2022

INTERIM REPORT AND ACCOUNTS: PERFORMANCE AND PROSPECTS

FOR THE SIX MONTHS TO 30 SEPTEMBER 2022

Scottish Water

Trusted to serve Scotland

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GOVERNANCE

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Douglas Millican, Chief Executive
Peter Farrer, Chief Operating Officer
Alan P Scott, Strategy & Commercial Director

Non-executive Members

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CHAIR'S STATEMENT
DAME SUSAN RICE

Come rain or shine, we must always put customers and communities first. They are the heart of our business.

Most often, understanding what's in the best interests of our customers is straightforward and the hard work comes trying to deliver in the most effective and efficient ways possible.

These times are not like that.

The economic situation we are now facing, with high inflation, high energy costs, high mortgage rates and continued uncertainty, and the growing environmental pressures, make it exceptionally difficult to determine what is in the overall best interests of customers and communities. We face a series of dilemmas to which there are no easy answers.

For example, how do we minimise the charges paid by the customers of today, experiencing a cost-of-living crisis, without unduly burdening the customers of tomorrow, who will also need high quality water and waste water services?

Or, how much should we invest in enhancing our natural environment by improving waste water system monitoring and performance relative to adapting our assets and services to deal with the impact of our changing climate?

Nowhere are these dilemmas more obvious than in the decisions we must take about future investment levels and the associated level of customer charges needed to fund them. In times of low inflation and economic growth, water and waste water charges get few people excited, in times of real hardship they are yet another unwelcome cost of living increase.

Unlike 2021, the first six months of this financial year were relatively unremarkable in terms of more extreme weather and yet we have still had to manage the impacts of drought, floods, and warmer water temperatures leading to water quality challenges. Perhaps it is the range of challenges we face in an 'unremarkable' summer, as much as the more dramatic challenges we faced last year, that illustrate the point that we do not have a 'do nothing' option. We must invest in replacing ageing assets and in our climate resilience or the water and waste water services we provide will decline in standard.

As a Board we constantly wrestle with these dilemmas while keeping a close eye on the real difficulties being faced by our customers and communities. We understand just how difficult these times are and we want to do what we can to help. But we also have a responsibility to invest to protect services before they fail and to ensure that future generations will get the same level of service we enjoy today.

Over the rest of this year and regulatory period to 2027, we are going to face some difficult decisions on charges and investment priorities. We will take those decisions responsibly and with customers fully in mind, both our present and future customers.

In many areas of life, we are all going to have to pull together to successfully navigate these times of crisis. The stewardship of Scotland's water and waste water services is no different but together we will find a way to provide the essential services of which we are all so proud.

Dame Susan Rice
Chair, Scottish Water
December 2022

CHIEF EXECUTIVE'S REPORT
DOUGLAS MILLICAN

Customers rightly expect us to be doing all we can to deliver excellent water services and protect the environment. And across the UK, the intersection of the climate emergency and economic crisis is shining a spotlight on the performance and actions of water companies. This has led to much greater scrutiny of water companies' environmental performance and growing calls, particularly in England, for them to reduce their environmental impact. We too are committed to further investing in waste water network enhancements where that will achieve environmental improvements.

In our 2021/22 Performance and Prospects report, published in June, we recognised that financial pressures on households and businesses were likely to increase for some time. As I look back on the last six months and look ahead to the future, it is clear we are in a more challenging economic situation than at any time in recent history, causing increasing pressure on the finances and wellbeing of the customers and communities we serve.

We will play our part in helping to minimise the financial pressure on our customers. We are actively exploring this with the Scottish Government and are looking at how we can meet these expectations. Customers are at the heart of all we do, and we know many are struggling. However, we also know they expect us to deliver water and waste water services to the highest standard possible, both now and in the future.

The long hot summer in England and Wales led to drought conditions and large numbers of customers there being subject to Temporary Use Bans. Thankfully, despite Scotland recording its hottest day ever, we escaped the worst of the sustained hot weather and we were able to maintain unconstrained water supplies. However events south of the border are a timely reminder of why we must make our networks and services more resilient to all types of weather impacts to ensure we maintain services to customers. There is no room for complacency when it comes to adapting to the changing weather patterns.

The summer weather led to an increase in algae blooms at some of our water sources, which impacted the taste and odour of some customers' water. This contributed to a rise in customer contacts over the summer months. And like many climate-related issues there is no quick or easy fix. It will take time to ensure we look at new and innovative ways to manage such challenges, including some that we have never faced previously.

Weather-related issues can significantly impact performance on our Customer Experience Measures and so it is pleasing that our performance in this area, has been relatively stable over the last six months. Our performance in the first half of the year in other service areas is more mixed, with strong performance in some areas and some challenges to address in others.

If we step back a year, our performance was similarly varied at the same point last year. And like last year, our teams will do all they can to address the areas of performance challenge in the second half of the year.

I am pleased to report strong performance in our capital programme delivery, building on the investment growth that we achieved last financial year. Our total revenue performance is strong and running ahead of budget. This is a significant achievement considering the challenging economic conditions we are facing.

Unsurprisingly given the rising rate of inflation, we are seeing significant cost pressures. In terms of energy costs, our forward purchasing of electricity has fully protected us for this financial year, but we are experiencing cost increases, particularly in Private Finance Initiative (PFI) fees linked to gas prices.

We are also experiencing cost pressures in other areas, such as the cost of chemicals used in our treatment and testing processes. However, with continued careful management of costs, we should be well placed to manage the financial challenges of the year. The future years, however, are much less certain, particularly in respect of energy costs.

With all the challenges and pressures we face, it has never been more important for us to continue to transform and deliver the investment to secure the services that our customers need.

Our Transformation is well underway and is already making a real difference, particularly in streamlining our business processes. It is also delivering real improvements to the data we can obtain, and the speed at which we access this, preventing water supply and flooding incidents.

One of our priorities is improving sewer system performance by, over time, installing monitors and sensors to give us real-time data to predict and prevent environmental incidents. We are seeing positive results in our work establishing an Intelligent Asset Base, equipping our people with the data, processes and skills to predict and prevent issues before they impact our customers and the environment. The use of state-of-the-art sensors and monitors to capture the condition and health of our assets in this way, together with data-driven insights, will also help us better understand the risks to service and enable us to invest customers money more wisely in maintaining and improving vital services.

I am impressed by the enthusiasm and commitment of our people in taking these first steps; the first of many more changes needed to make our assets, and indeed our organisation, fit for the future.

Another area where we are looking to improve the data we obtain is in respect of water lost from our pipes. Some areas of the country showed small increases in leakage this summer, in part due to much drier ground conditions causing pipes to move and burst. Continuing our year-on-year reduction in leakage is an important priority.

While we are working hard to identify hidden leaks on our network we are also busy finding and supporting the repair of leaks within customers' premises on their supply pipes. These customer-side losses equate to around a quarter of our total leakage volume and will be important to reduce over the coming years.

Turning to emissions reduction, we are making good progress in some areas. In September we published the second annual update of our routemap to net zero emissions and were able to report that we have now halved greenhouse gas emissions associated with the delivery of Scotland's water and waste water services over the past 15 years. This achievement keeps us focused and determined to continue towards our ambitious Net Zero emissions' targets.

On another positive, work began this summer on our biggest solar energy scheme to date at our most energy intensive site, Balmore water treatment works in East Dunbartonshire. We are installing more than 8,600 ground-mounted solar Photovoltaic panels which will offset nearly 20% of the electricity required to operate the facility. The work will save around 1,100 tonnes of carbon dioxide equivalent each year. We have several similar, if smaller scale, projects underway across many parts of the country and plan to continue using our land and assets to support decarbonisation and make us more efficient.

One area we are struggling with is carbon sequestration. We have recently completed some studies which have highlighted how trees on our land are capturing carbon but how some areas of peatland are emitting it – effectively cancelling out any benefits. To resolve this, we are planning to restore all peatland on our land.

We recently published our Circular Economy Approach, including how we plan to re-use waste from our works. An exciting project has looked at finding a way to recycle grit from our waste water treatment into products used in the construction industry. The initial results look promising and show the potential to deliver substantial carbon benefits and reduction of overall costs.

As always, I want to thank all our people who work tirelessly to keep Scotland's vital waste water and water services running year-round. The way they have risen to the challenges of the last few months has been inspiring once again.

Earlier this year I announced my intention to step down as Chief Executive after ten years in the role and twenty years on our board and executive team. I will work alongside my successor, Alex Plant, and the wider leadership team to support a smooth transition to his leadership over the coming months.

In our Strategic Plan we set out the challenges we will face and our three strategic ambitions to enable us to fulfil our role in achieving Scotland's ambitious Water Sector Vision. In this interim report, we highlight the challenges we have faced in the last six months and set out our performance and the future steps we are taking and how this links to the Delivery Plan we published in 2021.

So long as we stay calm and focused, I am confident we will remain on track to transform the way we operate and ensure we support a flourishing Scotland through our role of being trusted to care for the water on which Scotland depends.

Douglas Millican
Chief Executive, Scottish Water
December 2022

SERVICE EXCELLENCE
THE CHALLENGES WE HAVE FACED

While performance on our Customer Experience Measures has been relatively stable, the elements associated with customer satisfaction levels are around 2% lower than in recent years. We are seeking to understand the full reasons for the dip in customer satisfaction while recognising that nine in ten of our customers say they are "happy" with the way we have responded and supported them to resolve issues which have impacted them.

Looking with a wider lens, climate change and extreme weather events are arguably the biggest challenge we face as an industry. What were once one-in-30 or one-in 50-year events have become the new normal. Our challenge is to minimise, as far as we can, the impacts of climate change on the water and waste water services we deliver for customers.

In terms of rainfall, there were several days in July and August when parts of Scotland saw particularly heavy downpours, over a short period of a day or two, which led to an increase in sewer blockages and flooding during that period. However overall, we saw a strong reduction in blockages over the full six month period.

The performance of our waste water system has received greater interest from stakeholders, elected representatives, communities, and the media in recent months, in part due to the increased scrutiny of water companies elsewhere in the UK. Tackling Environmental Pollution Incidents (EPIs) has always been a priority for us and we have renewed our focus in this area with our £500 million Urban Waters Routemap and our Nature Calls customer behaviour campaign.

