SOUTHERN WATER SERVICES (FINANCE) LIMITED

ANNUAL REPORT

AND

FINANCIAL STATEMENTS FOR THE YEAR ENDED

31 MARCH 2011

SOUTHERN WATER SERVICES (FINANCE) LIMITED

REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2011

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2011

The directors of Southern Water Services (Finance) Limited (Registered No. CR 112331) present their report and the audited financial statements for the year ended 31 March 2011.

The Company is incorporated in the Cayman Islands and has no requirements to prepare statutory financial statements. However under the Common Terms Agreement, which governs the Company's banking arrangements, non-statutory financial statements are required to be produced.

PRINCIPAL ACTIVITIES

The Company provides financing to Southern Water Capital Limited and its subsidiaries, and enters into hedge transactions to manage the cash flow exposures of these borrowings.

RESULTS AND DIVIDENDS

The loss after tax for the year amounted to £0.9m (2010: profit after tax £0.5m). The directors do not recommend the payment of a final dividend (2010: £nil).

DIRECTORS

The Directors who served during the year and up to the date of signing were:

L Dawson (Resigned 25 May 2010)
H Goodbourn (Resigned 18 March 2011)
M Welton (Appointed 11 June 2010)
M Wright (Appointed 18 March 2011)

The company secretary in the year and at the date of signing was Kevin Hall.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2011

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for the preparation of the Annual Report and non-statutory Financial Statements.

The Common Terms Agreement requires the directors to prepare financial statements for each financial period in accordance with United Kingdom accounting standards which give a true and fair view of the state of affairs of the Company as at the end of the financial period and of the profit or loss of the Company for that period.

The directors consider that suitable accounting policies have been used and applied consistently and that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 March 2011. The financial statements have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice and that applicable accounting standards have been followed.

The directors believe that preparing the financial statements on the going concern basis is appropriate due to the expectation that the Company will continued to be able to meet its liabilities as they fall due, as well as the continued financial support of the parent company Southern Water Services Limited. The directors have received confirmation that Southern Water Services Limited intends to support the Company for at least one year after these financial statements are approved.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

PROVISION OF INFORMATION TO INDEPENDENT AUDITORS

So far as the directors are aware, there is no relevant information of which the company's auditors are unaware. The directors have taken all the steps, (such as making enquiries of other directors and the auditors and any other steps required by the director's duty to exercise due care, skill and diligence), that they ought to have taken in their duty as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

INDEPENDENT AUDITORS

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.

Registered office
Ugland House
P O Box 309
George Town
Grand Cayman, Cayman

… ………………………
K G Hall
Secretary

22 June 2011

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 2011

	Notes	**2011 £m**	2010 £m
Interest receivable and similar income	3	**230.7**	162.8
Interest payable and similar charges	4	**(231.9)**	(162.1)
(Loss)/profit on ordinary activities before taxation	2	**(1.2)**	0.7
Taxation on profit on ordinary activities	5	**0.3**	(0.2)
(Loss)/profit for the financial year	13	**(0.9)**	0.5

The above results relate entirely to continuing operations.

There is no difference between the (loss)/profit on ordinary activities before taxation and the (loss)/profit for the year stated above and their historical cost equivalents.

The Notes on pages 5 to 15 form part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2011

	2011 £m	2010 £m
(Loss)/Profit for the financial year	**(0.9)**	0.5
Movement on hedging reserve (Note 13)	**(56.1)**	(245.8)
Deferred tax movement on hedging reserve (Note 7)	**18.0**	79.1
Total recognised (loss)/profit for the year	**(39.0)**	(166.2)

BALANCE SHEET AS AT 31 MARCH 2011

	Note	**2011** **£m**	2010 £m
Current assets			
Debtors: Amounts falling due within one year	6	**46.3**	43.1
Debtors: Amounts falling due after one year	7	**3,449.1**	3,341.9
Restricted cash	8	**5.6**	15.8
		3,501.0	3,400.8
Creditors: Amounts falling due within one year	9	**(19.1)**	(26.6)
Net current assets		**3,481.9**	3,374.2
Total assets less current liabilities		**3,481.9**	3,374.2
Creditors: Amounts falling due after one year	10	**(3,279.5)**	(3,245.1)
Derivative financial instruments	11(ii)	**(670.6)**	(558.3)
Net liabilities		**(468.2)**	(429.2)
Capital and reserves			
Called up equity share capital	12	**-**	-
Other reserves	13	**(493.2)**	(455.1)
Profit and loss account	13	**25.0**	25.9
Total equity shareholders' deficit	14	**(468.2)**	(429.2)

The financial statements on pages 3 to 15 were approved by the Board on 22 June 2011 and are signed on its behalf by:

Matthew Wright
Director
22 June 2011

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

1 Accounting policies

a) Basis of accounting

The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments and in accordance with applicable UK accounting standards.

