Affinity Water

Your local supply, on tap

Understanding our finances

November 2020

Contents

Purpose of this report

The purpose of this report is to help our customers and stakeholders understand our finances and corporate governance arrangements. This includes our ownership and group structure, how we fund our business and how we spend our customers' money.

We recognise the importance of ensuring that our customers can trust the service we provide, and we must ensure that they are confident that we are operating in a way which is responsible, accountable and transparent.

Glossary of key water industry terms

AMP – Asset Management Plan
The five-year price control period covered by a company's Business Plan. AMP6 ran from 2015-20 and AMP7 runs from 2020-25.

C-MeX – Customer Measure of Experience
A measure of customer service levels used by Ofwat in AMP7.

CCW – Consumer Council for Water
The regulator tasked with investigating customer complaints relating to service, price and value for money.

CRI – Compliance Risk Index
A measure of water quality compliance designed to illustrate the risk arising from treated water compliance failures.

D-MeX – Developer Measure of Experience
A measure of developer service levels used by Ofwat in AMP7.

DWI – Drinking Water Inspectorate
The regulator ensuring compliance with drinking water quality regulations.

Ml/d – Megalitres per day
The amount of water used in one day. One megalitre is equal to one million litres.

MZC – Mean Zonal Compliance
A measure of water quality compliance derived from monitoring samples taken from customers' taps.

ODI – Outcome Delivery Incentive
The mechanism for financial rewards and penalties which underpins the Performance Commitments submitted in a company's Business Plan.

Ofwat – Water Services Regulation Authority
The economic regulator of the water industry.

PC's – Performance Commitments
Outcomes agreed with Ofwat during the Periodic Review process that reflect customers' views and priorities.

PCC – Per Capita Consumption
The amount of water used by each person, usually measured in litres per day.

PR – Periodic Review
The price determination process undertaken by Ofwat ahead of each new AMP. The PR19 process has set price controls for AMP7.

RCV – Regulatory Capital Value
The economic value of the regulated business, as determined by Ofwat's price control regime.

RORE – Return On Regulated Equity
A financial metric used by Ofwat to determine the profitability of the regulated company.

SIM – Service Incentive Mechanism
A measure of customer service levels used by Ofwat in AMP6.

Totex – Total Expenditure
The sum of operational expenditure and capital expenditure.

WRMP – Water Resources Management Plan
A long-term plan detailing how a water company will maintain a sustainable balance between future demand and supply of water.

Affinity Water at a glance

We are the largest water-only supply company in the UK, owning and managing the water assets and network in an area of approximately 4,500km^2 split over three supply regions in the South East of England.

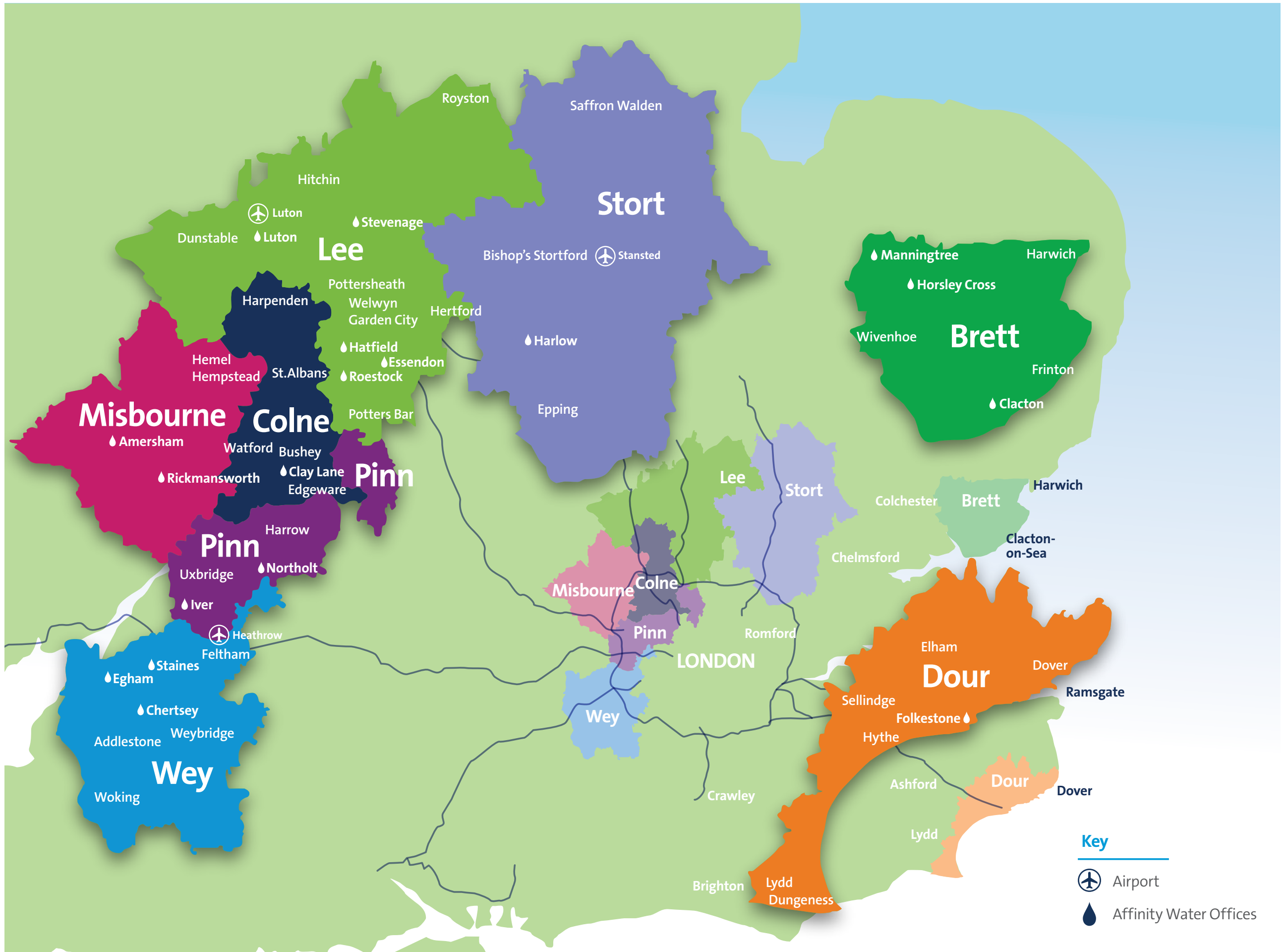
We supply on average 925 Ml/d to over 3.6 million people.

