

# **Interim results for the six months to 30 September 2011**

## **Overview**

We have continued our excellent start to the new five-year regulatory period.

Last month Ofwat confirmed that we are, once again, the best performing water and sewerage company in England and Wales.

We were the only company to be given a clean bill of health across the board for the way we provide water and sewerage services and we topped Ofwat's new Service Incentive Mechanism (SIM) for all areas of customer service.

We continue to deliver on customer satisfaction with 98% of customers who contacted us in the first six months of the year rating our services as good or very good.

Our strong financial performance continues and last year we out-performed our operating and capital cost allowances by more than any other company. And we have consistently delivered the highest returns over the past five years.

We continue to innovate and find better and cheaper ways of doing things. In the first six months of 2011-12, our expenditure continued below the assumptions made in our determination. The benefit of these savings is passed on to customers in subsequent regulatory periods. The independent water regulator, Ofwat, has calculated that bills are £100 lower today than they otherwise would have been because of innovation and efficiency.

In July we refinanced our £75m European Investment Bank (EIB) loan with repeat funding from the EIB and our liquidity (cash plus undrawn committed facilities) stands at around £140m.

In October we became responsible for many of our customers' private sewers and drains outside their property boundaries. This has doubled the length of our sewerage network but we are absorbing the extra work without any additional increase in customers' bills this year or next. We are also working hard to keep costs as low as possible in the longer term. We believe this is a positive change because as a sewerage undertaker we are very well placed to manage these assets efficiently, and to improve their environmental performance and service to customers.

Our preparations in Weymouth and Portland prior to the 2012 Olympic and Paralympic sailing events are well advanced and we have targeted our investment at infrastructure improvements to ensure that our services are resilient for next summer.

Our work continues to ensure that our services are increasingly socially and environmentally sustainable.

This autumn we finished our three-year metering and tariff study looking at how we can help our customers save water and save money and how we can make our charges more affordable. We found that metering works, cutting consumption by an average of 15% and reducing most customers' bills, as well as our impact on the environment.

However, metering can increase bills for poorer customers so it must be coupled with innovative tariffs, such as our award-winning Assist tariff, to improve affordability.

Another area of innovation and efficiency within Wessex Water is our catchment management work. We have made significant progress this year, demonstrating that this is a viable and low-cost alternative to traditional water treatment in many of our catchments.

Defra has said that the themes of affordability and sustainability will be key issues in its water white paper. We believe we are well placed to respond to these priorities, and to continue delivering for our customers and the environment in the months and years ahead.

## **Financial performance**

Our results for the half year show that historical cost profit after taxation increased by £1.1m from £60.4m to £61.5m.

- Turnover increased by £12.7m from £222.9m to £235.6m mainly due to the price increase permitted by our regulator Ofwat for the second year of the current regulatory period. This agreed increase amounted to 5.4% and comprised November 2010 RPI of 4.7%, a K factor of 0.3% and an allowance for tariff rebalancing of 0.4%. The remainder of the increase in turnover was due to new customer connections, partially offset by the impact of customers switching to metered supply. Overall, turnover has held up well despite the continuation of challenging economic conditions.
- Operational costs (excluding depreciation and capital maintenance) increased by only £1.4m from £64.7m to £66.1m. There was a £3.2m increase in the cost of new obligations, business rates, energy (including the new Carbon Reduction Commitment tax) and preparation costs for the adoption of private sewers. Efficiencies, plus a reduction in pension accounting adjustments and AMP preparation costs, amounted to £1.8m of offsetting operational cost savings.
- Depreciation and capital maintenance increased by only £0.1m. There was an increase of £1.1m on base depreciation, as new assets were depreciated for the first time, and an increase of £0.5m in infrastructure maintenance charges. These were offset by a profit on disposal of surplus assets of £1.2m, compared with a loss of £0.3m in the same period last year.
- Net interest payable increased by £11.6m. Underlying interest costs increased by £11.4m from £28.0m to £39.4m principally because of the impact of high inflation on our index linked bonds. Consequently the average cost of debt increased from 3.6% to 5.0%, although on a cash basis it remained at an historical low at around 3%. There was also an increase of £0.2m in respect of the interest element of pension accounting.
- Taxation fell by £1.5m from £16.3m to £14.8m. There was a £0.1m reduction in corporation tax as profit before tax fell by £0.4m and a £1.4m reduction in deferred taxation which moved from a charge of £0.2m last year to a credit of £1.2m this year.

