South East Water Limited

Group Financial Statements

31 March 2013

Registered Number: 02679874

Contents

Directors and Secretary

Directors

G W Maxwell (Chairman)

P Butler (Managing Director)

J E Stimpson (Finance Director)

P Seeley (Operations Director)

D G Shore (Resigned 30 June)

S George (Customer Services Director)

D Hinton (Asset and Regulation Director) (Appointed 1 June 2013)

V Rosati (Non-executive director)

J-E Leroux (Non-executive director)

K Bhatia (Non-executive director)

Independent non-executive directors

P Rich (Appointed 25 April 2013)

E Gilthorpe (Appointed 18 October 2012)

G H Setterfield

R Weeden (Resigned 25 April 2013)

C D Harries (Resigned 27 September 2012)

Company Secretary

N Truillet

Registered Office

Rocfort Road
Snodland
Kent
ME6 5AH

Registered No. 02679874

Country of domicile and incorporation: Great Britain

Chairman's Statement

South East Water serves a population of 2.1 million people in the south east of England and in providing this essential service is reliant on adequate levels of water resources. This time last year the Company had imposed temporary restrictions following two very dry winters when our aquifers in particular were not able to see anything approaching the normal levels of recharge. That dry period was followed by extensive rainfall and usage restrictions were lifted on 9 July. I would like to thank our customers, our regulators and our stakeholders for the support they showed us throughout this challenging period. I can confirm that following the high rainfall experienced through the summer and autumn of last year and into the spring of 2013, no user restrictions are in place nor do we anticipate the need for them for the rest of the year.

There has been good progress made elsewhere in the business. Our draft Water Resources Management Plan, which sets out what we need to do to meet the future water requirements of our customers over the next 25 year period, has been produced and is now subject to a period of consultation. Following this consultation, the Plan will be submitted to the Secretary of State for the Department for the Environment, Fisheries and Rural Affairs for final approval. We will use the Water Resources Management Plan to help us develop our detailed Business Plan for the five years, 2015 to 2020. This is due to be submitted to our regulator, Ofwat, later this year. Our Business plan will seek to achieve the best outcomes for our customers, balancing the investment needed to ensure delivery of the services our customers need at a price they are willing to pay. We are working closely with our stakeholders and, in particular, with the Customer Challenge Group to ensure that we present a robust customer focussed plan for the regulatory period 2015 to 2020.

Debate and discussion continues regarding how the water industry should evolve, and in particular how competition can be introduced to the benefit of all customers. The draft Water Bill has been useful in this context and we will consider the Water Bill issued in June 2013. The upcoming price review will be the first to require separate retail and wholesale plans, ahead of the market opening for all non-household customers which is being planned for 2017. Whilst South East Water, alongside most of the larger water companies, rejected the rather extensive licence reforms first proposed by Ofwat we have agreed to the necessary changes to allow Ofwat's proposed PR14 price methodology and were happy to confirm the Company's commitment to work constructively and cooperatively with Ofwat on the development of price controls. We expect to sign up to the agreed new licence terms in the coming months.

Results

The Operating Profit for the Group was £101.5 million compared to £99.1 million in 2011/12. Group Operating Profit as a percentage of revenue was 48.8%, compared with 49.5%. Operating profit includes an exceptional credit of £4.2 million reflecting the pension curtailment arising from the change to future benefits in the Group's pension schemes.

Our revenue has increased by £7.8 million to £207.9 million. Whilst prices increased by 6.9% (including RPI) this has been partly offset by customers moving from unmeasured to measured billing, and by a significant reduction in consumption. Operating costs for the year have increased from £105.9 million to £111.4 million, reflecting an underlying increase of £9.8 million which is partly offset by the pension curtailment benefit of £4.2 million. The increase in operating costs is due to additional asset expenses and inflationary pressure on salaries and other costs. Other income has increased marginally by £0.1 million to £5.1 million.

Profit before tax has seen a decrease from £42.4 million to £41.7 million and after allowing for the tax charge for the year of £2.6 million (2012: credit of £0.7 million), the profit after tax in the year was £39.1 million compared with £43.0 million in the previous year.

Customer Service

I am pleased with the progress achieved on our customer service overall. The investment that has been made to streamline our service, to develop IT solutions to increase effectiveness and efficiency, and to improve the training our staff receive as part of our "Commit and Deliver" programme has ensured that we are delivering sustainable higher levels of service to our customers. The improvements are evident in the quarterly surveys undertaken independently by Ofwat and in the satisfaction surveys undertaken by ourselves. Our focus on this area continues and we have a full programme of further improvements planned for the 2013/14 financial year.

Chairman's Statement

Water Resources

As noted above, with restrictions lifted and months of heavy rainfall our water resources are well positioned. Our aquifers, which provide in excess of 80% of our water supply, are replenished and our two principal reservoirs, Arlington and Ardingly are almost at full capacity.

Capital Investment

Capital investment in the year was £96.2 million with our cumulative expenditure for the first three years of the regulatory period now exceeding Ofwat's final determination by £8 million. We expect to continue to exceed the final determination targets in the remaining years of the regulatory period, underlining our commitment to ensure the capability of our assets meets the service levels our customers demand. We continue to work with our strategic partners, Jacobs to deliver our capital programme and I am confident that we will continue to deliver the remainder of our regulatory and customer commitments.

In the year we have invested £27.1 million on developing and improving our above ground assets and a further £26.6 million on renewing and replacing our underground mains infrastructure. As part of our strategic objective to improve our water resource supply and demand management, we plan to have 90% of our customer base on metered supply by 2020 and we have invested £12.8 million on meter installations during the year, installing over 58,000 new water meters. As at the end of the financial year, 54% of our domestic customer base is on metered supply.

We continue to invest in our infrastructure assets to improve the quality of our water and as such invested approximately £7 million in refurbishing our treatment works in Sevenoaks, Tonbridge and Eastbourne.

Operational performance

It has been a very positive year from an operational perspective with the achievement of our leakage target for the eleventh successive year. The mild winter meant that our burst mains activity was lower than usual with less reactive maintenance needed. Water quality continues to meet the high standards set by the Drinking Water Inspectorate and in 2012 we achieved 99.96% compliance with drinking water standards.

The Board of South East Water Limited

There have been a number of planned changes to the Board. Charles Harries and Robert Weeden resigned as non-executive directors and at the end of June 2013 David Shore retired from the position of Operations Director. I would like to thank Charles, Robert and David for their many years of service to the Company and to the Water Industry at large, and wish them all well for the future. Emma Gilthorpe and Paul Rich have taken up positions as independent non-executive directors and bring with them a wealth of regulatory and senior management experience from outside of the water industry. They both join us at a critical time, as we prepare our next Business Plan. In the Executive team Paul Seeley has taken responsibility for Operations and David Hinton has been appointed to the Board as Asset and Regulation Director. The new appointees to the Board bring fresh perspective and experience which will be critical as the Company moves forward. I would like to thank the Board for their support throughout this year and look forward to their continued contribution .

Prospects

The economic climate remains uncertain and resultant challenges such as inflationary pressure and bad debt risk remain. The Company continues to seek new and improved ways to interface with its customers and this, together with the changes in the regulatory environment, will remain a focus as the Company moves forward. Significant and intense work is currently being undertaken to allow the Company to produce a high quality business plan which will ensure we are able to deliver the service our customers require of us, both now and in the future.

Chairman's Statement

The recent changes to the board will support the Company's strategy and I am confident that board members and the wider management team will deliver on their objectives. This will not be achieved without the continued dedication of South East Water staff and I would like to take this opportunity to thank them for their support and hard work during the last twelve months.

Gordon Maxwell
Chairman
5 July 2013

Managing Director's report

Introduction

I am pleased to report on the performance for the financial year 2012/13.

2012/13 has been a year of sustained activity for the business. We have been focusing on our water resources management, how we can improve our customer service delivery and have commenced preparatory work for the Business Plan for the next regulatory period. We raised funding to allow us to complete our planned investment programme through to 2015 and we took the decision to take further action on our defined benefit pension schemes in order to cap liabilities and the associated volatility. We have also achieved our Investors In People bronze level accreditation.

Our capital programme continues to be a key area of our business and by working with our partners at Jacobs and Clancy Docwra, we are delivering important schemes to ensure that potable water continues to be delivered to our customers, both now and in the future. The water resources position has improved significantly compared with the situation a little over twelve months ago and I do not anticipate the need for usage restrictions during the next year.

We continue to focus on our service to our customers and I am pleased that the changes we are making are being reflected in the improving trend we see in our customer satisfaction surveys.

Key Performance Indicators (KPIs)

The Group's management regularly monitors its financial and operating performance through regular KPI measurement and is required to report these performance measures to a range of investors and other key stakeholders.

Financial KPIs
The Financial Statements show the results for the Group and the Company's business activities for the year with prior year comparisons.

The key financial measures at 31 March are as follows:

	2013 £m	2012 £m	Movement £m
Turnover	207.9	200.1	7.8
Operating expenditure	(111.4)	(105.9)	(5.5)
Group operating profit	101.5	99.1	2.4
Gross Capital Expenditure	(96.2)	(88.5)	(7.7)
Net Cash flow from Operating Activities	98.3	93.9	4.4

The overall price increase allowed by Ofwat for the 2012/13 year was 6.9% which included an allowance for RPI of 5.2%. However, underlying demand for the year has fallen for a second year and our overall increase in water revenue amounted to 3.9%

Group operating profit as a percentage of revenue has decreased from 49.5% to 48.8%. However, we have continued to see inflationary pressures on salaries and other costs and our asset expenditure has increased in the year.

The Net Cash flow from Operating Activities for the Group in 2013 was £98.3 million (2012: £93.9 million).

Covenant KPIs

Condition F of our Licence of appointment stipulates that the company maintains an investment grade credit rating. We are compliant with this requirement with Moody's continuing to rate the Group at Baa2 and Standard and Poor's rating the Group BBB. These ratings are satisfactory for the business and are compliant with the covenants of the company's financing package.

Managing Director's report

In addition, as part of the ring-fenced securitised group (Comprising of SEWH, SEWL & SEWF) for financing the Company is required to comply with financing covenants which include the following:

- Regulatory Asset Ratio (RAR) which is a measure of Net Debt as a percentage of Regulatory Asset Value. As at 31 March 2013 this ratio was 78.7%. Whilst a trigger event under our financing structure occurs at a ratio of 90%, the Company is not permitted to make any dividend payments if this ratio exceeds 85%; and
- Adjusted Interest Cover Ratio (ICR) which is a ratio of operational cash flow after maintenance capital expenditure to interest payments. For the year ended 31 March 2013 this ratio was 2.30 times, significantly in excess of the covenant trigger event ratio level of 1.1 times cover.

The Company is also required to maintain certain cash and loan facility reserves in order to be compliant with its covenants:

- the Company is required to transfer funds to Debt Service Reserves of not less than the amount required to meet its interest liabilities for the following twelve months;
- the Company is required to maintain a balance of available funds across the Operations and Maintenance Reserve and the Operations and Maintenance Reserve loan facility of not less than 10% of its operational and capital maintenance expenses for the following twelve months; and
- The aggregate of the Company's operating cash flows for the next six months, its authorised Credit Facilities for the next six months, and the credit on its Capex Reserves are to be greater than forecast capital maintenance expenditure and forecast working capital requirements for the next six months.

The Company was fully compliant with its covenants at 31 March 2013.

Operational KPIs

The Service Incentive Mechanism (SIM) was introduced by Ofwat to incentivise the industry to improve customer service and benchmark customer service performance within the industry. The SIM score is reported as a score out of 100 and there are two components to the score, the first of which is based on the number of customer contacts and complaints and the second relates to a qualitative score determined by customer satisfaction surveys. Our score for the year was 71.95 compared with a target of 67.65 and a score for 2011/12 of 56.2. Within the overall score there is a significant improvement in our satisfaction score from customers, increasing to 4.4 out of 5 from 4.1 out of 5 in the previous year.

As part of the Company's long-term water resources management plan we have a strategic objectives to increase the proportion of domestic customers on metered supply and the Company has adopted a customer metering programme. As a result of this programme the proportion of customers on metered supply as at 31 March 2013 was 54% compared with our target of 60%. The actual performance was lower than target owing to a delay in the start of the programme whilst we perfected our customer and stakeholder engagement plan.

Ofwat sets all water companies leakage targets each year. We achieved a leakage figure of 93 megalitres per day compared with our target of 94.

Our water quality compliance during the year was 99.96% compared with our aiming point of 100%. This measure relates to water quality complicance at customers' taps.

Through external audit the Group's quality systems have been certified to ISO9001 and our safety management systems to OHSAS 18001. The laboratory holds its UKAS accreditation and our people development processes are certified to Investor In People standard.

The Company absence rate for the year was 1.44% against a target of 2.00%.

Further disclosure in respect of Key Performance Indicators is set out in the Regulated Accounts of the Company which are available on the Company's website.

Managing Director's report

Water Resources

In April 2012, after nearly 18 months of extremely dry weather the company introduced a Temporary Use Ban restricting the use of hosepipes by domestic customers. This was immediately followed by the commencement of high rainfall across the region which persisted for a number of months. Reduced levels of customer demand followed, and, over time, our water resources position improved.

Higher than average rainfall continued throughout the year resulting in the lowest annual water demand for the Company on record, and a reduction of 5% from the previous year. Reservoirs, which had been seriously depleted prior to April, recovered rapidly with our two principal reservoirs at Arlington and Ardingly reaching 100% full by early May and early June 2012 respectively.

The Temporary Use Ban was removed on 9th July as we saw groundwater levels largely recovering back to more moderate drought conditions. At the present time, groundwater levels are at normal levels for the time of year.

No real peak demands were experienced during 2012 as the extensive rainfall dampened demand by all customers, and resulted in an unusually flat demand profile across the year.

Total domestic water demand reduced significantly and commercial consumption was down by over 10% from the previous year.

The leakage target of 94 Ml/d has been achieved due to the continued investment in leakage operational management and advances in the pressure management of the supply system.

Investment

Gross Capital investment on tangible fixed assets in 2012/13, the third year of the current regulatory period was £96.2 million representing an increase (8%) in investment compared to the prior year. Actual investment is in line with the Company's programme for the AMP which we anticipate will be £8.0 million in excess of the capital expenditure allowed in prices at the 2009 price review. The investment during the year has ensured all regulatory defined outputs for the year have been delivered.

£40.3 million (43%) of investment in 2012/13 has been made in the development of new assets and the enhancement of existing assets, including £33.1 million for the management of the supply demand balance and £5.7 million to meet the company's legal undertakings with respect to Drinking Water Quality standards.

£54.2 million (57%) of expenditure has been applied to existing assets on maintenance and repairs.

During the year our infrastructure renewals expenditure of £26.6 million (2012 £22.9 million) was invested in repairing and replacing burst and worn out pipes and mains renewals. This is an increase compared to the previous year and is a sign of the need for continued further investment to ensure stable serviceability. Additionally £27.1 million has been applied to the maintenance and repair of our above ground operational assets including a number of major water treatment works refurbishments.

Investment in supply and demand management has increased by 9% during 2012/13 to £33 million. £12.6 million of this was spent on our customer metering programme which saw the installation of 58,838 meters. This takes the percentage of domestic customers on a metered supply to 54.0%. Our business plan for the next three years will increase meter coverage to approximately 70% by 2015 and nearly 90% by 2020.

To ensure that sufficient water is available and that the distribution network is capable of delivering water to the various growth points forecast for the future, the Company has continued a comprehensive plan of work including mains reinforcements, mains extensions, development of new and existing boreholes and development of existing service reservoirs and pumping stations. A total of £11.9 million was spent in the year.

Security and Emergency Measures Direction (SEMD) compliance driven expenditure totalled £4.2 million in the year. Work included continued investment in security enhancements to 'designated' sites, based on improved physical and electronic security and continuation of the programme of Borehole security.

Managing Director's report

Implementation of the security programme ensures that SEW are in line with the requirements of the new 'Security Arrangements for Operational Assets' standards.

Investment continued in the delivery of the cryptosporidium programme during the year which is a programme of work to meet DWI legal undertakings. £1.1 million was invested in the construction of three new UV cryptosporidium treatment plants at Arlington, Friston and Greywell sites and planning works for plants required in 2013/14 has begun. This programme of work will continue throughout the current regulatory period and will deliver 11 new treatment plants by 2015.

Water Quality and Supply

The quality of the water supplied by SEW continues to be of an extremely high quality. The period over which our water quality metrics are measured is the calendar year ended December 2012 during which 99.96% of 90,978 tests for samples from customers' taps complied with EU and UK mandatory standards for the Company.

In addition we carried out 174,306 regulatory tests at Treatment Works and Service Reservoirs and over 400,000 non-regulatory tests to ensure that our assets performed consistently to deliver excellent quality water to our customers. The scope of the UKAS accreditation of our laboratory testing procedures was extended to include the enhanced Drinking Water Testing Specifications (DWTS) standard.

Our Customers

Continually improving our service to customers is the central priority for our customer service and operational teams. We recognised that the introduction of temporary usage restrictions at the beginning of the year would require careful communication with our customers. Our focus and attention ensured that they were implemented professionally, with adverse reaction from customers effectively minimised.

Overall customer service performance was strong through the year, with customer complaints falling by over 30% to their lowest levels for five years. Our performance as measured by Ofwat's SIM metric also improved significantly, reflecting the improved levels of customer complaints and favourable customer survey results. Collection performance was also strong through the year, but the challenging economic climate was reflected in a significant increase in customer calls relating to debt and payment difficulties.

Our Customer Metering Programme progressed well through the year. A dedicated metering team guides customers through the installation process, offering practical support as well as access to the financial support we have developed where new metered bills may have increased significantly. The approach has helped ensure a positive customer experience and will be maintained as the programme increases our metered customer base to 70% over the next two years.

Our focus on improving and simplifying the customer experience drove a major refresh of the Company's website, with additional self-service transactions added through the process, and a novel web-chat service introduced. Customer take-up has been positive, and has contributed to the reduction in written complaints.

Self-service facilities were also introduced through enhanced integration of our telephone and customer billing systems such that, at busy times, up to 30% of inbound calls on our main Customer Service lines are now entirely automated. This service is available to customers at all times, and customer satisfaction with these enhancements is contributing to our improved SIM performance.

Debt

Customer debt continues to provide a challenge to the business and the industry as a whole, particularly with the difficult economic environment. The Company continues to operate its Helping Hand Scheme aimed at helping customers in financial difficulty. Grants are available to help individuals and families meet arrears of water charges. An assessment is undertaken with a view to increasing financial stability and improving quality of life.

Whilst the Company can offer help to some of our most vulnerable customers, we will take tough action against those who can pay their water charges, but choose not to. Where appropriate we pursue customers through the County Court system in order to obtain settlement of both water and debt charges.

Managing Director's report

I am pleased to report that during the year the Company won the "Water Team of the Year" award from Credit Today's Utilities and Telecoms Awards. The judges particularly commended our ability to successfully adapt our systems and processes to help customers in debt, the introduction and use of our customer debt field team along with our Helping Hand Scheme.

Non Appointed Business

Overall performance of our commercial business was in line with expectation.

Our commercial services business which includes e-conveyancing and mast rental activity performed ahead of expectation. Revenues from our Thames and Southern Water contracts were also ahead of expectation.

Waterlink revenue was reduced as the focus moved to our Customer Metering Programme (CMP) with the increase in leak repairs. Over 2500 internal and external leaks were repaired during the period with very positive customer feedback. We expect this lower level of revenue will persist during 2013/14 while the CMP programme continues.

The Laboratory performance during the period was good with continued growth of new customers and additional income streams developed.

Our Property rentals business continued to reduce its revenue after disposal of some properties but strong cost management and a low level of void properties ensured profits were ahead of target.

Our Staff

The past twelve months has seen significant recruitment activity across the business, particularly in the Customer Services area. It has also seen the development of the Company's new Job Evaluation system which has been implemented throughout the Company. The system allows for greater consistency in reward management and creates the basis for a rewards package more closely aligned to performance.

The introduction of a new induction programme coupled with our new 'Perfecting Performance' management programme has led to improvements to retention rates and engagement. In February 2013, we were assessed for the Investors In People standard and improved our overall award to Bronze. In addition, we have continued to develop our electronic appraisal system and made significant improvements to our iTrent HR information system.

The Company absence rate for the year was 1.44% against a target of 2.00%. This figure remains lower than the national average. Our turnover rate of 12.90% represents all leavers, including redundancies, and is 0.5% lower than the previous 12 months. Our approach to rewards is outlined in the report of the Remuneration Committee.

Pensions

The Company is the sponsoring employer of two Defined Benefit Pension Schemes. In September the Company commenced a consultation with affected staff, setting out its intention to close these schemes to future accrual from 31 March 2015. Following the consultation the Company announced its intention to proceed with the closure and the deeds to effect the closure at the end of March 2015 were executed in May 2013. Both schemes carried out actuarial valuations as at 31 March 2011 and the Company and the Trustees agreed a comprehensive recovery plan to ensure the Schemes are appropriately funded for the future.

The value of the deficits, gross of deferred tax, at 31 March 2013 were £33.2 million (2012: £29.1) on the South East Water Scheme and £8.2 million (2012: £14.5 million) on the Mid Kent Water Group Scheme.

