AffinityWater

Understanding our finances 2021

Contents

Purpose of this report

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

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

Glossary of key water industry terms

AMP – Asset Management Plan
The five-year price control period covered by a company's Business Plan. AMP7 covers years 2020-25.

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

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

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

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

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

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

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

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

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

WINEP – Water Industry National Environment Programme
A set of actions that water companies must complete in order to meet their environmental obligations.

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

Our regulators

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

Defra – Department for the Environment, Food and Rural Affairs
The UK Government department responsible for water policy.

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

EA – Environment Agency
A non-governmental organisation which controls, among other things, how much water we can abstract from the environment.

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

Affinity Water at a glance

We are the largest water-only supply company in the UK, owning and managing the water assets and network in an area of approximately 4,500km² across three supply regions in the South East of England.

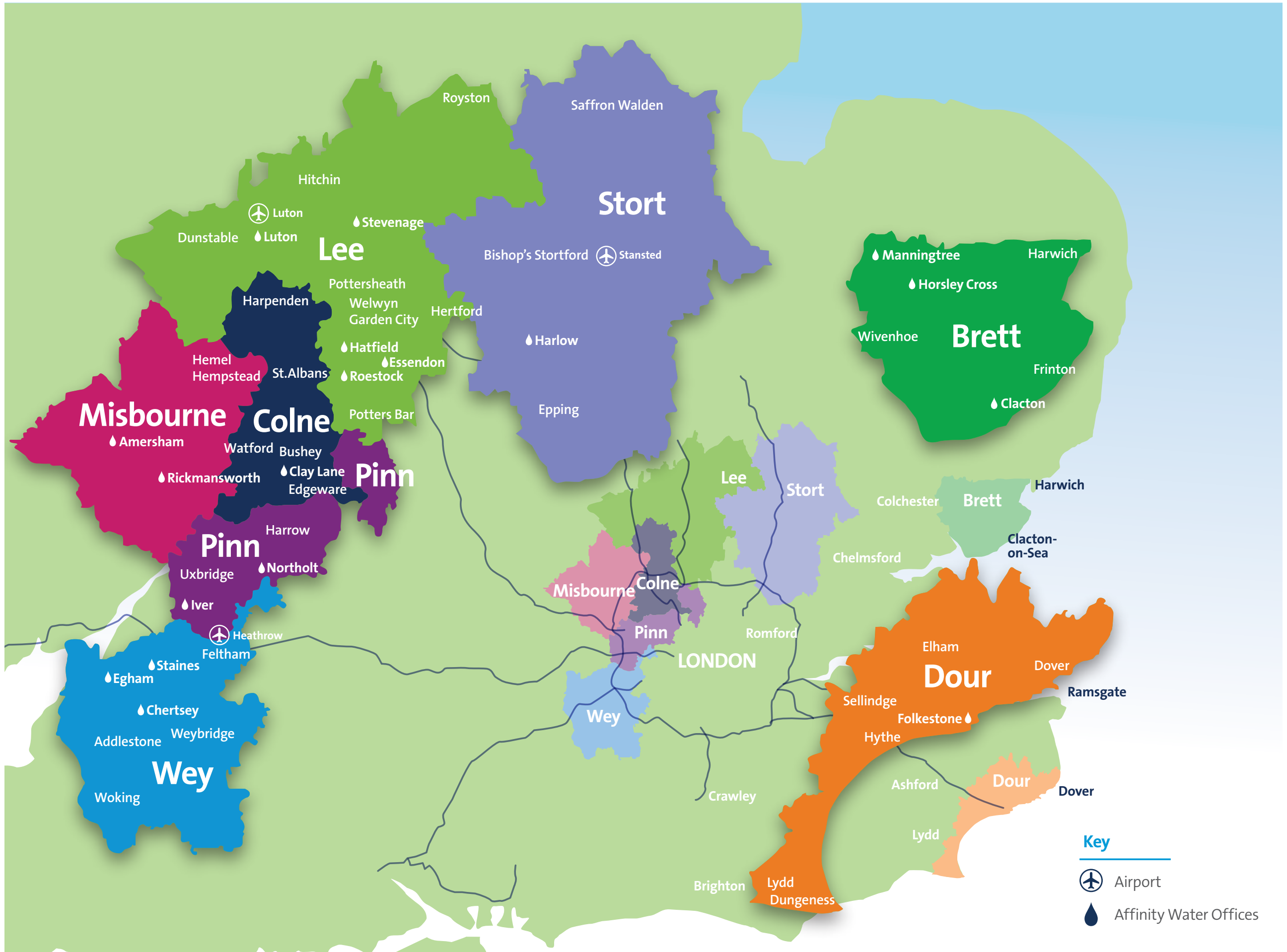
We sub-divide our supply regions into eight different communities, based on our existing water resource zones and each are named after a local river, allowing us to tailor a high-quality service to customers at a local level.

