South East Water Limited

Condensed Group financial statements
for the six months ended 30 September 2013

Registered number 02679874

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Introduction

I am pleased to present our interim report for the first half of the 2013/14 financial year.

Earlier this week we submitted the Company's business plans for the period 2015 to 2020 to Ofwat. These business plans – which cover both our wholesale and retail operations - present in detail how we have listened to our customers and incorporated their priorities, and those of our other stakeholders and regulators, into high quality business plans that result in prices which our customers consider affordable and acceptable. As well as satisfying the legal and statutory duties expected of a regional water company, our business plans include a comprehensive list of customer outcomes linked to financial incentives and penalties, and sets out how we will achieve our objectives in an efficient and effective way.

At the same time as producing our business plans we have prepared and submitted our Water Resources Management Plan to Defra. The draft of the Water Resources Management Plan was subject to a comprehensive consultation exercise throughout the summer and we value the feedback offered by our customers and stakeholders. The Water Resources Management Plan incorporates our assessment of likely levels of demand and water supply over both the short and the longer term and a full assessment of options to satisfy projected supply deficits. The requirements of our Water Resources Management Plan have been fully linked into our business plans.

As part of our 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 28,000 meters in the first half of the year. This has improved our household meter coverage in our area to 64%. The programme continues, planning to achieve 90% by 2020. I am pleased with progress in this area and would like to thank our customers for their cooperation and support throughout this process.

Following a wet autumn our water resources are well placed and I do not anticipate the need for any water restrictions in the months ahead. Whilst this is the case, we still continue to work with our regulatory stakeholders to carefully monitor the situation and with our customers to promote the importance of using water wisely.

There have been a number of planned changes to the Board over the last six months. At the end of June 2013 David Shore retired from the position of Operations Director. I would like to thank David for his many years of service to the Company. Paul Seeley has taken over responsibility for Operations and David Hinton was appointed to the Board in June as Asset and Regulation Director. In July, Jean Pierre Ouellet was appointed by our shareholder Caisse de dépôt et placement du Québec as a Non-Executive Director. The Board has a fresh perspective and I am confident it will lead the Company through the coming year 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 2013. 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 £107.8m compared with £102.1m for the same period in the previous year. Customer demand for water was greater in this six month period than in 2012 which included a Temporary Use Ban and exceptional summer rainfall.

Net operating costs for the year to 30 September 2013 were £64.8m, an increase of 2.2% compared with the same period in the previous year. The increase in operating costs of £1.4m is principally due to additional power costs arising from higher consumption, increased tariffs and environmental charges. Operating profit was £46.1m for the first half of the 2013/14 financial year which compares with £41.5m in the prior year. Operating profit as a percentage of revenue has increased from 40.7% in the first half of 2012/13 to 42.8% in the current year.

Interest costs have increased by £5.9m from £23.7m to £29.6m, the principal driver for this being the additional cost associated with the fair value of our interest rate swap. This is a non cash movement and reflects the change in value of this financial instrument.

Profit before tax has reduced from £20.8m to £19.2m when compared to the same period last year, and represents 17.8% of revenue compared with 20.4% for the corresponding period last year.

Profit after tax has increased from £16.2m to £23.6m for the first six months of the year. This increase is principally due to the reduction in the deferred tax liability arising from the reduction in the forward corporation tax rates from 23% to 20%. These reductions were substantively enacted by Parliament in July 2013.

Net cash generated from operations for the year was £65.0m for the six months ending 30 September 2013 compared to £66.3m in the same period for the previous year.

We continue to comply with the financial covenants set out in our securitisation structure and continues 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 2013 was £45.7m, compared with £47.2m for the same period in the previous year. During the year we have spent £12.4m on our below ground infrastructure network and our above ground asset expenditure includes £5.4m on our water treatment refurbishment programme. Our Customer Metering Programme has seen £6.8m of investment. This level of expenditure is above the level we committed to when prices were set in 2009, and underlines our commitment to ensure we continue to deliver a service that meets the priorities of our customers.