Our Environment

Our water supply operations are intrinsically linked to the environment. We abstract water from rivers and aquifers for treatment, carry out large scale engineering projects in both urban and rural communities and are a significant landowner. We recognise that the way we operate can impact the environment in both a positive and negative way. Wherever possible we aim to minimise our negative impacts and to promote positive impacts throughout all aspects of the business.

Managing Director's report

This is done through a variety of means, including:

- Carefully managing 24 Sites of Special Scientific Interest (SSSIs), one National Nature Reserve and two Local Nature Reserves. Furthermore 34% of our supply area lies within various Areas of Outstanding Natural Beauty and 10% of our supply area is within the new South Downs National Park. All company owned SSSIs have management plans in place which set out, and monitor, the work to be undertaken over a five year period and we are delighted to have now achieved our target of 100% compliance to ensure that all our SSSIs are in a favourable/recovering condition.
- Ensuring our in-house team of specialist ecologists carry out detailed environmental impact assessments on key engineering schemes to ensure that the least environmentally damaging options are chosen. This is carried out in tandem with mitigation programmes, which are developed to counteract any environmental damage which cannot be avoided. This often includes restoration work, or creating new habitats to encourage native species back into the area affected. We also often employ archaeologists on major schemes to protect our ancient heritage.
- South East Water acknowledges and supports the need for carbon footprinting, and we recognise the role we play in helping the UK reduce its carbon emissions. However, abstracting and transferring water to the customer's tap is an energy-intensive process, and approximately 95% of all carbon emitted from South East Water is related to grid electricity. A commitment to tackling our own carbon emissions across the organisation, establishing energy saving practices and carbon reduction initiatives are delivered through our detailed energy and carbon emissions strategy, which is championed within the business by the Asset Director and demonstrates our recognition, commitment and willingness to help meet the challenges of climate change.

We continue to work in close partnership with many environmental organisations, including the Environment Agency, Natural England, the Forestry Commission, amphibian and reptile groups and county Wildlife Trusts. We have continued to build on those existing relationships through our Environment Focus Group, which comprises a number of environmental groups with which we have engaged and consulted on the development of our 2014 Water Resources Management Plan.

Our Communities

South East Water continues to maintain close links with the communities it serves.

Public access to a number of our sites, particularly Arlington and Ardingly Reservoirs, provides facilities much valued by the public for walking, fishing, horse riding, bird watching and, at Ardingly, water sports.

During 2012/13 we continued our proactive water efficiency education programme with a further 12 members of staff joining the school speakers team. This has helped boost the talks programme to 60 schools and just under 4,000 pupils between 2012/2013. Proactively educating Key Stage 2 children between seven and 11 proves very popular and the numbers of requests have, at times, been double that of the previous year. Children are taught about the water cycle, where their water comes from, water treatment and water efficiency.

This year South East Water also commissioned the 'Water Drama' school play, which was part of our drought communication work in 2012. The play was shown in 71 primary schools between October and December 2012, taking an interactive water saving message to more than 10,000 Key Stage 2 pupils across Sussex and Kent.

We held our first open weekend for a number of years at Arlington Water Treatment Works and more than 100 people attended including local stakeholders such as the Mayor and Mayoress of Eastbourne.

We also continue to promote water efficiency by engaging with local community groups such as Rotary clubs and the University of the Third Age groups to talk about the Company, our water supply operations, water treatment and other activities. During 2012/13 we spoke to 11 Community groups, with subject matters which were tailored to the specific group's interest. Similarly, our promotional water efficiency trailer and stands were kept very busy over the summer with much emphasis on the drought. We attended 31 community events across our supply area helping to raise the visibility of South East Water, and promote water efficiency.

Managing Director's report

Our work with key stakeholders – our regulators, MPs, local authorities and community and interest groups – remains an important part of raising the profile of our business and the critical activities we undertake resulting in more than 70 drop-in sessions or stakeholder briefings arranged during the year. We have engaged on a wide range of important issues via letters, brochures and exhibitions, particularly on our Customer Metering Programme and Capital Programme, together with the latest water resource situation as we recovered from drought during 2012. Demonstrating the success of this early engagement our Capital Programme communications received over 80% positive feedback from customer surveys during the mains renewal programme, which saw 50km of new water mains laid across our region. The Customer Metering Programme, which will see 200,000 meters fitted by 2015, has also clearly demonstrated the effectiveness of proactive customer, community, media and stakeholder communications. The programme saw 45,833 meters (excluding optants) fitted in the year but generated less than 500 complaints relating to the installation and communication process. However, we are not complacent and continue to assess those complaints to see how we can further improve our processes and performance, and the customer experience.

Our staff continue to actively fundraise on behalf of local charities and the water industry's own nominated charity, WaterAid, a charity bringing clean water and sanitation to communities in the developing world. Our fundraising for WaterAid has gone from strength to strength since the appointment of a dedicated company WaterAid representative; we were also very pleased to support a trip to India by one of our keen fundraisers so he could see for himself the work being done by the charity.

During 2012-13 we launched our Community Chest Fund and we received 96 applications from right across our supply area with the requested donations totalling £165,000. The decision of where to split the £30,000 fund was taken by a panel of six South East Water staff from all levels with 27 organisations being chosen covering a range of projects from environmental, workshops and the provision of IT equipment.

Our close relationship with our communities is reciprocal and we gratefully acknowledge the contribution of over 150 volunteers, who have carried out conservation enhancement and monitoring work on some of our 24 SSSIs throughout the year.

Paul Butler
Managing Director
5 July 2013

Our Directors

Gordon Maxwell, Chairman
Gordon has a wide range of senior executive and managerial experience gained at Thames Water, where he was Managing Director, Mid Kent Water where he was Chairman and at Courtaulds plc. He also holds a number of non-executive directorships in business and charitable organisations.

Paul Butler, Managing Director
Paul has a wealth of water industry experience, including most recently serving as Managing Director of Mid Kent Water from 2001 to October 2006. A Chartered Accountant, he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer.

Jo Stimpson, Finance Director
Jo, a Chartered Accountant and a law graduate, was Finance Director at Mid Kent Water from August 2003 until October 2006. She has also held a number of senior management posts in finance, including those at Charteris and ICL.

Paul Seeley, Operations Director
Paul has more than 30 years experience in the water industry, most recently serving as Managing Director of Mid Kent Water from October 2006 to December 2007. A Chartered Environmentalist, he previously worked for Mid Kent Water as Asset Director. Prior to this he has held posts with Southern Water, Severn Trent and North West Water.

Steve George, Customer Services Director
Steve is a customer services specialist with over 25 years experience in the water industry. He was previously managing consultant at SECOR Consulting, a specialist customer management consultancy. At SECOR he had been working with South East Water for some time. Prior to this Steve held a number of senior IT and customer service roles in the water industry.

David Hinton, Asset and Regulation Director
David has more than 17 years' experience at South East Water with a Masters in Business Administration. His most recent post as Head of Assets and Economic Regulation follows a number of roles within the Company including Head of Water Quality and Head of Business Planning as well as experience elsewhere within scientific consultancies and the Public Health Laboratory Service.

Valeria Rosati, Non-executive Director
Valeria is an Executive Director at Hastings Funds Management (UK) Ltd and was appointed to the South East Water Board in December 2007. She is involved in the origination and execution of investment opportunities and the management of portfolio companies in the UK and Europe. She holds a degree cum laude in Business and Economics from L.U.I.S.S. University in Rome, and was heavily involved in both the acquisition of South East Water and the subsequent Competition Commission process in relation to its merger with Mid Kent Water.

Jean-Etienne Leroux, Non-executive Director
Jean-Etienne is responsible for Caisse de dépôt et placement du Québec's investment in South East Water. As an Investment Manager at Caisse de dépôt et placement du Québec he is both the investor and manager of a civil and energy infrastructure portfolio. Jean-Etienne is a Chartered Financial Analyst (CFA) and holds degrees in both Management and Finance from HEC Montreal. He led the investment in SEW on behalf of Caisse de dépôt et placement du Québec.

Kanishk Bhatia, Non-executive Director
Kanishk is an Associate Director at Hastings Funds Management. As a member of the investment team, he is responsible for the origination, execution and management of infrastructure equity investments in the UK and Europe. Kanishk has been heavily involved in South East Water since 2006 including both the acquisition and the subsequent Competition Commission process in relation to the merger with Mid Kent Water. Prior to joining Hastings, Kanishk worked as a consultant at global strategy consulting firm L.E.K. Consulting and provided advice to clients in the areas of business strategy and mergers and acquisitions.

Graham Setterfield, Independent Non-executive Director
Graham was appointed to the South East Water Board in December 2007 and previously served as Chairman of Mid Kent Water. Graham has also chaired the Institution of Civil Engineers Water Board. A former deputy managing director of Southern Water, Graham most recently worked at Water UK where he was Director of Water Services.

Our Directors

Emma Gilthorpe, Independent Non-executive Director
Emma Gilthorpe joins the water company from a prestigious national and international career working in the telecoms and airport industries. Currently working as Regulatory Director at Heathrow Holdings Ltd, Emma was previously BT plc's Group Director of Industry Policy and Regulation. She has also held a number of other senior regulatory and public policy roles in Cable and Wireless.

Paul Rich, **Independent Non-executive Director**
Paul Rich joins South East Water with 25 years' experience working in the national services businesses. Paul is Currently Chairman of NHS Business Services Authority and was previously Royal Mail plc's Deputy Managing Director and Marketing Director. He has also held a number of other senior management roles within Post Office Ltd.

Corporate Governance statement

Chairman's statement

The Company operates under an Instrument of Appointment as a Water Undertaker issued by the Water Services Regulatory Authority ("Ofwat") under the Water Industry Act 1991. As part of the Company's licence, the Company is required to conduct its regulated business as if it were a separate public limited company and in doing so should have particular regard, amongst other factors, to the principles of good governance set out in the UK Corporate Governance Code (the "Code") that was issued by the Financial Reporting Council in September 2012.

The Board is structured, managed and its performance measured to ensure that the role of the Board and its effectiveness complies with the highest standards of Corporate Governance, with a particular emphasis on the key principles of accountability, transparency, probity and focus on the longer term, sustainable success of the Company. In this statement we set out how we comply with the principles and provisions of the Code and explain those areas where we do not comply with the provisions because we consider we meet the principles in a more appropriate way.

Principle A - Leadership

The Role of the Board

The Board's role is to provide strategic leadership for the Group, ensuring that the financial and human resources are in place for the Group to meet its objectives. It is the Board's responsibility to promote good corporate governance within a framework of effective controls, enabling risk to be managed. The Board also reviews management performance and ensures its obligations to its customers, shareholders, regulators and other stakeholders are met. The Board is fully compliant with all the provisions set out in Section A.1. of the Code.

The Board has adopted a formal schedule of matters specifically reserved for it. These include; strategy and management, structure and capital, financial reporting and controls, risk and internal control, key regulatory submissions, board and other key appointments, directors' remuneration, approval of the annual business plan, corporate governance, major contracts and dividend policy. A statement of directors' responsibilities in respect of the financial statements is set out on page 30 and the responsibility of our auditor is set out in the independent audit report. A statement of Going Concern is given on page 27.

The Board schedules regular meetings throughout the year and will also meet on an ad hoc basis to discuss other matters as needed.

During the period 1 April 2012 to 31 March 2013, the board met on 10 occasions. The attendance of the directors was as follows:

Director	Number of meetings attended	Appointment/Resignation
G W Maxwell	10	
P Butler	10	
J E Stimpson	10	
P Seeley	10	
D G Shore	10	
S George	9	
V Rosati	6	
K Bhatia	9	
J-E Leroux	10	
C D Harries	3 out of 4	Resigned 27 September 2012
G H Setterfield	9	
R Weeden	10	Resigned 25 April 2013
E Gilthorpe	6 out of 6	Appointed 18 October 2012

The Company maintains appropriate Directors and Offers Insurance Cover and has issued Indemnity Letters to each Director.

Corporate Governance statement

Division of responsibilities

There is a clear division of responsibilities between the chairman and the managing director and this is set out in writing. The Board is fully compliant with all the provisions set out in Section A.2. of the Code.

The Chairman

The chairman is responsible for the leadership of the board and for its effectiveness. He sets the agenda for the board and ensures the information the directors receive is appropriate, prepared to a high standard and timely. He is responsible for the culture of the boardroom which is one of openness and debate. The board is fully compliant with all the provisions set out in Section A.3. of the Code.

Non-executive Directors

The board includes six non-executive directors, three of whom are shareholder appointees and three of whom are independent. The balance of executive and non-executive directors represents appropriate challenge to the Board and contribution to strategy. The non-executive directors monitor the performance of the executive directors with formal reviews being undertaken by the remuneration committee. The chairman meets with the non-executive directors without the executives being present at least 6-monthly and the independent non-executive directors meet without the chairman being present at least annually.

The board is fully compliant with provisions A4.2 and A.4.3 of the Code but is not compliant with provision A.4.1 re the appointment of a senior independent director. The nature of the experience of other board members is such that the Chairman can use all Directors as a sounding board depending on the particular matter at issue. Similarly, the presence of shareholder appointees on the Board removes the necessity for a senior independent director to act as an alternative channel for shareholders.

Principle B - Effectiveness

The Composition of the Board

The Board members have the appropriate balance of skills, experience, independence and knowledge of the company to ensure that they are able to discharge their duties and responsibilities effectively.

The Board comprises the chairman, five executive directors, three independent non-executive directors and three shareholder appointed non-executive directors. The independent non-executive directors who served throughout the year ended 31 March 2013 were Graham Setterfield and Robert Weeden. Charles Harries served as an independent non-executive director until his resignation when he was replaced by Emma Gilthorpe. In April 2013 Robert Weeden resigned from the board and was replaced as an independent non-executive director by Paul Rich.

The biographies on pages 14 and 15 demonstrate the calibre and range of experience of the non-executive directors which enable them to bring independent judgement on issues of strategy, performance and standards of conduct which is vital for the success of the Group.

Graham Setterfield has been a director of the Company for five years and was previously a director of Mid Kent Water Ltd, which merged with South East Water in 2007. Graham was first appointed to the Mid Kent Water board in 2001. Graham's extensive experience in the water industry, together with his independence of mind ensure that Graham meets the criteria for independence set out in the Code.

Emma Gilthorpe is Director of Regulation at Heathrow Holdings Ltd which is part owned by Caisse de dépôt et placement du Québec (CDPQ) which is also one of the ultimate shareholders of the Company. Emma was recruited via an external recruitment process and brings with her extensive experience of other regulated sectors. She does not in any way represent the views of CDPQ on the Board and fully meets the criteria for independence set out in the Code.

Corporate Governance statement

The Board is fully compliant with provision B.1.1. of the Code. The Company is not compliant with provision B.1.2. since less than half of the Board comprises independent non-executive directors. The Board consider this is appropriate given the Company is not listed and its shareholders are represented on the Board. The Board believes that the current mix of executive Directors, shareholder appointed non-executive directors, and independent non-executive directors provides an appropriate and desirable balance which is to the benefit of the Board.

Appointments to the Board

Other than for internal candidates for executive positions who have been identified through the Company's succession planning all recruitment to the Board is carried out by a formal, rigorous and transparent procedure using an external search firm. Role requirements are subject to detailed specification and the recruitment is carried out with due regard for the benefits of diversity on the board, including gender, skills and experience. The Board has a written diversity policy.

The Company is compliant with provision B.2.3. but as it does not have a Nominations Committee it is not compliant with the provisions of B.2.1 and B.2.2. B.2.4. is complied with other than the work described is not carried out by a nominations committee. Whilst the Company does not see the need for a Nominations Committee the Board considers it is fully compliant with the principles of section B.2. of the Code.

During the year the Board recruited two independent non-executive directors. Role specifications were produced by the chairman and managing director who together led the recruitment process on behalf of the board. The external search firm used was Odgers Berndtson. Following interviews the selected candidates were informally interviewed by the shareholder appointed Directors and met the independent non-executives in an informal setting. Following appropriate feedback from these meetings the appointments were made.

Commitment

Sufficient time is available both for the executive and non-executive directors to undertake their responsibilities. The expected time commitment is reviewed as part of the appointment process of non-executive directors including the requirement of additional commitment outside scheduled board meetings when required. A defined expected time commitment is not set out in the terms of appointment of non-executive directors, instead, and to reflect the need for sufficient flexibility, the terms of appointment of non-executive directors include an undertaking that the non-executive director is able to allocate sufficient time to discharge his or her responsibilities efficiently, taking account of other commitments. Directors disclose their other commitments at the time of appointment. An update of each director other commitments was provided to the Board following the year ending 31 March 2013. Further updates are made as required if a non-executive director takes any additional commitment with the agreement of the company. A non-executive director is also required to obtain prior agreement before accepting additional commitments. Executive Directors do not hold any non-executive directorship. The Board is compliant with all the provisions set out in Section B.3. of the Code.

Development

On joining the board each director receives a detailed, tailored induction programme which is supplemented as needed to ensure that the director's knowledge, familiarity with the Company and its industry, and their own capabilities are maintained at the appropriate level. The induction programme will include visits to production sites and other Company facilities away from the Company's head office and at least one board meeting per year is held away from head office at a different Company site. For example the October 2012 board meeting included a site visit to see an improvement scheme at a major treatment works with the main body of the meeting being held at a regional operations centre. Such visits give directors the opportunity to speak to a wider group of staff and contractors.

The Board is fully compliant with all the provisions set out in Section B.4. of the Code.

Corporate Governance statement

Information and Support

The directors are provided with appropriate, accurate and relevant financial and operational information necessary for them to discharge their duties. The management information is prepared by the senior management of the Group and produced on a timely basis for consideration and review by the directors. Senior managers periodically attend the board to provide appropriate levels of information on key issues.

The company secretary is responsible for the provision of legal guidance and support as and when appropriate.

All directors have access to the advice and services of the company secretary in furtherance of their duties. Directors also have access, when necessary, to independent professional advice at the Group's expense.

The Board is fully compliant with all the provisions set out in Section B.5. of the Code.

Evaluation

Evaluation of the performance of the South East Water Board, of board committees and of the performance of individual directors has been carried out informally. The board has agreed that whilst informal mechanisms should continue the Board should carry out a more formal and rigorous evaluation at least annually. This was carried out in June 2013 facilitated by the company secretary.

The Board is fully compliant with all the provisions set out in Section B.5. of the Code other than provision B.6.3, performance evaluation of the chairman, which is carried out by the shareholder appointed non-executive directors

Re-election

As a privately owned Company with shareholder appointed non-executive directors who can actively input into board appointments, board evaluation and succession planning the Group does not consider it necessary to comply with the provisions set out in Section B.7. of the Code

Principle C - Accountability

Financial and Business Reporting

The Board reports on the Group to shareholders annually in compliance with the Companies Act and submits Regulatory Accounts to the Water Services Regulation Authority in accordance with its instrument of appointment. This Annual report is compliant with appropriate Accounting Standards and audited by the external auditor. The Board reviews and approves the annual and interim financial statements to ensure appropriate financial, operational and performance information is communicated to the Group's wide range of stakeholders and that, taken as a whole, such reports are fair, balanced and understandable

The statement of directors' responsibilities is set out on page 30. The board acknowledge that the key drivers for maintaining and enhancing value over the longer term are maintaining and improving the Company's credibility with customers and stakeholders and the effectiveness, efficiency and innovation with which the Company is operated.

The factors that allow the Company to confirm that the business is a Going Concern are set out in the Director's report on page 28 and the independent auditor's report is set out on page 31.

The Board is fully compliant with all the provisions set out in Section C.1. of the Code.

Risk Management and Internal Control

The Board monitors the Group's principal risks and uncertainties and these are set out in the Directors' Report (page 24). The strategic approach to risk management is determined by the board and appropriate internal controls implemented to counter these risks.

Corporate Governance statement

Key features of the system of internal control include the following:

- regular board meetings with a formal schedule of matters reserved for the Board for discussion;
- clearly defined organisation structures, appropriate delegated authorities and established policies and procedures, which are reviewed annually, for conducting significant aspects of the Group's activities;
- risk management procedures and framework for the identification, evaluation and mitigation of risks including regular review by executive management and reporting to the Board;
- a comprehensive five year business plan and annual budget and a rigorous process of monitoring actual performance against the budget and business plan;
- through the executive investment committee, policies and procedures for the approval and control of all major items of capital expenditure and for the acquisition and disposal of material assets;
- policies and procedures for the approval and control of any arrangements which could give rise to a material liability for the Group; and
- board sign-off of regulatory business plan, water resources plan, annual compliance statement and principle statement.

During the course of its review of the risk management and control systems, the board has not identified nor been advised of any failings or weaknesses which it has determined to be significant.

The Board is fully compliant with all the provisions set out in Section C.2. of the Code.

Audit committee and Auditor

The board recognises and values the importance of the relationship with the auditor. Rather than create an audit committee the Board ringfences part of the board agenda at at least two meetings of the board to enable the entire board membership to understand and discuss the auditor's approach to their audit and to receive a full debrief as to their findings. If considered necessary by either the audit partner or by the non-executive directors part of this discussion may take place in the absence of the executive directors.

