

Registered no: 02366661 (England and Wales)

Thames Water Utilities Limited

Regulatory Financial Statements

For the year ended 31 March 2008

Thames Water Utilities Limited

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Thames Water Utilities Limited

Directors and Advisors at 31 March 2008

Directors

Sir Peter Mason KBE (Chairman)
L Abraira
M W Baggs
R Blomfield-Smith
M W Braithwaite
C R Deacon
D W Owens
G Parsons
D J Shah
S F Shine
M S W Stanley
L Webb

Independent non-executive directors

S J Box
M J Pavia
W Smit

(See page 57 for changes in directors since 31 March 2007).

Registered auditors

PricewaterhouseCoopers LLP
9 Greyfriars Road
Reading
Berkshire
RG1 1JG

Company secretary & registered office

J E Hanson
Clearwater Court
Vastern Road
Reading
Berkshire
RG 18DB

Assistant secretary

I A Hamilton

Thames Water Utilities Limited

Chairman's Introduction

This review covers the first full year since the new Board of Thames Water was put in place on 1 December 2006. I am pleased to be able to say that it has been a year of unprecedented operational and financial successes.

The new Board's first action 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. This strategy has been remarkably successful in reversing years of decline in important areas, and in some cases achieving 'best ever' performance. I recognise that the Company still has much to do in fully restoring the confidence of our customers, regulators and other stakeholders, but the essential building blocks of strong operational and financial performance are now in place.

Operational successes include achieving full compliance on a look up table basis with effluent standards at all 349 of our sewage treatment works, for the first time ever; meeting a second successive reduction in our leakage target; and providing drinking water of the highest ever quality against the official standards. Capital expenditure to maintain and improve the infrastructure needed to provide these and other services to our customers was also at a new high of almost exactly £1 billion in a single year.

The focus on essentials has not been confined to operational matters. Despite the high levels of activity required to achieve these excellent results, operating costs (excluding depreciation) have been reduced by 7.0% compared to the previous regulatory period. This represents a high level of efficiency and, combined with turnover up by 4.4% compared to the previous regulatory period, has been the major factor in a 55.2% increase in profits before tax.

Away from the operational arena, the Company has been actively preparing for the future. A lengthy and wide-ranging consultation process informed the preparation of the Company's first Strategic Direction Statement, covering the next 25 years. This document has been well-received and provides a sound platform on which to build the Company's Strategic Business Plan for the next Periodic Review of prices by Ofwat, which will take place in 2009.

One of the Company's key concerns will always be to ensure that we can meet our customers' long-term demands for water, in the face of factors such as population growth and climate change. A significant risk to London's short and medium term security of water supply was removed by the new Mayor of London, Boris Johnson, in his first week in office, when he withdrew objections to our desalination plant at Beckton. Looking further ahead, our draft Water Resources Management Plan for the period from 2010 to 2035 is open for consultation until 27 August 2008. The draft plan sets out our intentions for managing demand, which include progressive targeted metering of more than 80% of our customers, and 100% of buildings, and an extensive programme promoting the efficient use of water. We will also continue our major capital investment to achieve further leakage reduction. Since these measures will not be sufficient to meet the anticipated demand, we are also proposing to develop new water resources, including a major reservoir in Oxfordshire.

It has been confirmed that the Government wishes the Company to proceed with the much discussed Thames Tideway tunnel, to ensure that the UK meets the requirements of the Urban Waste Water Treatment Directive. This will be the largest single project ever undertaken by the Company, involving a relatively short River Lee tunnel from Abbey Mills to Beckton, a much longer River Thames tunnel from Hammersmith to Beckton, and a major extension of Beckton sewage treatment works (STW) to provide the necessary treatment. Preparatory work is well advanced and planning applications for the Lee tunnel and Beckton improvements will be made during 2008.

Thames Water Utilities Limited

Chairman's Introduction (continued)

During the year the new management team have set out a new cultural framework (brand, mission and values) within which the Company will operate. The vision is that 'if customers had a choice they would choose Thames Water'. This is a highly appropriate stance for a company that exists to serve its customers, yet is in most respects – and for the time being - a monopoly supplier. Strenuous efforts are being made to understand customer priorities, through consultation and the use of new techniques, such as deliberative research. At the same time, major improvements are being made at the Company's Customer Centre in Swindon, to ensure that customers receive the best possible service.

The Company has maintained its commitment to working closely with the communities it serves, seeking to minimise any negative impacts from its operations and to make positive contributions wherever possible. In this context, I am pleased to be able to say that the Company's shareholders have approved the management's recommendation that customers and communities should share in the benefits of this year's strong financial performance.

A total of £10 million that would otherwise have been available to be disbursed to shareholders will fund a range of schemes that are known to be important to the Company's customers and stakeholders. These projects go beyond the company's day-to-day business activities and will bring benefits across the Company's geographical area. These activities include establishing an independent charitable trust to help disadvantaged customers, providing additional educational and community activities, improving public access to the Company's sites, investigating cutting-edge water efficiency opportunities, and assisting disadvantaged students to become the engineers of the future.

The same determined approach to corporate responsibility also led to the Company's commitment to contribute £500,000 to restore and improve the River Wandle in south London, following a major pollution event at the Company's Beddington STW. The decision was also taken to donate the £250,000 profits from storage at our Maple Lodge STW of 'firewater' resulting from the Buncefield fire to environmental charities supported by the company and the Environment Agency.

After a year of sustained, and in some cases unprecedented, achievement I must once again commend the efforts of every member of the Thames Water staff, on behalf of the whole Board. These are their achievements, delivered through sustained hard work over the whole year, in every department.

In my report last year, I said that much work remained to be done before Thames Water would again lead the water industry, and that the Board intended to provide a period of business stability, while planning for the challenges ahead. Both those statements remain true, but it is a pleasure to be able to back up those words with evidence of significant progress during a highly successful first full year.

Sir Peter Mason KBE
Chairman

Thames Water Utilities Limited

Operating and Financial Review ('OFR')

INTRODUCTION

This review serves as an Operating and Financial Review for the regulatory year 1 April 2007 – 31 March 2008 and has been prepared in accordance with the Accounting Standards Board's Reporting Standard RS1.

Unless otherwise stated, all current year data included in this review is for the year ended 31 March 2008 ("2007/08"), and all comparative data in this review is for the year ended 31 March 2007 ("2006/07").

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.

This review is incorporated within and forms part of the Directors' Report appearing at page 56.

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 undertakers¹ 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 13.6 million people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, the Company supplies 3.6 million properties (just over 8.5 million people) with water, and collects sewage from 5.3 million properties (about 13.6 million people), including 97% of households in its sewerage region.

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

Thames Water Utilities Limited

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

1.1.1 Ownership

On 1 December 2006, the Company - as part of the wider Thames Water group of companies headed by Thames Water Holdings Limited ("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 and certain other Macquarie managed funds, together with a number of long-term investors made up largely of pension funds and other institutional investors.

On 21 June 2007, the immediate ownership of the Company was transferred from Thames Water Limited to Thames Water Utilities Holdings Limited, a new intermediate holding company, wholly owned by Thames Water Limited, and whose ultimate parent company is Kemble Water Holdings Limited.

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 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.

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

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, the Company has a provision within its licence to allow price limits to be reviewed when events beyond their control have a significant effect on costs or revenues.

Following the acquisition by Kemble Water, Ofwat 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 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; and
- To introduce conditions relating to adequate systems of planning and internal control.

Following the consultation, Ofwat confirmed that these changes to the Company's licence would be made, and they duly took effect on 8 November 2007.

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 conducted an effectiveness review of the board governance arrangements in November 2007, in line with the guidelines laid out in the Combined Code on Corporate Governance. Ofwat has stated its intention to look carefully at the outcome of the review to be assured that the new board structure works in the interests of customers as well as shareholders. The Company is currently awaiting Ofwat's comments.

Thames Water Utilities Limited

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

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.

2 CURRENT PERFORMANCE

INTRODUCTION

In 2007/08 the Company continued with the 'back to basics' strategy implemented when the new Board was put in place on 1 December 2006. This approach involved focussing on the essentials of the regulated business serving London and the Thames Valley.

The Company has demonstrated an improvement in every key area of performance, reflected in its highest-ever score in Ofwat's Overall Performance Assessment.

The year included major improvements in the area of water supply, which included the Company's best-ever performance on drinking water quality at customers' taps, a fall in the number of burst mains and a major reduction in the number of customers suffering low pressure.

The Company also met its leakage target for the second year running, and exceeded its target for security of water supplies. It accelerated its Victorian Mains Replacement programme, replacing 527km of mains in London, where leakage is at its highest.

There were also major advances in sewerage and waste treatment. The Company completed engineering schemes which met targets for the reduction of internal and external sewer flooding due to undersized sewers.

The number of sewer collapses was reduced and by the end of 2007, the Company had cut the number of failing sewage works from a total of 18 in 2006 to zero. In the calendar year 2007 the Company was fined for just one event leading to prosecution, compared to 15 events in the previous 12 months.

In the area of customer service, the Company in addition recorded best-ever performances in responding to both billing enquiries and written complaints.

The above achievements came in a year in which the Company delivered its biggest-ever programme of capital investment, valued at nearly £1bn.

The improvements resulted in a significant increase in the Company's Overall Performance Assessment – a yardstick by which Ofwat compares companies' overall performance. The Company's score improved from 342 to 397 – its highest ever total.

Thames Water Utilities Limited

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

2.1 Water Service

2.1.1 Leakage

The Company has outperformed its leakage target for the second year running and in doing so continues to meet the requirements set out in the section 19 undertaking to Ofwat. The acceleration of the Victorian Mains Replacement programme in London has proved beneficial, and the new mains have proved to be resilient to the two cold weather events between December 2007 and February 2008, when ground temperatures fell below zero. This work continues to be a fundamental element of the Company's asset investment plans over the next 25 years to ensure ongoing security of supply and service to customers.

2.1.2 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 2007/08 is reported as 89 against a target of 58 (2006/07: 57 against a target of 40) (see page 37 for definition of Security of Supply Index). The Thames Gateway desalination plant at Beckton received planning permission in June 2007 and the Company is working hard with the local authorities to ensure completion by March 2010, as this remains the principal measure by which the Company will achieve security of supply for its customers in the short and medium term. As stated on page 13 the Greater London Authority dropped its High Court challenge to the Government's decision to grant planning permission for this desalination plant in May 2008.

Because of the uncertainty and delay over the outcome of the planning application for the Thames Gateway desalination plant, the Company accelerated the Victorian Mains Replacement programme in London, delivering the leakage savings reported above.

2.1.3 Drought and Water Efficiency

The drought of 2006 enabled the Company to test its assumptions about the effect of introducing a hosepipe ban on the demand for water during a drought event. These were based on the previous significant event in 1976 and have been proven to be optimistic.

Both the Company and its customers have become more aware of the need to use water efficiently. So the impact of a hosepipe ban today, whilst still significant, provides less benefit in terms of water saved than in 1976. Consequently, the Company's current Water Resources Management Plan takes into account a revised view of savings available during a drought event.

The promotion of water efficiency to customers is an integral part of the Company's approach to managing the supply demand balance. In 2007/08 the Company undertook 6,078 commercial audits (2006/07: 1,435) and, in addition carried out 355 household audits (2006/07: 897). There was an encouraging take up of free water savings devices by customers, with 58,899 devices installed.

2.1.4 Drinking Water Quality

Every year the Company carries out around 250,000 tests for water quality parameters with mandatory standards. The number of tests failing the relevant standard for calendar year 2007 has reduced by 40% compared with the previous year (127 to 76). The calendar year 2007 result of 99.98% for compliance with standards at customers' taps represents the Company's best ever performance on drinking water quality (calendar year 2006: 99.97%).

Thames Water Utilities Limited

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

With fewer failures at works, reservoirs and in distribution the Company expects its performance to continue to be amongst the best in the industry for calendar year 2007.

2.1.5 Metering

An additional 21,156 properties have had a free meter installed in 2007/08 under the optional metering process, compared to the forecast of 13,093 in the final determination. The Company has witnessed significant increased demand from customers wishing to opt for a metered supply since 2005/06, far outstripping the anticipated levels of activity in the final determination. As at the end of 2007/08 a total of 67,534 free meters have been installed, compared to a total forecast of 62,770 for the entire five-year period 2005-10.

2.1.6 Water Services Serviceability

All water infrastructure and non-infrastructure serviceability measures have either seen a continued improvement or have been held broadly stable in 2007/08. This has largely been achieved by our continued efforts to operate the network to be "calm" (with minimal disruption from frequent changes in the pumping regime) and our fast response to issues such as burst mains, low pressure alarms and interruption to supply incidents, along with the continued mains replacement programmes. The Company believes that this second year of improvement demonstrates sustained stability in its network infrastructure and thus believes that the assessment of serviceability for water infrastructure assets should be stable (2006/07: deteriorating).

The Company experienced 10,729 mains bursts during 2007/08, continuing last year's improvement (2006/07: 12,196). The number of connected properties suffering from low pressure was at an all time low of 0.01% (2006/07: 0.03%).

The Company's DG3 (unplanned interruptions to supply) overall performance score for 2007/08 is 0.24 (2006/07: 0.93). This is a significant improvement on the previous two years and means we have achieved the regulatory target for the first time in AMP4. This result means that the Company has effectively reduced the impact of unplanned interruptions to supply for its customers to a quarter of those a year ago.

2.2 Sewerage Service

2.2.1 Sewage Treatment Works Compliance

A further priority for the Company during 2007 was to restore the effluent compliance of its sewage treatment works, which is measured on a calendar year basis. In 2006, the Company had 18 works failing the numeric consent standards set by the Environment Agency. During 2007, due to a significant investment programme and improved operational processes, the Company has reduced the number of failing sewage works to one on an absolute standard by the end of the year. The Company's investment programme continues in 2008 to ensure that this excellent result is sustained.

However, the Company had a serious pollution event at one of its works in September 2007. This resulted in a significant loss of fish and other aquatic life in the River Wandle and came as a huge disappointment given its effluent compliance recovery results. The pollution was caused by the accidental release of chemicals used for cleaning plant at Beddington Sewage Treatment Works as part of efforts to improve effluent quality. The Company can confirm that procedures have been tightened and that advanced monitoring equipment was operational within three months of the incident, allowing the Company to provide real time analysis of the water quality within and leaving the works.

Thames Water Utilities Limited

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

The Company has since pledged £500,000 to restore and improve the River Wandle, working in conjunction with the Wandle Trust, over the next five years.

The Company's further plans are to rejuvenate the river, to help local angling clubs and to appoint a full time development officer for the river through the Wandle Trust.

2.2.2 Pollution Incidents

The Company has been working hard to reduce pollution incidents, adopting a risk-based approach, ensuring that it understands the root cause of all pollution incidents and that lessons are learned to prevent repeats.

Additionally, the Company has been accelerating its programme of rising main rehabilitation to reduce repeated pollution incidents. This work has enabled the Company to maintain last year's low level of pollution incidents occurring in its region.

Overall, the Company has shown the greatest improvement in the industry with just one event leading to prosecution (and one fine of £6,000) in calendar year 2007, compared to 15 events leading to prosecution (with fines of £191,600) in calendar year 2006. The number of pollution incidents remains low when compared to the rest of the industry, but the Company intends to achieve further reductions, recognising that all such incidents are unacceptable.

2.2.3 Sewer Flooding

In 2007/08 the Company has alleviated the risk of internal and external flooding from 1,502 properties on the 2 in 10 years and 1 in 10 years internal flooding register, in excess of its annual target (2006/07: 1,375).

Of the 1,767 internal sewer flooding incidents due to overloaded sewers in 2007/08, 1,347 were due to severe weather, 1,316 of these during the severe storms on 20 July 2007. At the time, the Company experienced storms travelling across its region from the South Coast and on to the rest of the UK. The Company estimates that in some areas around 100mm of rainfall (equivalent to one month's rainfall) fell in a few hours and some areas saw rainfall at intensities expected at a frequency of 1 in 1000 years. The event developed further during the next five days as the impact of river flooding materialised. This was one of the largest emergencies that the Company has ever had to manage.

In the last three years, the Company has removed a total of 1,824 properties from its other causes register (properties flooded more than once due to other causes within the last 10 years) by capital solutions, operational activity (eg: cleaning) or investigation. However, additions to the register (by flooding or investigation showing that incidents of flooding thought to be hydraulic initially were actually due to other causes) mean that the net position is not much changed. A similar picture emerged on the external flooding.

2.2.4 Sewerage Service Serviceability

All serviceability measures have improved again this year, with the exception of properties flooded due to overloaded sewers, (which was caused mainly, as explained above, by the severe weather event experienced in July 2007. This has largely been achieved by the Company's continued efforts to rehabilitate the sewer network and its vigilance on pollution incidents.

Thames Water Utilities Limited

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

The principal measure for waste non-infrastructure is sewage treatment works compliance. In 2007, the Company recorded its best ever performance (100%) for the primary measure of population equivalent served by compliant sewage treatment works (measured by Water Resources Act Look-up table consents).

The total number of sewer collapses in 2007/08 was 465, compared to 530 for the previous year, the Company's best ever performance.

Sewer collapses can cause flooding and pollution incidents. The Company has been carrying out a programme of sewer rehabilitation to reduce the number of sewer collapses that occur. This year the Company inspected some 2,058km of sewers with CCTV cameras (2006/07: 1,739km) and renewed or renovated a total of 83.5 km of sewer (2006/07: 68km), both ahead of targets in our serviceability action plan.

2.3 Customer Services

2.3.1 Customer Contacts

The Company maintained high service levels in response to contacts, responding to 99.81% of billing contacts within 5 days (2006/07: 99.84%) and 99.64% of written complaints within 10 days (2006/07: 99.68%).

2.3.2 Meter Reading

Performance on meter reading improved, with 99.60% of metered accounts receiving a bill based on a meter reading (2006/07: 99.24%), despite the overall metered customer base increasing by 70,000 accounts in the year.

This improved performance has been delivered through a combination of increased dedicated resource, extended working hours at evenings and weekend, repeated visits to properties and new processes including letters and outbound telephone contact.

2.3.3 Service to Customers Contacting the Company by Telephone

The Company has made improvements in 2007/08 to its telephone systems to allow more self-service facilities for customers and improved routing of telephone calls to enable more effective call handling. Use of better technology means the Company is now able to respond more quickly to peaks in call volumes. This is reflected in a reduced rate of abandonment on customer calls to 7.34% (2006/07: 7.5%) and improved stated customer satisfaction with the way in which the Company handles telephone calls with a score of 4.42 out of 5, where 5 means "very satisfied" (2006/07: 4.32).

2.4 Key Performance Indicators ("KPIs")

The Company's Key Performance Indicators are shown at Table 1. They are based on the 12-month regulatory year to 31 March 2008, unless otherwise stated.

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).

Thames Water Utilities Limited

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

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 Limited²) 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.

2.5 Looking Ahead at Key Operational Issues

2.5.1 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 continues to improve the targeting and repair of leaking mains through the continued implementation and refinement of the Leakage Action Plan developed in 2006.

In addition to accelerating efforts on leakage and mains replacement, the Company is delivering a number of new water resources schemes, both increasing available resource and also optimising distribution around the network. This, with increased focus on water efficiency and continued expansion of the metering programme combine to deliver targets for restoring security of supply.

The Thames Gateway desalination plant at Beckton received planning permission in July 2007 and the Company is working hard with the local authorities to ensure completion by March 2010, as this remains the principal measure by which the Company may achieve security of supply for its customers in London in the short and medium term. Following discussions with the new mayor, Boris Johnson, the Greater London Authority has dropped its High Court challenge to the Government's decision to grant planning permission for the Company's desalination plant in London.

Because of the uncertainty and delay over the outcome of the planning application for the Thames Gateway desalination plant, the Company accelerated the Victorian Mains Replacement programme in London. In 2007/08 the Company delivered 527km, 204km more than in 2006/07, (an increase of over 60%). The Company has approached Ofwat seeking agreement to maintain an accelerated rate of investment to help bridge the gap in security of supply by 2009/10 mentioned above.

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

Thames Water Utilities Limited

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

This accelerated investment programme has also helped to deliver sustained reductions in the number of burst water mains, to deliver an overall level of asset performance in line with the Company's best historic position.

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'; and
- 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.

This has yielded benefits to customers in the year in the form of further leakage reductions, a smaller number of properties at risk of low pressure and fewer burst mains meaning a significant drop in the number of properties experiencing unforeseen interruptions to supply.

2.5.2 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 area 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 155 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 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 Management Plan, which was made public in May 2008 following approval from Defra. 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 conservation of existing resources, the Company faces a significant shortfall over the long term between demand for water and the amount it can supply during a drought.

Thames Water Utilities Limited

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

The Company is currently working on two major proposals to supplement water resource availability:

- A desalination plant in east London, which would use reverse osmosis technology to convert brackish water from the Thames estuary into drinking water; and
- 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.

2.5.3 Drinking Water Quality

The Company is committed to maintaining its high standards of drinking water quality. The bacteriological quality at water treatment works improved in calendar year 2007, with only 7 samples recording the presence of coliform bacteria³ compared to 12 in the previous calendar year, and should continue as a result of the improvement programme the Company has agreed.

2.5.4 Sewerage Service

The Company is committed to maintaining excellent performance on sewage treatment works compliance and is undertaking further work to ensure the sustainability of its compliance record.

The disposal of fats, oils and greases into sewers is responsible for approximately one half of the total blockages (60,256 in 2007/08) dealt with by the Company every year. Oils and fats flushed down drains solidify and cause blockages that reduce sewer capacity, causing flooding and consequent pollution of watercourses. The Company is carrying out targeted sewer cleaning to prevent blockages in hotspot areas as well as working to educate customers (domestic and commercial) about the perils of disposing of inappropriate material down the sewers. To this end, the Company has carried out over 2,500 visits to food preparation and other industrial establishments during the year.

