

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**ANNUAL REPORT**

**AND**

**FINANCIAL STATEMENTS FOR THE YEAR ENDED**

**31 MARCH 2018**

# SOUTHERN WATER SERVICES (FINANCE) LIMITED

## ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED

31 MARCH 2018

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## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2018

Southern Water Services (Finance) Limited ('SWSF') (Registered No. CR 112331) was incorporated in the Cayman Islands and has no requirements to prepare statutory financial statements. However under the Disclosure and Transparency Rules (DTR) 4.1, and the Common Terms Agreement, which governs the company's banking arrangements, financial statements are required to be produced. The company continues to provide financing to Southern Water Services Limited, and enters into swap transactions to manage the cash flow exposures of these borrowings.

The company did not trade during the year, and there is no intention for it to trade in the future. As such, it does not maintain any key performance indicators. The company has been an integral part of the financing structure of the Southern Water Services Limited group, and the finance income and costs reflect the performance of this activity. During the year a decision was made by the directors to look to transfer the assets and liabilities of the company to a UK company within the group by the end of the year ending March 2019.

Given the limited activity of the company, additional information including a review of the company's business and information of the principal risk and uncertainties facing the company is presented in the directors' report, but no further information is included in this strategic report.

Approved by the Board and signed on its behalf by:

Handwritten signature of William Lambe in black ink, consisting of the initials 'W.A.' followed by a stylized cursive signature.

William Lambe  
**Director**  
5 July 2018

## **SOUTHERN WATER SERVICES (FINANCE) LIMITED**

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2018**

The directors of Southern Water Services (Finance) Limited ('SWSF') (Registered No. CR 112331) present their annual report and the audited financial statements for the year ended 31 March 2018.

#### **PRINCIPAL ACTIVITIES**

The company provides financing to Southern Water Services Limited (SWS), and enters into swap transactions to manage the cash flow exposures of these borrowings.

#### **REVIEW OF THE BUSINESS**

The profit after tax for the year amounted to £nil (2017: £0.1m). The directors do not recommend the payment of a final dividend (2017: £nil).

The company has net assets of £36.4m (2017: £36.4m) comprising largely of amounts owed by group undertakings of £3,689.2m (2017: £3,642.9m), amounts owed externally of £3,763.6 (2017: £3,613.8m) and cash balances of £111.8m (2017: £8.3m).

The company is a subsidiary of SWS who recorded profits of £154.7m (2017: loss of £175.7m) after tax for the year ended 31 March 2018 and has net assets of £1,062.8m (2017: £954.1m). The directors consider the net asset position of SWS at 31 March 2018 sufficient to support the company and its activities for the foreseeable future.

#### **PRINCIPAL RISKS AND UNCERTAINTIES**

Due to the nature of the company being a financing company, the principal risks and uncertainties are aligned to the financial risks, such as interest rate risk, liquidity risk and RPI risk. These have been explained further in the financial risk management objectives and policies below.

#### **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. The company does not use derivative financial instruments for speculative purposes.

The company also notes that the result of the recent referendum will increase uncertainty around these risk areas in the short-term.

##### **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.

##### **Liquidity risk**

The company raises funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business of SWS for the next twelve months.

##### **RPI risk and sensitivity analysis**

The principal market risks are interest rates and movements in RPI. Interest rates are currently either fixed or fully effective swap 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.

#### **GOING CONCERN**

During the year a decision was made by the directors to look to transfer the assets and liabilities of the company to a UK company within the group by the end of 2018/19. Therefore it is no longer appropriate to adopt the going concern basis in preparing the annual financial statements, however, no adjustments were considered necessary to the amounts at which the assets and liabilities are included in these financial statements.

## **SOUTHERN WATER SERVICES (FINANCE) LIMITED**

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2018 (continued)**

#### **FUTURE DEVELOPMENTS**

As mentioned above, as part of the wider group financing objectives, the directors intend to transfer the assets and liabilities of the company to a UK company within the group, and ultimately wind-up Southern Water Services (Finance) Limited, ceasing all activity within the Cayman Islands by the end of the year ending March 2019.