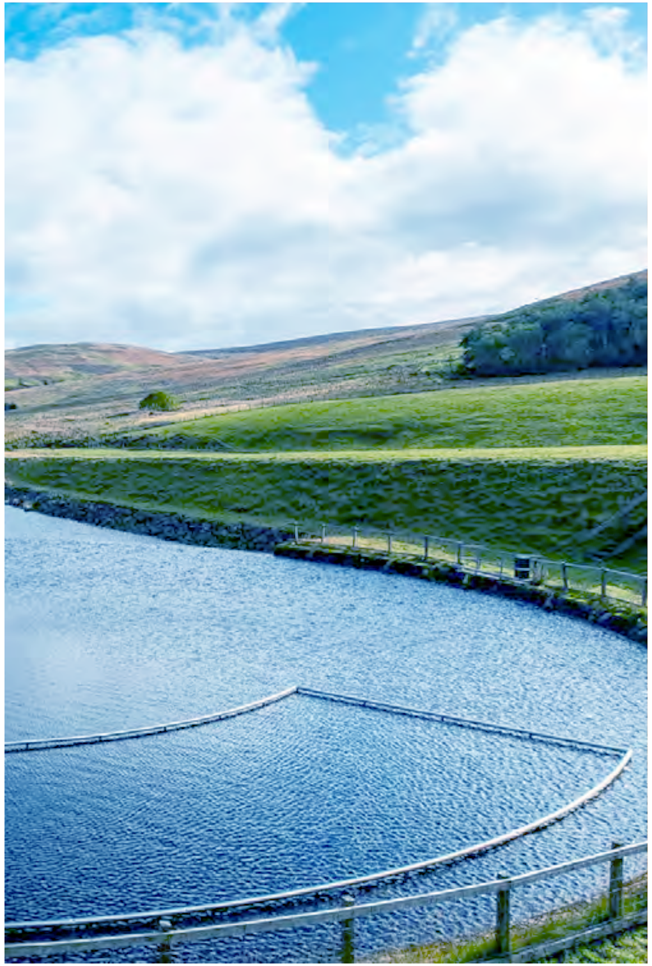
FACT

Health and Safety Performance to date this year:
There have been two Scottish Water RIDDOR incidents, both involving contractors.
This compares with 10, all involving contractors, at the same time last year.

Although we did not have the prolonged hot weather other parts of the UK had this summer, in mid-July and the start of August we asked customers in targeted areas to use water as efficiently as possible and help us to protect water resources. Past learning has made us better prepared during hotter weather and we closely monitor and manage water resources. We took several steps including tanker deployments to supplement supplies and adjusting the network to re-distribute water around the country to keep customers in the driest areas in supply.

FACT

At the beginning of August nationwide reservoir storage levels were 81% - which was around average for the time of year. In some eastern and southern areas levels were below average and in some instances reservoirs were topped up from alternative water sources to ensure supply resilience due to lower-than-average spring and summer rainfall in those areas.



Over the last few months we have started to experience cost inflation, particularly in the construction market. Supply shortages of some labour and materials have presented challenges. This led to a small number of projects being delayed and additional spend on products such as chemical and services, such as contractor costs for sludge disposal.

With the current economic climate expected to continue for some time we will keep working closely with our supply chain partners to understand and mitigate cost and supply issues where possible.

Internally, an area of concern for us is maintaining the ability to attract and retain employees with the skills we require to deliver our investment plans. As a public body we operate within the arrangements of Public Sector Pay Policy and have experienced retention challenges linked to remuneration and reward for some specialist roles. Looking ahead our Graduate and Modern Apprenticeship programmes are helping build the water sector workforce of the future.

OUR PERFORMANCE
DELIVERING CONSISTENTLY EXCELLENT WATER QUALITY

Although not as prolonged as last year, we suffered two very dry spells in the summer months and reservoirs serving Fife and parts of the Borders had particular challenges with low water levels. Our resilience plans, which have been further honed by the experience of the last few summers, kicked in and we effectively managed the risks to customer supplies and water quality.

FACT

The Drinking Water Quality Regulator's 2021 annual report reflected on what Scottish Water achieved in the 20 years since forming in 2002. We were praised for the 90% reduction in water quality failures and improvements made in microbiological performance at Water Treatment Works and service reservoirs due to improved operation and investment in the integrity of our tanks.

Our water quality performance to date in 2022 is broadly similar to this time last year.

Warmer weather led to an increase in bursts, as a result of very dry ground movement caused by reduced soil moisture. A number of these bursts were in more rural areas and a few were repeat issues for which we will seek longer-term solutions.

The majority of repeat interruptions are due to the failure of asbestos cement pipes. The cement that holds these pipes together is, in effect, being 'dissolved' by our soft waters. This reduces the strength of the pipes and, during the summer, we saw burst rates increase.

We are currently focusing our increased investment in water mains replacement on areas with high numbers of repeat bursts, mainly areas served by asbestos cement pipes. Through our asset base transformation, we will combine our burst, pressures, customer contact and leakage information to develop network risk models that optimise network replacement to deliver multiple benefits to our customers.

Customer water demand remains higher than it was pre-Covid, partly because of more people working from home. We are working to understand the new normal in terms of customer behaviours and how we continue to encourage people to use water wisely, reminding them it is a precious resource.

CASE STUDY
LISTENING AND LOGGING TO LOCATE LEAKS

We invest around £11 million every year – more than £30,000 every day - in finding and fixing leaks across Scotland.

Some are visible, and on many occasions our customers direct us to them, but many leaks never reach the surface. As a result, we must monitor the 30,400 miles of water pipes to identify changes in flow and pressure.

We effectively listen to the pipes to locate leaks by using conventional and innovative techniques such as acoustic logging.

Future Prospects

We will continue to increase investment to ensure year-on-year reduction on leakage by deploying advanced technologies and processes to better predict, locate and repair leaks. While we are working hard to identify leaks on our network we are also focusing on finding and supporting the repair of leaks on customer supply pipes. This equates to at least a quarter of the total leakage volume and addressing this issue will help us reach lower levels of leakage.

We know it will be a challenging to keep achieving year-on-year reductions in leakage but we are taking significant steps to bring leakage levels down again. This includes installing more intelligent assets, including sensors in the water network, and expanding the number of our people in leakage teams. To support water efficiency, we are also working with a range of partners, including developers, to create 'low water homes' with appliances and taps adapted to use less water.

We saw a slight rise in customer contacts due to algal bloom, which can cause taste and odour issues at some of our water sources, notably in Carron Valley in Forth Valley. The changing climate is making our source waters warmer and significantly increases the risk of algae blooms. We are taking action to address this issue which is set to worsen with further climate change. We are developing a risk assessment process based on satellite observations and from monitors at source waters. We are also investing in technology in our laboratories which will increase the capacity, speed and resilience of analysis for these compounds.

Looking ahead to the next six months we will be preparing for any storms or freeze events – which have led to customer supply issues in the past few years – to make our network as resilient as possible.

CASE STUDY
LOCH NESS WATER SUPPLY IN FULL FLOW

We installed a single and improved water supply for Fort Augustus and Glenmoriston building a new state-of-the-art Water Treatment Works capable of producing one million litres of water daily, with source water taken from Loch Ness.

More than six miles of new water main were installed along the lower route of the Great Glen Way and we built new water storage facilities. Due to the location, it involved complex work which lead to a delay in the project for some months.

The work will reduce the risk of water quality problems and ensure customers continue to receive a high-quality water supply which can adapt to the needs of the community, especially in summer when the population grows substantially.

TRANSFORMING WASTE WATER SERVICES

The dry summer meant, at times, our sewer system was not flushed out as much as normal and so there was a significant build-up of material in sewers. This meant we had to alter the way effluent was treated in order to ensure it met strict requirements before disposal.

FACT

Waste water handling and treatment is highly energy-intensive, currently consuming 53% of the total energy Scottish Water uses.

Environmental Pollution Incidents (EPIs) continue to be a challenge for us. We ended the last financial year with a total of 10 of the more serious Category 1 or 2 EPIs and this year we are experiencing a similar level of incidents. All reported and potential EPIs are investigated and classified by the Scottish Environment Protection Agency (SEPA).

Around 63% of EPIs are caused by sewer blockages – when water in the network can spill - however, such blockages were 11% lower than previously experienced. Other causes include asset failure and operator error.

CASE STUDY
TWO WASTE WATER PFI CONTRACTS COME TO AN END

Scottish Water inherited nine PFI contracts from its three predecessor authorities when formed in 2002. The contracts, entered into between 1996 and 2001, vary in duration between 25 and 40 years.

The Highland PFI contract - which comprised the provision and operation of conventional network, waste water and sludge treatment assets at Inverness and Fort William - expired in May and these assets are now operated by Scottish Water.

In December 2018, Scottish Water Horizons Holdings Limited acquired the North-East Scotland Waste Water PFI scheme, which comprised waste water facilities for Aberdeen, Peterhead, Fraserburgh and Stonehaven. Following repayment of the outstanding external bank debt, the Concession Agreement terminated on 1 October 2022 and the North-East Scotland Waste Water PFI scheme operations have now been integrated within Scottish Water's waste water operations.

CASE STUDY
INTELLIGENT ASSET PILOT PREVENTS WASTE WATER SPILL

We have 300 permanent flow and pressure sensors deployed on the waste water network in the Inverness area. These send signals to show the depth in a sewer and the rainfall coming into it in real time – enabling us to predict and prevent any issues.

To date we estimate three EPIs and two Bathing Water spills have been prevented using the data provided by this technology. It also helped us detect and quickly unblock 13 blockages, which could have resulted in flooding.

In one incident in July, sensors alerted analysts to an issue which showed the depth of water in part of the network in Lossiemouth was increasing rapidly without any rainfall. Working with our field teams and Intelligent Control Centre we were able to target the issue to a pumping station where pumps and telemetry system were not working as they should. The team carried out a repair which prevented the sewer spilling into the River Lossie.

Future Prospects

We are working with SEPA to develop plans to substantially increase the coverage of monitors on Combined Sewer Overflows (CSOs) to provide near real-time alerts to water users and to design solutions for overflows that most impact the environment. We are continuing to pilot 231 monitors across Scotland and plan to expand the network.

FACT

By December 2024 we aim to publish near real-time spill data for all monitored CSOs.

We estimate at least 80% of all sewer blockages we attend – 19,000 in the last six months – are caused by people putting unflushable items, including wet wipes, down the toilet and into the sewer system.

Our Nature Calls campaign encourages customers to bin all wipes and only ever put the 'three Ps, pee, poo and paper, down the toilet. The campaign is also calling for a ban on all wet wipes that contain plastic as they don't break down in the sewer network. To date the campaign for a ban on wipes containing plastic has been supported by a wide range of environmental groups, achieved cross-party support in the Scottish Parliament and more than 2,500 customer sign-ups.

CASE STUDY
LASER EQUIPPED DRONES IMPROVING SEWER NETWORK

A combination of hi-tech drones and laser technology, adapted for use in the waste water industry, is helping us survey sewers for potential problems by flying the drones inside them, often to hard-to-reach parts of the network. They will help us more accurately assess sewer conditions and help inform key decisions about investment in maintenance or rehabilitation work on our network.

This will, in turn, make the sewers more resilient, improve Scottish Water's service to customers, and reduce the risk of leaks, collapses and environmental pollution.

Replacing teams of up to 15 workers with just two operatives, this UK-first scanning and measurement technology will also reduce carbon emissions from sewer surveys by as much as 80%.

ENABLING SUSTAINABLE AND INCLUSIVE ECONOMIC GROWTH

Between April and September this year we completed nearly 12,000 new water connections, which is broadly similar to the same six-month period last year.

