

Our business

We supply top quality drinking water to 2.2 million customers in the south east of England. Through a network of 9,000 miles of pipe, we deliver **517 million** litres of water every day. The skill and expertise of our employees ensures our customers' water meets the highest of standards.

Our vision

Our vision is to be the water company people want to be supplied by and want to work for. Everything we do is underpinned by technical excellence.

Our supply area



Pure know h2ow



517 million litres of water a day – that's how much water we supply to around 2.2 million people



83 water treatment works - that's how we ensure our water is of the highest quality



500,000 water quality tests each year – that's how we ensure your water meets the highest standards



9,000 miles of water mains – that's how we transfer fresh drinking water direct to your tap



983 employees – that's how we make sure your water supply runs 24 hours a day, 365 days a year

How we invest in your water

Where each £1 of your bill is spent.





43%







Dividends

Interest & Tax



Financial highlights

Revenue

£224.8m

Increase of 2.7 per cent on last year

Operating profit

£75.0m

Decrease of 5.1 per cent on last year

Capital expenditure

£96.0m

Up from £89.8m last year

Cash generated from operating activities

£123.1m

Decrease of 3.5 per cent on last year

Contents

5	Group financial statements	
6	Directors' report	86
	Directors' responsibilities statement	90
	Independent auditor's report	91
16	Group income statement	99
25	Group statement of comprehensive income	99
31	Group statement of financial position	100
40	Company statement of financial position	101
41	Group statement of changes in equity	102
44	Company statement of changes in equity	103
	Group statement of cash flows	104
	Company statement of cash flows	105
57	Notes to the financial statements	106
77		
	Annual performance report	
	Disclosures and statements by directors	156
	Data assurance summary	165
	Risk and compliance statement	168
	Independent auditor's report	169
	Financial performance	172
	16 25 31 40 41 44	Directors' report Directors' responsibilities statement Independent auditor's report Group income statement Group statement of comprehensive income Group statement of financial position Company statement of financial position Group statement of changes in equity Company statement of changes in equity Group statement of cash flows Company statement of cash flows Notes to the financial statements Annual performance report Disclosures and statements by directors Data assurance summary Risk and compliance statement Independent auditor's report





Directors and Company Secretary

Nick Salmon (Independent Chairman)

John Barnes (Independent Non-Executive Director)

Emma Gilthorpe (Independent Non-Executive Director)

Chris Girling (Independent Non-Executive Director)

Célia Pronto (Independent Non-Executive Director) (Appointed 1 June 2018)

Paul Rich (Independent Non-Executive Director) (resigned 3 July 2017)

Marissa Szczepaniak (Non-Executive Director)

Oliver Schubert (Non-Executive Director) (appointed 3 May 2017)

Peter Dixon (Non-Executive Director) (resigned 27 April 2017)

Paul Butler (Managing Director)

Andrew Farmer (Finance Director)

David Hinton (Asset and Regulation Director)

Nicolas Truillet (Company Secretary)

Company's bankers

HSBC Bank plc, 60 Queen Victoria Street, London EC4N 4TR

Company's auditor

Deloitte LLP Statutory Auditor London, United Kingdom

Registered office

Rocfort Road, Snodland, Kent ME6 5AH

Registered No. 02679874
Country of domicile and incorporation: England and Wales

Chairman's introduction

On behalf of the Directors of South East Water, I am pleased to present our annual report and financial statements for the year ended 31 March 2018. This is the third reporting year of the current five year regulatory period and we have put particular emphasis this year on our ambition to ensure people (customers, the community we serve and our employees) and our environmental impact on the planet are at the centre of our strategy to responsibly deliver a continuous improvement in customer satisfaction.

The team has worked hard throughout the year to deliver the stretching objectives set in the 2015 to 2020 business plan, ensuring we provide great service to all our household customers and within the new non-household retail market, which opened on 1 April 2017. A great deal of effort has also been focused on developing our plans for the future in the form of the 60 year water resources management plan and our draft business plan for the next five year regulatory period from 2020 to 2025.

The operations team works hard 24 hours a day, seven days a week to maintain our extensive network of underground pipes while also finding and fixing more than 30,000 leaks and bursts, however in March 2018 we experienced a severe operational challenge caused by the "Beast from the East" (several days of freezing temperatures, high winds and significant snowfall), followed by a very rapid thaw. This led to a break out of burst pipes across the network at a scale we have never witnessed in our area, with around 70 per cent of the leaks on customer private plumbing. A dedicated team worked around the clock to get water supplies restored to around 20,000 properties, while distributing large volumes of bottled water to the public, focusing on vulnerable customers, and ensuring temporary supplies for livestock at affected farms. A major effort was made in communicating up-to-date information to our customers through our website, social media, tv and radio etc. We have now written to all customers impacted to apologise for the disruption and credited their account with above statutory compensation in recognition of the inconvenience that was caused.





IN MARCH 2018 WE EXPERIENCED A
SEVERE OPERATIONAL CHALLENGE
CAUSED BY THE "BEAST FROM THE
EAST" (SEVERAL DAYS OF FREEZING
TEMPERATURES, HIGH WINDS AND
SIGNIFICANT SNOWFALL), FOLLOWED
BY A VERY RAPID THAW. THIS LED TO A
BREAK OUT OF BURST PIPES ACROSS
THE NETWORK AT A SCALE WE HAVE
NEVER WITNESSED IN OUR AREA, WITH
AROUND 70 PER CENT OF THE LEAKS
ON CUSTOMER PRIVATE PLUMBING.

We would like to thank all our customers who were very patient and understanding of the circumstances. We are also very grateful to the number of organisations who helped, whether it was identifying vulnerable customers, or the fire service supporting filling bowsers for farmers. Our liaison with our local resilience forum made an important difference during the event.

I would like to add my personal thanks to all those who worked with such passion and dedication throughout the incident while at the same time apologising to all our customers who were affected. A full review into this incident has taken place.

The team had done a lot to prepare for the impact of the freeze and thaw on our network, and those bursts that occurred on our pipes were quickly identified and repaired. But the speed and scale of the upsurge in demand following the rapid thaw, due primarily to leaks on customer properties, is something we've never experienced before. That said we recognise that we must learn from this and identify opportunities to minimise the impact of such a severe incident in the future including what more we can do to proactively support customers so they can better protect their own properties' pipes - in fact customers being part of the resilience solution will be a key part of our next five year business plan. Ofwat has completed its own review into the impact of the freeze/thaw across the whole country and the lessons to be learned therefrom. We will work closely with the industry to ensure best practice approaches are built into our emergency plans for future events.

THE "FIVE-OUT-OF-FIVE" FOCUS
ACROSS THE BUSINESS CONTINUES
TO GROW WITH EMPLOYEES FROM
TEAMS IN BOTH THE OFFICE AND
THE FIELD ADOPTING THE MEASURE
TO REWARD AND RECOGNISE
DEDICATION TO CUSTOMER
SATISFACTION.

Customer engagement – shared know h₂ow

During 2017/18 we have engaged with more customers and stakeholders than ever before to help develop together our 2020-2025 business plan, which will be published in September 2018. Our engagement strategy "Shared know $h_{\rm 2}$ ow" seeks to develop a sustainable legacy by working together with all those who are impacted by our service. Partnerships with our community and all users of water will be the key to continuing to protect and improve the service we provide into the future.

We have worked closely with our independent Customer Challenge Group, led by chair Zoe McLeod, to develop our innovative engagement strategy both for the purposes of finalising a business plan driven by customer priorities and also to embed customer engagement in the way we do business day in day out. I would like to thank Zoe and her team for the challenge they have put to us during the year. In particular, their experience in identifying and understanding the needs of people in vulnerable circumstances is helping us develop our offering so our services are affordable and accessible at those times when they need support and protection the most.

Our draft water resources management plan was published in February 2018. This plan takes a long-term view (60 years) of how to ensure adequate supplies of water for both normal and drought conditions while balancing the needs of the natural environment on a sustainable basis. We engaged with customers to develop our draft plan, and have since held a 12 week public consultation during which time we have had 430 conversations with customers and met with more than 100 individual stakeholders to obtain feedback.

This public consultation has included holding eight drop-in sessions for the public to meet members of our team, a joint stakeholder event with other water companies in the south east region and numerous press and social media messages to encourage people to view the plans. Our web pages for the consultation received more than 1,900 visits during the period.

I'm pleased that many of the responses we received were very supportive of our plan - particularly the medium term need to develop new reservoirs at Broad Oak in Kent and Arlington in Sussex. Where we saw more challenge was around our ambitions for reducing customers' water use and overall leakage. We have listened to these challenges and have committed to deliver more ambitious plans to reduce demand for water both through reducing leakage and consumption, with a revised plan due to be published during summer 2018.

Engaging with others to develop our plans is important and will ensure customers are at the centre of our work. Ultimately it is continuing that engagement as we deliver the plan that will help us to realise our vision. We have seen the success of this collaborative approach over the last few years as we have strived to increase customer satisfaction with our service.

The "five-out-of-five" focus across the business continues to grow with employees from teams in both the office and the field adopting the measure to reward and recognise dedication to customer satisfaction. The Consumer Council for Water published a report in September 2017 that recognised our continuous improvement in customer service and highlighted our commitment to getting things right first time for customers. We have continued with the initiatives which have helped us achieve this including:

- increased digital communications such as 'My Account' with 60,029 customers signed up by April 2018, and an online 'in your area' map showing supply updates
- improved technology to help resolve customer queries, such as our dedicated digital team to support social media and live chat channels via our website
- encouraging ideas from employees and acting on feedback through our 'Pipe Up' ideas forum and employee workshops

Initiatives like these have seen our customer satisfaction measure scores increase to an average of 4.33 up from 4.28 in 2016/17 – customer satisfaction scores have increased slightly for all measures but most significantly for low pressure which has increased by 0.1.

Customers have told us it would make their lives easier to receive a combined bill rather than separate bills for drinking water from us and another one from Southern Water for wastewater services. This year we have teamed up with Southern Water to launch 'One Bill' – a single bill from South East Water that will also include Southern Water's wastewater charges too.

Designed to make things simpler for our shared customers, One Bill means customers only need to contact one company – South East Water – to make payments for both of the services they receive. This is an approach we have successfully followed for many years with Thames Water, and means now all our customers receive just the one bill, wherever they live.

This has been a significant project through the year and I commend the team for managing a complex billing transition smoothly for 465,466 customers.

With a project of this scale we anticipated a temporary rise in customer contacts and complaints due to the complexity of transferring thousands of accounts. As anticipated the project did lead to an increase in complaints, and together with those caused by the incident in March we have seen an increase in written complaints for the second half of the year, ending the year with 1,498 complaints compared to 1,400 the previous year. We are confident that now the transition is complete we can bring this number back down and continue our long-term improvement in reducing complaints, a fact already recognised by the Consumer Council for Water in its September 2017 report.

Our service incentive mechanism (SIM) score for 2017/18 was 85.6 out of 100 – a one point improvement on the previous year's score of 84.6. We are particularly pleased to see continued improvement in our qualitative SIM scores; in particular our billing scores are improving as a result of us billing on behalf of Southern Water as these have risen to 4.50 out of five, compared to 4.42 the previous year, which means that our combined billing and water scores this year bring us above industry average for the first time.

As part of our Board/Customer engagement programme, my fellow non-executive directors and I have spent time with the Customer Care team and have witnessed their dedication to supporting customers in vulnerable circumstances who may need extra support. They are always looking for opportunities to talk to customers and tell them about the services we offer, attending events from dementia cafes through to parent and toddler groups and working with partner organisations such as Citizens Advice to meet those who may need a helping hand. Throughout the year the team attended 45 per cent more events which enabled them to listen to customers about any issues they may have with their water services and offered ways to help manage their water bills. The team took an innovative approach this year by having specialist water efficiency training, run by Waterwise, so they can also provide advice to customers about further ways to manage their water use and see bill savings as a result. This proactive approach has led to a further 7,318 (a 32 per cent increase) customers benefiting from our support tariffs for those who are financially vulnerable and 12,903 (a 71 per cent increase) people being added to our priority services register to support their personal circumstances.

The Customer Care team has also worked with our digital specialists to find innovative ways to support customers with a range of issues via the ReciteMe system. Customers can now set visibility and language preferences on our website or have the content of our website spoken for those who can't see. The website can be translated into a number of different languages if English is not the user's first language. We are pleased to see that more than 26,000 customers have used the ReciteMe system during the year helping them engage with our business more easily.

Science and engineering excellence to deliver quality water

During the year we invested £96.0 million in new and existing assets as part of the £437 million investment planned for the period from 2015 to 2020. The expenditure in the year saw us install 11km of new pipelines and renew a further 36km of old pipelines across the region, continue our customer metering programme and improve our water treatment works. Schemes such as these are supporting our efforts to improve services for our customers and help safeguard the environment, and we are committed to continuing this level of investment.

Our largest capital scheme during this five year investment programme is the extension of our water treatment works at Bray, Berkshire which extracts water from the River Thames. The site is currently capable of treating up to 45 million litres of fresh drinking water per day and we plan to extend the works to be able to treat up to 68 million litres per day in order to secure water supplies for current and future customers across Berkshire, Surrey and Hampshire. The scheme was submitted for planning permission in November 2017 and work on the ground started in May 2018.

We also have our largest environmental programme of work taking place during this five year period through the Water Industry National Environment Programme (WINEP). Our catchment management partnership with Natural England has been recognised as industry leading, picking up the water resilience initiative at the Water Industry Awards, while our biodiversity programme has seen continued success with the reintroduction of the rare wart-biter cricket to our land at Deep Dean in East Sussex.

We strive to keep improving the quality of the water we supply. While we have maintained high overall water quality with 99.95 per cent of samples passing standards set by the Drinking Water Inspectorate (calendar year January to December 2017), we want to reduce the number of calls we receive about discoloured water which relate to naturally occurring, harmless deposits which build up over time.

To do this we are carrying out a flushing programme of approximately 900 miles of pipework per year to draw sediment deposits – such as iron and manganese – out of the network.

This year has been a particularly testing one operationally. We started the year working to ensure we managed our water resources following the dry winter experienced in 2016/17 by proactively moving water around our region to maintain supplies to customers without the need for temporary water restrictions. The winter of 2017/18 started dry again, but we have since seen increased rainfall later in the year which means as we move into the summer our water resources are in a good position.

The changeable weather during the winter put particular pressure on our distribution teams as they managed the impact of the various freeze/thaws on the network. Our supply interruption performance before March was good and April 2017 to the end of February 2018 our overall interruption performance for both planned and unplanned work was at 5.6 minutes per property (against our target of 12.0 minutes for the year). However the unprecedented "Beast from the East" freeze/thaw incident referred to previously had a major impact and our overall interruption performance for unplanned work for the full year as a whole deteriorated to 44.6 minutes.

Leakage is calculated to include leaks on customer pipes as well as our own, so this event also put our leakage target at risk as we saw a sudden rise in leaks across the network when the pipes thawed. When customer supplies were restored the incident team focussed on stepping up leakage activity to get back on target. The team had worked hard throughout the year to beat the target and therefore despite the severe weather we have been able to outperform our target of 90Ml/d, achieving 87.7Ml/d.

INVESTMENT IN TECHNOLOGY IS GIVING US THE OPPORTUNITY TO KEEP CUSTOMERS UPDATED WITH THE INFORMATION THEY NEED THROUGH OUR "IN YOUR AREA" PORTAL OPERATING ON THE WEBSITE.

We recognise the importance of regular and timely communication with customers during any supply interruption. Investment in technology is giving us the opportunity to keep customers updated with the information they need through our "in your area" portal operating on the website. It enables customers to enter their postcode to get up-todate information on work in their region that may affect them and receive texts or emails to keep them informed. This online information comes into its own during an incident and works well. This year we have sent more than 45,000 emails and 36,000 SMS text messages to help keep customers informed about our work; indeed during the major freeze/thaw event in March our website was viewed more than 320,000 times.

Non-household retail competition

On 1 April 2017 we, along with the other water companies in England and Wales, were ready for the opening of a new retail market for non-household customers. We welcomed the challenge and continue to work hard to ensure the new market is successful. Our dedicated Wholesale Service Desk is working closely with the new retailers to ensure a smooth transition and that the non-household customers continue to receive an excellent and reliable service.

We began the year with our non-household retail business, South East Water Choice operating within our supply region and the company had a good first year of trading. At the same time, Water Choice, owned by another company within our group of companies, Invicta Water Ltd, was offering water and wastewater retail services to all non-household customers across England. In April 2018 we transitioned South East Water Choice across to become one business owned by Invicta Water.

Invicta Water has subsequently sold the business to Castle Water with the completion of the sale on 1 July 2018. Castle Water has the scale and experience to build on the progress Water Choice has made since the market opened. South East Water is committed to providing an excellent wholesale service to all business retailers. We have worked closely with both Castle Water and Invicta Water during this period to ensure a smooth transition.

We look forward to building our relationships with all non-household retailers that operate within our region during 2018/19 as we concentrate on ensuring we provide an excellent wholesale customer service. Household customers in our region will continue to receive retail services exclusively from South East Water.

You can find out more about the new business retail market at open-water.org.uk

Financial results

The results published in this report describe our performance for the year and incorporate the performance of South East Water Ltd and South East Water (Finance) Ltd.

This year we have had a steady financial performance having generated an operating profit of £75.0 million for the year to 31 March 2018, compared with £79.0 million for the prior year. Our turnover was £224.8 million for the year compared to £218.9 million in the prior year.

Net operational costs have increased in the year to £158.7 million compared to £147.3 million in the prior year, an increase of £11.4 million. Included in this increase are additional costs of £2.1 million in respect of the major incident in March 2018, £2.2 million of additional business rates charges and £3.2 million additional depreciation on fixed assets.

Profit before tax has fallen by £1.6 million from £25.3 million to £23.7 million. Net finance costs have decreased in the year by £2.5 million to £51.2 million, offsetting the reduced operating performance. The decrease in net finance costs reflects the significantly smaller increase in the fair value of the group's interest rate swap liability in the year of £3.3 million (2017: £13.7 million). However, interest and indexation charges on the group's index linked loans and bonds have increased by £7.5 million to £52.5 million due to the significant upward movement in the Retail Price Index over the course of the year.

WE WILL WORK WITH OUR EMPLOYEES AND BUSINESS PARTNERS, TOGETHER WITH OUR CUSTOMERS AND STAKEHOLDERS, TO DEVELOP A SUSTAINABLE FUTURE FOR WATER IN OUR COMMUNITY OF THE SOUTH EAST.

Profit after tax has reduced from £27.1 million to £16.2 million, a reduction of £10.9 million which is driven by the additional operating costs noted above, an adjustment to the deferred tax treatment of the group's revaluation reserve resulting in a charge of £4.2 million and the tax benefit in the prior year of £6.2 million, due to the effect of changes in the future rate of corporation tax on deferred tax, not available in the 2017/18 financial year.

Overall the board is pleased with our financial performance in the year.

We want to ensure that South East Water is a trusted business and therefore our reporting aims to provide a transparent account of our performance and financial governance. We are this year carrying out further research with customers and stakeholders to ensure we continue to improve our reporting to ensure we are a trusted business.

Our people, working together towards future success

We want to ensure South East Water is the water company people want to work for – it's an integral part of our vision as we know great people, who see purpose in their work, are key to our future success. We are proud that this year we were shortlisted in three Water Industry Achievement Awards, including Water Company of the Year. Our people are proud of the job they do and the important role they play in our society.

Our health, safety and wellbeing strategy, Thrive 365, was launched at the end of last year. The strategy focusses on two strands, safe people and safe working, and is about more than just preventing accidents; it is about enhancing the overall wellbeing of our people.

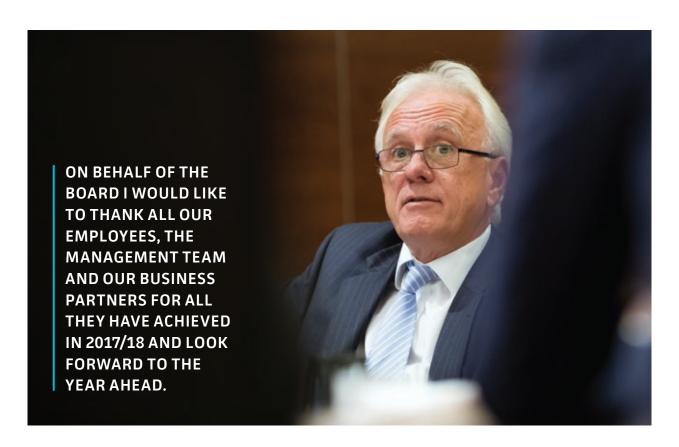
From a wellbeing perspective a number of activities go from strength to strength. One member of staff, Lee Allen, has set himself an impressive challenge and has now run 10km every day for more than 500 days. He has inspired a number of employees to increase their physical activities and there is now a thriving running club.

This year through this focus on fitness South East Water won the Kent Active Workplace Challenge, a competition involving 122 workplaces in Kent, we logged more activity than any other during the eight week challenge.

We work closely with every department to ensure safety is always the first thing that is considered before completing any task. During 2017/18 we unfortunately had two reportable accidents, one due to a strained shoulder injury, the other following a slip on some ice.

In March we published our gender pay gap report which shows an average hourly rate pay gap of 25 per cent, which is above the national average. We recognise that this is predominately due to more women working in our call centre, while more men are in technical operational roles. However, all our employees are paid the same for the same task. We also recognise that we have more men in senior leadership roles. Publishing this report is an important step to encourage a dialogue within the business about the gap and identify areas that require further attention.

We want to encourage more diversity across our business and the range of roles available to people. This includes thinking about our next generation of South East Water employees; that's why we have been developing our STEM (Science, Technology, Engineering and Maths) ambassador scheme, particularly led by women in our organisation to inspire a new generation to work in our industry.



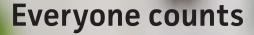
Supporting the continuous development of our employees has seen us deliver more than 10,000 hours of training and development through the year. We have also implemented a new employee review system, called iReview, which encourages employees to think about their own development, performance throughout the year and their ambitions for the future.

We welcome the appointment to the Board in June 2018 of Célia Pronto as an independent non-executive director. Célia brings her expertise in customer engagement and service improvement, digital engagement, e-commerce and technology and innovation to the board. She will help us expand our customer engagement and continue our efforts to place customers at the heart of what we do.

This year, maybe more than any other, has demonstrated the dedication of the workforce at South East Water. During the March freeze/thaw incident people from right across the business volunteered to help and took on roles outside their normal duties to ensure we were there for our customers. It is this passion and dedication to our business that comes through time and again from our employees. We will work with our employees and business partners, together with our customers and stakeholders, to develop a sustainable future for water in our community of the south east. On behalf of the Board I would like to thank all our employees, the management team and our business partners for all they have achieved in 2017/18 and look forward to the year ahead.

Nick Salmon

Chairman 13 July 2018



We inspire and motivate our people and partners

Competition

Can you invent a stylish and colourful water butt?

The best ideas will win a £so book voucher and a water butt for your school, so the more creative the better.

South East Water will judge the pictures at the end of each school term.

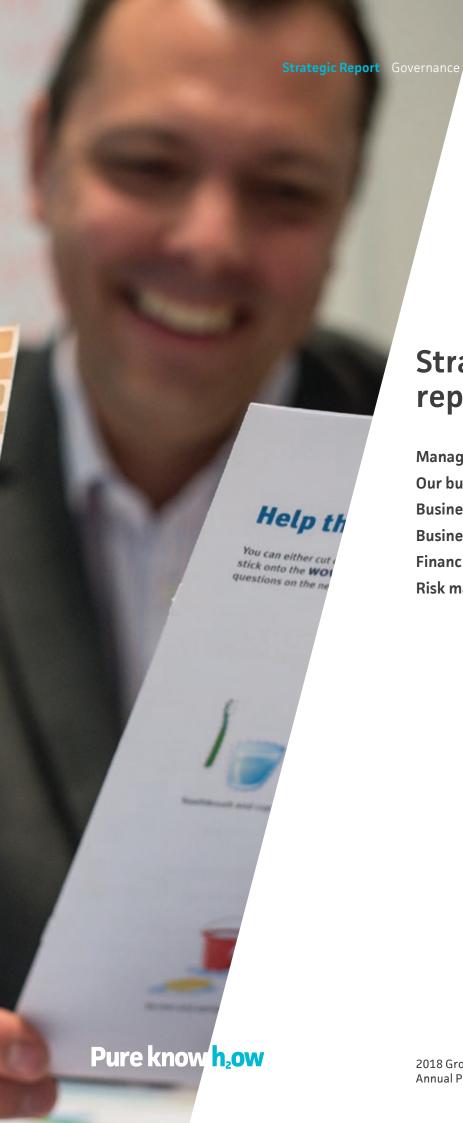


upand tounge stucks

Buckets Catch Extra Cain Water

World of Water

School competitions encourage young people to save water



Strategic report

Managing Director's introduction	16
Our business	25
Business environment	31
Business performance	40
Financial performance	41
Risk management	44

Financial statements Annual performance

Managing Director's introduction

I am pleased to present our annual report and financial statements for the year ended 31 March 2018.

This strategic report has been prepared to give you an understanding of South East Water, our business model and the environment in which we operate. This report details our business and financial performance during 2017/18 and the risks and opportunities our business faces and how we manage them.

The year 2017/18 has been one that has seen South East Water realise some significant achievements against our five business commitments which are important steps towards our vision of being the water company people want to be supplied by and want to work for.

Key highlights against our five commitments include:

Every customer counts – Delivering our "One Bill" initiative with Southern Water so that customers only need worry about one combined bill for water and wastewater services in future. Our qualitative SIM score for billing enquiries has improved during the year and is now at 4.5 out of five.

Everyone counts –87 per cent of employees completing their iReview so that everyone has a clear record of their performance, not just against objectives but also in the way they live the company values.

Every action counts – Delivering £96.0 million of investment to improve our infrastructure to deliver better water quality and reliability for customers.

Every drop counts – Our Customer Metering team was shortlisted for Team of the Year at the Utility Week Awards this year. Their efforts mean 84 per cent of customers now have a water meter and we have seen water savings of around 18 per cent through this programme.

Our future counts – Engaging with more than 9,000 customers to prepare both our business and water resources management plan and developing our "shared know h₂ow" engagement strategy for our long-term continued engagement.

Every customer counts

We believe customer satisfaction with our product, our services, our actions and behaviours is the best yardstick for everything we do. That's why it will remain a core theme of our future plans.

This ensures all customers, not just those who contact us, have a voice in improving our business. To ensure this throughout the year 1,600 customers were selected at random to take part in a telephone survey.

This survey is continuous and runs throughout the year, giving us real time feedback on our performance. We are the only company to take this approach and develop incentives truly based on customer satisfaction.

I am pleased to report we've seen a continuous improvement in our satisfaction levels and this year the average score is 4.33 out of five compared to 4.28 last year. This means that the majority of our customers are either satisfied or very satisfied with the service we provide. Please read our Performance, People and Planet report for a detailed review of all our satisfaction measures and activities and visit southeastwater.co.uk/feedback to get involved in our continuous engagement programme.

Importantly what we have learnt about our customers as a result of the satisfaction measures in place is being fed into our 2020-2025 business planning process. Significantly we've realised it is important that we do not think about our purpose in terms of supporting an 'average' customer, but instead recognise that our customers have different needs and priorities.

We have this year completed work to move away from the notion of planning our services for the 'average customer' and evolved an approach that is more targeted and tailored for customers. This work has been developed in collaboration with our Customer Challenge Group and customer and stakeholder workshops, their input and advice has influenced our work and helped us develop a more customer centric plan.

I AM PLEASED TO REPORT WE'VE SEEN A CONTINUOUS IMPROVEMENT IN OUR SATISFACTION LEVELS AND THIS YEAR THE AVERAGE SCORE IS 4.31 OUT OF FIVE COMPARED TO 4.28 LAST YEAR.

We have carried out a piece of work to segment customers based on their attitudes and values of water. This attitudinal segmentation enables us to understand how people prefer us to communicate with them, to test material to ensure we meet their personal preferences and to have a much deeper understanding of our customers. We have begun to measure the satisfaction scores per segment to see if there are differences in satisfaction and help us target improvements to have more impact.

A key initiative during the year has been the development of our website and digital offerings for customers. In November 2017 we launched our new website which takes a "mobile first" approach. The "My Account" online service is integrated into our main website, which means customers can log-in straight away. It is accessible from mobile and tablet devices, and people can simply sign in with an email address. At the end of the year we had 60,029 customers now logged on and using My Account.

Our digital team has also looked to find innovative ways to support customers who need extra help, and we are pleased to see the use of ReciteMe on our website has been used by 26,000 customers during the year.

This year we have seen a small increase in the number of customer complaints to 1,498, from 1,400 in 2016/17. While we are disappointed to see any increase, the increase was due to our extensive proactive contact with customers as we implemented the "One Bill" project and took on the management for Southern Water of the wastewater billing services for our mutual customers.

While the project implementation has seen a small impact on our complaint levels this year, we believe the long-term benefits for customers make this worthwhile and we have already seen an impact on our billing SIM scores which has increased this year to 4.5 out of five. We believe reducing the confusion for customers of having two separate bills is going to make a long-term positive impact and it is something that many customers and stakeholders have asked for.

Throughout the year our customer care team has been supporting customers who need support to either access our services, afford their water bill or require some protection if anything goes wrong with our service. They are always looking for opportunities to listen to customers and also advise them about the services we offer. As a result their efforts have seen us increase those on our social tariff from 9,471 to 16,548. We have also improved take up and interest in our priority services register which had 12,903 people added during the year.

We are continuing to work on ensuring that, as a business, our approach and services are fully inclusive and that we deliver a five-out-of-five customer service for all. The business, all the way from our shareholders through to our front line customer staff, is developing a new vulnerability strategy which will form a key part of our business plan, to be published in September 2018. We have worked with vulnerability engagement specialists to listen to those who are already experiencing the services we offer and/or want greater protection so they feel safe and cared about; and those third party agencies who represent their interests and understand the issues. The approaches that our strategy will adopt will ensure that all customers can access services and when we have a service disruption will ensure that customers who need our support receive it.

Managing Director's introduction continued

Everyone counts

Health, safety and wellbeing is fundamental to both our vision and our everyone counts business commitment, that is why we launched our Thrive 365 strategy to ensure we keep this at the forefront of everyone's mind. The strategy has a particular emphasis on willingness to intervene and the importance of personal ownership.

Some notable achievements in the year include:

- leakage and metering teams, and associated contractors, held a health and safety conference
- all Production technicians received refresher gas safety training and participated in emergency drills
- specialist road safety experience training for 20 employees delivered by Kent Fire and Rescue
- South East Water came top out of 122 workplaces competing in the Active Workplace Challenge.
 Well done to all!

Unfortunately we had two reportable accidents during the year, one due to a shoulder strain moving a gate, another a slip on an icy step outside a customer property.

We have continued to work hard to both inspire and motivate our people and partners.

In particular this year has seen us launch a new employee performance management framework called iReview. This is a system created to support the business objective of employee self-assessment.

Developed in collaboration with managers and staff through focus groups, iReview replaced the system of appraisals and 1-2-1s and has been designed to provide a more continuous approach of regular feedback from managers and recognition of achievements. Employees are able to assess their own performance against objectives as well as the new behavioural framework, tied to our values.

This approach puts employees in the driving seat of their development and we are delighted that we have ensured 87 per cent completion in this first year. As always there are lessons learned and employee feedback is contributing to improvements ready for next year.

Our talent and organisational development team has helped deliver 10,221 hours of training to colleagues.

We have also introduced more informal learning within the business, for example our operational and senior management teams are now receiving emails from "Clever Nelly", a system that uses algorithms to track progress against learning and to keep challenging individuals in areas they need to improve their knowledge through daily questions.

In September 2017 more than 400 employees came together to celebrate the stars of our business. This is our biennial awards programme where colleagues nominate their teams, projects and colleagues for recognition. We were pleased that more than 500 nominations were received and the judges had a difficult job deciding on the eventual winners due to the high standard. Congratulations to all those nominated, our finalists and winners.

Employee development is very important to us and we were delighted to welcome five new apprentices to our business into our customer service team. The new recruits were only a few weeks in when the freezing weather descended and did a great job helping support customers who called us and we were proud of their hard work.

Our intranet (named Gurgle) has continued to be an important channel for sharing news and views across the business. During the year there have been more than 463,000 page visits and 247 blogs published by colleagues to share news about their work.

In particular, Gurgle has been important in sharing key messages, such as cyber security advice and preparations for GDPR legislation that came into force in May 2018. The use of video has been a useful way to share messages in a quick and engaging way and we have published 14 videos on Gurgle during the year.

Importantly, our intranet allows open dialogue on a range of company issues. Following the winter weather and subsequent supply issues for customers we created a forum within our "Pipe Up" innovation area and more than 33 posts with ideas for improvement were shared.

The value of the intranet to our employment was highlighted this year as it picked up the "best success story" award at the Interact Awards in December 2017.

Congratulations go to all the teams and projects that received industry recognition through shortlisting in a number of awards during the year, including three categories at the Water Industry Achievement Awards.

During the year we have been shortlisted in:

- Utility Week Awards Customer facing team of the year
- Utility Week Stars Awards Constellation award for collaborative work with a customer community/education
- Utility Week Stars Awards Data demon award (won)
- Interact Intranet Awards Best success story (won)
- Water Industry Achievement Awards Water company of the year
- Water Industry Achievement Awards Customer service initiative of the year
- Water Industry Achievement Awards Water resilience initiative of the year

THE INTRANET IS ONE OF OUR SUCCESS STORIES OF THE YEAR AS IT PICKED UP THE "BEST SUCCESS STORY" AWARD AT THE INTERACT AWARDS IN DECEMBER 2017.

We are proud of our "Your Water Use" programme for winning in the "Data Demon" the Utility Week Stars Award in June 2017. This programme saw us join forces with behavioural science experts Advizzo to develop new innovative approaches to empower customers to better understand their water use (see page 36 for details of the project).

Every action counts

This is our commitment to ensure everything we do is safe, effective and efficient. We know this is important to ensure we continue to deliver a reliable supply of water to our customers and that our infrastructure is resilient into the long-term.

We invest around £18 million a year on the detection and repair of leaks and bursts. Most are not visible but by using the very latest technology we stop millions of litres of water being lost. The Aquanet system for example, invented by our in-house teams, has become a vital analysis tool for identifying those pipes which leak as little as 0.05 litres a second, more on this system can be found on page 35.

This year has been a particularly testing time for the operational teams as fluctuating winter temperatures and the dry autumn/winter caused ground movements. Despite this the number of burst water mains reduced from 3,032 in 2016/17 to 2,747.

We worked hard to reduce the length of any interruptions to supply from these bursts and had set ourselves a target for the year of an average interruption time of 12 minutes per property per year.

During the period April 2017 to February 2018 we had met this target and were tracking at 5.6 minutes. Then at the end of February freezing temperatures hit our region and led to us missing the target with a final interruptions score of 44.6 minutes per property for the year.

Managing Director's introduction continued

We can see the impact changing weather can make, not just to our customers' properties, but also to our network and we need to ensure this is robust to these changing patterns. That is why our continued investment in our water infrastructure is crucial.

This was the third year of our five year investment period and we delivered £96.0 million of capital investment. Important schemes during the year included preparations for the extension of the Keleher water treatment works at Bray in Berkshire, which will be the largest project in our five year programme of work and works to upgrade the treatment processes at Groombridge in Kent and Hazards Green in Sussex.

We also continued our customer metering programme which has now installed more than 336,260 meters meaning 84 per cent of our customers are now metered.

WE KNOW THAT CUSTOMERS EXPECT TO SEE US PLAYING OUR PART BEFORE WE ASK THEM TO SAVE WATER, WHICH IS WHY OUR LEAKAGE TEAM HAS AGAIN STRIVED TO REDUCE LEAKAGE FURTHER THAN OUR TARGET.

Ensuring we continue to improve the quality of the water we supply is a key priority. We have maintained high overall water quality with 99.95 per cent of samples passing standards set by the Drinking Water Inspectorate (as this is calculated on a calendar year basis this is the figure from January to December 2017). We have also been working to improve the appearance of the water we supply and reduce the number of customers who contact us due to discoloured water. This year we have seen a 15 per cent drop in the contact rate reduced from 0.96 contacts per thousand customers in 2016/17 to 0.82 contacts per thousand customers in 2017/18. We have achieved this through our pipe flushing programme of approximately 900 miles during the year and improvements at our water treatment works. We also laid 36km of new water mains which will improve water quality and reduce leakage.

Every drop counts

The winter of 2016/17 was particularly dry with rainfall being approximately 68 per cent of long-term average rainfall. We therefore spent this year prudently preparing for a second dry winter. This included setting up a drought management team and collaborating with our neighbouring water companies.

We were able to ensure we kept our reservoirs at a high level to preserve stocks ready for summer 2018. During the year we published our draft drought plan which has included considering more severe droughts than those witnessed historically, we expect to publish our final plan in 2018 following approval from Defra.

In December we launched a "Winter Water Counts" promotion with the KM Group together with Affinity Water and Southern Water. This joint sponsorship of the website weather pages led to 40,000 views of our message and 277 clicks through to more information.

We collaborated with education organisation, So Sussex, during the year to sponsor the wild art trail at the Elderflower Fields Festival. We also spoke to more than 400 children and their parents at the family festival in the heart of the Ashdown Forest who each made a water wish for the future and a pledge to save water. So Sussex also delivered an enhanced schools programme for us with 180 pupils from six primary school classes in Newhaven and Peacehaven receiving a "Water Matters" talk which involved outside learning about water and the treatment of water.

This was on top of our own popular "World of Water" schools programme which saw a further 1,375 pupils have a school talk during the year, while our water efficiency trailer attended 40 community events across the region.

We continue to support customers as they work to save water and this year have become supporters of Waterwise to work more closely with this environmental organisation to encourage water saving nationally and develop a culture of water saving behaviour in the UK.

We installed 38,260 meters during the year, providing advice and water efficiency devices to those customers. Our partnership with Save Water Save Money saw more than 33,500 customer orders for a range of water saving products.

We know that customers expect to see us playing our part before we ask them to save water, which is why our leakage team has again strived to reduce leakage further than our target. The team was on track to deliver a leakage level of below 85Ml/d, however the impact of the severe freeze/thaw event in March meant we missed this outperformance but, by working around the clock, the team managed to ensure we remained under the target agreed with Ofwat of 90Ml/d at 87.7Ml/d.

The winter of 2017/18 had a dry start, but later months rainfall and snow meant we have seen approximately 98 per cent of long-term average rainfall. We continue to carefully monitor our resources and will encourage our customers to use water wisely whatever the weather.

Our future counts

To ensure the sustainability of the business we must ensure that our financial performance continues to be satisfactory. Our revenue was £224.8 million (2017: £218.9 million). Our profit before tax for the year was £23.7 million (2017: £25.3 million). Further details of our financial performance are set out on page 41.

Our cyber controls helped us successfully evade the Wannacry and NotPetya attacks of 2017. However as cyber threats continued to increase in volume and complexity, we invested in advanced cyber defence tools and employee training and awareness schemes to protect our systems and our customers' data from attack.

We engaged a Security Operations Centre (SOC) to help monitor our network 24x7x365 and to alert us of any anomalous behaviour in and out of hours. We worked closely with Defra and the National Cyber Security Centre to ensure that emerging threats are understood and mitigating actions are in place. This included a cyber incident exercise involving IT, Security and Operations staff where our response to a number of scenarios was tested. We also were successful in renewing our Cyber Essentials Plus certification under the UK government-backed scheme to assess organisations' security controls.

The Communications, HR and IT teams worked closely together to combat the most prolific cyber threat - "phishing". Using the theme *Monsters! Don't let them in!*, a series of articles and an online video training module were rolled out to all employees. To help everyone manage the growing number and

complexity of passwords they need to remember, a password 'locker' solution was implemented. New email and web filtering solutions also were rolled out to take advantage of the latest cyber defence capabilities.

This year the market opened for non-household competition on the 1 April 2017. Our teams' extensive work in preparation for this meant that both the wholesale and retail parts of our business were ready for this and the opening went smoothly.

South East Water Choice was initially set up as a retailer for non-household customers within the South East Water supply area. The team worked hard through the year to provide good service to those customers. However, it made sense that this business transitioned to join Invicta Water Ltd that was operating across a wider geographical area. This transition took place in April 2018. Invicta Water has subsequently sold the business to Castle Water with the completion of the sale on 1 July 2018. Castle Water has the scale and experience to build on the progress Water Choice has made since the market opened.

South East Water's focus is now on providing excellent wholesale and household retail experience and we look forward to continuing to build our relationship with the retailers operating within our supply region.

Our five year National Environment Programme is the largest specific environmental investment we have made with 42 schemes due to bring real benefits to our natural habitats by 2020. Further to this, during the year we met all of our statutory environmental obligations, which included:

- delivering two new eel screens on our abstraction intakes on the Eastern Rother and Wallers Haven (ahead of the statutory deadline)
- catchment management work on five surface water and five groundwater catchments
- completing a joint investigation with Thames Water on sustainable abstractions on the River Darent
- completing an investigation into the sustainability of two of our abstractions on the Itchel Brook and River Hart
- delivered 10 biodiversity pilot projects to proactively manage our sites to develop rare, priority chalk grassland habitat

Managing Director's introduction continued

There have been many environmental highlights during this financial year including our innovative approach to nitrate pollution at Woodgarston, catchment management crop trials using maize on the River Cuckmere together with only one metaldehyde exceedance of the raw water abstraction on the lower reaches of the River Cuckmere.

This together with our partnership project on the River Ouse where we worked with the National Trust to reconnect the river back to its original flood plain has shown us how catchment partnership work can bring dividends for both the environment and for us as a water provider. It is this work that has led the team winning the Water Industry Achievement Awards this year for their innovative approach.

One area that we are particularly excited about is a partnership project with the South East Rivers Trust and Kent County Council. This project, PROWATER (Protecting and Restoring Raw Water through actions in the landscape) is an Interreg 2 Seas application submitted in September 2017. PROWATER is a unique project to tackle the water scarcity challenge with the aim of building environmentally resilient catchments by enhancing infiltration and water retention of landscapes in areas of strategic importance for drinking water production. In December 2017 we heard that the project had been successful. The project will be delivered over a four year period at a cost of 5.5 million euros, primarily funded by the EU, but also project partners. The project will also bring together other partners from Belgium, Netherlands, England and France.

This year South East Water maintained our position in the highest category of Ofwat's annual assessment on the quality of information and assurance that all water companies provide customers and stakeholders. This rating demonstrates our commitment to providing high quality information and assurance to our customers and stakeholders.

The level of assurance that we undertake is determined by the risk associated with the activity and the importance to stakeholders or customers. The higher the risk or importance identified the greater the level of assurance that is required to ensure that stakeholders trust and feel confident in the publication that we provide.

