south east water

2018/19

Investors Report

South East Water Financing Group:

South East Water (Holdings) Limited

South East Water Limited

South East Water (Finance) Limited

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Contents

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General overview and business update

This Investors Report from South East Water covers the 12 month period ending 31 March 2019. It also includes a summary of any subsequent material events in the period prior to the publication of this report.

1 Environment, social and governance framework

During the year we have been building our environment, social and governance (ESG) framework and we aim to be recognised as a leading responsible business. Our business plan incorporated a responsible business strategy with 10 new responsible business commitments to reflect the actions and behaviours customers expect a responsible business to display.

Activities we've been developing include:

- **increasing our schools programme of engagement**
- **developing more partnership working with charities and universities**
- **ensuring fair reward and recognition for all employees**
- **working with WaterUK and the Refill organisation to encourage the use of tap water as a sustainable alternative to bottled water**

Full details of our work and example case studies can be seen in our performance, people and planet report.

We have set up a Responsible Business board committee. The main purpose of the committee is to assist the board in defining the company's strategy relating to ESG matters and in reviewing related practices and initiatives to ensure they remain effective and up to date.

In July 2018 we submitted our response to the GRESB benchmarking for ESG. This was the first year the company had been involved in this process. We were able to maintain four stars but increased our GRESB score from 47 (2018) to 72 points out of 100. Further work has been carried out during 2018/19 to support continued improvement of our position and we submitted again in July 2019 (results expected in September 2019).

We have developed a Sustainability Finance Framework, under which the company can issue Sustainability Bonds and Sustainability Loans. We believe this is a European water utility company first. The framework will finance a range of activities, not only environmental projects but also ones which will benefit society such as improving drinking water quality. The framework was supported by ING, which acted as sole Green Structuring Advisor and independently reviewed by VigeoEiris.

This Sustainability Finance Framework highlights how our activities are supporting five of the United Nation Sustainable Development Goals, including climate action and sustainable cities and communities. It is an important step in our continuous development as a responsible business.

2 Operational performance

We continue to invest in our infrastructure network so that we can provide our customers with high quality water. In this, the fourth year of the five year investment period, we delivered £105.0 million of capital investment.

For our project engineers the dry summer weather provided excellent conditions as they progressed the company's largest ever single investment at the Keleher Water Treatment Works at Bray in Berkshire.

The first phase of work involved a site clearance programme removing approximately 25,000 cubic metres of earthworks, which completed ahead of schedule.

This trial will allow the transmission of data for analysis from digital water meters at 2,000 homes in a trial area, as well as information from other network sensors.

If successful, it has the potential to alert us to the smallest leaks on both our and our customers' pipes soon after they occur, and could even enable us to predict and prevent pipeline failure before it happens.

In August 2018 we published a revised water resources management plan which took on board the key challenges raised in the consultation, and in particular customer and stakeholder support for the reduction of customers' water use and overall leakage. In line with the guidelines we have made an estimate of the cost of our preferred plan. Over the 60 year planning period we estimate that the current cost of our plan will be £986.2 million in net present value (NPV) terms and will increase the supply of water by 266.5 Ml/d to secure the long-term resilience of water resources in our area. The revised plan is with the Secretary of State for approval and we hope to publish a final plan later this year.

4 Customer service

During the year we have worked collaboratively with our vulnerability stakeholders and our Customer Challenge Group to create a new vulnerability strategy which has formed part of our business planning process find out more – **corporate.southeastwater.co.uk/news-info/publications/our-draft-vulnerability-strategy-2019/**.

A reflection of this customer focus has been the achievement of BSI 18477 which demonstrates our support for vulnerable customers; an area in which we are showing leadership, being the first water company to have been accredited in this way. The standard provides a framework to help us build on the great work of our Customer Care team as we work to identify those customers who could benefit from our support in future. During the year the team has added a further 9,832 customers to our Priority Services Register (to provide additional support for those who need it) and also supporting greater numbers of customers who may struggle with their water charges through our social tariff, with over 27,860 customers now benefiting from a discount on their water charges.

Our overall annual result in the Ofwat Service Incentive Mechanism (SIM) scores for all water companies in 2018/19 was 85.4 out of 100.

Since 2010 SIM has provided a comparable measure of consumers' experience and how satisfied they are with the overall handling of an actual recent contact with their water supplier. Combined data gathered during each five-year investment period is then used to support Ofwat's decisions on financial incentives.

However, from 2020 a new customer survey mechanism called C-MeX is to replace SIM. Unlike its predecessor, C-MeX will link financial incentives to the performance level of the best performing companies in all sectors, taking account of water companies' performance relative to other companies and sectors

Some key activities developed during the year includes:

Follow Me – This functionality gives our agents the tools to increase their case ownership practices, allowing them to monitor accounts for bills, payments and contacts, ensuring we deliver as promised.

PAYG (Pay As You Go) – Payment plans are still one of the main reasons that our customers make contact and we have streamlined this process so that we can use the same language and views across all our channels, including, the customer relationship management tool (CRM), our bills and the website. The CRM changes are the first – we have developed new screens to simplify our existing functionality so that it's easy to understand, for both agents and customers. It uses the core system functionality but displays the calculations in a different way, consolidating the various components, helping us give consistency in our explanations.

