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Annual Report and Accounts 2012-13

Connecting with our customers



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Overview

Your Southern Water



Water	
Average daily water supply, millions of litres per day	529.3
People served, millions	2.4
Number of properties, millions	1.1
Number of water treatment works	90
Number of service reservoirs	202
Length of water mains, kilometres	13,735
Number of metered properties	662,308
Leakage, millions of litres per day	81
Overall drinking water quality, per cent	99.93
Wastewater	
Average daily wastewater recycled, millions of litres per day	730
People served, millions	4.5
Number of properties, millions	1.9
Number of wastewater treatment works	368
Number of pumping stations	2,360
Length of sewers, kilometres	39,000
Beaches meeting European water quality standards	82

Finance	2012-13	2011-12
Turnover	£778.7m	£716.2m
Operating profit	£331.0m	£271.6m
Profit on ordinary activities after tax	£156.9m	£79.9m
Average water and wastewater customer bill	£427	£402

Chairman's welcome

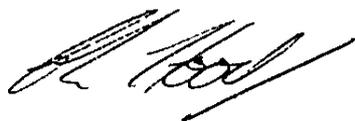
During the year, the company continued its transformation to ensure every business activity and decision places the interests of our customers at its heart.

To this end, the Board has played an integral role in the development to date of our 2015-20 Business Plan as well as our 25-year Water Resources Management Plan and Strategic Statement. Through these plans, the Board and employees of Southern Water are committed to laying the foundations for a service that is recognised as the best in the industry.

Our operational performance also continued to strengthen in 2012-13, with improvements across the majority of our water and wastewater services. For example, we were delighted to once again record the lowest level of leakage per property of all the main water and wastewater companies and the best safety performance in our history. In addition, we have now installed more than 215,000 water meters in our industry-leading metering programme. This is an important step in securing vital resources in the water-stressed South East.

We continue to make significant investment in the South East to improve services for our customers and help safeguard the environment. In turn, this investment has provided jobs and helped support the regional economy during a particularly challenging time for families and commerce.

It has been a year of change for the water industry as the sector embarks on a path of evolution, particularly around the introduction of competition. We have supported this evolution at a pace which delivers the best outcomes for our customers, investors and the environment and we will continue to play our part to create a confident and expert industry that delivers on its promises.



Colin Hood
Chairman

Your Board

The Board is responsible for the overall strategic direction of the business. It is made up of an independent non-executive Chairman, two executive directors (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, four of whom are independent.

The day-to-day operation of the company is overseen by the Executive Management Team, which comprises the Chief Executive Officer, Chief Financial Officer, Company Secretary and General Counsel and seven functional directors. None of these seven directors are members of the Board.

The ultimate holding company of Southern Water Services (Southern Water) is Greensands Holdings (Greensands), owned by a consortium of pension and infrastructure funds.

Seven of our Board members and the Company Secretary are pictured above visiting one of our two Sussex contact centres. From left, they are:

- Surinder Toor (Non-executive Director)
- David Golden (Senior Independent Non-executive Director)
- Cheryl Black (Independent Non-executive Director)
- Kevin Hall (Company Secretary and General Counsel)
- Michael Carmedy (Chief Financial Officer)
- Colin Hood (Chairman)
- Robert Armstrong (Independent Non-executive Director)
- Matthew Wright (Chief Executive Officer)

Our two other Board members are:

- Robert Jennings (Independent Non-executive Director)
- Paul Moy (Non-executive Director)

Find out more about the Board on pages 53 to 55.

CEO's summary

During 2012-13, we and our customers faced some of the driest weather on record followed by some of the wettest. We started 2012 in drought, with water restrictions in place in Sussex and Kent, and ended the year mobilising tankers and pumps to deal with flooding caused by unprecedented levels of rain and groundwater.

These extremes in weather have reinforced the importance of our plans to invest in our water and wastewater networks to ensure they meet the challenges of our changing climate in the future and can continue to deliver a reliable service for our customers.

We are committed to keeping our customers' needs at the heart of our operations and planning to ensure we can deliver the service they expect from us in the 21st century.

Despite the considerable challenges presented by the weather, we recorded some good results against our targets. These included continuing to supply drinking water to our customers that is among the best in Europe, achieving 99.93 per cent in the overall quality measure used by the Drinking Water Inspectorate. This result was slightly lower than the previous year due to some taste and odour issues in the Hastings area, which we have taken steps to resolve.

We maintained our industry-leading record on leakage at a time when we asked our customers to save water during the drought in the early part of the year. We continued to have the lowest level of leakage per property of all the main water and wastewater companies, beating our target of 90 million litres a day by nine million litres and delivering our best ever performance.

Our ongoing work to drive down leakage and help secure water resources for the future was supported by our metering programme. We have now installed more than 215,000 water meters in our five-year scheme to meter 500,000 households in Kent, Sussex and Hampshire by 2015. Metering puts customers in control of their water bills and nearly 60 per cent of those who moved to metered charges during the year saw their bills go down. Those whose bills increased were offered tariffs to manage the transition to higher charges as well as water and energy efficiency advice.

Our main purpose as a company is to deliver the service our customers expect, so we were disappointed with some aspects of our performance during the year. One way of measuring customer service in the water industry is the Service Incentive Mechanism (SIM), which is monitored by Ofwat. We did not always provide our customers with the service we would want to during the year. We received high levels of contact, partly because of drought and flooding, and were not always able to respond as effectively as we should have to customers' queries or complaints. These have impacted on our SIM measure, but, more importantly, on our customers.

We are determined to do better and have launched a 'turnaround plan' to ensure we deliver a rapid improvement in our performance. The plan includes better training, recruiting the right staff for the job, reviewing our processes and, above all, listening more effectively to our customers. We are pleased to report that our SIM measures in 2013-14 to date are ahead of the unsatisfactory level we achieved in the comparable period of 2012-13. We will focus on keeping our promises to our customers and helping them the first time they contact us. Restructures in our business during the year are helping us to work more efficiently and achieve these goals. The new structure provides greater clarity of roles and leadership as well as improved processes.

While water resources were stretched at the start of the year, the unprecedented amounts of rain that followed filled our reservoirs and left groundwater levels at a record high. Our supplies are in a strong position for the next 12 months.

The changing weather was a key factor as we updated our 25-year Water Resources Management Plan (WRMP) to submit to Defra, the Department for Environment, Food and Rural Affairs. The plan is updated every five years and, this time, we used an innovative and more sophisticated approach. Historically, plans have been based on the most severe droughts experienced in the past. Our model allows us to plan for a wider range of, and more serious, droughts which could happen in the future. We talked extensively to our

customers and stakeholders while developing the plan, which is open to public consultation between May and August 2013, and we would very much like to hear your views via our dedicated website at www.swhaveyoursay.co.uk

Future planning was a feature of the year. We also updated our Strategic Statement, which sets out our customers' priorities for their water and wastewater services in the next 25 years, and we laid the foundations for our five-year Business Plan, which will inform our regulator, Ofwat, as it sets price limits for our customers for 2015-20.

Our ambition is to be recognised as the UK's leading water company. The best, most successful companies across the world are those that put their customers at the heart of their business and incorporating our customers' views into our planning is critical. Extensive research with customers and stakeholders has helped us to develop six outcomes to deliver in the years ahead. Our work was scrutinised by our independent Customer Challenge Group, which has helped to shape and inform our interaction with our customers and the development of our plans.

A team has been set up to develop our 2015-20 Business Plan, which – for the first time – will set out our proposals for customers for the retail and wholesale sides of our business. Competition for business customers will open up in the industry from 2017, bringing new challenges and opportunities. We are focusing on developing retail and wholesale plans that will put us in a good position to make positive changes in the years ahead. To this end, we were in dialogue with Ofwat during the year about the changes needed to facilitate the introduction of competition. Along with other water companies, we established a clear and ordered approach to the changes.

Another area of focus for our Business Plan is the development of a wastewater network that will cope with the effects of more extreme wet weather. With groundwater levels at a record high at the end of the year, some of our sewer networks and pumping stations were overwhelmed by rain. In the short term, our operational and customer service teams worked round the clock to support our customers, keep the network flowing and minimise the risk of pollution from sewer flooding. We also allocated £4 million for investment in support schemes for the worst affected areas. In the long term, we want to further develop our partnership with the Environment Agency and councils, which will take the lead on surface water management plans, to tackle the causes of flooding in our catchments.

Our financial results show an increase in operating profit to £331.0 million compared with £271.6 million in 2011-12. This improvement was in line with expectations and was largely driven by an 8.7 per cent increase in turnover, reflecting our price increase and a continued focus on controlling our operating costs. Despite challenging operating conditions and the additional costs incurred in managing the drought and subsequent high groundwater levels from the wet summer and winter, overall operating costs, excluding depreciation, for 2012-13 fell by 0.5 per cent. This reduction was, in part, driven by savings made through changes to our final salary pension scheme together with process and contract improvements. These savings offset the impact of inflation and adverse weather on our costs.

As we prepare for our next Business Plan, we are making good progress against our £1.8 billion capital investment programme for 2010-15. We completed all of our planned work for 2012-13, spending £380 million in the year. This included our £300 million scheme to bring cleaner seas to Sussex, which reached the final phase of testing and will be commissioned during 2013-14. The main site at Peacehaven meets the requirements of the Environment Agency's Environmental Permit, which became effective on 31 March, 2013. We also completed a £14 million scheme to replace 48 kilometres of old water mains in Chatham, Kent, and invested more than £10 million to renovate 22 kilometres of sewers and replace nearly six kilometres of risings mains.

Our investment during the year helped us to maintain stable performance across three of our service areas – water infrastructure (including water mains and reservoirs), water non-infrastructure (water treatment works) and wastewater infrastructure (sewers). Our rating for wastewater non-infrastructure (wastewater treatment works and pumping stations), slipped to marginal from stable because of issues in operating new technology to remove iron from the wastewater we recycle. We have put an action plan in place to improve. Mitigating our impact on the environment remains a priority and we met our target to reduce greenhouse gas emissions and

pollution incidents, with serious incidents falling by more than 50 per cent. We continued to work to our environmental management system, which is certified to ISO 14001.

The health and safety of all our customers, employees and contractors is of fundamental importance and we achieved our best ever result in terms of reportable injuries (RIDDORs). For the fifth year running, we were presented with a President's Award by the Royal Society for the Prevention of Accidents (RoSPA).

Our work was recognised through a number of other awards during the year. These included a Water Industry Achievement Award for our campaign to keep sewers clear of fat, oil and grease and a Utility Industry Achievement Award for our Learn to Swim scheme, which helps to teach thousands of children to swim every year and which celebrated its 20th anniversary in 2012.

We continued to support the communities we serve through other educational work and charity events. We raised more than £190,000 for good causes and maintained our sponsorship of the South and South East in Bloom competition. Working in partnership with STEM (Science, Technology, Engineering and Maths) ambassadors, we reached thousands of pupils through education initiatives.

Our staff responded in record numbers to the year's employee survey as we strive towards our goal of appearing in The Sunday Times' Best Companies to Work For list. The headline results show an increase in how engaged our people feel and we want to build on this. We also achieved a silver award in our first application to be listed by the Business in the Community charity, which measures the performance of companies against criteria in the workplace, marketplace, community and environment.

In what was a particularly challenging year because of the weather, I would like to thank all of our staff and suppliers who worked tirelessly to deliver a good service for the four million people we serve in Kent, Sussex, Hampshire and the Isle of Wight.

We have taken significant steps to address areas for improvement and will continue to do so moving forward. We will also ensure we continue to listen to our customers' views as we develop our plans for the future to meet their needs and their priorities. I would like to thank our customers for their valuable help in shaping our plans so far.



Matthew Wright
Chief Executive Officer

Our business

Southern Water supplies drinking water to 2.39 million people and safely recycles the wastewater of 4.45 million people in Sussex, Kent, Hampshire and the Isle of Wight

During 2012-13, we provided drinking water to our customers through 13,735 kilometres of mains, 202 service reservoirs and 90 supply works. The quality of our tap water remained among the best in Europe, with 99.93 per cent of tests meeting stringent quality standards in 2012. We supplied an average of 529.32 million litres of water a day, with a peak of 595 million litres.

We also recycled 730 million litres of wastewater a day, transporting it through approximately 39,000 kilometres of sewers and 2,360 pumping stations to our 368 wastewater treatment works. After undergoing treatment to stringent European quality standards, wastewater is recycled back into the environment. By-products from the treatment process are used to produce fertiliser for agriculture and to generate renewable electricity.

Our spending on service improvements totalled £380 million as part of our five-year plan to invest £1.8 billion between 2010 and 2015, the equivalent of almost £1,000 for every property in our region. Our work included the final phase of our £300 million scheme to bring cleaner seas to Sussex, with the construction of a new wastewater treatment works at Peacehaven, and a £14 million project to replace 48 kilometres of water mains in Kent.

As part of our long-term plans to secure water resources for the region, we installed more than 125,000 water meters for our domestic customers. The total number of meters installed as part of the programme reached 217,163. More than 58 per cent of our domestic water customers and 90 per cent of our business water customers now have meters.

We have a number of minor activities that are not regulated by our licence but are related to our business. The non-appointed activities make up less than one per cent of our turnover and the main one is providing property search information for homebuyers. During the year, we supplied 65,000 residential property searches, 1,000 fewer than in 2011-12, the level of activity reflecting the current property market conditions.

Financial summary

	2012-13	2011-12	Change
Turnover	£778.7m	£716.2m	8.7%
Operating profit	£331.0m	£271.6m	21.9%
Profit on ordinary activities after tax	£156.9m	£79.9m	96.4%
Gross capital expenditure	£380.0m	£443.4m	(14.3%)
Net cash inflow from operating activities	£499.8m	£487.1m	2.6%

Our turnover for 2012-13 was £778.7 million, an increase of 8.7 per cent from 2011-12, principally reflecting our price increase. The wet summer led to lower water consumption, which reduced turnover. However, this was offset by an increase in turnover resulting from a project to identify occupiers of properties previously shown as empty on our records.

We continued to strive to control operating costs and these fell by 0.5 per cent from 2011-12. We achieved efficiencies through improved processes, contract re-negotiations and changes to the final salary pension scheme. These efficiencies offset cost increases incurred because of inflation and responding to the adverse weather conditions. As a result, operating profit increased to £331.0 million.

Profit on ordinary activities after taxation was £156.9 million. Our shareholders are committed to Southern Water in the long term and, for the second year running, our ultimate owners did not receive any dividend payments in order to support the business in focusing on improving operational and financial performance.

Interim dividends of £43.2 million were paid to Southern Water Services Group (SWSG) during the year and were more than offset by interest receivable of £56.9 million from SWSG. No other ordinary dividends were declared or paid for 2012-13.

We invested £380.0 million to improve our water supply and wastewater treatment infrastructure and provide a better service for the four million people we serve. This investment, which was less than the £443.4 million spent in 2011-12, reflected the completion of various projects to improve water quality and lower expenditure on our £300 million scheme to bring cleaner seas to Sussex as it reached its commissioning phase. We remain on track to deliver our £1.8 billion overall capital investment programme for 2010-15.

Net cash inflow from operating activities increased to £499.8 million for 2012-13 from £487.1 million in 2011-12. The increase mainly reflects the higher operating profit offset by an increase in working capital. The increase in working capital was expected and is mainly attributable to the price increase on turnover (which increases the value of debt relating to any current year), the roll out of our metering programme (which delays the timing of billing to customers compared with unmetered customers) and an outstanding payment from Southern Water in respect of the disposal of its investment in Veolia Water South East.

The average bill for our water and wastewater customers for 2012-13 was £427, a daily cost of £1.17. This compares with an average bill of £402 in 2011-12.

Strategic goals

Our ambition is to be recognised as the UK's leading water company. The best, most successful companies across the world are those that put their customers at the heart of their business. That's what we plan to do.

Developing our plans for the future over the past year has been the start of our journey to being recognised by our customers as an organisation which puts them first and gives them the service they want.

We have identified 12 targets in our One Team, One Goal initiative to help us work towards better serving our customers. The targets are updated each year and cover:

Customer service – how well we respond to customers' queries and complaints, and the level of satisfaction customers tell us they have with the service they receive.

Drinking water quality – the critically important measure which reflects the safety and cleanliness of the drinking water we supply and the level of contact we receive from customers in relation to this.

Environmental performance – the impact we have on the natural environment in our region, with the aim of minimising unsustainable activities.

Asset performance – the reliability of the assets and equipment used in delivering our services, where our objective is to ensure that service levels are maintained.

Planning of our investment programme – the effectiveness with which we decide where to invest customers' money, based on the feedback they give us on the service improvements they would like to see.

Financial performance – how efficiently we spend customers' money in delivering services to them, and how effectively we collect revenue from customers.

Corporate responsibility – by ensuring the health, safety and engagement of our employees and contractors, and contributing to social aims such as tackling affordability problems and minimising greenhouse gas emissions, we aim to be a company that delivers its services in a way that reflects customers' wider priorities for the communities in which they live.

One of the biggest challenges in the South East is ensuring secure water supplies in the face of water scarcity, changing weather patterns and legislative changes. We are currently leading the industry in our innovative approach to water resource planning. We pioneered a new modelling technique in our 2015-40 Water Resources Management Plan. This allows us to plan for a wider variety of weather patterns in the future. So far we are the only water company to adopt this approach. It builds on our industry-leading

metering programme and our position as the company with the lowest level of leakage per property of the main water and wastewater companies

On the wastewater side, we want to provide a network which copes better with the extremes of weather we sometimes experience. We will do this by developing partnerships with local authorities and the Environment Agency to create robust surface water management plans and secure funding for necessary investment. We also want to take a more holistic approach as we plan how to meet even stricter environmental standards in the future and develop solutions that are more cost-effective for customers and do not increase carbon emissions.

As we plan for the future, we are determined to put our customers at the heart of our business. We have significantly increased our level of customer consultation to ensure we deliver services that meet their needs. We have created a strong Customer Challenge Group, with an independent chair, to oversee and challenge the way in which we talk with customers and stakeholders and take their views into account.

We are focused on submitting a Business Plan for 2015-20, that offers value for money, reflects our customers' priorities, meets our environmental obligations and offers a robust water supply and wastewater network for the future.

In order to fund our capital programme, we must raise money from banks and investment funds. Our long-term plan assumes that we can continue to borrow money at low cost, which means investors must have confidence in our financial position and outlook. When we set our Business Plan for the next five years, we will need to balance our commitments with our ability to raise the funding needed for investment in our infrastructure.

Water is an essential service and we want to ensure that bills are affordable and to play a key role in developing payment schemes and tariffs that make it easier for our customers to pay. During the year, we worked with our customers to develop a Social Tariff, which we plan to pilot in 2013. When the Government finalises its reforms to the welfare system, we hope to be one of the first companies to introduce a solution that works with other agencies, councils and the Government to support customers struggling with their finances.

Our work in the communities we serve was recognised by the Business in the Community charity, which measures the corporate responsibility performance of companies against criteria in the workplace, marketplace, community and environment. We submitted our first application during the year, achieving a silver award, and we will continuously improve our performance and move up the Corporate Responsibility Index. We also took a step closer to our goal to appear in The Sunday Times' Best Companies to Work For list with an increase in staff engagement recorded in our annual survey.

Our regulators

We report on our performance to three key water industry regulators – Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA).

Ofwat monitors water companies to ensure they provide a good and efficient service for customers at a fair price. Every five years, water companies submit business plans to Ofwat, setting out how they will maintain and improve services for customers and the associated costs. Ofwat then sets the maximum level at which we can increase customers' bills for the next five-year period.

Ofwat issued a consultation document early in 2013 for the 2015-20 business plans and also published proposals to change the terms under which water companies operate. These changes mean the next business plans will cover retail and wholesale separately to ensure companies are focused on improving customer service and as a first step to open up the water industry to competition.

The last price limits were set in 2009. They allowed the following increases (known as the 'K' factor), plus the Retail Prices Index (RPI).

Price limits	2010-11	2011-12	2012-13	2013-14	2014-15
Allowed price increase 'K' factor	-0.7%	0.0%	3.6%	3.3%	-0.1%
Applied price increase 'K' factor	-0.7%	0.0%	3.6%	2.1%	

In addition to the 'K' factor, Ofwat allowed us to increase charges by an extra 1.4 per cent in 2011-12. This adjustment related to the provision of transitional tariffs to help customers move to water meters under our metering programme. As a result of a lower than expected take up of the transitional tariff, we reduced the 'K' factor allowance that we applied to charges for 2013-14 to 2.1 per cent from the 3.3 per cent allowed.

The DWI oversees standards of drinking water in England and Wales and ensures we comply with the stringent Water Supply (Water Quality) Regulations. During the year, we carried out more than 221,000 water quality tests to report to the DWI.

Abstraction and recycling wastewater are regulated by the EA via abstraction licences and discharge consents. The agency also ensures we meet the environmental standards set by UK and European legislation. We proactively report to the EA on our operations in relation to the water we abstract to supply to customers and the wastewater we recycle to the environment.

Our customers

Our performance

	2012-13		2011-12
	Target	Achieved	Achieved
SIM score	75	62.2	65.0
Quantitative score	34	21.9	25.5
Qualitative score	41	40.3	39.4

One of the important measures of the overall service we deliver for our customers is the Service Incentive Mechanism (SIM), which was introduced by Ofwat in 2010. SIM is a key performance target and we are focused on improving the underlying service to customers that it measures.

During the year, we received more contact from our customers than we could deal with effectively, particularly in relation to the drought and water restrictions, flooding incidents during the wet weather and queries during annual billing. As a result, we did not improve our SIM measure and we were not always able to offer our customers the level of service they deserve.

Our priority for the year ahead is to improve our service so that we efficiently deal with customers' queries or complaints the first time they contact us. To help us do this, we began a series of Voice of the Customer workshops to engage with our customers and find out where they think we need to improve. As a result, work has already started to ensure we are clearer about the service we want to provide and that we recruit staff who have the ability to deliver it.

We also launched a review of the letters we write to customers and the conversations we have with them on the telephone, but our approach is not just about the service received by phone or post. It is also about making sure every decision we make as a company puts the needs of our customers first. In the previous year, we improved our SIM measure by 20 per cent and this is the improvement we want to build on, ensuring we can keep on improving year on year.

The SIM measure comprises two elements, quantitative and qualitative. The quantitative score takes into account written complaints and telephone calls, including the number of times when all of our lines are busy, abandoned calls and 'unwanted calls' – those which we could have avoided receiving.

