**Preliminary Announcement of Annual Results**
**28 May 2010**
**Results for the year to 31 March 2010**

**DELIVERING CONTINUOUS IMPROVEMENT, HIGHER STANDARDS AND PROFIT GROWTH**

## Highlights

- Underlying profit before tax grew by 23.7%
- Full year dividend up 7.4% to 72.32 pence per share (3% above March 2010 RPI inflation)
- Delivered planned operating cost savings – Severn Trent Water opex lower year on year
- Upper quartile performance in 9 of 20 Key Performance Indicators
  - continued improvements in Customer Service, Sewer Flooding, Health & Safety and Water Quality
- Acceleration of efficiency programmes and realisation of benefits of AMP5 lead-in investments
- In good shape to deliver further efficiencies and meet the challenges of AMP5

| | 31 March 2010 £m | 31 March 2009 £m | Increase/ (decrease) % |
|---|---|---|---|
| Group turnover | 1,703.9 | 1,642.2 | 3.8% |
| Underlying group PBIT[1] | 557.1 | 469.9 | 18.6% |
| Underlying group profit before tax[2] | 338.4 | 273.5 | 23.7% |
| Profit before tax[3] | 334.4 | 167.6 | 99.5% |
| | pence/share | pence/share | |
| Adjusted basic eps[4] | 122.8 | 92.7 | 32.5% |
| Basic earnings/(loss) per share[5] | 105.6 | (24.61) | 529% |
| Total ordinary dividends | 72.32 | 67.34 | 7.4% |

1 before exceptional items (see note 3)
2 before exceptional items and gains/(losses) on financial instruments
3 includes gain on financial instruments of £45.7m (2009: loss of £87.0m)
4 before exceptional items, gains/(losses) on financial instruments and deferred tax
5 2009: after exceptional deferred tax of 79.0 pence per share

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

"Building on our track record of continuous improvement, I am pleased to be able to report today growth of 23.7% in underlying group PBT, achieved through our focus on delivering further improvements in efficiency, processes and standards. In line with our current policy to the end of March 2010, our full year dividend has grown by 7.4% to 72.32 pence per share, an increase of 3% above the rate of March RPI inflation.

During my tenure as Chairman, Severn Trent has successfully dealt with a number of challenges and transformed itself into a company with a clear focus on water, and on delivering improved performance year after year. Looking ahead, Severn Trent Water has already taken a number of actions to prepare for the next five year regulatory period, such as significant AMP5 lead-in investments and early start to its contractor programme, leaving it suitably positioned to deliver higher standards and sustainable, attractive returns to shareholders."

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

"These results demonstrate that we continue to deliver on our plans, focusing on raising standards, process and efficiency improvements, delivering the lowest possible bills for customers, developing our people and growing shareholder value.

Over the AMP4 period (2005/6 to 2009/10) Severn Trent Water has delivered an improved operational performance. We were pleased to receive the maximum score for our customer service in Ofwat's most recent assessment[1]. We have 9 of our 20 Key Performance Indicators at upper quartile and continue to drive significant improvements in areas such as health and safety and water quality, while maintaining high standards across many of our key environmental and quality obligations. I am pleased to confirm we exceeded our planned operating cost savings this year and delivered our capital programme for the AMP4 period.

Severn Trent Services was impacted by challenging economic conditions during the year, but made good progress in reducing its cost base and positioning for growth – our Operating Services business performed well, while in Water Purification we built a record order book. Analytical Services consolidated its facilities while expanding its service offering, and will benefit from new contracts in the year ahead.

Looking forward to the next five years, we enter AMP5 in a stronger position, with our plans well advanced due to our "early start" approach with contractors, SAP implementation and real estate rationalisation. The business is well placed to achieve higher levels of operational excellence and progressive, sustainable returns to shareholders.

Longer term, there is a growing consensus that the current policy and regulatory framework of the industry needs to evolve, and we have made our own contribution to the debate with our "Changing Course" report, published in April. Our operational excellence, low cost base geography, and expertise of our non-regulated business gives us confidence that Severn Trent is uniquely placed to take advantage of the opportunities that change will bring."

**Enquiries:**


| | | |
|---|---|---|
| Tony Wray | Severn Trent Plc | 0207 353 4200 (on the day) |
| *Chief Executive* | | 0121 722 4938 |
| Mike McKeon | Severn Trent Plc | 0207 353 4200 (on the day) |
| *Finance Director* | | 0121 722 4319 |
| Andrew Marsh | Severn Trent Plc | 0207 353 4200 (on the day) |
| *Media Relations* | | 0121 722 4555 |
| John Crosse | Severn Trent Plc | 0207 353 4200 (on the day) |
| *Head of Investor Relations* | | 0121 722 4523 |
| Peter Hewer/Mal Patel | Tulchan Communications | 0207 353 4200 |


1 Ofwat OPA assessment 2008-09, published October 2009

**Preliminary Results Presentation and Webcast**

There will be a presentation of these results at 9:30am on Friday 28 May 2010 at The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED. This presentation, will be available as a simultaneous webcast on the Severn Trent web site (www.severntrent.com) and will remain on the web site for subsequent viewing.

## Operating review

### Severn Trent Water

Severn Trent Water delivered a strong operational and financial performance in 2009/10. Planned cost savings were exceeded, while operational expenditure was lower year on year, against our target of stable costs, despite an increase in bad debt charges of £3.3 million. The capital programme for the year and for AMP4 was successfully completed according to plan, and we met our regulatory commitments.

During the second half of the year we accelerated a number of our efficiency programmes, investing £36.2 million in total for the year vs. our initial expectation of £20 million, in restructuring the business and in process improvements. This additional investment of £16.2 million will deliver sustainable annual operating cost savings totalling some £13 million, around 50% of which will be realised in 2010/11. For example, as a result of efficiencies gained from our SAP implementation, the first phase of which went live in December 2009, and other programmes, we are able to reduce the number of back office positions from 1,100 by around 275 posts. Most of those leaving will exit the business during the first half of this current financial year (2010/11). The reduced headcount and move to Severn Trent Centre later this year should allow further property rationalisation.

Our 20 Key Performance Indicators (KPIs) remain the primary basis through which we measure our performance and during the year we continued to improve our scores in many key areas of the business and achieved our targets.

Customer service levels showed further improvement, a result of investing in our people, increasing capability and focusing on process and technology improvements – for example, over 100,000 customers registered for our online account management system in its first year. We improved performance in customer call resolution, maintained our high performance in job resolution and delivered a 23% reduction in customer written complaints over last year.

Water quality improved again in 2009/10, while for the third year running we achieved our leakage target, despite the coldest winter for 30 years. Our teams reacted quickly to the prolonged period of freezing temperatures to bring leakage rates back down as rapidly as possible.

We also maintained our high standards in control of pollutions and made further improvements reducing sewer flooding incidents; our continued focus on creating and maintaining a safe working environment resulted in a 16% reduction in lost time incidents over last year.

We have improved our debt management processes and helped customers with our WaterSure tariff and "Water Direct", a scheme from the Department for Work and Pensions which allows payments direct from benefits to help customers manage their bills. Against the backdrop of the downturn in the economy, debtor days performance improved to 32.6 days at March 2010 (March 2009 33.1) although it has become more difficult to collect debt over one year old. As a result, we have increased our bad debt charge, which now represents around 2.5% of turnover (£35.0 million), up from around 2.3% (£31.7 million) at the end of last year. We continue to monitor developments closely.

The table below sets out our actual performance on the KPIs and includes benchmarking against other comparable companies in the water and waste water sector, as well as other companies with similar characteristics in other sectors. Our performance is classified in one of three categories - either lower quartile, upper quartile or median performance. We have 9 KPIs where we are achieving upper quartile performance (2008/09 – 11), with 9 at median (2008/09 - 8) and 2 at lower quartile (2008/09 - 1). The movement between categories is partly due to improved benchmarks, which we update in September every year, but there are still areas where we need to do more. For example, on unplanned interruptions, one of the KPIs in the lower quartile, we have not fully addressed issues such as poor network condition and incident response. We have an action plan in place focused on improving network monitoring and resilience, and how we deal with incidents causing supply interruptions. The other KPI in lower quartile, breach of consents, was impacted by non compliance with processes during some site upgrades or routine maintenance, and again we have taken action to address these issues. The implementation of SAP release 2 will help to provide a more structured approach to routine maintenance.

