Anglian Water Group Limited
Half-yearly report

for the six months ended 30 September 2012

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Half-yearly management report

for the half-year ended 30 September 2012

Summary Results for the six months to 30 September 2012	**2012** **Unaudited** **£m**	**2011** **Unaudited** **£m**
Turnover	768.0	747.1
Total operating profit before goodwill amortisation [1]	230.2	220.6
Profit/(loss) before tax, exceptional items and goodwill amortisation [1]	32.5	(0.4)
Loss before tax	(20.5)	(36.4)

[1] Excludes exceptional items of £17.8 million (2011: £nil) and goodwill amortisation of £35.2 million (2011: £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's results also include 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 2012.

On 7 November 2012 the group disposed of its Morrison Facilities Services business for a total consideration of £24.0 million. Provision of £17.8 million has been made for the anticipated loss on disposal of the business. Following its disposal, Morrison Facilities Services has been classified as a discontinued operation in accordance with FRS 3 'Reporting financial performance'.

Turnover for the period was £768.0 million, an increase of 2.8% from £747.1 million in 2011. Anglian Water turnover increased by 2.7%, reflecting the regulatory pricing formula partially offset by reductions in demand for commercial and household customers. Morrison Facilities Services revenues increased by 6.0% with new contract wins partly compensating for lost revenue from exited contracts while additional growth is being delivered organically.

Total operating profit before goodwill amortisation was £230.2 million, an increase of 4.4% from £220.6 million in 2011.

Operating profit before goodwill amortisation in Anglian Water decreased by 1.3% to £239.9 million compared with the prior period (£243.1 million), with increases in operating costs and depreciation more than offsetting the increase in turnover.

Morrison Facilities Services generated an operating loss before goodwill amortisation of £0.3 million, a significant improvement compared with a loss of £12.5 million in the prior period. This improvement was primarily driven by growth in revenue, improved gross margins and reduced overhead costs following a comprehensive restructure carried out last year.

AWG Property operates in the challenging commercial UK property market and reported an operating loss in line with expectations of £2.6 million for the period (2011: loss of £2.0 million).

The net finance charge for the period was £197.7 million (2011: £221.0 million). The reduction was principally due to a decrease of £18.1 million in the non-cash impact of RPI on index-linked bonds, due to the lower RPI than in the prior period.

Resultant profit before tax, exceptional items and goodwill amortisation was £32.5 million (2011: loss of £0.4 million). After goodwill amortisation and exceptional items, loss before tax was £20.5 million (2011: loss of £36.4 million).

Tax for the period was a credit of £5.3 million (2011: charge of £8.7 million). The credit for the period resulted from a 2% reduction in corporation tax rates in the current year, together with credits arising on agreeing previous years' tax computations with HMRC and greater use of capital allowances in the current period. In addition, there was a significantly higher deferred tax charge in the prior year.

Cash flow

Operating cash inflow for the group was £325.1 million (2011: £306.1 million), an increase of £19.0 million on the prior period. Anglian Water's operating cash flow was £8.3 million higher than the prior period at £346.3 million (2011: £338.0 million), while Morrison Facilities Services operating cash outflow of £9.4 million improved by £2.4 million from an outflow of £11.8 million in 2011.

The net cash outflow for capital expenditure was £247.1 million (2011: £132.4 million), which is net of a reduction in creditors and accruals in the period. The vast majority of capital expenditure relates to the Anglian Water capital programme, which comprised gross expenditure in the period of £230.5 million. Net cash outflow from capital expenditure is after grants and contributions of £10.5 million received towards the capital programme and refers to the actual cash spend.

Net debt

Net debt increased by £161.4 million to £6,261.0 million in the six months to 30 September 2012. This was in line with expectations and relates primarily to the capital enhancement expenditure program within Anglian Water. During the period the group agreed an additional £127.5 million of Class A US private placements and £55.5 million of Class B US private placements, the funds from which were received in early October and therefore do not form part of net debt at 30 September 2012.

Pensions

At 30 September 2012 the gross deficit for the group (before deferred tax) was £66.2 million (31 March 2012: £56.1 million). There were a number of actuarial changes in the period, principally a significant fall in market interest expectations, however, this was offset by lower inflation expectations. 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.

Divisional performances

Anglian Water

Results for the six months to 30 September 2012	2012 £m	2011 £m
Turnover	596.8	581.1
Operating costs	(226.3)	(210.0)
Depreciation	(130.6)	(128.0)
Operating profit before goodwill amortisation [1]	239.9	243.1

[1] Excludes goodwill amortisation of £34.3 million (2011: £34.3 million).

