

Registered Number: 08066326

KELDA FINANCE (No. 1) LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2015

KELDA FINANCE (No. 1) LIMITED
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2015

Contents

| | |
|---|----|
| Strategic Report for the year ended 31 March 2015 | 1 |
| Directors' Report for the year ended 31 March 2015 | 26 |
| Statement of Directors' Responsibilities for the year ended 31 March 2015 | 33 |
| Corporate Governance Report for the year ended 31 March 2015 | 35 |
| Independent auditors' report to the members of Kelda Finance (No. 1) Limited | 37 |
| Financial Statements | |
| Group Income Statement | 40 |
| Group Statement of Comprehensive Income | 41 |
| Group Balance Sheet | 42 |
| Group Statement of Changes in Equity | 43 |
| Group Cash Flow statement | 44 |
| Notes to the Group Financial Statements | 45 |
| Company Balance Sheet | 90 |
| Company Statement of Changes in Equity | 91 |
| Notes to the Company Financial Statements | 92 |
| Independent auditors' report to the members of Kelda Finance (No. 1) Limited for the Company financial statements | 95 |

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

INTRODUCTION

The principal activities of the Group are the supply of clean water and the treatment and disposal of waste water. Yorkshire Water Services Limited (Yorkshire Water or YW), the Group's regulated utility business in the UK, is responsible for both water and waste water services.

BUSINESS STRATEGY

The Group has a vision – 'taking responsibility for the water environment for good'.

The essence of the vision is doing what's right - for our customers, colleagues, partners and the environment.

To achieve the vision the Group has developed a plan and the plan has been named Blueprint. Blueprint is something everyone can contribute towards to make a difference.

Our strategic objectives:

To deliver the plan the Group has developed six Strategic Business Objectives (SBOs). These SBOs shape everything the Group does.

These are our six strategic objectives, that shape everything we do:

Trusted company – The way the Group does business means its products, services and promises are trusted by all our stakeholders, now and in the future.

Safe Water – The Group works safely to protect public health by ensuring drinking water is always safe to drink and waste water never harms customers or communities at any point in the process.

Excellent catchments, rivers and coasts – The Group maintains and improves the water environment from source to sea, and influences others to do the same.

Water efficient regions – The Group ensures water needs are met now and in the future by using water wisely and inspiring others to do the same.

Sustainable resources – The Group is efficient and effective now and in the future, with an industry leading workforce, zero waste and a responsible supply chain.

Strong financial foundations – The Group delivers services to customers at a price they are willing and able to pay, whilst providing investors with returns that attract long-term investment.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

BUSINESS PERFORMANCE

An overview is provided below of YW performance by examining progress towards each of the six SBOs which summarise the Group strategy to achieve its vision of: 'taking responsibility for the water environment for good'.

Reported under each SBO is:

- A table showing performance against the Office of Water Services' (Ofwat) Key Performance Indicators (KPIs) for the water industry. More information on these measures and performance in the Risk and Compliance Statement, available at: www.yorkshirewater.com/reports
- A table showing YW's progress against a suite of annual targets that YW set itself as part of its drive to achieve its vision and go beyond its regulatory duties. Arrows are used to show the trend in annual performance in the context of its long-term goals:

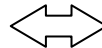
Progression
towards
long-term goals



Overall trend of
progression with
annual fluctuation



Stable



Regression from
long-term goals



- A commentary on the matters that are material to YW recent performance, future direction, risks and uncertainties.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

STRATEGIC BUSINESS OBJECTIVE – TRUSTED COMPANY

The way the Group does business means our products, services and promises are trusted by all our stakeholders, now and in the future.

| Measures of our regulatory commitments | 2013/14 performance | 2014/15 target | 2014/15 performance |
|--|---------------------|----------------|---------------------|
| Service Incentive Mechanism, SIM (Overall score) | 82 | ≥84 | 85 |
| Serviceability – water infrastructure (Stable / Improving / Marginal / Deteriorating) | Stable | Stable | Stable |
| Serviceability – water non-infrastructure (Stable / Improving / Marginal / Deteriorating) | Stable | Stable | Stable |
| Serviceability – sewerage infrastructure (Stable / Improving / Marginal / Deteriorating) | Stable | Stable | Stable |
| Serviceability – sewerage non-infrastructure (Stable / Improving / Marginal / Deteriorating) | Stable | Stable | Stable |

Ofwat define their Key Performance Indicators for the water industry on their website, at:

<http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi/>

| Measures of our ambition to go beyond our regulatory duties | | |
|--|---|---------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Achieve a “Colleague Trust” score of 7 out of 10 in our internal survey. | Annual average score increased to 6.7, up from 6.5 last year. This follows improvements to, for example, colleague communications, visibility of leadership, problem resolution, greater employee recognition and partnership working with trade unions. This remains below target and hence further focus will continue. | ↑ |
| Achieve 4 stars in the Business in the Community Corporate Responsibility Index. | Our improvements have enabled us to increase to 4.5 stars. We are aiming to achieve five stars within two years. | ↑ |
| Continue developing towards “integrated reporting” by externally reporting on our priority economic, environmental and social aspects. | We continue to embed sustainability throughout our reporting and decision making, sharing our performance transparently in this report. Our first integrated annual report, published last year, received positive feedback and we have made advances in this, our second, integrated annual report. | ↑ |
| Document our plan to achieve an externally recognised standard of best practice in transparent triple bottom line reporting. | | ↑ |
| Have face to face meetings with Kelda Group's 90 most important stakeholders. | We engaged with all of our most important stakeholders in 2014/15, including for example our regional MPs and Councillors. We held face to face meetings with the vast majority, more than once with several stakeholders. | ↑ |

The arrows show the trend of our annual performance in the context of our long-term goals. We provide further explanation on page 2.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

Delivering leading customer service

In January 2015 YW were recognised as the leader in customer service in the utilities sector by the Institute of Customer Service.

The Service Incentive Mechanism (SIM) is a water industry measure of customer service developed by our regulator, Ofwat. Individual company price controls for the period to 2020 were adjusted based on average comparative SIM performance for the periods 2011/12 to 2013/14. The SIM was not measured for price control purposes in 2014/15 and therefore no industry comparisons can be made. However, we decided to continue to measure customer service in 2014/15 based on the SIM methodology. Our performance improved, scoring 85 points out of 100 in 2014/15, compared to 82 points in 2013/14. Through our own analysis we estimated a relative ranking of 6th in the sector. It is a business priority to continue improving our SIM score and relative performance, striving to be first in the SIM by 2020.

We continue with our programme of customer service improvements. For example, YW have implemented a new website based on extensive analysis of customer expectation. The website will help customers to more easily access the information they want in a format suitable to them. In response to customer demand our aim is to increase the levels of self-service functionality that our website can offer, starting with how our customers can pay their bill online and through a mobile app. We will also be using the new website to enhance the quality and format of information we provide for customers and stakeholders.

The Water Act 2014 is introducing greater retail competition in the water industry, enabling all business, charity and public sector customers to switch their water and waste water supplier. We recognise that this presents both opportunities and threats to our business and we are monitoring national developments closely as we continue to prepare for the new retail operating regime. We consider the Water Act 2014 in further detail in the strong financial foundations SBO section later in this report.

Serviceability - Ensuring reliable services today and for the future

YW invest over a million pounds a day to maintain and enhance the assets and infrastructure we manage to ensure reliable services to our customers. In 2014/15 we achieved “stable serviceability” in all four asset categories for the third year running. Serviceability is a measure used by the water industry to demonstrate the effectiveness of asset maintenance.

Our services are highly reliable, for example YW have one of the most resilient water supply services in the UK. However, there is a limit to the level of resilience designed into any system because of engineering capability and affordability (for example).

Extreme weather, terrorism and other significant events could damage our assets, interrupt services, threaten human safety and pollute the environment. For our business, this can affect colleague and customer wellbeing, our operations, reputation and increase our costs. We manage risks to all hazards through our corporate and operational risk management processes which have worked well through numerous emergency events in recent years. We have extensive emergency plans to enable a fast and effective response and recovery. Our Incident Management Framework provides a staged response to ensure the effective allocation of resource to any incident.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

We undertake long-term planning to prepare for challenges including population growth, climate change and decreasing availability of resources. For example, in 2014 we published the final version of our latest 25 year Water Resources Management Plan (WRMP). We discuss our WRMP further in the water efficient regions SBO section later in this report.

In addition to providing information about the risks we observe to our services throughout this report, you can also find more information in our Risk and Compliance Statement. The Statement provides further details on our serviceability performance and the material or potentially material risks to service identified by the Board. The Risk and Compliance Statement publication is available at:

www.yorkshirewater.com/reports

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

STRATEGIC BUSINESS OBJECTIVE – SAFE WATER

The Group works safely to protect public health by ensuring drinking water is always safe to drink and waste water never harms customers or communities at any point in the process.

| Measures of our regulatory compliance | 2013/14 performance | 2014/15 target | 2014/15 performance |
|---|---------------------|----------------|---------------------|
| Internal sewer flooding (Number of incidents) | 76 | ≤118 | 121 |
| Water quality – overall compliance (Calendar year measure) | 99.96% | ≥99.95% | 99.94% |