We have made progress in a number of areas but recognise there is more to do, and will continue to update our benchmarks every year in September. As companies in our sector or elsewhere redefine what upper quartile means, our objectives move with them.

**Delivering higher standards**

In our drive for higher standards we have reviewed the measures we will need in the future to demonstrate our progress and to reflect the evolution of the regulatory environment. In most cases our objectives and regulatory requirements are unchanged as we move from AMP4 into AMP5 and so the majority of our KPIs – thirteen– will remain unchanged.

However, 5 KPIs will have improved measures:

- KPI 10 Gross Capex vs. FD
- KPI 11 Capital Process Quality to be introduced in 2011/12
- KPI 15 Pollution Incidents (cat 1,2 & 3) per 1,000 properties
- KPI 17 Sewage Treatment Works – breach of consents
- KPI 19 Net Energy Use

And 2 new KPIs will be introduced:

- KPI 18 Supply Availability, replacing Security of Supply
- KPI 14 Ofwat Efficient Billing Factor to be introduced in 2011/12, replacing Cost To Serve per property

We will provide more detail on these during 2010/11.

**KPI Performance 2009/10 vs. 2008/09**

| Description | Year | Basis | Note | Lower Quartile | Median | Upper Quartile |
|---|---|---|---|---|---|---|
| Lost time incidents per 100,000 hrs worked | 2010 | MAT | 1 | | | 0.36 |
| | 2009 | | | | | 0.43 |
| Employee motivation % | 2010 | QR | 2 | | 74% | |
| | 2009 | | | | | 83% |
| Water quality (test failure rate) ppm | 2010 | MAT | | | | 131 |
| | 2009 | | | | | 200 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Customer written complaints per 1,000 properties | 2010 | MAT | 3,4 | | | 4.95 |
| | 2009 | | | | | 6.44 |
| First time call resolution for billing % | 2010 | MAT | 5 | | 89% | |
| | 2009 | | | | 88% | |
| Unplanned interruptions > 6 hrs per 1,000 properties | 2010 | MAT | 3 | 10.09 | | |
| | 2009 | | | 7.29 | | |
| Properties at risk of low pressure per 1,000 properties | 2010 | NPR | 3,6 | | 0.12 | |
| | 2009 | | | | | 1.21 |
| First time job resolution % | 2010 | MAT | 5 | | | 96.5% |
| | 2009 | | | | | 96.0% |
| Non performance against Regulatory Obligations % | 2010 | QR | 5 | | | 5% |
| | 2009 | | | | 10% | |
| Capex (Gross) vs Final Determination % | 2010 | AMP | 7 | | 6.1% | |
| | 2009 | | | | 5.0% | |
| Capital process quality (no. of defects per £100k) | 2010 | MAT | 5 | | 0.07 | |
| | 2009 | | | | | - |
| Debtor days | 2010 | | 8 | | 32.6 | |
| | 2009 | | | | 33.1 | |
| Opex vs Final Determination (UK GAAP) - £m | 2010 | MAT | 8 | | | 492.4 |
| | 2009 | | | | 500.9 | |
| Cost to serve per property - £ | 2010 | MAT | 9 | | | 231.03 |
| | 2009 | | | | | 236.53 |
| Pollution incidents (cat 1, 2 & 3) per 1,000 properties | 2010 | MAT | 10,11 | | 0.08 | |
| | 2009 | | | | 0.08 | |
| Sewer flooding incidents - other causes per 1,000 properties | 2010 | MAT | 3 | | | 0.131 |
| | 2009 | | | | 0.172 | |
| Sewage Treatment Works - breach of consents % | 2010 | PPS | 10 | 0.31% | | |
| | 2009 | | | | | 0.00% |
| Security of supply | 2010 | | | | 99 | |
| | 2009 | | | | 98 | |
| Net Energy Use – Kwh/Ml | 2010 | MAT | 5,12 | | | 435 |
| | 2009 | | | | | 440 |
| Leakage Ml/d | 2010 | MLE | 3 | | 497 | |
| | 2009 | | | | | 492 |

Notes:

Benchmarks updated in September. The following have changed classification since 2008/09: Employee motivation; Properties at risk of low pressure; Non performance against Regulatory Obligations; Capital process quality; Opex vs Final Determination; Sewer flooding incidents; Sewage treatment works – breach of consents; Leakage.

MAT = Moving Annual Total
QR = Quarterly Review
NPR = Number of properties on register
AMP = AMP4 to date
PPS = Percentage of population served
MLE = Maximum Likelihood Estimate
ACT = Year end actual
IDX = Year end Index

1. Actual performance across all employees and agency staff
2. Performance based on 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 11 June 2010.
4. Performance excludes properties billed by other water companies.
5. Actual performance based partially or wholly on internal data.

6. Benchmark has been compiled using data inclusive of information from pressure loggers, previously calculated exclusive of pressure loggers.
7. Actual performance based on audited UK GAAP financial statements for AMP4 period ended 31 March 2010..
8. Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2010.
9. Actual performance based on audited regulatory accounts for the year ended 31 March 2010
10. Measure for calendar year to 31 December 2009.
11. Actual performance for calendar year to December 2009. Equates to 322 pollution incidents (313 December 2008).
12. Metrics of this KPI changed from waste water returned in 08/09 to waste water treated in 09/10. Prior year performance has been restated accordingly

## Severn Trent Water Final Determination

The Final Determination, published by Ofwat on 26 November 2009 and accepted by Severn Trent Water on 19 January 2010, included the following highlights:

- An AMP5 capital investment programme of £2.5 billion gross compared to £2.6 billion in the Final Business Plan;
- Annual average operating expenditure of £497 million compared to £514 million in the Final Business Plan;
- A cost of capital of 4.5% real, post tax compared to 5% in the Final Business Plan. The component parts of the assumed cost of capital are; real post tax cost of equity of 7.1%, real post tax cost of debt of 2.6% and 57.5% gearing.;
- A fall in average household bills of 4% in real terms (annual average fall of 0.9%) by 2015, compared to an increase of 4% in the Final Business Plan;

The Final Determination contains stretching objectives, which reflect Severn Trent Water's ambitious Final Business Plan. We have already made a number of lead-in investments, mobilising our supply chain in advance of AMP5 and reducing the number of contractors from twenty two to seven. We have accelerated some of our improvement plans as detailed above.

Severn Trent Water has hedged the majority of its wholesale energy requirements for the first 3 years of the AMP5 period resulting in a saving versus the final determination of around £20 million in total. We also continue to develop our renewable energy strategy, providing further "natural hedge" opportunities and contributing to our carbon reduction. In 2009/10, 20.3% of Severn Trent Water's total energy requirements were met by renewable and the objective remains to grow this to 30%.

Severn Trent has now fixed the cost of a significant portion of its existing and anticipated debt for the AMP5 period by entering into new forward start interest rate swaps at rates below that allowed in the Final Determination. As previously indicated, over the AMP5 period the business has a requirement to re-finance around £850 million of maturing debt; including additional funding for investment plans, the funding requirement for AMP5 is just over £1 billion.

Based on the process improvements and investment that Severn Trent Water has carried out over the last 3 years, and plans already in place to deliver efficiencies during AMP5, we are confident that we can meet the requirements of the Final Determination, while delivering a sustainable and progressive return to shareholders.

