South Staffs Water

incorporating

CAMBRIDGE WATER COMPANY

South Staffordshire Water PLC

Unaudited interim report and accounts

For the six months ended 30 September 2019

December 2019

making water count

About South Staffs Water

We supply clean water services to more than 1.7 million people and around 45,000 businesses in Staffordshire, parts of the West Midlands, and in and around Cambridge. Our South Staffs region extends from Ashbourne in the north to Halesowen in the south, and from Burton-upon-Trent in the east to Kinver in the west. Our Cambridge region stretches from Ramsey in the north to beyond Melbourn in the south, and from Gamlingay in the west to the east of Cambridge city.

South Staffs region

Cambridge region

	South Staffs region	Cambridge region
Area served (km²)	1,497	1,175
Population served	1,361,623	351,189
Water supplied each day on average (Million litres Ml)	312.38	84.26
Household connections	557,524	134,295
Non-household connections	34,886	10,409

Contents

Chair's foreword

Welcome to our interim results for the six-month period to 30 September 2019.

The year so far has been very much about the preparations we have been making, both for Brexit in the short term and for the next five-year planning period, which starts in April 2020. As a company with a long history of providing reliable water supplies, we know from experience that planning for a range of different scenarios is the key to making sure the services we provide to our customers are resilient now and in the future.

The past six months have also been about our business-as-usual activities. We have had a reasonably good year to date – with some improvements in the areas of water quality, leakage and supply interruptions. But we know that we have to continue working hard to ensure we always deliver the high-quality, reliable water supplies and great service our customers expect and pay for.

In addition, we have continued to engage with Ofwat's price review. In July, the regulator published its draft determination of our business plan for 2020 to 2025. This is the next step in a process that will determine the price, service and investment package that we will deliver for our customers – and which will be reflected in the bills they pay. Ofwat's determination was a challenging one for us and we responded in August with a robust representation that reinforced our commitment to our ambitious and innovative plan. Ofwat will make its final decisions shortly.

Once again, I would like to extend the Board's thanks to all our people for their ongoing commitment over the past six months. Their dedication to delivering for all our customers is crucial to our success as a business delivering an essential public service every day and in all weathers.

Sir James Perowne

Managing Director's introduction

Thank you for taking the time to read our latest interim results. I hope they provide a useful snapshot of the work we have been doing over the past six months and how we are performing against our targets.

In general, we are pleased with how the year is progressing. We have seen an improvement in a number of areas – in particular, in terms of leakage reduction, supply interruptions and water quality. And in September, the Consumer Council for Water recognised our South Staffs region as having the lowest level of written complaints in 2018/19. But there are areas where our performance has dipped and where we need to do more to get back on track and ensure we continue to always deliver the high-quality water supplies and levels of service our customers expect and pay for.

As a company that operates across two geographically diverse regions, we are mindful of the impact variations in the weather can have on our operations. This is something we have seen since September 2016, with our Cambridge region experiencing much lower levels of rainfall than our South Staffs region – particularly over successive autumns and winters when we would normally expect that rainfall to recharge the underground sources from where we take our water. We have been monitoring the water resources situation in our Cambridge region carefully over the past six months, working closely with the Environment Agency and local community partners to ensure our customers – and the environment – have not been negatively impacted.

Looking ahead, we will reach an important milestone later this month, when Ofwat makes its final determination on our business plan for 2020 to 2025. This is the culmination of a process that has taken nearly three years to complete. We are already preparing for the next five-year planning period, which will see us invest more than we have ever done before to ensure long-term, resilient and affordable water supplies for all our customers. This includes the work we will carry out to upgrade our two largest water treatment works at Hampton Loade and Seedy Mill in our South Staffs region so that we can be sure the water we supply is always of the highest quality.

I would like to take this opportunity to thank all our people for their continued hard work over the past six months. From the teams that are finding and fixing leaks every day to the people who speak to our customers on the phone or in the community, they are all playing their part to ensure we are making water count – now and in the future.

