



At a glance...

On average, our customers currently pay just over 50p a day for their water services.

50p

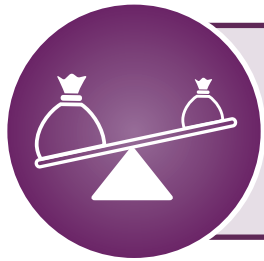


In December 2019 we received the Final Determination on our Business Plan for 2020 to 2025 from Ofwat, which will see bills fall by 15.6% in real terms over the five-year period.

We are jointly owned by two Japanese companies who have proved to be responsible and committed investors in our business.



We are financed through a combination of shareholder capital and debt. Our shareholders have significantly lowered our debt by putting more of their own money into the Company.



Like any investors, our shareholders expect a return on the money they put into our business but these dividends are not guaranteed – our Board first considers how well we have delivered for our customers. Our dividends continue to be consistent with the level of return that Ofwat has indicated as reasonable.



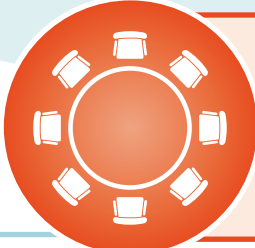
Similarly, it is important the amount of money that is paid to senior directors attracts and keeps people of a high calibre but also reflects how well we are performing.



We have never operated any complex, international financing arrangements and our holding company is based in the UK, paying corporation tax to the UK Government.



Independent non-executive directors make up the biggest group on our Board, providing targeted challenge and support in their areas of expertise.



I am pleased to present the latest edition of 'Keeping it clear', intended to be an easy-to-read guide on our finances, structure and decision-making. Our previous publications have received very positive feedback from our customers and other stakeholders, so it is important we continue to provide this level of transparency, together with the latest financial information.

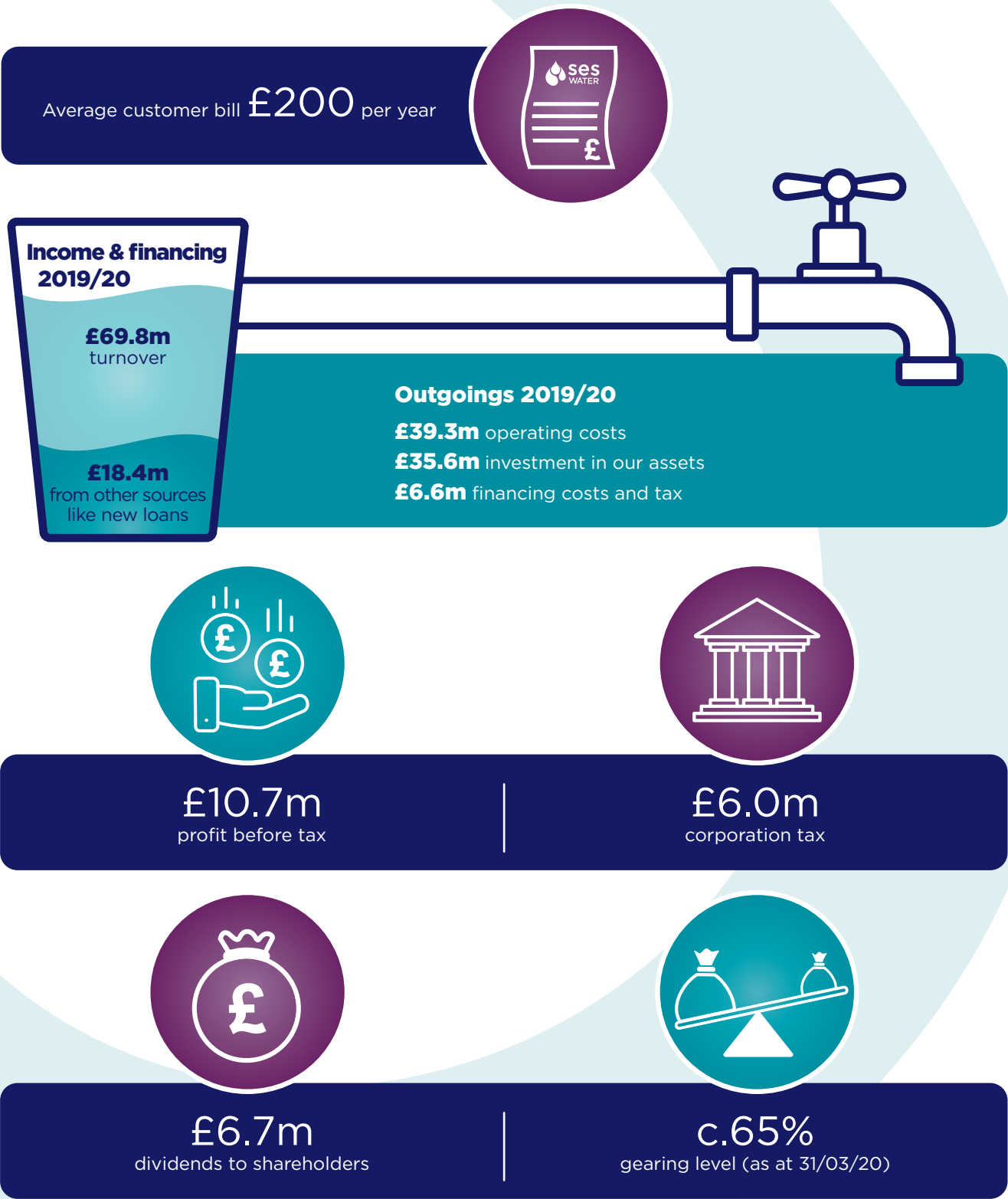
As with many companies this year, our revenue and profit is being impacted by the COVID-19 pandemic, but our long-term financial resilience remains strong with ready access to sources of liquidity if needed.

