

Registered no: 02366661 (England and Wales)

Thames Water Utilities Limited

Annual Report and Financial Statements

For the 15 month period ended 31 March 2007

Thames Water Utilities Limited

Annual report for the period ended 31 March 2007

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Thames Water Utilities Limited

Directors and advisors at 31 March 2007

Directors

Sir Peter Mason KBE (Chairman)
P S Antolik
M W Baggs
C R Deacon (Alternate: R D Israel – until 28 June 2007)
Dr P Dyer
R J Gregor
C Lynam
G J Matthews (Alternate: P E D Crone)
A P Santos (Alternate: J Santos)
M S W Stanley
L Webb

Independent non-executive directors

S J Box
M Pavia
W Smit

(See page 47 for changes in directors since 31 December 2005).

Registered auditors

PricewaterhouseCoopers LLP
9 Greyfriars Road
Reading
Berkshire
RG1 1JG

Registered office

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Utilities Limited

Chairman's Introduction

The new Board of Thames Water has been in place since 1 December 2006. We are determined to meet our commitments to our regulators and our customers and, in doing so, restore the company's reputation. Our first action on behalf of our shareholders was to install a new management team, with instructions to implement a 'back to basics' strategy, focussing on the essentials of the regulated business serving London and the Thames Valley.

My initial assessment for shareholders is that the new management team has made a promising start. Meeting the leakage target to 31 March 2007 was essential and I am pleased to say that this milestone was achieved, by a considerable margin. Security of supply has also been improved. Other significant achievements in water supply include a further improvement in the quality of our drinking water, a reversal of the adverse trend in the number of burst mains and reduction of the number of properties suffering from low pressure to an all time low.

The company's waste water service has also seen some significant improvements. Effluent compliance has now been restored at almost all of our previously failing works and the number of pollution incidents has been substantially reduced.

Delivering better customer service is essential and here too there has been real progress. The response to billing contacts and written complaints has improved and targets for metering have been exceeded, with more than double the anticipated numbers being installed.

I need also to report on the key areas where the management team is concentrating on making further improvements. The level of unplanned interruptions to water supply to our customers' properties is not yet satisfactory, nor is the proportion of bills based on an estimated meter reading. There are still too many incidents of sewer flooding due to causes such as collapses and blockages. Operating costs are being managed aggressively, but are still above the level agreed at the last price review, and spending on the capital programme remains behind target.

Looking further ahead, there is much work to do before Thames Water again leads the water industry. Nevertheless, a heritage that includes innovations such as the London Ring Main, the development of Advanced Water Treatment and the pioneering Reading sewage treatment works provides inspiration for the future. The Company is well-advanced in preparing its Asset Management Plan for Ofwat's 2009 price review, and in setting out a longer-term vision in its first Strategic Direction Statement. These documents will be complemented by an updated 25 year Water Resources Management Plan, identifying the demand and supply measures needed to ensure water supply to our growing customer base.

The Company's operations have a wide range of environmental impacts and considerable effort is made to meet and exceed the requirements of environmental regulation. In addition, climate change is now a significant factor in all our planning. We are implementing a strategy that will reduce the company's contribution to climate change and prepare for the significant changes forecast in weather conditions.

Finally, on behalf of the Board I wish to commend the performance of the company's employees during a difficult time. They have shown enormous commitment and dedication, responding with the utmost professionalism to a series of operational challenges, not least a major drought, at a time when the company's future ownership was uncertain.

The Board now intends to provide stakeholders with a period of business stability, while planning for the challenges presented by new regulation and environmental change. I look forward to being able to report further progress at this time next year.

Sir Peter Mason KBE
Chairman

Thames Water Utilities Limited

Operating and Financial Review ('OFR')

INTRODUCTION

This review is addressed to the Company's shareholders and has been prepared in accordance with the Accounting Standards Board's Reporting Standard RS1. It serves both as an Operating and Financial Review for the regulatory year 1 April 2006 - 31 March 2007, and subsequent developments since that date, and also as a Business Review for the statutory accounting period 1 January 2006 - 31 March 2007. To ensure consistency with the official data reported to Ofwat in the Company's June Return all data reported in this review (with the exception of the specific financials presented in sections 8 and 9) is for the regulatory year unless otherwise stated.

The review contains a number of forward-looking statements that the Company believes to be reasonable, based on the knowledge and information available to the Directors at the date of preparation, but about which it is unable to give any assurance that they will prove to be correct. Such forward-looking statements involve a number of risks and uncertainties and are subject to change at any time. In the event that such risks or uncertainties materialise, the Company's results could be materially affected. These risks and uncertainties include but are not limited to risks associated with the Company's operational performance, the regulatory regimes under which it operates and the need to obtain planning consents and other authorisations for capital works.

1 NATURE OF THE BUSINESS

1.1 Background

The Company is the largest supplier of water and provider of sewerage services in the UK, based on the number of customers served. It is one of ten companies currently holding appointments as water and sewerage undertakers (Note 1 page 28) in England and Wales, with a further 14 companies holding appointments as water only undertakers.

In total, the area served by the Company occupies approximately 13,331 km² and encompasses more than 9% of the area of England and Wales. This includes London and extends as far as Cirencester in the west, Dartford in the east, Banbury in the north and Haslemere in the south. This area has a population of about 13.5 million people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, the Company supplies 3.7 million properties (just over 8.5 million people) with water, and collects sewage from 5.5 million properties (about 13.5 million people), including 97% of households in its sewerage region.

1.1.1 New Ownership

On 1 December 2006, the Company, as part of the wider Thames Water group of companies ("Thames Water Group"), was acquired by Kemble Water Limited ("Kemble Water") from the German utility group RWE AG. Kemble Water is an investment vehicle for a consortium comprising Macquarie European Infrastructure Funds, Macquarie Bank Limited and certain other Macquarie managed funds, together with a number of long-term investors made up largely of pension funds and other institutional investors. Kemble Water is committed to the strategic objectives outlined in Section 2 of this review. The Company's management is focussed on the delivery of regulatory outputs, improving customer service and corporate reputation, and implementation of efficiencies in operating costs and capital investment.

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Operating and Financial Review ('OFR') (continued)

1.2 Regulatory Environment

All water and sewerage undertakers are subject to economic regulation by the Water Services Regulation Authority ("Ofwat"), which governs pricing and service standards as explained in paragraph 1.2.1. Further information about Ofwat can be found on its website at <http://www.ofwat.gov.uk>, including a glossary of water industry terminology. Ofwat requires all companies to publish an annual return containing a prescribed and comprehensive range of information, thus enabling it to monitor progress and compare performance between companies. This document is known as the 'June Return' and the majority of information that it contains is published on Ofwat's website towards the end of October of each year. Furthermore, in addition to the statutory accounts filed at Companies House, Ofwat requires companies to prepare a separate set of regulatory accounts and to publish these on their websites.

The Company is regulated by other bodies in addition to Ofwat, principally the Environment Agency and the Drinking Water Inspectorate, in respect of areas such as pollution control and water quality, as described in paragraph 1.2.2 below.

The Consumer Council for Water ("CCWater") - an organisation that represents the interests of consumers and also investigates complaints from them about their water and sewerage providers - engages with the Company on issues including price, quality and value for money of the services provided by the Company. These issues include consumer advice, handling of complaints and matters of policy.

1.2.1 Economic Regulation

Ofwat operates incentive-based economic regulation which imposes caps on price increases, rewards efficiency and high standards of customer service, and penalises the opposite. Ofwat also exercises powers under UK competition legislation. The Company's relationship with Ofwat is therefore its single most significant external relationship and is accorded high priority at all times.

The Company submits an Asset Management Plan ("AMP") to Ofwat for approval for each 5-year price review period, the terms of which are concluded by means of a Final Determination ("FD") published by Ofwat. AMP 4 is the plan covering the period from 1 April 2005 to 31 March 2010, AMP 5 will cover 2010-2015, and AMP 6 will cover 2015-2020.

Price control is implemented through the five yearly review, the outcome of which is a price cap as measured by UK Retail Price inflation ("RPI") plus an adjustment factor determined by Ofwat, which is known as 'K'. Each company has a unique 'K' factor reflecting the amount that it needs over and above the rate of inflation in order to finance the provision of services to its customers. 'K' can vary for each year of the review period, depending on the scale of that particular company's capital investment programme, cost of capital, and operational and environmental obligations, after taking into account the potential to improve efficiency. A company retains the benefit of any efficiency savings for the remainder of the five-year period, after which time the benefit passes to customers via the subsequent price setting process, while conversely the company bears the cost of any under-performance.

Unexpected costs or savings resulting from changes in certain regulatory assumptions during a review period are recorded and agreed by the Company and Ofwat in a process known as 'logging up' or 'logging down', the results of which are implemented in practice by adjusting prices at the next review period. In addition, where the change exceeds materiality thresholds, during the first four years of any 5-year period either the Company or Ofwat can instigate a process to reset the price limit. This process is known as an 'Interim Determination of K' or 'IDoK'. Finally, all water and sewerage companies have provisions within their licences to allow price limits to be reviewed when events beyond their control have a significant effect on costs or revenues.

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Operating and Financial Review ('OFR') (continued)

Following the acquisition by Kemble Water, Ofwat has consulted on resulting regulatory issues to consider whether there was a need for any modifications to the Licence. A period of public consultation closed at the beginning of March 2007.

In its initial consultation document, Ofwat proposed several modifications to the Company's Licence, including:-

- To modify Condition P (which deals with the position of an appropriate parent or holding company) to reflect the new ownership
- To require the Company to maintain an investment grade issuer credit rating
- To include a cash lock up provision limiting the ability to transfer cash or other assets from the Company to an associate company in circumstances where the Company's investment grade credit rating is threatened
- To introduce conditions relating to adequate systems of planning and internal control

Following the consultation, Ofwat has confirmed that these changes to the Company's licence will be made.

Ofwat also raised concerns in the consultation about the proposed board structure for Thames Water, including the lack of executive representation. To address these concerns, Kemble Water has appointed three executive officers (Chief Executive Officer, Chief Finance Officer and Chief Operating Officer) to the board of the Company to replace three of the existing shareholder-appointed non-executive directors. Kemble Water will also conduct an effectiveness review of the board governance arrangements within the next six to 12 months, in line with the guidelines laid out in the Combined Code on Corporate Governance. Ofwat has stated an intention to look carefully at the outcome of that review to be assured that the new board structure works in the interests of customers as well as shareholders.

1.2.2 Environmental and Quality Regulation

The water and wastewater industry is subject to significant domestic and European statutory obligations with regard, amongst other things, to the management of water resources, quality of treated water supplied and of environmental protection and wastewater treatment.

Environmental regulation is the responsibility of the Department for Environment, Food and Rural Affairs ("Defra") through the Environment Agency ("EA"), which regulates and enforces water abstraction consents and treated effluent quality standards, the Drinking Water Inspectorate ("DWI"), which sets standards for the quality of drinking water, and Natural England (the successor to English Nature) which is responsible for the protection of biodiversity.

1.2.3 Competition

The Water Act 2003 provides for a framework for competition in the water industry called Water Supply Licensing ("WSL"). Since 1 December 2005, suppliers - known as licensees - have been able to supply any premises with a likely annual demand of at least 50 megalitres ("MI") in England and Wales (a MI is 1 million litres, MI/d means Megalitres per Day). The new arrangements have nearly doubled the overall number of customers who are able to change supplier to around 2,200 customers.

As at 31 March 2007, seven new entrants had been granted supply licences by Ofwat but no consumers had switched. The Company received no new applications during the year for retail supply

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Operating and Financial Review ('OFR') (continued)

of water to existing customers within its water region.

The Company has in place a Code detailing how access to third party water supply licensees is to be granted. This complies with the Ofwat Customer Transfer Protocol, which is intended to enable customers to switch between water suppliers.

In April 2007, Ofwat published the findings of its internal review into market competition in the water industry. Ofwat is consulting on revisions to its WSL guidance and will also set out further ideas for longer-term change in a wide-ranging consultation to be launched in the summer. As part of the consultation process over the coming months, Ofwat plans to seek stakeholders' views on the future of competition in the water and sewerage industry.

1.2.4 Health and Safety

The health and safety duties of the Company are regulated by the Health and Safety Executive. Information about health and safety policy can be found in section 2.2 and performance in Table 1 at the end of the report.

1.2.5 Significant Regulatory Issues

1.2.5.1 Section 19 undertaking

On 3 July 2006, the Company gave a legally binding undertaking to Ofwat under Section 19 of the Water Industry Act 1991 concerning leakage and security of supply. The Company has committed to the following as part of the undertaking:

- To complete an additional 368 km of mains renewal in London at the Company's expense (the expenditure will never be considered as part of price limits or price setting)
- To bring forward (from 31 March 2010 to 31 March 2009) completion of the existing Victorian Mains Replacement ("VMR") programme in London as set out in the Final Determination of Prices for 2005-2010, being a total of 1,235 km of mains renewal in London
- To meet the reprofiled leakage targets, i.e. reducing leakage by an extra 5 Ml/d by 2009-10
- To meet the reprofiled Security of Supply Index ("SoSI") target securing the 2004 price review output of 100% by 2009-2010; and
- To submit a fully updated Water Resource Plan by 1 December 2006. (a plan was submitted by that date and subsequently remitted to the Company for further work).

1.2.5.2 Guaranteed Standards Scheme and Non-Financial data integrity

(a) Guaranteed Standards Scheme

In January 2006 Thames Water informed Ofwat that it had discovered that it had been:

- Failing to achieve required performance standards in customer services set out in the GSS; and
- Failing to make the payments due to customers as required under the GSS.

Under the terms of a notice issued by Ofwat (PN 21/06) on 19 July 2006, the company was advised that Ofwat proposed to impose a financial penalty for our failure to achieve customer service

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performance standards under the Guaranteed Standards Scheme (GSS).

Ofwat is required to issue notice within 12 months of the failure to achieve customer service standards and the notice applies only to those performance standard failures that have occurred since July 2005.

As a result Ofwat and Thames Water jointly appointed Ernst & Young LLP to carry out an independent investigation into these irregularities. Ofwat also asked Ernst & Young to examine whether there had been any mis-reporting of Thames Water's customer service performance to the regulator. Ernst & Young have concluded their investigation and have submitted their final reports to Ofwat.

(b) Non-Financial data integrity

On 7 June 2006, Ofwat issued notice under s.203(2) of the Water Industry Act 1991 stating that it considered that the company may have contravened conditions J and/or M of its appointment in providing information in its June Return which may not be reliable, accurate or complete. This notice would allow Ofwat to take steps to impose penalties on the company in respect of information contained in the June Return 2005 if it is satisfied that there has been any breach.

The company has been required to produce further information, as requested by Ofwat, which it has done in accordance with a mutually agreed timetable.

Any financial penalty which may be imposed in respect of each failure or breach may not exceed 10% of the Company's turnover as set out in Water Industry (Determination of Turnover for Penalties) Order 2005 No. 477. Thames Water's regulated turnover for 2005-06 was £1.4 billion.

2 OBJECTIVES AND STRATEGIES

2.1 Operational Strategy

The Company's operations are at the heart of the business, ensuring the achievement of regulatory outputs and the provision of good service to customers.

For AMP 4, the previous Board set the following strategic objectives:

- Focus on the UK regulated business
- Drive efficiency through the UK regulated business to outperform the key requirements set in the 2004 Final Determination
- Meet all regulatory outputs and deliver stable serviceability in all asset classes
- Improve the Company's reputation, credibility and trust with all its customers and other stakeholders
- Agree with Ofwat the best possible plan for AMP 5 to deliver value to shareholders and customers.

In addition, the previous Board set strategic objectives for the AMP 5 and AMP 6 price review periods to deliver long-term regulatory capital value growth through:

- Proactive large scale capital expenditure programmes, appropriately financed, aimed at delivering regulatory outputs in major areas
- Continuing with Victorian Mains Replacement ("VMR") to tackle legacy issues associated with security of supply and leakage
- Concentrating higher levels of capital maintenance on maintaining the integrity of underground assets

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- Developing new resources to increase water resource availability and therefore improve security of supply
- Delivering continuous out-performance of the Final Determination requirements for AMP 5 and AMP 6.

Under new ownership, the Company's strategy has a greater intensity of focus on the regulated business. The Company's ultimate parent undertaking has announced its intention to divest the majority of the activities undertaken by the commercial division of the Group. As a result, a number of collateral transactions affecting the Company are envisaged, including but not limited to transfers of assets, novation of certain contracts and assignments of intellectual property.

Individual members of the Executive Management Team are responsible for devising departmental strategies to achieve the required objectives in their own areas of responsibility, with performance reported monthly to the Board by the Chief Executive. These objectives include operating sustainably, improving environmental performance and reducing the Company's climate change impacts.

Key performance data is recorded and monitored through the Company's 'dashboard', which is updated monthly and available to all employees through the Company Intranet. The four key areas identified as requiring particular focus are:

2.1.1 Regulatory outputs

The achievement of regulatory outputs is essential, contributing to customer service, regulatory confidence, stakeholder credibility and corporate reputation. Key outputs include meeting annual targets for leakage and security of supply, and achievement by 2010 of stable serviceability for all classes of assets recognised by Ofwat.

2.1.2 Reputation and Transparency

The Company's corporate reputation is an important area of focus. The failure to meet the 2005/06 leakage target, while needing to impose a hosepipe ban as a result of the drought, led to much critical comment from the media and other stakeholders. The Company's reputation has suffered as a result, and research indicates that most of this is related to perceptions of performance on leakage. A sustained improvement in the Company's reputation must start with achieving significant long-term reductions in leakage and the delivery of improved customer service.

The Company needs to be transparent in the way it delivers and reports on the achievement of its targets. This will assist in building long-term reputation, credibility and trust with all stakeholders.

2.1.3 Customer Service

A significant improvement is needed in the service provided to customers, as measured by Ofwat's customer service rankings and by independent assessments of customer satisfaction.

2.1.4 Efficiency

The Company needs to achieve efficiencies in both operating costs and capital investment. Agreed capital outputs must be delivered within the total funding allowed in current price limits. Operating costs must be no greater than allowed in price limits by the base year for the next Price Review (PR09).

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Operating and Financial Review ('OFR') (continued)

2.2 Health and Safety Strategy

The overall Health and Safety objectives of the Company are to:

- Prevent injury to employees and others affected by its work
- Prevent damage to property
- Control accident potential and ill health
- Ensure co-operation and effective communication at all levels

- Continually improve health and safety management.

The Company has in place the necessary policies and arrangements intended to embed those objectives in the business and monitor their effectiveness.

The primary health and safety risks that the Company manages on a day-to-day basis are:

- Work on or near deep water
- Construction and tunnelling
- Machinery
- Streetworks
- Confined space work
- High voltage electricity
- Occupational health hazards
- Chemicals and gases
- Manual handling

Details of accident and incident rates, etc. can be found in Table 1 at the end of this report.

3 CURRENT PERFORMANCE

3.1 Water Service

3.1.1 Leakage

The Company has delivered leakage savings that have met the required target for 2006/07, by a considerable margin. This is gratifying for the Company, and particularly for the individuals whose efforts have made it possible, but customers and stakeholders should be able to expect this as 'business as usual' and that is unequivocally the Company's intention.

