BOARD'S OVERVIEW

Executive Overview and Summary of Achievements

The 2004 Periodic Review and the acquisition of South Staffordshire Plc principally dominated the report year 2004/05.

Despite these significant events, the Company is pleased to report another successful year in terms of outputs, investment to maintain future service and performance, and overall customer satisfaction. Long-term high performance of service standards has been sustained and in many cases improved further. The average household bill continued to be the second lowest in the industry (and will continue to be so in 2005/06, following Final Determinations). The Company believes that this combination has for many years given our customers the best value for money of any water company in England and Wales.

The Company remains committed to remaining at the leading edge of the industry, holding values of excellence, credibility, price and delivery.

2004 Periodic Review

The Company considers that the 2004 Periodic Review was conducted in a professional manner and that the conclusions reached were fair, but nonetheless challenging. The Company is content that the Final Determination should allow our operations and investment to be financed. The Board, however, do have continued concerns over the ability to meet future leakage targets and to achieve the output of stable serviceability of infrastructure assets as early as 2008-09. Nevertheless it is our intention to pursue these challenging targets with the greatest of vigour. We are working hard to integrate our leakage and burst reduction strategies and to improve the targeting of mains replacement going forward into the AMP5 period.

In terms of the maintenance of our overground assets, the Company has established a dedicated team in November 2004 to ensure that the Common Framework principles are adopted fully and robustly. We envisage that this will also improve the targeting of our maintenance expenditure, developing our knowledge of risks and consequences of asset failure.

Acquisition

On 18 November 2004 Arcapita Bank B.S.C., formerly known as First Islamic Investment Bank acquired South Staffordshire Plc. However whilst the shareholders have changed, the business profile and identity have been maintained.

Following this acquisition, two new non-executive Directors were appointed to the Water Company Board of Directors. They are Panton Corbett and Michael Hughes.

Achievements

The Company is pleased to report a number of notable achievements over the report year. These include:

- Achievement of the highest Ofwat category for each of the Levels of Service for 2004/05. In 2003/04 the OPA score verified by Ofwat placed us third in the industry ranking. The Company has been ranked in the top 3 for five consecutive years. The Company estimates that the 2004-05 OPA score will be slightly higher.
- Achievement of the 2004/05 leakage target of 74.5 Ml/d, although the mild winter played a major part in this. The number of bursts in 2004/05 fell slightly, which is likely to be linked to the very mild weather conditions. The overall level however remains at high levels. We remain of the view that the trend in bursts continues upwards.
- Further improvements have been seen to the telephone contact service, with the number of customer calls made when all lines are busy has reduced by 40% from the prior year. Further improvements are expected in future years.
- Sustained high levels of customer satisfaction, with 93% of domestic customers and 91% of commercial customers stating their satisfaction with overall levels of service. This represents an improvement of 4-5% compared to our 2003 survey.
- An overall water quality compliance rate of 99.96% (calendar year 2004).
- For 2003/04 Ofwat ranked the Company as the second most efficient in terms of operating costs. At the start of the AMP3 period the Company was ranked 17th. Further improvements in operating efficiency were secured in 2004/05, partly reflecting reduced business rates (local authority cumulo rates).
- Managed AMP3 capex is line with the 1999 Determination, reinvesting the capital efficiencies secured.

Delivering AMP3 Outputs and the AMP3 Monitoring Plan

The Company can confirm that AMP3 outputs as specified in the 1999 Supplementary Report have been completed. The only exceptions relate to the two items of logging down at the 2004 Periodic Review, which relate to a lower customer demand for meter switching and the DWI decision to assess phosphate dosing rather than replace lead communication pipes.

Customer service standards have all improved since 1997/98 and hence the Company has exceeded the commitments made in the AMP3 Monitoring Plan.

Looking ahead to the Future

The Company considers that the June Return Board Overview should also focus on high level issues going forward. Here we refer to issues relevant to the start of the AMP4 period and we also set the scene for some of the issues that we consider will be of significance at the 2009 Periodic Review.

