



South Staffordshire  
*Group Plc*

**Interim Report 2003/4**

# Highlights

## Financial Results

- Turnover increased by 30% to £145.5m (2002: £111.7m)
- Operating profits increased by 20% to £21.0m (2002: £17.4m)
- HomeServe operating profits increased by 112%, reflecting strong performance by Home Service
- Profit before tax and goodwill increased by 14% to £17.5m (2002: £15.3m)
- Earnings per share before goodwill increased by 5% to 18.0p (2002: 17.1p)
- Dividend per share increased by 9% to 6.1p (2002: 5.6p)

## Operating Highlights

- Home Service now has 2.6m policies and has increased its retention rate from 86% to 87%
- Highway is starting to benefit from the management and operational changes made and has secured a major new customer, Royal and Sun Alliance
- Regency has performed well considering the downturn in the retail furnishing market
- Commercial Outsourcing profits reduced, primarily reflecting the expected absence of a large software licence sale and implementation
- The Customer Solutions Division has focused on developing a capability for customers with high volume transactional work
- South Staffordshire Water continued to produce stable returns and again ranked as second in the industry for levels of service

# Chairman's Statement

## Interim Results

In the six months ended 30 September 2003 the Group's turnover increased by 30% to £145.5m (2002: £111.7m). Operating profits have increased 20% to £21.0m (2002: £17.4m) and profit before tax and goodwill by 14% to £17.5m (2002: £15.3m). Earnings per share before goodwill have increased by 5% to 18.0p (2002: 17.1p) incorporating a 1% increase in the effective tax rate to 29.5% and an increase in the minority charge before goodwill to £0.9m (2002: £0.2m). The Board has approved an interim dividend of 6.1p (2002: 5.6p), an increase of 9%.

Net debt at 30 September 2003 was £106m (31 March 2003: £103m) of which £99m was within the Water Company.

## HomeServe

HomeServe's turnover increased by 63% in the period to £70.9m (2002: £43.6m) representing organic growth of 18% and the full six months contribution from Regency and Highway, which were acquired in the first half of last year.

Home Service has grown its turnover by 33% to £37.6m (2002: £28.3m) and operating profit by 141% to £6.5m (2002: £2.7m). In the first half of the last financial year Home Service increased its marketing expenditure to acquire additional new policies, which reduced trading profits in that period. The benefit of these additional policies renewing, together with an increase in overall renewal rates to just over 87%, has provided the basis for the strong performance reported for the six months to 30 September 2003.

The number of Home Service policies has increased to 2.6m (31 March 2003: 2.4m), up 27% from 30 September 2002 (2.04m policies). The most substantial area of policy growth has been in the recently introduced supply pipe cover product. This product provides a full emergency repair service to customer's water supply pipes with a targeted two-hour response time. This product has been sold primarily to existing members with 286,000 policies held as at 30 September 2003, an increase of 129,000 in the last six months.

We have secured an agreement with Scottish Water to market the plumbing and drainage product in its area of supply. Scottish Water was formed from the merger of the three former water authorities in Scotland and supplies water and wastewater services to 2 million customers. This now provides us with full coverage across Great Britain.

The number of gas boiler breakdown policies has increased to 100,000 as a result of taking over policies from Zurich Warranty Management Services earlier in the year and the acquisition in March 2003 of Servowarm. We have developed a low cost boiler breakdown product which has achieved encouraging take-up in tests in the summer and is currently being rolled out with a number of our water and power company partners.

We have made progress in the development of our manufacturer warranty operation. Over 77,000 customers have registered their appliances on our Mira Showers and Ideal Boiler warranty programmes. Registration and mailing take-ups, on both of these schemes, are well ahead of those achieved by our partners with their previous providers. We have recently secured agreement with Applied Energy, to run their warranty programmes for Creda Heating, Redring Shower and Xpelair Fan brands.

Home Service and Home Hotline, our claims handling and network management operation, won a joint tender to manage Home Emergency business on behalf of Norwich Union Direct, for which marketing has recently begun. Under this agreement, Home Service handles the policy administration whilst Home Hotline handles claims and deploys jobs to its contractor network. Home Hotline was also recently appointed by Royal Bank of Scotland to manage a Home Emergency product for 550,000 premium bank account holders.

