)	(317.5)
Difference between actual and expected return on scheme assets	(10.6)	179.1	37.5
Experience adjustments on scheme liabilities	3.7	(152.8)	5.7

#### Defined contribution schemes

The group also operates defined contribution arrangements for certain of its UK and overseas employees. In September 2001, the Severn Trent Group Pension Scheme (an occupational defined contribution scheme) was established to ensure compliance with stakeholder legislation and to provide the group with an alternative pension arrangement. This was closed to new entrants on 1 April 2005 and replaced by the Severn Trent Stakeholder Pension Scheme.

The total cost charged to operating costs of £2.7 million (2006: £4.0 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2007, no contributions (2006: £nil) due in respect of the current reporting period had not been paid over to the schemes.

## 29 Provisions

	Environmental and landfill restoration £m	Restructuring £m	Insurance £m	Onerous contracts £m	Terminated operations and disposals £m	Other £m	Total £m
At 1 April 2005	77.4	13.5	27.5	3.7	–	0.7	122.8
Charged to income statement	9.8	4.0	10.5	–	4.5	1.0	29.8
Utilisation of provision	(12.2)	(9.9)	(9.3)	(1.5)	–	(1.7)	(34.6)
Unwinding of discount	2.3	–	–	–	–	–	2.3
Reclassification	(0.8)	–	–	–	–	0.4	(0.4)
Amounts classified as held for sale	(10.0)	–	–	–	–	–	(10.0)
Exchange differences	0.3	–	–	–	–	–	0.3
At 1 April 2006	66.8	7.6	28.7	2.2	4.5	0.4	110.2
Charged to income statement	2.6	1.1	9.0	3.1	4.5	0.8	21.1
Utilisation of provision	(4.0)	(5.4)	(8.1)	(0.5)	(3.1)	(0.7)	(21.8)
Unwinding of discount	1.2	–	–	–	–	–	1.2
Disposal of subsidiaries	(66.6)	–	(3.5)	(1.7)	–	–	(71.8)
At 31 March 2007	–	3.3	26.1	3.1	5.9	0.5	38.9

# Notes to the group financial statements continued

	2007 £m	2006 £m
<b>Included in</b>		
Current liabilities	6.7	30.1
Non current liabilities	32.2	80.1
	<b>38.9</b>	<b>110.2</b>

Environmental and landfill restoration provisions reflect costs to be incurred over the operational life of individual landfill sites and in the case of aftercare costs, for up to 30 years thereafter. Further details are explained in note 2 (l). Discounting is applied. Following the disposal of Biffa Belgium and the demerger of Biffa Plc the group no longer has any landfill operations.

The restructuring provision reflects costs to be incurred in respect of committed programmes.

Derwent Insurance Limited, a captive insurance company, is a wholly owned subsidiary of the group. Provisions for claims are made as set out in note 2 (l). The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

The onerous or loss making contract provision relates to specific contractual liabilities either assumed with businesses acquired or arising in existing group businesses, where estimated future costs are not expected to be recovered in revenues. The associated outflows are estimated to occur over a period of ten years from the balance sheet date.

Provisions relating to terminated operations and disposals include amounts that it is probable will be paid in respect of claims arising from services performed by these businesses; overseas employee tax liabilities and the indemnities described in note 37 (c).

## 30 Share capital

	2007 £m	2006 £m
<b>Total authorised share capital:</b>		
346,783,834 ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p (2006: 520,175,751 ordinary shares of 65 <sup>5</sup> / <sub>9</sub> p)	<b>339.5</b>	339.5
<b>Total issued and fully paid share capital:</b>		
233,164,566 ordinary shares of 97 <sup>17</sup> / <sub>19</sub> p (2006: 348,093,283 ordinary shares of 65 <sup>5</sup> / <sub>9</sub> p)	<b>228.3</b>	227.2

On the demerger of Biffa Plc the ordinary share capital of the company was consolidated with the intention that the share price of Severn Trent Plc shares would be similar before and after the demerger. Two new Severn Trent shares were issued for every three old Severn Trent shares held.

Changes in share capital were as follows:

	Number	£m
<b>Ordinary shares of 65<sup>5</sup>/<sub>9</sub>p</b>		
At 1 April 2006	348,093,283	227.2
Shares issued at 473p, 536p, 548p, 568p, 592p, 759p, 823p or 831p		
under the group's Employee Sharesave Scheme	1,062,231	0.7
Shares issued at 680.5p, 688p, 720p, 738p, 934p, or 1,005.3p under the group's Share Option Scheme	375,725	0.2
At 6 October 2006	349,531,239	228.1
Share consolidation	(116,510,413)	–
Ordinary shares of 97 17/19p	233,020,826	228.1
Shares issued at 473p, 536p, 548p, 568p, 592p, 759p, 823p or 831p		
under the group's Employee Sharesave Scheme	67,837	0.1
Shares issued at 680.5p, 688p, 720p, 738p, 934p, or 1,005.3p under the group's Share Option Scheme	75,903	0.1
<b>At 31 March 2007</b>	<b>233,164,566</b>	<b>228.3</b>

## 31 Share premium

	2007 £m	2006 £m
At 1 April	<b>48.6</b>	38.4
Employee share option scheme	<b>8.9</b>	10.2
<b>At 31 March</b>	<b>57.5</b>	<b>48.6</b>

### 32 Other reserves

	Capital redemption reserve £m	Infrastructure reserve £m	Translation exchange reserve £m	Hedging reserve £m	Total other reserves £m
At 1 April 2005	156.1	314.2	(3.8)	(57.0)	409.5
Total recognised income for the period	–	–	21.6	1.3	22.9
At 1 April 2006	156.1	314.2	17.8	(55.7)	432.4
Total recognised income for the period	–	–	(25.5)	12.1	(13.4)
<b>At 31 March 2007</b>	<b>156.1</b>	<b>314.2</b>	<b>(7.7)</b>	<b>(43.6)</b>	<b>419.0</b>

The capital redemption reserve arose on the redemption of B shares.

The infrastructure reserve arose on restating infrastructure assets to fair value as deemed cost on transition to IFRS.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries as well as foreign exchange differences arising from hedges of net investment.

