

**Southern Water Services Limited**

**Preliminary Results for the year ended  
31 March 2011**



# **Southern Water Services Limited**

## **Preliminary Results for the year ended 31 March 2011**

### Contents

Highlights	1
Profit and loss account	4
Statement of total recognised gains and losses	5
Balance sheet	6
Cash flow statement	7
Notes to the preliminary results	8

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Highlights

#### Financial performance

- Turnover decreased by 4.7% to £647.1m (2009-10: £679.1m). A significant element of this reduction reflects the outcome of a review of the method for estimating the amount of measured 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 has therefore been made to reflect the previously overestimated accrual.
- Costs increased by 11.1% to £417.1m (2009-10: £375.4m). This increase resulted mainly from the impact of higher depreciation charges, an increase in the ordinary bad debt charge, inflation, and an increase in power and maintenance costs.
- An exceptional item of £38.6m was charged due to a one-off revision to the level of bad debt provision carried against outstanding receivables.
- Operating profit for 2010-11 decreased from £303.9m in the previous year to £191.5m, a 37.0% fall.
- The profit after taxation for the year amounted to £32.0m (2009-10: £129.3m).
- The directors have not declared a final dividend for 2010-11 (2009-10: £35.0m).
- £408.5m was invested to deliver new and improved water supply and wastewater treatment infrastructure as part of a £1.7 billion programme across Kent, Sussex, Hampshire and the Isle of Wight between 2010 and 2015.
- The outflow of cash relating to the purchase of tangible fixed assets was £385.4m (2009-10: £226.7m) and the net cash outflow before financing in 2010-11 was £103.0m (2009-10: £12.8m inflow).

#### Operational Performance

Serviceability across three sectors (Sewage below-ground, Water below-ground and Water above-ground) has been assessed by us as 'Stable'. This follows significant investment, above the levels reflected in price limits, in restoring the serviceability of our water and sewerage above-ground water assets (principally treatment works).

On the sewage below-ground network, we believe serviceability, Ofwat's measure of the effectiveness of our maintenance activity in delivering services to customers, has this year fallen to 'Marginal' status. This follows increases in both pollution incidents and flooding and blockages. We have put in place an action plan to address these failures.

There are also significant challenges for us in managing our networks. Following three harsh winters, the resilience of our water below-ground network has reduced and as a result we have been unable to achieve the challenging leakage targets that we set for ourselves. We continue, however, 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. However, a re-profiling of our targets for this period, to reflect the impact of the unpredicted harsh winters is required.

The company made a significant investment to upgrade the treatment processes at its water treatment works during 2010-11 and continued to deliver supplies among the best in Europe. To help achieve this, the company launched a programme to 'flush over 1,000km of water mains during the next three years. This helps remove the build-up of iron deposits in the pipes which can lead to discoloured water.

The company also increased the amount of renewable energy it generates from Combined Heat and Power units during 2010-11 and also launched investigations into harnessing hydro, solar and wind power on operational sites.

The rivers and streams in the Southern Water region will also benefit from the start of a programme of investment at more than 100 treatment works across the region.

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Highlights (continued)

#### Operational Performance (continued)

We recognise that there is more to do in reshaping some of our key processes to drive out operating efficiencies, following a large increase in operating expenditure this year. Similarly, delivering the capital programme in the face of significant capital price deflation of 9% since the price review (as measured by COPI), represents a major challenge. This is because, under Ofwat's methodology, the fall in COPI effectively reduces the value of the final determination capital allowance. However, the reduction in the index is not necessarily matched by a reduction in the real costs that we face in procuring our capital programme.

There is also an urgent need to address the shortfall in our revenue base compared with the assumptions included in Ofwat's price limits. The ongoing element of this shortfall amounts to £24.5m in the report year and we believe it will remain at or above this level for the whole of the five-year period. While this shortfall can be recovered under the Revenue Correction Mechanism introduced at the last price review, this is likely to result in a significant bill spike in 2015-16. We believe it is prudent to take action to avoid this now and we have made some proposals to Ofwat to smooth these increases, by recovering part of the revenues in the current period and part in the next five-year period. We will continue to discuss the issue with Ofwat as well as consulting with customers on their preference between small steady bill increments immediately, or a much larger increase at some point in the future.

