South East Water Limited

Condensed Group financial statements
for the six months ended 30 September 2014

Registered number 02679874

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Chairman's statement

Introduction

I am pleased to present our interim report for the first half of the 2014/15 financial year.

This time last year we submitted the Company's business plans for the period 2015 to 2020 to Ofwat. Our business plans as submitted in December 2013, which cover both our wholesale and retail operations, presented in detail how we listened to our customers and incorporated their priorities, and those of our other stakeholders and regulators, into high quality business plans that would result in prices which our customers consider affordable and acceptable. As well as satisfying our legal and statutory duties required of a regional water company, our business plans included a comprehensive list of customer outcomes linked to financial incentives or penalties to us and set out how we will achieve our objectives in an efficient and effective way. This new way of measuring our success is generating a step change in the business, a change which puts customers' priorities right at the heart of everything we do.

Ofwat provided feedback on our plans and published a draft determination in August. In our view the draft determination no longer reflects a balanced plan and we have concerns with specific aspects; we provided further information to Ofwat to support our plans and these concerns in October. Final determinations will be published by Ofwat on 12th December.

With the challenge set, we are now preparing for the next five year period and, in particular, engaging our employees and partners in the challenge to ensure that everyone is focussed on our vision for the future: to be the water company people want to be supplied by and to work for.

In June, with approval from the Department for Environment, Food and Rural Affairs (Defra), we published our Water Resource Management Plan setting out what we will need to do, where and by when, to meet the future need for water from people, businesses and also the environment.

We asked for customers' views while we developed our plans and thank everyone who took part in the consultation process. Customers overwhelmingly supported our proposals to reduce demand for water through water efficiency programs, with on-going customer metering and leakage reduction programmes.

As part of this long term strategy to manage our water resources more efficiently, we are continuing with our Customer Metering Programme. Working closely with our external partner, Clancy Docwra, we have installed 21,000 meters in the first half of the year. This improved our household meter coverage in our area to 65%. The programme continues and we are planning to achieve 90% by 2020. I am pleased with the progress in this area and would like to thank our customers for their cooperation and support throughout this process.

Following average rainfall during the summer and autumn and reduced demand for water from customers, our water resources are well placed. We are not anticipating the need to consider any water restrictions in the coming year. As is routine, we will continue to work closely with our regulatory stakeholders to monitor the situation and with our customers to promote the importance of using water wisely whatever the weather.

I am writing this statement for the final time as, after 8 years, I am to retire in spring 2015. The Company is looking to appoint a new Chairman, ready to focus on the challenge of delivering our business plans for the next five years. We have had other changes to the Board too. In October, Olivier Fortin was appointed by our shareholder Caisse de dépôt et placement du Québec as a Non-Executive Director to replace Patrick Côté. We also welcomed Chris Girling as an independent Non-Executive Director. A Board which is enriched with fresh perspectives, together with those who have experience working with the Company means I am confident the new Chairman will find a team ready to lead the Company with appropriate challenge and support.

Results and Key Performance Indicators

The results published in this statement summarise our performance for the six months ended 30 September 2014. The financial statements are prepared under International Financial Reporting Standards and incorporate the performance of South East Water Limited and its subsidiary, South East Water (Finance) Limited.

Revenue for the period was £109.7m compared with £107.8m for the same period in the previous year. The increase in prices in respect of K and RPI, as allowed by Ofwat was 2.05% with effect from 1 April 2014. Our customer demand is marginally higher in the six month period to 30 September 2014 compared to the same period in the prior year, however this is offset by a reduction in revenue from customers within our metering programme who have transferred their supply from unmeasured to measured.

Net operating costs for the year to 30 September 2014 were £67.8m, an increase of 4.5% compared with the same period in the previous year. The increase in operating costs of £2.9m is principally due to inflationary pressure on our cost base. Operating profit was £45.1m for the first half of the 2014/15 financial year which compares with £46.1m in the prior year. Operating profit as a percentage of revenue has decreased from 42.8% in the first half of 2013/14 to 41.1% in the current year.

Interest costs have decreased by £2.3m from £29.6m to £27.3m. This reflects the lower RPI being applied to the indexed linked loans during the first half of the year.

Profit before tax has increased from £19.2m to £20.3m when compared to the same period last year. This represents 18.5% of revenue compared with 17.8% for the corresponding period last year.

Profit after tax has decreased from £23.6m to £16.9m for the first six months of the year. In the prior period there was a significant reduction in the deferred tax liability arising from the reduction in the forward corporation tax rates from 23% to 20%. During the six months to 30 September 2014 the deferred tax charge was £1.8m.

Net cash generated from operations was £72.1m for the six months ended 30 September 2014 compared to £65.0m in the same period for the previous year. This increase is predominantly due to improvements in the collection of water income during the period.

