

ANGLIAN WATER SERVICES FINANCING PLC

DIRECTORS' REPORT AND ACCOUNTS 2010

Anglian Water Services Financing Plc

Directors' Report and Accounts 2010

contents

page

1 directors' report

3 performance review

4 statement of directors' responsibilities

5 independent auditors' report

6 profit and loss account

7 balance sheet

8 notes to the financial statements

Anglian Water Services Financing Plc

directors' report

The directors present their report and the audited financial statements of Anglian Water Services Financing Plc for the year ended 31 March 2010.

principal activity and business review

The principal activity of Anglian Water Services Financing Plc (the company) is the raising of listed debt to on-lend to Anglian Water Services Limited. The information that fulfils the requirement of the business review including development and performance of the company during the year and its position at the year end, principal risks and uncertainties faced by the company, Key Performance Indicators and the company's future outlook, can be found in the performance review on page 3 which includes comments on the financial results.

results and dividends

The company's profit and loss account on page 6 shows the company's results for the year. For the financial year ended 31 March 2010 the company made a profit before taxation of £1.0 million (2009: £16.5 million). No dividend was paid during the year (2009: £nil). The directors are not recommending the payment of a final dividend (2009: £nil).

directors

The directors of the company who served during the year are listed below:

Sir Adrian Montague	-	Independent Non-Executive Director (appointed on 29 January 2010)
Jonson Cox	-	Chief Executive and Chairman (resigned on 29 January 2010)
Peter Simpson	-	Executive Director
Chris Newsome	-	Executive Director
Jean Spencer	-	Executive Director
Scott Longhurst	-	Executive Director
Christopher Garnett	-	Independent Non-Executive Director
Robert Napier	-	Independent Non-Executive Director
John Watkinson	-	Independent Non-Executive Director

charitable and political donations

There were no charitable or political donations during the year ended 31 March 2010 (2009: nil).

financial risk management

Details are included in the performance review on page 3.

Statement of disclosure of information to auditors

In the case of each of the persons who are directors at the time when the report is approved under section 418 of the Companies Act 2006 the following applies:

- (a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (b) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

directors' report (continued)

auditors

PricewaterhouseCoopers LLP has indicated its willingness to continue in office and a resolution proposing its re-appointment will be put to the Annual General Meeting.

By order of the board

Claire Russell
Company Secretary

27 May 2010

Registered Office:
Anglian House
Ambury Road
Huntingdon
Cambridgeshire,
PE29 3NZ
United Kingdom

Registered in England and Wales No. 4330322

Anglian Water Services Financing Plc

performance review

financial needs and resources

The company raised £200.0 million of new debt during the year as part of its ongoing funding requirement and repaid £298.3 million of debt maturing during the year. The monies raised were on lent to Anglian Water Services Limited on a back-to-back basis. As at 31 March 2010 the company had cash and deposits amounting to £39.0 million (2009: £338.6 million). In addition a further £130.0 million of funds were raised in May 2010 through the successful issue of a new index-linked bond as part of the planned debt financing programme.

profit for the financial year

The company made a profit on ordinary activities after taxation of £1.0 million (2009: £16.5 million).

principal risks and uncertainties

The management of the business and the execution of the company's strategy are subject to a number of risks, the principal risks being management of liquidity and interest rate exposure.

liquidity

The company's objective is to maintain flexibility, diversification and continuity of funding through access to different markets and debt instruments. At the year-end the company held cash, deposits and current asset investments of £39.0 million (2009: £338.6 million) and had undrawn committed facilities of £225.0 million (2009: £225.0 million). Cash is held on deposit in the company to the extent required to meet near term debt repayments. The reduction in cash held at 31 March 2010 compared to the prior year primarily reflects the repayment of a bond shortly after the 2009 year end. These resources are maintained to ensure liquidity and the continuation of the Anglian Water Services Limited investment programme. The maturity profile of the company's borrowings is set out in note 11 to the accounts. In addition the company has access to £355.0 million (2009: £340.0 million) of 'liquidity facilities'; £279.0 million (2009: £264.0 million) to finance Anglian Water Services Limited debt service costs and £76.0 million (2009: £76.0 million) to finance Anglian Water Services Limited operating expenditure and maintenance capital expenditure. These facilities address the risk of Anglian Water Services Limited being in default of its debt obligations and having insufficient liquidity.

