Your local supply, on tap

Annual Report and Financial Statements

for the year ended 31 March 2013

Affinity Water Limited
(formerly Veolia Water Central Limited)

Registered Number 2546950


Saffron Walden
Stevenage
Luton
Harwich
Clacton-on-Sea
Harlow
Watford
LONDON
Woking
Guildford
Dover
Folkestone

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Financial

Revenues	**£288 million**
Profit after tax	**£43 million**
Net cash from operations	**£140 million**
Investment in assets	**£103 million**

Operational

Average water supplied	**877 megalitres per day**
Population supplied	**c 3.48 million**
Treatment works operated	**101**
Length of mains	**16,549 kilometres**
Infrastructure stability	**Stable**
Non-infrastructure stability	**Stable**
Water quality (2012)	**99.95% mean zonal compliance**
Employees	**1,024 (including 196 in our shared services business)**

"On behalf of the Board, I would like to thank all our people for their hard work and achievements in a year of significant change and challenges"

Directors and advisers

Board of Directors

Dr Philip Nolan
Executive Chairman

Baroness Buscombe
Independent non-executive

Dr Jeffrey Herbert
Independent non-executive

Fiona Woolf CBE
Independent non-executive

Richard Bienfait
Chief Executive Officer

Duncan Bates
Chief Financial Officer

Antonio Botija
Non-executive

Kenton Bradbury
Non-executive

Andrew Dench
Non-executive

Yacine Saidji
Non-executive

James Wilmott
Non-executive

Company Secretary
Tim Monod

Board Commitees

*Denotes chairmanship of committee

Audit Committee
Kenton Bradbury*
Jeffrey Herbert
Yacine Saidji

Nomination Committee
Dr Philip Nolan*
Kenton Bradbury
James Wilmott

Remuneration Committee
Dr Philip Nolan*
Kenton Bradbury
James Wilmott

Regulation Committee
Richard Bienfait*
Duncan Bates
Kenton Bradbury
Baroness Buscombe
Yacine Saidji
Fiona Woolf

Registered Office
Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Registered Auditors
Ernst & Young LLP
1 More London Place
London
SE1 2AF

Registered Number
2546950

Bankers
Barclays Bank Plc
HSBC Bank Plc
Lloyds TSB Bank Plc
National Australia Bank Limited
Royal Bank of Canada
Royal Bank of Scotland Plc
Santander UK Plc

Chairman's statement

I am delighted to join the Board of Affinity Water and present its first annual report and financial statements for the year ended 31 March 2013. This follows the unification of the water supply businesses of Veolia Water Central Limited, Veolia Water East Limited and Veolia Water Southeast Limited under a single instrument of appointment on 27 July 2012 and the adoption of the Affinity Water identity on 1 October 2012.

Affinity Water supplies water to 3.5 million people in the South East of England, an area which the Secretary of State has determined to be of serious water stress. Over the past eighteen months we have been working with the Environment Agency, other regulators and neighbouring water companies as part of the Water Resources in the South East group to support the strategic planning of water resources for the South East of England for the next 25 years. This regional collaboration has allowed us to develop our draft Water Resources Management Plan – a plan which aims to manage our water resources over the next 25 years in the most effective and efficient manner – whilst taking responsibility for the impact we have on our local environment. We published our draft Water Resources Management Plan for consultation in May 2013.

Our draft Water Resources Management Plan includes our plans to reduce our daily water abstraction over the next five years by 55 million litres per day ('MLD') and over the next 25 years by 77MLD. This represents nearly six per cent of our resource base. With the Environment Agency's support, we believe this is necessary to reduce the environmental impact our current abstraction has on certain chalk streams and river catchments. There are very limited cost effective alternative sources of water for our supply area. We therefore plan to replace these lost water resources by reducing leakage and working with customers to reduce consumption through metering and promoting water efficiency and bringing in new supplies from neighbouring companies.

We have been working to prepare our business plan for the next regulatory period which will run from 2015 to 2020. We welcome Ofwat's commitment to placing greater responsibility on water companies to develop their plans in consultation with their customers, and to rewarding companies whose business plans are well balanced and well evidenced and provide a fair outcome for customers. We are committed to placing customers at the heart of our future plans and have established an independently-chaired Customer Challenge Group to advise, challenge and support us as we develop our plans to ensure they reflect customers' priorities.

We have recently launched a consultation of our business plan called "Let's talk water" using a specially designed website www.talkwater.co.uk. This consultation is aimed at engaging with our customers and local stakeholders, testing with them our priorities and our plans, in particular our preferred plan to install around 500,000 new meters over the next five years on a compulsory basis. We plan to install these meters on a community by community basis and, whilst doing so, reducing leakage on our network and promoting water efficiency with our customers. We believe this approach will demonstrate our commitment to be the leading community focused water company.

The ownership of the company changed on 28 June 2012. A consortium of infrastructure investors, led by Infracapital Partners II and Morgan Stanley Infrastructure Partners acquired the business from Veolia Environnement S.A. Our new owners view their investment in our business on a long-term basis and they have the ability to finance the investment our business needs to make in the future. In February 2013 we raised long-term debt finance issuing corporate bonds which replaced the existing short-term arrangements.

The governance of our business has been a priority for me since joining the Board. Our Board is committed to the highest standards of governance and is supportive of the principles of good corporate governance set out in the UK Corporate Governance Code and the Walker Guidelines. Following the change in ownership last summer, new governance arrangements were put in place and these continue to evolve. A number of recent improvements have been made, with further improvements planned in the coming year.

During the year, our financial performance in terms of operating efficiency has improved significantly. We reduced the cost of our operations by £6m in the year and our annual operating costs are now £12m lower than at the start of this current regulatory price control period. This includes £0.9m of efficiencies achieved from the unification of our businesses. Our customers will benefit from these cost savings in price limits from 2015. We also incurred one off operating costs in the year relating to the rebranding, the unification of the business and management of the drought. Overall our operating costs for the year remained in line with last year.

In order to continue to improve our service to customers, we have invested £6m more than we were funded during the first three years of the current price control period, including an additional 18km of mains renewed. Furthermore, customers are already benefiting from the operational efficiencies we have achieved to date through the decrease, in real terms, of average bills.

We continue to place the safety and health of our people and the public at the top of our priorities. Whilst we have seen a reduction in the frequency of reportable accidents, our overall safety performance needs to continue to improve. The improvement of our business in terms of customer, operational and financial performance is due to the hard work of our loyal and committed people. On behalf of the Board, I would like to thank all our people for their hard work and achievements in a year of significant change and challenges.

Philip Nolan
Chairman

10 July 2013

“We believe this approach will demonstrate our commitment to be the leading community focused water company”

Chief Executive's business review

At Affinity Water, we are committed to being the leading community-focused water company. We aim to provide our customers with the best possible water service, using our expertise and knowledge for the benefit of the environment and the community. We have pursued five strategic priorities in order to be successful in our ambition. The five priorities provide the direction for change and improvement within our whole business:

1. To demonstrate great asset management – making best use of our assets is critical to the success of our business. We aim to demonstrate to our stakeholders, including Ofwat, our extensive understanding and management of our assets.

2. To provide highly visible customer experience – we aim to understand the needs of our customers and their communities and to ensure we are able to meet their needs. We aim to improve our on-line and social media capability – providing customers visible access to our business through the web and our mobile app – when it is convenient for our customers. If our customers are affected by an interruption to their supply we are determined to be seen to take responsibility and resolve the issue swiftly and professionally, whilst keeping the community informed of our progress through on-line updates and giving those customers who are more vulnerable and dependent on our water supply direct updates.

3. To develop a team based collaborative organisation – previous to the unification of the Veolia operating businesses and the sale from Veolia, we operated as four separate businesses. We now aim to operate as one business with a common purpose. Our success is dependent on our people working collaboratively to ensure customers' needs are satisfied.

4. To apply proven technology to drive effectiveness and efficiencies – we have committed to addressing an under investment over the past years on technology within our business. We are aiming to invest in proven technology to yield efficiencies and improvement in our business performance.

5. To obtain a favourable AMP6 determination – for the past eighteen months we have been actively planning for the next periodic review. We aim to develop a coherent, well supported business plan for the period 2015 to 2020. Our business plan needs to reflect the expectations of our customers, the service levels they seek, and at a price which they are willing to pay. Our plan also needs to include investment in water quality improvements and investment to ensure we have sufficient availability of water resources in our area to satisfy demand from our customers today and in the future.

Our vision, our customer expectations and our strategic priorities are linked through a series of indicators against which we measure our performance. We measure and publish our performance for Ofwat, the Drinking Water Inspectorate and for internal purposes.

Performance indicators

Ofwat reporting

We measure our performance against a set of targets consistent with the guidelines set by Ofwat. Using a "traffic light system", the indicators provide our customers, regulators and investors with an overall view of our performance which is set out in the table below.

Ofwat key performance indicators		Central region	East region	Southeast region	Affinity Water Limited
Environmental impact					
Greenhouse gas emissions	$ktCO_2e$				120
Reliability and availability					
Serviceability water non-infrastructure	-	Stable	Stable	Stable	-
Serviceability water infrastructure	-	Stable	Stable	Stable	-
Leakage	Ml/d	178	4.2	7.1	-
Security of supply index	Score	100	100	100	-
Customer experience					
Service Incentive Mechanism	Score	80	85	83	-
Interruptions to supply	Hrs/prop	0.35	0.04	0.10	-
Financial performance					
Post tax return on capital	%		-		5.54
Credit rating (Class A)	-		-		A- / A3
Gearing	%		-		77
Interest cover	x		-		2.5

We report the performance for the three separate regions of Affinity Water for certain asset and customer experience measures. We will continue to report assets measures separately during the price control period.

Drinking Water Inspectorate reporting

We report our water quality performance against a range of measures established by the Drinking Water Inspectorate ('DWI'). 'Mean zonal compliance' is the principal measure used by the DWI and involves 39 separate parameters tested to establish the quality of drinking water.

In the calendar year 2012, we carried out over 210,000 tests on treated water from our treatment works at service reservoirs and at customers' taps as part of our regulatory monitoring programme. Our mean zonal compliance with drinking water quality standards was 99.95%.

Internal reporting

We have identified eight performance measures and targets which we routinely measure and publish throughout the business, on a weekly, monthly, quarterly and annual basis. The targets are calibrated on a quarterly basis, reflecting the seasonality of our business, and reflecting the continuous improvements in our performance that we expect and plan to make and they comprise the following:

- **Health and safety:** number of accidents resulting in more than three days' lost time
- **Water quality:** number of water quality compliance failures
- **Unplanned interruptions:** number of properties experiencing an interruption for more than 12 hours
- **Written complaints:** number of written complaints
- **Leakage:** leakage in terms of millions of litres per day
- **Unwanted contact:** number of unwanted contacts
- **Customer experience:** measured by net promoter score
- **Financial:** annual measure of earnings before interest, corporation tax, depreciation and amortisation ('EBITDA').

The internal performance targets for water quality, unplanned interruptions, and leakage are more stringent than the targets set by Ofwat.

Chief Executive's business review – continued

Important events in the year

2012/13 has been an exceptionally busy year for the business, a year where the overall performance of the business has continued to improve in terms of:

- **Customer service performance where the SIM score has increased from 78.2 to 80.4.**
- **Asset performance where our above and below ground assets are 'stable' in terms of Ofwat serviceability.**
- **Financial performance where we have achieved £6m of operating costs efficiencies.**

We have also managed a number of important events during the year. The directors' report provides more detail on each:

Change of ownership, on 28 June 2012, when Veolia Environnement S.A. sold our business to a consortium of financial investors, led by Infracapital Partners II and Morgan Stanley Infrastructure Partners;

Refinancing, on 3 February 2013, with long term bonds which has enabled the business to be financially and operationally 'ring-fenced' from the rest of group;

Management of the drought, with the introduction of a temporary use ban on the 5 April 2012, which was lifted on the 9 July 2012 following unprecedented high levels of rainfall and recharge of our ground water aquifers;

Unification, on 27 July 2012, of Veolia Water Central, Veolia Water East and Veolia Water Southeast into one company with one instrument of appointment;

Readiness for the Olympics, with a number of sporting events hosted at venues in our area of supply including at Wembley stadium, Wembley arena, and the road cycle events throughout the Olympics and Paralympics the business operated at heightened readiness;

Rebranding, on 1 October, the business rebranded to Affinity Water;

Proposed changes to future price controls, on 16 January 2013 the company notified Ofwat that it had accepted the licence modification proposed in the Section 13 Notice of December 2012; and

A new pension scheme, for Affinity Water members was established in February 2013 with all active, deferred and pensioner members of the Veolia UK Pension Plan transferring to the new Affinity Water pension scheme on 28 March 2013.

Financial performance

Price limits

The business is a regional monopoly and is subject to incentive-based economic regulation by Ofwat. Ofwat determines limits on the tariffs we charge our customers, known as price limits, and in doing so Ofwat seeks to reward efficiency and high standards of customer service, whilst penalising inefficiency and poor standards of customer service.

Price limits are set by Ofwat every five years through a periodic review. The last review was concluded in November 2009 and determined price limits for the period 2010/11 to 2014/15. As part of a determination, Ofwat will publish a 'k' factor for each company per year, being the limit to the annual change in price charged by a company. A 'k' factor can be negative as well as positive.

The 'k' factors set at PR09 for 2012/13 and 2011/12 for the three separate regions of the company are as below:

	2011/12 %	**2012/13 %**
Central region	0.8	**(2.8)**
East region	(1.4)	**(0.7)**
Southeast region	1.2	**1.6**

Turnover

An analysis of turnover for the year to 31 March 2013 can be compared to previous years as follows:

	2010/11 £m	2011/12 £m	**2012/13 £m**
Prior year	235.3	241.3	**254.8**
Effect of RPI + 'k' (a)	3.9	13.3	**6.8**
Higher/(lower) customer demand (b)	2.2	(2.0)	**(4.3)**
New connections (c)	1.5	1.5	**(0.1)**
Other (d)	(1.6)	0.7	**(0.6)**
Existing operations	241.3	254.8	**256.6**
Acquisitions (turnover for 12 months)	-	-	**35.6**
Total regulatory turnover note 2 page 110)	241.3	254.8	**292.2**
Pre-unification turnover from acquisitions	-	-	**(11.1)**
Revenue recognition adjustment	(1.7)	(1.7)	**(1.7)**
Total statutory turnover (note 2 page 64)	239.6	253.1	**279.4**

a. Increase in RPI+'k' is driven by RPI increases of 5.2 per cent (2011/12: 4.7 per cent) and 'k' of -2.8 per cent (2011/12: 0.8 per cent).

b. There has been a continued decrease in measured consumption as well as an increased effect of empty properties.

c. There has been a year on year decrease in revenue earned from new domestic property connections.

d. 'Other', includes the effect on turnover as a result of unmeasured customers switching to a measured supply, variations in the bulk export of water, variations in chargeable services work and variations from back billing in 2012/13 arising from investigations around specific customers.

Chief Executive's business review – continued

Operating expenditure

Operating costs of £202.2m include £16.0m relating to the transfer in of trade from Veolia Water East Limited and Veolia Water Southeast Limited post unification. Excluding the impact from unification, the company's cost base has remained broadly stable at £187.0m (2011/12: £188.0m).

Increases in the cost base, in excess of inflation, were experienced as a result of: higher provisions of £1.4m for doubtful debts as a result of poorer collection rates in the uncertain economic climate, carbon reduction commitment costs of £2.0m due to non availability of credits within the new group structure to offset the charges, and £5.8m of additional costs incurred to manage the drought, to effect the rebranding to Affinity Water and to undertake the restructuring following unification of the three businesses.

Decreases in the cost base have been achieved from improvements in our operating and customer performance which has resulted in efficiencies of £6m. In addition, the application of the company's overhead capitalisation methodology has been reviewed, driven by enhanced reporting from the upgrade of the accounting system, resulting in additional capitalisation of £4.6m.

Depreciation

Depreciation of tangible fixed assets and infrastructure assets totalled £75.7m in the year (2011/12: £74.9m).

Disposal of fixed assets

Gains on sale of properties in the year were £3.7m (2011/12: £4.4m) arising primarily on the completion of the second tranche of the Bushey sale.

Financial returns

The profit after tax for the year ended 31 March 2013 is £43.5m (2011/12: £35.9m).

Cash flow

Net cash inflow from operations in the year amounted to £140.2m compared to £120.7m in the previous year. This cash inflow contributed to the servicing of finance of £20.1m and taxation of £6.9m. Investment in capex during the year amounted to £103.5m, for which an amount of £11.7m was received by way of capital contributions; an equity dividend of £16.3m was paid, with a dividend of £137.2m paid in order to refinance the business.

Net debt increased to £747.8m at the end of March 2013 compared to £463.3m at the end of March 2012 as a direct result of the refinancing that occurred in February 2013.

Capital expenditure

Expenditure for the year, before contributions, was £100.5m (2011/12: £79.8m).

This figure is in line with the company's five year asset management plan which, after three years, remains on budget.

Debt financing

The £200m 22-year bond, issued by Affinity Water Finance (2004) Limited (formerly Veolia Water Central Finance Plc) in 2004 at 5.875 per cent, remained in issue throughout the year.

As a part of the refinancing in February 2013 all other existing loans and revolver facilities were replaced by the following four new bonds issued on 4 February by the company's subsidiary, Affinity Water Programme Finance Limited:

- **£80m Class A guaranteed notes maturing in September 2022 with a coupon rate of 3.625 per cent;**
- **£250m Class A guaranteed notes maturing in March 2036 with a coupon rate of 4.50 per cent;**
- **£150m Class A guaranteed RPI index-linked notes maturing in June 2045 with a coupon rate of 1.548 per cent; and**
- **£95m Class B guaranteed RPI index-linked notes maturing in June 2033 with a coupon rate of 3.249 per cent.**

The amount outstanding at year end, net of amortised debt issuance costs of £9.3m, is £565.9m (2011/12: £nil). For further details refer also to note 26.

On 4 February 2013, the company borrowed an amount of £3.55m from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.5 per cent.

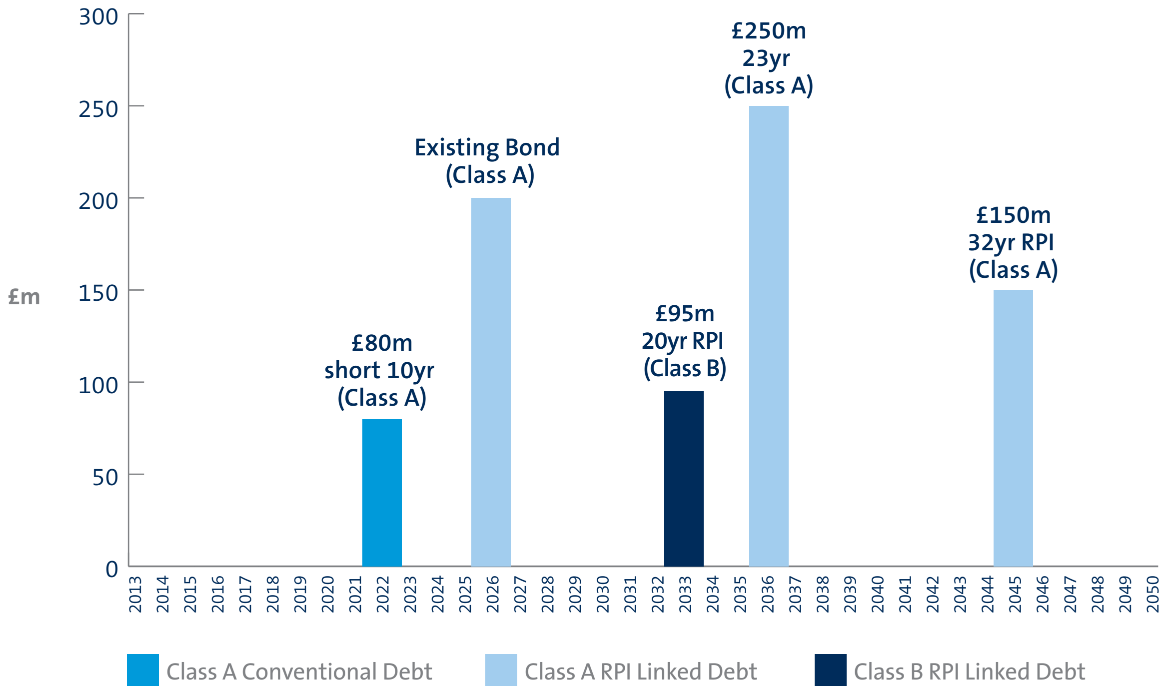
The credit-ratings given to the long-term bonds issued by the company by the credit rating agencies Moody's and Standard and Poor's supports the credit-worthiness of the company: Moody's A3 for Class A bonds and Baa3 for Class B bonds, Standard and Poor's A- for Class A bonds and BBB for Class B. The balance sheet remains strong, with compliance debt at around 77 per cent of regulatory capital value.

The bonds issued by the company's subsidiaries can be summarised as follows:

Debt	Bond £m	Cost	Maturity Date
Class A			
Existing bond (2004)	200.0	5.875%	July 2026
Class A index linked (IL) refinancing bond	150.0	1.548% (real)	June 2045
Class A fixed rate refinancing bond (1)	250.0	4.501%	March 2036
Class A fixed rate refinancing bond (2)	80.0	3.686%	September 2022
Total Class A	**680.0**		
Class B			
USS confirmed Class B IL refinancing bond	95.0	3.249% (real)	June 2033
Total Class B	**95.0**		
Total	775.0		

Chief Executive's business review – continued

The following chart shows the maturity profile of the bonds



The total value of the issued bonds can be reconciled to the company's net debt position at 31 March 2013 as follows:

	£000
Nominal value of fixed interest bonds issued	530,000
Nominal value of index linked bonds issued	245,000
Total nominal value of bonds issued	775,000
Accretion on index linked bonds	151
Capitalised bond issue costs	(12,387)
Loan from intermediate parent company	3,550
Debentures	36
Financing of shared reservoir assets	17,278
Cash in hand	(35,779)
Net debt	**747,849**

For the remainder of the current price review period, AMP5, the company anticipates that it will have a positive net cash inflow before equity dividends paid to shareholders and financing.

To the extent that additional funding is required during the period, the company has access to undrawn borrowing facilities totalling £100m, comprising a £70m capital expenditure facility and a £30m working capital facility (both with a tenure of five years from 28 June 2012).

Further, the company has available 364-day revolving structural facilities totalling £57.5m, comprising a Debt Service Reserve Liquidity Facility of £37.5m and an Operations and Maintenance Reserve Facility of £20m.

Dividend policy

The company's dividend policy is primarily based on maintaining a target level of gearing of 80 per cent. The scale of the dividend is dependent on the level of success of the company to generate cash flows and achieving its regulatory outputs in the reported period. The policy distributes earnings equal to the amount necessary to maintain net debt to regulatory capital value ('RCV') at the targeted gearing ratio. This is consistent with the requirements of Condition F of the licence that dividends paid will not impair the ability of the appointee to finance the appointed business and under a system of incentive regulation, dividends would be expected to reward efficiency and the management of economic risk.

Non financial performance

Health and safety

The total number of accidents across the unified business including the shared services business fell from 85 in 2011/12 to 77 in 2012/13. On the same basis the overall number of accidents resulting in more than three days' lost time fell from 12 in 2011/12 to 8 in 2012/13. Three of the accidents were attributable to slips trips and falls and two of the accidents related to injuries received from dog bites.

Safety Leadership Teams, led by the senior executives, have been established during the year to demonstrate strong and active leadership in health and safety matters and to facilitate improved communications and engagement with employees.

Service Incentive Mechanism ('SIM')

Service Incentive Mechanism ('SIM') measures both the quantitative and qualitative service that the company provides to its customers and gives equal weighting to both customer billing and community activities. Water companies are measured in terms of lines busy/abandoned calls, unwanted telephone contacts, written complaints, escalated written complaints and complaints investigated by Consumer Council for Water ('CCW'). The combined SIM score for the unified business was 80.4 in 2012/13 (2011/12: 78.2)

	Central		East		Southeast	
	2011/12	**2012/13**	2011/12	**2012/13**	2011/12	**2012/13**
Qualitative	41.25	41.25	44.75	45.50	42.00	43.38
Quantitative	36.47	38.59	39.41	39.28	37.66	39.83
SIM Score (score out of 100)	**77.7**	**79.8**	**84.2**	**84.8**	**79.7**	**83.2**

The company's aim is to provide an excellent service to customers and continuously to improve in each and every aspect of its service.

Leakage

	Central		East		Southeast	
	2011/12	**2012/13**	2011/12	**2012/13**	2011/12	**2012/13**
Leakage (Ml/d)	158.4	178.2	4.3	4.2	7.1	7.1
Target (Ml/d)	**185**	**185**	**5.1**	**5.1**	**7.8**	**7.7**

The company attaches high priority to meeting leakage targets. The company is pleased to confirm that for 2012/13 the leakage target in all three regions was met.

Chief Executive's business review – continued

Water quality

	2009	2010	2011	**2012**
Mean Zonal Compliance (%) (Supply water that meets quality standards)	99.97	99.99	99.98	**99.95**

Water quality is based on compliance data for the 12 months to 31 December. The Mean Zonal Compliance ('MZC') is the average of the 'mean zonal compliance' performance of 39 water quality parameters and is an important measure of the quality of the water supplied to customers. The individual results for each parameter are taken from the company's compliance sampling programme and are reported to the Drinking Water Inspectorate.

There were 51 failures of the pesticide standard (2011: 4 failures), which contributed to the reduction in the compliance rate for 2012. Many of these failures occurred as a result of greater use of pesticides by farmers in our water supply catchments in response to the very wet weather. We have reviewed the assets which are designed to remove pesticides during the treatment process and have committed to increase the investment in these assets.

Metering

	2010/11	2011/12	**2012/13**
Central	8,144	11,933	**12,834**
East	833	819	**753**
Southeast	5,853	3,933	**1,555**

This reflects the number of customers choosing to switch to a metered supply and selective meters installed in the year together with the small number of compulsory meters installed in the Southeast region.

