

Kelda Group Limited (formerly Kelda Group plc)
Annual review
31 March 2008

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Our business

Kelda Group Limited (Kelda) continues to perform well across a range of businesses.

Yorkshire Water

Yorkshire Water Services Limited (Yorkshire Water) is the principal UK subsidiary of Kelda, providing water and waste water services to more than 4.8m people and 130,000 businesses.

Every day the company supplies more than 1.3bn litres of water to homes and businesses in Yorkshire. Through the efficient operation of its extensive waste water network and treatment facilities, it also ensures that the region's domestic and industrial waste is returned safely to the environment.

Business strategy

- To be clearly the best water company in the UK.
- Focus on striking the right balance between service, compliance, value, people, partners and society.

UK Service Operations

Kelda Water Services

Kelda Water Services Limited (KWS) is a major player in the UK water and waste water contract operations market, with operations in England, Scotland, Wales and Northern Ireland.

Business strategy

- To be the best in UK water contract operations.
- Maximise value from existing operations.
- Be alert to potential growth opportunities.

Loop

Loop Customer Management Limited (Loop) specialises in cost effective customer relationship management. The company's main contract is to provide customer service support to Yorkshire Water.

Safe-Move

Safe-Move is a non-regulated business which provides search information to solicitors and conveyancers including information covering drainage and water services.

KeyLand

KeyLand Developments Limited (KeyLand) is responsible for managing, developing and disposing of the group's surplus property assets, either on its own or in partnership with outside organisations. The results of KeyLand include the group's share of its associates and joint ventures.

Business strategy

- To maximise the value of the group's surplus property portfolio.

Our strategy

Value

We are committed to creating enduring value by a focus on efficiency in everything we do. Our goal is to deliver consistently good financial results by outperforming regulatory and other financial targets and delivering efficiencies across the company. We will achieve this by sharing best practice across the group and employing world-class technology.

Our customers

Our aim is to provide a quality of service which is significantly better than any other utility or company and at a price which represents value for money. To achieve this we will design our service from the outside-in, considering the customer's point of view and eliminating service failures. This will lead to improved financial and operational performance and an enjoyable customer experience.

Our people

Kelda employs almost 3,400 people. Our aim is to create a great place to work, with zero accidents, a good work-life balance and the opportunity to make a real difference. We want to attract and retain the best people, with performance and contribution recognised and rewarded and success celebrated as part of our culture.

Environmental leadership

Kelda deals with environmental issues as diverse as catchment management, sustainable water management and river and bathing water standards. Our performance affects all customers and everyone who lives in all of the regions we serve. Our aim is to achieve 100% compliance with legal and regulatory obligations and to go beyond compliance where the benefits exceed the cost.

Society

Our aim is to make a difference to society, opening up land for public enjoyment and promoting the value of water, health and nutrition in schools. Over 30% of colleagues are involved in community volunteering, external leadership roles and in influencing matters relating to water.

Service partners

Kelda has created a new level of partnership, understanding and transparency with its key service providers. Our aim is to achieve a win-win-win, which means better customer service, lower costs and healthy profits for all. To make this happen, we set clear expectations and encourage new ideas and innovation.

Business review

Kelda

In February 2008, Kelda was acquired by a consortium of investment companies comprising Citigroup, GIC, Infracapital and HSBC. The consortium based its decision to acquire the group on Kelda's industry leading operational and service levels, and are committed to Kelda's vision to be clearly the best, maintaining momentum and progress achieved over recent years.

During the year, the group also completed its return of capital to shareholders, which is discussed further in the financial review, and completed the sale of its regulated US operations.

Yorkshire Water

Our strategy of continuing to focus on what we do best, providing high quality water and waste water services, has enabled us once again to deliver what we believe is sector leading financial and operational performance.

The summer floods of 2007 had a major impact, affecting many areas of the business, but the additional efforts of employees and our service partners enabled us to maintain services to customers and begin to reinstate damaged assets.

Key performance indicators

	Target	Current year	Previous year
Overall customer satisfaction	100%	86%	85%
Overall drinking water quality	99.975%	99.967%	99.965%
Waste water treatment works compliance	100%	99.51%	99.99%
Accidents			
- major and over 3 day accidents	15	28	35
- all accidents	75	150	180

Explanation of measures provided in the Key Performance Indicators glossary on pages 18 to 21.

Value

In line with our aim to be clearly Ofwat's frontier company, we were once again awarded four 'A' ratings for the cost efficient way we run our water and waste water operations. We retained our position as the benchmark company for water operating expenditure and improved our performance by also becoming the benchmark for water capital expenditure.

The summer floods put significant pressure on both operating and capital costs in the year and resulted in a loss in revenue. However our insurance cover ensured that we recovered a substantial proportion of the funds needed to pay for the repairs and reinstate damaged assets.

Due to the continuing pressure of rising energy prices, energy management is increasingly important and we have been proactively driving a major programme of energy efficiency throughout our operations. This has the dual benefit of addressing our commitment to reduce carbon emissions to assist in mitigating the impact of climate change. We have also focused on increasing the amount of renewable energy we generate, with an aspiration of generating 10% of our energy needs in-house by 2010. During 2007/08, three new wind turbines have been commissioned at our Loftsome Bridge water treatment works and our waste water treatment works at Saltend, near Hull.

Customer service

For the third year running we have maintained our position in the top two of Ofwat's annual Overall Performance Assessment (OPA). We have now remained consistently in the top four water and sewerage companies over the past six years on this measure, the only company to achieve this.

