Interim Financial Information and Report

For the six months ended
30 September 2016 (Unaudited)

Southern Water

Contents

Interim management report – operational performance

We are pleased to publish an update on our performance at the halfway point of the financial year.

Our focus over the past six months has been to make further improvements across the business while maintaining stability in areas where we have shown strong progress. We have also been working extremely hard to address aspects of performance where we fell short of our targets.

Overview

So far there's plenty to celebrate:

- *We have approximately halved the number of customer complaints we received during the same period in 2015.*
- *We have improved our ranking in terms of our Service Incentive Mechanism (SIM) score – our regulator, Ofwat's, measure of customer satisfaction – moving up to joint 14th in the league tables from 18th last year.*
- *We have increased the number of customers we help to get through times of genuine financial hardship.*
- *We have continued our strong performance in tackling blockages on our network that lead to flooding from sewers.*
- *Our wastewater treatment works have achieved a record 100% compliance with the required environmental standards.*
- *Our environmental performance is improving and includes:*
  - *a new record for recycling – none of our site and office waste is now sent to landfill*
  - *the launch of our Beauty of the Beach campaign to protect our bathing waters*
  - *fewer pollution incidents – we have recorded 5% fewer than at this point last year.*
- *We have launched a pilot of a new grant scheme designed to support our local communities.*

While we are taking steps to improve our customer service, we still have a lot of work to do in this area. We are also working hard to maintain our industry-leading standards in areas such as leakage.

How we measure our progress

Our targets are detailed in our business plan for 2015 to 2020 and are based on six key areas that our customers said they wanted us to focus on:

- *Responsible customer service*
- *Affordable bills*
- *Better information and advice*
- *A constant supply of high-quality drinking water*
- *Removing wastewater effectively*
- *Looking after the environment*

We measure our achievements by how we are doing against a series of targets we promised customers we would meet – our promise commitments. For more detailed information and a guide to our performance as at March 2016, see our Annual Report & Financial Statements 2015–16.

We set up a Customer Advisory Panel (CAP) to independently monitor our business plan delivery performance. It reports back to customers, stakeholders and regulators on its view of our progress.

The performance figures quoted here are based on our unaudited internal reporting. These will be independently verified at the end of the 2016–17 financial period by both our auditors and the CAP.

Responsible customer service

We set ourselves the goal of cutting the number of complaints we received by 40% by the end of the 2016–17 financial year. Half-way through the year, we are on track to beat this goal, having almost halved the number of complaints received in April to August 2016 compared with the same period in 2015.

Our latest SIM score of 81.68 is in line with our target at this point in the year and has seen us move up the industry league tables to joint 14th from the position of 18th last year.

Our aim is to better predict what customers need so that potential issues can be resolved before they become a problem. One way we are doing this is through our new proactive customer contact team.

When a problem is identified – such as an unusual increase in a customer's water use – the proactive team contacts them to find out the source of the increase and offer support. The team can then establish if the increase is due, for example, to more people at the property or a previously undetected leak in the pipe network.

We are confident that measures such as this will help us provide the high-quality service our customers expect and deserve, more of the time.

Affordable bills

Many people face genuine financial hardship and our aim is to offer additional support where we can. We have led the rest of the sector in providing proactive help for those most in need through partnerships with organisations such as local authorities and debt advice agencies. We also offer free water-saving audits to help customers bring down their consumption and bills, and home visits with our specialist partner, Orbit, to provide bespoke tariff and payment scheme advice.

Overall, we are now helping over 166,000 customers with additional support, which is well ahead of our target of 149,900.

Better information and advice

Part of our commitment to customers is to help them to help themselves by providing better information and advice.

Our *Keep It Clear* campaign aims to educate and help customers protect themselves from the effects of sewer overflows caused by blockages. We are calling for their help to keep fat, oil and grease (FOG) and 'unflushable' items such as wet wipes – which don't degrade quickly enough – out of our drains. We have also introduced more detailed investigations to locate, isolate and fix problem areas along the pipe and sewer network to prevent repeated incidents.

We are also asking customers to be more water efficient so they can help the environment and lower the cost of their bills. Our teams have been visiting customers at home to offer practical advice and install free water-saving devices. Analysis from the first wave of properties to receive these visits shows they have subsequently reduced their water consumption by 10%.

A constant supply of high-quality drinking water

We have promised to provide our customers with consistently high-quality drinking water. At the end of September, we recorded a good result of 99.97% but we're still pushing to do even better. The DWI Chief Inspector's Report: 'Drinking Water 2016: Quarter 1' identified a number of concerns regarding our water sampling and data reporting. As a result, we are working hard to upgrade our reporting systems and procedures and to put measures in place to help us achieve our ambitious targets.

