Investor Report

Affinity Water Limited (‘Affinity Water’)

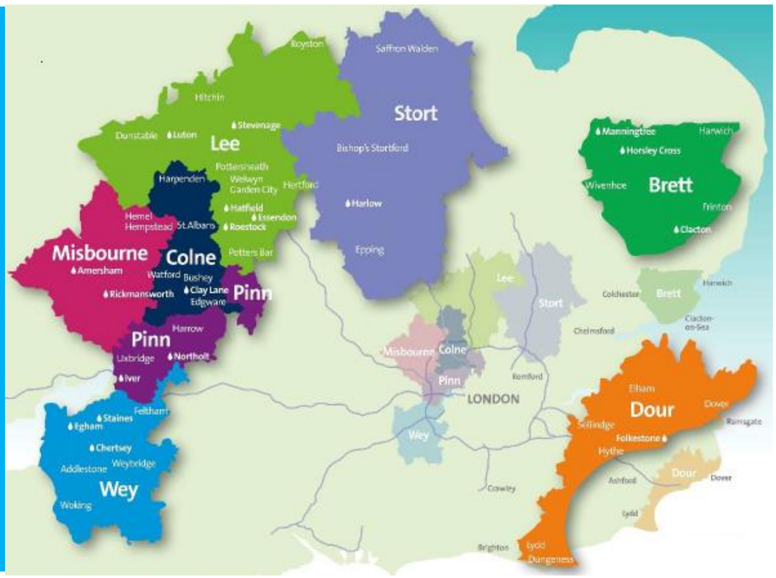
Six month period ended 30 September 2019

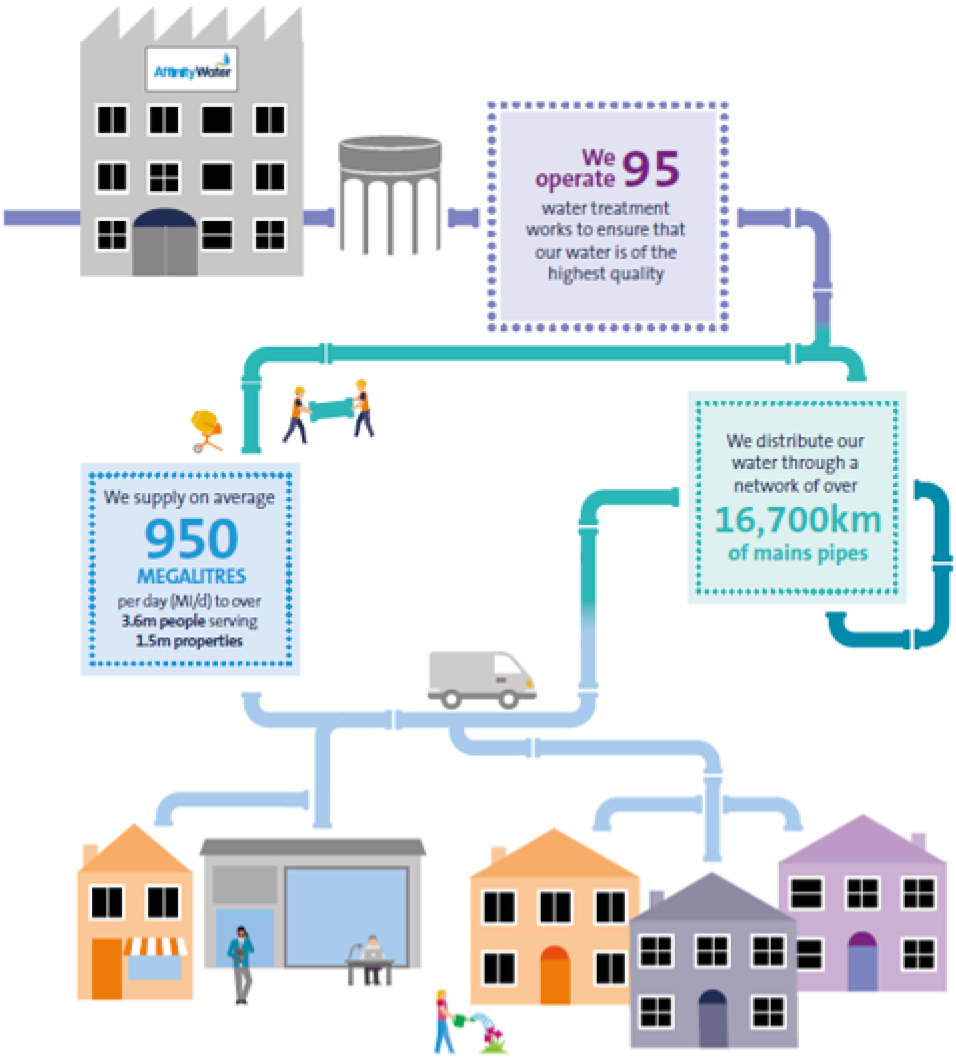
Published on 13 December 2019

Table of Contents

1 Affinity Water at a glance

Affinity Water is the UK's largest water only supply company by revenue and population served. We own and manage the water assets and network in an area of approximately 4,515km^2 split over three regions in the South East of England. We divide our supply area into eight different communities, based on our existing water resource zones and have named each of them after a local river, allowing us to tailor a high quality service to customers at a local level.