The issues we briefly cover in this section relate to:

i. Changes we are making to the delivery of capital investment schemes from April 2005, encouraging innovation through our contracting strategy.

ii. Enhancements proposed to the targeting of mains renewals activity, through integration of burst and leakage reduction strategies.

iii. The energy prices we have secured with our latest contract and our expectations for the later half of the AMP4 period.

iv. Changes made to our Charitable Trust to enhance our service to vulnerable customers.

v. The factors surrounding climate change and our early views on the issues this may raise for us at the next price review.

Capital Investment Contracting Strategy:

Following an extensive tendering process the Company has awarded a five-year Framework Contract to two contractors to undertake the overground asset maintenance programme.

The contracts will operate as partnerships, with staff from both of the contractors co-located with South Staffs engineers and project staff. The parties will agree to work together in a culture of partnering, with the aim of cultivating a mutually beneficial relationship enabling the parties to work together and facilitate continuous improvement, innovation and improved efficiency.

Infrastructure Renewal Targeting:

The Company's PR04 Final Business Plan included an integrated strategy to support achievement, and then maintenance, of stable underground asset performance. The strategy is to integrate the management of a number of activities associated with the operation, maintenance and development of the distribution system in order to maximise returns on investment. This primarily involves the integration of mains rehabilitation and network enhancement, together with development, monitoring and maintenance activities to improve asset performance, customer service and achievement of the leakage target.

Previously separate strategies existed for the management of bursts, leakage and customer levels of service, which restricted the opportunity for using the available investment to deliver multiple benefits. Although an integrated strategy is more complex and requires more intensive investigations and planning, the availability of the DMA monitoring systems and a more zonal-based approach to investigations enables the introduction and development of an integrated strategy, which will eventually lead to more effective overall investment. The Company has re-organised its Distribution Directorate with the new strategy in mind.

This strategy is intended to achieve the following key outputs:

- "Stable" infrastructure serviceability assessments by 2008/09
- Stable leakage levels, thus arresting the current rising trend
- Maintenance of existing very high levels of service (DG2 & DG3)

Energy Prices:

Electricity prices in the market have risen significantly over the past three years. We successfully signed a supply agreement in December 2004 when the electricity market price was around £28 - £29 MW/hr, a low point from the high prices of October 2004, but much higher than the 16 MW/hr contract secured in January 2003. Due to the volatility and uncertainty of future prices, we could only secure a 2½-year contract at these prices. The wholesale price at present is ranging between £35 - £40 MW/hr. Although we have secured a competitive agreement for our energy supplies, we are still unable to achieve the energy budget allowed for in the 2004 Final Determination for the first half of AMP4. The existing and forecast market rates suggest that we will be significantly under funded for the second half of the AMP4 period.

We believe the volatile nature of the electricity wholesale market and the external influences on the market will maintain the price levels around the £35 - £40 MW/hr level, which would add a further £1.2m to our annual energy spend beyond 2007.

Charitable Trust Improvements:

The Trust has been in operation now for a number of years and while at it's inception it was an innovative move on behalf of South Staffordshire Water (SSW), this is an opportune time, due to the increase in water service charges, to review the existing scheme to ensure that it continues to balance the changing needs of customers and assist in the protection of future debt levels.

The Trust is currently open to all those customers who are in financial difficulties within our area. Over the past two years, grants made by Trust have increased by £5.5k, reaching a total of £54,000 in 2004/05 (for water charges only). However the number of people helped through grants has decreased. The current operation of the Trust is helping fewer people that are due aged debt and it is not wholly achieving its intention of helping those customers who want to help themselves.

During 2005/6 a six-month trial will be conducted to change the Trust. It will incorporate help to those customers, who are experiencing a 'transitional' issue (crisis), e.g. bereavement, unemployment, recovery from sickness. Those who were previously good payers and are willing to pay, as well as those who are experiencing real financial difficulty, will be considered. We will look to award grants where this would make a real difference to them as an individual person or appeases the stress or where there is a willingness to pay but the customer cannot. The intention is to help those customers before they increase their water debt.

Preparations for Climate Change:

The Company is currently developing strategies to address what its deems to be the two most significant potential issues associated with the impact of climate change: water resource availability and energy.