Customer Service

Customer Service is an area where we have not always performed as well as our customers expect, and we continue to demand improvements in all areas, particularly systems, processes and communication. We achieved a significant improvement in our Service Incentive Mechanism score for 2012-13 (from 56 to 73) and are on track to improve further during the current year. Whilst our Board is pleased with this progress we are focussing on further developments to continue this improvement. We are also investing significantly in additional enhancements to our customer contact system to improve the way in which we communicate with our customers.

Principal risks and uncertainties

The principle risks and uncertainties facing the business are set out in the Directors' Report of the Group's Annual Report for 2012/13 and 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 feedback from Ofwat on our business plans and from Defra regarding our Water Resources Management Plan. At the same time we will continue to focus on delivering our committed obligations for the present regulatory period. 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
6 December 2013

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

P Butler
Managing Director
6 December 2013

Condensed Group income statement
for the six months ended 30 September 2013

	Notes	**Six months ended 30 September 2013 £000**	Six months ended 30 September 2012 £000 (Restated)
Revenue	3	**107,813**	102,050
Net operating costs	4	**(64,816)**	(63,446)
Other income	5	**3,123**	2,888
Operating profit		**46,120**	41,492
Finance costs	6	**(29,617)**	(23,696)
Finance income	7	**2,691**	2,998
Profit before tax		**19,194**	20,794
Taxation	8	**4,427**	(4,516)
Profit for the period		**23,621**	16,278
Earnings per share			
Basic and diluted from continuing operations		**47.90p**	33.01p

The restatement of the previous period relates to the adoption of IAS 19R and a correction to capitalised interest (see notes 2 and 6 below for further details).

Condensed Group statement of comprehensive income
for the six months ended 30 September 2013

	Six months ended 30 September 2013 £000	Six months ended 30 September 2012 £000 (Restated)
Profit for the period	**23,621**	16,278
Actuarial gain on pension schemes	**1,631**	6,348
Deferred tax on defined benefit pension plans	**(326)**	(1,460)
Other comprehensive gain	**1,305**	4,888
Total comprehensive income	**24,926**	21,166

Condensed Group statement of financial position
as at 30 September 2013

	Notes	**30 September 2013 £000**	31 March 2013 £000	30 September 2012 £000 (Restated)
Assets				
Non-current assets				
Intangible assets	10	**7,858**	7,816	6,631
Property, plant and equipment	11	**1,168,641**	1,143,773	1,108,756
Non-current receivables		**190,013**	190,013	190,013
		1,366,512	1,341,602	1,305,400
Current assets				
Inventories		**195**	136	234
Trade and other receivables	12	**69,303**	58,768	56,704
Cash and cash equivalents	13	**72,421**	99,494	19,470
		141,919	158,398	76,408
Total Assets		**1,508,431**	1,500,000	1,381,808
Liabilities				
Current liabilities				
Financial liabilities				
- Loans and borrowings	14	**(1,237)**	(4,149)	(4,149)
Trade and other payables	15	**(92,811)**	(93,161)	(95,854)
Deferred income		**(3,408)**	(3,408)	(3,372)
Provisions		**(1,649)**	(1,728)	(1,336)
		(99,105)	(102,446)	(104,711)
Non-current liabilities				
Financial liabilities				
- Loans and borrowings	14	**(845,896)**	(840,442)	(734,199)
- Derivative financial instruments	14	**(87,018)**	(81,917)	(66,054)
Deferred tax liabilities		**(124,189)**	(130,020)	(137,008)
Defined benefit pension liability		**(38,136)**	(41,363)	(34,941)
Trade and other payables	15	**(828)**	(955)	(568)
Deferred income		**(55,510)**	(55,034)	(52,491)
		(1,151,577)	(1,149,731)	(1,025,261)
Total Liabilities		**(1,250,682)**	(1,252,177)	(1,129,972)
Net assets		**257,749**	247,823	251,836
Equity				
Ordinary shares		**49,312**	49,312	49,312
Capital redemption reserve		**4,000**	4,000	4,000
Retained earnings		**204,437**	194,511	198,524
Total equity		**257,749**	247,823	251,836

The notes on pages 10 to 14 are an integral part of these condensed Group financial statements.