The entire board will also review reports from management on the effectiveness of the Group's internal control systems. The Company does not have an internal audit function but internal audit activity is conducted periodically by members of management, ensuring appropriate independence from the area of the Company that is subject to review.

The current auditor was appointed in November 2010 following an OJEU compliant tender. The Board satisfies itself as to the continuing independence of the external auditor. In doing so, it considered the following factors having regard to the views of management and the external auditor:

- the auditor's procedures in place for maintaining and monitoring independence including those to ensure that the partners and staff have no personal or business relationships with the Group other than those in the normal course of business permitted by UK ethical guidance;
- the auditor's policies for the rotation of lead partner and key personnel; and
- the auditor's policies provide for them to be engaged only for non-audit services which are not prohibited by professional or other regulatory requirements.

The board fully supports the principle of section C.2. of the Code but is not compliant with provision s C.3.1, C3.3., C3.4., C3.6. and C3.8. regarding the establishment and role of an audit committee. The board is compliant with provisions C.3.2, C3.5 and C3.7. other than the role and responsibilities identified are carried out by the board as a whole rather than by an audit committee. The need for an audit committee is kept under review and should circumstances change so that the establishment of an audit committee became necessary it would be put in place.

Corporate Governance statement

Principle D - Remuneration

The level and Components of remuneration and Procedure

The determinants of directors' remuneration are set out in the Remuneration Report on page 22.

Throughout the financial year the remuneration committee, which is chaired by an independent non-executive director, consisted of the chairman, the independent non-executive directors and the shareholders' appointed non-executive directors. Other individuals including the managing director, the head of human resources and external advisers are invited to submit reports or attend all or part of any meeting as and when appropriate. The committee met three times during this period.

The role and responsibilities of the remuneration committee are:

- to determine and agree with the board the framework or broad policy for the remuneration of the company's Managing Director, the executive directors and such other members of the executive management as it is designated to consider. The remuneration of independent non-executive directors shall be a matter for the chairman of the board in consultation with shareholders and the Managing Director. No director or manager shall be involved in any decisions as to their own remuneration;
- in determining such policy, to take into account all factors which it deems necessary including relevant legal and regulatory requirements, the provisions and recommendations of the UK Corporate Governance Code and associated guidance. The objective of such policy shall be to ensure that members of the executive management of the company are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contributions to the sustainable success of the company;
- when setting remuneration policy for directors, to review and have regard to the remuneration trends across the company or group;
- to review the ongoing appropriateness and relevance of the remuneration policy;
- within the terms of the agreed policy and in consultation with the chairman and/or Managing Director, as appropriate, to determine the total individual remuneration package of each executive director and other designated senior executives with specific emphasis on the design and determination of annual performance bonuses;
- to obtain reliable, up-to-date information about remuneration in other companies. To help it fulfil its obligations the committee shall have full authority to appoint remuneration consultants and to commission or purchase any reports, surveys or information which it deems necessary, within any budgetary restraints imposed by the board;
- to be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee;
- to approve the design of, and determine targets for, any performance related pay schemes operated by the company and approve the total annual payments made under such schemes;
- to determine the policy for, and scope of, pension arrangements for each executive director and other designated senior executives;
- to ensure that contractual terms on termination, and any payments made, are fair to the individual, and the company, that failure is not rewarded and that the duty to mitigate loss is fully recognised; and
- to oversee any major changes in employee benefits structures throughout the company or group.

The Board approves the remuneration report included in this Annual Report.

The remuneration committee was chaired by Charles Harries until his resignation, at which point the chairmanship was assumed by Graham Setterfield. The other members are Gordon Maxwell, Robert Weeden, Valeria Rosati, Kanishk Bhatia and Jean-Etienne Leroux. Emma Gilthorpe and Paul Rich became a member of the remuneration committee on their appointment to the board.

The Board is fully compliant with all the provisions set out in Section D.1. and D.2. of the Code.

Corporate Governance statement

Principle E - Relations with shareholders

Dialogue with Shareholders

Communication with shareholders is facilitated as the Company is a private limited company with shareholder appointed non-executive directors on the Board. The Board is accountable to the Group's shareholders and as such it is important that the Board appreciates the requirements of shareholders and equally that shareholders understand how the actions of the Board and short-term financial performance relate to the achievement of the Group's longer-term goals. The reporting calendar is dominated by the publication of interim and final results each year, in which the Board reports to shareholders on its stewardship of the Group. At other times during the year, presentations to rating agencies and updates to the stock exchange are made available to all. The chairman ensures that the managing director and finance director provide feedback to the Board following presentations to investors and meetings with shareholders.

Constructive use of the AGM

All companies in the Group are private companies which are not required under the Companies Act 2006 to hold an AGM. Non-executive directors appointed by shareholders sit on the board of the companies in the Group and shareholders have direct access to the executives directors and management information so that a high level of engagement and participation is achieved without holding an AGM.

Remuneration Report

The remuneration committee of the Board met on 31 May 2012, 29 November 2012, 6 March 2013, 25 April 2013 and 21 May 2013.

Rewards for independent non-executive directors are based on a structure of fees which are periodically compared with market practice.

Rewards for the managing director and senior executives are based on a total reward package of basic salary, performance incentive scheme and benefits sufficient to attract, motivate and retain individuals of the required calibre to lead the business. Our policy aims to be around median market practice, with a performance bonus for achieving stretching corporate, directorate and personal targets, which is sufficient to motivate strong commitment to achieving the goals set, and to establish a close link between overall rewards and corporate performance. Performance targets include improving the Group's SIM score and industry efficiency ranking, and reducing customer debt, as well as financial performance targets and meeting capital investment targets. The remuneration committee establishes corporate bonus targets at the beginning of the financial year and decides the performance bonus payment to each member of the executive team. Decisions on the pay of senior executives take into account information from independent reward surveys. The managing director and senior executives participate in the same pension schemes as other staff and do not participate in a long term incentive plan.

The Group's reward policy is to maintain a total reward package for staff throughout the business consisting of basic salary and benefits sufficient to attract, motivate and retain good quality staff. Senior managers participate in the management performance bonus scheme.

The intention is to be positioned around median market practice and the Group participates in reward surveys to benchmark its reward practices.

Further disclosure in respect of Directors emoluments are set out in the Regulated Accounts of the company which are available on the Company website.

On behalf of the Board

Gordon Maxwell
Chairman
5 July 2012

Directors' Report

The directors have pleasure in submitting their report and the audited financial statements for the year ended 31 March 2013.

Appointment as a Water Undertaker and the Ringfence

South East Water Limited has been appointed as a water undertaker under the Water Industry Act 1991 and the duties and the obligations of the appointmee are set out in that Act, in regulations created under that Act, and in its instrument of appointment. The conditions of the instrument of appointment cover a variety of areas including charges, accounts and information and various codes of practice.

Condition K of the instrument of appointment deals with ring-fencing and requires the Company to ensure, within the bounds of reasonable practicability, that it retains at all time sufficient rights and assets (other than financial resources) for a special administrator, if appointed, to be able to manage the affairs of the business. The Company must confirm this annually. Condition F requires the Company to ensure that it has sufficient financial and managerial resources and adequate systems of planning and internal control to carry out the regulated activities and again requires the Company to certificate this annually. Further Condition F requires that the Company should at all times conduct the appointed business as if if were substantially the Company's sole business and the Company was a separate public limited Company. The licence sets out a number of factors to which the Company should have particular regard when meeting this particular Condition. The ultimate controller of the appointee is bound by a binding undertaking with Ofwat required under condition P of the instrument of appointment to procure that its subsidiaries other than the appointee provide information required by the appointee to comply with its obligations under the Water Industry Act 1991 and the instrument of appointment and to refrain from any action that would cause the appointee to breach any of these obligations.

The effect of the relevant legislation and the terms of the instrument of appointment mean that whilst South East Water is not a publically listed company, its directors have an overriding responsibility to ensure the regulatory ringfence is maintained. The directors remain mindful of these obligations along with their duties as directors set out in the Companies Act 2006. One of the ways the directors meet the ringfencing obligations is by ensuring that all board level matters that affect the Company are decided at the board of South East Water Ltd, rather than at a holding company level.

Principal activities

The principal activities of the Group comprise the supply of water to a population of 2.1 million in an area of 5,657 square kilometres and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the regulating statutes. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future.

Group Structure

South East Water Limited is the main operating company in the group of companies headed by HDF (UK) Holdings Limited. The ultimate owners of HDF (UK) Holdings Limited are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, and Caisse de dépôt et placement du Québec. There are two intermediate holding companies between the Company and HDF (UK) Holdings Limited: South East Water (Holdings) Limited and Hastings Water (UK) Limited.

The debt financing of South East Water is arranged by South East Water itself and by its only subsidiary, South East Water (Finance) Limited. There is further debt finance in the group which is a mixture of both external and shareholder loans and this debt is issued by a separate group company, Hastings Luxembourg Water S.a.r.l.

Accounting framework

The financial information presented in the audited Group financial statements on pages 33 to 72 has been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union. The financial information concerning the Company as a single entity on pages 73 to 101 has been prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP).

Directors' Report

Business review and future developments

Turnover for the Group for the year ended 31 March 2013 was £207.9 million (2012: £200.1 million) and operating profit was £101.5 million for the year (2012: £99.1 million). Profit before taxation for the year was £41.7 million (2012: £42.4 million). The financial position at 31 March 2013 for the Group and for the Company is shown on pages 34 and 74 respectively. Further analysis of the performance of the business and future developments is included in the Chairman's Statement on page 4 and Managing Director's Report on page 7.

During the year, the Group raised £100 million of loan finance (see note 19 for details).

Dividends

The directors have approved dividends totalling £31 million (2012: £32 million) for the year paid in equal instalments of £7.75 million per quarter. Further details are given in notes 10 and 40. The Company's immediate parent company, South East Water (Holdings) Ltd used £5.3 million of this dividend (2012: £5.5 million) to pay interest on an inter-company loan back to South East Water Limited.

Capital expenditure

During the year the Group's capital expenditure totalled £96.2 million (2012: £88.5 million). Further details are given in notes 12 and 13. The Company's position is detailed in note 41.

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

Taxation

Whilst the Group makes profits, the extensive investment programme currently being undertaken by the Company typically means that any taxable profits are exceeded by available capital allowances. As tax losses are available elsewhere in the HDF (UK) Holdings Ltd group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge.

Directors and their interests

The directors who served at the date of this report are set out on page 3. Emma Gilthorpe and Paul Rich have been appointed to the Board as non-executive directors and Charles Harries and Robert Weeden resigned from the Board. Also, prior to the end of the financial year David Shore indicated his intention to leave the Board on 30 June 2013. David Hinton has been appointed to the Board on 1 June 2013.

No director held any shares or loan stock in the Company or other associated companies required to be disclosed under the Companies Act 2006 during the financial year.

Directors' liabilities

The Group has granted an indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

Principal risks and uncertainties

The Board is responsible for the Group's risk management processes. These processes are constantly reviewed for effectiveness and aspire to take a comprehensive view of business risk.

Directors' Report

Changes to the regulatory environment

The prices South East Water charge its customers are set every five years by OFWAT. In determining prices OFWAT make a number of assumptions on required investment levels, appropriate cost of capital and operational costs. The risk of variations in these assumptions is mitigated by the Group as far as possible but, to a significant extent, the risk of such variations is carried by the Group until the next price review.

The next price review is due to be concluded in 2014, with prices effective from April 2015. OFWAT are proposing significant changes to their approach to regulation for this review including the production of three individual plans (for the wholesale business and each of the contestable and non-contestable retail businesses). Whilst a number of consultation documents have been issued the final methodology for the price review has not been issued by OFWAT although it is likely that the plans will need to be submitted in early December 2013. The lack of clarity on the methodology is increasing the level of regulatory risk.

Climatic changes

The Group's resources are a mixture of water captured in reservoirs or abstracted from rivers or underground aquifers. These resources are closely linked to the weather and any changes in climate have the potential to impact on the Group's primary business activity of providing high quality water. These factors have been incorporated into the Water Resources Management Plan and as part of the Group's medium- to long-term strategy we are focusing on strengthening our water resources whilst at the same time promoting water efficiency with our customers.

Water Framework Directive

The Water Framework Directive (WFD) is the most substantial piece of European water legislation to date. It requires all inland and coastal waters to reach 'good status' by 2015. It will do this by establishing a river basin district structure within which demanding environmental objectives will be set, including ecological targets for surface waters. The WFD therefore sets a framework which aims to provide substantial benefits for the long term sustainable management of water.

This Directive has the potential to drive major additional capital investment and increases in customers' charges. The Final Business Plan which is the basis for the next price review incorporates projects necessary to ensure compliance with the WFD.

Water industry competition

The Water Act 2003 established a framework for market competition in the water industry but as yet, this has not resulted in any significant competitive activity. Both OFWAT, via regulation, and the government, via the draft Water Bill, is seeking to increase the level of competition in the industry. The threshold for non-household customers to be able to choose their water supplier has been reduced from 50 ml per annum to 5 ml per annum and it is anticipated that in 2017 all non-household customers will be able to choose their supplier.

A number of other measures have been included in the draft Water Bill with a view to expand the water supply licensing regime. These include the creation of new water supply authorisations which would replace the existing combined license and provide increased flexibility and access to water companies' assets including potentially treatment works and storage facilities. A new retail infrastructure authorisation would eventually replace inset appointments for supplies to new developments removing the need for new entrants to obtain an inset appointment for each site.

The draft Water Bill also provide for the removal of the cost principle and its replacement with a new wholesale pricing regime. These changes will mean that South East Water is vulnerable to loss of non-household customers to both other water companies and to new entrants and will inevitably be exposed to increased costs as market mechanisms are developed.

Directors' Report

Social influences

The Group is subject to social influences and may be required to change its business practices in light of regulatory changes brought about by stakeholder and consumer pressure. The Group works closely with its stakeholders including the Consumer Council for Water, Drinking Water Inspectorate, Natural England and The Environment Agency. In doing so we are able to manage this risk and take appropriate action as and when required.

Supplier markets

The Group is also subject to external market forces, where input prices can sometimes rise beyond the regulatory allowance. As part of the Group's procurement strategy, contracts are tendered and negotiated on a regular basis which ensures that all aspects of the cost base are continually reviewed. This allows the business to mitigate exceptional increases arising in the market.

Treasury management and financial risk

The Group manages its financial risk through securing cost-effective funding for the Group's operations and minimising the adverse effects of fluctuations in the financial markets on the value of the Group's financial assets and liabilities, on reported profitability and on the cash flows of the Group.

The Group's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Group's policy to minimise liquidity risk within an acceptable range of interest rates. The Group does not use foreign currency financial instruments.

The Group's financial instruments comprise fixed and variable rate borrowings, an interest rate swap, cash, short- and medium-term deposits, a loan to its parent undertaking and various other items, such as trade debtors and creditors, which arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

The main risks arising from the Group's financial instruments are interest rate risk and cash flow risk, credit risk, liquidity risk, counterparty risk, price risk and capital management.

Interest rate and cash flow risk

The Group finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long-term bonds and short-term bank borrowing facilities. Debentures are long-term fixed rate loans; bonds are long-term fixed rate loans of which some have been linked to inflation in order to reflect movements in the expected future income of the Group. There were no borrowings under the Group's bank facilities as at 31 March 2013 (2012: £nil). Finance leases are fixed rate instruments. Further details are given in notes 19 and 22. The Group's policy is to manage short-term interest rate risk by drawing down on its bank borrowing facilities as required, fixing the interest rate applied to the loan at the point of draw down for the loan period. It is the view of the Group that long term fluctuations in interest rates will be within the parameters that are considered acceptable by the Group.

Credit risk

The Group's financial assets are a loan and other amounts due from parent and group undertakings and cash and trade receivables, which collectively represent the Group's maximum exposure to credit risk in relation to financial assets. The Group's credit risk is primarily attributable to its trade receivables. These are stated in the balance sheet at original invoice amount less an allowance for doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile. The Group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Directors' Report

Liquidity risk

The Group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long term loans. Short-term flexibility is achieved by varying the amounts drawn down under short-term facilities. Further details are given in note 19 and 22. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

Counterparty risk

Counterparty risk is the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's receivables from cash on deposit and the mark to market position from the counterparty to the inflation swap. Under the terms of the Group's treasury policy, financial counterparties have to meet minimum credit rating criteria assigned by either Moody's or Standard & Poor's. There is also a mechanism for the swap counterparty to post collateral or be replaced if the counterparty drops below the minimum credit rating threshold.

The Group operates a diversified cash management policy, placing its cash deposits with several different financial institutions that have a strong short-term credit rating.

Price risk

The price of water charged by the Group is regulated by OFWAT as part of the five year price review. The price increases (or decreases) in line with RPI and an adjustment allowed under the licence ("k"). This latter adjustment is determined as part of the business planning process and determined by Ofwat.

Capital Management

The primary objective of the Group's capital management is to ensure that it maintains an appropriate credit rating and healthy financial ratios in accordance with covenants stipulated in the Group's financing documents as agreed with all financing parties. The Group manages its capital structure and makes adjustments as required, taking into account the delivery of its capital programme and economic conditions. To change or adjust the capital structure, the Group may adjust the dividend payment to shareholders or borrow additional capital from the money markets.

The Group monitors interest cover ratios and the ratio of net debt to Regulated Capital Value. This is monitored continuously to ensure covenant compliance both in the current reporting period and future reporting periods.

As at 31 March 2013, total capital employed comprised equity shareholders' funds and borrowings of the Group and amounted to £1,091.7 million (2012: £982.9 million).

Environmental and corporate social responsibility

The Group's approach to sustainable development of its business includes a strong commitment to the environment and corporate social responsibility. Further details are given in the Managing Director's report.

Employment policies

The Group offers equal opportunities to all staff and applicants for employment. Its managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm the Group as an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the Managing Director's report.

The Group gives full consideration to applications for employment from disabled persons where the candidate's particular aptitudes and abilities are consistent with meeting the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Where existing employees become disabled it is the Group's policy to provide continuing employment, wherever practicable, in the same position or in an alternative position and to provide appropriate training to achieve this aim.

Directors' Report

Employee consultation

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on various factors affecting the performance of the Group. This is achieved through formal and informal meetings, regular bulletins on the Group's intranet and the Group's employee magazine. Employee representatives are consulted regularly through the Staff Council on a wide range of matters affecting their current and future interest.

Supplier payment policy

The Group has established its own policy and procedures regarding the payment of suppliers and does not follow a prescribed supplier payment code. The Group's current policy concerning the payment of creditors for goods is as follows:

- to pay in accordance with its contractual and legal obligations; and
- whenever it is reasonable to do so, to agree terms of payment when initiating transactions and to ensure that suppliers are made aware of the terms of payment by inclusion in the relevant terms in contracts.

At the balance sheet date, the amount due to trade creditors by the Group represented 33 days (2012: 38 days) of purchases during the year.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chairman's Statement. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described on pages 33 to 72. This Report includes a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. Its facilities were undrawn during the year and at the date of signing these accounts. The Group's annual budget and forecasts together with its five year plan and longer resources planning all indicate that the Group should be able to continue operating utilising its current financial resources and the proceeds of future borrowing opportunities expected to become available.

The directors believe that the Company and Group are well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Auditor

The directors who were members of the Board at the time of approving the directors' report are listed on page 3. Having made enquiries of fellow directors, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which the Group's auditor is unaware; and
- each director has taken all the steps a director ought to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with provisions of s418 of the Companies Act 2006.

In the absence of a general meeting, Deloitte have been re-appointed as auditor in accordance with the terms of their contract.

Directors' Report

Donations

Charitable donations during the year to 31 March 2013 amounted to £157,000, including £111,000 to the Helping Hands Scheme, an independent charitable trust which assists customers who have genuine difficulties in paying their water bills (2012: £125,000, including £120,000 to the Helping Hands Scheme). No political donations were made by the Group in either period.

By order of the Board

N Truillet
Company Secretary
5 July 2013

Statement of Directors' Responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing the group financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

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

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

Responsibility statement
We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the directors' report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

P Butler
Managing Director
5 July 2013

J E Stimpson
Finance Director
5 July 2013

Independent auditor's report to the members of South East Water Limited

We have audited the financial statements of South East Water Limited for the year ended 31 March 2013 which comprise the Group Income Statement, the Group statement of comprehensive income, the Group statement of financial position, the Group statement of changes in equity, the Group statement of cash flows and the related Group notes 1 to 31, the Company income statement, the Company statement of total recognised gains and losses, the Company balance sheet, the Company cash flow statement and the related Company notes 32 to 58. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

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

Opinion on financial statements
In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2013 and of the group's and the parent company's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the members of South East Water Limited

Matters on which we are required to report by exception

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

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

James Leigh (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
5 July 2013

Group income statement
for the year ended 31 March 2013

	Note	2013 £000	2012 £000
Revenue	3	**207,887**	200,067
Operating costs before exceptional item		**(115,686)**	(105,904)
Exceptional item: pension curtailment gain	5/24	**4,245**	-
Group net operating costs	5	**(111,441)**	(105,904)
Other income	3	**5,089**	4,968
Group operating profit		**101,535**	99,131
Finance costs	7	**(65,584)**	(62,682)
Finance income	8	**5,789**	5,904
Profit before taxation		**41,740**	42,353
Taxation	9	**(2,606)**	665
Profit for the year		**39,134**	43,018
Earnings per share			
Basic and diluted from continuing operations	11	**79.36p**	87.24p

Profit for the year is generated entirely from continuing operations.

