Affinity Water
Your local supply, on tap

Investor Report

Affinity Water Limited ('Affinity Water')

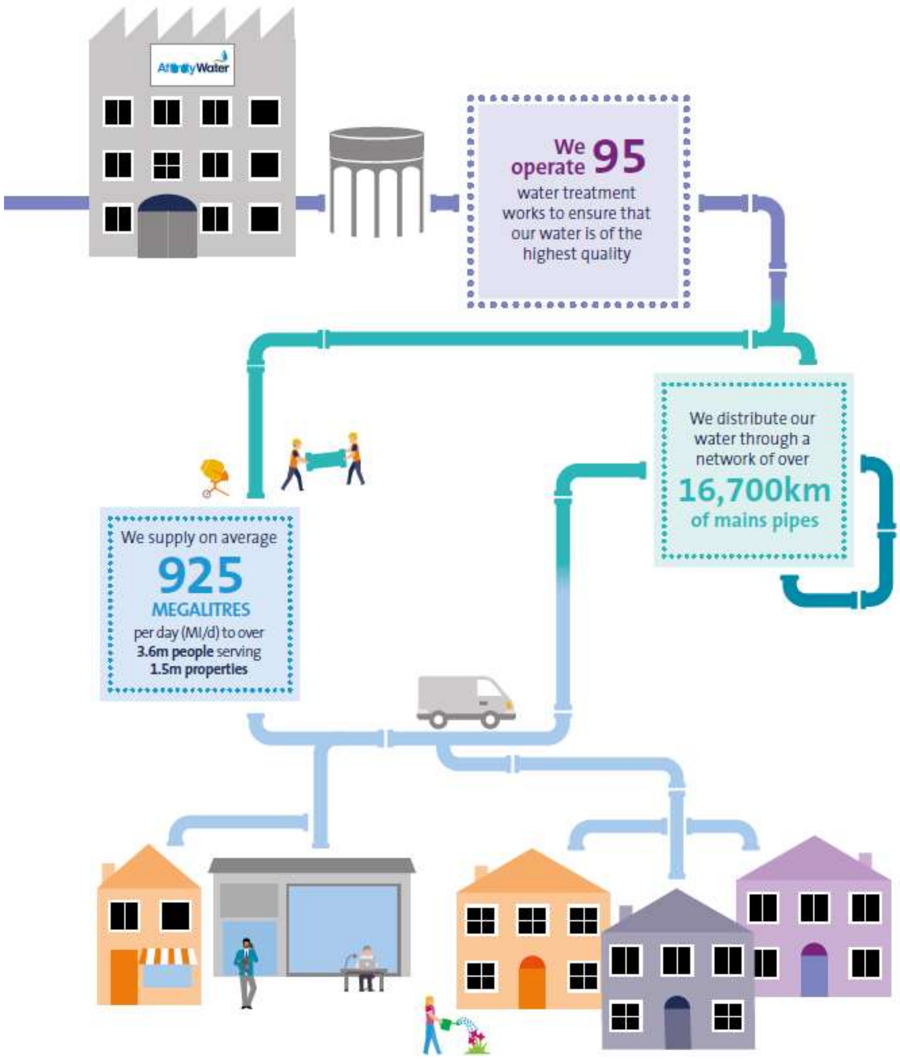
Published on 29 July 2020

Table of Contents

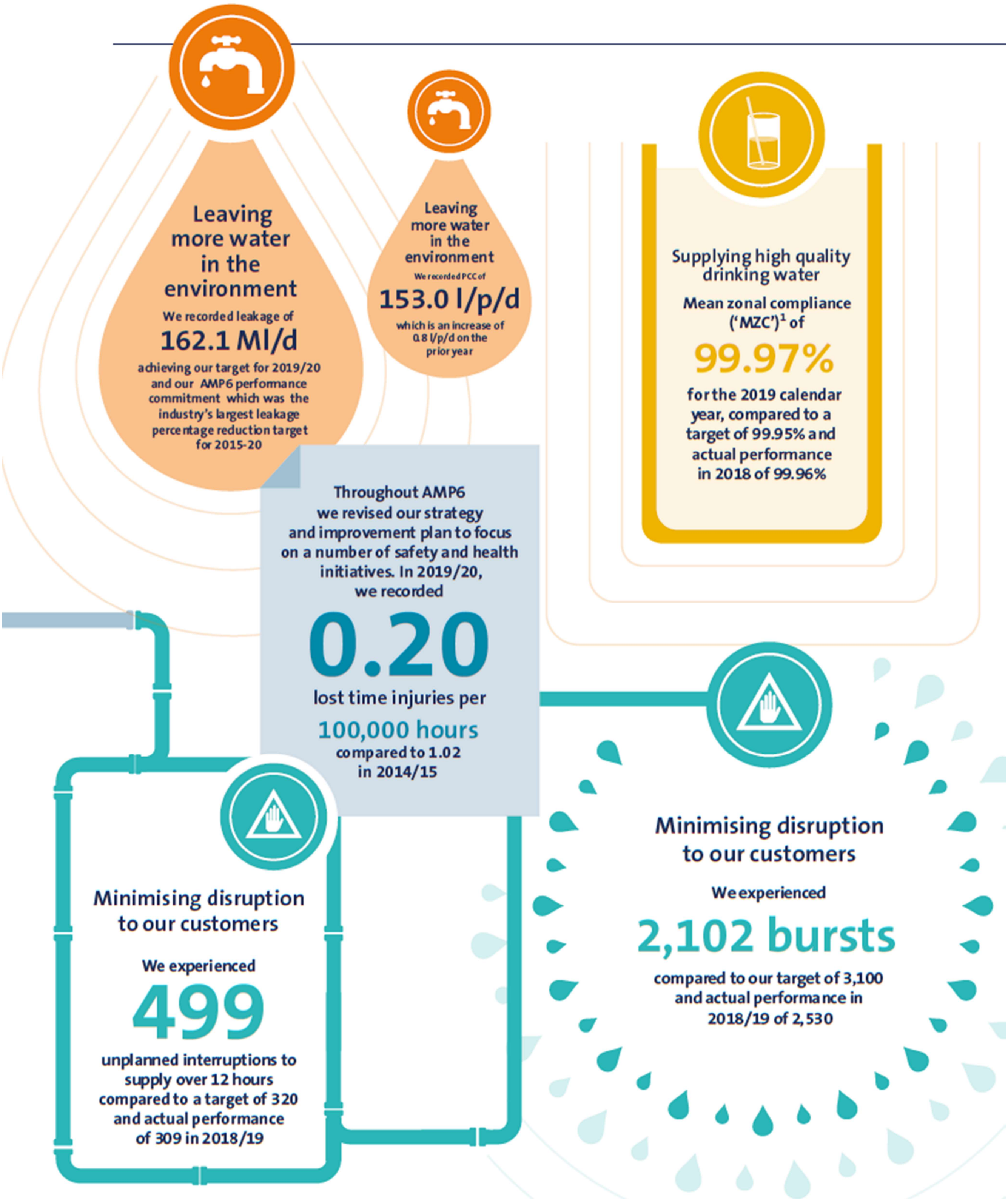
Contents

1 Affinity Water at a glance

Affinity Water Limited is the largest water-only supply company in the United Kingdom, owning and managing the water assets and network in an area of approximately 4,500km^2 across three supply regions in the South East of England. We sub-divide our supply regions into eight different communities, based on our existing water resource zones and each named after a local river, allowing us to tailor a high-quality service to customers at a local level.



2 Operational highlights



3 Financial highlights

Revenue (£m)	307.2	2019: 311.6
(Loss)/profit after tax (£m)	(21.7)	2019: 10.6
Regulatory Capital Value (RCV) (£m)	1,232.6	2019: 1,226.1
Senior Net Indebtedness (£m)	972.9	2019: 959.5
Gearing (%)	78.9%	2019: 78.3%
Conformed Senior Adjusted Interest Cover (times)	1.6	2019: 1.7

4 Our vision and commitments

Our continual vision is to be the UK's leading community focused water company. It reflects the importance we place on our people working within and for the communities of customers we serve. By understanding and responding to the needs of different community groups, we are accountable to them at a local level for how well we provide our services.

We draw upon our capitals as inputs for our business and transform them through our operating activities into our strategic outcomes, continuously balancing potentially competing imperatives to ensure alignment between the interests of customers, our people, our investors, regulators and stakeholders. This report shows how we are using our capitals to better understand our business impacts and dependencies, and the total contribution that we are making to all our stakeholders.

