Investor Report and Compliance Certificate

For the SWS Financing Group

For the period ended 31 March 2014

Confidential

Important Notice

This report is being distributed in fulfilment of a finance document, the Common Terms Agreement. It is directed to, and intended for, existing investors in the company. No other persons should act or rely on it. The company makes no representation as to the accuracy of forecast information. This report should not be relied on as a guide to future performance and should not be relied on in deciding whether to undertake future investment in the company. It should be noted that the information in this report has not been reviewed by the company's auditors.

Investor Report

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General overview and business update

This Investor Report covers the year ended 31 March 2014. The Investor Report is a requirement of the Common Terms Agreement (CTA), which governs the company's obligations to its lenders and investors.

General levels of service

Customer

The Service Incentive Mechanism (SIM), comprises two measures, a quantitative measure reflecting the number and type of "unwanted" contact from customers and a qualitative measure of customer satisfaction. These measures are combined into a score out of 100. Scores commencing from the financial year ending 31 March 2012 will contribute towards comparative performance for regulatory price setting.

The SIM score for the financial year 2013-14 was 75 (out of 100), an improvement of 21% on the score of 62 for 2012-13. Further improvement is planned for 2014-15, which should further improve our relative ranking position against other water companies.

	31 Mar 2011	31 Mar 2012	31 Mar 2013	31 Mar 2014
SIM score	54	65	62	75
Industry average	69	71	79	[82]

Note: the average score for 31 March 2014 is preliminary and calculated from an incomplete data set

Water Resource

Water resources were in a healthy position during the year. No restrictions were put in place and none are expected in 2014–15.

Security of Supply Index was 100 for 2013-14 and 2012-13 (for both critical period and annual average)

Health & Safety

For the 15th consecutive year, we achieved the Royal Society for the Prevention of Accidents (RoSPA) gold level award and were recognised with an Order of Distinction, the first water company to receive such an accolade.

Operational performance

	2013–14		2012–13
	Target	**Achieved**	**Achieved**
Overall drinking water quality	99.93%	**99.94%**	99.93%
Leakage (million litres of water per day)	89	**85**	81
Water non-infrastructure	Stable	**Stable**	Stable
Water infrastructure	Stable	**Stable**	Stable
Wastewater infrastructure	Stable	**Stable**	Stable
Wastewater non-infrastructure	Stable	**Stable**	Marginal
All pollution incidents (wastewater), Category 1-3	295	**320**	409
Serious pollution incidents (wastewater), Category 1-2	5	**9**	10

We continued to supply drinking water of the highest quality to more than two million people. In 2013, we achieved an overall rating of 99.94 per cent.

We continue to deliver one of the lowest levels of leakage per property of water and wastewater companies, working around the clock to find and repair leaks on our 13,753 kilometre network of water mains.

We continued our programme to install meters for the majority of our customers by 2015. The total number of meters fitted and brought on charge reached 326,768.

We achieved a Stable serviceability assessment across all four of our services

Despite the wettest winter on record, the number of pollution incidents in our region fell by 22 per cent in 2013 (2013/14). We were recognised by the Environment Agency as one of only two water companies with fewer serious pollution incidents during the year.

There was also a four per cent reduction in incidents related to sewers or combined sewer overflows, falling from 144 in 2012 to 138 in 2013. This followed a 14 per cent reduction in the previous year and is the result of an action plan put in place to improve our performance.

We were awarded the Carbon Trust Standard in recognition of our efforts to measure, manage and improve our carbon efficiency. It is the third time we have earned the standard for our ongoing efforts to reduce our impact on the environment.