Phil Newland

Managing Director’s half-year review

We are a successful and efficient water only company, with a long history of supplying clean, high-quality water to our customers. We also have one of the lowest bills of any water company in England and Wales. As a company that operates in a regulated sector, every year we measure our performance against a set of sector-wide and company-specific outcomes that we must deliver for our customers in the areas of:

- excellent water quality;
- secure and reliable water supplies;
- excellent customer service;
- environmentally sustainable operations; and
- fair customer bills.

Below, we highlight some aspects of our performance over first half of the year.

Performance against our key targets

In general, we are pleased with our performance against our key targets during the first half of the year. For example, in terms of our **water quality compliance** (or ‘Mean Zonal Compliance’), we have experienced just two failures in the current calendar year to date, leading to above 99.99% compliance going into the final quarter. While this is an improvement on last year’s performance, we are not being complacent. We are committed to always providing our customers with the high-quality and reliable water supplies they expect and pay for. The work we will carry out between 2020 and 2025 on our Hampton Loade and Seedy Mill water treatment works will ensure we continue to do this over the long term.

We are also on target to achieve our performance commitment of only 1.23 contacts per thousand of population for the **acceptability of water to customers**. This is another quality measure that relates to the colour, taste and odour of the water we supply to customers. Again, this is an improvement on last year. In addition, we have had very good performance over the first half of the year in the area of **supply interruptions**, and are expecting to achieve our target by the end of the 2019/20 financial year.

Our customers have consistently told us that they want us to do more to reduce **leakage** on our network of pipes. At a time when the idea of wasting water has become more of a moral issue because of the effects of climate change and population growth, for example, we are pleased to report that we are on target to meet our leakage performance commitments in both our South Staffs and Cambridge regions. This will give us a solid foundation on which to build, particularly as we want to deliver a transformational overall reduction in leakage of 23% across both regions[1] by 2024/25.

We are also performing well against our commitment to provide **help and support for customers** who are struggling to pay their bills or who are in debt. We have continued to promote our Assure social tariff through our first-ever billing roadshows that took place in our South Staffs region in April, and also through community events and our pop-up mobile community hubs. By the end of the 2019/20 financial year, we expect to have helped a further 2,000 customers above our target of 30,000.

One area where we are disappointed not to have reached the level of performance we want to achieve in both our South Staffs and Cambridge regions over the past six months is in the **services we provide to the developer community**. We are taking action to address this and are looking to improve consistency across both regions. This has included making changes to the structure of the developer services team and replacing manual processes that increase the risk of human error. We are confident that the measures we are putting in place will help us deliver improvements in our performance in the second half of the year.

There has also been a dip in our **customer service** performance during the first half of the year. This is particularly disappointing for us as in September the Consumer Council for Water (CCWater) recognised our South Staffs region as having the lowest level of written complaints in 2018/19. We are working hard to get our performance back on track in the second half of the year as our customers expect to always receive great service from us.

Water resources in our Cambridge region

We operate in two geographically diverse regions. So we are acutely aware of the impact variations in the weather can have on our operations. Our Cambridge region, for example, has experienced a succession of relatively dry autumns and winters since September 2016. This has had a significant impact on water supplies as it is generally winter rainfall that recharges the underground sources from where we take (or 'abstract') our water.

We have been monitoring the situation in our Cambridge region, working closely with the Environment Agency and

[1] 25% in our South Staffs region; 15% in our Cambridge region.

local community partners, and engaging with local and national media. For example, we attended six meetings with local interest groups, including the Cambridge City Council Water Forum. In addition, we have engaged with a number of local stakeholders, including the Cam Valley Forum, Hobsons Conduit Trust and Friends of Cherry Hinton Brook. As a business that relies on the environment and that cares passionately about it, we have also taken action and limited the volume of water we abstract from resources in the region to less than 80% of our permitted amount and used water from elsewhere. This is to ensure we help to protect the environment at times when water levels are low.

