# MEETING CUSTOMER EXPECTATIONS 2011/12

Incorporates KPIs and statements on risk and compliance

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## Meeting Customer Expectations

## Contents

# 1. Executive Summary

In 2009 we produced our five year business plan for the period 2010-2015. This set out our understanding of customer expectations and we made a commitment to meet these when we accepted OFWAT's Final Determination of prices in January 2010. This report reviews progress and performance against the plan. We believe that our overall performance in 2011/12 meets our statutory obligations along with the expectations of our customers.

Actual operational performance is a good indicator as to whether or not customer expectations are being met and we have had a strong year in this respect. Significant improvements in customer service have been achieved, resulting on a SIM KPI score of 80 compared to an equivalent score of 74 last year. This has largely been driven by reductions in unwanted contacts.

All operational performance indicators meet or exceed requirements and targets. The serviceability of our assets is stable for both infrastructure and non-infrastructure and in 2011-12 our leakage was the lowest ever. No customer has had their water supply interrupted for more than 6 hours for an unplanned event, testimony to the effectiveness of our network teams. However, in the year a small number of planned activities did run beyond 6 hours and 2,836 customers also experienced supply interruptions between 3 and 6 hours. We continue to strive to improve our performance in these areas.

Our capital investment is making good progress, with all obligations in the business plan on track for delivery. Replacement of our distribution mains has been running ahead of that planned. Financial results are in line with last year, before exceptional items.

Our systems of gathering and reporting management information ensure that any performance concerns and emerging matters are clearly indentified to the executive team and appropriate responses taken. The Executive Management Committee (EMC) meets monthly and all Board members receive copies of EMC minutes. The Board reviews key management information quarterly and seeks to ensure that it has the information and advice available to it for effective discussion and management. The Board and the Audit Committee seek to ensure that the company has in place the processes and systems to enable it to be confident that the company is meeting its statutory obligations and is being managed effectively.

The material risks and challenges we face are reviewed at Board level and the Board challenges the executive team on these on a regular basis. An overview of the current key challenges is contained in Section 5. Drought has been a particular focus this year, resulting in the introduction of a Temporary Use Ban in April. As a result of very high rainfall in April and June, groundwater levels have considerably recovered and the Temporary Use Ban was lifted on 9th July.

The controlling interest in VWSE's holding company was acquired on 28 June 2012 by a consortium including Infracapital Partners and Morgan Stanley Infrastructure Partners. The new owners intend to proceed with unification of the three regulated water businesses (Veolia Water Central, Veolia Water East and Veolia Water Southeast). Detailed transition plans have been developed to ensure this is a smooth process, and that the high standards of service and performance that customers currently receive are maintained.

Our employees and teams have achieved strong operational results this past year, with notable improvements in customer service and leakage performance. The business remains focused on continually improving its performance.

## 2. Meeting Customer Expectations

Overall our performance in 2011/12 meets the expectations of our customers as set out in our 2009 business plan. We also continue to review both the nature and quantity of feedback received from our customers as this informs us whether expectations have changed.

Actual operational performance is a good indicator as to whether customer expectations and statutory obligations are being met. All operational performance targets have been met and significant improvements in customer service have been achieved.

### 2.1. Operational performance summary

We are pleased that we have continued to reduce leakage, with a year-end result of 7.1Ml/d compared to a target of 7.8Ml/d. This is an important result in the context of the recent drought. Interruptions to supply have also been very low, with no unplanned interruptions greater than 6 hours, a significant achievement for the operational teams.

Customers are now getting the benefits of the investment and changes that have been made in customer services over the last two years. Our quantitative SIM score has improved from 208 in 2010/11 to 158 in 2011/12, a 24% improvement, largely as a result in reduced unwanted contacts. Our qualitative score also improved from 4.29 in 2010/11 to 4.36 this year. As a result of these improvements the overall KPI score for SIM this year is 80.

We continue to manage our assets responsibly and have maintained stable serviceability for infrastructure and non-infrastructure assets. Our programme to renew poor performing water mains is ahead of plan (11km renewed compared to 6km target) and the number of bursts in 2011/12 is below the reference level agreed with OFWAT. Our asset investment programme is progressing well. We have achieved sufficient efficiencies to continue meeting all regulatory commitments and remain on track to complete all major projects on time.

Underlying financial results are in line with the previous year. Profit before tax was £5.239m compared to £2.629m in 2010/2011. The increase of £2.61m is mainly due to atypical items including a land sale (£0.650m net) and a revision in accounting for pensions (£1.815m).

Water income has increased by £0.849m (4.6%), although overall turnover for the year is below Final Determination by £0.680m. The two main causes for this gap are the reduction in revenue resulting from compulsory metering (91% of our domestic customers now have a meter) and an 8% reduction in consumption by our key commercial customers. Standard commercial demand has remained static. We think that the continuing recession is a material factor in reduced turnover.

