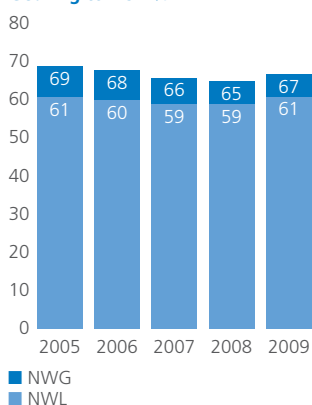


3. Financial performance

Gearing to RCV %



NWG and its subsidiaries use a range of indicators to monitor performance. For NWG, the key performance indicators (KPIs) are all financial. The

non-financial KPIs relating to NWL are summarised on page 4. The definition, purpose and source of each KPI are shown on pages 44 and 45.

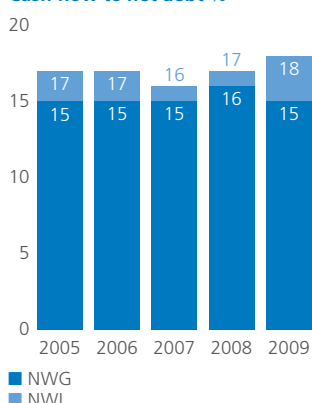
Performance against the financial KPIs is set out below:

KPI	Target	Performance				
		NWG	NWL	Current year	Previous year	
Gearing to RCV (%)	<75	<70 ¹	67 ³	61 ²	65	59
Cash interest cover (times)	>2.5	>3.0	3.1	3.8	3.1	3.9
Cash flow to net debt (%)	>13	>13	15	18	16	17

Notes:

1. Less than 65% for the regulated business of NWL.
2. NWL's Regulatory Capital Value (RCV), as advised by Ofwat, at 31 March 2009 was £2,998 million (2008: £2,976 million).
3. NWG's pro forma RCV at 31 March 2009 was £3,324.4 million (2008: £3,300.6 million) (see below).

Cash flow to net debt %



As a consequence of the current economic climate, there has been an increased focus on gearing across many sectors. The Group's gearing has previously been expressed as a percentage of NWL's RCV. However, this overstates gearing as it ignores any value attributable to the Kielder securitisation and the two PFI contracts. The level of associated debt included in the Group's net debt relating to those assets amounts to £215.6 million (2008: £214.9 million) and £110.8 million (2008: £109.7 million) for the Kielder securitisation and PFI contracts respectively. Adding these amounts to NWL's RCV of £2,998.0 million (2008: £2,976.0 million) results in a pro forma Group RCV of £3,324.4 million (2008: £3,300.6 million). This change results in gearing being restated from 72% to 65% at 31 March 2008.

The Group's gearing on this pro forma basis has increased from 65% to 67%, with net debt increasing by £79.3 million to £2,229.7 million over the year. The increase in the Group's gearing is principally due to the impact on the RCV of negative inflation of 0.4% at 31 March 2009.

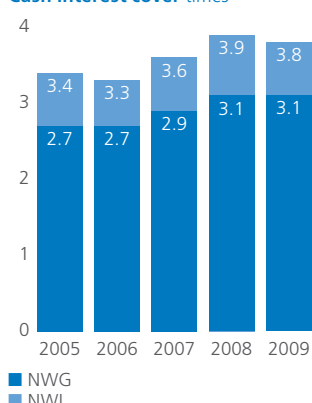
At NWL, gearing has also been reviewed and net debt has been restated to include £159.0 million (2008: £159.0 million) in respect of an intra-group loan, repayable on demand, as the Company believes this is a better reflection of NWL's net debt. This change results in gearing being restated from 64% to 59% at 31 March 2008.

NWL's gearing has increased from 59% to 61%. For the regulated business within NWL, gearing increased by 2% to 60%.

Cash interest cover has remained stable for the year.

The Group also prepares detailed medium term business plans and annual budgets, which are reviewed and submitted to the Board for approval. Targets are set to measure performance and regular financial forecasts are made. Business plans and budgets include an assessment of the key risks and success factors facing each business unit. On a monthly basis, management compares the actual operational and financial performance of each business with plan and budget and this is reported to the Board.

