Interim Financial Information and Report

for the six months ended 30 September 2019
(Unaudited)

from
Southern Water

Contents

Interim management report

Chairman's introduction

As Southern Water's new Chairman, I am pleased to introduce our Interim Financial Statements for 2019.

Since my appointment as Chairman of Southern Water in August 2019, I have spent significant time with employees, regulators and stakeholders understanding better the company and its context. Visiting many company locations, often with Ian McAulay, our CEO, I have been struck by the clear desire of our staff to succeed in our mission in a time of significant challenge for Southern Water and the sector.

We are now more than two years into an ongoing transformation programme to meet our challenges, both old and new. This programme covers every aspect of the business. At an operational level, we are investing in training our people, improving our processes, networks and systems to enable Southern Water to be more efficient and more resilient in the delivery of customer services. We have reinforced our 'three lines of defence' assurance model, strengthening compliance and regulatory reporting to provide transparent evidence of what we are doing and how we are doing it.

We have made changes to our structure, including restructuring our Executive Leadership Team and added to our Board to support and protect our customers' ambitions for our work. We have refreshed our company vision, values and purpose, centred on Doing the Right Thing, under-pinned by ethical business practices embedded through compulsory training and we have also refreshed and relaunched our Speak Up policies. These must be lived by our leadership.

We are continuing to work hard to deliver the commitments we made to customers at the start of this five-year regulatory period. Details of our current performance are included from page 6 onwards.

As we approach the start of our next five-year business plan, we face continuing and fresh operational challenges:

- We continue to experience an unacceptable number of pollution incidents. To address this we are working to understand the conditions that create these risks ahead of time, finding and fixing problems more quickly, and targeting investment at those sites most likely to fail.
- Changes to our abstraction licences in Western Hampshire presented us with water supply challenges during the summer months this year. We worked closely with the Environment Agency (EA) to monitor the situation and used public awareness campaigns to avoid the need for water restrictions in the area, to which our customers responded positively.
- During the summer we exceeded our target for leakage. To improve our performance in this important area, we have significantly increased resources, activity and investment.

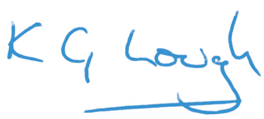
When we published our Annual Report for 2018–19, Ofwat was investigating breaches of licence conditions and statutory obligations regarding how we operated our wastewater treatment works between 2010 and 2017. Its Final Notice, published on 10 October 2019, set out the results of its investigations following a public consultation, and in undertakings given to Ofwat, Southern Water set out its commitment to make £123 million (at 2017–18 prices) in rebates to current customers and payments to some former customers, a promise of greater transparency on environmental performance and a number of other measures. These measures are being fully enacted and, along with our own initiatives, we hope that full trust and confidence in Southern Water from our customers, regulators and other stakeholders will be restored to us.

Starting before Ofwat's investigation began in 2017, we have made a number of fundamental improvements which were recognised in its report. As part of our turnaround, we have identified past performance failures and put in place plans to rectify them. We continue to co-operate with the Environment Agency as it continues its investigations.

Further details on these issues, as well as in relation to other extant regulatory investigations are set out on page 4 of this report.

I celebrate our collaboration with our region's three Wildlife Trusts, with whom we are entering into strategic partnerships to deliver tangible outcomes for customers, communities, and the natural environment. We continue to develop similar agreements with other organisations, including the Rivers Trust and National Parks.

Finally, against that backdrop of operational focus, transformational change and external scrutiny, our key focus has been preparing our business plan for the next five-year period, in line with our customers' expectations. Ofwat's Final Determination on this plan will be delivered on 16 December. We will carefully review Ofwat's determination when it is received against both our customers' aims and ambitions as well as ensuring that our ambitious investment programme is adequately financed. The impact on our credit ratings will also need to be assessed.



Keith Lough
Chairman

Interim management report

Update on regulatory investigations

Our organisation has been the subject of ongoing investigations by our regulators, Ofwat, the Drinking Water Inspectorate (DWI) and the EA. We have worked closely with them to understand past failings and implement fundamental changes to address those faults.

Ofwat investigation

As previously announced, Southern Water's wastewater treatment compliance has been under investigation by Ofwat since June 2017 for breaches of licence conditions and statutory obligations during the period from 2010 to 2017. Southern Water began investigating issues at its wastewater treatment sites in July 2016 before alerting Ofwat to deeper issues in March 2017.

Southern Water has fully supported these investigations and has simultaneously completed its own extensive internal review, which highlighted failures of people, processes and systems during that period.

As mentioned in the Chairman's introduction, Ofwat has now published its final decision to impose a financial penalty on Southern Water. As well as the plans to make financial reparations for the findings made by Ofwat set out in the Chairman's introduction, we have committed to implement a suite of improved organisational compliance measures and organisational culture change measures to prevent reoccurrence of the events identified by Ofwat. Details of the commitments made can be found in the undertakings given to Ofwat that has been published with the Final Notice on Ofwat's website.

As disclosed in our Annual Report, a provision in relation to these matters, of £138.5 million (in outturn prices), was made in the second six months to 31 March 2019 and is accrued within the Balance Sheet at 30 September 2019, this is referred to throughout this document as the 'regulatory settlement'.

In particular, we have committed to plans for improved transparency on environmental performance. Information that is available on pollution incidents, flow and spill reporting, wastewater treatment works, final effluent compliance, regional bathing water compliance results, emissions and river levels will be accessible on our website within six months[1].

Also, employees will not receive bonuses and incentive payments for personal objectives linked to wastewater compliance should Southern Water fail to meet its relevant performance commitments.

To account for the avoided penalties and the consequential bill reductions that would have been given between 2015–16 and 2019–20, we have also committed to make payments to those who were wastewater customers for any part of that period, but who are not wastewater customers as at 1 April 2020. Advice on how to claim will be published nearer the time. Redress for customers as at 1 April 2020 will still be by a credit on their bills from 2020 to 2025. Customers will not bear any of the costs.

EA investigations

The EA has recently confirmed its intention to prosecute us in relation to the historic performance of certain wastewater sites. The EA's investigation into the reporting of relevant compliance information is ongoing. We are working proactively with the EA to assist them and bring about a resolution to these matters.We are also in the process of delivering a range of initiatives to improve our wastewater treatment compliance and wider compliance performance and culture. These initiatives are within scope of the legal commitments we have made with Ofwat on the back of its investigation. Progress and effectiveness of this programme of activity is being reported to our regulator and independently assured.

The details of the EA prosecution or the findings of the ongoing EA investigation are not known at this time, so the potential financial impacts of these cannot be assessed. As a result no provision has been made in the interim financial statements for the period to 30 September 2019. We have disclosed further details of this contingent liability in note 18 to the financial information.

We are also subject to a small number of investigations associated with specific pollution incidents.

DWI enforcement orders and investigations

We continue to be under scrutiny from our water quality regulator, the DWI. We have been the subject of two Final Enforcement Orders – one regarding a final asset improvement scheme and another in relation to water quality sampling and information management in respect of which we have just received confirmation that it is going to be closed. We are working closely with the DWI in respect of both matters.

We are also subject to two legal investigations, one from 2014–15 and one due to operational issues in 2018 on which we are awaiting decisions from the DWI.

[1] The amount of information that can be made available by Southern Water is subject to any constraints on publishing environmental information or data that is provided by the EA.

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Update on our Business Plan 2020–25

We are awaiting Ofwat's Final Determination on our Business Plan 2020–25 following its Draft Determination published in July 2019 and our subsequent response. While we remain classified in the significant scrutiny category, we are pleased that Ofwat has acknowledged our positive engagement and actions to address its concerns.

In its Draft Determination, Ofwat asked us to make major efficiency gains and provide further evidence of our ability to deliver what is acknowledged to be an ambitious plan. We had already removed approximately £400 million of costs from our plan since submission in September 2018. Removing costs affects delivery risks and resilience, and we have necessarily had to challenge those areas where we feel Ofwat's view of costs undermines the effective delivery for our customers. This has meant in our response to the Draft Determination we have made representations on £262 million of costs. In addition, Ofwat has signalled that based on market data they anticipate a potential reduction in the weighted average cost of capital (WACC) in the Final Determination that could be as much as 0.37%. Any reductions in the WACC would cast the financeability of our plan into doubt.

Our Board and executives believe our response to Ofwat's Draft Determination presents a significant movement in our plan and demonstrates a commitment to continuous improvement, efficiency and long-term resilience. Our plan proposes spending circa £4 billion, including £800 million on improving the environment, and includes a 5.5% reduction in customer bills in addition to efficiency savings. Executive pay and bonuses will be directly linked to the achievement of outcomes for customers and communities. Dividend policy will likewise reflect Ofwat's expectations.

