Interim Financial Information and Report

for the six months ended 30 September 2020
(Unaudited)

from Southern Water

Contents

Chairman's introduction

I am pleased to introduce our Interim Financial Statements for 2020.

Over the past six months, I have seen the dedication with which every colleague at Southern Water has responded to both the continuation of weather extremes through this summer and the impact of the COVID-19 pandemic on our customers, our communities and, therefore, on our business. That dedication has also been apparent in the continuing transformation of the business and our response to the company's most challenging price review yet. We emphasise the need to engage openly with stakeholders at many levels on the question of whether the current five-year settlement is sufficiently responsive both to the wider environmental agenda and to the changes occurring to customers' circumstances and operational constraints through COVID-19.

So much change has already happened at Southern Water. While there are ongoing investigations into our past behaviours and performance record, I know the commitment among our teams to make the required changes to people, processes and systems. These are not just designed to prevent mistakes being repeated but also to ensure that we do the right things for our customers and stakeholders over the long term.

Delivering essential services as we assess the impact of COVID-19

Like every other business, over the past six months Southern Water has had to adapt to new ways of working in the wake of the COVID-19 pandemic. At the start of the pandemic, we moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities:

- Maintaining provision of essential services at all times;
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers;
- Providing the maximum practicable level of assistance to our vulnerable customers; and
- Protecting the financial stability of our business.

I am extremely proud of the way that our people, and our business as a whole, have performed against these priorities. All of our staff deserve credit for focusing on protecting the working of our essential services and our frontline workers deserve particular attention; many of them have taken, and continue to take on, a higher degree of risk for themselves and their families, to ensure that water keeps flowing and wastewater is treated continuously.

We took a number of immediate steps to help our customers, introducing payment breaks and streamlining the application process for our support tariffs. Given the financial impact of the pandemic, we took the position that it would be inappropriate to follow our usual debt collection processes, so we temporarily stopped many of those activities. We also made donations to food banks and community foundations across our region and focused our attention on increasing the number of customers in vulnerable circumstances on our Priority Register so we could make sure they had access to the services they need in an emergency. From February to September 2020, the number of customers on our register has increased by 52%.

For more detail about our COVID-19 response and new ways of working, see page 5.

Meeting demand for our services

We experienced record water demand this summer due to a combination of the hot weather and more people at home as a result of COVID-19 lockdowns and some of the highest increases in water use across the industry. Thankfully we had been preparing for such extremes, improving our resilience and incident response processes and systems, which meant we were able to keep our customers in supply during the hot weather in July and August.

Medium-term weather and demand forecasting allowed us to understand our risk early. We were also able to quickly set up 'COVID-19 friendly' drive-through bottled water sites in those areas where we had a high risk of impact to supplies; at the same time making enhancements to our vulnerable customer data enabling us to quickly deliver to those most in need, in case of an interruption to supply.

We know there is still more work to do to ensure our incident response is consistent and that our teams are on hand to reassure customers no matter when an issue should occur, but we are working hard to review every single incident, to understand where failures are happening so that they are not repeated.

Addressing failings in our environmental performance

The Environment Agency released the Environmental Performance Assessment (EPA) in October, downgrading Southern Water from a two-star to a one-star company. I have spoken to the Chair of the Environment Agency recently and been clear that changing pollution performance for the better is a central part of our transformation. That begins with detailed and full disclosure of where problems arise, even if this means highlighting our own poor performance through our self-reporting record which I am pleased to say is now industry-leading. The second part is all about deep understanding of root-causes and intelligent design of solutions and we have both made great progress in this over the past year and strengthened our executive team to deliver the programmes that will make a positive difference.

In September we published our Pollution Incident Reduction Plan, which was shared with the Environment Agency following months of work. The detailed Pollution Incident Reduction Plan is published at: **southernwater.co.uk/our-performance/reports/pollution-reduction-programme**.

Our plans for 2020–25 and our public commitment to creating a more resilient future

We accepted Ofwat's Final Determination of our price controls for 2020–25 in February 2020, despite the significant challenge it presents in delivering what our customers wanted within the financial envelope that Ofwat has set.

We decided not to take our case to the Competition Markets Authority; however, we watched with interest as the four companies that did received support for their arguments and, in some cases, access to additional funding. We await the final judgment of the CMA's independent review next year and we look forward to working with Ofwat to ensure that its findings are reflected in future price reviews.

Our priorities for 2020–25 are to be brilliant at the basics, delivering clean, safe water, through a reliable network, at a price that everyone can afford. We will continue to develop good quality customer service along the way, while ensuring the future resilience of our network through our transformative programmes.

Our plan to 2025 will see us invest £3.2 billion, at 2017–18 prices, across the region, creating jobs, protecting and improving the local environment, while updating our water and wastewater network. We have developed solutions that align to our customers' priorities: driving outcomes in customer service; support for those in vulnerable circumstances; water quality; managing flooding; and reducing leakage, pollution and interruptions to supply.

Our Water for Life – Hampshire programme work continues apace, to protect the Test and Itchen rivers in Hampshire while securing wholesome, reliable water sources for more than 700,000 customers in the area.

The most recent evidence presented to our regulators concludes that there is no certainty any of the major solutions can be successfully delivered in time to meet the March 2027 deadline. This commitment, which we continue to work with all best endeavours to meet, was made as part of our Section 20 Agreement with the Environment Agency. Further discussions with our regulators and stakeholders are needed to understand how we can work together to ensure the outcome delivers the best value for customers and the environment.

Rebuilding trust as we continue our transformation

As a Board, we adopted our refreshed core values – succeeding together, doing the right thing and always improving – in 2019. These inform everything we do. This cultural shift, supported by strong leadership, has helped us to begin to improve relationships with our regulators. However, we know that to continue to build confidence and credibility among our stakeholders, we need to continue to demonstrate tangible improvements in performance.

In spite of the challenging conditions created by the hot weather over the summer and the COVID-19 pandemic, we have maintained supply to our customers and met our abstraction compliance levels throughout a period of sustained increase in demand. We have also kept incidents of both internal and external flooding to a minimum in the face of weather events such as Storm Alex, as the hard work to address past failings in our processes, people and systems begins to deliver improved performance in incident response, particularly during supply interruption events.

Through careful planning and review of our four key priorities, we have maintained the financial stability of the company. Our business plan for 2020–25 sets out a number of challenging targets requiring a significant level of investment, and we continue to refine and implement these plans, as well as our key transformation programmes, as we deal with the current situation.

In May 2020 we successfully secured £825 million in sustainable bonds in one of the biggest public market financing issues for the water sector in recent years. This established an environmental, social and governance (ESG) sustainable financing framework to help support our business plan and aligns our long-term strategy with our social and environmental commitments.

We know that we still have a lot to do to improve our performance across key areas such as customer experience, pollutions, water quality and leakage, but I am confident that the plans we have in place and the continued transformation of the business will begin to deliver tangible results in terms of improved performance as we enter the latter half of this year.

K G Lough

Keith Lough
Chairman
27 November 2020

The market we operate in

Ofwat investigations

As previously announced, and as explained in our Annual Report 2019–20, Southern Water's wastewater treatment compliance was under investigation by Ofwat due to breaches of statutory obligations between 2010–17.

A Final Notice setting out the plans for Southern Water to make rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance, was published by Ofwat in October 2019.

The rebates to current customers began with the April 2020 bills. The scheme to compensate those eligible former customers was open until 30 September 2020. The Notice confirmed that the reduction in wastewater charges for current customers, and the payments to former customers, will total £123 million (in 2017–18 prices), together with a £3 million fine.

Environment Agency investigations

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations. The company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and we have entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation. We will be open and transparent and are committed to working with the agency to ensure a swift conclusion to resolve the case. Since Chief Executive Ian McAulay joined in 2017, he has been driving thorough internal reviews of our wastewater business and is leading a major transformation programme, which has already delivered a number of improvements to processes, people and systems.

For the reasons also set out in note 14 to the interim financial statements and note 26 to the financial statements in Southern Water's Annual Report and Financial Statements 2019–20 (see page 246), supported by legal advice, the Board has concluded that it is not yet possible to make a reliable overall estimate of the financial obligation that will arise from this prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with these charges and has therefore recognised a provision of £1 million reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level.

When considering the above it is noted that there is no clarity as to how these charges may evolve and how the disputed levels of culpability and environmental harm may be determined. The sentencing guidelines are very wide and there is a requirement for the court to examine the financial circumstances of the organisation in the round. The Board will continue to review the level of provision made as more information becomes available.

We are also committed to assisting the Environment Agency with its separate investigation into sampling compliance and reporting issues between 2010 and 2017 (inclusive). The Board, supported by legal advice, has again, and for similar reasons, concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

Our COVID-19 response

The COVID-19 pandemic continues to create a great amount of uncertainty, but throughout we have continued to provide essential water and wastewater services to customers. In doing so, we have needed to be both responsive and agile in our plans to ensure public health as the pandemic continues to develop. At the same time, we know the implications for our business have been and continue to be both significant and lasting, both operationally and financially.

Within a week of the start of the pandemic, we had developed our COVID-19 Business Continuity Plan, which is reviewed and adjusted on a weekly basis, as appropriate. Our budget for 2020 and plans to 2025 have been used as the baseline and all decisions and changes, implemented as a result of COVID-19, are managed through existing governance processes.

The Business Continuity Plan continues to run against four basic priorities:

- Maintaining provision of essential services at all times;
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers;
- Providing the maximum practicable level of assistance to our vulnerable customers; and
- Protecting the financial stability of our business

In terms of our frontline water and wastewater services, we are prioritising work and resources to maintain supplies to customers and protect the environment. As a result of some resource constraints and workforce limitations, it has been necessary for some of our regulatory compliance schemes to be delayed. We are taking a risk-based approach to these delays and we will not be delaying any regulatory scheme that is deemed to be critical where it can be delivered in a COVID-19 secure manner.

With more people working from home and families in lockdown, we have seen changes in water usage and demand for water. This is something we have needed to react to and ensure service levels have been maintained.

