

The directors present their report and audited financial statements for the Company for the year ended 31 March 2019.

Directors and their interests

The directors who served during the year or were appointed before this report was issued were:

- J Pelczer, chairman
- A Ferrar, managing director (informed the Board on 27 March 2019 of his intention to retire this year)
- J Chadwick, finance and regulation director and company secretary (resigned 27 September 2018)
- P Kerr, finance and regulation director and company secretary (appointed 18 July 2018)
- M Legg, senior independent non-executive
- D Shemmans, independent non-executive
- J Woods, independent non-executive
- Y Sakai, non-executive (resigned 6 February 2019)
- S Kitajima, non-executive (appointed 6 February 2019)
- R Nishida, non-executive (resigned 1 May 2019)
- K Oida, non-executive (appointed 1 May 2019)

Service contracts

All current executive directors have service contracts and notice periods as detailed in the Remuneration Committee report on page 59.

Contracts of significance

There were no contracts of significance (including provision of services) existing in the year between the Company and controlling shareholders, or to which the Company is a party and in which a director of the Company is, or was, materially interested.

Further information about directors' interests, together with confirmations and appointments, is contained in the Nomination and Remuneration Committee reports on pages 50 and 52.

Reappointment

Our articles of association provide that our directors must retire at every Annual General Meeting following their last election or reappointment which is consistent with the recommendation contained within the 2016 UK Corporate Governance Code (the 'Code') that all directors should be subject to annual election. Information regarding the appointment of our directors is included in the Corporate Governance report from page 37.

Ownership and relationship with associated companies

The Company is incorporated as a private limited company and domiciled in the UK, with its registered office and principal place of business at 66-74 London Road, Redhill, Surrey, England, RH1 1LJ.

The Company is jointly owned by the major Japanese businesses, Sumitomo Corporation and Osaka Gas. Each has a 50% stake in the UK-based holding company Sumisho Osaka Gas Water UK Ltd. The full corporate structure is shown on page 20. Except where indicated, all companies within this corporate structure are domiciled in the UK for tax purposes.

Financial transactions with associated companies are disclosed in the Regulatory Accounts on page 134.

Sumisho Osaka Gas Water UK Ltd was established at the time Osaka Gas became a shareholder to enable joint ownership of the East Surrey Holdings Group and is entirely financed by shareholders' equity. East Surrey Holdings Ltd is the holding company for the trading companies of the Group and was the entity acquired by Sumitomo in February 2013.

The immediate parent of the Company is SESW Holding Company Limited (which wholly owns the Company), and was established at the time that the Company's £100 million index-linked bond was issued in March 2001 to protect the interests of bond holders by exercising control over distributions. The Company is an associate of other trading and property businesses within the East Surrey Holdings Group, transactions with whom are disclosed on page 134.

The Company has entered into a management agreement with Sumitomo Corporation and Osaka Gas, as controlling shareholders, which complies with the independence procedures as set out in the Listing Rules 6.1.4D. Both the Company and the shareholders (as far as the Company is aware) have complied with these independence provisions. Further information with respect to the code of conduct applied by the controlling shareholders with respect to the Company is contained within the Corporate governance report on page 49.

Directors' indemnities and insurance

There are contractual entitlements in place for the directors of the Company to claim indemnification by the Company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. These arrangements, which constitute qualifying third-party indemnity provisions, have been established in compliance with the relevant provisions of the Companies Act 2006 and have been in force throughout the financial year. They include provision for the Company to fund the costs incurred by directors in defending certain claims against them in relation to their duties as directors of the Company.

The Company also maintains an appropriate level of directors' and officers' liability insurance.

Principal activities

The Company is engaged principally in the supply of water across the London boroughs of Croydon, Merton and Sutton, as well as east Surrey and parts of Kent and Sussex.

Financial results and dividends

Financial performance for the year is described on pages 24 and 27 in the Operating and financial review.

Revenue for the year ended 31 March 2019 was £66.8 million (2018: £65.0 million). Profit before taxation was £9.7 million (2018: £10.5 million). A profit for the year of £7.5 million (2018: £9.5 million) was transferred to reserves, out of which a dividend was paid to shareholders.

Details of ordinary dividends declared and paid during the year are given in note 9 of the financial statements. The total dividend declared and paid for the year ended 31 March 2019 was 11.9 pence (2018: 17.9 pence) per ordinary share and included a special dividend of nil (2018: 6.4 pence) paid from accumulated reserves and cash balances from activities not associated with the Company's principal water supply obligations. The Group of which the Company is a member used the prior year dividend received to fund the acquisition of the Company's non-household customer list, the proceeds of which were received by the Company's appointed business.

A preference dividend of 7.8 pence (2018: 7.8 pence) was also paid on each preference share in the first half of the year. During 2018 the preference shares were converted to ordinary shares as part of the Company's de-gearing strategy.

Dividend policy statement

The Board considers that the base level of ordinary dividend for the appointed business should reflect the return on regulatory equity (defined as Regulatory Capital Value less net debt) allowed in the regulator's most recent price review, subject to the Company having adequate resources available to fulfil its overall service commitments and its other financial obligations. This includes compliance with the covenants associated with its index-linked bond (which are designed to protect the interests of the Company's creditors).

