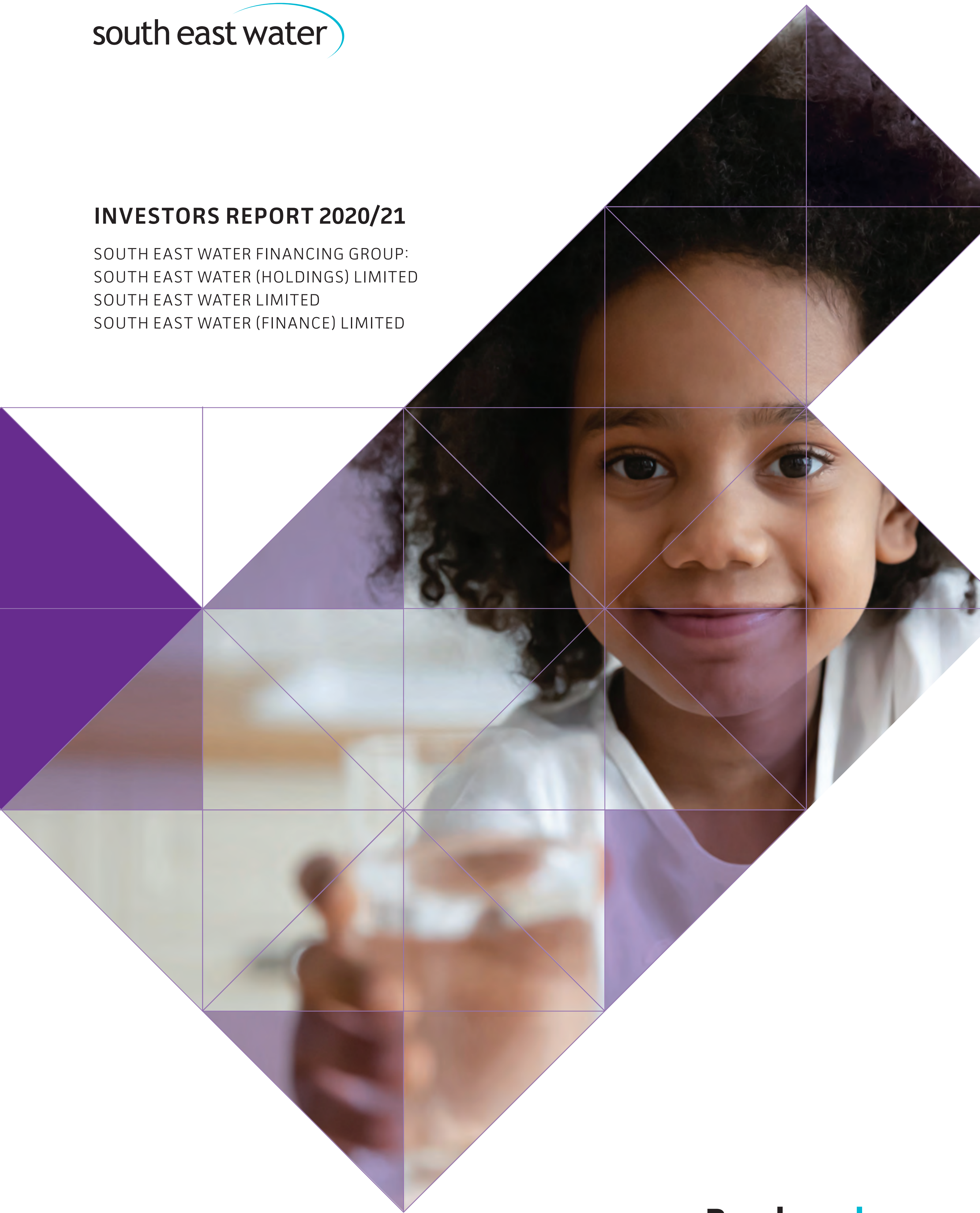
south east water

INVESTORS REPORT 2020/21

SOUTH EAST WATER FINANCING GROUP:
SOUTH EAST WATER (HOLDINGS) LIMITED
SOUTH EAST WATER LIMITED
SOUTH EAST WATER (FINANCE) LIMITED



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Investors Report 2020/21

CONTENTS

GENERAL OVERVIEW AND BUSINESS UPDATE

This Investors Report covers the 12 month period ending 31 March 2021. It also includes a summary of any subsequent material events in the period prior to the publication of this report.

1.0 ENVIRONMENTAL, SOCIAL AND GOVERNANCE FRAMEWORK

The global pandemic has highlighted the disruption and uncertainty we can face as a business. This has given us a glimpse into a future that we must be prepared for. Climate change and changing weather patterns will have an impact on the ability of our existing infrastructure to meet the demands for water sustainably. We intend to build a business that is well positioned to meet these future challenges, but this will require support from Government, our regulators and society as a whole.

A key step in meeting these challenges is to put them at the front of our mind in everything we do. The sense of duty seen across the organisation last year is the embodiment of our company purpose, enshrined in November 2020, in our Articles of Association.

This is just one of many steps taken to continue to focus on growing our responsible business approach. We were delighted to see this work recognised with sector leader status in the GRESB ESG infrastructure asset benchmarking for 2020.

Climate change remains our highest risk and we are preparing our next climate change adaptation report to be published this year. As a business we have committed to achieve net zero for operational emissions by 2030, which is an important part of our environmental leadership – but we believe we must go further. We have started to work with our stakeholders to develop an ambitious 25 year environment plan. We believe this approach to be an industry first. The plan will ensure we support both Government and global ambitions through the UN Sustainable Development Goals.