Condensed statement of changes in equity

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 gain			1,305	1,305
Total comprehensive income	-	-	24,926	24,926
Dividends	-	-	(15,000)	(15,000)
At 30 September 2013	**49,312**	**4,000**	**204,437**	**257,749**

for the six months ended 30 September 2012 (Restated)

	Issued capital £000	Capital redemption reserve £000	Retained earnings £000	Total equity £000
At 1 April 2012	**49,312**	**4,000**	**192,858**	**246,170**
Profit for the period	-	-	16,278	16,278
Other comprehensive gain	-	-	4,888	4,888
Total comprehensive income	-	-	21,166	21,166
Dividends	-	-	(15,500)	(15,500)
At 30 September 2012	**49,312**	**4,000**	**198,524**	**251,836**

Condensed Group statement of cash flows
for the six months ended 30 September 2013

	Notes	Six months ended 30 September 2013 £000	Six months ended 30 September 2012 £000
Cash flows from operating activities			
Net cash generated from operations		**65,047**	66,281
Interest received		**2,591**	3,653
Interest paid		**(26,887)**	(7,956)
Pension contributions paid		**(2,427)**	(3,310)
Group tax relief paid		**(2,000)**	(2,422)
Net cash from operating activities		**36,324**	56,246
Cash flows from investing activities			
Sale of property, plant and equipment		**96**	34
Purchase of property, plant and equipment		**(42,990)**	(43,868)
Purchase of intangible assets		**(1,290)**	(1,444)
Fixed asset contributions received /(paid)		**(64)**	402
Net cash used in investing activities		**(44,248)**	(44,876)
Cash flows from financing activities			
Finance lease principal payments		**(1,149)**	(1,066)
Repayment of borrowing		**(3,000)**	(3,000)
Dividends paid to shareholder	9	**(15,000)**	(15,500)
Net cash used in financing activities		**(19,149)**	(19,566)
Net decrease in cash and cash equivalents		**(27,073)**	(8,196)
Cash and cash equivalents at 1 April		**99,494**	27,666
Cash and cash equivalents at 30 September		**72,421**	19,470

Notes to the condensed Group financial statements
for the six months ended 30 September 2013

1. Basis of preparation

The condensed Group financial statements for the six months ended 30 September 2013 are set out on pages 6 to 14 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 2013, 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 unaudited. The information for the year ended 31 March 2013 does not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2013 were approved by the Board of directors on 5 July 2013 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 2013 as described in those financial statements.

New standards and interpretations adopted
The Group has adopted IAS 19 (revised) Employee Benefits as of 1 April 2013. The key impact of this revision is the removal of the separate assumptions for expected return on plan assets and discounting of scheme liabilities, replacing them with one single discount rate for the net deficit.

These interim financial statements are the first in which the Group has adopted IAS 19 (revised), which has been applied retrospectively. As the Group has always recognised actuarial gains and losses immediately, there is no effect on prior periods' defined benefit obligation and balance sheet disclosure. For the six months ended 30 September 2013, the consolidated income statement is £0.5 million lower and the statement of comprehensive income is £0.5 million higher than it would have been prior to the adoption of IAS 19 (revised). For the six months ended 30 September 2012, the consolidated income statement is £0.6 million lower and the statement of comprehensive income is £0.6 million higher than it would have been prior to the adoption of IAS 19 (revised).