This summary explains our bills and provides clarity on our financing structure and how we are governed so you can gain a good understanding of how we are owned and run, where we spend our money and the dividends and taxes we pay.

Paul Kerr
Group Chief Financial Officer



Our finances today



In March 2020 a change to the UK corporation tax was enacted. The UK Government confirmed that the rate of 19% would be retained, rather than reducing to 17% from 1 April 2020 which had previously been legislated. Deferred taxes at the balance sheet date have been measured using the tax rate of 19% and this has resulted in an increase in a one-off, non-cash, deferred tax charge of £5.0m.

Our income and expenditure

The majority of the income we receive comes from the water we provide.

The money we spend is split between four main areas – running our day-to-day operations, capital investment, costs associated with financing (interest repayments) and dividends to shareholders. We also pay corporation tax following UK tax rules.

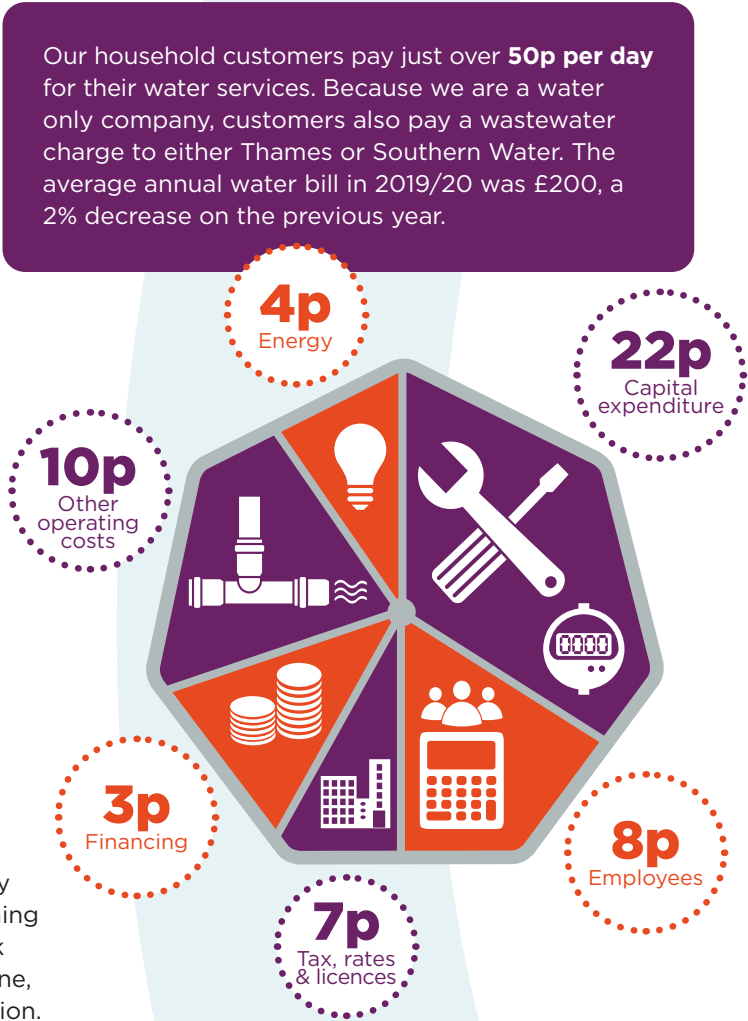
Below you can see our main sources of income in 2019/20 and what we spend our money on.

