GREENSANDS HOLDINGS LIMITED

OPERATING AND FINANCIAL REVIEW,

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 MARCH 2012

GREENSANDS HOLDINGS LIMITED

Directors' Report and Financial statements for the year ended

31 March 2012

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OPERATING AND FINANCIAL REVIEW

Greensands Holdings Limited ("GSH" or "the Company") is the ultimate parent company of the Southern Water group of companies.

The Company was incorporated in Jersey on 28 September 2007 and on 15 October 2007 acquired the entire share capital of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited. Also on 15 October 2007, Greensands Investments Limited acquired the entire share capital of Southern Water Capital Limited, the then ultimate parent company of the Southern Water group of companies (the "Group").

The principal operating company in the Group is Southern Water Services Limited ("Southern Water") and the information contained in this Operating and Financial Review ("OFR") is therefore mainly based upon the activities of this company only. Sections 1 and 2 that follow contain reviews of GSH for the year to 31 March 2012, and Southern Water for the year to 31 March 2012, respectively.

1) GREENSANDS HOLDINGS LIMITED

A. THE BUSINESS

The Company acts as a holding company, with the main trading subsidiary being Southern Water.

In addition to the activities of Southern Water (see section 2), the Group holds an investment of 25% in Veolia Water Southeast Ltd (formerly Folkestone & Dover Water Services Ltd). The investment was sold in June 2012.

Financial KPIs

Under the GSH group financial structure there is a comprehensive set of covenanted financial ratios. Of these, two are key ratios, namely the ratio of Consolidated Net Debt to Regulatory Capital Value (RCV) and the Ratio of Consolidated EBITDA to Consolidated Net Cash Interest Cost.

The net debt used in the net debt: RCV ratio is calculated as consolidated secured short and long-term borrowings less cash and short-term deposits. The RCV is set by Ofwat for five year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of consolidated net debt to RCV for the GSH group is targeted to reduce to 90% during the current five tears regulatory period ending March 2015, and the covenanted lock-up level is 93.0%. Lock-up is defined as a restriction on all dividend payments.

The consolidated EBITDA to consolidated senior debt interest is targeted to be maintained comfortably above the 2.0 times covenanted level.

Key Financial Ratios

Net debt: RCV	
2011-12 performance:	91%
Covenanted lock-up level:	Greater than 93.0%
Covenanted default level:	Greater than 95.0%
Consolidated EBITDA to cash interest cover	
2011-12 performance	3.1 times
Covenanted default level:	2.0 times

OPERATING AND FINANCIAL REVIEW (continued)

1) GREENSANDS HOLDINGS LIMITED (continued)

B. FINANCIAL PERFORMANCE

Financial performance

The accounting policies of the Group, including any changes in accounting policies in the period, are set out on pages 36 to 39.

Consolidated profit and loss account

The consolidated profit and loss account of GSH is summarised in Table 1.

	Years ended 31 March	
Table 1	2012	2011
	£m	£m
Turnover	716.2	647.1
Cost of sales and admin. expenses	(477.3)	(445.8)
Exceptional bad debt charge	-	(38.6)
Other income	0.7	0.8
Operating profit	239.6	163.5
(Loss)/profit on disposal of fixed assets	(1.1)	0.8
Net interest	(325.3)	(307.3)
Loss before tax	(86.8)	(143.0)
Tax	14.7	43.9
Loss after tax and for the financial period	(72.1)	(99.1)

Operating profit largely reflects the trading results of Southern Water for the year and additional depreciation from the revaluation of assets on acquisition.

The loss on disposal of fixed assets of £1.1m (2010-11: profit £0.8m) relates mainly to profit on the sale of land and buildings less an impairment of £2.3m relating to investments.

The loss after taxation for the year amounted to £72.1m (2010-11: loss of £99.1m).

Balance sheet

As at 31 March 2012 the Group had tangible fixed assets of £5,327.9m (2010-11: £5,122.9m), an increase of £205.0m from 31 March 2011. This increase largely results from the capital investment programme of the main operating company of the Group, Southern Water, of £443.4m, offset by depreciation of £228.2. Total fixed assets as at 31 March 2012 includes goodwill arising on acquisition of £97.8m (2010-11: £104.1m). Total fixed assets also includes £12.7m relating to an investment in Veolia Water Southeast Limited (formerly Folkestone and Dover Water Services Limited).

Creditors falling due within one year totalled £296.1m (2010-11: £670.4m) as at 31 March 2012. The decrease relates mainly to the repayment of Senior and Junior Holdco debt, amounting to £488.9m, in April 2011, offset by interest payable accruals of £118.4m due to timing of annual interest payments around the year end.

Creditors falling due over one year increased by £655.6m to £4,502.5m as at 31 March 2012. This increase principally resulted from the issue of new long term debt amounting to £450.0m less issue costs of £7.2m, increase in the capital facility by £50.0m, inflation on index-linked bonds of £113.5m and interest capitalisation of £60.6m on the Eurobond loan, offset by the repayment of indexation amounting to £5.1m on the A10 swap facility, and amortisation of debt issue costs and bond premiums.

As at 31 March 2012, net assets of the Group were £586.3m (2010-11: £688.9m).

Cash flow

During the period the Group had a net cash outflow of £12.1m (2010-11: outflow of £81.8m). With the exclusion of interest, tax and dividend payments, and issue of long-term debt, the cash flow of the Group largely reflects the cash-flow of the operating company.

OPERATING AND FINANCIAL REVIEW (continued)

1) GREENSANDS HOLDINGS LIMITED (continued)

C. CAPITAL STRUCTURE, LIQUIDITY AND OTHER FINANCIAL MATTERS

Capital structure and borrowing covenants
In September 2007, a consortium of infrastructure investors established the Greensands group of companies for the purpose of the acquisition of 100% of the share capital of Southern Water Capital Ltd (the then ultimate parent company of Southern Water Services Ltd). The group debt structure comprises two Euro Medium-term Note Programmes.

In April 2011, acquisition borrowing at Greensands debt companies was refinanced. A new company, Southern Water (Greensands) Financing Plc was incorporated into the Group and a new long term covenanted financing structure put in place. Southern Water (Greensands) Financing Plc issued a £250.0m listed bond, out of a £1.0bn Euro Medium-Term Note programme, and a new £225.0m bank facility, from which £200m is drawn. The proceeds were used to refinance the £441.2m of acquisition debt at Greensands debt holding companies and to provide a £25m liquidity facility at the holding company level. In addition, £47.8m of accrued inflation on index-linked swaps to 31 March 2011 was paid out of existing cash balances

Southern Water carried out a refinancing of its regulated business in 2003 with the aim of reducing its cost of capital through a substantial increase in the proportion of debt finance. At the same time a Common Terms Agreement (the CTA) between the members of the Southern Water Financing Group and its debt investors was entered into. The CTA sets out the arrangements for the ongoing management of Southern Water's debt issuance programme, including a set of financial covenants, trigger events and events of default.

Interest rate, liquidity and cash management risk
Southern Water (Greensands) Financing Plc has hedged its exposure to floating rate interest risk on 75% of the £200m drawn bank facility by fixing its LIBOR based interest rate.

Southern Water hedges its exposure to interest rate risk on at least 85% of its outstanding debt liabilities in respect of Class A and Class B debt for the period to the next Periodic review and at least 70% in the next period (on a rolling basis) into either index-linked or fixed rate obligations.

Additional funds are raised as required, to ensure that sufficient cash and/or facilities are available to fund the business for at least the next twelve months, and both Southern Water (Greensands) Financing plc and Southern Water Services Ltd have debt covenants to this effect.

The Group sets exposure and minimum credit rating limits for deposits of cash balances.

The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk. This risk is managed through the use of index-linked instruments within the overall debt portfolio.

An analysis of net debt is included in note 22 to the financial statements.

Credit risk
82% of the water and wastewater services revenue is received from household customers. The 1999 Water Act prohibits the disconnection of domestic customers for failure to pay water and wastewater charges. An extensive range of collection and recovery methods are employed, as appropriate to the individual circumstances of the customer, to minimise the risk of non-payment. For non-domestic customers, the right to disconnect supplies for non-payment remains and is exercised as appropriate.

The level of provision against non-collection of charges is reviewed on an annual basis, based on the age profile of the debt and the likelihood of recovery. A material increase in uncollected revenue, compared with that assumed in the setting of price limits, may provide grounds for an interim price determination by Ofwat.

Financing Risk
See page 23.

OPERATING AND FINANCIAL REVIEW (continued)

1) GREENSANDS HOLDINGS LIMITED (continued)

C. CAPITAL STRUCTURE, LIQUIDITY AND OTHER FINANCIAL MATTERS (continued)

Rating
In connection with the refinancing carried out in April 2011, both S&P and Fitch assigned ratings to Southern Water (Greensands) Financing, a company incorporated on 28 March 2011 for the purposes of raising additional external debt.

Credit ratings are:

Standard & Poors: Southern Water (Greensands) Financing BB- (negative outlook), Southern Water Services Class A debt, A- (negative outlook), Southern Water Services Class B debt, BBB (negative outlook).

Fitch: Southern Water (Greensands) Financing B+, Southern Water Services Class A debt, A- (stable outlook), Southern Water Services Class B debt, BBB (stable outlook). Fitch have also rated Greensands UK Ltd long term issuer default rating at B (negative outlook).

Moody's: Southern Water Services Class A debt, Baa1 (negative outlook), Southern Water Services Class B debt, Ba1 (negative outlook). Southern Water Services corporate family rating Baa2 (negative outlook).

The Group is fully in compliance with all of its covenants, and the company has an internal business plan which is expected to stabilise the overall credit rating position.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED

The following review covers the results for the whole financial year of Southern Water Services Limited to 31 March 2012 including comparatives.

A. THE BUSINESS

Southern Water Services Limited (Southern Water) holds an appointment as a water and sewerage undertaker for the South East area of England. Drinking water supplies and wastewater services are provided in an area covering Kent, East and West Sussex, Hampshire and the Isle of Wight. These activities, which are referred to as the appointed business, account for over 99 per cent of turnover. There are also a number of minor activities which are not regulated under the appointment and which are described below as the non-appointed activities.

Water services
Southern Water supplies high quality drinking water to more than one million properties across the region, through a network of more than 13,700 kilometres of mains, 94 water treatment works and numerous pumping stations and service reservoirs.

The average daily volume supplied in 2011-12 was 551 million litres a day. Of the domestic properties served, 50 per cent have a meter and pay by reference to the amount of water supplied. 89 per cent of business customers are metered.

Wastewater services
Every day we treat 800 million litres of wastewater from 1.9 million domestic and business properties. Wastewater is transported through a network of more than 38,900 kilometres of sewers, including 17,000 kilometers of private sewers adopted on 1 October 2011, and 2,334 pumping stations to 370 wastewater treatment works where it undergoes a number of treatment processes. Once treated the water is recycled safely back to the environment. Recycled by-products from these processes are used to produce agricultural fertilisers / soil conditioners and to generate renewable electricity using anaerobic digestion and combined heat and power plants.

Non-appointed activities
Southern Water also carries out a small number of non-appointed activities associated with the core business. The largest of these is the provision of property search information for homebuyers. During the year over 66,000 (2010-11: 58,000) residential searches were provided. The slight rise, year on year, is due to a small improvement in the general property market conditions.

Regulation of the water industry
The economic regulator for the water industry is the Water Services Regulation Authority (WSRA), more commonly known as 'Ofwat'. Ofwat's main duties are ensuring companies carry out and can finance their functions and protecting customers' interests. It is responsible for setting price limits every five years for all appointed water and sewerage undertakers. These price limits apply to the weighted average of water and wastewater charges.

Price limits were last set in 2009 for the period 2010-11 to 2014-15. The allowed increases are shown in Figure 1 below. Associated with these price limits are a set of required outputs and efficiency targets.

Figure 1: Price limits

	2010-11	2011-12	2012-13	2013-14	2014-15
Allowed real price increase ('K' factor)	-0.7%	0.0%	3.6%	3.3%	-0.1%

Charges can be increased by the Retail Prices Index (RPI) plus the 'K' factor.

In addition to the K factor, Ofwat has modified Southern Water's licence to allow it to increase charges by an additional 1.4 per cent in 2011-12. This additional adjustment relates to the provision of transitional tariffs to help customers moving to a water meter under Southern Water's Universal Metering Programme, which is described in further detail in section E.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

A. THE BUSINESS (continued)

Competition
One of Ofwat's primary duties is to protect customers, and to do so wherever it is appropriate by promoting competition. There are currently two main sources of competition in the sector – Water Supply licencees and inset appointments.

The water supply licensing regime was introduced in December 2005, but to date only one customer (in another company's supply area) has switched supplier. The failure of the regime is widely attributed to the pricing mechanism, which is set out in legislation and is designed principally to ensure that customers not eligible to switch supplier are no worse off. In its recent Water White Paper, the Government announced its intention to remove the cost principle from legislation and replace it with regulated access prices, overseen by Ofwat.

It is clear that non-household customers, particularly those operating on a national scale, are keen to exercise choice over their water supplier and deal with a smaller number of providers. We support giving these customers a choice of supplier and will continue to work hard to ensure that we are meeting the needs of all of our current customers. But we are clear that such choice should not be at the expense of domestic customers who will remain unable to choose their supplier for the foreseeable future.

Competition is also possible through cross-border supplies and inset appointments, where the incumbent's licensed area of supply is altered. Since 2007, 26 new appointments have been made in England and Wales. There are currently three inset appointments in Southern Water's area. While we continue to work constructively with developers and new appointees, in the long-term we believe creating a patchwork of water companies, using parts of incumbent water company's networks, will simply add to confusion and provide little meaningful benefit for customers who remain unable to choose supplier.

The Water White Paper also included proposals aimed at facilitating greater competition in water resources provision and trading. The water companies operating in the South East, which is the most water-stressed part of the country, have for a number of years worked collaboratively to best manage the regions scarce water resources. Nonetheless, we agree that there is more that could be done and we are keen to see more trading; where it makes economic sense. We recently published the results of some research we carried out in this area, looking at the impact on trading of 'shadow prices', which aim to recognise the scarcity value of water, and the barriers to trading. We have also initiated a pilot scheme to look at creating a trading pool (whereby certain types of trade would be 'pre-approved' by the Environment Agency following an impact assessment) on the River Rother, which has a large number of abstractors upstream of our treatment works at Hardham. We will continue to develop our thinking in this area and work with our regulators and Government to put in place a pragmatic water trading regime.

Strategic goals
2011-12 marked the second year of the new regulatory period, following the price review in 2009. During this period we are committed to improving our key processes to deliver better services for customers, protecting the environment and providing safe and reliable services in the most efficient way. In particular we are focused on transforming our asset management capabilities. Our goal is to be recognised as the leading water company by 2015.

To drive the performance of the business towards this goal, the Executive Management Team has set 13 targets, covering the full range of our activities including customer service, leakage reduction, delivery of our capital programme, improving efficiency and most importantly, the health and safety of our staff, contractors and customers.

During the year we have begun that journey. Particular highlights during this first year are:

- Recording our best health and safety performance in terms of reportable injuries (RIDDORs). The figure of seven RIDDORs beat our previous best performance of eight in 2010-11. We believe this represents sector-leading performance.

- Achieving our lowest level of leakage, beating the current target set by regulator Ofwat by eleven million litres a day. We remain the water and sewerage company with the lowest leakage level.

- Installing more than 150,000 water meters with leak alarms as part of our programme to install meters in the majority of homes in our region by 2015.

- Achieving all of the regulatory outputs agreed for AMP5.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

A. THE BUSINESS (continued)

Strategic goals (continued)

- Further improvements in customer services resulting in a 20 per cent improvement in our SIM score to achieve our internal target.

- Continuing to provide high quality drinking water. Compliance with Drinking Water Inspectorate (DWI) standards was 99.88 per cent in the 2011 calendar year.