Our research showed that customers, employees and other stakeholders have a strong appetite for us to place the environment, and in particular the local environment, at the heart of our business. Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future. We aim to achieve our purpose by:

SUSTAINABLE WATER FOR THIS GENERATION AND THE NEXT

- Investing in the infrastructure we need
- Becoming world leading on reducing leakage
- Helping customers use the right amount of water and leading nationally on reduction of consumption.

LOOK AFTER BEAUTIFUL LANDSCAPES EVERYONE CAN ENJOY

- Reducing plastics in watercourses
- Leading on restoring local rivers including campaigning for change where needed
- Securing UNESCO World Heritage status for chalk rivers.

Our purpose links to our vision to be the UK's leading community focused water company both through explicit reference to our communities and the neighbourhoods that we serve but also by creating significant public value. Through investing capital in the environment we will create economic value to the regions we serve.

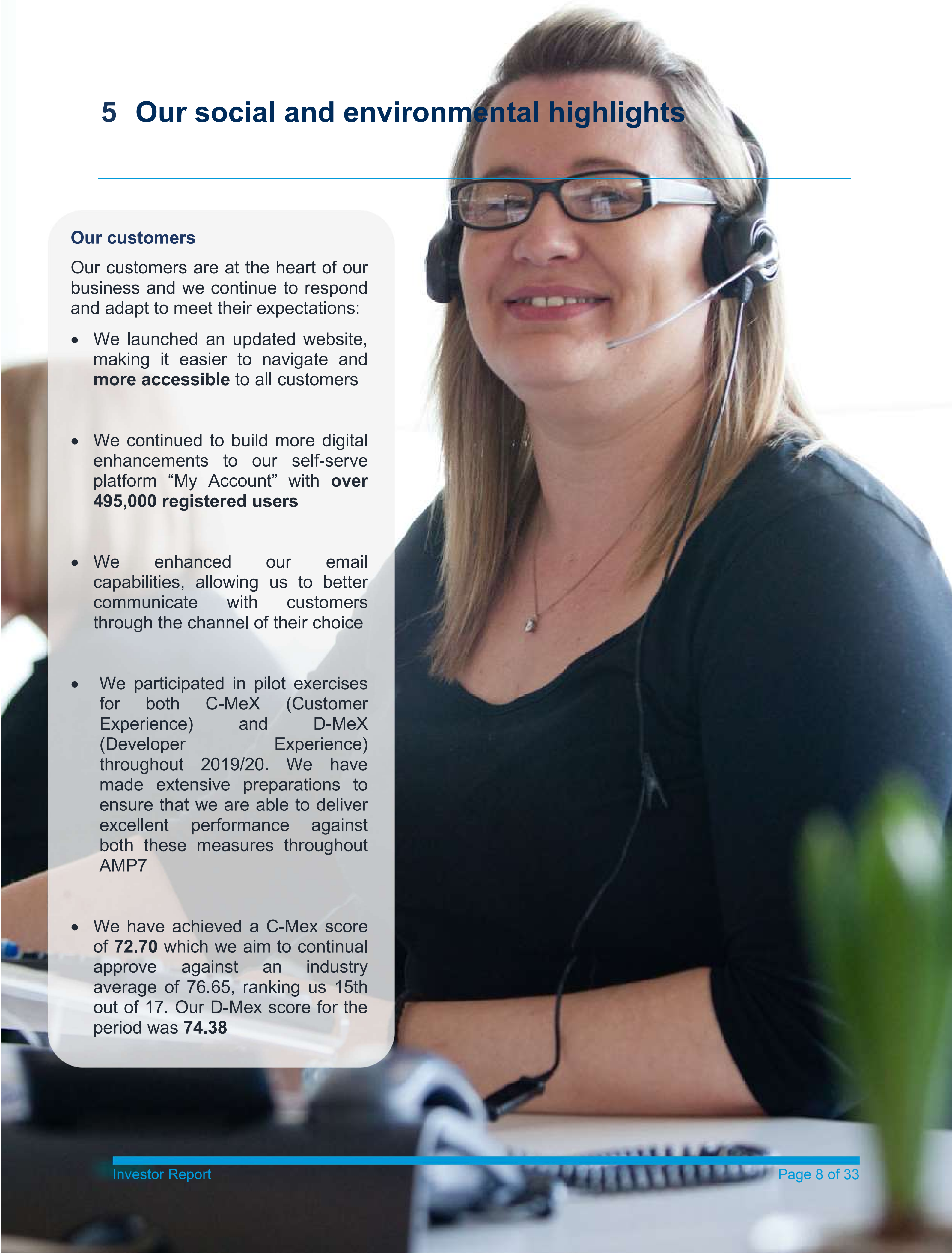
During Summer 2019, we unveiled our customer principles, which were borne out of the things that research has shown us matter most to our customers. Using these customer principles as a basis, we further established the values of our ideal internal culture that underpin how we will deliver for our stakeholders in the context of our purpose, giving us our company principles:

Going into AMP7, we have agreed even more challenging commitments with Ofwat. We recognise the difficulty of our targets but we owe it to our customers to achieve these targets. These commitments are a response to the significant social and environmental challenges we face, which are a rising population and increased demand for water, as well as a reduction in the availability of water in years ahead.

We want our customers and stakeholders to be able to measure our success and hold us to account. The table below summarises our achievements over AMP6 based on our promises. Additionally, the table includes some of our customers' expectations and the performance commitments we have made for AMP7 ('Asset Management Plan 7') which we have incorporated in our business plan. We have aligned our operational key performance indicators ('KPI's') to our key performance commitments in response to customer expectations.

Our AMP6 achievements	Our AMP7 commitments	
We maintained high quality drinking water throughout AMP6 by consistently meeting our MZC target of 99.95% We continued our targeted programme of lead pipe replacement to meet more stringent legal standards	To achieve a CRI score of less than 2.0 To continue to support the quality of our water resources through our catchment management and river restoration programmes to help habitats and biodiversity of rivers in our supply area To reduce the number of contacts about water appearance, taste and odour to 0.67 per thousand population per annum by 2024/25	**Supplying high quality water you can trust** KPI: Water quality
We reduced the amount of water we take from the environment by 42.1 Ml/d We encouraged our customers to use less water through our Water Saving Programme, by installing 159,000 meters We invested £500 million in our network to reduce leakage, saving the equivalent of 18.8 Ml/d	To reduce the amount of water we take from the environment by a further 27 Ml/d by 2024/25 and reduce abstraction from environmentally sensitive sites when flows or levels are low To reduce leakage from water pipes by 20% on a three year average basis from a 2019/20 baseline To reduce PCC by 12.5% on a three year average basis from a 2019/20 baseline	**Making sure you have enough water, whilst leaving more water in the environment** KPI: Sustainable abstraction
Average household bills reduced before inflation between 2015 and 2020 We promoted our social tariff (LIFT) to support those least able to pay their bill whilst keeping our bills as low as possible We made ourselves accountable to our communities for our performance	Average annual customer bills will reduce by 5.5% in real terms, and we will deliver over £200.0m of efficiencies to keep bills as low as possible To proactively provide assistance to more of our customers in vulnerable circumstances by understanding and prioritising their needs To improve customer experience by listening to customer needs and investing in the right technologies to deliver great customer interaction and increased engagement	**Providing a great service that you value** KPI: SIM (C-MeX in AMP7)
We invested in increased flexibility in our network enabling us to transfer water more effectively around our communities	To reduce supply interruptions to customers to 5 minutes per property per year on average by 2024/25 To reduce the number of properties at risk of receiving low pressure to 1.118 properties per 1,000 properties by 2024/25 To invest £1.44 billion in our wholesale business to maintain core network assets to keep services running 24 hours a day, 365 days a year, investing in local level assets such as pumps, mains upgrades, new mains and investment in service reservoirs that allow us to move water to where we need it	**Minimising disruption to you and your community** KPI: Mains bursts KPI: Unplanned interruptions to supply over 12 hours

5 Our social and environmental highlights



Our customers

Our customers are at the heart of our business and we continue to respond and adapt to meet their expectations:

- We launched an updated website, making it easier to navigate and **more accessible** to all customers
- We continued to build more digital enhancements to our self-serve platform "My Account" with **over 495,000 registered users**
- We enhanced our email capabilities, allowing us to better communicate with customers through the channel of their choice
- We participated in pilot exercises for both C-MeX (Customer Experience) and D-MeX (Developer Experience) throughout 2019/20. We have made extensive preparations to ensure that we are able to deliver excellent performance against both these measures throughout AMP7
- We have achieved a C-Mex score of **72.70** which we aim to continual approve against an industry average of 76.65, ranking us 15th out of 17. Our D-Mex score for the period was **74.38**

Our Assets and Sites

We continuously invest in our network, both in our above ground and below ground network of assets.

We produced **16,400 Tonnes of Sludge Cake** at two of our water treatment works which is used for agriculture.

The security of our assets and sites is extremely important to us and we worked hard to ensure all of our sites are now **compliant with the Security and Emergency Measure Directive obligation.**

We are constantly innovating and exploring new ideas and techniques to check whether our assets are running at optimum efficiency. We can now **monitor our pumps in real time** and identify the optimum mix of pumps.

The High Speed 2 ('HS2') project is a major national infrastructure project to develop the UK's new high speed rail network, with the proposed route passing through our supply area. We have worked hard to overcome complex design and construction challenges **while limiting the impact of the planned outages** on the wider network.

Our Community

We are privileged to serve our communities. Being the monopoly supplier and steward of a precious resource for future generations, we are acutely aware that we must continually invest in building trust and legitimacy with our customers. This is central to achieving our vision of being a community focused, sustainable and responsible business.

During the year we continued to hold stakeholder meetings across our communities, including our first **Stakeholder Assembly** with a cross section of delegates ranging from environmental agencies to regulators.

We maintain a **Priority Services Register** and include messages in our literature and on our bills to signpost customers to the help they need. We have trained our team members to recognise triggers that may indicate that a customer is in a vulnerable circumstance and to act accordingly. This is particularly important in light of the COVID-19 pandemic.