Regulatory obligations – serviceability

Serviceability is an assessment of the capability of assets to provide the required level of service to customers and to safeguard the environment now and into the future. This measure is important as, under its operating licence, the company is required to maintain its assets such that services to customers can be sustained over the long-term. Ofwat seeks to set its price limits so as to allow for sufficient maintenance of these assets. Assessments are made on a scale of (best to worst); improving, stable, marginal or deteriorating. The target is 'stable' for both infrastructure and non infrastructure assets.

Central region – serviceability

Serviceability	2008/09	2009/10	2010/11	2011/12	**2012/13**
Infrastructure	Marginal	Marginal	Marginal	Stable	Stable
Non-infrastructure	Marginal	Marginal	Stable	Stable	Stable

For 2012/13 the company has seen a further substantial reduction in bursts which taking into account variability resulting from weather conditions confirms the company's year-on-year situation as maintaining 'stable' for both infrastructure and non-infrastructure.

East region – serviceability

Serviceability	2008/09	2009/10	2010/11	2011/12	**2012/13**
Infrastructure	Stable	Stable	Stable	Stable	Stable
Non-infrastructure	Stable	Stable	Stable	Stable	Stable

For 2012/13 the company has seen performance within the control limits and taking into account variability resulting from weather conditions confirms the company's year-on-year situation as maintaining 'stable' for both infrastructure and non-infrastructure.

Southeast region – serviceability

Serviceability	2008/09	2009/10	2010/11	2011/12	**2012/13**
Infrastructure	Stable	Stable	Stable	Stable	Stable
Non-infrastructure	Stable	Stable	Stable	Stable	Stable

Infrastructure

In this region the number of mains bursts remained at 96; identical to last year and below the reference level of 100. The unusually cold weather in March led to a small increase in the burst level just at the year end. The number of customer contacts (discolouration) remained above the reference level but as 80 per cent of the total applied to the Denge Zone, where a new iron and manganese removal plant together with extensive network cleaning are both in hand, the company's rating has been assessed as 'stable'.

Non-infrastructure

There are minor improvements in some of the indicators but the company's overall assessment is 'stable'.

Network renewal

	2010/11	2011/12	**2012/13**
Length of main renewed (km)	157	148	**139**

The company renewed 139km of the highest priority mains of its network of approximately 16,549km. The number of burst mains during 2012/13 were 2,822 a reduction of 879 on 2011/12 (3,701).

Improve the company's reputation

	2010/11	2011/12	**2012/13**
Number of offences in year	-	-	-

As a water supplier serving the public, the reputation of the company is important. The company strives to work constructively and conscientiously with its regulators and to respond diligently to their instructions and targets. The company aims to comply with legislation and regulations at all times. The company is pleased to report that in 2012/13 there were no convictions for any offences.

Chief Executive's business review – continued

Future developments

During the year, the company indicated to Ofwat it would accept modifications to its instrument of appointment to facilitate the setting of separate price controls for wholesale and retail activities at the price review in 2014. These changes allow incentives for water companies to be better targeted and preserve features of the current regime that have allowed water companies to deliver continued investment at costs which customers have found acceptable. The company is facing significant challenges from population growth, the need for improved resilience, sustainability reductions and climate change and is supportive of legal and regulatory reform that addresses these challenges, delivers clear benefits to customers and builds on the recognised strengths of the existing regulatory framework.

The company has been working to prepare its Business Plan for the next regulatory period which will run from 2015 to 2020. Ofwat's commitment to placing greater responsibility on companies to develop their plans in consultation with their customers and to rewarding companies whose business plans are well balanced and well evidenced has been welcomed by the company.

The company is committed to placing customers at the heart of its future plans and, during the year, established an independently-chaired Customer Challenge Group to advise, challenge and support the company in the development of its plans to ensure they reflect customers' priorities. The Board recognises the need to produce a plan which balances the efficient cost of financing investment and operating the business over the longer term, with appropriate risk and reward sharing with customers who may face significant challenges of bill affordability at this time.

As part of the company's proposals to unify the three former separate operating businesses, it is already committed to ensuring that customers benefit from annual savings in operating costs from 1 April 2015.

Risks and uncertainties

The company has a formal and continuous process for identifying, evaluating and managing the key risks faced. Risks, both strategic and operational, are reviewed and discussed by the executive management team. A key aim is to foster a culture in which staff throughout the business manage all risks as part of their management of day to day operations. The Audit Committee reviews the executive management team's work on risk management and reports to the Board on significant risks.

Each of the key risks has a 'risk owner' from the senior management team who is responsible for establishing appropriate controls to mitigate the risks as far as possible.

In addition, and in accordance with regulatory obligations, the company produces an annual Risk and Compliance Statement for both Ofwat and other stakeholders.

The key areas in which risks are identified and reported on are:

- **Economic and regulatory**
- **Competition**
- **Revenue and cost**
- **Operational**
- **Security**
- **Environmental**
- **Health and safety**
- **Financial**

Further information on these can be found in the following sections.

Economic and regulatory risk

The regulated water industry in the United Kingdom comprises a number of regional monopolies which are subject to economic and technical regulation. Water charges are subject to price controls set by Ofwat on a five year cycle. Price determinations made by Ofwat can have a significant impact on profits and cash flows.

The water industry is subject to extensive legal and regulatory controls with which the company must comply. The application of the laws, regulations and standards and the policies published by Ofwat, the Environment Agency, the Department for the Environment, Food and Rural Affairs ('DEFRA'), the Drinking Water Inspectorate, Natural England and other regulators could have an adverse impact on the business, financial condition or operational performance of the company.

In this context the following areas of risk should be considered.

Instrument of appointment modifications

The conditions of the company's Instrument of Appointment may be modified by Ofwat with the consent of the company, or without the company's consent where, following a reference to the Competition Commission, the Competition Commission concludes that there are effects adverse to the public interest which can be remedied or prevented by modifications. Modifications could also result from a decision on a merger or market investigation reference by the Competition Commission. Modifications to the conditions of the Instrument of Appointment may also be made without the company's consent by the Secretary of State for the Environment by order following an adverse finding by the Competition Commission after it has investigated and reported on a monopoly or merger situation under other amendments.

Any modification to the conditions of the Instrument of Appointment could have an adverse impact on the business, financial condition or operational performance of the company.

Breach of conditions of the Instrument of Appointment

A failure by the company to comply with the conditions of its Instrument of Appointment or certain statutory duties may lead to the making of an enforcement order or the imposition of financial penalties of up to 10 per cent of the company's turnover. Failure by the company to comply with any enforcement order (as well as certain other defaults) may lead to the making of a special administration order, which could have an adverse impact on its business and cash flows.

Termination of the Instrument of Appointment

There are certain circumstances under which the company could cease to hold its Instrument of Appointment for all or part of its three regions. The termination, non-renewal or transfer of the Instrument of Appointment could have an adverse impact on the company.

If the Secretary of State for the Environment or Ofwat were to make an appointment or variation replacing the company as the regulated water undertaker for its currently appointed area, they would have a duty to ensure (so far as consistent with their other duties under the Water Industry Act 1991) that the interests of the company's creditors were not unfairly prejudiced by the terms on which the successor regulated company (or companies) replacing the company could accept transfers of its property, rights and liabilities.

Chief Executive's business review – continued

Competition

Ofwat has taken steps to introduce competition into the water supply market via inset appointments and the water supply licensing ('WSL') regime.

Inset appointments

Inset appointments allow one regulated company to replace another as the provider of water in a specified geographical area within another regulated company's appointed territory. There are currently no inset appointments within the company's regions; an inset appointment made in 2000 in respect of the Kodak site in the company's Central region having been reversed in 2004. Should any inset appointments be made in any of the company's regions in the future, this would lead to a reduction in revenue from any customers within an inset area that would otherwise have been supplied by the company and may potentially result in an adverse effect on its business.

Water supply licensing regime

The water supply licensing regime allows the holder of a retail or combined water supply licence to supply water to a non-household customer's premises where more than five megalitres per annum is being used at those premises. The Government is proposing to reduce the threshold level further to zero megalitres. The ability of these customers to obtain their water supply from a different supplier could adversely affect the company's turnover, which could adversely affect its business, operational performance, profitability or financial condition.

Revenue and cost risks

The significant capital expenditure required to maintain the company's assets presents the risk that the operating revenues generated by the company from its water business may not be sufficient to enable it to make full and timely payment of amounts due to creditors.

Periodic review

The turnover, profitability and cash flow of the appointed business is substantially influenced by the service levels, regulatory targets and price limits established by Ofwat in its periodic review, and Ofwat's assessment of delivery against those factors.

Although Ofwat has a duty to exercise and perform its powers and duties in the manner that it considers is best calculated to, amongst other primary duties, secure that companies are able (in particular, by securing reasonable returns on capital) to finance the proper carrying out of their functions, an adverse price determination (which would adversely affect turnover, profitability and cash flow for the company) may occur as a result of a number of factors. These include an inadequate allowed cost of capital or regulatory assumptions concerning operating expenses and required capital expenditure as well as turnover forecasts proving not to be sufficiently accurate. In addition, unforeseen financial obligations or costs may arise (for example, as a result of ensuring regulatory compliance or changes to legislation or regulatory requirements, some instances of which are provided below) after a periodic review which were not taken into account by Ofwat in setting price limits and are consequently not compensated for, which could materially adversely affect the financial performance and profitability of the company.

An additional consideration is the current uncertainty around how Ofwat will apply some of the regulatory mechanisms it introduced for AMP5. In particular, there remains uncertainty around how Ofwat will calculate the rewards or penalties from its Capital Expenditure Incentive Scheme ('CIS') at the end of AMP5 and therefore uncertainty around the impact of this mechanism on business cash flows. This uncertainty means it is difficult to predict how the company's business might be affected in the near future.

Interim determinations

An interim determination of price limits (an 'IDOK') may be made between periodic reviews in specified circumstances, including the Shipwreck Clause (also known as the substantial effects clause) in the Instrument of Appointment.

There is however no assurance that any IDOK sought by the company will be made or, if an IDOK or a determination pursuant to the provisions of the Shipwreck Clause is made, that such adjustment or determination, as the case may be, will provide adequate revenue compensation to the company. In such an event, the company would have to bear any additional cost from its own resources which could have an adverse impact on its profitability, cash flow and ultimate financial performance.

Where funding is considered during an interim determination, Ofwat may determine that the appropriate and reasonable level of cost of fulfilling certain obligations is likely to be less than the cost actually incurred by the company in fulfilling those obligations. In these circumstances, the funding allowed by Ofwat may not totally cover the actual costs and the company would bear this additional element from its own resources which could have an adverse impact on its profitability, cash flow and ultimate financial performance.

Failure by the company to deliver its capital investment programme

The appointed business requires significant capital expenditure for additions to, or replacement of, its assets. The price limits set by Ofwat take into account Ofwat's view of the level of capital expenditure expected to be incurred during the relevant periodic review period and the associated funding costs and operating costs.

If the company is unable to deliver its capital investment programme at expected expenditure levels or secure the expected level of efficiency savings on its capital investment programme, or the programme falls behind schedule or contains incorrect assumptions by the company as to the capital investment required, the company's profitability or performance might suffer because of a need for increased capital expenditure. Ofwat may also factor such failure into future periodic reviews by seeking to recover amounts equivalent to the "allowed costs" of any parts of the programme that are not delivered. The company's ability to meet regulatory output targets and environmental performance standards could also be adversely affected by such failure, which may result in fines imposed by Ofwat of an amount up to 10 per cent of turnover or other sanctions and further increases in capital expenditure and operating expenditure. Such consequences could impact on the company's financial performance.

Changes in the rate of inflation

The company's turnover and RCV are linked to the underlying rate of inflation (linked to the Retail Price Index or RPI) and as such are subject to fluctuations in line with changes in the rate of inflation. In addition, changes in the rate of inflation are likely to impact on the operating costs and capital expenditure of the company and on customers' ability to pay any increased charges. This element of unpredictability means that the company is exposed to such risks which it cannot accurately predict and provide for in its operations, and thus could lead to adverse consequences on its financial performance.

Construction Output Prices Index

Under the 2009 Final Determination, the allowed annual capital expenditure was indexed using the Construction Output Prices Index ('COPI'). There is a risk that the actual costs of capital investment in AMP5 will be higher than the ex-post COPI-adjusted allowed capital expenditure, resulting in a revenue penalty applied in the periodic review process for the next AMP period through the CIS mechanism. This may arise where contract conditions do not allow for index tracking (e.g. fixed cost contracts or contracts which are linked to RPI) and could lead to material, adverse consequences on the company's financial performance.

Non-recovery of customer debt

Non-recovery of customer debt is a risk to the company and may cause its profitability to suffer. This risk is exacerbated by the Water Industry Act 1991, which prohibits the disconnection for non-payment of a water supply for domestic use in any premises and the limiting of a supply with the intention of enforcing payment for domestic use in any premises, although allowance is made by Ofwat – in the price limits at each periodic review – for a proportion of debt deemed to be irrecoverable. To achieve a re-setting of its price limits through an IDOK during a periodic review period when changes in the regulatory assumptions as to the level of non-recoverable debt are material, the company would need to demonstrate that:

(a) the increase was due to a deterioration in the economy, and

(b) the company has put in place appropriate procedures and measures to mitigate the increase in debt levels.

The company may therefore suffer losses from its inability to recover its debts fully, which could adversely affect its business, operational performance, profitability or financial condition.

Chief Executive's business review – continued

Operational risks

Water shortages

In the event of water shortages, additional costs may be incurred by the company in order to provide emergency reinforcement to supplies in areas of shortage which may adversely affect its business, results of operations, profitability or financial condition. In addition, restrictions on the use or supply of water (including temporary use bans and drought orders) may adversely affect the company's turnover and may, in extreme circumstances require an emergency drought order (such circumstances have never been experienced by the company). Any of this could lead to significant compensation becoming due to customers because of interruptions to supply, which could adversely affect the company's business, operational performance, profitability or financial condition.

Potential water shortages may be exacerbated by reductions imposed by the Environment Agency in the volume of water licensed to be abstracted to mitigate environmental damage or to achieve sustainable levels of abstraction. Costs may be incurred by the company in implementing replacement sources for which it may not be compensated and abstraction charges could be increased by the Environment Agency to cover compensation payments made to other abstractors whose abstraction licences are revoked or varied to alleviate environmental impact, each of which could adversely affect the company's business, operational performance, profitability or financial condition.

Service interruptions due to key site or installation disruption

Unexpected failure of or disruption (including criminal acts or a major health and safety incident) at a key site or installation operated by the company or third parties (including a reservoir or treatment works) could cause a more significant interruption to the supply of services (in terms of duration or number of customers affected), materially affecting the way that the company operates, prejudicing its reputation and resulting in additional costs including liability to customers or loss of revenue, each of which could have an adverse effect on its business, operational performance, profitability or financial condition.

Contamination of water supplies

Water supplies may be subject to contamination, including contamination from the presence of naturally occurring compounds and pollution from man-made substances or criminal acts. In the event that the company's water supply is contaminated and the company is not aware of the contamination, the analysis of the contamination takes several days to complete or the company is unable to substitute water supply from an uncontaminated water source, or to treat the contaminated water source in a cost-effective manner, there may be an adverse effect on its business, operational performance, profitability or financial condition because of the resulting prejudice to reputation and required capital and operational expenditures. The company could also be fined for breaches of statutory requirements or regulations, or held liable for human exposure to hazardous substances in its water supplies or other environmental damage, which may also adversely affect the company's business, operational performance, profitability or financial condition.

Such operational costs may be partly recoverable through regulation mechanisms or future periodic reviews but, in the event that such recovery is not possible, such costs could be significant and could have an adverse effect on the company's business, operational performance, profitability or financial condition. The company maintains insurance policies in relation to legal liabilities likely to be associated with these risks. However, all the costs of any such liabilities may not be covered by insurance and insurance coverage may not continue to be available in the future. In addition, contamination of supplies could exacerbate water shortages, giving rise to the issues described above.

Catastrophe risk

Catastrophic events such as dam bursts, fires, earthquakes, floods, droughts, terrorist attacks, diseases, plant failure or other similar events could result in personal injury, loss of life, pollution or environmental damage, severe damage to or destruction of the company's operational assets. Subject to a possible IDOK under the Shipwreck Clause in the Instrument of Appointment, any costs resulting from suspension of operations of the company could have an adverse effect on the ability of the company to meet its financing obligations.

Although the company is required to maintain insurance against all risks which are required to be insured against under any applicable law or regulation and any additional risks which a prudent owner would insure against, provided an appropriate insurance is available on commercially reasonable terms, the proceeds from such insurance may not be adequate to cover reduced revenues, increased expenses or other losses or liabilities arising from the occurrence of any of the events described above. Moreover, there can be no assurance that such insurance coverage will be available for some or all of these risks in the future at commercially reasonable rates or at all. Any such catastrophic event could therefore have materially adverse consequences for the company's business.

Security risks

Security of supply

A large part of the water business operates in some of the driest and water stressed regions in the country. Combined with the growth of house building in the company's operating regions, these factors place pressures on the supply and demand balance, heightening the risk of having insufficient water to supply customers.

The company has a number of operational measures to address this risk. In addition the company actively promotes water efficiency amongst its customers, and has an active drought management plan to address risk of supply shortage.

Threats of terrorism

Acts of terrorism that threaten the company's operational sites, offices, mains infrastructure and water supply would severely disrupt business and operations.

Environmental risks

Environmental risk

The company's water supply operations are subject to a significant number of European Union and domestic laws and regulations concerning, among other factors, the quality of treated water supplied, the protection of the environment and human health. The company and other regulated companies can incur significant costs in order to comply with such requirements imposed under existing or future environmental laws and regulations. Where such costs were not considered as part of a periodic review, in certain limited circumstances, the company may apply for an interim determination. With the frequency of legislative changes, it is not always certain how future environmental laws will impact the company and its financial condition.

The environmental legislation governing the company's business means that the company is at risk of enforcement action, prosecution, substantial fines to third parties, requirements to deal with the effects of contamination and/or upgrade plant and equipment, in the event of incidents such as a breach of water quality standards. This could materially and adversely affect the company's reputation and/or financial position.

Water quality risk

The company is required to provide potable water of the highest standard compliant with relevant legislation (including the Water Framework Directive).

Failure to provide an uninterrupted water supply fit for consumption could result in significant public health issues, environmental damage, loss of reputation and fines.

Climate change risk

Climate change will directly impact the water industry. The company's draft Water Resources Management Plan makes provision for the anticipated effect of climate change on the availability of water resources over a 25-year period and the company has reported to the Secretary of State how it is adapting to climate change.

Health and safety risk

The risk to the company is that the health and safety of employees is adversely impacted through performance of their duties. The risk ranges from an injury resulting in the loss of working days to an incident leading to compensation payments for negligence. The company has a dedicated health and safety team who work towards identifying and mitigating these risks.

> "The company is required to deliver mandatory capital investment requirements generating an ongoing need for financing"

Financial risks

Financial instruments

The company's financial instruments comprise borrowings, debentures, cash and liquid resources, and various items, such as trade debtors and trade creditors that arise directly from operations. The main purpose of these financial instruments is to raise finance for the company's operations. It is the company's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks. These policies have remained unchanged during the period.

The company finances its operations through a mixture of retained profits, borrowings from its subsidiary company, borrowings from its parent company and debentures. Treasury policies are agreed in conjunction with the wider Affinity Water group (including liquidity and interest rate risks). The company does not undertake speculative transactions. Interest rate exposure is primarily managed by using a mixture of fixed and floating rate borrowings. The company has access to a further undrawn borrowing facility of £100m with a tenure of five years from 28 June 2012. This facility consists of a £70m capital expenditure facility and a £30m working capital facility.

For further details on financial instruments refer to note 26 of the financial statements.

High leverage

As at the date of these financial statements, the company's indebtedness is substantial in relation to its RCV. Under the external financing agreements, the company is entitled to increase its leverage to 90 per cent. However, a percentage exceeding 85 per cent for the company will result in a restriction on certain payments, such as dividends. The ability of the company to improve its operating performance and financial results will depend upon economic, financial, regulatory and other factors, including fluctuations in interest rates and general economic conditions in the United Kingdom.

The company is subject to a number of covenants in relation to its borrowings, which would result in its loans becoming immediately repayable if breached. These covenants specify certain limits in terms of key ratios such as net cash flow to debt interest and net debt to regulatory capital value. At the year end the group was not in breach of any financial covenants.

Hedging risks

The company is required to manage its exposure to interest rate and currency risks and may manage its inflation exposure and to that effect, will (and in the case of inflation risks, may) be required to enter into hedging transactions in accordance with the hedging policy. Any hedging agreement and the related hedging transactions may be terminated early, including as a result of a default by or insolvency of a hedging counterparty. The company will be required to maintain its total outstanding liability profile so that at all times at least 85 per cent of its total outstanding liability profile is not exposed to interest rate volatility for the current periodic review period to the next periodic review and at least 75 per cent of its total outstanding liability profile is not so exposed in the next periodic review period. In the event that any hedging agreement and the related hedging transactions entered into by the company are terminated early and is unable to find a replacement hedging counterparty, the company may be left exposed to interest rates, currency or inflation risks and, as a result, the funds available may be insufficient to meet the obligations of its subsidiaries under the external financing arrangements.

Financial liquidity risk

The company is required to deliver mandatory capital investment requirements generating an ongoing need for financing. The company is subject to variability of cash flow due to the billing cycle and the uncertainty of timing of customer payments. Disclosure on the management of liquidity risk is included in note 26 of the financial statements.

Financial credit risk

The company's main credit risk is in relation to trade debtors. There is a statutory requirement to provide a water supply to domestic water customers with no rights to terminate the service in the event of non payment. This risk is spread over a large number of low value customer accounts. The company ensures that sufficient resources are allocated to credit management to reduce the impact of this risk.

Richard Bienfait
Chief Executive Officer

10 July 2013

Directors' report

Introduction

The directors present their annual report and the audited statutory financial statements for the year ended 31 March 2013.

The name of the company was changed from Veolia Water Central Limited to Affinity Water Limited on 1 October 2012.

The Chief Executive's business review on pages 8 to 25 provides detailed information relating to the company, its strategy, the operation of its business and its results and financial position for the year ended 31 March 2013. Details of the risks and principal uncertainties facing the company are also set out on pages 18 to 25. All of the above are incorporated by reference in, and are deemed part of, this report.

Principal activity

The company supplies 900 million litres of water each day to a population of more than 3.5 million people. The company operates in an area of approximately 4,515km^2 split into three regions in the south east of England (which represent the three regions in which it operated as separate entities prior to the unification of these businesses on 27 July 2012, as set out in the section on significant events occurring during the year below): Southeast (412km^2) (the Southeast region), Central (3,721km^2) (the Central region) and East (382km^2) (the East region). The Central region covers North London and the Home Counties both North and West of the capital including key urban centres such as Luton, Harlow, Stevenage, Watford and Woking. The Southeast region includes the urban centres of Folkestone and Dover and the East region includes the urban centre of Clacton. All three regions are determined by the Secretary of State for the Environment to be areas of serious water stress with current or future household demand for water being or likely to be a high proportion of effective rainfall available to meet current or future demand. Consequently, the company has invested and continues to invest considerable resources in maintaining its water resources and managing demand to seek to ensure demand and supply remain in balance.

Significant events during the year

Change in ownership

On 6 December 2011, the company's then ultimate parent company and controlling party, Veolia Environnement S.A., announced its intention to sell its regulated water interests in the United Kingdom. On 28 June 2012, the majority shareholding in the group of companies, of which Affinity Water Limited (formerly Veolia Water Central Limited) was a wholly owned subsidiary, and of which Affinity Water Capital Funds Limited (formerly Veolia Water Capital Funds Limited) was the ultimate parent undertaking, was sold by Veolia Water UK Limited (formerly Veolia Water UK Plc) to Affinity Water Acquisitions Limited (formerly Rift Acquisitions Limited), an acquisition entity formed by Infracapital Partners II, the infrastructure investment fund managed by M&G (the European Investment arm of Prudential Plc), and Morgan Stanley Infrastructure Partners. Veolia Environnement S.A. has retained a 10 per cent minority shareholding through its subsidiary Veolia Water UK Limited. This acquisition was primarily funded by external bank debt of £552.1m. Further details on the company's ownership structure has been included on pages 34 and 35.

Refinancing

The company has since refinanced the acquisition debt by way of a securitisation of Affinity Water Limited. The refinancing was achieved by reorganising the group to create the desired securitisation structure and the existing debt was repaid using the proceeds of bonds issued. As a part of the refinancing, the company was financially and operationally "ring-fenced" from the rest of the group. This was effected by the transfer of the equity of the company from Affinity Water Capital Funds Limited to a newly created holding company, Affinity Water Holdings Limited. The principal business of Affinity Water Holdings Limited is holding the shares of Affinity Water Limited and it is a wholly owned subsidiary of Affinity Water Capital Funds Limited. Affinity Water Limited also incorporated Affinity Water Programme Finance Limited as a special purpose vehicle for the purpose of issuing asset backed securities. The external bonds were issued on 4 February 2013. The company believes that the ring-fencing structure will provide significant benefits, providing better access to long-term debt markets and an opportunity to reduce the cost of capital employed in the regulated business.

Affinity Water Programme Finance Limited is incorporated in the Cayman Islands and resident in the United Kingdom for tax purposes. This was necessary because restrictions under the Companies Act 2006 relating to the provision of financial assistance prevented the use of a company registered in the United Kingdom to raise financing that would, in part, be used to discharge financing put in place to make the acquisition.

Drought

During the two consecutive autumn and winter periods from 2010 to 2012 there was below average rainfall in the area supplied by the company, resulting in very low groundwater recharge (two-thirds of the company's resources are groundwater). During the previous financial year the company's groundwater declined to the level classed as severe drought. The company responded as required by its drought management plan, which sets out the measures the company needed to take to manage water supplies, depending on the severity of the drought conditions. As a result, a temporary use ban was introduced on 5 April 2012 along with six other water companies in the South East of England. The company stepped up publicity about drought and water efficiency measures to increase awareness amongst customers and encouraged them to use water carefully. Over the summer months the company made greater use of surface water sources in order to alleviate the environmental effects of its groundwater abstraction on chalk rivers and streams in the company's area. Together with the increased rainfall that followed, this resulted in the temporary use ban being lifted on 9 July 2012.