We operate 95 water treatment works to ensure that our water is of the highest quality, distributing our water through a network of over 16,700km of mains pipes.

Our vision

Our vision is to be the UK's leading community-focused water company. It reflects the importance we place on our people working within and for the communities of customers we serve.

By understanding and responding to the needs of different community groups, we are accountable to them at a local level for how well we provide our services.



Our purpose

Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future.

We aim to achieve our purpose by:

- Providing sustainable water for this generation and the next
- Looking after beautiful landscapes everyone can enjoy.

Our purpose links to our vision both through explicit reference to the communities that we serve and also by creating significant public value.

Through investing capital in the environment, we will create economic value to the regions we serve.

Chief Financial Officer’s introduction

Welcome to our second report aimed at helping our customers to understand our finances, including:

- **our ownership and group structure;**
- **our investment and borrowings;**
- **our bills;**
- **our executive remuneration; and**
- **our taxes.**

We are a business with a long-term outlook. In AMP7 we plan to invest £1.44bn in our wholesale business, to keep water flowing across each of our eight communities, whilst protecting our environment and the availability of clean, reliable drinking water for future generations.

Like most companies within our industry we are financed through shareholder capital and debt finance. We can help to keep customers’ bills affordable by managing our long-term debt and keeping the cost of our debt low.

Our gearing is calculated as the ratio between our net debt (the total of our borrowings less cash) and our RCV (the economic value of our regulated business, as determined by Ofwat). At 31 March 2020, our gearing was 79.2%.

We aim to reduce our gearing during AMP7. We will do this by restricting dividends to our shareholders, instead re-investing the majority[1] back into our business for the benefit of customers.

We operate as a regional monopoly, so our prices are tightly controlled by an independent regulator – Ofwat.

Our forecast average annual household bill for 2020/21 is £163, the equivalent of just 45 pence per day, which we think represents great value for money.

We have worked hard to keep our bills low across AMP7 whilst maintaining a high quality and trusted service, with our forecast average bill reducing by 6.9% in real terms from a 2019/20 baseline.

We plan to introduce a Customer Assistance Fund by the end of this financial year to provide assistance to more of our customers in vulnerable circumstances by understanding and prioritising their needs.

We already support more than 70,000 households with our social tariffs and our projections suggest that the number of customers receiving support will increase to 82,000 customers by 2025 with the new Customer Assistance Fund.

Our policy for executive director pay continues to be aligned to the company’s performance whilst ensuring the cost of water remains affordable.

Annual bonus plan targets continue to be aligned for the executive director, senior manager, selected manager and company-wide schemes.

This means that all employees across our business share a common focus and are accountable for delivering against our high customer and operational performance targets.

During the year, work has commenced on liquidating our Cayman Islands entity which was previously used as a financing subsidiary until it was substituted with a UK subsidiary in January 2019.

Although we have always been clear that having a Cayman Islands entity within our group structure did not avoid UK tax or bring any tax benefit, we decided to substitute the company with a UK entity to simplify our group structure and to improve transparency.

I am extremely proud that in March 2020, we were re-accredited with the Fair Tax Mark, which recognises that we pay the right amount of corporation tax, at the right time and in the right place.

Stuart Ledger
Chief Financial Officer

70,000 households now supported by our social tariffs

We plan to invest **£1.44bn** in our wholesale business

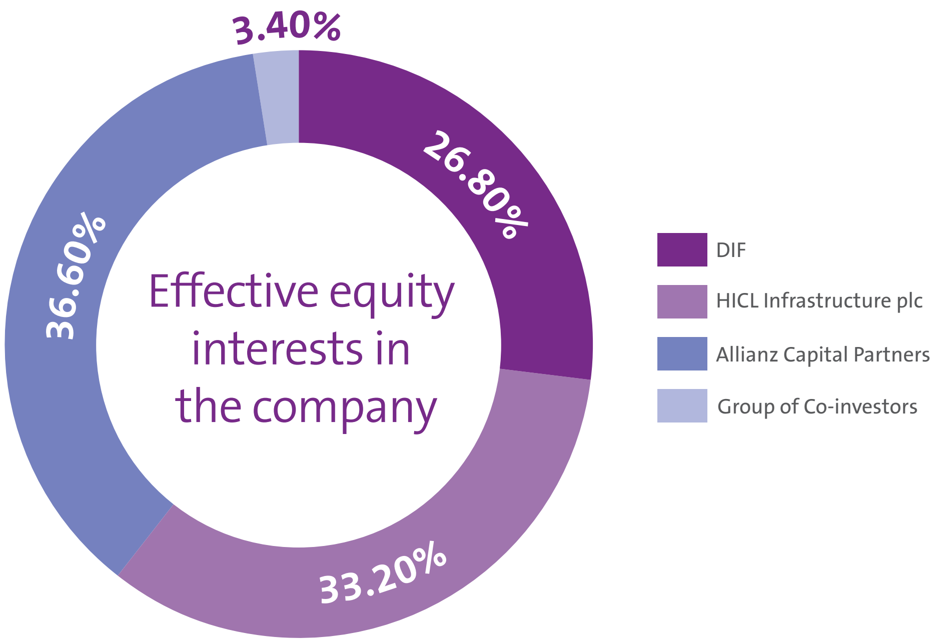
Our forecast average annual household bill for 2020/21 is **£163**

[1] All returns from our business will be re-invested after servicing certain group financing costs

Our shareholders

On 19 May 2017, the Affinity Water group was acquired by a consortium comprising DIF, HICL Infrastructure plc and Allianz Capital Partners. In June 2017, HICL Infrastructure plc subsequently sold down 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds.