#### Leakage

The winters of 2009 and 2010 saw extreme weather with the winter of 2010 being the harshest in 30 years. This led to a record number of mains bursts. More than 22,000 leaks were repaired by Southern Water in 2010-11 – a record number for the company.

The company continues to make significant investments to maintain one of the lowest levels of leakage per property in the industry.

Year two of the programme will see:

- 100km of water mains replaced across the region.
- More than 100,000 water metres fitted to properties as part of the universal metering programme. Water meters with leak alarms will be installed in the majority of homes in the South East from 2010 to 2015. The alarms, activated when water runs continuously through the meter over 24 hours, are expected to save up to five million litres of water per day.

#### Capital Delivery

Southern Water invested more than £405m in the South East in 2010-11.

The most significant element of this was in relation to construction of a scheme to bring Cleaner Seas to Sussex, for which the total investment will amount to £300m. Work is progressing well across 11 construction sites that will form a new wastewater treatment works in Peacehaven, East Sussex and an 11km sewer tunnel which will be operational by 2013 and will be able to fully treat the wastewater generated each day by the residents of Peacehaven, Telscombe, Saltdean, Rottingdean and Woodingdean, along with those of Brighton and Hove.

Other work has included the completion of a new water resource at Hardham, near Pulborough, West Sussex. This included the construction of a reservoir and a pumping station at Hardham Church Farm, and the installation of a 1.8km pipeline. It creates a new source able to provide 10 million litres of water per day in the summer, enough for the daily needs of a town the size of Horsham.

Other investment in 2010-11 included more than 10km of water mains being replaced in Hampshire, 10km in Kent, 24km in Sussex,

A scheme to reduce the risk of flooding in the Collier Road area of Hastings was completed, as was a project to increase the capacity of the wastewater infrastructure in Canterbury to cater for the growing population.

# **Southern Water Services Limited**

## **Preliminary Results for the year ended 31 March 2011**

### **Highlights (continued)**

#### **Customer Service**

Ofwat now measures company performance using the Service Incentive Mechanism (SIM), which focuses on six quantitative measures and one qualitative measure. The scores are not used from performance in year 1 of the AMP but will be for the remaining four years. We pay particular attention to these indicators, and Southern Water's comparative performance, and aim to achieving an incremental improvement in both the score and relative positioning of the Company.

Southern Water's Worthing-based call centre was named as one of the top 50 in the UK by Call Centre Focus magazine in 2010.

As part of a customer service improvement programme, the company merged its billing, technical and metering contact centres and multi-skilled its teams so its staff can now deal with all types of customer queries on their first call.

Following our three-year ISO 9001 Quality Management accreditation in 2010, Southern Water passed follow-up audits by the British Standards Institution. This standard recognises continuous improvement in the way companies deal with customers.

Southern Water's customer agents received 1.8 million calls in 2010-2011 and the number of complaints received fell by 19 per cent.

The company also raised more than £350,000 for charities in the year.

#### **People**

Southern Water's apprenticeship programme is in its sixth year. Its success helped Southern Water be named the best employer in Sussex for the training and development of its staff in 2009's Sussex Business Awards and win two prizes in the Water Industry Achievement Awards of the same year.

The Investors in People accreditation was successfully re-assessed in December 2010 having been first awarded in 2008. This is the hallmark of best practice in organisations and designed to help them develop performance through their employees.

A number of engineering graduates passed through the Southern Water Masters Excellence With Industry programme. They completed a two year scheme in partnership with the University of Brighton. Seven more graduates have been recruited to start in September 2011.