The South East faces significant challenges in ensuring adequate resilient water resources – as the EA's chief executive Sir James Bevan put it, 'the jaws of death' of changing climate and growing population. We believe our revised plan – independently assured – is up to the task of meeting the challenge of resources, the test of public partnership benefit and the scrutiny of regulators.

Interim management report

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 our achievements by how we are doing against a series of targets we promised customers we would meet – our promise commitments.

The table below shows how we are performing against our business plan commitments in 2019–20.

Our performance April 2019 to September 2019

On track | At risk | Needs attention

Responsive customer service

SIM qualitative score	N/A
Number of GSS payments made	Needs attention
% of contacts resolved first time	Needs attention
% of customers who feel our service meets their needs and those of their community	At risk

GSS payments are higher than planned to date due to two water supply interruption events in the period.

Contacts resolved first time is below target and we are reviewing our processes to try and

Affordable bills

% customers think we are providing value for money	On track
Customers in genuine hardship provided with improved support	On track

We have helped over 279,800 customers in hardship, beating our target to provide assistance to 194,700 customers by March 2020

Better information and advice

Per capita consumption (litres/head/day)	On track
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	On track
% of customers who are aware of how to deal with hard water	At risk

We remain on track to achieve our targets for per capita consumption.

We continue to analyse the root cause of every unwanted contact received in order to improve our service to customers.

A constant supply of high-quality drinking water

- Customer minutes lost supply >3 hours
- Leakage (megalitres/day)
- Mean Zonal Compliance %
- Number of contacts regarding discolouration
- Number of properties with low water pressure
- Number of customers affected by temporary use bans
- Maintain asset health

Customer minutes lost have exceeded our target to date due to a significant incident in September, although all efforts are being made to minimise further impact in the remaining six months.

We continue to forecast that we will miss our five-year leakage target and have increased resources to improve performance in this area.

Removing wastewater effectively

- Number of blockages per km/year
- Number of internal flooding incidents
- Number of external flooding incidents
- Number of customer complaints – odour
- Maintain asset health

We have received odour complaints regarding Portswood WTW and have put in place an odour management plan and continue to engage with customers in the area.

Looking after the environment

- Wastewater treatment works compliance %
- Maintain bathing waters at 54
- Number of serious pollution incidents
- Number of category 3 pollution incidents
- Distribution input (megalitres/day)
- Renewable energy usage

We have experienced an unacceptable level of pollution incidents and are working hard to prevent further incidents.

Dry weather over the six months to September resulted in an increase in volumes of water put into supply.

You can read a more detailed account of our performance, as at March 2019, in our Annual Report and Financial Statements 2018–19 at: **southernwater.co.uk/annual-report**.

All performance figures stated in this report are based on our unaudited internal reporting. These will be independently assured at the end of the 2019–20 financial period by our external non-financial auditors and reviewed by our Customer Challenge Group, which was set up to independently monitor our performance and report on our progress.

The quality of the regulatory information we publish is important because it helps to give our customers and other stakeholders' confidence that we are being open and honest.

We continue to make improvements in our information management processes, controls and assurance. This remains a key priority for further improvement. Our Statement of Risks, Strengths and Weaknesses has been developed using the feedback received from our customers and stakeholders about the information we provide. It also takes into account our own assessment of risks to our ability to provide information that they trust. You can read more of focus in this area at: **southernwater.co.uk/our-performance/reports/risks-strengths-and-weaknesses**.

Interim management report

Working for our customers

As we move into the final six months of delivery of our Five-year Business Plan for 2015 to 2020, we know that we still have a lot to do to deliver on the commitments we made to our customers, regulators and stakeholders. We have increased our capital spend and focused all areas of the business on driving forward our transformation programme.

Areas where we have already seen real improvement are in IT infrastructure resilience as a result of insourcing, alongside a continued focus on data management and information security. We have also changed the way we look at total spending, which includes capital spending (CapEx) – e.g. building a new asset and operational spending (OpEx) – e.g. fixing a pump. Reviewing total spend in this way allows us to balance our investments more wisely and is a key way of tackling our cost challenge, while also achieving value for money.

Responsive customer service

In June 2019, we made changes to the way we provide services to our customers to provide a more responsive service. This included transitioning our customer services provision to our existing partner, Capita.

We have also received third party recognition for the quality of our customer services leading up to the transition. We were the only utility company included in the Customer Service Institute's list of the top ten UK companies for complaint handling. The Consumer Council for Water also acknowledged our 'significant strides' in improving our service.

MOSL, the market operator of England's non-household water market, published its bi-annual trading party peer comparison league tables on 7 November 2019, showing wholesaler and retailer performance against the Market Performance Standards for the first six months of this financial year (April to September 2019). When compared to the 9 water and sewerage companies we were the most improved company jumping from bottom (9th) to 4th in the table.

Despite these successes, we still have work to do. This year, Ofwat is testing its new measure of customer experience, C-MeX, before launching it next year. Our industry position in these trials, currently 14th of 18, is disappointing and we are working hard to address the issues.

We have identified a number of areas of underperformance which we are taking action to reverse. For instance, the number of questions from customers that we resolve at the first time of asking is too low. We have included these in our improvement plans as we prepare for C-MeX's introduction.

We have included within our transformation plan a review of our Customer Charter and the policy, procedures and monitoring in relation to appointments, which will focus on identifying past, current and future compliance with the Guaranteed Service Standards (GSS) regulations and further improving the customer experience. This review has provided confirmation that appointments have not been made in full accordance with GSS in the current year and in 2018–19; we are seeking to ascertain whether any prior years are affected. The processing of GSS payments to all affected customers is in progress and immediate improvements have been implemented to ensure ongoing compliance.

Affordable bills

We continue to offer tailored financial support to help customers facing genuine hardship to better manage their bills. So far in 2015–20 we have helped 279,847 customers which means we have already beaten our March 2020 target overall. We are working with other water companies in our region and third sector partners to align the eligibility criteria of our social tariffs. This will make them easier for our customers to understand and enable third sector partners to refer additional customers for assistance.

We also maintain a Priority Services Register so we can deliver additional support to customers with individual needs who may require assistance in the event of a disruption to our services. We have entered a data-sharing agreement with Scottish and Southern Electricity Networks and UK Power Networks. This allows customers to easily register their needs across several utility providers, so we know how best to support them and they receive a consistent service.

Better information and advice

As referred to earlier, during the summer, we faced water supply deficit challenges in Western Hampshire. Changes to our abstraction licences restricted the amount of water we could take from the region's primary water sources, the Rivers Test and Itchen. The changes were introduced by the EA in 2018 to protect the rivers' ecosystems. After the River Test's flows dropped below an agreed prescribed level, we had to apply for a drought permit to continue taking water from the rivers to ensure that we could continue to supply water to customers. In these circumstances, water restrictions are usually introduced. However, with the help of our customers, we were able to avoid the need for restrictions. The drought permit remains in place until March 2020.

We launched a water efficiency-campaign in the area to make our customers aware of the water shortage and the possibility of restrictions. We used outdoor banners, newspaper adverts and social media advertising to promote saving water and share practical water-saving tips. During the August bank holiday consumption in the targeted areas dropped 1.43% compared to the previous year – despite a 6.25% rise in usage elsewhere. Alongside the campaign, we increased our leak-detection activity in the area and closely monitored the river flows. The combined efforts of our customers and employees avoided the need for water restrictions this summer.

Collaborating with our customers to drive down consumption is core to our wider water-efficiency programme, Target 100. In June and July, we hosted four workshops to gather feedback from stakeholders in the Isle of Wight, Sussex, Kent and Hampshire[2]. Stakeholders from a range of backgrounds attended, including representatives from local authorities. The workshops included Q&A sessions and opportunities for informal conversations between stakeholders and water company employees. 97% of attendees said they found the workshops 'interesting' or 'very interesting'.

Helping our customers to understand how their behaviour can impact our services can also help prevent blockages in our wastewater network. Our work to explain what customers should avoid putting down their drains and toilets has earned our Fat, Oil and Grease (FOG) and Unflushables team two awards so far this year.

In May, the team was awarded 'Drainage and Flood Management Initiative of the Year' at the Water Industry Awards. The award was for our Unflushables campaign, which encourages customers to dispose of wet wipes, sanitary products and other bathroom items in the bin instead of flushing them down the loo.

In June, the team won the 'Sustainable Use of Resources' Award at the Footprint Awards for improving sustainability in the food service industry by raising awareness about how to prevent fat, oil and grease from food waste causing blockages.

