Anglian Water Group Limited
Half-yearly report

for the six months ended 30 September 2008

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Half-yearly management report

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Summary	Six months to 30 September 2008 Unaudited	Six months to 30 September 2007 Unaudited
Turnover from continuing operations [1]	702.1	671.4
Total operating profit before goodwill amortisation from continuing operations [2]	219.6	206.5
Profit before tax, exceptional items and goodwill amortisation [3]	43.4	44.9
Profit before tax	20.9	6.9

[1] Turnover from discontinued operations was £65.7m (2007: £261.8m)
[2] Total operating profit from discontinued operations was £1.1m (2007: £7.5m)
[3] Excludes exceptional profit of £13.8m (2007: £nil) and goodwill amortisation of £36.3m (2007: £38.0m)

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 five million customers in the east of England and Hartlepool. The group also includes Morrison Facilities Services, a repair and maintenance business, and AWG Property, a specialist property development company.

This interim review has been prepared in respect of the six months ended 30 September 2008.

Turnover from continuing operations for the period was £702.1 million, an increase of 4.6 per cent from £671.4 million in 2007. Anglian Water showed strong growth principally as a result of the regulatory pricing formula, however Morrison Facilities Services revenues declined due to the expiry of some fixed term contracts.

Total operating profit from continuing operations before goodwill amortisation was £219.6 million, an increase of 6.3 per cent from £206.5 million in 2007. Operating profit before goodwill amortisation in Anglian Water increased by 6.9 per cent to £229.9 million compared with the prior year (£215.0 million) as a result of the increased turnover, partially offset by increases in operating costs and depreciation. Morrison Facilities Services operating profit before goodwill amortisation was £1.4 million, down from £4.8 million in the prior year reflecting the expiry of fixed term contracts and mobilisation costs on new contract wins. AWG Property is currently operating in the very difficult UK property market and reported an operating loss of £4.7 million for the period (2007: loss of £0.9 million).

The net interest charge for the period was £173.6 million, in line with the prior period (2007: £173.7 million).

Profit before tax, goodwill amortisation and exceptional items was £43.4 million (2007: £44.9 million). After goodwill amortisation and exceptional items profit before tax was £20.9 million (2007: £6.9 million).

The tax charge for the period was a credit of £2.7 million (2007: credit of £12.2 million). The underlying effective tax rate for the period excluding amortisation of goodwill, exceptional items, discounting of deferred tax and prior year adjustments was 30.7 per cent. This is in line with prior years and slightly higher than the corporation tax rate of 28% due to specific permanently disallowable items for tax purposes.

Cash flow

The total operating cash inflow for the group from continuing operations was £288.6 million (2007: £266.5 million), an increase of 8.3 per cent on the prior period. Anglian Water represented £17.4 million of the improvement, predominantly from higher turnover.

The net cash outflow for capital expenditure was £221.6 million (2007: £203.0 million). The vast majority of capital expenditure relates to the Anglian Water capital programme, which comprises gross expenditure in the period of £235.3 million. Net cash outflow from capital expenditure is after grants and contributions of £14.1 million received towards the capital programme and refers to the actual cash spend net of creditors and accruals for work completed but not yet paid for.

Net debt

Net debt increased by £149.2 million to £5,554.3 million in the six months to 30 September 2008. This was in line with expectations and relates primarily to the capital enhancement expenditure program within Anglian Water.

Pensions

At 30 September 2008 the gross deficit for the group (before deferred tax) was £41.1 million (31 March 2008: £82.1 million). During the period asset performance was below expectations, however this was more than compensated for by an increase in the discount rate used to value the scheme liabilities and experience gains on liabilities. Future additional contributions will continue to be made in line with actuarial advice.

Divisional performances

Anglian Water

Results for the six months to 30 September 2008	2008 £m	2007 £m
Turnover	525.8	487.4
Operating costs	(183.3)	(169.5)
Depreciation	(112.6)	(102.9)
Operating profit before goodwill amortisation [1]	229.9	215.0

[1] Excludes goodwill amortisation of £34.3m (2007: £34.3m)

Financial performance

Turnover for the period was £525.8 million, an increase of 7.9 per cent compared to the same period last year. This increase was due principally to the regulatory pricing formula.

Operating costs were up £13.8 million (8.1 per cent) on the prior period to £183.3 million. There have been significant increases in power and commodity prices in the period, which are partly offset by Anglian Water's continued focus on sustainable cost reduction initiatives. In addition there were one-off costs of £5.5 million relating to the water quality incident in Northamptonshire, which is described below. These costs will be borne by Anglian Water and will not be passed on to customers in any form.