interest rates

The company's policy, as agreed by the Board, is to achieve a balanced mix of funding at indexed (to the Retail Price Index), fixed and floating rates of interest to appropriately address the risks in the business. This includes the use of interest rate swaps, to manage the company's exposure to interest rate fluctuations. At the year-end, taking into account interest rate swaps, 54.2 per cent (2009: 51.0 per cent) of the company's borrowings were at rates indexed to inflation, 40.2 per cent (2009: 42.5 per cent) were at fixed rates, and 5.6 per cent (2009: 6.5 per cent) were at floating rates.

foreign currency

The company has currency exposures resulting from debt raised in currencies other than sterling and very small purchases in foreign currencies. The company uses a range of instruments to hedge such exposures. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits. The company has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the company.

future outlook

The company continues to monitor debt markets with a view to raising future funding to fulfil the requirements of Anglian Water Services Limited.

Anglian Water Services Financing Plc

performance review (continued)

key performance indicators ('KPIs')

Given the nature of the business, the directors are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the business.

directors' indemnities

The company maintains directors' and officers' liability insurance which gives appropriate cover for legal action brought against its Directors. The company has also provided an indemnity for its Directors, which is a qualifying third party indemnity provision for the purpose of section 234 ((2) – (6)) of the Companies Act 2006.

statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently, as set out in note 1, 'Accounting policies'. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the period ended 31 March 2010 and that applicable UK accounting standards have been followed.

The directors are responsible for ensuring that their report and accounts are published and where they are published on the Internet, for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements.

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

Anglian Water Services Financing Plc

Independent auditors' report to the members of Anglian Water Services Financing Plc

We have audited the financial statements of Anglian Water Services Financing Plc for the year ended 31 March 2010 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

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

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Stephen Snook (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
27 May 2010

Anglian Water Services Financing Plc

profit and loss account for the year ended 31 March 2010

Notes	2010 £m	2009 £m
1 Turnover	-	-
Operating costs	-	-
Operating profit	-	-
2 Interest payable and similar charges	(245.6)	(315.5)
2 Interest receivable and similar income	246.6	332.0
Net interest receivable	1.0	16.5
Profit on ordinary activities before taxation	1.0	16.5
3 Tax on profit on ordinary activities	-	-
Profit for the financial year	1.0	16.5

The results above arise from continuing operations.

The notes on pages 8 to 21 form part of these financial statements.

No statement of total recognised gains and losses has been presented, as all gains and losses have been included in the profit and loss account.

There was no difference between both the profit on ordinary activities before taxation and the profit for the financial years stated above, and their historical cost equivalents.

Anglian Water Services Financing Plc

balance sheet as at 31 March

Notes		2010 £m	2009 £m
	Fixed assets		
6	Investments	4,843.4	4,952.8
11	Derivative Financial Instruments	730.9	737.5
		5,574.3	5,690.3
	Current assets		
11	Derivative Financial Instruments	32.6	133.9
7	Debtors	4.5	0.2
8	Investment – money market deposits	15.0	-
9	Cash at bank and in hand (including short-term deposits)	24.0	338.6
		76.1	472.7
	Creditors: amounts falling due within one year		
11	Short-term borrowings	(109.5)	(515.2)
11	Derivative Financial Instruments	(13.1)	(11.2)
10	Other creditors	-	(296.3)
		(122.6)	(822.7)
	Net current liabilities	(46.5)	(350.0)
	Total assets less current liabilities	5,527.8	5,340.3
	Creditors: amounts falling due after more than one year		
11	Loans and other borrowings	(5,048.4)	(4,891.5)
11	Derivative Financial Instruments	(435.9)	(406.3)
		(5,484.3)	(5,297.8)
	Net assets	43.5	42.5
	Capital and reserves		
12	Called up share capital	-	-
13	Profit and loss account	43.5	42.5
13	Total shareholders' funds	43.5	42.5

Notes 1 to 15 are an integral part of these financial statements.