Group statement of comprehensive income
for the year ended 31 March 2013

	Note	2013 £000	2012 £000
Profit for the year		**39,134**	43,018
Income and expense recognised directly in other comprehensive income:			
Actuarial loss on defined benefit pension schemes	24	**(7,706)**	(27,855)
Transfer of assets into pension scheme	24	**-**	821
Deferred tax on defined benefit schemes	9	**1,849**	7,029
Impact of deferred tax rate change in respect of the pension schemes	9	**(624)**	(1,095)
		(6,481)	(21,100)
Total comprehensive income for the year		**32,653**	21,918

All transactions relate to the equity holders of the Company.

Group statement of financial position
as at 31 March 2013

	Note	2013 £000	2012 £000
Non-current assets			
Intangible assets	12	**7,816**	6,274
Property, plant and equipment	13	**1,143,773**	1,083,004
Investments	15	**190,013**	190,013
		1,341,602	1,279,291
Current assets			
Inventories	16	**136**	232
Trade and other receivables	17	**58,768**	53,938
Cash and cash equivalents	18	**99,494**	27,666
		158,398	81,836
Total assets		**1,500,000**	1,361,127
Current liabilities			
Financial liabilities - Loans and borrowings	19	**(4,149)**	(4,066)
Trade and other payables	21	**(93,161)**	(80,307)
Deferred income	25	**(3,408)**	(3,372)
Provisions	20	**(1,728)**	(1,535)
		(102,446)	(89,280)
Non-current liabilities			
Loans and borrowings	19	**(840,442)**	(732,656)
Trade and other payables	19	**(955)**	(596)
Derivative financial instruments	19/23	**(81,917)**	(64,221)
Deferred tax liabilities	9	**(130,020)**	(132,325)
Defined benefit pension liability	24	**(41,363)**	(43,545)
Deferred income	25	**(55,034)**	(52,334)
		(1,149,731)	(1,025,677)
Total liabilities		**(1,252,177)**	(1,114,957)
Net assets		**247,823**	246,170
Equity			
Ordinary share capital	26	**49,312**	49,312
Capital redemption reserve	27	**4,000**	4,000
Retained earnings	27	**194,511**	192,858
Total equity	27	**247,823**	246,170

Group statement of financial position
as at 31 March 2013

The accompanying notes are an integral part of this balance sheet.

The consolidated financial statements on pages 33 to 72 were approved by the Board of Directors on 5 July 2013 and were signed on its behalf by:

P Butler
Managing Director
5 July 2013

J E Stimpson
Finance Director
5 July 2013

Group statement of changes in equity
for the year ended 31 March 2013

	Issued share capital (note 26) £000	Capital redemption reserve (note 27) £000	Retained earnings (note 27) £000	Total equity £000
At 1 April 2012	49,312	4,000	192,858	246,170
Profit for the year	-	-	39,134	39,134
Other comprehensive loss	-	-	(6,481)	(6,481)
Total comprehensive income	-	-	32,653	32,653
Dividends (see note 10)	-	-	(31,000)	(31,000)
At 31 March 2013	**49,312**	**4,000**	**194,511**	**247,823**

for the year ended 31 March 2012

	Issued share capital (note 26) £000	Capital redemption reserve (note 27) £000	Retained earnings (note 27) £000	Total equity £000
At 1 April 2011	49,312	4,000	202,940	256,252
Profit for the year	-	-	43,018	43,018
Other comprehensive loss	-	-	(21,100)	(21,100)
Total comprehensive income	-	-	21,918	21,918
Dividends (see note 10)	-	-	(32,000)	(32,000)
At 31 March 2012	49,312	4,000	192,858	246,170

All transactions relate to the equity holders of the Company.

Group statement of cash flows
for the year ended 31 March 2013

	Note	**2013 £000**	2012 £000
Operating activities			
Net cash generated from operations	28	**120,566**	124,589
Interest received		**9,369**	6,025
Interest paid		**(26,497)**	(32,412)
Group tax relief paid		**(5,165)**	(4,342)
Net cash flow from operating activities		**98,273**	93,860
Investing activities			
Proceeds from sale of property, plant and equipment		**779**	799
Purchase of property, plant and equipment		**(88,562)**	(88,769)
Purchase of intangible assets		**(2,434)**	(4,388)
Fixed asset contributions received		**734**	3,568
Net cash flow used in investing activities		**(89,483)**	(88,790)
Financing activities			
Finance lease principal payments		**(1,066)**	(1,114)
Repayments of borrowings		**(3,000)**	(1)
Proceeds from new loan issue		**100,000**	-
Issue costs on new loan paid		**(1,896)**	-
Dividends paid to shareholder	10	**(31,000)**	(32,000)
Net cash flow received from/(used in) financing activities		**63,038**	(33,115)
Increase/(decrease) in cash and cash equivalents		**71,828**	(28,045)
Cash and cash equivalents at the beginning of the year		**27,666**	55,711
Cash and cash equivalents at the year end	18	**99,494**	27,666

Notes to the Group financial statements
as at 31 March 2013

1. Authorisation of financial statements and statement of compliance with IFRSs

The financial statements of South East Water Limited and its subsidiary (the "Group") for the year ended 31 March 2013 were authorised for issue by the Board of Directors on 5 July 2013 and the Statement of Financial Position was signed on the Board's behalf by Paul Butler and Jo Stimpson. South East Water Limited is a limited liability company incorporated in Great Britain and domiciled in England and Wales.

The principal accounting policies adopted by the Group are set out in note 2.

2. Accounting policies

Basis of preparation
The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the Companies Act 2006.

The Group financial statements are prepared under the historical cost convention except for pension assets and liabilities and certain financial instruments that have been measured at fair value and property, plant and equipment which was recognised at the date of transition to IFRS at deemed cost by reference to fair value.

The Group financial statements are presented in sterling and all values are rounded to the nearest thousand pounds (£000) except where otherwise indicated.

Changes in accounting policies
There have been no changes in accounting policy adopted during the year.

Basis of consolidation
The Group financial statements incorporate the financial information of South East Water Limited (the "Company") and its subsidiary South East Water (Finance) Limited.

Transactions and balances between the Company and its subsidiary have been eliminated fully on consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

Going concern
The directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements. Further details are given in the Directors' report on page 28.

Judgements and key sources of estimation uncertainty
The preparation of financial statements requires the application of judgements, estimates and assumptions by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those estimates.

The most critical judgements, estimates and assumptions are set out below.

- The remaining useful lives of infrastructure assets: the Group's infrastructure assets are a network for the supply of potable water to customers. There is no definite life of these assets, so management makes an assumption based on previous experience of the usage of the network. For the purposes of calculating depreciation on these assets a remaining life of an average of 94 years has been assumed;
- Un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year end a large volume of water has been supplied that has not been invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2013 was £24.4 million (2012: £20.0 million). The increase in un-invoiced water during the year is predominantly a result of more customers moving to measured supplies;

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

- The capitalisation of employee and other directly attributable costs: The Group determines employee costs directly attributable to capital projects based on time spent. Other directly attributable costs are then assessed and costs relating to capital projects are capitalised into individual projects. During the year £10.0 million of employee and other directly attributable costs have been capitalised (2012: £9.3 million);
- The provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions. The value of the provision for doubtful debts as at 31 March 2013 was £27.6 million (2012: £26.5 million);
- The fair value of the interest rate swap: this valuation requires the Group to make estimates about expected inflation and future interest rates, hence the valuation is subject to uncertainties. The fair value at 31 March 2013 is £81.9 million (2012: £64.2 million); and
- Pension and other post-employment benefits: the cost of defined benefit pensions schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets, and corporate bond performance projections as set out in note 24. Future salary increases and pension increases are based on expected future inflation rates. The net employee liability at 31 March 2013 is £41.3 million (2012: £43.5 million).

Revenue
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group, there has been a transfer of risk and control and the revenue can be reliably measured. All revenue arises within the United Kingdom and is recorded net of VAT. Specific recognition criteria must also be met before revenue is recognised as detailed below.

Metered and unmetered water income
Revenue is recognised when water has been delivered to the customer. Revenue includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Infrastructure charges
Infrastructure charges represent the fees charged to property developers and others for connecting new properties and water outlets to the Group's network. Such fees are recognised in the income statement when they are received.

Other income
Other income includes rechargeable works charges and charges for engineering, scientific, laboratory, billing and cash collection services. Rechargeable works represent payments received from developers for installing meters and connections to new property developments. Revenue is recognised when the work is complete.

Finance income
Finance income is recognised using the effective interest method.

Exceptional items
Exceptional items are material items of income and expense disclosed separately to enable a full understanding of the Group's financial performance.

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

Taxation
Current tax, being UK Corporation Tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred tax is provided using the liability method on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax liabilities are recognised for all taxable temporary differences except where the deferred tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences and the carry forward of unused tax assets and losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences and the carry forward of unused tax assets and losses can be utilised.

Deferred tax assets are recognised for the deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. In accordance with IAS 12 *Income Taxes,* deferred taxes are not discounted.

Dividends
Dividends are recorded in the accounts in the year in which they are approved by the Board.

Intangible assets
Software
Software intangible assets externally acquired are recognised at cost. They have finite useful lives and are amortised over 3 to 5 years on a straight-line basis. Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Employee and other costs directly attributable to intangible asset projects are capitalised in the financial statements as part of the cost of the intangible asset to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised.

Derecognition
An intangible asset is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the item, is included in the income statement in the year in which the item is derecognised.

Property, plant and equipment
Infrastructure assets
Infrastructure assets comprise a network of systems relating to water distribution. Infrastructure assets in the course of construction are depreciated from the time they are brought into use and are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets, being between 20 years for short life assets and 100 years for all other infrastructure assets.

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

Non - infrastructure assets
Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. All other non-infrastructure assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and office equipment	3-10

Derecognition
An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and useful lives
Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Capitalisation of employee and other directly attributable costs
Employee and other costs, including borrowing costs, directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs are not capitalised.

Leased Assets
Property, plant and equipment held under finance leases are capitalised at the lower of the fair value of the leased asset and the present value of the minimum lease payments. These assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Impairment of property, plant and equipment and intangible assets
At each reporting date an assessment is carried out to determine whether there is any indication that property, plant and equipment, investment and software intangible assets may be impaired. If there is an indication of impairment, the recoverable amount of the asset or respective cash-generating unit is compared to the carrying amount. Where the recoverable amount is less than the carrying amount, the asset value is reduced to the recoverable amount with an impairment loss recognised as an operating cost in the income statement in the year in which the respective assessment takes place.

Borrowing costs
Borrowing costs are incurred on the Group's general borrowings. Where appropriate borrowing costs are attributed to qualifying assets in line with IAS 23 Borrowing Costs. Otherwise borrowing costs are expensed as incurred. See note 7 for further details.

Grants and Contributions
Grants and contributions are received in respect of both infrastructure and non-infrastructure assets. These are recognised as deferred income and are released to the income statement over the life of the assets to which they relate.

Inventory
Inventory is valued at the lower of average cost or net realisable value. The stocks of treated water held by the Group are valued at nil. Consumable chemical purchases are recognised as an expense in the income statement at the point of purchase.

Work in progress for chargeable services is valued at the lower of cost and net realisable value.

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short term deposits in order to meet the interest and associated swap payments falling due in respect of listed debt and other long term borrowings.

Trade payables
Trade payables are measured at fair value and subsequently measured at amortised cost.

Financial instruments
The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term bank deposits, trade receivables and trade and other payables.

Recognition
Financial instruments are recognised on the balance sheet when the Group becomes party to the contractual provisions of the instrument. The Group determines the classification of its financial liabilities at initial recognition.

Derecognition
Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

Embedded derivatives
Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

Derivative financial instruments
The Group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

Interest bearing loans and borrowings
All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Short-term trade and other receivables
Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

Impairment of financial assets
At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced through the use of an allowance account in accordance with IAS 39 Financial Instruments: Recognition and measurement, with the loss being recognised in the income statement in the year in which the respective assessment takes place. Impaired debts are derecognised when they are assessed as irrecoverable.

Leases
Finance leases, which substantially transfer to the Group all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised, at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges related to assets prior to April 2009 were charged directly to the income statement whereas finance charges post April 2009 are capitalised as part of fixed assets as long as they are directly attributable to a qualifying asset. Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases and rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term.

Provisions
A provision is recognised when the Group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Research and development
Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised based on management's judgement that the technological and economic feasibility of a project is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Pension and other post-employment benefits
The Group accounts for pensions and other post-employment benefits under IAS 19 *Employee Benefits.* The Group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

Defined contribution plans
Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due.

Defined benefit plans
The pension scheme liability in the balance sheet represents the net present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans.

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

Notes to the Group financial statements
as at 31 March 2013

2. Accounting policies *(continued)*

The pension cost in the income statement includes current and past service cost and the effect of any settlements and curtailments. A net finance charge or credit is recognised within finance costs in the income statement and comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

All actuarial gains and losses and the related current and deferred taxation are recognised in the statement of recognised income and expense.

New standards and interpretations adopted
The Group has adopted the following new and amended IAS, IFRS and IFRC interpretations as of 1 April 2012:

International Standards (IAS/IFRSs)		Effective date
IAS 1 (amended)	Presentation of Financial Statements	1 July 2011
IFRS 1 (amended)	First Time Adoption of IFRS	1 July 2011
IFRS 7 (amended)	Financial Instruments: Disclosure	1 July 2011
IAS 12 (amended)	Income Taxes	1 January 2012

The adoption of the above standards and interpretations has had no significant impact on the financial statements of the Group or company.

New standards and interpretations not applied
As the Group prepare their financial statements in accordance with IFRS as adopted by the European Union, the application of new standards and interpretations will be subject to their having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the Group's discretion to early adoption of the standards.

At the date of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 7 (amended)	Offsetting Assets and Liabilities
IFRS 9 (amended)	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interest in Other Entities
IFRS 13	Fair Value Measurement
IAS 1 (amended)	Comprehensive Income
IAS 12 (amended)	Deferred Tax
IAS 19 (amended)	Employee Benefits
IAS 27 (amended)	Separate Financial Statements (May 2011)
IAS 28 (amended)	Investments in Associates and Joint Ventures (May 2011)
IAS 32 (amended)	Offsetting Financial Assets and Financial Liabilities

The adoption of IFRS 9 which the Group plans to adopt for the year beginning on 1 April 2015 will impact both the measurement and disclosure of Financial Instruments. The directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods.

Notes to the Group financial statements
as at 31 March 2013

3. Total income

	2013 £000	2012 £000
Revenue		
Unmetered water income	**95,340**	101,639
Metered water income	**108,681**	93,872
Other sales	**3,866**	4,556
	207,887	200,067
Other income		
Rental income	**1,222**	1,171
Sundry income	**3,867**	3,797
	5,089	4,968
Total revenue	**212,976**	205,035

All revenue is from customers within the United Kingdom.

Sundry income includes charges for billing and cash collection services amounting to £2.1 million (2012: £1.9 million), and laboratory income of £0.7 million (2012: £0.8 million).

4. Segmental analysis

The Group's revenue mainly arises from the supply of water and related activities. The activities of the Group, for management purposes, fall into three operating areas being regulated activities, non-regulated activities and new connections to the Group's network. However, because of the relative size of the latter two segments they are reported together as "Other activities" below.

The Group analyses results by segment to operating profits only so no segmental statement of financial position or statement of cash flows are presented.

The adjustment of revenue relates to work performed on the Group's network for new connections on behalf of third parties. This is reported as revenue for management purposes, but is treated as capital contributions for the purposes of these accounts.

Year ended 31 March 2013	Regulated activities £000	Other activities £000	Adjustments £000	Total £000
Total revenue	206,570	4,553	(3,236)	207,887
Operating profit	96,617	4,918	-	101,535
Investment income				5,789
Finance costs				(65,584)
Profit before taxation				41,740
Taxation				(2,606)
Profit for the year				**39,134**

Notes to the Group financial statements
as at 31 March 2013

4. Segmental analysis *(continued)*

Year ended 31 March 2012	Regulated activities £000	Other activities £000	Adjustments £000	Total £000
Total revenue	194,008	10,690	(4,631)	200,067
Operating profit	93,370	5,761	-	99,131
Investment income				5,904
Finance costs				(62,682)
Profit before taxation				42,353
Taxation				665
Profit for the year				43,018

5. Group net operating costs

	Note	**2013 £000**	2012 £000
Employee benefits expense excluding exceptional item	6	**22,178**	19,290
Exceptional item: pension curtailment gain (see below)	24	**(4,245)**	-
Asset expense/(income):			
Depreciation – owned assets		**29,317**	25,410
Depreciation – leased assets		**1,426**	1,426
Amortisation of intangible assets		**2,189**	1,573
Loss/(profit) on disposal of non-current assets		**151**	(668)
		33,083	27,741
Other operating expenses:			
Operating lease rentals:			
vehicles and office equipment		**127**	112
land and buildings		**403**	443
Fees payable to the Group's auditor		**184**	176
Other expenses (see page 47)		**64,379**	62,603
Other operating expenses charged to capital projects		**(4,668)**	(4,461)
		60,425	58,873
		111,441	105,904

During the year curtailment gains of £4.2 million arising from changes to the Group's defined benefit pension schemes, which came into effect on 13 December 2012, have been classified as an exceptional item. The gains arose as a result of changes to the schemes' benefits, which have reduced future liabilities. The directors consider that, due to the materially and the one-off nature of these curtailment gains, it is appropriate to classify them as exceptional items in order to show a true and fair view of the Group's underlying performance. The tax charge on the exceptional items is £1.0 million. The exceptional items had £nil impact on the Group's cash flows.

Notes to the Group financial statements
as at 31 March 2013

5. Group net operating costs *(continued)*

	2013 **£000**	2012 £000
Fees payable to the Group's auditor in respect of:		
Audit of the Group and Company financial statements	**100**	100
Audit of subsidiary	**8**	10
Total audit	**108**	110
Audit related assurance services	**28**	28
Services relating to taxation	**21**	31
Other	**27**	7
Total other non-audit services	**48**	38
Total non-audit services	**76**	66
Total fees	**184**	176
Other expenses comprise:		
Energy costs	**12,751**	13,108
Rates	**13,728**	12,947
Contractors	**10,058**	9,384
Bulk water supplies and abstraction licences	**9,230**	8,747
Bad debts	**2,718**	3,458
Chemicals	**2,365**	2,353
Insurance	**2,729**	2,614
Other	**10,800**	9,992
	64,379	62,603

6. Directors and employees

The average monthly number of persons, including salaried directors, employed by the Group in the year was:

	2013 **Number**	2012 Number
Operations	**489**	482
Management and administration	**260**	248
	749	730

Notes to the Group financial statements
as at 31 March 2013

6. Directors and employees *(continued)*

	Note	2013 £000	2012 £000
The aggregate payroll costs of these persons were:			
Wages and salaries		**22,764**	20,237
Social security costs		**2,289**	1,970
Pension costs for defined benefit schemes	24	**2,099**	1,636
Pension costs for defined contribution schemes	24	**237**	168
		27,389	24,011
Less: direct salary costs charged to capital projects		**(5,211)**	(4,721)
		22,178	19,290
Exceptional item: pension curtailment gain (see note 5)		**(4,245)**	-

Emoluments of the directors, who are the Group key management, were:

	2013 £000	2012 £000
Aggregate emoluments including bonuses	**1,262**	1,165
Company contributions to defined contribution scheme	**9**	9
	1,271	1,174
Emoluments of the highest paid director were:		
Aggregate emoluments including bonuses	**277**	331

Retirement benefits are accruing to four directors (2012: four) under the defined benefit pension schemes and one director (2012: one) under a defined contribution scheme. Further disclosure in respect of Directors' emoluments are set out in the Regulated Accounts of the company which are available on the Company's website.

7. Finance costs

	Note	2013 £000	2012 £000
Debenture interest		**427**	672
Effective interest on listed debt		**22,125**	20,610
Fair value movements on interest rate swap		**17,697**	14,767
Indexation on variable rate bonds		**6,274**	5,826
Bank interest and other finance charges		**563**	899
Financing guarantee fees		**1,457**	1,388
Interest payable on finance leases		**289**	369
Interest payable on index linked loans		**8,074**	7,799
Indexation on index linked loans		**7,049**	10,573
Amortisation of loan issue costs		**509**	472
Pension fund finance charge	24	**2,784**	752
Interest payable		**67,248**	64,127
Interest capitalised		**(1,664)**	(1,445)
		65,584	62,682

Interest capitalised during the year amounted to £1.7 million (2012: £1.4 million) and is calculated using the weighted average interest rate of the Group's long-term lending of 4.03% (2012: 4.39%).