In order to determine the potential impact from climate change on the Company's resource position further development of the Company's water resources model (Wrapsim) is required. There will be two main tasks to undertake. Firstly, the way in which the River Severn system is modelled will be improved. Secondly the data record for inflows to Blithfield Reservoir will be extended to the current date to capture recent drought periods. Both of these developments will give a more detailed and robust approach that will improve reliability in the model outputs.

These model developments will prepare the Company to utilise new climate change scenarios and new UKWIR methodologies timed for 2008 ready for preparation of AMP5 submissions. Solutions to the potential impacts are already being explored including areas such as conjunctive use of boreholes against surface water sources.

The Company is looking at renewable energy strategies. Since 1st April 2005 the Company has been purchasing most of its electricity from climate change levy exempt sources and is actively looking at ways to reduce costs and provide security of supply. Any achievements in this area will help offset the pressures to consume more electricity as treatment and pumping plant become more complex so there will be no overall increase in emissions. The Company will however be mindful of the potentially significant cost implications of pursing green energy options.

The Company is also pursuing initiatives to reduce sprinkler usage.

Chapter 1 Key Outputs and Service Delivery – (Tables A)

Operational

DG2 (low pressure) performance continues to be excellent. For the past twelve years the Company has been able to minimise low pressure disruption such that the percentage of properties receiving low pressure has not risen above 0.05%. Performance in 2004/05 was 0.00%, our best ever performance. At the year end only 25 properties out of a customer base of 556,200 properties suffered from DG2 problems.

DG3 (supply interruptions) performance remained ahead of industry standards. The overall performance score was 0.10, which compares to the industry average score in 2003/04 of 0.60.

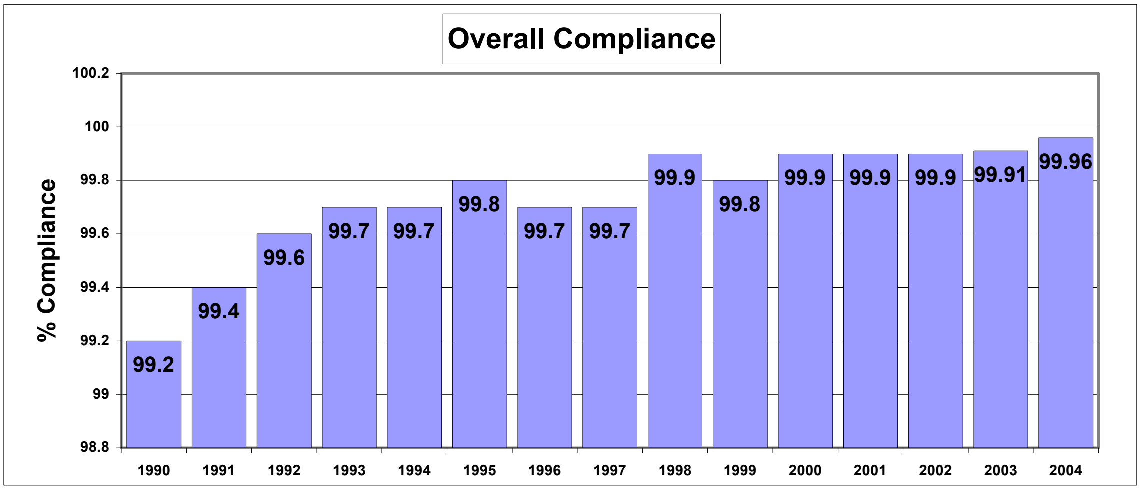
DG4 restrictions were again avoided. A hosepipe ban has not been imposed in the Company's supply area for 29 years.

Customer Services

DG6 (billing contact) remained above 99%. DG8 (meter reading) performance remained high at 99.8% and DG7 (response to written complaints) performance remained at 100%. DG9 (telephone contact) also improved in terms of the numbers of calls experiencing all lines busy, with the number in 2002/03 of 90,000 calls reduced to a level of 27,000 in 2004/05. The Company has plans to further improve this performance in future years.

Water Quality

The compliance rate for the calendar year 2004 was 99.96%, maintaining the Company's very high level of performance over recent years – the compliance rate has always been at or above 99.7% since 1993 (see following graph).



