Anglian Water Group Limited
Half-yearly financial report

for the six months ended 30 September 2010

Summary Results for the six months to 30 September 2010	**2010** Unaudited **£m**	**2009** Unaudited **£m**
Turnover	702.7	721.4
Total operating profit before exceptional operating profits and goodwill amortisation	232.6	240.5
Profit before tax, exceptional items and goodwill amortisation [1]	47.8	74.6
Profit before tax	23.7	38.6

[1] Excludes exceptional operating profits of £11.9 million (2009: £nil) and goodwill amortisation of £36.0 million (2009: £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 2010.

Turnover from continuing operations for the period was £702.7 million, a decrease of 2.6 per cent from £721.4 million in 2009. Anglian Water turnover decreased due to the regulatory pricing formula, while Morrison Facilities Services revenues declined slightly due to the expiry of a fixed term contract, partially offset by new business secured in the period.

Total operating profit from continuing operations before exceptional operating profits and goodwill amortisation was £232.6 million, a decrease of 3.3 per cent from £240.5 million in 2009. Operating profit before goodwill amortisation in Anglian Water decreased by 2.4 per cent to £239.3 million compared with the prior year (£245.3 million) as a result of the decreased turnover combined with increases in depreciation. Morrison Facilities Services operating profit before exceptional items and goodwill amortisation decreased to £5.2 million from £5.6 million in the prior year, reflecting the loss of a fixed term contract. On an underlying basis Morrison has continued to perform strongly with the order book significantly increased over the period. Significantly, in the first half of the year Morrison mobilised eleven new contracts and these are expected to improve profit and turnover in the second half of the year. AWG Property operates in the very difficult UK property market and reported an operating loss of £2.3 million for the period (2009: loss of £2.2 million).

In addition, exceptional operating profits of £11.9 million were recognised in the period due to a settlement gain on a joint venture pension scheme and provision releases following settlement of outstanding items associated with a prior year disposal.

The net finance charge for the period was £184.8 million, and while this represents a significant increase compared with the prior period (2009: £165.9 million) this was principally due to the non-cash impact of RPI on index-linked bonds, where RPI rebounded from the historically low levels seen in the prior period.

Resultant profit before tax, exceptional items and goodwill amortisation was £47.8 million (2009: £74.6 million). After goodwill amortisation and exceptional items profit before tax was £23.7 million (2009: £38.6 million).

The tax charge for the period was a charge of £30.6 million (2009: charge of £22.7 million). The year on year increase was primarily due to movements in discount rates impacting deferred tax liabilities. The underlying effective tax rate for the period excluding amortisation of goodwill, exceptional items, discounting of deferred tax and prior year adjustments was 37.4 per cent (2009: 35.1 per cent). This is higher than the corporation tax rate of 28 per cent due to specific permanently disallowable items for tax purposes.

Cash flow

The total operating cash inflow for the group from continuing operations was £303.3 million (2009: £300.7 million), an increase of 0.9 per cent on the prior period. Anglian Water's operating cash flow was slightly behind the prior period at £317.3 million (2009: £318.6 million), this was more than offset by higher cash generation within Morrison Facilities Services and Property.

The net cash outflow for capital expenditure was £120.5 million (2009: £184.1 million). The vast majority of capital expenditure relates to the Anglian Water capital programme, which comprised gross expenditure in the period of £92 million. Net cash outflow from capital expenditure is after grants and contributions of £11.9 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 due to a lower level of ongoing activity relative to the previous six months.

Net debt

Net debt increased by £109.1 million to £5,697.2 million in the six months to 30 September 2010. This was in line with expectations and relates primarily to the capital enhancement expenditure program within Anglian Water.

Pensions

At 30 September 2010 the gross deficit for the group (before deferred tax) was £136.1 million (31 March 2010: £200.9 million). There were a number of actuarial changes in the period, principally legislative changes to indexing of liabilities and a significant fall in market interest and inflation expectations. During the period asset performance was above expectations. 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 2010	2010 £m	2009 £m
Turnover	554.5	557.1
Operating costs	(194.2)	(193.1)
Depreciation	(121.0)	(118.7)
Operating profit before goodwill amortisation [1]	239.3	245.3

[1] Excludes goodwill amortisation of £34.3 million (2009: £34.3 million)

Financial performance

Turnover for the six months to September 2010 has remained broadly consistent with the same period in the prior year at £554.5 million (2009: £557.1 million). Volumes were generally consistent with the comparative period, but the regulatory price reduction of 0.4 per cent (including inflation), explains the slight decline in turnover.

Operating costs were up £1.1 million (0.6 per cent) on the prior period to £194.2 million, primarily due to inflationary increases across the business partially offset by targeted efficiency savings. Energy costs for AMP5 have been substantially hedged, reducing our exposure to volatility in power prices.

