



Your local supply, on tap

Investor Report

Six Month Period ended
30 September 2015

Affinity Water Limited
("Affinity Water")

Published on
23 December 2015



Affinity Water at a glance

Our fundamental strength resides from our vision to become the UK's leading community focused water company, leading our drive towards an efficient network and effective operations management.

Our vision reflects the importance we place on our people working within and for the communities of customers we serve. We attempt to understand and respond to these needs from the different community groups, and plan to be accountable to them at a local level for how well we provide our services. Our economic regulator, Ofwat, has acknowledged that our vision and approach is something that sets us apart from other water companies.

We believe in the unique privilege to serve our communities. Being the supplier and the steward of a precious resource for future generations, we are acutely aware that we must continually invest in building trust and legitimacy with our customers in their communities. This is central to achieving our vision.

Affinity Water owns and manages the water assets and network in an area of approximately 4,515km² split over three regions. These comprise eight separate water resource zones in the southeast of England. We are the sole supplier of drinking water in these areas.

We understand the trust and confidence our customers place in us to supply high quality drinking water every day and our business has been fulfilling this vital role in the communities we serve for over a hundred years.



The eight communities making up our area of supply have each been named after a local river to underline the link between the service we provide and the local environment from which we source water. We know that our customers' preferences and operating conditions may be unique to individual communities therefore we are tailoring our operations and plan to report our operating performance at a community level.

3.6

million people served

1.5

million homes and businesses

900

million litres of water a day

100

water treatment works

16.5

thousand km of mains network

Our Operational Performance

As part of PR14, we agreed a number of performance commitments with Ofwat for AMP6, 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.

In the first six months of the financial year, we have made progress in delivering on our ambitious commitments, whilst also preparing for the opening of a competitive retail market for all non-household customers in April 2017.

Managing our resources and minimising disruption to our customers and communities

We have committed to reduce the amount of water we take from the environment by 42 million litres per day by the end of AMP6. In order to reduce water abstraction in some places we need to find alternative supplies. Towards addressing this challenge, we conducted successful trials as part of our Sustainability Reduction Programme to stress-test our ability to import water to the Welwyn area of Hertfordshire from other areas of our network. This trial has given us confidence that when abstraction decreases there will still be enough water in the supply zone to meet demand.

To improve our resilience, we are targeting investment during AMP6 on replacing or renewing the most crucial pipes within our network. On the first day of the new price control period we commenced work on renewing the Kingsbury Road trunk main in north London. Pipe-laying was completed within four weeks and the trunk main was returned to service shortly afterwards. However we recognise that there is still more work we need to do to reduce the number of our customers at risk of suffering a prolonged interruption to supply in the event of a major burst. In June and July 2015 we experienced two major incidents affecting supplies to several thousand properties. As a result, as at 30 September 2015 we had exceeded our annual performance target of 320 properties for unplanned interruptions to supply over twelve hours.



Supporting our mains renewals and sustainability reduction programmes, we are also progressing with our Water Saving Programme. We estimate that around a third of total network leakage occurs from customers' supply pipes. Metering customers may allow these leaks to be more readily identified, potentially saving millions of litres of water every day. We aim to install over 300,000 meters by 2020. In September, we carried out our 7,000th meter installation under the programme, and we have also seen a steady rise in the uptake of our free Home Water Efficiency Check visits as we install more meters.

Supplying high quality water our customers can trust

We continue to supply high quality water to our customers and to achieve this we extensively sample and analyse the water supply. However we continue to face new pressures and obligations to maintain the high quality of our water. Increased use of existing and new pesticides puts additional stresses on our treatment processes. We are managing the risks using effective catchment management targeting pesticides at source, as well as enhancing our existing treatment and carrying out additional treatment where necessary. We are undertaking trials and design work with a view to establishing a treatment solution for the pesticide, metaldehyde, at both our North Mymms and Iver Water Treatment Works.

As part of our £25 million AMP6 lead pipe replacement programme, we have been proactively investigating the water supply arrangements for high risk groups across our supply area and have also been lining or replacing all lead pipes in Watford and Finchley. We continue to remove lead pipe on our side of the external boundary stop tap if customers inform us that they have replaced the lead on their side, or if water samples indicate the presence of lead exceeds the regulatory standard.

We have also been undertaking a programme of mains flushing in Romney Marsh to remove iron and manganese sediment from local mains pipes. This is part of a wider, more than £10 million package of investment in this area, which includes the construction of a new mains pipeline to improve security of supply and an upgrade of the Denge Water Treatment Works. Water from the treatment works supplies more than 8,000 homes and businesses with a population of around 17,000.



