

Anglian Water Group Limited
Half-yearly report

for the six months ended 30 September 2011

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Half-yearly management report
for the half-year ended 30 September 2011

Summary

Results for the six months to 30 September 2011

	2011	2010
	Unaudited	Unaudited
	£m	£m
Turnover	747.1	702.7
Total operating profit before exceptional operating profits and goodwill amortisation ¹	220.6	232.6
(Loss)/profit before tax, exceptional items and goodwill amortisation ¹	(0.4)	47.8
(Loss)/profit before tax	(36.4)	23.7

¹ Excludes exceptional operating profits of £nil (2010: £11.9 million) and goodwill amortisation of £36.0 million (2010: £36.0 million).

Group financial results

Anglian Water Group Limited's principal business is Anglian Water, the group's regulated water and wastewater company, which serves in excess of six million customers in the east of England and Hartlepool. The group also includes Morrison Facilities Services, a support services business, and AWG Property, a specialist property development company.

This interim review has been prepared in respect of the six months ended 30 September 2011.

Turnover from continuing operations for the period was £747.1 million, an increase of 6.3% from £702.7 million in 2010. Anglian Water turnover increased by 4.8%, reflecting the regulatory pricing formula, while Morrison Facilities Services revenues increased by 13.6% due to the successful win of the Leeds contract, together with other smaller contract wins and contract re-bids.

Total operating profit from continuing operations before exceptional operating profits and goodwill amortisation was £220.6 million, a decrease of 5.2% from £232.6 million in 2010. Operating profit before goodwill amortisation in Anglian Water increased by 1.6% to £243.1 million compared with the prior year (£239.3 million) as a result of the increased turnover partially offset by increased operating costs attributable to inflationary pressures across the business, combined with higher depreciation. Morrison Facilities Services generated an operating loss before exceptional items and goodwill amortisation of £12.7 million compared with a profit of £5.2 million in the prior year. The current economic climate and government austerity measures have resulted in less planned maintenance work, which generates a higher margin, being released by clients in the period, with greater focus on releasing lower margin reactive repair work. The results include restructuring charges taken in the period to reduce the cost base and improve operating performance in the second half of the year. AWG Property operates in the challenging commercial UK property market and reported an operating loss of £2.0 million for the period (2010: loss of £2.3 million).

The net finance charge for the period was £221.0 million, and while this represents a significant increase compared with the prior period (2010: £184.8 million) this was principally due to an increase of £30.1 million in the non-cash impact of RPI on index-linked bonds, due to the higher RPI than in the prior period. This was partly offset by a reduced interest charge on the defined benefit pension scheme.

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Resultant loss before tax, exceptional items and goodwill amortisation was £0.4 million (2010: profit of £47.8 million). After goodwill amortisation and exceptional items, loss before tax was £36.4 million (2010: profit of £23.7 million).

The tax charge for the period was £8.7 million (2010: £30.6 million). The charge for the period primarily relates to the discounting of deferred tax liabilities, with discount rates reducing over the period.

Cash flow

The total operating cash inflow for the group from continuing operations was £306.1 million (2010: £303.3 million), an increase of £2.8 million on the prior period. Anglian Water's operating cash flow was £20.7 million higher than the prior period at £338.0 million (2010: £317.3 million), this was offset by Morrison Facilities Services which incurred a cash outflow of £12.8 million (2010: inflow of £8.7 million).

The net cash outflow for capital expenditure was £132.4 million (2010: £120.5 million). The vast majority of capital expenditure relates to the Anglian Water capital programme, which comprised gross expenditure in the period of £137 million. Net cash outflow from capital expenditure is after grants and contributions of £10.9 million received towards the capital programme and refers to the actual cash spend, which is net of a reduction in creditors and accruals in the period.

Net debt

Net debt increased by £152.2 million to £5,969.6 million in the six months to 30 September 2011. This was in line with expectations and relates primarily to the capital enhancement expenditure program within Anglian Water.

Pensions

At 30 September 2011 the gross deficit for the group (before deferred tax) was £121.2 million (31 March 2011: £83.7 million). There were a number of actuarial changes in the period, principally a significant fall in market interest expectations, partly offset by lower inflation. During the period asset performance was below expectations due to poor equity performance partially offset by strong performance from the bond portfolio held. Future additional contributions will continue to be made in line with actuarial advice.

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Divisional performances

Anglian Water

Results for the six months to 30 September 2011	2011	2010
	£m	£m
Turnover	581.1	554.5
Operating costs	(210.0)	(194.2)
Depreciation	(128.0)	(121.0)
Operating profit before goodwill amortisation ¹	243.1	239.3

¹ Excludes goodwill amortisation of £34.3 million (2010: £34.3 million).