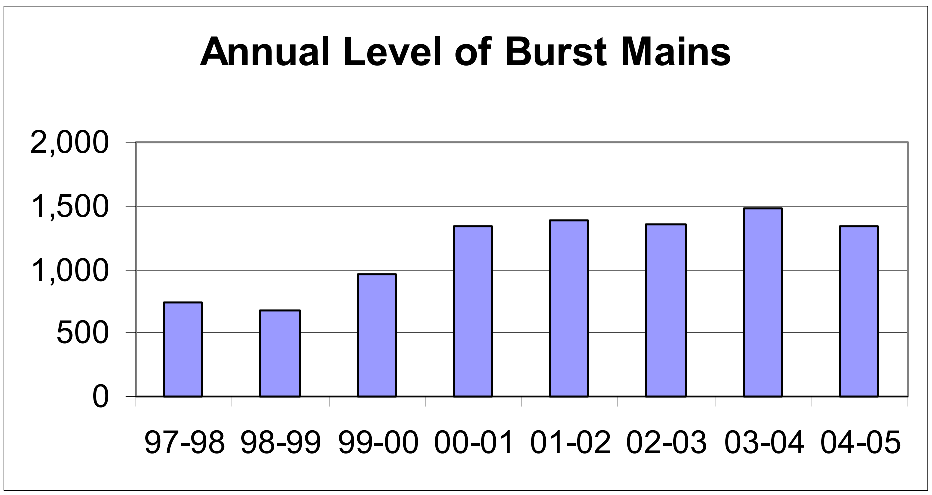
For the operational performance index the Company's performance was 99.93%.

There have again been no enforcement actions placed on the Company this year.

Investment in water quality schemes is substantially complete following AMP2 and AMP3. Hence there is not a large WQ programme required in AMP4. For plumbosolvency control, phosphate dosing is included rather than a strategic lead cp replacement programme. A review will be undertaken to assess the extent to which lead communication pipe replacements are required in AMP5 to meet the 10 ug/l standard for 2013.

Serviceability – Underground Assets

The Company continues to be concerned at the condition and serviceability of our underground assets. Burst and leakage levels are both relatively high and hence these issues received a major focus in our PR04 Final Business Plan. Burst trends over the past four years are showing slight signs of improvement. They do, however, remain high compared to other companies and have only improved marginally despite concurrent mild winters.



Serviceability – Overground Assets

As a consequence of good operational practice, including distribution and treatment hygiene and the reduced level of microbiological failures, it is considered that the non-infrastructure serviceability assessment will continue to be identified as 'stable'. Turbidity levels were at acceptable levels and hence not a concern for the DWI. Turbidity levels in water from our 2 largest sources, at Hampton Loade and Seedy Mill, are anticipated due to the lime dosing required for pH correction.

The Company has formed a new team to champion overground maintenance issues, ensuring we capture more data and align our asset management planning to the *Common Framework* principles. One of their responsibilities will be to develop appropriate serviceability indicators for the range of non-infrastructure assets that we operate. We intend to report progress in the 2006 June Return.

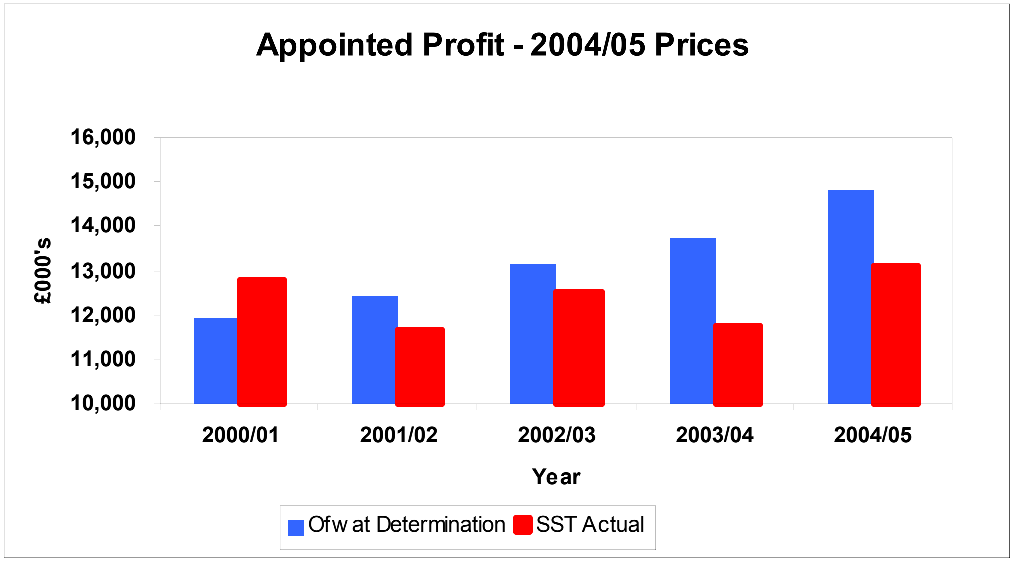
Chapter 2 Expenditure and Financial Performance Measures - (Table C)

