

Directors' report

The directors present their report for the year to 31 March 2003.

Result and dividends

The profit attributable to shareholders for the year was £126.1m. After dividends totalling £100.8m, £25.3m was transferred to the group's reserves.

The directors recommend a final dividend of 18.19p per share to be paid on 1 October 2003, to those shareholders on the register at the close of business on 29 August 2003. An interim dividend of 7.86p per share was paid on 28 February 2003. The total dividend for the year will amount to 26.05p per share (2002: 25.50p).

Principal activities

The directors' report should be read in conjunction with the operating and financial review, which includes information about group businesses, the financial performance during the year and future developments.

The principal activities of the group are the supply of clean water and the treatment and disposal of waste water. Yorkshire Water Services Limited (Yorkshire Water), the group's regulated utility business in the UK, is responsible for both water and waste water services. Aquarion Company (Aquarion) the group's US subsidiary provides water services and waste water contract services in the states of Connecticut, New York, Massachusetts and New Hampshire. The group's other businesses are KeyLand Developments Limited, a company which primarily develops surplus property assets of Yorkshire Water and Loop Customer Management Limited which provides managed customer services. In addition, the group holds 45.5% of the issued share capital of Waste Recycling Group plc, a leading waste management company.

Acquisitions and disposals

In April 2002 Aquarion acquired the New England operations of the American Water Works Company for \$120m in cash and the assumption of \$104m of debt. Further details of the acquisition are given on page 64. Timco, Aquarion's small timber business is being closed.

Directors

The directors are: John Napier, Chairman; Kevin Whiteman, Chief Executive; Martin Towers, Group Finance Director; Richard Schmidt, President and Chief Executive, Aquarion; Ken Jackson, Derek Roberts and David Salkeld, non executive directors.

Richard Schmidt and Martin Towers have been appointed since the company's 2002 annual general meeting, on 2 September 2002 and 1 March 2003 respectively. In accordance with article 82 of the company's articles of association they will retire at the forthcoming annual general meeting and offer themselves for election, which is recommended by the board, in accordance with article 111. Details of their service contracts appear in the remuneration report on page 34. In accordance with article 105, Derek Roberts will retire at the forthcoming annual general meeting and will offer himself for re-election, which is recommended by the board in accordance with article 109. Mr Roberts has no service contract with the company. Details of the unexpired term of his letter of appointment appear in the remuneration report on page 34.

The directors' service agreements and letters of appointment are described in the remuneration report on page 34. Additional information relating to directors who served during the year, including remuneration and interests in the company's shares is contained on pages 35 to 37. The details of directors' interests in the company's shares form part of this report.

Corporate and social responsibility

There are group policies for the Environment, Health and Safety, Human Resources, as well as a Code of Ethics, and related policies. The internal control processes described on page 32 take account of social, environmental and ethical risks. In addition, the board receives information as part of the normal reporting process to identify and assess such significant risks where they are relevant to the nature of the company's business. Further details are included in the following sections of the directors' report and in the Corporate & social responsibility section on pages 20 to 27.

Employees and employment policies

The group strives to create a positive working environment for its employees. The company is committed to increasing employee involvement and places great emphasis on open two way communications. There is an extensive consultation and communication process with employees and trade unions to keep employees informed and involved. Employees have opportunities to express their views including regular face to face sessions with senior management, and are kept informed via regular briefings and in-house publications.

The group's employment policies go well beyond current legal requirements. The company recognises that work/life balance is a key factor and offers a range of part time working opportunities, flexible working for some jobs, and a formal jobshare policy. UK based employees also have the opportunity to acquire a direct stake in the success of business through a sharesave scheme which has been operating since 1989.

The group is committed to treating job applicants and employees in the same way, regardless of their ethnic origin, gender, disability, race, colour, religion, sexual orientation or age. An active approach to keeping employees who become disabled in employment, and a commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK employment service.

The company's approach to equal opportunities and diversity applies to advertisements for jobs, recruitment and selection, training, conditions of work, pay and to any other aspect of employment. The company continues to build links with ethnic minority groups, and monitors the composition of the workforce to track the effectiveness of actions in relation to issues of diversity.

Kelda continues to be committed to high levels of training and employee development through a wide range of in-house and accredited programmes. Employees are encouraged to seek out the information, development and training needed to carry out their role to its full potential and to share learning, expertise and information with colleagues. The company recognises team and individual achievements via business excellence events and presentations.