We have made progress in developing an employed network of plumbing and drainage specialists to work alongside our subcontract network. The service, which is operated under the Highway brand, supports Home Service but is now extending its customer base and offering to Household Insurers, undertaking major drainage repairs. Customers now include both Prudential and Royal and Sun Alliance.

Regency achieved an operating profit of £2.1m consistent with £2.1m for the full six months to 30 September 2002. This is a good performance against the background of the downturn in the retail furnishings market over the summer period. Additionally, the results reflect the successful replacement of the structural warranty product operated for Harveys with an alternative extended warranty product. Regency is continuing to develop its high quality upholstery repair and cleaning operation, which works on behalf of retailers and manufacturers and has recently secured a number of new accounts. In addition, Regency has started to trial upholstery repair and cleaning on behalf of a number of Household Insurers, including Nationwide, Legal and General and Fortis. Regency is confident that there will be strong demand for a national service, which can demonstrate significant savings for Insurers from repair rather than cash settlement of accidental damage.

Highway made an operating loss of £0.2m compared to a profit of £0.2m for the full six months to 30 September 2002 in a period that is seasonally quiet for this business. Highway has made significant operational advances over the last few months, although this is not yet reflected in the trading performance. The strengthening of the management team in the summer has proved to be a successful catalyst for a number of initiatives, which should improve profitability in the longer term. We have already seen the impact of improved operational management over the last few months, examples include increased conversion of insurance leads and improving levels of productivity. Other initiatives include the development of new systems, which will automate workflow and invoicing to allow reductions in overheads. In addition, changes in procurement methods are realising cost reductions with our major suppliers. Highway is also now seeing the benefit of the new Royal and Sun Alliance account, which commenced in September 2003, and is already the third largest customer.

Our business in France, which is operated through a joint venture with Veolia Environnement and branded as Generale des Eaux Services, now has over 100,000 policies compared to 9,000 twelve months ago and the plumbing product will continue to be rolled out into new regions within France.

### **Commercial Outsourcing**

The Group's outsourcing businesses, which comprise OnSite and Customer Solutions, increased turnover by 15% to £54.1m (2002: £47.3m) reflecting the full six months contribution from Middleton/Doorman, which was acquired in August 2002. Operating profits have reduced to £4.5m (2002: £5.5m) primarily due to the absence of a large Rapid software licence sale and implementation.

The trading results for Commercial Outsourcing, excluding Rapid, show net margins reducing from 9.6% to 9% with no organic growth in turnover. This result reflects the competitive nature of the market. The individual businesses have continued to develop their own niche offerings with some success, but these are yet to reflect in a significant increase in profitability.

The Customer Solutions division has been developing its capability for transactional work particularly in the financial and telecom sectors. Examples include data processing, printing and distribution of billing documents on behalf of financial services customers as well as customer contact management and sales order processing.

The OnSite and Middleton/Doorman businesses have been affected by inconsistent workload from major contracts as a result of customer internal re-organisations and the exceptionally dry summer period reducing reactive drainage work. However Middleton/Doorman have been successful in winning national and regional contracts through facilities management providers for both Shell and HSBC. Additionally, OnSite has started new contract work for Anglian Water and Scottish Water who both have substantial future requirements.

#### **Regulated Water Supply**

Turnover from Regulated Water Supply increased by 3% to £30.1m (2002: £29.3m) with operating profits increasing to £8.1m (2002: £8.0m). OFWAT has again ranked South Staffordshire Water as the second highest in the industry for levels of service with the annual average household bill for water supply continuing to be the second lowest in the industry.

South Staffordshire Water submitted its draft business plan to OFWAT on 15 August 2003, as part of OFWAT's price review for the five years 2005 to 2010. The draft business plan requests a real term price increase over the five-year period of 12.8%. As part of the business plan, the company proposes to increase the rate of mains renewal by 40% in response to the increasing level of bursts in recent years. The Company will however be able to reduce investment in water quality and environmental projects following the successful completion of the large programme of works in these areas in the current five-year review period. The Company's draft business plan contains a capital expenditure investment programme of £118m before capital contributions of £15m, broadly consistent with the current five-year period.