We are grateful to the many stakeholders, especially members of our Customer Challenge Group and customers, who provided feedback on our reports last year. Their views were invaluable and really helped us to improve the quality of our reports. This year we have developed summary documents and social media content to run alongside the main reports to help engage even more people in understanding our performance.

Day-to-day across our business our employees work closely with customers and stakeholders to learn lessons and ensure we are focused on customer priorities. It is this experience that means we recognise the value of engaging with our customers and stakeholders and finding ways to have conversations and ongoing dialogue about our work.

This year in particular we have been preparing our water resources management plan (WRMP) that looks 60 years into the future to ensure we can continue to deliver a resilient water supply service and meet the key challenges of our region.

We published our draft WRMP on 26 February 2018 and have held a 12 week public consultation that ended on 21 May 2018. During the consultation period we promoted our plan through the media, undertaking interviews, meeting with stakeholder groups, undertaking customer research and holding public exhibitions across our area. The consultation attracted very good levels of interest with 147 people submitting representations on the plan, overall feedback has been very positive.

Where we received challenge was to see us consider more ambitious levels of leakage reductions to 2025 (and beyond), and adopt more ambitious forecast of long-term per capita consumption reductions.

In response we have modelled a number of alternative plans that address this feedback and tested acceptability of these with customers. We will be publishing a statement of response and revised plan in July 2018 that reflects the changes we are making as a result of this consultation.

During 2017/18 we have also been preparing our next business plan, which we will publish in September 2018. During the year we have engaged with more than 9,000 customers and stakeholders to help develop this plan together.



Our engagement approach is called "shared know h_2 ow" as we believe it is only through partnership with our communities and all consumers of water that we can continue to protect and improve the service we provide into the future. For us this is about an ongoing strategy that provides a foundation for continuing conversations year round to keep providing insight that can influence the way we do business.

Our Customer Challenge Group has played a key part in shaping our approach, the group was set up for three main reasons:

- to hold South East Water to account for the promises it has made to its customers and the communities in its region
- to challenge South East Water to engage with and listen to its diverse consumers and communities, and to reflect those views in the decisions that it makes every day. This includes important decisions for its upcoming business plan for 2020-25 on the environment, levels of service, support for customers with additional needs, and how much customers should pay for their water
- to provide feedback to the water regulator Ofwat on how well South East Water has engaged with and listened to its customers and acted on what they have said

The group is led by chair Zoe McLeod, who specialises in policy, communications and regulation issues - with particular emphasis on vulnerable groups.

Thank you to Zoe and the group not only, for their strong challenge during the year, but also for their encouragement as we have developed our plans. Their insight is helping us to create a better plan and in particular improving our strategy for customers in vulnerable circumstances and our responsible business approach.

Thank you

As we sign off the year 2017/18 I look back at all that happened during the year and am grateful to all our employees and those organisations that work with us for the passion, hard work and absolute dedication to our customers that I see in action day-in-day-out. I am looking forward to sharing our business plan later in the year and know that together we can deliver really outstanding service for our customers, the local community we serve and secure a lasting sustainable legacy for South East Water.

Paul Butler

Managing Director 13 July 2018



Our business

Our vision and strategy

Our vision for the future is to be the water company people want to be supplied by and want to work for. It puts both customers and our people at the heart of what we do.

Achieving our vision

To support the delivery of our vision we have five commitments which help us focus on how we run our business today and how we plan for the long-term, with our employees ensuring our customers are the priority in everything we do.

- Every customer counts Our customers' priorities lie at the heart of everything we do
- Everyone counts We inspire and motivate our people and partners
- Every action counts Our operational performance is safe, effective and efficient
- Every drop counts Our infrastructure delivers a reliable service to our customers
- Our future counts We plan effectively for the long-term

Our core values

Core values support our vision and commitments, and reflect what South East Water is all about.

Through workshops and interviews with employees talking about what it's like to work here, what our people stand for and what characterises the way we deliver our service, we created and defined our own unique set of core values:

Trust – Dependable, safe and sound, as a team always delivering on our commitments. Guardians of the environment

Passion – Dedicated to delivering a safe, reliable service, always caring for our customers and each other

Agility – Responsive, flexible and adapting quickly to change

Creativity – Fresh thinking, improving, never standing still

Excellence – Striving at all times to be the best and deliver the best

Our business strategy

Planning for water is a long-term business, which is why it is important we set out the opportunities and challenges we face in the future.

There are some considerable challenges for companies such as ours, which operate in a region which has been designated as being in serious water stress. The biggest of these is the need to meet the demand for water, from customers of today, and the customers of tomorrow.

It is vital we look a long way ahead to anticipate the changes and challenges that could impact our work in the future. The challenges we face include:

- Rising numbers of homes and people
- Meeting customer demand for water
- · Climate change
- Maintaining supplies
- · Customers' changing expectations

We put customers centre stage of our business strategy, while ensuring we take account of all our other legal and financial obligations, which has meant we have a clear direction of travel; one which we believe is better signposted as a result of our innovative and holistic approach to measuring our future performance through outcomes.

To develop our 2015 to 2020 plan we consulted with more than 8,000 people with an interest in our business, from customers and employees, through to community leaders and investors, to ensure we had developed a strategy that met their expectations.

Their feedback helped us to develop our five year Business Plan and to develop our Corporate Plan. This has led to the development of the five commitments, each of which leads to our customer outcomes which we measure to assess our current performance.

Read more online at corporate.southeastwater.co.uk/about-us/our-plans/business-plan-2015-to-2020

Water resources for the future

Every five years we update our water resources management plan (WRMP) which looks at how we'll keep your taps running while striking that delicate balance between protecting the environment and keeping bills affordable.

Since we published our previous plan in 2014 we have:

- reduced the amount of water lost through leaks, exceeding our target
- metered 80 per cent of our customers
- reached more than 22,000 people as part of our award-winning targeted behaviour change campaign

Previously these plans looked 25 years into the future, but because the south east faces a number of unique challenges, we've taken the decision to look forward 60 years to 2080.

By doing this we can make sure the work we do now lays the best foundation for future generations.

Over the next 60 years the population in our supply area is set to increase 53 per cent to 3.34 million. To ensure all existing and new customers continue to receive a reliable tap water supply we need to increase the amount of water available by an extra 294.2 million litres a day by 2080.

Our latest plan includes proposals for making what water we already have go further – by reducing leaks on our pipes further and developing water efficiency programmes.

Although this will help, these measures alone won't be enough to meet the predicted shortfall in water. Our larger scale proposals include:

2020 to 2045:

- building a new water treatment works at the former Aylesford Newsprint site, Kent by 2023
- upgrading existing water treatment works at Ford WTW in east Kent by 2027
- developing a water re-use scheme at Peacehaven, East Sussex by 2028
- building a new reservoir next to our existing Arlington Reservoir, East Sussex by 2032
- creating a new reservoir in Broad Oak, Kent by 2033
- a water re-use scheme at Aylesford, Kent by 2038
- developing a regional water transfer scheme from SES Water

Long-term considerations between 2045 and 2080:

- desalination at Eastbourne, Reculver and the River Medway
- water re-use on the River Stour, east Kent
- a new reservoir in West Sussex
- new raw water abstraction and treatment works from the River Thames near Maidenhead, Berkshire
- regional water transfers from Portsmouth and Thames Water
- a new groundwater resource near Farnborough, Hampshire

By planning so far in advance we can find the most sustainable long-term options to meet the demands of both our existing and our anticipated new customers. Our planning supports the 'twin track' approach to ensure that we adopt the best options to manage both customer demand for water and the development of the most sustainable sources of supply.

We asked for customers' views while we developed our plans and thank everyone who took part in the consultation process. In particular we are grateful to the members of our Environment Focus Group who have challenged our approach and helped ensure we develop an acceptable, resilient and innovative plan.

Following the public consultation which concluded on 21 May 2018 we are now preparing a revised plan that takes on board much of the feedback we have received about the draft plan. The revised plan will be published later this summer.

Read more online at southeastwater.co.uk/yourwateryoursay

Our objectives

We use outcome delivery incentives (ODIs) to measure our progress towards achieving our goals and priorities. We have published a summary of our performance against these ODIs in our annual performance report. We have also published our performance, people and planet report 2017-18 which provides much more detail on each of the ODIs, the challenges we face and our future plans to ensure we continue to improve, and further develop our focus on customer and stakeholder outcomes.

We have been engaging with customers to help us set our future priorities and prepare our outcomes for the next business plan that will cover the period 2020 to 2025. We will be publishing our plan in September – the priorities we have developed aim to exceed customers' expectations for us to ensure health and wellbeing through a quality, reliable water service, and improving the environment to secure a resilient service for the future. They also include commitments to ensure we are supporting all our customers, including those who are vulnerable.

Our business model

We deliver water to our customers. We do this by applying our pure know h_2 ow to the process of collecting, storing, abstracting, treating and transporting water using the infrastructure (reservoirs, treatment works, pipes and pumps) that we build and maintain.

We rely on the environment to provide us with the water resources to meet customer demand. Throughout our history we have put the quality of our water resource and protection of the environment that our water comes from at the heart of what we do. With increasing stresses on our environment, our history provides us with the platform for continuing to create value and meeting stakeholder expectations in the short and long-term.

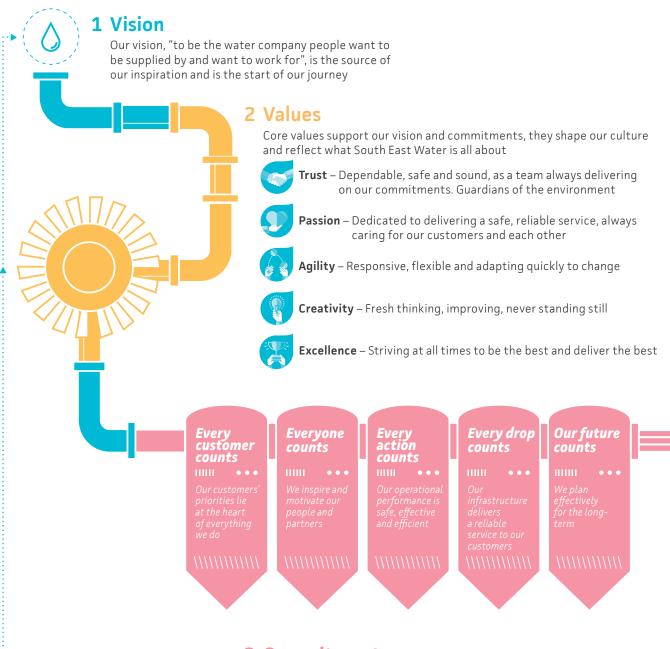
All our activities are regulated by Ofwat which is our economic regulator and has a duty to protect the interests of consumers. We operate under an instrument of appointment issued under the Water Industry Act 1991. Every five years under the terms of our licence and as part of the industry price review we submit a business plan to Ofwat. Our business plan sets out the costs that we expect will be required to run the water network and the capital investment we expect will be required to maintain a high quality of service to our customers.

These business requirements are used to determine appropriate tariffs for our customers which are set out in our charges schemes. Our revenues and costs are regulated by Ofwat as are our returns to investors. There are three price controls for the wholesale business, the retail household business and the non-household retail business.

Our business model has evolved with the opening of the non-household retail market on 1 April 2017 and the continued development of competition in the provision of water infrastructure and supply to new development sites by other water companies. We have significantly reviewed the way we operate for market opening and functionally separated our non-household retail business (which has since been sold to another retail business) from South East Water's wholesale and household retail business. Therefore we are now concentrating on retail services for household customers and ensuring we provide an excellent wholesale service to all that use the water we produce and supply.

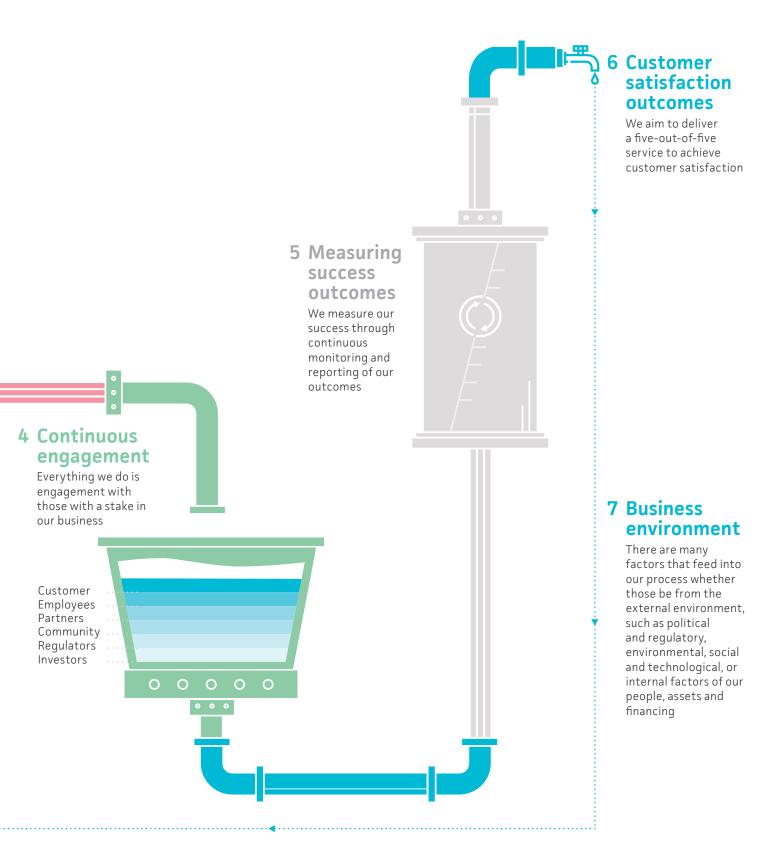
There are further changes on the horizon with new price controls for water resources and the operation of our network (Network Plus) replacing the single wholesale price control. This is designed to enable further innovation and potential competition for water resources. While we continue to provide the same services to our customers within a defined regulatory framework, we are also increasingly subject to competitive pressures and must adapt our strategy to this changing environment.

How we do business



3 Commitments

We developed five commitments which ensure we will reach our vision



Creating value by being a responsible business

Our business creates value in a variety of ways:

- value for customers maintaining and investing in our infrastructure to ensure current and future customer demand for water is met. Achieving customer outcomes
- value for the environment protecting and enhancing the environment
- value for employees providing training and fulfilling jobs
- value for our communities enabling communities to develop and thrive thanks to a reliable water infrastructure
- value for investors providing stable returns by anticipating and managing emerging risks and identifying new business opportunities

We believe that by focusing on creating and delivering value across these different dimensions we will be able to achieve our ambition of being a responsible business, one that creates value for, and is valued by, our stakeholders and society.

Taking the long view

We have a rich history of taking a long-term view: making decisions that balance meeting the needs of customers today with ensuring we can provide a quality service for our customers of the future. We design and build our infrastructure to meet expected changes in demand and environmental conditions.

We raise money for our investment programme from financial institutions like pension funds who take a long-term view and seek steady, reliable and reasonable returns on their investment.

The price that we charge our customers is regulated by Ofwat and set for a five-year period at a level that reflects the expected cost of running our business and funding our investment programme. Customer bills are inflation linked so providing some protection to the impact of increased operating costs, but we have to think about how best to manage the risks to the business of events not included in the prices set by Ofwat.

Increasingly, these risks may arise from environmental and societal factors beyond our control such as the extremely cold weather conditions we experienced earlier this year that led to customer pipes bursting. As the next five year price period is for the period 2020-2025 our business planning has been based on a good understanding of the medium to long-term business and external environment.

Engaging with stakeholders

To help develop our Business Plan for 2020-25 we developed a comprehensive engagement programme to ensure we capture all the differing views of our customers and stakeholders about their priorities and service expectations both now and in the future. This programme has seen us engage with more than 9,000 customers and stakeholders to help us build our plans.

We have more recently started engaging stakeholders about their views on changing societal needs and emerging issues for the next decade and their expectations of South East Water. This work will continue during 2018/19 and help to shape our strategy for being a responsible business and to identify emerging risks and opportunities relating to the long-term success of the business.

Reporting on value creation

Over the last few years we have worked hard to improve our reporting and ensure transparency. Our intention is during the next year we evolve this to ensure we are following the principles of Integrated Reporting as set out by the International Integrated Reporting Council, a global coalition promoting communication about value creation as the next step in the evolution of reporting.

Being part of the solution

We recognise that as a water company we cannot solve the many challenges that our communities face on our own. We are seeking to engage more deeply with different stakeholders to understand how value will be created over the longer term, what the role of South East Water is, who we should collaborate with, and what actions we need to take. We seek to be part of the solution to making our communities and our environment healthy and thriving.

Business environment

External environment

Political and regulatory

We operate within a strict regulatory environment and work closely with our regulators to ensure that we are delivering a great service for our customers both now and in the future.

- The Water Services Regulation Authority (Ofwat) regulates our prices and levels of customer service
- The Drinking Water Inspectorate (DWI) monitors drinking water quality
- The Environment Agency (EA) covers environmental protection
- The Consumer Council for Water (CCWater) represents customers' interests
- WATRS Water Redress Scheme is an independent service designed to adjudicate disputes that have not been resolved through the water company's customer service teams or by referring the matter to the Consumer Council for Water
- Natural England (NE) is responsible for the protection of designated sites for nature conservation
- Department for Environment, Food and Rural Affairs (Defra) deals with all aspects of policy relating to the water industry and we operate under a licence granted by the Secretary of State
- Centre for the Protection of National Infrastructure (CPNI) is the government authority for protective security advice to the UK national infrastructure

Our code of practice, "your water company" provides more details on who our regulators are and what they do.

The political and regulatory environment changes significantly over time and we ensure South East Water is able to respond to these changes and where appropriate influence future policy through our participation in consultations and as active members of the water industry trade body Water UK.

Our aim is to ensure any changes that affect the outcome for our customers, shareholders and other stakeholders are positive.

As we prepare for the next price review (PR19) that sets prices for 2020-2025 we will work closely with all of our regulators to ensure we develop our plans collaboratively with them, our customers and other stakeholders.

Environmental

Our business clearly relies on a secure supply of our natural resource – water. We must ensure we protect both the quantity and quality of our key resource.

Rainfall in the South East of England is lower than other parts of the country and we are officially designated as an area of serious water stress. Our water resources management plan (see page 26 for details) is key to our management of our precious resource.

As well as ensuring we have the supplies we need, now and into the future, we can also protect the quality of that water and reduce energy use through more efficient treatment processes.

We recognise that good effective environmental management must be at the heart of all of our water supply operations, which is why it is embedded into all aspects of our work. It is something that we do every day through the management of our assets, delivery of our product and investment in the community in which we serve. live and work.

Government and our industry are working together to understand future needs for water and we were active members of an industry-led project to look to improve resilience of water in the UK, details of which were published in our Water Resources Longterm Planning Framework in September 2016.

Our planning into the future includes considering the effects of climate change, working to protect the environment from pollution in our activities and reducing our carbon footprint.

Business environment continued

Our education programme continues to introduce pupils to the "wonderful world of water" and we visited 36 school classes during 2017/18 and gave out 33,500 water efficiency devices to customers across our region to help encourage a sustainable use of water.

Our careful stewardship of the 2,000 hectares of land we own ensures our groundwater sources produce a top quality product as the natural filtering through underground aquifers means minimal additional treatment is needed.

Where our water is sourced from surface water, such as rivers and reservoirs, we are working with local communities to improve the quality of the water within the catchment. Our water and farming partnership sees us work together with Natural England to support farmers with the management of the water catchment in their area.

We realise, as significant landowners ourselves, we have tremendous responsibility in looking after 33 sites which are within areas of Special Scientific Interest including the national nature reserve, Lullington Heath in East Sussex, two nature reserves, Arlington Reservoir and Ardingly Reservoir in Sussex and numerous areas of outstanding natural beauty.

How we do this is the result of many years of careful and sensitive management of a wide variety of flora and fauna flourishing on our sites and we often work in partnership with organisations such as Natural England and various wildlife trusts.

We are investing £16.7 million in our national environmental programme over the five year period to complete 42 schemes that cover various aspects of our operations.

These include biodiversity, surface and groundwater catchment management, abstraction, the installation of flow meters and the implementation of new eel regulations which seek to protect an endangered species at risk from water treatment processes.

This year we have delivered 10 biodiversity pilot projects. The aim of our pilots has been to establish the current value of the sites, and to proactively manage the sites to develop rare, priority chalk grassland habitat. To deliver this work our environmental team has delivered 79 invertebrate surveys, three botanical surveys, six dormice surveys and 24 reptile surveys.

One such project has resulted in the successful reintroduction of a near extinct species of cricket to the chalk grasslands around one of our water treatment works in East Sussex, work that Natural England described as being "instrumental in securing the future survival of the wart-biter in England."

This large cricket, whose name is derived from the ancient Swedish medical practice of using them to bite off skin warts, was once seen in numerous UK sites but their numbers have declined so dramatically that they are now only found in five locations. Make that six now that the wart-biter has made a home in Deep Dean, thanks to an extensive programme to create the correct environment and habitat to successfully reintroduce this dark green, ground-dwelling cricket.

The work has capitalised in further biodiversity gains as rare birds, butterflies and other scarce species have also been attracted to the site.

The environment team implemented a plan, which began in 1997 to work with local farmers, Natural England and volunteers from the South Downs National Park, to clear the site of brambles and introduce a programme of controlled grazing and scrub management to create a welcoming home for the wart-biter and a host of other rare insects, fauna and flora.

A carefully monitored four-year relocation programme commenced in 2015, with scores of wart-biters being transferred from a donor site to Deep Dean: but not before a fence, almost 1km in length, had been erected along the floor of the valley to prevent sheep and cattle from trampling and grazing on the slopes from March to October.

Astonishingly, a survey of the site on 28 June 2017 quickly found two active adult wart biters. The life of a wart-biter cricket is only six months, but it takes two years for eggs to develop and hatch. Due to the two-year gestation period, and because the species had been extinct on the site since the 1980s, those two crickets must have hatched from the 2015 relocation – certain evidence of a rare biodiversity gain from only the first year of the four-year relocation programme.

Not only has the attempt to reintroduce this near-extinct cricket proven successful, it has also created the appropriate habitat for a number of other rare species of birds, butterflies, moths, rodents, insects and grasses to establish themselves at the 70 hectare site. Botanical surveys reveal 108 species, many of them designated as 'unusual' or 'specialist', now evident at Deep Dean.

Environmental protection is a key pillar of sustainable development. By not using chemicals and pesticides on the land above the aquifer at Deep Dean and, hence, protecting a vital water source, this project embodies the environmental principles of sustainable development.

This year we completed a joint investigation with Thames Water related to the sustainability of abstractions in the vicinity of the River Darent. This investigation has shown that it is difficult to assess cumulative impacts of both our and Thames Water's abstraction on the Darent catchment and that there is no confirmed evidence of impacts to flows in the Darent from water abstraction.

Our work has also demonstrated that there are a number of other environmental factors such as the presence of non-native signal crayfish which are impacting on the ecology of the catchment. Our joint work will continue to establish alternative techniques to provide environmental resilience to the River Darent in low flows.

We have also completed our investigation into the sustainability of two of our abstractions on the Itchel Brook and River Hart. This investigation has concluded that there is no impact from abstraction on the River Hart. However, in low flow scenarios, one of our abstractions has the potential to impact priority habitats in the headwaters of the Itchel Brook. As a result of this, for this source we will investigate how this impact could be mitigated.

As detailed on page 22, we have developed a partnership project this year with the South East Rivers Trust and Kent County Council. This project, PROWATER (Protecting and Restoring Raw Water through actions in the landscape) is an Interreg 2 Seas application and in December 2017 we heard that the application for funding towards the four year project had been successful.

The innovative project will focus on availability and supply of stored water during periods of drought, in-conjunction with water quality and sustainable water availability, through implementation of Payment for Ecosystem Services.

The approach is pioneering and will also deliver other important environmental and social co-benefits such as improved health effects, recreation, pollination, timber production, nutrient retention (e.g. in biomass) and nutrient removal (denitrification). An Ecosystem Services Quantification Tool will be developed to identify measures which can be implemented to increase groundwater recharge. On the ground pilot case studies will measure the success of the Quantification Tool and Payment for Ecosystem Services approach in building environmentally resilient catchments. Case studies in our region include the Little Stour catchment, Friston catchment and the Beult catchment.

Social

We have many people that care about our business, including our customers, our communities and our employees. Our Performance, People and Planet report for 2017/18 summarises how we are working to meet the different requirements of this diverse group.

An important development in our preparations for the next business plan has been our focus on attitudinal customer segmentation. Historically, the water industry has tended to segment customers based on age, income or their metered or unmetered consumption of water.

Our engagement with customers shows us this is too simplistic and therefore during 2017/18 we completed a piece of work to segment our customers based on their attitudes to water. Successful retail businesses do this as a matter of course and we believe the results will enable us to develop better communications that meet the needs of these different groups for the future.

Thinking about future generations and the impact we have as a business and how we will ensure we are sustainable is important. We take our corporate social responsibility very seriously as we plan for future generations, the impact we have as a business and how we will ensure we are sustainable. Clearly the drinking water we supply is fundamental to the health and quality of life of our customers. The quality of the drinking water we supply is monitored at every stage of the treatment process through to when it flows from our customers' taps.

Business environment continued

We take samples every day, which are analysed in our state-of-the-art laboratory in Farnborough to ensure that the water is safe to drink and that we are complying with water quality regulations. We must supply water that complies with these regulations, exceeding these standards where possible.

The quality of water for domestic purposes is also monitored by the independent Drinking Water Inspectorate.

Our communities also benefit from the provision of educational, recreational and amenity opportunities that come from being able to access our land, or from the contributions we make through donations, organised charitable events and the support of our employees in their voluntary activities. In 2017/18 we donated £25,000 to support key community initiatives across our region including providing support to the volunteers organising promotions of "Refill", an online app to encourage people to refill bottles with tap water, rather than buying single-use plastic.

Our intention is to be a good neighbour and we take account of the views of our customers and the community in which we work, to ensure we minimise our social and economic impacts particularly when delivering our capital programme. We also recognise our obligation to observe high standards of corporate governance in the way we conduct our affairs.

The average household water bill from 1 April 2018 rose by two per cent to £210 (including RPI), which works out at 58 pence a day for the average family. For this we supply safe, high quality water for everyday needs such as drinking, washing and cooking which represents great value for money. We have also offered extra help for those struggling to pay their bill or who are in debt.

Our customer care team assist customers who are on a low income or in receipt of specific benefits. We understand that customers may have difficulty with paying their bills and our team has found the right assistance for more than 16,000 people by transferring them to our social tariff.

In addition, we assist customers with a wide range of support tariffs, payment schemes and financial assistance through our charitable trust, "Helping Hand".

We work closely with Citizens Advice and other organisations to share good practice in debt management and our customer care team worked constantly with external partners to ensure harder to reach customers did not miss out on support available to them.

We want to ensure the bills our customers receive for their water services are accurate and easy to understand. There is a postcode checker which allows customers to quickly check their charges on our website. An interactive online bill is also available to help people understand their bill better.

In 2017 we supported an innovative initiative to help keep track of the amount of water an older person drinks launched by Kent Community Health NHS Foundation Trust throughout the summer and winter of 2017 in community hospitals, nursing and care homes across the county.

The "Don't Dry Out" Hydration Campaign featured specially designed tear off pads, washable reusable posters, coasters and room thermometers to track the amount of water a person drinks throughout the day. These were used by carers and nursing staff to monitor daily water consumption, with the advice that an older person should have eight big drinks a day which can be water, fruit juice, squash or tea.

The campaign was stepped up as winter approached to highlight the importance of keeping hydrated, particularly when the heating is turned up in the colder months.

We know the value of our employees and the importance of making individuals feel engaged in running the business. We firmly believe that engaged employees go the extra mile to deliver a great service.

How we do this is by embracing the Investors in People ethos of continuous improvement and measuring performance against our corporate objectives. This framework enables us to channel resources more effectively and harness the talent of our people towards achieving our company goals. We are proud to be accredited to the Silver Investors in People standard.

Developments in our journey so far include improved training opportunities, better internal communications and ensuring all employees and contractors receive the living wage - the sum above the minimum wage and we are accredited by the Living Wage Foundation.

We want to ensure our customers are easily able to find the information they need about South East Water. Our customer 'code of practice' leaflets provide further information as follows:

- South East Water: Your water company
- · Water metering: A guide for household customers
- Household water charges, payment options and debt recovery
- · Leaks from customers' supply pipes
- Priority Service Register: Our services for customers with additional needs
- Guaranteed standards of service
- When things go wrong

Technological

We work closely with our employees and supply chain to research and develop technological advances that can help us improve the quality of our service.

An example of this in action is a computer system invented by our leakage team which has helped stop millions of litres of water being lost to leaks every year. Aquanet has become a vital research and analysis tool, identifying pipes which are leaking as little as 0.05 litres a second by using advanced mathematical algorithms to compare flow rates in thousands of water meters throughout the company's network of 9,000 miles of pipes.

It uses that data to find anomalies such as unusual increases in water flow which could suggest a leak and that enables distribution technicians to investigate and find and fix minor leaks before they have chance to turn into major bursts.

Aquanet is compatible with our other operations and asset management systems and constantly updates, adding more than one million rows of data a day to its database. We've found that up to 90 per cent of the anomalies Aquanet suggests are leaks are indeed leaks when investigated by our technicians on the ground.

Our aim is to use Aquanet to predict when pipes will fail looking at historical information, pipe history, condition reporting, pressure, demand and burst history. We are also using it to enhance our demand forecast, cross referencing demand with weather forecasts so we can accurately predict the amount of water required over a given period.

Embracing the latest digital technology is a vital business tool and we continue to invest heavily in our website to give customers a useful, comprehensive and instantaneous two-way communications channel simply by signing up for an online account.

This enables them to view bills, check their online balance, sign up for a direct debit, notify us when they move home, make a payment and submit a meter reading.

It also offers customers the ability to report an incident or a leak and check for the latest news on incidents, repairs or planned work in their area simply by entering their postcode on an interactive map. They can also sign up for updates on engineering work or incidents via email or mobile. We have had more than 82,000 alerts sent to customers through the year and by the end of the financial year 60,029 customers had signed up for My Account.

The website, which works seamlessly on desktop, tablet and mobile, can also talk to customers in more than 60 different languages.

In addition, it employs dyslexia software, an interactive dictionary and an electronic magnifying glass, alongside the translation tool which can instantly convert English into foreign text and then read it aloud if required.

Our investment in this new software underlines our commitment to providing a five-out-of-five service to all of our customers, including those for who English is not their first language, and for anyone with additional needs.

The new software, a proprietary cloud-based web accessibility platform called Recite Me, works on all computer platforms including desktop, tablet and mobile. It claims translation accuracy of 96 per cent. During the year the system has been accessed more than 26,000 times.

Customers should go to southeastwater.co.uk and click the "Speak or Translate Me" button on the right of the home page to access the service.

Internal factors (key resources)

People

We know that we can only achieve our ambitions for customers with a thriving and creative team of people to deliver our promises. That is why we ensured our vision was as much about the people we work with as it is about those we work for.

Case study

Developing a water saving culture through the latest engagement technology

We continue to encourage our customers to use water carefully. We do this through a wide variety of routes including our website, local press, attending community and education events, offering customers a range of free devices when they have a meter installed, and also through working in partnerships with other like-minded organisations. Examples include:

working in partnership with the University of Kent to support two of their MSc students working with our data to explore the most effective and efficient ways we can encourage our customers to save water. By doing this, the students are also developing skills we require within the water industry

training our customer facing employees in the latest water efficiency advice with Waterwise

during the 2017/18 year our partnership with Save Water Save Money led to more than 34,000 customer orders online for a range of water saving products

These and similar activities contribute to achieving the long-term reductions in water use.

We worked through the year with behavioural science experts Advizzo to develop new innovative approaches that empower customers to better control the water they use and therefore the bill they pay.

As part of this, our new "My Water Use Report" team uses information from customer meter reads, third-party data, customer metering surveys and micro component analysis to create an individual water report for customers that presents their consumption in comparison to similar homes.

This aims to help people understand their water consumption and what they do about it. It helps us to engage with our customers and decrease operating costs. Ultimately this initiative aims to provide customers the knowledge and insights needed to become more efficient (and happier) users.

Lee Dance, Head of Water Resources, said: "For several years we have been utilising various information channels to encourage behaviour change and have seen good results through our customer metering programme. But we can see there is potential to build on this using new innovative technological and behavioural science approaches to encourage future savings."

Results from the first stage of the programme showed water saving of a further 2-3 per cent among participants of the "My Water Use Report" than those who didn't receive the information.

The project won the Utility Week Stars Data Demon Award in June 2017.





Business environment continued

Protecting the interests of our employees and partners and ensuring that they are respected, fairly treated and highly motivated is a key objective through our "everyone counts" commitment.

The health, safety and wellbeing of our employees is vital to our business. In 2017 we developed and launched our Thrive 365! Strategy, which sets out how health, safety and wellbeing is at the heart of everything that we do and supports our ambition to be the water company that people want to work for.

Key achievements against this strategy include:

- safety now a STARS awards category
- · reward and recognition scheme in development
- Wellbeing champions nominated for business areas
- management standards trials undertaken to enhance positive mental health in the workplace
- health, safety and wellbeing reporting extended to 57 key measures displayed on a dashboard to the Executive
- comprehensive external audit of our operations team during the year
- site specific risk assessment confirmation now mandatory on every job for our distribution teams
- production risk assessment tool in development
- panel review process in place for service strikes when excavating in the highway

In March 2018 we published our gender pay gap report which shows that at April 2017 the gap was 25 per cent. The full report is available at southeastwater.co.uk/genderpaygap. Our gap is mainly driven by the number of women in nontechnical roles and more men in senior roles and these are key areas of focus for us. However, we are working to understand in more detail the causes behind our gap and will continue to develop appropriate actions.

Activities underway include:

- ensuring our recruitment advertising is accessible to all
- promoting STEM careers within schools in our local area, particularly using women role models
- developing a "Women at Work" group to share experiences and knowledge
- developing our in-house mentoring service

 working with the women returners programme to support women returning to work after a career break

This year we launched a new employee performance management framework called iReview. This is a system created to support the business objective of employee self-assessment.

Developed in collaboration with managers and staff through focus groups, iReview has been designed to provide a more continuous approach of regular feedback from managers and recognition of achievements. Employees are able to assess their own performance against objectives as well as the new behavioural framework, tied to our values.

This approach puts employees in the driving seat of their development and we are delighted that we have ensured 87 per cent completion this first year.

In 2017/18 we completed, achieved and gained:

- number of training hours: 10,221
- number of apprentices: 12
- number of apprentices recruited last year: 5 (in 2016/2017)
- number of apprentices recruited this year: 8 (in 2017/2018)

Our performance, people and planet report details the work we are doing to continue to ensure we are the water company people want to work for.

Assets

Keeping 9,000 miles of pipe, 83 treatment works, 86 boreholes and 254 pumping stations running efficiently requires the right investment at the right time. It is these assets that ensure we deliver a successful 24-hour water supply service for our customers. We use the latest technology and modelling capabilities to constantly assess the health of our assets which must be stable enough to deliver expected levels of service for many years ahead.

In September 2017 we were reaccredited with PAS55, the British Standard produced by the Institute of Asset Management and recognised as a benchmark for how physical assets and infrastructure are best managed.

Making sure we provide value for money to our customers, while maintaining our water supply and distribution systems is a complex job, and renewing our PAS55 certificate shows that we are getting our approach to asset management right.

Gross capital investment in the year was £96.0 million (2017: £89.8 million).

We have worked with our strategic partner, Jacobs, to deliver our capital programme which has seen us invest £32.1 million on maintaining our above ground assets (treatment works, service reservoirs and pumping stations). These assets are in good shape and their performance has been assessed as being stable. We have invested a further £13.4 million on renewing and replacing our underground mains infrastructure (the pipes that transfer water to our customers).

As part of our strategic objective to improve our supply and demand management, we have spent approximately £47.3 million. This includes progress towards our goal of having at least 90 per cent of our household customers on metered supply by 2020. With more than 40,400 new water meters installed 84 per cent of our customers are now on a metered supply.

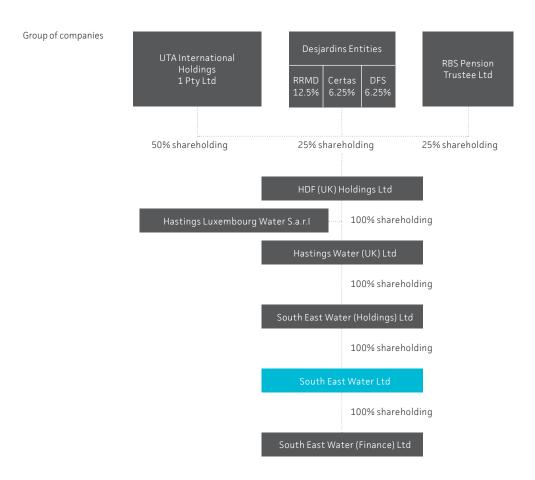
Group structure

South East Water Ltd is the main operating company in the group of companies headed by HDF (UK) Holdings Ltd. There are two intermediate holding companies between South East Water Ltd and HDF (UK) Holdings Ltd: South East Water

(Holdings) Ltd and Hastings Water (UK) Ltd, both of which, together with HDF (UK) Holdings Ltd, are registered and resident in the UK.

The ultimate owners of HDF (UK) Holdings Ltd are Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, RBS Pension Trustee Ltd as trustee for the Royal Bank of Scotland Group Pension Fund (Main Fund Section) and three entities of the Desjardins cooperative financial group based in Quebec (Régime de Rentes du Mouvement Desjardins, Desjardins Financial Security Life Assurance Company and Certas Home and Auto Insurance Company).

The debt financing of South East Water Ltd is arranged through our only subsidiary, South East Water (Finance) Ltd, although historically some existing debt has been arranged directly by the company. South East Water (Finance) Ltd is a company registered in the Cayman Islands but the company does not gain any tax benefit from this as the company is resident for tax purposes in the UK. There is further debt finance in the group which is a mixture of both external and shareholder loans and this debt is issued by a separate group company, Hastings Luxembourg Water S.a.r.l.



Business performance

We use a range of measures and targets to track our performance during our five year business plan. We call these outcomes. An outcome is our promise to customers, regulators and those with a stake in our business. It sets out what we are trying to achieve, rather than just what we will do. These include some innovative outcomes, relating to continuous assessments of our customers' levels of satisfaction which will help us demonstrate how we keep our customers at the heart of everything we do.

Traditionally, water companies have focused on output based measures, for example the number of customer complaints, rather than focusing on how satisfied customers are and how they feel about the service they receive from their water company. In 2015/16 we introduced seven customer satisfaction measures where we contact customers at random on a monthly basis to understand how satisfied they are with elements of our service.

The outcomes that are surveyed are as follows:

- customers consider the appearance of their water to be acceptable
- customers consider the taste and odour of their water to be acceptable
- customers consider the level of leakage to be acceptable
- customers consider their direct interaction experience to be positive
- customers consider their water supply is of sufficient pressure
- customers consider the frequency and duration of supply interruptions is acceptable
- customers consider the frequency of water use restrictions to be acceptable

Our customer satisfaction performance continues to show an upward trend across all of the measures over the past three years. We have seen a continuous improvement in our satisfaction levels and this year the average score is 4.33 compared to 4.28 out of five last year. This means that the majority of our customers are either satisfied or very satisfied with the service we provide.

The service incentive mechanism (SIM) is a water industry customer satisfaction measure designed to encourage companies to provide a better service to their customers. In 2017-18 we have scored 85.6 out of 100, an improvement of 1.0 points compared to 2016-17. During the year we have continued our focus on improving our customer service on every contact we receive with our teams striving to give a five-out-of-five experience every time a customer contacts us.

Customers can visit the website discoverwater. co.uk which gives everyone access to comparative information on the performance of water companies. We believe this is an important tool which enables customers and stakeholders, in particular our Customer Challenge Group, to compare the progress on our target with other water companies to ensure we are striving for continuous improvement and stretching ourselves to provide the best possible service.

For further information on all of our outcomes and targets please refer to our performance, people and planet report.

Financial performance

Our financial performance has been steady this year and we are well placed to continue to deliver on the financial requirements of all of our stakeholders as we begin the fourth year of the AMP. This year our operational focus has been on improving the delivery of services to customers and fulfilling our environmental obligations. The financial year also heralded the first year of competition in the non-domestic market and a severe weather event which caused previously unseen supply problems across large parts of the country.

There are a range of financial performance indicators that we use to monitor our business. These are linked to the key strategic financial requirements of our instrument of appointment and to those of our investors which underpin our capital structure and the financial governance that we apply to our business.

In addition, we monitor profitability, capital expenditure and cash performance, further details of which are set out in the table below.

The group financial statements are set out on pages 99 to 152. The group accounts are prepared under International Financial Reporting Standards (IFRS) and report the results for the consolidated South East Water group. The group accounts include the results of South East Water (Finance) Ltd.

Revenue

The turnover for the year was £224.8 million compared to the previous year of £218.9 million.

Under the price control mechanism, our prices are allowed to increase each year and for 2017/18 the tariffs increase was circa five per cent. Additional revenue generated from an increase in prices has been offset by the loss of revenue from customers who switch from unmetered to metered supply. As customers switch from unmetered to metered supply, we see a reduction in bills as customers use less water and therefore, in turn, revenue to the company reduces.

As the south east of England has been declared as a water stressed area, one of our strategic objectives is to improve water efficiency by increasing the number of customers on metered supply. This is part of our longer term strategy to monitor and improve water efficiency. Approximately 84 per cent of our water revenue is from measured supply in the year. This has increased from 78 per cent in the previous year.

Operating expenditure

Our operating costs for the year have increased from £147.3 million to £158.7 million. The increase in costs of £11.4 million includes the additional costs in relation to the extreme weather incident in March 2018 of £2.1 million, increases in depreciation of £3.2 million in respect of new fixed assets introduced to operations and a £2.2 million increase in rates charges following the review by central government. Additionally, we have seen other operational and inflationary pressures on our costs, particularly with respect to employee costs.

KPI	Measure	2017/18	2016/17
Credit rating	Standard & Poors	BBB	BBB
	Moodys	Baa2	Baa2
Interest cover	multiple	3.6	3.5
RCV (Regulated Capital Value)	£m	1,307.5	1,231.1
Net debt to RCV	%	77.7	79.8
Turnover	£m	224.8	218.9
Operating profit	£m	75.0	79.0
Profit before tax	£m	23.7	25.3
Capital expenditure	£m	96.0	85.7
Cash	£m	6.5	11.4

Operating profit

Operating profit has decreased from £79.0 million to £75.0 million with the principle driver being the additional operational costs detailed above. Allowing for the additional costs in respect of the extreme weather incident in March 2018, operating profit is largely in line with expectations.