Capital investment for the six months totalled £67.8m, an increase of 60% over the same period last year, as our five year investment programme gathered momentum. There were increases in expenditure on quality, capacity and capital maintenance schemes.

Net debt increased by £22.4m from £1,539.5m to £1,561.9m during the half year. The net cash inflow from operations was £172.4m, with cash outflows on the capital investment

programme of £67.8m, interest payments of £24.3m, tax payments of £16.5m and dividends of £86.2m.

Dividends declared in the six months to September 2011 were £107.8m compared to £54.6m for the same period last year. Part of the increase represented the final dividend for 2010-11, which this year was not declared until after period end, and part represented a special dividend earned through out-performance.

In July a new £75m loan was signed with the European Investment Bank, replacing a similar loan which had been repaid a month earlier. Consequently at 30 September 2011 liquidity, being cash plus undrawn bank facilities, stood at a healthy £143.9m.

## Operational performance and investment

We continue to make good progress in terms of both operational performance and capital investment, and we are on target to meet all 2010-15 milestones and regulatory outputs.

	2010-2011	First half 2010-2011	First half 2011-2012
<b>Customer service</b>			
SIM customer satisfaction score	89%	90%	92%
SIM customer contact score (lower is better)	119	66	50
Billing contacts dealt with in 5 days	100%	100%	100%
Written complaints dealt within 10 days	100%	100%	100%
<b>Water supply</b>			
Risk of receiving low pressure (per 10,000 properties)	3	6	4
Unplanned interruptions over 12 hours (per 10,000 properties)	1	0	0
Supply restrictions (per 10,000 properties)	0	0	0
Drinking water compliance	99.98%	99.98%	99.96%
Total leakage (millions of litres per day)	71	72	70
<b>Sewerage</b>			
Risk of internal sewage flooding once or more in 10 years (per 10,000 properties)	0.9	0.9	0.8
Internal sewage floodings (per 10,000 properties)	0.8	0.5	0.4
<b>Environmental standards</b>			
Compliance with EA abstraction licences	100%	100%	100%

Number of pollution incidents	85	55	44
Beaches meeting mandatory standards	100%	100%	100%
Population served by compliant sewage treatment works	100%	100%	100%
Sewage sludge disposed satisfactorily	100%	100%	100%
Carbon emissions (thousand tonnes CO <sub>2</sub> equivalent)	162	80	76

With regard to properties at risk of low water pressure our investment programme includes the removal of further properties in the second half of the year. We anticipate that the end of year figure will be around 165 compared with 173 properties last year.

## **Customer service and guarantees**

### **Service levels**

We continue to deliver the best performance on customer service in the industry.

In April 2010 Ofwat introduced the Service Incentive Mechanism (SIM), designed to encourage companies to provide better service to their customers. It comprises a customer satisfaction survey and a quantitative customer contact measure and Ofwat's recently published annual SIM performance report showed that we were the industry leaders for 2010/11.

Performance figures for the first six months of this year indicate that we are still in this leading position, coming top of the first two SIM satisfaction surveys this year. Such high satisfaction levels are due, we believe, to our prompt, warm voice telephone answering, quick response times, first time resolution of problems and our efforts to keep customers informed of what we are doing at all times.

Our score on the customer contact measure also continues to improve as we maintain our focus on reducing service failures and consequently reducing complaints and repeat contact.