[2] The Sussex and Kent workshops were co-hosted with South East Water, and Southern Water partnered with Portsmouth Water for the Hampshire workshop.

Interim management report

Delivering reliable services

A constant supply of high-quality drinking water

We continue to meet our targets for discolouration and water pressure. In September 2019, our compliance with the DWI's quality measures was 99.96%, consistent with industry average.

Minimising the amount of water lost to leaks is important to us and to our customers. The pressure on Western Hampshire's water supply over the late summer made the issue even more pertinent. During 2019, our leakage rate exceeded our annual target and we anticipate that we will underperform against our five-year leakage target.

We have, therefore, significantly increased activity and investment by deploying more field personnel and installing additional acoustic loggers, as well as an increased focus on reducing our backlog of leak repair work to decrease the impact of known leaks.

Our teams are also investigating unexpected usage which could be due to leaks – for example, customers whose consumption is unusually high during the night.

Performance year to date against both the DWI's new water quality metrics Compliance Risk Index and Event Risk Index has improved from performance last year, while remaining at the bottom of the sector. We recognise that further improvements will be delivered as our investment at sites, processes, training and capability being delivered under our Water First programme continues to progress. This programme improves water supply resilience including at those sites that were previously out of service.

Removing wastewater effectively

Our performance for wastewater management so far this year has been mixed.

Overall we have seen a higher level of blockages in the year to date. There have been 9,947 blockages reported to the end of September, which is 250 incidents more than we reported at this point last year, although we forecast that the end March 2020 our target of 0.58 blocks-per-km will be achieved. We continue to deploy additional teams to physically unblock pipes and drains in high-blockage areas and explain how our customers can help keep our sewers flowing.

We have received more odour complaints than usual for this point in the year. We have invested in new odour management plans and technology which have improved the situation.

The number of flooding incidents experienced has reduced overall. However, we know that any flooding can be distressing for customers and risks harming the environment.

Looking after the environment

Caring for the environment in which we, and our customers, live and work is a fundamental part of our business.

We have recorded five serious and 237 less serious pollution incidents so far this year, an increase from 123 this time last year. As discussed in our Annual Report 2018–19 (**southernwater.co.uk/annual-report**) as part of our Pollution Reduction Plan we are using root cause analysis to identify and report issues more quickly and are rolling out pollutions awareness training to 800 employees in our wastewater business. This activity is helping us find and fix issues sooner. Further, we are targeting spend of circa £2 million of specific investment on identified asset risks and power resilience activities.

We recognise we need to continue to improve the basics of clear processes, improving the reliability of critical assets, having the right on-site alarms and ensuring a fast response should an asset fail.

In addition, we are transitioning to a more forward-looking risk approach, making greater use of predictive analysis to identify actions that will prevent future incidents. This programme will embed a culture and a capability to prevent pollution incidents occurring.

We delivered 100% of our Environment Agency 'Wastewater National Environment Programme' providing enhanced treatment at our Wastewater plants to improve our regions rivers and coastal waters to the benefit of the environment, our customers and the wider general public.

We have published our Catchment First improvement plans online, so stakeholders can learn about the schemes we have launched to manage potential pollution risks and improve water quality in our catchments. These include work with stakeholders such as farmers and land managers to reduce the amount of nitrate, pesticides and phosphorous that find their way into waterways, along with initiatives to improve the quality of our region's rivers through sustainable abstraction.

Climate change and population growth are no longer distant challenges; they have become our present reality. There has never been a better opportunity to change society's perception of the value of water and the benefits it brings to our communities and economy, and the part we all play in securing our future.

Our purpose as an organisation is to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. This means we will continue our work with our partners, adopting a more collaborative approach to water resource management and drought planning, as well as flood risk management and bathing water quality improvements.

We have signed an initial agreement of understanding with our region's three Wildlife Trusts to enter into a strategic partnership which will help support the delivery of a range of tangible outcomes to benefit residents, communities and the natural environment. We are also in advance discussions with the Rivers Trust and National Parks regarding signing similar agreements in order to further expand our partnerships.

As mentioned earlier, abstraction licences have substantially reduced the amount of water we can take from the River Test and River Itchen in Hampshire. The licence reductions aim to secure the health of these rivers, however the changes mean a shortfall of some 135 million litres of water a day during a drought, about 80% of the amount needed to supply our customers in south Hampshire, which will likely mean putting in place water restrictions for some of our customers until at least 2027.

Under the new abstraction order and undertakings, we have committed to make best endeavours to implement solutions to meet the new conditions by 2027. We plan to invest more than £800 million to make up the deficit, while ensuring water resources continue to be resilient and environmentally sustainable. Our wide-ranging plans, some of which will need Ofwat and Environment Agency approval, include desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

With 700 miles of coastline in our region, the condition of our bathing waters is one of the most tangible and important examples of our environment management. As at the time of the publication of this report, we are pleased to report our bathing waters have achieved their highest ever ratings in Defra's Bathing Water summer sampling regime: 58 of the region's 83 bathing waters have now achieved 'Excellent', compared with 53 for the reporting year 2018–19.

There are many influences on bathing water quality such as road and agricultural run-off, sewers misconnected to the drainage network and litter, to name just three.

The reason we are permitted by the Environment Agency to discharge stormwater after heavy rain is simple. If we do not allow this highly-diluted stormwater out then our customers' homes will flood. Earlier this year we completed an enormous storm storage tank tunnelled beneath Arthur's Hill in Shanklin. This will cut storm discharges by about a third in the area.

For some people no stormwater release will ever be acceptable but we have to balance the needs of bathing water users against the advice of our regulators and value for money for our customers.

Our ongoing Beauty of the Beach campaign in partnership with the EA continued over the summer months. The campaign was used by Adur and Worthing Councils, Arun District Council, and Thanet District Council. It encourages our customers to take their litter home, avoid flushing anything other than pee, poo and paper down their toilets, and clean up after their dogs. All of this can reduce pollutions so everyone can enjoy a clean, safe visit to our region's beaches.

We believe it is crucial businesses comply with their trade effluent consents, not only from a legal point of view, but in the interests of protecting the environment and ensuring our other customers are not impacted by their discharge. We will always work with customers where possible, but we will not hesitate to take legal action if necessary. We prosecuted a food manufacturer in Partridge Green, Sussex, for misusing the local sewer network following their continued failure to comply with the limits of their trade effluent consent, despite numerous warnings. After pleading guilty at Crawley Magistrates Court on 19 September, the manufacturer was ordered to pay a £2,500 fine.

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Delivering reliable services

We have also begun upgrading the gas holders fitted at 16 of our sites. These devices allow us to capture biogas from our wastewater treatment process and use it to heat and power the site. The new design can store more gas – enough to power the equivalent of 1,000 homes a year. We have also seen increased availability and production from our combined heat and power engines, improving power generation by over 5%.

Improving the resilience of our services

Resilience is at the heart of our business plan for the period 2020–25. Over the past six months, our transformation programme has strengthened our systems and processes, and we have put in place a comprehensive operational improvement plan. Our activity includes the introduction of a new Wholesale Operating model, which includes improvements in systems and asset management, engineering and construction and operational support and maintenance. This plan is being delivered through integrated business planning. We have also reinforced an industry-standard ‘three lines of defence’ model for regulatory reporting and increased our reporting to Ofwat for greater scrutiny. We are making further improvements in our enterprise risk and resilience via improvements in incident management, integrated planning and an improved understanding of how interconnecting shocks or failures have potential to affect our services.

Our day-to-day performance has also been enhanced by our Operational Excellence (OE) programme. Initially led by a project team, we have now recruited a permanent OE team to oversee this activity as business as usual. Following successful trials, we have rolled out weekly, cross-functional hub meetings across every frontline operational team, along with hubs at senior management levels for escalation purposes. During our recent ISO 9001 quality management accreditation audit, our BSI auditors commended OE’s focus on continuous improvement.

Alongside operational improvements, a key focus of our transformation has been to create a culture of ethical decision-making with a new organisational structure that supports this. We have restructured our Executive Leadership Team and appointed a Director of Risk and Compliance to challenge front-line teams. Our Board has been further strengthened by the appointment of Keith Lough as the new Chairman and Kevin McCullough as an independent non-executive director. Both have held senior positions in the energy and utility sector and bring invaluable experience that will help shape our future direction.

We have refreshed our company vision, values and purpose and rolled-out compulsory training to support the introduction of a new Code of Ethics. This is supported by a robust Speak Up policy, initially introduced in 2016, recently refreshed and strengthened. In order to build a culture which promotes openness, trust and transparency, the policy encourages employees to actively raise concerns across multiple channels if they witness conduct or behaviour that is not right, and to be confident that they will be protected if they do.