Finance costs

We hold a number of listed bonds and indexed linked loans. The maturity dates of the loans range from 2019 to 2045 and further details with respect to these loans are set out in note 19 to the accounts. The associated finance costs of these loans are £56.0 million in the year compared to £58.8 million in the previous year. Offsetting the loan costs is interest receivable of £4.8 million (2017: £5.1 million) mainly from South East Water Limited's parent, South East Water (Holdings) Limited. The decrease of £2.8 million in finance costs includes the charge for the movement in the fair value of the interest rate swap liability on our indexed linked loan of £200 million, which is significantly less than the prior year at £3.3 million (2017: £13.7 million). However, this is offset by higher indexation charges on our indexed linked loans and listed bonds totalling £18.3 million (2017: £11.6 million) due to the large increase in the Retail Price Index over the year (see note 19). Interest capitalised in the year was £2.1 million (2017: £2.3 million).

Profit before tax

Profit before tax has reduced from £25.3 million to £23.7 million. The increase in turnover of £5.9 million has been offset by an increase in the cost base as discussed above. This has been mitigated by the reduced net finance costs, also discussed above, in arriving at the profit before tax. After allowing for the additional costs due to the weather incident in March 2018, the underlying profitability of the business is in line with expectations.

Profit after tax

Profit after tax has reduced from £27.1 million in the prior year to £16.2 million. Tax of £7.6 million has been charged in the year compared to a tax credit in the prior year of £1.8 million. The increase in the tax charged for the year of £9.4 million is a result of a correction to the treatment of deferred tax on the group's revaluation reserve of £4.2 million and the tax credit in the prior year resulting from the impact of the change in future tax rates on deferred tax of £6.2 million which is not repeated in the accounts for the year. Further details on the current and deferred tax calculations are set out in note 9 to the accounts.

Treasury

Our treasury policy seeks to ensure that sufficient funding is available to meet foreseeable requirements and maintain appropriate headroom for contingencies. We manage the financial risks of the business through a series of hedging policies and ensure that our short and long-term facilities are appropriate to the strategic objectives of the business. Our policy considers inflation risk, interest rate risk, currency risk and investment criteria. The policy is underpinned by the obligations of our securitisation structure. Our assessment of the associated risks are set out on page 50 and details of our long-term loans are set out in note 19.

Pensions

The company pays contributions to the South East Water and Mid Kent Water defined benefit schemes which both closed on 31 March 2015 to future accrual. During the year £3.7 million was paid to the South East Water scheme and £1.3 million was paid to the Mid Kent Water scheme. Further details on these schemes are set out in note 24 to the accounts.

In addition the company operates and funds a stakeholder pension scheme which is a defined contribution scheme. During the year 1,000 employees contributed to the scheme, many using the newly introduced salary sacrifice scheme to reduce the costs of the scheme to the employees, and the company made payments of £2.0 million by way of employer contributions to this scheme.

Net debt and cash flow

We use a combination of long-term funding and short term working capital to finance the extensive capital programme and to fund the ongoing operations of the business. During the year the net operating cash generated was £123.1 million. Also, during the year, we drew £20.0 million from our committed loan facilities. These funds were used to pay interest of £35.6 million and capital expenditure of £96.0 million.

The group statement of cash flows on page 104 shows a reduction in the cash balance from £11.4 million at the beginning of the financial year to £6.5 million at the end of the year. Owing to the significant capital expenditure programme, with expenditure of £96.9 million in the year, the reduction in cash is in line with expectations.

Dividend

The company's dividend policy is to ensure that a suitable return is paid to our shareholders, while ensuring that the company is able to finance the business and meet the requirements of our instrument of appointment, both as at the date of the proposed dividend and prospectively. When assessing the appropriate level of dividend, considerations will include the company's actual and forecast level of gearing, the need to maintain the company's credit rating, the allowed cost of capital, and the performance of the business. Dividends paid in the year were £18.0 million (2017: £16.0 million) and were in line with our plans.

Credit rating

Under our instrument of appointment, we are required to maintain an investment grade rating, and we are currently rated BBB with Standard and Poor's and Baa2 with Moody's. Our financial performance targets support these ratings and we review our actual and forecast indicators regularly to ensure that we are on track to maintain compliance. Equally important are the requirements of the securitisation underlying the capital structure of the business. The maintenance of the financial covenants set out under our loan documentation is essential for the continued support of our investors.

We manage our capital structure in a way that enables us to maintain our investment grade credit rating and comply with our loan covenants. We monitor interest cover ratios and the ratio of net debt to regulated capital value (RCV), ensuring covenant compliance both in the current and future reporting periods.

Gearing

The company operates a securitisation structure. Our long-term funding at the end of March 2018 was £1,025 million which represents 78.4 per cent of our regulated capital value. Our securitisation requirements maintain that we should maintain a level of gearing of 85.0 per cent or less. Our gearing levels are in line with expectations. We monitor the gearing closely and there is sufficient headroom as at 31 March 2018 and for future years.

Taxation and tax policy

Our taxation policy is set out in the directors' report and the regulatory annual performance report. A more detailed explanation of our tax policy is available on our website. We have a significant capital programme and as such hold significant capital allowances to offset tax liability, coupled with losses generated elsewhere in the group.

Risk management

How we manage risks

We have comprehensive systems of internal control and risk management and we monitor their effectiveness regularly in compliance with the principles of our corporate governance code. This risk management framework is also closely linked to the way we monitor and measure our performance and compliance with our statutory obligations and commitments which is subject to external assurance by third parties. This ensures that the board and the audit and risk committee review all material controls including financial, operational and compliance controls.

In November 2017 Ofwat recognised our robust approach to our company monitoring framework by maintaining our position as self-assured, the top category defined by Ofwat, which means we decide how we assure our information because we have consistently met high standards. The Ofwat report is an annual assessment on the quality of information and assurance all water companies provide customers and is intended to challenge them to publish information that can be trusted by their customers.

In their assessment Ofwat described South East Water as having continued to demonstrate examples of some leading-edge behaviour, which they expect from companies in the self-assurance category.

We maintain a formal risk register and risk management system for the identification, evaluation and mitigation of risks. The board defines South East Water's risk management framework and reviews the risks on the register and the effectiveness of the relevant mitigation measures at least once a year.

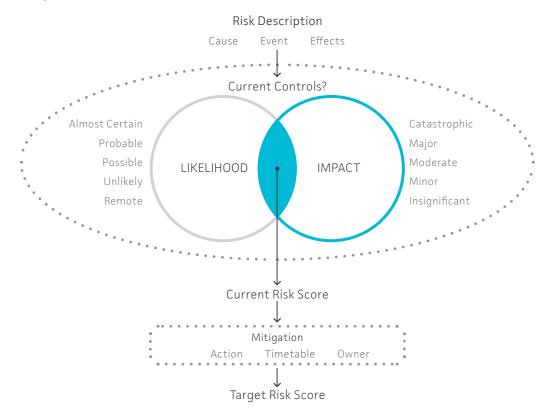
The board also reviews monthly, quarterly and annual reports on performance which highlight risks and business or operational issues as they arise. The audit and risk committee monitors the effectiveness of our systems of risk management and internal controls on an ongoing basis. Please see page 72 for the report from our audit and risk committee.

WE HAVE COMPREHENSIVE SYSTEMS
OF INTERNAL CONTROL AND RISK
MANAGEMENT AND WE MONITOR
THEIR EFFECTIVENESS REGULARLY IN
COMPLIANCE WITH THE PRINCIPLES OF
OUR CORPORATE GOVERNANCE CODE.

Individual managers and heads of department are responsible for identifying risks relevant to their area of responsibility and defining and implementing mitigation. Risks relevant to each directorate are monitored by the relevant director every month and the risk profile of a particular area is presented by the relevant head of department to the executive team each month ensuring that an in depth review of each department's risks is carried out at regular intervals.

Our risk management model uses standardised risk descriptions and categories for the controls, impact and likelihood of risks. Each risk is allocated a priority score based on its potential impact and likelihood. The prioritisation of risks in the register takes account of the controls and mitigation measures currently in place. Our risk management model also includes an assessment of planned mitigation measures. This gives visibility of the reduction in risk exposure expected from planned mitigation and is also used for reviewing the actual effectiveness of mitigation. This model allows the board to assess and manage risks at a strategic level and the executives to manage risks at an operational level.

Risk management model



Key characteristics of our risk management model

• Risk description

the tool ensures a consistent language regarding the description of risks is maintained. A risk must satisfy three criteria:

Cause

are definite events or set of circumstances that exist which will give rise to uncertainty

Event

an uncertain event is the true risk, as it may or may not happen and gives rise to uncertain outcomes

Effects

are unplanned variations that would arise as a result of the risk occurring

Current controls

the controls that are already in place to deal with the identified risk

• Likelihood

the likelihood of the risk occurring must be assessed using set criteria

Impact

risks are categorised and their impacts determined. There are 12 categories ranging from financial through to operational or reputational impacts. Each category has a defined level of impact ranging between insignificant and catastrophic. This allows for a consistent approach to be adopted across the whole of the business. Where appropriate a risk may have more than one category e.g. both financial and reputational

• Current risk score

this is the product of impact and likelihood. The most catastrophic risk is calculated with a score of 25, with the most insignificant scored at 1

Mitigation

actions we are undertaking to reduce or manage a risk. Once embedded these mitigation steps will form part of the current control assessment

• Target risk score

a target risk score can be calculated to show where the risk level will be once the controls and actions are put in place. INDIVIDUAL MANAGERS AND HEADS
OF DEPARTMENT ARE RESPONSIBLE
FOR IDENTIFYING RISKS RELEVANT
TO THEIR AREA OF RESPONSIBILITY
AND DEFINING AND IMPLEMENTING
MITIGATION. RISKS RELEVANT TO
EACH DIRECTORATE ARE MONITORED
BY THE RELEVANT DIRECTOR EVERY
MONTH AND THE RISK PROFILE OF A
PARTICULAR AREA IS PRESENTED BY
THE RELEVANT HEAD OF DEPARTMENT
TO THE EXECUTIVE TEAM EACH MONTH
ENSURING THAT AN IN DEPTH REVIEW
OF EACH DEPARTMENT'S RISKS IS
CARRIED OUT AT REGULAR INTERVALS.

For our latest annual review, we have compared our latest risk profile with the risk profile at our previous review. Our risk profile remained stable and there were no significant changes in the nature of the risks identified.

Risks relating to asset resilience and in particular the impact of large bursts on our performance on interruption were considered in the context of our ODIs, with an increased risk of penalty in respect of this measure due to exceptional incidents (such as the freeze/thaw in March 2018) and the impact of large bursts despite a good underlying performance.

We also monitor closely the risk of underperformance in respect of discoloration contacts and have implemented a number of mitigation measures, but the target remains tough.

Principal risks and uncertainties

Principal risks are those which due to their likelihood or magnitude can significantly impact on the long-term success of our company. We considered their impact on our business model, future performance, solvency and liquidity. We also reviewed the adequacy of the mitigation in place as recorded in our risk register.

As required by our corporate governance code, the audit and risk committee and the board carried out a robust review of our principal and strategic risks and of high impact and emerging risks on our risk register. We also compared them with risks identified by other companies in the water industry.

We describe our principal risks, their potential impact and how they are managed on the following pages. These principal risks have been considered in the context of our business model and strategy.

Some of the risks described in this section also bring business opportunities which we are preparing for. We also take advantage of the potential for business improvement that arises from risk management and the implementation of mitigation.

Our principal risks

Category	Risks description	Mitigation	
Health & safety	Our activities and assets present risks to the health and safety of our employees, contractors and the public.	We have comprehensive processes in place including policies, standard operating procedures, risks assessments and toolbox talks involving our employees, partners and contractors.	
	Failure to prevent accidents could have tragic implications for individuals and their families. There are severe criminal sanctions and civil sanctions for failing	Our performance on RIDDOR remains good, we continuously take actions on training and awareness to ensure that our employees and contractors always adopt safe practices.	
	to have appropriate safety measures and failure to meet health and safety standards.	This year we have developed a new safety strategy designed to support the company vision and provide clear direction and a road map for continuous improvement of our health, safety and wellbeing performance.	
		Our directors review health and safety performance at each board meeting.	
Water quality A water quality incident could lead to a failure to supply wholesome water and public health incidents which would significantly affect customer trust. This may also result in investigations and enforcement actions and potential prosecutions from the Drinking Water Inspectorate.		We control water quality risk through the operation of our treatment works and distribution network which are constantly monitored. We carry out extensive sampling of our water every day at our accredited laboratory. We follow the World Health Organisation (WHO) water safety plan approach which includes risk assessments and management of all aspects of our water supply chain from catchment to	
		customers' taps.	
		We invest in our treatment works to improve water quality and actively manage our catchments to reduce the discharge of chemicals by third parties. We have emergency plans for the deployment of alternative supplies if necessary.	
		We have implemented a programme of flushing, network management and investment in our treatment works to meet our targets on discolouration contacts.	
Operational performance	Strategic asset failures and significant operational incidents (such as bursts or water quality events) may affect our ability to deliver a safe and	We have established procedures and emergency plans for dealing with incidents and targeted investment to address specific operational risks when identified.	
	uninterrupted water supply to a large number of customers or cause damage to third parties. This can lead to penalties and legal action and impact customers' perception and satisfaction.	We have put in place a dedicated operational steering group to identify potential risk and work on prevention and mitigation. We are putting particular emphasis on this area to improve our performance on interruption which was affected by a small number of large bursts despite good underlying performance.	

Our principal risks continued

Category	Risks description	Mitigation	
Market reforms	The extension of competition on the non-household retail market, the introduction of competition for water resources, demand management and leakage services and the introduction of direct procurement at PR19 (Water 2020) as well as the potential introduction of competition for household retail customers create new risks and uncertainties.	We are keeping the proposals from Ofwat and government under review and contributing actively to ensure that risks are identified and taken into account in the definition of policy. We are reviewing and anticipating the potential impact of regulatory changes on our ability to secure finance at no less favourable terms.	
	We could face reputational damage and possible enforcement actions if we do not demonstrate compliance with the new market arrangements. We must also comply with competition law.		
Adverse changes to the regulatory framework	Decisions to change the approach to established aspects of the regulatory framework have an impact on our overall risk profile and on our medium and long-term planning.	We are assessing the implications of the use of CPI and are developing a strategy to limit the negative impact of the change, taking account of the fact that there is currently only a limited market for CPI indexed debt.	
	This includes Ofwat's decision to reduce the RCV which has now been confirmed and the use of CPI instead of RPI for the indexation of the RCV which has now been included in our licence conditions.		
Price determination	The price review at PR14 introduced separate price controls, the use of totex and new outcome delivery incentives (ODIs).	We have detailed processes to ensure compliance with our price determination and to ensure that we operate within the assumptions of the price determination (including ODIs and investment).	
	There are new compliance requirements in relation to separate prices controls.	We are developing our approach to PR19 and are considering the impact of the proposed changes and are contributing to the proposals for PR19 and	
	There are also uncertainties about PR19 totex modelling.	Water 2020.	

Category	Risks description	Mitigation
Delivery of business plan and performance against ODIs	There are financial and reputational risks associated with a failure to deliver our business plan commitments and ODIs and our position at PR19 may also be impacted.	We have taken a number of business improvement initiatives to deliver our ODIs and ensure customer and employee engagement. Dedicated steering groups monitor key measures such as interruption, water quality, customer services, customer perception and leakage.
	If our Service Incentive Mechanism (SIM) performance is less than expected we may incur a penalty but it may also have an impact on other ODIs based on customer satisfaction.	
Investment programme delivery	We need to ensure that we deliver the investment necessary to maintain and improve our services to customers. The risks affecting the delivery of our investment are internal, relating to the management of the delivery of our programme, and external such as extreme weather conditions, incidents affecting the works, or supply chain risks.	We have comprehensive processes involving our asset, engineering and operations functions to ensure that projects are planned and delivered on time and budget. Projects are reviewed by an investment committee and a programme management office. Project scopes and planned efficiencies are reviewed with our engineering partner and the early involvement of our framework contractors to identity risks and opportunities for innovation and savings.
Water resources and climate change	Failure to develop our infrastructure, to improve its resilience and to manage demand would mean that we would not be able to meet our statutory duties and meet future demand. Climate change will increase instances of severe flooding and drought which can affect the availability of resources and the operation of our infrastructure.	We operate in an area of serious water stress and manage demand through our metering programme which will be completed by 2020. We have also consistently met our leakage targets. Our water resources management plan is developed to take account of opportunities for cooperation between water companies in the south east. We also invest in flood protection at our operational sites and to improve our resilience to power outages, and have set up a drought team.
Regulatory and legal compliance	Our business operates within a specific legislative and regulatory framework and many of our activities have an impact on the environment. Failure to ensure compliance with regulatory and legislative requirements may lead to criminal and civil liability, regulatory enforcement actions and disruption to the business and loss of management time. It will also affect the perception of South East Water by customers, regulators and others with a stake in our business.	We have a wide range of policies, processes and controls to ensure that we meet our duties and obligations. We also monitor compliance with our statutory obligations for the purpose of reporting on our performance and for the purpose of our ODIs. We review annually compliance performance and processes with the relevant department. We monitor changes to compliance requirements in order to adapt our processes and policies when required.

Category	Risks description	Mitigation
Security and information security	The security and resilience of our information infrastructure is essential to maintain our service to the public. We must protect ourselves from loss of data and systems and cyberattacks and keep customers' data up-to-date and safe. Failure to protect personal data may lead to fines, enforcement actions and legal actions and would cause reputational damage. Loss or corruption of data would result in disruption to the business and additional costs. We must ensure compliance with the new requirements imposed by the General Data Protection Regulation.	Our corporate security steering group continuously monitors all physical and data security aspects and data protection to identify new risks and the effectiveness of our security processes. We have department champions who are specially trained on these issues and we continuously promote awareness of risks, highlighting how unsafe behaviour could be exploited by external threats. We maintain disaster recovery systems and facilities which are regularly tested. We invested in security measures against unauthorised access to our systems and in software to help us monitor activity on our network. We achieved recognised cyber security certifications. We work with relevant external organisations to test the effectiveness of our resilience and security measures. We maintain this risk as a high level due to the constant emergence of new threats and the risk of exploitation of vulnerabilities that may not have yet been fixed by software providers. We have implemented an extensive programme to achieve readiness for GDPR.
Financing	Unfavourable market conditions (including the impact of Brexit) and regulatory changes may affect our ability to obtain financing or low interest rates. We must ensure that we comply with covenants in our agreements with our debt providers and maintain our credit rating.	We will be refinancing a significant part of our debt in the next two years and are closely monitoring market conditions and the key risks for this refinancing. We continuously monitor and report regularly to our board on compliance with our financial covenants.
Bad debt	Customer bad debt and increased collection costs is an issue faced by all water companies which affects cash and liquidity and the cost incurred to recover income.	We maintain strict processes for the collection of debt and take steps to encourage payments through direct debits. We have maintained a good performance on collection of bad debt but keep the effectiveness of our recovery process under constant review. We also offer a social tariff and other similar tariffs to assist customers who may struggle to pay.

Category	Risks description	Mitigation
Human resources and culture changes	Employee retention and talent management is important to deliver performance and maintain company knowledge especially in operational areas with a more mature workforce and the need to manage planned retirements.	We have implemented a successful apprenticeship scheme in operations and the "steps to leadership" programme is developing managers over four levels. We have extensively communicated our values and objectives with employees to ensure their support and their involvement in cultural changes required to deliver the next step of performance improvements.
Economic environment and Brexit	Changes to the economic environment of the UK relating to Brexit will affect our business. We may see an increase in the cost of key inputs in our operations and rising inflation may affect customers' ability to pay and the level of bad debt. Our supply chain may be affected as well as our ability to access skilled resource if unfavourable changes affect the circulation of persons. Uncertainties due to changes in legislation, tax law and regulation will affect our ability to plan for the medium and long-term and may also affect our day to day operation and increase the complexity of our compliance activities.	We are working to anticipate the impact of macro economic changes on our business and the other impact on our operations. We are monitoring changes in the economic environment as well as considering the impact of future tax changes. We will consider the potential direct impact on our operation as more detailed information becomes available.

Long-term viability statement

To prepare our long-term viability statement, we have conducted our long-term viability assessment, taking into consideration our business model, our current financial position and principal risks that can affect our business.

The company is a regulated long-term utility business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP6 runs until March 2020. Following the publication of Ofwat's Final Methodology for assessing companies' business plans and setting price controls for the AMP7 period 2020 – 2025, South East Water has made significant progress in developing its AMP7 business plan, which is due to be submitted to Ofwat in September 2018.

Our assessment of the current financial position is set out on page 100.

Our long-term viability assessment reviewed the company's prospects and considered the potential impacts of the principal risks and uncertainties. Stress tests have been performed to assess the potential impacts of combinations of those risks and uncertainties. The assessment also considered the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of the mitigating actions. See text box 'Stress testing' for more detail on the scenarios tested.

Assessment period

On the recommendation of the audit and risk committee, and in line with Ofwat's guidance, we have assessed the prospects of the company over a period of five years to March 2023. This duration is consistent with our planning horizon and regulatory cycle. We consider that a five year rolling period is likely to remain appropriate as more information becomes available on performance against our regulatory commitments and on the price review methodology for the next regulatory period. Uncertainties arising from market competition within this period have been taken into consideration but do not affect the result of our assessment. This is due to the fact that monopoly activities form the main part of the business of the company.

Assessment results and mitigation strategy

The results of our assessment revealed that none of the stress-testing scenarios would lead to a default event in servicing the company's debt, nor would they lead to adverse impact on customer service or the company's ability to carry out normal operational activities.

Furthermore, none of the scenarios resulted in an impact on the company's expected financial metrics that cannot be reasonably mitigated using the existing safeguards within the company's financing structure.

The directors have identified actions, including reducing discretionary outflows of funds and working with providers of finance that would be available to the company to mitigate the impact of adverse outcomes.

The company has significant refinancing requirements on existing debt due for repayment in September 2019. During the 2008 financial crisis, water companies remained able to access the capital markets and therefore our assessment did not include the extremely unlikely event where the Company is entirely excluded from accessing capital markets to raise finance during the period under review.

Viability statement

The board have assessed the viability of the company over a five year period to March 2023, taking into account the company's current position and principal risks. The board was satisfied that they had sufficient information to judge the viability of the company, and have a reasonable expectation that the company will be able to continue to operate and meet its obligations over the period to March 2023.

Governance and assurance

The board reviews and approves the medium term plan on which this viability statement is based. The board also considers the period over which the assessment of prospects and viability statement should be made.

The audit and risk committee supports the board in performing this review. This statement has been read by Deloitte, our External Auditor. Their audit report, including comments on the viability statement, is set out on pages 91 to 98].

Going Concern Statement

In preparing the financial statements the directors considered the company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in

conjunction with the consideration of the long-term viability statement above. On this basis the directors considered it appropriate to adopt the going concern basis in preparing the financial statements.

Stress testing

The purpose of the targeted assessment was to measure the company's financial resilience facing the occurrence of certain risks in severe, reasonable and plausible scenarios. In line with Ofwat's guidance on assessing financial resilience, our scenarios combined qualitative and quantitative criteria and covered the following risk factors to assess their impact on liquidity and compliance with financial ratios until March 2023:

- Outturn inflation under forecast: Inflation risk primarily relates to the fact that the price control is in real terms and the allowed revenue moves up by a designated inflation figure (CPIH for PR19) while some of the costs are fixed in nominal terms. This means that when inflation is lower than assumed when the real-term costs were calculated, the company will face the risk of underfunding on these elements
- Interest rate above forecast: Interest rate risk can result in an increase in borrowing rate for new debt raised, and it can increase the borrowing cost for any floating rate debt. The most significant risk for the company is if borrowing rates rise materially above current rates between now and the £200m bond and associated RPI swap maturing in September 2019
- Revenue losses/financial penalties: Revenue risk may manifest itself as wholesale revenue under recovery as the amount that the vast majority of our customers pay depends on the amount of water they consume. We have also considered the risk of financial penalties in this category to capture the possibly of the company receiving (non ODI) fines from regulators
- Totex overspend: Totex over-spend is a risk that we have assessed carefully, when considering scenarios of company underperformance as well as unexpected costs due to severe weather related incidents
- **ODI penalties:** The effect of ODI penalties as a result of company underperformance or unexpected adverse conditions can materialise within the AMP7 period, which have been taken into account in our assessment
- Compensation payments: Compensation payments can be due to one-off unexpected events, such as major incidents caused by severe weather events or critical asset failure. The recent freeze/thaw event provides a good example of the level of compensation payments the company can incur
- Retail cost overspend: Retail cost to serve forms a part of the allowed revenue, which the company may underperform against for reasons such as cost escalation and bad debt

In addition to assessing the impact of the above risk factors separately, our stress test analysed scenarios which combined the above risk factors in a logical and systematic way, taking into account of possible events that could trigger these to occur simultaneously. The relevant risk factors were calibrated to represent severe, reasonable and plausible scenarios in line with Ofwat's guidance. These scenarios are summarised in the table below.

Combination scenarios for the stress test

Scenarios	Parameters		
Scenario 1: Severe major incident	Compensation payments		
-	Totex overspend		
	ODI penalties		
Scenario 2: Sustained adverse condition	Out-turn inflation significantly lower than assumed for the 3 years in AMP7		
	Totex overspend		
Scenario 3: Pervasive under-performance	Totex overspend		
	Refinancing rate above forecast		
	Out-turn inflation materially lower than assumed for the 3 years in AMP7		
	Financial penalty/ revenue loss		
	ODI under performance in AMP7		
	Retail cost overspend		
	•		

Darameters

Paul Butler

Scanarios

Managing Director 13 July 2018





Governance

Corporate governance report	57
Introduction from the Chairman	57
Our directors	58
Leadership and effectiveness	61
Transparency and accountability	71
Remuneration	76
Directors' remuneration report	77

Financial statements Annual performance



Corporate governance report

Introduction from the Chairman

Corporate governance and compliance are an integral part of how our board and our business as a whole operate. We keep our governance under constant review and this year we focused our efforts on managing the specific risks and ensuring the governance of the preparation of our exit from the non-household retail market and our business plan for the next regulatory period. We have a comprehensive and innovative customer engagement programme to help us place customers at the centre of what we do. It is for us a key part of our approach to governance as we recognise the importance of engagement and transparency to obtain the trust of our customers and other stakeholders.

We also continued reviewing the effectiveness of our processes and reporting in relation to our key outcome delivery incentives and our risks. In doing so, we relied on the governance framework we have developed in the last few years in line with our own code of corporate governance which incorporates the principles of governance published by Ofwat, our economic regulator. We have also made sure that we integrated the commitments we set out in our company monitoring framework in our approach.

We have also reviewed our operational readiness and how we can be more effective when responding to sudden operational events.

This year we will also increase our efforts to incorporate environmental, social and governance in our strategy and make this a central part of the day to day business.

During the year we have worked on the renewal of the skills of our board and recruited a new independent non-executive director with a strong customer focus. We will also be welcoming a new shareholder representative on the board in the summer of 2018. We have maintained a compact board with a strong representation of independent non-executive directors and a good balance of experience and skills. We provide more details on the changes to the board on pages 61 and 62 and on the activities of the nomination committee on page 65.

This annual report has been prepared to provide clear and concise information on our business to our customers, investors, regulators and other stakeholders.

We describe in more detail our corporate governance framework and how we put governance into practice in this corporate governance report which I hope you will find helpful in demonstrating our commitment to excellence in governance.

Nick Salmon

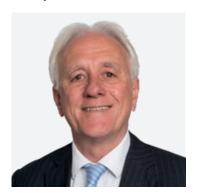
Chairman 13 July 2018

Read more online at

You will find our corporate governance code and more information on governance on our website at southeastwater.co.uk/ourgovernance

Our directors on 13 July 2018

Independent Non-Executive Directors*



Nick Salmon Independent Chairman

Nick was appointed as Chairman of South East Water on 1 April 2015. He brings a wealth of experience from a number of senior roles, including nine years as a Non-Executive director of United Utilities. He is currently also the Senior Independent Director of Elementis plc and a Non-Executive Director at Interserve plc. Nick is a Fellow of the Royal Academy of Engineering.



John Barnes Independent Non-Executive Director

John was appointed as a Non-Executive Director on 28 January 2016. Prior to his more recent involvement with a start-up company developing renewable energy schemes, John had gained over 30 years' experience in the water industry, mainly in the UK, but with spells in the Middle East and New Zealand.



Emma GilthorpeIndependent Non-Executive Director

Emma is a lawyer with over 20 years' experience working in regulated industries, including the telecoms and airport industries. Currently working as Executive Director Expansion at Heathrow Airport Holdings Ltd, Emma was previously BT plc's Group Director of Industry Policy and Regulation.



Chris GirlingIndependent Non-Executive Director

Chris, an experienced finance professional, has a background in a variety of sectors, including construction, support services, pharmaceuticals and aerospace. Chris retired as Group Finance Director of FTSE 250 Carillion plc in 2007 and since then he has chaired three audit committees and one pension fund.



Célia ProntoIndependent Non-Executive Director

Célia was appointed as a Non-Executive Director on 1 June 2018 and has a wealth of experience and expertise of the service sector in a range of industries. Célia is currently Chief Customer and Digital Officer of Casual Dining Group Ltd. She was previously Group Marketing & E-Commerce Director and board member of the Ford Retail Group. Célia is also a member of the Board of Trustees of Yes to Life, a cancer charity.

Our directors continued

Non-Executive Directors



Marissa Szczepaniak Non-Executive Director

Marissa is Investment Director at Vantage Infrastructure responsible for infrastructure and was appointed to the South East Water board in December 2016. Marissa has a Bachelor of Science in finance, accounting and economics and is also a non-executive director at rail company Porterbrook.



Oliver Schubert Non-Executive Director

Oliver leads Vantage Infrastructure's European equity investment team. He has more than 20 years' experience, and has worked on a number of acquisitions in the regulated electricity and gas distribution and transmission network industries across Europe, as well as in the renewable energy industry. He has a thorough understanding of regulatory regimes in the UK, Germany, Finland and Spain and of the relationships with the relevant regulators.

Executive Directors



Paul Butler
Managing Director

Paul has a wealth of water industry experience, having previously been Managing Director of Mid Kent Water from 2001 to 2006 and Chairman of UKWIR, a water industry research organisation from 2005 to 2012. A Chartered Accountant, he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer.



Andrew Farmer
Finance Director

Andrew, who joined as Finance Director on 1 August 2015, has held a number of senior management posts in finance, most recently at MAG plc, the country's largest UK owned airport operator, and Doosan Power Systems, a leading manufacturing, energy technologies and services company.



David HintonAsset and Regulation Director

David, who was appointed as Asset and Regulation Director on 1 June 2013, has a breadth of experience within the water industry. Previous roles include Head of Water Quality and Head of Business Planning. A strong science background, David has held previous senior roles in microbiology including laboratory management for Public Health Laboratory Services.

Resigning directors

Our directors who were in office during the period from 1 April 2017 to 31 March 2018 and have resigned before 13 July 2018. Please see pages 61 and 62 for details of the changes on our board.

Independent Non-Executive Director (Resigned on 3 July 2017)

Paul was appointed as a Non-Executive Director in 2013 bringing with him more than 25 years' experience working in national service businesses. Paul was Chairman of NHS Business Services Authority and was previously Royal Mail plc's Deputy Managing Director and Marketing Director.

Peter Dixon

Non-Executive Director (Resigned on 27 April 2017)

Peter was appointed as a Non-Executive Director in 2014. Peter brings with him extensive experience acquired in the gas and water UK utilities as a CEO and board member. Until recently, Peter was Group CEO of Phoenix Energy Holdings, a gas utility and service group in Northern Ireland.

Read more online at



You will find our corporate governance code on our website at southeastwater.co.uk/ourgovernance

Leadership and effectiveness

We are required to conduct our regulated business as if we were a separate public limited company and to have regard to the principles of good governance of the UK corporate governance code and of the disclosure and transparency rules. We are also expected to apply Ofwat's principles of leadership, transparency and governance. Our own corporate governance code combines these principles that can be reasonably applied to a privately owned company. This report describes how the board has applied the principle of our corporate governance code in the financial year.

The role of the board and of its committees

The board and its committees have overall responsibility for the management of South East Water. It is responsible for the long-term success of the company and sets the strategic aims, values and standards to ensure that the company meets its statutory duties and other obligations. It provides leadership within a framework of prudent and effective controls and ensures that the necessary financial and human resources are in place. The board has a strong Non-Executive component which provides both challenge and support to the executives in reviewing management performance.

Board balance and composition

Independent Non-Executive Directors are the majority group on the board and our committees are also chaired by an Independent Non-Executive Director. This ensures they play a significant role in challenging Executive Directors and management as well as in developing strategy. The wide range of their experience also ensures that a variety of views are considered in the board's deliberations. The independence of Non-Executive Directors is assessed by the board following the criteria of the UK corporate governance code. Non-Executive Directors also meet with the Chairman in the absence of the Executive Directors at least once a year. All Independent Non-Executive Directors have been Directors of South East Water for less than six years as shown in the table on page 58.

Nick Salmon, Chairman of the board, is independent of management and has no link to shareholders that could affect his impartiality as required by our corporate governance code and Ofwat's principles of governance. His appointment was extended in March 2018 for a period of three years to 31 March 2021 on the recommendation of the nomination committee which concluded that he continued to satisfy the criteria of independence set out in our corporate governance code.

Paul Rich resigned from the board of the company on 3 July 2017 to take office as the non-executive Chairman of Invicta Water, a group company which was granted a water supply and sewerage licence and was acquired in July 2018 by Castle Water Holdings Ltd.

Peter Dixon who was a shareholder nominated director, resigned in April 2017 as part of the changes made to shareholders representation following the review of the composition of the board after the sale of CDPQ's interests in HDF (UK) Holdings Ltd in February 2017.

John Barnes was appointed as a member of the nomination committee and the audit and risk committee on 6 July 2017 replacing Paul Rich on these committees.

WE BELIEVE THAT OUR BOARD
HAS A GOOD MIX OF SKILLS AND
EXPERIENCE AND HAS REACHED
A GOOD BALANCE BETWEEN NEW
DIRECTORS AND DIRECTORS WHO
HAVE HAD TIME TO ACQUIRE A GOOD
KNOWLEDGE OF OUR COMPANY.

The appointment of Chris Girling was extended in September 2017 for a period of three years to 29 October 2020 on the recommendation of the nomination committee which concluded that he continued to satisfy the requirements of independence and relevant financial experience.

Emma Gilthorpe has announced her intention to leave the board at the expiry of her term in September 2018. During the year we recruited a new independent non-executive director, Célia Pronto who was appointed to the board on 1 June 2018. Célia has specific expertise in customer engagement and service improvement, digital engagement, e-commerce and technology and innovation which will reinforce the skillset of the board as we continue to focus on placing customers at the heart of what we do.

Shareholders are represented on the board which ensures that there is constant communication between Independent Non-Executive Directors and shareholders and between Executive Directors and shareholders.

We believe that our board has a good mix of skills and experience and has reached a good balance between new directors and directors who have had time to acquire a good knowledge of our company and of our environment including the last price determination and our strategy and long-term plans. We also believe that the mix of Executive and Non-Executive Directors is appropriate.

Non-Executive Directors and Independent Non-Executive Directors are given direct access to management as requested and review specific areas of the business directly with management drawing on their particular expertise and to provide oversight and challenge on key regulatory matters or the review of the company's response to significant operational events.

Our directors' biographies can be found on page 58.

Board balance and composition

(Asset and Regulation

Director)

62

Independent Non-Executive Directors	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Nick Salmon (Chairman)	01/04/15	na	3 yrs			Chair		
John Barnes	28/01/16	na	2 yr 2 m	•	•		•	
Emma Gilthorpe	18/10/12	na	5 yrs 5 m		Chair	•	•	
Chris Girling	30/10/14	na	3 yrs 5 m	Chair				
Paul Rich	25/04/13	03/07/17		•	•	•		
Celia Pronto	01/06/18	na		•	•	•		
Non-Executive Directors (shareholder nominated)	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Peter Dixon	27/02/14	27/04/17						
Marissa Szczepaniak (Vantage Infrastructure)	08/12/16	na	1 yr 3 m	•	•	•	•	•
Oliver Schubert (Vantage Infrastructure)	03/05/17	na	11 m	•	•	•	•	•
Executive Directors	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Paul Butler (Managing Director)	02/10/06	na	11 yrs 6 m				•	•
Andrew Farmer (Finance Director)	01/08/15	na	2 yr 8 m				•	•
David Hinton	01/06/13	na	4 yrs 10 m				•	

*as at 31 March 2018

Composition of the audit and risk, remuneration and nomination committees

Emma Gilthorpe became a member of the nomination committee on 25 September 2014 and Chair of the remuneration committee on 1 October 2015.

Chris Girling became Chair of the audit and risk committee on 20 May 2015.

Nick Salmon became the Chair of the nomination committee on 1 April 2015.

John Barnes became a member of the remuneration committee on 10 March 2016 and a member of the nomination committee and audit and risk committee on 6 July 2017. John Barnes will replace Emma Gilthorpe as Chair of the remuneration committee before the expiry of Emma's appointment in September 2018.

Marissa Szczepaniak became a member of the nomination, remuneration and audit and risk committees on 8 December 2016.

Oliver Schubert replaced Marissa Szczepaniak as a member of the nomination, remuneration and audit and risk committees on 3 May 2018.

Célia Pronto became a member of the nomination, remuneration and audit and risk committees on 1 lune 2018.

The PR19 and PR19 Technical committees were formally constituted on 26 January 2017 and their members appointed on that date.

Where a director has resigned the membership of the relevant committee was until the date of resignation.

Read more online at

You will find our reserved matters and the terms of reference of our committees on our website at southeastwater.co.uk/ourgovernance

How the board operates

The board endeavours to reach unanimous decisions taking account of the views of all directors.

Chairman

The Chairman ensures the effectiveness of the decision making process of the board and promotes discussion on key issues based on quality information. The Chairman is also responsible for maintaining a direct channel of communication with shareholders and ensures that their concerns and objectives are taken into account and conveyed to the directors.

The Chairman and the Managing Director meet regularly throughout the year to maintain a good communication between the board and the Executive Directors. There is also a formal schedule setting out the division of responsibilities between the Chairman and the Managing Director.

Division of responsibilities

The board has adopted a formal list of reserved matters that it must consider and approve. These matters expressly refer to the relevant corporate governance requirements, our licence and regulatory obligations as well as our statutory obligations. They also reflect the allocation of responsibilities between the board and its committees as set out in the terms of reference of the committees.

The executive team manages matters that are not reserved to the board and its committees under their supervision which is achieved through regular reporting and specific updates. The main decisions delegated to management are taken after consideration by the executive team which includes the Managing Director, Finance Director, Asset and Regulation Director, Customer Services Director and Operations Director. There are several steering groups which deal with key aspects of the business.

Leadership and effectiveness continued

Committees

The audit and risk committee, nomination committee and remuneration committee are chaired by and have a majority of Independent Non-Executive Directors as required by our corporate governance code.

Board committees have formal terms of reference. Chris Girling the Chair of the audit and risk committee has recent and relevant financial experience. We have approved a formal schedule describing specifically the allocation of responsibilities and interactions between the board and the audit and risk committee.

We created two special committees of the board in January 2017 continuing the implementation of our board governance programme for our PR19 business plan which we have developed since 2016. These committees were set up to allow us to provide strategic input, oversight and challenge for the preparation of the business plan. This means that we are even more closely involved in the key strategic decisions and in ensuring that our plan meets our ambition for South East Water and is centred on customers. This also helps us influence how South East Water will deliver the other key themes and objectives defined by Ofwat in their PR19 methodology.

We have set the strategic direction and provided the overall oversight of the preparation and delivery of the plan. In addition through the PR19 committee we are able to monitor closely the progress of the PR19 programme and to discuss the key deliverables and strategic areas of the business plan and to challenge management. These key areas include in particular our customer engagement and research, our initiatives on vulnerability, how our findings and the input of our customer challenge group are built into our decision making, the definition of our performance commitments, operational and financial resilience, and the format of our plan and how we can differentiate South East Water.

WE HAVE DECIDED TO ESTABLISH AN ENVIRONMENTAL, SOCIAL AND GOVERNANCE COMMITTEE WHICH WE WILL SET UP IN 2018-19 AND WILL DEFINE OUR STRATEGY WITH A PRIMARY FOCUS ON CUSTOMER ENGAGEMENT.

The PR19 Technical committee allows us to dedicate time to the more technical, regulatory and financial matters and provide relevant information to the PR19 Committee and the board as a whole.

We have also set up a debt refinancing committee to oversee our refinancing in 2018-2019. This committee will also consider the wider aspects of our financing structure with a view to ensure resilience and transparency.

The members of the debt refinancing committee are Chris Girling, Marissa Szczepaniak, Oliver Schubert and Andrew Farmer.

We have decided to establish an environmental, social and governance committee which we will set up in 2018-19 and will define our strategy with a primary focus on customer engagement, our communities and the environment. Our strategy will build up on our innovative approach on customer satisfaction implemented in the current regulatory period which we will develop in the next to continue to place customers at the heart of what we do.

Functional separation

For market opening and our continued operation within the new market structure, we have functionally separated our non-household retail business (South East Water Choice) from the rest of our business (wholesale and household retail businesses). We had written arrangements between our non-household retail business and our wholesale business for the application of the market rules between the two businesses until our exit from the non-household retail market. We have also put in place new information separation arrangements to manage the flows of information between the different parts of our business and protect the confidentiality of retailers' information. These functional separation arrangements also applied in relation to Invicta Water Ltd trading as Water Choice.

We operated under these arrangements until we exited the non-household retail market on 1 May 2018. A number of these processes put in place will continue to apply after exit to ensure a level playing field for all retailers and to ensure compliance with the market codes.

Our non-household retail business was transferred to Invicta Water Ltd under a transfer scheme made pursuant to the Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016. The sale of the entire share capital in Invicta Water Ltd by Swan Group to Castle Water Holdings Ltd was subsequently concluded and completed on 1 July 2018.

Report from the nomination committee

I am pleased to report on the work of the nomination committee over the last 12 months.