Our Environment

51 Swift Boxes installed on company sites in the year to encourage this rapidly declining species

We provided **125,000+ free water saving devices** in the year to help our customers to reduce consumption

We submitted our **Water Resources Management Plan** to the Secretary of State on 7 June 2019, which sets out how we plan to meet long-term resource challenges, having consulted extensively with various stakeholders.

Many of the **world's only chalk streams** flow through our supply area. We have completed six projects of restoration and habitat enhancement directly on these rivers.

In November, we won a **Green Apple Environment** award in the "Partnership approach – connecting people and wildlife" category for our achievements in environmental best practice, primarily in biodiversity management.

Improving water quality through our catchment management

We ran an innovative scheme incentivising farmers to grow cover crops over the 2019/20 winter period. We used a reverse-auction platform for farmers to bid competitively for funding to deliver the eco-system services we required.

Our aim was to work in partnership with landowners and other experts to improve water quality by reducing the amount of bare soil during the winter months, which can have a range of benefits including nitrate and carbon capture, flood risk management, soil health improvement and increased biodiversity.

We achieved over 500 hectares of cover crops replacing bare soil over the winter, having 12 farm businesses committed to growing cover crops in partnership with the Farming and Wildlife Advisory Group.

We

- Reduced the amount of nitrate leaching into nearby groundwater by an estimated 25 tonnes
- Increased water infiltration and reduced sediment erosion in current and future climate change scenarios
- Improved aesthetics of the countryside for the benefit of the communities who live there

Our People

Our people are members of more than **30 different professional bodies** from a range of disciplines including engineering, chemistry, biology, environmental management and accountancy

We appointed **12 Diversity and Inclusion Ambassadors** to better represent the interests of our staff. These ambassadors have a clear reporting line to the Board

We have **189 People** trained in the principles of Lean Methodology and business transformation

We have **131 people** trained in mental health support, knowledge and awareness

We recognise our people play a critical role in creating long-term value. Attracting and retaining highly motivated people who are proud to work for us is central to our ability to deliver outstanding service for customers.

Inaugural Culture Survey

In establishing the company purpose and mechanisms for monitoring culture, the Board considered our Customer Experience Principles, which are set out from the point of view of customers. In light of the results of our inaugural Culture Survey, to which 60% of our employees responded, the Board approved a mechanism for monitoring culture involving Culture Ambassadors and Culture Forums, with these Forums attended by Ambassadors and Board member Trevor Didcock.

- The Director of HR's role on the Executive Management Team has been **expanded to take responsibility for monitoring culture**
- We appointed **48 Culture Ambassadors** representing every department in Affinity Water
- **Quarterly Cultural Forums** regularly communicate and support the creation and execution of changes relevant to their departments

6 Operational performance

We have aligned our operational KPI to our key performance commitments in response to customer expectations. We want customers and stakeholders to be able to measure our success and hold us to account.

Making sure our customers have enough water, whilst leaving more water in the environment

We delivered a 42.1 Ml/d reduction in abstraction as at 31 March 2020, a similar performance to the previous year, achieving our sustainability reductions in line with our AMP6 Business Plan.

During AMP6 we constructed new infrastructure to enable us to move water around our network more effectively to maintain the level of service to our customers whilst also leaving more water in the environment.

We also completed projects on six chalk streams in our Central region as part of our river restoration and habitat enhancement programme, using a collaborative approach to deliver this work under our Revitalising Chalk Rivers partnership with the Environmental Agency.

Supplying high quality water our customers can trust

Customers continued to benefit from high quality drinking water during the year. In 2019, our MZC was 99.97% which exceeded our target of 99.95%.

In the calendar year 2019, there were 50 exceedances of standards from 190,000 compliance samples taken from our sites and consumer properties (2018: 64 exceedances from 180,000 compliance samples). Of these, 18 exceedances (2018: 19 exceedances) contributed to the MZC calculation. Another measure of our performance is the number of serious and significant incidents. During 2019 one event notified to the DWI was classified as serious or significant (2018: seven events).

Minimising disruption to our customers and communities

We have achieved our target every year of AMP6, achieving our lowest number of bursts (2,102) this year, benefitting from settled weather conditions.

Moving into AMP7, our mains burst reporting target has changed to mains repairs per 1,000 km of mains, the target for which equates to a significant reduction over that for 2015-20. We expect this will need significant monitoring and work to ensure we look for ways to reduce bursts and their effects on customers.

Work will continue to be focused on reducing night pressure, reducing the volatility of our network and providing analysis where and when bursts occur to inform our mains renewals programme, identifying areas in most need of investment.

Providing a value for money service

In 2019/20, SIM was no longer measured and was replaced with the ‘shadow reporting year’ C-MeX metric. Ofwat has tracked a “proxy” SIM score for the year ended 31 March 2020 but this is based on C-MeX and is not consistent with the SIM score in prior years. Our “proxy” SIM score is 79.0.

We have continued to calculate an internal SIM score, using a methodology consistent with prior years in order to monitor performance improvement. Our internal SIM score is 82.4, which is an increase on the prior year and shows continued steady improvement across AMP6.

7 Financial performance

Financial results for the year ended 31 March 2020

This year has been impacted financially by some large one-off costs, however during the year we have seen more stability in our underlying base costs. Towards the end of the financial year the COVID-19 pandemic commenced and this has affected our full year profits. We expect this to continue and have a further effect in 2020/21 and possibly beyond.

	2020	2019
	£000	£000
Revenue	**307,240**	311,569
Cost of sales	**(227,820)**	(216,643)
Gross profit	**79,420**	94,926
Administrative expenses	**(42,839)**	(48,117)
Impairment losses on financial and contract assets	**(9,470)**	(6,128)
Other income	**18,449**	17,896
Operating profit	**45,560**	58,577
Profit on disposal of subsidiary	**-**	25
Finance income	**8,391**	6,590
Finance costs	**(52,044)**	(49,131)
Fair value loss on financial instrument	**(1,816)**	(2,389)
Net finance costs	**(45,469)**	(44,930)
Profit before tax	**91**	13,672
Tax expense	**(21,773)**	(3,103)
(Loss)/profit for the year	**(21,682)**	10,569

Revenue for 2019/20 was £307.2m, being a £4.4m (1.4%) decrease on the prior year (2019: £311.6m). The decrease is primarily due to lower non-household revenue as a result of final settlement reports issued by the market operator, as well as the impact of COVID-19 causing a large number of businesses to temporarily close and therefore use less water in March 2020.