As part of our Clear Water initiative, Yorkshire Water is driving innovation in customer service. This year has seen the use of platelet technology to repair leaks in a live environment and the installation of a live meter with no excavation or interruption to supply; both industry 'firsts'. These technologies will play a significant role in helping us to achieve our aspiration of zero interruptions to supply. In 2007/08 there was also a significant improvement in unplanned interruptions to supply and a continued downward trend in the number of properties suffering from low water pressure.

Our achievements in service this year have been recognised in the National Customer Service Awards where we won two accolades; the 'Utility Customer Service Team of the Year' and the 'Best Use of Technology in Customer Service' for the innovative use of mobile phone technology to detect problems in water pipes. We have also met the Government's Charter Mark standard for excellence in customer service again.

Customers are clearly benefiting from our focused approach to customer service, as we achieved our best ever score in Ofwat's customer satisfaction survey. Also, in November 2007, the Consumer Council for Water published their annual review of the industry for 2006/07 which showed that we have the lowest number of complaints per 10,000 customers in the industry, at 23 compared with an average of 80.

Environmental performance and compliance

The Drinking Water Inspectorate announced that the quality of Yorkshire's tap water remains high at 99.97% compliance and our leakage reduction programme and investment in specialised monitoring equipment have ensured that we have achieved Ofwat's leakage target for the tenth year running.

Our continued focus on the proactive maintenance and operation of our assets has resulted in a marked improvement in waste water related pollution incidents, with serious incidents reducing from 17 in 2006/07 to 3 in 2007/08. Better use of

telemetry and changed operating practices have allowed problems to be identified before they impact on customers or the environment. For example, 68% of combined sewer overflows are now fitted with real time monitoring equipment giving better visibility of asset performance and advanced warning of potential problems.

Despite the unprecedented rainfall in June and July 2007, our waste water treatment works on the East Coast coped well and the majority of the region's bathing waters met the Environment Agency's mandatory standards.

Significant progress continued towards achieving the target set by Natural England for improving the condition of Sites of Special Scientific Interest (SSSIs) on Yorkshire Water land, with 50.9% now in recovering status compared to 10% in 2003.

Social impact

It is now three years since the company's society vision was launched, including our clear commitment to supporting and enhancing the society we serve. Our community volunteering initiatives continued to make a real difference to the quality of lives in the region, with over 850 employees and service partners involved in community work during the past year.

Building on the success of our recent 'Cool Schools' campaign which tackled hydration issues, 2007/08 saw the launch of 'One Million Green Fingers', our biggest and most ambitious campaign to date. Yorkshire Water volunteers will create healthy and sustainable allotments and gardens in more than 350 primary schools across our region over the next three years, in line with our aspiration to become a national role model for volunteering.

We promoted awareness of our first land and recreation 'supersite' at the Washburn Valley, near Harrogate, and a survey of visitors showed that 82% were delighted with the improvements made to the facilities and signage.

We maintained platinum status in the Business in the Community's 'Top 100 Companies that Count 2007' report, published in partnership with the Sunday Times. This is the third year running that we have achieved the highest accolade for our overall impact on society, consistently scoring more than 95% against a range of social, ethical and environmental criteria.

Employees

It is testimony to the professionalism and dedication of our employees that we continued to maintain industry leading levels of service throughout 2007/08 despite the operational challenges posed by the floods.

As part of our ongoing drive to be clearly the best, the restructuring of two key parts of the business took place in 2007/08. The business unit dealing with waste water was renamed the 'Environmental Business' and restructured at the start of the year to bring all customer facing teams into one regional team. At the end of the year, the Water Business was reorganised to give improved focus on attaining

the operational improvements and efficiencies identified through our Clear Water initiative.

Our Information Technology department was named as the UK's 'Best Place to Work in IT' by Computer Weekly magazine in recognition both of the positive way in which IT strategy is aligned with the company vision and the commitment to innovation and provision of a stimulating, enjoyable and productive workforce. Our approach to diversity was also recognised by the Personnel Today publication which awarded us its top annual accolade of the award for 'Diversity in the Workplace'.

We continue to develop a culture of 'Think Safety First'. For the fifth consecutive year, we were awarded a Royal Society for the Prevention of Accidents Gold award for health and safety performance which reflects our achievements and approach to seek to continuously improve our health and safety performance although we recognise more needs to be done.

Partners

We continue to work with our service partners, including our extended supply chain, to deliver an improved service to customers and develop innovative solutions and processes. We have extended our use of information technology to key partners to enable a common platform.

To this end, we have undertaken a series of initiatives to promote innovation in the way we operate and maintain our assets, including integrated research and development activities which have, for example, undertaken trials of a more robust new gearbox that uses significantly less energy. In consultation with partners, we have also undertaken a number of initiatives to promote a stronger culture of health and safety issues across the supply chain.

In the aftermath of the summer flooding, our service partners played a significant supporting role in the emergency response and clean up operations. For example, during the first 24 hours, our repair and maintenance partner was required to attend almost 900 incidents, the equivalent of a normal week. Our electrical, maintenance and capital partners were also instrumental in helping to reinstate the assets affected.

UK Service Operations

UK Service Operations comprises Kelda Water Services (KWS), Loop and Safe-Move. Operating profit for the UK Service Operations group and its associated undertakings increased to £14.4m (2007: £10.7m), mainly reflecting the continuing strong operating performances of existing businesses.

Kelda Water Services

KWS is a leading UK water and waste water contract operations company. KWS continues to grow in its core markets, providing water and waste water operations and maintenance under long term contracts. In 2008, KWS had turnover of £169.5m (2007: £123.0m) and operating profits of £10.0m (2007: £8.5m).