2 Our commitments

As part the price review process for AMP6 ('Asset Management Plan 6', 'PR14'), we agreed a number of performance commitments with Ofwat, which were shaped by the expectations of our customers. These stretching targets are to respond to the significant social and environmental challenges we face – a rising population and increased demand for water, as well as a reduction in the availability of water in years ahead.

We want our customers and stakeholders to be able to measure our success and hold us to account. The table below summarises our customers' four expectations and the performance commitments we have made for AMP6 and the ones we included in our Business Plan as part of the price review process for AMP7 ('Asset Management Plan 7'). We have aligned our operational key performance indicators ('KPI') to our key performance commitments in response to customer expectations.

Our AMP6 commitments	Our AMP7 commitments	Our customer outcomes
We will maintain high quality drinking water. We will implement a targeted programme of lead pipe replacement to meet more stringent legal standards.	We will continue to support the quality of our water resources through our catchment management and river restoration programmes to help habitats and biodiversity of rivers in our supply area.	Supplying high quality water, you can trust KPI: Water quality
We will reduce the amount of water we take from the environment by 42 million litres per day. We will encourage our customers to use less water through our Water Saving Programme, reducing average water use by 7%. This includes installing 280,000 meters by the end of AMP6. We will invest £500 million in our network to reduce leakage by 14% - the equivalent of 27 million litres per day.	We will reduce the amount of water we take from the environment by 36 million litres per day. We will reduce leakage from water pipes by 18.5% on top of a 14% reduction between 2015 to 2020. We aim to reduce average consumption from 147 to 129 litres per person per day, operating at the forefront of demand-side management, and working with partners and communities to prompt behavioural change with regard to water conservation.	Making sure you have enough water, whilst leaving more water in the environment KPI: Sustainable abstraction reductions KPI: Leakage
Average household bills will reduce before inflation between 2015 and 2020. We will promote our social tariff (LIFT) to support those least able to pay their bill. We will make £106 million of efficiency savings in our running costs to keep bills as low as possible over the five years of AMP6. We will make ourselves accountable to our communities for our performance.	Average annual customer bills will reduce by 1.6%, and we will deliver over £200.0m of efficiencies to keep bills as low as possible. An additional 30,000 customers will benefit from our social tariff and we aim to increase the number of customers on our Priority Services Register. We will listen to customer needs and invest in the right technologies to deliver great customer interaction, increased engagement and cost efficiencies.	Providing a great service that you value KPI: SIM
We will invest in increased flexibility in our network so we can transfer water more effectively around our communities.	We will invest £1.37 billion in our wholesale business to maintain core network assets to keep services running 24 hours a day, 7 days a week and 365 days a year, investing in local level assets such as pumps, mains upgrades, new mains and investment in service reservoirs that allow us to move water to where we need it.	Minimising disruption to you and your community KPI: Mains bursts KPI: Unplanned interruptions to supply over 12 hours

We publish our performance on our website so our customers can see exactly how we are performing against the commitments we have made for AMP6. Our supply area is broken down into 8 water resource zones, which we call communities and we are now publishing performance at the community level as well. More information can be found at:

https://www.affinitywater.co.uk/corporate/about/performance

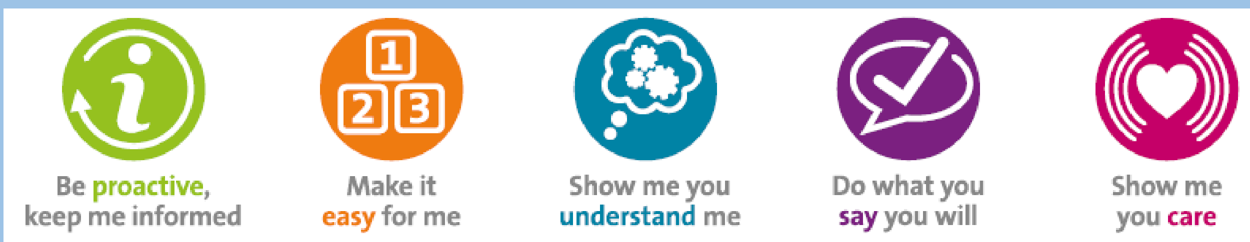
3 Operational performance

We continue to align our operational key performance indicators and targets to key performance commitments made in our Business Plan in response to our customer outcomes. These are necessarily stretching targets to respond to the significant social and environmental challenges we face – a rising population and increased demand for water, as well as a reduction in the availability of water in the years ahead.

Our customers and communities

In April 2019, we moved our internal customer satisfaction measure from a 1-5 scale to a 0-10 scale to align with C-MeX, In September 2019, we achieved a score of 9.22 out of 10 compared to 4.65 out of 5 for 2018/19. We have continued to deliver a reduction in operational complaints, which have reduced by 28% in the six-month period to September 2019 compared to the same period in the prior year. However, the number of escalated complaints has increased from 42 in the prior year to 49 for the six-month period to September 2019.