- Progress in re-building our internal asset management capability by bringing significant activities in-house.

- Laying the foundations for our next business plan so that we can continue to meet and exceed the expectations of our customers and stakeholders.

There remain a number of key challenges for this period to enable us to achieve our strategic goals.

In particular, we recognise that there is more to do in reshaping some of our key processes to deliver further operating efficiencies, and we will continue to focus our efforts to make these improvements during 2012-13 and beyond.

There are also significant challenges for us in managing our networks. During the year, we agreed revised leakage targets with Ofwat as, following the impacts of three harsh winters on the resilience of our water infrastructure network, we were unable to achieve the challenging leakage targets that we set for ourselves as part of the last price review. We have provided Ofwat with a formal undertaking that we will meet the new targets, as well as agreeing to return £5m to customers in recognition of the failure to meet our target in 2010-11. In 2011-12 we have significantly reduced our leakage to a level which is 11Ml/d below the new target. We continue to have the lowest leakage levels of any of the ten water and sewerage companies in England and Wales. Customers expect us to manage our resources effectively, and we remain committed to leading the industry on leakage.

On the sewer network, we continue to look for ways of reducing the number of pollution incidents to ensure we maintain serviceability, Ofwat's measure of the effectiveness of our maintenance activity in delivering services to customers. This follows increases in both pollution incidents and flooding in the previous reporting period. Whilst our action plan has had an impact on the underlying serviceability causes, and flooding incidents have reduced, we did not see a reduction in pollution incidents. The relative position of the five other indicators of serviceability would conclude an overall stable position as they either improved or remained as stable. The underlying causes of pollution incidents are constantly under review and we are committed to continue to look for ways of improving the performance.

Finally, revenues from customers continue to be significantly lower than assumed by Ofwat in setting price limits. In 2011-12, revenues were approximately £27m lower than the forecast revenues used to set prices. During the year we have put considerable effort in to analysing the underlying reasons for the shortfall and have identified a number of initiatives which will help mitigate the deficit. While this shortfall can be recovered under the Revenue Correction Mechanism introduced at the last price review, this is likely to result in pressure on bills from 2015-16. We have held discussions with Ofwat during the year about smoothing these increases, by recovering part of the revenues in the current period and part in the next five-year period, which would require an Interim Determination of K (IDoK). However, we have concluded that given the current economic climate and rate of inflation and K factors for this year and next, it would not be appropriate for customers to face higher bill increases at this time.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

B. FINANCIAL PERFORMANCE

Accounting policies

The accounting policies of Southern Water, including any changes in accounting policies in the year, are set out in the financial statements of Southern Water Services Ltd for the year to 31 March 2012.

Profit and loss account

The profit and loss account of Southern Water Services Ltd is summarised in Table 1.

Table 1	Years ended 31 March 2012 £m	2011 £m	*Change* %
Turnover	716.2	647.1	*10.7*
Cost of sales and admin. expenses	(240.6)	(231.3)	*4.0*
Depreciation	(204.1)	(185.8)	*9.8*
Other income	0.1	0.1	*0.0*
Operating profit before exceptional item	271.6	230.1	*18.0*
Exceptional item	0.0	(38.6)	*(100.0)*
Operating profit after exceptional item	271.6	191.5	*41.8*
Profit on disposal of fixed assets	1.2	0.8	*50.0*
Net interest payable	(187.9)	(180.2)	*4.3*
Profit before tax	84.9	12.1	*601.7*
Tax	(5.0)	19.9	*(125.1)*
Profit after tax	79.9	32.0	*149.7*

Turnover increased by 10.7 per cent to £716.2m (2010-11: £647.1m) compared with an average tariff increase on metered and unmetered income of 6.1 per cent, derived from an RPI of 4.7 per cent at November 2010 together with an allowance from Ofwat of 1.4 per cent for the transitional tariffs being offered to customers under Southern Water's Universal Metering Programme. The K factor for the year was nil as reported in section A. The significant increase over and above the tariff change reflects the impact of a one-off adjustment to turnover made during 2010-11, following a review of the method for estimating the amount of metered water and wastewater charges unbilled at the year-end. This review highlighted that an element of the previous year's estimated unbilled charges, were not subsequently being billed and an adjustment to turnover was therefore made to reflect the previously overestimated accrual.

Cost of sales and administrative expenses increased by 4.0 per cent to £240.6m (2010-11: £231.3m). This increase resulted mainly from the impact of new obligations including the adoption of private sewers and the carbon reduction commitment charge, together with inflation. Taking these items into consideration, the underlying operating costs fell in real terms by 2.3 per cent.

This real terms reduction has been achieved through process reviews and a focus on maintaining tight budgetary controls. This includes reducing the work issued to external contractors through more efficient use of our own internal resources and reductions in electricity costs and greater use of our Combined Heat and Power (CHP) facilities.

Depreciation increased by 9.8 per cent to £204.1m (2010-11: £185.8m) as a result of the continuing significant capital investment programme and an increase in the Infrastructure Renewals Charge reflecting the greater level of capital expenditure on infrastructure assets.

Operating profit for 2011-12, before exceptional items increased to £271.6m (2010-11 £230.1m), an 18.0 per cent improvement.

The exceptional item of £38.6m in 2010-11 related to a one-off revision to the level of bad debt provision carried against outstanding receivables.

The profit on disposals of £1.2m (2010-11: £0.8m) relates mainly to the sale of land and buildings.

Net interest payable of £187.9m increased by 4.3 per cent (2010-11: £180.2m). This increase principally related to non-cash interest associated with inflation on index-linked bonds, offset by reductions in interest payable following the repayment of part of the preference shares, the amortisation of a swap receipt and a reduction in the non-cash financing charge on the pension deficit.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

B. FINANCIAL PERFORMANCE (continued)

The tax on ordinary activities of £5.0m (2010-11: £19.9m credit) reflects the increase in profit before tax and the impact of changes made to the future taxation rate on the deferred tax liability as described in note 8.

The profit after taxation for the year amounted to £79.9m (2010-11: £32.0m).

Cash flow statement

The cash flow statement of Southern Water Services Ltd is summarised in Table 2.

	Years ended 31 March	
Table 2	2012	2011
	£m	£m
Net cash inflow from operating activities	487.1	462.4
Net cash outflow from returns on investment and servicing of finance	(80.7)	(99.1)
Taxation	(23.2)	(23.4)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(466.0)	(385.4)
Receipt of grants and contributions	11.7	9.3
Sale of tangible assets	0.9	0.2
Movement on loan to subsidiary	(14.8)	10.1
Net cash outflow for capital expenditure and financial investment	(468.2)	(365.8)
Equity dividends paid	(42.1)	(77.1)
Net cash outflow before financing	(127.1)	(103.0)
Net cash inflow/(outflow) from financing	30.5	(13.7)
Decrease in net cash	(96.6)	(116.7)
Reconciliation to net debt		
Net debt at beginning of year	(3,373.2)	(3,188.8)
Decrease in net cash	(96.6)	(116.7)
Movement in borrowings	(30.5)	13.7
Other non cash charges	(112.5)	(81.4)
Net debt at end of year	(3,612.8)	(3,373.2)

Net cash inflow from operating activities increased to £487.1m for 2011-12 from £462.4m in 2010-11. This increase mainly reflects the increased operating profit resulting from the price increase on income offset by increases to costs for new obligations and inflation, together with an improvement in working capital.

The net cash outflow from returns on investment and servicing of finance reduced to £80.7m for 2011-12 from £99.1m in 2010-11. This reduction results from lower interest paid following the full year effect of re-financing in 2010-11 and the partial repayment of the preference shares in 2011-12.

The outflow of cash relating to the purchase of tangible fixed assets was £466.0m (2010-11: £385.4m) and the net cash outflow before financing in 2011-12 was £127.1m (2010-11: £103.0m). The increase in cash outflow in relation to capital expenditure results from the profile of the overall capital programme, with the most notable increases being in relation to the metering programme, the adoption of private sewers and repairs and renewals to assets. There was also a reduction in the level of capital creditors at the year end as the Brighton and Hove project nears completion.

The reduction in dividends paid in 2011-12 relates to the final dividend for 2009-10 of £35.0m which was paid on 24 May 2010 and reported in the accounts for 2010-11. The interim dividends paid in the year totalling £42.1m being £751.43 per ordinary share (2010-11: £42.1m) are paid to Southern Water Services Group Ltd (SWSG) and are offset by interest receivable from SWSG of £56.9m (2010-11: £56.9m).

During the year, net cash inflow from financing was £30.5m as a result of an increase in a capital facility and a swap receipt offset by the repayment of part of the preference share capital.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

B. FINANCIAL PERFORMANCE (continued)

Balance sheet
The balance sheet of Southern Water Services Ltd is summarised in Table 3.

Table 3	Years ended 31 March 2012 £m	2011 £m
Fixed Assets		
Tangible assets	4,109.5	3,883.1
Investments	29.2	29.2
	4,138.7	3,912.3
Current Assets		
Stocks	1.9	1.6
Debtors falling due within one year	163.5	148.1
Debtors falling due after more than one year	812.3	812.3
Cash at bank and in hand	75.4	172.0
	1,053.1	1,134.0
Creditors falling due in one year	(250.6)	(228.6)
Net Current Assets	802.5	905.4
Creditors falling due after more than one year	(3,666.5)	(3,528.6)
Provisions for liabilities		
Environmental obligations	(0.8)	(0.9)
Deferred taxation	(349.6)	(402.9)
Grants and contributions	(47.9)	(49.1)
Pension deficit	(69.7)	(36.8)
Net assets	806.7	799.4
Capital and reserves		
Called up share capital	0.1	0.1
Share premium	46.3	46.3
Profit and loss account	760.3	753.0
	806.7	799.4

At the end of the year to 31 March 2012, Southern Water had fixed assets of £4,138.7m (2010-11: £3,912.3m) an increase of £226.4m from March 2011. This increase largely results from capital investment of £443.4m offset by depreciation of £206.8m.

Debtors falling due within one year increased to £163.5m at 31 March 2012 from £148.1m, the increase results from the higher short term inter-company cash debtor with Southern Water Services (Finance) Limited (SWSF).

As at 31 March 2012, creditors falling due within one year totalled £250.6m, the increase from £228.6m at 31 March 2011 results from an increase in amounts owed to group undertakings, offset by a reduction in capital creditors.

Creditors falling due after one year increased by £137.9m to £3,666.5m as at 31 March 2012, this increase principally resulted from inflation on index-linked bonds of £113.5m, the increase in the capital facility offset by the repayment of an inter-company creditor.

The net pension deficit increased in value to £69.7m following the latest actuarial valuation, as described in note 22 to the financial statements of Southern Water.

Overall net assets and shareholder’s funds increased from £799.4m to £806.7m.

The directors have not declared a final dividend for 2011-12 (2010-11: nil).

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

B. FINANCIAL PERFORMANCE (continued)

Dividend policy
Dividends are proposed with due regard to the following constraints

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

Distribution proposals submitted to the Board will also include an assessment of Southern Water's performance against the business plan including expected performance over the balance of the regulatory period.

These tests are not applied to the interim dividends paid to Southern Water Services Group (SWSG) as the dividend payment is instantly offset by a corresponding interest receipt from SWSG.

No ordinary dividend was paid or declared in relation to 2011-12.

Financial KPIs
Under our financial debt structure, there are a comprehensive set of covenanted financial ratios. Of these, there are two key ratios, namely the ratio of net debt to Regulatory Capital Value (RCV) and the ratio of adjusted cash income to net interest cost.

The net debt used in the net debt: RCV ratio is calculated from Southern Water's Regulatory Accounts as short and long-term senior borrowings, less cash and short-term deposits. The RCV for each year is set by Ofwat for five year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of senior debt to RCV is targeted to be maintained at below 85 per cent, in line with our debt covenants.

Senior adjusted cash interest cover (measured as net cash inflow from operating activities less Current Cost Depreciation and the Infrastructure Renewals Charge, to senior debt interest) is targeted to be maintained above 1.1 times, to meet covenanted levels.

Net debt: RCV	
2009-10 performance:	80%
2010-11 performance:	81%
2011-12 performance:	81%
Covenanted lock-up level:	<85%
Senior cash interest cover	
2009-10 performance:	1.5 times
2010-11 performance:	1.4 times
2011-12 performance:	1.6 times
Minimum target trigger level:	1.1 times

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

C. CAPITAL STRUCTURE, LIQUIDITY AND OTHER FINANCIAL MATTERS

Capital structure and borrowing covenants
Southern Water carried out a refinancing of its regulated business in 2003 with the aim of replacing a short term parent company loan and reducing its cost of capital through a substantial increase in the proportion of debt finance. At the same time a Common Terms Agreement (the CTA) between the members of the Southern Water Financing Group and its debt investors was entered into. The CTA sets out the arrangements for the ongoing management of Southern Water's debt issuance programme, including a set of financial covenants, trigger events and events of default.

Interest rate, liquidity and cash management risk
Southern Water hedges its exposure to interest rate risk on at least 85 per cent of its outstanding debt liabilities in respect of Class A and Class B debt for the period to the next periodic review and at least 70 per cent in the next period (on a rolling basis) into either index-linked or fixed rate obligations.

Additional funds are raised as required, to ensure that sufficient cash and/or facilities are available to fund the business for at least the next twelve months.

Southern Water sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody's P1, Standard & Poor A1 or Fitch F1.

The regulatory framework, under which revenues and the RCV are indexed, exposes Southern Water to inflation risk. This risk is managed through the use of index-linked instruments within the overall debt portfolio.

An analysis of net debt is included in note 21(b) to the financial statements of Southern Water.

Credit risk
Approximately 82 per cent of the water and wastewater services revenue is received from household customers. The 1999 Water Act prohibits the disconnection of domestic customers for failure to pay water and wastewater charges. An extensive range of collection and recovery methods are employed, as appropriate to the individual circumstances of the customer, to minimise the risk of non-payment. For non-domestic customers, the right to disconnect supplies for non-payment remains and is exercised as appropriate.

The level of provision against non-collection of charges is reviewed on an annual basis, based on the age profile of the debt and the likelihood of recovery. Southern Water strives to assist customers who are in financial hardship and provides schemes to help them manage their payments.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

D. OPERATIONAL PERFORMANCE

Customer services

Ofwat now measures company performance on the delivery of customer service using the Service Incentive Mechanism (SIM), which focuses on six quantitative measures and one qualitative measure. The SIM index influences the outcome of a price review as price limits can be adjusted for comparatively good or poor performance against the index. The first such consideration will be at the price review in 2014, based on performance in years 2011-12 to 2013-14.

There are two parts of the SIM index, quantitative and qualitative.

The quantitative measures cover inbound telephone calls and written complaints. The telephone calls focus on the number of occasions all lines are busy, the number of abandoned calls and the number of unwanted calls. Unwanted calls are broadly defined as a call the company would not have received if an action or inaction had not given cause for a customer to contact us, other than when specifically requested or required to do so. All of these criteria incur one point for each occurrence. The scoring for telephone calls is weighted and based on the number per 1,000 connections (water and/or sewerage) to give comparability between companies. The scoring mechanism is weighted for written complaints according to escalation level. A weighting of 5 points is incurred for each written complaint received, a weighting of 100 points for each escalated written complaint and 1,000 points for each investigation carried out by the Consumers Council for Water.

The qualitative measure is determined by a “consumer experience survey”, which is conducted on a quarterly basis. Each quarter, a market research company, acting on behalf of Ofwat, contact approximately 200 customers whose enquiry has been resolved within a defined period. Each customer ultimately ranks the level of service they consider that they received from “very satisfied” (5) to “very dissatisfied” (1).