KWS currently operates across the UK through its subsidiaries and associated undertakings:

- In Ireland, Dalriada Water Services, a 50% owned joint venture between KWS and Earth Tech, is near to completion of the construction of four water treatment plants ahead of schedule. These plants will provide 50% of Northern Ireland's water supply and are expected to be commissioned soon.
- Brey Utilities, another 50% joint venture between KWS and Earth Tech, completed its fifth year managing over 1,100 sites for the Ministry of Defence. During this time it has reduced leakage by 22%, down from 40% when it took over. During the year, the scope of the contract was once again increased with the addition of the Defence procurement agencies' headquarters at Abbeywood adding over six thousand new customers.
- KWS Wales, a 100% owned subsidiary, had another good year providing waste water operations and maintenance for Welsh Water (Dwr Cymru). During the year it installed 1.2 mw of combined heat and power engines which raised Dwr Cymru's renewable energy to 10% of its consumption. In 2008/09 it will support Dwr Cymru in its PR09 submission to Ofwat.
- In Scotland, Aberdeen Environmental Services, which is 45% owned by KWS, expanded the scope of its activities with Scottish Water by adding a £20m pipeline extension from the fishing village of Stonehaven to its main treatment plant at Nigg, ten miles away. Flows will commence in August 2008.

Loop

Loop specialises in cost effective customer relationship management. The company's main contract is to provide customer service support to Yorkshire Water. During the year, Loop enjoyed a succession of rising scores in the Ofwat Customer Satisfaction Survey, despite high levels of contacts during the summer flooding.

Safe-Move

Safe-Move is a non-regulated business which provides search information to solicitors and conveyancers, including information covering drainage and water services.

KeyLand Developments

Operating profit for KeyLand and its joint ventures increased by £1.0m to £5.3m for the year (2007: £4.3m). Revenue was significantly higher, at £39.8m (2007: £6.9m). This included the sale of land at Knostrop, which was sold to a joint venture of the company and is being developed in conjunction with Evans of Leeds, the joint venture partner. This project will contribute to the regeneration of this area, and management is confident of its potential to be successful.

The primary source of revenue for KeyLand continues to be from the disposal or development of brownfield sites. The timing of sales is impacted by the planning process.

Financial review

The group has had a successful year, with continued growth in revenue and operating profits. The group's financing was restructured during the year to increase the efficiency of the capital structure, mainly by way of the B share scheme in July 2007. In addition, the entire share capital of the group was purchased by Saltaire Water Limited in February 2008.

Key financial performance indicators

	2008		2007
Interest cover	2.9		3.5
Gearing	75.7%		63.2%
Group net debt to Regulatory Capital Value (RCV)	59.5%		48.0%

Explanation of measures provided in the Key Performance Indicators glossary on pages 18 to 21.

Group operating profit from continuing operations

Group revenue from continuing operations excluding associates and joint ventures increased by 5.4% to £877.6m (2007: £832.6m). Of this, £785.0m (2007: £741.1m) related to UK regulated water services, which benefited from a 7.9% tariff increase in Yorkshire Water. Revenue from UK Service Operations, including associates and joint ventures, increased by £48.0m (3.7%) to £178.9m (2007: £130.9m)

UK regulated water services continued to provide the majority of the group's operating profit, with an increase from £332.7m in 2007 to £364.0m in 2008, an increase of 9.4%.

UK Service Operations recorded operating profit of £14.4m (2007: £10.7m), an increase of 35%. Much of this increase is generated by the Dalriada construction project in Northern Ireland.

KeyLand profitability increased by £1.0m to £5.3m (2007: £4.3m), due in part to the sale of land at Knostrop.

The 2007/08 results include net exceptional items of £20.4m. This includes £33.2m of costs incurred in respect of corporate transactions and £4.7m relating to restructuring costs. This is offset by an exceptional profit of £17.5m on the disposal of fixed assets relating to insurance proceeds received to reinstate flood damaged assets, the cost of which will appear within capital expenditure as incurred.

Overall, operating profit from continuing operations including exceptional items increased by 3.1% to £348.4m (2007: £338.0m).

Financing income and expense

The net interest expense has increased by 25% to £121.2m (2007: £97.0m) following the return of £750m of cash to shareholders during the year. This included an increase in the borrowings of the group and an associated rise in the group's interest expense.

Net interest expense includes a net credit of £9.8m (2007: £6.9m) in relation to pension fund assets and liabilities.

Taxation

The group's taxation charge of £37.8m (2007: £69.5m) comprises a charge of £59.5m (2007: £48.2m) for current tax and a credit of £21.7m (2007: charge of £21.3m) for deferred tax. The latter includes a credit of £41.9m for a recalculation of the group's deferred tax balance following the change of tax rate from 30% to 28% with effect from 1 April 2008.

Balance sheet

The return of capital to shareholders resulted in a reduction to shareholders' funds of approximately £750m, with a corresponding increase in borrowings. This has increased the group's balance sheet gearing from 59% to 76%.

Group net debt was £2,525.0m (2007: £2,104.3m). Cash generated by continuing operations was £508.6m (2007: £489.4m), which helped to cover capital payments of £385.3m (2007: £358.7m).

At the year end, the group held a pension surplus under IAS 19 of £27.3m (2007: £7.3m). The triennial actuarial valuation of the pension scheme as at 31 March 2007 has been completed. The funding deficit has decreased significantly from £107m in 2004 to £10m and it is planned to be eliminated over the five year period to March 2013. Whilst company pension contributions to eliminate the deficit are reduced, the future service cost has increased, leaving overall a modest reduction in company pension contributions from 1 April 2008.