### **Customer guarantees**

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

### **Affordability**

The continuing fragile economic climate has brought growing affordability problems.

Our commitment to tackling this issue is reflected in our strong partnership work with the Citizens Advice Bureaux, other debt advice agencies across our region and National Debtline (Money Advice Trust) to improve the availability of debt advice to customers struggling to pay. This is delivering real benefits for customers, debt advice workers and Wessex Water alike.

Our Assist tariff continues to be popular with more than 8,000 now on the tariff. Assist reduces charges to customers who are in extreme financial difficulty and allows them to make a modest contribution towards the costs of water and sewerage services.

Similarly, our schemes for customers who can afford their ongoing charges but have fallen into debt, perhaps because of past difficulties, continue to be a success. Restart and Restart Plus are both designed to put customers who are in debt back on track and back into the habit of making regular payments to cover their water bills.

In September we received the Best Partner Award from Wiltshire Citizens Advice in recognition of our successful partnership with Citizens Advice Bureaux across our region.

### **Tariff studies**

We have completed our tariff study involving 5,000 customers to investigate the impact of three different tariffs: a rising block tariff, a seasonal tariff and a peak seasonal tariff. The study enabled us to understand the impact of both metering and tariffs on managing demand and affordability. We used smart meters and in-home monitoring devices to give customers more information on how and when they were using water, giving them more control over their bills.

The study findings show that fitting a meter when the occupier of a property changes reduces customer demand for water by 15% without causing adverse customer reaction. Seasonal charging structures encourage a further step change in water conservation behaviour and improve affordability of charges compared to both flat-rate and rising block charging structures, but are perceived negatively by customers.

We believe metering and tariffs have an important role to play in keeping our services affordable for all. We are continuing our work in this area through a new smart meter community project in the south of our region.

### **Education and community involvement**

We continue to provide an education programme offering a range of services to support schools, teachers and students from primary to university level. We are also working with organisations in our region to reach vulnerable customers, as well as offering community talks on wider water and sewerage issues.

Our community partnership programme, the Wessex Water Partnership, incorporates all our community involvement. In addition, it offers proactive help and advice on water conservation, our affordability schemes, our community support programmes and reinvestment of efficiency savings and customer service improvements.

### **Meeting new demands**

Maintaining the supply of water remains a primary objective and last summer marked the 34th year without supply restrictions in the Wessex Water region.

During the last 12 months we have received approximately 75% of average rainfall and this autumn river flows across much of our region are below average for the time of year. We have investigated the potential impacts on our water resource position for next year if the coming winter is drier than average and advised the Environment Agency of our findings.

Currently we do not anticipate any need for restrictions but if the dry weather continues then these will be considered at the appropriate time.

We continue to invest and optimise our water resources and treatment works to ensure we can meet demands from new development and reduce the impact of our existing abstractions on the environment. We have maintained our focus on reducing leakage from our extensive network of around 11,500 km of mains and despite a very severe winter met our leakage target in 2010-11. This level of active leakage control continues into this year and we are confident that we will meet the target again for the full year 2011-12.

Our ongoing water efficiency initiatives to help customers reduce their consumption include a comprehensive free service for repairing and replacing private supply pipes, free meter options and a variety of other initiatives, including a home water use MOT and work with schools. We are also working with British Gas to install water efficiency devices as part of their service visits to customers. We are on course to meet our water efficiency target for 2011-12.

The demand for the installation of free meters by customers who pay for their water on an unmetered basis was broadly in line with the corresponding six-month period last year.

Despite the depressed economic climate, the demand for mains and sewers to serve new development has been surprisingly buoyant.

Installation of water mains to service major development is nearing completion at Shaftesbury and Bridgwater and we have begun design of two new service reservoirs to accommodate growth in demand at Ramsey, near Wellington, and Grimstone near Dorchester.

