Anglian Water Group Limited
Half-yearly report
for the six months ended 30 September 2013

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Half-yearly management report

for the six months ended 30 September 2013

Summary

Results for the six months ended 30 September 2013

	2013 Unaudited £m	2012 Unaudited £m
Turnover		
Continuing operations	**650.0**	620.6
Discontinued operations	**-**	147.4
Total operating profit before goodwill amortisation [(1)]		
Continuing operations	**253.5**	230.5
Discontinued operations	**-**	(0.3)
Profit before tax and goodwill amortisation [(1)]	**45.5**	32.5
Profit/(loss) before tax	**12.5**	(20.5)

[(1)] Excludes exceptional profit of £1.3 million (2012: loss of £17.8 million) and goodwill amortisation of £34.3 million (2012: £35.2 million).

Group financial performance

Anglian Water Group Limited's principal business is Anglian Water, the group's regulated water and water recycling company, which serves in excess of six million customers in the east of England and Hartlepool. The group's results also include AWG Property, a specialist property development company.

To strengthen our company management structure, Peter Simpson was appointed Chief Executive of Anglian Water Group in October 2013, in a move that clarifies responsibilities and accountabilities across the business. Peter will continue as Managing Director of Anglian Water Services.

This interim review has been prepared in respect of the six months ended 30 September 2013.

Turnover from continuing operations was £650.0 million, an increase of 4.7% from £620.6 million in 2012. Anglian Water's turnover increased by 4.7%, reflecting the regulatory price increase of 4.1% (K factor of 1.1% and RPI of 3.0%), plus other increases of 0.6% due primarily to changes in household and non-household demand.

Total operating profit from continuing operations before goodwill amortisation was £253.5 million, an increase of 10.0% from £230.5 million in 2012.

Operating profit before goodwill amortisation in Anglian Water increased by 9.6% to £262.9 million compared with the prior period (£239.9 million), with increases in turnover more than offsetting the modest increases in operating costs and depreciation.

AWG Property operates in the challenging commercial UK property market and reported an operating loss in line with expectations of £2.3 million for the period (2012: loss of £2.6 million).

On 7 November 2012 the group disposed of its Morrison Facilities Services business to Mears Group Plc. In accordance with FRS 3 'Reporting financial performance', the results of Morrison Facilities Services in the prior period have been classified as a discontinued operation.

The net finance charge for the period was £208.0 million (2012: £197.7 million), largely due to the additional debt raised.

Resultant profit before tax, exceptional items and goodwill amortisation was £45.5 million (2012: £32.5 million). After goodwill amortisation and exceptional items, profit before tax was £12.5 million (2012: loss of £20.5 million).

Tax for the period was a credit of £8.9 million (2012: £5.3 million), an increase of £3.6 million compared with the same period last year. This reflects the reduction in future tax rates used to calculate deferred tax from 23% to 20% and an increase in long-term gilt rates used to discount that liability. These deferred tax credits are partially offset by increased tax on profits and a smaller prior year adjustment credit compared with last year.

Cash flow

Operating cash inflow for the group was £338.5 million (2012: £325.1 million), an increase of £13.4 million on the prior period. Anglian Water's operating cash flow was £5.1 million higher than the prior period at £351.4 million (2012: £346.3 million).

The net cash outflow for capital expenditure was £235.7 million (2012: £247.1 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 £215.8 million. Net cash outflow from capital expenditure is after grants and contributions of £15.5 million received towards the capital programme and refers to the actual cash spend.

Net debt

Net debt increased by £162.0 million to £6,588.0 million in the six months to 30 September 2013, which was in line with expectations. During the period the group also agreed an additional £203.5 million of Class A US private placements, the funds from which were received in October and therefore do not form part of the net debt at 30 September 2013. Whilst no significant debt repayments were made during the period, both the €650 million (£453.2m) 4.625% 2013 bond and £97.6 million of accreted indexation on a related £258 million RPI swap were repaid in early October.

