Interim Financial Information and Report

For the six months ended
30 September 2018 (Unaudited)

Southern Water

Contents

Interim management report – operational performance

We are pleased to publish an update on our performance at this halfway point in the financial year.

Our focus over the past six months has been to continue to transform our business, changing how we work, the partnerships we develop in our communities, shifting our outlook so that we can achieve our vision of **'a resilient future for water for customers in the South East'.**

In September we submitted our business plan 2020–25 to our regulator, Ofwat, and anticipate its initial draft determination in January 2019. It outlines our plans to achieve our vision and includes 43 separate commitments to our customers and a range of ambitious transformational programmes that will change the way we deliver our services and enhance the communities we serve. It means us becoming brilliant at delivering the basics, while achieving long-term goals, co-created with customers and stakeholders, which are:

- ***Resources*** *– We work together to recycle every drop of water.*
- ***Environment*** *– We keep rivers, lakes, reservoirs and coasts healthy and clean.*
- ***Economy*** *– We collaborate to build a resilient economy for the South East.*
- ***Communities*** *– We innovate together to create sustainable communities.*
- ***Value*** *– We recognise the value of water in our daily lives.*

Our business plan has also taken into account the UK Government's 25-year plan to improve the environment, the National Infrastructure Commission's report on preparing for a drier future, and our own 2017 Water Futures report, which identified major trends, including global climate change, new forms of regional governance, ecosystem thinking, the growth of innovation, and the changing cultural values of the public, our customers and stakeholders.

In order to ready ourselves to deliver this ambitious plan, we have put in place a detailed Pathway to PR19 that will see us fundamentally change the way our business is run, underpinned by ethical business practice, a strong purpose and authentic values that will help to reinforce cultural change within the business. This change will see us co-create our future with customers, stakeholders and partners, to provide water for life to improve health and wellbeing, protect the environment and sustain the economy.

Overview

In a number of areas our historic performance has not been as good as our peers and we are working hard to make improvements. While we are pleased to celebrate a number of successes, we also recognise that we have more to do. We know we also need to address historic challenges from our regulators Ofwat, the Drinking Water Inspectorate and Environment Agency regarding reporting standards and data quality. We remain fully focused on improving our performance in those areas where we have fallen short of the expectations of our customers and wider stakeholders.

The following is a summary of performance highlights and key challenges from April to September 2018:

- *Ofwat has revealed how we performed against other water companies in its second quarterly Service Incentive Mechanism (SIM) customer satisfaction survey of 2018–19. Our overall score was 4.32, putting us 10th out of the 18 companies in the industry table. With two surveys now completed in 2018–19, we are 13th for the year, to date, an improvement on our position in March 2018 of 15th.*
- *In the Consumer Council for Water's (CCW's) Consumer Complaints Annual Report, published in September 2018, we were still at the bottom of the industry league tables, despite having reduced written complaints by 59% over the past two years. Since April 2018, we have seen a further reduction of 32% on written complaints reported at the same point last year. CCW has now confirmed that based on our performance in the first half of this financial year we would have moved off the bottom of its league table.*
- *Almost 30% of our customers are now transacting with us online, at a time that is convenient to them.*
- *We have recorded 9,000 interactions with customers in vulnerable circumstances, who we have helped with individual advice about debt management, including the range of support services and payment schemes we offer. Since April 2015 we have recorded interactions with more than*

257,000 customers, higher than our target of reaching 183,496 at this point in our five-year business plan.

- *Our number of unwanted billing queries remains above target at 67,387, although this number is falling. In September, 10,200 unwanted billing and charges calls equate to 14% of calls handled, down from 15% in August 2018 – this represents 4,800 fewer unwanted contacts than in August 2017.*
- *Our leakage rate for this year is higher than expected, at 99.45 Ml/d, following the unusual freeze thaw event in March and the hot dry summer*, and we will exceed our year-end target. As we have met our leakage target for the past three years, we are disappointed by this increase and we are now investing in more resources and repairing more leaks than ever before in order to reduce this figure and meet our five-year target and the expectations of our customers.*
- *We are still on track to reach our year-end target of 0.58 blockages per kilometre, recording only 0.25 per kilometre so far this year. There have been 9,685 blockages reported to the end of September 2018, as a result of reduced water flow through the long, hot summer months – this is 700 incidents more than at the same point last year.*
- *So far this year we have recorded 123 category three (less serious) pollution incidents, which is an increase on 117 for the same period last year, but we want to do much better. Unfortunately so far this year we have reported five serious, category one and two, pollution incidents, although several of these were still under investigation at the time of publication.*
- *The heatwave in 2018 lasted for two months, during which time there was very little rain and temperatures remained high. Understandably all of our customers used more water and therefore usage per person, per day increased to 139 litres from 128.9 at March 2018.*
- *We implemented our new policy on our use of plastics to help our company, employees, suppliers and customers reduce plastic waste wherever possible. Our wide-ranging policy is the first of its kind for a water company.*
- *Since April our water efficiency team has conducted 2,389 free water-saving home visits, and 10 Waterwise talks in our communities.*
- *Our community team attended 42 events, engaging with more than 240,000 customers and visitors to our region about issues such as how to save water, energy and money and prevent sewer blockages and pollution incidents in their communities. In addition our roadshow vehicle was deployed across the region to help customers facing heatwave-related issues with practical support and advice.*

**The freeze thaw event had an impact on the amount of water we put into supply (our distribution input) in a number of ways. In the first instance we saw an increase in bursts. These bursts have inevitably weakened our network in places, resulting in an elevated rate of bursts and repairs. This situation was further compounded by the clay soil across our region drying out over the hot summer months, which has led to further bursts.*

Update on regulatory investigations

As disclosed in our Annual Report for 2017–18, the company faces investigations by the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of our wastewater treatment sites and the reporting of relevant compliance information, focused on the years from 2010 to 2017. We are working proactively with the Environment Agency and Ofwat to resolve their investigations which are still evolving. In relation to the ongoing investigations by Ofwat, the Environment Agency and the company itself, the company has recently adopted the prudent course of bringing the matter to the attention of the law enforcement authorities.

The Ofwat investigation could result in Ofwat taking enforcement action. This may include the imposition of a fine, which could be material in nature as Ofwat can impose a financial penalty of up to 10% of turnover of the relevant area of the business for each breach dependent on the severity of the findings of the investigations. It is possible that the other investigations may also result in fines being imposed. We are, however, committed to ensuring that our customers are not disadvantaged as a result of these matters. We are exploring direct customer reparation schemes which, consistent with some recent regulatory precedents for different matters (where reductions in customer bills or agreed additional expenditure have been agreed), may result in mitigation of some direct financial penalties.

However, reflecting the lack of firm precedent, the early stage of discussions with Ofwat, and as this is subject to ongoing discussion and agreement reflecting, amongst other matters, the reparation actions to be taken by the company, the amount of any potential fine and/or financial penalty is presently unquantifiable.

The company has also revisited the reporting of the Wastewater Treatment Works number of failed works and population equivalent performance measures provided in previous years. We have been performing a review of the relevant reported wastewater data for the years from 2010 to 2017. Whilst we have had that review independently verified, it is subject to a number of limitations and variable factors. We have very recently engaged in a discussion with Ofwat regarding the initial findings from the review and the consequences in relation to potential serviceability and Outcome Delivery Incentive penalties that should have been applicable in respect of AMP5 and AMP6. As a result of our initial findings from the review, we expect that we will have to make an adjustment to our Regulatory Capital Value (RCV) in respect of the period reviewed in the Ofwat 2019 Final Determination and that, as a result, there will be a reduction in future revenues. We intend to work closely with Ofwat to resolve this matter in the coming months, but until the further investigations and discussions with Ofwat are further advanced it is not possible to reliably estimate the reduction to RCV that may arise.

Our new Compliance and Asset Resilience directorate is leading improvements in our business processes and systems, governance and controls as well as data integrity and the planning, scheduling, monitoring and performance reporting to the Environment Agency and Ofwat. Further information on this programme can be found in our Final Assurance Plan 2018, which is available on our website **southernwater.co.uk/our-reports**.

How we measure our progress

Our current performance commitments are detailed in our five-year business plan for 2015 to 2020 and are based on six key areas that our customers said they wanted us to focus on: Responsive customer service; Affordable bills; Better information and advice; A constant supply of high-quality drinking water; Removing wastewater effectively and Looking after the environment.

We measure how well we are doing against a series of targets we told customers we would meet. From 2015–20, we said we would spend more than £3 billion improving water and wastewater services, with £1.8 billion invested in new and improved assets alone, equivalent to almost £1,000 for every property in our region.

You can read a more detailed account of our performance, as at March 2018, in our Annual Report and Financial Statements 2017–18 at: **southernwater.co.uk/annual-report**.

Our Customer Challenge Group (CCG), which was set up to independently monitor our business plans and delivery performance, reports back to customers, stakeholders and regulators on its view of our progress. Copies of the latest CCG reports are available to download at: **southernwater.co.uk/customer-challenge-group**.

All performance figures stated in this report are based on our unaudited internal reporting. These will be independently assured at the end of the 2018–19 financial period by our external non-financial auditors and reviewed by the CCG.

Trust and transparency

As part of the process of putting together our business plan 2020-25, we carried out three strands of research to explore the issues of trust, financial transparency and financial structure. YouGov carried out this research independently on our behalf.

This included:

- *deliberative workshops (May 2018) – two separate two-and-a-half hour workshops with representative groups of customers.*
- *in depth stakeholder interviews (July 2018) – anonymous interviews with a group of 12 stakeholders chosen by YouGov from a long list provided by us, to cover a diverse range of interests represented.*
- *an online survey (July 2018) – Around 1,000 customers, chosen by YouGov with a mix of age, gender, region and social grade, representative of the demographic of our region.*

This research and information gathered from a range of sources has led to us carrying out or planning a wide range of measures to address issues of trust.