Financial performance

Turnover for the half year was £596.8 million, up 2.7% on the same period last year. This reflects the regulatory price increase of 6.6% (K factor of 1.4% and RPI of 5.2%), partially offset by reductions in demand for commercial and household customers of approximately 4.5% on an aggregate basis. The reduction in household demand is primarily a consequence of the exceptionally wet spring and summer, but also reflects the impact of the water restrictions imposed from April to mid-June and our associated customer campaigns to reduce water usage. The continued challenging economic environment together with exceptional weather have contributed to the reduced commercial demand.

Operating costs were up £16.3 million (7.8%) on the prior period to £226.3 million as explained in the following table:

	£m
General inflationary pressures across the business	7.0
Maintenance costs in relation to private sewers transferred in October 2011	1.9
Private sewer set up costs in 2011 not repeating	(1.5)
Rates increases	2.7
Drought response and water restriction related costs	3.5
Operating costs of newly commissioned assets	1.9
Power costs associated with significantly greater pumping of raw water to fill reservoirs and waste water pumping and tankering costs due to the exceptional summer rainfall	4.0
Targeted efficiency savings	(3.2)
Net increase in operating costs	**16.3**

The bad debt charge remains broadly in line with the prior period, however, we have seen some encouraging improvements in cash collection rates over the six month period, despite the continuing difficult economic environment.

Depreciation is up 2.0% compared with the same period last year, consistent with a higher charge for infrastructure renewals as a result of additional proactive leakage detection and prevention expenditure.

Operating profit before goodwill amortisation has decreased by 1.3% to £239.9 million with increases in operating costs and depreciation more than offsetting the increase in turnover.

The net finance charge (excluding the intra-group interest received of £96.8 million, 2011: £96.8 million) decreased by £20.4 million, from £194.9 million in the same period last year to £174.5 million in the six months ended 30 September 2012. This was primarily the result of the non-cash impact of lower inflation in the current period on index-linked debt.

Despite the increase in profit before tax, the tax charge has reduced by £24.7 million compared with the same period last year. This resulted from a 2% reduction in corporation tax rates in the current year, together with credits arising on agreeing previous years' tax computations with HMRC and greater use of capital allowances in the current period. In addition, there was a significantly higher deferred tax charge in the prior year.

Additional funds were successfully raised in the six months ended 30 September 2012 from a £250 million 4.5% 2027 fixed rate bond issue and two private placement index-linked issues: £50 million at 2.05% maturing in 2033 and £15 million at 1.37% maturing in 2022. During the period we also agreed an additional £127.5 million of Class A US private placements and £55.5 million of Class B US private placements, the funds from which were received in early October and therefore do not form part of the net debt at 30 September 2012. The proceeds from these issues will be used primarily to repay debt maturing next year.

Debt repayments of £210.7 million were made during the period, comprising £12.6 million of open market repurchases and £198.1 million to fully redeem the balance outstanding on our £275 million Class B 2012/2037 bond.

We continue to focus on the efficient management of cash resources and during the six month period we increased our Operating and Maintenance Reserve Liquidity Facility by £5 million to £81 million (31 March 2012: £76 million). This is in addition to our existing debt service reserve liquidity facility of £279 million (31 March 2012: £279 million) and our working capital and capital expenditure facility of £420 million (31 March 2012: £420 million). All facilities remained undrawn as at 30 September 2012.

During the period we have invested £230.5 million in our capital programme (including £3.3 million for the non-appointed business), compared with £137.1 million in the same period last year. The increased expenditure is in line with our expectations for this stage of the Asset Management Plan (AMP) period, with more schemes progressing through to the construction phase. We also brought forward from later in the AMP certain expenditure in response to the drought conditions earlier in the year. This puts us in a strong position to deliver both our obligations and expenditure targets for the rest of the year.

Operational performance summary

The impact of extremes of weather

The weather has played a very significant role in the business over the last two years, and notably in the first six months of this financial year.

In April 2012, we introduced our first hosepipe ban for over 20 years, following 18 months of exceptionally dry weather and below average rainfall. The three months that followed the introduction of the hosepipe ban were, in some places, the wettest three summer months ever recorded, with significantly above average rainfall. This means that we were able to lift the Temporary Usage Ban placed on the domestic use of hosepipes by the middle of June.

This rainfall resulted in the refilling of reservoirs and aquifers right through the summer – a process which typically only occurs in winter. This is almost unprecedented, and means that we are going into this winter in a very secure position.

