

DEE VALLEY GROUP plc

Announcement of Preliminary Results Year Ended 31st March 2006

HIGHLIGHTS

	2006	2005
Revenue from continuing operations (£000)	18,317	16,838
Profit before depreciation and finance charges on continuing operations* (£000)	10,288	9,210
Profit before tax* (£000)	5,059	4,638
Earnings per ordinary share* (pence)	76.4	70.8
Total dividend per ordinary share (pence)	46.6	45.0

* 2005 figures restated under International Financial Reporting Standards

Enquiries

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CHAIRMAN'S STATEMENT

In the year ended 31st March 2006, revenue from continuing operations increased by 8.8% to £18.3 million reflecting the increase in charges allowed by the regulator for the year. Measured turnover increased by 15% whilst the increase for unmeasured turnover was just 3%. This resulted mainly from the first stage of adjustment of the differential between measured and unmeasured tariffs, a process that is to continue for a further two years.

Profit before depreciation and finance charges on continuing operations increased by 12% to £10.3 million and profit before tax by 9% to £5.1 million. The Board is proposing a final dividend of 31.2 pence per ordinary share, payable on 3rd August 2006. The total dividend for the year, if approved, will amount to 46.6 pence per ordinary share, an increase of 3.6%. Whereas the increase proposed is in line with the strategy of at least maintaining dividends in real terms, it does not fully reflect the increase in profit during the year. However, the Board considers the proposed increase to be consistent with the longer-term strategy of the Group, given the high level of capital expenditure associated with the Boughton treatment works in the first two years of the current five year charging period and the uncertainties in respect of higher, more volatile, energy prices.

Levels of service provided to customers were improved during the year. No water restrictions were applied in spite of the drier, warmer summer experienced during 2005, which resulted in higher demand. The current position with regard to water resources is healthy and no restrictions on the use of water during the coming summer months are envisaged at the present time.

Gross capital expenditure for the year was £5.9 million. This was lower than intended, mainly resulting from a delay in the construction phase of the Boughton project due to issues with planning consent, which have now been resolved.

As ever, our achievements rely heavily on the enthusiasm and commitment of all of our employees and my thanks go to them.

Graham Scott
Chairman

OPERATING AND FINANCIAL REVIEW

The Group's main operating Company is Dee Valley Water, a licensed water company operating within an area of 831 square kilometres in North East Wales and Cheshire. It supplies water to 105,000 households and 8,250 commercial and business customers.

Raw water is abstracted from a mix of river intakes, impounding reservoirs, boreholes and springs with the largest proportion, 81%, taken from the River Dee. The Company's own network of eight impounding reservoirs supplies approximately 14% of its needs, with the remaining 5% derived from underground sources.

Treatment of water to the required standards takes place at six treatment works, which are listed below together with their average throughputs:

Name	Average Throughput (MI/day)
Llwyn Onn	28
Boughton	24
Legacy	10
Pendinas	2
Oerog Springs	3
Plemstall	1
Total	68

Distribution of treated water takes place through a network of approximately 2,000 kilometres of water pipes utilising 34 pumping stations and 38 treated water storage reservoirs.

As the monopoly water supplier in the area, the Company is subject to strict financial, quality and environmental controls through three systems of regulation. Ofwat regulates the financial side of the business as well as ensuring that levels of service provided to customers achieve the required standards. The Drinking Water Inspectorate regulates the quality of the water supplied, and the Environment Agency controls the interface with the environment, in particular the level and timing of abstraction from watercourses and reservoirs and the quality of discharges.

Financial regulation undertaken by Ofwat is achieved by a system of quinquennial reviews of investment needs from which it sets the maximum annual charges. These Periodic Reviews set charges that are fixed for a five year period, although there are mechanisms in place whereby certain variations in the cost base can trigger an interim review of charges at any time within each five year period. The maximum charges set are based on the assumption by the regulator that they are sufficient for an efficiently run company to adequately remunerate its capital base. For the current five-year period, which commenced on 1 April 2005, the regulator has set the following year-on-year increases in charges. These increases (Ks) are applied annually in addition to the increase in the Retail Prices Index.