These financial statements have been prepared on a going concern basis. This basis is appropriate as the net liability position and current year loss for the financial period results from hedge accounting for cash flow hedges. The structure of the intercompany loans and swap arrangements in place are such that the company is expected to continue to make a profit before FRS 26 adjustments over the term of the current debt arrangements. Further, the Company has received confirmation from it's parent company, Southern Water Services Limited, that it intends to provide financial support to the company should it be required to enable the company to meet its liabilities as they fall due.

The Company has taken advantage of the exemption in 'FRS 8 Related Party Disclosures' not to disclose transactions with other members of the group.

The Company is a wholly owned subsidiary company of a group headed by Greensands Holdings Limited, and is included in the consolidated financial statements of that company, which are publicly available (see Note 15). Consequently, the company has taken advantage of the exemption within FRS 1 'Cashflow statements (revised 1996)' from preparing a cash flow statement.

b) Interest income, interest payable and similar income and charges

Interest income, interest payable and similar income and charges are recognised on an accruals basis, except where such expenditure is deferred and carried forward as set out herein. The policy for interest income and expense is detailed in the financial instruments policy.

c) Taxation

The taxation charge in the profit and loss account is based on the profit or loss for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with Financial Reporting Standard 19 "Deferred Tax" ("FRS 19"). Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

d) Financial Instruments

Loans and receivables and other financial liabilities are initially measured at fair value, plus directly attributable issue costs. After initial measurement they are measured at amortised cost using the effective interest rate method and not revalued.

Index-linked debt instruments are revalued to reflect the annual movement in the retail price index. The change in value arising from indexation is charged to interest payable for index-linked debt, and credited to interest receivable for index-linked loans, in the year in which it arises.

In accordance with FRS 26, derivative financial instruments e.g. swaps are held at fair value. Changes in fair value are included in the profit and loss account unless hedge accounting applies.

Proceeds from gilt lock agreements entered into by the company are deferred in the balance sheet and released to the profit and loss account over the life of the instrument that it relates to. The company does not apply hedge accounting to proceeds from gilt lock agreements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

1 Accounting policies (continued)

e) Hedge Accounting

A cash flow hedge is a hedge of the exposure to variability of cash flows that are attributable to a specific risk and that could affect profit or loss.

The Company enters into interest rate swaps to manage the cash flow exposures of its borrowings. Interest rate swaps are held to manage interest rate exposures and are designated as cash flow hedges of fixed and floating rate borrowings.

Conditions for hedge accounting must be met, including formal designation and documentation, and assessment of effectiveness of the hedge. Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting.

Hedge accounting for cash flow hedges operates as follows. The movement in fair value of the hedging instrument (for example an interest rate swap) related to the effective portion of the hedge is recognised through the Statement of Total Recognised Gains and Losses and is deferred in reserves, as part of a ‘hedging reserve’. The amount deferred is released to the profit and loss account in line with the impact that the hedged item has on the profit and loss account. The related hedged item (e.g. the loan to which the interest rate swap relates) is carried at amortised cost. Any movement in the fair value of the hedging instrument relating to the ineffective portion is recorded in the profit and loss account.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

2 (Loss)/profit on ordinary activities before taxation

The Company had no employees during the year ended 31 March 2011 (2010: nil).

In 2011 and 2010 audit fees were borne by Southern Water Services Limited ("SWS").

The services of the directors are deemed to be wholly attributable to their services to Southern Water Services Limited. Accordingly no details in respect of the emoluments paid to the directors are included here as they are fully disclosed in the financial statements of Southern Water Services Limited.

