DEE VALLEY GROUP plc

Announcement of Unaudited Preliminary Results
Year Ended 31 March 2007

HIGHLIGHTS

	2007 £000	**2006 £000**
CONTINUING OPERATIONS		
Revenue	18,446	18,317
Profit before depreciation and finance costs (£000)	9,703	10,185
Profit before tax (£000)	4,270	4,975
Basic earnings per ordinary share (pence)	65.4	74.7
Total dividend per ordinary share (pence)	48.7	46.6

Enquiries

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CHAIRMAN'S STATEMENT

In the year ended 31 March 2007, revenue from continuing operations increased by just under 1%. This increase was less than the overall average increase in charges of just over 1% owing to the effect of household customers switching to measured charging and a reduction in consumption by one major industrial customer.

Profit before depreciation and finance costs was 5% lower due to a combination of a higher level of debtor provisions and the higher power costs experienced during the year. The increase in power costs was mitigated to some extent by a 7% reduction in consumption owing to more efficient use of resources. Profit before tax reduced by 14% to £4.27 million, the major effect being an increase in finance costs, specifically the RPI-based indexation charge on the index-linked loan.

Subject to approval at the Annual General Meeting, the Board is proposing a final dividend of 32.7 pence per ordinary share. The total dividend for the year will amount to 48.7 pence per share, an increase of 4.5%, consistent with the policy of maintaining dividends in real terms until 2010. The final dividend will be paid on 2 August to shareholders on the register at 6 July.

Gross capital expenditure in the year increased, in line with expectations, to £10.1 million (2006 - £5.9 million) reflecting to a large extent the planned expenditure on the refurbishment of the Boughton Treatment Works. The first stage of this work is currently being commissioned, with final completion of the project anticipated in the early part of 2008.

In spite of the very high demands experienced during the hot summer of 2006, for the eighteenth successive year supplies to all customers were maintained without restrictions. Currently, water resources are reasonably healthy and no restrictions on use are envisaged during the summer of 2007.

The Company's record of providing high levels of service to its customers and of delivering water of the highest quality was once again maintained during the year. Leakage levels were again reduced and remain amongst the lowest in the industry in England and Wales.

Our achievements would not have been possible without the dedication and hard work of our employees and my thanks go to them.

Graham Scott
Chairman

OPERATING AND FINANCIAL REVIEW

The Group's operating company is Dee Valley Water (DVW), a licensed water company operating within an area of 831 square kilometres in North East Wales and Cheshire. It supplies potable and non-potable water to 106,000 households and 8,250 commercial, industrial and business customers.

The main source of water is the River Dee, which provides 81% of the raw water abstracted with a further 14% from a network of eight impounding reservoirs and the remaining 5% from underground sources.

DVW is a water-only company and as such does not supply sewerage services, although it does bill customers for these services on behalf of the providers.

Water is treated to the very high standards stipulated at six water treatment works and is distributed through a network of almost 2,000 kilometres of pipes, varying in size from 800 millimetres down to 65 millimetres in diameter. The age of the pipe network reflects the historic roots of the Company, with some pipes laid in the 1860s still in use today.

As a monopoly water supplier within its area, DVW 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 the performance of the Company, both in terms of the levels of service provided to customers and agreed outputs, is achieved. The Drinking Water Inspectorate regulates the quality of water supplied, whilst the Environment Agency controls the interface with the environment, ensuring in particular that abstractions and discharges to and from water bodies are within licensed limits.

Financial regulation undertaken by Ofwat is achieved by a system of quinquennial periodic reviews of investment and operating requirements, from which it sets the maximum annual charges for water services for the following five years. Maximum charges are based on the assumption by the Regulator that they are sufficient for an efficiently run company to adequately remunerate its investors. For the current five-year period, which commenced on 1 April 2005, the Regulator determined the following year-on-year increases in charges. These increases (Ks) are applied annually in addition to the increase in the Retail Prices Index (RPI).