Pensions

At 30 September 2013 the gross deficit for the group (before deferred tax) was £93.8 million (31 March 2013: £86.2 million). Actuarial assumptions remained largely unchanged in the period, other than a slight reduction in inflation expectations. Asset performance was below expectations due to poor performance from the bond portfolio partially offset by small gain on equities. Future additional contributions will continue to be made in line with actuarial advice.

Divisional performance

Anglian Water

Results for the six months ended 30 September 2013

	2013 £m	2012 £m
Turnover	**624.8**	596.8
Operating costs	**(227.7)**	(226.3)
Depreciation (1)	**(134.2)**	(130.6)
Operating profit before goodwill amortisation	**262.9**	239.9
Goodwill amortisation	**(34.3)**	(34.3)
Operating profit	**228.6**	205.6
Finance costs (adjusted) (2)	**(176.0)**	(174.5)
Profit before tax (adjusted) (3)	**52.6**	31.1
Tax charge (4)	**(9.7)**	(7.3)
Profit after tax (adjusted) (3)	**42.9**	23.8

(1) Depreciation net of amortisation of grants and contributions.

(2) Finance costs excluding the interest receivable from Anglian Water Services Holdings Limited of £96.4 million (2012: £96.8 million).

(3) The statutory profit before tax for Anglian Water Services Limited is £183.3 million (2012: £162.2 million), and the statutory profit after tax is £173.6 million (2012: £154.9 million) which includes the interest receivable from Anglian Water Services Holdings Limited referred to above.

(4) The tax charge of £9.7 million is lower than the corporate tax rate of 23% predominantly due to discounting of the deferred tax charge.

Financial performance

Turnover for the half-year was £624.8 million, up 4.7% on the same period last year. This reflects the regulatory price increase of 4.1% (K factor of 1.1% and RPI of 3.0%), plus other increases of 0.6% due primarily to a recovery in household demand whilst the recovery in non-household demand was more muted. This increase is consistent with the drier and warmer weather in the summer of 2013 which saw a return to more normal levels of consumption. This was in contrast to the late spring and summer of 2012 being exceptionally wet, which suppressed demand.

Operating costs were up £1.4 million (0.6%) on the same period last year to £227.7 million. This primarily reflects general inflationary increases and costs associated with newly commissioned plant, partially offset by savings from efficiency initiatives and one-off costs in the prior year in connection with the initial drought response followed by the prolonged wet spell. The table below explains the £1.4 million increase in operating costs in more detail:

	£m
One-off costs associated with the initial drought response followed by the prolonged wet spell in 2012	(7.5)
General inflationary increases	4.1
Operating costs of newly commissioned plant	3.3
Power - predominantly rate increases	3.7
Other increases (principally compliance with new regulations for water fittings, pension auto-enrolment, and private sewers)	1.6
Reduction in bad debt charge	(0.8)
Efficiency savings achieved	(3.0)
Net increase in operating costs	**1.4**

Due to pro-active management focus on debt recovery we have seen a £0.8 million reduction in the bad debt charge compared with last year from £17.1 million to £16.3 million.

Depreciation is up 2.8% compared with the same period last year, reflecting an increase in the infrastructure renewals charge and depreciation on newly commissioned operating assets.

Operating profit has risen by 9.6% to £262.9 million with increases in turnover more than offsetting the modest increases in operating costs and depreciation referred to above.

The net finance charge for the period (excluding the intra-group interest received of £96.4 million, 2012: £96.8 million) increased by £1.5 million to £176.0 million largely due to additional debt raised.

Compared with the same period last year the tax charge is up by £2.4 million. This reflects the higher profits and smaller prior year adjustment credits compared with last year, partially offset by an increase in the deferred tax credit for the current year due primarily to a rise in long-term gilt rates used to discount the liability.

Additional funds were raised in the six months ended 30 September 2013 with a £35 million 1.141% 2042 index linked private placement. During the period we also agreed a further £203.5 million of Class A US private placements, the funds from which were received in October and therefore do not form part of the net debt at 30 September 2013. The proceeds from these issues will be used primarily to repay debt maturing next year.