There is some uncertainty in the housing market due to the cost-of-living crisis and, increased mortgage interest rates but, to date, we have not yet seen a decrease in applications being received or properties being connected.

FACT

Peter Farrer, Scottish Water's Chief Operating Officer, took on the role of Chair of the Scottish Apprenticeship Advisory Board's (SAAB) Group Board in June. He will lead the strategic direction of the five groups in the body in charge of apprenticeships in Scotland. Peter has nearly 40 years of industry experience.

EMPOWERING CUSTOMERS AND COMMUNITIES

Our measures of customer experience are mostly stable at this point in the year. Our Household Customer Experience Measure (hCEM) score remains in the mid-point of our end of year target range. Overall, we have seen a reduction in Service issue Contacts and Complaints from same period last year although there has been some negative impact on satisfaction levels from repeat customer issues.

Performance on our Non-household Customer Experience Measure (nhCEM) is also within our target zone, albeit at the lower end of the scale. In nhCEM we have seen a welcome reduction of Service Issue Contacts, Complaints and Escalations.

We have seen a slight drop in our Stakeholder Customer Experience Measure (sCEM) over the first six months of the year. While the number of Stakeholder Issue Contacts has decreased, scores from our qualitative surveys of stakeholder satisfaction have declined.

The total number of customer contacts for the first six months of 2021/22 was over one quarter lower than the same period in the previous year when we suffered a spike in contacts about discoloured water in parts of Lanarkshire caused by increased manganese levels.

Along with the decrease in customer contacts we have seen a reduction in the number of escalations and complaints, likely linked to fewer extreme weather interruptions.

We are continuing with our 'Your Water Your Life' campaign. In August we announced our growing network of public water Top Up Taps had reached 75 with requests from customers across Scotland for future taps to be installed in their areas to help them refill on the go. To date the taps have saved the equivalent of more than two million single-use plastic bottles.

FACT

Throughout the summer a number of temporary pop-up taps were provided at major outdoor events, saving the equivalent of more than 48,000 plastic bottles of water. We attended around 20 events this summer to raise awareness of water efficiency.

FUTURE PROSPECTS

Future Prospects
We are developing opportunities to deepen our customer and community focus, by having conversations that start and end with those that use, and are impacted by, our services and activities and taking insight-led decisions which have them in mind.

To do this, we need to understand better our customers and communities, and what they value and expect from us, both today and into the future. In order to do this effectively we have started work on a Customer and Community insight project, which is exploring how we can dynamically capture and analyse data, intelligence and sentiment to provide the insight needed for decision makers at all levels to take action as if our customer was in the room talking with us.

At the end of September, over 30,000 people had signed up to our Join the Wave campaign to receive regular updates about our work. This is just one of the ways customers can stay in touch with us, and for us to share news on the wide-ranging work we do. We will continue to look at new and effective ways to engage with communities including holding virtual and in-person information events, digital newsletters and up-to-the-minute social media activity.

We are also looking at ways to improve our engagement with young people who are our future customers and future workforce. We are updating and expanding our Education Programme to create value for young people, teachers and communities. Our aim is to create responsible water citizens by engaging with schools, enabling positive behaviour change, realising career opportunities and highlighting the vital work Scottish Water does. We are working with our Academic Research partners to gain insight and learn from their Community Research to understand how best to engage with communities on this.

BEYOND NET ZERO

In September we published the second annual update of our Net Zero Emissions Routemap. In it we highlighted how we have now reduced the operational emissions associated with the delivery of Scotland's water and waste water services by 50% from our 2006/07 baseline.

This significant milestone was achieved though delivering a mixture of energy efficiency, generating our own renewable energy, transforming our fleet and planting more than 240,000 trees.

FACT

Scottish Water produces more than 1.5 billion litres of water a day and treats more than 1 billion litres of waste water, returning it safely to the environment.

Highlights of the last year include:

- Increasing the pace of energy efficiency delivery through improving control of waste water treatment work;
- Upping the rate of renewables delivery, adopting new battery technology to maximise solar power and concluding studies to help extend our renewables self-generation target to 120GWh by the end of the decade;
- Innovative partnerships to trial co-digestion of distillery material and waste water sludge to maximise biogas production;
- Piloting low carbon concrete, alternative materials and delivery approaches with partners to support development of a pathway to net zero capital investment;
- Starting to transition our 800 small van fleet to electric vehicles.

Activity in all key areas of our routemap has helped reduce, capture or eliminate emissions as well as identify areas for future innovation. To view our routemap update: Annual Update - Net Zero (scottishwaternetzero.co.uk)

The climate crisis clock is ticking ever more quickly and the need for us all to take urgent and considered action is vital. We are committed to doing much more at scale and speed to ensure we meet our net zero emissions targets. We are currently on track to exceed our original target on operational emissions of a 60% reduction by 2025.

FACT

We were the first UK water company to include investment emissions in our net zero goals. We aim to reduce the carbon intensity of our capital investment by 75% by 2033 through adopting low or zero emissions design, materials and construction techniques.

We have an ongoing focus with all our delivery partners on selecting lowest carbon options for use at our assets. In parallel to this we have been building our pathway to investment Net Zero by developing our understanding of what we need to do to reduce investment emissions and how much this will cost.

FACT

We are cutting carbon emissions from construction using two new types of concrete that emit 70% less CO_2 during production.

Although we are delivering deep decarbonisation of our operational and investment activities, we expect to have some residual emissions after all our decarbonisation improvements. These will require to be balanced by carbon sequestration, mostly by peatland restoration and tree planting.

CASE STUDY

CIRCULAR SOLUTION SEES 80% CARBON SAVING

Adopting circular economy principles to refurbish rather than replace four scraper bridges at Dalmarnock Waste Water Treatment Works in Glasgow has resulted in an 80% carbon reduction.

The refurbishment of the storm tank bridges at the works was part of a wider ongoing £53 million project to deliver a combination of new and refurbished assets that will ensure the works continue to meet regulatory standards.

FUTURE PROSPECTS

We are focusing on restoring all peatland on our land holdings and exploring the potential for tree planting on our 22,500 hectare landholdings.

At our biggest land holding at Loch Katrine in the Trossachs we are working in partnership with Forestry and Land Scotland to develop a ten-year land management plan. In the last six months we have engaged with communities on the development of the project, which will be submitted for planning approval later this year. This work could see the creation of up to 3,000 hectares of new woodland, predominantly through natural regeneration and restoring all peatland on the Loch Katrine estate.

FACT

We have been testing zero emissions plant and equipment, such as mini diggers, on construction sites with positive results. We are also exploring sustainable hydrotreated vegetable oil (HVO) to deploy in our heavy fleet to reduce emissions.

Additionally, we are looking to improve the biodiversity at more of our land holdings and are piloting this work at 20 sites across Scotland. This includes initiatives such as tree planting and removal of invasive non-native species and we aim to have some of these delivered by the end of this financial year.

FACT

We are partnering with Scottish Power and other hydrogen producers to enable water supply for new hydrogen facilities. The first project is with Scottish Power at the Whitelees windfarm south of Glasgow.

GREAT VALUE AND FINANCIAL SUSTAINABILITY

One of our ambitions is to ensure our customers receive great value, now and in the future, without compromising our financial sustainability. The investment planning framework we developed with our economic regulator and other stakeholders has enabled us to increase our investment to higher levels than any point over the last decade. Our planned capital investment, on a regulatory accounting basis in the six months to September of £330 million, was £15 million greater than for the same period last year and in line with our plan.

In our 2021 Delivery Plan we set out to invest between £610 million to £680 million in 2022/23 (compared to £623 million in 2021/22) and we increased this range to £620 million to £690 million in our Interim Prospects and Performance in late 2021. We currently expect to outturn towards the top of the revised range.

Future Prospects

Looking further ahead we face significant demands for additional investment to replace our ageing assets, improve services, adapt to our changing climate and achieve net zero emissions.

While we plan to increase investment by 30% in this regulatory period, and need to increase further thereafter, there will be difficult choices to be made in this regulatory period about the investment choices we prioritise and the implications for future levels of investment and customer charges.

A key aspect of our transformation planning is to develop a framework to ensure that we prioritise investment decision making robustly in line with the agreed priorities of Scottish Ministers, regulators and our customers.

We are also continuing to establish strong, long-term partnerships with our supply chain and alliance partners including developing a future workforce for the water industry with the skills that will be required.

SMARTER INVESTMENT CHOICES
TRANSFORMING HOW WE WORK:

We have a bold ambition to provide water and waste water services in a way that makes the broadest possible contribution to the life and wellbeing of people, businesses, communities and the environment across Scotland. And transforming how we deliver to achieve service excellence, fully decarbonising our activities, and then going beyond net zero emissions, all while providing great value for our customers.

CASE STUDY
FAST TRACK WORK APP'S SUCCESSFUL SECOND PHASE

We fast tracked more than 8,000 service needs raised through the second phase of a new scheme transforming the way we replace, repair and refurbish assets where the value of work is less than £500,000.

We introduced the Non-Complex Service Delivery (NCSD) app and portal to enable our people to order and manage repair work to our assets by updating processes to automate the approval of requests, without a lengthy sign-off process.

This reduces waiting times from months to just days, cuts costs and helps customers sooner. Almost 90% of needs raised are being given automated approval.

Our transformation is in place to unlock our potential to be a different Scottish Water - changing how we think, plan and act to achieve our strategic ambitions, and support a flourishing Scotland. Through our ten workstreams and over 50 'live' initiatives, we have been testing and trialling how we might work in the future. We have made significant progress putting the foundations in place to ensure our organisation will be truly fit for the future.

CASE STUDY
SWIFT SUCCESS SEES CUSTOMER ISSUES SORTED SOONER

We have saved more than £120,000 to date by introducing a technique called Scottish Water Intelligent Field Transformation (SWIFT). It triages and diagnoses customer cases from across Scotland remotely.

In the past few months we have addressed in excess of 3,000 customer issues using this. This resulted in almost all cases being handled quicker and prevented more than 1,000 site visits – reducing, time, costs and emissions and providing solutions to many customers quicker than ever.

In the last six months a number of projects have begun on our ambitious journey to help us ensure our organisation and assets are fit for the future.

We have installed sensors into parts of our waste water network which alert us to the build-up of blockages, often an accumulation of fats, grease, wet wipes and other non-flushables. This has enabled us to clear the blockages proactively, avoiding pollution and flooding.

Similarly, in our water network we have deployed smart water meters on business premises and pressure sensors into the Inverness network to enable us to better target and reduce leakage, whilst optimising pressure in the network to reduce the frequency of bursts and customer contacts for issues like low pressure, high pressure and discoloured water.

Using the learning from these innovative projects we will now look to extend this intelligence to more parts of the network as well as into other areas experiencing similar issues. This work will help to prevent environmental issues and keeping customers in supply.