The hedging reserve arises from gains or losses on hedging instruments taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

### 33 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 2005	225.8	38.4	409.5	1,116.1	1,789.8	1.9	1,791.7
Share options and LTIPs							
– proceeds from shares issued	1.4	10.2	–	–	11.6	–	11.6
– value of employees' services	–	–	–	4.1	4.1	–	4.1
Dividends	–	–	–	(171.3)	(171.3)	(0.7)	(172.0)
Deferred tax on items posted directly to equity	–	–	–	0.8	0.8	–	0.8
Total recognised income for the period	–	–	22.9	238.5	261.4	1.4	262.8
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
<b>At 31 March 2007</b>	<b>228.3</b>	<b>57.5</b>	<b>419.0</b>	<b>429.4</b>	<b>1,134.2</b>	<b>3.1</b>	<b>1,137.3</b>

Retained earnings are stated after deducting £7.3 million (2006: £7.3 million) representing own shares purchased by the Severn Trent Employee Share Ownership Trust for certain senior employees under the Long Term Incentive Plans (LTIPs). The main features of the LTIPs are set out in the directors' remuneration report on pages 37 and 38. Following the demerger, the trust sold its holding of Biffa shares and reinvested the proceeds in the purchase of Severn Trent shares. At 31 March 2007, the trust held 819,240 shares of 97<sup>17</sup>/<sub>9</sub>p (2006: 914,894 ordinary shares of 65<sup>5</sup>/<sub>9</sub>p).

The market value of these shares at 31 March 2007 was £11.7 million (2006: £10.2 million).

# Notes to the group financial statements continued

## 34 Share based payment

The group operates a number of share based remuneration schemes for employees and details of the share awards outstanding during the year are as follows:

	Employee Sharesave Scheme		Approved Share Option Scheme		Unapproved Share Option Scheme	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
Outstanding at 1 April 2005	6,678,273	579p	424,582	766p	1,064,320	731p
Granted during the year	1,017,512	823p	–	–	–	–
Forfeited during the year	(169,511)	534p	(15,528)	892p	(23,450)	784p
Cancelled during the year	(142,669)	587p	–	–	–	–
Exercised during the year	(1,652,278)	490p	(155,617)	755p	(295,786)	744p
Expired during the year	(16,252)	623p	–	–	–	–
Outstanding at 1 April 2006	5,715,075	641p	253,437	768p	745,084	724p
Granted during the year	561,552	1,172p	–	–	–	–
Forfeited during the year	(129,177)	693p	(86,656)	695p	(264,860)	691p
Cancelled during the year	(112,999)	734p	–	–	–	–
Exercised during the year	(1,124,660)	559p	(115,399)	800p	(329,216)	749p
Expired during the year	(24,239)	628p	–	–	–	–
<b>Outstanding at 31 March 2007</b>	<b>4,885,552</b>	<b>717p</b>	<b>51,382</b>	<b>816p</b>	<b>151,008</b>	<b>728p</b>

The weighted average share price during the period was £13.82 (2006: £10.29).

## Share option schemes

The options outstanding at the end of the period are exercisable as shown below:

### i) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant those employees who have entered into an Inland Revenue approved Save As You Earn contract for a period of three, five or seven years, the right to purchase ordinary shares in the company. Options outstanding at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares	
			2007	2006
January 1999	2004 or 2006	831p	–	28,683
January 2000	2003, 2005 or 2007	473p	<b>284,939</b>	301,455
January 2001	2004, 2006 or 2008	568p	<b>85,549</b>	448,188
January 2002	2005, 2007 or 2009	548p	<b>463,725</b>	500,388
January 2003	2006, 2008 or 2010	536p	<b>594,156</b>	1,277,674
January 2004	2007, 2009 or 2011	592p	<b>978,115</b>	1,061,142
January 2005	2008, 2010 or 2012	759p	<b>979,030</b>	1,086,938
January 2006	2009, 2011 or 2013	823p	<b>943,247</b>	1,010,607
January 2007	2010, 2012 or 2014	1,172p	<b>556,791</b>	–
			<b>4,885,552</b>	5,715,075

### ii) Approved Share Option Scheme

Under the terms of the Share Option Scheme (formerly the Executive Share Option Scheme), the board has granted directors and other executives options to purchase ordinary shares in the company. Options outstanding under this scheme at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares	
			2007	2006
June 1998	2001-2008	1005p	<b>8,956</b>	34,459
June 1999	2002-2009	934p	<b>12,677</b>	35,005
June 2000	2003-2010	688p	<b>14,360</b>	54,335
July 2001	2004-2011	738p	<b>7,722</b>	12,770
June 2002	2005-2012	720p	<b>7,667</b>	22,916
July 2003	2006-2013	680.5p	–	93,952
			<b>51,382</b>	253,437

### iii) Unapproved Share Option Scheme

The board has granted executives options to purchase ordinary shares in the company under an unapproved share option scheme. Options outstanding under this scheme at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares 2007	Number of shares 2006
June 1998	2001-2008	1005p	–	21,271
June 1999	2002-2009	934p	<b>5,899</b>	50,989
June 2000	2003-2010	688p	<b>36,758</b>	181,249
July 2001	2004-2011	738p	<b>58,897</b>	107,665
June 2002	2005-2012	720p	<b>49,454</b>	127,459
July 2003	2006-2013	680.5p	–	256,451
			<b>151,008</b>	745,084

### iv) Fair values of awards made in the year

	2007 Number	2007 Fair value £m	2006 Number	2006 Fair value £m
LTIP awards	<b>339,564</b>	<b>2.1</b>	704,790	5.6
Sharesave options	<b>561,552</b>	<b>1.7</b>	1,017,512	1.8
Share Incentive Plan (SIP)	<b>1,368</b>	–	131,475	1.3

The fair values of the LTIP awards were calculated using the Monte Carlo method. The principal assumptions were as follows:

LTIP award year	2006/07	2005/06	2004/05
Share price at grant date	<b>1178p</b>	1017p	903p
Number of shares awarded	<b>339,564</b>	704,790	980,591
Number of employees	<b>46</b>	190	231
Vesting period (years)	<b>3</b>	3	3
Expected volatility	<b>15%</b>	17%	20%
Expected life (years)	<b>3</b>	3	3
Expected dividend yield	<b>n/a</b>	n/a	6.5%
Proportion of employees expected to cease employment before vesting	<b>0%</b>	0%	0%
Expectation of meeting economic profit performance criteria	<b>n/a</b>	100%	100%
Fair value per share (EP scheme/TSR scheme)	<b>604p</b>	1017p/468p	484p

Details of the basis of the LTIP schemes are set out in the remuneration report on pages 39 to 40.