South Staffordshire Water continues to be one of the most efficient operations in the industry. The Company will continue to seek efficiency improvements over the five years 2005 to 2010. The business has successfully achieved the targeted 14% real reduction in overheads imposed by OFWAT for the five-year period to 2005, with the result that further large savings are not achievable. The draft business plan confirms our intention to deliver the best value for money services combined with high levels of service and low prices.

Although the summer and autumn have been particularly dry, the Company has a wide variety of water resources available and does not foresee the need to interrupt its 25 year record of avoiding supply restrictions. Water can be drawn from deep boreholes, from our impounding reservoir at Blithfield or from the River Severn, itself backed by reservoir storage controlled by the Environment Agency. Nevertheless, arrangements have been put in place to conserve Blithfield, which is currently half-full and it is expected that normal winter rainfall will adequately recharge the reservoir by the spring.

## **Prospects**

The Group's activities will continue to be heavily weighted towards the second half of the financial year, reflecting increased levels of activity in most of our service businesses across the winter months.

Home Service is currently experiencing a good response to the autumn marketing campaigns, Regency has seen some early signs of improvement in the retail furnishings market and Highway is expected to benefit from the positive impact of the recent changes made. Commercial Outsourcing should benefit from its new service offerings. The Regulated Water Supply business is expected to continue to demonstrate very high levels of performance and service.

The Directors remain confident in the prospects for the year.

**Lindsay Bury**

25 November 2003

# Consolidated Profit and Loss Account

For the six months ended 30 September 2003

	Note	Six months ended 30 September 2003 £'000	Six months ended 30 September 2002 £'000	Year ended 31 March 2003 £'000
<b>Turnover</b>				
Turnover	2	145,526	111,689	265,794
Less share of joint ventures' turnover		(2,269)	(2,000)	(4,456)
Group turnover		143,257	109,689	261,338
<b>Operating Profit</b>				
Operating profit before goodwill	3	20,998	17,432	50,491
Goodwill amortisation		(3,629)	(2,416)	(5,973)
		17,369	15,016	44,518
Net interest payable		(3,536)	(2,097)	(5,962)
<b>Profit before tax and goodwill</b>				
		17,462	15,335	44,529
Goodwill amortisation		(3,629)	(2,416)	(5,973)
<b>Profit on ordinary activities before taxation</b>				
		13,833	12,919	38,556
Taxation on profit on ordinary activities	4	(5,151)	(4,370)	(12,789)
<b>Profit on ordinary activities after taxation</b>				
		8,682	8,549	25,767
Minority shareholders' equity interests		(221)	190	(1,780)
<b>Profit for the financial period</b>				
		8,461	8,739	23,987
Dividends paid and proposed	6	(3,859)	(3,516)	(11,340)
<b>Retained profit</b>				
		4,602	5,223	12,647
<b>Earnings per share</b>				
Basic	5	13.4p	13.9p	38.2p
Adjusted - basic excluding goodwill	5	18.0p	17.1p	45.9p
Diluted	5	13.3p	13.8p	37.9p
Diluted - excluding goodwill	5	17.9p	16.9p	45.5p
<b>Dividend per share</b>				
	6	6.1p	5.6p	18.0p

# Consolidated Balance Sheet

At 30 September 2003

	30 September 2003 £'000	30 September 2002 (Restated) £'000	31 March 2003 £'000
<b>Fixed assets</b>			
Goodwill	121,192	126,696	127,363
Tangible assets	176,641	168,310	171,122
Investments	—	19	—
	297,833	295,025	298,485
<b>Current Assets</b>			
Stocks	7,034	5,440	6,103
Debtors	74,977	70,925	76,527
Cash at bank and in hand	8,809	9,649	10,792
	90,820	86,014	93,422
<b>Creditors - amounts falling due within one year</b>			
Borrowings	(23,871)	(34,671)	(22,892)
Other creditors	(97,124)	(90,018)	(99,050)
	(120,995)	(124,689)	(121,942)
<b>Net current liabilities</b>	(30,175)	(38,675)	(28,520)
<b>Total assets less current liabilities</b>	267,658	256,350	269,965
<b>Creditors - amounts falling due after more than one year</b>			
Borrowings	(91,306)	(90,167)	(91,021)
Other creditors - deferred consideration	(13,521)	(23,473)	(21,473)
	(104,827)	(113,640)	(112,494)
<b>Provisions for liabilities and charges</b>	(10,125)	(7,885)	(9,218)
<b>Accruals and deferred income</b>	(17,819)	(15,160)	(18,454)
<b>Net assets</b>	134,887	119,665	129,799
<b>Capital and reserves</b>			
Share capital	6,324	6,282	6,315
Share premium	16,776	15,110	16,520
Capital redemption reserve	1,200	1,200	1,200
Profit and loss account	106,208	94,700	101,606
<b>Equity shareholders' funds</b>	130,508	117,292	125,641
Minority shareholders' equity interests	4,379	2,373	4,158
	134,887	119,665	129,799

