Anglian Water Group Limited
Half-yearly report
for the six months ended 30 September 2014

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Half-yearly management report

for the six months ended 30 September 2014

Summary

Results for the six months ended 30 September 2014

	2014 Unaudited £m	2013 Unaudited £m
Turnover		
Continuing operations	**665.3**	650.0
Total operating profit before goodwill amortisation [(1)]		
Continuing operations	**252.3**	253.5
Profit before tax and goodwill amortisation [(1)]	**63.4**	45.5
Profit before tax	**29.1**	12.5

[(1)] Excludes exceptional profit of £nil (2013: £1.3 million) and goodwill amortisation of £34.3 million (2013: £34.3 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.

This interim review has been prepared in respect of the six months ended 30 September 2014.

Turnover from continuing operations was £665.3 million, an increase of 2.4% from £650.0 million in 2013. Anglian Water's turnover increased by 2.0%, reflecting an inflationary price increase of 2.6% offset by a small reduction in demand due to the wet Spring and a relatively cool and wet July and August, by comparison to the prior year. Our decision to abate the K element of the regulatory price increase means that customer bills will be reduced by around £10 million for the full year.

Total operating profit from continuing operations before goodwill amortisation was £252.3 million, slightly less that the £253.5 million in 2013.

Operating profit before goodwill amortisation in Anglian Water has fallen by 1.1% to £260.0 million consistent with the increased costs and depreciation more than offsetting the increased turnover, having abated the 0.9% K element of the regulatory price increase as referred to above.

AWG Property, the group's residual property development and investment business, reported an operating loss in line with expectations of £1.3 million for the period (2013: loss of £2.3 million).

The net finance charge for the period was £188.9 million (2013: £208.0 million), principally due to the effect of lower RPI on indexed linked debt.

Resultant profit before tax, exceptional items and goodwill amortisation was £63.4 million (2013: £45.5 million). After goodwill amortisation and exceptional items, profit before tax was £29.1 million (2013: £12.5 million).

Tax for the period was a charge of £24.0 million compared with a credit of £8.9 million in the same period last year, an increase of £32.9 million. This principally reflects an increase in the deferred tax charge for the current year due to a decrease in long-term gilt rates used to discount the liability. In addition the current year charge was impacted by the higher profit before tax, whilst the prior year benefitted from a deferred tax credit as a result of the reduction in the future corporation tax rate.

Cash flow

Operating cash inflow for the group was £360.8 million (2013: £338.5 million), an increase of £22.3 million on the prior period. Anglian Water's operating cash flow was £18.7 million higher than the prior period at £370.1 million (2013: £351.4 million).

The net cash outflow for capital expenditure was £183.5 million (2013: £235.7 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 includes £5.5 million of expenditure which we have brought forward from the next Asset Management Plan (AMP) period, using the Transition Investment methodology allowed by Ofwat to aid a smoother transition between the current and next AMP period. Net cash outflow from capital expenditure is after grants and contributions of £16.5 million received towards the capital programme and refers to the actual cash spend.

Net debt

Net debt increased by £60.7 million to £6,723.5 million in the six months to 30 September 2014, which was in line with expectations. Additional funds were raised in the six months ended 30 September 2014 with a £125 million 0.1% 2029 index-linked amortising drawdown on our European Investment Bank term facility. During the period the remainder of the £100 million Class B 6.75% bond (£60.9 million) was repaid following the partial buyback of £39.1 million in March 2013. A finance lease (£4.6 million) was also repaid.

Pensions

At 30 September 2014 the gross deficit for the group (before deferred tax) was £67.0 million (31 March 2014: £61.0 million). Actuarial assumptions reflect a reduction in the discount rate, partly offset by a smaller reduction in future inflation. Asset performance was above expectations due to a good performance from the bond portfolio. 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 2014

	2014 £m	2013 £m
Turnover	**637.3**	624.8
Operating costs	**(238.7)**	(227.7)
Depreciation [1]	**(138.6)**	(134.2)
Operating profit before goodwill amortisation	**260.0**	262.9
Goodwill amortisation	**(34.3)**	(34.3)
Operating profit	**225.7**	228.6
Finance costs (adjusted) [2]	**(155.1)**	(176.0)
Profit before tax (adjusted) [3]	**70.6**	52.6
Tax charge	**(27.8)**	(9.7)
Profit after tax (adjusted) [3]	**42.8**	42.9

(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 (2013: £96.4 million).
(3) The statutory profit before tax for Anglian Water Services Limited is £201.3 million (2013: £183.3 million), and the statutory profit after tax is £173.5 million (2013: £173.6 million) which includes the interest receivable from Anglian Water Services Holdings Limited referred to above.