Cash collection remains concerning. The introduction of a late payment charge for overdue accounts, plus the addition of a second debt collector and a migrant helpline have had a positive effect on collection rates for the year, but it is too early to say whether the weakening collection trends of recent years have been reversed.

## 2.2. Key Performance Indicators

Data on the principal Key Performance Indicators (KPIs) are shown in the following table.

| KPI | Veolia Water Southeast | Units |
|---|---|---|
| **Customer experience** | | |
| Service incentive mechanism (SIM) | **80** | Score |
| Water supply interruptions | **0.23** | Hours per total properties served |
| **Reliability and availability** | | |
| Serviceability water infrastructure | **Stable** | |
| Serviceability water non-infrastructure | **Stable** | |
| Leakage | **7.1** | Ml/day |
| Security of supply index (SoSI) | **100** | Index score |
| **Environmental impact** | | |
| Greenhouse gas (GHG) emissions | **6.07** | kt$CO_2$e |
| Pollution incidents (water) | **0** | Category 1-3 incidents per 1,000km of main |
| **Financial** | | |
| Post tax return on capital | **6.6** | % |
| Credit rating | **na** | |
| Gearing | **48** | % |
| Interest cover | **1.4** | Number |

Further commentary on the Key Performance Indicators is provided in Section 6.0.

### 2.3. Health and Safety Performance

Our target is 'zero harm' to employees, customers and the public. All employees are encouraged to take responsibility for their own safety and that of colleagues and the public. The process of shifting our culture from one where it is accepted that accidents happen, to one where the company and employees believe it can operate without accidents, is continuing, and we are making good progress. To monitor our safety performance we take account of three specific indicators: (i) accident rates, (ii) the number of reports of hazards in work places and (iii) near-miss reports.

Disappointingly, the total number of reportable accidents rose to 4 from 1 the previous year and there was an increase in the number of days lost to accidents from 95 last year to 140 (103 of which were from a single incident of wrist tendonitis) . Three of the accidents were muscular-skeletal in nature and we continue to seek changes to our working culture which will prevent future occurrences.

## 3. Management Systems

We consider that we have in place the processes and internal systems of control to fully meet our obligations and to manage efficiently and effectively.

### 3.1. Management information

The Executive Management Committee (EMC) monitors all key performance information for the business on a monthly basis. Matters of concern are captured in the minutes which are circulated to the Board to make them aware of any performance issues or emerging matters and allow them to call for further information.

This year we have prepared data tables and commentaries as in previous years as *a* means of providing assurance about the quality of information which we provide. The data have been reviewed by data owners, KPI owners and the EMC and directors. In addition the data have been audited by our financial auditor and Reporter as appropriate. These data are a key source for calculating the Key Performance Indicators, as well as being important in analysing underlying performance trends.

An important emerging issue is the effectiveness of the process for calculating a water balance when there are high levels of meter penetration. We propose to discuss this in more detail with OFWAT and our Reporter in the coming year.

### 3.2. Company Management System

We have an integrated management system accredited to ISO9001, ISO14000 and ISO18001. The management system encompasses quality, safety and environmental management and underpins the vision and objectives of the business.

Internal and external reviews monitor compliance, highlight areas of risk, and identify potential improvements. Any non-conformances are formally recorded and corrective action taken.

An annual audit has been undertaken to comply with the Sarbanes-Oxley Act; this work gives further underpinning to the data which the company reports. The results are reviewed by the Audit Committee. Following the recent sale, a Sarbanes-Oxley audit will not be required and we shall be considering how to provide this additional assurance in the future.

# 4. Managing Risks

We consider that we have appropriate systems and processes in place to allow us to identify, manage and review our risks.

## 4.1. Risk Management

We have a formal risk management process in place. Strategic risks are reviewed quarterly by the Risk Management Committee, which comprises members of the Senior Management Team. Each risk is scored in terms of its impact and likelihood; risk owners are assigned, and mitigation actions are identified. A report is made quarterly to the Board.

Monthly reports to the EMC highlight emerging risks and issues on a departmental basis, as well as any changes to strategic matters, which are then considered by the Risk Management Committee.

# 5. Managing Our Key Risks

We continuously monitor the risks we face and the Board challenges the executive team on its responses to both existing and emerging risks. The following are the material or potential risks faced by the company, with details of the steps we are taking to manage and mitigate them.

## 5.1. Water resources and drought

Throughout late 2011 and 2012 we were particularly concerned about the short-term sufficiency of our water resources after an intensely dry period. In April, a temporary use ban (including hosepipe restrictions) was necessary to preserve stocks for the summer if the drought continued. The very high rainfall in April and June has eased the position and we lifted the restrictions on 9 July. If there is a further dry winter, restrictions may still be necessary next year; and we may need to invest in capital schemes to ensure satisfactory supply to customers next summer. Such additional investment would be unplanned and may form part of a future log-up application to OFWAT. In the worst case, we believe additional investment up to £2.5m may be required to guarantee water supplies to customers under unprecedented conditions.