Over the summer we rolled out our new Customer Experience Principles to the business. Our customer principles are set out from the point of view of customers and borne out of the things that research has shown us matter most to our customers. Our ambition as a business is to apply these principles to every decision we make and to everything we do, so that we can deliver the experience our customers deserve.



In October 2019 Ofwat published the 2018-19 Service Delivery Report in which under the SIM performance we ranked in in the lower quartile. However, we are in the upper quartile in terms of meeting our performance commitment level.

In November 2019 MOSL published its league tables, showing trading party performance against the Market Performance Standards (MPS) and Operational Performance Standards (OPS) for the period until September 2019. We have maintained our rankings, fifth for MPS and second for OPS, despite improved performance compared to 2018-19.

Our environment

As a community-focused organisation we remain committed to those issues which our customers and stakeholders feel strongly about. We operate in geographical areas that the Secretary of State for the Environment, Food and Rural Affairs has designated as being under serious water stress. Protecting the rare and sensitive chalk streams within our operating area is a priority.

In our AMP6 Business Plan, we committed to reducing the amount of water we take from the environment by 42.1 Ml/d over five years, which we achieved 12 months earlier than planned in March 2019. As outlined in our latest Water Resource Management Plan (‘WRMP’) covering the period from 2020 to 2080, we will be making further sustainability reductions of 36.3 Ml/d by 2024.

In August 2019 we received the backing of Waterwise, the leading authority on water efficiency in the UK, for our #WhyNotWater campaign. The campaign was launched in May 2019 and aims to get the public behind our #WhyNotWater Manifesto and demand the right to water efficient housing and mandatory water efficiency labelling on goods to help avert a national crisis.

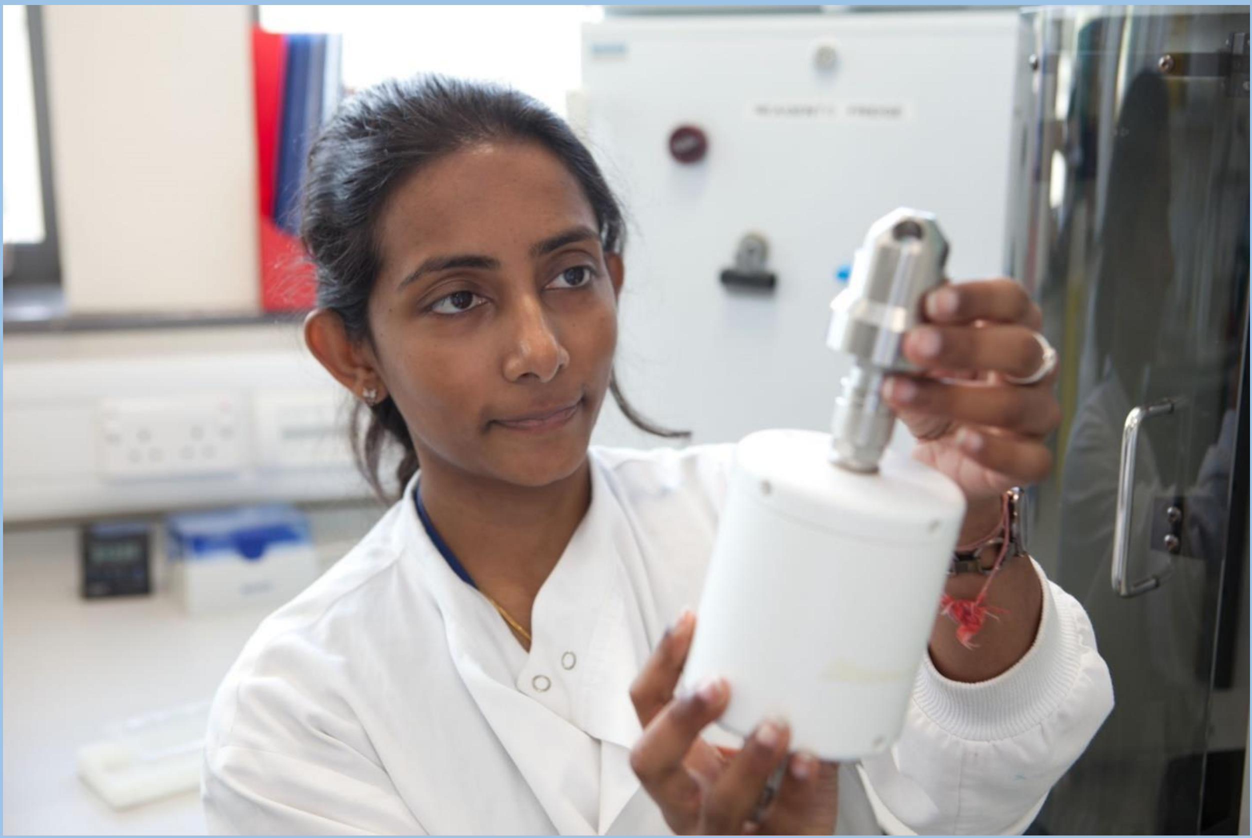
In September 2019 we launched a customer awareness campaign for potential future drought by sending an email to 500,000 customers, asking them to consider ways of reducing their consumption. Following this, we launched our ‘Drought Awareness – Your Views’ campaign in November 2019, writing to 1,000 stakeholders to ask them to spread the message. Despite the rain and flooding across the country, we are now in drought in our Central region and may need to introduce temporary restrictions from Spring 2020.