The fair values of the Sharesave options were calculated using the Black Scholes model. The principal assumptions were as follows:

Scheme year	2006/07			2005/06			2004/05		
Scheme type	<b>3 year</b>	<b>5 year</b>	<b>7 year</b>	3 year	5 year	7 year	3 year	5 year	7 year
Share price at grant date	<b>1428p</b>	<b>1428p</b>	<b>1428p</b>	1069p	1069p	1069p	979p	979p	979p
Number of options granted	<b>343,413</b>	<b>175,593</b>	<b>42,546</b>	605,633	346,668	65,211	619,784	461,680	118,420
Number of employees	<b>1,420</b>	<b>511</b>	<b>96</b>	1775	676	111	1,826	756	175
Vesting period (years)	<b>3</b>	<b>5</b>	<b>7</b>	3	5	7	3	5	7
Expected volatility	<b>15%</b>	<b>15%</b>	<b>15%</b>	17%	17%	17%	30%	30%	30%
Option life (years)	<b>3.5</b>	<b>5.5</b>	<b>7.5</b>	3.5	5.5	7.5	3.5	5.5	7.5
Expected life (years)	<b>3.25</b>	<b>5.25</b>	<b>7.25</b>	3.25	5.25	7.25	3.25	5.25	7.25
Risk free rate	<b>5.19%</b>	<b>5.04%</b>	<b>4.92%</b>	4.31%	4.28%	4.24%	4.52%	4.54%	4.56%
Expected dividend yield	<b>4.0%</b>	<b>4.0%</b>	<b>4.0%</b>	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Proportion of employees expected to cease employment before vesting	<b>15.0%</b>	<b>17.0%</b>	<b>13.0%</b>	15.0%	17.0%	13.0%	15.0%	17.0%	13.0%
Fair value per share – sharesave	<b>295p</b>	<b>305p</b>	<b>306p</b>	189p	168p	149p	232p	227p	216p

The SIP shares are purchased on the open market and vest with the employees immediately and hence the value of the shares purchased is charged straight to the income statement.

During the period, the group recognised total expenses of £3.6 million (2006: £4.1 million) related to equity settled share based payment transactions.

Volatility is based on historical observations as adjusted for unusual market fluctuations.

# Notes to the group financial statements continued

## 35 Disposal of subsidiaries

On 30 June 2006 the group sold Biffa Belgium to Veolia Proprete SA, on 3 November the group sold Severn Trent Property Limited to Prologis Group Holdings Limited and on 29 December the group sold Severn Trent Laboratories Inc. to Test America Holdings Inc.

The net assets at the date of sale were:

	Biffa Belgium £m	Severn Trent Property £m	Severn Trent Laboratories Inc. £m	Total £m
Property, plant and equipment	21.6	–	30.7	52.3
Intangible assets and goodwill	2.3	–	24.4	26.7
Interests in joint ventures	–	7.8	–	7.8
Inventory	0.3	28.6	4.9	33.8
Trade and other receivables	15.0	1.6	27.6	44.2
Trade and other payables	(15.6)	(6.2)	(8.8)	(30.6)
Net cash	–	–	1.7	1.7
Current and deferred tax	1.4	(2.6)	(0.9)	(2.1)
Provisions	(10.0)	–	–	(10.0)
	15.0	29.2	79.6	123.8
Foreign exchange movements recycled from reserves	(0.8)	–	(0.1)	(0.9)
Profit/(loss) on disposal	9.5	2.7	(2.4)	9.8
<b>Total consideration</b>	<b>23.7</b>	<b>31.9</b>	<b>77.1</b>	<b>132.7</b>
Satisfied by:				
Cash	23.7	31.9	77.1	132.7
Net cash inflow arising on disposal:				
Cash consideration	23.7	31.9	77.1	132.7
Cash and cash equivalents disposed of	–	–	(2.1)	(2.1)
	<b>23.7</b>	<b>31.9</b>	<b>75.0</b>	<b>130.6</b>

The profit on disposal is included in the exceptional costs analysed in note 8. Biffa Belgium and Severn Trent Laboratories Inc. have been classified as discontinued activities.

The contracts relating to the disposals of Biffa Belgium, Severn Trent Property and Severn Trent Laboratories Inc. included adjustments to the consideration based on the values of certain assets and liabilities in completion accounts drawn up to the date of disposal. The completion accounts for Biffa Belgium and Severn Trent Property were agreed with the respective purchasers during the year ended 31 March 2007. The process of reviewing and agreeing the completion accounts for Severn Trent Laboratories Inc. is ongoing. The consideration included above represents the directors' best estimate of the outcome of that process.

On 6 October 2006 the group completed the demerger of Biffa Plc. The net assets of Biffa Plc at the date of demerger were:

	Biffa Plc £m
Property, plant and equipment	339.5
Intangible assets and goodwill	391.6
Interests in joint ventures	1.1
Inventory	3.0
Trade and other receivables	157.0
Trade and other payables	(123.2)
Net debt	(355.7)
Pension deficit	(39.0)
Current deferred tax	(21.9)
Provisions	(71.8)
<b>Net assets demerged</b>	<b>280.6</b>

### Net cash outflow arising on demerger:

**Cash and cash equivalents demerged** **(21.9)**

The demerger of Biffa Plc has been accounted for as a distribution of the Biffa Plc net assets at their carrying values on the date of demerger. Biffa Plc has been classified as a discontinued operation.



### 36 Cash flow statement

#### a) Reconciliation of operating profit to operating cash flows

	2007 £m	2006 (restated) £m
Profit before interest and tax from continuing operations	430.0	377.4
Profit before interest and tax from discontinued operations	34.9	91.0
	464.9	468.4
Depreciation of property, plant and equipment	254.5	267.9
Amortisation of intangible assets	29.4	29.3
Impairment of goodwill	31.5	–
Pension service cost	49.3	39.7
Pension contributions	(97.4)	(105.2)
Share based payments charge	3.6	4.1
Profit on sale of property, plant and equipment	(39.6)	(4.3)
Profit on sale of subsidiaries and associates	(24.5)	–
Deferred income movement	(3.5)	(3.5)
Provisions for liabilities and charges	21.1	29.8
Utilisation of provisions for liabilities and charges	(21.8)	(34.6)
(Increase)/decrease in stocks	(4.5)	13.4
Increase in debtors	(92.0)	(10.8)
Decrease in creditors	3.0	64.7
Cash generated from operations	574.0	758.9
Interest paid	(148.6)	(139.4)
Interest element of finance lease rental payments	(20.2)	(45.1)
Tax paid	(36.0)	(68.3)
Net cash inflow from operating activities	369.2	506.1

#### b) Analysis of net cash and cash equivalents

	2007 £m	2006 £m
Cash and cash equivalents	143.2	142.6
Bank overdrafts	(0.1)	(32.2)
	143.1	110.4

#### c) Non cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2006: £0.3 million).

# Notes to the group financial statements continued

## 37 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 31 October 2005, as a result of a referral by Ofwat, the Serious Fraud Office (SFO) informed the company that it was undertaking a criminal investigation into alleged reporting irregularities made to Ofwat by Severn Trent Water Limited between 2000 and 2003. Ofwat had been conducting its own investigation following the allegations made by the employee of Severn Trent Water. Ofwat began its investigation into the allegations in January 2005. The matter reported to the SFO concerned data on leakage.