## 5.2. Revenue and debt

The current economic situation, and the drought, both have the potential to reduce revenue in future years. The income shortfall in the AMP5 period is projected to be in the region of £3.5m or 2.5% of Final Determination. The revenue correction mechanism provides some possible protection to recover most of this shortfall in the AMP6 period, though this would increase customers' bills. In addition to hardship for customers, such increases may increase bad debt and cash collection risks.

We remain concerned about cash collection and debt management, and in response to this we have increased our range of collection activities during 2011/12. The late payment charge has proved successful in encouraging customers to contact us and set up payment plans, whilst our doorstep collectors have improved collection of both monies and information. However, cash collection remains tough and our initiatives 'hold' the current position rather than dramatically improve collection rates.

### 5.3. Non-infrastructure serviceability

Non-infrastructure serviceability is stable for this reporting year. However, so far in 2012 there have been two coliform failures, resulting in the lead indicator, WTW coliforms non compliance, being close to our upper control limit mid-way through the year. We believe that the two coliform failures were the result of contaminated samples and did not reflect the quality of the water being supplied. The coliform failures were from two sites on the same day and the same sampling round. The coliform species were the same for both failures, Klebsiella oxytoca, a human-related coliform. Follow up sampling showed no further evidence of coliforms in the water being supplied. We continue to apply high operational standards to the monitoring and maintenance of disinfection processes and its sampling procedures. Should further failures occur, the position will be discussed with OFWAT in advance of the Risk and Compliance statement in 2013.

### 5.4. Capital Delivery

Delivery of all capital outputs within the determination envelope remains demanding. The status with respect to the key regulatory outputs is summarised below.

| Regulatory Outputs | Delivery Date | Status |
|---|---|---|
| Denge Iron and Manganese Removal Project (S19) | March 2013 | On track |
| Trunk Main TP28 Option | March 2013 | Alternative solution developed; main no longer required. Change agreed with OFWAT |
| Trunk Main TP03<br>Trunk Main TP04 | March 2014<br>March 2013 | On track |
| Selective and Optional Metering | March 2012 | Complete |
| Selective Metering - approved log up | March 2013 | Progressing |
| Security and Emergency Measures Directive | March 2013 / March 2015 | On track |
| National Environmental Programme | March 2015 | On track |

Under the log-up[1] approved in 2011, over 700 meters have been installed against the 1,997 approved under an approved Ofwat log up. However, it is now proving more difficult than anticipated to install the remaining 1,300 without substantial alterations to the customers' internal plumbing and this is increasing the unit cost. We are pursuing a number of approaches to ascertain whether it is possible to mitigate the expenditure risk. Meter penetration is currently 91% which is a significant achievement in an area of water scarcity.

[1] A log up is where a company makes a request to Ofwat to allow increased expenditure against a regulatory output in the current price limit period (in this case the selective metering programme), and where the costs of the log up are taken into account at the beginning of the next price limit period.

### 5.5. Strategic Changes

The controlling interest in VWSE's holding company was acquired on 28 June 2012 by a consortium including Infracapital Partners and Morgan Stanley Infrastructure Partners. The new owners intend to proceed with unification of Veolia Water Central, Veolia Water East and Veolia Water Southeast under a single instrument of appointment and this is expected to take place shortly. Detailed transition plans have been developed to ensure that this is a smooth process, and that the high standards of service and performance customers currently receive are maintained.

### 5.6. People

The performance and results achieved this year demonstrate the commitment, dedication and capability of our staff. The development of the skills and talent necessary for the future success of the business remains a priority. Maintaining the current high levels of momentum and motivation, particularly during the changes that the business is going through, is essential and remains a key focus of the executive team.

## 6. Key Performance Indicators and Additional Information

### 6.1. Customer Experience KPIs

| KPI | Veolia Water Southeast | Units |
|---|---|---|
| **Customer experience** | | |
| Service incentive mechanism (SIM) | **80** | Score |
| Water supply interruptions | **0.23** | Hours per total properties served |

***Overview***

Our customer service objective is to provide an exceptional experience at each point of contact with customers and to achieve upper quartile performance in the OFWAT rankings. Significant improvements have been made this year resulting in a KPI score of 80, an 8% improvement on last year. This was made up on a 24% improvement in the quantitative SIM score and a 2% improvement in the qualitative SIM.

A number of projects have been completed this year which underpin these improvements. The main change was to move from quarterly to six-monthly billing, to reduce unwanted contact resulting from the two estimated bills per year that were issued. This was a significant piece of work involving communications to all measured customers.

In addition, the variety of payment methods was further widened this year, by introducing the possibility of web payments, automated telephone payments, and paypoint. As a result of our plans, customer contacts have been reduced by 16%. Over 2,000 customers pay their bills using our website and 1,275 switched to direct debit payment online during the year. Automated telephone payment is very popular, with over 10,000 customers using this facility in the current year.