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Health Check – We have also developed new 'account health check' screens within CRM. This shows a score for each customer based on the accuracy of their account details. It has quick buttons which allows the advisor to update the details and gives them advice on how to help improve the account. Longer term we would like to introduce a version of this within MyAccount so that the customer can update their own details giving them control of their information.

During the year, we saw an increase in written complaints from customers from 1,476 (2017/18) to 1,823 this year. While we are disappointed to see an increase, this is against work to embed wastewater billing for 465,000 customers and operational recovery from the freeze/thaw incident in March 2018. Our results remain upper quartile for the industry and we are continuing work to reduce this number for 2019/20.

Interaction with our customers is of prime importance. Investing in the latest digital communications channels and in the technology that underpins the smooth running of our business allows us to offer customers online services. Our mobile functional website has received more than six million visitors which has seen more than 60,000 additional customers sign up this year for the "My Account" services and an increase in unique visitors of seven per cent for the "in your area" updates.

Our focus on great service experience continues to support efficient operational performance, as measured through our cost to serve. We have continued to absorb the increased costs arising from a metered customer base (now at 90 per cent). We have also maintained our particularly strong cash collection performance, and have again reduced debt for outstanding charges over 12 months old, by nearly £1 million within the year.

5 Our people
(including health and safety)

The health, safety and wellbeing strategy Thrive 365! continues to progress well. The strategy is focused on eight safety goals and two key themes, safe people and safe working. Actions and projects that form a part of Thrive 365! are being implemented throughout the business. Key activities during the year include:

- a health and safety conference was held on the subject of leadership. It was attended by the majority of operational managers and featured a keynote speech by Alan Chambers MBE, polar explorer
- operational teams attended a 'Don't Walk By' workshop intended to provide them with the tools to make a safe intervention when they observe unsafe behaviour
- a recognition and reward scheme has commenced for positive safety interventions
- an improved chemical awareness training course has been developed, approved and scheduled with our chemical supplier

Unfortunately South East Water experienced three accidents reportable under RIDDOR during 2018/19; following slips or trips in what are often perceived as low risk environments such as our offices and car parks. We are taking every opportunity to remind everyone of safe practice.

6 Environment

Excellent progress was made in this, the fourth year, of our Water Industry National Environment Programme (WINEP) with 100 per cent of planned actions delivered.

We now have eel compliant screens at Bray and Crowhurst Bridge (these have been signed off by the Environment Agency as compliant). We have constructed new screens at Shellbrook (Ardingly) and on the Wallers Haven (Hazards Green) ready for regulator sign off.

We now have 10 biodiversity plans in the implementation phase, being monitored and with active conservation work being delivered (for example rare wartbiter crickets are now breeding at our Deep Dean site following careful management of the chalk grassland habitat). Work such as this means that 98.3% of company sites of special scientific interest (SSSIs) are in either favourable or recovering condition compared to a target of 95 per cent by 2020.

Our catchment management partnership continues to have success, with six surface water and eight groundwater projects and investigations underway. The programme had success this year picking up the Water Industry Achievement Award for resilience project. A key pilot project in the year has been at Woodgarston to test catchment measures to reduce nitrate in the groundwater.

Seven out of 10 of our restoring sustainable abstraction schemes have been completed to agreed deadlines. The remaining three have deadlines in 2019/20 and are on track for delivery.

Blueprint for Water (a group of environmental Non Governmental Organisations) highlighted our Business Plan as a standout performer for our environmental ambitions including awarding a Blue Star for our catchment management innovation.

7 Financial performance in the 12 months ended 31 March 2019

The ring fenced SEW Group includes the following companies:

- South East Water (Holdings) Limited ("SEWH")
- South East Water Limited; ("SEWL" or "South East Water") and
- South East Water (Finance) Limited ("SEWF")
- SEWF is a 100 per cent owned subsidiary of SEWL and SEWL is a 100 per cent owned subsidiary of SEWH

The accounts for the SEW Group for the year to 31 March 2019 have been prepared and these results are set out in the appendix. These accounts have been prepared under International Financial Reporting standards ("IFRS"); they are not published, but are prepared for internal use. The consolidated group accounts for SEWL, including SEWF but excluding SEWH, for the same year are published on the company's website.

The entity accounts for SEWL, which are included in the published group accounts, are also prepared under IFRS. The entity accounts for SEWH and SEWF are prepared under FRS 101, taking advantage of the disclosure exemptions available under this standard.

Turnover

Turnover for the year to 31 March 2019 was higher at £238.3 million when compared to £224.8 million for the previous year. The increased revenue is due to increased prices averaging 5 per cent for the year, the impact of new properties in the area on water revenues and infrastructure charges, and the adoption of IFRS 15 on 1 April 2018 which now requires new connections income to the recognized on completion of works rather than over the lives of the assets.

Other income also increased during the year to £13.0 million, from £8.9 million in 2017/18. This is predominantly due to an expansion of our non-regulated business.

Operating costs

Net operating costs for the year to 31 March 2019 were £165.2 million compared to £159.0 million in the prior year. The increase in costs of £6.2 million includes the additional costs for reactive maintenance of £1.6 million in response to the number and severity of incidents in the year, increased depreciation of £1.6 million reflecting the company's continuing investment in infrastructure assets and the change in policy as a result of IFRS 15 which requires the surplus on new connections being recognised as income rather than offset against contractor costs as it has in the past.