| Income (£m) | | Outgoings (£m) | |
|------------------------------------|----------------|------------------------------------|----------------|
| | 2019/20 Actual | | 2019/20 Actual |
| Household bills | 54.3 | Employees | 13.3 |
| Business retailers | 10.9 | Energy | 5.7 |
| Developers, builders and other | 2.5 | Chemicals and materials | 2.5 |
| Non-appointed (unregulated) income | 2.1 | Rates | 3.4 |
| Turnover | 69.8 | Insurance | 0.8 |
| | | Other e.g. contractors | 13.6 |
| New loans | 17.5 | Operating expenditure | 39.3 |
| Changes in bank balances | 0.9 | Pipe replacement | 13.0 |
| Net new financing | 18.4 | Treatment works upgrades | 9.6 |
| | | Installing meters | 2.6 |
| | | Upgrading boreholes and reservoirs | 4.3 |
| | | IT, vehicles etc | 6.1 |
| | | Capital expenditure | 35.6 |
| | | Interest on loans | 5.6 |
| | | Dividends to shareholders | 6.7 |
| | | Financing costs | 12.3 |
| | | | |
| | | Tax payments | 1.0 |
| | | | |
| Total income | 88.2 | Total outgoings | 88.2 |

Customer bills

We keep our bills low by:

- **Operating efficiently** – between 2020 and 2025 we plan to reduce our costs by 7% by buying goods and services more economically, reducing our energy use and making efficiencies across our operations
- **Financing efficiently** – while as a small company we can't access debt financing as cheaply as the larger water companies, our reduction in debt means lower interest costs to be borne by us and our customers
- **Growth in our customer base** – as more homes are connected to our network the costs will be spread across more customers which helps lower bills in the long-term
- **Providing extra support** – our Water Support Scheme helps those who genuinely can't afford to pay their bill. This discount is funded through a supplement from other customers, as well as money from our shareholders



COVID-19 financial support

In March 2020 we quickly introduced a payment holiday for those people whose income was affected. Our Breathing Space scheme is a way to help those customers get back on their feet and allows them to pause their payments for one, two or three months depending on their financial situation.

We also receive income from:

- **Water retailers** who pay us for the water supplied to their business customers who they provide billing and customer services to.
- **Housing developers** who pay us to lay new pipes and connect new homes to our network.
- **Non-appointed income** which is money we receive from other parts of our business not directly related to providing water to our customers, such as payments for issuing wastewater bills on behalf of Thames Water.

Setting bills

Because the water industry is a regionalised monopoly and household customers can't switch supplier, customer bills are set every five years through a rigorous price review process. We develop a Business Plan which sets out everything we plan to deliver and what it will cost. The plan is based on extensive engagement with customers to make sure that we are spending money in the areas that matter most to them and that they are willing to pay for the investment we make.

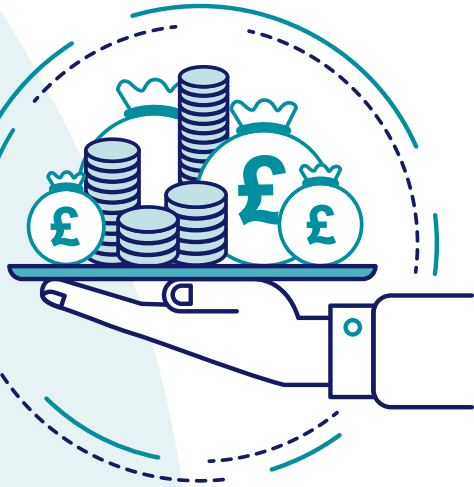
We submitted our Business Plan for 2020 to 2025 in September 2018 and in December 2019 Ofwat published its 'Final Determination' on the plan.

We have accepted the determination, which will see bills fall by 15.6% in real terms over the five-year period. It followed a period of intensive engagement with Ofwat following its Draft Determination in July 2019, on which we made a number of representations. This resulted in us securing additional investment for leakage reduction and improved network resilience. In September 2020, once our results for the full 2019/20 year had been finalised, Ofwat required minor adjustments to our 2020 to 2025 allowed revenues.