There is a “Think Customer” initiative and action plan in place across the business to improve the customer experience which is co-ordinated by Customer Services and ensures appropriate business processes are in place to deliver an improving SIM performance. We pay particular attention to our SIM score and our comparative performance with other water companies, aiming to achieve an incremental improvement in both the score and our relative positioning each year.

As a result of our continuous improvement initiatives, our SIM score has increased from 54 last year to 65 for the year ending March 2012; delivering a 20 per cent improvement, and meeting our internal target.

This performance has been achieved despite a very challenging period as a result of higher than expected customer contacts associated with annual billing during March, which adversely affected the quantitative elements of SIM.

Water services

Our Water Resources Management Plan was approved by Defra and was published in October 2009. The Water Resources Management Plan sets out how Southern Water intends to meet its anticipated demands over the next 25 years. The plans are reviewed every year and consulted on in detail every five years, or when there has been a material change in circumstances. In the South East of England an additional layer of interaction occurs as each of the companies, Ofwat, the Environment Agency and the Consumers Council for Water work together to find the best regional solution for customers.

The core aspect of the plan is to meet the anticipated demand in the most cost effective and sustainable way. For the current regulatory period this will be achieved through an industry leading Universal Metering Programme, developing new resources and leakage reductions.

The provision of high quality drinking water is fundamental to public health. The Drinking Water Inspectorate (DWI) oversees standards of drinking water in England & Wales and Southern Water is required to monitor water quality at its water treatment works, reservoirs and at customer taps. The overall DWI measure of tests meeting the standards at customer taps is reported as a percentage of mean zonal compliance and is measured over the calendar year. This is the key measure of the quality of water received by customers. Maintaining mean zonal compliance as close to 100 per cent as practicable is a key target to ensure consistently high standards for customers.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

D. OPERATIONAL PERFORMANCE

Water services (continued)

Drinking water compliance (based on calendar years)

2005 performance:	99.96%
2006 performance:	99.95%
2007 performance:	99.95%
2008 performance:	99.97%
2009 performance:	99.98%
2010 performance:	99.90%
2011 performance:	99.88% *

* Note the calculation method in relation to compliance with the regulatory quality standards for taste and odour changed in 2011

Leakage (based on financial years) – Prior years restated

2005-06 performance:	93 Ml/d
2006-07 performance:	82 Ml/d
2007-08 performance:	88Ml/d
2008-09 performance:	92 Ml/d
2009-10 performance:	97 Ml/d
2010-11 performance:	96 Ml/d
2011-12 performance:	82 Ml/d

Drinking water quality continued to be high across the region. Mean zonal compliance, based on compliance with DWI standards at the customer tap remained high at 99.88 per cent for the 2011 calendar year. To maintain these high standards, each year over 640,000 tests are carried out on water from its source to the customer's tap. Drinking water supply operations are accredited to ISO 9001 standards. Over the current price limit period further capital investment will be made in order to reduce turbidity (cloudiness) at four sources and reduce nitrate concentrations at a further two groundwater sources.

Minimising leakage, together with metering, is a key component of the strategy to ensure adequacy of water resources. Southern Water's aim is to beat annual leakage targets agreed with Ofwat. The target was 93 Ml/d for 2011-12.

We have beaten our Ofwat leakage target by some 11Ml/d and this result re-affirms our commitment to leakage reduction as a key component of balancing the supply demand balance. This result also demonstrates to our customers some of the measures we are taking to beat the current drought. We remain the water and sewerage company with the lowest leakage on a per property basis.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

D. OPERATIONAL PERFORMANCE

Wastewater services and the environment
The operation of such an extensive wastewater infrastructure has the potential to cause adverse effects on the natural environment. Southern Water's goal is to minimise these potential impacts by ensuring that pollution incidents are kept to a minimum and treated wastewater is appropriately and safely recycled back into the environment. We are committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice.

Unfortunately there has been deterioration in some aspects of our environmental performance during 2011 in particular pollution incidents and treatment works compliance. To address this we have instigated a wide scale programme of works across our wastewater asset base in order to reverse this recent performance.

Pollution incidents (based on calendar years)
(Category 1 'Major', Category 2 'Significant')

2005 performance:	13 Category 1&2 pollution incidents
2006 performance:	15 Category 1&2 pollution incidents
2007 performance:	7 Category 1&2 pollution incidents
2008 performance:	4 Category 1&2 pollution incidents
2009 performance:	9 Category 1&2 pollution incidents
2010 performance:	7 Category 1&2 pollution incidents
2011 *target:*	6 Category 1&2 pollution incidents

Wastewater treatment works compliance (failures of numeric consents)

2005 performance:	14
2006 performance:	15
2007 performance:	3
2008 performance:	3
2009 performance:	4
2010 performance:	4
2011 *target:*	6

Southern Water recognises that its activities have an effect on the natural environment, through the abstraction of water for supply and the release of treated wastewater to water courses and the marine environment. Both abstraction and the recycling of wastewater are regulated by the Environment Agency via abstraction licences and discharge consents.

During the 2011 calendar year the majority of our 370 Wastewater Treatment Works met their consent conditions but, unfortunately, 11 failed.

Pollution incidents occur mainly as a result of issues in the sewerage network. Incidents are classified as Category 1, 2 or 3 by the Environment Agency with categories 1 and 2 representing the most serious incidents. While Southern Water always works hard to avoid any incidents occurring, the nature of wastewater operations and the extent of the sewerage network mean that, on occasions, there will be some incidents. Southern Water has an incident response team to ensure that where incidents do occur, their impact on the environment is minimised. Both minimising the number of pollution incidents and ensuring compliance with discharge consents continue to be part of Southern Water's targets.

Bathing water quality
During the 2011 bathing water season (1 May to 30 September) the Environment Agency tested 82 beaches in the region for compliance with the EU Bathing Water Directive standards. Only one of these beaches failed to meet the mandatory or 'good' EU standard. This failure was not associated with Southern Water infrastructure. Furthermore 76 per cent met the much stricter (20 times tighter) guideline or 'excellent' standard.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

D. OPERATIONAL PERFORMANCE (continued)

Energy use
Southern Water is implementing a range of initiatives during AMP5 to reduce energy consumption and CO2 emissions to mitigate climate change.

We have made significant investment in bio-gas fuelled CHP (Combined Heat and Power) and now have 13 operational units with the capacity to generate over 13 per cent of our power demand. The CHP units produce renewable energy by capturing bio-gas created during the wastewater treatment process. This gas is then used to provide power and heat to the works, with any surplus power exported to the National Grid. The amount of renewable energy we generated from our CHP units increased by 30 per cent in 2010-11 and in 2011-12 this increased by a further 9 per cent.

Work also started during the year to build a new CHP unit at our new Peacehaven Wastewater Treatment Works (WTW). We are also investigating the delivery of a further 3 CHP units at Bexhill and Hastings WTW, Ford WTW and Sandown WTW and these units are expected to be fully operational in 2013. Additional CHP heat recovery is also being considered at Budds Farm WTW and Millbrook WTW so that all our process thermal requirements can be met via renewable sources.

Opportunities for solar energy are also being explored. Changes to the Government incentives available have caused some uncertainty within the solar power industry and this has created delays but we continue to review the opportunities to add solar power to our renewable generation portfolio..

Some of our standby generators are being updated to provide additional capacity for Short Term Operating Reserve (STOR) which is a scheme where National Grid can call upon our generators to operate during times of high energy demand on the network in exchange for an “Availability” and “Utilisation” payment.

Energy efficiency
Improved energy efficiency is also a key focus for AMP5 and we have a range of initiatives including improved pump and blower efficiency monitoring to enable approximately 100 of our largest and most used pumps and blowers to always operate at the peak of their performance.

Advanced aeration control is another initiative that we are exploring. The technology aims to deliver the correct amount of air to the aeration lanes in our wastewater treatment works based on the influent quantity and quality in real time, thus avoiding over aeration and wasted energy. The same project will also enable reduced use of chemicals such as polymer and methanol.

We are also making significant investment in improving management information on energy consumption, to help our carbon footprint as well as reduce costs. We have installed 2,000 smart meters at our smaller sites to provide accurate and timely consumption data which is transmitted to our Energy Management System. We are now reaping the rewards of this more accurate billing and consumption data, as estimated billing is avoided and the accuracy of our reporting on energy consumption, costs and carbon emissions is significantly improved. Rolling the smart metering programme out to a further 1,000 sites is also being considered.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

D. OPERATIONAL PERFORMANCE (continued)

Cleaner Seas for Sussex
Southern Water started construction work during the summer of 2009 on its £300m scheme to bring significant environmental improvements to the East Sussex coastline around Brighton. Southern Water is building a wastewater treatment works and sludge recycling centre on land at Lower Hoddern Farm in Peacehaven. Once complete it will deliver modern wastewater treatment facilities to serve the communities between Hove and Peacehaven and will ensure that we meet the requirements of the EU Urban Wastewater Treatment Directive.

Southern Water awarded a contract to B&H 4Delivery in June 2009 to commence the building works to deliver this vitally important scheme by the spring of 2013. Work is nearing completion on ten sites located between Brighton Marina and Friars Bay, Peacehaven, constructing the new wastewater treatment works, 11 kilometres of new sewer tunnel, three pumping stations, and access points to allow us to connect the new system to the existing sewer network.

The concrete structures, including the pumping stations at Marine Drive and Portobello, as well as the treatment works at Peacehaven, are mostly complete. Finishing works and landscaping works are ongoing at all sites. Mechanical and electrical fittings at all sites are ongoing with most of the plant installation complete. Testing and commissioning of various components of the pumping stations and treatment works commenced in December 2011.

All sections of the new sewer tunnel between Brighton Marina and Peacehaven are now complete. The outfall tunnels from Peacehaven to Friars Bay as well as the section of the outfall pipe under the seabed are also now complete. The remaining work at the outfall pipes will be completed in the first half of 2012.

Extensive community and stakeholder engagement is being conducted, and includes sponsorship and other initiatives, such as newsletters, a dedicated website, community liaison group meetings, one-to-one meetings, letters and updates.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

E. LOOKING AHEAD

AMP5

2011-12 was the second year of the current five year regulatory period, AMP5.

Over this period Southern Water expects to deliver capital investment of about £1.8bn. This expenditure will allow us to maintain our asset base in a way that continues to deliver stable service to customers, as well as secure adequate resources to meet growth and deliver environmental improvements and improved levels of service.

The largest single project in the programme is the completion of the Cleaner Seas for Sussex project, which commenced in AMP4 and is expected to be complete by March 2013.

Our five year Universal Metering Programme will increase the proportion of customers who pay according to measured volumes to 92 per cent. We believe water metering is the fairest way to charge for water and the overwhelming majority of our customers agree. The programme will entail the installation of around 486,000 meters. During the year we reached the landmark of 150,000 meters installed under the programme. We also began switching the first customers to a metered charge basis. Following installation of the meter all customers are given a three-month period to understand and, if appropriate, adjust their consumption before the meter is ‘switched on’. Metering leads on average to consumption reductions of about 10 per cent. Our programme will, therefore, help ensure that we can meet the demand of all of our current and future customers as well as benefit the environment.

Delivering ‘stable’ serviceability across all of our assets is a key target for AMP5. In 2010-11 we assessed our wastewater infrastructure assets as less than stable. Ofwat agreed with our assessment and we embarked on a wastewater Below Ground Improvement Plan (BGIP) designed to return our performance to stable. For wastewater non-infrastructure and both water sub-service areas, serviceability was assessed by both Ofwat and us as stable. For wastewater infrastructure, five of the six measures have either improved since last reporting period, or have been maintained as stable. The sixth measure of pollution incidents did not improve. Whilst the pollutions measure would not indicate ‘stable’ serviceability if considered in isolation from other factors, the overall improvements in other factors and detailed investigation into causes of pollutions indicate an overall stable position.

The 2014 price review

Ofwat will next set price limits for the industry in 2014. For the past 18 months it has been engaged in an extensive review of its approach to setting price limits and will publish more details on ‘Future Price Limits’ proposals in the Autumn. What is clear is that there will be considerable changes to some aspects of the price setting process and an additional focus on companies’ engagement with customers and other stakeholders.

We have already begun our preparations for the price review, establishing our programme management office and beginning our engagement with customers and stakeholders on the long term outcomes they want delivered. Over the next year we will be reviewing and publishing our long-term strategy, reflecting the external pressures on the industry and the outcomes our customers tell us they want us to deliver.

As required by Ofwat, we have also established a Customer Challenge Group (CCG) whose role will be to challenge Southern Water’s plans and the robustness of its engagement with customers and report to Ofwat on the same. Anna Bradley has been appointed as the independent Chair of this new Group and the first meetings have been held. We believe Anna’s expertise and experience as a customer advocate, and the collective experience and skills of the group, will deliver significant benefits to our plans and we look forward to working positively with the CCG throughout the price review process.

Water White Paper

As well as Ofwat’s programme of regulatory reform, in December the Government published a Water White Paper setting out its vision for the industry. The White Paper set out proposals to improve the management of water resources, extend competition for commercial customers and facilitate entry at other points in the value chain. However, it did not mandate legal separation of retail and wholesale functions, as proposed by the Cave Review of Competition in the sector, noting its commitment to maintaining investor confidence in the sector through evolutionary reforms.

As a company operating in a particularly water-stressed part of the country, we welcome the proposals for reform of the water abstraction regime and look forward to working with both Ofwat and Defra to develop the proposals. We also welcome the commitment of both Government and Ofwat to maintaining a stable regulatory and legislative regime for the sector, which will need to continue to attract significant investment to deliver improvements to customers and the environment.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

F. RESOURCES AND KEY RELATIONSHIPS

Management
The Board of Southern Water is responsible for the overall strategic direction of the business. During the year the Board has consisted of two executive directors, the Chief Executive Officer and the Chief Financial Officer, an independent non-executive Chairman, and five non-executive directors, of whom three are independent. We are required by our regulatory licence to have at least three independent non-executive directors.

Details of the Board are given in the accounts of Southern Water Services Limited and published on the Southern Water website.

The day-to-day operations of the business are overseen by the Executive Management Team. This group, led by the Chief Executive Officer, consists of the Chief Financial Officer and the directors of each department: Market Reform and Business Effectiveness, Operations, Capital Delivery & Commercial, Asset Management, Customer Services, IT and Estates, Human Resources, Communications and the Company Secretary and General Counsel.

People
At the year end, Southern Water had 1,898 full time equivalent (FTE) staff across the region. This number has increased by 336 from last year. We have seen a total of 488 FTE starters within the 2011-12 financial year, compared to 181 FTE starters in the 2010-11 financial year. This increase is driven by strengthening the asset management capability, company wide “Shaping the Future” initiatives and in-sourcing some previously out-sourced activities.

Southern Water’s focus has been to drive employee engagement and business performance through integrated organisational development, reward and learning and development strategies. Southern Water is committed to improving employees' skills through continued learning, and our investment in staff development continued through the year. During the year, 110 employees attended Leadership Conferences to engage people and develop business solutions to further improve operational performance and services to customers.

The development of the skill base was further enhanced during the year with an increased intake of apprentices and graduates to the business. In addition, we continued the sponsorship of an innovative engineering Masters degree in conjunction with the University of Brighton alongside some of our service delivery partners such as Morrison, 4D, and Clancy Docwra.

Southern Water also opened a training facility within our Falmer offices to increase the flexibility of our training delivery, and developed a Shaping the Future initiative to improve Programme & Project Management, and Performance Management skills across the organisation, alongside an accredited development programme for first line managers.

Key partners
The Multi Services Framework agreement, awarded in 2009 for all core Utility Services in AMP5, is provided to Southern Water by:

- Clancy Docwra Limited for maintenance of the water distribution and sewerage networks across the whole region and Mechanical & Electrical (M&E) work on the Isle of Wight,
- Morrison Utility Services Limited for Mechanical & Electrical work in the East of the region,
- Barhale Trant Utilities Limited for Mechanical & Electrical work in the West.