We were awarded a Silver Green Apple for our partnership with Herts & Middlesex Wildlife Trust in achieving environmental best practice in November 2019. The projects, which include work at Hilfield Park Reservoir, have seen more than 3,500 people from the local community take part and improved our stakeholder engagement.

Our people

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 ensure our contribution to those communities makes a difference. It is important that their voice is represented when making strategic decisions.

We remain fully committed to achieving zero harm and have launched a new programme aimed at making safety personal and have set a challenging target that will enable us to embed our safety culture in everything we do. Our people are encouraged to spot unsafe behaviour and take ownership to stop it. Challenging unsafe behaviour has steadily increased during the period, with the number of safety conversations reported increasing from 0.10 per person in April 2019 to 0.50 in September 2019. Despite this, we recorded five work related lost time injuries increasing our accident frequency rate to 0.35 lost time injuries per 100,000 hours worked for the 12-month period ended 30 September 2019 from 0.23 for the year ended 31 March 2019.



We are committed to promoting equality of opportunity in all areas of employment including recruitment, promotion, opportunities for training and pay and benefits. The following table provides a breakdown of the gender of directors and employees as at 30 September 2019:

	Men	Women
Our Board	6	4
Executive Management Team	8	2
All other employees	801	512

Our assets and sites

Our assets allow our people to make use of the water resources provided by the environment to supply our customers. Our above ground assets collect water from groundwater or river sources and deliver it to treatment works where we convert raw water into high quality wholesome drinking water. Our below ground network of assets take water from treatment works and deliver it to homes and commercial premises through more than 16,700km of mains.

We continuously invest in our network and are making steady progress against our mains renewals target of 17.5km by 31 March 2020, as well as replacing 4.5km of trunk mains this year. We aim to survey and complete 6,343 lead pipe replacements this year as part of our £17.0m AMP6 lead pipe replacement programme.

We have also worked hard in the period to reduce our energy usage and carbon emissions across all of our sites as part of the formulation of our energy strategy for the next 20 years, supporting our AMP7 Business Plan and our WRMP. We are aiming to use electricity more efficiently to reduce usage and cost, as well as reduce carbon emissions.

After two years of resilience testing at our Kings Walden water treatment works, datumpin Limited debuted the process to enhance existing Telemetry and SCADA information systems using eDM data technology. The data volume reduction achieved with the eDM eases the burden on telemetry communications while providing up to one second sample rate data collection. As the result, waste brine volume from the treatment process has reduced by 50 per cent, output treated water volume increased by 48 per cent and overall annual operational cost savings exceed £40,000.

During AMP7, we plan to invest £1.38bn in our wholesale business, including £740m in local level assets to keep services running across each of our eight communities 24 hours a day, 7 days a week and 365 days a year, through investing in local level assets such as pumps, mains upgrades, new mains and investment in service reservoirs.

Our finances

We have secured financing for the remainder of AMP6 and into the beginning of AMP7. We have issued debt with a book value of £1,014.2m in total with only £14.2m of debt maturing in AMP7 and a spread of maturity beyond this.

Our support for financially vulnerable customers who have a low household income or are claiming benefits has grown with 60,000 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 2020 and are projecting that the number of customers receiving support through our social tariff will increase to 82,000 customers in 2024/25.

Our average annual household bill for 2019/20 is £170.50, the equivalent of just 47 pence per day, which we think represents great value for money. We have worked hard to keep our bills low whilst maintaining a high quality and trusted service. Our water bills are consistently lower than the industry average and will have reduced in real terms by almost 7% across AMP6. We plan to reduce it by a further 2.3% across AMP7 to £166.60 by 2024/25.

Our plan for AMP7 keeps customers' bills as low as possible and ensures our business is financeable and able to withstand financial shocks. We have assessed these through stress testing our plan, whilst maintaining the ratios within our covenants at a level consistent with our family credit rating of BBB+/Baa1. The plan is built on the strong financial structure the company has in place and on access to the long-term financing needed for our investment during AMP7.