Debt, equity and gearing

Like most companies we are financed through a combination of debt and shareholder equity. After deducting the cash we hold, the amount we have borrowed is referred to as our net debt.

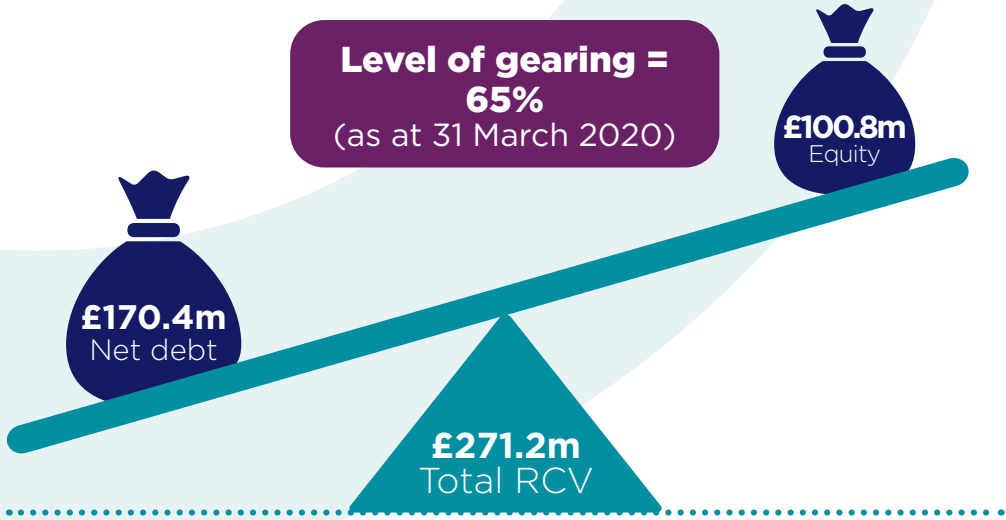
| NET DEBT (as at 31 March 2020) | | |
|---|---|---------|
| Retail Prices Index-linked bond | £ | 164.9m |
| A revolving credit facility from the bank | £ | 31.0m |
| Debentures | £ | 0.1m |
| Cash | £ | (25.6m) |
| Net debt | £ | 170.4m |



Net debt combined with shareholder equity equals our Regulated Capital Value (RCV), which is essentially the total value of our business as calculated by our regulator.

A good way to think about this is like a mortgage. The RCV represents the total value of your property (and increases in value in line with improvements and inflation over time), shareholder equity represents the deposit you put down and net debt represents what remains on your mortgage.

The proportion of the RCV that is funded by debt is commonly referred to as our level of gearing. Water companies operate with different levels of gearing, but historically it's not been unusual for gearing ratios to be above 75%. Our gearing at 31 March 2020 was 65% and while we expect this to increase over the next few years, we have committed to maintain our gearing below the levels considered reasonable by Ofwat for long-term financial resilience.



Money from the bank

In July 2020 we agreed an extension to our five-year revolving credit facility to £50 million, which is a line of credit with an agreed maximum amount which can be drawn on at any time when needed. Despite difficult economic conditions due to COVID-19, the extension demonstrates our continued credit worthiness and resilience.



Our index-linked bond

In 2001, we took out a £100 million Retail Prices Index-linked (RPI) bond which has provided the bedrock for funding our capital investment programme and has meant that in the years since we have not needed to borrow a material amount of additional funds. The bond was issued at a rate of 2.87% interest. Because it is index-linked to RPI it means that both the capital sum and the interest payments will vary accordingly.

The charges associated with the indexation are treated as an interest cost but don't have any immediate impact on cash flow as no actual cash payments are needed until maturity. The fees associated with the issue of the bond are paid back over the life of the bond, plus interest.

In 2019/20 we paid £5.0m of interest on our bond. The bond will be repaid between 2027 and 2031. Ahead of this we are already looking at longer term financing strategies to replace it, to ensure our long-term borrowing is secured at the most efficient rate possible.

