Anglian Water Group Limited
Half-yearly report
for the six months ended 30 September 2015

Anglian Water Group Limited

Half-yearly management report

for the six months ended 30 September 2015

Summary

Results for the six months ended 30 September 2015

	2015 **£m**	2014 £m
Revenue	**621.2**	650.2
Underlying operating profit [(1)]	**188.9**	241.8
Underlying profit before tax [(2)]	**25.5**	63.2
(Loss)/profit before tax	**(20.1)**	29.1

[(1)] Excludes fair value losses on energy hedges of £(0.9) million (2014: gains of £2.2 million).

[(2)] Excludes fair value losses on derivatives of £(45.6) million (2014: £(34.1) million).

Group financial performance

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

This interim review has been prepared in respect of the six months ended 30 September 2015.

Revenue was £621.2 million, a decrease of 4.5% from £650.2 million in 2014. Anglian Water's revenue decreased by 4.7%, reflecting the reduction in customer bills which came into effect on 1 April 2015 in line with the regulatory price setting review, partially offset by customer growth in the region.

Underlying operating profit, which excludes fair value losses on energy hedges, was £188.9 million, a reduction of £52.9 million from the £241.8 million in 2014.

Anglian Water's underlying operating profit decreased by £52.9 million to £193.0 million, consistent with the reduction in revenue and increased costs and depreciation.

AWG Property, the group's residual property development and investment business, reported a loss in line with expectations of £0.2 million for the period (2014: loss of £1.3 million).

Net finance costs for the period, excluding fair value losses on derivative financial instruments, were £164.1 million (2014: £179.0 million), principally due to the effect of lower RPI on index-linked debt.

Resultant underlying profit before tax was £25.5 million (2014: £63.2 million). After fair value losses on energy hedges and derivative financial instruments, the loss before tax was £20.1 million (2014: profit of £29.1 million).

The tax credit consists wholly of deferred tax and has reduced from a charge of £6.9 million last year to a credit of £8.1 million. This is due to the reduction in profit before tax, a reduction in the corporation tax rate from 21% to 20% and a prior year deferred tax credit that arose due to agreement of prior year tax computations.

Cash flow

Operating cash inflow for the group was £314.3 million (2014: £338.5 million), a decrease of £24.2 million on the prior period. Anglian Water's operating cash flow was £22.3 million lower than the prior period at £327.2 million (2014: £349.5 million).

The net cash outflow for capital investment was £130.1 million (2014: £162.9 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 and represents a good start to the new Asset Management Plan period, and is in line with management expectations. Net cash outflow from capital expenditure is after grants and contributions of £13.6 million received towards the capital programme and refers to the actual cash spend.

Net debt

Net debt increased by £58.7 million to £7,559.8 million in the six months to 30 September 2015, which was in line with expectations. During in the six months ended 30 September 2015 a £210 million 5% bond was issued by Osprey Acquisitions Limited dated 2023; allowing repayment of £110 million of the existing £350 million 7% bond dated 2018 and the £100 million term facility.

Pensions

At 30 September 2015 the net deficit for the group was £23.4 million (31 March 2015: £45.9 million). Actuarial assumptions reflect an increase in the discount rate, partly offset by a smaller increase in future inflation. Asset performance was below expectations due to poorer performance from corporate bonds and equities. Future additional contributions will continue to be made in line with actuarial advice.

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Results for the six months ended 30 September 2015

	2015	2014
	£m	£m
Revenue	**607.2**	637.3
Other operating income	**6.5**	6.3
Underlying operating costs [(1)]	**(273.9)**	(259.3)
Depreciation and amortisation	**(146.8)**	(138.4)
Underlying operating profit	**193.0**	245.9
Finance income (adjusted) [(2)]	**2.1**	2.1
Finance costs [(1)]	**(129.8)**	(145.4)
Underlying profit before tax	**65.3**	102.6

[(1)] In order to show pre-tax performance on an underlying basis the fair value gains and losses on energy hedges and financial derivatives have been excluded from the table.

[(2)] In order to show the position of the Anglian Water Services Financing (AWSF) group (which comprises Anglian Water Services Holdings Ltd, Anglian Water Overseas Holdings Ltd, Anglian Water Services Ltd and Anglian Water Services Financing Plc.), finance income is shown excluding internal interest receivable by the group from Anglian Water Services Holdings Ltd of £96.4 million (2014: £96.4 million).