By April 2008, the Company had completed CCTV surveys of 1,646 kilometres of critical 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 AMP5 and beyond.

The Company will continue to deliver solutions for properties affected by flooding from overloaded sewers, aiming for a total of 3,521 internally flooded properties and 2,040 externally flooded properties to have been alleviated by April 2010.

2.5.5 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.

³Presence of coliform bacteria can be an indicator of reduced water quality

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

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. Following a full review in 2006, the Government concluded in March 2007 that proposals to build two tunnels (the Lee tunnel and the Thames tunnel) should be progressed in order to comply with the EU Urban Waste Water Directive. On current estimates the project will cost between £2.5 billion and £3.0 billion. The Company is currently in discussion with Ofwat to ensure appropriate funding for this project.

2.5.6 2012 Olympic Games

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

2.5.7 SAP Initiative

The Company is committed to implementing SAP's enterprise business application suite for our core Customer Service and billing functions and back office operations including Finance, HR, Supply Chain and Programme Management. SAP is the global market-leader for this type of cross-business application and their utility-specific solution will underpin our deployment of best-practice business processes across our operations. This in turn will lead to further operating efficiencies.

3 OBJECTIVES AND STRATEGIES

3.1 PR09

The Company's preparations for its draft five-year Strategic Business Plan (SBP) build on its 25-year Strategic Direction Statement (SDS) and Company vision: "If customers had a choice they would choose Thames Water".

The Company's strategic objectives for the period 2010-15 are based on extensive research into customers' priorities and willingness to pay, and the views of stakeholders.

The draft plan meets the needs of the rapidly growing population across London and the Thames Valley, while providing the service improvements customers have said they want. These include seeking to reduce leakage well below economic levels and a commitment to progressive, targeted metering across the region.

The Company's proposals incorporate measures to adapt to climate change, such as minimising carbon emissions and maximising the amount of renewable energy generated from its own operations.

Sustainability is a major consideration throughout the draft plan, which also seeks to address the issue of affordability by clearly prioritising investment needs, and offering new tariff arrangements based on an 'ability to pay'.

The Company's SBP aims to maximise the benefits for customers while delivering the regulatory and statutory obligations the Company is required to meet, including the construction of the Thames Tideway tunnel. Customer willingness to pay is at the heart of this evaluation and the Company continues to test the acceptability of its plan and the resultant bill increases with customers.

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

Since the Company published its SDS in December 2007, the Government has published its Water Strategy and consultation paper on Social and Environmental Guidance to Ofwat. The Pitt review, referenced by the Water Strategy, has also been published and the Company has concluded work on its draft Water Resources Management Plan. There are also ongoing initiatives to review competition. The Company's draft SBP will update the conclusions of its SDS to take these issues into account.

3.2 Operational Strategy

The Company's strategy is to focus on the regulated business within Thames Water Utilities Limited, following the divestment of the majority of the activities undertaken by the commercial division of the Kemble Water Group. The regulated business aims to provide the best-in-class water and sewerage service, which is profitable and sustainable and acts in the long-term interests of both the Company's customers and the wider community. Furthermore, the Company recognises the importance of good customer relations and has made significant steps over to improve customer service. This essential service to society represents exceptional value for all the Company's 13.6 million domestic and business customers and supports the vision that, 'if customers had a choice they would choose Thames Water'.

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 over the regulatory period, achievement of stable serviceability for all classes of assets. Within this regulatory framework the Company must achieve efficiencies in both operating costs and capital investment.

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 Chief Executive Officer and Board. 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 Company seeks to be transparent in the way it delivers and reports on the achievement of its targets.

3.3 Competition

Inset Appointments provide opportunity for competition in water and sewerage services, where a new entrant may, in defined circumstances, replace the incumbent water and sewerage undertaker in a specified part of the undertaker's area. Although Insets have been possible since 1989, only 15 appointments have been made nationally. However, Thames has received some expressions of interest, and discussions are in progress with one potential inset provider, which may lead to an inset appointment in 2008.

A second opportunity for competition arises from the possible provision of water supplies to defined types of customer under the Water Supply Licensing ("WSL") regime. Since 1 December 2005, suppliers - known as licensees - have been able to supply specified types of premises with a likely annual demand of at least 50 megalitres ("MI") in England and Wales. Supply may be via a wholesale supply from the incumbent undertaker (a "retail" licence) or may include the provision of the licensee's own water supply (a "combined" licence).

Thames Water Utilities Limited

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

As at 31 March 2008, seven new entrants had been granted supply licences by Ofwat but no eligible customer in England or Wales had switched supplier. During the year two licenced suppliers have been in discussion with the Company to agree Master Wholesale Agreements (MWA); one has now been agreed. A completed MWA is a pre-requisite to a customer-specific application to switch supply to a new licensee. The Company received no customer-specific applications during the year for switching of retail supply of water.

The Company has in place a code of practice detailing how access to third party water supply licensees is to be granted and has revised the code during the year. This complies with the Ofwat Customer Transfer Protocol, which is intended to enable customers to switch water suppliers.

Ofwat has embarked on a programme of review and consultation on competition and Government has initiated its own review, led by Professor Martin Cave of Warwick Business School. Ofwat have recently issued a consultation on 16 May 2008 for which the closing date is the end of August 2008. This is expected to lead, in due course, to further legislative and regulatory measures to increase the opportunities for competition.

3.4 Health and Safety

The health and safety duties of the Company are regulated by the Health and Safety Executive. Statistics for Health and Safety can be found in Table 1 at the end of the Operating and Financial Review.

3.5 Significant Regulatory Issues

3.5.1 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) – As at the year end, progress is on target;
- 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 – The Company is ahead of target;
- To meet the reprofiled leakage targets, i.e. reducing leakage by an extra 5 Ml/d by 2009-10 – As at the year end, the Company is on target;
- To meet the reprofiled Security of Supply Index ("SoSI") target securing the 2004 price review output of 100% by 2009-2010 – The Company is on target to achieve this objective; 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) – Completed.

Thames Water Utilities Limited

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

3.5.2 Guaranteed Standards Scheme (GSS) and Non-Financial Data Integrity

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 payments due to customers as required under the GSS.

Ofwat notified the Company in 2006 that it intended to impose a financial penalty for failure to achieve customer service performance standards under the GSS between July 2005 and July 2006. It also considered that the Company may have contravened conditions J and/or M of its Licence in providing information in its June Return which may not be reliable, accurate or complete.

Ofwat and Thames Water jointly appointed Ernst & Young LLP to carry out an independent investigation into inconsistencies in the reporting and handling of the Company's Customer Service Guarantee Scheme (CGS) service levels and payments from 2002-2006. The investigation concluded in 2006 and found no evidence of deliberate misreporting but highlighted significant failings in the Company's reporting systems and controls. The Company has since implemented a range of actions to improve customer service performance and the accuracy of the information reported to Ofwat. Ernst & Young have confirmed the effective completion of these actions.

Customers who missed a GSS payment to which they were entitled have now been paid as set out in the Company's CGS, along with an additional amount by way of compensation for the Company's failure to make the initial payment. However, where the Company could not trace customers, money due to these customers plus interest on all missed payments has been used to reduce the overall level of charges to all customers. In total, the Company has returned over £5m to customers and the payment process and amounts have been audited for Ofwat by Ernst & Young.

In 2006, the Company commissioned Ernst & Young to undertake a review of the integrity of non-financial data reported to Ofwat. This review concluded in 2006 and, whilst it found material compliance with Ofwat's reporting requirements, it identified risks associated with the definition and control surrounding data reporting processes. The Company has successfully implemented some 190 resulting actions to improve and maintain the integrity of non-financial data including the adoption of formal governance processes for information reported in the June Return to Ofwat.

In September 2007, following the Company's provision of more information on the circumstances which led to the problems and its consideration of the results of the Ernst & Young investigation, Ofwat published its intention to fine Thames Water £11.1m (0.8% of its 2006/07 turnover) for information misreporting in the June Return 2005 and £1.4m (0.1% of its 2005/06 turnover) for providing poor service to customers as a result of the Company's failings. The Company has made representations to Ofwat over the proportionality of the proposed fines. As a result of these representations, in April 2008 Ofwat finalised the penalties at £8.3m (0.6% of its 2006/07 turnover) for information misreporting and £1.4m (0.1% of its 2005/06 turnover) for providing poor customer service.

Subsequent to year end the Company settled the finalised penalties with Ofwat.

Thames Water Utilities Limited

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

4 RELATIONSHIPS AND RESOURCES

4.1 Employees

The Company's employees have continued to demonstrate high commitment and dedication levels during a challenging year.

Following the acquisition by Kemble Water and changes to the senior leadership team, a significant number of changes have been implemented across the business.

The People Strategy is now in place, 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. One of the key drivers for the People Strategy is inspiring a culture of engagement, the 'Passionate about Thames' programme aims to engage employees with the business and help the Company become a great place to work.

The Chief Executive Officer and Executive Management Team are now holding quarterly management briefings with managers, these meetings provide the opportunity to discuss the Company's performance and how the Company can continue to move forward.

Staff turnover increased from 15% in 2006/07 to 16% in 2007/08. The increase was largely due to an increase in the number of resignations, as would be expected with a change in Company ownership and associated uncertainties. 16% is still considerably lower than the highest levels of turnover (22.6%) that can be found in private sector organisations. 355 Full Time Equivalents (FTE's) from Engenica were brought back into the business to form part of the Waste Water Services Maintenance team. The average number of persons employed by the Company for 2007/08 was 5,072 (2006/07: 5,280). Reported sickness absence was 3.35% for the year (2006/07: 3.0%).

4.2 Stakeholders

Establishing and maintaining good working 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. In addition, the Company's activities often have a significant impact on our stakeholders.

Key stakeholder groups include regulators such as Ofwat, the Drinking Water Inspectorate and the Environment Agency (dealt with separately at section 1.2 above), shareholders, domestic and commercial customers, the Consumer Council for Water, Local, Regional and National Government; MPs and MEPs, Natural England, local interest groups, environmental groups, employees, Trade Unions, suppliers and contractors. In addition, the Company has a specialised group of stakeholders interested primarily in its financial performance, such as investment banks.

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 relationship owner within the Company, with responsibility for maintaining good two-way communications and ensuring that the relationship works well to the mutual benefit of both the Company and the stakeholder. Other stakeholders are contacted on an 'issues' basis, often through workshops designed specifically to facilitate stakeholder engagement.

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

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

During the year, stakeholders have been consulted formally on the Company's 25 year business plan as detailed in the draft Strategic Direction Statement, through workshops and on an individual basis. The final version of this document was published in December 2007 and details how the comments the Company received from stakeholders have been incorporated into its plans. During 2008, the Company will be building on this exercise with further consultations on the 25 year water resources plan (as detailed in the draft Water Resource Management Plan) and the business plan for 2010 to 2015 (as described in the draft Strategic Business Plan).

4.3 Customers

The Company recognises the importance of good customer relations and improving customer service.

In 2007/08, the Company embarked on a major transformation programme targeted at improving customer service levels, reducing costs to serve and improving first time resolution for all customer queries. As part of this programme, the Company has introduced new on-line services for customers so that they can view their bill on-line, removing the need to send them a paper bill. The Company has updated its telephony self-service system to make it easier for customers to navigate and contact the Company. In addition, the Company is also introducing new systems, processes and training to make sure that customers can speak to the right person at the right time to ensure their query or issue is dealt with in the most effective way.

The Company has also made some significant changes to its escalation process and all repeat calls to the Customer Contact Centre are being escalated within the business. This is starting to drive improvements in customer service and the Company is already seeing a reduction in the time taken to resolve customer queries. As the transformation programme starts to make an impact, the Company is expecting to see these repeat calls drop significantly as it gets better at fixing problems at the first point of customer contact.

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.

There has been a 78% increase in the number of customers receiving special assistance in the year. This increase has been driven by a number of new initiatives including closer working with community police officers to publicise the Company's Doorstep Password Scheme and liaising with local authorities/housing associations to identify sheltered housing complexes and care homes/centres for the vulnerable.

The Company's Customer Assistance Fund continues to encourage customers on low incomes to act responsibly through sensible budgeting. More than 7,000 customers have been helped by the fund since it was set up in 1997, with approximately 944 joining in 2007/08.

Thames Water Utilities Limited

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

The Company continues to offer a Vulnerable Tariff Scheme, now known as the WaterSure Scheme to help households with a metered water supply that receive certain benefits and have a need to use more water than average because of a large family or a medical condition. This capped tariff ensures that these households are not placed at a disadvantage by their genuine need to use extra water. More than 2,300 customers are benefiting from this scheme with over 500 new customers joining in 2007/08.

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.

4.4 Key Suppliers and Contractors

In 2007/08, the Company spent in excess of £1.2 billion on construction, goods and services with a range of suppliers and contractors (2006/07: just in excess of £1 billion). Approximately 18 key suppliers were engaged with a spend greater than £10 million each (2006/07: 20). 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 the Utilities Contracts Regulations 2006 (as amended).

The Company's main trading arrangements during 2007/08 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 2007/08.

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. Some projects are tendered between two Performance Partners. Large projects (most 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 as the Company moves towards AMP5.

The Company is committed to continuously reviewing procurement processes in the light of developing procurement best practice in the area of sustainability. The Company's environmental responsibilities extend beyond the direct environmental impact of its process plant and infrastructure. Improvements are underway to the Company's systems, processes, strategy, people skills, business alignment and supplier measurement. As part of this process improvement, a new senior management role has been formed, with specific responsibility for coordinating, defining and implementing policies on Sustainability, Environment and Corporate Social Responsibility (CSR). The Company's procurement policies require these issues to be assessed as part of all significant purchases.

Thames Water Utilities Limited

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

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 have been steadily improved in response to feedback, including the introduction of a facility for customers to 'self-serve' online.

An entirely new website is under development and will go live in July 2008. 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 2007/08, the site received an average of 7,500 visits per day, or 2,780,000 over the year.

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 £4.1m for the year (2007: £4.6m).

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 waste, and general office waste.

Support provided by the Company to its construction partners reduces the amount of waste going to landfill. In 2006/07, 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.

Thames Water Utilities Limited

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

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 with 99.9% put to beneficial use in 2007/08. 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.

Other examples from the Company's capital programme in 2007/08 include: using trenchless technology to lay 40% of the total 527km of pipe that has been laid as part of the Victorian Mains Replacement scheme; creating a facility at Beckton Sewage Treatment Works to produce shingle and Type 1 roadstone from excavated material from the Victorian Mains Replacement scheme; and using a machine to produce a Type 1 roadstone replacement from highway arisings. The combined result has been a reduction in: the quantity of waste sent to landfill; the purchase of primary aggregates from quarries; and the amount of traffic disruption.

5.2 Climate Change

Climate change is a serious concern for the Company. 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 (a recent example being the July 2007 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 prolonged drought from November 2004 to April 2006 highlighted many of the difficulties ahead.

The Company is committed to adapting to climate change and taking steps to mitigate its impacts. Following the publication of its Climate Change Policy and Climate Change and Carbon Management Strategy, the Company has made the next step in tackling climate change by creating a new, high-profile Carbon Management team. With the appointment of a new Energy manager and Carbon Integration manager, the Company is now in a position to deliver on its carbon reduction promises and truly make a difference strategy.

The Climate Change and Carbon Management Strategy is in line with the UK's Climate Change Bill, which is expected to receive Royal Assent in summer 2008 and sets legally binding targets for at least a 60% reduction in UK emissions by 2050, based on 1990 levels. The Company is adapting to climate change, by including climate change factors in water resource planning (protecting future water supplies), and sewerage design (to prevent sewer flooding). The Company will continue to deliver its share of relevant carbon reduction targets. In line with the Climate Change Bill, it will reduce its emissions by 20% by 2015 (compared to 1990 levels), as this level of action is essential to ensure the sustainability of the natural environment and the Company's business operations.

The Company continues to reduce its emissions through energy and business efficiencies and increasing its own generation of renewable energy. However, in order to meet its carbon reduction targets it believes that a step change is now required through additional investment in improving the energy efficiency of current assets, purchasing energy efficient new technology and developing further renewable energy options.

The Company will keep its climate change and emissions reduction solutions under constant review as part of its Climate Change and Carbon Management Strategy.

Thames Water Utilities Limited

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

5.3 Energy Efficiency and Renewable Energy

The Company, in line with the rest of the sector, introduced a new standardised methodology during the year for calculating its greenhouse emissions. The Company's greenhouse gas (GHG) emissions for 2007/08 were 876,033 tonnes CO₂ equivalent (2006/07: 892,141 tonnes CO₂ equivalent). This represents a reduction of 2 % for the year.

Overall in 2007/08, the Company consumed 1,591 gigawatt-hours (GWh) of energy (2006/07: 1,193 GWh), of which 73% was purchased electricity and gas from outside the Company and 27% was self-generated renewable energy. Over this period, the Company produced more renewable electricity than ever before, generating 169 GWh from its 19 combined heat and power (CHP) engines and two sludge-powered generators. When added to heat energy, the Company generated a total of 437 GWh of renewable energy for the year (2006/07: 412 GWh).

The work being carried out on the Company's pumps (the most energy intensive part of the business) is of particular importance. Through comprehensive testing and refurbishment, this project alone has led to reductions in greenhouse gas emissions of approximately 2,000 tonnes CO₂. By the end of the project, savings are expected to total approximately 10,000 tonnes CO₂.

In the future the Company believes that a "cultural shift" is critical if it is to make Company-wide improvements in energy efficiency, and reductions in carbon emissions. To achieve this a number of high-awareness projects are underway on all of its sites where, lighting controls are being improved, which will save energy and be a visible demonstration of the Company's energy reductions. By installing a combination of motion sensors, modern switches, and timers, the trials suggests that the Company will see electricity savings of up to 90%.

5.4 Biodiversity

The Natural Environment and Rural Communities Act was passed in October 2006, in which Section 40 requires public bodies, including utilities, to have regard to the purpose of conserving biodiversity in exercising its functions. The Company welcomed the new statutory duty and continued to protect and conserve biodiversity as a high priority.

The Company progressed its biodiversity project to further develop the means to ensure the conservation of biodiversity assets under its stewardship. The Company also worked in the community, supporting several local biodiversity partnerships in the delivery of national and local biodiversity action plans, and facilitated greater access to the enjoyment of biodiversity on its landholdings.

During 2007/08, the Company's largest ever capital programme required it to check more than the usual annual number of projects to ensure compliance with statutory and non-statutory ecological and archaeological obligations. This supported efficient delivery of the capital infrastructure projects.

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

6 SOCIAL AND COMMUNITY

6.1 Community Investment

The nature of the Company's business activities mean that it is constantly working with local communities in delivering its services. The Company aims to understand the needs of its communities and to work in partnership to achieve these and to minimise any negative impacts. The Company's Community Investment Strategy continues to focus on three water-related themes: environment, education and healthy living. During the year, the Company joined the London Benchmarking Group to improve the focus of its Community Investment programme and ensure rigorous reporting of its activities. During 2007/08, the value of the Company's Community Investment was around £1 million. As an output of this investment, the Company was able to leverage more than a further £1 million through its customers, employees and partners, benefiting the community and various charitable organisations.

6.2 Education

As a major employer across London and the Thames Valley, the Company depends on today's young learners to be able to provide the skills it will need in the future. The Company is also keenly aware of the important role for education in encouraging students, their families and communities to improve their water conservation and how they use the sewerage system. The Company's Chief Executive, in a keynote speech at the national education business partnership conference in December 2007, confirmed this commitment to education.

There has been great demand for the Company's 'Aquabatics' Key Stage 2 (ages 7-11) teaching resource with over 200 packs requested in 2007/08. Based on the key parts of the water industry, these resources look at ways to conserve water and avoid blockages in drains and sewers, as well as the principles of water and sewage treatment. The Company also ran ten 'Reservoir to Tap' network challenges across its region for key stage 3/4 students (aged up to 16). Students work in teams under time pressure to meet a series of realistic engineering challenges and learn about the business of supplying water by building their own water network.

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 and are made available to all primary schools across London, with around 540 schools participating this year. As well as providing financial support to the awards scheme Thames Water staff assisted by volunteering with school projects on water and the environment.

6.3 Employee Volunteering and Working with Charities

The Company continued its 'Time to Give' employee volunteering scheme which allows staff to spend two days a year working with charity partners and at corporately organised volunteering events. During 2007/08 a total of 453 volunteers donated 373 days in volunteering time. The biggest volunteering event of the year took place in March 2008 when, as part of the Reading Rivers and Environmental Spaces Clean-Up Event (RESCUE), 100 employees were joined by our Chief Executive Officer and other members of the Executive Management Team to clean up three large sites around Reading.

Thames Water Utilities Limited

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

Numerous activities were undertaken within the framework of the Company's long-standing strategic partnership with WaterAid including an annual raft race, sponsored walks and marathons, a treasure hunt and race night and a hugely successful 'Love Water' Ball that the Company staged in February 2008 which in itself raised in excess of £200,000. These activities resulted in over £350,000 being raised during 2007/08 by staff and pensioners. When added to our annual customer appeal, the funds raised in 2007/08 through this partnership will help to deliver safe water, sanitation and hygiene education for around 150,000 people in countries such as India, Tanzania and Burkina Faso.

The Company also continued to develop its support for water and healthy living closer to home. The Company is involved in several initiatives to promote well-being through drinking tap water in the build up to the 2012 Olympics and Paralympic Games. The Company provides a bursary to Harry Akinees-Aryeetey, a young sprinter and potential medallist in 2012, as well as support for the East London Business Alliance 'Banking on Talent' programme and support for the British Paralympic Association. The Company continued as the official water supplier to the London Youth Games and a premier sponsor of the Aquateers Swimming Project which encourages participation and improves performance at swimming clubs across the country. The Company worked with the Aquateers organisers to secure 'SportsMatch' funding for eight free 'Oceans of Fun' days to encourage families from deprived areas to take up swimming for exercise, health and fun.