Whilst no debt repayments were made during the period, both the €650 million (£453.2 million) 4.625% 2013 bond and £97.6 million of accreted indexation on a related £258 million RPI swap were repaid in early October.

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 £91 million (31 March 2013: £86 million). This is in addition to our existing debt service reserve liquidity facility of £279 million (31 March 2013: £279 million) and our working capital and capital expenditure facility of £420 million (31 March 2013: £420 million). A planned £67 million draw-down was made in September on the capital expenditure facility in order to optimise the timing of fund raising and overall cash management costs. All other facilities remain undrawn as at 30 September 2013.

During the period we have invested £215.8 million in our capital programme (including £1.3 million for the non-appointed business), compared with £230.5 million in the same period last year which included some additional expenditure for drought response measures. We are ahead of our expectations for the six months to 30 September, which puts us in a strong position to deliver both our obligations and expenditure targets for the rest of the year.

Operational performance summary

Building a resilient business

During the first six months of 2013/14, we have been focussed on our preparation for the forthcoming regulatory Price Review (PR14), and the largest customer and stakeholder engagement programme that we have ever undertaken, to help us prepare our business plan for 2015-2020 (Asset Management Plan (AMP) 6).

Having conducted an extensive, in-depth and far-reaching customer and stakeholder consultation involving around 50,000 customers, we published our Draft Business Plan at the end of July, asking customers if they found it acceptable. We will shortly be submitting our final Business Plan to Ofwat, incorporating our responses to customer feedback, input from our Customer Engagement Forum, and responses to challenges we have set ourselves.

During the summer we were awarded a Platinum Big Tick by Business in the Community (BITC), in recognition of the work that we are doing to become a more sustainable business. We join just 31 companies in the country who were awarded the accolade this year. In addition, we were one of just five companies shortlisted for the Sustainable Company of the Year award, competing against Jaguar Land Rover and Sainsbury's.

To strengthen our company management structure, Peter Simpson was appointed Chief Executive of the Anglian Water Group in October. Peter will continue as Managing Director of Anglian Water Services, in a move that clarifies responsibilities and accountabilities across the business as we finalise our AMP6 business plan for 2015-2020.

In November we further strengthened the Board of Anglian Water Services with the appointment of Paul Whittaker as an independent Non-Executive Director. As Director of UK Regulation at National Grid Plc, Paul brings a wealth of valuable experience to the table. His appointment, which begins with immediate effect, means there are now equal numbers of executive and independent Non-Executive Directors on the board, underlining our commitment to the highest standards of corporate governance.

Getting it right for customers

We remain committed to our goal of 100% of our customers being very satisfied with the service they receive from us. We have made significant progress towards that goal, having achieved first place in the combined (quantitative and qualitative) SIM league table for the full year 2012/13, and have retained a leading, first position for the first half of 2013/14 in the qualitative measure.

This industry-leading position reflects continued investment in improvements to customer service, including innovations such as 'Face of Anglian Water' training for field-based staff and contractors, focusing on behaviours that drive high satisfaction; proactive calling of customers when we believe they may be affected by an incident; improved support for social media; the launch of our online 'virtual' assistant; and reducing turnaround times for customer correspondence.

A safe and secure supply, now and in the future

A prolonged period of hot weather during this summer saw a marked rise in the amount of water put into supply. However, tight operational management, investment made in response to the recent drought, and exceptionally low levels of leakage ensured we did not encounter any pressure or supply problems for our customers. We now turn our focus towards preparation for winter, ensuring our business and our customers are resilient to any challenges that the weather may pose.

In July, we convened the region's first *Water Summit*. The purpose of the meeting was to pool expertise in response to the challenges laid out in our Water Resources Management Plan, which we will be submitting to Defra for the approval of the Secretary of State later this year. Key decision makers from the Environment Agency and Defra attended, alongside local authorities, business and domestic customers, regulators, farming and agricultural interest groups, and other stakeholders.