#### **EVENTS AFTER THE BALANCE SHEET DATE**

As at the date of signing, there were no significant events after the balance sheet date.

#### **DIRECTORS**

The directors who served during the year and up to the date of signing, unless otherwise stated, were:

Ian McAulay  
William Lambe  
Joanne Statton

The company secretary in the year and at the date of signing was Joanne Statton.

#### **DIRECTOR'S INDEMNITIES**

The company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

#### **DIRECTORS' RESPONSIBILITIES STATEMENT**

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

The Disclosure Transparency Rules (DTR) 4.1 requires the directors to prepare financial statements for each financial year. Under these rules the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 Reduced Disclosure Framework. Under the applicable company law (UK Companies Act 2006) the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company; and
- the directors' report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face.

#### STATEMENT OF DISCLOSURE OF INFORMATION TO AUDITOR

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

#### INDEPENDENT AUDITOR

Deloitte LLP have indicated their willingness to continue in office. Deloitte LLP have indicated their willingness to be reappointed for another term and appropriate arrangements will be put in place for them to be deemed reappointed as auditor in the absence of an Annual General Meeting.

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



Joanne Statton  
**Company Secretary**  
5 July 2018

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

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2018**

|   | Notes | 2018<br>£m     | 2017<br>£m |
|---|-------|----------------|------------|
| <b>Continuing operations</b>                                    |       |                |            |
| Administrative expenses   |       | -              | (0.1)      |
| <b>Loss before interest and taxation</b>                        |       | -              | (0.1)      |
| Finance income  | 4     | <b>211.4</b>   | 193.0      |
| Finance costs   | 5     | <b>(211.3)</b> | (192.8)    |
| Fair value gains and losses on derivative financial instruments | 5     | -              | -          |
| <b>Net finance income</b>                                       |       | <b>0.1</b>     | 0.2        |
| <b>Profit before taxation</b>                                   | 3     | <b>0.1</b>     | 0.1        |
| Tax   | 6     | <b>(0.1)</b>   | -          |
| <b>Result/profit for the financial year</b>                     | 15    | -              | 0.1        |

The above results relate entirely to continuing operations.

The Notes on pages 8 to 17 form part of these financial statements.

There have been no recognised gains or losses for the current or the prior financial year other than as stated in the income statement and, accordingly, no separate statement of comprehensive income is presented.

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2018**

|   | Notes | 2018<br>£m       | 2017<br>£m       |
|---|-------|------------------|------------------|
| <b>Non-current assets</b>                       |       |                  |                  |
| Financial assets                                |       |                  |                  |
| - Derivative financial instruments - group      | 13    | 1,288.0          | 1,338.0          |
| - Derivative financial instruments - external   | 13    | 4.2              | 9.3              |
| Other non-current assets                        | 7     | 3,344.0          | 3,611.8          |
|   |       | <u>4,636.2</u>   | <u>4,959.1</u>   |
| <b>Current assets</b>                           |       |                  |                  |
| Other receivables                               | 8     | 464.7            | 46.6             |
| Cash and cash equivalents                       | 9     | 111.8            | 8.3              |
|   |       | <u>576.5</u>     | <u>54.9</u>      |
| <b>Total assets</b>                             |       | <u>5,212.7</u>   | <u>5,014.0</u>   |
| <b>Current liabilities</b>                      |       |                  |                  |
| Other payables                                  | 10    | (130.6)          | (12.3)           |
| Borrowings: amounts falling due within one year | 11    | (411.5)          | (8.4)            |
|   |       | <u>(542.1)</u>   | <u>(20.7)</u>    |
| <b>Non-current liabilities</b>                  |       |                  |                  |
| Borrowings: amounts falling due after one year  | 12    | (3,342.0)        | (3,609.6)        |
| Derivative financial instruments                | 13    | (1,292.2)        | (1,347.3)        |
|   |       | <u>(4,634.2)</u> | <u>(4,956.9)</u> |
| <b>Total liabilities</b>                        |       | <u>(5,176.3)</u> | <u>(4,977.6)</u> |
| <b>Net assets</b>                               |       | <u>36.4</u>      | <u>36.4</u>      |
| <b>Equity</b>                                   |       |                  |                  |
| Called up share capital                         | 14    | -                | -                |
| Retained earnings                               | 15    | 36.4             | 36.4             |
| <b>Total equity</b>                             |       | <u>36.4</u>      | <u>36.4</u>      |

