



Investor Report and Compliance Certificate

For the SWS Financing Group

For the period ended 30 September 2011

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 six months ended 30 September 2011. The Investor Report is a requirement of the Common Terms Agreement (CTA), which governs the company's obligations to its lenders and investors.

Capitalised terms used in this Investors Report/Compliance Certificate shall have the same definitions as in the CTA.

General levels of service

From 2010/11, the Service Incentive Mechanism, a quantitative and qualitative customer service score, has replaced the overall performance assessment, and scores from this 2011/12 financial year will be used to determine comparative performance for regulatory price setting. The financial year 2010/11 provided an opportunity for companies to familiarise themselves with this new comparative performance mechanism prior to it being used for comparative performance from 2011/12.

Financial performance for the six months to 30 September 2011

Turnover increased by 3.8% to £356.3m (September 2010: £343.3m) compared with an average tariff increase of 6.1%. Operating profit increased by 3.1% to £141.0m (September 2010 £136.7m). No final dividend was declared for 2010/11.

Net cash flow from operating activities is in line with expectations, and decreased to £195.0m (September 2010 £204.2m).

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, the financial ratios exceed 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 (a shortfall in turnover over the AMP5 period of £150m), projected costs associated with the adoption of private sewers (£52m over the remainder of the AMP period), plus other cost pressures such as the carbon reduction commitment levy on energy costs.

Forecast RPI's used for this Investor Report are 3.7% at March 2012 and 2.5% thereafter. RPI at March 2011 was 5.3%

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.

Operational performance

Drinking water compliance for the 2010 Calendar year was 99.90% (2009: 99.98%). This is a key measure of the quality of water received by customers. Maintaining compliance as close to 100% as practicable is a key target to ensure consistently high standards to customers.

The Leakage target for 2011/12 has been revised upwards to 93 MI/d (from an original target of 80 MI/d), and for future years is now 88 MI/d by 2015 from 77 MI/d by 2015. Southern Water is however required to provide a customer rebate of £5m in AMP6 as a condition of this relaxation of leakage targets for the remainder of this AMP5 period. The revised targets will continue to reinforce Southern Water's position of having one of the lowest levels of leakage of the water and sewerage companies. Leakage for 2010/11 was 92 MI/d (an improvement on 2009/10 performance of 95MI/d) but performance in both of these years was higher than the OFWAT target of 83MI/d for 2010/11 and 92 MI/d for 2009/10.

Water resource levels continue to be managed at a sustainable level, with a maximum security of supply index of 100%.

There were seven of the more serious Category 1 and 2 pollution incidents in the 2010 Calendar year (nine in 2009).

Serviceability performance for Water non-infrastructure, Water infrastructure and Wastewater non-infrastructure has been assessed by the company as 'Stable' and Wastewater infrastructure has been assessed as 'Marginal'. The performance of Water non-infrastructure has improved from 'Deteriorating' in 2009/10 and the performance of Wastewater infrastructure has fallen from 'Stable' in 2009/10.

Capital expenditure

Capital expenditure for the six months to 30 September 2011 was in line with expectations at £206.1m.

Financing

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).

Board membership

Mick Carmedy was appointed as Chief Finance Officer in November 2011.

Ultimate parent company

The ultimate parent company is Greensands Holdings Ltd.

Consolidated cashflow

Ref.		31 Mar	31 Mar	31 Mar	31 Mar	31 Mar	31 Mar
		2010	2011	2012	2013	2014	2015
		£m	£m	£m	£m	£m	£m
	Revenue						
1	Appointed	669.0	684.0	710.1	751.9	805.4	836.1
2	Non Appointed	5.3	3.9	4.1	4.0	4.1	4.3
	Operating Costs						
3	Appointed	213.5	223.6	233.8	251.2	272.7	298.5
4	Non Appointed	2.7	1.9	2.0	2.3	2.5	2.7
	Exceptional operating cash outflow *	56.1	0.0	0.0	0.0	0.0	0.0
5	Net Capital Expenditure (inc Disposals of Assets)	212.5	375.9	469.1	402.7	354.1	251.2
	Annual Finance Charge	136.5	131.9	126.0	131.4	134.9	131.5
6	Taxation	0.0	0.0	0.2	0.2	0.2	0.9
	Payments on Subordinated Debt and Distributions	23.5	65.8	34.4	51.6	20.3	22.4
	Net cash reserves movement	29.5	-111.2	-151.3	-83.5	24.8	133.2

* This relates to a one-off payment into the final benefit pension scheme

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	102.7	105.4	108.9	111.4
	Class B debt interest	21.6	21.8	23.0	25.5	26.1	22.7
	Interest income	4.9	2.2	1.9	1.7	2.3	4.8
	Class A Facilities commitment fees	1.3	4.7	2.2	2.2	2.2	2.2
7	Class A Debt Interest	114.9	110.1	103.0	105.9	108.8	108.8
8	Senior Debt Interest	136.5	131.9	126.0	131.4	134.9	131.5
	Annual Finance Charge	136.5	131.9	126.0	131.4	134.9	131.5
	Monthly Payment Amount *	12.0	11.2	10.7	11.1	11.4	11.4

* Monthly payment amount is stated gross and reduced by interest received in the DSPA