Operating expenditure

Operating costs for the year increased by £9.2m (3.4%) to £280.1m (2019: £270.9m). The largest cost increases were due to inflation, which was 2.63% for the year to March 2020 and depreciation (excluding right-of-use assets) as a result of the ongoing investment in our mains network and IT software, as more assets have been capitalised and are therefore now being depreciated.

Finance costs

The net finance expense of £45.5m was £0.6m higher than last year. This was to some extent offset by our net interest receivable on the £135.0m RPI linked inflation swap, which was entered into in August 2018. In March 2020, we entered into our 1st CPI linked swap with a nominal value of £25.0m. Post the reporting date, we entered into CPI-linked interest swap bringing the total CPI linked interest nominal value to £250.0m. This will reduce the financing costs over the upcoming periods.

Profit before tax

Profit before tax for 2019/20 was £0.1m, being a £13.6m (99.3%) decrease on prior year (2019: £13.7m), primarily due to the increase in operating costs and the swap's fair value loss, as well as the effect of changes to statutory reporting on adoption of IFRS 16: 'Leases' ('IFRS 16').

Taxation

The income tax expense on profit before tax was £21.8m (2019: £3.1m). The effective current tax rate (23,928.8%; 2019: 28.6%) was higher (2019: higher) than the UK corporation tax rate of 19.0% (2019: 19.0%), primarily due to a change in the tax rate. In the 2020 Spring Budget, the government announced that the Corporation Tax rate would remain at 19% from 1 April 2020, rather than reducing to 17% as had been previously announced. This resulted in an additional deferred tax liability and charge in the year.

All our profits are taxed in the UK, and we do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities. In March 2020, we were once again accredited with the Fair Tax Mark.

Capital expenditure

Capital expenditure in the year was £129.9m (2019: £107.2m), and was incurred principally in our mains renewals, trunk main replacement, lead pipe replacement, water treatment (including pesticide treatment) and integrated water savings programmes.

This excluded £17.2m (2019: £17.3m) of infrastructure renewal expenditure, which is treated as an operating cost under FRS 101. The higher capital expenditure in 2019/20 reflected our increased work on the HS2 project, for which we also received higher capital contributions offsetting these costs.

Net debt and gearing

Our net debt as at 31 March 2020 was £972.9m, an increase of £13.4m since last year (2019: £959.5m) primarily due to accretion on the index-linked bonds. Our gearing as measured by net debt to RCV at 31 March 2020 was 78.9% (2019: 78.3%) which remains below our internal maximum gearing level of 80.0% of RCV. This allows sufficient headroom within financial covenants, which are only triggered at a level of more than 85.0%. While we have at first sight higher gearing than some of our peers in the water industry, this measure does not necessarily reflect the actual cost of this debt, and our strong pension position. It is our intention to reduce our gearing over AMP7. The company renewed two revolving credit facilities on 24 June 2020 totalling £100.0m, which use SONIA as the reference rate and have sustainability performance measures included.

Dividends

No equity dividends were paid during the year (2019: £6.6m, none of which related to the regulated business) reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

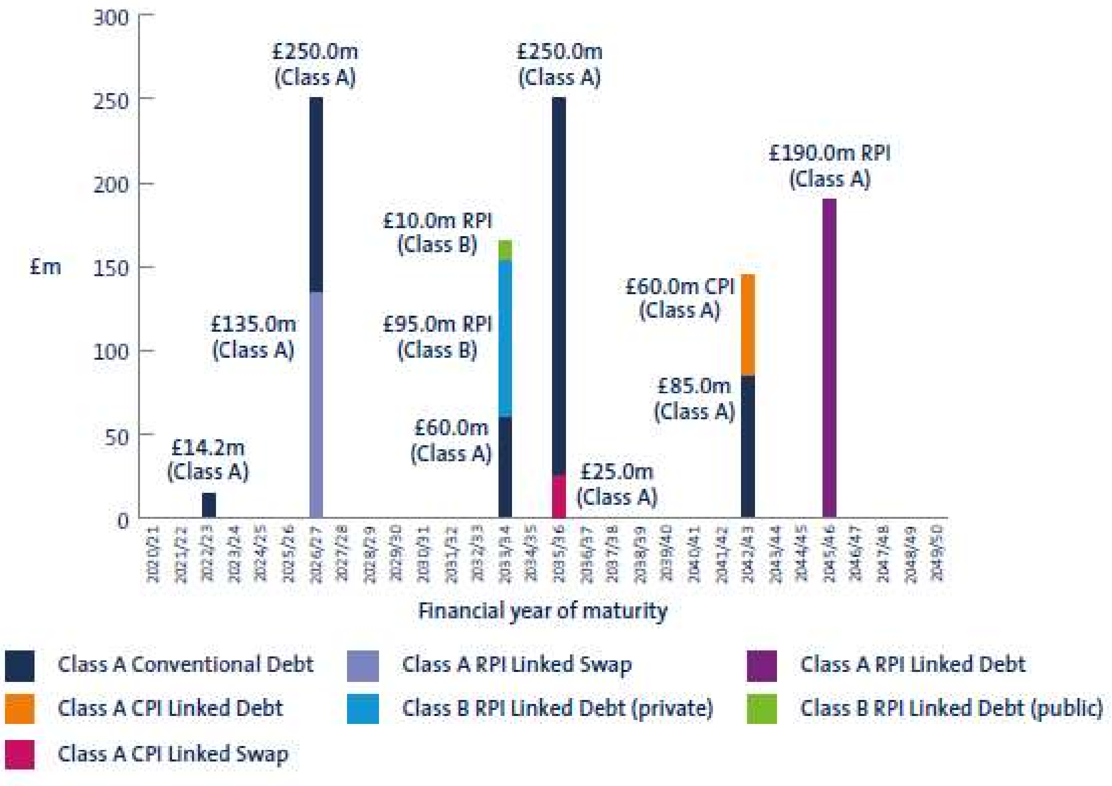
AMP6 total expenditure ('totex')

Our overall totex for AMP6 showed an overspend of £30.3m (2.56%) in outturn prices compared to our allowed expenditure, although the amount we expect customers to fund through the sharing mechanism is only £4.0m (in 19/20 prices). This was primarily due to pension deficit costs higher than allowed in our PR14 Final Determination (we paid more into our pension scheme to take it to a fully funded basis on a self-sufficiency basis). These costs are outside the sharing mechanism and therefore have been fully at the company's expense and offsetting the financing cost of an underspend in the first few years of AMP6.