Financial performance

Turnover for the half year was £637.3 million, up 2.0% on the same period last year. This reflects an inflationary price increase of 2.6% offset by a small reduction in demand due to the wet Spring and a relatively cool and wet July and August, by comparison to the prior year. Our decision to abate the K element of the regulatory price increase means that customer bills will be reduced by around £10 million for the full year.

Operating costs were up £11.0 million (4.8%) on the same period last year to £238.7 million. The increase is primarily due to general inflationary increases and costs associated with newly commissioned plant, partially offset by savings from efficiency initiatives. The table below explains the £11.0 million increase in operating costs in more detail:

	£m
General inflationary increases	4.9
Operating costs of newly commissioned plant	2.3
Power - predominantly price increases	2.9
Rates increase	2.0
Increase in sludge treatment and tankering costs	2.0
Reduction in bad debt charge	(1.3)
Efficiency savings achieved	(1.8)
Net increase in operating costs	**11.0**

We have seen a modest improvement in customer debt collection, which has led to the bad debt charge reducing by £1.3 million compared with the same period last year to £15.5 million.

Depreciation is up 3.3% compared with the same period last year, reflecting an increase in the infrastructure renewals charge and depreciation on newly commissioned operating assets.

Operating profit before goodwill amortisation has fallen by 1.1% to £260.0 million, consistent with the increased costs and depreciation more than offsetting the increased turnover, having abated the 0.9% K element of the regulatory price increase as referred to above.

The net finance charge for the period (excluding the intra-group interest received of £96.4 million, 2013: £96.4 million) decreased by £20.9 million to £155.1 million principally due to the effect of lower RPI on indexed-linked debt, and the reduced cost of carry of cash due to a lower average cash balance held in the period.

Compared with the same period last year the tax charge is up by £18.1 million to £27.8 million. This mainly reflects an increase in the deferred tax charge for the current year due to a decrease in the long-term gilt rates used to discount the liability, together with the modestly higher profit before tax.

Additional funds were raised in the six months ended 30 September 2014 with a £125 million 0.1% 2029 index-linked amortising drawdown on our European Investment Bank term facility. The proceeds from this issue will be used to fund our capital investment programme.

During the period the remainder of the £100 million Class B 6.75% bond (£60.9 million) was repaid following the partial buyback of £39.1 million in March 2013. A finance lease (£4.6 million) was also repaid.

Capital investment in the six months to 30 September 2014 was £175.4 million compared with £214.5 million in the same period last year. This includes £5.5 million of expenditure which we have brought forward from the next Asset Management Plan (AMP) period, using the Transition Investment methodology allowed by Ofwat to aid a smoother transition between the current and next AMP period. We are in a good position to deliver all our obligations and expenditure targets for the remainder of the current AMP period, which ends in March 2015.

Operational performance summary

Preparing for the future

During the first six months of 2014, discussions have been ongoing with Ofwat following the initial submission, in December 2013, of our Business Plan for the next Asset Management Plan (AMP) period covering 2015 to 2020. A revised plan was submitted in June 2014 following initial feedback. Ofwat's Draft Determination was issued at the end of August, and the outcome of subsequent additional customer consultation and further modelling was presented to Ofwat at the beginning of October.

Our revised plan has been praised by Ofwat for its high quality, and the independent Customer Engagement Forum was able to "commend it to Ofwat". We now await Ofwat's Final Determination, due on 12 December.

While the Business Plan is being finalised, much of the business has been readying itself for the next five years. In May, we announced our capital delivery partners for a contract worth approximately £1.3 billion to the end of the decade. Balfour Beatty, Barhale, Grontmij, MMB (a joint venture of Mott MacDonald and JN Bentley), MWH and Skanska signed contracts to form our Integrated Main Works Capital (IMWC) Alliance, after being successful in a procurement process which builds on our existing @oneAlliance. Black & Veatch also signed a contract as a reserve partner.