At the same time, our wastewater teams have also safely disposed on around 2.5 million pints of waste beer at 177 sites, avoiding pollution and compliance issues while supporting local businesses. They have also been supplying waste disposal for cruise liners along our coast.

At this point, we are pleased to report no service loss due to COVID-19 while all operational incidents have been managed in a COVID-19 secure manner, building on the investment in our incident management capability since the Freeze/Thaw in March 2018, successfully preventing or limiting customer impact and adopting new approaches to support customers in a COVID-19-secure manner when incidents have happened.

The health and safety of our own employees has been a priority as all teams, both office and field-based, have adapted to new ways of working. We are pleased to report that all our workplaces are now COVID-19 secure, as we continue to follow stringently Government guidance. We have not furloughed any colleagues. Remote working has been enabled for over 1,700 employees and we have improved dependency leave during COVID-19. Around 450 colleagues have so far been offered self-isolation support. We continue to monitor the situation and adapt our plans. Read our full COVID-19 risk assessment at **southernwater.co.uk/media/3520/ covid-19-risk-assessment-v10-final.pdf.**

In terms of our household customers, we know that many are facing uncertain futures and will find it difficult to pay their water bills. As a result, we made the decision to support them in the short term, offering payment breaks and increased access to our support tariffs while making sure that we monitor and prepare for the potential of increasing bad debt in the long term. We have also signed up nearly 8,000 additional customers in vulnerable circumstances to our Priority Services Register.

The business retail market has been hit hard, as businesses felt the impact of COVID-19. As a wholesaler, we are offering support where we can, improving the level of service we offer, supporting our most vulnerable customers, while optimising our activities to deliver further efficiencies.

In terms of our supply chain resilience, there are risks that some chemicals, equipment and manpower may become more difficult to secure in a timely manner during COVID-19 disruption. To date we have widened our sourcing approaches and worked collaboratively with the sector, our supply chain and regulators to prepare for any issues. We have conducted a risk assessment across all our critical supply chain partners to understand their ability to maintain continuity of essential goods and services and have supported a number of supply chain partners where appropriate. We have not yet seen any significant impact in this area. Risk monitoring and management continues, in particular with regard to COVID-19 and the end of the EU exit transition period coinciding in 2021.

As time goes on, we still do not know the full extent to which our business, our employees or supply chain partners will be affected by the COVID-19 pandemic. Nor do we know the final financial impact this pandemic will have, and how that may influence our business priorities in the long term. However, we are tracking all COVID-19 costs against our baseline and continue to assess the situation.

It is clear that the impact of COVID-19 will last for months, if not years, and we will continue to follow all Government guidelines in their entirety, doing all we can to enable the ongoing operation of the business, while equipping our colleagues to continue to work 'as normal' during the pandemic while maintaining our essential services and support for our customers.

Responding to Brexit

Changes in the political landscape (e.g. Brexit) may cause costly consequential impacts on the water sector to which we will have to adapt. We are well advanced with our Brexit planning and have worked with the wider industry and Government to ensure an integrated approach. Ian McAulay, our Chief Executive Officer also regularly attends meetings and other events with Water UK in respect of matters pertinent to the water sector as a whole, such as preparations for Brexit.

How we measure our progress

Deliver great service

DWI Compliance Risk Index (CRI) – Aim for a score of zero on this new measure of drinking water compliance risk.

Drinking water appearance, taste and odour – Continue to reduce the number of customers needing to contact us about their water quality, be that appearance or taste and odour.

Replace lead customer pipes – Provide customers in affected areas with grants towards the cost of replacing lead plumbing, reducing the risk from lead in drinking water.

Water supply interruption – Continue to reduce the average time customers are without water with a reduction of 23% between 2020–21 and 2024–25.

C-MeX – Improve both the overall customer experience and our handling of customer contacts.

Void properties and gap sites – Reduce by more than 10% the number of unbilled, occupied households, reducing the burden of debt on our bill paying customers, as well as identifying any properties missing from our billing system.

Internal sewer flooding – A 20% reduction in the number of internal sewer flooding incidents affecting customers' homes between 2020 and 2025.

External sewer flooding – A 20% reduction in sewer flooding affecting outside areas between 2020 and 2025.

Customer satisfaction with vulnerability support – Satisfaction with the tailored support offered to customers in vulnerable circumstances, with the aim of a 90% satisfaction rate by 2025.

Effectiveness of financial assistance – Aiming for 90% effectiveness of our financial assistance for customers, making their bills more affordable and helping them pay their bills.

Priority services for customers in vulnerable circumstances – Increase the number of customers in vulnerable circumstances on our Priority Services Register.

Value for money – Increasing, to 75% by 2025, the proportion of customers who believe we deliver services that represent value for money.

Properties at risk of receiving low pressure – A 25% reduction in the number of households suffering from persistent water pressure problems, reducing the number to just 182 by 2025.

Use water wisely

Leakage – Reduce leakage by 15% over the five years from 2020 to 2025.

Per capita consumption – Reduce personal water consumption by 7%, to 122.7 litres per person, per day by 2025.

Target 100 – Reduce personal water consumption to 100 litres per person, per day by 2040, with 55% of households meeting this target by 2025.

Water saved from water efficiency visits – Reduce household water use by increasing the number of free water efficiency visits conducted in customers' homes, saving 2,500 cubic metres a day by 2025.

Access to daily water consumption data – Provide customers with easy access to data about how much water they use, helping them to make informed choices and reduce their bills.

Protect and improve the environment

Pollution incidents – Reduce pollution incidents to less than 80 by 2025, aiming for zero pollution by 2040.

Thanet sewers – Deliver the third phase of our groundwater protection sewer scheme for Thanet.

Delivery of water industry national environment programme of requirements – Deliver more than £500 million of investment to meet the requirements of the Water Industry National Environment Programme (WINEP), improving the natural environment and ensuring that water can be taken from rivers and lakes without any negative impact.

River water quality – Deliver our part of the Water Industry National Environment Programme (WINEP), improving the health of 182 kilometres of rivers in our region.

Maintain bathing waters at 'Excellent' – Maintain the current 'Excellent' water quality status at 57 beaches designated for swimming in our region, supporting the continued development of the leisure and tourism industries.

Improve the number of bathing waters to at least 'Good' and improve the bathing waters at 'Excellent' quality – Improve bathing water quality, at five sites to Good and at two sites to Excellent water quality status.

Treatment works compliance – Maintain and improve our wastewater treatment works, aiming for 100% compliance with Environment Agency standards.

Combined Sewer Overflows (CSO) monitoring – Ensure we have effective and functioning monitoring equipment in place at all of our CSOs, helping to reduce sewer flooding and pollution incidents.

Distribution input – Effective management of our water resources, in turn reducing the need to take water from the environment.

Abstraction incentive mechanism – Reduce, by 15 Ml/d, the amount of water we take from the River Itchen at Otterbourne and Twyford in September when river flows or levels are low.

Effluent re-use – Develop effluent re-use solutions, reducing the demand for potable water and, in the long term, improving the resilience of drinking water supplies.

Renewable generation – Generate 24% of our electricity from renewable sources by 2025.

Natural capital – Better understand the current condition of the environment that we own, or can influence, and the impact of our work, producing natural capital accounts for three catchments in our region by 2025.

Satisfactory bioresources recycling – Ensure correct use and disposal of sludge created from the wastewater treatment process, ensuring that 100% of biosolids we recycle to agricultural land are compliant with guidelines.

Fit for the future

Mains repairs and unplanned outage – Maintain and improve the health of our water treatment sites and network, reducing the number of mains bursts by 30% over five years and the proportion of treatment capacity out of service from 9% to 3%.

Risk of sewer flooding in a storm – Improve our understanding of flood risk and ensure the proportion of customers at risk of flooding in a severe storm does not increase.

Sewer collapses – Maintain and improve the health of our wastewater network, reducing the number of asset failures.

Water supply resilience – Through our Network 2030 initiative, reduce the risk of customers experiencing loss of supply for more than 48 hours in the Thanet, Brighton and Isle of Wight water supply zones.

Long-term supply and demand schemes – Ensure future customers have access to sufficient water supplies, by making progress toward delivering an additional 182.5 Ml/d of new water resource capacity.

Risk of severe restrictions in a drought – Maintain our performance of no customers being at risk of severe water restrictions in a drought.

Impounding reservoirs – Deliver our agreed reservoir safety schemes, reducing the risk of failures.

D-MeX – Improve the experience we provide to developer services (new connections) customers, including property developers, self-lay providers and those with new appointments and variations (NAVs).

Surface water management – Use Sustainable Urban Drainage (SUDs) approaches to reduce the amount of surface water in our network, reducing the risk of pollution incidents and sewer flooding.

Community engagement – Improve our community engagement, as measured by external benchmarks and reflecting an ongoing commitment to working with charities, community groups and partners in our region.

Schools visited and engagement with children – Increase the amount of good or excellent feedback from schools we visit to raise awareness and improve understanding of the value of water, water efficiency and 'unflushables'. Targeting 90% positive feedback.

RAG status, based on forecast end-of-year position:

- Green indicates where we have met or exceeded a performance commitment.
- Amber indicates where we have missed a performance commitment but are still on target to deliver the outcomes we promised to customers over the five-year period.
- Red indicates where we have not met a performance target and have not delivered the outcomes we promised to customers. In some cases we will incur a penalty for the shortfall.
- Not measured mid-year based on annual survey.