Ofwat define their Key Performance Indicators for the water industry on their website, at:
<http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi/>

| Measures of our ambition to go beyond our regulatory duties | | |
|--|---|---------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Kelda Group to achieve the Occupational Health and Safety Assessment Series (OHSAS) Standard 18001. | On course to secure certification during 2015, an external audit has confirmed that our health and safety management system is fit for purpose for the standard. | ↑ |
| *Service reservoir programme continuing to deliver improved water quality, with no more than 10 coliform sample failures. | 8 failures during the 2014 calendar year and we continue to drive improvement. | ↑ |
| Inform our developing storm water management strategy by discussing our storm water policy with the Environment Agency (EA) and key local authorities. | We documented our policy statement and received positive feedback when engaging with external stakeholders. Our strategy is being drafted. | ↑ |
| Establish the process by which we review, prioritise and recommend flood partnership investment, and make the EA and Local Authorities aware of the process to effectively engage with us. | Process and steering group established to lead our flood partnership, so far agreeing to co-fund three local flood management initiatives. | ↑ |
| Raise £200,000 for WaterAid in the first year of our five year commitment to raise £1m. | Our colleagues have helped to raise over £279,000 for WaterAid in 2014/15, continuing our long standing support. | ↑ |
| At least 25% of Kelda Group colleagues involved in a Safe Water participation and/or volunteering activity. | Over 27% of colleagues involved, including volunteering and charitable giving. | ↑ |
| Colleagues will visit an Ethiopian town to share water quality and leakage control skills. | Our technicians visited Ethiopia in June 2015 and shared our expertise. Also supporting innovation to address specific local needs. | ↑ |
| Incorporate safe water messages in our discussions with stakeholders, our education programme and our annual water efficiency campaign. | We launched the innovative Big Wish for Ethiopia in March 2015, in collaboration with WaterAid. We also included information in our communications to customers and stakeholders. | ↑ |
| Document our detailed plans for Global Safe Water to 2020 and ambitions to 2040. Discuss with WaterAid and the Dep't for International Development. | | |

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

| Measures of our ambition to go beyond our regulatory duties | | |
|---|---|----------------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Publish our draft recreation strategy by 31/03/15, for consultation in 2015/16. | We have continued to develop our recreation strategy and we plan to engage the Customer Forum about our aim to increase the diversity of those taking value from our recreational activities. | ↑ |
| Review existing stakeholder engagement groups to assess options to include recreational engagement matters. | | ↑ |

* Regulatory requirement

The arrows show the trend of YW's annual performance in the context of its long-term goals. Further explanation is provided on page 2.

Maintaining excellent drinking water quality

Protecting public health is our primary duty. Drinking water quality within Yorkshire remains excellent with 99.94% of hundreds of thousands of samples meeting stringent regulatory standards. While this is near total compliance, this performance is lower than last year (99.96%) and behind the target we set ourselves for 2014 (99.95%). We strive for total compliance by working internally and with others. In particular, customers and the agricultural sector also have critical roles in determining performance against this measure.

We continue to see the benefits of the service reservoir inspection and improvement programme we undertook in 2013/14 and the new programme of inspections and remedial actions we have implemented more recently. The main area of non-compliance in 2014 related to metaldehyde, a pesticide used in slug control on arable crops. There is currently no effective process to remove metaldehyde from water supplies and we are researching possible future treatment options and working with the agricultural sector to minimise future risk.

There was an increase in the number of positive samples for bacteria taken from customer's premises which were shown to be due to the condition of the tap rather than that of the water being supplied. There was also an increased number of exceedences of the standard for lead in samples taken from customers' premises as a result in the change in standard for 2014 onwards. We are continuing our treatment of water to minimise the risk and our programme of lead communication pipe replacement is ahead of programme.

We have continued to work closely with the drinking water quality regulator, the Drinking Water Inspectorate (DWI), for example with one of our team joining the DWI on a six month secondment during 2014/15. Performance in the first few months of 2015 has seen no sample failures from service reservoirs and lower numbers from customers' premises. However, metaldehyde is generally a problem in the Autumn so it is too early to comment on the benefit of our activity there.

Further details on our water quality performance can be found in the Risk and Compliance Statement publication, available at: www.yorkshirewater.com/reports

Over recent decades' raw water quality has deteriorated in many of our catchments, increasing the level of treatment we need to undertake to make water fit for drinking. We

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

use a twin-track approach to ensure that our customers receive high quality drinking water. We are investing to enhance treatment capabilities where the probability of failure presents an unacceptable risk to our customers. Our long-standing programme of capital investment will continue with further investment in the period from 2015 to 2020, including action at six large treatment works. We are also investing in catchment management as our primary long-term response to address the issue at source.