The general economic climate remains difficult, with considerable uncertainty surrounding household finances. We have continued to see deterioration in underlying cash collection from our customers in the period. We continue to focus resources in this area, and consequently the bad debt charge remains broadly in line with the prior period.

As a result of the ongoing capital programme, depreciation is up 1.9 per cent compared with the same period last year.

Operating profit has fallen by 2.4 per cent to £239.3 million as a result of the slight decrease in turnover, together with the modest increases in operating costs and depreciation.

The net finance charge (excluding the intra-group interest received of £96.8 million, 2009: £96.8 million) increased by £35.2 million, from £130.1 million in the same period last year to £165.3 million in the six months to September 2010. This was principally due to the non-cash impact of higher inflation in the current period on index-linked bonds.

Dividends of £210.0 million (excluding intra-group dividends of £96.8 million, 2009: £96.8 million) were paid during the period (2009: £37.7 million). This includes £90.0 million of a special dividend which the company was able to make due to higher dividend capacity, arising from an increase in the regulatory asset base of the company at the conclusion of AMP4 in respect of additional capital expenditure incurred and allowed by the Regulator, together with allowed inflationary adjustments.

Additional funds of £130 million were successfully raised in the six months to September 2010 through the issuance of a new index-linked bond. There were no debt repayments made during the period. We continue to focus on effective management of cash, and have extended our committed bank facilities to help reduce the impact of the cost of holding large cash balances due to historically low interest rates.

During the first half of the year we invested £92 million in the capital programme, compared with £169 million for the same period last year. This profile is consistent with this being the first year of a new five year Asset Management Plan period, with much of the work in this first half-year focused on the development, selection and design of capital solutions.

Operational performance

We began the year confidently, with our strong end to AMP4 equipping us to meet the anticipated challenges of the 2010/2015 five-year Asset Management Plan period (AMP5).

In October Ofwat confirmed our operational performance assessment (OPA) score for the year 2009/10 at 418 points out of a maximum 438 (2008/09: 415). This score ranks us second and confirms our position as one of the top two water and wastewater companies in England and Wales for the fourth year running.

While Ofwat's report criticised some companies for the amount of water lost through leaks, we note that we have met our leakage targets, despite the large number of burst pipes during the harsh winter weather.

Our wastewater compliance performance continues to be strong, with 100 per cent compliance against regulatory requirements.

We have had an exceptionally good year regarding 'significant' pollution incidents and have had just one consented event of this type confirmed to date – our best ever position at this time of year. The number of minor pollution incidents is similar to last year and we have implemented a number of actions to reduce the frequency of these in future.

The 2010 bathing water season has now finished and we have returned 100 per cent compliance with mandatory bathing water standards for the ninth year in succession, with a record high level of 85 per cent of bathing waters meeting EU guideline bacteriological quality.

Seeking efficiencies across our operations

We continue to focus on efficiencies across our operations. We completed a restructuring of our support service functions early in 2010, followed by the implementation of new working practices for our front-line operational staff in July. These have enabled us to deliver significant operational efficiencies while improving customer service. New contracts agreed with our capital scheme delivery partners in the *@one Alliance* prioritise collaborative working and the delivery of efficiencies across our AMP5 capital program. During the first half-year we also tendered our IT services, awarding the five-year contract to Capgemini.

Energy

Our energy efficiency programme is now entering its fifth year, with savings since 2006 of £11.6 million. We continue to manage our power consumption to minimise costs and usage by scheduling our consumption to gain maximum benefit from our energy tariffs. Our smart meter installation programme continues with the target of an additional 2,000 meters by the year-end. Over the half-year we have increased our generation of renewable power to 20 GWhs, compared to 16.7 GWhs in the previous six month period.

We are committed to reducing our operational carbon emissions by 10 per cent by 2015 from a 2010 baseline (adjusted for new assets). We set out to lead the water and wastewater sector on carbon reporting, and in September, published our first annual **Greenhouse Gas Emissions Report**. We were also one of the first water and wastewater companies to register for the Carbon Reduction Commitment Energy Efficiency Scheme (formerly known as the Carbon Reduction Commitment).

Focus on customer service

Customer service continues to be a core element across our operations and we are pleased to see this commitment reflected in the introduction of Ofwat's new Service Incentive Mechanism measure from this year. Our contact centre teams have made considerable progress in improving performance over the first half of the year. They remain focussed on stretching year-end targets which are aligned to our long-term goal of all of our customers being *Very Satisfied* with the service they receive from us.

We are committed to making sure that when customers contact us directly their queries are dealt with by Anglian Water employees based in our own region. As we work to achieve sustainable cost efficiencies by outsourcing certain back-office activities overseas, and in line with our goal to be a leading employer, we are retraining and redeploying UK-based back-office staff where possible to front-line posts at our contact centres in Lincoln, Huntingdon and Hartlepool.