The new IMWC Alliance will deliver the type of work previously undertaken by both the @one Alliance and Anglian Water's Special Projects team and is characterised by its focus on our ten outcomes[1] defined as part of the creation of our business plan for the next five years.

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[1] More detail about the ten outcome agreed with our customers and included in our business plan for 2015-2020 can be found here: http://www.anglianwater.co.uk/_assets/media/54702_OID_v3a_WEB.pdf

The appointment of partners to the IMWC Alliance was followed by the confirmation of Clancy Docwra and Kier MG to the Integrated Metering and Developer Services (IMDS) programme, worth around £200 million in AMP6. These partners, working alongside Anglian Water employees, will deliver the entire domestic and business metering programme including water efficiency audits to help customers save water, and save money. They will also lay new mains and divert existing pipework, and install new water connections to housing developments.

At the same time, Barhale, Kier MG and Morrison Utility Services were appointed to deliver the Integrated Operational Solutions (IOS) programme, worth in the region of £250 million in AMP6. They will deliver the majority of small replacement and refurbishment projects, such as work on filter screens at our existing operational sites and treatment works, as well as programmes of small scale new installations, such as pumping stations and control kiosks across the entire Anglian Water region.

Clancy Docwra and Kier MG have also been selected as preferred bidders for our Integrated Maintenance and Repair, Water (IMR) alliance, while Clancy Docwra, Claret Civil Engineering, Danaher & Walsh and Public Sewer Services will take up the IMR, Water Recycling contract. Confirmation of these contracts is expected in late 2014.

Preparations are underway to ensure innovation sits at the heart of our plans for the next AMP period. Several well-attended events have been held since Spring to introduce suppliers of all sizes to the challenges we expect to face in the coming years, and to invite proposals from them. This work has been carried out with the Water Innovation Network (WIN), a collaborative initiative between Anglian Water and Opportunity Peterborough.

Getting it right for customers

Our focus on ensuring 100% of our customers are very satisfied with the service they receive from us continues to drive excellence and innovation in many parts of the business. Having achieved joint first place in Ofwat's combined qualitative and quantitative Service Incentive Mechanism (SIM) league table for 2013/14, we are confident that we are leading the industry on customer service and that our innovations are keeping pace with the changing expectations of our customers.

This is in addition to our first place in Ofwat's qualitative SIM league table for the year to April 2014, placing us in first place overall for the three years from 2011-2014.

We are now focused on further improvements that will allow us to maintain our leading position while we address the changing nature of customer service measurement, in our continued drive for 100% very satisfied customers.

During the summer we became the first water company in England and Wales to achieve the Institute of Customer Service's ServiceMark accreditation for our call centres. Employees in our Lincoln, Hartlepool and Huntingdon-based contact centres achieved the international standard by matching up to a world-class model for customer service during a six-month assessment.

Customers are also benefitting from our decision to not impose the full rise in bills during 2014/15 that we had previously agreed with Ofwat. This is saving customers £10 million in aggregate, or £4 off the average bill.

Securing and safeguarding resilient supplies

The level of our water resources remains healthy, despite lower than average rainfall in some months during the first half of 2014/15 (September's rainfall was just 27% of the long-term average). Over the 12 months to the end of September 2014, rainfall has been 122% of the long-term average, meaning river flows and reservoir levels are at or above target levels for the time of year. The only exceptions to this are where reservoir levels have been held deliberately low for operational reasons, for instance, so that shoreline repair and protection work can be completed.

The Drinking Water Inspectorate (DWI) Chief Inspector's annual report was published in July 2014. The overall measure for drinking water quality compliance remained excellent for the year with a mean zonal compliance figure of 99.96% (2012: 99.96%). Performance against key DWI indices continues to be consistent with Anglian Water's previous performance.