We supply on average 950 Ml/d to over 3.8 million people. We operate 93 water treatment works to ensure that our water is of the highest quality, distributing our water through a network of over 16,800km of mains pipes.

Our vision

Our vision is to be the UK's leading community-focused water company. Our people serve our customers and their communities every day of the year.

In doing so we understand the needs of our communities at a grass roots level and provide them with the best possible service.



Our purpose

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

Our Strategic Direction Statement ambitions are:

- Leave the environment in a sustainable and measurably improved state;
- Deliver what our customers need, ensuring affordability for all;
- Be prepared for change, and resilient to shocks and stresses; and
- Work with our communities to create value for the local economy and society.

Interim Chief Executive Officer's introduction

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

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

We are a business with a long-term outlook. We planned to invest £1.44bn in our wholesale business during AMP7 (2020-25) and have spent a total of £286.6m in 2020/21. Our investment will be key to maintaining resilience and making sure our customers have enough water, whilst leaving more water in the environment. Refer to page 6 for more detail on our investment.

During 2020/21, we paid £1.1m into Ofwat's Innovation Fund in Water Challenge, an industry-wide initiative to drive transformational change and better meet the evolving needs of customers, society and the environment. In April 2021, Ofwat announced 11 winning projects, two of which we had led on – Seagrass Seeds of Recovery and Smarter Tanks, both of which will improve the efficiency and resilience of our water supplies.

In February 2021, we liquidated our Cayman Islands entity, having previously substituted it with a UK subsidiary. We have an ongoing project to further simplify our group structure and to improve transparency. Refer to pages 4 to 5 for more detail on our ownership and group structure.

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

Our gearing is calculated as the ratio between our net debt (the total of our borrowings less cash) and our RCV (the economic value of our regulated business, as determined by Ofwat). At 31 March 2021, our gearing was 76.0% and we intend to continue to reduce our gearing over AMP7. We will do this by restricting dividends to our shareholders, instead re-investing the majority[1] back into our business for the benefit of customers.

In March 2021, we issued shares totalling £4.0m, demonstrating the long-term investment of our shareholders.

In October 2021, we issued our first green bond with a nominal amount of £130.0m and total proceeds of £147.8m, which will be used to fund projects which are fundamental to our Sustainability Strategy and will support our environmental objectives.

We operate as a regional monopoly, so our prices are tightly controlled by Ofwat. Our AMP7 price control set an initial drop in revenue, followed by real terms increases, so household bills in 2021/22 are expected to be about 6.6% higher than in 2020/21 (£173). Refer to page 8 for more detail on our bills.

Our policy for executive director pay as well as annual bonus plan targets continue to be aligned to the company's performance whilst ensuring the cost of water remains affordable.

Annual bonus plan targets continue to be aligned for the executive director, senior manager, selected manager and company-wide schemes. This means that all employees across our business share a common focus and are accountable for delivering against our high customer and operational performance targets. Refer to page 12 for more detail on our executive remuneration.

I am extremely proud that in February 2021, we were re-accredited with the Fair Tax Mark for the third year running, which recognises that we pay the right amount of corporation tax, at the right time and in the right place. Refer to pages 13 to 14 for more detail on our taxes.