Interest

Interest payable for the group for the year to 31 March 2019 was £61.6 million compared to £61.2 million in the prior year. Significant variances were recorded on specific indexed linked bonds in the year due to the timing of movements in RPI, however these movements largely offset over the course year.

Interest payable includes the following:

- £22.8 million interest on listed debt/bonds (2018: £22.3 million)
- £4.7 million fair value movement on interest rate swap (2018: £3.3 million)
- £4.6 indexation on index linked listed bonds (2018: £5.7 million)
- £12.2 million interest on Index linked loans (including Artesian Finance loans) (2018: £11.8 million)
- £11.5 million Indexation on Index linked loans (including Artesian Finance loans) (2018: £12.6 million)
- £5.6 million interest payable by SEWH to group companies (2018: £5.2 million)
- £2.7 million relating to other interest payable (2018: £2.4 million)
- £(2.5) million capitalised interest (2018: £(2.1) million)

Taxation

The income statement shows a tax charge of £4.9 million (2018: credit of £5.7 million). The current tax charge includes the utilisation of and payment for other group losses, which was lower in the year due to losses being utilised elsewhere in the group. Deferred tax increased in the year due to the use of increased capital allowances.

Cash

The SEW Group has cash and cash equivalent balances of £12.8 million as at 31 March 2019 compared with £6.6 million as at 31 March 2018. During the period £35.0 million has been drawn down from the authorised credit facilities to fund the continuing capital programme.

The restricted cash balance as at 31 March 2019 was £0.2 million compared to £0.3 million as at 31 March 2018. Cash held in these designated bank accounts are to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans.

Debt funding

In addition to the £35 million drawn down on the authorised credit facility, new facilities totalling £295 million have been agreed during the year. These comprise of a variable rate loan of £120 million and fixed rate US private placements of £175 million, both to be drawn down in September to meet the repayment of the £200 million listed bond and associated swap instrument.

8 Regulatory update

Regulatory reporting

The 2018/19 Annual Report and Financial Statements which includes the Statutory Accounts, the Regulatory Accounts, the Ofwat prescribed Performance Report and the Risk and Compliance Statement has been published on our website.

In addition, we have also published on our website our performance, people and planet report for 2018/19 which gives further information about our performance against our agreed outcomes.

In 2018/19, our leakage team have detected a record number of leaks (1300 higher than 2016/17). 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 – 86.9 Ml/d against a target of 89.1 Ml/d.

In 2018/19 we have achieved discolouration contacts rate of 0.59 (per 1,000) compared to 0.82 last year. We are disappointed that we have not met our in year target of 0.58, but pleased that we have reduced our discolouration contacts by a further 28 per cent this year.

During the past four years we have undertaken a number of activities to reduce our discolouration contacts, some of which, such as treatment works improvements, take time to realise the full benefits. Our performance in 2018/19 shows a reduction of 50 per cent since 2014/15 as a result of this work, which has included optimising treatment works performance and removing historic mineral deposits from our pipe network. We fully expect this ongoing programme of work, as part of our discolouration action plan, to continue to deliver benefits and reduce our contacts to the target level in 2019/20.

In 2018/19 we have had one category two pollution incident as reported by the Environment Agency. We continue to monitor and report incidents to ensure that we are performing to a high level and that our processes are working successfully. We have an ongoing dialogue with the Environment Agency and site visits to ensure that we are continually improving our overall performance.

Outcome	FD Target	Performance	Reward / penalty if applicable	£m (if applicable)
Customer Satisfaction				
A1. Appearance	4.6	4.5	No penalty	
B1. Taste	4.3	4.2	No penalty	
C1. Leakage	4.0	3.6	Penalty	-0.111
D1. Interaction	4.5	4.3	Penalty	-0.008
F1. Pressure	4.5	4.3	Penalty	-0.027
G1. Interruptions	4.7	4.6	No penalty	
H1. Water restrictions	4.1	4.4	Reward	0.048
C2. Leakage	89.1	86.9	Reward	0.378
D2. SIM Score	N/A	85.4	N/A	N/A
E1. Customers consider bills to be value for money and affordable	N/A	73%	N/A	N/A
F2. Number of properties at risk of low pressure	60	47	Reward	0.004
G2. Average interruption time lost per property	12.0	14.2	Penalty	-0.293
H2. Meeting the Water Resource Deficit	0	0	No penalty	N/A
I1. Mean Zonal Compliance	100	99.98	No penalty	N/A
J1. Number of breaches of abstraction licences, discharge consents and environmental permits	0	11	N/A	N/A
J2. Number of pollution incidents (Category 1-2)	0	1	N/A	N/A
K1. Number of compliance breaches of legislation	0	0	N/A	N/A
L1. Number of breaches of National Security obligations	0	0	N/A	N/A
M1. Number of compliance breaches of other statutory obligations and licence conditions	0	1	N/A	N/A
N1. Discolouration Contacts	0.58	0.59	Penalty	-0.015
N2. Above ground asset performance	Stable	Stable	No penalty	N/A
N3. Number of sites at risk of flooding	N/A	2	N/A	N/A
N4. Water mains bursts	2429	2826	No penalty	N/A
O1. KG of carbon emissions per customer per year	N/A	36.3	N/A	N/A
O2. We will monitor our abstractions at low flows at environmentally sensitive sites	N/A	-0.1	N/A	N/A

2020 to 2025 price review

On 3 September 2018 we published our business plan for the five year period commencing April 2020 (**corporate.southeastwater.co.uk/about-us/our-plans/our-business-plan-2020-2025/**) as did all of the other water and wastewater companies in England and Wales, following which, Ofwat published its Initial Assessment of Plan (IAP) for each company in January 2019.