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;
- An internal audit function providing independent scrutiny of internal control systems and risk management procedures; and
- A review of reports produced by internal and external audit.

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

Thames Water Utilities Limited

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

7.2 Risk Overview

The Company uses an Integrated Business Risk Management approach to minimise the organisation's exposure to unforeseen events and to help manage known risks. This creates a stable environment within which the organisation can deliver its strategic objectives. The Company manages its risk portfolio through a process of consistent and replicable risk identification, assessment and escalation, and each business area maintains a risk register.

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 embedded, i.e. operational risks, and those of external origin (i.e. imposed risks).

7.2.1 Operational Risks

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

- **PR09 Determination** – the PR09 price determination will be a negotiated agreement with Ofwat that determines the level of expenditure authorised over the coming 5-year Asset Management Period, and accordingly the revenue available to the Company. There is a risk that the Company will not be authorised to incur the expenditure needed to maintain and upgrade its assets in order to provide the service expected by our customers.
- **Failure to deliver the regulatory contract** – The shortage of available skilled labour in London and the South East creates an environment where the Company must compete with other organisations for staff with the necessary skills, particularly engineering, in order to deliver the capital programme agreed in the Final Determination and additional major planned projects. 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 regulation and/or law until it is 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 internal 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.

7.2.2 Extrinsic Risks

These types of risks are usually of a temporary nature, outside of the normal macro-operating environment of an organisation and therefore outside of the Company's control. Accordingly, they are managed by specific response plans. The Company has a risk management process for the identification of such risks before they impact, allowing influencing and other management responses to be adopted.

Thames Water Utilities Limited

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

Examples of significant external 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** – Some processes involved in water treatment consume significant amounts of energy. Whilst the Company continues to introduce increasing energy efficiency measures, 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 its 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 Mar 08	12 mths to Mar 07
EBITDA (Operating profit plus profit on sale of fixed asset excluding depreciation and Infrastructure Renewals Charge (IRC))	£m	916.7	768.6
Appointed Capex Spend (Including IRC)	£m	996.6	777.6
Net cash inflow from operating activities	£m	920.0	765.0
Operating expenditure (excluding depreciation and IRC)	£m	622.6	673.9

Thames Water Utilities Limited

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

9 FINANCIAL POSITION

Turnover was £1,494.2m for the year to 31 March 2008 (2007: £1,431.0m). Turnover has increased by 4.4% on the previous regulatory year. Real increases in price, as agreed with Ofwat, together with increases linked to the Retail Price Index (RPI), increased turnover by 5.1% when compared to the prior year. This increase has been diluted by a reduction in other turnover activities, including lower metered consumption.

Operating costs, excluding depreciation and Infrastructure Renewals Charge (IRC), were £622.6m for the year to 31 March 2008 (2007: £673.9m). Operating costs decreased on the previous regulatory year by 7.6%. During the year, a detailed review of the current methodology of setting the provision against bad and doubtful debts was undertaken, which has led to an increase in the level of provision by £24.1m. Excluding this item, operating costs have decreased by 11.2% compared to the prior regulatory year, with the emphasis on driving operating efficiency, whilst ensuring the delivery of the Company's regulatory outputs, being the main contributory factor. Key cost efficiencies arose in the areas of staff costs, power costs and the reduction in other external costs, including contractor costs.

Profit on ordinary activities before taxation was £419.2m for the year to 31 March 2008 (2007: £270.1m). The increase in turnover together with continued operational efficiencies have given rise to the improved results, being a 55.2% increase in profit before taxation on the previous regulatory year.

The FRS 17 pension cost for the year to 31 March 2008 was £18.1m (2007: £22.3m). Further information about the Company's pension schemes is set out in note 26 on page 95 of these accounts.

Capital investment in the year has been particularly targeted towards leakage reduction, security of drinking water supplies to customers, water and wastewater quality programmes and the alleviation of sewer flooding. Gross capital expenditure continued to accelerate into, and through, the third year of AMP 4, increasing to nearly £1 billion. Gross capital investment of £997.1m was made during the year (2007: £779.4m), including net infrastructure renewal expenditure of £176.2m (2007: £117.8m). This continuing substantial investment programme is reflected in the depreciation charge of £326.6m for the year (2007: £324.2m).

The Company paid interim dividends totalling £102.0m during the year 2007: £535.3m).

On 22 May 2008, the Directors approved a further interim dividend of £131.0m (12.7p per ordinary share) in respect of the year ended 31 March 2008. This interim dividend was subsequently paid on 30 May 2008.

Details of critical accounting policies are given in note 2 to the Accounts on page 74.

Thames Water Utilities Limited

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

10 CAPITAL STRUCTURE

10.1 Equity

The Company has an authorised share capital of 1,029,050,000 £1 Ordinary Shares, all of which is in issue.

On 21 June 2007, the immediate ownership of the Company was transferred from Thames Water Limited to Thames Water Utilities Holdings Limited, a new intermediate holding company, wholly owned by Thames Water Limited, and whose ultimate parent company is Kemble Water Holdings Limited.

10.2 Capital Structure

Following the acquisition of Thames Water by Kemble Water Limited, the whole business securitisation of Thames Water Utilities Holdings Limited, the Company and its wholly owned subsidiaries (the securitisation group) was completed in August 2007.

Key features of the capital structure following securitisation are as follows:

1. The ratio of net debt to Regulated Capital Value (RCV) within the securitisation group is limited to 75 per cent until the end of the current regulatory period (31 March 2010).
2. All debt issued by the securitisation group will be documented pursuant to a Common Terms Agreement.
3. Until March, 2010, all Thames Water Utilities Limited debt will be in one single class ("Class A").
4. From April 2010, the Directors of Thames Water Utilities Limited will have the option to trigger an increase of the Debt/RCV ratio to 85 per cent by the issue of Subordinated Debt ("Class B").
5. Each Obligor (the companies within the securitisation group) has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited will guarantee the obligations of each other Obligor under the finance documents and the Company and its wholly owned subsidiaries will guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.
6. Following an Event of Default, the documents will provide for an automatic 18-month standstill of the claims of the creditors that have entered into the STID.

10.3 Debt Financing

Following the completion of the whole business securitisation, debt financing is raised by the Company or through the Company's new wholly owned subsidiary; Thames Water Utilities Cayman Finance Limited. Previously debt had been raised via Thames Water Utilities Finance Limited; legacy debt obligations will remain outstanding but no new debt will be issued by Thames Water Utilities Finance Limited.

Thames Water Utilities Limited

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

Post completion of securitisation, Moody's Investor Service rates Class A debt as issued by Thames Water Utilities Cayman Finance Ltd at A3 long term with stable outlook. Moody's also issues a Corporate Family Rating for the securitisation group of companies, which stands at Baa1, reflecting the ability to issue Class B debt post 31 March 2010. Standard and Poor's Rating Services rates Class A debt as issued by Thames Water Utilities Cayman Finance Ltd at BBB+ long-term with a stable outlook. As such the Company maintains an investment grade issuer credit rating in accordance with the requirements of its Licence.

The Company's borrowings net of cash and short-term deposits of £4,746.5 million at 31 March 2008, comprised £3,840.7 million of intercompany loans relating to bonds issued by Thames Water Utilities Cayman Finance Limited and Thames Water Utilities Finance Limited, £475 million of loans from the European Investment Bank, £250 million of intercompany loan relating to draw downs under Thames Water Utilities Cayman Finance's Revolving Credit Facility, £86.3 million loans from other group companies and £204.5 million of long-term leasing offset by £81.4 million of cash and short-term deposit and £28.6 million of pre-paid fees.

10.4 Treasury Policy

The Company's treasury operations are managed centrally by a small specialist team, which 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.

Following the completion of the whole business securitisation, a further key objective of treasury policy is to ensure compliance with key financial covenants, including interest cover and gearing ratios; with the requirements to maintain liquidity and a balanced debt maturity profile, and to ensure that at least 85% of interest cost within the securitisation group is calculated on the basis of either fixed or RPI-linked interest rates.

10.5 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 63 of the Accounts, in the financial year ended 31 March 2008 net cash generated from the Company's continuing operating activities was £920.0 million for the 12 months to 31 March 2008, compared with £765.0m for the 12 months to 31 March 2007. 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.

10.6 Short-term Liquidity

The Company's short term liquidity requirements are met through an intercompany loan arrangement providing access to Thames Water Utilities Cayman Finance Limited's £750m committed revolving credit facility, arranged in August 2007. Participation in this facility is split equally between nine banks. At 31 March 2008, the Company had £500m of this facility available to be drawn. The Company has access to a further £305m of committed bank facilities via Thames Water Utilities Cayman Finance Limited, which may only be drawn if the Company has entered into a period of standstill (see paragraph 10.2).

Thames Water Utilities Limited

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

10.7 Long Term Liquidity

The Company has effective access to the debt capital markets through the £10 billion Debt Issuance Programme, which provides for the periodic issuances of debt instrument by Thames Water Utilities Cayman Finance Limited 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 secured when debt securities have been successfully issued.

Loans and obligations to the European Investment Bank were £475 million at 31st March 2008, compared to £332.5 million at 31st March 2007. Other loans and obligations under finance leases were £4,339.1 million at 31 March 2008, compared with £3,093.1 million at 31st March 2007. Amounts repayable after more than five years comprise capital market obligations and other loans repayable between 2013 and 2062. Fixed interest rates, for amounts after more than five years, range from 1.68 percent to 8.35 percent.

On 9 April 2008, amidst very difficult market conditions, Thames Water Utilities Cayman Finance Limited issued a £400 million bond due 2058. The proceeds of the bond issue were on-lent to the Company, which allowed the Company to repay its £250 million intercompany loan in respect of the Revolving Credit Facility, and provided additional liquidity for the Company.

10.8 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 and compliance with financial covenants as defined under whole business securitisation. At 31 March 2008, 87% 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.

10.9 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 2008, unutilised committed facilities of £500 million expiring in more than one year, together with cash and short-term deposits of £81.4 million, provide substantial liquidity protection for the Company.

Signed on behalf of the Board

David Owens
Chief Executive Officer

Thames Water Utilities Limited

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

Table 1 – Non-financial Indicators for 2007/08

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 37.

Water Service

Measure	Unit	Actual 2006/07	Target 2007/08	Actual 2007/08
Total leakage	MI/d	790	755 ¹	713
Security of Supply Index:	SoSI	57 (42 critical period)	58 ²	89
DG4 – restrictions on use	Population Affected	100%	Restrictions less than 1 in 20 years	0%
Total mains bursts	No.	12,196	11,412	10,729 ³
Mains bursts per '000km	No.	389	377 to 412 ⁴	342
DG2 – water pressure number of properties	Properties %	1,189 0.03%	2,455 0.07%	349 0.01%
DG3 – unplanned supply interruptions	Properties Index	30,636 0.93	14,591 0.41	7,218 0.24
Infrastructure serviceability assessment		Deteriorating	Marginal	Stable
Drinking Water Quality (at the tap)	MZCP			
Water quality regulations	%	99.97% *	99.95% *	99.98% *
Iron	%	99.78% *	99.73% *	99.88% *
Cat 1 & 2 pollution incidents for water	Incidents	1 *	0 *	0 *
Non infrastructure serviceability assessment		Stable	Stable	Stable

* Reporting based upon calendar years

1 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.

2 Monitoring Plan target has been substituted by the section 19 undertaking target

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

4 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 2006/07	Target 2007/08	Actual 2007/08
% of sewage works non compliant (WRA numeric consents)	%	4.5 *	2.0	0.03 *
% of sewage works non compliant (UWWTD consents)	%	1.3 *	1.3 *	0.0 *
% of total pe served by STWs in breach of WRA consents	%	3.3 *	0.3 *	0.0 *
% of total pe served by STWs in breach of UWWTD consents	%	0.0 *	0.0 *	0.0 *
Intermittent discharges deemed satisfactory	%	99.0	97.8	99.1
Sewage sludge managed in a satisfactory way	%	100	100	100
Pollution incidents process (STW) category 1,2 and 3	No.	34	27 * ¹	44 *
Sewerage non infrastructure serviceability assessment		Deteriorating	Stable	Marginal
Total sewer collapses in the year	No.	530	870 ¹	465
Sewer collapses per 1000km	No.	7.8	12.8	6.8
Pollution incidents at CSOs, foul sewers & rising mains categories 1,2 and 3	No.	95 *	N/a	96 *
Sewerage infrastructure serviceability assessment		Marginal	Marginal	Stable
DG5 – Properties at risk of internal flooding				
Twice in 10 years	No.	575	683	491
Once in 10 years	No.	2,599	2,734	2,139
Once in 20 years	No.	12,567	N/a	12,477
Properties flooded in the year:				
Internally flooded due to overloaded sewers	No.	648	231	1,686
Internally flooded due to other causes	No.	1,225	704	1,020
Externally flooded due to overloaded sewers	No.	1,117	338	1,292
Externally flooded due to other causes	No.	5,489	4,098	5,209

* 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	Unit	Actual 2006/07	Target 2007/08	Actual 2007/08
DG6 - Responding within 5 days to customer billing enquiries	%	99.84	99.20	99.81
DG7 - Responding within 10 days to written complaints	%	99.68	99.60	99.64
DG8 - Providing bills for metered customers based on a meter reading	%	99.24	99.73	99.60
DG9 - Calls abandoned	%	7.5 (including IVR calls – 3.67 excluding IVR)	4.0	7.34 (including IVR calls)

Overall Performance

Measure	Unit	Actual 2006/07	Target 2007/08	Actual 2007/08
Overall Performance Assessment (OPA)	Score	342	N/a	397

Employees

People and Health and Safety:		Actual 2006/07	Target 2007/08	Actual 2007/08
Absenteeism	%	3.0	3.5	3.35
Injury Rate per 1000 employees	nr	8.1	6.9	8.3

During the year to 31 March 2008, there were no fatalities, prosecutions or enforcement notices directly affecting the Company. There were however, 48 reportable accidents in total. Eight were 'major injuries' the remainder were injuries resulting in more than three days absence (as defined under the Reporting of Injuries, Illnesses and Dangerous Occurrences Regulations ('RIDDOR') 1995). As a result of these reportable injury accidents, 1,101 days were lost in total. Also during the period, there were five '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 Company's 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 Outfall 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 sewage 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.

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

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.
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 measures.
20. Absenteeism: This measure indicates the average percentage of their time that employees were unavailable based on sickness.
21. Injury Rate: This is the number of RIDDOR reportable injuries (excluding occupational diseases) per 1000 employees. The goal is for significant reductions, however the Company aspiration is for zero or as low levels as are realistically achievable.

Thames Water Utilities Limited

Corporate Governance Report

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, corporation 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 provision 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 June 2006 version of the Code (which is applicable to the period ending 31 March 2008) 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”). The Chairman’s performance was assessed as part of the Board effectiveness review conducted in November 2007
- Section A.2.2: The Chairman was not independent at the time of appointment and the shareholders’ agreement was modified accordingly.
- Section A.3.2: The composition of the Board is governed by Ofwat’s requirements as described by the Ofwat consultation document (see “Board Membership” below). The composition of the Board is not per the Combined Code requirements, but is compliant with Ofwat’s requirements.
- Section A.3.3: Three of the directors are considered to be independent non-executive directors (“iNEDs”).
- Section A.4.1: The Compensation & HR Committee fulfils the major functions of both 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 & 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.

Thames Water Utilities Limited

Corporate Governance Report (continued)

- 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 LTIS.

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.

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 in 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. In response to the consultation, 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. These changes are set out on page 7.

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 ("PFI"s) 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 31 March 2008, the Board comprises 15 Directors, 12 of whom are non-executive. Throughout the year in total there were 22 Directors. 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 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.

Thames Water Utilities Limited

Corporate Governance Report (continued)

These independent non-executive directors 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 the 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 director, 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 served as Chief Executive of the construction services company SGB Services Limited, and by CFO Mark Braithwaite who joined the Thames Water Group in 2007 having previously worked as Finance Director of the Customer and Energy divisions of EDF Energy Plc.

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 including 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 environmental protection, incident and accident prevention, promotion of a health and safety culture, and implementation and compliance with applicable standards.
- The objectives of the Compensation & HR Committee include reviewing the appointments and remuneration of senior executives and senior management, incentives and bonus arrangements, and performance targets.

Thames Water Utilities Limited

Corporate Governance Report (continued)

Membership of the Audit & Risk Review Committee, the Regulatory Committee, the Health, Safety & Environment Committee, and the Compensation & HR Committee throughout the year are set out below:

Audit & Risk Review Committee:	S Box (Chairman), M W Baggs, L Webb (1), R Blomfield-Smith (2)
Regulatory Committee:	M W Baggs (Chairman), S Box, G Parsons, D Shah, and P Antolik (1)
Health, Safety & Environment Committee:	M J Pavia (Chairman), M W Baggs, G Matthews (1), L Webb (2)
Compensation & HR Committee:	M Stanley (Chairman), Sir Peter Mason, W Smit, C Deacon

(1) Resigned 14/02/08 (2) Appointed 14/02/08

Attendance at Board and Committee Meetings

The Board of Directors met 9 times between 1 April 2007 and 31 March 2008.

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 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.

Thames Water Utilities Limited

Corporate Governance Report (continued)

The table below gives attendance details for Board and Committee meetings between 1 April 2007 and 31 March 2008:

	Board	Audit & Risk Review	Regulatory	Health, Safety & Environment	HR Compensation &
Total number of meetings held	9	6	9	5	3
Sir Peter Mason	8				3
Luis Abreira (5)	6 (a)				
Peter Antolik (1)	9		9 (h)		
Martin Baggs	9	6	9	5	1 (g)
Simon Batey (6) (7)	7 (b)	3 (g)			
Rosamund Blomfield-Smith (4)	1	-			
Stephen Box	9	6	8		
Mark Braithwaite (8)	4 (c)	3 (g)	3 (g)		
Christopher Deacon	7				3
Peter Dyer (9)	8				
Robert Gregor (10)	5		4		
Charles Lynam (9)	9				
Graham Matthews (1)	4			1	
David Owens (6)	9 (d)	5 (g)	8 (g)	4 (g)	3 (g)
Gordon Parsons (4)	2 (e)		3 (i)		
Michael J Pavia	9			5	
Antonio Santos (2)	7				
Dipesh Shah (3)	5 (f)		3		
Stephen Shine (6)	7		5 (g)	5 (g)	
Willem Smit	7				3
Martin Stanley	7				3
Lincoln Webb (11) (12)	7	4		-	

Key

- | | | | |
|------------------------|------------------------|------------------------|------------------------|
| (1) Resigned 14/02/08 | (2) Resigned 09/01/08 | (3) Appointed 15/10/07 | (4) Appointed 14/02/08 |
| (5) Appointed 09/01/08 | (6) Appointed 24/5/07 | (7) Resigned 31/8/07 | (8) Appointed 31/8/07 |
| (9) Resigned 24/5/07 | (10) Resigned 15/10/07 | (11) Resigned 1/12/07 | (12) Appointed 26/2/08 |

- | | |
|---|---|
| (a) All meetings as an attendee | (f) 2 meetings as board member, 3 as attendee |
| (b) 5 meetings as board member, 2 as attendee | (g) All meetings as an attendee |
| (c) 2 meetings as board member, 2 as attendee | (h) 8 meetings as committee member, 1 as attendee |
| (d) 7 meetings as board member, 2 as attendee | (i) 1 meetings as committee member, 2 as attendee |
| (e) 1 meeting as board member, 1 as attendee | |

Thames Water Utilities Limited

Corporate Governance Report (continued)

Information and Professional Development

All Directors who were appointed during the period were invited to an induction upon appointment and the majority were able to attend. Programme presentations by operational management and site visits were also offered. 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 Board engaged external consultant Egon Zehnder Limited to undertake formal performance evaluations of the Board and Audit Committee in November 2007. Further review of the effectiveness of its committees and individual directors will become an annual process thereafter.

Internal Controls

The Board has overall responsibility for maintaining sound systems of internal control, including financial, operational and compliance and risk management, and for reviewing their effectiveness.

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.

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, including financial, operational and compliance 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 Report

Introduction

The focus of this report is on the Company's remuneration policy as it applies to Directors. It sets out the Company's remuneration policy and also gives details of the salaries, incentives and pensions received by all the Directors for the year ended 31 March 2008.

This report has been prepared in accordance with the requirements of the Companies Act 1985 (as amended), the Directors Remuneration Report Regulations 2002 and associated legislation, together with the Listing Rules. Under the provisions of Part III Schedule 7A of the Companies Act 1985, PricewaterhouseCoopers LLP has audited the Directors' Emoluments, Long Term Incentive Schemes, Interests in Shares and Share Options, Pension Benefits and Compensation for Past Directors sections of this report.

Compensation & HR Committee

The Company operates a Compensation & HR Committee ("Committee") 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 Committee's 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 year, the Committee 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 competitive, the Committee has access to detailed external research on market data and trends from experienced specialist remuneration consultants. The Committee has received advice from Hay Management Consultants and Monks Partnership, a subsidiary of PricewaterhouseCoopers, during the year.

Remuneration Policy

The Committee bases its decision-making with respect to remuneration policy on a number of underlying principles, which can be summarised as follows:

- 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 shareholders 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; and
- packages should include a mix of basic salary plus performance related incentives.