#### **Awards**

The company won 14 awards with recognition at regional, national and international level across a wide range of activities. These included an imaginative campaign to reduce the amount of fat, oil and grease poured down the sink and helping thousands of children create water-efficient gardens at their schools.

Southern Water's unique training programme for graduates, new IT practices, engineering projects and continuing excellent safety performance also won awards during the year.

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Profit and loss account

For the year ended 31 March 2011

	Note	2011 £m	2011 £m	2010 £m	2010 £m
<b>Turnover</b>			<b>647.1</b>		679.1
Cost of sales					
- before exceptional item		<b>(382.6)</b>		(348.1)	
- exceptional item		<b>(38.6)</b>		-	
Cost of sales including exceptional item			<b>(421.2)</b>		(348.1)
Gross profit			<b>225.9</b>		331.0
Administrative expenses			<b>(34.5)</b>		(27.3)
Other operating income			<b>0.1</b>		0.2
<b>Operating profit before exceptional item</b>			<b>230.1</b>		303.9
<b>Exceptional item</b>			<b>(38.6)</b>		-
<b>Operating profit</b>			<b>191.5</b>		303.9
Profit on disposal of fixed assets			<b>0.8</b>		1.4
<b>Profit on ordinary activities before interest and taxation</b>			<b>192.3</b>		305.3
Interest payable and similar charges	2		<b>(240.5)</b>		(177.0)
Interest receivable and similar income	2		<b>60.3</b>		61.8
<b>Profit on ordinary activities before taxation</b>			<b>12.1</b>		190.1
Tax on profit on ordinary activities	3		<b>19.9</b>		(60.8)
<b>Profit on ordinary activities after taxation</b>			<b>32.0</b>		129.3
Dividends	4		<b>(77.1)</b>		(40.9)
<b>(Loss)/profit for the financial year</b>			<b>(45.1)</b>		88.4

The above results relate to continuing operations.

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

An exceptional item of £38.6m relates to a revision of the level of bad debt provision required for outstanding receivables.

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Statement of total recognised gains and losses

For the year ended 31 March 2011

	2011 £m	2010 £m
<b>Profit on ordinary activities after taxation</b>	<b>32.0</b>	129.3
Actuarial loss recognised in the pension scheme	<b>48.6</b>	(54.3)
Movement on deferred tax relating to pension deficit	<b>(18.5)</b>	10.5
Movement on current tax relating to pension deficit	<b>4.1</b>	4.7
<b>Total recognised gains for the year</b>	<b>66.2</b>	90.2

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Balance sheet

As at 31 March 2011

	Note	2011 £m	2010 £m
<b>Fixed assets</b>			
Tangible assets		3,883.1	3,666.6
Investments		29.2	29.2
		<b>3,912.3</b>	<b>3,695.8</b>
<b>Current assets</b>			
Stocks		1.6	1.2
Debtors: amounts falling due within one year		148.1	234.5
Debtors: amounts falling due after one year		812.3	812.3
Cash at bank and in hand		172.0	288.7
		<b>1,134.0</b>	<b>1,336.7</b>
<b>Creditors: amounts falling due within one year</b>		<b>(228.6)</b>	<b>(194.4)</b>
<b>Net current assets</b>		<b>905.4</b>	<b>1,142.3</b>
<b>Total assets less current liabilities</b>		<b>4,817.7</b>	<b>4,838.1</b>
<b>Creditors: amounts falling due after more than one year</b>		<b>(3,528.6)</b>	<b>(3,460.0)</b>
<b>Provision for liabilities and charges</b>			
Environmental obligations		(0.9)	(0.3)
Deferred taxation		(402.9)	(451.5)
<b>Grants and contributions</b>		<b>(49.1)</b>	<b>(50.1)</b>
<b>Net assets excluding pension deficit</b>		<b>836.2</b>	<b>876.2</b>
<b>Pension deficit</b>		<b>(36.8)</b>	<b>(65.9)</b>
<b>Net assets including pension deficit</b>		<b>799.4</b>	<b>810.3</b>
<b>Capital and reserves</b>			
Called up share capital	5	0.1	0.1
Share premium	5	46.3	46.3
Profit and loss account	5	753.0	763.9
<b>Total shareholders' funds</b>		<b>799.4</b>	<b>810.3</b>