Managing flood risk

We play our part in managing and mitigating flood risk by providing an effective drainage function through our sewer network. The number of sewer flooding incidents shows an overall trend of reduction over time as we continue to invest in the network and lower the number of properties on the regulated flood risk register. However, there is annual fluctuation in the figures because flooding performance is strongly influenced by the weather. Last year the region suffered from a number of flash flood events, the most significant of which was in August 2014 when the UK experienced the tail-end of the weather system which produced hurricane Bertha. Overall our assets performed well and we played a significant role in mitigating flooding and managing the impacts where flooding did occur.

In 2014/15, 121 incidents of sewer flooding inside properties were reported in the region, compared to 76 incidents in 2013/14 and 155 in 2012/13. We continue to invest in the region's drainage network and reduce the number of properties at risk from sewer flooding. In 2014/15 we removed 90 properties from being at risk of sewer flooding and reduced the overall number of properties at risk of sewer flooding on our regulated risk register to approximately 175 across the region.

The number of incidents in 2014/15 exceeded our target for no more than 118 incidents in the year. The Yorkshire region experienced exceptionally wet weather in August 2014, leading to an increase in the number of sewer flooding incidents recorded. This regulatory KPI is reported as Amber in our 2014/15 Risk and Compliance Statement. A summary of our action plan to further improve performance on internal sewer flooding is provided in the Statement, which is available at:

www.yorkshirewater.com/reports

We are working in ever closer partnership with others to manage flood risk in Yorkshire, for example:

- Our new internal Flood Steering Group has approved a number of smaller scale joint flood alleviation works in York and Malton, and two small drainage schemes in Hull;
- We have jointly mapped known flood risks with the Environment Agency, identifying approximately 120 opportunities to be investigated for potential future collaboration;
- We continue to share information and models with the Environment Agency and Lead Local Flood Authorities. For example, providing Sheffield City Council with our new Drainage Area Plan (DAP) for the city to inform their developing flood risk management plans;
- We also continue to play an active part in the Yorkshire Regional Flood and Coastal Committee (RFCC) and all four sub-regional strategic flood management partnerships; and
- We are part of the River Hull Advisory Board (RHAB) which was established to develop the River Hull Integrated Catchment Strategy (RHICS) for one of the most 'at-risk' developed flood plains in England. Integrated catchment modelling has been undertaken and options have been identified that could reduce flood risk in the area.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

We are investing to protect our own assets from flood risk to enhance the resilience of our services. We have completed a scheme at Moor Monkton raw water pumping station to give the site a 1 in 1000 year level of fluvial flood protection. This follows investment at Hull and Market Weighton to provide the same level of protection. We have also updated our Flood Plans for areas like York and Sheffield, and our Vulnerable Asset Plans (VAPs) which provide our mitigation plans to protect sites from flooding in large flood events. Consultants working for the Department for Environment, Food and Rural Affairs (Defra) found our approach to resilience to be satisfactory when they visited us in 2014.

Climate change and urban growth increase the pressure on our sewer network and the risk of flooding. We have published documents setting out our risks and plans for climate change and storm water management. We will continue to invest to mitigate the risk and manage the consequences of sewer flooding.

YW is also working to reduce sewer blockages caused by customer activities, in particular disposal of fats, oils and greases (FOGs), nappies, wipes and other materials which are inappropriately disposed of via the sewer network. For example, our trial of above ground collection of used vegetable oil is proving successful in an area of Bradford where we have observed repeated sewer blockages. We are now working with Living Fuels to establish a regional approach to the collection of used vegetable oil and we aim to use the material to generate renewable energy on our operational sites.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

STRATEGIC BUSINESS OBJECTIVE – EXCELLENT CATCHMENTS, RIVERS AND COASTS

The Group maintains and improves the water environment from source to sea, and influence others to do the same.

| Measures of our regulatory compliance | 2013/14 performance | 2014/15 target | 2014/15 performance |
|--|---------------------|----------------|---------------------|
| *Pollution incidents, sewerage (No. Category 1-3 incidents per 10,000km of sewer) | 78.10 | ≤91.50 | 58.82 |
| *Serious pollution incidents, sewerage (No. Category 1-2 incidents per 10,000km of sewer) | 3.27 | ≤2.61 | 1.31 |
| *Discharge permit compliance | 98.00% | ≥98.30% | 99.32% |

Ofwat define their Key Performance Indicators for the water industry on their website, at:

<http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi/>

*Calendar year measures

| Measures of our ambition to go beyond our regulatory duties | | |
|---|---|---------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Complete delivery of our five year (2010 - 2015) programme of activities to protect and enhance the environment, as defined in the National Environment Programme. | Environmental programme delivered, for example fish passage installation and ancient woodland restoration. Final activities are being completed in 2015. | ↑ |
| Complete the detailed design of our programme of activities to protect and enhance the environment from 2015 to 2020, as defined in the National Environment Programme. | Detailed design developed and in 2015 we will finalise 'Phase 5' of the programme in agreement with the Environment Agency. | ↑ |
| Document the plan for engagement on our programme of activities to protect and enhance the environment, including an evaluation of the potential and benefits of partnership delivery. | We continue to develop how we best collaborate to deliver our environmental programme, for example agreeing to partner with the River Don Trust on fish passage installations. | ↑ |
| Publish our policy on catchment management to protect raw water quality and other benefits, and draft a long-term strategy. | We have documented our policy on catchment management and continue to engage stakeholders about our approach. | ↑ |
| Document river catchment plans for the six main Water Framework Directive river catchments in Yorkshire (not including a seventh catchment where we have little impact, Idle and Thorne). | We continue to develop river catchment plans and these will be finalised once the fifth phase of our environmental investment programme is confirmed with the Environment Agency later in 2015. | ↑ |
| No more than eight serious pollution incidents (Category 1 and 2). | Best ever performance achieved in 2014 with four Category 1 or 2 incidents and 191 Category 3 incidents. 2015 performance has started strongly . | ↑ |
| No more than 272 Category 3 pollution incidents. | | |
| Water quality at 15 of Yorkshire's bathing beaches exceeding the revised Bathing Water Directive 'Sufficient' standard in the 2014 bathing season. | 18 Yorkshire beaches achieved Good or Excellent standard in 2014, with a step change at three beaches following our investment. | ↑ |
| Real-time remote monitoring equipment installed at all of our bathing water assets to support coastal management. | Real-time remote monitoring equipment installed enabling enhanced coastal management. | ↑ |

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

The arrows show the trend of our annual performance in the context of our long-term goals. We provide further explanation on page 2.

Reducing pollution and enhancing river water quality

We collect, treat and return 1 billion litres of waste water safely back to the environment every day. We have delivered a step change in river water quality over the last 20 years by investing in the region's waste water treatment works and network.

We were delighted that our high standards were recognised by the Environment Agency in their annual environmental performance review of the water companies. Yorkshire Water stood alone as the only 'industry leading' company in 2014.

We further improved our performance on waste water treatment in 2014, with discharge permit compliance reaching 99.3% (two failing works), improved from 98.0% in 2013 (six failing works). We continued our capital investment programme, responding to new legislative drivers and population growth. Plans are in place to further improve our discharge permit compliance, details of which can be obtained in the Risk and Compliance Statement publication available at:

www.yorkshirewater.com.reports

The total number of pollution incidents from our sewer network has continued to reduce over recent years. Performance fluctuates each year because sewer performance is influenced by the weather. We achieved best ever performance in 2014 with 58.82 Category 1, 2 or 3 pollution incidents per 10,000km of sewer, down from 78.10 in 2013 and 82.68 in 2012. The number of the most serious pollution incidents also shows an overall trend of improvement and best ever performance with 1.31 Category 1 and 2 incidents per 10,000km of sewer. This has fallen from 3.27 Category 1 and 2 incidents per 10,000km of sewer in 2013 and 1.63 incidents in 2012.

Our pollution performance improved over the period 2010 to 2015, following implementation of our pollution reduction plan. We have made customer performance commitments to go even further in the next five year period, 2015 to 2020.

We have worked with the Environment Agency (EA) to model the ecological implications of our discharges. Together, we are defining our programme of environmental investment and investigation needs to 2020, our part of the National Environmental Programme (NEP). In 2015 we are refining details of the final part of this programme, known as Phase 5. We will further enhance our waste water treatment capabilities where we have confirmed biological and/or chemical issues that need to meet legislative standards. Where there is uncertainty we will be carrying out investigations to inform the long-term approach.

While delivering environmental water quality benefits, the new waste water treatment capabilities described above are often capital and carbon intensive. In 2014/15 we made a suite of commitments to the governments Infrastructure Carbon Review to work in partnership and use innovative solutions to protect both the atmospheric and aquatic environments.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015







STRATEGIC BUSINESS OBJECTIVE – WATER EFFICIENT REGIONS

The Group ensures water needs are met now and in the future by using water wisely and inspiring others to do the same.

| Measures of our regulatory compliance | 2013/14 performance | 2014/15 target | 2014/15 performance |
|---|---------------------|----------------|---------------------|
| Water supply interruptions (Hours per property served) | 0.17 | ≤0.25 | 0.17 |
| Total leakage (Mega Litres per Day, Ml/d) | 282 | ≤297 | 288 |
| Security of Supply Index | 100% | 100% | 100% |