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 indicators measuring the operational performance of DVW are those specified by Ofwat and comprise the following:

- Number of properties suffering low water 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 response to telephone contacts
- 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 (OPA) score.

In addition to the above, DVW produces 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

The OPA for the year ended 31 March 2006 was a score of 278 out of a maximum possible of 288; this achievement was an improvement on the score of 269 in the previous year. For the year ended 31 March 2007 the OPA is expected to either match or improve on that achieved in the previous year.

CAPITAL INVESTMENT

Over the five years commencing 2005, DVW is planning around £28 million of capital expenditure. The majority of this investment is associated with the maintenance of and extension to the current asset base.

The single largest project in the five-year period is an investment of £13.6 million in Boughton Treatment Works, which supplies the City of Chester. This investment entails the replacement of the existing filtration plant with modern, automated filtration and the upgrading of other parts of the works to modern standards.

Significant progress has been achieved on the Boughton project during the year and parts of the new plant are due to be operational imminently. Completion of the whole of the work is still planned in the early part of 2008.

In addition to the above, other areas of investment have included the planned replacement of 8 kilometres of water mains in order to maintain the serviceability of the distribution network, the installation of 2,620 water meters to existing households and the first-time connection of 1,123 new households.

FINANCIAL

During the year, revenue from continuing operations increased by 0.7% to £18.4 million. This compares with an overall increase in charges of 1.03%, being inflation of 2.43% less a K factor of 1.40%. The difference between the allowed and actual charges increase relates primarily to the reduction in unmeasured revenue owing to customers moving to a measured supply.

Profit before depreciation and finance costs reduced by 5% compared to 2006. After adjusting for disposal of assets, other operating costs increased by £781,000. Of this, £295,000 relates to electricity, as foreshadowed in last year's Financial Review. Electricity prices have since fallen from the peaks experienced in 2006/07, and the annual contracts have been renewed at lower prices. The provision for impairment of trade receivables increased by £213,000 during the year. The calculation of the provision was changed in 2005/06 to include an element of the current year unmeasured debt relating to current occupiers. These two factors accounted for approx. two-thirds of the increase in adjusted operating costs during the year.

During the year, the accounting policy on finance costs and finance income was changed to align with best practice. The expected return on pension scheme assets and interest on pension scheme liabilities are now included within finance income and finance costs respectively. The 2006 figures have been restated accordingly. Approximately two-thirds of the increase in net finance costs was attributable to loan indexation, which is based on the Retail Prices Index. Interest receivable was also lower than in 2006 as the Group generally held lower cash balances in 2006/07 owing to the high level of capital expenditure.

The above increases in operating and finance costs are reflected in a decrease in pre-tax profit of approximately 14%. Given that the effective tax rate is similar to 2006, the decrease in pre-tax profit results in a similar decrease in earnings per share.

The major feature of the cash flow statement is an increase in net capital expenditure of £4.0 million. The financing of this expenditure is essentially short-term in nature through trade payables and drawings under the revolving credit facility. This facility is committed until 2010 and the drawdown period can be from 14 days to 6 months, giving the Group the flexibility to utilise internal cash flows to finance capital expenditure without the necessity of incurring borrowing costs. DVW's capital expenditure is expected to reduce significantly in 2009 and 2010, and it is therefore expected that the majority of the additional borrowings will be repaid by 2010.

The majority of the Group's borrowings are at fixed rate, although there is some exposure to the Retail Prices Index because of the index-linked nature of the long-term borrowings (see comment on Group Income Statement above, and on covenants, below). The interest rate on drawings under the revolving credit facility is fixed at the time of the drawdown. Despite the high capital expenditure programme in 2007/08, it is still expected that the Group will have cash in hand at certain times during the year, which will be invested at around base rate, thereby partly mitigating the interest exposure on the drawdown under the revolving credit facility.

