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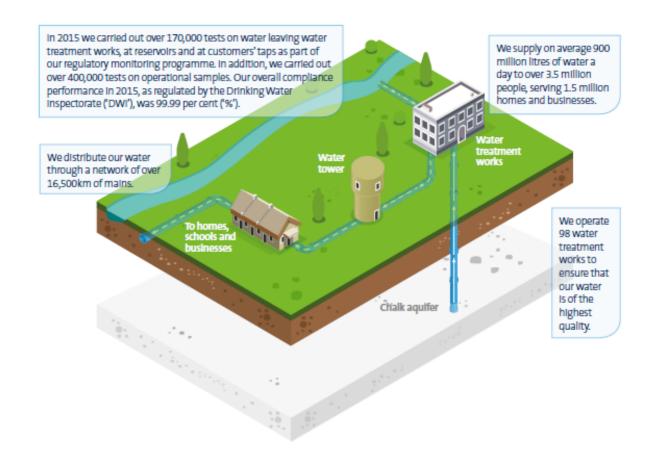


Affinity Water at a glance

Affinity Water is the UK's largest water only supply company. We own and manage the water assets and network in an area of approximately 4,515km² split over three regions in the southeast of England. We divide our supply area into eight different communities, based on our existing water resource zones and have named each of them after a local river, allowing us to tailor a high quality service to customers at a local level. We are the sole supplier of drinking water in these areas.

Our vision is to be the UK's leading community focused water company.







Operational highlights

Protecting our people

Implemented a number of initiatives aimed at significantly reducing our accident frequency rate, recording

0.27 lost time injuries per 100,000 hours worked

compared to a target of 0.7 and actual performance of 1.02 in 2014/15



Managing our water resources

Achieved our stretching regulatory leakage target, reducing leakage by

2 megalitres per day

compared to our 2014/15 performance

Supplying high quality water

Recorded our best ever performance in terms of mean zonal compliance,

99.99%

for the 2015 calendar year compared to a target of 99.95% and 99.97% for 2014

Minimising disruption

Strengthened the resilience of our network, reducing mains bursts by

9%

compared to our 2014/15 performance, 29% lower than our regulatory target

Value for money customer service

Introduced an innovative value for money index, achieving a score of

71.6 out of 100

higher than our baseline performance assessed in 2014/15, providing a basis for setting targets in subsequent years



Financial highlights

Revenue (£m)

302.6

2015: 296.1

Profit after tax (£m)

59.7

2015: 48.9

Regulatory Capital Value (RCV) (£m)

1,080.3

2015: 995.1

Senior Net Indebtedness (£m)

809.3

2015: 788.1

Gearing (%)

75

2015: 80

Conformed Senior Adjusted Interest Cover (times)

2.1

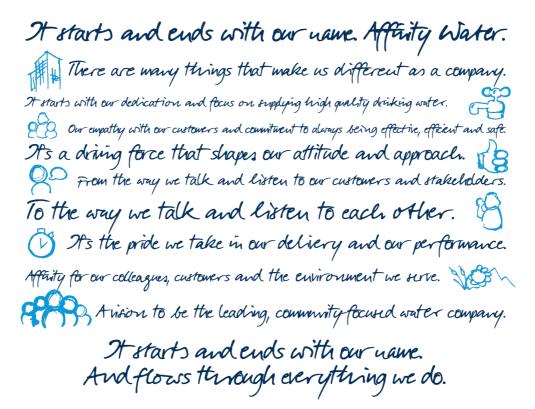
2015: 2.0



Our vision and The Affinity Way

Our vision to be the UK's leading community focused water company 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. Underpinning our vision to be the UK's leading community focused water company is the responsible approach we take to doing business, 'The Affinity Way'. We believe that The Affinity Way separates us from the industry. It clearly sums up who we are, the responsibility we have for the services we provide and the behaviours we are looking for from our people and the business partners that support us.

The Affaity Way



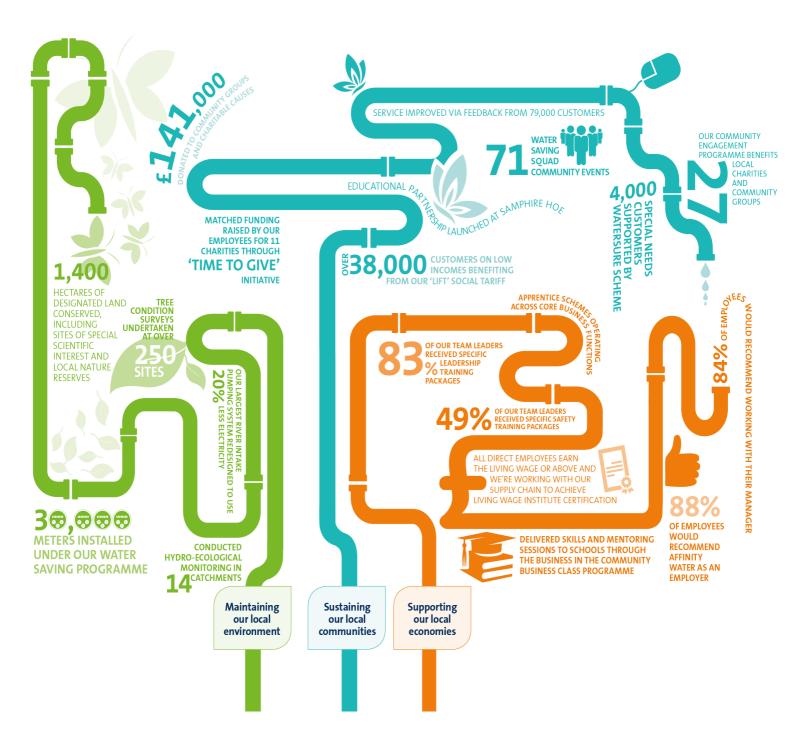
The Affinity Way is centred on issues which are material to our customers and stakeholders, and to the responsible delivery of our business plans. We must be able to articulate, measure and report our performance to ensure there is a clear line of sight between the activities we undertake and the social, economic and environmental impacts we have.

Our responsible approach to doing business is reflected in the industry-leading commitments we have made for the 2015-2020 price control period (Asset Management Plan 6, 'AMP6') on sustainable abstraction, reducing leakage and working with customers to reduce household water consumption. We have been recognised for our leading approach to customer consultation and innovation in water efficiency, and are addressing affordability issues through social tariff, value for money and living wage commitments.



Corporate Social Responsibility

The Affinity Way provides the context for our Corporate Social Responsibility ('CSR') programme. Our CSR performance highlights in 2015/16, in relation to issues that we understand matter most to our stakeholders and those which have the most profound effect on our business, are set out below.







Our commitments

As part the price review process for AMP6 ('PR14'), we agreed a number of performance commitments with Ofwat, which were shaped by the expectations of our customers. These stretching targets are to respond to the significant social and environmental challenges we face – a rising population and increased demand for water, as well as a reduction in the availability of water in years ahead.

We want our customers and stakeholders to be able to measure our success and hold us to account. The table below summarises our customers' four expectations and the performance commitments we have made for AMP6.

Customers' expectations

Our commitments



We will reduce the amount of water we take from the environment by 42 million litres per day.

We will encourage our customers to use less water through our Water Saving Programme.

We will invest in increased flexibility in our network so we can transfer water more effectively around our communities.



We will maintain high quality drinking water.

We will implement a targeted programme of lead pipe replacement to meet more stringent legal standards.



We will invest £500 million in our network to reduce leakage by 14 per cent – the equivalent of 27 million litres per day.



Bills will reduce by 1 per cent per year before inflation until 2020.

We will promote our LIFT social tariff to support those least able to pay their bill.

We will make £106 million of efficiency savings in our running costs to keep bills as low as possible over the next five years.

We will make ourselves accountable to our communities for our performance.

We will publish our performance on our website so our customers can see exactly how we are performing against the commitments we have made for AMP6 and our performance report for 2015/16 is already available.

https://stakeholder.affinitywater.co.uk/company-performance.aspx

We will also be giving customers the chance to comment on our performance through events in each of our eight communities.

Alongside this, we have developed a customer experience improvement programme based on direct customer feedback combined with our desire to ensure our customers have great service from us. We have a new Customer Engagement and Operational Excellence team, established to deliver improvements to our customer service.



Operational performance

During the year we have made progress delivering on our ambitious commitments, however there is more to do in the coming years, a reflection of the stretching targets we set ourselves.

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

Our region is one of the most water-stressed in the country. We have a growing population to serve and we have challenged ourselves to take less water from the environment to help safeguard the future. We have committed to reduce the amount of water we take from the environment by 42 million litres per day by the end of AMP6.

That is why the work of our leakage task force has been so important. This year we have reduced leakage on our network to 181 megalitres. By achieving this we have met our regulatory target as well as the high standards we set ourselves.

We are also progressing with our Water Saving Programme. We estimate that around a third of total network leakage occurs from customers' supply pipes. Metering customers may allow these leaks to be more readily identified, potentially saving millions of litres of water every day. We have installed more than 40,000 meters under this programme so far, as well as conducting over 18,000 home water efficiency checks.

Supplying high quality water our customers can trust

We continue to supply high quality water to our customers and to achieve this we extensively sample and analyse the water supply. Our customers continue to benefit from high quality drinking water. Our Mean Zonal Compliance was 99.99%, making this our best year ever.

Minimising disruption to our customers and communities

The number of bursts on our network this year fell to 2,201, which was under our target of 3,100 and also lower than the level of bursts we experienced last year. At a time when we are asking our customers to save water, it is important we are able to demonstrate that we are playing our part by managing our assets well and providing clean, safe drinking water for our customers.

Providing a value for money service

We have improved our Service Incentive Mechanism ('SIM') score for the provision of customer services in billing and operation water supply. In the second half of the year, we moved up three places to thirteenth position relative to the industry in respect of our qualitative SIM score. These results demonstrate that the steps we are taking to improve our service are beginning to have an impact.



Financial performance

Financial results for the year ended 31 March 2016

	2016	2015
_	£m	£m
Revenue	302.6	296.1
Operating costs Other income	(237.5) 17.2	(211.2) 12.5
Operating profit	82.3	97.4
Net finance costs	(36.7)	(37.2)
Profit before income tax	45.6	60.2
Income tax credit/(expense)	14.1	(11.3)
Profit for the period	59.7	48.9
Dividends	(40.0)	(30.8)
Transfer to reserves	19.7	18.1

Revenue was £302.6m, being a 2% increase on last year (£296.1m). This increase is primarily due to inflationary price adjustments allowed by Ofwat in our last regulatory determination.

Operating expenditure

Increases in operating costs	£m
Inflationary increases	2.2
Major operational incidents	0.4
One-off costs of senior management team changes	0.7
Customer experience improvement programme	1.3
Higher depreciation due to newly commissioned assets	2.2
Higher costs associated with new customer connections	2.5
Market opening preparation costs	1.4
Costs associated with increased leakage detection and prevention activity	2.8
Higher power consumption	2.9
IT transformation costs	3.3
Non-recurring reimbursement from the EA recognised in 2014/15 operating costs	5.5
Other increases	1.1
Net increase in operating costs	26.3



Financial performance (continued)

Finance costs

The net finance expense of £36.7m was £0.5m lower than last year, with the full year effect of the £50.0m bond tap issue in July 2014, further £40.0m bond tap in October 2015 and £10m of Class B debt issued in February 2016, partially offsetting the impact of lower Retail Price Index ('RPI') inflation on the company's index-linked debt and higher net income from post-employment benefits.

Taxation

The total income tax credit of £14.1m (2015: an income tax expense of £11.3m) comprised a current tax expense of £1.6m (2015: £8.7m) and a deferred tax credit of £15.7m (2015: a deferred tax expense of £2.6m).

The current tax expense on profit before income tax of £45.6m (2015: £60.2m) was £1.6m (2015: £8.7m). The effective current tax rate (3.5%; 2015: 14.5%) was lower than the UK corporation tax rate of 20% (2015: 21%) mainly as a result of preparing financial statements in accordance with FRS 101 for the first time this year. Under FRS 101, grants and contributions that have been received and taxed in previous years in respect of assets constructed are now recognised as income and taxed in future years. In order to avoid this income being taxed twice, the tax previously paid is now repayable. This results in a current tax credit, and corresponding deferred tax charge, of £5.7m.

In the current year we had a large deferred tax credit due to the impact on our deferred tax liability of reductions in the UK corporation tax rate enacted in October 2015.

Capital expenditure

Capital expenditure in the year was £83.7m (2015: £88.8m), and occurred principally in our mains renewal, sustainability reduction and lead pipe replacement AMP6 programmes, as well as on undertaking trials and design work with a view to establishing a treatment solution for the pesticide, metaldehyde, at both our North Mymms and Iver water treatment works. This excludes £19.5m (2015: £19.0m) of infrastructure renewals expenditure, which is treated as operating expenditure under FRS 101 (the new accounting standards in place for 2015/16).

In aggregate, asset-related expenditure for the year was lower than the amount for 2015/16 allowed in our Business Plan. However this was primarily due to a slower than anticipated start to our metering programme and delays in technology selection for water quality projects. Programmes of work are expected to accelerate in 2016/17, in particular for increased meter coverage associated with our water saving programme.

Pension funding

At 31 March 2016, the retirement benefit under International Accounting Standard 19: 'Employee benefits' showed a surplus of £72.6m compared to a surplus of £45.1m at 31 March 2015. This increase reflects a decrease in the pension plan's liabilities primarily caused by an increase in the discount rate applied and a reduction in inflation.



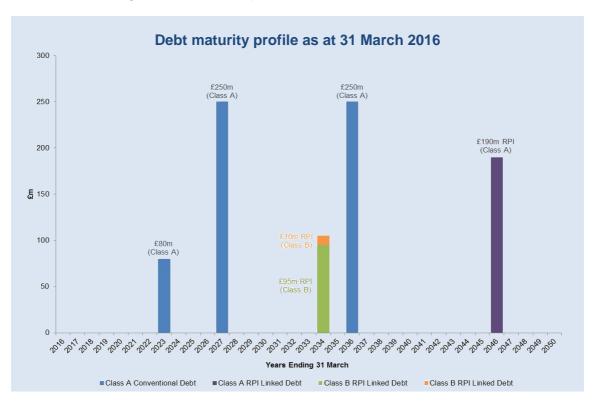
Financing update

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

On 29 July 2015, Affinity Water Programme Finance Limited announced that it had conditionally agreed the issuance of an additional £40 million of the 1.548% RPI linked guaranteed bonds due 2045. The proposed issuance was priced on 29 July 2015 by reference to the yield on the UK Government 0.75% index-linked gilt due 2047. The proceeds from this additional tap were received on 29 October 2015.

On 19 February 2016, Affinity Water Programme Finance Limited announced that it had completed the issuance of a new Class B £10 million 1.024 per cent RPI Linked Guaranteed Bonds due 2033.

The chart below shows the maturity profile of all the bonds issued by Affinity Water's financing subsidiaries, including the £40 million tap issue and £10 million Class B issue.



Moody's

Class A Bonds: A

Class B Bonds: Baa3

Our credit ratings

Class A Bonds: A-

Class B Bonds: BBB

Standard & Poor's

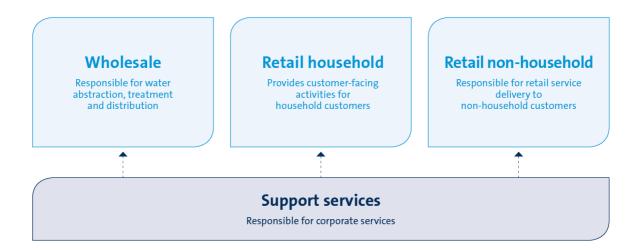


Regulatory update

Open Water Programme

We are currently preparing for the biggest transformation of the water industry in England since privatisation. The Open Water Programme was created to deliver the required market reforms to allow the non-household retail market to be opened on 1 April 2017.

In January 2016 we made changes to our organisation design so that we can improve our community strategy and position ourselves as a leader in our sector. These changes will help us deliver a better service for customers and ensure that we organise ourselves more efficiently. Our business is now split into three distinct operating units as follows:



For the first time, many of our non-household customers will now have the chance to choose their retail service provider. This is a significant change and over the course of 2016/17 we are working to ensure that our non-household customers are aware and informed of the changes that will be taking place. We are also expecting to commence "shadow operations" on 1 October 2016, ahead of the anticipated market opening date if 1 April 2017.

Water 2020

In July 2015 Ofwat launched "Towards Water 2020" and, following on from this, launched a consultation in December 2015 on its preferred approach to the design of the regulatory framework for the water industry at the next price review ('PR1'). Ofwat published further thinking in May 2016 confirming their preferred approach and setting out areas requiring further consultation. The new framework aims to make greater use of markets in relation to the areas of sludge and water resources with separate binding price controls for both. For PR19 Ofwat has also set out its intention to use the Consumer Price Index ('CPI') or CPIH (which includes owner occupier housing costs) rather than RPI for indexing allowed revenues (and therefore customers' bills). RCV is also to be indexed using a combination of CPI/CPIH and RPI.

We continue to fully engage with all our regulators regarding developments impacting the sector and are always happy to discuss publicly available information on this with our investors.



Governance update

Our Board is collectively responsible for the long-term success of the company. It sets our strategic aims, ensures that the necessary financial and human resources are in place to meet our objectives and reviews management performance. It sets our values and standards and ensures that our obligations to shareholders and others are understood and met.

We remain committed to the highest standards of governance and support the principles of good corporate governance set out in the 2014 UK Corporate Governance Code, and the UK Stewardship Code. Our business is owned by private investors and we therefore apply the principles of the UK Corporate Governance Code in this context. Our Governance Code, updated in March 2016, sets out for our customers, investors, regulators and other stakeholders how we govern and operate our business to high standards of governance and transparency.

Executive appointments

We have strengthened our senior management team with three new appointments during the year. Amanda Reynolds joined as the new Director of Customer Relations (Household), bringing with her over 20 years' experience in customer services and a passion for improving the customer experience. Helen Gillet joined as our Director of Retail Non-Household and will use her experience in operational and strategic leadership to drive forward our sales and business development strategy for our retail non-household business. Andrew Ritchie, in his appointment as the new Managing Director of Wholesale Operations, brings a wealth of experience to our business, including extensive hands-on exposure across the full value chain covering capital projects and programmes, operations and business development.

Board appointments

Baroness Peta Buscombe and Dr Jeffrey Herbert, independent non-executive directors of Affinity Water Limited, retired in September 2015.



Susan Hooper joined the Board in November 2015. She is a non-executive director at Rank Group plc. and Wizz Air Holdings plc., a Professor of Practice at the LUISS Business School in Rome with a special focus on Customer Centricity and works with private equity companies developing opportunities in the travel industry. Susan was previously Managing Director of British Gas Services Limited and Chief Executive of the Acromas Group's travel division from 2009 to 2013, where she was responsible for Saga Holidays, Hotels, Cruises, the AA Travel division and Titan Travel.

Trevor Didcock was appointed to the Board in November 2015. Trevor was Chief Information Officer at EasyJet plc. from 2010 to 2015, HomeServe plc. from 2008 to 2010, the Automobile Association ('AA') Limited from 2003 to 2007 and Group IT Director at RAC Motoring Services Limited from 1999 to 2003. Trevor now provides advisory services to organisations in IT and transformation programmedelivery and is a non-executive member of the Risk and Assurance Board at the Civil Aviation Authority.



Our chairman, Dr Phillip Nolan has been reappointed for a further three year term from 1 April 2016.



Common Terms Agreement compliance

Calculation of financial ratios

Test Period		Year 1 1 April 2015 to 31 March 2016 Actual	Year 2 1 April 2016 to 31 March 2017 Forecast	Year 3 1 April 2017 to 31 March 2018 Forecast	Year 4 1 April 2018 to 31 March 2019 Forecast	Year 5 1 April 2019 to 31 March 2020 Forecast
Net Cash Flow divided by	£m	124.3	120.9	125.7	133.0	137.2
Class A Debt Interest	£m	31.8	33.0	33.9	34.9	35.7
Class A ICR	Ratio	3.9	3.7	3.7	3.8	3.8
Net Cash Flow less	£m	124.3	120.9	125.7	133.0	137.2
CCD and IRC	£m	0	0	0	0	0
Adjusted Net Cash Flow divided by	£m	124.3	120.9	125.7	133.0	137.2
Class A Debt Interest	£m	31.8	33.0	33.9	34.9	35.7
Class A Adjusted ICR	Ratio	3.9	3.7	3.7	3.8	3.8
Net Cash Flow less	£m	124.3	120.9	125.7	133.0	137.2
CCD and IRC	£m	0	0	0	0	0
Adjusted Net Cash Flow divided by	£m	124.3	120.9	125.7	133.0	137.2
Senior Debt Interest	£m	35.1	36.4	37.3	38.4	39.3
Senior Adjusted ICR	Ratio	3.5	3.3	3.4	3.5	3.5



Test Period		Year 1 1 April 2015 to 31 March 2016 Actual	Year 2 1 April 2016 to 31 March 2017 Forecast	Year 3 1 April 2017 to 31 March 2018 Forecast	Year 4 1 April 2018 to 31 March 2019 Forecast	Year 5 1 April 2019 to 31 March 2020 Forecast
Year 1	Ratio	3.9				
Year 2	Ratio	3.7	3.7			
Year 3	Ratio	3.7	3.7	3.7	3.7	3.7
Year 4	Ratio		3.8	3.8	3.8	3.8
Year 5	Ratio			3.8	3.8	3.8
Class A Average Adjusted ICR	Average	3.8	3.7	3.8	3.8	3.8
Year 1	Ratio	3.5				
Year 2	Ratio	3.3	3.3			
Year 3	Ratio	3.4	3.4	3.4	3.4	3.4
Year 4	Ratio		3.5	3.5	3.5	3.5
Year 5	Ratio			3.5	3.5	3.5
Senior Average Adjusted ICR	Average	3.4	3.4	3.4	3.4	3.4
Net Cash Flow less	£m	124.3	120.9	125.7	133.0	137.2
RCV Depreciation and Capitalised IRE	£m	51.7	61.9	63.3	64.3	64.9
Conformed Adjusted Net Cash Flow divided by	£m	72.6	59.0	62.4	68.7	72.3
Class A Debt Interest	£m	31.8	33.0	33.9	34.9	35.7
Conformed Class A Adjusted ICR	Ratio	2.3	1.8	1.8	2.0	2.0



Test Period		Year 1 1 April 2015 to 31 March 2016 Actual	Year 2 1 April 2016 to 31 March 2017 Forecast	Year 3 1 April 2017 to 31 March 2018 Forecast	Year 4 1 April 2018 to 31 March 2019 Forecast	Year 5 1 April 2019 to 31 March 2020 Forecast
Net Cash Flow less	£m	124.3	120.9	125.7	133.0	137.2
RCV Depreciation & Capitalised IRE	£m	51.7	61.9	63.3	64.3	64.9
Conformed Adjusted Net Cash Flow divided by	£m	72.6	59.0	62.4	68.7	72.3
Senior Debt Interest	£m	35.1	36.4	37.3	38.4	39.3
Conformed Senior Adjusted ICR	Ratio	2.1	1.6	1.7	1.8	1.8
Year 1	Ratio	2.3				
Year 2	Ratio	1.8	1.8			
Year 3	Ratio	1.8	1.8	1.8	1.8	1.8
Year 4	Ratio		2.0	2.0	2.0	2.0
Year 5	Ratio			2.0	2.0	2.0
Conformed Class A Average Adjusted ICR	Average	2.0	1.9	1.9	1.9	1.9
Year 1	Ratio	2.1				
Year 2	Ratio	1.6	1.6			
Year 3	Ratio	1.7	1.7	1.7	1.7	1.7
Year 4	Ratio		1.8	1.8	1.8	1.8
Year 5	Ratio			1.8	1.8	1.8
Conformed Senior Average Adjusted ICR	Average	1.8	1.7	1.8	1.8	1.8



Date		31 March 2016 Actual	31 March 2017 Forecast	31 March 2018 Forecast	31 March 2019 Forecast	31 March 2020 Forecast
Class A Net Indebtedness divided by	£m	698.2	764.2	815.5	841.9	850.9
RCV	£m	1,080.3	1,142.6	1,186.0	1,207.9	1,215.3
Class A RAR	Ratio	0.65	0.67	0.69	0.70	0.70
Senior Net Indebtedness divided by	£m	809.3	877.4	931.8	961.4	973.7
RCV	£m	1,080.3	1,142.6	1,186.0	1,207.9	1,215.3
Senior RAR	Ratio	0.75	0.77	0.79	0.80	0.80

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

Date	31 March 2016 £m
Borrowings	902.2
Exclude Permitted Legacy Loan	(3.6)
Add Back Unamortised Debt Issue Costs and Bond Premium	(8.6)
Add Accrued Interest	12.7
Less Cash and cash equivalents	(93.4)
Senior Net Indebtedness	809.3
Remove Class B Debt Amounts	(111.1)
Class A Net Indebtedness	698.2



Further certifications

Debt Service Reserve Accounts

There is no balance in each of the Debt Service Reserve Accounts as at 31 March 2016. The required debt service reserve is provided by a liquidity facility from HSBC Bank PLC totalling £38.0 million.

Permitted Subsidiaries Acquired

There were no Permitted Subsidiaries acquired pursuant to a Permitted Acquisition in the period to 31 March 2016.

Annual Finance Charge

Affinity Water Limited has calculated the Annual Finance Charge for the period from 1 April 2016 to 31 March 2017 as £35.8 million and the Monthly Payment Amount to be £2.981 million. Calculation of the Annual Finance Charge is set out in the table to the right.

	1 April 2016 to 31 March 2017 (£m)
Forecast interest paid on bonds	35.4
Forecast interest paid on loans	0.0
Other recurring finance fees paid	0.4
Total	35.8

Additional Confirmations

Affinity Water Limited also confirms that:

- (a) no Default or Potential Trigger Event is outstanding; and
- (b) that Affinity Water Limited's insurances are being maintained in accordance with the Common Terms Agreement.

Yours faithfully,

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