Deliver great service

		Performance 2020–21
Water quality: It is essential to always provide clean safe drinking water. This is seen a basic service from a water company and the most important of the services we provide. Our customers' preference is for water to be as natural as possible.	DWI Compliance Risk Index (CRI)	Red
	Drinking water appearance	Green
	Drinking water taste and odour	Green
	Replace lead customer pipes*	Red
Supply interruption: Customers want us to be able to deal with problems, such as interruptions, quickly and efficiently. Any interruptions require clear communication, as they can cause inconvenience and distress to customers.	Water supply interruption	Red
Customer experience: Customers want to see us improve our customer service performance. They want us to minimise the impact of issues and disruptions to their daily life. When shown comparative information, they expect us to do better.	C-MeX	Amber
	Void properties**	Red
	Gap sites***	Red
Sewer flooding prevention: It is essential that our network stops homes being flooded with waste from sewers. There is strong support to ensure we continue to improve sewer flooding prevention.	Internal sewer flooding	Amber
	External sewer flooding	Green
Supporting the vulnerable: Customers find the concept of the social tariff acceptable. They want us to protect the most vulnerable in society, and find it acceptable to pay a little extra on their bill to help those in genuine need. They want us to partner and provide support by understanding and acting on customers' individual circumstances.	Customer satisfaction with vulnerability support	Not measured
	Effectiveness of financial assistance	Red
	Priority services for customers in vulnerable circumstances	Red
	Value for money	Not measured
Water pressure: Customers expect a standard of water pressure to be part of the basic service we provide.	Properties at risk of receiving low pressure	Red

* 'Replace lead customer pipes' only applies in the Deal (Kent) water supply zone, where a co-delivery trial is being conducted, offering grants to affected customers. The scheme is currently on hold.

** While progress year to date is below target, work is ongoing to reduce the number of void properties on our systems. With COVID-19 impacting in-person visits, we have run letter campaigns and continue to source occupier details through third-party services.

*** Focus on Gap Sites identified through the South East Water Joint Billing service. Activities will be operated across Q4.

Deliver great service

Great service for most customers means minimal interaction with us and a reduced impact from issues/disruptions on everyday life.

Where there is engagement, customers want an efficient, tailored and personalised service that provides holistic assistance to those customers who are in genuine need of support.

Water quality

The water reaching customers' taps continues to meet the Drinking Water Inspectorate's stringent water quality tests, with 99.97% of samples meeting all the necessary standards. Our predicted Compliance Risk Index (CRI) score year to date is 5.39. The largest factor affecting the score is bacteriological detections at water supply works. The CRI scoring of some compliance breaches is uncertain due to sampling changes made to accommodate social distancing due to COVID-19. We predict that our CRI score for year-end will see us towards the bottom of the industry league tables.

The number of appearance (formerly discoloration) contacts year-to-date is less than at the same time last year at 0.48 and we are on track to meet our year-end target of 0.83. In terms of taste and odour we have achieved 0.20 contacts against a target of 0.24, and we remain confident we will meet our year-end target. Both appearance and taste and odour measure contacts per 1,000 of the population.

Supply interruptions

Despite a number of major incidents over the prolonged dry period and exceptional temperatures of the summer months, the number of minutes that customers' properties were interrupted for have stayed within target at five minutes and 31 seconds for the first six months of 2020–21. As we enter the winter period, it is unlikely that we will achieve our end-of-year target of six minutes and 30 seconds. However, we continue to do all we can operationally to minimise supply interruptions in the remaining months.

Customer experience

Our performance against Ofwat's new Customer Measure of Experience (C-MeX) for the first two quarters of the year saw us in 16th place out of 17 companies. While our customer experience improvement programme continues to make changes to processes, people and systems, we know we still have more work to do before our performance starts to significantly improve.

C-MeX replaced SIM from April 2020 with each company's score calculated from responses to two surveys, the customer service survey (CSS) and the customer experience survey (CES), each contributing 50% to the calculation of the overall C-MeX score for each company.

Year-on-year our complaint volumes are relatively stable. While we have seen a decrease in both billing and water supply complaints this is being offset by an increase in wastewater complaints. Our underlying metrics show an increase in billing digital transactions, a reduction in call volumes and an increase in Webchat. In August this year we delivered our first set of new online journeys for customers on our website. First contact resolution remains on target with satisfaction from interim customer surveys at 87%.

Sewer flooding prevention

Each flooding incident is hugely distressing for our customers. As such, we take this area of our performance extremely seriously. As of September, we reported 152 internal flooding incidents against a target of no more than 168 at this point in the year. However, as we enter the winter period we expect the number of incidents to increase..

In terms of the number of external flooding incidents, a total of 1,810 have been reported against a target of 2,026.

Factors beyond our control will always put pressure on our sewer network, such as weather events. However, we are confident that our performance during extreme weather events since the beginning of 2020 has started to demonstrate our improved resilience.

Our Zero Flooding project, which began in 2017, is aiming to eliminate sewer flooding incidents in 10 towns and cities across our region, while our Pollution and Flooding Resilience team, is focused on delivering best practice reduction programmes and continuously improving our incident response across our network.

Supporting customers in vulnerable circumstances

Much of the activity over the past six months has inevitably been shaped by the COVID-19 pandemic. Our immediate focus following the national lockdown in March was to ensure that our vulnerable customers were getting the best possible support and that we were providing as much assistance as possible to those who were impacted by the virus. To that end we introduced a number of immediate measures:

- Introduced payment breaks of up to three months for those in financial difficulty as a result of the impact of COVID-19
- Moved to automated renewals for those already on a scheme or tariff
- Simplified the application process for our capped tariff to reduce the burden on customers
- Changed our policy in relation to priority services registration to allow referrals from relatives and trusted third parties
- Provided £20,000 of funding to food banks in our region.

We also focused on customers who we knew may be impacted by the restrictions on daily life that arose from the lockdown measures. We contacted all our customers who pay by cash or payment card (and therefore may not have been able to use their usual payment points) to let them know of the help they could access if they were struggling. We also contacted directly all our Priority Services customers, letting them know of the financial help available, and called our most vulnerable customers simply to 'check-in' and see if there was any further help we could offer.

We know that not all of those customers who need additional help are on our Priority Service Register, so we took the unprecedented step of contacting electronically all those customers for whom we held an email address in order to encourage anyone who required a little bit of extra assistance to get in touch. As a consequence we received approximately 8,000 new registrations, reaching 29,850 customers on our register, an increase of 52% since March 2020. This is slightly below Ofwat's stretching target of 31,587, but we are confident that focused campaigns throughout the autumn will see this figure continue to increase.

Water pressure

During the high temperatures we experienced from the end of May, into both July and August we saw an exceptional increase in water demand, largely as a combined effect of the hot weather and COVID-19 restrictions causing more people to be at home and observing Government hygiene guidance on washing hands. The impact of this and the reconfiguration of the network to maintain consistent supplies of water to our customers has impacted the number of properties at risk of experiencing low pressure, increasing the number of properties at risk on our register to 1,672 against our year-end target of 242. We continue to review of our data to assess how many properties remain affected by poor pressure but we are confident we will be able to start removing properties from the risk register now that the hot summer months have passed.

Use water wisely

		Performance 2020–21
Leakage: Customers say it is essential to reduce the amount of water lost through leaks from our network. They believe water is a precious, natural resource and expect us to look after and use it wisely.	Leakage	✗
Water consumption: Customers were interested in understanding more about their water usage. They see saving water as a partnership issue and are looking for us to help them save more.	Per capita consumption	✗
	Target 100	✓
	Water saved from water efficiency visits	✗
	Access to daily water consumption data*	✗

* While reducing consumption remains a priority, a strategic decision was made to place this metric on hold and focus on other challenges. This is now under review to understand how we can progress the metric.

Use water wisely

Without water, life would be impossible. The work that goes on behind the scenes to deliver drinking water and remove wastewater can sometimes be taken for granted.

When informed, customers recognise the value these services bring to our daily lives, enabling everything that we do. They also understand water is a precious resource that needs to be looked after.

Leakage

We are continuing to invest in improvements in the teams and technology used to detect leaks. We have installed 7,400 acoustic loggers on our network, increased the number of find-and-fix teams on the ground and we are aiming to complete 20,000 leak repairs by April 2021.

Current total average leakage level for the company is 99.58 Ml/d. This increase is expected and follows historical seasonal trends, however, higher than expected household consumption due to COVID-19 measures and the exceptionally hot weather this summer has also impacted estimated leakage levels. The validation of allowances applied to leakage continues and should have a positive impact.

Water consumption

As a company operating in a water-stressed area, we are committed to helping our customers reduce their water consumption. We are aiming to help them get from 126.5 litres per person, per day (2019–20) to 122.7 litres by 2025 and 100 litres by 2040.

We have seen an increase in domestic consumption since the start of the COVID-19 pandemic, albeit offset by a decrease in commercial consumption. Individual daily usage is currently 131.9 litres, which is now calculated on a rolling 12 month average.

Our target for 2020–21 was to get 49% of domestic households using fewer than 100 litres per person, per day; we have already reached this target. We have achieved this through continued customer education campaigns and water-saving home visits to offer free water-saving product installation to households with high consumption. These briefly stopped during the COVID-19 lockdown, but resumed again in August.

Protect and improve the environment

		Performance 2020–21
Pollution: Customers want us to treat and dispose of wastewater in a way that does not harm the environment. They believe we have a duty to protect and improve the environment in which we operate, and ensuring we do no harm through pollution incidents is the minimum they expect.	Pollution incidents	✗
	Thanet sewers	✓
High quality bathing and river waters: Our customers want to see us do more to deliver excellent bathing and river water quality. They want us to recognise the importance of this to tourism.	Delivery of water industry national environment programme requirements*	✗
	River water quality	✓
	Maintain bathing waters at 'Excellent'	⊘
	Improve the number of bathing waters to at least 'Good'	⊘
	Improve the bathing waters at 'Excellent' quality	⊘
	Treatment works compliance**	✗
	Combined Sewer Overflows (CSO) monitoring	✓
Water resource abstraction: Customers want us to use a range of sources to provide reliable services in the future and expect removal of water from the environment to be done in a sustainable way.	Distribution input	✗
	Abstraction incentive mechanism	✓
	Effluent re-use	✓
Renewables: We should be increasing the amount of renewable energy we use in our operations. There is a growing expectation that we should be using our own wastewater services to generate energy as well.	Renewable generation	✗
	Natural capital	⊘
	Satisfactory bioresources recycling	✓

* Year one scheme deadlines have been moved into year two due to COVID-19 so there are no year 1 AMP7 deliveries with a deadline this year. Some Year 5 2015–20 deliveries were moved into this year. Based on information from the Environment Agency, we have 42 schemes to deliver, but unfortunately have missed one.