Meanwhile, reports of discoloured water are encouragingly low at just 0.56 per 1,000 of the population we serve – that's one in every 1,785 Southern Water customers – so we should beat our calendar year-end target of 0.85.

Leakage

We promised customers that we would keep the amount of water lost through leaks in our network to a maximum of 87 million litres a day.

For the six months to the end of September, we recorded a figure of 88.2 million litres, which puts us slightly behind where we wanted to be at this point. However, we are working hard to hit our targets and maintain our industry-leading position.

Removing wastewater effectively

We are among the industry leaders for the quality of our wastewater service and are on track to hit tough targets for tackling blockages, keeping external flooding incidents down and ensuring customers are not disturbed by smells from our treatment works. As mentioned earlier, we have seen no failures against compliance targets at our wastewater treatment works so far this year.

In 2015, we promised customers we would reduce internal flooding incidents by 25% by 2020. Internal flooding incidents were down to 253 at the end of September and we should meet our year-end target of not exceeding 436.

We are continuing our work to reduce the number of external flooding incidents and are on track to hit our promise commitment target of keeping these incidents to fewer than 8,850 at the end of the year.

Looking after the environment

We are continuing the improving picture of performance detailed in our last annual report. We are pleased to note that, overall, pollution incidents are currently around 5% fewer than last year, which, if maintained, puts us on track to record one of our best performance years ever.

Pollution incidents are categorised against three levels of severity, with categories one and two being the most serious, and category three incidents being less significant. We are on track to beat the reduction we promised customers of not exceeding 221 category three incidents. We have also worked hard to avoid serious category one and two pollution incidents and look set to fulfil the promise we made to customers of not exceeding six such events in this period. Of course, we are also constantly reviewing our processes to be as ready as we can be to tackle threats from outside factors such as extreme or unseasonal weather events.

Meanwhile, we are proud to announce a 'first' for us this year: we are now recycling 100% of Southern Water's waste. Since July, no waste from our works or offices has been sent to landfill, putting us among the industry leaders in this area.

We are also recycling 100% of our biosolids (a by-product of the treatment process) which are recycled as fertiliser.

Bathing waters

We promised customers that we would maintain the number of the region's bathing waters which achieve 'excellent' quality status at 54, and bring a further seven up to 'excellent' by 2020. This season, we have achieved 51 – an improvement on 43 last year. We will be keeping up our efforts to better this even further by working with colleagues in local councils and environmental groups to tackle causes of beach pollution together.

Among our greatest allies in protecting the local environment are our customers and we have been successfully enlisting their help to keep our beaches clear of rubbish and dog waste with our Beauty of the Beach campaign.

The campaign, which has been endorsed by the Environment Agency, has reached more than two million people in just three months through social media.

Health and Safety

Health and safety at work continues to be our number one priority and we recorded more than 100 days free of any reportable injury to our employees earlier in the 2016–17 period. However, since then, there have been some accidents which, although thankfully relatively minor, have required members of staff, or our contractors, to take time off work.

As the volume of construction work ramps up on our sites over the remainder of the year, we are committed to making sure we protect the health and safety of those who work for us so that we can return to our industry-leading standards.

Community

This year, we have made a great start to our new fundraising partnership with the Kent, Surrey & Sussex Air Ambulance Trust.

So far, we have already raised more than £20,000 and aim to increase that sum to £100,000 by the end of the two-year partnership.

Meanwhile, our four regional charity partners have received £10,000 to support specific projects. These are Howletts Wild Animal Park in Kent, the Chailey Heritage Foundation in Sussex, the Honeypot Charity in Hampshire and SSAFA, the armed forces charity, on the Isle of Wight.

Sometimes, even investing in improvements can cause temporary but significant disruption to a community. We understand this and so we are pleased to announce the launch of a pilot scheme to give something back to the communities affected by our company's activities – whether it's been the result of our capital projects or when we have been responding to a major incident. Information on our Community Grants scheme is available on our website.

Looking ahead

In April 2017, non-household customers will be able to choose which company provides their water and sewerage retail services. These services include handling customer queries and complaints, billing and meter reading.

After looking at our options, we decided to sell our non-household retail business to Business Stream, a specialist company in this field, so we can concentrate on our wholesale operation (the water and sewer networks) and our domestic retail customers. This transfer will take place in April 2017 when the market opens.

Although we have decided not to compete in the business retail market, as a wholesaler we have an important role to play in the new market. We have now successfully entered the shadow market, the six-month testing period where we can run new systems and processes to iron out any issues before the market opens. We are on course to be ready for the changes.