Treasury policy

The group's treasury strategy is designed to manage exposure to fluctuations in interest rates, preclude speculation and to source and structure the group's borrowing requirements.

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

Looking forward

Yorkshire Water

Keeping the right balance for all of Yorkshire Water's stakeholders is fundamental to achieving the company's vision of being clearly the best water company in the UK. The company's plans are therefore aligned with making progress in 6 key areas – service, compliance, value, people, partners and society.

A great customer service

A key aspiration is to develop innovative thinking and employ new technologies to deliver an improved level of operational and customer service. By reducing the number of customer supply interruptions and the invasive nature of repair and maintenance work, the company will deliver better service for lower cost. By March 2009 we aim to have carried out 2,000 repairs using new, non-invasive technology.

Environmental leadership

Real progress was made in 2007/08 in terms of minimising pollution incidents and enhancing waste water treatment works compliance, which we aim to emulate in 2008/09. Over the next year we are targeting our best ever performance in Ofwat's overall performance assessment, with a focus on eliminating serious pollution incidents altogether.

Setting the pace for value

In 2008/09 the aim remains to outperform key financial targets and to be Ofwat's frontier company for efficiency.

During 2008/09 we will deliver a £369m investment programme, with a further injection of £24m of capital efficiency to help meet the aspirations set out in our 25 year Strategic Direction Statement and Water Resource and Asset Management Plans.

A great place to work

Health and safety will remain a key area of focus for 2008/09 with a continued push on 'Think Safety First' initiatives. We will be taking leadership to the next level with a senior management leadership development programme based around our Clear Leadership framework. There will also be more work on career planning and personal development, embedding a coaching culture amongst line managers.

The bigger team

Successful service partners share Yorkshire Water's philosophy of improved service and lower costs. During 2008/09 there will be further sharing of IT platforms, innovation and accommodation. We will also roll out a new strategy for electrical and mechanical asset maintenance within our Environmental Business Unit to minimise asset and compliance failures.

Making a difference in Yorkshire

In 2008/09 Yorkshire Water volunteers will be creating 100 healthy and sustainable school gardens as part of the company's new One Million Green Fingers campaign.

Work will begin on the company's first ever environmental visitor centre at Esholt, near Bradford. We also plan to officially launch significant improvements to the recreational facilities at Langsett Reservoir in South Yorkshire.

UK Service Operations

Kelda Water Services

The KWS vision is to be the best in UK water contract operations and the company is totally focussed on providing the best in water and waste water solutions on behalf of its clients in England, Scotland, Northern Ireland and Wales.

2008/09 will see the completion of new water treatment works and pipeline infrastructure for Water Services Northern Ireland, with the commencement of the operational part of the contract. The state-of-the-art treatment works will provide significant water quality benefits to people in Northern Ireland.

KWS Wales will continue to work closely with Dwr Cymru in preparation for the new investment period.

The company is also actively pursuing opportunities for further growth in the UK market for outsourced clean and waste water services.

Loop

In 2008/09, Loop will continue to invest in people and build on its industry leading levels of customer services in its contact centre.

KeyLand

In 2008/09, KeyLand will continue its successful partnership approach in order to maximise shareholder value from surplus Yorkshire Water assets.

Principal risks

The group's risk management process aims to be comprehensive, systematic and continuous and based on constant monitoring of business risk. The board is also responsible for the group's internal control and for reviewing its effectiveness.

We classify principal risks in five categories:

- Changes to the regulatory environment
- Changes in legislation
- Climatic changes
- Social influences
- Supplier markets

Changes to the regulatory environment

PR09 price review

In December 2007 Yorkshire Water submitted its 25 year Strategic Direction Statement to Ofwat, the first milestone in the 2009 price review process. Companies will submit and publish their draft business plans in August 2008, after which a period of consultation will follow.

Final business plans will be submitted in April 2009, with draft determinations published by Ofwat in July 2009 and final determinations in November 2009. New price limits will take effect in April 2010.

Water industry competition

In February 2008, the Government published its new water strategy for England, 'Future Water'. At the same time it announced an independent review of competition and innovation in the water industry, which is expected to be completed in Spring 2009, to be led by Professor Martin Cave, a former member of the Competition Commission and Ofwat's advisory board.

Review of metering policy

An independent review of water charging was also announced which will cover the role of metering and the potential to introduce mandatory metering in seriously water stressed areas where there is a clear case for doing so. Measures, such as tariffs, to help vulnerable customers would also be covered. Further details are expected to be announced shortly.

Changes in legislation

Water Framework Directive

The Water Framework Directive (WFD) is the most substantial piece of European water legislation to date. It requires all inland and coastal waters to reach 'good' status by 2015. It will do this by establishing a river basin district structure within which demanding environmental objectives will be set, including ecological targets for surface waters. The WFD therefore sets a framework which aims to provide substantial benefits for the long term sustainable management of water.

This new Directive has the potential to drive major additional capital investment and increases in customers' charges.

Climate Change Bill

The Government's Climate Change Bill was introduced in Parliament in November 2007 and completed its passage through the House of Lords on 31 March 2008. It will then go to the House of Commons for consideration before receiving Royal Assent which is planned to happen by summer 2008.

The Bill creates a new approach to managing and responding to climate change by setting ambitious targets, taking powers to achieve them and establishing clear and regular accountability to Parliament.

For the first time, the Government is proposing to set clear and legally binding targets for reducing carbon dioxide emissions. In doing so, the Government is encouraging businesses to make significantly more efficient use of energy and invest more in low carbon fuels and technologies, such as carbon capture and storage, wind, wave and solar power.