Providing a value for money service

We want to provide water at affordable prices to all of our customers. Our support for vulnerable customers, who have a low household income or are claiming benefits, continues to grow with increasing numbers supported by our LIFT social tariff (approximately 30,000 customers at 30 September 2015). Customers benefiting from this tariff receive a fixed bill for the year that can be spread over the twelve months.

We also want to provide excellent proactive customer service, which reduces the need for customers to contact us. We proactively contacted approximately 9,000 customers to inform them about the major operational incident at our Egham Water Treatment Works in July, also providing regular updates on our website and through social media channels. However we still received high levels of 'low pressure' and 'no water' calls from our customers, and we recognise that we need to do more to keep our customers informed when experiencing prolonged disruptions to supply.

Value for money surveys are being conducted during 2015/16 in order to establish a baseline level of performance, which will enable us to set performance targets for the remainder of AMP6.

Our Financial Performance

Unaudited financial results for the six months to 30 September 2015

| | 2015 £m | 2014 £m |
|---------------------------------|----------------|------------|
| Revenue | 152.7 | 148.9 |
| Operating costs | (113.0) | (107.6) |
| Other income | 7.5 | 5.1 |
| Operating profit | 47.2 | 46.4 |
| Net finance costs | (19.8) | (19.0) |
| Profit before income tax | 27.4 | 27.4 |
| Income tax expense | (5.6) | (5.2) |
| Profit for the period | 21.8 | 22.2 |
| Dividends | (28.0) | (17.8) |
| Transfer to reserves | (6.2) | 4.4 |

Revenue for the first six months of the year was up 3% on the same period last year primarily due to warmer weather in summer 2015 leading to higher water consumption. Total operating costs were 5% higher than in the same period last year and are explained below.

| Increases/(decreases) in operating costs | £m |
|--|------------|
| Inflationary increases | 0.6 |
| Lower infrastructure renewals activity at this early stage in AMP6 | (5.3) |
| One-off costs of senior management team changes | 0.7 |
| Major operational incidents | 0.7 |
| Higher depreciation due to newly commissioned assets | 0.8 |
| Higher costs associated with new customer connections | 1.3 |
| Market opening preparation costs | 1.3 |
| Higher power consumption | 1.6 |
| IT transformation costs | 2.0 |
| Other increases | 1.7 |
| Net increase in operating costs | 5.4 |

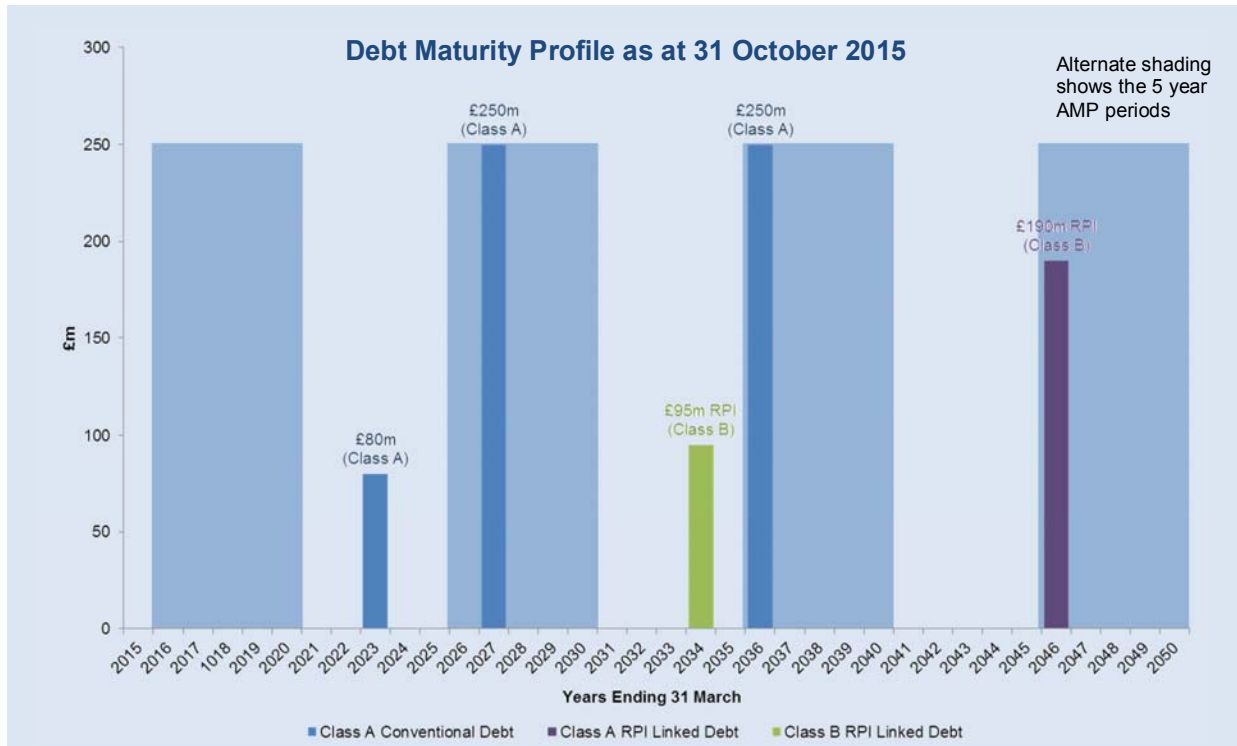
Our capital expenditure in the period was £29.9m (2014: £37.2m), and occurred principally in our mains renewals, sustainability reduction and lead pipe replacement AMP6 programmes, as well as projects carried forward from AMP5.