Meanwhile, we remain focused on fulfilling our customer promises by 2020 through continued excellent operational performance and by improving levels of customer satisfaction.

Interim management report – financial performance

Key financial performance indicators

	Six months ended 30 September 2016	Six months ended 30 September 2015	
	Unaudited	Unaudited	Increase
	£m	£m	%
Revenue	409.2	400.7	2.1
Operating costs	(277.2)	(270.1)	2.6
Operating profit	133.5	132.0	1.1
Gross capital expenditure	128.7	108.0	19.2
Net cash inflow from operating activities	243.8	225.5	8.1

Income statement

Revenue for the period has risen by 2.1% to £409.2 million (period to 30 September 2015: £400.7 million) principally resulting from an increase in our charges linked to RPI as set out in our Business Plan for 2015–20.

Operating costs for the first half of the year of £277.2 million increased by 2.6% (period to 30 September 2015: £270.1 million). This increase mainly resulted from inflation, an increase to our bad debt charge and initiatives to improve our customer services performance. This includes the creation of a proactive outbound calling team and the use of a specialist partner to provide bespoke tariff and payment scheme advice to customers facing genuine financial hardship.

As a result of the above, operating profit for the period increased by 1.1% to £133.5 million (period to 30 September 2015: £132.0 million).

We raise finance to fund our capital investment programme. Our financial instruments comprise fixed, floating and inflation linked loans and derivatives.

The inflation linked loans and derivatives are in place to match movements in our revenues and regulatory capital value and we are required to measure the fair value movement of the derivatives through the income statement.

Finance costs for the period increased to £80.8 million (period to 30 September 2015: £76.0 million). This increase was largely due to higher indexation on the inflation linked loans as a result of higher RPI in the first six months of this year.

The fair value loss on our derivative financial instruments amounted to £380.5 million (period to 30 September 2015: gain £56.9 million). To calculate the fair value of our derivative instruments we discount their forecast future cash flows using UK government bond yields. These future forecast cash flows are predictable, and match the future forecast movement in our revenues and Regulatory Capital Value, but government gilt yields are constantly moving with the result that the valuation of our derivative instruments can be volatile. There has been a significant reduction in gilt yields during the past six months which results in a large increase in the liability associated with our derivative instruments for this period, despite there being little change to their future forecast cash flows. The changes in value that are recorded during the lives of derivatives, unless crystallised, do not represent cash flows.

Tax on loss from continuing operations amounted to a credit of £60.1 million (period to 30 September 2015: charge of £26.8 million) largely as a result of the fair value of our derivative financial instruments.

The loss after tax from continuing operations was £238.6 million (period to 30 September 2015: profit of £115.4 million).

Statement of financial position

At the end of the period to 30 September 2016, non-current assets were £6,504.1 million (£6,491.0 million at 31 March 2016), an increase of £13.1 million from 31 March 2016. This increase mainly results from capital investment of £128.7 million, sewer adoptions of £3.6 million, capitalised interest of £3.3 million offset by depreciation and amortisation of £122.5 million for the period.

Current assets have increased by £348.8 million from £212.6 million at 31 March 2016 to £561.4 million at 30 September 2016. This increase principally results from the receipt of net proceeds totalling £240.0 million following the issue and repayment of loans which contributed to an increase in cash and cash equivalents of £284.2 million. In addition there was an increase in the loan to our subsidiary of £57.0 million in order to fund interest payments due in the second half of the year.

Current liabilities have increased by £69.6 million from £277.0 million at 31 March 2016 to £346.6 million at 30 September 2016. The movement largely results from an accrual for our interim dividend and a higher interest accrual due to the timing of interest payments on our bonds, these increases are partially offset by the repayment of a £50 million term facility.

Borrowings have increased by £294.3 million, from £3,631.8 million at 31 March 2016 to £3,926.1 million at 30 September 2016. This principally results from new loans issued of £290.0 million.

The liability associated with our derivative financial instruments increased by £380.5 million, from £923.7 million at 31 March 2016 to £1,304.2 million at 30 September 2016 largely due to a fall in government bond yields as described in the commentary in relation to the income statement on page 7.

The pension deficit at 30 September 2016 of £236.6 million (31 March 2016: £102.3 million) is based on the latest actuarial valuation as at 31 March 2016 updated by a qualified independent actuary to reflect the latest market yields and asset values as at 30 September 2016. The increase in the deficit of £134.3 million largely results from the fall in corporate bond yields.

Overall net assets decreased from £1,359.8 million at 31 March 2016 to £940.1 million at 30 September 2016.