CASE STUDY
WASTE WATER GRIT TURNED INTO CONSTRUCTION GOLD

Our Research and Innovation team is playing a key role in our transformation, including how we embrace circular economy principles more fully. We have recently completed a successful trial to reuse the grit removed from waste water at our treatment works by turning it into aggregate for the construction industry; and every year 3,000 tonnes of this grit will be available.

The first results show that this grit can be turned into non-structural concrete and used to make bollards and bricks. Historically this grit has been burned or gone to landfill and this new use is set to save us on a proportion of landfill costs and reduce carbon emissions.

One of our next trials will look at how screened waste, such as wet wipes, collected at our Waste Water Treatment Works could be converted to biochar and used as a filter or used in construction. Another project will study the possibility of removing phosphorus from the waste water stream using microalgae to prevent it getting into watercourses.

FUTURE PROSPECTS

Looking ahead, in the short and medium-term, we have a number of projects in the pipeline which will help us continue to transform. These range from using the natural environment – through blue/green infrastructure – to reduce and better deal with surface water, to ensuring our workforce has the skills needed to deliver first class services for generations to come.

Our plan for transformation is fluid and flexible to allow us to respond to new data, feedback and take account of the external environment around us. There are some significant projects due to be delivered over the next six months. These include a new leadership development programme to support and help our leaders to lead as effectively as possible while we transform. We will also continue to look at our end-to-end processes to improve the way we work and deliver for customers and communities across Scotland ensuring they play a vital role in our plans and throughout capital project delivery.

Our Sustainable Investment Decision Making workstream will ensure we continue to balance external challenges with our internal plans – making sure we spend our customers' money in the right way. The plan is focusing on delivering value, delivering benefits and doing this at pace.

Forthcoming transformation activities are also focusing on our business customers within the wholesale area. Wholesale transformation is expected to increase first time resolution rates and reduce the number of site visits which we have to make – our aim is to improve service for those customers whilst supporting our Net Zero ambitions.

Internally, we will be continuing to look at ways to ensure that our people all have access to the equipment they need, especially those on the frontline working in more remote areas.

DELIVERY PLAN

The key initiatives and change programmes we will deliver by the end of 2022/23, beyond our transformation planning, are set out in the table opposite.

Ambition	Service Excellence				Beyond Net Zero Emissions		Great Value and Financial Stability		
Strategic Objective	**Delivering Consistently Excellent Water Supply**	**Transforming Waste Water Services**	**Enabling Sustainable and Inclusive Economic Growth**	**Empowering Customers and Communities**	**Transforming Our Emissions**	**Embracing the Circular Economy & Enhancing the Natural Environment**	**Making Smarter Investment Choices**	**Transforming How We Work**	**Financing Our Services**
What we are planning to deliver in 2021/22 - 2022/23	- Deliver SR15 & IR18 investment milestones. - Achieve accreditation for our water supply risk management system in 2023. - Progress delivery of 4 priority system needs and bring forward appraisals for a minimum of a further 3 in 2021/22. - Water Operational Systems Plans for all water treatment works.	- Deliver SR15 & IR18 investment milestones. - Develop a further 3 drainage partnerships. - Develop long-term plans for all waste water catchments by 2023. - Expect to appraise UIDs in 23 catchments. - Take ownership of Highland PFI assets in 2022 and finalise options for Daldowie PFI.	- Take the lead in delivering increased capacity in our existing network infrastructure. - Improve our service to developers.	- Establish Independent Customer Group by Spring 2021 and develop a national engagement strategy. - Transform wholesale service to Licensed Providers. - Boost support to vulnerable customers and those most impacted by recurring issues.	- Appraise opportunities so we can continue the momentum in reducing our operational emissions in future years. - Work with a partner to develop a 260GWh opportunity for new renewables in south-west Scotland on our land. - Report on emissions driven by our investment and target opportunities. - Commence pilots to improve our land to store carbon.	- Establish the biodiversity status of our land and identify projects to support. - Pilot improving the community access to 6 popular Scottish Water reservoirs.	- Deliver our Asset Management Transformation Routemap. - Implement (Summer 2022) portfolio reviews. - Implement improvements to our project appraisals including community engagement. - Procure contractor partners for a new delivery vehicle in the area of refurbishment and repair work.	- Roll out and embed our Scottish Water 'character'. - Deliver research and innovation Routemap. - Digital investment to continue cyber security focus while providing transformation opportunity.	- Target is to achieve, at least, a 1% year-on-year real reduction. - Plan to invest between £570m to £650m and £620m to £690m in each of 2021/22 and 2022/23 respectively. - Implement a framework to assess, drive improvements, and enable us to report on the delivery value for money achieved for customers.

We will invest in line with the policies we have set out, progressing larger projects through investment appraisals and learning from these experiences.

FINANCIAL SUSTAINABILITY
GROUP OVERVIEW

Scottish Water's regulated business supplies water and waste water services to households and is also the wholesaler to the 24 retailers (Licensed Providers) who operate in the water retail market for businesses in Scotland.

Within the Scottish Water group, our subsidiary Business Stream, operates as a Licensed Provider competing with other Licensed Providers in the Scottish and English markets to supply water and waste water retail services to business customers.

The group also provides non-regulated and other commercial services through Scottish Water Horizons Holdings Ltd. From December 2018 to 1 October 2022, it owned the companies that operate the four former PFI waste water treatment works in North-East Scotland, under contract to Scottish Water. The rationale for the acquisition of these companies was to protect environmental performance and reputation whilst also ensuring a commercial return on investment. The acquisition was made through Scottish Water Horizons Holdings Ltd (rather than Scottish Water) as a method of protecting Scottish Water's regulated customers from any operational and financial risks associated with the newly acquired plants within the scheme which, prior to acquisition, had experienced environmental and operational issues.

Since acquisition, the original corporate and contractual structures have remained in place, with Scottish Water paying the service fee to Aberdeen Environmental Services Ltd, as required under the terms of the incumbent bank facility agreements. However, there has been extensive operational integration of the scheme into the Scottish Water group of companies.

The restrictions in the contractual project agreements meant that there has only been limited scope for synergies under the current structure. So, several strategic options were explored for the PFI scheme which led to the decision to repay the external bank debt held by Aberdeen Environmental Services Ltd, including swap break costs in September 2022, and subsequently on 1 October 2022, fold the Aberdeen Environmental Services Group of companies into Scottish Water's waste water operations. This provides opportunities to increase efficiencies and deliver financial benefits for our customers.

Government borrowing will be drawn to replace the £30.8 million external bank debt repaid. The Scottish Government has confirmed that this is appropriate given that, at the time of acquisition, Scottish Water's gross borrowings were reduced to reflect the external bank debt being included within Scottish Water's borrowing cap. As such, Group total borrowing will remain unchanged.

Business Stream is operated in accordance with the Governance Code (agreed with the WICS). The code sets out the operating regime that Scottish Water and Business Stream must comply with to enable the operation of the licensed retail market. Business Stream has the same Chair as Scottish Water but has its own independent Board and management team. Scottish Water exercises governance over Business Stream through Scottish Water Business Stream Holdings Ltd in accordance with the above code.

This report highlights the performance over the period 1 April 2022 to 30 September 2022 for Scottish Water's group of companies.

The performance for the three main business areas covering regulated, Business Stream and non-regulated services is detailed on pages 39 to 41 with an overview of group performance on page 42.

SCOTTISH WATER
REGULATED SERVICES

Performance

The financial performance of Scottish Water's regulated activities is measured on a regulatory accounting basis which includes items subject to a long-term normative charge (LTNC)[1]. The following tables and commentary have therefore been presented on that basis. Reconciliations to Scottish Water's group results (as detailed in the Financials section on pages 44 to 51), along with relevant cross-references are provided on pages 33 to 43.

The Regulated Income & Expenditure Statement for the six months to September 2022 compared to the mid-point of our Delivery Plan is presented opposite.

Scottish Water's Regulated Income & Expenditure Statement	Actual £m	Mid-point Delivery Plan to 30 September £m	Variance £m	Delivery Plan Re-forecast for 2022/23 [2] £m
Total revenue	**696.5**	**693.8**	**2.7**	**1,375 – 1,400**
Regulatory operating costs	(201.6)	(302.5)	8.3	(590 – 620)
PFI operating costs	(92.6)			
Interest charges	(69.9)	(70.0)	0.1	(135 – 145)
Costs before items subject to LTNC	**(364.1)**	**(372.5)**	**8.4**	**(725 – 765)**
Total available to support investment before LTNC items	**332.4**	**321.3**	**11.1**	**610 – 675**
Responsive repair & refurbishment	(107.5)	(107.5)	-	(215)
Developer contributions	(15.0)	(15.0)	-	(30)
Tax paid	(15.0)	(15.0)	-	(30)
Total LTNC Items	**(137.5)**	**(137.5)**	**-**	**(275)**
Total available to support investment after charging LTNC items	**194.9**	**183.8**	**11.1**	**335 - 400**

[1] LTNC Items - Responsive repair and refurbishment costs, developer contributions and tax.

[2] Re-forecast for 2022/23 per Scottish Water's Interim Performance and Prospects Report in 2021/22, page 30

The financial contribution for the six months to September 2022 from customer revenue to planned investment was £195 million. This was at the upper end of the range of the re-forecast Delivery Plan for 2022/23 set out in our Interim Performance and Prospects Report to 30 September 2021 (£168 million-£198 million).

This performance was primarily driven by increased wholesale consumption that has returned close to pre pandemic levels, increased other revenue mainly fire hydrant work and strong cost control. Costs before items subject to long term normative charge were £364 million, £8 million lower than plan. Exposure to increased inflation in the first six months of this year has been managed effectively, supported significantly by our energy procurement strategy which enabled the forward purchase of our energy requirements before the start of the 2022/23 financial year.

Responsive repair and refurbishment expenditure is difficult to predict over a short-term time horizon as there can be significant variability in the annual level of expenditure associated with, for example, significant water main bursts or collapsed sewers. Long-term normative charges have been applied to remove variability with the expectation that the long-term normative charges will balance with actual expenditure incurred over the 2021-27 period. As we progress through the 2021-27 period a rebasing of the LTNC may be required to reflect up-to-date forecasts. If so, this will be highlighted within our interim and annual reports.

During 2021/22 we developed our processes to enhance cost capture. These changes informed our decision to increase the forecast overall responsive repair and refurbishment costs with the offset being in regulated operating costs. The rebased annual normative charge of £215 million per annum (£108 million in the six months to 30 September) has therefore been applied. Actual expenditure in the six months to 30 September was £83 million.

Developer contributions and taxation may also experience significant annual variability and hence we have adopted a similar normative charge approach in these areas for the same reason with normative charges of £30 million per annum for developer contributions and £30 million per annum for tax paid being applied with £15 million for each applied to 30 September. In the six months to 30 September actual expenditure was £19 million and zero respectively. Consequently, total actual expenditure on LTNC items in the six months to 30 September was £101 million, £36 million lower than the LTNC but over the 2021-27 period we expect the normative charge to balance with actual expenditure incurred.