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

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

Policy on Outside Directorships

David Owens (Chief Executive Officer) and Stephen Shine (Chief Operating Officer) were appointed as Executive Directors on 24 May 2007 and Mark Braithwaite (Chief Financial Officer) was appointed as an Executive Director on 31 August 2007. In line with their contracts of employment, none of the Executive Directors may hold outside directorships with any organisation who may be wholly or partly in competition with the Company or which may impair the Executive's ability to act at all times in the best interests of the Company, without the prior written consent of the Board.

Remuneration of the Chairman and Other Non-Executive Directors

The remuneration for the Non-Executive Directors is determined by reference to external market data, to ensure that the fees paid are in line with external practice. The fee levels are reviewed annually and recommended by the Compensation and HR Committee and approved by the Board.

During the year, Sir Peter Mason was paid fees of £150,000 for his role as Chairman of the Company. Sir Peter does not receive any other benefits from the Company. Sir Peter's fee has recently been reviewed and raised to £165,000 for the 2008/09 financial year.

Stephen Box, Michael J Pavia, and Willem Smit were each paid fees of £35,000 for their roles as non-executive directors of the Company for the year. These non-executive directors did not receive any other benefits from the Company.

In addition to his fee, Stephen Box received an additional £10,000 for the year as Chairman of the Audit & Risk Review Committee.

All other non-executive directors were paid a fee of £35,000 (on a pro rata basis based on period of appointment) by Thames Water Limited in respect of the services rendered to ten separate Boards of Directors within the Kemble Water group of companies, including the Company. These Non-Executive Directors did not receive any other benefits from the Company.

In certain cases, Non-Executive Directors have had their fees paid directly to their employer.

With the exception of the Chairman, all Non-Executive Directors have recently had their fees reviewed and raised to £45,000 for the 2008/09 financial year. Stephen Box will continue to receive an additional £10,000 for his role as Chairman of the Audit & Risk Review Committee.

Alternate Directors do not receive any fees for their services.

Remuneration of Executive Directors

The remuneration arrangements for Executive Directors comprise the following elements:

- Base salary and benefits;
- Bonuses;
- Long Term Incentive Schemes (LTIS's); and
- Post retirement benefits.

Details of each of the above elements are set out on the following pages.

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

Base Salaries and Benefits

Base salaries are normally reviewed annually with any changes taking effect from the commencement of the financial year. Base salaries are a fixed sum payable monthly.

The base salary for each Executive Director has recently been reviewed for the financial year 2008/09 and are as follows:

Director	Annual salary with effect from April 2008
David Owens	£280,000*
Stephen Shine	£247,500
Mark Braithwaite	£250,000

The salary shown above reflect the results of an external market review of the total remuneration package offered to Executive Directors against a number of relevant comparators (mainly utility companies).

In addition to salary, the Executive Directors receive a car or cash allowance, private medical insurance, a defined benefit pension scheme**, life assurance and 25 days' holiday. These benefits are reviewed periodically to ensure that the overall remuneration package is competitive against companies of a similar size and complexity.

* David Owens' salary could vary depending on the proportion of time spent on the regulated group and non regulated group.

** Simon Batey (a Director that resigned in the year) received a cash allowance in lieu of membership of the defined benefit pension scheme.

Audited base salaries and benefits for each Director for the year ended 31 March 2008 are set out on page 52.

Bonuses

Executive Directors are eligible to participate in bonus schemes, which are designed to motivate them to achieve the Company's key operational and strategic objectives.

i) Executive Directors' Annual Bonus Plan Measures 2007/08

The 2007/08 annual bonus plan aimed to reward significant improvement in the Company's financial performance and an executive's personal contribution to that performance due to be paid in June/July 2008. The financial measures used in the bonus plan are selected from operational expenditure, capital expenditure, cash flow and Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) targets. These targets were selected as being the most critical for the organisation during 2007/08. No payment will be made for personal performance unless the Company's EBITDA business plan figure is achieved.

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

The following table indicates the bonus opportunity and the percentage of overall bonus opportunity attributed to each bonus measure:

	Bonus Opportunity (% salary)	Financial Performance Measure				Personal Performance	Total
		Group * EBITDA **	Cash Flow Before Funding	Capex ***	Opex ****		
David Owens	200%	20%	35%	20%	-	25%	100%
Mark Braithwaite	100% ⁽¹⁾	20%	35%	20%	-	25%	100%
Stephen Shine	166.25%	12.5%	-	12.5%	50%	25%	100%

⁽¹⁾ Pro-rated to 8/12ths based on joining date in August 2007

* Group includes Thames Water Limited and any other company under its control within the meaning of Section 736 of the Companies Act 1985.

** EBITDA means Earnings Before Interest, Tax, Depreciation and Amortisation.

*** Capital Expenditure includes any expenditures used to upgrade tangible or intangible assets used in the business.

**** Opex means Operating Expenditure and includes the on-going costs for running the business.

***** Achievement of individual performance objectives related to financial and operational performance.

Under the bonus plan rules 25% of the bonus is automatically deferred into the 2007 Long Term Incentive Scheme (refer page 50), but the 25% may, at the discretion of the Compensation and HR Committee, be paid as cash.

The bonus plan rules also provide for discretion to be exercised by the board in determining an appropriate level of payment.

David Owens, Stephen Shine and Mark Braithwaite received a bonus under the plan for the period ended 31 March 2008. Audited annual bonuses for each director for the year ended 31 March 2008 are set out on page 52.

ii) Additional Bonus Payments for 2007 only

In addition to participation in the annual bonus plan outlined above, for the calendar year 2007 only, David Owens participated in an additional bonus scheme. The scheme paid up to a maximum of 200% of basic salary at two six-monthly intervals dependent on satisfactory performance against the business plan and personal performance targets.

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

Simon Batey did not participate in the 2007/08 Annual Bonus plan or Long Term Incentive Scheme. Instead, his participation in these schemes was replaced by a single bonus scheme with a maximum bonus opportunity of 100% of annual salary subject to his continued employment with the Company at 31st August 2007. The bonus targets were as follows:-

Bonus Target	Percentage of Salary Payable
Successful securitisation (all or nothing target)	50% of base salary
Achievement of EBITDA target (all or nothing target)	25% of base salary
Achievement of cash flow target (all or nothing target)	25% of base salary

Audited additional bonuses for David Owens and Simon Batey for the year ended 31 March 2008 are set out on page 52.

iii) Executive Directors' Annual Bonus Plan Measures 2008/09

The 2008/09 Annual Bonus plan will mirror the 2007/08 plan. However, there will be a regulatory underpin on the personal element of the bonus which is based on no deterioration on the 07/08 Overall Performance Assessment score and there will be no deferral into an LTIS. Instead a separate stand-alone LTIS will be offered.

The following table indicates the bonus opportunity and the percentage of overall bonus opportunity attributed to each bonus measure:

	Bonus Opportunity (% salary)	Financial Performance Measure				Personal Performance	Total
		Group EBITDA	Cash Flow Before Funding	Capital Expenditure	Opex		
David Owens	100%	20%	35%	20%	-	25%	100%
Mark Braithwaite	100%	20%	35%	20%	-	25%	100%
Stephen Shine	100%	25%	-	25%	25%	25%	100%

Definitions are in line with the 2007/08 plan.

Long Term Incentive Schemes ("LTIS's")

As an element of the retention strategy, the Company's Executive Directors and senior management team, including any Executive Directors, are from time to time invited to participate in LTIS's. 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 Report (continued)

LTIS 2007

As a result of new ownership, an LTIS was introduced in May 2007. Under the new scheme, a conditional award of cash units representing 25% of the Executive Directors 2007/08 Annual Bonus could be made to participants (refer page 47). The awards will be deferred for a two-year period, after which they will vest and payments will be made, depending on an assessment of performance against regulatory targets. Participants must remain employed on the vesting date, or have left employment due to a 'good-leaver' reason to receive the award at vesting, otherwise the award is forfeited. Between 100% and 400% of the deferred cash award will vest based on performance against the "Overall Performance Assessment" (OPA) score, independently assessed by Ofwat. OPA is the key measure by which Ofwat judge the Company's overall performance against regulatory targets, and was selected as it is critical that the Company meets its regulatory targets and delivers a high quality service to its customers.

For the year ended 31 March 2008 Stephen Shine and Mark Braithwaite both received an award under the scheme. Audited awards under the LTIS 2007 for each director for the year ended 31 March 2008 are set out on page 53.

LTIS 2008

A new, stand-alone LTIS will be operated in 2008, in which the Executive Directors will participate. The plan period will run from 1 April 2008 to 31 March 2011 and payment will be made in July 2011 following Board approval of the audited accounts. The plan will be based on four cumulative financial measures, being EBITDA, Cash Flow Before Funding, Distributions and Capital Expenditure. These measures were selected as being critical for the Company's value creation.

The measures will be reviewed annually to make any required amendments, taking into account business acquisitions, capital restructuring, long-term debt draw-downs and any refinancing of the Company (including fees paid for any refinancing).

Payment will be made in full if all four measures have been achieved, no payment will be made under the plan if one or more measures have not been achieved.

Post Retirement Benefits

The current Executive Directors participate in the 2005 and Senior Executive Sections of the Thames Water Pension Scheme. The scheme is a funded HMRC registered final salary occupational pension scheme which provides:

- A normal retirement age of 65 years;
- An overall pension at normal retirement age based on an annual accrual of 1/45ths for each year's pensionable service of final pensionable salary, subject to a maximum of 2/3rds;
- Life cover of 4 x base salary;
- A pension payable in the event of retirement on the grounds of ill-health; and
- A dependent's pension on death of half of the members pension.

If an Executive Director leaves the Company with less than two years' service and has not transferred any benefits in to the scheme, then the individual may elect to receive a refund of their contributions, or transfer their pension to another pension arrangement.

After two years' service, or if an Executive Director has transferred in previous pension benefits, on leaving an individual can elect to receive preserved benefits or transfer their benefits in to an alternative pension arrangement.

Under the Trust Deed and Rules, pensions in payment will rise in line with the Retail Prices Index subject to a maximum of 2.5%.

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

Audited post retirement benefits for each director for the year ended 31 March 2008 are set out on page 53 and 54.

Service Contracts

Reflecting current market practice, the Executive Directors do not hold service contracts that provide 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 on 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 below provides the dates, terms and notice periods of the service contracts for Directors who served during the year:

	Commencement date of current term of office	Notice period (if applicable)
David Owens	24/05/2007	12 months
Stephen Shine	24/05/2007	12 months
Mark Braithwaite	31/08/2007	12 months
Luis Abreira	09/01/2008	(1)
Martin Baggs	01/12/2006	(1)
Stephen Box (2)	01/12/2006	12 months (2)
Rosamund Blomfield-Smith	14/02/2008	(1)
Christopher Deacon	01/12/2006	(1)
Sir Peter Mason	01/12/2006	3 months
Gordon Parsons	14/02/2008	(1)
Michael J Pavia (2)	01/12/2006	12 months (2)
Dipesh Shah	15/10/2007	(1)
Willem Smit (2)	01/12/2006	12 months (2)
Martin Stanley	01/12/2006	(1)
Lincoln Webb (8)	26/02/2008	(1)
Dr Peter Dyer (3)	01/12/2006	(1)
Robert Gregor (4)	01/12/2006	(1)
Charles Lynam (3)	01/12/2006	(1)
Graham Matthews (5)	01/12/2006	(1)
Antonio Santos (6)	01/12/2006	(1)
Peter Antolik (5)	01/12/2006	(1)
Simon Batey (7)	24/05/2007	24 months (reducing on a sliding scale to 12 months by 01/08/07)

(1) Notice period is undetermined as governed by the appointing investor (2) Initial appointment for 12 months, subject to renewal for a further period of two years (3) Resigned 24/05/2007 (4) Resigned 15/10/2007 (5) Resigned 14/02/2008 (6) Resigned 09/01/2008 (7) Resigned 31/08/2007. (8) Resigned 01/12/2007.

S G Batey, E Beckley, P E D Crone, P Gomez, R J Gregor, R D Israel, S Kolenc, W R McKenzie, J Santos and P F C DeSouza acted as Alternate Directors during the year and are not subject to service contracts. Details of Alternate Directors periods of appointment can be found in the Directors Report on page 57.

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

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

Directors' Emoluments (audited)

A fixed fee of £35,000 per annum is payable on a pro rata basis based on period of appointment by Thames Water Limited in respect of the services rendered by each of Luis Abaira, Peter Antolik, Martin Baggs, Rosamund Blomfield-Smith, Christopher Deacon, Peter Dyer, Robert Gregor, Charles Lynam, Graham Matthews, Gordon Parsons, Antonio Santos, Dipesh Shah, Martin Stanley and Lincoln 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.

The following table provides a breakdown of the amounts attributable to the Company in respect of directors who served during the year ending 31 March 2008:

	Base salary/fees	Bonuses *	Benefits in kind	Other Emoluments	Year End 31 March 2008	Year End 31 March 2007
	£'000	£'000	£'000	£'000	£'000	£'000
Executive Directors						
David Owens (1)	150.1	661.9	**	0.6	10.2	822.8
Stephen Shine (1)	192.3	192.6		1.0	14.5	400.4
Mark Braithwaite (2)	117.1	130.7	***	0.7	12.4	260.9
Simon Batey (1) (3)	108.6	416.8	****	6.0	41.9	573.3
Non-executive Directors						
Sir Peter Mason	150.0	-	-	-	150.0	25.0
Independent non-executive Directors						
Stephen Box (5)	45.0	-	-	-	45.0	15.0
Michael J Pavia	35.0	-	-	-	35.0	11.7
Willem Smit	35.0	-	-	-	35.0	11.7
Total	833.1	1,402.0	8.3	79.0	2,322.4	157.5

(1) Appointed 24/5/2007 (2) Appointed 31/08/2007 (3) Resigned 31/8/2007 (4) Resigned 14/2/2008

(5) Receives an extra £10,000 per annum as Chairman of the Audit & Risk Review Committee

* All bonuses relate to the 2007/08 Annual Bonus plan unless otherwise stated.

** Includes an additional bonus of £212,900.

*** Includes a sign on bonus of £21,600.

**** The full amount relates to an additional bonus.

Simon Batey, Edward Beckley, Peter Crone, Pilar Gomez, Robert Gregor, Ross Israel, Stan Kolenc, William McKenzie, Joao Santos and Paul DeSouza acted as Alternate Directors during the year, for which they did not receive a fee for their services.

The highest paid Director for the year was David Owens (£822,800). The highest paid Director for the prior period was Jeremy England (£519,800).

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

LTIS 2007 (audited)

The following table provides a breakdown of the scheme interests under the LTIS 2007 in respect of directors who served during the year ending 31 March 2008:

Director	Number of £1 cash units at 1 April 2007	Awarded during year	Awards vesting during year	Number of £1 cash units at 31 March 2008
	'000	£'000	£'000	'000
Stephen Shine	-	64.2	-	64.2
Mark Braithwaite	-	36.4	-	36.4

The performance period for the scheme interests is two years from award, after which they will vest and payments will be made, depending on an assessment of performance against regulatory targets, and subject to the Director continuing to be employed at the time of vesting.

Interest in Shares and Share Options (audited)

Other than through directorships or management interests in other Group companies and undertakings, none of the directors declared any interest in the shares or debentures of the Company throughout the year.

Pension Benefits (audited)

The following table is in line with the Listing Rules of the UK Listing Authority (the "Rules") and provides information to cover the period during which the individuals* were Directors of the Company:

Director	Accrued pension at 31.3.08	Increase in accrued pension during the Year	Increase in accrued pension during the year (net of inflation)	Transfer value of increase in accrued benefits net of Directors' Contributions
	£	£	£	£
David Owens	7,407	5,092	4,883	47,974
Stephen Shine	13,711	4,583	4,395	32,305
Mark Braithwaite	2,592	2,477	2,375	9,091

* Simon Batey, who resigned on 31/08/2007, received a cash allowance of £38,011 (2007 £16,936).

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

The following table is in line with the requirements of the Directors' Remuneration Report Regulations 2002 and provides information to cover the full financial year:-

Name	Service completed in years (including transferred in service credits)	Accrued pension as at 31.3.08 £	Increase in accrued pension during the year £	Increase in accrued pension during the year (net of inflation) £	Transfer value of accrued pension at 31.3.08 £	Transfer value of accrued pension at 31.3.07 £	Increase/Decrease in transfer value over the year, net of Directors contributions £
David Owens	1.3 years	7,407	5,556	5,328	100,864	25,216	50,649
Stephen Shine	5.6 years	13,711	12,461	11,950	156,890	14,056	120,335
Mark Braithwaite	0.7 years	2,592	2,477	2,375	22,154	1,397	9,091

Compensation for Past Directors (audited)

Under the 2004 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 2004. The shares were deferred for a 28 month period and vested in July 2007, provided that the executives were still employed within the Thames Water Group on the vesting date. 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. None of the current Directors of the Company had awards under the 2004 LTIP. Three ex-Directors had awards under the 2004 LTIP that vested in July 2007 and these are summarised below. These are the total awards made, with no apportionment in respect of services provided to the Group and/or the Company.

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

Thames Water Utilities Limited

Directors' Remuneration Report (continued)

In 2005, RWE introduced a new cash LTIS called "Beat" 2005. Under this LTIS, 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. However, at the discretion of the RWE Board, those Directors who left the Company prior to the divestment of Thames Water remained in the plan until the end of the performance period in December 2007. The final assessment of RWE's total shareholder performance was independently assessed by HSBC Trinkhaus and the cash payments which were made to ex-directors are summarised below:

	Cash Payment
Werner Boettcher	£588,930
Bill Alexander	£281,400
Stephen Walker	£241,200
Tim Weller	£649,230
Steven Buck	£156,780

Approved by the Board on 4 June 2008 and signed on its behalf by

M Stanley
Chairman of the Compensation & HR Committee

Thames Water Utilities Limited

Directors Report

The Directors present their report and audited financial statements for the regulatory year from 1 April 2007 to 31 March 2008. These are not the Company's statutory accounts as required to be delivered to the Registrar of Companies in accordance with Section 242 of the Companies Act 1985. Separate statutory accounts have been prepared for the financial year 1 April 2007 to 31 March 2008 and which contain an unqualified Auditors' Report provided in accordance with Section 235 of the said Act.

On 21 June 2007, the immediate ownership of the Company was transferred from Thames Water Limited to Thames Water Utilities Holdings Limited, a new intermediate holding company, wholly owned by Thames Water Limited, and whose ultimate parent company is Kemble Water Holdings 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 13.6 million customers in London and the Thames Valley.

An Operating and Financial Review ("OFR") can be found on pages 5 to 38 and forms part of this Directors Report. 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 2008 and Key Performance Indicators ("KPIs"). In accordance with Ofwat's requirements, this follows the 'Reporting Statement of Best Practice on the OFR' issued by the Accounting Standards Board on 26 January 2006, and also includes supplementary information specifically requested by Ofwat.

Details of parent and subsidiary undertakings are given in Notes 27 and 12 to the Financial statements, on page 100 and 84 respectively, and the Company has no branches outside the United Kingdom.

Results and Dividends

The profit and loss account on page 61 gives the Company's financial results for the year.

The Company paid interim dividends totalling £102.0 million during the year (2007: £535.3 million).

On 22 May 2008, the Directors approved a further interim dividend of £131.0m (12.7p per ordinary share) in respect of the year ended 31 March 2008. This interim dividend was subsequently paid on 30 May 2008.

The Board does not recommend a final dividend.

Directors

Details of the Directors who served from 1 April 2007 to the date of this report are shown on the following page. The constitution of the Board is covered in more detail in the Company's Corporate Governance Report, which can be found on pages 39 to 44.

All Board members from 1 April 2007 to 31 March 2008 inclusive were Non-Executive Directors ("NEDs") throughout the period, with the exception of David Owens (Chief Executive Officer), Steve Shine (Chief Operating Officer), both appointed on 24 May 2007, Simon Batey and Mark Braithwaite (respectively, the Chief Financial Officer for the period to 31 August 2007 and from 31 August 2007).

Thames Water Utilities Limited

Directors Report (continued)

Eight of the NEDs nominated Alternate Directors to represent them when they were unavailable. These were S G Batey (Alternate to A Santos from 3 September 2007 until 9 January 2008), E Beckley (Alternate to G Parsons from 26 March 2008), P E D Crone (Alternate to G J Matthews until 14 February 2008 and R Blomfield-Smith from 14 February 2008), P Gomez (Alternate to L Abraira from 9 January 2008), R J Gregor (Alternate to D J Shah from 15 October 2007 until 14 February 2008), R D Israel (Alternate to C D Deacon until 28 June 2007), S Kolenc (Alternate to L Webb from 26 February 2008), W R McKenzie (Alternate to D Shah from 26 February 2008), J Santos (Alternate to A Santos until 3 September 2007) and P F C DeSouza (Alternate to C D Deacon from 6 July 2007).

Directors Serving from 1 April 2007 to the date of this Report are as follows:

Sir Peter Mason KBE – Chairman

L Abraira (Appointed: 9 January 2008)

P S Antolik (Resigned: 14 February 2008)

M W Baggs

S G Batey (Appointed: 24 May 2007; Resigned: 31 August 2007)

R Blomfield-Smith (Appointed: 14 February 2008)

S J Box

M W Braithwaite (Appointed: 31 August 2007)

C R Deacon

Dr P Dyer (Resigned: 24 May 2007)

R J Gregor (Resigned: 15 October 2007)

C Lynam (Resigned: 24 May 2007)

G J Matthews (Resigned: 14 February 2008)

D W Owens (Appointed: 24 May 2007)

G Parsons (Appointed: 14 February 2008)

M J Pavia

A Santos (Resigned: 9 January 2008)

D J Shah (Appointed: 15 October 2007)

S F Shine (Appointed: 24 May 2007)

W Smit

M S W Stanley

L Webb (Resigned: 1 December 2007; Appointed: 26 February 2008)

Material Financial Instruments

Financial risk management is covered on pages 27 to 29 of the Operating and Financial Review.