***Service Incentive Mechanism***

Our quantitative SIM score improved from 208 in 2010/11 to 158 this year. The number of unwanted contacts reduced 32%, from 13,186 to 9,012. The current figure is under 50% of that in 2009/10. The number of calls abandoned (>10 seconds) also reduced dramatically to 459 compared to 1,161 in the previous year, reflecting the improved service which can be given by the team now that overall contact levels have been reduced.

The total number of written complaints this year rose from to 140 compared to 118 in 2010/11 and, while two more complaints than last year were escalated to second stage review, none were escalated to the Consumer Council for Water. Despite this increase, the number of written complaints per 1000 customers is still one of the lowest in the industry.

The qualitative element of SIM showed some marginal improvement from 4.29 to 4.36, but further work remains to improve the overall service. The split between billing and non billing qualitative scores was 4.50 and 4.22 respectively.

The combination of the qualitative and quantitative scores results in the overall score of 80 in the KPI.

It should be noted that the overall improvement comes in a year when it was necessary to have high levels of contact with customers in connection with the move to six-monthly billing, the installation of Automatic Read meters, and the tariff trial in Folkestone.

### *Water Supply Interruptions*

The number of properties interrupted for more than 3 hours was 2,836; of these 1,096 were for more than 6 hours and 77 properties were interrupted between 12 and 24 hours. The 77 properties were interrupted for up to 15 hours as a result of planned work over-running on a mains renewal project. A lessons-learnt exercise was undertaken and improvements to our processes have been implemented.

No unplanned interruptions exceeded 6 hours, which is an excellent achievement and testimony to the operational teams' responsiveness. Unplanned interruptions affected 1,161 properties representing 1.5% of all properties connected to the network.

### *Guaranteed standards*

We have appropriate procedures in place to identify cases where GSS payments are due and to ensure that these are made, therefore complying with the requirements of the Guaranteed Standards Scheme.

There were 110 GSS payments during the year all of which were under the statutory scheme. This was a material increase on 2010/11, and was primarily the result of two planned activities. A review of both incidents has taken place to ensure lessons have been learnt.

## 6.2. Reliability and Availability

| KPI | Veolia Water Southeast | Units |
|---|---|---|
| **Reliability and availability** | | |
| Serviceability water infrastructure | **Stable** | |
| Serviceability water non-infrastructure | **Stable** | |
| Leakage | **7.1** | Ml/day |
| Security of supply index (SoSI) | **100** | Index score |

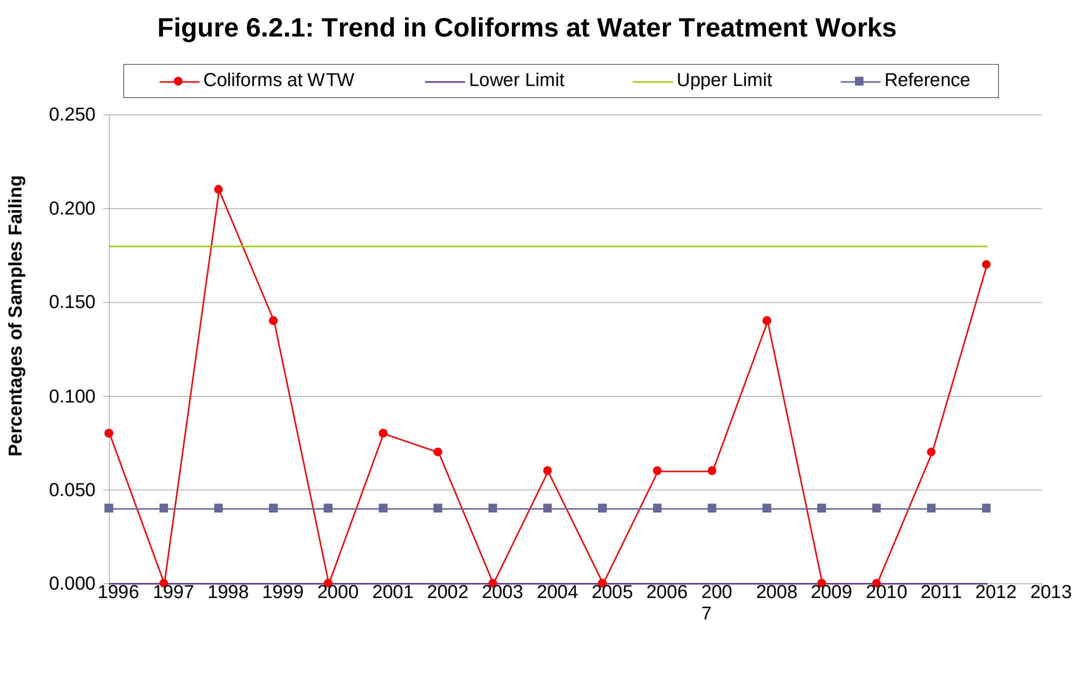
### *Non-infrastructure Serviceability*

The overall assessment for non infrastructure serviceability is stable. Performance against the non infrastructure serviceability measures contained in the final determination is set out in the following table.

