

Interim results for the six months to 30 September 2008

Overview

Wessex Water is pleased to report another strong set of results for the six months ending 30 September 2008. We remain focussed on delivering ever higher standards to our customers, further improving our efficiency, continuing progress towards our sustainability vision and providing good returns to our investor.

We continue to be recognised as one of the leading companies in the industry. Recent reports from the industry regulator show:

- over the last four years we delivered the highest levels of service of any water and sewerage company
- we continue to be at the forefront of efficiency
- our returns to investors continue to be the best in the industry.

We have:

- delivered all required outputs in AMP4 while still saving against the regulator's capital investment allowance
- delivered our highest ever levels of service and customer satisfaction
- increased our self generation of renewable energy to 15%
- begun to introduce new tariffs to promote sustainable water use and protect those on lowest incomes – and won a national award for this
- been awarded the Queen's Award for Enterprise for Sustainable Development
- secured enough finance to meet our cash requirements until mid 2010.

We are not immune from the turbulence in the economy. This year will see energy prices – our second largest expense – rise substantially. The cost of raising new finance is approximately three times higher than it was 12 months ago.

In August we published our draft business plan for the five years starting in April 2010. That proposed to keep average bills flat in real terms until 2015 and to invest substantially in areas that customers had highlighted to us as important to them – security of supply, leakage and metering, flooding, taste and appearance of drinking water, and reducing our carbon footprint. Since then higher taxes on water companies have been announced and there is a potential that government may impose new obligations upon us. These changes are significant enough to make it difficult to maintain bills at current levels.

Additionally, the substantial increase in the cost of capital will place a significant burden on a business that needs to raise around £0.9bn of new debt over the next five years. The Board will only be able to recommend the proposed investment plan if it is confident that the returns allowed by the regulator reflect the current conditions in the markets.

Financial performance

The first half of the year saw historic cost profits increase by £6.2m (12%) to £58.2m. Regulatory returns increased by £13m (19%) to £83m. Dividends have been maintained at the same level as last year (£54.3m). Detailed results are as follows and the key points to note are:

Revenues

Turnover increased by £16.2m (8.2%) but within this, the impact of the wet weather and recession was evident. While prices increased by 8.7%:

- sales were down 3% as a consequence of the wet summer and the economic conditions
- customers switching to meters increased by 20%
- new connections reduced by a quarter.

Operating costs

OPEX increased by £3.7m (6.4%). Approximately half of this was due to inflation, the rest resulting from new obligations and bad debts. On a like for like basis, savings were 1%.

Depreciation and infrastructure maintenance charges increased by £3m as new assets were depreciated for the first time.

Interest and tax

Net interest payable increased by £4.9m. Within this, underlying interest costs increased by £4.5m, primarily as a consequence of deferred bond accruals and the additional debt caused by the high level of capital investment. The weighted average cost of interest fell from 5.7% to 5.6%. There was also an increase of £0.4m in respect of the FRS17 pension cost.

Corporation tax fell by £3.0m as a consequence of the reduction in tax rate to 28%, and additional capital allowance. By contrast, the deferred tax credit fell by £1.4m.

Cashflow, debt and gearing

The cash outflow of £85m reflected:

- an increase in CAPEX of £32m
- the unwinding of the capital creditor from the last quarter of 2007-08.

Net debt increased from £1,358m to £1,443m. At the same time, pro-forma RCV increased by £130m to £2,197m, leaving underlying gearing at 66%.

We have secured a new £50m bank facility and a £140m 10 year term loan from the EIB. Together, these facilities provide sufficient funds to meet cash needs until June 2010.