The table below sets out the reconciliation between Anglian Water's statutory results and the underlying financial performance as shown above.

	2015	2014
	£m	£m
Underlying profit before tax	**65.3**	102.6
Operating costs - fair value (losses)/gains on energy hedges	**(0.9)**	2.2
Finance costs - fair value losses on financial derivatives	**(39.7)**	(38.5)
Finance income - intragroup interest receivable	**96.4**	96.4
Profit before tax on a statutory basis	**121.1**	162.7

Revenue for the half year was £607.2 million, down £30.1 million (4.7%) on the same period last year. This primarily reflects the reduction in customer bills which came into effect on 1 April 2015 in line with the regulatory price setting review, partially offset by customer growth in the region.

Other operating income comprises primarily the amortisation of developer contributions received in respect of new housing developments, and is largely unchanged from the prior year.

Underlying operating costs were up £14.6 million (5.6%) on the same period last year to £273.9 million. The increase is explained in the table below:

Increases/(decreases) in operating costs
(before depreciation and amortisation)

	£m
Increase in minor repair activities to maintain water and waste water below ground infrastructure [(1)]	6.0
Additional funding to ensure we meet our Outcome Delivery Targets, and the transfer of funding from capital to operational in order to optimise Totex efficiencies	5.3
General inflationary increases	2.2
Power - predominantly price increases	1.2
Operating costs of newly commissioned plant	1.2
Increase in bad debt charge	1.0
Efficiency savings achieved	(2.3)
Net increase in operating costs	14.6

[(1)] IFRS has increased operating expenditure volatility from minor repair costs which, in the past, would have been treated as capital expenditure under the old UK GAAP infrastructure renewals accounting rules.

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We continue to take a proactive approach to customer debt collection. As a consequence, the bad debt charge for the period of £16.5 million is aligned with the charge for the previous full year of £33.0 million, but up by £1.0 million compared with same period last year.

Depreciation and amortisation is up 6.1% compared with the same period last year, reflecting depreciation on newly commissioned operating assets, particularly IT and telemetry which have a relatively shorter economic life.

Underlying operating profit has fallen by 21.5% to £193.0 million, which is consistent with the effect of the regulatory price reduction, increased operating costs and depreciation.

The underlying net finance charge for the period decreased by £15.6 million to £127.7 million principally due to the effect of lower RPI on indexed linked debt.

Compared to the previous year the total tax charge has reduced by £14.1 million to £1.5 million. This is due to a reduction in profit before tax, a reduction in the corporation tax rate from 21% to 20% and a prior year deferred tax credit in the current period. Our relatively low rate of taxation reflects the incentives available for capital investment, and the interest we pay to fund that investment. We are one of the largest private investors in infrastructure in our region, worth more than £2 billion over five years. The Government actively encourages infrastructure investment and grants us capital allowances, which defer some of our corporation tax liabilities until a later period. Customers also benefit from the deferral as it helps to keep their bills lower.

During the period no new debt was issued and there were no significant debt repayments.

Gross regulated capital investment in the six months to 30 September 2015 was £103.8 million. This represents a good start to the new Asset Management Plan period, and is in line with management expectations.

Principal risks and uncertainties

Effective risk management is central to the achievement of strategic priorities. It is managed across our business through a number of formal and informal processes to identify new risks in a timely manner and ensure swift mitigation can be implemented. The principal risks and uncertainties that the business faces over the remainder of this financial year are largely unchanged from those reported in our last annual report and financial statements listed below:

- Cyber security and data protection
- Climate change and flooding
- Financing our business
- Regional growth
- Water sector reform and other legislation, including compliance with competition law
- Bad debt
- Energy and carbon management
- Efficient delivery of our operations
- Pollutions
- Outcome delivery incentives

Further detail on these risks and uncertainties is included in the annual report and financial statements for the year ended 31 March 2015, which can be found on the Anglian Water Group website at http://www.awg.com/investors/annual reports/.

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Operational performance summary

In preparation for the Asset Management Period that runs from 2015 to 2020, AMP6, we carried out our largest ever consultation with our customers. More than 50,000 told us what matters to them, resulting in the creation of ten outcomes in three broad areas, against which we will measure our success[1]. Here, we report on progress against our outcomes in these three broad areas.