Being a public drinking water provider we reach into the heart of the communities we serve every day. Most of us live and work in our supply area and so are dedicated to supporting those who need it most, supporting communities while also providing the high standards of service. Recognising that our role in society is far wider than simply supplying water to customers we're continuing to actively involve ourselves in the communities we serve.

We are helping to reduce the use of single use plastics through support of the Refill campaign, such as installing new drinking water fountains in Seaford this year. We have supported local communities through the pandemic by working with foodbanks both by donating and delivering food parcels to residents. To help keep children occupied, our teams also put hundreds of activity packs together for community use.

Some of our customers are experiencing both emotional and financial hardship due to the pandemic and we have been supporting them through our priority services register and providing payment support options, which we will continue to prioritise.

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

2.0 OPERATIONAL PERFORMANCE

Our community entrusts us to deliver a continuous supply of safe, wholesome drinking water directly to their homes. To ensure we retain that trust we are constantly monitoring our performance against expectations through a wide range of measures, from the taste and smell of the water to how often the supply is interrupted.

We are delighted to have once again beaten our leakage target (a 1.9 per cent improvement on our 2019/20 leakage levels). This is the first year of a journey where we have challenged ourselves to improve year on year, a 15 per cent target reduction over the five year period. The leakage team is expanding and embracing advances by using satellite technology to hunt for leaks and building on our award winning smart networks trial by installing more meters, sensors and loggers to monitor our pipeline network. This work is at the cutting edge of leakage initiatives and will cement our position as one of the top performers in the industry.

This year only 0.4 properties per 10,000 were at risk of low pressure (beating our target of 0.5) and we have improved the taste, odour and appearance of drinking water through installing new water treatment processes, flushing pipes to remove sediment and adjusting the way we operate our networks. The number of customer contacts per 10,000 population for discolouration was 1.00 (beating our target of 1.09) and for taste and odour we achieved 0.34 (beating our target of 0.42).

Despite our ongoing programme to upgrade our infrastructure, burst pipes, site outage or other external factors do unfortunately happen and can result in customers going without water for short periods. We were able to keep our overall unplanned outage levels low (3.09 per cent against a target of 4.23), however a heatwave in August 2020, coupled with more people being at home due to the Covid-19 restrictions led to a perfect storm which created a stress on our network never seen before.

Only a small area of our supply region was affected, but those who were affected went without water for too long. We have learnt lessons from this, not least how the pandemic has altered how water is used.

One of the lessons is we need to do more to help customers reduce water use during dry periods so that we keep demand to a sustainable level both in terms of our ability to supply but also to minimise impacts on the environment.

The August heatwave and other related events led to us missing our interruptions to supply target as our average interruption time was 31.27 minutes per property.

The increased demand also had a big impact on our water use targets. With people working from home, not commuting out of our supply area or travelling on holidays, consumption has increased 16 per cent to 166 litres per person per day. This is an area we're monitoring closely as travel and commuting restrictions ease – but we know lifestyles for many have changed. We want to work with all of our customers to reduce water usage and help manage the wider impact on the environment. We have been working on enhancements to our online customer account so we can provide them with even more information about their water use and comparisons to similar properties in their area to help people make decisions about how they use water and save both water and money.

3.0 WATER RESOURCES

This year we have prepared our draft dry weather plan, our operational plan for managing periods of drought, and we are working with our partners in the Water Resources in the South East (WRSE) to create a regional plan which looks forward to 2100. This will be the basis of our own water resources management plan designed to secure long term future water resources for the community we serve.

During 2020/21 we received an average of 107 per cent of long term average (LTA) rainfall through the 12 months to March 2021. Across the supply area, an average of 139 per cent of LTA rainfall was received during the winter months, which is the important season for the recharge of underground water storage. This means that our water resources are in a good position to supply water for the summer of 2021, which we expect to be a period of sustained high demand from customers spending more time at home.

GENERAL OVERVIEW AND BUSINESS UPDATE continued

4.0 CUSTOMER SERVICE

We are highly focused on customer satisfaction not just with the service we provide but also in how we act as an organisation.

To deliver this we need to understand our customer views and have set out a new range of comprehensive satisfaction measures, adding to those we put in place in 2015, to help us understand how customers feel we are doing, and encouraging us via stretching targets to keep improving.

The industry wide Customer Measure of Experience (C-MeX) surveys enable us to compare ourselves with other water companies. Our C-MeX scores have improved this year, with a final score of 80.70 out of 100 (Ofwat will publish a league table later this year). Last year we relaunched our My Account web portal to make it easier for customers to access water bills and make payments through real time functionality and providing access to wider information on water usage including relevant advice on water efficiency.

We also maintained upper quartile performance in the CCW complaint report. Future plans include more frequent and improved communications, testing plans with customers, together with a complete website refresh due later this year.

Last year has been a challenge for many of our customers, especially for those who needed a little extra help. We have supported those struggling financially by providing assistance to more than 42,000 customers and we have introduced payment holidays, an initiative that's supported more than 3,500 households. We also encouraged more people to join our Priority Services Register (meaning they receive priority treatment in the event of a supply interruption) reaching more than 29,000 households, which is 3.3 per cent of our customer base.

While short of our target of 31,000 we are working to reach almost 50,000 households by the end of next year. We are working with more than 15 partners to help us achieve a collaborative approach to supporting those in our communities that need us most.

