

# Kelda Finance (No.1) Limited

## *Consolidated Interim Financial Statements*

For the 6 month period ended 30 September 2016

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# Information to accompany the consolidated interim financial statements

The consolidated results for Kelda Finance (No.1) Limited for the 6 month period ended 30 September 2016 are presented in this report.

These are prepared under International Financial Reporting Standards.

Kelda Finance (No.1) Limited is the holding company of a group including Kelda Finance (No.2) Limited, Kelda Finance (No.3) PLC, Yorkshire Water Services Holdings Limited and its subsidiary companies.

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## Group statement of Profit and loss

For the 6 month period ended 30 September 2016

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
<b>Group revenue</b>	<b>504.0</b>	493.5	973.9
Operating costs	<b>(346.0)</b>	(332.5)	(708.9)
Exceptional items	<b>0.1</b>	-	(26.5)
<b>Group operating profit from continuing operations</b>	<b>158.1</b>	161.0	238.5
Finance income	<b>50.7</b>	41.9	85.6
Exceptional finance income	<b>79.8</b>	106.1	137.1
Finance costs	<b>(154.8)</b>	(140.7)	(272.5)
Exceptional finance costs	<b>(685.4)</b>	(20.1)	(4.4)
<b>(Loss)/profit from continuing operations before taxation</b>	<b>(551.6)</b>	148.2	184.3
Tax credit/(charge) on continuing operations	<b>131.8</b>	(9.9)	41.3
<b>(Loss)/profit for the period from continuing operations</b>	<b>(419.8)</b>	138.3	225.6

## Group statement of other comprehensive income

For the 6 month period ended 30 September 2016

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
<b>(Loss)/profit for the period</b>	<b>(419.8)</b>	138.3	225.6
Other comprehensive income for the period	<b>2.5</b>	-	5.0
<b>Total comprehensive income for the period</b>	<b>(417.3)</b>	138.3	230.6

# Group statement of financial position

As at 30 September 2016

	Note	Unaudited at 30 Sep 2016 £m	Unaudited at 30 Sep 2015 £m	Audited at 31 Mar 2016 £m
<b>Non-current assets</b>				
Intangible assets		59.8	14.2	40.3
Property, plant and equipment		6,903.0	6,763.7	6,871.2
Financial assets	6	166.4	50.8	90.8
Trade and other receivables		1,259.4	1,261.0	1,248.8
		<b>8,388.6</b>	<b>8,089.7</b>	<b>8,251.1</b>
<b>Current assets</b>				
Inventories		2.4	1.9	2.0
Trade and other receivables		201.1	203.1	193.8
Tax assets		-	5.2	2.5
Cash and cash equivalents	5	52.9	44.1	25.8
		<b>256.4</b>	<b>254.3</b>	<b>224.1</b>
<b>Total Assets</b>		<b>8,645.0</b>	<b>8,344.0</b>	<b>8,475.2</b>
<b>Current liabilities</b>				
Trade and other payables		(316.3)	(470.5)	(653.4)
Tax liabilities		-	(0.1)	-
Short term borrowings	5	(161.6)	(125.3)	(161.9)
		<b>(477.9)</b>	<b>(595.9)</b>	<b>(815.3)</b>
<b>Non-current liabilities</b>				
Long term borrowings	5	(4,826.0)	(4,676.1)	(4,650.5)
Long-term payables		(15.8)	(33.5)	(15.5)
Financial liabilities	6	(2,225.1)	(1,661.2)	(1,619.8)
Deferred grants and contributions on depreciated assets		(411.0)	(47.2)	(46.3)
Provisions		(0.5)	(0.6)	(0.7)
Deferred tax liabilities		(308.7)	(499.5)	(443.2)
		<b>(7,787.1)</b>	<b>(6,918.1)</b>	<b>(6,776.0)</b>
<b>Total liabilities</b>		<b>(8,265.0)</b>	<b>(7,514.0)</b>	<b>(7,591.3)</b>
<b>Net assets</b>		<b>380.0</b>	<b>830.0</b>	<b>883.9</b>
<b>Equity</b>				
Share capital	9	-	-	-
Hedging reserve		(13.2)	(13.9)	(13.2)
Revaluation reserve		208.9	201.6	206.4
Retained earnings		184.3	642.3	690.7
<b>Total equity</b>		<b>380.0</b>	<b>830.0</b>	<b>883.9</b>