The financial statements of Southern Water Services (Finance) Limited (Registered No. CR 112331) were approved by the Board of directors and authorised for issue on 5 July 2018. They are signed on its behalf by:

*W. A. Lambe*

William Lambe  
Director

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2018**

|  | Called up<br>share capital<br>£m | Retained<br>earnings<br>£m | Total<br>£m |
|--|----------------------------------|----------------------------|-------------|
| <b>Balance at 1 April 2016</b>                 | -                                | <b>36.3</b>                | <b>36.3</b> |
| Profit for the financial year                  | -                                | 0.1                        | 0.1         |
| <b>Total comprehensive result for the year</b> | -                                | 0.1                        | 0.1         |
| <b>Balance at 31 March 2017</b>                | -                                | <b>36.4</b>                | <b>36.4</b> |
| Result for the financial year                  | -                                | -                          | -           |
| <b>Total comprehensive profit for the year</b> | -                                | -                          | -           |
| <b>Balance at 31 March 2018</b>                | -                                | <b>36.4</b>                | <b>36.4</b> |

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018

#### 1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below.

##### Basis of preparation

Southern Water Services (Finance) Limited is a private company limited by shares, incorporated in the Cayman Islands. The address of the registered office is given on page 4. The nature of the company's operations and its principal activities are set out in the business review on pages 2 to 3.

The company meets the definition of a qualifying entity under Financial Reporting Standard 100 (FRS 100) issued by the Financial Reporting Council (FRC). Accordingly, the company prepared its financial statements in accordance with FRS 101 'Reduced Disclosure Framework' as issued by the FRC 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 financial statements have not been prepared on a going concern basis, due to management's intention to transfer the assets and liabilities to a UK registered company within the group, however no adjustments to the assets and liabilities were considered necessary and these therefore continue to be valued under the historical cost convention, except for the revaluation of financial instruments. Financial instruments are measured at their fair value at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services.

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except measurements that have some similarities to fair value but are not fair value, such as value in use in IAS 36 'Impairment of Assets'.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The financial statements contain information about Southern Water Services (Finance) Limited (SWSF) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is included in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained from the address shown in Note 16.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, standards not yet effective and related party transactions. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited, the group financial statements are available to the public and can be obtained from the address shown in Note 16.

##### Adoption of new and revised Standards

There were no new or revised standards and interpretations adopted in the current year.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 1 Accounting policies (continued)

##### Going concern

During the year a decision was made by the directors to look to transfer the assets and liabilities of the company to a UK company within the group and ultimately wind-up Southern Water Services (Finance) Limited, ceasing all activity within the Cayman Islands by the end of the year ending March 2019.

##### Interest income, interest payable and similar income and charges

Interest income, interest payable and similar income and charges are recognised on an accruals basis. The policy for interest income and expense is detailed in the financial instruments policy.

##### Taxation

The taxation charge in the profit and loss account is based on the company being considered a securitisation company under the UK 'Taxation of Securitisation Companies Regulations 2006' (SI 2006/3296). Therefore, the company does not calculate its UK corporation tax based on its accounting profit or loss. Instead the company applies current tax rates to its retained profits as specified in the documentation governing the securitisation transaction into which the company has entered.