During the year, we received 2.1 million telephone and written contacts from customers, of which 1.8 million concerned billing enquiries and 0.3 million were related to operational matters. We answered 99.90 per cent of written enquires within five working days and 99.74 per cent of written complaints within 10 working days.

Our quantitative score was disappointing in the first half of the year because of a higher than expected number of telephone calls from customers. However, following the implementation of an action plan, performance improved for the second half of the year.

For the qualitative score, Ofwat carries out a 'consumer experience survey' four times a year to assess the views of 200 customers whose enquiries have been resolved. In this area, we scored 40.3, an improvement on our performance in 2011-12.

Our Guaranteed Standards Scheme (GSS) offers enhanced guarantees and/or payments to compensate customers where we have failed to provide a minimum standard of service. Details of the scheme can be found on our website, www.southernwater.co.uk

The number of events under the statutory GSS and our voluntary Customer Charter, and the total value of payments made last year compared to the previous year, are shown in the table below.

	2012-13	2011-12
Statutory GSS – number of events	3,105	1,746
Statutory GSS – number of payments made	2,774	1,704
Statutory GSS – payments made £'000	313	186
Company Customer Charter – number of payments made	59	480
Company Customer Charter – payments made £'000	4	17

The number of GSS payments increased during the year as a direct result of the persistent heavy rain, which led to unprecedented flooding incidents across our region. Other factors included a major burst main and two planned water mains repairs, which took longer than expected.

Customer improvements

We launched a 'turnaround' plan during the year to ensure the service we provide for our customers improves. This included the appointment of a Chief Customer Officer, the restructuring of the customer senior management team and re-launch of our Customer Call Centre, with a focus on having better conversations with our customers to help us provide a better service.

A large-scale training programme was introduced for members of staff who deal directly with customers. To help facilitate this, specialist contractors were brought in to handle customer enquiries, giving staff the time to attend training sessions. The training is focused on four key areas:

- Keep customers properly informed
- Reduce time taken to solve issues
- Keep our promises
- Resolve issues first time

We want to put customer service at the heart of all the work we do and the campaign is not just aimed at staff who speak to customers on the telephone, but at every one of our employees.

Improvements and initiatives included a review of processes, particularly the way in which we correspond with customers, and better quality management and workflow. One area of focus is a redesign of our water and wastewater bills so that they are easier for customers to understand. We have been talking to customers in workshops to find out their views. We plan to implement this change later this year.

The busiest time of the year for customer calls is between February and April – when bills are sent out – so we appointed an Annual Billing Manager, recruited more staff and held briefing workshops for employees. We also introduced an improved online reference tool, WaterPedia, to help our staff answer a wide range of customer queries in a shorter time.

We are updating our billing system in 2014 and we talked to customers to find out what improvements they would like to see. As a result, the new system will include e-billing to enable more customers to easily monitor and pay their bills online.

During the year, we redesigned our website so that it better meets the needs of our customers as well as to give it a modern look and feel. The navigation and layout were improved to make it quicker and easier for customers to pay their bills, change their accounts and find out information.

The number of visitors to the site increased by 43 per cent, breaking through the one million mark for the first time with 1,023,604 people viewing 6.6 million pages. We launched a 'Need Help?' online service, offering guidance and quick answers to hundreds of customer queries. The feature was used 189,000 times during the year.

We can help you pay

The current state of the economy has put pressure on our customers and, during the year, we helped more than 12,600 customers who were struggling to pay their bills, an increase of eight per cent on the previous year

Overdue and bad debt is a key issue in the water industry, adding about £15 to every customer's bill, so it's important we work with our customers to keep debt to a minimum. Our Debt Advice Team answered 44,408 calls from customers in financial difficulties and more than 34,000 people visited the debt advice pages on our website. The sympathetic and practical work of our Debt Advice Centre was recognised in two categories of the national Credit Excellence Awards.

A total of 418 customers received grants totalling £157,516 from the Southern Water Charitable Trust Fund, a registered charity established to help people facing financial hardship. We also helped 3,098 customers, nearly a third more than in the previous year, through the WaterSure tariff, which gives financial help to those who use large amounts of water for essential purposes. This includes people on income-related benefits with three children under 19 in full-time education or customers with certain medical conditions.

More than 2,200 customers who started to pay for their current yearly water bill by regular instalments had the same amount cleared from their arrears under our NewStart scheme. A further 6,930 customers joined a Department for Work and Pensions scheme to repay their debts directly through their benefit payments. More than 10,800 customers are now making payments under this scheme.

The total we secured in benefits and tax credit payments for our customers as part of our metering programme rose above £1 million during the year. Customers concerned about paying metered bills are put in touch with IncomeMAX, an independent social enterprise that helps people claim their full benefit and tax credit entitlement.

The majority of our customers who move to a meter see their water bills decrease. For those who experience an increase in charges, about 40 per cent, we offer our Changeover Tariff, which introduces any increase gradually, and our Support Tariff, for those who have genuine difficulty in paying a higher bill.

In the longer term, we are developing a Social Tariff, which we plan to pilot in 2013-14 with about 2,000 customers after the Government finalises its reform to the welfare system and the introduction of Universal Credit. We have been talking to our customers about how the Social Tariff may work, how it can meet their needs and how much customers are prepared to pay to subsidise others.

We would like the Government, local authorities and other utility companies to work more closely so it is simpler for customers to find support to pay their bills and manage debt.

Water

Water quality

	2012		2011
	Target	Achieved	Achieved
Overall drinking water quality index	99.98%	99.93%	99.95%
Disinfection control index	99.98%	99.99%	99.96%
Process control index	100%	99.92%	99.98%

The drinking water we supplied in 2012 remained of the highest quality, with an overall rating of 99.93 per cent.

We carried out more than 221,000 water quality tests to report to the Drinking Water Inspectorate (DWI) and achieved an overall quality score of 99.93 per cent. Scientists tested for more than 100 substances in samples taken from 90 water treatment works, 202 service reservoirs and from customers' taps. We also carried out more than 200,000 additional tests to measure samples against our own standards, which are more stringent than those set by our regulators.

The most significant concern remains the number of taste and odour failures in the year and, as a result, our overall score was slightly below our own company target of 99.98 per cent. To address this issue, we have installed a new treatment plant at our Beauport works in Hastings, East Sussex, where the majority of the failures occurred. We also completed our £70 million programme of improvements at our water treatment works, helping us to maintain our excellent performance in the DWI's disinfection control index.

We invested more than £15 million to upgrade processes at our water treatment works during 2012-13. This included beginning work on a £2 million scheme to remove nitrates from a groundwater source in Hampshire. We also flushed 192 kilometres of water mains during the year. This was slightly lower than our target because we suspended mains flushing during the drought to conserve water supplies.

An update of our drinking water safety plans was completed by March 2013, providing us with a revised set of risk assessments that will be used to help us identify future investments for inclusion in our next Business Plan.

Water supply

	2012-13		2011-12
	Target	Achieved	Achieved
Performance water non-infrastructure	Stable	Stable	Stable
Performance water infrastructure	Stable	Stable	Stable
Distribution maintenance index (2012 calendar year)	100%	99.94%	99.88%
Security of supply index (critical period)	100	100	100
Security of supply index (annual average)	100	100	100

The year began in drought, with the announcement of water restrictions in Kent and Sussex after one of the driest 12 months on record. We were among seven water companies to introduce restrictions in April following two dry winters that left groundwater and reservoir levels very low.

To help refill our largest reservoir, Bewl Water, we applied to the Environment Agency (EA) for a Drought Permit to allow us to take more water from the River Medway in Kent. However, the introduction of water restrictions was followed by unprecedented downpours during the spring and early summer, with some areas experiencing more than double the average rainfall. This helped to return groundwater and reservoirs to healthier levels, enabling us to lift the restrictions in June.

Thanks to improvements made to our supply network, we were in a better position than we would have been in similar dry circumstances in previous years. Leakage is at our lowest level ever, our new storage reservoir is now in operation at Hardham, West Sussex, and our metering programme is well under way.

We carried out investigations into developing new sources of water identified in our Water Resources Management Plan. Alongside metering, this will help to secure supplies for the future. Our investigations included the possibility of developing aquifer storage and recovery in Sussex. This is where water is pumped from rivers when flows are high in winter to be stored in underground aquifers (natural reservoirs) ready for use when water is less plentiful.

In Hampshire, we carried out a public consultation on a scheme to secure water supplies involving the construction of an 18.5 kilometre pipeline between Testwood Water Supply Works (WSW) in Totton and Otterbourne WSW, together with work to enhance the existing treatment facilities at the Testwood site. The scheme would enable us to treat more water at Testwood and pump it to Otterbourne. Linking these two strategic sites would provide greater flexibility and help secure supplies when a more stringent limit is placed by the EA on the amount of water we can take from the River Itchen after 2015.

Leakage

	2012-13		2011-12
	Target	Achieved	Achieved
Leakage (million litres of water per day)	90	81	82

We invested £13 million during the year to further drive down leakage to our lowest ever level, beating the target set by Ofwat by nine million litres of water each day.

We continue to deliver one of the lowest levels of leakage per property of all water supply companies and the lowest of the water and wastewater companies, working round the clock to find and repair leaks on our 13,735 kilometre network of water mains. The milder winter weather helped us to achieve our target because we did not experience the freezing conditions that lead to more bursts and leaks.

Leak alarms on the water meters we are installing as part of our metering programme are also helping to reduce leakage and save water. The first of their type in the UK, the alarm is activated when water runs continuously through the meter for four hours. The alarm is picked up when the meter is read (four times in the first year) so that a leak can be identified and repaired.

Since the start of our metering project, leaks have been detected in 1.3 per cent of the properties involved. Between 2010 and 2015, this could save 7.6 million litres of water each day – enough to supply the needs of 60,000 people, or a town the size of Ashford.

We replaced 71 kilometres of ageing water mains during the year to reduce the risk of burst pipes and leaks. This was part of our plans to replace 256 kilometres of water mains between 2010 and 2015.

Metering

More than 250,000 new water meters have been fitted under our five-year programme to introduce them for the majority of our customers across Hampshire, Sussex and Kent. From these, more than 215,000 households have now moved to metered charges.

Metering is a key part of our long-term plans to secure water resources for the future because households with a meter tend to use around 10 per cent less. On the Isle of Wight, where nearly every property was metered about 20 years ago, water consumption has dropped from 165 litres per person a day to 135 litres – a substantial saving of 18 per cent.

During the year, our meter installation teams worked in Worthing and Brighton and Hove in Sussex, the New Forest and north of Southampton in Hampshire, as well as in Gravesend in Kent.

Nearly 60 per cent of households that have moved to metered charges under the project have experienced their water bills going down. Customers whose bills increased were offered support through our changeover and support tariffs. These help to introduce any bill increase gradually, giving households time to make savings on their water use.

We provided our customers with practical advice and support on how to save water, energy and money, including advice in booklets and online. A total of 21,449 home water and energy audits were carried out by our team of Green Doctors in customers' homes.

Expert help is available for those who may have genuine difficulty in paying their metered water bill, including free support from independent money experts IncomeMAX. To date, this support has helped customers to claim more than £1 million in benefits and tax credits which they did not know they were entitled to or were not claiming previously.

We are leading the UK water industry with our metering scheme and, during the year, hosted a conference for colleagues from other companies, as well as the Government and other organisations, to share what we have learned from developing and implementing the first programme of its kind in the country.

Our water efficiency campaigns helped us to reach our target of saving 1.01 million litres of water each day during 2012-13. Practical and educational initiatives were used to promote saving water during the year and you can find out more about these in our community section.

Sales of discounted water efficiency products from our partners Straights and B&Q soared during the year.

Wastewater

Safely recycling wastewater

	2012-13		2011-12
	Target	Achieved	Achieved
Performance wastewater non-infrastructure	Stable	Marginal	Stable
Performance wastewater infrastructure	Stable	Stable	Stable

Our work to recycle wastewater safely is a priority and we invested nearly £218 million during the year to improve our service

We spent more than £6 million to renovate 22 kilometres of sewers and £4 million on replacing nearly six kilometres of rising mains – the large sewers that connect to our treatment works and pumping stations. We also used cameras in 336 kilometres of sewers to check for blockages, a build-up of fat, oil and grease, and damage that could lead to pollution and flooding

The majority of our wastewater treatment works, 359 out of 368, met the stringent conditions set by the Environment Agency (EA). A key part of our investment was the introduction of new processes at 19 of our treatment works to help remove iron from the wastewater we clean and recycle to rivers and the sea. This involved new technology that has proved more challenging to operate. As a result of this and the very wet weather during the year, our rating for operating our works slipped from stable to marginal. To address this, we launched an action plan to increase training and increase the level of understanding of new processes.

In a major milestone, our new wastewater treatment works at Peacehaven in East Sussex became compliant with EA requirements, bringing wastewater treatment in the area up to the latest European standards. The project includes a new wastewater treatment works and sludge recycling centre, 11 kilometres of sewer tunnel, two pumping stations and a 2.5 kilometre long sea outfall. The works will handle 95 million litres of wastewater each day, serving the residents of Peacehaven, Telscombe Cliffs, Ovingdean, Rottingdean, Saltdean and Brighton and Hove. More than 3.5 million man hours were worked at the site without a single accident that resulted in time off work. The site covers 39 hectares and is surrounded by four kilometres of perimeter fencing and more than one million cubic metres of earth were moved during construction work.

The site went into its final phase of work during the year – where we test to ensure the new equipment works correctly – and each of the processes was tested in turn. The majority of landscaping was completed and, featuring one of the largest grass roofs in Europe, the works seamlessly blends into the surrounding downland landscape.

Other key investments included the start of a £9 million upgrade of three wastewater treatment works around Tunbridge Wells in Kent and another £9 million upgrade at Morestead Road Wastewater Treatment Works in Winchester, Hampshire.

Work began on a £12 million scheme at Ashford Wastewater Treatment Works in Kent to increase its capacity to allow for future population growth in the area. A £25.8 million major environmental improvement scheme also got under way at Millbrook Wastewater Treatment Works in Southampton to upgrade treatment of the water before it is recycled to the Solent.

Flood protection

Flooding was a serious issue during the wettest year on record in England. Record levels of groundwater compounded the challenges to our network. This increased the risk of flooding because the ground was so saturated it led to water infiltrating our sewer network and customers' private drains. Hampshire and Sussex were the worst affected areas.

We responded to emergency incidents round the clock, using tankers where necessary to clear drains as sewers became overwhelmed, pumping water to rivers and the sea to avoid flooding and drafting in teams of customer support staff to help affected households.

The issue of flooding is complex, with various agencies responsible for different aspects of drainage. To address the issues in the long term, we are working with councils and the Environment Agency to develop and implement surface water management plans in the areas affected. A multi-agency solution would, in many cases, help prevent rain getting into the sewers and ensure drains can better cope with high levels of rain in the future.

We are already investing to improve our network and will continue to do so as part of a partnership approach. In the short term, we allocated £4 million to help address some of the immediate flooding issues in the region. This included investigating public and private sewers with cameras to identify and seal leaks, thereby preventing groundwater from flooding the network, and upgrading pumping stations and sewers to cope with the increased flows.

During the year, we also invested nearly £500,000 to tackle flooding at the properties of more than 100 customers across the region.

Work continued on our £20 million scheme to radically change the Victorian sewer system in Portsmouth. The project will reduce the risk of properties in Portsmouth and Southsea being flooded by overflowing sewers, as well as protect water quality in and around Langstone Harbour. Since Victorian times, the sewers have carried both wastewater and rainwater in a combined system. The new network will include pipes that will carry only rainwater, which will be discharged into the sea to ease pressure on the sewers.

We also continued our £1.6 million investment in a scheme to reduce the risk of flooding at Milford-on-Sea in Hampshire, where sewers become overloaded in heavy rain. An underground tank, capable of holding up to one million litres of water, will store water during storms.

Preventing smells

With 368 wastewater treatment works and 2,360 pumping stations, it is important for us to be a good neighbour in the communities we serve.

We work hard to prevent smells from our sites and, during 2012-13, the number of complaints we received fell to 322, the lowest level recorded. Overall, complaints about smell have reduced by more than 60 per cent over the past 10 years.

During the year, we spent £470,000 on proactively maintaining odour control equipment at many sites, with particular focus on sensitive works, such as East Worthing in Sussex, and places where we received more than 10 complaints. We have adopted a practice of writing to residents, warning them of possible smells, if we need to carry out essential maintenance work.

Odour control equipment was upgraded at three of our treatment works: Aylesford and Paddock Wood in Kent and Goddards Green in West Sussex. Further upgrade work is under way at Peel Common in Hampshire and our new wastewater treatment works and sludge recycling centre at Peacehaven in East Sussex has state-of-the-art odour control equipment.

Protecting the environment

Bathing water quality

Every beach in our region met European standards for bathing water quality in 2012, despite the wettest year on record

All 82 of our bathing waters met the European mandatory standard during weekly sampling carried out by the Environment Agency between May and September. More than 70 per cent met the tighter guideline standard

The wet summer posed a risk for bathing water quality because run-off from roads and agricultural land can carry pollutants into streams, rivers and seas. We worked with a group called the Cleaner Seas Forum, led by Defra minister Richard Benyon, to take a lead on issues that affect coastal water quality

Under the revised Bathing Water Directive, new higher quality standards will be introduced for bathing water quality from 2015 and there will be a requirement to provide public information on water quality at all bathing water areas

We continued to take part in a voluntary trial to notify local authority beach managers, in as close to real-time as possible, of any stormwater releases from our combined sewer overflow pipes, which are pipes that release water from the sewer network if it becomes overwhelmed during very heavy rain. The number of sites involved was extended to 20 during the year, taking in Chichester and Brighton

Preventing pollution

	2012		2011
	Target	Achieved	Achieved
All pollution incidents (wastewater), Category 1-3	314	409	479
Serious pollution incidents (wastewater), Category 1-2	6	10	21
Discharge permit compliance	97.8%	96.8%	96.1%

There were fewer pollution incidents in the year despite the challenges of the wettest year on record in England. We recorded 409 incidents, a reduction of 14 per cent, while the number of serious incidents also fell by more than 50 per cent, from 21 to 10. Even so, the impact of the weather meant that we did not see the reduction we hoped to achieve

There was a 28 per cent reduction in incidents related to sewers or combined sewer overflows. The number of incidents fell from 200 in 2011 to 144 in 2012

We achieved the improvements following the implementation of an action plan to target our investment better, improve maintenance, provide extra training and review our alarms. This included a review of our sewer jetting programme and the introduction of Total Care Plans for more than 400 wastewater pumping stations. When there are incidents, a dedicated team ensures that any impact on the environment is minimised and instigates remedial and mitigation work if the affected sites do not recover quickly

During the year, we started work on an £8 million improvement scheme for East Worthing Wastewater Treatment Works in Sussex after a build-up of non-biodegradable debris blocked the flow into the works and wastewater was diverted into the sea via an emergency outfall

Nearly three-quarters of sewer blockages are caused by things that should not go down them. A number of pollution incidents resulted from sewer blockages caused by a build-up of fat. We targeted areas where

blockages are a problem and continued to highlight the dangers of pouring fat, oil and grease (FOG) down drains

Our work to keep sewers clear won the FOG Reduction Initiative of the Year category in the Water Industry Achievement Awards. The initiative was delivered in partnership with Work This Way, a charity which helps to rehabilitate offenders by employing them to recycle cooking oils into bio-fuels.

With other water companies and the Environment Agency, we reviewed the national guidelines on pollution reporting to ensure it is consistent. In future, this may be based on the impact of pollutions rather than the number. We reported 86 per cent of pollution incidents to the Environment Agency ourselves, the highest rate of self-reporting in the water industry.

Recycling waste

	2012-13		2011-12
	Target	Achieved	Achieved
Satisfactory sludge disposal	100%	100%	100%

We achieved our target to safely recycle 100 per cent of the solids left over after we clean and return the water from wastewater to our rivers and seas.

In previous years, we have dried most of this product to create a granular fertiliser, but we have changed our strategy because of rising energy costs and a drive to reduce carbon emissions.

We now produce more bio-solids, which are treated with lime and sold to farmers to be used as fertiliser on their land. The wet weather during 2012-13 made this more challenging because of the saturated land, but we were still able to meet our target of 100 per cent for satisfactory sludge disposal.

Caring for the environment

Southern Water's care for the environment is recognised in our on-going commitment to maintaining our certification to ISO 14001. Compliance with ISO 14001 helps us identify, manage and mitigate our impacts on the environment, prevent pollution, maximise efficiency savings and ensures that we meet environmental legislation.

Following our three-year re-certification in 2011, we again passed our annual five-day audit and were praised for "our notable enthusiasm to get things right, combined with a marked improvement in environmental awareness and housekeeping on the sites visited". The ISO 14001 auditors also recorded significant improvement in our management of chemicals, oils and environmental hazard documents.

We completed an updated 'risk list' for our water treatment works to be incorporated into our Asset Risk Management Scheme. This addresses an action by the ISO 14001 auditors to consider in more detail how we manage risk and considers our treatment works by the type of treatment they use and their impact on the environment. We also updated our Environmental Management System manual with guidance on how to tackle oil spills on our sites and new procedures to assess the environmental consequences of fire.

In addition, we introduced a new process to ensure we can thoroughly assess the merits of employees' environmental proposals for our sites – such as planting trees, enhancing habitats and setting up partnerships with conservation groups. This will ensure proposals comply with our health and safety standards, our daily operations and future plans.

The success of our on-going certification relies on all of our staff working to the same environmental principles and, during the year, the number of employees who successfully completed Environmental Management System training rose to 96 per cent.

Climate change

Carbon performance

	2012-13		2011-12
	Target	Achieved	Achieved
Greenhouse gas emissions – ktCO ₂ e	334	286	268

Although our carbon emissions increased slightly on the previous year, they were significantly below our target of 334 kilotonnes of carbon dioxide and other greenhouse gasses

We produced 286 kilotonnes of such gases in 2012-13 – beating our target by 48 kilotonnes, the equivalent of travelling 144 million miles in an average petrol car

The target is based on our projections of our emissions rising by 57 kilotonnes each year between 2010 and 2015 as we use more energy to treat water and wastewater to the more stringent quality standards set by the Environment Agency and to allow for the extra demands of population growth. We work continuously to mitigate these increases by generating more renewable energy and becoming more energy and water efficient. We are also exploring more holistic ways to meet the tighter standards through alternative methods which require less energy and emissions.

The record level of rain during the year resulted in an increase in energy use because we needed to pump and treat more water entering the sewerage network. An increase in energy use directly impacts on our emissions, so we worked hard on a number of energy efficiency initiatives to mitigate the increases and stay in line with our target.