Further detail can be found in the Affinity Water Limited unaudited half-year financial report.

Financing Update

In July 2015, Affinity Water completed the refinancing of its existing £100 million revolving credit facility provided by a syndicate of five banks. The facility has been replaced with two separate revolving credit facilities, £60 million provided by Barclays Bank PLC and £40 million by Lloyds Bank PLC.

On 29 July 2015, Affinity Water Programme Finance Limited announced that it had conditionally agreed the issuance of an additional £40 million of the 1.548% RPI linked guaranteed bonds due 2045, which would form part of the same series as, and be fungible with, such bonds. The proposed issuance was priced on 29 July 2015 by reference to the yield on the UK Government 0.75% index-linked gilt due 2047. The proceeds from this additional tap were received on 29 October 2015. The chart below shows the maturity profile of all the bonds issued by Affinity Water's financing subsidiaries, including the £40 million tap issue.



Regulatory Update

Open Water Programme

The Water Act 2014 enables the creation of a new market for the retailing of water and sewerage services to all non-household customers in England. The Open Water Programme was created to develop a programme to deliver the required market reforms to allow the non-household retail market to be opened on 1 April 2017. Further market reforms and the introduction of competition into upstream activities are under consideration by Ofwat and the Department for Environment, Food and Rural Affairs ('Defra') for implementation beyond 2019.

Looking specifically at the opening of a competitive retail market for all non-household customers in April 2017, we have been progressing with the internal organisational changes required to our business. In line with its publicised timetable, Market Operator Services Limited, a company established by the water sector to deliver the IT systems for the new market, has appointed CGI Group Inc. (a global company which specialises in providing end-to-end IT and business process services across a number of industries) to deliver the central market systems required. We are in the process of ensuring our own systems will be able to interact with the central market systems.



Improving Resilience in our Industry

For AMP6 there has been an industry-wide movement to focus on improving resilience, with both Defra and Ofwat consulting with the industry on how best to approach and deliver a more resilient sector. In its consultation entitled "Reliable services for customers - consultation on Ofwat's new role in resilience", Ofwat proposed a definition for resilience relating to the water and wastewater sector, as the "ability to cope with, and recover from, disruption, trends and variability in order to maintain services for people and protect the natural environment, now and in the future".

We consider that improving the resilience of our operations, through efficient sharing of water resources and investment in our network is vital for us to succeed during a time of rapidly increasing population and less predictable climate. The major incident at our Egham Water Treatment Works during the period highlighted areas where we could strengthen the resilience of our operations through targeted investment in our assets. We are carrying out research to better understand customer and stakeholder priorities to ensure our investment is supported by our customers.

Environmental, Social and Governance

Environmental Highlights

As a responsible supplier of water we remain focused on reducing our impact on the environment, working closely with a range of strategic partners to meet our challenging targets.

In July we joined the Herts and Middlesex Wildlife Trust to remove Himalayan Balsam from the River Lee, a precious chalk stream in our catchment area. Himalayan Balsam is an invasive non-native weed species which spreads rapidly, suppressing the growth of native grasses and other flora in and around water courses. We are committed to reducing the impact of our operations on sensitive habitats, such as chalk streams, and to maintain flow in our local rivers to protect them for future generations.