Year	2005-06	2006-07	2007-08	2008-09	2009-10
K(%)	5.7	-1.4	0.2	0.6	-0.7

OPERATIONAL PERFORMANCE

Key performance measuring the operational performance of the Water Company are those used by Ofwat and comprise the following:

- Number of properties suffering inadequate pressure
- Number of properties affected by unplanned and prolonged interruptions to supply
- Number of properties affected by water restrictions
- Speed of response to billing contacts
- Speed of response to written complaints
- Meter reading performance
- Quality of telephone contact
- Drinking water quality
- Environmental impact (pollution incidents)
- Leakage

Although measured and monitored separately, each of the above indicators is weighted and combined by Ofwat to give an “Overall Performance Assessment” which is compared with the assessment for other water providers in England and Wales.

In addition to the above regulatory measures, the Company produces and monitors a number of departmental performance indicators associated with the quality of customer service, health and safety issues, water resource prospects and performance of the asset base.

OPERATING PERFORMANCE IN THE YEAR

Ofwat assessed the overall performance achieved in the year ended 31st March 2005 to be a score of 269 out of a maximum possible of 288. For the current year the Company expects to achieve an improvement on this score. This improvement has been mainly achieved in the areas of water pressure and water quality.

With regard to water resources, the situation at the end of the year was one of reasonable confidence that no restrictions on the use of water will be required during 2006.

FINANCIAL

Water charges for 2005/06 were increased overall by 9.1%, being K of 5.7% plus inflation of 3.4%. Turnover on continuing operations increased by 8.8% during the year, the shortfall being due to domestic meter optants.

Profit before tax increased during the year by £421,000, although the increase on continuing operations amounted to £664,000 (15.4%). This is mainly made up of an increase in turnover and other income of £1,663,000, less an increase in operating costs and depreciation of £955,000. Of the latter figure, after depreciation and disposal of infrastructure assets, the highest adverse movement was in power costs; the charge of £969,000 in 2005/06 represented a 46% increase over the 2004/05 level. Power costs are expected to increase again in 2006/07 by approximately 30%.

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). As required by IFRS1, the prior year period and opening reserves have been restated to provide a consistent view of the results and financial affairs of the Group.

A Scheme of Arrangement and return to shareholders was effected in 2002/03. In order to finance the return to shareholders, a long-term index-linked loan of £35 million was advanced by Artesian Finance. The effect on the balance sheet was to move from an ungeared position to a gearing of approximately 71% at 31 March 2006 on a debt/debt + equity basis.

In order to finance Dee Valley Water’s capital expenditure programme over the period 2005 to 2010, it will be necessary to increase borrowings on a temporary basis. It is currently anticipated that additional borrowings will be required in 2006/07, that a peak will be reached in 2007/08 and that a significant portion of the additional borrowings will be repaid by the end of 2009/10. An appropriate borrowing facility will be put into place shortly.

KEY PERFORMANCE INDICATORS (“KPIs”)

Dee Valley Water is a licensed water undertaker and is under a duty to promote the efficient use of water. Consequently, the Company is not able to generate increased profits by promoting more usage of water on a measured basis. Therefore, KPIs are mainly based on the control of operating costs and cash flows. Amongst others, the following KPIs are utilised by management:

- operating costs v budget
- operating profit v budget
- net cash flow v budget
- capital expenditure v budget (in categories and in total)
- historic trends on debtor days and debt segments
- employee costs, including employee numbers and variable employees costs v budget

Since increases in operating costs may be financed through the ‘K’ factor following a Periodic Review, one important measure of profitability is the ratio of profit before tax to revenue. The data is taken directly from the Group Income Statement, and the ratios for 2005/06 and 2004/05 were 27.6% and 27.5% respectively, indicating virtually no change in margin.

There are three further important KPIs relating to cash flow. Referring to the £35 million loan described earlier in this Review, Dee Valley Water has entered into a number of financial covenants with the lender, Artesian Finance. These are:

(1) **Regulatory Asset Ratio**

The balance outstanding on the Artesian loan, plus other borrowings, less cash balances, divided by the Company's Regulatory Capital Value as published by Ofwat. The covenant level is a maximum of 85%.

(2) **Cash-Based Interest Cover Ratio**

Operating cash flow divided by interest paid

This ratio has a minimum covenant level of 1.5.

(3) **Operating Account Reserve**

Cash and overdraft facilities less assessed working capital requirement

The covenant level for this indicator is >0.

The Company has a committed undrawn overdraft facility of £3 million.