We continue to comply with the financial covenants set out in our securitisation structure and continue to hold ratings from Moodys and Standard & Poors consistent with the requirements of both our securitisation and our instrument of appointment.

Capital Expenditure

Capital expenditure in the six months to September 2014 was £46.8m, compared with £45.7m for the same period in the previous year. During the year we have spent £14.7m on our below ground infrastructure network and our above ground asset expenditure includes £7.7m on our water treatment refurbishment programme. Our Customer Metering Programme has seen £6.1m of investment.

Customer Service

A report from the Consumer Council for Water published in September 2014 shows that during 2013-14 South East Water saw a 29 per cent drop in customer complaints compared to the previous year. This trend is continuing and for the first six months of this year we have seen a reduction in complaints compared to the same time last year.

We saw our Service Incentive Mechanism score improve for a second year in a row for 2013-14 (from 73 to 75) and we are on track to improve further during the current year. While we are pleased with this progress, we appreciate that our performance is below industry standard and, therefore, we remain focused on improving the area of our performance.

Principal risks and uncertainties

The principle risks and uncertainties facing the business are set out in the Strategic Report within the Group's Annual Report for 2013/14, which can be found on the South East Water website.

Going Concern

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report.

Looking ahead

For the immediate term, we await the final determination from Ofwat on our business plans and we are completing our final commitments for our 2010-15 programme of work. At the same time we are preparing to deliver our business plan for 2015-2020 and ensuring everyone is focussed on putting customer priorities at the heart of everything we do. My Board and I are confident that we have the right management team in place to deliver on our plans, both now and in the longer term, to the benefit of today and tomorrow's customers and we would like to thank our staff and our partners for their continued hard work and support.

Gordon Maxwell
Chairman
5 December 2014

Statement of directors' responsibilities

The directors confirm that to the best of their knowledge:

- the condensed Group financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as endorsed by the European Union; and

- the condensed Group statements herein include a fair review of the information required by the Disclosure and Transparency Rules 4.2.7R.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

By order of the Board

Paul Butler
Managing Director
5 December 2014

Condensed Group income statement
for the six months ended 30 September 2014

	Notes	**Six months ended 30 September 2014 £000**	Six months ended 30 September 2013 £000
Revenue	3	**109,695**	107,813
Net operating costs	4	**(67,755)**	(64,816)
Other income	5	**3,131**	3,123
Operating profit		**45,071**	46,120
Finance costs	6	**(27,319)**	(29,617)
Finance income	7	**2,593**	2,691
Profit before tax		**20,345**	19,194
Taxation	8	**(3,432)**	4,427
Profit for the period		**16,913**	23,621
Earnings per share			
Basic and diluted from continuing operations		**34.30p**	47.90p

Condensed Group statement of comprehensive income
for the six months ended 30 September 2014

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Profit for the period	**16,913**	23,621
Items that will not be reclassified subsequently to profit or loss:		
Re-measurement of defined benefit liability	**642**	1,631
Income tax relating to items not reclassified	**(128)**	(326)
	514	1,305
Total comprehensive income for the period attributable to Owners of the Company	**17,427**	24,926

Condensed Group statement of financial position
as at 30 September 2014

	Notes	**30 September 2014 £000**	31 March 2014 £000	30 September 2013 £000
Assets				
Non-current assets				
Intangible assets	10	**9,429**	9,713	7,858
Property, plant and equipment	11	**1,231,083**	1,206,508	1,168,641
Non-current receivables		**190,013**	190,013	190,013
		1,430,525	1,406,234	1,366,512
Current assets				
Inventories		**332**	267	195
Trade and other receivables	12	**67,368**	63,713	69,303
Cash and cash equivalents	13	**46,016**	52,710	72,421
		113,716	116,690	141,919
Total Assets		**1,544,241**	1,522,924	1,508,431
Liabilities				
Current liabilities				
Financial liabilities				
- Loans and borrowings	14	-	(1,237)	(1,237)
Trade and other payables	16	**(99,180)**	(87,950)	(92,811)
Deferred income		**(3,444)**	(3,444)	(3,408)
Provisions		**(1,550)**	(3,233)	(1,649)
		(104,174)	(95,864)	(99,105)
Non-current liabilities				
Financial liabilities				
- Loans and borrowings	14	**(858,778)**	(853,338)	(845,896)
- Derivative financial instruments	14/15	**(87,960)**	(82,971)	(87,018)
Deferred tax liabilities		**(122,528)**	(120,619)	(124,189)
Defined benefit pension liability		**(29,532)**	(33,230)	(38,136)
Trade and other payables	16	**(1,113)**	(1,012)	(828)
Deferred income		**(58,693)**	(58,282)	(55,510)
		(1,158,604)	(1,149,452)	(1,151,577)
Total Liabilities		**(1,262,778)**	(1,245,316)	(1,250,682)
Net assets		**281,463**	277,608	257,749
Equity				
Ordinary shares		**49,312**	49,312	49,312
Capital redemption reserve		**4,000**	4,000	4,000
Retained earnings		**228,151**	224,296	204,437
Total equity		**281,463**	277,608	257,749

The notes on pages 11 to 16 are an integral part of these condensed Group financial statements.