Research and Development Activities

This has been noted in the Operating Financial Review on page 23.

Employee Involvement

Updates on operational and financial performance are 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 briefings for managers and employees.

Thames Water Utilities Limited

Directors Report (continued)

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 takes place on a group basis with employee representatives being elected for the relevant area.

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

Other than through directorships or management interests in other Group companies and undertakings, none of the Directors declared any interest in the shares or debentures of the Company throughout the year.

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 year under review, the average amount due to trade creditors represented 70 days (2007: 67 days) purchases received from these creditors.

Political and Charitable Donations and Expenditure

No political donations were made by the Company. The Company made charitable donations totalling £236,682 (2007: £170,568). Details of these charitable donations are:

- £187,942 (2007: £128,092) from the Company's Customer Assistance Fund, thereby helping customers who were unable to settle their outstanding water bills owing to financial difficulty, hardship or distress,
- £19,740 (2007: £42,476) to the Charities Aid Foundation, and
- £29,000 (2007: £nil) to Wateraid.

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.

Thames Water Utilities Limited

Directors Report (continued)

Compliance with Condition K of the Company's Instrument of Appointment

The Directors consider that, during the period under review and up until the date of signature of these statements, the Company has been in compliance with paragraph 3.1 of Condition K as it has ensured, so far as is reasonably practicable, that if a special administration order were made under section 23 of the Water Industry Act 1991 it would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator so to manage the affairs, business and property of the Company such that the purposes of such an order could be achieved, provided that this shall not require the Company to seek to re-negotiate the terms of any contract or obligation which, in accordance with a scheme under Schedule 2 of the Instrument of Appointment (Conditions of the Appointments as a Water and Sewerage Undertaker), is transferred to the Company.

Post Balance Sheet Events

On 9 April 2008, amidst very difficult market conditions, Thames Water Utilities Cayman Finance Limited issued a £400 million bond due 2058. The proceeds of the bond issue were on-lent to the Company, which allowed the Company to repay its £250 million intercompany loan in respect of the Revolving Credit Facility, and provided additional liquidity for the Company.

On 9 May 2008, the Greater London Authority (GLA) dropped its High Court challenge to the Government's decision to grant planning permission for a desalination plant at Beckton, London. The move follows discussions with the new Mayor of London, Boris Johnson, who overturned the decision of his predecessor to contest the permission granted to the Company.

On 22 May 2008, the Directors approved a further interim dividend of £131.0m (12.7p per ordinary share) in respect of the year ended 31 March 2008. This interim dividend was subsequently paid on 30 May 2008.

Disclosure of Information to Auditors

Each of the Directors at the date of the approval of this report confirm that there is no relevant audit information (as defined by Section 234ZA of the Companies Act 1985) of which the Company's auditors are unaware. Each of the Directors have taken all the necessary steps to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' Indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its Directors, which were made during the year and remain in force at the date of this report.

Auditors

The Company has entered into a contract of appointment with the auditors which satisfies the requirements of paragraph 9.2 of Condition F of the Instrument of Appointment.

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

Thames Water Utilities Limited

Directors Report (continued)

Statement of Directors' Responsibilities

In addition to the matters covered by the Statement of Directors' Responsibilities included in the statutory accounts, the directors are responsible under Condition F of the Instrument of Appointment issued by the Secretary of State for the Environment under the Water Industry Act 1991 for:-

- (a) ensuring that proper accounting records are prepared and maintained by the Company in a form enabling compliance with the requirements of Condition F, having regard to the terms of any guidelines notified by the Water Services Regulation Authority ("the WSRA") from time to time.
- (b) preparing on a consistent basis in respect of each regulatory financial year, accounting statements in agreement with the Company's accounting records and in accordance with the requirements of Condition F and any guidelines notified from time to time by the WSRA. So far as is reasonably practicable having regard to the purposes of Condition F, these accounting statements should have the same content as the annual accounts of the Company prepared under the Companies Act 1985 and be prepared in accordance with the formats and the accounting policies and principles which apply to those accounts and state the principal accounting policies applied.
- (c) preparing accounting statements on a current cost basis in accordance with guidelines issued to by the WSRA from time to time.

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.

Approved by the Board of Directors on 4 June 2008 and signed on its behalf by

David Owens
Chief Executive Officer

Thames Water Utilities Limited

Regulatory historic cost profit and loss account for the year ended 31 March 2008

	Note	2008			2007		
		Appointed business	Non-Appointed business	Total	Appointed business	Non-Appointed business	Total
		£m	£m	£m	£m	£m	£m
Turnover		1,454.4	39.8	1,494.2	1,385.8	45.2	1,431.0
Operating costs	4	(701.3)	(28.2)	(729.5)	(753.0)	(31.8)	(784.8)
Historical cost depreciation		(219.4)	(0.3)	(219.7)	(218.4)	(0.2)	(218.6)
Operating income	5	45.1	-	45.1	11.5	-	11.5
Operating profit		578.8	11.3	590.1	425.9	13.2	439.1
Net interest	7	(183.8)	0.6	(183.2)	(170.8)	0.5	(170.3)
Other finance income	26	12.3	-	12.3	1.3	-	1.3
		(171.5)	0.6	(170.9)	(169.5)	0.5	(169.0)
Profit on ordinary activities before taxation		407.3	11.9	419.2	256.4	13.7	270.1
Taxation on profit on ordinary activities:	8						
- Current tax		(106.6)	(3.6)	(110.2)	(52.3)	(4.1)	(56.4)
- Deferred tax		71.0	-	71.0	(23.2)	-	(23.2)
		(35.6)	(3.6)	(39.2)	(75.5)	(4.1)	(79.6)
Profit for the year	23	371.7	8.3	380.0	180.9	9.6	190.5
Dividends	9	(93.7)	(8.3)	(102.0)	(525.7)	(9.6)	(535.3)
Profit/(deficit) for the year	22 & 23	278.0	-	278.0	(344.8)	-	(344.8)

All amounts above relate to continuing operations.

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

Statement of total Recognised Gains and Losses

	Note	2008 £m	2007 £m
Profit for the year		380.0	190.5
Actuarial gain on pension scheme	26	3.9	49.9
Deferred tax relating to actuarial gain		(1.1)	(15.0)
Total recognised gains for the year		382.8	225.4

Thames Water Utilities Limited

Regulatory historic cost balance sheet at 31 March 2008

	Note	2008			2007		
		Appointed business	Non-Appointed business	Total	Appointed business	Non-Appointed business	Total
		£m	£m	£m	£m	£m	£m
Fixed assets							
Tangible assets	10, 11	6,455.3	3.9	6,459.2	5,929.2	3.8	5,933.0
Investments	12	0.1	-	0.1	0.1	-	0.1
		<u>6,455.4</u>	<u>3.9</u>	<u>6,459.3</u>	<u>5,929.3</u>	<u>3.8</u>	<u>5,933.1</u>
Current assets							
Stocks	13	7.0	-	7.0	6.1	-	6.1
Debtors: amounts falling due within one year	14	473.7	8.9	482.6	435.6	9.0	444.6
Debtors: amounts falling due after more than one year	15	1,223.8	-	1,223.8	-	-	-
Cash at bank and in hand	18	65.8	-	65.8	89.4	-	89.4
Short term deposits	18	15.6	-	15.6	112.5	-	112.5
Infrastructure renewals	14	36.7	-	36.7	-	-	-
		<u>1,822.6</u>	<u>8.9</u>	<u>1,831.5</u>	<u>643.6</u>	<u>9.0</u>	<u>652.6</u>
Creditors: amounts falling due within one year							
Infrastructure renewals		-	-	-	(32.6)	-	(32.6)
Creditors		(818.7)	-	(818.7)	(709.7)	-	(709.7)
Borrowings		(366.3)	-	(366.3)	(21.2)	-	(21.2)
Corporation tax payable		(7.7)	-	(7.7)	-	-	-
Total creditors	16	<u>(1,192.7)</u>	<u>-</u>	<u>(1,192.7)</u>	<u>(763.5)</u>	<u>-</u>	<u>(763.5)</u>
Net current assets/(liabilities)							
		<u>629.9</u>	<u>8.9</u>	<u>638.8</u>	<u>(119.9)</u>	<u>9.0</u>	<u>(110.9)</u>
Total assets less current liabilities							
		<u>7,085.3</u>	<u>12.8</u>	<u>7,098.1</u>	<u>5,809.4</u>	<u>12.8</u>	<u>5,822.2</u>
Creditors: amounts falling due after more than one year							
Borrowings	17	(4,461.6)	-	(4,461.6)	(3,416.8)	-	(3,416.8)
Provisions for liabilities & charges							
Deferred tax provision	19	(841.4)	-	(841.4)	(916.6)	-	(916.6)
Deferred income		(173.1)	-	(173.1)	(168.5)	-	(168.5)
Post employment assets	26	26.1	-	26.1	11.1	-	11.1
Other provisions	19	(35.9)	-	(35.9)	-	-	-
Net assets		<u>1,599.4</u>	<u>12.8</u>	<u>1,612.2</u>	<u>1,318.6</u>	<u>12.8</u>	<u>1,331.4</u>
Capital and reserves							
Called up share capital	20	1,029.0	-	1,029.0	1,029.0	-	1,029.0
Share premium	21	100.0	-	100.0	100.0	-	100.0
Profit and loss account	22	470.4	12.8	483.2	189.6	12.8	202.4
Total shareholder's funds	23	<u>1,599.4</u>	<u>12.8</u>	<u>1,612.2</u>	<u>1,318.6</u>	<u>12.8</u>	<u>1,331.4</u>

The notes on pages 64 to 100 form part of these historic cost financial statements.

The regulatory historic cost financial statements were approved by the Board of Directors on 4 June 2008 and were signed on its behalf by:

Mark Braithwaite
Chief Financial Officer

Thames Water Utilities Limited

Regulatory historic cost statement of cash flow for the year ended 31 March 2008

	Note	2008			2007		
		Appointed business £m	Non-Appointed business £m	Total £m	Appointed business £m	Non-Appointed business £m	Total £m
Net cash inflow from operating activities	(a)	908.3	11.7	920.0	750.1	14.9	765.0
Returns on investments and servicing of finance							
Interest received		12.1	0.6	12.7	19.9	0.5	20.4
Interest paid		(184.4)	-	(184.4)	(148.0)	-	(148.0)
Interest element in finance lease payments		(16.5)	-	(16.5)	(13.7)	-	(13.7)
Net cash outflow from returns on investments and servicing of finance		(188.8)	0.6	(188.2)	(141.8)	0.5	(141.3)
Taxation		(72.6)	(3.6)	(76.2)	(62.6)	(4.1)	(66.7)
Capital expenditure and financial investment							
Gross cost of purchased fixed assets		(799.6)	(0.4)	(800.0)	(583.3)	(1.7)	(585.0)
Infrastructure renewals expenditure		(160.4)	-	(160.4)	(115.2)	-	(115.2)
Receipt of grants and contributions		56.6	-	56.6	59.8	-	59.8
Movement on long term loans to group companies		(1,180.0)	-	(1,180.0)	-	-	-
Sales proceeds of fixed assets		75.6	-	75.6	19.8	-	19.8
Net cash outflow from investment activities		(2,007.8)	(0.4)	(2,008.2)	(618.9)	(1.7)	(620.6)
Dividends paid		(93.7)	(8.3)	(102.0)	(525.7)	(9.6)	(535.3)
Management of liquid resources							
Decrease/(increase) in short term deposits		96.9	-	96.9	(112.5)	-	(112.5)
Net cash outflow before financing		(1,357.7)	-	(1,357.7)	(711.4)	-	(711.4)
Financing							
Capital element in finance lease payments		(11.1)	-	(11.1)	(9.8)	-	(9.8)
New loans		1,369.6	-	1,369.6	1,200.0	-	1,200.0
Repayment of loans		(24.4)	-	(24.4)	(401.4)	-	(401.4)
Net cash inflow from financing	(b), (c)	1,334.1	-	1,334.1	788.8	-	788.8
(Decrease)/increase in cash	(b), (c)	(23.6)	-	(23.6)	77.4	-	77.4

Thames Water Utilities Limited

Notes to regulatory historic cost cash flow statement for the year ended 31 March 2008

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

	Note	2008 £m	2007 £m
Historic cost operating profit		590.1	439.1
Infrastructure renewals charge	4	106.9	110.9
Depreciation		219.7	218.6
Assets written off		6.9	9.0
Profit on sale of assets	5	(45.1)	(11.5)
Difference between pension charge and cash contributions		(4.2)	(2.2)
(Increase)/decrease in stocks and work in progress		(0.9)	0.4
(Increase)/decrease in debtors and prepaid expenses		(26.1)	1.9
Increase in creditors and accrued expenses		71.8	9.9
Increase in provisions		13.1	-
Effect of other deferrals and accruals on operating activity cash flow		(12.2)	(11.1)
Net cash inflow from operating activities		920.0	765.0

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

	Note	2008 £m	2007 £m
(Decrease)/increase in cash in the period		(23.6)	77.4
Cash (outflow)/inflow from (decrease)/increase in liquid resources		(96.9)	112.5
Cash (inflow) from movement in net debt and financing		(1,334.1)	(788.8)
(Increase) in net debt resulting from cashflows		(1,454.6)	(598.9)
Non-cash (increase) in net debt		(55.8)	(24.2)
Total increase in net debt		(1,510.4)	(623.1)
Opening net debt		(3,236.1)	(2,613.0)
Closing net debt	(c)	(4,746.5)	(3,236.1)

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

Thames Water Utilities Limited

Notes to regulatory historic cost cash flow statement for the year ended 31 March 2008 (continued)

(c) Analysis of net debt

	2007 £m	Cashflow £m	Non-cash £m	2008 £m
Cash at bank and in hand	89.4	(23.6)	-	65.8
Short term deposits	112.5	(96.9)	-	15.6
	<u>201.9</u>	<u>(120.5)</u>	<u>-</u>	<u>81.4</u>
Debt due within 1 year	(9.4)	(356.9)	-	(366.3)
Debt due after 1 year	(3,213.0)	(988.3)	(55.8)	(4,257.1)
Finance leases	(215.6)	11.1	-	(204.5)
	<u>(3,438.0)</u>	<u>(1,334.1)</u>	<u>(55.8)</u>	<u>(4,827.9)</u>
Total	<u>(3,236.1)</u>	<u>(1,454.6)</u>	<u>(55.8)</u>	<u>(4,746.5)</u>

(d) Exceptional items

The proceeds received regarding the exceptional profit on the sale of fixed assets has been included within Capital expenditure and financial investment (2008: £75.6m, 2007: £19.8m).

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory financial statements have been prepared to show separately in respect of the appointed business, non-appointed business and total business, a profit and loss account, balance sheet and a cash flow statement, together with notes for the total business thereto, prepared on a historic cost basis.

These are not the Company's statutory financial statements within the meaning of the Companies Act 1985. The Company's statutory financial statements for the year ended 31 March 2008 were approved on 4 June 2008.

The financial statements have been prepared in accordance with the historical cost convention and, except for the classification of profit on the sale of fixed assets as explained in note (b) below and the treatment of infrastructure renewals expenditure as explained in note (c), with applicable Accounting Standards in the United Kingdom. The financial statements have been prepared in accordance with the Companies Act 1985 with the exception of the treatment of certain capital contributions as explained in note (e) below.

Changes to accounting policies

The same accounting policies used for the period ended 31 March 2007 have been applied with the following exception:

The amendment to FRS 17 'Retirement benefits' has been adopted in these financial statements for the first time and the content of the disclosures it requires have been presented for both the current and comparative period. The amendment to FRS 17 also requires that quoted securities are valued at their current bid-price rather than their mid-market value.

On the basis of materiality, the effect of the change in accounting policy to adopt the amendments to FRS 17 did not affect the brought forward profit and loss reserves or the net actuarial gain/loss in the year.

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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (continued)

(b) Operating profit

Profit and loss on sale of fixed assets has been included within operating profit, as operating income as disclosed in note 5, in accordance with RAG 3. This represents a departure from FRS 3 and the treatment adopted in the Company's 31 March 2008 statutory financial statements where profit and loss on sale of fixed assets is shown after operating profit.

(c) 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, over ground plant and equipment).

Directly attributable costs are capitalised within fixed assets. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the company.

- **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.

Infrastructure renewals expenditure has been accounted for in accordance with RAG 3 in these regulatory financial statements. Accordingly infrastructure renewal expenditure net of depreciation has been included within debtors. This represents a departure from the accounting policy adopted in the Company's 31 March 2008 statutory financial statements for infrastructure renewals expenditure and renewals accounting per FRS 15, which requires this amount to be included within fixed assets. The effect of this reclassification on fixed assets is shown in notes 10 and 11 of these regulatory financial statements.

- **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:

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (continued)

(c) Tangible fixed assets (continued)

- Other assets (continued)

Buildings	10 - 60 years
Operational structures	5 - 100 years
Other	20 - 60 years
Fixtures, fittings, vehicles and computers	3 - 10 years
Fixed and mobile plant	5 - 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 the profit and loss account.

(d) Impairment of tangible fixed assets

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.

(e) 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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (continued)

(f) Stocks, and 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.

(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 via the Statement of Total Recognised Gains and Losses.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (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. (a complete actuarial valuation is performed every three years). Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) 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 other finance income / expenses 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 two closed defined contribution pension schemes. The Company has no further payment obligations for these schemes; however, defined funds for individuals are held within these schemes.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (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. FRS25 'Financial Instruments: Presentation' has been adopted in the current and prior year.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (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 and development 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 cash flows 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 within the Kemble Water Holdings Limited Group, 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 year-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 regulatory historic cost financial statements for the year ended 31 March 2008

1 Principal accounting policies and presentation of financial information (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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

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.

(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.

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 the amended 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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

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

(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.

(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 regulatory historic cost financial statements for the year ended 31 March 2008

4 Operating costs

Analysis of operating costs by type of expense:

	Note	2008 £m	2007 £m
Staff costs	6	195.9	231.2
Materials and consumables		24.3	31.1
Other operating charges		507.6	495.0
Assets written off	10	6.9	9.0
Infrastructure renewals charge	10	106.9	110.9
Rentals under operating leases:			
- hire of plant and machinery		4.1	3.9
- other		7.4	6.4
Research and development		4.1	4.6
		<u>857.2</u>	<u>892.1</u>
Own work capitalised		<u>(127.7)</u>	<u>(107.3)</u>
		<u>729.5</u>	<u>784.8</u>

Comparatives for other operating charges have been amended to exclude severance costs which are now disclosed within staff costs.

	2008 £m	2007 £m
Auditors' remuneration		
Fees payable to the company's auditors for the audit of the company's accounts	0.2	0.2
Fees payable to the company's auditors and its associates for other services		
- Other services pursuant to legislation	0.1	0.1
- Tax services	-	0.3
- All other services	-	0.1
Audit fees in respect of the Thames Water Limited pension schemes	0.1	0.1
Total aggregate remuneration	<u>0.4</u>	<u>0.8</u>

5 Operating income

Analysis of operating income:

	2008 £m	2007 £m
Profit on disposal of fixed assets	<u>45.1</u>	<u>11.5</u>
Taxation attributable, included in the charge for the year	<u>3.6</u>	<u>1.1</u>

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008

6 Information regarding directors and employees

Aggregate directors emoluments:

	2008	2007
	£'000	£'000
Salary	833	741
Bonus	1,402	243
Other benefits	87	813
Total aggregate emoluments	<u>2,322</u>	<u>1,797</u>

At 31 March 2008 £24,000 is accruing to 3 directors (2007: £Nil) under a defined benefit scheme.

Highest paid director

The highest paid director during the year was David Owens. Full details of the highest paid director can be found in the Remuneration Report on page 52.

Employee information

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

	2008	2007
	Number	Number
Support	343	526
Operations	4,729	4,759
Total	<u>5,072</u>	<u>5,285</u>

Employment costs including executive directors' remuneration were:

	Note	2008	2007
		£m	£m
Salaries and wages		158.3	168.3
Social security costs		13.4	15.3
Pension costs	26	18.1	22.3
Severance costs		8.2	28.1
		<u>198.0</u>	<u>234.0</u>
Employment costs included within research and development costs		<u>(2.1)</u>	<u>(2.8)</u>
Net employment costs		<u>195.9</u>	<u>231.2</u>

Comparatives have been amended to include severance costs which were previously disclosed within other operating charges.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

7 Net interest

	2008 £m	2007 £m
Bank loans, overdrafts and other loans:		
- group loans	(194.1)	(141.7)
- bank loans	(26.6)	(22.7)
- other loans	(21.2)	(8.8)
Finance charges in respect of finance leases	<u>(10.0)</u>	<u>(9.8)</u>
Interest payable and similar charges	(251.9)	(183.0)
Interest receivable		
- group loans	43.8	-
- other loans	24.9	12.7
	<u>68.7</u>	<u>12.7</u>
Net interest	<u>(183.2)</u>	<u>(170.3)</u>

Included in net interest payable other loans is net swaps of £2.4m (March 2007: £1.9m) comprising interest payable swaps of £18.2m (March 2007: £4.7m) and interest receivable swaps of £15.8m (March 2007: £2.8m).