Stuart Ledger
Interim CEO

85,000 households now supported by our social tariffs

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

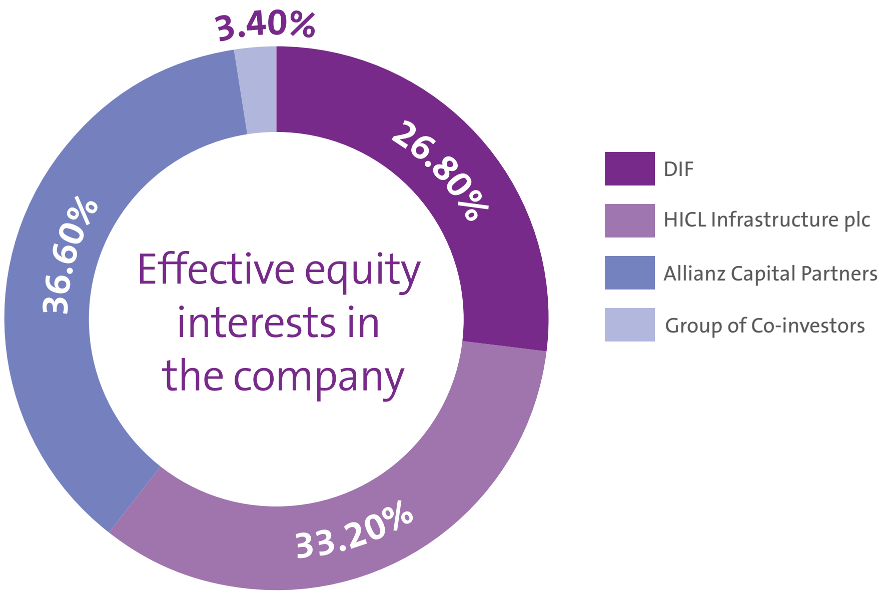
Our average annual household bill for 2020/21 was **£173**

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

Our shareholders

On 19 May 2017, Affinity Water Acquisitions (Investments) Limited was acquired by a consortium comprising DIF, HICL Infrastructure Company Limited (advised by InfraRed Capital Partners Limited) and Allianz Capital Partners on behalf of the Allianz Group. Subsequent to the initial acquisition, HICL Infrastructure Company Limited sold 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds in June 2017.

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



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

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

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

Engaging with our shareholders

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

Equity dividends of £1.0m were paid from our non-appointed business (the parts of our business not regulated by Ofwat) in 2020/21. This was in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers. No dividends were paid in 2019/20.

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

affinitywater.co.uk/governance-assurance

Understanding our group structure

The chart on the right shows the structure of the group, excluding dormant subsidiaries, as at 31 March 2021. Unless otherwise indicated, all companies are wholly owned by the parent company shown.

Whole Business Securitisation ring-fence

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

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

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

Our financing subsidiaries

We have two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority (‘UKLA’) and the proceeds of which have been lent on to and are guaranteed by the company.

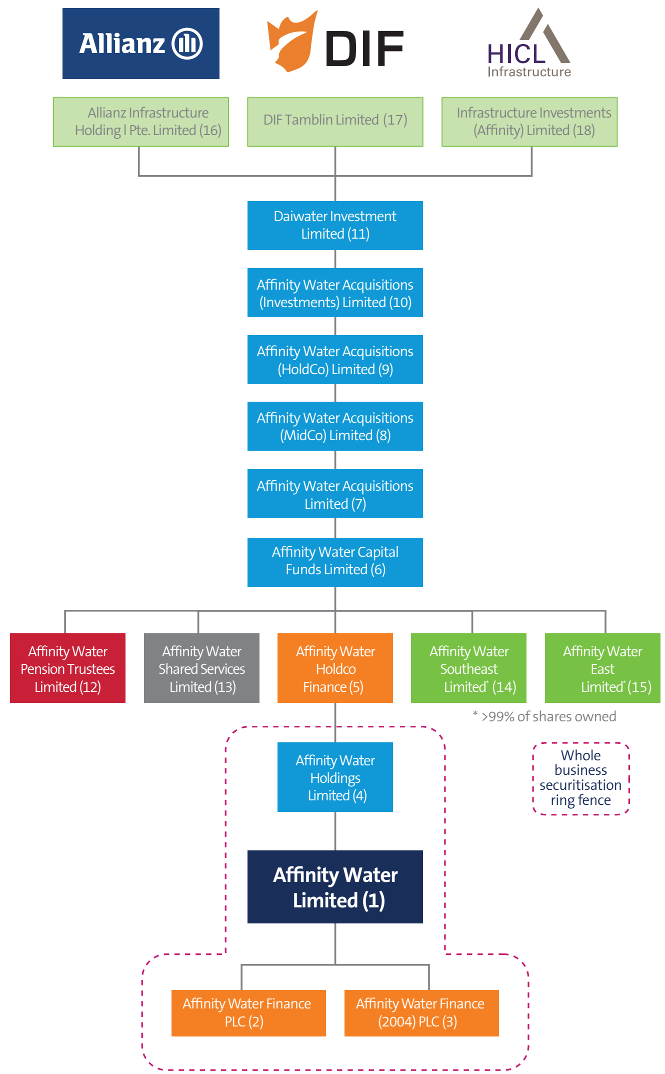
As at 31 March 2021:

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

Group simplification

During 2020/21, we liquidated Affinity Water Programme Finance Limited, our Cayman Islands entity, which had previously been substituted with a UK subsidiary.