## Severn Trent Services

Severn Trent Services made good progress in positioning for growth and responding to the challenging economic conditions during the year. Operating Services delivered growth year on year, building on its presence in the US and UK, with a strong pipeline of contract bids presenting further opportunities. Water

Purification and Analytical Services experienced challenging conditions due to the economic climate, but took the opportunity to restructure their businesses, lowering the cost base and improving efficiency, while investing in higher growth areas. In Water Purification, many projects were delayed, but not cancelled, resulting in the largest ever order book at year end of around $100 million and a strong start to 2010/11. Analytical Services also streamlined its operations while expanding its service offering and will benefit from new contracts, most notably with Yorkshire Water which began on 1 April 2010.

**Operating Services**

Operating Services provides contract operating services to manage and maintain water and waste water plants and networks worldwide. The business performed well in 2009/10 - Severn Trent Services is one of the leading providers in the US, with high renewal rates and new business opportunities arising as many municipalities looked to public private partnerships to help lower their costs. The business also entered new regions in the US in 2009/10, for example winning its first project in Georgia.

The business also built on its strong presence in the UK and Ireland with a joint venture, Severn Trent Response, which has already won one long term contract in Ireland and has received notice of award for a second. In the UK we capitalised on the Ministry of Defence contract managed through Coast to Coast (C2C) to take on another design, build and operate contract in the commercial sector. Following our award of a water supply licence by Ofwat, Severn Trent Select is now working with a large industrial customer in Essex to supply their water needs.

**Water Purification**

Severn Trent Services is one of the leading three providers of advanced technologies and products for disinfection, filtration and absorption in the world. Given the challenging economic conditions, a large proportion of customers, mainly municipalities in the US, as well as customers in the Middle East and Asia /Pacific postponed investment in new equipment or technology, although no orders were cancelled. However, an increase in activity in the second half led to the highest order book in Severn Trent Services' history and a strong start to 2010/11. In addition, the project pipeline continues to grow.

Efficiency improvements were also made during the year - through using centralised sourcing to make combined purchases of similar technologies from lower cost locations and through producing membranes for our filtration business in China.

Other notable contracts included the $7 million installation for an oil refinery of the largest reverse osmosis, sea water system in Pakistan; several new contracts in China; and the first deep bed filtration system in Libya for Al Hadba.

**Analytical Services**

Analytical Services is a leader in UK environmental water testing services. During the year we restructured the business, to become focused on core water and waste customers, lowering the cost base and putting new services in place to serve our new 10 year contract with Yorkshire Water. We consolidated our facilities into three sites, and expanded our services, introducing new technologies, on-site testing and operator self-monitoring - both growth areas.

**Group financial performance**

We have in the past year, moved from a "credit crunch" through a deep economic recession. Our prompt action in early 2009, to pre fund our investment and cash needs for the following 24 months, meant that we retained a sound financial position throughout the year. We were, however, not immune to the economic stresses that our customers and markets were experiencing. We have seen a rise in bad debt charges in our regulated business Severn Trent Water and a slowdown in sales at Severn Trent Services in the early part of the year.

Against this background, the financial performance of the group has continued to show progress and as described elsewhere, the business areas have invested much time, effort and money to improve their base operations. These improvements are backed by a continuing drive to fund the business at the lowest possible cost.

We enter the new five year regulatory period and new opportunities for our non regulated business in a strong financial position.

In this preliminary results announcement: PBIT is profit before interest and tax; underlying PBIT is PBIT excluding exceptional items as set out in note 3.

Group turnover was £1,703.9 million (£1,642.2 million), an increase of 3.8% over last year. The growth in turnover was mainly due to the price increases in Severn Trent Water, partially offset by the impact of lower consumption across our measured commercial income base, which reduced year on year revenues by around £3.5 million, less than initially expected due to a stabilisation of volumes over the year.

Underlying group PBIT increased by 18.6% to £557.1 million (£469.9 million). The primary factors affecting underlying PBIT are described in the commentary on Severn Trent Water and Severn Trent Services below. There were net exceptional charges of £(49.7) million (£(18.9) million). Group PBIT increased 12.5% to £507.4 million (£451.0 million).

**Severn Trent Water**

Turnover in Severn Trent Water increased by 4.6% in 2009/10, to £1,385.3 million. Sales prices increased by 5.3% (including inflation) from 1 April 2009. The decline in consumption across our measured base stabilised during the year and turnover was £3.5 million lower as a consequence.

Underlying PBIT increased by 18.7% on the previous year to £541.3 million. Beyond the increase in turnover of £60.4 million, a number of factors impacted underlying PBIT. Employee costs decreased by £5.6 million as a result of lower pension costs, hired and contracted services were £8.3 million lower but there was an increase in the bad debt charge of £3.3 million, with the incidence of bad debt as a proportion of turnover increasing marginally to 2.5% from 2.3% at the end of last year. Depreciation increased by £12.6 million due to the growing asset base. There was also a reduction in infrastructure renewals expenditure of £25.6 million, as spending had peaked in the prior year 2008/09.

During the financial year, Severn Trent Water invested £644.8 million (gross, UK GAAP) in fixed assets and maintaining and improving its infrastructure network. Included in this total was net infrastructure renewals expenditure of £104.5 million, charged to the income statement under IFRS.

Adjusting for minor timing differences and modifications to the AMP4 capital programme (notified to Ofwat through the change control process) we successfully completed the 5 year programme (2005/06 to 2009/10) with capital expenditure, net of grants, contributions and other income (UK GAAP) of around £2.6 billion.

### Severn Trent Services

| | 2010 £m | 2009 £m | Increase/ (decrease) % |
|---|---|---|---|
| **Turnover** | | | |
| Services as reported | **336.5** | 339.3 | (0.8%) |
| Apliclor SA - acquired May 2009 | **(6.7)** | - | |
| Meters business and CCM - sold May 2009 | **(1.0)** | (8.9) | |
| | **328.8** | 330.4 | (0.5%) |
| Impact of exchange rate fluctuations | **-** | 19.9 | |
| Like for like businesses in constant currency | **328.8** | 350.3 | (6.1%) |

| | 2010 £m | 2009 £m | Increase/ (decrease) % |
|---|---|---|---|
| **Underlying PBIT** | | | |
| Services as reported | **28.7** | 30.5 | (5.9%) |
| Apliclor SA - acquired May 2009 | **(0.3)** | - | |
| Meters business and CCM - sold May 2009 | **(0.9)** | 0.9 | |
| | **27.5** | 31.4 | (12.4%) |
| Impact of exchange rate fluctuations | **-** | 1.3 | |
| Like for like businesses in constant currency | **27.5** | 32.7 | (15.9%) |

Reported turnover in Severn Trent Services was £336.5 million in 2009/10, a decrease of 0.8% vs. the prior year, and reported underlying PBIT decreased by 6% to £28.7 million.

After adjusting for the impact of exchange rate fluctuations and the effects of small acquisitions and disposals, turnover on a like for like constant currency basis was down 6.1% and underlying PBIT measured on the same basis was down 15.9%.

### Corporate and other

Corporate overheads amounted to £12.7 million (£12.7 million). Our captive insurance company and other businesses generated an underlying loss of £2.9 million (loss of £3.7 million). The group's captive insurance company insures Severn Trent group risks only and does not write any external business.

**Exceptional items**

There were net exceptional charges in the year to 31 March 2010 of £49.7 million (£18.9 million) comprising:

- a charge of £42.1 million in Severn Trent Water arising from programmes to restructure and realign the business. This included redundancy and pension curtailment costs amounting to £16.2 million arising from the reduction in central functions posts and a further £5 million from redundancies arising from previously announced initiatives. Costs relating to the implementation of SAP were £9.9 million, including accelerated amortisation of £5.9 million. Provision for onerous leases and other costs relating to Severn Trent Centre amounted to £6.8 million; and
- a charge of £5.9 million in Severn Trent Services from the programmes to restructure the Water Purification and Analytical Services businesses and a charge of £1.7 million from the disposal of Complete Credit Management Limited and the group's meters business.

Exceptional charges included accelerated amortisation and other non-cash items amounting to £6.6 million.