Deferred taxation is tax expected to be payable on temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all temporary-differences that have originated but not reversed by the end of the reporting period. It is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is regarded as probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 1 Accounting policies (continued)

##### Financial Instruments

Financial assets and financial liabilities are recognised in the company's statement of financial position when the company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss (FVTPL)) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in profit or loss.

##### Financial assets

###### (i) Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

###### (ii) Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment is the differences between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets.

###### (iii) Derecognition of financial assets

The company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. On derecognition of a financial asset the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

##### Financial liabilities

Fixed rate interest-bearing borrowings are initially measured at fair value, net of transaction costs and are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the profit and loss account in the year in which it arises.

Premiums and proceeds from gilt lock agreements received on issue of debt instruments are credited to the profit and loss account over the term of the debt at a constant rate on the carrying amount.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 1 Accounting policies (continued)

##### Derecognition of financial liabilities

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

##### Derivative financial instruments

The company enters into a variety of derivative financial instruments to manage its exposure to inflation and interest rate risk in line with the company's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 13.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in the income statement immediately.

Certain derivative instruments, principally index-linked swaps, do not qualify for hedge accounting and as such, the company does not currently apply hedge accounting.

A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. Intercompany derivative assets/liabilities held with SWS are set-off against each other with the net position being presented as either a financial liability or financial asset. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

##### Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit and loss.

An embedded derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the hybrid instrument to which the embedded derivative relates is more than 12 months and is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

#### 2 Critical accounting judgements and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in note 1 above, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

##### Critical judgements in applying the company's accounting policies

The following are the critical judgements that the directors have made in the process of applying the company's accounting policies and that have the most significant effect on the amounts recognised in financial statements.

###### (i) Financial instruments

The fair value of the financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined using valuation techniques.

The company uses its judgement to select the most appropriate valuation method for each instrument to estimate expected future cash flows, and apply discount rates that reflect counterparty credit risk. The valuation techniques are described in note 13.

###### (ii) Taxation

The tax charge is based on the profit for the period and the tax rates in force at the end of the reporting period. Estimation of the tax charge involves an assessment of the potential tax treatment of certain items, which will only be resolved once finally agreed with the tax authorities.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 3 Profit for the year

The company had no employees, other than the directors, during the year ended 31 March 2018 (2017: nil).

In 2018 and 2017 audit fees of £1,000 were borne by Southern Water Services Limited ('SWS').

The services of the directors are deemed to be wholly attributable to their services to SWS. 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 SWS.

#### 4 Finance income

|   | 2018<br>£m | 2017<br>£m |
|---|------------|------------|
| Interest on loans to group undertakings                 | 134.5      | 131.3      |
| Interest on swaps                                       | 42.0       | 43.3       |
| Amortisation of gilt lock proceeds (see note (i) below) | 0.1        | 0.1        |
| Indexation  | 34.8       | 18.3       |
|   | 211.4      | 193.0      |

#### 5 Finance costs

|   | 2018<br>£m | 2017<br>£m |
|---|------------|------------|
| Loan interest and facility fee charges                  | 176.4      | 174.4      |
| Indexation  | 34.8       | 18.3       |
| Amortisation of gilt lock proceeds (see note (i) below) | 0.1        | 0.1        |
|   | 211.3      | 192.8      |

Movements in the fair value of derivative liabilities through the income statement in the year amount to a credit of £51.4m (2017: charge of £413.7m) within interest payable and similar charges. This is offset by the movements in the fair value of derivative assets which amount to the equivalent opposite value within the same caption.

The derivative liability was also reduced by £3.7 million in the year (2017: £2.5 million) due to payment of accrued indexation associated with the swap instruments.

The net decrease in the derivative liability was £55.1m (2017: net increase of £411.2m).

- (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 income statement on an effective interest rate basis (see note 11 and 12). These proceeds have been on-lent to SWS.