We have an ongoing project to further simplify our group structure, with the aim to remove four holding companies as well as our former shared service company by March 2022.



Company Key

- Shareholder company
- Holding company
- Affinity Water Pension Plan Trustee
- Former shared service company
- Financing company
- Former regulated water company
- Regulated water company

Our investment

Our capital expenditure programme has been impacted by COVID-19, with some expenditure scheduled for 2020/21 having been delayed until later in AMP7. Capital expenditure in the year was £139.4m, and was incurred principally in our mains renewals, trunk main replacement, water treatment (including pesticide treatment) and integrated water savings programmes.

We are investing £59.0m on our metering programme and planning a range of measures to influence our customers to reduce their consumption.

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

However, we have seen consumption rise during 2020/21 as businesses close and households stay at home, following the UK Government's COVID-19 advice.

We plan to spend approximately £100.0m to tackle leaks in AMP7. Our plan is to:

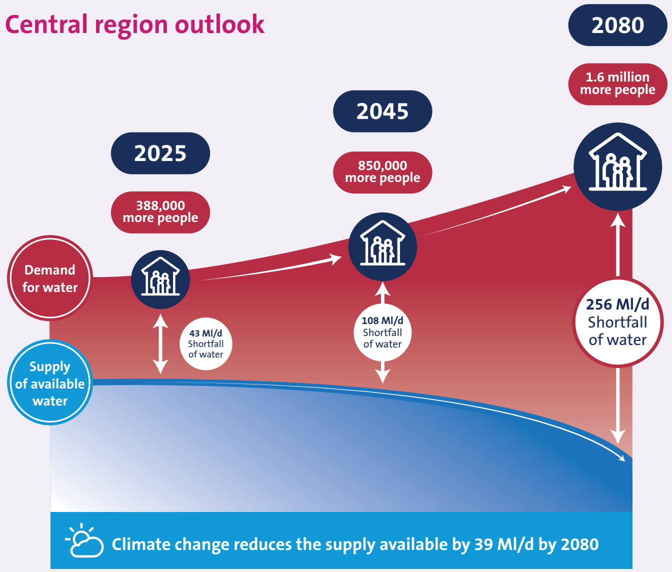
- fix 50% of visible leaks in 24 hours, 70% within 48 hours and 90% within five days;
- use quantum technologies to detect and fix leaks;
- use new techniques to monitor flows and fast logging and pressure reduction schemes to locate leaks so we can target them more effectively and maximise the amount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

Our new leakage technician apprenticeship scheme is industry leading, as is our use of Artificial Intelligence data sharing to allow water companies to better monitor the impact of the weather and COVID-19 on water demand. This is a model we are sharing with others in the sector.

We have also deployed the Step Testing technique – a series of short steps isolating sections of pipe – which will allow our engineers to systematically work through district areas, opening and closing valves to isolate parts of the network to narrow down areas suffering from loss of water due to leakage.

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

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



Water Resources Management Plan

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

For further information on how we aim to manage the long-term supply and demand of our water resources, please refer to our WRMP for 2020-80 on our website:

affinitywater.co.uk/waterresourcesplan

Understanding our borrowings

As we are a business with a long-term outlook and expenditure commitments, we need to match this with long-term sources of debt finance.