3 Interest receivable and similar income

	2011 £m	2010 £m
External interest received	**45.1**	28.5
Interest on loans to group undertakings	**134.5**	145.1
Indexation	**51.1**	(10.8)
	230.7	162.8

Interest receivable is shown net of releases from the hedge reserve of £48.7m (2010: £31.3m), in accordance with the hedge accounting policy.

4 Interest payable and similar charges

	2011 £m	2010 £m
Loan interest and facility fee charges	**170.8**	166.8
Indexation	**51.1**	(10.8)
Interest payable to group undertakings	**2.6**	0.8
Amortisation of gilt lock proceeds (note i)	**(0.1)**	(0.1)
Swap break costs released from hedging reserve (note ii)	**7.5**	5.4
	231.9	162.1

(i) The company entered into an agreement prior to the issue of a £300m bond in 2007, whereby the proceeds of the loan were fixed, resulting in a 'gilt lock'. The loan was issued at a discount with compensating proceeds under the gilt lock of £6.3m. This receipt has been deferred to the balance sheet and will be released to the profit and loss account over the life of the bond.

(ii) Prior to refinancing in 2003, a swap was taken out as a hedge for the future issue of bonds. This swap was closed out and close out costs ('Swap break costs') were incurred reflected in a higher interest rate. The bonds were issued such that the premium was a similar amount to the swap close out costs. As hedge accounting has been applied, the loss on closing the swap has been taken to a cash flow hedging reserve. This loss is charged to the profit and loss account over the term of the related financial instruments to offset the impact of the premium on the effective interest rate received.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

5 Tax on profit on ordinary activities

	2011	2010
	£m	£m
Current Tax		
UK corporation tax on profits for the year at 28% (2010: 28%)	**(0.3)**	0.2
Tax on profit on ordinary activities	**(0.3)**	0.2

No deferred tax arose during the year to 31 March 2011 (2010: nil).

6 Debtors: Amounts falling due within one year

	2011	2010
	£m	£m
Loan to parent undertaking (see note (i) below)	**30.3**	30.3
Group relief surrendered	**0.6**	0.3
Prepayments	**3.0**	3.0
Deferred gilt lock proceeds (see note 7(vi) below)	**0.1**	0.1
Accrued interest receivable	**10.3**	7.7
Other borrowings	**2.0**	1.7
	46.3	43.1

Notes

(i) The amounts due from the parent undertaking is a balance of £30.3m (2010: £30.3m), this amount is unsecured, interest free, and is repayable in whole or part upon demand at any time, provided that:

(a) on the date of such demand, no class A, B or mezzanine debt is outstanding (see note 7); or

(b) it is done with the consent of the security trustee

7 Debtors: Amounts falling due after one year

	2011	2010
	£m	£m
Loans and receivables (see note (a) below)	**3,274.8**	3,185.6
Deferred tax (see note (b) below)	**174.3**	156.3
	3,449.1	3,341.9

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

7 Debtors: Amounts falling due after one year (continued)

Note (a) Loans and receivables

Under the loan agreement between SWS and SWSF, SWSF on-lends an amount equal to each bond or other debt raised at the same interest rate plus 0.01%.

An analysis of the loans with SWS is shown below:

	2011	2010
Loans and receivables	**£m**	£m
Class A £350m 6.202% fixed rate 2029	**350.0**	350.0
Class A £150m 3.716% index linked 2034	**200.3**	190.7
Class A £35m 3.716% index linked 2034	**47.4**	45.2
Class A £350m 6.650% fixed rate 2026	**350.0**	350.0
Class A £150m 3.826% index linked 2023	**195.6**	186.8
Class A £350m 5.010% fixed rate 2021	**349.8**	349.9
Class A £150m 5.010% fixed rate 2041	**150.6**	150.5
Class A £200m 4.510% fixed rate 2052	**198.5**	198.2
Class A £300m 5.135% fixed rate 2056	**291.5**	291.7
Class A £300m 6.135% fixed rate 2019	**296.7**	296.4
Artesian £165m 4.086% index linked 2033	**222.1**	211.4
Artesian £156.5m 3.645% index linked 2032	**202.2**	192.4
	2,854.7	2,813.2
Fixed swapped to Index-linked – (see note (i) below)	**(868.2)**	(868.2)
Index-linked swaps – (see note (i) below)	**1,002.8**	955.0
Total Class A Debt	**2,989.3**	2,900.0
Class B £250m 7.879% fixed rate 2038 (see note (ii) below)	**250.0**	250.0
Senior mezzanine £15.4m 11.97% fixed rate 2038 (see note (ii) below)	**15.4**	15.4
Intercompany debtor	**14.4**	14.4
Deferred gilt lock proceeds	**5.7**	5.8
	3,274.8	3,185.6