We have also encouraged open dialogue; our Executive Leadership Team travelled to 29 of our sites throughout August and September to meet colleagues and hear their feedback. Meanwhile, we held our first ‘Values Week’ in October to prompt teams to discuss the importance of one of our values ‘doing the right thing’ in their roles.

Public recognition of our approach to risk came with the award of ‘Risk Management Programme of the Year’ at the CIR Risk Management Awards held in November 2019, to the company’s risk management team responsible for engineering and construction programme management.

Health, safety, security and wellbeing

The health, safety, security and wellbeing (HSSW) of our staff, supply chain and the communities in which we operate continues to be a priority. Our performance remains amongst the strongest in the sector and we enjoyed a six month period with no lost time or major accidents in our capital delivery programme (approximately half a million person hours accident free). We do not, however, rest on that level of performance and insist on a year-on-year 10% reduction in accidents. During the first six months of 2019–20 we fell just short of this expectation and efforts have been increased across the business to raise awareness of risks, improve processes and ensure every employee plays their part in maintaining and improving performance.

In July, we held our six-monthly Partnership Forum which focused on best practice in HSSW and highlighted the importance of working together to ensure everyone feels safe and supported at work. It was attended by our operational employees alongside representatives from our key partners. During September, our employees were also offered a free health check from our construction partner CMDP's occupational health experts.

Our communities

Our community team has attended 30 local community events so far this year, engaging with over 8,100 people. Ten of these events took place in the Isle of Wight, where our team on the island spoke with over 700 customers. We also attended events in Western Hampshire during the summer months to promote water-efficiency and raise awareness about the supply challenge in the area.

So far this year, 267 employees have used their community volunteer days – contributing 1,584 hours of volunteering to 37 different charity and community projects.

Many of our employees live near beaches and caring for our coastline is important to them. So far this year, our employees have spent 272 hours taking part in beach cleans at: Atherington, Dymchurch, Ovingdean, Seaford, Selsey and Shoreham.

We have also committed to help underrepresented groups and people from disadvantaged backgrounds pursue careers in the energy and utilities sector. Our sector is not yet representative of the UK workforce for gender, BAME, disability, and under 24s. To help address this, we have signed up to the Energy and Utilities Skills Partnership's Inclusion Commitment and The Social Mobility Pledge.

Looking ahead

Over the months ahead, our main focus will be to continue transforming our business to ensure we are ready to deliver our ambitious plan for the period 2020–25. However, the changes will not stop there.

We are taking care to ensure our improvements are sustainable. The progress of our transformation is tracked through monthly Executive and Board updates and we have developed an integrated roadmap that pulls together our key programmes to enable its delivery.

Through our transformation, Southern Water is determined to begin the next five-year period on a strong foundation to deliver our commitments to customers and make sure our organisation is fit for the challenges and opportunities facing our region.

Interim management report

Financial performance

Key financial performance indicators

	Six months ended 30 September 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m	Increase/ (decrease) %
Revenue	**439.9**	440.1	(0.1)
Operating costs	**(320.8)**	(300.5)	(6.8)
Operating profit	**120.5**	140.1	(14.0)
Net finance costs*	**(70.8)**	(57.5)	(23.1)
Underlying profit before taxation	**50.2**	82.9	(39.4)
Gross capital expenditure**	**241.9**	187.0	29.4
Net cash inflow from operating activities	**210.2**	237.2	(12.2)

* In order to show pre-tax performance on an underlying basis the fair value gains and losses on financial derivatives have been excluded from the table.

** Excludes asset adoptions, capitalised interest and leased assets transferred as part of the transition to IFRS16.

Income statement

Revenue to £439.9 million (period to 30 September 2018: £440.1 million). This decrease principally results from a fall in income from our developer related activities, particularly sewer adoptions. Our wastewater and water revenue increased due to changes to our water and wastewater tariffs which are linked to inflation, although this has been partially reduced by lower levels of consumption due to the extended heatwave last summer as well as an increase in vacant properties. An analysis of revenue is provided in note 5.

Operating costs for the first half of the year of £320.8 million increased by 6.8% (period to 30 September 2018: £300.5 million). This increase, described in more detail below, was largely driven by inflation, costs associated with the ongoing transformation programme, the cost of operational incidents, increased activity to tackle leakage and additional depreciation arising from our capital programme.

As described in the Chairman's Introduction, we have been continuing our transformation of the business. In particular we incurred increased costs insourcing our IT management which has included investing in the right people and developing new process and systems. In addition we incurred one-off costs in Customer Services transferring our operations to our new partner, Capita.

Operationally we have experienced a number of wastewater pollution incidents this year and have increased our expenditure in this area in order to prevent any reoccurrences. We have also been experiencing higher levels of water leakage than in previous years and have increased our efforts to tackle this. While the additional leakage activity has incurred extra operating costs we are pleased to report that this is starting to deliver improvements to our performance.

These additional costs have partially been offset by efficiencies and a reduction in costs regarding the submission of our Business Plan 2020–25 where the majority of work was completed in the prior year.

As a consequence of the above, operating profit for the period decreased by 14.0% to £120.5 million (period to 30 September 2018: £140.1 million).

Net finance costs, excluding fair value movements on financial derivatives, increased to £70.8 million (period to 30 September 2018: £57.5 million). This increase was largely due to a reduction in interest receivable from group companies (£23.9 million) following the partial repayment of an inter-group loan to SWSG Limited, offset by higher interest capitalised following the continued investment in our capital programme (£2.9 million) and a decrease in bond interest payable net of swap receipts following a restructure of our debt portfolio (£8.2 million).

As a result of the reduction in operating profit and the increase in finance charges, the underlying profit before taxation reduced to £50.2 million (period to 30 September 2018: £82.9 million).

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 loss on our derivative financial instruments amounted to £123.9 million (period to 30 September 2019: gain of £17.6 million). To calculate the fair value of our derivative instruments we discount their forecast future cash flows using UK Government bond gilt 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 decrease in gilt yields during the past six months which has resulted in an increase 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 the loss from continuing operations amounted to a credit of £11.2 million (period to 30 September 2018: charge £18.4 million).

The loss from continuing operations after tax was £62.5 million (period to 30 September 2018: profit of £82.1 million).

Statement of financial position

As at 30 September 2019, non-current assets were £6,517.7 million (£6,302.1 million at 31 March 2019), an increase of £215.6 million from 31 March 2019. This increase mainly results from capital investment of £241.9 million, finance lease additions of £45.4 million, sewer adoptions of £0.7 million, capitalised interest of £14.4 million offset by depreciation and amortisation of £131.4 million for the period. Our non-current financial derivative assets also increased their value by £44.6 million.

Current assets decreased by £415.7 million from £709.2 million at 31 March 2019 to £293.5 million at 30 September 2019. This reduction primarily arises from a fall in cash of £366.4 million, explained in the cash flow analysis below, and a decrease in intercompany debt with Southern Water Services (Finance) Limited (SWSF) of £75.3 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 2019, payments relating to the prior year were made in the first week of April 2019 reducing our inter group debt in the current period.

Current liabilities of £578.1 million at 30 September 2019 were £292.9 million lower than at 31 March 2019. This fall is largely caused by a reduction in current borrowings following the repayment of our Class A1 £300 million loan although this was partially offset by an increase in our short term facilities of £90.0 million. Current liabilities at 30 September 2019 also include a lower interest accrual than March, of £77.3 million, due to the timing of interest payments on our bonds.

Included Included within current and non-current liabilities are amounts totalling £138.5 million, which were recognised in the second six months to 31 March 2019, in respect of the regulatory settlement following the Ofwat investigation into wastewater treatment compliance as discussed on page 4. The company is also subject to ongoing EA investigations as set out on page 4. The details of the EA prosecution or the findings of the ongoing investigation are not known at this time, so the potential financial impacts of these cannot be assessed. As a result no provisions have been made in the interim financial statements for the period to 30 September 2019. We have disclosed further information of this contingent liability in note 18 to the financial information.

Long-term borrowings have marginally declined from 31 March 2019, decreasing by £18.6 million, from £3,270.9 million to £3,252.3 million at 30 September 2019. This decrease predominantly results from the partial repayments of our preference shares (£29.2 million) and EIB loan (£4.7 million) offset by indexation charged on inflation-linked bonds for the period (£16.3 million). Gearing remains comfortably within the requirements of our debt covenants of being below 85%.

