Interim Financial Information and Report

for the six months ended 30 September 2023
(Unaudited)

from
Southern Water

Contents

Chief Executive's introduction

Looking back over the past six months, we can see that our focused Turnaround Plan is delivering positive change and improving results

We put in place our Turnaround Plan in March of this year to accelerate improvements in our performance. I am pleased to present these interim financial statements for the period, from 1 April to 30 September, and to be able to report the good progress made against stretching turnaround objectives in the Plan. I feel a deep-rooted connection with our region, and I am proud to lead a business motivated and committed to delivering the step-change in performance that our customers and the environment expect.

The plan, involving capital investment of £3 billion during this regulatory period 2020–25, is underpinned by the support of our shareholders. Funds managed by Macquarie Asset Management, our largest shareholder, provided £375 million of equity to Southern Water as part of a £550 million injection into the group. This supports the investments central to our continuing transformation, and will be supplemented by an additional £825 million of borrowing in the remainder of FY24 (see page 11 for more detail regarding the effect on our going concern status, including the related material uncertainty). It means that after the short, sharp improvement up to 2025 outlined in the Turnaround Plan, we will be ready to drive forward improvements under our next Business Plan (2025–30).

Improving our performance across the business

Progress can already be seen across many areas, including total pollutions and water quality. Our work to drive down pollutions continues. While we have made good progress in reducing the total number during the first half of this year, our serious pollutions have increased. We are committed to a zero-compromise approach to all pollutions. Through our Pollution Incident Reduction Plan we are improving network resilience, using digitalisation and other technologies to make improvements in our control room. We can now spot blockages early using 23,000 sewer level monitors, leading to about 15,000 preventative call-outs over the period. We are already almost half-way towards one of our Turnaround Plan objectives of investing over £40 million improving our pumping stations to avoid pollutions and protect the environment.

Water quality compliance is another area where we are making good progress following new processes being put in place. To improve reliability and quality of supply, we are making progress towards our Turnaround Plan target to deliver 103 projects at our four largest water supply works through an investment of £150 million. This investment will continue over the coming years.

With climate change and an increasing population, saving water is vital. We continue to develop our leakage reduction plans and encourage water saving by our customers. We are now finding 20% more leaks thanks to the work we have done using innovative approaches such as using tubagel, acoustic logging and spotting leaks with satellites. The average amount of water used daily by customers in our region is also reducing in line with our Turnaround Plan target.

In our continuing drive to minimise the use of storm overflows, our Clean Rivers and Seas Task Force is successfully driving work forwards using nature-based sustainable drainage solutions through our six Pathfinder projects, such as the installation of smart water butts in Havenstreet, in the Isle of Wight, reducing storm overflows by up to 70% in the area. We published our Clean Rivers and Seas Plan in November 2023, with a planned investment of nearly £700 million between 2025–2030.

A recent report by CCW (the voice for water consumers) gave us poor ratings for customer complaints in the previous year. We want to make sure our customer service is 'trusted and easy' – a cornerstone of our Turnaround Plan. Since putting our plan in place, we have already made progress in first-contact resolution and service. Alongside a number of other measures, we have introduced a system of video triage, allowing our skilled technicians to visually inspect an issue over a mobile device, allowing in many cases an instant remote solution, and where a visit is required, targeting a rapid fix. In addition, a new website will be up-and-running before the end of this financial year, to enable customers to have better access to information and ways to self-serve. We continue to seek to improve our overall Customer Experience (C-MeX) score of 16th place and to improve our Developer Services (D-MeX).

Part of our commitment to high quality customer service is how we support customers in vulnerable situations during these challenging economic times. Some 10% of our customers are registered on the Priority Services Register (PSR), with an increase for patients requiring dialysis (up by 28%), since partnering with Kidney Care in April. We have also been working with Age UK, focusing on better tariff allocation for customers of pensionable age and from April to September 2023, our Hardship Fund has provided 235 customers in need with £122,292.42 of support covering debt write-off, food vouchers and white goods.

We want to provide a reliable and sustainable supply of water, and this means that we need to reduce the number of water supply interruptions and the average time we have left our customers without supply during an incident.

We are publishing an update to our Turnaround Plan.

Looking to the future – our next Business Plan (2025–30)

With the increased capital investment forming part of our Turnaround Plan, during our current regulatory period between 2020 and 2025, we are spending a total of £4 billion, £1 billion more than the amount in the original settlement. Our new Business Plan for 2025–30 will look to nearly double our spend to £7.8 billion, making it the largest investment we have ever made over a five-year period. We estimate our plan would create 5,000 jobs across the region, representing a spend of about £3,500 per household. We surveyed 25,000 customers about our plan to listen to their views, and we have shaped our plan to respond to the priorities they identified.

Called “Creating a better environment for our communities”, the 2025–30 Business Plan demonstrates our strong commitment to the environment, seeing us plan our largest ever single investment in the environment of £3.3 billion and one of the largest in the sector. The new Business Plan will enable us to continue to protect our region with its 700 miles of coastline, unique chalk streams and environmentally significant sites, guided by our WRMP (Water Resources Management Plan) in maintaining the water supply and protecting water sources in the future.

We plan to spend £3.4 billion on our water services in our next Business Plan and £4.1 billion to improve our wastewater services. We are also looking to double the number of customers receiving support on social tariffs, increase the Hardship Fund to £1.25 million and expanding the PSR register to reach 20% of customers.

Making a difference

I would like to thank the team of over 2,500 colleagues, with very many more in our supply partners, collaborating to take forward our plans with this transformational approach. Together, we are making sure we can provide our region, its customers and its environment with a resilient water future where generations to come can enjoy the communities we all live in.

Lawrence Gosden
Chief Executive Officer
27 November 2023

Our performance improvements

Alongside our Turnaround Plan priorities, we're measured against a wider set of metrics, shared by all water companies.

	2020–21	2021–22	2022–23	Mid-year assessment 2023–24*
Consumer experience	–	–	–	=
Developer experience	–	–	–	↑
Water quality	–	✖	–	↑
Leakage (in year)	–	–	✖	↑
Water usage	✖	✖	✖	↑
Internal flooding	–	✖	–	↑
External flooding	✔	✔	✔	↑
Supply interruptions	✖	–	✖	=
Pollution incidents	–	–	–	↑
Unplanned outage	✔	✔	✔	↑
Treatment works compliance	✖	–	–	↑
Mains repairs	✖	✔	✖	↑
Sewer collapses	✖	–	–	↑

Key
- ✔ Final Determination target met or exceeded
- – Final Determination target missed but performance improved in relation to prior year outcome
- ✖ Final Determination target missed and performance worse than prior year outcome
- ↑ Performance improving from 22/23 APR
- = Performance static from 22/23 APR
- ↓ Performance declining from 22/23 APR

* This is our assessment comparing our year end 2022–23 outcome with the forecast outcome for 2023–24, based on YTD performance to the end of September. Final outcomes will be determined at the end of the year and reported in the Annual Report.