Notes to the Group financial statements
as at 31 March 2013

8. Finance income

	2013 £000	2012 £000
Interest receivable on bank balances and short-term deposits	**504**	370
Interest receivable from group undertakings	**5,285**	5,534
	5,789	5,904

9. Taxation

Major components of the tax expense for the years ended 31 March 2013 and 2012 are:

	2013 £000	2012 £000
Group income statement		
Current tax:		
Current UK tax charge	**3,938**	4,331
Amounts over provided in previous years	**(252)**	(101)
	3,686	4,230
Deferred tax:		
Relating to origination and reversal of temporary differences	**5,189**	7,226
Impact of deferred tax rate change	**(6,269)**	(12,121)
	(1,080)	(4,895)
Tax charge/(credit) reported in the group income statement	**2,606**	(665)
Tax credit to equity		
Deferred tax on defined benefit pension schemes	**(1,849)**	(7,029)
Impact of deferred tax rate change in respect of the pension schemes	**624**	1,095
Tax reported in equity	**(1,225)**	(5,934)

Factors affecting the tax charge for the year

The tax for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	2013 £000	2012 £000
Profit before tax	**41,740**	42,353
Profit multiplied by the rate of corporation tax in the UK of 24% (2012: 26%)	**10,018**	11,012
Effects of:		
Adjustments to current tax charge in respect of previous periods	**(252)**	(101)
Adjustments to deferred tax charge in respect of previous periods	**(384)**	534
Expenses not deductible for tax purposes	**256**	8
Rolled over gains	**(763)**	3
Impact of rate change on deferred tax	**(6,269)**	(12,121)
Total tax charge/(credit) reported in the group income statement	**2,606**	(665)

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 23% (2012: 24%).

Notes to the Group financial statements
as at 31 March 2013

9. Taxation *(continued)*

Deferred tax
The movement on the net deferred tax liability is as shown below:

	2013 **£000**	2012 £000
At 1 April	**132,325**	143,154
Credit to the income statement	**(1,080)**	(4,895)
Credit to equity	**(1,225)**	(5,934)
At 31 March	**130,020**	132,325

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered by giving relief against future taxable profits.

The movements in deferred tax assets and liabilities during the year are shown below:

	Accelerated tax depreciation £000	Rolled over gains £000	Total £000
Deferred tax liabilities			
At 1 April 2011	163,485	860	164,345
Credit to the income statement	(6,437)	(64)	(6,501)
At 1 April 2012	157,048	796	157,844
Credit to the income statement	(704)	(796)	(1,500)
At 31 March 2013	156,344	-	156,344

	Fair value Swap £000	Deferred income £000	Pension provision £000	Other provision £000	Total £000
Deferred tax assets					
At 1 April 2011	1,763	12,949	6,331	148	21,191
Credit/(charge) to the income statement	530	(312)	(1,814)	(10)	(1,606)
Credit to equity	-	-	5,934	-	5,934
At 1 April 2012	2,293	12,637	10,451	138	25,519
Credit/(charge) to the income statement	1,607	110	(2,163)	26	(420)
Credit to equity	-	-	1,225	-	1,225
At 31 March 2013	3,900	12,747	9,513	164	26,324

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax liability at 31 March 2013 was £130.0 million (2012: £132.3 million).

Capital investment is expected to remain at similar levels and the Group expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Limited group of companies.

Notes to the Group financial statements
as at 31 March 2013

9. Taxation *(continued)*

A reduction in the headline rate of corporation tax from 24% to 23% starting from 1 April 2013 was enacted in the 2012 Finance Bill of 3 July 2012. As the rate change was enacted by the balance sheet date, deferred tax balances have been calculated at the new rate of 23%.

Further reductions to 21% by 1 April 2014 and 20% by 1 April 2015 have also been announced. If enacted these rate changes will affect the amount of future cash tax payments to be made by the Group and will also reduce the size of the Group's balance sheet deferred tax liability in the future.

10. Dividends

	2013 £000	2012 £000
Equity dividends paid during the year:		
First interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share)	**7,750**	8,000
Second interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share)	**7,750**	8,000
Third interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share)	**7,750**	8,000
Final dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share)	**7,750**	8,000
	31,000	32,000

There were no dividends proposed for approval as at 31 March 2013 and 31 March 2012.

11. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

The following reflects the income and shares data used in the basic and diluted earnings per share computations:

	2013 £000	2012 £000
Profit for the year	**39,134**	43,018
	Number	Number
Basic and diluted weighted average number of shares	**49,312,354**	49,312,354
Basic and diluted earnings per share	**79.36p**	87.24p

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

Notes to the Group financial statements
as at 31 March 2013

12. Intangible assets

	Computer software £000
Cost	
At 1 April 2012	19,696
Additions	3,731
Disposals	(123)
At 31 March 2013	**23,304**
Amortisation	
At 1 April 2012	(13,422)
Charge for the year	(2,189)
Eliminated on disposals	123
At 31 March 2013	**(15,488)**
Net book amount at 31 March 2013	**7,816**
Cost	
At 1 April 2011	16,709
Additions	4,388
Disposals	(1,401)
At 31 March 2012	19,696
Amortisation	
At 1 April 2011	(13,236)
Charge for the year	(1,573)
Eliminated on disposals	1,387
At 31 March 2012	(13,422)
Net book amount at 31 March 2012	6,274

Notes to the Group financial statements
as at 31 March 2013

13. Property, plant and equipment

	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Assets in the course of construction £000	Total £000
Cost					
At 1 April 2012	207,040	708,791	278,314	82,838	1,276,983
Reclassification	(303)	(118)	421	-	-
Additions	-	-	-	92,442	92,442
Transfers	11,329	45,068	21,472	(77,869)	-
Disposals	(1,047)	(2,410)	(4,255)	-	(7,712)
At 31 March 2013	217,019	751,331	295,952	97,411	1,361,713
Accumulated depreciation					
At 1 April 2012	(30,596)	(46,287)	(117,096)	-	(193,979)
Charge for the year	(2,799)	(10,221)	(17,723)	-	(30,743)
Eliminated on disposals	192	2,410	4,180	-	6,782
At 31 March 2013	(33,203)	(54,098)	(130,639)	-	(217,940)
Net book amount at 31 March 2013	**183,816**	**697,233**	**165,313**	**97,411**	**1,143,773**
Net book amount of leased assets included above	3,840	706	7,871		12,417
Assets under construction relate to the following categories	4,915	51,811	40,685		97,411
Cost					
At 1 April 2011	194,656	646,776	259,860	101,825	1,203,117
Additions	-	-	1,190	82,960	84,150
Transfers	12,418	63,525	26,004	(101,947)	-
Disposals	(34)	(1,510)	(10,201)	-	(11,745)
At 31 March 2012	207,040	708,791	276,853	82,838	1,275,522
Accumulated depreciation					
At 1 April 2011	(27,457)	(40,533)	(109,320)	-	(177,310)
Charge for the year	(3,141)	(7,264)	(16,431)	-	(26,836)
Eliminated on disposals	2	1,510	10,116	-	11,628
At 31 March 2012	(30,596)	(46,287)	(115,635)	-	(192,518)
Net book amount at 31 March 2012	176,444	662,504	161,218	82,838	1,083,004
Net book amount of leased assets included above	3,966	706	8,309	-	12,981
Assets under construction relate to the following categories	9,892	42,135	30,811	-	82,838

The Group’s index linked loans and listed bonds are secured on certain assets of the Group (see note 19).

Notes to the Group financial statements
as at 31 March 2013

14. Investments in subsidiaries

Details of the Company's subsidiary, the results of which are included in the Group financial statements at 31 March 2013 and 31 March 2012 are as follows:

Name of subsidiary	Place of incorporation	Principal activity	Ownership interest %	Voting rights held %
South East Water (Finance) Limited	Cayman Islands	Finance Company	100	100

South East Water (Finance) Limited's principle purpose is to raise listed debt on behalf of South East Water Limited and any proceeds from such issues are lent on to South East Water Limited. South East Water (Finance) Limited is tax resident in the UK.

15. Investments

	2013 £000	2012 £000
Non-current assets		
Loans receivable carried at amortised cost		
Amount due from parent due in more than one year	**190,013**	190,013

The amount due from parent undertaking falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus 2%.

16. Inventories

	2013 £000	2012 £000
Consumables	**78**	78
Work in progress	**58**	154
	136	232

17. Trade and other receivables

	2013 £000	2012 £000
Financial asset receivables		
Trade receivables	**28,483**	27,984
Accrued income	**24,364**	20,040
Amounts due from parent and fellow subsidiary undertakings due within one year	**21**	229
	52,868	48,253
Non-financial asset receivables		
Prepayments and accrued income	**3,366**	3,198
Other receivables	**2,534**	2,487
	5,900	5,685
Total trade and other receivables	**58,768**	53,938

All trade receivables at 31 March 2013 and 31 March 2012 are denominated in sterling.

Notes to the Group financial statements
as at 31 March 2013

17. Trade and other receivables *(continued)*

Trade receivables are stated after provision for doubtful debts of £27.6 million (2012: £26.5 million). They are non-interest bearing and generally for immediate settlement. Receivables are determined to be impaired where there is a poor payment history or insolvency of the debtor and are fully or partially provided for.

Movements in the provision for impairment of receivables were as follows:

	2013 £000	2012 £000
Provision brought forward	**26,545**	26,597
Charge for the year	**2,718**	3,458
Amounts written off	**(1,621)**	(3,510)
Provision carried forward	**27,642**	26,545

As at 31 March, the analysis of trade receivables is as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2013	28,483	4,281	4,299	2,299	1,332	1,259	9,232	5,781
2012	27,984	4,302	3,750	2,111	1,271	1,162	8,912	6,476

18. Cash and cash equivalents

Cash and cash equivalents comprise the following at 31 March:

	2013 £000	2012 £000
Cash at bank and in hand	**15,670**	3,166
Short-term bank deposits	**83,824**	24,500
	99,494	27,666

At 31 March 2013, £18.2 million (2012: £13.1 million) of restricted cash is held in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 19).

19. Financial liabilities

	2013 £000	2012 £000
Non-current liabilities: summary analysis		
Loans and borrowings	840,442	732,656
Derivative financial instruments – Inflation swap	81,917	64,221
Trade and other payables	955	596
	923,314	797,473

Notes to the Group financial statements
as at 31 March 2013

19. Financial liabilities *(continued)*

		2013 £000	2012 £000
Loans and borrowings: detailed analysis			
Irredeemable debenture stock	(i)	**1,048**	1,048
Redeemable debenture stock	(ii)	**-**	3,000
Listed bonds due after five years	(iii)	**509,421**	504,660
Index linked loans	(iv)	**328,736**	221,562
Obligations under finance leases	(v)	**1,237**	2,386
		840,442	732,656
Trade and other payables: detailed analysis			
Trade payables	(vi)	**735**	336
Financial guarantee fees received in advance	(vi)	**220**	260
		955	596
Current liabilities			
11 % debenture stock 2012/2016	(ii)	**-**	3,000
10 % debenture stock 2013/2017	(ii)	**3,000**	-
Obligations under finance leases	(v)	**1,149**	1,066
		4,149	4,066
(i) Irredeemable debenture stock			
3 % perpetual stock		**26**	26
3 ½ % perpetual stock		**391**	392
4 % perpetual stock		**178**	176
5 % perpetual stock		**415**	415
5 ½ % perpetual stock		**1**	2
6 % perpetual stock		**37**	37
		1,048	1,048
(ii) Redeemable debenture stock			
11 % debenture stock 2012/2016		**-**	3,000
10 % debenture stock 2013/2017		**3,000**	3,000
		3,000	6,000

Redeemable debenture stocks are redeemable at par in the year stated. Where more than one redemption year is quoted it is at the Group's option to redeem the stock at any time between the dates stated. Interest on irredeemable and redeemable debenture stock is payable six monthly.

The Group redeemed the entire stock of 10% redeemable debentures on 30 June 2013 at par.

Notes to the Group financial statements

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19. Financial liabilities *(continued)*

(iii) Listed bonds due after five years

The Group holds £496 million (2012: £496 million) of bonds listed on the London Stock Exchange, with effective terms, having taken account of a related interest rate swap, as follows:

- £200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Group);
- £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Group); and
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the Group).

Issue costs incurred by the Group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the loan repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the loan repayable in 2041 under the terms of the loan.

Listed bonds are stated at the original consideration received plus accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Total £000
2013				
Original loan consideration	200,000	166,000	130,000	496,000
Indexation on bonds	-	-	18,014	18,014
Less: unamortised issue costs	(1,408)	(1,768)	(1,417)	(4,593)
Listed bonds due after five years	198,592	164,232	146,597	509,421
2012				
Original loan consideration	200,000	166,000	130,000	496,000
Indexation on bonds	-	-	13,630	13,630
Less: unamortised issue costs	(1,624)	(1,879)	(1,467)	(4,970)
Listed bonds due after five years	198,376	164,121	142,163	504,660

(iv) Index linked loans

The Group holds £269 million of index linked loans with effective terms as follows:

- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the Group);
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the Group); and
- £100 million at a variable rate linked to inflation (taken out during the year), falling due for repayment on 1 December 2037 (or earlier at the option of the Group).

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the Group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

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19. Financial liabilities *(continued)*

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2013				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	51,932	9,667	1,889	63,488
Less: unamortised issue costs	(1,606)	(287)	(1,859)	(3,752)
Loans due after five years	185,326	43,380	100,030	328,736
2012				
Original loan amounts	135,000	34,000	-	169,000
Indexation on bonds	46,218	8,332	-	54,550
Less: unamortised issue costs	(1,688)	(300)	-	(1,988)
Loans due after five years	179,530	42,032	-	221,562

Indexation accrues on the loan repayable in 2037 under the terms of the loan.

The irredeemable and redeemable debentures, listed bonds and index linked loans detailed in (i), (ii), (iii) and (iv) above respectively are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence. The agreements for the bonds and loans contain a number of covenants that the Group is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Managing Director's report on page 7.

(v) Finance leases

The Group has finance lease contracts for various items of plant and machinery. Future minimum lease payments under finance leases, together with the present value of the net minimum lease payments are as follows:

	Minimum payments 2013 £000	**Present value of payments 2013 £000**	Minimum payments 2012 £000	Present value of payments 2012 £000
Within one year	**1,332**	**1,149**	1,332	1,066
In second to fifth years	**1,333**	**1,237**	2,665	2,386
	2,665	**2,386**	3,997	3,452
Less: future finance charges	**(279)**		(545)	
Present value of minimum lease payments	**2,386**		3,452	
Non-current		**1,237**		2,386
Current		**1,149**		1,066
		2,386		3,452

Each finance lease is secured against the asset to which it relates, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence. Each lease can be cancelled before its termination date or renewed for a secondary period at the option of the Group.

Notes to the Group financial statements
as at 31 March 2013

19. Financial liabilities *(continued)*

(vi) Trade and other payables
Trade and other payables comprise financing guarantee fees of £220,000 (2012: £260,000) and deposits payable to developers of £735,000 (2012: £336,000). Financing guarantee fees waived comprises cash received in advance to settle fees in connection with the £200 million listed debt raised (see (iii)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

20. Provisions

	2013	2012
	£000	£000
As at 1 April	1,535	1,308
Additional provisions	1,353	1,182
Amounts utilised	(1,160)	(955)
As at 31 March	1,728	1,535

Provisions largely comprise compensation payments in excess of the Group's insurance cover of £1.6 million (2012: £1.5 million). It is anticipated that all provisions will be utilised in the current year.

21. Trade and other payables

	2013	2012
	£000	£000
Financial liability payables		
Trade payables	**13,587**	14,182
Amounts due to parent and fellow subsidiary undertakings	**10,728**	12,349
Other payables	**501**	300
Accruals	**40,108**	26,488
	64,924	53,319
Non-financial liability payables		
Payments received in advance	**27,426**	26,156
Other taxes and social security	**811**	832
	28,237	26,988
	93,161	80,307

As at 31 March 2013 and 2012, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to the surrender of group tax relief.

22. Financial instruments

Financial risk management objectives and policies
The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term deposits and trade receivables and trade and other payables. The main purpose of the Group's financial instruments other than the interest rate swap is to raise finance for the Group's operations.

Notes to the Group financial statements
as at 31 March 2013

22. Financial instruments *(continued)*

Derivative activity is undertaken as determined by the Board of Directors. The Board considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The Group does not use derivative financial instruments for speculative purposes.

The Group's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Group's policy to minimise liquidity risk within an acceptable range of interest rates. The Group does not use foreign currency financial instruments. The main risks arising from the Group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the Group.

Interest rate and cash flow risk
The Group finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans. Bonds comprise long-term fixed rate loans and long-term variable rate loans which have been linked to inflation, partly through the use of an interest rate swap. The interest rate swap is used in order to reflect movements in the expected future income of the Group. Long-term index linked loans comprise loans linked to inflation. Finance leases are fixed rate instruments. The Group's policy is to manage short-term interest rate risk by using short-term fixed rate draw downs under a committed facility. During the year to 31 March 2013 there was a net inflow of £94.0 million from financing activities within the Group (excluding dividend payments) (2012: outflow of £1.1 million). It is the view of the Group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the Group.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, on the Group's profit before tax (through the impact on floating rate borrowings). The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments.

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on Shareholders' equity £000
2013			
Sterling	+200	(4,800)	(3,648)
Sterling	-200	4,800	3,648
2012			
Sterling	+200	(2,800)	(2,072)
Sterling	-200	2,800	2,072

Liquidity risk
The Group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below and in note 19. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

Inflation risk
The Group manages its inflation risk on its financial liabilities through the use of an interest rate swap and other index linked bonds and loans (note 19). The Group considers that the inflation rate risk is effectively managed as OFWAT allows revenues to be increased in line with inflation.

Notes to the Group financial statements
as at 31 March 2013

22. Financial instruments *(continued)*

Credit risk
The Group's financial assets include a loan due from its parent undertaking, short-term and medium-term bank deposits and trade receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets. The Group's credit risk is primarily attributable to its trade receivables, which are stated in the balance sheet at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions (see note 17). The Group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Capital management risk
The objectives and management of the Group's capital management risk are discussed in the Directors' report on page 27.

Fair values of financial assets and financial liabilities
Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. In the opinion of the directors, the fair values of the financial assets and liabilities of the Group (apart from the specific items shown in the fair value table below) are not materially different from the book values. The fair value of the Group's long-term borrowings has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

The following tables provide a comparison by category of the carrying amount and the fair values of the Group's financial assets and financial liabilities at 31 March 2013.

	Note	**Book Value 2013 £000**	**Fair Value 2013 £000**	Book Value 2012 £000	Fair Value 2012 £000
Loans and receivables					
Trade receivables	17	**52,868**	**52,868**	48,253	48,253
Cash	18	**99,494**	**99,494**	27,666	27,666
Amounts due from parent	15	**190,013**	**190,013**	190,013	190,013
		342,375	**342,375**	265,932	265,932
Financial liabilities at amortised cost					
Trade and other payables	21	**54,196**	**54,196**	40,970	40,970
Finance leases	19	**2,386**	**2,386**	3,452	3,452
Redeemable debentures	19	**3,000**	**3,000**	6,000	6,000
Irredeemable debentures	19	**1,048**	**737**	1,048	737
Listed bonds	19	**514,014**	**545,433**	509,630	541,049
Index linked loans	19	**332,488**	**429,752**	223,550	244,536
Amounts due to parent and group undertakings	21	**10,728**	**10,728**	12,349	12,349
		917,860	**1,046,232**	796,999	849,093
At fair value through profit and loss account					
Interest rate swap	23	**81,917**	**81,917**	64,221	64,221

Notes to the Group financial statements
as at 31 March 2013

22. Financial instruments *(continued)*

The net book values of listed bonds, redeemable fixed rate debentures and the interest rate swap are considered to equate to their fair value. Due to the majority of the Group's income being index-linked through the five-year pricing reviews, it is the opinion of the Directors that net book value fairly reflects the future exposure of the Group to these financial liabilities. The net book value is considered to equate to the fair value for trade receivables and trade and other payables due to the short maturity of the amounts receivable and payable. The fair value of fixed rate finance leases have been calculated using discounted cash flow methods using appropriate discount rates in effect at the balance sheet dates.

For all other financial instruments the net book value is considered to equate to the fair value of future cash flows which are discounted at the effective interest rate of the respective financial instrument.