This year's achievement follows an acceleration of the Company's Victorian Mains Replacement (VMR) programme and the development and implementation of a Leakage Action Plan that provided a stronger focus on the efficient targeting of detection and repair activities. One of the key components was a winter contingency plan incorporating measures to ensure the right level of resourcing, predictive weather impacts modelling and severe weather contingency planning. This Plan was fully implemented during the winter of 2006/07 and, together with new optimised pumping schedules introduced in London, made a major contribution to meeting the leakage target.

3.1.2 Security of Supply Index

The Company also delivered improvements to security of supply beyond the required target, largely due to its success in reducing leakage in London. The Security of Supply Index (annual average) for 2006/07 is reported as 57.3 against a target of 40. The forecast for the remainder of the AMP4 period is that the Company will meet the targets set out in the Section 19 Undertaking given to Ofwat, but with a deficit remaining in 2009/10 due to the Company's planned desalination plant now being

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unlikely to be available in that time scale.

The majority of the schemes to deliver new water resources or relieve network constraints are progressing as planned. There have been two changes since the Company's 2006 Water Resource Plan was submitted. The first is the early delivery of the North London Artificial Recharge Scheme (NLARS) Extension and the second is the revised schedule for the desalination plant (see section 3.5.1 below). An extra schemes list has been developed to review a wider selection of potential opportunities.

3.1.3 Drought and Water Efficiency

The second driest period in the last 100 years began in November 2004. From then until August 2006, 19 out of 22 consecutive months experienced below average rainfall. This led to low groundwater levels, resulting in flows in local rivers being at between one half and a third of their normal levels. Throughout this period the Company worked closely with the Environment Agency and neighbouring water companies to make best use of available resources and plan for all contingencies. An Event Team was set up to manage the situation as it developed. This was chaired at director level, with technical staff dedicated to managing the event, under a full-time Project Manager. Company technical specialists from all disciplines were brought in as required.

The Company introduced a hosepipe and sprinkler ban on 3 April 2006 to help ensure best use of limited supplies and protect the environment. The restrictions applied to the entire Company area and were the first to be imposed for 15 years. The restrictions were lifted on 18 January 2007 following substantial autumn and winter rainfall.

Throughout the spring and summer of 2006, the Company ran a communications campaign to encourage customers to reduce their use of water. This helped achieve an average reduction in demand of about 7% from March to September 2006, saving enough water to supply more than one million customers.

The promotion of water efficiency to customers is an integral part of the Company's approach to managing the supply demand balance, and became more critical during the drought. The Company undertook 1,435 commercial audits in 2006/07 and, in addition carried out 897 household audits. There was an encouraging take up of free water savings devices by customers, with an estimated 225,000 devices installed. This represented a 190% increase in activity on the previous year.

3.1.4 Drinking Water Quality

The Company delivered an improvement in drinking water quality as measured by 490,000 drinking water quality tests during the calendar year 2006. Water quality tests carried out at customers' taps showed we achieved 99.98% compliance with national and European standards. This compares with 99.95% for calendar year 2005 and restores the Company to a leading position within the industry.

3.1.5 Pollution incident

The Company regrets that water discharged from a burst main in the Aylesbury area caused sediment and silt to enter a nearby watercourse. There were no long-term effects and the lessons learnt from this unusual event have been used to improve operational practices.

3.1.6 Metering

30,168 properties had a free meter installed under the optional metering process during 2006/07. This is more than twice the expected number. The AMP4 regulatory output of 62,770 is now expected to be exceeded before the end of the regulatory period.

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This is the second year of the Change of Occupier (selective) metering trial as part of the AMP4 five-year plan. The two original trial areas, chosen as being representative of areas with high supply/demand issues, were supplemented with additional areas to ensure delivery of the programme. In addition, the Company committed to deliver a further 1,000 installations during this regulatory year to help deliver the required Security of Supply Index (SOSI) performance. In total, 17,036 selective meters were installed in the year, against a target of 16,445.

3.1.7 Water Services Serviceability

All water infrastructure and non-infrastructure serviceability measures have either seen a continued improvement or have been held broadly stable in 2006/07. The Company experienced 12,196 mains bursts during the year. This is the lowest total for six years and a clear reversal of a previously deteriorating trend. The number of connected properties suffering from low pressure was at an all time low of 0.03%. The Company is working hard to reduce the level of unplanned interruptions to supply. Extensive root cause analysis has been carried out to understand the characteristics and drivers for previous events and a targeted strategy is being implemented, but meeting the regulatory target by 2007/08 remains a significant challenge.

3.2 Sewerage Service

3.2.1 Sewage Treatment Works Compliance

The effluent compliance of the Company's sewage treatment works is measured on a calendar year basis. The number of works failing numeric consents set by the Environment Agency at 31 December 2006 was 18, a slight improvement on the 2005 position. The population equivalent served by works failing consents was 3.3%, an increase on 2005, mostly due to a failure at one large treatment works. However, the Company's intensive action plan to recover compliance at 156 works is taking effect. By June 2007 the number of failing works had reduced to one.

3.2.2 Pollution Incidents

The Company's incident avoidance process has been working successfully. There was a 33% reduction in the number of incidents compared to 2005. For calendar year 2006 there were 34 incidents in Categories 1 – 3, compared to 51 in 2005.

3.2.3 Sewer flooding

The Company delivered solutions to 830 properties suffering internal flooding from overloaded sewers, exceeding the target for 2006/07 and making up for the delivery shortfall in 2005/06. It also met and exceeded the target for a net reduction in the register of properties suffering from flooding at least once in ten years. This was despite a significant increase in the number of new flooding incidents in 2006/07, largely as a result of eight severe storm events in 2006.

The Company has implemented a new process to manage sewer-flooding incidents. This has been designed to prevent as far as possible the development of a backlog of properties where there has been no investigation as to the cause of flooding. Under this process every property suffering any internal flooding incident, or an external flooding incident due to overloaded sewers, will receive a visit from a Network Engineer within 5 days of the incident. A report on the cause of flooding will then be compiled.

Due to the large increase in sewer flooding incidents experienced in 2006/07, the Company was unable to meet all its targets and concentrated its efforts on internal flooding. This was disappointing, but the process has greatly improved the Company's understanding and gives greater confidence that properties are entered onto the correct registers in a timely fashion. The Company will review this process and monitor performance over the coming year.

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Operating and Financial Review ('OFR') (continued)

3.2.4 Sewerage Service Serviceability

The total number of sewer collapses in 2006/07 was 530, compared to 916 for the previous year, and well below the target agreed with Ofwat as representing stable serviceability. This low value is principally due to the low number of gravity sewer collapses, attributable to the dry weather during the summer, as well as more rigorous enforcement of the definition of a reportable collapse.

Despite the low number of collapses the Company has continued with its extensive programme of inspections to identify and enable repair to sewers where there are integrity issues. This year the Company completed inspection of over 3 times the length surveyed last year, which is 36% above the level identified in the Serviceability Action Plan. The total comprised some 1739km of sewers, 651km of which are critical sewers. This includes programmes to inspect sewers with high consequences of failure, for example sewers below railways.

The programme of sewer repairs generated by these inspections has also increased since last year with a total of 68km (up from 37km last year) of sewers replaced or rehabilitated throughout the year, including 50km of critical sewers.

The Company's pollution prevention work is progressing and over 2500 visits to commercial and food preparation premises have been carried out to ensure that customers are using the sewerage system appropriately. This, together with a variety of other measures, is thought to be the reason for a reduction in pollution incidents arising from the sewerage network of some 22%.

3.3 Customer Services

3.3.1 Customer contacts

The Company delivered a significantly improved level of service in response to contacts, responding to 99.8% of billing contacts within 5 days and to 99.7% of written complaints within 10 days.

3.3.2. Meter Reading

Performance on meter reading improved, with 99.2% of metered accounts receiving a bill based on a meter reading, but the Company recognises that a further improvement will be needed to reach the regulatory target of 99.73% in 2007/08.

A major contribution to this year's improved performance was the rollout of the Meter Reading System Sustainability project in August 2006, which introduced an automated system of hand-held terminals for meter readers. The Company also increased the number of meter reading staff and introduced a resource planning tool to provide greater visibility and control of the workloads for all meter readers. A forecasting model is being developed, to enable accurate planning of headcount requirements for the delivery of operational targets.

From December 2006 the Thames Water website has been able to accept meter readings from customers. Customers fill in an online form that generates an email to a team within Customer Services who then bill the account accordingly.

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Operating and Financial Review ('OFR') (continued)

3.4 Key Performance Indicators ("KPIs")

The Company's Key Performance Indicators are shown at Table 1. They are based on the 12-month regulatory year, not the 15-month financial period covered by these accounts.

The Company has a number of focused key performance indicators that it uses to manage business performance. These centre on stakeholder and regulatory requirements, including shareholder returns, regulatory targets, and compliance requirements (for example as to water quality). The source of the underlying data is based on:

- financial statement figures for EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation), and Regulated Capital Expenditure ("Capex") spend, and;
- internal Company data that has been audited by the Company's Reporter (Halcrow Management Sciences Limited, see Note 2 page 28) in the case of the Water Service, Wastewater Service and Customer Service KPIs included in the June Return filed with Ofwat.

The Company's KPIs are grouped together in the Company's 'dashboard' which is updated monthly and provides an 'at a glance' view of performance to the Board, management and staff.

3.5 Looking Ahead at Key Operational Issues

3.5.1 Leakage and Security of Supply

Reducing leakage remains the Company's biggest priority – especially in London, where the level of leakage is still above the national average. Over the five years to 2010 the Company intends to invest more than £500,000 a day to reduce leakage: a total of around £1.15 billion.

The Company's Victorian Mains Replacement (VMR) programme will provide the majority of the reduction in leakage as old pipes are replaced by new in the leakiest parts of London. Although this work inevitably involves some short-term disruption to residents and commuters, it will bring many long-term benefits, most importantly a reduction in the potential for future bursts and leaks, thereby lessening the need for unplanned streetworks. A great deal of effort is devoted to minimising disruption – for example, as much work as possible is completed using 'no dig' technology, which removes the need to dig long trenches along streets.

The Company will also continue to improve the targeting and repair of leaking mains. The development of a Leakage Action Plan in 2006 has led to many process improvements being identified, which will continue to be implemented throughout the coming year.

In addition to accelerating efforts on leakage and mains replacement, the Company will be delivering a number of new water resources schemes, increasing efforts on water efficiency through more water audits with its customers, and continuing to expand its metering programme in order to meet targets for restoring security of supply.

To achieve security of supply by the end of AMP 4, the Company is dependent on the construction and commissioning of its first desalination plant, in East London. This plant has been the subject of a planning inquiry for which the outcome was announced on 14 June 2007. The Secretary of State for Communities and Local Government and the Secretary of State for Environment, Food and Rural Affairs accepted the decision of the Inspector who held the public inquiry that the appeal should be allowed and that planning permission should be granted subject to an amended Section 106 Unilateral Undertaking, which will formally refer to the agreement of the parties as to the appointed use of the desalination plant. The Company has taken steps to partially mitigate the delay to the desalination plant as described in section 3.1.2 above and has brought forward several water resource schemes as well as investigating sources previously assessed as uneconomic.

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Operating and Financial Review ('OFR') (continued)

The Company is also carrying out a large engineering project to improve the way that it supplies water. This is called the 'Network Improvement Project' and has two main areas of work:

- dividing up large water supply areas (known as zones) into smaller areas in order to deliver water more efficiently and meet local demands, referred to as 'zonal reconfiguration'.
- carrying out 'pressure management' to reduce the strain on water mains, caused by variations in pressure throughout the day and night as people's demand changes, and thereby reduce the likelihood of bursts.

3.5.2 Ensuring Water for Future Generations

The Company's water region is one of the driest in the UK. London actually receives less rainfall each year than cities which are generally perceived to be much drier, such as Rome, Dallas and Istanbul. About 24% of water supply is derived from groundwater and 76% from rivers. Licensed abstraction in the Company's catchment is equivalent to 55% of the effective rainfall, making this one of the most intensively used catchments in the world.

In order to ensure there is sufficient water to supply the Company's drinking water customers, both now and in the future, the Company needs to manage its water resources, treatment and distribution efficiently and effectively. The Company also needs to help customers to use water more efficiently – current use in the water region is an average of 159 litres of water per person per day - and demand is rising as a result of population growth, smaller households, changing water-use habits and climate change. The importance of this was highlighted in the drought of 2005/06 (see section 3.1.3), but the Company has had a comprehensive water efficiency strategy in place for over ten years, focusing on raising customer awareness of the need to use water wisely and providing water saving advice and access to water saving products.

To meet these long-term water resource challenges, the Company is committed to a 'twin-track' approach, addressing both the management of demand for water, and developing new schemes to increase supplies.

The long-term supply and demand strategy is set out in the Company's Water Resource Plan, which was updated towards the end of 2006. Each water resource zone is assessed in terms of supply capability and expected demand. The assessment takes into account future trends including demographic, legislative and climate changes. On the basis of these assessments, the Company plans demand management activities or resource development schemes.

Even with major progress on reducing leaks and encouraging water conservation, the Company is still anticipating a significant shortfall between demand for water and the amount it can supply during a drought, and a deficit in supplies into the future. The Company is currently working on two major proposals to supplement water resource availability:

- A proposed desalination plant in east London, which would use reverse osmosis technology to convert brackish water from the Thames estuary into drinking water
- The Upper Thames Major Resource Development Project, a proposed new reservoir that would boost supplies to London and parts of the Thames Valley from about 2019. The project is currently in the pre-planning phase, with an Environmental Impact Assessment ("EIA") being undertaken, and will form part of the Company's 2008 Water Resource Plan.

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Operating and Financial Review ('OFR') (continued)

3.5.3 Drinking Water Quality

The Company is not complacent about maintaining its high standards of drinking water quality. The coliform (Note 3 page 28) compliance at water treatment works was of concern, with 12 failures recorded at eight works, although the results did not affect the overall compliance figure. An improvement programme has been agreed which is expected to lead to some immediate improvements during 2007/08, although some actions will take a number of years to complete.

3.5.4 Sewerage Service

The Company is committed to improving its performance on wastewater compliance and is delivering a plan to return to stable serviceability for its non-infrastructure sewerage assets. The key components of the plan are an increased number of front line operators, additional training for operators, increased sampling of influent and effluent, and increased investment at all treatment works identified as being at risk of failing consent standards.

The disposal of fats, oils and greases into sewers is responsible for approximately one half of the total blockages (60,396 in 2006/07) dealt with by the Company every year. These solidify and cause blockages that reduce sewer capacity, causing flooding and consequent pollution of watercourses. To combat this, the Company will continue its programme to reduce blockages through proactive sewer cleaning, research and customer education.

By April 2007, the Company will have completed CCTV surveys of 1,600 kilometres of sewers. This has enabled the identification of sewers in need of renovation to avoid collapse. The Company will deliver this renovation programme during the remainder of AMP4 and continue with its CCTV programme to inform plans for AMP 5 and beyond.

The Company will continue to deliver solutions for properties affected by flooding from overloaded sewers, aiming for a further 3,570 properties to have been alleviated by April 2010.

3.5.5 Thames Tideway Tunnel

The River Thames can be affected by sewers overflowing during heavy rainfall. Generally, in winter, the higher river flow means that little, if any, environmental damage is caused. However, in summer, the river flows are generally lower so discharges may reduce the levels of oxygen in the water, resulting in fish and other aquatic life being killed. There are also aesthetic impacts from sewage-derived litter and health impacts on recreational users of the river. The Thames Tideway Strategic Study assessed a number of possible options and concluded that the best technical and value for money solution was a storage and transfer tunnel running under the river. This tunnel, almost 35km long and over 7m wide, will intercept storm discharges and take storm sewage to Beckton sewage treatment works in East London. The Government concluded in March 2007 that the tunnel should be built, in order to comply with the EU Urban Waste Water Directive. On current estimates the project will cost approximately £2 billion and is expected to be completed around the year 2020. The Company is currently in discussion with Ofwat to ensure appropriate funding for this project.

3.5.6 2012 Olympic Games

Thames Water Utilities Limited is working with the Olympic Delivery Authority to ensure adequate water supplies and sewerage services are available for the Olympic Park and other facilities associated with the London 2012 Games, within the Company's statutory area.

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Operating and Financial Review ('OFR') (continued)

4 RELATIONSHIPS AND RESOURCES

4.1 Employees

The employees of the Company have continued to demonstrate enormous commitment and dedication during a difficult period. Operational issues such as leakage, security of supply and a potential drought have had to be tackled against a backdrop of uncertainty as to the future ownership and structure of the Company.

Upon acquisition by Kemble Water, there were a number of senior management changes and organisational restructures including the appointment of a new Chief Executive, Chief Operating Officer and Board of Directors.

A new People Strategy has been developed in partnership with the trade unions, which seeks to develop a positive working environment that celebrates diversity and inclusion, and which provides excellence in HR solutions, products and processes. This strategy has introduced a new Performance and Development Review process for employees, aiming to make the most of everyone's contributions and potential by directly linking personal performance with the core objectives of the business and its values.

The Company recognises the importance of having a positive employee relations climate and has reaffirmed its commitment to working in partnership with its recognised trade union.

Given the change of ownership there has been a focus on ensuring that effective communication channels operate throughout the organisation, with briefings taking place with both management and staff to increase understanding of the management structure, ways of operating and business plan.

Staff turnover increased from 8.2% in 2005 to 14% in 2006. The increase largely reflected the loss of approximately 222 employees through redundancy related to restructuring and streamlining of business operations. However, overall headcount in 2006/2007 increased as the Company increased the number of people working on the top business priorities, e.g. growing the number of people dedicated to fixing leaks and replacing Victorian Water Mains. The average headcount for the period was 5,285 Full Time Equivalents (FTE), reducing to 5,119 FTE as at March 2007. In addition 46 graduates were recruited to the Graduate Programme and 45 modern apprentices were hired. Reported sickness absence was 3.0% for the period.

4.2 Stakeholders

Establishing and maintaining relationships with stakeholders is of vital importance to the Company. Stakeholders represent important constituencies and can have considerable influence over the Company's operations and, ultimately, business success. The Company's approach to engaging stakeholders is a two-stage process. The first is to make contact and understand expectations and aspirations; the second is to manage the issues that emerge from stage one and the ongoing relationship.

Key stakeholder groups include regulators such as Ofwat, the DWI and the EA (dealt with separately at section 1.2 above), domestic and commercial customers, CCWater, Local and Regional Authorities; MPs and MEPs, Natural England, local interest groups, employees, Trade Unions, suppliers and contractors. In addition, the Company has a specialised sub-set of stakeholders interested primarily in financial performance, such as the capital markets.

The Company maintains contact with stakeholders both reactively and proactively. Key stakeholders (those organisations with whom the Company has contact on a range of issues) have a designated lead contact within the Company, with responsibility for keeping in touch and ensuring good two-way

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Operating and Financial Review ('OFR') (continued)

communications. Other stakeholders are contacted on an 'issues' basis, often through workshops designed specifically to facilitate stakeholder engagement. There is a designated lead individual in the Company for each major issue.

The Company monitors customer and stakeholder expectations and perceptions on an ongoing basis, through quarterly customer satisfaction research and an annual reputation study. Both research projects provide a valuable insight into the way the Company is perceived and help to identify areas in which it should seek to improve performance.

4.3 Customers

The Company recognises the importance of good customer relations and improving customer service. A review is currently being carried out on how to incorporate customer concerns more effectively into its day-to-day business operations.