As some aspects of the water and sewage treatment process can be relatively energy intensive, this legislation has the potential to impact on the company's energy strategies and operating costs.

Climatic changes

The company's core activities, the provision of high quality water and sewerage services, are inextricably linked with the weather and therefore any climate changes have the potential to impact on business. This was evidenced by the widespread flooding which affected the Yorkshire region and many of the company's assets in Summer 2007.

As the company's resources are a mixture of water captured in reservoirs or abstracted from rivers or underground aquifers, climate change could alter many of the variables in this complex equation.

Social influences

The company is subject to social influences and may be required to change its business practices in light of regulatory changes brought about by stakeholder and consumer pressure.

Public and private sewers

In February 2007, DEFRA announced that private sewers, which are currently the responsibility of the owners of the properties they serve, are to be transferred into the ownership of the nine statutory water and sewerage companies in England.

This decision follows an extensive review of private sewers which was launched in 2001 in response to concerns raised by householders. A consultation in 2003 revealed a high level of support for the transfer and the Government concluded there was a clear case for action. This will almost double the length of sewers that Yorkshire Water is responsible for maintaining in the future.

In July 2007 the Government launched a second public consultation to seek views on how the transfer should be implemented. DEFRA is currently examining the issues raised and will make an announcement on the method of transfer before consulting further on regulations to bring any transfer into effect.

Supplier markets

The group is also subject to external market forces, where input prices can sometimes rise beyond the regulatory allowance, for example, the current fluctuation in energy and chemical prices.

Key performance indicators – glossary

FINANCIAL KEY PERFORMANCE INDICATORS

Interest cover

This measure provides an indication of whether the group's profit is sufficient to cover its interest obligations and is calculated as operating profit divided by net interest payable. These figures are disclosed in the audited accounts in the group income statement.

Gearing

This ratio measures the proportion of assets invested in the business that are financed by borrowing and is calculated as net debt as a proportion of net debt plus net assets. These figures are disclosed in the audited accounts in the balance sheet and Note 25.

Net debt to Regulatory Capital Value (RCV)

The RCV is determined by Ofwat and is the value of the capital base on which a return is allowed for price setting purposes. The values are calculated and published annually by Ofwat. This ratio expresses the group's net debt as a proportion of the RCV, which is published in Yorkshire Water's audited regulatory accounts.

NON FINANCIAL KEY PERFORMANCE INDICATORS

These all relate to Yorkshire Water.

Overall customer satisfaction

The company recognises the value of listening to customers in order to deliver improvements that not only meet but surpass expectations. Customer satisfaction is monitored on a regular basis using a combination of random telephone surveys and event-based questionnaires.

Yorkshire Water's tracker research is an ongoing telephone survey involving 900 customers chosen at random each quarter. This monitors customers' general perceptions and the experience that customers receive when they come into contact with the company.

The survey covers a range of issues including satisfaction with the service received and whether the customer agrees that Yorkshire Water is trustworthy, listens to its customers, considers the customer's point of view, deals with complaints quickly and satisfactorily, is enjoyable to deal with, is sensitive to customers' needs and plays key roles in protecting the environment and helping people with the community.

Yorkshire Water also has a separate telephone survey each month to a sample of customers who have telephoned our contact centre. This survey is based upon Ofwat's regulatory customer survey.

Ongoing event-based surveys cover 12 specific areas of customer contacts, namely clean water and waste water repair and maintenance work, customer visits by water and waste water field technicians, meter installations, supply pipe repairs, new supply applications, mains rehabilitation works, waste water capital works and calls to our contact centre about billing and operational matters.

Water quality

The Drinking Water Inspectorate (DWI) regulates public water supplies in England and Wales. It is responsible for assessing the quality of drinking water, taking enforcement action if standards are not being met and appropriate action when water is unfit for human consumption.

The Government has set legal standards for drinking water in the Water Quality Regulations. Most of these standards come directly from European law and are based on World Health Organisation guidelines. The UK has additional standards to safeguard the already high quality of water in England and Wales. The standards are strict and generally include wide safety margins. They cover:

- Bacteria
- Chemicals such as nitrate and pesticides
- Metals such as lead
- Appearance and taste

The measure we use is for overall drinking water quality which consists of the average mean zonal compliance for 40 different parameters.

Waste Water Treatment Works compliance

The Environment Agency issues consents to allow the discharge of treated water from waste water treatment works. The 3 principal consented limits are for suspended solids, biochemical oxygen demand and ammonia. A range of other substances may be limited depending on the type of discharge. This indicator shows loads for the following determinands:

- suspended solids, which can blanket the river bed, thereby destroying fish habitat;
- biochemical oxygen demand (BOD), which is a measure of the amount of oxygen consumed in water - usually by organic pollution - and therefore reflects the quality of the water;
- ammonia, which is toxic to fish;
- phosphate, which can lead to eutrophication in fresh waters.

All waste water treatment works are monitored for compliance with their discharge consents and the receiving waters are monitored to assess their compliance with water quality targets. The frequency of monitoring depends on the size of the treatment works; small works are monitored on a quarterly basis and large works are monitored every week.

Reportable and notifiable accidents

The Health and Safety Commission is responsible for health and safety regulation in Great Britain. The Health and Safety Executive and local government are the enforcing authorities who work in support of the Commission.

RIDDOR - or the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR) - place a legal duty on employers to notify and report some work-related accidents, diseases and dangerous occurrences.

These include, for example, deaths, injuries to employees, members of the public or people not at work, some work-related diseases and dangerous occurrences (where no injury results, but could have done).