# Consolidated Cash Flow Statement

For the six months ended 30 September 2003

	Note	Six months ended 30 September 2003 £'000	Six months ended 30 September 2002 £'000	Year ended 31 March 2003 £'000
<b>Net cash inflow from operating activities</b>				
Operating profit		17,369	15,016	44,518
Depreciation and profit on disposal of assets		8,723	7,810	16,650
Amortisation of goodwill		3,629	2,416	5,973
Share of operating loss in joint ventures		296	336	408
Provision against investments		—	—	52
Decrease/(increase) in working capital		1,100	(392)	(1,017)
		31,117	25,186	66,584
<b>Returns on investments and servicing of finance</b>				
Net interest paid		(2,287)	(1,534)	(3,725)
Dividends paid to minority interests		(1,415)	(1,216)	(2,293)
		(3,702)	(2,750)	(6,018)
<b>Corporation tax paid</b>				
		(5,306)	(5,133)	(12,958)
<b>Capital expenditure and financial investment</b>				
Purchase of tangible fixed assets		(17,538)	(18,351)	(31,755)
Investment in joint ventures		—	(100)	(100)
Purchase of own shares		—	(32)	(32)
Sale of tangible fixed assets		548	326	1,070
Capital contributions received		2,911	2,727	4,795
		(14,079)	(15,430)	(26,022)
<b>Acquisitions and disposals</b>				
Investment in subsidiary undertakings	8	(2,300)	(76,019)	(78,929)
<b>Equity dividends paid</b>				
		(7,822)	(6,961)	(10,481)
<b>Financing</b>				
Issue of ordinary share capital		265	66	991
Proceeds from bond issue		—	83,712	83,712
Repayment of loan notes		(144)	(401)	(3,364)
Finance lease and hire purchase payments		(697)	(181)	(1,285)
		(576)	83,196	80,054
<b>(Decrease)/increase in cash</b>				
		(2,668)	2,089	12,230
<b>Reconciliation of movement in net debt</b>				
(Decrease)/increase in cash		(1,983)	2,682	3,825
(Increase)/decrease in bank overdraft		(685)	(593)	8,405
		(2,668)	2,089	12,230
Debt in companies acquired		—	(1,455)	(1,455)
Debt issued in respect of acquisitions		—	(3,761)	(3,761)
Assets purchased under finance leases		(200)	(100)	(788)
Index-linked bond - proceeds from issue		—	(83,712)	(83,712)
- indexation		(1,220)	(253)	(1,705)
Debt repayments		841	582	4,649
Increase in net debt in period		(3,247)	(86,610)	(74,542)
Net debt brought forward		(103,121)	(28,579)	(28,579)
Net debt carried forward	9	(106,368)	(115,189)	(103,121)

## Notes

**1 Financial reporting**

The group's principal accounting policies are consistent with those adopted in the financial statements for the year ended 31 March 2003 and with those adopted in the interim financial statements for the six months ended 30 September 2002. In line with the accounts at 31 March 2003 the presentation of the balance sheet at 30 September 2002 has been changed to show amounts of £10,922,000 previously included within creditors due within one year under the heading accruals and deferred income.

This interim financial information is unaudited and does not constitute statutory accounts. Comparative figures for the year ended 31 March 2003 have been extracted from the latest published accounts which received an unqualified audit report and have been filed with the Registrar of Companies.