Financial performance for the year ended 31 March 2014

Years ended 31 March	2014 £m	2013 £m	*Change %*
Turnover	806.2	778.7	*3.5*
Operating costs	-246.5	-239.4	*3.0*
Other income	0.7	6.1	
EBITDA	**560.4**	**545.4**	***2.8***
Depreciation	-234.9	-213.4	
Exceptional item	-18.8	0	
Net interest	-167.2	-152.9	
Profit before tax	**139.5**	**179.1**	***-19.3***
Tax	30.3	-22.2	
Profit after tax	**169.8**	**156.9**	***8.2***

Turnover increased by 3.5 per cent to £806.2 million (2012–13: £778.7 million) principally a result of the average tariff increase on metered and unmetered income of 5.1 per cent, partly offset by reduced income from customers switching from an unmetered supply to a metered supply (as a result of our metering programme). For 2013/14 we voluntarily chose not to implement the maximum allowed price increase (we applied a K factor of 2.1% rather than 3.3%) because take-up of our metering transitional tariff has been lower than expected.

Operating costs before exceptional items increased by 3.0 per cent to £246.5 million (2012–13: £239.4 million). Cost pressure from inflation (£8m), an increase in the bad debt provision (£4.1m) and the commisioning of the £300m Peacehaven scheme (£1.6m) were offset by contract efficiencies, power effiicencies, and process improvements (£14.7m saving in total). In addition, the operating cost movement in pension costs was £8.0m, as a result of a one-off curtailment credit in 2012/13 of £9.0m form the implementation of changes to the final salary pension scheme.

During the period from December through to February, the South of England experienced a series of storms and heavy rainfall that was in excess of 260 per cent of the historical average, and resulted in significant operational disruption with many sites without power and lengthy periods of flooding due to high groundwater levels. As a result of this exceptional weather event, we have incurred significant additional costs for pumping and tankering to alleviate the flooding and to ensure that we continue to serve our customers. We have recorded the costs associated with this event as an exceptional item of £18.8 million within the accounts for 2013–14.

Net interest payable of £167.2 million increased by 9.4 per cent (2012–13: £152.9 million). This increase principally relates to the cost of carry associated with raising the B2 £250m bond in March 2013, in advance of repaying the £250m B1 bond on 31 March 2014; along with writing-off issue fees associated with the existing loan.

We have recognised a tax credit to the profit and loss account of £30.3 million (2012–13: £22.2 million charge). This is primarily a result of the announcement of the reduction in the rate of corporation tax from 23 per cent to 21 per cent with effect from 1 April 2014, and to 20 per cent from 1 April 2015. The current tax charge is also reduced by the capital investment programme, and a further credit from an agreement with HMRC relating to the tax allocation of capital expenditure.

Capital expenditure

Capital expenditure for the year ended 31 March 2014 was £415.5m (£372.1m net cash outflow after deducting grants, contributions and movement in capital creditors).

£106.2m of expenditure relates to our Water service, £72.4m in maintaining our exisiting assets and £33.8m on enhancement expenditure, including £30m on water quality improvements

£309.3m of expenditure relates to our Wastewater service, £189.4m in maintaining our exisiting assets and £119.9m on enhancement expenditure, including the completion of our £300m Peacehaven wastewater treatment and recycling centre which was officially opened in October 2013.

Financing

The £250m 7.869% Class B1 bond was repaid on 31 March 2014, out of the proceeds of the £250m Class B2 bond issued March 2013.

Credit rating	
Standard & Poor's	Class A debt: A- Class B debt: BBB
Fitch	Class A debt: A- Class B debt: BBB
Moody's	Class A debt: Baa1 (negative outlook) Class B debt: Ba1 (negative outlook)

On 17 September 2013 Standard and Poor's improved the credit rating outlook of Class A debt to A- stable and the Class B debt to BBB stable as a result of an improvement in credit metrics. This improvement to the credit rating follows Standard and Poor's, on 7 May 2011, placing the Class A debt and Class B debt on negative outlook. On 7 July 2011, Moody's downgraded the rating on the Class A debt from A3 to Baa1 (negative outlook), the Class B debt from Baa3 to Ba1 (negative outlook) and the corporate family rating from Baa1 to Baa2 (negative outlook). On 15 July 2011, Fitch also downgraded the rating on the Class A debt from A (negative outlook) to A- (stable outlook) and the Class B debt from BBB+ (negative outlook) to BBB (stable outlook).