Directors' report

The directors present their report, together with the audited financial statements for the year ended 31 March 2008.

The results of the company are set out from page 36 onwards.

The directors do not recommend the payment of a final dividend in respect of the year ended 31 March 2008 (2007: 23.0p). An interim dividend of 10.65 pence was paid on 4 January 2008 (2007: 9.25p).

Business Review

A review of the developments and performance of the business of the group, including the financial performance during the year, key performance indicators and a description of the principal risks and uncertainties facing the group, forward-looking statements, and treasury policy are set out in the business review section of this annual report on page 5 onwards.

The annual report contains certain forward looking statements with respect of the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated.

Principal activities

The principal activities of the group are the supply of clean water and the treatment and disposal of waste water. Yorkshire Water, the group's regulated utility business in the UK, is responsible for both water and waste water services.

The group's other businesses are the UK non-regulated water and waste water services business, Kelda Water Services Limited, and KeyLand Developments Limited, a company which primarily develops surplus property assets of Yorkshire Water.

Following the sale of the group's US regulated water supply business in 2007, it continues to operate a contract for supply of water in Bridgeport, Connecticut.

Directors

The following directors held office during the year:

John Alan Napier
Edmund John Seward Anderson (resigned 13 February 2008)
Catherine Rosemary Reid Avery (resigned 13 February 2008)
Allison Margaret Bainbridge (appointed 18 February 2008)
Stuart Harvey Baldwin (appointed 13 February 2008 and resigned 6 June 2008)
Richard John Cole (appointed 13 February 2008 and resigned 22 May 2008)
John George Norman Duthie-Jackson (appointed 13 February 2008 and resigned 6 June 2008)
Christopher Charles Fisher (resigned 13 February 2008)
Stephen Bernard Lilley (appointed 19 February 2008 and resigned 6 June 2008)
Richard Schmidt (resigned 1 August 2007)
Martin George Towers (resigned 18 February 2008)
Kevin Ian Whiteman

Disclosure of information to the auditor

At the date of this report, as far as each director is aware, there is no relevant audit information which the group's auditor is unaware and each director has taken such steps as he or she should have taken as a director in order to make him or herself aware of any relevant audit information, and to establish that the group's auditor is aware of that information.

Corporate and social responsibility

There are group policies for the environment, health and safety and human resources, as well as a code of ethics.

The internal control processes, described on page 30 take account of social, environmental and ethical risks. In addition, the board receives information as part of the normal reporting process to identify and assess such significant risks where they are relevant to the nature of the company's business. Further details are included in the following sections of this report.

Employees and employment policies

The group strives to create a positive working environment for all colleagues and places great emphasis on open two-way communications. It values involvement at all levels, recognising that everyone in the business is a potential source of innovation and change. Internal consultation and communication processes provide the key to this involvement, and play a large part in achieving our vision to be a great place to work.

The group promotes freedom of association, principally through its diversity strategy and through collective bargaining arrangements with its recognised

trade unions. In those parts of the group where union representation is low, wider franchise is achieved through involving workforce representatives on joint working parties and works council type arrangements.

The group communications strategy is based on a 'face-to-face' first approach and all messages are delivered through 'two-way' channels, including regular 'TalkBack' sessions with senior management. The group magazine *Connections* is distributed throughout the business and aims to provide business news through the eyes of the group's employees.

Regular employee satisfaction surveys are undertaken throughout the group, using a variety of survey tools including telephone-based, online and paper-based surveys.

A 'total reward' approach is taken to salary and benefits which are designed to be competitive. Performance-related pay gives colleagues at all levels the opportunity to share in the success of the business, through quarterly or annual bonus payments linked to the achievement of business plan targets.

The group's equality and diversity, 'open to all', policy covers gender, marital status, parental status, sexual orientation, race, colour, ethnic or national origin, disability, age, religion or belief and trade union membership. During the year the group completed a diversity recruitment project and held a successful diversity conference for colleagues and external partners. The group's diversity work was recognised with Yorkshire Water receiving the Personnel Today award for Diversity in the Workplace. Also in 2007 the company's business-focused approach to diversity featured as a case study on a website created by the London Development Agency for businesses in their region.

The group provides a wide range of development opportunities, including in-house and accredited programmes to help employees develop the necessary skills, knowledge, values and experience to realise their performance potential.

Disabled persons

We have an active approach to keeping employees who become disabled in employment and our commitment to equal opportunities for less able job applicants has been recognised with the 'double tick' accreditation from the UK Employment Service.

Health and safety

The group is committed to achieving high health and safety standards throughout the business. The management of health and safety issues operates in the context of the health and safety policy adopted by the board and the system of internal control.

The group has established a framework of policy procedural requirements by which all subsidiaries must have in place appropriate health and safety policies and procedures and provide necessary information, instruction, training and supervision. In addition, the group provides occupational health, safety and welfare advisory services for employees.

Specific health and safety goals are also set by the business. These goals include a combination of reduction in accidents and working time lost as a result of accidents, training delivery, internal safety audits and health promotion and surveillance programmes.

Senior management awareness and active employee involvement in health and safety is fundamental to company success. The 'Think Safety First' programme launched in 2006 included projects for sharing personal accident experiences, promoting key safety messages, managers leading by example, rewarding and recognising colleagues and implementing a behavioural safety coaching process. We have seen raised safety awareness, a 20% reduction in reported accidents and reduced sickness absence since the programme was launched.

Consultation with all employees via health and safety forum groups and safety committees is actively encouraged. Where possible, the intent is for local health and safety issues to be discussed and resolved with line management. In Yorkshire Water there are health and safety champions who work alongside the Trade Union safety representatives and line management. This ensures that health and safety issues are regularly discussed within each team in the Water and Environmental business units.