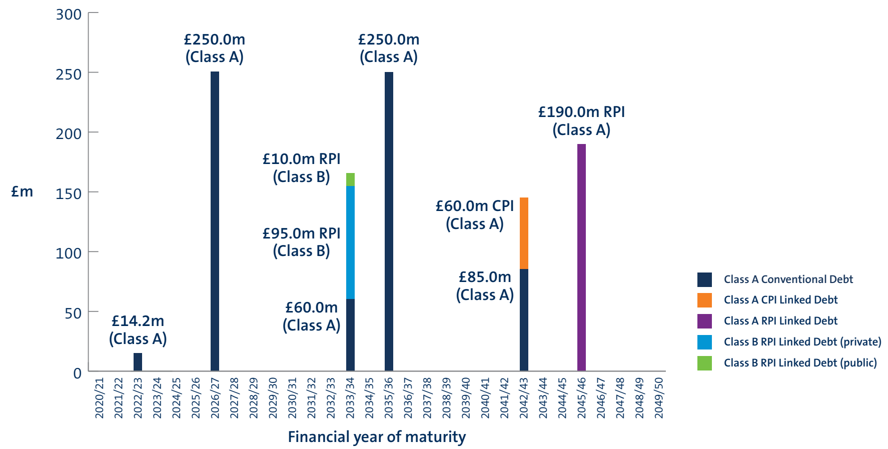
We consider the most cost-effective way to raise long-term debt is through the debt capital markets. As at March 2021, we had issued external bonds with a nominal value totalling £1,014.2m, having a range of debt maturities to mitigate against refinancing risk.

In October 2021 we issued our first green bond, with a nominal value of £130.0m. Which will help to fund projects which are relevant to our Sustainability Strategy and will support our environmental objectives.

We mitigate against inflation and interest rate risk by using a mixture of fixed rate and inflation-linked borrowings. Since August 2018, we have swapped £460m of fixed rate debt for RPI- and CPI-linked debt.

Around a fifth (19%) of our debt is fixed rate, which provides certainty of future interest payments, and allows us to manage our future cashflows. As our bills are linked to movements in inflation, around four fifths (81%) of our debt is now inflation-linked.

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



Liquidity and access to markets

Our objective is to ensure we have banking arrangements and adequate, though not excessive, cash resources, borrowing arrangements and standby facilities to enable us at all times to have the level of funds available which are necessary for the achievement of our business and service objectives.

At 31 March 2021, we had cash balances of £84.8m (2020: £85.6m) and short-term deposits held as investments of £15.1m (2020: £25.2m).

The relatively high cash balance reflects the level of funding we had already secured during AMP6 in order to finance our AMP7 expenditure commitments, ensuring financial resilience and thereby reducing the financing risk.

Gearing

Gearing refers to the relationship between a company's debt and equity.

$$\frac{\textbf{Net debt £990.7m}}{\textbf{RCV £1,303.2m}} =$$

76.0%

At 31 March 2021, our gearing was 76.0%, which, although within our internal threshold, may be considered to be relatively high.

It is our intention to continue to reduce our gearing over the course of AMP7.

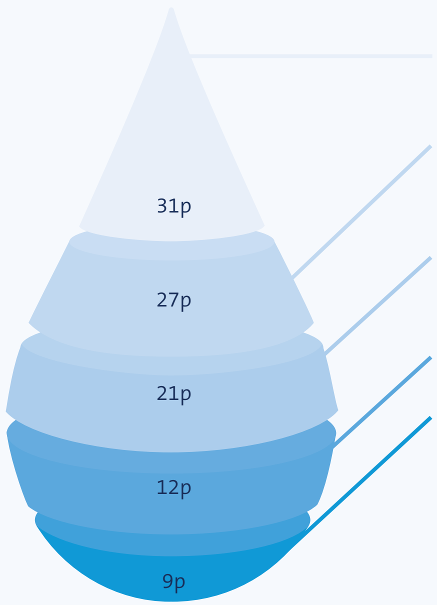
Understanding our bills

Where we spend your money

In 2020/21, we spent 79p of every £1 collected from customers' bills on our suppliers for operating services, our assets and our people, ensuring customers receive the highest quality water and service.

12p of every £1 was spent on debt financing and the remaining 9p of every £1 was spent on taxes and charges relevant to the local and central government.

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



Our assets: 31p (2020: 28p)
Investment in our assets

Our suppliers for operating services: 27p (2020: 31p)
Operational costs of suppliers' services

Our people: 21p (2020: 21p)
Wages, salaries and pensions

Our bondholders: 12p (2020: 12p)
Interest paid on debt financing

Local and central government: 9p (2020: 8p)
Corporation tax, business rates, abstraction charges, employers' national insurance, Climate Change Levy and streetworks permits.

Our shareholders: 0p (2020: 0p)
Dividends from our regulated business and interest on shareholder debt.

Price Reviews

Every five years Ofwat reviews our Business Plan which sets out how we will fund our operations.