Operational performance

Operational performance on almost all key measures is better than the corresponding period last year. Key metrics are as follows:

Operational performance			
Operational performance	2007-2008	First half 2007-2008	First half 2008-2009
OPA performance % age of maximum	96%	95%	97%
Water supply			
Properties at risk of low pressure	0.03%	0.04%	0.03%
Properties subject to unplanned supply interruption of more than 12 hours	0.2%	0.05%	0.0%
Properties experiencing supply restrictions	0.0%	0.0%	0.0%
Customer complaints on taste/odour/appearance	2741	1565	1518
Drinking water compliance	99.9%	99.9%	99.9%
Sewerage			
Properties at risk of internal sewage flooding once or more in 10 years	343	457	329
Properties flooded: inadequate capacity	72	62	27
Properties flooded: other reasons	108	52	48
Customer service			
Customers satisfied/ very satisfied with service	98%	98%	96%
Customer complaints (operational)	1910	1181	871
Customer complaints (non operational)	5863	2670	3453
Billing contacts answered within 5 days	100%	100%	100%
Written complaints dealt within 10 days	100%	100%	100%
Bill based on meter reading	100%	100%	100%
Telephone call handling satisfaction	94%	95%	95%
Environmental standards			
Compliance with abstraction licenses	100%	100%	100%
Total leakage	72	72	71

Number of pollution incidents	110	53	51
Beaches meeting manitory standards	100%	100%	100%
Satisfactory discharges to river or sea	99.4%	98.9%	99.5%
Pollution served by works complaints with discharge consent	99.9%	99.9%	99.9%
Sewage disposed within standard	100%	100%	100%

Progress against public monitoring plan

Our monitoring plan for the period 2005 to 2010 describes what needs to be achieved within the price limits set for customers' bills by industry regulator Ofwat.

Our progress against the plan continues to be encouraging, the key elements of which are set out below:

Meeting new demands

Maintaining the supply of water is one of our primary objectives and last summer marked the 32nd year without supply restrictions.

We continue to invest and optimise our water resources and treatment works to ensure we can meet increasing demands from our existing customers and new development. We have maintained our focus on reducing leakage from our extensive network of 11,400 kms of mains. Leakage is currently 71MI/d, below the economic level of 74MI/d, representing some 20% of water put into supply.

We also continue to promote water efficiency by offering customers a comprehensive free service for repairing and replacing private supply pipes. We offer free meter options and a variety of other initiatives to help customers reduce their demands.

We are currently reviewing ways to meet Ofwat's recently announced non-mandatory water efficiency target reduction for 2008/9 of 0.8MI/d. We now offer free water efficiency audits to metered domestic customers. We are also trialling an initiative with Somer Housing Association to fit water efficient taps and toilets.

Improving drinking water and the environment

Addressing the impact of water abstraction on river flows

Concerns have been raised that some of our abstractions from groundwater for public water supply may be having an adverse impact on river flows. Accordingly, we have been working for some time to assess the impact and potential solutions.

Work on the Malmesbury Avon, Chitterne Brook and River Piddle has concluded that acceptable river flows can be restored by increasing the volume of water discharged to the river from boreholes and reducing the average volume abstracted for public supply, while

maintaining the volume that can be abstracted for public supply during peak demand periods. This strategy will safeguard the environment and avoid the need for substantial investment.

We have completed investigations at 15 other sites to determine the impact of our abstractions on the environment. The Environment Agency has reviewed the results and concluded that abstractions from four of our sources are having an adverse effect. The Environment Agency has given us their view of what licence changes we should plan for to mitigate the impact of these abstractions. We have taken this into account in preparing our draft water resources and draft business plans.

Coping with the worsening raw water quality

The raw water quality in a number of our sources has deteriorated over a number of years with elevated levels of pesticides and nitrates due to contamination of groundwater by farming practices. Rather than install treatment plants that are expensive to build and operate to remove these contaminants, we are trialling more sustainable solutions.

Our work with the farming community to reduce the risk of contaminating groundwater with pesticides continues to show promising results. At Friar Waddon in south Dorset, we have agreements with three farms to assess the effect of a ban on spraying of pesticides on land around the source. Results are encouraging and we believe it will be possible to avoid construction of expensive treatment plants.

At groundwater sources where the level of nitrate in the raw waters is gradually increasing, we are working to ensure that the quality of water meets the required stringent standards.