The further development of our Optimised Water Network strategy, which sees pressure in the network proactively managed, has marked a step-change in our ability to manage our water mains, and dramatically reduced the number of bursts and leaks that require repair. Enough water to supply more than 39,000 people is now being saved every day as part of the schemes currently operational, with over 25 schemes covering around one-fifth of our network introduced in the last four years. Our largest scheme to date, covering much of the city of Peterborough and some of the surrounding area, was introduced in June. The intention is to expand these schemes further in AMP6, with the aim of having 50% of the network proactively pressure-managed by 2020.

During the summer both our Water Resources Management Plan and our Drought Plan were approved by Defra and the Secretary of State. Our Water Resources Management Plan, which addresses future resource availability challenges, is based on an innovative new methodology known as Robust Decision Making. This methodology creates a plan that is better able to cope with the uncertainties associated with future growth and climate change.

Our leakage level for 2014/15 remains on a par with what we achieved in 2013/14, following a relatively benign winter. Over the course of AMP5, from 2015 to 2020, we will have reduced leakage by almost 10%. We are now working to put ourselves in the best position to achieve the very ambitious targets we have set for AMP6, when we intend to progressively reduce leakage to its lowest ever level by 2020, as agreed with our customers during our business planning consultation.

We remain actively engaged in the Government's Green Construction Board, which is leading the way in the transition to a low carbon economy. Anglian Water's Asset Management Director, Chris Newsome, sits on the board. An event to mark one year since the publication of the Infrastructure Carbon Review, held in October, marked a high point in Anglian Water's leadership of the low carbon agenda, with extensive references to our leading position in this challenging area of work. This comes after we concluded 2013/14 having achieved a 42% reduction in embodied carbon. This positions us very well to achieve our target of a 50% reduction, against a 2010 baseline, by March 2015.

The Water Act 2014 received Royal Assent on 14 May, 2014. This helped pave the way for the opening up of the market for businesses to choose their water retailer from 2017. We have been engaged in the creation of this competitive market through our ongoing participation in Ofwat's High Level Group and the Open Water programme. We are also making the appropriate preparations internally to strengthen the Anglian Water Business team ready for a competitive non-household retail market.

Protecting our environment

All 48 of the designated bathing beaches in Anglian Water's region met or exceeded European standards this summer, for the 13th consecutive year. 89% of our designated bathing beaches met the higher 'Guideline' standard (up from 83% in Summer 2013). Having invested £300 million in our coastal assets since 1995, and as we begin to develop our Integrated Catchment Management strategy, we are confident of retaining a leading position as new, tighter bathing water standards are introduced in 2015.

Our Catchment Management strategy will see us forge collaborations with farmers, developers, councils, tourism operators and local communities who all have a role to play in protecting river, aquifer and bathing water quality. Trial projects are already underway in several parts of our region, including the CamEO project working in the Cam and Ely Ouse catchment.

Our Keep it Clear campaign, which aims to change customer behaviour and protect our water recycling infrastructure from misuse, is delivering very good results in the communities we have targeted. This year it has been extended to cover Skegness, Grantham, Kettering and Boston. In each location we have engaged with a range of stakeholders, including local councils, voluntary groups, and the Migrant Communities Network. Letters are also being distributed to all customers in the areas.

Blockage reductions are proving to be substantial and sustained over multiple years in areas targeted in previous waves of the campaign. For instance, Peterborough (where the campaign initially launched) has seen a reduction in blockages of 88%, Southend 50%, Tilbury 59%, Northampton 73%, and Lincoln 80%.

We are developing more innovative engagement techniques to communicate the Keep it Clear message. For instance, we are touring the region with '3D street art' which helps bring the campaign physically into communities, at the same time as generating social media interest in the scheme. We are partnering with high street supermarkets to deliver messaging at point of sale, alongside equipment such as funnels and cardboard collection cartons that enable shoppers to keep fat out of the sewers.

Periods of very intense and highly localised rainfall during the summer resulted in several instances of flooding, particularly in parts of Lincolnshire, Cambridgeshire, and Essex. In response, and in addition to any appropriate investigation of our assets in the affected areas, we are working in partnership with local and highways authorities, the Environment Agency, and other stakeholders to support Lead Local Flood Authorities in their investigations into causes and required remedial actions, commonly referred to as 'Section 19 Investigations'.