At the *Water Summit* we highlighted the innovative methodology, *Robust Decision Making*, which we have used while compiling the Water Resources Management Plan. This methodology creates a plan that is better able to cope with the uncertainties associated with future growth and climate change.

The Drinking Water Inspectorate (DWI) Chief Inspector's annual report was published in July 2013. Our overall mean zonal compliance figure for water quality for 2012 was confirmed as 99.96%, above the industry average, and we had the highest overall compliance of the Water and Sewerage Companies (WASCs) in two out of the other four key comparative measures published by DWI. We continue to maintain a favourable regulatory relationship with DWI through our open reporting approach, high levels of water quality compliance, and our industry-leading DWI scientific secondment initiative.

In August, water first flowed into the new storage reservoir at Hall Water Treatment Works, a £44 million scheme at Newton-on-Trent, Lincolnshire. The scheme is significantly ahead of schedule, and we anticipate it will become fully operational in summer 2014. When complete, the treatment works will supply up to 20 million litres every day to Lincoln, a recognised Growth Point in our region, and have the ability to supply around 50,000 new properties in central Lincolnshire, over the coming years.

Our reported leakage performance for 2012/13 was exceptionally good, coming in at 12% below our regulatory target set by Ofwat. We have continued to see a similar level of performance in the first half of 2013/14. We are now focussed on maintaining this position as we move into winter, encouraging customers to support our work on the wider network in their own homes by preparing for cold weather, and by reporting leaks to us so they can be quickly repaired.

Following a warm, wet summer that resulted in an unprecedented boom in the slug population, significant quantities of metaldehyde-based slug pellets were applied to farmland nationally to protect vital crops. Due to the intense arable agriculture in our region we were particularly impacted and we saw a sharp increase in the concentration of pesticides in our raw water reservoirs, although levels remain significantly below the point at which there would be any risk to public health. We continue to work with the Metaldehyde Stewardship Group, the collaborative industry body behind the *Get Pelletwise* campaign that encourages careful stewardship of metaldehyde, and other industry forums to address the issue. In addition, we have further reiterated our concerns regarding current measures to protect drinking water quality to the Environment Agency, particularly in relation to the use of alternative slug control products in sensitive catchments. The engagement has led to constructive dialogue with the EA and the agriculture industry to further address the issue.

Above average rainfall over the 2012/13 winter led to high river flows and significant groundwater recharge. Rainfall for the six months to the end of September was 209mm, 70% of the long term average. We took advantage of last winter's wet weather to refill our reservoirs, and at the end of the summer, all of our water stores are well above their drought curves, and at or around the level that we would expect for the time of year, with the exception of Rutland Water which has been kept deliberately low to allow work to protect its shoreline. Now this work is complete the reservoir is refilling as planned. The average level of storage in all of our reservoirs at the end of September was 82% full. Aquifer storage is in a similarly healthy position.

Protecting our environment

In a small but significant change to the way we talk about our business, we are phasing out the use of the phrase 'waste water'. This is based on the premise that no water can ever be 'waste', and fits closely with our *Love Every Drop* objectives to encourage a greater connection with, and respect for, water in the environment. In future we will more accurately reflect what we do by referring to the process and the department as Water Recycling Services, and our sites as Water Recycling Centres. This change will be implemented efficiently and gradually across the business, with some flagship and highly visible sites already rebranded.

In April, we met with Richard Benyon, then the Water minister, to discuss our partnership with the seafood industry body, Seafish, and update him on our progressive approach to monitoring of our coastal assets. The information was well received by the minister, and we were praised for our engagement with the seafood industry, and coastal communities.

We have continued to engage communities across our region with our *Keep it Clear* programme, focused on changing behaviours to reduce the number of blockages and pollutions caused by inappropriate items being flushed into our sewers. Recent towns targeted include Grimsby and Stamford, where we have seen a 31% and 63% reduction in blockages respectively.

We have also begun to engage several FMCG companies and industry groups on the issue of 'non-flushables', with a view to improving the labelling of these products. Initial engagement has been positive, and we expect collaborative working to develop in the coming months.