**Net finance costs**

The group's net finance costs were £218.8 million, compared to £196.4 million in the prior year. The increase was largely due to higher interest charges as a result of higher average group net debt during the year. Net finance costs on pension obligations were also higher as the expected return on pension assets was lower which in turn was due to the lower value of investments in the opening balance sheet in the current period vs. the prior year. The effective interest rate for 2009/10 was 5.6% (5.6%).

**Gains/(losses) on financial instruments**

The group issues notes in foreign currency under its EMTN programme and uses cross currency swaps to convert the proceeds to sterling. The effect of these swaps is that interest and principal payments on the borrowings are denominated in sterling and hence the currency risk is eliminated. The foreign currency notes and the cross currency swaps are recorded in the balance sheet at their fair values and the changes in fair values are taken to gains/(losses) on financial instruments in the profit and loss account. Since the terms of the swaps closely match those of the underlying notes, such changes tend to be broadly equal and opposite.

The group holds interest rate swaps with a net notional principal amount of £834.8 million under which it pays fixed rate interest and receives floating rate interest. These swaps are carried in the balance sheet at fair value. The changes in fair value are taken to gains/(losses) on financial instruments in the profit and loss account. During the period there has been an increase of £41.9 million in the fair value of these instruments because market interest rates were higher at 31 March 2010 than at 31 March 2009 and hence the difference between market rates and the rates payable in the fixed legs of the swaps has decreased. This gain has been credited to gains/(losses) on financial instruments.

It is important to note that we intend to, and typically do hold these swaps to maturity. Further, this is not a cash movement and, over the life of the swaps, these changes in fair value will net out because the swaps will have a zero fair value when they mature.

**Profit before tax**

Underlying Group profit before tax increased by 23.7% to £338.4 million (£273.5 million). Group profit before tax was £334.4 million (£167.6 million).

### Taxation

The total tax charge for the full year was £82.9 million (£223.6 million), of which current tax represented a charge of £40.7 million (£52.1 million) and deferred tax (see note 4) was a charge of £42.2 million (£171.5 million including an exceptional charge of £185.6 million in relation to the phased withdrawal of Industrial Buildings Allowances).

The effective rate of current tax, excluding prior year charges and exceptional items, calculated on profit before tax, exceptional items and gains/(losses) on financial instruments was 22.7% (24.7%). The change in effective rate is as a result of increased capital allowances in Severn Trent Water and agreement of uncertain tax positions during the year rendering further provisions for these items unnecessary.

Going forward, we expect the effective current tax rate for 2010/11 to be in the range of 25% to 27%.

### Profit for the period and earnings per share

Profit for the period was £251.5 million (loss of £56.0 million)

Basic earnings per share were 105.6 pence (loss per share 24.6 pence). Adjusted basic earnings per share (before exceptional items, gains/(losses) on financial instruments and deferred tax) were 122.8 pence (92.7 pence) (see note 9).

### Cash flow

| | **2010** **£m** | 2009 £m |
|---|---|---|
| Cash generated from operations | **708.0** | 643.5 |
| Net capital expenditure | **(487.8)** | (465.0) |
| Net interest paid | **(194.2)** | (173.9) |
| Tax (paid)/received | **(53.8)** | 1.1 |
| Other cash flows | **(1.6)** | (1.3) |
| Free cash flow | **(29.4)** | 4.4 |
| Acquisitions and disposals | **(11.0)** | - |
| Dividends | **(159.7)** | (158.8) |
| Net issue of shares | **2.4** | 6.2 |
| Change in net debt from cash flows | **(197.7)** | (148.2) |
| Non cash movements | **(3.8)** | (18.5) |
| Change in net debt | **(201.5)** | (166.7) |
| Net debt 1 April | **(3,559.9)** | (3,393.2) |
| Net debt at 31 March | **(3,761.4)** | (3,559.9) |
| **Net debt comprises:** | | |
| Cash and cash equivalents | **227.8** | 648.1 |
| Cross currency swaps hedging debt | **187.3** | 237.1 |
| Bank loans | **(689.8)** | (789.8) |
| Other loans | **(3,185.9)** | (3,310.9) |
| Finance leases | **(300.8)** | (344.4) |
| | **(3,761.4)** | (3,559.9) |

The group’s definition of net debt has been amended during the year to include cross currency swaps that are used to convert to sterling the proceeds of debt raised in foreign currency where the swap is the hedging instrument in a fair value hedge. This broadly eliminates the impact of the revaluation of the debt which results from hedge accounting and consequently the restated net debt figure is a better representation of the group’s debt obligations.

Cash generated from operations was £708.0 million (£643.5 million). Capital expenditure net of grants and proceeds of sales of fixed assets was £487.8 million (£465.0 million). Net interest paid increased to £194.2 million (£173.9 million).

Net debt at 31 March 2010 was £ 3,761.4 million (£ 3,559.9 million). Balance sheet gearing (net debt/net debt plus equity) at the year end was 79.9% (78.9%). Net debt, expressed as a percentage of Regulatory Capital Value at 31 March 2010 was 59.3% (57.4%). The group's net interest charge, excluding gains/(losses) on financial instruments and net finance costs from pensions, was covered 4.0 times (3.7 times) by profit before interest, tax, depreciation and exceptional items, and 2.7 times (2.4 times) by underlying PBIT.

The fair value of the group’s borrowings at 31 March 2010 is estimated to be £4,267.9 million (£4,246.3 million) compared to the book value of £4,176.5 million (£4,445.1 million). The group’s debt instruments are not traded in an active market and hence the fair value disclosed above is based on a theoretical discounted cash flow calculation and does not represent an estimate of the amount for which the debt could be settled.

**Pensions**

The Group operates two defined benefit pension schemes, of which the Severn Trent Pension Scheme (STPS) is by far the largest. Formal triennial actuarial valuations and funding agreements for the STPS are due to be renewed as at 31 March 2010. The key actuarial assumptions from these valuations have been updated for the accounts as at 31 March 2010 with overall contribution levels remaining unchanged, including deficit reduction payments of £10 million per annum, until new agreements are in place following the actuarial valuations now underway.

On an IAS 19 basis, the estimated net position (before deferred tax) of the group's defined benefit pension schemes was a deficit of £354.9 million as at 31 March 2010. This compares to a deficit of £233.0 million as at 31 March 2009. The movements in the net deficit are summarised in note 9.

On an IAS 19 basis, the funding level has reduced from around 82.2% at 31 March 2009 to around 79.7% at 31 March 2010.

| | **2010**<br>**%** | 2009<br>% |
|---|---|---|
| Price inflation | **3.6** | 2.9 |
| Salary increases | **4.1** | 3.9 |
| Pension decreases in payment | **3.6** | 3 |
| Pension increases in deferment | **3.6** | 2.9 |
| Discount rate | **5.7** | 6.7 |
| Long term rate of return on: equities | **8.00** | 8.00 |
| Age to which current pensioners aged 65 are expected to live | | |
| - men (years) | **85.3** | 85.1 |
| - women (years) | **88.6** | 88.2 |
| Age to which future pensioners aged 45 at the balance sheet date are expected to live | | |
| - men (years) | **86.5** | 85.9 |
| - women (years) | **89.6** | 88.9 |

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

| Assumption | Change in assumption | Impact on scheme liabilities |
| --- | --- | --- |
| Discount rate | Increase/decrease by 0.1% | Decrease/increase by £34million |
| Price inflation | Increase/decrease by 0.1% | Increase/decrease by £34million |
| Mortality | Increase in life expectancy by 1 year | Increase by £40 million |

**Treasury management and liquidity**

The group continues to carefully monitor liquidity. At 31 March 2010 the group had £227.8 million in cash and cash equivalents. During the year the group signed a European Investment Bank facility of £150 million which needs to be drawn down on or before April 2011. The group also has an undrawn £500 million committed bank facility that matures in 2013. Average debt maturity is around 17 years. The group is funded for its investment and cash flow needs up to the end of the first year of AMP 5.

Cash is invested in deposits with highly rated (A+) banks and liquidity funds and the list of counterparties is regularly reviewed and reported to the board.