Providing the services our customers expect: satisfied customers, fair charges, safe clean water, resilient services

In April 2015, we cut the average annual household bill by £29, reducing average bills by 7% – the largest percentage saving of all water and sewerage companies in England and Wales. Average annual bills are now £402 per year, or £1.10 per day. Customers with a water meter pay even less, with the average bill dropping to £371.

This price cut is part of our promise to keep bills as low as possible, and flat in real terms to the end of the decade, at the same time as delivering a multi-billion pound, five year investment programme to maintain and improve essential water and sewerage services for our customers. This follows our decision in 2014/15 to not raise bills by the amount we were entitled to under our previous settlement with Ofwat, reducing the amount payable by customers by £10 million.

As well as bill reductions, we continue to offer a comprehensive package of measures to help customers manage their bill. In April, we introduced a social tariff, called LITE, which offers customers on low incomes up to 80 per cent discount on their bill. We've also increased the Anglian Water Assistance Fund to £1 million this year, to help customers who have debt get back on track.

We remain committed to our goal of having 100% of our customers very satisfied with the service they receive from us. We're continually making changes throughout our operations to ensure our service is as good as it can be, and we meet or exceed customer expectation. We are currently fourth in the Service Incentive Mechanism qualitative league table, following two survey rounds. In order to push improvement, we continue with weekly customer surveys, along with automated text surveys following some jobs. These have resulted in more than 45,000 surveys being completed by customers, feedback from which has driven measurable improvements in satisfaction.

Our Digital Customer Service Team is now supporting customers using social media channels over a wider working window, with 'live chat' proving a particularly popular facility. When combined with improvements to our online billing facility, quicker customer response times, and improved text-message communications, these changes should also result in improved customer satisfaction scores. As the frontier on customer service excellence moves further forward, greater resources and investment are required to maintain or improve our relative position.

Following the Discover, Discuss, Decide customer consultation that contributed to the creation of our Business Plan for AMP6, we are holding a series of open days at our operational sites to share feedback on the plan, and the work we have begun since it came into operation. These give customers the chance to see behind the scenes at our facilities, and learn about our behavioural change campaigns on water efficiency (Drop 20) and the protection of the water recycling network (Keep it Clear). Almost 2,000 customers have so far visited five sites, with social and traditional media coverage of the events reaching almost a quarter of a million people. Feedback gathered at these events will help shape our Annual Performance Report, which we will produce at the end of the financial year.

We are committed to minimising the disruption to customers caused by planned and unplanned interruptions to their supply, with a number of innovative initiatives keeping periods without water to a minimum. Over the year to date our annualised average interruption per customer is less than four minutes, against a target of ten minutes. We are, however, aware that severe winter weather could quickly change this, so we remain focused on keeping the underlying baseline low.

[1] More detail about the ten outcomes 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

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In September, the Water Resource East Anglia (WREA) Partnership was established. This is a leadership group which brings together representatives from water companies, regulators, Local Enterprise Partnerships, Internal Drainage Boards, Agriculture and significant business interests. It will encourage a collaborative approach to water resource planning and catchment management across the whole region. Anglian Water chairs both the delivery group and the technical groups to ensure the project will deliver outputs that feed into the next Periodic Review, and Water Resource Management Plan. This approach is seen as a model for collaborative working on water infrastructure at the national level.

Protecting our world: caring for communities, a smaller footprint, a flourishing environment, supply meets demand

We operate on the understanding, held across the entire business, that no job is so important that we cannot take the time to do it safely. This protects both our community of colleagues, and the customers that we serve. Several internal campaigns conducted over a number of years have resulted in behaviour changes that lead to a continuous improvement in our health and safety metrics. We are currently on target to beat last year’s best ever safety performance with a current RIDDOR Accident Frequency Rate (AFR) of 0.14, against a target of 0.18. Accident severity and lost time accident AFR are also on target.

