

## Operating and Financial Review

# Moving forward under a renewed banner



We are not changing who we are, we just look more modern and prepared for the opportunities ahead.

**Anthony Ferrar**  
Managing Director



### Why?

We have a vision of being an outstanding water company delivering service excellence. We needed a brand to reflect this.

### How?

We listened to feedback from our customers, employees and stakeholders.

### What?

The shorter name and consistent visual identity makes us look more modern and ready for the future.



### A new name reflects a new era

February 2017 saw a significant change for the Company as we re-branded to SES Water. After more than 20 years as Sutton and East Surrey Water, this signalled an important new era with the trading name and logo aiming to reflect wider changes in the industry, namely the introduction of competition for business customers. Extensive consultation with employees, customers and other stakeholders fed directly into all decision-making and we are really excited about our new look. Employee roadshows were held to help explain the re-branding process and engage them in what it means for the Company going forward. We wrote to every customer and stakeholder ahead of the launch and offered dedicated contact methods for queries and comments. Feedback so far has been overwhelmingly positive and we look forward to further implementing the brand so that everything is consistent and underpins our vision of being an outstanding water company delivering service excellence.



Thanks to a lot of hard work by all involved, we were ready for the market opening on 1 April 2017, an historic event in the water industry. Just under two years ago, we started preparing for the change and will continue to supply water to all properties in our supply area. However, the Company is not operating in the new retail market and we sold our right to trade with existing business customers to an associated company trading as SES Business Water. In October 2016 'shadow' operations successfully began when all the water companies and the new market operator, MOSL, practised the transactions that take place, ahead of the market opening for real. During this period we launched our new Wholesale Service Desk which

is our primary contact channel with SES Business Water and all the other retailers. They will be monitoring our performance against the required standards and ensuring we make any improvements needed. The team has also taken the lead in training employees on the changes to our ways of working and ensuring understanding of our Compliance Code which outlines how we will comply with the relevant regulatory and legal requirements.

### Our promises to customers (see pages 9 to 19 for a full breakdown of our measures and performance)

Our last Business Plan made a number of promises to our customers focused around delivering six aims.

### Overall Aim - Continue to be a well-run, respected and successful business:

We are a local company and are proud to have served the community for over 150 years. This year we have donated over £9,000 to support local causes. As well as giving money to charities, including our long-standing support to WaterAid and also our 'Give-a-Day' scheme where we donate employees' time, we seek ways to make a positive impact on the community. For instance, guides and brownies in Horley are enjoying safer access to their meetings thanks to us laying a new driveway outside their hall whilst we were also renewing water mains in the town. Further afield, we have donated thirty of our old computers to Sierra Leone for use by a charity supporting street children and orphans.

Our overall 2016 Employee Engagement Survey results were disappointing but a reminder that we must continuously look for ways to improve engagement across the business. While some scores had slipped from 2015, others showed an encouraging increase, particularly for customer focus and innovation. At the last quarterly Employee Engagement Forum of the year, discussion was very constructive with one of the topics being the need for employees to be more proactive in looking for ways to develop including ways they can learn about the business.

Having a dedicated Innovation Manager is helping to achieve momentum in implementing many improvements across the business and progressing the way we work. Many timesheets have been moved to an electronic system and our inspectors now use mobile devices, drastically cutting down on paperwork and increasing efficiency.

Overhauling our procurement processes to buy goods and services more efficiently took a major step forward with a new Procurement Forum focusing on centrally negotiating agreements, undertaking joint procurement with partners and reducing the number of suppliers we use. One success included a joint appointment of a specialist supplier providing reservoir and water tower maintenance in collaboration with Portsmouth Water and Dee Valley Water.

Ensuring the health and safety of our employees, contractors and the public is extremely important and there were only two lost time accidents this year. There was one 'dangerous occurrence' reported to the Health & Safety Executive under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013 (RIDDOR). This was due to the unintentional release of chlorine gas within the confines of a building at one of our treatment works.