8 Taxation

(a) Analysis of charge in period

	Note	2008 £m	2007 £m
Current tax:			
Amounts payable in respect of corporation tax for the year		-	39.3
Amounts payable in respect of group relief		99.1	22.2
Adjustments in respect of previous periods		<u>11.1</u>	<u>(5.1)</u>
Total current tax	8(b)	<u>110.2</u>	<u>56.4</u>
Deferred tax:			
Origination and reversal of timing differences		14.0	16.9
Pension cost charge lower than pension cost relief		4.2	1.0
Adjustments in respect of previous periods		(12.1)	5.3
Effect of decreased tax rate from 30% to 28%		(60.1)	-
Release of deferred tax liability on abolition of Industrial Building Allowances		<u>(17.0)</u>	<u>-</u>
Total deferred tax		<u>(71.0)</u>	<u>23.2</u>
Taxation on profit on ordinary activities		<u>39.2</u>	<u>79.6</u>

Of the deferred tax credit as at 31 March 2008 of £71m (31 March 2007 £23.2m charge), a deferred tax credit for the year ended 31 March 2008 of £75.2m (31 March 2007: £22.2m charge) is shown as a movement within note 19 provisions for liabilities and charges, and a deferred tax charge for the year ended 31 March 2008 of £4.2m (31 March 2007: £1.0m) within note 26 pension schemes.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

8 Taxation (continued)

(b) Factors affecting tax charge for period

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

	2008 £m	2007 £m
Profit on ordinary activities before tax	<u>419.2</u>	<u>270.1</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2007: 30%)	125.8	81.0
Effects of:		
Income not taxable (primarily intra-group disposals of property) less disallowable costs	(7.9)	(2.9)
Capital allowances for period in excess of depreciation and other timing differences	(13.9)	(15.6)
Pension cost charge lower than pension cost relief	(4.9)	(1.0)
Adjustments to tax charge in respect of previous periods	<u>11.1</u>	<u>(5.1)</u>
Current taxation charge for the period	8(a) <u>110.2</u>	<u>56.4</u>

9 Dividends

	2008 £m	2007 £m
First interim paid: 9.91p (2007: 3.43p) per ordinary share	102.0	35.3
Second interim paid: Nil (2007: 48.59p) per ordinary share	<u>-</u>	<u>500.0</u>
	<u>102.0</u>	<u>535.3</u>

As a post balance sheet event, on 22 May 2008 the directors approved a further interim dividend of £131.0m (12.7p per ordinary share) in respect of the year ended 31 March 2008. This interim dividend was paid to Thames Water Utilities Holding Limited on 30 May 2008.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

10 Tangible fixed assets

	Notes	Land and Buildings	Plant and equipment	Infra-structure assets	Total
		£m	£m	£m	£m
<u>UK GAAP (FRS 15) historic cost values</u>					
Cost					
At 1 April 2007		2,195.9	3,359.3	3,494.4	9,049.6
Additions		153.4	284.6	559.1	997.1
Disposals		(43.6)	(17.3)	-	(60.9)
Assets written off		-	(6.9)	-	(6.9)
At 31 March 2008		<u>2,305.7</u>	<u>3,619.7</u>	<u>4,053.5</u>	<u>9,978.9</u>
Capital contributions					
	1				
At 1 April 2007		-	-	507.5	507.5
Additions		-	-	37.6	37.6
At 31 March 2008		<u>-</u>	<u>-</u>	<u>545.1</u>	<u>545.1</u>
Depreciation					
At 1 April 2007		550.7	1,485.2	605.8	2,641.7
Provided during the year		37.5	182.2	106.9	326.6
Disposals		(17.8)	(12.6)	-	(30.4)
At 31 March 2008		<u>570.4</u>	<u>1,654.8</u>	<u>712.7</u>	<u>2,937.9</u>
<u>UK GAAP net book value</u>					
At 31 March 2008		<u>1,735.3</u>	<u>1,964.9</u>	<u>2,795.7</u>	<u>6,495.9</u>
At 31 March 2007		1,645.2	1,874.1	2,381.1	5,900.4
<u>RAG 3 Net infrastructure renewal reclassification</u>					
	1 & 11				
At 1 April 2007		-	-	32.6	32.6
Infrastructure renewal expenditure in the year		-	-	(176.2)	(176.2)
Infrastructure renewal depreciation charge		-	-	106.9	106.9
Infrastructure renewal charge to align RAG 3 charge to FRS 15		-	-	-	-
At 31 March 2008		<u>-</u>	<u>-</u>	<u>(36.7)</u>	<u>(36.7)</u>
<u>Regulatory historic cost net book value</u>					
At 31 March 2008		<u>1,735.3</u>	<u>1,964.9</u>	<u>2,759.0</u>	<u>6,459.2</u>
At 31 March 2007		1,645.2	1,874.1	2,413.7	5,933.0

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

10 Tangible fixed assets (continued)

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

	2007	2007
	£m	£m
Freehold land and buildings	1,731.9	1,622.3
Leasehold - over 50 years	0.9	9.1
- under 50 years	2.5	13.8
	<u>1,735.3</u>	<u>1,645.2</u>

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

	2008		2007	
	Cost	Net Book Value	Cost	Net Book Value
	£m	£m	£m	£m
Plant and equipment	<u>272.5</u>	<u>155.2</u>	<u>272.5</u>	<u>164.8</u>

Depreciation has not been charged on freehold land stated in the financial statements at cost of £30.4m (2007: £30.0m).

Tangible fixed assets at 31 March 2008 include assets in the course of construction of £1,503.6m (2007: £926.1m).

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. An appeal was lodged and a public inquiry completed in June 2006. On 9 May 2008, following discussions with the new Mayor of London, Boris Johnson, has dropped its objection to the grant of planning permission.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

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 2008 the total spent on this project was £34.4m, comprising principally costs of planning, environmental, impact assessment, consultation, 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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

11 Reconciliation of UK GAAP to regulatory historic cost fixed assets, debtors and creditors

(a) Debtors: amounts falling due within one year	Note	2008	2007	
		£m	£m	
At 31 March per UK GAAP		482.6	444.6	
Adjustment for infrastructure renewals accounting		36.7	-	
At 31 March per RAG 3	14	519.3	444.6	
(b) Creditors: amounts falling due within one year	Note	2008	2007	
		£m	£m	
At 31 March per UK GAAP		1,192.7	730.9	
Adjustment for infrastructure renewals accounting		-	32.6	
At 31 March per RAG 3	16	1,192.7	763.5	
(c) Tangible fixed assets	Note	Other Assets	Infra-structure assets	Total
		£m	£m	£m
Cost				
At 31 March 2008 per FRS 15		5,925.4	4,053.5	9,978.9
Infrastructure renewals expenditure capitalised in prior years		-	(574.1)	(574.1)
Infrastructure renewals expenditure capitalised in the year		-	(176.2)	(176.2)
Disposals in prior years		-	0.9	0.9
Cost at 31 March 2008 per RAG 3		5,925.4	3,304.1	9,229.5
Capital contribution				
Contributions at 31 March 2008 per FRS 15		-	545.1	545.1
Contributions at 31 March 2008 per RAG 3		-	545.1	545.1
Depreciation				
At 31 March 2008 per FRS 15		2,225.2	712.7	2,937.9
Depreciation charge for infrastructure renewals expenditure in prior years		-	(606.7)	(606.7)
Depreciation charge for infrastructure renewals expenditure in the year		-	(106.9)	(106.9)
Disposals in prior years		-	0.9	0.9
Depreciation at 31 March 2008 per RAG 3		2,225.2	(0.0)	2,225.2
Net book value				
At 31 March 2008 per FRS 15		3,700.2	2,795.7	6,495.9
Adjustment for infrastructure renewals accounting		-	(36.7)	(36.7)
At 31 March 2008 per RAG 3	10	3,700.2	2,759.0	6,459.2

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

12 Fixed asset investments

	2008 £m	2007 £m
Cost of shares in subsidiaries	<u>0.1</u>	<u>0.1</u>

Investments in subsidiaries during the period

Acquisition of Thames Water Utilities Cayman Finance Holdings Limited

On, 3 October 2007 the Company acquired the entire issued share capital in Thames Water Utilities Cayman Finance Holdings Limited, an intermediate holding company incorporated in the Cayman Islands. Thames Water Utilities Cayman Finance Holdings Limited subsequently purchased the entire issued share capital in Thames Water Utilities Cayman Finance Limited from the Company.

At 31 March 2008 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
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance Company
Thames Water Utilities Cayman Finance Holdings Limited	\$1 Ordinary	100%	Finance Company

Thames Water Utilities Finance Limited was incorporated and registered in Great Britain. Thames Water Utilities Cayman Finance Holdings Limited was incorporated and registered in the Cayman Islands.

At 31 March 2008 Thames Water Utilities Finance Limited had net assets of £53,000 (March 2007: £71,000). Loss for the year ended 31 March 2008: £18,000 (March 2007: profit £21,000)

At 31 March 2008 Thames Water Utilities Cayman Finance Holdings Limited had net assets of \$1. No profit or loss had been made in the period.

The following investments were disposed of on 24 May 2007, to Thames Water Limited, a company within the Kemble Water Holdings group:

Gemwel Limited, Thames Water Drainage Services Limited, Thames Water Procurement Limited and County Wide Collections Limited.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

13 Stocks

	2008 £m	2007 £m
Raw materials and consumables	<u>7.0</u>	<u>6.1</u>

14 Debtors: amounts falling due within one year

	2008 £m	2007 £m
Trade debtors	192.3	182.0
Amounts owed by group undertakings	21.1	10.2
Other debtors	36.8	22.6
Insurance claims receivable	42.8	49.8
Infrastructure renewals prepayment	36.7	-
Prepayments and accrued income	<u>189.6</u>	<u>180.0</u>
	<u>519.3</u>	<u>444.6</u>

15 Debtors: amounts falling due after more than one year

	2008 £m	2007 £m
Amounts owed by group undertakings	<u>1,223.8</u>	<u>-</u>

Amounts owed by group undertakings, are comprised of:

- A loan of £1,180.0m (March 2007: £Nil) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking. The Directors are not anticipating any repayment of this loan within the next 12 months.
- Interest receivable of £43.8m (March 2007 £Nil) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking, on a loan of £1,180.0m. Interest rate is charged at Libor + 0.35%. The Directors are not anticipating any repayment of this interest within the next 12 months.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

16 Creditors: amounts falling due within one year

	2008 £m	2007 £m
Bank loans	30.0	9.4
Obligations under finance leases	-	11.8
Trade creditors:		
- Operating	182.7	167.0
- Capital	245.8	209.2
Amounts owed to group undertakings:		
- Loan amounts	336.3	-
- Non-loan amounts	54.8	63.5
Insurance claims payable	42.8	49.8
Taxation:		
- Corporation tax	7.7	-
- Amounts payable in respect of group relief	49.8	23.5
- Other taxation and social security payable	4.4	4.7
Infrastructure renewals accrual	-	32.6
Accruals	<u>238.4</u>	<u>192.0</u>
	<u>1,192.7</u>	<u>763.5</u>

In July 2007 the Company arranged for the transfer of two of its leases from Societe Generale to Royal Bank of Scotland. As part of this transfer the profile of the rental payments on the leases were changed so that there were no capital repayments until 2009. These leases are now held as falling due after more than one year (note 17 below).

17 Creditors: amounts falling due after more than one year

	2008 £m	2007 £m
Bank loans	458.8	335.5
Obligations under finance leases	204.5	203.8
Amounts owed to group undertakings (see below)	<u>3,798.3</u>	<u>2,877.5</u>
	<u>4,461.6</u>	<u>3,416.8</u>
Amounts owed to group undertakings are:		
	2008 £m	2007 £m
Inter company loans:		
- Within one year	336.3	-
- After more than one year	<u>3,798.3</u>	<u>2,877.5</u>
	<u>4,134.6</u>	<u>2,877.5</u>
Non-loan amounts due within one year	<u>54.8</u>	<u>63.5</u>
	<u>4,189.4</u>	<u>2,941.0</u>

Amounts due to group undertakings in respect of non-loan amounts are unsecured, interest free and payable on demand.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

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

Loan amounts owed to group undertakings, includes:

- £2,899.5m (March 2007: £2,877.5m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, of which £Nil (March 2007: £Nil) is included within creditors due within one year and £2,899.5m (March 2007: £2,877.5m) within creditors due after more than one year.
- £1,160.9m (March 2007: £Nil) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking, of which £250.0m (March 2007: £Nil) is included within creditors due within one year and £910.9m (March 2007: £Nil) within creditors due after more than one year.

Following the completion of the whole business securitisation of the Company, the terms and conditions of Thames Water Utilities Finance Limited bonds have been amended so creditors benefit from the terms of The Security Trust and Inter-creditor Deed to which the Company is an obligor.

Following the completion of the whole business securitisation of the Company, creditors of Thames Water Utilities Cayman Finance Limited bonds benefit from the terms of The Security Trust and Inter-creditor Deed to which the Company is an obligor.

Following the completion of the whole business securitisation of the Company, the terms and conditions of the European Investment Bank loans have been amended so creditors benefit from the terms of The Security Trust and Inter-creditor Deed to which the Company is an obligor. The company has guaranteed its obligations with its future cashflows.

Prior to the whole business securitisation of the Company, Thames Water Limited had 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.

Other loans and finance leases, as disclosed in more detail in note 18, are:

	2008	2007
	£m	£m
Inter company loans (as above)	4,134.6	2,877.5
Finance leases:		
- Within one year	-	11.8
- After more than one year	204.5	203.8
	<u>4,339.1</u>	<u>3,093.1</u>

18 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 and Thames Water Utilities Cayman 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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

18 Financial instruments (continued)

Funding and treasury policy (continued)

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 Group and are managed as a cost, 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:

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	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 %	2007 %	2008 Years	2007 Years
Bank loans & overdraft										
- £ Sterling	264.2	108.9	224.6	236.0	488.8	344.9	7.4	7.5	4.2	4.0
Other loans & finance leases										
- £ Sterling	101.5	215.6	4,237.6	2,877.5	4,339.1	3,093.1	6.1	5.5	26.5	24.5
Total	365.7	324.5	4,462.2	3,113.5	4,827.9	3,438.0	6.2	5.6	25.4	23.0

The Company's interest rate and cross currency swaps convert £78.1m (March 2007: £102.9m) of floating rate borrowing to fixed rate and £26.9m (March 2007: £26.9m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £62.4m (March 2007: £81.8m) of foreign currency borrowing through conversion to Sterling. Index linked swaps of £500.0m (March 2007: £nil) swapped fixed rate debt to index linked debt. A further £100.0m of fixed rate debt was swapped to index linked debt in April 2008. All swaps are included at carrying amount.

* Included in fixed rate liabilities are index linked loans at a fixed coupon rate and indexation calculated using RPI.

Short-term loans bear interest at rates linked to LIBOR.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

18 Financial instruments (continued)

Financial assets

	Total at floating rates		Total at book value	
	2008 £m	2007 £m	2008 £m	2007 £m
Short term deposits	15.6	112.5	15.6	112.5
Cash at bank and in hand				
- Sterling	65.8	89.4	65.8	89.4
Total	81.4	201.9	81.4	201.9

Base rate 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.

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
	2008 £m	2007 £m	2008 £m	2007 £m
Primary financial instruments				
Financial assets				
- Short term deposits	15.6	112.5	15.6	112.5
- Cash at bank and in hand	65.8	89.4	65.8	89.4
Financial liabilities				
- Bank loans	(475.0)	(332.5)	(479.0)	(337.3)
- Other loans & finance leases	(4,339.1)	(3,093.1)	(4,612.3)	(3,343.7)
Derivative financial instruments				
- Interest rate swaps	(9.0)	-	(13.9)	(4.6)
- Cross currency swaps	(4.8)	(12.4)	(5.5)	(12.4)
Total	(4,746.5)	(3,236.1)	(5,029.3)	(3,496.1)

Primary financial instruments include bonds, which are traded on a public market. Fair values for these have been calculated using the 31 March 2008 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.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

18 Financial instruments (continued)

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.

Maturities	2008	2007
	£m	£m
Bank loans and overdrafts		
- Within one year	30.0	9.4
- Between one and two years	153.3	30.0
- Between two and five years	146.5	305.5
- After more than five years	159.0	-
	488.8	344.9
Other loans and finance leases		
- Within one year	336.3	11.8
- Between one and two years	51.1	29.3
- Between two and five years	350.4	374.0
- After more than five years	3,601.3	2,678.0
	4,339.1	3,093.1
Total borrowing	4,827.9	3,438.0

- Loans are repayable between 2008 and 2062.
- Loans wholly repayable after more than five years are:

	2008	2007
	£m	£m
Bank Loans	159.0	-
Other Loans	3,490.8	2,558.2
	3,649.8	2,558.2

Other loans, repayable to Group undertakings, 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.
- £50m 1.98% Index linked bond due 2042.
- £100m 1.85% Index linked bond due 2047.
- £200m 1.82% Index linked bond due 2049.
- £200m 1.77% Index linked bond due 2057.
- £350m 1.76% Index linked bond due 2062.
- £250m 6.00% Short-term loan due 2009.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

18 Financial instruments (continued)

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

	2008	2007
	£m	£m
Finance leases	<u>110.5</u>	<u>119.9</u>

- The ranges of interest rates on outstanding loans are 1.68% to 8.35% (2007: 1.7% to 8.4%).

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

At 31 March 2008 the Company has access to committed facilities of £1.1bn (31 March 2007: £Nil) of which £0.3bn (31 March 2007: £Nil) had been drawn at the balance sheet date, through its subsidiary company Thames Water Utilities Cayman Finance Limited. This access to funding replaces the Company's access to committed facilities through Kemble Water Limited of £0.7bn as at 31 March 2007.

Following the completion of the whole business securitisation programme in August 2007 the company has access to funding through Thames Water Utilities Cayman Finance Limited £10bn multi-currency bond programme of which £0.9bn had been drawn at the balance sheet date.

Previously debt has been raised through the Company's wholly owned subsidiary, Thames Water Utilities Finance Limited's £5bn debt issuance programme. Legacy debt obligations will remain outstanding but no new debt will be issued by Thames Water Utilities Finance Limited.

19 Provisions for liabilities and charges

	Deferred tax	Restructuring	Other	Total
	£m	£m	£m	£m
At 1 April 2007	916.6	-	-	916.6
Reclassifications in the year	-	3.6	19.2	22.8
Utilised during the year	-	(4.7)	-	(4.7)
Charge/(credit) to profit and loss for the year	(75.2)	4.4	14.7	(56.1)
Amounts released unused	-	-	(1.3)	(1.3)
At 31 March 2008	<u>841.4</u>	<u>3.3</u>	<u>32.6</u>	<u>877.3</u>

The directors have reviewed the liabilities of the Company and, after due consideration of their nature, consider that it is appropriate to reclassify certain liabilities, in respect of restructuring and potential claims against the Company, from accruals to provisions for liabilities and charges. The total effect is to increase provisions for liabilities and charges and decrease accruals and deferred income within creditors falling due within one year by £22.8m during the year.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

19 Provisions for liabilities and charges (continued)

The restructuring provision principally relates to severance costs as a result of the Company's restructuring and reorganisation and represents management's best estimate. This provision is expected to be utilised over the next two years.

Other provisions principally relate to claims against the Company and represents management's best estimate of the value of settlement and costs. It is estimated that claims will be settled in more than one year.

The elements of deferred tax are as follows:

	2008 £m	2007 £m
Accelerated capital allowances	852.5	922.6
Other timing differences	<u>(11.1)</u>	<u>(6.0)</u>
	<u>841.4</u>	<u>916.6</u>

Total deferred tax provision:

	2008 £m	2007 £m
Included above	841.4	916.6
Deferred tax (asset) provided on pension surplus	<u>10.1</u>	<u>4.8</u>
	<u>851.5</u>	<u>921.4</u>

At 31 March 2008 there are no amounts of deferred tax unprovided for (March 2007: £nil).

The pension asset per note 26 is shown net of deferred tax.

20 Share capital

	2008 £m	2007 £m
Authorised		
1,029,050,000 (March 2007: 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 (March 2007: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>

21 Share premium reserve

	2008 £m	2007 £m
Premium of 25p on issue of 400 million £1 ordinary shares	<u>100.0</u>	<u>100.0</u>

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

22 Profit and loss reserve

	Note	2008 £m	2007 £m
At 1 April		202.4	512.3
Profit for the year		380.0	190.5
Dividends	9	<u>(102.0)</u>	<u>(535.3)</u>
Profit/(deficit) for the year		278.0	(344.8)
Actuarial gain on pension scheme	26	3.9	49.9
Deferred tax relating to actuarial gain on pension scheme		<u>(1.1)</u>	<u>(15.0)</u>
As at 31 March including total pension asset		<u>483.2</u>	<u>202.4</u>
Total pension (asset)	26	(26.1)	(11.1)
As at 31 March excluding pension (asset)		<u>457.1</u>	<u>191.3</u>

23 Reconciliation of movements in shareholder's funds

	Note	2008 £m	2007 £m
Shareholder's funds at the beginning of the year		1,331.4	1,641.3
Profit for the financial year		380.0	190.5
Dividends		<u>(102.0)</u>	<u>(535.3)</u>
Net movement in shareholder's funds		278.0	(344.8)
Actuarial gain on pension scheme	26	3.9	49.9
Deferred tax relating to actuarial gain on pension scheme		<u>(1.1)</u>	<u>(15.0)</u>
Shareholder's funds at the end of the year including pension (asset)		<u>1,612.2</u>	<u>1,331.4</u>

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

24 Capital commitments and contingencies

	2008 £m	2007 £m
Contracted for but not provided	<u>497.5</u>	<u>372.0</u>

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

Mogden Sewage Treatment Works

A number of residents living close to Mogden Sewage Treatment Works have filed a claim against the Company alleging (in the alternative) nuisance, negligence and breach of Articles 1 & 8 of the First Protocol of the European Convention on Human Rights. A private action is being pursued by 1350 claimants, 816 Group A claimants (those with property interests) and 534 Group B claimants (those without property interests). At this date, the Company does not have details of the values of the individual claims being made against it.