** This is a calendar year based measure, with the number of failed works at the end of September being 7. While the number of monthly sample breaches and exceptions has reduced, and we continue to make compliance a priority, the underlying risk remains high and we are forecasting a penalty in this area.

Protect and improve the environment

We are all responsible for the state of the environment. Customers want to see us protect and improve the environment; doing no harm is the absolute minimum they expect.

Pollution

We had 374 pollution incidents as of September (pre-verification by the Environment Agency (EA)), above our target for this point in the year. Post-verification our year-end forecast is 394. We know this performance is unacceptable and we have now published a detailed Pollution Incident Reduction Plan (PIRP), which we have shared with the Environment Agency (**southernwater.co.uk/media/3839/pirp-final-20200904.pdf**).

The start of 2020 was very challenging as we experienced the fifth wettest winter and the wettest February on record. Our primary focus in the drafting of our PIRP has been on wastewater pumping stations and wastewater treatment works, which is where we have seen the largest increase in pollutions since 2018, to a large extent driven by improvements in self-reporting culture. Pollutions from these sites have been trending below 2019–20 levels, apart from an increase in August. However, network pollutions have been trending above last year's performance and this is where we are focusing our attention. Overall we are forecasting an improvement over 2019, but a difficult winter could affect this forecast.

High quality bathing waters

Bathing water sampling started in July, around ten weeks after the start of the bathing season due to the COVID-19 pandemic. It was carried out weekly in areas of concern to the Environment Agency, and monthly elsewhere. At the moment it is unclear whether samples collected in 2020 will be used in the end-of-year assessment. However, it is likely to be based on the 2017, 2018 and 2019 results, which show 62 bathing waters at excellent in our region. These results are normally based on rolling four-year performance.

Distribution input – the amount of water we put into supply

The year to date, company distribution input (DI) – the amount of water we put into supply – was 575.26 megalitres per day (Ml/d) on average. As predicted, we have seen a strong link between temperature and increases in DI this year with significant increases in late May, early June, July and again in August as the UK experienced a heatwave. The highest DI was seen on 25 June with 667 Ml/d.

The impact of COVID-19 has increased the intensity of these events, with many more people working from home and an increase in the number of people taking short holiday breaks within our region.

In terms of the amount of water we take from the environment (abstraction) we are set strict monthly reduction targets by our regulators. We are currently meeting these.

Reducing our carbon footprint

Southern Water has been contributing to the Net Zero Public Interest Commitment (PIC) since its inception in March 2019. This PIC commits the water sector to reaching net zero for greenhouse gas emissions released from operating our water and wastewater services by 2030. We will then need to maintain net zero from 2030.

Through Water UK we have supported the development of a sector work stream to provide guidance to companies on the possible routes to get there and the supportive tools for planning. The launch of this sector route map was on 12 November 2020.

We have formed a cross-sector team who will report to the Board on the implementation plan available to Southern Water in March 2021. Achieving net zero is going to require joined-up thinking from water companies, regulators, government, stakeholders and our supply chain. It will involve seeking to reduce our impact, mitigate where we cannot reduce, and removal or offset through nature-based solutions.

Renewable energy generation

Renewable generation is below our target of 21.2%, averaging 16.3% year to date. We have experienced a number of mechanical issues with our biogas fleet, as well as undertaking asset maintenance at our biogas production facilities which has led to reduced output. We are working hard to increase our renewable generation capacity and brought online new solar capacity at our Hardham Water Supply Works at the start of the August 2020.

Fit for the future

		Performance 2020–21
Asset health: It is essential to be investing in our sewer networks, pipes and drains. Our customers want us to upgrade where we can and use innovative and sustainable solutions.	Mains repairs	✓
	Unplanned outage	✗
	Risk of sewer flooding in a storm	✓
	Sewer collapses	✗
Water resilience: Customers want to ensure supply for future generations. They are willing to invest now to ensure that there is no deterioration of services in the future.	Water supply resilience	✓
	Long-term supply demand schemes	✓
	Risk of severe restrictions in a drought	✓
	Impounding reservoirs	✓
Growth: Businesses think it is important to work with councils and developers on infrastructure. Customers recognise the challenge of new homes drawing on our network and expect us to ensure it is fit for the future.	D-MeX	–
	Surface water management*	✗
Community engagement: Keen for us to focus on our role in the community, our customers want us to collaborate with local groups on important issues, support community outreach programmes and educate the next generation in schools.	Community engagement	⊘
	Schools visited and engagement with children	⊘

* This programme is under review and we are forecasting a penalty.

Customers recognise the challenges we face and expect us to ensure that future generations have access to at least the same level of water services as we do today.

Bills are broadly felt to be affordable now, and customers are willing to invest to ensure that there is no deterioration in services in the future.

Asset health

Unplanned outage

Our current unplanned outage sits at 17.98%. However, we now have an asset recovery plan in place to achieve 14% by February 2021, which would trigger a penalty. We are carrying out a thorough data review which we expect to further reduce the gap.

Sewer collapses

There have been 189 sewer failures to the end of September 2020. This is higher than at the same time last year and represents a mix of sewer collapses and rising main bursts. The trend is upward on previous years and the end of March 2021 target of 228 is likely to be missed, incurring a penalty payment in year one of this five-year period.

Fit for the future

Water resilience

Long-term Supply Demand schemes

The Long-term Supply Demand schemes encompass a variety of different projects with completion dates in 2027. Benefits come from a number of strategic pipelines, three water recycling projects, a desalination scheme and a small aquifer recharge project.

Risk of severe restrictions in drought

Our resilience to needing to implement severe drought restrictions remains higher than the threshold of a 1 in 200 year drought event used in the drought resilience target. This means our customers are currently not at risk of severe drought restrictions in a 1 in 200 year severity drought over the next 25 years, providing we implement the measures set out in our published 2019 Water Resource Management Plan. We are closely monitoring the impact of COVID-19 upon outturn demand as this could affect the risk come year end.

Water supply resilience

Our plans include a reduction in the number of properties at risk of loss of supply due to poor asset resilience in three key zones across our region in Kent, the Isle of Wight and East Sussex. Improvements will be driven through development schemes planned for delivery in the final two years of this five-year period.

Supporting growth

We finished the first quarter of this year with a D-MeX score of 77.8 against our internal target of 79 for year one. Ofwat has not released a league table to enable us to benchmark our performance, but we are expecting this in December 2020 as part of the new Water UK reporting tool. Our Developer Services improvement programme continues.

Community engagement

Our company community engagement strategy is focused on:

- Community support
- Employee volunteering
- Education programmes and community events.

The impact of COVID-19 has meant that we needed to quickly adapt this strategy, cancelling our planned calendar of community events. Where possible we have honoured our financial commitments to these events companies, supported their transition to hosting online events and provided their employees with access to financial support information at this difficult time.

In terms of educational outreach, we collaborated with Thames Water, South East Water and Affinity Water to provide a live streamed Big Virtual Water Quiz hosted and cross-promoted by Nat Geo Kids UK platforms. The quiz supported families and schools during lockdown and aimed to provide home-schooling tools and educational content. Aimed at 7 to 11 year olds, the live stream of the quiz was viewed by 940 people on the day, and 11,000 times since its launch in July.

With face-to-face volunteer days suspended, we asked our local community partners what we could do to help remotely. As a result we have been working with Sussex charity Lifelines and 15 members of Southern Water staff are currently making weekly telephone calls to 30 vulnerable adults in the Sussex community to provide a friendly voice, listening ear and support welfare checks on a weekly basis.

To support local communities, we have delivered 720 care packs across our region via 14 foodbank partners to date. A cross collaboration between the outreach arms of our Vulnerability, Fat, Oil and Grease (FOG) and Community teams, the packs contained information about how to save water and money, as well as practical tips and products to help in the home. They also contained information about our tariffs and payment plan options and Priority Register forms.

We also brought forward part of our regular programme of regional community funding support, our Community Foundations in Kent, Sussex, Hampshire and IOW, re-directing and streamlining the funding application processes for local charities. We also joined forces with UK Power Networks, SGN, Thames Water, Anglian Water, Affinity Water and SES Water to provide a national donation of £500,000 to local charities.

Interim management report – financial performance

Key financial performance indicators

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m	Increase/ (decrease) %
Revenue	**397.4**	439.9	(9.7)
Operating costs	**(335.6)**	(320.8)	4.6
Operating profit	**63.3**	120.5	(47.5)
Net finance costs*	**(33.4)**	(70.8)	(52.8)
Underlying profit before taxation*	**30.2**	50.2	(39.8)
Loss after taxation from continuing operations	**(134.7)**	(62.5)	115.5
Gross capital expenditure**	**165.3**	241.9	(31.7)
Net cash inflow from operating activities	**150.3**	210.2	(28.5)

* In order to show pre-tax performance on an underlying basis the fair value gains and losses on financial derivatives have been excluded from these items.

** Excludes asset adoptions, capitalised interest and leased assets transferred as part of the transition to IFRS16.

Income statement

Revenue for the period decreased to £397.4 million (period to 30 September 2019: £439.9 million). This decrease is in line with expectations and principally results from reductions to our water and wastewater tariffs which were agreed as part of our Business Plan 2020–25.

We experienced a record rise in our household consumption during the first six months of the year a result of the hot weather in the summer and the increase in demand during the lockdown. The increased revenue associated with this was largely offset by a fall in our non-household income, reflecting the impact the pandemic had on our business customers.

The reduction in tariff as a result of the Ofwat penalty referred to on page 5 was offset by the release of part of the provision for this made in the financial statements for 2018–19. A detailed analysis of revenue is provided in note 5.

Operating costs for the first half of the year of £335.6 million increased by 4.6% (period to 30 September 2019: £320.8 million). This increase, described in more detail below, was largely driven by the effect of COVID-19 on our bad debt charge, operational and weather related incidents, together with additional depreciation arising from our capital programme of £8.7 million and inflation. These costs increases were offset by efficiencies delivered as a result of our transformation programme.

Over the past six months we have had to adapt to new ways of working in the wake of the COVID-19 pandemic. We know that many of our household customers are facing uncertain futures and will find it difficult to pay their bills. We have taken a number of immediate steps to help our customers, for example, introducing payment breaks and providing additional support to vulnerable customers, in addition, in light of the current circumstances, we have also paused many of our debt collection activities.