The table opposite, Reconciliation to the consolidated group surplus before tax, reconciles the regulatory surplus, before LTNC items, from the table above to the consolidated surplus before tax as per the financial statements of £48.8 million for the six months to 30 September 2022.

Scottish Water's Reconciliation to consolidated Group surplus before tax	September 2022 £m
Regulated funding for planned investment before LTNC adjustments (per table above)	**332.4**
Deduct actual expenditure on LTNC items	(101.3)
Add non-core and subsidiaries surplus before tax	4.3
Less depreciation & amortisation charges	(145.1)
Less SW cloud computing arrangement costs associated with the IFRIC agenda decision	(9.3)
Add back developer contributions less infrastructure charge income awaiting investment	7.5
Planned maintenance costs less refurbishment costs capitalised	(18.7)
Group Retirement benefit obligation:	
Operating costs	(16.4)
Finance costs	(1.0)
IFRIC 12 PFI finance lease costs adjustment	(3.6)
Group Surplus Before Tax per statutory accounts	**48.8**

FINANCIAL SUMMARY OF YEAR-ON-YEAR PERFORMANCE

Revenue

Regulated revenue for the six months to 30 September 2022 increased by £44 million or 6.9% to £685 million (2021: £641 million) and is analysed by category in the table below. The increase reflects an average charge increase of 4.2% for household and wholesale customers applied on 1 April 2022, new connections to services and increased wholesale consumption which has now returned to close to pre-pandemic levels.

Regulated renvenue	Notes	September 2022 £m	September 2021 £m	Change £m
Household		495	469	26
Wholesale		180	165	15
Other		10	7	3
Total regulated revenue	**2**	**685**	**641**	**44**

Capital Investment

Our planned investment on a regulatory accounting basis in the six months to 30 September was £330 million, £15 million higher than the same period last year (2021: £315 million) in line with our plans to increase investment to replace our ageing assets.

On a statutory accounting basis investment for the six months to September 2022 was £309 million, £7 million higher than the same period last year. The table opposite reconciles investment on a gross regulatory accounting basis with investment as stated in the statutory accounts.

	September 2022 £m	September 2021 £m
Investment on a regulatory accounting basis	**329.6**	**315.0**
Less planned repairs charged to the Income Statement	-23.0	-22.0
Add refurbishment costs included in Tier 1a costs	4.3	12.2
Add developer contributions from Tier 1 costs	18.6	8.9
Less investment funded mainly from infrastructure charges and the settlement of contractual claims etc	-15.8	-11.0
Group assets acquired from Scottish Water Services Grampian Ltd	4.5	-
Less cloud-based projects charged to income statement	-9.3	-0.9
Company capital additions as at 30 September	**308.9**	**302.2**

Operating Costs, PFI and Depreciation

Total operating costs increased £45 million or 8.9% to £561 million (2021: £516 million) reflecting increased operating and repair costs of £24 million to £303 million (2021: £279 million). This was predominantly due to inflationary impacts associated with payroll, including increased national insurance costs, and chemical costs with the latter increasing by 48% or £4 million. In addition Cloud computing service arrangement costs increased £8 million to £9 million. On a like-for-like basis regulated operating costs reduced by 1.2% in real-terms as shown in the table opposite.

PFI costs increased by £12 million or 15.4%, to £90 million (2021: £78 million). However, £8 million of the increase related to the realignment of asset values associated with the former Highland PFI scheme which returned to Scottish Water at the end of May 2022, compared to those used in the IFRIC 12 valuation adjustments made in previous years. The remaining increase (£4 million) was predominantly due to contract indexation, particularly the impact of gas indexation on the Levenmouth contract.

Total depreciation and amortisation charges, net of the gain on sale from asset disposals, increased by £4 million or 3.0% to £143 million (2021: £139 million) due to the profile of capital investment and completed projects coming into beneficial use.

	September 2022 £m	September 2021 £m	Inc/(dec) £m	Inc/(dec) %
SW regulatory operating costs	201.6	188.1	13.5	7.2%
Covid -19 pandemic costs excluding bad debt charges	-	(1.5)	1.5	
Incident and weather-related costs	(1.3)	(2.5)	1.2	
Bad debt charges	(11.0)	(11.0)	-	
One-off refunds associated with previous years	-	3.0	(3.0)	
New operating costs	(1.1)	-	(1.1)	
Like-for-like controllable costs	**187.2**	**176.1**	**11.1**	**6.3%**
Average CPI inflation at 7.61%	-	13.4	(13.4)	
Like-for-like real costs reduction	**187.2**	**189.5**	**(2.3)**	**(1.2%)**

Finance Costs

Net interest payable in the period to 30 September was £78 million, a decrease of £3 million (2021: £81 million).

As at 30 September 2022, the weighted average interest cost of the outstanding long-term debt within Scottish Water's regulated business reduced to 3.1% (March 2022: 3.2%). This was mainly due to the repayment of £65 million loans with a weighted average interest rate of 5.0%. No new loans were drawn down during the period from the Scottish Government.

Cash balances

Cash balances within Scottish Water decreased by £125 million to £391 million due mainly to the growth on the investment programme in the six months, the £31 million intercompany loan to Aberdeen Environmental Services Ltd, enabling it to repay its external bank debt (as highlighted above), and the initial payment for the purchase of the investment associated with the North-East waste water treatment works from Scottish Water Horizons Holdings (£18 million).

Any large infrastructure organisation that provides an essential service requires significant access to cash to maintain its activities and to respond to unforeseen events. Our cash balances each year are largely a function of when we borrow from the Scottish Government relative to when we invest and, unlike similar infrastructure businesses, we do not have access to any other form of credit facilities. Before the pandemic our risk appetite determined that Scottish Water (regulated business) should always hold a minimum cash balance of £100 million.

However, considering the increased risks faced as a consequence of the pandemic, we increased this to holding a minimum £200 million cash balance, which is equivalent to approximately eight weeks expenditure. Given the current uncertain economic environment we will continue to hold a £200 million minimum cash balance. The balance of our cash has been committed for future investment delivery as set out in note 9 to the financial statements on page 58.

PROSPECTS

We remain committed to delivering our Strategic Plan and as part of this increasing investment to replace our ageing assets, achieving our net zero ambitions and taking all possible steps to drive for further efficiency to reduce our expenditure, targeting at least a 1% year-on-year real reduction (CPI-1%) in line with the challenging target set in the Final Determination.

Our latest forecast of the contribution to support planned investment for 2022/23 is a range of £345 million to £385 million after adjusting for Long-Term Normative Charges and reflecting the latest view on inflation. This is higher than the level forecast in our June 2022 Performance and Prospects Report (£300 million to £340 million) and is driven by increased revenues and strong cost control offsetting the anticipated impact of inflation.

For 2022/23 we forecast that our revenue will be in the range £1,358 million to £1,368 million. Customer charges for 2023/24 will be determined later this year but will be heavily influenced by the cost of living crisis. However, we would expect revenue to increase by c. £9 million to reflect household growth; additionally, revenue would grow by c. £13 million for every 1% increase to customer charges.

For 2022/23 we forecast operating, PFI and interest costs to be in the range of £730 million to £760 million. The wide range reflects uncertainty around gas indexation on the Levenmouth PFI contract, inflationary pressures and the required level of household bad debt charges.

Our operating costs will increase in 2023/24 due to higher electricity costs. 53% of our electricity costs are exposed to market prices. The government cap of £211/MWH expires on 31 March 2023. If electricity prices in 2023/24 out-turn at that level our electricity costs would increase by c. £38 million. Consequently, we are monitoring energy prices closely as well as inflation forecasts covering our key supply chain requirements.

BUSINESS STREAM

Strategic and Financial Framework

Business Stream is Scottish Water's licensed retail subsidiary which supplies water and waste water services to business customers throughout Scotland and England. The commercial strategy is to retain and grow market share through a combination of acquisition and organic growth. With the aim of being the water and waste water services supplier of choice for businesses, Business Stream strives to differentiate itself in the market through quality of service and added value by helping customers find the solution that's right for them.

Within the Scottish Water group, the licensed and commercial activities are generally self-financing with any profits generated being retained and invested in future developments of the business. Where additional financing is required to fund operations and planned expansion, Business Stream is limited to borrowing from Scottish Water Business Stream Holdings, subject to the appropriate board approvals.

Performance Review

Business Stream's main priority during the first half of this year has been delivering high quality service and support to its customers as they continue to recover from the impact of the pandemic and face into challenging macro-economic conditions. Business Stream has continued to grow its market share, retaining its position as one of the largest retailers in the UK water market, and delivered strong results against its key business performance targets.

Financial Performance

Revenue from this business segment for the period to 30 September 2022 totalled £327 million (2021: £314 million) (per note 2 to the financial statements). This represents 32% (2021: 32%) of the group revenue, before intercompany eliminations. The operating profit within this segment was £1 million (restated 2021: £2 million), reflecting increased gross profit from a growing customer base (£0.5 million) and synergies arising from the Yorkshire Water integration, being offset by higher bad debt provisioning costs (£2.4 million) in response to the macro-economic challenges.

Despite the continuing challenges within the economy, Business Stream's balance sheet remains strong and debt free, with net assets of £110 million at the end of September 2022.

Cash balances at 30 September 2022 were £41 million (31 March 2022: £73 million). Business Stream group cash, including Scottish Water Business Stream Holdings, decreased by £32 million in the six month period to £65 million due mainly to timing of wholesale payments, ongoing costs associated with the implementation of the Transformation programme and delays in cash receipts following the implementation of the new billing system. The reduction in cash balances was anticipated, with the release of bills to customers migrated to the new billing platform, carefully phased as part of a robust quality assurance process.

Prospects

Business Stream is in the process of delivering a multi-million pound transformation programme designed to transform its systems, processes and the way it works so that it can continue to provide a market-leading experience for its customers. This includes replacing ageing technology with a scalable, resilient, modern technology platform that will directly benefit its customers, improve operational efficiency and reduce cost to serve.

NON-REGULATED BUSINESSES

Overview

Our non-regulated business activities are governed and monitored within Scottish Water Horizons Holdings and mainly operate through Scottish Water Horizons and the North-East Scotland PFI waste water treatment operations.

Revenue from this business segment to 30 September 2022 totalled £26 million (2021: £26 million) (per note 2 to the financial statements). This represents 2.5% (2021: 2.6%) of the group revenue, before intercompany eliminations. The operating surplus within this segment to 30 September 2022 was £5 million (2021: £3 million), £4 million from North-East Scotland PFI waste water activities (2021: £2 million) and £1 million from Scottish Water Horizons and Horizons Holdings (2021: £1 million). The profits generated from the other licensed and commercial activities are all retained within the group and invested in the future development of the business.

Investment in the six months within Scottish Water Horizons totalled £3 million with a focus on low carbon investments. This has included successfully completing an energy centre and a district heating network project in partnership with Clyde Gateway, with further solar, hydro-electric and battery storage schemes being progressed.

