

Chief Executive's summary



Ian McAulay
Chief Executive Officer

→ Read more on our operational performance on pages 74 to 99

As a supplier of essential public services, our priorities throughout this year have been to keep water flowing and our wastewater services operating safely and smoothly for our customers, while also protecting and supporting our employees and supply chain and offering help and advice to customers who found themselves in vulnerable circumstances.

At the same time, we have needed to make rapid and complex decisions to ensure the financial stability of the business, making sure that delays to capital projects, increases in delayed payments (and bad debt) and workforce and supply chain constraints were managed and accounted for.

As we entered this financial year, the primary impacts of the COVID-19 crisis relating to people and logistics were already being felt. Ensuring safe working practices for colleagues and customers and adequate supplies of chemicals and personal protective equipment were a priority. As we came to the height of the summer months, we also experienced a significant shift in demand for water as domestic customers used more water at home while commercial customers used far less. We have increased our provision for bad debt to reflect the fact that customers have faced financial hardship as a result of the impact of the pandemic.

“ Our culture is underpinned by our values of succeeding together, doing the right thing and always improving ”

Throughout these difficult times, I am extremely proud of all those involved in keeping those essential services running for our customers, both direct employees of Southern Water and those working for us through our supply chain, and I can only thank them for their dedication and for, on many occasions, putting themselves on the front line.

Ensuring the resilience of the business

Despite redirecting our operational efforts to ensure the smooth running of our front line services throughout the year, we have continued the transformation of our business. As Keith Lough, our Chairman, already highlighted, we need to continue to deliver tangible improvements in historic areas of concern such as customer experience, pollutions and water quality, through better planning and the introduction of more efficient processes.

Although we are in 16th place out of 17 water companies in terms of our customer overall satisfaction (C-MeX) score, our customer service improvement programme has delivered some positive progress. Billing calls have reduced by 21% year on year as a result of proactive work with high usage customers and a focus on collections activity. Digital transactions have increased 47% compared to the same period last year as a result of improvements made to our 'Your Account' self-serve portal and new self-serve journeys. We know we have more to do to improve our satisfaction (C-MeX) ranking, but we believe the work undertaken this year has improved our underlying trajectory and

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is focused on the right drivers to improve our performance over the remaining four years of this business plan period.

Our Business Channels team, serving our commercial and developer customers, meanwhile, ended the year in 15th place, driven by our levels of service for water and wastewater design and improved communications. This year, we launched a new workflow solution, web pages and cleared project delays caused by the impact of COVID-19.

Although our pollution performance is still not where we would like it to be, the first few months of 2021 have delivered some significant improvements. For the last quarter of 2020 incident numbers were over 40% of their 2019 equivalent, and we were able to finish the year with under 400 category 3 incidents, four category 2 and no category 1 incidents on the Environment Agency's (EA) tracker. This improvement has been driven through our Pollution Incident Reduction Plan, published in September 2020 (southernwater.co.uk/our-performance/reports/pollution-reduction-programme).

From a water quality point of view, our provisional score for the end of the first regulatory year of the Drinking Water Inspectorate's new Compliance Risk Index (CRI) measure is 4.53 (2019: 7.7). Although this represents a significant improvement, it is still not as good as we would like it to be.

Our leakage for 2020–21 was 98.5 Ml/d (2020: 94 Ml/d) largely due to extreme seasonal fluctuations in the weather, alongside the demand associated with increased customer usage due to COVID-19. We are continuing to invest in improvements in the teams and technology used to detect leaks and our plans are to reduce leakage by 15% by 2025, 40% by 2040 and 50% by 2050.

Our financial performance

We accepted Ofwat's funding settlement for our business plan of our price controls for 2020–25 in February 2020, despite the significant challenge it presents in delivering what our customers want within the financial envelope Ofwat has set. It led to a 13% reduction in average customer bills and that, in turn, is the principal reason for the reduction in our operating profit of £73.5 million to £138.8 million.

As I have already mentioned, COVID-19 had a significant impact on the demand for water from our customers. We experienced an increase to our revenues from the additional household demand, however, this was offset by the reduction in our income from our non-household customers and new housing developments.

COVID-19 also increased our operating costs by £2.7 million, with additional expenditure to ensure the health and safety of staff, facilitate remote working, support suppliers and maintain services to meet the significant increase in water demand.

In order to support our customers in vulnerable circumstances, we introduced a number of support schemes to assist them in paying their bills.