Cash interest cover times



Directors' report and business review

3. Financial performance continued

Financial results and dividends

	Year to 31.3.2009 £m
Profit before tax	152.7
Loss for the year	(11.9)
Interim dividend paid (ordinary – 4.29 pence per share)	22.2
Final dividend proposed (ordinary – 8.50 pence per share)	44.0

Revenue for the year to 31 March 2009 was £694.1 million (2008: £670.4 million). This 3.5% increase is mainly due to the application of Retail Price Index (RPI) (4.28%) to water and sewerage charges, partially offset by a small overall reduction in demand for both water and sewerage services and a reduction in other services related to the housing market. The difficult economic climate continues to have an impact on industrial and commercial customers where volumes are down by c.4% compared to the prior year.

Profit on ordinary activities before interest for the year was £273.6 million (2008: £277.8 million). Operating costs increased by £27.9 million (7.1%) to £420.5 million. At NWL, operating costs have increased from £356.0 million to £380.1 million. This increase principally reflects the impact of inflation, increases in energy costs and bad debt charges. These increases have been partially offset by efficiencies including lower manpower costs following the changes made to our defined benefit pension scheme where, from 1 January 2008, the scheme was closed to new entrants, the benefit structure amended and employee contribution rates were increased.

Energy costs at NWL for 2008/09 (£38.8 million) are over 50% higher than both last year and the level assumed by the regulator at the last price review. Although energy prices have softened recently, we expect them to remain volatile for the future. NWL has procured all its requirements for 2009/10, at prices c.5% lower than 2008/09, and procured 44% for the following year. This has been purchased in small tranches, in accordance with its risk management policy, to mitigate energy price movements.

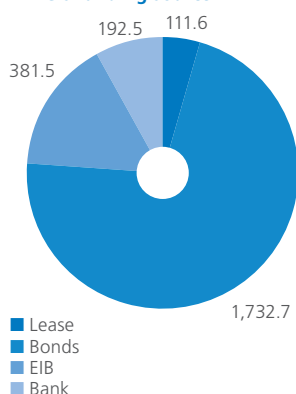
Interest charges increased by £13.7 million within which, cash interest charges decreased by £0.6 million. The non-cash elements of the increase reflect inflation on the index linked bonds (£6.2 million), a reduction in the expected return on pension assets (£4.1 million), an increase in the interest cost of pension plan obligations (£3.3 million) and an increase in other non-cash movements of £0.7 million.

At 31 March 2008, the Group's debt structure included £440 million of index linked bonds which increase in line with the July RPI. The RPI adjustment for July 2008 was 5.05% and, therefore, the principal accretion and interest charge for the year ending 31 March 2009 increased by £22 million. Current forecasts for the July 2009 RPI indicate a negative adjustment, in which case the interest charge for 2009/10 would be reduced significantly.

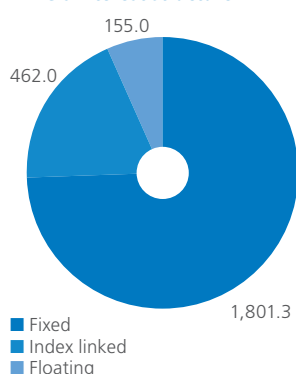
Profit on ordinary activities before tax for the year was £152.7 million, 10.3% lower than the previous year (2008: £170.3 million). The current tax charge of £32.1 million (2008: £25.6 million) has increased, despite a reduction in profitability, mainly due to changes in the tax rules on capitalised maintenance expenditure, the phased abolition of industrial buildings allowances and the timing of relief for prepaid pension contributions, offset by a 2% reduction in the corporation tax rate.

The deferred tax charge of £132.5 million (2008: credit, £13.6 million) includes a one-off charge of £117.2 million following the withdrawal of industrial buildings allowances in the Finance Act 2008. NWL included the impact of reduced allowances in its Final Business Plan submission to Ofwat for the period 2010-2015. The deferred

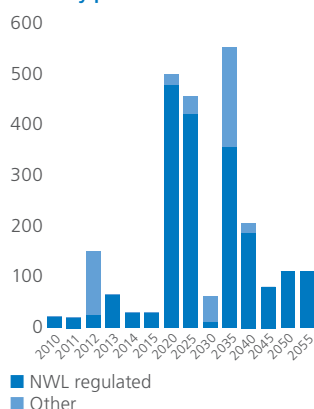
NWG's funding source £m



NWG's interest structure £m



NWG's gross debt maturity profile £m



tax credit in 2008 reflected the change in the tax rate from 30% to 28% and resulted in a credit of £35.4 million.

