



INTERIM REPORT

For the six months to 30 September 2002

CHAIRMAN'S STATEMENT

Financial Performance

I am pleased to report a satisfactory financial start for Scottish Water. In the first six months of operation, turnover of £445 million was in line with the annual revenue cap set by Scottish Ministers of £888 million for the year to 31 March 2003. Profit before tax was £34 million and net debt reduced by £5.1 million to £2,092.8 million. However, Scottish Water will incur significant costs in the second half of the year associated with new PFI schemes, transformation of its business processes and delivery of its substantial capital investment programme. As at 30 September, Scottish Water had delivered £157million of the £1.8 billion capital programme to March 2006.

Profile

Scottish Water is a new organisation, created on 1 April 2002 by merging the three former water authorities. It is the fourth largest provider of water and sewerage services in the UK and an important employer and purchaser of goods and services in Scotland. Scottish Water is answerable to the Scottish Parliament and to its customers, the people of Scotland. Water and wastewater services are supplied to around five million customers in homes and businesses across Scotland, covering an area of some 30,410 square miles. From 400 water treatment works, 2.5 billion litres of tap water a day are supplied, through 28,000 miles of water mains. Over 17,500 miles of sewer pipes carry Scotland's wastewater to be treated in 1,600 wastewater treatment plants. Scottish Water's vision is to deliver excellent customer service through the effective and efficient use of its assets.

Customer Service

While there has been significant integration activity within Scottish Water over the last six months, we have been committed, at all times, to maintaining 'business as usual' for our customers. The old and inadequate assets that Scottish Water inherited have led to some failures in customer service, which we take very seriously. Lessons are learnt from these failures and processes and procedures continue to improve to minimise inconvenience to customers. These incidents underline the importance of the £1.8 billion investment programme to March 2006, and the need for continuing high investment beyond then, to provide customers with good quality, safe tap water and clean beaches and coastlines. As a start, two new wastewater treatment plants have been opened, one at St Andrews and the other at Inverclyde, as well as completing over 250 miles of rehabilitation of water mains and sewers.

Outlook

The merging of the three former authorities is significant both in scale and complexity and has inevitably brought many challenges to my Board and Executive Team. The first six months have, however, clearly demonstrated that Scottish Water has the right mix of skills and experience to meet these challenges. The new management structure is well established. The Directors have now appointed their senior managers and the creation of their teams is progressing smoothly and on track. This has put in place a very strong blend of existing industry experience and new employees and ideas following an external recruitment campaign. I am confident that this gives Scottish Water the ability, enthusiasm and commitment to meet the very tough efficiency, environmental and water quality targets expected by the Scottish Executive and associated regulatory bodies.

Professor Alan Alexander
Chair

PROFIT AND LOSS ACCOUNT
For the period 1 April 2002 to 30 September 2002

		Half year to 30 September 2002 unaudited
	Note	£M
Turnover		445.4
Total operating costs	4	<u>330.5</u>
Operating profit before exceptional items		114.9
Exceptional items	5	<u>10.6</u>
Operating profit after exceptional items		104.3
Net interest payable		<u>70.3</u>
Profit on ordinary activities before tax		34.0
Taxation	6	<u>10.2</u>
Profit on ordinary activities after tax		<u>23.8</u>

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the period 1 April 2002 to 30 September 2002

	Half year to 30 September 2002 unaudited
	£M
Profit for the financial period	<u>23.8</u>

BALANCE SHEET
At 30 September 2002

At
30 September 2002
unaudited

	Note	£M
Fixed assets	4	2,377.4
Stocks		3.7
Debtors		514.6
Cash at bank and in hand		0.7
Creditors - amounts falling due within one year		<u>-515.1</u>
Net current assets		3.9
Total assets less current liabilities		2,381.3
Deferred taxation	5	34.3
Provisions for liabilities and charges		<u>85.4</u>
Net assets		<u>2,261.6</u>
Capital and reserves		
Government and other loans		2,093.5
Other reserve	7	144.3
Profit and loss account		<u>23.8</u>
		<u>2,261.6</u>