The most recent report to the lender, dated 31 March 2006 and covering the period up to 31 March 2008, showed no actual or potential breach of any of the above three financial covenants.

EMPLOYEES

The Company's aim is to create a safe working environment for all employees and to encourage a culture of openness, honesty and mutual respect in which colleagues can constructively challenge and ask questions. The Company offers equal opportunities to all.

PERFORMANCE MEASURES

The Company monitors measures and investigates all accidents in the workplace and these are discussed with employee representatives at quarterly meetings of the Health and Safety Committee.

Employees' attendance at work is monitored as a measure of general health and morale/motivation.

PERFORMANCE IN THE YEAR

The total number of days lost in the year owing to accidents amounted to 148.

Employee absences owing to reported ill health during the year amounted to 3.4% of the total days worked.

**GROUP INCOME STATEMENT
for the year ended 31st March 2006**

	2006 £000	2005 £000 Restated
Revenue – continuing operations	18,317	16,838
Other income	1,426	1,242
Work performed by the Group and capitalised	1,126	1,294
Raw materials and consumables used	(483)	(460)
Employee benefits expense	(5,069)	(5,216)
Other operating costs	(4,945)	(4,161)
Profit before depreciation and finance costs	10,372	9,537
Depreciation	(2,949)	(2,579)
Finance costs (net)	(2,364)	(2,320)
Profit before tax	5,059	4,638
Taxation	(1,520)	(1,360)
Profit for the period		
Continuing operations	3,460	3,049
Discontinued operations	79	229
	3,539	3,278
Basic Earnings Per Ordinary Share	76.4p	70.8p

**GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE
for the year ended 31st March 2006**

	2006 £000	2005 £000 Restated
Actuarial gain on defined benefit pension schemes	665	280
Deferred tax on actuarial gain	(200)	(84)
Net expense recognised directly in equity	465	196
Profit for the period	3,539	3,278
Total recognised income and expense for the period	4,004	3,474

GROUP BALANCE SHEET
as at 31st March 2006

	Group 2006	Group 2005 Restated	Company 2006	Company 2005 Restated
	£000	£000	£000	£000
ASSETS				
Non-Current Assets				
Goodwill	8,315	8,315	-	-
Property, plant and equipment	63,854	62,156	-	-
Investments	2	2	32,365	32,365
	72,171	70,473	32,365	32,365
Current Assets				
Inventories – raw materials and consumables	114	173	-	-
Trade receivables	2,074	1,721	-	-
Other receivables	223	478	3,035	3,333
Cash and cash equivalents	5,142	4,930	-	-
	7,553	7,302	3,035	3,333
TOTAL ASSETS	79,724	77,775	35,400	35,698
LIABILITIES				
Current Liabilities				
Trade and other payables	9,471	11,047	2,607	2,799
Current tax liabilities	944	527	-	-
	10,415	11,574	2,607	2,799
Non-Current Liabilities				
Borrowings	38,894	37,804	-	-
Deferred tax	12,763	12,204	-	-
Retirement benefit obligations	2,057	2,499	-	-
	53,714	52,507	-	-
TOTAL LIABILITIES	64,129	64,081	2,607	2,799
NET ASSETS	15,595	13,694	32,793	32,899
EQUITY				
Share capital	232	232	232	232
Fair value and other reserves	7,919	7,727	29,358	29,165
Retained earnings	7,444	5,735	3,203	3,502
TOTAL EQUITY	15,595	13,694	32,793	32,899

GROUP CASH FLOW STATEMENT
for the year ended 31st March 2006

	2006	2005
	£000	Restated £000
Cash flows from operating activities		
Profit before taxation	5,059	4,638
Adjustments for:		
Depreciation	2,949	2,579
Loss on disposal of assets	522	256
Finance costs	2,364	2,320
	<hr/> 10,894	<hr/> 9,793
Decrease/(increase) in inventories	59	(27)
Decrease/(increase) in trade & other receivables	99	(127)
(Decrease) in trade & other payables	(1,488)	(444)
Cash generated from operations	9,564	9,195
Interest paid	(1,535)	(1,521)
Tax paid	(613)	(291)
Net cash from operating activities	<hr/> 7,416	<hr/> 7,383
Cash flows from investing activities		
Purchase of property, plant and equipment	(5,185)	(6,663)
Proceeds from sale of plant and equipment	15	78
Interest received	261	311
Net cash used in investing activities	<hr/> (4,909)	<hr/> (6,274)
Cash flows from financing activities		
Repayment of B shares	(192)	(277)
Equity dividends paid	(2,103)	(2,062)
Net cash used in financing activities	<hr/> (2,295)	<hr/> (2,339)
Net increase/(decrease) in cash and cash equivalents	212	(1,230)
Cash & cash equivalents at beginning of period	4,930	6,160
Cash and cash equivalents at end of period	<hr/> 5,142	<hr/> 4,930