Our three main shareholders are long-term international investors, bringing a wealth of knowledge to our Board gained from their portfolios of similar infrastructure investments across the world. They play a vital role in supporting the investment we need to make, but do also seek reasonable, stable returns on their investment.



Allianz Capital Partners is the Allianz Group's in-house investment manager for alternative equity investments. The investment focus is on infrastructure and renewables as well as private equity funds. Allianz Capital Partners' investment strategy is targeted to generate attractive, long-term and stable returns while diversifying the overall investment portfolio for the Allianz Group insurance companies.

DIF is an independent and specialist fund management company, which invests in infrastructure assets that generate long-term stable cash flows, including public-private partnerships, regulated infrastructure assets and renewable energy projects in Europe, North America and Australia.

HICL Infrastructure plc is a long-term investor in infrastructure assets which are predominantly operational and yielding steady returns. HICL has a portfolio of infrastructure investments, which are positioned at the lower end of the risk spectrum, in three target market segments: public-private partnerships, regulated assets and demand-based assets. The Investment Manager to HICL is InfraRed Capital Partners Limited, a leading international investment manager focused on infrastructure and real estate.

Engaging with our shareholders

To maintain transparency about our governance and the involvement of our shareholders in our business, we set out the matters we will consult them about in our 'Consulting with our shareholders' publication to ensure that their interests as shareholders are respected, while maintaining the role of our Board to lead and govern the business.

We paid no dividends to our shareholders in 2019/20.

We have agreed with our shareholders to restrict their dividends for AMP7 and that all returns from our regulated business will be re-invested back into the company.

For further information on how we engage with our shareholders and the dividends we pay, please refer to the governance and assurance page of our website:

affinitywater.co.uk/governance

Understanding our group structure

The chart on the right shows the current structure of the group. Unless otherwise indicated, all companies are wholly owned by the parent company shown.

Whole Business Securitisation ring-fence

Affinity Water Limited is the principal trading subsidiary of the group.

Along with its two financing subsidiaries, and its immediate parent company, it is financially and operationally ‘ring-fenced’ from the rest of the group by way of a Whole Business Securitisation.

We believe that the ring-fencing structure provides significant corporate benefits, such as providing better access to long-term debt markets.

As the cost of debt is typically cheaper than the return expected by equity investors, the cost saving can then be passed on to our customers through lower bills.

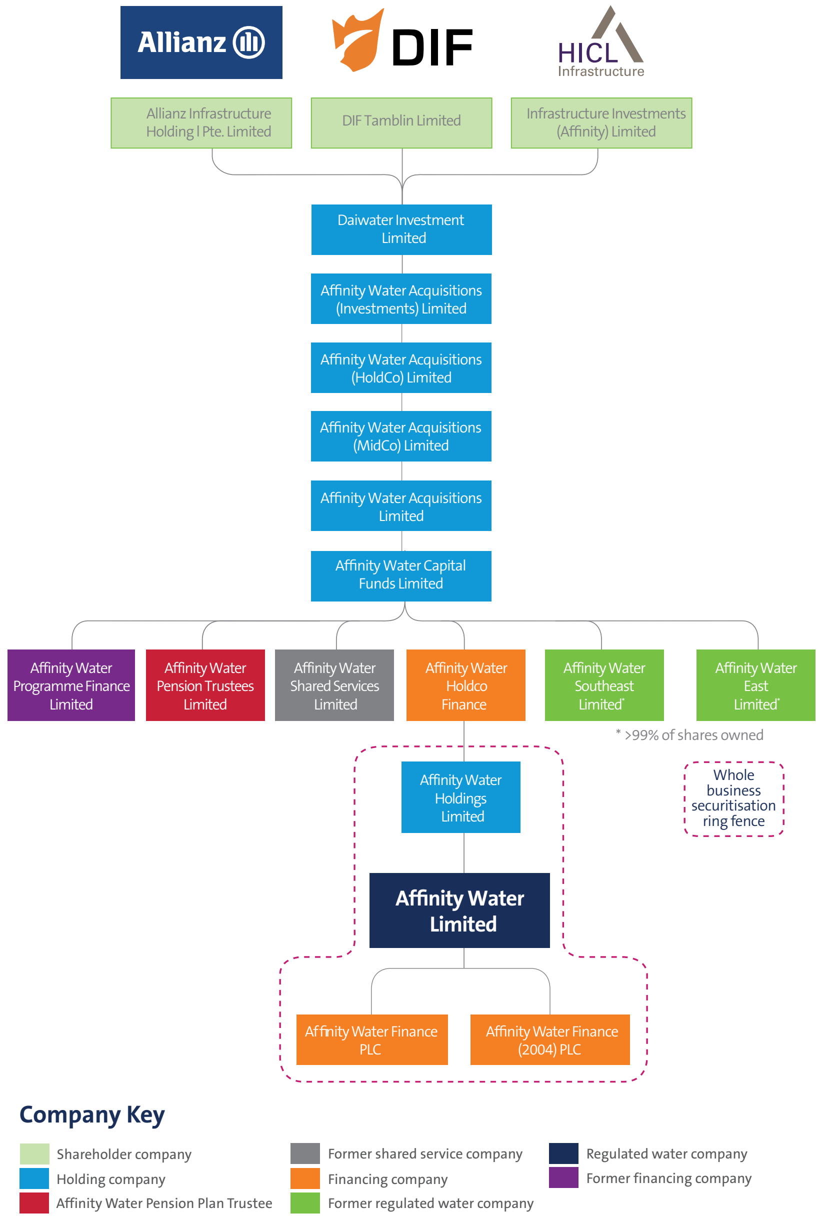
Our financing subsidiaries

We have two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority and are subject to the Listing Rules and Disclosure and Transparency Rules:

- Affinity Water Finance PLC has issued external bonds totalling £764.2m; and
- Affinity Water Finance (2004) PLC has issued an external bond of £250.0m.