We developed a model to assess the carbon impact of new schemes to upgrade our water and wastewater network in the future. The model calculates the carbon emission to construct the scheme and the on-going running costs. These calculations will help us become more aware of the levels of carbon in different materials and the relative carbon efficiency of different types of treatment. The model is being used to consider schemes for our 2015-20 Business Plan and will help us deliver lower whole life carbon solutions in the future.

We continued to hold the Carbon Trust Standard in recognition of our steps to measure and manage our carbon emissions. We also bought £2.8 million of carbon allowances in the Government's Carbon Reduction Commitment Energy Efficiency Scheme in which we were ranked second against other water and wastewater companies for the management of carbon emissions.

Renewable energy

We invested more than £4 million during the year to install additional Combined Heat and Power (CHP) plants at our wastewater treatment works in Peacehaven, Ford, Bexhill and Hastings in Sussex and at Sandown on the Isle of Wight.

The plants capture bio-gas produced during the wastewater treatment process and use it to produce energy to power the works, with any surplus exported to the National Grid. Heat recovered from engines and exhausts is used to warm the treatment tanks. This helps to speed up the digestion process and makes it more efficient.

The four new plants will help us reduce our carbon emissions by about 10,335 tonnes a year, equivalent to driving 31 million miles in an average petrol car. We now have 16 operational plants with a capacity to generate about 70 million kWh of electricity each year, about 15 per cent of our total electricity use.

We also increased the amount of renewable energy we generate by targeting the waste we treat at the plants which have the capacity to generate the most energy. Our CHP plant at Budds Farm in Hampshire generated enough renewable energy to provide all the heat needed for the treatment processes. In addition, we are investigating the possibility of injecting biogas into the mains gas network at five of our treatment works and exploring opportunities for large-scale solar power use.

Working more efficiently

Our daily work to supply water and recycle wastewater requires a lot of energy and we continually strive to work more efficiently to reduce our impact on the environment.

We use an aeration process to treat wastewater and this is energy intensive. During the year, we carried out feasibility studies into adding 'real time' controls that could reduce energy use by up to 20 per cent. The controls work by adjusting the process to deal with conditions in the works at the present time, rather than working to an overall average. We awarded contracts during the year to install the controls at two sites, with a further two in the pipeline.

More than 75 per cent of our energy consumption is for powering pumps and air blowers and we continued to test their efficiency at 100 of our largest works. This has helped us to plan a major refurbishment programme to gain optimum efficiency and reduce our carbon emissions.

Centrifuges used to reduce the amount of water in the waste we treat are also using 15 per cent less electricity thanks to changes in the way we operate them. We also planned trials to install more effective pumps at seven boreholes where we abstract water from underground aquifers.

Other initiatives during the year included pilots for more targeted use of chemicals to reduce the overall amount required and the introduction of CoPilot systems with Satnav technology for our meter readers to help them calculate the most efficient routes to take drive-by readings.

We also installed energy sensors at several pumping stations to detect when blockages happen so that the pumps automatically operate to remove the material creating the blockage. This reduces the risk of pollution and means that staff don't have to travel to the site to remove the blockage manually.

During the winter, the National Grid uses peak rates, known as Triad charges, to encourage users to reduce their energy consumption. We implemented plans to improve our Triad avoidance performance by switching off more plant and producing more power from our own generators.

Our contractors also found an innovative way to recycle off-cuts from plastic pipes into products such as bags and compost bins and to recycle sewer grit and screenings into compost, both of which would previously have gone to landfill.

Our future plans

Our long-term vision

We published our Strategic Statement for 2015-40 in stages between September 2012 and April 2013. This is a key document that sets out our customers' priorities for the next 25 years and how we plan to deliver them.

The statement is based on extensive research with our customers and stakeholders who reviewed each chapter as it was published. It looks at the challenges the water industry will face in the future and outlines six outcomes that customers say matter most to them. They are:

- A constant supply of high quality drinking water
- Removing wastewater effectively
- Looking after the environment
- Responsive customer service
- Better information and advice
- Affordable bills

The statement then considers the options available to us to deliver these long-term outcomes and which are the most cost-effective and sustainable.

Securing water supplies

Planning takes place 25 years in advance for how we will secure healthy, reliable water supplies for our customers. We updated our plans during the year and our draft Water Resources Management Plan (WRMP) for 2015-40 was submitted to Defra in March, ahead of a 12-week public consultation between May and August.

We conducted extensive customer research and held a series of workshops with stakeholders to explain the planning process and gain feedback on the options we are considering to secure a robust water supply network. This identified strong support for aquifer storage and recovery, water re-use, tackling leaks and water efficiency.

With the University of East Anglia and Newcastle University, we carried out pioneering work which enables us to understand the impact on customers of a wider range of droughts than we have previously seen. Typically, plans are based on historic rainfall data, the frequency and severity of past droughts and the impact this will have on water resources. We are piloting a planning process that not only looks at historic events but also generates a series of alternative events, for example, a continuation of the 1976 drought. This will improve the resilience of our water supplies and put us in a better position to cope with the challenges of changing weather in the water-stressed South East.

The investment required to supply water for the first five years of the WRMP is then included in the 2015-20 Business Plan for financing. During the planning process, we worked with other local water companies to develop a plan for the whole region. This will help to build a regional grid to transfer water supplies to areas where they are most under pressure.

We also updated our Drought Plan, which sets out how we would secure drinking water supplies for our customers during very dry periods. We held a public consultation on the plan and published a final version in February after responding to feedback and receiving approval from Defra.

During the year, we also took steps to meet the aspirations of the Water White Paper, the Government's vision for the future of the water industry. We took a lead role in engaging with our regulators in the development of a more sustainable water abstraction regime and explored initiatives to set up opportunities for trading water with other licence holders, such as farmers.

Five-year business plan

Every five years, water companies draw up their business plans, which set out how they will maintain and improve their services for customers and the associated costs

During the year, we started to develop our Business Plan for 2015-20, using the results of extensive research with customers and stakeholders on a wide range of issues. This process helped us identify the six long-term outcomes that customers want us to deliver. Our plans will set out the delivery of outcomes in the next five year period while, at the same time, addressing the challenges of the future, such as population growth and housing development, climate change and water industry reform

In February, the industry regulator, Ofwat, published a consultation on its approach to setting prices for water companies' business plans. The consultation confirmed that Ofwat expects companies to focus far more on engaging with their customers and stakeholders and delivering the outcomes they want. It also confirmed that Ofwat expects us to produce a single business plan with four elements: household retail services, non-household retail services, wholesale water services and wholesale wastewater services. Retail services include customer service, billing and meter reading while wholesale includes the operation, maintenance and improvement of our treatment works, pumping stations and pipe network

Our new Business Plan is due to be published in draft format in late summer 2013 for review and comment by customers and stakeholders. It will also be reviewed by our Customer Challenge Group, an independent body set up to ensure we reflect our customers' priorities in our plans. The final Business Plan will be submitted to Ofwat for approval in late 2013 under its Price Review 2014 (PR14). Ofwat will determine the investment we can make and the charges customers will pay in the five years ahead

Challenges for the future

The water industry faces many challenges in the future to balance the need to supply and safely recycle water at a price customers can afford while also protecting the environment

As we draw up our 25-year plans for the future, we are taking these challenges into account to ensure we can develop and maintain a resilient system for the 21st century. Among the biggest challenges we face are the effects of climate change and changing weather patterns

During the year, we experienced drought and water restrictions followed by the wettest year on record in England. We can plan ahead for climate change, but it is more challenging to predict the frequency of more extreme weather conditions. We want to take a more holistic approach which balances the demand to meet stricter standards with the need to keep customer bills and carbon emissions as low as possible

More housing and an increase in the population in the South East, in addition to more people living on their own, will put additional pressure on resources and we are working closely with the planning authorities to cater for their predictions of growth

We also need to ensure that we invest and work with others to comply with European legislation to deliver higher environmental standards. These might mean that we have to significantly reduce the amount of water we are able to take from rivers and underground aquifers to supply drinking water

The Water Framework Directive also calls for higher environmental standards to be met when recycling water. This could lead to a need for more treatment processes and increased costs, potentially adding up to an investment for us of £490 million over the next 15 years

Other key challenges include the rising cost of energy and its effect on the environment and climate change as well as the state of the economy, its impact on our customers and our ability to finance investments in the company. It is vital we take these challenges into account as we plan to deliver the water and wastewater services our customers have asked for over the next 25 years

We are listening

Consulting our customers

As a regulated monopoly and the provider of an essential service, we need to ensure that everything we do is in the best interests of customers

Hearing the views of our customers and the communities we serve is at the core of our future planning. During the last year, we carried out extensive customer research through more than 50 focus groups, online and phone surveys with thousands of customers, face-to-face interviews with nearly 100 customers and via a dedicated website www.swhaveyoursay.co.uk

In addition, we held more than 15 stakeholder workshops with representatives from councils, business forums, environmental groups, trade organisations, financial advice groups and other interested parties to understand their priorities. We also spoke to youth groups and organisations representing the elderly to ensure we heard the views of all our customers.

We talked to customers and stakeholders about the quality of their water, how we secure water resources for the future, how we recycle wastewater and how to tackle flooding. This has helped us to better understand the aspects of our service customers value most, the areas where they would like to see improvements and how much they would like to pay for improvements. We will continue talking to our customers as we develop and deliver our plans.

Working in partnership

We recognise that working in partnership with the communities we serve can bring wider benefits to our customers and help us provide a better service.

During the year, we engaged with organisations in the South East to help develop schemes to protect the quality of the water in our rivers, deliver water-saving advice to our customers, understand their financial difficulties and tackle the growing problem of flooding. We are also working extensively with other water companies to develop a regional water grid and plans for sustainable water abstraction.

We talked to river and wildlife trusts and the South Downs National Park Authority about developing catchment management schemes. By working to prevent nitrates reaching our water sources or helping to keep rivers flowing freely, we can preserve our water sources for longer while also protecting the environment.

Tackling flooding is a key issue and we worked in partnership with councils and the Environment Agency to develop plans to help reduce the risk of all types of flooding as more extreme weather patterns become increasingly common. We continued to work with the environmental charity Groundwork to offer water and energy saving advice to our customers as part of our metering programme. We also worked with Waterwise, the leading water efficiency organisation.

Our research to develop a social tariff to help customers who have difficulty paying their water bills was conducted with input from the Citizens Advice Bureau and we worked closely with Kent, Sussex and Hampshire Police to help protect our customers from bogus callers.

Our aim is to continue to develop strong and innovative partnerships across our region to help us deliver the services our customers want in the most cost-effective and beneficial way to our communities.

Customer Challenge Group

The Customer Challenge Group (CCG) for Southern Water met regularly during the year, offering feedback and advice as we developed our plans for the future

We set up the group as part of the process to develop our Business Plan and set price and investment limits for 2015-20. Anna Bradley, former Chief Executive of the National Consumer Council, is the independent chair of the group, which also includes members from the Consumer Council for Water, East Sussex County Council, the Environment Agency, Sussex Enterprise, Central and South Sussex Citizens Advice, the Drinking Water Inspectorate, Natural England, WWF and Waterwise

The group's purpose is to scrutinise, advise and challenge our customer engagement strategy and the way in which we interpret the feedback we receive. The group will report to Ofwat on the quality of our consultation and how well our customers' opinions have been reflected in our plan. We value the work of the CCG and intend to continue working with the group beyond the next price review.

The CCG held four meetings, six conference calls and a series of one-to-one meetings on key areas including the Water Resources Management Plan, investment strategy and retail strategy. The group has also issued a number of formal advice notes to the Board on our engagement, which are published on the group's website www.swccg.org.uk

Anna Bradley also visited a number of our water and wastewater works, a metering installation site and spoke at our Asset Conference on Customer Service and the Future of Utilities Conference in London.

Reform and competition

Reform in the water industry

We have seen a continued debate about reform and change in the water sector. As a major company in this sector, we want to play an active part in the debate and we will support reforms where the change is in the best interest of our customers.

The Draft Water Bill was published in July 2012. It outlines the changes required to bring competition to the retail market for commercial customers and reforms for the wholesale market, as set out in the Water White Paper, *Water for Life*, published in 2011. These changes sit alongside measures to encourage bulk trading of water between companies, extend the scope of the environmental permit regime to abstraction licences and make the costs associated with connecting new developments more transparent.

We responded to the Parliamentary Environment Food and Rural Affairs (EFRA) Committee to say that we did not believe the Bill sufficiently picked up the themes of the White Paper – such as resilience, climate change, population growth and sustainability – as strongly as it could have done. EFRA subsequently published its report on the Bill, making similar comments. We will continue to lobby for more focus on the resilience of water and wastewater services.

We are also keen to play a leading role in the development of an Abstraction Incentive Mechanism (AIM), abstraction licence reform and trading pools and are working closely with our regulators to work out the best way to develop real water trading mechanisms and reduce the abstraction of water from sites under environmental pressure.

Getting ready for competition

The publication of the Draft Water Bill during the year paves the way for retail market opening in the water industry from April 2017. From this date, all businesses and public sector bodies in England will be able to switch their water and wastewater suppliers, improve their efficiency and tender for services best suited to their individual needs. The Bill also potentially opens up a market for wholesale water supply services further down the line.

Our economic regulator, Ofwat, will now set separate price controls for retail and wholesale activities for 2015-20. Our Business Plan, therefore, will cover our retail activities, such as billing and answering customer calls, and our wholesale activities, supplying water and recycling wastewater.

In order to achieve this, Ofwat needed to modify water company licences. A number of proposals were brought forward by Ofwat in 2012 to increase regulatory flexibility over how it sets price limits in the future. Changes have now been agreed which provide the basis for evolutionary change to the regulatory regime, with increased flexibility for Ofwat in how it can set retail prices but not wholesale prices at this stage.

We think it is both healthy and inevitable that the water industry evolves. However, we felt the first proposals created too much uncertainty. The industry continues to need to raise significant debt to finance investment programmes. If lenders think that the uncertainty has increased, this will mean higher borrowing costs and higher customer bills.

We are in favour of introducing retail competition for business customers and are committed to delivering more and better services for them and are working towards the April 2017 date.

There are no current plans to introduce competition for households. The Government's assessment is that the costs of introducing competition into the household market at this time would significantly outweigh any benefits.

Our workplace

Health and safety

We achieved our best health and safety performance during the year and improved on 2011-12, which was our previous record for the lowest number of safety-related injuries

This achievement included our lowest rate of 0.20 RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations) injuries per 100 full-time employees and key contractors. We also had a three-month period with no incidents for our staff.

For the fifth year running, we were presented with the Royal Society for the Prevention of Accidents (RoSPA) President's Award. This is given to companies that demonstrate outstanding performance in health and safety at work by achieving 10 or more consecutive RoSPA Gold Awards. We reached the Gold RoSPA standard for the 14th year in a row and several of our contractors were also recognised with RoSPA awards.

More than 100 people attended our health and safety conference for office-based staff. The conference, which focused on health and well-being, was supported by a range of partners, including local NHS trusts and the British Heart Foundation. About 200 employees and contractors also attended a supply chain conference on innovation, working together and sharing best practice.

During the year, we played a key role in developing a national Safe Dig Charter, which we and our main contractors signed up to. The charter outlines seven steps to help reduce the risk of damaging underground utility services during excavations.

We continued our Aim for Zero Injuries campaign, with £2 donated to charity for every near miss or hazard reported by staff and contractors. The challenge raised nearly £14,000 for Air Ambulance trusts in the region. This equates to about 16 potentially life-saving missions by the air ambulance crews.

Our people

At 31 March, we employed 2,092 people across our region, including 38 apprentices and 527 staff in our two Sussex-based call centres. Indirectly, we support more than 2,000 jobs through our current capital investment programme.

We are committed to developing our staff and invested the equivalent of £1,325 per employee in training during the year to support them in their roles.

As part of our strategic initiatives to develop the skills of our managers, 54 employees took part in our Leaders for Tomorrow course and another 60 received training in project management. Both schemes are approved by the appropriate professional bodies and successful candidates receive an accredited qualification. In addition, more than 200 staff are scheduled to take part in customer service training to help improve our performance in this area.

Seventeen apprentices graduated from our award-winning scheme at our Apprentice of the Year ceremony and 12 more were recruited into new water supply and distribution schemes. Thirty-two people also took part in our week-long Employee Development Programme, which ran for the 43rd time in 2012.

In addition to training and development, we maintained our focus on helping to make our company a better place to work, supported by 150 employee engagement champions. In new initiatives, more than 160 nominations were received in the first Southern Water STAR (Staff Thanks And Recognition) Awards and a choir was formed, bringing together people from across the company.

Seventy-two per cent of staff responded in our annual employee survey, the highest since it began in 2003. The results showed a 1.5 per cent increase in the level of staff engagement compared with last year, a positive step as we aim to appear in The Sunday Times' Best Company to Work For list.

More than 1,600 staff were also updated on progress against the company's targets and our aims for the future in a series of half-day presentations led by our Executive Management Team

Our suppliers

We secured new suppliers and reviewed contracts with our existing ones to help us provide an even more cost-effective and efficient service for our customers

This builds on the Multi-Services Framework agreements awarded in 2009 to deliver our core utility services between 2010 and 2015. These contracts were awarded to Clancy Docwra, Morrison Utility Services and Barhale Trant Utilities. We also have a four-year contract with Dyno-Rod following the adoption of private sewers to our network and a Single Entity Contract (SEC) with 4Delivery for improvements to treatment works across our region.

During 2012-13, we awarded a contract to our key supplier Tata Consulting Services to develop and upgrade our billing system. A three-year leak detection contract was awarded to two partners, PN Daly and RPS, with whom we developed a new and improved leakage strategy. This will provide better value for our customers and help us maintain our industry-leading record on fixing leaks.

We continued our partnerships in India, where we now have eight suppliers in 10 cities. Our main supplier in India is Wipro, a leading global IT service, which provides round the clock services for the company and monitors our IT network and telemetry. We also have Business Process Outsourcing agreements with RRD and Wipro to provide support for our customers' written enquiries, including billing, and also HR, finance, data management, reporting and engineering design.

We developed our engagement with our supply chain with the support of trade associations. They included British Water and the Civil Engineering Contractors Association (CECA), who are helping us gain the maximum benefit from our suppliers to provide a better customer service.

A workshop took place with 30 contract partners during National Customer Service Week to promote a customer-centric attitude to everyone who represents our company. Our contractors are encouraged to focus on engaging with customers before and after their work, maintaining good site management, being polite and courteous and showing attention to detail.

We also continued to work in partnership with our suppliers to maintain our excellent health and safety record and to support our community and charity initiatives.

Our community

Community campaigns

We want to play a positive role in the communities we serve and we do this through a number of initiatives

They include our Learn to Swim scheme, which celebrated its 20th anniversary in 2012, and has helped to teach more than 600,000 children this life-saving skill since its launch in 1992. To celebrate the anniversary in Olympics year, former World Champion swimmer Karen Pickering MBE led swim clinics for aspiring future competitors

Our two annual achiever events recognised children who have shown courage and commitment in learning to swim while our annual swimming instructors' seminar was attended by 145 teachers and guests. The key speaker was the head coach of British swimming Bill Furniss, who coached Rebecca Adlington to Olympic gold medal success

During the year, a further 38,000 children learned to swim at 85 pools across our region. The scheme, which won the Community Initiative of the Year category in the 2012 Utility Industry Achievement Awards, is sponsored by our suppliers Morrison Utility Services, Clancy Docwra, Barhale Trant Utilities and 4Delivery

We continued our sponsorship of the South and South East in Bloom competition, which received a record 329 entries, including 96 from schools. The horticultural competition, which is championed by celebrity gardener Chris Collins, promotes sustainable gardening and water efficiency

Children also learned about water and water for health while keeping fit through our Sporting Chance programme with partners Sussex Cricket Club, Kent Girls Cricket, Gillingham FC, Southampton FC, Portsmouth FC and Brighton and Hove Albion FC. Together with our STEM (Science, Technology, Engineering and Maths) and Kent Walk to School projects, we reached more than 35,000 children

Lifelong learning

Education is at the heart of our community work, particularly with young people who will become customers in the future. Many of our education initiatives focus on water efficiency, the supply of water and how we can protect our environment from pollution caused when fat, oil and grease are poured down drains

Following the extremes of dry and wet weather during the year, we updated our Waterwise community and school talks to address the issue of more unreliable weather patterns. Eighty talks were given to an audience totalling 4,787 and 10 more of our staff were trained to join our team of volunteer speakers. We also distributed Waterwise activity packs and awarded badges for completing the tasks inside to 62 groups, totalling 2,064 children

In primary schools, 4,848 children watched 29 performances of our Drips mime show, which emphasises the importance of using water wisely. In secondary schools, our award-winning Aqua Innovation programme was delivered in 10 schools and a further 10 were recruited for the new academic year. Pupils are asked to use design, innovation and creativity to come up with water-saving ideas. Last year's winners, Bitterne Park School in Southampton, invented a device called Mr Mister, which turns a shower's water flow into a mist for washing and back to normal for rinsing

We took part in interactive water workshops for more than 1,000 children from 22 schools during Crawley Junior Citizen Week. A further 1,000 children learned about water efficiency at a Junior Citizen Week in Horsham

During the year, we recruited 20 new volunteers to become STEM (Science, Technology, Engineering and Maths) ambassadors to work with pupils in schools to share the skills they use daily at work. Members of staff also signed up as volunteers with Young Enterprise, a national charity that works with industry to inspire young people to set up and run their own businesses

We toured the region with our Water Café, reaching more than 14,000 people at 16 events where we gave advice on water efficiency and the dangers of pouring fat, oil and grease down drains

Nearly 300 children took part in nine theatrical workshops we ran in partnership with the Brighton Theatre Royal, delivering water-saving messages in schools. We also teamed up with meals-on-wheels providers to encourage elderly people to drink more water

We worked with three other water companies to host a Climate Calm garden at the 2012 RHS Chelsea Flower Show. The garden of the future, able to cope with the extremes of weather, was featured extensively in national and international media and seen by thousands of visitors who followed an online blog. We also launched a Wrap Up For Winter campaign in partnership with water efficiency organisation Waterwise, Channel 4 and the Met Office

A new award-winning partnership was launched with Nickelodeon UK and GabiH2O, a company established to help deliver water efficiency messages to schoolchildren. The campaign, which uses a rapping TV cartoon camel, includes a resource kit for teachers to download so that the water cycle can be taught to Key Stage 2 children

Charity support

Southern Water has a long-standing ethos of giving back through charity fund-raising and we raised and distributed more than £190,000 to good causes during the year

The charities we support are chosen by our staff and included the NSPCC, Macmillan Cancer Support, Cancer Research UK, WaterAid, RNLI and Help for Heroes. Locally, we supported the Air Ambulance organisations, Chestnut Tree House Children's Hospice, St Barnabas Hospice and AAIR (Asthma, Allergy and Inflammation Research)

We raised £60,000 at our Moulin Rouge-themed annual charity ball, £35,000 at our sixth annual horseracing day – which was attended by more than 4,000 people – and £11,000 at our annual WaterAid golf day. All of the events were supported by our suppliers. Other charity activities included Wear a Santa Suit to Work day, monthly Dress Down days and the inclusion of an RNLI fund-raising leaflet with our annual bills

We also made 56 small donations worth more than £9,500 to community organisations, schools and to support staff fund-raising initiatives

Our staff spent 308 days helping community projects as part of our Community Volunteering Programme. The scheme allows staff to take two days' paid leave each year to volunteer their services for charities, community organisations or environmental work

Conservation

Our work to supply water and recycle wastewater is central to the environment and we take great care to conserve habitats and protected species. We completed a number of conservation projects during the year, both in partnership with specialist organisations and in association with construction work

A £1.5 million scheme in Hastings, East Sussex, to prevent flooding and pollution in the Gill stream involved installing new surface water pipes and required particular care. The Gill woodland supports wildlife habitats and is a designated Local Nature Reserve, Site of Importance for Nature Conservation and Ancient Woodland. Our work, agreed with Natural England, was designed to cause minimum disruption to the wildlife and the pipeline route was adapted to avoid trees covered by a Tree Protection Order. Some stretches were dug by hand to avoid damaging roots

Conservation work on our own sites is just as careful. We have created protective islands for rare orchids, which are flourishing on our land in ever-increasing numbers thanks to our proactive land management and the wet weather. The rural location and chalky soil of many of our sites make ideal habitats for bee orchids

and we have developed a catalogue of where they are in order to ensure we maintain the land to support them

Our Testwood Lakes site, near Southampton, is managed on our behalf by the Hampshire and Isle of Wight Wildlife Trust. The Trust continued to manage the woodlands, hedgerows, grasslands, lakes and ponds in the third year of its 10-year Higher Level Stewardship scheme, promoted by Natural England. The Friends of Testwood carried out a considerable amount of the practical conservation work to improve the site, including controlling alien plants and maintaining the sand martin bank, tern rafts, fencing and the dry and sensory gardens. Although breeding birds were affected by the wet weather, 130 species were recorded on the site, including a record nine species of birds of prey on one day.