Because we recognise that we all have a part to play in reducing water use, we continually encourage our customers to use water wisely and offer a range of free water-saving devices. In addition, we run water efficiency campaigns in the summer and autumn. Our summer campaign this year, for example, encouraged customers to make water count by being 'summer water savers'. In addition, we visit schools to help children learn about the importance of saving water and become water-saving champions in their families.

And we are also playing our part by reducing leakage across both regions, through investment in new water mains and innovative technologies. In addition, we have committed to working with developers to build more water efficient homes – for example, by using grey water recycling and rainwater harvesting. This is to help reduce the volume of water we take from the environment.

Our Cambridge region is experiencing rapid growth and an increase in the number of new developments. By 2045, for example, we are forecasting a 34% increase in connected properties. So, the need to secure resilient, long-term water supplies is crucial. We are part of a regional group called Water Resources East, which comprises other water companies and representatives from the environmental, agricultural and energy sectors. Along with other members of the group, we are looking at how we can meet everyone's need for water in a sustainable way, while protecting the environment for the long term. This includes looking at options to transfer water from wetter parts of the country to drier ones.

Delivering for our customers and the environment

We are committed to always delivering for our customers, including those who are struggling to pay their water bills or who may prefer to engage with us face to face. At the end of April, we celebrated an important milestone with the first anniversary of the opening of our community hub in our South Staffs region.

What started as a pilot project has turned into a tangible success story. More than 7,600 customers have visited the hub since it opened, attending a wide range of events, asking for advice on water meters, support to pay their bills and to sign up for our Priority Services Register. In addition, the strong connections and partnerships we have formed with local charities and other organisations, such as JobCentre Plus and Citizens Advice, have also proved popular. In July, our hub was recognised with an award for making an outstanding contribution to the wellbeing of the people of Sandwell at the Celebrate Sandwell event.

Another of the ways we deliver for our customers is by maintaining our assets. In July, for example, we started work on a £400,000 project to replace 7km of water main in Aldridge in our South Staffs region. It is part of our ongoing improvement programme in the area and represents a significant investment to maintain water quality. And in August, we started work on a £450,000 mains replacement programme in West Bromwich in our South Staffs region. The original cast iron mains in this area are more than 65 years old. We are replacing them with flexible and more durable plastic pipes, which are less likely to crack and so minimise the risks of bursts, helping to ensure a reliable water supply to customers and improved water quality.

We also help to protect the environment by encouraging our customers to use water wisely. In August, we launched our brand new water bar at the Cambridge Big Weekend, one of the best-loved free outdoor events in our Cambridge region. As well as offering information and advice to customers on the need to conserve water, we also encouraged those who attended to replace their single-use plastic bottles with our special reusable ones. The water bar also put in an appearance at the Cambridge Folk Festival, which is held in the grounds of Cherry Hinton Hall each year.

Planning for the future

For us, the focus of the past six months has largely been about preparing for Brexit and for the next five-year planning period, which starts in April 2020.

On Brexit, for example, we have been working closely with the rest of the water sector. We have taken part in exercises to test collaboration across government and the sector, as well as to test the processes that would normally be important when managing a large-scale incident. We have also carried out a thorough evaluation of our stock levels and provided additional training for our people. We believe that we are well prepared and the sector's plans in this area have been commended by Government ministers.

We have also continued to engage with our regulator, Ofwat, on its price review process (PR19). In July, we received Ofwat's draft determination on the business plan we submitted in April. This is the next stage in a process that that will determine the price and shape of the service and investment package that we will deliver for customers over the five years from 2020 to 2025 – which will be reflected in the bills they pay. Ofwat's determination was challenging and our response in August reinforced our Board's commitment to our high-quality, ambitious and innovative plan. Ofwat will make its final decision on our plan later this month.