The liability associated with our derivative financial instruments increased by £168.5 million, from £1,428.2 million at 31 March 2019 to £1,596.7 million at 30 September 2019 largely due to a decrease in government bond yields as described in the commentary in relation to the income statement on page 15.

The pension deficit at 30 September 2019 of £174.7 million (31 March 2019: £186.7 million) is based on the latest actuarial valuation as at 31 March 2019 updated by a qualified independent actuary to reflect the latest market yields and asset values as at 30 September 2019. The decrease in the deficit of £12.0 million largely results from a lump sum payment of £17.3 million which forms part of the agreed long term funding arrangement with the Trustees.

Overall net assets decreased from £837.7 million at 31 March 2019 to £769.6 million at 30 September 2019.

Cash flow

The cash position decreased from £372.0 million at 31 March 2019 to £5.6 million at 30 September 2019, a reduction of £366.4 million. This resulted from net cash outflows in investing activities of £179.3 million and financing activities of £397.3 million being offset by net cash inflows from operating activities of £210.2 million. These movements are explained in more detail below.

Net cash inflow from operating activities in the period amounted to £210.2 million (period to 30 September 2018: £237.2 million). This decrease in cash inflow compared to the prior year mainly results from lower operating profits, and an additional lump sum pension contribution made as part of the funding arrangement agreed with the Pensions Trustees.

Net cash used in investing activities amounted to £179.3 million (period to 30 September 2018: £137.7 million). The increase of £41.6 million primarily relates to an escalation in our capital programme this year, partially offset by the movement in the loan to our subsidiary SWSF.

Net cash used in financing activities amounted to £397.3 million (period to 30 September 2017: £152.1 million) an increase of £245.2 million. The principal reasons for this increase in cash outflow were the repayments of a £300 million Class A loan and £29.2 million of preference shares offset by a net increase in our facilities of £90.0 million. Also our interest payments were higher as some of last year's half year payments fell into October.

There were no equity dividend payments in the first six months of this year, these relate to the Southern Water Services Group Limited (SWSG) dividend loop (period to 30 September 2018: £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.

Credit ratings

Our credit ratings were revised lower in the period as a result of Ofwat's Draft Determination of our proposed Business Plan 2020–25, which included a further challenge on Totex (total operating and capital investment expenditure), a further challenge on the weighted average cost of capital, and negatively skewed Outcome Delivery Incentive (ODI) rewards and penalties. We have made representations on these challenges and highlighted the risk to Ofwat of a further reduction to the weighted average cost of capital on the financeability of our plan.

The Final Determination is expected to be published by Ofwat on 16 December. There is a risk of a further credit rating downgrade by one or more Rating Agencies following the Final Determination, which could result in a Trigger Event under our Common Terms Agreement (defined below) which in turn would require creditor consents to the raising of new debt and restrictions on the payment of dividends. A further credit rating downgrade by Moody's would lead to a restriction on the payment of dividends under the terms of our Licence. We have recourse to the Competition and Markets Authority to appeal the Final Determination.

Our current credit ratings are shown in the table below:

Credit rating	As at signing date of accounts
Standard & Poor's	Class A debt: BBB+ (negative outlook)
Fitch	Class A debt: BBB+ (negative outlook)
Moody's	Class A debt: Baa3 (stable outlook)

Note:

- A Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below.
- A cash lock-up under our Licence of Appointment would occur where the credit rating outlook assigned the lowest investment grade credit rating has been changed from stable or positive to negative.
- A Default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

How we finance the business

Southern Water established a financing structure, known as a Whole Business Securitisation (WBS), in 2003 following its sale by ScottishPower. The WBS sets strict rules which helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. The financing group provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings. No security is provided over our individual regulated operating assets. This structure is designed to ensure that, in the event that either Southern Water or SWSF were to default on their debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the event of default.

In 2003, a Common Terms Agreement (CTA) between the members of the financing group and its debt investors was established. The CTA sets out arrangements for the ongoing management of the debt issuance programme as well as a number of operating arrangements in order to minimise our financial risk and adhere to good industry practice.

This includes precautionary 'early warning' limits, called Trigger Events or cash lock ups, which prevent the payment of dividends if a pre-determined limit is breached. We have not breached a limit at any time since the implementation of the financing framework in 2003.

Going concern

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 30 September 2019.

In forming this assessment the directors have considered the following information:

- The company's business activities, together with the factors likely to affect its future development, performance and position.
- The financial position of the company, its forecast monthly cash flows for the period to March 2021, liquidity position, covenants and borrowing facilities.
- Reasonable downside sensitivities to the cash flows to check that that the company can operate within its current facilities and covenants.
- The company has available a combination of cash and committed undrawn bank facilities totalling £120.6 million at 30 September 2019 (30 September 2018: £111.8 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements. In addition, the company has current plans to raise funds to provide greater liquidity in the period.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.
- The company has a regular requirement to raise new finance in order to repay scheduled loan maturities and to finance the capital investment programme. The next requirement is to refinance a loan of £350 million by 31 March 2021 and plans, which the Board has reviewed, are underway to ensure that funding is in place to achieve this.
- The Board also considered the downside scenario of a credit rating downgrade (noted under Credit ratings above) and the ability to both maintain existing finance facilities (including the regular rollover of the £350 million Revolving Credit Facility) and the likelihood of raising further finance in advance of the March 2021 £350 million loan facility maturity. This included obtaining legal and financial advice that it was highly likely that the required consents would be forthcoming if such a scenario were to arise.

As a consequence, the directors believe that the company is well placed to manage its business risks successfully.

The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the interim financial statements.

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 quarterly basis and the Risk Committee. The Risk Committee receives a risk report at its meetings three times per year, and advises the Board on the company's overall risk appetite, tolerance and strategy. The Board retains ownership and approval of the company's overall risk appetitie, tolerance and strategy.

The 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 Financial Statements although, as a result of changes to our credit ratings and Ofwat's Draft Determination of our Business Plan for 2020–25, our financial resilience risk has increased. The principal risks are 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 and information technology systems
- Wastewater treatment works failures and pollution incidents
- Health and safety
- Financial resilience
- Compliance with regulations and legislation
- Delivery of our capital investment programme
- Political and regulatory reform and PR19 price review
- Transformation and business change

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 18.

Further detailed descriptions of these risks and uncertainties and our risk management process is included in the Annual Report and Financial Statements for the year ended 31 March 2019, 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 2019 were:

Keith Lough
(Chairman) (appointed 1 August 2019)

Ian McAulay
(Executive director – Chief Executive Officer)

Sebastiaan Boelen
(Executive director – Chief Financial Officer)

Paul Sheffield
(Senior independent non-executive director)
(Acting Chairman 1 April to 31 July 2019)

Rosemary Boot
(Independent non-executive director)

Gillian Guy
(Independent non-executive director)

Kevin McCullough
(Independent non-executive director)
(appointed 18 July 2019)

Michael Putnam
(Independent non-executive director)

Wendy Barnes
(Non-executive director)

Sara Sulaiman
(Non-executive director)

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 FRS 104 ‘Interim Financial Reporting’; 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 27 November 2019:

Keith Lough
Chairman

Sebastiaan Boelen
Chief Financial Officer

Interim financial statements

Condensed income statement

For the six months ended 30 September 2019

Condensed income statement for the six months ended 30 September 2019			
		Six months ended 30 September 2019	Six months ended 30 September 2018
	Notes	**Unaudited**	Unaudited
Continuing operations		**£m**	£m
Revenue	5	**439.9**	440.1
Other operating income	5	**1.4**	0.5
Operating costs			
– before depreciation and amortisation		**(189.4)**	(171.9)
– depreciation and amortisation		**(131.4)**	(128.6)
Total operating costs		**(320.8)**	(300.5)
Operating profit		**120.5**	140.1
Other income	5	**0.1**	0.1
Profit on disposal of fixed assets	5	**0.4**	0.2
Finance income		**9.7**	28.9
Finance costs		**(80.5)**	(86.4)
Fair value (losses)/gains on derivative financial instruments		**(123.9)**	17.6
Net finance cost	6	**(194.7)**	(39.9)
(Loss)/profit before taxation from continuing operations		**(73.7)**	100.5
Tax credit/(charge)	7	**11.2**	(18.4)
(Loss)/profit after taxation from continuing operations		**(62.5)**	82.1