This table shows how we are performing against our business plan commitments in 2018–19

In summary:

- On track
- At risk
- Needs attention

Responsive customer service	
SIM qualitative score	At risk
Number of GSS payments made	On track
% of contacts resolved first time	Needs attention
% of customers who feel our service meets their needs and those of their community	At risk
Affordable bills	
% customers think we are providing value for money	At risk
Customers in genuine hardship provided with improved support	On track
Better information and advice	
Per capita consumption (l/head/day)	Needs attention
Number of unwanted billing queries	Needs attention
% of customers who agree they are aware of the causes of blocked drains	On track
% of customers who agree they are aware of how their money is used	At risk
% of customers who are aware of how to deal with hard water	At risk
A constant supply of high-quality drinking water	
Customer minutes lost supply >3 hours	On track
Leakage (Ml/day)	Needs attention
Mean Zonal Compliance %	On track
Number of contacts regarding discolouration	On track
Number of properties with low water pressure	Needs attention
Maintain asset health	On track
Removing wastewater effectively	
Number of blockages per km/year	On track
Number of internal flooding incidents	On track
Number of external flooding incidents	On track
Number of customer complaints – odour	Needs attention
Maintain asset health	On track
Looking after the environment	
Wastewater treatment works compliance %	On track
Maintain bathing waters at 54	On track
Number of serious pollution incidents	Needs attention
Number of category 3 pollution incidents	On track
Distribution input (Ml/day)	Needs attention
Renewable energy usage	On track

Measures already underway, or planned include:

- *a re-financing which will reduce gearing at Southern Water, maintain strong financial resilience into the future, and reduce the value of the inter-company loan to SWSG*
- *a commitment to make our tax status clearer and easier to understand*
- *a revised dividend policy, which will be further updated*
- *a revised policy on the bonus element of executive pay, which will be further updated*
- *closure of the Cayman Islands subsidiary.*

Working for our customers

Responsive customer service

Each year, our regulator, Ofwat, produces a customer satisfaction league table, which ranks us against other water companies in the UK. With two surveys now completed in 2018–19, we are 13th for the year to date, an improvement on March 2018 when we were 15th.

These results show an increase in our billing score, and our operational scores are consistently performing above the industry average, although we know we still have work to do to improve customer satisfaction further.

Our written complaints performance during 2017–18 was much improved, with a further reduction of 20% on 2016–17 figures, that is a reduction of 59% in the past two years. However, as documented in the Consumer Council for Water's (CCW's) Consumer Complaints Annual Report, published in September 2018, we remained at the bottom of the industry league table for 2017–18. In this financial year we have continued to improve performance in this area, further reducing written complaints by 32% from April to September. CCW has now confirmed that based on our performance in the first half of this financial year we would have moved off the bottom of its league table.

Our number of unwanted billing queries remains above target at 67,387, although this number is falling. In September, 10,200 unwanted billing and charges calls equate to 14% of calls handled, down from 15% in August 2018 – this represents 4,800 fewer unwanted contacts than in August 2017.

We are always working hard to make life a little easier for our customers, and in the past six months we have introduced a number of internal initiatives and new services that are doing just that:

- *New customers moving into our area can now set up an account with us online, and even complete their first meter readings without having to pick up the phone.*
- *30% of our customers are now transacting online, at a time that is convenient to them.*
- *Customers can now more accurately set their monthly payments due to changes to a number of our payment schemes, reducing confusion and repeat contact.*
- *An internal Make it Count campaign is encouraging our agents to always 'get it right first time' for our customers by keeping our interactions simple and easy.*
- *Customers are now receiving more accurate bills thanks to a redesigned meter reading process. Again this is helping to reduce the need for them to contact us.*
- *All water usage queries are now handled by a dedicated team, whether that is reporting of leaks or questions around spikes in the amount of water people are using.*
- *Customers are also starting to experience the benefits of our move to a single Customer Service partner for all direct contact, rather than getting passed from team to team.*

We still have a long way to go to meet the standards our customers expect but the changes we have introduced this year mean we are more proactively managing customers' accounts and resolving more problems the first time they call us.

Affordable bills

Over the past two years our dedicated teams have helped more than 32,500 customers in vulnerable circumstances to avoid debt or manage their payments better, since April 2018 we have recorded 9,000 interactions alone.

In addition, our **Reach & Support** initiative, in partnership with organisations and local councils, is allowing us to better engage with customers in need of extra support so that we can predict when they might need help from us, and what that looks like.

Since April 2015 we have recorded interactions with more than 257,000 customers to offer them tailored advice about how to pay their bills and tackle debt, higher than our target of reaching 183,496 at this point in our five-year business plan. We are very pleased that this means we are on track to far exceed the targeted number of customers helped by our affordability programme by 2020.

This support comes in the form of home visits by our specialist partners offering independent counselling on managing debt, advice on how to access the help they may be entitled to or guidance on applying for the right Southern Water scheme or tariff to help make life a little easier.

Through our **Here to Help** social media campaign over the summer we were able to reach around 17,000 customers highlighting our support schemes and tariffs. We also produced a communications pack for local charities, councils and NGOs, which included template press and social media copy and imagery, offered tips on social media, messaging and creating a clear call to action. By adopting this co-ordinated approach we can better encourage communities to take action through a ripple approach to campaign messaging.

Better information and advice

We have a duty of care to ensure that customers have the right information available, when they need it most. This means constantly talking to customers and stakeholders about the issues that are important to them.

Our region faces a future of more people and less water. Our population is growing fast, and climate change is bringing greater risk of both flooding and drought. It is a challenge we will only solve by working closely with customers, communities and partners.

This was a particular priority over the summer as we experienced an extended heatwave. Understandably, our customers used more water and therefore usage per person, per day increased to 139 litres from 128.9 litres on average. Typically, over the summer months, we would expect demand to increase to around 600 million litres per day (Ml/d), however this year that peak reached 640 Ml/d. This meant putting an extra 3,802 million litres of water into supply over the hottest two months of the summer.

As a result, we placed a priority on proactive water efficiency publicity including digital and radio advertising. The success of the campaign was reflected in visitor numbers to our website, with customers looking for additional water-saving tips and advice. In May, there were 878 visits, in June 3,326 and in July there were 5,115 visitors before dropping back as the campaign eased off and the weather cooled.

Our Universal Metering Programme and water efficiency awareness campaigns have already significantly reduced the amount of water our customers are using by around 16% since 2010 to 128.9 litres per person, per day in 2017–18. In fact, we have one of the lowest levels of water usage, per customer of any water company in the UK – a fact we are particularly proud of.

We still want to do more though, and although the Government has challenged the entire industry to reduce water usage levels to around 120 litres per person, per day, our ambition is to get to 100 litres. Our industry leading **Target 100** (T100) initiative, one of the five transformation initiatives contained in our business plan 2020–25, is a commitment to, and agreement with, our customers. We will advise, support, incentivise and provide information on how to reduce their water use to 100 litres per person per day by 2040. At the same time we will reduce our leakage by at least 15% by 2025 and 50% by 2050.

To achieve our T100 goal, we need to work with developers, local authorities and other stakeholders to lobby for changes to sustainability regulations, co-create and co-deliver customer education campaigns, trial new technologies such as smart meters and new ways of working, and share vital data and best practice across industries. We have already started to engage with these partners to get this initiative off the ground.

Our water efficiency, fat oil and grease (FOG) and community teams of advisers and engineers have continued to offer customers across our region advice on how to save water, energy and money, and how to prevent flooding from sewers in their homes.

Since April our water efficiency team has conducted 2,389 free water-saving home visits and 10 Waterwise talks in our communities, while the community team attended 42 community events, meeting hundreds of thousands of customers face-to-face.

Our FOG team also offered 370 sewer-flushing visits to customers experiencing blockages at their properties, and visited around 10,400 customers at home to educate them about the causes of these blockages. The team also visited 230 food businesses to offer them advice about grease management and delivered 64 presentations to different community groups across our region.

Delivering reliable services

A constant supply of high-quality drinking water

Ensuring our customers have a constant supply of safe, clean drinking water is the most important service we provide. We are therefore pleased to report that in September we achieved 99.98% compliance with the Drinking Water Inspectorate's (DWI) quality measures.

We are also pleased to report strong performance in customer minutes lost to supply, achieving 3.6 minutes at this point in the year, largely due to increased customer awareness around how to report leaks. Unfortunately, we have fallen behind our own target on leakage for the past six months, recording 99.45 million litres per day, above the 87.1 million litres we were aiming for, largely due to the unusual freeze thaw event in March and the hot, dry summer*. Over the first three years of the five year regulatory period we are on target and we are investing in more resources and repairing more leaks than we have before in order to reduce leakage further and meet our target by 2020.

Since late 2017 our **Water First** programme has looked at improving our performance, capability and compliance across our water teams.

**The freeze thaw event had an impact on the amount of water we put into supply (our distribution input) in a number of ways. In the first instance we saw an increase in bursts. These bursts have inevitably weakened our network in places, resulting in an elevated rate of bursts and repairs. This situation was further compounded by the clay soil across our region drying out over the hot summer months, which has led to further bursts.*

The programme has five main priorities:

- *Delivering best practice policies, procedures and work methods*
- *Developing systems that provide assured water quality data on time*
- *Critically reviewing and improving our assets*
- *Improving our approach to managing risks across all water activities, and*
- *Provide for better communication about water quality throughout the organisation.*

It also features a number of initiatives looking at water quality from source to tap.

Hazard Reviews – One of the largest initiatives within Water First, this project involves a detailed audit and review of our water treatment works, looking at the quality of the water entering the sites from the local catchment, the treatment processes, and the overall site itself. The outcomes of these audits – and action plans to resolve issues – are then shared with our water quality regulator, the Drinking Water Inspectorate (DWI). We have shared our approach with other companies.