As a result we have reviewed the recoverability of our outstanding debt at 30 September and recognised a bad debt charge for the period of £17.5 million (period to 30 September 2019: £7.0 million). This increase of £10.5 million in the bad debt charge for the period is partially offset by a reduction in our debt collection costs of £5.3 million.

During the period to 30 September we have experienced an increase in water demand as a result of two spells of very hot weather over the summer, as well as from customers spending more time at home due to the pandemic. We have also responded to a number of bursts on both our water and wastewater network. These operational incidents have resulted in increased operating costs of £5.0 million.

These cost increases have been partially offset through efficiencies from team restructures and the reorganisation of our pension schemes including the closure of our final salary scheme. In the prior six months we incurred some one-off costs including re-organisation costs, particularly the insourcing of IT services. Overall these transformational activities resulted in a cost reduction from the prior year of £4.8 million. The prior year also included a provision of £3 million for guaranteed standards of service payments for missed appointments.

As a consequence of the above, operating profit for the period decreased by 47.5% to £63.3 million (period to 30 September 2019: £120.5 million).

Net finance costs, excluding fair value movements on financial derivatives, decreased to £33.4 million (period to 30 September 2019: £70.8 million). This was largely due to a reduction in bond interest payable, net of swap receipts, following a restructure of our debt portfolio of £29.2 million and higher interest capitalised following the continued investment in our capital programme of £2.6 million.

As a result of the reduction in operating profit and the decrease in finance charges, the underlying profit before taxation reduced to £30.2 million (period to 30 September 2019: £50.2 million).

The fair value loss on our derivative financial instruments amounted to £200.7 million (period to September 2019: loss of £123.9 million). We made changes to some of our derivatives in the second half of the prior year, but the primary driver for changes in the valuation is the fluctuation in UK Government bond yields which are used to discount the future cash flows. As Government gilt yields are constantly moving the valuation of our derivative instruments can be volatile. These changes do not represent cash flows.

Tax on the loss from continuing operations amounted to a credit of £35.8 million (period to 30 September 2019: credit £11.2 million).

The loss from continuing operations after tax was £134.7 million (period to 30 September 2019: loss of £62.5 million).

Statement of financial position

Non-current assets increased by £32.7 million at 30 September 2020 to £6,754.0 million (31 March 2020: £6,721.3 million). This increase results from our ongoing capital investment programme which, after depreciation, increased the value of property plant and equipment and intangible assets by £42.2 million, partially offset by a decrease in the value of our non-current financial derivative assets of £9.5 million.

Current assets increased by £322.8 million from £407.6 million at 31 March 2020 to £730.4 million at 30 September 2020. This growth primarily arises from an increase in cash of £362.7 million, explained in the cash flow analysis below, offset by a decrease in intercompany debt with Southern Water Services (Finance) Limited (SWSF) of £52.7 million. We transferred funds to SWSF at the end of March 2020 in order for it to make interest payments on its debt and these have been largely used to pay for the half-year interest payments.

Current liabilities reduced by £356.7 million, to £660.8 million at 30 September 2020 (31 March 2020: £1,017.5 million). This fall is largely caused by a reduction in current borrowings following the repayment of our revolving credit facility of £330.0 million. Also trade and other payables fell by £20.4 million from £260.8 million at 31 March 2020 to £240.4 million at 30 September 2020, largely resulting from reduced capital spend in the first six months of this year.

Long-term borrowings have increased from 31 March 2020, increasing by £822.7 million, from £2,884.8 million to £3,707.5 million at 30 September 2020. This increase predominantly results from the £825 million (net £812.9 million) sustainable bond raised in May 2020, and indexation charged on inflation-linked bonds for the period (£17.9 million). These were offset by partial repayments of our EIB loan (£8.0 million). Gearing remains comfortably within the requirements of our debt covenants of being below 85%.

The liability associated with our derivative financial instruments increased by £94.7 million from £1,376.4 million at 31 March 2020 to £1,471.1 million at 30 September 2020. The revaluation loss at September amounted to £158.3 million and this was partially offset by accretion payments of £63.6 million.

The pension scheme deficit of £178.0 million (31 March 2020: £62.5 million) is based on the latest actuarial valuation as at 31 March 2020 updated by a qualified independent actuary to reflect the reduction in corporate bond yields from March which are used to set the discount rate and the latest asset values as at 30 September 2020. The increase in the deficit of £115.5 million largely results from the revaluation loss of £132.4 million following a movement in market conditions partially offset by a lump sum payment of £17.5 million which forms part of the agreed long-term funding arrangement with the Trustees.

Overall net assets decreased from £1,253.5 million at 31 March 2020 to £1,007.6 million at 30 September 2020.

Cash flow

The cash position increased from £129.3 million at 31 March 2020 to £492.0 million at 30 September 2020, a rise of £362.7 million. This resulted from net cash inflows in financing activities of £328.4 million and operating activities of £150.3 million being offset by cash outflows in investing activities of £116.0 million. These movements are explained in more detail below.

Net cash inflow from operating activities in the period amounted to £150.3 million (period to 30 September 2019: £210.2 million). This decrease mainly results from lower operating profits explained on page 18.

Net cash used in investing activities amounted to £116.0 million (period to 30 September 2019: £179.3 million). The decrease of £63.3 million primarily relates to a reduction in our capital programme this year, partially offset by the movement in the loan to our subsidiary SWSF.

Net cash generated in financing activities amounted to £328.4 million (period to 30 September 2019: Used £397.3 million) an increase of £725.7 million. This principally resulted from the dual tranche public bonds issued in May under our Sustainable Financing Framework which raised net proceeds of £812.9 million offset by higher loan repayments and restructuring costs made this year following the refinancing. Also our interest payments were lower as last year's interest payments included some bond payments normally made in the preceding March.

Credit ratings

Our current credit ratings are shown in the table below and have not changed since publication of the Annual Report of 2019–20.

Credit rating	As at signing date of accounts
Standard & Poor's	Class A debt: BBB+ (negative outlook)
Fitch	Class A debt: BBB+ (negative outlook)
Moody's	Class A debt: Baa3 (stable outlook)

As noted in our Annual Report, a further credit rating downgrade by one or more Rating Agency could result in a Trigger Event under our Common Terms Agreement (defined below) which in turn would require creditor consents to the raising of new debt and restrictions on the payment of dividends. A further credit rating downgrade by Moody's would lead to a restriction on the payment of dividends under the terms of our Licence.

Note:

- A Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below.
- A cash lock-up under our Licence of Appointment would occur where the credit rating outlook assigned the lowest investment grade credit rating has been changed from stable or positive to negative.
- A Default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade, BB+ (Standard & Poor's), BB+ (Fitch) or Ba1 (Moody's).

The Board has resolved that the company will not pay any dividends until it is clear that to do so would not be detrimental to the company's financial position.

How we finance the business

Southern Water established a financing structure, known as a Whole Business Securitisation (WBS), in 2003 following its sale by ScottishPower. The WBS sets strict rules which helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. The financing group provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings. No security is provided over our individual regulated operating assets. This structure is designed to ensure that, in the event that either Southern Water or SWSF were to default on their debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the event of default.

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

This includes precautionary 'early warning' limits, called Trigger Events or cash lock ups, which prevent the payment of dividends if a pre-determined limit is breached. We have not breached a limit at any time since the implementation of the financing framework in 2003.

Financing during the period

During 2019–20 a Sustainable Financing Framework was put in place at SWS which aligns our long-term strategy with our social and environmental commitments. An independent Second Party Opinion is also provided by DNV-GL to ensure alignment with the relevant bond/loan principles and guidelines.

The Framework also sets out a robust process for project evaluation, project selection, the management of proceeds and reporting.

The majority of our assets and expenditure on projects, and programmes of work, fall within the eligible green categories and the eligible social categories taken from the Green Bond Principles and the Social Bond Principles.

In May 2020 we issued our inaugural financing under the Sustainable Financing Framework with a dual tranche public bond amounting to £825 million.

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 interim financial statements to 30 September 2020.

In forming this assessment the directors have considered the following information:

- The company's business activities, together with the factors likely to affect its future development, performance and position.
- The potential impact of COVID-19 on the company's operations and financial performance.
- The financial position of the company, its forecast monthly cash flows for the period to March 2022, liquidity position, covenants and borrowing facilities.
- Reasonable downside sensitivities to the cash flows to check that the company can operate within its current facilities and covenants.
- The positive financial headroom across all key debt covenant ratios, recognising that there is limited financial headroom against the adjusted interest cover ratio to a Trigger Event although the headroom to Default is significant and the associated pressure of this limited headroom on credit ratings.
- The plans in place, which the Board believe are deliverable, to mitigate the impact of a Trigger event relating to either a breach of interest cover ratios or credit ratings. A Trigger Event would not have an impact on liquidity.
- Additional financing of £825 million (net £812.9 million) was raised in May 2020 by the company's subsidiary Southern Water Services (Finance) Limited, for SWS, under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose.
- The company has available a combination of cash and committed undrawn bank facilities totalling £867.0 million at 30 September 2020 (30 September 2019: £120.6 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements.
- The company's requirement to repay scheduled loan maturities and to finance the capital investment programme. The next scheduled requirement is to repay a loan of £350 million by 31 March 2021. This repayment will be made out of the proceeds of £825 million (net £812.9 million) dual tranche sustainable bond issuance in May 2020 referred to above.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.

The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the interim financial statements.

Principal risks

Risk management is a core component of our wider governance and internal control framework. It provides the overarching structure through which the company is managed to achieve its objectives.

The most significant risks facing us are referred to as 'principal risks'. These are monitored by our Executive Committee which undertakes a review on a quarterly basis and the Board's Risk Committee. The Risk Committee receives a risk report at its meetings three times per year, and advises the Board on the company's overall risk appetite, tolerance and strategy. The Board retains ownership and approval of the company's overall risk appetite, tolerance and strategy.