# Group statement of cash flows

For the 6 month period ended 30 September 2016

	Note	Unaudited 6 month period ended 30 Sep 2016 £m	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
<b>Cash flows from operating activities</b>	7	<b>342.5</b>	310.7	543.1
Income taxes received/(paid)		2.3	(0.2)	3.0
Interest paid	8	(171.7)	(168.3)	(269.0)
<b>Net cash generated from operating activities</b>		<b>173.1</b>	142.2	277.1
<b>Cash flows from investing activities</b>				
Interest received	8	50.7	41.7	84.9
Proceeds on disposals of property, plant and equipment		0.5	0.2	4.3
Purchases of property, plant and equipment		(191.6)	(131.4)	(255.5)
Capital grants and contributions		5.0	5.5	17.1
<b>Net cash used in investing activities</b>		<b>(135.4)</b>	(84.0)	(149.2)
<b>Cash flows from financing activities</b>				
Dividends paid	4	(86.6)	(35.2)	(74.7)
Borrowings raised (net of fees)		200.0	173.9	-
Repayment of borrowings		(89.4)	(158.2)	(30.3)
Repayments of obligations under finance leases and hire purchase agreements		(34.6)	(31.6)	(34.1)
<b>Net cash used in financing activities</b>		<b>(10.6)</b>	(51.1)	(139.1)
<b>Net increase in cash and cash equivalents</b>		<b>27.1</b>	7.1	(11.2)
<b>Cash and cash equivalents at the start of the period</b>		<b>25.8</b>	37.0	37.0
<b>Cash and cash equivalents at the end of the period</b>	5	<b>52.9</b>	44.1	25.8

## Group statement of changes in equity

For the 6 month period ended 30 September 2016

	Ordinary shares	Hedging reserve	Revaluation reserve	Retained earnings	Total equity
	£m	£m	£m	£m	£m
At 1 April 2015	-	(13.2)	201.6	539.2	727.6
Profit for the year	-	-	-	225.6	225.6
Dividends paid	-	-	-	(74.7)	(74.7)
Revaluation of infrastructure assets	-	-	(0.2)	-	(0.2)
Other movements	-	-	-	0.6	0.6
Other comprehensive income	-	-	5.0	-	5.0
<b>At 31 March 2016</b>	<b>-</b>	<b>(13.2)</b>	<b>206.4</b>	<b>690.7</b>	<b>883.9</b>
Loss for the period	-	-	-	(419.8)	(419.8)
Dividends paid	-	-	-	(86.6)	(86.6)
Other comprehensive income	-	-	2.5	-	2.5
<b>At 30 September 2016</b>	<b>-</b>	<b>(13.2)</b>	<b>208.9</b>	<b>184.3</b>	<b>380.0</b>

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 1. Basis of preparation and accounting

The financial statements are prepared under International Financial Reporting Standards (IFRS).

The accounting policies, methods of computation and presentation are consistent with those used for the audited financial statements of Kelda Finance (No.1) Limited for the year ended 31 March 2016.

These interim financial statements consolidate the results of Kelda Finance (No.1) Limited, Kelda Finance (No.2) Limited, Kelda Finance (No.3) PLC, Yorkshire Water Services Holdings Limited and its subsidiary companies for the six months ended 30 September 2016.

## 2. Exceptional finance income and costs

	<b>Unaudited 6 month period ended 30 Sept 2016 £m</b>	Unaudited 6 month period ended 30 Sept 2015 £m	Audited year ended 31 March 2016 £m
<b>Included in operating profit</b>			
Impairment of assets resulting from flooding	-	-	(35.0)
Insurance Income	<b>10.0</b>	-	10.0
Operating costs	<b>(9.9)</b>	-	(1.5)
	<b>0.1</b>		(26.5)
<b>Interest receivable and similar income</b>			
Movement in fair value of combined cross currency interest rate swaps	<b>38.5</b>	-	(3.7)
Movement in fair value of cross currency debt	-	6.7	-
Movement in fair value of fixed to floating interest rate swaps	<b>41.3</b>	-	8.0
Movement in fair value of associated bonds	-	17.5	-
Movement in fair value of finance lease interest rate swap	-	2.1	-
Movement in fair value of index linked swaps	-	79.8	129.1
	<b>79.8</b>	106.1	133.4
<b>Interest payable and similar charges</b>			
Movement in fair value of index linked swaps	<b>(614.7)</b>	-	-
Movement in fair value of finance lease interest rate swap	<b>(4.4)</b>	-	(0.7)
Movement in fair value of fixed to floating interest rate swaps	-	(10.4)	-
Movement in fair value of associated bonds	<b>(30.4)</b>	-	-
Movement in fair value of combined cross currency interest rate swaps	-	(9.7)	-
Movement in fair value of cross currency debt	<b>(35.9)</b>	-	-
	<b>(685.4)</b>	(20.1)	(0.7)

The exceptional item included within operating profit is the net amount of income and costs relating to the flooding incident that occurred in December 2015 on Yorkshire Water's assets. In this six month period Yorkshire Water has received a further £10.0m from the insurance claim and incurred £9.9m of operational costs associated with the assets damaged in the event.