Ofwat define their Key Performance Indicators for the water industry on their website, at:

<http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi/>

| Measures of our ambition to go beyond our regulatory duties | | |
|---|--|---|
| 2014/15 target | 2014/15 performance | Overall trend |
| Undertake a gap analysis on requirements to achieve the Carbon Trust Water Standard and use this to inform a review of our policy on water efficiency. | Gap analysis and investigations completed, identifying a series of possible improvements which is informing our plan to continually improve our operational water efficiency and achieve the Carbon Trust Standard for Water in 2017/18. |  |
| Investigate our use of potable water at our largest waste water treatment works and undertake cost benefit assessment of opportunities to reduce potable water use. | | |
| *Continued domestic customer water efficiency saving of at least 1.55Ml/d per year. | Supported water efficiency of over 7.5Ml/d per year and reviewing innovative approaches to inform future plans for further water efficiencies. |  |
| Continued business customer water efficiency saving of at least 4Ml/d per year. | | |
| Re-assess regional average night pressure and create a baseline to inform future management opportunities. | Greatly improved ability to monitor the water network. Currently reviewing newly available data to confirm baseline and inform future approach. |  |
| Complete a strategic assessment of new opportunities to create headroom in our supply demand balance, including a high level examination of the costs and benefits. | Assessment complete and opportunities will be considered further as we prepare our next Water Resources Management Plan. |  |
| Document our process to identify new opportunities for water efficiency by assessing a catchment's water supply demand balance in detail, and use the Sheffield catchment as a test case. | Process documented and Sheffield analysis started. Further assessment to be undertaken in 2015/16, including application of the new process to the Aire Valley and Hull. |  |
| Continue to monitor and inform national reform of abstraction licencing, and document our policy on abstraction and water trading. | Policy on water trading documented and continuing to monitor and inform nationally developing approach, with primary legislation expected. |  |

* Regulatory requirement.

The arrows show the trend of our annual performance in the context of our long-term goals. We provide further explanation on page 2.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

Securing water supplies

Our customers place a high value on the reliability of their water supply. We operate, maintain and enhance over 50 water treatment works and a distribution network of over 31,000km of water mains in order to treat and supply around 1.3 billion litres of drinking water each day. We can be proud that following our extensive investments, Yorkshire has had no service restrictions such as hosepipe bans since the 1995/1996 drought.

The risk of water shortages or supply interruptions is a constant priority for us because of the consequences to our customers, and to our operations and finances. Our performance in 2014/15 remained strong, with improved performance on the duration of supply interruptions (reduced to an average of 9 minutes 36 seconds per property, or 0.16 hours per property) and maximum possible performance maintained on the industry measure for security of supply. We have also shown strong performance against leakage and other water efficiency targets, which are discussed in the next sections.

In 2014/15 we published the final version of our new Water Resources Management Plan (WRMP), which followed the 2013/14 publication of our revised Drought Plan. Our detailed assessments for these plans confirm that climate change presents a growing threat to our ability to maintain the balance between supply and demand. We are well placed to manage this threat because water resources management is our most mature area of current resilience and future planning. We have maximised the benefit of the good range and balance of water supply options in our region by developing infrastructure that allows us to move water around the region to where it is needed. We call this the Yorkshire grid and it covers 99% of our customers. We manage our grid to offer one of the most resilient water supply systems in the country.

Our WRMP describes how we will maintain the balance between water supply and demand over the next 25 years. Our Drought Plan contains a framework of options that allow a drought to be best managed dependent on conditions. In the event of a drought, our advance planning enables us to act quickly because our selection of options have been assessed for their potential environmental impact and mitigation strategies. Both documents and more information can be found at:

<https://www.yorkshirewater.com/resources>

We agreed our future plans with Ofwat at the end of 2014. These plans describe our operational and investment programme to manage water services. Our activities will include increasing network storage and working on projects to manage network pressure. To allow us to respond to bursts and other network problems more effectively, we will be enhancing our visibility of the network by installing further data loggers that automatically send data to our command centre.

Sustainably reducing leakage

Leakage is by far the dominant source of water waste. We measure, report and reduce leakage, of which about two thirds results from our distribution network and a third is from leaks in customers' supply pipes.

We have almost halved leakage since 1995 and recorded our lowest ever levels in 2012/13, at 265 mega litres per day (Ml/d). This was below the Sustainable Economic Level of Leakage (SELL), 297.1Ml/d. The SELL is an industry term and methodology that defines the optimum level of leakage based on a suite of economic, environmental and

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

social considerations. The 2012/13 leakage performance was not affordable on a long term basis so we have managed our leakage control activities to return closer to the SELL, reporting 288Ml/d in 2014/15.