The directors are proposing to increase the limit on the company's borrowing powers set out in its Articles of Association which are out of line with the company's current borrowing requirements. This amendment is part of a comprehensive update of the company's Articles of Association to be proposed to the Annual General Meeting to reflect the final provisions of the Companies Act 2006 which came into effect last year. Whilst carrying out this update it became apparent that the borrowing limit was lower than the level of gross borrowing of the group at 31 March 2010. There was therefore a technical breach of Article 102. The directors have reviewed the implications of this technical breach and have plans in place to address it, including the above Resolution. They consider that the resolution to be proposed to the Annual General Meeting is in the best interests of shareholders.

The group's current policy for the management of interest rate risk requires that no less than 45% 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 2010, interest rates for some 82.4% of the group's net debt of £3,761.4 million were so fixed.

**Exchange rates**

The trading results of overseas subsidiaries are translated to sterling at the average rate of exchange ruling during the period and their net assets are translated at the closing rate on the balance sheet date. The impact of changing exchange rates on net assets was immaterial. Details of the impact of changing exchange rates on turnover and underlying PBIT are set out in the commentary on Severn Trent Services above.

**Dividend**

In line with its policy for growing dividends by 3% above the rate of RPI inflation until March 2010, the end of the AMP4 regulatory period, the Board has proposed a final ordinary dividend of 45.61p (2008/09 41.05p). This would give a total ordinary dividend for the year of 72.32p, an increase of 7.4% over the 2008/09 total ordinary dividend (67.34p), being March 2010 RPI inflation of 4.4% plus 3%. The final ordinary dividend is payable on 30 July 2010 to shareholders on the register at 18 June 2010.

**Principal risks and uncertainties**

The Board consider the principal risks and uncertainties affecting the business activities of the group to be those detailed below:

- Risks relating to the ongoing implementation of our coordinated change programme and achieving the significant and sustainable forecasted benefits.
- As a regulated business, we are subject to numerous and changing obligations with which we must comply and management of these is often dispersed across and through the organisation. We pay particular attention to management of risks in these areas, particularly in relation to changing legal and regulatory requirements.
- External financial market factors could adversely impact on our financial position.
- Due to the nature of our business we continue to face risks arising during our normal course of business, including risk of failure of our assets, processes, or systems which could otherwise impact on the health, safety and security of our people or customers, or on our financial position and our reputation.
- Whilst acceptance of the price determination from Ofwat leads to greater certainty over what we need to achieve for the coming AMP period, nevertheless we must still manage the risk associated with our ability to effectively meet the challenging targets set.
- Our ability to influence customer behaviour or to operate in an environmentally responsible way could affect our financial position and our reputation.
- In the challenging economic environment, we continue to closely monitor risks to the achievement of the growth plan for our unregulated businesses.

**Board Appointments**

On 10 May 2010 it was announced that Andrew J Duff, Chairman of RWE npower plc, had been appointed to the Boards of Severn Trent Plc and Severn Trent Water Limited with immediate effect and would succeed Sir John Egan as Chairman of both companies following Sir John's retirement at the Annual General Meeting in July 2010. Mr Duff has also been appointed to the Nominations Committee. Mr Duff is also a Non-Executive Director of Wolseley Plc.

**Outlook**

Severn Trent enters 2010/11 in a strong position. In Severn Trent Water, we continue to build on our lead-in investments and drive performance improvements to deliver higher standards and efficiencies, enabling us to meet the challenges and opportunities ahead. The capital programme for AMP5 has now commenced, and we anticipate total capital expenditure (UK GAAP, net of grants, contributions and other income) of £2.2 billion for the period, below the level for AMP4 due to our early start contracting strategy pursuing innovative construction techniques and process improvements with our partners. The net spend profile across the five years is expected to be broadly equal. Over each of the next five years net infrastructure renewals expenditure is expected to be, on average, broadly in line with the figure reported for 2009/10. Assuming no deterioration in the economy, commercial consumption trends should revert to our longer term assumptions of an average decline of 2% p.a.. Notwithstanding our proactive approach to managing bad debt, we continue to monitor trends in household debt levels, which will be largely driven by economic factors such as unemployment levels.

For Severn Trent Services, all three business areas are looking to continue to grow or return to growth in the coming year. In the medium term the strength of the underlying markets provides the opportunity for sustained growth. Severn Trent Services is working to a focused growth strategy, building on its brand recognition and reputation, strong market positions, international presence and product portfolio, targeting higher growth and higher margin segments and geographies, while continuing to capture additional efficiencies.

As previously announced, the Board decided to rebase the dividend for the first year of AMP5 (2010/11) to a level 10% below the total ordinary dividend for 2009/10 (72.32p). The policy for subsequent years is for growth in the dividend from that new base, as business performance improves, to deliver sustainable returns to shareholders. The group intends to provide more detail on future dividend growth prospects with the 2010/11 Interim Results, to be released on 23 November 2010.

Severn Trent is targeting a flexible and sustainable balance sheet structure and believes that the planned investment program for AMP5 and new dividend policy are commensurate with an investment grade credit rating. The group is funded for its investment and cash flow needs for the first full year of AMP5.

The management team has a clear and focused strategy, delivering continuous improvement and higher standards, to achieve higher levels of operational excellence and sustainable, attractive returns to shareholders.

**Further information**

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

## Consolidated income statement

## Year ended 31 March 2010

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| **Turnover** | | **1,703.9** | 1,642.2 |
| Operating costs before exceptional items | | **(1,146.8)** | (1,172.3) |
| Exceptional restructuring costs and termination of operations | 3 | **(48.0)** | (14.6) |
| Exceptional flood costs net of insurance recoveries | 3 | **-** | 1.5 |
| Exceptional fines and penalties | 3 | **-** | (7.2) |
| Exceptional provision for third party legal costs | 3 | **-** | 1.4 |
| **Total operating costs** | | **(1,194.8)** | (1,191.2) |
| **Exceptional loss on disposal of business** | | **(1.7)** | - |
| Profit before interest, tax and exceptional items | 2 | **557.1** | 469.9 |
| Exceptional items | 3 | **(49.7)** | (18.9) |
| **Profit before interest and tax** | | **507.4** | 451.0 |
| Finance income | 4 | **80.9** | 126.2 |
| Finance costs | 4 | **(299.7)** | (322.6) |
| Net finance costs | 4 | **(218.8)** | (196.4) |
| Gains/(losses) on financial instruments | 5 | **45.7** | (87.0) |
| Share of results from associates and joint ventures | | **0.1** | - |
| Profit before tax, gains/(losses) on financial instruments and exceptionals | | **338.4** | 273.5 |
| Exceptional items | | **(49.7)** | (18.9) |
| Gains/(losses) on financial instruments | | **45.7** | (87.0) |
| **Profit on ordinary activities before taxation** | | **334.4** | 167.6 |
| Taxation on profit on ordinary activities | | | |
| Current tax | 6 | **(40.7)** | (52.1) |
| Deferred tax | 6 | **(42.2)** | 14.1 |
| Exceptional deferred tax | 6 | **-** | (185.6) |
| Total taxation | 6 | **(82.9)** | (223.6) |
| **Profit/(loss) for the period** | | **251.5** | (56.0) |
| **Attributable to** | | | |
| **Equity holders of the company** | | **249.2** | (57.8) |
| **Equity minority interests** | | **2.3** | 1.8 |
| | | **251.5** | (56.0) |
| **Earnings/(loss) per share (pence)** | | | |
| Basic | | **105.6** | (24.6) |
| Diluted | | **105.5** | (24.6) |