Water First is also trialling an innovative new water quality monitoring system in the Southampton area, which involves a sensor device being placed directly into the water network via a hydrant, which can then provide real-time water quality data.

Catchment First – One of our five transformational programmes written into our business plan 2020–25, Catchment First will help monitor pollutants to understand their impact on raw water resources. Our Catchment Officers have already been consulting with local farmers and landowners to develop a number of grant schemes to raise awareness about issues such as phosphate run off and oil and septic tank pollution, which can affect local rivers and streams, as well as underground water sources.

As water quality in the UK generally remains of a high standard, the DWI has introduced a new risk based approach to target those areas of risk where performance can and therefore should improve further. The new metrics give an indication of relative risk to the individual consumer. They are weighted by population and therefore bring into focus issues at larger works. We were below industry average for Compliance Risk Index (CRI) in 2017, and our Event Risk Index (ERI) was the worst performing in the sector due primarily to a single event at a very large water supply works. To date in 2018 we have also had a large event at Testwood Water Supply Works, which is undergoing significant improvements.

Significant asset replacement is in progress in order to stabilise asset performance and improve ERI and CRI, with major rebuilds at large works such as Testwood and Otterbourne from 2017 to 2025.

Improving the resilience of our services

In light of the fact that 3,000 of our customers were affected by the impact of the 'Beast from the East' and subsequent rapid thaw in February to March 2018, we have put in place a number of key improvement programmes to enhance our overall operational resilience.

Our plan was developed in consultation with our CCG and the Consumer Council for Water, as well as Local Resilience Forums, and covers the improvement areas recommended in Ofwat's 'Out in the Cold' report, including incident preparedness and incident management, providing alternative water supplies, and strengthening customer support, communication and compensation. The plan is available at: **southernwater.co.uk/freeze-thaw-response**.

We are also leading a project with Water UK and The Water Resources in the South East (WRSE) group in areas such as mutual aid, non-household retail, stakeholder engagement, bulk supplies and bottled water provision.

Resilience is at the heart of our recently submitted PR19 business plan and we are committed to transforming Southern Water in order to achieve our ambition to create a resilient water future for customers in the South East.

Removing wastewater effectively

Although we have seen an increase in the number of blockages reported by customers this year due to the dry weather we experienced during the summer, we have still managed to keep blockages on our network at 0.25 per kilometre of sewer – better than our target for this point in the year of 0.28. This is largely a result of our Fat, Oil and Grease (FOG) team's targeted campaigns across our region and home visits to customers in hotspot areas (see Better Information and Advice, page 8).

We are also on track to further reduce external flooding incidents across our network this year, recording a figure of 3,566 across our region at this point in the year – significantly lower than our target of keeping external floods to fewer than 4,300.

Our new **Environment+** programme aims to improve visibility and governance at all our wastewater treatment works to identify compliance risks and potential issues. As of September 2018, we have addressed over 500 specific corrective actions as part of this improvement programme. This holistic programme will encompass a number of workstreams across Water Supply, our Wastewater Network, Wastewater Treatment, Waste Management and Emissions and Catchment, and as with **Water First**, it is underpinned by improvements in people, processes, systems, culture, training, and risk and information management. A significant focus is improving risk management, asset improvements and expanded catchment management.

Looking after the environment

We are committed to improving and enhancing the environment in which we, and our customers, live and work.

We are continuing to recycle 100% of the waste produced as a by-product of our wastewater treatment process, and have also been steadily increasing the amount of renewable energy used in our operations.

So far this year we have recorded 123 category three (less serious) pollution incidents, which is an increase on 117 for the same period last year, but we want to do much better. An 'Eyes and Ears' engagement campaign across all of our operational teams and among key regional stakeholders means that more incidents are now being reported to the Pollution Team, which means we are able to look at root cause, and proactively ensure equipment is fixed or replaced as a priority.

Unfortunately so far this year we have reported five serious, category one and two, pollution incidents, although several of these were still under investigation at the time of publication.

A serious electrical fault at our Budds Farm wastewater treatment works in Portsmouth, led to a 21-minute discharge of highly-diluted, double-screened wastewater from the storm tanks into the short sea outfall at Langstone Harbour in September. Our teams have been working hard to ensure a permanent fix is put in place to ensure this does not happen again; four new generators are now installed at the site to provide the necessary backup should the power supply fail.

Other incidents at Tangmere, Uckfield and Stoke were made worse by a build up of unflushable items, such as nappies and sanitary products over the prolonged period of dry weather we experienced over the summer months and a lack of flow through water courses, which caused a number of serious blockages and wastewater spillage from our sewers. We know the adverse impact these incidents can have on the environment and how unpleasant they are for our customers so we are making changes to our processes to further reduce the possibility of this kind of incident happening in the future.

We are committed to building better relationships with stakeholders and regulators in our region, such as the Environment Agency, to work on how we can improve our environmental record. As a result, we have continued our review of our end-to-end reporting processes and controls in relation to environmental data, as part of our Environment+ programme, already mentioned.

Direct benefits of the programme for 2018–19 include:

- *A focus on spill reporting and compliance*
- *A reduction in manual interventions, instead utilising IT systems and analytics*
- *Enhanced external assurance to strengthen corporate reporting*
- *Speedy identification and correction of failed or unreliable alarms or telemetry equipment*
- *New monitoring telemetry for water and wastewater*
- *Water supply outage recovery plan and delivery improvements*
- *Enhanced abstraction data quality assurance and metering improvements*
- *Refreshed sampling integrity and security*
- *Process reviews and assurance of our wastewater sampling programme.*

Earlier this year, we also launched a groundbreaking new policy on our use of plastics to help our company, employees, suppliers and customers reduce plastic waste wherever possible. Our wide-ranging policy is the first of its kind for a water company.

It includes:

- *carrying out an audit of our plastic use and setting targets for reduction*
- *working with our supply chain on reducing plastics and increasing recycling rates*
- *cutting out single-use plastics in our offices and operations, wherever possible*
- *helping promote water bottle refill schemes across our region to reduce reliance on single-use plastic bottles*
- *expanding our Unflushables campaign to highlight the environmental impact of plastic waste*
- *funding academic studies into the removal and recycling of plastic waste.*

We have also partnered with the national Refill campaign, which encourages our customers to carry refillable water bottles when they are out and about, and local retailers to provide a free refill service should they visit their establishment.

Our new plastics policy can be read in full at: **southernwater.co.uk/plasticspolicy**.

Perhaps the most visible example of our ongoing environmental management though is the improving condition of our bathing waters. During 2017-18 all 83 of our bathing waters met minimum standards of ‘sufficient’ with 53 at ‘excellent’ standard. As of November, 2018, that number rose to 55, with 23 ‘good’, and five ‘sufficient’. No bathing waters were rated as ‘poor’.

Our ongoing Beauty of the Beach campaign in partnership with the Environment Agency, continued up and down our 700 miles of coastline, over the summer months. It encourages our customers to take their litter home, avoid flushing anything other than pee, poo and paper down their toilets, and generally respect their environment so we can reduce pollutions and everyone can enjoy a clean, safe visit to their local beach.

Health, safety and wellbeing

Health, safety and wellbeing at work continues to be a priority and in these first six months of 2018–19 there has been a reduction in the year-on-year number of accidents.

In April, as mentioned in our annual report, we were notified of the award of the Order of Distinction from the Royal Society for the Prevention of Accidents (RoSPA), this is external recognition of our commitment to maintaining an excellent health and safety record over the past 19 years.

Our wellbeing group has been particularly active, running various campaigns from April to September 2018, including a focus on ‘Good Mental Health and Resilience’ which included 11 site visits, stress awareness and mindfulness sessions. The group also helped to arrange for training of 18 Mental Health First Aiders, with a long waiting list for more to join them.

We also held our annual health and safety and wellbeing conference with our suppliers to share best practice and highlight the importance of working together to ensure everyone feels safe when they come to work.

Our communities

Since April we have celebrated a successful conclusion to our two-year fundraising partnership with the Kent, Surrey & Sussex Air Ambulance Trust. We raised more than £137,000, beating our target of £100,000. It meant we were able to fund 15 life-saving missions.

Our new charity partner for 2018–20 is The Alzheimer's Society. We have set a target of £100,000 and will work with them to make Southern Water a dementia friendly and aware utility with specialist training for our vulnerability and affordability teams and advice and support for all employees who may be carers or have contact with people living with dementia. We will also be offering every Southern Water employee training to become a 'Dementia Friend', which will enable our employees to offer better services to vulnerable customers.

Each of our four regional charities for 2018–19 listed below received a grant of £10,000:

- *Battersea Dogs & Cats (Brands Hatch) – project to build a water-efficient laundry facility*
- *The Footprint Trust – refurbishing ponds project on the Isle of Wight*
- *Off the Fence – hygiene project for the homeless in Brighton and Hove*
- *The Aldingbourne Trust – supporting the construction of a community water-efficient garden in Bognor Regis*
- *Naomi House and Jacksplace children's hospices – building a sensory hydrotherapy pool for young patients and their families.*

To date this year, our employee volunteers have donated 253 days or 2,024 hours to charities and other good causes.

Meanwhile, our flagship Learn to Swim programme hosted its annual event for instructors from our pools and clubs. More than 60 instructors gathered to hear presentations on topics including disability swimming and techniques for engaging young swimmers.

We also partnered with the RNLI at five sites in our region over the summer to support safe swimming in the sea. More than 2,600 children attended the events.

With the spirit of collaboration in mind, in early summer we held our second conference for community engagement professionals at The Historic Dockyard Chatham. More than 80 community engagement professionals from companies including Legal & General, Gatwick airport, PwC, Welsh Water and the Environment Agency heard presentations on Science, Technology, Engineering and Maths education, volunteering and social insight.

