

Board Assurance Statement
2020 to 2025 Business Plan
September 2018

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Board assurance statement

Introduction

The Directors of South East Water all recognise our collective responsibility to provide the strategic leadership for a business that provides an essential service; and to promote good corporate governance and professional conduct within a framework of effective controls that identify and manage any risks to the provision of that service.

We understand our collective duty to achieve the long-term success of the company by striking the right balance between the interests of current and future customers, of the communities we serve, of the environment that underpins the provision of our essential service, of our employees, and of our shareholders.

We want to remain focused on maintaining the right level of service to our customers at a fair and affordable price while ensuring they can benefit from resilient and sustainable water supplies in the long-term.

In providing this essential service, we recognise the responsibility of being a regulated monopoly. Customers cannot choose their water supplier, so it is our role to make sure our actions and behaviours, as well as our product and services, make customers feel that we can be trusted to serve them.

Effective engagement is a key tool to establishing that trust with customers and we have taken significant strides to do just that. This plan has been co-created with our customers and other stakeholders to ensure it reflects their needs and expectations.

As the company's Board of Directors, we own the overall strategy and direction of this business plan and take collective responsibility for assuring its quality and ambition.

This statement, together with the remainder of this appendix, describes the framework of engagement, control, challenge and oversight that we have put in place to satisfy ourselves as Directors that the company has a high quality, resilient, and deliverable plan that is ambitious and innovative while remaining affordable to our customers. Our plan is supported by customers and stakeholders because it has placed them at the heart of our decision-making and has been underpinned by:

- Robust business planning
- comprehensive customer and stakeholder engagement

- a thorough and systematic assessment of the current resilience of our systems and services; and of interventions that are necessary to manage resilience in the long-term interest of customers, the environment and society
- robust and efficient expenditure forecasts

We are confident that our business plan will, over the next control period and in the long term, enable the company to:

- Fulfil its statutory and licence obligations
- remain resilient - operationally, financially and corporately
- meet the expectation of the UK government's strategic policy statements

This statement sets out the governance, assurance and assessment processes that have given us a high degree of confidence in the quality of this business plan. It explains how we have provided rigorous Board scrutiny and made strategic decisions based on robust effective engagement with the independent Customer Challenge Group (CCG) at Board and senior management level. It also explains how we have established clear accountability for data collection and analysis, and for the preparation of the different components of our plan which was reinforced by thorough internal and external validation.

Engagement

Engaging with our customers and stakeholders to increase their satisfaction with our product and services has empowered everyone in the company to strive to do things differently and better. Our unique and innovative approach at the last price review included a suite of satisfaction measures as core performance commitments; and we see this business plan as an evolutionary advancement of that approach. Our engagement this time included corporate and financial structures; including profits, dividends, executive pay and taxation, although there was generally limited interest in this.

Our focus on engagement has directly shaped the choices and decisions we have made. It underpins our strong community-based presence and wider corporate reputation as a socially responsible business.

Our Customer Challenge Group (CCG) has provided a vital contribution and challenge on many areas of our work and on the decisions we have made. Thanks to the CCG, we have achieved high levels of wide and effective engagement and transparency that translated customers' expectations into our plan and our incentive mechanism.

A similar level of engagement with members of our Environmental Focus Group (EFG) for the preparation of our Water Resources Management Plan (WRMP) and, later, of the environmental aspects of the business plan, ensured a continuity of

representation from our WRMP to our business plan. The now well established EFG contributed to an informed and effective challenge throughout the entire process to provide the right solutions at the right time.

We believe our engagement for this plan (which has been independently assured) has been innovative and successful, providing valuable feedback and constructive challenge throughout. We would like to thank the members of the CCG and of the EFG for their valued contribution. We are confident that these high levels of transparency and engagement with customers will enable our customers' trust and confidence in our plan.

Affordability

Affordability continues to be high on our, and our customers' agenda, but this price review takes us even further.

We have considered a number of options to ensure that we provide the best possible package of price and service to our customers. We have made sure that we understand who all our customers are, and this includes vulnerable customers. Our innovative approach to customer segmentation is based on how customers consider and value water. It has enabled us to offer help that's suitable for each circumstance, and we have strived to achieve a balance between the needs of our current and future customers.