To alleviate the nitrate problems at Empool, Winterbourne Abbas and Eagles Lodge sources in Dorset and at Deans Farm near Salisbury, we are following a catchment management approach of working with farmers. This work aims to reduce the use of nitrates, thereby reducing nitrate concentrations in the groundwater abstracted at these sources. The approach and activities required, including the appointment of two dedicated catchment advisers, have been agreed with the Drinking Water Inspectorate.

We have seen an increase in levels of metaldehyde, a slug treatment, in surface water sites in Somerset. We, together with the Environment Agency, are currently working with farmers in these catchments to diminish the impact of their activities on raw water quality, to reduce the likelihood of requiring investment in further treatment.

Maundown water treatment works

This is our largest treatment works, serving around 200,000 customers in central Somerset. It was built in the 1960s and extended in the early 1970s and is now being commissioned following a major rebuild. We have installed advanced treatment to deal with increasing problems of algae in the raw water which can cause taste and odour problems. The capacity of the works has been increased in line with growth in the region. The project is on track for completion in 2009.

Lead in drinking water

Over the past few years we have been installing treatment to reduce the tendency for water from some of our sources to dissolve lead in lead service pipes and customers' plumbing. Where this is ineffective in meeting the long term standard for lead in drinking water, we

have continued to replace our section of lead service pipe and encouraged customers to replace their lead plumbing.

Water pressure

Work is ongoing to reduce the number of properties at risk of suffering poor pressure to less than 160, well below our monitoring plan target of 275.

Maintaining Water Services

Maintaining water supply to our customers is one of our key objectives. When one of our water mains bursts, or a water source is unavailable we are generally able to maintain services to our customers through the extensive investments we have made in integrating our network.

We continue to make further strategic investments this year to ensure our services are as secure as possible. Our intent is that all communities should be served from at least two different sources of supply. This is a long term investment strategy and forms a major component of our planned investments for AMP5.

Sewerage and sewage treatment improvements

Sewer flooding

We continue to make good progress on our programme to reduce the risk of internal and external flooding caused by overloaded sewers. By 2010, we plan to have relieved some 830 properties from the risk of internal flooding and around 750 open spaces from external flooding. Last year we completed work to reduce the risk of internal flooding to 170 properties and to protect 150 open spaces from external flooding. Over the past six months we have completed schemes to protect a further 36 properties from internal flooding and 57 properties from external flooding.

We are completing construction of a major 900 metre flood relief tunnel under Bristol. This £9m scheme will protect 57 properties from the risk of flooding. The tunnel has recently broken through some of the strongest rock in the country and the project is on track for completion in March.

Intermittent discharges

During the five years ending 2010, we plan to improve 25 unsatisfactory storm discharges that currently discharge dilute sewage to rivers following heavy rainfall. By 31 March 2008 16 of the schemes had been completed. This year a further five schemes will be completed at Poole, Calne, Sherston, Shrewton and Filton. We anticipate 100% compliance by 2010.

First time sewerage

We continue with our work to provide communities with a proper sewerage system to overcome public health or environmental issues. During AMP4 we expect to provide 23 villages with first time sewerage services. A total of 12 schemes have been completed to date. This year we will complete schemes at Bridgegate, Gaunts Common, Holt, Luckington, Orcheston, Abbots Leigh and Wrington.

Urban Waste Water Treatment Directive, UWWTD

This European directive sets standards and dates for the treatment of inland and coastal waters to improve the quality of treated sewage discharges to the environment. Most of our programme is now complete. At Poole sewage treatment works we are installing advanced

treatment for nitrogen removal to reduce nutrient enrichment in Poole Harbour. Installation is now complete and we have started plant commissioning.

EU Habitats Directive

This European directive is designed to protect sites and water bodies of special nature conservation status. A total of 17 schemes were included in our 2005 to 2010 programme, comprising phosphorus removal and/or other works to achieve higher standards of sewage treatment. By March 2008 we completed schemes at NetherAvon and Tetbury, and we will commission further schemes at Abbotsbury, Amesbury, Ratfyn and Warminster by the end of the year. At Cranborne sewage works we are undertaking a trial with a waste product from aluminium smelting to assess the scope for a more sustainable approach to reducing phosphorus in the effluent.