The principal risks and uncertainties that the business faces over the remainder of this financial year remain unchanged from those we reported in our last Annual Report and Financial Statements. The principal risks are listed on page 22 (in no particular order).

Operational risks

- **Water** – ensuring that we can supply enough good quality drinking water for a growing population
- **Wastewater** – ensuring we provide a reliable wastewater service to maintain public health and protect the environment
- **Customer** – ensuring we provide an excellent customer service

Corporate risks

- **Financial** – ensuring we maintain our credit ratings and overall financial position in order to ensure that we can finance our capital investment programme and refinance any debt maturities
- **Compliance** – ensuring we meet the requirements of our regulators, Ofwat, the Drinking Water Inspectorate and the Environment Agency
- **Climate change** – ensuring that we are able to respond to the impact of climate change and extreme weather events in our business
- **Delivery of capital investment** – ensuring that we deliver the investment programme of £2.1 billion for 2020–25
- **Information technology** – ensuring we maintain the resilience of our operational and enterprise IT systems
- **Resources** – ensuring that we have critical resources available to maintain services
- **Health, safety and wellbeing** – ensuring the health, safety and wellbeing of our employees and the public
- **Regulatory and corporate affairs** – ensuring that we are responding to the additional political and regulatory focus on the water industry in order to meet customer expectations
- **Transformation** – ensuring our ongoing transformation programme is delivered effectively
- **COVID-19** – ensuring that our essential services continue to be delivered safely and provide support for those in hardship during the pandemic

The significance and potential financial risks of these uncertainties change over time. The key matters of operational and financial performance relating to these risks since the Annual Report are provided within the interim management report on pages 3 to 21.

Further detailed descriptions of these risks and uncertainties and our risk management process is included in the Annual Report and Financial Statements for the year ended 31 March 2020, which can be found on our website **southernwater.co.uk/our-reports**.

Directors and their interests

The directors who held office during the period ended 30 September 2020 were:

Keith Lough
(Chairman)

Ian McAulay
(Executive director – Chief Executive Officer)

Sebastiaan Boelen
(Executive director – Chief Financial Officer)

Paul Sheffield
(Senior independent non-executive director)

Rosemary Boot
(Independent non-executive director)

Malcolm Cooper
(Independent non-executive director)

Gillian Guy
(Independent non-executive director)

Kevin McCullough
(Independent non-executive director)

Michael Putnam
(Independent non-executive director)

Marykay Fuller
(Non-executive director) (Appointed 15 June 2020)

Sara Sulaiman
(Non-executive director)

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

Directors' responsibilities statement

The directors confirm to the best of their knowledge that:

- the report and condensed financial statements have been prepared in accordance with FRS 104 'Interim Financial Reporting'; and give a true and fair view of the assets, liabilities, financial position and profit of the company as required by Disclosure and Transparency Rule 4.2.4R;
- the report includes a fair review of the information required by Disclosure and Transparency Rule 4.2.7R (indication of important events) during the period and description of the principal risks and uncertainties for the remaining months of the financial period; and
- the report includes a fair review of the information required by Disclosure and Transparency Rule 4.2.8R (disclosure of related parties' transactions and changes therein).

Signed on behalf of the Board who approved the half-yearly financial report on 27 November 2020:

Keith Lough
Chairman

Sebastiaan Boelen
Chief Financial Officer

Interim financial statements

Condensed income statement for the six months ended 30 September 2020

Continuing operations	Notes	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Income	5	379.6	439.9
Amortisation of provision for regulatory settlement payments		17.8	–
		397.4	439.9
Other operating income	5	1.5	1.4
Operating costs			
• before charge for bad and doubtful debts, depreciation and amortisation		(178.0)	(182.4)
• charge for bad and doubtful debts		(17.5)	(7.0)
Operating costs before depreciation and amortisation		(195.5)	(189.4)
Depreciation and amortisation		(140.1)	(131.4)
Total operating costs		(335.6)	(320.8)
Operating profit		63.3	120.5
Other income	5	–	0.1
Profit on disposal of fixed assets	5	0.3	0.4
Finance income		39.4	9.7
Finance costs		(72.8)	(80.5)
Fair value losses on derivative financial instruments		(200.7)	(123.9)
Net finance cost	6	(234.1)	(194.7)
Loss before taxation from continuing operations		(170.5)	(73.7)
Tax credit	7	35.8	11.2
Loss after taxation from continuing operations		(134.7)	(62.5)

Condensed statement of other comprehensive income for the six months ended 30 September 2020

	Notes	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Continuing operations			
Loss for the period		**(134.7)**	(62.5)
Items that cannot be reclassified to profit or loss			
Actuarial loss on retirement benefit obligation	15	**(132.4)**	(2.4)
Deferred tax asset movement relating to retirement benefit obligation	7	**25.2**	0.4
		(107.2)	(2.0)
Total comprehensive loss for the period		**(241.9)**	(64.5)

Condensed statement of financial position as at 30 September 2020

	Notes	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Non-current assets			
Intangibles	9	38.0	42.1
Property, plant and equipment	10	6,372.0	6,325.7
Investments		29.2	29.2
Derivative financial instruments	11	184.8	194.3
Other non-current assets	12	130.0	130.0
		6,754.0	6,721.3
Current assets			
Inventories		5.6	5.1
Trade and other receivables		232.8	273.2
Cash and cash equivalents		492.0	129.3
		730.4	407.6
Total assets		7,484.4	7,128.9
Current liabilities			
Borrowings	17	(383.8)	(713.8)
Lease liabilities	17	(2.4)	(2.2)
Trade and other payables		(240.4)	(260.8)
Regulatory settlement liability	13	(29.9)	(35.6)
Provisions for liabilities	14	(4.3)	(5.1)
		(660.8)	(1,017.5)
Non-current liabilities			
Borrowings	17	(3,707.5)	(2,884.8)
Lease liabilities	17	(28.2)	(28.2)
Derivative financial instruments	11	(1,471.1)	(1,376.4)
Deferred tax liabilities		(307.0)	(368.7)
Retirement benefit obligations	15	(178.0)	(62.5)
Regulatory settlement liability	13	(87.8)	(99.9)
Provisions for liabilities	14	(4.1)	(4.7)
Other non-current liabilities		(32.3)	(32.7)
		(5,816.0)	(4,857.9)
Total liabilities		(6,476.8)	(5,875.4)
Net assets		1,007.6	1,253.5
Equity			
Called up share capital		0.1	0.1
Share premium account		46.3	46.3
Non-distributable reserve		59.4	60.2
Retained earnings		901.8	1,146.9
Total equity		1,007.6	1,253.5

Condensed statement of changes in equity for the six months ended 30 September 2020

	Called up share capital £m	Share premium £m	Non-distributable reserve £m	Retained earnings £m	Total £m
Balance at 1 April 2020	**0.1**	**46.3**	**60.2**	**1,146.9**	**1,253.5**
Loss for the financial period	–	–	–	(134.7)	(134.7)
Other comprehensive (loss)/income for the period:					
Actuarial loss on pension scheme	–	–	–	(132.4)	(132.4)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	25.2	25.2
Total comprehensive loss for the period	**–**	**–**	**–**	**(241.9)**	**(241.9)**
Reserves transfer	–	–	(0.8)	0.8	–
Equity dividends (note 8)	–	–	–	(4.0)	(4.0)
At 30 September 2020	**0.1**	**46.3**	**59.4**	**901.8**	**1,007.6**

Condensed statement of changes in equity for the six months ended 30 September 2019

	Called up share capital £m	Share premium £m	Non-distributable reserve £m	Retained earnings £m	Total £m
Balance at 1 April 2019	**0.1**	**46.3**	**53.8**	**737.5**	**837.7**
Profit/(loss) for the financial period	–	–	0.7	(63.2)	(62.5)
Other comprehensive (loss)/income for the period:					
Actuarial loss on pension scheme	–	–	–	(2.4)	(2.4)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	0.4	0.4
Total comprehensive income/(loss) for the period	**–**	**–**	**0.7**	**(65.2)**	**(64.5)**
Reserves transfer	–	–	(1.9)	1.9	–
Equity dividends (note 8)	–	–	–	(3.6)	(3.6)
At 30 September 2019	**0.1**	**46.3**	**52.6**	**670.6**	**769.6**

Condensed statement of cash flows for the six months ended 30 September 2020

	Notes	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Cash from operations		151.2	210.2
Tax paid		(0.9)	–
Net cash from operating activities	16	150.3	210.2
Investing activities			
Interest received		19.5	6.9
Purchase of property, plant and equipment		(184.4)	(255.4)
Purchase of intangible assets		(3.9)	(9.0)
Receipt of grants and contributions*		–	2.7
Proceeds on disposal of property, plant and equipment		0.1	0.2
Repayments of intercompany loan receivables		52.7	75.3
Net cash used in investing activities		(116.0)	(179.3)
Financing activities			
Equity dividends paid		(4.0)	–
Interest paid		(45.5)	(147.8)
Preference share dividends		–	(4.8)
Repayment of borrowings		(338.0)	(389.0)
Repayments of obligations under finance leases	17	(0.5)	(0.7)
Payments on restructure of derivative instruments		(96.5)	–
Proceeds of new loans		812.9	145.0
Net cash generated/(used) in financing activities		328.4	(397.3)
Net increase/(decrease) in cash and cash equivalents		362.7	(366.4)
Cash and cash equivalents at beginning of the period		129.3	372.0
Cash and cash equivalents at end of the period	17	492.0	5.6

* Contributions and grants received of £1.2 million have been presented as operating cash flows in the period to 30 September 2020 as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were presented as investing cash flows in the period to 30 September 2019.

Notes to the interim financial information

For the six months ended 30 September 2020

1. Basis of preparation and accounting policies

The audited annual financial statements of the company are prepared in accordance with FRS 101 'Reduced Disclosure Framework' incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to company law made by the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015. The condensed financial statements for the six months ended 30 September 2020, which are unaudited, have been prepared in accordance with FRS 104 'Interim Financial Reporting' as adopted by the United Kingdom.