In addition, our community team, alongside Southern Water employee ambassadors have attended 42 local community events over the summer. The total footfall for these events was more than 240,000. Our team were able to help with advice on Fat, Oil and Grease and unflushables, affordability and water efficiency. In addition the road show vehicle was deployed across the region over the summer to help customers facing heatwave-related issues with practical support and advice.

We also submitted our first return to the London Benchmarking Group. The data will enable us to compare our community engagement with companies across the other participating utilities and other sectors and improve our community engagement offering even further.

Looking ahead

The main focus for us in the coming months is to get our business ready to deliver the ambitious plan we have submitted to Ofwat, as part of the water industry's five-year price review process (PR19). As a result, we have put in place a detailed **Pathway to PR19** transformative programme with clear deliverables, milestones and benefits, as well as a range of fundamental changes to the structure of our business, underpinned by ethical business practice and significant culture change.

To support this plan, a new leadership governance framework has been created to oversee the delivery of these programmes, with Wholesale Transformation, Operations & Customer, Business Performance and Health & Safety and Compliance committees reporting on progress. In addition, 20 new workstreams have been created with clear sponsors and leads.

We know that we have fallen short of the expectations of our customers, regulators and other stakeholders in the past, which is why our Pathway to PR19 is focusing on capability, capacity and investment to frame our journey to a better business – building capability, delivering rapid improvements in performance by being more aware of our capacity and focusing on key priorities and investing in critical areas like IT to underpin our delivery confidence.

Our business plan 2020–25 is 25% bigger, as we are proposing to significantly increase investment to £4 billion from £3.2 billion 2015–20.

This plan has been rigorously challenged and assured internally and independently, co-created with more than 42,000 customers and endorsed by more than 40 key regional stakeholders who are already helping us deliver our ambitious vision of a resilient water future in the South East.

Interim management report – financial performance

Key financial performance indicators

	Six months ended 30 September 2018 Unaudited £m	Six months ended 30 September 2017 Restated* Unaudited £m	Increase/ (decrease) %
Revenue	**440.1**	418.7	5.1
Operating costs	**(300.5)**	(284.7)	5.5
Operating profit	**140.1**	134.5	4.2
Profit after taxation	**82.1**	108.6	(24.4)
Gross capital expenditure**	**187.0**	201.5	(7.2)
Net cash inflow from operating activities	**237.2**	216.3	9.7

*The prior year has been restated for the transition to IFRS 15 as explained in Note 3 to the interim financial information

**Excludes asset adoptions and capitalised interest

Income statement

Revenue for the period increased to £440.1 million (period to 30 September 2017: £418.7 million). This increase principally results from changes to our water and wastewater tariffs which are linked to RPI. Revenue also increased due to higher levels of consumption from the extended heatwave over the summer but this was offset by an increase in vacant properties. An analysis of revenue is detailed in note 5. Following the adoption of IFRS 15 'Revenue from Contracts with Customers', revenue from developers, in relation to new infrastructure is now recognised immediately, and our prior year numbers have been restated to reflect this. Futher details on revenue from developers and the effect of changes resulting from IFRS 15 are shown in note 3.

Operating costs for the first half of the year of £300.5 million increased by 5.5% (period to 30 September 2017: £284.7 million). This increase in costs is largely driven by inflation, together with increased deprecation arising from our capital programme, and increased expenditure following the effect of the extreme hot weather during the summer. We have also incurred further costs on completing our business plan for 2020–25 which was submitted to Ofwat in September. We have continued to invest in initiatives to improve our debt collection activities, as bad debt remains a principal risk.

As a consequence of the above, operating profit for the period increased by 4.2% to £140.1 million (period to 30 September 2017: £134.5 million).

Other income in 2017 amounted to £15.0 million and related to the sale of our non-household retail business to Business Stream.

Finance costs for the period decreased to £86.4 million (period to 30 September 2017: £91.8 million). This decrease was largely due to higher interest capitalised following the continued investment in our capital programme.

We raise finance in order to fund our capital investment programme. Our financial instruments comprise fixed, floating and inflation-linked loans and derivatives.

The inflation linked loans and derivatives are in place to match movements in our revenues and Regulatory Capital Value and we are required to measure the fair value movement of the derivatives through the income statement.

The fair value gain on our derivative financial instruments amounted to £17.6 million (period to 30 September 2017: £44.5 million). To calculate the fair value of our derivative instruments we discount their forecast future cash flows using UK Government bond yields. These future forecast cash flows are predictable, and match the future forecast movement in our revenues and Regulatory Capital Value, but government yields are constantly moving with the result that the valuation of our derivative instruments can be volatile. There has been a slight increase in gilt yields during the past six months which has resulted in a decrease in the liability associated with our derivative instruments for this period, despite there being little change to their future forecast cash flows. The changes in value that are recorded during the lives of derivatives, unless crystallised, do not represent cash flows.

Tax on profit from continuing operations amounted to a charge of £18.4 million (period to 30 September 2017: £23.1 million).

The profit from continuing operations after tax was £82.1 million (period to 30 September 2017: £108.6 million).

Statement of financial position

As at 30 September 2018, non-current assets were £6,844.1 million (£6,767.9 million at 31 March 2018), an increase of £76.2 million from 31 March 2018. This increase mainly results from capital investment of £187.0 million, sewer adoptions of £6.3 million, capitalised interest of £11.5 million offset by depreciation and amortisation of £128.6 million for the period.

Current assets decreased by £85.6 million from £490.4 million at 31 March 2018 to £404.8 million at 30 September 2018. This reduction primarily arises from a fall in cash of £52.6 million, explained in the cash flow analysis below, and a decrease in inter company debt with Southern Water Services (Finance) Limited (SWSF) of £49.0 million. We transfer funds to SWSF in order for it to make interest payments on its debt at the end of the year, but due to the timing of the weekend at the end of March 2018, payments relating to the prior year were made in the first week of April 2018 reducing our inter group debt in the current period.

Current liabilities of £636.8 million at 30 September 2018 were £73.2 million lower than at 31 March 2018. Current liabilities at 30 September 2018 include a lower interest accrual than March, of £56.9 million, due to the timing of interest payments on our bonds. Further there is a reduction in current borrowings following the repayment of our Class A1 preference shares of £12.9 million.

Long term borrowings have also remained largely in line with 31 March 2018, increasing by £8.3 million, from £3,652.4 million at 31 March 2018 to £3,660.7 million at 30 September 2018. This increase predominantly results from indexation charged on inflation-linked bonds for the period (£19.3 million) offset by the repayment of the A1 preference shares (£9.8 million). Gearing has increased by 1% from March 2018, to 78% at September 2018, comfortably within the requirements of our debt covenants of being below 85%.

The liability associated with our derivative financial instruments decreased by £17.6 million, from £1,288.0 million at 31 March 2018 to £1,270.4 million at 30 September 2018 largely due to a slight increase in government bond yields as described in the commentary in relation to the income statement on page 13.

The pension deficit at 30 September 2018 of £165.2 million (31 March 2018: £171.7 million) is based on the latest actuarial valuation as at 31 March 2018 updated by a qualified independent actuary to reflect the latest market yields and asset values as at 30 September 2018. The decrease in the deficit of £6.5 million largely results from the use of a higher discount rate following a rise in corporate bond yields.

The March 2016 triennial valuation and the timing and quantum of future contributions in relation to the deficit have now been agreed with the Trustees and Pensions Regulator.

Overall net assets increased from £1,128.3 million at 31 March 2018 to £1,195.6 million at 30 September 2018.

Our refinancing plan to maintain strong financial resilience into PR19 is progressing. Southern Water is expecting to receive sufficient funds to reduce our current gearing to below 70% and to restructure some of the inflation-linked derivative portfolio in order to reduce interest payments for the period from 2020 to 2030. There were £177.2 million of inflation-linked derivatives with mandatory breaks at March 2019 and these breaks have been extended to November 2025. These restructured derivatives have also been transferred to Southern Water Services Ltd, from Southern Water Services (Finance) Ltd, in preparation for the removal of the Cayman incorporated Southern Water Services (Finance) Ltd. Funds received by Southern Water will reduce the value of the inter-company loan to Southern Water Services Group Ltd.

Cash flow

The cash position decreased from £164.4 million at 31 March 2018 to £111.8 million at 30 September 2018, a reduction of £52.6 million.This resulted from net cash outflows in investing activities of £137.7 million and financing activities of £152.1million being offset by net cash inflows from operating activities of £237.2 million.These movements are explained in more detail below.

Net cash inflow from operating activities in the period amounted to £237.2 million (period to 30 September 2017: £216.3 million). This increase in cash inflow mainly results from higher operating profits and the impact of the sale of our non-household retail business to Business Stream on the timing of cash receivables in the prior period.

Net cash used in investing activities amounted to £137.7 million (period to 30 September 2017: £233.1 million). The decrease of £95.4 million primarily relates to the movement in the loan to our subsidiary SWSF. We transfer funds to SWSF in order for it to make interest payments on its debt at the end of the year, but due to the timing of the weekend at the end of March 2018, payments relating to the prior year were made in the first week of April 2018 reducing our inter-group debt in the current period.The corresponding movement in interest paid is disclosed and explained in the movements in financing activities below.

Net cash used in financing activities amounted to £152.1 million (period to 30 September 2017: £83.2 million) an increase of £68.9 million. This increase mainly results from higher interest paid, following the timing of interest payments on our bonds, since last year's payments fell into the first week of April 2018. We also repaid £22.7 million of preference shares. These increases were offset by a reduction in equity dividends paid, since the 2017 dividend payments included the the final dividend for 2016–17 of £63.2 million which was made in April 2017.