The proceeds have been lent onto and are guaranteed by Affinity Water Limited.

Work has commenced on liquidating Affinity Water Programme Finance, an entity registered in the Cayman Islands, which was previously used as a financing subsidiary until it was substituted with a UK entity in January 2019.



Our investment

During AMP7, we plan to invest £1.44bn in our wholesale business, including a capital expenditure allowance of £788m to keep services running across each of our eight communities 24 hours a day, 7 days a week and 365 days a year, investing in pumps, mains upgrades, new mains and investment in service reservoirs.

We are adopting a twin-track approach to resilience, investing to improve the security of our supply for the future while at the same time seeking to reduce customer consumption.

We are investing £59m on our metering programme and planning a range of measures to influence our customers to reduce their consumption.

We will combine data from Automated Meter Reading meters with data from logging and network hydraulic models to provide customers with information about water use in their locality.

We plan to spend about £100m to tackle leaks and deliver a 20% reduction from our 2019/20 baseline. Our plan is to:

- fix 50% of visible leaks in 24 hours, 70% within 48 hours and 90% within 5 days;
- use quantum technologies to detect and fix leaks;
- use new techniques to monitor flows and fast logging and pressure reduction schemes to locate leaks so we can target them more effectively and maximise the amount of water we save; and
- offer more free repairs to customers where there are leaks on the pipe supplying their home.

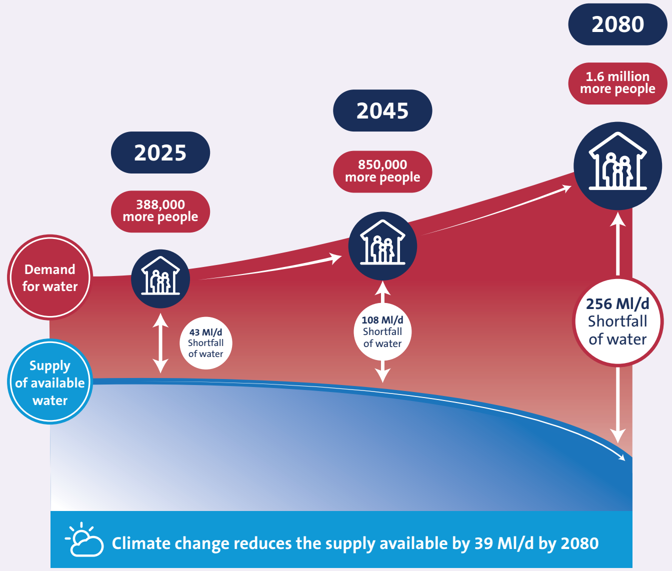
We are also planning to spend
£53m
on projects to protect the environment

We are also planning to spend £53m on projects to protect the environment and increase the region's resilience to drought. Our significant investment is being made to meet the environmental requirements and commitments supported by our customers.

Our investment will be key in allowing us to continue to deliver and to improve the quality of the service we provide to our customers, whilst reducing the amount of water we take from the environment.

Our Water Resources Management Plan ('WRMP') indicates that there will be a daily shortfall of 256Ml/d of water by 2080.

We are investing today to improve resilience of supplies for future generations. We will deliver major programmes to allow us to distribute treated water more widely across our supply area, and when it is most needed.



Water Resources Management Plan

New access to water, improved demand management and increased flexibility in the movement of water are all essential. We have led work with other water companies in the South East of England to encourage the best use of existing resources through the introduction of new sources and transfers of water and to secure the development of additional regional supply resources before 2040, when they will be needed.

For further information on how we aim to manage the long-term supply and demand of our water resources, please refer to our WRMP for 2020-2080 on our website:

affinitywater.co.uk/waterresourcesplan

Understanding our borrowings

We are a business with a long-term outlook and expenditure commitments, which need to be matched with long-term sources of debt finance.

We consider the most cost-effective way to raise long-term debt is through the debt capital markets. We have issued external bonds with a nominal value totalling £1,014.2m, having a range of debt maturities to mitigate against refinancing risk.

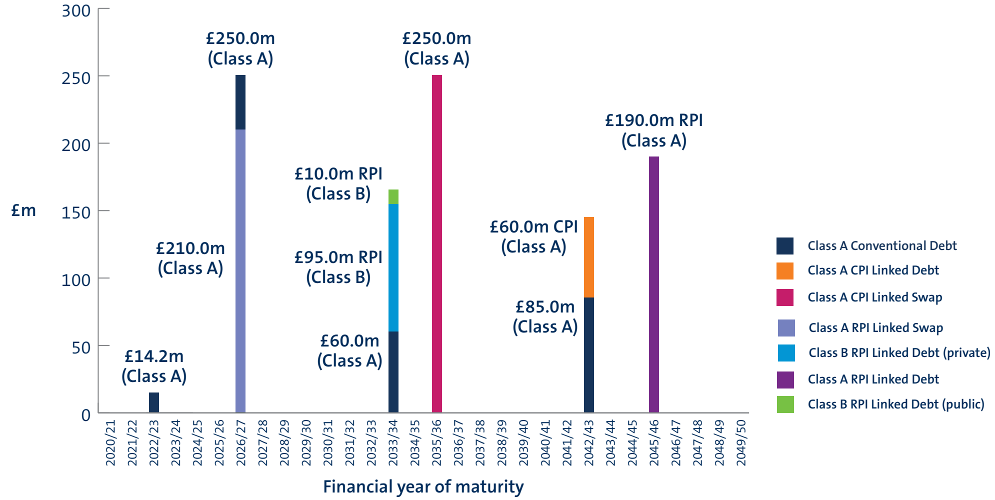
Our bonds had a weighted average of 15.9 years to maturity at 31 March 2020, with only £14.2m of our existing debt maturing during AMP7.