In August, we hosted a visit from Defra. The visit was an opportunity to share our plans for river restoration, catchment management and our National Environment Programme. It included an overview of our Water Resources Management Plan submissions to Ofwat, and AMP6 and future programmes.

We have been working in partnership with other water companies to develop our understanding of high risk areas for pesticide pollution in the Thames River Basin, sampling weekly at over 200 rivers and streams to identify the areas where our catchment management work will have the greatest benefit. We also took part in Cereals 2015, the leading annual agricultural event for the arable sector in the UK. We joined forces with five other water companies to continue raising awareness of issues affecting the water environment, particularly pesticides getting into rivers. Our aim is to help farmers reduce their pesticide use and we have made good progress with our 'Zero Metaldehyde' pilot project in the catchment area for our North Mymms Water Treatment Works, with initial results from the scheme showing positive signs.



In March 2015 we published our 'Environment Policy' clearly setting out our environmental commitments. More recently we published our 'Conservation, Access and Recreation Report' for the 2014/15 year and in August 2015 we published our report 'Adapting to Climate Change' All of these documents are available on our website:

<https://stakeholder.affinitywater.co.uk/corporate-responsibility.aspx>

Social Highlights

Our Community

As a community-focused organisation serving local people we want to be involved in projects which benefit the communities we serve. Our Community Engagement Programme provides an opportunity for local charities and community groups to benefit from our resources, expertise and grant funding of up to £2,500 per project. We are especially keen to support specific projects within our supply area which promote sustainable water use, have a positive environmental impact or help disadvantaged groups. During the first half of the year we awarded grants to fifteen organisations based on their commitment and passion to improve the local community.



We aim to increase awareness of water, energy and environmental issues within our communities. Our water saving squad, a dedicated group of volunteer employees, attended various events throughout the period giving advice to local people, along with free water saving devices with the potential to save thousands of litres of water a year, as well as reducing our customers' energy consumption and bills.

Our water saving message is also promoted through our Education Centre in Bushey, where our team welcomes around 6,000 school pupils each year, providing a highly educational and informative learning experience that enriches the school curriculum. In addition, we have been engaging with primary schools to develop their own water efficiency campaigns, empowering children to save water at home and school, while developing water saving habits for the future.

Our People

Safety and health are an integral part of our business. Our vision and performance commitments for AMP6 are all set in the context of our commitment to operating our business without harm to our people and the public through injuries and accidents, or failure to supply wholesome water. We seek to operate our business to the OHSAS18001 safety standard and help our employees to take personal responsibility for their own safety and the safety of others.

We are committed to achieving zero harm. This means everyone getting home safe, and returning fit for work, every day. We are currently implementing a number of initiatives aimed at significantly reducing our accident frequency rate over AMP6. We have already seen a reduction in lost time injuries in the first half of 2015/16 compared to the same period in the previous year.

Continuous improvement and development of our employees is of paramount importance in enabling us to deliver on our AMP6 commitments. We continue to roll out our structured coaching programme to further develop the leadership skills of all our team leaders across the business. All Affinity Water direct employees earn the Living Wage or above.

Governance Highlights

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.

We remain committed to the highest standards of governance and support the principles of good corporate governance set out in the 2014 UK Corporate Governance Code, effective for the first time this year, and the UK Stewardship Code. Our business is owned by private investors and we therefore apply the principles of the UK Corporate Governance Code in this context. Our Governance Code, updated in March 2015, sets out for our customers, investors, regulators and other stakeholders how we govern and operate our business to high standards of governance and transparency.

Executive Appointments

Affinity Water made three new appointments to our senior management team in October 2015.

Amanda Reynolds joined as the new Director of Customer Relations (Household), bringing with her over 20 years' experience in customer services and a passion for improving the customer experience.

David Lee, with a track record in building successful businesses in the water and energy sectors, was appointed as the new Director of Customer Relations (Non-Household).

Andrew Ritchie, in his appointment as the new Managing Director of Wholesale Operations, brings a wealth of experience to our business, including extensive hands-on exposure across the full value chain, capital projects and programmes, operations and business development.

Board Appointments

Baroness Peta Buscombe and Dr Jeffrey Herbert, independent non-executive directors of Affinity Water Limited, retired at the Annual General Meeting of the company in September 2015.