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. Ofwat has stated that this penalty will be discussed with Severn Trent Water on completion of the SFO investigation into leakage.

In April 2006 the company announced that the board believed there was prima facie evidence of customer relations data being misstated by Severn Trent Water in submissions to Ofwat. We are working and fully cooperating with Ofwat and Ernst & Young LLP on their investigations into this. In June 2006 Ofwat issued a notice under section 22A of the water Industry Act stating its intention to fine Severn Trent Water for failure to meet customer service standards.

No reliable estimate can currently be made of the amounts that might become payable as a result of the SFO enquiry, Ofwat's final conclusion in respect of the allegations of false reporting or its review of customer relations data. Consequently, except as noted above, 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. Although two of the Biffa Belgium companies were indicted by the Flemish prosecuting authorities on 13 December 2005, the proceedings against these companies have not progressed any further since that date. 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.

No provision has been made for any criminal penalties that might result from this investigation since no reliable estimate can be made of the amount that might become payable. 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 that may result from this indemnity.

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 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.

**38 Financial and other commitments**

	2007 £m	2006 £m
Investment expenditure commitments		
Contracted for but not provided in the financial statements	<b>242.7</b>	148.5

In addition to these contractual commitments, Severn Trent Water Limited has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services and to provide for growth in demand for water and sewerage services.

At the balance sheet date the group had outstanding commitments for future minimum operating lease payments under non cancellable operating leases, which fall due as follows:

	2007 £m	2006 £m
Within one year	<b>7.0</b>	19.3
In the second to fifth years inclusive	<b>17.0</b>	33.6
After more than five years	<b>10.0</b>	54.0
	<b>34.0</b>	106.9

Operating lease payments represent rentals payable by the group for certain of its office properties, plant and equipment.

**39 Post balance sheet events**

Following the year end the Board of Directors has proposed a final dividend of 38.68 pence per share. Further details of this are shown in note 13.

**40 Related party transactions**

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group and its associates and joint ventures are disclosed below.

**a) Trading transactions**

	Sale of goods		Purchase of goods		Amounts due from related parties		Amounts due to related parties	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Cognica	–	–	<b>0.1</b>	0.1	–	0.1	–	–
Detroit Water	<b>0.2</b>	0.2	–	–	–	0.1	–	–
SII	<b>7.7</b>	9.1	–	–	<b>9.5</b>	11.7	–	–
Severn Trent De Nora	–	–	–	0.2	–	0.2	–	–
	<b>7.9</b>	9.3	<b>0.1</b>	0.3	<b>9.5</b>	12.1	–	–

The related parties are associated and joint ventures in which the group has a participating interest.

**b) Remuneration of key management personnel**

Key management personnel comprise the executive directors and senior management of Severn Trent Plc, Severn Trent Water, and Severn Trent Services.

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the Directors' remuneration report on pages 41 to 43.

	2007 £m	2006 £m
Short term employee benefits	<b>6.4</b>	8.7
Post employment benefits	<b>0.8</b>	1.6
Termination benefits	<b>0.5</b>	0.3
Share based payments	<b>0.1</b>	1.1
	<b>7.8</b>	11.7

# Notes to the group financial statements continued

## 41 Principal subsidiary undertakings and their directors

Details of the principal operating subsidiaries are given below.  
A complete list of subsidiary undertakings is available on request to the company and will be filed with the next Annual Return.

### Water and Sewerage

Severn Trent Water Limited  
2297 Coventry Road, Birmingham B26 3PU  
Telephone 0121 722 4000

Directors	
Sir John Egan	C S Matthews
B Bulkin	M J E McKeon
R H Davey	J B Smith
M J Houston	A P Wray

### Water Technologies and Services

Severn Trent Services Inc.  
Suite 300, 580 Virginia Drive,  
Ft Washington Pennsylvania 19034 2707, USA  
Telephone 001 215 646 9201  
(Incorporated and operational in the United States of America)

Directors	
D L Chester	L F Graziano
C S Matthews	

Severn Trent Environmental Services Inc.  
Park 10, 16337 Park Row  
Houston, Texas 77084, USA  
Telephone 001 281 578 4200  
(Incorporated and operational in the United States of America)

Directors	
D L Chester	L F Graziano
K J Kelly	

Severn Trent Services Limited  
Park Lane, Minworth, Sutton Coldfield, West Midlands B76 9BL  
Telephone 0121 313 2300

Directors	
L F Graziano	R C McPheely
K A A Porritt	P M Senior

Severn Trent Water Purification Inc.  
3000 Advance Lane, Colmar  
Pennsylvania 18915, USA  
Telephone 001 215 997 4000  
(Incorporated and operational in the United States of America)

Directors	
D L Chester	L F Graziano
K J Kelly	

Severn Trent Metering Services Limited  
Smeckley Wood Close  
Chesterfield Trading Estate  
Chesterfield S41 9PZ  
Telephone 01246 456658

Directors	
L F Graziano	R C McPheely
K A A Porritt	P M Senior

Severn Trent Services International Limited  
(formerly Severn Trent Water International Limited)  
2308 Coventry Road, Birmingham B26 3JZ  
Telephone 0121 722 6000

Directors	
L F Graziano	R C McPheely
K A A Porritt	P M Senior

C2C Services Limited  
(80% owned)  
2308 Coventry Road, Birmingham B26 3JZ  
Telephone 0121 722 6000

Directors	
W F Earp	A J Handford
B M Horner	R J Phillips
W G Weatherdon	E A Wilson

Severn Trent Laboratories Limited  
STL Business Centre, Torrington Avenue  
Coventry CV4 9GU  
Telephone 024 764 21213

Directors	
L F Graziano	R C McPheely
K A A Porritt	P M Senior

### Other Businesses

Derwent Insurance Limited  
6A Queensway, PO Box 64, Gibraltar  
Telephone 00 350 47529  
(Insurance company – incorporated and operational in Gibraltar)

Directors	
N Feetham	F B Smith
F White	

Country of incorporation and main operation is Great Britain and registration is England and Wales unless otherwise stated.