Business planning

With the objectives of transparency and accountability in mind, from the outset we have embedded key principles of governance within our process for the preparation of our plan.

The full Board has collectively assumed ownership of the overall strategy and direction of the plan in the long term through regular meetings to set the plan's strategic direction, offer advice and challenge, and oversee its implementation and submission.

In addition, our Independent Non-Executive Directors have constructively challenged and helped develop the proposals for strategy, the key principles underpinning this plan and the selection of best options. We have also created sub-groups of the Board for the price review to allow for the in-depth examination of all aspects of the plan.

The Board as a whole has scrutinised, tested and challenged the options and assumptions in the plan; each director has contributed his or her experience and perspective; and all have been conscious to keep water bills affordable while ensuring an appropriate level of ambition and the long term viability of the necessary infrastructure and environmental resilience. Through this scrutiny we have challenged and satisfied ourselves that all the elements add up to a business plan

that is high quality and deliverable, and that it will enhance our operational, financial and corporate resilience in the short and long term.

Through a comprehensive review of statutory and licence obligations, processes, service levels and investment programme we are satisfied that the company is able to meet its statutory and licence obligations now and in the future and take account of the government's strategic policy statements.

The Board considered a range of options and scenarios to inform its decisions and test the management team's assumptions to make sure that the plan results in low but sustainable bills for all customers and provides specific help for our vulnerable and low income customers. The management team has been encouraged to refine options and develop alternatives that strike the right balance for customers and other stakeholders.

This approach informed many other aspects of our plan and all of our strategic choices. We have conducted comprehensive customer research to understand what our customers think about our service now and what they want the service to be in the future; and gathered their views on what actions and behaviours best represent a responsible business. For the latter especially social and environmental issues had most traction and became more credible as we are seen as a local, smaller company with a real commitment to the region, its staff and its customers.

We developed innovative approaches that allowed us to respond to customer challenges and make this plan ambitious and innovative while keeping the bills affordable.

We have made our plan accessible for customers and made sure that our outcomes and incentives reflect the preferences, expectations and needs of our customers and other key stakeholders, and are considered by them to be sufficiently stretching.

We have put in place a transparent governance structure that promotes accountability and responsibility. Our risk-based assurance framework, built on the principles of our Company Monitoring Framework, ensures our data is high quality, reliable and fully auditable, and we have ensured that recommendations from the external assurance process have been appropriately addressed.

Outcomes

Our customer engagement for this plan has been extensive with 107 specific elements of research undertaken with nearly 13,000 household customers and businesses so we can understand their needs, expectations and priorities for the 2020 to 2025 period, and for the longer term too.

This research, along with the insight we have gained from the thousands of daily transactions and conversations we have with customers, shows a continuing importance of safety, quality, reliability and resilience of tap water - but there is an increased focus on the service and customer experience, particularly when things go wrong.

Unsurprisingly, tackling leakage remains a top priority, while addressing the impacts of climate change and ensuring we continue to educate current and future customers to reduce their water use is important too.

We have set a comprehensive range of performance commitments that represent our customers' priorities. We have set stretching targets with improved levels of performance across the full range of our performance commitments. This includes a number of commitments in areas of:

- Customer satisfaction and vulnerability
- leakage and per capita consumption
- resilience – including drought and flooding
- interruptions and low pressure
- environmental improvements
- water quality

In the development of our performance commitments, we have worked with and have been challenged by our Customer Challenge Group and Environmental Focus Group.

We will continue to report our performance against commitments in our Annual Report and Performance, People and Planet Report and will introduce new ways to let customers know how we are performing.

We closely monitor our performance against targets and report progress during the year through our Company Monitoring Framework, which includes assessing risks of not achieving the performance levels we have committed to, and a plan to mitigate these risks. We have applied the principles of our Company Monitoring Framework in the Risk Assessment and Mitigation Plan we have developed for 2020-25. It demonstrates to our customers and stakeholders our resolve to manage the risks and achieve our performance commitments. This can be found in Appendix 15 Risk Management and Mitigation.