Equity dividends paid of £23.0 million relate to the Southern Water Services Group Limited (SWSG) dividend loop (period to 30 September 2017: £23.0 million). Under the SWSG dividend loop the company makes dividend payments via intermediary holding companies to SWSG. These dividends, along with associated group tax relief payments enable SWSG to pay the interest due to Southern Water Services Limited on an inter-company loan. The result of this is a circular transaction, the effect of which is a net cash flow for the company of nil.

Going concern

The directors have reassessed the principal risks associated with the company's business activities, together with the factors likely to affect its future development and position. As part of their review the directors have considered the need to repay the Class A £300 million bond due in March 2019 and £177.2 million of inflation-linked swaps with a legal maturity of March 2037 which include a mandatory break at March 2019. The bond will be repaid in March 2019 out of existing liquidity and the mandatory breaks on the inflation-linked swaps have been extended to 2025.

On the basis of their assessment of the company's financial position the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the interim financial information.

Principal risks

Risk management is a core component of our wider governance and internal control framework. It provides the overarching structure through which the company is managed to achieve its objectives.

The most significant risks facing us are referred to as 'principal risks'. These are monitored by our Executive Leadership Team which undertakes a review on a biannual basis and the Audit and Risk Review Committee which receives a risk report at its meetings 4 times per year.

The categories of principal risks and uncertainties that the business faces over the remainder of this financial year remain unchanged from those we reported in our last Annual Report and Accounts listed below (in no particular order).

- *Customer Service*
- *Bad debt*
- *Resilience to drought*
- *Resilience to flooding*
- *Resilient supply of good quality water*
- *Information security and governance*
- *Wastewater treatment works failures and pollution incidents*
- *Health and safety*
- *Financing our business*
- *Defined benefit pension scheme*
- *Compliance with regulations and legislation*
- *Delivery of our capital investment programme*
- *PR19 price review and regulatory reform.*

The significance and potential financial risks of these uncertainties change over time. The key matters of operational and financial performance relating to these risks since the annual report are provided within the interim management report on pages 3 to 15.

Further detailed descriptions of these risks and uncertainties and our risk management process is included in the Annual Report and Accounts for the year ended 31 March 2018, which can be found on our website **southernwater.co.uk/our-reports**.

Directors and their interests

The directors who held office during the period ended 30 September 2018 were:

Bill Tame
(Chairman)

Ian McAulay
(Executive director – Chief Executive Officer)

William Lambe
(Executive director – Chief Financial Officer)

Paul Sheffield
(Senior independent non-executive director)

Rosemary Boot
(Independent non-executive director)

Michael Putnam
(Independent non-executive director)

Ian Francis
(Independent non-executive director)
(appointed on 12 September 2018)

Gillian Guy
(Independent non-executive director)
(appointed on 12 November 2018)

Wendy Barnes
(Non-executive director)

Sara Sulaiman
(Non-executive director)

Alternate directors for the year were as follows:

Andrew Gilbert
(Alternate non-executive director for Sara Sulaiman) (resigned 4 October 2018)

None of the directors who held office during the period had any disclosable interests in the shares of the company or the group.

Directors' responsibilities statement

The directors confirm to the best of their knowledge that:

- *the report and condensed financial statements have been prepared in accordance with UK GAAP; and give a true and fair view of the assets, liabilities, financial position and profit of the company as required by Disclosure and Transparency Rule 4.2.4R;*
- *the report includes a fair review of the information required by Disclosure and Transparency Rule 4.2.7R (indication of important events) during the period and description of the principal risks and uncertainties for the remaining months of the financial period; and*
- *the report includes a fair review of the information required by Disclosure and Transparency Rule 4.2.8R (disclosure of related parties' transactions and changes therein).*

Signed on behalf of the Board who approved the half yearly financial report on 28 November 2018:

Bill Tame
Chairman

William Lambe
Chief Financial Officer

Condensed income statement

For the six months ended 30 September 2018

Condensed income statement for the six months ended 30 September 2018			
		Six months ended 30 September 2018	Six months ended 30 September 2017 Restated*
	Notes	**Unaudited**	Unaudited
Continuing operations		**£m**	£m
Revenue	5	**440.1**	418.7
Other operating income	5	**0.5**	0.5
Operating costs			
– before depreciation and amortisation		**(171.9)**	(161.1)
– depreciation and amortisation		**(128.6)**	(123.6)
Total operating costs		**(300.5)**	(284.7)
Operating profit		**140.1**	134.5
Other income	5, 6	**0.1**	15.0
Profit on disposal of fixed assets	5	**0.2**	0.6
Finance income		**28.9**	28.9
Finance costs		**(86.4)**	(91.8)
Fair value gains on derivative financial instruments		**17.6**	44.5
Net finance cost	7	**(39.9)**	(18.4)
Profit before taxation from continuing operations		**100.5**	131.7
Tax charge	8	**(18.4)**	(23.1)
Profit after taxation from continuing operations		**82.1**	108.6

* The prior year has been restated for the transition to IFRS 15 as explained in Note 3 to the interim financial information.

Condensed statement of other comprehensive income

For the six months ended 30 September 2018

Condensed statement of other comprehensive income for the six months ended 30 September 2018			
		Six months ended 30 September 2018	Six months ended 30 September 2017 Restated*
	Notes	**Unaudited**	Unaudited
		£m	£m
Profit for the period		**82.1**	108.6
Items that cannot be reclassified to profit or loss			
Actuarial gain on retirement benefit obligation	14	**9.9**	14.4
Deferred tax asset movement relating to retirement benefit obligation	8	**(1.7)**	(1.9)
		8.2	12.5
Total comprehensive income for the period		**90.3**	121.1

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the interim financial information.

Condensed statement of financial position

As at 30 September 2018

Condensed statement of financial position as at 30 September 2018			
	Notes	Six months ended 30 September 2018 Unaudited £m	Year ended 31 March 2018 Restated* Unaudited £m
Non-current assets			
Intangibles	10	**57.8**	61.1
Property, plant and equipment	11	**5,944.8**	5,865.3
Other non-current assets	12	**812.3**	812.3
Investments		**29.2**	29.2
		6,844.1	6,767.9
Current assets			
Inventories		**3.1**	2.9
Trade and other receivables		**289.9**	323.1
Cash and cash equivalents		**111.8**	164.4
		404.8	490.4
Total assets		**7,248.9**	7,258.3
Current liabilities			
Trade and other payables		**(299.9)**	(357.6)
Borrowings		**(336.9)**	(352.4)
		(636.8)	(710.0)
Non-current liabilities			
Borrowings		**(3,660.7)**	(3,652.4)
Derivative financial instruments	13	**(1,270.4)**	(1,288.0)
Deferred tax liabilities		**(290.3)**	(277.9)
Retirement benefit obligations	14	**(165.2)**	(171.7)
Provisions for liabilities		**(3.3)**	(3.4)
Other non-current liabilities		**(26.6)**	(26.6)
		(5,416.5)	(5,420.0)
Total liabilities		**(6,053.3)**	(6,130.0)
Total net assets		**1,195.6**	1,128.3
Equity			
Called up share capital		**0.1**	0.1
Share premium account		**46.3**	46.3
Non-distributable reserve		**52.3**	46.7
Retained earnings		**1,096.9**	1,035.2
Shareholders' equity		**1,195.6**	1,128.3

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the interim financial information.

Condensed statement of changes in equity

For the six months ended 30 September 2018

Condensed statement of changes in equity for the six months ended 30 September 2018	Called up share capital	Share premium	Non-distributable reserve Restated*	Retained earnings Restated*	**Total Restated***
	£m	£m	£m	£m	**£m**
Balance at 1 April 2018	**0.1**	**46.3**	**46.7**	**1,035.2**	**1,128.3**
Profit for the financial period	–	–	6.3	75.8	82.1
Other comprehensive income for the period	–	–	–	8.2	8.2
Total comprehensive income for period	**–**	**–**	**6.3**	**84.0**	**90.3**
Reserves transfer	–	–	(0.7)	0.7	–
Equity dividends paid (note 9)	–	–	–	(23.0)	(23.0)
At 30 September 2018	**0.1**	**46.3**	**52.3**	**1,096.9**	**1,195.6**

Condensed statement of changes in equity for the six months ended 30 September 2017	Called up share capital	Share premium	Non-distributable reserve Restated*	Retained earnings Restated*	**Total Restated***
	£m	£m	£m	£m	**£m**
Balance at 1 April 2017	**0.1**	**46.3**	**24.1**	**926.1**	**996.6**
Profit for the financial period	–	–	4.8	103.8	108.6
Other comprehensive loss for the period	–	–	-	12.5	12.5
Total comprehensive income for period	**–**	**–**	**4.8**	**116.3**	**121.1**
Reserves transfer	–	–	(1.1)	1.1	-
Equity dividends paid (note 9)	–	–	-	(31.0)	(31.0)
At 30 September 2017	**0.1**	**46.3**	**27.8**	**1,012.5**	**1,086.7**

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the interim financial information.

Condensed statement of cash flows

For the six months ended 30 September 2018

Condensed statement of cash flows for the six months ended 30 September 2018			
		Six months ended 30 September 2018	Six months ended 30 September 2017 Restated*
	Notes	**Unaudited**	Unaudited
		£m	£m
Operating activities			
Cash generated from operations		**242.6**	225.0
Tax paid		**(5.4)**	(8.7)
Net cash from operating activities	15	**237.2**	216.3
Investing activities			
Purchase of property, plant and equipment		**(174.8)**	(184.9)
Purchase of intangibles		**(15.2)**	(7.1)
Receipt of grants and contributions		**0.8**	1.3
Sale of property, plant and equipment		**–**	0.6
Movement on loan to subsidiary		**49.0**	(55.5)
Other income		**2.5**	12.5
Net cash used in investing activities		**(137.7)**	(233.1)
Financing activities			
Interest received		**28.9**	29.0
Interest paid		**(128.5)**	(10.2)
Equity dividends paid		**(23.0)**	(94.2)
Preference share dividends		**(6.5)**	(8.0)
Repayment of redeemable preference shares	16	**(22.7)**	–
Finance lease payments		**(0.3)**	0.2
Net cash used in financing activities		**(152.1)**	(83.2)
Net decrease in cash and cash equivalents		**(52.6)**	(100.0)
Cash and cash equivalents at beginning of the period		**164.4**	285.3
Cash and cash equivalents at end of the period	16	**111.8**	185.3

*The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the interim financial information.