- Following the sale of CDQP's interest, consideration was given to maintaining the balance between
 independent non-executive directors, shareholder nominated non-executive directors and executive
 directors. This was considered in particular, in relation to Paul Rich's resignation as an independent nonexecutive director to take on new responsibilities within the group. We recommended the appointment of
 Oliver Schubert to the board and the opportunity was taken to reduce the number of shareholder nominated
 directors to create a more compact board while maintaining independent directors as the largest group.
- The committee managed the recruitment of a new independent non-executive director which concluded with the appointment of Célia Pronto in June 2018 by the board on the recommendation of the committee. The committee considered the overall balance of skills on the board and defined the profile of the new director recognising the need for experience in customer engagement and new technology. The recruitment was guided by our willingness to increase our focus on customer satisfaction. It was carried out through the external search consultancy firms Ridgeway Partners, a firm accredited under the Women on Board code. Ridgeway Partners did not have any other connection with South East Water. Célia brings her experience in customer engagement and service improvement, digital engagement and e-commerce.
- The committee considered and recommended the renewal of the appointment of Chris Girling and Nick Salmon concluding that they continued to meet the requirements of independence set out in our corporate governance code. The committee also considered and recommended changes to the composition of the nomination, remuneration and audit and risk committee. John Barnes was appointed on the nomination and audit and risk committee in July 2017. Oliver Schubert and Célia Pronto were appointed on the nomination, remuneration and audit and risk committee in May 2018 and June 2018 respectively.
- The committee reviewed its effectiveness as part of the overall board evaluation process and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference.

Nick Salmon

Chairman 13 July 2018

Our governance structure

Board

Chair: Nick Salmon

Is responsible for the long-term success of the company. It sets strategy within a framework of effective controls and ensures the company has the necessary financial and human resources. It sets the company's values and standards of governance and monitors compliance with regulatory and statutory obligations. It balances the interests of customers, the environment, shareholders and stakeholders.

Managing DirectorPaul Butler

Executive Team

Chair: Paul Butler

The Executive Team under the direction of the Managing Director comprises the Finance Director, Asset and Regulation Director, Customer Services Director and Operations Director. It implements the strategy and policies, manages the operational and financial performance of the company and day-to-day management, and matters not reserved to the board.

Competition and Regulatory Strategy

Our Future Market Counts Steering Group and the Regulatory Strategic Group provide oversight of the implementation of competition and regulatory strategies including our business plan and water resources management plan. They also review and define management's strategy proposals to the board.

Corporate Security

The Corporate Security Steering Group monitors the implementation and effectiveness of security measures and policies covering all aspects of security: information and data protection, cyber risks, physical security and prevention of fraud. It monitors emerging threats and opportunities to improve resilience.

Audit and Risk Committee

Chair: Chris Girling

Exercises oversight over financial statements and reports to the board on significant aspects of financial reporting. It reviews the scope and results of financial audits, accounting policies and judgements. It assesses the systems of internal control and risk management and the prevention and detection of fraud and reviews whistleblowing arrangements.

Remuneration Committee

Chair: Emma Gilthorpe

Reviews the remuneration policy for the executive directors and the Chairman of the board. It determines the remuneration package of executive directors, and other designated senior executives including the design and application of any annual performance based remuneration. It reviews any performance related pay scheme.

Nomination Committee

Chair: Nick Salmon

Reviews the structure and composition of the board taking account of the board evaluation, succession planning of the board and senior management. It makes recommendations on proposed board appointments and committees' membership.

PR19 Committees

The PR19 Committee monitors the progress of the PR19 programme and of the preparation of the business plan. It discusses and defines the key strategic areas of the business plan in relation to customer research, vulnerability, innovation and differentiation, resilience, ODIs, key strategic objectives, and the key messages and the overall presentation of the business plan. It also oversees the effectiveness and robustness of the data and of the processes relied on for the preparation of the business plan.

The PR19 Technical Committee focuses on key technical aspects and informs the PR19 Committee. It considers in detail the definition of totex, financing requirements and financeability, and the design of rewards and penalties.

Health & Safety

The Health & Safety Committee monitors the effectiveness of health and safety practices, policies, procedures, training and communication. It analyses safety audit reports and through sub-committees ensures practices are adapted to the different areas of the business.

Investment

The Executive Investment Committee approves and ensures the governance of capital investment and the Programme Management Office controls the delivery of capital expenditure. The Information Systems Steering Group approves and controls IT investment. The Strategic Procurement Group approves and monitors key procurement activities.

Outcomes Delivery

The Every Action Counts and the Every Customer Counts steering groups monitor the implementation and effectiveness of our initiative to ensure the delivery of our ODIs, customer services performance, corporate plan objectives and business improvement.

During the period from 1 April 2017 to 31 March 2018 the board met on seven occasions reflecting the agreed pattern of meetings for the board and its committees. The board meets for regular meetings every two months but receives a full performance report every month. As required additional meetings are held. A specific strategy session focusing on the preparation on the next price determination and customer engagement was also held in October 2017.

Attendance at board and committee meetings

Director	Board	Audit	Nomination	Remuneration
N Salmon	7/7		2/2	
J Barnes	7/7	2/2	2/2	3/3
E Gilthorpe	7/7		2/2	3/3
C Girling	7/7	3/3		
P Rich – R-03/07/2017	1/1			1/1
M Szczepaniak	7/7	3/3	2/2	3/3
O Schubert – A: 03/05/2017	7/7			
P Butler	7/7			
A Farmer	7/7			
D Hinton	7/7			



B: Board A: Audit and risk committee R: Remuneration committee N: Nomination committee

Board activities in 2017/18

Business performance

- reviewed the performance against agreed KPIs and ODIs at board meetings and in monthly performance reports
- reviewed the annual report on the delivery of our capital programme and capital expenditure in 2016/17, our capital programme for 2017/18 as well as the half-year review of its delivery
- reviewed the water resources position, the readiness and resilience of the company in case of drought in accordance with our drought plan and the impact of a possible drought on our bulk supplies
- carried out regular reviews at each of our meetings and an annual review of performance against our operational commitments and outcome delivery incentives and of the initiatives taken to ensure we meet our targeted performance. Carried out in depth reviews of our performance and action plans on water quality and discoloration
- reviewed the operation of our framework agreement with Jacobs, our engineering partner for the delivery of our capital programme, and approved the terms of its extension
- reviewed the lessons learnt from the cryptosporidium incident experienced by United Utilities at Franklaw WTW and the steps to be implemented to improve the prevention of and response to similar or large scale incidents that could affect South East Water
- reviewed the update on the "Freeze and Thaw" incident at the beginning of 2018 and our operational response. Approved the compensation package to customers affected by interruptions

Financial

- reviewed and approved the annual report and financial statements and the regulatory accounts for 2016/17 and the half-year financial reporting for 2017/18. Reviewed and approved this annual report including regulatory accounts
- considered the extension of our capex facility and our plan for refinancing in 2018/19. Created a committee to oversee our refinancing and consider changes to gearing and financing structure in line with regulatory requirements
- reviewed the financial forecast for 2017/18 and approved the budget assumptions and the budget for 2018/19
- considered the feedback from the audit committee on the audit plan and the auditor's fees
- · considered and approved dividends
- reviewed the position of the pension schemes, including deficit and pension scheme strategy as well as the 2017 funding valuation
- reviewed the methodology for and valuation of our non-household retail business for the purpose of our exit from the non-household retail market and also considered the impact of a potential sale of the acquiring licensee on that valuation to ensure the transaction was at arm's length

Governance, internal controls and risk management

- reviewed the composition of the board and its committees and the recommendations of the nomination committee on the appointment of new directors to the board and carried out the annual evaluation of the board's effectiveness
- carried out the annual review of our health & safety performance and the effectiveness of our policies and processes and reviewed the initiatives implemented in 2016/17 and the programme of initiatives for 2017/18
- considered the report from the remuneration committee on executive performance related pay, the relevant performance measures and objectives for the financial year
- reviewed the process for the monitoring of compliance with our statutory obligations and reporting against the corresponding ODI M
- adopted our modern slavery statement and reviewed the related procedures implemented to ensure compliance with legislation on modern slavery
- reviewed our insurance programme and the renewal of the policies and benchmarking
- reviewed the annual IT update to the board and the review of cyber security including in the context of the preparation for the General Data Protection Regulation (GDPR)
- carried out the annual review of risks and of the effectiveness of our risk management process
- reviewed the company's preparation programme and readiness for the implementation of GDPR
- considered the changes of investment managers of the ultimate shareholders of the company and their impact on the composition of the board

Strategy, regulation and stakeholders

- reviewed our People Plan for succession planning, talent management, diversity and engagement with our employees
- considered Ofwat's communications with water companies' chairs on key policy issues including financing structures, trust in the water sector and placing customers at the heart of water companies' businesses. Agreed our responses and considered how to incorporate these considerations into our strategy
- reviewed and approved the approach to the preparation and assurance of our annual regulatory reporting and approved the annual regulatory reporting including the annual performance report, the risk and compliance statement, cost assessment tables and our performance, people and planet report
- reviewed the development of our business plan at each board meeting, and through two dedicated PR19 committee. Dedicated our strategy session to PR19 and especially to our approach to customer engagement and segmentation. Developed and participated in our programme of direct board engagement with customers and in our customer research
- reviewed our submissions for RCV separation, performance commitments and cost adjustment for PR19
- reviewed the development of our new water resources management plan
- met with Sir Tony Redmond, Regional Chair of the Consumer Council for Water to discuss our performance and the priorities of CCW
- reviewed our strategy and readiness programme for the exit from the non-household retail market and the transfer of our non-household retail business to Invicta Water Ltd as the acquiring licensee
- met with Zoe McLeod to discuss the work of the CCG and receive feedback from the CCG on the preparation of our business plan, how best to address their challenges and how to ensure a step change in customer engagement

Leadership and effectiveness continued

- reviewed the household and non-household tariffs structure and the approach for setting charges for 2018-19 and the assurance for the publication of the statement of significant change in relation to the new non-household assessed charge, indicative and final charges and approved the related board assurance statements. Set detailed conditions for the delegation of authority of the final calculation of the charges following publication of the relevant RPI
- reviewed the approach for the new charging structure for new connection services and our new charging arrangements
- reviewed the update of the Company Monitoring Framework
- considered the steps required to prepare the company to the changes introduced by the new standard of reporting developed with the industry for consistency in reporting
- reviewed our reporting on gender pay gap and the actions to take to address gender pay gap
- reviewed the proposed changes for the simplification of the instrument of appointment

Board evaluation

Our board evaluation was carried out by means of a confidential online questionnaire. The results were collated and summarised by the Company Secretary on a non-attributable basis and the Chairman led a discussion on the conclusions to draw from the survey results and recommendations for change or improvement.

The questionnaire covered the key aspects of the performance of the board and its committees and included open questions on the working and effectiveness of the board and committees in fulfilling their roles. Each committee also considered its own practices against its terms of reference and the chairs' reports on their findings in their respective sections of this corporate governance report.

The Chairman also met with each Non-Executive and Executive Director to provide feedback on their performance and to receive suggestions from them. The evaluation of the Chairman was carried out by the Non-Executive Directors and the shareholders nominated directors receiving feedback from the Executive Directors in the absence of the Chairman.

Several suggestions made in the responses to the board evaluation carried out in 2017 were adopted and in particular the suggestion to put more emphasis on the information on environmental aspects and on the environmental impact of decisions. It was also agreed to expand the reporting on the monitoring of compliance with the company's obligations adding to the existing reporting on compliance already carried out in relation to ODIs. In line with these recommendations changes were made to the performance, people and planet report to give more emphasis to these aspects. During the year the board also decided to establish an environmental. social and governance committee which will be formally constituted during 2018-19 taking account of planned changes to the composition of the board following changes of investment managers and shareholder representatives on the board.

The 2018 board evaluation concluded that the board and its committees were operating effectively. The board agreed to hold a workshop on the board collective working after the appointment of a new independent non-executive director and a new shareholder nominated director. The board also agreed to work during the year to incorporate customer engagement further into the day to day operations of the business and to build on the significant engagement carried out for the preparation of the PR19 business plan. It would also consider how it could engage further with key stakeholders to influence the definition of policies.

Commitment, information and support

The expected commitment including outside scheduled board meetings when required is reviewed as part of the appointment process of the Non-Executive Directors. The terms of appointment of Non-Executive Directors do not include a set expected time commitment but instead include an undertaking that the director will dedicate sufficient time to discharge his or her responsibilities. None of our Non-Executive Directors have raised concerns over the time required to fulfil their duties and this aspect is also considered in the board evaluation process.

The Chairman's and directors' other commitments were disclosed and considered prior to appointment and have not materially changed since their appointment. Details on the Chairman's and directors' other commitments can be found on page 58.

The board receives monthly performance reports to ensure that directors are regularly informed of performance. Directors raise questions directly with the Executive Directors when there is no scheduled board or raise questions at the following board. The monthly report covers all aspects of performance including performance against key regulatory obligations and outcome delivery incentives.

Directors also receive specific updates and reports as appropriate at and outside of scheduled board meetings. This includes detailed reports on Service Incentive Mechanism (SIM) results or updates on significant operational events. Senior executives also regularly present board items and updates on their particular areas to ensure that the board receives the information it needs.

On joining the board each director receives a detailed, tailored induction programme which is supplemented as needed to ensure that the director's knowledge, familiarity with South East Water and our industry, and their own capabilities are maintained at the appropriate level. The induction programme includes meetings with senior managers and visits to production sites and other facilities away from the head office. Such visits give directors the opportunity to speak to a wider group of employees and contractors.

The feedback provided by Ofwat following their pre-appointment interview is also incorporated into the induction programme.

Transparency and accountability

The board and the audit and risk committee ensure that the business, financial and regulatory reporting of South East Water is transparent and informative and accurately reflects material issues and describes our business model, strategy and performance.

The board is responsible for defining the risk management strategy and processes including the risk register and the identification of the principal risks. It also carries out an annual review of the effectiveness of the risk management and internal control systems (financial, operational and compliance), of the principal risks and of the prospects of our company. We provide details on these aspects on page 47 of the strategic report.

The audit and risk committee plays a key role in the ongoing monitoring of the adequacy and effectiveness of the internal controls and risk management systems established by the board. This involves reviewing the ability to identify and manage new risks types, ensuring effective controls are embedded into management and governance processes, and continuously monitoring risks with relevant items at each meeting. The audit and risk committee also ensures that appropriate audit work is carried out on risk management.

Report from the audit and risk committee

I am pleased to report on the work of the audit and risk committee since 1 April 2017 and in relation to this annual report for 2017/18.

- We have taken into account the increased emphasis of our revised corporate governance code on risk
 management and, in particular, our role in ensuring the ongoing monitoring of South East Water's risk
 management systems. We carried out reviews of selected key controls and transactions and ensured that the
 external audit covered a wider range of key controls.
- We reviewed the half-year financial reporting and recommended to the board the approval of the half-year financial statements, and of this annual report for 2017/18.
- We considered the prospects of the company for the purpose of both the going concern statement by the directors and the longer term viability described in the viability statement. We have recommended that the board maintain a lookout period of five years for its viability statement. We have also considered and made recommendations to the board on the appropriate nature and extent of stress testing to be used to assess the future prospects of South East Water. The description of our principal risks and our viability statement are included on pages 47 to 49 of the strategic report.
- We have considered the content and format of this annual report in line with the requirements of our
 corporate governance code and our company monitoring framework. Our aim is that this annual report and
 our regulatory reporting is informative, specific, clear and simple to understand. We have applied the same
 approach and scrutiny to our corporate social responsibility reporting.
- We have paid particular attention to ensure that our reporting on our outcome delivery incentives accurately reflects South East Water's performance in the year and on the quality and quality assurance of the data used for our reporting.
- We considered IFRS developments and in particular IFRS 15 which focuses on revenue earnt from contracts with customers, IFRS 9 and IFRS 16.

Financial statements and annual performance report

• Audit plan

The committee reviewed the audit plan with the auditors and was satisfied that it covered the key issues and was consistent with prior years with adjustments to take account of changes in the business and in particular the separation of the non-household retail business and the transfer of this business on exit which took place on 1 May 2018. We also reviewed the areas of focus of the audit and significant audit risks typical of a water company, including revenue recognition, leakage allowance, fixed assets, bad debt, and the definition of charges in line with the price determination. We also ensured that the external environment and the impact of Brexit would be considered as appropriate.

The audit plan recognised that there would be a requirement for an enhanced audit opinion as a public interest entity due to our bond financing. It also included an assessment of the impact of the adoption of new accounting standards, IFRS 15 on revenue recognition, IFRS 9 on financial instruments and IFRS 16 on leases and the requirement to provide explanations on the impact of their adoption.

• Fair, balanced and understandable

The committee has reviewed the annual report and financial statements and the regulatory reporting in order to assess whether they present a fair, balanced and understandable assessment of South East Water's position and prospects. The auditors presented their audit report to the committee and we discussed with them how the financial statement risks had been identified and described. We reviewed in particular any specific note and explanation to the financial statements to ensure they provided clear explanation of accounting policies and technical matters. Following this review, we recommended to the board that, taken as a whole, South East Water's annual report 2017/18 is fair, balanced and understandable.

We also reviewed the report from Jacobs, our external assurance partners, on our regulatory reporting and recommended to the board the approval for publication of our regulatory reporting, cost assessment tables and our performance, people and planet report.

• Significant judgements and sources of estimation uncertainty considered.

A significant proportion of water supplied to our domestic and our smaller commercial customers remains unbilled at the end of the financial year. As such judgements and estimates are made in respect of the value of unbilled water revenue. These estimates are based on previous consumption levels and are validated to ensure that the assessments are reasonable. This had also to be considered in the context of the exit from the non-household retail business on 1 May 2018, in addition to customer payments in advance and the treatment of unmeasured charges relating to consumption after the exit date.

Our trade receivables balance includes a provision for bad debt, which is our assessment of debts that will be unpaid by our customers. The provision is based on the application of expected recovery rates to our aged debt balances.

We have a significant capital programme and therefore it is important that the policies underpinning the capitalisation of expenditure are closely validated and compliant with current appropriate accounting standards. The committee ensures that the costs capitalised as fixed assets are directly attributable to capital projects.

Another area of judgement associated with our capital programme is the useful economic lives of fixed assets. This has a direct impact on the value of depreciation charged to the income statement. The lives of assets are reviewed annually based on managements' judgement and experience. An impairment review is also undertaken annually to write down the value of assets where it is considered appropriate to do so.

The audit committee keeps the judgements and sources of estimation uncertainty under review and challenges as appropriate, typically as part of the half year reporting and throughout the year as part of the Board review of the monthly management accounts in the Finance Report.

• Other areas of audit and risk committee focus

With the separation of the non-household retail business and of the billing system and the reliance on the market operator for non-household wholesale revenue, the committee reviewed specifically the related processes and data during the first year of operation under a separated structure and with reliance on external market data.

The transfer of our non-household retail business on exit to Invicta Water Ltd which occurred on 1 May 2018 and the valuation of the business and the presentations and disclosures relating to that transaction were specifically considered by the committee.

Other areas of focus reviewed by the committee included the appropriateness of actuarial assumptions for the valuation of the assets and liabilities of the two defined benefit pension schemes to ensure they were are within an acceptable range considering the economic environment, valuations assumptions relating to the valuation of financial instruments and consideration of future financing and going concern.

We also considered the processes put in place for billing and collection on behalf of Southern Water to provide a single bill to our joint household customers.



You will find the terms of reference of our audit and risk committee on our website at southeastwater.co.uk/ourgovernance

External auditors

Audit fee

We reviewed the audit fee proposal from the auditors and, based on the audit plan and comparing with the previous year's fee and taking account of the specific work required in relation to the non-household retail separation and exit, we were satisfied to recommend the fee to our board for approval.

• Effectiveness of the external audit process

We reviewed the effectiveness of the external audit process receiving feedback from the auditors, the Finance Director and the Head of Finance on the conduct of the audit and any issues and potential improvements. The Chair of the committee met with the auditors to discuss the audit. We were satisfied with the performance of the auditors and the effectiveness of the overall process.

• Objectivity and independence of auditors

We reviewed the objectivity and independence of the auditors considering the proportion of the total fees received by the auditors which is paid by South East Water, non-audit services, the duration of the appointment of the auditors, and the confirmation of independence from the auditors. We also considered the level of non-audit services relating essentially to regulatory reporting which are best provided by Deloitte to ensure consistency. The committee concluded that Deloitte remained objective and independent in their role as external auditor.

We applied a revised policy on non-audit services defined in the previous financial year that requires approval of non-audit work by the Chair of the audit committee or, for any work in excess of £50,000, the full committee. The auditors performed tax work with the required approval in relation to items allowable under the relevant independence regulations.

Risk management and internal controls

- The committee dedicates time at each of its meeting to the monitoring of the effectiveness of South East Water's risk management systems. We also reviewed specific areas of risk or compliance.
- We commissioned and reviewed a report from PWC on the controls surrounding the contract with Clancy
 Docwra our main contractor for strategic mains laying which concluded that adequate controls were in place.
 We also commissioned and reviewed a report from PWC on the pain gain mechanism under our reactive
 maintenance contract and the transparency of cost information provided for that mechanism. We considered
 the findings and recommendations for improvement of the existing processes and their implementation
 including additional QS resource and further engagement with our contractor to improve the flows of
 information between the parties.
- We considered whether or not an internal audit function was required. We considered the established
 processes in place for regulatory and performance reporting which include both internal and external
 assurance, the size and structure of the company and the nature of the core activities. We concluded that an
 internal audit function was not required at this stage and that the current combination of internal reviews
 of controls and systems carried out by the finance team and of specific reviews by external consultants
 was appropriate and allowed access to specialist skills and knowledge that it would not be cost effective to
 maintain internally.
- We also reviewed the effectiveness of our policies and practices in relation to the prevention of fraud, whistleblowing and anti-bribery and introduced a reporting at each meeting of any issue raised in relation to these aspects.
- We reviewed the effectiveness of the committee as part of the board evaluation and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference.

Chris Girling

Chair 13 July 2018

Relations with shareholders

Communication with shareholders is facilitated, as South East Water, is a private limited company, with shareholder nominated non-executive directors on the board.

It is important that the board appreciates the requirements of shareholders and equally that shareholders understand how the actions of the board and financial performance relate to the achievement of South East Water's longer-term goals. The reporting calendar is dominated by the publication of interim and final results each year, in which the board reports to shareholders on its stewardship of South East Water. At other times during the year, presentations to rating agencies and updates to the stock exchange are made available to all. The Chairman ensures that the Managing Director and Finance Director provide feedback to the board following presentations to investors and meetings with shareholders.



Remuneration

Report from the remuneration committee

On behalf of the board, I am pleased to present the directors' remuneration report for the year ended 31 March 2018. The report summarises our key objectives, our remuneration policy, the key linkages between directors' pay and the performance of the company as well as the level of each director's emoluments for the year.

Our aim is to ensure that executive pay is aligned with South East Water's strategy and that remuneration reflects the company's performance against clear operational and financial measures as well as individual objectives.

We take on board the concerns expressed to the industry regarding the linking of executive pay to successful business performance. Whilst ensuring in turn that successful business performance is linked to demonstrable consumer benefits. We set out in the remuneration report how this has been achieved this year.

I would highlight the following:

2017/18 Annual Bonus Scheme

- We decided that the construct of the scheme would be based on that applied in 2016/17 save that we increased the number of operational objectives from five to six. This ensured a broader range of customer outcomes were incentivised and it maintained the incentive to outperform, even if one objective was not met, which the committee felt was in the consumers' interest
- The March 2018 freeze/thaw had a significant impact on the leakage and interruptions operational objectives which prior to the event were heading for above target outcomes
- We reviewed the full year performance of the company and that of individual executive directors, taking account of their contribution in delivering the targets set

2018/19 Annual Bonus Scheme

- We decided that the construct of the scheme should follow that applied in 2017/18 but allowing for a review to take account of changes resulting from our planned exit from the non-household retail market
- In defining objectives for the Executive Directors, we ensured that they included improving diversity and inclusion, the development of our ESG framework and of our customer engagement strategy beyond PR19

2018 annual salary review

• The committee decided that the Executive pay award would continue to follow the company wide pay award. The same principle was applied to the remuneration of Independent Non-Executive Directors

Long-term Incentive Plan (LTIP)

• South East Water operates a Long-term Incentive Plan (LTIP) covering the five year period from April 2015 to March 2020. Similar to the annual bonus plan, the LTIP is designed to give priority to delivering operational objectives linked to customer outcomes. The related bonus payments are phased 20 per cent in 2018, 30 per cent in 2019 and 50 per cent in 2020. We have reviewed progress against the LTIP targets considering actual performance in 2015/16 and 2016/17 as well as the pre-audited performance in 2017/18 and estimated performance in 2018/19 and 2019/20. We authorised the first 20 per cent payment subject to publication and confirmation of the final performance measures for 2017/18

Governance

• We reviewed the effectiveness of the committee as part of the overall board evaluation process and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference

Emma Gilthorpe

Chair 13 July 2018

Directors' remuneration report

Remuneration policy

The remuneration of independent non-executive directors' is built on a structure of fixed fees which are periodically compared with market practice, ensuring that pay is competitive in order to encourage the retention and motivation of board members.

Rewards for the managing director and senior executives are based on a total reward package of basic salary and annual performance and long-term incentive schemes in addition to benefits sufficient to attract, motivate and retain individuals of the required calibre to lead the business. Our policy aims to be around median market practice, with performance incentives for achieving challenging operational, financial and personal targets to motivate strong commitment to achieving the goals set, as well as to establish a close link between overall rewards, corporate performance and the benefits delivered to our customers. Operational targets include improving South East Water's customer satisfaction and service incentive mechanism scores, health and safety performance in addition to performance measures such as leakage, interruptions and discoloration.

Financial performance targets are focussed on "totex" costs and cash collection efficiency. The remuneration committee establishes annual bonus targets at the beginning of each financial year and decides the performance bonus payment to each member of the executive team based on an assessment of their performance at the end of the year. For the long-term incentive scheme, targets have been set to cover the five year regulatory period to end March 2020. Decisions on the pay of senior executives take into account information from independent reward surveys. The managing director and senior executives participate in the same pension schemes as other employees.

South East Water's reward policy is to maintain a total reward package for employees throughout the business consisting of basic salary and additional benefits sufficient to attract, motivate and retain high quality personnel. Senior managers participate in the management performance bonus scheme. The intention is to be positioned around median market practice and we participate in reward surveys to benchmark our reward practices in order to ensure this outcome.

2017/18 Annual bonus performance criteria

At the end of the 2016/17 financial year the remuneration committee opted to amend the structure of the executive bonus scheme, with any alterations made taking effect from April 2017.

These alterations did not impact the premise of the executive bonus scheme, whereby the bonus payable to each director is calculated by establishing multipliers for each performance category and applying the product of those multipliers to the maximum bonus level. The new scheme has seen the number of operational objectives increase from five to six with the introduction of an objective relating to customer contacts regarding the discoloration of water supplied. In addition to this, no bonus becomes payable if three or more out of the six operational objectives are not met (operational objectives multiplier becomes zero) and the reward progressively decreases if one or more operational objectives are not met. This is a shift from prior years where no bonus became payable if more than one of the then five operational objectives were not met and a reduced rate of 75 per cent was paid in circumstances where only one of the operational objectives was not met.

These changes are designed to ensure that focus is maintained on the other operational objectives in the event of the failure of one operational objective, while ensuring that the bonus scheme remains to prioritise the delivery of operational objectives above all else.

Directors' remuneration report continued

Operational objectives	 Customer satisfaction Health and safety Leakage (MI/d) Interruptions SIM score Discolouration contacts 	Multiplier range 0% to 118% Interruptions and discoloration contacts objectives not met; all others achieved, therefore actual performance 44%
Financial objectives	 Cash collection as a percentage of actual billing Whole business totex 	Multiplier range 0% to 140% Actual performance 100%
Personal objectives	· Set individually for each Executive Director	Multiplier range of 0% to 100%

The March 2018 freeze/thaw had a significant impact on the leakage and interruptions operational objectives which prior to the event were heading for above target outcomes.

2017/18 Bonus as a percentage of basic salary

Directors	Percentage of salary paid if 100% of target achieved	Awarded
Paul Butler	50.0%	19.8%
Andrew Farmer	30.0%	11.9%
David Hinton	30.0%	11.9%

The payments under the performance incentive scheme were made in July 2018 and are set out in the directors' emoluments section below.

Long-term incentive plan

A long-term incentive plan (LTIP) was introduced at the beginning of the 2015/16 financial year. This incentive plan aligns the long-term interests of shareholders and the executive team, retains and rewards executive management of appropriate calibre as well as rewards executive directors for the performance over the regulatory period, including the impact of AMP6 performance on the final determination for the next regulatory period.

The LTIP has been constructed to give priority on delivering operational objectives, such that no bonus becomes payable if the overall performance on ODI's generates a penalty.

The LTIP grants cash awards at the beginning of the AMP6 period and vests over the six year period, 2015/16 to 2020/21, in increasing stages. Awards equivalent to one year's salary have been granted and will vest as detailed opposite.

Vesting of awards will be subject to three interdependent performance conditions as illustrated below:

		Multiplier 1		Multiplier 2		Multiplier 3	
Base award	Х	Operational cash flow	Х	ODI	х	SIM	= Final award vested

The criteria are as follows:

Operational cash flow*	Outcome delivery incentive	Service incentive mechanism ranking
Multiplier	Multiplier	Multiplier
0 x to 1.5 x (depending on outcome achieved)	0 x to 1.25 x (depending on outcome achieved)	1.35 x to 0.25 x (depending on position achieved)

^{*} OCF is defined as the sum of cumulative net cash generated from operations less cumulative net cash flow over the 5 years of the AMP6 period as reported in the SEW Statutory accounts (adjusted for AMP7 Revenue and RCV penalties in respect of totex outperformance and revenue correction mechanism adjustments).

The awards are as follows:

	Base award £000	Corporate plan target £000	Maximum award £000	2017/18*	2018/19*	2019/20*
Paul Butler	240	360	607.5	20%	30%	50%
Andrew Farmer	180	270	455.6	20%	30%	50%
David Hinton	140	210	354.5	20%	30%	50%

^{*} The remuneration committee will assess the level of award payable shortly after each of the financial years set out above.

As noted above the first vesting period for the long-term incentive plan is 2017/18. The remuneration committee has considered the performance objectives of the directors and decided to award payment under the scheme rules as follows:

	2017/18 £000
Paul Butler	54
Andrew Farmer	41
David Hinton	32

These payments were made in July 2018.

Directors' remuneration report continued

Directors' emoluments

	Salary and fees £000	Other £000	LTIP £000	Bonus £000	2017/18 Total £000	2016/17 Total £000
Directors						
Nick Salmon (Non-executive Chairman)	100		-	-	100	100
Paul Butler (Managing Director)	246	66	54	49	415	418
Andrew Farmer (Finance Director)	187	13	41	22	263	249
David Hinton (Asset & Regulation Director)	146	18	32	17	213	195
Marissa Szczepaniak (Non-Executive Director)	-	-	-	-	-	-
Oliver Schubert (Non-Executive Director) (A – 3 May 2017)	-	-	-	-	-	-
Peter Dixon (Non-Executive Director) (R – 27 April 2017)	-	-	-	-	-	-
Independent Non-Executive Directors						
John Barnes	33	8	-	-	41	33
Emma Gilthorpe	37	1	-	-	38	37
Chris Girling	40	2	-	-	42	43
Paul Rich (R – 3 July 2017)	9	1	-	-	10	34
Célia Pronto (A – 1 June 2018)	-	-	-	-	-	_

A – Appointed R – Resigned

With effect from 1 April 2018 the salaries of the Executive Directors were increased in line with the company's pay award of 2.2 per cent. The executive bonus scheme for 2018/19 is unchanged.

In the year, Paul Butler was a member and David Hinton was a deferred member of a defined benefit pension scheme. For Paul Butler, the above table includes a cash supplement in lieu of the pension cap of £49,248 (2017: £48,000). David Hinton is a member of a stakeholder pension scheme and was not in receipt of a cash supplement in the lieu of the pension cap in the year (2017: £nil).

Other emoluments also comprise benefits-in-kind in the form of company car allowances, fuel costs and healthcare insurance.

^{· 2016/17} represents 4 months for M Szczepaniak.

^{· 2017/18} represents 3 months for P Rich.

The Executive Directors have employment contracts with notice periods not exceeding one year and have a performance related bonus included within their remuneration. The independent non-executive directors all have letters of appointment. As South East Water Ltd is a wholly-owned subsidiary, there are no listed shares and no directors are offered any share incentives in the company. The employment contracts and letters of appointment of the directors employed during the year include the following terms:

Executive Directors	Date of contract	Unexpired term (months)	Notice period (months)
Paul Butler	2 October 2006	N/A	12
Andrew Farmer	29 June 2015	N/A	6
David Hinton	1 June 2013	N/A	12
Independent Non-Executive	Directors		
Nick Salmon	1 April 2015	36	3
Emma Gilthorpe	1 October 2015	6	3
Chris Girling	30 October 2014	31	3
John Barnes	28 January 2016	9	3

The contracts of both Nick Salmon and Chris Girling were extended in the year. Their initial contracts were due to expire on the 31 March 2018 and 29 October 2017 respectively, however Nick Salmon has seen his contract extended until 31 March 2021 and Chris Girling until 29 October 2020.

Marissa Szczepaniak, Oliver Schubert and Peter Dixon were appointed by South East Water's ultimate shareholders to sit on the Board of South East Water Ltd and do not receive any remuneration for this service from South East Water Ltd.

Directors' remuneration report continued

Pension benefits earned

Approved contributory final salary pension scheme

One Executive Director was a member of the defined benefit pension scheme during the year. Their accrued entitlements under the scheme were as follows:

Accrued benefits	David Hinton
At March 2018	
Annual pension	28,442
Lump sum	85,237
At March 2017	
Annual pension	27,615
Lump sum	82,755
Increase in accrued benefits excluding inflation	
Annual pension	-
Lump sum	-
Increase in accrued benefits after allowing for inflation	
Annual pension	827
Lump sum	2,482

Paul Butler has exercised his right to draw a pension and as such there are no benefits accruing in the pension scheme as at 31 March 2018.

The defined benefit pension was closed to future accrual on 31 March 2015.

Approved defined contribution scheme

In the year to 31 March 2018 two Executive Directors were members of the defined contribution scheme. The table below summarises the contributions that were made in the scheme as at 31 March 2018:

	Contributions in 2015/16	Contributions in 2016/17	Contributions in 2017/18
Andrew Farmer	27,274	37,453	22,170
David Hinton	28,000	28,392	29,934

Approved by the board and signed on its behalf by:

Emma Gilthorpe

Chair 13 July 2018





Group financial statements

Directors' report	86
Directors' responsibilities statement	90
Independent auditor's report	91
Group income statement	99
Group statement of comprehensive income	99
Group statement of financial position	100
Company statement of financial position	101
Group statement of changes in equity	102
Company statement of changes in equity	103
Group statement of cash flows	104
Company statement of cash flows	105
Notes to the financial statements	106

Directors' report

The Directors have pleasure in presenting the group directors' report relating to South East Water Ltd ("South East Water" or the "company") and its subsidiary South East Water (Finance) Ltd (together referred to as the "group") for the year ended 31 March 2018, together with the audited financial statements.

Principal activities

The principal activities of the group comprise the supply of water to a population of 2.2 million in an area of 5,657 square kilometres and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the relevant legislation. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future.

Appointment as a water undertaker and the ring-fence

South East Water has been appointed as a water undertaker under the Water Industry Act 1991 and the duties and the obligations of the appointee are set out in that Act, in regulations created under that Act, and in its instrument of appointment. The conditions of the instrument of appointment cover a variety of areas including charges, accounts and requirements to produce information and various codes of practice.

Condition K of the instrument of appointment deals with ring-fencing and requires South East Water to ensure, so far as is reasonably practicable, that it retains at all times sufficient rights and assets (other than financial resources) for a special administrator, if appointed, to be able to manage the affairs of the business, which must be confirmed annually. Condition F requires South East Water to ensure that it has sufficient financial and managerial resources and adequate systems of planning and internal control to carry out the regulated activities and to certify this annually.

Condition F requires South East Water to conduct the appointed business as if it was substantially the company's sole business and it was a separate public limited company. The ultimate controller of South East Water is bound by a binding undertaking required under Condition P to procure that its subsidiaries, other than South East Water, provide information required by South East Water to comply with its obligations under the Water Industry Act 1991 and the instrument of appointment and to refrain from any action that would cause the appointee to breach any of these obligations.

The effect of the relevant legislation and the terms of the instrument of appointment mean that our directors have an overriding responsibility to ensure the regulatory ring-fence is maintained. The directors remain mindful of these obligations along with their duties as directors set out in the Companies Act 2006. One of the ways the directors meet the ring-fencing obligations is by ensuring that all board level matters that affect the company are decided at the board of South East Water, rather than at a holding company level.

Group structure

South East Water Ltd is the main operating company in the group of companies headed by HDF (UK) Holdings Ltd. Further details of the structure of the HDF group are provided in the strategic report on page 39.

Capital structure

Details of the authorised and issued share capital are shown in note 26 of the financial statements. There have been no movements during the year. South East Water has one class of share which carries no right to fixed income.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the Articles of Association and prevailing legislation.

Details of South East Water's immediate and ultimate controlling parties are provided in note 32 and in the strategic report.

Accounting framework

The financial information presented in these audited financial statements has been prepared in accordance with the disclosure and transparency rules of the Financial Services Authority and International Financial Reporting Standards (IFRS) as adopted for use in the European Union. The financial statements are presented in Sterling.

The results published in this report describe our performance for the year and incorporate the performance of South East Water Ltd and South East Water (Finance) Ltd.

Business review

The turnover of the group for the year ended 31 March 2018 was £224.8 million (2017: £218.9 million) and operating profit was £75.0 million for the year (2017: £79.0 million). Profit before taxation for the year was £23.7 million (2017: £25.3 million). The financial position at 31 March 2018 for the group and for the company is shown on pages 100 and 101 respectively. Further analysis of the performance of the business and future developments is included in the strategic report.

From 1 April 2017 the market for the supply of water to non-household customers was opened to competition. At the time of market opening the company had some 54,000 business customers which accounted for approximately 15 per cent of the company's water revenue. The extensive preparations that the company implemented meant that we were ready for these changes from both the wholesale and retail parts of our business.

The wholesale part of the business is responsible for the abstraction, treatment and distribution of drinking water. The retail part has operated throughout the financial year and has included all the customer related activities. Following our engagement in the previous financial year with Open Water and Market Operator Systems Ltd (MOSL) programmes, we have established ourselves in the new retail market.

On 30 April 2018, the company sold its interest in the non-household business to its sister subsidiary, Invicta Water Ltd. Details of the sale are provided in note 31 of these financial statements.

Research and development activities

South East Water is a member of UK Water Industry Research (UKWIR) and participates in their research programmes.

Dividends

The directors have approved dividends totalling £18.0 million (2017: £16.0 million) for the year, paid in equal instalments of £4.5 million per quarter. Further details are given in note 10 of the financial statements. South East Water's immediate parent company, South East Water (Holdings) Ltd used £4.5 million of this dividend (2017: £4.7 million) to pay interest on an inter-company loan back to South East Water Ltd.

Capital expenditure

During the year the group's capital expenditure totalled £96.0 million (2017: £89.8 million). Further details are given in notes 12 and 13 of the financial statements.

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.

Group financial statements continued

Taxation

While the group makes profits, the extensive investment programme currently being undertaken by South East Water typically means that any taxable profits are exceeded by available capital allowances. As tax losses are available elsewhere in the HDF (UK) Holdings Ltd group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge. The payment of group relief is made at the statutory rate for corporation tax so does not impact the effective tax rate. The effective rate after making allowance for the future rate change and prior year adjustments is 31.9 per cent. Additional information on taxation is provided in note 9.

Directors and their interests

The directors who served at the date of this report are set out on page 5. On 3 May 2017 Oliver Schubert was appointed a Non-executive director and on 1 June 2018 Célia Pronto was appointed as Independent Non-Executive Director.

Also, during the year Paul Rich and Peter Dixon resigned from the board. Further information regarding our directors is set out on pages 58 to 60.

No director held any shares or loan stock in South East Water or other associated companies required to be disclosed under the Companies Act 2006 during the financial year.

Directors' indemnities

South East Water has granted an indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

Principal risks and uncertainties

A description of the principal risks and uncertainties and an explanation of the steps the board takes to mitigate these risks are provided in the strategic report.

Environmental and corporate social responsibility

South East Water's approach to sustainable development of our business includes a strong commitment to the environment and corporate social responsibility. Further details are given in the strategic report. We also report on our greenhouse gas emissions in our performance, people and planet report.

Employment policies

South East Water offers equal opportunities to all employees and applicants for employment. Our managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm South East Water is an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the strategic report.

South East Water gives full consideration to applications for employment from disabled persons where the candidate's particular aptitudes and abilities are consistent with meeting the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Where existing employees become disabled it is South East Water's policy to provide continuing employment, wherever practicable, in the same position or in an alternative position and to provide appropriate training to achieve this aim.

Employee consultation

South East Water places considerable value on the involvement of our employees and has continued to keep them informed on matters affecting them as employees and on various factors affecting the performance of the company. This is achieved through formal and informal meetings, regular bulletins on the intranet and an employee magazine. Employee representatives are consulted regularly through the Staff Council on a wide range of matters affecting their current and future interest.

Financial instruments

Information about the use of financial instruments by South East Water and our subsidiary is given in note 23 of the financial statements.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the strategic report. The group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. The group's annual budget and forecasts, together with its five year plan and longer resources planning, all indicate that the group should be able to continue operating. Our longer term viability statement is set out on page 52.

Therefore, the directors believe that South East Water Ltd and the group are well placed to manage their business risks successfully. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Post balance sheet events

On 30 April 2018, the company transferred its rights and interests in the trade and customer base of its non-domestic customers to another HDF group company, Invicta Water Limited, for a consideration of £10.0m. See note 31 for further details

On 10 April 2018 Hastings Fund Managers Limited, who are the managers of the group's ultimate holding company, changed its name to Vantage Infrastructure Holdings Limited.

Directors' statement on audit information

The directors who were members of the Board at the time of approving the directors' report are listed on page 5, further information regarding our directors is set out on pages 58 to 60. Having made enquiries of fellow directors, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which the group's auditor is unaware; and
- each director has taken all the steps a director ought to have taken to be aware of 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 provisions of s418 of the Companies Act 2006.

In the absence of a general meeting, Deloitte LLP has been re-appointed as auditor in accordance with the terms of their contract.

Donations

No political donations were made by the group in either the current or prior period.