CASH FLOW STATEMENT

For the period 1 April 2002 to 30 September 2002

Half year to
30 September 2002
unaudited

	Note	£M
Net cash inflow from operating activities	8	238.0
Returns on investments and servicing of finance		<u>-75.6</u>
Free cash flow		162.4
Capital expenditure		-160.7
Sale of tangible fixed assets		<u>3.4</u>
Cash inflow before management of of liquid resources and financing		5.1
Financing		<u>-6.3</u>
Decrease in cash in the period	9	<u>-1.2</u>

NOTES TO THE INTERIM ACCOUNTS

1. Basis of preparation

The accounts have been prepared under the historical cost convention, in accordance with the Water Industry (Scotland) Act 2002. The accounts comply with all applicable United Kingdom accounting and financial reporting standards, but do not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985.

2. Transfer of undertakings, assets and liabilities

The undertakings, assets and liabilities of the former North of Scotland Water Authority, East of Scotland Water Authority and West of Scotland Water Authority were transferred to Scottish Water on 1 April 2002 in terms of the Water Industry (Scotland) Act 2002. No adjustment to the transfer values of assets and liabilities has been made in the interim report.

3. Approval

The Board approved the interim report for the half year ended 30 September 2002 on 21 November 2002.

4. Accounting Issues

The interim report has been prepared on the basis of Scottish Water's accounting policies.

The infrastructure depreciation accounting policy adopts renewals accounting, which requires that the depreciation charge takes account of the long-term planned expenditure on maintaining Scottish Water's operating capability of infrastructure assets. The assessment of Scottish Water's asset management policies and standards, which guide the maintenance of infrastructure assets will be completed before finalisation of the audited annual accounts for the year to 31 March 2003. Accordingly, a prudent, provisional assessment of infrastructure depreciation has been made in the interim accounts.

As set out in note 2, the balance sheet values in the interim report reflect the transferred-value of assets and liabilities from the former water authorities to Scottish Water on 1 April 2002. Before finalisation of the audited annual accounts for the year to 31 March 2003, Scottish Water will determine whether any fair value adjustment is required to its opening balance sheet values, particularly in respect of infrastructure assets.

5. Exceptional Items

Exceptional costs total £10.6m and relate to staff severance costs and costs associated with transforming business processes.

6. Tax

Tax has been charged at 30% recognising deferred taxation. No tax is due or payable in the period. Deferred tax is recognised in respect of all timing differences, which have originated but not reversed at the balance sheet date.

7. Other Reserves

Other reserves represent the reserve balances transferred from the former water authorities as at 1 April 2002. These are summarised below:-

	£M
North of Scotland Water Authority	98.9
East of Scotland Water Authority	-19.2
West of Scotland Water Authority	<u>64.6</u>
	<u>144.3</u>

8. Reconciliation of Operating Profit to Net Cashflow from Operating Activities

	Half year to 30 September 2002 £M
Operating Profit after exceptional item	104.3
Depreciation	52.6
Infrastructure maintenance	70.1
(Profit) on disposal of tangible fixed assets	-0.8
Decrease in stock	0.2
Decrease in debtors	0.9
Increase in creditors	12.6
Decrease in provisions	<u>-1.9</u>
Net cash inflow from operating activities	<u>238.0</u>

9. Analysis of Net Debt

	April 2002 £M	Cash movement £M	30 Sept 2002 £M
Cash at bank and in hand	8.1	-7.4	0.7
Overdrafts	<u>-6.2</u>	<u>6.2</u>	<u>0.0</u>
Net cash	1.9	-1.2	0.7
Government and other loans	<u>-2,099.8</u>	<u>6.3</u>	<u>-2,093.5</u>
Net Debt	<u>-2,097.9</u>	<u>5.1</u>	<u>-2,092.8</u>