Loans and receivables are measured at amortised cost using the effective interest rate method.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

7 Debtors: Amounts falling due after one year (continued)

Notes in respect of the specific instruments above:

(i) As at 31 March 2011, SWSF was party to various swap agreements converting a total of £877.0m (nominal value) of Class A debt from the original fixed interest rate to a real interest rate linked to RPI (Retail Price Index) plus capitalised inflation on the nominal value of the underlying Class A debt.

The table below analyses the total value of all swaps entered into by SWSF as at 31 March 2011:

Nominal value of debt at amortised cost	Original Fixed interest rate	Swapped Index Linked interest rate	Swapped value of debt plus capitalised RPI measured at amortised cost
£50.0m	6.192%	3.190%	£53.9m
£176.9m	5.000%	2.151%	£182.3m
£150.7m	5.000%	0.500%	£189.5m
£198.5m	4.500%	0.060%	£243.9m
£292.1m	5.125%	0.647%	£333.2m
£868.2m			£1,002.8m

These are cash flow hedges as they hedge the exposure in SWSF to the variability of the index-linked cash flows on the interest and principal payments it receives from SWS. The hedges are for the same period as the loan to which they relate.

(ii) The interest rate on the class B1 £250m is fixed at 7.879% until March 2014 when it reverts to LIBOR plus a margin to be determined with a premium of 0.01%.

(iii) The interest rate on the senior mezzanine loan is fixed at 11.97% until March 2022 when it reverts to LIBOR plus 6.25% with a premium of 0.01%.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

7 Debtors: Amounts falling due after one year (continued)

Note (b) Deferred tax

	2011 £m	2010 £m
Deferred taxation		
Other timing differences	**174.3**	156.3
Deferred taxation	**174.3**	156.3

Movement in deferred tax asset:	2011 £m	2010 £m
Deferred tax asset recognised at 1 April	**156.3**	77.2
Amount credited to statement of total recognised gains and losses	**18.0**	79.1
Deferred tax asset recognised at 31 March	**174.3**	156.3

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered as the company expects to make future profits.

8 Restricted Cash

Restricted cash of £5.6m (2010: £15.8m) is held in a designated bank account in order to meet certain interest requirements on loan finance.

9 Creditors: Amounts falling due within one year

	2011 £m	2010 £m
Receipts in advance from parent undertaking	**3.0**	3.0
Accruals and deferred income	**10.4**	7.8
Deferred gilt lock proceeds (note 10 (ii) below)	**0.1**	0.1
Other borrowings	**5.6**	15.7
	19.1	26.6

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

10 Creditors: Amounts falling due after one year

	2011	2010
Loans and other borrowings	**£m**	£m
Class A £350m 6.192% fixed rate 2029	**389.6**	390.9
Class A £150m 3.706% index linked 2034	**219.7**	210.6
Class A £35m 3.706% index linked 2034	**51.9**	49.8
Class A £350m 6.640% fixed rate 2026	**388.3**	389.9
Class A £150m 3.816% index linked 2023	**204.3**	195.6
Class A £350m 5.000% fixed rate 2021	**349.9**	349.9
Class A £150m 5.000% fixed rate 2041	**151.0**	150.9
Class A £200m 4.500% fixed rate 2052	**198.5**	198.5
Class A £300m 5.125% fixed rate 2056	**292.4**	292.4
Class A £300m 6.125% fixed rate 2019	**296.7**	296.4
Class B £250m 7.869% fixed rate 2038 (note (i) below)	**256.6**	259.3
Artesian £165m 4.076% index linked 2033	**245.3**	234.8
Artesian £156.5m 3.635% index linked 2032	**199.8**	190.5
Deferred gilt lock proceeds (note (ii) below)	**5.7**	5.8
	3,249.7	3,215.3
Amounts owed to group companies		
Senior Mezzanine £15.4m LIBOR plus 6.25% 2038 (note (iii) below)	**15.4**	15.4
Intercompany creditor (see note 7(ii))	**14.4**	14.4
	29.8	29.8
Total creditors falling due after one year	**3,279.5**	3,245.1

These loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of SWS, SWSF, SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence.

