YORKSHIRE WATER SERVICES LIMITED

INTERIM REPORT FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2011

OVERVIEW

The first half year shows a sound performance in the context of operational challenges and cost pressures.

KEY FINANCIAL PERFORMANCE INDICATORS
for the six months to 30 September

	2011	2010	Increase
Turnover	**£453.7m**	£441.1m	2.9%
Regulated operating costs (excluding exceptional items)	**£172.7m**	£160.9m	7.3%
Operating profit (before exceptional items)	**£169.2m**	£173.5m	(2.5%)
Regulated capital investment	**£174.6m**	£77.6m	125.0%
Adjusted class A net debt to Regulatory Capital Value ("RCV")	**66.9%**	65.1%	2.8%
Adjusted senior net debt to Regulatory Capital Value ("RCV")	**75.6%**	74.7%	1.2%

FINANCIAL PERFORMANCE

Turnover increased by 2.9% to £453.7m (2010: £441.1m), compared with an average tariff increase of 3.4%. The impact of the average increase in tariffs is slightly offset by domestic customers opting to switch from unmeasured to measured tariffs and a reduction in demand as a result of continued water conservation and commercial decline compared to the first half of 2010/11.

Operating profit reduced by 2.5% to £169.2m (2010: £173.5m), due to a 7.3% increase in regulated operating costs. The increases in operating costs are driven by an increase in RPI of 4.86%; £2.3m costs relating to the transfer of private sewers; and a stepped increase in the non domestic rates charge of £7.3m for the year (of which £3.7m has been recognised in the six months ending 30 September). The Valuation Office Agency carries out a revaluation of all rateable values in England and Wales every five years. The latest revaluation came into effect on 1 April 2010. The outcome of the 2010 review was an uplift to the non domestic rates bill faced by the company of £13m per annum, however this stepped increase is being phased in over 2010 - 2013. These additional operating costs have been offset to some extent by additional efficiencies identified throughout the business.

During the period, total net debt increased from £2,956.3m at 31 March 2011 to £3,080.8m at 30 September 2011. Debt at September 2011 includes a £364.1m loan from Yorkshire Water Odsal Finance Limited, a company within the securitised group, and £769m of loans to parent companies. Adjusted net debt, as defined by the bank covenants excludes internal loans and includes all securitised companies. Based on an RCV value of £5,120m, senior adjusted net debt to RCV at September 2011 is 75.6% (2010: 74.7%).

Interest rate swaps with break dates in 2012 and 2014 ("Type 2 swaps") were successfully restructured during July. All Type 2 swaps either had their break dates removed or extended so that no 2012 or 2014 break dates remain.

£29.1m dividends have been paid during the period (2010: £15.7m). In addition £128.8m has been distributed to shareholders during the period by way of internal loans.

OPERATIONAL PERFORMANCE

Effective management of the region's water resources ensured that Yorkshire Water's customers continued to receive a high quality and reliable service during the spring and summer of 2011/12.

No restrictions on customers' use were necessary, despite particularly dry weather conditions in South Yorkshire where at one stage reservoir stocks were 17% lower than the same period last year.

Drinking water quality continued to be of an excellent standard and we remain on target to meet the year end targets set for us by the Drinking Water Inspectorate.

We also remain on course to meet our annual leakage reduction target and in October we achieved our best ever performance.

This success follows the creation of a new Demand Management and Leakage Reduction Team. An additional 44 colleagues have been recruited, including 30 trainee leakage inspectors, 10 network engineers and four data analysts.

As well as focusing on the short-term delivery of this year's targets, the team is responsible for developing a longer-term strategy for sustainable demand management and leakage reduction in the Yorkshire region. As we approach winter, preparations have been put in place to ensure we achieve this year's target even if we see a repeat of last year's prolonged cold spell which caused an unprecedented number of bursts and leaks.

Significant additional resources were also put in place to manage changes on the sewerage side of the business.

As a result of changes to Government legislation, on October 1st we became responsible for an additional 22,000 kms of private sewers. In preparation for the transfer, we wrote to all 2 million households in the region informing them of the change in responsibilities and implemented plans to manage the forecast increase in activities. This involved the recruitment of an additional 80 colleagues. The transition went well with no adverse impact on new or existing levels of operational or customer service. The situation will be kept under review as we enter the colder and wetter winter period when historically we have seen an increase in customer contacts.

July and August were particularly challenging, with a number of bursts and sewer flooding incidents impacting our customers.

However there was better news in November when the Environment Agency announced the results of the 2011 bathing water season. All 20 designated beaches in the Yorkshire region achieved the minimum water quality standards, with 18 of them achieving the highest 'guideline' standard.