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Cash flow statement

for the year ended 31 March 2011

	2011 £m	2010 £m
<b>Net cash inflow from operating activities</b>	<b>472.5</b>	389.4
<b>Returns on investments and servicing of finance</b>		
Interest received	60.3	62.7
Interest paid	(137.1)	(144.8)
Preference share dividends	(22.3)	(14.5)
<b>Net cash outflow from returns on investments and servicing of finance</b>	<b>(99.1)</b>	(96.6)
<b>Taxation</b>	<b>(23.4)</b>	(25.5)
<b>Capital expenditure and financial investment</b>		
Purchase of tangible fixed assets	(385.4)	(226.7)
Receipt of grants and contributions	9.3	10.7
Sale of tangible assets	0.2	2.4
<b>Net cash outflow for capital expenditure and financial investment</b>	<b>(375.9)</b>	(213.6)
<b>Equity dividends paid</b>	<b>(77.1)</b>	(40.9)
<b>Net cash (outflow)/inflow before financing</b>	<b>(103.0)</b>	12.8
<b>Financing</b>		
Increase in borrowings	-	50.0
Repayment of loans	(13.7)	(183.3)
Deferred swap receipts	-	48.8
<b>Net cash outflow from financing</b>	<b>(13.7)</b>	(84.5)
<b>Decrease in net cash</b>	<b>(116.7)</b>	(71.7)
<b>Reconciliation to net debt</b>		
Net debt at beginning of year	(3,188.8)	(3,189.8)
Decrease in net cash	(116.7)	(71.7)
Movements in borrowings	13.7	133.3
Deferred swap receipts	-	(48.8)
Other non cash changes	(81.4)	(11.8)
<b>Net debt at end of year</b>	<b>(3,373.2)</b>	(3,188.8)

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Notes to the preliminary results

The financial information set out above does not constitute the Company's statutory financial statements for the year ended 31 March 2011, or for the year ended 31 March 2010, within the meaning of section 435 of the Companies Act 2006. The financial information is based upon the audited statutory financial statements for the year ended 31 March 2011, upon which the auditors have issued an unqualified audit opinion.

The financial statements for the year ended 31 March 2010 have been delivered to the Registrar of Companies. The financial statements for the year ended 31 March 2011 will be delivered to the Registrar of Companies in due course.

#### 1 Basis of preparation

The financial statements have been prepared on the going concern basis, under the historical cost convention, and in accordance with applicable accounting standards and, on a consistent basis with prior years as set out in the Companies Statutory Accounts.

#### 2 Interest

	2011 £m	2010 £m
<b>Interest payable and similar charges</b>		
Interest payable on other loans	6.4	3.6
Interest paid to group companies	131.4	140.3
Indexation	84.0	13.7
Amortisation of issue costs	2.7	2.7
Amortisation of gilt lock proceeds	(0.1)	(0.1)
Amortisation of deferred credits	(5.0)	(4.2)
Amortisation of bond premium	(0.6)	(0.6)
Amortisation of discount	0.3	0.3
Other finance expense	(0.9)	6.8
Dividends on preference shares- see note below	22.3	14.5
<b>Total interest payable and similar charges</b>	<b>240.5</b>	<b>177.0</b>
<b>Interest receivable</b>		
Interest receivable from Southern Water Services Group Limited	56.9	56.9
Deposit interest receivable	3.4	4.9
<b>Total interest receivable</b>	<b>60.3</b>	<b>61.8</b>

The preference share dividends were paid on 30 September 10 and 31 March 11 and Class A1 amounted to £40 per share and Class B £70 per share (totalling £13.7m (2010: £13.7m)). A dividend of £8.6m (2010: £0.8m) was declared and paid to the Class A2 preference shareholders in September 2010 at base value (see note 16(vi)) plus an amount for outperformance in the year ending 31 March 2010.