Dividend and Financing Policy

Southern Water aims to deliver a sustainable long-term financial strategy, taking into account the interests of all stakeholders. Our shareholders are long-term investors and fully support the strategy adopted.

We do not plan any significant deviation from the current level of around 80% senior gearing in AMP6.

Southern Water's dividend policy is to propose dividends having given due consideration to the following financial and performance criteria.

1. Assessment of headroom under debt covenants
2. Assessment of the impact on the company's credit rating
3. Assessment of the liquidity position and ability to fulfil licence conditions
4. Assessment of key areas of business risk
5. Assessment of current year and cumulative distributable reserves
6. Directors' duties under law and Ofwat administered regulatory arrangements

Southern Water's dividend policy and the associated financial and performance criteria are intended to support the credit ratings of the business and ensure continued access to diversified sources of finance.

We do not intend to access future index-linked debt through derivatives but will instead seek such debt from "natural" sources such as public and private bond markets.

From a Treasury management perspective, we will include accretion on PAYG swaps in our maturity buckets for CTA testing.

The shareholders continue to support the business and no dividends were paid to the shareholders of our ultimate parent company, Greensands Holdings Limited.

Board membership

Robert Jennings	
Colin Hood	(Resigned as Chairman 1 April 2014)
Matthew Wright	
Michael Carmedy	
Paul Moy	
Surinder Toor	(Resigned as director 7 March 2014)
Mark Walters	(Appointed as director 7 March 2014)
Cheryl Black	
David Golden	
Robert Armstrong	

Ultimate parent company

The ultimate parent company is Greensands Holdings Ltd.

Financial ratios

As required by the CTA, financial ratios are reported up to the end of the current five year regulatory period. In all cases, financial ratios are within the 'trigger levels' as defined in the CTA. The forecasts used to generate the financial ratios are derived from the SWS Business Financial Model and are in the format specified by the CTA.

Financial forecasts in this report fully reflect the projected shortfall in revenues against those assumed in the PR09 price determination (in the order of £200m over this AMP period, including an opening indexation adjustment).

Short term forecast RPI's used for this Investor Report are calculated as the average of inflation forecasts published by a number of UK banks. RPI at March 2014 was 2.45%, and forecast RPI used at March 2015 is 2.83%.

For investor reporting, interest paid is reported on an accruals basis in line with the requirements of the CTA.

Projected distributions comprise preference share dividends and group relief tax payments.

Consolidated cashflow

Ref.		31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
	Revenue						
1	Appointed	669.0	684.0	711.0	747.6	784.2	802.7
2	Non Appointed	5.3	3.9	5.2	11.0	6.9	4.2
	Operating Costs						
3	Appointed	213.5	223.6	227.1	256.2	240.9	267.5
4	Non Appointed	2.7	1.9	2.0	2.0	2.1	0.6
	Exceptional item *	56.1	0.0	0.0	0.0	4.8	14.0
5	Net Capital Expenditure (inc Disposals of Assets)	212.5	375.9	453.4	349.4	371.8	359.3
	Annual Finance Charge	136.5	131.9	122.1	128.0	135.8	128.6
6	Taxation	0.0	0.0	0.1	0.1	0.1	0.1
	Payments on Subordinated Debt and Distributions	23.5	65.8	39.1	11.6	21.2	36.7
	Net cash reserves movement	29.5	-111.2	-127.6	11.3	14.4	0.1

* The 31 March 2010 payment relates to a one-off payment into the final benefit pension scheme, and the 31 March 2014 charge relates to costs associated with the exceptional wet weather of winter 2013/14

Annual Finance Charge

Ref.		31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
	Class A debt interest	118.5	107.6	99.4	101.4	102.2	105.0
	Class B debt interest	21.6	21.8	22.9	26.4	36.3	17.5
	Interest income	4.9	2.2	2.4	2.0	4.9	0.4
	Class A Facilities commitment fees	1.3	4.7	2.2	2.2	2.2	6.5
7	Class A Debt Interest	114.9	110.1	99.2	101.6	99.5	111.1
8	Senior Debt Interest	136.5	131.9	122.1	128.0	135.8	128.6
	Annual Finance Charge	136.5	131.9	122.1	128.0	135.8	128.6
	Monthly Payment Amount *	12.0	11.2	10.4	10.8	11.7	10.8