5.0 OUR PEOPLE (INCLUDING HEALTH AND SAFETY)

All our achievements of the last 12 months would not have been possible without the dedication and commitment to our purpose, vision and values of the people who work for South East Water – including our employees, partners and the businesses we work with.

Our people are dedicated to providing the best service possible, whether they are out in the field searching for leaks, managing our operational sites, testing water quality, answering customer queries, or supporting the business behind the scenes. We're proud of our culture and the wide ranging support , training and activities available to all our employees.

We have set an ambitious five year people plan to build a culture which inspires excellence, improves business performance, is resilient to future challenges and drives a thriving, diverse and engaged workforce. Our commitments in the people plan have foundations in our values and clear company purpose.

These foundations served us well during last year as we pivoted to ensure the 600 employees who were able to work from home did so within three weeks of the first lockdown. While all our people were considered key workers, we worked hard to make sure those working in the field, our laboratory or who continued to work in offices, felt safe. Employee surveys showed 92 per cent trust that South East Water is treating their health and safety as a high priority. Keeping our staff safe and well minimised Covid-19 absence such that our sickness rate during the year was just 1.75 per cent.

A visit by the HSE to our Head Office in Kent received positive feedback that they were happy with the Covid-19 safe work environment and could make no suggestions for improvement which is a credit to all involved.

The health and safety of those we work with is of the utmost importance. We were therefore disappointed to experience a high reportable injury rate during the last year. This was in part due to two cases of Covid-19 contracted while at work and overall lost time injuries were also high, although below the industry average. Most were the result of slips and trips or manual handling and thankfully the severity of the injuries and the amount of time lost for each was low. Manual handling activities are being reassessed and retrained in the coming year and awareness regarding slips and trips will be promoted as we work hard to reduce this in future.

Understanding how our people felt during challenging times last year was a key part of our mental health strategy designed to support colleagues, remove stigma and create parity between mental and physical health.

During the year we ran six pulse surveys which focused on a range of topics achieving record engagement results with an average 92 per cent of our people feeling engaged over the last 12 months.

A Wellbeing Hub created on our intranet held key information, signposted support and updated colleagues on the latest information on a weekly basis. Our Mental Health First Aiders are now embedded throughout the business and are trained to take calls from colleagues, triage any immediate concerns and signpost people to the most appropriate source of help and support.

While the Covid-19 pandemic has thrown many challenges at us, one thing it proved is that we have the tools available to enable remote working and therefore we should be able to continue working flexibly in the future. We've created an agile working team who are engaging with colleagues to understand how we might achieve this while maintaining the ability for teams to collaborate face-to-face.

It's important we thoroughly explore the long term impacts of any choices we make as these decisions will fundamentally change how the business operates. The potential for us to be working differently in the future allows us to consider how we attract, recruit, and retain a more diverse and socially mobile workforce.

6.0 ENVIRONMENT

Our business is intrinsically linked to the environment. For this reason we do all we can to ensure there is a clean, resilient and sustainable supply available for current and future customers while ensuring there is enough water available to support the needs of the environment too. Over this five year period we are investing £59.4 million in our National Environment Programme to complete 65 schemes that will bring real benefits to our natural habitats.

As significant landowners, we own and manage 33 Sites of Special Scientific Interest, a National Nature Reserve, two local nature reserves and numerous Areas of Outstanding Natural Beauty. Over the next five years we are working to ensure that almost 70 per cent of our estate is proactively managed to enhance biodiversity. This year we have been able to manage 1,172 hectares to benefit wildlife, exceeding our target for the year of 1,166.

We also work closely with landowners to test and promote sustainable land management practices ultimately improving the rivers, wells and reservoirs we rely on. Our work in partnership with Natural England has ensured that we are able to deliver bespoke advice to support land managers enabling them to protect and enhance the environment across 2,858 hectares, exceeding our target of 2,843. This has included a number of innovative pilot projects reducing the use of pesticides and nutrients, and the volume of soil which washes into watercourses.

As part of a Defra Environment Land Management (ELMS) trial on the Pevensey Levels we have worked in conjunction with the Cuckmere and Pevensey Catchment Partnership. Our work here focused on how farmers and land managers could be paid in the future for changing practices which help deliver wider environmental benefit, for example locking carbon into soils. In addition to this work, we achieved our target to sign off with our regulators nine Water Industry National Environment Programme projects also aimed at improving the wider water environment.

GENERAL OVERVIEW AND BUSINESS UPDATE continued

We are also conscious that we have a part to play in working with others who abstract from the same water environment as us to ensure a joined up approach to environmental resilience. During the year we have been building a team to work with other water abstractors and develop a set of tools to enable them to reduce their water abstraction needs during low flow events. Our aim is to be working with 20 different abstractors by 2025. This work has the potential to create much needed drought resilience in a number of our surface water catchments, and we are one of the first companies to promote this innovative practice.

A key strand of our environmental ambition is to achieve net zero carbon by 2030. A company roadmap has been created which aligns us to the water industry's ambition to be net zero carbon by 2030. During the year our greenhouse gas emissions were above our target (192kgCO_2e/Ml against a target of 152.3kgCO_2e/Ml due to this being a preparatory year.

During the coming year we will focus on finalising a 25 year environment plan, potentially the first of its kind in the industry; this plan will link all our environmental ambitions together, we will use customers, stakeholders and staff to challenge that ambition and we aim to use it to guide our performance over the longer term. This kind of long term clear thinking is essential if we are to overcome the environmental challenges that lie ahead.

