Financial review

Group profit before tax and exceptional items increased 7.7%, with adjusted earnings per share growth of 8.4%. The group's key balance sheet ratios continue to be some of the strongest in the sector.

Group operating profit

Group turnover increased by 4.8% to £690.5m (2002: £658.8m) for the full year, after the 5.2% increase reported in the interim results. £29.5m of the increase in turnover was a result of acquisitions by Aquarion in the US. Group turnover (including share of associates and joint ventures) was £838.1m (2002: £799.8m).

Group operating profit increased to £265.3m (2002: £245.0m), including £10.5m from the US acquisitions. Operating profit from continuing activities increased 1.9% to £256.6m (2002: £251.9m), of which 48% (2002: 47%) accrued in the second half year. The group's operating results reflect the strong financial performance of the Yorkshire Water UK regulated business whose operating profit increased 3.6% to £233.7m (2002: £225.5m). The combined US operations, which were adversely affected by the weaker dollar and a number of cost pressures, now account for 13% (2002: 12%) of group operating profit.

The group's share of associates' and joint ventures' operating profit, before the exceptional items reported by WRG in their results for the year ended 31 December 2002, was £18.8m (2002: £20.3m). Group operating profit (including share of associates and joint ventures) was £277.1m (2002: £265.3m).

Group profit before taxation

A number of exceptional items affect the year on year comparison of the group's results. The group's share of the exceptional costs reported by WRG, amounting to £7.0m before taxation, have been adjusted in arriving at the group's underlying profit before taxation and exceptional items. Non operating exceptional items comprise a loss of £3.9m on the closure of the Timco timber business in the US and, in the prior year, an overall profit of £34.4m from the major land sale in the US and the disposal of the renewable energy business.

The group interest charge increased to £98.1m (2002: £93.3m) reflecting the continuing regulated capital investment programme in Yorkshire Water. £71.0m (2002: £64.1m) of the group total relates to the Yorkshire Water UK regulated business. Low short term interest rates in the US reduced the cost of financing both the existing operations and the US acquisitions, which were earnings enhancing in the period.

The group's share of associates' and joint ventures' interest increased to £10.8m (2002: £9.3m). Interest cover was 2.6 times (2002: 2.6) before exceptional items and 4.2 times (2002: 4.1) on an earnings before interest, tax, depreciation and amortisation (EBITDA) basis.

Group profit before taxation and the exceptional items described above increased 7.7% to £175.2m (2002: £162.7m). Group profit before taxation was £164.3m (2002: £197.1m).

Taxation

The group current taxation charge decreased to £7.0m (2002: £7.3m) after the inclusion of an £11.7m prior year adjustment, an effective tax rate of 4.2% (2002: 4.8%). The effective tax rate will remain sensitive to the value of capital allowances arising from the Yorkshire Water investment programme. As reported in the interim results, the deferred tax charge has been affected by the reduction in gilt rates and, therefore, the discount rate applied to the deferred tax provision. This has resulted in a significant increase in the deferred tax charge, which is a non cash item, to £29.0m (2002: £14.8m).

Earnings per share and dividends

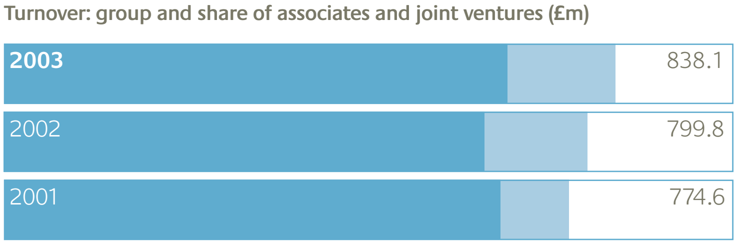
Earnings per share, adjusted to exclude exceptional items and deferred tax, increased 8.4% to 42.4p (2002: 39.1p). Basic earnings per share was 32.7p (2002: 39.3p).

An interim dividend of 7.86p (2002: 7.70p) was paid to shareholders on 28 February 2003. The board is recommending the payment of a final dividend of 18.19p (2002: 17.80p) per share, to make a total dividend for the year of 26.05p (2002: 25.50p) per share, an increase of 2.2%. Dividend cover was 1.5 (2002: 1.7) times earnings before deferred tax.