The group places significant emphasis on both accident prevention and health promotion. Yorkshire Water has again been awarded a National Safety Award from the British Safety Council and a Gold Award for Occupational Safety from the Royal Society for the Prevention of Accidents for its health and safety performance during 2007/08.

Environment and community

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

Environmental performance is reported through the group's web-based environment and community report which is regularly updated and independently verified. This can be viewed at <http://csr.keldagroup.com>

The group contributes actively to the communities which it serves. It encourages and supports colleagues in volunteering, charitable giving and community involvement. One in three employees is active in a wide range of supported community activities. These include a Speakers' Panel and support to local education ranging from 'right to read' in junior schools through to coaching at senior schools and mentoring university students from diverse ethnic backgrounds.

Charitable and political donations

Charitable donations totalling £0.7m (2006: £0.6m) were made during the year. No political donations were made.

Research and development

The group undertakes a major programme of research in pursuit of improvements in service and operating efficiency. In 2007/08, £4.4m (2007: £4.6m) was committed to research and development including £3.6m (2007: £3.7m) on fixed assets.

Auditor

The group policy designed to safeguard the independence and objectivity of the external auditor is included in the corporate governance section on page 29.

Payments to suppliers

The group's normal terms are to make payment in accordance with suppliers' terms of trade or within 30 days from receipt of services or invoices subject to satisfactory performance by the supplier. Kelda Group Limited is a holding company and, at 31 March 2008, had no trade creditors outstanding. The payment terms of individual operating subsidiaries are disclosed in their accounts.

Financial instruments

Details are provided in the accounts section under note 23.

Likely future developments

Future events are dealt with on pages 13 to 14 in the Looking forward section.

Change of name

On 3 July 2008, Kelda Group plc was re-registered as a private company and consequently changed its name to Kelda Group Limited.

Annual General Meeting

The notice convening the company's 2008 annual general meeting to be held on 29 July is set out in a separate document issued to shareholders.

By order of the Board

Stuart McFarlane
Group Company Secretary
7 July 2008

Corporate Governance report

Throughout the year the board remained accountable to the company's shareholders for maintaining standards of corporate governance. The board considers that the company has complied throughout the accounting period with the provisions set out in Section 1 of the Combined Code.

The following is an explanation of how the company has complied with the Combined Code throughout the year.

The board of directors

The board held seven scheduled meetings during the year. Additional meetings were held where it was considered appropriate or where business needs required. In addition, meetings of the non executive directors were held when required. The board had a schedule of matters reserved for its decision and the requirement for board approval on these matters was communicated widely throughout the senior management of the group.

The board determines the group's strategic objectives and key policies, and approves the business plans for each group company, interim and final financial statements, recommendations of dividends, significant investment and major new business proposals, as well as significant organisational matters and corporate governance arrangements. The board is also responsible for establishing and reviewing the group's system of internal control and risk management, and reviewing at least annually its effectiveness. The roles of the board, the chairman and the chief executive are formally set out and agreed by the board. There are clear levels of delegated authority, which enable management to take decisions in the normal course of business.

All new directors, where applicable, received an induction and training on joining the board, including information about the group and their responsibilities, meetings with key managers, and visits to the group's operations. There is an agreed procedure for directors to take independent professional advice at the company's expense in furtherance of their duties in relation to board or committee matters. Directors have access to the group company secretary who is responsible for ensuring that board procedures are followed. The directors receive full and timely access to all relevant information, including a monthly board pack of operational and financial reports. Direct access to key executives is encouraged. The company has directors' and officers' insurance in place.

At the end of the year, the board comprised a chairman, two executive directors and four non executive directors. Prior to their resignations after the completion of the acquisition of the company by Saltaire Water Limited, Ed Anderson, Kate Avery, Christopher Fisher and David Salkeld were considered by the board to be independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent

judgements. David Salkeld was the senior independent director. The roles of chairman and chief executive are separate and held by John Napier and Kevin Whiteman respectively. John Napier met the independence criteria of the Combined Code on his appointment, although he subsequently served in an interim executive capacity, which he relinquished in September 2002.

Any director appointed during the year is required, under the provisions of the company's articles of association, to retire and seek election by shareholders at the next annual general meeting. The articles of association of the company require each director to be subject to re-election at intervals of no more than three years.

The board has delegated certain authority to the following committees, each having formal terms of reference.

Executive committee

Chaired by the chief executive and comprising the executive directors and the chairman, it has delegated authority to deal with specific matters remitted to it by the board.

Audit committee

Until his resignation on 13 February 2008, Ed Anderson was the chairman of the audit committee from 1 September 2007, having taken over from Christopher Fisher. The other members of the committee (until their resignations at the same time) were Christopher Fisher and Kate Avery. The committee is to be reconstituted from the new non executive directors. All three members of the audit committee were independent non executive directors and each had sufficient recent relevant financial experience to discharge his/her functions. Kate Avery was a director of Legal & General which owned 4.1% of the company's shares as at 12 February 2008. The company did not consider this to affect her independence and her role in Legal & General did not include direct responsibility for investment decisions. The external auditor, the head of internal audit and the company secretary attended all meetings. The group finance director and group financial controller attended by invitation. The committee also met with the external auditor without the presence of executive management when it considered it necessary or appropriate to do so. The committee chairman reported on the activities of the committee to the board meeting immediately following each committee meeting.