Our bathing waters during the summer of 2013 have been assessed, once again, to be amongst the cleanest in Europe. Of the 48 bathing waters in our region in 2013, 40 have met the higher 'guideline' standard for water quality (compared to 35 in 2012), while the remaining eight have all met the 'mandatory' standard. We are now into our thirteenth year with 100% of our bathing waters being compliant with at least the 'mandatory' standard.

We continue to lead the industry in our protection of the coast, as the only water company using region-wide coastal modelling to inform our investment strategy and support the provision of water quality information, in real-time, to coastal communities. We are continuing to promote our BeachAware programme, and encouraging more beach owners and managers to participate. We are also looking ahead to understand the impacts of the revised Bathing Water Directive, which will come into effect in 2015.

An innovative approach to sludge treatment, developed entirely in-house by Anglian Water's innovation team, has begun to improve the efficiency of our water recycling process. Heating Pasteurisation Hydrolysis (HPH) is a unique process, developed, trialled, and scaled to full operational capacity by Anglian Water's own teams. It is now in operation at two sites, Cliff Quay, near Ipswich, and Basildon, Essex. The process produces higher quality biosolids (our Nutribio product), and generates more renewable energy for use on the site and for export to the grid.

We have also taken a lead role in the development of an industry-wide assurance scheme for the production of biosolids, and will continue to support the launch of this scheme.

Collaborating for a better future

We continue to play a significant role in shaping the blueprint for the non-household retail market, through our involvement in the High Level Group, a group established to help drive forward the market reform process and implement the wholesale and retail arrangements outlined in the Water Bill.

We are also working in partnership with the Cambridge Programme for Sustainability Leadership (CPSL) to encourage more interaction on issues such as water trading, abstraction reform, and a catchment-based approach to water management. We recently held two events in conjunction with CPSL, one at the House of Lords and one at *The Guardian's* London headquarters, to encourage more organisations to join us in this work.

In partnership with Business in the Community (BITC), we and our supply chain partners, the @oneAlliance, are working in the Fenland area alongside charities, schools, and other organisations to support BITC's *Business Connectors* programme. The initiative supports those who are not in employment, education or training in an area that is facing particularly acute social and economic challenges. Its objectives are to improve employability, create job opportunities, and encourage enterprise. We have seconded a member of staff full time to support the programme, and many employees across our supply chain network have joined us in volunteering to support the scheme.

A safe and healthy workplace
Health and safety in the workplace remains a focus, with our accident frequency rate now at an all-time low.

We're also proud to have been awarded the 'Gold Standard' by The National Skills Academy (NSA), in recognition of our commitment to continuous improvements in process safety. Not only does this validate the work that we have put into process safety over the last year, but it puts Anglian Water into the same league as many global brands. We are the first water company to achieve this standard.

Looking ahead
Our focus remains on delivering excellent operational performance and the highest levels of customer satisfaction as we continue to deliver targeted and sustainable efficiencies across our operations and capital investment programme. We remain focused on delivering a stable assessment of our serviceability, across all relevant measures.

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

We have also agreed that we will not increase prices in 2014/15 by the full allowed price increase previously agreed with Ofwat. This means that the average household customer bill will rise by less than inflation in the coming year.

Finally, we are committed to the production and submission of an outstanding business plan for the next regulatory period, 2015-2020, that best meets all stakeholder interests, and to securing its approval from Ofwat.

Property

Results for the six months ended 30 September 2013

	2013	2012
	£m	£m
Turnover, including share of joint ventures	**5.1**	8.0
Operating loss	**(2.3)**	(2.6)
Capital employed	**14.9**	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 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 £2.3 million for the period compared to an operating loss of £2.6 million for the comparative period, with turnover slightly lower than the prior period.

The funding for a majority of the joint ventures has been secured through to March 2016, which should provide a platform for future recovery of the relevant AWG Property Limited investment.

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

Other business activities

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 increased from £16.2 million to £20.4 million, whilst the operating loss increased from £6.8 million in the prior year to £7.1 million.