Resilience - Ofwat's requirements

A central theme of this plan is defining the resilience of our future services in terms of financial, corporate, operational and environmental resilience. The results of our customer research to understand their views and priorities on resilience clearly show that customers want us to focus on managing and protecting our assets, planning for

future water needs and managing customer demand. We used these views, along with our systematic assessment of resilience at resource zone level, to identify core resilience risks and to develop options to keep these risks to appropriate and acceptable levels. In selecting the final options to include in the plan, we again engaged with customers to understand their preferences, with catchment management, leakage reduction and licence trading having high appeal for both businesses and households.

Cost assessment and financeability

Our large investment proposals are informed by customer preferences and underpinned by cost information derived from a single source of cost data, our Unit Cost Database (UCDB). Our investment process including options screening, UCDB and the resulting investment proposals have been assured both internally and by external assurance partners. This helps us to ensure that the solutions we develop are robust and deliverable, and provide the best value for our customers and the environment over their entire asset life. Our comprehensive assurance activities (guided by our Company Monitoring Framework and defined in detail in our PR19 Assurance Framework) give us additional confidence that our proposals are robust and efficient.

Our expenditure forecasts are efficient and underpinned by a three-way assessment: a comparative top down econometric assessment relative to the England and Wales water sector; bottom up benchmarking of our relative efficiency performance; and comparison of the unit costs used in this plan against our historical project delivery costs. This gives us a good indication of our relative efficiency compared to the leading companies in the market; the extent of efficiency catch up required for the period 2020 to 2025, to maintain our upper quartile position, and any areas that require improvement. As a result, we have applied an overall plan efficiency of 4.5 per cent of our total expenditure, which equates to savings of £45 million over the period 2020 to 2025.

Our business plan is financeable on both the notional and actual capital structure on the basis of the business plan taken as a whole and protects customer interests in both the short and the long term. We have analysed the financeability of our plan with support from NERA Economics using the financial forecasts taken from the financial model issued by Ofwat as part of the PR19 process.

The data tables that populate the Ofwat model that we consider to be high risk have been assessed by Deloitte to assure the Board of the accuracy of the data tables. Deloitte have also assessed specific areas of the plan in relation to financeability, focusing on the process governance and supporting assumptions.

We have reviewed the financial ratios generated by our business plan and compared them to rating agency ratio guidance levels and our bank financial covenant levels. The proposed level of gearing allows us to maintain our current investment grade credit ratings over the period, albeit with tighter ratios (notably around AICR and FFO to debt) than before. In addition, we show that we are financially resilient to reasonable cost and revenue shocks, with our financial covenant protections and stand-by bank facilities providing protection to both customers and creditors.

Risk and return

We have identified the key risks to the delivery of the business plan using the principles of our Company Monitoring Framework (CMF). We have updated the CMF and our Corporate Risk Register ready for the 2020-25 period. These risks, together with the plan for their monitoring and mitigation, can be seen in Appendix 15 Risk Management and Mitigation. This approach has been subject to our three-level assurance (as dictated by our PR19 Assurance Framework) including independent assurance, and we consider it to be robust and appropriate.

Data and reporting

South East Water has a track record of producing high quality information that secured us a self-assured category from Ofwat. To ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience, we built on the approach set out in our Company Monitoring Framework and previously applied in our Performance, People and Planet reports.

That approach, used for reporting on our performance commitments, ODIs and projections of outcomes, is also supported and, crucially, trusted by customers. During our research with them on what actions and behaviours best represent a responsible business, they were clear our corporate transparency and reporting was not the most pressing issue or concern for them; as a heavily regulated business they are confident we will do the right thing - for those we serve and those that regulate that service.

Summary

Our plan is ambitious. It innovates in areas of greatest need, such as engagement with customers and environmental improvements. Our performance commitments reflect the priorities of our customers, and our targets are the most stretching yet.

The challenge of doing more for less should not be underestimated. We have worked hard to design a plan that is compliant and delivers for our customers and stakeholders. The business plan is designed to work as a complete package and material changes to any of these elements are likely to have a significant impact on the deliverability of the plan as a whole. To achieve our ambitious performance commitments while lowering water bills has required us to make aggressive

assumptions on our ability to reduce total expenditure, via strong efficiency and productivity improvements. The performance commitments also create significant risk of financial penalties to the business.

Furthermore, maintaining a financeable structure and credit rating with the historical low cost of capital nominated by Ofwat has required our shareholders to accept the lowest-ever returns on their investment.