As part of our preparations for the next five-year period, in April we launched an 'Enhancing our ways of working' programme. The aim is to transform our business processes, making us more agile and efficient, and able to respond quickly and flexibly to changing circumstances. Over the past six months, members of the programme team have engaged with colleagues across the business, holding workshops and reviewing a number of our existing business processes. The team is also responsible for implementing an upgraded version of Maximo, which is the works management system we use to help us manage our assets.

But we have also been looking further ahead. In July, we convened our first Cambridge Young Innovators' Panel, selecting 18 students – and future customers – from schools across the region. The students were split into teams and over the summer they worked on a real business challenge looking at ways to reduce household water consumption from 330 to 290 litres a day by 2045. The winning team devised a QR code approach that would give customers easy access to their water usage. They combined this with a tiered system of rewards to enable customers to set a personalised goal for their water usage.

And we have continued to focus our attention on succession planning. In September, we welcomed our latest five apprentices, who will fill a number of roles in different areas of the business. They have joined the nine who are already in place, bringing our total to 14. Over the period 2020 to 2025, we have committed to recruiting between 25 and 30 apprentices (at least five a year) to build our resilience in business critical areas such as leak detection.

Statement of Directors' responsibilities

The Directors confirm that these condensed interim financial statements represent a fair view of our performance for the six months to 30 September 2019.

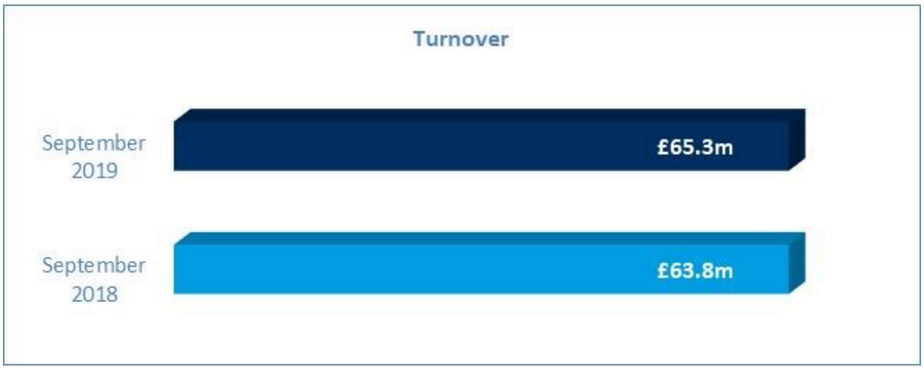
A list of the current Directors of South Staffordshire Water PLC is available on our website at www.south-staffs-water.co.uk.

Assurance

These accounts have been reviewed by our independent Group Internal Audit function and by our Board.

Financial performance

Turnover for the first six months of the year increased by £1.5 million to £65.3 million compared with the same period last year. Increases in turnover principally reflects increases in allowed regulatory uplifts, with the Retail Price Index (RPI) of 3.2% offset by a negative K[2] factor of 0.6%. Non-appointed (that is, non-regulated) turnover is broadly in line with 2018 at £3.0 million (2018: £2.9 million).

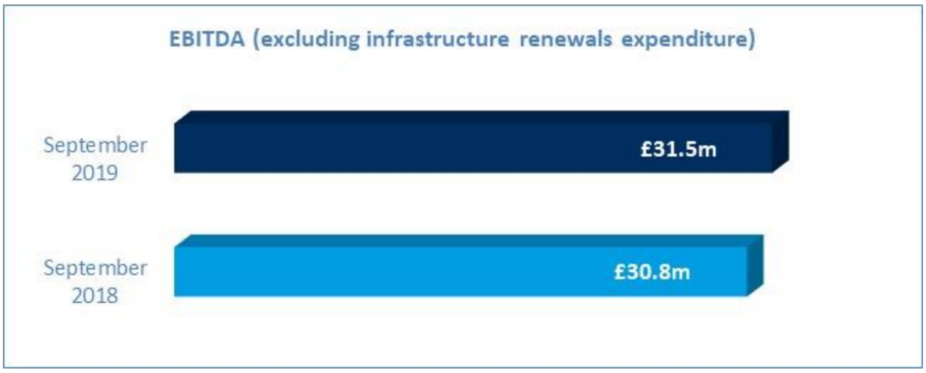


Our operating costs were £49.2 million (2018: £48.4 million). Our operating profit for the first six months of the year increased by £0.8 million to £16.1 million compared with the same period last year.