7.0 FINANCIAL PERFORMANCE IN THE 12 MONTHS ENDED 31 MARCH 2021

The ring fenced SEW Group includes the following companies:

- South East Water (Holdings) Limited ("SEWH")
- South East Water Limited ("SEWL")
- South East Water (Finance) Limited ("SEWF")

South East Water (Finance) Limited is a 100 per cent subsidiary of South East Water Limited and South East Water Limited is a 100 per cent subsidiary of South East Water (Holdings) Limited.

The accounts for the SEW Group for the year to 31 March 2021 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.

REVENUE

Turnover for the year to 31 March 2021 was higher at £248.2 million when compared to £243.5 million for the previous year. The increased revenue is due to higher prices, averaging 1.8 per cent for the year (£4.4 million), and a 4 per cent increase in consumption due to the Covid-19 pandemic and the hot summer in 2020 (£8.4 million). This was offset by additional social tariff allowances given to customers (£2.7 million) as more households faced economic hardship due to the Covid-19 and lower developer activity during the lockdown periods (£5.4 million).

Other income was slightly lower in the year at £11.4 million compared to £12.2 million in the prior year. This reduction is largely due to a change in contract terms (£0.6 million) and lower laboratory income as a result of the Covid-19 restrictions (£0.2 million).

OPERATING COSTS

Our operating costs for the year, including charges for doubtful debts, have increased from £174.3 million to £182.1 million, an increase in costs of £7.8 million. The most significant impacts on costs in the year was additional expenditure on contractors which increased by £2.5 million, including £1.5 million as a result of Covid-19, and energy costs, which increased by £1.5 million due to price increases, the impact of Covid-19 on fixed third party charges and higher usage due to increased water demand in respect of Covid-19 and because of the hot summer. Depreciation and other asset related costs increased by £4.9 million as new assets were introduced and disposals of old assets were made during the year. The increased asset related costs also included £2.3 million for the impairment of the Aylesford reservoir following the sinkhole incident that occurred during the year. Insurance costs increased by £0.7 million and bulk supplies of water from other water companies increased by £0.6 million, reflecting the higher demand during the year.

Offsetting the increases in costs are savings in staff costs due to a reduction of £7.8 million in respect of past service costs on one of the group's defined benefit pension schemes, which is a result of the change from RPI to CPI in measuring the liabilities of the scheme. This has been offset by increases in salary costs of £3.7 million.

FINANCE COSTS

Interest payable for the group for the year to 31 March 2021 was £48.1 million compared to £58.4 million in the prior year. The reduction reflects the lower costs of finance following the refinancing event in September 2019. Also, during the year debt indexation charges where lower than the prior year due to low inflation rates during the pandemic.

Interest payable includes the following:

- £13.7 million interest on listed debt/bonds (2020: £18.4 million)
- £nil fair value movement on interest rate swap (2020: £2.7 million)
- £2.4 million indexation on index linked listed bonds (2020: £4.4 million)
- £12.8 million interest on Index linked loans (2020: £12.5 million)
- £6.7 million indexation on Index linked loans (2020: £10.4 million)
- £5.4 million interest on loan notes (2020: £2.9 million)
- £1.7 million interest on loan facility (2020: £1.2 million)
- £5.1 million interest payable by SEWH to group companies (2020: £5.6 million)
- £3.0 million relating to other interest payable (2020: £3.1 million)
- £(2.7) million capitalised interest (2020: £(2.8) million)

GENERAL OVERVIEW AND BUSINESS UPDATE continued

TAXATION

Taxation for the year was £5.0 million (2020: £15.1 million). Our tax charge comprises:

- current tax of £1.3 million (2020: £nil). The increase in current tax is due to an increase in taxable profit after allowing for appropriate tax adjustments
- deferred tax of £3.7 million (2020: £15.1 million). The deferred tax in the prior year includes the effect of the rate of corporation tax changing from 17 per cent to 19 per cent

CASH

The SEW Group has cash and cash equivalent balances of £41.7 million as at 31 March 2021 compared with £13.1 million as at 31 March 2020. During the period £50.0 million has been drawn down from our committed revolving credit facilities. Included in the drawn downs during the year was £40.0 million as a safeguard against possible disruption to the financial markets during the pandemic and £10.0 million to fund the continuing capital programme.

The restricted cash balance as at 31 March 2021 was £0.8 million compared to £0.4 million as at 31 March 2020. Cash held in these designated bank accounts are to meet interest and other related finance costs falling due in respect of the group's senior debt.

8.0 REGULATORY UPDATE

REGULATORY REPORTING

The 2020/21 Annual Report and Financial Statements which includes the Statutory Accounts, the Regulatory Accounts, the Ofwat prescribed Performance Report and the Risk and Compliance Statement are published on our website. Our performance on our Outcome Delivery Incentives can be seen on page 308 of our Annual Report.

In addition, we also publish on our website our performance, people and planet report for 2020/21 which gives further information about our performance against our agreed outcomes.

INSTRUMENT OF APPOINTMENT

Ring-fencing obligations

In October 2019 Ofwat issued a pre-consultation document setting out how it intended to standardise ring-fencing licence conditions relating to credit rating and cash lock-up, notification of material issues and change of control (requesting companies to notify their consent in principle) before issuing a formal consultation. We notified our consent in principle on 11 December 2019. Ofwat issued a consultation under section 13 of the Water Industry Act 1991 in May 2020 on substantially the same wording except for changes requested by companies. We notified our consent to the modification on 25 June 2020.