Cash flow

Net cash inflow from operating activities in the period amounted to £243.8 million (period to 30 September 2015: £225.5 million). During the period to 30 September 2015 a lump sum contribution in respect of our pension deficit of £16.0 million was made, which reduced the cash inflow from operating activities last year. Taking this payment into consideration the underlying cash inflow from operating activities has remained consistent with last year.

Net cash used in investing activities amounted to £178.4 million (period to 30 September 2015: £155.1 million). The increase of £23.3 million primarily relates to the movement in the loan to our subsidiary Southern Water Services (Finance) Limited (SWSF). This loan is used to fund interest payments on our debt and in 2015 accrued indexation payments were also made from the loan account on some of our debt.

Net cash received in financing activities amounted to £218.8 million (period to 30 September 2015: used £61.6 million) an increase of £280.4 million. This increase results from a net cash inflow of £240.0 million in 2016 from changes to loans together with a reduction in equity dividends paid, of £29.2 million, due to the timing of dividend payments. The ordinary dividend of £61.0 million declared at 30 September 2016 was paid during October 2016.

Equity dividends paid reflect a payment of £22.7 million in relation to the 'Southern Water Services Group (SWSG) dividend loop' (period to 30 September 2015: £22.7 million). Under the 'SWSG Dividend Loop' the company makes dividend payments via intermediary holding companies to SWSG. These dividends, along with associated group tax relief payments enable SWSG to pay the interest due to Southern Water Services Limited on an inter-company loan. The result of this is a circular transaction, the effect of which is a net cash flow for the company of nil.

Going concern

Please see the director's assessment of 'going concern' contained in note 1 of the interim financial information.

Principal risks

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company is managed to achieve its objectives. The principal risks and uncertainties that the business faces over the remainder of this financial year are largely unchanged from those reported in our last Annual Report & Financial Statements listed below.

- *Customer Service*
- *Bad debt*
- *Resilience to drought*
- *Preventing flooding of our sites and from our network*
- *Resilient supply of good quality water*
- *Cyber security*
- *Wastewater treatment works failures and pollution incidents*
- *Health and safety*
- *Financing our business*
- *Defined benefit pension scheme*
- *Delivery of our capital investment programme*
- *Compliance with regulations and legislation*
- *Regulatory reform*

Further detail on these risks and uncertainties is included in the Annual Report & Financial Statements for the year ended 31 March 2016, which can be found on the Southern Water website.

Condensed income statement

For the six months ended 30 September 2016

Condensed income statement for the six months ended 30 September 2016			
		Six months ended 30 September 2016	Six months ended 30 September 2015
	Notes	**Unaudited**	Restated* and unaudited
Continuing operations		**£m**	£m
Revenue		**409.2**	400.7
Other operating income		**1.5**	1.4
Operating costs			
– before depreciation and amortisation		**(154.7)**	(146.8)
– depreciation and amortisation		**(122.5)**	(123.3)
Total operating costs		**(277.2)**	(270.1)
Operating profit		**133.5**	132.0
Profit on disposal of fixed assets		**0.3**	0.1
Finance income		**28.8**	29.2
Finance costs		**(80.8)**	(76.0)
Fair value(losses)/gains on derivative financial instruments		**(380.5)**	56.9
Net finance (cost)/income	4	**(432.5)**	10.1
(Loss)/profit before taxation from continuing operations		**(298.7)**	142.2
Tax credit/(charge)	5	**60.1**	(26.8)
(Loss)/profit after taxation from continuing operations		**(238.6)**	115.4

* The unaudited results for 30 September 2015 have been restated to reflect presentational changes and changes to the tax charge resulting from the adoption of FRS 104 for the period ending 30 September 2016.

Condensed statement of other comprehensive income

For the six months ended 30 September 2016

Condensed statement of other comprehensive income for the six months ended 30 September 2016			
		Six months ended 30 September 2016	Six months ended 30 September 2015
	Notes	**Unaudited**	Restated* and unaudited
		£m	£m
(Loss)/profit for the period		**(238.6)**	115.4
Items that cannot be reclassified to profit or loss			
Actuarial loss on retirement benefit obligation	12	**(131.7)**	(3.3)
Deferred tax asset movement relating to retirement benefit obligation	5	**23.7**	0.7
Deferred tax asset movement due to rate change relating to pension deficit	5	**10.6**	–
		(97.4)	(2.6)
Total comprehensive (loss)/income for the period		**(336.0)**	112.8

* The unaudited results for 30 September 2015 have been restated to reflect presentational changes and changes to the tax charge resulting from the adoption of FRS 104 for the period ending 30 September 2016.