The movement in the fair value of index linked swaps is a result of swaps which were taken out by the Company during 2007/08. These swaps were hedged against movements in the retail price index (RPI) by receiving interest based on LIBOR and accruing interest payable based on RPI. The swaps have been valued at the reporting date at fair value, which at 30 September 2016 resulted in a £2,285.7m liability (31 March 2016: £1,734.2m liability). Of this, £2,194.3m (31 March 2016: £1,579.5m) is recognised within other financial liabilities and £91.4m (31 March 2016: £154.7m) is recognised within long term borrowings.



# Notes to the interim financial statements

For the six months ended 30 September 2016

## 2. Exceptional finance income and costs (continued)

The movement in the fair value of finance lease swaps is a result of floating to fixed interest rate swaps taken out by the Company to hedge against movements in 12 month LIBOR interest rates on floating rate finance leases. The swaps hedge the movement in interest rates by receiving interest based on 12 month LIBOR and accruing interest payable at a fixed rate. The swaps have been valued at the reporting date at fair value, which at 30 September 2016 resulted in a £29.3m liability (31 March 2016: £24.9m). The increase in the period in the liability of £4.4m has been recognised as an exceptional finance cost. This has been included in the profit and loss account as the specific circumstances which would allow it to be held in reserves were no longer met.

Exceptional finance income includes the fair value movement of various fixed to floating interest rate swaps and combined cross currency interest rate swaps which were designated in fair value hedge relationships. These fair value interest rate swaps have been valued at the reporting date at fair value. The net impact of the fair value movement of the combined cross currency interest rate swaps and the associated bonds has resulted in a £10.9m credit to the group statement of profit and loss, and the net impact of the fair value movement of the fixed to floating interest rate swaps and associated bonds has resulted in a £2.6m credit to the group statement of profit and loss.

## 3. Tax credit/(charge)

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
Tax relating to continuing operations:			
Current tax charge	-	(0.1)	(0.2)
Deferred tax credit/(charge)	<b>130.6</b>	(9.8)	41.5
Prior year tax	<b>1.2</b>	-	-
	<b>131.8</b>	(9.9)	41.3

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

## 4. Dividends paid

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
Cash dividends	<b>86.6</b>	35.2	74.7
<b>Total dividends</b>	<b>86.6</b>	35.2	74.7

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 5. Analysis of net debt

	Unaudited at 30 Sep 2016 £m	Unaudited at 30 Sep 2015 £m	Audited at 31 Mar 2016 £m
<b>Cash and cash equivalents:</b>			
Cash at bank and in hand	9.9	24.8	8.3
Short term deposits	43.0	19.3	17.5
	<b>52.9</b>	<b>44.1</b>	<b>25.8</b>
<b>Short term borrowings:</b>			
Bank loans	(48.4)	(88.2)	(61.2)
Finance leases	(49.6)	(37.1)	(37.2)
Bank loans under Kelda Finance facility	(63.6)	-	(63.5)
	<b>(161.6)</b>	<b>(125.3)</b>	<b>(161.9)</b>
<b>Long term borrowings:</b>			
Bank loans	(242.6)	(262.4)	(245.5)
Bank loans under Kelda Finance facility	(197.9)	(65.0)	-
Fixed rate guaranteed bonds due in less than 5 years	(533.9)	(722.8)	(533.6)
Fixed rate guaranteed bonds due in more than 5 years	(1,723.6)	(1,507.4)	(1,969.2)
Index linked guaranteed bonds due in less than 5 years	-	(6.0)	-
Index linked guaranteed bonds due in more than 5 years	(1,520.2)	(1,468.9)	(1,223.9)
Fixed rate US Dollar bonds due in less than 5 years	(127.4)	(28.2)	(28.2)
Fixed rate US Dollar bonds due in more than 5 years	(240.0)	(282.1)	(303.2)
Fixed rate AUS Dollar bonds due in more than 5 years	(33.4)	(25.4)	(29.5)
Index linked swaps	(91.4)	(142.7)	(154.7)
Finance leases	(115.6)	(165.2)	(162.7)
	<b>(4,826.0)</b>	<b>(4,676.1)</b>	<b>(4,650.5)</b>
Amounts owed by parent entities	<b>1,009.0</b>	1,009.0	1,009.0
<b>Total net debt</b>	<b>(3,925.7)</b>	<b>(3,748.3)</b>	<b>(3,777.6)</b>

The long term bank loans stated above of £242.6m is held by Yorkshire Water Services Limited. With the exception of the £197.9m loan which is held by Kelda Finance (No.3) Plc, all long-term debt is held within the Yorkshire Water Services Holdings Limited group of companies.