We also mitigate against inflation and interest rate risk by using a mixture of fixed rate and index-linked borrowings.

Around a quarter of our debt is fixed rate, which provides certainty of future interest payments, and allows us to manage our future cashflows.

As our bills are linked to movements in inflation, around three quarters of our debt is now index-linked.

Our Class A debt is rated A3 by Moody's and BBB+ by both Fitch and Standard & Poor's. By maintaining investment grade ratings, we can continue to borrow at attractive rates, allowing us to keep our bills low.



Cash and liquidity

Our objective is to ensure we have adequate funding arrangements, cash and standby facilities to enable us at all times to have the level of funds available for the achievement of our business and service objectives.

At 31 March 2020, we had total cash and term deposit balances of £110.8m. In addition, we had access to a further £161.0m of bank facilities in the event of a liquidity shortfall that would otherwise prevent payments being made.

The relatively high cash balance at the end of the last financial year reflects the level of funding we have already secured in order to finance a number of AMP7 expenditure commitments to ensure financial resilience and reduce the financing risk.

Gearing

Gearing refers to the relationship between a company's debt and equity. Our gearing is calculated as the ratio between our net debt (the total of our borrowings less cash) and our RCV.

$$\frac{\textbf{Net debt £976.2m}}{\textbf{RCV £1,232.6m}} =$$

79.2%

At 31 March 2020, our gearing was 79.2%, which, although within our internal threshold, may be considered to be relatively high.

As such, we plan to reduce our gearing over the course of AMP7 by restricting dividends to our shareholders.

Understanding our bills

Price Reviews

We operate as a regional monopoly, so our prices are tightly controlled by an independent regulator – Ofwat. Every five years Ofwat reviews our Plan which sets out how we will fund our operations. Ofwat then sets the prices we can charge our customers for each of the five years of the Plan considering our operational requirements and the significant capital investment needed to maintain a high quality water supply.

Price limits for AMP7, the five year period from April 2020 to March 2025, were announced in December 2019.

Pay As You Go ('PAYG') ratio

We know that stability of future bills is a key concern of customers. Our PAYG ratio is agreed with Ofwat and it determines how much revenue we can collect from customers' bills now (known as fast money) and how much is deferred for future customers (slow money).

Our PAYG ratio means that the investment we make in our network, which will benefit future generations, is recovered from customers' bills in future periods. During a period of significant investment, this keeps our current bills low and fairer for all.

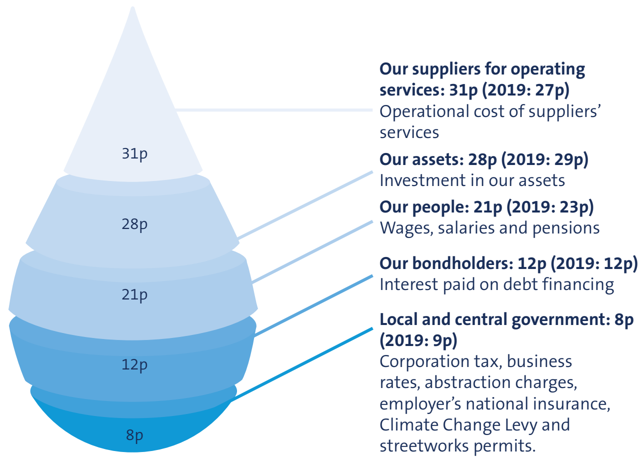
Value for money

Value for money for customers is achieved by delivering the standards of service customers expect along with the Performance Commitments included in our Plan at a reasonable price.

Our forecast average annual household bill for 2020/21 is £163, the equivalent of just 45p per day, which we think represents great value for money.

70,000 households now supported by our social tariffs

Our forecast average annual household bill for 2020/21 is **£163**



Where we spend your money

In 2019/20, we spent 80p of every £1 collected from customers' bills on our suppliers for operating services, our assets and our people, ensuring customers receive the highest quality water and service.

The remaining 20p of every £1 was spent on debt financing and taxes.

None of our customers' money was spent on dividends or interest on shareholder debt.

Supporting our customers

We want to provide water at an affordable price to all our customers.

Our support for financially vulnerable customers who have a low household income or are claiming benefits has grown with 70,000 households now supported by our social tariffs.

Customers benefitting from these tariffs receive a reduced fixed rate which can be spread over 12 months, rather than requiring payment either once or twice a year.

We plan to introduce a Customer Assistance Fund by the end of 2020 and are projecting that the number of customers receiving support through our social tariff will increase to 82,000 customers in 2024/25.

Understanding our bills (continued)

Funding our regulated business

Not all of the funds required by our business comes from customers' water bills. For every £1 we collected from customers' in 2019/20, we required an additional 35p in order to operate.

Our bills also include sewerage costs charged by other water companies. Some of the additional funds we require are received through commission earned on billing and collecting sewerage charges for these companies. We also receive funds from non-household retailers who pay us for the wholesale water we supply to their customers, or developers who contribute towards the cost of adding new connections to our network.

The remainder is borrowed from external debt capital markets. By carefully managing our long-term finance we can keep customers' bills low and fairer for all by avoiding significant fluctuations.