4 Financial performance

Financial results for the period ended 30 September 2019

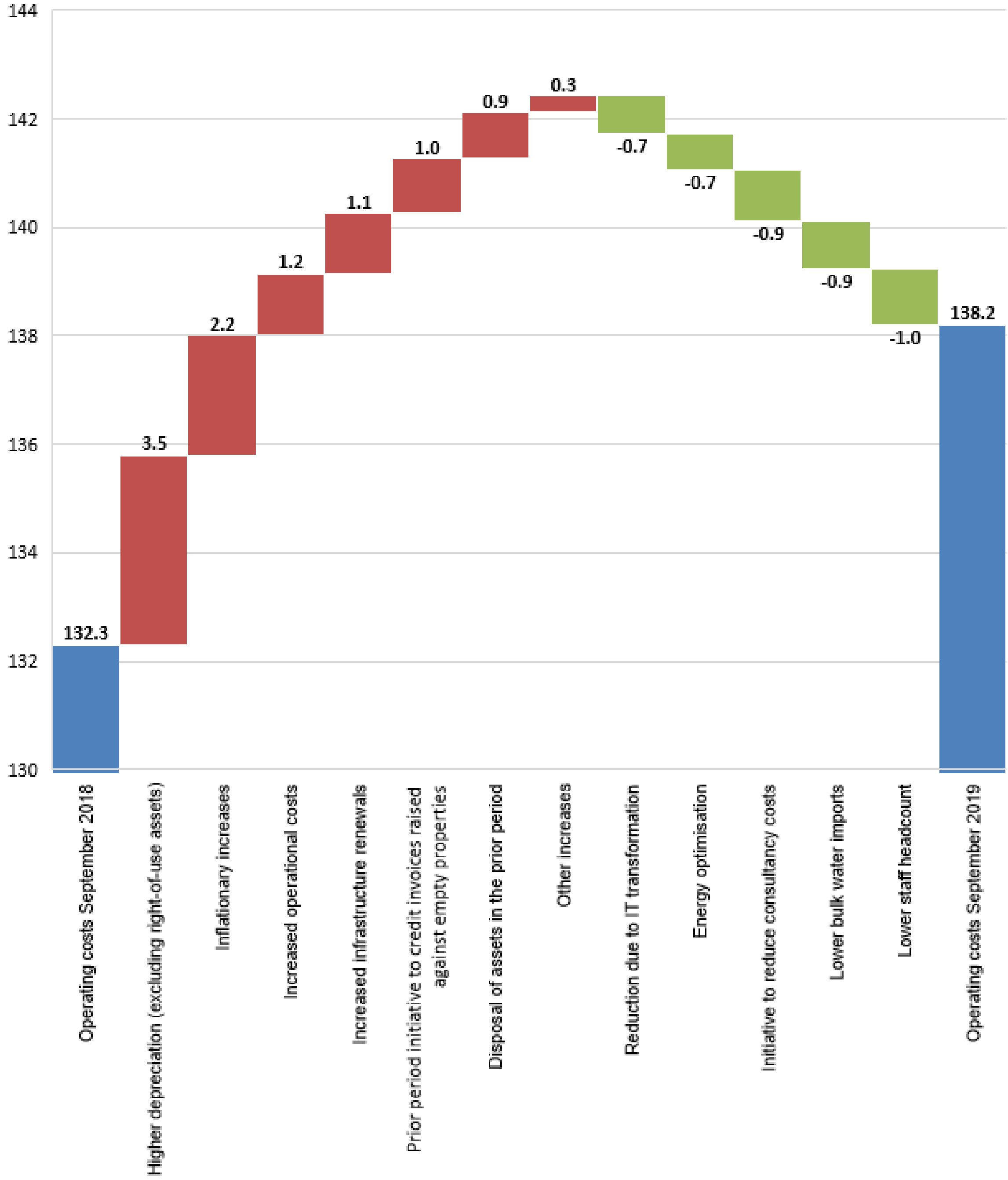
Our financial results are prepared in accordance with the recognition and measurement requirements of EU-adopted International Financial Reporting Standards ('IFRS'). Our unaudited financial results for the six months to 30 September 2019 are summarised as follows:

	2019 £m	2018 £m
Revenue	**153.9**	156.1
Operating costs	**(138.2)**	(132.3)
Other income	**9.2**	8.8
Operating profit	**24.9**	32.6
Net finance costs	**(36.6)**	(30.2)
(Loss)/profit before tax	**(11.7)**	2.4
Tax credit/(expense)	**0.7**	(0.5)
(Loss)/profit for the period	**(11.0)**	1.9

Revenue for the first six months of the year was £153.9m, being a 1.4% decrease on the same period last year (2018: £156.1m). The decrease is primarily due to lower non-household wholesale revenue and lower new connections activity partially offset by higher household revenue due to higher measured consumption.

Operating expenditure

Total operating costs of £138.2m for the first half of the year were £5.9m higher than for the same period last year (2018: £132.3m). The variance is explained in the graph on the following page:



Our operational costs increased due to higher unit costs as a result of the complexity of jobs being carried out, higher reinstatement costs, and increased leakage detection. The location of mains bursts in our network also had an impact with a number of bursts causing significant damage to customer property and some requiring the use of costly specialist equipment.

Finance costs

The net finance cost of £36.6m was £6.4m higher in the current year primarily as a result of unfavourable movements in RPI resulting in higher accretion on our index-linked bonds and a fair value loss on financial derivative in relation to the RPI linked inflation swap.

Profit before tax

Profit before tax decreased by £14.1m (587.5%) to a £11.7m loss (2018: £2.4m profit), primarily due to the reduction in revenue, the increase in operating costs and higher net finance costs as explained above.