Interim financial statements

Condensed statement of other comprehensive income

For the six months ended 30 September 2019

Condensed statement of other comprehensive income for the six months ended 30 September 2019			
	Notes	**Six months ended 30 September 2019 Unaudited £m**	Six months ended 30 September 2018 Unaudited £m
(Loss)/profit for the period		**(62.5)**	82.1
Items that cannot be reclassified to profit or loss			
Actuarial (loss)/gain on retirement benefit obligation	15	**(2.4)**	9.9
Deferred tax asset movement relating to retirement benefit obligation	7	**0.4**	(1.7)
		(2.0)	8.2
Total comprehensive (loss)/income for the period		**(64.5)**	90.3

Interim financial statements

Condensed statement of financial position

As at 30 September 2019

Condensed statement of financial position as at 30 September 2019			
	Notes	Six months ended 30 September 2019 Unaudited £m	Year ended 31 March 2019 Unaudited £m
Non-current assets			
Intangibles	9	**39.9**	45.6
Property, plant and equipment	10	**6,227.8**	6,051.1
Investments		**29.2**	29.2
Derivative financial instruments	11	**90.8**	46.2
Other non-current assets	12	**130.0**	130.0
		6,517.7	6,302.1
Current assets			
Inventories		**5.2**	4.7
Trade and other receivables		**282.7**	332.5
Cash and cash equivalents		**5.6**	372.0
		293.5	709.2
Total assets		**6,811.2**	7,011.3
Current liabilities			
Borrowings		**(294.3)**	(504.3)
Trade and other payables		**(277.3)**	(362.3)
Lease liabilities		**(2.3)**	(0.2)
Regulatory settlement liability	13	**(3.0)**	(3.0)
Provisions for liabilities	14	**(1.2)**	(1.2)
		(578.1)	(871.0)
Non-current liabilities			
Borrowings		**(3,252.3)**	(3,270.9)
Lease liabilities		**(39.6)**	(0.8)
Derivative financial instruments	11	**(1,596.7)**	(1,428.2)
Deferred tax liabilities		**(230.9)**	(247.7)
Retirement benefit obligations	15	**(174.7)**	(186.7)
Regulatory settlement liability	13	**(135.5)**	(135.5)
Provisions for liabilities	14	**(5.3)**	(5.4)
Other non-current liabilities		**(28.5)**	(27.4)
		(5,463.5)	(5,302.6)
Total liabilities		**(6,041.6)**	(6,173.6)
Net assets		**769.6**	837.7
Equity			
Called up share capital		**0.1**	0.1
Share premium account		**46.3**	46.3
Non-distributable reserve		**52.6**	53.8
Retained earnings		**670.6**	737.5
Total equity		**769.6**	837.7

Interim financial statements

Condensed statement of changes in equity

For the six months ended 30 September 2019

Condensed statement of changes in equity for the six months ended 30 September 2019	Called up share capital £m	Share premium £m	Non-distributable reserve £m	Retained earnings £m	**Total £m**
Balance at 1 April 2019	**0.1**	**46.3**	**53.8**	**737.5**	**837.7**
Profit/(loss) for the financial period	–	–	0.7	(63.2)	(62.5)
Other comprehensive (loss)/income for the period:					
Actuarial loss on pension scheme	–	–	–	(2.4)	(2.4)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	0.4	0.4
Total comprehensive income/(loss) for the period	**–**	**–**	**0.7**	**(65.2)**	**(64.5)**
Reserves transfer	–	–	(1.9)	1.9	–
Equity dividends (note 8)	–	–	–	(3.6)	(3.6)
At 30 September 2019	**0.1**	**46.3**	**52.6**	**670.6**	**769.6**

Condensed statement of changes in equity for the six months ended 30 September 2018	Called up share capital £m	Share premium £m	Non-distributable reserve £m	Retained earnings £m	**Total £m**
Balance at 1 April 2018 (restated*)	**0.1**	**46.3**	**46.7**	**1,032.4**	**1,125.5**
Profit for the financial period	–	–	6.3	75.8	82.1
Other comprehensive income/(loss) for the period:					
Actuarial gain on pension scheme	–	–	–	9.9	9.9
Movement on deferred tax relating to retirement benefit obligations	–	–	–	(1.7)	(1.7)
Total comprehensive income for period	**–**	**–**	**6.3**	**84.0**	**90.3**
Reserves transfer	–	–	(0.7)	0.7	–
Equity dividends (note 8)	–	–	–	(23.0)	(23.0)
At 30 September 2018	**0.1**	**46.3**	**52.3**	**1,094.1**	**1,192.8**

*The prior year opening balances have been restated to align with the final adjustments on transition to IFRS 15 as disclosed in the financial statements for the year to 31 March 2019.

Interim financial statements

Condensed statement of cash flows

For the six months ended 30 September 2019

Condensed statement of cash flows for the six months ended 30 September 2019

	Notes	Six months ended 30 September 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m
Cash from operations		210.2	242.6
Tax paid		–	(5.4)
Net cash from operating activities	16	210.2	237.2
Investing activities			
Interest received		6.9	28.9
Purchase of property, plant and equipment		(255.4)	(174.8)
Purchase of intangible assets		(9.0)	(15.2)
Receipt of grants and contributions		2.7	0.8
Proceeds on disposal of property, plant and equipment		0.2	–
Repayments of intercompany loan receivables		75.3	49.0
Proceeds from disposal of business		–	2.5
Net cash used in investing activities		(179.3)	(137.7)
Financing activities			
Equity dividends paid		–	(23.0)
Interest paid		(147.8)	(128.5)
Preference share dividends		(4.8)	(6.5)
Repayment of borrowings		(389.0)	(22.7)
Repayments of obligations under finance leases	17	(0.7)	(0.3)
Proceeds of new loans		145.0	–
Net cash used in financing activities		(397.3)	(152.1)
Net decrease in cash and cash equivalents		(366.4)	(52.6)
Cash and cash equivalents at beginning of the period		372.0	164.4
Cash and cash equivalents at end of the period	17	5.6	111.8

Notes to the interim financial information For the six months ended 30 September 2019

1 Basis of preparation and accounting policies

The audited annual financial statements of the company are prepared in accordance with FRS 101 'Reduced Disclosure Framework' 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 2019, 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 2019 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 2019 were approved by the Board on 12 July 2019 and the auditor's report on those accounts was unqualified. The condensed financial statements for the six months ended 30 September 2019 should be read in conjunction with the Annual Report and Financial Statements for the year ended 31 March 2019 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 risk of a Trigger Event as a result of limited credit rating headroom. The next event which may affect credit rating will be the Final Determination announcement on 16 December 2019. A Trigger Event at Southern Water Services will not affect forecast liquidity headroom.

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 2019, 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 16 'Leases' has been applied.

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 was effective for the company from 1 April 2019. Changes to significant accounting policies and the impact on the results and net assets of the company are set out in note 3.

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 2019.

As at 31 March 2019, the accrual for unbilled measured income was £107.4 million. The value of household billings raised in the period to 30 September 2019 for consumption in prior years was £104.2 million, £3.2 million (3.0%) less than the accrual at 31 March 2019, with further billing for prior years still to be finalised.

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 2019 (the policy for recognising and measuring income taxes in the interim period is described in Note 1 above).

A number of new standards and amendments are effective for periods beginning from 1 January 2019, including IFRS 16 'Leases'. The effect of this new standard on the company's financial statements is described below.

Other changes to accounting standards in the current year had no material impact.

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance lease, requiring the recognition of a right-to-use asset and a lease liability at commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged.

The company acts as a lessor in respect of the sale of income rights relating to aerial masts and sites owned by the company to third parties. Income received from such sales is received entirely in advance and is taken to deferred revenue and credited to the income statement over the life of the lease. This accounting treatment remains unchanged from previous periods.

Other than the aerial mast agreement detailed above, the company is not party to any material leases where it acts as a lessor, but does have a number of material property and vehicle leases.

Details of the company's accounting policies under IFRS 16 are set out below, followed by a description of the impact of adoption.

Accounting policies under IFRS 16 Leases

The company assesses whether a contract is or contains a lease, at inception of the contract. The company recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less), and leases of low value assets (£5,000 or less). For these leases, the company recognises the lease payments as an operating expense on a straight-line basis over the term of the lease.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the company uses its incremental borrowing rate.

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The right-of-use assets comprise the initial measurement of the corresponding lease, lease payments made at or before the commencement day and any direct initial costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented separately from other assets in the notes to the financial statements.

For short-term leases (lease term of 12 months or less) and leases of low-value assets, the company has opted to recognise a lease expense on a straight-line basis as permitted by IFRS 16. This expense is presented within operating costs in the income statement.