During the period to 30 September 2022 the £31 million of external bank debt of the North-East Scotland PFI waste water treatment operations business was repaid and replaced with an intercompany loan from Scottish Water. In addition, as highlighted above, Scottish Water made an initial payment to purchase the investment in the North-East waste water treatment works from SWHH for £18 million.

As a consequence of these transactions, cash balances within the Horizons group of companies increased by £19 million to £63 million and with effect from 1 October, the activities, assets and liabilities of the North-East Scotland PFI waste water treatment operations business and the contractual arrangements were terminated.

FINANCIAL PERFORMANCE - GROUP

Financial Summary

The group surplus before tax for the six months to 30 September 2022 increased by £1 million to £49 million (2021 restated: £48 million). Consolidated revenue in the period increased by £53 million to £918 million (2021: £865 million) reflecting tariff increases effective from 1 April 2022 and increased consumption by businesses as consumption levels recovered to near pre-pandemic levels. Associated cost of sales increased by £57 million to £700 million (2021 restated: £643 million) reflecting inflation pressures, additional cloud computing service arrangement costs and the realignment of asset values associated with the former Highland PFI scheme which returned to Scottish Water at the end of May 2022.

In the six month period, consolidated net debt increased by £43 million to £3,800 million. The increase was driven by a £138 million decrease in cash balances to £519 million partially offset by loan repayments of £95 million. The movement in cash is summarised opposite. These cash balances have been committed for future investment delivery or are required for working capital.

	Scottish Water £m	Business Stream Group £m	Horizons Group £m	Group Total £m
Opening balance at 1 April 2022	516	97	44	657
Cash generated/(utilised)	(125)	(32)	19	(138)
Closing balance at 30 September 2022	391	65	63	519

Taxation

Scottish Water was awarded the Fair Tax Mark for the second time in November 2021. The Fair Tax Mark is reviewed on an annual basis with the expectation it will be awarded in future years demonstrating the continued commitment from Scottish Water to play fair by tax.

The Fair Tax Mark is the world's first independent accreditation for fair responsible tax and it was established in response to widespread public concern about apparent tax avoidance. To meet the criteria set by the Fair Tax Mark, Scottish Water is transparent about its tax affairs and has demonstrated with the publication of its tax strategy a firm commitment to shun tax avoidance, not take an aggressive interpretation of tax legislation and not use tax havens to secure a tax benefit.

The consolidated tax charge on the income statement to 30 September 2022 was £13 million (2021: £152 million), with the high tax charge in 2021 due primarily to a deferred tax charge of £148 million. The high deferred tax charge last year is a consequence of the revaluation of the deferred tax provision caused by the increase in the UK's main corporation tax rate from 19% to 25% effective from 1 April 2023. The effective tax rate for the six months to 30 September 2022 was 27% (2021: 350%).

Scottish Water is currently appealing the 2017 rateable value of its Water Undertaking listing but will not know the outcome of this until later this financial year.

Group Pension Arrangements

Scottish Water is a participating employer in the Scottish Local Government Pension Schemes across three funds – Strathclyde Pension Fund, the North-East Scotland Pension Fund and the Lothian Pension Fund. These funds are administered by Glasgow, Aberdeen and Edinburgh City Councils respectively. Business Stream is also a participating employer in the Strathclyde Pension Fund.

Under IAS 19 a snapshot is taken of pension fund assets and liabilities at a specific point in time. Thus, movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities. As at 30 September the discount rate had increased by 2.45% from 2.7% at 31 March 2022 to 5.15%. The Impact was a reduction in the pension liabilities of £780 million. This is partially offset by lower than forecast asset returns to 30 September 2022 and a higher expectation of CPI growth in 2022/23 than originally forecast at 31 March 2022. The overall impact is an actuarial gain of £584 million resulting in a pension asset of £498 million at 30 September 2022.

However, under the relevant accounting standards (IAS19 and IFRIC14) the pension asset is restricted to reflect the amount the employer is entitled to as an unconditional refund of the surplus or reduction in future contributions to the pension fund. Management review of the Local Government Pension Scheme regulations concluded that there are no likely circumstances which would result in the Company having an unconditional right to a refund in the event of a fund surplus. Actuarial advice was sought in relation to the benefit to the Employer in the form of reduced future contributions. This has been calculated as nil for Scottish Water and £1.9 million for Business Stream. As such the full pension asset of £498 million is not recognised but is restricted to a pension asset of £1.9 million with an actuarial gain of £87.3 million

The actuarial movements, net of deferred tax, are presented in the consolidated statement of comprehensive income with further detail in note 8 to the financial statements (on pages 56 to 57).

Employees who joined Business Stream after December 2016 participate in a defined contribution scheme, administered by Standard Life. All Employees of the North-East Scotland Waste Water PFI also participate in a defined contribution scheme administered by Aviva.


FINANCIALS

INDEPENDENT REVIEW REPORT TO SCOTTISH WATER
FOR THE SIX MONTH PERIOD ENDED 30 SEPTEMBER 2022

Conclusion

We have been engaged by the entity to review the condensed set of financial statements in the interim report and accounts for the six months ended 30 September 2022 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed balance sheet, the condensed consolidated statement of changes in equity, the condensed consolidated balance sheet and the condensed consolidated statement of cash flows and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim report and accounts for the six months ended 30 September 2022 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted for use in the UK.

Basis for conclusion

We conducted our review in accordance with International Standard on Review Engagements (UK) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* ("ISRE (UK) 2410") issued for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the interim report and accounts and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusions relating to going concern

Based on our review procedures, which are less extensive than those performed in an audit as described in the Basis of conclusion section of this report, nothing has come to our attention that causes us to believe that the members have inappropriately adopted the going concern basis of accounting, or that the members have identified material uncertainties relating to going concern that have not been appropriately disclosed.

This conclusion is based on the review procedures performed in accordance with ISRE (UK) 2410. However, future events or conditions may cause the entity to cease to continue as a going concern, and the above conclusions are not a guarantee that the entity will continue in operation.

Members' responsibilities

The interim report and accounts is the responsibility of, and has been approved by, the members.

As disclosed in note 1, the annual financial statements of the entity are prepared in accordance with International Financial Reporting Standards (IFRSs), and where appropriate as interpreted and adapted by the 2021/22 Government Financial Reporting Manual and the next annual financial statements will be prepared in accordance with International Financial Reporting Standards (IFRSs), and where appropriate as interpreted and adapted by the 2022/23 Government Financial Reporting Manual. The members are responsible for preparing the condensed set of financial statements included in the interim report and accounts in accordance with IAS 34 as adopted for use in the UK.

In preparing the condensed set of financial statements, the members are responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the members either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT REVIEW REPORT TO SCOTTISH WATER
FOR THE SIX MONTH PERIOD ENDED 30 SEPTEMBER 2022 (CONTINUED)

Our responsibility

Our responsibility is to express to the entity a conclusion on the condensed set of financial statements in the interim report and accounts based on our review. Our conclusion, including our conclusions relating to going concern, are based on procedures that are less extensive than audit procedures, as described in the Basis for conclusion section of this report.

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the entity in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the entity those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the entity for our review work, for this report, or for the conclusions we have reached.

Timothy Cutler
for and on behalf of KPMG LLP
Chartered Accountants
1 St Peter's Square,
Manchester,
M2 3AE

CONDENSED CONSOLIDATED INCOME STATEMENT
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2022

	Note	Half year to September 2022 Unaudited £m	Half year to September 2021 Unaudited & Restated* £m	Year to March 2022 Audited £m
Revenue	2	**918.0**	**865.0**	**1,733.5**
Cost of sales		(700.1)	(643.0)	(1,303.1)
Gross surplus		**217.9**	**222.0**	**430.4**
Administrative expenses		(90.4)	(93.3)	(178.4)
Operating surplus	2	**127.5**	**128.7**	**252.0**
Finance income		0.8	-	0.1
Finance costs		(79.5)	(81.2)	(161.3)
Surplus before taxation		**48.8**	**47.5**	**90.8**
Taxation	3	(12.9)	(152.4)	(158.0)
Surplus / (loss) for the period		**35.9**	**(104.9)**	**(67.2)**

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2022

	Note	Half year to September 2022 Unaudited £m	Half year to September 2021 Unaudited & Restated* £m	Year to March 2022 Audited £m
Surplus / (loss) for the period		35.9	(104.9)	(67.2)
Other comprehensive income for the period				
Items which will not subsequently be reclassified to the income statement				
Actuarial gain on post employment benefit obligations	8	87.3	51.0	218.7
Deferred tax on remeasurement of post employment benefit obligations		(21.8)	(8.7)	(55.2)
Effective portion of changes in fair value of cash flow hedge, net of deferred taxation		2.5	1.4	3.0
Total comprehensive income for the period		103.9	(61.2)	99.3

* refer to note 12
The surplus for the period and total comprehensive income for the period are attributable to the owners of Scottish Water.
The notes on pages 51 to 59 form an integral part of the condensed consolidated interim financial information.

CONDENSED CONSOLIDATED BALANCE SHEET
AS AT 30 SEPTEMBER 2022

	Note	Half year to September 2022 Unaudited £m	Half year to September 2021 Unaudited & Restated* £m	Year to March 2022 Audited £m
Assets				
Non-current assets				
Property, plant and equipment		6,956.2	6,681.7	6,813.1
Intangible asset	5	26.8	25.7	26.0
Deferred tax asset		3.1	6.5	3.6
Retirement benefit asset	8	1.9	-	-
		6,988.0	6,713.9	6,842.7
Current assets				
Inventories		4.4	4.6	4.2
Trade and other receivables		736.6	724.1	265.1
Current tax asset		8.4	8.4	11.8
Cash and cash equivalents	7	519.2	479.7	657.1
		1,268.6	1,216.8	938.2
Total assets		**8,256.6**	**7,930.7**	**7,780.9**
Liabilities				
Current liabilities				
Trade and other payables		(1,000.7)	(961.8)	(495.1)
Other loans and borrowings		(21.7)	(25.6)	(26.3)
Current tax liabilities		(3.3)	(1.1)	(2.6)
Provisions for liabilities		(12.6)	(9.4)	(11.9)
		(1,038.3)	(997.9)	(535.9)
Non-current liabilities				
Trade and other payables		(79.0)	(71.7)	(84.9)
Other loans and borrowings		(164.8)	(214.8)	(201.5)
Deferred tax liabilities		(672.6)	(599.3)	(644.7)
Retirement benefit obligations	8	-	(209.2)	(51.9)
Provisions for liabilities		(9.9)	(8.8)	(9.3)
		(926.3)	(1,103.8)	(992.3)
Total liabilities		**(1,964.6)**	**(2,101.7)**	**(1,528.2)**
Net assets		**6,292.0**	**5,829.0**	**6,252.7**
Equity				
Government loans	7	4,319.0	4,120.4	4,383.6
Retained earnings		1,839.6	1,579.3	1,738.2
Cash flow hedge reserve		-	(4.1)	(2.5)
Other reserves		133.4	133.4	133.4
		6,292.0	**5,829.0**	**6,252.7**