Our commercial arrangements continue with 4Delivery to deliver the £300m Cleaner Seas for Sussex wastewater treatment scheme in Peacehaven and the Single Entity Contract (SEC) to deliver the quality improvements projects to treatment works across our region.

As of 1 October 2011, property owners were no longer responsible for certain sewer pipes that connect their homes to public sewers. New legislation transferred responsibility for these pipes, called private sewers and lateral drains, to Southern Water. To support this, and following an open-market competitive tender, Southern Water awarded a four year framework contract to Dyno-Rod Ltd for sewerage maintenance services including blockage clearage, CCTV and sewer repair services.

Southern Water also awarded a new 5 year Waste Management and Recycling Contract to MTS Cleansing Services Ltd, commencing in November 2011. MTS now handle all inter-site, emergency and non-routine tankering and cake operations, as well as removal of grit and screenings, general rubbish and fly tipped material together with all bio-solids recycling.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

F. RESOURCES AND KEY RELATIONSHIPS (continued)

Key partners (continued)

Southern Water awarded a contract, through its Multi Services Framework, to Morrison Utility Services for 48.5km of mains renewal in Chatham, Kent. The 18 month programme commenced in the summer of 2011.

Following a detailed review of our regulatory water sampling and analytical requirements, Southern Water agreed to extend the Water Quality Services Contract with Eurofins Environmental Limited to June 2015. Eurofins has been providing these services to Southern Water since July 2007.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

G. RISK MANAGEMENT

A central database of key risks is maintained and all managers have access to and the ability to raise risks on the database. Risks are assessed in terms of impact in the following areas:

- Financial
- Reputation
- Health and safety
- Security of supply
- Regulatory, environmental and legal

Creating clear visibility throughout the organisation of all key risks ensures that adequate controls are put in place, and mitigating action taken, to reduce the impact and/or likelihood of the risk materialising. All risks within the database are assigned to designated managers to ensure clear ownership of each risk and responsibility for its control and mitigation.

All risks scoring in the highest category are reviewed by the Chief Executive Officer and all risks above a specified threshold are reviewed regularly by the Executive Management Team. Newly registered, or escalating risks are alerted to a relevant manager, Director, or the Chief Executive Officer as appropriate.

Over the period of review, Southern Water's governance process required senior managers to sign a six-monthly Letter of Compliance, certifying that the function for which they are responsible understood the importance of risk management and that risks of corporate significance were raised and managed in accordance with Southern Water guidelines.

KEY RISKS

Regulatory risk
Southern Water is a highly regulated business. The water sector has three main regulators – Ofwat, the Environment Agency and the Drinking Water Inspectorate. Not meeting any of the regulatory requirements or failing obligations placed upon Southern Water by regulators could result in financial loss through the price setting mechanism, fines, legal enforcement action and ultimately the loss of the appointment as a water and sewerage undertaker. Any change in regulatory policy could also have a significant impact on the organisation. The most prominent of these risks currently is the risk of adverse changes to the regulatory regime and market reform.

Ofwat continues to review and revise the regulatory regime to ensure it remains fit to face the challenges of the future, including the greater use of market mechanisms in order to drive innovation and efficiencies. This raises the risk that any significant changes to the regulatory regime will disadvantage water companies in general or Southern Water specifically.

Mitigation
We continue our constructive engagement with Ofwat and Defra on the proposals for reform and are also working with Water UK to ensure that any changes deliver better, more effective, regulation in the interests of all stakeholders.

Operational risk
Water and sewerage services are essential to public health and the safeguarding of the environment. Whether arising from a failure to maintain and invest in assets or operational issues, any failures could lead to interruptions to public water supplies, risk to health through supply of unfit water, or severe environmental damage from the failure of our wastewater assets. These are ongoing risks which are managed as part of the everyday business, but the impact of failure is potentially significant for both customers and the environment.

The key risks in this area are as follows:

The risk of not containing pollution incidents and works compliance targets not being met
Southern Water operates 370 wastewater treatment works and, following the adoption of private sewers in October 2011, now manages approximately 39,000km of sewers across five counties. While one of the key objectives for Southern Water is to minimise the impact of its operations on the environment, the scale of these operations means that despite proactively managing associated risk, some incidents and compliance failures still occur, perhaps as result of poor maintenance, human error or system incapacity.

As well as the risk of damage to the environment, or distress to customers, such incidents can impact our serviceability rating given by Ofwat, lead to prosecutions by the Environment Agency and fines being imposed, and damage the reputation of Southern Water.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

G. RISK MANAGEMENT (continued)

KEY RISKS (continued)

Operational risk (continued)

Mitigation
Southern Water has recruited 60 new Asset Management roles and is investing approximately £400m on wastewater asset maintenance over AMP5. It also has a pollution incident response team on standby to ensure that where incidents do occur, their impact on the customers and environment is minimised. Significant focus continues in the area of pollution reduction through a dedicated team leading planned programmes of sewer maintenance and rehabilitation, rising main replacement, extensive jetting and condition-based monitoring.

The risk of not containing microbiological failures and water supply works compliance targets not being met
Southern Water operates 94 water supply works across the region. It is essential for Southern Water to minimise any breach of regulations affecting water quality to reduce any public health risks. The safeguarding of public health is paramount and we have in place control procedures to ensure this. Any regulation breach is thoroughly investigated and action taken to correct.

Such incidents can lead to enforcement by the Drinking Water Inspectorate and affect our serviceability rating given by Ofwat, both of which can damage the reputation of Southern Water.

Mitigation
To minimise the risk of such incidents and failures, Southern Water is carrying out a Water Compliance Project which has and will continue to deliver improvements to all operational water supply works over the early part of AMP5.

The risk to security of supply
Southern Water supplies drinking water to over 1 million properties across Kent, East and West Sussex, Hampshire and the Isle of Wight. Following two successive winters of significantly lower than average rainfall there is a risk that the water resources available will not meet customer demand.

Mitigation
To minimise the risk to customers' supplies Southern Water has implemented its Company Drought Plan. The measures already implemented have:

- Reduced leakage to below the target set by Ofwat;
- sought drought permits to increase the storage in Bewl Water;
- issued temporary use bans across all Sussex and Kent;
- changed the mode of operation of water sources and commenced strategic transfers to move water between reservoirs and water supply zones;
- undertaken a comprehensive water awareness campaign to make customers aware of the drought and the need to be water efficient.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

G. RISK MANAGEMENT (continued)

KEY RISKS (continued)

Financing risk

Southern Water intends to at least maintain its present risk profile. It does not enter into treasury transactions for the purpose of speculation, but will do so only to manage risk inherent in the business or funding on a prudent basis.

Negative cash flows before financing, which have been a feature of the water industry since privatisation as a result of mandatory capital investment requirements, result in an ongoing need to maintain access to the capital markets.

The risk of a significant increase in interest rates or closure of the capital markets to water companies in general

Any significant movement in interest rates or reduction in the availability of credit to the water industry might put at risk Southern Water's ability to finance the future capital investment programme.

Mitigation

This risk is managed by ensuring that sufficient cash reserves and liquidity facilities are maintained to finance business operations for at least 12 months, and the aggregate nominal value of debt maturities does not exceed 40 per cent of RCV in any single regulatory period (and 20 per cent of RCV in any 24 month period). Exposure to interest rate rises on current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance) Limited, and accordingly current borrowings are at either fixed rates or index-linked.

There are no debt maturities to 31 March 2013, with the next debt maturity being a £100m bank loan due June 2013.

Southern Water ensures that sufficient funds are available for its operational and capital investment programme through ongoing monitoring and forecasting of cash flow and takes steps to manage this accordingly.

The risk of a sustained period of negative inflation

Although inflation is currently above the Bank of England target, both revenues and capital values are linked to RPI, and a sustained period of negative inflation causing a reduction in cash inflow from revenue linked to inflation, along with a reduction in the Regulatory Capital Value would result in a strain on the debt/RCV ratio included in our debt covenants.

Mitigation

This risk is managed by the inclusion of index-linked debt and derivatives within the borrowing portfolio of Southern Water, which has the result of moving the value on index-linked debt and derivatives in line with movements in inflation, albeit with a time lag.

The risk of a ratings downgrade below investment grade

An investment grade credit rating is required to be maintained to ensure continued access to the capital markets, in order to efficiently finance the capital investment programme, and to refinance existing debt maturities when they fall due. This requirement is a condition of the regulatory licence (and also a primary duty of Ofwat when setting prices to ensure companies can finance their functions), and a condition of borrowing covenants where a failure to maintain certain prescribed credit ratings could lead to a restriction on dividend payments.

Credit ratings at Southern Water are:

- Standard & Poor's: Class A debt, A- (negative outlook); Class B debt, BBB (negative outlook)
- Fitch: Class A debt, A-; Class B debt, BBB
- Moody's: Class A debt, Baa1 (negative outlook); Class B debt, Ba1 (negative outlook); Corporate family rating Baa2 (negative outlook).

Mitigation

Southern Water has an internal business plan which is expected to stabilise the overall credit rating position.

A primary duty of Ofwat when setting prices is to ensure companies can finance their functions and a company can apply to reset customer prices during the five yearly regulatory period through an Interim Determination of K (IDoK).

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

G. RISK MANAGEMENT (continued)

KEY RISKS (continued)

Capital Investment Risk
The 2011-12 accounts mark the completion of the second year of the current five year regulatory review period. For this period, a capital investment programme of £1.8bn has been allowed for in price limits by Ofwat.

The risk of not delivering the capital programme
Whilst Southern Water remains on target to deliver the programme, there are pressures on the programme which are being managed to deliver Regulatory outputs and stable serviceability within the funding allowed by Ofwat. Failure to deliver significant elements of the capital programme, risks adjustments to the Regulatory Capital Value at the next review, enforcement action by the Environment Agency, DWI or Ofwat and threatens the integrity of services.

Mitigation
Progress against the allowed investment programme is monitored closely to ensure that any risks or potential programme slippage are pro-actively managed with our regulators and other stakeholders.

The risk of a significant impact from the adoption of private sewers
The new legislation to transfer privately owned sewers and lateral drains to water and wastewater companies came into effect on 1 October 2011. The total length of transferred sewers is unknown, but we estimate that it may be as much as 17,000 km, which has a potentially significant impact on our capital and operational expenditure. However, the level of incidents so far on the newly transferred sewers is significantly lower than that expected, and planned for, which could be attributed to lower than expected rainfall since adoption of private sewers and low customer awareness of the new legislation.

Mitigation
A reactive sewers team which includes our contractor Dyno-Rod was set up to maintain serviceability of the newly adopted assets. The costs associated with maintaining these newly adopted assets were not allowed for when Ofwat set price limits in 2009 but, as this is a change of legislation, they qualify as a ‘relevant change of circumstance’ under the conditions of our Licence, which means that we can apply to Ofwat for an interim determination of our K factor (IDoK) to recover the costs incurred.

If the low level of activity experienced to date continues the costs of private sewers will not reach the materiality threshold required to qualify for an IDoK. However significant elements of the expenditure will be “logged up” and charges recovered in future periods

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

H. CORPORATE RESPONSIBILITY

Environmental Governance

In 2008 Southern Water was registered to ISO14001, the international standard for environmental management. Southern Water's management is committed to the development and execution of its environmental management system requirements. In 2011 we were pleased to be re-certified to this standard.

The aims of Southern Water's Environmental Management System (EMS) are:

- To identify, manage and mitigate our impacts on the environment to ensure that present and future environmental effects are controlled and that Southern Water's environmental performance continually improves.
- To ensure compliance with environmental legislation, to identify and minimise environmental risk, to prevent pollution and to maximise efficiency savings.

The scope of Southern Water's ISO14001 certification covers "the supply of water and treatment of wastewater, including management of capital projects by project teams and supply chain arrangements; control of operational and maintenance activities on our assets; control of waste and its transfer on specific sites and landfill facilities".

Southern Water's full commitment to the environment is presented within the Environment Policy, signed by the Chief Executive Officer. This is communicated to all employees and relevant contractors.

Southern Water has examined its operational activities to determine their potential impact on the environment and combined this with environmental legislation and regulations that apply. This influences environmental improvement and action plans through the development of objectives and targets, which are reviewed on a regular basis. This effectively maintains the performance commitments in our Environment Policy, supported through a programme of training, checking, audit and management review.

Health and Safety

We recorded our best ever annual health and safety performance in terms of reportable injuries (RIDDORs) in the reporting year. The figure of seven RIDDORs in 2011-12 beat our previous best result of eight, which was recorded the year before. We believe this performance is sector leading and is in the order of twice as good as the industry average.

The health and safety of all employees, customers and contractors is an ongoing priority for Southern Water. There are regular meetings of employee representatives and every member of staff can see and comment on the health and safety corporate policy statement.

Other health and safety successes included receiving the Royal Society for the Prevention of Accidents (RoSPA) President's Award for the fourth year running. This award is presented to companies which have achieved excellent health and safety performance over a number of years. Several key contractors were also recognised by RoSPA, winning a number of awards during the year.

During 2011-12, a range of health and safety initiatives were run by Southern Water and contractors under the award-winning 'Aim for Zero Injuries' campaign. A health and safety conference took place for more than 250 operational staff and key contractors as part of a number of activities to support the European Week of Safety and Health. A conference for office-based staff was held for the first time and concentrated on topics related to health and wellbeing. In addition, Southern Water continued to support campaigns by the UK Health and Safety Executive (HSE) and the European Agency for Safety and Health at work.

Southern Water is a member of the HSE's stakeholder group and has played an active role as a partner in developing the new Estates Excellence model for improving health and safety which has been adopted for national implementation.

Community Programme

We continue to play an active part in the communities we serve and are committed to supporting them through a series of programmes, partnerships, sponsorships and donations.

Our flagship Learn to Swim programme reached its 20th year in 2012 and a congratulatory Early Day Motion was tabled in the House of Commons. The scheme teaches about 38,000 children to swim each year and during the year, five new pools and clubs joined, bringing the total number to 85. Paralympic gold medallist Sascha Kindred and Olympic gold medallist Duncan Goodhew act as ambassadors for the award-winning programme which is also supported by British swimmer Karen Pickering.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

H. CORPORATE RESPONSIBILITY (continued)

Community Programme (continued)
We continued to sponsor the South and South East in Bloom competition, which attracted 251 entries, including 85 in the schools' section. We also continued our award-winning Blooming Schools programme in which more than 74,000 children have created 494 gardens in their schools. To celebrate the 10th anniversary of the sponsorship, we held a competition to create a community legacy garden. Children from the winning school, St Margaret's at Angmering in West Sussex, created the garden with the help of celebrity gardener Chris Collins.

Now in its 13th year, our popular water efficiency play, The Drips, was seen by more than 4,000 children aged five to 11. Facepack Theatre visited 24 schools and gave performances of the show, which incorporates our water efficiency and water for health characters Mr Save-It and Mr Drink-It.

Ten secondary schools from across our region took part in the 2011 Water Design Challenge. The Education programme, which supports our five-year metering programme, tasked the students to come up with ways to save water with the support of a professional design mentor. The winning school, Fort Pitt Grammar in Kent, designed a water-saving toilet cistern device which was presented at the Big Bang 2012, the largest science and technology event in the UK.