We are continuing to work closely with the Environment Agency, local councils, Welcome To Yorkshire and other interested parties to ensure the region is in the best possible position to reach new and higher standards of bathing water quality due to be introduced by Europe in 2015.

In August there was a significant increase in the number of customer complaints about odours at Hull Waste Water Treatment Works in Saltend. A new, £3.5 million odour control unit is due to be commissioned in December 2011 which will ensure a significant reduction in the frequency and strength of smells emanating from the site, bringing them within accepted industry guidelines. A new odour management plan has also been developed to ensure the works can better cope with peak loads.

This was one of the issues that impacted our performance in Ofwat’s Service Incentive Mechanism (SIM), which saw us fall behind our business plan targets on both the quantitative and qualitative elements of the measure. New escalation procedures have now been put in place to drive improvements in this area.

A particular focus over this period has been to develop a strong plan to deliver safety excellence across the company. Early progress has been made in performance reporting, the management of risk and incident investigation.
We are now focusing on some key risk areas – working at heights, management of contractors and control of work.

In the past year over 180 managers have been trained in how to conduct root cause analysis of health and safety incidents. In addition, we are encouraging positive action by everyone through Safe and Unsafe Acts (SUSA) conversations, hazard and near miss reporting.

PRINCIPAL RISKS AND UNCERTAINTIES

The company’s risk management process aims to be comprehensive, systematic and continuous and based on constant monitoring of business risk. The board is also responsible for the company’s internal control and for reviewing its effectiveness.

The company’s principal risks and uncertainties include changes to the regulatory environment, changes in legislation, climatic changes, social influences and supplier markets.

Further detail on the risks and uncertainties is included in the Annual Report and Financial Statements for the year ended 31 March 2011.

Profit and loss account
for the 6 months ended 30 September 2011

		Unaudited		Audited
		6 months ended		Year ended
		30 Sep 2011	30 Sep 2010	31 Mar 2011
	Note	**£m**	£m	£m
Turnover		**453.7**	441.1	867.4
Operating costs		**(284.5)**	(267.6)	(547.9)
Exceptional operating costs	2	**(6.7)**	-	(5.9)
Profit on ordinary activities before interest		**162.5**	173.5	313.6
Net interest payable and similar charges		**(147.1)**	(122.5)	(231.2)
Exceptional finance costs	2	**-**	-	(40.0)
Net interest payable		**(147.1)**	(122.5)	(271.2)
Profit before taxation		**15.4**	51.0	42.4
Tax on profit on ordinary activities	3	**3.3**	20.0	75.3
Profit for the year		**18.7**	71.0	117.7

All of the above results relate to continuing activities.

Statement of total recognised gains and losses

There are no recognised gains and losses other than those included in the profit and loss account.

There is no difference between the profit before taxation and the profit for the year stated above and their historical cost equivalents.

Balance sheet

At 30 September 2011

	Note	**Unaudited At 30 Sep 2011 £m**	Unaudited At 30 Sep 2010 £m	Audited At 31 Mar 2011 £m
Fixed assets				
Intangible assets		**7.1**	8.0	7.6
Tangible assets		**4,421.3**	4,251.2	4,357.8
Investments		**0.1**	0.1	0.1
		4,428.5	4,259.3	4,365.5
Current assets				
Stock		**1.1**	0.9	1.2
Debtors	9	**1,232.9**	1,027.5	1,088.9
Cash and short term deposits		**20.3**	23.8	45.4
		1,254.3	1,052.2	1,135.5
Creditors: amounts falling due within one year				
Short term borrowings		**(69.7)**	(52.3)	(63.3)
Other creditors		**(300.7)**	(265.9)	(333.8)
		(370.4)	(318.2)	(397.1)
Net current assets		**883.9**	734.0	738.4
Total assets less current liabilities		**5,312.4**	4,993.3	5,103.9
Creditors: amounts falling due after more than one year				
Loans and other borrowings		**(3,800.4)**	(3,468.3)	(3,578.6)
Other creditors		**(134.4)**	(134.9)	(134.4)
		(3,934.8)	(3,603.2)	(3,713.0)
Provisions for liabilities and charges		**(494.9)**	(512.5)	(497.9)
Net assets		**882.7**	877.6	893.0
Capital and reserves				
Called up share capital	5	**10.0**	10.0	10.0
Profit and loss account	5	**817.6**	811.8	827.9
Share-based payment reserve	5	**3.5**	3.6	3.5
Revaluation Reserve	5	**51.6**	52.2	51.6
Total shareholder's funds	5	**882.7**	877.6	893.0