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)**

**6 Tax on profit on ordinary activities**

|                      | <b>2018</b>         | <b>2017</b> |
|----------------------|---------------------|-------------|
|                      | <b>£m</b>           | <b>£m</b>   |
| <b>Tax</b>           |                     |             |
| UK corporation tax   | <b>(0.1)</b>        | -           |
| Tax charge on profit | <u><b>(0.1)</b></u> | <u>-</u>    |

No deferred tax arose during the year to 31 March 2018 (2017: nil).

The tax assessed for the year is different to the standard rate of corporation tax in the UK due to the following factors:

|   | <b>Year ended</b>   | <b>Year ended</b> |
|---|---------------------|-------------------|
|   | <b>31 March</b>     | <b>31 March</b>   |
|   | <b>2018</b>         | <b>2017</b>       |
|   | <b>£m</b>           | <b>£m</b>         |
| <b>Profit before taxation</b>   | <u><b>0.1</b></u>   | <u>0.1</u>        |
| UK corporation tax rate at standard rate of tax of 19% on profit for the year (2017: 20%) | -                   | -                 |
| Adjustments in accordance with securitisation tax rules (see note (i) below)              | <u><b>(0.1)</b></u> | <u>-</u>          |
| <b>Tax charge for year</b>  | <u><b>(0.1)</b></u> | <u>-</u>          |

- (i) For UK corporation tax purposes, the company has been considered as a securitisation company under the 'Taxation of Securitisation Companies Regulations 2006' (SI 2006/3296). Therefore, the company is not required to pay corporation tax on its accounting profit or loss. Instead the company is required to pay tax on its retained profits as specified in the documentation governing the securitisation transaction into which the company has entered.

Factors that may affect future tax charges:

Reductions in the main rate of corporation tax to 17% from the 1 April 2020 were enacted in the Finance Bill 2016 and deferred tax balances are calculated at this rate..

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 7 Other non-current assets

Under the loan agreement between SWS and SWSF, SWSF on-lends to SWS an amount equal to each bond or other debt raised externally at the same interest rate plus 0.01%. These loans have the same repayment terms as the external loans disclosed in note 12.

|   | 2018<br>£m     | 2017<br>£m     |
|---|----------------|----------------|
| Loans and receivables from parent undertaking | <u>3,344.0</u> | <u>3,611.8</u> |

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

#### 8 Other receivables

|   | 2018<br>£m   | 2017<br>£m  |
|---|--------------|-------------|
| Loan to parent undertaking (see note (i) below) | 329.9        | 30.3        |
| Group relief surrendered                        | 0.9          | 0.9         |
| Prepayments                                     | 3.1          | 3.1         |
| Accrued interest receivable                     | 126.4        | 8.3         |
| Other borrowings                                | 4.4          | 4.0         |
|   | <u>464.7</u> | <u>46.6</u> |

#### Notes

- (i) Amounts due from the parent undertaking includes a balance of £30.3m (2017: £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 12); or
  - (b) it is done with the consent of the security trustee.

#### 9 Cash and cash equivalents

Cash of £111.8m (2017: £8.3m) is held in a designated bank account in order to meet certain interest requirements on loan finance.

#### 10 Other payables

|   | 2018<br>£m   | 2017<br>£m  |
|---|--------------|-------------|
| Receipts in advance from parent undertaking | 3.1          | 3.1         |
| Corporation tax creditor                    | 0.1          | -           |
| Accruals and deferred income                | 126.4        | 8.3         |
| Amounts owed to parent company              | 1.0          | 0.9         |
|   | <u>130.6</u> | <u>12.3</u> |

Amounts owed to parent company are unsecured, interest free and repayable on demand.