## Consolidated statement of comprehensive income

## Year ended 31 March 2010

| | 2010 £m | 2009 £m |
|---|---|---|
| **Profit/(loss) for the period** | **251.5** | (56.0) |
| (Losses) on cash flow hedges taken to equity | **(13.2)** | (7.8) |
| Deferred tax on losses on cash flow hedges taken to equity | **3.7** | 2.2 |
| Amounts on cash flow hedges transferred to the income statement in the period | **7.6** | 4.9 |
| Deferred tax on transfers to income statement | **(2.1)** | (1.3) |
| Exchange movement on translation of overseas results and net assets | **(9.0)** | 42.1 |
| Tax on exchange differences on foreign currency | **(0.4)** | 2.5 |
| Actuarial (losses) on defined benefit pension schemes | **(124.4)** | (123.1) |
| Tax on actuarial losses | **34.8** | 33.8 |
| **Other comprehensive loss for the period** | **(103.0)** | (46.7) |
| **Total comprehensive income/(loss) for the period** | **148.5** | (102.7) |
| **Attributable to:** | | |
| Equity shareholders of the company | **146.5** | (105.8) |
| Minority interests | **2.0** | 3.1 |
| | **148.5** | (102.7) |

## Consolidated statement of changes in equity

### Year ended 31 March 2010

| | Share capital £m | Share premium £m | Other reserves £m | Retained earnings £m | Equity attributable to equity holders of Severn Trent Plc £m | Minority interests £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2009 | 231.0 | 71.9 | 468.7 | 174.5 | 946.1 | 6.0 | 952.1 |
| Profit for the period | - | - | - | 249.2 | 249.2 | 2.3 | 251.5 |
| Losses on cashflow hedges taken to equity | - | - | (13.2) | - | (13.2) | - | (13.2) |
| Deferred tax on losses on cashflow hedges taken to equity | - | - | 3.7 | - | 3.7 | - | 3.7 |
| Amounts on cash flow hedges transferred to the income statement | - | - | 7.6 | - | 7.6 | - | 7.6 |
| Deferred tax on transfers to the income statement | - | - | (2.1) | - | (2.1) | - | (2.1) |
| Exchange movement on translation of overseas results and net assets | - | - | (8.7) | - | (8.7) | (0.3) | (9.0) |
| Tax on exchange differences | - | - | (0.4) | - | (0.4) | - | (0.4) |
| Actuarial losses | - | - | - | (124.4) | (124.4) | - | (124.4) |
| Tax on actuarial losses | - | - | - | 34.8 | 34.8 | - | 34.8 |
| Total comprehensive income for the period | - | - | (13.1) | 159.6 | 146.5 | 2.0 | 148.5 |
| Share options and LTIPs | | | | | | | |
| - proceeds from shares issued | 0.6 | 4.0 | - | - | 4.6 | - | 4.6 |
| - value of employees' services | - | - | - | 5.1 | 5.1 | - | 5.1 |
| - free shares issued | - | - | - | (2.2) | (2.2) | - | (2.2) |
| Current tax on share based payments | - | - | - | 0.3 | 0.3 | - | 0.3 |
| Dividends paid | - | - | - | (159.7) | (159.7) | (1.7) | (161.4) |
| **At 31 March 2010** | 231.6 | 75.9 | 455.6 | 177.6 | 940.7 | 6.3 | 947.0 |

## Consolidated statement of changes in equity

## Year ended 31 March 2010 (continued)

| | Share capital £m | Share premium £m | Other reserves £m | Retained earnings £m | Equity attributable to equity holders of Severn Trent Plc £m | Minority interests £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2008 | 229.7 | 64.3 | 427.4 | 479.6 | 1,201.0 | 4.2 | 1,205.2 |
| Loss for the period | - | - | - | (57.8) | (57.8) | 1.8 | (56.0) |
| Losses on cashflow hedges taken to equity | - | - | (7.8) | - | (7.8) | - | (7.8) |
| Deferred tax on losses on cashflow hedges taken to equity | - | - | 2.2 | - | 2.2 | - | 2.2 |
| Amounts on cash flow hedges transferred to the income statement | - | - | 4.9 | - | 4.9 | - | 4.9 |
| Deferred tax on transfers to the income statement | - | - | (1.3) | - | (1.3) | - | (1.3) |
| Exchange movement on translation of overseas results and net assets | - | - | 40.8 | - | 40.8 | 1.3 | 42.1 |
| Tax on exchange differences | - | - | 2.5 | - | 2.5 | - | 2.5 |
| Actuarial losses | - | - | - | (123.1) | (123.1) | - | (123.1) |
| Tax on actuarial losses | - | - | - | 33.8 | 33.8 | - | 33.8 |
| Total comprehensive loss for the period | - | - | 41.3 | (147.1) | (105.8) | 3.1 | (102.7) |
| Share options and LTIPS | | | | | | | |
| - Shares issued | 1.3 | 7.6 | - | - | 8.9 | - | 8.9 |
| - Value of employees' services | - | - | - | 5.3 | 5.3 | - | 5.3 |
| - Payroll tax on awards vesting | - | - | - | (2.5) | (2.5) | - | (2.5) |
| Current tax on share based payments | - | - | - | 1.3 | 1.3 | - | 1.3 |
| Deferred tax on share based payments | - | - | - | (3.3) | (3.3) | - | (3.3) |
| Dividends paid | - | - | - | (158.8) | (158.8) | (1.3) | (160.1) |
| At 1 April 2009 | 231.0 | 71.9 | 468.7 | 174.5 | 946.1 | 6.0 | 952.1 |

## Consolidated balance sheet

## At 31 March 2010

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| **Non current assets** | | | |
| Goodwill | | **70.6** | 63.3 |
| Other intangible assets | | **138.5** | 121.3 |
| Property, plant and equipment | | **6,260.5** | 5,980.1 |
| Interests in joint ventures | | **0.3** | 0.3 |
| Interests in associates | | **4.6** | 4.8 |
| Derivative financial instruments | | **203.8** | 225.4 |
| Available for sale financial assets | | **0.1** | 0.1 |
| | | **6,678.4** | 6,395.3 |
| **Current assets** | | | |
| Inventory | | **26.5** | 30.6 |
| Trade and other receivables | | **472.8** | 447.1 |
| Derivative financial instruments | | **2.9** | 29.8 |
| Cash and cash equivalents | | **227.8** | 648.1 |
| | | **730.0** | 1,155.6 |
| Assets held for sale | | **-** | 4.6 |
| **Total assets** | | **7,408.4** | 7,555.5 |
| **Current liabilities** | | | |
| Borrowings | | **(260.9)** | (256.2) |
| Derivative financial instruments | | **(4.4)** | (0.4) |
| Trade and other payables | | **(464.2)** | (442.7) |
| Current income tax liabilities | | **(67.2)** | (81.1) |
| Provisions for liabilities and charges | | **(25.5)** | (9.2) |
| Liabilities associated with assets held for sale | | **-** | (0.4) |
| | | **(822.2)** | (790.0) |
| **Non current liabilities** | | | |
| Borrowings | | **(3,915.6)** | (4,188.9) |
| Derivative financial instruments | | **(140.3)** | (171.6) |
| Trade and other payables | | **(243.6)** | (241.1) |
| Deferred tax | | **(956.4)** | (948.4) |
| Retirement benefit obligations | 9 | **(354.9)** | (233.0) |
| Provisions for liabilities and charges | | **(28.4)** | (30.4) |
| | | **(5,639.2)** | (5,813.4) |
| **Total liabilities** | | **(6,461.4)** | (6,603.4) |
| **Net assets** | | **947.0** | 952.1 |
| **Capital and reserves attributable to the company's equity shareholders** | | | |
| Called up share capital | | **231.6** | 231.0 |
| Share premium account | | **75.9** | 71.9 |
| Other reserves | | **455.6** | 468.7 |
| Retained earnings | | **177.6** | 174.5 |
| **Equity attributable to the company's equity shareholders** | | **940.7** | 946.1 |
| Minority interests | | **6.3** | 6.0 |
| **Total equity** | | **947.0** | 952.1 |