Interim report – financial performance

Key financial performance indicators

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited (restated*) £m	Increase/ (decrease) %
Total revenue	441.0	417.2	5.7
Operating costs	(450.3)	(392.6)	14.7
Operating (loss)/profit	(8.5)	25.4	(133.5)
Net finance costs	(119.5)	(113.3)	5.5
Loss before taxation and movement in fair value of derivatives	(127.7)	(85.7)	49.0
Profit after taxation from continuing operations	41.1	503.4	(91.8)
Gross capital expenditure*	363.3	313.2	16.0
Net cash inflow from operating activities	89.7	142.9	(37.2)

* Excludes asset adoptions and capitalised interest

Income statement

Revenue for the period increased to £441.0 million (period to 30 September 2022: £417.2 million). This increase principally arises from the change in our regulatory tariff and is largely due to the application of inflation of £28.8 million, lower regulatory outcome delivery penalties than in the prior year £1.3 million and the recovery of a tax adjustment applied in the prior year of £12 million offset by lower levels of consumption billed against the accrual made at March 2023 and in relation to the current year of £21.4 million.

In 2018–19 we made provision for rebates, based on our regulatory settlement with Ofwat, to be provided to customers over the period from 2020 to 2025. These rebates are now included within our tariffs and so part of the revenue reported in the income statement. The provision made for these rebates is being released in line with the tariff adjustment £13.3 million in the six months to September 2023 (September 2022: £11.2 million). A detailed analysis of revenue is provided in note 5.

Operating costs increased by 14.7% to £450.3 million (period to 30 September 2022: £392.6 million). This increase was largely driven by an increase in operating expenditure described below and additional depreciation arising from our capital programme of £7.3 million.

Over the period to September 2023 the principal drivers of additional operating costs were as follows:

- Pollution management, including a Clean Rivers and Seas Task Force to identify solutions to the management of surface water and improvements to our sewers and pumping stations to reduce the risk of pollution events totalling £9.5 million
- Additional wastewater tankering and sludge haulage costs linked to the resolution of repairs and maintenance activities at wastewater treatment works, £6.3 million
- Compliance tankering at our Testwood Water Supply Works where we have enhanced water quality performance through capital investment to replace all the chemical dosing equipment on site. Consequently, and in order to maintain compliance, this increased the amount of tankering and treatment required for the waste produced, so that it can be safely returned to the environment. This increased costs significantly by £4.3 million in the year and we are working hard to identify an alternative solution to mitigate and reduce these exceptional costs for the future
- Increased leakage identification and repair activity £1.1 million
- Transformation activities to drive future cost savings and efficiencies, £2.0 million
- Inflation which has increased prices for all our operational costs by £24.5 million. The main increases were in power which we had previously fixed and our contractor and employee related costs

We disclosed in our Annual Reports for March 2022 and March 2023 that we are investing heavily to improve the resilience of our existing assets, improve operational performance and enhance the level of wastewater treatment we undertake. The increase in depreciation in relation to these operational schemes was £4.1 million. In addition, we have been making improvements to our IT infrastructure and systems which increased depreciation in the period by £2.9 million.

In the period to 30 September 2023, we recognised a bad debt provision charge of £7.6 million (period to 30 September 2022 £7.4 million). To date we have not identified a significant change in cash collection performance linked to the current economic pressure. However, recognising that this pressure is continuing for customers, we have retained the additional cost of living affordability provision of £9.6 million held in the accounts at March 2023.

As a consequence of the above we incurred an operating loss of £8.5 million for the period (period to 30 September 2022: £25.4 million profit).

Net finance costs, excluding fair value movements on financial derivatives, increased to £119.5 million (period to 30 September 2022: £113.3 million). This was largely due to an increase in the interest payable on our loans of £13.7 million as a result of a new £400 million term loan facility which was put in place in March 2023 offset by an increase in the value of interest capitalised £7.8 million.

As a result of the above movements the loss before taxation and movement in fair value of derivatives amounted to £127.7 million (period to 30 September 2022: loss £85.7 million).

The fair value gain on our derivative financial instruments amounted to £186.1 million (period to September 2022: gain of £754.0 million). The primary driver for the decrease in our derivative liabilities, which result in the profit reported in the income statement, 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, as experienced with the significant market movements in gilt yields over the past 2 years. These changes do not represent cash flows.

In the Finance Act 2021, the main rate of corporation tax was increased from 19% to 25% effective from 1 April 2023 and the deferred tax balances at 30 September 2022 and 2023 have been calculated based on the increased rate. Our tax charge of £17.3 million largely results from our profit from continuing operations (period to 30 September 2022: £164.9 million charge).

The gain from continuing operations after tax was £41.1 million (period to 30 September 2022: gain of £503.4 million).

Statement of financial position

As at 30 September 2023, non-current assets were £7,530.9 million (£7,297.8 million at 31 March 2023), an increase of £233.1 million. This largely results from the increase in the value of property plant and equipment and intangible assets of £215.9 million, resulting from our ongoing capital investment programme and an increase in the asset value of our derivative financial instruments of £19.3 million.

Current assets decreased by £11.4 million from £379.6 million at 31 March 2023 to £368.2 million at 30 September 2023. This movement was largely driven by a reduction in our cash and cash equivalents balance of £58.8 million, due to our increase capital investment and operating costs in the period, partially offset by an increase in trade and other receivables of £46.4 million, reflecting the higher tariff in our revenues, a temporary timing difference in the receipt of cash from South East Water for customers' who they bill on our behalf and higher intercompany balance with SW (Finance) I Plc (SWFI). We transfer funds to SWFI to enable it to make interest payments on its debt as they fall due. These transfers are shown as an inter-company receivable until the interest is paid.

Current liabilities of £543.2 million at 30 September 2023 were £12.8 million higher than at 31 March 2023 (current liabilities of £530.4 million) largely due to movements in trade and other payables, reflecting the timing of payments to suppliers and for our interest liability.

There was an increase to the value of our long-term borrowings which grew by £306.6 million, from £4,165.3 million at 31 March 2023 to £4,471.9 million at 30 September 2023, from indexation on our loans of £46.1 million and a revolving credit facility of £270.0 million which was drawn in the period offset by a repayment of loans of £10.2 million. Gearing remains comfortably within the requirements of our debt covenants of being below 85%.

The liability associated with our derivative financial instruments was revalued at September 2023 and decreased by £145.1 million from £1,655.3 million at 31 March 2023 to £1,510.2 million at 30 September 2023.

The pension scheme deficit of £55.1 million (31 March 2023: £73.0 million) is based on the latest actuarial valuation as at 31 March 2023 updated by a qualified independent actuary to reflect the increase in corporate bond yields from March which are used to set the discount rate and the latest asset values as at 30 September 2023. The reduction in the deficit of £17.9 million largely results from the increase in returns on corporate bond yields which are used to determine the discount rate offset by lower projected investment returns as a result of market conditions.

Overall net assets increased from £864.6 million at 31 March 2023 to £920.4 million at 30 September 2023.

Cash flow

The cash position decreased from £115.8 million at 31 March 2023 to £57.0 million at 30 September 2023, a reduction of £58.8 million. Details of the principal movements in the cash flow are provided in the table below.