| | Serviceability Indicator | OFWAT Reference Level and Control Limits | | | 2011/12 | Status |
|---|---|---|---|---|---|---|
| | | Ref. Level | High | Low | | |
| Water Non Infrastructure | Water Treatment Works Coliforms non-compliance (%) | 0.04 | 0.18 | 0 | 0.17 | Stable |
| | Service Reservoir Coliforms non compliance (%) | 0 | 8.00 | 0 | 0 | Stable |
| | Turbidity (nr) | 0 | 2 | 0 | 1 | Stable |
| | Enforcement Incidents (nr) | 0 | 1 | 0 | 0 | Stable |
| | Unplanned Maintenance (nr) | 1,648 | 1,907 | 1,389 | 1,588 | Stable |

The lead indicator for non-infrastructure serviceability is Water Treatment Works (WTW) coliform non compliance. For VWSE this indicator is very sensitive to any variation in performance and as the number of samples taken annually is relatively low (circa 1,200); even a single sample failure will result in a value of 0.08% which is well above the Reference Level of 0.04%.

This year's performance of 0.17% (two failures) is within the Upper Control Limit of 0.18%. In previous years, values were below the Upper Limit. We therefore assess this indicator as Stable. Historic performance is shown in figure 6.2.1 below.




In 2012, there have so far been two coliform failures, resulting in the lead indicator, WTW coliforms non compliance, being close to our upper control limit mid-way through the year. We believe the two coliform failures this year were the result of contaminated samples and did not reflect the quality of the water being supplied. The coliform failures were from two sites on the same day and the same sampling round. The coliform species were the same for both failures, Klebsiella oxytoca, a human related coliform. Follow up sampling showed no further evidence of coliforms in the water supplied. We continue to apply high operational standards to the monitoring and maintenance of disinfection processes and its sampling procedures. Should further failures occur, the position will be discussed with OFWAT in advance of publishing next year's KPIs.

In regard to the other serviceability indicators, service reservoir coliform non compliance continued at 0% maintaining the long term performance with zero sample failures. This indicator is stable.

For turbidity at Water Treatment Works (number where the 95 percentile > 0.5NTU), one failure occurred during the year continuing the trend of being within the upper control limit of 2. The assessment for this indicator is stable.
There were no enforcement actions considered by the DWI for microbiological standards which continues a long term trend where the indicator is stable.

The indicator for unplanned maintenance visits was 1,588 in 2011/12 continuing the trend of results in recent years where performance is below or around the Reference Level of 1,648. The assessment is stable.

### *Infrastructure Serviceability*

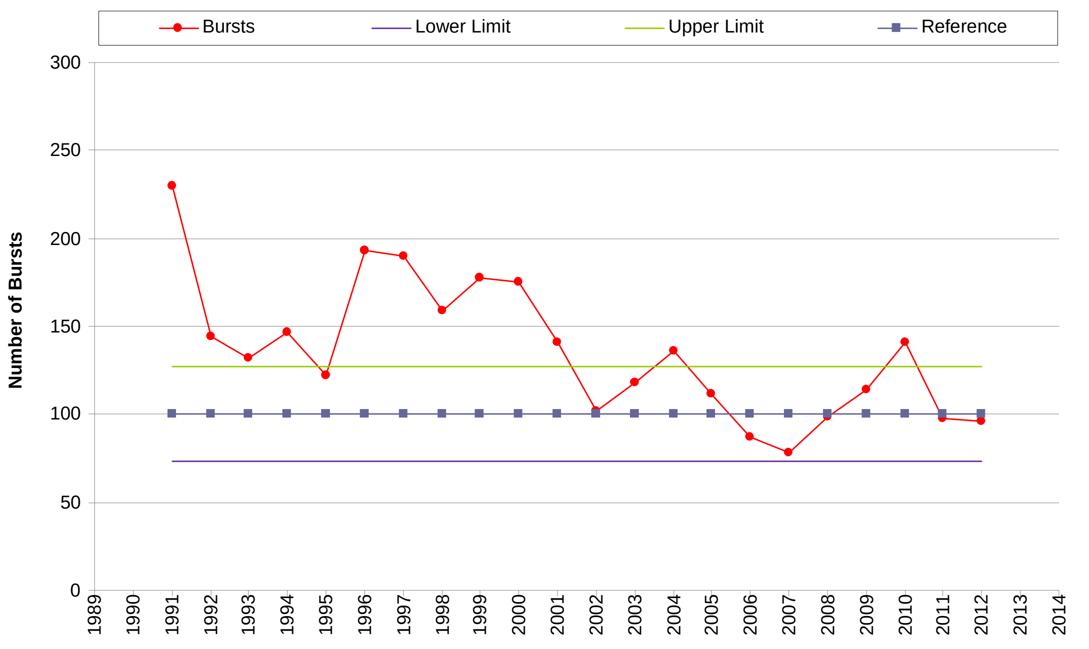
Performance against the infrastructure serviceability measures contained in the final determination is set out below.