Unification

Following discussions with Ofwat during 2011, the company made a formal application to Ofwat on 23 February 2012 to unify the licences of the formerly named companies Veolia Water Central Limited, Veolia Water East Limited and Veolia Water Southeast Limited so as to operate the three areas under a single licence. Approval was received from Ofwat following a period of formal public consultation. The unification of the regulated businesses was effected on 27 July 2012. Affinity Water Limited borrowed £131.2m from Affinity Water Capital Funds Limited to fund the acquisition of the net assets of the East and Southeast regions on that date.

As part of the unification the licence conditions of the company were updated. This included updating provisions to reflect the combined 2013/14 and 2014/15 price limits, to prevent differing service levels for customers in the regions served by the company, to ensure separate information continues to be held for the three supply areas for comparative purposes, to maintain an investment grade issuer credit rating, and to clarify the fees position. In addition, the ring-fencing provisions were updated to bring them in line with Ofwat's current standard. These changes were made with effect from 27 July 2012.

A cash lock-up provision was also introduced which prohibits, subject to certain limited exceptions, the transferring, leasing, licensing or lending of any sum of cash or other assets to an associated company when the company no longer holds an investment grade rating or has not maintained the required investment grade rating.

Olympics

During the year, London hosted the Olympic and Paralympic Games, which included events taking place in the company's regions of water supply. The company mobilised a number of teams across the business in order to ensure that effective plans were in place in the eventuality of significant bursts or interruptions to supply that would impact the venues, increased population or travel routes. There were no issues of this nature experienced.

Directors' report – continued

Rebranding

As a part of the rebranding of the whole retained group post divestment from Veolia Water UK Limited, the name of the company changed to Affinity Water Limited on 1 October 2012.

Proposed changes to future price controls

In November 2011, Ofwat published 'Future price limits – a consultation on the framework', ('Future Price Limits') a consultation on how Ofwat might set price limits that come into effect from 2015. Following the consultation, Ofwat set out its high-level framework for setting price limits from 2015 and beyond in the 'Future Price Limits – statement of principles' ('FPL Principles') in May 2012. The proposals set out include moves to:

- **split price controls for retail and wholesale, rather than using a single price control;**
- **regulate outcomes with appropriate measures of success and incentives, rather than outputs; and**
- **use a total expenditure ('totex') approach for cost assessment, cost recovery and incentives, rather than maintaining the current distinction between capex and opex.**

The impacts of these changes are uncertain as Ofwat has not yet defined its regulatory policies and methodology. The proposed changes could have a material impact on the company's business and cash flows.

Following the publication of Future Price Limits, Ofwat issued Section 13 Notices in both December 2011 and October 2012, each of which set out proposed modifications to each water company's licence which would allow Ofwat significantly more flexibility in how it sets price limits in the future.

The company responded to each Section 13 Notice stating that it was unable to accept the proposals made but was broadly in favour of the separation of the 'retail' and 'wholesale' price limits. In the company's response to the October 2012 Section 13 Notice, it stated that it was prepared to accept alternative licence modifications which would allow Ofwat to set separate retail and wholesale price controls from 1 April 2015 and conveyed its willingness to engage in further discussions with Ofwat.

Following a period of consultation with undertakers, Ofwat issued a third Section 13 Notice on 21 December 2012, which proposed modifications to each water company's licence but limited the flexibility sought by Ofwat as to the number, form and length of controls to 'retail' controls. On 16 January 2013, the company notified Ofwat that it accepted the licence modification proposed in the December 2012 Section 13 Notice.

Pensions

On 27 June 2012, in accordance with the terms of the sale of the Affinity Water Capital Funds Limited group by Veolia Water UK Limited, an exceptional deficit repair contribution amounting to £14.0m was made into the Veolia UK Pension Plan (the 'VUKPP'), in which the company participated at that time.

The new Affinity Water Pension Plan was established in February 2013, set up as an identical scheme to the VUKPP, the scheme in which the company participated until 28 March 2013. The benefits of employees and former employees of the company, and its predecessor companies, were transferred into the Affinity Water Pension Plan with effect from 28 March 2013.

The VUKPP was a multiemployer sectionalised pension plan with defined benefits and defined contribution sections. The defined benefit section was closed to new entrants in 2004 since which new members have only been eligible to join the defined contribution section.

Results, financial performance and dividends

Profit on ordinary activities after tax for the year was £43,495,000 (2012: £35,889,000).

The balance sheet detailed on page 55 shows shareholder's funds amounting to £341,743,000 (2012: £350,965,000).

The directors have declared and paid the following ordinary dividends during the year ended 31 March 2013:

	£000
Interim – paid June 2012	16,291
Interim – February 2013 (repayment of intercompany debt)	137,164
	153,455

This compares to an interim dividend of £32,582,000 declared and paid in December 2011.

No final dividend is proposed (2012: £nil).

Directors

The directors of the company, together with their periods of office and their biographical details, are shown on pages 36 and 37.

Market environment

Competition in the water industry

Each regulated company effectively holds a geographic monopoly within its appointed area for the provision of water services or water and sewerage services although there is some limited competition. Ofwat has stated that it will use its powers under the Competition Act to investigate and prohibit anticompetitive practices and abuses of a dominant position to ensure a level playing field in the industry.

The current main methods for introducing competition are:

a. inset appointments which allow one company to replace another as the statutory undertaker for water or sewerage services in a specified geographical area within the other regulated company's appointed territory. An inset appointment can be granted to a company seeking to provide water and/or sewerage services on an unserved site, or in respect of a site with water and/or sewerage services within an existing regulated company's area where 50 megalitres of water are supplied or likely to be supplied to particular premises in any 12 month period or where the incumbent regulated company consents to the variation. The inset mechanism continues alongside the regime for licensing new entrants under the Water Act;

b. facilitating developers, or their contractors, to provide new water mains and service pipes instead of asking regulated companies to do the work ('self-lay'). The Water Act introduced a statutory framework for self-lay;

c. water supply licence (retail) – when a holder of a water supply licence purchases wholesale supplies of water from the existing water undertaker and supplies water to a customer's eligible premises (i.e. using more than five megalitres per annum). Regulated companies have published indicative access prices, based on the "cost principle" which indicate the approximate scale of discount they would offer to licensees;

d. water supply licence (combined) – when a holder of a water supply licence introduces water into the supply system and supplies water to its customer's eligible premises using a regulated company's network (referred to as 'common carriage'). All regulated companies maintain access codes which set out the conditions under which licensees may introduce water into their networks; and

e. cross-border supplies (raw/treated water) where a customer in an area adjacent to a neighbouring regulated company's territory can connect to another regulated company's network and receive a supply.

Directors' report – continued

Research and development activities

The development and application of new techniques and technology is an important part of the company's activities.

Charitable and political contributions

The charitable contributions made by the company during the year amounted to £600,515 (2012: £605,659), largely to water-related and local organisations which aim to:

- **improve opportunities and create worthwhile experiences for the disadvantaged**
- **improve the quality of life of senior citizens and the vulnerable within the community**
- **educate young people about water and sustainability issues**
- **assist customers who have serious financial difficulties in paying their water bills.**

During the year £569,500 has been paid to the Affinity Water Trust. This trust seeks to assist customers whom it deems need help with their water debts. The company has committed to donate £2.6m to the Trust in the five years to March 2014.

The company has a policy of not making political contributions.

Creditor payment policy

The company's policy is to negotiate the terms of payment with suppliers when agreeing terms of business and to pay in accordance with contractual and other legal obligations. The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services. The average number of creditor days is 49 (2012: 47).

The company's people, community and environment

The company consults and informs its employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings and the intranet. The company constantly discusses ways to enhance and improve its communications and consultation channels with its Trade Unions. Several initiatives have also been introduced with the aim of improving the health and well-being of the company's employees.

The company aims to ensure that each employee or applicant for employment receives the same treatment irrespective of race, gender, disability, sexual orientation, religious beliefs, creed, marital or parental status. This extends through all company policies including recruitment where the candidate's particular aptitudes and abilities are consistent with the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Employees who become disabled whilst employed by the company are actively encouraged to find appropriate employment within the business.

The company continued to increase employee awareness of safety and health issues. The total number of accidents across the unified business including the shared services company fell from 85 in 2011/12 to 77 in 2012/13. On the same basis the overall number of accidents resulting in more than three days' lost time fell from 12 in 2011/12 to 8 in 2012/13. The company continues to provide, and where possible improve, employee health and safety training associated with their operational role.

The health and safety of staff is paramount. Staff are trained and continually urged to work safely. Following a comprehensive review of the company's health and safety performance, the culture has changed to one of "zero harm". The company can only be successful if everything is achieved without harm to the company's people, the environment or property.

The health and safety of the public who may be affected by the company's operations is of equal importance. In addition to training, the company's staff is continually reminded of the need to work safely within the community. The company also works closely with the police, local authorities, crime prevention groups and the media to tackle the nuisance caused by bogus callers.

The company is committed to creating a learning environment where its employees are able to release their potential and be the best they can be. The company provides training and development to ensure its people are able to successfully fulfil their roles and the emphasis for the last 12 months has been on the provision of core technical and health and safety training which has also coincided with a review of external training providers and an improvement in quality of training overall. Opportunities have also been explored to increase the amount of training delivered in-house, and team leader training and toolkits will be developed during 2013/14.

Between April 2012 and March 2013, the company spent over £150,000 across its businesses. The company's investment in training and development doesn't stop there as learning is also encouraged through vocational learning such as National Vocational Qualifications, and its graduate and apprenticeship schemes, which have structured learning and development programmes to support them, have been further reviewed and developed.

For the fourth year in succession all employees received an annual bonus aligned to the company's performance. The company continues to operate a company-wide flexible working scheme, which aims to meet the changing demands of its employees.

As a responsible business the company is committed to managing its impact on the environment. The company is focusing its efforts on reducing the amount of energy consumed, reducing, reusing or recycling resources, reducing the amount of waste going to landfill and maintaining improvements in fuel consumption.

The company's Education Centre, located in South Watford, has communicated water efficiency and wider sustainability messages to over 177,000 adults and schoolchildren since it was founded in 1998. It welcomes in the region of 200 schools to its classroom and outdoor facilities at Bushey each year, with visiting children numbers reaching almost 6,000 for 2012/13. The company visited around 30 schools in its supply area as part of the outreach programme. The educational activities help to raise awareness of the environment and the need to save water with these children.

The company is a responsible local business which cares about the community and continues to support environmental projects within the regions it serves. In order to assist in the company's vision to be the leading community-focused water company, a full review has been conducted of community engagement over the past year, with a view to increasing the benefit offered by supporting organisations and charities in the future. Following this review, a new Community Engagement Programme will be launched in July 2013 with the aim of providing maximum benefit and increased engagement by the company in the community, through the use of company assets, donations, employee time and expertise.

A monthly 'Time to Give Friday' is an on-going initiative to encourage staff to collect money for local charities, which is match funded by the company. In 2012/13 charities received a total of £13,876. Affinity Water is a strong supporter of WaterAid, the water industry's flagship charity, which aims to help in providing safe, clean water and sanitation to the world's poorest people.

The company established an independent charity. The Affinity Water Trust at the end of March 2009. The company has made contributions to the trust annually as outlined in the section on charitable and political contributions.

"The company continued to increase employee awareness of safety and health issues"

Directors' report – continued

Post balance sheet events

On 1 April 2013, the company entered into a Business Transfer Agreement with Affinity Water Shared Services Limited. The fixed assets and stock were purchased from Affinity Water Shared Services Limited for a value of £1.9m with the remaining assets due to be transferred at book value during the year.

Going concern

The company has adequate resources to meet its current operational and financial obligations, and the directors have a reasonable expectation that this will continue for the foreseeable future. This assessment is based on the consideration of the company's budgeted cash flows, long term forecasts and related assumptions, and available debt facilities. For this reason, the directors continue to adopt the going concern basis in the statutory financial statements.

Directors' qualifying third party indemnity provisions

The company has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in Section 234 of the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- **select suitable accounting policies and then apply them consistently**
- **make judgements and accounting estimates that are reasonable and prudent**
- **state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements**
- **prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, and**
- **be responsible for the maintenance and integrity of the website on which the financial statements have been published.**

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions, disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of information to auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the company's auditor, each director has taken all the steps that he or she is obliged to take as a director in order to make himself or herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

In accordance with Section 485 of the Companies Act 2006, Ernst and Young LLP are not seeking reappointment and a resolution to appoint the auditors, PricewaterhouseCoopers LLP, will be proposed at the annual general meeting.

By order of the Board

Tim Monod
Company Secretary

10 July 2013

> "As a responsible business the company is committed to managing its impact on the environment"

Ownership and corporate governance

Ownership

Introduction

The company recognises the importance of transparency with respect to its ownership and governance arrangements in order to maintain trust and legitimacy with its customers, regulators and other stakeholders. To this end, the sections that follow explain the ownership of the company, the structure of the group in which it operates and the governance arrangements that are in place. The year ended 31 March 2013 has seen significant change in ownership and the governance arrangements of the company and it is anticipated that governance arrangements will be further refined over the course of the next 12 months.

The effective equity interest in the company is as follows:

Infracapital Partners II	40%
Morgan Stanley Infrastructure Partners	40%
Beryl Datura Investment Limited	10%
Veolia Water UK Limited	10%

Infracapital Partners II

Infracapital Partners II has made its investment in the company through Infracapital F2 Rift S.à.r.l., which is a wholly owned subsidiary of Infracapital F2 Rift Holdings S.à.r.l. Both Infracapital F2 Rift S.à.r.l. and Infracapital F2 Rift Holdings S.à.r.l. are incorporated in Luxembourg.

Infracapital Partners II is one of a number of European infrastructure funds managed by M&G Investment Management Limited, a subsidiary of Prudential Plc. It was established in 2010 to make investments in income-generative infrastructure assets and businesses, including electricity and gas networks, water companies, transport infrastructure and renewable energy.

Morgan Stanley Infrastructure Partners

Morgan Stanley Infrastructure Partners has made its investment in the company indirectly through MSIP Dalis B.V. MSIP Dalis B.V. is incorporated in the Netherlands.

Morgan Stanley Infrastructure Partners is a global infrastructure investment fund managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. It was established in 2007 to make investments in core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management.

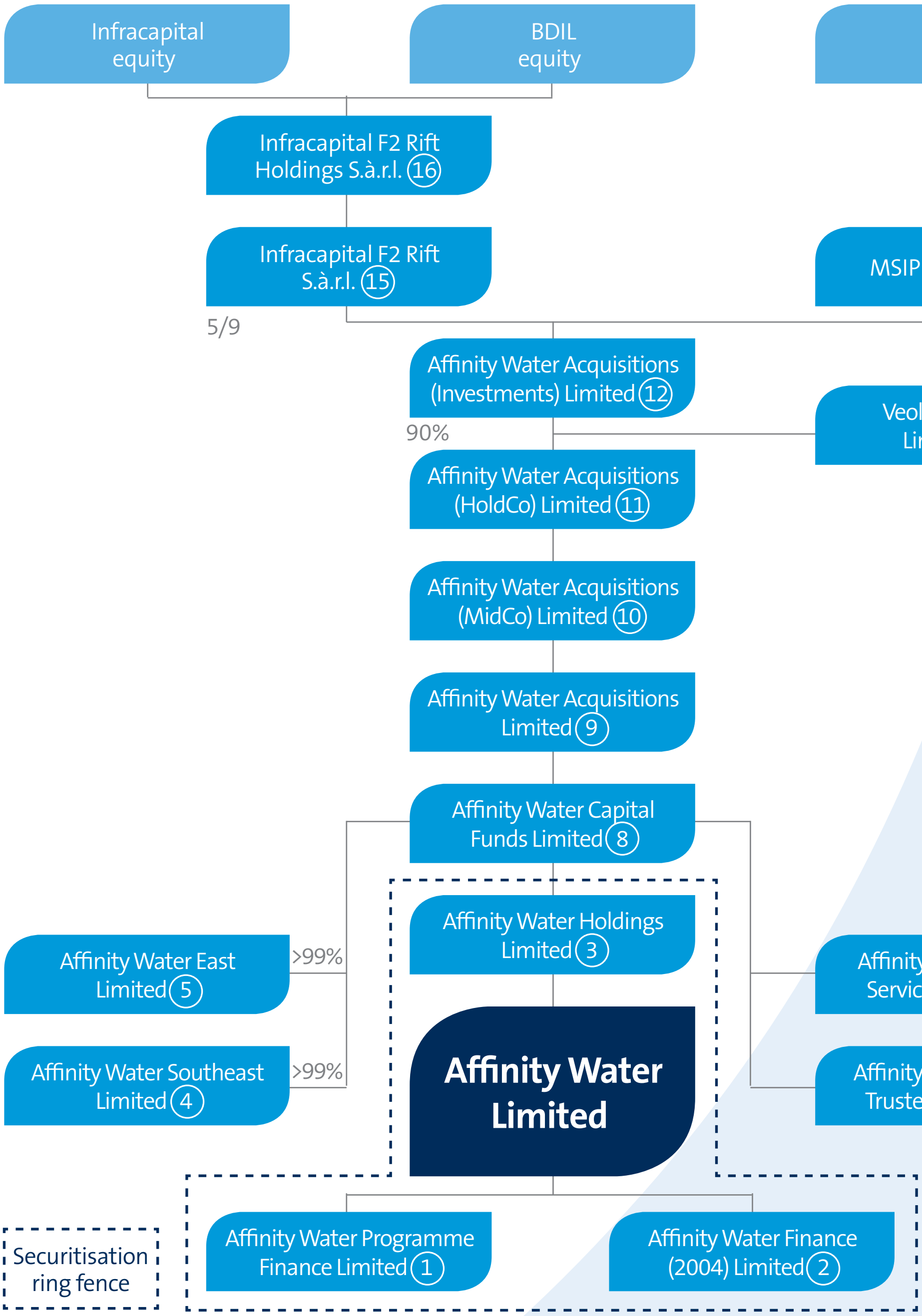
Beryl Datura Investment Limited

Beryl Datura Investment Limited has made its investment in the company through Infracapital F2 Rift Holdings S.à.r.l. It is a company established by the State Administration of Foreign Exchange of the People's Republic of China. It is managed by Gingko Tree Investments Limited which focuses on investments in real assets such as infrastructure and real estate and is attracted to relatively stable, predictable, long-term investments.

Veolia Water UK Limited

Veolia Water UK Limited is incorporated in England and Wales and is a subsidiary of Veolia Environnement S.A. which is listed on the Paris and New York Stock Exchanges. It has made its investment in the company through its shareholding in Affinity Water Acquisitions (HoldCo) Limited and has established with the company a capability sharing arrangement. This arrangement gives it access to the company's knowhow, experience and expertise while the company has access to Veolia Water's advice on global water technologies and developments.

The chart opposite shows the ownership of the company and the group structure, excluding dormant subsidiaries. Unless otherwise indicated, all companies are wholly owned by the parent company shown. The numbers indicated alongside a company can be cross-referenced to the directors' biographies on pages 36 and 37 to indicate relevant cross-directorships within the group.



The company has two wholly owned financing subsidiaries: Affinity Water Finance (2004) Limited and Affinity Water Programme Finance Limited. The latter is incorporated in the Cayman Islands and resident in the United Kingdom for tax purposes. This was necessary because restrictions under the Companies Act 2006 relating to the provision of financial assistance prevented the use of a company registered in the United Kingdom to raise financing that would, in part, be used to discharge financing put in place to make the acquisition.

Ownership and corporate governance – continued

Board of Directors

Chairman

Dr Philip Nolan (appointed 1 April 2013)

12

Philip Nolan was appointed executive Chairman on 1 April 2013 and is also Chairman of Affinity Water Acquisitions (Investments) Limited. He is Chairman of John Laing Plc, a specialist investor, operator and manager of public sector infrastructure assets and Ulster Bank Limited. He was previously chief executive of Eircom, Ireland's national telecommunications supplier from 2002 to 2006. Prior to that, he served as an executive director of BG Group and chief executive of Transco from 1998 and in 2000, leading the demerger of Transco as chief executive of the Lattice Group.

Independent non-executive directors

Baroness Peta Buscombe

Baroness Buscombe was appointed director of the company in 2006 and is a member of the Regulation Committee. She is a barrister, an active member of the House of Lords and has held a number of shadow ministerial positions including responsibility for industry and enterprise, regulatory reform, the media and education. Formerly Chairman of the Press Complaints Commission, she is a member of the House of Lords European Select Committee responsible for infrastructure, employment and the Single Market, a parliamentary delegate on the Council of Europe (effective January 2013) and Chairman of the Advisory Board for the Samaritans.

Dr Jeffrey Herbert (appointed 27 July 2012)

Jeffrey Herbert was appointed director of the company in 2012 having previously been chairman of Veolia Water East Limited. He is a member of the Audit Committee. He is an industrialist who has held CEO and chairman roles for a number of large, international business in the automotive, mineral extraction and mechanical engineering sectors. His non-executive roles have included chairman/deputy chairman in the retail, aerospace, investment and water sectors. He is a Fellow of the Royal Academy of Engineering.

Fiona Woolf CBE

Fiona Woolf was appointed director of the company in 2006 and is a member of the Regulation Committee. She is a member of the Competition Commission, a partner with CMS Cameron McKenna and trustee of Raleigh International. Fiona Woolf is an Alderman of the City of London and a former president of the Law Society.

Executive directors

Richard Bienfait – Chief Executive Officer

1 2 3 4 5 6 7 8

Richard Bienfait is Chief Executive Officer and was appointed Managing Director of the company in March 2010. He began his career at Veolia Water in 1997 as Group Financial Controller and joined the Board of Veolia Water UK and became Chief Financial Officer in 2004. He is a member of the Institute of Chartered Accountants and an associate member of the Association of Corporate Treasurers.

Duncan Bates – Chief Financial Officer (appointed 20 September 2012)

1 2 3 4 5 7

Duncan Bates is Chief Financial Officer of Affinity Water Limited, having joined the company in March 2012 and appointed to the Board in September of that year. He began his career in Veolia in 1992 and held a number of financial posts until his appointment as Veolia Environnement UK's Group Financial Controller in 1999. In 2007, he became Finance Director of Veolia Water's non regulated business, a post he held until joining Affinity Water. He is a Fellow of the Chartered Institute of Management Accountants.

Non-executive directors

Antonio Botija

8 9 10 11 12 15 16

Antonio Botija was appointed director on 25 July 2012. He joined Infracapital in 2009 as an Associate Director and is responsible for investment origination and execution. Prior to joining Infracapital, Antonio worked as Associate Director at the Infrastructure and Transport Group of UBS Investment Bank in London, where he was a financial advisor on infrastructure projects and transactions across many sectors including roads, railroads, airports, ports and airlines.

Kenton Bradbury

1 2 3 7 8 9 10 11 12

Kenton Bradbury was appointed a director on 25 July 2012 and is chairman of the Audit Committee and a member of both the Remuneration Committee and Nomination Committee. He is a Director of Infracapital and a number of companies in which Infracapital has invested including companies within the Zephyr Investments, Calvin Capital, Associated British Ports, Red Funnel Ferries and Infracapital Solar groups of companies. Prior to joining Infracapital, he was Senior Vice President of Infrastructure and Regulation for E.ON based in Germany.

Andrew Dench

1 2 3 7 8 9 10 11 13

Andrew Dench was appointed a director on 25 July 2012. He is Chief Financial Officer and Deputy Chief Executive Officer of Veolia Water UK Limited, Ireland and Northern Europe having joined the business in June 2010. He holds a number of directorships of companies within the Veolia Water group and previously spent more than 15 years working in corporate finance advisory with Morgan Stanley, and more latterly, with Credit Suisse.

Yacine Saidji

1 2 3 8 9 10 11 12

Yacine Saidji was appointed a director on 25 July 2012. He is a Vice President at Morgan Stanley Infrastructure focusing on European investing and holds directorships in the Madrileña Red de Gas group of companies. Prior to joining Morgan Stanley in 2006, he spent three years at McKinsey & Company advising clients in the energy sector.

James Wilmott

8 9 10 11 12

Jim Wilmott was appointed a director on 25 July 2012 and is a member of the Remuneration Committee and Nomination Committee. He is a Managing Director and Head of Europe of Morgan Stanley Infrastructure and is a director of European Rail Finance (GB) Limited, the Eversholt Rail Group and a number of companies affiliated with Morgan Stanley.

Former directors

Olivier Bret

Olivier Bret is Chief Executive Officer of Veolia Water UK. He served as a non-executive director and chairman of the company between 25 January 2012 and 27 June 2012.

Alberto Donzelli

Alberto Donzelli is an executive director at Morgan Stanley Infrastructure. He served as a non-executive director between 25 July 2012 and 27 June 2013.

Philippe Guitard

Philippe Guitard is Executive Vice President Europe of Veolia Water S.A.. He served as a non-executive director of the company between 7 July 2008 and 27 June 2012.

Olivier Grunberg

Olivier Grunberg was General Secretary of Veolia Transdev. He served as a non-executive director of the company between 7 July 2008 and 27 June 2012.

Deven Karnik

Deven Karnik was a managing director of Morgan Stanley. He served as a non-executive director of the company between 25 July 2012 and 8 March 2013.

Mathieu Lief

Mathieu Lief joined as a director of Infracapital. He served as a non-executive director of the company between 25 July 2012 and 22 April 2013.

Bernd Schumacher

Bernd Schumacher is an associate director at Infracapital. He served as a non-executive director between 25 July 2012 and 27 June 2013.

Dr Neil Summerton CB

Neil Summerton served as an independent non-executive director of the company between 1 October 2000 and 20 August 2012.

Ownership and corporate governance – continued

Corporate governance report

Introduction

As required by its Instrument of Appointment, the company is governed having regard to the principles of good governance set out in the UK Corporate Governance Code (June 2010). The following is a summary of how the company applies the principles of the UK Corporate Governance Code in practice in the context of its status as a portfolio company owned by a combination of private equity and private investors. The company has regard to the Guidelines for Disclosure and Transparency in Private Equity (the Walker Guidelines) and the work of the Guidelines Monitoring Group, established to monitor conformity with the Walker Guidelines and to keep them under review.