Profitability

The profitability profile in the AMP3 period compared to the 1999 Determination has been as follows:

Current cost operating profits in 2004/05 price base	2000/01 £'000	2001/02 £'000	2002/03 £'000	2003/04	2004/05 £'000
Allowed in FD99	11,933	12,456	13,149	13,751	14,831
Actual reported	12,815	11,679	12,527	11,772	13,123
	882	(777)	(622)	(1,979)	(1,708)

The information in the above table is graphed below:



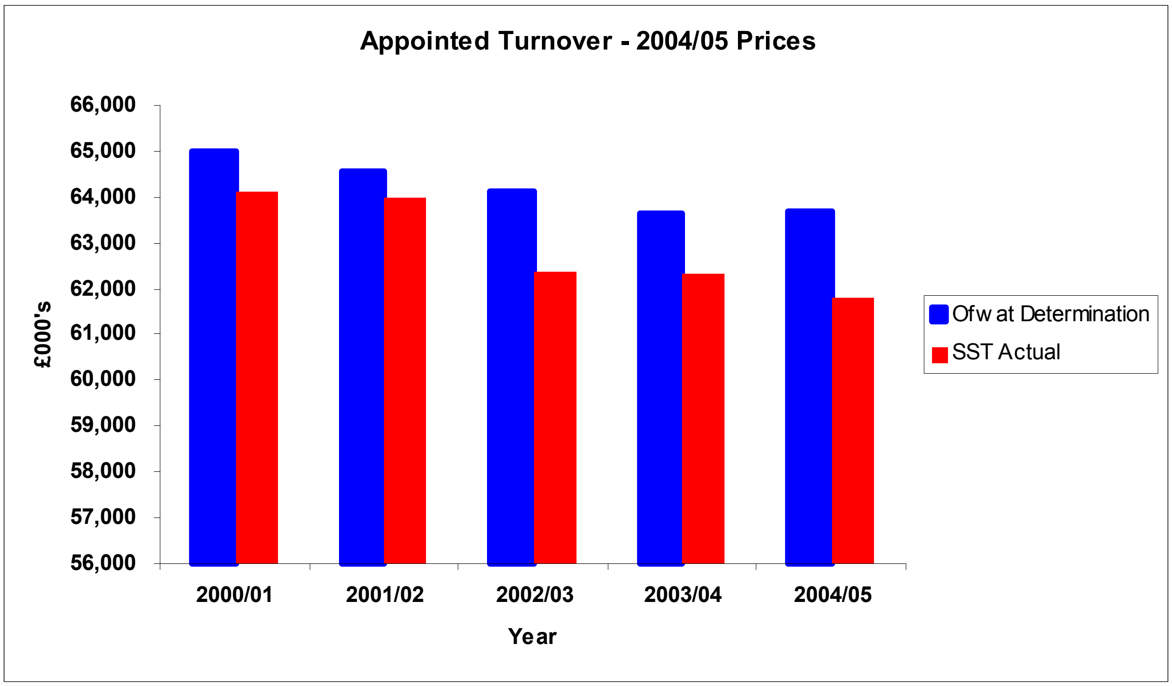
The % post-tax returns for the Company in 2004/05 amounted to 6.83%, against the FD99 figure of 7.0%. Despite AMP3 opex outperformance, our returns are below the 1999 Determination assumptions due to the deficiencies with turnover and depreciation that are described below.