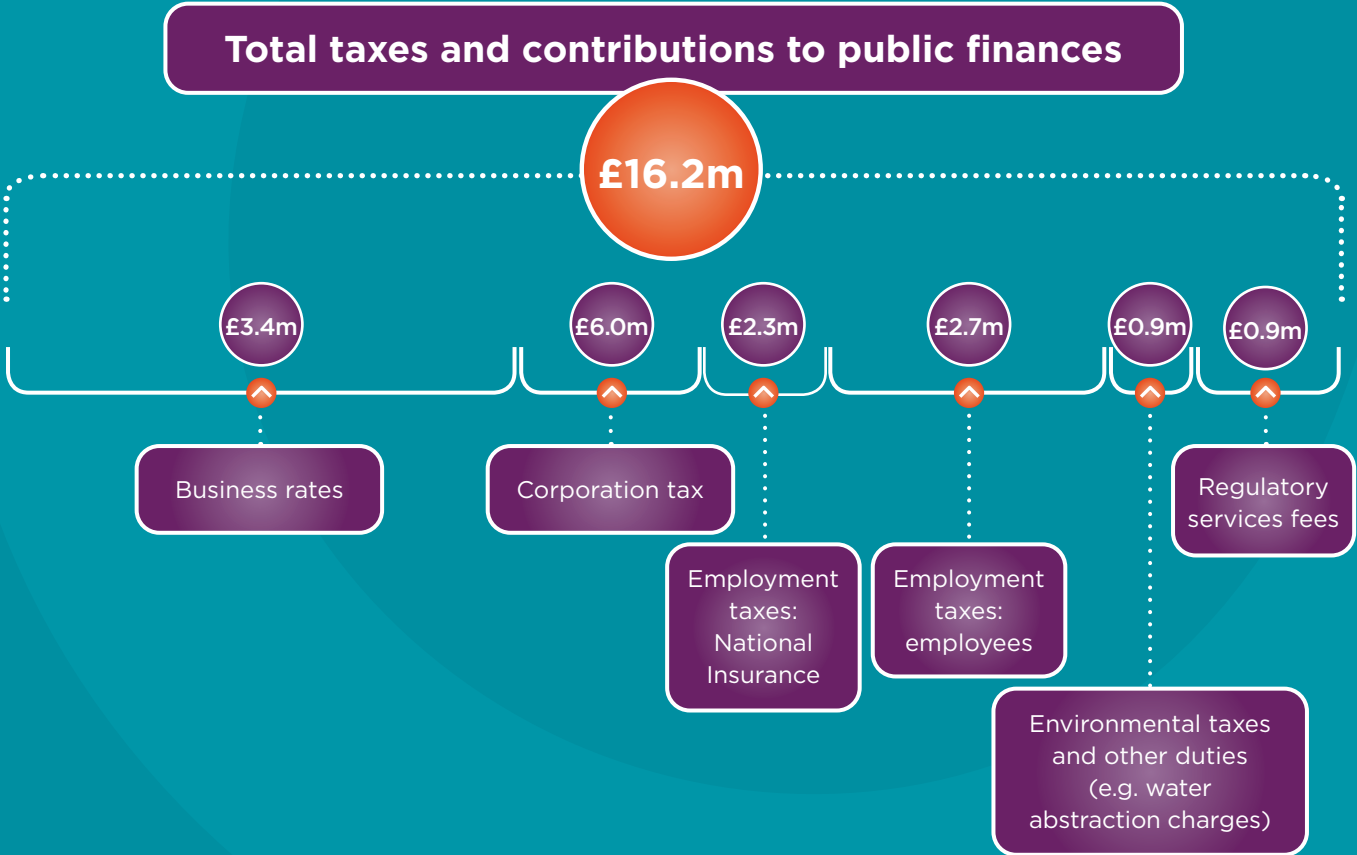


Profits and tax

In 2019/20 our profit before tax was £10.6m. This was the amount of profit left after taking into account our operating costs, investment and the interest we paid on our borrowing.

We also paid business rates, PAYE and national insurance contributions which help fund the vital services we all rely on. The below diagram illustrates the taxes and contributions we made to public finances in 2019/20.

In March 2020 a change to the UK corporation tax was enacted. The UK Government confirmed that the rate of 19% would be retained, rather than reducing to 17% from 1 April 2020 which had previously been legislated. Deferred taxes at the balance sheet date have been measured using the tax rate of 19% and this has resulted in an increase in a one-off, non-cash, deferred tax charge of £5.0m.