Elsewhere, we undertake biodiversity and habitat improvement work where our operations have a negative impact on the environment. When Tilmore Brook at Petersfield in Hampshire was polluted by sewage, we installed flow detectors and created a backwater area to provide a refuge for fish and invertebrates in dry, summer months. We also reviewed our operations to prevent environmental damage in the future.

At the Knepp Castle Estate at Shipley in Sussex, we helped to plant more than 1,000 trees as part of a project to restore one of the rarest habitats in the county. We also launched a Southern Water Conservation Volunteers' Group to work with organisations such as the Sussex, Hampshire and Isle of Wight and Kent wildlife trusts and the Sussex Amphibian and Reptile Group. Projects will include clearing invasive species from riverbanks, coppicing woodland, carrying out beach cleans and conducting surveys.

During the drought, water conservation was especially important and we teamed up with Medway Council in Kent to reuse water to nurture plants and trees. The water was used during our Chatham mains replacement scheme, which involved disinfecting pipes in chlorinated water. Instead of being wasted, the water was collected by the council and used for watering.

Water butts were given to community groups to support conservation projects as part of our on-going campaign run in partnership with Eco-Faith and the Wildfowl and Wetland Trust Arundel Wetland Centre, adding up to savings of 25,000 litres of water.

Our work to consider our neighbours, the environment and our staff at construction sites was again recognised in Considerate Constructors Scheme National Site Awards. Six of our sites were given awards, including our £300 million scheme to bring cleaner seas to East Sussex.

Access and recreation

Hundreds of thousands of visitors enjoy the great outdoors each year at Southern Water sites and learn more about water, wildlife and the environment.

Bewl Water in Kent is the largest reservoir in the South East and hosts a range of recreation and leisure activities. More than 150,000 people visit the reservoir each year to take part in activities such as windsurfing, sailing, fishing, cycling and walking. During 2012, we produced a new visitor information leaflet in conjunction with South East Water, which also takes water from the reservoir.

Our Testwood Lakes site in Hampshire is popular with schools, community groups, walkers, birdwatchers and nature-lovers. About 25,000 people are estimated to have visited the Lakes during the year with more than 3,000 children and adults taking part in education programmes and sessions. The education centre extended its opening hours to include every Saturday and Sunday afternoon while access to it was supported by planning permission to lay a tarmac path from the main visitors' car park and the installation of a Mobility Buggy store.

Car parks, walks and outdoor activities are also available at our Darwell and Powdermill Reservoirs in East Sussex, while fishing, sailing and a Millennium Walk can be enjoyed by visitors to Weir Wood Reservoir in West Sussex.

Visitors can see water heritage pumping machinery, cared for and displayed by Brede Steam Engine Society, at our water treatment works at Brede in East Sussex. The society opens the museum on the first Saturday of the month for enthusiasts to learn about steam power.

Our waterworks site at Twyford, near Winchester, is home to an Edwardian pumping station and is also open to visitors on certain days of the year.

Our tours of the Victorian sewer network in Brighton continued to be popular with more than 1,500 people taking part during the year. The tours offer a unique glimpse into an otherwise unseen subterranean world built 150 years ago. Online booking was introduced as part of our new sewer tours website, which attracted more than 8,000 hits during its first season.

Above ground, we joined forces with Visit Kent, Thanet District Council and local businesses to promote the area's beaches and extend the traditional tourism season. We supported a series of community events and Active Coast, a campaign to bring visitors to the area to take part in sports, cycling and walking.

Pupils from 10 schools in our region enjoyed educational tours of our water treatment works and meter installation sites to find out where water they use comes from. The trips were part of their participation in our Aqua Innovation education programme for secondary schools.

A disused country footpath was given a new lease of life at Otterbourne in Hampshire. The path, which runs along the perimeter of our offices and down to the River Itchen, was renovated as part of a project to commemorate the Queen's Diamond Jubilee.

Financial performance

Financial performance

Accounting policies

The accounting policies of the company, which are consistent with the prior year, are set out on pages 70 to 74

Profit and loss account

The profit and loss account of Southern Water Services Ltd is summarised in Table 1 below

Table 1	Years ended 31 March		Change
	2013 £m	2012 £m	%
Turnover	778.7	716.2	8.7
Operating costs	(239.4)	(240.6)	(0.5)
Depreciation	(213.4)	(204.1)	4.6
Other income	5.1	0.1	-
Operating profit	331.0	271.6	21.9
Profit on disposal of fixed assets	1.0	1.2	(16.7)
Net interest	(152.9)	(187.9)	(18.6)
Profit before tax	179.1	84.9	111.0
Tax	(22.2)	(5.0)	344.0
Profit after tax	156.9	79.9	96.4

Turnover increased by 8.7 per cent to £778.7 million (2011-12 £716.2 million) principally because of the average tariff increase on metered and unmetered income of 8.8 per cent as a result of the annual RPI increase of 5.2 per cent at November 2011 together with the K factor allowed by Ofwat of 3.6 per cent. Water consumption during the year fell by approximately four per cent as a result of the hosepipe restrictions that were put in place in April 2012 as a consequence of the drought and also the wet weather that was subsequently experienced over the summer. The lower consumption reduced income by approximately £12 million and this reduction was largely offset by income from properties previously believed to be empty and for which occupiers have now been identified and charged.

Operating costs reduced by 0.5 per cent to £239.4 million (2011-12 £240.6 million) and the major reasons for this movement of £1.2 million are explained in Table 2.

Table 2 Increase/(decrease) in operating costs	£m
Inflation	9.8
High ground water levels (tankering and pumping)	3.2
Power consumption – drought and water volumes	3.1
Compliance related costs	3.4
Pension curtailment	(9.0)
Targeted efficiencies	(11.7)
Movement in operating costs	(1.2)

The targeted efficiencies have been achieved through business process reviews, contract renegotiations and a focus on maintaining tight budgetary controls. This includes reducing the work issued to external contractors through more efficient use of our own internal resources and reduced chemical usage.

During 2012-13, we undertook a comprehensive review and consultation process relating to the final salary pension scheme, which resulted in the implementation of significant changes to the scheme to ensure its long-term sustainability. This resulted in a non-cash curtailment gain of £9 million in 2013.

Depreciation increased by 4.6 per cent to £213.4 million (2011-12 £204.1 million) as a result of the continuing significant capital investment programme and an increase in the infrastructure renewal charge, reflecting the greater level of capital expenditure on infrastructure assets.

Other income increased by £5.0 million for services provided in the disposal of an investment in Veolia Water Southeast Ltd held by another group company.

Operating profit for 2012-13 increased to £331.0 million (2011-12 £271.6 million), a 21.9 per cent improvement as a result of the factors set out above.

The profit on disposal of fixed assets of £1.0 million (2011-12 £1.2 million) mainly relates to the sale of land and buildings surplus to operational requirements.

Net interest payable of £152.9 million reduced by 18.6 per cent (2011-12 £187.9 million). This reduction principally related to lower non-cash interest associated with inflation on index-linked bonds as a result of lower RPI applicable during 2012-13. It also includes reductions in interest payable following the repayment of part of the preference shares offset by an increase in the non-cash financing charge on the pension deficit.

The tax on ordinary activities of £22.2 million (2011-12 £5.0 million) reflects the increase in profit before tax and the impact of changes made to the future taxation rate on the deferred tax liability as described in note 8.

The profit after taxation for the year amounted to £156.9 million (2011-12 £79.9 million).

Cash flow statement

Net cash inflow from operating activities increased to £499.8 million for 2012-13 from £487.1 million in 2011-12. This increase mainly reflects the higher operating profit as described above offset by an increase in working capital. The increase in working capital was expected and is mainly attributable to the increase in turnover (which increases the value of debt relating to any current year), the roll out of our metering programme (which delays the timing of billing to customers compared with unmetered customers) and an outstanding payment in respect of the disposal of its investment in Veolia Water Southeast Ltd.

The net cash outflow from returns on investment and servicing of finance increased to £81.8 million for 2012-13 from £80.7 million in 2011-12. This increase results from lower interest receivable on cash balances and

additional interest payable, which arises from the impact of inflation on the underlying nominal values of a number of our loans

A tax payment of £13.7 million (2011-12 £14.8 million) was made to Southern Water Services Group (SWSG) as group relief for taxable losses. This, together with the interim dividend of £43.2 million (2011-12 £42.1 million), is offset by interest received from SWSG of £56.9 million (2011-12 £56.9 million). No other ordinary dividends were declared or paid during the year.

The outflow of cash relating to the purchase of tangible fixed assets was £360.1 million (2011-12 £466.0 million). The reduction in cash outflow results from the timing of the overall capital programme, with the biggest reductions being the completion of projects to improve water quality in 2011-12 and the completion of major construction in relation to our Brighton and Hove project which is now being commissioned.

The net cash outflow before financing in 2012-13 was £215.4 million (2011-12 £127.1 million).

In preparation for the refinancing of the Class B £250.0 million loan in March 2014, a new bond for £250.0 million was issued in March 2013. This new bond, along with the drawdown of an existing capital facility of £50.0 million to support the financing of the capital programme and the repayment of part of the mezzanine debt, £15.4 million, resulted in a net cash inflow from financing of £279.9 million (2011-12 £30.5 million).

Balance sheet

At the end of the year to 31 March 2013, we had fixed assets of £4,293.5 million (2011-12 £4,138.7 million), an increase of £154.8 million from March 2012. This increase largely results from capital investment of £380.0 million offset by depreciation of £216.2 million.

Following the new bond issue in March 2013, the £250.0 million funds raised were transferred to Southern Water Services (Finance) Ltd in preparation for the repayment of the Class B £250.0 million loan. As a result, debtors falling due within one year increased from £163.5 million to £416.6 million at 31 March 2013. Creditors falling due within one year increased to £505.9 million from £250.6 million to reflect the timing of the Class B loan repayment.

As at 31 March 2013, creditors falling due after one year increased by £101.0 million to £3,767.5 million. This increase principally resulted from inflation on index-linked bonds of £77.5 million together with the drawdown of an existing capital facility of £50.0 million offset by the repayment of an inter-company creditor.

The net pension deficit increased in value to £72.1 million (2011-12 £69.7 million) following the latest actuarial valuation, as described in note 22.

Overall net assets increased from £806.7 million to £914.3 million.

Dividend policy

Dividends are proposed with due regard to the following constraints:

- 1 Assessment of headroom under debt covenants
- 2 Assessment of the impact on the Company's credit rating
- 3 Assessment of the liquidity position and ability to fulfil licence conditions
- 4 Assessment of key areas of business risk
- 5 Assessment of current year and cumulative distributable reserves
- 6 Directors duties under law and Ofwat administered regulatory arrangements

Distribution proposals submitted to the Board will also include an assessment of our performance against the business plan, including expected performance over the balance of the regulatory period.

These tests are not applied to the interim dividends paid to SWSG as the dividend payment is instantly offset by a corresponding interest receipt from SWSG.

No other ordinary dividend was paid or declared in relation to 2012-13 (2011-12 nil), and no dividends were paid to the shareholders of our ultimate parent company Greensands Holdings Limited

Taxation

Since privatisation in 1989 there has been a requirement for large capital investment programmes in order to upgrade our asset base and invest in improvements to our environment. As a result the taxable profits are lower than the accounting profits due to capital allowances arising from this capital programme.

We continue to pay business rates, environmental charges, PAYE and National Insurance on employees' salaries and these amounted to £52.7 million in 2012-13. Our expenditure with suppliers and contractors also generates a substantial amount of tax revenues in the wider economy.

Financial KPIs

Under our financial debt structure, there are a comprehensive set of covenanted financial ratios. Of these, there are two key ratios, namely the ratio of net debt to Regulatory Capital Value (RCV) and the ratio of adjusted cash income to net interest cost.

The net debt used in the net debt/RCV ratio is calculated from our Regulatory Accounts as short and long-term senior borrowings, less cash and short-term deposits. The RCV for each year is set by Ofwat for five-year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of senior debt to RCV is targeted to be maintained at below 85 per cent, in line with our debt covenants.

Senior adjusted cash interest cover (measured as net cash inflow from operating activities less Current Cost Depreciation and the Infrastructure Renewals Charge, to senior debt interest) is targeted to be maintained above 1.1 times, to meet covenanted levels.

Net debt: RCV	%	Senior adjusted cash interest cover	Times
2009-10 performance	80	2009-10 performance	1.5
2010-11 performance	81	2010-11 performance	1.4
2011-12 performance	81	2011-12 performance	1.6
2012-13 performance	79	2012-13 performance	1.5
Covenanted lock-up level	<85	Minimum target trigger level	1.1

Credit rating	
Moody's corporate family rating	Baa2 (negative outlook)

Capital structure

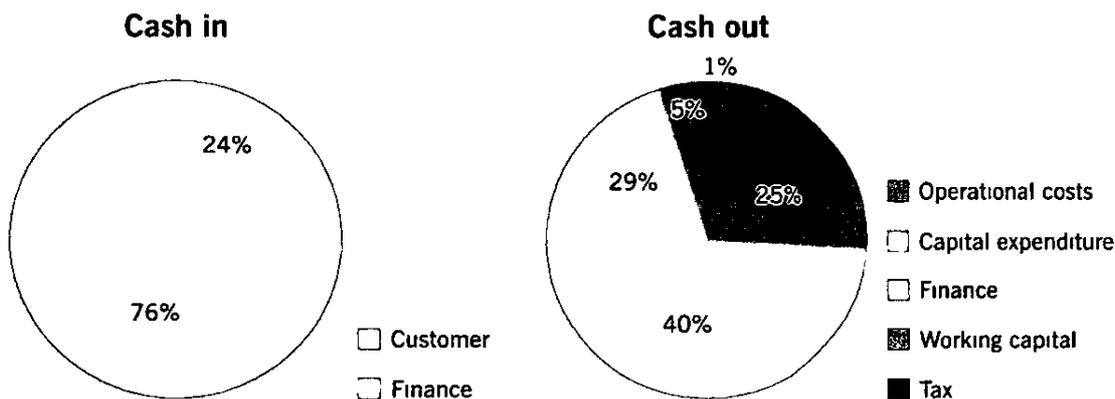
Why Southern Water raises finance

Significant capital investment programmes have been a feature of Southern Water's business since privatisation in 1989. We have invested in both maintaining our asset base and constructing new assets to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population growth in our area of operation. As an example, prior to privatisation, wastewater discharged into our coastal waters was untreated, but the planned completion of our £300 million Cleaner Seas for Sussex scheme in 2013 will mark the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight.

We raise new finance to pay for the construction of new assets. As a shareholder-owned company, we are incentivised to drive efficiency and have shareholder equity to absorb financial risk and contribute to financing the construction of new assets. New finance is also required to repay loans taken out in previous years.

The level of customer charges is set to cover our operating expenditure, our annual financing costs (including dividend to our shareholders) and the amount required to maintain our assets, such as water pipes, sewers, pumping stations and treatment works.

The charts below illustrate expected cash flows for the current regulatory period from April, 2010 to March, 2015. The data is based upon the regulatory price determination, which sets out our obligations and limits for customer charges for this current five-year price period.



Capital structure and borrowing covenants

We refinanced our regulated business in 2003 with the aim of reducing our cost of capital and gaining access to long-term secure sources of finance. This was achieved by replacing a short-term parent company loan with a long-term framework for sustainable future financing.

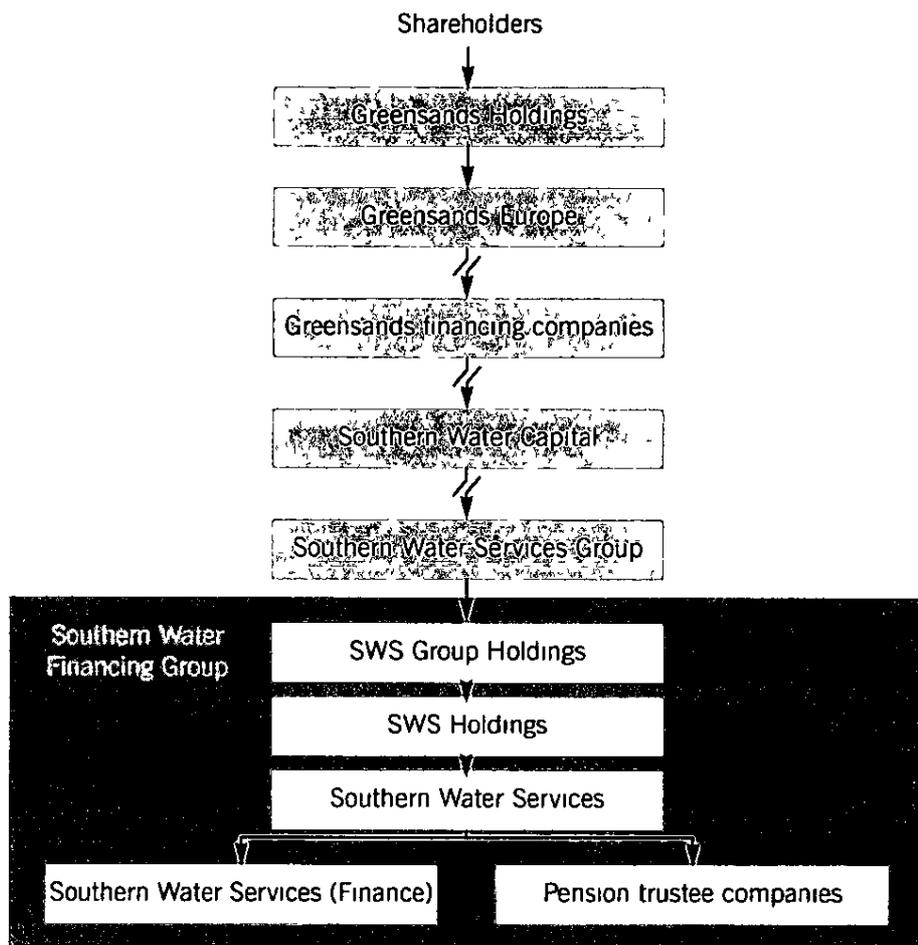
Our financing subsidiary Southern Water Services (Finance) (SWSF) was established for the express purpose of raising finance on our behalf. The Southern Water Financing Group (see ownership chart below) was also established at that time to create a financial ring-fence to protect our ongoing operation. The immediate parent company of the financing group is Southern Water Services Group (SWSG).

The financing group also provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings (SWSGH). No security is provided over our individual regulated operating assets. This structure ensures that, in the unlikely event that either Southern Water or SWSF were to default on its debt obligations, we will continue to operate our business as usual. Debt providers are not permitted to either break up or interrupt our business and are therefore likely to look for a new owner of the financing group to recover their debt in the unlikely event of default.

In 2003, a Common Terms Agreement (the CTA) between the members of the financing group and its debt investors was established. The CTA set out arrangements for the ongoing management of our debt issuance programme and sets out a number of operating arrangements in order to minimise financial risk and adhere to good industry practice.

One of the CTA arrangements is a limit on the indebtedness of Southern Water and SWSF. This limit includes precautionary 'early warning' limits, which prevent us from paying dividends. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the 2003 refinancing.

Southern Water ownership structure



Greensands Holdings is the ultimate parent company of Southern Water and all other group companies, with no minority interests. A number of Greensands companies were set up to finance the acquisition of the share capital of Southern Water Capital (SWC) from the Royal Bank of Scotland in October 2007 (investing £1.9 billion of equity and debt to finance the acquisition). The shareholders of Greensands Holdings are a consortium of infrastructure funds and pension companies, with no single shareholder having majority control. The principal investors are Australian pension funds, a fund advised by JP Morgan Asset Management and a fund advised by UBS Global Asset Management.

Shareholders of Greensands Holdings are represented on our Board through two of six non-executive directors. The other four non-executive directors are independent of the shareholders. The remaining directors are a non-executive Chairman, the Chief Executive Officer and the Chief Financial Officer. Find out more about them on page 53.