The condensed financial statements for the six months ended 30 September 2020 do not constitute statutory accounts of the company. They do not include all of the information required for a complete set of FRS 101 financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the company's financial position and performance since the last annual financial statements. Statutory financial statements for the year ended 31 March 2020 were approved by the Board on 10 July 2020 and the auditor's report on those accounts was unqualified. The condensed financial statements for the six months ended 30 September 2020 should be read in conjunction with the Annual Report and Financial Statements for the year ended 31 March 2020 which have been delivered to the Registrar of Companies and can be obtained from the Company Secretary, Southern House, Yeoman Road, Worthing, BN13 3NX, or from our website.

The directors have reassessed the principal risks associated with the company's business activities, together with the factors likely to affect its future development and position. As part of their review the directors have considered the risk of a Trigger Event as a result of limited financial headroom against the adjusted interest cover ratio and the associated credit rating headroom. A Trigger Event at Southern Water Services will not affect forecast liquidity headroom.

On the basis of their assessment of the company's financial position, and the plans in place to mitigate a potential Trigger event, the directors 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 interim financial information.

The accounting policies adopted in these condensed financial statements are consistent with those applied and set out in the Annual Report and Financial Statements for the year ended 31 March 2020, except as described below.

The tax charge is based on the estimated effective tax rate before exceptional items, fair value adjustments and adjustments in respect of prior periods, for the full year to 31 March 2020.

Adoption of new and revised accounting and financial reporting standards

There have been no new or revised accounting standards adopted in the current year that had a significant or material impact on the financial statements.

2. Key assumptions and significant judgments

In preparing these interim financial statements, management has made judgments and estimates that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgments made in applying the company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements for the year ended 31 March 2020. The uncertainty regarding the ongoing COVID-19 pandemic has increased the level of judgment required when considering the level of unbilled revenue and the impairment of trade receivables.

As at 31 March 2020, the accrual for non-South East Water unbilled measured income was £213.1 million. The value of household Non-South East Water billings raised in the period to 30 September 2020 for consumption in prior years was £203.5 million, £9.6 million (4.5%) less than the accrual at 31 March 2020, with further billing for prior years still to be finalised.

3. Changes in significant accounting policies

The accounting policies applied in these interim financial statements are the same as those applied in the company's financial statements as at and for the year ended 31 March 2020 (the policy for recognising and measuring income taxes in the interim period is described in Note 1 above).

A number of new standards and amendments are effective for periods beginning from 1 January 2020. These changes had no material impact on the company's financial statements.

4. Seasonality of operations and segmental analysis

The company's business is not seasonal in nature.

The directors believe that the whole of the company's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this interim report.

5 Income

An analysis of the company's income is as follows:

Continuing operations

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Water and sewerage services		
Household – measured	257.7	271.6
Household – unmeasured	55.4	65.8
Non-household – measured	44.7	74.2
Non-household – unmeasured	1.9	2.5
Total water and sewerage services	359.7	414.1
Bulk supplies	2.0	1.8
Infrastructure charge receipts	2.8	4.5
Requisitioned mains and sewers	(0.3)	0.4
Diversions	1.2	1.4
Adoptions	–	0.7
Other services	14.2	17.0
Total revenue	379.6	439.9
Other operating income*	1.5	1.4
Other income	–	0.1
Profit on disposal of fixed assets	0.3	0.4
Interest receivable (note 6)	34.5	5.2
Interest revenue from SWSG Limited (note 6)	4.9	4.5
Total income	420.8	451.5

• Other operating income includes the release of deferred grants and contributions relating to non-current assets from the balance sheet, as amortised in line with the useful economic life of the related assets, and rents receivable.

6 Net finance costs

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Finance income		
Interest revenue from SWSG Limited	4.9	4.5
Interest receivable on swap instruments	33.4	5.0
Deposit income on short-term bank deposits	1.1	0.2
	39.4	9.7
Finance costs		
Interest payable on other loans	(2.5)	(6.4)
Interest paid to SWSF Ltd	(65.8)	(66.6)
Indexation of index-linked debt	(14.8)	(16.3)
Amortisation of issue costs	(5.7)	(1.8)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of deferred credits	2.2	2.3
Amortisation of bond premium	0.3	0.3
Finance lease interest	(0.6)	(0.6)
Other finance expense	(0.6)	(2.1)
Dividends on preference shares*	(2.4)	(3.8)
	(89.8)	(94.9)
Amounts capitalised on qualifying assets	17.0	14.4
	(72.8)	(80.5)
Fair value losses on derivative financial instruments		
Derivative financial instruments not designated as hedges	(200.7)	(123.9)
Net finance costs	(234.1)	(194.7)

* The preference share dividend of £2.4 million for the period to 30 September 2020 has been accrued.

7 Taxation

Taxation presented in the income statement is based on the result for the period using current rates and takes into account tax deferred due to timing differences.

Tax on profit on continuing operations

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Current tax:		
In respect of the current period	0.7	5.1
Total current tax charge	0.7	5.1
Deferred tax:		
Origination and reversal of temporary differences	(36.5)	(16.3)
Total deferred tax charge	(36.5)	(16.3)
Total tax credit on loss from continuing operations	(35.8)	(11.2)

In line with the requirements of FRS 104, the tax charge for the six months ended 30 September 2020 is based on the estimated effective tax rate before exceptional items, fair value gains/losses and adjustments in respect of prior periods, for the full year to 31 March 2021.

Reductions in the main rate of corporation tax to 17% from the 1 April 2020 were enacted in the Finance Bill 2016, and deferred tax balances at 30 September 2019 were calculated based on these reduced rates. It was subsequently announced in March 2020 that the corporation tax rate would instead be maintained at 19% from 1 April 2020. This change has been substantively enacted in Finance Bill 2020 at the Balance sheet date, and deferred tax balances at 30 September 2020 have been calculated using the 19% rate.

In addition to the tax charged to the income statement, the following amounts of tax relating to components of other comprehensive income were recognised:

Deferred tax

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Arising on income and expenses recognised on other comprehensive income:		
Tax credit on actuarial losses on defined benefit pension scheme	(25.2)	(0.4)
Total deferred tax credit recognised in other comprehensive income	(25.2)	(0.4)

8 Dividends

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Equity dividends paid:		
– SWSG Dividend Loop*	**4.0**	3.6
– Ordinary	**–**	–
	4.0	3.6

* These dividends are paid via intermediary holding companies to Southern Water Services Group Limited (SWSG), along with associated group tax relief payments. This enables SWSG to pay the interest due on the inter-company loan to SWS. This is a circular transaction, the effect of which is a net result/cash flow for the company of nil.

9 Intangible assets

	£m
Cost	
At 1 April 2020	137.7
Additions	1.1
At 30 September 2020 (unaudited)	138.8
Accumulated amortisation	
At 1 April 2020	95.6
Charge for the period	5.2
At 30 September 2020 (unaudited)	100.8
Net book amount	
At 30 September 2020 (unaudited)	**38.0**

10 Property, plant and equipment

	£m
Cost	
At 1 April 2020	9,291.2
Additions in the period	181.2
Disposals	(0.8)
At 30 September 2020 (unaudited)	9,471.6
Accumulated depreciation	
At 1 April 2020	2,965.5
Charge for the period	134.9
Disposals	(0.8)
At 30 September 2020 (unaudited)	3,099.6
Net book amount	
At 30 September 2020 (unaudited)	**6,372.0**

11 Derivative financial instruments

Categories of financial instruments at fair value

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	184.8	194.3
Total derivative financial assets	184.8	194.3
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	(1,471.1)	(1,376.4)
Total derivative financial liabilities	(1,471.1)	(1,376.4)

Changes in value of financial instruments at fair value

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Profit for the year has been arrived at after (charging)/crediting:		
Financial assets at fair value		
Designated as FVTPL	(42.4)	44.6
Financial liabilities at fair value		
Designated as FVTPL	(158.3)	(168.5)
Fair value loss on derivative financial instruments	(200.7)	(123.9)

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk.

The regulatory framework, under which revenues and the Regulatory Capital Value are indexed, exposes the company to inflation risk. The company enters into inflation linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

12 Non-current assets

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Amounts owed by SWSG	**130.0**	130.0

Amounts owed by group undertakings represent a loan to SWSG 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 annum.

13 Regulatory settlement liability

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
At 1 April	**135.5**	138.5
Increase in period/year	**(17.8)**	(3.0)
At 30 September 2020 and 31 March 2020	**117.7**	135.5
Included in:		
Current liabilities	**29.9**	35.6
Non-current liabilities	**87.8**	99.9
	117.7	135.5

The company co-operated with Ofwat in relation to its investigation into the management, operation and performance of the company's wastewater treatment works. The investigation resulted in Ofwat taking enforcement action. Ofwat issued Southern Water with a financial penalty amounting to £3.0 million and, to ensure that customers are not disadvantaged as a result of these matters, the company agreed to make direct customer rebates totalling £135.5 million in outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflected the seriousness of the breaches identified in the investigation and these amounts were recognised and provided for in the financial statements for 2018–19. The company also gave a number of formal undertakings to Ofwat in relation to measures to ensure that the issues identified in the investigation have ceased and cannot be repeated.

14 Provisions for liabilities

	Environmental obligations	Other	Total
	£m	£m	£m
At 1 April 2020	5.8	4.0	**9.8**
Utilised in period/year	(0.6)	(0.8)	**(1.4)**
Increase in period/year	–	–	**–**
At 30 September 2020	**5.2**	**3.2**	**8.4**
At 1 April 2019	6.6	–	**6.6**
Utilised in period/year	(1.0)	–	**(1.0)**
Increase in period/year	0.2	4.0	**4.2**
At 31 March 2020	**5.8**	**4.0**	**9.8**

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Included in:		
Current liabilities	**4.3**	5.1
Non-current liabilities	**4.1**	4.7
	8.4	9.8

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and environmental commitments made for ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

Other provisions includes £2.2 million (31 March 2020: £3.0 million) relating to the payment of compensation for missed appointments under our Guaranteed Standards of Service Scheme and represent a best estimate of the value of payments to be made over the course of the coming year.

Environment Agency

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations following wastewater incidents. In addition to those, the company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and we have entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation.

The Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the company's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, it does recognise that there will be a minimum liability associated with the charges before the court and has therefore recognised a provision of £1.0 million reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

There is a wide range of possible outcomes which reflects the uncertain and disputed levels of culpability and environmental harm (both being amongst a number of key criteria that the court uses to help determine the level of the fine), the lack of a similar precedent, and the extent of the applicability of the Sentencing Council's Guidelines to the company which vary very widely. Further, as the company is a Very Large Organisation, there is a requirement for the court to examine the financial circumstances of the organisation in the round. The court has a very broad discretion to assess the level of fine and the minimum provision the company has made is not intended to indicate or predict any particular level. The Board will continue to review the level of provision made as more information becomes available.

The company is working proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues 2010 and 2017 (inclusive). The Board, supported by external legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

The Board has taken these investigations extremely seriously and has continued to monitor and support the work of the Risk and Compliance directorate, which continues to deliver a programme of improvements to the company's non-financial regulatory reporting including the collection, verification, reporting and assurance of data.

15 Retirement benefit obligations

The latest actuarial valuation of the SWPS was carried out as at 31 March 2019 using the projected unit method. The timing and quantum of future contributions in relation to the deficit have been agreed with the Trustees and Pensions Regulator. These contributions will be dependent on future levels of RPI, but if market breakeven rates are borne out at 31 March 2019 the expected base deficit contributions will be paid annually and total £194.7 million over the period from 1 April 2020 to 1 April 2029.

The retirement benefit obligations shown at 30 September 2020 are based on the valuations at 31 March 2020, updated by a qualified independent actuary reflecting the movement in corporate bond yields, which impact the discount rate, and asset values. These are not formal interim valuations of the scheme assets and liabilities; however an assessment of the actuarial losses has been made and shown in the summarised statement of other comprehensive income.

The major assumptions used by the actuary are set out in the table below:

The major assumptions used by the actuary are set out in the table below:

	Six months ended 30 September 2020 **Unaudited** %	Year ended 31 March 2020 Audited %
Price inflation (RPI)	**2.80**	2.50
Price inflation (CPI)	**2.00**	1.70
Rate of increase in salaries (plus an age-related promotional scale)	**2.40**	2.40
Rate of increase of pensions in payment (MIS* members only)***	**2.00**	1.70
Rate of increase of pensions in payment (Old section** members only)***	**2.80**	2.50
Rate of increase of pensions in payment (New section and ex FSLP (RPI max 5%))***	**2.80**	2.50
Rate of increase of pensions in payment (Post 5 April 1988 GMP (CPI max 3%))***	**1.80**	1.60
Rate of increase of pensions in payment (All sections post 31 March 2013 service (RPI max 2.5%))***	**2.00**	1.90
Rate of increase for deferred pensions (MIS* members only)***	**2.00**	1.70
Rate of increase for deferred pensions (Old section** members only)***	**2.80**	2.50
Rate of increase for deferred pensions (New section and ex FSLP (RPI max 5%))***	**2.80**	2.50
Rate of increase for deferred pensions (Post 5 April 1988 GMP (CPI max 3%))***	**1.80**	1.60
Rate of increase for deferred pensions (All sections post 31 March 2013 service (RPI max 2.5%))***	**2.00**	1.90
Discount rate	**1.45**	2.40

* 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 annum cap on increases that apply to other sections of the Scheme.

*** Pension increase assumptions allow for caps and floors where appropriate based on a statistical model (the Black Scholes model).

15 Retirement benefit obligations (continued)

The amounts included in the statement of financial position arising from the company's obligations under the defined benefit scheme were as follows:

Amounts included in the statement of financial position

	Six months ended 30 September 2020	Year ended 31 March 2020
	Unaudited	Audited
	£m	£m
Total fair value of assets	838.4	777.6
Present value of the defined benefit obligation	(1,016.4)	(840.1)
Deficit recognised in the statement of financial position	(178.0)	(62.5)

Analysis of the movement in the scheme's deficit during the period

	Six months ended 30 September 2020	Six months ended 30 September 2019	Year ended 31 March 2020
	Unaudited	Unaudited	Audited
	£m	£m	£m
At 1 April	(62.5)	(186.7)	(186.7)
Employer's contributions	17.5	19.8	24.4
Employer's current service cost	–	(3.3)	(6.4)
Employer's past service cost	–	–	–
Curtailment	–	–	(1.3)
Financing charge	(0.6)	(2.1)	(4.2)
Actuarial (loss)/gain	(132.4)	(2.4)	111.7
Deficit in the scheme at end of the period	(178.0)	(174.7)	(62.5)

16 Cash generated by operations

	Six months ended 30 September 2020 Unaudited £m	Six months ended 30 September 2019 Unaudited £m
Continuing operations		
Operating profit	63.3	120.5
Adjustments for:		
Fair value of sewer adoptions	–	(0.7)
Depreciation of property, plant and equipment	134.9	121.9
Amortisation of intangible assets	5.2	9.5
Receipt of grants and contributions*	1.2	–
Difference between pension charge and cash contributions	(17.5)	(16.5)
Amortisation of grants and contributions	(1.4)	(1.4)
Operating cash flow before movement in working capital	185.7	233.3
Increase in inventories	(0.5)	(0.5)
Decrease/(increase) in receivables	6.3	(27.2)
Increase/(decrease) in payables	(21.2)	4.6
(Decrease)/Increase in regulatory settlement liability	(17.8)	–
Decrease in provisions	(1.3)	–
Cash generated by operations	151.2	210.2
Tax paid		
– Group relief	–	–
– Payments made within SWSG Dividend Loop	(0.9)	–
Net cash generated from operating activities	150.3	210.2

* Contributions and grants received of £1.2 million have been presented as operating cash flows in the period to 30 September 2020 as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were presented as investing cash flows in the period to 30 September 2019.

17 Analysis of net debt (unaudited)

	At 1 April 2020 £m	Cash flow £m	Fair value adjustments £m	New finance leases £m	Other non-cash changes £m	At 30 September 2020 £m
Cash and cash equivalents	129.3	362.7				**492.0**
Net liabilities from financing activities:						
Term facilities/index linked loans	(422.7)	338.0	(2.8)	–	–	**(87.5)**
Loans from subsidiary	(3,106.1)	(812.9)	(12.0)	–	(3.0)	**(3,934.0)**
Finance lease liabilities	(30.4)	0.5	–	(0.7)	–	**(30.6)**
Redeemable preference shares	(69.8)	–	–	–	–	**(69.8)**
Net interest rate swaps	(1,182.1)	96.5	(200.7)	–	–	**(1,286.3)**
Total liabilities from financing activities	(4,811.1)	(377.9)	(215.5)	(0.7)	(3.0)	**(5,408.2)**
Net debt	(4,681.8)	(15.2)	(215.5)	(0.7)	(3.0)	**4,916.2**

Balances at 30 September 2019 comprise:

	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	492.0	–	–	**492.0**
Derivative financial instruments	184.8	–	–	(1,471.1)	**(1,286.3)**
Lease liabilities	–	–	(2.4)	(28.2)	**(30.6)**
Borrowings due within one year	–	–	(383.8)	–	**(383.8)**
Borrowings due after one year	–	–	–	(3,707.5)	**(3,707.5)**
Net debt	184.8	492.0	(386.2)	(5,206.8)	**(4,916.2)**

The non-cash movement of £3.0 million relates to the amortisation of loan issue costs, gilt lock proceeds and deferred proceeds.

Loans due within one year relate to loans from group undertakings that are repayable on demand.

18 Contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims, disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements.

Separate consideration of the EA investigations is set out in note 14.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the rivers Itchen, Test and Candover Stream between 2018 and 2030. A provision has been made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 14 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £2 million.

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 Services Limited's valuation.

The company had no contingent liabilities for capital claims at the year-end (2019: £nil).

19 Financial commitments

(a) Capital commitments

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	754.3	301.3
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	19.6	10.7
	773.9	312.0

(b) The company as lessee

	Six months ended 30 September 2020 Unaudited £m	Year ended 31 March 2020 Audited £m
Lease payments under operating leases recognised as an expense in the year	0.8	1.3

20 Related party transactions

The consortium of investors owning Greensands Holdings Limited (GSH) are considered to be related parties of the company as they each have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

There has been no material change during the six months ended 30 September 2020 in transactions with these related parties from that disclosed in the company's annual report and GSH consolidated financial statements for the year ended 31 March 2020.

21 Post balance sheet events

There were no events to report subsequent to the Balance Sheet date

Independent review report to the members of Southern Water Services Limited

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2020 which comprises the condensed income statement, the condensed statement of financial position, the condensed statement of changes in equity, the condensed statement of cash flows and related notes 1 to 21. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the company are prepared in accordance with United Kingdom Generally Accepted Accounting Practice (including Financial Reporting Standard 101 'Reduced Disclosure Framework'). The condensed set of financial statements included in this half-yearly financial report have been prepared in accordance with Financial Reporting Standard 104 'Interim Financial Reporting'.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Financial Reporting Council for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2020 is not prepared, in all material respects, in accordance with Financial Reporting Standard 104 and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Emphasis of matter – Litigation and claims associated with the wastewater treatment works

We draw attention to note 14 and note 18 in the financial statements concerning the uncertain outcome of certain regulatory investigations regarding the performance of certain wastewater treatment works. Southern Water faces a prosecution and other investigations from the Environment Agency ('EA') regarding the performance of certain wastewater sites. The ultimate obligation arising from this matter cannot presently be determined because of the very wide range of possible outcomes in the sentencing guidelines, the uncertain and disputed levels of culpability and environmental harm, the lack of precedent, and the fact that for sentencing purposes Southern Water would be considered a Very Large Organisation meaning that the court has broad discretion in determining the penalty that might be applied. The Board, supported by legal advice, was not able to make a reliable overall estimate of the financial obligation that will arise from this EA prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches the Board has therefore recognised a provision of £1 million for the 51 cases brought to date, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. Our review conclusion is not modified in respect of this matter.

Use of our report

This report is made solely to the company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Financial Reporting Council. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Deloitte LLP.

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London, United Kingdom
27 November 2020

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