Cash collected from customers' bills in 2019/20
£239.5m

Additional funds required
£84.9m

Total £324.4m

Regulated business

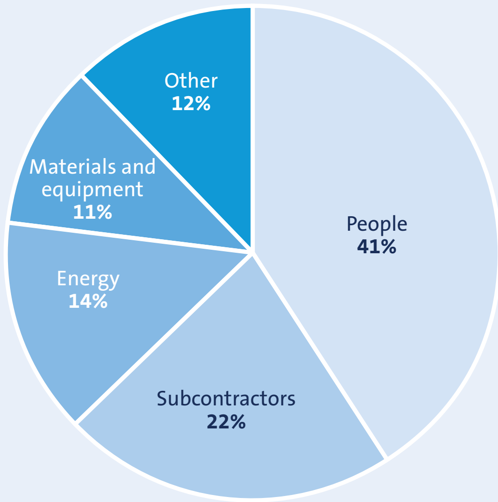
Operational costs
£169.0m

Net investment in our assets
£89.3m

Interest, tax and dividends
£66.0m

Our operational costs

Our £169.0m operational costs for 2019/20 are broken down as follows:



Our single biggest operational cost is our people, including wages and salaries, pension costs and bonuses (only paid upon realisation of operational and financial targets). Our people play a critical role in creating long-term value. They are our ambassadors, living and working in the communities we serve. They have the local knowledge and understanding to make sure we deliver what our communities expect of us and to ensure that our contribution really makes a difference.

Our subcontractors provide us with essential services which we rely on to deliver our short and long-term plans. It is vital that we work closely with them, where delivery on time, to budget and with minimal customer impact has economic, societal and environmental benefits.

The treatment and supply of water requires a large amount of energy. Through procuring and locking into favourable base rate prices for our energy usage we have realised savings on our energy costs and have commenced an energy optimisation programme to reduce our energy usage across our production sites.

Our rewards and penalties

We provide an essential service to over 3.6 million people and we are committed to delivering the highest levels of operational and customer service.

At the start of each regulatory period, we work with our customers and Ofwat to agree on Performance Commitments, to deliver what is most important to our customers in the most efficient way. We can earn financial rewards for meeting some of these commitments and can incur penalties for failing to do so.

For 2019/20 we received a reward for meeting our leakage target, which was the industry's largest leakage percentage reduction target for AMP6. However, we also incurred a penalty of £1.75m due to underperformance in relation to our average water use commitment.

The total net penalty for AMP6 was £23.3m.

Our customers do not fund our penalties. In fact, the opposite is true – we have to pay this amount back to our customers through a reduction in bills in future years.

For further information on our performance, please refer to our Annual Report and Financial Statements for the year ended 31 March 2020, which can be found on our website:

affinitywater.co.uk/performance

During the first four years of AMP6 we incurred a £21.6m total net penalty (broken down below) which has already been factored into the AMP7 price review process.

£4.9m penalty
for failing to meet our performance commitment for unplanned interruptions to supply over 12 hours in 2015/16, 2016/17 and 2017/18

£8.0m penalty
for failing to meet our leakage target in 2017/18 and 2018/19

£10.0m penalty
for SIM underperformance over the first four years the AMP

£1.3m reward
for outperformance in relation to our sustainable abstraction reduction, achieved in 2017/18.

2019/20 performance

Measure	Target	Actual	Reward/Penalty	Met
Leakage	< 162.2 Ml/d	162.1 Ml/d	£0.01m	✓
Average water use	< 147.4 l/person/d	153.0 l/person/d	£1.75m	✗
Water available for use	1,067.0 Ml/d	1,075.3 Ml/d	£nil	✓
Sustainable abstraction reduction	42.1 Ml/d	42.1 Ml/d	£nil	✓
Compliance with water quality standards	99.95%	99.97%	£nil	✓
Customer contacts for discolouration (per 1,000 people)	< 0.66	0.25	£nil	✓
Unplanned interruptions to supply over 12 hours	< 320	499	£nil	✗
Mains bursts	< 3,100	2,102	£nil	✓
Customers not being notified of planned interruptions	< 110	433	£nil	✗
Planned works taking longer than notified	< 550	178	£nil	✓

Our rewards and penalties (continued)

Our Business Plan for AMP7 includes a total of 28 stretching Performance Commitments that will ensure we deliver our four strategic outcomes:

Strategic outcome	Performance Commitment	Reward/penalty
Supplying high quality water you can trust	• Reduce the number of contacts about appearance, taste and odour to 0.67 per thousand population by 2024/25 • Meet water quality standards on compliance failures by scoring less than 2 annually in DWI's new water quality measure CRI	Penalty only Penalty only
Making sure you have enough water, while leaving more water in the environment	• 20% leakage reduction on a 3-year average from the 2019/20 baseline • 12.5% reduction in PCC on a 3-year average from the 2019/20 baseline • Complete river restoration and habitat enhancement projects under the Water Framework Directive • Reduce water abstraction by 27.3 Ml/d by 2024/25 • Complete 8 environmental pilot projects working in partnership with our local communities • Delivery of schemes within the WINEP programme • Reduce abstraction from environmentally sensitive sites to nil when flows or levels are low	Reward/penalty Reward/penalty Reward/penalty Penalty only Reward only Reputational only Reward/penalty
Providing a great service that you value	• Improve the overall customer experience provided to our household customers • Improve the overall experience provided to developer services customers including property developers, self-lay providers and NAVs • Proactively provide assistance to more of our customers in vulnerable circumstances by understanding and prioritising their needs • 90% of customers in vulnerable circumstances receiving financial help are satisfied with the service from us • 90% of customers in vulnerable circumstances receiving financial help found us easy to deal with • 90% of customers in vulnerable circumstances receiving non-financial help are satisfied with the service from us • 90% of customers in vulnerable circumstances receiving non-financial help found us easy to deal with • Maintain the BSI standard for inclusive service provision throughout 2020-2025, ensuring our services are accessible, easy and supportive for all • Achieve a score of at least 7.8 out of 10 for customer satisfaction in a Value for Money survey • Identify at least 50 household property gap sites per year • Proactively reducing the number of household properties falsely classed as empty on our billing system to 2.10% in 2024/25	Reward/penalty Reward/penalty Reputational only Reputational only Reputational only Reputational only Reputational only Reputational only Reputational only Penalty only Reward/penalty
Minimising disruption to you and your community	• Reduce supply interruptions to customers to 5 minutes in 2024/25 • No more than 320 properties affected by a supply interruption per year of more than 12 hours duration – this includes planned interruptions • Improve IT resilience by a 29% reduction in the impact of disruption to customers and employees by 2024/25 • Reduce the properties at risk of receiving low pressure to 1.118 per thousand properties by 2024/25 • Reduce the average time each property experiences low water pressure to less than 8 hours 42 minutes in 2024/25 • To have no customers at risk of experiencing severe restrictions in a 1-in-200 drought on average over 25 years • Reduce the number of mains repairs to 142.3 per thousand kilometres of network • To keep outage of production capacity below 2.34% between 2020-25	Reward/penalty Reward/penalty Reputational only Penalty only Reputational only Reputational only Penalty only Penalty only