Statement of Changes in Equity

	Share Capital	Capital Redemption Reserve	Merger Reserve	Fair Value Reserve	Retained Earnings	Total
	£000	£000	£000	£000	£000	£000
Balance as at 1st April 2005	3,031	29,165	(40,630)	-	10,946	2,512
Changes in accounting policy on transition to IFRS (see appendix)	(2,799)	-	8,315	10,877	(5,211)	11,182
Restated balance as at 1st April 2005	232	29,165	(32,315)	10,877	5,735	13,694
Redemption of B shares (held as current liabilities)	-	192	-	-	(192)	-
Profit for the year	-	-	-	-	3,539	3,539
Actuarial gain (net of deferred tax) on defined benefit pension scheme	-	-	-	-	465	465
Dividends paid	-	-	-	-	(2,103)	(2,103)
Balance as at 31st March 2006	232	29,357	(32,315)	10,877	7,444	15,595

Purpose of reserves

Capital redemption reserve - reserve arising on redemption of B shares.

Merger reserve - non-distributable reserve arising from previous Schemes of Arrangement accounted for under merger accounting principles

Fair value reserve - non-distributable reserve arising on restatement of infrastructure assets at fair value

Notes

- The Board of Directors approved this preliminary announcement on 5th June 2006.
- The Board recommends a final dividend of 31.2p per Ordinary Share and Non-Voting Ordinary Share, making a total for the year of 46.6p. The final dividend of 31.2p is payable on 3rd August 2006 to shareholders on the register at close of business on 7th July 2006.
- | Taxation | 2006 | 2005 |
|---|--------------|--------------|
| Analysis of charge in the period | £000 | £000 |
| Current tax expense | 1,170 | 939 |
| Adjustment for prior periods | <u>(9)</u> | <u>(139)</u> |
| Current tax charge | 1,161 | 800 |
| Deferred tax - temporary timing differences | 359 | 560 |
| | ----- | ----- |
| Total tax expense | <u>1,520</u> | <u>1,360</u> |
- Earnings per ordinary share have been calculated on the basis of the weighted average number of ordinary shares in issue during the year of 4,632,170 (2005 – 4,632,170) and earnings attributable to the ordinary shares of £3,539,000 (2005 - £3,278,000).

5.	Cash and cash equivalents	2006	2005
		£000	£000
	Cash in hand and balances with banks	(111)	(292)
	Short-term investments	<u>5,253</u>	<u>5,222</u>
		<u>5,142</u>	<u>4,930</u>

6. The results for the year ended 31st March 2006 are not full accounts within the meaning of Section 240 of the Companies Act 1985. The Company's auditors have not yet made a report on the statutory accounts for that year under Section 235 of the Companies Act 1985. The statutory accounts will be delivered to the Registrar of Companies in due course.

The results for the year ended 31st March 2005 have been extracted from the statutory accounts for that period, which have been filed with the Registrar of Companies, and have been adjusted retrospectively as described in the appendix. The report of the auditors on the accounts, which were prepared under UK GAAP, was unqualified.

7. The accounting policies adopted in this preliminary announcement are those set out in the 2005 Annual Report, other than as stated below:

Basis of Preparation

The 2006 statutory consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The standards adopted by the Group are those endorsed by the European Union and effective at the date the consolidated IFRS financial statements are approved by the Board.

These are the first consolidated financial statements prepared in accordance with IFRS. The rules for first time adoption of IFRS are set out in IFRS1, which requires that the Group establishes its IFRS accounting policies for the 2006 reporting year and applies these retrospectively. An explanation of how the transition to IFRS has affected the reported financial position of the Group is contained in the appendix.