The Group's treasury policy is to finance its operations by a combination of retained profits and long and short-term borrowings. Despite the high level of capital expenditure during the year, the Group was able to utilise its internal cash flow as the primary source of financing, with drawdowns under the revolving credit facility limited to those necessary to meet the covenants on the index-linked long-term borrowings. The continued implementation of this policy in 2007/08 has resulted in the Group having no current bank borrowings from the end of April 2007 to the date of these accounts.

The Group's capital structure was established in 2002 following a Scheme of Arrangement and return of funds to shareholders. Prior to 2002, the Group had been ungeared for a number of years. In setting price limits in 1999, Ofwat assumed a level of gearing higher than that of DVW, to its relative disadvantage. At the 2004 Price Review, Ofwat assumed a gearing level of 55% debt and 45% equity, and DVW's gearing exceeded this figure. In addition, the index-linked nature of the loan was beneficial to the DVW in that, at the last Price Review, Ofwat assumed that all interest was paid as incurred rather than being deferred and added to the loan. In view of the stable and predictable nature of DVW's cash flows, the Board considers that a high level of gearing is both appropriate and financially efficient.

Accounting Policies and Restatement

Other than finance income and costs relating to the defined-benefit pension scheme, there has been no change in accounting policies during the year. In respect of the carrying value of long-life assets, the Directors continue to believe that the asset lives are appropriate and similar to those adopted by comparator companies. Although the provision for impairment of trade receivables has increased significantly during the year, the policy and calculation method has remained unchanged from 2006. During 2007/08, debt collection resources will be increased with a view to mitigating the effect of higher doubtful receivables.

The assumptions used to calculate the liabilities of the Defined Benefit Pension Scheme represent the current central estimates recommended by the Group's actuarial advisors.

During the year, goodwill on the acquisition of Chester Water was restated (note 6). There was no effect on the profit for the period.

Covenants and Key Performance Indicators (KPIs)

There are three main financial covenants relating to the index-linked loan. These are:

- **Regulatory Asset Ratio**
  The balance outstanding on borrowings, less cash balances, divided by the DVW's Regulatory Capital Value as published by Ofwat. This covenant has a maximum operating level of 86%.

- **Cash-Based Interest Cover Ratio**
  Operating cash flow divided by interest paid. This ratio has a minimum level of 1.5.

- **Operating Account Reserve**
  Cash and overdraft facilities less assessed working capital requirement based on turnover. The minimum level is 0.

Of the 3 measures above, the Regulatory Asset Ratio is a key performance indicator. At 31 March 2007, the ratio stood at 69.4% and was calculated as follows:

	£000
Non-current borrowings (note 5)	40,166
Current borrowings under revolving credit facility (note 5)	2,500
Less interest payable on non-current borrowings in next 6 months	(730)
Net indebtedness	41,936
Divided by:	
Regulatory Capital Value of DVW in 06/07 prices - as published by Ofwat in April 2007	60,436

The most recent report to the lender, dated 31 March 2007 and covering the period up to 31 March 2009, showed no actual or potential breach of any of the above three financial covenants.

The Group's financial models include a high inflation scenario. As RPI increases, the additional indexation is added to the loan and charged to the Group Income Statement. However, since the Regulatory Capital Value also increases by the same index, the Regulatory Asset Ratio is not significantly affected. If inflation increases, the additional indexation charged to the Group Income Statement tends to reduce the earnings per share and dividend cover. The Group has set its current dividend policy cognisant of this risk.

Management also utilises other financial KPIs such as:

- Operating costs v. budget
- Net cash flow v. budget
- Capital expenditure v. budget
- Historic trends in debtor days and debt segments

RISKS

The risks inherent in the operation of DVW are well understood and control measures in place are well established and ensure that risks are adequately controlled both in terms of frequency and consequences.

Risks are reviewed by the Board on a regular basis.

Financial risks are described in more detail in the section above.

ENVIRONMENT

DVW's aim is to reduce, as far as possible, the negative effects of its operations on the environment. Water abstraction is kept to a minimum by ensuring that leakage levels are maintained at the lowest economic level and that water efficiency activities are proportionate to the supply position.