Notes in respect of the specific instruments above:

(i) The 3 month sterling LIBOR plus 4.75% interest rate on the class B £250m is fixed at 7.869% until March 2014.

(ii) Prior to the issue of the new £300m bond, the Company entered into a gilt lock agreement, resulting in the receipt of £6.3m.The proceeds have been deferred and are being released to the profit and loss account over the life of the loan.

(iii) The senior mezzanine loan is owed to Southern Water Capital Limited. The floating rate of LIBOR plus 6.25% interest rate on the senior mezzanine loan has been converted to a fixed rate of 5.71% plus 6.25% until March 2022. The hedge is for the same period as the loan to which it relates.

	2011	2010
	£m	£m
Repayments fall due as follows:		
Between two and five years	**-**	-
After five years not by instalments	**3,273.8**	3,239.3
	3,273.8	3,239.3

The note above does not include gilt lock proceeds of £5.7m (2010: £5.8m) which will be amortised as per note (ii) above.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

11 Financial Instruments

(i) Financial risk management objectives and policies

The principal financial risks to which the Company is exposed are interest rate, liquidity and RPI risks. The Board has approved policies for the management of these risks.

Interest rate risk
The Company's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk) and floating rate borrowings (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile within the company policy, which is to maintain a higher proportion of net debt at fixed rates of interest having regard to the prevailing interest rate outlook. These are designated as either fair value or cash flow hedges as appropriate.

Liquidity risk

The Company raises funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business of the Southern Water Services Limited for the next twelve months.

RPI risk and sensitivity analysis

The principle market risks are interest rates and movements in RPI. Interest rates are currently either fixed or fully effective hedging instruments are in place to swap floating rates for fixed. RPI impacts indexation, however annual indexation credited to interest income is the same as that charged to interest expense, so there is no impact on the company’s profit or loss.

(ii) Derivative financial instruments

Net fair values of derivative financial instruments

The net fair values and book values of derivative financial instruments and designated for cash flow hedges at the balance sheet date were:

	2011	2010
	£m	£m
Contracts with negative fair values:		
Interest rate swaps - cash flow hedges	**670.6**	558.3

Cash flow hedges

The notional principal amount of the outstanding interest swap contracts at 31 March 2011 was £877.0m (2010: £877.0m). Details of the hedges taken out are shown in note 7(i).

	2011	2010
Movement in hedges	**£m**	£m
At 1 April	**(558.3)**	(275.8)
Movement in fair value recognised in hedging reserve	**(112.3)**	(282.5)
At 31 March	**(670.6)**	(558.3)

The terms of the interest swap contracts are given in notes 7 and 10. Cash flows in relation to the pre-hedge detailed in note 4(ii) have already occurred, and the balance is being released to the profit and loss account over the period of the related debt.

In relation to the swaps detailed in note 7(a)(i) and (iii), cash receipts under the swap will continue over the term of the instrument, with a cash payment equal to the indexation receivable from SWS payable at the end of the term of the related debt. The interest swap contracts will affect the profit and loss account throughout the period of the instruments.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

11 Financial Instruments (continued)

(iii) Fair values of non derivative financial assets and financial liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. Where available, market values have been used to determine fair values. The carrying amounts of short term borrowings approximate to book value.

	Book value 2011 £m	**Fair value 2011 £m**	Book value 2010 £m	Fair value 2010 £m
Long term borrowings	**(3,279.5)**	**(3,258.6)**	(3,245.1)	(3,195.5)
Short term borrowings	**-**	**-**	-	-
Long term debtors	**3,274.8**	**3,258.6**	3,185.6	3,195.5
Short term loan	**30.3**	**30.3**	30.3	30.3
Restricted Cash	**5.6**	**5.6**	15.8	15.8

(iv) Interest rate risk

In respect of income earning financial assets and interest bearing financial liabilities, the following tables indicate their effective interest.