Basis of Consolidation

The Group financial statements consolidate the financial results of Dee Valley Group plc and all its subsidiary undertakings made up to 31st March 2006. Goodwill arising from business combinations is treated as a non-current asset and is reviewed annually for impairment.

Revenue Recognition

Revenue comprises amounts due in respect of goods and services supplied during the year in the ordinary course of business. Revenues are stated net of VAT, where applicable.

Revenue from metered water is based on the invoiced value of water supplied to customers.

Segmental Analysis

It is the opinion of the Directors that there are no appropriate business or geographical segments requiring disclosure under IAS14.

Recognition of Dividends

Dividends declared after the balance sheet date are not recognised as a liability as at the balance sheet date, but are charged against retained earnings when the dividends are paid.

Property, Plant and Equipment

Depreciation is provided on all property, plant and equipment, excluding freehold land and easements, at rates calculated to write off the cost less estimated residual value of each asset evenly over the following estimated useful lives:

Buildings and service reservoirs	50 - 80 years
Meters and fixed plant	5 - 25 years
Mobile plant, vehicles and equipment	3 - 20 years
Impounding reservoirs and raw water aqueducts	50 - 300 years
Water mains	50 - 60 years

Deferred Taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events resulting 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.

Timing differences are differences between the Group's taxable profits and its results as stated in the financial statements, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

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 from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax 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 or substantively enacted by the balance sheet date.

Deferred tax is provided on an undiscounted basis.

Employee Benefits

Dee Valley Water plc operates a defined benefit pension scheme with pension benefits funded over employees' periods of service. The Scheme is closed to new members.

Actuarial gains and losses are recognised in full in the period in which they occur. As permitted by IAS19, actuarial gains and losses are not recognised in the Group Income Statement and are presented in the Group Statement of Recognised Income and Expense. The liability recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of section assets. The cost of providing benefits is determined using the Projected Unit Credit Method.

8. The Annual Report and Accounts will be despatched to shareholders by 26th June 2006, from which date further copies will be available from the Company's Registered Office: Packsaddle, Wrexham Road, Rhostyllen, Wrexham LL14 4EH.

The Annual Report and Accounts will also be available on the Company's website: www.deevalleygroup.com

APPENDIX

Explanation of Transition to IFRS

This is the first year that the Company has presented its financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31st March 2005 and the date of transition was therefore 1st April 2004.

Reconciliation of equity at 1st April 2004 (date of transition to IFRS)

	Notes	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000
Non-current assets				
Property, plant and equipment	(i)	42,739	15,539	58,278
Goodwill	(ii)	-	8,315	8,315
Investments		2	-	2
		42,741	23,854	66,595
Current assets				
Inventories		146	-	146
Trade receivables		1,200	-	1,200
Other receivables due within one year		1,186	-	1,186
Other receivables due after one year	(iii)	2,868	(2,868)	-
Cash and cash equivalents		6,470	-	6,470
		11,870	(2,868)	9,002
Total assets		54,611	20,986	75,597
Current liabilities				
Trade and other payables	(v)	(8,401)	(3,076)	(11,477)
Current tax liabilities		(621)	-	(621)
Borrowings		(310)	-	(310)
Proposed final dividend	(vi)	(1,367)	1,367	-
		(10,699)	(1,709)	(12,408)
Non-current liabilities				
Borrowings		(36,694)	-	(36,694)
Retirement benefit obligations	(iii)	-	(2,653)	(2,653)
Deferred tax	(i)(iii)(iv)	(5,526)	(6,034)	(11,560)
		(42,220)	(8,687)	(50,907)
Total liabilities		(52,919)	(10,396)	(63,315)
Net assets		1,692	10,590	12,282
Equity				
Share capital	(v)	3,308	(3,076)	232
Capital redemption reserve		28,888	-	28,888
Merger reserve	(ii)	(40,630)	8,315	(32,315)
Fair value reserve	(i)	-	10,877	10,877
Retained earnings		10,126	(5,526)	4,600
Total equity		1,692	10,590	12,282

Reconciliation of equity at 31st March 2005 (date of last UK GAAP Financial Statements)