An options appraisal was carried out for the 2014 WRMP to identify a cost effective solution to ensure supply can meet demand over the next 25 years while minimising the impact on the environment. Initially we will be investing in further leakage reduction because this has been assessed as the most cost and environmentally effective way to mitigate the risk of climate change reducing supply. By 2020 we will further reduce leakage, to no more than 287.1Ml/d. We will strive to continue finding ways to sustainably reduce leakage by focusing our operational resources and further innovation.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

STRATEGIC BUSINESS OBJECTIVE – SUSTAINABLE RESOURCES

The Group uses sustainable resources, get the most out of them and reduces emissions and waste.

| Measures of our regulatory compliance | 2013/14 performance | 2014/15 target | 2014/15 performance |
|--|---------------------|----------------|---------------------|
| Greenhouse gas emissions (Kilotonnes of Carbon Dioxide equivalent, ktCO ₂ e) | 357 | ≤367 | 369 |
| Satisfactory sludge disposal (Calendar year measure) | 100% | 100% | 100% |

Ofwat define their Key Performance Indicators for the water industry on their website, at:

<http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi/>

| Measures of our ambition to go beyond our regulatory duties | | |
|---|---|---------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Document the approach we will use to assess the sustainability of our assets and investment programme. | Sustainable asset transformation programme initiated. Six commitments made to the Infrastructure Carbon Review. | ↑ |
| Reuse or recycle 92% of construction and demolition waste. | Reusing or recycling 96% of construction and demolition waste. | ↑ |
| Document Kelda Group's accommodation strategy, assessing economic, environmental and social considerations. | Assessments undertaken and we continue to develop our long term accommodation strategy. | ↑ |
| Plan to further reduce our HQ energy use, using the improved granularity of data provided by our energy monitors. | Continual improvement in our office energy efficiency, for example through the installation of LED lighting. | ↑ |
| Baseline Kelda Group's mileage and document a plan to achieve maintainable reduction targets. | Baseline developed and strategic review of our fleet completed, with improvements to be implemented over coming years. | ↑ |
| No more than 367ktCO ₂ e of operational emissions, meaning no more than a 3% rise compared to 2013/14, despite an 11% increase in national grid emissions. | Emissions up 3.4% on last year to 369ktCO ₂ e. We almost entirely mitigated the 11% increase in the national grid emissions conversion factor by continuing to reduce our energy consumption and generating more renewable energy. | ↗ |
| Reduce our electricity consumption by at least 8% compared to 2010/11 baseline. | We're now generating over 12% of our energy needs and the efficiency of our energy generation increased to an average of 415 KWh per TDS. Emissions are down 15% since 2008/09. | ↑ |
| Provide at least 13% of our electricity needs through our own generation. | | ↑ |
| Take value from sewage sludge by generating 398kWh per tonne of dry solid (TDS) sludge treated. | | ↑ |
| 90% of our wastes diverted from landfill. | Waste diverted from landfill increased to 93.5%. | ↑ |
| Develop and introduce a new sustainable supply chain risk assessment tool kit. | We continue to develop our new approach and from September 2015 we will ensure systematic completion of a sustainability risk assessment for all new contracts. | ↑ |
| Introduce a new process for the approval of sustainable suppliers. | | ↑ |
| 50% of aggregates used in our Repair & Maintenance (R&M) activities to be sourced from recycled materials. | 71% recycled aggregates used in our R&M activities. | ↑ |
| Filter bed media being recovered for beneficial reuse. | Filter media being recovered at Bradford's treatment works, some used at a nearby train station development. | ↑ |

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

| Measures of our ambition to go beyond our regulatory duties | | |
|---|---|----------------------|
| 2014/15 target | 2014/15 performance | Overall trend |
| Waste Fats, Oils and Greases (FOG) generating energy through generators operated by Living Fuels on our sites. | Preparing to generate energy from FOG in partnership with Living Fuels in coming months. | ↑ |
| Our trial of a new renewable energy technology, Advanced Thermal Conversion (ATC), will be generating energy from our sewage sludge and we'll have investigated options to fuel ATC using other organisations' surplus materials. | ATC pilot plant built and generating renewable energy. The use of business customers waste streams has been investigated and may be trialled in the longer term. | ↑ |
| Work with external partners to develop our ability to take a circular economy approach to our waste and resources, delivering quick wins and a documented plan. | Plan continues to develop, including examples above and more. Engaging with Bradford University's re:centre to further our approach. | ↑ |
| £625k of benefit generated for us and others by developing the circular economy. | We have been unable to quantify the mutual benefits however progress towards circular economy is starting to deliver financial, environmental and social benefits to us and others. | ↑ |

The arrows show the trend of our annual performance in the context of our long-term goals. We provide further explanation on page 2.