During the first six months of the year we have also made significant progress leading the industry in the development of a Biosolids Assurance Scheme. This scheme will operate as a kitemark to certify the production of biosolids, assuring agricultural customers that the product has been produced in accordance with the most rigorous standards.

Supporting communities and recognising success

In partnership with Business in the Community (BITC), we and our supply chain partners in the @oneAlliance have continued our work 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. This work has continued during the first six months of this year.

We achieved national recognition at the annual Business in the Community Responsible Business Awards in London during the summer. The company's Keep it Clear campaign was announced as the winner in the Engaging Customers on Sustainability category, beating competition from Waitrose and Thames Water. The award looked for businesses that use their marketing activity to inspire and enable people to live more sustainable lifestyles.

Love Every Drop was awarded a Ruban D'Honneur medal in the European Business Awards, for being placed in the top ten in Europe in the Environment and Corporate Sustainability category. This is a significant achievement given the competition covers 17,000 businesses in 31 countries.

Over the past year, Anglian Water staff and customers raised £589,257 for international charity WaterAid, the largest amount ever raised by the company in a single year. This is enough to transform the lives of 39,283 people through improved access to safe, clean water. Since it was established by the water industry in 1981, WaterAid has helped more than 21 million people get access to safe water, and 18 million people access improved toilets and sanitation.

Finally, the Prince of Wales and Duchess of Cornwall paid a visit to Rutland Water in July, in recognition of the contribution made to wildlife and conservation by the partnership between Anglian Water and The Leicestershire and Rutland Wildlife Trust, and to celebrate the extensive support that Anglian Water offers for the Prince's charities.

Looking ahead

We are anticipating Ofwat's Final Determination on our Business Plan in early December, but work is already well underway to deliver against the promises we made to our customers during the Discover, Discuss, Decide consultation that was part of our business planning process. For instance, preparations are underway for the introduction of a social tariff from April 2015, to support hard-pressed customers. This will build on our existing support for customers who struggle to pay their bill or face financial hardship, such as free water saving devices, an independently administered Assistance Fund, and tariffs specifically for vulnerable customers.

Central to the successful delivery of a work programme worth in the region of £5 billion in total over the next five years is our drive to establish a culture of innovation, collaboration and transformation within the business. This development within the business will underpin the next phase of Love Every Drop, our platform which aims to put water at the heart of a whole new way of living.

Dr Stephen Billingham has been appointed to the board of Anglian Water Services as an Independent Non-Executive Director, bringing significant experience of large-scale infrastructure projects, and rigorous financial management within complex businesses. The appointment adds considerable value to the independent scrutiny of our business.

A recruitment process is well underway to appoint a new Chairman, following the announcement in September that Sir Adrian Montague will be stepping down from his role with Anglian Water in March 2015. Sir Adrian joined Anglian Water in March 2009. He has successfully lead the Board and the business throughout AMP5, a period of significant challenge and change within the industry.

We remain focused 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. Work continues to deliver a stable assessment of our serviceability, across all relevant measures.

We welcome the introduction of competition, are assisting in the creation of the market, and actively engaging in its development.

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

Property

Results for the six months ended 30 September 2014

	2014 **£m**	2013 £m
Turnover, including share of joint ventures	**7.5**	5.1
Operating loss	**(1.3)**	(2.3)
Capital employed	**17.7**	14.9

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 some residual investments in Wales and England.

During the half-year to 30 September 2014, the group's strategy has been to continue to pursue the realisation of value and mitigation of risk from its property investments. This process has allowed a reduction in joint venture off balance sheet debt by £4.2 million to a level of £62.2 million at the half-year. The funding for a majority of the joint ventures has been secured through to March 2016, providing a platform for recovery of the relevant AWG Property Limited investment, based on completion of both the specific asset management strategy and the presence of an improved property market at the relevant point.

Property reported an operating loss in line with expectations of £1.3 million for the period compared to an operating loss of £2.3 million for the comparative period, with turnover higher than the prior period at £7.5 million (2013: £5.1 million).

AWG Property will continue to focus on the controlled realisation of value from its remaining property portfolio over time and as the market recovers.

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 marginally from £20.4 million to £20.8 million, whilst the operating loss decreased from £7.1 million in the prior year to £6.4 million.