Condensed statement of changes in equity

for the six months ended 30 September 2014

	Issued capital £000	Capital redemption reserve £000	Retained earnings £000	Total equity £000
At 1 April 2014	**49,312**	**4,000**	**224,296**	**277,608**
Profit for the period	-	-	16,913	16,913
Other comprehensive income			514	514
Total comprehensive income	-	-	17,427	17,427
Dividends (see note 9)	-	-	(13,572)	(13,572)
At 30 September 2014	**49,312**	**4,000**	**228,151**	**281,463**

for the six months ended 30 September 2013

	Issued capital £000	Capital redemption reserve £000	Retained earnings £000	Total equity £000
At 1 April 2013	**49,312**	**4,000**	**194,511**	**247,823**
Profit for the period	-	-	23,621	23,621
Other comprehensive income			1,305	1,305
Total comprehensive income	-	-	24,926	24,926
Dividends (see note 9)	-	-	(15,000)	(15,000)
At 30 September 2013	**49,312**	**4,000**	**204,437**	**257,749**

Condensed Group statement of cash flows
for the six months ended 30 September 2014

	Notes	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Cash flows from operating activities			
Net cash generated from operations		**72,074**	65,047
Interest received		**2,549**	2,591
Interest paid		**(15,755)**	(26,887)
Pension contributions paid		**(4,250)**	(2,427)
Group tax relief paid		**(1,524)**	(2,000)
Net cash from operating activities		**53,094**	36,324
Cash flows from investing activities			
Sale of property, plant and equipment		**104**	96
Purchase of property, plant and equipment		**(44,624)**	(42,990)
Purchase of intangible assets		**(1,168)**	(1,290)
Fixed asset contributions received /(paid)		**709**	(64)
Net cash used in investing activities		**(44,979)**	(44,248)
Cash flows from financing activities			
Finance lease principal payments		**(1,237)**	(1,149)
Repayment of borrowing		**-**	(3,000)
Dividends paid to shareholder	9	**(13,572)**	(15,000)
Net cash used in financing activities		**(14,809)**	(19,149)
Net decrease in cash and cash equivalents		**(6,694)**	(27,073)
Cash and cash equivalents at 1 April		**52,710**	99,494
Cash and cash equivalents at 30 September		**46,016**	72,421

Notes to the condensed Group financial statements
for the six months ended 30 September 2014

1. Basis of preparation

The condensed Group financial statements for the six months ended 30 September 2014 are set out on pages 7 to 16 and have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and IAS 34 *Interim Financial Reporting* as endorsed by the European Union. The statements should be read in conjunction with the financial statements for the year ended 31 March 2014, which have been prepared in accordance with International Financial Reporting Standards endorsed by the European Union.

The condensed Group financial statements are presented in sterling.

These interim financial results are neither audited nor reviewed by our auditor. The information for the year ended 31 March 2014 does not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2014 were approved by the Board of directors on 4 July 2014 and delivered to the Registrar of Companies. The report of the auditors on those accounts was not qualified, did not include any reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain any statement under section 498(2) or (3) of the Companies Act 2006.

2. Accounting policies

Changes in accounting policies
The accounting policies adopted are consistent with those of the financial statements for the year ended 31 March 2014 as described in those financial statements.

3. Revenue

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Metered water income	**70,454**	64,323
Unmetered water income	**37,478**	41,929
Other sales	**1,763**	1,561
	109,695	107,813

All revenue is generated from activities within the United Kingdom and was from external customers.

4. Net operating costs

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Employee benefits expense	**12,388**	12,159
Asset expense	**19,968**	18,343
Other operating expenses	**35,399**	34,314
	67,755	64,816

5. Other income

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Rental income	**557**	632
Sundry income	**2,574**	2,491
	3,131	3,123

6. Finance costs

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Effective interest on listed debt	**12,057**	11,864
Fair value movements on interest rate swap	**7,395**	7,995
Interest on index linked loans	**4,247**	4,133
Indexation on index linked loans	**2,762**	3,524
Other finance costs	**1,541**	1,876
Pension fund finance charge	**644**	831
	28,646	30,223
Less: interest capitalised	**(1,327)**	(606)
	27,319	29,617

7. Finance income

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Interest receivable from Group undertakings	**2,423**	2,389
Interest receivable on bank balances and short term deposits	**170**	302
	2,593	2,691

8. Taxation

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Current taxation	**(1,653)**	(1,729)
Deferred taxation	**(1,779)**	6,156
	(3,432)	4,427

The current tax charge is recognised based on management's estimate of the weighted average annual corporation tax rate expected for the full financial year.