[2] K is the amount of investment a water company needs to implement. So, if a company needs to invest in new water pipes, for example, it will be able to increase prices to finance this investment.

EBITDA for the first six months of the year increased by £0.7 million to £31.5 million compared with the same period last year. EBITDA is the measure of our operating performance, excluding infrastructure renewals expenditure (see reconciliation below). The increase in operating profits and EBITDA reflects the one-off costs of £1 million in the hot, dry summer of 2018 not re-occurring.

	September 2019 £m	September 2018 £m
Operating Profit	**16.1**	**15.3**
Depreciation: non-infrastructure assets	10.3	9.5
Depreciation: infrastructure assets	1.9	2.0
Infrastructure renewals expenditure	4.7	5.3
Amortisation of capital contributions	(1.5)	(1.3)
EBITDA (excluding infrastructure renewals expenditure)	**31.5**	**30.8**



Finance charges for the first six months of the year increased by £0.3 million to £6.4 million compared with the same period last year, while the tax charge was in line with last year at £1.8 million.

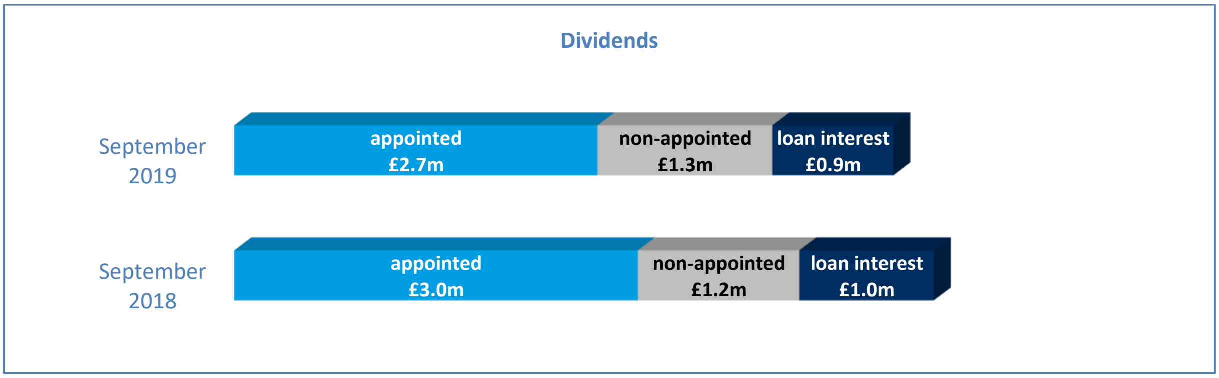
Capital investment

We continued to make good progress in delivering our capital programme to ensure our assets remain in good condition and we continue to provide high-quality, reliable water supplies to our customers.

Our wholesale appointed capital expenditure for the first half of the year totalled £19.8 million (net of contributions and excluding infrastructure renewals expenditure) (2018: £19.0 million), bringing the four-year cumulative spend broadly in line with our PR14 final determination.

Dividend payment

Dividends paid during the period were £4.0 million (2018: £4.2 million). The dividend comprises £1.8 million paid from appointed profits (2018: £2.0 million), which represents 2.5% of our regulated equity; £1.3 million from non-appointed profits (2018: £1.2 million); and £0.9 million to enable intra-group loan interest to be paid to the company (2018: £1.0 million).



Moving forward, the Directors will continue to take a responsible approach in determining the levels of dividends to be paid.