All subsidiary undertakings are wholly owned unless otherwise indicated. All shareholdings are in ordinary shares.

All subsidiary undertakings have been included in the consolidation.

As at 5 June 2007

# Independent auditors' report to the members of Severn Trent Plc

We have audited the parent company financial statements of Severn Trent Plc for the year ended 31 March 2007 which comprise the balance sheet, statement of total recognised gains and losses and the related notes 1 to 19. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of Severn Trent Plc for the year ended 31 March 2007 and on the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

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

Our responsibility is to audit the parent company financial statements and the part of the directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985.

We also report to you whether in our opinion the directors' report is consistent with the parent company financial statements. The information given in the directors' report includes that specific information presented in the chairman's statement, the group chief executive's review and the performance review that is cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed. We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited parent company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

## Basis of audit opinion

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

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

## Opinion

In our opinion:

- > the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2007;
- > the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- > the information given in the directors' report is consistent with the parent company financial statements.

## Deloitte & Touche LLP

Chartered Accountants and Registered Auditors  
London, UK  
5 June 2007

# Company balance sheet

## At 31 March 2007

	Notes	2007 £m	2006 £m
<b>Fixed assets</b>			
Tangible fixed assets	2	0.1	5.8
Investments in subsidiaries	3	3,260.9	3,670.5
Derivative financial instruments		0.6	0.7
		<b>3,261.6</b>	3,677.0
<b>Current assets</b>			
Debtors	4	108.2	54.4
Derivative financial instruments		1.6	3.9
Short term deposits		–	40.0
Cash at bank and in hand		498.0	330.2
		<b>607.8</b>	428.5
Creditors: amounts falling due within one year	5	(703.9)	(873.5)
<b>Net current liabilities</b>		<b>(96.1)</b>	(445.0)
Total assets less current liabilities		<b>3,165.5</b>	3,232.0
Creditors: amounts falling due after more than one year	6	(238.3)	(269.9)
<b>Net assets</b>		<b>2,927.2</b>	2,962.1
<b>Capital and reserves attributable to the company's equity shareholders</b>			
Called up share capital	10	228.3	227.2
Share premium account	11	57.5	48.6
Other reserves	12	140.8	137.6
Retained earnings	13	2,500.6	2,548.7
<b>Equity attributable to the company's equity shareholders</b>	13	<b>2,927.2</b>	2,962.1

Signed on behalf of the board who approved the accounts on 5 June 2007.



**Sir John Egan**  
Chairman



**Michael McKeon**  
Group Finance Director

# Company statement of total recognised gains and losses

## For the year ended 31 March 2007

	2007 £m	2006 £m
<b>Transfers</b>		
Transfers to profit and loss account on cashflow hedges	3.2	3.2
Deferred tax on transfers to profit and loss account	(1.0)	(0.8)
	<b>2.2</b>	2.4
Profit for the period	<b>1,402.4</b>	145.4
Total recognised gains and losses for the period	<b>1,404.6</b>	147.8



# Notes to the company financial statements

## 1 Accounting policies

### a) Basis of accounting

The financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through profit or loss and in accordance with applicable United Kingdom Accounting Standards and comply with the requirements of the United Kingdom Companies Act 1985 ('the Act').

### b) Tangible fixed assets and depreciation

Tangible fixed assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated on a straight line basis over their estimated economic lives, which are principally as follows:

	Years
Buildings	30-60
Vehicles, computers and software	2-15

### c) Leased assets

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are accounted for as if they had been purchased and the fair values of minimum lease payments are shown as an obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor and the finance charge being written off to the profit and loss account over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period. All other leases are accounted for as operating leases. Rental costs arising under operating leases are charged to the profit and loss account on a straight line basis over the life of the lease.

### d) Impairment of fixed assets and investments

Impairments of fixed assets and investments are calculated as the difference between the carrying value of net assets of income generating units, including where appropriate investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the net amount that can be generated through sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit. Impairment reviews are carried out if there is some indication that an impairment may have occurred, or, where otherwise required, to ensure that goodwill and fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the profit and loss account and, where material, are disclosed as exceptional.

### e) Financial instruments

#### Debt instruments

All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date with gains or losses being recognised in the income statement (see below).

Gains and losses are recognised in the profit and loss account when the liabilities are derecognised or impaired, as well as through the amortisation process.

#### Derivative financial instruments and hedging activities

The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently remeasured at fair value for the reported balance sheet. The fair value of cross currency swaps, interest rate swaps and forward currency contracts is calculated by reference to market exchange rates and interest rates at the period end.

In relation to fair value hedges which meet the conditions for hedge accounting, the gain or loss on the hedging instrument is taken to the profit and loss account where the effective portion of the hedge will offset the gain or loss on the hedged item (see above).

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in reserves, and the ineffective portion in the profit and loss account. The gains or losses deferred in reserves in this way are recycled through the profit and loss account in the same period in which the hedged underlying transaction or firm commitment is recognised in the profit and loss account.

For derivatives that do not qualify for hedge accounting, gains or losses are taken directly to the profit and loss account in the period.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that date any cumulative gain or loss on the hedging instrument recognised in reserves is kept in reserves until the forecast transaction occurs, or transferred to the profit and loss account if the forecast transaction is no longer expected to occur.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract or the host contract is not carried at fair value with gains and losses reported in the profit and loss account.

# Notes to the company financial statements continued

## f) Investments

Investments in subsidiary undertakings are held at historical cost.

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as held for trading or available for sale are measured at fair value, with gains or losses recognised in income or equity respectively. When an available for sale investment is disposed of, or impaired, the gain or loss previously recognised in reserves is taken to the profit and loss account.

Other investments are classified as held to maturity when the group has the positive intention and ability to hold to maturity. Investments held for an undefined period are excluded from this classification. Such investments (and those held to maturity) are subsequently measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the profit and loss account.

## g) Share based payments

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

The fair value of employee services is determined by reference to the fair value of the awards granted calculated using a pricing model, excluding the impact of any non market conditions. The number of awards expected to vest takes into account non market vesting conditions including, where appropriate, continuing employment by the group. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non market based condition.

## h) Cash flow statement

The company has taken advantage of the exemption under Financial Reporting Statement 1 'Cash flow statements' and has not produced a cash flow statement.

## i) Deferred taxation

Deferred taxation is fully provided for in respect of timing differences between the treatment of certain items for taxation and accounting purposes only to the extent that the group has an obligation to pay more tax in the future or a right to pay less tax in the future. Deferred tax assets are only recognised to the extent that taxable profits are expected to arise in the future. Material deferred taxation balances arising are discounted by applying an appropriate risk free discount rate.