We have seen a significant reduction in the number of Category 3 (minor) pollution incidents (100 to the end of September 2015, compared to 361 to the end of September 2014), but we are seeing more Category 2 (significant) incidents than we would like (10 to the end of September 2015, compared to 8 to the end of September 2014). While progress against Category 3 pollutions is welcome, we are increasing our focus on the prevention of all incidents. Key activities include the use of predictive analytics and targeted proactive maintenance of our network and pumping stations; reviewing our incident management process; enhanced Combined Sewer Overflow and network monitoring; and community engagement through a ‘Pollution Watch’ campaign. The reduction in the number of Category 3 pollutions in 2015 has principally been driven by improved operational focus and clarification around impact assessment.

2015 bathing water monitoring results indicate that there are 34 ‘Excellent’ bathing waters in our region. Coastal catchment plans have been completed for all regional bathing waters, identifying potential sources of diffuse pollution. Partnerships with third parties are in place for the majority of areas with declining water quality, and Source Apportionment studies have begun in Southend to look at all seven bathing waters in that region; results are expected December. We are also the first water company in the UK to use aerial photographic surveys, conducted in partnership with APEM Aviation, to identify potential sources of pollution along the coastline.

The amount of water we put into the network increased during the summer, largely as a result of increased consumption due to warm weather. This has now returned to expected levels, as the weather has returned to more typical temperatures. All resources are at or near target levels for the time of year.

The Drinking Water Inspectorate (DWI) Chief Inspector’s annual report was published in July 2015. The overall measure for drinking water quality compliance remained excellent for the year with a mean zonal compliance figure of 99.95% (2014: 99.96%).

Leakage detection and prevention remains very important for us and our customers, and proactive leakage detection teams are finding a large proportion of leaks before customers are aware of them. This is a direct result of much better and faster network data coming from our Integrated Leakage and Pressure Management (ILPM) system, allowing us to develop a more accurate picture than ever before of where water is going within our distribution zones. We are currently on course to hit our annual leakage target, which is well ahead of the regulatory economic level of leakage.

We have set ourselves a goal of becoming a zero waste company, and one which gets it right first time, every time. To facilitate this we introduced, in June, an in-house bespoke training system to certify our teams on the management and disposal of waste. This training and certification system has been audited and approved by the Environment Agency, LRQA and UKAS, and replaces previous externally-provided WAMITAB (Waste Management Industry Training and Advisory Board) training for waste permit holders.

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Being able to provide this training in-house saves money, makes us more resilient, and results in a training programme that is more specific and appropriate for our industry.

Working groups are also looking at the development of co-digestion opportunities, and the potential impact of Ofwat's 'Towards Water 2020' proposal to separate out sludge treatment activities.

As part of our commitment to leading and championing the effective management of climate change and growth, we have completed our second, five-year Climate Change Adaptation Report, for Defra. This was submitted in September. It collates all of our adaptation work from 2010 to 2015, gives details of our intended actions over the next five years, and provides our views on the challenges ahead. Following our AMP5 adaptation investment we have started to deliver our AMP6 site flooding, sewer flooding, supply resilience, power resilience and partnership flood defence investments. An example of the latter is our £3 million contribution to the coastal defences at Clacton-on-Sea, which will protect our strategic assets there.

We have developed our understanding of climate change risk through research focussed on quantifying the impacts of weather. This has resulted in a UKWIR (UK Water Industry Research) project establishing a number of linkages between weather patterns and asset performance, and the development of a model which includes future climate projections to inform odour and septicity investment.

We remain committed to making a positive contribution to the communities we serve. For instance, RiverCare groups, supported by hundreds of local volunteers from across the region, celebrated World Rivers Day in September by holding river clean-ups. The Bedford Sub Aqua Club pulled out bicycles, shopping trolleys and a garden gate from the riverbed of the River Ouse, whilst 30 local volunteers removed more than 1,000 cans and 100 metres of cabling from the banks and the surrounding area. In Southend, 35 people participated in a clean-up event at Leigh Marshes National Nature Reserve, where over 160kg of litter was removed.

In support of National Women in Engineering Day, our Education team organised a three-day event at Pitsford Water Treatment Works. The aim was to inspire female engineers and scientists of the future. More than 215 female students from local schools came to meet employees from Anglian Water and our delivery partners to see what goes into designing, building and delivering our vital service.