Approved by the board on 13 July 2018 and signed on its behalf by:

Nicolas Truillet

Company Secretary 13 July 2018

Directors' responsibilities statement

The directors are responsible for preparing the annual report and 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 are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and Article 4 of the IAS Regulation and have also elected to prepare the parent company financial statements in accordance with IFRS. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the group and company financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- make an assessment of the company's ability to continue as a going concern

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole
- the strategic report includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's performance, business model and strategy

Paul Butler

Managing Director 13 July 2018

Andrew Farmer

Finance Director 13 July 2018

Independent auditor's report to the members of South East Water Limited

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and as regards the group financial statements, Article 4 of the IAS Regulation

We have audited the financial statements of South East Water Limited (the 'parent company') and its subsidiaries (the 'group') which comprise:

- the group income statement;
- the group statement of comprehensive income;
- the group and parent company statement of financial position;
- the group and parent company statement of changes in equity;
- the group and parent company statement of cash flows; and
- the notes 1 to 32 to the financial statements, which include a summary of significant accounting policies.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

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

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independent auditor's report to the members of South East Water Limited continued

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: · Bad debt provisioning · Revenue recognition – estimating unbilled revenue · Classification of costs between operating and capital expenditure, in particular focusing on the appropriateness of capitalised costs and classification of assets in the course of construction ('AICC').
Materiality	The materiality that we used for the group financial statements was £3.5m (2017: £3.6m) which was determined on the basis of 3.25% of earnings before interest, tax, depreciation and amortisation ("EBITDA") (2017: 5% of net operating profit).
Scoping	The group comprises South East Water Limited (the regulated water business) and its only subsidiary company South East Water (Finance) Limited (which issues part of the group's debt). Both of these companies were subject to a financial statement audit by the group audit engagement team.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in note 2 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 47 to 49 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 90 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 89 as to how they have assessed the
 prospects of the group, over what period they have done so and why
 they consider that period to be appropriate, and their statement as to
 whether they have a reasonable expectation that the group will be able
 to continue in operation and meet its liabilities as they fall due over the
 period of their assessment, including any related disclosures drawing
 attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Key audit matters

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

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

Bad debt provisioning

Key audit matter description



As a proportion of South East Water's customers do not or cannot pay their bills, there is the need for a provision to be made for non-payment of part of the account's receivable balance. We have identified a key audit matter in relation to the bad debt provision as significant judgement is involved in determining the provision. The provision is determined based on analysis of historical cash collections and estimation of future cash collectability of the the aged debt balance as at 31 March 2018. We have identified a risk of fraud in relation to this audit matter due to its impact on key performance metrics. The value of the bad debt provision at 31 March 2018 is £28.05m (2017: £28.44m). The value of trade receivables net of the provision at 31 March 2018 is £34.5m (2017; £32.7m).

The Board of Directors' also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 72. This is also reflected as a key source of estimation uncertainty in note 2 to the financial statements and the relevant accounting policy adopted is disclosed in note 2.

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



We obtained and challenged the information used to determine the bad debt provision by considering cash collection performance against historical trends and the level of bad debt charges over time. We reviewed the actual history of slow paying customers in the period to understand the collection of previously aged debtors. We assessed the mechanical accuracy of the calculation and the reasonableness of assumptions used in determining the bad debt provision.

We evaluated the design and implementation of key management review controls and those relating to the provision model used in management's bad debt provision calculation.

Key observations



We are satisfied that the assumptions applied in assessing the impairment of trade receivables and the calculation of the ageing of trade receivables are materially appropriate.

Independent auditor's report to the members of South East Water Limited continued

Revenue recognition - estimating unbilled revenue

Key audit matter description



For customers with meters, the revenue recognised depends upon the volume used, including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. The unbilled accrual at 31 March 2018 was £34.7m (2017: £32.4m) and is disclosed in note 17.

The risk is focused on the usage estimate, which is based on historical data and assumptions around consumption patterns upon which management then recognise unbilled revenue. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

The Board of Directors also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 72. This is also reflected as a key source of estimation uncertainty in note 2 to the financial statements and the relevant accounting policy adopted is disclosed in note 2.

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



We challenged the validity of management's estimate of current year accrued revenue by comparing actual amounts billed to the estimate made in the prior year to determine the accuracy of the estimation techniques.

We also evaluated the design and implementation of key controls throughout the unbilled revenue cycle.

In addition, we recalculated the total level of unbilled revenue for the current year using data extracted from the billing system and applying management's consumption assumptions. We challenged the validity of these assumptions to ensure they are supportable and in line with our understanding of the business model and customer profile.

Key observations



We are satisfied that management's assumptions in relation to the recognition of unbilled revenue are appropriate.

Classification of costs between operating and capital expenditure

Key audit matter description



The group has a substantial capital programme (fixed asset additions in the year were £92.4m (2017: £86.6m), see note 13, including £11.8m (2017:£11.6m) of capitalised costs) and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets.

Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred. Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and therefore the allocation of costs between capital and operating expenditure is inherently judgemental, as is the quantification of directly attributable costs to be capitalised.

The group also has assets in the course of construction ('AICC') of £59.9m (2017: £61.0m). We identified a risk in relation to the aged AICC as there is a greater risk that these assets will not generate future economic benefit and consequently are impaired.

We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

The Board of Directors also considered capital expenditure as an area of significant judgement as discussed in the Corporate Governance Report on page 72. This is reflected as a key source of estimation uncertainty in note 2 to the financial statement and the relevant accounting policy adopted is disclosed in note 2.

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



We assessed the group's capitalisation policy to determine compliance with relevant accounting standards and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the group's capital programme during the year. This included consideration of the allocation of costs between capital and operating expenditure. We specifically challenged the assumptions and judgements made in allocating overheads to capital projects, through understanding the nature of activities performed.

We evaluated the design and implementation and operating effectiveness of key management controls operating throughout the capital expenditure cycle.

In addition, for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by agreement to third party invoices, as well as assessing the appropriateness of capitalised overheads based on our understanding of the nature of the cost capitalised. We inspected the list of projects for which AICC was significantly aged (3 years or greater) and for a sample of aged projects we investigated project recovery by making further enquiries with the project managers outside the finance team to understand the project progression in order to determine if the amounts were correctly presented as AICC.

Key observations



Based on our audit of a sample of capital projects, the testing of controls, and our review of the project budgets, we consider that the classification of costs between operating and capital expenditure is appropriate.

Independent auditor's report to the members of South East Water Limited continued

Our application of materiality

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

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

	Group financial statements	Parent company financial statements		
Materiality	£3.50m	£3.46m		
Basis for determining materiality	3.25% of Earnings before interest, tax, depreciation and amortization ('EBITDA').	3.25% of EBITDA.		
Rationale for the benchmark applied	An earnings measure has been selected as our basis for materiality as this is a key driver of business value, is a critical component of the financial statements and is a focus for users of the financial statements.			
	Using an EBITDA measure excludes the impact of items such as the fair value movement of derivatives, to focus on the group's underlying trading performance, consistent with the group's internal and external reporting.			
	As the group is also part of HDF (UK) Holdings appropriateness of the consolidation of this s results.			

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.2m for the group and parent company, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level.

South East Water Limited and South East Water (Finance) Limited were subject to full scope audits and together account for 100 per cent of the group's turnover, net assets, profit before tax, gains/losses on financial instruments and exceptional items.

All work was carried out directly by the group audit team.

Other information

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

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in respect of these matters.

Other information continued

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

We have nothing to report in respect of these matters.

In this context, matters that we report to you as uncorrected material misstatements of the other information include where we conclude that:

- Fair, balanced and understandable the statement given by the
 directors that they consider the annual report and financial statements
 taken as a whole is fair, balanced and understandable and provides the
 information necessary for shareholders to assess the group's position
 and performance, business model and strategy, is materially inconsistent
 with our knowledge obtained in the audit; or
- Audit committee reporting the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

Responsibilities of directors

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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.

Independent auditor's report to the members of South East Water Limited continued

Report on other legal and regulatory requirements Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

matters.

report in respect of these

We have nothing to

We have nothing to report in respect of these matters.

Other matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the company to audit the financial statements for the year ending 31 March 2011 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 8 years, covering the years ending 31 March 2011 to 31 March 2018.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

Jacqueline Holden FCA

Senior Statutory Auditor

for and on behalf of Deloitte LLP Statutory Auditor London, United Kingdom 13 July 2018

Group income statement

for the year ended 31 March 2018

		2018	2017
	Notes	£000	£000
Revenue	3	224,776	218,905
Group net operating costs	5	(158,713)	(147,302)
Other income	3	8,895	7,407
Group operating profit Finance costs Finance income	7 8	74,958 (56,019) 4,803	79,010 (58,793) 5,119
Profit before taxation Taxation	9	23,742 (7,574)	25,336 1,759
Profit for the year		16,168	27,095
Earnings per share Basic and diluted	11	32.79p	54.95p

Group statement of comprehensive income

for the year ended 31 March 2018

		2018	2017
N	otes	£000	£000
Profit for the year		16,168	27,095
Items that will not be reclassified subsequently to profit or loss: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes Impact of deferred tax rate change in respect of the	24 9	9,355 (1,590)	(3,933) 708
pension schemes	9	-	(286)
		7,765	(3,511)
Total comprehensive income for the year attributable to owners of the company		23,933	23,584

Group statement of financial position

as at 31 March 2018

	Notes	31 March 2018 £000	31 March 2017 £000
Non-current assets Intangible assets Property, plant and equipment Amount due from parent undertaking Defined benefit pension surplus	12 13 15 24	10,758 1,501,707 190,013 21,229	11,058 1,455,380 190,013 9,616
		1,723,707	1,666,067
Current assets Inventories Trade and other receivables Cash and cash equivalents	16 17 18	236 78,255 6,528	214 72,113 11,371
		85,019	83,698
Total assets		1,808,726	1,749,765 ————
Current liabilities Loans and borrowings Trade and other payables Deferred income Provisions Non-current liabilities Loans and borrowings Trade and other payables	20/23 22 25 21 19/23 19/23	(20,000) (94,379) (7,593) (2,515) (124,487) (900,897) (5,979)	(96,130) (6,573) (2,472) (105,175) (882,024) (4,261)
Derivative financial instruments Net deferred tax liabilities Defined benefit pension liability Deferred income	19/23 9 24 25	(104,169) (140,085) - (74,471)	(100,916) (132,895) (1,851) (69,938)
Total liabilities		(1,225,601)	(1,191,885)
-		(1,350,088)	(1,297,060)
Net assets		458,638	452,705
Equity Ordinary share capital Revaluation reserve Retained earnings	26	49,312 256,396 152,930	49,312 261,549 141,844
Total equity		458,638	452,705

The accompanying notes are an integral part of this statement of financial position.

The consolidated financial statements of South East Water Limited (company number 02679874) on pages 99 to 152 were approved by the board of directors and authorised for issue on 13 July 2018 and were signed on its behalf by:

Paul Butler

Andrew Farmer

Managing Director 13 July 2018 Finance Director 13 July 2018

Company statement of financial position

as at 31 March 2018

Notes	31 March 2018 £000	31 March 2017 £000
12 13 15	10,758 1,501,707 190,013	11,058 1,455,380 190,013
24	21,229	9,616
	1,723,707	1,666,067
16 17 18	236 77,701 6,310	214 71,555 10,754
	84,247	82,523
	1,807,954	1,748,590
20 22 25 21 19 19 19 19 9 24 25	(20,000) (95,012) (7,593) (2,515) (125,120) (900,897) (5,979) (104,169) (140,085) - (74,471)	(96,319) (6,573) (2,472) (105,364) (882,024) (4,261) (100,916) (132,895) (1,851) (69,938) (1,191,885)
		(1,297,249)
		451,341
26	49,312 256,396 151,525	49,312 261,549 140,480 451,341
	12 13 15 24 16 17 18 20 22 25 21 19 19 19 19 9 24 25	Notes 12 10,758 13 1,501,707 15 190,013 24 21,229 1,723,707 16 236 17 77,701 18 6,310 84,247 1,807,954 20 (20,000) 22 (95,012) 25 (7,593) 21 (125,120) 19 (900,897) 19 (104,169) 9 (104,169) 9 (140,085) 24 25 (74,471) (1,225,601) (1,350,721) 457,233

The accompanying notes are an integral part of this statement of financial position.

The company has not presented an income statement or a statement of comprehensive income. The profit for the year of the company was £16.1 million (2017: £27.1 million). The total comprehensive income for the year attributable to owners of the company was £23.9 million (2017: £23.6 million).

The consolidated financial statements of South East Water Limited (company number 02679874 on pages 99 to 152 were approved by the board of directors and authorised for issue on 13 July 2018 and were signed on its behalf by:

Paul Butler

Group statement of changes in equity for the year ended 31 March 2018

	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2016	49,312	264,134	129,328	442,774
Profit for the year	-	-	27,095	27,095
Other comprehensive income: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes Impact of deferred tax rate change in respect of the pension schemes	- -	- - -	(3,933) 708 (286)	(3,933) 708 (286)
Total other comprehensive income	-	-	(3,511)	(3,511)
Total comprehensive income Dividends (see note 10) Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases Impact of deferred tax rate change	- - - - -	- (6,130) (28) 1,226 2,347	23,584 (16,000) 6,130 28 (1,226)	23,584 (16,000) 2,347
Balance at 31 March 2017	49,312	261,549	141,844	452,705
Profit for the year	-	-	16,168	16,168
Other comprehensive income: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes	-	-	9,355 (1,590)	9,355 (1,590)
Total other comprehensive income	-	-	7,765	7,765
Total comprehensive income Dividends (see note 10) Release of revaluation reserve Release of revaluation reserve on disposals Deferred tax on revaluation and retained earnings transfer	- - - -	- (6,129) (70) 1,046	23,933 (18,000) 6,129 70 (1,046)	23,933 (18,000) - - -
Balance at 31 March 2018	49,312	256,396	152,930	458,638

All transactions relate to the equity holders of the company.

Company statement of changes in equity

for the year ended 31 March 2018

	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2016	49,312	264,134	128,006	441,452
Profit for the year	-	-	27,053	27,053
Other comprehensive income: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes Impact of deferred tax rate change in respect of the pension schemes	-	- - -	(3,933) 708 (286)	(3,933) 708 (286)
Total other comprehensive income	-	_	(3,511)	(3,511)
Total comprehensive income Dividends (see note 10) Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases Impact of deferred tax rate change	- - - -	- (6,130) (28) 1,226 2,347	23,542 (16,000) 6,130 28 (1,226)	23,542 (16,000) - - - 2,347
Balance at 31 March 2017	49,312	261,549	140,480	451,341
Profit for the year	-	_	16,127	16,127
Other comprehensive income: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes	-	-	9,355 (1,590)	9,355 (1,590)
Total other comprehensive income	-	-	7,765	7,765
Total comprehensive income Dividends (see note 10) Release of revaluation reserve Release of revaluation reserve on disposals Deferred tax on revaluation and retained earnings transfer	- - - -	- (6,129) (70) 1,046	23,892 (18,000) 6,129 70 (1,046)	23,892 (18,000) - -
Balance at 31 March 2018	49,312	256,396	151,525	457,233

All transactions relate to the equity holders of the company.

Group statement of cash flows for the year ended 31 March 2018

	2018	2017	
Notes	£000	£000	
Operating activities Net cash flow from operating activities 27 Interest received Interest paid Group tax relief paid	123,089 4,554 (35,619) (4,020)	127,462 4,827 (35,169) (2,000)	
Net cash flow before investing and financing activities	88,004	95,120	
Investing activities Proceeds from sale of property, plant and equipment Purchase of property, plant and equipment Purchase of intangible assets Fixed asset contributions received	264 (93,763) (3,106) 1,758	212 (83,423) (3,197) 1,712	
Net cash flow used in investing activities	(94,847)	(84,696)	
Financing activities New bank loans received Dividends paid to shareholder 10	20,000 (18,000)	(16,000)	
Net cash flow used in financing activities	2,000	(16,000)	
Decrease in cash and cash equivalents Cash and cash equivalents at the beginning of the year	(4,843) 11,371	(5,576) 16,947	
Cash and cash equivalents at the year end 18	6,528	11,371	

Company statement of cash flows for the year ended 31 March 2018

	2018	2017
Notes	£000	£000
Operating activities Net cash flow from operating activities Interest received Interest paid Group tax relief paid	123,095 4,543 (35,235) (4,000)	127,462 4,815 (35,187) (2,000)
Net cash flow before investing and financing activities	88,403	95,090
Investing activities Proceeds from sale of property, plant and equipment Purchase of property, plant and equipment Purchase of intangible assets Fixed asset contributions received	264 (93,763) (3,106) 1,758	212 (83,423) (3,197) 1,712
Net cash flow used in investing activities	(94,847)	(84,696)
Financing activities New bank loans received Dividends paid to shareholder 10	20,000 (18,000)	- (16,000)
Net cash flow used in financing activities	2,000	(16,000)
Decrease in cash and cash equivalents Cash and cash equivalents at the beginning of the year	(4,444) 10,754	(5,606) 16,360
Cash and cash equivalents at the year end 18	6,310	10,754

Notes to the financial statements

for the year ended 31 March 2018

1. Authorisation of financial statements and statement of compliance with IFRSs

The financial statements of South East Water Ltd and its subsidiary (the "group") for the year ended 31 March 2018 were authorised for issue by the Board of Directors on 13 July 2018 and the Statement of Financial Position was signed on the Board's behalf by Paul Butler and Andrew Farmer. South East Water Ltd is a limited liability company incorporated in the United Kingdom and domiciled in England and Wales.

The principal accounting policies adopted by the group are set out in note 2.

2. Accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union and applied in accordance with the Companies Act 2006.

The financial statements are prepared under the historical cost convention except for pension assets and liabilities and certain financial instruments that have been measured at fair value and certain assets under property, plant and equipment which were recognised at the date of transition to IFRS at deemed cost by reference to fair value.

The group financial statements are presented in Sterling and all values are rounded to the nearest thousand pounds (£000) except where otherwise indicated.

Basis of consolidation

These financial statements incorporate the financial information of South East Water Ltd (the "company") and its subsidiary South East Water (Finance) Ltd.

Transactions and balances between the company and its subsidiary have been eliminated fully on consolidation. Subsidiaries are consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control is transferred out of the group.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the strategic report. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described on pages 99 to 152. The strategic report on page 15 includes a description of the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. The group's annual budget and forecasts together with its five year plan and longer-term resources planning all indicate that the group should be able to continue in operation utilising its current financial resources and the proceeds of future borrowing opportunities expected to become available.

The directors believe that the company and group are well placed to manage its business risks successfully. After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

The preparation of financial statements requires the application of judgements and assumptions by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those arrived at based on management's judgements and assumptions.

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Key judgements

The most significant judgements and assumptions for the group are set out below:

- the useful lives of infrastructure and non-infrastructure assets: the group's asset lives, as detailed on page 110, represent a key judgement which impacts the value of depreciation charged to the income statement. The useful lives of the asset categories which determine the value of depreciation charged to the income statement are reviewed annually and are based on management's judgement and experience. An impairment review is undertaken annually to write down the value of assets where it is considered appropriate to do so
- the capitalisation of employee and other directly attributable costs: the group determines employee costs directly attributable to capital projects based on time spent. Other directly attributable costs are then assessed and costs relating to capital projects are capitalised into individual projects. During the year £11.8 million of employee and other directly attributable costs have been capitalised (2017: £11.6 million)
- pension and other post-employment benefits: there are a range of variables required to be determined to value the company's pension schemes and the underlying costs of providing post-employment benefit. The costs of defined benefit pension schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets, and corporate bond performance projections as set out in note 24. Pension increases are based on expected future inflation rates. The net defined benefit pension scheme asset at 31 March 2018 is £21.2 million (2017: asset of £7.7 million) The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind up, or otherwise augment the benefits due to members of, the scheme. Based on these rights, any net surplus in the UK scheme is recognised in full.

Key sources of estimation uncertainty

Estimates are also required by management when preparing the financial statements which affect assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The most significant estimates included in the group's financial statements are set out below.

 un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year-end a large volume of water has been supplied but not invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2018 was £34.7 million (2017: £32.2 million)

The methodology for this estimate incorporates estimates of water use based on historic consumption and the relevant tariff per customer. Previous billing consumption history for customers provide a reliable basis for the estimate that we included in the accounts. Within the methodology the key consideration is consumption of water and our historic analysis suggests that billed revenue has been within two per cent of our previous estimates. To illustrate the sensitivity of this estimate, fluctuations in estimated water consumption up to three per cent has been set out in the table below:

	31 March 2018	Sensitivity			
		+1%	+3%	-1%	-3%
Un - invoiced water estimate	£34.7m	+£0.3m	+£1.0m	-£0.3m	-£1.0m

 the provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the group based on applying expected recovery rates to an aged debt. The value of the provision for doubtful debts as at 31 March 2018 was £28.1 million (2017: £28.4 million)

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

The methodology for determining the bad debt provision at the year-end incorporates customer debt categories and estimated cash collection percentages for different groups of customers. The key determining factor in the calculation is the estimated balance remaining after all cash collection activities have been exhausted. Our sensitivity analysis suggests that the bad debt provision would vary between £0.5m and £1.5m if cash collections estimates were between one per cent and three per cent above or below those predicted.

	31 March 2018	Sensitivity			
		+1%	+3%	-1%	-3%
Bad debt provision estimate	£28.1m	+£0.3m	+£0.8m	-£0.3m	-£0.8m

Note – as our policy is to provide fully for debts over four years old, the sensitivity application is applicable only to that debt which is less than four years old. Based on experience our best estimate is that debt over four years old is not recoverable.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group, there has been a transfer of risk and control and the revenue can be reliably measured. All revenue arises within the United Kingdom and is recorded net of VAT. The company only recognises revenue in respect of "named" customers. Specific recognition criteria must also be met before revenue is recognised as detailed below.

Metered and unmetered water income

Metered water and wastewater income is recognised when water has been delivered to the customer. This income includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Unmetered water and wastewater income was invoiced in full for the financial year 2017/18 on 1 April 2017.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Infrastructure charges

Infrastructure charges represent the fees charged to property developers and others for connecting new properties and water outlets to the group's network. Such fees are recognised in the income statement when they are received.

Other income

Other income includes rechargeable works' charges and charges for engineering, scientific, laboratory, billing and cash collection services. Rechargeable works represent payments received from developers for installing meters and connections to new property developments. Other income is recognised when the work is complete.

Finance income

Finance income is recognised using the effective interest method.

for the year ended 31 March 2018

2. Accounting policies (continued)

Taxation

Current tax, being UK Corporation Tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred tax is provided using the liability method on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax liabilities are recognised for all taxable temporary differences except where the deferred tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences and the carry forward of unused tax assets and losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences and the carry forward of unused tax assets and losses can be utilised.

Deferred tax assets are recognised for the deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. In accordance with IAS 12 Income Taxes, deferred taxes are not discounted.

Dividends

Dividends are recorded in the financial statements in the year in which they are approved by the board.

Investments in subsidiaries

Investments are recorded at historical cost. Where the directors are of the opinion that there has been a permanent diminution in the value of investments, the carrying amount of such investments is written down to the recoverable amount.

Intangible assets

Software

Software intangible assets externally acquired are recognised at cost. They have finite useful lives and are amortised over three to five years on a straight-line basis. Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Employee and other costs directly attributable to intangible asset projects are capitalised in the financial statements as part of the cost of the intangible asset to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised.

Derecognition

An intangible asset is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the item, is included in the income statement in the year in which the item is derecognised.

for the year ended 31 March 2018

2. Accounting policies (continued)

Property, plant and equipment

Infrastructure assets

Infrastructure assets comprise a network of systems relating to water distribution. Infrastructure assets in the course of construction are depreciated from the time they are brought into use and are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets, being between 20 years for short life assets and 100 years for all other infrastructure assets.

Non-infrastructure assets

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. All other non-infrastructure assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and office equipment	3-10

Derecognition

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and useful lives

Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Capitalisation of employee and other directly attributable costs

Employee and other costs, including borrowing costs, directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs are not capitalised.

Leased assets

Property, plant and equipment held under finance leases are capitalised at the lower of the fair value of the leased asset and the present value of the minimum lease payments. These assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Impairment of property, plant and equipment, investments and intangible assets

At each reporting date an assessment is carried out to determine whether there is any indication that property, plant and equipment, investments and software intangible assets may be impaired. If there is an indication of impairment, the recoverable amount of the asset or respective cash-generating unit is compared to the carrying amount. Where the recoverable amount is less than the carrying amount, the asset value is reduced to the recoverable amount with an impairment loss recognised as an operating cost in the income statement in the year in which the respective assessment takes place.

for the year ended 31 March 2018

2. Accounting policies (continued)

Borrowing costs

Borrowing costs are incurred on the group's general borrowings. Where appropriate borrowing costs are attributed to qualifying assets in line with IAS 23 Borrowing Costs. Otherwise borrowing costs are expensed as incurred. See note 7 for further details.

Grants and contributions

Grants and contributions are received in respect of both infrastructure and non-infrastructure assets. These are recognised as deferred income and are released to the income statement over the life of the assets to which they relate.

Inventory

Inventory is valued at the lower of average cost or net realisable value. The stocks of treated water held by the group are valued at nil. Consumable chemical purchases are recognised as an expense in the income statement at the point of purchase.

Work-in-progress for chargeable services is valued at the lower of cost and net realisable value.

Short-term trade and other receivables

Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short term deposits with an original maturity of three months or less.

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short-term deposits in order to meet the interest and associated swap payments falling due in respect of listed debt and other long-term borrowings.

Trade payables

Trade payables are measured at fair value and subsequently measured at amortised cost.

Financial instruments

The group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term bank deposits, trade receivables and trade and other payables.

Recognition

Financial instruments are recognised on the statement of financial position when the group becomes party to the contractual provisions of the instrument. The group determines the classification of its financial liabilities at initial recognition.

Derecognition

Financial liabilities are removed from the statement of financial position when the related obligation is discharged, cancelled or it expires.

Financial assets are removed from the statement of financial position when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

for the year ended 31 March 2018

2. Accounting policies (continued)

Embedded derivatives

Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

Derivative financial instruments

The group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the statement of financial position at fair value with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Short-term trade and other receivables

Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Impairment of financial assets

At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced through the use of an allowance account in accordance with IAS 39 Financial Instruments: Recognition and Measurement, with the loss being recognised in the income statement in the year in which the respective assessment takes place. Impaired debts are derecognised when they are assessed as irrecoverable.

Revaluation reserve

The revaluation reserve was created on the adoption of IFRS when the company took the option to treat the revalued amounts as deemed cost. This reserve, is released over the life of the underlying assets to which it relates in line with the depreciation of the revalued assets and transferred to retained earnings. The revaluation uplift remaining on any assets that are disposed of is also transferred to retained earnings at the time of the disposal.

Leases

Finance leases, which substantially transfer to the group all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised, at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

for the year ended 31 March 2018

2. Accounting policies (continued)

Provisions

A provision is recognised when the group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Research and development

Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised based on management's judgement that the technological and economic feasibility of a project is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Pension and other post-employment benefits

The group accounts for pensions and other post-employment benefits under IAS 19(R). The group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

Defined contribution plans

Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due.

Defined benefit plans

The pension scheme asset or liability in the statement of financial position represents the net present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans.

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

The pension cost in the income statement includes current and past service cost and the effect of any settlements and curtailments. A net finance charge or credit is recognised within finance costs in the income statement and comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

All actuarial gains and losses and the related current and deferred taxation are recognised in the statement of recognised income and expense.

for the year ended 31 March 2018

2. Accounting policies (continued)

New standards and interpretations adopted

In the current year, the group has applied a number of amendments to IFRSs issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for accounting periods beginning on or after 1 January 2017. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

New standards and interpretations not applied

As the group prepares their financial statements in accordance with IFRS as adopted by the European Union, the application of new standards and interpretations will be subject to their having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the group's discretion regarding early adoption of the standards.

At the date of these financial statements, the following Standards and Interpretations were in issue but not yet effective (and in some cases had not yet been adopted by the EU) and have not been applied to these Financial Statements:

IFRS 4 (amended) Insurance Contracts
IFRS 9 (amended) Financial Instruments

IFRS 12 (amended) Disclosure of Interests in Other Entities
IFRS 15 Revenue from Contracts with Customers

IFRS 16 Leases

IFRS 17 Insurance Contracts (replaces IFRS 4)

IAS 19 (amended) Employee Benefits

IAS 28 (amended) Investments in Associates and Joint Ventures

IAS 40 (amended) Investment Property

IFRS 9 Financial Instruments

The adoption of IFRS 9 Financial Instruments ("IFRS 9"), which the group plans to adopt for the year beginning on 1 April 2018, will impact both the measurement and disclosure of financial instruments.

When considering the classification of financial instruments, IFRS 9 has one classification approach for all financial assets. Two criteria are used to determine how financial assets should be classified and, hence, measured:

- the entity's business model for managing the financial assets
- the contractual cash flow characteristics of the financial asset

IFRS 9 does not change the classifications of financial liabilities from the current IAS 39 requirements. IFRS 9 requires all financial liabilities to be measured at amortised costs, except for financial liabilities through profit or loss. Liabilities measured at fair value through profit or loss include:

- derivative financial instruments
- liabilities held for trading
- liabilities an entity designates as fair value through profit or loss

An entity may, at initial recognition, designate a liability at fair value through profit or loss if doing so would eliminate or substantially reduce a measurement or recognition inconsistency. After initial recognition, an entity cannot reclassify a financial liability.

for the year ended 31 March 2018

2. Accounting policies (continued)

The assets and liabilities that are affected by the adoption of IFRS 9 and the impact on the future results of the group are considered below.

Financial asset	Classification	Measurement
Non-current financial assets: Loan to parent undertaking	The asset is classified as "measured at amortised cost" because: 1. The asset generates contractual cash flows solely of principal and interest. 2. The asset is held to collect contractual cash flows only.	Valued at amortised cost less transactions costs on issue of the financial asset and a credit loss allowance. The potential for default on this loan is viewed as low due to the historic performance in the payment of interest and security within the borrower. The loss allowance has been calculated as £95,000 which would be charged to the income statement.
Current financial assets: Trade debtors Accrued income Amounts due from parent undertaking	These assets are currently classified as "Loans and receivables. As this classification does not exist in IFRS 9 the assets will be classified as "measured at amortised cost" because: 1. The asset generates contractual cash flows solely of principal. 2. The asset is held to collect contractual cash flows only.	Trade debtors are valued at amortised cost less transactions costs on issue of the financial asset. Accrued income almost exclusively consists of the estimation of unbilled water consumption and is, therefore, aligned with trade debtors and valued accordingly. Amounts due from parent undertaking are valued at amortised cost less transactions costs on issue of the financial asset.

The bad debt provision is an integral part of the value of trade debtors and is the recognition of the credit risk on this financial asset. IFRS 9 requires trade receivables to include a lifetime expected credit loss provision based on historical experience, current experience and economic conditions and forecast changes in the debtors' circumstances and economic conditions. However, the standard also allows for the use of "practical expedients" in the calculation of expected credit losses. In this instance it is not possible to reliably predict future cash flows and there appears to be no correlation between the cash collections and the movement in indices such as RPI, CPI or LIBOR to aid prediction. Therefore, the application of historic credit loss experience as an acceptable expedient should be applied to trade debtors.

An expected credit loss is also required for the accrued income. In view of the close relationship between accrued income and water trade debtors, an expected credit loss of similar proportions to the estimated uncollected debt would be appropriate. Using a probability weighted analysis of the accrued income at 31 March 2018, an expected credit loss of £2.0 million would be required. The existing provision for loss of accrued income is £0.9 million. The balance of the required expected credit loss of £1.1 million would be charged to the retained earnings.

for the year ended 31 March 2018

2. Accounting policies (continued)

All of the group's financial liabilities within the scope of IFRS 9 are classified as "measured at amortised cost" with the exception of the derivative swap arrangement, which is classified as "measured at fair value through profit or loss". These are the same classifications as currently recognised under IAS 39.

The adoption of IFRS 9 will also have no significant impact on the measurement of the value of the group's financial liabilities as the current carrying values of the liabilities measured at amortised costs meets the criteria for the measurement at amortised cost under the new standard. The current carrying value of the derivative, which is measured at fair value through profit or loss, also meets the IFRS 9 criteria for such liabilities.

Financial asset	Classification	Measurement
Current financial liabilities: Trade creditors Other payables Other taxes Accruals Amounts due to parent	Classified as "measured at amortised cost".	There is no financing element within these liabilities and they are measured at their price that is payable.
Current financial liabilities: Bank loans	Classified as "measured at amortised cost".	Measured at amortised cost being the value of the loan. There are no unamortised loan issue costs.
Non-current financial liabilities: Irredeemable debentures Listed bonds	Classified as "measured at amortised cost".	Irredeemable debenture stocks are measured at amortised cost being the value of the loan. There are no unamortised loan issue costs.
Index linked loans		Listed bonds and index linked loans are measured at amortised cost being the value of the loan less transactions costs on issue of the financial asset.
Derivative instrument – interest rate swap	Classified as "fair value through profit or loss".	Measured at fair value based on the discounted future cash flows of the fixed and variable rate elements of the arrangement. The movement in the fair value each year is charged to the income statement.

The standard requires the effective interest rate to be used for the amortisation loan issue costs. Changing the accounting policy would reduce the life to date amortisation charged to the income statement on the company's loans by £31,000.

for the year ended 31 March 2018

2. Accounting policies (continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15, which the group is required to adopt on 1 April 2018, delivers its core principles of revenue recognition in a five step framework as follows:

- 1 Identify the contracts with customers.
- 2 Identify the performance obligations in the contract.
- 3 Determine the transaction price.
- 4 Allocate the transaction price to the performance obligations in the contract.
- 5 Recognise revenue as and when performance obligations are met.

The group has a number of different income streams that need to be considered in the context of IFRS 15.

Income from the supply of water and wastewater services is currently recognised as the service is supplied. Under IFRS 15 there is no significant judgment required in identifying the customer in these contracts with customers. The performance obligations are the supply of the water and wastewater services and revenue is recognised as these obligations are satisfied over time. The adoption of the new standard is not expected to have any impact on the timing and amount of revenue recognised in these services.

Other income, including mast rentals, billing and collections services and laboratory services, involve similarly readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated. Revenue is recognised as the contracts are completed and the performance obligations satisfied. This is in line with the current accounting policies for these income streams.

Income from transactions relating to the group's network assets in providing a network connection and on-going access to the network ("capital income") requires significantly more judgment in identifying contracts with customers and the related performance obligations. This is an area that remains under active consideration within the water industry and the accounting profession and the accounting treatment ultimately adopted by the group could be impacted by the results of these ongoing discussions.

Capital income can be categorised under the following headings:

- · infrastructure charges
- new connections income
- developer contributions to new mains and mains diversions

Infrastructure charges are currently recognised in the income statement when access to the mains supply is granted. New connections income, to the extent it relates to the cost of the new connection, and developer contributions are currently held as deferred income on the statement of financial position and released to the income statement over the life of the underlying assets.

These activities relate to the establishing a connection to the water network and are performed for developers. Each of these activities are performed as separate contracts with the developers as required and on request from developers. Not all developments require all of these activities to be performed. The overall result from these contracts is that properties are allowed access to the network prior to the properties being sold. These activities are part of the group's ordinary activities associated with the operation, maintenance and expansion of a water network and, because they are deemed to result in an exchange transaction, we have determined that they fall within the scope of IFRS 15 as transactions arising from contracts with customers, i.e. the developers who request the services.

for the year ended 31 March 2018

2. Accounting policies (continued)

The performance obligations in contracts for the different capital related income streams are recognised as:

- infrastructure charges the provision of access to the network
- new connections income the connection of individual properties via a communication pipe to the mains supplying the development
- developer contributions to new mains and mains diversions the completion of the laying of a new main or replacement main, as defined by the contract

The prices attaching to these contracts and relating to these performance obligations are set in line with the guidance provided by Ofwat. In the case of infrastructure charges and new connections a number of properties are aggregated together in determining when performance obligations are completed and the price relating to the obligation.

Revenue is recognised on each of these capital income streams on completion of the performance as described above.

IFRS 15 will be applied retrospectively in the group's financial statements for the year ending 31 March 2019. The cumulative effect of initially applying the standard will be recognised as an adjustment to the opening retained earnings balance at the date of initial application. Applying IFRS 15 results in a significant change to the accounting policy for new connections income and developer contributions to new and diverted mains.

At the date of adoption of IFRS 15, the group had £75.7 million of deferred income in respect of infrastructure charges, new connection charges and developer contributions to new and diverted mains. Of this amount, £70.6 million relates to contracts that have been completed and where the assets are in current use under the current accounting standards. The group will be applying the practical expedience allowed in IFRS 15 not to adjust for income from assets where the contract has been completed. Our initial assessment is that this will result in an adjustment being made to the opening balance of retained earnings of £70.6 million for the year ended 31 March 2019 as the balance of deferred income in respect of closed contracts is reduced to nil.

The remaining £5.1 million of charges and contributions received from developers relate to contracts where the performance obligations have not yet been satisfied. These will be recognised in the income statement on completion of the respective performance obligation under each contract.

The impact of the adoption of IFRS 15 for 2018/19 financial year is estimated to be an additional £5.9 million of revenue recognised in the income statement. The deferred income carried in the balance sheet, which will include new contributions received until each performance obligation is complete, will be reduced by the release of £5.9 million of revenue upon the adoption of the new standard.

It is expected that a similar value of capital related revenue will be recognised in the income statement in future years under IFRS 15.

IFRS 16 Leases

The adoption of IFRS 16, which the group is required to adopt on 1 April 2019, will require the recognition of the assets from four leases. The most significant of the leases is for the use of the company's laboratory building and the recognition of the related financing under the terms of the 20 year lease. The value of both the fixed asset and the financing liability at the balance sheet date, based on discounted future cash flows is £2.5 million. The remaining three leases have a combined total asset value and related liabilities of £12,000.

The directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the group in future periods.

for the year ended 31 March 2018

3. Total income

	2018 £000	2017 £000
Revenue Unmetered water income Metered water income Unmetered sewerage income Metered sewerage income Other sales	34,971 183,033 4 507 6,261	46,115 166,513 - - - 6,277
Total revenue	224,776	218,905
Other income Rental income Sundry income	1,178 7,717	1,245 6,162
Total other income	8,895	7,407
Total income	233,671	226,312

All revenue is from customers within the United Kingdom.

Sundry income includes charges for billing and cash collection services amounting to £4.8 million (2017: £4.0 million), and laboratory income of £2.0 million (2017: £1.2 million).

for the year ended 31 March 2018

4. Segmental analysis

The group's revenue mainly arises from the supply of water and related activities. The activities of the group, for management purposes, fall into three operating areas being the supply of potable water on a wholesale basis, the supply of potable water and waste water services on a retail basis, both of which are governed by the Water Act 2014, and related non-regulated activities.

In prior years the wholesale and retail operations of the group have been reported jointed as "Regulated activities". However, during the year the reporting of these activities to the Board were separated and the below table reflects the new segments reported. The comparative year has been restated to present the same level of detail in the table.

Year ended 31 March 2018	Wholesale activities £000	Retail activities £000	Other activities £000	Total £000
Total income	200,438	25,349	7,884	233,671
Operating profit	66,903	5,978	2,077	74,958
Finance costs Finance income				(56,019) 4,803
Profit before taxation Taxation				23,742 (7,574)
Profit for the year				16,168
Year ended 31 March 2017				
Total income	194,201	24,506	7,605	226,312
Operating profit	69,673	5,825	3,512	79,010
Finance costs Finance income				(58,793) 5,119
Profit before taxation Taxation				25,336 1,759
Profit for the year				27,095

The group analyses results by segment to operating profits only, so no segmental statement of financial position or statement of cash flows are presented.

for the year ended 31 March 2018

5. Net operating costs

Notes	2018 £000	2017 £000
Employee benefits expense 6	29,962	27,870
Asset expense/(income): Depreciation – owned assets Depreciation – leased assets Impairment of fixed assets Amortisation of intangible assets Impairment of intangible assets (Profit)/loss on disposal of non-current assets	45,655 579 19 3,399 6 (120)	42,696 579 38 3,180 3 (94)
	49,538	46,402
Other operating expenses: Operating lease rentals: Vehicles and office equipment Land and buildings Fees payable to the group's auditor (see below) Other expenses (see below) Other operating expenses charged to capital projects	122 286 230 83,851 (5,276)	102 204 199 77,651 (5,126)
	79,213	73,030
Total operating costs	158,713	147,302
Fees payable to the group's auditor in respect of: Audit of the group and company financial statements Audit of subsidiary	168 1	113 1
Total audit	169	114
Regulatory accounts Other assurance services	36 15	25 29
	51	54
Services relating to taxation	10	31
Total non-audit services	61	85
Total fees charged to income statement	230	199

for the year ended 31 March 2018

5. Net operating costs (continued)

	2018 £000	2017 £000
Other expenses comprise:		
Energy costs	15,484	16,456
Rates	17,252	15,003
Contractors	20,055	19,486
Bulk water supplies and abstraction licences	8,666	8,295
Bad debts	1,950	1,408
Chemicals	3,077	2,745
Insurance	2,818	2,848
Other	14,549	11,410
	83,851	77,651

6. Directors and employees

The average monthly number of employees, including salaried directors, of the group in the year was:

		2018 Number	2017 Number
Operations		515	484
Management and administration		460	415
		975	899
		2018	2017
	Notes	£000	£000
The aggregate payroll costs of these persons were:			
Wages and salaries		29,875	28,189
Social security costs		2,995	3,083
Pension costs for defined benefit schemes	24	1,090	1,012
Pension costs for unfunded pensions		534	266
Pension costs for defined contribution schemes	24	2,007	1,772
		36,501	34,322
Less: direct salary costs charged to capital projects		(6,539)	(6,452)
		29,962	27,870

for the year ended 31 March 2018

6. Directors and employees (continued)

Emoluments of the directors, who are the group's key management, were:

	2018 £000	2017 £000
Aggregate emoluments including bonuses Company contributions to defined contribution scheme	1,122 52	1,109 66
	1,174	1,175
Emoluments of the highest paid director were: Aggregate emoluments including bonuses	415	418

Retirement benefits are accruing to one director (2017: two) under the defined benefit pension schemes and two directors (2017: two) under a defined contribution scheme. Further disclosures in respect of directors' emoluments are set out in the remuneration report on page 77.

7. Finance costs

	2018 £000	2017 £000
Debenture interest Effective interest on listed debt Fair value movements on interest rate swap Indexation on variable rate bonds Bank interest and other finance charges Financing guarantee fees Interest payable on index linked loans Indexation on index linked loans Amortisation of loan issue costs	42 22,401 3,253 5,680 652 1,158 11,767 12,644 548	43 21,973 13,690 4,258 661 1,165 11,420 7,339 548
Interest payable Interest capitalised	58,145 (2,126) 56,019	61,097 (2,304) 58,793

Interest capitalised during the year amounted to £2.1 million (2017: £2.3 million) and is calculated using the weighted average interest rate of the group's long-term lending of 4.43 per cent (2017: 4.42 per cent).