The new ownership arrangements implemented during the year have resulted in significant changes to the governance of the business and a renewed emphasis on maintaining the highest standards of governance. The Board considers that the company complies with all of the principles of the UK Corporate Governance Code and the Walker Guidelines that recommend greater shareholder involvement in governance. The Board keeps governance matters under review and where improvements are identified, implements them. Details of the improvements that have been made and are planned are set out below, together with an explanation of the small number of Code provisions which are not fully met.

Leadership

The company is managed by its Board of Directors comprising an executive chairman, three independent non-executive directors, two executive directors and five non-executive directors. The Board considers Baroness Buscombe, Jeffrey Herbert and Fiona Woolf to be independent. The senior independent non-executive director, Dr Neil Summerton, stepped down from the Board on 20 August 2012 and a replacement appointment will be made in due course.

The composition of the Board does not meet the Code provision in that at least half the Board, excluding the chairman, should be non-executive directors determined by the Board to be independent. However, the composition is such that no single director or group of directors can dominate the Board's decision taking because:

- **no investor has a majority of voting rights and none of the directors appointed by investors is individually able to veto Board decisions; and**
- **there is no arrangement between investors as to how to vote on certain matters; directors representing an investor act independently of those appointed by the other investors.**

The Board is led by the Chairman, Dr Philip Nolan, who was appointed on 1 April 2013. He succeeds Olivier Bret, Chief Executive Officer of Veolia Water UK, who stood down from the role on 27 June 2012. As executive Chairman, Dr Nolan is not considered by the Board to be independent. The roles of Chairman and Chief Executive Officer are separated, set out in writing and agreed by the Board. The chairman meets the non-executive directors without executives present. His performance will be appraised during the year by the non-executive directors.

Richard Bienfait, as Chief Executive Officer, is responsible to the Board for managing the business from day to day in an efficient, economical and effective manner. He is responsible for implementing Board decisions and for those matters delegated to him by the Board.

Directors do not vote on (nor are counted in a quorum for) any resolution relating to a proposed or existing contract or arrangement or any other proposal in which they have an interest by virtue of other directorships. Where potential conflict exists between the interests of the company as a water undertaker and those of other companies in the group, each director has regard exclusively to the interests of the company as a water undertaker. These arrangements are reflected in the company's Articles of Association. All decisions relating to the company are taken by the Board; there are no matters that the Board has reserved for the decision of its shareholders.

The company's Articles of Association require that at each annual general meeting, any director who:

- **has been appointed by the Board since the last annual general meeting;**
- **held office at the time of the two preceding annual general meetings and who did not retire at either of them; or**
- **has held office with the company, other than employment or executive office, for a continuous period of nine years or more at the date of the meeting,**

must retire from office and may seek re-appointment by the company's shareholder. At this year's annual general meeting, all directors other than Richard Bienfait, Baroness Buscombe and Fiona Woolf will be required to retire from office and may seek re-election.

The Board's role is to lead and control the company and to set corporate strategy, objectives and major plans bearing on the success of the business. The Board is responsible for ensuring that the company has competent, prudent and effective executive management and that all necessary management systems and processes are in place and are working effectively. It also brings judgement to bear on issues of performance, resources and standards of conduct.

Since the acquisition, the Board has met monthly and reserves to itself the approval of certain key matters such as strategy and management, changes to the company's structure and capital, annual capital and operating budgets, financial statements, declaration of interim dividends and key regulatory submissions, reports and plans. It also approves key policies relating to safety, health and the environment, corporate responsibility and ethical conduct, risk management and business continuity crisis planning.

During the year, the Board reviewed the structure of its committees. It established a Nomination Committee and Regulation Committee which operate in accordance with terms of reference approved by the Board. It also adopted revised terms of reference for the Audit Committee and Remuneration Committee. Each committee is able to take independent advice on any matters being considered. The terms of reference of each committee are reviewed periodically and it is planned to publish them on the company's website following further review. Membership of each committee is shown on page 5. Appointment letters for non-executive directors setting out any specific responsibilities are being put in place.

Currently, the composition of the Audit Committee, Nomination Committee and Remuneration Committee does not meet relevant Code provisions:

- **that the Audit Committee is chaired by an independent non-executive director with recent and relevant financial experience;**
- **for the Audit Committee and the Remuneration Committee each to comprise at least three independent non-executive directors; and**
- **for a majority of the members of the Nomination Committee to be independent non-executive directors.**

The current arrangements reflect the needs of the business post acquisition and are subject to on-going review. It is planned for two independent non-executive directors to sit on the Remuneration Committee and the Nomination Committee, both chaired by the Chairman of the company. The Chairman is currently an executive chairman and therefore not independent. It is further planned for three independent non-executive directors to sit on the Audit Committee. It is anticipated that the Board will be further strengthened during the coming months ensuring there is a depth of skills across a number of areas and that the specific responsibilities of the independent non-executive directors are fully captured in appointment letters. Consideration will also be given to the appointment of a senior independent non-executive director, with particular responsibility for governance matters.

Ownership and corporate governance – continued

The Regulation Committee has been established to support the Board in discharging its responsibilities with respect to the oversight, scrutiny and challenge of key regulatory submissions to regulators and the monitoring of regulatory performance against regulatory, financial and operating targets. It meets monthly and its membership includes the executive directors, two independent non-executive directors, other non-executive directors and members of the senior executive team.

The table below sets out attendance at meetings for year ended 31 March 2013.

	Board	Audit Committee	Remuneration Committee	Nomination Committee	Regulation Committee
Number of meetings in period	**16**	**5**	**6**	**1**	**6**
Duncan Bates	9/10*	-	-	-	5/6
Richard Bienfait	16/16	-	-	-	6/6
Antonio Botija	4/11*	-	-	-	-
Kenton Bradbury	8/11*	3/3	5/6	1/1	6/6
Baroness Buscombe	13/16	2/2	1/1	-	5/6
Andrew Dench	6/11*	-	-	-	-
Jeffrey Herbert	10/10*	3/3	-	-	-
Yacine Saidji	11/11*	-	-	-	-
James Wilmott	11/11*	-	5/6	1/1	-
Fiona Woolf	15/16	2/2	-	-	6/6
Former directors					
Olivier Bret	4/4*	-	1/1	-	-
Alberto Donzelli	9/11*	3/3	-	-	4/6
Philippe Guitard	2/4*	-	-	-	-
Olivier Grunberg	0/4*	-	-	-	-
Dr Neil Summerton	6/6*	2/2	1/1	-	-
Deven Karnik	8/9*	-	-	-	-
Mathieu Lief	9/11*	-	-	-	4/6
Bernd Schumacher	1/11*	-	-	-	-

- denotes non-membership of that committee
* denotes not a member of the Board for the whole 12 months

Effectiveness

The Board considers that Baroness Buscombe, Jeffrey Herbert and Fiona Woolf are independent. They are of sufficient calibre and experience for their views to carry significant weight in Board decisions. Jeffrey Herbert joined the Board in July 2012, having previously served as chairman of Veolia Water East Limited. Collectively, the Board is satisfied that they have connections with, and knowledge of, the areas within which the company provides water services and an understanding of the interests of customers and how these can be respected and protected.

Certain Board members are also directors of other group companies. All directors declare their position when as individuals they have a possible conflict of interest and do not vote on any contract, arrangement or proposal in which they have an interest by virtue of other directorships. Directors have access to the advice and services of the Company Secretary and are able to obtain access to independent professional advice where they think it necessary.

Directors are expected to allocate sufficient time to the company to discharge their responsibilities effectively. In addition to formal Board and committee meetings, directors are encouraged to participate in informal briefings from management. The expected time commitment from directors is clear although this is not recorded in a letter of appointment. Arrangements are being made to put in place letters of appointment for all non-executive directors.

The Company Secretary is responsible for ensuring that the Board and its committees receive regular written reports from management of sufficient quality to enable them to discharge their duties. The Company Secretary also advises the Board on governance matters and facilitates information flows between management and the directors.

Where a director requires access to independent professional advice the Company Secretary is responsible for making appropriate arrangements. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The Board recognises that improvement is needed in the arrangements for the induction of directors following appointment and for the provision of a tailored training programme for each director. Appropriate arrangements for induction and on-going training will be developed by the Chairman and Company Secretary.

The performance of the Board and its committees is evaluated both informally and from time to time, formally by the Board. The Board has undertaken a self-assessment of its performance for the year ended 31 March 2013 and noted a number of areas for improvement including the provision of on-going training for Committee members and more formal reporting to the Board of matters such as the Committee's review of the effectiveness of the systems of internal control.

Nomination Committee

The Nomination Committee, which was established during the year, is responsible for keeping under review the structure, size and composition of the Board and the executive and non-executive leadership needs of the company. The Committee currently comprises the Chairman and two non-executive directors and will be strengthened by the appointment of two independent non-executive directors. During the year, the Committee oversaw the process to select and recommend to the Board the appointment of Dr Philip Nolan as Chairman, engaging Spencer Stuart, a specialist external unconnected search company, to help prepare a specification for the role and identify potential suitable candidates.

Ownership and corporate governance – continued

Accountability

Financial and business reporting

The Board is responsible for presenting a fair, balanced and understandable assessment of the company's position and prospects in the company's financial statements. The directors' report sets out the basis on which the company generates or preserves value over the longer term and the strategy for meeting the company's objectives.

Risk management and internal control

The Board has overall responsibility for the company's systems of internal control and for reviewing the effectiveness of these systems, including financial, operational and compliance controls and risk management, and is advised by its Audit Committee on these matters. The systems are designed to manage the risk of failure to achieve business objectives (though it cannot be completely eliminated), and provides assurance against material misstatement or loss. Particular features of the systems of risk management, planning and internal control include:

- **a comprehensive suite of internal control procedures across both operational and financial matters, supported by segregation of duty matrixes and detailed delegated levels of authority;**
- **an Internal Audit Team, the Head of which reports to the Audit Committee together with other internal control and assurance resources which monitor compliance with policies and procedures;**
- **the setting and monitoring of annual budgets at a detailed level supported by a long term plan;**
- **specialist planning teams retained within the organisation to work on major projects, such as business planning activities supported by external specialists where appropriate; and**
- **the use of considerable external assurance review, both fiscal and operational.**

The Board approves the company's annual budget and annual capital expenditure budget and regularly reviews actual performance. There is a defined organisational structure with appropriate delegation of authorities to line management and all major transactions are reviewed and approved by the Board.

A whistleblowing procedure is in place that supports the open culture that the company promotes in its dealings with members of staff and all people with whom it engages in its business activities. The procedure encourages members of staff to communicate their concerns about malpractice or misconduct in an open and honest manner without fear of any form of detriment to their employment or career prospects.

The Chief Executive Officer and his executive management team keep under review the management of risks already identified and emerging and expected risks, in order to integrate fully the consideration of risk into the overall management of the business. The Chief Executive Officer appraises the Board of any significant emerging risks. A review of the process for identifying, evaluating and managing the significant risks faced by the company is being undertaken to ensure it is aligned to and integrated within the company's new governance arrangements.

Audit Committee

The Audit Committee comprises three non-executive directors and meets at least four times a year. It is chaired by Kenton Bradbury. The Chief Financial Officer, Head of Internal Audit, external auditors and other parties are invited to attend meetings as appropriate. The Board recognises that the Committee would benefit from the appointment of an independent non-executive director with recent and relevant financial experience and has asked the Nomination Committee to consider this requirement and advise the Board.

The Committee reviews the company's statutory annual financial statements and regulatory accounts before submission to the Board to ensure that the report and accounts meet the obligations of the directors and give a true and fair representation of the company's financial position. The key areas of audit focus agreed with the auditors for the year ended 31 March 2013 related to revenue recognition, capitalisation of expenses, doubtful debt provisioning, acquisition accounting and the whole business securitisation. The Committee considers the matters identified by the external auditors in its report to the Committee and, where significant, reports these to the Board.

The Committee meets with the external auditors and reviews the information to be provided in the annual performance report to Ofwat before submission to the Board to ensure that the information meets Ofwat's reporting requirements.

Discussions are held with the external auditors before audits begin, in the course of their work and when the work is completed, to establish the nature and scope of the audit work, its cost effectiveness, the auditors' independence and objectivity and the results of audit work.

The Committee keeps under review the level of audit fees, the appointment of the external auditors, and the nature and extent of non-audit services provided by them, seeking to balance the maintenance of objectivity with value for money. During the year the Committee considered tenders for the provision of audit services and recommendations were made to the Board. The Committee also approves in advance the internal audit plan and keeps under review the effectiveness of the internal audit function.

The Committee is responsible for drawing the attention of the Board to, and advising on, any matters which should appropriately be decided by the Board as a whole. It also considers and advises the Board on the policies and procedures for controlling and managing risks throughout the company and supervises actions to define, assess, control and limit risk.

The Committee each year evaluates its performance by means of a questionnaire covering the range of its responsibilities and procedures. It is anticipated that the Audit Committee will be further strengthened during the coming year with the addition of a further independent non-executive director with strong financial and accounting skills.

Remuneration

The Remuneration Committee operates under terms of reference established by the Board and is responsible for determining and agreeing with the Board the broad policy for the remuneration of the Chairman, executive directors and other members of the executive management team. The Committee comprises the Chairman and two non-executive directors. It is planned for two independent non-executive directors to be appointed to the Committee in the coming year. The Committee is responsible, in consultation with the Chief Executive Officer, for determining the total individual remuneration package including bonuses and, incentive payments of the Chairman, executive directors and other members of the executive management team. No director or manager is involved in any decisions as to their own remuneration. Further information on the work of the Remuneration Committee is contained in the remuneration report on pages 44 to 49.

Relations with shareholders

The presence of Infracapital Partners II, Morgan Stanley Infrastructure Partners and Veolia Water directors on the Board facilitates effective dialogue with shareholders and allows all the members of the Board, in particular the independent non-executive directors, to develop an understanding of their views.

By order of the Board

Tim Monod
Company Secretary

10 July 2013

Remuneration report

The Remuneration Committee is responsible for determining the remuneration policy and terms and conditions of employment of the executive directors and senior executives. It operates in accordance with terms of reference approved by the Board from time to time.

The Committee meets as and when required. There was one Committee meeting held prior to the sale of the company by Veolia Environnement S.A., with five additional Committee meetings held during the remainder of the year.

During the year, the Committee was chaired by Jim Wilmott. Philip Nolan was appointed Chairman of the Committee on 1 April 2013. The other member of the Committee is Kenton Bradbury. Richard Bienfait attends the meetings and, at the request of the Company Secretary, acts as secretary to the Committee. The Director of Organisation Design, Richard Brimble, also attends meetings as required. Members of the Committee and attendees are excluded from discussions regarding their own remuneration and conditions of employment.

The Board recognises that the composition of the Committee does not fully meet the expectations of the UK Corporate Governance Code. The Board plans to appoint two independent non-executive directors to the Committee.

The company appointed external independent consultants to offer advice to the Committee on remuneration matters. During the last six months of this financial year advice and assistance has been obtained from PricewaterhouseCoopers LLP ('PwC') and Baker & McKenzie LLP, neither of which are connected to the company.

The Committee meets to review the performance of the business as well as the performance of executive directors and senior executives against planned targets. The Committee also meets to consider and apply an appropriate remuneration framework to retain high calibre management. Their focus is on ensuring that the company can attract, motivate and reward executives who can lead the business to achieve short and long-term targets and ensuring those targets are closely linked to standards of performance which are of benefit to customers.

The remuneration framework is structured and appropriately balanced between fixed elements and incentive pay, to ensure that executives deliver a high standard of performance, whilst minimising risk. In common with other utility providers a high priority is placed on minimising risks to maintain the highest safety standards. The Committee ensures that the performance measures are objective, easy to understand and motivational to the participants.

The Committee also reviews and approves the company wide bonus scheme for all employees with reference to eight performance measures described opposite.

Non-executive directors

The current non-executive directors in office at 31 March 2013 fall into two groups.

Group A	Group B
Baroness Buscombe	Jim Wilmott
J Herbert	Kenton Bradbury
F Woolf	Antonio Botija
-	Andrew Dench
-	Yacine Saidji

The directors in Group A are considered by the Board to be independent. They are appointed by resolution of the Board and there is no further written agreement relating to their services. They receive a fee in respect of their services which is set by the Board and which is not related to company performance. They are not in receipt of share options or long-term incentive plans. Non-executive directors fees are set taking into account the market rate for non-executive directors, with particular reference to the water industry in the United Kingdom. There are no specific termination payments applicable to these appointments.

In September, the director fees for the Group A directors were reviewed and it was decided to increase the annual fee to £30,000 per annum plus £5,000 per annum if the director was a member of one or more sub committees of the Board.

The directors in Group B are appointed by resolution of the Board and represent the shareholders. They can be removed from the Board by the shareholder. They do not receive from the company any fees or other forms of remuneration in respect of their services and are not entitled to receive any payment on termination of their appointment.

Executive directors

Chairman – Philip Nolan

Dr Nolan's appointment took effect on 1 April 2013 and was therefore not remunerated during the year.

Chief Executive Officer – Richard Bienfait

Notice periods are as follows:
From the executive to the company – 6 months
From the company to the executive – 12 months

On 1 June 2012 the Chief Executive Officer's employment was transferred to the company from Veolia Water UK Limited. Until the date of the transfer, his salary was set and paid by Veolia Water UK Limited and subsequently recharged to the company on a time proportional basis.

Chief Financial Officer – Duncan Bates

Notice periods are as follows:
From the executive to the company – 6 months
From the company to the executive – 12 months to 31 July 2013 and 6 months thereafter

There are no arrangements in place for the remuneration of executive directors by any holding company or other company in the group.

Remuneration report – continued

Remuneration of executive directors and other senior executives

The Committee aims to position salaries for executive directors and senior executives at slightly below mid-market levels, preferring to compensate total reward with variable remuneration.

In December, the Committee used the findings from a benchmarking remuneration study by PwC of the senior executive roles to consider the level of fixed and variable remuneration in the future. The review also considered the:

- the performance of the individual executive;
- progression within the executive's current position; and
- comparative positions against similar roles.

As part of this review, the performance-related discretionary bonus for the Chief Executive Officer was increased from a maximum payable of 50 per cent of salary to 75 per cent of salary and for the Chief Financial Officer was increased from a maximum payable of 30 per cent of salary to 75 per cent of salary. The performance-related discretionary bonus other senior executives was increased from a maximum of 30 per cent of salary to 40 per cent of salary.

Under the discretionary senior executive bonus scheme, awards are dependent on the success of the company and are determined by reference to three components:

- 50 per cent of the total bonus is dependent on the achievement of the financial performance target, which is based on EBITDA (earnings before interest, corporation tax, depreciation and amortisation).
- 25 per cent of the total bonus is dependent on the achievement of operational and customer performance targets which is based on the number of health and safety incidents leading to three days or more of lost time, the number of water quality compliance failures, the number of properties which received an interruption of supply greater than 12 hours, the level of actual leakage compared to the Ofwat target, the number of written complaints, the number of unwanted contacts and the level of the company's Net Promoter Score.
- 25 per cent of the total bonus is dependent on the achievement of personal objectives.

The discretionary bonus scheme is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remains discretionary.

There was no long-term incentive plan during the year although the Committee is planning for a scheme in 2013/14.

Discretionary bonuses for the twelve months to December 2012 were awarded to the Chief Executive Officer, Chief Financial Officer and a number of senior executives in April 2013.

The company provides to the executive directors and other senior executives private health care insurance cover, a fully expensed company car (or car allowance) and access to a defined benefit or defined contribution pension scheme. The defined benefit scheme has been closed to new entrants since 2004.

Directors' emoluments

Directors' emoluments for the year were £393,000 (2012: £243,000). Full details are provided within note 5 on page 67.

Directors' interests

There are no disclosable interests under the Companies Act 2006.

Senior management

The company operates a discretionary senior manager bonus scheme for selected members of the senior management team who meet the criteria for inclusion in the scheme. Members of the senior management team are entitled to participate in a performance-related discretionary bonus scheme of up to 10 per cent of their salary. This is paid after the end of the financial year. Bonus awards are dependent on the success of the company and are determined by reference to three components:

- 50 per cent of the total bonus is dependent on the achievement of the financial performance target, which is based on EBITDA (earnings before interest, corporation tax, depreciation and amortisation).
- 25 per cent of the total bonus is dependent on the achievement of operational and customer performance targets which is based on the number of health and safety incidents leading to three days or more of lost time, the number of water quality compliance failures, the number of properties which received an interruption of supply greater than 12 hours, the level of actual leakage compared to the Ofwat target, the number of written complaints, the number of unwanted contacts and the level of the company's Net Promoter Score.
- 25 per cent of the total bonus is dependent on the achievement of personal objectives.

The scheme is designed to provide a direct link between senior management and company performance and bonus award, although payment remains discretionary. During the year, 74 bonus payments were made to senior managers who met the criteria for inclusion in the scheme.

"The discretionary bonus scheme is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remains discretionary"

Remuneration report – continued

Company-wide bonus scheme

The Committee reviews and approves a discretionary company-wide bonus scheme for all employees, who are not otherwise entitled to the discretionary senior manager or senior executive bonus scheme. The discretionary company-wide bonus scheme targets eight operational, customer and financial performance measures.

The non-financial performance measures are assessed quarterly against a target set for the relevant quarter so that a quarterly bonus amount can be earned where the target is met and paid after the end of the year. Performance against the financial performance measure is assessed annually. Performance against the financial performance measure is assessed annually. The internal performance targets for water quality, unplanned interruptions, and leakage are more stringent than the targets set by Ofwat.

The targets are calibrated on a quarterly basis, reflecting the seasonality of our business, and reflecting the continuous improvements in our performance that we expect and plan to make and they comprise the following:

- **Health and safety:** number of accidents resulting in more than three days' lost time
- **Water quality:** number of water quality compliance failures
- **Unplanned interruptions:** number of properties experiencing an interruption for more than 12 hours
- **Written complaints:** number of written complaints
- **Leakage:** leakage in terms of millions of litres per day
- **Unwanted contact:** number of unwanted contacts
- **Customer experience:** measured by net promoter score
- **Financial:** annual measure of earnings before interest, corporation tax, depreciation and amortisation ('EBITDA').

The targets for operational, customer and financial performance are identical to the bonus schemes for the senior executive, senior manager and company-wide. This ensures there is a common focus across the business, particularly with respect to service to customers.

For the year ended 31 March 2013, 17 of the 28 quarterly non-financial performance targets set were achieved. These targets are designed to be stretching, to support high standards of services to customers and to incentivise year on year improvements in performance.

By order of the Board

Philip Nolan
Chairman of the
Remuneration Committee

10 July 2013

Independent auditor's report to the members of Affinity Water Limited

We have audited the financial statements of Affinity Water Limited for the year ended 31 March 2013 which comprise the profit and loss account, the statement of total recognised gains and losses, the note of historical profits and losses, the balance sheet, the cash flow statement and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of directors' responsibilities set out on page 32, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the

"Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland)" annual report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Steven Dobson
(Senior statutory auditor)

for and on behalf of Ernst & Young LLP,
Statutory Auditor

London
11 July 2013

Notes:

1. The maintenance and integrity of the Affinity Water Limited web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Profit and loss account

for the year ended 31 March 2013 (Registered Number 2546950)

	Note	2013 £000	2012 £000
Turnover			
Continuing operations:			
- Existing	2	**254,960**	253,040
- Acquisitions	2	**24,509**	-
Cost of sales		**(172,431)**	(155,294)
Gross profit		**107,038**	97,746
Customer services and administrative expenses		**(38,810)**	(40,860)
Other operating income	3	**9,020**	8,148
Analysis of net operating profit			
Continuing operations:			
- Existing	4	**69,835**	65,034
- Acquisitions	4	**7,413**	-
Operating profit		**77,248**	65,034
Profit on disposal of fixed assets		**3,752**	4,474
Profit on ordinary activities before interest and taxation		**81,000**	69,508
Interest receivable and similar income	6	**12**	19
Interest payable and similar charges	7	**(24,647)**	(19,940)
Other finance income/(charges)	8	**71**	(578)
Profit on ordinary activities before taxation		**56,436**	49,009
Tax on profit on ordinary activities	9	**(12,941)**	(13,120)
Profit on ordinary activities after taxation and for the financial year	21	**43,495**	35,889

All profits of the company are from continuing operations. The notes on pages 58 to 91 form part of these financial statements.

Statement of total recognised gains and losses

for the year ended 31 March 2013 (Registered Number 2546950)

	Note	2013 £000	2012 £000
Profit for the financial year	21	**43,495**	35,889
Actuarial (loss)/gain recognised in the pension scheme	21	**(20,015)**	4,741
Deferred tax movement relating to actuarial (loss)/gain	21	**4,603**	(1,138)
Total recognised gains for the year	21	**28,083**	39,492

The notes on pages 58 to 91 form part of these financial statements.

Note of historical cost profits and losses

for the year ended 31 March 2013 (Registered Number 2546950)

	Note	2013 £000	2012 £000
Reported profit on ordinary activities before taxation		56,436	49,009
Realisation of property revaluation gains of previous years	21	1,775	1,793
Historical cost profit on ordinary activities before taxation		58,211	50,802
Historical cost profit for the year retained after taxation		45,270	37,682

The notes on pages 58 to 91 form part of these financial statements.