Having considered the trends in each indicator and recognising that mains bursts is the lead indicator, the overall infrastructure serviceability is assessed as stable.

| | Serviceability Indicator | OFWAT Reference Level and Control Limits | | | 2011/12 | Status |
|---|---|---|---|---|---|---|
| | | Ref. Level | High | Low | | |
| Water Infrastructure | Total Bursts (nr) | 100 | 127 | 73 | 96 | Stable |
| | Interruptions > 12hr (nr) | 0 | 23 | 0 | 0 | Stable |
| | Iron non-compliance (as 100% MZC) (%) | 0.13 | 0.55 | 0 | 0 | Stable |
| | DG2 Pressure (nr) | 2 | 17 | 0 | 7 | Stable |
| | Customer contacts discolouration (nr/1000 population) | 0.42 | 0.64 | 0.20 | 0.81 | Stable |
| | Distribution Index TIM (as 100% MZC) (%) | 0 | 0.20 | 0 | 0 | Stable |

The lead indicator for serviceability infrastructure is mains bursts. There were 96 bursts on the network, down from 98 in the previous year and below the reference level of 100. The severe winter of 2009/10 had a significant impact on the burst rate which increased to 141 but good performance has now been restored as demonstrated in Figure 6.2.2 below. The assessment of this indicator is stable.

Figure 6.2.2: Trend in Bursts - VWSE



To maintain bursts around the reference level, we have been following a serviceability action plan. The main feature is that on average, 3km/year of the distribution network identified as being at highest risk of bursting is replaced. In response to higher burst rates in 2009/10 and 2010/11, we have accelerated renewals so that they are ahead of 3km/year and we have renewed 11km to date in AMP5 compared to 6km in the plan.

In regard to the other serviceability indicators, no properties experienced unplanned interruptions greater than 12 hours, repeating the achievement of last year. The assessment for this indicator is stable.

The Distribution Index TIM (%) has been held at 0% for the last four years matching the reference level of 0% and is assessed as stable.

For customer contacts about discolouration (nr/1000 population), this year saw an increase to 0.81, above the upper control limit of 0.64. The increase is attributable to a single event in the Denge Zone in September 2011 when, despite an agreed operating protocol, the fire and rescue service attended an emergency and operated multiple hydrants without first consulting us. This created an abnormal flow regime in the network resulting in discolouration to customers. We received 49 contacts in relation to this single event; without these call this indicator would be 0.50, just above the reference level.

Although the performance is above the control limit this year, it was driven by a single third party event and excluding this event the indicator would be stable. In the light of these factors, we have classified this indicator as stable.

A marked improvement in performance of this indicator is expected on completion of the Denge Iron and Manganese plant and the subsequent cleaning of the downstream distribution network in 2013.

The number of properties that receive pressure below the reference level is 9; although 7 are fed by private boosters and fall within Section 65 of the Water Industry Act. This indicator is stable and we expect to reduce this to 7 in 2012/13 through a change in operational practice.

### *Leakage*

This year's result is particularly good. We have exceeded the regulatory target by 0.7Ml/d, achieving a leakage level of 7.1 Ml/day. This performance continues the trend of previous years: levels of leakage have consistently been better than the regulatory target. We attach a high priority to meeting its leakage target, particularly so during the drought, when we restricted some uses of water and were asking customers to use water carefully. The leakage performance was also aided by a milder winter compared to previous years.

### *Security of supply*

The security of supply index is a measure for establishing whether our water resources plan allows sufficient safety margin to ensure that we can meet our planned levels of service in dry year conditions. We also 'stress test' our plans against scenarios of severe drought and demand conditions, 'critical conditions'. For each of these cases we have recorded a security of supply index of 100.

Over the last two years, there has been less rainfall than the long term average. In these circumstances, resources are managed by following the plans laid down in our drought management plan, which requires that progressively stronger measures are introduced to manage water supplies, as a drought become more prolonged and severe. As part of this plan, a temporary use ban was introduced on 5th April 2012. Publicity has also been stepped up to encourage customers to use water carefully.

High rainfall in April and June 2012 was beneficial as it postponed the onset of the summer recession in ground water levels and led to some replenishment of aquifers. Accordingly, it was possible to lift the temporary use ban on 9 July.

Distribution input continues its downward trend and is influenced by a mix of extensive drought communications and water efficiency guidance, our compulsory domestic metering programme and the reduction in commercial use. The proportion of domestic households with a meter now stands at 91%.