Excluding the one-off charge of £117.2 million attributable to the Finance Act 2008, the effective tax rate for the period was 31% (2008: 28% excluding the credit of £35.4 million).

Earnings per share and dividend cover

Basic and diluted loss per share for the year were 2.45 pence. In 2008, basic and diluted earnings per share were 30.52 pence and 30.48 pence respectively. Earnings per share from continuing operations, adjusted for deferred tax and the amortisation of debt fair value, were 22.05 pence (2008: 26.72 pence).

A final dividend of 8.50 pence per share for the year ended 31 March 2009 will be recommended by the Board to shareholders at the AGM on 30 July 2009 and, if approved, will be paid on 11 September 2009 to shareholders on the Company's Register of Members at the close of business on 14 August 2009. Together with the ordinary interim dividend of 4.29 pence per share, the ordinary dividends paid and proposed for the year will be 12.79 pence per share (2008: 12.07 pence per share). This represents an increase of 6%, based on average inflation over the year of 3%, on the ordinary dividend for the previous year and is consistent with the Board's decision to maintain a progressive dividend policy with real increases of around 3% per annum. The board of our main subsidiary, NWL, has proposed a dividend policy consistent with the underlying assumptions adopted by Ofwat at its price review in 2004.

The dividend cover for the year, excluding deferred tax and the amortisation of debt fair value, was 1.8x (2008: 2.3x). The cover level has reduced principally as a consequence of the application of higher RPI to the index linked bonds and a significant increase in energy costs.

Northumbrian Water Share Scheme Trustees Limited, which at the date of this report held 1,038,252 shares

to be used in the future to satisfy the vesting and exercise of awards under the Company's Long Term Incentive Plan (LTIP), has waived the right to all dividends on the shares it holds. Further details of the LTIP can be found in the directors' remuneration report on page 57.

Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). This is consistent with IFRS as adopted by the European Union as it applies to the financial statements of the Group for the year ended 31 March 2009.

Capital structure

On 19 September 2008, a further European Investment Bank (EIB) facility of £120 million was drawn by NWL on a fixed rate basis with a 17 year maturity and an amortising principal repayment profile.

On 29 September 2008, a £50 million lease facility was fully drawn by way of a further tranche of £20.8 million. The lease was for renewed infrastructure assets and is at a variable rate linked to RPI with a final maturity in March 2043.

In October 2008, a variable rate EIB loan of £100 million maturing in March 2022 was swapped to a fixed rate of 4.98%.

In January 2009, £125 million variable rate debt at Northumbrian Services Limited was fixed at a rate of 2.80% to its maturity in May 2011.

As stated, the Group has converted £225 million of variable rate borrowing to fixed rate. As a consequence, the Group's and NWL's regulated business debt structure has changed to 75% (NWL: 71%) fixed at an average rate of 5.80% (NWL: 5.99%), 19% (NWL: 22%) index linked at an average real rate of 1.85% (all NWL) and 6% (NWL: 7%) on a variable rate basis.

Total cash and short term cash deposits available to meet the requirements of the business through to 2011 amounted to £252.9 million at 31 March 2009.

3. Financial performance continued

Credit rating

The credit rating for NWL has remained consistent throughout the year at BBB+ stable (Fitch and S&P) and Baa1 stable (Moody's).

Treasury policy

The main purposes of the Group's treasury function are to assess the Group's ongoing capital requirement, to maintain short term liquidity and to raise funding, taking advantage of any favourable market opportunities. It ensures access to medium term committed back up facilities renewable on a five year basis.

It also invests any surplus funds the Group may have, based on its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process, but the Group's policies prohibit their use for speculation. Full details are provided in note 20 to the financial statements. The Group is operating in compliance with its policies.

Cash flow/liquidity

As noted previously, the Group has substantial cash resources and undrawn committed bank facilities available to maintain general liquidity.