We were very pleased that Ofwat recognised the ambition in our plan and how we had challenged ourselves to deliver significant improvements over current performance levels at efficient cost. In particular, Ofwat commended us for showing ambition and innovation in the areas of improving customer service, support for vulnerable customers and the environment.

We were one of only three companies to meet Ofwat's stretching requirements with a high quality package of outcome delivery incentives (ODI's) based on customer views.

However, Ofwat's overall assessment was that in certain areas our plan required further evidence and/or justification for some of the decisions made. We have responded comprehensively to all of the issues and actions raised by Ofwat and published our full response to the IAP on our website on 1 April **corporate.southeastwater.co.uk/news-info/publications/ofwat-iap-response-submission/**

The plan, if agreed, will see the investment of a further £472 million to improve water infrastructure over the five year period. We consider this to be the most ambitious five year plan we have ever proposed which includes a 36-strong suite of performance commitments and innovative incentives that challenge us to deliver performance levels well beyond anything we have achieved before.

Tariffs

In line with guidance issued by Ofwat, we published charges for 2019/20 which can be found using the following link:

corporate.southeastwater.co.uk/news-info/publications/our-charges

Instrument of appointment

Condition E1

Following engagement with companies in February and June 2018 and a formal consultation under section 13 of the Water Industry Act 1991 in July 2018, Ofwat modified the instruments of appointment of all water companies on 2 November 2018 introducing a new condition E1 relating to the prohibition of undue discrimination and undue preference and restriction on the use of information provided by third parties in relation to certain services. This new condition took effect on 1 April 2019. It prohibits undue preference or undue discrimination being shown to inset appointees (water undertakers that may be appointed instead of an incumbent water company usually for supplies to a new development site), self-lay providers and entities that may submit bids for the provisions of water resources, demand management or leakage services as introduced by condition M1 in April 2017. It also imposes obligations to maintain the confidentiality and to control the use and dissemination of the information provided by these third parties to water companies.

Licence simplification

Following engagement with water companies in 2017 and 2018 and following a formal consultation under section 13 of the Water Industry Act 1991 in September 2018, Ofwat amended the instruments of appointment of all water companies on 17 December 2018. Such modification took effect on 1 January 2019 for the majority of provisions and on 1 March 2019 for the remaining provisions. The licence amendments were developed in collaboration with the water industry as part of a licence simplification project. The provisions that were amended as part of this project were conditions A (Interpretation and construction), C (Infrastructure charges), D (New connection), E (Undue preference/ discrimination in charges), F (Regulatory accounting statements), G (Core customer information), H (Procedure on leakage), I (Ring-fencing), J (Levels of service information and targets), M (Provision of information to Ofwat), N (Fees), O (Termination and replacement of appointments) and Q (Interruption in supply because of drought).

Ring-fencing obligations

In May 2018 Ofwat issued a first consultation on possible modifications related to change of control and the introduction of an obligation to comply with a direction from Ofwat to enforce a condition P undertaking. The consultation also discussed proposals to introduce an obligation to comply with Ofwat's principles of board leadership, transparency and governance and to strengthen the existing obligation to maintain an investment grade credit rating.

In November 2018 Ofwat issued a consultation on proposals for strengthening the regulatory ring-fencing framework. The proposal sought to standardise the provisions in companies' licences. The consultation related to five main topics (i) maintaining investment grade credit ratings and cash lock-up, (ii) providing ring-fencing certificates, (iii) reporting of material issues to Ofwat, (iv) notification and provision of information relating to change of control and (v) and an obligation to comply with a direction from Ofwat to enforce an undertaking provided by an ultimate controller pursuant to condition P. Some of these proposals had already been included in the instruments of appointments of certain companies. We responded to these consultations making a number of observations and Ofwat is currently considering the responses provided by companies.

Licence modification process

In January 2019, Defra issued a consultation on improving the management of water in the environment which also included a proposal to revise the process set out in the Water Industry Act 1991 for amending water companies' instruments of appointment. The consultation proposed to give new powers to Ofwat to amend companies' licences without their consent. To challenge licence modifications, companies would have to appeal on limited grounds to the CMA who would decide whether or not the modifications should be finally applied. We responded to the proposal on 12 March 2019, questioning the need for and the appropriateness of the proposal considering in particular that a number of licence changes had been successfully made by Ofwat and that the current provisions had not in practice operated as a barrier for amending licences when required and provided an appropriate equilibrium between the regulator and water companies. At the time of writing Defra was considering the responses to its consultation.

Condition to meet the objectives of the BLTG principles

Following previous consultations in 2018 and engagement with companies, Ofwat issued a formal consultation under section 13 of the Water Industry Act 1991 in May 2019 proposing to introduce a new condition in the instrument of appointment of 17 water companies (and Tideway) to meet the objectives of Ofwat's board leadership, transparency and governance principles. These principles were last updated in January 2019 and include high level objectives which companies will have an obligation to meet, and provisions which companies are expected to meet but may in certain cases explain how they have met the objectives through other means. The proposal also included the removal of existing overlapping provisions. On 14 June 2019, we confirmed our consent to the proposed modification of our instrument of appointment.