The threat of a third dry winter may have receded, but we are now working at a national level to build on the experience of the recent drought, and to secure a positive legacy from the experience. In particular, we are challenging current thinking on resilience, and together with the Environment Agency have held several national events to encourage the industry and its regulators to understand the true impacts of drought, and ensure better preparedness for future consecutive dry seasons. We have also had a significant input into the Defra lessons-learned process, and have an active role in the National Drought Management Team.

In response to the drought conditions we experienced, we had planned to bring forward into the current year £100 million of expenditure from later in the AMP to increase our resilience and protect customers' supplies. However, the summer rainfall and subsequent recovery of our resources enabled us to reprioritise delivery of these schemes in the most efficient way possible, and therefore, we have revised this accelerated investment to £43 million, with the balance to be invested later in AMP5.

This is in addition to £20 million of schemes which we had already identified in our AMP5 programme to enhance our resilience. The schemes we are investing in include finding new sources of water, improving our ability to move water around the region, and protecting the supplies we already have by investing in leakage detection and repair work.

During our response to the drought, we took significant steps to improve our leakage performance, doubling our expenditure in this area, recognising this is a key concern for our customers. We ended the last financial year with the lowest leakage level the company has ever achieved – a position we have maintained in the first half of this year.

The increase in rainfall has put pressure on other parts of the business, however, with intense storms and heavy rain causing localised flooding. Our response to this has put some pressure on our operating costs, with an increase in tankering costs to mitigate flooding and minimise any pollution risks. Pumping costs have also increased as we sought to capture as much available water as possible to store in our reservoirs.

Serving our customers

We continue to hold a good position in Ofwat's Service Incentive Mechanism (SIM) league table of water and sewerage companies, despite the challenging external circumstances posed by extremes of weather.

We finished 2011/12 in second place overall in the combined league table of quantitative and qualitative measures, just 0.02 points behind first place. We have held the number one position in the qualitative only survey for three consecutive quarters (up to the end of August 2012), and also have plans in place to improve our quantitative score (which will be assessed at year-end).

Particularly notable in these results has been the performance of our water services division, which has made considerable improvements with regard to customer satisfaction. Across the company we continue to target 100% of our customers being very satisfied with the service we provide.

Having seen a steady increase in workload relating to the transfer of Private Sewers to our ownership since October 2011, we have taken steps to ensure customer satisfaction levels are not adversely affected. We are recruiting an additional ten field technicians to assist with increased average demand, and are reviewing work patterns internally and with our contractors to generate an improvement in the response, support and service currently offered.

Serviceability and extremes of weather

Wet weather, particularly in April, June and July (257%, 204% and 194% of the long-term averages for each month respectively[1]), put some pressure on our Wastewater Infrastructure serviceability position. However, we are still in a better position than this time last year, and are confident of maintaining a good position through to the year-end. To date this year, we have reported significantly fewer pollution incidents than last year (serviceability pollutions up to September 2012 were 107 compared with 167 for the same period last year).

We continue to target improvements in our wastewater non-infrastructure serviceability position, delivering a programme of risk-mitigation works. This plan ranges from new capital schemes as part of additional capital maintenance reinvestment, through to a focus on enhanced operation of sewage treatment works enabled by our investment in improved technology and better information availability for our site and field-based technicians, enabling an increase in the planned management of our wastewater treatment works.

For the 11th consecutive year, we achieved 100% compliance in the summer of 2012 with the 'Mandatory' standard for bathing water quality across all 48 of the bathing water beaches in our region. The wet weather contributed to a slight drop in the number of beaches achieving the higher 'Guideline' standard (35 in 2012, 41 in 2011), although two beaches did regain 'Guideline' status this year. Although we should not be complacent, this is an impressive result given this summer's record rainfall, and reflects significant investment in recent years to improve our coastal combined sewer overflows (CSOs), and water treatment facilities.

Influencing our regulatory environment

The Draft Water Bill was published in July 2012, and we continue to work with the Government and our regulators as it passes through parliament. We submitted written and oral evidence to the EFRA Select Committee reviewing the White Paper during its pre-legislative scrutiny phase.

We are also actively preparing for the introduction of a retail market for business customers in England, and formally launched the Anglian Water Business brand at a very successful event in London. The event coincided with Defra's launch of the Draft Water Bill, and the announcement of the opening up of the non-domestic retail market. Many high profile national companies attended the launch, and we received positive feedback on our plans to support business customers in improving their water resource planning and service.

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[1] Met Office National Climate Information Centre data, based on long-term average rainfall data for Anglian Water region, 1961 - 1990.