Of the total net debt, £587.2m (31 March 2016: £587.2m) relates to Class B debt. Net debt at 30 September 2016 includes £1,009.0m of amounts due from group companies (31 March 2016: £1,009.0m).

Index linked swaps of £91.4m (31 March 2016: £154.7m), represent £176.0m (31 March 2016: £237.1m) of RPI accretion discounted by £84.5m (31 March 2016: £82.4m) to reflect the net present value of the future liability.

Included in net debt above are £13.7m (2016: £14.1m) of unamortised loan issue costs.

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 6. Other financial assets and liabilities

	Unaudited 6 month period ended 30 Sep 2016 £m	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 March 2016 £m
Financial assets:			
Fixed to floating interest rate swaps	85.5	28.6	48.5
Combined cross currency interest rate swaps	80.9	22.2	42.3
	<b>166.4</b>	50.8	90.8
Financial liabilities:			
Finance lease interest swaps	(29.3)	(22.1)	(24.9)
Inflation linked swaps	(2,194.3)	(1,628.8)	(1,579.5)
Combined cross currency interest rate swaps	(1.2)	(9.6)	(5.5)
Energy swap	(0.3)	(0.7)	(9.9)
	<b>(2,225.1)</b>	(1,661.2)	(1,619.8)

### Interest rate swaps

Yorkshire Water holds £45.0m notional value of floating to fixed rate interest swaps. These swaps are recognised at a fair value liability of £29.3m at 30 September 2016 (31 March 2016: £24.9m). Hedge accounting has not been applied.

Yorkshire Water holds £430.0m notional value of fixed to floating rate interest swaps. These swaps are recognised at a fair value asset of £85.5m at 30 September 2016 (31 March 2016: £48.5m). Hedge accounting has been applied.

### Cross currency interest rate swaps

Yorkshire Water hedges the fair value of the US dollar notes using a series of combined interest rate and foreign currency swaps that in combination form cross currency interest rate swaps, swapping dollar principal repayments into sterling and fixed rate dollar interest payments into floating rate sterling interest payments. These swaps are recognised at a fair value asset of £80.9m at 30 September 2016 (31 March 2016: £42.3m). Hedge accounting has been applied.

Yorkshire Water hedges the fair value of the Australian dollar bond using a combined interest rate and foreign currency swap, swapping Australian dollar principal repayments into sterling and fixed rate Australian dollar interest payments into floating rate sterling interest payments. These swaps are recognised at a fair value liability of £1.2m at 30 September 2016 (31 March 2016: £5.5m). Hedge accounting has been applied.

### Index linked swaps

The Company holds a number of index linked swaps, with a notional value of £1,289.0m (31 March 2016: £1,289.0m).

There are three cash flows associated with the swaps:

- six monthly interest receivable linked to LIBOR;
- six monthly interest payable linked to RPI; and
- an RPI-linked bullet that is payable on maturity of the instruments or at certain predetermined dates over the duration of the swaps.

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 6. Other financial assets and liabilities (continued)

Interest payments and receipts are accrued in the profit and loss account. The RPI bullet accumulated at the balance sheet date has been discounted using an appropriate rate applied to the specific life of the future accretion pay downs of the index linked swaps. This is accrued in the profit and loss account and recognised within long term borrowings.

With six month LIBOR and applicable discount rates at historically low levels in the short term, these swaps gave rise to a fair value liability of £2,285.7m at 30 September 2016 (31 March 2016: £1,734.2m). Of this, £91.4m has been recognised within long term borrowings, and represents the discounted value of the RPI bullet accrued to 30 September 2016 (31 March 2016: £154.7m). The remaining £2,194.3m is recognised within other financial liabilities (31 March 2016: £1,579.5m). The RPI bullet accrued to 30 September 2016 was £176.0m (31 March 2016: £237.1m) which has been reduced by £84.5m (31 March 2016: £82.4m) when discounted to present values.