Revenue incentive mechanism

Ofwat carried out pre-consultation engagement with companies between March and June 2019 on the proposed amendment of condition B of their instruments of appointments in relation to the revenue incentive mechanism and to determine a baseline for the network plus revenue as this price control is introduced for the first time at PR19. The changes are intended to add clarification to the existing provisions in the context of the changes implemented for PR19, in particular that the price control limit does not prevent companies from levying charges to recover a relevant shortfall under the new revenue forecast incentive mechanism.

9 Capital expenditure

South East Water Final Determination (FD) capital expenditure for 2015 to 2020 is £488.1m (2017-18 price base). Net capital investment for 2018/19, the fourth year of the AMP6 five year programme, is £80.1m. Cumulative spend in this regulatory period is £227.0m.

2018/19 expenditure:

- £34.7m (43 per cent) of investment has been made in the development of new assets and the enhancement of existing assets, including £30.3m for the management of the supply demand balance and £4.4m to meet the company's legal undertakings with respect to drinking water quality standards
- £13.4m (17 per cent) of investment has been made in the maintenance of our below ground assets. This investment is essential to maintain the performance of the mains network and maintain a stable level of service, thus preventing a rise in disruption to customers with the associated water quality and leakage issues. Investment in the period has been predominantly in the following key areas:
  - mains renewal programme
  - reactive mains burst repairs
  - reactive communication pipe and stop tap repairs and replacement
- £32.0m (40 per cent) of investment has been made in the maintenance of our above ground assets. Again, this investment is essential in maintaining a stable level of service to our customers and has been targeted in the following key areas:
  - resource facilities
  - treatment works maintenance
  - service reservoirs and water towers
  - pumping stations
  - management and general spend such as IT infrastructure

10 Water quality

Ensuring we continue to improve the quality of the water we supply is a key priority. Each year the Chief Inspector of the Drinking Water Inspectorate (DWI) publishes a report summarising drinking water quality in England and Wales which includes a number of comparative compliance indices.

Our overall drinking water quality performance, as measured using the DWI's key performance indicator at the customer's tap "mean zonal compliance" is in line with our performance commitment at 99.98 per cent. A further indication of the high performance standards of our water treatment works is provided by the treatment process control index which was again maintained at 100.00 per cent and the disinfection index which dropped slightly to 99.96 per cent, but remains in line with industry average performance. Performance against other water quality indices has improved on the previous high level demonstrated throughout 2018, with the Reservoir Integrity Index reaching 99.97 per cent and the distribution maintenance index reaching a company record high of 99.90 per cent. These results are based on 208,093 tests measured against EU and UK mandatory standards.

In addition to these regulatory tests the company carried out over 400,000 operational tests to ensure that our assets consistently performed to deliver excellent quality water to our customers.

11 Outsourcing

South East Water continues to deliver a competitive tendering/outsourcing programme using a number of standard tools including:

- call for competition (OJEU)
- request for Information (RFI) and pre-qualification of potential vendors
- use of Achilles Utility Vendor Database (industry specific supplier database & qualification system)
- invitation to tender
- contract negotiation

All procurement activities are compliant with relevant laws and undertakings including EU Utilities Contracts Regulations and the Outsourcing Policy of the Common Terms Agreement.

Contracts awarded, extended and/or signed (during last 12 months) include:

Supplier	Description	Contract value £
Saint Gobain PAM	Supply of Ductile Iron Pipe & Fittings	10,000,000
GPS PE Pipe Systems	Supply of PE Pipe & Fittings	6,800,000
Solo	Office Cleaning Services - Eastern Region	1,600,000
Plasson	Plastic Service Fittings	1,520,000
RPM Installations	Kingfisher building HVAC replacement	745,000
GSF	Office Cleaning Services - Western Region	600,000
Sensus/Xylem	Smart Water Networks - 12 month trial	450,000
Managed Print Services	Toshiba	34,000

Tenders in hand	Estimated contract value £
Network Maintenance and Strategic Mains	360,000,000
Consultancy Services Framework	56,000,000
Fuel Cards	6,000,000
Fire Systems, CCTV, Alarms, Door Access, ID Cards, Response Services (Security)	4,000,000
Chamber Sections	2,112,000
Building Maintenance	2,000,000
Network Valve Contracts	1,500,000
Clothing, PPE & Consumables	1,440,000
Gunmetal Service Fittings	1,416,000
Trace & collect (debt)	800,000
GAC Reactivation Services	464,000
Office and doorstep debt collections	400,000
Boundary Boxes	350,000
Semi-Rugged Laptop replacement	250,000
Fire Extinguishers	200,000

South East Water operates a sustainable procurement policy whereby suppliers of goods and services are rated for whole life cost, environmental impact and sustainability as part of the contract award decision criteria.

12 Financing

The Group has strong liquidity with £12.8 million on the balance sheet at the year end and a further £35 million available to draw down on the authorised credit facility.

Authorised credit facility

The £90 million Authorised Credit Facility was extended to 18 June 2022. Currently, £55 million has been drawn on this facility.