#### 11 Borrowings: amounts falling due within one year

|   | 2018<br>£m   | 2017<br>£m |
|---|--------------|------------|
| Deferred gilt lock proceeds (note 12 (i)) | 0.1          | 0.1        |
| Loans and other borrowings                | 411.4        | 8.3        |
|   | <u>411.5</u> | <u>8.4</u> |

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)**

**12 Borrowings: amounts falling due after one year**

|  | 2018           | 2017           |
|--|----------------|----------------|
|  | £m             | £m             |
| <b>Loans and other borrowings</b>              |                |                |
| Class A £350m 6.192% fixed rate 2029           | 376.9          | 378.7          |
| Class A £150m 3.706% index linked 2034         | 267.7          | 259.2          |
| Class A £35m 3.706% index linked 2034          | 62.6           | 60.4           |
| Class A £350m 6.640% fixed rate 2026           | 373.0          | 375.3          |
| Class A £150m 3.816% index linked 2023         | 241.9          | 235.2          |
| Class A £350m 5.000% fixed rate 2021           | 348.6          | 348.2          |
| Class A £150m 5.000% fixed rate 2041           | 145.8          | 145.7          |
| Class A £200m 4.500% fixed rate 2052           | 197.2          | 197.1          |
| Class A £300m 5.125% fixed rate 2056           | 292.7          | 292.7          |
| Class A £300m 6.125% fixed rate 2019           | 299.6          | 299.2          |
| Class A £175m 2.780% fixed rate 2031           | 173.9          | 173.9          |
| Class A £75m 2.960% fixed rate 2036            | 74.5           | 74.5           |
| Artesian £165m 4.076% index linked 2033        | 299.6          | 290.5          |
| Artesian £156.5m 3.635% index linked 2032      | 233.9          | 225.8          |
| <b>Total Class A debt</b>                      | <u>3,387.9</u> | <u>3,356.4</u> |
| Class B £250m 4.500% fixed rate 2022           | 248.9          | 248.3          |
| Deferred gilt lock proceeds (note (i) below)   | 4.9            | 5.0            |
| Other loans from SWS                           | 111.8          | 8.3            |
| <b>Total loans and other borrowings</b>        | <u>3,753.5</u> | <u>3,618.0</u> |
| <b>Borrowings: falling due within one year</b> | <u>(411.5)</u> | <u>(8.4)</u>   |
| <b>Borrowings: falling due after one year</b>  | <u>3,342.0</u> | <u>3,609.6</u> |

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) Prior to the issue of the £300m Class A 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 on an effective interest rate basis.

|   | 2018           | 2017           |
|---|----------------|----------------|
|   | £m             | £m             |
| <b>Repayments fall due as follows:</b>          |                |                |
| Between one and two years                       | 0.1            | 299.2          |
| Between two and five years                      | 839.7          | 348.2          |
| After five years not by instalments             | 2,502.2        | 2,962.2        |
|   | <u>3,342.0</u> | <u>3,609.6</u> |
| On demand or within one year not by instalments | 411.5          | 8.4            |
|   | <u>3,753.5</u> | <u>3,618.0</u> |

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)**

**13 Derivative financial Instruments**

**Categories of financial instruments at fair value**

|   | 2018<br>£m       | 2017<br>£m       |
|---|------------------|------------------|
| <b>Derivative assets carried at fair value through profit or loss (FVTPL):</b>      |                  |                  |
| Interest rate swaps – not hedge accounted (group)                                   | 1,288.0          | 1,338.0          |
| Interest rate swaps – not hedge accounted (external)                                | 4.2              | 9.3              |
| <b>Total derivative financial assets</b>  | <b>1,292.2</b>   | <b>1,347.3</b>   |
| <br>  |                  |                  |
|   | 2018<br>£m       | 2017<br>£m       |
| <b>Derivative liabilities carried at fair value through profit or loss (FVTPL):</b> |                  |                  |
| Interest rate swaps – not hedge accounted (external)                                | (1,292.2)        | (1,347.3)        |
| <b>Total derivative financial liabilities</b>                                       | <b>(1,292.2)</b> | <b>(1,347.3)</b> |
| <br>  |                  |                  |
|   | 2018<br>£m       | 2017<br>£m       |
| <b>Changes in value of financial instruments at fair value</b>                      |                  |                  |
| <br>  |                  |                  |
| <b>Profit for the year has been arrived at after charging/(crediting):</b>          |                  |                  |
| <b>Financial assets at fair value</b>   | <b>51.4</b>      | <b>(413.7)</b>   |
| Designated as FVTPL   |                  |                  |
| <b>Financial liabilities at fair value</b>  | <b>(51.4)</b>    | <b>413.7</b>     |
| Designated as FVTPL   |                  |                  |
|   | <b>-</b>         | <b>-</b>         |