Our annual fundraising ball for WaterAid raised a record breaking £410,000 in May. The evening, organised by employee volunteers, is WaterAid's biggest annual fundraising event. Our WaterAid Ball Committee has been nominated to receive a WaterAid President's Award, the highest level of commendation WaterAid can offer its supporters.

Getting it right for our customers: investing for tomorrow, fair profits

In April this year we were granted a Queen's Award for Enterprise: Sustainable Development, the most prestigious sustainability business award. The awarding body indicated that this was because we have embedded sustainability throughout our operations, stating we have adopted a commendable range of initiatives to improve our performance, and improve the sustainability of customers, supply chain organisations and others within the water industry. We will hold this award for the next five years.

We've created four Alliances that are unique to our industry to deliver our capital programme for the next five years. This has required significant organisational change as we made the transition to AMP6, but these are now fully operational. The partners we have appointed will deliver our capital and maintenance programmes for a period of up to 15 years, with a focus on the ten outcomes we agreed with our customers during our PR14 planning process.

Balfour Beatty, Barhale, Grontmij, MMB (a joint venture of Mott MacDonald and JN Bentley), MWH and Skanska form our Integrated Main Works Capital (IMWC) Alliance, which builds on our existing @oneAlliance. The IMWC Alliance will deliver the type of work previously undertaken by both the @one Alliance and Anglian Water's Special Projects team. These contracts will be worth approximately £1.3 billion to the end of AMP6.

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Clancy Docwra and Kier MG are delivering our 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.

Barhale, Kier MG and Morrison Utility Services are delivering 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 are delivering our Integrated Maintenance and Repair, Water (IMR Water) alliance, while Clancy Docwra, Claret Civil Engineering, Danaher & Walsh and Public Sewer Services have taken up the IMR Water Recycling contract.

We continue to focus on delivering our business plan in the most efficient way that we can. Over the last five years we have generated efficiencies of £486 million which has allowed us to keep bills down, reinvest hundreds of millions of pounds in improving services such as leakage and resilience, and to absorb around £80 million of unfunded costs (from the adoption of private sewers, introduction of the Carbon Reduction Charge and bad debt) that would otherwise have pushed up bills.

In September we published our outcomes reporting policy. This includes our commitments to transparency, engagement, assurance and data quality risk assessment, and what we are going to do to communicate our performance to stakeholders.

Looking ahead

As part of our delivery plan for AMP6, we understand that stakeholders will require information about our performance. We have asked members of our Customer Engagement Forum (CEF) and attendees at our customer open days about what information they would like and how they would like to receive it. We are also seeking the views of customers on these questions as part of our community perception survey. We will use this feedback when designing our annual performance report, which we will produce at the end of the financial year.

We have also been assessing the best way to deliver our Outcome Delivery Incentive (ODI) performance reporting to ensure its quality, accuracy and transparency. We will shortly publish, for consultation, a statement on the strengths and weaknesses of our assurance framework. We will then use this statement to formulate our assurance plans. Third party examination also forms part of our assurance framework; in September, together with the CEF, we appointed Halcrow to this role.

The CEF has met twice during the year. The Forum continues to provide an opportunity for customer representatives to challenge the company about its performance.

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.

Finally, we are committed to the delivery of an outstanding business plan for this regulatory period, 2015 to 2020, that best meets all customer, stakeholder and regulatory interests.

PROPERTY

Results for the six months ended 30 September 2015

	2015	2014
	£m	£m
Operating loss	**(0.9)**	(1.7)
Share of joint ventures operating profit	**0.7**	0.4
Operating cash flow	**(4.5)**	(3.6)

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 and England.

During the half-year to 30 September 2015, the group's strategy has been to continue to pursue the realisation of value and mitigation of risk from its property investments.

Property reported an operating loss in line with expectations of £0.9 million for the half-year compared to an operating loss of £1.7 million for the comparative period, with revenue slightly lower than the prior period at £3.7 million (2014: £4.1 million).

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

OTHER BUSINESS ACTIVITIES

The 'Other' business segment mainly comprises head office, Alpheus Environmental which operates industrial and commercial wastewater treatment works in the UK, and Celtic Anglian Water which is treated as a joint venture and operates wastewater treatment works in the Republic of Ireland.

Revenue for the 'other' segment increased from £9.1 million to £10.7 million, whilst the operating loss increased from £2.4 million in the prior year to £3.2 million.