Maturity of financial instruments
The table below summarises the maturity profile of the Group's financial assets and liabilities based on contractual undiscounted payments:

Year ended 31 March 2013	Within 1 year £000	1 – 2 years £000	2 – 5 Years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Finance leases	1,332	1,333	-	-	2,665
Irredeemable debentures	45	45	135	1,170	1,395
Redeemable debentures	3,075	-	-	-	3,075
Listed bond	9,268	9,268	27,805	277,221	323,562
Total fixed rate financial liabilities	13,720	10,646	27,940	278,391	330,697
Floating rate					
Floating rate financial assets:					
Short-term financial assets	52,868	-	-	-	52,868
Long-term financial assets	5,159	5,159	15,477	274,274	300,069
Total floating rate financial assets	58,027	5,159	15,477	274,274	352,937
Floating rate financial liabilities:					
Short-term financial liabilities	64,924	-	-	-	64,924
Listed bond	15,089	15,187	46,146	618,713	695,135
Interest rate swap	(3,185)	(2,896)	(6,904)	126,248	113,263
Index linked loans	10,627	10,878	34,112	665,761	721,378
Total floating rate financial liabilities	87,455	23,169	73,354	1,410,722	1,594,700

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

Notes to the Group financial statements
as at 31 March 2013

22. Financial instruments *(continued)*

Year ended 31 March 2012	Within 1 year £000	1 – 2 years £000	2 – 5 Years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Finance leases	1,332	1,332	1,333	-	3,997
Irredeemable debentures	45	45	135	1,170	1,395
Redeemable debentures	3,465	3,007	-	-	6,472
Listed bond	9,268	9,268	27,805	286,490	332,831
Total fixed rate financial liabilities	14,110	13,652	29,273	287,660	344,695
Floating rate					
Floating rate financial assets:					
Short-term financial assets	48,253	-	-	-	48,253
Long-term financial assets	5,159	5,159	15,477	279,433	305,228
Total floating rate financial assets	53,412	5,159	15,477	279,433	353,481
Floating rate financial liabilities:					
Short-term financial liabilities	53,319	-	-	-	53,319
Listed bond	15,073	15,162	46,078	628,230	704,543
Interest rate swap	(3,420)	(3,169)	(8,091)	122,569	107,889
Index linked loans	8,086	8,247	25,809	505,332	547,474
Total floating rate financial liabilities	73,058	20,240	63,796	1,256,131	1,413,225

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The Group held the following financial instruments measured at fair value:

31 March 2013	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Financial liabilities at fair value through profit and loss account				
Interest rate swap	81,917	-	81,917	-
31 March 2012				
Financial liabilities at fair value through profit and loss account				
Interest rate swap	64,221	-	64,221	-

During the reporting period ending 31 March 2013, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

Notes to the Group financial statements
as at 31 March 2013

22. Financial instruments *(continued)*

Borrowing facilities
The Group has committed borrowing facilities of £137.0 million (2012: £130.9 million), of which £nil (2012: £nil) was drawn down. Any draw downs under these facilities are repayable in less than one year.

Items of income, expense, gains and losses
The net gains or losses of the different classes of financial instruments on the income statement are:

	2013 £000	2012 £000
Financial assets, loans and receivables (see note 8)	**5,789**	5,904
Financial liabilities at amortised cost (see note 7)	**(45,103)**	(47,163)
Financial liabilities at fair value through profit or loss (see note 7)	**(17,697)**	(14,767)
Financial assets due to impairment (see note 17)	**(2,718)**	(3,458)

23. Derivative financial instruments

	2013 £000	2012 £000
Interest rate swap	**81,917**	64,221

As at 31 March 2013 the interest rate swap is stated at its fair value of a liability of £81.9 million (2012: £64.2 million). The increase of the fair value of the liability of £17.7 million (2012: £14.8 million) during the year has been recognised in the income statement in finance costs (see note 7).

24. Retirement benefit schemes

The South East Water pension scheme provides benefits to Company and former Company employees. Up until 17 June 2011, benefits were provided on either a defined benefit basis or a defined contribution basis depending on the category of membership. On 17 June 2011, all assets and liabilities of the defined contribution section of the scheme were transferred to a newly set-up separate pension scheme. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided on a defined benefit basis only.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the Company decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the Company has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Company contribution rate was 33.8% (2012: 30.2%) of pensionable remuneration during the year plus an annual contribution of £5.95 million (2012: £5.95 million). The Company's future contribution rate is expected to be 33.8% of pensionable salary plus an annual contribution of £5.95 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2012 for the year to 31 March 2013). The overall gross expected return on assets used for the start year figures was 4.79% p.a. (2012: 5.23%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 65.

Notes to the Group financial statements
as at 31 March 2013

24. Retirement benefit schemes *(continued)*

The pension expense for the year to 31 March 2013 takes account of assumptions set at the start of the year (i.e. as at 1 April 2012). The calculation of the pension expense for the year to 31 March 2013 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2013 are equivalent to a deduction of 0.6% (2012: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 4.19% (2012: 4.63%) has been used in the calculation of the 2013 pension cost.

As a result of the merger of SEW Limited and MKW Limited in October 2006, the Company acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Company contributed 36.1% (2012: 27%) of pensionable remuneration plus £1.35 million (2012: £1.35 million) in respect of the deficit as at 31 March 2013 to the scheme during the year. The Company's future contribution rate is expected to be 36.1% of pensionable salary plus an annual contribution of £1.35 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2012 for the year to 31 March 2013). The overall gross expected return on assets used for the start year figures was 3.99% p.a. (2012: 3.99%).

On 31 March 2015 both of the Group's defined benefit schemes will close to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members will become deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members will be invited to join the Group's deferred contribution scheme from 1 April 2015. These changes to the future status of the schemes have led to a curtailment of future liabilities of the schemes of £4.25 million as detailed below.

Pension costs recognised in the profit and loss account for the defined contribution scheme were as follows:

	2013 £000	2012 £000
Defined contribution scheme	**237**	168

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2013 %	SEW Pensions 2012 %	**MKW Pensions 2013 %**	MKW Pensions 2012 %
Main assumptions:				
Rate of increase in salaries	**3.60**	3.55	**3.60**	3.55
Rate of increase in pensions in payment	**2.35**	2.30	**3.35**	3.30
Rate of increase in deferred pensions	**2.35**	2.30	**2.35**	2.30
Discount rate	**4.15**	4.80	**4.15**	4.80
RPI assumption	**3.35**	3.30	**3.35**	3.30
CPI assumption	**2.35**	2.30	**2.35**	2.30

Post-retirement mortality (in years)

	SEW Pensions 2013	SEW Pensions 2012	**MKW Pensions 2013**	MKW Pensions 2012
Current pensioners at 65 – male	**23.9**	23.7	**23.9**	23.7
Current pensioners at 65 – female	**25.7**	25.6	**25.7**	25.6
Future pensioners at 65 – male	**26.7**	26.6	**26.7**	26.6
Future pensioners at 65 – female	**27.9**	27.8	**27.9**	27.8

Notes to the Group financial statements
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24. Retirement benefit schemes *(continued)*

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities £000	(Decrease)/ increase %
0.1% increase to the discount rate	(2,600)	(1.0)
0.1% decrease to inflation	(2,600)	(1.0)
0.1% increase to salary growth	17	0.0
One year increase in life expectancy	5,900	2.3

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Market Value £000	Total £000
2013					
Equities	6.25	41,870	6.25	26,502	68,372
Corporate bonds	3.55	44,518	3.55	30,147	74,665
Government bonds	2.45	31,557	2.45	30,900	62,457
Property	4.05	11,117	4.05	8,229	19,346
Other	-	720	-	-	720
Cash	0.50	395	0.50	596	991
Total fair value of assets		130,177		96,374	226,551
Present value of funded obligations		(159,159)		(104,566)	(263,725)
Net under funding in funded plans		(28,982)		(8,192)	(37,174)
Present value of unfunded obligations		(4,189)			(4,189)
Deficit in the schemes		**(33,171)**		**(8,192)**	**(41,363)**

Notes to the Group financial statements
as at 31 March 2013

24. Retirement benefit schemes *(continued)*

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Expected long-term rates of return %	Market Value £000
2012					
Equities	6.50	40,021	6.85	28,648	68,669
Corporate bonds	4.20	38,644	4.55	19,339	57,983
Government bonds	2.70	19,747	3.05	25,124	44,871
Property	4.30	14,782	4.65	4,291	19,073
Cash	0.50	3,791	0.50	11,747	15,538
Total fair value of assets		116,985		89,149	206,134
Present value of funded obligations		(141,945)		(103,611)	(245,556)
Net under funding in funded plans		(24,960)		(14,462)	(39,422)
Present value of unfunded obligations		(4,123)		-	(4,123)
Deficit in the schemes		(29,083)		(14,462)	(43,545)

Equity investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return investments.

Analysis of amounts charged to operating profit:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Current service cost	**877**	**992**	**1,869**
Past service cost	**230**	**-**	**230**
Exceptional item: Pension curtailment gains	**(2,102)**	**(2,143)**	**(4,245)**
	(995)	**(1,151)**	**(2,146)**
2012			
Current service cost	638	873	1,511
Past service cost	-	125	125
	638	998	1,636

Notes to the Group financial statements
as at 31 March 2013

24. Retirement benefit schemes *(continued)*

Analysis of amounts charged to other finance expense:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Expected return on pension schemes' assets	5,437	3,570	9,007
Interest on pension schemes' liabilities	(6,889)	(4,902)	(11,791)
Net charge to other finance expense	**(1,452)**	**(1,332)**	**(2,784)**
2012			
Expected return on pension schemes' assets	6,372	4,782	11,154
Interest on pension schemes' liabilities	(7,064)	(4,842)	(11,906)
Net charge to other finance expense	(692)	(60)	(752)

Analysis of amounts recognised in the statement of total recognised gains and losses:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Actual return less expected return on pension schemes' liabilities	(17,433)	(1,185)	(18,618)
Experience gains arising on the schemes' assets	5,948	4,964	10,912
Actuarial (loss)/gain recognised in the statement of total recognised gains and losses	(11,485)	3,779	(7,706)
Cumulative actuarial losses	**(28,004)**	**(30,412)**	**(58,416)**
2012			
Actual return less expected return on pension schemes' liabilities	(15,475)	(13,493)	(28,968)
Experience gains arising on the schemes' assets	387	726	1,113
Actuarial loss recognised in the statement of total recognised gains and losses	(15,088)	(12,767)	(27,855)
Cumulative actuarial losses	(16,519)	(34,191)	(50,710)

The cumulative actuarial loss for 2012 includes a transfer balance of £126,000 from the Mid Kent Water Limited Pension & Life Assurance Scheme.

Notes to the Group financial statements

as at 31 March 2013

24. Retirement benefit schemes *(continued)*

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Opening defined benefit obligations	146,068	103,611	249,679
Current service costs	877	992	1,869
Past service costs	230	-	230
Interest cost	6,889	4,902	11,791
Contributions by scheme participants	305	300	605
Actuarial losses	17,433	1,185	18,618
Gains on curtailments	(2,102)	(2,143)	(4,245)
Benefits paid	(6,352)	(4,281)	(10,633)
Closing defined benefit obligations	**163,348**	**104,566**	**267,914**
2012			
Opening defined benefit obligations	128,676	87,754	216,430
Transfer of obligations into scheme	-	155	155
Current service costs	638	873	1,511
Past service costs	-	125	125
Interest cost	7,064	4,842	11,906
Contributions by scheme participants	369	318	687
Actuarial losses	15,475	13,493	28,968
Benefits paid	(6,154)	(3,949)	(10,103)
Closing defined benefit obligations	146,068	103,611	249,679

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Opening fair values of schemes' assets	116,985	89,149	206,134
Expected return on assets	5,437	3,839	9,276
Contributions by scheme participants	305	300	605
Contributions by employer	7,854	2,673	10,527
Actuarial gains	5,948	4,694	10,642
Benefits paid	(6,352)	(4,281)	(10,633)
Closing fair values of schemes' assets	**130,177**	**96,374**	**226,551**
2012			
Opening fair values of schemes' assets	108,209	83,872	192,081
Transfer of assets into scheme	-	976	976
Expected return on assets	6,372	4,782	11,154
Contributions by scheme participants	369	318	687
Contributions by employer	7,802	2,424	10,226
Actuarial gains	387	726	1,113
Benefits paid	(6,154)	(3,949)	(10,103)
Closing fair values of schemes' assets	116,985	89,149	206,134

Notes to the Group financial statements
as at 31 March 2013

24. Retirement benefit schemes *(continued)*

The five year history of the schemes is as follows:

	2013	2012	2011	2010	2009
	£000	£000	£000	£000	£000
SEW Pensions					
Fair value of scheme assets	**130,177**	116,985	108,209	100,135	74,903
Present value of defined benefit obligation	**(163,348)**	(146,068)	(128,676)	(148,931)	(106,896)
Deficit in the scheme	**(33,171)**	(29,083)	(20,467)	(48,796)	(31,993)
Experience adjustment on schemes' assets:					
Amount	**5,948**	387	659	20,888	(30,058)
Percentage of scheme's assets (%)	**4.6%**	0.3%	0.6%	20.9%	(40.1)%
Experience adjustments on schemes' liabilities:					
Amount	**(200)**	-	-	-	3,122
Percentage of the scheme's liabilities (%)	**(0.1)%**	-	-	-	2.9%
MKW Pensions					
Fair value of plan assets	**96,374**	89,149	83,872	79,506	63,551
Present value of defined benefit obligation	**(104,566)**	(103,611)	(87,754)	(86,672)	(63,317)
(Deficit)/surplus in the scheme	**(8,192)**	(14,462)	(3,882)	(7,166)	234
Experience adjustment on schemes' assets:					
Amount	**4,694**	726	294	14,463	(13,921)
Percentage of schemes' assets (%)	**4.9%**	0.8%	0.4%	18.2%	(21.9)%
Experience adjustment on schemes' liabilities:					
Amount	**(11,500)**	-	-	-	606
Percentage of the schemes' liabilities (%)	**(11.0)%**	-	-	-	1.0%

25. Deferred income

	2013	2012
	£000	£000
As at 1 April	**55,706**	52,702
Received in the year	**8,483**	9,545
Released during the year	**(5,747)**	(6,541)
As at 31 March	**58,442**	55,706
Non-current	**55,034**	52,334
Current	**3,408**	3,372
	58,442	55,706

Amounts received towards above ground assets are released to the income statement over the period to which they are deemed to relate. Contributions received towards below ground assets are released to the income statement over the period that corresponds to the life of the asset to which the contribution relates which is typically 100 years.

Notes to the Group financial statements
as at 31 March 2013

26. Authorised and issued share capital

	2013 £000	2012 £000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2012: 49,312,354)	**49,312**	49,312

There is one class of ordinary share, which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital was £100 million at 31 March 2013 (2012: £100 million).

27. Changes in shareholder's equity

	Share capital £000	Capital redemption reserve £000	Retained earnings £000	Total £000
At 1 April 2011	49,312	4,000	202,940	256,252
Dividends paid	-	-	(32,000)	(32,000)
Total comprehensive income for the year	-	-	21,918	21,918
At 1 April 2012	49,312	4,000	192,858	246,170
Dividends paid	-	-	(31,000)	(31,000)
Total comprehensive income for the year	-	-	32,653	32,653
At 31 March 2013	49,312	4,000	194,511	247,823

Non-distributable reserves

The retained earnings of the Group includes a non-distributable reserve of £10.7 million (2012: £10.7 million) arising from the transfer of the trade and certain assets and liabilities of Mid Kent Water Limited to the Group.

The capital redemption reserve relates to the redemption of 4,000,000 8.75% redeemable preference shares on 31 March 1996.

28. Cash flow from operating activities

	2013 £000	2012 £000
Profit for the year	**39,134**	43,018
Adjustments for:		
Income tax expense	**2,606**	(665)
Finance income	**(5,789)**	(5,904)
Finance costs	**65,584**	62,682
Depreciation	**29,282**	26,836
Amortisation of intangibles	**3,650**	1,573
Loss/(profit) on disposal of fixed assets	**151**	(668)
Release of deferred income	**(639)**	(603)
Difference between pension contributions paid and amounts recognised in the income statement	**(12,672)**	(8,590)
Changes in working capital:		
(Increase)/decrease in trade and other receivables	**(4,865)**	66
Decrease in inventory	**96**	8
Increase in trade and other payables	**4,028**	6,836
Net cash generated from operations	**120,566**	124,589

Notes to the Group financial statements
as at 31 March 2013

29. Capital Commitments

	2013 £000	2012 £000
Contracts placed for future capital expenditure not provided in the financial statements	**45,915**	**49,534**

30. Obligations under operating leases

	2013 £000	2012 £000
Minimum lease payments under operating leases recognised as an expense in the year (see note 5)	**530**	555

Minimum lease payments under non-cancellable operating leases are as follows:

	Land and buildings 2013 £000	Land and buildings 2012 £000	**Vehicles and office equipment 2013 £000**	Vehicles and office equipment 2012 £000
Amounts for the following periods:				
- within one year	**381**	400	37	**95**
- between two and five years	**888**	1,125	-	**39**
	1,269	1,525	37	**134**

31. Related party transactions

The Group's joint ultimate holding companies are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, which is resident in Australia, and Caisse de dépôt et placement du Québec, which is resident in Canada. It is the directors' belief that they control the Group jointly.

The group of companies into which results of the Group are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.

Transactions with the Group's parent company
An unsecured loan to the immediate parent company South East Water (Holdings) Limited of £190 million (2012: £190 million) is disclosed in note 15 under non-current receivables. Loan interest receivable during the year was £5.3 million (2012: £5.5 million). There was no interest outstanding as at 31 March 2013 (2012: £nil) included under trade and other receivables in note 17.

Also, as at 31 March 2013 the Group has a current account debt due to its parent company of £3.6 million (2012: £3.9 million) in respect of group tax relief payable.

Transactions with other related parties
As at 31 March 2013 the Group has net current account balances due to other related parties totalling £7.0 million (2012: £8.4 million). These balances relate to group tax relief payable of £7.1 million (2012: £8.6 million) and recoverable amounts for invoices paid on behalf of other related parties of £0.1 million (2012: £0.2 million).

Key management compensation is disclosed in note 6.

Contributions to retirement benefit schemes are disclosed in note 24.

Company income statement

For the year ended 31 March 2013

	Notes	2013 £000	2012 £000
Turnover	33	**207,248**	199,464
Operating costs before exceptional item		**(132,333)**	(124,113)
Exceptional item: pension curtailment gain	35/55	**4,245**	-
Operating costs	35	**(128,088)**	(124,113)
Other operating income	34	**5,089**	4,968
Profit on ordinary activities before interest		**84,249**	80,319
Interest receivable and similar income	37	**5,725**	5,940
Interest payable and similar charges	38	**(64,501)**	(63,371)
Other finance expense	55	**(2,784)**	(752)
Profit on ordinary activities before taxation		**22,689**	22,136
Tax on profit on ordinary activities	39	**(6,511)**	(13,497)
Profit on ordinary activities after taxation		**16,178**	8,639

Profit for the year is generated entirely from continuing operations.

The accompanying notes are an integral part of this profit and loss account.

Company statement of total recognised gains and losses

For the year ended 31 March 2013

	Notes	2013 £000	2012 £000
Profit for the year		**16,178**	8,639
Actuarial loss on pension scheme for the year	55	**(7,706)**	(27,855)
Transfer pension assets to pension scheme	55	**-**	821
Deferred tax on defined benefit pension schemes	55	**1,849**	7,029
Impact of deferred tax rate change	55	**(624)**	(1,095)
Total recognised gains/(loss) for the year		**9,697**	(12,461)

Company balance sheet
as at 31 March 2013

	Notes	2013 £000	2012 £000
Fixed assets			
Tangible assets	41	**889,762**	849,173
		889,762	849,173
Current assets			
Stocks	42	**136**	232
Debtors: due after more than one year	43	**190,013**	195,613
Debtors: due within one year	43	**60,723**	55,292
Investments		**83,750**	13,900
Cash at bank and in hand		**570**	3,109
		335,192	268,146
Creditors: amounts falling due within one year	44	**(85,263)**	(81,769)
Net current assets		**249,929**	186,377
Total assets less current liabilities		**1,139,691**	1,035,550
Creditors: amounts falling due after more than one year	45	**(923,314)**	(797,473)
Provisions for liabilities	46	**(1,728)**	(1,535)
Deferred tax liabilities	46	**(36,738)**	(36,052)
Deferred income	47	**(3,019)**	(3,051)
Net assets excluding pension liability		**174,892**	197,439
Defined benefit pension liability	55	**(31,850)**	(33,094)
Net assets including pension liability		**143,042**	164,345
Capital and reserves			
Called up share capital	48	**49,312**	49,312
Capital redemption reserve	49	**4,000**	4,000
Profit and loss account	50	**89,730**	111,033
Shareholder's funds	51	**143,042**	164,345

The accompanying notes are an integral part of this balance sheet.

The financial statements of South East Water Limited (registered number 02679874) on pages 73 to 101 were approved by the Board of Directors on 5 July 2013 and were signed on its behalf by:

P Butler
Managing Director
5 July 2013

J E Stimpson
Finance Director
5 July 2013

Company cash flow statement

For the year ended 31 March 2013

	Note	2013 £000	2012 £000
Net cash inflow from operating activities	52	**120,572**	124,589
Returns on investments and servicing of finance			
Interest paid		**(31,893)**	(32,659)
Interest received		**4,931**	5,928
Interest element of finance lease payments		**(289)**	(369)
Net cash outflow from returns on investments and servicing of finance		**(27,251)**	(27,100)
UK corporation tax paid/group relief		**(5,165)**	(4,342)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(90,996)**	(93,157)
Fixed asset contributions received		**734**	3,568
Net proceeds from disposal of tangible fixed assets		**779**	799
Net cash outflow from capital expenditure and financial investment		**(89,483)**	(88,790)
Equity dividends paid to shareholders		**(31,000)**	(32,000)
Net cash outflow before management of liquid resources and financing		**(32,327)**	(27,643)
Management of liquid resources		**(69,850)**	21,100
Financing			
Capital element of finance leases		**(1,066)**	(1,114)
Repayment of intercompany debtor		**5,600**	(1)
Proceeds on issue of intercompany loan		**100,000**	-
Redeemed debenture stock		**(3,000)**	-
Issue costs on intercompany loan		**(1,896)**	-
Net cash inflow/(outflow) from financing		**99,638**	(1,115)
Decrease in net cash		**(2,539)**	(7,658)

Reconciliation of increase in net cash to movement in net debt:

	Note	2013 £000	2012 £000
Net cash at the start of the year		**3,109**	10,767
Decrease in net cash (above)		**(2,539)**	(7,658)
Total cash		**570**	3,109
Opening borrowings		**(605,330)**	(574,797)
Net decrease in borrowings from cash movements		**(99,638)**	1,115
Other non-cash changes		**(31,527)**	(31,648)
		(736,495)	(605,330)
Current asset investments		**83,750**	13,900
Net debt at the end of the year	53	**(652,175)**	(588,321)

Company cash flow statement

For the year ended 31 March 2013

At 31 March 2013, £3.2 million (2012: £2.4 million) of restricted cash is held in designated bank accounts in order to meet interest payments falling due in respect of the Company's senior debt (see note 45).