Turnover

The turnover profile in the AMP3 period compared to the 1999 Determination has been as follows:

Turnover in 2004/05 price base	2000/01 £'000	2001/02 £'000	2002/03 £'000	2003/04	2004/05 £'000
Allowed in FD99	65,006	64,563	64,120	63,631	63,699
Actual reported	64,103	63,988	62,383	62,314	61,813
	(903)	(575)	(1,737)	(1,317)	(1,886)

The information in the above table is graphed below:



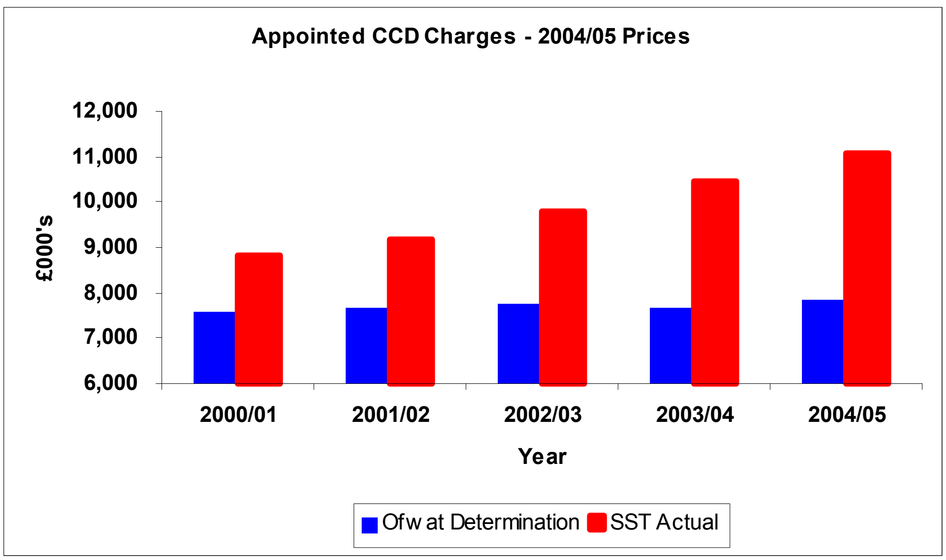
Large user revenue reduced in line with a reduction in consumption of those using above 100 Ml/a (Table 8 of this June Return indicates a consumption reduction of 5.5% compared to 2003/04).

Depreciation Charge

Current cost depreciation allowed in FD99 continues to prove to have been materially inadequate, as illustrated by:

CCD in 2004/05 price base	2000/01 £'000	2001/02 £'000	2002/03 £'000	2003/04	2004/05 £'000
Allowed in FD99	7,569	7,660	7,785	7,660	7,853
Actual reported	8,839	9,172	9,785	10,460	11,094
	(1,270)	(1,512)	(2,000)	(2,800)	(3,241)

This is illustrated as follows:



This shortfall is due to the fact that the calculation method for CCD used at the last price review was based on use of standard industry allocations of expenditure to asset lifes. The Company does not anticipate such material problems for the AMP4 period, following the 2004 Final Determination.

Dividends

The total dividend for 2004/05 increased to £8.3m (2003/04: £4.2m). In the past the Company had historically declared dividends based upon being covered 1.8 times by earnings, which was a high ratio from an industry perspective. The Board have now approved a policy to pay dividends that maintain the level of net debt to regulated asset value at 65%, rather than have a policy based upon a set level of cover.

Financing investment

Net debt rose to £112.0m (2003: £105.7m). Net debt at 31 March 2005 represents 64.4% of the Regulated Asset Value of £174m (year-end).

Chapter 3 Key Supporting Information - (Tables D)

Expenditure

The final year of AMP3 (2004/05) was one with a reduced level of capital expenditure, as much of the activity by the Company had been front-loaded. For example, the mains renewal programme had sought to produce early benefits as part of our desire to tackle leakage and burst problems.

Capital Works Activity

The Company has renewed 241.5km of main in the AMP3 period. Our 1999 business plan had indicated that 250km would be completed over 5 years, but this was not quite achieved due to the complexity and size of some individual projects. IRE was managed so that there was no accrual or prepayment at the end of the AMP3 period.