### Aim 1 - To provide a reliable and sufficient supply of safe, high quality drinking water:

Some supply interruptions are unavoidable as we do work to improve the long-term resilience of our network. We continue to invest in ways to reduce the number of interruptions necessary due to planned activity. The number of customers whose supply was interrupted for over three hours was considerably fewer than last year, equating to a 30 per cent improvement and well within our target. As a result, we expect to earn a reward under Ofwat's incentive schemes for our achievement in reducing the inconvenience to customers.

The number of bursts is a key measure of the general condition and performance of our network so it is encouraging to report only 234 bursts this year which is well below the target of 290 and 10 per cent lower than the long-term average.

We have achieved 99.98 per cent for the Overall Drinking Water Quality Index in 2016. There were only two breaches of the water quality standards at customer properties that impacted our performance and one of those was completely outside of our control as it related to high concentrations of nickel in the water due to leaching from the customer's tap. The other failure, for iron at a customer's tap, followed a localised short-term increase in flow that may have been due to illegal hydrant use. We have continued to prosecute organisations which persist in using our hydrants illegally and thereby

compromising the quality of supplies to customers. We achieved 100 per cent compliance for standards at our treatment works.

There were 375 contacts from customers during the year about the taste, odour and discolouration of their water. This is above our challenging target but far fewer than in the previous year which shows that the measures we have put in place, such as improved communication and innovative ways of carrying out essential repairs and renewals, are working.

In September, we connected a communication pipe (the pipe from the mains supply to a property boundary) to an isolated main which resulted in one customer receiving unwholesome water, contravening water quality regulations. The Drinking Water Inspectorate (DWI) investigated and issued a warning letter but since the incident we have implemented a number of remedial measures to prevent it happening again.

### Aim 2 - Offer good value for money and keep bills at a fair and reasonable level:

With just 6.3 per cent of customers considering that their water bill is not good value for money, this is fewer than last year and well within the target of 15 per cent. The average household bill was £186, less than a two per cent rise on the previous year. We communicate regularly on the range of options available for those suffering financial hardship, including the Water Support tariff which continues to attract customers who find it difficult to pay their bill.

Our Debt Recovery team scored 25 out of 25 following an audit in February by the Consumer Council for Water, the statutory consumer body for the water industry. The score is based on our debt recovery processes and we are the first company in the water industry to achieve top marks. This demonstrates our commitment to reducing bad debt and supporting customers facing financial hardship.

### Aim 3 - Increase the resilience of our network to drought, flooding and equipment failure:

No restrictions were put in place this year but there was a prolonged period of dry weather in the last six months of 2016. Despite some wet weather returning in January, we kept a close eye on our water resources, especially our groundwater sources which were below average but provide 85 per cent of our supplies.

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Continued

Our continued commitment to investing in infrastructure means we have one of the lowest burst mains and leakage levels in the UK. As well as renewing over 11 kilometres of mains this year, work has continued to significantly redevelop our Woodmansterne Water Treatment Works in Chipstead. £22 million is being spent in total and in July the new soakaway lagoon was completed and is now fully operational. The three year programme is due to be completed in 2018.

In July we signed new long-term contracts with both Clancy Docwra and J. Murphy & Sons Limited who both play a significant role in improving our network, including mains renewal and building pipelines. We have been working more consistently and efficiently together - including changing processes, office space and systems - to benefit customers and the 'One Team' programme is putting our vision for closer contractor working relationships into practice.

### Aim 4 - Deliver consistently high levels of service:

Satisfaction with the overall water service we provide remains above target and higher than last year. However, our Service Incentive Mechanism (SIM) score places us second from bottom in the national league tables and we have also seen an increase in complaints. Huge efforts have been made to improve, including a new Customer Relations team, and customers are satisfied with their water but still say there is more we need to do when they have a need to contact us. This is clearly not a position we want to be in and improving our service and score remains a priority. In addition to the actions that are already being taken, such as streamlining processes and recruiting more employees into our call centre, we are also reviewing our key customer journeys to ensure the service we offer to customers is as good as it can possibly be.