The audit committee's key tasks include:

- reviewing and monitoring of the integrity of the interim and annual financial statements;
- reviewing of the group's system of internal control, including financial, operational, compliance and risk management;

- overseeing the company's relationship with the external auditor, agreeing the nature and scope of the audit and reviewing the independence and objectivity of the external auditor;
- monitoring and reviewing of the effectiveness of the internal audit function.

In undertaking these tasks the committee receives and reviews work carried out by the internal and external auditors and their findings. Both the internal and external auditor work to an annual plan developed in consultation with the committee. In addition the committee reviews specific business areas and processes from time to time. In particular, during the year, the committee considered significant accounting policies in relation to the adoption of International Financial Reporting Standards.

The regular business of the audit committee includes consideration of reports on financial statements, audit planning, the activities of internal audit and its key findings, and the consideration of the operation of internal control processes. Additional matters considered during the year included; accounting for the disposal of Aquarion (the group's US water interests); the scope of the 2008 June Return; and the impact of the Transparency Directive. The company has a policy for disclosure of malpractice and the audit committee reviews the arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

The independence and objectivity of the external auditor is considered on a regular basis, with particular regard to the level of non audit fees.

The group has adopted an auditor independence policy which establishes procedures and guidance under which the group's relationship with its external auditor is governed so that the audit committee is able to satisfy itself that there are no factors which may, or may be seen to, impinge upon the independence and objectivity of the audit process.

The split between audit and non audit fees for the year to 31 March 2008 appears at Note 4 to the financial statements. The amount and nature of non audit fees are considered by the committee not to affect the independence or objectivity of the external auditor.

Remuneration committee

Members of the committee during the year were David Salkeld, Christopher Fisher and Kate Avery. Following their collective resignations on 13 February 2008, it is proposed to re-constitute the committee from the new non executive directors.

Nomination committee

John Napier was chairman of the nomination committee. The other members were Kate Avery, Ed Anderson, Christopher Fisher and David Salkeld until their resignations.

Corporate social responsibility committee

John Napier is chairman of the corporate social responsibility committee and Kevin Whiteman is a member of it. Roger Hyde, a non executive director of Yorkshire Water, is also a member of the committee. He was formerly the Head of the Environment Agency, North East Region. The committee recommends to the board appropriate corporate social responsibility policies and procedures. It is responsible for the updating the corporate social responsibility review which is available on the internet at <http://csr.keldagroup.com>

Board attendance

Board members attended all scheduled meetings, with the exception of Kate Avery who was unable to commit to two meetings.

Communication with shareholders

Throughout the year shareholders had direct access to the company via the investor relations section of its website at www.keldagroup.com and its free shareholder information telephone service.

Prior to the acquisition of the company by Saltaire Limited, there was regular dialogue with individual institutional shareholders as well as general presentations after the interim and preliminary results. All shareholders had the opportunity to put questions at the company's annual general in August 2007 and the EGM in January 2008. The board received reports from executive directors following meetings with investors. Formal reports of investor feedback were presented to the board following the interim and annual results presentations. An investor relations report was presented to the board each month.

Internal control

The board is responsible for the group's system of internal control and for reviewing its effectiveness. An ongoing process, in accordance with the guidance of the Turnbull Committee on Internal Control, has been established for identifying, evaluating and managing the significant risks faced by the group and this has been in place for the year under review and up to the date of approval of the annual report and accounts. Strategic, financial, commercial, operational, and social, environmental and ethical risks fall within the scope of this process. The process is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. During the financial year, material joint ventures have been dealt with as part of the group for the purposes of applying the guidance.

The group has comprehensive and well defined control policies with clear structures, delegated authority levels and accountabilities. There is a group procedure governing appraisal and approval of business development and investment expenditure. Post completion reviews are required on significant business development projects and material investment expenditure.

The group's risk management process aims to be comprehensive, systematic and continuous, and based on constant monitoring of business risk. The key features of the process include the following:

- The main risks facing the group are identified and recorded in a strategic risk register together with the control mechanisms applicable to each risk. These are collated from risk registers maintained by individual businesses.
- There is clear allocation of management responsibility for risk identification, recording, analysis and control.
- The audit committee generally meets four times each year and reviews the effectiveness of the systems which are in place and reports to the board.
- A risk management forum, chaired during the year by the group financial controller, has been established with formal terms of reference comprising senior management from key disciplines and operating companies. It advises and assists operational managing directors and the board on the implementation of the risk management process and monitors risk on behalf of the board. It reports to the audit committee.
- Business units are required to report annually on principal business risks and the operation of control mechanisms.
- The internal audit department provides objective assurance and advice on risk management and control, and monitors the risk management process.

The audit committee reviews and monitors the effectiveness of the process on behalf of the board. During the year the audit committee undertook a detailed review of the process. As a result, a more detailed process for evaluation and prioritisation of risks has been adopted, involving specific measures of potential impact and likelihood of risks arising.

In addition to this process, Kelda's businesses were subject to: a quarterly comprehensive review by the executive team; independent internal and external audits which were reported to the executive team and the audit committee; an extensive budget and target setting process; a quarterly reporting and forecasting process reviewing performance against agreed objectives; appropriate delegated authority levels; established financial policies and procedures; and other risk management policies and procedures such as health and safety and environmental policies.

The board confirms that it has reviewed the effectiveness of the system of internal control. It has received the reports of the audit committee and has conducted a formal annual review covering all controls including financial,

operational, compliance and risk management, in accordance with the *Internal Control: Guidance for Directors on the Combined Code*, issued in September 1999 and updated in October 2005. Following its review the board determined that it was not aware of any significant deficiency or material weakness in the system of internal control.