Financial performance

Turnover for the six months ended September 2011 is up 4.8% compared with the same period in the prior year, which reflects the regulatory price increase. Volumes overall are in line with the prior period.

Operating costs were up £15.8 million (8.1%) on the prior period to £210.0 million. The increase is attributable to inflationary and above inflationary commodity price pressures across the business (£9.8 million); rates increases (£6.3 million); the newly introduced Carbon Reduction Commitment charge (£2.5 million); operating costs of newly commissioned assets (£1.9 million); and reflects set-up costs (£1.4 million) in respect of the transfer of private sewers on 1 October 2011. These cost increases were partially offset by targeted efficiency savings of £6.1 million.

Despite the continued challenging economic environment, underlying cash collection from our customers has remained generally consistent with the prior period. This reflects our focus on this key area and consequently the bad debt charge remains broadly in line with the prior year.

Depreciation is up 5.8% compared with the same period last year, which reflects the recent commissioning of shorter life assets, principally IT systems and meters and the general ongoing capital enhancement programme.

Operating profit before goodwill amortisation has increased by 1.6% to £243.1 million as a result of the increase in turnover, partially offset by the increases in operating costs and depreciation.

The net finance charge (excluding the intra-group interest received of £96.8 million, 2010: £96.8 million) increased by £29.6 million, from £165.3 million in the same period last year to £194.9 million in the six months ended September 2011. This was principally due to the non-cash impact of higher inflation in the current period on index-linked debt.

Additional funds were successfully raised in the six months ended September 2011 from a US\$160 million private placement. The proceeds from this, together with existing cash resources were used to repay debt maturing in July 2011. We recently concluded a £150 million facility with the European Investment Bank that we expect to start to draw down in the second half of the year. In addition, on 15 November 2011 we closed a US\$410 million private placement issue, the funds from which will be received in early December.

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We continue to focus on the efficient management of cash resources and have established a new lower cost £420.0 million (up from £355.0 million previously) working capital and capital expenditure bank facility, maturing in 2016.

During the first half of the year we invested £137 million in the capital programme, compared with £92 million for the same period last year. The expenditure rate is faster than last year, which is consistent with more schemes progressing from the design to the more cost intensive build phase.

Operational performance summary

Overall our operational performance has been in line with our expectations and remains strong.

Focus on customer service

Customers are at the heart of our business, and across our operations we are striving to achieve our goal of 100% customers very satisfied with our service. Every week we conduct a poll of over 600 customers; we listen to their views and feedback and incorporate both into our programme of continuous improvements to our service.

We welcomed the introduction of the Ofwat Service Incentive Mechanism measure (SIM) last year, benchmarking levels of customer satisfaction across the industry. We have been greatly encouraged to be the only water and wastewater company to have consistently improved the score we achieve from the quarterly customer surveys, placing us second in the Water and Wastewater Companies (WASCs) in the last quarter of 2010/11 for this element of the SIM measure. Overall we took sixth place in the WASCs SIM ranking and whilst we certainly recognise the value of the Service Incentive Mechanism as a tool for improvement, we remain concerned that lack of consistency between the water and wastewater companies in reporting on some of the quantitative measures represents a challenge to meaningful comparisons across the sector.

Our customer focused campaigns and our commitment to minimising leakage whilst maintaining supplies to customers in challenging weather conditions, exemplify our strategic focus on the delivery of sustainable, long-term and valued benefits to the communities we serve.

Targeting investment to meet customer needs

Our success in safeguarding water supplies during last winter's severe weather allowed us to move into the spring with full reservoirs and able to meet our commitment to secure supplies this summer without supply restrictions or hosepipe bans.

To improve our resilience, reduce costs and maintain our commitment to continually increasing levels of service, we increased our investment above planned levels in two areas:

We continue to prioritise leakage, where reactive and pro-active initiatives are delivering real benefits to customers. Last winter we were extremely disappointed to have missed our overall leakage target for the first time in 10 years. In what was the harshest winter in living memory and with extreme temperatures resulting in a 300% increase in the number of leaks and bursts, our focus was on maintaining pressurised supply to customers, particularly in the holiday season. We met leakage targets in every part of the region, with the exception of Lincolnshire, which suffered

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exceptionally severe conditions. Nonetheless, we brought leakage levels back to normal within eight weeks.

To prepare for winter 2011/12, we have increased capacity, with the recruitment of over sixty additional skilled leakage detection technicians, and have made significant additional investment in the identification and repair of leaks.

Our industry-leading *Keep It Clear* campaign is a key part of achieving our business goal of 'no pollutions'. Launched in October in Peterborough, *Keep It Clear* targets domestic customers, restaurants and take-away food outlets in pollution 'hot spots' with innovative campaign techniques designed to inspire behavioural change on the inappropriate disposal of fats, oils, greases and unflushable items. Pilots conducted in the first half of the year have been shown to significantly reduce blockages in targeted areas, indicating potential for considerable reductions in the approximately £7 million we currently spend annually on preventing blockages and clearing pipes in our wastewater network.