### Aim 5 - Reduce our impact on the environment while seeking to make a positive contribution to its quality:

Managing leakage is one of our customers' top priorities and therefore a key area of focus for us, ensuring that we continue to be one of the top performing companies for leakage management.

This year we installed 6,542 water meters through both home moves and customer applications, which exceeds the internal target we set ourselves to help meet

our commitment to reducing customer usage. This is especially important as we have one of the highest levels of usage in the country as well as a growing population. Promoting water efficiency to customers continued and received a boost with the launch of our new Water Savings Calculator in collaboration with Save Water Save Money.

Reaching over 10,000 children and adults through our education programme this year means we have continued to help them place more value on the water they use to make small changes that will benefit the environment. Our presence at summer events in 2017 will be even more impactful thanks to the work that has taken place this year to secure a new interactive, branded trailer.

We had one minor pollution incident which resulted in clean water entering a water course from a burst pipe.

Our 12 Environmental Representatives within our business promote the 'green agenda' in all that we do which includes initiatives such as producing free electricity and reducing paper consumption by increasing e-billing, online payslips and secure printing.

### Our dedicated employees

Following last year's success in obtaining Investors in People (IIP) Silver recognition, undoubtedly one of our greatest accomplishments this year has been being awarded Gold, something that only five per cent of accredited companies achieve. The assessment in January saw us meet 18 new evidence requirements, on top of the 154 already achieved for Silver. Some of the highlights included employees demonstrating a much greater awareness of our vision and values, managers having a consistent approach to our work-life balance whilst still meeting business needs and some really positive feedback on the trust and openness of the Company. We chose to be a part of IIP to show that we have what it takes to lead, support and manage our employees for sustainable results. It is rare for an organisation to progress so quickly from Silver to Gold and the scheme has added real value in helping us understand our capabilities and gain new insights into how we can improve.

We have recruited new people from outside the Company into some key roles this year, which reflects our desire to bring in specific expertise to help move the business forward.

Notably, Tom Kelly joined us in January as Wholesale Services Director and brings with him a wealth of operational experience from different sectors. He has been busy working closely with teams to understand the opportunities and challenges that exist and is keen to find ways for the Company to exceed our goals. Retail Services has the most contact with customers and is therefore a key part of the business. Our vision is to deliver service excellence so we have brought in Daniel Lamb who has held a number of senior customer service management positions to head up the department.

We would not have been able to achieve all that we have this year without the commitment of our employees and their response to a significant operational incident this year was testament to this. In February we temporarily closed Elmer Treatment Works due to a chlorine release inside the site. There was no wider risk to the public or local residents but individuals across the business involved in the initial response went above and beyond to ensure that the closure did not impact on customers' water supplies. Long hours, little sleep and disruption to personal lives was felt by many at all levels. Thanks to their invaluable dedication the site was re-opened quickly and it was really encouraging to see that lessons learned during the major flooding at Kenley Treatment Works in 2014 were put into practice at Elmer.

### Our regulator

One of Ofwat's roles is to set the price, investment and service package that customers receive as households are not able to choose their water supplier. They must balance the interests of consumers with the need to ensure companies can finance the delivery of services. Price controls are set every five years and will next be set in December 2019 with effect on bills from 2020 - this process is known as 'PR19'. We will produce a proposed business plan for 2020-25 which sets out what we want to deliver during that period. Although this is not submitted to Ofwat until September 2018, work has begun this year on our customer engagement programme to ensure that extensive consultation with all stakeholders is carried out to help shape our early thinking. The programme, in three phases, is a combination of detailed research, such as workshops, interviews and surveys to gather specific views, supplemented with what we already know from our customers through the day-to-day

running of the business. The role of the Customer Scrutiny Panel (CSP) in the business planning process is to ensure and provide validation to Ofwat, that thorough engagement with stakeholders is genuinely reflected in the final plan. Hear more from Graham Hanson, Chair of the CSP, on page 28.

It is important that we communicate regularly about how we are performing against our targets. As well as releasing information at the end of the year in the Annual Report, we also hold stakeholder briefing sessions, provide quarterly updates to the CSP and include information on our website and other channels such as newsletters and bills.