The remaining schemes are under appraisal, design or construction for completion in 2010.

Investigations

We have now completed all the 16 investigations in our AMP4 programme. These investigations have provided information to help implementation of the Water Framework Directive and clarify the scope of future environmental investment.

Bristol sewage sludge treatment

We are committed to the sustainable recycling of sewage sludge, which is the residue from the sewage treatment process. However, the European Nitrate Directive has imposed severe restrictions on the availability of agricultural land to dispose of sludge from our largest treatment works, serving a population equivalent of around 750,000 in the Bristol area.

We are therefore building an enhanced sludge treatment facility at Bristol sewage treatment works at Avonmouth which will comprise thermal drying using a belt drier. Construction of the new installation is now underway. We have also built an acid phase digestion plant to enhance the performance of the existing sludge digesters, increase methane gas production and further reduce the sludge volume. This has allowed us to increase power generation at this site. The secondary digesters are being converted to primary digesters to further increase gas production. When fully operational, these improvements will double the production of renewable energy from this site to four megawatts and reduce our carbon footprint by 10,000 tonnes of CO₂.

EU Water Framework Directive

We continue to engage fully with the Environment Agency and other stakeholders to assess the potential impact of this important European legislation on water customers and bills. We are pleased that for the first time, environmental regulation is geared towards assessing the costs and benefits of proposed improvements and holistic solutions are being considered to ensure the most sustainable delivery. We endorse solutions which are geared towards controlling pollution at source rather than relying on end-of-pipe treatment where this can be shown to be the most cost effective and sustainable approach.

Customer service and guarantees

We have continued to develop our affordability work. We are continuing our close collaboration and funding of local Citizens Advice Bureaux (CABs) in an effort to improve the debt advice given to customers who are struggling to pay their bills. This is proving to be

a great success and we have been awarded a CAB Oscar award for being the most caring and sensitive creditor. This is a real achievement for a water company.

Our schemes for customers in financial difficulty continue to be a success. Restart and Restart Plus are both designed to get customers who are having difficulty paying back on track. Evidence suggests that 14 out of 15 people on the schemes no longer fall into arrears.

Our new tariff, Assist, is continuing to prove popular, and has fulfilled the criteria for final approval from Ofwat. The tariff is designed to reduce the charges to customers who are in severe financial difficulty and, despite their best efforts, are genuinely unable to pay the full amount of their water bills. As hoped, customers who are on the tariff are now paying more than they did before.

All of these initiatives are aimed at enabling those with the greatest difficulty in paying to make at least a modest contribution towards the costs of water and sewerage services. If successful, the cost burden on all other customers will be reduced.

We have commenced a tariff study with 5,000 customers. This is studying the impact of three tariffs, a rising block tariff, a seasonal tariff and a peak-seasonal tariff. The study will enable us to understand the impact of both metering and tariffs to manage demand and affordability. Smart meters are being used in conjunction with the trial, giving customers more information on how and when they use water, and thereby giving them more control over their bills.

We continue our education programme, both with organisations that come into contact with vulnerable customers and also on wider water and sewerage issues, for example, through our schools' programme.

Our community partnership programme, the Wessex Water Partnership, wraps up all of our community involvement. In addition it covers proactive help and advice on water conservation, a re-launch of our community support programmes and reinvestment of efficiency savings and customer service improvements.

Through the Wessex Water Promise we continue to provide customer guarantees and compensation well in excess of the statutory guaranteed standards scheme. We continue to have the best overall package of guarantees in the industry.

Customer research involving both domestic and business customers has been carried out to establish customers views of our current service levels, their preferences for the future and willingness to pay for service enhancements. This has informed our draft business plan for 2010 to 2015, submitted to Ofwat in August.