Taxation

In Income tax credit of £0.7m was £1.2m favourable to the prior period due to lower taxable profits. The effective tax rate of 6.0% is lower than the current corporation tax rate of 19.0% and lower than the effective tax rate for the prior year (21.2%).

All our profits are taxed in the UK, and we do not use tax avoidance schemes or tax havens to reduce our tax liabilities. We comply with what we understand to be both the letter and the spirit of the law.

£2.2m of corporation tax was paid during the period (2018: £nil). No corporation tax was paid in the prior period as a result of an overpayment in 2017/18.

Capital expenditure

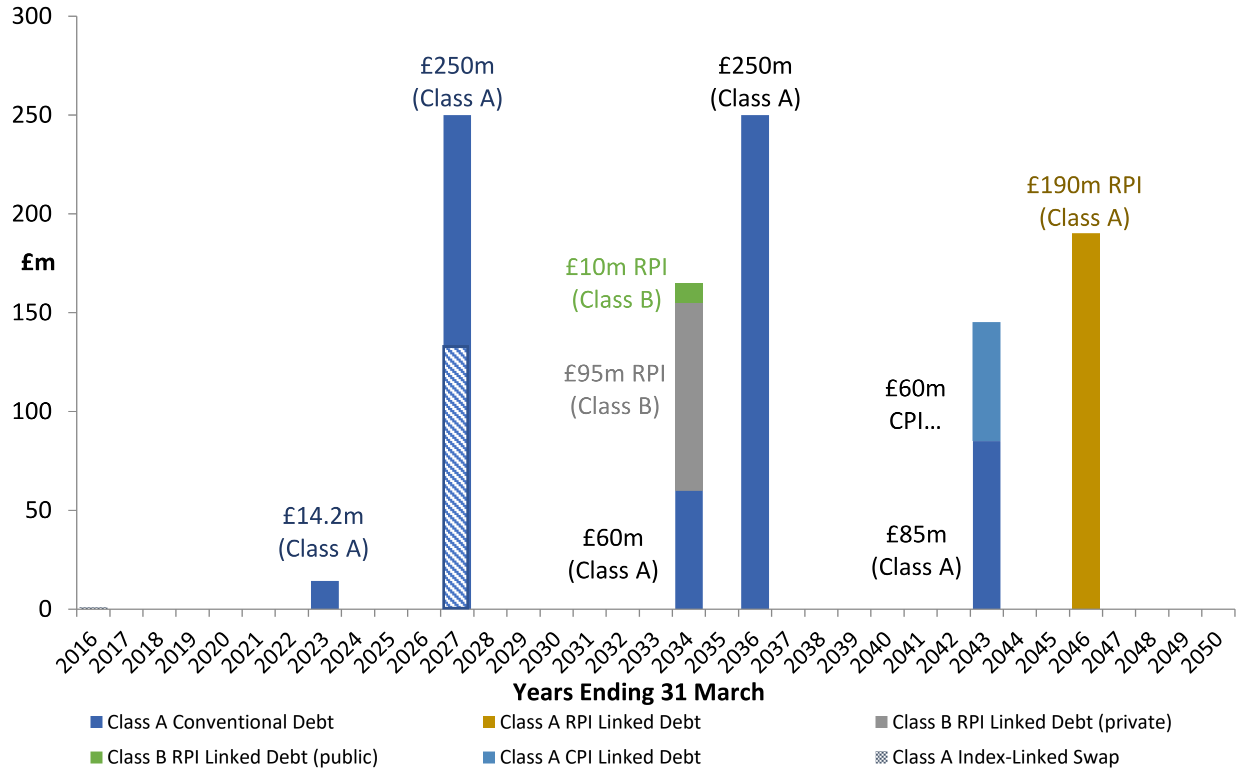
Capital expenditure in the period was £56.6m (2018: £48.1m), and was incurred principally on our mains renewals, trunk main replacement, lead pipe replacement, water treatment and integrated water savings programmes. The higher capital expenditure in the first half of this year reflects our increased work in the current period on the HS2 project, for which we also received higher capital contributions offsetting these costs.

Net cash inflow before tax and financing for the first six months of the year was £24.2m being a £3.2m (15.2%) increase on the same period last year (2018: £21.0m). The increase is primarily due to lower net (including capital contributions) investment in fixed assets in the current period and the cessation of additional pension contributions since November 2018 as a result of our defined benefit pension scheme becoming self-sufficient, partially offset by higher operational expenditure.

5 Financing update

There has been no financing exercise since the index-linked swap transacted in August 2018. We will, however, be commencing the process of refinancing the two Revolving Credit Facilities in January 2020 as they will be maturing in July 2020.

The chart below shows the maturity profile of all the bonds issued by Affinity Water's financing subsidiaries.



There has been no change during the period in credit ratings for the Class A bonds, rated A3 and A- by Moody's and Standard & Poor's (S&P) respectively, or the Class B bonds, rated Baa3 and BBB.