The Board will consider variations from this base level of ordinary dividend reflecting:

- The overall level of service delivered to customers, compliance with statutory obligations and progress with the delivery of regulatory and other obligations
- Financial performance against regulatory assumptions and internal targets.

The Board will explain the way in which these factors have been taken into account in arriving at the dividend declared in this Annual Report, and other publications, and will refer to any quantitative analysis required by reporting standards in support of such explanations.

The dividend paid by the appointed business for the year ended 31 March 2019 was £3.1m (2018: £3.0m).

Dividends paid by the non-appointed business was £0.6 million (2018: £0.6 million). Dividends from non-appointed activities undertaken by the Company are determined based on the financial performance and prospects of these activities and their anticipated need for future investment.

Future developments

A review of future developments for the water industry and the potential effect on the Company is provided within the Industry review on page 16.

Research and development

While the Company does not have a specific research and development function, significant innovation initiatives continue to be researched and implemented via a dedicated Innovation manager. Activity in 2018/19 included the development and trial of a highly innovative combined smart meter and valve which incorporates internet-of-things technology, the design and testing of a device to minimise water use on empty properties and the implementation of artificial intelligence solutions to manage leakage.

Greenhouse gas emissions

Greenhouse gas emissions are calculated using the UK Water Industry Research Carbon Accounting Workbook which is updated annually to reflect changes to emission factors and carbon reporting guidance from the UK Government. Net operational greenhouse gas emissions in 2019 were 5,574 tonnes of carbon dioxide equivalent (tCO₂eq) (2018: 22,597 tCO₂eq), a 75% reduction on the previous year. This equates to operational emissions of 71 kgCO₂eq per million litres of treated water (2018: 376 kgCO₂eq).

Operational greenhouse gas emissions for the regulated business include:

- Direct emissions from Company vehicles and fossil fuel use
- Indirect energy use emissions from the purchase of electricity
- Emissions from outsourced services, business travel and transportation and distribution of purchased electricity.

The significant reduction in our greenhouse gas emissions in 2018/19 reflects the Company's decision to purchase 100% renewable electricity from 1 June 2018 onwards, as well as reduced use of gasoil.

The Company has solar panels installed at five of our treatment works and this year has also installed solar panels at our Redhill head office. In 2019 on-site renewable electricity generation was 211,561 kWh (2018: 201,188 kWh) and we have also introduced the first electric vans to our fleet.

Directors' report

continued

Charitable and political donations

During the year the Company made charitable donations amounting to £18,839 (2018: £13,244). There were no political donations (2018: £nil). The largest donation to UK charities was £5,000 to the Reigate and Banstead Junior Citizen Scheme.

Payment to suppliers

Settlement terms are agreed with suppliers as part of contract terms and it is the Company's policy to pay in accordance with these terms. Other creditors are paid in accordance with invoice terms. Creditor days are approximately 28 days (2018: 30 days).

Going concern and long-term viability

The going concern and long-term viability statements required by the Disclosure and Transparency Rules are set out on pages 47 and 48 of the Corporate governance report and are incorporated by reference in this report.

Financial instruments

Our policy in relation to the use of financial instruments can be found in Note 17 to the financial statements.

Instrument of Appointment and Regulatory Accounts

In accordance with its Instrument of Appointment made under the Water Industry Act 1991 as amended, the directors are of the opinion that the Company is in compliance with paragraph 3.1 of Condition K of that Instrument, which relates to the control of the assets of the Appointed Business.

Post balance sheet events

Effective 1 May 2019, Ryuichi Nishida, one of the Company's shareholder nominated non-executive directors, ended his term on the Board and was succeeded by Kenji Oida.

Disclosure of information to auditor

The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware:

- There is no relevant audit information of which the Company's auditor is unaware; and
- Each director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of c418 of the Companies Act 2006.

Auditors

KPMG LLP is the auditor at the date of this report. PricewaterhouseCoopers LLP ('PwC') will replace KPMG LLP following the approval of these accounts at which time KPMG LLP will not seek reappointment. PwC will be appointed by directors as auditors for the financial year ending 31 March 2020 onwards and their appointment is subject to shareholder approval at the forthcoming Annual General Meeting.

Corporate governance

The Company's statement on corporate governance can be found in the Corporate governance report on pages 37 to 49 of this annual performance report. The Corporate governance report forms part of this Directors' report and is incorporated into it.

Annual General Meeting

Our 2019 Annual General Meeting (AGM) will be held on 27 September 2019. Full details of the resolutions proposed to our shareholders, and explanatory notes in respect of these resolutions, can be found in our notice of AGM, a copy of which can be found on our website. At our 2019 AGM, resolutions will be proposed, amongst other matters, to receive the Annual Report and financial statements; to approve the directors' remuneration report; to declare a final dividend; and to appoint PwC as statutory auditor.

By Order of the Board.

Paul Kerr

Finance and regulation director & Company secretary
Redhill, Surrey
15 July 2019

Company number 02447875