8. Finance income

	Notes	2018 £000	2017 £000
Interest receivable on bank balances and short term deposits Interest receivable from group undertakings Pension fund finance income	24	51 4,504 248	86 4,711 322
		4,803	5,119

for the year ended 31 March 2018

9. Taxation

Major components of the group's tax expense for the years ended 31 March 2018 and 2017 are:

	2018 £000	2017 £000
Group income statement		
Current tax:		
Current UK tax charge	1,975	3,168
Amounts over provided in previous years	(1)	(25)
	1,974	3,143
Deferred tax:		
Relating to origination and reversal of temporary differences Impact of deferred tax rate change	5,600 -	1,300 (6,202)
	5,600	(4,902)
Tax charge/(credit) reported in the group income statement	7,574	(1,759)
Tax charge/(credit) to equity		
Deferred tax on defined benefit pension schemes	1,590	(708)
Impact of deferred tax rate change in respect of the pension schemes	-	286
Tax reported in comprehensive income statement	1,590	(422)

Factors affecting the tax charge for the year

The tax for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	2018 £000	2017 £000
Profit before tax	23,742	25,336
Profit multiplied by the rate of corporation tax in the UK of 20% (2016: 20%) Effects of: Adjustments to current tax charge in respect of previous years Impact of amortisation on revaluation reserve Expenses not deductible for tax purposes Impact of rate change on deferred tax	4,511 (1) 2,523 541	5,067 (25) (1,162) 563 (6,202)
Total tax charge/(credit) reported in the group income statement	7,574	(1,759)

The adjustments to current and deferred tax in respect of previous years represents the changes between the year end and submitted computations. The expenses not deductible for tax purposes are made up of the movement on general provisions, entertainment expenses and depreciation on non-qualifying capital expenditure.

for the year ended 31 March 2018

9. Taxation (continued)

Deferred tax

The movement on the net deferred tax liability is as shown below:

	2018 £000	2017 £000
At 1 April (Credit)/Charge to the income statement (Credit)/charge to equity Impact of rate change on deferred taxation on the revaluation reserve	132,895 5,600 1,590	140,566 (4,902) (422) (2,347)
At 31 March	140,085	132,895

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered by giving relief against future taxable profits.

The movements in deferred tax assets and liabilities during the year are shown below:

	Accelerated tax depreciation £000	Pension provision £000	Total £000
Deferred tax liabilities			
At 1 April 2016	140,320	1,355	141,675
(Credit)/Charge to the income statement	(3,600)	385	(3,215)
Charge to equity	-	(422)	(422)
Impact of rate change on deferred taxation on the			
revaluation reserve	(2,347)	-	(2,347)
At 1 April 2017	134,373	1,318	135,691
(Credit)/charge to the income statement	3,866	699	4,565
Charge to equity	-	1,590	1,590
At 31 March 2018	138,239	3,607	141,846
	Fair value swap	Other provision	Total
	£000	£000	£000
Deferred tax assets			
At 1 April 2016	818	291	1,109
(Charge)/credit to the income statement	1,729	(42)	1,687
At 1 April 2017	2,547	249	2,796
(Charge)/credit to the income statement	(1,045)	10	(1,035)
At 31 March 2018	1,502	259	1,761

for the year ended 31 March 2018

9. Taxation (continued)

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax liability at 31 March 2018 was £135.9 million (2017: £132.9 million).

Capital investment is expected to remain at similar levels and the group expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Ltd group of companies.

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 19 per cent, changing to 17 per cent from 1 April 2020 (2017: 19 per cent changing to 18 per cent from 1 April 2020).

For the year ended 31 March 2018 a UK corporation tax rate of 19 per cent has been used as enacted by Finance Act 2013. A reduction in the UK corporation tax rate to 18 per cent (effective 1 April 2020) was substantively enacted 26 October 2015, and an additional reduction to 17 per cent (effective 1 April 2020) was substantively enacted on 6 September 2016. The deferred tax on temporary differences as at 31 March 2018 have been calculated at the rate applicable to the year in which the temporary differences are expected to reverse.

10. Dividends

	2018 £000	2017 £000
Equity dividends paid during the year:		
First interim dividend of 9.13p per ordinary share (2017: 8.11p per ordinary share)	4,500	4,000
Second interim dividend of 9.13p per ordinary share (2017: 8.11p per ordinary share)	4,500	4,000
Third interim dividend of 9.13p per ordinary share (2017: 8.11p per ordinary share)	4,500	4,000
Final dividend of 9.13p per ordinary share (2017: 8.11p per ordinary share)	4,500	4,000
	18,000	16,000

There were no dividends proposed for approval as at 31 March 2018 and 31 March 2017.

for the year ended 31 March 2018

11. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. The following reflects the income and shares data used in the basic and diluted earnings per share computations:

Group	2018	2017
	£000	£000
Profit for the year	16,168	27,095
Basic and diluted weighted average number of shares	Number 49,312,354	Number 49,312,354
Basic and diluted earnings per share	32.79p	54.95p

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

12. Intangible assets

Cost At 1 April 2017 16,842 3,067 19,909 Additions - 3,554 3,554 Transfers 5,710 (5,710) - Reclassifications 167 (615) (448) Disposals (313) - (313) At 31 March 2018 22,406 296 22,702 Amortisation and impairment 4t 1 April 2017 (8,851) - (8,851) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - (5) At 31 March 2017 16,842 3,067 19,099 Amortisation and impairment	Group and company	Computer software £000	Assets in the course of construction £000	Total £000
Additions - 3,554 3,554 Transfers 5,710 (5,710) - Reclassifications 167 (615) (448) Disposals 2313) - (313) At 31 March 2018 22,406 296 22,702 Amortisation and impairment (8,851) - (8,851) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - (3,399) Eliminated on disposals 312 - (6) Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909	Cost			
Transfers 5,710 (5,710) - Reclassifications 167 (615) (448) Disposals (313) - (313) At 31 March 2018 22,406 296 22,702 Amortisation and impairment Kt 1 April 2017 (8,851) - (8,851) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - (3,399) Eliminated on disposals 312 - (3,399) Eliminated on disposals (11,944) - (11,944) Net book amount at 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,099 Amortisation and impairment (5,671) - (5,671) Charge for the y		16,842	3,067	19,909
Reclassifications 167 (615) (448) Disposals (313) - (313) At 31 March 2018 22,406 296 22,702 Amortisation and impairment (8,851) - (8,851) Charge for the year (3,399) - (3,392) Eliminated on disposals 312 - (6) Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,197 3,197 At 1 April 2016 13,248 3,469 16,717 Additions - 3,599 (3,599) - Disposals 5 - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 -		-	•	3,554
Disposals (313) - (313) At 31 March 2018 22,406 296 22,702 Amortisation and impairment (8,851) - (8,851) At 1 April 2017 (8,851) - (3,399) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,197 3,197 At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180)	Transfers	5,710	(5,710)	-
At 31 March 2018 22,406 296 22,702 Amortisation and impairment (8,851) - (8,851) At 1 April 2017 (8,851) - (3,399) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - (3,197) 3,197 3,197 Additions - (3,197) 3,197 3,197 Transfers 3,599 (3,599) - (5) Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment 4 1,4 pril 2016 (5,671) - (5,671) Charge for the year (3,180) - (5,671) - (5,671) Charge for the year (3,180) - (3,180) - (3,180) Eliminated on disposals 3 - (3,28) Impairment (3,851)	Reclassifications	167	(615)	(448)
Amortisation and impairment (8,851) - (8,851) At 1 April 2017 (8,851) - (3,399) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,197 3,197 At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - (5) Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - (3,180) Eliminated on disposals 3 - (3,851) At 31 March 2017 (8,851) - (8,851)	Disposals	(313)	-	(313)
At 1 April 2017 (8,851) - (8,851) Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - (3,180) Eliminated on disposals 3 - (3,180) At 31 March 2017 (8,851) - (8,851)	At 31 March 2018	22,406	296	22,702
Charge for the year (3,399) - (3,399) Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,197 3,197 At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3,851) At 31 March 2017 (8,851) - (8,851)	Amortisation and impairment			
Eliminated on disposals 312 - 312 Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	At 1 April 2017	(8,851)	-	(8,851)
Impairment (6) - (6) At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost - 3,469 16,717 At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Charge for the year	(3,399)	-	(3,399)
At 31 March 2018 (11,944) - (11,944) Net book amount at 31 March 2018 10,462 296 10,758 Cost -	Eliminated on disposals	312	-	312
Net book amount at 31 March 2018 10,462 296 10,758 Cost At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment At 1 April 2016 (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Impairment	(6)	-	(6)
Cost At 1 April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment 4t 1 April 2016 (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	At 31 March 2018	(11,944)	-	(11,944)
At 1April 2016 13,248 3,469 16,717 Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment - (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Net book amount at 31 March 2018	10,462	296	10,758
Additions - 3,197 3,197 Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment - (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Cost			
Transfers 3,599 (3,599) - Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment - (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	At 1 April 2016	13,248	3,469	16,717
Disposals (5) - (5) At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment At 1 April 2016 (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Additions	-	3,197	3,197
At 31 March 2017 16,842 3,067 19,909 Amortisation and impairment At 1 April 2016 (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)		3,599	(3,599)	-
Amortisation and impairment (5,671) - (5,671) At 1 April 2016 (3,180) - (3,180) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Disposals	(5)	-	(5)
At 1 April 2016 (5,671) - (5,671) Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	At 31 March 2017	16,842	3,067	19,909
Charge for the year (3,180) - (3,180) Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Amortisation and impairment			
Eliminated on disposals 3 - 3 Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	At 1 April 2016	(5,671)	-	(5,671)
Impairment (3) - (3) At 31 March 2017 (8,851) - (8,851)	Charge for the year	(3,180)	-	(3,180)
At 31 March 2017 (8,851) - (8,851)	Eliminated on disposals	3	-	3
<u> </u>	Impairment	(3)	-	(3)
Net book amount at 31 March 2017 7,991 3,067 11,058	At 31 March 2017	(8,851)	-	(8,851)
	Net book amount at 31 March 2017	7,991	3,067	11,058

The impairment loss on computer software relates to website and internet software which has become obsolete. There is no recoverable value on this asset.

for the year ended 31 March 2018

13. Property, plant and equipment

Group and company	Land, wells, reservoirs and		Plant, equipment and	Assets in the course of	
	buildings	Mains	vehicles	construction	Total
	£000	£000	£000	£000	£000
Deemed cost At 1 April 2017 Additions	227,272	998,456	293,430	61,021 92,410	1,580,179 92,410
Transfers Reclassifications	3,957 -	49,966 -	40,215 (167)	(94,138) 615	448
Disposals	(71)	(205)	(660)	_	(936)
At 31 March 2018	231,158	1,048,217	332,818	59,908	1,672,101
Accumulated depreciation and impairment At 1 April 2017 Charge for the year Eliminated on disposals Impairment	(11,862) (4,267) 6	(50,651) (18,487) 10 -	(62,286) (23,479) 641 (19)	- - - -	(124,799) (46,233) 657 (19)
At 31 March 2018	(16,123)	(69,128)	(85,143)	-	(170,394)
Net book amount at 31 March 2018	215,035	979,089	247,675	59,908	1,501,707
Net book amount of leased assets included above	4,255	-	5,457	-	9,712
Assets under construction relate to the following categories	4,807	19,362	35,739	-	59,908
Deemed cost At 1 April 2016 Additions Transfers Disposals	222,593 - 4,679 -	934,850 - 63,768 (162)	267,135 - 26,673 (378)	69,516 86,625 (95,120)	1,494,094 86,625 - (540)
At 31 March 2017	227,272	998,456	293,430	61,021	1,580,179
Accumulated depreciation and impairment At 1 April 2016 Charge for the year Eliminated on disposals Impairment	(7,794) (4,068) - -	(33,043) (17,670) 62	(41,073) (21,537) 362 (38)	- - - -	(81,910) (43,275) 424 (38)
At 31 March 2017	(11,862)	(50,651)	(62,286)	-	(124,799)
Net book amount at 31 March 2017	215,410	947,805	231,144	61,021	1,455,380
Net book amount of leased assets included above	4,415	-	5,877	-	10,292
Assets under construction relate to the following categories	5,238	25,747	30,036	-	61,021

for the year ended 31 March 2018

13. Property, plant and equipment (continued)

Plant, equipment and vehicles have been impaired in respect of sampling equipment in our laboratory which is obsolete. There is no recoverable value on any of these impaired assets.

The group's index linked loans and listed bonds are secured on certain assets of the group (see note 19).

14. Investments in subsidiaries

Details of the company's subsidiary, the results of which are included in the group financial statements at 31 March 2018 and 31 March 2017 are as follows:

Company			Ordinary share	
Name of subsidiary			ownership	Voting rights
	Place of incorporation	Principal activity	interest %	held %
South East Water (Finance) Limited	Cayman Islands	Finance company	100	100

South East Water (Finance) Ltd's principal purpose is to raise debt on behalf of South East Water Ltd and any proceeds from such issues are lent on to South East Water Ltd. South East Water (Finance) Ltd is a company registered in the Cayman Islands but the company does not gain any tax benefit from this as the company is resident for tax purposes in the UK.

South East Water (Finance) Limited is wholly-owned by South East Water Limited, which owns 100 per cent of the voting rights. Its registered address is P O Box 309GT, Ugland House, South Church Street, Georgetown, Grand Cayman, Cayman Islands.

15. Amount due from parent undertaking

Group and company	2018 £000	2017 £000
Non-current assets Loans receivable carried at amortised cost Amount due from parent due in more than one year	190,013	190,013

The amount due from parent undertaking falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus two per cent.

16. Inventories

Group and company	2018 £000	2017 £000
Consumables Work-in-progress	201 35	203 11
	236	214

for the year ended 31 March 2018

17. Trade and other receivables

	Gr	oup	Com	Company	
	2018 £000	2017 £000	2018 £000	2017 £000	
Financial asset receivables Trade receivables Accrued income Amounts due from parent and fellow subsidiary undertakings due within	34,463 35,506	32,669 32,433	34,463 35,506	32,669 32,433	
one year	26	96	26	96	
	69,995	65,198	69,995	65,198	
Non-financial asset receivables Prepayments and accrued income Other receivables	5,132 3,128	3,302 3,613	4,578 3,128	2,744 3,613	
	8,260	6,915	7,706	6,357	
Total trade and other receivables	78,255	72,113	77,701	71,555	

Group and company

All trade receivables at 31 March 2018 and 31 March 2017 are denominated in Sterling.

Trade receivables are stated after provision for doubtful debts of £28.1 million (2017: £28.4 million). They are non-interest bearing and generally for immediate settlement. Receivables are determined to be impaired where there is a poor payment history or insolvency of the debtor and are fully or partially provided for.

Movements in the provision for impairment of receivables were as follows:

	2018 £000	2017 £000
Provision brought forward Charge for the year Amounts utilised	28,443 1,950 (2,339)	29,647 1,408 (2,612)
Provision carried forward	28,054	28,443

As at 31 March, the analysis of trade receivables past due but not impaired is as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2018	34,463	7,372	4,581	2,698	1,647	1,480	9,455	7,230
2017	32,669	6,715	3,871	2,545	1,535	1,541	8,928	7,534

for the year ended 31 March 2018

18. Cash and cash equivalents

Cash and cash equivalents comprise the following at 31 March:

	Gro	oup	Com	pany
	2018	2017	2018	2017
	£000	£000	£000	£000
Cash at bank and in hand	6,528	11,371	6,310	10,754

Included in the group and company cash at bank and in hand balance at 31 March 2018 was £4.1 million (2017: £10.2 million) held on an on demand deposit account.

At 31 March 2018, £nil (2017: £0.7 million) of restricted cash was held for the group in designated bank accounts and £nil million (2017: £0.1 million) of restricted cash was held for the company in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 19).

19. Non-current financial liabilities

Group		2018 £000	2017 £000
Loans and borrowings Trade and other payables Derivative financial instruments – Inflation swap	(i) (ii) (iii)	900,897 5,979 104,169	882,024 4,261 100,916
		1,011,045	987,201
(i) Loans and borrowing: Irredeemable debenture stock Listed bonds Index linked loans	(a) (b) (c)	991 529,337 370,569 900,897	991 523,281 357,752 882,024
		2018 £000	2017 £000
(a) Irredeemable debenture stock 3 % perpetual stock 3 ½ % perpetual stock 4 % perpetual stock 5 % perpetual stock 5 ½ % perpetual stock 6 % perpetual stock		25 384 178 366 1 37	25 384 178 366 1 37

Interest on irredeemable debenture stock is payable six monthly.

for the year ended 31 March 2018

19. Non-current financial liabilities (continued)

(b) Listed bonds

The group holds bonds listed on the London Stock Exchange with an original value of £496 million (2017: £496 million), with effective terms, having taken account of a related interest rate swap, as follows:

- •£200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the group)
- •£166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the group)
- •£130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the group)

Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the bond repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the bond repayable in 2041 under the terms of the bond.

Listed bonds are stated at the original consideration received plus accrued indexation less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Total £000
2018 Original loan consideration Indexation on bonds Less: unamortised issue costs	200,000 - (326)	166,000 - (1,217)	130,000 36,045 (1,165)	496,000 36,045 (2,708)
Listed bonds	199,674	164,783	164,880	529,337
2017 Original loan consideration Indexation on bonds Less: unamortised issue costs	200,000 - (542)	166,000 - (1,327)	130,000 30,365 (1,215)	496,000 30,365 (3,084)
Listed bonds				

(c) Index linked loan

The group holds index linked loans with an original value of £269 million and with effective terms as follows:

- •£135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the group)
- •£34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the group)
- •£100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the group)

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

for the year ended 31 March 2018

19. Non-current financial liabilities (continued)

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2018				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	75,714	15,223	13,530	104,467
Less: unamortised issue costs	(1,197)	(222)	(1,479)	(2,898)
Loans	209,517	49,001	112,051	370,569
Loans 2017	209,517	49,001	112,051	370,569
	209,517 135,000	49,001 34,000	112,051 100,000	370,569 269,000
2017	·	·	•	·
2017 Original loan amounts	135,000	34,000	100,000	269,000

The irredeemable debentures, listed bonds and index linked loans detailed in (ii), (iii) and (iv) above respectively are secured on the assets of South East Water (Holdings) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd's licence. The agreements for the bonds and loans contain a number of covenants that the group is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

(ii) Trade and other payables

Trade and other payables comprise financing guarantee fees of £20,000 (2017: £60,000) and deposits payable to developers of £6.0 million (2017: £4.2 million). Financing guarantee fees waived comprises cash received in advance to settle fees in connection with the £200 million listed debt raised (see above) which were subsequently waived. The balance is being amortised over the life of the listed debt.

(iii) Derivative financial instruments – interest rate swap

The group has entered into an interest rate swap arrangement in respect of the £200 million listed bonds with Deutsche Bank AG. This arrangement swaps the fixed rate of interest on the bond for a variable rate of interest which is linked to inflation as reported by the Retail Price Index.

As at 31 March 2018 the interest rate swap is stated at its fair value of a liability of £104.2 million (2017: £100.9 million). The increase in the fair value of the liability of £3.3 million (2017: increase of £13.7 million) during the year has been recognised in the income statement in finance costs (see note 7).

Company	2018 £000	2017 £000
Loans and borrowings (i) Trade and other payables (ii) Derivative financial instruments (iii)	900,897 5,979 104,169	882,024 4,261 100,916
	1,011,045	987,201

for the year ended 31 March 2018

19. Non-current financial liabilities (continued)

Company		2018 £000	2017 £000
(i) Loans and borrowings Irredeemable debenture stock Amounts due to subsidiary undertakings Index linked loans	(a) (b) (c)	991 641,388 258,518	991 631,662 249,371
		900,897	882,024
		2018 £000	2017 £000
(a) Irredeemable debenture stock 3% perpetual stock 3½% perpetual stock 4% perpetual stock 5% perpetual stock 5½% perpetual stock 6% perpetual stock		25 384 178 366 1 37	25 384 178 366 1 37
		991	991

(b) Amounts due to subsidiary undertakings

The company's subsidiary undertaking, South East Water (Finance) Ltd, has debt with an original consideration of £596 million (2017: £596 million), of which £496 million (2017: £496 million) is listed on the London Stock Exchange. The funds raised are lent to the company under loan agreements between the company and its subsidiary. An annual fee of £43,000 (2017: £43,000) is charged by South East Water (Finance) Ltd.

The effective terms of the £596 million loans due to South East Water (Finance) Ltd are as follows:

- •£200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the company)
- £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the company)
- •£130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the company)
- •£100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the company)

Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the loan repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the loan repayable in 2041 under the terms of the loan.

The amounts due to subsidiary undertakings and the indexed loans are secured on the assets of South East Water (Holdings) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd's licence.

The agreements for the bonds and loan contain a number of covenants that the company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

for the year ended 31 March 2018

19. Non-current financial liabilities (continued)

The amounts due to group undertakings are stated at the original consideration plus fair value of the interest rate swap, accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Loan due 2037 £000	Total £000
2018					
Original loan consideration	200,000	166,000	130,000	100,000	596,000
Indexation on bonds	-	-	36,045	13,530	49,575
Less: unamortised issue costs	(326)	(1,217)	(1,165)	(1,479)	(4,187)
Loans	199,674	164,783	164,880	112,051	641,388
Loans 2017	199,674	164,783	164,880	112,051	641,388
	199,674 200,000	164,783 166,000	164,880 130,000	112,051 100,000	641,388 596,000
2017		•	•	•	· ·
2017 Original loan amounts		•	130,000	100,000	596,000

(c) Index linked loans

The company holds index linked loans with an original consideration of £169 million and effective terms as follows:

- •£135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the company)
- •£34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the company)

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate. Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date. The issue costs for this debt were borne by the company on behalf of its subsidiary company.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd's licence.

The agreements for the loans contain a number of covenants that the company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

for the year ended 31 March 2018

19. Non-current financial liabilities (continued)

	Loan due 2032 £000	Loan due 2033 £000	Total £000
2018			
Original loan consideration	135,000	34,000	169,000
Indexation on bonds	75,714	15,223	90,937
Less: unamortised issue costs	(1,197)	(222)	(1,419)
Index-linked loans	209,517	49,001	258,518
2017			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	68,378	13,508	81,886
Less: unamortised issue costs	(1,280)	(235)	(1,515)
Index-linked loans	202,098	47,273	249,371

(ii) Trade and other payables

Trade creditors and other payables comprise financing guarantee fees of £20,000 (2017: £60,000) and deposits payable to developers of £6.0 million (2017: £4.2 million). Financing guarantee fees are cash received in advance to settle fees in connection with the £200 million owed to South East Water (Finance) Ltd (see above) which were subsequently waived. The balance is being amortised over the life of the listed debt.

(iii) Derivative financial instruments

The company has entered into an interest rate swap arrangement in respect of the £200 million intercompany loan with its subsidiary company. This mirrors the SEWF's arrangement with Deutsche Bank AG. This arrangement swaps the fixed rate of interest on the bond for a variable rate of interest which is linked to inflation as reported by the Retail Price Index.

As at 31 March 2018 the interest rate swap is stated at its fair value of a liability of £104.2 million (2017: £100.9 million), as detailed in the above table. The increase in the fair value of the liability of £3.3 million (2017: increase of £13.7 million) during the year has been recognised in the income statement in finance costs (see note 7).

	2018 £000	2017 £000
Amounts due to subsidiary undertakings	104,169	100,916

20. Current loans and borrowings

Group and company	2018 £000	2017 £000
Bank loans	20,000	-

During the year the group utilised its committed borrowing facilities by drawing down a total of £20.0 million of loans. The loan facilities are secured on the assets of the group, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence and against the assets of the immediate parent company, South East Water (Holdings) Ltd, at a variable interest rate of LIBOR plus 0.45 per cent.

for the year ended 31 March 2018

21. Provisions

Group and company	Insurance excess £000	Leak allowance £000	Cash accounts £000	Total £000
As at 1 April 2017 Additional provisions Amounts utilised	1,789 1,004 (805)	553 2,252 (2,278)	130 - (130)	2,472 3,256 (3,213)
31 March 2018	1,988	527	-	2,515
As at 1 April 2016 Additional provisions Amounts utilised	1,556 1,139 (906)	2,152 311 (1,910)	126 4 -	3,834 1,454 (2,816)
31 March 2017	1,789	553	130	2,472

It is anticipated that all provisions will be utilised within the next year.

22. Trade and other payables	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Financial liability payables Trade payables Amounts due to parent and fellow	13,610	14,339	13,610	14,339
subsidiary undertakings Other payables Accruals	9,217 1,866 32,556	11,266 949 33,354	16,838 1,866 25,568	18,201 949 26,608
	57,249	59,908	57,882	60,097
Non-financial liability payables Payments received in advance Other taxes and social security	36,118 1,012	35,207 1,015	36,118 1,012	35,207 1,015
	37,130	36,222	37,130	36,222
	94,379	96,130	95,012	96,319

As at 31 March 2018 and 2017, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to, for the group, the surrender of group tax relief and for the company the surrender of group tax relief and interest due on debt with the subsidiary company.

for the year ended 31 March 2018

23. Group financial instruments

Financial risk management objectives and policies

The group's financial instruments comprise index linked loans, fixed rate debentures, variable rate bank loans, an interest rate swap, a variable rate loan to its parent undertaking, cash, short-term and medium-term deposits, trade receivables and trade and other payables. The main purpose of the group's financial instruments other than the interest rate swap is to raise finance for the group's operations.

Derivative activity is undertaken as determined by the Board of Directors. The board considers the overall risk profile of the group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The group does not use derivative financial instruments for speculative purposes.

The group's treasury operations are managed within parameters defined by the board and its parent undertaking. It is the group's policy to minimise liquidity risk within an acceptable range of interest rates. The group does not use foreign currency financial instruments. The main risks arising from the group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the group.

Interest rate and cash flow risk

The group finances its activities through a mixture of cash generated from operations, debenture loans, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans. Bonds comprise long-term fixed rate loans and long-term variable rate loans which have been linked to inflation, partly through the use of an interest rate swap. The interest rate swap is used in order to reflect movements in the expected future income of the group. Long-term index linked loans comprise loans linked to inflation.

The group's policy is to manage short term interest rate risk by using short term fixed rate drawdowns under a committed facility. During the year to 31 March 2018 there was a net inflow of £20.0 million from financing activities within the group (excluding dividend payments) (2016: £nil). It is the view of the group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the group.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, on the group's profit before tax (through the impact on floating rate borrowings). The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments.

	Increase/ decrease in basis points	profit before tax £000	Shareholders' equity £000
2018 Sterling	+300	(12,870)	(10,296)
Sterling	-100	4,290	3,432
2017 Sterling	+300	(12,270)	(9,816)
Sterling	-100	4,090	3,272

Liquidity risk

The group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below and in note 20. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

for the year ended 31 March 2018

23. Group financial instruments (continued)

Inflation risk

The group manages its inflation risk on its financial liabilities through the use of an interest rate swap and other index linked bonds and loans (note 19). The group considers that the inflation rate risk is effectively managed as Ofwat allows revenues to be increased in line with inflation.

Credit risk

The group's financial assets include a loan due from its parent undertaking, short-term and mediumterm bank deposits and trade receivables, which represent the group's maximum exposure to credit risk in relation to financial assets. The group's credit risk is primarily attributable to its trade receivables, which are stated in the statement of financial position at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the group's management based on expected recovery rates of the aged debt profile and an assessment of current socio-economic conditions (see note 17). The group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Capital management risk

The objectives and management of the group's capital management risk are discussed in the strategic report.

Fair values of financial assets and financial liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. In the opinion of the directors, the fair values of the financial assets and liabilities of the group (apart from the specific items shown in the fair value table below) are not materially different from the book values.

The following tables provide a comparison by category of the carrying amount and the fair values of the group's financial assets and financial liabilities at 31 March 2018.

		Book Value 2018	Fair Value 2018	Book Value 2017	Fair Value 2017
	Notes	£000	£000	£000	£000
Loans and receivables					
Trade and other receivables	17	69,246	69,246	65,198	65,198
Cash	18	6,528	6,528	11,371	11,371
Amounts due from parent undertaking	15	190,013	142,573	190,013	140,373
		265,787	218,347	266,582	216,942
Financial liabilities at amortised cost					
Trade and other payables	22	48,031	47,608	48,642	48,058
Irredeemable debentures	19	991	862	991	766
Listed bonds	19	529,337	672,137	523,281	659,312
Index linked loans	19	370,569	494,338	357,752	441,423
Bank loans	20	20,000	20,000	-	-
Amounts due to parent and group undertakings	22	9,217	9,136	11,266	11,131
		978,145	1,244,081	941,932	1,160,690
At fair value through the income statement					
Interest rate swap		104,169	104,169	100,916	100,916

for the year ended 31 March 2018

23. Group financial instruments (continued)

The net book value is considered to equate to the fair value for trade receivables due to the short maturity of the amounts receivable. The fair value of trade and other payables and amounts due to parent and group undertakings have been adjusted for the appropriate credit risk. The fair values of amounts due from parent and irredeemable debentures have been calculated using the discounted cash flow method. The calculation includes all future capital and interest payments discounted by an amount representing credit risk and a further amount representing future inflation. Index-linked loans have been calculated by discounted cash flow method, taking into account future capital and interest payments based on estimated interest and inflation rates appropriate to the loans. These amounts have been similarly discounted for credit risk and inflation using appropriate discount rates in effect at the balance sheet dates. The fair values of listed bonds are based on market prices. The book value of the interest rate swap has been adjusted to reflect its fair value.

The fair value of the interest rate swap attributable to credit risk for the year is £0.2 million (2017: £0.1 million) and for the life to date of the swap is £3.1 million (2017: £2.9 million). The difference between the carrying value of the swap, above, and the amount payable at maturity is £7.1 million (2017: £12.1 million).

The movement in the value attributable to credit risk is calculated as the movement in fair value less that movement attributable to market factors for the year and the life to date of the swap.

Fair value hierarchy

The group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

for the year ended 31 March 2018

23. Group financial instruments (continued)

The group held the following financial instruments measured at fair value:

	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
31 March 2018				
Financial liabilities at fair value through the income statement Interest rate swap	(104,169)	-	(104,169)	-
31 March 2017				
Financial liabilities at fair value through the income statement Interest rate swap	(100,916)	-	(100,916)	_

The group held the following financial instruments which are not measured at fair value but fair value disclosures are required:

	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
31 March 2018				
Fair value of financial assets: loans and receivables Amounts due from parent undertaking	142,573	-	142,573	-
Fair value of financial liabilities at amortised cost	//=>		(1 = 000)	
Trade and other payables	(47,608)	-	(47,608)	-
Irredeemable debentures Listed bonds	(862)	(((72,127)	(862)	-
Index linked loans	(672,137)	(672,137)	- (404 220)	-
Bank loans	(494,338) (20,000)	-	(494,338) (20,000)	_
Amounts due to parent and group undertakings	(9,136)	-	(9,136)	-
Total fair value of financial liabilities at amortised cost	(1,244,081)	(672,137)	(571,944)	-
31 March 2017				'
Fair value of financial assets: loans and receivables Amounts due from parent undertaking	140,373	-	140,373	-
Fair value of financial liabilities at amortised cost				
Trade and other payables	(48,058)	_	(48,058)	_
Irredeemable debentures	(766)	-	(766)	-
Listed bonds	(659,312)	(659,312)	-	_
Index linked loans	(441,423)	-	(441,423)	-
Amounts due to parent and group undertakings	(11,131)	_	(11,131)	-
Total fair value of financial liabilities at amortised cost	(1,160,690)	(659,312)	(501,378)	-

During the reporting years ended 31 March 2018 and 2017, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

for the year ended 31 March 2018

23. Group financial instruments (continued)

Maturity of financial instruments

The table below summarises the maturity profile of the group's financial assets and liabilities based on contractual undiscounted payments:

Year ended 31 March 2018	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate Fixed rate financial liabilities: Irredeemable debentures Listed bond	42 9,268	42 9,268	126 27,805	1,088 249,416	1,298 295,757
Total fixed rate financial liabilities	9,310	9,310	27,931	250,504	297,055
Floating rate Floating rate financial assets: Short term financial assets Long-term financial assets	69,246 4,843	- 4,843	- 14,529	- 248,131	69,246 272,346
Total floating rate financial assets	74,089	4,843	14,529	248,131	341,592
Floating rate financial liabilities: Short term financial liabilities Listed bond Index-linked loans	57,248 13,302 11,958	- 13,744 12,225	- 326,503 38,280	- 235,410 680,244	57,248 588,959 742,707
Total floating rate financial liabilities	82,508	25,969	364,783	915,654	1,388,914
Year ended 31 March 2017					
Fixed rate Fixed rate financial liabilities: Irredeemable debentures Listed bond	42 9,268	42 9,268	126 27,804	1,088 258,684	1,298 305,024
Total fixed rate financial liabilities	9,310	9,310	27,930	259,772	306,322
Floating rate Floating rate financial assets: Short-term financial assets Long-term financial assets	65,198 4,843	- 4,843	- 14,529	- 252,974	65,198 277,189
Total floating rate financial assets	70,041	4,843	14,529	252,974	342,387
Floating rate financial liabilities: Short-term financial liabilities Listed bond Index-linked loans	59,910 12,618 11,549	- 12,928 11,858	344,767 37,428	- 389,743 716,062	59,910 760,056 776,897
Total floating rate financial liabilities	84,077	24,786	382,195	1,105,805	1,596,863

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

for the year ended 31 March 2018

23. Group financial instruments (continued)

Borrowing facilities

The group has committed borrowing facilities of £144.0 million (2017: £144.0 million), of which £20.0 million (2017: £nil) was drawn down. Any drawdowns under these facilities are repayable in less than one year.

The capital and working capital facility of £90.0 million (2017: £90.0 million) expires in June 2020. The DSR Liquidity Facility of £36.0 million (2017: £36.0 million) and the 0&M Reserve Facility of £18.0 million (2017: £18.0 million) expire in June 2018. The DSR Liquidity Facility and the 0&M Reserve Facility were successfully renegotiated in June 2018 and the facilities were increased to £38.0 million and £19.0 million respectively. The new facilities expire on 29 June 2019.

Items of income, expense, gains and losses

The net gains or losses of the different classes of financial instruments on the income statement are:

	Notes	2018 £000	2017 £000
Financial assets, loans and receivables	8	4,803	5,119
Financial liabilities at amortised cost	7	(52,766)	(45,103)
Financial liabilities at fair value through profit or loss	7	(3,253)	(13,690)
Financial assets due to impairment	17	(1,950)	(1,408)

24. Retirement benefit schemes

Group and company (hereafter referred to as "group" in this note)

The South East Water pension scheme provides benefits to group and former group employees. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided solely on a defined contribution basis.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the group decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the group has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2017.

The group contribution rate was nil (2017: nil) of pensionable remuneration during the year plus an annual contribution of £3.8 million (2017: £3.6 million). The group's future annual contribution is expected to be £3.7 million.

As a result of the merger of South East Water Ltd and Mid Kent Water Ltd in October 2006, the group acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2017.

The group contributed nil (2016: nil) of pensionable remuneration plus £1.27 million (2017: £1.25 million) in respect of the deficit as at 31 March 2018 to the scheme during the year. The group's future annual contribution is expected to be £1.3 million.

for the year ended 31 March 2018

24. Retirement benefit schemes (continued)

On 31 March 2015 both of the group's defined benefit schemes closed to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members became deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members were invited to join the group's defined contribution scheme from 1 April 2015.

Pension costs recognised in the income statement for the defined contribution scheme were as follows:

	2018	2017
	£000	£000
Defined contribution scheme	2,007	1,772

The major assumptions used for the actuarial valuations were:

	SEW	SEW	MKW	SEW
	Pensions	Pensions	Pensions	Pensions
	2018	2017	2018	2017
	%	%	%	%
Main assumptions: Rate of increase in pensions in payment Rate of increase in deferred pensions	2.15	2.20	2.15	2.20
	2.15	2.20	2.15	2.20
Discount rate	2.70	2.55	2.70	2.55
RPI assumption	3.15	3.20	3.15	3.20
CPI assumption	2.15	2.20	2.15	2.20
Post-retirement mortality (in years) Current pensioners at 65 – male Current pensioners at 65 – female Future pensioners at 65 – male Future pensioners at 65 – female	21.6	21.8	21.6	21.8
	23.4	23.6	23.4	23.6
	22.8	23.6	22.8	23.6
	25.5	24.9	25.5	24.9

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities	(Decrease)/ increase
	£000	%
0.1% increase to the discount rate	4,000	1.3
0.1% decrease to inflation	3,500	1.5
One year increase in life expectancy	10,500	3.9

for the year ended 31 March 2018

24. Retirement benefit schemes (continued)

The fair value of the assets in the schemes and the present value of the liabilities in the schemes were:

	SEW	MKW	
	Pensions	Pensions	Total
	£000	£000	£000
2018			
Equities	35,890	25,064	60,954
Corporate bonds	76,571	50,154	126,725
Government bonds	41,508	32,906	74,414
Property	8,458	6,071	14,529
Cash	1,746	3,901	5,647
Insured persons	5,296	4,827	10,123
Total fair value of assets	169,469	122,923	292,392
Present value of funded obligations	(160,169)	(107,713)	(267,882)
Net over funding in funded plans	9,300	15,210	24,510
Present value of unfunded obligations	(3,281)	-	(3,281)
(Deficit)/surplus in the schemes	6,019	15,210	21,229
2017			
Equities	36,794	27,044	63,838
Corporate bonds	76,951	50,257	127,208
Government bonds	43,938	35,492	79,430
Property	7,919	5,684	13,603
Cash	1,952	1,953	3,905
Insured persons	5,600	5,622	11,222
Total fair value of assets	173,154	126,052	299,206
Present value of funded obligations	(170,485)	(116,436)	(286,921)
Net over funding in funded plans	2,669	9,616	12,285
Present value of unfunded obligations	(4,520)	-	(4,520)
(Deficit)/surplus in the schemes	(1,851)	9,616	7,765

 $\label{thm:equity} \ Equity\ investments\ include\ Global\ Tactical\ Asset\ Allocation, Private\ Equity\ Fund\ and\ Absolute\ Return\ investments.$

for the year ended 31 March 2018

24. Retirement benefit schemes (continued)

Analysis of amounts charged/(credited) to income statement:

	SEW Pensions £000	MKW Pensions £000	Total £000
2018 Net interest on defined liability/(asset) Administrative expenses	8 642	(256) 448	(248) 1,090
Total amount charged to income statement	650	192	842
2017 Net interest on defined liability/(asset) Administrative expenses	(1) 611	(321) 401	(322) 1,012
Total amount charged to income statement	610	80	690
Analysis of amounts recognised in the statement of comprehensive	ve income:		
	SEW Pensions £000	MKW Pensions £000	Total £000
2018 Return on schemes' assets excluding interest income Actuarial gain due to changes in financial assumptions Actuarial losses due to changes in demographic assumptions Experience gain on obligation	(1,544) 3,811 (967) 3,543	(1,536) 5,186 (338) 1,200	(3,080) 8,997 (1,305) 4,743
Actuarial gains recognised in the statement of comprehensive income	4,843	4,512	9,355
Cumulative actuarial losses	(7,098)	(12,080)	(19,178)
2017 Return on schemes' assets excluding interest income Actuarial gains due to changes in financial assumptions Actuarial gains due to changes in demographic assumptions	20,358 (26,415) 2,681	15,451 (18,055) 2,047	35,809 (44,470) 4,728
Actuarial losses recognised in the statement of comprehensive income	(3,376)	(557)	(3,933)
Cumulative actuarial losses	(11,941)	(16,592)	(28,533)

for the year ended 31 March 2018

24. Retirement benefit schemes (continued)

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Total £000
2018 Opening defined benefit obligations Interest cost Actuarial losses Benefits paid	175,005 4,341 (6,387) (9,509)	116,436 2,898 (6,048) (5,573)	291,441 7,239 (12,435) (15,082)
Closing defined benefit obligations	163,450	107,713	271,163
2017 Opening defined benefit obligations Interest cost Actuarial losses Benefits paid	154,125 5,105 23,734 (7,959)	102,555 3,393 16,008 (5,520)	256,680 8,498 39,742 (13,479)
Closing defined benefit obligations	175,005	116,436	291,441
Reconciliation of fair value of plans' assets:	SEW Pensions £000	MKW Pensions £000	Total £000
2018 Opening fair values of schemes' assets Interest income on assets Return on scheme assets excluding interest income Contributions by employer Administrative expenses Benefits paid	173,154 4,333 (1,544) 3,677 (642) (9,509)	126,052 3,154 (1,536) 1,274 (448) (5,573)	299,206 7,487 (3,080) 4,951 (1,090) (15,082)
Closing fair values of schemes' assets	169,469	122,923	292,392
2017 Opening fair values of schemes' assets Interest income on assets Return on scheme assets excluding interest income Contributions by employer Administrative expenses Benefits paid	152,659 5,106 20,358 3,601 (611) (7,959)	111,558 3,714 15,451 1,250 (401) (5,520)	264,217 8,820 35,809 4,851 (1,012) (13,479)
Closing fair values of schemes' assets	173,154	126,052	299,206

for the year ended 31 March 2018

24. Retirement benefit schemes (continued)

The five year history of the schemes is as follows:

	2018 £000	2017 £000	2016 £000	2015 £000	2014 £000
SEW Pensions Fair value of scheme assets Present value of defined benefit obligation	169,469 (163,450)	173,154 (175,005)	152,659 (154,125)	156,844 (166,627)	133,097 (160,473)
Deficit in the scheme	6,019	(1,851)	(1,466)	(9,783)	(27,376)
Experience adjustment on schemes' assets: Amount Percentage of scheme's assets (%)	2,789 1.6%	25,464 14.7%	1,558 1.0%	18,108 11.5%	(3,378) (2.5)%
Experience adjustments on schemes' liabilities: Amount Percentage of the scheme's liabilities (%)	6,387 3.9%	(23,734) (13.6)%	(8,928) (5.8)%	1,400 0.8%	- -
MKW Pensions Fair value of plan assets Present value of defined benefit obligation	122,923 (107,713)	126,052 (116,436)	111,558 (102,555)	113,948 (111,154)	97,237 (103,091)
Surplus/(deficit) in the scheme	15,210	9,616	9,003	2,794	(5,854)
Experience adjustment on schemes' assets: Amount Percentage of scheme's assets (%)	1,618 1.3%	19,165 15.2%	2,477 2.2%	14,813 13.0%	(1,447) (1.5)%
Experience adjustments on schemes' liabilities: Amount Percentage of the scheme's liabilities (%)	6,048 5.6%	(16,008) (13.7)%	(6,521) (6.4)%	(2,903) (2.6)%	-

The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind up, or otherwise augment the benefits due to members of, the scheme. Based on these rights, any net surplus in the UK scheme is recognised in full.

25. Deferred income

Group and company	2018 £000	2017 £000
As at 1 April Received in the year Released during the year	76,511 14,676 (9,123)	72,436 15,406 (11,331)
As at 31 March	82,064	76,511
Non-current Current	74,471 7,593	69,938 6,573
	82,064	76,511

Amounts received towards above ground assets are released to the income statement over the period to which they are deemed to relate. Contributions received towards below ground assets are released to the income statement over the period that corresponds to the life of the asset to which the contribution relates, which is typically 100 years.

for the year ended 31 March 2018

26. Issued share capital

Group and company	2018 £000	2017 £000
Allotted, issued, called up and fully paid 49,312,354 ordinary shares of £1 each (2017: 49,312,354)	49,312	49,312

There is one class of ordinary share which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital was £100 million at 31 March 2018 (2017: £100 million).