Notes to the interim financial information

For the six months ended 30 September 2018

1 Basis of preparation and accounting policies

The audited annual financial statements of the company are prepared in accordance with FRS 101 incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to company law made by the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015. The condensed financial statements for the six months ended 30 September 2018, which are unaudited, have been prepared in accordance with FRS 104 'Interim Financial Reporting' as adopted by the United Kingdom.

The condensed financial statements for the six months ended 30 September 2018 do not constitute statutory accounts of the company. They do not include all of the information required for a complete set of FRS 101 financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the company's financial position and performance since the last annual financial statements. Statutory financial statements for the year ended 31 March 2018 were approved by the Board on 5 July 2018 and the auditor's report on those accounts was unqualified. The condensed financial statements for the six months ended 30 September 2018 should be read in conjunction with the annual report and financial statements for the year ended 31 March 2018 which have been delivered to the Registrar of Companies and can be obtained from the Company Secretary, Southern House, Yeoman Road, Worthing, BN13 3NX, or from our website.

The directors have reassessed the principal risks associated with the company's business activities, together with the factors likely to affect its future development and position. As part of their review the directors have considered the need to repay the Class A £300 million bond due in March 2019 and £177.2 million of inflation-linked swaps with a legal maturity of March 2037 which include a mandatory break at March 2019. The bond will be repaid in March 2019 out of existing liquidity and the mandatory breaks on the inflation-linked swaps have been extended to 2025.

On the basis of their assessment of the company's financial position the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the interim financial information.

The accounting policies adopted in these condensed financial statements are consistent with those applied and set out in the annual report and financial statements for the year ended 31 March 2018, except as described below.

The tax charge is based on the estimated effective tax rate before exceptional items, fair value adjustments and adjustments in respect of prior periods, for the full year to 31 March 2019.

Adoption of new and revised accounting and financial reporting standards

This is the first set of the company's financial statements where IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments' have been applied. Changes to significant accounting policies are described in note 3.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and will be effective for the company from 1 April 2019. The impact on the results or net assets of the company of the changes to the standard has not yet been quantified in detail but this is not expected to be significant because the company does not hold a significant value of operating leases. In the period to 30 September 2018 the value of operating lease expenditure charged to the income statement was £2.3 million (2017: £2.2 million)

Notes to the interim financial information (continued)

2 Key assumptions and significant judgments

In preparing these interim financial statements, management has made judgments and estimates that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgments made in applying the company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements for the year ended 31 March 2018, except for new significant judgments and key sources of estimation uncertainty related to the application of IFRS 15 which is described in note 3 below. Under IFRS 15, revenue is recognised when a customer obtains control of the goods or services. Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgment is therefore required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

3 Changes in significant accounting policies

Except as described below, the accounting policies applied in these interim financial statements are the same as those applied in the company's financial statements as at and for the year ended 31 March 2018 (the policy for recognising and measuring income taxes in the interim period is described in Note 1 above).

The following changes in accounting policies are also expected to be reflected in the company's financial statements as at and for the year ending 31 March 2019.

A number of new standards are effective for periods beginning from 1 January 2018, including IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers'. The effect of these new standards on the company's financial statements is described below.

IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. There was no material impact resulting from the application of this standard.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires companies to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

As at 1 April 2018, the directors reviewed and assessed the company's existing trade receivables for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9 to determine the credit risk of the respective items at the date they were initially recognised. This is no change to the methodology applied in the financial statements for the year ended 31 March 2018 as materially the risk of future credit losses were already applied within the model which calculates the bad and doubtful debt provision and therefore no additional credit

Notes to the interim financial information (continued)

loss allowance has been recognised against retained earnings in the period as a result of the implementation of the new standard.

The company has adopted IFRS 15 'Revenue from Contracts with Customers' from 1 April 2018.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations.

The standard requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. The effect of applying IFRS 15 results in the immediate recognition, due to the completion of the performance obligation, of certain developer related revenue, previously treated as deferred revenue. This income relates to diversions, requisitions and adoptions and its effect on our financial statements is detailed below.

Transition approach

The company has adopted IFRS 15 retrospectively to each prior period presented in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', using the practical expedient in paragraph C5(d) of IFRS 15, under which the company does not disclose the amount of consideration allocated to the remaining performance obligations or an explanation of when the company expects to recognise that amount as revenue for all reporting periods presented before the date of initial application – i.e. 1 April 2018. The details and quantitative impact of the changes in accounting policies are disclosed below.

Water and wastewater services

The company supplies water and wastewater services to customers in Sussex, Kent, Hampshire and the Isle of Wight. The performance obligation is the supply of services over the contractual term and is considered to be satisfied as the customer consumes based on the volume of water supplied. This is the point at which revenue is recognised. The determination of the performance obligation does not result in a change to the company's approach to accounting for this revenue under previously applicable accounting standards.

Since the group is under a statutory obligation to provide water and wastewater services to its domestic properties these services could be provided to customers who are unlikely to pay. Under IFRS 15 such revenue is not recognised. Currently we consider that at the point of billing customers there is no one identifiable group of customers who are unlikely to pay and so all revenue is recognised.

New connections and infrastructure charges

Under IFRS 15 the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point. This does not result in a change to the company's approach to accounting for this revenue under previously applicable accounting standards.

Requisitions

For requisitions of water mains and public sewers, the company previously deferred the lump sum cash consideration received, and recognised the associated revenue to the income statement over a period of 12 years. Under IFRS 15, the company has determined that the performance obligation is satisfied at the point of completion of the requisition works and connection of the water main or lateral drain, and the total consideration receivable is recognised in full as revenue at that point. For the six months to 30 September 2018, this has resulted in the recognition of £0.3 million (2017: £0.5 million) of revenue recognised that would previously have been deferred to the statement of financial position and amortised over 12 years. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in deferred revenue of £10.5 million (as at 1 April 2017: £9.7 million) and a reduction in long term grants and contributions of £0.9 million (as at 1 April 2017: £0.5 million).

Notes to the interim financial information (continued)

Diversions

Contributions received in respect of diversions of water mains and sewers were previously deferred to the statement of financial position and amortised to income over the life of the related assets. Under IFRS 15, we have determined that the performance obligation, and the point of revene recognition, is on completion of the diversion of the water main or sewer. For the six months to 30 September 2018, £0.9 million (2017: £0.3 million) of revenue has been recognised that would previously have been deferred to the statement of financial position and amortised over the life of the asset. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in long-term grants and contributions of £15.3 million (as at 1 April 2017: £12.4 million).

Adoptions

Adoptions of assets were previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the company recognises the fair value of the asset upon adoption i.e. the point at which control of the asset is obtained, within revenue as an increase to non-distrubutable reserves. For the six months to 30 September 2018, this has resulted in the recognition of £6.3 million (2017: £4.8 million) of revenue recognised and taken to non-distributable reserves that would previously have been deferred to the statement of financial position and amortised over the life of the asset. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in long-term grants and contributions of £46.7 million (as at 1 April 2017: £24.1 million).

Notes to the interim financial information (continued)

3 Changes in significant accounting policies (continued)

Impacts on previously reported financial statements

The following tables summarise the impacts of adopting IFRS 15 on the company's previously reported interim statement of financial position as at 1 April 2017 and 31 March 2018 and its interim income statement and other comprehensive income for the six months ended 30 September 2017 for each of the line items affected. There was no material impact on the company's previously reported interim statement of cash flows for the six month period ended 30 September 2017 however these have been restated to reflect the opening balance adjustments.

As a result of the difference in the treatment of adoptions as explained in the transition approach to IFRS 15 above, an adjustment has been made to the cumulative deferred tax liability in respect of adopted assets previously treated as non-qualifying of £4.2 million and £7.9 million as at 1 April 2017 and 31 March 2018 cumulatively and respectively.

Statement of financial position

		Impact of changes in accounting policies	
1 April 2017	**As previously reported**	**Adjustments**	As restated
	£m	**£m**	£m
Other	7,072.5	–	7,072.5
Total assets	7,072.5	–	7,072.5
Accruals and deferred revenue	(105.0)	9.7	(95.3)
Other non-current liabilities – Grants and contributions	(48.0)	37.0	(11.0)
Deferred tax liabilities	(257.6)	(4.2)	(261.8)
Other	(5,707.8)	–	(5,707.8)
Total liabilities	(6,118.4)	42.5	(6,075.9)
Retained earnings	907.7	18.4	926.1
Non-distributable reserves	–	24.1	24.1
Other	46.4	–	46.4
Total equity	954.1	42.5	996.6

Notes to the interim financial information (continued)

3 Changes in significant accounting policies (continued)

Impacts on previously reported financial statements (continued)

Statement of financial position			
		Impact of changes in accounting policies	
31 March 2018	As previously reported	Adjustments	As restated
	£m	£m	£m
Other	7,258.3	–	7,258.3
Total assets	7,258.3	–	7,258.3
Accruals and deferred revenue	(98.5)	10.5	(88.0)
Other non-current liabilities – Grants and contributions	(75.7)	62.9	(12.8)
Deferred tax liabilities	(270.0)	(7.9)	(277.9)
Other	(5,751.3)	–	(5,751.3)
Total liabilities	(6,195.5)	65.5	(6,130.0)
Retained earnings	1,016.4	18.8	1,035.2
Non-distributable reserves	–	46.7	46.7
Other	46.4	–	46.4
Total equity	1,062.8	65.5	1,128.3

Income statement and other comprehensive income			
		Impact of changes in accounting policies	
For the six months ended 30 September 2017	As previously reported	Adjustments	As restated
	£m	£m	£m
Revenue	413.1	5.6	418.7
Other income	1.1	(0.6)	0.5
Corporation tax charge	(23.1)	–	(23.1)
Other	(287.5)	–	(287.5)
Profit for the period	103.6	5.0	108.6
Other	12.5	–	12.5
Total comprehensive income for the year	116.1	5.0	121.1

Notes to the interim financial information (continued)

4 Seasonality of operations and segmental analysis

The company's business is not seasonal in nature.