Notes to the interim financial information (continued)

Transition approach

The company has applied IFRS 16 using the modified retrospective approach, without restatement of comparative information. In respect of those leases previously treated as operating leases, the company has elected to measure its right-of-use assets using the approach set out in IFRS 16.C8(b)(ii). Under IFRS 16 C8(b)(ii) right-of-use assets are calculated as an amount equal to the lease liability (being the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application), adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of application.

The company's weighted average incremental borrowing rate applied to lease liabilities as at 1 April 2019 is 3.509%.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The company has used this practical expedient with respect to the maintenance element associated with vehicle leases.

As part of the modified retrospective approach to transition to IFRS 16 for leases previously classified as operating leases applying IAS 17, the company has also elected to use the practical expedient permitted to apply a single discount rate to portfolios of leases with reasonably similar characteristics.

Impact on lessee accounting

Former operating leases

IFRS 16 changes how the company accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

Applying IFRS 16, for all leases, the company now recognises right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments as described above.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets.

Under IFRS 16 the company recognises depreciation of right-of-use assets and interest on leases liabilities in the income statement, whereas under IAS 17 operating leases previously gave rise to a straight-line expense in operating expenditure.

Under IFRS 16 the company separates the total amount of cash paid for leases that are on balance sheet into a principal portion (presented within financing activities as repayments of obligations under finance leases) and interest (presented within financing activities as interest paid) in the cashflow statement. Under IAS 17 operating lease payments were presented as operating cash flows.

Former finance leases

The main differences between IFRS 16 and IAS 17 with respect to assets formerly held under a finance lease is the measurement of the residual guarantees provided by the lessee to the lessor. IFRS 16 requires that the company recognises as part of its lease liability only the amount expected to be payable under a residual value guarantee, rather than the maximum amount guaranteed as required by IAS 17. This change did not have a material effect on the company's financial statements.

Notes to the interim financial information (continued)

Financial impact

The application of IFRS 16 to leases previously classified as operating leases under IAS 17 resulted in the recognition of right-of-use assets and lease liabilities. Prepayments of rentals as at the transition date have been derecognised and adjusted through the value of the related assets. The adjustments as at the date of initial application are shown in the table below.

Statement of financial impact

	As previously reported at 31 March 2019	Impact of IFRS 16	As restated at 1 April 2019
	£m	£m	Unaudited
Non-current assets			
Property, plant and equipment	6,051.1	45.4	6,096.5
Current assets			
Prepayments	17.4	(3.7)	13.7
Total impact on assets		41.7	
Current liabilities			
Lease liabilities	(0.2)	(2.1)	(2.3)
Non-current liabilities			
Lease liabilities	**(0.8)**	(39.6)	(40.4)
Total impact on liabilities		(41.7)	
Retained earnings		–	

Of the total right-of-use assets of £45.4 million recognised at 1 April 2019, £42.1 million related to leases of property and £3.3 million to leases of vehicles.

The table below presents a reconciliation from operating lease commitments disclosed at 31 March 2019 to lease liabilities recognised at 1 April 2019.

	£m
Operating lease commitments disclosed under IAS 17 at 31 March 2019	20.1
Effect of discounting	(0.9)
Contracts reassessed under IFRS 16 to contain a lease	22.9
Prepayments on reassessed contracts as at 31 March 2019	(0.4)
Finance lease liabilities recognised under IAS 17 at 31 March 2019	1.0
Lease liabilities recognised at 1 April 2019	**42.7**

In terms of the income statement impact, the application of IFRS 16 resulted in a decrease in other operating expenses and an increase in depreciation and interest expense compared to IAS 17. During the six months ended 30 September 2019, in relation to leases under IFRS 16, the company recognised the following amounts in the income statement:

	£m
Depreciation	1.8
Interest expense	0.6

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 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m
Water and sewerage services		
Household – measured	**271.6**	268.7
Household – unmeasured	**65.8**	67.8
Non-household – measured	**74.2**	69.4
Non-household – unmeasured	**2.5**	2.5
Total water and sewerage services	**414.1**	408.4
Bulk supplies	**1.8**	1.8
Infrastructure charge receipts	**4.5**	6.7
Requisitioned mains and sewers	**0.4**	0.3
Diversions	**1.4**	0.9
Adoptions	**0.7**	6.3
Other services	**17.0**	15.7
Total revenue	**439.9**	440.1
Other operating income	**1.4**	0.5
Other income	**0.1**	0.1
Profit on disposal of fixed assets	**0.4**	0.2
Interest receivable (note 6)	**5.2**	0.5
Interest revenue from SWSG Limited (note 6)	**4.5**	28.4
Total income	**451.5**	469.8

Notes to the interim financial information (continued)

6 Net finance costs

Net finance costs	Six months ended 30 September 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m
Finance income		
Interest revenue from SWSG Limited	**4.5**	28.4
Interest receivable on swap instruments	**5.0**	–
Deposit income on short-term bank deposits	**0.2**	0.5
	9.7	28.9
Finance costs		
Interest payable on other loans	**(6.4)**	(4.1)
Interest paid to SWSF Ltd	**(66.6)**	(69.8)
Indexation	**(16.3)**	(19.3)
Amortisation of issue costs	**(1.8)**	(1.8)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of deferred credits	**2.3**	4.9
Amortisation of bond premium	**0.3**	0.3
Finance lease interest	**(0.6)**	–
Other finance expense	**(2.1)**	(2.3)
Dividends on preference shares	**(3.8)**	(5.9)
	(94.9)	(97.9)
Amounts capitalised on qualifying assets	**14.4**	11.5
	(80.5)	(86.4)
Fair value (losses)/gains on derivative financial instruments		
Derivative financial instruments not designated as hedges	**(123.9)**	17.6
Net finance costs	**(194.7)**	(39.9)

Notes to the interim financial information (continued)

7 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 2019	Six months ended 30 September 2018
	Unaudited	Unaudited
	£m	£m
Current tax:		
In respect of the current period	**5.1**	7.7
Total current tax charge	**5.1**	7.7
Deferred tax:		
Origination and reversal of temporary differences	**(16.3)**	10.7
Total deferred tax charge	**(16.3)**	10.7
Total tax charge on profit on continuing operations	**(11.2)**	18.4

In line with the requirements of FRS 104, the tax charge for the six months ended 30 September 2019 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 2020.

A reduction in the main rate of corporation tax to 17% from the 1 April 2020 was enacted in the Finance Act 2016, and deferred tax balances at 30 September 2019 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 2019	Six months ended 30 September 2018
	Unaudited	Unaudited
	£m	£m
Arising on income and expenses recognised on other comprehensive income:		
Tax (credit)/charge on actuarial (losses)/gains on defined benefit pension scheme	**(0.4)**	1.7
Total deferred tax (credit)/charge recognised in other comprehensive income	**(0.4)**	1.7

Notes to the interim financial information (continued)

8 Dividends

Dividends	Six months ended 30 September 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m
Equity dividends paid:		
– SWSG Dividend Loop*	**3.6**	23.0
– Ordinary	**–**	–
	3.6	23.0

* These dividends are paid via intermediary holding companies to Southern Water Services Group Limited (SWSG), along with associated group tax relief payments. This enables SWSG to pay the interest due on the inter-company loan to SWS. This is a circular transaction, the effect of which is a net result/cash flow for the company of nil.

9 Intangible assets

Intangible assets	£m
Cost	
At 1 April 2019	128.1
Additions	3.8
At 30 September 2019 (unaudited)	131.9
Accumulated amortisation	
At 1 April 2019	82.5
Charge for the period	9.5
At 30 September 2019 (unaudited)	92.0
Net book amount	
At 30 September 2019 (unaudited)	**39.9**

Notes to the interim financial information (continued)

10 Property, plant and equipment

Property, plant and equipment	
	£m
Cost	
As previously reported at 31 March 2019	8,822.6
Recognition of right-to-use assets at 1 April 2019 (note 3)	45.4
As restated at 1 April 2019	8,868.0
Additions in the period	253.2
Disposals	(0.9)
At 30 September 2019 (unaudited)	9,120.3
Accumulated depreciation	
At 1 April 2019	2,771.5
Charge for the period	121.9
Disposals	(0.9)
At 30 September 2019 (unaudited)	2,892.5
Net book amount	
At 30 September 2019 (unaudited)	**6,227.8**

Notes to the interim financial information (continued)

11 Derivative financial instruments

Categories of financial instruments at fair value		
	Six months ended 30 September 2019	Year ended 31 March 2019
	Unaudited	Audited
	£m	£m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**90.8**	46.2
Total derivative financial assets	**90.8**	46.2
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**(1,596.7)**	(1,428.2)
Total derivative financial liabilities	**(1,596.7)**	(1,428.2)

Changes in value of financial instruments at fair value		
	Six months ended 30 September 2019	Six months ended 30 September 2018
	Unaudited	Unaudited
	£m	£m
Profit for the year has been arrived at after (charging)/crediting:		
Financial assets at fair value		
Designated as FVTPL	**44.6**	3.9
Financial liabilities at fair value		
Designated as FVTPL	**(168.5)**	13.7
Fair value (loss)/gain on derivative financial instruments	**(123.9)**	17.6

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)

12 Non-current assets

Non-current assets	Six months ended 30 September 2019	Year ended 31 March 2019
	Unaudited	Audited
	£m	£m
Amounts owed by SWSG	130.0	130.0

Amounts owed by group undertakings represent a loan to SWSG 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.