The derivative liability and corresponding derivative asset held with SWS reduced by £3.7 million in the year (2017: £2.5 million) due to payment of accrued indexation associated with the swap instruments.

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 (RCV) are indexed, exposes the securitised group to inflation risk. The company enters into derivative financial instruments to manage the group's 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.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018 (continued)

#### 14 Called-up share capital

|   | 2018<br>£           | 2017<br>£           |
|---|---------------------|---------------------|
| <b>Authorised:</b>                      |                     |                     |
| <b>Equity shares</b>                    |                     |                     |
| 25,000 Ordinary Shares of £1 each       | <u>25,000</u>       | <u>25,000</u>       |
|   | <b>25,000</b>       | <b>25,000</b>       |
| <br>                                    |                     |                     |
| <b>Allotted, issued and fully paid:</b> |                     |                     |
| <b>Equity shares</b>                    |                     |                     |
| 1,000 Ordinary Shares of £1 each        | <u>1,000</u>        | <u>1,000</u>        |
| Called up share capital                 | <u><b>1,000</b></u> | <u><b>1,000</b></u> |

#### 15 Reserves

|                         |  | <b>Profit and<br/>loss account<br/>£m</b> |
|-------------------------|--|---|
| At 1 April 2017         |  | <b>36.4</b>                               |
| Result for the year     |  | -   |
| <b>At 31 March 2018</b> |  | <u><b>36.4</b></u>                        |
|                         |  | <br>Profit and loss<br>account<br>£m      |
| At 1 April 2016         |  | 36.3                                      |
| Profit for the year     |  | 0.1                                       |
| <b>At 31 March 2017</b> |  | <u><b>36.4</b></u>                        |

#### 16 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 Jersey. As at 31 March 2018, the majority shareholder in Greensands Holdings Limited was an institutional investment company advised by J.P. Morgan Asset Management.

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 the registered address, Southern House, Yeoman Road, Worthing, BN13 3NX.

#### 17 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 Limited.

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

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED

#### Report on the audit of the financial statements

#### Opinion

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##### In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2018 and of its result for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework".

We have audited the financial statements of Southern Water Services (Finance) Limited (the 'company') which comprise:

- the income statement;
- the statement of financial position;
- the statement of changes in equity; and
- the related notes 1 to 17.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework".

#### Basis for opinion

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We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Summary of our audit approach

|                          |   |
|--------------------------|---|
| <b>Key audit matters</b> | The key audit matter that we identified in the current year was the valuation of derivatives financial instruments.         |
| <b>Materiality</b>       | The materiality that we used in the current year was £11.6 million which was determined on the basis of 2% of total assets. |
| <b>Scoping</b>           | Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.            |

#### Conclusions relating to going concern

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We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

**We have nothing to report in respect of these matters.**

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED (continued)

#### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

#### Valuation of derivatives financial instruments

##### Key audit matter description



The Company had total borrowings of £3,753.5 million at the balance sheet date. To mitigate the exposure to interest rate risk and inflation risk, the Company uses complex derivative instruments such as swaps and futures.