Pensions

The Group operates both a defined benefit pension scheme, which closed to new entrants on 31 December 2007, and an occupational defined contribution arrangement which began on 1 January 2008.

The surplus (under IAS 19) of the defined benefit scheme of £90.5 million, at 31 March 2008 has moved to a deficit of £119.4 million at 31 March 2009. This is mainly due to the fall in the market value of the scheme's assets since March 2008 and a reduction in the discount rate assumption to 6.1% (March 2008: 6.8%) to better match the average duration of the schemes liabilities.

The triennial actuarial valuation of the final salary scheme as at 31 December 2007 is complete and the formal report and certificates were signed in November 2008. The valuation resulted in a surplus of £42 million (6%) on an

'ongoing' basis, which takes into account the prepaid contributions (in 2006 and 2007) for the period up to 31 December 2010. While the actuarial valuation incorporates longer term forecasts and assumptions than the IAS 19 valuation, the prevailing market conditions are difficult and we will continue to monitor carefully. The Final Business Plan submission to Ofwat included a proposal for deficit recovery contributions.

Creditors

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. The Company's policy is to make payment not more than 30 days after receipt of a valid invoice, except as otherwise agreed. The ratio, expressed in days, between the amount invoiced by its suppliers during the year and the amount owed to its trade creditors at 31 March 2009, was 20 days (2008: 13 days).

Structure of the Company's share capital

The authorised share capital of the Company is £70,000,000 divided into 700,000,000 ordinary shares of 10 pence each. As at 31 March 2009, the Company had 518,623,845 ordinary 10 pence shares admitted to trading.

Rights and obligations attaching to the shares

The rights attaching to the shares in the Company are set out in the Articles and may be changed with the approval of the shareholders. Subject to the provisions of the Companies Acts, shares may be issued with or have attached thereto such preferred, deferred, qualified or other rights or such restrictions, whether in regard to dividend, voting, return of capital or otherwise, as the Company may by ordinary resolution determine or, if there has not been any such determination, as the Board may determine.

Shareholders are entitled to requisition a general meeting of the Company and to attend, vote and speak at general meetings, in accordance with the Companies Acts and the Articles. Shareholders have the right to appoint proxies.

Restrictions on the transfer of shares

Any shareholder may transfer a certificated share, as defined in the Articles, by an instrument of transfer in the usual form or in such other form as the Board may approve. However, the transfer of an uncertificated share, as defined in the Articles, need not be in writing and shall comply with any rules adopted by the Board under Article 13.7. The Board may, however, in its absolute discretion and without assigning any reason, decline to register any transfer of any share that is not a fully paid up share or on which the Company has a lien, provided that such discretion may not be exercised in such a way as to prevent dealings in the shares from taking place on an open and proper basis. The Board may also decline to register any transfer unless:

- in the case of a certificated share, the instrument of transfer, duly stamped, is lodged with the Company accompanied by the certificate for the shares to which it relates and such other evidence as the Board may

- reasonably require to show the right of the transferor to make the transfer;
- in the case of a certificated share, the instrument of transfer is in respect of only one class of share; and
- in the case of a transfer to joint holders of a certificated or uncertificated share, the number of joint holders to whom the share is to be transferred does not exceed four.

If the share to be transferred is an uncertificated share, the Board may refuse to register a transfer if the Uncertificated Securities Regulations 2001 allow it to do so.

Additionally, where a member or other person on whom a Disclosure Notice has been served (pursuant to section 793 of the Companies Act 2006) and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction declining to register any transfer of shares, other than a sale to a bona fide unconnected third party.

Significant shareholdings

Details of shareholders with significant holdings in the Company's issued share capital are set out below:

	Number of shares at 31.3.2009	% share capital	Number of shares at 2.6.2009	% share capital
Ontario Teachers' Pension Plan Board	138,776,864	26.76	138,776,864	26.76
Amvescap PLC	78,021,024	15.04	78,007,151	15.04
Pictet Asset Management SA	35,407,090	6.83	35,399,120	6.83
Legal & General Investment Management Ltd	16,536,333	3.19	16,715,683	3.22

Restrictions on voting rights

In accordance with the Company's Articles, no member shall, unless the Board otherwise determines, be entitled to be present or to vote, either personally or by proxy, unless all calls or other sums presently payable by him in respect of shares in the Company have been paid.