Condensed statement of financial position

As at 30 September 2016

Condensed statement of financial position as at 30 September 2016			
	Notes	Six months ended 30 September 2016 Unaudited £m	Year ended 31 March 2016 Audited £m
Non-current assets			
Intangibles	7	**54.0**	42.0
Property, plant and equipment	8	**5,608.6**	5,607.5
Other non-current assets		**812.3**	812.3
Investments		**29.2**	29.2
		6,504.1	6,491.0
Current assets			
Inventories		**2.9**	2.4
Trade and other receivables		**256.4**	192.3
Cash and cash equivalents		**302.1**	17.9
		561.4	212.6
Total assets		**7,065.5**	6,703.6
Current liabilities			
Trade and other payables		**(307.7)**	(188.1)
Borrowings		**(38.9)**	(88.9)
		(346.6)	(277.0)
Non-current liabilities			
Borrowings		**(3,926.1)**	(3,631.8)
Derivative financial instruments	11	**(1,304.2)**	(923.7)
Deferred tax liabilities		**(264.8)**	(365.0)
Retirement benefit obligations	12	**(236.6)**	(102.3)
Provisions for liabilities		**(0.5)**	(0.5)
Other non-current liabilities		**(46.6)**	(43.5)
		(5,778.8)	(5,066.8)
Total liabilities		**(6,125.4)**	(5,343.8)
Total net assets		**940.1**	1,359.8
Equity			
Called up share capital		**0.1**	0.1
Share premium account		**46.3**	46.3
Revaluation reserve		**738.9**	745.1
Retained earnings		**154.8**	568.3
Shareholders' equity		**940.1**	1,359.8

Condensed statement of changes in equity

For the six months ended 30 September 2016

Condensed statement of changes in equity for the six months ended 30 September 2016

Six months ended 30 September 2016	Called up share capital £m	Share premium £m	Revaluation reserve £m	Retained earnings £m	Total £m
Balance at 1 April 2016	**0.1**	**46.3**	**745.1**	**568.3**	**1,359.8**
Loss for the financial period	–	–	–	(238.6)	(238.6)
Other comprehensive loss for the period	–	–	–	(97.4)	(97.4)
Total comprehensive loss for period	**0.1**	**46.3**	**745.1**	**(336.0)**	**(336.0)**
Equity dividends paid (note 6)	–	–	–	(83.7)	(83.7)
Revaluation reserve transfer	–	–	(6.2)	6.2	–
At 30 September 2016	**0.1**	**46.3**	**738.9**	**154.8**	**940.1**

Condensed statement of changes in equity for the six months ended 30 September 2015

Six months ended 30 September 2015 (Restated)	Called up share capital £m	Share premium £m	Revaluation reserve £m	Retained earnings £m	Total £m
Balance at 1 April 2015	**0.1**	**46.3**	**757.3**	**553.9**	**1,357.6**
Profit for the financial period	–	–	–	115.4	115.4
Other comprehensive loss for the period	–	–	–	(2.6)	(2.6)
Total comprehensive income for period	**0.1**	**46.3**	**757.3**	**112.8**	**112.8**
Equity dividends paid (note 6)	–	–	–	(51.9)	(51.9)
Revaluation reserve transfer	–	–	(6.1)	6.1	–
At 30 September 2015	**0.1**	**46.3**	**751.2**	**620.9**	**1,418.5**

The revaluation reserve arose on transition to FRS 101 at 1 April 2014, when the company elected to measure its infrastructure and operational assets at their fair value and to use that fair value as their deemed cost at that date.

Condensed statement of cash flows

For the six months ended 30 September 2016

Condensed statement of cash flows for the six months ended 30 September 2016			
	Notes	**Six months ended 30 September 2016 Unaudited £m**	Six months ended 30 September 2015 Restated* and unaudited £m
Operating activities			
Cash generated from operations		**249.5**	231.2
Tax paid		**(5.7)**	(5.7)
Net cash from operating activities	9	**243.8**	225.5
Investing activities			
Purchase of property, plant and equipment		**(122.4)**	(120.9)
Purchase of intangibles		**–**	(3.4)
Receipt of grants and contributions		**1.0**	0.8
Movement on loan to subsidiary		**(57.0)**	(31.6)
Net cash used in investing activities		**(178.4)**	(155.1)
Financing activities			
Interest received		**28.5**	29.4
Interest paid		**(26.6)**	(27.9)
Equity dividends paid		**(22.7)**	(51.9)
Preference share dividends		**–**	(6.8)
Repayment of loans		**(50.0)**	(64.4)
New loans granted		**290.0**	60.0
Issue costs of new loans		**(0.3)**	–
Finance lease payments		**(0.1)**	–
Net cash received/(used) in financing activities		**218.8**	(61.6)
Net increase in cash and cash equivalents		**284.2**	8.8
Cash and cash equivalents at beginning of the period		**17.9**	173.5
Cash and cash equivalents at end of the period	10	**302.1**	182.3

* The unaudited results for 30 September 2015 have been restated to reflect presentational changes and changes to the tax charge resulting from the adoption of FRS 104 for the period ending 30 September 2016.