Cash flow for the six months ended 30 September 2023

	2023 £m	2022 £m	Movement £m	Explanation
Net interest related transactions	**(50.2)**	(29.8)	(20.4)	In total, the net cash outflow in relation to interest increased by £20.4 million. The principal reasons were: An increase in the value of our inter-company transfer to SW (Finance) I Plc which is used to pay the interest on our bonds resulting in a £18.8 million cash outflow (2022: £34.9 million inflow). Cash interest paid on loans in total was £9.8 million lower than in the prior year. This was largely due to 30 September 2023 falling at the weekend and interest payments of £25.7 million due that day were not paid until October. These delayed payments offset the payments made in relation to new loans in the period of £15.4 million. No preference share dividends were paid in the period to 30 September 2023 (2022: £12.3 million) Two new swaps were put in place during the period which resulted in additional swap receipts of £9.6 million.
Net movement on borrowings	**259.8**	(14.0)	273.8	During the period, we drew £270.0 million on our revolving credit facility (2022: nil) and made loan repayments of £10.2 million (2022: £8.9 million). No repayments of preference shares have been made in this period (2022: £5.1 million).
Movements in short-term investments	**0.0**	285.0	285.0	There were no funds held on deposit for periods greater than three months at either March 2023 or September 2023. (2022: £285.0 million inflow).
Net cash movement from operation	**89.7**	142.9	(53.2)	Largely driven by the increase in our operating costs and the movements on working capital described previously.
Capital investment	**(355.8)**	(317.9)	(37.9)	A continuation of our capital investment programme targeted at making refurbishments to our assets to improve operational performance as well as schemes to enhance the level of wastewater treatment we undertake, for example to reduce phosphorus levels.
Other	**(2.3)**	(1.5)	(0.8)	
	(58.8)	64.7		

Credit ratings

Our current credit ratings are shown in the table below.

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

As noted in our Annual Report, on 7 July 2023 Fitch announced its decision to downgrade the Class A Unwrapped Debt of the company to BBB (negative outlook) from BBB+ (negative outlook). Subsequent to the reporting date, on 10 November 2023, Standard and Poor's downgraded its rating of the company from BBB+ (negative outlook) to BBB (stable outlook).

As a consequence of the Fitch credit rating action, a credit rating downgrade Trigger Event has occurred. A credit rating downgrade by one or more Rating Agency results in a Trigger Event under our Common Terms Agreement (defined below) which in turn is limited to a restriction on the payment of dividends.

Note:

- A Trigger Event occurs if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below.
- A Trigger Event leads to a restriction on paying dividends under the terms of our Licence.
- 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).

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 Southern Water or its financing subsidiaries 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. Following publication of our compliance reporting in July 2023, where interest cover was reported below its Trigger Event threshold, in addition to a downgrade by Fitch Ratings at the same time, the company entered a Trigger Event. This was the first time that a limit has been breached since the implementation of the financing framework in 2003.

The regulatory framework under which revenues and the RCV are indexed exposes us to inflation risk. This risk is managed through the use of inflation-linked loans and derivatives within the overall debt portfolio. We do not intend to access future inflation-linked debt through the use of derivatives, but will instead seek such debt from natural sources, such as public and private bond markets. As a consequence, we expect the proportion of the RCV and debt that is currently linked to inflation through the use of derivatives will decrease over time. We are not restricted to issuing only sterling debt, but will ensure any other currency loans are fully hedged back to sterling. We also hedge our exposure to interest rate volatility by ensuring that at least 85% of our outstanding debt liabilities (in respect of Class A and Class B debt) is either inflation-linked or fixed rate for the current five-year regulatory period and at least 70% in the next period (on a rolling basis).

Financing since 31 March 2023

On 7 July 2023, Fitch Ratings announced its decision to downgrade the Class A Unwrapped Debt of the company from BBB+ (negative outlook) to BBB (negative outlook), largely due to the constrained financial metrics forecast caused by spending related to our turnaround plan and the effects of high inflation and high interest rates until the end of AMP7. Subsequent to the reporting date, on 10 November 2023, Standard and Poors downgraded the company from BBB+ (negative outlook) to BBB (stable outlook).

In August 2023, funds managed by Macquarie Asset Management ('Macquarie') agreed to invest an additional £550 million of equity into the Southern Water group, of which £375 million was invested into the company. This additional equity funding was received in October 2023 and will help us to maintain the momentum of our turnaround plan and manage the impact of a high inflation and interest rate environment on our operating, maintenance and funding costs.

At the same time, following discussions with our creditors, a covenant amendment to provide the ability to raise gearing (from 74% to 75% of the Senior Regulatory Asset Ratio) whilst in a Trigger Event for certain types of expenditure was obtained, with the flexibility to continue this until 2035.

In September 2023, £400 million of new index-linked swaps were entered into, to manage the company's exposure to inflation. These replaced the maturity of index-linked debt in March 2023.

Going concern

The directors believe, after due and careful enquiry, that it is appropriate to adopt the going concern basis in preparing the financial statements for the six months to 30 September 2023, notwithstanding the material uncertainty discussed below.

For the six months to 30 September 2023 the company incurred an operating loss of £8.5 million (2022: profit of £25.4 million). As of 30 September 2023, it had cash on hand of £57.0 million (31 March 2023: £115.8 million) and undrawn bank facilities of £80.0 million (31 March 2023: £435.0 million). Subsequent to the period end, the equity injection of £375 million from the company's largest shareholder, committed in August 2023, was received in October 2023. As a result, in October 2023, the bank facility of £270.0 million, drawn at 30 September 2023, was repaid and cash on hand increased by £105 million with undrawn bank facilities of £350 million at 31 October 2023. At 30 September 2023, the company also had borrowings totalling £4,527.3 million (31 March 2023: £4,221.0 million), for which the earliest repayment is £400 million in March 2025. In the half year to September 2023, borrowings attracted a total monthly cash interest charge of circa £8.8 million (31 March 2023: circa £6.1 million).

The borrowings are subject to financial ratio covenants, reported semi-annually, as well as covenants relating to the credit rating of debt issued by the company and its subsidiaries. A breach of these covenants can result in either a Trigger Event or a Default Event. Following publication of its compliance reporting in July 2023, where interest cover was reported below its Trigger Event threshold, in addition to a downgrade by Fitch Ratings at the same time, the company entered a Trigger Event.

A Trigger Event is a structural buffer intended to protect the company and its finance creditors from a Default Event. If a Default Event were to occur, all lenders' claims are frozen, and they have the right to exercise their security of a charge over the share capital of the parent company of SWS (see how the company is financed on page 119 of our Annual Report and Financial Statements for March 2023).; The main consequence of a Trigger Event is that the company is prevented from making distributions. It is also required to prepare a plan to recover from a Trigger Event.

Should a Default Event occur, the business enters a 'standstill period'. Committed and undrawn reserves of £190 million are available to finance the business during this period, but there would however be restrictions on the company's operations, including the cessation of capital investment expenditure.

In the annual report for the year ended 31 March 2023, the company concluded that the going concern basis was appropriate, but that a material uncertainty existed around the receipt of the equity injection (subsequently received as set out above). It further concluded that liquidity headroom over the going concern period was limited, and that should total expenditure exceed plan by more than 12%, the company would not have sufficient liquidity for the going concern period. During the period to 30 September 2023, total expenditure exceeded plan by 6%; due to the effects of operational incidents, the acceleration of certain capital projects and operational activity to reduce the risk of pollutions together with price pressures resulting from high inflation.

In assessing the going concern position of the company, the directors considered the forecast cash flows over the 12 months to November 2024, and the capital structure of the company and financing needs for the period. The directors have considered a base case and various sensitivities in establishing that in order to meet the company's commitments over and above its obligations under PR19 price determination, it is necessary to raise additional debt funding as set out below.

Base case – forecast cash flows

The company has a significant level of planned expenditure over at least the next twelve months to continue to enhance its assets and improve operational performance. The company is also facing the effect of high inflation, particularly on costs such as energy, chemicals, and materials. As a result, the company has forecast net cash outflows for every month throughout the going concern assessment period of 12 months to November 2024.