The financial statements were approved by the board on 27 May 2010 and signed on its behalf by:

Sir Adrian Montague
Director

Scott Longhurst
Director

notes to the financial statements

1. Accounting policies

The financial statements are prepared on a going concern basis under the historical cost convention as modified by the revaluation of derivative financial instruments at fair value, and in accordance with applicable accounting standards (UK GAAP) and with the Companies Act 2006.

The following principal accounting policies and estimation techniques have been consistently applied to the financial statements as stated.

a) Basis of preparation

The Directors have undertaken a detailed review to assess the liquidity requirements of the company compared against the cash and facilities available, and have reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

b) Cash flow statement

The company is a wholly-owned subsidiary of Anglian Water Services Limited and is included in the consolidated financial statements of Anglian Water Services Limited. Consequently, the company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1.

c) Related party transactions

The company has taken advantage of the exemption not to disclose transactions with other members of the group under Financial Reporting Standard (FRS) 8 "Related Party Disclosures" as it is a wholly owned subsidiary.

d) Investments

Investments held as fixed assets represents loans to the immediate parent undertaking (Anglian Water Services Limited) and reflects the 'back-to-back' arrangement with the company (see 1(e)).

e) Financial instruments

The company uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from financing activities. In accordance with its treasury policy, the company does not hold or issue derivative financial instruments for trading purposes.

Derivatives are initially recognised and subsequently re-measured at fair value. However, within the company hedge accounting is not applied and therefore the movements in the fair value of these derivatives are included in the profit and loss account within interest payable.

The company has a "back-to-back" arrangement with Anglian Water Services Limited whereby all borrowings and derivatives are replicated on identical terms, thus resulting in net neutral impact on the profit and loss account. Where there is no formal arrangement for replication of derivatives associated with specific debt items, the company has a "back-to-back" arrangement with Anglian Water Services Limited whereby all borrowings and derivatives are replicated on identical terms, i.e. these are deemed back-to-back, thus resulting in net neutral impact on the profit and loss account. Anglian Water Services Limited lends cash back to the company to provide the funds for the company to repay its external debt, normally 12 months in advance of debt falling due for payment.

notes to the financial statements (continued)

1. Accounting policies (continued)

f) Foreign currencies

Individual transactions denominated in foreign currencies are translated into local currency at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the balance sheet date. Profits and losses on both individual foreign currency transactions during the year and monetary assets and liabilities are dealt with in the profit and loss account.

g) Borrowings

Borrowings are recognised initially at fair value. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

h) Dividends

Dividends are recognised as a liability in the period in which they are approved. Interim dividends are recognised in the period in which they are paid.

i) Current asset investments

Cash deposits with a maturity of greater than three months and within one year are classified as current asset investments within the balance sheet. Cash deposits with a maturity of greater than one day but less than three months are classified as cash at bank and in hand within the balance sheet.

notes to the financial statements (continued)

2. Net Interest receivable

	2010	2009
	£m	restated ¹ £m
Interest payable and similar charges –		
Indexation on index linked loan stock	(17.2)	(92.4)
Interest payable on external loans	(209.5)	(233.3)
	(226.7)	(325.7)
Exchange movements on foreign currency debt	46.8	(281.9)
Fair value gains on external derivative financial instruments	(65.7)	292.1
	(245.6)	(315.5)
Interest receivable and similar income -		
Interest receivable from Anglian Water Services Limited	226.7	325.7
Management fee treated as interest receivable	0.2	0.2
Gains/(losses) on back to back arrangements with Anglian Water Services Limited	18.9	(10.2)
	245.8	315.7
Interest receivable from money market deposits	0.8	16.3
	246.6	332.0
Net interest receivable	1.0	16.5

¹ The exchange movements on foreign currency debt and fair value gains on external derivative financial instruments have been restated to eliminate changes in values arising on maturity of derivative instruments from the reported fair value gains

The company holds RPI swaps to enable the Anglian Water Services group to hedge against RPI movement in the Regulated Capital Value (RCV) and revenues of Anglian Water. These RPI swaps do not qualify for hedge accounting under FRS 26 and consequently are held at fair value with movements taken to the profit and loss account, however, it is the opinion of the directors that they remain highly effective economic hedges.

The company holds interest rate swaps and cross currency swaps to enable the group to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activity. Within the company hedge accounting is not applied and therefore the movements in the fair value of these derivatives are included in the profit and loss account. The company has a “back-to-back” arrangement with Anglian Water Services Limited whereby all borrowings and derivatives are replicated on identical terms, thus resulting in net neutral impact on the profit and loss account.