Notes to the interim financial information

1 Basis of preparation and accounting policies

The condensed financial statements for the six months ended 30 September 2016, which are unaudited, have been prepared in accordance with FRS 104 'Interim Financial Reporting' as adopted by the United Kingdom.

The condensed financial statements for the six months ended 30 September 2016 do not constitute statutory accounts of the company. Statutory accounts for the year ended 31 March 2016 were approved by the board on 28 June 2016 and the auditor's report on those accounts was unqualified. The condensed financial statements for the six months ended 30 September 2016 should be read in conjunction with the annual report and financial statements for the year ended 31 March 2016 which have been delivered to the Registrar of Companies and can be obtained from the Company Secretary, Southern House, Yeoman Road, Worthing, BN13 3NX, or from our website.

Having reassessed the principal risks, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the interim financial information.

The accounting policies adopted in these condensed financial statements are consistent with those applied and set out in the annual report and financial statements for the year ended 31 March 2016, except as described below.

The tax charge is based on the estimated effective tax rate before exceptional items, fair value adjustments and adjustments in respect of prior periods, for the full year to 31 March 2017.

Prior period restatement

Prior period figures in the condensed financial statements and related notes have been restated to present the figures on a consistent basis with the annual report for the year ended 31 March 2016 and the requirements of the related accounting standards together with the requirements of FRS 104.

2 Key assumptions and significant judgments

In preparing these condensed financial statements, the significant judgments made in applying the company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements for the year ended 31 March 2016.

3 Seasonality of operations and segmental analysis

The company's business is not seasonal in nature.

The directors believe that the whole of the company's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this interim report.

Notes to the interim financial information (continued)

4 Net finance costs

Net finance costs		
	Six months ended 30 September 2016	Six months ended 30 September 2015
	Unaudited	Restated and unaudited
	£m	£m
Finance income		
Interest revenue from SWSG Limited	**28.4**	28.4
Deposit Income on short-term bank deposits	**0.4**	0.8
	28.8	29.2
Finance costs		
Interest payable on other loans	**(4.2)**	(3.5)
Interest paid to Southern Water Services (Finance) Ltd	**(66.2)**	(64.0)
Indexation	**(8.3)**	(5.7)
Amortisation of issue costs	**(1.6)**	(1.6)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of deferred credits	**4.8**	4.8
Amortisation of bond premium	**0.2**	0.3
Other finance expense	**(2.2)**	(2.1)
Dividends on preference shares	**(6.7)**	(6.7)
	(84.1)	(78.4)
Amounts capitalised on qualifying assets	**3.3**	2.4
	(80.8)	(76.0)
Fair value (losses)/gains on derivative financial instruments		
Derivative financial instruments not designated as hedges	**(380.5)**	56.9
Net finance (costs)/income	**(432.5)**	10.1

Notes to the interim financial information (continued)

5 Taxation

Taxation presented in the income statement is based on the result for the period using current rates and takes into account tax deferred due to timing differences.

Tax on (loss)/profit on continuing operations	Six months ended 30 September 2016 Unaudited £m	Six months ended 30 September 2015 Restated and unaudited £m
Current tax:		
In respect of the current period	**5.8**	4.1
Total current tax charge	**5.8**	4.1
Deferred tax:		
Origination and reversal of temporary differences	**(60.9)**	22.7
Effect of corporation tax rate change	**(5.0)**	–
Total deferred tax (credit)/charge	**(65.9)**	22.7
Total tax (credit)/charge on (loss)/profit on continuing operations	**(60.1)**	26.8

The tax credit for the six months ended 30 September 2016 is based on the estimated effective tax rate before exceptional items, fair value gains/loses and adjustments in respect of prior periods, for the full year to 31 March 2017.