Directors' report

Health and safety

The company is committed to achieving high health and safety standards throughout its businesses. The management of health and safety issues operates in the context of the policy adopted by the board and the system of internal control. The company has put in place a number of safety policies and procedures, and provides such information, instruction, training and supervision as is appropriate. In addition, the company provides occupational health, safety and welfare advisory services.

Health and safety goals are set annually in relation to numbers of accidents, working time lost as a result of accidents, training delivery, internal safety audits and the health surveillance programme. These are monitored and reported monthly to senior managers and directors. The use of stretching goals, the effective provision of training and advice, and the continued emphasis by all parties on the importance of health and safety matters has resulted in significant reductions in reportable accidents, all accidents, and working days lost. By the nature of accidents, there can be no guarantee that they will never occur. The measures taken by the company are intended to place emphasis on prevention and continuing vigilance.

In 2002, 14 senior managers were awarded the Institute of Occupational Safety and Health accredited Safety for Senior Executives certificate. Yorkshire Water has been awarded a National Safety Award 2002 from the British Safety Council and a Silver Award for Occupational Safety 2002 from the Royal Society for the Prevention of Accidents.

The company consults with all employees via area and functional health and safety forum groups and subsidiary company safety committees. Local safety issues are discussed and resolved within these groups.

Environment and community

The environmental policy of the company recognises that a sustainable water and waste water business is dependent on environmentally sustainable operations. It is, therefore, committed to integrating environmental best practice and continuous improvement in environmental performance through the efficient, effective and proper conduct of its business.

Environmental performance is reported through the company's web based environment and community report which is regularly updated and independently verified. This can be viewed at www.keldagroup.com/environment

The company contributes actively to the communities which it serves. One in five employees has volunteered to take part in a wide range of community activities. These include a community ambassadors scheme, a speakers panel, and support to local education ranging from 'Right to Read' in junior schools through to coaching at senior schools, and mentoring university students from diverse ethnic backgrounds.

Charitable and political contributions

Charitable contributions totalling £0.6m (2002: £0.6m) were made during the year. No political contributions were made.

Research and development

During the year £3.9m (2002: £3.3m) was committed to research and development including £3.0m (2002: £2.3m) on fixed assets.

Purchase of own shares

At the forthcoming annual general meeting, the company will be seeking authority to purchase up to 10% of its ordinary shares. Authority was previously granted at the annual general meeting in 2002 in respect of 10% of the company's issued ordinary share capital but expires at the close of the forthcoming meeting.

Auditors

A resolution to reappoint Ernst & Young LLP as the company's auditors and to authorise the directors to determine their remuneration will be proposed at the forthcoming annual general meeting. The company has adopted an auditor independence policy. It establishes procedures and guidance under which the company's relationship with its external auditors is governed so that the audit committee is able to satisfy itself that there are no factors which may, or may be seen to, impinge upon the independence and objectivity of the audit process. The key features of the policy are:

- Clear accountability of the auditors to the audit committee and the chairman of the board of the company
- The audit committee considers annually its recommendation to reappoint the auditors
- The auditors are required to disclose the safeguards and steps taken to ensure independence and objectivity
- Rotation of audit partners and appropriate restrictions on appointment of employees of the auditors
- Specific restrictions and procedures in relation to the allocation of non audit work to the auditors, which is controlled and monitored by the audit committee

Payment terms to suppliers

The company's normal terms are to make payment in accordance with suppliers' terms of trade or within 30 days from the receipt of services or invoices subject to satisfactory performance by the supplier. Kelda Group plc is a holding company and, at 31 March 2003, had no trade creditors outstanding. The payment terms of individual operating subsidiaries are disclosed in their accounts.

Major shareholdings

As at 4 June 2003 the company had been notified of the following interests amounting to 3% or more of the company's issued ordinary share capital:

M & G Investment Management Ltd 4.76%
Legal & General Investment Management Ltd 3%

Annual general meeting

The notice convening the company's 2003 annual general meeting at the Barbican Centre, York on 31 July 2003 at 11am is set out in a separate document issued to shareholders.

By order of the board
Philip Hudson
Group Company Secretary
5 June 2003

Registered office:
Western House
Halifax Road
Bradford
BD6 2SZ

Registered in England
No. 2366627