Our Chairman is also independent Chairman of the Greensands Holdings Board, which meets four times a year. No other independent members of our Board sit on the Board of Greensands Holdings.

All companies within the Greensands Holdings group of companies are UK resident for tax, with all profits and losses falling within the UK tax jurisdiction.

How we finance the business

Note 16 to the financial statements provides an analysis of our outstanding debt at 31 March 2013 and 31 March 2012. The majority of our loans are sterling bonds issued and listed on the UK Stock Exchange. The regulatory framework, under which revenues and the RCV are indexed, exposes us to inflation risk. This risk is managed through the use of index-linked loans and derivatives within the overall debt portfolio (note 16).

We are not restricted to issuing sterling bonds, but will ensure that any other currency loans are fully hedged back to sterling. We also hedge our exposure by ensuring that at least 85 per cent of our outstanding debt liabilities (in respect of Class A and Class B debt) is either index-linked or fixed rate for the current regulatory period and at least 70 per cent in the next period (on a rolling basis).

We also consider refinancing risk by ensuring that loan maturities are not concentrated in any single year or regulatory period. When issuing new loans, we test that refinancing obligations are less than 20 per cent of RCV in any two consecutive years and 40 per cent of RCV within any five-year regulatory period. The maturity profile of loans range from within one year to March 2056, which ensures we comfortably meet this test.

Southern Water ensures that sufficient liquidity (cash and committed bank facilities) is in place to fund the business for at least the next 12 months, an important consideration given that we have negative cash flow generation in the majority of years as a result of our ongoing capital investment programme.

During the year ended 31 March 2013, SWSF issued a £250 million sterling bond listed on the UK Stock Exchange and we also increased a bank loan from £100 million to £150 million while extending the term of the loan to June 2017. The £250 million proceeds of the new bond issue will be used to repay an existing loan due in March 2014 and has been deposited with SWSF so that the cash is available to repay the maturing loan. The additional £50 million loan proceeds will be used to invest in the construction of new assets.

We also maintain a £200 million committed bank credit facility, which is used as a liquidity buffer and was undrawn at 31 March 2013 and 31 March 2012.

As a result of our liquidity policy, SWS can have large cash balances. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits with any bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody's), A1 (Standard & Poor) or F1 (Fitch). Funds must be AAA rated. These are the most secure ratings.

In addition to our loans (analysed in note 16), we have a loan of £812.3 million that was issued to SWSG as part of the refinancing in 2003 (note 14). We receive £56.9 million annual interest on this loan, which is financed by dividend and tax payments we make to SWSG. For the year ended 31 March 2013, the dividend was £43.2 million and the tax payment, for the taxable losses at SWSG, amounted to £13.7 million. This loan provides no tax benefit to either us or the Greensands Group, with the tax payment from Southern Water to SWSG simply negating any tax effect of this loan. This is illustrated in figure 1 below.

The Greensands companies also have their own loans: a UK listed bond and bank loan issued by Southern Water Greensands (Financing) (SWGF), represented in the tables as Greensands financing companies, and Eurobonds issued by Greensands Europe. The UK listed bond and bank debt issued by SWGF result in tax deductions which can be used within the Greensands Holdings group of companies. All companies within the Greensands Holdings group are UK tax resident and form a single 'family' of companies for UK tax purposes.

Figure 2 below highlights cash flow movements between Southern Water and the Greensands Holdings group of companies for 2012-13.

Interest and dividends payments 2012-13

Figure 1

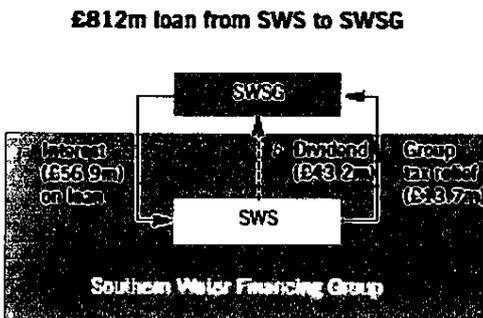
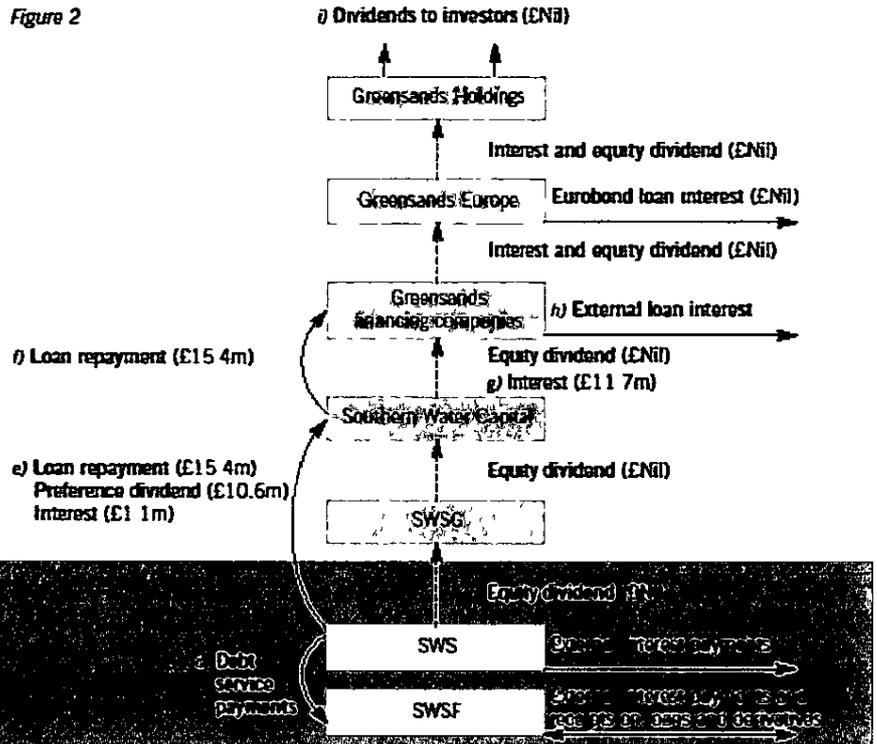


Figure 2



Footnote-

- a) Interest paid by SWSG to SWS on £812.3m loan.
- b) Dividend paid by SWS to SWSG.
- c) Payment of group tax relief by SWS for the taxable losses at SWSG.
- d) Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.
- e) Repayment of the mezzanine debt (see note 16) and associated interest and interest payments on the preference shares.
- f) Repayment of an intercompany loan.
- g) Interest payable on an intercompany loan.
- h) External interest payable, funded from interest receivable, loan repayments and cash held in the Greensands financing companies.
- i) No dividends were paid to investors.

Risks

In order to provide a reliable and consistent service for our customers, it is important we recognise and monitor risks to our business

We ensure controls are in place so we can take action to minimise the impact of these risks. To do this, we manage risks through a central database where they are ranked and assigned to a senior manager who is responsible for implementing mitigation plans

Risks are reviewed each month and the highest are escalated to our Executive Management Team, the Board and the Audit and Risk Review Committee. Any new risks added to the database with a score above a certain level are passed to a director and Chief Executive Officer for immediate review. Key risks during the year included

Regulatory reform: During the last two years, there has been a significant focus on reform within the water industry. This has included the Government's Water White Paper and Ofwat's Future Price Limits, which focus on changes to the way customer prices are set, the introduction of competition and a greater use of market mechanisms to promote innovation and efficiency. Our economic regulator, Ofwat, is continuing to review and revise the regulatory regime to ensure it is fit for the challenges of the future, including changes to water company licences

Mitigation: We have continued to engage constructively with Ofwat and Defra on the proposals for reform. We are also working with Water UK to ensure that any changes deliver better, more effective, regulation in the interests of our customers and the business. An example during the year was a proposal by Ofwat to make changes to water company licences. Following substantial and positive dialogue with Ofwat, a satisfactory agreement was reached that provided the flexibility for Ofwat to review price limits and reduced uncertainties for water companies, which had been greater in earlier proposals

Future price limits: The process for Ofwat's 2014 Periodic Review began in 2011-12. This will determine price limits for the period 2015 to 2020. The review is significantly changed with the introduction of separate price controls for retail and wholesale services. We will be submitting our final Business Plan to Ofwat in December 2013. Failure by Ofwat to recognise significant investment needs or other major issues included within the plan may lead to a shortfall in funding for the regulatory period

Mitigation: We are completing extensive development work, including substantial consultation with customers, to produce a robust Business Plan. Our plan will be reviewed by our independent Customer Challenge Group and subjected to assurance testing. We have responded to all Ofwat's consultations on price review methodology and will maintain close dialogue with Ofwat and other regulators on key issues

Compliance with legislation. Southern Water is a highly regulated business with three main regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. If we do not meet the regulations set by these bodies, the company could face penalties during the five-year price review that sets our levels of investment and customer bills. We could also face fines, legal action and, in the worst case scenario, the loss of our appointment as a water and wastewater company

Mitigation: We have procedures in place to comply with legislation and key procedures have been certified to meet standards, including ISO 9001 and ISO 14001. Awareness training is provided throughout the company for critical issues, such as the Bribery Act and Competition Law, to ensure everyone understands our legal obligations. All sections of the business review their compliance with company procedures through self-assessment every six months and implement improvement plans if necessary

Operational failures and pollution incidents. Reliable water and wastewater services are essential to maintain public health and protect the environment. Operational failures can lead to interruptions to drinking water supplies, risks to health or severe damage to the environment from pollution. As well as the risk of damage to the environment or distress to customers, incidents like these can also affect our performance rating with Ofwat, lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate and cause damage to our reputation

Mitigation: The majority of our £1.8 billion capital investment programme from 2010-15 is targeted to maintain our water and wastewater sites and networks to reduce the risk of failure and incidents. We have response teams on standby to make sure, if there are problems, we can minimise the impact to our customers and the environment.

Resilience to drought. The South East is classified as an area of severe water stress and changing weather patterns are predicted to pose an increasing challenge for all water companies in the region in future years. Southern Water supplies drinking water to more than one million households across Kent, Sussex, Hampshire and the Isle of Wight and it is critical we are able to develop a resilient network to continue to do so now and in the future.

Mitigation: We have secured extra water resources through our new River Arun reservoir in West Sussex to achieve our target for the Security of Supply Index in the region. We have also continued to drive down leakage below our company target and are on track to install water meters for the majority of our customers by 2015, supported by a wide range of water efficiency initiatives. Should a drought occur, as in 2012, we have a Drought Plan which we follow to introduce measures to conserve water and secure additional resources through Drought Permits and Drought Orders and by changing the way in which we operate our sources. During the year, we also updated our Water Resources Management Plan, using an industry-leading approach that allows us to plan for a wider range of droughts than we have seen in the past.

Preventing flooding of our sites and from our network: Changing rainfall patterns, more frequent storms and rising sea levels, could all lead to an increased risk of flooding. The serious floods in recent years have also highlighted the need to protect our water and wastewater treatment works and pumping stations from being put out of action in floods.

Mitigation: To help combat this increased risk, we are investing nearly £90 million in flood protection schemes between 2010 and 2015 to increase the capacity of our sewer network by 20 per cent. This includes £20 million on sewer improvements in Portsmouth to help protect the city from flood damage during storm conditions after it was extensively damaged in a storm in 2000. Nearly £10 million is also being invested in updating sewer plans, computer models and drainage area plans to look at how our network can cope with changing weather in the future and how we can reduce the risk of flooding to homes and gardens.

Regional growth: The population in the South East has grown considerably during the last 20 years and is expected to grow by a further 16 per cent between 2010 and 2030. The populations of Portsmouth and the Isle of Wight are forecast to be the fastest growing. This presents significant challenges because our region has increasingly scarce water resources, many environmentally important areas and a densely populated coastline, which will require higher standards of protection.

Mitigation: We need to ensure we can supply enough drinking water to cater for a growing population and that we have enough capacity at our wastewater treatment works and in our water mains and sewer network to cope with the extra flows. We continually review population forecasts as part of our forward planning in our five-year Business Plan and our 25-year Water Resources Management Plan. While the current economic conditions have resulted in a decline in the housing market, we expect population will increase in line with forecasts. By 2020, we anticipate housing development will have started to grow again. Our future investment plans are developed in consultation with developers and local planners to make sure we have the necessary infrastructure in place to cater for new developments.

Bad debt: Levels of bad debt, which cannot be recovered and have to be written off as a loss, continue to be a significant issue for the water industry. In the current economic climate, there is a risk that the number of customers who do not pay their bills will increase. This puts an additional burden on customers who do pay their bills.

Mitigation: We understand that some customers may experience financial difficulties, particularly in these difficult economic times. We encourage customers who are struggling to make payments to contact our Debt Advice Centre as early as possible. We offer a range of flexible instalment plans and tariffs and also refer those in severe financial hardship to our Charitable Trust, which can give grants. As part of our metering programme, we can offer water and energy audits in the customer's home to help them make savings and a free referral to the community organisation IncomeMAX, which can ensure households are receiving all the

benefits and grants they are entitled to. We are proactive in collecting payment from our customers and in helping households to pay their bills and debt. When necessary, we also utilise a leading debt management system to recover overdue payments to keep bad debt to a minimum.

Financing our business: Significant change in interest rates or a reduction in the availability of credit to the water industry could put our ability to finance our capital investment programme at risk in the future. The industry requires on-going access to capital markets because of negative cash flows, which have been a feature of the water industry since it was privatised in 1989. As a minimum, we intend to maintain our current risk profile. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

Mitigation: We ensure that we maintain sufficient cash reserves and liquidity facilities to finance our operations for at least 12 months. We also ensure the aggregate nominal value of debt maturities does not exceed 40 per cent of Regulatory Capital Value (RCV) in any single regulatory period (and 20 per cent of RCV in any 24 months). Exposure to interest rate rises on our current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance) Limited, and current borrowings are at either fixed rates or index-linked. Our next debt maturity is on March 31, 2014, and we have already raised the finance to ensure we are able to repay this loan. We ensure that sufficient funds are available for our operational and capital investment programme through on-going monitoring and forecasting of our cash flow and we take steps to manage this when necessary.

Credit ratings: We need to maintain an investment grade credit rating to ensure we can continue to access the capital markets to efficiently finance our capital investment programme and refinance our existing debt maturities. This is required as a condition of our regulatory licence and it is also a primary duty of Ofwat to ensure we can finance our business. In addition, it is a condition of borrowing covenants, where a failure to maintain certain credit ratings could lead to a restriction in dividend payments. Our current credit ratings are

- Standard & Poor's Class A debt, A- (negative outlook), Class B debt, BBB (negative outlook)
- Fitch Class A debt, A-, Class B debt, BBB
- Moody's Class A debt, Baa1 (negative outlook), Class B debt, Ba1 (negative outlook), Corporate family rating Baa2 (negative outlook)

Mitigation: We have an internal business plan which is expected to stabilise our overall credit rating position. A primary duty of Ofwat when setting prices is to ensure companies can finance their business. If necessary, a company can apply to reset customer prices during the five-yearly regulatory periods through an Interim Determination of K (IDoK).

Delivery of our capital investment programme. We have a capital investment programme of £1.8 billion between 2010 and 2015. We are on target to deliver this, and some schemes are ahead of schedule, however, we have to continue our focus to complete all our work on time. If we are unable to deliver significant parts of the programme on schedule, we face a risk to our ability to provide the best service we can for our customers, and possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

Mitigation: We closely monitor the progress of our programme to ensure we manage any risks to completing the work on time. We work closely with our regulators and other interested parties to resolve issues as they arise.

Corporate Governance

Chairman's overview

Introduction

Southern Water is committed to maintaining high standards of corporate governance. The directors have taken account of the principles of good governance in the UK Corporate Governance Code and have recently taken further steps to ensure the code's requirements are met appropriately for our privately owned company. As a Board, we are responsible and accountable to stakeholders for ensuring effective governance processes are in place and followed.

The Board's role is to

- Ensure that the company's obligations to, and interests of, its stakeholders, including customers and regulators, are known and met appropriately
- Provide effective leadership and collective responsibility for the long-term success of the company, to the benefit of its stakeholders
- Determine overall strategic aims and direction
- Ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately
- Ensure that appropriate and effective processes and controls are in place to assess and manage risk

Board membership

During the year under review, I have been the independent non-executive Chairman, and the Board has also comprised two executive directors, (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, of whom four are independent.

I believe that we comprise a balanced and rounded board, giving independent support and advice as well as providing new ideas and healthy challenge. The presence of six non-executive directors provides appropriate governance. The members of the Board, their biographies and descriptions of their complementary skills and extensive experience are on pages 53 to 55.

All members of the Board are able to allocate the necessary time to the company and its areas of business to discharge their responsibilities effectively.

Chairman

As Chairman, my role is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board.

I discuss and agree agendas for Board meetings with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. I have authority to act and speak for the Board between its meetings, including engaging with the Chief Executive Officer. I report to the Board, chairmen of its committees and individual directors as appropriate on decisions and actions taken between meetings of the Board. I also meet with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback.

Two investors, but not all, are represented on the Board, and I ensure that the views of all investors can be communicated to the Board.

Senior Independent Non-executive Director

David Golden is the senior independent non-executive director. He chairs the Remuneration Committee, is a member of the Audit and Risk Review Committee and would chair Board meetings in the event that I am unable to do so for any reason. David has been a non-executive director for nine years and the Board recognises that his character and judgement show him to be independent. He is available to discuss matters or concerns with investors as required.

Independent Non-executive Directors

The four independent non-executive directors are valued members of the Board. As well as meeting the company's obligation in its licence to have independent non-executive directors, they bring overall independent advice, review and challenge on behalf of all stakeholders, including customers. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement and finance, and for the range of their experience of general corporate management. They meet without me at least once a year, and appraise my performance annually.

The Board considers the four independent non-executive directors to be independent in character and judgement and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company's area and understanding of the interests of our customers and how these can be respected and protected.

The standard terms and conditions of the independent non-executive directors are published on our website.

Investor-nominated Non-executive Directors

The two investor-nominated non-executive directors bring the extensive knowledge, skills and resources of their nominating investors and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors similar to our own. They have all the duties, obligations and rights of a director of Southern Water. They do not receive any remuneration from this company.

Chief Executive Officer

The Chief Executive Officer, Matthew Wright, is a member of the Board and has all of the responsibilities of a director of the company. In his executive role, responsibility has been delegated to him to achieve the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgement, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls. The non-executive directors, led by me, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer, Michael Carmedy, is a member of the Board and has all of the responsibilities of a director of the company. In his executive role and reporting to Matthew Wright, he has the responsibility to manage the company's financial affairs and assist the Chief Executive Officer in the delivery of the company's strategy. His executive performance is reviewed annually by Matthew Wright.

Executive Management Team

Reporting to Matthew Wright, the Executive Management Team supports him in driving the implementation of strategy in the company. The team is committed to do this in a responsible way that takes account of our commitment to our customers, the environment, the communities in which we live and work and all of our other stakeholders and with a view towards the long-term responsible stewardship of the business.

Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary and General Counsel, Kevin Hall, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework it has adopted and that there are good information flows to the Board and its committees and between senior executives and the non-executive directors. The appointment and removal of the Company Secretary is reserved to the Board.

Director induction, training and development

On appointment to the Board, a director will discuss and agree induction coverage and then an appropriate comprehensive and individualised induction pack is provided, which will include information on the company and holding group structure, the regulatory framework of the company's business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework. This and further relevant information is summarised in a directors' handbook.

Meetings are arranged with members of the Executive Management Team and with external advisers, who provide support to the relevant Board committees the directors may serve on, as well as visits to operational and office sites.

Directors receive updates through the year on matters such as the impacts of the proposals on changes to the regulatory framework, the Government's White Paper Water for Life and the next regulatory Price Review 2014 (PR14). They also have access to professional development provided by external bodies and our specialist advisers.

Performance and effectiveness reviews

In April 2012, I launched a review of the effectiveness of the Board, which began with each member and those of our holding company board completing a questionnaire. This enabled me to have subsequent one-to-one discussions with each of them. No areas of major concern or weakness were identified, but I have been able to initiate improvements in some areas of information provision and discussion and to further strengthen governance. I shall carry out another evaluation during 2013.

Led by David Golden, Senior Independent Non-executive Director, the Board recently completed a review and appraisal of my performance as Chairman, without my participation.

Board operation

There is good understanding of the principles and processes in place regarding the tasks and activities of the Board, the authority delegated to the Chief Executive Officer and the relationship between us.

The following matters are routinely determined by the Board:

- Business strategy
- Financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and charges schemes
- Approval of financial statements
- Key regulatory submissions (including, but not limited to, Price Review submissions to Ofwat, Interim Determination of K applications, Risk and Compliance Statement and Regulatory Financial Statements)
- Key customer and stakeholder publications (including, but not limited to, the Annual Report)
- Entering into significant contracts or commitments (including capital schemes over £5 million and disposals over £1 million), in accordance with rules agreed with the Chief Financial Officer
- Approval of dividends
- Commencing into new businesses

- Appointment of auditor
- Appointment and remuneration of independent non-executive directors
- Appointment or removal of the Company Secretary
- Amendment, qualification, addition to or removal from the above

Good governance requires a clear division of responsibilities between the Chairman and Chief Executive Officer. A statement of these responsibilities is published on our website.

Board meetings

The Board held 10 scheduled monthly meetings during the year. The agenda and papers are sent to Board members in advance of each meeting. The monthly financial, performance and economic regulation reports are also distributed for the other two months when there is no scheduled meeting (August and December). The Board holds its meetings at its principal office in Worthing, but at least two meetings each year are held at other locations following visits to company sites and at least two meetings each year are held in London, to facilitate meetings with investors.

Additionally, ad hoc Board meetings were held to consider the section 13 notices issued by Ofwat to bring about modifications to Conditions of the Licence. Informal meetings of Board members also took place to discuss matters, such as the section 13 notices and PR14 Ofwat consultations.

Directors have access to the advice and services of the Company Secretary and are able to take appropriate independent professional advice for the performance of their duties. Where a director has a concern over any unresolved matter, he/she is entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, I, as Chairman, will bring it to the attention of the Board.

Attendance at scheduled Board meetings in 2012-13			
Colin Hood	10/10		
Robert Armstrong	9/10	Cheryl Black	10/10
Michael Carmedy	10/10	David Golden	10/10
Robert Jennings (appointed 1 July 2012)	7/7	Matthew Wright	10/10
Paul Moy	9/10	Surinder Toor	5/10
Bronte Somes (as alternate)	1/10	Peter Antolik (as alternate)	5/10

Note – Attendance includes personal attendance and attendance by telephone.