Balance sheet

as at 31 March 2013 (Registered Number 2546950)

	Note	2013 £000	2012 £000
Fixed assets			
Intangible assets	12	**15,423**	6,678
Tangible assets	13	**1,187,818**	906,544
Investment	14	**61**	50
		1,203,302	913,272
Current assets			
Stocks	15	**1,576**	952
Debtors	16	**77,709**	62,207
Cash at bank and in hand		**35,779**	713
		115,064	63,872
Creditors – amounts falling due within one year	17	**(122,413)**	(142,341)
Net current liabilities		**(7,349)**	(78,469)
Total assets less current liabilities		**1,195,953**	834,803
Creditors – amounts falling due after more than one year	18	**(786,105)**	(421,363)
Provisions for liabilities	19	**(55,087)**	(47,705)
Net assets excluding pension liability		**354,761**	365,735
Net pension liability	25	**(13,018)**	(14,770)
Net assets including pension liability		**341,743**	350,965
Capital and reserves			
Called up share capital	20	**26,506**	26,506
Share premium	21	**1,400**	-
Other reserves	21	**207,993**	125,168
Capital contribution	21	**30,150**	-
Profit and loss account	21	**75,694**	199,291
Shareholder's funds	22	**341,743**	350,965

The notes on pages 58 to 91 form part of these financial statements. The statutory financial statements on pages 52 to 91 have been approved by the Board of Directors and were signed on 10 July 2013 on its behalf by:

Richard Bienfait
Chief Executive Officer

Duncan Bates
Director

Cash flow statement

for the year ended 31 March 2013

	Note	2013 £000	2012 £000
Net cash inflow from operating activities	(a)	**140,162**	120,646
Returns on investments and servicing of finance			
Interest received		**12**	17
Interest paid		**(20,013)**	(13,055)
Interest element of finance lease payments		**(127)**	(271)
Net cash outflow from returns on investments and servicing of finance		**(20,128)**	(13,309)
Taxation		**(6,940)**	(8,736)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(103,455)**	(84,258)
Capital contributions		**11,679**	6,929
Proceeds on disposal of tangible fixed assets		**6,379**	9,805
Net cash outflow from capital expenditure and financial investment		**(85,397)**	(67,524)
Acquisitions			
Purchase of assets and liabilities of East and Southeast		**(131,200)**	-
Net debt acquired from East and Southeast		**(57,351)**	-
Net cash outflow for acquisitions		**(188,551)**	-
Equity dividends		**(153,455)**	(32,582)
Net cash inflow/(outflow) before financing		**(314,309)**	(1,505)
Financing			
Proceeds on issue of share capital		**1,400**	-
Capital contribution from Affinity Water Capital Funds Limited		**30,150**	-
Capital element of finance lease payments		**(1,591)**	(1,484)
Loan from subsidiary		**565,885**	-
Loan from parent company		**(205,787)**	(10,000)
Loan from other group undertaking		**(43,903)**	11,903
Loan from intermediate parent company		**3,550**	-
Financing of assets operated by other parties		**(329)**	700
Net cash inflow from financing		**349,375**	1,119
Increase/(decrease) in net cash	(b)/(c)	**35,066**	(386)

The notes on pages 58 to 91 form part of these financial statements.

Notes to the cash flow statement

for the year ended 31 March 2013

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2013 £000	2012 £000
Operating profit	77,248	65,034
Depreciation of tangible fixed assets	75,683	74,874
Amortisation of goodwill	297	-
Amortisation of deferred credit	(311)	(302)
Increase in stocks	(198)	(101)
Increase in debtors	(4,078)	(6,067)
Increase in provisions	704	1,204
Increase/(decrease) in creditors	10,654	(8,690)
Increase in pension liability	(19,837)	(5,306)
Net cash inflow from operating activities	140,162	120,646

(b) Reconciliation of net cash flow to movement in net debt

	2013 £000	2012 £000
Increase/(decrease) in cash in the year	35,066	(386)
Cash inflow from increase in debt and finance leasing	(317,825)	(1,119)
Non cash inflow from increase in debt and finance leasing	(1,809)	(6,769)
Movement in net debt in the year	(284,568)	(8,274)
Net debt at the beginning of the year	(463,281)	(455,007)
Net debt at the end of the year	(747,849)	(463,281)

(c) Analysis of net debt

	At 1 April 2012 £000	Cash Flow £000	Non cash flow £000	At 31 March 2013 £000
Net cash				
Bank	713	35,066		35,779
Debt				
Loans from subsidiary financed by bond issue	(196,728)	(565,885)	(151)	(762,764)
Deposit with parent company	2,097	(2,097)	-	-
Loan from other group undertakings	(204,133)	205,787	(1,654)*	-
Loan from parent company	(46,000)	46,000	-	-
Loan from intermediate parent company	-	(3,550)	-	(3,550)
Debentures	(32)	-	(4)	(36)
Finance leases (including sale and leaseback)	(1,591)	1,591	-	-
Financing of assets used by the company and operated by other parties	(17,607)	329	-	(17,278)
	(463,994)	(317,825)	(1,809)	(783,628)
Net debt	(463,281)	(282,759)	(1,809)	(747,849)

* capitalised interest payable to Veolia Environnement S.A. up to the date of the sale of the regulated businesses

Notes to the financial statements

for the year ended 31 March 2013

1. Statement of accounting policies

Basis of preparation

These financial statements have been prepared on the going concern basis as included in the directors' report on page 32 , under the historical cost convention, as modified by the revaluation of certain tangible fixed assets described below, and in accordance with the Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410), which forms part of the Companies Act 2006, and applicable UK accounting standards, except for the treatment of certain grants and contributions, described below, and the non-amortisation of the goodwill relating to the acquisition of North Surrey Water Limited.

The financial statements of Affinity Water Limited and its wholly owned subsidiaries, Affinity Water Finance (2004) Limited (formerly Veolia Water Central Finance Plc) and Affinity Water Programme Finance Limited, are not presented in consolidated format as Affinity Water Limited is itself a wholly owned subsidiary of Affinity Water Acquisitions Limited (formerly Rift Acquisitions Limited), which is the parent undertaking of the smallest group to consolidate the statutory financial statements. The company has not prepared group accounts as allowed under Section 400 of the Companies Act 2006.

Use of estimates

The preparation of accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from those estimates.

Revenue recognition

Revenue is recognised in accordance with Financial Reporting Standard 5: 'Reporting the substance of transactions' in the period in which it is earned. The company does not recognise revenue where payment is received in advance. However, payments made in the previous period in respect of the current period will be recorded as revenue in the current period. In accordance with Application Note G of Financial Reporting Standard 5, the company does not recognise revenue where historic evidence indicates that the company will probably never be able to collect the revenue billed. Where relevant, this includes an estimate of the sales value of water supplied to customers between the date of the last meter reading and the period end, exclusive of value added tax.

Bad debt provisioning

At each reporting date, the company evaluates the collectability of debtors and records provisions for doubtful debts based on experience. The bad debt provision is calculated by applying a range of different percentages to debt of different ages. These percentages also vary between categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the debt provision is sensitive to the specific percentages applied.

Financial instruments

Income and expenditure arising on financial instruments is recognised on an accruals basis and credited or charged to the profit and loss in the financial period in which it arises.

Issue costs on capital instruments are allocated to accounting periods over the term of the debt as a consistent proportion of the outstanding amount of the related debt in accordance with the requirements of Financial Reporting Standard 4: 'Capital instruments'.

Research and development

The costs of research and development are written off in the year in which they are incurred.

Current taxation

Current taxation is corporation tax in the United Kingdom based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Taxable profit differs from the net profit as reported in the profit and loss account as it excludes items of income or expenditure that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred taxation

Deferred tax is provided, except as noted below, on timing differences that have arisen but not reversed by the balance sheet date, where the timing differences result in an obligation to pay more tax, or a right to pay less tax, in the future. Timing differences arise because of differences between the treatment of certain items for accounting and taxation purposes. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

In accordance with Financial Reporting Standard 19: 'Deferred tax', deferred tax is not provided on timing differences arising from:

(a) revaluation gains on land and buildings, unless there is a binding agreement to sell them at the balance sheet date;

(b) gains on the sale of non-monetary assets, where on the basis of all available evidence it is more likely than not that the taxable gain will be rolled over into replacement assets; and

(c) fair value adjustment gains to fixed assets and stock to uplift prices to those ruling when an acquisition is made.

Deferred tax is measured at the tax rates that are expected to apply in the periods when the timing differences are expected to reverse, based on tax rates and law enacted or substantively enacted at the balance sheet date.

Where law or accounting standards require gains and losses to be recognised in the statement of total recognised gains and losses, the related taxation is also taken directly to the statement of total recognised gains and losses in due course.

The company has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money. Deferred tax assets and liabilities are discounted using a discount rate equivalent to the post tax yield that could be obtained at the balance sheet date on government bonds with similar maturity dates and currencies. The increase or decrease in the discount deducted in arriving at the deferred tax balance is included in the deferred tax charge or credit in the profit and loss account.

Notes to the financial statements – continued

for the year ended 31 March 2013

1. Statement of accounting policies

Pension costs

The company operates a pension scheme providing benefits based on final pensionable salary. The scheme closed to new members in April 1996 and September 2004. The assets of the scheme are held separately from those of the company.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised in profit or loss on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or a curtailment occur the change in the present value of the scheme liabilities and the fair value of the plan assets reflects the gain or loss which is recognised in the profit and loss account. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long-term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The difference between the expected return on plan assets and the interest cost is recognised in the profit and loss account as other finance income or expense. Actuarial gains and losses are recognised in full in the statement of total recognised gains and losses in the period in which they occur.

The defined benefit pension asset or liability in the balance sheet comprises the total for each plan of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds that have been rated at AA or equivalent status), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net pension benefit asset is limited to the amount that may be recovered either through reduced contributions or agreed refunds from the scheme.

Contributions to defined contribution schemes are recognised in the profit and loss account in the period in which they become payable.

The company also has an unfunded obligation to pay pensions to former non-executive directors. A provision in respect of the obligation is included within the net pension liability.

Goodwill and amortisation

Positive goodwill arising on acquisitions since 1 January 1998 is capitalised, classified as an asset on the balance sheet and amortised on a straight line basis over its useful economic life up to a maximum of 20 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

Positive goodwill is the excess of the cost of the acquired entity over the aggregate of the fair values of that entity's identifiable assets and liabilities. In estimating the useful economic life of goodwill, account has been taken of the nature of the unified business and the stability of the industry.

If a subsidiary, associate or business is subsequently sold or closed, any goodwill arising on acquisition that was written off directly to reserves or that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

Goodwill relating to the acquisition of North Surrey Water Limited in the year ended 31 March 2001 amounting to £6.7m has been capitalised. The directors consider that this goodwill has an indefinite life and accordingly is not amortised but is subject to annual review for impairment. In estimating the useful economic life of goodwill arising, account has been taken of the nature of the business acquired and the stability of the industry. This is not in accordance with Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which forms part of the Companies Act 2006, which requires that all goodwill be amortised. The directors consider that this would not give a true and fair view of the profit for the year and that the economic measure of performance in any period is properly made by reference only to any impairment that may have arisen. The effect on the accounts of this departure amounts to £334,000 per annum over 20 years. Any impairment charge is included within operating profits.

Tangible fixed assets and depreciation

Financial Reporting Standard 15: 'Tangible fixed assets' requires fixed assets which are carried at revalued amounts to be shown at their current value at the balance sheet date. To achieve this, all tangible fixed assets are subject to a full valuation every five years with an interim valuation carried out in the third year of this cycle.

Tangible fixed assets comprise:

- Infrastructure assets – mains and associated underground pipe-work.
- Other assets – land and buildings, operational structures, fixed plant, vehicles and mobile plant.

Infrastructure assets (being mains and associated underground pipe-work) comprise a network of systems. Expenditure on infrastructure assets, including renewals, is treated as an addition and included at cost after deducting grants and contributions.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the company's independently certified asset management plan. Disposals of infrastructure assets are calculated based on the estimated lives of the assets before they are replaced.

Depreciation is provided on all other fixed assets except freehold land and is calculated to write off their cost over their estimated useful lives on a straight-line basis. Assets acquired under finance leases are depreciated over the shorter of their useful life or the lease term. The performance of assets is continually monitored and where impairment is identified, fixed assets are written down to their recoverable amount. Tangible fixed assets are reviewed for impairment at the end of each reporting period when the estimated remaining useful economic life of the assets exceeds 50 years. Information on the condition of assets is also provided to the Regulator every five years as part of the price review mechanism.

Notes to the financial statements – continued

for the year ended 31 March 2013

1. Statement of accounting policies

Tangible fixed assets and depreciation (continued)

Buildings		40-60 years
Operational structures		15-100 years
Fixed plant	- Short life	3-10 years
	- Other	10-30 years
Vehicles and mobile plant		3-10 years

Land is not depreciated.

Any revaluation surplus is credited to the revaluation reserve in equity except to the extent that it reverses a decrease in the carrying value of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except to the extent of any existing surplus in respect of that asset in the revaluation reserve.

Capital contributions

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated.

Grants and contributions receivable relating to infrastructure assets have been deducted from the cost of tangible fixed assets. This is not in accordance with Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which forms part of the Companies Act 2006, which requires tangible fixed assets to be shown at cost, and hence grants and contributions are accounted for as deferred income. This departure from the requirements of the Companies Act 2006 is, in the opinion of the directors, necessary for the financial statements to show a true and fair view as, while a provision is made for depreciation of infrastructure assets, these assets have indefinite economic lives and therefore no basis exists on which to recognise grants and contributions in the profit and loss account. The effect of this treatment on the book value of tangible fixed assets is disclosed in note 13.

Capital contributions received in respect of tangible fixed assets, other than infrastructure assets, are deferred and credited to the profit and loss account by instalments over the expected useful lives of the related assets.

Leased assets

Assets financed by leasing are included in tangible fixed assets and the net obligation to pay future rentals is included within creditors. Instalments are apportioned between the finance element, which is charged to the profit and loss account as interest, and the capital element, which reduces the outstanding obligation for future instalments.

Rentals paid under an operating lease are charged against profits on a straight-line basis over the life of the lease.

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have passed to the company, and hire purchase contracts are capitalised in the balance sheet and are depreciated over the shorter of the lease term and the asset's useful lives. The capital elements of future obligations under leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged in the profit and loss account over the periods of the leases and hire purchase contracts and represent a constant proportion of the balance of capital repayments outstanding.

Fixed asset investments

Fixed asset investments are stated at cost less any provisions in respect of permanent diminution in value.

Grafham reservoir

Under the Great Ouse Water Act of 1961, Affinity Water Limited has an entitlement to water from the Grafham reservoir owned and operated by Anglian Water Services Limited.

Affinity Water Limited includes within its fixed assets (and RCV) a proportion of the original cost of the reservoir and annual increments related to capital expenditure made by Anglian Water Services Limited on the reservoir. The credit entry related to this accounting treatment of the assets is an obligation of around £17m related to the original embedded debt of Anglian Water Services Limited as incremented by the subsequent asset additions.

This amount is treated as a quasi-finance lease within these financial statements under the category of 'financing of assets operated by third parties' (see notes 24 and 26).

The model utilised for allocating the costs between the company and Anglian Water as required by the legislation includes an interest charge and capital repayment on this quasi-finance lease. The maturity period of the quasi-finance lease is currently assessed as being 28 years, assuming no further capital expenditure on the reservoir by Anglian Water. In practice, both the value of the lease obligation and the maturity period have remained broadly constant for a number of years as the capital repayments made have been similar to the company's proportion of the incremental expenditure by Anglian Water on the reservoir.

Ardleigh reservoir

The company and Anglian Water Services Limited own the reservoir and ancillary works jointly in approximately equal shares, the company's share of the capital expenditure being included in tangible fixed assets in note 13. The reservoir is operated on behalf of both undertakings through the Ardleigh Reservoir Committee, and the company's share of the expense is included within abstraction licences and bulk purchase.

Stocks and work in progress

Stocks are valued at the lower of cost or net realisable value after allowance for obsolete and slow moving items. In accordance with established practice in the water industry no value has been placed upon the water in reservoirs, mains or in the course of treatment. Work in progress for chargeable services is valued at cost.

Loans

All loans held with the company's subsidiaries are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the profit and loss account is allocated to accounting periods over the term of the debt using the effective interest method.

Provision for liabilities

A provision is recognised when the company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

Notes to the financial statements – continued

for the year ended 31 March 2013

2. Turnover

Turnover represents income from the supply of water and other chargeable services exclusive of VAT arising wholly within the United Kingdom. Turnover relating to unmeasured supplies comprises amounts due to the company for the accounting year.

	2013 £000	2012 £000
Continuing operations:		
Existing		
Unmeasured supplies	**131,128**	131,237
Measured supplies	**123,333**	121,477
Chargeable services	**499**	326
	254,960	253,040
Acquisitions		
Unmeasured supplies	**3,275**	-
Measured supplies	**21,228**	-
Chargeable services	**6**	-
	24,509	-
	279,469	253,040

3. Other operating income

	2013 £000	2012 £000
Continuing operations:	**9,020**	8,1148

4. Operating profit

Operating profit is stated after charging/(crediting):	2013 £000	2012 £000
Purchase of bulk water and water supplied under statutory entitlement	2,079	1,443
Water abstraction	5,675	5,179
Business rates	14,999	12,245
Chargeable services direct expenditure	916	775
Depreciation of infrastructure assets	45,809	42,134
Depreciation of tangible fixed assets - owned	29,138	31,521
Depreciation of tangible fixed assets - leased	736	1,219
Research and development	222	253
Restructuring costs arising from the unification of the water licences	732	-
Other costs arising from the unification of the water licences	310	-
Costs relating to rebranding	728	-
Hire of equipment	638	609
Operating lease rentals – land and buildings	1,547	1,547
Operating lease rentals – other	783	244
Amortisation of deferred credit	(311)	(302)
Amortisation of goodwill	297	-
Pension scheme set up costs	620	-
Auditor' remuneration		
Audit of the financial statements	199	144
Other fees		
Audit-related assurance services	45	50
Services relating to corporate finance*	61	-
Other non-audit services	6	-

* included in this amount is £49,000 of costs that have been capitalised as part of the transaction fees in relation to the issue of bonds in Affinity Water Limited. These costs are amortised over the debt term.

These items are included within the cost of sales, customer service and administrative expenses in the profit and loss account.

Notes to the financial statements – continued

for the year ended 31 March 2013

5. Employees and directors

Staff costs (including executive directors) consist of:	**2013 £000**	2012 £000
Wages and salaries	**29,415**	23,762
Social security costs	**2,656**	2,120
Defined benefit pension costs (note 25)	**4,047**	3,531
Defined contribution pension costs	**443**	426
Other pension costs	**528**	434
Effect of pension asset limit (note 25)	**(1,491)**	-
	35,598	30,273

The average number of employees (including executive directors) during the year was as follows:

	2013 £000	2012 £000
Operations	**391**	333
Customer service	**350**	332
Administration	**87**	54
	828	719

Directors' emoluments	2013 Salary and fees £000	2013 Benefits in kind £000	2013 Pension £000	2013 Other* £000	2013 Total £000	2012 Total £000
Non Executives						
O Bret	12	-	-	-	12	-
Baroness Buscombe	31	-	-	-	31	27
F Devos	-	-	-	-	-	108
O Grunberg	7	-	-	-	7	27
P Guitard	7	-	-	-	7	27
J Herbert	23	-	-	-	23	-
Dr N W Summerton	11	-	-	27	38	27
Fiona Woolf	31	-	-	-	31	27
Executives						
D Bates	71	6	-	-	77	-
R Bienfait	152	8	7	-	167	-
	345	14	7	27	393	243

* Other emoluments relate to compensation for loss of office.

No directors exercised share options during the year.

There were two directors accruing retirement benefits under the money purchase and defined benefit schemes during the year (2012: none). There were £7,000 (2012: £nil) contributions paid to money purchase pension schemes and there were no amounts outstanding at the year end. The emoluments of R Bienfait were paid by Veolia Water UK Limited until 1 June 2012, the then intermediate parent company. Veolia Water UK Limited recharged an amount of £49,000 (for the year 2012: £287,000) to the company in respect of that period.

Benefits in kind comprise company car allowance and healthcare insurance. As the company is a wholly owned subsidiary, there are no listed shares and no directors are offered any share incentives. There are no other long term incentive schemes for directors.

The directors who sit on the Board as representatives of Morgan Stanley Infrastructure, Infracapital or the Veolia group of companies do not receive any emoluments from the company.

Highest paid director

The amount of accrued pension under defined benefit schemes was £49,600. The highest paid director did not exercise any share options during the year and did not have any benefits accruing under any other long term incentive schemes.

Notes to the financial statements – continued

for the year ended 31 March 2013

6. Interest receivable and similar income

	2013 £000	2012 £000
Other interest	**12**	19

7. Interest payable and similar charges

	2013 £000	2012 £000
Interest payable to parent company	**3,711**	346
Interest payable to other group undertaking	**4,176**	6,618
Financing costs of assets used by the company and operated by other parties	**961**	931
Finance lease charges	**97**	242
Debenture interest	**1**	1
Interest payable to subsidiary in respect of bond issue	**15,059**	11,904
Other interest	**642**	(102)
	24,647	19,940

The loan and accrued interest thereon from Veolia Environnement S.A. was transferred to Affinity Water Acquisitions Limited on 28 June 2012 on the sale of the regulated entities. The interest payable to Veolia Environnement S.A. and thereafter to Affinity Water Acquisitions Limited has been included as interest payable to other group undertaking.

8. Other finance income/(charges)

	2013 £000	2012 £000
Expected return on pension scheme	**13,894**	12,752
Interest on pension scheme liabilities	**(13,823)**	(13,330)
	71	(578)

9. Tax on profit on ordinary activities

	2013 £000	2012 £000
Current taxation		
Current tax on profit of the year	8,807	10,991
Adjustment in respect of prior years	(920)	(3,431)
Current taxation	7,887	7,560
Deferred taxation		
Origination and reversal of timing differences – current year	7,753	3,109
Adjustment in respect of prior years	841	651
Decrease in discounting	48	8,165
Impact of change in tax rate	(3,588)	(6,365)
Deferred tax charge for the year	5,054	5,560
Tax on profit on ordinary activities	12,941	13,120
Current taxation reconciliation		
Profit on ordinary activities before taxation	56,436	49,009
Theoretical tax at UK corporation tax rate of 24% (2012: 26%)	13,545	12,742
Effects of:		
Adjustment to tax in respect of prior years	(920)	(3,431)
Accelerated capital allowances	(3,161)	(873)
Developer contributions	1,024	1,230
Other timing differences	(2,813)	(1,665)
Permanent differences	212	(443)
Actual current taxation charge	7,887	7,560

Tax on recognised gains and losses not included in the profit and loss account (see note 21):

	2013 £000	2012 £000
Other deferred tax movements relating to pension scheme	4,603	1,138

Notes to the financial statements – continued

for the year ended 31 March 2013

9. Tax on profit on ordinary activities

Factors that may affect future tax charges

A change in the main corporation tax rate in the United Kingdom from 24 per cent to 23 per cent was substantively enacted on 3 July 2012 to become effective from 1 April 2013.

Further reductions announced in the March 2013 Budget are expected to be enacted separately each year with the intention of reducing the rate to 20 per cent effective from 1 April 2015. Future changes in the main corporation tax rate from 23 per cent to 20 per cent had not been substantively enacted at the balance sheet date and, therefore, are not recognised in these financial statements.

10. Dividends on equity shares

	2013 £000	2012 £000
Ordinary:		
First interim paid of 6.15p per share (2012: 12.29p)	**16,291**	32,582
Second interim paid of 51.75p per share (2012: £nil)	**137,164**	-
	153,455	32,582

The second interim dividend was paid in order to refinance the business.

11. Business combination

On 27 July 2012 Affinity Water Limited acquired the assets and liabilities of Affinity Water East Limited and Affinity Water Southeast Limited.

The fair value of the identifiable assets and liabilities at the date of acquisition, which were equal to book values, amounted to:

	East £000	**Southeast £000**	**Total £000**
Tangible fixed assets	79,087	107,030	186,117
Investment	1	-	1
Cash at bank and in hand	2	58	60
Stocks and work in progress	236	190	426
Debtors	2,798	6,688	9,486
Net pension asset/(liability)	(237)	2,266	2,029
Provisions for liabilities	(2,385)	(4,012)	(6,397)
Creditors falling due within one year	(13,752)	(36,812)	(50,564)
Creditors falling due after more than one year	(6,500)	(12,500)	(19,000)
	59,250	**62,908**	**122,158**
Cash consideration	65,000	66,200	131,200
Goodwill	**5,750**	**3,292**	**9,042**

The fair value of the identifiable assets and liabilities as at the date of acquisition were equal to the book values for all line items on the balance sheet apart from tangible fixed assets. Tangible fixed assets were revalued during the year (refer note 13) of which £34.6m related to assets transferred in from Affinity Water East Limited and Affinity Water Southeast Limited. This was subsequently adjusted against the book value of the tangible fixed assets acquired as a result of unification.

	Affinity Water East Limited £000	Affinity Water Southeast Limited £000
Turnover	5,171	5,863
Operating costs	(3,623)	(5,798)
Other income	309	170
Operating profit	1,857	235
Profit on disposal of fixed assets	(52)	96
Interest	(211)	(371)
Profit before taxation	1,594	(40)
Taxation	(890)	233
Profit after taxation	704	193
Dividend paid	(2,392)	(1,707)

In the year ended 31 March 2012 the profit after tax of Affinity Water East Limited was £2,902,000 and of Affinity Water Southeast Limited was £4,652,000.

Affinity Water East Limited and Affinity Water Southeast Limited contributed £9,311,304 to the company's net operating cash flows, paid £1,014,711 in respect of interest, £238,216 in respect of taxation and utilised £3,341,449 for capital expenditure.

12. Intangible fixed assets

	2012 £000
Cost at 1 April 2012	6,678
Additions during the year	9,042
At 31 March 2013	15,720
Depreciation at 1 April 2012	
Charge for the year	297
At 31 March 2013	297
Net Book Value at 31 March 2013	15,423
Net Book Value at 31 March 2012	6,678

Additions during the year comprises of £9.0m on the unification of the regulated businesses on 27 July 2012. The directors consider that this goodwill has a life of 20 years and it has been amortised accordingly. In estimating the useful economic life of goodwill, account has been taken of the nature of the unified business and the stability of the industry.