Reductions in the main rate of corporation tax to 19% from 1 April 2019 and to 18% from 1 April 2020 were enacted in the Finance Bill 2015, and deferred tax balances at 31 March 2016 are calculated based on these reduced rates. It was subsequently announced in the 2016 UK Budget that the corporation tax rate would instead reduce to 17% from 1 April 2020. This further reduction has been substantively enacted in Finance Bill 2016 at the statement of financial position date, and deferred tax balances at 30 September 2016 have been calculated using this reduced rate. A £5.0 million credit has been recognised in the income statement in the period to reflect the reduction in the deferred tax liability as a result of the rate change. In addition, a credit of £10.6 million has been recognised in the statement of other comprehensive income to reflect the increase in the deferred tax asset relating to the pension deficit.

In addition to the tax (credited)/charged to the income statement, the following amounts of tax relating to components of other comprehensive income were recognised:

Deferred tax	Six months ended 30 September 2016 Unaudited £m	Six months ended 30 September 2015 Restated and unaudited £m
Arising on income and expenses recognised on other comprehensive income:		
Tax credit on actuarial losses on defined benefit pension scheme	**(23.7)**	(0.7)
Deferred tax asset movement due to rate change relating to pension deficit	**(10.6)**	–
Total deferred tax credits recognised in other comprehensive income	**(34.3)**	(0.7)

Notes to the interim financial information (continued)

6 Dividends

The following dividends were paid by the company:

Dividends	Six months ended 30 September 2016 Unaudited £m	Six months ended 30 September 2015 Restated and unaudited £m
Equity dividends paid:		
– SWSG Dividend Loop *	**22.7**	22.7
– External	**61.0**	29.2
	83.7	51.9

* These dividends are paid via intermediary holding companies to Southern Water Services Group Limited (SWSG) and, along with associated group tax relief, enable SWSG to pay the interest due to SWS on an inter-company loan. The result of this is a circular transaction, the effect of which is a net cash flow for the company of nil.

7 Intangible assets

Intangible assets	£m
Cost	
At 1 April 2016	76.2
Transfers	16.8
At 30 September 2016 (unaudited)	93.0
Accumulated amortisation	
At 1 April 2016	34.2
Charge for the period	4.8
At 30 September 2016 (unaudited)	39.0
Net book amount	
At 30 September 2016 (unaudited)	**54.0**

Notes to the interim financial information (continued)

8 Property, plant and equipment

Property, plant and equipment	
	£m
Cost	
At 1 April 2016	7,709.1
Additions	135.6
Transfers	(16.8)
Disposals	(1.3)
At 30 September 2016 (unaudited)	7,826.6
Accumulated depreciation	
At 1 April 2016	2,101.6
Charge for the period	117.7
Disposals	(1.3)
At 30 September 2016 (unaudited)	2,218.0
Net book amount	
At 30 September 2016 (unaudited)	**5,608.6**

Notes to the interim financial information (continued)

9 Cash generated by operations

Cash generated by operations		
	Six months ended 30 September 2016	Six months ended 30 September 2015
	Unaudited	Restated and unaudited
	£m	£m
Continuing operations		
Operating profit	**133.5**	132.0
Adjustments for:		
Depreciation of property, plant and equipment	**117.7**	118.9
Amortisation of intangible assets	**4.8**	4.4
Amortisation of grants and contributions	**(1.5)**	(1.4)
Operating cash flow before movement in working capital	**254.5**	253.9
Increase in inventories	**(0.5)**	(0.1)
Increase in receivables	**(10.3)**	(6.2)
Increase/(decrease) in payables	**5.8**	(16.4)
Cash generated by operations	**249.5**	231.2
Tax paid		
– Payments made within SWSG Dividend Loop	**(5.7)**	(5.7)
Net cash from operating activities	**243.8**	225.5

Notes to the interim financial information (continued)

10 Analysis of net debt

Analysis of net debt (unaudited)

	At 1 April 2016 £m	Cash flow £m	Other non-cash changes £m	**At 30 September 2016 £m**
Cash and cash equivalents	17.9	284.2	–	**302.1**
Derivative financial instruments	(923.7)	–	(380.5)	**(1,304.2)**
Borrowings due within one year	(88.9)	50.0	–	**(38.9)**
Borrowings due after one year	(3,631.8)	(289.6)	(4.7)	**(3,926.1)**
Net debt	(4,626.5)	44.6	(385.2)	**(4,967.1)**

Balances at 30 September 2016 comprise:

	Current assets £m	Current liabilities £m	Non-current liabilities £m	**Total £m**
Cash and cash equivalents	302.1	–	–	**302.1**
Derivative financial instruments	–	–	(1,304.2)	**(1,304.2)**
Borrowings due within one year	–	(38.9)	–	**(38.9)**
Borrowings due after one year	–	–	(3,926.1)	**(3,926.1)**
Net debt	302.1	(38.9)	(5,230.3)	**(4,967.1)**

The non-cash movement of £385.2 million relates to an increase in debt as a result of indexation, movements on the fair value of derivatives, plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and an increase in finance lease obligations.