This modification came into effect on 13 July 2020 and brings all ring-fencing related provisions into a new condition P, replacing the current condition P. Ring-fencing provisions in current conditions K and I were transferred (with or without changes) to the new condition P which also includes new provisions. The current condition I was removed entirely and condition K now only relates to disposals of land.

The main modifications include:

- a new obligation to notify Ofwat of changes in ultimate controller and of merger controls
- a new obligation to comply with a direction to enforce a condition P undertaking against an ultimate controller
- a revised obligation to ensure that an investment grade credit rating is maintained (as opposed to a "reasonable endeavours" obligation to do so) and revised provisions on cash lock-up
- the inclusion of corporate family ratings and alternative ratings in the definition of issuer credit rating
- revised provisions relating to ring-fencing certificates
- a new obligation to report any issues that may materially affect the ability of a company to carry out its regulated activities

In August 2020 South East Water received a letter from Ofwat confirming that its ratings are compliant with the Licence definition.

Revenue Forecast Incentive Mechanism

Following several stages of consultation on technical changes relating to the Revenue Forecast Incentive (RFI) mechanism formula, Ofwat issued a formal section 13 consultation in September 2020 proposing to:

- include the blind year reconciliation of totex menus in the RFI's blind year adjustment figures in order to apply it in period (for all companies)
- allow for the correction of "unambiguous revenue errors"

The RFI only applies to wholesale price controls i.e. for the company: water network plus and water resources activities.

Ofwat considered that it was appropriate to apply all revenue-based blind year adjustments to wholesale price controls over the last four years of the price control period as this would ensure that the impacts on revenue would be felt by companies closer to the performance to which they related. This is consistent with the approach adopted by Ofwat for all in-period adjustments. Any RCV adjustments would be applied at PR24.

Paragraph 8.1A of Condition B was introduced in November 2019 to clarify that despite the limits set in price controls, companies can collect revenue above the price limits in the final determination pursuant to the RFI mechanism.

Paragraph 8.1A provides that Ofwat should notify the RFI formula to companies by 31 December 2019 and accordingly it was set out in final determinations. Ofwat subsequently proposed to amend the formula, but because the 31 December 2019 deadline had passed, a licence modification was required to implement changes.

The RFI formula notified in the Final Determination included a blind year adjustment term that was labelled "TBYA" and the modification added any revenue adjustment associated with the blind year reconciliation of totex menus to the TBYA.

We notified our consent to the modification on 12 October 2020 and the change of the RFI formula came into effect on 11 November 2020.

9.0 CAPITAL EXPENDITURE

This was the first year of our 2020 to 2025 investment period and while our capital programme was to a degree impacted by Covid-19, with a number of schemes being disrupted or activity reduced to facilitate safe working, £34.4 million of infrastructure improvements have been completed.

Gross capital investment for 2020/21, the first year of the AMP7 capital programme, is £90.6 million.

- £15.6 million (17 per cent) of investment has been made in the development of new assets and the enhancement of existing assets, including management of the supply demand balance and the company's legal undertakings with respect to drinking water quality standards
- £16.8 million (19 per cent) relates to new mains and boosters on housing development and supporting infrastructure
- £14.7 million (16 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 replacements
- £43 million (48 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
- £0.5 million of investment in our IT systems to support customer billing, collection and debt management

GENERAL OVERVIEW AND BUSINESS UPDATE continued

10. WATER QUALITY

The laboratory is one of the areas of the business that has continued to work on site during the Covid-19 pandemic. Throughout the first half of the year we worked to develop Covid-19 safe practices across the business. Within the laboratory this has included a full site lockdown with access for key personnel only, the implementation of split shifts and dedicated welfare facilities for each team to minimise social interaction and a rationalisation of our operational sampling programmes as a result of the impact on capacity. Despite these challenges, the laboratory has continued to perform to high standards of quality and output.

Each year the Chief Inspector of the Drinking Water Inspectorate publishes a report summarising drinking water quality in England and Wales, which includes a number of comparative compliance metrics. These are also used by Ofwat to assess asset performance.

The company's overall Drinking Water Quality performance, as measured using the DWI's key performance indicator "Compliance Risk Index" which assesses performance across all final water samples was better than industry average at 2.26. 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 the high level of 99.97 per cent, the disinfection index which has improved to 99.97 per cent and the Reservoir Integrity Index which has also improved to 99.98 per cent. "Mean Zonal Compliance" which measures performance at the customer's tap was maintained at above industry average at 99.98 per cent. These results are based on 213,775 tests measured against EU and UK mandatory standards.

In addition to these regulatory tests the company carried out over 300,000 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 (Find a Tender)
- 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 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
Atkins	Consultancy Services Framework	£56,000,000
Itron	Domestic and Commercial Water Meter	£4,400,000
Vauxhall Motors	Commercial Vehicles	£4,000,000
Kings Security	Man Guarding Services	£1,911,564
Ford	Commercial Vehicles	£1,000,000

Tenders in preparation and/or issued include:

Tenders In Hand	Estimated Contract Value
Power Purchasing Agreement – Green Energy	£10,000,000
Cloud Services Framework	£8,000,000
Sludge & Cess Removal Service	£6,000,000
Bill Print Services	£4,000,000
Asset Investment & Optimisation Solution	£3,400,000
Financial Auditor Services	£3,200,000
Pipe Connection and Repair Fittings	£3,000,000
Building Maintenance	£2,000,000

- 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
- an extension of the appointment of Deloitte LLP as our auditors for the financial period ending 31 March 2021 was requested due to the impact of the Covid-19 pandemic and granted by the Financial Reporting Council in May 2020 and the tendering process was extended accordingly
- we oversaw the tender process for audit services taking account of the developments of rules relating to the provision of audit services and the appointment is planned to be made in the middle of the financial year ending 31 March 2022

12. FINANCING

The Group had adequate liquidity with £41.7 million on the balance sheet at the year end and a further £10 million available to draw down on the authorised credit facility.