27. Cash flow from operating activities

	Gr	oup	Com	mpany	
	2018	2017	2018	2017	
	£000	£000	£000	£000	
Profit for the year	16,168	27,095	16,127	27,053	
Adjustments for: Income tax charge/(credit) Finance income Finance costs Depreciation and impairment of property, plant and equipment Amortisation and impairment of intangibles Profit on disposal of fixed assets Difference between pension contributions paid and amounts recognised in the income statement	7,574	(1,759)	7,564	(1,769)	
	(4,835)	(5,119)	(4,792)	(5,107)	
	56,051	58,793	56,062	58,836	
	46,253	43,313	46,253	43,313	
	3,405	3,183	3,405	3,183	
	(120)	(94)	(120)	(94)	
Changes in working capital: Increase in trade and other receivables Decrease/(increase) in inventory Increase in trade and other payables	(5,958)	(5,492)	(5,955)	(5,495)	
	(22)	(29)	(22)	(29)	
	8,434	11,410	8,434	11,410	
Net cash flow from operating activities	123,089	127,462	123,095	127,462	

for the year ended 31 March 2018

28. Movement in liabilities arising from financing activities

Group non-current loans and borrowings	Irredeemable debenture stock £000	Listed bonds £000	Indexed linked loans £000	Non-current loans and borrowing £000
Balance 1 April 2016 Changes from other financing activities:	991	518,645	350,243	869,879
Indexation on index linked instruments	-	4,258	7,339	11,597
Movement in fair value of interest rate swap Amortisation of issue costs		- 378	170	- 548
Balance at 31 March 2017	991	523,281	357,752	882,024
Balance 1 April 2017 Changes from other financing activities:	991	523,281	357,752	882,024
Indexation on index linked instruments Movement in fair value of interest rate swap	-	5,680	12,645	18,325
Amortisation of issue costs	-	376	172	548
Balance at 31 March 2018	991	529,337	370,569	900,897
Company non-current loans and borrowings	Irredeemable debenture stock £000	Listed bonds £000	Indexed linked loans £000	Non-current loans and borrowing £000
Balance 1 April 2016	991	624,167	244,721	869,879
Changes from other financing activities: Indexation on index linked instruments Movement in fair value of interest rate swap	-	7,041	4,556	11,597
Amortisation of issue costs	-	454	94	548
Balance at 31 March 2017	991	631,662	249,371	882,024
Balance 1 April 2017 Changes from other financing activities:	991	631,662	249,371	882,024
Indexation on index linked instruments Movement in fair value of interest rate swap	-	9,274	9,051	18,325
Amortisation of issue costs	-	452	96	548
Balance at 31 March 2018	991	641,388	258,518	900,897
Group and company current loans and borrowings			2018 £000	2017 £000
Balance 1 April Changes from financing cash flows: New loans received during the period			- 20,000	
Balance 31 March			20,000	-

for the year ended 31 March 2018

28. Movement in liabilities arising from financing activities (continued)

Group and company derivative financial instruments	2018 £000	2017 £000
Balance 1 April	100,916	87,226
Changes in fair values: Movement in fair value of interest rate swap	3,253	13,690
Balance 31 March	104,169	100,916

29. Capital commitments

Group and company	2018 £000	2017 £000
Contracts placed for future capital expenditure not provided in the financial statements	47,288	27,268

All of the above capital commitments relate to property, plant and equipment.

30. Obligations under operating leases

Group and company	2018	2017
Note	£000	£000
Minimum lease payments under operating leases recognised		
as an expense in the year	408	306

Future minimum lease payments under non-cancellable operating leases are as follows:

Group and company	Land and buildings 2018 £000	Land and buildings 2017 £000
Amounts for the following periods: - within one year - in the first to second - in the second to fifth years - after five years	195 195 585 2,340	197 197 589 2,535
	3,315	3,518

for the year ended 31 March 2018

31. Events after the balance sheet date

On 30 April 2018, the group transferred its rights and interests in the trade and customer base of its non-domestic customers to another HDF group company, Invicta Water Limited, for a consideration of £10.0m. This transfer was by virtue of a Statutory Transfer Scheme under the Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016. Under the transfer, no assets or liabilities of SEWL in respect of the customers transferred for the period prior to the transfer date were moved out of the group.

The consideration was paid in two tranches of £650,000 on 30 April 2018 and £9.35m on 16 May 2018. The terms of the transfer were contingent on the sale of Invicta Water Limited to Castle Water Limited. The Share Purchase Agreement for the sale of Invicta Water Limited was signed on 14 May 2018 and the sale was completed on 1 July 2018.

On 10 April 2018 Hastings Fund Managers Limited, who are the managers of the group's ultimate holding company, changed its name to Vantage Infrastructure Holdings Limited.

32. Group related party transactions

The group's ultimate holding company is Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, which is resident in Australia.

The group of companies into which results of the group are consolidated is that headed by HDF (UK) Holdings Ltd, a company registered in England and Wales. The consolidated financial statements of HDF (UK) Holdings Ltd may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.

Transactions with the group's parent company

An unsecured loan to the immediate parent company South East Water (Holdings) Ltd of £190 million (2017: £190 million) is disclosed in note 15 under non-current receivables. Loan interest receivable during the year was £4.5 million (2017: £4.7 million). There was no interest outstanding as at 31 March 2018 (2017: £nil) included under trade and other receivables in note 17.

Also, as at 31 March 2018 the group has a current account debt due to its parent company of £5.8 million (2017: £8.0 million) in respect of group tax relief payable.

Transactions with other related parties

As at 31 March 2018 the group has net current account balances due to other related parties totalling £3.2 million (2017: £3.2 million) all relating to group tax relief payable.

The company has received loans totalling £749.7 million (2017: £737.2 million) on various terms from its subsidiary company as disclosed in note 19. Interest of £25.2 million (2017: £24.7 million) has been charged on these loans during the year. Interest outstanding on the loans at 31 March 2018 totalled £7.6 million (2016: £7.0 million).

Key management compensation is disclosed in note 6 and discussed further in the remuneration report. Contributions to retirement benefit schemes are disclosed in note 24.







Annual Performance

Disclosures and statements	
by directors	156
Data assurance summary	165
Risk and compliance statement	168
Independent auditor's report	169
Financial performance	172

Disclosures and statements by directors

These accounts are prepared in accordance with Condition F of South East Water Ltd's instrument of appointment ("Licence") and in accordance with the latest regulatory accounting guidelines ("RAGs") issued by Ofwat.

In instances where there are differences between international financial reporting standards ("IFRS") as adopted for use in the European Union and the RAGs, the RAGs take precedence.

These accounts should be read in conjunction with the information set out in the financial statements of South East Water Ltd for the year ended 31 March 2018.

Directors' remuneration and standards of performance

The directors' remuneration report in the company's annual report and financial statements sets out the remuneration paid or due for the financial year to the directors under arrangements linking the remuneration of directors to standards of performance in connection with the carrying out by South East Water of its functions as a relevant undertaker. It provides details of these arrangements and of the relevant remuneration. The relevant information provided in the directors' remuneration report is incorporated by reference into this annual performance report as the statement required under section 35A of the Water Industry Act 1991. The report from the Remuneration Committee in the corporate governance report also provides information on the arrangements in place for the remuneration of directors and how they have been reviewed by the Committee.

Disclosure to auditor

The directors who were members of the board at the time of approving the annual performance report are listed in the company's financial statements. Having made enquiries of fellow directors, and exercising reasonable care, skill and diligence, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which South East Water Ltd's auditor is unaware
- each director has taken all the steps that a director ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that South East Water Ltd's auditor is aware of that information

Dividend policy

Dividends are authorised in accordance with the Companies Act 2006 and our dividend policy, having due regard to conditions F6A.5A(f) and F6.12 of the Licence which state that dividends paid must be in accordance with the dividend policy, must not impair the ability of South East Water Ltd to finance the appointed business and that, under a system of incentive regulation, the dividend would be expected to reward efficiency and the management of economic risks. Dividends are paid as declared and are recognised as a distribution when paid. No unpaid dividends exist at the year end. Additional information on our dividend policy is set out in the Strategic Report.

Dividends paid in the year amounted to £18.0 million, of which £4.5 million was used by our parent company, South East Water (Holdings) Ltd, to pay interest on a loan from South East Water Ltd.

Accounting policies

Price segments

Operating costs are directly attributed to price control units, where possible, based on the activities that cause the cost to be incurred. Costs are attributed based on the guidelines set out in RAG 2.07. Where costs cover more than one price control unit, an appropriate basis of allocation consistent with the activities that cause the costs is used in order to allocate the costs to the relevant price control units.

In the majority of cases, assets and their associated depreciation are directly attributed to price control units that solely use the assets. However, where assets are used by more than one price control unit, the assets are initially allocated to the price control unit where the principal use occurs with a recharge being made to other price control units using the asset in proportion to the use of the assets.

There have been no significant changes in the methodology of allocating costs to price segments in the year. For further information on the allocations of costs and assets, see South East Water Ltd's accounting methodology statement which is available on our website.

Revenue recognition

The revenue recognition policy is the same in the regulatory accounts as in the statutory accounts. Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as a credit within operating costs in both the statutory and regulatory accounts and as such do not affect turnover.

There have been no changes made to the procedure followed in calculating the measured income accrual in the year. A review was undertaken of the measured income accrual for the year 2016/17 and there were no significant differences between the accrual and the amounts billed in the year.

The following applies in relation to our policy on billing:

- if supply is not required, charges on an unoccupied or void property will normally be waived from the date we are informed. When informed of the vacation of a property, we may choose to turn off or disconnect the water supply at the stop tap. If we are requested not to turn off or disconnect the water supply either by the outgoing or incoming occupier they must undertake to pay all water charges arising until we are otherwise notified
- we do not send a bill to "the occupier" for premises where the name of the customer is not known. At the point that the occupier's details are known we will issue a bill as appropriate
- where we have donated to a charitable trust/ assistance fund in relation to assisting customers with payment of water debt, any associated billing is included within water turnover
- when a new property is connected to our network, billing commences upon meter installation

When a property is identified as unoccupied on the billing system it will then proceed into our void property process to verify with as much certainty as possible whether the property is truly empty or not. As part of this process we will send out letters along with an application form to properties that are recorded as being empty for over 21 days. If there is no response a further letter is then sent. If there is still no response, we will review the account and take a range of additional steps including further written communication, meter reader visits to the property and enquiries to view the land registry to confirm the owner of the property whom we then contact.

Capitalisation

We determine employee costs directly attributable to capital projects based on the time spent on each project recorded on timesheets completed by employees. Other directly attributable costs are then assessed and any costs relating to capital projects are capitalised into individual projects. Training costs, administration and other general overhead costs are not capitalised. Over the past year our policies on the capitalisation of costs have not changed.

Disclosures and statements by directors continued

Bad debt

The bad debt policy remained unchanged during the year.

Debt is written off in only a limited number of scenarios when all collection avenues have been fully exhausted. Examples include where a debtor is not a current customer and all procedures to trace their whereabouts have been undertaken or where a customer is insolvent and we have been advised that no payment will be forthcoming.

An estimate for the provision for doubtful debts is calculated by our management based on applying expected recovery rates to an aged debt profile. We have no significant concentration of credit risk with exposure spread over a large number of domestic and commercial customers.

Condition K compliance

The directors of South East Water Ltd confirm that, in their opinion, the company was in compliance with sub-paragraph 3.1 of Condition K of its Licence at the 31 March 2018 and would have available sufficient rights and assets, other than financial resources, to enable a special administrator to manage the affairs, business and property of the company.

Diversification and protection of core business

Under condition F of the Licence, sub-paragraph 6A.2A - Certificate of Adequacy, the directors of the company are required to provide a certificate in relation to the wholesale and household retail business (referred to as the Residual Business in the condition) including, in respect of the wholesale business only, a statement on any contracts entered into with any associated company. The following certificate is set out below in accordance with the requirements of this condition.

Certificate of adequacy in relation to the wholesale and household retail business (Residual Business)

- In the opinion of the directors, the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least 12 months from the date of signing the accounts, the regulated activities as defined in the Licence (including the investment programme necessary to fulfil its obligations under the Licence).
- In the opinion of the directors, the company will, for at least 12 months from the date of signing of the accounts, have available management resources and systems of planning and internal control which are sufficient to enable it to carry out the regulated activities.
- In respect of the wholesale business only, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the company, to ensure that it is able to meet all its obligations as a water undertaker.

South East Water exited the non-household retail market on 1 May 2018 and transferred its non-household retail business to Invicta Water Ltd as the acquiring licensee pursuant a transfer scheme made under the Water and Sewerage Undertakers (Exit from Non-Household Retail Market) Regulations 2016. In accordance with the provisions of condition F sub paragraph 6A.2A as amended on 25 August 2016 and which took effect on 1 April 2017 (the retail market opening date), the requirement under that condition to provide a separate certificate of adequacy in relation to the non-household retail business ceased to apply on 1 May 2018.

Main factors taken into account by the directors

In providing the certificate set out above, the directors have taken into account the following:

- our financial statements, which have been prepared on the going concern basis
- the outcome of the 2014 price review for the five years from 1 April 2015 to 31 March 2020
- the outcome of the 2016 non-household price review
- the updates provided at each board meeting on the financial performance of the company
- that we have complied with our financial covenants and have maintained our investment grade rating of BBB
- borrowing facilities which include significant undrawn bank facilities
- our formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and assesses the potential impact of risks
- the processes we put in place under the company monitoring framework
- the long term viability statement set out in the strategic report and the going concern statement set out in the company's financial statements
- the results from the stress testing and examinations as requested to be performed by Ofwat to improve the robustness of the viability statement

Explaining company direction and performance

Our 2015 to 2020 business plan is based around outcomes which, in the broadest sense, set out what we want to achieve in all areas of our performance, as opposed to just meeting a set of prescribed targets. This approach enables our ambition to become a more customer-centric business - which measures our customers' satisfaction with how well we delivered those outcomes - to flourish. Those outcomes included a suite of innovative customer satisfaction metrics that measure all aspects of our service delivery, as well as a comprehensive set of targets around the quality, reliability and management of supplying drinking water. This renewed focus on customer satisfaction has led to a shift in our company culture and how we run the business – one that ensures that customers are at the centre of our decision making and planning.

As a provider of a service that is essential for our society to thrive now and in the future our board is focused on delivering a great level of service to our customers today as well as setting the strategic direction over the longer term. Our business planning process for 2015 to 2020 was an important step along our board's continuing journey to develop the strategic direction of our business; this was translated into our vision and objectives, the 2015-2020 corporate plan and the annual reporting and governance associated with meeting our strategic objectives.

Our experience to date has shown us that having a strong focus on customer satisfaction ensures that we are constantly listening to our customers and stakeholders so that we can adapt and improve our services to their changing needs and requirements. In our plans for 2020-25 we are taking this approach even further to ensure that the voice of all of our customers is heard and acted on.

Developing attitudinal segmentation

We have evolved our use of customer satisfaction – and are deliberately moving away from the notion of a service aimed at the average customer. We have developed an innovative 'attitudinal segmentation' approach to identify the diverse and changing values, priorities and expectations of our customers. Attitudinal segmentation has been a defining element for our entire research programme for our next five year plan – for each piece of research we undertook, we developed a set of golden questions that matched the segment that every customer identified with. The benefits are two-fold:

- we will evolve our performance commitments and outcome delivery incentives (ODIs) to better match the range of our customers' views
- we can identify how best to 'nudge' the customer segments so they are empowered to act and advocate – whether it's reacting intuitively to the weather, looking after their own pipes and plumbing, or promoting the services we offer vulnerable customers

Developing an interactive insight database

Our listening and learning approach has gone far beyond what emerges from our extensive customer research and engagement on our strategic plans. We are analysing insights from multiple channels and sources – including what we learnt at the last price review, from our daily business as usual transactions, conversations and surveys - but also third party data and/or research within and beyond our sector too. We are developing an interactive insight database to bring all of this information together, to help us see and understand any conflicting views, and help us learn from our experiences so that we can continually adapt and improve our service delivery to customers.

The relationship between business performance and executive rewards

Our executive rewards policy aims to ensure our performance incentives encourage the achievement of challenging operational, financial and personal targets. We want to motivate a strong commitment to achieving the goals set, as well as to establish a close link between overall rewards, corporate performance and the benefits delivered to our customers. Operational targets include improving South East Water's customer satisfaction and service incentive mechanism scores, health and safety performance in addition to performance measures such as leakage, interruptions and discoloration. Financial performance targets are focussed on "totex" costs and cash collection efficiency.

The remuneration committee establishes annual bonus targets at the beginning of each financial year and decides the performance bonus payment to each member of the executive team based on an assessment of their performance at the end of the year. For the long term incentive scheme, targets have been set to cover the five year regulatory period to end March 2020. Decisions on the pay of senior executives take into account information from independent reward surveys. The Managing Director and senior executives participate in the same pension schemes as other employees. Please refer to the Directors' Remuneration Report in our Annual Report for further details.

Statement of directors' responsibilities

The directors are responsible under Condition F of the Licence for:

- ensuring that proper accounting records are maintained by the appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by Ofwat to the appointee from time to time
- preparing regulatory financial statements on a consistent basis for each financial year in accordance with Condition F, having regard also to the terms of guidelines notified by Ofwat from time to time, which, so far as is reasonably practicable, have the same content as the annual financial statements of the appointee prepared under the Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to those financial statements
- preparing financial statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by Ofwat from time to time
- preparing such other financial and related information as is required by Condition F having regard also to the terms of guidelines issued by Ofwat from time to time
- ensuring that South East Water maintains an investment grade credit rating (license condition F6A.6)
- ensuring that South East Water has adequate resources to continue as a going concern for the foreseeable future

Differences between statutory and RAG definitions

Material differences between the statutory financial statements and the RAG definitions are:

- in the income statement, the difference of £2.3 million in profit before tax includes capitalised interest of £2.1 million, the removal of depreciation on capitalised interest of £0.1 million and pension costs adjustments of £0.3 million
- in the statement of financial position, cumulative capitalised interest less depreciation of £15.4 million has been excluded from fixed assets

Disclosures and statements by directors continued

Transactions with associate companies

Loans from associate companies

Associate	Interest	Loan period	2018 £000
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in September 2019	200,000
	Indexation	September 2013	104,169
South East Water (Finance) Limited	Fixed rate	Repayable in March 2029	166,000
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in December 2041	130,000
	Indexation		36,045
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in December 2037	100,000
	Indexation		13,530

Interest and related fees payable to associate companies

Associate	Nature of transaction	Terms of supply	2018 £000
South East Water (Finance) Limited	Interest, RPI indexation and margin fees on intercompany loans (see below)	(See above)	37,686
South East Water (Finance) Limited	Ambac fees on both £166 million and £200 million loans	Monoline fees	754
South East Water (Finance) Limited	Facility fees	Commitment fees on loan facilities	186

Loans to associate companies

Associate	Nature of transaction	Terms of supply	2018 £000
South East Water (Holdings) Limited	Interest on intercompany loans of £190 million	LIBOR plus 2%	4,504

Fees payable to associate companies

Associate	Nature of transaction	Terms of supply	2018 £000
Invicta Water Limited	Fees for the provision of meter reading services	Market values	52

Fees receivable to associate companies

Associate	Nature of transaction	Terms of supply	2018 £000
Invicta Water Limited	Fees for the provision of support services	Market values	185

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in compliance with condition F and RAG 5.07.

Taxation and current tax reconciliation

South East Water Ltd is committed to the effective, sustainable and active management of our tax affairs in support of our overall business performance and, as with all other aspects of our business, to maximise shareholder value and minimise customer bills as any tax payable is required to be funded via the prices set by Ofwat.

We are committed to pay tax according to the law and conducting our tax affairs according to clear principles. We seek to maintain good working relationships with tax authorities, sharing our views either directly or through trade associations.

South East Water believes it is important to state our views on tax in the context of corporate responsibility. We believe our obligation is to pay the amount of tax legally due and observe all applicable rules and regulations relating to tax compliance. However, at the same time we also have an obligation to maximise shareholder value, minimise customer bills and to manage financial and reputational risk. This includes controlling our overall liability to taxation.

We do not condone either personal or corporate tax evasion under any circumstances and were such issues to be identified, full disclosure of the activities undertaken would be required to be made to the tax authorities.

Our aim is to have a constructive relationship with the tax authorities on an on-going basis. Nevertheless we recognise that there may be some areas that are not free from doubt or differing legal interpretations may be possible. Where disputes arise with the tax authorities with regard to interpretation and application of tax law, we are committed to addressing the matter promptly and seek resolutions in a responsible manner. A more detailed explanation of our tax policy is available on our website.

For the year ended 31 March 2018 a UK corporation rate of 19 per cent has been used as enacted on 26 October 2015 by Finance Act 2013. A reduction in the UK corporation tax rate to 18 per cent (effective 1 April 2020) was also enacted 26 October 2015, however an additional reduction to 17 per cent (effective 1 April 2020) was substantively enacted on 6 September 2016.

The deferred tax on temporary differences as at 31 March 2018 have been calculated in full under the liability method at the rate applicable to the year in which the temporary differences are expected to reverse.

The table opposite shows a comparison between the amount funded within the final determination (FD) and the tax charge within the regulatory accounts.

Disclosures and statements by directors continued

Wholesale tax reconciliation:

	2017/18 Prices £000
Final determination (2012/13 prices) Indexation	1,402 173
Final determination	1,575
Actual in regulatory accounts Retail tax	1,339 (1,253)
Wholesale tax	86

The reconciliation of wholesale taxation to funded taxation is as follows:

	2018 £000
Wholesale tax	86
Contributions and Infrastructure charges	(549)
Capital allowances	1,028
Variance in operating profit	795
Corporation tax reduction	79
Other	136
Final determination	1,575

The reconciliation of current appointed tax is as follows:

	2018 £000
Profit before tax	23,691
Taxation at 19%	4,502
Expenses not deductible	541
Capital allowance exceed depreciation	(854)
Prior year adjustment	(1)
Fair value of swap	(1,045)
Pension movements	(775)
Allocated to non-appointed activities	(625)
Other	(404)
Current tax charge for the year	1,339

Data assurance summary

Our internal controls and board oversight

In 2015/16 Ofwat issued new reporting requirements for the annual performance report which would incorporate a number of tables and information previously contained in the regulatory accounts. Further changes to reporting requirements were issued by Ofwat in 2017/18, with the introduction of the financial flows metric and additional cost assessment tables. We have included these changes into our annual reporting and have chosen to publish the cost assessment tables (4J to 4W) as a separate document alongside our annual performance report.

The data assurance that we have undertaken for the contents of the annual performance report section of the annual report also covers all contents in our Performance, People and Planet (PPP) report.

Our governance and assurance process for the preparation of our annual performance report and PPP report were based on our well-established systems of internal control for all regulatory and performance reporting and incorporated oversight by the board and scrutiny by the audit and risk committee following reviews by the executive team, and heads of department and manager level sign off.

The assurance structure that we have adopted is in line with our approach set out in our company monitoring framework with the three levels of assurance as described below:

Level 1

- peer review data and information is checked by a separate individual
- manager review/sign off data and information is checked by the line manager responsible for the individual completing the submission

Level 2

- internal data and process audit data validity is tested through taking a sample and verifying the data
- the methodology document is reviewed to

- ensure that the process and internal controls are complete and being followed
- a review of methodology, data sampling and internal controls is undertaken
- meetings undertaken with senior managers and those who produce the data to ensure a thorough understanding is obtained

Level 3

- director/executive approval final review of submission information
- audit and risk committee review
- board approval overall review of assurance and auditing undertaken
- discussion and approval of external assurance partner findings

Annual reporting has a clear ownership structure with relevant head of departments taking ownership of sections of the reporting and supporting material. Each data table has data providers assigned for each line and each table has an overarching table owner who is a head of department, reporting to an executive director. The data providers are responsible for collecting, compiling and reporting the data to the table owner and the table owner is responsible for reviewing such data.

The board considered and approved the final processes for the generation of the 2017/18 annual reporting. The audit and risk committee also scrutinised the annual performance report and related narrative, the risk and compliance statement and PPP report. This committee reported to the board before the board approved the annual reports.

A summary on the performance of the company in 2017/18 against our performance targets including comments and recommendations received from Jacobs were reviewed by the committee. The

Data assurance summary continued

committee and board also reviewed the annual performance report, the risk and compliance statement and PPP report. Our annual performance tables have been prepared under the scrutiny of our audit and risk committee, which also considered the declarations to be provided under conditions F and K of the Licence, and have been approved by the board.

Our external assurance

As the processes and associated data items are complex and detailed, the board focuses on the process followed to prepare and review data, the robustness and clarity of the reported information, and obtains additional information and analysis from the executive directors. In addition, the board assures itself of the robustness of data by gaining assurance from Jacobs.

Jacobs are our independent assurance partners whose role is to assist the board to ensure, completeness of the annual reporting, compliance with relevant duties and obligations, and to ensure that the information we provide to demonstrate compliance with our relevant duties and obligations is consistent, comparable, reliable and robust. They presented their summary report and findings to the audit and risk committee.

During 2017/18 Jacobs undertook a half year review of some of our performance commitments providing feedback on any potential improvements identified.

Details of the work performed by Deloitte on our Annual Performance report are provided in the Independent Auditor's Report on page 169.

For the current reporting period Jacobs have reviewed all of our performance commitments and the following annual performance report tables:

- 2B Totex analysis wholesale water and wastewater
- 2C Operating cost analysis retail
- 3C AIM table
- 3D SIM table
- 4A Non-financial information
- 4B Wholesale totex analysis
- 4C Impact of AMP performance to date on RCV
- 4D Wholesale totex analysis water
- 4F Cost analysis household retail

Jacobs also reviewed the following tables not included within the Annual Performance Report:

- 3S Shadow reporting of new definition data
- 4J Atypical expenditure by business unit wholesale water
- 4P Non-financial data for WR, WT and WD wholesale water
- 4Q Non-financial data Properties, population and other wholesale water
- 4V Operating cost analysis water resources

Deloitte, our financial auditors have audited:

- Section 1
- Section 2

Deloitte also reviewed the following tables:

- 4B Wholesale totex analysis
- 4C Impact of AMP performance to date on RCV
- 4D Wholesale totex analysis water
- 4F Cost analysis household retail
- 4G Wholesale current cost financial performance
- 4H Financial metrics
- Remaining cost assessment tables not covered by Jacobs

The findings from annual audits will be incorporated into the process of updating our company monitoring framework which will be published in summer/autumn 2018.

Our company monitoring framework

In June 2015 Ofwat published guidance on its company monitoring framework. In which it stated:

"The company monitoring framework is a tool to challenge all companies to provide information for customers and stakeholders that is reliable, timely, appropriate to the audience, and for companies to be transparent with customers and stakeholders about the data assurance they put in place."

Each autumn we publish our company monitoring framework which sets out what we do to ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience. We publish our strengths, risks and weaknesses statement and the subsequent draft assurance plan we have developed in order to address any risks that have been identified. In March each year we publish our final assurance plan for the year which takes into account any feedback we have received as a result of the publication of our draft assurance plan.

Ofwat's 2017 assessment

In November 2017 Ofwat published its Company Monitoring Framework Assessment in which we were commended for the quality of the performance information we publish.

The report is an annual assessment on the quality of information and assurance all water companies provide to customers about their performance and is intended to challenge them to publish information that can be trusted by their customers.

The conclusion of this report saw us retain the highest category of self-assured, which the company earned in 2016.

Our plans for publishing our future company monitoring frameworks

In their assessment, Ofwat said: "We have looked across how well the company has met or exceeded our expectations in all of our assessments, including whether they have demonstrated that they have met expectations by a clear margin, demonstrated leading edge behaviour, and whether there were any behaviours that we considered led to a reduction in trust and confidence. Taking all of this into account, there were no examples of behaviour that would reduce trust and confidence and the company demonstrated behaviours that met our

expectations by a clear margin with some leadingedge behaviour, which we expect from companies in the self-assurance category".

This status means that we are not required to publish a full analysis of the strengths, risks and issues in relation to data and information provision and instead only need to publish a summary of the outcome of the assurance that has been carried out.

However, we believe that our customers and stakeholders value the transparency that we have provided by publishing our strengths, risks and weaknesses statement and assurance plans. Despite the fact that being categorised as self-assured means we are no longer required to provide as much information as targeted and prescribed companies, we realise the value our customers and stakeholders place on transparency and have therefore opted to provide the same level of detail as if we were still in the targeted category.

All companies in the targeted assurance band were required to:

- identify the risks, strengths and weaknesses in providing the quality of information that stakeholders want and trust
- carry out an exercise with stakeholders to target issues to address
- consult on our draft assurance plans to ensure that they are sufficient to address the issues identified
- publish a statement on this in the autumn of each year

We will be producing a new company monitoring framework and assurance plan for 2018/19 and publishing this in autumn 2018. The findings from our annual audits for 2017/18 will be incorporated into the process of updating our risk assessments and assurance plans. In particular, we will be reviewing our risks associated with environmental breaches due to our 2017/18 performance.

Risk and compliance statement

As directors of South East Water, we have relied on the established systems of internal control the company operates to ensure that it delivers its statutory, regulatory and Licence obligations and manages its risks in order to prepare this statement, the regulatory accounts, the annual performance report and all related narrative.

We have also relied on comprehensive and transparent controls and assurance mechanisms which set out clear accountability for data collection, analysis and verification following the approach defined in our company monitoring framework. The data and control processes themselves have been thoroughly reviewed by external financial and technical auditors to ensure that the information we publish is robust and of high quality.

This enables us to have a high degree of confidence in the information presented in this year's regulatory reporting and supporting data on which the declarations of compliance set out at the end of this statement are based.

We describe our risk management systems and our principal risks in our strategic report. We describe our governance and how we comply with the principles of our corporate governance code including on transparency and accountability in our corporate governance report. Our company monitoring framework describes our approach to reporting and assurance of information and a summary of the process we followed to assure the quality of our reporting is set out in our data assurance summary.

In addition to regular reporting during the year, compliance with our obligations under sector specific legislation or regulation and under our Licence was reviewed for our annual reporting on several of our outcome delivery incentives.

Our innovative approach on outcomes is based on customer satisfaction and we describe how we measure customer satisfaction in our strategic report. For further information about our customer satisfaction outcomes and the approach we have taken in 2017/18 to improve our customers' experience please see our Performance, People and Planet report.

For the preparation of this statement we have considered compliance with our statutory, regulatory and Licence obligations, particularly those considered by our annual reviews as set out above. We have also specifically considered compliance with our statutory, regulatory and licence obligations that have not been confirmed by other processes and for which Ofwat is the enforcement authority.

Our annual reviews have not identified any material deviation from or non-compliance with these obligations and to the best of the board's knowledge after reasonable enquiries South East Water has complied in all material respects with these obligations and is taking appropriate steps to manage and/or mitigate the risks it faces.

This statement is published alongside our annual report and financial statements, and annual performance report for the year ended 31 March 2018, and in making this statement we have taken account of the other statements made in compliance with our obligations under conditions F and K of our Licence and under section 35A of the Water Industry Act 1991 (which are set out in the directors' remuneration report).

Based on the scope and outcome of the review processes detailed in this statement and in our annual financial and regulatory reporting the board is able to confirm that South East Water:

- considers it has a full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations and has taken steps to understand and meet customer expectations;
- has satisfied itself that it has sufficient processes and internal systems of control to meet its obligations; and
- has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

Approved by the Board and signed on its behalf by:

Paul Butler

Managing Director 13 July 2018

Andrew Farmer

Finance Director 13 July 2018

Independent auditor's report

To the Water Services Regulation Authority ("WSRA") and Directors of South East Water Limited

Opinion

We have audited the tables within of South East Water Ltd's Annual Performance Report for the year ended 31 March 2018 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2I) and the related notes.

We have not audited the financial flows for the 12 months (table 1F), the outcome performance table (tables 3A to 3D) and the additional regulatory information in tables (4A to 4I).

In our opinion, South East Water Ltd's Regulatory Accounting Statements within the Annual Performance Report have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.10, RAG 4.07 and RAG 5.07) and the accounting policies (including the company's published accounting methodology statement(s), as defined in RAG 3.10, appendix 2).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditor's responsibilities for the audit of the Regulatory Accounting Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Regulatory Accounting Statements in the UK, including the Financial Reporting Council's Ethical Standard, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.10, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

Independent auditor's report continued

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and have not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 172 to 200 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

The Regulatory Accounting Statements are prepared in accordance with a special purpose framework for the specific purpose as described in the respective directors' and auditor's responsibilities sections below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Our opinion is not modified in this respect.

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

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

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement or inconsistency of this other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out on page 161, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.10, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the Audit of the Regulatory accounting statements within the Annual Performance Report

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

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F: and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2018 on which we reported on 13 July 2018, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP

London, United Kingdom 13 July 2018

Independent auditor's report continued

The following tables are set out following the order defined in Appendix 1 of the regulatory accounting guidance 3.10.

Where the following tables include line items which do not include numerical data, the line has been omitted from the table.

Additional tables have been included under each of the tables in section 1 to provide a reconciliation of the differences in applying RAGs and IFRS.

As detailed earlier, we have opted to not include tables 4J to 4W within the annual performance report and these will instead be published separately along with the financial flows tables for 2015/16, 2016/17 and the average for the AMP.

Financial performance

for the 12 months ended 31 March 2018

TOT THE 12 MONTHS ended 31 March 2016			Adjustments		
1A – Income statement	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	224,776	3,057	8,620	(5,563)	219,213
Operating costs Other operating income	(158,710) 8,895	(2,899) (8,775)	(5,202)	2,303 (8,775)	(156,407) 120
Operating profit Other income Interest income Interest expense Other interest expense	74,961 - 4,792 (56,062)	(8,617) 8,457 (248) 1,127 248	3,418 - - (130)	(12,035) 8,457 (248) 1,257 248	62,926 8,457 4,544 (54,805) 248
Profit before tax and fair value movements Fair value gains/(losses) on financial instruments	23,691	967 (3,253)	3,288	(2,321) (3,253)	21,370 (3,253)
Profit before tax UK Corporation tax Deferred tax	23,691 (1,964) (5,600)		3,288 (625)	(5,574) 625 -	18,117 (1,339) (5,600)
Profit for the year	16,127	(2,286)	2,663	(4,949)	11,178
Dividends	(18,000)	-	(2,663) Adjustments	2,663	(15,337)
1A – Tax analysis	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Current year Adjustments in respect of prior years	1,965 (1)	-	625	(625) -	1,340 (1)
UK Corporation tax	1,964	-	625	(625)	1,339
1A – Analysis of non-appointed revenue					Non- appointed £000
Other non-appointed revenue					8,620
Non-appointed revenue					8,620

1A – Income Statement (Differences between statutory and RAG definitions))	Revenue £000	Operating costs £000	Other operating income £000	Operating profit £000
Movement of Amortisation of Contributions		(1,238)	-	-	(1,238)
Movement of Infrastructure Income		(4,137)	-	-	(4,137)
Movement of developer contributions immediately recognised in income statement		-	(2,619)	-	(2,619)
Movement of Laboratory Income		2,015	-	(2,015)	-
Movement of Thames Water Billing Commission		2,194	-	(2,194)	-
Movement of Southern Water Billing Commission		2,642	-	(2,642)	-
Movement of Other Sundry Income		1,581	-	(1,581)	-
Removal of Depreciation on Capitalised Interest		-	141	-	141
Adjust Pension Contributions		-	(301)	-	(301)
Movement of Profit/(Loss) on Disposal of Fixed Assets		-	(120)	120	-
Movement of Rental Income		-	-	(463)	(463)
Movement of Return Made on Pensions		-	-	-	-
Movement of Fair Value Gains/(Losses)		-	-	-	-
Removal of Interest Capitalised		-	-	-	-
Total differences		3,057	(2,899)	(8,775)	(8,617)
	Other income £000	Interest Income £000	Interest expense £000	Other Pri interest expense £000	ofit before tax and fair value movements £000
Movement of Amortisation of Contributions	1,238	-	-	-	-
Movement of Infrastructure Income	4,137	-	-	-	-
Movement of developer contributions immediately recognised in income statement	(2,619)	-	-	-	-
Movement of Laboratory Income	-	-	-	-	-
Movement of Thames Water Billing Commission	-	-	-	-	-
Movement of Southern Water Billing Commission	-	-	-	-	-
Movement of Other Sundry Income	-	-	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	-	-	141
Adjust Pension Contributions	-	-	-	-	(301)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-	-	-
Movement of Rental Income	463	-	-	-	-
Movement of Return Made on Pensions	-	(248)	-	248	-
Movement of Fair Value Gains/(Losses)	-	-	3,253	-	3,253
Removal of Interest Capitalised			(2,126)		(2,126)
Total differences	8,457	(248)	1,127	248	967

1A - Income Statement (Differences between statutory and RAG definitions) continued

(Differences between statutory and RAG definitions) continued	Fair value gains/ (losses) on financial instruments £000	Profit before tax £000	Profit for the year £000
Movement of Amortisation of Contributions	-	-	_
Movement of Infrastructure Income	-	-	-
Movement of developer contributions immediately recognised in income statement	-	-	-
Movement of Laboratory Income	-	-	-
Movement of Thames Water Billing Commission	-	-	-
Movement of Southern Water Billing Commission	-	-	-
Movement of Other Sundry Income	-	-	-
Removal of Depreciation on Capitalised Interest	-	141	141
Adjust Pension Contributions	-	(301)	(301)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-
Movement of Rental Income	-	-	-
Movement of Return Made on Pensions	-	-	-
Movement of Fair Value Gains/(Losses)	(3,253)	-	-
Removal of Interest Capitalised	-	(2,126)	(2,126)
Total differences	(3,253)	(2,286)	(2,286)

Adjustments

Total comprehensive income for the year	23,892	(2,286)	2,663	(4,949)	18,943
Actuarial gains/(losses) on post-employment plans	7,765	-	-	-	7,765
Profit for the year	16,127	(2,286)	2,663	(4,949)	11,178
1B – Statement of comprehensive income	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000

Adjustments

1C - Statement of financial position	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Non-current assets					
Fixed assets	1,501,707	(4,604)	_	(4,604)	1,497,103
Intangible assets	10,758	(10,758)	_	(10,758)	_
Investments - loans to group companies	190,013	-	-	-	190,013
Retirement benefit assets	21,229	-	-	-	21,229
Total non-current assets	1,723,707	(15,362)	-	(15,362)	1,708,345
Current assets					
Inventories	236	-	-	-	236
Trade & other receivables	77,701	-	1,655	(1,655)	76,046
Cash & cash equivalents	6,310		_	_	6,310
Total current assets	84,247	-	1,655	(1,655)	82,592
Current liabilities					
Trade & other payables	(76,369)		(1,655)	1,655	(74,714)
Capex creditor	(18,643)		-	-	(18,643)
Borrowings	(20,000)		-	-	(20,000)
Provisions	(10,108)	_	_	_	(10,108)
Total current liabilities	(125,120)	-	(1,655)	1,655	(123,465)
Net current assets/(liabilities)	(40,873)	-	-	-	(40,873)
Non-current liabilities				-	
Trade & other payables	(5,979)		-	-	(5,979)
Borrowings	(900,897)		-	-	(900,897)
Financial instruments	(104,169)		-	-	(104,169)
Deferred income - G&C's	(74,471)		-	-	(74,471)
Deferred tax	(140,085)	-			(140,085)
Total non-current liabilities	(1,225,601)	-	-	-	(1,225,601)
Net assets	457,233	(15,362)	-	(15,362)	441,871
Equity					
Called up share capital	(49,312)		-	-	(49,312)
Retained earnings & other reserves	(407,921)	15,362		15,362	(392,559)
Total equity	(457,233)	15,362	-	15,362	(441,871)

1C - Statement of financial position (Differences between statutory and RAG definitions)	Fixed assets £000	Intangible assets £000	Total non- current assets £000	Net assets £000	Retained earnings & other resources £000	Total equity £000
Removal of Capitalised Interest	(15,817)	-	(15,817)	(15,817)	(15,817)	(15,817)
Removal of Depreciation on Capitalised Interest	455	-	455	455	(455)	(455)
Movement of Computer Software Cost	22,406	(22,406)	-	-	-	-
Movement of Computer Software Depreciation	(11,944)	11.944	_	_	_	_
Movement of Computer Software	, , ,	,-	_	_	_	
Work in Progress Cost	296	(296)	-	_	_	
Total differences	(4,604)	(10,758)	(15,362)	(15,362)	15,362	15,362

Under IFRS, computer software is recorded as an intangible asset in the statutory accounts. However, Ofwat require that computer software is reported as part of tangible fixed assets, hence the balance of intangible assets of £10.8 million in the statutory accounts has been restated under tangible fixed assets in the above table.