Board committees

We have established standing committees of the Board with specific responsibilities. They assist by monitoring and reviewing performance and issues in the areas within their respective scopes and by advising and making recommendations to the Board. Specific responsibilities have been delegated to those committees.

The standing committees of the Board that met in 2012-13 are

- Audit and Risk Review
- Health and Safety
- Remuneration (formerly Compensation and Human Resources in 2012-13)

Each committee has written terms of reference to exercise oversight on behalf of the Board and provide advice in its remit area. These terms of reference are published on our website.

Other committees are constituted if and when required for specific matters.

The company has previously appointed a Regulatory Committee. However, given the significance of the regulatory issues and changes taking place or proposed in the regulatory environment in 2012-13, such regulatory matters have been discussed and decided by the full Board. Consequently, the Regulatory Committee did not meet during the year. This position will continue to be reviewed by the Board, which itself receives an economic regulation report at each scheduled monthly meeting and for the other two months, as described above.

The company has appointed a Nomination Committee. Previously, ad hoc committees for appointments were formed as required. The terms of reference of the Nomination Committee are published on our website.

Remuneration

The directors' remuneration report is set out on pages 59 to 61.

Interests

No director declared a material interest at any time during the year in any contract of significance with the company.

Conflicts of interests

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts. If a conflict should arise, the conflicted director takes no part in discussions or voting on that issue.

Annual General Meeting

Southern Water Services Limited is a private company with single corporate ownership and is not required to hold an Annual General Meeting (AGM). Greensands Holdings Limited, as the ultimate parent company, does hold an AGM under its own corporate requirements.

UK Corporate Governance Code

The UK Corporate Governance Code (the Code) was designed for companies listed on the Stock Exchange. A key focus of the Code is the protection of minority investors not otherwise represented directly in the governance structure of the company. For this reason, not all aspects of the Code are directly relevant to a company with concentrated ownership such as Southern Water. Nevertheless the directors have taken account of the principles of good governance in the UK Corporate Governance Code in determining the governance arrangements of the company. For the financial year ended 31 March 2013, the company has complied with the spirit and letter of the Code to the extent appropriate for a privately owned company. Schedules of our compliance with the Code are published on our website.

In a limited number of respects, we consider that alternative provisions to those in the Code should be adopted by us, as more appropriate to our private ownership status but still in the spirit of the Code's objectives.

Conclusions

The Board and I are committed to the company continuing to follow good corporate governance to underpin business strategies and plans which ensure that its obligations to, and interests of, its stakeholders, in particular customers and regulators, are known and met appropriately.



Colin Hood,
Chairman

Board of Directors

The day-to-day running of our company is led by Matthew Wright our Chief Executive Officer, and our Executive Management Team, which reports to our Board of Directors

Colin Hood
Chairman

Appointed Chairman in February 2012, Colin Hood joined the board as a Non-executive Director in February 2011. He is a former Chief Operating Officer of Scottish and Southern Energy (SSE), which he joined in 2001 as Power Systems Director. Before this, he was Director of Distribution for Southern Electric, having joined the industry with the North of Scotland Hydro Electric Board in 1977. Colin is Chairman of the Offshore Renewable Energy Catapult in Glasgow, a Technology Strategy Board funded innovation company, an Independent Director on the board of the Glasgow 2014 Commonwealth Games and a Non-executive Director of First Group and High Speed 1, the Channel Tunnel rail link. He is a graduate of Strathclyde University, where he studied Electrical Engineering.

Matthew Wright
Chief Executive Officer

Appointed in February 2011, Matthew Wright joined us from United Utilities where he was Managing Director, Asset Management and Delivery. Prior to that, he was Managing Director, Operations, and his role included management of the operations, maintenance and customer service activities of United Utilities' regulated water and wastewater business as well as oversight of the company's external contracts with Dwr Cymru Welsh Water, Scottish PFI projects and other industrial customers. Matthew has more than 23 years' experience of utility management in both UK and international markets. He joined United Utilities in 2007 from ScottishPower's US operation, where he was Executive Vice-President of PacifiCorp's transmission, distribution and customer service division. He has also held senior management positions in operations, regulation, corporate strategy and commercial utility functions.

Michael Carmedy
Chief Financial Officer

Appointed in November 2011, Michael Carmedy joined us from United Utilities where he was previously the Group Controller and Finance Director United Utilities Water Plc. He joined United Utilities in January 2008 from Thames Water where he worked for 17 years in various financial, commercial and regulatory roles based in both the UK and the US. Immediately prior to joining United Utilities, he was Thames Water Group Financial Controller, a role he took up following his return from the US where he spent four years with Thames Water Americas, including two years as VP Regulation, American Water.

David Golden

Senior Independent Non-executive Director

Appointed in November 2003, David Golden is Chairman of the MPSL Group of Construction/Design companies and EOS Ethical. Previously, he was Contracts Director of Amec, Contracts Director of British Nuclear Fuels plc and Procurement Director of North West Water, each entity embracing significant civil engineering based capital programmes. Subsequently he was Chief Executive of Banner Business Supplies and Executive Chairman of Altrix Healthcare plc. He is a former Chairman of the Water Industry Certification Scheme.

Robert Armstrong

Independent Non-executive Director

Appointed in May 2008, Robert Armstrong was previously Managing Director of United Utilities Customer Sales and a Director of United Utilities Water plc. He is a former chairman of Water UK and was awarded the OBE for services to the water industry in 2006.

Cheryl Black

Independent Non-executive Director

Cheryl Black joined the board in 2008. She has spent her entire career in customer-focused roles, including Customer Service Director at Telefonica O2 (2006-2011) and Scottish Water (2002-2006). She currently holds non-executive roles at Skipton Building Society and EDF Nuclear Generation Ltd, and is a Director of Telefonica UK Pension Trustee Ltd. Cheryl is a Vice-President of the Institute of Customer Service (ICS) and is a special advisor to the Customer Contact Association (CCA). She is also a Director of Cheryl Black & Partners Ltd, a customer strategy consultancy.

Robert Jennings

Independent Non-executive Director

Appointed in July 2012, Robert Jennings is also the Department for Transport's representative on the Board of Crossrail. He joined SG Warburg & Co in 1986 and remained with the organisation until February 2009 where for many years he had been head/joint head of the bank's infrastructure group. During this period, he was also seconded to HM Treasury on two occasions. Robert graduated from Bristol University in 1976 after reading Economics & Accounting. Articled to Coopers and Lybrand, he became a Chartered Accountant in 1979 and, in 2005, was made a CBE in recognition of his services to the transport sector and finance industry.

Paul Moy

Non-executive Director

Paul Moy is the global Head and Chief Investment Officer for UBS Infrastructure and Private Equity, a division of UBS Global Asset Management. He has extensive principal investment, investment banking and advisory experience in the infrastructure sector across a broad range of asset types, including electricity generation, transmission and distribution, gas, water, toll roads, ports, rail, telecommunications and waste management. Paul also has considerable experience as a non-executive director and is currently a Non-executive Director of Northern Star Generation, CWF Holdings and Njord Gas Infrastructure. Paul holds a BA and PhD in Economics.

Surinder Toor

Non-executive Director

Surinder is a Managing Director at JP Morgan Asset Management and the global head of asset management for JP Morgan's Infrastructure Investments Group. In addition to Southern Water, he holds directorships in Electricity North West and Noatum Ports Holdings. Previously, he was the Chief Financial Officer at Scotia Gas Networks plc and prior to that he was Managing Director of American Electric Power's European operations. He has also held positions with Arthur Andersen, PowerGen plc and at PricewaterhouseCoopers, where he started his career. Surinder holds an MA in Engineering, Economics and Management from the University of Oxford and he is a Chartered Accountant.

Kevin Hall

Company Secretary and General Counsel

Kevin is a qualified solicitor and has worked for Southern Water since 1975. Having also undertaken legal environmental and regulatory work, he focused on customers and water supply on the creation of Southern Water Services in 1989 and became Company Secretary of the Southern Water Group in 1997 following its acquisition by ScottishPower. Since then, he has been involved in many significant corporate and financing activities in addition to his overall legal responsibilities for Southern Water. In February 2008, he also became Company Secretary of the Greensands companies and his role continues to be in supporting and advising the companies' boards and businesses.

Audit and Risk Review Committee

This report describes the role of the Audit and Risk Review Committee (ARRC) and the work it has undertaken during the year

The members of the ARRC are Paul Moy (Chairman), Surinder Toor, David Golden, Cheryl Black and (from 1 July 2012) Robert Jennings, whose experience and background are set out on pages 54 and 55

The members of the committee receive updates on financial reporting and the regulatory framework in various forms throughout the year. The ARRC Chairman, the Chief Executive Officer, the Chief Financial Officer, the Head of Internal Audit, the Group Financial Controller and the external auditors are invited to all meetings and are usually in attendance. Other members of senior management are also invited to attend when necessary or appropriate. The ARRC has access to the services of the Head of Internal Audit, the Company Secretary and external professional advisers to assist it in performing its duties.

The ARRC met three times in 2012-13 and its work focused on the following key areas

- Financial statements
- Internal controls
- Corporate governance matters
- Areas of risk
- Oversight of internal and external audit
- The regulatory reporting obligations

Audit and Risk Review Committee attendance in 2012-13			
Paul Moy	3/3	Cheryl Black	2/3
David Golden	3/3	Robert Jennings (from 1 July 2012)	2/2
Peter Antolik (as alternate to Surinder Toor)	3/3		

Note – Attendance includes personal attendance and attendance by telephone

The terms of reference of the ARRC are published on our website

Financial statements

The ARRC received and reviewed the financial statements and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgement that have been made, before making a recommendation to the Board to approve the annual results. There were no significant issues to be addressed.

Internal controls

The ARRC receives regular reports from Internal Audit in respect of its work on internal controls and reviews management letters received from the external auditors. In addition, the company's risk management processes and arrangements are also reviewed together with the on-going development of the compliance and assurance processes in respect of the key risks.

The ARRC also receives a regular report of incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrong-doing under investigation. There were no material incidents during the year.

Further details of our internal control framework, including the main features of our internal control and risk management systems in relation to the financial reporting process, can be found in the Annual Report on page 44

Oversight of Internal Audit and external audit

The ARRC is responsible for overseeing the work of the Internal Audit function and also for managing the relationship with the external auditor. It reviews the performance of the internal and external auditors annually to ensure that they are effective and recommends to the Board whether the external auditor should be reappointed.

The ARRC regularly holds discussions with both the internal and external auditors in the absence of management.

Internal Audit

The Head of Internal Audit and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources. This work is reported to the ARRC on a regular basis and is a key element of the assurance that the ARRC receives on the risks and controls in the company.

The ARRC reviews, at least annually, the level of resources and the budget of the Internal Audit function. The Head of Internal Audit is free to raise any issues with the ARRC or its Chairman at any time during the year.

External auditor

Deloitte LLP was appointed auditor of the company in 2011 following a tendering process. The ARRC considers the auditor's effectiveness each year and would report to the Board any concerns over the auditor's continuing appointment.

The ARRC reviews annually information provided by the external auditor confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards, including any non-audit work. The company does not have a formal policy of tendering the external audit at specific intervals but would initiate a tender process if there were any concerns about the quality of the audit or the independence and objectivity of the auditor. There are no contractual obligations that act to restrict the Board's choice of external auditor.

Details of the amounts paid to Deloitte for audit and non-audit services are provided in note 4 to the accounts page 75.

Health and Safety Committee

The Health and Safety Committee (H&SC) is responsible for reviewing and advising on the company's health and safety policy and the implementation of, and compliance with, agreed policies, applicable guidance and standards. The H&SC reviews incident and accident prevention performance and policies, and any other matters assigned by the Board.

The members of the H&SC are Colin Hood (Chairman), David Golden, Matthew Wright and Robert Armstrong.

The H&SC generally meets in September and March each year, but the March 2013 meeting was postponed to April. In consequence, during the year to 31 March 2013 the H&SC met on only one occasion, but will maintain its required frequency of meetings in 2013-14.

Health and Safety Committee attendance in 2012-13			
Colin Hood	1/1	Matthew Wright	1/1
David Golden	1/1	Robert Armstrong	1/1

Note – Attendance includes personal attendance and attendance by telephone.

The terms of reference of the H&SC are published on our website.

Remuneration Committee (formerly Compensation and Human Resources in 2012-13)

The role of the Remuneration Committee (RemCom) is to ensure that the company's directors and senior managers are fairly rewarded for their overall contribution to company performance, giving due regard to market rates, individual performance and the financial health of the company. The RemCom reviews proposals for the total remuneration package, to include salary and benefits, and any other matters assigned by the Board.

The RemCom determines, on behalf of the Board, the company's policy on the remuneration of executive directors and the Chairman. It sets the annual level of remuneration of the directors. The RemCom is also consulted on the remuneration policy for the next band of senior executive managers. The policy framework for remunerating all senior executive managers is consistent with the approach taken for executive directors.

To ensure that the company's remuneration practices are market competitive, the RemCom annually calls upon experienced specialist consultants. The RemCom has received material advice from Towers Watson (a leading global professional services company), which has been appointed by the RemCom for the purpose of providing this advice.

Overall packages are linked to market rates of pay, externally assessed and provided by Towers Watson using both national and industry specific benchmarking data. Basic salary and the other benefits, with the exception of the bonus scheme, are not linked to standards of performance.

The members of the RemCom are David Golden (Chairman), Paul Moy, Robert Armstrong and Surinder Toor and during the year the RemCom met on five occasions.

Remuneration Committee attendance in 2012-13			
David Golden	4/5	Robert Armstrong	5/5
Paul Moy	4/5	Peter Antolik (as alternate to Surinder Toor)	5/5

Note – Attendance includes personal attendance and attendance by telephone.

The terms of reference of the RemCom are published on our website.

The Chief Executive Officer, Matthew Wright, and the Director of Human Resources also attended the RemCom meetings to provide advice and respond to specific questions. Such attendances specifically excluded any matter concerning their own remuneration.

Details are given below of the remuneration policy for the directors of Southern Water Services and the amounts paid to them in the year ended 31 March 2013.

Directors' pay and standards of performance

As required by the Water Act 2003 and Regulatory Accounting Guidance from the Water Services Regulation Authority (Ofwat), additional information is given below regarding the remuneration of the directors of Southern Water Services.

Executive directors who served during the 2012-13 year are shown below.

Matthew Wright	Chief Executive Officer
Michael Carmedy	Chief Financial Officer

Elements of remuneration

Executive directors' remuneration comprises the following elements

- Base salary
- Benefits, including car allowance, health cover, pension supplement and disturbance/relocation expenses
- Annual incentive scheme
- Pension
- A long-term incentive plan

Base salaries and benefits for each director are reviewed annually by the CHRC with regard to individual performance and contribution, together with consideration of developments in the relevant employment market for similar roles in utility companies

The base salary is a fixed figure and does not vary in relation to business or individual performance

Details of the remuneration received by the executive directors are shown below

£'000	Base Salary	Benefits	Bonus	Total	DC pension contribution	Total including pension
Matthew Wright	348.5	42.7	241.2	632.4	32.6	665.0
Michael Carmedy	230.6	23.6	92.9	347.1	34.6	381.7

The Chairman and the independent non-executive directors each receive a fee and do not participate in any of the company's performance related incentive arrangements. The investor-nominated non-executive directors do not receive any remuneration from the company.

Details of the emoluments received by the Chairman and non-executive directors are shown below

£'000	Fees	Other	Total
Colin Hood (Chairman)	225.0	-	225.0
David Golden	60.0	14.4	74.4
Robert Armstrong	40.0	-	40.0
Cheryl Black	40.0	-	40.0
Robert Jennings	30.0	-	30.0
Paul Moy	0.0	-	0.0
Surinder Toor	0.0	-	0.0

Other amounts paid to David Golden relate to consultancy services provided separately to his duties as the senior independent non-executive director.

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group, there are no share options in place and no payments were made to them by any other group companies.

Annual performance related incentive scheme

The Southern Water Incentive Scheme focuses on the achievement of specific strategic goals which are designed to drive exceptional financial and operational performance. The structure of the scheme and specific target criteria, both corporate and individual, are set and reviewed on an annual basis by the Remuneration Committee.

Under the scheme, the executive directors have a maximum bonus opportunity as shown below, of which 60 per cent is linked to the achievement of the overarching corporate objectives with the remaining 40 per cent linked to individual performance targets.

Matthew Wright	100 per cent of salary
Michael Carmedy	70 per cent of salary

For 2012-13, the attainment of any payment in relation to the corporate objectives is based on the following criteria:

- Service standards – deliver the targeted improvement in the Service Incentive Mechanism score for 2012
- Performance assessment (serviceability) – achieving a stable assessment in all four categories (water above ground, water below ground, wastewater above ground, wastewater below ground) for 2012-13, no score for lesser assessment in any category
- Cash revenue – cash receipts from unmeasured and measured customers
- Opex – total operational expenditure

Performance against these corporate targets is reviewed annually in May by the Remuneration Committee and any bonus awarded in June. As a result of this, together with the individual performance element, the following payments have now been made in relation to 2012-13:

Matthew Wright	£ 200,388
Michael Carmedy	£ 92,940

Following confirmation of the final performance scores for 2011-12 and assessment by the committee, an additional payment of £40,800 was also made to Matthew Wright during 2012-13 in relation to the incentive award for 2011-12.

Long-term incentive plan

A Long-Term Incentive Plan (LTIP) for the period 1 April 2011 to 31 March 2015 was agreed by the Remuneration Committee in 2011-12. Performance payments under the LTIP will be based on the company's serviceability, Asset Management Assessment (AMA) score, operating efficiency and Service Incentive Mechanism (SIM) score at 31 March 2015.

To date, no payments have been made in relation to this scheme.

Directors' report for the year ended 31 March 2013

The directors of Southern Water Services Limited (registered no 02366670) present their report and the audited financial statements for the year ended 31 March 2013

Principal activities

The principal activities of the company, also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to nearly 2.4 million people and provides wastewater services to nearly 4.5 million people.

Business review

The information that fulfils the requirement of the business review can be found in our Annual Report on pages 9 to 46.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 9 to 46.

Results and dividends

The profit and loss account on page 66 shows the company's results and profit for the year. Further details are also available in the Annual Report on pages 36 to 39.

Interim dividends of £771.76 per ordinary share (2011-12 £751.44 per share), totalling £43.2 million (2011-12 £42.1 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £13.7 million, enable SWSG to pay the interest of £56.9 million due to Southern Water Services on an inter-company loan as disclosed in note 7 to the accounts.

The directors do not recommend payment of a final dividend for 2012-13 (2011-12 £nil). For the second year running, no dividends were paid to our ultimate investors.

Directors and their interests

The directors who held office during the year ended 31 March 2013 and up to the date of signing the financial statements were as follows and further details can be found on pages 53 to 55.

Colin Hood	(Chairman)
Matthew Wright	(Executive Director – Chief Executive Officer)
Michael Carmedy	(Executive Director – Chief Financial Officer)
Robert Armstrong	(Independent Non-executive Director)
Cheryl Black	(Independent Non-executive Director)
David Golden	(Senior Independent Non-executive Director)
Robert Jennings	(Independent Non-executive Director) (Appointed 1 July 2012)
Peter Antolik	(Alternate Non-executive Director)
Paul Moy	(Non-executive Director)
Bronte Somes	(Alternate Non-executive Director)
Surinder Toor	(Non-executive Director)

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £0.5 million (2011-12: £0.5 million).

Financial risk management

The Financial Risk Management Policy is included in the Annual Report on pages 9 to 46.

Employees

Employee involvement: The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company has established Business Involvement Groups to facilitate meaningful consultation between company management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level. An employee survey is also completed on an annual basis to seek input from employees.

The company recognises the rights of every employee to join a trade union and participate in its activities. SWS has a single union agreement with Unison.

The company publishes its own in-house newspaper, Southern Water News, on a regular basis. General information is posted on the company intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business, including progress on business and capital projects, the impact of regulatory issues and wider financial and economic issues that may affect the company.

Equal opportunity: The company's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The company takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health and safety: The company recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition, there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

SWS provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

Creditor payment policy and practice

The company's policy and practice is to pay all suppliers, contractors and service providers in accordance with pre-agreed terms. The company's trade creditor days at 31 March 2013 were 54 days (2011-12: 57 days).

Environmental issues

The company is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice, and aims to contain the environmental impact of its activities to a practicable minimum

The company's environmental performance is reported on pages 21 to 22. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Charitable donations

The company made donations of £323,070 (2011-12 £320,181) to a variety of charities over the year.

Donations in the year comprised £240,000 (2011-12 £220,000) to the Southern Water Charitable Trust Fund, a charitable trust set up to assist customers who are suffering hardship, poverty or a poor quality of life by providing grants to help them pay their water bills, and a further £83,070 (2011-12 £100,181) of donations to other charities within the region.

No political donations were made.

Land and buildings

In the opinion of the directors, the market value of land is significantly more than its book value. However, it would not be practicable to quantify the difference precisely.

Going concern

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2013. Further information is set out in note 1 'Going concern' on page 70.