However, that passion to do more for less is what this plan is built upon. This drives us to set a new tone of trust and transparency in water by evolving our use of satisfaction and introducing responsible business commitments. This makes the promises in this plan credible – so that customer satisfaction is responsibly achieved.

Relying on this comprehensive governance framework and stringent quality assurance, the Board of South East Water states that it has ownership of the overall strategy and direction in the long term and that it has satisfied itself that this business plan is of high quality, innovative, deliverable and will enhance operational, financial and corporate resilience over the next control period and the long term. The Board is able to confirm that:

- The plan will enable the company to meet its statutory and licence obligations, now and in the future and take account of the government's strategic policy statements
- the plan has been informed by comprehensive customer and stakeholder engagement during the plan development, and by feedback from our CCG about the quality of our customer engagement, which has been incorporated into the plan
- it has satisfied itself that the plan is affordable for all customers, including in the long term, and includes appropriate assistance for those struggling, or at risk of struggling, to pay
- it has challenged and satisfied itself that the plan will enable our customers' trust and confidence, through appropriate measures to provide a fair balance between customers and investors (which include outperformance sharing, dividend policies and any performance related element of executive pay) and high levels of transparency and engagement, on issues that matter to customers
- it has confidence that the business plan will achieve its outcomes and performance commitments
- the proposed outcomes, performance commitments and outcome delivery incentives are ambitious and reflect customer preferences

- the company has a robust approach to reporting on its performance commitments, ODIs and projections of outcomes which includes monitoring by the Board
- the plan has been informed by a robust and systematic assessment of the resilience of the company's systems and services, by customers' views on managing resilience and a comprehensive and objective assessment of interventions to manage resilience in customers' long-term interests
- the expenditure forecasts included in the plan are robust and efficient
- the plan's investment proposals are based on a rigorous assessment of options, are robust and deliverable, and are the best options for customers and the environment
- the Board has identified the risks associated with delivering the plan and has put in place appropriate plans for managing and mitigating these risks
- the business plan is financeable on both the notional and actual capital structure and protects customer interests in both the short and the long term.

The clarity and transparency of the process followed allows the Board to be satisfied that this high quality, ambitious and innovative business plan reflects that our business is:

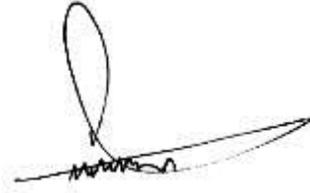
- *driven by customer satisfaction*: co-created by our customers, focused on what matters most to them, and is affordable
- *driven by new ways of working*: customers, stakeholders and society play a greater part in the delivery of our services and become part of the solution to overcoming the water supply challenges we face
- *a business that does more than just supply water*: our wider responsibilities to vulnerable customers, the environment, our staff and society are embedded in our decision making and activities
- *a business that is ambitious and innovative*: our stretching performance commitments are anchored in what our customers, stakeholders and regulators expect of us, with innovation focused on meeting their priorities for water
- *a business that had a significant challenge*: Our CCG, EFG and regulators were central to shaping the development of this plan
- *acts and behaves in the right way*: in addition to our stretching performance commitments, we want to be known as a company with strong and transparent social and corporate ethics; with a reasonable balance of risk and reward for

customers, investors and all stakeholders, while meeting its statutory obligations now and in the future.

These principles have guided us in achieving our primary objectives of legitimacy and transparency, which we recognise as the essential conditions to obtain the support of our customers. This customer-centric focus, strong Board leadership, high standards of governance and transparency about our performance will continue to be our guiding principles as we implement our plan.

Board signatures

Nick Salmon (Independent Chair)



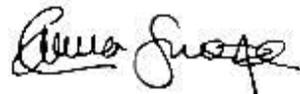
John Barnes (Independent Non-Executive Director)



Celia Pronto (Independent Non-Executive Director)



Emma Gilthorpe (Independent Non-Executive Director)



Chris Girling (Independent Non-Executive Director)



Stephen Jordan (Shareholder-Nominated Non-Executive Director)



Oliver Schubert (Shareholder-Nominated Non-Executive Director)



Paul Butler (Managing Director)



Andrew Farmer (Finance Director)



David Hinton (Asset and Regulation Director)



south east water

Pure know_how