Liquidity Facilities

The DSR and O&M facilities were renewed in June 2019 with Commonwealth Bank of Australia and Credit Agricole Corporate and Investment Bank each taking a 50 per cent share of each facility. The renewal is for the period to June 2020. The DSR liquidity facility has a commitment of £38 million and the O&M facility has a commitment of £19 million.

Refinancing process

On 30 September 2019 the £200.0 million fixed rate bond and associated inflation linked swap will mature. We have secured the finance to fund the maturing debt. We have entered into a 7 year £120 million floating rate loan which will be drawn prior to 30 September. We have raised £175 million on the US Private Placement market in two tranches; a £75m tranche maturing in 2031 and a £100m tranche maturing in 2042. Finally our shareholders have committed to investing £54m into South East Water Ltd and have secured the funds to make this investment. The proceeds will be used to refinance the debt maturing on 30 September and to reduce our net debt.

13 Credit ratings

The credit rating of South East Water is covered by Moody's Investor Service ("Moody's") and Standard and Poor's ("S&P"). Moody's and S&P issued credit opinions in November and October 2018, respectively. There was no change in South East Water's rating from either rating agency.

	Moody's	S&P
Credit rating	Baa2	BBB

14 Surplus

The SEWH Board approved £18.5 million of dividends to Hastings Water (UK) Limited in the financial year.

15 Board/Management changes

The South East Water Board of directors is as follows:

South East Water Limited

N Salmon
Independent Non-Executive Chairman

P Butler
Managing Director*

A Farmer
Finance Director*

D Hinton
Asset and Regulation Director*

J Barnes
Independent Non-executive Director

C Pronto
Independent Non-executive Director
(appointed 1 June 2018)

C Girling
Independent Non-executive Director

S Jordan
Non-executive Director
(appointed 17 August 2018)***

M Szczepaniak
Non-executive Director
(resigned 17 August 2018,
appointed 30 January 2019)**

O Schubert
Non-executive Director
(resigned 30 January 2019)**

E Gilthorpe
Independent Non-executive Director
(resigned 30 September 2018)

The Company Secretary is **Nicolas Truillet**

South East Water (Holdings) Limited

S Jordan
Non-executive Director
(appointed 3 August 2018)***

M Szczepaniak
Non-executive Director
(resigned 3 August 2018,
appointed 4 March 2019)**

O Schubert
Non-executive Director
(resigned 4 March 2019)**

South East Water (Finance) Limited

P Butler
Executive Director

A Farmer
Executive Director

M Szczepaniak
Non-executive Director
(resigned 3 August 2018,
appointed 5 March 2019)**

S Jordan
Non-executive Director
(appointed 3 August 2018)***

O Schubert
Non-executive Director
(resigned 5 March 2019)**

* Denotes an Executive Director

** Denotes a Vantage appointee

*** Denotes a Morrison appointee

Ratios

1 Historic

We confirm that in respect of the Calculation Date on 31 March 2019, by reference to the most recent financial statements that we are obliged to deliver to you in accordance with Paragraph 1 (Financial Statements) of Part 1 (Information Covenants) of Schedule 4 (Covenants) of the Common Terms Agreement that the ratios are as detailed in the table below in respect of the Calculation date on 31 March 2019.

Date	31-Mar-16	31-Mar-17	31-Mar-18	Calculation Date	31-Mar-20
RAR (at such Calculation Date or, in the case of forward-looking ratios, as at 31 March falling in the relevant Test Period)	80.8%	78.3%	77.7%	78.5%	74.0%
Test Period	1-Apr-15 to 31-Mar-16	1-Apr-16 to 31-Mar-17	1-Apr-17 to 31-Mar-18	1-Apr-18 to 31-Mar-19	1-Apr-19 to 31-Mar-20
ICR	3.56 x	3.76 x	3.62 x	3.50 x	3.12 x
Adjusted ICR	3.56 x	3.76 x	3.62 x	3.50 x	3.12 x
Average Adjusted ICR	3.65 x	3.62 x	3.40 x	3.40 x	3.40 x
Conformed Adjusted ICR	1.90 x	2.09 x	1.90 x	1.61 x	1.44 x
Conformed Average Adjusted ICR	1.96 x	1.86 x	1.64 x	1.64 x	1.64 x

2 We confirm that each of the above Ratios has been calculated in respect of each of the relevant period(s) for which it is required under the Common Terms Agreement and has not breached the Trigger Event Ratio Levels and has not caused Paragraph 17 (Ratios) of part 2 (Event of Default (SEW)) of Schedule 6 of the Common Terms Agreement to be breached.

3 We set out below the computation of the following ratios set out in the table in Paragraph 1 above for your information:

a) RAR

Date	31-Mar-16 £m	31-Mar-17 £m	31-Mar-18 £m	Calculation Date £m	31-Mar-20 £m
Senior Debt (Closing Balances)					
Finance Leases	0.0	0.0	0.0	0.0	0.0
Debentures	1.0	1.0	1.0	1.0	1.0
Nominal Debt	166.0	166.0	166.0	166.0	166.0
Synthetic Index Linked Bonds	282.9	287.5	296.3	306.7	0.0
Index Linked Bonds	156.1	160.4	166.0	170.6	175.5
Fixed Rate Bonds	0.0	0.0	0.0	0.0	175.0
Variable rate bonds	0.0	0.0	0.0	0.0	120.0
Index Linked Bonds	0.0	0.0	0.0	0.0	0.0
Index Linked Loans (USS)	107.2	109.9	113.5	116.6	120.0
Index Linked Loans	246.3	250.9	259.9	268.3	275.5
Capex Drawdown Facility	0.0	0.0	20.0	55.0	25.0
Total Senior Debt Closing Balance	959.5	975.7	1022.8	1084.3	1060.2
Less: Cash Balance	(17.0)	(11.4)	(6.5)	(12.8)	(7.2)
Senior Net Indebtedness	942.5	964.3	1016.2	1071.4	1050.8
Regulatory Capital Value	1166.6	1231.1	1307.5	1365.0	1420.1
RAR	80.8%	78.3%	77.7%	78.5%	74.0%