We launched a programme of partnerships with professional sports clubs in our region. The Sporting Chance programme includes:

- Saints and Savers – an education programme delivered in partnership with the Saints Foundation, the charity arm of Southampton Football Club. Workshops promoting water for health and water efficiency took place in 25 schools in Southampton and involved 2,719 children.
- GLOW – Gillingham Learn Our Way puts youth coaches from Gillingham Football Club into schools across the Medway towns in Kent. The programme, which promotes water for health, is engaging with about 1,000 pupils.
- Southern Water Ashes – our partnership with Sussex Cricket Club brought the sport to 500 students in Sussex and highlighted the importance of drinking water for health.
- Albion in the Community – an education programme delivered by the community arm of Brighton and Hove Albion Football Club that focuses on the importance of water in our lives, water for health and water efficiency was launched with 880 children taking part in the first year.
- Nelson Investigates – primary school children in Portsmouth are benefiting from a programme run in partnership with Portsmouth Football Club's Community and Study Centre. In the first year nearly 500 students were involved in workshops which explained the history of the sewer system and showed where wastewater goes before it is released into the environment. The workshops also highlighted the problems caused when fat, oil and grease and non-biodegradable items are disposed of in the sewer system.
- Tennis in Eastbourne – we partnered with not-for-profit organisation Tennis in the Park to take the sport into primary schools in the town, giving 400 children the chance to take part. We also held a tennis taster day, which was visited by more than 3,000 people and also promoted water for health.

We worked in partnership with the Smallpiece Trust to deliver Science, Technology, Engineering and Maths (STEM) Days in 10 secondary schools on the Isle of Wight and Isle of Sheppey. About 500 students took part in a water-themed practical challenge, using skills associated with science, technology, engineering and maths. In addition, we joined STEM Sussex to work with students in Brighton as part of the Engineering Education Scheme. Members of our Peacehaven team helped youngsters to solve real-life problems associated with large construction projects.

We again supported the Brighton Theatre Royal's creative educational programme and more than 180 children attended workshops where they learned the importance of staying hydrated during exercise. In addition, we continued to support the Brighton Festival Fringe by sponsoring Fringe City and 1,642 people visited Brighton's Victorian sewers on organised tours.

During the summer, our water café visited 17 events to promote water efficiency across our water supply area. We were also actively involved in Junior Citizen events in Horsham and Crawley, engaging with more than 2,000 young people about water efficiency.

We supported numerous other events and projects, including Kent Coastal Week, a programme of activities for families around the Kent coastline; Trees for Shade, a tree planting scheme in association with West Sussex County Council; Run the World, in which 4,238 children from Brighton ran 1km, totalling the distance from Brighton to Bangalore; Personal Bests, a school sports programme in Winchester; and Even Keel, a sailing programme for youngsters in Kent.

OPERATING AND FINANCIAL REVIEW (continued)

2) SOUTHERN WATER SERVICES LIMITED (continued)

H. CORPORATE RESPONSIBILITY (continued)

Community Programme (continued)

More than £325,000 was raised through charity events. These included our annual ball, which raised £110,000 for the National Society for the Prevention of Cruelty to Children, the Royal National Lifeboat Institution, Cancer Research UK and WaterAid. The same charities benefited from £80,000 raised at our annual race day, along with St Barnabas Hospice, AAIR (Asthma, Allergy and Inflammation Research), Chestnut Tree House Children's Hospice, Help for Heroes, Macmillan Cancer Support and our regional Air Ambulance Trusts.

Our 12th WaterAid golf day raised £10,000 for the charity, which provides water, sanitation and hygiene education to some of the world's poorest people. Our Health and Safety Charity Challenge, in which we make a donation for each hazard or near miss reported in the workplace, raised £13,640 for regional Air Ambulance trusts.

In addition, monthly Dress Down Days and charity initiatives at our main offices raised more than £19,000 for 40 charities and our Community Chest forum made 115 donations totalling over £10,175.

Staff contributed £2,324 through a workplace giving scheme and another £1,550 was donated to staff for charity fundraising activities.

Our Community Volunteering Programme gives staff the opportunity to spend two days a year helping a charity or community project and 208 days were taken during the year.

Staff from Southern Water delivered 73 Waterwise talks to 2,589 people including schools and community groups.

Awards and Achievements
Our work was recognised with a number of awards:

- In the 2011 Utility Industry Achievement Awards, our Church Farm reservoir at Hardham in West Sussex won the Capital Project Management category while our 'intelligent' water metering programme was named IT Initiative of the Year.

- We were successful for the sixth consecutive year at the 2012 Water Industry Achievement Awards, winning the Customer Satisfaction Initiative of the Year category for our sympathetic approach to customer debt through our Debt Advice Centre. We were also highly commended in the Carbon Reduction Initiative of the Year category. This recognised our industry-leading work with MWH/4Delivery on catchment-based consenting which focuses on how we can meet required quality standards at wastewater treatment sites at a lower carbon cost. We were also shortlisted in three other categories.

- Our communications team was named Outstanding In-House PR Team for the fifth consecutive year at the regional Chartered Institute of Public Relations (CIPR) Awards in both the Home Counties South and Wessex areas. We also won nine other gold CIPR awards for initiatives including our Learn to Swim scheme, Drips school play, campaign and website to inform customers about our metering programme and our communications and community work in building a new wastewater treatment works at Peacehaven in Sussex.

- Our Learn to Swim scheme won the Best Corporate Social Responsibility Strategy category in the 2011 CorpComms Awards.

- Our health and safety performance was recognised with a further Royal Society for the Prevention of Accidents (RoSPA) President's Award, presented to companies demonstrating outstanding performance in health and safety.

- We received new ISO 14001 certification for the next three years, confirming that we continue to meet the international standard for Environmental Management Systems.

- We were again awarded the Carbon Trust Standard in recognition of our steps to measure and manage carbon emissions over a three-year period.

- In the Considerate Constructors Scheme's 2011 National Site Awards, we won silver for our Ashford Wastewater Treatment Works, Eastney Pumping Station and Peacehaven projects and bronze for our Twyford Water Supply Works scheme.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2012

The directors of Greensands Holdings Limited (Registered Number: Jersey 98700) present their report and the audited financial statements for the year to 31 March 2012.

GROUP

Greensands Holdings Limited ("the Company") was incorporated on 28 September 2007 as the parent company of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited.

On 15 October 2007, the Company became the ultimate parent company of the Southern Water Group of companies, via the acquisition of Southern Water Capital by Greensands Investments Limited.

PRINCIPAL ACTIVITIES OF THE COMPANY

The Company's principal activity is that of a holding company for Greensands Europe Limited and its subsidiaries.

PRINCIPAL ACTIVITIES OF THE GROUP

The principal activities of the Group are the provision of water supply and wastewater services in the south-east of England.

The trading results reflect the performance of the major trading subsidiary Southern Water Services Limited (Southern Water).

BUSINESS REVIEW

The information that fulfils the requirement of the business review can be found in the Operating and Financial Review (OFR) on pages 1 to 27, which are incorporated in this report by reference.

FUTURE DEVELOPMENTS

The information regarding future developments can be found in the OFR on pages 1 to 27.

RESULTS AND DIVIDENDS

The profit and loss account on page 32 shows the Group's results, dividends and profit for the period. Further details are also available in the OFR on pages 1 to 27.

No dividends were paid during the year.

DIRECTORS

The directors who served during the year and up to the date of signing the financial statements were:-

Colin Hood	Chairman *(Appointed 20 February 2012)*
Michael Welton	Chairman *(Resigned 20 February 2012)*
Peter Antolik	*(Appointed as Alternate to Surinder Toor 23 June 2011, resigned and appointed as Director 22 February 2012)*
Keith Budinger	
Toby Buscombe	Alternate to Keith Budinger *(Resigned 28 September 2011)*
Mark Gilligan	Alternate to Paul Moy *(Resigned 19 July 2011)*
Craig McAllister	Alternate to Keith Budinger *(Appointed 29 September 2011)*
Paul Moy	*(Resigned as Director and appointed as Alternate to Bronte Somes 4 October 2011)*
Michael Nagle	
Bronte Somes	*(Appointed as Alternate to Paul Moy and Jaron Yuen 19 July 2011, resigned and appointed as Director 4 October 2011)*
Surinder Toor	*(Resigned 22 February 2012))*
Mark Walters	Alternate to Surinder Toor *(Resigned 23 June 2011)* Alternate to Peter Antolik *(Appointed 22 February 2012)*
Jaron Yuen	

None of the directors who held office during the financial year had any disclosable interests in the shares of the Company.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2012 (continued)

RESEARCH AND DEVELOPMENT

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the Group's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £0.5m (2010-11 £0.9m, including £0.4m on fixed assets).

EMPLOYEES

Employee involvement
The Group recognises the importance of its employees and is committed to effective two-way communication and consultation.

The Group has established Business Involvement Groups to facilitate meaningful consultation between Group Management and employees through elected Employee Representatives. The Groups meet regularly at both functional and company-wide levels. An employee survey is also completed on an annual basis to seek input from employees.

The Group also recognises the rights of every employee to join a trade union and participate in its activities. Southern Water has a single union agreement with Unison.

The Group publishes its own in-house newspaper, 'Southern Water News' on a regular basis. General information is posted on the Group Intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business including, progress on business and capital projects, the impact of regulatory issues, including the recent Ofwat price determination and wider financial and economic issues that may affect the Group.

Equal opportunity
The Group’s policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The Group takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health and safety
The Group recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition there is a health and safety management review group which ensures that there is an adequate system for meeting the Group’s responsibilities for health and safety to its staff, customers and members of the public.

The Group provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

ENVIRONMENTAL ISSUES

The Group is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice, and aims to contain the environmental impact of its activities to a practicable minimum.

The Group's environmental performance is reported in its annual Stakeholder Report, which is available on our website. The Group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2012 (continued)

CHARITABLE DONATIONS

The Group made donations of £320,181 (2010-11 £286,403) to a variety of charities over the period. Donations in the period comprised £220,000 (2010-11 £220,000) to the Southern Water Trust Fund, a charitable trust set up to assist customers who are suffering hardship, poverty or a poor quality of life by providing grants to help them pay their water bills, and a further £100,181 (2010-11 £66,403) of donations to other charities within the region.

No political donations were made.

LAND AND BUILDINGS

In the opinion of the directors, the market value of land is significantly more than its book value, however it would not be practicable to precisely quantify this.

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group intends to at least maintain its present risk profile, as measured by its investment grade credit rating. The Group does not enter into treasury transactions for the purpose of speculation, but only to manage risk inherent in the business or funding on a prudent basis.

Interest Rate Risk - The Group hedges its exposure to interest rate risk on at least 85% of its total outstanding debt liabilities in respect of Class A Debt and Class B Debt for the current period to the next Periodic Review and at least 70% in the next period to the subsequent Periodic Review (on a rolling basis) into either index-linked obligations or fixed rate obligations.

Inflation Risk - The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk. The Group manages this risk through the use of index-linked instruments within its overall debt portfolio.

Liquidity risk – The Group raises additional funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business for at least the next twelve months.

Cash management risk – The Group sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody’s P1, Standard & Poors A1 or Fitch F1.

GOING CONCERN

The directors believe, after due and careful enquiry, that the Group has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2012. Further information is set out in note 1 ‘Going concern’ on page 36.

QUALIFYING THIRD PARTY INDEMNITY

Following shareholder approval the Company has also provided an indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2012 (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law 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). The financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and 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 Group will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Group’s website. Legislation in Jersey governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

PROVISION OF INFORMATION TO AUDITOR

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

(1) so far as the director is aware, there is no relevant audit information of which the Group’s auditor is unaware; and

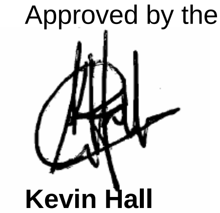
(2) each director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Group’s auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Companies (Jersey) Law 1991.

INDEPENDENT AUDITOR

Deloitte LLP have indicated their willingness to continue in office.

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



Kevin Hall
Company Secretary
24 July 2012

CONSOLIDATED PROFIT AND LOSS ACCOUNT
For the year ended 31 March 2012

	Note	**2012 £m**	**2012 £m**	2011 £m	2011 £m
Turnover	1,2,3		**716.2**		647.1
Cost of sales	3				
- before exceptional item		**(445.6)**		(410.4)	
- exceptional item	4	**-**		(38.6)	
Cost of sales including exceptional item			**(445.6)**		(449.0)
Gross profit			**270.6**		198.1
Administrative expenses	3		**(31.7)**		(35.4)
Other operating income	3		**0.7**		0.8
Operating profit before exceptional item			**239.6**		202.1
Exceptional item			**-**		(38.6)
Operating profit			**239.6**		163.5
(Loss)/profit on disposal of fixed assets			**(1.1)**		0.8
Profit on ordinary activities before interest and taxation			**238.5**		164.3
Interest payable and similar charges	7		**(331.2)**		(312.4)
Interest receivable and similar income	7		**5.9**		5.1
Loss on ordinary activities before taxation	4		**(86.8)**		(143.0)
Tax on loss on ordinary activities	8		**14.7**		43.9
Loss on ordinary activities after taxation			**(72.1)**		(99.1)

The above results relate to continuing operations.

The Notes on pages 36 to 59 form part of these financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the year ended 31 March 2012

	Notes	**2012 £m**	2011 £m
Loss on ordinary activities after taxation		**(72.1)**	(99.1)
Actuarial (loss)/gain recognised in the pension fund	23	**(40.0)**	48.6
Movement on deferred tax relating to pension deficit	17	**9.5**	(18.5)
Movement on current tax relating to pension deficit		**-**	4.1
Total recognised losses for the period		**(102.6)**	(64.9)

There are no differences between the loss on ordinary activities before taxation and the loss transferred from reserves for the financial year, and their historical cost equivalents.

CONSOLIDATED AND COMPANY BALANCE SHEETS
As at 31 March 2012

	Notes	**Group 2012 £m**	**Company 2012 £m**	Group 2011 £m	Company 2011 £m
Fixed Assets					
Intangible assets – Goodwill	9	**97.8**	**-**	104.1	-
Tangible assets	10	**5,327.9**	**-**	5,122.9	-
Investments	11	**12.7**	**1.0**	15.0	1.0
		5,438.4	**1.0**	5,242.0	1.0
Current assets					
Stocks	12	**1.9**	**-**	1.6	-
Debtors: amounts falling due within one year	13	**151.9**	**-**	147.1	-
Debtors: amounts falling due after one year	14	**-**	**1,016.5**	-	1,016.5
Cash at bank and in hand	18	**260.1**	**-**	272.2	-
		413.9	**1,016.5**	420.9	1,016.5
Creditors: amounts falling due within one year	15	**(296.1)**	**(31.9)**	(670.4)	(31.9)
Net current assets		**117.8**	**984.6**	(249.5)	984.6
Total assets less current liabilities		**5,556.2**	**985.6**	4,992.5	985.6
Creditors: amounts falling due after one year	16	**(4,502.5)**	**(59.2)**	(3,846.9)	(59.2)
Provision for liabilities and charges	17				
Environmental obligations		**(0.8)**	**-**	(0.9)	-
Deferred taxation		**(349.0)**	**-**	(369.9)	-
Grants and contributions	19	**(47.9)**	**-**	(49.1)	-
Net assets excluding pension deficit		**656.0**	**926.4**	725.7	926.4
Pension deficit	23	**(69.7)**	**-**	(36.8)	-
Net assets including pension deficit		**586.3**	**926.4**	688.9	926.4
Capital and reserves					
Called up share capital	20	**921.9**	**921.9**	921.9	921.9
Share premium account	21	**4.5**	**4.5**	4.5	4.5
Profit and loss account	21	**(340.1)**	**-**	(237.5)	-
Total shareholders' funds		**586.3**	**926.4**	688.9	926.4

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 32 to 59 were approved by the Board and authorised for issue on 24 July 2012. They were signed on its behalf by:

Bronte Somes
Director

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Net cash inflow from operating activities	22	**482.0**	462.7
Returns on investments and servicing of finance			
Interest paid		**(42.7)**	(158.9)
Interest received		**3.5**	4.0
Net cash outflow from returns on investments and servicing of finance		**(39.2)**	(154.9)
Taxation		**(0.3)**	-
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(466.0)**	(385.4)
Receipt of grants and contributions		**11.7**	9.3
Sale of tangible fixed assets		**0.9**	0.2
Net cash outflow for capital expenditure and financial investment		**(453.4)**	(375.9)
Equity dividends paid		**-**	-
Net cash outflow before financing		**(10.9)**	(68.1)
Financing			
Repayment of long term loan/bonds		**(52.8)**	(13.7)
Issue of long term loans/bonds		**58.8**	-
Issue costs of new loans/bonds		**(7.2)**	-
Net cash outflow from financing		**(1.2)**	(13.7)
Decrease in net cash		**(12.1)**	(81.8)
Reconciliation to net debt			
Net debt at beginning of year		**(4,050.2)**	(3,826.7)
Decrease in net cash		**(12.1)**	(81.8)
Movement in borrowings		**(6.0)**	13.7
Debt issue costs		**7.2**	-
Non-cash items		**(172.3)**	(155.4)
Net debt at 31 March	22	**(4,233.4)**	(4,050.2)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

1 Accounting policies

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

Basis of accounting
The financial statements have been prepared on the going concern basis, under the historical cost convention and in accordance with United Kingdom Generally Accepted Accounting Practice and with the requirements of the Companies (Jersey) Law 1991.