Notes to the condensed Group financial statements *(continued)*
for the six months ended 30 September 2014

9. Dividends

	Six months ended 30 September 2014 £000	Six months ended 30 September 2013 £000
Equity dividends paid during the period of 27.5p per share (2013: 30.4p)	**13,572**	15,000

10. Intangible assets

	£000
Net book amount	
At 1 April 2014	**9,713**
Additions for the period	**1,169**
Amortisation for the period	**(1,453)**
At 30 September 2014	**9,429**
Net book amount	
At 1 April 2013	7,816
Additions for the year	4,580
Amortisation for the year	(2,683)
At 31 March 2014	9,713
Net book amount	
At 1 April 2013	7,816
Additions for the period	1,290
Amortisation for the period	(1,248)
At 30 September 2013	7,858

11. Property, plant and equipment

	£000
Net book amount	
At 1 April 2014	**1,206,508**
Additions for the period	**45,673**
Disposals for the period	**(889)**
Depreciation for the period	**(20,209)**
At 30 September 2014	**1,231,083**

Net book amount	
At 1 April 2013	1,143,773
Additions for the year	95,002
Disposals for the year	(180)
Depreciation for the year	(32,087)
At 31 March 2014	1,206,508

Net book amount	
At 1 April 2013	1,143,773
Additions for the period	44,439
Disposals for the period	(847)
Depreciation for the period	(18,724)
At 30 September 2013	1,168,641

12. Trade and other receivables

	30 September 2014 £000	31 March 2014 £000	30 September 2013 £000
Trade receivables	**27,199**	29,607	31,267
Amounts due from Group undertakings	**51**	17	39
Prepayments and accrued income	**37,572**	31,168	34,898
Other receivables	**2,546**	2,921	3,099
	67,368	63,713	69,303

13. Cash and cash equivalents

	30 September 2014 £000	31 March 2014 £000	30 September 2013 £000
Cash at bank	**416**	610	71
Short term cash deposits	**45,600**	52,100	72,350
	46,016	52,710	72,421

Notes to the condensed Group financial statements *(continued)*
for the six months ended 30 September 2014

14. Financial liabilities

	30 September 2014 £000	31 March 2014 £000	30 September 2013 £000
Current liabilities			
Obligations under finance leases	-	1,237	1,237
Non-current liabilities			
Irredeemable debenture stock	**1,048**	1,048	1,048
Listed bonds due after five years	**515,697**	513,784	511,802
Index linked loans	**342,033**	338,506	333,046
	858,778	853,338	845,896
Interest rate swap	**87,960**	82,971	87,018
	946,738	936,309	932,914

15. Financial Instruments

Fair values of financial assets and financial liabilities carried at fair value

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. The following table details the financial instruments that are carried in the Group's books at the fair value at 30 September 2014.

	Book and Fair Value 30 September 2014 £000	Book and Fair Value 31 March 2014 £000	Book and Fair Value 30 September 2013 £000
At fair value through profit and loss account			
Interest rate swap	**87,960**	82,971	87,018

The book value of the interest rate swap has been adjusted to reflect its fair value.

Fair value hierarchy

The Group held the following financial instruments measured at fair value:

	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Financial liabilities at fair value through profit and loss account				
30 September 2014				
Interest rate swap	**(87,960)**	-	**(87,960)**	-
31 March 2014				
Interest rate swap	(82,971)	-	(82,971)	-
30 September 2013				
Interest rate swap	(87,018)	-	(87,018)	-

During the reporting period ending 30 September 2014, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

Notes to the condensed Group financial statements *(continued)*
for the six months ended 30 September 2014

15. Financial Instruments *(continued)*

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

16. Trade and other payables

	30 September 2014 £000	31 March 2014 £000	30 September 2013 £000
Current liabilities			
Trade payables	**13,698**	13,784	15,424
Amounts due to group undertakings	**10,273**	10,144	10,458
Payments received in advance	**35,594**	29,436	33,817
Other taxes and social security	**855**	889	815
Other payables	**1,792**	1,398	324
Accruals	**36,968**	32,299	31,973
	99,180	87,950	92,811
Non-current liabilities			
Other creditors	**1,113**	1,012	828
	1,113	1,012	828