	Notes	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000
Non-current assets				
Property, plant and equipment	(i)	46,137	16,019	62,156
Goodwill	(ii)	-	8,315	8,315
Investments		2	-	2
		46,139	24,334	70,473
Current assets				
Inventories		173	-	173
Trade receivables		1,721	-	1,721
Other receivables due within one year		478	-	478
Other receivables due after one year	(iii)	3,087	(3,087)	-
Cash and cash equivalents		5,222	-	5,222
		10,681	(3,087)	7,594
Total assets		56,820	21,247	78,067
Current liabilities				
Trade and other payables	(v)	(8,248)	(2,799)	(11,047)
Current tax liabilities		(527)	-	(527)
Borrowings		(292)	-	(292)
Proposed final dividend	(vi)	(1,389)	1,389	-
		(10,456)	(1,410)	(11,866)
Non-current liabilities				
Borrowings		(37,804)	-	(37,804)
Retirement benefit obligations	(iii)	-	(2,499)	(2,499)
Deferred tax	(i)(iii)(iv)	(6,048)	(6,156)	(12,204)
		(43,852)	(8,655)	(52,507)
Total liabilities		(54,308)	(10,065)	(64,373)
Net assets		2,512	11,182	13,694
Equity				
Share capital	(v)	3,031	(2,799)	232
Capital redemption reserve		29,165	-	29,165
Merger reserve	(ii)	(40,630)	8,315	(32,315)
Fair value reserve	(i)	-	10,877	10,877
Retained earnings		10,946	(5,211)	5,735
Total equity		2,512	11,182	13,694

Reconciliation of profit for the year ended 31st March 2005

	Notes	UK GAAP £000	Effect of transition to IFRS £000	IFRS £000
Revenue		16,838	-	16,838
Operating costs	(i)(iii)	(11,257)	135	(11,122)
Other income		1,242	-	1,242
Finance costs	(v)	(2,206)	(114)	(2,320)
Profit before tax		4,617	21	4,638
Taxation		(1,322)	(38)	(1,360)
Profit for the period		3,295	(17)	3,278

Reconciliation of Equity as at 31st March 2004

	UK GAAP £000	IAS 16 Note (i)	IFRS 3 Note (ii)	IAS 19 Note (iii)	IAS 12 Note (iv)	IAS 32 Note (v)	IAS 10 Note (vi)	IFRS £000
BALANCE SHEET								
Non-current assets								
Goodwill	-		8,315					8,315
Property, plant and equipment	42,739	15,539						58,278
Investments	2							2
	42,741							66,595
Current assets								
Inventories	146							146
Trade receivables	1,200							1,200
Other receivables due within one year	1,186							1,186
Other receivables due after one year	2,868			(2,868)				-
Cash and cash equivalents	6,470							6,470
	11,870							9,002
Current liabilities	(10,699)					(3,076)	1,367	(12,408)
Non-current liabilities								
Borrowings	(36,694)							(36,694)
Retirement benefit obligations	-			(2,653)				(2,653)
Deferred tax	(5,526)			960	(6,994)			(11,560)
	(42,220)							(50,907)
Net assets	1,692	15,539	8,315	(4,561)	(6,994)	(3,076)	1,367	12,282
Equity								
Share capital	3,308					(3,076)		232
Capital redemption reserve	28,888							28,888
Merger reserve	(40,630)		8,315					(32,315)
Fair value reserve	-	15,539			(4,662)			10,877
Retained earnings	10,126			(4,561)	(2,332)		1,367	4,600
Total equity	1,692	15,539	8,315	(4,561)	(6,994)	(3,076)	1,367	12,282

Reconciliation of Equity as at 31st March 2005

	UK GAAP £000	IAS 16 Note (i)	IFRS 3 Note (ii)	IAS 19 Note (iii)	IAS 12 Note (iv)	IAS 32 Note (v)	IAS 10 Note (vi)	IFRS £000
Balance Sheet								
Non-current assets								
Goodwill	-		8,315					8,315
Property, plant and equipment	46,137	16,019						62,156
Investments	2							2
	<u>46,139</u>							<u>70,473</u>
Current assets								
Inventories	173							173
Trade receivables	1,721							1,721
Other receivables due within one year	478							478
Other receivables due after one year	3,087			(3,087)				-
Cash and cash equivalents	5,222							5,222
	<u>10,681</u>							<u>7,594</u>
Current liabilities	<u>(10,456)</u>					(2,799)	1,389	<u>(11,866)</u>
Non-current liabilities								
Borrowings	(37,804)							(37,804)
Retirement benefit obligations	-			(2,499)				(2,499)
Deferred tax	(6,048)			980	(7,136)			(12,204)
	<u>(43,852)</u>							<u>(52,507)</u>
Net assets	<u>2,512</u>	<u>16,019</u>	<u>8,315</u>	<u>(4,606)</u>	<u>(7,136)</u>	<u>(2,799)</u>	<u>1,389</u>	<u>13,694</u>
Equity								
Share capital	3,031					(2,799)		232
Capital redemption reserve	29,165							29,165
Merger reserve	(40,630)		8,315					(32,315)
Fair value reserve	-	15,539			(4,662)			10,877
Retained earnings	10,946	480		(4,606)	(2,474)		1,389	5,735
Total equity	<u>2,512</u>	<u>16,019</u>	<u>8,315</u>	<u>(4,606)</u>	<u>(7,136)</u>	<u>(2,799)</u>	<u>1,389</u>	<u>13,694</u>