In preparing the forecasts, management has considered:

- The company's business activities, together with the factors likely to affect its future development, performance, and position. In particular, the company has considered the significant level of expenditure we have committed to in addition to that allowed at the PR19 price determination.
- The financial position of the company, its forecast monthly cash flows, liquidity position, covenants and borrowing facilities.
- The effects of the operational incidents in the period to 30 September 2023 (see page 6) for details of our operating cost performance in the period.
- The effects of current high levels of inflation on costs such as energy, chemicals, and materials.
- Investment needed to improve operational performance and reduce the impact on the environment from the treatment and processing of water and wastewater and mitigate the effects of climate change.
- The company operates in an industry that is largely 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.

Base case – financing needs

In planning for the future financing needs of the company, the directors have also considered the following information:

- The committed revolving credit facility was increased from £330 million to £350 million on 31 October 2022 and renewed for a further five years. £270 million of this facility was utilised in the period to 30 September 2023 as described above but has been settled since the period end. The facility is expected to be further utilised in the remainder of the going concern period.
- Borrowings are generally at fixed interest rates but include certain inflation-linked loans and derivatives. The inflation-linked instruments are subject to inflation risk which is expected to be offset by inflation movement of the RCV and revenues.

To finance the planned expenditure over the remainder of the going concern period, and repay the £400 million borrowings due in March 2025, the company expects to receive a total of circa £825 million of new debt ('the debt raise'), with cash expected to be received by the end of March 2024 and included within the base case. The directors anticipate receiving the debt, based on a history of successful fundraising in the past and following advice from its financial advisors. Financing plans are well advanced and the company expects to be able to respond quickly to recent constructive market conditions.

Base case – covenant compliance

- The company's credit rating as at 30 September 2023 was Baa3/BBB+/BBB, and in November 2023 has been downgraded to Baa3/BBB/BBB as a result of pressure on financial ratios from the planned level of expenditure, plus operational performance challenges which are being addressed by the company's turnaround plan.
- The adjusted interest cover ratio is expected to have negative headroom until at least March 2025 and therefore as a result of this and the initial downgrade from Fitch Ratings in July 2023, the company is in a Trigger Event and is expected to continue to be in a Trigger Event to at least March 2025.
- The company obtained a waiver from its lenders in August 2023 which allows full use of available borrowing facilities, plus the raising of new finance, during a Trigger Event related to either a credit rating downgrade or a breach of a financial ratio. This waiver is in place to 2035, and the company also increased the associated debt/RCV limit to 75% while in a Trigger Event.

There is positive financial headroom across all Default debt covenant ratios for the going concern period in the base case, although there is limited financial headroom against the post maintenance interest cover ratio for 2023–24, and the debt/RCV ratio of 75%.

Sensitivities

- **Liquidity:** Downside sensitivities to the cash flows to check that the company can operate within its current facilities and covenants, have identified that if total expenditure, over the going concern period, is 29% over plan, the company will not have sufficient liquidity for the going concern period, on the assumption that the debt raise succeeds as forecast.
- **Financing:** Should the debt raise not succeed and £825 million not be received, the company will not have sufficient liquidity for the going concern period, with headroom reduced to nil in September 2024.
- **Covenants:** The post maintenance interest cover ratio covenant would be breached if net cash flow from operating activities less capital maintenance expenditure were to exceed plan by £27 million; the consequences of this would be a Default Event.

Conclusion

If the company's financing plans do not proceed as planned, the company may not be able to finance the full amount of planned expenditure in addition to that allowed at the PR19 price determination and to meet its regulatory obligations and financial commitments as they fall due. The company plans to raise £825 million; the minimum required to finance its base case activities throughout the going concern period is approximately £450 million, which must proceed by August 2024.

Based on the company's investment grade credit rating, its history of successful fundraising in the past and upon the advice of its professional advisors as to current market conditions, the Directors are of the opinion that the financing proceeds will be received but given they have not been committed at the date of the financial statements and that commitment is not within the Directors' control, believe that the risk that the funding is not received constitutes a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern such that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

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 Audit Committee. The Audit Committee receives a risk report at its meetings four 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.

At November 2023, 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. We regularly review key developments and emerging risks to assess whether the current set of risks require any changes and will report proposals for any changes to the Audit Committee and Board.

The principal risks are listed below (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 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 on our water resources and the effect of extreme weather events, such as droughts or flooding, on 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
- **Corporate affairs** – ensuring that we are responding to the additional political and regulatory focus on the water industry in order to meet customer expectations
- **People** – managing and developing our workforce in a competitive employment market

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 13.

Further detailed descriptions of these risks and uncertainties and our risk management process are included in the Annual Report and Financial Statements for the year ended 31 March 2023, 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 2023 and up to the date of signing the interim financial statements were:

Keith Lough
(Chairman)

Lawrence Gosden
(Executive director – Chief Executive Officer)

Stuart Ledger
(Executive director – Chief Financial Officer)
(Appointed 3 January 2023)

Malcolm Cooper
(Independent non-executive director)

Gillian Guy
(Independent non-executive director)

Michael Putnam
(Independent non-executive director)

Christèle Delbé
(Independent non-executive director)
(Appointed 31 May 2023)

Kerensa Jennings
(Independent non-executive director)
(Appointed 31 May 2023)

Mark Mathieson
(Non-executive director)
(Resigned 31 October 2023)

William Price
(Non-executive director)

Stephen Fraser
(Non-executive director)

Phil Swift
(Non-executive director)
(Appointed 31 May 2023)

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 2023:

Keith Lough
Chairman

Stuart Ledger
Chief Financial Officer

Interim financial statements

Condensed income statement for the six months ended 30 September 2023

Continuing operations	Notes	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Revenue		**427.7**	406.0
Amortisation of regulatory settlement		13.3	11.2
Total revenue	5	**441.0**	417.2
Other operating income	5	0.8	0.8
Operating costs			
• before charge for bad and doubtful debts, depreciation and amortisation		(268.0)	(217.7)
• charge for bad and doubtful debts		(7.6)	(7.4)
Operating costs before depreciation and amortisation		(275.6)	(225.1)
Depreciation and amortisation		(174.7)	(167.5)
Total operating costs		(450.3)	(392.6)
Operating (loss)/profit		**(8.5)**	25.4
Operating (loss)/profit before regulatory settlement		(21.8)	14.2
Amortisation of regulatory settlement		13.3	11.2
Operating (loss)/profit		(8.5)	25.4
Income from subsidiary	5	–	1.1
Profit on disposal of fixed assets	5	0.3	1.1
(Loss)/profit before interest and taxation		(8.2)	27.6
Finance income		1.6	1.4
Finance costs		(121.1)	(114.7)
Movements on derivative financial instruments		186.1	754.0
Net finance (cost)/income	6	66.6	640.7
Profit before taxation from continuing operations		**58.4**	668.3
Tax charge	7	(17.3)	(164.9)
Profit after taxation from continuing operations		**41.1**	503.4

Condensed statement of other comprehensive income for the six months ended 30 September 2023

	Notes	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Profit for the period		**41.1**	503.4
Items that cannot be reclassified to profit or loss			
Actuarial gain on retirement benefit obligation	16	19.6	45.8
Deferred tax asset movement relating to retirement benefit obligation	7	(4.9)	(11.4)
		14.7	34.4
Total comprehensive profit for the period		**55.8**	537.8