Anglian Water Services Financing Plc

notes to the financial statements (continued)

3. Taxation

	2010 £m	2009 £m
Tax on profit on ordinary activities comprises:		
UK Corporation Tax at 28 per cent (2009: 28 per cent)	-	-

Factors affecting tax charge for the year

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (28 per cent, 2009: 28 per cent)

The differences are explained below:

	2010 £m	2009 £m
Profit on ordinary activities before taxation	1.0	16.5
Profit on ordinary activities at the standard UK rate of tax (28 per cent, 2009: 28 per cent)	0.3	4.6
Effects of:		
Group relief not paid for	(0.3)	(4.6)
Current tax charge for the year	-	-

It has been agreed that companies within the Anglian Water Services Financing Group (AWSFG) will not pay each other for tax losses. The AWSFG consists of Anglian Water Services Limited, Anglian Water Services Financing Plc, Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited.

4. Employee information

The company has no employees. Anglian Water Services Limited employees carry out all the activities of the company.

directors' emoluments

None of the directors of the company received any emoluments during the year (2009: nil) for their services to the company.

5. Auditors' remuneration

The auditors' remuneration for audit services is borne by Anglian Water Services Limited.

notes to the financial statements (continued)

6. Fixed asset investments

Loans to immediate parent undertaking (Anglian Water Services Limited)

	£m
As at 1 April 2009	4,952.8
Increase in loans	200.0
Repayments of amounts borrowed	(298.3)
Movements on back to back loan arrangements with Anglian Water Services Limited	(11.1)
At 31 March 2010	4,843.4

As stated in the Directors' Report (see page 1) the company exists to raise debt for Anglian Water Services Limited. The company on-lends an equal amount to the sterling equivalent of each external bond raised (see note 11) to Anglian Water Services Limited on identical terms.

7. Debtors: amounts falling due within one year

	2010 £m	2009 £m
Other debtors	-	0.2
Amounts owed by immediate parent undertaking	4.5	-
	4.5	0.2

The amounts owed by the immediate parent undertaking falling due within one year are not interest bearing.

8. Investments – money market deposits

	2010 £m	2009 £m
Money market deposits (maturity date in excess of 3 months)	15.0	-

9. Cash at bank and in hand

	2010 £m	2009 £m
Cash at bank and money market deposits (maturity date of greater than 1 day and less than 3 months)	24.0	338.6

10. Other creditors

	2010 £m	2009 £m
Amounts owed to immediate parent undertaking	-	296.3

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments

	2010 £m	2009 £m
Loans and other borrowings		
£100m 12.375% Fixed 2014 (c), (e)	102.9	102.9
£200m 6.875% Fixed 2023 (c), (e)	208.4	208.4
£200m 6.625% Fixed 2029 (c), (e)	202.8	202.8
£150m 4.125% Index Linked 2020 (a), (c), (e)	195.5	196.6
EUR 350m 5.375% Fixed 2009 (c), (e)	-	336.8
USD 25m 7.07% Private Placement 2009 (c), (e)	-	3.0
USD 23m 7.13% Private Placement 2009 (c), (e)	-	16.2
USD 195m 7.23% Private Placement 2011 (c), (e)	130.1	137.5
EUR 650m 4.625% Fixed 2013 (c), (d)	591.8	614.8
£246m 6.293% Fixed 2030 (c), (e)	256.4	256.4
£275m 7.882% Fixed 2012/2037 ¹ (b), (c), (e)	289.5	289.5
£250m 5.837% Fixed 2022 (c), (e)	259.8	259.8
£200m 3.07% Index Linked 2032 (a), (c), (e)	247.9	249.5
£60m 3.07% Index Linked 2032 (a), (c), (e)	75.5	75.4
£75m 3.666% Index Linked 2024 (a), (c), (e)	93.1	93.6
£250m 5.25% Fixed 2015 (c), (d)	255.5	255.5
£150m 5.5% Fixed 2017/2040 ² (b), (c), (d)	153.9	153.9
£402m 2.4% Index-linked 2035 (a), (c), (e)	464.8	464.2
£50m 1.7% Index-linked 2046 (a), (c), (e)	55.5	55.8
£50m 1.7% Index-linked 2046 (a), (c), (e)	56.1	55.4
£40m 1.7146% Indexation Bond 2056 (a), (c), (e)	44.5	44.7
£50m 1.6777% Indexation Bond 2056 (a), (c), (e)	55.7	55.9
£60m 1.7903% Indexation Bond 2049 (a), (c), (e)	66.7	67.0
£100m 1.3784% Indexation Bond 2057 (a), (c), (e)	112.1	110.9
£50m 1.3825% Indexation Bond 2056 (a), (c), (e)	56.0	55.5
£50m RBS Class B Authorised Loan Facility (c), (e)	-	50.2
£100m Class A Wrapped Floating Rate Bonds (c), (e)	100.2	100.5
£75m 1.449% Indexation Bond 2062 (a), (c), (e)	80.9	79.0
£50m 1.52% Indexation Bond 2055 (a), (c), (e)	53.9	52.7
JPY 15bn 2.925% Fixed Rate Bond 2018/2037 (c), (d)	106.6	106.4
£110m Class A Unwrapped Floating Rate Bond 2043 (c), (e)	110.2	110.3
JPY 5 bn 3.22% Fixed Rate Bond 2038 (c), (d)	35.7	35.6
Euro 500m 6.25% Fixed Rate Bond 2016 (c), (e)	466.4	484.6
£25m 6.875% Private Placement 2034 (c), (e)	25.4	25.4
£100m Class B 6.75% Fixed Rate Bond ³ 2024 (c), (e)	102.1	-
EIB £50m 1.626% Term Facility 2019 (a), (c), (e)	51.4	-
EIB £50m 1.3% Term Facility 2020 (a), (c), (e)	50.6	-
Total loans and other borrowings	5,157.9	5,406.7
Less amounts included in creditors falling due within one year	(109.5)	(515.2)
Loans and other borrowings falling due after more than one year	5,048.4	4,891.5

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

- a) The value of the capital and interest elements of the Index Linked Loans are linked to movements in the Retail Price Index. The increase in the capital value during the year of £3.7 million (2009: £62.0 million) has been taken to the profit and loss account as part of interest payable.
- b) Legal maturity of these instruments is the second of the two years quoted. Coupons increase for the first of the years quoted in accordance with the pricing terms agreed at issue.
- c) Under a security agreement dated 30 July 2002 between Anglian Water Services Financing Plc (AWSF), Anglian Water Services Limited (AWS), Anglian Water Services Overseas Holdings Limited (AWSOH), Anglian Water Services Holdings Limited (AWSH) and Deutsche Trustee Company Limited a fixed and floating charge was created over the assets of Anglian Water Services Limited to the extent permissible under the Water Industry Act 1991. In addition there is a fixed charge over the issued share capital of AWS, AWSOH and AWSF. At 31 March 2010 this charge applies to £5,157.9 million (2009: £5,406.7 million) of the debt listed above.
- d) These instruments are exposed to fair value interest rate risk, before taking into account the impact of interest rate swaps.
- e) These instruments are exposed to cash flow interest rate risk before taking into account the impact of interest rate swaps.

Debt issue costs are excluded from the amounts disclosed and borne by the parent company, Anglian Water Services Limited.

¹ The coupon for this instrument will increase to Floating rate LIBOR plus 6.0 per cent effective July 2012

² The coupon for this instrument will increase to Floating rate 3 month LIBOR plus 3.5 per cent effective October 2017

³ The basis for this instrument will change from fixed rate to floating rate 3 month LIBOR plus 10.9 per cent effective June 2014

Anglian Water Services Financing Plc

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below:

At 31 March	2010			2009		
	Assets at fair value through the profit and loss £m	Other financial Assets £m	Total £m	Assets at fair value through the profit and loss £m	Other financial assets £m	Total £m
Assets as per balance sheet						
Investment – money market deposits	-	15.0	15.0	-	-	-
Cash at bank and in hand	-	24.0	24.0	-	338.6	338.6
Investments – loan to immediate parent undertaking	-	4,843.4	4,843.4	-	4,952.8	4,952.8
Derivative financial instruments	763.5	-	763.5	871.4	-	871.4
Total	763.5	4,882.4	5,645.9	871.4	5,291.4	6,162.8

At 31 March	2010			2009		
	Liabilities at fair value through the profit and loss £m	Other financial liabilities £m	Total £m	Liabilities at fair value through the profit and loss £m	Other financial liabilities £m	Total £m
Liabilities as per balance sheet						
Borrowings	-	(5,157.9)	(5,157.9)	-	(5,406.7)	(5,406.7)
Derivative financial instruments	(449.0)	-	(449.0)	(417.5)	-	(417.5)
Total	(449.0)	(5,157.9)	(5,606.9)	(417.5)	(5,406.7)	(5,824.2)

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

Derivative Financial Instruments	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps and swaptions	338.4	(23.9)	483.4	(29.5)
RPI swaps	425.1	(425.1)	388.0	(388.0)
	763.5	(449.0)	871.4	(417.5)

Derivative financial instruments can be analysed as follows:

Current	32.6	(13.1)	133.9	(11.2)
Non-current	730.9	(435.9)	737.5	(406.3)
	763.5	(449.0)	871.4	(417.5)

The effective interest rate at the balance sheet dates were as follows:

	2010	2009
Borrowings – GBP	4.2%	6.0%
Borrowings – USD	7.3%	7.3%
Borrowings – EUR	4.1%	5.5%
Borrowings - JPY	4.4%	4.4%

The weighted average interest costs at the balance sheet dates were as follows:

Fixed	7.0%	7.0%
Floating	1.9%	3.4%
Indexed	2.7%	6.3%

In accordance with FRS 26, 'Financial instruments: Measurement', Anglian Water Services Financing Plc has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. There were no amounts recorded in the profit and loss account for gains and losses on embedded derivatives in the year ended 31 March 2010 (2009: £nil)

Interest rate swaps and swaptions

The notional principal amount of the outstanding interest rate swap contracts at 31 March 2010 was £2,200.7 million (2009: £2,449.0 million) and outstanding swaptions at 31 March 2010 was £300.0 million (2009: £300.0 million).

The notional foreign currency principal amount of the outstanding cross currency interest rate swap contracts at 31 March 2010 was USD 195.0m (2009: USD 222.2m), EUR 1,150m (2009: EUR 1,500m), JPY 20,000m (2009 20,000m).

At 31 March 2010 the fixed interest rates vary from 6.900% to 7.163% and floating rates vary from 0.986% (LIBOR plus 37bp) to 1.961% (LIBOR plus 113bp) and index-linked interest rates vary from 1.399% plus RPI to 3.740% plus RPI.

At 31 March 2009 the fixed interest rates vary from 6.325% to 7.168% and floating rates vary from 2.536% (LIBOR plus 37bp) to 5.728% (LIBOR plus 113bp) and index-linked interest rates vary from 1.399% plus RPI to 3.740% plus RPI.

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

Fair value of financial assets, liabilities, borrowings and derivatives

	2010		2009	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Current asset investments	15.0	15.0	-	-
Cash at bank and in hand (including short term deposits)	24.0	24.0	338.6	338.6
Short-term borrowings	(109.5)	(109.5)	(515.2)	(395.5)
Long-term borrowings	(5,048.4)	(5,211.0)	(4,891.5)	(4,669.8)
Short-term derivative financial instruments				
- interest rate swaps	19.5	19.5	122.7	122.7
Long-term derivative financial instruments				
- Interest rate swaps and swaptions	295.0	295.0	331.2	331.2
"Net debt"	(4,804.4)	(4,967.0)	(4,614.2)	(4,272.8)
Fixed asset investments	4,843.4	4,843.4	4,952.8	4,952.8
	39.0	(123.6)	338.6	680.0

The estimated fair values of quoted loans and other borrowings are based on period end mid-market quoted prices (where available). The fair value of derivative financial instruments is determined by calculating (with reference to market exchange and interest rates at 31 March) the net realisable value that would have arisen if these contracts terminated at 31 March.

The short-term derivative financial instruments at 31 March 2010 consist of interest rate swaps £19.5m (2009: £122.7m). The long-term derivative financial instruments at 31 March 2010 consist of interest rate swaps £295.0m (2009: £331.2m). The fair value of investments has been estimated as not materially different from book value.

Maturity of financial liabilities

The maturity profile of the carrying amount of the company's liabilities, at 31 March 2010 was as follows:

	Debt £m	Derivatives £m	Total £m
< 1 year	109.5	(19.5)	90.0
1 – 2 years	128.4	9.7	138.1
2 – 5 years	678.9	(160.3)	518.6
> 5 years	4,241.1	(144.4)	4,096.7
	5,157.9	(314.5)	4,843.4

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

The maturity profile of the carrying amount of the company's liabilities, at 31 March 2009 was as follows:

	Debt £m	Derivatives £m	Total £m
< 1 year	515.2	(122.7)	392.5
1 – 2 years	-	-	-
2 – 5 years	837.1	(182.4)	654.7
> 5 years	4,054.4	(148.8)	3,905.6
	<u>5,406.7</u>	<u>(453.9)</u>	<u>4,952.8</u>

Borrowing facilities

The company has the following undrawn committed borrowing facilities available at 31 March 2010 in respect of which all conditions precedent had been met at that date:

	2010 £m	2009 £m
Expiring within 1 year	<u>580.0</u>	340.0
Expiring between 1 and 2 years	-	225.0
	<u>580.0</u>	<u>565.0</u>

In June 2009 a £355m forward starting facility was signed to replace the existing £225.0m facilities when they mature in July 2010.

The company has borrowing facilities for the purpose of supporting Anglian Water Services Limited operations. Borrowing facilities comprise a syndicated £225.0m authorised loan facility for working capital and capital expenditure requirements provided by Barclays Bank Plc and syndicated to certain other banks; Class A and Class B debt service reserve facilities totalling £279.0m provided by Barclays Bank Plc, HSBC Bank Plc, Royal Bank of Scotland Plc and Lloyds TSB Bank Plc and a £76.0m operating and capital maintenance expenditure reserve facility provided by Barclays Bank Plc, BNP Paribas Plc and Royal Bank of Scotland Plc.

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

Financial risk management

Management of financial risk

Financial risks faced by the company include funding, interest rate, contractual and currency risks. The board regularly reviews these risks and has approved written policies covering treasury strategy and the use of financial instruments to manage risks. The last review was in April 2010 and treasury matters are reported to the board each month.

A Finance, Treasury and Energy Policy Group (FTEPG), comprising the Managing Director of Finance and Non Regulated Business, the Group Treasurer, together with several other Directors and senior managers, meets monthly with the specific remit of reviewing treasury matters.

The company aims to meet its funding requirements primarily through public bond markets, private placements, bank loans and finance leases. Surplus cash is invested in short-term bank deposits, commercial paper and AAA rated money funds.

The company also enters into derivative transactions (principally currency and interest rate swaps) to manage the interest rate and currency risks arising from the treasury policy.

To ensure continued effectiveness and relevance, the board carries out a formal annual review of the treasury organisation and reporting.

Borrowing covenants

With the exception of asset-based funding, all the Anglian Water Services group's borrowings are raised by the company and guaranteed by the Anglian Water Services Financing group. The treasury function monitors compliance against all financial obligations and it is the group's policy to manage the balance sheet so as to ensure operation within covenant restrictions.

a) Market risk

i) Foreign currency

The company has currency exposures resulting from debt raised in currencies other than sterling and very small purchases in foreign currencies. The company uses a range of instruments to hedge such exposures. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits. The company has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the company.

ii) Interest rate

The company has a "back-to-back" arrangement with Anglian Water Services Limited whereby all borrowings and derivatives are replicated on identical terms. Where there is no formal arrangement for replication of derivatives associated with specific debt items, the company has a "back-to-back" arrangement with Anglian Water Services Limited whereby all borrowings and derivatives are replicated on identical terms, i.e. these are deemed back-to-back. Any exposure to interest rate or RPI risk is passed onto Anglian Water Services Limited, hence, this arrangement eliminates interest rate and RPI risk and results in a net neutral impact on the profit and loss account.

notes to the financial statements (continued)

11. Loans, other borrowings and financial instruments (continued)

Sensitivity analysis

In managing interest rate risk on cash and deposits the company aims to reduce the impact of short-term fluctuations on the company's earnings. Deposits are placed for fixed terms and for the year ended 31 March 2010, the average period on deposit was 29 days (2009: 56 days). Deposits are matched against floating rate debt, and are therefore hedged against interest rate movements. Thereafter, there is an exposure to LIBOR movements for which a 0.25 per cent increase or decrease would result in an increase/decrease in interest receivable of £0.2 million (2009: £0.5 million).

b) Credit risk

The company has an intercompany receivable which is not passed due nor impaired.

Placements of cash on deposit expose the company to credit risk against the counterparties concerned. The company has credit protection measures in place within agreements which provide protection in the event of counterparty rating downgrade or default. The company only places cash deposits with banks of high credit standing (as measured by reputable rating agencies) and also seeks to diversify exposure such that concentration with individual banks is avoided.

The table below shows the counterparty by rating type and the balances on deposit

Counterparty	31 March 2010 £m	31 March 2009 £m
Institutions with a minimum of three short-term ratings of P1/A1/F1 or higher or in the case of money market funds with a minimum of three ratings of A+/A1/A+ or higher	39.0	338.6

The maximum exposure to credit risk at the reporting date is the carrying value of the deposits above, along with the debtor balances.

c) Liquidity risk

The company's objective is to maintain flexibility, diversification and continuity of funding through access to different markets and debt instruments.

The table below analyses the company's financial liabilities and net-settled derivative financial instruments into relevant maturity groupings based on the remaining period at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows and include interest payable.

At 31 March 2010	Less than 1 year £m	Between 1 and 5 years £m	Between 5 and 25 years £m	Over 25 years £m
Borrowings	(236.4)	(2,041.1)	(5,280.2)	(5,335.3)
Derivative financial instruments	5.7	114.3	(300.9)	(1,032.6)
At 31 March 2009	Less than 1 year £m	Between 1 and 5 years £m	Between 5 and 25 years £m	Over 25 Years £m
Borrowings	(587.1)	(1,993.9)	(5,037.0)	(4,771.9)
Derivative financial instruments	109.7	158.0	(371.5)	(839.0)

Anglian Water Services Financing Plc

notes to the financial statements (continued)

12. Called up share capital

	2010	2009
	£m	£m
Authorised:		
100,000 Ordinary shares of £1 each	0.1	0.1
Allotted, issued and fully paid:		
Ordinary shares of £1 each	-	-

The issued share capital is 50,000 (2009: 50,000) ordinary shares of £1 each, of which 49,998 (2009: 49,998) have been issued, a quarter paid-up and two shares are fully paid-up, giving an issued share capital of £12,502 (2009: £12,502).

13. Movements in shareholder's funds

	Share capital	Profit and loss account	2010 Total	2009 Total
	£m	£m	£m	£m
At beginning of year	-	42.5	42.5	26.0
Profit after taxation	-	1.0	1.0	16.5
At end of year	-	43.5	43.5	42.5

14. Contingent liabilities

The company, as part of the Anglian Water Services group of companies, guarantees unconditionally and irrevocably all the borrowings of Anglian Water Services Limited, Anglian Water Holdings Limited and Anglian Water Overseas Holdings Limited, which at 31 March 2010 amounted to £1,673.8 million (2009: £1,671.4 million). These include a £1,609.1 million (2009: £1,609.1 million) loan made by Anglian Water Services Limited to Anglian Water Services Holdings Limited and £64.7 million (2009: £62.3 million) in finance leases and other fixed rate loans owed by Anglian Water Services Limited to third parties.

The company had no other material contingent liabilities at 31 March 2010 or 31 March 2009.

15. Ultimate parent company

The company's immediate parent undertaking is Anglian Water Services Limited, a company registered in England and Wales, which is the parent undertaking of the smallest group to consolidate the financial statements.

Anglian Water Group Limited is the parent company of the largest group to consolidate the financial statements of the company, copies of which can be obtained from the Company Secretary, Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

The directors consider Anglian Water Group Limited, a company registered in Jersey, to be the ultimate parent company. Anglian Water Group Limited is itself owned by a consortium of investors consisting of the Canada Pension Plan Investment Board, Colonial First State Global Asset Management, Industry Funds Management, and 3i.

Copies of the Anglian Water Services Limited accounts can be obtained from the Company Secretary, Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.