Our current authorised credit facility expires in June 2022. Discussions are currently being held to replace this facility with a replacement facility with an increased limit of £125 million. This process is expected to be completed in summer 2021.

The DSR and O&M facilities were renewed in June 2021. The new facilities are in place for the period to June 2022. The DSR liquidity facility has a commitment of £38 million and the O&M facility has a commitment of £20 million.

In April 2021 our lenders approved an amendment to our finance documents by way of a STID proposal. The amendment addressed potential consequences of Covid-19 on compliance with our financial covenants to improve our financial resilience, in particular preserving the ability to draw down additional debt even under certain trigger event scenarios.

The amendment also included certain other changes:

- to allow parties to enter into operating leases without acceding to our finance documents
- to allow the issuance of bonds as long as our rating is at least investment grade
- to introduce a restriction on our debt maturity concentration

RESTRUCTURING

South East Water repaid an inter-company loan to simplify the presentation of its accounts and allow for greater clarity of financial reporting, in particular around actual dividends paid.

As part of South East Water's securitisation in 2004, a new intercompany loan was put in place between South East Water (Holdings) Limited (SEWH) and South East Water. South East Water has paid dividends each year, not available for onward distribution to shareholders, which flowed up to SEWH to enable SEWH to immediately pay interest on the loan back to South East Water. In December 2020 South East Water paid a one-off non-distributable restructuring dividend of £136 million, which flowed up to SEWH, and SEWH used the proceeds to immediately repay the inter-company loan. There was no cash impact for either of the companies involved, as all cash was immediately returned to South East Water. In future, the presentation in the accounts of dividends paid will therefore be more straightforward.

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 issued its credit opinion in November 2020. S&P issued its most recent credit opinion in December 2020. 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 £5.5 million of dividends to Hastings Water (UK) Limited in the financial year.

15. BOARD / MANAGEMENT CHANGES

Paul Butler retired as Managing Director in July 2020, having served in the role at South East Water and previously Mid Kent Water for 18 years. Paul has overseen three price reviews since the merger of South East Water and Mid Kent Water in 2007 and his strategic leadership has developed a company which puts customer satisfaction at its heart and his legacy is an organisation with a strong future.

David Hinton, has been promoted from the role of Asset and Regulation director to replace Paul as Chief Executive Officer. He has many years' experience within the organisation and was instrumental in developing the 2020 to 2025 five year plan and our responsible business strategy.

The South East Water Board of directors is as follows:

South East Water Limited

N Salmon
Independent Non-Executive Chair

P Butler
Managing Director* (resigned 31 July 2020)

D Hinton
Chief Executive Officer*
(appointed 01 August 2020)

A Farmer
Chief Financial Officer*

J Barnes
Independent Non-Executive Director

C Pronto
Independent Non-Executive Director

C Girling
Independent Non-Executive Director

R Drew
Non-Executive Director***

A Le Gal
Non-Executive Director** (appointed 18 June 2021)

M Szczepaniak
Non-Executive Director** (resigned 18 June 2021)

The Company Secretary is Nicolas Truillet

South East Water (Holdings) Limited

R Drew
Non-Executive Director***

A Le Gal
Non-Executive Director** (appointed 19 June 2021)

M Szczepaniak
Non-Executive Director** (resigned 19 June 2021)

South East Water (Finance) Limited

D Hinton
Executive Director* (appointed 05 March 2021)

P Butler
Executive Director* (resigned 31 July 2020)

A Farmer
Executive Director*

R Drew
Non-Executive Director***

A Le Gal
Non-Executive Director** (appointed 19 June 2021)

M Szczepaniak
Non-Executive Director** (resigned 19 June 2021)

* Denotes an Executive Director

** Denotes a Vantage appointee

*** Denotes a H.R.L. Morrison & Co. appointee

RATIOS

1. Historic

We confirm that in respect of the Calculation Date on 31 March 2021, 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 2021.

Date	Calculation date	31-Mar-22	31-Mar-23	31-Mar-24	31-Mar-25
RAR (at such Calculation Date or, in the case of forward-looking ratios, as at 31 March falling in the relevant Test Period)	78.4%	78.1%	77.8%	77.6%	76.9%
Test Period	1-Apr-20 to 31-Mar-21	1-Apr-21 to 31-Mar-22	1-Apr-22 to 31-Mar-23	1-Apr-23 to 31-Mar-24	1-Apr-24 to 31-Mar-25
ICR	3.55 x	3.45 x	3.23 x	3.47 x	3.59 x
Adjusted ICR	3.55 x	3.45 x	3.23 x	3.47 x	3.59 x
Average Adjusted ICR	3.41 x	3.39 x	3.43 x	3.43 x	3.43 x
Conformed Adjusted ICR	1.59 x	1.69 x	1.46 x	1.62 x	1.77 x
Conformed Average Adjusted ICR	1.58 x	1.59 x	1.62 x	1.62 x	1.62 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 (South East Water)) 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