On 1 October 2011, we became responsible for an estimated additional 23,500 Km of pipes, when ownership of private sewers and laterals was transferred by the Government from customers to wastewater companies. This increased our sewer network by approximately 60%. It is too early to determine the long-term impact of the transfer, although early indications suggest a significant increase in customer-driven work. In the first half of the year in readiness for the transfer, we invested to increase our internal resource capacity and implemented a number of system changes. We continue to monitor the impact and adapt our service model as appropriate. There is provision within the terms of our licence to seek funding for the incremental costs associated with maintaining these additional assets. We will continue to review the actual cost impact and seek recovery through the appropriate mechanism if and when qualifying thresholds are met.

Water and wastewater compliance

The Drinking Water Inspectorate Report¹ for 2010 was published in July. The overall measure for drinking water quality compliance remained excellent for the year with a mean zonal compliance figure of 99.96% (2009: 99.96%). Performance measures relating to water treatment (process control and disinfection indices) shared top position as best in the industry.

The Report also noted the continued long-term increase in consumer confidence. This is measured by the continuing decline in customer concerns about the quality of the water, notably discolouration, air in water and chlorine taste. Our complaint rate was below the industry average (1.45 per 1,000 population compared to 1.98 per 1,000 population). The Chief Inspector also highlighted our strategy for minimising the risk from lead in pipes, as an example of how they expect companies to further develop their action plans to deal with lead failures at customers' taps.

In wastewater we again achieved 100% compliance against regulatory requirements in 2010. After an exceptional year in 2010, our 2011 results on serious pollution incidents are consistent with our best performance in prior years. We have had six events termed 'significant' confirmed to date, one of which was consented.²

The 2011 bathing water season has now ended and we have beaten our own best ever performance, returning 100% compliance with mandatory bathing water standards for the 10th year in succession, with a record high level of 85.4% of bathing waters meeting EU guideline bacteriological quality.

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Water resources and security of supply

This half-year period has been notable for exceptionally low rainfall. Spring 2011 was our driest in over 80 years, and September rainfall was around half the seasonal average. These conditions are particularly challenging given the east of England is already the driest region in the country.

Despite these exceptional conditions, we have safeguarded water supplies with a strategy of active demand management; investment in leakage prevention; and the transfer of water from areas in our region where resources are more plentiful.

Our high-profile water efficiency campaign continues to offer customers, particularly those in water-stressed areas, the opportunity to switch to a meter together with the free installation of water-efficient domestic products.

We will continue to actively manage water resources up to and throughout the coming crucial winter replenishment period, to ensure security of supply in 2012. This includes working closely with the Environment Agency on a range of measures, including consulting on, and where appropriate applying for, drought permits.³

Seeking efficiencies across our operations

We continue to focus on delivering efficiencies across our operations and are slightly ahead of our target to deliver £10.4 million of operating cost savings from initiatives in 2011/12.

We have also achieved significant cost efficiencies in our capital programme, making improvements to our entire capital delivery process, with the result that we are slightly ahead of our targeted efficiency savings for the AMP.

Our emphasis continues to be on securing sustainable cost efficiencies across the life of new capital projects, with our drive for low capex, low carbon and lowest whole-life cost solutions proving very successful to date.

Our performance on measuring, managing and reducing embodied carbon in new-build and refurbishment projects is particularly strong. There is considerable momentum from our own teams and our leading suppliers to identify and adopt innovative solutions. Our rigorous challenge on cost and carbon at the design phase is delivering excellent progress towards meeting our own stretching target of halving the embodied carbon in new assets that we build in 2015.⁴

Supporting our focus on reducing operational and embodied carbon emissions, our energy efficiency programme is now entering its sixth year. Cumulative savings since 2006 now total £13.5 million. Over the half year we have increased our generation of renewable power to 22 GWhs, compared to 19 GWhs in the previous six month period, and we have completed another 46 site specific energy efficiency projects.

Consulting on pension benefits

In common with many UK companies, our defined benefit pension scheme represents an unsustainable level of rising future service costs and volatility of deficit funding. We have recently begun consultation with our trade unions and affected employees on proposals to change the way benefits build up in the future and how risks can be better managed within the scheme.

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Our role in the community

Love Every Drop, our campaign to put water at the heart of a whole new way of living, encompasses our strategic objectives and business goals, and brings to life our response to the unique challenges of growth and climate change in the east of England. Launched in October 2010, Love Every Drop underpins our position as a leading innovative force in our industry, transforming our relationship with customers to raise awareness about the value of water and to change fundamentally how we all engage with it and use it.