DVW is constantly reviewing its ability to re-use material that would otherwise have been taken to landfill. In particular, agreement has been reached with local authorities to treat and re-use excavated material where conditions and location permit.

DVW has a significant power requirement both for treating and distributing water. The efficiency of pumping installations is being measured with a view to reducing DVW's energy consumption and carbon footprint.

DVW is currently working closely with the Environment Agency to assess the impact of abstractions of raw water on the natural habitats of species native to the River Dee.

RELATIONSHIPS

Customers

As a small, locally based water supplier, DVW's relationship with customers is key to its overall performance and sets it apart from larger suppliers.

DVW aims to provide a personal service in all aspects of its dealings with customers and ensures that all complaints are dealt with in a fair manner. Customers are offered direct contact with knowledgeable employees when they telephone and timed appointments are also made available when there is a need to visit their premises. This applies throughout our customer base from large industrial to single household customers.

During the year 258 written customer complaints were received, representing 2.25 complaints per 1,000 properties (2006 – 2.16). The industry average is 6.2 complaints per 1,000 properties. The increase in the number of complaints cannot be ascribed to any particular issue although the number of complaints from measured customers increased in line with the increasing number of measured households.

The Consumer Council for Water audits the quality of responses to written complaints. During the year, 87% of responses were rated as 'good'. This was a reduction from the previous year's performance and procedures in this area are being reviewed.

Employees

DVW has well-developed policies covering all aspects of its relationship with employees. The aim is to be able to recruit and retain employees with a broad range of skills, experience and background and to provide them with opportunities to enhance and develop their skills by training and so equipping them with the tools required to be successful in their roles within the Company.

DVW 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. They are also discussed at monthly meetings that directors attend.

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

The total number of reportable accidents during the year reduced from 13 to 9, although the associated lost time increased from 135 to 228 days principally owing to the nature of the accidents.

Employee absences owing to ill health amounted to 4.2% of available working days compared to 3.4% in the previous year. Procedures for dealing with absence resulting from ill health have recently been reviewed and updated.

Regulatory

DVW has developed a good relationship with the industry regulators. It also works closely with local authorities on matters such as planning and highways.

Suppliers

The majority of specialist water industry materials are purchased through a consortium with other water utilities, which affords DVW and other members of the consortium both additional purchasing power and a sharing of the cost of administration.

In general, our relationship with suppliers remains very good.

GROUP INCOME STATEMENT
for the year ended 31 March 2007

	2007 £000	Restated 2006 £000
CONTINUING OPERATIONS		
Revenue	18,446	18,317
Other income	1,554	1,426
Raw materials and consumables used	(517)	(483)
Employee benefits expense	(3,873)	(3,574)
Other operating costs	(5,907)	(5,501)
Profit before depreciation and finance costs	**9,703**	**10,185**
Depreciation	(2,887)	(2,949)
Finance income	2,352	2,260
Finance costs	(4,898)	(4,521)
Profit before tax	**4,270**	**4,975**
Taxation	(1,241)	(1,515)
Profit for the period on continuing operations	**3,029**	**3,460**
Profit for the period on discontinued operations	7	79
Profit for the period	**3,036**	**3,539**
Basic and diluted earnings per ordinary share:		
Continuing operations	65.4p	74.7p
Discontinued operations	0.2p	1.7p
Total	**65.6p**	**76.4p**
Dividends:		
Interim paid	16.0p	15.4p
Final proposed	32.7p	31.2p
Total	**48.7p**	**46.6p**

GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE
for the year ended 31 March 2007

	2007 £000	2006 £000
Actuarial gain on defined benefit pension schemes	1,980	665
Deferred tax on actuarial gain	(594)	(200)
Net income recognised directly in equity	1,386	465
Profit for the period	3,036	3,539
Total recognised income and expense for the period	**4,422**	**4,004**