There are early signs of increasing difficulty in collecting customer debt, in the face of worsening economic conditions, and consequently Anglian Water have increased their bad debt provision compared to the same period last year.

There has been a 9.4 per cent increase in the depreciation charge compared with the same period last year. Approximately half of this increase is due to taking a longer term view of the expenditure on below ground infrastructure, and the remaining increase is consistent with the continued investment in the capital programme.

Operating profit before goodwill amortisation has grown by 6.9 per cent to £229.9 million as a result of the increased turnover, partially offset by the increases in operating costs and depreciation.

In May Anglian Water had a successful private debt placement in Japan, followed in June by a Eurobond issue, which between them raised £419 million of new funds at favourable rates. These new funds are adequate to finance the remainder of the capital programme for the current regulatory period, which ends in 2010.

Capital expenditure in the period remains on track with Anglian Water's commitment for the current Asset Management Plan (AMP) period which covers 2005 to 2010. During the first half of the year Anglian Water invested £203 million in the capital programme, compared with £208 million for the same period last year.

Operational performance

In October, Ofwat announced that Anglian Water had achieved the highest score in the industry for the second consecutive year in its overall performance assessment (OPA) for 2007/8. Anglian Water scored 419 points (2006/7: 413), compared with an average score of 383 points by the 10 water and wastewater companies in England and Wales.

The OPA encompasses a range of service measures, including water, wastewater and customer service performances, as well as impact on the environment. In the year to date, Anglian Water has continued to perform well from an operational perspective.

Investment in leakage in 2007/8 was reduced to normal levels in response to higher rainfall and availability of water resources. As anticipated, this led to a slight increase in leakage which Ofwat reported to be 5.6 cubic metres of water per kilometre of main per day (2007: 5.5 m^3 per km/day). This performance maintains Anglian Water's position as one of the best performing companies in terms of leakage management.

According to the latest published report from the Drinking Water Inspectorate, Anglian Water's drinking water quality remained high, with 99.96 per cent 'mean zonal compliance' against the regulatory standards in the 2007 calendar year (2006: 99.95 per cent).

All 46 designated bathing waters in the Anglian Water region passed the mandatory standards of the Bathing Water Directive during this year's bathing water season. This is the tenth time in the past 12 years that 100 per cent compliance has been achieved. Of these, 73.9 per cent also passed the guideline standard of the Directive, one of the requirements for a beach to be awarded Blue Flag status. This is a marked improvement on the previous year (68.1 per cent), which was achieved despite poor weather conditions during the bathing water season.

The Environment Agency (EA) published its latest assessment of river water quality in the region in August, relating to the 2007 calendar year. The assessment showed that 99.8 per cent of rivers' biological quality was classed as 'very good' to 'fair' (2006: 99.8 per cent). The chemical quality of rivers remained at 92.1 (2006: 92.3) per cent in the 'very good' to 'fair' range. These results have been recalculated by the EA, following a reduction in the number of rivers being measured.

Northamptonshire water quality incident

On 24 June routine tests detected traces of cryptosporidium, a microscopic parasite, in water coming from the Pitsford water treatment works, which supplies approximately 106,000 homes in Northampton, Daventry and the surrounding area. Cryptosporidium can lead to illness if ingested.

Further tests confirmed the presence of cryptosporidium and the decision was taken to instruct customers to boil their water before drinking. A notice was sent to customers affected and a coordinated media and communications programme was initiated to keep affected customers and other stakeholders informed throughout the incident.

The decision to lift the notice for all affected customers was taken, ahead of schedule, 10 days later on 4 July following the success of the considerable operational effort and resource committed to the incident, including the installation of ultraviolet treatment and an accelerated cleaning, flushing and testing programme.

The cause of the cryptosporidium was traced to a small rabbit, which had entered an isolated part of the works. Following the incident, Anglian Water submitted its report to the Drinking Water Inspectorate (DWI), which published its independent assessment of the incident in November. While the report was critical of the failures that led to the incident, it highlighted "how it was Anglian Water's own robust monitoring procedures which raised the alarm and secured a quick and effective multi agency response". The DWI has confirmed that there will be no prosecution as a result of this incident.

In recognition of the inconvenience caused to its customers Anglian Water made goodwill payments to those affected. The total cost of the cleaning, flushing, mitigation programme, and goodwill payments amounted to £5.5 million.