Notes to the Company financial statements

For the year ended 31 March 2013

32. Accounting policies

The principal accounting policies are summarised below. The policies were applied consistently throughout the current and prior years.

Basis of preparation

The parent company to the group headed by South East Water Limited has prepared financial statements in accordance with applicable UK accounting standards and under the historical cost convention and the Companies Act 2006, other than in respect of grants and contributions as described below and certain financial instruments that have been measured at fair value.

Judgements and key sources of estimation uncertainty

The preparation of financial statements requires the application of judgements, estimates and assumptions by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year.

The five points below are the most critical judgements, estimates and assumptions.

- Un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year end a large volume of water has been supplied that has not been invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2013 was £24.4 million (2012: £20.0 million);
- The capitalisation of employee and other directly attributable costs: The Company determines employee costs directly attributable to capital projects based on timesheet data. Other directly attributable costs are assessed by each relevant department where capital costs are incurred and costs relating to capital projects are then capitalised into the relevant project. During the year ended 31 March 2013 £10.0 million of employee and other directly attributable costs have been capitalised (2012: £9.3 million);
- The provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the Company's management based on applying expected recovery rates to an aged debt profile. The value of the provision for doubtful debts as at 31 March 2013 was £27.6 million (2012: £26.5 million);
- The fair value of the interest rate swap: this valuation requires the Company to make estimates about expected inflation and future interest rates, hence the valuation is subject to uncertainties. The fair value at 31 March 2013 is £81.9 million (2012: £64.2 million); and
- Pension and other post-employment benefits: the cost of defined benefit pensions schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets, and corporate bond performance projections as set out in note 55. Future salary increases and pension increases are based on expected future inflation rates. The net employee liability at 31 March 2013 is £26.5 million (2012: £33.1 million).

Turnover

Turnover arises solely in the United Kingdom and represents income from the supply of water and other chargeable services to customers. Turnover is recorded net of VAT and is stated before any deduction for bad and doubtful debts. The Company only recognises turnover in respect of "named" customers. Water charges are not levied on "the Occupier", or where the customer name is not known.

Metered and unmetered water income

Water income is recognised when water has been delivered to the customer. Water income includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data. Unmetered water income was invoiced in full for the financial year 2012/13 on the 1 April 2012.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Research and development

Research and development expenses are charged to the income statement in the year in which they are incurred.

Notes to the Company financial statements

For the year ended 31 March 2013

32. Accounting Policies *(continued)*

Capitalisation of employee and overhead costs

Employee and overhead costs directly attributable to capital projects are capitalised in the financial statements as part of the cost of the assets to which they relate.

Taxation

Current tax, being UK Corporation tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in respect of the material tax effect of all timing differences between the treatment of certain items for taxation and accounting purposes, at the rates of tax expected to apply when the timing differences reverse. Deferred tax assets and liabilities recognised have been discounted at rates equivalent to the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with similar maturity dates. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Dividends

Dividends are recognised as a distribution when paid. Dividends are paid as declared. No unpaid dividend exists at the year end.

Infrastructure renewals accounting

Infrastructure assets comprise a network of systems relating to water distribution, such as water mains and surface reservoirs. Expenditure on infrastructure assets relating to enhancements and renewals of the network is treated as additions, which are included at cost. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost.

The depreciation charge for infrastructure assets is the estimated level of average annual expenditure required to renew the network based upon the Company's independently certified asset management plans. No other depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

Grants and contributions in respect of non-infrastructure assets

Grants and contributions received in respect of non-infrastructure assets are recognised as deferred income and released to the profit and loss account over the life of the assets to which they relate.

Grants and contributions in respect of infrastructure assets

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. Capital contributions towards infrastructure assets are deducted from the cost of these assets. This is not in accordance with the Companies Act 2006 and the regulations thereunder which infrastructure assets should be stated at their purchase price or production cost and capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

The directors are of the opinion that, as infrastructure assets have no finite economic lives for the reason set out above and the capital contributions would therefore remain in the balance sheet in perpetuity, the treatment otherwise required by the Companies Act 2006 would not present a true and fair view of the Company's effective investment in infrastructure assets. Contributions received and the effect of this policy in the financial year is shown in note 41.

Depreciation

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. Infrastructure assets are depreciated using infrastructure renewals accounting as set out above. Other fixed assets are depreciated on a straight-line basis over their estimated useful lives as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and equipment	3-10

Notes to the Company financial statements

For the year ended 31 March 2013

32. Accounting Policies *(continued)*

Borrowing costs

Borrowing costs are recognised as an expense when incurred.

Leases

Assets acquired under finance leases are included in tangible fixed assets and are depreciated on a straight-line basis over the shorter of the estimated useful life and the term of the lease. The related obligations, representing the capital element of future rentals, are included in creditors. The interest element of rentals is charged to the profit and loss account at a constant rate over the remaining life of the lease.

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

Investments in subsidiaries

Investments are recorded at historical cost. Where the directors are of the opinion that there has been a permanent diminution in the value of investments, the carrying amount of such investments is written down to the recoverable amount.

The Company has one subsidiary, South East Water (Finance) Limited which is incorporated in the Cayman Islands but which is resident for tax purposes in the UK.

Stocks and work in progress

Stocks are valued at the lower of average cost or net realisable value. No value is placed upon stocks of treated water. Consumable chemical purchases are recognised as an expense in the profit and loss account at the point of purchase.

Work in progress for chargeable services is valued at the lower of cost and net realisable value.

Short-term trade and other receivables

Short- term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Company’s management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Trade payables

Trade payables are measured at fair value and subsequently measured at amortised cost.

Financial instruments

The Company’s financial instruments comprise fixed and variable rate borrowings, fixed rate debentures, a derivative financial instrument comprising an interest rate swap, finance leases, a loan owed by its parent undertaking, cash, short-term and medium-term deposits, trade debtors and trade and other creditors.

The Company has taken the exemption allowed by FRS 29 to not disclose the financial instruments disclosure. These disclosures are included in the South East Water Group accounts.

Recognition

Financial instruments are recognised in the balance sheet when the Company becomes party to the contractual provisions of the instrument.

Derecognition

Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

Notes to the Company financial statements

For the year ended 31 March 2013

32. Accounting Policies *(continued)*

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Interest costs are expensed in the profit and loss account as incurred.

Impairment

At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced in accordance with FRS 26 *Financial Instruments: Measurement*, with the loss being recognised in the profit and loss account in the year in which the respective assessment takes place.

Debt issue costs

Debt instruments are stated at the amount of net proceeds received. Issue costs incurred for the purpose of providing future funds are accounted for as a deduction from the amount of consideration received and amortised over the period of the loan to which the issue costs relate.

Embedded derivatives

Financial instruments that are not carried at fair value through profit and loss are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Derivative financial instruments

The Company uses derivative financial instruments in the form of interest rate swaps to hedge its risks associated with interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the profit and loss account. The fair value is determined by reference to market values for similar instruments.

Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Pension benefits

The Company accounts for pension benefits under FRS 17 *Retirement Benefits.* The Company operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension schemes.

Defined contribution schemes

Contributions to defined contribution schemes are recognised as an operating expense when the contributions fall due.

Defined benefit schemes

The defined benefit pension scheme liability in the balance sheet represents the net present value of the defined benefit liability and the fair value of the scheme assets at the balance sheet date, and is disclosed after deferred taxation. It is shown on the face of the balance sheet above total net assets.

Notes to the Company financial statements

For the year ended 31 March 2013

32. Accounting Policies *(continued)*

The present value of the defined benefit liability and the cost of providing benefits under defined benefit schemes is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

The pension cost charged to operating profit includes current and past service cost and the effect of any settlements and curtailments. Other finance cost or income comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

Actuarial gains and losses and the related deferred taxation are recognised outside the profit and loss account in the statement of total recognised gains and losses.

33. Turnover

	2013	2012
	£000	£000
Unmetered water income	**95,340**	101,639
Metered water income	**108,681**	93,872
Other sales	**3,227**	3,953
	207,248	199,464

All turnover is from customers within the United Kingdom.

34. Other operating income

	2013	2012
	£000	£000
Rental income	**1,222**	1,171
Sundry income	**3,867**	3,797
	5,089	4,968

Sundry income includes charges to waste water companies for billing and cash collection services amounting to £2.1 million (2012: £1.9 million) and laboratory income of £0.9 million (2012: £0.9 million).

Notes to the Company financial statements
For the year ended 31 March 2013

35. Operating costs

	Notes	2013 £000	2012 £000
Wages and salaries	36	**22,176**	19,298
Exceptional item: pension curtailment gain (see below)		**(4,245)**	-
Fixed asset related expenses:			
Depreciation:			
- owned assets		**48,157**	45,188
- leased assets		**1,426**	1,426
Non-exceptional loss/(profit) on sale of fixed assets	41	**151**	(668)
Other operating charges			
Operating lease rentals:			
- vehicles and office equipment		**127**	112
- land and buildings		**403**	443
Fees payable to the Company's auditor		**184**	176
Other operating costs (see below)		**64,377**	62,599
Non-salary operating costs charged to capital projects		**(4,668)**	(4,461)
		128,088	124,113

	2013 £000	2012 £000
Other operating costs include:		
Energy costs	**12,751**	13,108
Rates	**13,728**	12,947
Contractors	**10,058**	9,384
Bulk water supplies and abstraction licences	**9,230**	8,747
Bad debts	**2,718**	3,458
Chemicals	**2,365**	2,353
Insurance	**2,729**	2,614
Other	**10,798**	9,988
	64,377	62,599

During the year curtailment gains of £4.2 million arising from changes to the Group's defined benefit pension schemes, which came into effect on 13 December 2012, have been classified as an exceptional item. The gains arose as a result of changes to the schemes' benefits, which have reduced future liabilities. The directors consider that, due to the materially and the one-off nature of these curtailment gains, it is appropriate to classify them as exceptional items in order to show a true and fair view of the Group's underlying performance. The tax charge on the exceptional items is £2.6 million. The exceptional items had £nil impact on the Group's cash flows.

36. Directors and employees

The average monthly number of persons, including salaried directors, employed by the Company during the year was:

	2013 Number	2012 Number
Operations	**489**	482
Management and administration	**260**	248
	749	730

Notes to the Company financial statements

For the year ended 31 March 2013

36. Directors and employees *(continued)*

The aggregate payroll costs of these persons were as follows:

	Note	2013 £000	2012 £000
Wages and salaries		**22,762**	20,245
Social security costs		**2,289**	1,970
Defined benefit scheme pension costs	55	**2,099**	1,636
Defined contribution scheme pension costs	55	**237**	168
		27,387	24,019
Less: direct salary costs charged to capital projects and infrastructure renewals schemes		**(5,211)**	(4,721)
		22,176	19,298
Exceptional item: pension curtailment gain (see note 35)		**4,245**	-

Remuneration of the directors, who are the Group key management, is as follows:

	2013 £000	2012 £000
Aggregate emoluments including bonuses	**1,262**	1,165
Company contributions to defined contribution scheme	**9**	9
	1,271	1,174

Retirement benefits are accruing to four directors (2012: four) under the defined benefit pension schemes and one director (2012: one) under a defined contribution scheme.

Emoluments of the highest paid director are as follows:

	2013 £000	2012 £000
Aggregate emoluments including bonuses	**277**	331

Further disclosure in respect of Directors emoluments are set out in the Regulated Accounts of the company which are available on the Company website.

37. Interest receivable and similar income

	2013 £000	2012 £000
Interest receivable from group undertakings	**5,347**	5,698
On bank balances and short term deposits	**378**	242
	5,725	5,940

Notes to the Company financial statements
For the year ended 31 March 2013

38. Interest payable and similar charges

	2013 £000	2012 £000
Debenture interest	**427**	672
On loans from group undertakings	**46,133**	41,251
Bank interest and other finance charges	**462**	477
Interest payable on index linked loan	**8,074**	7,799
Indexation on index linked loan	**7,049**	10,573
Financing guarantee fees	**1,457**	1,336
Interest payable on finance leases	**289**	369
Amortisation of issue costs	**509**	472
Other interest payable and similar charges	**101**	422
	64,501	63,371

39. Taxation

	Note	2013 £000	2012 £000
Analysis of tax charge for the period			
Current tax			
UK Corporation tax charge on profits		**3,914**	4,342
Over provision in prior years		**(252)**	(101)
Total current tax charge		**3,662**	4,241
Deferred tax			
Origination and reversal of timing differences		**(840)**	86
Impact of deferred tax rate change		**(3,751)**	(7,585)
Decrease in discount		**5,277**	14,941
	46	**686**	7,442
Adjustments to deferred tax on pension movements		**2,374**	2,038
Impact of deferred tax rate charge on pension movements		**(211)**	(224)
Total deferred tax charge		**2,849**	9,256
Tax on profit on ordinary activities		**6,511**	13,497
Factors affecting tax for the period			
Profit on ordinary activities before taxation		**22,689**	22,136
Profit on ordinary activities before taxation multiplied by the standard rate of tax of 24% (2012: 26%)		**5,445**	5,755
Effects of:			
Adjustment for non-taxable items		**257**	73
Capital allowances exceeding depreciation		**(1,402)**	(180)
Other timing differences		**208**	9
Adjustment to tax charge in respect of previous periods		**(252)**	(101)
Adjustment to tax for pensions FRS 17 charge		**(2,374)**	(2,038)
Timing difference on RPI indexation		**1,780**	723
Current tax charge for the year		**3,662**	4,241

Notes to the Company financial statements
For the year ended 31 March 2013

39. Taxation *(continued)*

Factors that may affect future tax charges
Capital investment is expected to remain at similar levels and the Company expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Limited group of companies.

Changes in the medium- and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account.

A reduction in the headline rate of corporation tax from 24% to 23% starting from 1 April 2013 was enacted in the 2012 Finance Bill of 3 July 2012. As the rate change was enacted by the balance sheet date, deferred tax balances have been calculated at the new rate of 23%.

Further reductions to 21% by 1 April 2014 and 20% by 1 April 2015 have also been announced. If enacted these rate changes will affect the amount of future cash tax payments to be made by the Group and will also reduce the size of the Group's balance sheet deferred tax liability in the future.

40. Dividends

	2013 £000	2012 £000
Equity dividends paid during the year:		
First interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share	**7,750**	8,000
Second interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share	**7,750**	8,000
Third interim dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share	**7,750**	8,000
Final dividend of 15.72p per ordinary share (2012: 16.22p per ordinary share	**7,750**	8,000
	31,000	32,000

There were no dividends proposed for approval as at 31 March 2013 (2012: £nil). All dividends declared in the year were paid in the year up to March 2013.

Notes to the Company financial statements

For the year ended 31 March 2013

41. Fixed assets

Tangible fixed assets	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Assets in course of construction £000	Total £000
Cost					
At 1 April 2012	214,222	718,063	343,433	82,838	1,358,556
Additions	-	-	443	94,066	94,509
Disposals	(1,047)	-	(4,378)	-	(5,425)
Reclassification	(303)	(118)	421	-	-
Transfers	11,329	43,404	24,760	(79,493)	-
Grants and contributions	-	(3,407)	-	-	(3,407)
At 31 March 2013	224,201	757,942	364,679	97,411	1,444,233
Depreciation					
At 1 April 2012	(40,009)	(293,082)	(176,292)	-	(509,383)
Charge for the year	(2,766)	(26,946)	(19,871)	-	(49,583)
Disposals	192	-	4,303	-	4,495
Reclassification					
At 31 March 2013	(42,583)	(320,028)	(191,860)	-	(554,471)
Net book amount at 31 March 2013	**181,618**	**437,914**	**172,819**	**97,411**	**889,762**
Net book amount of leased assets included above	3,840	706	7,871	-	12,417
Assets under construction relate to the following categories	4,915	51,811	40,685	-	97,411
Net book amount at 31 March 2012	174,213	424,981	167,141	82,838	849,173
Net book amount of leased assets included above	3,966	706	8,309	-	12,981
Assets under construction relate to the following categories	9,892	42,135	30,811	-	82,838

The net book amount of land and buildings comprises:

	2013 £000	2012 £000
Freehold	**75,568**	**73,077**
Long leaseholds	**220**	**225**
Short leaseholds	**4**	**5**
	75,792	**73,307**

The net book amount of infrastructure assets at 31 March 2013 is stated after the deduction of grants and contributions amounting to £96.7 million (2012: £93.2 million) to give a true and fair view (see note 32).

Advanced capital contributions and deposits received in 2013 amounted to £3.3 million (2012: £4.2 million), and £3.4 million (2012: £3.8 million) was released to fixed assets.

Notes to the Company financial statements
For the year ended 31 March 2013

41. Fixed assets *(continued)*

Asset disposals were as follows:

	Proceeds 2013 £000	Proceeds 2012 £000	**Net Book Value 2013 £000**	Net Book Value 2012 £000	**Profit & Loss 2013 £000**	Profit & Loss 2012 £000
Land	**49**	512	**49**	11	**-**	501
Buildings	**648**	149	**806**	21	**(158)**	128
Reservoirs	**-**	-	**-**	-	**-**	-
Vehicles	**86**	143	**58**	78	**28**	65
Other	**(4)**	(5)	**17**	21	**(21)**	(26)
	779	799	**930**	131	**(151)**	668

Investments in subsidiaries
The carrying value of the Company's investment in its subsidiary is £100 (2012: £100) (see note 14).

42. Stocks

	2013 £000	2012 £000
Consumables	**78**	78
Work in progress	**58**	154
	136	232

43. Debtors

	2013 £000	2012 £000
Financial asset debtors		
Trade debtors	**28,483**	27,984
Accrued income	**24,364**	20,040
Amounts due from parent and group undertakings	**2,521**	2,164
	55,368	50,188
Non-financial asset debtors		
Corporation tax	**-**	138
Other debtors	**2,534**	2,313
Prepayments and accrued income	**2,821**	2,653
	5,355	5,104
Total due within one year	**60,723**	55,292
Amounts due from parent and group undertakings after more than one year	**190,013**	195,613
Total debtors	**250,736**	250,905

Trade debtors are stated after provision for doubtful debts of £27.6 million (2012: £26.5 million). They are non-interest bearing and for immediate settlement.

Amounts due from parent and fellow subsidiary undertakings relate mainly to interest and group tax relief.

Notes to the Company financial statements

For the year ended 31 March 2013

43. Debtors *(continued)*

At 31 March 2013, the amounts due from the Company's parent undertaking after more than one year comprised £190.0 million (2012: £195.6 million) due from the parent company, falling due for repayment on 27 July 2034 and bearing interest at the rate of LIBOR plus 2%.

Movements in the provision for doubtful debts were as follows:

	2013 £000	2012 £000
At 1 April	**26,545**	26,597
Charge for the year	**2,718**	3,458
Amounts written off during the year	**(1,621)**	(3,510)
At 31 March	**27,642**	26,545

At 31 March, the age of trade receivables was as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2013	28,483	4,281	4,299	2,299	1,332	1,259	9,232	5,781
2012	27,984	4,302	3,750	2,111	1,271	1,162	8,912	6,476

44. Creditors: amounts falling due within one year

	2013 £000	2012 £000
Financial liability creditors		
Trade creditors	**13,586**	14,182
Redeemable debenture stock	**3,000**	3,000
Obligations under finance leases	**1,149**	1,066
Amounts due to parent and group undertakings	**14,381**	14,986
Accruals	**24,411**	21,247
	56,527	54,481
Non-financial liability creditors		
Payments received in advance	**27,426**	26,156
Other taxes and social security	**811**	832
Other creditors	**499**	300
	28,736	27,288
Creditors: amounts falling due within one year	**85,263**	81,769

At 31 March 2013 and 2012, amounts owed to parent and group undertakings represent unsecured non-interest bearing balances including the surrender of group tax relief to the Company.