Under the index linked swaps, Yorkshire Water has contracted to pay a fixed rate on an inflation accreting notional and in return receives 6 month GBP LIBOR on a semi-annual basis. The contractual obligations of approximately two thirds of Yorkshire Water's portfolio of index linked swaps require Yorkshire Water to pay the inflation accretion of the notional amount at maturity as a single "bullet" payment. The remaining (i.e. one third) require Yorkshire Water to make periodic payments of the inflation accretion on the notional amount throughout the life of each swap.

This payment profile at maturity increases the potential credit exposure for the counterparties involved. In order to mitigate this credit exposure, a number of these swaps are subject to mandatory termination clauses ("MTC"). Under the MTC the inflation linked swaps will automatically be terminated for a cash settlement amount at each MTC date unless both Yorkshire Water and the respective counterparty agree to extend the MTC date or restructure the existing transactions.

As at 31 March 2016 Yorkshire Water's portfolio of index linked swaps had a total fixed notional value of £1,289m and a total fair value liability of £1,734.3m. Of this amount approximately 22.7% of the total notional value was subject to MTCs. As at 30 September 2016 Yorkshire Water's portfolio of index linked swaps had a total fixed notional of £1,289m and a total fair value liability of £2,285.7m. Of this amount approximately 22.7% of the total notional of the portfolio was subject to MTCs (with the mandatory breaks occurring in February 2020, February 2023 and February 2025).

The valuation model used by Yorkshire Water to determine the fair value of the inflation linked swap portfolio as at 30 September 2016 includes a funding valuation adjustment, credit valuation adjustment and debit valuation adjustment to reflect the long term credit risk of Yorkshire Water's index linked swap portfolio. Reflecting this model and the inputs involved, some of the inflation linked swaps are now considered a level 3 valuation under IFRS13 and are disclosed accordingly.

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 7. Reconciliation of (loss)/profit from continuing operations to cash generated by continuing operations

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Audited year ended 31 Mar 2016 £m
(Loss)/profit from continuing operations before taxation	<b>(551.6)</b>	148.2	184.3
Finance income	<b>(50.7)</b>	(41.9)	(85.6)
Finance costs	<b>154.8</b>	140.7	272.5
Exceptional finance costs/(income)	<b>605.6</b>	(86.0)	(132.7)
Movements of fair value of derivative financial instrument (energy contracts)	<b>(9.6)</b>	-	9.9
Depreciation and amortisation of capital grants	<b>131.9</b>	125.2	270.1
Profit on disposal of property, plant and equipment	<b>-</b>	(0.2)	(1.6)
Amortisation of intangibles	<b>2.6</b>	-	4.4
Exceptional impairment of property, plant and equipment	<b>-</b>	-	35.0
Increase in inventories	<b>(0.4)</b>	(0.6)	(0.7)
(Increase)/decrease in trade and other receivables	<b>(17.6)</b>	(19.2)	2.2
Increase/(decrease) in trade and other payables	<b>78.0</b>	44.5	(15.0)
Other movements	<b>(0.5)</b>	-	0.3
<b>Cash generated from continuing operations</b>	<b>342.5</b>	310.7	543.1

## 8. Cash interest

	<b>Unaudited 6 month period ended 30 Sep 2016 £m</b>	Unaudited 6 month period ended 30 Sep 2015 £m	Unaudited year ended 31 Mar 2016 £m
<b>Cash interest received:</b>			
External interest received by Yorkshire Water financing group	<b>31.3</b>	10.0	22.0
Interest received from parent entities	<b>19.4</b>	31.7	62.9
	<b>50.7</b>	41.7	84.9
<b>Cash interest paid:</b>			
External interest on Kelda Finance facility	<b>6.9</b>	13.4	15.0
External interest paid by Yorkshire Water financing group	<b>164.8</b>	154.9	254.0
	<b>171.7</b>	168.3	269.0

# Notes to the interim financial statements

For the six months ended 30 September 2016

## 9. Share capital

	Ordinary shares	
	Number	£
Closing balance at 30 September 2016 and 31 March 2016	100	100

## 10. Contingent liabilities

On 20 July 2015 an employee of Yorkshire Water Services Limited suffered a fatal accident while carrying out their duties. The duration, timing and outcome of this investigation are currently unknown.

Should Yorkshire Water be found liable as a result of these investigations (which has not been intimated by any authority) it is possible it will be subject to fines, the size and timing of which are unknown due to the early stages of the investigation.