Condensed statement of financial position as at 30 September 2023

	Notes	Six months ended 30 September 2023 Unaudited £m	Year ended 31 March 2023 Audited £m
Non-current assets			
Intangibles	9	108.6	110.0
Property, plant and equipment	10	7,310.1	7,092.8
Investments	11	0.2	0.2
Derivative financial instruments	12	103.2	83.9
Other non-current assets		8.8	10.9
		7,530.9	7,297.8
Current assets			
Inventories		11.4	10.4
Trade and other receivables		299.8	253.4
Cash and cash equivalents		57.0	115.8
		368.2	379.6
Total assets		7,899.1	7,677.4
Current liabilities			
Trade and other payables		(489.9)	(477.6)
Borrowings	20	(19.6)	(19.2)
Lease liabilities	20	(3.9)	(4.0)
Regulatory settlement liability	13	(28.0)	(27.4)
Provision for liabilities	14	(1.8)	(2.2)
		(543.2)	(530.4)
Non-current liabilities			
Borrowings	20	(4,471.9)	(4,165.3)
Lease liabilities	20	(31.8)	(32.5)
Derivative financial instruments	12	(1,510.2)	(1,655.3)
Deferred tax liabilities		(306.7)	(284.5)
Retirement benefit obligations	16	(55.1)	(73.0)
Regulatory settlement liability	13	(14.3)	(28.2)
Provisions for liabilities	14	(3.2)	(3.3)
Other non-current liabilities		(42.3)	(40.3)
		(6,435.5)	(6,282.4)
Total liabilities		(6,978.7)	(6,812.8)
Net assets		920.4	864.6
Equity			
Called up share capital	17	0.1	0.1
Share premium account	18	437.5	437.5
Non-distributable reserve		96.1	94.6
Retained earnings		386.7	332.4
Total equity		920.4	864.6

Condensed statement of changes in equity for the six months ended 30 September 2023

	Called up share capital (Note 17) £m	Share premium (Note 18) £m	Non-distributable reserve £m	Retained earnings £m	Total £m
Balance as at 1 April 2023	**0.1**	**437.5**	**94.6**	**332.4**	**864.6**
Profit for the financial period	–	–	2.5	38.6	41.1
Other comprehensive income/(loss) for the period:					
Actuarial gain on pension scheme	–	–	–	19.6	19.6
Movement on deferred tax relating to retirement benefit obligation	–	–	–	(4.9)	(4.9)
Total comprehensive income for the period	**–**	**–**	**2.5**	**53.3**	**55.8**
Reserves transfer*	–	–	(1.0)	1.0	–
Equity dividends (note 8)	–	–	–	–	–
At 30 September 2023 (unaudited)	**0.1**	**437.5**	**96.1**	**386.7**	**920.4**

Condensed statement of changes in equity for the six months ended 30 September 2022

	Called up share capital (Note 17) £m	Share premium (Note 18) £m	Non-distributable reserve £m	Retained earnings £m	Total £m
Balance at 1 April 2022	0.1	437.5	85.1	66.3	589.0
Profit for the financial period	–	–	4.0	499.4	503.4
Other comprehensive loss for the period:					
Actuarial loss on pension scheme	–	–	–	45.8	45.8
Movement on deferred tax relating to retirement benefit obligation	–	–	–	(11.4)	(11.4)
Total comprehensive income for the period	**–**	**–**	**4.0**	**533.8**	**537.8**
Reserves transfer*	–	–	(0.9)	0.9	–
Equity dividends (note 8)	–	–	–	–	–
At 30 September 2022 (unaudited)	**0.1**	**437.5**	**88.2**	**601.0**	**1,126.8**

* The non-distributable reserve arose upon adoption of IFRS 15 and relates to deemed revenue on adoption of assets from customers and is being amortised to retained earnings in line with the depreciation of the related assets.

Condensed statement of cash flows for the six months ended 30 September 2023

	Notes	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited (Restated)* £m
Cash from operations		89.7	142.9
Tax paid		–	–
Net cash from operating activities	19	89.7	142.9
Investing activities			
Interest received		2.6	1.5
Purchase of property, plant and equipment		(341.2)	(303.1)
Purchase of intangible assets		(14.6)	(14.8)
Proceeds on disposal of property, plant and equipment		–	0.9
Acquisition of short term investments		–	(50.0)
Maturity of short term investments		–	335.0
Return on investment in subsidiary		–	1.1
Return of investment in subsidiary		–	29.2
Net cash used in investing activities		(353.2)	(0.2)
Financing activities			
Equity dividends paid		–	–
Preference share dividends paid		–	(12.3)
Interest paid		(74.5)	(30.5)
Receipts on derivative financial instruments		21.7	11.5
Repayment of borrowings	20	(10.2)	(44.3)
Repayments of principle on leases	20	(2.3)	(2.4)
Proceeds of new loans	20	270.0	–
Net cash generated from/(used) in financing activities		204.7	(78.0)
Net (decrease)/increase in cash and cash equivalents		(58.8)	64.7
Cash and cash equivalents at beginning of the period		115.8	157.4
Cash and cash equivalents at end of the period	19	57.0	222.1

Notes to the interim financial information

For the six months ended 30 September 2023

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 2023, 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 2023 do not constitute statutory accounts of the company as defined in section 434 of the Companies Act 2006. 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 2023 were approved by the Board on 7 July 2023 and the auditor's report on those accounts was not qualified and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

The condensed financial statements for the six months ended 30 September 2023 should be read in conjunction with the Annual Report and Financial Statements for the year ended 31 March 2023 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 fact that the company is currently in a credit ratings Trigger Event, which due to certain covenant waivers obtained does not affect forecast liquidity headroom.

The company has a significant level of planned expenditure, over at least the next twelve months and will continue to March 2025 to improve operational performance, the resilience of its assets, and reduce the impact on the environment from the treatment and processing of water and wastewater. The company is also facing the effect of high inflation, particularly on costs such as energy, chemicals, and materials.

To assist in financing the planned expenditure and repay borrowings of £400 million due in March 2025, the company expects to raise £825 million of new debt in the coming months and financing plans are well advanced but the receipt has not been committed at the date of signing these financial statements.

The directors are of the opinion, based on the company's investment grade credit rating, a history of successful fundraising and following advice from financial advisers, that the company will be able to raise this finance, but given it has not been committed at the date of the financial statements and its commitment is not within the directors' control, believe that the risk that the financing is not raised constitutes a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern such that it may be unable to realise its assets and discharge its liabilities in the normal course of business. See pages 10 to 12 for further details of the going concern assessment.

On the basis of their assessment of the company's financial position, 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 material 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 2023, 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 2023.

Separate line items on face of income statement

When assessing whether an event should be presented separately on the face of the income statement management considers the nature, frequency, materiality and the facts and circumstances of each event. Management considers whether there is any precedent, and ensures consistent treatment for both favourable and unfavourable transactions.

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 2023.

The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end and is a key source of estimation uncertainty. As at 31 March 2023, the accrual for unbilled measured income was £223.5 million. The value of household billings raised in the period to 30 September 2023 for consumption in prior years was £212.1 million, £11.4 million (5.1%) less than the accrual at 31 March 2023, with further billing for prior years still to be finalised. This difference is well within our view of acceptable tolerances for accounting estimates.