Notes to the financial statements – continued

for the year ended 31 March 2013

13. Tangible fixed assets

	Land, building and operational structures £000	Mains and other infrastructure £000	Fixed plant £000	Vehicales and mobile plant £000	Assets in the course of construction £000	Total £000
Cost or valuation						
At 1 April 2012	227,174	939,628	518,255	43,405	33,616	1,762,078
Additions at cost	210	40,102	7,962	312	51,959	100,545
Transfers to complete	511	6,833	2,028	3,043	(12,415)	
Acquisitions*	49,655	105,626	21,362	3,847	5,627	186,117
Capital contributions	-	(11,679)	-	-	-	(11,679)
Disposals	(2,614)	-	-	(198)	-	(2,812)
Revaluation	-	84,600	-	-	-	84,600
At 31 March 2013	**274,936**	**1,165,110**	**549,607**	**50,409**	**78,787**	**2,118,849**
Depreciation						
At 1 April 2012	57,449	429,819	332,458	35,808	-	855,534
Charge for the year	9,333	45,809	15,458	5,083	-	75,683
Disposals	-	-	-	(186)	-	(186)
At 31 March 2013	**66,782**	**475,628**	**347,916**	**40,705**	**-**	**931,031**
Net book value						
At 31 March 2013	**208,154**	**689,482**	**201,691**	**9,704**	**78,787**	**1,187,818**
At 31 March 2012	169,725	509,809	185,797	7,597	33,616	906,544

*Transferred from Affinity Water East Limited and Affinity Water Southeast Limited on unification of the water licences (see note 11).

Finance leases have been arranged for assets included above at 31 March 2013 and 31 March 2012 as follows:

	Land, building and operational structures £000	Mains and other infrastructure £000	Fixed plant £000	Vehicales and mobile plant £000	Assets in the course of construction £000	Total £000
31 March 2013						
Cost	8,419	23,165	63,874	4,834	-	100,292
Depreciation	(7,811)	(10,930)	(63,305)	(4,834)	-	(86,880)
Net book value	**608**	**12,235**	**569**	**-**	**-**	**13,412**
31 March 2012						
Cost	8,419	23,165	63,874	4,834	-	100,292
Depreciation	(7,684)	(10,793)	(62,833)	(4,834)	-	(86,144)
Net book value	735	12,372	1,041	-	-	14,148

The net book value of mains and other infrastructure assets for the company is stated after the deduction of grants and contributions received since April 1990 amounting to £174.0m (2012: £145.5m) in order to give a true and fair view. All land and buildings are held as freehold.

Certain classes of the tangible fixed assets were professionally valued at October 2009 and March 2010 by independent qualified valuers, PricewaterhouseCoopers LLP ('PwC'), a firm of independent chartered accountants. These valuations were performed in accordance with Financial Reporting Standard 15 which requires that assets subject to a policy of revaluation should be carried at their current value. Current value is defined in Financial Reporting Standard 15 as the lower of replacement cost and recoverable amount. The recoverable amount is further defined as the higher of Net Realisable Value ('NRV') and Value in Use ('VIU').

Having considered the above definitions of value, PwC concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a water company in the United Kingdom was a two step approach:

- Step 1: Estimating the business VIU, using a discounted cash flow ('DCF') model to determine the business enterprise value, cross-checked against the regulatory capital value ('RCV'), followed by
- Step 2: Allocating the VIU of the business (less relevant working capital balances, deferred tax liabilities and other adjustments) to individual classes of tangible fixed assets.

Such valuations were incorporated into the financial statements with the resulting revaluation adjustments taken to the revaluation reserve.

PwC carried out an interim valuation using a consistent basis during the year ended 31 March 2013. The revaluation surplus of £84.6m was attributable to infrastructure assets and was taken to the revaluation reserve. Deferred tax has not been provided on timing differences arising from the revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.

If the revalued assets were stated on a historical cost basis, the historic cost before depreciation would be £1,576.5m (2012: £1,381.5m). If the revalued assets were stated on a historical cost basis, the net book value would be £648.9m (2012: £536.5m).

Notes to the financial statements – continued

for the year ended 31 March 2013

14. Investment

	£000
Cost at 1 April 2012	50
Acquisitions*	1
Additions during the year	10
At 31 March 2013	**61**

The company has an investment of £50,000 in 100 per cent of the £1 ordinary shares of a subsidiary company, Affinity Water Finance (2004) Limited. The principal activity of Affinity Water Finance (2004) Limited is to raise finance for the company. It made neither a profit nor loss for the year ended 31 March 2013 (2012: £nil).

On 11 January 2013, Affinity Water Limited incorporated Affinity Water Programme Finance Limited as a special purpose vehicle, registered in the Cayman Islands (tax registered in the United Kingdom), for the purpose of issuing asset backed securities. The company invested £10,000 in 100 per cent of the £1 ordinary shares of Affinity Water Programme Finance Limited. The principal activity of Affinity Water Programme Finance Limited is to raise finance for the company. It made neither a profit nor loss in 2013.

* The company acquired an investment by way of shares in the Water Resource Committee (WRC) amounting to £572 from Affinity Water East Limited on unification. The principal activity of the WRC is to undertake projects on behalf of all water companies, aimed at the improvement of water services and water quality (see note 11).

15. Stocks

	2013 £000	2012 £000
Raw materials and consumables	**1,576**	952

16. Debtors

	2013 £000	2012 £000
Due within one year		
Trade debtors and customers' water charges	**30,689**	19,184
Deposit with parent company	**-**	2,097
Accrual for unbilled metered customers	**36,044**	31,767
Amounts due from group undertaking	**736**	1,143
Other debtors	**7,548**	5,567
Prepayments and accrued income	**2,692**	2,449
	77,709	62,207

Deposit with parent company related to overnight cash pooling. This cash pooling arrangement was terminated on the refinancing of the company.

17. Creditors – amounts falling due within one year

	2013 £000	2012 £000
Net obligations under finance leases (note 24)	**-**	1,591
Financing of assets used by the company		
and operated by other parties (note 24)	**1,093**	856
Amounts due to group undertaking	**1,655**	4,973
Loan from parent company	**-**	46,000
Payments received in advance	**39,091**	38,619
Trade creditors	**8,238**	3,994
Interest payable to subsidiary companies	**11,417**	8,402
Interest payable to intermediate parent company	**25**	-
Corporation tax	**4,951**	3,404
Taxation and social security	**1,343**	792
Other creditors	**7,969**	6,332
Capital accruals	**20,181**	15,902
Other accruals and deferred income	**26,450**	11,476
	122,413	142,341

The loan from parent company related to a short-term borrowing facility that the company had access to prior to refinancing. The facility was terminated on the refinancing of the company.

18. Creditors – amounts falling due after more than one year

	2013 £000	2012 £000
Financing of assets used by the company and operated by other parties (note 24)	**16,185**	16,751
Deferred credit – contributions to surface assets	**3,570**	3,719
Loan from Affinity Water Finance (2004) Limited financed by bond issue	**196,879**	196,728
Loan from Affinity Water Programme Finance Limited financed by bond issue	**565,885**	-
Loan from intermediate parent/parent company	**3,550**	204,133
3.5% irredeemable consolidated debenture stock	**4**	-
4% irredeemable consolidated debenture stock	**9**	9
4% irredeemable debenture stock	**1**	1
4.25% irredeemable debenture stock	**1**	1
5% irredeemable debenture stock	**20**	20
5.25% irredeemable debenture stock	**1**	1
	786,105	421,363

During the year the company repurchased £nil nominal irredeemable outstanding debenture stock for cancellation (2012: £399).

On 13 July 2004 Affinity Water Finance (2004) Limited issued a £200 million bond at an interest rate of 5.875 per cent and repayable in July 2026. The net proceeds of the bond issue were then lent to the company.

On 4 February 2013, as a part of the refinancing, Affinity Water Programme Finance Limited issued £80m Class A Guaranteed Notes maturing in September 2022 with a coupon rate of 3.625 per cent, £250m Class A Guaranteed Notes maturing in March 2036 with a coupon rate of 4.50 per cent, £150m Class A Guaranteed RPI index-linked Notes maturing in June 2045 with a coupon rate of 1.548 per cent and £95m Class B Guaranteed RPI index-linked Notes maturing in June 2033 with a coupon rate of 3.249 per cent (together 'Bonds'). The net proceeds of the bond issue were then lent to the company.

On 4 February 2013, the company borrowed an amount of £3.55m from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.5 per cent.

The company has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Affinity Water Finance (2004) Limited and Affinity Water Programme Finance Limited in respect of the issued bonds. This guarantee constitutes direct, general and unconditional obligations of the company which will at all times rank at least pari passu with all other present and future unsecured obligations. These issues are guaranteed by Affinity Water Holdings Limited, the immediate parent undertaking of Affinity Water Limited.

All loans held with the company's subsidiaries are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the profit and loss account is allocated to accounting periods over the term of the debt using the effective interest method.

The company is subject to a number of covenants in relation to its borrowings, which would result in its loans becoming immediately repayable if breached. These covenants specify certain limits in terms of key ratios such as net cash flow to debt interest and net debt to regulatory capital value. At the year end the company was not in breach of any financial covenants.

19. Provisions for liabilities

	Deferred tax £000	Insurance £000	Other £000	Total £000
At 1 April 2012	(44,426)	(1,994)	(1,285)	(47,705)
Charged to the profit and loss account	(282)	(940)	(280)	(1,502)
Utilised in the year	-	375	142	517
Acquisitions*	(6,161)	(236)	-	(6,397)
At 31 March 2013	**(50,869)**	**(2,795)**	**(1,423)**	**(55,087)**

*Transferred from Affinity Water East Limited and Affinity Water Southeast Limited on unification of the water licences (see note 11).

Deferred tax	**2013 £000**	2012 £000
Accelerated capital allowances	**99,429**	83,239
Other timing differences	**(3,080)**	(1,049)
Undiscounted provision for deferred tax	**96,349**	82,190
Discount	**(45,480)**	(37,764)
Discounted provision for deferred tax	**50,869**	44,426
Deferred tax asset on pension liability (see note 25)	**(3,889)**	(4,665)
Provision at the end of the year including deferred tax on pension liability	**46,980**	39,761

Deferred tax asset relating to pension liability	**2013 £000**	2012 £000
At 1 April 2012	**4,665**	7,515
Acquisitions*	**(605)**	-
Deferred tax credit to the profit and loss account	**(4,774)**	(1,713)
Deferred tax (credit)/charge to the statement of total recognised gains and losses (see note 25):		
- on actuarial gain	4,803	**(1,233)**
- change in tax rate	(200)	**96**
At 31 March 2013	3,889	**4,665**

*Transferred from Affinity Water East Limited and Affinity Water Southeast Limited on unification of the water licences (see note 11).

Notes to the financial statements – continued

for the year ended 31 March 2013

19. Provision for liabilities

The deferred tax asset of £3.9m (2012: £4.7m) has been deducted in arriving at the net pension liability on the balance sheet.

Factors that may affect future tax charges:

Based on current capital investment plans, the group expects to continue to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

Reference should also be made to note 9 regarding recently proposed changes to the tax system in the United Kingdom.

Insurance

Insurance represents the amount of the company's liability in respect of excesses on individual claims. This is based upon data provided by loss adjusters to insurers on levels of reserve and is calculated on settlement experience. It is expected that this provision will be utilised within 24 months.

Other provisions

Other provisions include £0.2m covering the risk of remedy to the buyer of St George's Hill land due to an encroachment issue and £0.2m for the charitable trust both of which are anticipated to be utilised within 12 months. In addition there is a £0.7m provision in relation to unfunded pension liabilities for former directors which will be utilised over the 20 years from January 2019.

20. Share capital

Allotted, called up and fully paid share capital	**2013 £000**	2012 £000
Ordinary shares (265,057,824 of £0.10 each) (2012: 265,057,823 of £0.10 each).	**26,506**	26,506

Affinity Water Capital Funds Limited subscribed to one share of Affinity Water Limited on 27 July 2012 for a total amount of £1.4m (including share premium).

21. Reserves

	Share premium £000	Capital contribution £000	Revaluation reserve £000	Profit and loss account £000	Total £000
At 1 April 2012	-	-	125,168	199,291	324,459
Actuarial gain recognised in the pension scheme	-	-	-	(20,015)	(20,015)
Deferred tax arising thereon	-	-	-	4,603	4,603
Realisation of property revaluation gains of previous years	-	-	(1,775)	1,775	-
Revaluation during the year	-	-	84,600	-	84,600
Profit for the financial year	-	-	-	43,495	43,495
Additions during the period	1,400	30,150	-	-	31,550
Dividends paid	-	-	-	(153,455)	(153,455)
At 31 March 2013	**1,400**	**30,150**	**207,993**	**75,694**	**315,237**

A non-returnable capital contribution of £18.9m was received from Affinity Water Capital Funds Limited on 26 July 2012, with a further £11.3m being received on 27 July 2012.

Affinity Water Capital Funds Limited subscribed to one £0.10 share of Affinity Water Limited on 27 July 2012 for a total amount of £1.4m (including share premium).

22. Reconciliation of movements in shareholder's funds

	2013 £000	2012 £000
Profit for the financial year	**43,495**	35,889
Actuarial (loss)/gain recognised in the pension scheme	**(20,015)**	4,741
Deferred tax arising thereon	**4,603**	(1,138)
Total gains recognised for the year	**28,083**	39,492
Dividends paid	**(153,455)**	(32,582)
Capital contribution received	**30,150**	-
Movement in called up and fully paid share capital (including share premium)	**1,400**	-
Revaluation during the year	**84,600**	-
Net (reduction)/addition to shareholder's funds	**(9,222)**	6,910
Opening equity shareholder's funds	**350,965**	344,055
Closing equity shareholder's funds	**341,743**	350,965

Notes to the financial statements – continued

for the year ended 31 March 2013

23. Capital commitments

The directors have authorised a programme of capital expenditure (including infrastructure renewals), of which the contracted element not provided for in the accounts amounts to £20.2m (2012: £17.8m).

24. Commitments under finance and operating leases

Maturity of Debt:	2013 £000	2012 £000
Finance Leases	-	-
In one year or less, but on demand	-	1,591
In more than one year but not more than two years	-	-
In more than two years but not more than five years	-	-
In more than five years	-	-
Net obligations due	-	1,591

Financing of assets operated by third parties:

	2013 £000	2012 £000
In one year or less, but on demand	1,093	856
In more than one year but not more than two years	1,029	909
In more than two years but not more than five years	2,682	2,378
In more than five years	12,474	13,464
Net obligations due	17,278	17,607

The company had annual commitments under non-cancellable operating leases as follows:

Operating leases which expire:	2013 Land and Buildings £000	2013 Other £000	2012 Land and Buildings £000	2012 Other £000
Within one year	-	123	-	244
In two to five years	-	862	-	539
After five years	1,547	-	1,547	-
	1,547	985	1,547	783

25. Pensions

Composition of the pension scheme

The new Affinity Water Pension Plan was established in February 2013, set up as an identical scheme to the Veolia UK Pension Plan ('VUKPP'), the scheme in which the company participated until 28 March 2013. The benefits of employees and former employees of the company, and its predecessor companies, were transferred into the Affinity Water Pension Plan with effect from 28 March 2013.

The VUKPP was a multiemployer sectionalised pension plan with defined benefits and defined contribution sections. The defined benefit section was closed to new entrants in 2004 since which new members have only been eligible to join the defined contribution section. The sectionalised plan has separate Central, East and Southeast divisions.

Veolia UK Pension Plan

Until 31 March 1996, the company was a member of The Water Companies' Association Pension Scheme, which provided benefits based on final pensionable pay. On 1 April 1996 the assets and liabilities of the General Utilities Plc subsidiaries which participated in the Water Companies' Association Scheme were transferred to a "mirror image" plan called the Veolia Water Supply Companies' Pension Plan ('VWSCPP') which was closed to new members. This plan continued to provide benefits on a no less favourable basis than those previously provided for existing members of the scheme.

A new scheme was inaugurated as at 1 April 1996, the Générale des Eaux UK Retirement Benefits Scheme. This scheme was merged with the Générale des Eaux UK Pension Plan on 1 April 1998 to form the VUKPP, which was open to all new staff and existing members. The scheme provided a selection of benefits based upon final pensionable pay or money purchase according to the members' wishes. The final salary section was closed to new members on 30 September 2004.

On 31 May 2011, each of the divisions of the VWSCPP was merged into its corresponding division of the VUKPP.

The latest formal valuation of the plan for the company, determined by an independent qualified actuary, was at 31 December 2010, prior to the merger. The following disclosure is therefore presented for both the VWSCPP and VUKPP schemes combined. The actuarial valuation was made on the "attained age" funding method, based on the following assumptions:

Rate of investment return	6.2% (pre-retirement), 5.2% (post-retirement)
Rate of increase in remuneration	4.8%
Rate of pension increase	2.8% (former members of VWSCPP scheme)
Rate of pension increase	3.3% (VUKPP other members)

The valuation as at 31 December 2010 stated the market valuations of the plan to be £219.0m with a funding level of 90 per cent for the Central division, £16.6m with a funding level of 93 per cent for the East division, and £23.7m with a funding level of 119 per cent for the Southeast division.

Contributions to the VUKPP over the period ended 31 March 2013 were paid by members in accordance with the rules of the plan and by the company expressed as fixed monetary amounts according to the size of the relevant payroll and any surplus or deficit in the relevant division of the plan.

The contributions expected to be paid in the year from the balance sheet date are £8.8m (2012: £8.0m).

25. Pensions

Principal assumptions

The present values of pension liabilities are estimated by discounting pension commitments, including salary growth, at an AA corporate bond yield.

In calculating the liabilities of the plan, the following financial assumptions have been used:

	2013	2012	2011
Discount rate	**4.20% pa**	4.95% pa	5.50% pa
Salary growth	**4.20% pa**	4.70% pa	4.90% pa
RPI	**3.20% pa**	3.20% pa	3.40% pa
CPI	**2.50% pa**	2.50% pa	2.90% pa
Life expectancy for a male pensioner from age 65 (years)	**23**	23	23
Life expectancy for a female pensioner from age 65 (years)	**25**	25	26
Life expectancy from age 65 (years) for a male participant currently aged 40 (years)	**25**	23	23
Life expectancy from age 65 (years) for a female participant currently aged 40 (years)	**27**	25	27

Deferred pensions are revalued to retirement age in line with the CPI assumption of 2.5 per cent per annum unless otherwise prescribed by statutory requirements or the plan rules.

The assets of the plan are held separately to those of the company, being invested by independent fund managers. Contributions to the plan are charged to the profit and loss account so as to spread the cost of pensions over the employees' working lives with the company.

The total pensions charge including the defined contributions scheme for the period ended 31 March 2013 was £4.5m (2012: £4.0m). The effect of the asset limit credited to the profit and loss account is £1.5m (2012: £nil). This has arisen from a change in the maximum allowable surplus relating to the net asset position of the Southeast division.

The assets of the scheme and the weighted average expected rate of return were:

	At 31 March 2013		At 31 March 2012	
	Value £m	**Long term rate of return expected (% pa)**	Value £m	Long term rate of return expected (% pa)
Equities	**143.1**	6.24	107.9	6.90
Bonds	**56.3**	4.10	45.6	5.30
Property	**10.0**	6.75	12.4	6.90
Cash and cash equivalents	**114.5**	2.96	71.2	3.40
Fair value of assets	**323.9**	-	237.1	-

The amounts for the current period and the previous four periods are as follows:

	Year ended 31 March 2013	Year ended 31 March 2012	Year ended 31 March 2011	Year ended 31 March 2010	Year ended 31 March 2009
Defined benefit obligation (£m)	**340.2**	256.5	246.6	262.6	197.0
Plan assets (£m)	**323.9**	237.1	217.7	217.1	184.4
Effect of asset limit (£m)	**0.6**	-	-	-	-
Surplus/(deficit) (£m)	**(16.9)**	(19.4)	(28.9)	(45.5)	(12.6)
Difference between expected and actual return on plan assets:					
Percentage of plan assets	**4.9%**	(4%)	1%	18%	(21%)
Experience gains/(losses) on plan liabilities:					
Percentage of plan liabilities	**0%**	1%	0%	0%	0%

Reconciliation of present value of scheme liabilities:

	2013 £000	2012 £000
At 1 April	**256,513**	246,620
Current service cost	**4,047**	3,531
Interest cost	**13,823**	13,330
Liabilities transferred in*	**40,048**	-
Liabilities assumed in a business combination	**(633)**	-
Actuarial loss	**36,614**	3,475
Benefits paid	**(10,957)**	(11,143)
Contributions by scheme participants	**739**	700
At 31 March	**340,194**	256,513

25. Pensions

Reconciliation of fair value of scheme assets:

	2013 £000	2012 £000
At 1 April	237,078	217,716
Contributions paid by employer	22,393	8,837
Contribution by scheme participants	739	700
Expected return on scheme assets	13,894	12,752
Assets acquired in a business combination	(633)	-
Assets transferred in*	44,741	-
Actuarial gain	16,599	8,216
Benefits paid	(10,957)	(11,143)
At 31 March	323,854	237,078
Deficit of funded plan liabilities	16,340	19,435
Effect of asset limit	567	-
Pension liability before deferred tax	16,907	19,435
Related deferred tax	(3,889)	(4,665)
Net pension liability at 31 March	13,018	14,770

* from Affinity Water East Limited and Affinity Water Southeast Limited on the unification of the water licences

The amounts recognised in the profit and loss account are as follows:

	2013 £000	2012 £000
Current service cost	4,047	3,531
Expected return on scheme assets	(13,894)	(12,752)
Interest on pension scheme liabilities	13,823	13,330
Effect of asset limit	(1,491)	-
Total charge	2,485	4,109

Total actuarial gains and losses recognised in the statement of total gains and losses:

	2013 £000	2012 £000
Actuarial gains on scheme assets	**16,599**	8,216
Actuarial losses on scheme liabilities	**(36,614)**	(3,475)
Total (charge)/credit	**(20,015)**	4,741
Deferred tax arising thereon	**4,603**	(1,138)
(Charge)/credit after deferred tax	**(15,412)**	3,603

26. Financial instruments and risk management

The company's financial instruments comprise borrowings, debentures, cash and liquid resources, and various items, such as trade debtors and trade creditors that arise directly from operations. The main purpose of these financial instruments is to raise finance for the company's operations.

It is the company's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks. These policies have remained unchanged during the period.

The company finances its operations through a mixture of retained profits, borrowings from its subsidiary companies, borrowings from its parent company and debentures. Treasury policies are agreed in conjunction with the wider Affinity Water group (including liquidity and interest rate risks). The company does not undertake speculative transactions. Interest rate exposure is primarily managed by using a mixture of fixed rate, floating rate and RPI linked borrowings.

As a part of the refinancing, all existing loans and revolver facilities were replaced by the following four new bonds issued on 4 February 2013 by the company's subsidiary, Affinity Water Programme Finance Limited: £80m Class A Guaranteed Notes maturing in September 2022 with a coupon rate of 3.625 per cent, £250m Class A Guaranteed Notes maturing in March 2036 with a coupon rate of 4.50 per cent, £150m Class A Guaranteed RPI index-linked Notes maturing in June 2045 with a coupon rate of 1.548 per cent and £95m Class B Guaranteed RPI index-linked Notes maturing in June 2033 with a coupon rate of 3.249 per cent (together 'Bonds').

On 4 February 2013, the company borrowed an amount of £3.55m from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.5 per cent.

Further disclosures are included in notes 17 and 18.

Financial assets: excluding non-debt receivables due within one year

The company has £nil held on deposit with its parent company (2012: £2.1m).

Financial liabilities: excluding non-debt current liabilities

The company has a £3.55m loan from its parent/intermediate parent company (2012: £46.0m).

26. Financial instruments and risk management

The interest rate profile of the company's financial liabilities excluding non-debt current liabilities and deferred credits at 31 March 2013 was as follows:

	Total £000	Floating rate financial liabilities £000	Fixed rate financial liabilities £000	RPI Linked financial liabilities £000
31 March 2013	**783,628**	**-**	**542,319**	**241,309**
31 March 2012	466,092	205,725	260,367	-

Fixed rate liabilities represent the loans by the Affinity Water Finance (2004) Limited and Affinity Water Programme Finance Limited, irredeemable debenture stock and the financing of assets used the company and operated by other parties. The RPI linked liabilities represent the loans by Affinity Water Programme Finance Limited.

Fixed rate financial liabilities (including RPI linked)

As at	Weighted average interest rate %	Weighted average period for which rate is fixed* Years	Weighted average period until maturity years
31 March 2013			
Loan from subsidiaries	**4.2**	**20.5**	**20.5**
Loan from intermediate parent	**4.5**	**23.0**	**23.0**
Other	**5.3**	**28.8**	**28.8**
31 March 2012			
Loan from subsidiaries	6.0	14.0	14.0
Loan from intermediate parent	1.1	0.1	0.1
Other	0.1	35.4	35.4

*This calculation excludes the irredeemable debenture stock where the interest rate is fixed in perpetuity (see note 18).

The maturity profile for the company's financial liabilities at 31 March 2013 was as follows:

	2013 £000	2012 £000
In one year or less or on demand	-	-
(bank overdrafts, inter company borrowings and obligations under finance leases)	1,093	48,447
In more than one year but not more than two years	1,029	909
In more than two years but not more than five years	2,682	2,378
In more than five years	778,824	414,358
	783,628	466,092

All financial liabilities due after one year comprise financing of assets used by the company and operated by other parties, irredeemable debenture stock, amounts due to its subsidiary companies and other group undertakings.

The company has various undrawn committed borrowing facilities. The undrawn facilities available at 31 March 2013 in respect of which all conditions precedent had been met were as follows:

	2013 £000	2012 £000
Expiring in one year or less	57,500	-
Expiring in more than one year but not more than two years	-	54,000
Expiring in more than two years	100,000	-
	157,500	54,000

The company has access to an undrawn borrowing facility of £100m with a tenure of five years from 28 June 2012. This facility consists of a £70.0m capital expenditure facility and a £30.0m working capital facility.

26. Financial instruments and risk management

The company has available a 364 day revolving Debt Service Reserve Liquidity Facility of £37.5m. The facility is intended for the purpose of funding any debt service payments in the event of a liquidity shortfall that would otherwise prevent such payments being made.

The company has also available a 364 day revolving Operations and Maintenance Reserve Facility of £20.0m. The facility is intended for the purpose of funding any general liquidity shortfall.