Basis of consolidation
The Group financial statements include the financial statements of the Company and all of its subsidiary undertakings therefore no discrete profit and loss account is presented by the Company. The Company is not required to prepare a cash flow statement under FRS 1 (revised).

The results of the subsidiaries are included in the Profit and Loss Account from the date of acquisition. Intra group sales and profits are eliminated fully on consolidation. The acquisition method of accounting has been used to consolidate the subsidiaries.

Going concern
The Directors have undertaken a detailed review of the Group's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk and have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Tangible fixed assets and depreciation
Tangible fixed assets are stated at historic purchase cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use, these include materials, labour and applicable overheads. Interest costs are not capitalised.

i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of assets covering the Group's geographic area.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs that directly relate to the construction of a specific infrastructure asset are capitalised on the basis of the amount of time spent by individuals on projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator, Ofwat, as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

ii) Other tangible assets (including over-ground assets, plant and equipment) are stated at cost less accumulated depreciation and any provision for impairment. These assets are depreciated down to their residual values on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

iii) Freehold land is not depreciated.

iv) Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

1 Accounting policies (continued)

Tangible fixed assets and depreciation (continued)

v) Private Sewers have been adopted during the year and have been valued at nil value, as permitted by UKGAAP and by reference to the net present value of the incremental cash flows as a result of the adoption. These assets form part of our infrastructure assets and expenditure associated with them has been treated as described above.

Grants and contributions

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Capital grants and customer contributions in respect of additions to non-infrastructure tangible fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the UK Companies Act 2006, as applicable to the Group's subsidiaries.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of tangible fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 1 of the Companies Act 2006 which requires tangible fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Leased assets

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a "finance lease". The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

Rentals payable under operating leases are charged to profit and loss account as incurred.

The sale of income rights relating to aerials masts and sites owned by the company to third parties is treated as an operating lease. Income received from such sales is received entirely in advance and is therefore taken to deferred revenue and will be credited to other operating income in the profit and loss account over the life of the lease.

Sale and leaseback transactions occur when an asset is sold but use is immediately re-acquired by entering into a lease with the buyer. Where the new lease is an operating lease, the transaction is treated as the disposal of an asset and the operating lease accounted for in accordance with existing policies.

Goodwill and intangible fixed assets

Businesses and interests acquired have been dealt with in the consolidated financial statements using acquisition accounting. Upon the acquisition of a business, fair values are attributed to the identifiable assets and liabilities acquired that reflect the condition at the date of acquisition and any required adjustments made to bring the accounting policies of the businesses acquired into alignment with those of the Group. Where the consideration paid exceeds the fair value of the net assets acquired, the difference is treated as goodwill.

In line with FRS 10, goodwill arising on acquisitions is capitalised and amortised through the profit and loss account over its estimated useful economic life, not exceeding 20 years.

Impairment reviews of goodwill are carried out at the end of the first financial year after acquisition and provision is made where there is any indication of impairment.

Fixed asset investments

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable

Stocks

Stock is held for use in the production of water supply and treatment of wastewater. Stock is held at replacement cost.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

1 Accounting policies (continued)

Deferred revenue
Deferred revenue includes monies received from customers where the related turnover has not yet been recognised. Amounts are deferred to the balance sheet and released to the profit and loss account in line with the period of the service provided.

Provisions
An environmental provision is made in accordance with FRS12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected.

Taxation
The taxation charge in the profit and loss account is based on the profit 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.

Turnover
Turnover represents the income receivable (excluding value added tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes accrued income.

Turnover relates to services provided in the year and excludes payments received in advance which are recorded as deferred revenue.

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption.

Turnover includes an estimate of the consumption between the date of the last meter reading and the period end. The unbilled income accrual is based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff.

Bad debts
The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

Pensions
The Group operates a defined benefit pension scheme. An independent actuary conducts a valuation this pension scheme every three years.

In accordance with FRS 17 the pension deficit has been recognised on the balance sheet and operating and financing costs of pension and post-retirement schemes are recognised separately in the profit and loss account.

Pension scheme assets are measured using market value. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent terms and currency to the liability. The increase in the present value of the liabilities of the Group’s defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on the schemes’ assets and the increase during the year in the present value of the schemes’ liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the consolidated statement of total recognised gains and losses.

Service costs are systematically spread over the service lives of the employees and financing costs are recognised in the period in which they arise. The costs of past service benefit enhancements, settlements and curtailments are also recognised in the period in which they arise. The amendment to FRS 17 (issued December 2006) has been fully implemented. Quoted securities have been valued at current bid price.

The differences between actual and expected returns on assets and liabilities during the year, including changes in actuarial assumptions, are recognised in the statement of total recognised gains and losses.

The Group also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Group in an independently administered fund. Group contributions to the scheme are charged to the profit and loss account in the period to which they relate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

1 Accounting policies (continued)

Research and development
Expenditure on research and development is charged to the profit and loss account as it is incurred.
Expenditure on fixed assets relating to development projects is written off over the expected useful life of those assets.

Capital instruments
Interest-bearing borrowings are recorded at the proceeds received, net of direct issue costs. Finance charges are accounted for on an accruals basis in the profit and loss account and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

The issue costs of capital instruments have been amortised over the life of the financial instrument to which they relate.

Premiums 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.

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.

Financial instruments
Derivative transactions include interest rate, currency and index-linked swaps that are only used for non speculative purposes. These derivatives are entered into for the purpose of matching or eliminating risk from potential movements in interest and currency rates and RPI associated with the long term borrowing requirements of the Group (see note 18). All derivatives, being non speculative, are accounted for on an accruals basis.

Provisions are made for losses, if appropriate, in the event that it is expected that any portion of a financial instrument will not be a hedge of the long term borrowing requirements of the Group.

Interest rate and currency swaps are used to manage interest rate profiles and mitigate exchange risks. When matched with primary financial instruments, the net position is measured at the hedge rate and presented within creditors on the balance sheet. Income, costs, gains, losses and expenses are recognised within net interest payable in the profit and loss account over the life of the instruments.

Greensands Holdings Limited does not adopt FRS 25, 'Financial Instruments: Disclosure and Presentation' or FRS 26 Financial Instruments: Recognition and Measurement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

2 Segmental analysis

The directors believe that the whole of the Group's activities constitute a single class of business. The Group's turnover is generated wholly from within the UK.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable and dividends received from investments.

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging/(crediting):	**Year ended 31 March 2012 £m**	Year ended 31 March 2011 £m
Staff costs (note 6a)	**40.5**	40.4
Depreciation on		
- owned assets	**227.8**	206.8
- assets held under finance leases	**0.4**	0.4
	228.2	207.2
Amortisation of goodwill	**6.3**	6.3
Rentals under operating leases – vehicles	**3.7**	3.5
Research and development expenditure	**0.5**	0.5
Release of grants and contributions (note 19)	**(2.7)**	(2.7)
Exceptional item (see note (a) below)	**-**	38.6

During the year, the Group's auditor earned the following fees:

Fees payable for the audit of parent company and consolidated annual financial statements	**0.1**	0.1
Fees payable for the audit of the Company's subsidiaries'	**0.1**	0.2
Fees payable for other services pursuant to legislation	**0.1**	0.1
Fees payable for all other services to the Group	**0.1**	0.8
Total audit and non-audit fees	**0.4**	1.2

The Group's auditor for the year ended 31 March 2012 was Deloitte LLP (2010-11: PricewaterhouseCoopers LLP). Fees in respect of other services in 2011-12 relate to taxation advisory services to Deloitte LLP. Fees payable to PricewaterhouseCoopers for other services in 2010-11 relate to services concerning non-financial data and business projects.

(a) The exceptional item of £38.6m in 2010-11 relates to a revision of the level of bad debt provision required for outstanding receivables.

5 Profit of Parent Company

The profit for the financial period dealt with in the financial statements of the parent company is £nil (2010-11: £nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

6 Employee information

	2012 £m	2011 £m
(a) Employee costs		
Wages and salaries	**52.7**	46.9
Social security costs	**4.7**	4.0
Pension costs - Defined contribution	**0.7**	0.4
- Defined benefit	**6.2**	8.1
Total employee costs	**64.3**	59.4
Less: charged as capital expenditure	**(23.8)**	(19.0)
Charged to the profit and loss account	**40.5**	40.4

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

The Company has no employees and did not bear any employee costs.

For directors' emoluments see note 26.

	2012 Number	2011 Number
(b) Average number of persons employed		
Operations	**941**	886
Customer Services	**447**	325
Corporate Centre	**354**	294
	1,742	1,505

7 Interest

	2012 £m	2011 £m
Interest payable and similar charges		
Interest payable on other loans	**(272.0)**	(252.8)
Interest rate swap receipts	**52.6**	41.6
Total interest payable on other loans	**(219.4)**	(211.2)
Indexation	**(113.5)**	(106.2)
Amortisation of issue costs	**(8.0)**	(4.7)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of bond premium	**9.6**	9.6
Total interest payable and similar charges	**(331.2)**	(312.4)
Interest receivable		
Other interest receivable	**2.9**	4.2
Other finance interest (note 23)	**3.0**	0.9
Total interest receivable	**5.9**	5.1

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

8 Tax on profit on ordinary activities

	2012 **£m**	2011 £m
Current tax:		
UK corporation tax on losses of the year	**-**	0.1
Adjustment in respect of prior years	**-**	0.2
	-	0.3
Deferred tax:		
Origination and reversal of timing differences	**11.7**	(15.5)
Pension cost relief in excess of pension cost charge	**4.9**	4.1
Impact of corporation tax rate change	**(29.1)**	(28.4)
Impact of rate change on pension charge	**1.3**	1.0
Adjustment to opening tax estimates	**(3.5)**	(5.4)
Total deferred tax	**(14.7)**	(44.2)
Total tax on loss on ordinary activities	**(14.7)**	(43.9)

The rate of current tax charge on loss on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2012 **£m**	2011 £m
Loss on ordinary activities before tax	**(86.8)**	(143.0)
Current tax:		
UK corporation tax rate at 26% on loss for the year (2010-11: 28%)	**(22.5)**	(40.1)
Timing differences	**(11.7)**	15.5
Pension cost relief in excess of pension cost charge	**(4.9)**	(4.1)
Permanent differences	**32.7**	28.8
Tax losses not recognised	**6.4**	-
Adjustments in respect of prior years	**-**	0.3
Current tax charge for year	**-**	0.4

Factors that may affect future tax charges:

On 21 March 2012 the UK Government announced a reduction in the main rate of corporation tax from 26% to 24% effective from 1 April 2012. The rate change was substantively enacted by the balance sheet date, and deferred tax balances have been calculated using the new rate of 24%. A £29.1m credit is recognised in the profit and loss account in the year to reflect the reduction in the deferred tax liability as a result of the rate change. In addition, charges of £1.3m in the profit and loss account and £0.9m in the statement of total recognised gains and losses are recognised to reflect the reduction in the deferred tax asset relating to the pension deficit.

The Government has also indicated that it intends to enact future reductions in the main tax rate of 1% each year down to 22% by 1 April 2014. The future main tax rate reductions are expected to have a similar impact on the financial statements as outlined above albeit at a rate of reduction of 1% rather than 2%, however the actual impact will be dependent on the Company's deferred tax position at that time.

Based on current capital investment plans, the Group expects to continue to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

9 Goodwill

Group	**£m**
Cost:	
At 1 April 2011 and 31 March 2012	**126.2**
Amortisation:	
At 1 April 2011	22.1
Charge for the period	6.3
At 31 March 2012	**28.4**
Net book amount:	
At 31 March 2012	**97.8**
At 31 March 2011	104.1

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

10 Fixed assets and capital commitments

The Group tangible assets are shown below. The Company has no tangible assets.

(a) Group tangible assets

	Freehold land & buildings £m	Plant & Machinery £m	Infra-structure assets £m	Assets in the course of construction £m	Other £m	Total £m
Cost or valuation:						
At 1 April 2011	1,621.5	1,271.2	2,126.1	478.8	285.8	5,783.4
Additions	0.3	70.3	69.5	253.0	50.3	443.4
Transfers	1.0	40.8	33.4	(90.3)	15.1	-
Grants & contributions	-	-	(8.1)	(2.1)	-	(10.2)
Disposals	-	-	(3.9)	-	(38.4)	(42.3)
At 31 March 2012	1,622.8	1,382.3	2,217.0	639.4	312.8	6,174.3
Depreciation:						
At 1 April 2011	196.5	187.1	169.4	-	107.5	660.5
Charge for the period	56.3	66.9	64.1	-	40.9	228.2
Disposals	-	-	(3.9)	-	(38.4)	(42.3)
At 31 March 2012	252.8	254.0	229.6	-	110.0	846.3
Net book value:						
At 31 March 2012	**1,370.0**	**1,128.3**	**1,987.4**	**639.4**	**202.8**	**5,327.9**
At 31 March 2011	1,425.0	1,084.1	1,956.7	478.8	178.3	5,122.9

Of the additions and transfers to infrastructure assets, the amount spent on infrastructure renewals net of contributions during the years ended 31 March 2012 and 31 March 2011 was £86.5m and £62.5m, respectively. The associated contributions were £4.1m for the year ended 31 March 2012 and £3.6m for the year ended 31 March 2011.

For the years ended 31 March 2012 and 31 March 2011, the net book value of infrastructure assets is stated after deducting grants and contributions of £37.1m and £29.0m respectively.

Freehold land is stated at a value of £98.1m at 31 March 2012 (2010-11: £98.3m), and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices.

One asset acquired on purchase of the subsidiary is under a finance lease and included in plant and machinery:

	Group 2012 £m	Group 2011 £m
Cost	**11.7**	11.7
Aggregate depreciation	**(10.6)**	(10.2)
Net book amount	**1.1**	1.5

(b) Group Capital Commitments

	2011 £m	2010 £m
In respect of contracts placed	**291.9**	402.3

The Company has no capital commitments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

11 Investments

	Group 2012 £m	**Company 2012 £m**	Group 2011 £m	Company 2011 £m
Greensands Europe Limited				
At 1 April and 31 March	**-**	**1.0**	-	1.0
Other external investments (see below)				
At 1 April	**15.0**	**-**	15.0	-
Impairment	**(2.3)**	**-**	-	-
At 31 March	**12.7**	**-**	-	-
Total investments	**12.7**	**1.0**	15.0	1.0

Other Group external investments are stated below.

Company	Class of share capital	Proportion of shares held	Activity
Veolia Water Southeast Ltd (formerly Folkestone & Dover Water Services Ltd)	Ordinary Preference Deferred	25.1% 21.8% 12.2%	Water treatment and supply

The undertaking operates in its country of incorporation (the UK). The investment is held by a subsidiary of Greensands Holdings Limited. Veolia Water Southeast Ltd had profits of £4.6m for the year ended 31 March 2012 (2010-11: profit £2.6m) and net assets of £43.7m at 31 March 2011 (2010-11: £43.0m).