However, in September 2019, S&P moved the Company's rating to a negative outlook, along with Sutton and East Surrey Water PLC. This is due to the impact on ratios of AWL's Draft

Determination published by Ofwat. However, it would take a multinotch downgrade for AWL not to maintain investment grade and therefore meet its licence requirements.

Another point of note is that we have recently been notified by HSBC that due to the ring-fencing of UK banks, our DSR Facility is now under HSBC UK Bank Plc (the ringfenced bank) rather than HSBC Bank Plc. The entity is a wholly owned subsidiary of HSBC Holdings and even though it carries an S&P short term rating of A-1+ and Fitch rating of F1+, it does not yet have a Moody's rating that is required for our DSR facility. However, we have confirmation by Moody's that the bond rating is not impacted by this and we have formally notified the Trustee.

6 Regulatory and business update

PR19 Update

In September 2018 we submitted our AMP7 Business Plan to Ofwat. It builds on our vision to be the UK's leading community focused water company, setting out our plans and the funding we require, to meet the expectations of our customers and stakeholders.

On 18 July 2019 Ofwat published our Draft Determination which set out what we need to deliver, the allowed revenue that we can recover from our customers and how it was determined based on their calculation of efficient costs and the allowed return on capital.

We submitted our response to Ofwat's draft determination on 30 August 2019; see below the summary of our response:

	Response
WACC	Not Represented
Lower WACC Assurance	Not Provided
New Connection Charges	Amended post DD
Botex	Not Represented
Enhancement	Represented
ODI rates: Leakage, Gap & Voids	Not Represented
ODI rates: Burst Mains & Low Pressure	Represented
Reconciling PR14	Not Represented
WRFIM-AMP 6 Developer Service Income	Represented
PAYG	Represented
RCV Run-off Rates	Represented
Retail Cost of Serve	Represented
PR14 SIM	Not Represented
Customer Bills	Represented
Financeability - Board & Third Party Assurance	Provided

We met with Senior Ofwat executives at the end of September 2019 to discuss our response. Ofwat will publish its Final Determination for all companies on 16 December 2019.

Further information on the business plan can be found at our website:

https://stakeholder.affinitywater.co.uk/business-plan.aspx

7 Governance update

Our Board is collectively responsible for the long-term success of the company. It sets our strategic aims, ensures that the necessary financial and human resources are in place to meet our objectives and reviews management performance. It sets our values and standards and ensures that our obligations to shareholders and others are understood and met.

Executive management team changes

Stève Hervouet has joined as Director of Regulation and Strategy in November 2019. Stève has 17 years of experience in the water industry and joined us from Water Plus where he held the position Head of Regulation and Compliance. Previously he was Head of Economic Regulation at Sembcorp Utilities, a Global water and Wastewater supplier.

Mandi Plummer has joined as interim HR Director while we are searching for a permanent HR Director. Mandi has held HR director roles for the last 15 years. Working for a number of FTSE 100 organisations she has led teams both internationally and in the UK.

In September 2019, Colin Caldwell was recruited as interim Company Secretary, joining us from Bristol Water where he held the same role.

Board changes

On 3 September 2019, Chris Bolt stepped down from his role as an independent non-executive director.

8 Common Terms Agreement compliance

Calculation of financial ratios

Test period		Year 1 1 April 2018 to 31 March 2019 Actual	Year 2 1 April 2019 to 31 March 2020 Forecast	Year 3 1 April 2020 to 31 March 2021 Forecast
Net Cash Flow divided by	£m	122.8	112.0	131.2
Class A Debt Interest	£m	31.1	29.3	31.0
Class A ICR	**Ratio**	**3.9**	**3.8**	**4.3**
Net Cash Flow less	£m	122.8	112.0	131.2
CCD and IRC	£m	0	0	0
Adjusted Net Cash Flow divided by	£m	122.8	112.0	131.2
Class A Debt Interest	£m	31.1	29.3	31.0
Class A Adjusted ICR	**Ratio**	**3.9**	**3.8**	**4.3**

Test period		Year 1 1 April 2018 to 31 March 2019 Actual	Year 2 1 April 2019 to 31 March 2020 Forecast	Year 3 1 April 2020 to 31 March 2021 Forecast
Net Cash Flow less	£m	122.8	112.0	131.2
CCD and IRC	£m	0	0	0
Adjusted Net Cash Flow divided by	£m	122.8	112.0	131.2
Senior Debt Interest	£m	34.8	33.1	34.4
Senior Adjusted ICR	**Ratio**	**3.5**	**3.4**	**3.8**
Year 1	Ratio	3.9	3.9	3.9
Year 2	Ratio	3.8	3.8	3.8
Year 3	Ratio	4.3	4.3	4.3
Class A Average Adjusted ICR	**Average**	**4.0**	**4.0**	**4.0**
Year 1	Ratio	3.5	3.5	3.5
Year 2	Ratio	3.4	3.4	3.4
Year 3	Ratio	3.8	3.8	3.8
Senior Average Adjusted ICR	**Average**	**3.6**	**3.6**	**3.6**