Cash flow statement

for the 6 months ended 30 September 2011

	Note	**Unaudited Six months ended 30 Sep 2011 £m**	Unaudited Six months ended 30 Sep 2010 £m	Audited Year ended 31 Mar 2011 £m
Net cash inflow from operating activities	6	**298.6**	387.4	631.5
Returns on investments and servicing of finance				
Interest received		**32.1**	17.7	51.6
Interest paid		**(137.2)**	(102.0)	(182.2)
Interest element of finance lease rentals		**(10.0)**	(14.5)	(20.4)
Net cash outflow from returns on investments and servicing of finance		**(115.1)**	(98.8)	(151.0)
Taxation				
Tax paid		**(3.2)**	(1.4)	(11.7)
Capital expenditure and financial investment				
Investment in subsidiary		**-**	-	-
Gross cost of purchase of fixed assets		**(204.5)**	(99.2)	(241.2)
Receipt of grants and contributions		**4.1**	4.8	7.6
Infrastructure renewals expenditure		**-**	-	-
Disposal of fixed assets		**0.6**	0.1	1.3
Net cash outflow for investing activities		**(199.8)**	(94.3)	(232.3)
Equity dividends paid	4	**(29.1)**	(15.7)	(46.9)
Net cash (outflow) / inflow before management of liquid resources and financing		**(48.6)**	177.2	189.6
Financing				
Capital element of finance lease rentals		**(14.6)**	(12.9)	(15.7)
New loans raised		**230.5**	655.0	721.4
Repayment of loans		**(63.6)**	(264.3)	(187.8)
Loans to group companies		**(128.8)**	(590.0)	(720.9)
Net cash inflow / (outflow) from financing		**23.5**	(212.2)	(203.0)
Decrease in cash and cash equivalents	8	**(25.1)**	(35.0)	(13.4)

Notes to the interim financial information

The financial information for the year ended 31 March 2011 does not constitute the company's statutory accounts for that period but has been extracted from the statutory accounts which were prepared in accordance with United Kingdom Generally Accepted Accounting Practices ("UK GAAP") and filed with the Registrar of Companies. The auditors' report on those accounts was unqualified. The financial information for the half year ended 30 September 2010 and the equivalent period in 2009 has not been audited.

The interim financial information was approved for issue by the board of directors on 23 November 2011.

1. Basis of preparation

The financial information for the 6 month period ended 30 September 2011 has been prepared in accordance with UK GAAP and in accordance with pronouncements on interim reporting issued by the Accounting Standards Board. The accounting policies, methods of computation and presentation are consistent with those of the annual financial statements for the year ended 31 March 2011, as described in those annual financial statements. The half-yearly financial report should be read in conjunction with these annual financial statements.

No new standards, amendments or interpretations which will have a material impact on the financial statements have been adopted in the period.

2. Exceptional items

Following the severe winters experienced during 2009/10 and 2010/11, YW's network of water mains suffered an increase in the number of bursts and consequently experienced a higher level of leakage. During 2011/12 additional expenditure is forecast to improve leakage performance such that leakage targets can be achieved in the event of another severe winter. This additional spend is being monitored separately by management and is over and above historic levels of investment. The planned additional spend is material and therefore is disclosed separately within the financial statements in line with FRS 3. Of the additional spend forecast for 2011/12, £6.7m has been spent at the end of September.

The prior year exceptional finance cost of £40.0m relates to certain index linked swaps with a nominal value of £1,289m were out of the money at 31 March 2011. An onerous contract provision of £335.5m was recognised at 31 March 2011, an increase of £40.0m compared to the provision at 31 March 2010.

3. Taxation

	Unaudited		Audited
	Six months ended		Year ended
	30 Sep 2011	30 Sep 2010	31 Mar 2011
	£m	£m	£m
Current tax – current period	**-**	0.1	14.7
Current tax – prior year adjustment	**(0.2)**	(19.7)	(30.8)
Deferred tax – current year	**(2.6)**	(0.4)	(59.2)
Deferred tax – prior year adjustment	**(0.5)**	-	-
	(3.3)	(20.0)	(75.3)

The current tax expense comprises corporation tax calculated at the estimated effective tax rates for the year.