The company enters into a variety of derivative financial instruments to manage its exposure to inflation and interest rate risk in line with the company's risk management policy. The value of derivatives is highly sensitive to assumptions of inflation and interest rates, and the following scenarios indicate the impact of a 1% movement in the respective rate structures on the fair value of the derivatives portfolio as at 30 September 2023. These values have been obtained by recalculating the entire portfolio value by shifting the interest rate curve and the inflation curve by +-1%.

Event	+1% Increase £m	-1% Decrease £m
Interest rates	303.8	(375.0)
Inflation rates	(822.6)	671.6

3. Changes in 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 2023 (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 2023. 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 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Water and sewerage services		
Household – measured	269.0	256.4
Household – unmeasured	59.0	55.7
Non-household – measured	69.5	66.8
Non-household – unmeasured	2.2	2.1
Total water and sewerage services	399.7	381.0
Bulk supplies	2.3	2.3
Infrastructure charge receipts	4.7	2.2
Trade effluent	4.5	3.6
Cesspools	3.1	3.9
New connections	2.9	1.9
Adoptions (see note (a) below)	2.5	4.0
Other services	8.0	7.1
Total revenue before amortisation of regulatory settlement	427.7	406.0
Amortisation of regulatory settlement (see note (b) below)	13.3	11.2
Total revenue	441.0	417.2
Other operating income (see note (c) below)	0.8	0.8
Income from subsidiary	–	1.1
Profit on disposal of fixed assets	0.3	1.1
Interest receivable (note 6)	1.6	1.4
Total income	443.7	421.6

a) Revenue associated with the adoption of assets from customers is treated as non-distributable upon recognition, and amortised to retained earnings in line with the depreciation of the related assets..

b) As reported on page 27 the company co-operated with Ofwat in relation to its investigation into the management, operation and performance of its wastewater treatment works.

To ensure that customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation. These rebates are now being made and recorded through the water and sewerage services revenue shown above. The provision for these rebates made in the financial statements for 2018–19 is also being released through revenue in line with the annual profile of the rebates to be made.

Amortisation of £13.7 million in the period ended 30 September 2023 is shown net of changes for future inflation estimates of £0.4 million.

c) Other operating income in the current year relates to 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

	Notes	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Finance income			
Deposit income on short-term bank deposits		1.6	1.4
		1.6	1.4
Finance costs			
Interest payable on other loans		(17.3)	(0.6)
Interest paid to SW (Finance) I Plc (2022: Southern Water Services (Finance) Ltd)		(78.1)	(81.1)
Indexation of index-linked debt		(45.7)	(46.0)
Amortisation of issue costs		(0.8)	(0.8)
Amortisation of gilt lock proceeds		0.1	0.1
Amortisation of bond premium		0.3	0.3
Finance lease interest		(0.5)	(0.5)
Other finance expense		(1.7)	(0.8)
Dividends on preference shares*		(2.3)	(2.4)
		(146.0)	(131.8)
Amounts capitalised on qualifying assets		24.9	17.1
		(121.1)	(114.7)
Movements on derivative financial instruments	11	186.1	754.0
Net finance income/(costs)		66.6	640.7

* Dividends due to Class B preference shareholders of £70 per share for the period ending 30 September 2023 totalled £2.3 million (30 September 2022: £2.4 million). Of this amount £nil was paid during the year (30 September 2022: £0.1 million) with £2.3 million accrued at 30 September 2023 (30 September 2022: £2.3 million). The cumulative balance sheet liability for unpaid preference share dividends at 30 September 2023 was £6.8 million (30 September 2022: £2.3 million).

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/loss on continuing operations

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Current tax:		
In respect of the current period	–	–
Total current tax charge	–	–
Deferred tax:		
Origination and reversal of temporary differences	17.3	164.9
Total deferred tax charge	17.3	164.9
Total tax charge on profit/(loss) from continuing operations	17.3	164.9

In line with the requirements of FRS 104, the tax charge for the six months ended 30 September 2023 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 2024.

An increase in the main rate of corporation tax from 19% to 25% effective from the 1 April 2023 was enacted in the Finance Act 2021, and deferred tax balances at 30 September 2023 were calculated based on the increased 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 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Arising on income and expenses recognised on other comprehensive income:		
Tax charge/(credit) on actuarial losses on defined benefit pension scheme	4.9	11.4
Total deferred tax charge recognised in other comprehensive income	4.9	11.4

8. Dividends

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Equity dividends:		
– Ordinary	–	–
	–	–

9. Intangible assets

	£m
Cost	
At 1 April 2023	260.0
Additions	12.9
Disposals	–
At 30 September 2023 (unaudited)	272.9
Accumulated amortisation	
At 1 April 2023	150.0
Charge for the period	14.3
Disposals	–
At 30 September 2023 (unaudited)	164.3
Net book amount	
At 30 September 2023 (unaudited)	**108.6**

10. Property, plant and equipment

	£m
Cost	
At 1 April 2023	10,898.8
Additions in the period	377.8
Disposals	(31.2)
At 30 September 2023 (unaudited)	11,245.4
Accumulated depreciation	
At 1 April 2023	3,806.0
Charge for the period	160.4
Disposals	(31.1)
At 30 September 2023 (unaudited)	3,935.3
Net book amount	
At 30 September 2023 (unaudited)	**7,310.1**

11. Investments

	Six months ended 30 September 2023 Unaudited £000	Year ended 31 March 2023 Audited £000
Shares in subsidiaries:		
SW (Finance) I Plc	136.1	136.1
SW (Finance) II Limited	37.6	37.6
Total investments	173.7	173.7

The company has the following direct investments in subsidiary undertakings at 30 September 2023:

	Registered Office	Class of share capital	Activity
SW (Finance) I Plc	Southern House, Yeoman Road, Worthing	Ordinary (100%)	To raise debt finance
SW (Finance) II Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

12. Derivative financial instruments

Categories of financial instruments at fair value

	30 September 2023 Unaudited £m	31 March 2023 Audited £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Inflation swaps	103.2	83.9
Total derivative financial assets	103.2	83.9
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Inflation swaps	(1,510.2)	(1,655.3)
Total derivative financial liabilities	(1,510.2)	(1,655.3)

Changes in value of financial instruments at fair value

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Movements on derivative financial assets at FVTPL	19.3	29.2
Movements on derivative financial liabilities at FVTPL	166.8	724.8
Total movements on derivative financial instruments at FVTPL	186.1	754.0
Realised movements on derivative financial liabilities in the period	(21.7)	(11.5)
Total movements on derivative financial instruments	164.4	742.5

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.

13. Regulatory settlement liability

	Six months ended 30 September 2023 Unaudited £m	Year ended 31 March 2023 Audited £m
At 1 April	**55.6**	78.8
Decrease in period/year	(13.7)	(25.0)
Reassessment of provision for changes in future inflation estimates	0.4	1.8
At 30 September 2023 and 31 March 2023	**42.3**	55.6
Included in:		
Current liabilities	28.0	27.4
Non-current liabilities	14.3	28.2
	42.3	55.6

In 2018–19 Ofwat concluded its investigation in relation to the management, operation and performance of the company's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action. Ofwat issued Southern Water with a financial penalty amounting to £3.0 million as published on its website. To ensure that customers are not disadvantaged as a result of these matters, the company agreed to make direct customer rebates totalling £122.9 million in 2017–18 prices over the period 2020–25 reflecting the seriousness of the breaches identified in the investigation. These amounts have been provided for in the financial statements at outturn prices and are reassessed each year to account for the impact of inflation. After reassessment at 30 September 2023, the profile for release of the provision is as follows:

Year Ending 31 March:	2020–21	2021–22	2022–23	2023–24	2024–25	Total
AMP6 Bill Rebate (2017–18 CPI real)	33.54	22.33	22.33	22.33	22.33	122.86
Inflation	2.21	1.60	2.70	5.05	6.27	17.83
Provision (Nominal)	35.75	23.93	25.03	27.38	28.60	140.69

The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

14. Provisions for liabilities

	Environmental obligations
	£m
At 1 April 2023	5.5
Utilised in period	(0.5)
At 30 September 2023	**5.0**
At 1 April 2022	6.5
Utilised in year	(1.3)
Increase in year	0.3
At 31 March 2023	**5.5**

	30 September 2023	31 March 2023
	Unaudited	Audited
	£m	£m
Included in:		
Current liabilities	1.8	2.2
Non-current liabilities	3.2	3.3
	5.0	5.5

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.