There are several channels through which customers and the Company can contact each other, including by post, telephone or e-mail. In addition, an online facility (see section 4.5) has recently been established for customers to advise the Company of a change of address and to leave meter readings. The Company intends to increase its facility for customers to 'self-serve' where this improves customer experience and meets expectations.

The Company's Customer Service Centre looks after all types of customer, including domestic, vulnerable, small/medium enterprises, large key accounts and commercial chains. It is responsible for billing and collecting payment for water and sewerage service charges and also acts as the front-end for service delivery, handling contacts from customers about their water supply and sewerage services. The main contact medium is by telephone – the contact centre receives over 4 million calls annually - including self-service options for billing enquiries.

The Company's Customer Assistance Fund continues to encourage customers on low incomes to act responsibly through sensible budgeting. More than 5000 customers have been helped by the fund since it was set up in 1997, with approximately 700 joining in 2006/07.

The Company continues to offer a Vulnerable Tariff Scheme to help households with a metered water supply that receive certain benefits and have a need to use more water than average. This capped tariff ensures that these households are not placed at a disadvantage by their genuine need to use extra water. More than 2000 customers are benefiting from this scheme with 631 joining in 2006/07.

The Company works closely with CCWater on major strategic projects as well as all aspects of customer service. The aim is to establish an ongoing dialogue with regard to customer complaints, wastewater operations and security of supply, building on the regular public meetings of the CCWater Thames and Western regions. Looking forward, there are major strategic themes, such as the 2009 Price Review, wider metering and affordability, where CCWater will play an important role in informing and guiding the Company's long-term plans.

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Operating and Financial Review ('OFR') (continued)

4.4 Key Suppliers and Contractors

In 2006/07 the Company spent just in excess of £1 billion on construction, goods and services with a range of suppliers and contractors. Approximately 20 key suppliers were engaged with a spend greater than £10 million each. The Company's policy is to establish trading arrangements which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Company's corporate responsibility commitments and where applicable comply with the requirements of EU Directives on Utility Procurement.

The Company's main trading arrangements during 2006 continued to be based on "performance partnering". This term describes long term commercial arrangements, collaborative working, transparency of costs, open access to all activities and processes to eliminate waste and inefficiency, continuous improvement against stretch targets and a rigorous performance regime which provides continuity of work for good performers and reduced work followed by replacement for poor performers.

Performance partnering agreements for operational support activities are based on the above approach and a number of changes to supplier workload have occurred during 2006.

On capital projects, target costs are set by the Company and, if not agreed by a performance partner, are subject to contestation by other contractors. Large projects (above £7m for network and £15m for process) are competitively tendered and a proportion of lower value projects are competitively tendered as a benchmark to performance partnering. This strategy is under review and a move to replace the target cost approach with fixed prices or capped rates where appropriate is under consideration.

The Company is committed to continuously reviewing procurement processes in the light of developing procurement best practice in the area of sustainability. We recognise that our environmental responsibilities extend beyond the direct environmental impact of our process plant and infrastructure. Our procurement policies require these issues to be assessed as part of all significant purchases.

4.5 Internet

The Company's website (www.thameswater.co.uk) is an important communications tool that aims to meet the information needs of the Company's stakeholders. The website supports the Company's brand and values and provides a key outlet for the Company's messages. The content and functionality are being steadily improved in response to feedback. In addition, a number of developments have been planned specifically to cater for the clearly expressed wish of a growing number of customers to 'self-serve' online. The ability to provide answers to many customer questions, at any time of the day or night, and without the direct involvement of an employee, or the cost of a telephone call or letter, offers a significant opportunity to reduce costs while meeting expectations. During 2006/07 the site received an average of 236,733 'hits' per day.

4.6 Research and Development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. R&D deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP4 and PR09 and also provide specialist technical support to the business. Expenditure on research and development totalled £5.9m for the 15 month period end 31 March 2007 (year ended 31 December 2005: £5.3m).

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Operating and Financial Review ('OFR') (continued)

4.7 Intellectual Property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

5 ENVIRONMENTAL MATTERS

The Company is closely linked to the environment in everything it does, and has a range of policies in place to govern its impacts and interactions with the environment. In addition to overall environmental and corporate responsibility policies, it has a range of detailed policies on various topics, as set out below.

The Company monitors performance against its policies and related environmental targets, reporting results in its annual Corporate Responsibility Report, which can be downloaded from the Company's website or obtained from the Customer Centre, PO Box 436, Swindon, SN38 1TU.

5.1 Waste Management

The Company continues to manage its waste streams following the principles outlined in Defra's waste guidelines. Waste streams are split into operational waste, capital investment works waste, and general office waste.

Support provided by the Company to its construction partners reduces the amount of waste going to landfill. In 2006/7, the Company incorporated Site Waste Management Plans into the design stage of every capital programme costing more than £200,000. These plans identify potential waste at the earliest design stage in order to minimise amounts produced and help monitor waste management.

New technologies and innovative solutions to minimise waste and increase recycling are being constantly explored. As an example, sewage sludge is the main waste produced in the treatment of wastewater. The Company aims to utilise this material in a beneficial and sustainable way. Recycling treated sewage sludge (also known as biosolids) to agricultural land is its main outlet. Incineration of sewage sludge at Crossness and Beckton incinerators is the second major disposal route for sewage sludge, generating renewable energy.

The Company has been successful in recycling the ash produced during incineration of sewage sludge. The ash has been found to be an excellent replacement for aggregate and can be used in many different ways, such as in highway works. In 2006, 91% of this ash was successfully recycled.

5.2 Climate change

Climate change presents the Company with a serious dilemma. All parts of the business are likely to be affected by seasonal droughts, hotter and drier summers, generally wetter winters and more extreme events such as flooding. However, the Company is also a significant producer of greenhouse gases because it needs to use large quantities of energy to pump and treat drinking and wastewater. As treatment standards become more demanding, energy use generally rises and the Company's potential climate change impact will increase.

Since the Company operates in one of the driest and most densely populated parts of the UK, and in a sector that will be particularly sensitive to the impacts of climate change, it faces a very real challenge. The recent prolonged drought highlighted many of the difficulties ahead. The Company is committed to reducing its climate change impacts and to building adaptation into the way its business is operated.

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Operating and Financial Review ('OFR') (continued)

Following the publication of its climate change policy, the Company has now developed an integrated Climate Change and Carbon Management Strategy. This is expected to be adopted in the coming year. The strategy tackles adaptation to climate change and the steps the Company can take to mitigate its impacts. Both approaches are essential if the Company is to sustainably deliver its regulatory responsibilities and meet wider stakeholder requirements in the future.

The strategy aims to provide clear targets and deliverables across the whole of the Company's business. It builds on substantial related activity already underway, including water resource planning, energy efficiency, renewable energy generation, and waste minimisation. However, the extent to which the strategy can be implemented will depend on the way the Company's regulators choose to treat funding for climate change mitigation and adaptation at the next price review.

5.3 Energy Efficiency and Renewable Energy

The Company's greenhouse gas (GHG) emissions for 2006/07 were 1,467,7440 tonnes CO₂ equivalent. This represents a reduction of 12.13% when compared to the 1990 baseline (normalised per megalitre of water supplied and wastewater treated).

Overall, in 2006/07 the Company consumed 1,193 gigawatt-hours (GWh) of electricity, of which 85.2% was purchased from outside the Company and 14.8% was self-generated (compared to 12.6% in the previous twelve months). Over this period the Company produced more renewable electricity than ever before, generating 157 GWh from its 20 combined heat and power (CHP) engines and two incinerators.

In October 2006, the Company appointed an Energy Efficiency Manager who began a programme to assess and improve energy performance at 89 of its largest treatment works and pumping stations. The work complements an ongoing project to improve performance of pumps across the Company's operational sites through comprehensive testing and refurbishment.

The Company also conducted a detailed energy audit of its Clearwater Court headquarters and implemented the energy-saving measures identified. This resulted in a 40% decrease in energy consumption at the site. It is estimated that this will save almost 400 tonnes of CO₂ emissions every year, based on current headcount.

5.4 Biodiversity

The Company's reservoirs and landholdings act as a significant biodiversity resource across London and the Thames Valley, offering opportunities for nature conservation and, where appropriate, public access and recreation. The Company works to protect and enhance biodiversity on these sites and also across its wider landholdings, having surveyed over 800 sites to establish their biodiversity interest and running an annual programme of enhancements.

The Company was pleased to win a national conservation award in 2006, for its Crossness Nature Reserve and Southern Marshes project, in partnership with Bexley Council and Groundwork South East London, and with additional funding from the Office of the Deputy Prime Minister. This £500,000 project has seen the restoration of one of the last remnants of grazing marsh in Greater London, and a range of access enhancements. As a result, people and wildlife have been brought closer together in east London.

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Operating and Financial Review ('OFR') (continued)

6 SOCIAL AND COMMUNITY

6.1 Engaging with Communities

The Company's business activities make it an integral part of a wider society. The Company aims to understand what others expect of it and to look for opportunities to work in partnership with them. There is a clear commitment to engaging positively with all the communities served, and to minimising any negative impacts that the Company's activities may have.

Compared to previous price preview periods, AMP 4 involves a much larger number of highly visible construction projects, causing unavoidable disruption for customers and local communities. (e.g. VMR and sewer flooding alleviation). The Company has appointed designated coordinators to oversee all communications relating to specific projects. This ensures a consistent, proactive approach across the Company and ensures that messages are delivered effectively to those customers most affected by the work. For example, prior to mains replacement work, local drop in sessions are held and a series of information letters are sent, at various stages of the work, to residents and businesses in the area. The Department for Transport has included this approach in its best practice guide for streetworks.

6.2 Community Investment

The Company's Community Investment Strategy focuses on three water-related themes: environment, education and healthy living. During 2006/07 the Company developed and launched the first in a series of resources to support primary school teachers. The 'Aquabatics' pack is a lively and engaging introduction to the water business for Key Stage 2 pupils. It includes a variety of activities and information on topics such as responsible disposal of waste and saving water at school and at home. The materials and supporting DVD are available free of charge from the Company's website to all teachers in the catchment area.

Sport is a key element of the Company's water and healthy living theme. In July 2006 the Company was official water supplier to 16,000 participants at the London Youth Games and to runners in the 2006 Sports Relief Mile event held on London's embankment. The Company also sponsored the Total Swimming 'Aquateers' programme, creating a 'one-stop-shop' of guidance, activities and resources for the next generation of swimmers.

The Company was pleased to continue its partnership with the Greater London Authority and the Mayor of London's office through the London Schools Environment awards. These awards are intended to develop children's sense of responsibility for the environment. Thames Water staff assisted with school projects on water and the environment during Volunteer Month in March 2007.

The Company was designated a 'London Region Urban Tree Champion' in March 2007 for its long-standing contribution to improving the urban environment through the 'Trees for Cities' partnership.

The Company also worked with Age Concern and the Metropolitan Police to promote the importance of drinking water to stay healthy in old age. More than 60 local residents came to the event which also raised awareness of the dangers of bogus callers.

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Operating and Financial Review ('OFR') (continued)

6.3 Employee Volunteering

The Company continued its 'Time to Give' employee volunteering scheme which allows staff to spend two days a year working with charity partners, including WaterAid, the Royal Society for the Protection of Birds and Age Concern. A huge variety of activities were undertaken within the framework of the Company's long-standing strategic partnership with WaterAid. These activities resulted in over £366,300 being raised during the year by staff, pensioners and customers, enough to provide over 24,400 people in the developing world with safe water and sanitation.

The Company's employees also volunteered to tackle a number of environmental community challenges in 2006/7, including five in Swindon that involved work on a therapeutic gardening project, redecorating an infants' school and creating a huge mural at an educational city farm.

7 PRINCIPAL RISKS AND UNCERTAINTIES

7.1 Internal Control

Key features of the system of internal control and risk management are:

- A control environment with clearly defined organisation structures operating within a framework of policies and procedures covering every aspect of the business;
- Comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- Regular monitoring of risks and control systems throughout the year, supported by the use of risk registers;
- A self-certification process, whereby management are required to confirm that the system of internal control is operating effectively; and
- An internal audit function providing independent scrutiny of internal control systems and risk management procedures.

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the Board and to the executive management by heads of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks;
- Significant changes to the Company's overall risk profile are reported to the Audit & Risk Review Committee and the Board;

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- Standing reports to the Audit & Risk Review Committee from the Internal Audit Department; and
- Reports to the Audit & Risk Review Committee on the results of a self-certification process, and independent reports thereon by the internal audit department.

7.2 Risk Overview

The Company has developed an Enterprise-Wide Risk Management ("EWRM") approach to minimise the organisation's exposure to unforeseen events and to provide certainty to the management of identified risks. This is intended to create a more stable environment within which the organisation can deliver its strategic objectives. This approach allows the Company to identify and manage a continually updated risk portfolio, detailing the risks to the achievement of the organisation's strategic objectives. This is done by a process of consistent and replicable risk identification, assessment and escalation.

The Company is exposed to a number of potential risks and uncertainties that could have a material impact on its long-term performance. These comprise a mix of those of internal derivation (i.e. operational risks) and those of external origin (i.e. extrinsic risks).

7.2.1 Operational Risks

Operational Risks are defined as those that are intrinsic to company performance; they will remain a constant potential threat to the Company. They are, therefore, controlled via internal policies and procedures. Examples of significant operational risks are:

- **Failure to deliver the regulatory contract** – The Final Determination contains outputs for the Company covering capital investment and operating performance and efficiencies. Failure to deliver agreed targets may result in fines, intervention by Ofwat and less favourable future determinations.
- **Failure to comply with current laws or regulation** – The Company operates in a highly regulated and legislative environment. Regulatory and/or legislature changes could leave the Company in breach of one or more changes only until the point at which it had been able to re-align its business to comply with those changes.
- **Operational loss as a result of a failure to comply with internal processes** - The Company has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training. However it is only possible to be reasonably (not absolutely) certain that such procedures will be effective in controlling each of the operational risks faced by the Company.

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7.2.2 Extrinsic Risks

These types of risks are usually of a transient nature, outside of the normal macro-operating environment of an organisation and therefore outside of the organisation's control. They are usually only relevant during a finite time period and are, therefore, managed via unique and dedicated response plans. The Company has a risk management process for the identification of such risks before they become an issue, allowing influencing and other management responses to be adopted.

Examples of significant extrinsic risks are:

- **Future changes in laws or regulations** – The Company is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Company may, for example, have to meet the obligations resulting from changes in environmental legislation without recourse to Ofwat. However, changes that are specific to, or are more material for, the water industry will be funded by Ofwat as a relevant change of circumstance. This can be claimed at an interim determination of K if the impact meets the Ofwat materiality threshold, or claimed via logging up at the next periodic price review.
- **Managing increased competition in the water industry** – As a result of the reduction in the barriers to entry to the water industry the Company will have to meet the challenges posed by aspiring new entrants and the resultant effect of competition on its pricing schemes and modes of operation.
- **Increasing energy prices** – Whilst the Company continues to introduce increasing energy efficiency measures to offset the growing volumes of treated wastewater and clean water it is still affected by price fluctuations in the energy market.
- **The effects of climate change and long-term changes in weather patterns** - As the Company continues to supply a rapidly increasing population, the effects of climate change could adversely affect its ability to maintain Security of Supply Index (SoSI) requirements. Consequently, in addition to substantially enhanced demand management measures, the Company is currently making provision for increased storage capacity, greater network integrity and the development of new sources of potable water.

8 FINANCIAL KEY PERFORMANCE INDICATORS

Performance Measure	Unit	12 mths to Dec 05	15 mths to Mar 07
EBITDA (Operating profit plus profit on sale of fixed asset excluding depreciation and Infrastructure Renewals Expenditure (IRC))	£m	752.3	945.0
Regulated Capex Spend (Including IRC)	£m	558.5	919.7

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9 FINANCIAL POSITION

Turnover was £1,778.1m for the 15 month period (year ended 31 December 2005: £1,333.5m). Turnover has increased due to real increases in price, as agreed with Ofwat together with increases linked to the Retail Price Index (RPI). However, the impact of the summer 2006 drought has had a negative impact on income.

Profit on ordinary activities before taxation was £342.1m for the 15 month period (year ended 31 December 2005: £322.7m). Results continue to be adversely affected by increased provision for renewal of infrastructure assets in the next five years and costs incurred during the period in respect of drought management and fuel costs. These increased costs have been offset by continuing operational efficiency programmes.

The FRS 17 pension cost for the 15 month period was £28.5m (year ended 31 December 2005: £22.6m). To ensure our future pension obligations to employees are met, the Company pension scheme contribution rate has been increased. Further information about the Company's pension schemes is set out in note 24 on page 86 of these accounts.

Capital investment in the period has been particularly targeted towards leakage reduction, security of drinking water supplies to our customers, water and wastewater quality programmes and the alleviation of sewer flooding. Gross capital investment of £922.1m (year end 31 December 2005: £558.8m), including net infrastructure renewal expenditure of £136.4m (year end 31 December 2005: £41.8m), was made during the 15 month period. This continuing substantial investment programme is reflected in the depreciation charge of £404.5m (year ended 31 December 2006: £293.6m).

The Company paid interim dividends totalling £656.3 million during the period (2005: £155.0 million). The Board does not recommend a final dividend.

Details of critical accounting policies are given in note 2 to the Accounts on page 65.

10 CAPITAL STRUCTURE

10.1 Equity

The Company has an authorised share capital of 1,029,050,000 £1 Ordinary Shares, all of which are in issue. Thames Water Ltd is the beneficial owner of the entire issued share capital

10.2 Debt financing

Debt financing is raised by the Company or through the Company's wholly owned subsidiary, Thames Water Utilities Finance Ltd.

Moody's Investor Service rates the credit of Thames Water Utilities Finance Ltd as Baa1 on a long-term basis with a developing outlook. Equivalent ratings published by Standard and Poor's Rating Services are BBB+ long-term with a negative outlook. The Company's borrowings net of cash and short-term deposits of £3,236.1m million at 31 March 2007 comprised £2,889.9 million of bonds, £332.5 million of loans from the European Investment Bank (EIB – the Company's largest investor), £215.6 million of long-term leasing offset by £201.9 million of cash and short-term deposits, and £Nil million loans to other group companies.

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10.3 Treasury policy

The Company's treasury function operates with the delegated authority of, and under policies approved by, the Board of Directors. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of funding strategy are defined by the regulatory regime within which the Company operates and are to ensure that it meets all funding related requirements under the terms of its Licence, including maintaining access to undrawn committed bank facilities in order to fund at least 12 months net cash flow and to maintain necessary bank facilities and access to liquidity in order to maintain an investment grade credit rating as set out in the terms of the Licence.

10.4 Liquidity and resources

The Company's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cashflow statement on page 55 of the Accounts, in the financial year ended 31 March 2007 net cash generated from the Company's continuing operating activities was £863.4 million for 15 months, compared with £781.2 million for 12 months to 31st December 2005. Ofwat has established price increase limits to 2010, which will provide certainty for a large majority of the Company's revenues from ongoing operations, providing both a stable and a predictable source of funds.

10.5 Shorter-term liquidity

Short-term liquidity requirements are met from the Company's normal operating cashflow. Further liquidity is provided by cash and short-term deposit balances, supported by committed bank facilities and proceeds from bond pre-funding. Cash and short-term deposit balances were £201.9 million at 31 March 2007, compared with £10.3 million at 31 December 2005.