The Group is not considered to exercise significant influence over the operating and financial policies of Veolia Water Southeast Ltd, for reasons including that there is no Board representation.

12 Stocks

	Group 2012 £m	Group 2011 £m
Raw materials	**1.0**	1.1
Work in progress	**0.9**	0.5
	1.9	1.6

The Company does not hold any stock.

13 Debtors: amounts falling due within one year

	Group 2012 £m	**Company 2012 £m**	Group 2011 £m	Company 2011 £m
Trade debtors	**62.1**	**-**	**69.6**	**-**
Unbilled income	**55.6**	**-**	**48.1**	**-**
Prepayments	**13.4**	**-**	**13.1**	**-**
Other debtors	**20.8**	**-**	**16.3**	**-**
	151.9	**-**	**147.1**	**-**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

14 Debtors: amounts falling due after one year

	Group 2012 £m	**Company 2012 £m**	Group 2011 £m	Company 2011 £m
Amounts owed by other Southern Water group undertakings	**-**	**1,016.5**	**-**	**1,016.5**

All amounts owed by group undertakings are unsecured. Of this amount £897.3m accrued interest at 0.01% for the year ended 31 March 2012. The remaining balance is interest free and repayable on demand. The directors have confirmed that neither of these balances will be called upon for 12 months from the date of these financial statements.

15 Creditors: amounts falling due within one year

	Group 2012 £m	**Company 2012 £m**	Group 2011 (Restated)* £m	Company 2011 £m
Loans and other borrowings (see note (i) below)	**-**	**-**	**488.9**	**-**
Trade creditors	**15.7**	**-**	**12.3**	**-**
Amounts owed to group undertakings	**-**	**32.0**	**-**	**31.9**
Capital creditors and capital accruals	**55.3**	**-**	**77.8**	**-**
Corporation tax	**0.1**	**-**	**0.3**	**-**
Other taxation and social security	**2.3**	**-**	**2.0**	**-**
Other accruals and deferred revenue	**215.7**	**-**	**86.2**	**-**
Premium deferred on issue (note 16 (vii))	**9.6**	**-**	**9.6**	**-**
Debt issue costs	**(2.6)**	**-**	**(6.7)**	**-**
	296.1	**32.0**	**670.4**	**31.9**

* The prior year has been restated for a reclassification of goods received not invoiced from trade creditors to accruals.

Notes:

(i) In April 2011 the Group repaid the Senior and Junior Holdco Term Facility Loans of £215.6m and £225.6m respectively plus aggregate accretion of indexation owed on the related swap agreements of £23.3m and £24.4m respectively.

16 Creditors: amounts falling due after one year

	Group 2012 £m	**Company 2012 £m**	Group 2011 £m	Company 2011 £m
Loans and other borrowings:				
Loans from group undertakings	**-**	**59.2**	-	59.2
Long term borrowings	**4,395.6**	**-**	3,726.7	-
Debt issue costs	**(43.5)**	**-**	(40.2)	-
Premium deferred on issue (note 16 (vii))	**134.4**	**-**	144.0	-
Total loans and other borrowings	**4,486.5**	**59.2**	3,830.5	59.2
Deferred revenue (note (vi) below)	**16.0**	**-**	16.4	-
Total creditors falling due after one year	**4,502.5**	**59.2**	3,846.9	59.2

	Group 2012 £m	Group 2011 £m
Repayments fall due as follows:		
Between two and five years	**300.0**	50.0
After five years not by instalments	**4,095.6**	3,676.7
	4,395.6	3,726.7

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

16 Creditors: amounts falling due after one year (continued)

An analysis of the external loans is shown below:

Loans	**Group 2012 £m**	Group 2011 £m
Class A £350m 6.192% fixed rate 2029	**350.0**	350.0
Class A £150m 3.706% index linked 2034	**197.5**	188.2
Class A £35m 3.706% index linked 2034	**46.7**	44.5
Class A £350m 6.640% fixed rate 2026	**350.0**	350.0
Class A £150m 3.816% index linked 2023	**197.6**	188.2
Class A £350m 5.000% fixed rate 2021	**350.0**	350.0
Class A £150m 5.000% fixed rate 2041	**150.0**	150.0
Class A £200m 4.500% fixed rate 2052	**200.0**	200.0
Class A £300m 5.125% fixed rate 2056	**300.0**	300.0
Class A £300m 6.125% fixed rate 2019	**300.0**	300.0
Artesian £165m 4.076% index linked 2033	**217.3**	207.0
Artesian £156.5m 3.635% index linked 2032	**201.2**	191.6
	2,860.3	2,819.5
Fixed swapped to Index-linked – (note (i) below)	**(1,318.2)**	(877.0)
Index-linked swaps – (note (i) below)	**1,487.5**	978.8
Total Class A Debt	**3,029.6**	2,921.3
Class B £250m 7.869% fixed rate 2038 (note (ii) below)	**250.0**	250.0
£250m 8.500% Guaranteed Secured Fixed Rate Notes 2019	**250.0**	-
£225m Facility Agreement 2016 – Libor plus 4% (note (iii) below)	**200.0**	-
Eurobonds 12% 2021	**566.0**	505.4
Capex facility 6 month LIBOR plus 3%	**100.0**	50.0
Debt issue costs (note (iv) below)	**(49.1)**	(45.9)
Premium deferred on issue (note (vii) below)	**134.4**	144.0
Deferred gilt lock proceeds (see note (v) below)	**5.6**	5.7
	4,486.5	3,830.5

Class A and Class B 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 Southern Water Services Limited, Southern Water Services (Finance) Limited ('SWSF'), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

In respect of the specific instruments above:

(i) As at 31 March 2012, SWSF was party to various swap agreements converting a total of £1,318.2m (book 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 swaps entered into by SWSF as at 31 March 2012:

Loan	Book value of Class A debt swapped	Fixed interest rate	Index Linked interest rate	Book value of Class A debt plus capitalised RPI
Class A £350m 6.192% fixed rate 2029	£349.3m	6.192%	3.340%	£371.5m
Class A £350m 6.640% fixed rate 2026	£141.9m	6.640%	3.699%	£149.5m
Class A £350m 5.000% fixed rate 2021	£177.0m	5.000%	2.060%	£190.0m
Class A £150m 5.000% fixed rate 2041	£150.0m	5.000%	0.500%	£190.0m
Class A £200m 4.500% fixed rate 2052	£200.0m	4.500%	0.060%	£247.6m
Class A £300m 5.125% fixed rate 2056	£300.0m	5.125%	0.480%	£338.9m
	£1,318.2m			£1,487.5m

(ii) The interest rate on the Class B debt of £250m is fixed at 7.869% until March 2014 when it becomes LIBOR plus 4.75%.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

16 Creditors: amounts falling due after one year (continued)

(iii) Of the £225m Facility Agreement, £200m has been drawn, with the remaining £25m providing a liquidity facility for future interest payments. The Group has entered into swap agreements that have converted £150m of the £200m drawn on the £225m Facility Agreement from a floating rate of Libor plus 4% (4.25% from 1 April 2012), to a fixed rate of 2.909%.

(iv) Debt issue costs represent issue fees paid by SWSF and Southern Water (Greensands) Financing Plc. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2012 debt issue costs amounted to £51.8m (2010-11: £52.6m) of which £2.7m (2010-11: £6.7m) represents the short-term amount which is disclosed separately in note 15.

(v) Prior to the issue of the Class A £300m bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3m, which was advanced to Southern Water along with the proceeds of the bond issue. The proceeds have been deferred and are being released to the profit and loss account over the life of the loan.

(vi) Deferred revenue relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by Southern Water. The income will be credited to the profit and loss account evenly over the life of the lease.

(vii) The deferred bond premium represents the additional book value of certain of the Group's bonds which were issued in 2003, and arose when a number of the Group's swap instruments were effectively closed out and the resulting loss was rolled forward into the pricing of those bonds. The premium is being amortised over the lives of the relevant bonds.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

17 Provision for liabilities and charges

	Group 2012 £m	Group 2011 £m
(a) Environmental obligations		
Provision as at 1 April 2011/2010	**0.9**	0.3
Utilised in year	**(0.1)**	-
Increase in year	**-**	0.6
Provision at 31 March at 2012/2011	**0.8**	0.9

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted. Discounting the provision would not materially affect its value.

(b) Deferred taxation		
Accelerated capital allowances	**371.8**	426.5
Other timing differences	**(22.8)**	(56.6)
Deferred taxation at 31 March	**349.0**	369.9

Movement in deferred tax provision:	Group 2012 £m	Group 2011 £m
Deferred tax provision as at 1 April 2011/2010	**369.9**	419.2
Deferred tax charge in Profit and Loss Account	**11.7**	(15.5)
Adjustment to opening tax estimates	**(3.5)**	(5.4)
Impact of corporation tax rate change	**(29.1)**	(28.4)
Deferred tax provided at 31 March 2012/2011	**349.0**	369.9

Group losses of £24.5m (2010-11: £nil), with a deferred tax asset of £5.9m (2010-11: £nil) have not been recognised in the accounts due to the uncertainty of suitable taxable profits in the foreseeable future on which to utilise these losses.

The deferred tax asset of £26.6m (2010-11: £23.3m) relating to the pension deficit has been deducted from the pension deficit and so has not been included in this balance. An analysis of the movement in the deferred tax relating to the pension deficit is shown below.

No provision has been made for potential deferred tax liability on fair value adjustments made to the fixed assets recognised on acquisition. Such tax would only become payable if a contract was entered into to sell the related assets. The total amount of deferred tax unprovided is £292.3m (2010-11: £322.3m). At present it is not envisaged that any such tax will become payable in the foreseeable future.

The Company has no provisions for liabilities and charges.

Deferred tax asset relating to pension deficit	2012 £m	2011 £m
At 1 April 2011/2010	**23.3**	42.9
Adjustment in respect of prior years	**-**	(0.1)
Deferred tax charge in profit and loss account	**(4.9)**	-
Deferred tax charged to the statement total recognised gains and losses	**10.4**	(17.7)
Impact of rate change:		
Charge in profit and loss account	**(1.3)**	(1.0)
Charged to the statement total recognised gains and losses	**(0.9)**	(0.8)
At 31 March 2012/2011	**26.6**	23.3

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

18 Financial instruments

Derivative activity is undertaken by subsidiaries in the Group, Greensands Senior Finance Limited, Southern Water (Greensands) Financing Plc and Southern Water Services (Finance) Limited ("SWSF"), as determined by the Board, which considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

The SWSF business consists of lending to other group companies and raising external finance.

Fair values of hedging instruments (as described in the table below) have not been recognised in the financial statements as the Group does not adopt FRS 25, 'Financial Instruments: Disclosure and Presentation' or FRS 26 Financial Instruments: Recognition and Measurement. The fair value in respect of these instruments has been disclosed on page 51.

All fair values are based on arms length transactions in normal market conditions. Where available, market values have been used to determine fair values.

The fair value of the Group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

For foreign currency and interest rate swap agreements the fair value has been estimated based on market valuations at the balance sheet dates.

The Group has no material un-hedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

The table below describes the main activities and risks which lead to the use of derivatives.

Activity	**Risk**	**Type of hedge in place**
Floating rate borrowing / financing	Increased interest expense due to increases in interest rates	Interest rate swaps which fix the amount of interest payable.
Currency rate borrowing / financing	Increased currency losses due to increases in exchange rates	Currency rate swaps which fix the exchange rates.
Indexation	The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk	Index-linked instruments

For the purposes of the notes below, short term debtors and creditors have been excluded, on the basis that their fair values are not considered to be different to book value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

18 Financial instruments (continued)

Interest Rate Risk profile of financial liabilities

Currency	Total £m	Index Linked financial liabilities £m	Fixed rate financial liabilities £m	Variable rate financial liabilities £m
GBP	3,726.7	1,798.3	1,683.4	245.0
At 31 March 2011	3,726.7	1,798.3	1,683.4	245.0
GBP	**4,395.6**	**2,347.8**	**1,702.8**	**345.0**
At 31 March 2012	**4,395.6**	**2,347.8**	**1,702.8**	**345.0**

The balance above includes the debt raised in external finance markets (described further in note 16).

	Fixed rate financial liabilities	
Currency	**Weighted average interest rate %**	**Weighted average time for which rate is fixed Years**
GBP		
31 March 2011	8.1	11.1
GBP		
31 March 2012	**8.3**	**7.8**

The Group held the following financial assets:

	2012 £m	2011 £m
GBP Cash	**260.1**	272.2

The above financial assets attract interest at floating rates.

Fair values of financial assets and financial liabilities
The following table provides a comparison by category of the carrying amounts and the fair values of the Group's financial assets and financial liabilities at 31 March 2012. 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.

	Book value 2012 £m	**Fair value 2012 £m**	Book value 2011 £m	Fair value 2011 £m
Long term borrowings	**(4,395.6)**	**(4,552.5)**	(3,726.7)	(3,680.0)
Cash at Bank and in Hand	**260.1**	**260.1**	272.2	272.2
Derivative financial instruments held to manage interest rate profile				
Interest Rate and index linked Swaps	-	**(821.8)**	-	(500.9)

There is no expectation these losses will be realised within 5 years as the Group expects to hold these instruments until maturity. In the event of any repayment of associated debt, the intention is to match the liability with a new debt instrument.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

19 Grants and contributions

	Group £m
At 1 April 2011	49.1
Receivable in period	1.5
Released to profit and loss account	(2.7)
At 31 March 2012	**47.9**

Grants and contributions relate to non-infrastructure assets.

20 Share capital

	Group and Company 2012 £m	Group and Company 2011 £m
Authorised		
1,100,000,000 Ordinary shares of £1 each	**1,100.0**	1,100.0
	1,100.0	1,100.0
Allotted, called up and fully paid		
921,874,025 Ordinary shares of £1 each	**921.9**	921.9
	921.9	921.9

21 Reconciliation of shareholders funds

Group	Called up share capital £m	Share Premium account £m	Profit and loss account £m	Total £m
At 1 April 2011	**921.9**	**4.5**	**(237.5)**	**688.9**
Loss for the year	-	-	(72.1)	(72.1)
Actuarial loss on pension scheme	-	-	(40.0)	(40.0)
Movement on deferred tax relating to pension asset	-	-	9.5	9.5
At 31 March 2012	**921.9**	**4.5**	**(340.1)**	**586.3**
At 1 April 2010	921.9	4.5	(172.6)	753.8
Profit for the year	-	-	(99.1)	(99.1)
Actuarial gain on pension scheme	-	-	48.6	48.6
Movement on deferred tax relating to pension asset	-	-	(18.5)	(18.5)
Movement on current tax relating to pension asset	-	-	4.1	4.1
At 31 March 2011	**921.9**	**4.5**	**(237.5)**	**688.9**

Company	Called up share capital £m	Share Premium account £m	Profit and loss account £m	Total £m
At 1 April 2011	921.9	4.5	-	926.4
Profit for the year	**-**	**-**	-	-
At 31 March 2012	**921.9**	**4.5**	**-**	**926.4**
At 1 April 2010	921.9	4.5	-	926.4
Profit for the year	**-**	**-**	-	-
At 31 March 2011	**921.9**	**4.5**	**-**	**926.4**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

22 Notes to the cash flow statement

Cash flow from operating activities	2012 £m	2011 £m
Continuing operations		
Operating profit	**239.6**	163.5
Depreciation charge	**228.2**	207.2
Amortisation of goodwill	**6.3**	6.3
Amortisation of grants & contributions	**(2.7)**	(2.7)
Increase in stocks	**(0.3)**	(0.3)
(Increase)/decrease in debtors	**(0.8)**	76.9
Increase/(decrease) in creditors	**12.5**	10.4
Increase in provisions	**-**	0.6
Difference between pension charge and cash contributions	**(0.8)**	0.8
Total net cash inflow from operating activities	**482.0**	462.7

Analysis of Net Debt:

	At 1 April 2011 £m	Cash flows £m	Other non-cash £m	At 31 March 2012 £m
Cash	272.2	(12.1)	-	**260.1**
	272.2	(12.1)	-	**260.1**
Debt due within one year	(491.8)	47.7	437.1	**(7.0)**
Debt due after one year	(3,830.6)	(46.5)	(609.4)	**(4,486.5)**

23 Pensions

The Group accounted for pension costs during the period under FRS17. These disclosures show a net FRS 17 deficit (after deferred tax) of £69.7m (2011 deficit: £36.8m). The deficit has arisen mainly as a result of lower expected future returns on investments and turbulence in the stock market. The movement in the deficit is mainly due to changes in actuarial assumptions (financial and demographic) in the period. These movements are analysed below.