GROUP BALANCE SHEET
as at 31 March 2007

	Group 2007 £000	Restated Group 2006 £000	Company 2007 £000	Company 2006 £000
ASSETS				
Non-Current Assets				
Goodwill	5,381	5,381	-	-
Property, plant and equipment	70,026	63,854	-	-
Investments	2	2	32,365	32,365
	75,409	69,237	32,365	32,365
Current Assets				
Inventories – raw materials and consumables	143	114	-	-
Trade receivables	1,860	2,074	-	-
Other receivables	322	223	2,707	3,035
Cash and cash equivalents	4,967	5,253	-	-
	7,292	7,664	2,707	3,035
TOTAL ASSETS	**82,701**	**76,901**	**35,072**	**35,400**
LIABILITIES				
Current Liabilities				
Borrowings	4,950	2,718	2,377	2,607
Trade and other payables	8,156	6,864	-	-
Current tax liabilities	63	944	-	-
	13,169	10,526	2,377	2,607
Non-Current Liabilities				
Borrowings	40,166	38,894	-	-
Deferred tax	14,339	12,763	-	-
Retirement benefit obligations	130	2,057	-	-
	54,635	53,714	-	-
TOTAL LIABILITIES	**67,804**	**64,240**	**2,377**	**2,607**
NET ASSETS	**14,897**	**12,661**	**32,695**	**32,793**
EQUITY				
Share capital	232	232	232	232
Other reserves	5,215	4,985	29,588	29,358
Retained earnings	9,450	7,444	2,875	3,203
TOTAL EQUITY	**14,897**	**12,661**	**32,695**	**32,793**

GROUP CASH FLOW STATEMENT
for the year ended 31 March 2007

	2007 £000	Restated 2006 £000
Cash flows from operating activities		
Profit before taxation	4,270	4,975
Adjustments for:		
Depreciation	2,887	2,949
Loss on disposal of assets	146	522
Net finance costs	2,546	2,261
	9,849	10,707
(Increase)/decrease in inventories	(29)	59
Decrease in trade & other receivables	115	99
Increase/(decrease) in trade & other payables	1,299	(1,617)
Increase in retirement benefit obligations	212	316
Cash generated from operations	11,446	9,564
Interest paid	(1,624)	(1,535)
Tax paid	(1,140)	(613)
Net cash from operating activities	8,682	7,416
Cash flows from investing activities		
Purchase of property, plant and equipment	(9,220)	(5,185)
Proceeds from sale of plant and equipment	15	15
Interest received	191	261
Net cash used in investing activities	(9,014)	(4,909)
Cash flows from financing activities		
Repayment of B shares	(230)	(192)
Equity dividends paid	(2,186)	(2,103)
Net cash used in financing activities	(2,416)	(2,295)
Net (decrease)/increase in cash and cash equivalents	**(2,748)**	**212**
Cash and cash equivalents at beginning of period	5,142	4,930
Cash and cash equivalents at end of period	**2,394**	**5,142**

Cash and cash equivalents comprise:

	2007 £000	Restated 2006 £000
Demand deposits	4,860	5,244
Cash at bank and in hand	107	9
Drawings under revolving credit facility	(2,500)	-
Bank overdrafts	(73)	(111)
	2,394	**5,142**

Reconciliation of Movements in Capital and Reserves

	Share Capital £000	Capital Redemption Reserve £000	Merger Reserve £000	Fair Value Reserve £000	Retained Earnings £000	Total £000
Balance at 1 April 2005 (as previously reported)	232	29,166	(32,316)	10,877	5,735	13,694
Restatement of goodwill (note 6)	-	-	-	(2,934)	-	(2,934)
Balance at 1 April 2005 (as restated)	232	29,166	(32,316)	7,943	5,735	10,760
Redemption of B shares (held as current liabilities)	-	192	-	-	(192)	-
Profit for the period	-	-	-	-	3,539	3,539
Actuarial gain (net of deferred tax) on defined benefit pension scheme	-	-	-	-	465	465
Dividends paid	-	-	-	-	(2,103)	(2,103)
Balance at 1 April 2006	232	29,358	(32,316)	7,943	7,444	12,661
Redemption of B Shares (held as current liabilities)	-	230	-	-	(230)	-
Profit for the period	-	-	-	-	3,036	3,036
Actuarial gain (net of deferred tax) on defined benefit pension scheme	-	-	-	-	1,386	1,386
Dividends paid	-	-	-	-	(2,186)	(2,186)
Balance at 31 March 2007	232	29,588	(32,316)	7,943	9,450	14,897