Sustainable capex efficiencies

Following the successful completion of our AMP4 capital programme, our emphasis in the first six months of the new AMP period has been on securing sustainable cost efficiencies across the whole life of new capital projects.

This critical solution and design phase incorporates our carbon reduction goal, which is to halve the embodied carbon in new assets that we deliver in 2015, compared to a 2010 baseline. As more AMP5 projects now move from the design to the construction phase, we expect capital expenditure to increase in the second half of the year.

Drinking water quality

Our drinking water quality continues to be excellent, with more than 99.99 per cent of tests at our water treatment works confirmed by the Drinking Water Quality Inspectorate as meeting or bettering required regulatory standards.

Our overall drinking water compliance for the calendar year 2009 was 99.96 per cent (2008: 99.98 per cent). This slight reduction from 2008 was due in part to the introduction of new regulatory sampling for the pesticides metaldehyde and clopyralid in 2009.

Our emphasis in AMP5 will be on safeguarding the quality of water at source - where we are working with businesses on the sustainable use of chemicals - and supply, continuing our investment in lead pipe replacement.

Inspiring behavioural change

In the six months to September preparations for a major strategic project gathered momentum for the launch in October of our new leadership and campaigning platform, ***Love Every Drop***.

We are the first water company in the UK to campaign for social behavioural change with a range of initiatives that will drive business performance and help control and reduce costs across the business. For example, a major transformational project planned for January 2011 will inspire behavioural change among target groups on the disposal of fats, oils, grease and unflushables such as nappies and wet wipes in our wastewater network.

Other campaigns will include water efficiency, reduction in energy costs, environmental protection and reducing significantly our carbon footprint.

Looking ahead

We believe that our continued strong financial and operational performance in the first six months of AMP5 provide a solid platform for the full year and beyond.

Focus remains on continuing to deliver targeted and sustainable efficiencies across our operations and asset management programme, while continuing to deliver superior operational performance and enhanced customer service.

Morrison Facilities Services

Results for the six months to 30 September 2010	**2010 £m**	**2009 £m**
Turnover including share of joint ventures	122.5	129.9
Operating profit before exceptional operating profit and goodwill amortisation [1]	5.2	5.6
Operating cash flow	8.7	1.3

[1] Excludes exceptional operating profit of £3.7 million (2009: £nil) and goodwill amortisation of £1.7 million (2009: £1.7 million)

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 Facilities Services operates on a stand alone basis. The business looks after more than 450,000 homes and 4,000 public buildings in the UK for Councils, Housing Associations and Arms Length Management Organisations (ALMO's). It has an annual turnover in excess of £260m and an established presence in London and the South East, Scotland, the North East, the North West, the Midlands and East Anglia.

Although there has been a drop in turnover in the first six months of the year compared to 2009/10, this is mainly due to revenues generated in the first six months of last year from a contract that has now ended. This same contract coming to an end also drives the slight reduction in profit.

The success of Morrison over the last twelve months in bidding for new business has led to the mobilisation of eleven new contracts in the first six months of 2010/11 and these new contracts are expected to improve both turnover and profit in the second half of the year.

In addition a further three new contracts have been successfully negotiated in the first six months of 2010/11, one of which was the renewal of the large North Lanarkshire contract in Scotland, and will mobilise in the next few months.

Recent financial difficulties of a major competitor has provided a number of additional opportunities to Morrison including the transfer of work with One Vision Housing in the North West, with Midland Heart in the Midlands, with Lambeth Council in London and in Dover. Morrison Facilities Services continues to investigate other associated opportunities.

The pipeline for further new orders continues to look positive, although there can be a lead time of up to twelve months from initial bid to contract award. The business has a solid foundation, and it is expected that further outsourcing from local authorities will result from the recent Government spending review, as Local Councils look to find sustainable cost savings and operational efficiencies. This leaves Morrison well placed for future growth.

AWG Property

Results for the six months to 30 September 2010	2010 £m	2009 £m
Turnover including share of joint ventures	9.1	8.7
Operating loss	(2.3)	(2.2)
Capital employed	14.7	23.6

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.

Turnover is consistent with the prior period; as is the operating loss.

Notwithstanding the continuing difficult market environment, in the first half of the year the group achieved some success, with the realisation of value from the disposal of its largest commercial property and the conditional agreement to sell a significant element of two of its major strategic land assets following achievement of planning permission.

With respect to other development assets, 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, Alpheus Environmental which operates industrial and commercial wastewater treatment works, a major 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 decreased from £26.1 million to £17.1 million primarily as a result of foreign exchange movements and Irish government spending cuts impacting our wastewater business in the Republic of Ireland. The operating loss before exceptional items for the 'other' segment was unchanged from the prior year at £8.2 million.