Ofwat then sets the prices we can charge our customers for each of the five years of the Business Plan considering our operational requirements and the significant capital investment needed to maintain a high-quality water supply.

Price limits for AMP7, were announced in December 2019.

Pay As You Go ('PAYG') ratio

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

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

Value for money

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

Our average household bill for 2020/21 was approximately £173, the equivalent of just 47p per day, which we think represents great value for money. Our AMP7 price control however, set an initial drop in revenue, followed by real terms increases, thus household bills in 2021/22 are expected to be approximately 6.6% higher than in 2020/21.

Supporting our customers

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

Our support for financially vulnerable customers who have a low household income or are claiming benefits has grown with 85,000 households now supported by our social tariffs.

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

We also teamed up with seven other utility networks to provide a boost to local community foundations, contributing £15,000.

Understanding our bills (continued)

Funding our regulated business

Not all of the funds required by our business comes from customers' water bills.

For every £1 we collected from customers in 2020/21, we required an additional 35p in order to operate.

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

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

Cash collected from customers' bills in 2020/21
£238.2m

Additional funds required
£82.6m

Total £320.8m

Regulated business

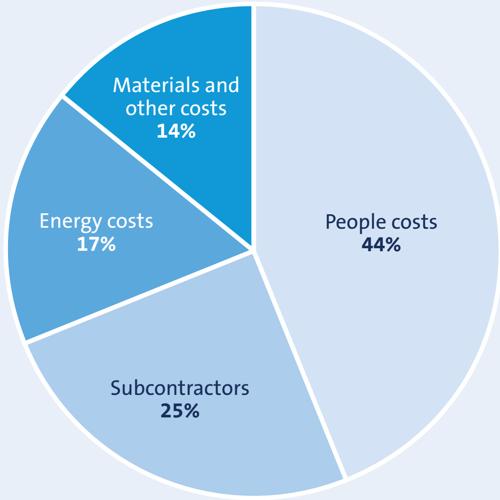
Operational costs
£154.7m

Net investment in our assets
£99.5m

Interest, tax and dividends
£66.7m

Our operational costs

Our £154.7m operational costs for 2020/21 are broken down as follows:



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

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

The treatment and supply of water requires a large amount of energy. Through procuring and locking into favourable base rate prices for our energy usage we have realised savings on our energy costs and have commenced an energy optimisation programme to reduce our energy usage across our production sites. We entered into our first energy swap in May 2021, fixing the price on a proportion of our future energy costs.

Our Performance Commitments

We provide an essential service to over 3.8 million people and are committed to delivering the highest levels of operational and customer service. Our Business Plan is agreed with our customers and Ofwat at the start of each regulatory period, to deliver what is most important to our customers in the most efficient way. Our AMP7 Business Plan includes a total of 28 stretching Performance Commitments, that will ensure we deliver our four customer outcomes:

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

Our rewards and penalties

Each Performance Commitment contains an Outcome Delivery Incentive, which can carry a financial reward, penalty or both.

In 2020/21, we incurred penalties of £5.2m for failing to meet our commitments on customer contacts for discolouration, leakage, per capita consumption, unplanned interruptions to supply over 12 hours, properties at risk of receiving low pressure and mains repairs.

In contrast, we received a reward totalling £0.4m for successfully meeting our commitments on the number of sources operating under the Abstraction Incentive Mechanism, reducing the number of void properties (by identifying properties falsely classified as empty) and water supply interruptions over three hours.

This has resulted in a net penalty of £4.8m which we will pay back to our customers through a reduction in bills in future years.

For further information on our performance, please refer to our Annual Report and Financial Statements for the year ended 31 March 2021, which can be found on our website:

affinitywater.co.uk/performance

Outcome Delivery Incentive	Target	Actual	Reward/(Penalty)
Customer contacts for discolouration (per 1,000 people)	0.67	0.83	£(326,000)
Water quality compliance (CRI score)	0.00	1.31	-
Leakage (Ml/d)	2.7	1.7	£(288,000)
Per capita consumption reduction (%)	4.9%	-3.8%	£(2,457,000)
River restoration (number)	7	7	-
Abstraction reduction (Ml/d)	0	0	-
Environmental innovation (Ml/d)	0	0	-
Abstraction Incentive Mechanism (Ml/d)	0	-304	£29,000
C-MeX score (league position out of 17)	14th	15th	-
D-MeX score (league position out of 17)	13th	10th	-
Occupied properties not billed (number of gap sites)	50	118	-
Reducing the number of void properties (%)	2.27%	2.37%	£24,000
Water supply interruptions over three hours (time)	00:06:30	00:05:49	£357,000
Unplanned interruptions to supply over 12 hours (number)	320 or less	538	£(715,000)
Properties at risk of receiving low pressure (per 10,000)	1.845	196.850	£(869,000)
Mains repairs (per 1,000 km mains)	150.7 or less	155.8	£(576,000)
Unplanned outage (%)	2.34%	1.65%	-