Qualifying third party indemnity

Following shareholder approval, the company has also provided an indemnity for its directors and the Company Secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- Select suitable accounting policies and then apply them consistently
- Make judgements and accounting estimates that are reasonable and prudent
- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

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

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

Statement of disclosure of information to auditor

Each of the persons who is a director at the date of approval of this report confirms that

- (1) So far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and
- (2) He/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board



Kevin Hall
Company Secretary
26 June 2013

Financial statements

Profit and loss account

For the year ended 31 March 2013

	Note	2013 £m	2012 £m
Turnover	2,3	778.7	716.2
Cost of sales	3	(425.3)	(417.3)
Gross profit		<u>353.4</u>	<u>298.9</u>
Administrative expenses	3	(27.5)	(27.4)
Other operating income	3	5.1	0.1
Operating profit		<u>331.0</u>	<u>271.6</u>
Profit on disposal of fixed assets		1.0	1.2
Profit on ordinary activities before interest and taxation		<u>332.0</u>	<u>272.8</u>
Interest payable and similar charges	7	(211.8)	(250.2)
Interest receivable and similar income	7	58.9	62.3
Profit on ordinary activities before taxation	4	<u>179.1</u>	<u>84.9</u>
Tax on profit on ordinary activities	8	(22.2)	(5.0)
Profit on ordinary activities after taxation	20	<u>156.9</u>	<u>79.9</u>

The above results relate to continuing operations

The notes on pages 70 to 95 form part of these financial statements

There is no difference between the profit on ordinary activities before taxation for the years as stated above and their historical cost equivalents

Statement of total recognised gains and losses

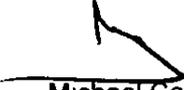
For the year ended 31 March 2013

	Note	2013 £m	2012 £m
Profit on ordinary activities after taxation		156.9	79.9
Actuarial loss recognised in the pension scheme	20,22	(7.3)	(40.0)
Movement on deferred tax relating to pension deficit	17	1.2	9.5
Total recognised gains for the year		150.8	49.4

Balance sheet
As at 31 March 2013

	Note	2013 £m	2012 £m
Fixed assets			
Tangible assets	10	4,264.3	4,109.5
Investments	11	29.2	29.2
		<u>4,293.5</u>	<u>4,138.7</u>
Current assets			
Stocks	12	1.5	1.9
Debtors amounts falling due within one year	13	416.6	163.5
Debtors amounts falling due after more than one year	14	812.3	812.3
Cash at bank and in hand		139.9	75.4
		<u>1,370.3</u>	<u>1,053.1</u>
Creditors: amounts falling due within one year	15	<u>(505.9)</u>	<u>(250.6)</u>
Net current assets		<u>864.4</u>	<u>802.5</u>
Total assets less current liabilities		<u>5,157.9</u>	<u>4,941.2</u>
Creditors: amounts falling due after more than one year	16	(3,767.5)	(3,666.5)
Provision for liabilities			
Environmental obligations	17	(0.8)	(0.8)
Deferred taxation	17	(356.8)	(349.6)
Grants and contributions	18	(46.4)	(47.9)
Net assets excluding pension deficit		<u>986.4</u>	<u>876.4</u>
Pension deficit	22	(72.1)	(69.7)
Net assets		<u>914.3</u>	<u>806.7</u>
Capital and reserves			
Called up share capital	19	0.1	0.1
Share premium	20	46.3	46.3
Profit and loss account	20	867.9	760.3
Total shareholder's funds		<u>914.3</u>	<u>806.7</u>

The financial statements of Southern Water Services Limited (Registered no 02366670) on pages 66 to 95 were approved by the Board and authorised for issue on 26 June 2013. They were signed on its behalf by


Michael Carmedy
Chief Financial Officer

Cash flow statement

For the year ended 31 March 2013

	Notes	2013 £m	2012 £m
Net cash inflow from operating activities	21	499.8	487.1
Returns on investments and servicing of finance			
Interest received		58.5	59.7
Interest paid		(129.7)	(129.5)
Preference share dividends		(10.6)	(10.9)
Net cash outflow from returns on investments and servicing of finance		(81.8)	(80.7)
Taxation		(13.7)	(23.2)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(360.1)	(466.0)
Receipt of grants and contributions		10.1	11.7
Sale of tangible assets		0.6	0.9
Movement on loan to subsidiary		(227.1)	(14.8)
Net cash outflow for capital expenditure and financial investment		(576.5)	(468.2)
Equity dividends paid		(43.2)	(42.1)
Net cash outflow before financing		(215.4)	(127.1)
Financing			
Increase in borrowings		300.0	50.0
Repayment of loans		(15.4)	(19.5)
Issue costs of new loans		(4.7)	-
Net cash inflow from financing		279.9	30.5
Increase/(decrease) in cash		64.5	(96.6)
Reconciliation to net debt			
Net debt at beginning of year		(3,612.8)	(3,373.2)
Increase/(decrease) in cash		64.5	(96.6)
Short term loan to subsidiary		247.5	-
Movements in borrowings		(284.6)	(30.5)
Debt issue costs		4.7	-
Other non-cash changes		(70.8)	(112.5)
Net debt at end of year		(3,651.5)	(3,612.8)

Notes to the financial statements

For the year ended 31 March 2013

1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below

Basis of accounting

The financial statements have been prepared on the going concern basis, under the historical cost convention, and in accordance with applicable UK accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 2006

Basis of preparation

The financial statements contain information about Southern Water Services Limited (SWS) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertaking are included by full consolidation in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited

Going concern

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk and have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements

Tangible fixed assets and depreciation

Tangible fixed assets are stated at historic purchase cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use, these include materials, labour and applicable overheads. Interest costs are not capitalised

i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of assets covering the company's geographic area

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs that directly relate to the construction of a specific infrastructure asset are capitalised on the basis of the amount of time spent by individuals on projects

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by Ofwat as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets

Notes to the financial statements (continued)

For the year ended 31 March 2013

1 Accounting policies (continued)

Tangible fixed assets and depreciation (continued)

ii) Other tangible fixed assets (including above ground assets, plant and equipment) are stated at cost less accumulated depreciation and any provision for impairment. These assets are depreciated down to their residual values on a straight-line basis over their estimated operating lives which are principally as follows

	<u>Years</u>
Buildings	10-60
Operational structures	15-80
Fixed plant	10-40
Vehicles, computers and mobile plant	3-10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

iii) Freehold land is not depreciated.

iv) Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new work is officially taken over from the contractor following completion of performance and take-over tests.

v) Private Sewers were adopted in October 2011 and have been valued at nil value, as permitted by UKGAAP and by reference to the net present value of the incremental cash flows as a result of the adoption. These assets form part of our infrastructure assets and expenditure associated with them has been treated as described above.

Grants and contributions

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Capital grants and customer contributions in respect of additions to non-infrastructure tangible fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of tangible fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 1 of the Companies Act 2006 which requires tangible fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Leased assets

Where the company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a "finance lease". The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

Rentals payable under operating leases are charged to the profit and loss account as incurred.

Notes to the financial statements (continued)

For the year ended 31 March 2013

1 Accounting policies (continued)

Leased assets (continued)

The sale of income rights relating to aerial masts and sites owned by the company to third parties is treated as an operating lease. Income received from such sales is received entirely in advance and is therefore taken to deferred revenue and will be credited to other operating income in the profit and loss account over the life of the lease.

Sale and leaseback transactions occur when an asset is sold but use is immediately re-acquired by entering into a lease with the buyer. Where the new lease is an operating lease, the transaction is treated as the disposal of an asset and the operating lease accounted for in accordance with existing policies.

Fixed asset investments

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Stocks

Stock is held for use in the production of water supply and treatment of wastewater. Stock is held at replacement cost.

Deferred revenue

Deferred revenue includes monies received from customers where the related turnover has not yet been recognised.

Amounts are deferred to the balance sheet and released to the profit and loss account in line with the period of the service provided.

Provisions

An environmental provision is made in accordance with Financial Reporting Standard (FRS) 12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected.

Taxation

The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS19 'Deferred Tax'. Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Notes to the financial statements (continued)

For the year ended 31 March 2013

1 Accounting policies (continued)

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes accrued income

Turnover relates to services provided in the year and excludes payments received in advance which are recorded as deferred revenue

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption

Turnover includes an estimate of the consumption between the date of the last meter reading and the period end. The unbilled income accrual is based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff

Bad debts

The bad debt provision is calculated by applying estimated recovery rates to various categories of debt and reflecting past collections experience and expectations of future recovery of outstanding receivables at the year end

Pensions

SWS operates a defined benefit pension scheme, the assets of which are held separately from those of the company in independently administered funds. An independent actuary conducts a valuation of this pension scheme every three years

In accordance with FRS 17 the pension deficit has been recognised on the balance sheet and operating and financing costs of pension and post-retirement schemes are recognised separately in the profit and loss account

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent terms and currency to the liability. The increase in the present value of the liabilities of the company's defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on the schemes' assets and the increase during the year in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses

Service costs are systematically spread over the service lives of the employees and financing costs are recognised in the period in which they arise. The costs of past service benefit enhancements, settlements and curtailments are also recognised in the period in which they arise

The differences between actual and expected returns on assets and liabilities during the year, including changes in actuarial assumptions, are recognised in the statement of total recognised gains and losses

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Company contributions to the scheme are charged to the profit and loss account in the period to which they relate

Notes to the financial statements (continued)

For the year ended 31 March 2013

1 Accounting policies (continued)

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred. Expenditure on fixed assets relating to development projects is written off over the expected useful life of those assets.

Preference shares

Preference shares are classified as debt in accordance with FRS 25 'Financial instruments: disclosure and presentation'. The preference shares are redeemable on a specific date or at the company's option anytime earlier. Dividends on preference shares classified as debt are recognised in the profit and loss account through interest payable. The value of the debt has been based on the original nominal value and share premium on issue of the shares.

Capital instruments

Interest-bearing borrowings are recorded at the proceeds received, net of direct issue costs. Finance charges are accounted for on an accruals basis in the profit and loss account and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

The issue costs of capital instruments are amortised over the life of the financial instrument to which they relate.

Premiums and proceeds from gilt lock agreements received on issue of debt instruments are credited to the profit and loss account over the term of the debt at a constant rate on the carrying amount.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the profit and loss account in the year in which it arises.

2 Segmental analysis

The directors believe that the whole of SWS's activities constitute a single class of business. The company's turnover is generated wholly from within the United Kingdom.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income includes rents receivable and a management charge relating to the sale of an investment in a group company.

Notes to the financial statements (continued)

For the year ended 31 March 2013

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging/(crediting)	2013 £m	2012 £m
Employee costs	43.3	40.5
Pension curtailment gain	(9.0)	-
Employee costs (note 5a)	<u>34.3</u>	<u>40.5</u>
Depreciation on		
- owned assets	215.4	206.4
- assets held under finance leases	0.8	0.4
	<u>216.2</u>	<u>206.8</u>
Rentals under operating leases		
Vehicles	3.5	3.7
Research and development expenditure	0.5	0.5
Amortisation of grants and contributions (note 18)	(2.8)	(2.7)
Fees payable to the company's auditor in respect of		
- Statutory audit of the company's financial statements	0.2	0.2
- Other services pursuant to legislation	0.1	0.1
- All other services	0.1	0.1

5 Employee information

	2013 £m	2012 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	56.0	52.7
Social security costs	5.6	4.7
Pension costs - Defined contribution	1.0	0.7
- Defined benefit	6.5	6.2
- Curtailment gain*	(9.0)	-
Total employee costs	<u>60.1</u>	<u>64.3</u>
Less charged as capital expenditure	(25.8)	(23.8)
Charged to the profit and loss account	<u>34.3</u>	<u>40.5</u>

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets

*During 2012-13 a curtailment gain arose from changes made to the benefits accruing to employee members of the Southern Water Pension scheme, these changes are detailed in note 22

Notes to the financial statements (continued)

For the year ended 31 March 2013

5 Employee information (continued)

(b) Average number of persons employed by activity

The average monthly numbers of persons (including executive directors) employed by the company during the year was

	2013 Number	2012 Number
Operations	1,055	941
Customer Services	461	447
Corporate Centre	422	354
	<u>1,938</u>	<u>1,742</u>

6 Directors' emoluments

	2013 £000	2012 £000
Aggregate emoluments (including benefits in kind)	1,389	1,225
Company pension contributions to money purchase pension schemes	<u>67</u>	<u>63</u>

No retirement benefits accrued to directors (2011-12 none) under a Southern Water defined benefit scheme

Retirement benefits accrued to two directors (2011-12 two) under a Southern Water defined contribution scheme

Details of emoluments and benefits for the highest paid director

	2013 £000	2012 £000
Highest paid director's aggregate emoluments and benefits	<u>632</u>	<u>632</u>

During the year the company made contributions of £32,575 (2011-12 £48,583) to a money purchase pension scheme in respect of the highest paid director's qualifying services

Notes to the financial statements (continued)

For the year ended 31 March 2013

7 Interest

	2013 £m	2012 £m
Interest payable and similar charges		
Interest payable on other loans	7.2	5.5
Interest paid to group companies	123.1	121.3
Indexation	76.9	113.5
Amortisation of issue costs	2.7	2.7
Amortisation of gilt lock proceeds	(0.1)	(0.1)
Amortisation of deferred credits	(9.8)	(9.8)
Amortisation of bond premium	(0.6)	(0.6)
Amortisation of discount	0.3	0.3
Other finance expense (note 22)	1.5	-
Dividends on preference shares - see note below	10.6	17.4
Total interest payable and similar charges	211.8	250.2
Interest receivable and similar income		
Interest receivable from Southern Water Services Group Limited	56.9	56.9
Deposit interest receivable	2.0	2.4
Other finance interest (note 22)	-	3.0
Total interest receivable	58.9	62.3

Class A1 preference share dividends amounted to £40 per share and Class B £70 per share totalling £9.0m (2011-12 £9.6m)

A dividend due to the Class A2 preference shareholders of £49 (2011-12 £239) per share totalling £1.6m (2011-12 £7.8m) was declared and settled in the year at base value plus an amount for out-performance in the year ended 31 March 2012 (see note 16(vi))

The interest receivable from Southern Water Services Group Limited relates to the long term debtor disclosed in note 14

Notes to the financial statements (continued)

For the year ended 31 March 2013

8 Tax on profit on ordinary activities

	2013 £m	2012 £m
Current tax:		
UK corporation tax on profits for the year	9.3	50.5
Adjustment in respect of prior years	<u>(0.7)</u>	<u>1.6</u>
Total current tax	8.6	52.1
Deferred tax:		
Origination and reversal of timing differences	24.3	(20.4)
Adjustment in respect of prior years	(1.5)	(3.8)
Pension cost relief in excess of pension charge	5.9	4.9
Effect of corporation tax rate change	(15.5)	(29.1)
Impact of rate change on pension charge	<u>0.4</u>	<u>1.3</u>
Total deferred tax	13.6	(47.1)
Total tax on profit on ordinary activities	22.2	5.0

The tax assessed for the year is different to the standard rate of corporation tax in the UK (24%) due to the following factors

	2013 £m	2012 £m
Profit on ordinary activities before tax	179.2	84.9
Current tax:		
UK corporation tax on profits for the year at 24% (2011-12 26%)	43.0	22.1
Adjustment in respect of prior years	(0.7)	1.6
Pension cost relief in excess of pension charge	(5.9)	(4.9)
Group relief received	(13.1)	-
Permanent differences	<u>9.6</u>	<u>12.9</u>
Tax charge on ordinary activities	32.9	31.7
Timing differences	<u>(24.3)</u>	<u>20.4</u>
Current tax charge for year	8.6	52.1

Factors that may affect future tax charges

On 21 March 2012 the UK Government announced a reduction in the main rate of corporation tax from 24 per cent to 23 per cent effective from 1 April 2013. The rate change was enacted in Finance Bill 2012 during the period, and deferred tax balances have been calculated using the new rate of 23 per cent. A £15.5m credit is recognised in the profit and loss account in the year to reflect the reduction in the deferred tax liability as a result of the rate change. In addition, charges of £0.4m in the profit and loss account and £0.5m in the statement of total recognised gains and losses are recognised to reflect the reduction in the deferred tax asset relating to the pension deficit.

The Government has also announced further reductions in the main tax rate to 21 per cent from 1 April 2014 and 20 per cent from 1 April 2015. If enacted these rate reductions are expected to have a similar impact on the financial statements as outlined above, however the actual impact will be dependent on the company's deferred tax position at that time.

Based on current capital investment plans, the company expects to continue to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

The company pays group relief in full to Southern Water Services Group Limited and at a reduced rate of ten pence in the pound for certain losses in other group companies.

Notes to the financial statements (continued)

For the year ended 31 March 2013

9 Dividends per share

	2013 £ per ordinary share	2012 £ per ordinary share	2013 £m	2012 £m
Ordinary shares				
Interim dividend – Q1	192.94	187.86	10.8	10.5
Interim dividend – Q2	192.94	187.86	10.8	10.5
Interim dividend – Q3	192.94	187.86	10.8	10.6
Interim dividend – Q4	192.94	187.86	10.8	10.5
Total interim dividend	<u>771.76</u>	<u>751.44</u>	<u>43.2</u>	<u>42.1</u>
Final dividend	-	-	-	-
Total ordinary dividend	<u><u>771.76</u></u>	<u><u>751.44</u></u>	<u><u>43.2</u></u>	<u><u>42.1</u></u>

The directors do not recommend payment of a final dividend for 2012-13 (2011-12 £nil)

The interim dividends totalling £43.2m are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief, enable SWSG to pay the interest of £56.9m due to Southern Water Services Limited on an inter-company loan as disclosed in note 7.

10 Tangible fixed assets and capital commitments

(a) Tangible assets	Freehold land & buildings £m	Plant & Machinery £m	Infra- structure assets £m	Assets in the course of construction £m	Other £m	Total £m
Cost:						
At 1 April 2012	1,330.6	1,798.3	1,892.8	639.4	539.9	6,201.0
Additions	1.5	43.9	50.0	230.0	54.6	380.0
Transfers	11.4	150.6	72.4	(264.1)	29.7	-
Grants & contributions	-	-	(8.8)	-	-	(8.8)
Disposals	(0.4)	(19.1)	(4.1)	-	10.7	(12.9)
At 31 March 2013	<u>1,343.1</u>	<u>1,973.7</u>	<u>2,002.3</u>	<u>605.3</u>	<u>634.9</u>	<u>6,559.3</u>
Accumulated depreciation:						
At 1 April 2012	453.3	670.0	631.1	-	337.1	2,091.5
Charge for the year	37.3	71.8	66.6	-	40.5	216.2
Disposals	(1.0)	(18.3)	(4.1)	-	10.7	(12.7)
At 31 March 2013	<u>489.6</u>	<u>723.5</u>	<u>693.6</u>	<u>-</u>	<u>388.3</u>	<u>2,295.0</u>
Net book amount:						
At 31 March 2013	<u><u>853.5</u></u>	<u><u>1,250.2</u></u>	<u><u>1,308.7</u></u>	<u><u>605.3</u></u>	<u><u>246.6</u></u>	<u><u>4,264.3</u></u>
At 31 March 2012	877.3	1,128.3	1,261.7	639.4	202.8	4,109.5

Notes to the financial statements (continued)

For the year ended 31 March 2013

10 Tangible fixed assets and capital commitments (continued)

Of the additions and transfers into infrastructure assets, the amount spent on infrastructure renewals net of contributions during the year ended 31 March 2013 and 31 March 2012 was £78.2m and £86.5m, respectively. The associated contributions were £2.6m for the year ended 31 March 2013 and £4.1m for the year ended 31 March 2012.

For the years ended 31 March 2013 and 31 March 2012, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £204.4m and £195.6m, respectively.

Freehold land is stated at a cost of £46.0m and £46.0m at 31 March 2013 and 31 March 2012, respectively, and is not depreciated.

Other assets relate primarily to computer equipment, meter reading devices and motor vehicles.

Assets held under finance leases have been capitalised and included in plant and machinery.

	2013 £m	2012 £m
Cost	16.3	11.7
Aggregate depreciation	<u>(11.4)</u>	<u>(10.6)</u>
Net book amount	<u>4.9</u>	<u>1.1</u>

Outstanding payments and interest associated with this lease are not material.

(b) Capital commitments	2013 £m	2012 £m
In respect of contracts placed	<u>184.7</u>	<u>291.9</u>

11 Fixed asset investments

Shares in group undertakings	2013 £m	2012 £m
At 1 April and 31 March	<u>29.2</u>	<u>29.2</u>

The investment represents a 100 per cent holding of the issued Ordinary shares of Southern Water Services (Finance) Ltd (SWSF), a company incorporated in the Cayman Islands but registered for tax in the UK. The principal activity of SWSF is to raise debt finance.

The directors are satisfied that the carrying value of the investment is supported by the underlying assets and activities of SWSF.

There are no indirect subsidiaries resulting from this investment.

12 Stocks

	2013 £m	2012 £m
Raw materials	1.0	1.0
Work in progress	<u>0.5</u>	<u>0.9</u>
	<u>1.5</u>	<u>1.9</u>

Notes to the financial statements (continued)

For the year ended 31 March 2013

13 Debtors amounts falling due within one year

	2013 £m	2012 £m
Trade debtors	76.9	62.1
Loan to Southern Water Services (Finance) Limited	247.5	20.4
Amounts owed by group undertakings	8.6	2.5
Other debtors	9.0	9.5
Accrued income	62.7	55.6
Prepayments	11.9	13.4
	<u>416.6</u>	<u>163.5</u>

The funds raised from the new Class B loan (note 16(iv)) have been lent to SWSF in readiness for the repayment of the existing Class B loan (note 15) in 2013-14. Amounts owed by group undertakings are unsecured, interest-free and settled regularly.

14 Debtors: amounts falling due after more than one year

	2013 £m	2012 £m
Loans owed by group undertakings	<u>812.3</u>	<u>812.3</u>
	<u>812.3</u>	<u>812.3</u>

Loans owed by group undertakings represent a loan to Southern Water Services Group Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7 per cent per annum.

15 Creditors: amounts falling due within one year

	2013 £m	2012 £m
Trade creditors	19.4	15.7
Loans from group undertakings (see note (i) below)	30.3	30.3
Loan from Southern Water Services (Finance) Limited (see note 16 (iii))	250.0	-
Amounts owed to group undertakings	48.8	53.5
Capital creditors and capital accruals	73.7	55.3
Taxation and social security	2.3	2.3
Debt issue costs (note 16 (vii))	(3.4)	(2.6)
Accruals and deferred revenue	74.7	86.0
Bond premium deferred	0.3	0.3
Deferred gilt lock proceeds (note 16 (viii))	0.1	0.1
Deferred proceeds	9.7	9.7
	<u>505.9</u>	<u>250.6</u>

Notes (i) The loan from group undertakings is unsecured, interest free, and shall be repayable in whole or part upon demand at any time, provided that

- (a) On the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding, or
- (b) The consent of the Security Trustee is given

Notes to the financial statements (continued)

For the year ended 31 March 2013

16 Creditors: amounts falling due after more than one year

	2013 £m	2012 £m
Loans and other borrowings		
Loan from Southern Water Services (Finance) Limited	3,356.6	3,295.0
Capex facility £150m – 6 month Libor plus 3% 2013	150.0	100.0
Class A1 Preference shares (see note (vi) below)	32.6	32.6
Class B Preference shares (see note (vi) below)	110.0	110.0
Debt issue costs (see note (vii) below)	(42.9)	(41.6)
Bond premium deferred	4.4	4.8
Deferred gilt lock proceeds (see note (viii) below)	5.4	5.5
Deferred proceeds*	134.5	144.2
Obligations under finance leases	1.3	-
Total loans and other borrowings	<u>3,751.9</u>	<u>3,650.5</u>
Deferred revenue (see note (ix) below)	15.6	16.0
Total creditors falling due after more than one year	<u>3,767.5</u>	<u>3,666.5</u>
	2013 £m	2012 £m
Repayments fall due as follows:		
Between two and five years	150.0	100.0
After five years not by instalments	3,499.2	3,437.6
	<u>3,649.2</u>	<u>3,537.6</u>

Under the loan agreements between SWS and SWSF, SWSF advances an amount equal to each bond or other debt raised at the same interest rate plus 0.01 per cent. Therefore each individual back to back inter-company loan has been separately disclosed.