**2 Turnover**

	<b>Six months ended 30 September 2003 £'000</b>	<b>Six months ended 30 September 2002 £'000</b>	<b>Year ended 31 March 2003 £'000</b>
HomeServe	70,854	43,600	121,267
Commercial outsourcing	54,189	47,321	104,026
Inter division	(9,619)	(8,501)	(18,335)
Support services	115,424	82,420	206,958
Regulated water supply	30,102	29,269	58,836
	<b>145,526</b>	<b>111,689</b>	<b>265,794</b>

Inter divisional turnover relates wholly to commercial outsourcing.

**3 Operating profit**

	<b>Six months ended 30 September 2003 £'000</b>	<b>Six months ended 30 September 2002 £'000</b>	<b>Year ended 31 March 2003 £'000</b>
HomeServe	8,337	3,930	23,997
Commercial outsourcing	4,517	5,540	9,980
Support services	12,854	9,470	33,977
Regulated water supply	8,144	7,962	16,514
	<b>20,998</b>	<b>17,432</b>	<b>50,491</b>
Goodwill amortisation	(3,629)	(2,416)	(5,973)
	<b>17,369</b>	<b>15,016</b>	<b>44,518</b>

Operating profit includes the group's share of losses in joint ventures of £296,000 for the period (six months ended 30 September 2002: £336,000, year ended 31 March 2003: £408,000).

# Notes

## 4 Taxation

The tax charge is based on the estimated effective tax rate, calculated on profit before goodwill, for the full year to 31 March 2004 of 29.5% (six months ended 30 September 2002: 28.5%, year ended 31 March 2003: 28.7%), including deferred tax.

## 5 Earnings per share

Basic earnings per share is calculated by dividing the profit for the financial period by the weighted average number of ordinary shares in issue during the period. Adjusted earnings per share is calculated excluding goodwill.

	<b>Six months ended 30 September 2003 £'000</b>	<b>Six months ended 30 September 2002 £'000</b>	<b>Year ended 31 March 2003 £'000</b>
Profit for the financial period	8,461	8,739	23,987
Amortisation of goodwill - total	3,629	2,416	5,973
- relating to minority shareholders	(719)	(451)	(1,145)
Adjusted profit for the financial period	11,371	10,704	28,815
Weighted average number of shares (000's)			
Basic	63,184	62,746	62,772
Diluted	63,538	63,504	63,319

## 6 Dividend per share

An interim dividend of 6.1p (2002: 5.6p) per share has been approved and will be paid on 2 January 2004 to shareholders on the register at the close of business on 5 December 2003.

The dividend from the regulated water business to the ultimate parent company was £1.48m (2002: £2.05m).

## 7 Reconciliation of movements in shareholders' funds

	<b>Six months ended 30 September 2003 £'000</b>	<b>Six months ended 30 September 2002 £'000</b>	<b>Year ended 31 March 2003 £'000</b>
Profit for the financial period	8,461	8,739	23,987
Dividends	(3,859)	(3,516)	(11,340)
	4,602	5,223	12,647
New share capital subscribed	265	66	991
Net additions to shareholders' funds	4,867	5,289	13,638
Opening shareholders' funds	125,641	112,003	112,003
Closing shareholders' funds	130,508	117,292	125,641

**8 Acquisitions**

Deferred consideration of £2,300,000 was paid in the period in respect of Regency Financial Holdings Plc which was acquired in May 2002.

Adjustments to goodwill in the period of £2,542,000 relate to a reduction in the anticipated level of deferred consideration payable.

**9 Analysis of net debt**

	<b>30 September 2003 £'000</b>	<b>30 September 2002 £'000</b>	<b>31 March 2003 £'000</b>
Bank overdraft, net of cash at bank and in hand	(10,765)	(18,238)	(8,097)
Irredeemable debenture stock	(1,633)	(1,633)	(1,633)
Index-linked bond	(86,637)	(83,965)	(85,417)
Obligations under finance leases	(5,056)	(5,969)	(5,553)
Loan notes	(2,277)	(5,384)	(2,421)
<b>Net debt</b>	<b>(106,368)</b>	<b>(115,189)</b>	<b>(103,121)</b>

The retail price index-linked unsecured bond was issued by South Staffordshire Water PLC and is repayable in 2025.

**10 Other information**

This interim report has been sent to shareholders and further copies are available from the registered office at Green Lane, Walsall, WS2 7PD.



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