8 Financing Update

In March 2020, we transacted further £25.0m interest rate swap aligned with the terms Affinity Water Finance PLC £250.0m bond which matures on 31 March 2036. We have transacted a further £225.0m worth of swaps with this bond over the financial year 2020/21. These swaps will further increase our Interest Cover Ratio Headroom over AMP7.

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



During the period we obtained an additional credit rating from Fitch. Moody's affirmed the credit rating of our Class A and B bonds maintaining A3 and Baa3 respectively. However, Standard & Poor's had downgraded both classes from A- and BBB to BBB+ and BBB- respectively.

Bonds	Moody's	Standard & Poor's	Fitch
Class A	A3	BBB+	BBB+
Class B	Baa3	BBB-	BBB-
Corporate family rating	Baa1	Not applicable	Not applicable

9 Regulatory update

Asset Management Plan 7 (AMP7)

In December 2019, Ofwat published our Final Determination which set out what we need to deliver over the next 5 years. This includes the allowed revenue that we can recover from our customers and how it was determined based on their calculation of efficient costs and the allowed return on capital.

The main points of the determination include the below:

1. At the start of this new regulatory period, we are facing a significant cut in allowed wholesale returns to around 2.4% real in cash terms, compared with 3.6% in AMP6, as well as challenging performance targets
2. Affinity Water routinely have customer billing below the industry average. We are committed to further reduce average annual customer bills by 5.5% in real terms, and we will deliver over £200.0m of efficiencies to keep bills as low as possible
3. To reduce average supply interruptions to customers to 5 minutes per property per year by 2024/25 as well as to reduce the number of properties at risk of receiving low pressure to 1.118 properties per 1,000 properties also by 2024/25
4. A leakage reduction target of 20% (142.80Ml/d by 2024/25) on a three year average as well as a Per Capita Consumption reduction target of 12.5% (to 132.6 litres per household per day by 2024/25);
5. Reduce the number of customer contacts regarding appearance, taste and odour of water to 0.67 per thousand population by 2024/25, achieving a Compliance Risk Index score of less than 2.0.
6. Delivering our biggest investment programme and reducing operating costs. We are to invest £1.441 billion in our wholesale business to maintain core network assets to keep services running 24 hours a day. Of the £1.441 billion allowed expenditure: £121.0 million to improve the environment by efficiently delivering our obligations as set out in the Water Industry National Environment Programme (‘WINEP’), £146.0 million for supply and demand balance schemes and strategic water resource development, including long-term drought resilience; and £57.3 million for new meter installations

10 Governance update

Our shareholders have an important role to play and a direct interest in the strong and effective governance and stewardship of our business. We explain how we engage with our shareholders and involve them in decision making in our publication: *Engaging with our Shareholders*.

Our Board now reports under the revised Ofwat Board Leadership, transparency and governance principles. These have been incorporated into the Board's Governance framework.

We continue to meet Ofwat's expectations for independent non-executive directors to form the largest single group on the Board, compared to investor-appointed non-executive directors and executive directors. During the year the Board has continued to focus on the company's risk management and internal control systems.

Furthermore, our annual statement has been prepared in accordance with the principles of the UK Corporate Governance Code 2018. Our disclosures reflects the principles within the Code and provides details on the activities and governance processes of the Board and its Committees.

We believe that we already met many of the objectives and principles, however, further work was undertaken during the year to ensure the company's purpose, strategy and values were clear, transparent and reflective of the needs of our stakeholders.

Executive appointments

Keith Gardner joined as our Asset Strategy, Data and Innovation Director on 23 April 2019 from Black and Veatch where he was Head of Strategic Business Consultancy. Prior to his consultancy roles, Keith has worked extensively across the water sector.

Joe Brownless joined as our Customer Experience Director on 10 June 2019 from Mars, Inc, where he held the position of Consumer Relations Director, Europe. Prior to that, Joe has worked across a range of businesses including Capita and Tesco Mobile.

Graham Turk was promoted to the new position of Director of Production and Supply on 1 July 2019. He previously held the position of Head of Production and Supply.

Gurvinder Badesha was appointed Director of Assurance, SHEQ and Water Quality, a new position, on 5 August 2019. He joins from National Grid where he led the development and delivery of a robust second line assurance function for the UK's Gas Transmission business.

On 11 November 2019, **Stève Hervouet** was appointed as Director of Regulation and Supply. With experience in the industry, Steve joins from Water Plus he held the position as Head of Regulation and Compliance also holding the position of Head of Economic Regulation at Sembcorp Utilities.

Sue Flower started as Director of HR and Culture on 19 February 2020. Sue has a track record of successfully implementing HR strategies, particularly in companies undergoing transformation and change. She's worked in a variety of companies including Motorola Solutions/Airwave, Barclays Bank and Bristol Myers Squibb and has led improvements in management competencies, employee relations and productivity levels.

Sunita Kaushal was appointed as General Counsel and Company Secretary on 1 April 2020. Sunita is an accomplished solicitor with experience in global businesses. She has worked for Bakkavor Plc, a global food manufacturing business, De Vere Group who specialise in the hospitality sector and Cushman and Wakefield, a global real estate business.

Board appointments

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

During this period, we appointed two new members to our board. On 19 December 2019, **Mark Horsley** was appointed as an Independent Non-Executive Director ('INED'). As a newly appointed INED, Mark brings to the Board his extensive experience working within the energy sector. His previous senior roles enable him to offer specialist advice, strategic guidance, while constructively challenging in order to hold management to account against agreed performance objectives, As a member of the Audit Committee, Mark's fundamental participation is to satisfy himself on the integrity of information and that financial controls and systems of risk management are robust and defensible.

On 25 March 2020, **Ann Bishop** was appointed as an INED. Ann was the founder and managing director of a management consultancy company, working with clients facing the challenges of regulation, deregulation, competition and restructuring. She has over 30 years' experience in the regulated sectors working with investors, the chair, chief executives, board members and senior executive teams, helping to develop and implement policy and strategy. Ann has advised across regulated industries since privatisation, through price reviews and industry reform and has a good understanding of the water, regulated energy networks, telecoms and rail industries across the world.