Understanding our executive remuneration

For 2019/20 executive director pay continued to be aligned to our strategy of delivering value through high quality customer, operational and financial performance whilst ensuring the cost of water remains affordable for customers.

We offer competitive benchmarked salaries and link executive directors' annual bonuses and long-term incentive plan ('LTIP') payments to the standards of performance we provide to customers as well as the value created for our shareholders.

The remuneration of executive directors in 2019/20 reflected the performance of the company through the annual bonus plan, consisting of:

50.0%
financial measure

15.4%
operational measures (split equally between leakage and water quality)

9.6%
customer and community measures

5.0%
safety and health measure

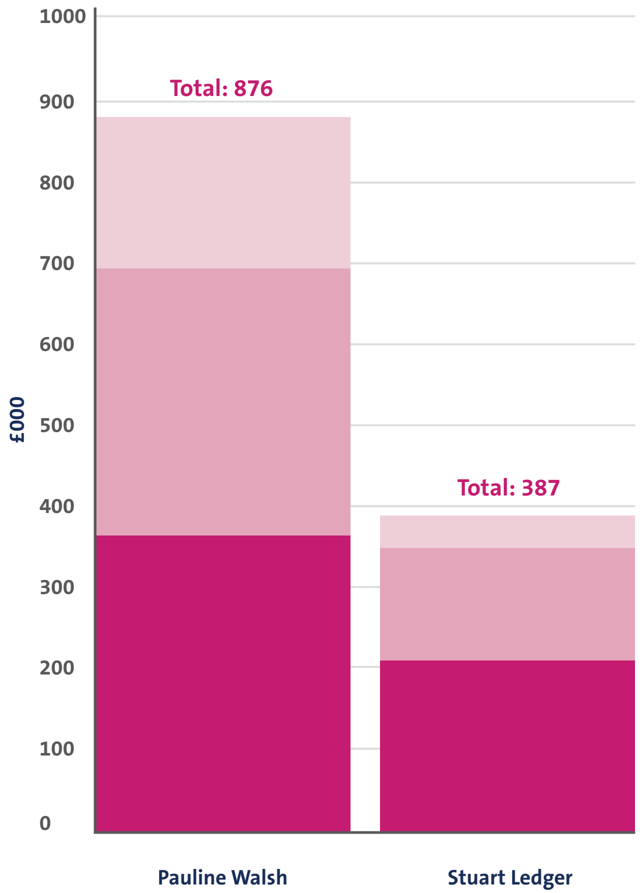
20.0%
personal performance.

The annual bonus plan targets were established by the Board's Remuneration Committee and continued to be aligned for the executive director, senior manager, selected manager and company-wide schemes. This ensured there was a common focus across the company.

The achievement of performance against these targets provided the basis for determining the value of annual bonus awards.

We also have a LTIP to incentivise executive directors and senior management to meet both financial and strategic targets, including service and performance commitments over a five year period. No awards vested in the year ended 31 March 2020.

Remuneration paid in 2019/20



Pauline Walsh		Stuart Ledger
184	Other remuneration	38
331	Annual bonus	140
361	Base salary	209

NB. Other remuneration relates to pensions related benefits, taxable benefits and for Pauline Walsh only discretionary payments including compensation for the forfeit of a variable remuneration arrangement with her previous employer.

Our executive remuneration policy

For further information on our executive remuneration, please refer to our executive remuneration policy and our directors remuneration summary, both of which can be found on the governance page of our website:

www.affinitywater.co.uk/governance

Understanding our taxes

Approach to risk management and governance

The Chief Financial Officer is ultimately responsible for our tax strategy. Responsibility for day to day tax matters, and for reporting to the Audit Committee and the Board on significant tax risks and developments, is delegated to the Group Tax Manager. Tax strategy is part of our overall risk management and governance framework, which is overseen by the Audit Committee and the Board.

We consider our main tax risk to be the introduction of new legislation or changes in tax practice, which could result in increased tax payments that have not been included in the current regulatory settlement.

Dealing with HMRC

We have an open relationship with HMRC, and we advise them of any complex issues so that we can work with them to determine the correct amount of tax due.

We actively engage with HMRC and other relevant authorities on proposed changes to tax legislation, either directly or as part of our industry group.

Attitude to tax planning

We do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities, and we always comply with what we understand to be both the letter and the spirit of the law.

We operate solely in the UK and all our customers are based here. All our profits are reported and taxed in the UK. No funds are held off-shore, and all finance is raised and held within the UK.

Whilst we do not interpret tax legislation aggressively, we try to minimise our tax liability so that our customers are not funding excessive and unnecessary charges through increased bills.

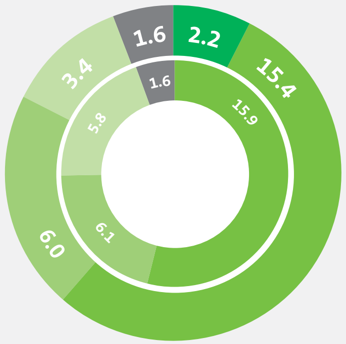
We seek external advice when necessary, in order to ensure that our interpretation of current tax law and practice is correct.