Notes to the financial statements (continued)

For the year ended 31 March 2013

16 Creditors. amounts falling due after more than one year (continued)

An analysis of the loans is shown below

Loans	2013 £m	2012 £m
Class A £350m - £349.3m 3.350% index linked 2029/2037 & £0.7m 6.202% fixed rate 2029 (note (i) below)	384.7	372.2
Class A £150m - 3.716% index linked 2034	203.8	197.5
Class A £35m - 3.716% index linked 2034	48.2	46.7
Class A £350m - £141.9m 3.709% index linked & £208.1m 6.650% fixed rate 2026 (note (i) below)	362.7	357.6
Class A £150m - 3.826% index linked 2023	203.8	197.6
Class A £350m - £177.0m 2.070% index linked & £173.0m 5.010% fixed rate 2021 (note (i) below)	369.3	363.0
Class A £150m - 0.510% index linked 2041 (note (i) below)	195.9	190.0
Class A £200m - 0.070% index linked 2052 (note (i) below)	255.2	247.6
Class A £300m - 0.490% index linked 2056 (note (i) below)	351.4	338.9
Class A £300m - £195.0m Libor plus 3.029% 2019 & £105.0m 6.135% fixed rate 2019 (note (ii) below)	300.0	300.0
Artesian £165m - 4.086% index linked 2033	224.1	217.3
Artesian £156.5m - 3.645% index linked 2032	207.5	201.2
Total Class A debt	3,106.6	3,029.6
Class B £250m - 7.879% fixed rate 2038 (note (iii) below)	-	250.0
Class B £250m - 4.51% fixed rate 2022 (note (iv) below)	250.0	-
Senior Mezzanine £127.2m - 11.97% fixed rate 2038 (note (v) below)	-	15.4
Debt issue costs (note (vii) below)	(42.9)	(41.6)
Bond premium deferred	4.4	4.8
Deferred gilt lock proceeds (note (viii) below)	5.4	5.5
Deferred proceeds*	134.5	144.2
Total loans and other borrowings from SWSF	3,458.0	3,407.9
Capex facility £150m – 6 month Libor plus 3% 2017	150.0	100.0
Class A1 Preference shares (note (vi) below)	32.6	32.6
Class B Preference shares (note (vi) below)	110.0	110.0
Obligations under Finance Leases	1.3	-
Total loans and other borrowings	3,751.9	3,650.5

*Deferred proceeds represent consideration received by the company in connection with taking on various debt obligations that were "out of the money" at the time the debt obligations were entered into. The deferred proceeds are amortised over the lives of the related debt instruments.

Notes to the financial statements (continued)

For the year ended 31 March 2013

16 Creditors: amounts falling due after more than one year (continued)

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement) The agreement is over the entire property, assets, rights and undertaking of each of SWS, SWSF, SWS Holdings Limited, and SWS Group Holdings Limited In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence Further, the company has a contingent liability arising on certain inter-company financing arrangements which will have the effect that if certain refinancings do not take place when the underlying instruments mature in 2021 to 2029, the company will make good certain obligations of its subsidiary SWSF The directors do not believe this to be likely and the liability, if any, cannot currently be quantified as it will depend wholly on the circumstances at the time of the maturity

In respect of the specific instruments above

- (i) As at 31 March 2013, SWSF was party to various swap agreements converting a total of £1,318.2m of Class A debt from the original fixed interest rate to a real interest rate linked to RPI (Retail Price Index) plus capitalised inflation on the nominal value of the underlying Class A debt

The table below analyses the total value of swaps entered into by SWSF as at 31 March 2013

Nominal value of debt	Original Fixed interest rate	Swapped Index Linked interest rate	Nominal value of debt plus capitalised RPI
£349.3m	6.192%	3.340%	£384.0m
£141.9m	6.640%	3.699%	£154.6m
£177.0m	5.000%	2.060%	£196.3m
£150.0m	5.000%	0.500%	£195.9m
£200.0m	4.500%	0.060%	£255.2m
£300.0m	5.125%	0.480%	£351.4m
<u>£1,318.2m</u>			<u>£1,537.4m</u>

- (ii) SWSF has entered into swap agreements that have converted £195m of its Class A £300m from a fixed rate of 6.125 per cent to floating rates of Libor plus a margin with a Libor cap at 5 per cent This swapped rate has been reflected in the rate charged to SWS plus 0.01 per cent
- (iii) The interest rate on the Class B £250m is fixed at 7.879 per cent until March 2014 when it reverts to Libor plus a margin to be determined with a premium of 0.01 per cent This loan will be repaid in March 2014 and has been reclassified as a creditor under one year for 2012-13, see note 15
- (iv) The interest rate on the Class B £250m is fixed at 4.51 per cent until March 2022 when it reverts to Libor plus a margin to be determined with a premium of 0.01 per cent
- (v) The interest rate on the Senior Mezzanine loan is fixed at 11.97 per cent until March 2022 when it reverts to Libor plus 6.25 per cent with a premium of 0.01 per cent
- (vi) The preference shares issued have been classified as loans in the financial statements as required by FRS 25 All shares are redeemable at the option of SWS at any time

The Class A1 and B preference shares, which do not carry voting rights, were issued on 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038 or at the company's option anytime earlier Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0m for both classes of shares Class A2 preference shares were issued for £0.01 per share on 7 May 2003 and the amount received totalled £1.500 Class A2 shares, which do

Notes to the financial statements (continued)

For the year ended 31 March 2013

16 Creditors: amounts falling due after more than one year (continued)

not carry voting rights, are also redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows

Class A1 – £40 per share

Class A2 – the base value dividend plus an amount for company out-performance and any savings arising from any refinancing of the Mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Out-performance from 1 April 2007 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by Ofwat in the periodic review.)

Class B – £70 per share

These dividends are payable on 31 March and 30 September each year.

It is anticipated that a dividend will be declared and paid to the A2 preference shareholders in September 2013 for out-performance in the year ending March 2012.

On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

- (vii) Debt issue costs represent issue fees paid to SWSF. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2013 debt issue costs amounted to £46.3m of which £3.4m represents the short-term amount which is disclosed separately in note 15.
- (viii) Prior to the issue of the Class A £300m bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3m, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the profit and loss account over the life of the loan.
- (ix) Deferred revenue relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the profit and loss account evenly over the life of the lease.

Notes to the financial statements (continued)

For the year ended 31 March 2013

17 Provision for liabilities

(a) Environmental obligations	2013	2012
	£m	£m
At 1 April 2012/2011	0.8	0.9
Utilised in year	-	(0.1)
At 31 March 2013/2012	0.8	0.8

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted. Discounting the provision would not materially affect its value.

(b) Deferred taxation	2013	2012
	£m	£m
Accelerated capital allowances	378.3	371.8
Other timing differences	(21.5)	(22.2)
Deferred taxation	356.8	349.6

Movement in deferred tax provision	2013	2012
	£m	£m
Deferred tax provided at 1 April 2012/2011	349.6	402.9
Prior year adjustment	(1.6)	(3.8)
Deferred tax charge in profit and loss account	24.3	(20.4)
Effect of corporation tax rate change	(15.5)	(29.1)
Deferred tax provided at 31 March 2013/2012	356.8	349.6

Deferred tax asset relating to pension deficit	2013	2012
	£m	£m
At 1 April 2012/2011	26.6	23.3
Deferred tax charge in profit and loss account	(5.9)	(4.9)
Deferred tax charged to the statement of total recognised gains and losses	1.8	10.4
Impact of rate change		
Charge in profit and loss account	(0.4)	(1.3)
Charged to the statement of total recognised gains and losses	(0.5)	(0.9)
At 31 March 2013/2012	21.6	26.6

The total deferred tax asset of £21.6m (2011-12 £26.6m) relating to the pension deficit has been deducted from the pension deficit and so has not been included in this balance.

Notes to the financial statements (continued)

For the year ended 31 March 2013

18 Grants and contributions

	£m
At 1 April 2012	47.9
Receivable in year	1.3
Released to profit and loss account	(2.8)
At 31 March 2013	46.4

These grants and contributions relate to non-infrastructure assets

19 Called up share capital

	2013 £m	2012 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	<u>46.1</u>	<u>46.1</u>
Allotted and fully paid		
56,000 ordinary shares of £1 each	<u>0.1</u>	<u>0.1</u>
Non-equity shares		
Issued		
Preference shares		
32,607 Class A1 shares of £1 each	0.0	0.0
32,607 Class A2 shares of £0.01 each	0.0	0.0
110,000 Class B shares of £1 each	<u>0.1</u>	<u>0.1</u>

The preference shares are classified as debt in line with FRS 25. They are disclosed within note 16 at an amount of £142.6m including share premium of £142.5m. The total statutory company share premium of £188.8m includes ordinary share premium of £46.3m.

Notes to the financial statements (continued)

For the year ended 31 March 2013

20 Reconciliation of movement in shareholder's funds

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2012	0.1	46.3	760.3	806.7
Profit after tax	-	-	156.9	156.9
Dividends paid	-	-	(43.2)	(43.2)
Actuarial loss on pension scheme	-	-	(7.3)	(7.3)
Movement on deferred tax relating to pension asset	-	-	1.2	1.2
At 31 March 2013	0.1	46.3	867.9	914.3

The profit and loss reserve includes recognised losses of £93.7m (2011-12 £96.3m) less deferred taxation of £21.6m (2011-12 £26.6m) in respect of pension scheme liabilities of the company pension fund

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2011	0.1	46.3	753.0	799.4
Profit after tax	-	-	79.9	79.9
Dividends paid	-	-	(42.1)	(42.1)
Actuarial loss on pension scheme	-	-	(40.0)	(40.0)
Movement on deferred tax relating to pension asset	-	-	9.5	9.5
At 31 March 2012	0.1	46.3	760.3	806.7

21 (a) Cash flow from operating activities

	2013 £m	2012 £m
Continuing operations		
Operating profit	331.0	271.6
Depreciation charge	216.2	206.8
Difference between pension charge and cash contributions	(11.4)	(0.8)
Amortisation of grants and contributions	(2.8)	(2.7)
Decrease in environmental provision	-	(0.1)
Decrease/(Increase) in stocks	0.4	(0.3)
Increase in debtors	(25.8)	(1.0)
(Decrease)/Increase in creditors	(7.8)	13.6
Total net cash inflow from operating activities	499.8	487.1

Notes to the financial statements (continued)

For the year ended 31 March 2013

21 (b) Analysis of net debt

	At 31 March 2012 £m	Cash Flow £m	Other non- cash changes £m	At 31 March 2013 £m
Cash deposits	75.4	64.5	-	139.9
Cash	75.4	64.5	-	139.9
Debt issue costs	44.4	4.7	(2.8)	46.3
Gilt lock proceeds (see note 16)	(5.7)	-	0.2	(5.5)
Loan to subsidiary	-	247.5	-	247.5
Loans due within one year	(40.3)	(250.0)	-	(290.3)
Loans due after one year	(3,686.6)	(34.6)	(66.9)	(3,788.1)
Finance leases	-	-	(1.3)	(1.3)
	<u>(3,612.8)</u>	<u>32.1</u>	<u>(70.8)</u>	<u>(3,651.5)</u>

The non-cash movement of £70.8m relates to an increase in debt as a result of indexation plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and an increase in finance lease obligations

Loans due within one year relate to loans from group undertakings that are repayable on demand (see note 15)

22 Pensions

The company accounted for pension costs during the year under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £72.1m (2011-12 deficit £69.7m). The deficit has arisen mainly as a result of lower expected future returns on investments and turbulence in the stock market, including low interest rates. The net FRS 17 deficit has increased due to a reduction in the related deferred tax asset, although the underlying deficit before tax has improved slightly. These movements are analysed below.

Pension schemes operated

The company principally operates two schemes, details of which are shown below.

- 1 Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, was closed to new members on 31 December 1998, re-opened in July 2003 and closed once more to new entrants on 1 April 2005. This scheme has nine trustee directors. The Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS, on 1 April 2005.

The assets of the scheme are held separately from those of the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual Pooled Fund level (not Client holding level).

- 2 A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

Contributions made to the defined contribution scheme for the year ended 31 March 2013 amounted to £1.0m (2011-12 £0.7m). No contributions were outstanding at the year end.

Notes to the financial statements (continued)

For the year ended 31 March 2013

22 Pensions (continued)

Members of all schemes receive an annual statement of their accrued benefits

The latest actuarial valuation of the SWPS was carried out as at 31 March 2010 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows

	2010
	SWPS
	% pa
Return on investments pre-retirement	7.2
Return on investments post-retirement (pensioner/non-pensioner)	5.2/5.25
Salary growth	5.2
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.8

The assets of the scheme had a market value of £479.6m at 31 March 2010. This was sufficient to cover 81 per cent of the scheme's benefits.

Following a comprehensive review process in 2012-13 the company implemented significant agreed changes to the SWPS to improve the long term sustainability of the scheme. These changes were implemented on 1 April 2013 and include the capping of pensionable pay increases (at the lower of RPI and 2.5 per cent each year), increasing the minimum rate of employee contributions, and reducing the standard accrual rate from 60ths to 80ths. As a result of the agreement of these changes in 2012-13 a curtailment gain of £9.0m has been included within operating profit for 2012-13.

Expected employer and employee contributions to the defined benefit scheme for 2013-14 are £8.9m and £0.3m respectively under the current Schedule of Contributions. An actuarial valuation as at 31 March 2013 is currently underway, and a new Schedule of Contributions will be agreed as part of this valuation, which could result in a different level of contributions being paid.

Notes to the financial statements (continued)

For the year ended 31 March 2013

22 Pensions (continued)

FRS 17 – assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuation was carried out as at 31 March 2010 and updated to 31 March 2013 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2013	2012	2011
	% pa	% pa	% pa
Price inflation (RPI)	3.2	3.0	3.5
Price inflation (CPI)	2.3	2.1	2.6
Rate of increase in salaries (plus an age-related promotional scale)	2.5	3.0	3.0
Rate of increase of pensions in payment (MIS* members only)***	2.3	2.1	2.6
Rate of increase of pensions in payment (Old section** members only)***	3.2	3.0	3.5
Rate of increase of pensions in payment (all other members)***	3.1	3.0	3.3
Rate of increase for deferred pensions (MIS* members only)***	2.3	2.1	2.6
Rate of increase for deferred pensions (all other members)***	3.1	3.0	3.5
Discount rate	4.4	4.8	5.6
Expected return on assets	4.7	5.4	6.9

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5 per cent per annum cap on increases that apply to other sections of the Scheme.

*** In excess of any Guaranteed Minimum Pension (GMP) element.

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2012-13, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with the medium cohort projections with a 1 per cent pa underpin, modified to reflect actual experience.

	2013	2012
	years	years
Longevity at age 65 for current pensioners		
Male	22.7	21.9
Female	24.6	24.7
Longevity at age 65 for future pensioners		
Male	24.6	23.3
Female	26.4	26.2

Notes to the financial statements (continued)

For the year ended 31 March 2013

22 Pensions (continued)

The assets and liabilities in the schemes and the expected rates of return at 31 March 2013 and 31 March 2012 were

	Rate of return 2013	Rate of return 2012	Value at 2013 £m	Value at 2012 £m
Equities	6.8%	7.1%	261.7	268.9
Government bonds	2.8%	3.1%	128.8	118.9
Non-Government bonds	4.1%	4.6%	178.0	125.1
Cash	3.2%	3.0%	7.5	6.9
Total market value of Plan assets			576.0	519.8
Total value of Plan liabilities			(669.7)	(616.1)
Accrued deficit in the Plan			(93.7)	(96.3)
Related deferred tax asset			21.6	23.1
Deferred tax on current year pension contribution			-	3.5
Net pension liability			(72.1)	(69.7)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price following the adoption of the amendment to FRS 17

Reconciliation of the present value of the scheme liabilities

	2013 £m	2012 £m
At 1 April 2012/2011	616.1	560.7
Current service cost	6.5	6.2
Interest cost	29.2	31.0
Member contributions	0.3	0.3
Actuarial loss on liabilities	50.3	39.5
Benefits paid	(23.7)	(21.6)
Curtailments	(9.0)	-
Scheme liabilities at 31 March 2013/2012	669.7	616.1

Sensitivity analysis of scheme liabilities

The sensitivity of the present value of the scheme liabilities to changes in the principle assumptions used is set out below

	Change in assumption	Impact on scheme liabilities (%)	Impact on scheme liabilities (£m)
Discount rate	+/- 1%	-/+ 15	-/+ 100
Rate of inflation*	+/- 1%	+/- 13	+/- 90
Rate of increase in pensions in payment	+/- 1%	+/- 11	+/- 75
Mortality	+/- 1yr	+/- 2	+/- 13

*A change in inflation is assumed to be reflected in a change in the assumed rates of deferment revaluation and pension increase (on pension in excess of GMP)

Notes to the financial statements (continued)

For the year ended 31 March 2013

22 Pensions (continued)

Reconciliation of the fair value of the scheme assets	2013	2012
	£m	£m
At 1 April 2012/2011	519.8	500.6
Expected return on assets	27.7	34.0
Gain/(loss) on assets	43.0	(0.5)
Employer contributions	8.9	7.0
Member contributions	0.3	0.3
Benefits paid	(23.7)	(21.6)
Bid value of scheme assets at 31 March 2013/2012	576.0	519.8

The actual gain on scheme assets was £70.7m (2012 £33.5m)

Analysis of amounts charged to operating profit are as follows	2013	2012
	£m	£m
Employer's current service cost	6.5	6.2
Expected return on pension scheme assets	(27.7)	(34.0)
Interest on pension scheme liabilities	29.2	31.0
Curtailments	(9.0)	-
Total P&L expense before deduction for tax	(1.0)	3.2

Analysis of the amounts recognised in STRGL	2013	2012
	£m	£m
Actuarial return less expected return on pension scheme assets	43.0	(0.5)
Experience gain/(loss) arising on scheme liabilities	1.1	(4.9)
Loss on change of assumptions (financial and demographic)	(51.4)	(34.6)
Total loss recognised in STRGL before adjustment for tax	(7.3)	(40.0)

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses is £139.6m (2011-12 £132.3m)

Analysis of the movement in the schemes' deficit during the year	2013	2012
	£m	£m
Deficit in the scheme at 1 April 2012/2011	(96.3)	(60.1)
Employer's contributions	8.9	7.0
Employer's current service cost	(6.5)	(6.2)
Cost of curtailments	9.0	-
Other finance expense	(1.5)	3.0
Actuarial loss	(7.3)	(40.0)
Deficit in the scheme at end of year	(93.7)	(96.3)
Deferred tax relating to scheme deficit	21.6	23.1
Deferred tax on current year pension contribution	-	3.5
Net deficit at end of year	(72.1)	(69.7)

Notes to the financial statements (continued)

For the year ended 31 March 2013

22 Pensions (continued)

History of gains and losses for the year to 31 March 2013 are as follows	2013	2012	2011	2010	2009
a. Experience adjustment on planned assets					
Amount (£m)	<u>(43 0)</u>	<u>0 5</u>	<u>(1 1)</u>	<u>(83 6)</u>	<u>104 3</u>
b. Experience adjustment on scheme liabilities					
Amount (£m)	<u>1.1</u>	<u>4 9</u>	<u>(6 0)</u>	<u>12 9</u>	<u>(13 1)</u>
c. Total amount recognised in the STRGL					
Fair value of assets at year end (£m)	576 0	519 8	500 6	480 2	318 8
Actuarial value of liabilities at year end (£m)	(669.7)	(616 1)	(560 7)	(589 0)	(434 5)
Deficit in scheme at year end (£m)	<u>(93.7)</u>	<u>(96 3)</u>	<u>(60 1)</u>	<u>(108 8)</u>	<u>(115 7)</u>

The assets in the current year and the years ended 31 March 2012, 2011 and 2010 have been valued at bid value as per FRS 17 amendment. Southern Water has taken advantage of an exemption in FRS 17 amendment, not to restate the years prior to 31 March 2009 at bid value.

23 Contingent liabilities

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water's valuation.

The company had no contingent liabilities for capital claims at the year end (2011-12 £nil).

24 Financial commitments

As at 31 March 2013, the company had annual commitments under non-cancellable operating lease agreements in respect of vehicles and land and buildings for which the payment extends over a number of years as follows:

	Land and Buildings		Other	
	2013 £m	2012 £m	2013 £m	2012 £m
Expiring within one year	-	-	-	-
Expiring between two and five years	-	-	-	0 1
Expiring after more than five years	<u>1.3</u>	<u>1 3</u>	<u>-</u>	<u>0 1</u>
	<u>1.3</u>	<u>1 3</u>	<u>-</u>	<u>0 2</u>

Operating leases are charged to the profit and loss account over the lease term.

25 Related party transactions and ultimate holding party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited, a company incorporated in Jersey.

The major shareholders in Greensands Holdings Limited as at 31 March 2013 are IIF International SW UK Investments Limited (advised by JP Morgan Investments Inc.) and The Northern Trust Company.

Notes to the financial statements (continued)

For the year ended 31 March 2013

25 Related party transactions and ultimate holding party (continued)

Greensands Holdings Limited is the only group company to prepare consolidated financial statements, copies of which may be obtained from the Company Secretary of Greensands Holdings Limited at Southern House, Yeoman Road, Worthing, BN13 3NX

The company has taken advantage of the exemption under FRS 8, 'Related Party Disclosures', (revised) in not disclosing details of transactions with other companies which are 100 per cent owned on the basis that the consolidated financial statements in which the company is included are publicly available

Independent Auditor's report to the members of Southern Water Services Ltd

We have audited the financial statements of Southern Water Services Ltd for the year ended 31 March 2013 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements

- Give a true and fair view of the state of the company's affairs as at 31 March 2013 and of its profit for the year then ended
- Have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice
- Have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- Adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- The financial statements are not in agreement with the accounting records and returns, or
- Certain disclosures of directors' remuneration specified by law are not made, or
- We have not received all the information and explanations we require for our audit



James Leigh (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
26 June 2013