3. Revenue

	Six months ended 30 September 2013 £000	Six months ended 30 September 2012 £000
Metered water income	**64,323**	51,805
Unmetered water income	**41,929**	48,689
Other sales	**1,561**	1,556
	107,813	102,050

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

Notes to the condensed Group financial statements (continued)
for the six months ended 30 September 2013

4. Net operating costs

	Six months ended 30 September 2013 £000	Six months ended 30 September 2012 £000
Employee benefits expense	**12,159**	11,589
Asset expense	**18,343**	18,778
Other operating expenses	**34,314**	33,079
	64,816	63,446

5. Other income

Rental income	**632**	643
Sundry income	**2,491**	2,245
	3,123	2,888

6. Finance costs

Effective interest on listed debt	11,864	10,461
Fair value movements on interest rate swap	7,995	4,251
Interest on index linked loans	4,133	4,002
Indexation on index linked loans	3,524	3,143
Other finance costs	1,876	1,705
Pension fund finance charge	831	1,054
	30,223	24,616
Less: interest capitalised	(606)	(920)
	29,617	23,696

Finance costs for the period ending 30 September 2012 have been restated to reflect the adoption of IAS 19R (decrease of £0.3 million) and a correction to interest capitalised (decrease of £1.0 million).

7. Finance income

Interest receivable from Group undertakings	**2,389**	2,837
Interest receivable on bank balances and short term deposits	**302**	161
	2,691	2,998

8. Taxation

	Six months ended 30 September 2013 £000	Six months ended 30 September 2012 £000
Current taxation	**(1,729)**	(1,293)
Deferred taxation	**6,156**	(3,223)
	4,427	(4,516)

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. This has been offset in the period by the reduction of 3% in the rate applied to deferred tax, which has resulted in a credit to the income statement for the period.

9. Dividends

Equity dividends paid during the period of 30.4p per share (2012: 31.4p)	**15,000**	15,500

10. Intangible assets

	£000
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**
Net book amount	
At 1 April 2012	6,274
Additions for the year	3,731
Amortisation for the year	(2,189)
At 31 March 2013	7,816
Net book amount	
At 1 April 2012	6,274
Additions for the period	1,444
Amortisation for the period	(1,087)
At 30 September 2012	6,631

Notes to the condensed Group financial statements (continued)

for the six months ended 30 September 2013

11. Property, plant and equipment

	£000
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**

Net book amount	
At 1 April 2012	1,083,004
Additions for the year	92,442
Disposals for the year	(7,712)
Depreciation for the year	(23,961)
At 31 March 2013	1,143,773

Net book amount	
At 1 April 2012	1,083,004
Additions for the period	45,739
Disposals for the period	(2,059)
Depreciation for the period	(17,928)
At 30 September 2012	1,108,756

12. Trade and other receivables

	30 September 2013 £000	31 March 2013 £000	30 September 2012 £000
Trade receivables	**31,267**	28,483	23,998
Amounts due from Group undertakings	**39**	21	190
Prepayments and accrued income	**34,898**	27,730	29,016
Other receivables	**3,099**	2,534	3,500
	69,303	58,768	56,704

13. Cash and cash equivalents

Cash at bank	**71**	15,670	8,170
Short term cash deposits	**72,350**	83,824	11,300
	72,421	99,494	19,470

Notes to the condensed Group financial statements (continued)

for the six months ended 30 September 2013

14. Financial liabilities

	30 September 2013 £000	31 March 2013 £000	30 September 2012 £000
Current liabilities			
Obligations under finance leases	**1,237**	1,149	1,149
Redeemable debenture stock	**-**	3,000	3,000
	1,237	4,149	4,149
Non-current liabilities			
Irredeemable debenture stock	**1,048**	1,048	1,048
Obligations under finance leases	**-**	1,237	1,237
Listed bonds due after five years	**516,207**	514,014	512,048
Less: unamortised issue costs	**(4,405)**	(4,593)	(4,887)
Index linked loans	**336,713**	332,488	226,693
Less: unamortised issue costs	**(3,667)**	(3,752)	(1,940)
	845,896	840,442	734,199
Interest rate swap	**87,018**	81,917	66,054
	932,914	922,359	800,253

15. Trade and other payables

Current liabilities			
Trade payables	**15,424**	13,587	14,748
Amounts due to group undertakings	**10,458**	10,728	11,083
Payments received in advance	**33,817**	27,426	32,173
Other taxes and social security	**815**	811	812
Other payables	**324**	501	523
Accruals	**31,973**	40,108	36,515
	92,811	93,161	95,854
Non-current liabilities			
Other creditors	**828**	955	568
	828	955	568