Test period		Year 1 1 April 2018 to 31 March 2019 Actual	Year 2 1 April 2019 to 31 March 2020 Forecast	Year 3 1 April 2020 to 31 March 2021 Forecast
Net Cash Flow less	£m	122.8	112.0	131.2
RCV Depreciation and Capitalised IRE	£m	56.9	51.7	73.0
Conformed Adjusted Net Cash Flow divided by	£m	65.9	60.3	58.2
Class A Debt Interest	£m	31.1	29.3	30.6
Conformed Class A Adjusted ICR	**Ratio**	**2.1**	**2.1**	**1.9**
Net Cash Flow less	£m	122.8	112.0	131.2
RCV Depreciation & Capitalised IRE	£m	56.9	51.7	73.0
Conformed Adjusted Net Cash Flow divided by	£m	65.9	60.3	58.2
Senior Debt Interest	£m	34.8	33.1	34.4
Conformed Senior Adjusted ICR	**Ratio**	**1.9**	**1.8**	**1.7**
Year 1	Ratio	2.1	2.1	2.1
Year 2	Ratio	2.1	2.1	2.1
Year 3	Ratio	1.9	1.9	1.9
Conformed Class A Average Adjusted ICR	**Average**	**2.0**	**2.0**	**2.0**

Test period		Year 1 1 April 2018 to 31 March 2019 Actual	Year 2 1 April 2019 to 31 March 2020 Forecast	Year 3 1 April 2020 to 31 March 2021 Forecast
Year 1	Ratio	1.9	1.9	1.9
Year 2	Ratio	1.8	1.8	1.8
Year 2	Ratio	1.7	1.7	1.7
Conformed Senior Average Adjusted ICR	**Average**	**1.8**	**1.8**	**1.8**

Date		30 September 2019 Actual	31 March 2020 Forecast	31 March 2021 Forecast
Class A Net Indebtedness divided by	£m	841.9	849.1	902.2
RCV	£m	1,238.6	1,237.1	1,300.8
Class A RAR	**Ratio**	**0.68**	**0.69**	**0.69**
Senior Net Indebtedness divided by	£m	966.2	974.3	1,030.1
RCV	£m	1,238.6	1,237.1	1,300.8
Senior RAR	**Ratio**	**0.78**	**0.79**	**0.79**

The following table reconciles the Class A Net Indebtedness and Senior Net Indebtedness to the amounts reported in the financial statements.

Date	**30 September 2019 £m**
Borrowings	1,103.3
Exclude Permitted Legacy Loan	(3.6)
Add Back Unamortised Debt Issue Costs and Bond Premium	(17.6)
Add Accrued Interest	5.4
Add Swap Accretion	4.9
Less Cash and cash equivalents	(112.5)
Exclude Lease Liabilities	(13.7)
Senior Net Indebtedness	**966.2**
Remove Class B Debt Amounts	(124.3)
Class A Net Indebtedness	**841.9**

The impact of the IFRS16, which changed the accounting treatment for operating leases in the Annual Accounts has been backed out of the ratios. If included, the accounting change would be positive to the ICR ratios.

Affinity Water

9 Further certifications

Surplus

Our dividend policy was changed during the year to ensure that any group debt can be serviced from the non-appointed business before a distribution to shareholders is considered.

For the 6 month period to 30 September 2019, Affinity Water Limited paid no equity dividends (6 months to 30 September 2018: £5.0 million).

Authorised Investments

Terms	Bank Deposits (£m)	Liquidity Funds (£m)	Total (£m)
Overnight	10.0	38.0	48.0
3 Months	20.0	-	20.0
6 Months	10.0	-	10.0
9 Months	10.0	-	10.0
1 Year	10.0	-	10.0
Total	60.0	38.0	98.0

Annual Finance Charge

Affinity Water Limited has calculated the Annual Finance Charge for the period from 1 April 2019 to 31 March 2020 as £29.8m after incorporating the swap executed back in August 2018 and the Monthly Payment Amount to be £2.5m. Calculation of the Annual Finance Charge is set out in the table to the right.

	1 April 2019 to 31 March 2020 (£m)
Forecast interest paid on bonds	29.3
Forecast interest paid on loans	0.0
Other recurring finance fees paid	0.4
Total	**29.8**

Additional confirmations

Affinity Water Limited also confirms that:

(a) no Default or Potential Trigger Event is outstanding; and

(b) that Affinity Water Limited's insurances are being maintained in accordance with the Common Terms Agreement.

Yours faithfully,

Stuart Ledger

Chief Financial Officer

For and on behalf of

Affinity Water Limited

(in its capacity as Transaction Agent)

Appendix

Additional periodic information

We have included links below to the following documents which may be of further interest to investors.

Affinity Water Limited's annual charges scheme and details of tariffs

Affinity Water Limited's annual drinking water quality report

Affinity Water Limited's environmental performance

Risk, strengths and weaknesses statement

Customer performance report[1]

Draft water resources management plan 2019

Governance code

Draft assurance plan

Gender pay gap report

Understanding our finances

[1] The Customer Performance report for 2018/19 will be available shortly