The directors believe that the whole of the company's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this interim report.

5 Income

An analysis of the company's income is as follows:

Continuing operations		
	Six months ended 30 September 2018	Six months ended 30 September 2017 Restated*
	Unaudited	Unaudited
	£m	£m
Water and sewerage services		
Household – measured	**268.7**	252.2
Household – unmeasured	**67.8**	66.6
Non-household – measured	**69.4**	68.8
Non-household – unmeasured	**2.5**	2.6
Total water and sewerage services	**408.4**	390.2
Bulk supplies	**1.8**	1.5
Infrastructure charge receipts	**6.7**	3.9
Requisitioned mains and sewers	**0.3**	1.2
Diversions	**0.9**	0.3
Adoptions	**6.3**	4.8
Other services	**15.7**	16.8
Total revenue	**440.1**	418.7
Other operating income	**0.5**	0.5
Other income (note 6)	**0.1**	15.0
Profit on disposal of fixed assets	**0.2**	0.6
Interest receivable (note 7)	**0.5**	0.5
Interest revenue from Southern Water Services Group Limited	**28.4**	28.4
Total income	**469.8**	468.2

6 Other income

Other income in the prior year of £15.0 million relates to proceeds on disposal of the non-household retail business function on 1 April 2017.

Notes to the interim financial information (continued)

7 Net finance costs

Net finance costs		
	Six months ended 30 September 2018	Six months ended 30 September 2017
	Unaudited	Unaudited
	£m	£m
Finance income		
Interest revenue from SWSG Limited	**28.4**	28.4
Deposit income on short-term bank deposits	**0.5**	0.5
	28.9	28.9
Finance costs		
Interest payable on other loans	**(4.1)**	(3.5)
Interest paid to Southern Water Services (Finance) Ltd	**(69.8)**	(68.8)
Indexation	**(19.3)**	(19.3)
Amortisation of issue costs	**(1.8)**	(1.8)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of deferred credits	**4.9**	4.9
Amortisation of bond premium	**0.3**	0.3
Other finance expense	**(2.3)**	(2.4)
Dividends on preference shares	**(5.9)**	(8.0)
	(97.9)	(98.5)
Amounts capitalised on qualifying assets	**11.5**	6.7
	(86.4)	(91.8)
Fair value gains on derivative financial instruments		
Derivative financial instruments not designated as hedges	**17.6**	44.5
Net finance costs	**(39.9)**	(18.4)

Notes to the interim financial information (continued)

8 Taxation

Taxation presented in the income statement is based on the result for the period using current rates and takes into account tax deferred due to timing differences.

Tax on profit on continuing operations		
	Six months ended 30 September 2018	Six months ended 30 September 2017
	Unaudited	Uunaudited
	£m	£m
Current tax:		
In respect of the current period	**7.7**	8.3
Total current tax charge	**7.7**	8.3
Deferred tax:		
Origination and reversal of temporary differences	**10.7**	14.8
Total deferred tax charge	**10.7**	14.8
Total tax charge on profit on continuing operations	**18.4**	23.1

In line with the requirements of FRS 104, the tax charge for the six months ended 30 September 2018 is based on the estimated effective tax rate before exceptional items, fair value gains/losses and adjustments in respect of prior periods, for the full year to 31 March 2019.

A reduction in the main rate of corporation tax to 17% from the 1 April 2020 was enacted in the Finance Bill 2016, and deferred tax balances at 30 September 2018 are calculated based on this rate.

In addition to the tax charged to the income statement, the following amounts of tax relating to components of other comprehensive income were recognised:

Deferred tax		
	Six months ended 30 September 2018	Six months ended 30 September 2017
	Unaudited	Unaudited
	£m	£m
Arising on income and expenses recognised on other comprehensive income:		
Tax charge on actuarial gains on defined benefit pension scheme	**1.7**	1.9
Total deferred tax charges recognised in other comprehensive income	**1.7**	1.9

Notes to the interim financial information (continued)

9 Dividends

The following dividends were paid by the company:

Dividends

	Six months ended 30 September 2018	Six months ended 30 September 2017
	Unaudited	Unaudited
	£m	£m
Equity dividends paid:		
– SWSG Dividend Loop*	**23.0**	23.0
– Ordinary	**–**	8.0
	23.0	31.0

* These dividends are paid via intermediary holding companies to Southern Water Services Group Limited (SWSG), along with associated group tax relief payments of £5.4 million as per the cash flow statement. This enables SWSG to pay the interest due on the inter-company loan of £28.4 million (see Note 7) back to SWS. The result of this is a circular transaction, the effect of which is a net cash flow for the company of nil.

10 Intangible assets

Intangible assets

	£m
Cost	
At 1 April 2017	123.6
Additions	5.8
At 30 September 2018 (unaudited)	129.4
Accumulated amortisation	
At 1 April 2018	62.5
Charge for the period	9.1
At 30 September 2018 (unaudited)	71.6
Net book amount	
At 30 September 2018 (unaudited)	**57.8**

Notes to the interim financial information (continued)

11 Property, plant and equipment

Property, plant and equipment	
	£m
Cost	
At 1 April 2018	8,399.7
Additions	199.0
Disposals	(2.4)
At 30 September 2018 (unaudited)	8,596.3
Accumulated depreciation	
At 1 April 2018	2,534.4
Charge for the period	119.5
Disposals	(2.4)
At 30 September 2018 (unaudited)	2,651.5
Net book amount	
At 30 September 2018 (unaudited)	**5,944.8**

12 Non-current assets

Non-current assets	
	£m
Amounts owed by SWSG	**812.3**

Amounts owed by group undertakings represent a loan to Southern Water Services Groups Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7% per annum.

Notes to the interim financial information (continued)

13 Derivative financial instruments

Categories of financial instruments at fair value		
	Six months ended 30 September 2018	Year ended 31 March 2018
	Unaudited	Audited
	£m	£m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**8.1**	4.2
Total derivative financial assets	**8.1**	4.2
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**(1,278.5)**	(1,292.2)
Total derivative financial liabilities	**(1,278.5)**	(1,292.2)

The derivative assets and liabilities meet the offsetting criteria in paragraph 42 of IAS 32. This results in the presentation of a net derivative liability of £1,270.4 million at 30 September 2018 in the statement of financial position.

Changes in value of financial instruments at fair value		
	Six months ended 30 September 2018	Six months ended 30 September 2017
	Unaudited	Unaudited
	£m	£m
Profit for the year has been arrived at after crediting:		
Financial assets at fair value		
Designated as FVTPL	**3.9**	3.1
Financial liabilities at fair value		
Designated as FVTPL	**13.7**	41.4
Fair value gains on derivative financial instruments	**17.6**	44.5

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk.

The regulatory framework, under which revenues and the Regulatory Capital Value are indexed, exposes the company to inflation risk. The company enters into inflation linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

Notes to the interim financial information (continued)

14 Retirement benefit obligations

The March 2016 triennial valuation and the timing and quantum of future contributions in relation to the deficit have now been agreed with the Trustees and Pensions Regulator. These contributions will be dependant on future levels of RPI, but if market breakeven rates are borne out at 31 March 2016 the expected base deficit contributions will be paid annually and total £223.5 million over the next 12 years. The first payment will be made in November 2018.

The retirement benefit obligations shown at 30 September 2018 and 30 September 2017 are based on the valuations at 31 March 2018 and 31 March 2017 respectively, updated by a qualified independent actuary reflecting market yields and asset values. These are not formal interim valuations of the scheme assets and liabilities; however an assessment of the actuarial losses has been made and shown in the summarised statement of other comprehensive income.

The major assumptions used by the actuary are set out in the table below:

	Six months ended 30 September 2018	Year ended 31 March 2018
	Unaudited	Audited
	%	%
Price inflation (RPI)	3.2	3.2
Price inflation (CPI)	2.2	2.2
Rate of increase in salaries	2.4	2.4
Rate of increase of pensions in payment (MIS* members)***	2.2	2.2
Rate of increase of pensions in payment (old section** members)***	3.2	3.2
Rate of increase of pensions in payment (all other members)***	3.1	3.1
Rate of increase for deferred pensions (MIS* members only)***	2.2	2.2
Rate of increase for deferred pensions (all other members)***	3.1	3.1
Discount rate	2.9	2.7

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the Scheme.