Intercompany loans from Thames Water Ltd, which are repayable in less than one year, were £Nil at 31 March 2007, compared with £86.9 million at 31 December 2005.

The weighted average rate of interest on intercompany loans was 5.5% (December 2005: 5.3%). The Company had available unutilised committed loan facilities from its ultimate parent company, RWE AG of £450 million (December 2005 £150 million), of which £450 million expired within one year (December 2005: £150 million). These committed loan facilities were repaid on the sale to Kemble Water. Post the sale, on 1 December 2006, the Company had available unutilised term committed bank facilities of £700m through facilities arranged at the holding company, Kemble Water Limited.

10.6 Longer-term liquidity

The Company has effective access to the debt capital markets through its £5 billion Debt Issuance Programme, which provides for the periodic issuance by its wholly owned financing subsidiary, Thames Water Utilities Finance Ltd, of debt instruments on terms and conditions determined at the time that the instruments are issued. This programme does not represent a funding commitment, with funding only becoming committed when debt securities have been successfully issued.

The Company arranged a new £150 million medium-term funding facility from EIB in the year, which remains undrawn at 31 March 2007. Other loans and obligations under finance leases were £3,093.1 million at 31 March 2007, compared with £1,997.5 million at 31 December 2005. Amounts repayable after more than five years comprise capital market obligations and other loans repayable between 2012 and 2055. Fixed interest rates, for amounts after more than five years, range from 1.680 per cent to 8.35 percent.

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

10.7 Interest rate and foreign currency management

The Board sets interest rate management and funding policies. The objective of interest rate management policy is to ensure cost of debt financing is within the cost of debt as set out in the regulatory contract while ensuring a prudent level of protection against interest rate volatility. At 31 March 2007, 91% of outstanding debt obligations were either at fixed rate or fixed index-linked rate. The Company has limited exposure to foreign currency exchange rate movements.

10.8 Capital Structure

Following the acquisition of Thames Water by Kemble Water Limited the company is undertaking a review of options with regard to capital structure, including consideration of whether to undertake a whole business securitisation of the regulated water company.

10.9 Summary

The Board has reviewed the business plan and considers that the Company has sufficient liquidity to meet the anticipated financial commitments for the next 12 months. In total, at 31 March 2007, unutilised committed facilities of £700 million expiring in more than one year, together with cash and short-term deposits of £201.9 million and undrawn funding from EIB of £150 million, provide substantial pre-funding for the Company.

Signed on behalf of the Board

David Owens
Chief Executive Officer

Notes:

1. A company that has been appointed to provide water and/or sewerage services to customers in England and Wales is known as an "undertaker". The Company's Instrument of Appointment - usually referred to as "the Licence" - was issued by the Secretary of State for the Environment in August 1989.
2. The Reporter is an independent engineering consultant who is under a duty of care to report to Ofwat on the accuracy of the June Return.
3. Coliforms are an indicator micro-organism that should not normally be present in drinking water.

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

Table 1 – Non-financial Indicators for 2006/7

The non-financial performance measures used by the Company are largely those used by Ofwat to measure the Company's performance against the regulatory targets set out in the 2004 Final Determination.

Further guidance regarding these Key Performance Indicators is provided on page 32.

Water Service

Measure	Unit	Actual 2005/6	Target 2006/7	Achieved 2006/7
Total leakage	MI/d	862 ¹	810 ²	790.3
Security of Supply Index:	SOSI	22	40 ³	57.3 (42.2 critical period)
DG4 – restrictions on use	Population Affected	0%	Restrictions less than 1 in 20 years	100%
Total mains bursts	No.	14,901 ⁴		12,196
Mains bursts per 000km	No.	479	377 to 412 ⁵	389
DG2 – water pressure number of properties	Properties %	1,338 0.04%	2,455 0.07%	1,189 0.03%
Increase in the DG2 register	Properties	4,572	-	223
DG3 – unplanned supply interruptions	Properties Index	32,171 0.97	0.49	30,636 0.93
Infrastructure serviceability assessment		Deteriorating	Deteriorating ⁵	Marginal
Drinking Water Quality (at the tap)	MZCP			
Water quality regulations	%	99.95%	-	99.97%
Iron	%	99.74%	-	99.78%
Cat 1 & 2 pollution incidents for water	Incidents	0	0	1
Non infrastructure serviceability assessment		Stable	Stable	Stable

¹ JR06 result was 894MI/d but after adjustment for wastage in houses was 862MI/d which is comparable to the JR07 target and actuals.

² Monitoring Plan target has been substituted by the revised target published by Ofwat in the security of supply, leakage and water efficiency report 2005/06.

³ Monitoring Plan target has been substituted by the section 19 undertaking target.

⁴ Mains bursts have been restated since JR06 following a change in reporting methodology.

⁵ Targets taken from Serviceability Action Plan submitted to Ofwat 18 November 2005.

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

Sewerage Service

Measure	Unit	Actual 2005/06	Target 2006/07	Achieved 2006/07
% of sewage works non compliant (WRA numeric consents)	%	4.9 *	2.0 *	4.5 *
% of sewage works non compliant (UWWTD consents)	%	1.6 *	1.3 *	1.3 *
% of total p.e. served by STWs in breach of WRA consents	%	0.76 *	0.5 *	3.3 *
% of total p.e. served by STWs in breach of UWWTD consents	%	2.21 *	0.5 *	0 *
Intermittent discharges deemed satisfactory	%	98.9	97.6	99.0
Sewage sludge managed in a satisfactory way	%	100	100	100
Pollution incidents process (STW) category 1,2 and 3	No.	51 *	30-50 * ¹	34
Sewerage non infrastructure serviceability assessment		Deteriorating	Marginal	Deteriorating
Total sewer collapses in the year	No.	898	1079 ¹	530
Sewer collapses per 1000km	No.	13.5	13.4 ¹	7.8
Pollution incidents at CSOs and foul sewers categories 1,2 and 3	No.	122 *	156 * ¹	95 *
Sewerage infrastructure serviceability assessment		Marginal	Deteriorating	Stable
DG5 – Properties at risk of internal flooding				
Twice in 10 years	No.	660	849	575
Once in 10 years	No.	3,065	4,560	2,599
Once in 20 years	No.	14,080	n/a	12,567
Properties flooded in the year:				
Internally flooded due to overloaded sewers	No.	495	236	648
Internally flooded due to other causes	No.	562	718	1,225
Externally flooded due to overloaded sewers	No.	162	347	1,117
Externally flooded due to other causes	No.	3,430	4,182	5,489

* Reporting based upon calendar years

¹ Targets taken from Serviceability Action Plans submitted to Ofwat

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

Customer Services

Measure (%)	Actual 2005/06	Target 2006/07	Achieved 2006/07
DG6 - Responding within 5 days to customer billing enquiries	99.6	99.2	99.8
DG7 - Responding within 10 days to written complaints	99.0	99.6	99.7
DG8 - Providing bills for metered customers based on a meter reading	98.65	99.73	99.24
DG9 - Calls abandoned	4.1	4.0	7.5 (including IVR calls – 3.67 excluding IVR)

Overall Performance

Overall Performance Assessment ("OPA") score	362		343
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Employees

People and Health and Safety:		Actual 2005/06	Target 2006/07	Achieved 2006/07
Absenteeism	%	2.9	n/a	3.0
Injury Rate per 1000 employees	No.	13.3	10.7	8.1

During the 15 month period there were no fatalities, prosecutions or enforcement notices directly affecting the Company. There were however, 56 reportable accidents in total. Four were 'major injuries' the remainder were injuries resulting on more than 3 days absence (as defined under the Reporting of Injuries, Illnesses and Dangerous Occurrences Regulations ('RIDDOR') 1995). As a result of these reportable injury accidents, 2003 days were lost in total. Also during the period, there were 6 'Dangerous Occurrences', as defined under RIDDOR.

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

Methodology and Calculation of KPIs:

1. Leakage (Total Rolling Average): This measure is based on a 12 month rolling average for operational leakage across the Company and is aligned with the Company's 'reported' leakage calculation approach as agreed with Ofwat.
2. SoSI (Annual): The security of supply index ("SoSI") describes the companies planned and reference levels of service for present and future water supplies for average demand in a dry year.
3. DG4 (Water restrictions): This indicator is a measure percentage of the population affected by hosepipe restrictions.
4. Serviceability (Infrastructure and Non-infrastructure): These indicators are based on the concept of serviceability to customers. Overall trends in a range of indicators that describe the performance of assets is examined and judgements are made as to whether the capital maintenance carried out by the Company over the period has resulted in stable, improving or deteriorating services to customers. The four classes of assets and the leading serviceability indicators are:
 - a. Water Infrastructure: Measured by the number of mains bursts
 - b. Water Non Infrastructure: Measured by drinking water quality
 - c. Sewerage Infrastructure: Measured by the number of sewer collapses
 - d. Sewerage Non Infrastructure: Measured by sewage works effluent compliance
5. DG2 (Inadequate Pressure): This indicator shows the number of connected properties that have received pressure below the reference level (10m head).
6. DG3 (Supply Interruptions): This performance indicator is based on proportion of connected properties subject to supply interruptions of >6, 12 & 24 hours converted to a points score.
7. Water Quality (mean zonal compliance): This measure indicates the Company's overall performance with regard to water quality across each water zone based on a basket of important water quality parameters.
8. Pollution Incidents – the number of pollution incidents occurring on either the water or waste network and treatment sites. A CSO is a Combined Sewer Overflow which diverts excess storm water and diluted sewage to a nearby watercourse. The categories are nominated by the Environment Agency and describe the severity of the incident.
9. STW Compliance (Water Resources Act 1991 ("WRA") Compliance): This indicator demonstrates performance of sewage treatment works against Environment Agency effluent consents based on the Water Resources Act 1991.
10. STW Compliance (UWWTD): This indicator demonstrates performance of sewage treatment works against the Urban Wastewater Treatment which is relevant for all sites with a population equivalent greater than 2,000.
11. Intermittent Discharges: These are consented discharges to watercourses that may be made from combined sewer overflows or storm tanks at sewage works
12. % of unsatisfactory sludge disposal: This indicator monitors the quality compliance of sludge production at the Company's sludge treatment works against agreed standards.
13. DG5 (Sewer Flooding - risk): This indicator examines company performance in respect of internal sewerage flooding of properties (no. of properties at risk of sewer flooding)
14. DG5 (Properties internally flooded in the year): These measures demonstrate the number of properties internally flooded in the year due to either hydraulic incapacity (overloaded sewers) or from other causes (sewer blockages, collapses or equipment failure)
15. DG6 (Billing Enquiries): This indicator shows the percentage of billing contacts that the Company responded to within five working days.
16. DG7 (Complaint Handling): This indicator shows the percentage of written customer complaints that the Company responded to within ten working days.
17. DG8 (Meter Reading): This indicator shows the percentage of metered customers who receive at least one bill during the year based on a meter reading taken by either the water company (or its representative) or the customer.

Thames Water Utilities Limited

Operating and Financial Review ('OFR') (continued)

18. DG9 (Call Abandon Rate inc. IVR, i.e. Interactive Voice Recognition): This measure indicates the abandonment rate of calls to the Company's advertised telephone numbers including those dropping out from the automated handling system
19. OPA (Overall Performance Assessment): This is a measure of a company's overall performance used by Ofwat to incentivise good performance and penalise poor performance at periodic price reviews. The measure is based on a weighted basket of operational, environmental and customer service performance.
20. Absenteeism: This measure indicates the average percentage of their time that employees were unavailable based on sickness.
21. Injury Rate: This is the year to date measure for lost time associated with incidents per 1000 employees. The goal is for significant reductions, however the Company aspiration is for zero or as low levels as are realistically achievable.

Commentary on the Company's current and future performance against these measures is contained in section 3.

Thames Water Utilities Limited

Corporate governance

Compliance Regime

The term 'corporate governance' is generally taken to refer to the supervision of how a company is run and how the risks to its business are managed. It embraces regulation, corporate structure, and the function of the Board of Directors.

The Company's shareholders and directors are all committed to maintaining high standards of corporate governance. This commitment is underpinned by the fact that, under the terms of its Licence from Ofwat, the Company is required to pay particular regard to the Combined Code on Corporate Governance (the "Code"), which is something that generally applies only to companies whose shares are listed on the London Stock Exchange. The introduction to this document acknowledges that departure from the Code's provisions may be justifiable in particular circumstances. As the Company is a wholly-owned subsidiary of a privately-owned group, the Board considers that a significant number of the provisions of the Code are not directly applicable, since the Company's shareholders have already established a written framework governing the material aspects of the day-to-day operation of all companies within the Thames Water group as a whole.

An explanation of specific areas of non-compliance with the July 2003 version of the Code (which is applicable to the period ending 31 March 2007) is set out below:

- **Section A.1.1:** Certain matters are reserved to the Board of Kemble Water Holdings Limited. There is a schedule of matters delegated to executive management but there are no formal schedules in place for matters reserved to intermediate company boards, including that of Thames Water Utilities Limited.
- **Section A.1.3:** There is no senior independent non-executive director ("SiNED").
- **Section A.2.2:** The Chairman was not independent at the time of appointment and the shareholders' agreement was modified accordingly.
- **Section A.3** The composition of the board is governed by Ofwat's requirements as described by the Ofwat consultation document (see "Board Membership" below).
- **Section A.3.3:** Although three of the directors are considered to be independent non-executive directors ("iNEDs") none of them has been formally appointed as the SiNED.
- **Section A.4.1:** The Compensation & HR Committee fulfills the major functions of both a Nomination and Remuneration Committee. The majority of members of that Committee are shareholder representative non-executive directors NEDs and not iNEDs. There is no requirement for an iNED to be present in order for there to be a quorum. The Committee is advisory only and makes recommendations to the Board.
- **Section A.4.3:** The appointment of the Chairman is a shareholder reserved matter.
- **Section A.4.4:** In compliance with the Companies Act 1985, the terms and conditions of appointment of the non-executive directors are made available to the shareholders
- **Section A.7.1:** Appointment of directors is governed by the Subscription and Shareholders' Agreement ("SSA").
- **Section B.2.1:** The majority of members of the Compensation and HR Committee are shareholder representative NEDs and not iNEDs.
- **Section B.2.2:** Matters are reserved for the Board under the SSA and the Compensation & HR Committee may make recommendations at any time.
- **Section C.3.1:** The majority of members of the Audit & Risk Review Committee are shareholder representative NEDs and not iNEDs.
- **Section C.3.6:** Auditors are appointed by the shareholders in accordance with the SSA.
- **Schedule A:** It is only intended to seek Board approval to the new LTIP.

The Board, having reviewed the extent of compliance with the Code, considers that the various departures from its terms are justified, and looks to focus on the strengths of the Company's compliance regime as a whole.

Thames Water Utilities Limited

Corporate governance (continued)

The Board has adopted, and regularly reviews, a Schedule of Delegated Authorities that limits the financial and other commitments that may be entered into by executive management without further formal approval either at Board or shareholder level.

Board Membership

It is standard practice for Ofwat to consult on any takeover within the UK water industry. In February 2007, Ofwat published a consultation paper stating that it wanted assurance that the Board has appropriate engagement with the day-to-day running of the company and that issues raised by stakeholders, including itself, will be given due consideration by the Board. Ofwat invited comments on the structure of the Board and its compatibility with good corporate governance of a regulated water company. It also proposed certain amendments to the Company's Licence. Following the close of the consultation period on 5 March 2007 the Board has been in dialogue with Ofwat over the responses received and the composition of the Board has been revised from its original structure upon inception in December 2006 to meet the concerns raised in the consultation.

The Board is confident that it acts as independently of the shareholders as is feasible, and that it takes decisions objectively in the best interests of the Company. It also believes that it has demonstrated its commitment to ensuring that the Company's obligations to its stakeholders are understood and met and that the necessary financial and management resources, and systems of planning and internal control, are in place to achieve these obligations. Supported by the Chief Executive Officer ("CEO") and the executive management team, the Board is taking positive action towards regenerating the Company's values and standards, and establishing a clear strategic direction for the future.

The current Board of Directors is chaired by Sir Peter Mason, KBE. Sir Peter has had a long and distinguished career in the engineering and construction industries, including Private Finance Initiatives ("PFIs") and design and project management. He has also held several public service appointments, primarily with the Department for Trade and Industry. Sir Peter's current external appointments include directorships of BAE Systems plc, Acergy and the Olympic Delivery Authority. Since he holds directorships in other group companies, Sir Peter is not considered to be independent, and nor was he so upon appointment. As Chairman, he is responsible for leadership of the Board, including ensuring its effectiveness in all aspects of its role and in setting its agenda. As well as making sure that there is effective communication with the Company's shareholders, he is also responsible for ensuring that the directors receive accurate, timely and clear information and that constructive relations exist between the Board and the executive management.

As of 24 May 2007, the Board comprises 15 directors, 12 of whom are non-executive with the exception of Peter Antolik, who was originally appointed as a non-executive director but has been acting in an interim executive capacity as Director of Regulation since 1 February 2007, together with 3 executive directors, namely the CEO, Chief Financial Officer ("CFO") and Chief Operating Officer ("COO"). The directors are confident that they have a clear understanding about the expectations of all stakeholders, including the ultimate shareholders on whose behalf they are appointed. Between them, the directors have a wealth of management and financial experience, together with extensive specialist knowledge of the water industry and other regulated utilities. Both the Board and Ofwat consider three of the directors to be independent non-executives.

These are Stephen Box - former Finance Director of National Grid, Michael Pavia - former Chief Financial Officer of the London Electricity Group, and Willem Smit - who was Managing Director of the regulated utility TXU Europe. The Board considers, and Ofwat has agreed, that Stephen Box fulfils the definition of independence notwithstanding that he also serves on the Boards of Wales & West Utilities Limited and MGN Gas Networks together with fellow directors Peter Antolik and Martin Baggs. David Owens, the CEO, has significant experience of regulated utility management having served as CEO of 24Seven Utility Services (the electricity distribution arm of Eastern Electricity and London Electricity). David is supported by COO Steve Shine who most recently

Thames Water Utilities Limited

Corporate governance (continued)

served as Chief Executive of the construction services company SGB Services Limited, and by CFO Simon Batey who joined the Thames Water group in 2006 from United Utilities plc and is a non-executive director of Arriva plc, and Chairman of its Audit Committee.

Committees of the Board

There are four standing committees of the Board:

- Audit & Risk Review
- Regulatory
- Health, Safety & Environment
- Compensation & HR

Each Committee has written Terms of Reference and, between them, they advise the Board on a range of matters that are commonly dealt with by Audit, Remuneration and Nomination committees. From time to time other Board committees are formed to deal with specific matters, for example drought.

- The Audit & Risk Review Committee's duties include monitoring the integrity of financial statements, the effectiveness of internal controls and risk management systems, internal and external audit functions, and arrangements for employees to raise concerns, in confidence, about possible wrongdoing in financial or regulatory reporting or other matters. One particular function of the Committee is to oversee the non-audit services provided by the Company's auditors (currently PricewaterhouseCoopers LLP).
- The Regulatory Committee reviews the governance, policy and strategy of decisions with water industry-specific regulatory implications and progress on delivering the levels of service and performance required by Ofwat. It also provides guidance on such regulatory matters and oversees the preparation and submission of documentation to Ofwat and other regulators.
- The Health, Safety & Environment Committee's responsibilities include monitoring environmental protection, incident and accident prevention, promotion of a health and safety culture, contractor management and workplace planning, control and reporting issues.
- The Compensation & HR Committee's duties include reviewing the appointments and remuneration of senior executives and senior management, incentives and bonus arrangements, and performance targets.