13 Regulatory settlement liability

Regulatory settlement liability	Six months ended 30 September 2019	Year ended 31 March 2019
	Unaudited	Audited
	£m	£m
At 1 April	138.5	–
Increase in period/year	–	138.5
At 30 September 2019 and 31 March 2019	138.5	138.5
Included in:		
Current liabilities	3.0	3.0
Non-current liabilities	135.5	135.5
	138.5	138.5

The company has been co-operating with Ofwat in relation to its investigation into the management, operation and performance of the company's wastewater treatment works. That investigation has resulted in Ofwat taking enforcement action. Ofwat has issued Southern Water with a financial penalty amounting to £3.0 million and, to ensure that customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and these amounts were recognised and provided for in the financial statements for 2018–19. The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

Notes to the interim financial information (continued)

14 Provisions for liabilities

Environmental obligations	Six months ended 30 September 2019	Year ended 31 March 2019
	Unaudited	Audited
	£m	£m
At 1 April	**6.6**	3.4
Utilised in period/year	**(0.1)**	(0.1)
Increase in period/year	**–**	3.3
At 30 September 2019 and 31 March 2019	**6.5**	6.6
Included in:		
Current liabilities	**1.2**	1.2
Non-current liabilities	**5.3**	5.4
	6.5	6.6

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and environmental commitments made for ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

Notes to the interim financial information (continued)

15 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 dependent 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 was made in November 2018.

The retirement benefit obligations shown at 30 September 2019 are based on the valuations at 31 March 2019, 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 2019	Year ended 31 March 2019
	Unaudited	Audited
	%	%
Price inflation (RPI)	3.0	3.2
Price inflation (CPI)	2.0	2.2
Rate of increase in salaries	2.4	2.4
Rate of increase of pensions in payment (MIS* members)***	2.0	2.2
Rate of increase of pensions in payment (old section** members)***	3.0	3.2
Rate of increase of pensions in payment (all other members)***	2.9	3.1
Rate of increase for deferred pensions (MIS* members only)***	2.0	2.2
Rate of increase for deferred pensions (all other members)***	2.9	3.1
Discount rate	1.8	2.4

* 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)

15 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 2019	Year ended 31 March 2019
	Unaudited	Audited
	£m	£m
Total fair value of assets	835.4	755.8
Present value of the defined benefit obligation	(1,010.1)	(942.5)
Deficit recognised in the statement of financial position	(174.7)	(186.7)

Analysis of the movement in the scheme's deficit during the period	Six months ended 30 September 2019	Six months ended 30 September 2018	Year ended 31 March 2019
	Unaudited	Unaudited	Unaudited
	£m	£m	£m
At 1 April	(186.7)	(171.7)	(171.7)
Employer's contributions	19.8	2.3	21.6
Employer's current service cost	(3.3)	(3.4)	(6.2)
Employer's past service cost	–	–	(1.8)
Financing charge	(2.1)	(2.3)	(4.4)
Actuarial (loss)/gain	(2.4)	9.9	(24.2)
Deficit in the scheme at end of the period	(174.7)	(165.2)	(186.7)

Notes to the interim financial information (continued)

16 Cash generated by operations

Cash generated by operations	Six months ended 30 September 2019 Unaudited £m	Six months ended 30 September 2018 Unaudited £m
Continuing operations		
Operating profit	**120.5**	140.1
Adjustments for:		
Fair value of sewer adoptions	**(0.7)**	(6.3)
Depreciation of property, plant and equipment	**121.9**	119.5
Amortisation of intangible assets	**9.5**	9.1
Difference between pension charge and cash contributions	**(16.5)**	1.1
Amortisation of grants and contributions	**(1.4)**	(0.5)
Operating cash flow before movement in working capital	**233.3**	263.0
Increase in inventories	**(0.5)**	(0.2)
Increase in receivables	**(27.2)**	(18.8)
Increase/(decrease) in payables	**4.6**	(1.3)
Decrease in environmental provisions	**–**	(0.1)
Cash generated by operations	**210.2**	242.6
Tax paid		
– Group relief	**–**	–
– Payments made within SWSG Dividend Loop	**–**	(5.4)
Net cash generated from operating activities	**210.2**	237.2

Notes to the interim financial information (continued)

17 Analysis of net debt

Analysis of net debt (unaudited)	At 1 April 2019 £m	Cash flow £m	Other non-cash changes £m	At 30 September 2019 £m
Cash and cash equivalents	372.0	(366.4)	–	**5.6**
Net liabilities from financing activities:				
Term facilities/index linked loans	(274.8)	(85.2)	(0.7)	**(360.7)**
Loans from subsidiary	(3,380.5)	300.0	(14.7)	**(3,095.2)**
Finance lease liabilities	(1.0)	0.7	(41.6)	**(41.9)**
Redeemable preference shares	(119.9)	29.2	–	**(90.7)**
Net interest rate swaps	(1,382.0)	–	(123.9)	**(1,505.9)**
Total liabilities from financing activities	(5,158.2)	244.7	(180.9)	**(5,094.4)**
Net debt	(4,786.2)	(121.7)	(180.9)	**(5,088.8)**

Balances at 30 September 2019 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	5.6	–	–	**5.6**
Derivative financial instruments	90.8	–	–	(1,596.7)	**(1,505.9)**
Lease liabilities	–	–	(2.3)	(39.6)	**(41.9)**
Borrowings due within one year	–	–	(294.3)	–	**(294.3)**
Borrowings due after one year	–	–	–	(3,252.3)	**(3,252.3)**
Net debt	90.8	5.6	(296.6)	(4,888.6)	**(5,088.8)**

The non-cash movement of £180.9 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 an increase 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)

18 Contingent liabilities

Environment Agency – wastewater sites

As noted in our Annual Report and on page 4 of this report, the company has recently been advised it faces a prosecution from the Environment Agency regarding the performance of certain wastewater sites and together with an ongoing investigation into the reporting of relevant compliance information. We are working proactively with the Agency to resolve these matters. Having considered them carefully the Board has concluded that it is not possible to make a reliable estimate for any obligation that may arise from these matters for the following reasons:

- The uncertainty of the nature and rectitude of any charges;
- The uncertainty of the basis for any offence i.e. what level of culpability will be alleged and what level of culpability would be the basis for sentence (culpability being one of the key criteria that determines the level of fine);
- The uncertainty regarding the environmental harm risked by the commission of any offence i.e. what likelihood of harm will be alleged and what likelihood of harm would be the basis for sentence (likelihood of environmental harm being one of the key criteria that determines the level of fine).

Our Board have taken these matters extremely seriously and have continued to monitor and support the work of our Risk and Compliance directorate, who have continued to deliver a programme of improvements to our non-financial regulatory reporting including the collection, verification, reporting and assurance of data. Further information on this can be found in our Final Assurance Plan 2019, which is available on our website **southernwater.co.uk/our-reports**.

Other contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims disputes and potential litigation. The significant ones 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 a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the rivers Itchen, Test and Candover Stream between 2018 and 2030. A provision was made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £2 million.

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 2018: £nil).

Notes to the interim financial information (continued)

19 Capital commitments

Capital commitments	Six months ended 30 September 2019 Unaudited £m	Year ended 31 March 2019 Audited £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**270.6**	615.2
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**6.5**	15.8
	277.1	631.0

20 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 2019 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 2019.

21 Post balance sheet events

On 27 November 2019, the Board approved the redemption of £25 million of its Class B preference shares, at nominal value plus the premium on issue, to include settlement for fixed value dividends due to the date of redemption of the shares.

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 2019 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 21.

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 2019 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 18 in the financial statements concerning the uncertain outcome of certain regulatory investigations regarding the performance of certain wastewater plants. Southern Water faces a prosecution and other investigations from the Environment Agency regarding the performance of certain wastewater sites. At this time, no clarity of the findings of the prosecution and other investigations 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, UK

27 November 2019

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