Susan Hooper has been appointed to the Board as an independent non-executive director and will also chair the Remuneration Committee. Susan has extensive experience in consumer-facing businesses, most recently as Managing Director of British Gas Services. Prior to this she was Chief Executive Officer of Acromas Travel, responsible for Saga Holidays and Hotels and the travel division of the Automobile Association. Susan is also a non-executive director of Rank Group PLC.

Trevor Didcock has been appointed to the Board as an independent non-executive director. Trevor has a strong background in information technology and was formerly Chief Information Officer of EasyJet PLC. Prior to this Trevor held chief information officer roles at Homeserve PLC and the Automobile Association. Trevor is also a non-executive member of the Risk and Assurance Board at the Civil Aviation Authority.

Common Terms Agreement Compliance

Calculation of Financial Ratios

| Test Period | | Year 1 1 April 2015 to 31 March 2016 Forecast | Year 2 1 April 2016 to 31 March 2017 Forecast | Year 3 1 April 2017 to 31 March 2018 Forecast | Year 4 1 April 2018 to 31 March 2019 Forecast | Year 5 1 April 2019 to 31 March 2020 Forecast |
|-----------------------------------|--------------|--|--|--|--|--|
| Net Cash Flow divided by | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| Class A Debt Interest | £m | 32.7 | 33.1 | 33.6 | 34.4 | 35.0 |
| Class A ICR | Ratio | 3.6 | 3.9 | 3.8 | 4.1 | 4.1 |
| Net Cash Flow less | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| CCD and IRC | £m | 0 | 0 | 0 | 0 | 0 |
| Adjusted Net Cash Flow divided by | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| Class A Debt Interest | £m | 32.7 | 33.1 | 33.6 | 34.4 | 35.0 |
| Class A Adjusted ICR | Ratio | 3.6 | 3.9 | 3.8 | 4.1 | 4.1 |
| Net Cash Flow less | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| CCD and IRC | £m | 0 | 0 | 0 | 0 | 0 |
| Adjusted Net Cash Flow divided by | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| Senior Debt Interest | £m | 35.9 | 36.4 | 36.9 | 38.5 | 40.0 |
| Senior Adjusted ICR | Ratio | 3.2 | 3.5 | 3.5 | 3.6 | 3.6 |

| Test Period | | Year 1 1 April 2015 to 31 March 2016 Forecast | Year 2 1 April 2016 to 31 March 2017 Forecast | Year 3 1 April 2017 to 31 March 2018 Forecast | Year 4 1 April 2018 to 31 March 2019 Forecast | Year 5 1 April 2019 to 31 March 2020 Forecast |
|---|----------------|--|--|--|--|--|
| Year 1 | Ratio | 3.6 | | | | |
| Year 2 | Ratio | 3.9 | 3.9 | | | |
| Year 3 | Ratio | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Year 4 | Ratio | | 4.1 | 4.1 | 4.1 | 4.1 |
| Year 5 | Ratio | | | 4.1 | 4.1 | 4.1 |
| Class A Average Adjusted ICR | Average | 3.8 | 3.9 | 4.0 | 4.0 | 4.0 |
| Year 1 | Ratio | 3.2 | | | | |
| Year 2 | Ratio | 3.5 | 3.5 | | | |
| Year 3 | Ratio | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Year 4 | Ratio | | 3.6 | 3.6 | 3.6 | 3.6 |
| Year 5 | Ratio | | | 3.6 | 3.6 | 3.6 |
| Senior Average Adjusted ICR | Average | 3.4 | 3.5 | 3.6 | 3.6 | 3.6 |
| Net Cash Flow less | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| RCV Depreciation and Capitalised IRE | £m | 58.6 | 59.6 | 63.7 | 64.6 | 65.2 |
| Conformed Adjusted Net Cash Flow divided by | £m | 57.9 | 67.8 | 65.4 | 75.1 | 79.7 |
| Class A Debt Interest | £m | 32.7 | 33.1 | 33.6 | 34.4 | 35.0 |
| Conformed Class A Adjusted ICR | Ratio | 1.8 | 2.1 | 1.9 | 2.2 | 2.3 |