* refer to note 12

The notes on pages 51 to 59 form an integral part of the condensed consolidated interim financial information. The condensed set of financial statements on pages 47 to 50 were approved by the Board on 6 December 2022 and signed on its behalf by:

Douglas Millican,
Chief Executive.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2022

	Cash flow hedging reserves £m	Retained earnings £m	Other reserves £m	Total reserves £m
Balance at 1 April 2021	(5.5)	1,641.9	133.4	1,769.8
Restated loss for the six months ended 30 September 2021*	1.4	(104.9)	-	(103.5)
Other comprehensive income:				
Actuarial gain on post employment benefit obligations, net of tax	-	42.3	-	42.3
Restated total comprehensive income for the period*	1.4	(62.6)	-	(61.2)
Balance at 30 September 2021	(4.1)	1,579.3	133.4	1,708.6
Balance at 1 April 2021	(5.5)	1,641.9	133.4	1,769.8
Loss for the year ended 31 March 2022	-	(67.2)	-	(67.2)
Other comprehensive income:				
Actuarial gain on post employment benefit obligations, net of tax	-	163.5	-	163.5
Effective portion of changes in fair value of cash flow hedge, net of tax	3.0	-	-	3.0
Total comprehensive income for the year	3.0	96.3	-	99.3
Balance at 31 March 2022	**(2.5)**	**1,738.2**	**133.4**	**1,869.1**
Surplus for the six months ended 30 September 2022	-	35.9	-	35.9
Other comprehensive income:				
Actuarial gain on post employment benefit obligations, net of tax	-	65.5	-	65.5
Effective portion of changes in fair value of cash flow of cash flow hedge, net of tax	2.5	-	-	2.5
Total comprehensive income for the period	2.5	101.4	-	103.9
Balance at 30 September 2022	-	1,839.6	133.4	1,973.0

* refer to note 12

The 'Statement of changes in equity' above excludes Government loans which, in accordance with the Corporate Governance Direction, are recorded on the balance sheet under Equity. The notes on pages 51 to 59 form an integral part of the condensed consolidated interim financial information.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2022

	Note	Half year to September 2022 Unaudited £m	Half year to September 2021 Unaudited & Restated* £m	Year to March 2022 Audited £m
Surplus before taxation		48.8	47.5	90.8
Depreciation charges		150.8	148.3	293.9
Amortisation of intangible asset	5	6.5	7.7	14.0
Amortisation of grants		(0.9)	(1.2)	(1.8)
Loss/(surplus) on disposal of property, plant and equipment		7.9	(2.6)	(2.7)
Non cash adjustment for retirement benefit obligations		16.4	21.1	42.8
Finance costs - net		78.7	81.2	161.2
Operating cashflow before changes in working capital and provisions		**308.2**	**302.0**	**598.2**
Changes in working capital and provisions:				
Decrease in receivables		41.2	7.7	(19.8
(Increase) in inventories		(0.2)	(0.7)	(0.3)
(Decrease) / increase in payables		(4.3)	30.9	44.8
Increase in provisions		2.5	3.1	3.2
Cash flows from operating activities		**347.4**	**343.0**	**626.1**
Taxation paid		(3.1)	(7.1)	(12.9)
Net cash generated from operating activities		344.3	335.9	613.2
Cash flows from investing activities				
Purchase of property, plant and equipment		(302.5)	(320.4)	(604.9)
Sale of property, plant and equipment		0.2	2.6	3.6
Purchase of intangible asset		(7.3)	(2.8)	(10.0)
Government grant income received		-	0.2	2.0
Infrastructure income receipts		11.1	12.6	29.6
Net cash used in investing activities		(298.5)	(307.8)	(579.7)
Cash flows from financing activities				
Repayments of loans	7	(95.4)	(30.5)	(144.8)
Proceeds from borrowings	6	-	-	374.9
Interest received		0.8	-	0.1
Interest paid		(78.6)	(78.3)	(157.0)
Payment of finance lease liabilities		(10.5)	(10.0)	(20.0)
Net cash used in financing activities		(183.7)	(118.8)	53.2
Net (decrease)/increase in cash and cash equivalents		(137.9)	(90.7)	86.7
Cash and cash equivalents - opening balance		657.1	570.4	570.4
Cash and cash equivalents - closing balance		519.2	479.7	657.1

* refer to note 12

The notes on pages 51 to 59 form an integral part of the condensed consolidated interim financial information.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM STATEMENTS
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2022

1. ACCOUNTING POLICIES

1.1 General information
Scottish Water is a public sector body, classified as a public corporation of a trading nature, and is answerable to the Scottish Parliament through Scottish Ministers.

The condensed consolidated interim financial information was approved by the Board on 6 December 2022. The condensed consolidated interim financial information is unaudited but has been reviewed by the auditor. The Auditor's report is set out on pages 45 and 46. These condensed consolidated financial statements do not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2022, were approved by the Board on 31 May 2022 and laid before the Scottish Parliament. The report of the auditors on those accounts was unqualified.

1.2 Basis of preparation
The condensed consolidated interim financial information for the six months ended 30 September 2022 has been prepared in accordance with IAS 34 'Interim Financial Reporting'. The condensed consolidated interim financial information is presented on a condensed basis as permitted by IAS 34 and therefore does not include all disclosures that would otherwise be required in a full set of financial statements. Consequently, this report should be read in conjunction with Scottish Water's annual financial statements for the year ended 31 March 2022 which were prepared in accordance with International Financial Reporting Standards (IFRSs) and, where appropriate, as adapted and interpreted by the 2021/22 Government Financial Reporting Manual (FReM). Scottish Water's annual financial statements for the year ending 31 March 2023 will be prepared in accordance with IFRSs and, where appropriate, as adapted and interpreted by the 2022/23 FReM.

The condensed consolidated financial statements are presented in Pounds Sterling which is the functional and presentational currency of Scottish Water and its subsidiaries.

1.3 Going concern
The condensed consolidated interim financial statements have been prepared on the going concern basis which the Members consider to be appropriate for the following reasons.

In considering the basis of accounting, cash flow forecasts have been prepared for a period of at least 12 months from the date of approval of these financial statements which consider various scenarios, taking into consideration severe but plausible impact downsides. These forecasts include the assessment of the group's strategic and financial frameworks, including the borrowing limit, operational positions and the level of the capital investment programme.

Under all of the scenarios, Scottish Water will be able to operate within its available facilities. Consequently, the Members are confident that Scottish Water will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of these financial statements and therefore have prepared the financial statements on a going concern basis.

1.4 Accounting estimates and judgements
The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. A full disclosure of accounting policies can be found in the statutory accounts for the year ended 31 March 2022.

1.5 Significant accounting policies
These financial statements have been prepared in accordance with accounting policies expected to be followed for the year ending 31 March 2023. The accounting policies, as set out in the Annual Report and Accounts for the year ended 31 March 2022, have been applied consistently to all the periods presented.

1.6 New standards and interpretations
As at the date of authorisation of these financial statements, Annual improvements to IFRSs 2018-2020 Cycle had been issued and came into effect from periods beginning on or after 1 January 2022. None of the amendments impact the financial statements of Scottish Water and its subsidiaries.

IFRS 16 Leases came into effect for financial periods beginning on or after 1 January 2019 for the subsidiary companies. However, the implementation for public sector was deferred by the Financial Reporting Advisory Board (FRAB) in April 2022 to 1 April 2024. IFRS 16 is not expected to have a material impact on the results and net assets of Scottish Water.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM STATEMENTS FOR THE SIX MONTHS ENDED SEPTEMBER 2022 **(CONTINUED)**

2. SEGMENTAL ANALYSIS

The principal activities of the Scottish Water Group are the supply of water and waste water services to household and business customers across Scotland. In view of the integrated nature of Scottish Water's operational activities, the financial statements include all of the costs of water and waste water collection, treatment and distribution within cost of sales.

Scottish Water's reportable segments are the provision of regulated water and waste water services, Business Stream (a licensed provider in the supply of water and waste water services to non-household customers) and non-regulated businesses. These operating segments reflect the internal management reporting regularly reviewed by the Board in order to allocate resources to and assess the performance of the segments.

	Half year to September 2022 £m	Half year to September 2021 £m	Year to March 2022 £m
Revenue			
Scottish Water regulated water and waste water services	685.2	641.0	1,285.3
Business Stream	326.9	313.7	629.0
Scottish Water non-regulated activities	25.8	25.9	50.0
	1,037.9	980.6	1,964.3
Less Intercompany elimination	(119.9)	(115.6)	(230.8)
	918.0	**865.0**	**1,733.5**

	Half year to September 2022 £m	Half year to September 2021 *Restated £m	Year to March 2022 £m
Operating surplus / (loss)			
Scottish Water regulated water and waste water services	123.8	125.4	234.5
Business Stream	0.9	1.9	12.4
Scottish Water non-regulated activities	4.6	3.2	8.6
Reversal of IFRIC 12 adjustments on consolidation	(1.8)	(1.8)	(3.5)
	127.5	**128.7**	**252.0**

	Half year to September 2022 £m	Half year to September 2021 Restated £m	Year to March 2022 Restated £m
Total assets			
Scottish Water regulated water and waste water services	7,891.1	7,582.5	7,414.5
Business Stream	253.2	255.6	273.0
Scottish Water non-regulated activities	138.5	121.1	120.7
Reversal of IFRIC 12 adjustments on consolidation	(26.2)	(28.5)	(27.3)
	8,256.6	**7,930.7**	**7,780.9**

*refer to note 12

NOTES TO THE CONDENSED CONSOLIDATED INTERIM STATEMENTS FOR THE SIX MONTHS ENDED SEPTEMBER 2022 **(CONTINUED)**

2. SEGMENTAL ANALYSIS (continued)

An analysis of revenue and operating surplus by geographical location of customers is provided below:

	Half year to September 2022 £m	Half year to September 2021 £m	Year to March 2022 £m
Revenue			
United Kingdom	917.9	864.9	1,733.3
Rest of the World	0.1	0.1	0.2
	918.0	**865.0**	**1,733.5**

3. TAXATION

The effective tax rate for the six months to September 2022 was 26.5% (2021: 350.3%). The high deferred tax charge last year is a consequence of the revaluation of the deferred tax provision caused by the increase in the UK's main corporation tax rate from 19% to 25% effective from 1 April 2023. This was announced in the budget on 3 March 2021 and was substantively enacted on the 24 May 2021. Analysis of the tax charge recognised in the income statement is as follows:

		Half year to September 2022 £m	Half year to September 2021 £m	Year to March 2022 £m
Current Tax:	UK corporation tax	7.0	4.0	9.6
	Overseas corporation tax	–	–	–
	Adjustment in respect of prior years	–	–	(1.6)
		7.0	4.0	8.0
Deferred tax:	Origination and reversal of timing differences			
	- Current year	5.9	7.1	13.8
	- Prior year	–	–	(1.0)
		5.9	7.1	12.8
Effect of rate change		–	141.3	137.2
		5.9	148.4	150.0
Total taxation charge		**12.9**	**152.4**	**158.0**

4. PROPERTY, PLANT AND EQUIPMENT

During the period, additions to property, plant and equipment totalled £308.0 million (September 2021 restated: £306.2 million).