Justin Read was appointed to the Board on the 14 July 2020 as a INED Board member. Justin has a wealth of financial and management experience working across a number of different industry sectors, including real estate, support services, building materials and banking. His experience of managing businesses across multiple jurisdictions has been honed at Euro Disney, Bankers Trust and Hanson plc. Justin has a proven track record of creating successful growth in a wide variety of businesses both within the UK and internationally. His substantial experience within corporate finance has seen him appointed as non-executive director within a range of companies.

11 Significant Business Developments

COVID-19

The provision of high-quality water and the health and well-being of our people are of utmost importance and as a company we are closely managing the situation through our COVID-19 Incidence Response Team.

Operational Changes

Affinity Water continue to follow government health advice to make sure our customers and our colleagues stay safe, and are putting all the necessary measures in place to ensure this advice is followed by everyone. We understand this is a challenging time for everybody and we have put our robust business continuity plans into action so we can make sure we can still supply our water services to all our customers in the South East. We are focusing our teams on essential work to ensure we have sufficient resources available to continue to supply high quality drinking water. Research from the World Health Organisation shows that the water treatment process, specifically the addition of chlorine, which is routinely used for disinfection, neutralises the virus. Customers can therefore trust the virus is not spread through the water from source to tap.

To reduce the risk of spreading the virus, our colleagues are practising the social distancing measures as instructed by the government. Colleagues are not entering customers' properties unless for a water quality, loss of supply or safety issue. Teams have been provided with the appropriate protective equipment to allow them to do this safely; other teams are working from home where possible and we have increased the distance between workspaces in our call centres.

Our people are also regularly updated on the company policies on COVID-19. We have created an intranet site to directly inform colleagues on update in the pandemic. In addition, our EMT regularly release company updates through weekly newsletter and recordings regarding COVID-19.

Customer and Community Changes

Customers are central to our business; we are obligated to ensure that they not only receive high quality water but they are also supported by the company. We recognise that many of our customers may be impacted financially by COVID-19. We have several schemes in place in response to COVID-19 in addition to those we already offer our customers. The additional schemes include payment breaks, the option of spreading the cost of bills and alternative tariffs such as our WaterSure scheme. Details of these are widely available to customers on our website.

Financial Provisions

As the extent of the pandemic is still emerging, the financial implications are not yet known. We as a business have taken several steps to ensure our continuity. Affinity Water have ample liquidity for the next 2 years which provides a strong position when entering a potentially difficult period.

We have carried out several stress test scenarios, detailed in our viability statement. The base case cash flow has taken into consideration the impact of COVID-19 in the first year of AMP7, using the assumption that the pandemic has a one-off impact impacting revenue and bad debt projections and has reprofiled capital expenditure, however has not been considered to have a material impact on our operating costs. Any longer-term financial implications of COVID-19 are then considered to be covered as part of our stress test scenarios. Our Board continues to monitor the impact of COVID-19 and this has become a key agenda item at Board meetings. For a more detailed breakdown of the provision for COVID-19 please refer to our viability statement in our annual accounts.

12 CTA compliance

AWL has adopted IFRS 16: 'Leases' ('IFRS 16') from 1 April 2019, but has not restated comparatives for the prior reporting period, as permitted under the specific transitional provisions in the standard. Reclassifications and adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 April 2019. The key change arising from IFRS 16 is that most operating leases will be accounted for on balance sheet for lessees, thereby impacting the Income Statement and Statement of Financial Position from the adoption date. In particular IFRS 16 would result in the removal of operating lease costs from Operating Expenditure, being replaced with additional depreciation and interest charges. This accounting treatment has been excluded for the purposes of calculating the ratios.

Calculation of financial ratios

Date		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Class A Net Indebtedness divided by	£m	848.1	869.3	934.9	994.9	1,001.0	1,014.7
RCV	£m	1,232.6	1,315.7	1,426.6	1,533.9	1,624.0	1,677.2
Class A RAR	**Ratio**	**0.69**	**0.66**	**0.66**	**0.65**	**0.62**	**0.61**

Senior Net Indebtedness divided by	£m	972.9	997.8	1,067.2	1,131.2	1,141.5	1,159.3
RCV	£m	1,232.6	1,315.7	1,426.6	1,533.9	1,624.0	1,677.2
Senior RAR	**Ratio**	**0.79**	**0.76**	**0.75**	**0.74**	**0.70**	**0.69**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Net Cash Flow divided by	£m	108.7	103.7	116.0	125.4	127.9	140.4
Class A Debt Interest	£m	29.1	24.2	23.6	23.7	24.4	24.5
Class A ICR	**Ratio**	**3.7**	**4.3**	**4.9**	**5.3**	**5.2**	**5.7**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Net Cash Flow less	£m	108.7	103.7	116.0	125.4	127.9	140.4
CCD and IRC	£m	0	0	0	0	0	0
Adjusted Net Cash Flow divided by	£m	108.7	103.7	116.0	125.4	127.9	140.4
Class A Debt Interest	£m	29.1	24.2	23.6	23.7	24.4	24.5
Class A Adjusted ICR	**Ratio**	**3.7**	**4.3**	**4.9**	**5.3**	**5.2**	**5.7**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Net Cash Flow less	£m	108.7	103.7	116.0	125.4	127.9	140.4
CCD and IRC	£m	0	0	0	0	0	0
Adjusted Net Cash Flow divided by	£m	108.7	103.7	116.0	125.4	127.9	140.4
Senior Debt Interest	£m	32.8	28.0	27.6	27.8	28.6	28.8
Senior Adjusted ICR	**Ratio**	**3.3**	**3.7**	**4.2**	**4.5**	**4.5**	**4.9**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Year 1	Ratio	3.7	4.3	4.9	5.3	5.3	5.3
Year 2	Ratio	4.3	4.9	5.3	5.2	5.2	5.2
Year 3	Ratio	4.9	5.3	5.2	5.7	5.7	5.7
Class A Average Adjusted ICR	**Average**	**4.3**	**4.8**	**5.2**	**5.4**	**5.4**	**5.4**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Year 1	Ratio	3.3	3.7	4.2	4.5	4.5	4.5
Year 2	Ratio	3.7	4.2	4.5	4.5	4.5	4.5
Year 3	Ratio	4.2	4.5	4.5	4.9	4.9	4.9
Senior Average Adjusted ICR	**Average**	**3.7**	**4.1**	**4.4**	**4.6**	**4.6**	**4.6**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Net Cash Flow less	£m	108.7	103.7	116.0	125.4	127.9	140.4
RCV Depreciation and Capitalised IRE	£m	54.8	63.9	70.9	75.9	83.8	94.7
Conformed Adjusted Net Cash Flow divided by	£m	53.9	39.8	45.1	49.6	44.1	45.8
Class A Debt Interest	£m	29.1	24.1	23.6	23.7	24.4	24.5
Conformed Class A Adjusted ICR	**Ratio**	**1.9**	**1.6**	**1.9**	**2.1**	**1.8**	**1.9**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Net Cash Flow less	£m	108.7	103.7	116.0	125.4	127.9	140.4
RCV Depreciation & Capitalised IRE	£m	54.8	63.9	70.9	75.9	83.8	94.7
Conformed Adjusted Net Cash Flow divided by	£m	53.9	39.8	45.1	49.6	44.1	45.8
Senior Debt Interest	£m	29.1	24.1	23.6	23.7	24.4	24.5
Conformed Senior Adjusted ICR	**Ratio**	**1.9**	**1.6**	**1.9**	**2.1**	**1.8**	**1.9**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Year 1	Ratio	1.8	1.7	1.9	2.1	2.1	2.1
Year 2	Ratio	**1.7**	1.9	2.1	1.8	1.8	1.8
Year 3	Ratio	**1.9**	2.1	**1.8**	1.9	1.9	1.9
Conformed Class A Average Adjusted ICR	**Average**	**1.8**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**