* Monthly payment amount is stated gross and reduced by interest received in the Debt Service Payment Account

Cash accounts and reserves

Ref.		31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
	SWS O&M Reserve account						
	Opening balance	44.4	46.3	46.3	46.3	46.3	46.3
	Cash transferred	1.9	0.0	0.0	0.0	0.0	0.0
	Closing balance	46.3	46.3	46.3	46.3	46.3	46.3
	Capex Reserve account						
	Opening balance	312.8	216.0	125.5	25.5	86.9	52.4
	Cash transferred	-96.8	-90.5	-100.0	61.4	-34.5	0.0
	Closing balance	216.0	125.5	25.5	86.9	52.4	52.4
	Debt Service Payment account						
	Opening balance	10.8	11.5	5.0	20.4	247.5	12.8
	Cash transferred	0.7	-6.5	15.4	227.1	-234.7	0.0
	Closing balance	11.5	5.0	20.4	247.5	12.8	12.8
	SWS Operating accounts						
	Opening balance	0.9	30.6	0.8	3.6	5.2	36.0
	Cash transferred	29.7	-29.8	2.8	1.6	30.8	-8.1
	Closing balance	30.6	0.8	3.6	5.2	36.0	27.9
	Total Cash Balances						
	Opening balance	368.9	304.4	177.6	95.8	385.9	147.5
	Cash transferred	-64.5	-126.8	-81.8	290.1	-238.4	-8.1
9	Closing balance	304.4	177.6	95.8	385.9	147.5	139.4

Bonds, Authorised Loan Facilities and Leases

Ref.			31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
	*	Senior £350m A1 6.192% Fixed Rate Bonds due 2029	350.0	350.0	350.0	350.0	350.0	350.0
	*	£150m A2a 3.706% Index Linked Bonds due 2034	179.6	188.2	197.6	203.8	210.2	215.8
	*	£35m A2b 3.706% Limited Index Bonds due 2034	41.9	43.9	46.1	48.2	49.7	50.3
		£350m A4 6.64% Fixed Rate Bonds due 2026	350.0	350.0	350.0	350.0	350.0	350.0
		£150m A5 3.816% Index Linked Bonds due 2023	179.6	188.2	197.6	203.8	210.2	215.8
	*	£350m A7 5.0% Fixed Rate Bonds due 2021	350.0	350.0	350.0	350.0	350.0	350.0
	*	£150m A8 5.0% Fixed Rate Bonds due 2041	150.0	150.0	150.0	150.0	150.0	150.0
	*	£200m A9 4.5% Fixed Rate Bonds due 2052	200.0	200.0	200.0	200.0	200.0	200.0
	*	£300m A10 5.125% Fixed Rate Bonds due 2056	300.0	300.0	300.0	300.0	300.0	300.0
		£300m A11 6.125% Fixed Rate Bonds due 2019	300.0	300.0	300.0	300.0	300.0	300.0
		RPI accretion on Index-Linked swaps	70.4	97.4	169.9	219.2	260.6	298.6
		£250m B1 step-up Fixed/Floating rate Bonds due 2038	250.0	250.0	250.0	250.0	0.0	0.0
		£250m B2 step-up Fixed/Floating rate Bonds due 2038	0.0	0.0	0.0	250.0	250.0	250.0
		£150m Class B loan facility	50.0	50.0	100.0	150.0	150.0	150.0
	*	£165m Artesian 4.076% Index Linked Bonds due 2033	197.5	207.0	217.3	224.1	231.3	237.4
	*	£156m Artesian 3.635% Index Linked Bonds due 2032	182.7	191.5	201.2	207.5	214.0	219.7
	**	New cash required	0.0	0.0	0.0	0.0	0.0	0.0
		Revolving Credit Facilities	0.0	0.0	0.0	0.0	0.0	0.0
		DSR Liquidity Facility Drawings	0.0	0.0	0.0	0.0	0.0	0.0
		Finance Leases	0.0	0.0	0.0	0.0	0.0	0.0
		Class A Indebtedness	2851.7	2916.2	3029.7	3106.6	3176.0	3237.6
		Senior Indebtedness	3151.7	3216.2	3379.7	3756.6	3576.0	3637.6
10		Class A Net Indebtedness	2547.3	2738.6	2933.9	2720.7	3028.5	3098.2
11		Senior Net Indebtedness	2847.3	3038.6	3283.9	3370.7	3428.5	3498.2
		Nominal value of fixed rate debt swapped to Index Linked	877.0	877.0	1318.0	1318.0	1318.0	1318.0