### Financial performance

Turnover increased to £64.7 million (2016: £63.0 million). Operating cost increases were restricted to 1.4%, totalling £43.5 million (2016: £42.9 million). Operating profits therefore increased by £1.1 million to £21.2 million (2016: £20.1 million). Interest charges increased by 16% to £9.2 million (2016: £7.9 million) largely as a result of higher inflation increasing the indexation charge on our £100 million index-linked bond. Interest receivable and similar charges generated £0.9 million (2016: £0.7 million). As a result, profit before tax fell by £1.4 million to £12.9 million (2016: £14.3 million). Further reductions in future rates of corporation tax reduced the provisions we need to make for tax payable in future years, and restricted our accounting tax charge for the year to £0.4 million (2016: a credit of £0.4 million).

### Capital investment

The Company's latest five year investment programme has made good progress in the year, with £23.4 million invested in new and replacement plant and equipment (2016: £18.1 million). Our biggest ever capital project - the £22 million upgrade of Woodmansterne Treatment Works - moved into the major phase of construction, with £7.7 million invested in civil structures and mechanical plant on site. The project remains on track for commissioning in summer 2018, well ahead of the March 2019 deadline. Also included in this year's investment programme was a further £5.2 million for the ongoing replacement of pipes within our distribution network - selected according to their age, condition and performance - as a contribution to our stewardship of these critical underground assets. A further £3 million was invested in our network, including £1 million in enhancements

to improve resilience by enabling more water to be moved around our supply area and £900,000 in pipes to supply new developments.

Of the remaining £7.5 million, £3.1 million was for water resources and the replacement of equipment at treatment works, pumping stations, service reservoirs and other operational sites. £1.8 million was invested as part of our ongoing programme of meter installation and £2.6 million on IT, vehicles, the laboratory and office equipment and renewals.

The major competitive tendering exercise to renew our principal infrastructure services contracts was completed in the first quarter of the year and the new collaborative way of working, integrating suppliers and employees in to one team to deliver shared targets, has quickly been embedded. Similarly, our strategic review of the way in which we procure all our goods and services - and the collaboration with a neighbouring water company on joint procurement exercises - has already started to deliver benefits through keener prices and more efficient ways of working. We see scope for further benefits in the future.

### Net debt

Net debt for the Company at 31 March 2017 rose by £7.3 million to £178.1 million (2016: £170.8 million), including £2.2 million additional utilisation of facilities provided by the Royal Bank of Scotland. The carrying value of our £100 million index-linked bond was increased by £2.8 million due to the link to RPI (2016: £1.5 million). Cash and liquid resources decreased by £1.9 million in the year (2016: £3 million increase).

The level of gearing is a key ratio under the covenants associated with our index-linked bond and is measured by the ratio of net indebtedness to regulatory Capital Value (RCV). The RCV is indexed by movements in RPI and linking of our principal debt instrument to the same inflation index provides an effective hedge against the impact of inflation. The ratio as defined by our bond was 77% at 31 March 2017 (2016: 78.0%) - comfortably within the 80% permitted by our covenants.

### Pensions

The Company is a member of the Water Companies Pension Scheme (WCPS), details of which are disclosed in the Financial Statements under the requirements of IAS 19(R). A net

pension scheme asset of £25.2 million (2016: £23.8 million) is included in the balance sheet.

The last funding valuation was carried out by the Pension Scheme Trustee at 31 March 2014. Actuarial valuations are required to adopt more conservative assumptions than those used for accounting purposes, and the valuation indicated a small deficit in our element of the fund of £1.9 million. The Company agreed with the Pension Scheme Trustee's proposal that contributions to the deficit would continue at the rate agreed under the previous actuarial valuation (at March 2011), which were sufficient to eliminate the current deficit by the end of April 2017. The next actuarial valuation (at 31 March 2017) is now underway and will be finalised before next year's Annual Report.

**Anthony Ferrar**  
Managing Director  
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