Construction of major schemes to upgrade sewage treatment capacity is progressing well at Wootton Bassett, Tarrant Crawford, which serves the Blandford area, and Castle Cary. Design is also underway for major works at Amesbury and Taunton.

Liaison with developers and planning authorities alike has been very active due to the authorities preparing and revising their future development core strategies following the government's withdrawal of Regional Spatial Strategy guidance.

We have been praised by developers for our proactive approach in dealing with transition arrangements for sewer adoption agreements following the blanket transfer of private sewers in October.

## **Improving drinking water and the environment**

Our mean zonal compliance for the half year is above the industry-wide level and equal to our average compliance over the past three years. The measure is very sensitive to individual failures. Three marginal taste and odour failures in our Porlock zone have brought compliance down from the previous year. We have stopped using this source at times of high risk and our AMP6 business plan will include proposals to abandon it.

## **Coping with worsening raw water quality**

Deteriorating raw water quality has often triggered multi-million pound investment in water

treatment works. To avoid these high cost schemes and to develop more sustainable solutions we are continuing our innovative strategy of catchment management.

Our catchment management specialists are working alongside the local farming community to identify potential pollutant pathways and find alternative management practices that protect and improve groundwater quality at 15 sources.

In April 2011 we published *Catchment management – managing water – managing land*, which advocates catchment management as the primary tool for managing raw water quality, including nitrates. This report has been very well received by our regulators and government and we hope its recommendations will be supported in the water white paper.

### **Sutton Bingham water treatment works**

Major process extensions and extensive maintenance are proposed for this works which serves the Yeovil area. The aim is to improve the performance of the works, first developed in the 1980s, in dealing with pesticides and taste and odour problems. Design work is complete and construction began on site in the autumn of 2011.

### **Mains relining for iron compliance and reduction in discoloured water**

Our programme of mains rehabilitation is well underway to reduce discoloured water complaints and improve our performance with regard to iron compliance. The work is targeted at nine particular high risk zones and work in the zone which supplies Bridgwater, also known as Operation Clean and Clear, is substantially complete. Our collaborative approach with the highway authorities and an active public relations campaign helped to ensure the project went smoothly.

Mains rehabilitation is also progressing in other zones including the Exmoor, Porlock and Yeovil areas. Planning for the next major scheme in Taunton is underway.

### **Addressing the impact of water abstraction on river flows**

We have an active programme of work to address concerns that have been raised about our groundwater abstractions and their impact on river flows. In particular, to improve river flows in the Wylde and Bourne catchments, in accordance with the National Environment Programme, abstraction licences will be reduced by a further 23.5 Ml/d once the construction of our proposed water supply transfer scheme is completed.

In addition the new projects under the water supply grid programme will enable us to manage water more effectively around our region and ensure future demand is met. The projects will include new trunk mains, new service reservoirs and new or refurbished pumping stations and will take place across Dorset, Somerset and Wiltshire.

While the overall programme will take eight years to complete, planning and design is well advanced. Construction on the first two projects will begin in the summer of 2012 and further projects will start later in the year.

In summary, once complete the projects will:

- improve the security of supply to customers, even in the event of a catastrophic source failure

- meet our customers' demands for water over the next 25 years
- meet the reductions in abstraction licences required by the Environment Agency to improve flows in some rivers and protect their ecology
- deal with deteriorating raw water quality, particularly increasing concentrations of nitrates at some of our groundwater sources.

## **Sewerage and sewage treatment improvements**

### **Sewer flooding**

Fortunately, sewer flooding is rare but when it does happen it is one of the worst service failures our customers and the environment can experience. Substantial investment over recent years has meant that out of more than 1.1 million properties, only 102 were at risk of internal flooding more than once in 10 years because of inadequate capacity – our lowest number ever.

Through further investment we aim to keep the number at risk at around the same level and also propose to reduce the risk of external flooding problems and newly arising flooding problems. We are currently on target to deliver the 527 flooding outputs planned in 2010-15.