* Wrapped by MBIA or FSA

** 'New cash required' is a notional class of debt included to forecast compliance ratios correctly. This is not an attempt to forecast the actual quantum, mix, cost and timing of future financing.

Interest Cover Ratios

		Trigger	Default	31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
A	Net Appointed Income (1+3+6)			455.5	460.4	483.8	491.3	543.2	535.1
B	Net Total Income (1+2+3+4+6)			458.1	462.4	487.0	500.3	548.0	538.7
C	Depreciation (CCD & IRC)			259.5	279.0	306.9	323.9	341.4	353.1
D	Class A Debt interest (7)			114.9	110.1	99.2	101.6	99.5	111.1
E	Senior Debt interest (8)			136.5	131.9	122.1	128.0	135.8	128.6
F	Period end VAT debtor			4.4	7.0	8.9	8.1	10.8	7.0
G	Capital Maintenance (MNI & IRE)			92.4	164.2	223.8	219.7	258.7	N/A
Class A Adjusted ICR									
	Historic: (B-C+F)/D Projected: (A-C+F)/D	1.3	N/A	1.8	1.7	1.9	1.8	2.2	1.7
Class A Average ICR		1.4	N/A	1.8	1.9	1.9	1.9	1.9	1.7
Senior Adjusted ICR									
	Historic: (B-C+F)/E Projected: (A-C+F)/E	1.1	N/A	1.5	1.4	1.6	1.4	1.6	1.5
Senior Average Adjusted ICR		1.2	N/A	1.5	1.5	1.5	1.5	1.5	1.5
Class A ICR									
	Historic: B/D Projected: A/D	N/A	1.6	4.0	4.3	5.0	5.0	5.6	4.9
Class A Post Maintenance ICR									
	Historic: (B-G+F)/D	N/A	1.0	3.2	2.8	2.7	2.8	3.0	N/A

Regulatory Asset Ratios

		Trigger	Default	31 Mar 2010 £m	31 Mar 2011 £m	31 Mar 2012 £m	31 Mar 2013 £m	31 Mar 2014 £m	31 Mar 2015 £m
G	Class A Net Indebtedness (10)			2,547.3	2,738.6	2,933.9	2,720.7	3,028.5	3,098.2
H	Senior Net Indebtedness (11)			2,847.3	3,038.6	3,283.9	3,370.7	3,428.5	3,498.2
I	RCV			3,566.9	3,745.1	4,044.0	4,277.0	4,380.5	4,481.6
Class A RAR									
	Projected: G/I	0.750	N/A	0.714	0.731	0.725	0.636	0.691	0.691
Senior RAR									
	Projected: H/I	0.900	0.950	0.798	0.811	0.812	0.788	0.783	0.781

Declaration

We confirm that each of the above Ratios has been calculated in respect of each of the relevant periods for which it is required under the Common Terms Agreement and has not breached the Trigger Event Ratio Levels and has not caused Paragraph 20 (Ratios) of Part 2 (Event of Default (SWS and the Issuer)) of Schedule 7 of the Common Terms Agreement to be breached.

We confirm that the Annual Finance Charge is £128.6m for 2014/15 equating to a Monthly Payment Amount for this period of £10.8m.

We also confirm that no Default or Potential Trigger Event is outstanding and that SWS's insurances are being maintained in accordance with the Common Terms Agreement.

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