Having been active in the Scottish market for several years since the establishment of Osprey Water in 2008 we are now actively involved in the establishment of the non-domestic retail market in England. We are committed to the development of retail competition for business customers, and are one of only two water companies with a seat on the high-level steering group driving the market's implementation.

Defra has also published its draft Strategic Policy Statement to Ofwat. This sets out the Government's principles for a transparent and predictable regulatory regime for an innovative water sector. We will be responding to the consultation in due course.

Licence modifications

In October 2012, Ofwat announced a consultation inviting comments on proposals to modify the conditions of appointment (licences) of all appointed water and sewerage and water only companies in England and Wales. This Notice was made under section 13 of the Water Industry Act 1991.

Anglian Water is committed to working with Ofwat to make sure changes introduced are at a pace and of a nature which protects customers and maintains investor confidence. Having fully considered the modifications set out in the s13 Notice, the Board is unable to agree to the full extent of Ofwat's proposals. The Board is happy to accept Licence modifications as necessary to implement separate retail and wholesale price controls at PR14. The Board is also committed to discussing future changes that may be required to implement Government policy and which are introduced in a manner consistent with due process and the protection of the interests of consumers and investors.

Maintaining drinking water quality and supply

The Drinking Water Inspectorate (DWI) Chief Inspectors annual report was published in July 2012. The DWI continues to regard Anglian Water as 'low risk', however we are committed to learning from the report to ensure drinking water quality remains high.

Work has also begun on a new £44 million water treatment works at Newton-on-Trent, which will supply Lincoln, a recognised Growth Point in our region, with up to 20 million litres of water every day.

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.

With the drought behind us, our focus is on improved long-term resilience, supporting our emphasis on meeting customer expectations regardless of the challenges this coming winter may pose.

We will also continue to work with Government and our regulators on water sector reform, to ensure a stable and transparent regulatory and investment framework in the best long term interests of our customers.

Morrison Facilities Services (Morrison)

Results for the six months to 30 September 2012	2012 £m	2011 £m
Turnover	147.4	139.1
Operating loss before exceptional items and goodwill amortisation [1]	(0.3)	(12.5)
Operating cash flow	(9.4)	(11.8)

[1] Excludes exceptional items of £17.8 million (2011: £nil) and goodwill amortisation of £0.9 million (2011: £1.7 million).

Morrison is one of the leading providers of social housing repairs in the United Kingdom, delivering outsourced property repair and maintenance and capital investment services to housing associations and local authorities.

Morrison currently has over 40 major clients, and manages more than 500,000 homes and other local authority buildings and provides facilities services to over 500 schools. Morrison provides repair and maintenance services along with related activities such as call centre management and tenant liaison. Morrison also manages local authority and housing association capital spending programmes such as kitchen and bathroom replacement.

On 7 November 2012 the group disposed of its Morrison Facilities Services business for a total consideration of £24.0 million. Provision of £17.8 million has been made for the anticipated loss on disposal of the business. Following its disposal, Morrison Facilities Services has been classified as a discontinued operation in accordance with FRS 3 'Reporting financial performance'.

The result for the half year to 30 September 2012 shows significant improvement on the prior year with revenue growth, improved margins and better cash flows. The underlying business has returned to growth as clients have better visibility of their funding.

Revenue for the first half was £147.4 million, up £8.3 million (6.0%) on last year showing continued improvements and growth of the business despite exiting four contracts. New contract wins with the Home Group and in Woking partly compensate for lost revenue while additional growth is being delivered organically.

The operating loss before exceptional items and goodwill amortisation improved significantly from a loss of £12.5 million to a loss of £0.3 million for the current period. The improvement on the prior year was primarily driven by growth in revenue, improved gross margins and reduced overhead costs following a comprehensive restructure carried out last year.

AWG Property

Results for the six months to 30 September 2012	2012 £m	2011 £m
Turnover including share of joint ventures	8.0	9.2
Operating loss	(2.6)	(2.0)
Capital employed	14.7	14.0

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 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 in line with expectations of £2.6 million for the period compared to an operating loss of £2.0 million for the comparative period, with turnover slightly lower than the prior period.

AWG Property continues to focus on the controlled realisation of value from its remaining property portfolio.

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, and Alpheus Environmental which operates industrial and commercial wastewater treatment works in the UK.

Turnover for the 'other' segment decreased slightly from £18.1 million to £16.2 million, whilst the operating loss decreased from £8.0 million in the prior year to £6.8 million.

Ends