In June we achieved Business in the Community's premier award - Platinum Plus – which places Anglian Water in the 'Top 10' of the UK's most sustainable companies. We continue to contribute constructively to the public policy agenda: for example, as consultees on a range of industry-related issues, including the Government's Water White Paper; as contributors to the UK Water Research and Innovation Framework; and through involvement with the Guardian's Sustainable Business Network.

Looking ahead

Our focus remains on delivering excellent operational performance and high levels of customer satisfaction as we continue to deliver targeted and sustainable efficiencies across our operations and capital investment programme.

Increased investment in improved resilience and service, particularly around leakage, supports our emphasis on meeting customer demand in anticipation of another challenging winter period.

Notes

¹ The Drinking Water Inspectorate (DWI) confirmed our performance indices measures in the Chief Inspector's Report *Drinking Water 2010*, published 7 July 2011 and available on the DWI website. <http://dwi.defra.gov.uk>

² All sewage discharge requires a consent set by the Environment Agency, limiting the amount of sewage (and wastewater) permitted to overflow. The terms of the consent at the discharge could be breached resulting in what is termed a 'consented incident'. An 'unconsented incident' is a discharge from a point which has not been designated eg, a blockage in the main causing the manhole to overflow.

³ This enables the company to abstract more water from designated rivers to replenish reservoir levels.

⁴ Compared to a 2010 baseline.

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Morrison Facilities Services

Results for the six months to 30 September 2011	2011	2010
	£m	£m
Turnover	139.1	122.5
Operating (loss)/profit before exceptional operating profits and goodwill amortisation ¹	(12.7)	5.2
Operating cash flow	(12.8)	8.7

¹ Excludes exceptional operating profits of £nil (2010: £3.7 million) and goodwill amortisation of £1.7 million (2010: £1.7 million).

Morrison Facilities Services is our housing repairs and maintenance business, managing outsourced contracts awarded by local authorities and housing associations and a leading provider in its market place. Although part of the Anglian Water Group, Morrison Facilities Services operates on a stand alone basis. The business looks after more than 500,000 homes and other local authority buildings in the UK for Councils, Housing Associations and Arms Length Management Organisations (ALMO's). It has an annual turnover in excess of £270 million and an established presence in London, the South East, Scotland, Yorkshire, the North East, the North West, the Midlands and East Anglia.

The current year has shown a growth in turnover for the first six months of the year compared to 2010/11. The increase is mainly attributable to the successful win of the Leeds contract compounded by other smaller contract wins in London such as Catalyst and Ealing. The business has also been successful with large contract re-bids, specifically in North Lanarkshire and Lambeth.

Morrison Facilities Services generated an operating loss before exceptional items and goodwill amortisation of £12.7 million compared with a profit of £5.2 million in the prior year. The current economic climate and government austerity measures have resulted in less planned maintenance work, which generates a higher margin, being released by clients in the period, with greater focus on releasing lower margin reactive repair work. The results include restructuring charges taken in the period to reduce the cost base and improve operating performance in the second half of the year.

At 30 September 2011 the business had a positive closing cash at bank balance of £8.5 million. Morrison Facilities Services requires only a limited fixed asset base, although it continues to make targeted investment in IT to enhance productivity and reduce operating costs. The business remains in a positive asset position at the balance sheet date with no debt financing and has significant undrawn bank facilities available if required.

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AWG Property

Results for the six months to 30 September 2011	2011	2010
	£m	£m
Turnover including share of joint ventures	9.2	9.1
Operating loss	(2.0)	(2.3)
Capital employed	14.0	14.7

AWG Property comprises our property development and investment business and is based in Edinburgh. Most of the property projects are based in Scotland, although there are some residual investments in Wales, Ireland and England.

The UK property market has suffered dramatically as a result of the significant economic downturn. As a consequence the group has decided to hold, manage and add value to its existing property assets until the market recovers at which point it intends to dispose of individual assets. We anticipate that this process could take a number of years.

Property reported an operating loss of £2.0 million for the period compared to an operating loss of £2.3 million for the comparative period, with turnover consistent with the prior period.

We continue to pursue cost effective strategies to increase the value ahead of subsequent disposal when the market improves.

Other

The 'Other' business segment mainly comprises head office, amortisation of fair value adjustments made on acquisition, Celtic Anglian Water which operates wastewater treatment works in the Republic of Ireland, Alpheus Environmental which operates industrial and commercial wastewater treatment works, and minimal residual international interests.

The group intends to exit the remaining international businesses. The group will continue to operate its long-term wastewater treatment business in the Republic of Ireland.

Turnover for the 'other' segment increased slightly from £17.1 million to £18.1 million, whilst the operating loss before exceptional items decreased from £8.2 million in the prior year to £7.8 million.

Ends