## j) Pensions

The company participates in the group's defined benefit and defined contribution pension schemes, details of which are set out in note 28 to the group financial statements. However, the company is currently unable to identify its share of assets and liabilities relating to the defined benefit schemes. The pension costs charged against the operating profit are the contributions payable to the scheme in respect of the accounting period in respect of the defined benefit and defined contribution schemes.

## 2 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Total £m
<b>Cost</b>			
At 1 April 2006	6.7	6.2	12.9
Disposals	(6.0)	(2.0)	(8.0)
<b>At 31 March 2007</b>	<b>0.7</b>	<b>4.2</b>	<b>4.9</b>
<b>Depreciation</b>			
At 1 April 2006	2.1	5.0	7.1
Charge for year	–	0.3	0.3
Disposals	(1.4)	(1.2)	(2.6)
<b>At 31 March 2007</b>	<b>0.7</b>	<b>4.1</b>	<b>4.8</b>
<b>Net book value</b>			
<b>At 31 March 2007</b>	<b>–</b>	<b>0.1</b>	<b>0.1</b>
At 31 March 2006	4.6	1.2	5.8

### 3 Investments

	Shares £m	Subsidiary undertakings Loans £m	Total £m
At 1 April 2006	1,291.5	2,379.0	3,670.5
Additions/loans advanced	3.8	73.7	77.5
Disposals/loans repaid	(3.8)	(470.8)	(474.6)
Dividend in specie received	711.3	–	711.3
Dividend in specie paid	(711.3)	–	(711.3)
Loans exchanged for shares	2.6	(2.6)	–
Foreign exchange movement	–	(12.5)	(12.5)
<b>At 31 March 2007</b>	<b>1,294.1</b>	<b>1,966.8</b>	<b>3,260.9</b>

Details of the principal subsidiaries of the company are given in note 41 of the group financial statements.

The dividend in specie received represents the cost of shares in Biffa Plc which were distributed to the company by its subsidiary, from Severn Trent Holdings Limited. The dividend in specie paid represents the same shares in Biffa Plc that were transferred to Severn Trent Plc's shareholders on demerger.

### 4 Debtors

	2007 £m	2006 £m
Amounts owed by group undertakings	94.0	14.2
Corporation tax receivable	–	14.2
Deferred tax	9.6	17.4
Other debtors	0.9	0.8
Prepayments and accrued income	3.7	7.8
	<b>108.2</b>	<b>54.4</b>

### 5 Creditors: amounts falling due within one year

	2007 £m	2006 £m
Bank overdrafts	–	25.9
Other loans	551.2	671.8
Borrowings	551.2	697.7
Derivative financial instruments	18.8	40.3
Trade creditors	0.8	–
Amounts due to group undertakings	101.3	108.4
Other creditors	7.3	7.7
Taxation and social security	0.8	0.8
Corporation tax payable	10.0	–
Accrued expenses	13.7	18.6
	<b>703.9</b>	<b>873.5</b>

# Notes to the company financial statements continued

## 6 Creditors: amounts falling due after more than one year

	2007 £m	2006 £m
Borrowings – other loans	207.4	244.5
Derivative financial instruments	23.4	11.7
Other creditors	7.5	13.7
	238.3	269.9

## 7 Employee costs and auditors' remuneration

	2007 £m	2006 £m
Wages and salaries	10.7	10.8
Social security costs	0.8	1.0
Pension costs	1.0	4.2
Total employee costs	12.5	16.0

For details of directors' remuneration see pages 43 to 45.

Auditors' fees in respect of the company were £200,000 (2006: £135,000). For full details of the fees paid to the auditors by the group, see note 7 of the group financial statements.

Fees payable to Deloitte & Touche LLP and their associates for non audit services to the company are not required to be disclosed because the group financial statements are required to disclose such fees on a consolidated basis.

## 8 Employee numbers

Average number of employees of the company (including executive directors) during the year (full time equivalent) was 73 (2006: 88).

All were based in the United Kingdom.

## 9 Borrowings

	2007 £m	2006 £m
Bank overdrafts	–	25.9
Other loans	<b>758.6</b>	916.3
<b>Borrowings</b>	<b>758.6</b>	942.2

The company's borrowings are denominated in the following currencies after taking account of cross currency swaps the company has entered into:

	2007 £m	2006 £m
Sterling	<b>758.6</b>	916.3
Euro	–	25.9
	<b>758.6</b>	942.2

The fair values of the company's borrowings were:

	2007 £m	2006 £m
Bank overdrafts	–	25.9
Other loans	<b>711.3</b>	919.4
	<b>711.3</b>	945.3

Fair values are based on expected future cash flows discounted using LIBOR forward interest rates related to the expected timing of payments.

After taking into account interest and cross currency swaps, 38% of the company's borrowings are at fixed interest rates (2006: 32%). The remainder of the company's debt is held at floating rate. Sterling debt bears interest at LIBOR, US dollar debt bears interest at US dollar LIBOR, whilst euro debt bears interest at EURIBOR.

Fixed rate debt has a weighted average interest rate of 6.4% (2006: 6.4%) for a weighted average period of 7.2 years (2005: 8.2 years).

### Borrowings analysed by maturity date

	2007 £m	2006 £m
Borrowings due within one year	<b>529.0</b>	697.7
Borrowings due after one year:		
Between one and two years	<b>130.7</b>	17.4
Between two and five years	<b>53.4</b>	192.0
After more than five years	<b>45.5</b>	35.1
<b>Total borrowings due after one year</b>	<b>229.6</b>	244.5
	<b>758.6</b>	942.2

# Notes to the company financial statements continued

## 10 Share capital

	2007 £m	2006 £m
Total authorised share capital: 346,783,834 ordinary shares of 97 <sup>1</sup> / <sub>4</sub> p (2006: 520,175,751 ordinary shares of 65 <sup>5</sup> / <sub>8</sub> p)	<b>339.5</b>	339.5
Total issued and fully paid share capital: 233,164,566 ordinary shares of 97 <sup>1</sup> / <sub>4</sub> p (2006: 348,093,283 ordinary shares of 65 <sup>5</sup> / <sub>8</sub> p)	<b>228.3</b>	227.2

On the demerger of Biffa Plc the ordinary share capital of the company was consolidated with the intention that the share price of Severn Trent Plc shares would be similar before and after the demerger. Two new Severn Trent shares were issued for every three old Severn Trent shares held.