Net debt and borrowing covenants

Our net debt includes index-linked debt, bank loans and debenture stock less cash. For covenant reporting purposes, our net debt was £239.3 million at 30 September 2019 and represented a ratio of 60% of the regulatory capital value (RCV). The reduction in net debt is largely due to the repayment of a £15.0 million inter-company loan that was repaid in full, as noted in last year’s annual report and accounts.

The company has reduced leverage in the period ahead of the expected significant increase in capital expenditure and lower returns in the next five years.

We continue to maintain significant headroom in respect of all of our borrowing covenants and liquidity with cash of £4.3 million and undrawn facilities of £25.0 million, giving total liquidity headroom of £29.3 million.

Standard & Poor continues to rate the company as BBB+, while Moody’s rating is Baa2; both are within investment grade. However, along with most of the water sector, we are currently on negative outlook with both rating agencies pending the outcome of Ofwat’s PR19 process.

Unaudited interim profit and loss account

For the six months ended 30 September 2019

	30 Sept 2019	30 Sept 2018
	£'000	£'000
Turnover	65,282	63,766
Operating costs (net)	(49,160)	(48,449)
Operating profit	16,122	15,317
Finance charges (net)	(6,428)	(6,087)
Profit before taxation	9,694	9,230
Taxation on profit ordinary activities	(1,784)	(1,775)
Profit for financial year	7,911	7,455
Earnings per share		
Basic	372.6p	351.1p
Diluted	372.6p	351.1p

Unaudited interim balance sheet

As at 30 September 2019

	30 Sept 2019 Unaudited £'000	31 Mar 2019 Audited £'000
Fixed Assets		
Tangible assets	544,640	531,869
Current Assets		
Stocks	2,794	2,366
Debtors - amounts recoverable within one year	37,850	47,398
Debtors - amounts recoverable in more than one year	28,792	28,424
Investments	2	2
Cash at bank and in hand	4,276	764
	73,714	78,954
Other creditors - amounts falling due within one year	(64,913)	(58,068)
Net current assets	8,801	20,886
Total assets less current liabilities	553,441	552,755
Borrowings - amounts falling due after more than one year	(264,207)	(269,114)
Other creditors - amounts falling due after more than one year	(15,035)	(16,590)
Accruals and deferred income - falling due after more than one year	(155,991)	(152,310)
Provisions for liabilities - falling due after more than one year	(39,882)	(39,732)
Net Assets	78,326	75,009
Capital and reserves		
Called up share capital	2,123	2,123
Share premium account	495	495
Capital redemption reserve	4,450	4,450
Revaluation reserve	33,760	33,987
Profit and loss account	44,505	40,361
Hedging reserve	(7,007)	(6,407)
Shareholders' Funds	78,326	75,009

Unaudited interim statement of comprehensive income

For the six months ended 30 September 2019

	30 Sept 2019 Unaudited	31 Mar 2019 Audited
	£'000	**£'000**
Profit on ordinary activities after taxation	7,911	15,489
Movement in hedging reserve (gross of deferred tax)	(723)	(306)
Deferred tax impact of movement in hedging reserve	123	52
Total comprehensive income	7,311	15,235