Pension schemes operated

The Group principally operates two schemes, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme was closed to new members on 31 December 1998, re-opened in July 2003 and finally closed to new entrants on 1 April 2005. This scheme has nine trustee directors. On 1 April 2005 Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS.

   The assets of the scheme are held separately from those of the Group. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual Pooled Fund level (not Client holding level).

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

   Contributions made to the defined contribution scheme for the year ended 31 March 2012 amounted to £0.7m (2010-11 £0.4m). No contributions were outstanding at the year end.

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuation of the combined SWPS was carried out as at 31 March 2007 using the projected unit method. The valuation of the combined scheme as at 31 March 2010 is currently in progress. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, the rate of future pensionable salary increases and the level of pension increases.

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

23 Pensions (continued)

For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement.

Expected employer and employee contributions to the defined benefit scheme for 2012-13 are £8.1m and £0.3m respectively.

The principal assumptions made by the actuary in the valuation were as follows:

	2007 SWPS % pa
Return on investments	**6.6**
Salary growth	**5.2**
Pension increases on the excess over guaranteed minimum pensions	**3.2**

The assets of the scheme had a market value of £410.6m at 31 March 2007. This was sufficient to cover 81% of the scheme's benefits.

FRS 17 - assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuations were carried out at 31 March 2007 and updated to 31 March 2012 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below.

	2012 % pa	2011 % pa	2010 % pa
Price inflation (RPI)	**3.0**	3.5	3.8
Price inflation (CPI)	**2.1**	2.6	-
Rate of increase in salaries (plus an age-related promotional scale)	**3.0**	3.0	4.3
Rate of increase of pensions in payment (MIS* members only)***	**2.1**	2.6	-
Rate of increase of pensions in payment (Old section** members only)***	**3.0**	3.5	3.8
Rate of increase of pensions in payment (all other members)***	**3.0**	3.3	3.8
Rate of increase for deferred pensions(MIS* members only)***	**2.1**	2.6	-
Rate of increase for deferred pensions(all other members)***	**3.0**	3.5	3.8
Discount rate	**4.8**	5.6	5.7
Expected return on assets	**5.4**	6.9	7.2

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the Scheme.

*** in excess of any Guaranteed Minimum Pension (GMP) element

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. In 2011, the Group has used the post-retirement mortality assumptions comprising the '92' series based medium cohort mortality tables modified for appropriate assumptions.

	2012 years	2011 Years
Longevity at age 65 for current pensioners		
Male	**21.9**	21.8
Female	**24.7**	24.7
Longevity at age 65 for future pensioners		
Male	**23.3**	23.2
Female	**26.2**	26.2

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

23 Pensions (continued)

FRS 17 - assumptions, asset, liability and reserves disclosures (continued)

The assets and liabilities in the schemes and the expected rates of return at 31 March 2012 and 31 March 2011 were:

	Rate of return 2012	Rate of return 2011	**Value at 2012 £m**	Value at 2011 £m
Equities	**7.1%**	8.0%	**268.9**	325.8
Government bonds	**3.1%**	4.3%	**118.9**	79.8
Non-Government bonds	**4.6%**	5.6%	**125.1**	92.0
Cash	**3.0%**	3.9%	**6.9**	3.0
Total market value of Plan assets			**519.8**	500.6
Total value of Plan liabilities			**(616.1)**	(560.7)
Accrued deficit in the Plan			**(96.3)**	(60.1)
Related deferred tax asset			**23.1**	15.6
Deferred tax on current year pension contribution			**3.5**	7.7
Net pension liability			**(69.7)**	(36.8)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price following the adoption of the amendment to FRS17. Previously these were valued at mid price.
The pension deficit includes a deferred tax asset of £3.5m in relation to the increased pension contribution made by the company during the year.

Reconciliation of the present value of the scheme liabilities

	2012 £m	2011 £m
Scheme liabilities at start of year	**560.7**	589.0
Current service cost	**6.2**	8.1
Interest cost	**31.0**	33.3
Member contributions	**0.3**	0.3
Actuarial loss/(gain) on liabilities	**39.5**	(47.5)
Actual benefit payments	**(21.6)**	(21.3)
Administrative expenses paid	**-**	(1.2)
Curtailments	**-**	-
Scheme liabilities at end of year	**616.1**	560.7

Sensitivity analysis of scheme liabilities

	Change in assumption	**Impact on scheme liabilities (%)**	**Impact on scheme liabilities (£m)**
Discount rate	+/- 1%	-/+ 13	-/+ 80
Rate of inflation*	+/- 1%	+/- 12	+/- 74
Rate of increase in salaries	+/- 1%	+/- 3	+/- 18
Rate of increase in pensions in payment	+/- 1%	+/- 9	+/- 55
Mortality	+/- 1 yr	+/- 2	+/- 12

*A change in inflation is assumed to be reflected in a change in the assumed rates of deferment revaluation, salary increase and pension increase (on pension in excess of GMP).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

23 Pensions (continued)

FRS 17 - assumptions, asset, liability and reserves disclosures (continued)

Reconciliation of the fair value of the scheme assets

	2012 £m	2011 £m
At 1 April 2011/2010	**500.6**	480.2
Expected return on assets	**34.0**	34.2
Gain on assets	**(0.5)**	1.1
Company contributions	**7.0**	7.3
Member contributions	**0.3**	0.3
Benefit payments	**(21.6)**	(21.3)
Administrative expenses paid	**-**	(1.2)
Bid value of scheme assets at 31 March 2012/2011	**519.8**	500.6

The actual gain on scheme assets was £33.5m (2010-11 £35.3m).

Analysis of amounts charged/ (credited) to operating profit:

	2012 £m	2011 £m
Employer's current service cost	**6.2**	8.1
Expected return on pension scheme assets	**(34.0)**	(34.2)
Interest on pension scheme liabilities	**31.0**	33.3
Curtailments	**-**	-
Total P&L expense before deduction for tax	**3.2**	7.2

Analysis of the amounts recognised in STRGL:

	2012 £m	2011 £m
Actuarial return less expected return on pension scheme assets	**(0.5)**	1.1
Experience (loss)/gain arising on scheme liabilities	**(4.9)**	6.0
(Loss)/gain on change of assumptions (financial and demographic)	**(34.6)**	41.5
Total (loss)/gain recognised in STRGL before adjustment for tax	**(40.0)**	48.6

The cumulative amount of actuarial losses recognised in the statement of recognised gains and losses is £132.3m (2010: £92.3m).

Analysis of the movement in the schemes' deficits during the period

	2012 £m	2011 £m
Deficit in the scheme at 1 April 2011/2010	**(60.1)**	(108.8)
Employer's contributions	**7.0**	7.3
Employer's current service cost	**(6.2)**	(8.1)
Cost of curtailments	**-**	-
Other finance expense	**3.0**	0.9
Actuarial loss	**(40.0)**	48.6
Deficit in the scheme at end of year	**(96.3)**	(60.1)
Deferred tax relating to scheme deficit	**23.1**	15.6
Deferred tax on current year pension contribution	**3.5**	7.7
Net deficit at end of year	**(69.7)**	(36.8)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

23 Pensions (continued)

FRS 17 - assumptions, asset, liability and reserves disclosures (continued)

History of gains and losses for the year to 31 March 2012 are as follows:

	2012	2011	2010	2009	2008
a. Experience adjustment on planned assets					
Amount (£m)	**0.5**	**(1.1)**	(83.6)	104.3	37.5
Experience adjustment on scheme liabilities					
Amount (£m)	**4.9**	**(6.0)**	12.9	(13.1)	7.1
b. Total amount recognised in the STRGL					
Fair value of assets at year end (£m)	**519.8**	**500.6**	480.2	318.8	398.4
Actuarial value of liabilities at year end (£m)	**(616.1)**	**(560.7)**	(589.0)	(434.5)	(479.4)
Deficit in scheme at year end (£m)	**(96.3)**	**(60.1)**	(108.8)	(115.7)	(81.0)

The assets in the current year and the years ended 31 March 2011, 2010 and 2009 have been valued at bid value as per FRS 17 amendment. Southern Water has taken advantage of an exemption in FRS 17 amendment, not to restate the years prior to 31 March 2009 at bid value.

24 Contingent liabilities

Contractors submit claims to Southern Water for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water's valuation.

The Group had no contingent liabilities for capital claims at the year end (2010-11 £nil).

25 Financial commitments

As at 31 March 2012, the Company had annual commitments under non-cancellable operating lease agreements in respect of vehicles and land and buildings for which the payment extends over a number of years as follows:

	Land and Buildings		**Other**	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Expiring within one year	**-**	-	**-**	0.1
Expiring between two and five years	**-**	-	**0.1**	0.1
Expiring after more than five years	**1.3**	1.3	**0.1**	0.1
	1.3	1.3	**0.2**	0.3

Operating leases are charged to the profit and loss account over the lease term.

The Company has no such commitments.

26 Directors' emoluments

One director received £30,000 (2010-11 £22,500) paid by the group for services as a director of Greensands Holdings Limited. One other director received £15,000 (2010-11 £11,250) paid by one of the ultimate shareholders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

27 Related party transactions

The major shareholders in Greensands Holdings Limited as at 31 March 2012 are IIF International SW UK Investments Limited and The Northern Trust Company.

The transactions and balances with the Group's related parties (i.e. the shareholders), as defined by Financial Reporting Standard 8 and the extent of the transactions with them are summarised below.

	2012 £m	2011 £m
Eurobond interest		
National Nominees Ltd	**7.3**	6.8
Britel Fund Trustees	**-**	0.1
Paceweald Ltd	**0.7**	0.6
JP Morgan Nominees	**1.6**	1.4
IIF Int'l SW UK Investment Ltd	**17.0**	15.2
UBS AG	**-**	0.1
Sumaya Investments Ltd	**2.9**	2.6
Challenger Property Nominees Pty Ltd	**-**	1.9
Phildrew Nominees Ltd	**9.5**	8.4
Sky Brace Investments Ltd	**2.9**	2.6
The Northern Trust Company	**14.2**	10.8
STC Funds Nominee Pty Limited	**1.9**	1.7
Britel Guernsey Investments Ltd	**2.3**	2.0
Nambawan Super Limited	**0.1**	-
JP Morgan Nominees Australia	**0.2**	-
Total Eurobond interest payable to related parties	**60.6**	54.2
Loans and other borrowings greater than one year:		
Eurobonds – Shareholder loans		
IIF Int'l SW UK Investment Ltd	**105.3**	101.1
Phildrew Nominees Ltd (UBS IIF)	**20.1**	20.1
Phildrew Nominees Ltd (UBS IINF)	**2.8**	2.8
Phildrew Nominees Ltd (UBS II4F)	**22.2**	22.2
Phildrew Nominees Ltd (UBS IIUSTEF)	**11.1**	11.1
Britel Guernsey Investments Ltd	**14.0**	14.0
National Nominees Ltd - Motor Trades association of Australia Super Fund	**16.8**	16.8
National Nominees Ltd - Sunsuper super fund	**11.2**	11.2
STC Funds Nominee Pty Limited as trustee of the SW Unit Trust	**11.2**	11.2
National Nominees Ltd - Westscheme Pty Ltd	**-**	5.6
National Nominees Ltd - Farm Plan Pty Ltd	**4.2**	4.2
National Nominees Ltd - Statewide Super Pty Ltd	**5.6**	5.6
National Nominees Limited as nominee for Nambawan Super Limited as trustee for the Nambawan Superannuation Fund	**-**	1.7
Paceweald Ltd	**-**	4.2
The Northern Trust Company (as custodian for Future Fund Investment Company No.2 Pty Ltd)	**28.1**	28.1
The Northern Trust Company (as custodian for Future Fund Investment Company No.2 Pty Ltd)	**56.1**	56.1
Sky Brace Investments Ltd	**17.1**	17.1
Sumaya Investments Ltd	**17.1**	17.1
JPMorgan Nominees - Retail Employees Super Pty ltd	**9.5**	9.5
Nambawan Super Limited as trustee for the Nambawan Superannuation Fund	**1.7**	-
JP Morgan Nominees Australia	**5.6**	-
Accrued interest	**206.3**	145.7
Total Eurobonds – Shareholder loans	**566.0**	505.4

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

28 Principal subsidiaries

As at 31 March 2012 the Company held 100% of the ordinary share capital of Greensands Europe Limited. Greensands Europe Limited's principal subsidiaries are listed below.

Company	Class of share capital	Proportion of shares held	Activity
Greensands UK Limited	Ordinary	100%	Non-trading activities
Southern Water (Greensands) Financing Plc	Ordinary	100%	To raise debt finance
Greensands Junior Finance Limited	Ordinary	100%	To raise debt finance
Greensands Senior Finance Limited	Ordinary	100%	To raise debt finance
Greensands Investments Limited	Ordinary	100%	Non-trading activities
Southern Water Capital Limited	Ordinary	100%	Non-trading activities
Southern Water Investments Limited	Ordinary	100%	Non-trading activities
Southern Water(NR) Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water(NR) Limited (formerly Aspen 4 Limited)	Ordinary	100%	Non-trading activities
SWS Group Holdings Limited	Ordinary	100%	Non-trading activities
SWS Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water Limited (formerly Southern Water plc)	Ordinary	100%	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Ordinary	100%	Supply of Water and Wastewater Services
Southern Water Services Finance Limited	Ordinary	100%	To raise debt finance
Southern Water Services Group Limited	Ordinary	100%	Non-trading activities
Southern Water Industries Limited	Ordinary	100%	Dormant
Southern Water Services Finance plc	Ordinary	100%	Dormant
Bowsprit Holdings Limited	Ordinary	100%	Dormant
Monk Rawling Limited	Ordinary	100%	Dormant
Bowsprit Property Development Limited	Ordinary	100%	Property Development
EcoClear Limited	Ordinary	100%	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Ordinary	100%	Dormant
Southern Water Pension Trustees Limited	Ordinary	100%	Dormant

All subsidiaries have been included in Greensands Holdings Limited's consolidated financial statements.

29 Post balance sheet events

In June 2012, the Group sold its entire interest in Veolia Water Southeast Ltd (see note 11).

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF GREENSANDS HOLDINGS LIMITED

We have audited the financial statements of Greensands Holdings Limited for the year ended 31 March 2012 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and company balance sheets, the consolidated cash flow statement and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company’s members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the Company’s members those matters we are required to state to them in an 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 and the Company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
As explained more fully in the Statement of Directors’ Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company’s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the Group’s and the Company’s affairs as at 31 March 2012 and of the Group’s loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been properly prepared in accordance with the Companies (Jersey) Law 1991.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- proper accounting records have not been kept, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

James A. Leigh

James Leigh
for and on behalf of Deloitte LLP
Chartered Accountants
London, United Kingdom
24 July 2012