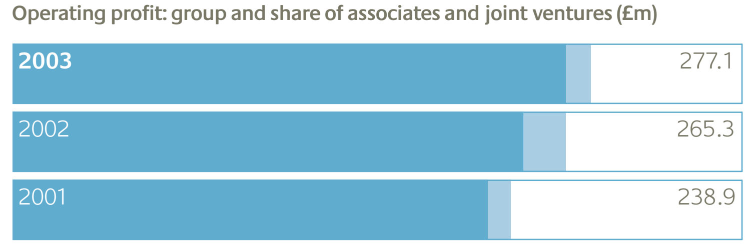
Cash flow

The group's cash flow reflects the characteristics of the Yorkshire Water UK regulated and US water businesses. Strong operating cash flow of £441.4m (2002: £387.8m) was offset by high capital investment of £389.6m (2002: £323.6m) and interest payments of £82.1m (2002: £83.7m). In 2003, acquisitions in the US cost £78.0m together with debt acquired of £82.0m, whereas in the prior year proceeds from the major land sale in the US amounted to £57.2m.

Turnover: group and share of associates and joint ventures (£m)



Operating profit: group and share of associates and joint ventures (£m)



Dividend payments to shareholders, which are funded by the Yorkshire Water regulated business, were £99.0m (2002: £96.3m).

Group net debt at 31 March 2003 increased by £283.9m to £1,720.4m (2002: £1,436.5m). Balance sheet gearing (expressed as the relationship between net debt and net debt plus shareholders' funds) increased slightly to 50% (2002: 46%). Group net debt included £1,170.5m (2002: £1,042.0m) in respect of the Yorkshire Water UK regulated business. The increasingly important ratio of Yorkshire Water net debt compared to the Regulatory Asset Value of 40% (2002: 39%) is one of the strongest in the sector.

On 21 February 2003 £200m 5.375% fixed rate bonds maturing in 2023 together with £100m of 30 year index linked bonds, guaranteed by Yorkshire Water, were issued. This long term funding will meet Yorkshire Water's financing requirements to the end of the current price determination period in March 2005.

Pensions

The disclosures required in accordance with the phased implementation requirements of FRS 17 'Retirement Benefits' are made in note 28 to the group accounts. The disclosed deficit in the main UK defined benefit scheme at 31 March 2003 is £111.9m after tax (2002: £17.6m asset). The group's pension liabilities are funded on a long term basis based on periodic actuarial reviews and not the FRS 17 figures that can produce volatile results over short time periods. An interim actuarial review at 31 March 2003 has been commissioned as a basis for reviewing the long term funding of the scheme.

Accounting policies

The group accounts have been prepared in accordance with the accounting policies described in note 1 to the accounts. Aquarion prepares accounts in accordance with Generally Accepted Accounting Principles in the US (US GAAP). Where material, adjustments are made to the results of the US operations to align US GAAP with the group's accounting policies.

In accordance with FRS 18 'Accounting Policies', the director's have reviewed the group's accounting policies and consider that they continue to be the most appropriate to the group's operations. As permitted by FRS 19 'Deferred Tax', which requires provision to be made for deferred tax arising from timing differences between the recognition of gains and losses in the accounts and their recognition in the tax computation, a policy of discounting has been adopted. This has the effect of significantly reducing the deferred tax liability shown in the group balance sheet. The requirement to provide for deferred tax has no effect on the group's cash or borrowing position.

Treasury policy

The group's treasury operations are controlled centrally in accordance with approved board policies, guidelines and procedures. Treasury strategy is designed to manage the group's exposure to fluctuations in interest and currency exchange rates, preclude speculation and to source and structure the group's borrowing requirements. Note 21 to the accounts shows details of the financial instruments held by the group for these purposes.

The group uses a combination of fixed capital, retained profits, long term loans and finance leases, and bank borrowings to finance its operations. Any funding required is raised by the group treasury department in the name of the appropriate company and supported by guarantees as necessary. Funds raised by the holding company may be lent to operating subsidiaries at commercial rates of interest. Cash surplus to operating requirements is invested in short term instruments with institutions having a long term rating of at least A- or A3 and a short term rating of at least A1 or P1 issued by Standard and Poor's and Moody's respectively.

Shareholder value

The strength of the company's share price against a negative market background in the new calendar year resulted in the company's promotion to the FTSE 100 index of leading UK companies on 24 March 2003. The company's mid market share price at the close of business on 31 March 2003 was 409.5p (2002: 389.5p). The yield on the company's shares at that date, based on the recommended final dividend, was 6.4% (2002: 6.5%).

Going concern

After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Martin Towers
Group Finance Director

Group profit before taxation and exceptional items (£m)

Adjusted earnings per share (excluding deferred tax) (p)