Membership of the Audit & Risk Committee, the Remuneration Committee, the Nomination Committee, the Health, Safety & Environment Committee, and the Compensation & HR Committee are set out below:

Prior to 1 December 2006

Audit Committee:	C Bowe (Chairman), S Slipman, Sir John Gains
Environmental & Corporate Responsibility:	Sir John Gains, R Aylard, J Pelczer, J England, S Slipman (Chairman)
Health & Safety Review Committee:	Sir John Gains (Chairman), J England, J Pelczer
Regulation Committee:	S Buck (Chairman), J Pelczer, S Batey, S Walker, R Aylard, J England
Remuneration Committee:	S Slipman (Chairman), C Bowe, Sir John Gains
Nomination Committee:	J Pelczer (Chairman), C Bowe, S Slipman, Sir John Gains

Thames Water Utilities Limited

Corporate governance (continued)

Post 1 December 2006

Audit & Risk Review Committee:	S Box (Chairman), M Baggs, L Webb
Compensation & HR Committee:	M Stanley (Chairman), Sir Peter Mason, W Smit, C Deacon
Health, Safety & Environment Committee:	M J Pavia (Chairman), M W Baggs, G Matthews
Regulatory Committee:	P Antolik (Chairman), M Baggs, S Box, R Gregor

Attendance at Board and Committee Meetings

The former Board of Directors met 17 times between 1 January and 1 December 2006 and the new Board met twice between 1 December 2006 and 31 March 2007.

The table below gives attendance details for Board and Committee meetings between 1 January 2006 and 1 December 2006 (i.e. the date when the Board and Committee structures changed). The Board considers that it is too early in the cycle of meetings of the new Board and its committees for such attendance details to be meaningful and, therefore, these are not included at this time.

All directors are entitled to attend Board meetings either in person or by telephone or video conferencing. This enables those who are unable to attend meetings in person to participate equally in discussions and decisions. In addition to the directors, a number of official observers also have the right to attend Board meetings.

All directors are entitled to attend and observe committee meetings, and certain senior executives attend by invitation.

	Board	Health & Safety Review	Remuneration	Nomination	Audit	Environmental & Corporate Responsibility	Regulation
Total number of meetings held	17	4	5	2	8	3	11
Richard Aylard (3)	11					3	5
Simon Batey (1)	3						
Steven Buck (3)	15						6
Jeremy England (3)	16	3				2	10
Jeremy Pelczer (3)	16		5	1		3	
Stephen Walker (3)	16						
Werner Böttcher (2)	1						1
Colette Bowe (3)	12		4	2	8		
Sir John Gains (3)	14	4	5	2	5	2	
Susan Slipman (3)	13		5	2	8	2	

(1) Appointed 19/10/2006, (2) Resigned 20/01/2006 (3) Resigned 1/12/06

Thames Water Utilities Limited

Corporate governance (continued)

Information and Professional Development

All directors who were appointed on 1 December 2006 were invited to a two-day induction upon appointment and the majority were able to attend. The programme included site visits and presentations by operational management. Briefing packs and supplementary notes were circulated to all those who were absent.

The Company Secretary is responsible for advising the Board on the majority of governance issues. However, owing to the nature of the business, certain matters are the responsibility of the Regulation Department or the Chief Financial Officer. All non-executive directors have access to independent professional advice at the company's expense where appropriate. In accordance with the principles of the Combined Code, the Company's Articles of Association require that the appointment and removal of the Company Secretary is a matter for the Board as a whole.

Performance Evaluation

The previous Board engaged external consultants, Independent Audit Limited, to undertake formal performance evaluations of the Board and the Audit Committee. The current Board has undertaken to carry out an evaluation of its effectiveness within the next 6 to 12 months. Further reviews of the effectiveness of its committees and individual directors, are planned once a sufficient period of time has elapsed to make this a meaningful exercise, and it is anticipated that this will become an annual process thereafter.

Internal Controls

The directors aim to maintain a sound system of internal control to safeguard not just shareholders' investments, but also the Company's assets and its ability to deliver on its obligations to its stakeholders. There is a dedicated Internal Audit Department that conducts a wide range of audit and risk review functions and reports its findings regularly to the Audit & Risk Review Committee which, in turn, reports on such matters to the Board. The Internal Audit Department also manages the confidential 'whistleblowing' arrangements that allow individuals to raise matters of concern that they feel unable to address through normal management channels.

In common with other organisations, the internal control system is designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. Subject to the GSS issues discussed on page 7 of the OFR, systems that accord with the Financial Reporting Council's guidance on Internal Control are considered to have been in place for the entire period under review and up to the date of approval of the Annual Report & Accounts.

The Board, assisted by the Audit & Risk Review and Regulatory committees, conducted a review of the effectiveness of the Company's system of internal controls during the period February - May 2007. This review covered all material controls, including financial, operational and compliance controls and risk management systems. The Audit & Risk Review Committee receives regular reports on internal controls and risk management. The Board reviews the proceedings of the Audit & Risk Review Committee, aims to conduct additional risk management reviews on a routine basis and to organise periodic presentations by senior management.

Thames Water Utilities Limited

Directors' remuneration statement

Remuneration Committee and Compensation & HR Committees

Prior to 1 December 2006, the Remuneration Committee comprised exclusively independent non-executive directors. It was chaired by Sue Slipman and the other members were Colette Bowe and Sir John Gains, all three of whom served throughout the period until their resignations on 1 December 2006. On 1 December 2006, owing to the change in ownership, a new Compensation & HR Committee was established which broadly functions as both a remuneration and a nomination committee. It comprises four non-executive directors, one of whom is independent, and is chaired by Martin Stanley. The other members are Willem Smit (independent non-executive director), Sir Peter Mason and Christopher Deacon.

The committees' responsibilities include, but are not limited to, making recommendations to the Board on the Company's executive remuneration policy and directors' terms of appointment. During the period, both committees advised the Board of Directors and received advice and input from various directors and specialist staff within the Company, including the Chief Executive Officer and the Director of Human Resources (both of whom are invited to attend from time to time). No individuals are involved in the determination of their own remuneration.

To ensure that the Company's remuneration practices are market competitive, use is made of detailed external research on market data and trends from experienced specialist remuneration consultants. The committees have received material advice from Watson Wyatt, Hewitts, CJW Consulting and Hay Management Consultants during the period. Where remuneration advisers undertake significant work for the Company outside the area of executive remuneration, the terms of engagement would be vetted by the Committee and approved by the Board.

Remuneration Policy

During the period the committees based their decision making on a number of underlying principles which can be summarised as being that, in respect of remuneration:

- arrangements should attract, retain, motivate and reward high calibre directors and executives.
- packages should be aligned with the interests of the Company's stakeholders, in particular its shareholder and its customers.
- packages should be commensurate with those provided by other companies of similar size and complexity, taking into account individual contribution and experience.
- policy should establish firm links between an executive's performance and remuneration and between the Company's performance and the executive's total remuneration.

The Committee will continue to regularly review arrangements to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards.

Directors' emoluments.

A fixed fee of £35,000 per annum is payable by Thames Water Ltd in respect of the services rendered by each of M Baggs, C Deacon, P Dyer, R Gregor, C Lynam, G Matthews, A Santos, M Stanley and L Webb to ten separate Boards of Directors within the Kemble Water group of companies, including the Company. It is not practicable to apportion this remuneration between the different group companies. No additional remuneration is payable in respect of any Alternate Directors.

Thames Water Utilities Limited

Directors' remuneration statement (continued)

The following table provides a breakdown of the amounts attributable to the Company in respect of directors who served during the period ending 31 March 2007:

	Basic salary/fees	Bonuses	Benefits in kind	Compensation for loss of office	Period End 31 March 2007 £'000	Year End 31 December 2005 £'000
	£'000	£'000	£'000	£'000	£'000	£'000
Executive Directors						
Craig Anderson (1)	-	-	-	-	-	20.2
Richard Aylard (3)(8)	57.9	44.1	30.9	-	132.9	61.7
Simon Batey (2)(3)(8)	48.4	24.0	21.7	-	94.1	-
Werner Böttcher (4)(8)	17.3	-	6.1	-	23.4	457.0
Steven Buck (3)	168.7	-	43.6	244.0	456.3	170.3
Jeremy England (3)	155.6	138.7	83.0	187.2	564.5	216.9
Jeremy Pelczer (3)(8)	124.1	-	190.4	-	314.5	-
John Sexton (1)	-	-	-	-	-	467.7
Stephen Walker (3)(8)	48.2	36.6	22.2	-	107.0	75.2
Non-executive Directors (fees and expenses)						
Sir Peter Mason (5)(8)	25.0	-	-	-	25.0	-
Peter Antolik (5)	11.7	-	-	-	11.7	-
Independent Non-executive Directors (fees and expenses)						
Colette Bowe (3)(7)	59.2	-	-	-	59.2	42.5
Stephen Box (5)(7)	15.0	-	-	-	15.0	-
Sir John Gains (3)	91.6	-	-	-	91.6	23.3
Michael Pavia (5)	11.7	-	-	-	11.7	-
Willem Smit (5)	11.7	-	-	-	11.7	-
Sue Slipman (3)	79.2	-	-	-	79.2	32.5
Peter Warry (6)	-	-	-	-	-	1.7
Total	925.3	243.4	397.9	431.2	1,997.8	1,569.0

(1) Resigned 31/01/2005 (2) Appointed 19/10/06 (3) Resigned 01/12/2006 (4) Resigned 20/01/2006 (5) Appointed 01/12/2006 (6) Resigned 21/01/2005 (7) Receives an extra £10,000 per annum as Chairman of the Audit & Risk Review Committee (8) Represents the portion of services directly attributable to the Company's business.

The highest paid director was Jeremy England. The highest paid director in December 2005 was Werner Böttcher.

Basic Salary

Certain directors as indicated by note 8 in the table above were employed and remunerated by Thames Water Limited and performed a wider role within the Group. For this reason, the emoluments shown above reflect only the portion of their services that is directly attributable to the Company's business and the sums quoted represent only a portion of their total earnings. (Their remuneration is reported in the Report and Accounts of Thames Water Limited.) Details of options and cash awards received from RWE AG on pages 41 to 44 reflect the total awards made.

The base annual fee for Colette Bowe, Sue Slipman and Sir John Gains was £35,000. In view of the additional work created by the divestment of Thames Water from the RWE Group, they all received additional fees for the period 1 April 2006 to 30 November 2006. Sue Slipman and Sir John Gains also received a payment in respect of the balance of their contractual periods as at the date of their resignations.

Thames Water Utilities Limited

Directors' remuneration statement (continued)

The non-executive fees shown above will not be paid to Peter Antolik but will instead be paid to the entities who have jointly nominated him, which include the manager of Macquarie's European Infrastructure Funds. Peter Antolik is employed by Macquarie Bank Limited (London branch) and is remunerated by Macquarie Bank Limited in relation to his role as Head of Regulation for the Macquarie European Infrastructure Funds managed by Macquarie. In this role he provides services to Macquarie Bank's advisory division, the Macquarie European Infrastructure Funds and to certain entities in which those funds have invested including Thames Water Utilities Limited, Wales and West Utilities and MGN Gas Networks. It is not possible to reliably allocate his total remuneration from Macquarie Bank Limited between that awarded for services as Interim Director of Regulation and Strategy to the Company and the other services provided.

The basic salary for each executive director who served throughout the period was reviewed annually, taking into account market data from relevant comparators (mainly utility companies) and the relative experience of each individual. A mid-market position was targeted once an individual was fully established in the role. The fees of the non-executive directors are reviewed every two years and are determined by the Board taking into account the responsibilities, time commitments and fee levels in comparable companies.

Details of Directors Service Contracts for the period are contained below.

Annual Bonus

Non-executive directors are not, and have never been, eligible to participate in the Company's bonus arrangements. Senior executives - including any executive directors - are eligible to participate in an annual bonus scheme, which is designed to motivate them to achieve the Company's key operational and strategic objectives.

The 2006 annual bonus plan aimed to reward significant improvement in the Company's performance, both financial and regulatory, and an executive's personal contribution to that performance and payment was due in March 2007. However, under the rules of the plan, the Board reserved the right to reduce the overall award where financial or individual performance was judged to be such that an award should not be triggered. In February 2007, the Board of Directors exercised this right and, as a result, no discretionary bonus payments were made to the directors, senior executives, senior or middle management team.

For 2007, the bonus plan will be based on the achievement of financial and personal performance targets. Financial measures will be selected from operational costs, capital expenditure, cash flow and earnings before interest, tax, depreciation and amortisation targets. The personal element of the annual bonus is underpinned by pre-determined Company financial targets, which must be achieved before the personal element of bonus is paid.

Long Term Incentive Plans ("LTIPs")

As an element of the retention strategy, the Company's directors and senior management team, including any executive directors, are from time to time invited to participate in LTIPs. There is no automatic right to participate and each year executives and managers are selected at the discretion of the Board.

Thames Water Utilities Limited

Directors' remuneration statement (continued)

Under the 2003 LTIP, executives were awarded rights to acquire shares in RWE AG ("RWE"). Conditional awards of shares were granted based on performance against financial measures in 2003. The shares were deferred for a 28 month period and vested in July 2006, provided that the executives were still employed within the Thames Water Group on the vesting date. Awards to Directors under the 2003 LTIP that vested in July 2006 are summarised below. N.B. These are the total awards made, with no apportionment in respect of services provided to the Group and/or the Company.

	Number of RWE Shares vesting
Richard Aylard	768
Steven Buck	395
Jeremy England	373
Stephen Walker	1,317

The 2004 LTIP followed the same structure as the 2003 LTIP. When the divestment of Thames Water from the RWE Group completed, participants had a two-week window in which they could elect to convert their conditional awards of shares into conditional awards of cash on an irrevocable basis. The 2004 LTIP vests at the end of July 2007 and the following table summarises the awards made to Directors:

	Conditional RWE Shares Award	Conditional Cash Award
Richard Aylard		£118,714
Jeremy England	976	
Stephen Walker		£123,175

During the period Jeremy Pelczer participated in an alternative LTIP: the RWE Stock Appreciation Rights Plan (SAR Plan). The Plan awarded stock appreciation rights in RWE. The Plan was operated by Thames Water Group's previous ultimate parent company, RWE and lay outside the role of the Remuneration and Compensation & HR committees. The Plan was based on RWE's absolute and relative share price performance and any gain was subject to a cap of 50% of the original exercise price. Final payment was made in cash. The 2004 SAR Plan vested in June 2006 and the cash payments listed below were made to directors and former directors:

	Number of Stock Appreciation Rights	Cash Value
Jeremy Pelczer	50,000	£609,279

In 2005, RWE introduced a new cash LTIP called "Beat" 2005. Under this LTIP, executives were awarded a number of phantom or "RWE Performance" shares. At the end of the three-year performance period, the value of each RWE Performance Share was to be determined based on RWE's relative total shareholder return performance against a comparator group of European Utility companies which form the DJ Stoxx Utilities Index. Under the rules of the Plan, awards of performance shares lapsed when the divestment of Thames Water from the RWE Group was completed and a compensation payment was payable equivalent to the individual grant value, pro-rated for service during the performance period. The cash payments made to the directors are summarised below:

	Cash Payment
Richard Aylard	£40,193
Jeremy England	£35,274

Thames Water Utilities Limited

Directors' remuneration statement (continued)

At the discretion of the RWE Board, Stephen Walker and Steven Buck retained their entitlements to participate in the 2005 Beat Scheme. These vest in Q1 2008 and their original share awards are given below. Jeremy Pelczer's award under the 2005 LTIP lapsed.

	"RWE Performance" Shares
Steven Buck	2,200
Stephen Walker	6,000

In 2006, the Thames Water group introduced an LTIP under which awards were made to executives and senior managers. Each award took the form of a conditional right to receive a specified number of "cash units". Under the rules of the plan, the conditional awards vested on completion of the divestment of the Thames Water group from the RWE group. A cash payment, pro-rated to reflect completed service during the performance period was made to directors in December 2006 and is summarised below:

	Cash Award
Richard Aylard	£19,250
Steven Buck	£15,130
Jeremy England	£15,360
Stephen Walker	£19,940

Jeremy Pelczer did not participate in the 2006 LTIP.

As a result of new ownership, a new LTIP was introduced in May 2007. Under the new plan, a conditional award of cash units will be made to participants. The awards will be deferred for a two-year period, after which payment will be made, depending on an assessment of performance against regulatory targets. 100%-400% of the deferred cash award will vest based on performance against the "Overall Performance Assessment" score, independently assessed by Ofwat.

Interest in shares and share options

Prior to the divestment of Thames Water from RWE, all employees and executives were eligible to participate in the RWE Thames Water Share Investment Plan (SIP). This was a conventional HMRC approved share incentive plan in which individuals could contribute (out of pre-tax salary) an amount of up to £125 per month. This money was used by the Trustee of the SIP to acquire RWE shares on the individual's behalf ("Partnership Shares"). In addition, the Company provided funds to the Trustee to enable it to acquire free "Matching Shares" for individuals on the basis of one Matching Share for every four Partnership Shares acquired (but doing so only in relation to the first £30 per month of an individual's contributions.) The scheme was closed on 1 December 2006 when Thames Water was divested from RWE and participants can retain the shares already purchased within the Trust for a five-year period to enable them to receive their shares free of income tax.

	Number of Partnership Shares at 1 December 2006	Number of Matching Shares at 1 December 2006
Jeremy England	48	2
Stephen Walker	41	2

Thames Water Utilities Limited

Directors' remuneration statement (continued)

Pension Benefits

Details of accrued pension benefit values for Executive Directors* who served during the period ended 31 March 2007 are as follows:

	Period End 31 March 2007 £	Year End 31 March 2006 £
Richard Aylard (1)	£12,207.81	£8,017.86
Steven Buck (1)	£13,739.79	£8,604.52
Jeremy England (1)	£19,789.11	£17,013.33
Jeremy Pelczer (1)	£31,667.01	£25,670.68
Stephen Walker (1)	£39,041.16	£33,981.94

(1) Resigned 01/12/2006.

* Simon Batey received a cash allowance of £16,936.

Other Benefits

The executive directors during the period received a car or cash allowance, private medical insurance, a defined benefit pension scheme* and life assurance and 30 days holiday. These benefits were reviewed periodically to ensure that the overall remuneration package was competitive against companies of a similar size and complexity.

* Simon Batey received a cash allowance in lieu of membership of the defined benefit pension scheme.

Service Contracts

Reflecting current market practice, the Executive Directors who resigned on 1 December 2006 had service contracts that were terminable on one year's notice by either the individual or the Company, with the exception of Simon Batey whose notice period is described in the table below. Details of their compensation for loss of office are included on page 40. David Owens (Chief Executive Officer), Steve Shine (Chief Operating Officer) and Simon Batey (Chief Financial Officer) were appointed as Executive Directors on 24 May 2007. With the exception of Simon Batey, none of these appointees holds a service contract that provides for a notice period longer than one year. It is not the Committee's intention to recommend the appointment of any new Executive Directors with contracts that provide for a longer notice period.