	Calculation date £m	31-Mar-22 £m	31-Mar-23 £m	31-Mar-24 £m	31-Mar-25 £m
Senior Debt (Closing Balances)					
Finance Leases	3.9	3.9	3.8	3.7	3.6
Debentures	1.0	1.0	1.0	1.0	1.0
Nominal Debt	166.0	166.0	166.0	166.0	166.0
Index Linked Bonds	177.4	181.7	186.7	192.3	198.0
Fixed Rate Loan Notes	175.0	255.0	255.0	255.0	255.0
Variable rate loans	120.0	120.0	120.0	120.0	120.0
Index Linked Loans	121.9	124.5	128.0	131.3	135.2
Index Linked Loans	280.2	286.5	294.5	303.3	312.4
Authorised Credit Facility	80.0	0.0	5.0	5.0	10.1
Total Senior Debt Closing Balance	1125.4	1138.6	1160.0	1177.6	1201.3
Less: Cash Balance	(41.7)	(21.3)	(11.6)	(6.4)	(12.1)
Senior Net Indebtedness	1083.7	1117.2	1148.4	1171.3	1189.1
Regulatory Capital Value	1382.0	1429.9	1475.2	1509.0	1547.1
RAR	78.4%	78.1%	77.8%	77.6%	76.9%

RATIOS continued

b) ICR

	1-Apr-20 to 31-Mar-21 £m	1-Apr-21 to 31-Mar-22 £m	1-Apr-22 to 31-Mar-23 £m	1-Apr-23 to 31-Mar-24 £m	1-Apr-24 to 31-Mar-25 £m
Net Cash Flow					
Net cash flow from operating activities	119.9	131.3	125.7	137.0	144.0
Exceptional items	0.0	0.0	0.0	0.0	0.0
Recoverable VAT	1.9	0.0	0.0	0.0	0.0
Corporation tax paid	0.1	0.0	0.0	0.0	0.0
Pension funding	0.0	0.0	0.0	0.0	0.0
Non-appointed	0.0	(3.9)	(4.6)	(5.0)	(5.4)
Net Cash Flow	121.9	127.5	121.2	132.0	138.6
Senior Debt Interest					
Leases	0.1	0.5	0.5	0.5	0.5
Debentures	0.0	0.0	0.0	0.0	0.0
Nominal Debt	14.7	16.8	16.8	16.8	16.8
Variable rate loan facility	2.1	1.6	1.7	1.7	1.7
Index Linked Debt	17.2	17.5	18.0	18.5	19.0
Financial Guarantor fees	0.3	0.6	0.6	0.6	0.6
Senior Debt Interest Payable	34.5	37.0	37.5	38.0	38.6
Interest Receivable	(0.1)	0.0	0.0	0.0	0.0
Senior Debt Interest	34.4	37.0	37.5	38.0	38.6
ICR	3.55 x	3.45 x	3.23 x	3.47 x	3.59 x

c) Adjusted ICR

	1-Apr-20 to 31-Mar-21 £m	1-Apr-21 to 31-Mar-22 £m	1-Apr-22 to 31-Mar-23 £m	1-Apr-23 to 31-Mar-24 £m	1-Apr-24 to 31-Mar-25 £m
Net Cash Flow	121.9	127.5	121.2	132.0	138.6
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	121.9	127.5	121.2	132.0	138.6
Senior Debt Interest	34.4	37.0	37.5	38.0	38.6
Adjusted ICR	3.55 x	3.45 x	3.23 x	3.47 x	3.59 x

RATIOS continued

d) Average Adjusted ICR

	1-Apr-20 to 31-Mar-21 £m	1-Apr-21 to 31-Mar-22 £m	1-Apr-22 to 31-Mar-23 £m	1-Apr-23 to 31-Mar-24 £m	1-Apr-24 to 31-Mar-25 £m
Net Cash Flow	121.9	127.5	121.2	132.0	138.6
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	121.9	127.5	121.2	132.0	138.6
Senior Debt Interest	34.4	37.0	37.5	38.0	38.6
Adjusted ICR	3.55 x	3.45 x	3.23 x	3.47 x	3.59 x
Average Adjusted ICR	3.41 x	3.39 x	3.43 x	3.43 x	3.43 x

e) Conformed Adjusted ICR

	1-Apr-20 to 31-Mar-21 £m	1-Apr-21 to 31-Mar-22 £m	1-Apr-22 to 31-Mar-23 £m	1-Apr-23 to 31-Mar-24 £m	1-Apr-24 to 31-Mar-25 £m
Net Cash Flow	121.9	127.5	121.2	132.0	138.6
RCV Depreciation	51.7	52.6	54.3	55.9	57.2
Capitalised IRE	15.5	12.5	12.3	14.6	13.2
Total regulatory depreciation	67.2	65.2	66.6	70.5	70.4
Net Cash Flow after regulatory depreciation	54.7	62.3	54.6	61.5	68.2
Senior Debt Interest	34.4	37.0	37.5	38.0	38.6
Conformed Adjusted ICR	1.59 x	1.69 x	1.46 x	1.62 x	1.77 x

RATIOS continued

f) Conformed Average Adjusted ICR

	1-Apr-20 to 31-Mar-21 £m	1-Apr-21 to 31-Mar-22 £m	1-Apr-22 to 31-Mar-23 £m	1-Apr-23 to 31-Mar-24 £m	1-Apr-24 to 31-Mar-25 £m
Net Cash Flow	121.9	127.5	121.2	132.0	138.6
RCV Depreciation	51.7	52.6	54.3	55.9	57.2
Capitalised IRE	15.5	12.5	12.3	14.6	13.2
Total regulatory depreciation	67.2	65.2	66.6	70.5	70.4
Net Cash Flow after regulatory depreciation	54.7	62.3	54.6	61.5	68.2
Senior Debt Interest	34.4	37.0	37.5	38.0	38.6
Conformed Adjusted ICR	1.59 x	1.69 x	1.46 x	1.62 x	1.77 x
Conformed Average Adjusted ICR	1.58 x	1.59 x	1.62 x	1.62 x	1.62 x