Changes in share capital were as follows:

	Number	£m
<b>Ordinary shares of 65<sup>5</sup>/<sub>8</sub>p</b>		
At 1 April 2006	348,093,283	227.2
Shares issued at 473p, 536p, 548p, 568p, 592p, 759p, 823p or 831p under the group's Employee Sharesave Scheme	1,062,231	0.7
Shares issued at 680.5p, 688p, 720p, 738p, 934p, or 1,005.3p under the group's Share Option Scheme	375,725	0.2
At 6 October 2006	349,531,239	228.1
Share consolidation	(116,510,413)	–
<b>Ordinary shares of 97<sup>1</sup>/<sub>4</sub>p</b>	233,020,826	228.1
Shares issued at 473p, 536p, 548p, 568p, 592p, 759p, 823p or 831p under the group's Employee Sharesave Scheme	67,837	0.1
Shares issued at 680.5p, 688p, 720p, 738p, 934p, or 1,005.3p under the group's Share Option Scheme	75,903	0.1
<b>At 31 March 2007</b>	<b>233,164,566</b>	<b>228.3</b>

## 11 Share premium

	2007 £m	2006 £m
At 1 April	<b>48.6</b>	38.4
Employee share option schemes	<b>8.9</b>	10.2
At 31 March	<b>57.5</b>	48.6

## 12 Other reserves

	Capital redemption reserve £m	Hedging reserve £m	Special reserve £m	Total other reserves £m
At 1 April 2005	156.1	(21.7)	–	134.4
Cash flow hedges – transfer to net profit	–	3.2	–	3.2
At 31 March 2006	156.1	(18.5)	–	137.6
Cash flow hedges – transfer to net profit	–	3.2	–	3.2
Transfer from profit and loss account	–	–	711.3	711.3
Dividend in specie paid	–	–	(711.3)	(711.3)
<b>At 31 March 2007</b>	<b>156.1</b>	<b>(15.3)</b>	<b>–</b>	<b>140.8</b>

The capital redemption reserve arose on the repurchase of B shares. This is not distributable.

### 13 Reconciliation of 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
At 1 April 2005	225.8	38.4	134.4	2,570.9	2,969.5
Cash flow hedges					
– Transfers to net profit	–	–	3.2	–	3.2
Share options and LTIPs					
– proceeds from shares issued	1.4	10.2	–	–	11.6
– value of employees' services	–	–	–	4.1	4.1
Net profit for the year	–	–	–	145.4	145.4
Dividends	–	–	–	(171.3)	(171.3)
Deferred tax on items posted directly to equity	–	–	–	(0.4)	(0.4)
At 31 March 2006	227.2	48.6	137.6	2,548.7	2,962.1
Cash flow hedges					
– Transfers to net profit	–	–	3.2	–	3.2
Share options and LTIPs					
– proceeds from shares issued	1.1	8.9	–	–	10.0
– value of employees' services	–	–	–	1.4	1.4
Net profit for the year	–	–	–	1,402.4	1,402.4
Transfer to special reserve	–	–	711.3	(711.3)	–
Dividend in specie paid	–	–	(711.3)	–	(711.3)
Dividends	–	–	–	(739.4)	(739.4)
Deferred tax on items posted directly to equity	–	–	–	(1.2)	(1.2)
<b>At 31 March 2007</b>	<b>228.3</b>	<b>57.5</b>	<b>140.8</b>	<b>2,500.6</b>	<b>2,927.2</b>

In previous years £1,221.2 million of the company's retained profit arose as a result of group restructuring exercises, and is not considered likely to be distributable. As permitted by Section 230 of the Companies Act 1985, no profit and loss account is presented for the company.

### 14 Employee share schemes

For details of employee share schemes and options granted over the shares of the company, see note 34 of the group financial statements.

Under the terms of the Sharesave Scheme, the board may grant those employees who have entered into an Inland Revenue approved Save As You Earn contract for a period of three, five or seven years, the right to purchase ordinary shares in the company.

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2006	11,068	994p
Granted during the year	1,106	1,172p
Forfeited during the year	(535)	1,128p
Exercised during the year	(2,257)	1,065p
<b>Outstanding at 31 March 2007</b>	<b>9,382</b>	<b>1,029p</b>

The weighted average share price during the year was £13.82 (2006: £10.29)

Options outstanding at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares 2007	2006
January 2000	2007	831p	<b>2,688</b>	2,688
January 2001	2006	473p	–	2,257
January 2002	2007 or 2009	548p	<b>1,614</b>	1,614
January 2004	2009	536p	–	535
January 2005	2008, 2010 or 2012	759p	<b>249</b>	249
January 2006	2009, 2011 or 2013	823p	<b>3,725</b>	3,725
January 2007	2010, 2012 or 2014	1,172p	<b>1,106</b>	–
			<b>9,382</b>	11,068



# Notes to the company financial statements continued

During the period the following LTIP awards, SIP awards and share options have been granted to company employees:

	2007		2006	
	Number	Fair value £m	Number	Fair value £m
LTIP awards	200,345	1.2	203,450	1.5
Sharesave options	7,377	–	20,766	–
Share Incentive Plan (SIP)	1,368	–	1,900	–

Details of the calculation of the fair value of share awards is given in note 34 of the group financial statements.

The company has charged £1.4 million (2006: £1.1 million) to the profit and loss account in respect of share based payments.

## 15 Pensions

The company operates a number of defined benefit schemes (being the Severn Trent Pension Scheme, the Severn Trent Water Mirror Image Pension Scheme and the Severn Trent Senior Staff Pension Scheme). In addition, the group operates an unfunded arrangement for certain employees whose earnings are above the pension cap.

Further details regarding the operation of these schemes are given in note 28 of the group financial statements.

The company is currently unable to identify its share of the underlying assets and liabilities from the group's defined benefit schemes, and hence it continues to account for the cost of contributions as if the schemes were defined contribution schemes.

The pension charge for the year was £1.0 million (2006: £4.2 million).

## 16 Related party transactions

The company has taken advantage of the exemption under FRS 8 and not disclosed details of transactions with other undertakings within Severn Trent group of companies.

## 17 Contingent liabilities

### a) Bonds and guarantees

The company has entered into bonds and guarantees in the normal course of business. No liabilities are expected to arise in respect of either the bonds or guarantees.

### b) Bank offset arrangements

The banking arrangements of the company operate on a pooled basis with certain of its subsidiaries undertakings. Under these arrangements participating companies guarantee each others' overdrawn balances to the extent of their credit balances, which can be offset against balances of participating companies.