Cash accounts and reserves

Ref.		31 Mar	31 Mar	31 Mar	31 Mar	31 Mar	31 Mar
		2010	2011	2012	2013	2014	2015
		£m	£m	£m	£m	£m	£m
	SWS O&M Reserve account						
	Opening balance	44.4	46.3	46.3	44.4	44.4	44.4
	Cash transferred	1.9	0.0	-1.9	0.0	0.0	0.0
	Closing balance	46.3	46.3	44.4	44.4	44.4	44.4
	Capex Reserve account						
	Opening balance	312.8	216	125.5	24.1	0.0	14.9
	Cash transferred	-96.8	-90.5	-101.4	-24.1	14.9	118.2
	Closing balance	216.0	125.5	24.1	0.0	14.9	133.1
	Debt Service Payment account						
	Opening balance	10.8	11.5	5.0	5.0	5.0	5.0
	Cash transferred	0.7	-6.5	0.0	0.0	0.0	0.0
	Closing balance	11.5	5.0	5.0	5.0	5.0	5.0
	SWS Operating accounts						
	Opening balance	0.9	30.6	0.8	0.0	0.0	0.0
	Cash transferred	29.7	-29.8	-0.8	0.0	0.0	0.0
	Closing balance	30.6	0.8	0.0	0.0	0.0	0.0
	Total Cash Balances						
	Opening balance	368.9	304.4	177.6	73.5	49.4	64.3
	Cash transferred	-64.5	-126.8	-104.1	-24.1	14.9	118.2
9	Closing balance	304.4	177.6	73.5	49.4	64.3	182.5

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	204.4	209.5	214.7
* £35m A2b 3.706% Limited Index Bonds due 2034	41.9	43.9	46.1	47.7	48.9	50.1
£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	204.4	209.5	214.7
* £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	171.7	213.6	252.9	293.2
£250m B1 step-up Fixed/Floating rate Bonds due 2038	250.0	250.0	250.0	250.0	350.0	350.0
£50m Class B loan facility	50.0	50.0	100.0	100.0	0.0	0.0
* £165m Artesian 4.076% Index Linked Bonds due 2033	197.5	207.0	217.3	224.8	230.4	236.2
* £156m Artesian 3.635% Index Linked Bonds due 2032	182.7	191.5	201.0	208.0	213.2	218.5
** New cash required	0.0	0.0	0.0	50.0	50.0	50.0
Revolving Credit Facilities	0.0	0.0	0.0	9.9	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	3031.3	3162.8	3214.4	3277.4
Senior Indebtedness	3151.7	3216.2	3381.3	3512.8	3564.4	3627.4
10 Class A Net Indebtedness	2547.3	2738.6	2957.8	3113.4	3150.1	3094.9
11 Senior Net Indebtedness	2847.3	3038.6	3307.8	3463.4	3500.1	3444.9
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	476.1	500.5	532.5	536.7	
B	Net Total Income (1+2+3+4+6)			458.1	462.4	478.2	502.2	534.1	538.3	
C	Depreciation (CCD & IRC)			259.5	275.6	303.4	319.8	332.5	341.9	
D	Class A Debt interest (7)			114.9	110.1	103.0	105.9	108.8	108.8	
E	Senior Debt interest (8)			136.5	131.9	126.0	131.4	134.9	131.5	
F	Period end VAT debtor			4.4	7.0	7.6	7.1	6.2	4.8	
G	Capital Maintenance (MNI & IRE)			92.4	164.2	N/A	N/A	N/A	N/A	
Class A Adjusted ICR										
	Historic: (B-C+F)/D	Projected: (A-C+F)/D	1.3	N/A	1.8	1.8	1.8	1.8	1.9	1.8
Class A Average ICR										
			1.4	N/A	1.8	1.8	1.8	1.8	1.9	1.8
Senior Adjusted ICR										
	Historic: (B-C+F)/E	Projected: (A-C+F)/E	1.1	N/A	1.5	1.5	1.4	1.4	1.5	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	4.7	4.8	5.0	5.0
Class A Post Maintenance ICR										
	Historic: (B-G+F)/D		N/A	1.0	3.2	2.8	N/A	N/A	N/A	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)		2547.3	2738.6	2957.8	3113.4	3150.1	3094.9	
H	Senior Net Indebtedness (11)		2847.3	3038.6	3307.8	3463.4	3500.1	3444.9	
I	RCV		3566.9	3745.1	4063.3	4256.7	4361.9	4447.7	
Class A RAR									
	Projected: G/I	0.750	N/A	0.714	0.731	0.728	0.731	0.722	0.696
Senior RAR									
	Projected: H/I	0.900	0.950	0.798	0.811	0.814	0.814	0.802	0.775

The opening RCV on 1 April 2010 was reduced by £99m, the most significant part of which was a "log down" for uncommitted expenditure on the Brighton & Hove scheme, with delayed expenditure on that scheme forming part of the capital expenditure programme for AMP5.

Opening RCV for the next AMP6 period, may also be adjusted as a result of variance to projected capital expenditure and changes to the notified index. This is presently forecast to be a reduction of £100m, resulting in an adjusted opening Senior RAR of 79.6%.

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 £126.0m for 2011/12 equating to a Monthly Payment Amount for this period of £10.7m.

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.

Matthew Wright
Director



Mick Carmedy
Chief Financial Officer

for and on behalf of Southern Water Services Limited

Matthew Wright
Director



Mick Carmedy
Chief Financial Officer

for and on behalf of Southern Water Services (Finance) Limited