Notes

1. The Board of Directors approved this preliminary announcement on 4 June 2007.

2. The Board recommends a final dividend of 32.7p per Ordinary Share and Non-Voting Ordinary Share, making a total for the year of 48.7p. The final dividend of 32.7p is payable on 2 August 2007 to shareholders on the register at close of business on 6 July 2007.

3. Taxation

Analysis of charge in the period	**2007 £000**	**2006 £000**
Current year tax		
Current tax expense: continuing operations	278	1,160
: discontinued operations	3	5
Adjustment for prior periods	(22)	(9)
Current tax charge	259	1,156
Deferred tax		
Temporary differences:		
Accelerated capital allowances	998	416
Retirement benefits	(16)	(57)
	982	359
Total tax expense	1,241	1,515

In March 2007 proposals were announced to change the UK rate of corporation tax from 30% to 28% with effect from 1 April 2008. This will reduce the deferred tax liability in future periods.

4. Basic and diluted earnings per ordinary share (EPS) have been calculated on the basis of the weighted average number of ordinary shares in issue during the year of 4,632,170 (2006 – 4,632,170)

The net profit for the period used in the calculation of EPS was as follows:

	2007 £000	2006 £000
Continuing operations	3,029	3,460
Discontinued operations	7	79
	3,036	3,539

5. **Group Borrowings**

	2007 £000	2006 £000
Current		
Drawings under revolving credit facility	2,500	-
B shares	2,377	2,607
Bank overdrafts	73	111
	4,950	2,718
Non-Current		
3.5% Irredeemable Consolidated Debenture Stock	99	99
3.635% Secured Index-Linked Loan 2032:		
Principal	35,000	35,000
Indexation	5,067	3,795
	40,166	38,894

6. **Change in Accounting Policy and Restatement**

Employee Benefits

As permitted by IAS19, the accounting policy on finance costs and finance income was changed during the year so that the expected return on pension scheme assets and interest on pension scheme liabilities are now included within finance income and finance costs respectively. These items were previously included in operating profit before depreciation and finance costs. The change in accounting policy has the following impact:

	2007 £000	2006 £000
Decrease in operating profit before depreciation and finance costs	(159)	(103)
Increase in finance income	2,161	1,999
Increase in finance costs	(2,002)	(1,896)
Change in profit before tax	-	-

This change in accounting policy has no effect on basic and diluted earnings per share.

Goodwill

During the year, goodwill on the acquisition of Chester Water has been restated to comply with the requirements of IFRS 3. Using the adjusted Regulatory Capital Value to derive a fair value at the time of the acquisition, the property, plant and equipment of Chester Water had a fair value uplift of £2.9 million, reducing goodwill to £5.4 million. The restatement has the following impact:

	2007 **£000**	**2006** **£000**
Decrease in balance sheet value of goodwill	(2,934)	(2,934)
Decrease in other reserves	(2,934)	(2,934)

This restatement has no effect on basic and diluted earnings per share.

7. The financial information set out above does not constitute the Company's statutory accounts for the years ended 31 March 2007 or 2006 but is derived from those accounts. Statutory accounts for 2006 have been delivered to the Registrar of Companies. The previous auditors, Saffery Champness, have reported on the 2006 accounts; their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 237(2) or (3) of the Companies Act 1985. The statutory accounts for 2007 will be finalised on the basis of the financial information presented by the directors in this preliminary announcement and will be delivered to the Registrar of Companies in due course.