| Test Period | | Year 1 1 April 2015 to 31 March 2016 Forecast | Year 2 1 April 2016 to 31 March 2017 Forecast | Year 3 1 April 2017 to 31 March 2018 Forecast | Year 4 1 April 2018 to 31 March 2019 Forecast | Year 5 1 April 2019 to 31 March 2020 Forecast |
|---|----------------|--|--|--|--|--|
| Net Cash Flow less | £m | 116.5 | 127.4 | 129.1 | 139.7 | 144.9 |
| RCV Depreciation & Capitalised IRE | £m | 58.6 | 59.6 | 63.7 | 64.6 | 65.2 |
| Conformed Adjusted NCF divided by | £m | 57.9 | 67.8 | 65.4 | 75.1 | 79.7 |
| Senior Debt Interest | £m | 35.9 | 36.4 | 36.9 | 38.5 | 40.0 |
| Conformed Senior Adjusted ICR | Ratio | 1.6 | 1.9 | 1.8 | 2.0 | 2.0 |
| Year 1 | Ratio | 1.8 | | | | |
| Year 2 | Ratio | 2.1 | 2.1 | | | |
| Year 3 | Ratio | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Year 4 | Ratio | | 2.2 | 2.2 | 2.2 | 2.2 |
| Year 5 | Ratio | | | 2.3 | 2.3 | 2.3 |
| Conformed Class A Average Adjusted ICR | Average | 1.9 | 2.1 | 2.1 | 2.1 | 2.1 |
| Year 1 | Ratio | 1.6 | | | | |
| Year 2 | Ratio | 1.9 | 1.9 | | | |
| Year 3 | Ratio | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| Year 4 | Ratio | | 2.0 | 2.0 | 2.0 | 2.0 |
| Year 5 | Ratio | | | 2.0 | 2.0 | 2.0 |
| Conformed Senior Average Adjusted ICR | Average | 1.8 | 1.9 | 1.9 | 1.9 | 1.9 |

| Date | | 30 September 2015 Actual | 31 March 2016 Forecast | 31 March 2017 Forecast | 31 March 2018 Forecast | 31 March 2019 Forecast | 31 March 2020 Forecast |
|-------------------------------------|--------------|--------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|
| Class A Net Indebtedness divided by | £m | 706.1 | 720.7 | 776.8 | 815.5 | 835.9 | 847.6 |
| RCV | £m | 1,055.6 | 1,079.5 | 1,142.6 | 1,186.0 | 1,207.9 | 1,215.3 |
| Class A RAR | Ratio | 0.67 | 0.67 | 0.68 | 0.69 | 0.69 | 0.70 |
| Senior Net Indebtedness divided by | £m | 807.2 | 821.1 | 879.1 | 931.4 | 958.5 | 973.2 |
| RCV | £m | 1,055.6 | 1,079.5 | 1,142.6 | 1,186.0 | 1,207.9 | 1,215.3 |
| Senior RAR | Ratio | 0.76 | 0.76 | 0.77 | 0.79 | 0.79 | 0.80 |

The following table reconciles the Class A Net Indebtedness and Senior Net Indebtedness to the Net Debt reported in the unaudited half-year financial report.

| Date | 30 September 2015 £m |
|---------------------------------------|-------------------------|
| Net Debt as Reported | 838.3 |
| Exclude Permitted Legacy Loan | (3.6) |
| Add Back Unamortised Debt Issue Costs | 3.1 |
| Add Accrued Interest | 5.1 |
| Less Cash and Investments | (35.7) |
| Senior Net Indebtedness | 807.2 |
| Remove Class B Debt Amounts | (101.1) |
| Class A Net Indebtedness | 706.1 |

Further Certifications

Debt Service Reserve Accounts

There is no balance in each of the Debt Service Reserve Accounts as at 30 September 2015. The required debt service reserve is provided by a liquidity facility from HSBC Bank PLC totalling £38.0 million.

Permitted Subsidiaries Acquired

There were no Permitted Subsidiaries acquired pursuant to a Permitted Acquisition in the period to 30 September 2015.

Annual Finance Charge

Affinity Water Limited recalculated the Annual Finance Charge for the period from 1 April 2015 to 31 March 2016 following the £40m bond tap on 29 October 2015. It was recalculated to be £35.1 million and the Monthly Payment Amount to be £2.925 million. Recalculation of the Annual Finance Charge is set out in the table.

| | 1 April 2015 to 31 March 2016 (£m) |
|-----------------------------------|---------------------------------------|
| Forecast interest paid on bonds | 34.6 |
| Forecast interest paid on loans | 0.0 |
| Other recurring finance fees paid | 0.5 |
| Total | 35.1 |

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,



Duncan Bates
Chief Financial Officer
For and on behalf of
Affinity Water Limited
(in its capacity as Transaction Agent)