This included pausing our normal debt recovery activities and introducing payment breaks for those in financial difficulty. As a result, we incurred lower debt recovery costs in the year although they were in part offset by an increase in our provision for bad debt, reflecting the impact of the pandemic on our likelihood of recovering some of our charges. The net impact of these items was a reduction in our operating costs of £4.0 million.

Over the past two years, we have undertaken a number of transformation and re-organisation activities in order to improve our performance and efficiency. These resulted in an overall reduction in operating costs from the prior year of £14.6 million, reflecting both the one-off costs incurred last year to make the transformation and the ongoing savings resulting from the changes made.

Our capital programme for the new investment period commenced with over £380 million spent on improvements to our assets. This included initial payments towards the construction of a new reservoir at Havant Thicket and a number of schemes in Hampshire aimed at tackling the impacts of climate change and population growth.

Our credit ratings are an indicator of financial health used by our lenders when we borrow money to finance our capital investment programme; our licence of appointment also contains minimum credit rating provisions. Our ratings have continued to be under pressure in 2020–21 as a result of operational performance challenges against key regulatory indicators such as pollutions, wastewater treatment works compliance and customer performance, plus a challenging financial position with reduced turnover and increased costs, and financial uncertainty regarding the outstanding prosecution by the Environment Agency relating to wastewater permit breaches from 2010 to 2015.

Action taken to support our credit ratings include a commitment by the Board to not pay dividends, if to do so will undermine the company's financial resilience and our transformation programmes to improve both operational and financial performance. During the year, we have also mitigated a risk from credit rating downgrade by securing consent from our lenders to continue to be able to finance the business in the event either our credit ratings or financial ratios fall below prescribed levels set out in our borrowing covenants.

20k
leak repairs
completed to
April 2021

Chief Executive's summary continued

7,000
acoustic loggers
were installed
on our network
this year

£2.7m
increase in our
operating costs
as a result of
COVID-19

In order to support the delivery of our business plan, we have continued to benefit from the support of our lenders in the successful issuance of £825 million bonds in May 2020 plus a further issuance of £300 million of bonds in March 2021. These bonds were issued under our newly established sustainable financing framework which includes a set of environmental, social and governance (ESG) standards for our operations that socially-conscious investors use to screen potential investments.

Other areas of significant progress

A number of key strategic projects were approved by the Board in December 2020, which will see us focus on improving digital, logistics and asset maintenance capability across our network, allowing us to take a more proactive approach to the management of risk, in turn protecting our environment and improving our performance and services for customers. You can read more about them in 'Our progress' on pages 26 to 27.

These projects, which will drive £150 million of efficiency improvements to 2025, represent the final phase of our transformation programme. Started in 2017, it has focused on improving people, processes and systems, in support of our business plan 2020–25 targets; providing Southern Water with a new baseline to start allowing for outperformance in the next asset management period to 2030.

A key pillar of our purpose, protecting and improving the environment is something that sits at the very heart of our business, which is why I would like to join Keith in welcoming Dr Toby Willison to our Executive Leadership Team. Toby brings with him a wealth of experience from the Environment Agency, and over the past few months has helped us to redefine our environmental ambitions.

Over the next four years, we will invest nearly £1 billion in programmes that will deliver environmental benefits as a result of improvements to our network, and we have committed an extra £5 million to an environmental improvement fund, which will be focused on initiatives that deliver nature-based solutions and environmental net-gain, in partnership with local Wildlife Trusts and the Rivers Trusts. One project already identified is focusing on the important natural habitats in Chichester and Langstone Harbours working in partnership with the Chichester Harbour Protection & Recovery of Nature (CHAPRoN) project.

I am excited about the year ahead; as we publish our net zero plans, we take further steps to embed natural capital approaches in our planning processes and we refocus our efforts on helping customers reduce their water usage as part of our flagship Target 100 water efficiency programme.

As I have already mentioned, we saw an enormous increase in demand for water as a result of changes to people's lifestyle due to COVID-19, which has seen individual daily water usage increase significantly. With life slowly returning to something like normal, we still expect demand to remain high over the summer as people continue to work from home and holiday closer to home. We are prepared for this, and have adjusted our plans. We continue to work with Ofwat and our peers to understand the longer-term effects on usage. The increase we have seen is not unique to our region. However, as an area of water scarcity we need to work with our customers to try and drive down consumption in order to meet our target of 118.8 litres per person, per day by 2025 (this is a three-year rolling average).