Understanding our executive remuneration

For 2020/21, executive director pay continued to be aligned to our strategy of delivering value through high quality customer, operational and financial performance whilst ensuring the cost of water remains affordable for customers.

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

The remuneration of executive directors in 2020/21 reflected the performance of the company through the annual bonus plan, consisting of:

40.0%
financial measure

28.6%
operational measures

5.7%
customer and community measures

5.7%
safety and health measure; and

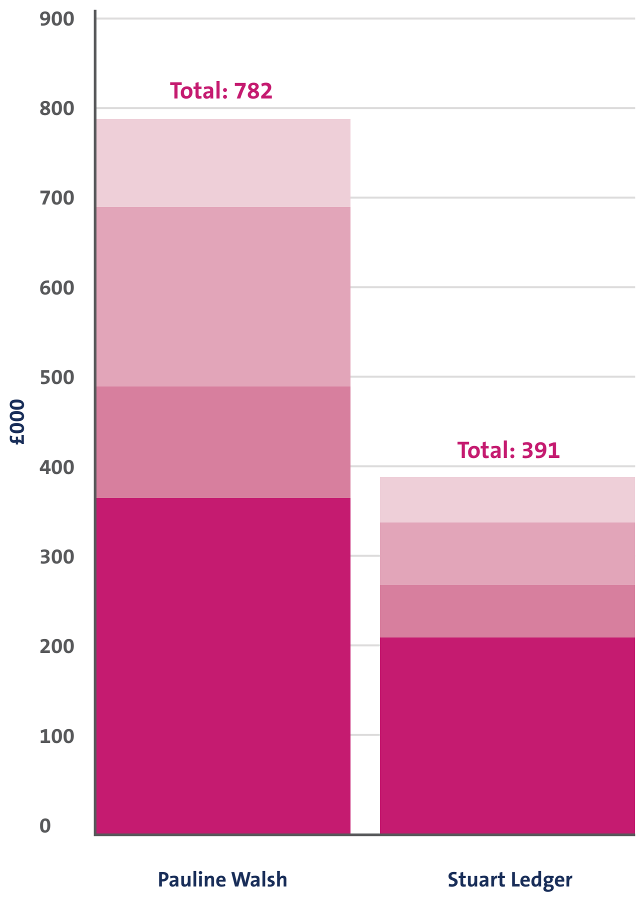
20.0%
personal performance.

The annual bonus plan targets were established by the Board's Remuneration Committee and continue to be aligned for the executive director, senior manager, selected manager and company-wide schemes. This ensures there is a common focus across the business, particularly with respect to service to customers.

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

We also have an LTIP to incentivise executive directors and senior management to meet both financial and strategic targets, including service and performance commitments over a six-year period. Awards from the 2018/19 LTIP were vested during 2020/21.

Remuneration earned in 2020/21



Pauline Walsh		Stuart Ledger
365	Base salary	210
125	Annual bonus	57
206	LTIP	76
86	Other remuneration	48

NB. Other remuneration relates to pensions related benefits and taxable benefits.

Our executive remuneration policy

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

www.affinitywater.co.uk/governance-assurance

Understanding our taxes

Approach to risk management and governance

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

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

Dealing with HMRC

We have an open relationship with HMRC, and we advise them of any complex issues so that we can work with them to determine the correct amount of tax due. We actively engage with HMRC and other relevant authorities on proposed changes to tax legislation, either directly or as part of our industry group.

Attitude to tax planning

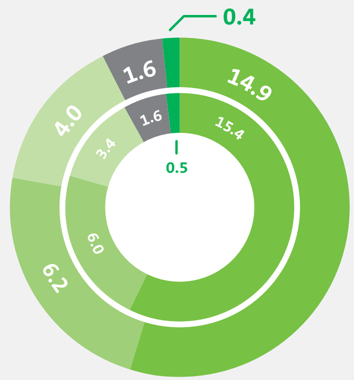
We do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities, and we always comply with what we understand to be both the letter and the spirit of the law. We operate solely in the UK and all our customers are based here. All our profits are reported and taxed in the UK. No funds are held offshore, and all finance is raised and held within the UK.