Test period		Year 1 1 April 2019 To 31 March 2020	Year 2 1 April 2020 To 31 March 2021	Year 3 1 April 2021 To 31 March 2022	Year 4 1 April 2022 To 31 March 2023	Year 5 1 April 2023 To 31 March 2024	Year 6 1 April 2024 To 31 March 2025
Year 1	Ratio	1.6	1.4	1.6	1.8	1.8	1.8
Year 2	Ratio	1.4	1.6	1.8	1.5	1.5	1.5
Year 3	Ratio	1.6	1.7	1.6	1.6	1.6	1.6
Conformed Senior Average Adjusted ICR	**Average**	**1.6**	**1.6**	**1.7**	**1.6**	**1.6**	**1.6**

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

Date	**31 March 2020 £m**
Borrowings	1,090.6
Exclude Permitted Legacy Loan	(3.6)
Add Back Unamortised Debt Issue Costs and Bond Premium	(17.1)
Add Accrued Interest	8.8
Add Swap Accretion	4.9
Less Cash and cash equivalents and short term deposits classified as investments	(110.8)
Senior Net Indebtedness	**972.9**
Remove Class B Debt Amounts	(124.8)
Class A Net Indebtedness	**848.1**

13 Further certifications

Surplus

Our Board has approved dividend and executive remuneration policies that provide for dividends and executive remuneration proportionate with long-term returns and performance of the company, whilst not impairing its longer term financeability. The performance of the company comprises our financial performance as well as an assessment of performance in the following areas: customer service, operational commitments, community commitments and people.

During the financial year, Affinity Water Limited paid no equity dividends (2019: £6.6m). This was agreed with our shareholders to reinvest funds into the entity to the benefit of our customers.

Authorised Investments

Terms	Bank Deposits (£m)	Liquidity Funds (£m)	Total (£m)
Overnight	10.0	42.0	52.0
3 Months	10.0	-	10.0
6 Months	20.0	-	20.0
9 Months	10.0	-	10.0
1 Year	0.0	-	0.0
Total	50.0	42.0	92.0

Debt Service Reserve Accounts

There is no balance in each of the Debt Service Reserve Accounts as at 31 March 2020. The required debt service reserve is provided by a liquidity facility from HSBC Bank PLC totalling £38.0m.

Permitted Subsidiaries acquired

There were no Permitted Subsidiaries acquired pursuant to a Permitted Acquisition in the period to 31 March 2020.

Annual Finance Charge

Affinity Water Limited has calculated the Annual Finance Charge for the period from 1 April 2020 to 31 March 2021 as £30.2m after incorporating swaps transacted in 2020/21 and the Monthly Payment Amount to be £2.8m. Calculation of the Annual Finance Charge is set out in the table to the right.

	1 April 2020 to 31 March 2021 (£m)
Forecast interest paid on bonds and swap	29.5
Forecast interest paid on loans	0.0
Other recurring finance fees paid	0.7
Total	**30.2**

Additional confirmations

Affinity Water Limited also confirms that:

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

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

Affinity Water adopted a new standard for the current reporting period:

(a) IFRS 16: Leases

Yours faithfully,

Stuart Ledger

Chief Financial Officer

For and on behalf of

Affinity Water Limited

(in its capacity as Transaction Agent)

Appendix

Additional periodic information

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

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

https://www.affinitywater.co.uk/docs/charges/2019-20/2019-20-Charges-Scheme.pdf

Affinity Water Limited's annual drinking water quality report

https://www.affinitywater.co.uk/docs/Water_quality/water-quality-report-2018.pdf

Affinity Water Limited's environmental performance

https://stakeholder.affinitywater.co.uk/environment.aspx

Risk, strengths and weaknesses statement

https://www.affinitywater.co.uk/docs/governance_assurance/Risks,%20Strengths%20and%20Weaknesses%20Statement%20November%202019%20FINAL.pdf

Customer performance report

https://www.affinitywater.co.uk/docs/corporate/Our-Year-In-Review-2018-19-March-20.pdf

Draft Water Resources Management Plan 2019

https://www.affinitywater.co.uk/docs/corporate/plans/portal/Draft_Water_Resources_Management_Plan_2020-2080_March%202018.pdf

Governance code

https://www.affinitywater.co.uk/corporate/about/governance-assurance

Gender pay gap report

https://www.affinitywater.co.uk/docs/reports/Gender-Pay-Gap-2019.pdf