Price review

The water industry operates on five-yearly cycles called Asset Management Plan (AMP) periods. Prices are set by Ofwat at the beginning of each period, following submissions from each company about what it will cost to deliver their plans.

In August, Anglian Water submitted its draft business plan for AMP5, which covers the period 2010 to 2015. The report took into account a considerable amount of research among customers. It is also set in the context of Anglian Water's 25-year Strategic Direction Statement, published in November 2007, which identified regional growth and climate change as the company's key long-term challenges.

Anglian Water is proposing a £2.5 billion capital investment programme for AMP5. This equates to an increase in the average household bill from £360 in 2010 to £373 in 2015 in real terms. This is equivalent to an annual increase of 0.7 per cent.

Final business plans are due to be submitted in April 2009, with Ofwat's final determination being announced in November 2009. The new prices will come into effect in April 2010, the beginning of the new AMP period.

Morrison Facilities Services

Results for the six months to 30 September 2008	**2008** **£m**	**2007** **£m**
Turnover including share of joint ventures	135.0	159.5
Operating profit before goodwill amortisation [1]	1.4	4.8

[1] Excludes goodwill amortisation of £1.7m (2007: £1.7m)

Morrison Facilities Services is our housing repairs and maintenance business, managing outsourced contracts awarded by local authorities and housing associations and is a leading provider in its market place. Although part of the Anglian Water Group, Morrison FS operates on a stand alone basis. The business looks after 400,000 homes in the UK for Councils, Housing Associations and Arms Length Management Organisations (ALMO's), has an annual turnover in excess of £250m and an established presence in London, Scotland, the North East, the North West, Norfolk and Essex.

During the period the business showed a decline in turnover and profit reflecting the difficulties experienced in the wider economy, the expiration of certain fixed term contracts and mobilisation costs on new contract wins.

The business, however, continues to be profitable and cash generative with a good spread of operational contracts nationwide. During the period Morrison Facilities Services began mobilisation of two new contracts, Midland Heart and Liverpool Riverside.

The pipeline for further new orders continues to look positive although there can be a lead time of over 12 months from initial bid to contract award. The business has a solid foundation and, with further outsourcing from local authorities expected, is well placed for future growth.

Guy Wakeley, the former managing director of Amey plc's Built Environment Division, recently joined the business as Chief Executive. The appointment of Guy underpins our commitment to retain and grow Morrison Facilities Services.

AWG Property

Results for the six months to 30 September 2008	**2008** **£m**	**2007** **£m**
Turnover including share of joint ventures	18.4	15.8
Operating loss	(4.7)	(0.9)

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 also relatively small investments in Wales, Ireland and England. The majority of properties are held in joint ventures and the carrying value of our share in these assets in AWG's accounts is around £30m.

Last year the group decided that it intended to realise value from its property investments and began a process to seek out buyers for the business as a whole.

However, the UK property market has suffered significantly as a result of the global financial crisis. As a result potential buyers for the whole property portfolio were unable to raise sufficient finance to complete the purchase as originally expected. As a consequence the group has decided to hold and manage its property assets until the market recovers at which point it intends to dispose of the individual assets. We anticipate that this process could take up to three years. In the first half of the year the group achieved some success and disposed of a significant residential property in Glasgow and an office development in England.

In the meantime, the investment projects continue to generate sufficient cash to service their debt interest. We also expect that the development properties we hold will increase in value over the next three years, particularly as we obtain planning permission and the general property market stabilises.

Other

The 'Other' business segment mainly comprises head office, Alpheus Environmental, a wastewater treatment works in the Republic of Ireland and a limited number of small 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 from £17.8 million to £23.3 million primarily as a result of agreed pricing changes for our wastewater business in the Republic of Ireland. Operating loss for the 'other' segment decreased from £12.0 million in the prior period to £7.0 million as a result of a number of non-recurring items including a profit on sale of an investment that had previously been provided against and the release of provisions following settlement of outstanding items associated with disposals in prior years.

Utility Services

The disposal of the Morrison Utility Services business was completed on 8 May 2008 and this business has been shown as a discontinued operation within this half-yearly financial report. An exceptional profit of £13.8 million was generated on the disposal of Morrison Utility Services. In addition to expenses related to the disposal of Morrison Utility Services recognised in the current period, £5.1 million of disposal costs were charged to the profit and loss account as an exceptional operating cost in the prior year.