Environment Agency

The company is seeking to work proactively with the Environment Agency to resolve its ongoing investigation into sampling and flow compliance and reporting issues for the period 2013 to 2017 (inclusive). The Board has concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation and further details are provided in note 21 Contingent liabilities, to these interim financial statements.

15. Other non-current liabilities

	Grants & contributions	Deferred Revenue	Total
	£m	£m	£m
Balance at 1 April 2023	28.3	12.0	40.3
Increase in year	3.0	–	3.0
Released to income statement	(0.8)	(0.2)	(1.0)
Balance at 31 March 2023	**30.5**	**11.8**	**42.3**

Grants and contributions relate to property, plant and equipment.

Deferred revenue of £11.8 million (31 March 2023: £12.0 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

16. Retirement benefit obligations

The latest actuarial valuation of the SWPS was carried out as at 31 March 2022 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. The first payment was made in November 2018 and payments up to 1 April 2021 totalled £69.1 million. On 31 March 2022 the company made an additional one-off contribution of £59.6 million into the Scheme covering agreed the deficit contribution for 1 April 2022 of £20.6 million plus a further prepayment of £39.0 million in relation to deficit contributions due in future years. Future contributions will be dependent on levels of RPI, and the base deficit contributions (before adjustment for RPI) over the period from 1 April 2023 to 1 April 2029 are payable annually and, offset by the £39.0 million prepayment made on 1 April 2022 as described above, total £105.3 million.

If the assumptions documented in the Scheme's Statement of Funding Principles dated 14 March 2023 are borne out in practice, the deficit will be removed by 1 April 2029.

The retirement benefit obligations shown at 30 September 2023 are based on the valuations at 31 March 2023, 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 resulting net defined benefit liability has decreased in the 6 months to 30 September 2023. This is primarily due to an increase of 0.8% per annum in the discount rate used to calculate the defined benefit obligation, which is based on high-quality corporate bond yields, which were higher at 30 September 2023 than at 31 March 2023. The decrease in the defined benefit obligation has been largely offset by lower than assumed investment returns over the period, which is primarily due to the value of the Government Bonds / Liability Driven Investment Portfolio decreasing as a result of significant increases in gilt yields over the period.

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

	Six months ended 30 September 2023 Unaudited % per annum	Year ended 31 March 2023 Audited % per annum
Price inflation (RPI)	3.30	3.25
Price inflation (CPI)		
– RPI less 1% pa up to 2030	2.30	2.25
– Equal to RPI after 2030	3.30	3.25
Rate of increase of pensions in payment:		
– MIS* members only***	2.30	2.25
– Old section** members only***	3.30	3.25
– New section and ex FSLP (RPI max 5%)***	3.20	3.15
– Post 5 April 1988 GMP (CPI max 3%)***	2.00	2.00
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.20	2.20
Rate of increase for deferred pensions:		
– MIS* members only***	2.30	2.25
– Old section** members only***	3.30	3.25
– New section and ex FSLP (RPI max 5%)***	3.20	3.15
– Post 5 April 1988 GMP (CPI max 3%)***	2.00	2.00
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.20	2.20
Discount rate	5.45	4.65

* 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).

† Rate shown applies up to 2030

16. 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:

	30 September 2023 Unaudited £m	31 March 2023 Audited £m
Total fair value of assets	560.4	612.8
Present value of the defined benefit obligation	(615.5)	(658.8)
Deficit recognised in the statement of financial position	(55.1)	(73.0)

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

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m	Year ended 31 March 2023 Audited £m
At 1 April	(73.0)	(59.9)	(59.9)
Employer's contributions	–	–	–
Financing charge	(1.7)	(0.8)	(1.6)
Actuarial gain/(loss)	19.6	45.8	(11.5)
Deficit in the scheme at end of the period	(55.1)	(14.9)	(73.0)

17. Called up share capital

	30 September 2023 Unaudited £000	31 March 2023 Audited £000
Equity shares		
Authorised		
46,050,000 Ordinary shares of £1 each	46,050	46,050
Allotted and fully-paid		
Ordinary shares of £1 each		
At 1 April	112	112
Issued for cash	–	–
At 30 September/31 March	112	112
Non-equity shares		
Issued		
64,665 (31 March 2022: 69,829) Class B Preference shares of £1 each	65	65

The redeemable preference shares are presented as a liability at an amount of £64.7 million (31 March 2023: £64.7 million) including share premium of £64.6 million (31 March 2023: £64.6 million) and accordingly are excluded from called up share capital in the balance sheet.

18. Share premium account

	30 September 2023 Unaudited £m	31 March 2023 Audited £m
Equity share premium		
At 1 April	437.5	437.5
Issued for cash	–	–
At 30 September/31 March	437.5	437.5

19. Cash generated by operations

	Six months ended 30 September 2023 Unaudited £m	Six months ended 30 September 2022 Unaudited £m
Continuing operations		
Operating (loss)/profit	(8.5)	25.4
Adjustments for:		
Fair value of sewer adoptions	(2.5)	(4.0)
Depreciation of property, plant and equipment	160.4	157.9
Amortisation of intangible assets	14.3	9.6
Receipt of grants and contributions	3.0	1.3
Amortisation of grants and contributions	(0.8)	(0.8)
Operating cash flow before movement in working capital	165.9	189.4
Increase in inventories	(0.9)	(1.4)
Increase in receivables	(26.2)	(36.5)
(Decrease)/increase in payables	(35.2)	3.8
Decrease in regulatory settlement liability	(13.3)	(11.2)
Decrease in provisions	(0.6)	(1.2)
Cash generated by operations	89.7	142.9
Tax paid		
– Group relief	–	–
– Payments made within SWSG Dividend Loop	–	–
Net cash generated from operating activities	89.7	142.9

20. Analysis of net debt

	At 1 April 2023 Audited £m	Cash flow £m	Fair value adjustments £m	New finance leases £m	Other non-cash changes £m	At 30 September 2023 Unaudited £m
Cash and cash equivalents	115.8	(58.8)	–	–	–	57.0
Net liabilities from financing activities:						
Term facilities/index linked loans	(400.0)	(270.0)	–	–	–	(670.0)
Index linked loans	(57.1)	10.2	(2.8)	–	–	(49.7)
Loans from subsidiary	(3,662.7)	–	(44.0)	–	(0.4)	(3,707.1)
Finance lease liabilities	(36.5)	2.3	–	(1.5)	–	(35.7)
Redeemable preference shares	(64.7)	–	–	–	–	(64.7)
Net interest rate swaps	(1,571.4)	(21.7)	186.1	–	–	(1,407.0)
Total liabilities from financing activities	(5,792.4)	(279.2)	139.3	(1.5)	(0.4)	(5,934.2)
Net debt	(5,676.6)	(338.0)	139.3	(1.5)	(0.4)	(5,877.2)

The non-cash movement on loans from subsidiary of £0.4 million relates to the amortisation of loan issue costs and gilt lock proceeds.