Liability is denied and the claim is being vigorously defended by the Company. A hearing of preliminary legal issues took place in 2007 and judgment on those preliminary issues was handed down on 24 August 2007. The trial of the claim has been listed to commence on 2 February 2009 with a time estimate of 6 weeks.

British Waterways Board

The Company is in dispute with the British Waterways Board (BWB) in relation to the charges payable for abstraction of water by the Company from the River Lee, whereby BWB are claiming a potentially significant increase in their charges. The Company is vigorously disputing their claim on the basis that it does not agree with the legal grounds for any increase to these charges or the economic analysis used to justify the level of charges proposed by BWB.

As the competent authority, DEFRA has been asked to determine the issue and it is believed that such determination will take place by means of inquiry. It is unclear when this decision will be made.

The Company has set aside amounts considered appropriate for all legal and similar claims.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

25 Operating leases

At 31 March 2008 the Company was committed to making the following payments during the next year in respect of non-cancellable operating leases:

	2008		2007	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Leases which expire:				
Within one year	0.2	1.1	0.2	1.0
Between one and two years	1.8	0.7	-	0.7
Between two and five years	1.1	0.5	0.9	0.4
After more than five years	4.6	-	4.6	-
	<u>7.7</u>	<u>2.3</u>	<u>5.7</u>	<u>2.1</u>

26 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 year.

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 year ended 31 March 2008 payments amounted to £3.0m (2007: £5.5m).

The latest full actuarial valuation was undertaken as at 31 December 2004. This valuation has been updated at 31 March 2008 by Hewitt Associates Limited (Hewitt) using revised assumptions that are consistent with the requirements of FRS 17 and shown in the table below.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

26 Pension schemes (continued)

The next full actuarial valuation as at 31 December 2007 will be undertaken by Hewitt (the independent and professionally qualified consulting actuaries to the schemes) during 2008. The recent exceptional volatility on the credit markets has impacted the pension valuation as calculated under the requirements of FRS17. Consequently the results of the full actuarial valuation may be significantly adverse from that included in these accounts.

Thames Water Group has taken advice from Hewitt in respect of the funding position of the Group pension schemes.

Reconciliation of funded status to balance sheet:

	2008 £m	2007 £m
Fair value of scheme assets	1,214.8	1,246.4
Present value of scheme liabilities	<u>(1,098.9)</u>	<u>(1,205.9)</u>
Surplus in scheme	115.9	40.5
Impact of irrecoverable surplus	<u>(79.7)</u>	<u>(24.6)</u>
Asset recognised on the balance sheet	36.2	15.9
Deferred tax liability	<u>(10.1)</u>	<u>(4.8)</u>
Net pension asset	<u>26.1</u>	<u>11.1</u>

Movements in present value of the scheme liabilities:

	2008 £m	2007 £m
Opening present value of scheme liabilities	1,205.9	1,211.8
Current service cost: Thames Water Utilities Limited	21.1	27.3
Current service cost: Other Thames Water Group participating companies	4.5	6.2
Interest cost	64.7	59.8
Contributions by scheme participants	5.6	6.1
Actuarial (gains)/losses on scheme liabilities	(157.9)	(69.3)
Net benefits paid out	(45.0)	(36.5)
Past service cost	-	(5.0)
Termination pension cost	3.0	5.5
Gains on curtailments	(6.7)	-
Loss on settlements	3.7	-
	<u> </u>	<u> </u>
Closing present value of scheme liabilities	<u>1,098.9</u>	<u>1,205.9</u>

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

26 Pension schemes (continued)

Movements in fair value of scheme assets:

	2008 £m	2007 £m
Opening fair value of scheme assets	1,246.4	1,174.3
Expected return on scheme assets	80.8	68.4
Actuarial (losses) on scheme assets	(102.7)	(2.1)
Contributions by the employer	22.2	24.5
Contributions by other Thames Water Group participating companies	4.5	6.2
Contributions by scheme participants	5.6	6.1
Termination pension cost	3.0	5.5
Net benefits paid out	<u>(45.0)</u>	<u>(36.5)</u>
Closing present value of scheme assets	<u>1,214.8</u>	<u>1,246.4</u>

Expense recognised in the profit and loss account:

	2008 £m	2007 £m
Current service cost	21.1	27.3
Past service cost	-	(5.0)
Curtailment cost	(6.7)	-
Settlement cost	3.7	-
Interest cost	64.7	59.8
Expected return on scheme assets	(80.8)	(68.4)
Impact of restriction on expected return on assets due to irrecoverable surplus	<u>3.8</u>	<u>7.3</u>
Total expense recognised in the profit and loss account	<u>5.8</u>	<u>21.0</u>

The expense recognised in the following line items in the profit and loss account:

	2008 £m	2007 £m
Operating costs: staff costs	18.1	22.3
Other finance income	<u>(12.3)</u>	<u>(1.3)</u>
Total expense charged in the profit and loss account	<u>5.8</u>	<u>21.0</u>

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

26 Pension schemes (continued)

Amount recognised in Statement of total recognised gains and losses:

	Year end 31 March 2008 £m	Period end 31 March 2007 £m
Actual return less expected return on pension scheme assets	(102.7)	(2.1)
Experience (losses) arising on the scheme liabilities	(5.4)	(6.8)
Changes in assumptions underlying the present value of scheme liabilities	163.3	76.1
Adjustments relating to irrecoverable surplus	<u>(51.3)</u>	<u>(17.3)</u>
Actuarial gain recognised in Statement of total recognised gains and losses	<u>3.9</u>	<u>49.9</u>
Cumulative amount of (losses) recognised in Statement of total recognised gains and losses	<u>(70.9)</u>	<u>(74.8)</u>

Fair value of scheme assets and return on those assets:

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 average expected pay term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table

	2008		2007		2006	
	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	8.5%	519.9	8.8%	577.8	8.3%	597.4
Bonds	5.5%	70.9	5.3%	66.0	4.8%	62.9
Gilts	4.3-4.5%	532.3	4.5-4.8%	472.4	4.3%	441.4
Property	7.5%	82.9	7.8%	95.0	8.3%	67.0
Other assets	<u>6.0%</u>	<u>8.8</u>	5.5%	35.2	4.5%	5.6
Average expected long term rate of return/total fair value of assets	<u>6.4%</u>	<u>1,214.8</u>	6.8%	1,246.4	6.2%	1,174.3

Thames Water employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

26 Pension schemes (continued)

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

	2008	2007	2006
Price inflation	3.7%	3.2%	3.0%
Salary increases	4.7%	4.2%	4.0%
Pension increases	3.7%	3.2%	3.0%
Discount rate	6.9%	5.4%	4.9%

In valuing the liabilities of the pension schemes at 31 March 2008, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future mortality improvements.

The assumptions are that a member who retires in 2028 at age 60 will live on average for a further 25 years after retirement if they are male and for a further 28 years after retirement if they are female. In addition, it is assumed that a current pensioner who is aged 60 will live on average for a further 24 years after retirement if they are male and a further 26 years after retirement if they are female.

History of asset values, present value of liabilities, surplus/deficit in schemes and experience gains and losses:

	31 March 2008 £m	31 March 2007 £m	31 March 2006 £m	31 March 2005 £m	31 March 2004 £m
Fair value of scheme assets	1,214.8	1,246.4	1,174.3	1,016.5	896.7
Present value of scheme liabilities	(1,098.9)	(1,205.9)	(1,211.8)	(1,070.7)	(1,023.4)
(Deficit)/surplus in scheme	115.9	40.5	(37.5)	(54.2)	(126.7)

Experience adjustments:

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Experience (losses)/gains on scheme assets:					
Amount	(102.7)	(2.1)	111.9	77.9	123.0
Percentage of scheme assets	(8.5%)	(0.2%)	9.5%	7.7%	13.7%
Experience (losses)/gains on scheme liabilities:					
Amount	(5.4)	(6.8)	0.4	25.0	(50.0)
Percentage of present value of schemes liabilities	(0.5%)	(0.6%)	0.0%	2.3%	(4.9%)
Total amount recognised in statement of total recognised gains and losses					
Amount	3.9	49.9	14.4	71.2	49.8
Percentage of present value of schemes liabilities	0.4%	4.1%	1.2%	6.6%	4.9%

The company expects to contribute approximately £32.1m to the defined benefit schemes in the next financial year.

Thames Water Utilities Limited

Notes to the regulatory historic cost financial statements for the year ended 31 March 2008 (continued)

27 Intermediate and ultimate parent company and controlling party

Thames Water Utilities Holding Limited, a company incorporated in the United Kingdom is the immediate parent company.

Kemble Water Finance Limited, (2007: 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.

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.

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.

Thames Water Utilities Limited

Regulatory current cost profit and loss account for the appointed business for the year ended 31 March 2008

	Note	2008 £m	2007 £m
Turnover	2	1,454.4	1,385.8
Current cost operating costs	3	(1,027.2)	(1,074.4)
Operating income	2	24.9	7.5
Working capital adjustment	2	7.8	6.3
Current cost operating profit		459.9	325.2
Net Interest:		(171.5)	(169.5)
Financing adjustment		95.9	123.4
Current cost profit on ordinary activities before taxation		384.3	279.1
Taxation			
- Current tax		(106.6)	(52.3)
- Deferred tax		71.0	(23.2)
Current cost profit attributable to shareholders		348.7	203.6
Dividends		(93.7)	(525.7)
Current cost profit/(deficit) for the year	6	255.0	(322.1)

Thames Water Utilities Limited

Regulatory current cost balance sheet for the appointed business at 31 March 2008

	Note	2008 £m	2007 £m
Fixed assets			
Tangible assets	4	48,645.2	46,647.9
Third party contributions since 31 March 1990		(857.9)	(790.8)
		<u>47,787.3</u>	<u>45,857.1</u>
Working capital			
Cash	5	(282.4)	(204.8)
Short term deposits		65.8	89.4
Infrastructure renewals prepayment/(accrual)		15.6	112.5
		<u>36.7</u>	<u>(32.6)</u>
Net operating assets		47,623.0	45,821.6
Borrowings		(366.3)	(21.2)
Non-trade debtors		91.8	73.6
Non-trade creditors due within one year		(147.4)	(136.8)
Investment - loan to group company		1,223.8	-
Investments - other		0.1	0.1
Corporation tax payable		(7.7)	-
Total non operating assets and liabilities		48,417.3	45,737.3
Creditors: amounts falling due after more than one year			
Borrowings		(4,461.6)	(3,416.8)
Other creditors		(24.8)	-
Total creditors falling due after more than one year		<u>(4,486.4)</u>	<u>(3,416.8)</u>
Provisions for liabilities and charges			
Deferred tax provision		(841.4)	(916.6)
Post employment asset		26.1	11.1
Other provisions		(35.9)	(20.8)
Total provisions		<u>(851.2)</u>	<u>(926.3)</u>
Net assets		43,079.7	41,394.2
Capital and reserves			
Called up share capital		1,029.0	1,029.0
Share premium		100.0	100.0
Profit and loss account	6	(594.0)	(851.8)
Current cost reserve	7	42,544.7	41,117.0
Total capital and reserves		43,079.7	41,394.2

The notes on pages 104 to 116 form part of these regulatory current cost financial statements.

The regulatory current cost financial statements were approved by the Board of Directors on 4 June 2008 and were signed on its behalf by:

M Braithwaite

Chief Financial Officer

Thames Water Utilities Limited

Regulatory current cost statement of cash flow for the year ended 31 March 2008

	Note	2008			2007		
		Appointed business	Non-Appointed business	Total	Appointed business	Non-Appointed business	Total
		£m	£m	£m	£m	£m	£m
Net cash inflow from operating activities	(a)	908.3	11.7	920.0	750.1	14.9	765.0
Returns on investments and servicing of finance							
Interest received		12.1	0.6	12.7	19.9	0.5	20.4
Interest paid		(184.4)	-	(184.4)	(148.0)	-	(148.0)
Interest element in finance lease payments		(16.5)	-	(16.5)	(13.7)	-	(13.7)
Net cash outflow from returns on investments and servicing of finance		(188.8)	0.6	(188.2)	(141.8)	0.5	(141.3)
Taxation		(72.6)	(3.6)	(76.2)	(62.6)	(4.1)	(66.7)
Capital expenditure and financial investment							
Gross cost of purchased fixed assets		(799.6)	(0.4)	(800.0)	(583.3)	(1.7)	(585.0)
Infrastructure renewals expenditure		(160.4)	-	(160.4)	(115.2)	-	(115.2)
Receipt of grants and contributions		56.6	-	56.6	59.8	-	59.8
Movements on long term group loans		(1,180.0)	-	(1,180.0)	-	-	-
Disposal of fixed assets		75.6	-	75.6	19.8	-	19.8
Net cash outflow from investment activities		(2,007.8)	(0.4)	(2,008.2)	(618.9)	(1.7)	(620.6)
Equity dividends paid		(93.7)	(8.3)	(102.0)	(525.7)	(9.6)	(535.3)
Management of liquid resources							
Decrease/(increase) in short term deposits		96.9	-	96.9	(112.5)	-	(112.5)
Net cash (outflow) before financing		(1,357.7)	-	(1,357.7)	(711.4)	-	(711.4)
Financing							
Capital element in finance lease payments		(11.1)	-	(11.1)	(9.8)	-	(9.8)
New loans		1,369.6	-	1,369.6	1,200.0	-	1,200.0
Repayment of loans		(24.4)	-	(24.4)	(401.4)	-	(401.4)
Net cash inflow from financing	(b) & (c)	1,334.1	-	1,334.1	788.8	-	788.8
(Decrease)/increase in cash	(b) & (c)	(23.6)	-	(23.6)	77.4	-	77.4

Thames Water Utilities Limited

Notes to regulatory current cost cash flow statement for the year ended 31 March 2008

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

	2008	2007
	Appointed business	Appointed business
	£m	£m
Current cost operating profit	459.9	325.2
Working capital adjustment	(7.8)	(6.3)
Decrease in working capital (excluding short term capital creditors)	41.0	72.8
Current cost depreciation	327.1	324.0
Current cost profit on sale of fixed assets	(24.9)	(7.5)
Infrastructure renewals charge	106.9	110.9
Other non-cash profit and loss items	6.1	(69.0)
Net cash inflow from operating activities	908.3	750.1

The definition of “decrease in working capital” has been amended in the June Return to exclude short-term capital creditors. The prior year has not been restated.

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

	Note	2008	2007
		£m	£m
(Decrease)/increase in cash in the period		(23.6)	77.4
(Decrease)/increase in short term deposits		(96.9)	112.5
Cash inflow from movement in net debt and financing		(1,334.1)	(788.8)
Increase in net debt resulting from cash flows		(1,454.6)	(598.9)
Non-cash increase in net debt		(55.8)	(24.2)
Total increase in net debt		(1,510.4)	(623.1)
Opening net debt		(3,236.1)	(2,613.0)
Closing net debt	(c)	(4,746.5)	(3,236.1)

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

Thames Water Utilities Limited

Notes to regulatory current cost cash flow statement for the year ended 31 March 2008 (continued)

(c) Analysis of net debt

	2007 £m	Cash flow £m	Non-cash £m	2008 £m
Cash at bank and in hand	89.4	(23.6)	-	65.8
Short term deposits	112.5	(96.9)	-	15.6
	<u>201.9</u>	<u>(120.5)</u>	<u>-</u>	<u>81.4</u>
Debt due within 1 year	(9.4)	(356.9)	-	(366.3)
Debt due after 1 year	(3,213.0)	(988.3)	(55.8)	(4,257.1)
Finance leases	(215.6)	11.1	-	(204.5)
	<u>(3,438.0)</u>	<u>(1,334.1)</u>	<u>(55.8)</u>	<u>(4,827.9)</u>
Total	<u>(3,236.1)</u>	<u>(1,454.6)</u>	<u>(55.8)</u>	<u>(4,746.5)</u>

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008

1 Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by the Water Services Regulation Authority for modified real term financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of which assets are valued at their current cost value to the business.

These financial statements have been prepared in accordance with applicable Regulatory Accounting Guidelines (RAG). In respect of cost allocations, the Company has continued to allocate costs by cost centre as in previous years rather than on an activity based method, which is the preferred system under RAG 3.

The principal current cost accounting policies used are the same as those adopted in the regulatory historic cost financial statements, except as set out below.

Changes to accounting policies

The same accounting policies used for the period ended 31 March 2007 have been applied with the following exception:

The amendment to FRS 17 'Retirement benefits' has been adopted in these financial statements for the first time and the disclosures it requires have been presented for both the current and comparative period. The amendment to FRS 17 also requires that quoted securities are valued at their current bid-price rather than their mid-market value.

On the basis of materiality, the effect of the change in accounting policy to adopt the amendments to FRS 17 did not affect the brought forward profit and loss reserves or the net actuarial gain/loss in the year.

(a) Valuation bases for determining the current cost of fixed assets

(i) Review of asset valuations

The Company undertook a review of the "modern equivalent asset" (MEA) values at 31 March 1998 as one aspect of the 1999 Periodic Review. This involved a comprehensive review of the asset stock at the time, as well as the unit costs underpinning the valuations. The Company has, on an ongoing basis, recognised improved information regarding the physical asset stock. All such changes are on a basis consistent with the valuations established in the 1999 review.

(ii) Tangible fixed assets

The assets have been valued in accordance with RAG 1.04, on an MEA basis. Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historic cost values. Disposals are stated at the value of the replacement assets.

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008

1 Current cost accounting policies (continued)

(a) Valuation bases for determining the current cost of fixed assets (continued)

- **Land and buildings**

Non-specialised operational properties are valued on the basis of estimated open market value for existing use at 31 March 1991, indexed since that date by the movement in the RPI, except for certain properties which have been valued at 31 March 1995 by professionally qualified employees of the Company.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually, between periodic reviews of replacement costs, by adjusting for inflation as measured by changes in the RPI.

- **Infrastructure assets**

Mains, sewers, impounding and pumped raw water storage reservoirs, and sludge pipelines are stated at their MEA value, in a manner as described above. Due to the nature of these assets, the MEA value is calculated based on the length of sewer or pipe, or the capacity of the asset.

Following the repeal of Section 24 of the Public Health Act 1936 by the Water Act 1989 the Company assumed responsibility for the maintenance and operation of a significant length of additional sewers. The Company has estimated the length of these pipes in order to include their asset values in these accounts. The value is £5,661m (2007: £5,454m) based upon a pipe length of 19,000km (2007: 19,000km). Adjustments may be required to those estimates in future years as more accurate information becomes available.

- **Specialised/non-specialised assets**

Specialised operational assets include those assets, used routinely in operating the business, which are directly attributable to water supply or sewerage services.

Non-specialised assets are those assets used routinely within the business, which cannot be directly attributed to either part of the business.

- **Surplus land**

Surplus land is valued at recoverable amounts less, where appropriate, that part of any proceeds to be passed on to customers under Condition B of the Licence.

(iii) Capital contributions

All third party capital contributions received since 31 March 1990 are carried forward as deferred income to the extent that any balance has not been credited to revenue, or deducted from net operating assets in the case of infrastructure assets. The balance carried forward is restated for the change in the RPI for the year.

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008

1 Current cost accounting policies (continued)

(b) Real finance capital maintenance adjustments

The following adjustments are made to historic cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

- (i) **Depreciation adjustment** - this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historic cost profit.
- (ii) **Working capital adjustment** - this is calculated by applying the change in the RPI over the year to the working capital of the Company at the beginning of the year.
- (iii) **Disposal of fixed assets adjustment** - this is the difference between the book values of realised assets in the current cost financial statements and in the historic cost financial statements.
- (iv) **Financing adjustment** - this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital, but excluding index rate linked debt and the deferred tax provision.

(c) Operating costs

In note 3, direct costs incurred with associated companies are less than 20% of the total operating costs of the business before interest and tax. Therefore the costs have been allocated across the appropriate headings in accordance with RAG 3.