5. INTANGIBLE ASSET

Investment intangible assets relate to the acquisition of the non-household customer base of Southern Water Services Limited in April 2017 and, in October 2019, of the non-household customer books of Yorkshire Water Business Services and Three-Sixty, both part of the Kelda Group. The investments are treated as having a finite life and are being amortised on a straight-line basis over the expected useful life, currently set at 8 years. The cost, additions, amortisation charge and carrying value are shown in the table below.

Software intangible assets relate to implementation costs associated with cloud computing software that meet the definition of an intangible asset under IAS38 and software that is controlled by Scottish Water and/or its subsidiaries. Software intangible assets are amortised on a straight-line basis over a period of 3-5 years. The cost, additions, amortisation and carrying value are shown in the table below.

	Software £m	Investments £m	Total £m
Cost			
At 31 March 2022	77.3	23.2	100.5
Additions in the year	7.3	-	7.3
Disposals	-	-	-
At 30 September 2022	84.6	23.2	107.8
Accumulated Amortisation			
At 31 March 2022	60.8	13.7	74.5
Amortisation charge	5.3	1.2	6.5
Disposals	-	-	-
At 30 September 2022	66.1	14.9	81.0
Net book value			
At 30 September 2022	18.5	8.3	26.8
At 31 March 2022	16.5	9.5	26.0

6. GOVERNMENT BORROWING

Government loans, both short and long-term, are recorded on the balance sheet under Capital and Reserves in accordance with the Scottish Water Governance Directions 2022. Other debt is recorded under short and long-term payables following best practice.

Scottish Water did not draw down any loans from the Scottish Government during the six months to 30 September 2022. Repayments of Government loans of £64.6 million were made, in line with repayment terms.

7. ANALYSIS OF NET DEBT

	As at 1 April 2022 £m	Decrease in cash £m	Decrease in debt £m	As at 30 September 2022 £m
Cash and cash equivalents	657.1	(137.9)	–	519.2
Government loans	(4,383.6)	–	64.6	(4,319.0)
Other loans (exc PFI lease liabilities)	(30.8)	–	30.8	–
Net debt	**(3,757.3)**	**(137.9)**	**95.4**	**(3,799.8)**

The movement in cash is summarised below:

	Scottish Water £m	Business Stream group £m	Non Regulated group £m	Total £m
Balance at 1 April 2022	515.9	97.0	44.2	657.1
Government loans repaid	(64.6)	–	–	(64.6)
Cash utilised	(60.4)	(31.6)	18.7	(73.3)
Balance at 30 September 2022	**390.9**	**65.4**	**62.9**	**519.2**

The consolidated cash balance as at 30 September 2022 was £519.2 million (2021: £479.7 million).

NOTES TO THE CONDENSED CONSOLIDATED INTERIM STATEMENTS FOR THE SIX MONTHS ENDED SEPTEMBER 2022 **(CONTINUED)**

8. PENSIONS

	Half year to September 2022 £m	Half year to September 2021 £m	Year to March 2022 £m
Movement in pension liability in the period			
At start of period	(51.9)	(221.9)	(221.9)
Current service cost	(33.6)	(37.1)	(75.3)
Employer contributions	1.1	1.3	31.5
Net finance cost	(1.0)	(2.5)	(4.9)
Remeasurement - actuarial gains recognised	87.3	51.0	218.7
At end of period	**1.9**	**(209.2)**	**(51.9)**

Employees of Scottish Water participate in the North East Scotland Pension Fund, the Lothian Pension Fund and the Strathclyde Pension Fund, which are part of the Scottish Local Government Pension Scheme administered by Aberdeen, Edinburgh and Glasgow City Councils respectively.

The principal risks to Scottish Water impacting the pension liability are the longevity assumptions, statutory changes to the scheme, structural changes to the scheme, changes to inflation, bond yields and the performance of the equity investments held by the three funds. These are mitigated to a certain extent by the statutory requirements to charge to the Consolidated Income Statement any increase in the present value of liabilities expected to arise from employee service in the period and the net interest cost, outlined in note 1.19 - Employee benefit obligations in our Annual Report and Accounts for the year ended March 2022.

Assets are valued at fair value. Liabilities are valued on an actuarial basis using the projected unit method which assesses the future liabilities of the fund and discounts these back to their present value.

An actuarial gain of £583.7 million has been calculated resulting in a pension asset of £498.3 million at 30 September 2022. This is as a result of a higher discount rate than forecast at 31 March 2022, reducing the pension liabilities. This is partially offset by lower than forecast asset returns to 30 September 2022 and a higher expectation of CPI growth in 2022/23 than originally forecast at 31 March 2022.

	September 2022 %	March 2022 %
The major assumptions used by the actuaries were:		
Rate of increase in pensionable salaries	3.15	3.30
Rate of increase in pensions payment	10.0	3.30
Discount rate	5.15	2.70
CPI inflation rate	3.15	3.30

Actual asset returns for period from 1 April 2022 to 30 September 2022	
North East Scotland Pension Fund*	-15.10%
Lothian Pension Fund	-2.50%
Strathclyde Pension Fund	-6.20%

* The actual asset return for North East Scotland in the period from 1 July 2022 to 30th September 2022 were not available. As such an estimate of the asset return at 30th September 2022 of -15.10% has been calculated by an independent actuary using movements in various indices in the period reflecting the asset categories held by the North East Scotland fund. If the actual asset returns, when available, are + / - 2% from the estimate, the actuarial gain would increase from £583.7 million to £594.6 million or decrease to £572.9 million respectively. Neither would result in an impact to retirement benefit obligations or retirement benefit asset on the Balance Sheet.

8. PENSIONS (continued)

To comply with IFRIC 14 and IAS 19 the pension asset is restricted to reflect the amount the employer is entitled to as an unconditional refund of the surplus or reduction in future contributions to the pension fund. Management review of the Local Government Pension Scheme regulations concluded that there are no likely circumstances which would result in the Company having an unconditional right to a refund in the event of a fund surplus. Actuarial advice was sought in relation to the benefit to the Employer in the form of reduced future contributions. This has been calculated as £1.9 million. As such the full pension asset of £498.3 million is not recognised but is restricted to a pension asset of £1.9 million with an actuarial gain of £87.3 million.

Any updated measurement of the pension liability is a snapshot in time. The following table illustrates the potential impact of changes in the assumptions:

Assumption	Change in assumption	Approximate Impact on IAS 19 liability %	Approximate Impact on IAS 19 liability £m
Rate of increase in pensionable salaries	+/- 0.1% per annum	Increase / decrease by c. 0.28%	Increase / decrease by c. £4m
Discount rate	+/- 0.1% per annum	Decrease / increase by c. 1.74%	Decrease / increase by c. £26m
CPI Inflation rate	+/- 0.1% per annum	Increase / decrease by c. 1.44%	Increase / decrease by c. £22m
Longevity	Increase life expectancy by 1 year	Increase by c. 3.0%	Increase by c. £45m

9. CAPITAL COMMITMENTS

The Group has contracted capital commitments of £592.0 million (30 September 2021: £496.2 million; 31 March 2022: £455.6 million) relating to property, plant and equipment at the balance sheet date.

10. RELATED PARTY TRANSACTIONS

As disclosed in the annual report for the year ended 31 March 2022, the Scottish Water group has related party relationships with the Scottish Government and with its Members and Executive Management.

Scottish Government
During the six months to 30 September 2022, Scottish Water had the following material transactions with the Scottish Government

	Half year to September 2022 £m	Half year to September 2021 £m	Year to March 2022 £m
Loans repaid	64.6	28.0	139.7
Loans drawndown	–	–	(374.9)
Interest paid	69.4	70.9	140.6

Scottish Water had various material transactions with entities for which the Scottish Government is regarded as the parent. However, under IAS 24 'Related Party Disclosures' paragraph 25, Scottish Water is exempt from the disclosure requirements of IAS 24 paragraph 18 in respect of other government related entities.

11. FINANCIAL INSTRUMENTS

Scottish Water's financial assets and liabilities comprise trade and other receivables, cash and cash equivalents, borrowings and trade and other payables.

In special circumstances, Scottish Water may use financial instruments to mitigate certain financial risk exposures such as foreign exchange fluctuations. As such circumstances are rare, in addition to the approval of the Scottish Water Board, approval is required from Scottish Ministers under the terms of section 42(3)(b) Water Industry (Scotland) Act 2002.

12. RESTATEMENT OF COMPARITIVES

A summary of the restatements required for the six months ended 30 September 2021 as a result of the April 2021 IFRS Interpretations Committee (IFRIC) agenda decision in relation to the application of IAS 38 Intangible Assets to cloud computing arrangements is provided below.

The restatements for the September 2021 results have been made to maintain consistency with the approach taken in our annual report and accounts for the period ending 31 March 2022. No restatements are required for any other prior periods.

	Note	As prevously reported £m	Adjustments £m	Restated £m
Balance sheet				
At 30 September 2021				
Property, plant and equipment		6,694.6	(12.9)	6,681.7
Intangible Assets	5	15.0	10.7	25.7
Trade and other receivables		719.9	4.2	724.1
Current tax asset		10.3	(1.9)	8.4
Total		7,439.8	0.1	7,439.9
Deferred tax liabilities		(598.4)	(0.9)	(599.3)
Net assets		6,841.4	(0.8)	6,840.6
Retained earnings		1,580.1	(0.8)	1,579.3
Consolidated statement of comprehensive income				
For the six months ended 30 September 2021				
Cost of sales		(644.1)	1.1	(643.0)
Loss for the period		(106.0)	1.1	(104.9)
Total comprehensive Income		(62.3)	1.1	(61.2)

Cashflow statement

The restatement in the six months to 30 September 2021 had no impact on total cashflows from operating activities or total cashflows from investing activities.

13. POST BALANCE SHEET EVENT

From the 1st October 2022 the activities of the Aberdeen PFI companies have been absorbed into the regulated activities of Scottish Water. Aberdeen Environmental Services Ltd (AES) ceased trading from that date.

As at the balance sheet date Scottish Water paid an initial consideration to SWHH of £18.3 million for the net assets of AES. Work continues to establish a "hold harmless" position for Scottish Water Horizons Holdings Ltd (SWHH) which acquired the four Aberdeen PFI companies for £16.2 million in December 2018 and has continued to provide funding to Scottish Water Services (Grampian) since that date. It is expected that the transaction will be reported in full as part of the annual report and accounts of Scottish Water for the year ended 31 March 2023.

Scottish Water
Trusted to serve Scotland