The Committee endorses the principle of mitigation of loss of early termination of a service contract and generally seeks to achieve that objective, where possible and appropriate. In the event that the Company wished to terminate an Executive Director's contract other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary and benefits. The table overleaf provides the dates, terms and notice periods of the service contracts for Directors who served during the period:

Thames Water Utilities Limited

Directors' remuneration statement (continued)

	Commencement date of current term of office	Date of initial appointment with the Company (if applicable)	Notice period (if applicable)
Richard Aylard (1)	21/01/2005	n/a	12 months
Simon Batey (1)	19/10/2006	19/10/2006	24 months (reducing on a sliding scale to 12 months by 01/08/07)
Steven Buck (1)	01/02/2005	n/a	12 months
Jeremy England (1)	07/06/2004	n/a	12 months
Jeremy Pelczer (1)	17/11/2005	n/a	12 months
Stephen Walker (1)	20/09/2001	n/a	12 months
Peter Antolik	01/12/2006	n/a	(3)
Martin Baggs	01/12/2006	n/a	(3)
Colette Bowe (1)	03/07/2001	n/a	12 months (2)
Stephen Box	01/12/2006	n/a	(3)
Christopher Deacon	01/12/2006	n/a	(3)
Dr Peter Dyer	01/12/2006	n/a	(3)
Sir John Gains (1)	01/04/2005	n/a	12 months
Robert Gregor	01/12/2006	n/a	(3)
Charles Lynam	01/12/2006	n/a	(3)
Sir Peter Mason	01/12/2006	n/a	3 months
Graham Matthews	01/12/2006	n/a	(3)
Michael Pavia (2)	01/12/2006	n/a	12 months (2)
Antonio Santos	01/12/2006	n/a	(3)
Susan Slipman (1)	01/01/2002	n/a	12 months
Willem Smit	01/12/2006	n/a	12 months (2)
Martin Stanley	01/12/2006	n/a	(3)
Lincoln Webb	01/12/2006	n/a	(4)

(1) Resigned 01/12/2006 (2) Initial appointment for 12 months, subject to renewal for a further period of two years (3) Notice period is undetermined as governed by the appointing investor (4) Appointed for an initial fixed term of a year.

Directors' retirement dates are determined by reference to the Trust Deeds of the Company's Pension Schemes as amended from time to time.

Policy on outside directorships

David Owens (Chief Executive Officer), Steve Shine (Chief Operating Officer) and Simon Batey (Chief Financial Officer) were appointed as Executive Directors on 24 May 2007. The Compensation & HR committee will consider the appropriate policy on outside directorships and make recommendations to the Board of Directors.

Approved by the Board on 28 June 2007 and signed on its behalf by

C Deacon

Director and Member of the Compensation & HR Committee

Thames Water Utilities Limited

Directors' report

The directors present their report and the audited financial statements for the period 1 January 2006 to 31 March 2007. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies.

The Company's accounting reference date was extended to 31 March 2007 in order to coincide with Kemble Water Limited, its new owner. As a result, this report and the financial statements cover a 15 month period and financial and related information linked to the period may not, therefore, be directly comparable with the figures for the previous financial year ended 31 December 2005.

On 21 June 2007 the ownership of the Company was transferred from Thames Water Holdings Limited to Thames Water Utilities Holdings Limited, a new intermediate holding company, wholly owned by Thames Water Limited.

Principal activities and likely future developments

The principal activities of the Company are the supply of water and the collection and treatment of sewage, serving approximately 13 million customers in London and the Thames Valley.

The information which complies with the Business Review requirements of the Companies Act 1985 can be found within the voluntary Operating and Financial Review ("OFR") on pages 4 to 33. The Company chose to produce a voluntary OFR on the basis that this reflects best practice in corporate reporting and, in doing so, it looked to the 'Reporting Statement of Best Practice on the OFR' issued by the Accounting Standards Board on 26 January 2006 as the best guidance currently available. The OFR comprises an analysis of the development and performance of the business and includes an assessment of future prospects, information about research and development activities, details of important events that have occurred since 31 March 2007 and Key Performance Indicators ("KPIs").

Details of parent and subsidiary undertakings are given in note 25 and note 11 to the Financial statements on page 89 and 74 respectively, and the Company has no branches outside the United Kingdom.

Results and dividends

The profit and loss account on page 53 gives the Company's financial results for the period.

The Company paid interim dividends totalling £656.3 million during the period (2005 : £155.0 million). The Board does not recommend a final dividend.

Directors

Following the acquisition by Kemble Water Limited on 1 December 2006, all the Directors serving at that time, whose details are included in the first table below, relinquished their appointments. With the exception of Simon Batey, who was appointed to the Board on 19 October 2006, and Werner Böttcher, who resigned on 20 January 2006, all directors served throughout the period 1 January 2006 - 1 December 2006 inclusive.

Thames Water Utilities Limited

Directors' report (continued)

Directors Serving Between 1 January 2006 and 1 December 2006 inclusive:

J D Pelczer - Chairman
C Bowe (independent NED)
R Aylard
S G Batey (appointed 19 October 2006)
W U Böttcher (resigned 20 January 2006)
S J Buck
J M England
Sir John Gains (independent NED)
S Slipman (independent NED)
S C A Walker

Subsequent to 1 December 2006, Richard Aylard, Simon Batey and Steve Walker remained with the Company in executive capacities. Simon Batey continued to serve as Chief Financial Officer and was reappointed to the Board on 24 May 2007 (see below).

Details of the directors who served from 1 December 2006 to the date of this report are shown in the following table. The constitution of the Board is covered in more detail in the Corporate Governance Statement, which can be found on pages 34 to 38.

All Board members from 1 December 2006 to 23 May 2007 inclusive were non-executive directors ("NEDs") throughout the period, with the exception of Peter Antolik who took on interim executive duties as from 1 February 2007. On 23 May 2007, Charles Lynam and Peter Dyer both tendered their resignations. On 24 May 2007, three new executive directors were appointed, namely David Owens (Chief Executive Officer), Simon Batey (Chief Financial Officer) and Steve Shine (Chief Operating Officer). Three of the NEDs have nominated Alternate Directors to represent them when they are unavailable. These are P E D Crone (Alternate to G J Matthews), R D Israel (Alternate to C R Deacon until 28 June 2008) and J Santos (Alternate to A P Santos).

Directors Serving from 1 December 2006 to the date of this report:

Sir Peter Mason, KBE - Chairman
P S Antolik
M W Baggs
S G Batey (reappointed 24 May 2007)
S J Box (independent NED)
C R Deacon
Dr P Dyer (resigned 23 May 2007)
R J Gregor
C Lynam (resigned 23 May 2007)
G J Matthews
D W Owens (appointed 24 May 2007)
M Pavia (independent NED)
A P Santos
S F Shine (appointed 24 May 2007)
W Smit (independent NED)
M S W Stanley
L Webb

Thames Water Utilities Limited

Directors' report (continued)

Material financial instruments

Financial risk management is covered on pages 24 to 25 of the OFR.

Employee involvement

Operational and financial performance information is available to all employees, through briefings by the Chief Executive Officer ("CEO"), Company-wide emails and team briefings.

Methods of communication with employees vary dependent on the subject matter. Company-wide announcements, changes to Company policy and business updates are disseminated to all employees and the CEO and his Executive Management Team ("EMT") undertake regular face to face briefings for managers and employees.

Consultation with non-management employees is undertaken in partnership with the recognised Trade Unions ("TUs"). Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation would take place on a group basis with employee representatives being elected for the relevant area.

Although share incentive plans existed during the period in question, following the divestment from RWE AG (which was a publicly traded company) it was no longer practicable to offer share based incentives to employees.

Employment of disabled persons

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Company has policies and procedures in place that aim to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and training is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

Directors' interests

Throughout the period, none of the directors declared any interest in the shares or debentures of the Company or any other body corporate in the Group. In accordance with Statutory Instrument 1985/802, interests in shares of RWE AG (the ultimate holding company until 1 December 2006) are not required to be disclosed.

Policy and practice on payment of creditors

The Company's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the period under review the average amount due to trade creditors represented 68 days (2005: 64 days) purchases received from these creditors.

Thames Water Utilities Limited

Directors' report (continued)

Political and charitable donations and expenditure

No charitable or political donations were made by the Company during the period other than donations totalling £159,026 made out of the Company's Customer Assistance Fund, thereby helping customers who were unable to pay their bills owing to financial difficulty, hardship or distress. These costs are charged to the Profit and Loss Account.

Going concern

The directors have adopted the going concern basis in preparing these financial statements. This is based upon a review of the group's budget, business plan and investment programme, together with the cash and committed borrowing facilities available. The board also took into account potential contingent liabilities and other risk factors as interpreted by the 'Guidance on Going Concern and Financial Reporting for Directors of Listed Companies registered in the United Kingdom', published in November 1994.

Post balance sheet events

On 24 May 2007 the Company transferred its interests in County Wide Collections Limited, Thames Water Procurement Services Limited, Thames Water Drainage Services Limited and Gemwel Limited to Thames Water Limited. On 21 June 2007 the ownership of the Company was transferred from Thames Water Holdings Limited to Thames Water Utilities Holdings Limited, a new intermediate holding company, wholly owned by Thames Water Limited. On 28 June 2007 the Company acquired a new financing undertaking, Thames Water Utilities Cayman Finance Limited.

On 28 June 2007, the Company executed deeds of indemnity for the benefit of each director of the Company. These provisions are qualifying third party indemnity provisions as defined by s.309B of the Companies Act 1985.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and accounting standards, which in the case of these accounts is United Kingdom Generally Accepted Accounting Practice ("UK GAAP").

In the case of UK GAAP accounts, the directors are responsible for preparing financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Thames Water Utilities Limited

Directors' report (continued)

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of information to auditors

So far as they are aware, the directors at the date of this report confirm that there is no relevant audit information of which the Company's auditors are unaware, and that the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as the Company's auditors will be proposed at the Annual General Meeting.

Approved by the Board of Directors on 28 June 2007 and signed on its behalf by

David Owens
Chief Executive Officer

Thames Water Utilities Limited

Independent auditors' report to the members of Thames Water Utilities Limited

We have audited the financial statements of Thames Water Utilities Limited for the 15 month period ended 31 March 2007 which comprise the primary financial statements, such as the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

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

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report, the Operating and Financial Review and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

We also, at the request of the directors (because the company applies the Listing Rules of the Financial Services Authority as if it were a listed company), review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the Combined Code 2003 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

Thames Water Utilities Limited

Independent auditors' report to the members of Thames Water Utilities Limited (continued)

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2007 and of its profit and cash flows for the 15 month period then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
Reading

28 June 2007

Thames Water Utilities Limited

Profit and loss account for the period ended 31 March 2007

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Turnover		1,778.1	1,333.5
Operating costs	4	<u>(1,249.7)</u>	<u>(883.9)</u>
Operating profit		528.4	449.6
Profit on sale of fixed assets	5	12.1	9.1
Net interest payable and similar charges	7	(205.7)	(142.9)
Other finance income		<u>7.3</u>	<u>6.9</u>
Profit on ordinary activities before taxation		342.1	322.7
Taxation on profit on ordinary activities	8	<u>(101.5)</u>	<u>(94.3)</u>
Profit for the period		240.6	228.4
Dividends	9	<u>(656.3)</u>	<u>(155.0)</u>
Deficit/retained profit for the period	20 & 21	<u>(415.7)</u>	<u>73.4</u>

All amounts above relate to continuing operations.

There is no difference between the profit on ordinary activities before taxation for the periods stated above and their historical cost equivalents.

Statement of total recognised gains and losses

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Profit for the period	240.6	228.4
Actuarial gain on pension scheme (note 24)	81.2	34.9
Deferred tax relating to actuarial gain	<u>(24.4)</u>	<u>(10.5)</u>
Total recognised gains for the period	<u>297.4</u>	<u>252.8</u>
Prior year adjustment in respect of a change in accounting policy - Pensions (FRS 17)	<u>-</u>	<u>(74.2)</u>
Total gains recognised since last report	<u>297.4</u>	<u>178.6</u>

Thames Water Utilities Limited

Balance sheet at 31 March 2007

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Fixed assets			
Tangible assets	10	5,900.4	5,446.7
Investments	11	0.1	0.1
		<u>5,900.5</u>	<u>5,446.8</u>
Current assets			
Stocks and work in progress	12	6.1	6.2
Debtors	13	444.6	466.4
Investments	16	112.5	-
Cash at bank and in hand		89.4	10.3
		<u>652.6</u>	<u>482.9</u>
Creditors: amounts falling due within one year	14	(730.9)	(864.8)
Net current liabilities		<u>(78.3)</u>	<u>(381.9)</u>
Total assets less current liabilities		<u>5,822.2</u>	<u>5,064.9</u>
Creditors: amounts falling due after more than one year	15	(3,585.3)	(2,435.2)
Provisions for liabilities and charges	17	(916.6)	(887.5)
Net assets excluding pension asset/(liability)		<u>1,320.3</u>	<u>1,742.2</u>
Net pension asset/(liability)	24	11.1	(51.9)
Net assets including pension asset/(liability)		<u>1,331.4</u>	<u>1,690.3</u>
Capital and reserves			
Called-up share capital	18	1,029.0	1,029.0
Share premium	19	100.0	100.0
Profit and loss reserve	20	202.4	561.3
Equity shareholder's funds	21	<u>1,331.4</u>	<u>1,690.3</u>

The notes on pages 56 to 89 form part of these financial statements.

The financial statements were approved by the Board of Directors on 28 June 2007 and signed on its behalf by:

Simon Batey
Chief Financial Officer

Thames Water Utilities Limited

Cash flow statement for the period ended 31 March 2007

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Net cash inflow from operating activities	(a)	863.4	781.2
Returns on investments and servicing of finance			
Interest received		20.9	-
Interest paid		(181.9)	(125.2)
Interest element in finance lease payments		(13.7)	(13.4)
Net cash outflow from returns on investments and servicing of finance		(174.7)	(138.6)
Taxation		(81.4)	(48.8)
Capital expenditure and financial investment			
Gross cost of purchased fixed assets		(719.3)	(488.7)
Infrastructure renewals expenditure		(135.0)	(49.4)
Receipt of grants and contributions		70.2	63.1
Sale proceeds of fixed assets		20.5	9.1
Net cash outflow for capital expenditure and financial investment		(763.6)	(465.9)
Equity dividends paid		(656.3)	(155.0)
Management of liquid resources			
Increase in short term deposits		(112.5)	-
Net cash outflow before financing		(925.1)	(27.1)
Financing			
Capital element in finance lease payments		(9.8)	(8.1)
New loans		1,200.0	737.0
Repayment of loans		(186.0)	(693.0)
Net cash inflow from financing	(b) & (c)	1,004.2	35.9
Increase in cash	(b) & (c)	79.1	8.8

Thames Water Utilities Limited

Notes to the cash flow statement for the period ended 31 March 2007

(a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Operating profit		528.4	449.6
Assets written off		9.0	-
Depreciation (infrastructure)	4	131.1	86.0
Depreciation (non-infrastructure)	4	273.4	207.6
Difference between pension charge and cash contributions		(1.6)	11.1
Decrease/(Increase) in stocks and work in progress		0.1	(0.3)
Decrease/(increase) in debtors and prepaid expenses		28.2	(46.2)
(Decrease)/Increase in creditors and accrued expenses		(91.7)	84.1
Release of deferred income		<u>(13.5)</u>	<u>(10.7)</u>
Net cash inflow from operating activities		<u>863.4</u>	<u>781.2</u>

(b) Reconciliation of net cash flow to movement in net debt

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Increase in cash in the period		79.1	8.8
Cash inflow from increase in liquid resources		112.5	-
Cash inflow from movement in net debt and financing		<u>(1,004.2)</u>	<u>(35.9)</u>
Increase in net debt resulting from cashflows		(812.6)	(27.1)
Non-cash increase in net debt		<u>(25.3)</u>	<u>(5.7)</u>
Total increase in net debt		(837.9)	(32.8)
Opening net debt		<u>(2,398.2)</u>	<u>(2,365.4)</u>
Closing net debt	(c)	<u>(3,236.1)</u>	<u>(2,398.2)</u>

Non-cash changes comprise the carrying value uplift by RPI, of an RPI index-linked bond. This adjustment is in accordance with FRS 4 'Capital instruments', which requires the carrying value of such index-linked loans to be recalculated at each balance sheet date.

Thames Water Utilities Limited

Notes to the cash flow statement for the period ended 31 March 2007 (continued)

(c) Analysis of net debt

	As at 1 Jan 06 £m	Cashflow £m	Non-cash £m	As at 31 Mar 07 £m
Cash at bank and in hand	10.3	79.1	-	89.4
Short term deposits	-	112.5	-	112.5
	<u>10.3</u>	<u>191.6</u>	<u>-</u>	<u>201.9</u>
Debt due within 1 year	(114.6)	105.2	-	(9.4)
Debt due after 1 year	(2,068.5)	(1,119.2)	(25.3)	(3,213.0)
Finance leases	(225.4)	9.8	-	(215.6)
	<u>(2,408.5)</u>	<u>(1,004.2)</u>	<u>(25.3)</u>	<u>(3,438.0)</u>
	<u>(2,398.2)</u>	<u>(812.6)</u>	<u>(25.3)</u>	<u>(3,236.1)</u>

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies

Basis of preparation

The financial statements are prepared on the going concern basis and in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 1985. An explanation of this departure from the requirements of the Act is given below.

In accordance with the requirements of FRS 18, the directors review the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The Company has not prepared consolidated group financial statements, as permitted under section 228 of the Companies Act 1985. The Company and its subsidiaries are included in the consolidated accounts of its parent company Kemble Water Holdings Limited, a Company registered in the United Kingdom.

The Company's accounting reference date was extended to 31 March 2007 in order to coincide with Kemble Water Limited, its new owner. As a result, this report and the financial statements cover a 15 month period and financial and related information linked to the period may not, therefore, be directly comparable with the figures for the previous financial year ended 31 December 2005.

Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below. These policies are consistently applied to all the periods presented, unless otherwise stated.

(a) Revenue Recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided and is recognised in accordance with FRS 5 'Reporting the Substance of Transactions'. Where relevant, this includes an estimate of the sales value of water supplied to customers between the date of the last meter reading and the period end together with unbilled waste water charges, exclusive of value added tax.

The Company recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. Should the Company consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of delivery are recorded as deferred revenue.

(b) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), and other assets (including land, buildings, properties, overground plant and equipment).

Directly attributable costs, including employee costs, incurred in implementing the capital programme of the Company are capitalised within fixed assets.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(b) Tangible fixed assets (continued)

- **Infrastructure assets**

Infrastructure assets comprise a network of systems. In the UK water regulated business, all expenditure on infrastructure assets is capitalised at cost, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as depreciation.

- **Other assets**

All other assets, comprising plant and equipment and land and buildings, are stated at cost less accumulated depreciation.

Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit and loss account during the period in which they are incurred.

Freehold land is not depreciated and assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful lives, based on management's judgement and experience, which are principally as follows:

Buildings 20 - 80 years

Operational structures 40 - 80 years

Other 20 - 60 years

Fixtures, fittings, vehicles and computers 3 - 10 years

Fixed and mobile plant 20 - 40 years

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(c) Impairment of tangible assets excluding goodwill

Fixed assets are assessed for impairment whenever there is an indicator of impairment to determine whether there is any indication that those assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

(d) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 1985 that requires fixed assets to be stated at their purchase price without deduction of contributions, which are accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the Directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. Accordingly, related capital contributions would not be recognised in the profit and loss account.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

(e) Stocks, work in progress

Stock and work in progress, with the exception of long-term contracts, are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(f) Long-term contracts

Long-term contracts are included in the profit and loss account by recording turnover and related costs as contract activity progresses. Profit attributable to turnover to date is included where the outcome of the contract can be foreseen with reasonable certainty. Full provision is made for losses on unprofitable contracts.