Notes to the Company financial statements

For the year ended 31 March 2013

45. Creditors: amounts falling due after more than one year

		2013 £000	2012 £000
Irredeemable debenture stock	(i)	**1,048**	1,048
Redeemable debenture stock:	(ii)	**-**	3,000
Obligations under finance leases	(iii)	**1,237**	2,386
Amounts due to group undertakings	(iv)	**691,368**	568,881
Index linked loans	(v)	**228,706**	221,562
Trade creditors and other payables	(vi)	**955**	596
Creditors : amounts falling due after more than one year		**923,314**	797,473

(i) Irredeemable debenture stock

	2013	2012
3% perpetual stock	**26**	26
3½% perpetual stock	**392**	392
4% perpetual stock	**177**	177
5% perpetual stock	**415**	415
5½% perpetual stock	**1**	1
6% perpetual stock	**37**	37
	1,048	1,048

(ii) Redeemable debenture stock

	2013	2012
10% debenture stock 2013/2017	**-**	3,000
	-	3,000

Redeemable debenture stocks are redeemable at par in the year stated. Where more than one redemption year is quoted it is at the Company's option to redeem the stock at any time between the dates stated. Interest on irredeemable and redeemable debenture stock is payable six monthly. Redeemable debenture stock is secured on the future revenues of the Company.

The Company redeemed the entire stock of 10% redeemable debentures on 30 June 2013.

(iii) Finance leases

The Company has finance lease contracts for various items of plant and machinery with an effective interest rate for 2013 of 7.7% (2012: 7.7%). Each lease can be cancelled before its termination date or renewed for a secondary period at the option of the Company.

Finance leases are secured against the asset to which they relates, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

The maturity of obligations under finance leases is as follows:

	2013 £000	2012 £000
Between one and two years	**1,237**	1,149
Between two and five years	**-**	1,237
	1,237	2,386

Notes to the Company financial statements

For the year ended 31 March 2013

45. Creditors: amounts falling due after more than one year *(continued)*

(iv) Amounts due to group undertakings

The Company's subsidiary undertaking, South East Water (Finance) Limited, has £496 million (2012: £496 million) of debt listed on the London Stock Exchange and a further £100 million of unlisted loans, which were issued during the year. The funds raised are lent to the Company under loan agreements between the Company and its subsidiary. An annual fee of £43,000 (2012: £33,000) is charged by South East Water (Finance) Limited.

The effective terms of the £596 million loans due to South East Water (Finance) Limited are as follows:

- £200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Company);
- £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Company);
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the Company); and
- £100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the Group).

Issue costs incurred by the Company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the loan repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the loan repayable in 2041 under the terms of the loan.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

The agreements for the bonds and loan contain a number of covenants that the Company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Managing Director's report on page 7.

The amounts due to group undertakings are stated at the original consideration plus fair value of the interest rate swap, accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Loan due 2037 £000	Total £000
2013					
Original loan consideration	200,000	166,000	130,000	100,000	596,000
Fair value of interest rate swap	81,917	-	-	-	81,917
Indexation on bonds	-	-	18,014	1,889	19,903
Less: unamortised issue costs	(1,408)	(1,768)	(1,417)	(1,859)	(6,452)
Listed bonds due after five years	280,509	164,232	146,597	100,030	691,368
2012					
Original loan consideration	200,000	166,000	130,000	-	496,000
Fair value of interest rate swap	64,221	-	-	-	64,221
Indexation on bonds	-	-	13,630	-	13,630
Less: unamortised issue costs	(1,624)	(1,879)	(1,467)	-	(4,970)
Listed bonds due after five years	262,597	164,121	142,163	-	568,881

Notes to the Company financial statements

For the year ended 31 March 2013

45. Creditors: amounts falling due after more than one year *(continued)*

(v) Index linked loans

The Company holds £169 million of index linked loans with effective terms as follows:

- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the Company); and
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the Company).

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the Company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

The agreements for both loans contain a number of covenants that the Company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Managing Director's report on page 7.

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Total £000
2013			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	51,932	9,667	61,599
Less: unamortised issue costs	(1,606)	(287)	(1,893)
Index linked loans	185,326	43,380	228,706
2012			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	46,218	8,332	54,550
Less: unamortised issue costs	(1,688)	(300)	(1,988)
Index linked loans	179,530	42,032	221,562

(vi) Trade creditors and other payables

Trade creditors and other payables comprise financing guarantee fees of £220,000 (2012: £260,000) and deposits payable to developers of £735,000 (2012: £336,000). Financing guarantee fees are cash received in advance to settle fees in connection with the £200 million owed to South East Water (Finance) Limited (see (iv)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

Notes to the Company financial statements
For the year ended 31 March 2013

46. Provisions for liabilities

	Other provisions £000	Deferred tax £000	Total £000
At 1 April 2012	1,535	36,052	37,587
Additional provisions charged to income statement	1,796	686	2,482
Amounts utilised	(1,160)	-	(1,160)
Amounts unused and reversed	(443)	-	(443)
At 31 March 2013	1,728	36,738	38,466

Other provisions largely relate to compensation payments in excess of the Company's insurance cover of £1.6 million (2012: £1.5 million). It is anticipated that these provisions will be utilised in the current year.

Deferred tax provision

	2013 £000	2012 £000
Accelerated capital allowances	**90,505**	93,463
Discount	**(49,826)**	(55,155)
Discounted accelerated capital allowances	**40,679**	38,308
RPI indexation	**(3,900)**	(2,293)
Discount	**123**	175
Discounted RPI indexation	**(3,777)**	(2,118)
Other	**(164)**	(138)
Total undiscounted provision excluding deferred tax on pension liability	**86,441**	91,032
Total discount	**(49,703)**	(54,980)
	36,738	36,052

47. Deferred income

Income received for work not yet started or services not provided at the balance sheet date is as follows:

	2013 £000	2012 £000
At 1 April	**3,051**	3,224
Received in the year	**5,076**	5,765
Released during the year	**(5,108)**	(5,938)
At 31 March	**3,019**	3,051

48. Authorised and issued share capital

	2013 £000	2012 £000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2012: 49,312,354)	**49,312**	49,312

There is one class of ordinary share which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital is £100 million (2012: £100 million).

Notes to the Company financial statements

For the year ended 31 March 2013

49. Capital redemption reserve

	2013	2012
	£000	£000
At 31 March	**4,000**	4,000

The capital redemption reserve relates to 4,000,000 8.75% redeemable preference shares redeemed on 31 March 1996.

50. Profit and loss account

	£000
At 1 April 2012	111,033
Profit for the year	16,178
Dividends	(31,000)
Actuarial loss on pension schemes for the year	(7,706)
Deferred tax on defined benefit pension schemes	1,225
Retained loss for the year	(21,303)
At 31 March 2013	**89,730**

Of the profit and loss reserve above £22.7 million (2012: £22.7 million), which resulted from the merger of MKW Limited and SEW Limited, is not available for distribution.

51. Reconciliation of movements in equity shareholder's funds

	2013	2012
	£000	£000
Opening shareholder's funds	**164,345**	208,806
Total recognised gains and losses;		
Profit for the year	**16,178**	8,639
Actuarial loss on pension schemes for the year	**(7,706)**	(27,855)
Transfer pension assets to pension scheme	**-**	821
Deferred tax on defined benefit pension schemes	**1,225**	5,934
	9,697	(12,461)
Dividends	**(31,000)**	(32,000)
Net movement on shareholder's funds	**(21,303)**	(44,461)
Closing shareholder's funds	**143,042**	164,345

Notes to the Company financial statements

For the year ended 31 March 2013

52. Reconciliation of operating profit to net cash inflow from operating activities

	2013 £000	2012 £000
Profit on ordinary activities before interest	**84,249**	80,319
Depreciation and impairment of tangible fixed assets	**49,583**	46,614
Profit on disposal of fixed assets	**151**	(668)
Decrease in stocks	**96**	8
(Increase)/decrease in trade and other debtors	**(4,865)**	66
Increase in creditors	**4,030**	6,840
Pension costs less contributions	**(12,672)**	(8,590)
Net cash inflow from operating activities	**120,572**	124,589

53. Analysis of movement in net debt

	At 1 April 2012 £000	Cash flow £000	Other non-cash changes £000	**At 31 March 2013 £000**
Cash at bank and in hand	3,109	(2,539)	-	**570**
Irredeemable debenture stock	(1,048)	-	-	**(1,048)**
Redeemable debenture stock	(6,000)	3,000	-	**(3,000)**
Obligations under finance leases	(3,452)	1,066	-	**(2,386)**
Indexed linked loans	(169,000)	-	-	**(169,000)**
RPI indexation on loans	(54,550)	-	(7,049)	**(61,599)**
Less: unamortised issue costs	1,988	-	(95)	**1,893**
Amounts due to group undertakings	(496,000)	(100,000)	-	**(596,000)**
Indexation on amounts due to subsidiary	(77,851)	-	(23,969)	**(101,820)**
Less: unamortised issue costs	4,970	1,896	(414)	**6,452**
Group loans	195,613	(5,600)	-	**190,013**
Net borrowings	(605,330)	(99,638)	(31,527)	**(736,495)**
Current asset investments	13,900	69,850	-	**83,750**
Net debt	(588,321)	(32,327)	(31,527)	**(652,175)**

54. Commitments and contingent liabilities

Capital commitments

	2013 £000	2012 £000
Contracts placed for future capital expenditure not provided in the financial statements	**45,915**	**49,534**

Notes to the Company financial statements
For the year ended 31 March 2013

54. Commitments and contingent liabilities *(continued)*

Operating lease commitments
The Company's commitments in respect of non-cancellable operating leases for land and buildings and other operating leases are as follows:

	Land and buildings 2013 £000	Land and buildings 2012 £000	**Vehicles and office equipment 2013 £000**	Vehicles and office equipment 2012 £000
Amounts due next year on operating leases expiring:				
- within one year	**380**	388	**37**	77
- between two and five years	**533**	912	**-**	37
	913	1,300	**37**	114

55. Pensions

The South East Water pension scheme provides benefits to Company and former Company employees. Up until 17 June 2011, benefits were provided on either a defined benefit basis or a defined contribution basis depending on the category of membership. On 17 June 2011, all assets and liabilities of the defined contribution section of the scheme were transferred to a newly set-up separate pension scheme. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided on a defined benefit basis only.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the Company decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the Company has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Company contribution rate was 33.8% (2012: 30.2%) of pensionable remuneration during the year plus an annual contribution of £5.95 million (2012: £5.95 million). The Company's future contribution rate is expected to be 33.8% of pensionable salary plus an annual contribution of £5.95 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2012 for the year to 31 March 2013). The overall gross expected return on assets used for the start year figures was 4.79% p.a. (2012: 5.23%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 96.

The pension expense for the year to 31 March 2013 takes account of assumptions set at the start of the year (i.e. as at 1 April 2012). The calculation of the pension expense for the year to 31 March 2013 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2013 are equivalent to a deduction of 0.6% (2012: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 4.19% (2012: 4.63%) has been used in the calculation of the 2013 pension cost.

As a result of the merger of SEW Limited and MKW Limited in October 2006, the Company acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

Notes to the Company financial statements

For the year ended 31 March 2013

55. Pensions *(continued)*

The Company contributed 36.1% (2012: 27%) of pensionable remuneration plus £1.35 million (2012: £1.35 million) in respect of the deficit as at 31 March 2013 to the scheme during the year. The Company's future contribution rate is expected to be 36.1% of pensionable salary plus an annual contribution of £1.35 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2012 for the year to 31 March 2013). The overall gross expected return on assets used for the start year figures was 3.99% p.a. (2012: 3.99%).

On 31 March 2015 both of the Group's defined benefit schemes will close to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members will become deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members will be invited to join the Group's deferred contribution scheme from 1 April 2015. These changes to the future status of the schemes have led to a curtailment of future liabilities of the schemes of £4.25 million as detailed below.

Pension costs recognised in the profit and loss account for the defined contribution scheme were as follows:

	2013 £000	2012 £000
Defined contribution scheme	**237**	168

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2013 %	SEW Pensions 2012 %	**MKW Pensions 2013 %**	MKW Pensions 2012 %
Main assumptions:				
Rate of increase in salaries	**3.60**	3.55	**3.60**	3.55
Rate of increase in pensions in payment	**2.35**	2.30	**3.35**	3.30
Rate of increase in deferred pensions	**2.35**	2.30	**2.35**	2.30
Discount rate	**4.15**	4.80	**4.15**	4.80
RPI assumption	**3.35**	3.30	**3.35**	3.30
CPI assumption	**2.35**	2.30	**2.35**	2.30

Post-retirement mortality (in years)

	SEW Pensions 2013	SEW Pensions 2012	**MKW Pensions 2013**	MKW Pensions 2012
Current pensioners at 65 – male	**23.9**	23.7	**23.9**	23.7
Current pensioners at 65 – female	**25.7**	25.6	**25.7**	25.6
Future pensioners at 65 – male	**26.7**	26.6	**26.7**	26.6
Future pensioners at 65 – female	**27.9**	27.8	**27.9**	27.8

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities £000	(Decrease)/ increase %
0.1% increase to the discount rate	(2,600)	(1.0)
0.1% decrease to inflation	(2,600)	(1.0)
0.1% increase to salary growth	17	0.0
One year increase in life expectancy	5,900	2.3

Notes to the Company financial statements

For the year ended 31 March 2013

55. Pensions *(continued)*

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Market Value £000	Total £000
2013					
Equities	6.25	41,870	6.25	26,502	68,372
Corporate bonds	3.55	44,518	3.55	30,147	74,665
Government bonds	2.45	31,557	2.45	30,900	62,457
Property	4.05	11,117	4.05	8,229	19,346
Other	-	720	-	-	720
Cash	0.50	395	0.50	596	991
Total fair value of assets		130,177		96,374	226,551
Present value of funded obligations		(159,159)		(104,566)	(263,725)
Net under funding in funded plans		(28,982)		(8,192)	(37,174)
Present value of unfunded obligations		(4,189)		-	(4,189)
Deficit in the schemes		(33,171)		(8,192)	(41,363)
Related deferred tax asset		7,629		1,884	9,513
Deficit appearing in the Company's balance sheet		**(25,542)**		**(6,308)**	**(31,850)**

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Expected long-term rates of return %	Market Value £000
2012					
Equities	6.50	25,621	6.85	17,667	43,288
Bonds	4.20	38,644	4.55	19,339	57,983
Index linked gilts	2.70	19,747	3.05	25,124	44,871
Property	4.30	14,782	4.65	4,291	19,073
Other	6.50	14,400	6.85	10,981	25,381
Cash	0.50	3,791	0.50	11,747	15,538
Total fair value of assets		116,985		89,149	206,134
Present value of funded obligations		(141,945)		(103,611)	(245,556)
Net under funding in funded plans		(24,960)		(14,462)	(39,422)
Present value of unfunded obligations		(4,123)		-	(4,123)
Deficit in the schemes		(29,083)		(14,462)	(43,545)
Related deferred tax asset		6,980		3,471	10,451
Deficit appearing in the Company's balance sheet		(22,103)		(10,991)	(33,094)

Other investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return investments.

55. Pensions *(continued)*

Notes to the Company financial statements

For the year ended 31 March 2013

Analysis of amounts charged to operating profit:

	Notes	SEW Pensions £000	MKW Pensions £000	Total £000
2013				
Current service cost		**877**	**992**	**1,869**
Past service cost		**230**	**-**	**230**
Exceptional item: pension curtailment gains	**35**	**(2,102)**	**(2,143)**	**(4,245)**
		(995)	**(1,151)**	**(2,146)**
2012				
Current service cost		638	873	1,511
Past service cost		-	125	125
		638	998	1,636

Analysis of amounts charged to other finance expense:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Expected return on pension schemes' assets	5,437	3,570	9,007
Interest on pension schemes' liabilities	(6,889)	(4,902)	(11,791)
Net charge to other finance expense	**(1,452)**	**(1,332)**	**(2,784)**
2012			
Expected return on pension schemes' assets	6,372	4,782	11,154
Interest on pension schemes' liabilities	(7,064)	(4,842)	(11,906)
Net charge to other finance expense	(692)	(60)	(752)

Notes to the Company financial statements

For the year ended 31 March 2013

55. Pensions *(continued)*

Analysis of amounts recognised in the statement of total recognised gains and losses:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Actual return less expected return on pension schemes' liabilities	(17,433)	(1,185)	(18,618)
Experience gains arising on the schemes' assets	5,948	4,964	10,912
Actuarial (loss)/gain recognised in the statement of total recognised gains and losses	(11,485)	3,779	(7,706)
Cumulative actuarial losses	**(28,004)**	**(30,412)**	**(58,416)**
2012			
Actual return less expected return on pension schemes' liabilities	(15,475)	(13,493)	(28,968)
Experience gains arising on the schemes' assets	387	726	1,113
Actuarial loss recognised in the statement of total recognised gains and losses	(15,088)	(12,767)	(27,855)
Cumulative actuarial losses	(16,519)	(34,191)	(50,710)

The cumulative actuarial loss for 2012 includes a transfer balance of £126,000 from the Mid Kent Water Limited Pension & Life Assurance Scheme.

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Opening defined benefit obligations	146,068	103,611	249,679
Current service costs	877	992	1,869
Past service costs	230	-	230
Interest cost	6,889	4,902	11,791
Contributions by scheme participants	305	300	605
Actuarial losses	17,433	1,185	18,618
Gains on curtailments	(2,102)	(2,143)	(4,245)
Benefits paid	(6,352)	(4,281)	(10,633)
Closing defined benefit obligations	**163,348**	**104,566**	**267,914**
2012			
Opening defined benefit obligations	128,676	87,754	216,430
Transfer of obligations into scheme	-	155	155
Current service costs	638	873	1,511
Past Service costs	-	125	125
Interest cost	7,064	4,842	11,906
Contributions by scheme participants	369	318	687
Actuarial Losses	15,475	13,493	28,968
Benefits paid	(6,154)	(3,949)	(10,103)
Closing defined benefit obligations	146,068	103,611	249,679

Notes to the Company financial statements
For the year ended 31 March 2013

55. Pensions *(continued)*

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2013			
Opening fair values of schemes' assets	116,985	89,149	206,134
Expected return on assets	5,437	3,839	9,276
Contributions by scheme participants	305	300	605
Contributions by employer	7,854	2,673	10,527
Actuarial gains	5,948	4,694	10,642
Benefits paid	(6,352)	(4,281)	(10,633)
Closing fair values of schemes' assets	**130,177**	**96,374**	**226,551**
2012			
Opening fair values of schemes' assets	108,209	83,872	192,081
Transfer of assets into scheme	-	976	976
Expected return on assets	6,372	4,782	11,154
Contributions by scheme participants	369	318	687
Contributions by employer	7,802	2,424	10,226
Actuarial gains	387	726	1,113
Benefits paid	(6,154)	(3,949)	(10,103)
Closing fair values of schemes' assets	116,985	89,149	206,134

The five year history of the schemes is as follows:

	2013 £000	2012 £000	2011 £000	2010 £000	2009 £000
SEW Pensions					
Fair value of scheme assets	**130,177**	116,985	108,209	100,135	74,903
Present value of defined benefit obligation	**(163,348)**	(146,068)	(128,676)	(148,931)	(106,896)
Deficit in the scheme	**(33,171)**	(29,083)	(20,467)	(48,796)	(31,993)
Experience adjustment on schemes' assets:					
Amount	**5,948**	387	659	20,888	(30,058)
Percentage of scheme's assets (%)	**4.6%**	0.3%	0.6%	20.9%	(40.1)%
Experience adjustments on schemes' liabilities:					
Amount	**(200)**	-	-	-	3,122
Percentage of the scheme's liabilities (%)	**(0.1)%**	-	-	-	2.9%
MKW Pensions					
Fair value of plan assets	**96,374**	89,149	83,872	79,506	63,551
Present value of defined benefit obligation	**(104,566)**	(103,611)	(87,754)	(86,672)	(63,317)
(Deficit)/surplus in the scheme	**(8,192)**	(14,462)	(3,882)	(7,166)	234
Experience adjustment on schemes' assets:					
Amount	**4,694**	726	294	14,463	(13,921)
Percentage of schemes' assets (%)	**4.9%**	0.8%	0.4%	18.2%	(21.9)%
Experience adjustment on schemes' liabilities:					
Amount	**(11,500)**	-	-	-	606
Percentage of the schemes' liabilities (%)	**(11.0)%**	-	-	-	1.0%

Notes to the Company financial statements

For the year ended 31 March 2013

55. Pensions *(continued)*

Deferred tax asset on pension liability:

	SEW Pensions £000	MKW Pensions £000	Total £000
At 1 April 2012	6,980	3,471	10,451
Charge to statement of total recognised gains and losses	2,756	(907)	1,849
Impact of tax rate change to total recognised gains and losses	(320)	(304)	(624)
Charge to income statement	(1,776)	(598)	(2,374)
Impact of tax rate change to income statement	(11)	222	211
At 31 March 2013	**7,629**	**1,884**	**9,513**

56 Subsequent events

On 30 June 2013 the Company redeemed the entire stock of 10% redeemable bonds at par.

57. Related party transactions

As a wholly-owned subsidiary of HDF (UK) Holdings Limited, the Company has taken advantage of the exemption under FRS 8 *Related Party Disclosures* not to provide information on related party transactions with other companies within the HDF (UK) Holdings Limited group.

58. Parent company and ultimate controlling parties

The Company's joint ultimate holding companies are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, which is resident in Australia and Caisse de dépôt et placement du Québec, which is resident in Canada. It is the directors' belief that they now control the Company jointly.

The immediate parent company is South East Water (Holdings) Limited.

The largest group of companies into which results of the Company are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of South East Water Limited and HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.