4. We certify that on 31 March 2021 the Permitted Non-Appointed Business Limits have not been exceeded.

	1-Apr-18 to 31-Mar-19 Actual £m	1-Apr-19 to 31-Mar-20 Actual £m	1-Apr-20 to 31-Mar-21 Actual £m
Non-Appointed Expenses	6.1	7.1	7.0
Aggregate Excluded Non-Appointed Expenses	-2.7	-3.8	-3.8
Total Non-Appointed Expenses	3.4	3.3	3.1
Capital Expenditure	100.1	98.3	94.8
Group Tax Relief	1.3	0.0	1.6
Operating Expenditure	112.3	115.5	118.8
Pension	4.1	4.9	12.6
Cash Expenses	217.9	218.7	227.9
3 per cent. of Cash Expenses			6.6
Average of Non-Appointed Expenses			3.3

5. We certify that for the period to 31 March 2021 the Annual Finance Charge is £35.1 million.

6. Annual Finance Charge calculation:

RATIOS continued

	31 March 2021 £m
Senior Debt Interest	
Finance Leases	0.1
Debentures	0.0
Nominal Debt (£166 million)	9.3
Fixed rate loan notes	5.4
Variable rate loan	1.7
Synthetic Index Linked Bonds (£200 million)	0.0
Index Linked Bonds (£130 million)	4.5
Index linked loans (USS)	2.9
Index Linked Loans	9.8
Working Capital Facility	0.4
Ambac fee	0.3
Commitment fee	0.6
	35.2
Less: interest earned	(0.1)
12 Months Total	35.1

Total payments into the DSR Accounts for the period to 31 March 2021 were £35.5 million.

7. We also confirm that:

(a) no Default of Potential Trigger Event is outstanding; and

(b) that South East Water's insurance's are being maintained in accordance with:

(i) the Common Terms Agreement; and

(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 year ended 31 March 2021

	Companies £m	Eliminations £m	Group £m
Turnover	248.2	-	248.2
Operating costs	(181.4)	-	(181.4)
Profit/(loss) on disposal of fixed assets	(0.7)	-	(0.7)
Other operating income	11.4	-	11.4
Operating profit	77.5	-	77.5
Income from investments	147.0	(147.0)	-
Interest receivable – group	2.2	(2.2)	-
Interest receivable – other	0.1	-	0.1
Interest payable – group	(7.3)	2.2	(5.1)
Interest payable – other	(43.0)	-	(43.0)
Return on pension scheme assets	0.8	-	0.8
Profit on sale of intangible assets	-	-	-
Profit on ordinary activities before taxation	177.3	(147.0)	30.3
Tax (charge)/credit on profit on ordinary activities	(5.0)	-	(5.0)
Profit on ordinary activities after taxation	172.3	(147.0)	25.3
Dividends	(152.5)	147.0	(5.4)
	19.9	-	19.9
STRGL – pension	(12.1)	-	(12.1)
Profit/(loss) for period taken to reserves	7.8	-	7.8

South East Water (Holdings) Limited
Consolidated balance sheet
for the year ended 31 March 2021

	Companies £m	Eliminations £m	Group £m
Tangible assets	1,652.1	-	1,652.1
Investments	361.4	(361.4)	-
Net Current (liabilities)/assets	(7.0)	-	(7.0)
Creditors: amounts falling due after more than one year	(175.5)		(175.5)
Current asset investments	-	-	-
Cash and cash equivalents:			
Current accounts	40.9	-	40.9
DSR	0.8	-	0.8
O&M	-	-	-
First loss account	-	-	-
Financing liabilities:			
Intra group loan creditors	(465.2)	465.2	-
Intra group loan debtors	465.2	(465.2)	-
Other HDF group loans	(82.2)	-	(82.2)
Debentures	(1.0)	-	(1.0)
Finance leases	(3.6)	-	(3.6)
Bonds	(296.0)	-	(296.0)
Indexation	(47.4)	-	(47.4)
Artesian loans	(269.0)	-	(269.0)
Indexation	(133.1)	-	(133.1)
Loan notes	(175.0)	-	(175.0)
Variable rate loan	(120.0)	-	(120.0)
Unamortised costs	6.7	-	6.7
Bank loans	(80.3)	-	(80.3)
Net pension liability	31.2	-	31.2
Net assets	**703.0**	**(361.4)**	**341.5**
Capital and reserves			
Called up share capital	194.7	(49.3)	145.4
Revaluation reserve	235.8	-	235.8
Profit and loss account b/fwd.	259.1	(312.1)	(53.0)
Profit for period	13.4	-	13.4
Capital employed	**703.0**	**(361.4)**	**341.5**

FINANCIAL STATEMENTS continued

South East Water (Holdings) Limited
Consolidated movement in the profit and loss reserve
for the year ended 31 March 2021

	Companies £m	Eliminations £m	Group £m
At 1 April 2020	259.1	(312.1)	(53.0)
Profit for the year	172.3	(147.0)	25.3
Pension scheme in STRGL	(12.1)	-	(12.1)
Dividends	(152.5)	147.0	(5.4)
Movement through reserves	5.6	-	5.6
	13.4	-	13.4
At 31 March 2021	272.5	(312.1)	(39.6)