Notes to Reconciliation of Equity and Profit

(i) Depreciation of Infrastructure Assets (IAS 16)

The Group's accounting policy under UK GAAP was to calculate an infrastructure renewals charge (IRC) based on the estimated level of annual expenditure required to maintain the operating capability of the infrastructure network.

IAS 16 requires that all assets be depreciated based on their remaining useful economic lives. The Group has made use of the transition option available under IFRS 1 to use 'fair value' as the deemed cost of infrastructure assets as at 1st April 2004, giving rise to an increase in value of £15,539,000 (less deferred tax of £4,662,000). The result is to create a 'fair value' reserve within equity.

The application of depreciation to these assets rather than the IRC results in a credit to operating costs of £480,000 in the year ended 31st March 2005.

(ii) Business Combinations and Goodwill (IFRS 3)

The acquisition of Chester Water plc in 1997 was accounted for using merger accounting principles. Merger accounting is not permitted by IFRS 3. The transaction has been restated by applying the purchase method, giving rise to goodwill of £8,315,000 within non-current assets, and a corresponding credit to the merger reserve.

The resulting goodwill will be tested for impairment annually as required by IAS 36 'Impairment of Assets'.

(iii) Employee Benefits (IAS 19)

For UK GAAP reporting, the Group applied the measurement and recognition policies of SSAP 24, whilst providing detailed disclosures for the alternative measurement principles of FRS 17. IAS 19 allows a similar approach to FRS 17 for defined benefit schemes. On transition, the deficit disclosed under FRS 17 has been recognised in the balance sheet. At 1st April 2004, this resulted in a pre-tax reduction in net assets of £5,521,000, which represents the sum of the deficit and reversal of the SSAP 24 prepayment in the UK GAAP balance sheet

An associated deferred tax asset of £960,000 was recognised in respect of the pension deficit, giving an overall adjustment to net assets at 1st April 2004 of £4,561,000.

The amendment to IAS 19 allows actuarial gains and losses to be recognised immediately in the Statement of Recognised Income and Expense. Thus actuarial gains and losses will be taken directly to equity.

In the year ended 31st March 2005, the application of IAS 19 resulted in additional operating costs of £345,000 with an actuarial gain of £196,000, net of deferred tax, credited directly to equity.

(iv) Income Taxes (IAS 12)

Under UK GAAP, the deferred tax liability was recognised on a discounted basis. IAS 12 requires that the gross liability be provided. The discount at 31st March 2004, amounting to £2,495,000, has been charged against retained earnings.

Additional deferred tax of £334,000 has been charged to profit after tax in the year ended 31st March 2005.

(v) Financial Instruments (IAS 32)

The balance sheet at 31st March 2004 included B shares that were created as part of the capital reconstruction carried out in 2002. Under UK GAAP these shares were classified as part of equity.

IAS 32 requires that these shares (£3,076,000 at 31st March 2004) be transferred to current liabilities, as they are redeemable twice yearly and carry a fixed dividend.

The 'dividends' paid on these shares, amounting to £114,000 in the year ended 31st March 2005, have been reclassified as finance costs.

(vi) Recognition of Dividends (IAS 10)

Under IFRS, dividends declared after the balance sheet date are not recognised as a liability as at that balance sheet date.

The final dividend of £1,367,000 declared in June 2004 and paid in August 2004 has been added back to equity in the balance sheet at 1st April 2004, and deducted from equity at 31st March 2005.