**Consolidated cash flow statement**

**Year ended 31 March 2010**

| | Note | **2010 £m** | 2009 £m |
|---|---|---|---|
| Cash generated from operations | | **708.0** | 643.5 |
| Tax (paid)/received | | **(53.8)** | 1.1 |
| **Net cash generated from operating activities** | | **654.2** | 644.6 |
| **Investing activities** | | | |
| Interest received | | **10.5** | 32.5 |
| Dividends received from associates and joint ventures | | **0.1** | - |
| Net cash inflow from sale of investments | | **2.2** | - |
| Acquisition of subsidaries | | **(13.2)** | - |
| Proceeds on disposal of property, plant and equipment | | **6.9** | 5.9 |
| Purchases of intangible assets | | **(47.8)** | (34.1) |
| Purchases of property, plant and equipment | | **(464.9)** | (462.7) |
| Contributions and grants received | | **18.0** | 25.9 |
| **Net cash used in investing activities** | | **(488.2)** | (432.5) |
| **Financing activities** | | | |
| Interest paid | | **(194.7)** | (190.2) |
| Interest element of finance lease payments | | **(10.0)** | (16.2) |
| Dividends paid to shareholders of the parent | | **(159.7)** | (158.8) |
| Dividends paid to minority interests | | **(1.7)** | (1.3) |
| Repayments of borrowings | | **(180.0)** | (221.5) |
| Repayments of obligations under finance leases | | **(43.2)** | (41.0) |
| New loans raised | | **1.0** | 400.1 |
| Issues of shares | | **4.6** | 8.9 |
| Purchase of own shares | | **(2.2)** | (2.7) |
| **Net cash used in financing activities** | | **(585.9)** | (222.7) |
| Decrease in cash and cash equivalents | | **(419.9)** | (222.7) |
| Net cash and cash equivalents at beginning of period | | **648.1** | 653.4 |
| Effect of foreign exchange rates | | **(0.4)** | 5.3 |
| **Net cash and cash equivalents at end of period** | | **227.8** | 648.1 |
| Net cash and cash equivalents comprise: | | | |
| Total cash and cash equivalents | | **227.8** | 648.1 |
| Bank overdrafts | | **-** | - |
| **Net cash and cash equivalents at end of period** | | **227.8** | 648.1 |

## Notes

## 1 Basis of preparation

### 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 2010 and those parts of the Companies Act 2006 applicable to companies reporting under IFRS as adopted by the European Union. While the financial information included in this Preliminary Announcement of Annual Results (“the Preliminary Announcement”) has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards (IFRSs), the Preliminary Announcement does not itself contain sufficient information to comply with IFRSs. The company will publish full financial statements that comply with IFRSs in June 2010. The Preliminary Announcement has been prepared in accordance with the Disclosure and Transparency rules of the Financial Services Authority.

The financial statements have been prepared on the going concern basis 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 financial information set out above does not constitute the company's statutory accounts, within the meaning of section 435 of the Companies Act 2006, for the year ended 31 March 2010, and section 240 of the Companies Act 1985, for the year ended 31 March 2009, but is derived from those accounts. Statutory accounts for 2009 have been delivered to the Registrar of Companies and those for 2010 will be delivered following the company's annual general meeting. The auditors have reported on those accounts; their reports were unqualified and did not contain statements under section 498(2) or (3) of the Companies Act 2006, in respect of the report for the year ended 31 March 2010, and under section 237(2) or (3) Companies Act 1985, in respect of the report for the year ended 31 March 2009.

The auditors have consented to the publication of the Preliminary Announcement as required by Listing Rule 9.7a having completed their procedures under APB bulletin 2008/2.

## 2 Segmental analysis

The group is operated in two main segments:

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

Severn Trent Services
Proves services and products associated with water, waste water and contaminated land principally in the US, UK and Europe.

| **2010** | Severn Trent Water £m | Severn Trent Services £m |
|---|---|---|
| External sales | 1,383.6 | 320.3 |
| Inter-segment sales | 1.7 | 16.2 |
| Total sales | 1,385.3 | 336.5 |
| Profit before interest, tax and exceptional items | 541.3 | 28.7 |
| Exceptional items | (42.1) | (7.6) |
| Profit before interest and tax | 499.2 | 21.1 |
| Profit before interest, tax and exceptional items is stated after: | | |
| Amortisation of intangible assets | 23.4 | 1.6 |
| Depreciation of property plant and equipment | 232.5 | 6.1 |
| Profit on disposal of fixed assets | (4.3) | (0.2) |

| 2009 | Severn Trent Water £m | Severn Trent Services £m |
|---|---|---|
| External sales | 1,323.5 | 318.7 |
| Inter-segment sales | 1.4 | 20.6 |
| Total sales | 1,324.9 | 339.3 |
| Profit before interest, tax and exceptional items | 456.0 | 30.5 |
| Exceptional items | (19.4) | (0.7) |
| Profit before interest and tax | 436.6 | 29.8 |
| Profit before interest, tax and exceptional items is stated after charging: | | |
| Amortisation of intangible assets | 22.9 | 1.3 |
| Depreciation of property plant and equipment | 220.0 | 6.1 |
| Profit on disposal of fixed assets | (4.0) | - |

The segmental profit before interest tax and exceptional items is reconciled to the consolidated income statement below:

| | **2010 £m** | 2009 £m |
|---|---|---|
| Severn Trent Water | **541.3** | 456.0 |
| Severn Trent Services | **28.7** | 30.5 |
| Consolidation adjustments | **1.3** | (0.2) |
| Corporate and other costs | **(14.2)** | (16.4) |
| | **557.1** | 469.9 |

## 3 Exceptional items

| | **2010 £m** | 2009 £m |
|---|---|---|
| Restructuring programmes: | | |
| Severn Trent Water | **42.1** | 13.7 |
| Severn Trent Services | **5.9** | 2.1 |
| Corporate and Other release of disposal provisions made in previous periods | **-** | (1.2) |
| **Exceptional restructuring costs** | **48.0** | 14.6 |
| Flood costs | **-** | 13.1 |
| Insurance recoverable | **-** | (14.6) |
| **Severn Trent Water exceptional flood income** | **-** | (1.5) |
| Fine and costs relating to leakage reporting | **-** | 2.2 |
| Contribution to charitable trust | **-** | 5.0 |
| **Severn Trent Water exceptional charge relating to regulatory matters** | **-** | 7.2 |
| **Severn Trent Services release of provision for third party legal costs** | **-** | (1.4) |
| **Total exceptional operating costs** | **48.0** | 18.9 |
| **Exceptional loss on disposal of businesses** | **1.7** | - |
| **Total exceptional items** | **49.7** | 18.9 |

## 4 Net finance costs

| | 2010 £m | 2009 £m |
|---|---|---|
| **Investment income** | | |
| Bank deposits | **7.0** | 32.0 |
| Other financial income | **2.8** | 4.4 |
| Total interest revenue | **9.8** | 36.4 |
| Expected return on defined benefit scheme assets | **71.1** | 89.8 |
| | **80.9** | 126.2 |
| **Finance costs** | | |
| Interest on bank loans and overdrafts | **(7.6)** | (13.0) |
| Interest on other loans | **(195.0)** | (191.7) |
| Interest on finance leases | **(10.1)** | (16.3) |
| Total borrowing costs | **(212.7)** | (221.0) |
| Other financial expenses | **(0.9)** | (9.7) |
| Interest cost on defined benefit scheme obligations | **(86.1)** | (91.9) |
| Total finance costs | **(299.7)** | (322.6) |
| Net finance costs | **(218.8)** | (196.4) |

In accordance with IAS 23 borrowing costs of £2.6 million (2009:£nil million) incurred funding eligible capital projects have been capitalised at an interest rate of 5.65%.