*** In excess of any Guaranteed Minimum Pension (GMP) element.

Notes to the interim financial information (continued)

14 Retirement benefit obligations (continued)

The amounts included in the statement of financial position arising from the company's obligations under the defined benefit scheme were as follows:

Amounts included in the statement of financial position	**Six months ended 30 September 2018**	Year ended 31 March 2018
	Unaudited	Audited
	£m	£m
Total fair value of assets	**695.7**	736.7
Present value of the defined benefit obligation	**(860.9)**	(908.4)
Deficit recognised in the statement of financial position	**(165.2)**	(171.7)

Analysis of the movement in the scheme's deficit during the period	**Six months ended 30 September 2018**	Six months ended 30 September 2017	Year ended 31 March 2018
	Unaudited	Unaudited	Unaudited
	£m	£m	£m
At 1 April	**(171.7)**	(176.9)	(176.9)
Employer's contributions	**2.3**	2.6	7.0
Employer's current service cost	**(3.4)**	(3.4)	(6.7)
Financing charge	**(2.3)**	(2.4)	(4.9)
Actuarial gain	**9.9**	14.4	9.8
Deficit in the scheme at end of the period	**(165.2)**	(165.7)	(171.7)

Notes to the interim financial information (continued)

15 Cash generated by operations

Cash generated by operations	Six months ended 30 September 2018 Unaudited £m	Six months ended 30 September 2017 Unaudited £m
Continuing operations		
Operating profit	**140.1**	134.5
Adjustments for:		
Fair value of sewer adoptions	**(6.3)**	(4.8)
Depreciation of property, plant and equipment	**119.5**	122.0
Amortisation of intangible assets	**9.1**	1.6
Difference between pension charge and cash contributions	**1.1**	0.7
Amortisation of grants and contributions	**(0.5)**	(0.5)
Operating cash flow before movement in working capital	**263.0**	253.5
(Increase)/Decrease in inventories	**(0.2)**	0.2
Increase in receivables	**(18.8)**	(26.7)
Decrease in payables	**(1.3)**	(2.0)
Decrease in environmental provisions	**(0.1)**	–
Cash generated by operations	**242.6**	225.0
Tax paid		
– Group relief	**–**	(3.3)
– Payments made within SWSG Dividend Loop	**(5.4)**	(5.4)
Net cash generated from operating activities	**237.2**	216.3

Notes to the interim financial information (continued)

16 Analysis of net debt

Analysis of net debt (unaudited)	At 1 April 2018 £m	Cash flow £m	Other non-cash changes £m	**At 30 September 2018 £m**
Cash and cash equivalents	164.4	(52.6)	–	**111.8**
Liabilities from financing activities:				
Term facilities/index linked loans	(257.1)	–	(1.9)	**(259.0)**
Loans from subsidiary	(3,603.5)	–	(13.9)	**(3,617.4)**
Finance lease liabilities	(1.6)	0.3	–	**(1.3)**
Redeemable preference shares	(142.6)	22.7	–	**(119.9)**
Interest rate swaps	(1,288.0)	–	17.6	**(1,270.4)**
Total liabilities from financing activities	(5,292.8)	23.0	1.8	**(5,268.0)**
Net debt	(5,128.4)	(29.6)	1.8	**(5,156.2)**

Balances at 30 September 2018 comprise:	Current assets £m	Current liabilities £m	Non-current liabilities £m	**Total £m**
Cash and cash equivalents	111.8	–	–	**111.8**
Derivative financial instruments	–	–	(1,270.4)	**(1,270.4)**
Borrowings due within one year	–	(336.9)	–	**(336.9)**
Borrowings due after one year	–	–	(3,660.7)	**(3,660.7)**
Net debt	111.8	(336.9)	(4,931.1)	**(5,156.2)**

The non-cash movement of £1.8 million relates to an increase in debt as a result of indexation, offset by movements on the fair value of derivatives, plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and a decrease in finance lease obligations.

Loans due within one year relate to loans from group undertakings that are repayable on demand.

Notes to the interim financial information (continued)

17 Contingent liabilities

As disclosed in our Annual Report for 2017–18, the company faces investigations by the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of our wastewater treatment sites and the reporting of relevant compliance information, focused on the years from 2010 to 2017. We are working proactively with the Environment Agency and Ofwat to resolve their investigations which are still evolving. In relation to the ongoing investigations by Ofwat, the Environment Agency and the company itself, the company has recently adopted the prudent course of bringing the matter to the attention of the law enforcement authorities.

The Ofwat investigation could result in Ofwat taking enforcement action. This may include the imposition of a fine, which could be material in nature as Ofwat can impose a financial penalty of up to 10% of turnover of the relevant area of the business for each breach dependent on the severity of the findings of the investigations. It is possible that the other investigations may also result in fines being imposed. We are, however, committed to ensuring that our customers are not disadvantaged as a result of these matters. We are exploring direct customer reparation schemes which, consistent with some recent regulatory precedents for different matters (where reductions in customer bills or agreed additional expenditure have been agreed), may result in mitigation of some direct financial penalties.

However, reflecting the lack of firm precedent, the early stage of discussions with Ofwat, and as this is subject to ongoing discussion and agreement reflecting, amongst other matters, the reparation actions to be taken by the company, the amount of any potential fine and/or financial penalty is presently unquantifiable. Consequently, and in line with IAS37 'Provisions, contingent assets and contingent liabilities' paragraph 26 it is not possible to reliably estimate and recognise an accounting provision at this time. This disclosure sets out the best information available on the range of potential financial effects and uncertainties as to the amount or timing of any outflow. There is no expected possibility of reimbursement.

The company has also revisited the reporting of the Wastewater Treatment Works number of failed works and population equivalent performance measures provided in previous years. We have been performing a review of the relevant reported wastewater data for the years from 2010 to 2017. Whilst we have had that review independently verified, it is subject to a number of limitations and variable factors. We have very recently engaged in a discussion with Ofwat regarding the initial findings from the review and the consequences in relation to potential serviceability and Outcome Delivery Incentive penalties that should have been applicable in respect of AMP5 and AMP6. As a result of our initial findings from the review, we expect that we will have to make an adjustment to our Regulatory Capital Value (RCV) in respect of the period reviewed in the Ofwat 2019 Final Determination and that, as a result, there will be a reduction in future revenues. We intend to work closely with Ofwat to resolve this matter in the coming months, but until the further investigations and discussions with Ofwat are further advanced it is not possible to reliably estimate the reduction to RCV that may arise.

Our new Compliance and Asset Resilience directorate is leading improvements in our business processes and systems, governance and controls as well as data integrity and the planning, scheduling, monitoring and performance reporting to the Environment Agency and Ofwat. Further information on this programme can be found in our Final Assurance Plan 2018, which is available on our website **southernwater.co.uk/our-reports**.

Other contingent liabilities

Aside from the matters described above, companies of the size and scale of Southern Water are sometimes subject to a number of claims disputes and potential litigation. The significant ones can often take many years to be withdrawn or to reach resolution and currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where it is possible to be estimated reasonably an appropriate position has been taken

Notes to the interim financial information (continued)

in reflecting such items in these financial statements. It is not currently possible to estimate the financial effect and likely timing of any associated outflow of some of these given the stage of the investigations and claims and the potential range of outcomes.

Following the South Hampshire abstraction inquiry Southern Water Services Limited has committed to undertake certain environmental work should a drought order be required on the rivers Itchen, Test or Candover Stream between 2018 and 2030. Details of the agreement are still being finalised, as a result it is not possible to provide an estimate of the potential financial effect of the agreement.

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water's valuation.

The company had no contingent liabilities for capital claims at the period-end (September 2017: £nil).

Notes to the interim financial information (continued)

18 Capital commitments

Capital commitments	Six months ended 30 September 2018 Unaudited £m	Year ended 31 March 2018 Audited £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**731.0**	516.5
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**44.2**	14.6
	775.2	531.1

19 Related party transactions

The consortium of investors owning Greensands Holdings Limited (GSH) are considered to be related parties of the company as they each have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

There has been no material change during the six months ended 30 September 2018 in transactions with these related parties from that disclosed in the company's annual report and GSH consolidated financial statements for the year ended 31 March 2018.

20. Post balance sheet events

On 26 October 2018 the High Court ruled that guaranteed minimum pensions should be equalised between men and women. As a result pension scheme trustees will be obliged to adjust benefit payments in order that benefits received by male and female members with equivalent age, service and earnings histories are equal. We will be working with the trustees of our UK pension schemes and our actuarial and legal advisors to fully understand the extent to which this ruling could crystallise additional liabilities in our UK pension schemes over the coming months. We expect that any adjustment will be recognised in the second half of the current financial year.

Our refinancing plan to maintain strong financial resilience into PR19 is progressing.

On 23 November 2018 our inflation-linked derivative portfolio was restructured and this included the extension of mandatory breaks at March 2019 on £177.2 million of the derivatives to November 2025. These restructured derivatives have also been transferred to Southern Water Services Ltd, from Southern Water Services (Finance) Ltd, in preparation for the removal of the Cayman incorporated Southern Water Services (Finance) Ltd.

On 29 November 2018 the group received the first funds as part of the overall refinancing plan which is aimed at reducing our current gearing to below 70% and further steps in this restructuring plan are expected to be completed before 31 March 2019.

Independent review report to the members of Southern Water Services Limited

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2018 which comprises the condensed income statement, the condensed statement of financial position, the condensed statement of changes in equity, the condensed statement of cash flows and related notes 1 to 20.

We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the company are prepared in accordance with United Kingdom Generally Accepted Accounting Practice (including Financial Reporting Standard 101 "Reduced Disclosure Framework"). The condensed set of financial statements included in this half-yearly financial report have been prepared in accordance with Financial Reporting Standard 104 "Interim Financial Reporting".

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independent review report to the members of Southern Water Services Limited (continued)

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2018 is not prepared, in all material respects, in accordance with Financial Reporting Standard 104 and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Emphasis of matter – contingent liability in respect of regulatory investigations

We draw attention to note 17 in the financial statements concerning the uncertain outcome of certain regulatory investigations regarding the performance of certain wastewater plants. Southern Water faces investigations from the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of wastewater treatment sites and the reporting of relevant compliance information. At this time, no clarity of the findings of these investigations or further action and associated financial impact, if any, can be quantified. As the ultimate outcome of the matter cannot presently be determined no provision for any liability that may result has been made in the interim financial information.
Our review conclusion is not modified in respect of this matter.

Deloitte LLP

Deloitte LLP

Statutory Auditor
London, United Kingdom

29 November 2018

southernwater.co.uk

Southern Water
Southern House
Yeoman Road
Worthing
West Sussex
BN13 3NX

Registered no. 02366670

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