Loans due within one year relate to loans from group undertakings that are repayable on demand.

Notes to the interim financial information (continued)

11 Derivative financial instruments

Categories of financial instruments at fair value	Six months ended 30 September 2016 Unaudited £m	Year ended 31 March 2016 Audited £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**18.5**	12.4
Total derivative financial assets	**18.5**	12.4
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**(1,322.7)**	(936.1)
Total derivative financial liabilities	**(1,322.7)**	(936.1)

The derivative assets and liabilities meet the offsetting criteria in paragraph 42 of IAS 32. This results in the presentation of a net derivative liability of £1,304.2 million at 30 September 2016 in the statement of financial position.

Notes to the interim financial information (continued)

11 Derivative financial instruments (continued)

Changes in value of financial instruments at fair value	Six months ended 30 September 2016 Unaudited £m	Six months ended 30 September 2015 Restated and unaudited £m
Profit for the year has been arrived at after (charging)/crediting:		
Financial assets at fair value	**6.1**	3.7
Designated as FVTPL		
Financial liabilities at fair value	**(386.6)**	53.2
Designated as FVTPL		
	(380.5)	56.9

The derivative liability has reduced by a further £nil (31 March 2016: £298.4 million) due to payment of accrued indexation associated with the swaps.

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk.

The regulatory framework, under which revenues and the Regulatory Capital Value are indexed, exposes the company to inflation risk. The company enters into inflation linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

Notes to the interim financial information (continued)

12 Retirement benefit obligations

The retirement benefit obligations shown at 30 September 2016 and 30 September 2015 are based on the valuations at 31 March 2016 and 31 March 2015 respectively, updated by a qualified independent actuary reflecting market yields and asset values. These are not formal interim valuations of the scheme assets and liabilities; however an assessment of the actuarial losses has been made and shown in the summarised statement of other comprehensive income.

The major assumptions used by the actuary are set out in the table below:

Assumptions	Six months ended 30 September 2016 Unaudited %	Year ended 31 March 2016 Audited %
Price inflation (RPI)	**3.1**	3.0
Price inflation (CPI)	**2.1**	2.0
Rate of increase in salaries	**2.5**	2.5
Rate of increase of pensions in payment (MIS members)	**2.1**	2.0
Rate of increase of pensions in payment (old section members)	**3.1**	3.0
Rate of increase of pensions in payment (all other members)	**3.0**	2.9
Discount rate	**2.4**	3.6

The amounts included in the statement of financial position arising from the company's obligations under the defined benefit scheme were as follows:

Retirement benefit obligations	Six months ended 30 September 2016 Unaudited £m	Year ended 31 March 2016 Audited £m
Total fair value of assets	**745.0**	674.1
Present value of the defined benefit obligation	**(981.6)**	(776.4)
Deficit recognised in the statement of financial position	**(236.6)**	(102.3)

Analysis of the movement in the scheme's deficit during the period	Six months ended 30 September 2016 Unaudited £m	Six months ended 30 September 2015 Unaudited £m
At 1 April	**(102.3)**	(115.3)
Employer's contributions	**2.7**	3.5
Employer's current service cost	**(2.7)**	(2.9)
Financing charge on net statement of financial position	**(1.4)**	(1.9)
Administration expenses	**(1.2)**	(0.8)
Actuarial loss	**(131.7)**	(3.3)
Deficit in the scheme at end of the period	**(236.6)**	(120.7)

Notes to the interim financial information (continued)

13 Contingent liabilities

Contractors submit claims to the company 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 company had no contingent liabilities for capital claims at the period-end (September 2015: £nil).

14 Capital commitments

Capital commitments	Six months ended 30 September 2016 Unaudited £m	Year ended 31 March 2016 Audited £m
Contracted for but not provided for in respect of contracts placed	113.4	193.8

15 Related party transactions

The consortium of investors owning Greensands Holdings Limited (GSH) are considered to be related parties of the company as they each have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

There has been no material change during the six months ended 30 September 2016 in transactions with these related parties from that disclosed in the company's annual report and GSH consolidated financial statements for the year ended 31 March 2016.

16 Events after the statement of financial position date

On 5 October 2016 the company paid the ordinary dividends of £61.0 million, disclosed in note 6 of these financial statements, to the shareholders of the company being SWS Holdings Limited. This payment represents £1,089.29 per share.

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