Long-term contract work in progress is stated at net cost less foreseeable losses and progress payments received and receivable. The amount by which turnover is in excess of payments on account is separately disclosed within debtors as amounts recoverable on contracts. Progress payments received in excess of costs less foreseeable losses are disclosed in creditors. Where foreseeable losses exceed net costs, the excess is disclosed in provisions for liabilities and charges.

Pre-contract costs are expensed as incurred, except where it is virtually certain that the contract will be awarded, in which case they are recognised as an asset and written off to the profit and loss account over the life of the contract.

(g) Taxation

The tax expense represents the sum of current tax and deferred tax.

- **Current taxation**

Current tax, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

- **Deferred taxation**

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted by the balance sheet date.

Deferred taxation is measured on a non-discounted basis.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with in via Statement of Total Recognised Gains and Losses in Equity.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(h) Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

- **Finance leases**

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

- **Operating leases**

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

(i) Pension and other post retirement benefits

The Company operates two significant defined benefit pension schemes, which are independently administered funds, for the substantial majority of its employees. Actuarial valuations of the schemes are carried out as determined by the pension scheme trustees using the projected unit credit method at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates. Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the two amounts is recognised as a surplus or obligation in the balance sheet. The cost of providing pension benefits to employees is included in the profit and loss account within cost of employee benefits. The difference between the expected return on scheme assets and interest on scheme liabilities are included within interest in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and presented in the statement of total recognised gains and losses.

In addition, the Company also operates defined contribution pension schemes. Payments are charged as employee costs as they fall due. The Company has no further payment obligations once the contributions have been paid.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(j) Foreign currencies

Transactions in foreign currencies are recorded at the exchange rates ruling on the dates of the transactions. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange ruling on the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account for the period.

(k) Cash

Cash includes cash at bank and in hand, deposits, and other short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

(l) Trade receivables

Trade receivables are stated at nominal value (which approximates to fair value) less allowances for estimated irrecoverable amounts.

(m) Trade payables

Trade payables are stated at their nominal value (which approximates to fair value).

(n) Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

- **Borrowings**

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis to the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

- **Financial instruments and derivatives**

Interest rate swap agreements and financial futures are used to manage interest rate exposure. While the Company enters into currency swaps to manage its exposure to fluctuations in exchange rates, the Company does not use derivative financial instruments for speculative purposes.

The Company currently does not apply FRS 26 'Financial Instruments: Recognition and Measurement', therefore there is no fair valuing of derivatives. FRS 25 'Financial Instruments: Presentation' has been adopted in the current period and prior year.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(o) Accruals and deferred income

Grants and contributions receivable in respect of depreciating fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated economic lives of the related assets.

(p) Research and development

Research expenditure is recognised as an expense as incurred.

(q) Provisions

Provisions, except for insurance provisions, are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cashflows under insurance contracts.

(r) Related party disclosures

The company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 'Related party disclosures', which requires the disclosure of the details of material transactions between the reporting entity and any related parties, on the grounds that it is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom.

(s) Post Balance Sheet Events

In accordance with FRS 21, dividends declared after the period end are not recognised as a liability at the balance sheet date.

(t) Financial risk management

The Company has an Executive Management Team, which receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The Company is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Company aims to manage its risk by fixing contract prices where possible.

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk.

The operation of the Treasury function is governed by specific policies and procedures that set out specific guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

1 Principal accounting policies (continued)

(t) Financial risk management (continued)

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Company's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Company actively maintains a broad portfolio of debt, diversified by source and maturity designed to ensure the Company has sufficient available funds for operations.

2 Critical accounting policies and key sources of estimation uncertainty

The preparation of financial statements in conformity with UK GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at reporting date and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below:

(a) Fixed assets and depreciation

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively.

The carrying values of fixed assets are also reviewed for impairment where there has been a trigger event by assessing the present value of estimated future cash flows and net realisable value compared with net book value. The calculation of estimated future cash flows and residual values is based on the Directors' best estimates of future prices, output and costs and is therefore subjective.

From 1 April 2006, the Company has revised its methodology with regards to the capitalisation of support costs that arise that are directly attributable and incremental to the delivery of the tangible fixed assets of the Company. The change in methodology followed a review of the cost allocation principles and impact of the previous methodology. This has resulted in the capitalisation of indirect costs amounting to 15.7% (2005: 14.6%) of capital additions, an increase of £24.5m over the amount that would have been capitalised under the previous methodology. The change in methodology is not considered a change in accounting policy and accordingly no prior year restatement is required.

(b) Revenue recognition

The Company recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. Should management consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of revenue recognition are recorded as deferred revenue.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

2 Critical accounting policies and key sources of estimation uncertainty (continued)

(b) Revenue recognition (continued)

For regulated utility operations, the Company raises bills and recognises revenue in accordance with its entitlements to receive revenue in line with the limits established by the periodic regulatory price review process. For water and wastewater customers with water meters, the revenue is dependent upon the volumes supplied and includes an estimate of the volume supplied between the date of the last meter reading and the period end. Meters are read on a cyclical basis and the Company recognises revenue for unbilled amounts based on estimated usage from the last billing through to the end of the reporting period. The estimate of sales value is calculated using a defined methodology based on a measure of unbilled water consumed which is calculated from historical billing information.

(c) Pensions

Within the UK, the Company operates two approved defined benefit schemes. The Company accounts for these schemes in accordance with FRS 17 'Retirement Benefits' with the cost of providing benefits determined using the projected unit credit method, and actuarial valuations being carried out at each reporting date. Inherent in these valuations are key assumptions, including: mortality rates, discount rates, expected returns on plan assets and compensation increases. These actuarial assumptions are reviewed annually and modified as appropriate. The Company believes that the assumptions utilised in recording obligations under the scheme are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions.

(d) Accounting for provisions and contingencies

The Company is subject to a number of claims that are incidental to the normal conduct of its business. These relate to and include commercial and contractual claims, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. A provision is recognised when it is probable that an obligation exists for which a reliable estimate of the obligation can be made and after careful analysis of the individual matter. The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed, unless the possibility of transferring economic benefits is remote.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

2 Critical accounting policies and key sources of estimation uncertainty (continued)

(e) Provision for doubtful debts

At each reporting date, the Company evaluates the collectability of trade receivables and records provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

(f) Deferred taxation

Full provision is made for deferred taxation, as required under FRS 19 'Deferred Tax', at the rates of tax prevailing at the period end dates unless future rates have been substantively enacted. Deferred tax assets are recognised where it is more likely than not that they will be recovered.

3 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

4 Operating costs

Analysis of operating costs by type of expense:

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Staff costs	6	250.6	177.7
Materials and consumables		39.2	28.4
Other operating charges		652.5	428.9
Assets written off	10	9.0	-
Depreciation:			
- owned asset (infrastructure)	10	131.1	86.0
- owned assets (non-infrastructure)	10	261.3	198.0
- assets held under finance leases (non-infrastructure)	10	12.1	9.6
Rentals under operating leases:			
- hire of plant and machinery		5.6	3.8
- other		8.0	5.6
Research and development		5.9	5.3
		<u>1,375.3</u>	<u>943.3</u>
Own work capitalised		<u>(125.6)</u>	<u>(59.4)</u>
		<u>1,249.7</u>	<u>883.9</u>

Included in the above is auditors' remuneration in respect of the following:

	Period end 31 March 2007 £000	Year end 31 December 2005 £000
Fees payable to the company's auditors for the audit of the company's accounts	205	310
Fees payable to the company's auditors and its associates for other services		
- Other services pursuant to legislation	75	124
- Tax services	354	154
- All other services	151	150
Audit fees in respect of the Thames Water Limited pension scheme	15	22
Total aggregate remuneration	<u>800</u>	<u>760</u>

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

5 Profit on sale of fixed assets

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Profit on disposal of fixed assets	<u>12.1</u>	<u>9.1</u>
Taxation attributable, included in the charge for the period	<u>1.4</u>	<u>1.0</u>

6 Information regarding directors and employees

Aggregate directors emoluments:

	Period end 31 March 2007 £'000	Year end 31 December 2005 £'000
Salary	925	952
Bonus	244	123
Other benefits	<u>829</u>	<u>494</u>
Total aggregate emoluments	<u>1,998</u>	<u>1,569</u>

At 31 March 2007 no retirement benefits are accruing to directors (December 2005: 7) under a defined benefit scheme.

Included in the above, is compensation for loss of office £243,995 paid to S Buck and £187,153 paid to J England (December 2005: £460,920 paid to J R Sexton).

Highest paid director

The highest paid director during the period was J England. Full details of the highest paid director can be found in the Remuneration Report on page 40.

Employee information

The average number of persons employed by the Company, including executive directors, during the period was:

	Period end 31 March 2007 Number	Year end 31 December 2005 Number
Average monthly number of employees	<u>5,285</u>	<u>4,748</u>

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

6 Information regarding directors and employees (continued)

Employment costs including executive directors' remuneration were:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Salaries and wages	206.8	145.0
Social security costs	19.0	13.0
Pension costs (note 24)	28.5	22.6
Total	254.3	180.6
Employment costs included within research and development costs	(3.7)	(2.9)
Net employment costs	250.6	177.7

7 Net interest payable and similar charges

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Bank loans, overdrafts and other loans:		
- group loans	(167.5)	(102.9)
- bank loans	(28.7)	(25.1)
- other loans	(10.7)	(7.6)
Finance charges in respect of finance leases	(12.3)	(10.5)
Interest payable and similar charges	(219.2)	(146.1)
Interest receivable	13.5	3.2
Net interest payable and similar charges	(205.7)	(142.9)

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

8 Taxation

(a) Analysis of charge in period

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Current period:			
Amounts payable in respect of corporation tax for the year		75.4	74.6
Adjustments in respect of previous periods		<u>(5.7)</u>	<u>(4.6)</u>
Total current tax	8(b)	<u>69.7</u>	<u>70.0</u>
Deferred tax:			
Origination and reversal of timing differences	17	22.6	23.1
Pension cost charge lower than/(in excess of) pension cost relief		2.7	(1.3)
Adjustments in respect of previous periods	17	<u>6.5</u>	<u>2.5</u>
Total deferred tax		<u>31.8</u>	<u>24.3</u>
Taxation on profit on ordinary activities		<u>101.5</u>	<u>94.3</u>

(b) Factors affecting tax charge for period

The tax charge for the period is lower (2005: lower) than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Profit on ordinary activities before tax	<u>342.1</u>	<u>322.7</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (December 2005: 30%)	102.6	96.8
Effects of:		
Income not taxable (intra-group disposals of property)	(3.5)	(1.8)
Capital allowances for period in excess of depreciation	(21.6)	(22.2)
Disallowable expenditure	0.6	0.5
Pension cost charge (lower than)/in excess of pension cost relief	(2.7)	1.3
Adjustments to tax charge in respect of previous periods	<u>(5.7)</u>	<u>(4.6)</u>
Current tax charge for the period	<u>69.7</u>	<u>70.0</u>

The 2007 Finance Bill contains proposals under which the UK Corporation Tax rate will reduce from 30% to 28% with effect from 1 April 2008. It was also announced that balancing adjustments on assets on which Industrial Buildings Allowances (IBA's) are claimed will no longer apply and there will be a phasing out of annual writing down allowances.

At 31 March 2007 the above changes were not substantively enacted. Had these changes been enacted, the deferred tax liability as at 31 March 2007 would have been reduced by £88.5m. The IBA's available in the period, equivalent to £27.2m per annum, will be phased out on a straight line basis over three years commencing 1 April 2008.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

9 Dividends

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
First interim paid: 2.90p (December 2005: 9.27p) per ordinary share	29.8	95.4
Second interim paid: 8.86p (December 2005: 5.79p) per ordinary share	91.2	59.6
Third interim paid: 3.43p (December 2005: Nil) per ordinary share	35.3	-
Fourth interim paid: 48.59p (December 2005: Nil) per ordinary share	<u>500.0</u>	<u>-</u>
	<u>656.3</u>	<u>155.0</u>

10 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Infrastructure assets £m	Total £m
Cost				
At 1 January 2006 (as restated)	2,092.0	3,030.2	3,044.3	8,166.5
Additions	114.6	357.4	450.1	922.1
Disposals	(10.7)	(19.3)	-	(30.0)
Assets written off	-	(9.0)	-	(9.0)
At 31 March 2007	<u>2,195.9</u>	<u>3,359.3</u>	<u>3,494.4</u>	<u>9,049.6</u>
Capital contributions				
At 1 January 2006 (as restated)	-	-	461.0	461.0
Additions	-	-	46.5	46.5
At 31 March 2007	<u>-</u>	<u>-</u>	<u>507.5</u>	<u>507.5</u>
Depreciation				
At 1 January 2006	507.3	1,276.8	474.7	2,258.8
Provided during the period	46.0	227.4	131.1	404.5
Disposals	(2.6)	(19.0)	-	(21.6)
At 31 March 2007	<u>550.7</u>	<u>1,485.2</u>	<u>605.8</u>	<u>2,641.7</u>
Net Book Value				
At 31 March 2007	<u>1,645.2</u>	<u>1,874.1</u>	<u>2,381.1</u>	<u>5,900.4</u>
At 31 December 2005	<u>1,584.7</u>	<u>1,753.4</u>	<u>2,108.6</u>	<u>5,446.7</u>

The opening balances of infrastructure assets have been restated as a result of a misclassification in previous years between cost and capital contributions.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

10 Tangible fixed assets (continued)

The net book value of land and buildings is analysed as follows:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Freehold land and buildings	1,622.3	1,561.1
Leasehold - over 50 years	9.1	9.4
- under 50 years	13.8	14.2
	<u>1,645.2</u>	<u>1,584.7</u>

Depreciation has not been charged on freehold and leasehold land stated in the accounts at cost of £30.0m (2005: £30.1m).

Tangible fixed assets at 31 March 2007 include assets in the course of construction of £926.1m (2005: £718.7m).

Details of the Company's tangible fixed assets, which are held under finance leases are:

	Cost		Net book value	
	Period end 31 March 2007 £m	Year end 31 December 2005 £m	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Plant and equipment	<u>272.5</u>	<u>272.5</u>	<u>164.8</u>	<u>176.9</u>

Thames Gateway Water Treatment Plant

In June 2005 the London Borough of Newham, following a direction from the Mayor of London, formally refused planning permission for the Company's proposed Thames Gateway Water Treatment Plant, employing desalination technology at Beckton in East London. The site is operational land owned by the Company. An appeal was lodged and a public inquiry completed in June 2006. The works carried out to date are a combination of site preparation, for which planning permission is not considered a requirement, a pilot plant constructed on the site to prove the technology, for which planning permission has been granted and some preliminary construction works in readiness for the permanent plant which has been refused planning permission. The works on site were ceased pending the outcome of the public inquiry with the exception of work required to make the site safe and to fulfil contractual obligations. To 31 March 2007 the Company has spent £68.4m, of which £15m is in respect of site preparation and the pilot plant. On 14 June 2007, the Secretary of State for Communities and Local Government and the Secretary of State for Environment, Food and Rural Affairs accepted the decision of the Inspector who held the public inquiry that the appeal should be allowed and that planning permission should be granted, subject to an amended Section 106 Unilateral Undertaking, which will formally refer to the agreement of the parties as to the appointed use of the desalination plant.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

10 Tangible fixed assets (continued)

Upper Thames Major Resource Development Project

On 14 September 2006 the Company announced the proposed construction of a large reservoir to the South West of Abingdon to ensure security of water supply in the longer term. A period of public consultation is in progress, which will be followed by an application by the Company for a compulsory works order for the construction of the reservoir. To 31 March 2007 the total spent on this project was £26.7m, comprising principally costs of site selection, design and land acquisition in the proposed area. This expenditure has been capitalised on the basis that these costs are directly attributable to the asset and that, because it is an essential part of longer term security of water supply for southern England, it is anticipated that the project will go forward.

11 Fixed asset investments

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Cost of shares in subsidiaries	<u>0.1</u>	<u>0.1</u>

At 31 March 2007 the Company held more than 10% of the allotted share capital of the following undertakings:

Name of undertaking	Nominal value and class of shares held	Proportion of nominal value of issued shares held	Activity
Gemwel Limited	£1 Ordinary	50%	Water and sewerage services
Thames Water Drainage Services Limited	£1 Ordinary	100%	Sewerage management
Thames Water Procurement Limited	£1 Ordinary	100%	Procurement
Thames Water Utilities Finance limited	£1 Ordinary	100%	Finance company
County Wide Collections Limited	£1 Ordinary	100%	Debt collection

All of the above companies were incorporated and are registered in Great Britain.

At 31 March 2007 and 31 December 2005 the net asset values of Thames Water Drainage Services Limited and County Wide Collections Limited were £2 and £1 respectively. No profits or losses have been made in either of the periods concerned.

At 31 March 2007 Thames Water Utilities Finance Limited had net assets of £71,000 (December 2005: £50,000). Profit for the period ended 31 March 2007: £21,000 (December 2005: Nil).

Thames Water Procurement Limited had a deficit on reserves of £Nil at 31 March 2007 (December 2005: £1,523,000). Profit for the period ended 31 March 2007: £1,523,000 (December 2005: £1,000).

Gemwel Limited has a statutory accounting reference date of 31 March. At 31 March 2007 there were net assets of £Nil (March 2006: £Nil). No profits or losses have been made in the current year (March 2006: £10,000 loss).

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

11 Fixed asset investments (continued)

All of the above investments, with the exception of Thames Water Utilities Finance Limited, were disposed of on 24 May 2007, to Thames Water Limited.

12 Stocks and work in progress

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Raw materials and consumables	<u>6.1</u>	<u>6.2</u>

13 Debtors: amounts falling due within one year

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Trade debtors	182.0	191.4
Amounts owed by group undertakings	10.2	26.2
Other debtors	22.6	34.8
Insurance claims receivable	49.8	36.0
Prepayments and accrued income	<u>180.0</u>	<u>178.0</u>
	<u>444.6</u>	<u>466.4</u>

14 Creditors: amounts falling due within one year

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Bank loans	9.4	14.3
Obligations under finance leases	11.8	9.8
Trade creditors:		
- Operating	167.0	110.0
- Capital	209.2	141.4
Amounts owed to group undertakings	63.5	156.9
Insurance claims payable	49.8	36.0
Amounts payable in respect of corporation tax	-	32.4
Amounts payable in respect of group relief	23.5	2.8
Other taxation and social security payable	4.7	4.8
Accruals and deferred income	<u>192.0</u>	<u>356.4</u>
	<u>730.9</u>	<u>864.8</u>

Amounts owed to group undertakings include interest bearing loans, which are described in more detail in note 15.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

15 Creditors: amounts falling due after more than one year

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Bank loans	335.5	396.7
Obligations under finance leases	203.8	215.6
Amounts owed to group undertakings (see below)	2,877.5	1,671.8
Accruals and deferred income	168.5	151.1
	<u>3,585.3</u>	<u>2,435.2</u>

Amounts owed to group undertakings are:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Inter company loans:		
- Within one year	-	100.3
- After more than one year	2,877.5	1,671.8
	<u>2,877.5</u>	<u>1,772.1</u>
Non-loan amounts due within one year	63.5	56.6
	<u>2,941.0</u>	<u>1,828.7</u>

Loan amounts owed to group undertakings, are comprised of:

- £2,877.5m (December 2005: £1,460.1m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, of which £Nil (December 2005: £13.4m) is included within creditors due within one year and £2,877.5m (December 2005: £1,446.7m) within creditors due after more than one year.