Unaudited interim statement of changes in equity

As at 30 September 2019

	Called up Share Capital	Share Premium Account	Capital Redemption Reserve	Revaluation Reserve	Profit and Loss Account	Hedging Reserve	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 April 2018	2,123	495	4,450	34,441	32,842	(6,153)	68,198
Profit for financial period	-	-	-	-	15,489	-	15,489
Change in value of hedging instruments - cash flow hedges (gross of deferred tax)	-	-	-	-	-	(484)	(484)
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	82	82
Amounts recycled to profit and loss (gross of deferred tax)	-	-	-	-	-	178	178
Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(30)	(30)
Amounts transferred to profit and loss	-	-	-	(454)	454	-	-
Total comprehensive income/(loss)	2,123	495	4,450	33,987	48,785	(6,407)	83,433
Dividends	-	-	-	-	(8,424)	-	(8,424)
Balance at 31 March 2019	2,123	495	4,450	33,987	40,361	(6,407)	75,009
Balance at 1 April 2019	2,123	495	4,450	33,987	40,361	(6,407)	75,009
Profit for financial period	-	-	-	-	7,911	-	7,911
Change in value of hedging instruments - cash flow hedges (gross of deferred tax)	-	-	-	-	-	(811)	(811)
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	138	138
Amounts recycled to profit and loss (gross of deferred tax)	-	-	-	-	-	88	88

Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(15)	(15)
Amounts transferred to profit and loss	-	-	-	(227)	227	-	-
Total comprehensive income/(loss)	2,123	495	4,450	33,760	48,499	(7,007)	82,320
Dividends	-	-	-	-	(3,994)	-	(3,994)
Balance at 30 September 2019	2,123	495	4,450	33,760	44,505	(7,007)	78,326

Unaudited interim cash flow statement

For the six months ended 30 September 2019

	30 Sept 2019		30 Sept 2018	
	£'000	**£'000**	**£'000**	**£'000**
Cash inflow from operating activities		40,619		21,666
Corporation tax paid		(2,791)		(939)
Net cash inflow from operating activities		37,828		20,727
Cash flows from investing activities				
Purchase of tangible fixed assets	(23,860)		(22,913)	
Proceeds from sale of tangible fixed assets	448		216	
Capital contributions received	5,136		4,515	
Interest received	993		1,276	
Net cash outflow from investing activities		(17,283)		(16,906)
Cash flows from financing activities				
Interest paid	(5,195)		(4,385)	
Equity dividends paid	(3,994)		(4,212)	
(Repayment)/draw down of bank loans	(7,844)		2,962	
Net cash outflow from financing activities		(17,033)		(5,635)
Increase/(decrease) in cash		3,512		(1,814)
Cash or cash equivalents at the beginning of the year (1 April)		764		2,192
Cash or cash equivalents at the end of the period (30 September)		4,276		378

Unaudited interim cash flow statement (cont'd)

For the six months ended 30 September 2019

	Balance at 31 Mar 2019 £'000	Cash Flow £'000	Non-Cash Movements £'000	Balance at 30 Sep 2019 £'000
Cash at bank and in hand	764	3,512	-	4,276
Irredeemable debenture stock	(1,652)	-	-	(1,652)
Bank loans (net of issue costs)	(37,707)	7,844	(38)	(29,901)
Index-linked debt (net of issue costs and including premium)	(229,755)	-	(2,899)	(232,654)
Net debt	(268,350)	11,356	(2,937)	(259,931)

	30 Sept 2019 Unaudited £'000	31 Mar 2019 Audited £'000
Book net debt (as reported above)	(259,931)	(268,350)
Exclude book premium on issue of index-linked debt	13,283	13,447
Difference between long-term RPI assumption and actual RPI inflation	8,872	7,673
Exclude unamortised issue costs	(1,760)	(1,819)
Exclude accrued interest	222	215
Net debt reported for borrowing covenants	(239,314)	(248,834)

Unaudited notes to the financial statements

1. The interim results for the six months to 30 September 2019 have been prepared under FRS102 and on the basis of accounting policies consistent with those adopted for the year ended 31 March 2019.

   The interim financial information is unaudited and does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. The balance sheet for the year to 31 March 2019 has been extracted from the latest published audited accounts, which have been filed with the Registrar of Companies and on which the report of the auditors was unqualified.

2. The tax charge is based on the estimated effective rate of tax, including deferred tax, for the full year to 31 March 2020.

Copies of the interim report are available from our Registered Office – South Staffs Water, Green Lane, Walsall, WS2 7PD – or from our website at www.south-staffs-water.co.uk/publications/annual-reports