The responsibility for flooding is often complex and we are working with local authorities in their production of surface water management plans to investigate these shared problems. We are currently contributing towards these plans in Bournemouth, Bristol, Minehead, Taunton and Weston-super-Mare.

### **Storm overflows**

During particularly heavy rainfall storm overflows act as relief valves to ensure properties do not flood and the conditions under which they are allowed to spill are consented by the Environment Agency. We have begun a five-year programme to improve 65 unsatisfactory storm overflows to watercourses, 63 of which are in Bristol.

We have started appraisals for all these schemes and have a programme to deliver eight by the end of the financial year.

### **First-time sewerage**

We provide first time sewerage schemes to communities not connected to the public sewerage system where it can be shown that this is a cost effective solution to any public health or environmental problems.

Last year we completed schemes in Edington (Bridgwater), Loxton (Weston-super-Mare) and Monkton Combe (Bath) which allowed 73 properties to connect to the public sewerage system for the first time. Construction is currently underway at Greinton (near Street) to allow connection of a further 20 properties in a few months time. We also are designing a scheme at Cold Harbour (Wareham) where a local nature reserve is being affected by sewage discharges.

We are currently appraising the viability of four other applications.

### **Urban Waste Water Treatment Directive**

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. Designation

of two river systems in the Somerset Levels as Sensitive Areas means we are required to install phosphorus removal processes at six of our sewage treatment works (STWs).

In addition phosphorus removal is required at Paulton STW, where the connected population has increased above 10,000. During the first six months of this year we have progressed the design work on these schemes with the detailed design of the first two projects now completed.

### **Revised Bathing Water Directive**

The revised EU Bathing Water Directive requires that by 2015 bathing waters must meet tighter microbiological standards.

This means providing improved secondary biological treatment at Weston-super-Mare STW, together with storm storage capacity to reduce the frequency of storm sewage discharges from Black Rock pumping station. Construction of a new activated sludge plant, final settlement tanks and storm tanks began in May 2011 and is progressing well and on schedule for completion by the target date of March 2013.

### **Coastwatch**

Wessex Water was the first water company in the country to publish information that shows when storm overflows have been in use. During the summer bathing season water quality can be checked for any of the 47 bathing waters in the Wessex Water region through a new facility on the company's website.

### **Sludge treatment**

All sludge generated from the waste water treatment process is disposed of safely and in a way that meets mandatory standards. The sludge digestion process is a means of reducing the volume of sludge while generating renewable energy to minimise our costs and our carbon footprint.

We have a target for 2010-15 to extend and upgrade our sludge digestion facilities. This includes the installation of advanced anaerobic digestion facilities at three of our major sludge treatment centres. During the first six months of this year we have progressed design work on advanced digestion schemes at Trowbridge, Taunton and Berry Hill (Bournemouth) sludge treatment centres.

### **Biodiversity and conservation**

Like all water companies Wessex Water has a duty to protect, conserve and enhance the wildlife on the land we own. In recognition of this, we have initiated two five-year projects at 15 sites of high biodiversity potential within our region. We have completed two seasons of survey work on these sites which has yielded some interesting results.

The data shows that our sites are very important regionally for populations of the species monitored and the next stage of these projects is to understand what management actions we can take to enhance populations without conflicting with the operation of these sites.

Our wider biodiversity work continues through our Partners Programme. Recent government changes and spending reviews are beginning to hit the environmental non-governmental organisation sector hard and our private sector funding is becoming even more valuable for this type of work.

**Investigations**

To address future uncertainty surrounding improvements required by European legislation a programme of investigations is taking place to plan capital investment for the five-year period beginning in April 2015. The investigations started in April 2010 and include bathing water investigations at Weston-super-Mare, Burnham and Blue Anchor, the impact of our discharges on algal growth in watercourses and more sustainable methods of phosphorus removal.

The majority of these investigations are more than 50% complete and will provide information to help implement this legislation and clarify the scope of future environmental investment.