4. Dividends paid

	Unaudited		Audited
	Six months ended		Year ended
	30 Sep 2011	30 Sep 2010	31 Mar 2011
	£m	£m	£m
Interim dividend paid	**29.1**	15.7	46.9

5. Movement in shareholder's funds

	Share capital	Profit and loss reserve	Share-based payment reserve	Revaluation reserve	**Unaudited six months ended 30 Sep 2011 Total**	Unaudited six months ended 30 Sep 2010 Total	Audited year ended 31 Mar 2011 Total
	£m	£m	£m	£m	**£m**	£m	£m
At 1 April	10.0	827.9	3.5	51.6	**893.0**	822.1	822.1
Profit for the period	-	18.7	-	-	**18.7**	71.0	117.7
Dividends paid	-	(29.0)	-	-	**(29.0)**	(15.7)	(46.9)
Share based payments amount due to parent	-	-	-	-	**-**	0.2	0.1
Shareholder's funds at end of period	**10.0**	**817.6**	**3.5**	**51.6**	**882.7**	877.6	893.0

6. Reconciliation of operating profit on ordinary activities before interest to net cashflow from operating activities

	Unaudited Six months ended 30 Sep 2011	Unaudited Six months ended 30 Sep 2010	Audited Year ended 31 Mar 2011
	£m	£m	£m
Operating profit	**162.5**	173.5	313.6
Depreciation (net of amortisation of grants and contributions)	**110.7**	107.2	219.6
Decrease / (increase) in stocks	**0.1**	0.2	(0.1)
(Increase) / decrease in debtors	**(14.9)**	68.5	95.3
Increase / (decrease) in creditors	**39.7**	38.0	1.8
Other non-cash movements	**0.5**	-	1.3
Net cash inflow for operating activities	**298.6**	387.4	631.5

7. Reconciliation of movement in cash to movement in net debt

	Unaudited Six months ended 30 Sep 2011	Unaudited Six months ended 30 Sep 2010	Audited Year ended 31 Mar 2011
	£m	£m	£m
(Decrease) / increase in cash and cash equivalents in the period	**(25.1)**	(35.0)	(13.4)
Cash inflow / (outflow) from increase in debt and leasing finance	**(23.5)**	212.2	203.0
Indexation on index linked loans and other non cash movements	**(75.9)**	(49.9)	(71.8)
Movement in net debt in the period	**(124.5)**	127.3	117.8
Net debt at the beginning of the period	**(2,956.3)**	(3,074.1)	(3,074.1)
Net debt at the end of the period	**(3,080.8)**	(2,946.8)	(2,956.3)

8. Reconciliation of movement in adjusted net debt

	Audited		Unaudited		Unaudited
	At 31 Mar 2011	Cash flow	Non- cash Movements	**At 30 Sep 2011**	At 30 Sep 2010
	£m	£m	£m	**£m**	£m
Cash at bank and in hand	40.4	(34.0)	-	**6.4**	19.3
Short term deposits	5.0	8.9	-	**13.9**	4.5
Cash and cash equivalents	45.4	(25.1)	**-**	**20.3**	23.8
Loans due within one year	(45.9)	(2.9)	-	**(48.8)**	(35.9)
Finance leases due within one year	(17.4)	(3.5)	-	**(20.9)**	(16.3)
Loans due after one year	(259.7)	21.7	-	**(238.0)**	(281.3)
Finance leases due after one year	(347.8)	18.1	-	**(329.7)**	(351.9)
Index linked swaps	(40.0)	39.4	(51.3)	**(51.9)**	(35.4)
External net debt	(710.8)	72.8	(51.3)	**(689.3)**	(720.8)
Amounts owed from parent companies	640.2	128.8	-	**769.0**	550.0
Amounts owed to subsidiary company	(2,931.1)	(225.1)	(24.6)	**(3,180.8)**	(2,799.8)
	(2,290.9)	(96.3)	(24.6)	**(2,411.8)**	(2,249.8)
Total adjusted net debt	(2,956.3)	(48.6)	(75.9)	**(3,080.8)**	(2,946.8)

Of the total net debt, £450m (2010: £450m) is Class B debt.

Net debt at 30 September 2011 includes £769.0m presented within debtors.

Index linked swaps of £51.9m (2010: £40.0m) represents £117.2m (2010: £93.1m) of RPI accretion discounted by £65.3m (2010: £53.1m) to reflect the net present value of the liability.

The following represents an analysis of the net debt used for the purpose of covenant calculations:

	£m
Total net debt	**(3,080.8)**
Less amounts due from parent	**(769.0)**
Less discount on index linked swaps	**(65.3)**
Less unamortised issue costs	**0.1**
	(3,915.0)

9. Debtors

	30 Sep 2011	30 Sep 2010	31 Mar 2011
	£m	£m	£m
Amounts due from parent companies	**1,059.3**	852.2	933.9
Amounts due from subsidiary companies	**1.4**	1.3	1.4
Amounts due from other group companies	**1.2**	1.2	5.5
External debtors	**171.0**	172.8	148.1
	1,232.9	1,027.5	1,088.9