Water is a precious, and increasingly scarce, resource for people and wildlife. It is essential that we strike the right balance between protecting the environment and maintaining supplies for customers. In Hampshire, that means taking less water from the sensitive chalk stream habitats of the Rivers Test and Itchen and more from sustainable sources instead. As part of our Water for Life Hampshire plans, which launched its first consultation in February of this year, we are planning to create a new network of water mains across this region and we are investigating new treatment techniques such as desalination and water recycling. You can read more at southernwater.co.uk/water-for-life-hampshire.

Challenges we are still facing as a business

Climate change and population growth in the South East present very real challenges that initiatives like Water for Life Hampshire are looking to address. Plans like these, and bulk supply collaborations with neighbouring water companies, are needed to secure reliable water supplies for the future, alongside reducing the amount of water lost through leaks and encouraging people to use less water.

This will help the country tackle extremes in weather such as droughts, which are likely to happen more often, and be more serious, as our climate changes. It will also help provide water supplies to more customers in the future and enable us to leave more water in the environment to support habitats and wildlife.

In February, we signed an 80-year bulk supply agreement with Portsmouth Water, under which it will supply us with 21 million litres of water a day. Together, we are developing Havant Thicket Reservoir in Portsmouth Water's supply area; the first new reservoir to be developed in the UK since the 1990s, which will play a key role in reducing the amount of water taken from the Rivers Test and Itchen. It will be the first time a large water supply asset has been developed in this collaborative way.

Reflections on a difficult year and our future priorities

At the end of the first year of delivery of this new five-year period, I would like to reflect on how far we have come in what has been a year of unprecedented challenge for all of us. We started in a tough place, with a challenging Final Determination from our regulator and increased regulatory scrutiny as a result of a number of legacy issues with our culture and performance. We also received the lowest score in the industry in our annual Environmental Performance Assessment from the Environment Agency.

I am pleased to report that, as a result of our transformation programme, we have continued to drive the changes in people, processes and systems that our Board and regulators have been asking for. A great example is the development of our People Strategy and focus on diversity and inclusion, our commitment to which earned us a ranking in the Inclusive Companies list of Top 50 UK Employers.

The Consumer Council for Water (CCW) mentioned us in its annual 'Water for All' report, published in November, citing our partnership working approach to vulnerability and our proactive contact methods to build our Priority Services Register as best practice.

A great example of collaboration in action is the development of our catchment-based Drainage and Wastewater Management Plans (DWMPs), engagement for which has been ongoing throughout the year via a series of online stakeholder workshops. These plans set out how we intend to extend, improve and maintain a robust and resilient drainage and wastewater system in the future, providing greater transparency, robustness and clarity towards investment decisions. Working with our regional stakeholders is vital if we are to manage future risks to the people, businesses and the environment of the South East.

As our Chairman already mentioned, our new culture dashboard is allowing us to measure and track the development of our company culture. The development of such metrics to track our progress in this area has been highlighted by Ofwat in its Board governance review as good practice.

Our culture is underpinned by our values of succeeding together, doing the right thing and always improving and this year, more than ever, we have embedded them at the heart of how we deliver our services to our stakeholders. A clear focus on our core priorities during the pandemic has ensured that our customers have had priority services and financial support when they have needed it most, and that our employees and

supply chain have been able to work safely, prioritising our essential services and keeping our customers in supply and avoiding significant spikes in flooding incidents despite the challenges of extreme demand and fluctuations in our weather.

As we move into a new financial year, we are focused on continuing to drive the changes needed in our business to improve performance and our services for our many stakeholders.

I would like to take this opportunity to say thank you again for the hard work, commitment and sacrifice demonstrated by all our employees – whether Southern Water or supply chain – during the year. We have all had to adjust to new ways of working, meeting significant challenges along the way and that is not easy when you are juggling huge changes in your personal circumstances and home lives at the same time. We have achieved a lot despite this and, although we know we have challenges going forward to build on the confidence and trust we have now established with our stakeholders, there is positive change happening and we need to keep that momentum.



Ian McAulay
Chief Executive Officer

30 June 2021

Highlights:

- A number of key strategic projects were approved by the Board in December 2020, which will see us focus on the digitalisation of our network and logistics and asset maintenance capability.
- In February, we signed an 80-year bulk supply agreement with Portsmouth Water, under which it will supply 21 million litres of water a day to Southern Water.
- A clear focus on our core priorities during the pandemic has ensured our customers have had priority services and financial support when they have needed it most, and that our employees and supply chain have been able to work safely.

c.£1bn
investment in
environmental
benefits to 2025