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

2 Analysis of turnover and operating income for the appointed business

	Water supply £m	2008 Sewerage services £m	Appointed business £m	Water supply £m	2007 Sewerage services £m	Appointed business £m
Turnover						
Unmeasured	429.8	420.8	850.6	403.4	413.2	816.6
Measured	269.4	244.5	513.9	245.8	221.2	467.0
Trade effluent	-	6.6	6.6	-	7.3	7.3
Large user and special agreement	32.7	25.5	58.2	33.4	24.7	58.1
Rechargeable works	0.7	7.1	7.8	1.5	6.8	8.3
Bulk supplies/intercompany payments	2.7	-	2.7	2.5	-	2.5
Other appointed business (third party)	-	-	-	-	7.9	7.9
Third party services (excl non-potable water)	3.4	7.1	10.5	4.0	14.7	18.7
Other sources	8.6	6.0	14.6	10.7	7.4	18.1
Total turnover	743.9	710.5	1,454.4	697.3	688.5	1,385.8
Operating income						
Current cost profit on disposal of fixed assets	27.2	(2.3)	24.9	6.4	1.1	7.5
Total operating income	27.2	(2.3)	24.9	6.4	1.1	7.5
Working capital adjustment	4.0	3.8	7.8	3.2	3.1	6.3

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

3(a) Operating costs and associated fixed asset book values (year ended 31 March 2008)

	Water supply			Sewerage services			
	Resource & treatment £m	Distribution £m	Water supply total £m	Sewerage £m	Sewage treatment £m	Sludge treatment & disposal £m	Sewerage service total £m
Direct costs							
Employment costs	15.5	12.4	27.9	4.2	17.0	7.0	28.2
Power	8.2	20.5	28.7	8.1	17.0	6.7	31.8
Hired and contracted services	6.5	57.9	64.4	31.2	18.2	25.2	74.6
Materials and consumables	6.0	0.9	6.9	0.8	6.1	6.3	13.2
Service charges	13.0	-	13.0	1.3	3.3	-	4.6
Bulk supply imports	0.1	-	0.1	-	-	-	-
Other direct costs	10.1	2.3	12.4	0.4	0.4	3.2	4.0
Total direct costs	59.4	94.0	153.4	46.0	62.0	48.4	156.4
General & support expenditure	13.9	65.0	78.9	11.3	10.3	6.9	28.5
Total functional expenditure	73.3	159.0	232.3	57.3	72.3	55.3	184.9
Business activities							
Customer services			29.6				35.1
Scientific services			6.8				3.2
Other business activities			3.1				3.1
Business activities sub-total			39.5				41.4
Local authority rates			24.0				24.8
Doubtful debts			6.6				8.1
Exceptional items			13.6				17.4
Total opex less third party services			316.0				276.6
Third party services - opex			3.9				4.2
Total operating expenditure			319.9				280.8
Capital maintenance							
Infrastructure renewals charges	4.9	56.4	61.3	45.6	-	-	45.6
Current cost depreciation							
- service activities	76.5	60.5	137.0	27.2	111.3	45.2	183.7
- business activities			2.9				3.5
Amortisation of grants			(3.0)				(4.5)
Total capital maintenance			198.2				228.3
Total operating costs			518.1				509.1
CCA (MEA) values							
Services activities	2,451.7	8,829.5	11,281.2	34,222.5	2,464.7	651.0	37,338.2
Business activities			12.8				13.0
Service totals			11,294.0				37,351.2

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

3(b) Operating costs and associated fixed asset book values (year ended 31 March 2007)

	Water supply			Sewerage services			
	Resource & treatment £m	Distribution £m	Water supply total £m	Sewerage £m	Sewage treatment £m	Sludge treatment & disposal £m	Sewerage service total £m
Direct costs							
Employment costs	13.0	18.3	31.3	6.2	18.6	8.5	33.3
Power	11.1	24.8	35.9	6.3	21.0	7.2	34.5
Hired and contracted services	5.5	92.9	98.4	25.2	18.3	27.0	70.5
Materials and consumables	5.4	4.6	10.0	0.8	6.9	6.4	14.1
Service charges	11.8	-	11.8	1.1	3.2	0.1	4.4
Bulk supply imports	0.1	-	0.1	-	-	-	-
Other direct costs	0.3	1.0	1.3	0.5	1.0	0.5	2.0
Total direct costs	47.2	141.6	188.8	40.1	69.0	49.7	158.8
General & support expenditure	19.0	62.7	81.7	15.5	17.8	11.7	45.0
Total functional expenditure	66.2	204.3	270.5	55.6	86.8	61.4	203.8
Business activities							
Customer services			32.9				31.5
Scientific services			7.0				3.1
Other business activities			2.9				2.7
Business activities sub-total			42.8				37.3
Local authority rates			22.8				29.5
Doubtful debts			9.0				11.0
Exceptional items			3.6				5.4
Total opex less third party services			348.7				287.0
Third party services - opex			5.1				7.6
Total operating expenditure			353.8				294.6
Capital maintenance							
Infrastructure renewals charges	4.3	49.6	53.9	57.0	-	-	57.0
Current cost depreciation							
- service activities	77.8	55.6	133.4	31.4	109.5	42.4	183.3
- business activities			3.6				3.7
Amortisation of grants			(5.6)				(3.3)
Total capital maintenance			185.3				240.7
Total operating costs			539.1				535.3
CCA (MEA) values							
Services activities	2,381.9	8,377.6	10,759.5	32,831.9	2,373.1	654.3	35,859.3
Business activities			14.7				14.4
Service totals			10,774.2				35,873.7

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

4 (a) Current Cost Analysis of Fixed Assets by Asset Type as at 31 March 2008

Water Services

	Specialised operational assets £m	Non- Specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2007	3,610.7	47.4	8,793.3	185.7	12,637.1
RPI adjustment	136.0	1.8	331.3	7.0	476.1
Disposals	(90.6)	(1.2)	(195.8)	(29.7)	(317.3)
Additions	206.9	2.7	242.1	12.3	464.0
At 31 March 2008	<u>3,863.0</u>	<u>50.7</u>	<u>9,170.9</u>	<u>175.3</u>	<u>13,259.9</u>
Depreciation					
At 1 April 2007	1,682.5	22.3	-	158.1	1,862.9
RPI adjustment	63.4	0.8	-	6.0	70.2
Disposals	(86.8)	(1.2)	-	(19.1)	(107.1)
Charge for year	123.8	1.6	-	14.5	139.9
At 31 March 2008	<u>1,782.9</u>	<u>23.5</u>	<u>-</u>	<u>159.5</u>	<u>1,965.9</u>
Net book amount					
At 31 March 2008	<u>2,080.1</u>	<u>27.2</u>	<u>9,170.9</u>	<u>15.8</u>	<u>11,294.0</u>
Net book amount at 31 March 2007	<u>1,928.2</u>	<u>25.1</u>	<u>8,793.3</u>	<u>27.6</u>	<u>10,774.2</u>

Note: The disposal of £195.8m of infrastructure assets, shown above, relates to the MEA value of the length of main abandoned in 2007/08 as a result of the Victorian mains replacement programme. The corresponding entry, shown in note 7 is against the current cost reserve.

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

4 (b) Current Cost Analysis of Fixed Assets by Asset Type as at 31 March 2008

Sewerage Services

	Specialised operational assets	Non- specialised operational properties	Infra - structure assets	Other tangible assets	Total
	£m	£m	£m	£m	£m
Gross replacement cost					
At 1 April 2007	6,508.0	41.4	32,104.0	273.8	38,927.2
RPI adjustment	245.1	1.6	1,209.4	10.3	1,466.4
Disposals	(234.1)	(1.5)	-	(34.5)	(270.1)
Additions	226.1	1.4	111.3	17.7	356.5
At 31 March 2008	6,745.1	42.9	33,424.7	267.3	40,480.0
Depreciation					
At 1 April 2007	2,784.5	26.9	-	242.1	3,053.5
RPI adjustment	104.9	1.0	-	9.1	115.0
Disposals	(206.4)	(2.0)	-	(18.5)	(226.9)
Charge for year	168.8	1.6	-	16.8	187.2
At 31 March 2008	2,851.8	27.5	-	249.5	3,128.8
Net book amount					
At 31 March 2008	3,893.3	15.4	33,424.7	17.8	37,351.2
Net book amount at 31 March 2007	3,723.5	14.5	32,104.0	31.7	35,873.7

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

4 (c) Current Cost Analysis of Fixed Assets by Asset Type at 31 March 2008

Total

	Specialised operational assets £m	Non- specialised operational properties £m	Infra- structure assets £m	Other tangible assets £m	Total £m
Gross replacement cost					
At 1 April 2007	10,118.7	88.8	40,897.3	459.5	51,564.3
RPI adjustment	381.1	3.4	1,540.7	17.3	1,942.5
Disposals	(324.7)	(2.7)	(195.8)	(64.2)	(587.4)
Additions	433.0	4.1	353.4	30.0	820.5
At 31 March 2008	10,608.1	93.6	42,595.6	442.6	53,739.9
Depreciation					
At 1 April 2007	4,467.0	49.2	-	400.2	4,916.4
RPI adjustment	168.3	1.8	-	15.1	185.2
Disposals	(293.2)	(3.2)	-	(37.6)	(334.0)
Charge for year	292.6	3.2	-	31.3	327.1
At 31 March 2008	4,634.7	51.0	-	409.0	5,094.7
Net book amount					
At 31 March 2008	5,973.4	42.6	42,595.6	33.6	48,645.2
Net book amount at 31 March 2007	5,651.7	39.6	40,897.3	59.3	46,647.9

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

5 Working capital (Current cost)

	2008 £m	2007 £m
Stocks	7.0	6.1
Trade debtors - measured household	46.7	41.0
- unmeasured household	93.7	85.1
- measured non-household	24.8	23.5
- unmeasured non-household	1.0	0.8
- other	26.1	31.6
Measured income accrual	120.9	111.1
Prepayments and other debtors	68.7	68.9
Trade creditors	(182.7)	(167.0)
Deferred income - customer advance receipts	(93.7)	(84.2)
Capital creditors	(245.8)	(209.2)
Accruals and other creditors	(149.1)	(112.5)
Total working capital	(282.4)	(204.8)

6 Profit and loss account

	2008 £m	2007 £m
At 1 April	(851.8)	(564.6)
Profit for the year	348.7	203.6
Dividends	(93.7)	(525.7)
Profit/(deficit) for the year	255.0	(322.1)
Actuarial gain on pension scheme	3.9	49.9
Deferred tax relating to actuarial gain on pension scheme	(1.1)	(15.0)
As at 31 March including total pension asset	(594.0)	(851.8)

7 Movement on current cost reserve

	2008 £m	2007 £m
Balance at 1 April	41,117.0	39,208.3
RPI adjustments		
Fixed assets	1,757.3	2,133.6
Working capital	(7.8)	(6.3)
Financing	(95.9)	(123.4)
Grant and third party contributions	(30.1)	(31.7)
Mains Replacement Adjustment (see note 4a)	(195.8)	(61.2)
Other movements	-	(2.3)
Balance at 31 March	42,544.7	41,117.0

Thames Water Utilities Limited

Notes to the regulatory current cost financial statements for the year ended 31 March 2008 (continued)

8 Net debt analysis

March 2008:

	Interest rate risk profile			Total
	Fixed Rate	Floating Rate	Index linked	
<u>Maturity profile</u>				
Less one year	-	(366.3)	-	(366.3)
Between one and two years	(125.8)	(78.6)	-	(204.4)
Between two and five years	(449.5)	(47.4)	-	(496.9)
Between five and twenty years	(680.7)	(206.3)	(206.6)	(1,093.6)
In more than twenty years	(620.9)	0.0	(2,045.8)	(2,666.7)
Total Borrowings	(1,876.9)	(698.6)	(2,252.4)	(4,827.9)
Cash	65.8	-	-	65.8
Short term deposits	15.6	-	-	15.6
Net Debt	(1,795.5)	(698.6)	(2,252.4)	(4,746.5)

March 2007:

	Interest rate risk profile			Total
	Fixed Rate	Floating Rate	Index linked	
<u>Maturity profile</u>				
Less one year	(9.4)	(11.8)	-	(21.2)
Between one and two years	(17.6)	(41.7)	-	(59.3)
Between two and five years	(480.4)	(199.1)	-	(679.5)
Between five and twenty years	(672.8)	(71.9)	(198.0)	(942.7)
In more than twenty years	(1,120.3)	-	(615.0)	(1,735.3)
Total Borrowings	(2,300.5)	(324.5)	(813.0)	(3,438.0)
Cash	89.4	-	-	89.4
Short term deposits	112.5	-	-	112.5
Net Debt	(2,098.6)	(324.5)	(813.0)	(3,236.1)

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March 2008

Rolling five-year summary

Regulatory current cost profit and loss account for the appointed business for the year ended 31 March 2008 with corresponding amounts for prior periods (at 2008 prices)

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Turnover	1,454.4	1,443.2	1,459.8	1,266.0	1,263.1
Current cost operating costs	(1,027.2)	(1,118.9)	(1,057.6)	(948.5)	(953.0)
Operating income	24.9	7.8	10.0	7.6	17.7
Working capital adjustment	7.8	6.6	4.9	4.0	2.8
Current cost operating profit	459.9	338.7	417.1	329.1	330.6
Net interest	(171.5)	(176.5)	(155.9)	(151.0)	(145.4)
Financing adjustment	95.9	128.5	98.1	125.6	89.4
Current cost profit on ordinary activities before taxation	384.3	290.7	359.3	303.7	274.6
Taxation					
- Current tax	(106.6)	(54.5)	(77.6)	(12.6)	(27.1)
- Deferred tax	71.0	(24.2)	(28.4)	(70.2)	(54.7)
Current cost profit on ordinary activities after taxation	348.7	212.0	253.3	220.9	192.8
Dividends	(93.7)	(547.4)	(291.9)	(46.3)	(149.9)
Current cost (loss)/profit retained	255.0	(335.4)	(38.6)	174.6	42.9

Corresponding amounts have been stated at current year prices using movements in the average RPI.

From 1 January 2005, the Company adopted the full requirements of FRS 17 'Retirement Benefits' and FRS 21 (IAS 10) 'Events after the Balance Sheet Date'. The adoption of FRS 17 and FRS 21 represent a change in accounting policies and the comparative figures for 2005 have been restated accordingly. 2004 has been left as previously reported.

Current cost operating costs in 2008, 2007, 2006 and 2005(restated) include the reclassification of active leakage costs from capital to operating costs.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March 2008 (continued)

Rolling five-year summary

Regulatory current cost balance sheet for the appointed business at 31 March 2008 with corresponding amounts for prior periods (at 2008 prices)

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Fixed assets					
Tangible assets	48,645.2	48,405.2	48,142.2	47,999.6	47,719.6
Third party contributions since 31 March 1990	(857.9)	(820.6)	(779.0)	(728.8)	(653.9)
	<u>47,787.3</u>	<u>47,584.6</u>	<u>47,363.2</u>	<u>47,270.8</u>	<u>47,065.7</u>
Working capital	(282.4)	(212.5)	(143.5)	(206.5)	(135.4)
Cash	65.8	92.8	13.1	-	1.8
Short term deposits	15.6	116.7	-	-	-
Infrastructure renewals (accrual)/prepayment	36.7	(33.8)	(43.0)	-	6.8
	<u>47,623.0</u>	<u>47,547.8</u>	<u>47,189.8</u>	<u>47,064.3</u>	<u>46,938.9</u>
Net operating assets	47,623.0	47,547.8	47,189.8	47,064.3	46,938.9
Borrowings	(366.3)	(22.0)	(431.6)	(29.9)	(57.8)
Non-trade debtors	91.8	76.4	111.0	67.3	67.6
Non-trade creditors due within one year	(147.4)	(142.0)	(129.9)	(848.8)	(813.1)
Investment - loan to group company	1,223.8	-	-	-	-
Investments - other	0.1	0.1	0.1	0.1	0.1
Corporation tax payable	(7.7)	-	(34.9)	(12.7)	(18.5)
	<u>48,417.3</u>	<u>47,460.3</u>	<u>46,704.5</u>	<u>46,240.3</u>	<u>46,117.2</u>
Total non operating assets and liabilities	48,417.3	47,460.3	46,704.5	46,240.3	46,117.2
Creditors: amounts falling due after more than one					
Borrowings	(4,461.6)	(3,545.5)	(2,423.6)	(1,865.6)	(1,948.6)
Other creditors	(24.8)	-	-	-	-
Total creditors falling due after more than one year	<u>(4,486.4)</u>	<u>(3,545.5)</u>	<u>(2,423.6)</u>	<u>(1,865.6)</u>	<u>(1,948.6)</u>
Provisions for liabilities and charges					
Deferred tax provision	(841.4)	(951.1)	(972.8)	(967.4)	(927.8)
Post employment asset/(liabilities)	26.1	11.5	(28.6)	(42.2)	-
Other provisions	(35.9)	(21.6)	(19.0)	-	-
Total provisions	<u>(851.2)</u>	<u>(961.2)</u>	<u>(1,020.4)</u>	<u>(1,009.6)</u>	<u>(927.8)</u>
	<u>43,079.7</u>	<u>42,953.6</u>	<u>43,260.5</u>	<u>43,365.1</u>	<u>43,240.8</u>
Net assets employed	43,079.7	42,953.6	43,260.5	43,365.1	43,240.8
Financed by					
Called up share capital	1,029.0	1,067.8	1,119.3	1,145.6	1,182.2
Share premium	100.0	103.8	108.7	111.3	114.9
Profit and loss account	(594.0)	(883.9)	(614.1)	(600.1)	(751.9)
Current cost reserve	42,544.7	42,665.9	42,646.6	42,708.3	42,695.6
	<u>43,079.7</u>	<u>42,953.6</u>	<u>43,260.5</u>	<u>43,365.1</u>	<u>43,240.8</u>
Total capital and reserves	43,079.7	42,953.6	43,260.5	43,365.1	43,240.8

Corresponding amounts have been stated at current year prices using movements in the year-end RPI.

From 1 January 2005, the Company adopted the full requirements of FRS 17 'Retirement Benefits' and FRS 21 (IAS 10) 'Events after the Balance Sheet Date'. The adoption of FRS 17 and FRS 21 represent a change in accounting policies and the comparative figures for 2005 have been restated accordingly. 2004 has been left as previously reported.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March 2008 (continued)

Regulatory Capital Value (RCV)

	2008 £m
Opening RCV (March 2007 prices)	6,501.0
Indexation to year end (March 2008 prices)	<u>245.0</u>
Opening RCV at year end prices	6,746.0
Capital expenditure (excluding infrastructure renewals expenditure)	677.0
Infrastructure renewals expenditure	120.0
Grants and contributions	(39.0)
Depreciation	(364.0)
Infrastructure renewals charge	(104.0)
Out performance of past regulatory assumptions	<u>(46.0)</u>
Closing RCV (March 2008)	<u>6,990.0</u>
Average RCV (2007/2008 year average prices)	<u>6,755.0</u>

The figures quoted reflect those used by Ofwat at the 2004 Periodic Review to set prices for 2007/2008, as published by Ofwat in RD 07/08. All costs have been indexed to March 2008 prices (RPI index) except for the average RCV, which is shown at year average prices (RPI index) in accordance with Ofwat's convention.

Differences between the figures shown above and actual costs/income will not affect price limits in the current period. Capital efficiencies will be taken into account in the calculation for the next price review.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March 2008 (continued)

Intra-group trade

The following contracts are in excess of 0.5% (£m) of the Company's turnover:

Company	Service	Turnover of Associate in the year (£000)	Terms of Supply	Value of Turnover with TWUL in the year (£000)
Engenica	Maintenance services	44,473	At cost	30,202
Thames Water Investments	Rents	26,753	3 rd Party defined	1,194
ISIS Insurance Company Limited	Insurance	12,591	Tendered	12,294

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed.

Thames Water Utilities Limited

Supplementary regulatory information for the year ended 31 March 2008 (continued)

Directors' interests information (in accordance with RAG 5.04)

Listed below are details of directorships held by Thames Water Utilities Limited directors at 31 March 2008 in associated companies that have traded with the regulated business during the year.

Directorships held in Associated Companies

The following directors held Directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Sir Peter Mason
LF Abraira (appointed 9 January 2008)
PS Antolik (resigned 14 February 2008)
MW Baggs
R Bloomfield-Smith (appointed 14 February 2008)
CR Deacon
Dr P Dyer
R Gregor (resigned 15 October 2008)
C Lynam
GJ Matthews (resigned 14 February 2008)
GIW Parsons (appointed 14 February 2008)
AFC DeP Santos (resigned 9 January 2008)
DJ Shah (appointed 15 October 2007, resigned 14 February 2008)
MSW Stanley
L Webb (resigned 1 December 2007, reappointed 26 February 2008)

The following directors have formally appointed Alternate Directors to represent them when they are unavailable. These Alternate Directors also held Alternate Directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director	Alternate Director
LF Abraira	P Gomez (appointed 9 January 2008)
CR Deacon	RD Israel (resigned 28 June 2007) PFC Desouza (appointed 6 July 2007)
GJ Matthews	PED Crone (resigned 14 February 2008)
AFC DeP Santos	J Santos (resigned 3 September 2007) SG Batey (appointed 3 September 2007, resigned 9 January 2008)
DJ Shah	RJ Gregor (appointed 15 October 2007, resigned 14 February 2008) WR McKenzie (appointed 26 February 2008)
L Webb	S Kolenc (appointed 26 February 2008)

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

No directorships are held by Thames Water Utilities Limited directors in circumstances, which might, in practice, result in conflicts of interest in intra-group trading relationships.

Thames Water Utilities Limited

Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 4 June 2008 the Directors of Thames Water Utilities Limited ("the Appointee") resolved as follows:

- that in the opinion of the Directors the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment(s)): and
- that in the opinion of the Directors the Appointee will, for at least the next 12 months, have available to it :
 - (a) management resources; and
 - (b) systems of planning and internal control

which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1); and

- that in the opinion of the Directors, all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

M Braithwaite
Chief Financial Officer

Thames Water Utilities Limited

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

We have audited the Regulatory Accounts of Thames Water Utilities Limited (“the Company”) on pages 61 to 116 which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account and the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes including the statement of accounting policies.

This report is made, on terms that have been agreed, solely to the Company and the Water Services Regulation Authority (“the WSRA”) in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 (“the Regulatory Licence”). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company. There are differences between United Kingdom Generally Accepted Accounting Principles (“UK GAAP”) and the basis of preparation of information provided in the Regulatory Accounts as the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the WSRA, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA’s purposes. Accordingly we make no assessment.

The Directors’ responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors’ responsibilities for regulatory information on page 60.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing issued by the Auditing Practices Board, except as stated in the “Basis of audit opinion”, below and having regard to the guidance contained in Audit 05/03 “*Reporting to Regulators of Regulated Entities*”.

Thames Water Utilities Limited

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited (continued)

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets); and whether the regulatory current cost accounting statements on pages 101 to 116 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F and whether the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the performance review, the notes on regulatory information, and the additional information required by the Company's Regulatory Licence.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 61 to 100 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disappplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given on page 83.

Thames Water Utilities Limited

Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited (continued)

Opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2008 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 66 to 75 and 106 to 108, the state of the Company's affairs at 31 March 2008 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

In respect of this information we report that in our opinion:

- a) proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F of the instrument;
- b) the information is in agreement with the appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- c) the regulatory historical cost accounting statements on pages 61 to 100 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the appointee and its appointed business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA;
- d) the regulatory current cost accounting statements on pages 101 to 116 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

12 June 2008

1. The maintenance and integrity of the Company web site is the responsibility of the Directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Water Services Regulation Authority ("WSRA"), the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdiction