

Understanding our finances

November 2019



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Purpose of this report

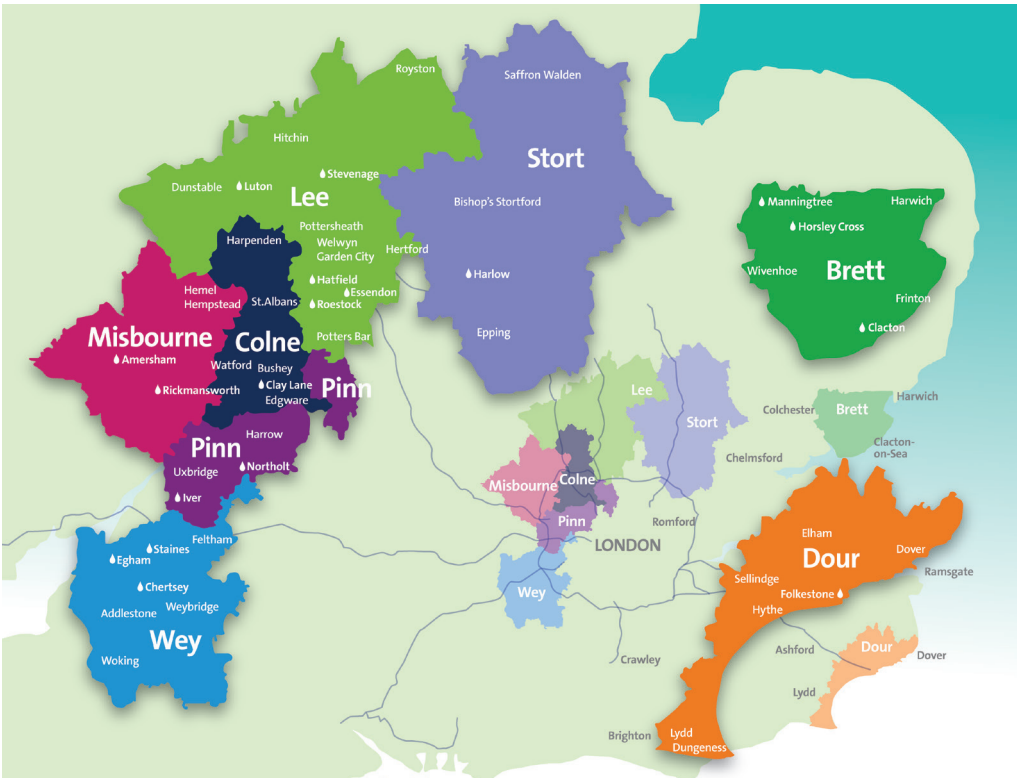
The purpose of this report is to help our customers and stakeholders understand our finances and corporate governance arrangements. This includes our ownership and group structure, how we fund our business and how we spend our customers' money.

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.

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 4,515km² split over three supply regions in the South East of England.

Our 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.



Our year in review

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.

To meet our commitment of being open and transparent, we report our performance to customers and stakeholders both at a company level and broken down by community.

For further information please refer to the performance page of our website:

www.affinitywater.co.uk/performance

£13.7m
profit before
tax in 2018/19

Chief Financial Officer's introduction

Welcome to our first report aimed at helping our customers to understand our finances, which includes understanding our group structure, our bills, our investment and borrowings, our dividends and executive remuneration, and our taxes.

Given the capital-intensive nature of the water industry, coupled with the need for new investment, and its vital importance to society, we strongly believe that companies in our industry must be financially resilient in the round, and able to withstand shocks.

We operate as a regional monopoly, so our prices are tightly controlled by an independent regulator – Ofwat. We are proud of our record in keeping bills down; reducing our average household bill by 7.7% during the current price control period, 2015-20, (Asset Management Plan 6 'AMP6'), to £170.50 for 2019/20, which is less than 50p per day. We also continue to support 60,000 financially vulnerable households through our social tariffs, and aim to increase this to 82,000 customers by 2024/25.

We are a business with a long-term outlook and expenditure commitments. During the next price control period, AMP7, we plan to invest £1.38bn in our wholesale business to maintain core network assets to keep services running across each of our three regions, whilst also improving the environment and the long-term resilience of water supply.

Like most companies within our industry we are financed through shareholder capital and finance. We consider the most cost effective way to raise long-term finance is through the debt capital markets.

By carefully managing our long-term debt we can keep customers' bills low and fairer for all by avoiding significant fluctuations.

Our gearing is calculated as the ratio between our net debt (total borrowings less cash) and the economic value of our regulated business, as determined by the regulatory price control (our Regulatory Capital Value, 'RCV'). At 31 March 2019, our gearing was 79.7%.

As part of our Business Plan ('our Plan') for AMP7, we plan to reduce our gearing to 76.8% by restricting dividends to our shareholders, instead re-investing all planned returns from our regulated business and non-regulated business (after servicing certain group financing needs), for the benefit of customers. We have not paid a dividend from the regulated business in the current year or prior year.

We reviewed our dividend policy and executive pay policy during 2018/19. Our dividend policy is to pay a dividend commensurate with the long-term returns and performance of the business to allow shareholders to earn an appropriate return from their investment, whilst not impairing the company's longer term financeability and taking into account commitments to its stakeholders and customers.

In determining the level of the dividend, the financial performances of our regulated

and non-regulated businesses are considered separately. The base dividend for our regulated business is determined by reference to the company's internal business plan, and in line with Ofwat's expectations, will not exceed a nominal 5% yield on equity as an annual average over the AMP, based on the company's actual financial structure.

Our policy for executive director pay continues to be aligned to the company's performance and strategy of delivering value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for customers by incentivising financial efficiencies as well as the value created for shareholders.

The revisions to the policy that came effective from 1 September 2018 ensure that there is a substantial link between performance delivery for customers through 2020-25 and performance-related pay.

Annual bonus plan targets continue to be aligned for the executive director, senior manager, selected manager and company-wide schemes, ensuring there is a common focus across the business.

Stuart Ledger
Chief Financial Officer

Planned
reduction in
gearing from
**79.7% to
76.8%**
by 2025



Fair Tax Mark

I am extremely proud that in March 2019, we were awarded the Fair Tax Mark, which recognises that we pay the right amount of corporation tax, at the right time and in the right place.

In 2018/19 our profit before tax was £13.7m. Despite this, we paid no corporation tax during the year to 31 March 2019. This was due to significant tax payments having been made in advance in the previous financial year.

During 2018/19, we completed the substitution of our Cayman Islands financing subsidiary with a UK subsidiary. Although we have always been clear that having a Cayman Islands entity within our group structure did not avoid UK tax or bring any tax benefit, we decided to substitute the company with a UK entity to simplify our group structure and to improve transparency.

Our ownership and group structure

On 19 May 2017, the Affinity Water group was acquired by a consortium comprising DIF, HICL Infrastructure plc and Allianz Capital Partners. In June 2017, HICL Infrastructure plc subsequently sold down 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds.

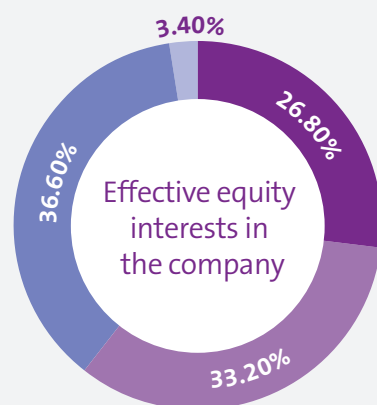
To maintain legitimacy about our governance and the involvement of our shareholders in our business, we set out the matters we will consult them about in our 'Engaging with our shareholders' publication to ensure that their interests as shareholders are respected, while maintaining the role of our Board to lead and govern the business. For further information, please refer to the governance page of our website:

www.affinitywater.co.uk/governance

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.

In 2018/19 we paid total dividends of £6.6m from our non-regulated business to our shareholders, while investing £93.8m in our assets. We have agreed with our shareholders to restrict their dividends for AMP7 and that all returns from our regulated and non-regulated businesses (after servicing certain group financing needs) will be re-invested into the company. For further information on the dividends we pay to our shareholders, please refer to our dividend policy found on the governance page of our website:

www.affinitywater.co.uk/governance



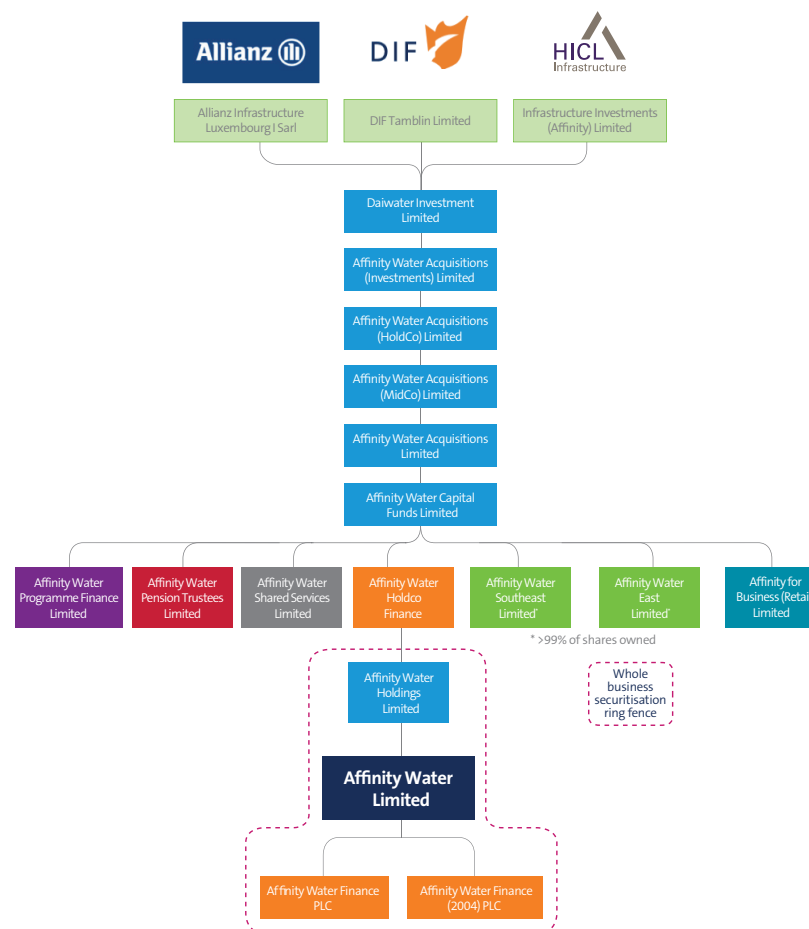
■ DIF
 ■ Allianz Capital Partners
 ■ HICL Infrastructure plc
 ■ Group of Co-investors

Regulatory Capital Value of
£1,226.1m
at 31 March 2019

Group structure

The chart shows the structure of the group as at 31 March 2019.

Unless otherwise indicated, all companies are wholly owned by the parent company shown.



Company Key

■ Shareholder company
 ■ Former shared service company
 ■ Water supply and sewerage license
 ■ Holding company
 ■ Financing company
 ■ Regulated water company
 ■ Affinity Water Pension Plan Trustee
 ■ Former regulated water company
 ■ Former financing company

Our ownership and group structure (continued)

Whole Business Securitisation ring-fence

We are financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of a Whole Business Securitisation. The securitisation further enhances the ring-fencing provisions already in our licence.

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 onto our customers through lower bills.

Substitution of our Cayman Islands financing subsidiary

During 2018/19, we completed the substitution of our Cayman Islands financing subsidiary, Affinity Water Programme Finance Limited, with a UK subsidiary as part of simplifying our group structure.

Affinity Water Programme Finance Limited was previously used to raise funding for the group by issuing bonds. Although there was no tax benefit associated with the company being registered in the Cayman Islands, we decided to substitute the company with a UK entity to simplify our group structure and to improve transparency.

The bonds issued by Affinity Programme Finance Limited were transferred to Affinity Water Finance PLC in January 2019.

Affinity for Business (Retail) Limited

April 2017 saw the first major reform of the water industry since it was privatised in 1989, allowing non-household customers (businesses) to choose who provides their water and wastewater services.

As Affinity Water Limited, we exited the non-household retail market through a sale of our business to a newly formed company in our group, Affinity for Business (Retail) Limited ('Afb'). We act as a wholesaler in the new market, selling water to many retailers including Afb.

Although still a part of our group, we must separate ourselves from Afb and any services that we provide to them must be charged at a fair rate, i.e. at a rate that we would charge an unrelated entity. We charged Afb for the following services during the year ended 31 March 2019:

Services provided	Terms of supply	Value
Wholesale water charges	At market rate from reports issued by Market Operator Service Limited ('MOSL')	£45.1m
Recharges for support services (including Finance, HR, Information Technology, Legal, Facilities and other)	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	£0.7m
Recharges for meter read costs	Actual costs to the company recharged	£0.4m

Our financing subsidiaries

We have two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority and are subject to the Listing Rules and Disclosure and Transparency Rules:

Affinity Water Finance PLC has issued external bonds totalling

£764.2m

Affinity Water Finance (2004) PLC has issued an external bond of

£250.0m



Interaction with MOSL

MOSL is the independent operator of the non-household retail market in England and Wales, which oversees all transactions through its central IT system.

There are now more than 20 retailers competing in the market.

The retailer is responsible for submitting meter readings for its customers to MOSL, which then issues a settlement report.

The wholesaler, such as ourselves, will then raise an invoice to the retailer for the cost of the water provided, with MOSL ensuring a smooth settlement and payment.

Understanding our bills

Price Reviews

We operate as a regional monopoly, so our prices are tightly controlled by an independent regulator – Ofwat. Every five years Ofwat reviews our Plan which sets out how we will fund our operations. Ofwat then sets the price limits for each of the five years of the Plan considering our operational requirements and the significant capital investment needed to secure a high quality water supply.

Our Plan for the five year period April 2020 to March 2025 has been submitted to Ofwat with Price Limits expected to be 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.

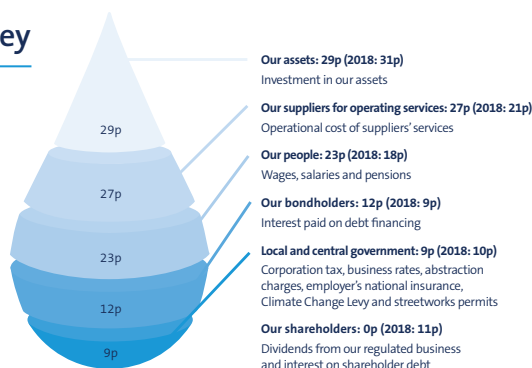
Value for money

Value for money for customers is achieved by delivering the standards of service customers expect along with the Performance Commitments included in our Plan at a reasonable price. Our average annual household bill for 2019/20 is £170.50, the equivalent of just 47p per day, which we think represents great value for money, although we plan to reduce it by a further 2.3% across AMP7 to £166.60 by 2024/25.

Where we spend your money

In 2018/19, we spent 79p of every £1 collected from customers' bills on our assets, our suppliers for operating services, and our people, ensuring customers receive the highest quality water and service.

The remaining 21p of every £1 was spent on debt financing and taxes. None of customers' money was spent on dividends or interest on shareholder debt.



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 60,000 households now supported by our social tariffs.

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

We plan to introduce a Customer Assistance Fund by 2020 and are projecting that the number of customers receiving support through our social tariff will increase to 82,000 customers in 2024/25.

Our average annual household bill for 2019/20 is **£170.50**

The equivalent of just **47p per day**

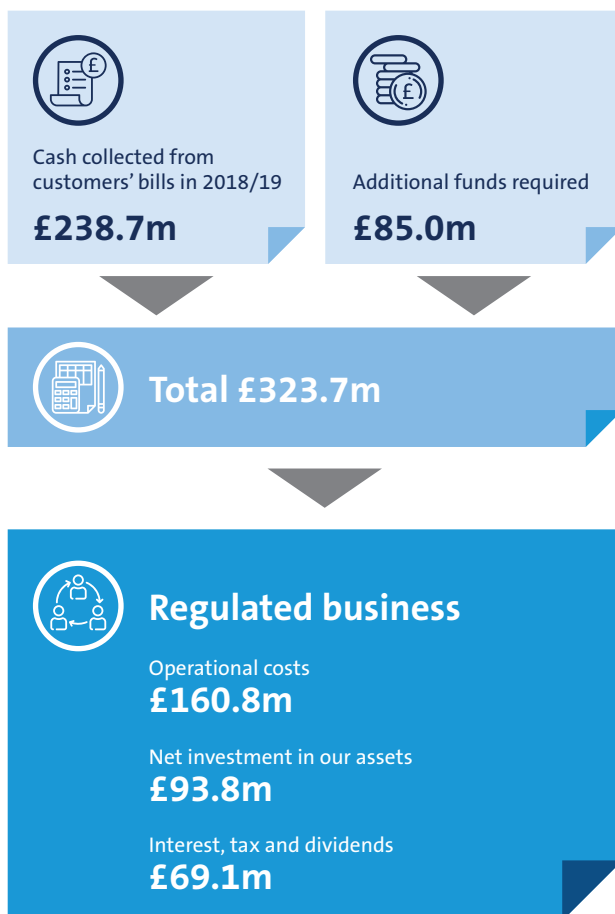
Understanding our bills (continued)

Funding our regulated business

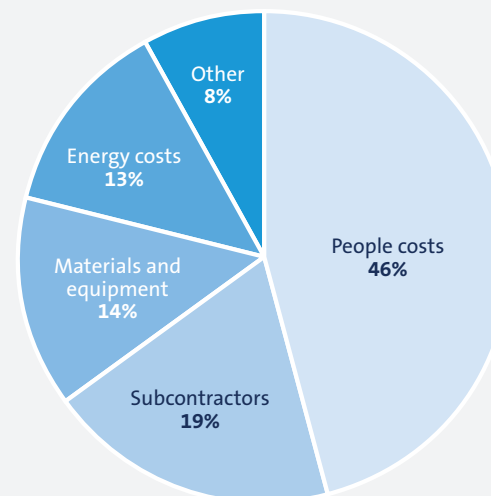
The income we get from customers' water bills each year is not enough to cover all the investment we need to make. For every £1 we collected from customers' bills in 2018/19, we required an additional 36p in order to fund our regulated business.

Our bills also include sewerage costs charged by other water companies. Some of the additional funds we require are received through commissions 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.



Our operational costs



Nearly half of our operational costs in 2018/19 were spent on our people, including wages and salaries, bonuses and pension costs. 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 realised savings on our energy costs in 2018/19. We also ran an energy optimisation programme to reduce our energy usage across our production sites.



For
every £1
we collect
from customers,
we require an
additional 36p
to fund our
business



Our investment

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

We are adopting a twin-track approach to resilience with investment in improving the security of our supply for the future while at the same time seeking to reduce customer consumption.

We will deliver major programmes to treat water for wider distribution across our supply area, where and when it is most needed, to improve resilience of supplies for future generations by beginning investment today to secure the development of additional regional supply resources before 2040, when they will be needed.

We are also planning to influence our customers to reduce their consumption and are planning a range of measures to achieve this, including the continuation of our ten-year Water Saving Programme and the use of fast data. This 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.

New access to water, improved demand management and increased flexibility in the movement of water are all essential. We have led work with other water companies in the South East of England to encourage best use of existing resources through the introduction of new transfers of water.

Our significant investment is being made to meet the environmental requirements and commitments supported by our customers.

It will be key to enabling us to continue to deliver and to improve the quality of the service we provide to our customers, whilst delivering sustainability reductions requiring our assets to work harder.

Our delivery will be efficient and innovative. We consider innovation to be essential in an ever-changing world as we deliver more for less in meeting our stretching AMP7 Performance Commitments and addressing Ofwat's four Price Review themes:



Great customer service

Our investment proposals have been developed to meet our Customer Outcomes and deliver our Performance Commitments, which will improve our customer service in many areas.



Affordable bills

Our thorough and robust approach to investment planning ensures that every penny spent is necessary and provides best value for customers now and in the future. We have set ambitious efficiency targets to ensure that our water bills remain fair and affordable, especially for those who are most vulnerable.



Innovation

Our Plan proposes a wide variety of solutions to meet customer needs and legal and regulatory requirements. Some of these involve cutting edge solutions such as the online pesticide monitor that we will install on the River Thames and partnering with housing associations to promote water efficiency to residents.



Long term resilience

We will invest in our assets at the right time and in the right places to ensure that resilience is maintained in the long-term. In AMP7 we will implement the first stage of a 20-year strategic supply transfer scheme designed to improve interconnectivity in our Central region and maintain long term supply resilience despite sustainability reductions.



Managing supply and demand

For further information on how we aim to manage the long-term supply and demand of our water resources, please refer to our Water Resources Management Plan 2020-2080, and for our AMP7 investment, please refer to our Business Plan 2020-2025 on the following pages of our website:

www.affinitywater.co.uk/resources

www.affinitywater.co.uk/plans

£1.38bn
investment
between 2020
and 2025

Understanding our borrowings

We are a business with a long-term outlook and expenditure commitments, which need to be matched with long-term sources of debt finance.

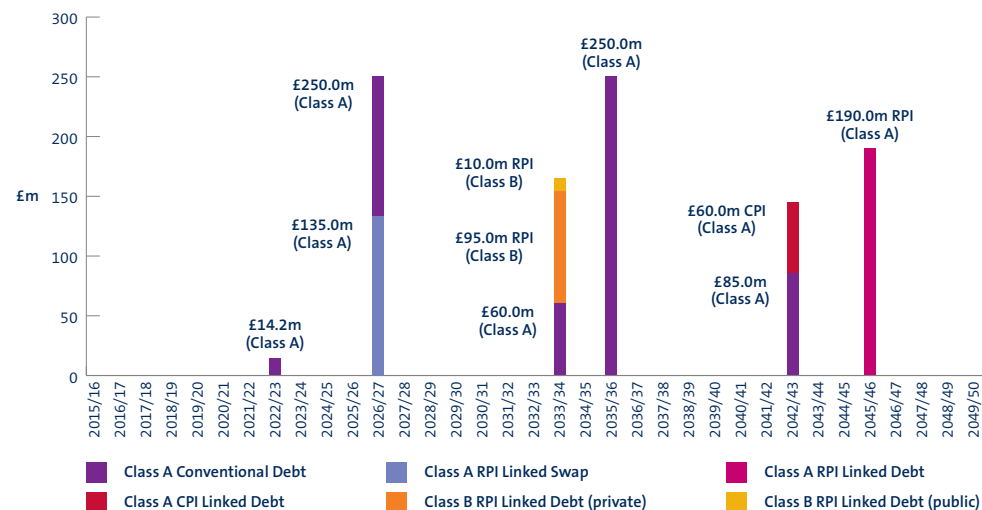
We consider the most cost-effective way to raise long-term debt is through the debt capital markets. We have issued external bonds totalling £1,014.2m. At 31 March 2019, our total borrowings, including all other loans, were £1,082.9m.

Interest rate exposure is primarily managed by using a mixture of fixed rate and index-linked borrowings. Around half 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 currently linked to movements in inflation, around half of our debt is also index-linked (including £135.0m which was swapped from fixed to RPI-linked in August 2018).

Our bonds had a weighted average of 16.87 years to maturity at 31 March 2019. We maintain a range of debt maturities to further mitigate against inflation and interest rate risk, as well as refinancing risk.

The chart below shows the maturity profile of our bonds at 31 March 2019:



Gearing

Our gearing is calculated as the ratio between our net debt (total borrowings less cash from our regulated business) and our RCV (the economic value of our regulated business, as determined by Ofwat).

Net debt £976.7m
RCV £1,226.1m

79.7%

At 31 March 2019, our gearing was 79.7%. We plan to reduce our gearing to 76.8% over the course of AMP7, and our Board has also confirmed their ambition to reduce it further to 75.0% or lower. We aim to do this by restricting dividends to our shareholders from 2019/20 to 2024/25, instead re-investing all planned returns from our regulated and non-regulated businesses (after servicing certain group financing needs) for the benefit of our customers.

Our Class A debt is rated A3 (negative outlook) by Moody's and A- (negative outlook) by Standard and Poor's. Our corporate family rating is rated Baa1 (negative outlook) by Moody's. By maintaining investment grade ratings, we can continue to borrow at attractive rates, allowing us to keep our bills low.

Our objective is to ensure we have adequate funding arrangements, cash and standby facilities to enable us at all times to have the level of funds available for the achievement of our business and service objectives.

At 31 March 2019, we had total cash balances of £111.5m, and access to £100.0m of bank

facilities to finance capital expenditure and working capital requirements.

In addition, we had access to a further £61.0m of liquidity facilities to fund any debt service payments or operating and capital maintenance expenditure in the event of a liquidity shortfall that would otherwise prevent such payments being made.

The high cash balance reflects the pre-funding of AMP7 expenditure undertaken to ensure financial resilience and reduce the financing risk. A further £86.0m of debt is required to fund the investments planned in AMP7. Only £14.2m of our existing debt matures during AMP7.

Our rewards and penalties

We provide an essential service to over 3.6 million people and we are committed to delivering the highest levels of operational and customer service.

At the start of each regulatory period, we work with our customers and Ofwat to agree on Performance Commitments, to deliver what is most important to our customers in the most efficient way.

We can earn financial rewards for meeting some of these commitments and can incur penalties for failing to do so.

For 2018/19 we incurred a penalty of £7.0m due to underperformance in relation to our leakage reduction commitment.

We attach a high priority to meeting our leakage reduction commitments, as we want to demonstrate that we are playing our part when we are asking customers to save water.

In November 2018, we identified a large burst on the outlet pipe of one of our key water treatment works, which contributed to a deterioration in our leakage performance for 2018/19 and, because we found that the burst started in 2017/18, resulted in us restating our leakage figure and failing our target for that year, incurring a further penalty of £1.0m.

Equity dividends of £6.6m were paid during 2018/19, none of which related to the regulated business reflecting the anticipated regulatory penalties in relation to not achieving our leakage reduction commitments for 2018/19 and 2017/18.

Across the whole of AMP6 to date, we have incurred further penalties of £4.9m for failing to meet our performance commitment for unplanned interruptions to supply over 12 hours in 2015/16, 2016/17 and 2017/18.

We have also earned a reward of £1.3m for outperformance in relation to our sustainable abstraction reduction, achieved in 2017/18. The total net penalty for AMP6 (£11.6m to date) will be captured in the prices that will be set for AMP7.

For further information on our performance, please refer to our Annual Report and Financial Statements for the year ended 31 March 2019, which can be found on the investor page of our website:

www.affinitywater.co.uk/investors

We have incurred net penalties of **£11.6m** over AMP6 to date which will be passed back to customers through cheaper bills in AMP7

2018/19 performance

Leakage

Target: < 167.7 MI/d Actual: **196.1 MI/d** Reward/Penalty: **(£7.0m)**

Average water use

Target: < 150.3 l/person/d Actual: **149.2 l/person/d** Reward/Penalty: **£nil**

Water available for use

Target: 1,068.1 MI/d Actual: **1,105.3 MI/d** Reward/Penalty: **£nil**

Sustainable abstraction reduction

Target: 42.1 MI/d Actual: **42.1 MI/d** Reward/Penalty: **£nil**

Compliance with water quality standards

Target: 99.95% Actual: **99.96%** Reward/Penalty: **£nil**

Customer contacts for discolouration (per 1,000 people)

Target: < 0.66 Actual: **0.23** Reward/Penalty: **£nil**

Unplanned interruptions to supply over 12 hours

Target: < 320 Actual: **309** Reward/Penalty: **£nil**

Mains bursts

Target: < 3,100 Actual: **2,530** Reward/Penalty: **£nil**

Customers not being notified of planned interruptions

Target: < 110 Actual: **68** Reward/Penalty: **£nil**

Planned works taking longer than notified

Target: < 550 Actual: **477** Reward/Penalty: **£nil**

Understanding our executive remuneration

For 2018/19 executive director pay continued to be aligned to our strategy of delivering value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for customers by incentivising financial efficiencies.

We offer competitive benchmarked 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 our shareholders.

The remuneration of executive directors in 2018/19 reflected the performance of the company through the annual bonus plan, consisting of:

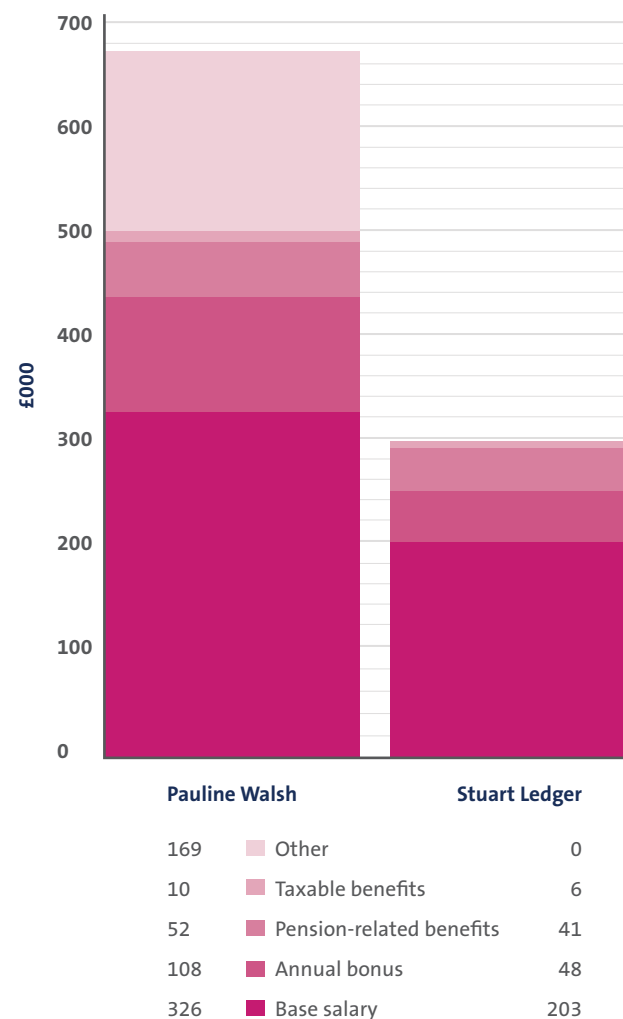
- 50% financial measure;
- 18% operational measures (split equally across leakage, water availability, water quality, unplanned interruptions to supply and per capita consumption)
- 7% customer and community measures;
- 5% safety and health measure; and
- 20% personal performance.

The annual bonus plan targets were established by the Board's Remuneration Committee and continued to be aligned for the executive director, senior manager, selected manager and company-wide schemes.

This ensured there was a common focus across the company. The achievement of performance against these targets provided the basis for determining the value of annual bonus awards.

We also have a LTIP to incentivise executive directors and senior management to meet both financial and strategic targets, including service and performance commitments over a five year period. No awards vested in the year ended 31 March 2019.

Remuneration paid in 2018/19



NB. Pauline Walsh was not remunerated for the full year. Other remuneration related to discretionary payments made in connection with commencement of qualifying services during 2018/19, including compensation for the forfeit of a variable remuneration arrangement with her previous employer.



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 the governance page of our website:

www.affinitywater.co.uk/governance

Understanding our taxes

Total tax contribution of **£29.4m** in 2018/19

Approach to risk management and governance

The Group Chief Financial Officer is ultimately responsible for our tax strategy. Responsibility for day to day tax matters, and for reporting to the Audit 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 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.

Level of acceptable risk in relation to UK tax

Our approach to tax risk is part of our wider risk management framework, in the context of our regulatory settlement.

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 off-shore, 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.

Dealing with HMRC

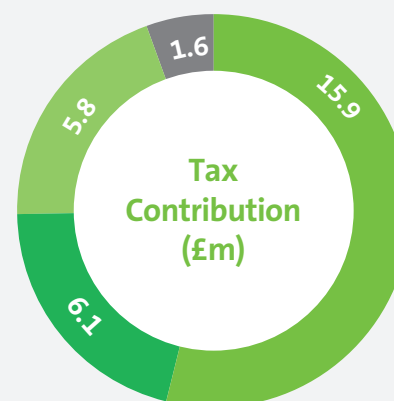
We have an open relationship with HMRC, and we advise them of any complex issues so that we can work with them to determine the correct amount of tax due.

We actively engage with HMRC and other relevant authorities on proposed changes to tax legislation, either directly or as part of our industry group.

In March 2019, we were awarded the Fair Tax Mark, becoming only the 50th UK company to receive this certification, which 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 no corporation tax during the year to 31 March 2019 due to significant tax payments having been made in advance in the previous financial year.

Our indirect taxes paid for the year were £29.4m consisting of £15.9m business rates payable to local authorities, £6.1m employer's national insurance, £5.8m environmental taxes and £1.6m streetworks permits.



Business rates Environmental taxes
Employment taxes Streetworks permits



Our tax strategy

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

"We always act honestly, openly and responsibly, so that we are trusted. We uphold the Affinity Way 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 2018/19, our profit before tax was £13.7m. Our total tax charge was £3.1m, with an effective tax rate of 22.7% being higher than the UK corporation tax rate of 19.0%.

2018/19 corporation tax reconciliation

	£000	%
Profit before tax	13,672	
Tax on profit on ordinary activities at standard UK tax rate of 19.0%	2,598	19.0%
Tax effect of:		
Depreciation in excess of capital allowances	2,327	17.0%
Pension movements	(833)	(6.1%)
Increase in provisions	56	0.4%
Expenses not deductible for tax purposes	190	1.4%
Adjustment to tax charge in respect of prior years	(417)	(3.1%)
Reported current tax charge and effective rate	3,921	28.6%
Depreciation in excess of capital allowances	(1,647)	(12.0%)
Pension movements	745	5.5%
Increase in provisions	(50)	(0.4%)
Adjustments to tax charge in respect of prior years	134	1.0%
Reported deferred tax charge and effective rate	(818)	(5.9%)
Total tax charge and effective rate	3,103	22.7%

Understanding the terminology

Timing differences

These adjustments will reverse in future years, so a higher tax charge in 2018/19 will result in a lower 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.

- **Depreciation in excess of capital allowances**

The tax relief on our infrastructure assets is different from the depreciation of these assets in our Financial Statements (although over the total life of the assets the two amounts will be equal). In 2018/19 the amount written off for tax purposes was lower than the depreciation in our 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 funds in the year, not the amount charged in our accounts. In 2018/19 the amount paid into the pension funds was higher than the amount charged in our accounts, resulting in a lower tax charge for the year.

- **Increase in provisions**

Some provisions charged in our accounts are not deductible for tax purposes until the amounts provided are actually paid. This has the effect of increasing our taxable profit. As we had an increase in provisions in 2018/19, this has resulted in a higher tax charge for the year.

Permanent differences

These adjustments will not reverse in future years.

- **Expenses not deductible for tax purposes**

Permanent disallowable expenses include fines, business entertaining and some legal fees, resulting in a higher tax charge.

- **Adjustment to tax charge in respect of prior years**

The tax provision in our accounts is a best estimate at the time. This is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year end. In 2018/19, the correction made resulted in a lower tax charge.

£3.1m
corporation tax
charge for
2018/19

Frequently asked questions

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.

Are you profiting at the expense of customers?

Our revenue is set by Ofwat every five years, and we cannot charge our customers any more over that price control period.

We have some of the lowest average bills in the country and have held prices at below inflation levels over AMP6, whilst investing more than £500m over the same period.

Our average annual household bill has reduced from £183.50 in 2015/16 to £170.50 for 2019/20, the equivalent of just 47p per day. We plan to reduce it by a further 2.3% across AMP7, to £166.60 by 2024/25.

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 £500m investment programme for AMP6 which includes significant 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.

Why have your dividend payments been high?

Our dividend policy is to pay a dividend commensurate 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 financeability and taking into account its commitments to stakeholders and customers. In determining the level of the dividend, the financial performance of our regulated and non-regulated businesses is considered separately. The base dividend for our regulated business is determined by reference to the company's internal business plan and will not exceed a nominal 5% yield on equity as an annual average over the AMP, based on the company's actual financial structure.

Equity dividends of £6.6m were paid during 2018/19, none of which related to the regulated business reflecting the anticipated regulatory penalties in relation to not achieving our leakage reduction target for 2017/18 and 2018/19. Higher dividends of £58.5m in 2017/18 can be partly attributed to proceeds from the disposal of the company's non-household retail business in that year.

We have agreed with our shareholders to restrict their dividends for AMP7 and that all returns from our regulated and non-regulated businesses (after servicing certain group financing needs) will be re-invested into the company.



Where can I find further information?

Further information on a range of topics can be found on our website: www.affinitywater.co.uk

including:

- Our Annual Report and Financial Statements;
- Our Year in Review;
- Our Business Plan;
- Our Water Resources Management Plan;
- Our executive remuneration policy;
- Our directors' remuneration summary;
- Our dividend policy; and
- Engaging with our shareholders

Glossary of key terms

AMP – Asset Management Plan

The five-year price control period covered by a company's Business Plan. AMP6 runs from 2015-2020 and AMP7 will run from 2020-2025.

CCW – Consumer Council for Water

The regulator tasked with investigating customer complaints relating to service, price and value for money.

C-MeX – Customer Measure of Experience

A measure of customer service levels to be used by Ofwat in AMP7.

D-MeX – Developer Measure of Experience

A measure of developer service levels to be used by Ofwat in AMP7.

DWI – Drinking Water Inspectorate

The regulator ensuring compliance with drinking water quality regulations.

MI/d – Megalitres per day

The amount of water used in one day. One megalitre is equal to one million litres.

MOSL – Market Operator Service Limited

The independent operator of the non-household retail market in England and Wales.

MZC – Mean Zonal Compliance

A measure of water quality compliance derived from monitoring samples taken from customers' taps.

ODI – Outcome Delivery Incentive

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

Ofwat – Water Services Regulation Authority

The economic regulator of the water industry.

PCs – Performance Commitments

Outcomes agreed with Ofwat during the Periodic Review process that reflect customers' views and priorities.

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 will set price controls for AMP7.

RCV – Regulatory Capital Value

The economic value of the regulated business, as determined by the price control regime.

RORE – Return on regulated equity

A financial metric used by Ofwat to determine the profitability of the regulated company.

SIM – Service Incentive Mechanism

A measure of customer service levels used by Ofwat in AMP6.

Totex – Total expenditure

The sum of operational expenditure and capital expenditure.

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.

Affinty Water Limited

Registered office:
Tamblin Way,
Hatfield,
Hertfordshire
AL10 9EZ

Tel: 0345 878 0900

 affinitywater.co.uk

 [@AffinityWater](https://twitter.com/AffinityWater)

 [AffinityWater](https://www.linkedin.com/company/AffinityWater)