Fair values of financial liabilities

Set out below is a comparison by category of book values and fair values of the financial liabilities of the company as at 31 March 2013, with the exception of the fixed rate liability in respect of the financing of assets by the company operated by other parties, where the fair value calculated by market interest rates of the financial instrument is not expected to be materially different from book value.

	Book value		Fair value	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Primary financial instruments held or issued to finance the company's operations				
Long-term borrowings	**762.8**	196.7	**829.9**	213.4
	762.8	196.7	**829.9**	213.4

The fair value of the Bonds, having a combined book value of £762.8m, has been determined by reference to published and other information, as well as prices from the active markets on which the instruments involved are traded.

The company has taken advantage of the exemption of Financial Reporting Standard 29: 'Financial Instruments: Disclosures' and has not disclosed information required by that standard, as the group's consolidated financial statements, in which the company is included, provide equivalent disclosures.

27. Billing on behalf of Thames Water and Anglian Water

The company bills and collects charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited. No amounts are included in the accounts in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2013 (2012: £nil).

28. Related party transactions

Purchases	Nature of relationship	In respect of	2013 Value £000	2013 Balance outstanding £000	2012 Value £000	2012 Balance outstanding £000
Affinity Water Acquisitions Limited	Intermediate parent	Interest paid on loan	**2,493**	**-**	-	-
Affinity Water Capital Funds Limited	Intermediate parent	Interest paid on various loans	**3,711**	**25**	346	26
Affinity Water Capital Funds Limited	Intermediate parent	Loans outstanding	**-**	**3,550**	n/a	46,000
Affinity Water Capital Funds Limited	Intermediate parent	Dividends paid	**153,455**	**-**	32,582	-
Affinity Water Shared Services Limited	Group undertaking	Support services (including capital expenditure)	**21,630**	**2,460**	17,095	2,605
Affinity Water Finance (2004) Limited	Subsidiary undertaking	Interest on bonds	**11,909**	**8,402**	11,904	8,402
Affinity Water Programme Finance Limited	Subsidiary undertaking	Interest on bonds	**3,150**	**3,010**	-	-
Affinity Water Trust	Trust Fund	Donations	**570**	**-**	545	-
Veolia Water UK Limited (formerly Veolia Water UK Plc)	Associate	Management and technical support (including capital expenditure)	**158**	**1,645**	5,989	2,014
Veolia Environnement S.A.	Associate	Interest paid on loan	**1,654**	**-**	-	-
Veolia Environnement Europe Services	Associate	Interest paid on loan	**-**	**-**	6,615	204,133*
Other Veolia entities	Associate	Waste water disposal and other support	**304**	**62**	301	321
Southern Water Services Limited	Associate	Bulk water and sewerage	**240**	**-**	-	-

The company has an outstanding loan balance of £196.9m (2012: £196.7m) with Affinity Water Finance (2004) Limited and £565.9m (2012: £nil) with Affinity Water Programme Finance Limited.

*inclusive of accrued interest

There are no other material related party transactions which require disclosure.

28. Related party transactions

Sales	Nature of relationship	In respect of	2013 Value £000	2013 Balance £000	2012 Value £000	2012 Balance £000
Affinity Water Shared Services Limited	Group undertaking	Rent and asset usage recharge	**2,196**	**736**	3,887	182
Veolia Water UK Limited (formerly Veolia Water UK Plc)	Associate	Transitional services and capability sharing agreement and other support	**1,224**	**735**	1,299	7
Southern Water Services Limited	Associate	Meter reading	**238**	-	-	-
Other Veolia entities	Associate	Transitional services and capability sharing agreement	**482**	**157**	87	953
Affinity Water Capital Funds Limited	Intermediate parent	Cash pool	-	-	n/a	2,097

There are no other material related party transactions which require disclosure.

29. Post balance sheet events

On 1 April 2013, the company entered into a Business Transfer Agreement with Affinity Water Shared Services Limited. The fixed assets and stock were purchased from Affinity Water Shared Services Limited for a value of £1.9m with the remaining assets due to be transferred at book value during the year.

30. Ultimate parent company and controlling party

The immediate parent undertaking of the company is Affinity Water Holdings Limited, a company registered in England and Wales.

Affinity Water Capital Funds Limited (formerly Veolia Water Capital Funds Limited), a company registered in England and Wales, was the parent undertaking of the smallest group to consolidate the financial statements of the company for the year ended 31 March 2012. Veolia Environnement S.A., a company incorporated in France, was the parent undertaking of the largest group to consolidate the statutory financial statements of this company, through its investment in the company's intermediate parent undertaking, Veolia Water UK Limited, and was the ultimate holding and controlling company until the divestment of the majority shareholding in the Affinity Water Capital Funds Limited group by Veolia Water UK Limited on 28 June 2012.

Since 28 June 2012, Affinity Water Limited has been wholly owned by Affinity Water Acquisitions Limited (formerly Rift Acquisitions Limited), a company registered in England and Wales, which is the smallest group to consolidate the statutory financial statements of the company for the year ended 31 March 2013. Affinity Water Acquisitions (Investments) Limited, a company registered in England and Wales, is the parent undertaking of the largest group to consolidate the statutory financial statements of this company.

The directors consider that Affinity Water Acquisitions (Investments) Limited is the ultimate holding and controlling company in the United Kingdom.

Copies of the group financial statements of Affinity Water Acquisitions Limited and Affinity Water Acquisitions (Investments) Limited may be obtained from the Company Secretary, Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Affinity Water Acquisitions (Investments) Limited is owned by a consortium of investors led by Infracapital Partners II, the infrastructure investment fund managed by M&G (the European Investment arm of Prudential Plc), and Morgan Stanley Infrastructure Partners. Veolia Environnement S.A. has retained a 10 per cent minority shareholding through its subsidiary Veolia Water UK Limited. The directors do not consider there to be an ultimate parent or controlling party.

Infracapital Partners II is one of a number of European infrastructure funds managed by M&G Investment Management Limited, a subsidiary of Prudential Plc. It was established in 2010 to make investments in income-generative infrastructure assets and business, including electricity and gas networks, water companies, transport infrastructure and renewable energy.

Morgan Stanley Infrastructure Partners is a leading global infrastructure investment fund. It is managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. Morgan Stanley Infrastructure Partners targets core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management.

Affinity Water

Your local supply, on tap

Regulatory Financial Statements

for the year ended 31 March 2013

Registered Number 2546950

The following accounts are prepared to enable the Water Services Regulation Authority (Ofwat) to monitor the financial performance of the regulated water businesses. At the request of the Regulator these accounts have been prepared on the basis that the combination of Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited was in effect from 1 April 2012, rather than 27 July 2012 as is the case for statutory accounts. Comparatives have been based on last year's regulatory accounts of Affinity Water Limited. This is consistent with the statutory accounts.

Certificates of compliance

**To: Water Services Regulation Authority
Centre City Tower
7 Hill Street
Birmingham B5 4UA**

Certificate of compliance with licence condition F6A

This is to certify that on 10 July 2013 of the Board of Affinity Water Limited ('the Appointee') resolved that in its opinion:

> the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and

the Appointee will, for at least the next 12 months, have available to it

> (a) financial resources and facilities;
>
> (b) management resources; and
>
> (c) systems of planning and internal control

which are sufficient to enable it to carry out those functions; and

> all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water undertaker.

These statements are based on:

- the net worth of the company as shown in the financial statements, the budget and plan for the forthcoming year, and the financing arrangements available to the company;
- the adequacy of the senior management team and management resources, robust internal control and delegated authority procedures, an internal audit team reporting to the Audit Committee, the availability of specialist planning teams, as well as the information from the first statement itself; the company is also subject to considerable external assurance review, both fiscal and operational;
- an examination of the contracts with associated companies.

**Tim Monod
Company Secretary**

10 July 2013

Statement of directors' responsibilities

In addition to their responsibilities to prepare financial statements in accordance with Companies Act 2006, the directors are also responsible under Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker as amended by the variation and modifications dated 27 July 2012 under what is now the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat for:

(a) ensuring that proper accounting records are maintained by the Appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by the Ofwat, to the Appointee from time to time;

(b) preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, or as specified under the Variation and Modifications dated 27 July 2012, having regard also to the terms of guidelines notified by the Ofwat from time to time, which so far as is reasonably practicable have the same content as the annual financial statements of the Appointee prepared under Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to these accounts;

(c) preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by the Ofwat from time to time or as specified under the Variation and Modifications dated 27 July 2012;

(d) preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by the Ofwat from time to time;

(e) preparing accounting separation tables with regards to the guidelines issued by the Ofwat from time to time.

Compliance with condition K

Paragraph 3.1 of Condition K of the company's Instrument of Appointment requires the company to ensure at all times, so far as reasonably practicable, that if a special administration order were made, it would have available to it sufficient rights and assets (other than financial reserves) to enable a special administrator to manage the affairs, business and property of the appointed business of the company.

The company hereby certifies that at 31 March 2013 it was in compliance with paragraph 3.1 of Condition K.

Statement of disclosure of transactions with associated companies

With respect to the disclosure of transactions with associated companies, the directors declare that to the best of their knowledge:

- all appropriate transactions with associated companies have been disclosed;
- transactions with associated companies are at arms length (except where agreed with Ofwat) with no cross-subsidy occurring; and
- no directors have acted as both purchaser and supplier in any transaction with an associate company.

Independent auditor's report to the Director General of Water Services ('the WRSA') and the Directors of Affinity Water Limited

We have audited the regulatory accounts of Affinity Water Limited for the year ended 31 March 2013 on pages 99 to 129 which comprise:

- the regulatory historical cost accounting statements comprising the regulatory historical cost profit and loss account, the regulatory historical cost statement of total recognised gains, the regulatory historical cost balance sheet, and losses and the historical cost reconciliation between statutory and regulatory accounts; and
- the regulatory current cost accounting statements for the appointed business comprising the current cost profit and loss account, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies.

These regulatory accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies.

This report is made, on terms that have been agreed, solely to the company and the WRSA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker under what is now the Water Industry Act 1991. Our audit work has been undertaken so that we might state to the company and the WRSA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WRSA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the WRSA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the WRSA, the directors and auditors

As explained more fully in the Statement of directors' responsibilities set out on page 95, the directors are responsible for the preparation of the regulatory accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the regulatory accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the regulatory accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the regulatory accounts

An audit involves obtaining evidence about the amounts and disclosures in the regulatory accounts sufficient to give reasonable assurance that the regulatory accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the regulatory accounts. In addition, we read all the financial and non-financial information in the regulatory accounts to identify material inconsistencies with the audited regulatory accounts. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the regulatory accounts are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of regulatory accounts are determined by Ofwat, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

Opinion on regulatory accounts

In our opinion the regulatory accounts:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WRSA and the accounting policies set out on pages 108 and 109 (including the accounting separation methodology), the state of the company's affairs at 31 March 2013 on an historical cost and current cost basis, the current cost analysis of fixed assets (wholesale business only and retail business only) at 31 March 2013,and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies (including the accounting separation methodology).

Basis of preparation

The regulatory accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The regulatory accounts are separate from the statutory financial statements of the company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

Furthermore, the regulatory historical cost accounting statements on pages 99 to 102 have been drawn up in accordance with Regulatory Accounting Guideline 3.07 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied and as described on page 103. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on pages 103 and 104.

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed resp onsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the regulatory accounts are in agreement with the accounting records and returns retained for the purpose of preparing the regulatory accounts.

Independent auditor's report to the Director General of Water Services ('the WRSA') and the Directors of Affinity Water Limited – continued

Other matters

The nature, form and content of regulatory accounts are determined by the WRSA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WRSA's purposes. Accordingly we make no such assessment.

Our opinion on the regulatory accounts is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2013 on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our 'statutory audit') was made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Ernst & Young LLP
Statutory Auditor
London

11 July 2013

Historical cost profit and loss account

for the year ended 31 March 2013

		2013			2012		
	Note	Appointed £000	Non-appointed £000	Total £000	Appointed £000	Non-appointed £000	Total £000
Turnover	2	292,277		292,277	254,805	-	254,805
Operating costs		(141,123)	(2,443)	(143,566)	(120,575)	(2,772)	(123,347)
Historical cost depreciation		(32,287)	-	(32,287)	(32,740)	-	(32,740)
Amortisation of deferred credit		605	-	605	302	-	302
Infrastructure renewals charge		(47,189)	-	(47,189)	(42,134)	-	(42,134)
Operating income		5,668	-	5,668	6,154	-	6,154
Operating profit/(loss)		77,951	(2,443)	75,508	65,812	(2,772)	63,040
Other income		-	7,626	7,626		6,466	6,466
Interest		(25,131)	(5)	(25,136)	(20,494)	(5)	(20,499)
Profit on ordinary activities before taxation		52,820	5,178	57,998	45,318	3,689	49,007
Taxation		-	-	-	-	-	-
Current tax		(7,201)	(1,243)	(8,444)	(6,675)	(885)	(7,560)
Deferred tax		(5,324)		(5,324)	(5,560)	-	(5,560)
Profit for the financial year		40,295	3,935	44,230	33,083	2,804	35,887
Dividends		(153,619)	(3,935)	(157,554)	(29,778)	(2,804)	(32,582)
(Loss)/profit transferred to reserves		(113,324)	-	(113,324)	3,305	-	3,305

Historical cost statement of total recognised gains and losses

for the year ended 31 March 2013

	2013 £000	2012 £000
Profit for the financial year	**40,295**	33,083
Actuarial (losses)/gains in the pension scheme	**(19,932)**	(4,741)
Deferred tax arising thereon	**4,584**	(1,138)
Total gains recognised since last report	**24,947**	36,686

Historical cost balance sheet

as at 31 March 2013

	2013 Appointed £000	2013 Non-appointed £000	2013 Total £000	2012 Appointed £000	2012 Non-appointed £000	2012 Total £000
Fixed assets						
Tangible assets	**1,198,774**	**-**	**1,198,774**	908,163	-	908,163
Investments	**61**	**-**	**61**	50	-	50
Total fixed assets	**1,198,835**	**-**	**1,198,835**	908,213	-	908,213
Current assets						
Stocks and work in progress	**1,576**	**-**	**1,576**	952	-	952
Debtors	**76,938**	**770**	**77,708**	59,688	422	60,110
Cash	**31,033**	**4,746**	**35,779**		5,824	5,824
Short-term deposits	**-**	**-**	**-**	2,097	-	2,097
Total current assets	**109,547**	**5,516**	**115,063**	62,737	6,246	68,983
Creditors – amounts falling due within one year						
Overdrafts	**-**	**-**	**-**	(5,111)	-	(5,111)
Infrastructure renewals accrual	**(10,956)**	**-**	**(10,956)**	(1,619)	-	(1,619)
Creditors	**(112,838)**	**(3,532)**	**(116,370)**	(86,050)	(4,441)	(90,491)
Borrowings	**(1,093)**	**-**	**(1,093)**	(48,447)	-	(48,447)
Corporation tax payable	**(2,967)**	**(1,984)**	**(4,951)**	(1,599)	(1,805)	(3,404)
Total creditors	**(127,854)**	**(5,516)**	**(133,370)**	(142,826)	(6,246)	(149,072)
Net current liabilities	**(18,307)**	**-**	**(18,307)**	(80,089)	-	(80,089)
Total assets less current liabilities	**(1,180,528)**	**-**	**(1,180,528)**	(828,124)	-	(828,124)
Creditors – amounts falling due after more than one year						
Borrowings	**(782,534)**	**-**	**(782,534)**	(417,644)	-	(417,644)
Total creditors	**(782,534)**	**-**	**(782,534)**	(417,644)	-	(417,644)
Provisions for liabilities and charges						
Deferred tax	**(50,869)**	**-**	**(50,869)**	(44,426)	-	(44,426)
Deferred income	**(3,570)**	**-**	**(3,570)**	(3,719)	-	(3,719)
Post employment liabilities	**(13,018)**	**-**	**(13,018)**	(14,770)	-	(14,770)
Other provisions	**(4,218)**	**-**	**(4,218)**	(3,278)	-	(3,278)
Net assets employed	**326,319**	**-**	**326,319**	344,287		344,287
Capital and reserves						
Called up share capital	**26,506**	**-**	**26,506**	26,506	-	26,506
Share premium	**1,400**	**-**	**1,400**	-	-	
Capital contribution	**30,150**	**-**	**30,150**	-	-	
Other reserves	**487,855**	**-**	**487,855**	420,442	-	420,442
Profit and loss account	**(219,592)**	**-**	**(219,592)**	(102,661)	-	(102,661)
Equity shareholder's funds	**326,319**	**-**	**326,319**	344,287	-	344,287

Historical cost balance sheet – continued

as at 31 March 2013

The treatment of infrastructure renewals accruals/ prepayments within the regulatory accounts differs from that in the historical cost financial statements. Consequently tangible assets above are reported at £11.0m more (2012: £1.6m more) than in the historical cost financial statements with an addition to debtors of the same amount.

In the historical cost financial statements goodwill of £6.7m arose on the acquisition of North Surrey Water Limited on 1 October 2000. The directors consider that this goodwill has an indefinite life and accordingly is not amortised but is subject to annual review for impairment.

Additions to goodwill during the year comprises £9.0m on the unification of the regulated businesses on 27 July 2012. The directors consider that this goodwill has a life of 20 years and it has been amortised accordingly. In estimating the useful economic life of goodwill, account has been taken of the nature of the unified business and the stability of the industry.

No goodwill arises in the regulatory accounts, as the acquisitions have been accounted for as mergers.

Reconciliation between statutory accounts and regulatory accounts

as at 31 March 2013

In the preparation of its annual report and financial statements for the year ended 31 March 2013 ('statutory accounts'), the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in Financial Reporting Standard 15: 'Tangible Fixed Assets'. However for the purposes of the regulatory accounts, Ofwat has requested that Financial Reporting Standard 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. In addition, Ofwat has decided to depart from UK GAAP and disapply the provisions of Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions', which states the turnover should not include amounts that the company does not expect to collect.

At the request of the Regulator these accounts have been prepared on the basis that the combination of Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited was in effect from 1 April 2012, rather than 27 July 2012 as is the case for statutory accounts.

Reconciliation of the historical cost balance sheet to the historical cost statutory accounts is set out below:

	Statutory accounts					
	Affinity Water Limited*	Affinity Water East Limited**	Affinity Water Southeast Limited**	Total	Regulatory accounts £m	
Profit and loss account	£m	£m	£m	£m	£m	
Turnover	279.5	5.2	5.9	290.6	292.3	Disapplication of the provisions of Application Note G of Financial Reporting Standard 5 in the regulatory accounts of £1.7m.
Operating profit	77.2	1.9	0.2	79.3	77.9	Statutory accounts include other operating income of £7.6m but exclude profit on disposal of fixed assets which in 2012/13 was £3.8m. Non appointed cost excluded from operating profit in the regulatory accounts is £2.4m.
Balance sheet						
Tangible fixed assets	-	-	-	1,187.8	1,198.8	In the statutory accounts the tangible fixed assets figure includes infrastructure renewals. For regulatory accounts, Ofwat requires infrastructure renewals to be shown separately on the balance sheet.
Debtors	-	-	-	77.7	76.9	Non appointed debtors excluded from the debtors in the regulatory accounts is £0.7m.
Deferred income	-	-	-	N/A	3.6	Amount relates to deferred credit for contributions to surface assets of £3.6m and has been classified within creditors falling due after more than one year in the statutory accounts.

*12 months **4 months to 27 July 2012

Reconciliation between statutory accounts and regulatory accounts – continued

as at 31 March 2013

Reconciliation of reserves – regulatory accounts

	Share Premium £000	Capital Contribution £000	Other Reserve £000	Profit and loss account £000	Total £000
As at 1 April 2012			420,442	(102,661)	317,781
Actuarial losses recognised in the pension scheme	-	-	(19,932)	-	(19,932)
Deferred tax arising thereon	-	-	4,584	-	4,584
Realisation of property revaluation gains of previous years	-	-	(1,775)	1,775	-
Revaluation during the year	-	-	84,600	-	84,600
Transfer for the historic cost profit and loss account	-	-	-	(113,324)	(113,324)
Additions during the period	1,400	30,150	-	-	31,550
Goodwill acquired on unification (net of amortisation)	-	-	-	(8,745)	(8,745)
Dividend paid pre-unification*	-	-	-	4,099	4,099
Actuarial gains recognised pre-unification*	-	-	(83)	-	(83)
Deferred tax arising thereon*	-	-	19	-	19
Profit movement arising pre-unification*	-	-	-	(736)	(736)
As at 31 March 2013	1,400	30,150	487,855	(219,592)	299,813

*At the request of the Regulator these accounts have been prepared on the basis that the combination of Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited was in effect from 1 April 2012, rather than 27 July 2012 as is the case for statutory accounts. Comparatives have been based on last year's regulatory accounts of Affinity Water Limited. This is consistent with the statutory accounts.

Dividends, actuarial gains and losses, deferred tax and profit arising in the pre unification books of Affinity Water East Limited and Affinity Water Southeast Limited have been adjusted for in the above table to enable reconciliation of the regulatory reserves of Affinity Water Limited.

Current cost profit and loss account for appointed business

for the year ended 31 March 2013

	Note	2013 £000	2012 £000
Turnover	2	**292,277**	254,805
Current cost operating costs		**(235,671)**	(205,000)
Other operating income/(cost)		**2,925**	10,940
Working capital adjustment		**1,018**	1,665
Current cost operating profit		**60,549**	62,410
Net interest		**(25,131)**	(20,494)
Financing adjustment		**9,200**	12,819
Current cost before taxation		**44,618**	54,735
Net Revenue movement out of tariff basket		**214**	148
Back-billing amount identified		**4,524**	5,527

Current cost cash flow statement

as at 31 March 2013

		2013			2012		
	Note	Appointed £000	Non-appointed £000	Total £000	Appointed £000	Non-appointed £000	Total £000
Net cash inflow from operating activities	(a)	134,249	5,182	139,431	115,764	3,483	119,247
Returns on investments and servicing of finance							
Interest received		(7)	-	(7)	17	-	17
Interest paid		(20,602)	(5)	(20,607)	(13,050)	(5)	(13,055)
Interest element of finance leases		(126)	-	(126)	(271)	-	(271)
Net cash outflow from returns on investments and servicing of finance		(20,735)	(5)	(20,740)	(13,304)	(5)	(13,309)
Taxation							
Corporation tax paid		(5,976)	(885)	(6,861)	(7,198)	(1,538)	(8,736)
Net cash outflow from taxation paid		(5,976)	(885)	(6,861)	(7,198)	(1,538)	(8,736)
Capital expenditure and financial investment							
Purchase of fixed assets		(69,001)	-	(69,001)	(45,987)	-	(45,987)
Capital contributions		11,347	-	11,347	6,929	-	6,929
Infrastructure renewals expenditure		(37,309)	-	(37,309)	(38,271)	-	(38,271)
Proceeds on disposal of fixed assets		8,009	-	8,009	11,204	-	11,204
Movements on long-term group loans to group companies		31,550	-	31,550	-	-	-
Payments for investment		(131,200)	-	(131,200)	-	-	-
Net cash outflow from capital expenditure and financial investment		(186,604)	-	(186,604)	(66,125)	-	(66,125)
Acquisitions and disposals		(52,240)	-	(52,240)			
Equity dividends paid		(153,619)	(3,935)	(157,554)	(29,778)	(2,804)	(32,582)
Net cash inflow/(outflow) before financing and management of liquid resources		(284,925)	357	(284,568)	(641)	(864)	(1,505)

	Note	2013 Appointed £000	2013 Non-appointed £000	2013 Total £000	2012 Appointed £000	2012 Non-appointed £000	2012 Total £000
Financing	(a)						
Capital element of finance lease repaid		**(1,591)**	**-**	**(1,591)**	(1,484)	-	(1,484)
Loan from subsidiary		**565,885**	**-**	**565,885**	-	-	-
Loan from group undertaking		**(204,133)**	**-**	**(204,133)**	(10,000)	-	(10,000)
Loan from parent company		**(42,450)**	**-**	**(42,450)**	14,000	-	14,000
Deposit with parent company		**2,097**	**-**	**2,097**	(2,097)	-	(2,097)
Financing of assets operated by other parties		**(329)**	**-**	**(329)**	700	-	700
Debentures		**4**	**-**	**4**	-	-	-
Non cash net debt movement		**151**	**-**	**151**	-	-	-
Net cash inflow from financing		**319,634**	**-**	**319,634**	1,119	-	1,119
Increase/(decrease) in cash		**34,709**	**357**	**35,066**	478	(864)	(386)

Notes to the current cost cash flow statement

as at 31 March 2013

Reconciliation of current cost operating profit to net cash flow from operating activities

	2013 £000	2012 £000
Current cost operating profit	**60,549**	62,410
Working capital adjustment	**(1,018)**	(1,665)
Movement in working capital	**(18,386)**	(9,351)
Current cost depreciation	**47,864**	42,292
Current cost profit on sale of fixed assets	**(2,653)**	(10,657)
Infrastructure renewals charge	**47,189**	42,134
Other non-cash profit and loss Items	**704**	(9,399)
Net cash flow from operating activities	**134,249**	115,764

Notes to the current cost financial information

1. Statement of accounting policies

Basis of current cost accounting

These accounts have been prepared in accordance with relevant Regulatory Accounting Guidelines (RAGs).

The accounting policies used are the same as those adopted in the statutory accounts, except as set out below.

The following accounts are prepared to enable the Director General of Water Services (the Regulator) to monitor the financial performance of the regulated water businesses. At the request of the Regulator these accounts have been prepared on the basis that the combination of Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited was in effect from 1 April 2012, rather than 31 March 2013 as is the case for statutory accounts. Comparatives have been based on the last years' regulatory accounts of Affinity Water Limited. This is consistent with the statutory accounts.

Revenue recognition

The regulatory accounts disapply the provisions of Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions', which states that turnover should not include amounts that the company does not expect to collect.