***Drinking Water Quality***

In the 2011 calendar year the mean zonal compliance[2] with drinking water quality standards was 100%, maintaining the high performance achieved in 2010 which is an excellent achievement.

Investment in the long-term removal of iron and manganese from treated water at our Denge source and the subsequent cleaning of deposits form the surrounding network is ongoing, with the Denge project being a regulatory output. During the year the rate of customer contacts for water discolouration per thousand properties rose to 0.81 from 0.56 last year. From a total of 129 customer contacts, 89 were related to discolouration in the Denge zone. We anticipate that the benefits of the work at Denge will be reflected in future results.

### 6.3. Environmental Impact KPIs

| KPI | Veolia Water Southeast | Units |
|---|---|---|
| **Environmental impact** | | |
| Greenhouse gas (GHG) emissions | **6.07** | kt$CO_2$e |
| Pollution incidents (water) | **0** | Category 1-3 incidents per 1,000km of main |

***Greenhouse Gas Emissions***

About 95% of our carbon emissions arise indirectly when we use energy to abstract, treat and distribute water. Therefore the weight of emissions depends on the amount of water demanded by our customers, the quality of raw water, and the efficiency of our pumps, equipment and operations. There are few opportunities for largr-scale renewable generation in our area, so our strategy to reduce emissions is to;

- Influence our customers in the amount of water used
- Increase the efficiency of our plant and operations

The total amount of $CO_2$ emissions fell to 6.07kt this year from 6.13kt in 2010/11, a reduction of 1.0%. Although not directly equivalent, this compares with an annual target in our Strategic Direction Statement to reduce energy carbon use by 1%. The amount of water put into supply reduced by 0.7% which indicates a real reduction in $CO_2$ emissions.

[2] Mean Zonal Compliance is a Drinking Water Inspectorate measure for the percentage of water samples taken from water supply zones or supply points in the company's supply area complying with the standard for iron during the calendar year.

As well as total emissions, we measure our performance through the carbon intensity per megalitre of water put into supply. This has risen from 380.0kg$CO_2$e/Ml to 407.2kg$CO_2$e/Ml in the last year. Higher energy use associated with abstracting water from abnormally low levels has influenced this increase.

To encourage customers to use water carefully the programme of water efficiency activity has continued, achieving savings of 0.11Ml/d and exceeding our regulatory target for water efficiency savings (0.07Ml/d).

***Pollution incidents (Water Service)***

We did not cause any pollution incidents during the year.

### 6.4. Financial Performance KPIs

| KPI | Veolia Water Southeast | Units |
|---|---|---|
| **Financial** | | |
| Post tax return on capital | **6.6** | % |
| Credit rating | **na** | |
| Gearing | **48** | % |
| Interest cover | **1.4** | Number |

***Post tax return on capital***

The post tax return on capital is measured as the current cost operating profit after current tax, divided by the year end regulatory capital value and is 6.6%. The principal reason for lower returns is that turnover was lower than expected and operating costs are higher. Some of the underperformance was recovered through the proceeds from land sales (£1.0m) and the pension asset credit (£1.8m).

***Credit rating***

We have not had external funding that leads to a credit rating.

***Gearing***

The ratio of net debt to RCV was 48%.

***Cash interest cover***

Cash interest cover measures the ratio of gross interest payable on all debt to operating cash flow. The cash interest cover is 1.4.

***Operating performance – appointed business***

Revenue in the year was £19.505m, compared to £18.646 in 2010/11, an overall increase of 4.6%. This is below the RPI + K allowance for 2011/12 of 5.91%. The major influences on income remain the metering programme and the overall economic conditions. Distribution input has fallen by 1% and this has a direct impact on our measured income.

Uncertainty about whether revenue will fall further in real terms remains a risk to the business, although this will be part mitigated in AMP6 by the Revenue Correction Mechanism.

Operating costs, excluding depreciation, for the year ended 31 March 2012 were £10.357m compared with £11.392m for the year ended 31 March 2011. The 2011/12 year includes a credit of £1.8m in respect of the pension valuation adjustment. After adjusting for this atypical item the increase in operating costs is above inflation.

This has been a challenging year for opex performance with some atypical costs:

| **2011/12 Opex Performance** | **£m** |
|---|---:|
| Actual Opex less IRC | 8.084 |
| Plus pension credit | 1.815 |
| *Total Gross Opex* | *9.899* |
| Atypical - Bluehouse repairs following earthquake | -0.090 |
| Atypical - Restructure provision | -0.066 |
| *Total excluding atypical* | *9.743* |
| Final Determination (FD) (11/12 pb) | 9.794 |
| *Variance Actual to FD, excluding atypicals, £m* | *0.051* |
| *Variance Actual to FD, excluding atypicals, %* | *0.5%* |

We continue to strive for efficiency savings, whilst facing considerable upward cost drivers. These include:

| **2011/12 Opex upward cost drivers** | **£m** |
|---|---:|
| Increase in insurance provision | 0.080 |
| Increased power costs | 0.041 |
| Business rates above inflation | 0.036 |
| Water debt provision | 0.100 |
| *Total* | *0.257* |

The depreciation charge, excluding IRC, for the year ended 31 March 2012 was £3.153m compared with £3.231m for the year ended 31 March 2011, a reduction of £0.078m. There is a significant value (£6.960m) of capital expenditure classified as 'Under Construction'. This includes above ground and below ground assets. Once these above ground assets have been commissioned they will start to depreciate, in line with our accounting policy, there will be an increase in the annual depreciation charge.