## 18 Post balance sheet events

On 6 June 2007 the board of directors proposed a final dividend of 38.68 pence per share.

## 19 Dividends

For details of the dividends paid and proposed in 2006/07 and 2005/06 see note 13 in the group financial statements.

# Five Year Summary

Continuing operations (IFRS)/Continuing and discontinued (UK GAAP)	IFRS 2007 £m	IFRS 2006 (restated) £m	IFRS 2005 (restated) £m	UKGAAP 2004 (restated) £m	UKGAAP 2003 £m
Turnover	1,480.2	1,455.3	1,252.3	2,015.1	1,852.0
Profit before interest, goodwill amortisation and exceptional items	405.3	393.0	309.5	440.6	409.8
Goodwill amortisation	–	–	–	(29.8)	(25.2)
Profit before interest, tax and exceptional items	405.3	393.0	309.5	410.8	384.6
Net exceptional items	24.7	(15.7)	(2.3)	11.6	(40.8)
Net interest payable before fair value movements on treasury instruments	(153.8)	(163.9)	(164.1)	(168.0)	(159.4)
Fair value movements on treasury instruments	48.8	(36.7)	–	–	–
Results of associates and joint ventures	0.5	1.1	0.7	–	–
Profit on ordinary activities before taxation	325.5	177.8	143.8	254.4	184.4
Current taxation on profit on ordinary activities	(58.5)	(61.5)	(19.1)	(33.3)	(24.8)
Deferred taxation	(18.4)	7.3	(34.3)	(36.3)	(59.5)
Profit on ordinary activities after taxation	248.6	123.6	90.4	184.8	100.1
Discontinued (IFRS)	20.0	99.4	67.7	–	–
Profit for the period	268.6	223.0	158.1	184.8	100.1
Net assets employed					
Fixed assets	5,675.5	6,391.6	6,290.8	5,803.9	5,480.6
Other net liabilities excluding net debt, retirement benefit obligation and provisions	(242.9)	(212.2)	(218.3)	(266.7)	(232.1)
Financial instruments	(102.6)	(130.0)	–	–	–
Retirement benefit obligation	(135.1)	(221.9)	(317.5)	–	–
Provisions for liabilities and charges and deferred tax	(930.0)	(980.4)	(1,010.9)	(572.0)	(523.1)
Net assets held for sale	–	13.0	–	–	–
	4,264.9	4,860.1	4,744.1	4,965.2	4,725.4
Financed by					
Called up share capital	228.3	227.2	225.8	225.2	224.4
Reserves	905.9	1,669.2	1,621.8	1,988.5	1,993.2
Total shareholders' funds	1,134.2	1,896.4	1,847.6	2,213.7	2,217.6
Minority shareholders' interests	3.1	2.6	1.9	2.4	2.2
Net debt	3,127.6	2,961.1	2,894.6	2,749.1	2,505.6
	4,264.9	4,860.1	4,744.1	4,965.2	4,725.4
Statistics					
Earnings per share (continuing) (UK GAAP continuing and discontinued)	106.1p	52.9p	39.0p	80.3p	43.4p
Adjusted earnings per share	82.4p	70.4p	52.6p	92.1p	87.2p
Dividends per share	61.45p	51.13	48.51p	47.04p	45.9p
Dividend cover (before exceptional items and before deferred tax)	1.8	1.3	1.2	1.3	1.3
Gearing	73.3%	60.9%	61.0%	55.4%	53.0%
Ordinary share price at 31 March	1,434p	1,117p	915p	761p	716p
Average number of employees – Water and Sewerage	5,289	5,188	5,106	4,998	4,780
– other	7,172	11,124	11,268	10,795	9,867

Following the implementation of UITF 38 – 'Accounting for ESOP Trusts', the 2004 balance sheet was restated to reflect shares held by the Severn Trent Employee Share Ownership Trust which have not vested unconditionally at the balance sheet date. The 2003 comparatives have not been restated for this in the above table.

Gearing has been calculated as net debt divided by the sum of net equity and net debt.

# Information for Shareholders

## Financial calendar and results announcements

### Annual General Meeting

24 July 2007, at 11.00am  
at the National Motorcycle Museum, Coventry Road,  
Bickenhill, Solihull, West Midlands B92 0EJ

### Dividend payments in respect of the year ended 31 March 2007:

Interim dividend – paid 24 January 2007

Proposed final dividend – payable 3 August 2007

### The results of the group will normally be published at the following times:

Interim results for the six months to 30 September	November
Preliminary results for the year to 31 March	June
Report and accounts for the year to 31 March	June

### Shareholder enquiries

If you have a question about your shareholding in the company you should contact our registrar, Lloyds TSB Registrars, who are responsible for making dividend payments and updating the register of shareholders, including details of changes to addresses and names.

### Analysis of shareholdings at 31 March 2007

Category	Number of shareholders	% of shareholders	Number of shares (millions)	% of shares
Individual and joint accounts	72,688	92.82	26.5	11.37
Other*	5,619	7.18	206.7	88.63
Total	78,307	100.00	233.2	100.00

Size of Holding	Number of shareholders	% of shareholders	Number of shares (millions)	% of shares
1-499	58,856	75.16	11.5	4.93
500-999	13,549	17.30	9.6	4.11
1,000-4,999	4,920	6.28	8.3	3.56
5,000-9,999	263	0.34	1.8	0.77
10,000-49,999	334	0.43	8.1	3.47
50,000-99,999	114	0.15	8.0	3.44
Over 100,000	271	0.34	185.9	79.72
Total	78,307	100.00	233.2	100.00

\*Includes insurance companies, nominee companies, banks, pension funds, other corporate bodies, limited and public limited companies

You should also contact the registrar if you would like to have your dividends paid directly into your bank or building society account.

The registrar's contact details are:

Telephone helpline: 0870 600 3967

E-mail: [severntrent@lloydstsb-registrars.co.uk](mailto:severntrent@lloydstsb-registrars.co.uk)

Lloyds TSB Registrars, The Causeway, Worthing,  
West Sussex, BN99 6DA

### Online communication

Shareview, is operated by Lloyds TSB Registrars and gives you access to services over the internet that enable you to check details of your shareholding at any time.

You can also elect to receive communications from the company electronically. You will receive an e-mail notification when the Annual Report and Notice of Annual General Meeting become available on our website.

You can register for both of these services at [www.shareview.co.uk](http://www.shareview.co.uk).

### Company information

The company's website at [www.severntrent.com](http://www.severntrent.com) provides news and details of the company's activities, latest results, information on the share price and links to our businesses' websites.



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