The company classifies unoccupied council/housing association properties as "occupied" if they are empty for less than 26 weeks for short-term situations such as refurbishment or change of tenancy. These properties are billed in full and then a percentage is deducted from the amount owed in recognition that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the council/housing association provides that the local authority will notify the company so that the property can be formally recorded as "empty" on the company's billing system and, therefore, will not be billed.

The company no longer raises bills addressed to "The Occupier" and these accounts are made void where there is no consumption. The company's assumption is that these properties are not occupied. The company makes further enquiries and when the company receives information that the property has become occupied the status of the account will be amended, the customer's name applied to the account and billing will commence. Where enquiries gives the company reason to believe that the property is inhabited but it has not been possible to obtain the customer's name a bill will then be issued in the name of "The Occupier".

In each of the above cases, if a bill is sent, the company would recognise it within turnover.

Acquisitions

On 1 October 2000 the company acquired the assets and liabilities of North Surrey Water Limited. Details of the acquisition are given in the statutory accounts of the company for the year ended 31 March 2001. The acquisition was funded by the issue of share capital and debt. The additional debt taken on of £20.0m was added to the opening balance of long-term creditors. No goodwill arises in the regulatory accounts, as the acquisition has been accounted for as a merger.

On 27 July 2012 the company acquired the trade, assets and liabilities of Affinity Water East Limited and Affinity Water Southeast Limited on unification of the water licences. The acquisition was funded by the debt. No goodwill arises in the regulatory accounts, as the acquisition has been accounted for as a merger. Any difference between the consideration transferred and the net assets acquired are recognised directly in reserves.

Tangible fixed assets

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. Costs relating to increases in capacity or enhancements to the network are capitalised. No depreciation is charged on mains because the network is required to be maintained in perpetuity and therefore has no finite economic life.

The treatment in the current cost accounts differs from that in the historical cost accounts in relation to the disapplication of renewals accounting paragraphs of Financial Reporting Standard 15: 'Tangible fixed assets' and Financial Reporting Standard 12: 'Provisions, contingencies and commitments', as required by RAGs. The non-compliance has no effect on the profit and loss account other than to reclassify infrastructure renewals charges as depreciation.

Third party contributions

Infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated. Contributions received relating to infrastructure assets, which are not depreciated, have been deducted from the cost of tangible fixed assets in order to show a true and fair view.

Real financial capital maintenance adjustments

The following adjustments are made to historical cost profit in order to arrive at profit after maintenance of financial capital in real terms.

(a) **Depreciation adjustment:** this is the difference between depreciation based on the current cost value of assets in these accounts and depreciation charged in arriving at historical cost profit.

(b) **Working capital adjustment:** this is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

(c) **Financing adjustment:** this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

(d) **Disposal of fixed asset adjustment –** per RAG1.02: this is calculated by applying the difference between the net book value of the current cost and the net book value of the historical cost of disposed assets, to the profit from disposal of fixed assets as shown in the historical cost accounts.

Accounting separation policy

The tables presenting the analysis of operating costs and fixed assets (activity cost analysis for appointed business 2012/13 on pages 120 to 123, activity cost analysis for appointed business 2011/12 restated on pages 124 to 127 and current cost analysis of tangible fixed assets by type on pages 111 and 112) have been prepared in accordance with the company's accounting separation methodology statement, which can be found at www.affinitywater.co.uk. The methodology statement explains the basis for the allocations of costs and assets and has been updated for changes to the requirements in the year. There have otherwise been no major changes. Wherever possible, direct costs and assets have been directly attributed to business units. Where this is not possible, appropriate cost allocations have been applied, as described in the methodology.

Notes to the current cost financial information – continued

2. Analysis of turnover

		2013 £000	2012 £000
Unmeasured	– household	**134,536**	130,223
	– non-household	**2,822**	2,176
Measured	– household	**95,493**	72,475
	– non-household	**46,612**	38,961
Large users and special agreement		**9,531**	8,295
Non-potable large user and special agreement		**623**	108
Rechargeable works		**507**	326
Bulk supplies		**2,131**	2,207
Other appointed business – third party		**22**	34
Total turnover		**292,277**	254,805

3. Reconciliation of historical cost operating profit to current cost operating profit for appointed business

	2013 £000	2012 £000
Total historical cost operating profit	**77,951**	65,812
Current cost depreciation and amortisation of deferred credit	**(47,360)**	(42,292)
Historic cost deferred credit	**(605)**	(302)
Historical cost depreciation	**32,288**	32,741
Current cost adjustment on disposal of fixed assets	**(2,743)**	4,786
Working capital adjustment	**1,018**	1,665
Current cost operating profit	**60,549**	62,410

4. Current cost analysis of tangible fixed assets by type

Wholesale

	Resources £000	Raw water distribution £000	Treatment £000	Treated distribution £000	Total £000
Non infrastructure assets					
Gross replacement cost					
At 1 April 2012	1,204,139	41,990	1,772,152	1,219,119	4,237,400
AMP/SIR adjustment	-	-	-	-	-
RPI adjustment	39,505	1,378	58,140	39,996	139,019
Disposals	-	-	-	-	-
Additions	9,156	1,176	13,907	32,030	56,269
At 31 March 2013	1,252,800	44,544	1,844,199	1,291,145	4,432,688
Depreciation					
At 1 April 2012	221,977	14,493	400,047	329,858	966,375
AMP/SIR adjustment	-	-	-	-	-
RPI adjustment	7,282	475	13,124	10,822	31,703
Disposals	-	-	-	-	-
Charge for the year	15,645	551	17,254	9,247	42,697
At 31 March 2013	244,904	15,519	430,425	349,927	1,040,775
Net book value at 31 March 2013	1,007,896	29,025	1,413,774	941,218	3,391,913
Net book value at 1 April 2012	982,162	27,497	1,372,105	889,261	3,271,025
Infrastructure assets					
Gross replacement cost					
At 1 April 2012	11,635	163,878	-	4,980,423	5,155,936
AMP/SIR adjustment	-	-	-	-	-
RPI adjustment	382	5,376	-	163,394	169,152
Disposals	-	-	-	-	-
Additions	-	358	-	8,082	8,440
At 31 March 2013	12,017	169,612	-	5,151,899	5,333,528

Notes to the current cost financial information – continued

4. Current cost analysis of tangible fixed assets by type – continued

Retail

	Household £000	Non-household £000	Total £000
Gross replacement cost			
At 1 April 2012	246,092	15,352	261,444
AMP/SIR adjustment	-	-	-
RPI adjustment	8,074	504	8,578
Disposals	(5,195)	(302)	(5,497)
Additions	1,065	712	1,777
At 31 March 2013	250,036	16,266	266,302
Depreciation			
At 1 April 2012	129,784	8,363	138,147
AMP/SIR adjustment	-	-	-
RPI adjustment	4,258	274	4,532
Disposals	(120)	(7)	(127)
Charge for the year	4,846	322	5,168
At 31 March 2013	138,768	8,952	147,720
Net book value at 31 March 2013	111,268	7,314	118,582
At 31 March 2012	116,308	6,989	123,297

5. Analysis of capital expenditure, grants and land sales

	2013			2012		
	Gross £000	**Grants and Contributions £000**	**Net £000**	Gross £000	Grants and Contributions £000	Net £000
Capital expenditure – water						
Base						
Infrastructure renewals expenditure (IRE)	**39,786**	-	**39,786**	38,271	-	38,271
Maintenance non-infrastructure (MNI)	**39,969**	-	**39,969**	25,770	-	25,770
Enhancements	-	-	-	-	-	-
Infrastructure enhancements	**7,864**	**(11,679)**	**(3,815)**	10,071	(6,929)	3,142
Non-infrastructure enhancements	**17,411**	-	**17,411**	5,720	-	5,720
Total capital expenditure – water	**105,030**	**(11,679)**	**93,351**	79,832	(6,929)	72,903
Grants and contributions – water	-	-	-		-	-
Developer contributions (i.e. enhancement requisitions, grants and contributions)	-	**(9,836)**	-	-	(4,634)	-
Infrastructure charge receipts – new connections	-	**(1,843)**	-	-	(2,295)	-
Other contributions						
Total grants and contributions – water	-	**(11,679)**	-	-	(6,929)	-
Land sales – proceeds from disposals of protected land	-	-	**(5,692)**	-	-	(11,190)

Notes to the current cost financial information – continued

6. Working Capital

	2013 £000	2012 £000
Stocks	**1,576**	952
Trade debtors – measured household	**7,048**	1,689
– unmeasured household	**9,704**	8,372
– measured non-household	**10,999**	8,831
– unmeasured non-household	**238**	220
– other	**5,079**	72
Measured income accrual	**36,044**	31,767
Prepayments and other debtors	**2,692**	2,448
Trade creditors	**(8,238)**	(3,994)
Deferred income – customer advance receipts	**(31,000)**	(25,428)
Capital creditors	**(20,181)**	(15,902)
Accruals and other creditors	**(48,236)**	(40,070)
	(34,275)	(31,043)
Total revenue outstanding – household	**33,110**	24,768
– non-household	**18,192**	11,933

7. Analysis of net debt, gearing and interest costs

	Fixed rate £000	Index linked £000	Total £000
Borrowings	542,319	241,309	783,628
Add: – capitalised bond issue costs			12,387
Less: – financing of assets used by the company and operated by other parties			(17,278)
– loan from intermediate parent company			(3,550)
– non-redeemable debentures			(36)
			775,151
Add: – accrued interest on borrowings			11,417
Adjusted borrowings			786,568
Cash			(35,779)
			750,789
Regulatory capital value			976,570
Gearing			76.88%
Full year equivalent nominal interest cost*			31,851
Full year equivalent cash interest payment*			31,309
Indicative interest rates			
Indicative weighted average nominal interest rate			4.11%
Indicative weighted average cash interest rate			4.04%
Weighted average years to maturity			20.5

*excludes the impact of the Retail Price Index (RPI)
Borrowings have been adjusted to reflect the definition of net debt per the securitisation financing agreement.

Using the methodology applied by Ofwat, the gearing would be calculated as follows:

Borrowings	542,319	241,309	783,628
Appointed cash			(31,033)
			752,595
Regulatory capital value			976,570
Gearing			77.07%

Notes to the current cost financial information – continued

8. Non financial information

	2013 Water	2012 Water
Number of properties		
Households billed	1,333,208	1,184,500
Non-households billed	71,643	62,489
Households void	31,840	30,634
Non household voids	9,393	8,434
Properties served by new appointee in supply as at 1 April 2009	1,450,252	1,286,057
Per capita consumption (excluding supply pipe leakage) l/h/d		
Unmeasured household		
- Central region	162.96	169.20
- Southeast region	196.50	n/a
- East region	145.41	n/a
Measured household		
- Central region	133.49	146.18
- Southeast region	124.62	n/a
- East region	99.05	n/a
Volume (Ml/d)		
Bulk supply export	30.58	29.73
Bulk supply import	25.97	18.85
Distribution input	877.03	831.15

9. Regulatory capital value

	2013 £000	2012 £000
Opening RCV for the year*	**980,572**	819,893
Capital expenditure	**59,358**	46,592
Infrastructure renewals expenditure	**49,551**	38,706
Infrastructure renewals charge	**(49,165)**	(43,153)
Grants and contributions	**(3,441)**	(5,714)
Depreciation	**(51,590)**	(43,212)
Out performance of regulatory assumptions (5 years in arrears)	**(8,715)**	(7,909)
Closing RCV carried forward	**976,570**	805,203
Average regulatory capital value	**962,733**	800,879

* the opening RCV in 2013 has been adjusted to reflect the unified business

The table shows the RCV used in setting the price limits for the period; the differences from the actual capital expenditure, depreciation and other items will not affect price limits in the current period. Capital efficiencies and the effects of construction price inflation will be taken into account in the calculation for the next periodic review.

Notes to the current cost financial information – continued

10. Transactions with associated companies

Company		Turnover of associate* £000	Terms of supply	Value £000
Expenditure				
Affinity Water Acquisitions Limited**	Interest paid on loan	-	No market	2,493
Affinity Water Capital Funds Limited**	Interest paid on various loans	-	No market	4,313
Affinity Water Capital Funds Limited**	Dividends paid	-	No market	157,554
Affinity Water Shared Services Limited	Support services (including capital expenditure)	GBP 19,542	Market tested	21,941
Southern Water Services Limited	Bulk water, sewerage and dividend	GBP 716,200	No market	253
Veolia Water UK Limited (formerly Veolia Water UK Plc)	Management and technical support (including capital expenditure)	GBP 262,916	No market	397
Veolia Environnement SA	Interest paid on loan	EUR 29,439,000	No market	1,683
Veolia Environnement UK Limited**	Other support services	-	No market	260
Affinity Water Finance (2004) Limited	Interest on bonds	-	No market	11,909
Affinity Water Programme Finance Limited	Interest on bonds	-	No market	3,150
Affinity Water Trust	Trust Fund	-	No market	570

10. Transactions with associated companies – continued

Company		Turnover of associate* £000	Terms of supply	Value £000
Income				
Affinity Water Shared Services Limited	Rent and asset usage recharge	GBP 19,542	Market tested	2,196
Southern Water Services Limited	Metered billing data and GIS plans	GBP 716,200	No market	238
Veolia Water UK Limited (formerly Veolia Water UK Plc)	Transitional services and capability sharing agreement	GBP 262,916	No market	1,094

* from latest publicly available financial statements.
** these companies do not have turnover.

The company has applied a materiality threshold on disclosing transactions of over £100,000.

In 2004, Affinity Water Limited took out a loan of £200.0m through a wholly owned subsidiary, Affinity Water Finance (2004) Limited, the loan being the proceeds of its £200m Class A bonds issued in that year and maturing in July 2026 with an annual coupon rate of 5.875 per cent. The amount outstanding at year end, net of amortised debt issuance costs, is £196.9m (2012: £196.7m).

As a part of the refinancing, all other existing loans and revolver facilities were replaced by a loan from the company's subsidiary, Affinity Water Programme Finance Limited from the proceeds of its four new bonds issued on 4 February 2013, as follows: £80m Class A Guaranteed Notes maturing in September 2022 with a coupon rate of 3.625 per cent, £250m Class A Guaranteed Notes maturing in March 2036 with a coupon rate of 4.50 per cent, £150m Class A Guaranteed RPI index-linked Notes maturing in June 2045 with a coupon rate of 1.548 per cent and £95m Class B Guaranteed RPI index-linked Notes maturing in June 2033 with a coupon rate of 3.249 per cent (together 'Bonds'). The amount outstanding at year end, net of amortised debt issuance costs of £9.3m, is £565.9m (2012: £nil).

On 4 February 2013, the company borrowed an amount of £3.55m from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.5 per cent.

Licence condition F – Paragraph 7

Activity cost analysis for appointed business 2012/13

Wholesale	Water resources £000	Raw Water Distribution £000	Water Treatment £000	Treated Water Distribution £000	Water Service Total £000
Employment costs	355	792	5,203	8,347	14,697
Power	-	2,483	13,373	3,248	19,104
Hired and contracted services	168	312	2,039	15,158	17,677
Associated companies	3	(2)	(35)	417	383
Materials and consumables	36	422	2,435	1,742	4,635
Service charges	5,805	-	-	-	5,805
Bulk supply imports	-	-	4,013	-	4,013
Other direct costs	91	97	627	2,492	3,307
Total direct costs	6,458	4,104	27,655	31,404	69,621
General support Expenditure	411	684	3,499	11,118	15,712
Scientific services	1,050	175	1,287	1,802	4,314
Other business activities	392	392	392	393	1,569
Total business activities	1,442	567	1,679	2,195	5,883
Local authority rates	1,968	320	2,870	9,525	14,683
Exceptional items					
Total opex less third party services	10,279	5,675	35,703	54,242	105,899
Third party services – opex	-	-	-	2,811	2,811
Total operating expenditure	10,279	5,675	35,703	57,053	108,710

Wholesale – continued	Water resources £000	Raw Water Distribution £000	Water Treatment £000	Treated Water Distribution £000	Water Service Total £000
Reactive and planned maintenance infrastructure	32	1	591	24,537	25,161
Reactive and planned maintenance non-infrastructure	126	1,498	7,091	944	9,659
Infrastructure renewals charge (exc. third party services)	-	1,336	-	45,853	47,189
Current cost depreciation	14,729	(365)	16,261	8,500	39,125
Amortisation of deferred credit	(58)	(12)	(81)	(355)	(506)
Amortisation of intangible assets	-	-	-	-	-
Business activities current cost depreciation	916	916	916	747	3,495
Capital maintenance excluding third party services	15,587	1,875	17,096	54,745	89,303
Third party services – current cost depreciation	-	-	77	-	77
Third party services – infrastructure renewals charge	-	-	-	-	-
Total capital maintenance	15,587	1,875	17,173	54,745	89,380
Total operating costs	**25,866**	**7,550**	**52,876**	**111,798**	**198,090**

Licence condition F – Paragraph 7 – continued

Activity cost analysis for appointed business 2012/13

Retail	Retail household £000	Retail Household and support memo £000	Retail Non-Household £000	Retail Non-Household and support memo £000	Retail Services Total £000
Billing	2,349	157	127	9	2,476
Payment handling, remittance and cash handling	351	18	19	1	370
Debt management	313	429	116	159	429
Doubtful debts	6,773	353	1,466	76	8,239
Charitable trust donations	545	43	-	-	545
Vulnerable customer schemes	117	49	-	-	117
Non-network customer enquiries and complaints	3,139	1,607	170	87	3,309
Meter reading	2,990	523	314	55	3,304
Meter maintenance / installation non-capex	-	67	-	7	-
Network customer enquiries and complaints	2,743	809	148	44	2,891
Disconnections	-	-	19	8	19
Demand side water-efficiency initiatives	311	16	95	5	406
Services to developers	-	-	-	-	-
Support for trade effluent compliance	-	-	-	-	-
Customer side leaks	799	42	84	4	883
Other direct costs	1,317	608	878	404	2,195
Total direct costs	21,747	4,721	3,436	859	25,183

Retail – continued	Retail household £000	Retail Household and support memo £000	Retail Non-Household £000	Retail Non-Household and support memo £000	Retail Services Total £000
General and support	4,721		859		5,580
Scientific services	834		-		834
Other business activities	372		20		392
Total business activities	1,206		20		1,226
Local authority rates	399		25		424
Exceptional items	-		-		-
Total opex less third party services	28,073		4,340		32,413
Third party services	-		-		-
Total operating expenditure	28,073		4,340		32,413
Infrastructure renewals charge					
Current cost depreciation	4,846		322		5,168
Amortisation of deferred credit	-		-		-
Amortisation of intangible assets	-		-		-
Total capital maintenance	4,846		322		5,168
Total operating costs	**32,919**		**4,662**		**37,581**

Licence condition F – Paragraph 7

Activity cost analysis for appointed business 2011/12 restated

Combined for Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited

Wholesale	Water resources £000	Raw Water Distribution £000	Water Treatment £000	Treated Water Distribution £000	Water Service Total £000
Employment costs	330	651	5,299	8,110	14,390
Power	-	2,131	11,473	2,786	16,390
Hired and contracted services	127	205	1,840	17,293	19,465
Associated companies	(11)	(6)	(109)	504	378
Materials and consumables	16	386	2,717	1,643	4,762
Service charges	5,149	-	-	-	5,149
Bulk supply imports	-	-	3,272	-	3,272
Other direct costs	100	74	644	2,095	2,913
Total direct costs	5,711	3,441	25,136	32,431	66,719
General support Expenditure	373	614	3,507	12,208	16,702
Scientific services	993	165	1,217	1,703	4,078
Other business activities	407	407	407	407	1,628
Total business activities	1,400	572	1,624	2,110	5,706
Local authority rates	1,862	303	2,716	9,012	13,893
Exceptional items	(12)	(70)	(448)	(664)	(1,194)
Total opex less third party services	9,334	4,860	32,535	55,097	101,826
Third party services – opex	-	-	-	2,721	2,721
Total operating expenditure	9,334	4,860	32,535	57,818	104,547

Wholesale – continued	Water resources £000	Raw Water Distribution £000	Water Treatment £000	Treated Water Distribution £000	Water Service Total £000
Reactive and planned maintenance infrastructure	25	-	551	24,019	24,595
Reactive and planned maintenance non-infrastructure	123	1,175	7,068	912	9,278
Infrastructure renewals charge (exc. third party services)	-	1,301	-	44,681	45,982
Current cost depreciation	14,475	(664)	20,065	6,652	40,528
Amortisation of deferred credit	(61)	(10)	(84)	(354)	(509)
Amortisation of intangible assets	-	-	-	-	-
Business activities current cost depreciation	992	992	992	992	3,968
Capital maintenance excluding third party services	15,406	1,619	20,973	51,971	89,969
Third party services – current cost depreciation	-	-	77	-	77
Third party services – infrastructure renewals charge	-	-	-	-	-
Total capital maintenance	15,406	1,619	21,050	51,971	90,046
Total operating costs	**24,740**	**6,479**	**53,585**	**109,789**	**194,593**

Licence condition F – Paragraph 7 – continued

Activity cost analysis for appointed business 2011/12 restated

Combined for Affinity Water Limited, Affinity Water East Limited and Affinity Water Southeast Limited

Retail	Retail household £000	Retail Household and support memo £000	Retail Non-Household £000	Retail Non-Household and support memo £000	Retail Services Total £000
Billing	1,861	153	101	8	1,962
Payment handling, remittance and cash handling	351	22	19	1	370
Debt management	290	527	107	195	397
Doubtful debts	5,618	350	1,216	76	6,834
Charitable trust donations	565	51	-	-	565
Vulnerable customer schemes	112	52	-	-	112
Non-network customer enquiries and complaints	4,053	1,918	219	104	4,272
Meter reading	2,378	557	250	60	2,628
Meter maintenance/ installation non-capex	-	70	-	7	-
Network customer enquiries and complaints	2,949	943	160	50	3,109
Disconnections	-	-	19	9	19
Demand side water-efficiency initiatives	273	17	83	5	356
Services to developers	-	-	-	-	-
Support for trade effluent compliance	-	-	-	-	-
Customer side leaks	608	38	64	4	672
Other direct costs	1,649	524	1,099	350	2,748
Total direct costs	20,707	5,222	3,337	869	24,044

Retail – continued	Retail household £000	Retail Household and support memo £000	Retail Non-Household £000	Retail Non-Household and support memo £000	Retail Services Total £000
General and support	5,222		869		6,091
Scientific services	788		-		788
Other business activities	386		21		407
Total business activities	1,174		21		1,195
Local authority rates	377		24		401
Exceptional items	(467)		(25)		(492)
Total opex less third party services	27,014		4,227		31,241
Third party services					
Total operating expenditure	27,014		4,227		31,241
Infrastructure renewals charge	-		-		-
Current cost depreciation	4,689		332		5,021
Amortisation of deferred credit	-		-		-
Amortisation of intangible assets	(3)		-		(3)
Total capital maintenance	4,686		332		5,018
Total operating costs	**31,700**		**4,559**		**36,259**

Accounting separation trial 2012/13

	Water resources £000	Raw water distribution £000	Water treatment £000	Treated water distribution £000
Operating expenditure	10,279	5,675	35,703	57,053
Infrastructure renewals charge	-	1,336	-	45,853
Current cost depreciation	15,645	551	17,254	9,247
Amortisation of deferred credit	(58)	(12)	(81)	(355)
Total operating costs	25,866	7,550	52,876	111,798

	Water resources		Raw water distribution			Treated water distribution	
	Abstraction licence £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Trunk treated water distribution £000	Local treated water distribution £000
Operating expenditure	5,678	4,601	5,655	20	35,703	1,020	56,033
Infrastructure renewals charge	-	-	1,336	-	-	24,427	21,426
Current cost depreciation	-	15,645	-	551	17,254	4,926	4,321
Amortisation of deferred credit	-	(58)	(12)	-	(81)	(189)	(166)
Total operating costs	5,678	20,188	6,979	571	52,876	30,184	81,614

The above data is derived from the accounting separation data on pages 120 to 123 and the current cost depreciation data on pages 111 and 112 . The following allocations have been made in order to split the costs into the service categories required.

Water resources

The actual cost of licences is collected separately in the company's accounting system. It has been separated from the operating expenditure in this area, and entered into the abstraction licence operating expenditure. All other costs are allocated to raw water abstraction.

Raw water distribution

There is very little raw water storage within the business (Ardleigh reservoir jointly owned with Anglian; one small bankside storage facility in Chertsey; two gravel lakes; one reservoir at Hilfield which is out of service; three reservoirs at Cherry Garden Upper Works in Folkestone, all of which are out of service).

Therefore the approach was taken to estimate the operating expenditure for these facilities and to then subtract these from the total to derive the operating expenditure for raw water transport. The total estimated operating expenditure for these facilities is £35,000, which mostly consists of inspection costs and ground works. £10,000 relates to the operating costs of Ardleigh reservoir (total cost of £20,000 of which half is paid for by Anglian Water). It has been assumed that all current cost depreciation in this area relates to storage reservoirs, and that all infrastructure renewals expenditure relates to distribution assets.

Water treatment

No allocation was required for water treatment costs.

Treated water distribution

The company's accounting systems do not allow operating expenditure spent on trunk mains to be distinguished with that spent on local distribution mains. Therefore an estimate is made as to the amount of operating expenditure relating to trunk mains and the residual attributed to local distribution mains. There is a small amount of operating expenditure incurred in monitoring and inspection of trunk mains, estimated to be £40,000. The vast majority of the operating expenditure is incurred in fixing burst or leaking mains. The company had approximately 120 burst trunk mains in 2012/13; the definition of a trunk main is ambiguous. It is estimated that the average cost of each burst is £8,166 including reinstatement costs and consequential damage expenditure. The resulting total operating expenditure for trunk mains is £1.02m.

Infrastructure renewals charge is allocated between trunk mains and local mains in proportion to their replacement values. Replacement value is calculated by multiplying the unit cost for each type of main replacement by the length of main in each category. Current cost depreciation and amortisation of deferred credits were allocated using the same proportion.

Amortisation of deferred credits

A line was added to the template in order to allow the company to show current cost depreciation consistently with the tables on pages 120 to 123 and allow the totals to be consistent, whilst also protecting the integrity of the total line in this table.

Areas of supply

Affinity Water
Your local supply, on tap

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