Payment reporting

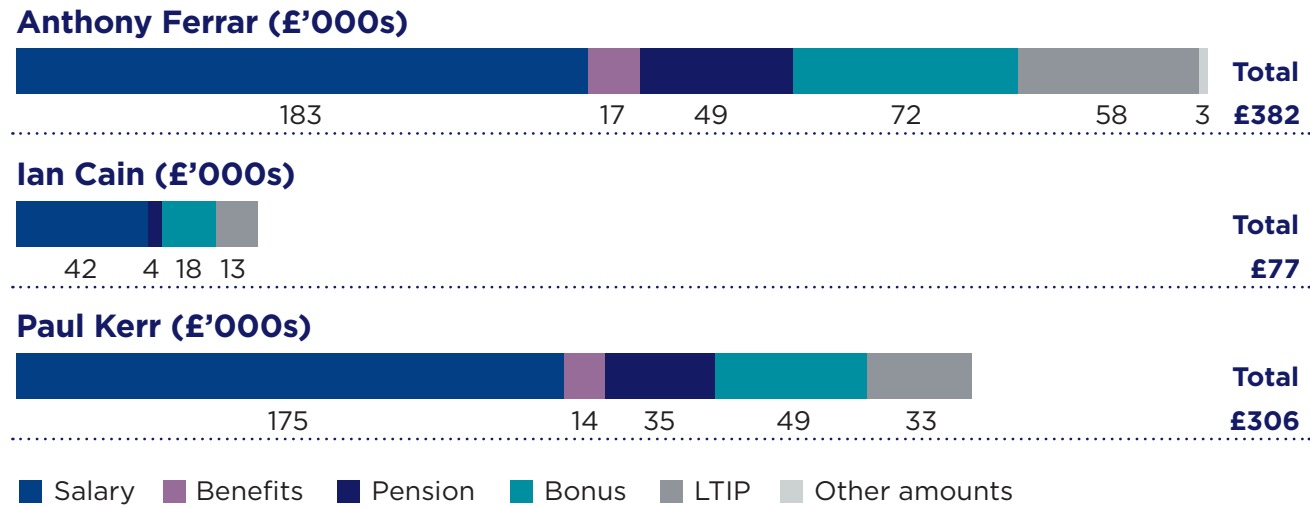
We regularly report on our payment practices, policies and performance in line with the department for Business, Energy and Industrial Strategy (BEIS) guidance for large UK companies and Limited Liability Partnerships. This reporting ensures we are focused and committed to paying suppliers promptly.

Executive pay

The amount of money that is paid to executive directors and senior managers is overseen by the Remuneration Committee. This includes making decisions around what is paid to new directors and the amount of money that senior executives receive through a bonus and long-term incentive plans.

Single total figure of remuneration for executive directors for 2019/20

Salary pay comprises base salary, benefits and pension.



Our Remuneration Committee developed an updated and enhanced executive director pay policy which was published on 1 April 2020 and includes even stronger links with delivery for customers and more stretching targets.

Anthony Ferrar retired from the Company on 29 February 2020. Ian Cain was appointed as Chief Executive Officer on 12 February 2020. The above amounts represent – where applicable – their earned salary, pension, benefits, bonus, long term incentive plan amounts and other benefits up to 31 March 2020. Please read our Annual Report 2020 for further detail and more information about our Remuneration Policy.

Gender pay

We believe in creating a diverse and gender-balanced workforce which ensures equal opportunities for all employees and reflects the customers we serve. Most importantly, we are confident that men and women are paid equally for doing equivalent jobs, regardless of gender.

Our mean gender pay gap of 12.3% is caused by having fewer women in senior roles and this is not uncommon in the utilities industry as the STEM (science, technology, engineering and maths) fields have been predominantly male occupations with historically low participation among women. In fact, just 22% of the core STEM workforce in the UK are women (WISE UK statistics 2018) and the UK has the lowest percentage of female engineering professionals in Europe.

Nevertheless, our figures highlight the need for us to ensure we are continually challenging ourselves to be more inclusive. Some of the actions we are taking include job grading so we have more effective career progression, transparency and clarity over pay bands and reviewing our recruitment processes and appraisal system to ensure capable employees can progress, regardless of gender.



Our ownership

We are jointly owned by Osaka Gas and Sumitomo Corporation. Both are Japanese companies that run UK-based operations, and each hold a 50% share in our ultimate UK holding company Sumisho Osaka Gas Water UK Limited.

Holding companies are recognised legal entities and exist to bring together the investment made by shareholders to own and control their interests in other companies.

In our case this enables Osaka Gas and Sumitomo Corporation to jointly own East Surrey Holdings Limited. It is the holding company for the trading companies of the group. A separate holding company, SESW Holding Company Limited, exists to

control the funding associated with SES Water and protect the interests of bond holders.

The diagram below shows our ownership structure. All companies apart from those based in Japan are subject to UK tax laws. This has been the case since 2013 and we have not operated any complex, off-shore financing arrangements at any time during this period.