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Notes to the preliminary results (continued)

#### 3 Taxation

	2011 £m	2010 £m
<b>Current tax:</b>		
UK corporation tax on profits for the year	32.3	49.4
Adjustment in respect of prior years	(4.6)	-
	27.7	49.4
<b>Deferred tax:</b>		
Origination and reversal of timing differences	(16.4)	12.0
Adjustment in respect of prior years	(1.2)	(0.6)
Effect of corporation tax rate charge	(31.0)	-
Impact of rate change on pension charge	1.0	-
Total deferred tax	(47.6)	11.4
Total tax on profit on ordinary activities	(19.9)	60.8

The tax assessed for the year is different to the standard rate of corporation tax in the UK (28%) due to the following factors:

	2011 £m	2010 £m
<b>Profit on ordinary activities before tax</b>	12.1	190.1
<b>Current tax:</b>		
UK corporation tax on profits for the year at 28% (2010: 28%)	3.4	53.2
Adjustment in respect of prior years	(4.6)	-
Permanent differences	12.5	8.2
<b>Tax charge on ordinary activities</b>	11.4	61.4
Timing differences	16.4	(12.0)
<b>Current tax charge for year</b>	27.7	49.4

Factors that may affect future tax charges:

On 23 March 2011 the UK Government announced a reduction in the main rate of corporation tax from 28% to 26% effective from 1 April 2011. The rate change was substantively enacted by the balance sheet date, and deferred tax balances have been calculated using the new rate of 26%. A £31.0m 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 £1.7m in the profit and loss account and £0.8m 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 23% 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 Company 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.

Deferred tax liabilities have not been discounted.

# Southern Water Services Limited

## Preliminary Results for the year ended 31 March 2011

### Notes to the preliminary results (continued)

#### 4 Dividends

	2011 £ per ordinary share	2010 £ per ordinary share	2011 £m	2010 £m
<b>Ordinary shares</b>				
Interim dividend – 2 Jul	182.78	-	10.2	-
Interim dividend – 30 Sep	182.78	365.57	10.2	20.5
Interim dividend – 16 Dec	182.78	-	10.3	-
Interim dividend – 31 Dec	-	182.78	-	10.2
Interim dividend – 31 Mar	203.09	182.78	11.4	10.2
<b>Total interim dividend</b>	<b>751.43</b>	731.13	<b>42.1</b>	40.9
Final dividend – prior year	625.00	-	35.0	-
<b>Total ordinary dividend</b>	<b>1,376.43</b>	731.13	<b>77.1</b>	40.9

The final dividend paid in 2011 related to the year ended 31 March 2010 (2009: £nil) and was declared on 28 April 2010 and paid on 24 May 2010.

#### 5 Reconciliation of movement in shareholders' funds

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2010	0.1	46.3	763.9	810.3
Profit after tax	-	-	32.0	32.0
Dividends paid	-	-	(77.1)	(77.1)
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
<b>At 31 March 2011</b>	<b>0.1</b>	<b>46.3</b>	<b>753.0</b>	<b>799.4</b>

The profit and loss reserve includes recognised losses of £60.2m (2010: £108.8m) less deferred taxation of £23.3m (2010: £42.9m) in respect of pension scheme liabilities of the group pension fund.

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2009	0.1	46.3	714.6	761.0
Profit after tax	-	-	129.3	129.3
Dividends paid	-	-	(40.9)	(40.9)
Actuarial loss on pension scheme	-	-	(54.3)	(54.3)
Movement on deferred tax relating to pension asset	-	-	10.5	10.5
Movement on current tax relating to pension asset	-	-	4.7	4.7
<b>At 31 March 2010</b>	<b>0.1</b>	<b>46.3</b>	<b>763.9</b>	<b>810.3</b>