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

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

In February 2021, we were re-accredited with the Fair Tax Mark for the third year running. This recognises that we pay the right amount of corporation tax, at the right time and in the right place, and have reached the highest standard of transparency.

We paid £0.4m corporation tax during the year to 31 March 2021, as well as indirect taxes of £26.7m consisting of £14.9m business rates payable to local authorities, £6.2m employer's national insurance, £4.0m environmental taxes and £1.6m streetworks permits.



Tax Contribution (£m)

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

2020/21 (Outer) £27.1m
2019/20 (Inner) £26.9m

Our tax strategy

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

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

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

Understanding our taxes (continued)

In 2020/21, our loss before tax was £63.5m and our current tax credit was £0.8m. This results in an effective tax rate of 1.3%, which is lower than the UK corporation tax rate of 19.0%, as per the reconciliation below.

All significant adjustments to taxable profits for the year ended 31 March 2021 were timing differences. These will reverse in future years, so a lower tax charge in 2020/21 will result in a higher tax charge in a later year and vice versa. The impact on the tax charge in future years is reflected in the deferred tax account.

2020/21 corporation tax reconciliation

	£000	%
Loss before tax	**(63,500)**	
Tax on profit on ordinary activities at standard UK tax rate of 19.0%	(12,065)	19.0%
Tax effect of:		
Depreciation in excess of capital allowances	12,490	(19.7%)
Pension movements	(394)	0.6%
Provisions movements	(29)	<0.1%
Expenses not deductible for tax purposes	(2)	<0.1%
Adjustment to tax charge in respect of prior years	(830)	1.3%
Reported current tax charge and effective rate	**(830)**	**1.3%**

Tax adjustments explained

- **Depreciation in excess of capital allowances**
  The tax relief on our infrastructure assets is different from the depreciation of these assets in the accounts (although over the total life of the assets the two amounts will be equal). In 2020/21 the amount written off for tax purposes was lower than the depreciation in the accounts, resulting in a higher tax charge for the year.

- **Pension movements**
  Tax relief is given for the amount actually paid into the company's pension plan in the year, not the amount charged in the accounts. In 2020/21 the amount paid into the pension plan was higher than the amount charged in the accounts, resulting in a lower tax charge for the year.

- **Provisions movements**
  Some provisions charged in the accounts are not deductible until the amounts provided are actually paid. Taxable profits in 2020/21 have been reduced by payments made in respect of provisions charged in previous years.

- **Expenses not deductible for tax purposes**
  These will not reverse in future years, therefore the increase in the tax charge is permanent. Permanent disallowable expenses include fines, business entertaining and certain legal fees.

  A penalty that was previously disallowed for tax purposes has been written back in the 2020/21 accounts. The amount written back is not taxable, and this has resulted in a decrease in taxable profits for the year.

- **Adjustment to tax charge in respect of prior years**
  The tax provision in the accounts is a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year-end. The correction made to the tax return for the year ended 31 March 2020 resulted in a lower tax charge, mainly as a result of claiming capital allowances.

Frequently asked questions

Do you pay your shareholders dividends?

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

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

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

Equity dividends of £1.0m were paid from our non-appointed business (the parts of our business not regulated by Ofwat) during the year in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

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

Why are you paying your executives high salaries and bonuses?

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

Our Executive Directors have committed to not receiving an increase in their salary for either 2020/21 or 2021/22.

What do the water charges pay for?

The charges enable us to:

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

Are you profiting at the expense of customers?

We have worked hard to keep our bills low across AMP7 whilst maintaining a high quality and trusted service, with our annual household bill for 2020/21 being £173, the equivalent of just 47p per day, which we think represents great value for money.

Our AMP7 price control however, set an initial drop in revenue, followed by real terms increases, thus household bills in 2021/22 are expected to be approximately 6.6% higher than in 2020/21.

Where can I find further information?

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

affinitywater.co.uk

including:

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

Affinity Water

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AffinityWater

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The Social Mobility Pledge

disability confident EMPLOYER

Fair Tax