We paid
£2.2m
corporation tax during the year to 31 March 2020

In March 2020, we were re-accredited with the Fair Tax Mark, which recognises that we pay the right amount of corporation tax, at the right time and in the right place, and have reached the highest standard of transparency.

Fair Tax

We paid £2.2m corporation tax during the year to 31 March 2020, as well as indirect taxes of £26.4m consisting of £15.4m business rates payable to local authorities, £6.0m employer's national insurance, £3.4m environmental taxes and £1.6m streetworks permits.



Tax Contribution (£m)

- Direct tax paid
- Business rates
- Employment taxes
- Environmental taxes
- Streetworks permits

2019/20 (Outer) £28.6m
2018/19 (Inner) £29.4m

Our tax strategy

Our approach to tax is based on the values incorporated in the "Behave ethically" section of our Code of Conduct:

"We always act honestly, openly and responsibly, so that we are trusted. We uphold our Standards of Conduct together by complying with the law and regulatory requirements, making decisions with integrity, and speaking up when we believe that conduct falls short of our Principles.

We are transparent in our dealings with government and regulators, fulfilling our obligations honestly and promptly. We don't hide information that should be in the public domain and we don't disclose information that we shouldn't. We are clear and honest about our services, processes, policies, achievements and prospects. We encourage people to speak up whenever they see conduct that falls short of our Principles and we take their concerns seriously."

Understanding our taxes (continued)

In 2019/20, our profit before tax was £0.1m and our current tax charge was £2.1m. This results in an effective tax rate of 2,304.8%, which is significantly higher than the UK corporation tax rate of 19.0%, as per the reconciliation below.

2019/20 corporation tax reconciliation

	£000	%
Profit before tax	**91**	
Tax on profit on ordinary activities at standard UK tax rate of 19.0%	17	19.0%
Tax effect of:		
Depreciation in excess of capital allowances	4,022	4,419.2%
Pension movements	(644)	(707.4%)
Increase in provisions	103	113.6%
Expenses not deductible for tax purposes	55	60.4%
Adjustment to tax charge in respect of prior years	(1,457)	(1,600.07)
Reported current tax charge and effective rate	**2,096**	**2,304.8%**

Tax adjustments explained

- **Depreciation in excess of capital allowances**
  The depreciation charge in the accounts is not allowable for tax purposes, so it is added back in the tax computation.

  Tax relief on our investment in infrastructure assets is in the form of capital allowances, which can be claimed by all companies investing in essential capital assets.

  In 2019/20 the depreciation charge in our accounts was higher than the amount of capital allowances claimed in the tax computation, resulting in an increase in the tax charge for the year.

- **Pension movements**
  Tax relief is given for the amount actually paid into the company's pension funds in the year, not the amount charged in our accounts. In 2019/20 the amount paid into the pension funds was higher than the amount charged in our accounts, resulting in a decrease in the tax charge for the year.

- **Increase in provisions**
  These are other expenses that were charged in our accounts in 2019/20 but which are not tax deductible until a later year. They had the effect of increasing our tax charge in 2019/20.

- **Expenses not deductible for tax purposes**
  These include fines, business entertaining expenses and some legal fees. They are not tax deductible and have the effect of increasing our tax charge.

- **Adjustment to tax charge in respect of prior years**
  The tax provision in our accounts is a best estimate at the time. This is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year end. In 2019/20, the correction made to the estimate of tax for prior years resulted in a lower tax charge.

Frequently asked questions

Do you pay your shareholders dividends?

Our dividend policy is to pay a dividend commensurate with the long-term returns and performance of the business and to allow shareholders to earn an appropriate return from their investment, whilst not impairing on the company's longer term financeability and taking into account its commitments to stakeholders and customers.

In determining the level of dividend, the financial performance of the regulated and non-regulated businesses is considered separately.

Our dividend policy was revised during the year to ensure that any group debt above Affinity Water Limited can be serviced from the non-regulated business before a distribution to shareholders is considered.

No equity dividends were paid during 2019/20.

During AMP7, our shareholders are restricting their dividends to enable the substantial investments to improve resilience and protect the environment.

Why are you paying your executives high salaries and bonuses?

We have continued to keep the reward packages for our Executive Directors and other senior managers under review to ensure they remain market competitive, incentivise company and individual performance, and focus on the achievement of short-term targets that will enable the company to fulfil its long-term vision and purpose.

Executive Directors have committed to not taking the AMP7 readiness bonus as previously reported in our 2018/19 Annual Report and Financial Statements and to not receiving an increase in their salary for 2020/21.

What do the water charges pay for?

The charges enable us to:

- make sure customers have enough water, while leaving more water in the environment;
- continue to supply high quality water to customers by implementing a significant investment programme which includes upgrading of treatment and distribution systems;
- minimise disruption in the community by maintaining and enhancing water infrastructure and reduce leakage;
- reduce environmental impacts; and
- manage and conserve a range of habitats in company ownership.

Are you profiting at the expense of customers?

We have announced our annual charges for 2020/21, with a forecast average annual household bill of £163, the equivalent of just 45 pence a day.

We have worked hard to keep our bills low across AMP7 whilst maintaining a high quality and trusted service, with our forecast average bill reducing by 6.9% in real terms from a 2019/20 baseline. We have planned total expenditure of £1.44bn over the same period.

Where can I find further information?

Further information on a range of topics can be found on our website:

affinitywater.co.uk

including:

- Our Annual Report and Financial Statements;
- Our AMP7 Business Plan;
- Our Water Resources Management Plan;
- Our executive remuneration policy;
- Our directors' remuneration summary;
- Our dividend policy; and
- Our 'Consulting with our shareholders' document.

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The Social Mobility Pledge

disability confident EMPLOYER

Fair Tax

Affinity Water