## 5 Gains/(losses) on financial instruments

| | 2010 £m | 2009 £m |
|---|---|---|
| Gain on cross currency swaps used as hedging instruments in fair value hedges | **(10.9)** | 221.1 |
| Gain/(loss) arising on adjustment for foreign currency debt in fair value hedges | **22.3** | (222.7) |
| Fair value gain/(loss) on cash flow hedges transferred from equity | **(7.6)** | (4.9) |
| Gain/(loss) arising on interest rate swaps where hedge accounting is not applied | **41.9** | (80.5) |
| | **45.7** | (87.0) |

## 6 Taxation

| | 2010 £m | 2009 £m |
|---|---|---|
| **Current tax** | | |
| Current year at 28% | **71.3** | 65.0 |
| Prior year at 28% | **(30.6)** | (12.9) |
| Total current tax | **40.7** | 52.1 |
| **Deferred tax** | | |
| Origination and reversal of temporary differences - current year | **25.9** | (23.3) |
| Origination and reversal of temporary differences - prior year | **16.3** | 9.2 |
| Exceptional deferred tax (credit)/charge | **-** | 185.6 |
| **Total deferred tax** | **42.2** | 171.5 |
| **Total tax charge** | **82.9** | 223.6 |

## 7 Dividends

Amounts recognised as distributions to equity holders in the period:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Pence per share** | **£m** | Pence per share | £m |
| Final dividend for the year ended 31 March 2009 (2008) | **41.05** | **96.5** | 41.29 | 97.0 |
| Interim dividend for the year ended 31 March 2010 (2009) | **26.71** | **63.2** | 26.29 | 61.8 |
| | **67.76** | **159.7** | 67.58 | 158.8 |
| **Proposed final dividend for the year ended 31 March 2010** | **45.61** | | | |

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

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

**Earnings**

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| Earnings for the purpose of basic and diluted earnings per share from operations being: | | |
| Profit/(loss) for the period attributable to the equity holders of the company | 249.2 | (57.8) |

| | **2010** | 2009 |
|---|---|---|
| | **m** | m |
| Weighted average number of ordinary shares for the purpose of basic earnings per share | **236.0** | 234.9 |
| Effect of dilutive potential ordinary shares: | | |
| Share options and LTIPs | **0.3** | 0.7 |
| Weighted average number of ordinary shares for the purpose of diluted earnings per share | **236.3** | 235.6 |

| | **2010** | 2009 |
|---|---|---|
| | **Pence** | Pence |
| Adjusted basic earnings per share | **122.8** | 92.7 |
| Adjusted diluted earnings per share | **122.6** | 92.4 |

Adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, gains/(losses) on financial instruments and exceptional items in both 2010 and 2009. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

The adjustments to earnings are as follows:

**Adjustments to earnings**

| | 2010 £m | 2009 £m |
|---|---|---|
| Earnings for the purpose of basic and diluted earnings per share from continuing operations | **249.2** | (57.8) |
| Adjustments for: | | |
| Exceptional items | **49.7** | 18.9 |
| Current tax related to exceptional items at 28% | **(5.6)** | (1.8) |
| (Gains)/losses on financial instruments | **(45.7)** | 87.0 |
| Deferred tax | **42.2** | 171.5 |
| Earnings for the purpose of adjusted basic and diluted earnings per share | **289.8** | 217.8 |

## 9 Retirement benefit obligations

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

| | 2010 £m | 2009 £m |
|---|---|---|
| Present value at 1 April | **(233.0)** | (126.0) |
| Service cost | **(14.7)** | (23.8) |
| Curtailment | **(7.4)** | - |
| Interest cost | **(15.0)** | (2.1) |
| Contributions from the sponsoring companies | **39.6** | 42.0 |
| Actuarial losses recognised in the statement of comprehensive income | **(124.4)** | (123.1) |
| Present value at 31 March | **(354.9)** | (233.0) |

## 10 Cash flow statement

### a) Reconciliation of operating profit to operating cash flows

| | 2010 £m | 2009 £m |
|---|---|---|
| Profit before interest and tax | **507.4** | 451.0 |
| Depreciation of property, plant and equipment | **236.1** | 223.7 |
| Amortisation of intangible assets | **25.2** | 24.2 |
| Exceptional impairment and depreciation | **6.6** | - |
| Pension service cost | **14.7** | 23.8 |
| Curtailment cost | **7.4** | - |
| Pension contributions | **(39.6)** | (42.0) |
| Share based payments charge | **5.1** | 5.3 |
| Profit on sale of property, plant and equipment | **(4.5)** | (4.0) |
| Loss on disposal of businesses | **1.7** | - |
| Deferred income movement | **(7.4)** | (5.3) |
| Provisions charged to the income statement | **24.3** | 10.8 |
| Utilisation of provisions for liabilities and charges | **(10.6)** | (48.9) |
| Decrease/(increase) in stocks | **3.9** | (2.7) |
| Increase in debtors | **(26.4)** | (9.2) |
| (Decrease)/increase in creditors | **(35.9)** | 16.8 |
| Cash generated from operations | **708.0** | 643.5 |
| Tax (paid)/received | **(53.8)** | 1.1 |
| **Net cash generated from operating activities** | **654.2** | 644.6 |

## b) Exceptional cash flows

| | 2010 £m | 2009 £m |
|---|---|---|
| Restructuring costs | **(15.9)** | (16.2) |
| Fines and penalties | **(2.0)** | (40.0) |
| Third party legal costs | **-** | (1.4) |
| Cash paid on disposal of business | **(0.9)** | - |
| | **(18.8)** | (57.6) |

## c) Reconciliation of movement in cash and cash equivalents to movement in net debt

| | As at 1 April 2010 £m | Cash flow £m | Fair value adjustments £m | RPI uplift on index linked debt £m | Foreign exchange £m | Other non-cash movements £m | As at 31 March 2010 £m |
|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 648.1 | (419.9) | - | - | (0.4) | - | **227.8** |
| Bank loans | (789.8) | 100.2 | - | 2.1 | - | (2.3) | **(689.8)** |
| Other loans | (3,310.9) | 78.8 | 22.3 | (15.7) | 0.1 | 39.5 | **(3,185.9)** |
| Finance leases | (344.4) | 43.2 | - | - | - | 0.4 | **(300.8)** |
| Net debt as previously stated | (3,797.0) | (197.7) | 22.3 | (13.6) | (0.3) | 37.6 | **(3,948.7)** |
| Cross currency swaps hedging debt | 237.1 | - | (10.9) | - | - | (38.9) | **187.3** |
| Net debt | (3,559.9) | (197.7) | 11.4 | (13.6) | (0.3) | (1.3) | **(3,761.4)** |

## 11 Contingent liabilities

### a) Bonds and guarantees

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

### b) Disposal of subsidiaries

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

On 5 March 2007 the group received notice of a claim for €23.4 million from Veolia Proprete S.A (‘Veolia’) alleging breach of warranty in relation to the disposal of Biffa Belgium. The group subsequently received notice from Veolia of a further claim for €5 million relating to the same matter. The group considered that there was no basis for this claim and hence no provision was recorded in the financial statements in relation to this matter. Following a hearing in the Commercial Court in Belgium in February 2010, the Court rendered judgment in favour of the group on 1 April 2010 and declared all of Veolia’s claims to be unfounded.

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.

## 12 Related party transactions

There have been no related party transactions that materially affected the financial position or performance of the group during the period.

### 13 Post balance sheet events

Following the year end the Board of Directors has proposed a final dividend of 45.61 pence per share. Further details of this are shown in note 7.

### 14 Annual report

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

### 15 Annual general meeting

The Annual General Meeting will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Tuesday 20 July 2010.

### 16 Cautionary statement regarding Forward Looking Statements

This document contains certain ‘forward looking statements’ with respect to Severn Trent’s financial condition, results of operations and business and certain of Severn Trent’s plans and objectives with respect to these items.

Forward looking statements are sometimes, but not always, identified by their use of a date in the future or such words as ‘anticipates’, ‘aims’, ‘due’, ‘could’, ‘may’, ‘should’, ‘expects’, ‘believes’, ‘intends’, ‘plans’, ‘potential’, ‘reasonably possible’, ‘targets’, ‘goal’ or ‘estimates’. By their very nature forward-looking statements are inherently unpredictable, speculative and involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future.

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

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

Nothing in this document should be regarded as a profits forecast.

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).