Historic cost profit on ordinary activities before tax for the year ended 31 March 2012 was £5.239m compared with £2.629m for the year ended 31 March 2011. This increase of £2.610 includes the pension adjustment of £1.815m as mentioned above and the sale of Drellingore Farm which generated a net profit of £0.646m.

There was a £56k net cash inflow in the year. Once again the key driver in the cash flow was capital expenditure, which was funded by cash generated from operations and an increase in the loan from our parent company. We paid dividends of £3.105m which also contributed to the net cash outflow.

The overall effect of the above factors was that net debt increased from £33.449m at 31 March 2011 to £37.436m at 31 March 2012.

***Capital investment***

2011/12 capital investment performance is on track with the Final Determination, with £9.34m invested this year against a determination of £9.53m.

The position to date for the AMP5 period is summarised in the following table, but overall gross expenditure is marginally ahead of determination.

| **All prices in £m** | **2010 - 2012 Determination** (Regulatory Year Prices, Post CIS) | **2010 - 2012 Actual** | **Variance** |
|---|---|---|---|
| IRE (net) | 3.24 | 3.74 | -0.51 |
| MNI | 6.99 | 5.24 | 1.75 |
| Supply Demand | 1.61* | 3.24 | -1.63 |
| Quality | 2.88 | 2.79 | 0.09 |
| ESL | 0.12 | 0.03 | 0.09 |
| **Total Gross** | **14.83** | **15.04** | **-0.21** |
| Grants and Contributions | 0.37 | 0.98 | -0.61 |
| Total Net | 14.46 | 14.06 | 0.40 |

***** £1.61m is the determination number and does not include the approved log up for additional metering

IRE is ahead of the determination, owing to the acceleration of the mains renewal programme. MNI is behind determination, in large part due to finding an alternative and lower cost solution to the Hills Reservoir 2nd cell project, and a delay in the construction of the new booster station associated with the Hills reservoir to Paddlesworth reservoir link, following a review of alternative solutions. Supply demand investment is ahead of determination. This reflects the additional metering expenditure, the Folkestone AMR trial and higher than determined developer services activity. The higher grant and contributions results from 2010/11 where income was recognised on a significant off-site reinforcement project undertaken in AMP4.

Overall, delivery of the capital programme to within the AMP5 determination remains challenging; however, all regulatory deliverables from the determination are on programme for delivery as described in Section 5.4. We remains focused on ensuring our investment decision making targets customer service benefits and that investment delivers value for money through benchmarking of supply chain arrangements.

## 7. Compliance Statement

We recognise the importance of demonstrating to our customers, stakeholders and regulators that we are meeting the statutory and regulatory obligations that apply to our activities. We have set out in this report our compliance with, and performance against, certain key performance indicators, legal requirements and regulatory outputs. We have also identified the risks that we are facing and the steps we are taking to manage and mitigate those risks.

In preparing this report we have considered, in particular, our compliance with those legal and regulatory obligations for which OFWAT is the enforcement authority. In respect of these obligations, subject to the matters set out in this report, we confirm that:

- we have a full understanding of, and are meeting, our statutory and regulatory obligations;
- we have taken steps to understand and meet our customers' expectations;
- we are satisfied that we have sufficient processes and internal systems of control to meet fully our obligations;
- we have appropriate systems and processes in place to allow us to identify, manage and review our risks; and
- where we have identified material or potential risks, we have set out in this report the steps we are taking to manage and or mitigate those risks.

Alongside this report, we are publishing our Regulatory Accounts for the year ended 31 March 2012 in which we:

- confirm that we have sufficient financial and management resources available to us for at least the next twelve months to meet our obligations as a water undertaker;
- confirm that transactions with associated companies are at arms length (except where agreed by OFWAT) with no cross-subsidy occurring;
- confirm that contracts entered into with associated companies include requirements concerning the standard of service to be provided, to ensure we can meet our obligations as a water undertaker;
- confirm that, if a special administration order were to be made, we would have available sufficient rights and assets (other than financial reserves) to enable a special administrator to manage the affairs, business and property of our regulated activities;
- explain links between the standards of performance we achieve and directors' and senior executives' pay;

For and on behalf of the Board,
**Chris Taylor**, General Manager
Veolia Water Southeast