The determination of fair values for these instruments is a key judgement in the financial statements, including the assessment of the credit risk adjustment which is a complex and judgemental area. At the year end, the company had derivative financial assets of 1,292.2 million (2017: £1,347.3 million) and derivative financial liabilities of 1,292.2 million (2017: £1,347.3 million). The treatment of derivative financial instruments is disclosed in; note 1: the accounting policies, note 2: the critical accounting judgements and key sources of estimation uncertainty and in note 13: Derivative financial Instruments.

##### How the scope of our audit responded to the key audit matter

We have performed the following procedures:

- evaluated the design and implementation of key controls which relate to the recording and valuing of derivative transactions;
- obtained independent bank or counterparty confirmations;
- performed an independent valuation of a sample of derivative financial instruments; and
- performed an independent assessment of the potential impact of credit risk.

##### Key observations

The results of our procedures were satisfactory and on this basis we concluded that the valuation of derivative financials instruments is appropriate.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

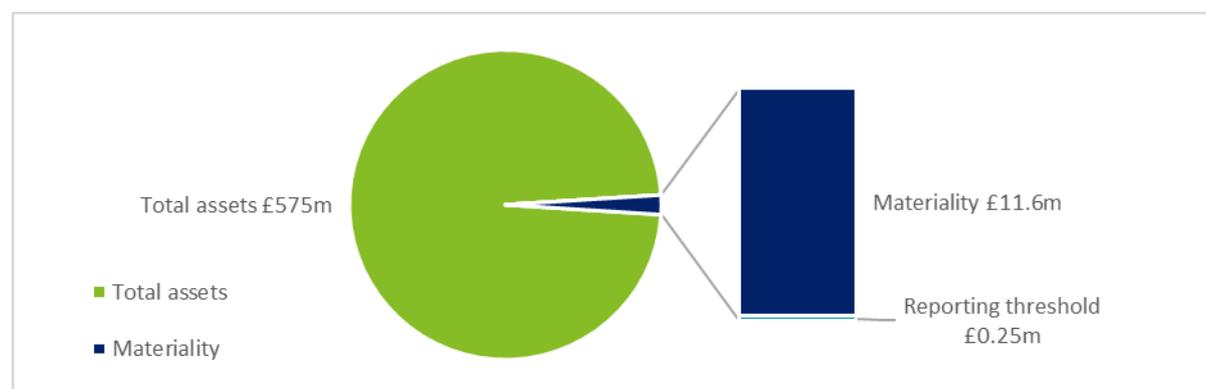
### INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED (continued)

#### Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

|  |  |
|--|--|
| <b>Materiality</b>                         | £11.6 million  |
| <b>Basis for determining materiality</b>   | 2% of total assets   |
| <b>Rationale for the benchmark applied</b> | <p>The principal activity of the company is to provide financing to Southern Water Services Limited and enters into swap transactions to manage the cash flow exposures of these borrowings. On this basis we deem the benchmark which will be the focus of users of the financial statements to be total assets.</p> <p>When determining materiality, as the company is part of Southern Water Service Limited group, we also considered that this materiality is appropriate for the consolidation of this set of financial statements to the group's results.</p> |



We agreed with the directors that we would report to the directors all audit differences in excess of £0.25 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

#### An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the entity and its environment and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

## SOUTHERN WATER SERVICES (FINANCE) LIMITED

### INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED (continued)

#### Other information

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The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

***We have nothing to report in respect of these matters.***

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

#### Responsibilities of directors

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As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

#### Auditor's responsibilities for the audit of the financial statements

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Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

**SOUTHERN WATER SERVICES (FINANCE) LIMITED**

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES (FINANCE) LIMITED (continued)**

**Use of our report**

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This report is made solely to the company's directors in accordance with our engagement letter dated 5 July 2018 and solely for the purpose of clause 6.2.1(i) of the Company's Shareholders' Agreement. Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an independent auditor's 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 audit work, for this report, or for the opinions we have formed.



*Deloitte LLP.*

Deloitte LLP  
London, United Kingdom  
13 July 2018