Weighted average effective interest rates by class

	Loans & Receivables 2011 %	**Financial Liabilities 2011 %**	Loans & Receivables 2010 %	Financial Liabilities 2010 %
Class A	**4.13**	**4.84**	4.08	5.00
Class B	**7.90**	**6.53**	7.88	6.53
Artesian	**4.66**	**4.04**	4.45	4.05
Mezzanine	**11.97**	**11.96**	11.97	11.96

(v) Maturity of financial liabilities

The maturity profile of the company’s financial liabilities at 31 March 2011 is disclosed within note 10

12 Share capital

	2011 £	2010 £
Authorised:		
Equity shares		
25,000 Ordinary Shares of £1 each	**25,000**	25,000
	25,000	25,000

	2011 £	2010 £
Allotted, issued and fully paid:		
Equity shares		
1,000 Ordinary Shares of £1 each	**1,000**	1,000
Called up share capital	**1,000**	1,000

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2011

13 Reserves

	Hedging reserve £m	Profit and loss account £m
At 1 April 2010	(455.1)	25.9
Swap break costs charged to interest payable	7.5	-
Interest rate swap balance released to interest income	48.7	-
Movement in fair value of interest rate swaps	(112.3)	-
Deferred tax movement	18.0	-
Loss for the year	-	(0.9)
At 31 March 2011	**(493.2)**	**25.0**

14 Reconciliation of movement in shareholders' deficit

	2011 £m	2010 £m
(Loss)/profit for the financial year	**(0.9)**	0.5
Other recognised gains and losses relating to the year	**(38.1)**	(166.7)
Net change in shareholders' deficit	**(39.0)**	(166.2)
Opening shareholders' deficit	**(429.2)**	(263.0)
Closing shareholders' deficit	**(468.2)**	(429.2)

15 Ultimate holding company and related party transactions

The immediate parent undertaking is Southern Water Services Limited.

The ultimate parent and controlling company is Greensands Holdings Limited, a company incorporated in the Jersey. As at 31 March 2011, the major shareholders in Greensands Holdings Limited were a consortium including IIF International SW UK Investments Limited (advised by JP Morgan Investments Inc.) and The Northern Trust Company.

Greensands Holdings Limited is the only group company that prepares consolidated financial statements, which contain the financial statements of Southern Water Services (Finance) Limited. Copies of Greensands Holdings Limited's consolidated financial statements may be obtained from the Company Secretary of Greensands Holdings Limited, at Southern House, Yeoman Road, Worthing, BN13 3NX.

16 Capital instruments

The company's objective when managing capital is to maintain a positive value of capital employed to safeguard the company's ability to continue as a going concern, so that it can continue to provide finance for its parent company, Southern Water Services Ltd.

No specific value of capital, or capital ratio, is required to be maintained.

17 Post balance sheet events

In April 2011, the principle borrowings of Greensands Holdings Limited were refinanced. As part of this refinancing the Company entered into £441.0m of long dated inflation linked swaps at their market value of £124.0m, which were applied to the back to back loans to Southern Water Services Limited.

No change has been made to the Southern Water securitisation covenants.

INDEPENDENT AUDITORS' REPORT TO THE DIRECTORS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED FOR THE YEAR ENDED 31 MARCH 2011

We have audited the non-statutory financial statements of Southern Water Services (Finance) Limited for the year ended 31 March 2011 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes. These non-statutory financial statements have been prepared under the accounting policies set out herein.

These non-statutory financial statements were prepared solely for the purposes of management of the company's affairs, have not been prepared under the Companies Act 2006 and are not the company's statutory financial statements.

Respective responsibilities of the directors and auditors

The directors' responsibilities for preparing the non-statutory financial statements in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the non-statutory financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the directors for management purposes in accordance with our engagement letter dated 30 March 2010 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come including without limitation under any contractual obligations of the company, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the non-statutory financial statements give a true and fair view.

We read the other information contained in the Directors' Report, and consider whether it is consistent with the audited non-statutory financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the non-statutory financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the non-statutory financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the non-statutory financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the non-statutory financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the non-statutory financial statements.

Opinion

In our opinion the non-statutory financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2011 and of its loss for the year then ended.

Emphasis of matter

We draw your attention to the paragraph in note 1(a) explaining the basis of preparation. Our opinion is not qualified in this respect.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Gatwick
22 June 2011