Adjustments

1D - Statement of cash flows	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Operating profit	74,961	(8,617)	3,418	(12,035)	62,926
Other income Depreciation Changes in working capital Pension contributions Movement in provisions Profit/Loss on sale of fixed assets	49,658 1,394 (3,861) 1,063 (120)	-	- - - -	8,457 (141) 1,391 (1,090)	8,457 49,517 2,785 (4,951) 1,063 (120)
Cash generated from operations Net interest paid Tax paid	123,095 (30,692) (4,000)		3,418 (130) (625)	(3,418) 130 625	119,677 (30,562) (3,375)
Net cash generated from operating activities	88,403		2,663	(2,663)	85,740
Investing activities Capital expenditure Grants & contributions Disposal of fixed assets	(96,869) 1,758 264	- - -	- - -	- - -	(96,869) 1,758 264
Net cash used in investing activities	(94,847)	_	-	-	(94,847)
Net cash generated before financing activities	(6,444)	-	2,663	(2,663)	(9,107)
Cash flows from financing activities Equity dividends paid Net loans received	(18,000) 20,000	-	(2,663)	2,663	(15,337) 20,000
Net cash generated from financing activities	2,000	-	(2,663)	2,663	4,663
Increase/(decrease) in net cash	(4,444)	-	-	-	(4,444)

1D – Statement of cash flows (Differences between statutory and RAG definitions)

	Operating Profit £000	Other Income £000	Depreciation £000	Changes in working capital £000	Pension contributions £000
Operating Profit as per Table 1A	(8,617)	-	-	-	-
Movement of Rental Income	-	463	-	-	-
Movement of Infrastructure Income	-	4,137	-	-	-
Movement of Amortisation of Contributions	-	1,238	-	-	-
Movement of developer contributions immediately recognised in income statement	-	2,619	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	(141)	-	-
Inclusion of Pension Asset	-	-	-	1,391	-
Inclusion of Pension Contributions		-		_	(1,090)
Total differences	(8,617)	8,457	(141)	1,391	(1,090)

	Cash generated from operations £000	Net cash generated from operating activities £000	Net cash used in investing activities £000	Net cash generated before financing activities £000	Net cash generated from financing activities £000	Increase/ (decrease) in net cash £000
Operating Profit as per Table 1A	(8,617)	(8,617)	-	(8,617)	-	(8,617)
Movement of Rental Income	463	463	-	463	-	463
Movement of Infrastructure Income	4,137	4,137	-	4,137	-	4,137
Movement of Amortisation of Contributions	1,238	1,238	-	1,238	-	1,238
Movement of developer contributions immediately recognised in income statement	2,619	2,619	-	2,619	-	2,619
Removal of Depreciation on Capitalised Interest	(141)	(141)	-	(141)	-	(141)
Inclusion of Pension Asset	1,391	1,391	-	1,391	-	1,391
Inclusion of Pension Contributions	(1,090)	(1,090)	-	(1,090)	-	(1,090)
Total differences	-	-	-	-	-	-

1E - Net debt analysis at 31 March 2018

Interest rate risk profile	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares) Preference share capital	166,990	20,000	835,774	1,022,764
Total borrowings Cash Short-term deposits				1,022,764 (6,310) -
Net Debt				1,016,454
Gearing (%) Adjusted Gearing				77.74
Full year equivalent nominal interest cost Full year equivalent cash interest payment	9,310 9,310	84 84	53,914 25,126	63,308 34,520
Indicative interest rates Indicative weighted average nominal interest rate (%) Indicative weighted average cash interest rate (%)	5.58 5.58	0.77 0.77	6.45 3.01	6.19 3.38
Weighted average years to maturity	10	1	12	11
The total borrowings in the above table differs to the bo	orrowings in ta	able 1C as follo	WS:	
				£000
Short term borrowing per table 1C				20,000
Long term borrowing per table 1C				900,897
Total borrowings per table 1C Cumulative accretion due to RPI on synthetic variable rate Unamortised loan arrangement costs	e bonds			920,897 92,262 5,605
Borrowing per table 1E above				1,022,764

1F - Financial flows for the 12 months

ended 31 March 2018

Interest rate risk profile	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Regulatory return on equity	5.60%	3.32%	5.60%
Actual performance adjustment 2010-2015	0.08%	0.05%	0.08%
Adjusted return on regulatory equity	5.68%	3.37%	5.68%
Regulatory equity base (£m)	440	440	261
Financing			
Gearing	-	1.23%	2.07%
Variance in corporation tax	-	0.07%	0.11%
Group relief	-	-	-
Cost of debt	-	(1.00%)	(1.65%)
Hedging instruments	-	1.11%	1.88%
Sub total	5.68%	4.78%	8.09%
Operational performance			
Totex out/(under) performance	-	1.23%	2.07%
ODI out/(under) performance	-	(0.32%)	(0.54%)
Retail out/(under) performance	-	0.80%	1.34%
Sub total	-	1.70%	2.87%
Total earnings	5.68%	6.48%	10.97%
RCV growth	3.74%	3.74%	3.74%
Total shareholder return	9.42%	10.22%	14.70%
Net Dividend	4.00%	2.20%	3.72%
Retained value	5.42%	8.01%	10.99%
Dividends reconciliation			
Gross dividend	4.00%	3.11%	5.25%
Interest receivable on intercompany loans	-	(0.91%)	(1.53%)
Net dividend	4.00%	2.20%	3.72%

Actual returns and actual regulatory equity when compared to notional returns and notional regulatory equity show a difference on the retained shareholder return of 5.57 per cent. This is largely due to the actual gearing of 2.07 per cent in comparison to zero notional gearing and the outperformances on totex and retail of 2.07 per cent and 1.34 per cent respectively compared to the final determination.

The difference between the notional and actual gearing conveys the different structure of the company compared to the gearing level assumed by Ofwat. As reported in Table 1E, the actual gearing level of the company as at the end of the 2017/18 finance year was 77.74 per cent. The assumed gearing ratio was 62.50 per cent. The variance in this, together with the difference between the allowed return on regulated equity and the allowed cost of debt results in a saving in financing on the average regulatory capital value of £5.4 million.

In the year, the company's actual totex equated to £153.8m in base year or 2012/13 prices which is substantially lower than the allowed value for the year of £165.5m. After adjusting for the company's customer sharing ratio of 50 per cent, the final totex outperformance value equated to £5.4m which represents 2.07 per cent of the company's actual regulatory equity base. The company also outperformed against its allowed household retail cost by £4.5m. This was reduced slightly by an underperformance by allowed non-household retail costs of £1.0m, resulting in an overall outperformance on retail costs of £3.5m. This represents a benefit of 1.34 per cent on the company's actual regulatory equity base.

2A-Segmental income statement for the 12 months ended 31 March 2018

	Retail			Wholesale		Total
	Household £000	Non- household £000	Water Resources £000	Water Network+ £000	Wholesale Total £000	£000
Revenue – price control Revenue – non-price control	22,215	2,772 -	-	193,017 1,209	193,017 1.209	218,004 1.209
Operating Expenditure Depreciation – tangible fixed assets	(15,106) (70)	(3,287) (10)	(13,346) (7,173)	(75,151) (42,264)	(88,497) (49,437)	(106,890) (49,517)
Other operating income Operating profit/(loss) before recharges	7,039	(525)	-	120	120 56,412	62,926
Operating profit/(loss)	7,039	(525)			56,412	62,926

2B - Totex analysis

for the 12 months ended 31 March 2018 - wholesale water only

	Water Resources £000	Water Network+ £000	Total £000
Operating expenditure			
Power	3,802	11,571	15,373
Abstraction charges/ discharge consents	2,905	167	3,072
Bulk supply/bulk discharge	1,320	4,274	5,594
Other operating expenditure:			
Other operating expenditure excluding renewals	4,434	42,718	47,152
Local authority rates	885	15,978	16,863
Total operating expenditure excluding third party services	13,346	74,708	88,054
Third party services	-	443	443
Total operating expenditure	13,346	75,151	88,497
Capital expenditure			
Maintaining the long term capability of the assets – infra	75	13,313	13,388
Maintaining the long term capability of the assets – non-infra	1,546	30,448	31,994
Other capital expenditure – infra	(21)	27,017	26,996
Other capital expenditure – non-infra	3,646	11,177	14,823
Infrastructure network reinforcement	-	5,469	5,469
Total gross capital expenditure (excluding third party)	5,246	87,424	92,670
Total gross capital expenditure	5,246	87,424	92,670
Grants and contributions (price control)	-	(12,594)	(12,594)
Totex	18,592	149,981	168,573
Cash expenditure			
Pension deficit recovery payments	507	3,061	3,568
Totex including cash items	19,099	153,042	172,141

2C - Operating cost analysis

for the 12 months ended 31 March 2018 - retail

Household

Overall expenditure for household retail is below equivalent final determination (FD) expectations, with total operating costs (excluding third party services) at £15.1 million versus an FD of £19.7 million. This has largely been achieved by a better cash collection performance allowing the release of amounts previously provided. We have continued to maintain customer service costs at 2013/14 levels despite an increasing measured customer base due to our metering programme. Subsequently, given the increased measured customer base we now calculate our measured cost to serve at £18.27, compared to FD target of £24.31. The impact of the above savings on unmeasured cost to serve means this is now below the FD expectations at £18.21 compared to £15.18.

Non-household

Overall expenditure for non-household retail is £3.3 million. We note that doubtful debts has increased from our 2013/14 position due to the lower cash collections in the year partly as a result of the business structure change required for the opening of the market to competition.

	Household £000	Non-household £000	Total £000
Operating expenditure			
Customer services	6,205	1,500	7,705
Debt management	472	76	548
Doubtful debts	1,200	751	1,951
Meter reading	877	70	947
Service to developers	-	121	121
Other operating expenditure	6,352	769	7,121
Total operating expenditure excluding third party services Third party services operating expenditure	15,106	3,287	18,393
Total operating expenditure	15,106	3.287	18,393
Depreciation – tangible fixed assets	70	10	80
Total operating costs	15,176	3,297	18,473
Debt written off	2,376	110	2,486

2D - Historic cost analysis of fixed assets

wholesale & retail

	Who	lesale	Reta	Total	
	Water	Water Network+	Household	Non- household	
	£000	£000	£000	£000	£000
Cost					
At 1 April 2017	114,346	1,463,887	4,932	1,463	1,584,628
Disposals	(54)	(1,122)	(73)	-	(1,249)
Additions	5,246	87,424	1,008	160	93,838
Assets	-	1,771	-	-	1,771
At 31 March 2018	119,538	1,551,960	5,867	1,623	1,678,988
Depreciation					
At 1 April 2017	(19,328)	(113,797)	(188)	(26)	(133,339)
Disposals	48	849	72	-	969
Adjustments	-	-	-	-	-
Charge for the year	(7,173)	(42,264)	(70)	(10)	(49,517)
At 31 March 2018	(26,453)	(155,212)	(186)	(36)	(181,887)
Net book value at 31 March 2018	93,085	1,396,748	5,681	1,587	1,497,101
Net book value at 1 April 2017	95,018	1,350,090	4,744	1,437	1,451,289
Depreciation charge for year					
Principal services	(7,173)	(42,264)	(70)	(10)	(49,517)
Total	(7,173)	(42,264)	(70)	(10)	(49,517)

The net book value includes £58.1 million in respect of assets in the course of construction.

2E - Analysis of capital contributions and land sales

wholesale

	Fully recognised in income statement £000	Capitalised and amortised against depreciation £000	Fully netted off capex £000	Total £000
Grants and contributions – water				
Connection charges (s45)	2,619	4,174	-	6,793
Infrastructure charge receipts (s146)	4,137	-	-	4,137
Requisitioned mains (s43,s55 & s56)	-	612	-	612
Diversions (s185)	-	1,052	-	1,052
Total	6,756	5,838	-	12,594

There were no assets adopted during the year.

	Water £000
Balance sheet	
Brought forward	71,109
Capitalised in the year	5,838
Amortisation (in income statement)	(1,238)
Carried forward	75,709

There were no sales of protected land during the year.

2F - Household

revenues by customer type

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers £000	Average household retail revenue per customers £
Unmeasured water only customers	30,700	3,092	33,792	142,376	22
Measured water only customer	118,773	19,123	137,896	711,993	27
Total	149,473	22,215	171,688	854,369	26

2G - Non-household water

revenues by customer type

revenues by customer type	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers £000	Average non-household retail revenue per customers £
Total non-default tariffs	-	-	-	-	-
Default tariffs					
Potable water – unmetered	1,077	104	1,181	4,238	25
Potable water – metered 0 to 2.5 Ml/a	21,734	1,365	23,099	45,765	30
Potable water – metered 2.5 to 5 Ml/a	3,976	250	4,226	720	347
Water supplies 5 to 50 Ml	12,250	770	13,020	759	1,014
Water supplies 50 Ml and over	4,507	283	4,790	36	7,861
Total default tariffs	43,544	2,772	46,316	51,518	54
Total	43,544	2,772	46,316	51,518	54

	Number of customers 000	Average non-household retail revenue per customer £000
Revenue per customer Total	51,518	54

2I - Revenue analysis and wholesale control reconciliation

The wholesale revenue for 2017/18 is lower than allowed revenue in the Final Determination (FD) and is due to lower consumption experienced in the year and a different mix of properties between unmeasured and measured supply. This is part offset by an additional number of new connections and higher infrastructure income compared to the FD.

The overall number of customers and the number of void properties has no material impact on the adverse variance for 2017/18.

The table below reconciles the allowed and actual wholesale revenues.

	£000
Allowed revenue for the year	209,830
Reduction due to lower consumption Reduction due to mix of properties	(5,848) (2,955)
Increase due to new connections	2,684
Increase due to infrastructure income Increase due to capital contributions	1,588 (740)
Actual revenue for the year	204,559

2I - Revenue analysis and wholesale control reconciliation

(continued

As a company with a high level of metering, our revenue is very dependent on the consumption forecast used for each year. Each year consumption is forecast based on a 'normal' water resources demand profile. Should weather and/or rainfall not follow this 'normal' profile then this will impact our measured revenue accordingly. Any variation in wholesale revenue is adjusted for using the wholesale revenue forecasting incentive mechanism as prescribed by Ofwat.

New connections and infrastructure continues to exceed expectations and it is likely that a similar improvement in comparison to the final determination will be seen in future years.

	Household £000	Non-household £000	Total £000
Wholesale charge – water Unmeasured Measured Third party revenue	30,700 118,773	1,077 42,467 -	31,777 161,240
Wholesale total	149,473	43,544	193,017
Retail revenue Unmeasured Measured	3,092 19,123	104 2,668	3,196 21,791
Retail total	22,215	2,772	24,987
Third party revenue – non-price control Other third party revenue			1,209
Total appointee revenue			219,213
	Water £000		
Wholesale revenue governed by price control Grants & contributions	193,017 11,542	_	
Total revenue governed by wholesale price control	204,559	_	
Amount assumed in wholesale determination Adjustment for in-period ODI revenue Adjustment for WRFIM	207,905 - 1,925	_	
Total assumed revenue	209,830	_	
Difference	(5,271)	<u> </u>	

2J – Infrastructure network reinforcement costs for the 12 months

ended 31 March 2018

	Network reinforcement capex £000	On site / site specific capex (memo only) £000
Wholesale water network+ (treated water distribution) Distribution and trunk mains Pumping and storage facilities Other	5,391 61 17	10,701 - 612
Total	5,469	11,313

3A-Performance summary

The following table shows the performance against the company's 25 outcomes for 2017/18.

2017/18 performance

For commentary on our performance for the year please see our 2017/18 Performance, People and Planet report www.southeastwater.co.uk/PPP2018

For performance commitment J1: Number of breaches of abstraction licences, discharge consents and environmental permits we have reported 216 breaches. This is broken down as six discharge consent breaches and 209 daily abstraction breaches. At the time of printing this report we have received six discharge consent breach notifications by form of letter but our annual report from the Environment Agency states seven. We have contacted the Environment Agency to request further information about this further breach. Until we have had the opportunity to understand this additional breach we will exclude it from our reporting but will adjust for this in our next return if applicable.

Performance commitment met

Where our in year performance has met the target set by Ofwat 'yes' has been selected, if the target has not been met then 'no' has been entered. For measures that only have targets for 2019/20 'blank' has been entered.

2017/18 reward or penalty (in period outcome delivery incentives (ODIs)) and £m absolute value

We do not have any in period incentives so 'blank' has been entered in this column and therefore the adjacent column is blank.

Notional reward or penalty accrued at 31 March 2018 and £m absolute value

Where in year performance is better than target and above the outperformance payment deadband 'outperformance payment' has been selected and the accrued amount has been added in to the adjacent column.

Where in year performance is worse than target and above the underperformance penalty deadband 'underperformance penalty' has been selected and the accrued amount has been added in to the adjacent column.

Where in year performance is within the dead bands either 'outperformance payment deadband' or 'outperformance penalty deadband' is selected, the adjacent column is then blank.

For service incentive mechanism (SIM) its outperformance payment or underperformance penalty does not get calculated until the end of the price control, therefore 'blank' has been selected and the adjacent column is blank.

If the measure is a reputational performance commitment 'Not applicable' has been selected and the adjacent column is blank.

This financial year we have accrued £0.024m underperformance penalty for our customer satisfaction performance measures. We have seen slight increases in our scores across the measures but we are falling short of our target for all except satisfaction with the level of water restrictions which has incurred an outperformance payment of £0.048m. A company wide effort is being made to improve these scores but maintaining a stable score recognises that we are continually improving to meet rising customer expectations.

In 2017/18, we have achieved a leakage performance of 87.7Ml/d compared to a leakage target of 90Ml/d. Our 2017/18 performance level includes methodological changes which are equivalent to 0.7Ml/d, we have therefore decided that we will not claim a reward on this element. Our leakage performance of 87.7Ml/d equates to a reward of £0.409m but we are instead claiming a reward of £0.189m due to the methodological change. This has been achieved by improvements in our leakage programme, including investment in the latest technology, increases in the number of technicians, and a record number of leaks detected by our teams.

We have incurred a £1.331m underperformance penalty for exceeding our target for interruptions to customers' water supply in 2017/18. While our underlying performance for interruptions was very good, at 6.8 minutes per property, the impact of a one-off extreme event in February/March means our overall interruption performance for the year was 44.6 minutes against a target of 12.0 minutes.

We received a £0.004m outperformance payment due to reducing the number of properties at risk of low pressure in our region due to continual investment in schemes which will affect these properties.

In 2017/18 we received an underperformance penalty of £0.358m for our discolouration contacts performance commitment. We have achieved 0.82 contacts per 1,000 population compared to a target of 0.58. We are disappointed that we have not met our in year target of 0.58, but pleased that we have reduced the number of discolouration contacts from 0.96 last year.

Total AMP6 reward or penalty 31 March 2020 forecast

We are forecasting to hit the targets for the remainder of the AMP that we will have the following outperformance payments and underperformance penalties:

- leakage we are forecasting a £0.063m outperformance payment in 2018/19 and to be within our outperformance deadband in 2019/20
- interruptions to supply we are forecasting a £0.266m outperformance payment in both 2018/19 and 2019/20
- discolouration contacts we are forecasting that we will receive an underperformance penalty of £0.179m in 2018/19 but will be within our outperformance deadband in 2019/20

3A-Performance summary (continued)

Performance commitment		2017/18 performance level – actual	2017/18 CPLmet?	2017/18 reward or penalty (in-period ODIs)	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast
Wholesale performance								
A1: Customer satisfaction - appearance of water	4.5	4.5	No	-	Penalty deadband	-	Penalty deadband	-
B1: Customer satisfaction - taste and odour of water	4.2	4.2	No	-	Penalty deadband	-	Penalty deadband	-
C1: Customer satisfaction - level of leakage	3.8	3.8	No	-	Penalty	(0.0259)	Penalty	(0.0513)
C2: Leakage (actual reported leakage per MI/d per year)	88.6	87.7	Yes	-	Payment	0.1890	Payment	1.6330
D1: Customer satisfaction - direct interaction experience	4.3	4.3	No	-	Penalty	(0.0016)	Penalty	(0.0033)
D2: Service Incentive Mechanism (SIM)	84.6	85.6	-	-	-	-	-	-
E1: Customer satisfaction - bills are value for money and affordable	74%	71%	-	-	-	-	-	-
F1: Customer satisfaction - water supply is of sufficient pressure	4.2	4.3	No	-	Penalty	(0.0243)	Penalty	(0.0720)
F2: Number of properties at risk of low pressure, as recorded on the DG2 register	49	47	Yes	-	Payment	0.0040	Payment	0.0170
G1: Customer satisfaction - frequency and duration of supply interruptions	4.6	4.6	No	-	Payment deadband	-	Penalty deadband	-
G2: Average time lost per property (measured in minutes, per property served)	12.9	44.6	No	-	Penalty	(1.3310)	Penalty	(1.7310)
H1: Customer satisfaction - frequency of water use restrictions	4.4	4.4	Yes	-	Payment	0.0432	Payment	0.1737
H2: Meeting the water resource deficit	0	0	Yes	-	-	-	-	-
I1: Mean zonal compliance (MZC)	99.95	99.95	No	-	Penalty deadband	-	Penalty deadband	-
J1: Number of breaches of abstraction licences, discharge consents and environmental permits	5	215	No	-	-	-	-	-
J2: Number of pollution incidents (category 1-2)	2	1	No	-	-	-	-	-
K1: Number of breaches of health and safety regulations, as defined by the Health and Safety Executive	0	0	Yes	-	-	-	-	-
L1: Number of breaches of National Security obligations (Security and Emergency Measures Direction)	0	0	Yes	-	-	-	-	-
M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes through to K	1	0	Yes	-	-	-	-	-
N1: Discolouration contacts	0.96	0.82	No	-	Penalty	(0.3580)	Penalty	(0.5360)
N2: Above ground asset performance assessment	Stable	Stable	Yes	-	-	-	-	-
N3: Number of company sites at risk of flooding	33	7	-	-	-	-	-	-

3A-Performance summary (continued)

Performance commitment		2017/18 performance level - actual	2017/18 CPLmet?	2017/18 reward or penalty (in-period ODIs)	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast
N4: Water mains bursts	3,032	2,747	No	-	Penalty deadband	-	Penalty deadband	-
O1: Kg of carbon emissions per customer per year	37.2	37.2	-	-	-	-	-	-
O2: We will monitor our abstractions at low flows at environmentally sensitive sites (in line with AIM)	-0.18	-0.24	Yes	-	-	-	-	-
Household retail performance								
A1: Customer satisfaction - appearance of water	4.5	4.5	No	-	Penalty deadband	-	Penalty deadband	-
B1: Customer satisfaction - taste and odour of water	4.2	4.2	No	-	Penalty deadband	-	Penalty deadband	-
C1: Customer satisfaction - level of leakage	3.8	3.8	No	-	Penalty	(0.0111)	Penalty	(0.0220)
D1: Customer satisfaction - direct interaction experience	4.3	4.3	No	-	Penalty	(0.0064)	Penalty	(0.0133)
D2: Service Incentive Mechanism (SIM)	84.6	85.6	-	-	-	-	-	-
E1: Customer satisfaction - bills are value for money and affordable	74%	71%	-	-	-	-	-	-
F1: Customer satisfaction - water supply is of sufficient pressure	4.2	4.3	No	-	Penalty	(0.0027)	Penalty	(0.0080)
G1: Customer satisfaction - frequency and duration of supply interruptions	4.6	4.6	No	-	Payment deadband	-	Payment deadband	-
H1: Customer satisfaction - frequency of water use restrictions	4.4	4.4	Yes	-	Payment	0.0048	Payment	0.0193

3B - Sub-measure performance table

Unique ID	PC / sub-measure ID	PC / sub-measure	2016/17 performance level - actual	2017/18 performance level - actual	2017/18 CPLmet?
PR14SEWWSW_N2	00	N2: Above ground asset performance assessment	Stable	Stable	Yes
PR14SEWWSW_N2	01	WTW coliforms non-compliance	0.08	0.05	Yes
PR14SEWWSW_N2	02	Service reservoir coliforms non-compliance	-	-	Yes
PR14SEWWSW_N2	03	Turbidity non-compliance	-	-	Yes
PR14SEWWSW_2N	04	Enforcement incidents	-	-	Yes

3C-AIM table

Abstraction site	2017/18 AIM performance (ML)	2017/18 normalised AIM performance	Cumulative AIM performance 2016/17 (ML) onwards	Cumulative normalised AIM performance 2016/17 onwards	Contextual information relating to AIM performance
Windmill Hill	(72.7)	(0.16)	(116.1)	(0.16)	-
Kingston	(84.5)	(0.08)	(84.5)	(0.08)	-
Total	(157.2)	(0.24)	(200.6)	(0.24)	

3D-SIM table

1st survey score	4.35
2nd survey score	4.30
3rd survey score	4.44
4th survey score	4.42
Qualitative SIM score (out of 75)	63.38
Quantitative performance	Score
Total contact score	55.92
Quantitative SIM score (out of 25)	22.20
SIM score	Score
Total annual SIM score (out of 100)	85.58

4A-Non-financial information

for 12 months ended 31 March 2018

Retail - household	Unmeasured 000	Measured 000
Number of void households	5,194	15,597
Per capita consumption (excluding supply pipe leakage) I/h/d	183.56	141.70
Wholesale		Water
Volume (MI/d)		
Bulk supply export		0.890
Bulk supply import		32.692
Distribution input		517.157

4B - Wholesale totex analysis

At the beginning of the AMP6 Period we set up a new team whose focus was on efficient delivery of the engineering programme. The programme definition and optimisation team (PDOT) was challenged with identifying significant savings over the five year period. The focus of their work includes:-

- working with the supply chain to identify innovation
- profiling the programme so that our supply partners could deliver the programme more efficiently
- identifying alternative approaches to dealing with complex problems
- providing better information to our supply chain earlier to help them with their resource management
- reviewing our standards to see if alternative approaches provide the same outcome without impacting on risk

In addition to this, we have found further efficiencies by reviewing some of our key strategies. An example being our leakage strategy, where we have spent additional money in the first three years of the AMP, which has reduced leakage and allowed us to defer a £4m water resources scheme from the programme. This water resources scheme had potential environmental impacts.

Our engineering and assets teams have developed new contracts with the supply chain, incentivising them on efficiency targets. For instance Jacobs, our delivery partner, is incentivised on OPEX as well as CAPEX, ensuring we optimise TOTEX, and they have helped us review our generator strategy which has helped us to reduce power costs – a programme we will continue to roll out over the rest of the AMP.

We have made efficiency savings in our domestic metering programme while at the same time remain committed to delivering the metering plan set out in our water resources management plan (WRMP) and business plan.

Expenditure for 2017/18 has seen us deliver our SOSI regulated commitments such as SEMD, DWI and SOSI projects and also refurbishments of water treatment works and water mains.

	Current Year Water £000	Cumulative 2015-20 Water £000
Actual totex Menu totex	172,141	486,320
Items excluded from the menu		
Third party costs	443	1,202
Pension deficit recovery payments	3,568	9,530
Other 'rule book' adjustments	1,437	2,117
Total costs excluded from the menu	5,448	12,849
Adjusted actual totex		
Adjusted actual totex	166,693	473,471
Adjusted actual totex base year prices	148,361	434,624
Allowed totex		
Allowed totex based on final menu choice – base year prices	165,500	469,300

4C - Impact of AMP performance to date on RCV

Table content summary

This table tracks year on year changes to the regulatory capital value (RCV) and reports a 'shadow' RCV as a result of actual totex and any ODI adjustments.

Background and purpose

This information is intended to show the rolling impact on the RCV of changes in investment activity relative to the determination and ODI performance over the year.

Table completion methodology

Key inputs to the table and their sources are summarised in the table below: Some of the methodologies require some choices which are discussed further in the following section.

Line	Description	Source data and analysis
1	Cumulative totex over/underspend so far in the price control period	This line is calculated as the difference between the actual totex (4B L8) and the baseline totex (4B L9) (at base year prices) inflated to current year prices using the actual RPI.
2	Customer share of cumulative totex over/underspend	The customer share of the cumulative totex over/underspend is 50% as per the baseline menu choice.
3	RCV element of customer share of cumulative totex over/underspend	The RCV element of customer share of cumulative totex over/underspend is calculated using the Totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook. The cumulative totex over/underspend from line 4C.1 is entered into the model along with the baseline of 100 from our final menu choice.
		The model applies an adjustment for the time value of money (WACC) and takes into account the movement from the implied menu choice (103.1) to the actual menu choice (100.0) including the final 2 years of the AMP.
		The RCV adjustment is then inflated to outturn using the issued RPI of 278.3.
4	Adjustment for ODI rewards or penalties	There are no projected ODI adjustments to the RCV for 2017/18.
5	RCV determined at FD at 31 March	RCV at 31 March 2018 as reported in Table A2.9 of SEW's FD company specific appendix (p28).
		£1,149.5m (2012/13 av prices RPI = 244.675)
		This is inflated using March 18 prices using the issued RPI of 278.3 to £1,307,508m.

Table completion methodology discussion

The line definitions specify that the RCV is to be inflated to March 2018 using the March RPI. This correctly reports the RCV at a 'year end' position.

The year by year PAYG ratio reported in table A2.5 of SEW's FD company specific appendix is given below:

2015/16	2016/17	2017/18	2018/19	2019/20	Total
61.6%	58.2%	56.4%	59.7%	64.1%	60.0%

Ofwat guidance has specified that the weighted average PAYG ratio is to be used for this calculation

The weighted average PAYG ratio is 59.9 per cent. This is consistent with the totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook.

4C - Impact of AMP performance to date on RCV (continued)

Table calculations

Line	Description	Unit		
	Price base RPI index		2012-13 av 244.7	Mar-18 y/e 278.3
1	Cumulative totex over/underspend so far in the price control period (4B L8 – 4B L9 in outturn prices)	£m		(39.442)
2	Customer share of cumulative totex over/underspend (4C L1 * 50%)	£m		(19.721)
3	RCV element of customer share of cumulative totex over/ underspend (calculated using the totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook)	£m	(14.975)	(17.032)
4	Adjustment for ODI rewards or penalties	£m		-
5	RCV determined at FD at 31 March	£m		1,307.510
6	Projected 'shadow' RCV	£m		1,290.476

Changes in methodology since prior years

The methodology has changes this year. Totex outperformance has been included in the totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook to generate the shadow RCV. The table below shows the shadow RCV for prior years if they were calculated using the same methodology.

Line	Description	2015/16	2016/17
1	Cumulative totex over/underspend so far in the price control period	(4.936)	(19.302)
2	Customer share of cumulative totex over/underspend	(2.468)	(9.651)
3	RCV element of customer share of cumulative totex over/underspend	(4.076)	(9.594)
4	Adjustment for ODI rewards or penalties	-	-
5	RCV determined at FD at 31 March	1,166.575	1,231.145
6	Projected 'shadow' RCV	1,162.499	1,221.551

Risks to data accuracy and robustness

None.	Water £000
Cumulative totex over/underspend so far in the price control period Customer share of cumulative totex over/underspend	(39.442) (19.721)
RCV element of customer share of cumulative totex over/underspend Adjustment for ODI rewards or penalties RCV determined at FD at 31 March	(17,032) - 1,307,509
Projected 'shadow' RCV	1,290,477

4D - Wholesale totex analysis for the 12 months ended 31 March 2018 - water

	Water resources		Raw water distribution				
	Abstraction licences £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure							
Power Abstraction charges/	- 2,905	3,802	454 -	-	282 167	10,835	15,373 3,072
discharge consents Bulk supply	_	1,320	-	-	4,274	-	5,594
Other operating							
expenditure excluding renewals Local authority and	7	4,427	215	4	13,505	28,994	47,152
Cumulo rates	-	885	188	196	1,334	14,260	16,863
Total operating expenditure excluding							
third party services Third party services	2,912	10,434	857 -	200	19,562 -	54,089 443	88,054 443
Total operating expenditure	2,912	10,434	857	200	19,562	54,532	88,497
Capital expenditure Maintaining the long							
term capability of the assets - infra Maintaining the long	-	75	63	-	504	12,746	13,388
term capability of the assets - non-infra	-	1,546	177	-	19,778	10,493	31,994
Other capital expenditure - infra Other capital	-	(21)	130	-	-	26,887	26,996
expenditure - non-infra Infrastructure network	-	3,646	19	-	7,144	4,014 5,469	14,823 5,469
Total gross capital							
expenditure (excluding third party)	-	5,246	389	-	27,426	59,609	92,670
Total gross capital expenditure	-	5,246	389	-	27,426	59,609	92,670
Grants and contributions	-	-	_	-	-	(12,594)	(12,594)
Totex	2,912	15,680	1,246	200	46,988	101,547	168,573
Cash expenditure Pension deficit recovery payments	4	503	15	-	1,278	1,768	3,568
Totex including cash items	2,916	16,183	1,261	200	48,266	103,315	172,141

4D - Wholesale totex analysis (continued)

for the 12 months ended 31 March 2018 - water

Unit cost information (operating expenditure)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume – water treatment	Distribution input volume – treated water
Volume (MI)	274,068.769	178,705.380	24,689.563	668.658	188,245.326	188,245.326
Unit cost (£/MI)	10.625	58.387	34.711	299.107	103.918	289.686
Population (000's) Unit cost (£/pop)	2,211.400	2,211.400	2,211.400	2,211.400	2,211.400	2,211.400
	1.317	4.718	0.388	0.090	8.846	24.659

4F - Operating cost analysis for the 12 months ended 31 March 2018 - household retail

	Household unmeasured water	Household measured water	Total
	£000	£000	£000
Operating expenditure			
Customer services	836	5,369	6,205
Debt management	79	393	472
Doubtful debts	200	1,000	1,200
Meter reading	-	877	877
Other operating expenditure	1,033	5,319	6,352
Total operating expenditure	2,148	12,958	15,106
Depreciation – tangible fixed assets			
On assets existing at 31 March 2015	9	48	57
On assets acquired since 1 April 2015	2	11	13
Total operating cost	2,159	13,017	15,176
Capital expenditure	168	840	1,008

Household	£000
Demand-side water efficiency – gross expenditure Demand-side water efficiency – expenditure funded by wholesale	336 (193)
Demand-side water efficiency - net retail expenditure	143
Customer-side leak repairs – gross expenditure Customer-side leak repairs – expenditure funded by wholesale	1,468 (1,030)
Customer-side leak repairs - net retail expenditure	438

4G - Wholesale current cost financial performance

for the 12 months ended 31 March 2018

	Water £000
Revenue	194,226
Operating expenditure	(88,497)
Capital maintenance charges	(76,838)
Other operating income	120
Current cost operating profit	29,011
Other income	8,457
Interest income	4,544
Interest expense	(54,805)
Other interest expense	248
Current cost loss before tax and fair value movements	(12,545)
Fair value gain/(losses) on financial instruments	(3,253)
Current cost loss before tax	(15,798)

4H - Financial metrics - Return on regulated equity

Table/Line content summary

This parameter reports the return on regulated equity (RORE) which is a measure of the return to shareholders allowing for any out/(under) performance in the year.

Background and purpose

RORE is a measure of the return to shareholders allowing for any out/(under) performance in the year primarily from:

- Totex out/(under) performance (adjusted for RCV runoff)
- Retail household costs out/(under) performance
- Any reward/(penalty) from ODIs in the year
- Debt financing costs out/(under) performance compared to the cost of debt set by Ofwat in the final determination
- The above are adjusted for the impact net of tax

RORE is referenced against the notional balance sheet and the allowed cost of equity in the WACC assumed by Ofwat in the final determination. For PR14 Ofwat set a notional gearing level for all companies of 62.50 per cent and a base return to equity of 5.60 per cent. This information is intended to show the rolling impact on the RCV of changes in investment activity relative to the determination and ODI performance over the year.

Table/Line completion methodology

The Ofwat line definition for RORE is given below.

Line	Description	Definition
5	RORE (return on regulatory equity)	RORE calculates the return on a regulatory basis by reference to the notional gearing level of 62.50% for PR14 and average RCV for each year. Where a regulated business ceases to undertake a particular activity (e.g. exiting the non-household retail market), then a note should be included setting out how this has impacted on the RORE compared to the base RORE set at FD.
		The base RORE set at the final determination should be adjusted for the following factors net of any tax impact. 1) The company share of totex out or under performance only. Any totex over or underspend which is due to timing (i.e. reprofiling of expenditure within the AMP) should not be recognised as out or under performance for the purpose of the calculation of RORE. 2) The company share of any out or underperformance on retail costs. 3) The impact of any ODI or SIM penalties or rewards earned in the year, even if they are not payable/receivable until the following AMP. 4) The difference between the actual average interest rate paid on borrowings (in real terms) and the allowed interest rate (real) on notional debt. This should be calculated based on the notional capital structure i.e. difference in actual interest rate and allowed interest rate multiplied by notional net debt. When calculating the actual real interest rate paid from actual nominal interest rate paid (nominal interest paid/average net debt) the actual year average inflation rate should be used to deflate the nominal rate to a real rate. 5) The impact of tax on the above should be calculated using headline tax rate.
		RORE should be presented on an average basis (calculated as an arithmetic average of the annual figures in the AMP to date) and should recognise gains and losses made in the period from the start of the AMP to the date of the APR.
		The Fisher equation should be used to translate from nominal to real interest rates; $(1+n)=(1+r)^*(1+i)$.

4H - Financial metrics - Return on regulated equity (continued)

Key inputs to the calculation of RORE and the sources of data are summarised in the table below:

Item	Approach
Base RORE	Base RORE is 5.60% (source: Ofwat populated SEW FD RAT model available at http://webarchive.nationalarchives.gov.uk/20150624091829/https://www.ofwat.gov.uk/pricereview/pr14/pap_tec201412pr14ratmodel_sew.xlsm)
	The base RORE is converted to £m for each year using the FD notional regulated equity using the regulatory notional balance sheet gearing of 62.50%. Base RORE = RCV x $(100.00\%-62.50\%)$ x 5.60%.
Totex out/(under)	The outperformance is calculated as:
performance	Adjusted actual totex – converted to base year prices (APR Table 4B Line 8) less the Allowed totex based on final menu choice – base year prices (SEW FD company specific report – Table A2.4 Line 6). This outperformance is adjusted for any re-profiling of expenditure over the AMP.
	This is adjusted for tax at a rate of 20%.
Retail costs out/(under)	The outperformance is calculated as:
performance	Retail HH – Actual retail HH costs (APR Table 2C Line 12) – outturn prices, less the Allowed retail HH costs (calculated as actual property numbers times the ACTS for measured and unmeasured properties from SEW FD company specific report – Table A3.10 Lines 9&10) – outturn prices. The actual retail HH costs are adjusted to exclude any depreciation on assets existing at March 2015. The difference between allowed and adjusted actuals are converted to base year prices for consistency on inclusion in RORE.
	Retail Non HH-Actual retail NHH costs (APR Table 2C Line 12) – outturn prices, less the Allowed retail NHH costs (taken from Ofwat's FD model for SEW – Calc NHH'!J\$980) – outturn prices. The actuals are adjusted to exclude any depreciation on assets existing at March 2015.
	Both items are adjusted for tax at a rate of 20%.
RCV runoff on totex out/ (under) performance	Calculated using the above out/(under) performance on totex and FD RCV runoff rates for new RCV expenditure additions.
Impact of ODI/SIM penalties/rewards in year	Although any reward/(penalty) from the ODIs are not due to be recovered from customers until the next price review, for the purposes of the RORE calculation the impact is considered in the year of occurrence.
	The net £m reward/(penalty) from ODIs is taken from SEW APR Table 3A.
	Items are adjusted for tax at a rate of 20%.
Difference between	Allowed real interest rate comes from the Ofwat FD model for SEW.
actual interest charge (real terms) and allowed interest (real) on notional debt.	Actual interest costs on a nominal basis (excluding fees and bank charges) is taken from the P&Linterest note supporting APR Table 1A. This is divided by the average net debt for the year.
	This actual nominal figure is converted to a real figure by using actual RPI in the fisher formula: $(1+real) \times (1+RPI) = (1+nominal)$.
	The difference between allowed and actual real interest (%) is multiplied by notional debt to generate a £m out/(under) performance on debt costs.
RORE (in year)	Sum of above in £m converted to % return on regulated equity.
RORE (cumulative)	A simple average of the in year and prior year RORE %'s.

4H - Financial metrics - Return on regulated equity (continued)

Summary calculation

Calculation of RORE	2012-13 prices Unit	2015-16	2016-17	2017-18
Year average RCV	£m	1,082.7	1,105.9	1,134.0
Notional gearing	%	62.50	62.50	62.50
Notional debt	£m	676.7	691.2	708.8
Regulatory equity	£m	406.0	414.7	425.3
Base RORE – appointee	%	5.60	5.60	5.60
Base case return	£m	22.7	23.2	23.8
Adjustments to base case return				
Company share of totex out/(under) performance	£m	1.9	4.7	6.6
Company share of out/(under) performance on retail costs	£m	1.0	2.3	2.8
Impact on RCV runoff of the out/(under) performance of totex	£m	(0.0)	(0.1)	(0.2)
Impact on ODI/SIM in year	£m	0.2	0.4	(1.4)
Difference between actual interest charge and allowed on notional debt	£m	(6.1)	(2.8)	1.6
Adjustments to base case return	£m	(3.1)	4.5	9.4
Adjusted return	£m	19.7	27.7	33.2
Regulatory equity	£m	406.0	414.7	425.3
Outturn annual RORE	%	4.84	6.68	7.80
Outturn cumulative RORE (arithmetic average)	%	4.84	5.76	6.44

4H - Financial metrics - Return on regulated equity (continued)

Commentary on results

RORE for the year was 7.80 per cent compared to the base case RORE of 5.60 per cent. RORE to date is 6.44 per cent. A breakdown of the RORE components is shown below.

Breakdown of RORE components	2015/16	2016/17	2017/18	To date
Base RORE - appointee	5.60%	5.60%	5.60%	5.60%
1 Company share of totex out/(under) performance	+0.46%	+1.33%	+1.56%	+1.05%
2 Company share of out/(under) performance on retail costs	+0.25%	+0.57%	+0.66%	+0.49%
3 Impact on RCV runoff of the out/(under) performance of totex	(0.00%)	(0.02%)	(0.05%)	(0.03%)
4 Impact on ODI/SIM in year	+0.04%	+0.09%	(0.34%)	(0.07%)
5 Difference between actual interest charge and allowed on notional debt	(1.51%)	(0.67%)	+0.37%	(0.60%)
Outturn RORE	4.84%	6.68%	7.80%	6.44%

The outperformance on RORE for the year was primarily driven by outperformance on both wholesale totex and retail costs.

The value reported for 2016/17 above has been restated due to a change in the totex outperformance number post audit. The adjusted outturn annual RORE for 2016/17 is 0.25 per cent lower than reported previously at 6.68 per cent.

Changes in methodology since prior years

None.

Risks to data accuracy and robustness

None.

4H - Financial metrics

Financial Indicators	Metric
Net debt (£m)	1,016.454
Regulated equity (£m)	291,055
Regulated gearing (%)	77.74
PPost tax return on regulated equity (%)	7.19
RORE (return on regulated equity) (%)	6.42
Dividend yield (%)	3.72
Retail profit margin – Household (%)	4.10
Retail profit margin – Non household (%)	(1.13)
Credit rating	BBB
Return on RCV (%)	5.50
Dividend cover (number)	1.42
Funds from operations (FFO)	82.955
Interest cover (cash) (number)	3.40
Adjusted interest cover (cash) (number)	2.05
FFO/debt (number)	0.08
Effective tax rate (%)	7.39
Free cash flow (RCF)	67.618
RCF/capex (number)	0.70
Revenues and earnings	£m
Revenue (actual)	218.004
EBITDA (actual)	111.114
Borrowings	%
Proportion of borrowings which are fixed rate	16.33
Proportion of borrowings which are floating rate	1.96
Proportion of borrowings which are index linked	81.72
Proportion of borrowings due within 1 year or less	1.95
Proportion of borrowings due in more than 1 year but no more than 2 years	28.97
Proportion of borrowings due in more than 2 years but no more than 5 years	-
Proportion of borrowings due in more than 5 years but no more than 20 years	52.75
Proportion of borrowings due in more than 20 years	16.33

41 - Financial derivatives

		value by m 31 March	,	Total Va 31 Marcl		Total- accretion at 31 March 2018	Interest (weighted a for 12 mor 31 March	iverage iths to
	1 to 2 years	2 to 5 years	over 5 years \	Nominal value (net)	Mark to Market		Payable Re	ceivable
	£m	£m	£m	£m	£m	£m	%	%
Interest Rate Swap (Sterling) Fixed to index-linked	-	-	-	-	(104,169)	(96,263)	6.17	5.38
Total financial derivatives	_	-	-	-	(104,169)	(96,263)		

Notes	