Dividends

Dividend are agreed each year by the Board and take into account how well we are performing against a range of targets. The Board also considers how well we are performing against our budget and the commitments made to customers. Only when all these factors have been considered are dividend levels determined.

From our profits in 2019/20 we paid £6.7m of dividends to our shareholders from our regulated activities.

Like any investors, our shareholders expect a return on the equity they put into the business. Over time they have taken a fair and reasonable level of dividend, allowing more money to be reinvested in services or kept in reserve.

Below you can see the ordinary dividend paid to our shareholders each year, all of which were below Ofwat's allowed level of return. We also expect future annual dividend payments to be below this level too.



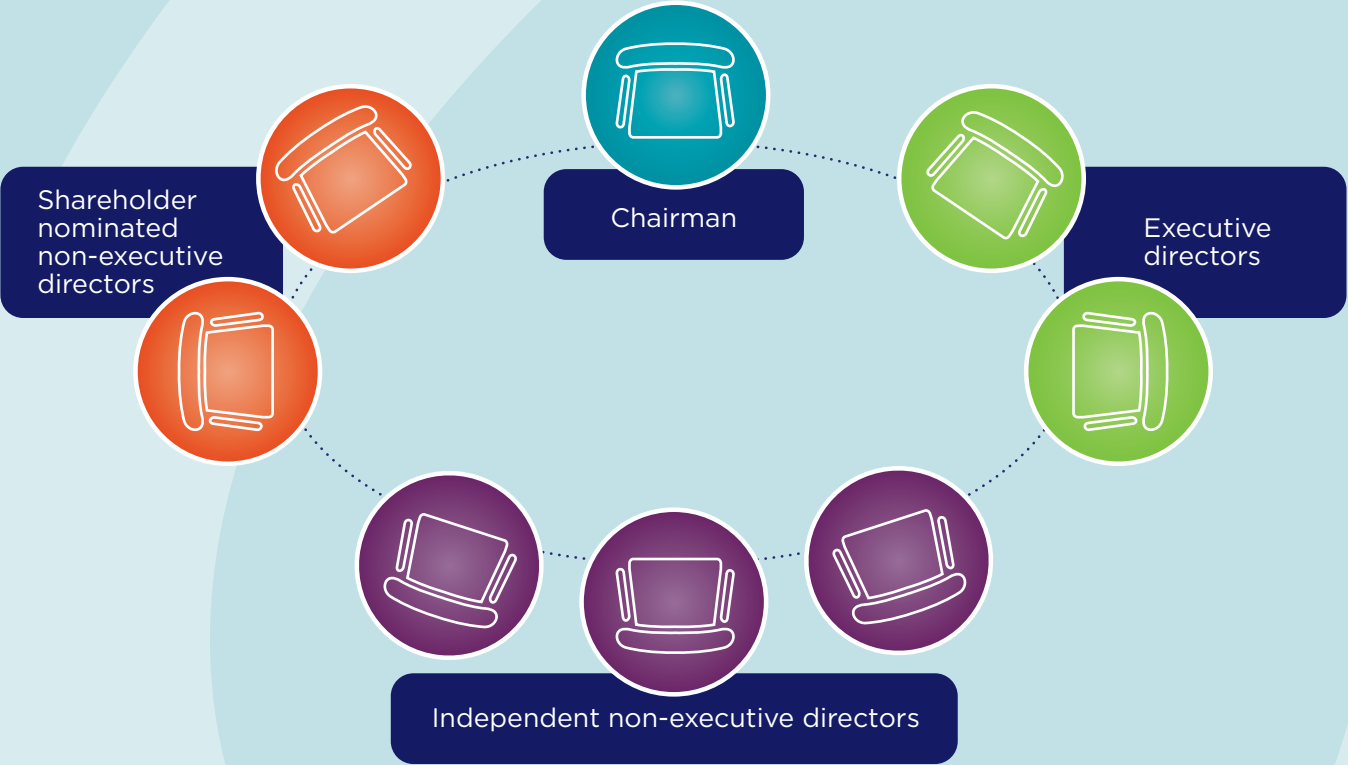
We made changes to our dividend policy in April 2020, elements of which Ofwat has already highlighted as industry best practice. We want to ensure that our decision-making and payments to our shareholders are as transparent and accessible as possible, including explanations in this document and our Annual Report, which have both been published on our website.