Unaudited balances at 30 September 2023 comprise:

	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	57.0	–	–	57.0
Derivative financial instruments	103.2	–	–	(1,510.2)	(1,407.0)
Lease liabilities	–	–	(3.9)	(31.8)	(35.7)
Borrowings due within one year	–	–	(19.6)	–	(19.6)
Borrowings due after one year	–	–	–	(4,471.9)	(4,471.9)
Net debt	103.2	57.0	(23.5)	(6,013.9)	(5,877.2)

Borrowings due within one year relate to loans from group undertakings that are repayable on demand or within 12 months of the balance sheet date.

Cash and cash equivalents (which are presented as a single class of assets on the face of the Statement of Financial Position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

Cash on deposit with a maturity of more than three months from the date of acquisition is shown as current asset investments in the statement of financial position.

21. Contingent liabilities

There are currently two significant ongoing investigations being conducted by the Environment Agency (EA) of which one is also being considered by Ofwat.

As has been reported previously, we continue to assist the EA in its investigation into legacy issues relating to wastewater sampling compliance for the period 2013 to 2017. This investigation is ongoing and there have not been any significant developments during the year. We do not know when the investigation stage will be concluded, and we do not know if or when any charges against the company are likely, nor how many charges may be brought, nor how any specific charges might be framed. As the investigation is ongoing, and as the EA has not stated what its intentions are so far as the next steps in the investigation are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this investigation, nor its timing (which could be several months or years), but will keep the situation under review.

In November 2021 the Environment Agency and Ofwat launched an investigation into sewage treatment works belonging to all water and wastewater companies in England and Wales. As we reported in our Annual Report at March 2022, Ofwat has opened enforcement cases into six water companies (not Southern Water). However, all water and wastewater companies in England and Wales remain subject to their ongoing investigation as they continue to review the information they have gathered. As the investigations are ongoing, and as neither the EA nor Ofwat have stated what their intentions are so far as the next steps in the investigations are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from these investigations, or its timing (which could be several months or years), but will keep the situation under review.

The Board monitors and supports the work of the Risk and Compliance teams, 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.

As well as the ongoing EA and Ofwat investigations, companies of the size and scale of Southern Water Services Limited are sometimes subject to civil claims, disputes and potential litigation. 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.

There is an ongoing claim in respect of property search income going back six years. A number of property search companies claim the return of amounts paid in respect of CON29DW water and drainage search reports, which they allege should have been provided to them either free of charge or for a nominal fee in accordance with the Environmental Information Regulations. It is a highly complex group action against multiple Defendants across the sector, with many legal, factual, and evidential issues to be resolved. It is proceeding in phases, with the stage 1 trial expected in late 2023, and it is not anticipated to be concluded for several years. The Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this claim, or its timing, but will keep the situation under review.

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 period end (2022: £nil).

22. Financial commitments

(a) Capital commitments are as follows:

	Six months ended 30 September 2023 Unaudited £m	Year ended 31 March 2023 Audited £m
Contracted for but not provided for in respect of contracts placed in respect of:		
– property, plant and equipment	1,053.1	682.5
– intangible assets	7.8	18.4
Right to receive water from Portsmouth Water Limited[1]	658.0	658.0[2]
	1,718.9	1,358.9

[1] In February 2021 the company entered into a contractual arrangement with Portsmouth Water Limited ('Portsmouth Water'), under which after constructing the reservoir, and Southern Water have laid a pipe, Portsmouth Water will supply Southern Water with 21 million litres of water a day from 1 April 2029 as part of the development of the Havant Thicket Reservoir in Portsmouth Water's supply area. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The present value of the fixed contractual payments, which total £658 million over the period to 2100, using a discount rate of 4.98%, being the nominal return on capital allowed per the PR19 final determination, is £137.3 million at 31 March 2023 (31 March 2022: £130.8 million). The volumetric charge will be recognised as water is supplied, from 1 April 2029.

[2] The amount disclosed in the equivalent table in the annual financial statements at 31 March 2023 was inadvertently disclosed as £700.9 million and has been amended in the above table to show the correct figure of £658.0 million.

(b) The company as lessee

	Six months ended 30 September 2023 Unaudited £m	Year ended 31 March 2023 Audited £m
Lease payments under operating leases recognised as an expense in the year	2.8	4.0

Operating leases are charged to the income statement over the lease term and comprise short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less).

23. Related party transactions

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey, which is the parent undertaking and controlling party of the smallest, largest and only group to consolidate these financial statements. Copies of the consolidated financial statements may be obtained from the registered office of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from the Southern Water website.

Macquarie Asset Management, as the major shareholder in the consortium of investors owning Greensands Holdings Limited (GSH) is considered to be a related party of the company as they have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

24. Post balance sheet events

On 19 October 2023, 37,500,000 ordinary shares with aggregate nominal value of £37.5 million were issued at £10 each to SWS Holdings Limited. The total premium arising on issue amounted to £337.5 million and costs of the equity issue to date amount to £4.8 million.

On 10 November 2023, Standard and Poor's announced its decision to downgrade the Class A Unwrapped debt of the company to BBB (stable outlook) from BBB+ (negative outlook). Further details regarding the implications of a Trigger Event can be found on page 9.

Independent review report to the members of Southern Water Services Limited

Conclusion

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 2023 which comprises the condensed income statement, the condensed statement of other comprehensive income, the condensed statement of financial position, condensed statement of changes in equity, condensed statement of cash flows, and related notes 1 to 24.

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 2023 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.

Basis for Conclusion

We conducted our review in accordance with International Standard on Review Engagements (UK) 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 (ISRE (UK) 2410). 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.

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".

Material uncertainty relating to going concern

We draw attention to note 1 in the condensed set of financial statements, which indicates that the planned debt raise of £825 million is required to have sufficient liquidity over the going concern period has not been carried out at the date of signing the financial statements. As stated in note 1, these events or conditions, along with the other matters as set forth in note 1, indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. Our review conclusion is not modified in respect of this matter.

Notwithstanding the material uncertainty discussed above, based on our review procedures, which are less extensive than those performed in an audit as described in the Basis for Conclusion section of this report, nothing has come to our attention to suggest that the directors have inappropriately adopted the going concern basis of accounting or that the directors have identified material uncertainties relating to going concern that are not appropriately disclosed.

This Conclusion is based on the review procedures performed in accordance with ISRE (UK) 2410; however future events or conditions may cause the entity to cease to continue as a going concern.

Responsibilities of 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.

In preparing the half-yearly financial report, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the review of the financial information

In reviewing the half-yearly financial report, we are responsible for expressing to the company a conclusion on the condensed set of financial statements in the half-yearly financial report. Our Conclusion, including our Conclusion Relating to Going Concern, are based on procedures that are less extensive than audit procedures, as described in the Basis for Conclusion paragraph of this report.

Use of our report

This report is made solely to the company in accordance with ISRE (UK) 2410. 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

Deloitte LLP
London, United Kingdom
28 November 2023

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Southern Water
Ensuring water for life