The loan from Thames Water Utilities Finance Limited relates to Guaranteed Bonds that it has in issue, the net proceeds of which have been loaned to Thames Water Utilities Limited under the same commercial terms. Thames Water Utilities Limited has guaranteed the principal and interest payments of the subsidiary undertaking due under the terms of the bonds.

Thames Water Limited has guaranteed the principal and interest payments of certain bank loans of the Company. The principal amount guaranteed as at 31 March 2007 was £332.5m (December 2005: £404.2m).

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

15 Creditors: amounts falling due after more than one year (continued)

Other loans and finance leases, as disclosed in more detail in note 16, are:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Inter company loans (as above)	2,877.5	1,772.1
Finance leases:		
- Within one year	11.8	9.8
- After more than one year	203.8	215.6
	<u>3,093.1</u>	<u>1,997.5</u>

16 Financial instruments

FRS 25 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

Funding and treasury policy

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance Limited is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps and interest rate swaps, are employed to manage the interest rate and currency risks arising from the primary financial instruments used to finance the Company's activities.

The Company's treasury operations are managed centrally by a small specialist team within the Thames Water Division and are managed as a cost centre, not a profit centre; no material open or speculative positions are taken.

Short-term debtors and creditors have been excluded from the financial instruments disclosures.

Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows:

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

16 Financial instruments (continued)

Financial liabilities

	Total at floating rates		Total at fixed rates		Total at book value		Fixed rate liabilities			
							Weighted average interest rate		Weighted average period until maturity for which rate is fixed	
	2007 £m	2005 £m	2007 £m	2005 £m	2007 £m	2005 £m	2007 %	2005 %	2007 Years	2005 Years
Bank loans & overdrafts										
- £ Sterling	108.9	106.5	236.0	304.5	344.9	411.0	7.5	7.7	4.0	4.3
Other loans & finance leases										
- £ Sterling	215.6	504.6	2,877.5	1,492.9	3,093.1	1,997.5	5.5	5.3	24.5	14.4
Total	324.5	611.1	3,113.5	1,797.4	3,438.0	2,408.5	5.6	5.8	23.0	12.6

The Company's interest rate swaps convert £48.0m (December 2005: £50.4m) of floating rate borrowing to fixed rate and £26.9m (December 2005: £26.9m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £81.8m (December 2005: £94.8m) of foreign currency borrowing through conversion to Sterling.

Short term lending bears interest at rates linked to LIBOR.

Financial assets

	Total at floating rates		Total at fixed rates		Total at book value	
	2007 £m	2005 £m	2007 £m	2005 £m	2007 £m	2005 £m
Short term deposits	112.5	-	-	-	112.5	-
Cash at bank and in hand						
- Sterling	89.4	10.3	-	-	89.4	10.3
Total	201.9	10.3	-	-	201.9	10.3

LIBOR is the benchmark rate for all cash at bank.

Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

16 Financial instruments (continued)

Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value	Book value	Fair value	Fair value
	Period end	Year end	Period end	Year end
	31 March	31 December	31 March	31 December
	2007	2005	2007	2005
	£m	£m	£m	£m
Primary financial instruments				
Financial assets				
- Short term deposits	112.5	-	112.5	-
- Cash at bank and in hand	89.4	10.3	89.4	10.3
Financial liabilities				
- Bank loans	(332.5)	(404.1)	(337.3)	(427.7)
- Other loans & finance leases	(3,093.1)	(1,997.5)	(3,343.7)	(2,317.5)
Derivative financial instruments				
- Interest rate swaps	-	-	(4.6)	(7.8)
- Cross currency swaps	(12.4)	(6.9)	(12.4)	0.3
Total	<u>(3,236.1)</u>	<u>(2,398.2)</u>	<u>(3,496.1)</u>	<u>(2,742.4)</u>

Primary financial instruments include bonds, which are traded on a public market. Fair values for these have been calculated using the 31 March 2007 quoted prices. Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowing and all derivative financial instruments. Floating rate liabilities have fair values, which approximate to book value.

Book values of primary financial instruments are shown gross of the effect of any hedging instrument. Therefore, the effect of revaluing foreign currency borrowing at closing rates is included in the fair valuation.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

16 Financial instruments (continued)

Maturities	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Bank loans and overdrafts		
- Within one year	9.4	14.3
- Between one and two years	30.0	59.4
- Between two and five years	305.5	236.8
- After more than five years	-	100.5
	<u>344.9</u>	<u>411.0</u>
Other loans and finance leases		
- Within one year	11.8	110.1
- Between one and two years	29.3	11.8
- Between two and five years	374.0	372.0
- After more than five years	2,678.0	1,503.6
	<u>3,093.1</u>	<u>1,997.5</u>

Loans are repayable between 2007 and 2055.

- Loans wholly repayable after more than five years are:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Bank loans	-	100.5
Other loans	2,558.2	1,356.0
	<u>2,558.2</u>	<u>1,456.5</u>

- Other loans include:
 - £330m 6.75% MTN Eurobond due 2028.
 - £200m 6.50% MTN Eurobond due 2032.
 - £600m 5.13% MTN Eurobond due 2037.
 - £175m 3.38% Index linked bond due 2021.
 - £300m 1.68% Index linked bond due 2053.
 - £300m 1.68% Index linked bond due 2055.
 - £225m 6.59% Guaranteed bond due 2021.
 - £250m 4.75% Guaranteed bond due 2010.
 - £200m 4.90% Guaranteed bond due 2015.
 - £200m 5.05% Guaranteed bond due 2020.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

16 Financial instruments (continued)

- Loans repayable by instalments after more than five years hence are:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Finance leases	<u>119.9</u>	<u>147.6</u>

- The ranges of interest rates on outstanding bank loans are 1.7% to 8.4% (December 2005: 1.0% to 10.9%) and other loans and finance leases are 1.7% to 6.8% (December 2005: 1.7% to 6.8%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

Borrowing facilities

The Company previously relied on committed borrowing facilities from its ultimate parent company RWE AG (December 2005: £150m). These facilities were cancelled when RWE AG disposed of Thames Water Utilities Limited in December 2006. At March 2007 the Company has access to committed facilities of £700m through its parent company Kemble Water Limited.

Thames Water Utilities Finance Limited has a £5 billion (December 2005: US\$ 4 billion) uncommitted Euro-Medium Term Note programme, which provides the Company with access to the capital markets in a range of currencies and maturities. At 31 March 2007, outstanding debt obligations of Thames Water Utilities Finance Limited were £2,877.5m (December 2005: £1,460.1m), with a weighted average term of 24.5 years (December 2005: 15 years) at a weighted averaged rate of 5.49% (December 2005: 5.49%).

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

17 Provisions for liabilities and charges

Provisions for liabilities and charges consist entirely of a provision for deferred taxation. There are no amounts of deferred tax unprovided for (December 2005: £nil).

The movement in the provision was as follows:

	Note	£m
Provision brought forward at 1 January 2006		887.5
Deferred tax charge:		
- Current period	8(a)	22.6
- Prior period	8(a)	6.5
		<u>916.6</u>
Provision carried forward at 31 March 2007		<u>916.6</u>

An analysis of amounts provided at current tax rates is as follows:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Accelerated capital allowances	922.6	892.3
Other timing differences	<u>(6.0)</u>	<u>(4.8)</u>
	<u>916.6</u>	<u>887.5</u>
Total deferred tax provision:		
Included above	916.6	887.5
Deferred tax liability/(asset) provided on pension surplus/liability	<u>4.8</u>	<u>(22.3)</u>
	<u>921.4</u>	<u>865.2</u>

The pension asset/liability per note 24 is shown net of deferred tax.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

18 Share capital

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Authorised 1,029,050,000 (2005: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>
Allotted, called up and fully paid 1,029,050,000 (2005: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>

19 Share premium reserve

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
At 1 January and 31 March/ 31 December	<u>100.0</u>	<u>100.0</u>

Premium of 25p on issue of 400 million £1 ordinary shares.

20 Profit and loss reserve

	Note	Period end 31 March 2007 £m	Year end 31 December 2005 £m
At 1 January as previously reported		561.3	442.3
Restatement - FRS 17	24	-	(74.2)
Restatement - FRS 21		-	95.4
At 1 January - Restated		561.3	463.5
Profit for the period/year		240.6	228.4
Dividends	9	(656.3)	(155.0)
(Deficit)/retained profit		(415.7)	73.4
Actuarial gain on pension scheme	24	81.2	34.9
Movement on deferred tax relating to pension scheme		(24.4)	(10.5)
As at 31 March/31 December including total pension asset/liability		<u>202.4</u>	<u>561.3</u>
Total pension (asset)/liability	24	(11.1)	51.9
As at 31 March/31 December excluding pension (asset)/liability		<u>191.3</u>	<u>613.2</u>

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

21 Reconciliation of movements in shareholder's funds

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Profit for the financial period/year	240.6	228.4
Dividends	<u>(656.3)</u>	<u>(155.0)</u>
Net movement in shareholder's funds	(415.7)	73.4
Shareholder's funds at the beginning of the period/year as previously reported	1,690.3	1,571.3
Restatement - FRS 17	-	(74.2)
Restatement - FRS 21	<u>-</u>	<u>95.4</u>
Shareholder's funds at the beginning of the period/year as restated	<u>1,690.3</u>	<u>1,592.5</u>
Actuarial gain on pension scheme (note 24)	81.2	34.9
Movement on deferred tax relating to pension scheme	<u>(24.4)</u>	<u>(10.5)</u>
Shareholder's funds at the end of the period/year including pension (asset)/liability	<u>1,331.4</u>	<u>1,690.3</u>

22 Capital commitments and contingencies

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Contracted for but not provided	<u>372.0</u>	<u>155.9</u>

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

Guaranteed Standards Scheme and Non-Financial data integrity

(a) Guaranteed Standards Scheme

In January 2006 Thames Water informed Ofwat that it had discovered that it had been:

- failing to achieve required performance standards in customer services set out in the GSS; and
- failing to make the payments due to customers as required under the GSS.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

22 Capital commitments and contingencies (continued)

Under the terms of a notice issued by Ofwat (PN 21/06) on 19 July 2006, the company was advised that Ofwat proposed to impose a financial penalty for our failure to achieve customer service performance standards under the Guaranteed Standards Scheme (GSS).

Ofwat is required to issue notice within 12 months of the failure to achieve customer service standards and the notice applies only to those performance standard failures that have occurred since July 2005.

As a result Ofwat and Thames Water jointly appointed Ernst & Young LLP to carry out an independent investigation into these irregularities. Ofwat also asked Ernst & Young to examine whether there had been any mis-reporting of Thames Water's customer service performance to the regulator. Ernst & Young have concluded their investigation and have submitted their final reports to Ofwat.

(b) Non-Financial data integrity

On 7 June 2006, Ofwat issued notice under s.203(2) of the Water Industry Act 1991 stating that it considered that the company may have contravened conditions J and/or M of its appointment in providing information in its June Return which may not be reliable, accurate or complete. This notice would allow Ofwat to take steps to impose penalties on the company in respect of information contained in the June Return 2005 if it is satisfied that there has been any breach.

The company has been required to produce further information, as requested by Ofwat, which it has done in accordance with a mutually agreed timetable.

Any financial penalty which may be imposed in respect of each failure or breach may not exceed 10% of the Company's turnover as set out in Water Industry (Determination of Turnover for Penalties) Order 2005 No. 477. Thames Water's regulated turnover for 2005-06 was £1.4 billion.

The directors believe that to disclose the amount set aside for any penalty would be commercially prejudicial and have applied the exemption in FRS 12 not to disclose.

Mogden Sewage Treatment Works

A number of residents living close to the Mogden Sewage Treatment Works have filed a claim against the company under Articles 1 & 8 of the First Protocol of the European Convention on Human Rights in respect of odour and mosquitoes caused by the works. A private action is being pursued by 1326 claimants, 775 Group A claimants (those with property interests) and 551 Group B claimants (those without property interests). The Company does not have details of individual claims values and is being advised by Counsel and external legal advisors on the conduct of the defence of the claims. The Company has made an accrual in the financial statements for these matters.

British Waterways Board

The Company is also in discussions with the British Waterways Board in relation to payment for abstraction costs from the River Lee. There is a large differential between the company's interpretation of the costs to be charged under the River Lee Act and that of the British Waterways Board. The expectation is that the Secretary of State (DEFRA) will appoint an Inspector to hold an inquiry and resolve the issue in due course.

The Company has set aside amounts considered by the directors to be an adequate reserve for all legal and similar claims.

Notes to the financial statements for the period ended 31 March 2007

Thames Water Utilities Limited

23 Operating leases

At 31 March 2007 the Company was committed to making the following payments during the next year in respect of non-cancellable operating leases:

	Period end 31 March 2007		Year end 31 December 2005	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Leases which expire:				
Within one year	0.2	1.0	0.2	0.3
Between one and two years	-	0.7	-	0.6
Between two and five years	0.9	0.4	0.8	0.2
After more than five years	4.6	-	4.3	-
	<u>5.7</u>	<u>2.1</u>	<u>5.3</u>	<u>1.1</u>

24 Pension schemes

Pension arrangements for the majority of the Company's employees are of the defined benefit type, funded through pension schemes covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds. In addition, there are unfunded defined benefits provided for directors and senior employees affected by the cap on earnings, which cannot be provided through approved arrangements.

The Company's pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes' assets and liabilities are included with those of other companies in the Thames Water Group. The Company contributes the vast majority of the contributions into the schemes and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the Directors have decided it is appropriate to recognise the total surplus and deficit of the two Group pension schemes within these financial statements.

The service cost of the Company, as included with these financial statements, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

In addition to the ongoing cost of the UK Pension arrangements, the Company operates discretionary arrangements under which it augments benefits on retirement. These augmentations are funded by way of additional employer contributions to the schemes. In the period ended 31 March 2007 payments amounted to £7.8m (December 2005: £1.8m).

The latest full actuarial valuation was undertaken as at December 2004. This valuation has been updated at 31 March 2007 by Hewitt, Bacon and Woodrow using revised assumptions that are consistent with the requirements of FRS 17 and shown in the table below.

The next full actuarial valuation as at 31 December 2007 will be undertaken by Hewitt, Bacon and Woodrow (the independent and professionally qualified consulting actuaries to the schemes) during 2008.

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

24 Pension schemes (continued)

Thames Water Group has taken advice from Hewitt, Bacon and Woodrow in respect of the funding position of the Group pension schemes. With consideration of the funding position of the schemes, the Company contribution rate has been increased where necessary in accordance with Hewitt, Bacon and Woodrow recommendations.

The main financial assumptions used for FRS 17 purposes are as follows:

	31 March 2007	31 December 2005	31 December 2004
Price inflation	3.2%	2.9%	2.9%
Salary increases	4.2%	3.9%	3.9%
Pension increases	3.2%	2.9%	3.0%
Discount rate	5.4%	4.8%	5.3%

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the value of the schemes' liabilities assessed on the assumptions described above are shown in the following table:

	31 March 2007		31 December 2005		31 December 2004	
	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	8.8%	577.8	8.0%	525.7	8.0%	445.0
Bonds	5.3%	66.0	4.5%	63.8	4.5 – 5.0%	477.0
Gilts	4.5-4.8%	472.4	3.8 - 4.0%	445.1	-	-
Property	7.8%	95.0	8.0%	118.0	8.0%	87.0
Other assets	5.5%	35.2	4.5%	2.3	4.0%	-
Total market value of assets		1,246.4		1,154.9		1,009.0
Present value of schemes' liabilities		(1,205.9)		(1,229.1)		(1,113.9)
Irrecoverable surplus		(24.6)		-		-
Surplus/(deficit) in the schemes		15.9		(74.2)		(104.9)
Related deferred tax (liability)/asset		(4.8)		22.3		31.5
Net pension surplus/(deficit)		11.1		(51.9)		(73.4)

This can be analysed as follows:

	31 March 2007 £m	31 December 2005 £m
Thames Water Mirror Image Pension Scheme	37.3	36.8
Thames Water Pension Scheme	(26.2)	(88.7)
	11.1	(51.9)

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

24 Pension schemes (continued)

Analysis of amount charged to operating profit:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Current service cost	33.5	22.6
Past service cost	<u>(5.0)</u>	<u>-</u>
Total operating charge included in operating profit	<u>28.5</u>	<u>22.6</u>

Analysis of amount credited to other finance income:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Expected return on pension scheme assets	87.5	65.4
Impact of restriction on expected return on assets due to irrecoverable surplus	(7.3)	-
Interest on pension scheme liabilities	<u>(72.9)</u>	<u>(58.5)</u>
Net finance income	<u>7.3</u>	<u>6.9</u>

Analysis of amount recognised in statement of recognised gains and losses:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Actual return less expected return on pension scheme assets	7.1	98.4
Experience gains and losses arising on the scheme liabilities	11.9	24.7
Changes in assumptions underlying the present value of scheme liabilities	79.5	(88.2)
Adjustments relating to irrecoverable surplus	<u>(17.3)</u>	<u>-</u>
Actuarial gain recognised in STRGL	<u>81.2</u>	<u>34.9</u>

Thames Water Utilities Limited

Notes to the financial statements for the period ended 31 March 2007

24 Pension schemes (continued)

The movement in the surplus/(deficit) during the period to 31 March 2007 was as follows:

	Period end 31 March 2007 £m	Year end 31 December 2005 £m
Deficit in scheme at start of period	(74.2)	(104.9)
Operating charge	(28.5)	(22.6)
Employer contributions	30.1	11.5
Other finance income	7.3	6.9
Actuarial gain	<u>81.2</u>	<u>34.9</u>
Surplus/(deficit) in scheme at end of period	<u>15.9</u>	<u>(74.2)</u>

The details of experience gains and losses for the period to 31 March 2007 are as follows:

	Period end 31 March 2007 £m	Year end 31 December		
		2005 £m	2004 £m	2003 £m
Difference between the expected gains and losses on scheme assets:				
Amount	7.1	98.4	37.0	96.9
Percentage of scheme assets	<u>0.6%</u>	<u>8.5%</u>	<u>3.7%</u>	<u>10.6%</u>
Experience gains and losses on scheme liabilities:				
Amount	11.9	24.7	(39.1)	4.6
Percentage of the present value of the scheme liabilities	<u>1.0%</u>	<u>2.0%</u>	<u>3.5%</u>	<u>0.5%</u>
Total amount recognised in statement of total recognised gains and losses:				
Amount	81.2	34.9	(80.2)	28.5
Percentage of the present value of the schemes' liabilities	<u>6.7%</u>	<u>2.8%</u>	<u>7.2%</u>	<u>3.0%</u>

25 Intermediate and ultimate parent company and controlling party

The directors' consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

Kemble Water Investments Limited, a company incorporated in the United Kingdom is the intermediate parent company and the smallest group to consolidate these financial statements.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.