b) ICR

Date	1-Apr-15 to 31-Mar-16 £m	1-Apr-16 to 31-Mar-17 £m	1-Apr-17 to 31-Mar-18 £m	1-Apr-18 to 31-Mar-19 £m	1-Apr-19 to 31-Mar-20 £m
Net Cash Flow					
Net cash flow from operating activities	120.2	127.5	123.1	125.0	130.9
Exceptional items	0.0	0.0	0.0	0.0	0.0
Recoverable VAT	2.2	2.7	4.1	2.8	1.0
Corporation tax paid	0.0	0.0	0.0	0.0	0.0
Pension funding					
Non-appointed	0.0	0.0	0.0	0.0	(5.3)
Net Cash Flow	122.4	130.2	127.2	127.8	126.7
Senior Debt Interest					
Finance Leases	0.0	0.1	0.0	0.0	0.0
Debentures	0.0	0.0	0.0	0.0	0.0
Nominal Debt	9.3	9.3	9.3	9.3	13.4
Synthetic Index Linked Bonds	8.6	8.7	8.8	9.3	9.4
Index Linked Bonds	3.9	4.0	4.1	4.3	4.4
Index Linked Loans (USS)	2.6	2.6	2.7	2.8	2.9
Index Linked Loans	8.6	8.8	9.0	9.4	9.6
Drawdown Facilities	0.8	0.5	0.5	0.9	0.6
Ambac fee	0.7	0.8	0.8	0.7	0.3
Senior Debt Interest Payable	34.6	34.7	35.2	36.7	40.6
Interest Receivable	(0.2)	(0.1)	(0.0)	(0.1)	(0.0)
Senior Debt Interest	34.4	34.6	35.2	36.6	40.6
ICR	3.56 x	3.76 x	3.62 x	3.50 x	3.12 x

c) Adjusted ICR

Date	1-Apr-15 to 31-Mar-16 £m	1-Apr-16 to 31-Mar-17 £m	1-Apr-17 to 31-Mar-18 £m	1-Apr-18 to 31-Mar-19 £m	1-Apr-19 to 31-Mar-20 £m
Net Cash Flow	122.4	130.2	127.2	127.9	126.7
CCD & IRC					
CCD	0.0	0.0	0.0	0.0	0.0
IRC	0.0	0.0	0.0	0.0	0.0
Total regulatory depreciation	0.0	0.0	0.0	0.0	0.0
Net Cash Flow after regulatory depreciation	122.4	130.2	127.2	127.9	126.7
Senior Debt Interest	34.4	34.6	35.2	36.6	40.6
Adjusted ICR	3.56 x	3.76 x	3.62 x	3.50 x	3.40 x

d) Average adjusted ICR

Date	1-Apr-15 to 31-Mar-16 £m	1-Apr-16 to 31-Mar-17 £m	1-Apr-17 to 31-Mar-18 £m	1-Apr-18 to 31-Mar-19 £m	1-Apr-19 to 31-Mar-20 £m
Net Cash Flow	122.4	130.2	127.2	127.9	126.7
CCD & IRC					
CCD	0.0	0.0	0.0	0.0	0.0
IRC	0.0	0.0	0.0	0.0	0.0
Total regulatory depreciation	0.0	0.0	0.0	0.0	0.0
Net Cash Flow after regulatory depreciation	122.4	130.2	127.2	127.9	126.7
Senior Debt Interest	34.4	34.6	35.2	36.6	40.6
Adjusted ICR	3.56 x	3.76 x	3.62 x	3.50 x	3.12 x
Average Adjusted ICR	3.65 x	3.62 x	3.40 x	3.40 x	3.40 x

e) Conformed adjusted ICR

Date	1-Apr-15 to 31-Mar-16 £m	1-Apr-16 to 31-Mar-17 £m	1-Apr-17 to 31-Mar-18 £m	1-Apr-18 to 31-Mar-19 £m	1-Apr-19 to 31-Mar-20 £m
Net Cash Flow	122.4	130.2	127.2	127.9	126.7
RCV Depreciation Capitalised IRE	38.3 18.9	43.1 14.7	46.8 13.4	49.1 19.9	50.2 17.9
Total regulatory depreciation	57.2	57.8	60.2	69.0	68.1
Net Cash Flow after regulatory depreciation	65.2	72.4	67.0	58.8	58.6
Senior Debt Interest	34.4	34.6	35.2	36.6	40.6
Conformed Adjusted ICR	1.90 x	2.09 x	1.90 x	1.61 x	1.44 x