* The profit before tax figure includes a one-off gain of £2.0m from the sale of our right to trade with non-household customers to one of our group's associated companies, SES Business Water. The 2017/18 dividend to shareholders includes £2.0m reflecting that one-off profit.

Our Board

Our Board is made up of executive directors from SES Water, non-executive directors representing our shareholders and independent non-executive directors. It is led by a Chairman and is responsible for making decisions affecting the Company.



Our Board operates three main committees, each chaired by an independent non-executive director:

Audit Committee – responsible for making sure we follow robust and effective processes for financial and regulatory reporting, internal controls and risk management.

Remuneration Committee – responsible for our remuneration policy and its application, including levels of executive pay and the targets that are set as part of the performance-related employee bonus.

Nomination Committee – responsible for making sure the Board size, structure and membership is reviewed, succession planning for Board members and senior managers and reviewing Board performance.

Trust and confidence

In July 2019 Ofwat made it compulsory for all water companies to meet new objectives about Board leadership, transparency and governance (BLTG), including the need to establish a purpose, strategy and set of values. Company boards must also be satisfied that these, and its culture, reflect the needs of all those it serves. We are already meeting the updated requirements and our Annual Report includes a new statement from the Board explaining the actions taken for each objective.

Enhancing Board leadership, transparency and governance

Our Board works within a governance framework that is laid down by the UK Corporate Governance Code and the Companies Act. Members have been focused on enhancing their board leadership, transparency and governance for some time and recognise the importance of being open and accountable to both our employees and customers about how the business is run. Steps taken so far include:

Publishing clear and accessible information through our Annual Report – including levels of executive pay and dividends.

Recruiting high-calibre, experienced independent non-executive directors to challenge our activities and decision making.

Establishing a strong succession planning process so we appoint individuals with the right mix and level of skills and experience.

Reducing the number of shareholder representatives so our independent non-executive directors make up the single biggest group on our Board.

Linking executive pay and dividend levels to performance and service to customers.

Placing high importance on continuous training and development of our Board directors.

Carrying out periodic reviews of Board member performance and Board effectiveness with the last one taking place in May 2020.

We are committed to enhancing our Board leadership, transparency and governance by:

Ensuring we continue the high level of interaction amongst our independent non-executive directors, managers and stakeholders so that all views can be understood and represented.

Appointing a designated independent non-executive director to work with our CEO on engagement with our workforce and help increase employee input through our Joint Negotiating and Consultative Committee.

Inviting the chairs of our Customer and Environmental Scrutiny Panels to a Board meeting each year.

Publishing this document every year to explain our finances and governance.

Inviting external representatives to attend our Board meetings, including from Consumer Council for Water and the Drinking Water Inspectorate, where appropriate.

Reviewing our executive pay policy so it gives appropriate weight to performance for customers.

Using an independent facilitator to review Board effectiveness.

Explaining how we have reached decisions on the level of dividends, taking into account the delivery of our obligations and commitments to customers and other stakeholders.

Publishing summary Board minutes.

Our Environmental Scrutiny Panel continues to help us make decisions with an environmental focus and ensures we play a role in enhancing the environment through our investment programme.

To follow our performance against our annual targets and find out more details about the work of our Board you can read our Annual Report on our website.

What the words mean

Fixed assets
Physical items used in running our business that we continuously invest in (called capital investment), such as our pipe network or reservoirs.

Bond
A type of long-term borrowing.

Corporation tax
A tax on a company's profits before dividends are paid to shareholders.

Debt
An amount of money that is borrowed by one party from another.

Dividends
Money that is given back to our shareholders in return for their investment.

Dividend yield
How much is paid out in dividends each year in relation to how much shareholders have put in.

Equity
Money from shareholders that is invested in our Company.

Gearing
Shows the balance between money we receive from our shareholders compared to lenders like banks.

Inflation
The rate at which the general level of prices for goods and services is rising. It is commonly measured by the Consumer Price Index (CPI) or the Consumer Price Index including owner occupiers' housing costs (CPIH).

Interest
Money that is paid regularly at a particular rate on debt.

Operating costs
The money we pay out to run our Company, such as wages, maintenance and electricity.

Profit
The difference between the money we receive, mainly from customer bills, and the money we spend on running and financing our Company.

Regulated Capital Value (RCV)
The total value of our Company calculated as required by our regulator Ofwat.

Retail Prices Index (RPI)
A measure of inflation published monthly.

Shareholders
Our owners who have shares in our Company.

Turnover
Another word for sales or income during a specific time period.