Additionally, where a member or other person on whom a Disclosure Notice (pursuant to section 793 of the Companies Act 2006) has been served and has not, within the period specified, supplied to the Company the information required in respect of any shares, the Board may impose a sanction

preventing the member from attending and voting at any general meeting.

Shares required to fulfil vested awards made under the Northumbrian Water Group plc Employee Trust are acquired through Northumbrian Water Share Scheme Trustees Limited. In line with ABI guidelines, dividends and voting rights are waived on these shares. At 31 March 2009, the Employee Trust held a total of 1,038,252 shares.

The deadline for delivering either written or electronic proxy voting forms is 48 hours before the appointed time of the meeting.

3. Financial performance continued

Appointment and replacement of directors

The Company may by ordinary resolution appoint any person to be a director. The Board may also appoint directors, either to fill casual vacancies or as an addition to the Board, but any director so appointed shall hold office only until the next following AGM and shall then be eligible for re-appointment, but shall not be taken into account in determining the number of directors who are to retire by rotation at such meeting. These provisions will apply to John Cuthbert's successor if the appointee is not an existing director. A director retiring by rotation at an AGM shall be eligible for re-appointment. Details of the directors retiring by rotation at this year's AGM are set out in the Notice of Meeting.

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. The work of the Nomination Committee is described in the corporate governance report.

The Company may by special resolution, or by ordinary resolution of which special notice has been given in accordance with the provisions of the Companies Acts, remove any director before the expiration of his period of office and may by ordinary resolution appoint another person in his place. Any person so appointed shall be subject to retirement

at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director. The Company will be proposing a Special Resolution at this year's AGM to amend its Articles of Association to provide for the annual re-election of all directors.

Amendments to the Company's Articles

The Company may amend its Articles by passing a special resolution of its members. The Company will be proposing a Special Resolution at this year's AGM to amend its Articles, as mentioned above. The proposed changes are explained in the Notice of Meeting.

Powers of the Board

The Articles provide that the business of the Company shall be managed by the Board, which may exercise all such powers of the Company as are not required (by the Companies Acts or the Articles) to be exercised by the Company in general meeting. Subject to the Companies Acts, the Memorandum of Association, the Articles and any directions given by special resolution, the Board may, inter alia:

- establish local or divisional boards or agencies to manage any of the Company's affairs and appoint any persons to be members of such local or divisional boards, or agents, and fix their remuneration;

- appoint attorney(s) for such purposes and with such powers, authorities and discretions and for such period and subject to such terms and conditions as it may think fit;
- delegate its powers to any director;
- sign, draw, accept, endorse or otherwise execute all cheques, promissory notes, drafts, bills of exchange and other instruments and all receipts for moneys paid to the Company in such manner as the Board shall from time to time determine;
- exercise all of the powers of the Company to grant and pay pensions, annuities, gratuities, superannuation or other allowances and benefits in favour of any person; and
- exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property and assets and uncalled capital of the Company and to issue debentures and other securities for any debt, liability or obligation of the Company or of any third party.

Allotment of shares

Subject to the provision of the Companies Acts, the Articles and any authorising resolutions passed in general meeting, the unissued shares of the Company shall be at the disposal of the Board, which may offer, allot, grant options over or otherwise dispose of

them to such persons, at such times, for such consideration and upon such terms and conditions as the Board may determine. The directors are not currently authorised to allot shares but the Company will be seeking authority from shareholders at this year's AGM for the directors to allot shares during the ensuing year, although, at present, the Company has no intention of doing so.

Purchase of own shares

Subject to the provisions of the Companies Acts and the Articles and to any confirmation or consent required by law, the Company may from time to time purchase its own shares. The Company is not currently authorised to purchase its own shares but will be seeking authority from shareholders at this year's AGM to purchase its own shares during the ensuing year, although, at present, the Company has no intention of doing so.

Significant agreements

As at 31 March 2009, NWL had £381.5 million of loans provided by the EIB and the applicable terms include change of control clauses. If, after consultation with NWL, the EIB is of the opinion that a change of control has had or is likely to have a material adverse effect, then the EIB could seek early repayment of the loans plus, in certain circumstances, a premium.