f) Conformed average adjusted ICR

Date	1-Apr-15 to 31-Mar-16 £m	1-Apr-16 to 31-Mar-17 £m	1-Apr-17 to 31-Mar-18 £m	1-Apr-18 to 31-Mar-19 £m	1-Apr-19 to 31-Mar-20 £m
Net Cash Flow	122.4	130.2	127.2	127.9	126.7
CCD & IRC CCD IRC	 38.3 18.9	 43.1 14.7	 46.8 13.4	 49.1 19.9	 50.2 17.9
Total regulatory depreciation	57.2	57.8	60.2	69.0	68.1
Net Cash Flow after regulatory depreciation	65.2	72.4	67.0	58.8	58.6
Senior Debt Interest	34.4	34.6	35.2	36.6	40.6
Conformed Adjusted ICR	1.90 x	2.09 x	1.90 x	1.61 x	1.44 x
Conformed Average Adjusted ICR	1.96 x	1.86 x	1.64 x	1.64 x	1.64 x

4 We certify that for the period to 31 March 2019 the Annual Finance Charge is £36.6m.

5 Annual Finance Charge calculation:

	to 31 March 2019 £m
Senior Debt Interest	
Finance Leases	0.0
Debentures	0.0
Nominal Debt (£166m)	9.3
Synthetic Index Linked Bonds (£200m)	9.2
Index Linked Bonds (£130m)	4.3
Index linked loans (USS)	2.8
Index Linked Loans	9.4
Working Capital Facility	0.3
Capex Drawdown Facility	0.0
Ambac fee	0.8
Commitment fee	0.6
	36.7
Less: interest earned	(0.1)
12 Months Total	36.6

Total payments into the DSR Accounts for the period to 31 March 2019 were £36.2 million.

6 We also confirm that:

(a) no Default of Potential Trigger Event is outstanding

(b) that SEW's insurance's are being maintained in accordance with:

(i) the Common Terms Agreement

(ii) the provisions of the Finance Leases

Yours faithfully,

Director

For and on behalf of

SOUTH EAST WATER LIMITED

Director

For and on behalf of

SOUTH EAST WATER (FINANCE) LIMITED

Director

For and on behalf of

SOUTH EAST WATER (HOLDINGS) LIMITED

Appendix

Financial statements

South East Water (Holdings) Limited

Consolidated profit & loss account for the period ended 31 March 2019

	Companies £000	Eliminations £000	Group £000
Turnover	238,281	-	238,281
Operating costs	(165,218)	-	(165,218)
Profit on disposal of fixed assets	377	-	377
Other operating income	12,997	-	12,997
Operating profit	86,437	-	86,437
Income from investments	28,000	(28,000)	-
Interest receivable - group	5,305	(5,305)	-
Interest receivable - other	136	-	136
Interest payable - group	(10,885)	5,305	(5,580)
Interest payable - other	(56,008)	-	(56,008)
Return on pension scheme assets	636	-	636
Profit on sale of intangible assets	9,253	-	9,253
Profit on ordinary activities before taxation	62,874	(28,000)	34,874
Tax (charge)/credit on profit on ordinary activities	(4,924)	-	(4,924)
Profit on ordinary activities after taxation	57,950	(28,000)	29,950
Dividends	(46,450)	28,000	(18,450)
	11,500	-	11,500
STRGL - pension	(2,925)	-	(2,925)
Profit/(loss) for period taken to p&l reserves	8,575	-	8,575

South East Water (Holdings) Limited
Consolidated balance sheet at 31 March 2019

	Companies £000	Eliminations £000	Group £000
Tangible assets	1,565,624	-	1,565,624
Investments	361,421	(361,421)	-
Net Current (liabilities)/assets	(12,717)	-	(12,717)
Creditors: amounts falling due after more than one year			
Current asset investments	(153,959)		(153,959)
Cash and cash equivalents:	-	-	-
Current accounts			
DSR	12,650	-	12,650
O&M	197	-	197
First loss account	-	-	-
Financing liabilities	-	-	-
Intra group loan creditors			
Intra group loan debtors	(952,095)	952,095	-
Other HDF group loans	952,095	(952,095)	-
Debentures	(82,152)	-	(82,152)
Bonds	(991)	-	(991)
Indexation	(496,000)	-	(496,000)
Artesian loans	(149,444)	-	(149,444)
Indexation	(269,000)	-	(269,000)
Unamortised costs	(115,955)	-	(115,955)
Bank loans	7,751	-	7,751
Net pension liability	(55,000)	-	(55,000)
	22,410	-	22,410
Net assets	**634,835**	**(361,421)**	**273,414**
Capital and reserves			
Called up share capital	140,720	(49,312)	91,408
Revaluation reserve	251,259	-	251,259
Profit and loss account b/fwd.	229,144	(312,109)	(82,965)
Profit for period	13,712	-	13,712
Capital employed	**634,835**	**(361,421)**	**273,414**

South East Water (Holdings) Limited
Consolidated movement in the profit and loss reserve for the period ended 31 March 2019

	Companies £000	Eliminations £000	Group £000
At 1 April 2018	229,144	(312,109)	(82,965)
Profit for the year	57,950	(28,000)	29,950
Pension scheme in STRGL	(2,925)	-	(2,925)
Dividends	(46,450)	28,000	(18,450)
Movement through reserves	5,137	-	5,137
	13,712	-	13,712
At 31 March 2019	242,856	(312,109)	(69,253)