Water Balance (inc. leakage)

The Company had no supply restrictions and achieved the 2004/05 leakage target of 74.5 Ml/d, albeit the mild weather proved a major factor in this achievement. Distribution input fell, mainly because the prior year (2003/04) had been a dry year.

Metering

Numbers of meter optants were steady, at levels similar to prior years in the AMP3 period. Since annual billing for 2005/06 commenced in March 2005, we are experiencing a large increase in meter options and no doubt this will be reflected in JR06 numbers. The Company metered 762 non-household properties in 2004/05 through the compulsory metering programme.

Other Key Supporting Information

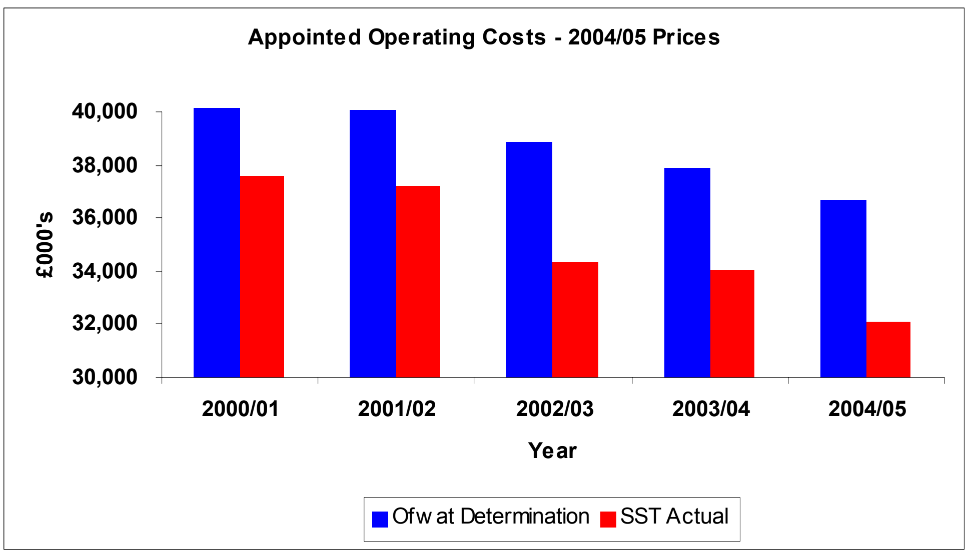
The general trend of increased customer debt continues. In 2000/01 there was 9.1% of revenue outstanding, compared to the present figure of 12.91% as the period of time to collect bills is lengthening. The Company has however successfully avoided an IDOK by increasing the intensity of debt collection activities over the period, although the cost of collections has increased.

Chapter 4 Efficiencies

Operating efficiencies

In 2004/05 the Company benefited from a £500,000 reduction in local authority cumulo rates, which was anticipated in the 1999 Determination. A further explanation for the 2004/05 reduction in operating costs relates to the fact that 2003/04 had been a dry year (hence we declared atypical costs of £170k). Costs were maintained at a low level in 2004/05 because we were still enjoying the benefits of the power contract signed before market rates rose dramatically, and prices did not rise with RPI in 2004/05.

The following graph shows the extent to which the Company has outperformed the 1999 Final Determination for the operating cost efficiency target. The Company was ranked 17th in 1999/00 and it now ranked 2nd, which represents outstanding progress.



Operating costs in 1999/00 were £39.142m (2004/05 prices) and have reduced by 18% (£7.0m) over five years (2004/5: £32.100m). The Company is proud of this achievement.

Capital Efficiencies

AMP3 capex is in line with the 1999 Determination since those capital efficiencies secured have been reinvested. In terms of the future, the Company has already noted the measures being taken for the AMP4 capital investment contracting strategy to encourage innovation and capital efficiencies going forward.

Chapter 5 Competition

The Company received no specific competition enquiries during the year. In addition, no new customers were secured through competition.

Board Approval

This Board Overview to the 2005 June Return has been reviewed and approved by the Board of Directors of the Water Company.

Dr Jack Carnell

9 June 2005