Reducing operational greenhouse gas emissions

Operational emissions are those produced through the activities we undertake to provide our water and waste water services, predominantly from the substantial amount of electricity required to move and treat water and waste water. We also monitor the emissions embedded in the assets we build, which we discuss further below.

Our reported emissions depend on both our activities and the nationally determined emissions conversion factors. In order to report the greenhouse gas (GHG) emissions associated with our activities, we convert 'activity data', such as distance travelled, into carbon emissions. For example, in 2014 1kWh of national grid electricity was multiplied by a factor of 0.49426 to reflect the carbon dioxide equivalent emissions. In the UK, the department for environment, food and rural affairs (Defra) publish updated emissions conversion factors each year to ensure carbon footprints are based on best available information.

Electricity dominates our emissions footprint and we use more electricity in periods of extreme weather when we increase pumping during floods or dry spells. While we are generating increasing amounts of our own low carbon, renewable electricity, the majority is supplied by the national grid. Defra's conversion factor repository states: "In the 2014 GHG conversion factors there was an 11% increase in the UK electricity factor from the previous year because there was a significant increase in coal powered electricity generation share in 2012 (the inventory year for which the 2014 GHG conversion factor was derived)". Overall, our emissions increased 3.4% in 2014/15 compared to the previous year. While we ultimately strive to reduce our absolute emissions, we are pleased that our recent investments almost entirely mitigated the 11% increase in the national grid electricity emissions factor in 2014.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

We have reduced our operational emissions by 15% since 2008/09 by reducing the amount of electricity we use and increasing the amount of renewable electricity we generate. Previous years of reducing national grid emissions conversion factors also helped our position. The 2015 conversion factor has decreased by 6.5% compared to 2014, following a decrease in coal powered generation in 2013.

Our success in achieving the Carbon Trust Standard (CTS) demonstrates our leading performance through an independent verification process. We will continue to monitor and publish our operational emissions and we are committed to maintaining the CTS which will require continued reduction in our operational emissions.

Our emissions for 2014/15 and the previous year are shown in the table below. We estimate our emissions using the agreed water industry approach that aligns with Defra reporting guidelines and latest emission factors.

| | 2014/15 | 2013/14 |
|---|---------|---------|
| Operational emissions – tonnes of carbon dioxide equivalent (tCO₂e) | | |
| Scope 1 emissions tCO ₂ e | 85,880 | 83,066 |
| Scope 2 emissions tCO ₂ e | 252,034 | 245,228 |
| Scope 3 emissions tCO ₂ e | 31,824 | 29,262 |
| Total emissions tCO ₂ e | 369,778 | 357,558 |
| Intensity ratio – kilogrammes of carbon dioxide equivalent (kgCO₂e) | | |
| Emissions per million litres of water served | 301 | 264 |
| Emissions per million litres of waste water treated | 326 | 320 |

*Please note that Scope 1, 2 and 3 emissions do not add up to Total emissions in the table above because the Scope 1, 2 and 3 figures are gross emissions.

Scope 1 emissions are those directly released to the atmosphere. We release Scope 1 emissions from: burning fossil fuels on our sites; driving group vehicles; and releasing gasses during treatment processes.

Scope 2 emissions are those indirectly released to the atmosphere through the purchase of electricity, heat or steam. We purchase large amounts of grid electricity to pump and treat water and waste water.

Scope 3 emissions are other indirect emissions. We include business travel on public transport and in private vehicles, activities from outsourced operators and emissions from the transmission and distribution of the grid electricity that we purchase.

Reducing embedded greenhouse gas emissions

Embedded emissions are those that result from the purchase of goods and the construction of new assets. We have substantial embedded emissions because we have a large supply chain and asset investment programme.

In 2014/15 we have further matured our process to capture as-built carbon information from our capital investment schemes and use this to continually improve our carbon models to inform our investment planning.

We are working to reduce the emissions embedded in our capital investments and we recently made six commitments to the government's Infrastructure Carbon Review. One of our commitments is that by 2020 we aspire to be halving the carbon emissions embedded in the new assets we build, compared to a 2015 baseline. We believe that driving a transformation in embedded carbon will also help us realise new cost efficiencies.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

STRATEGIC BUSINESS OBJECTIVE – STRONG FINANCIAL FOUNDATIONS

The Group delivers services to customers at a price they are willing and able to pay, while providing investors with returns that attract long-term investment.

The financial performance of the Group is reviewed on pages 22 to 23.

Determining future prices and operational and investment plans

YW worked with Ofwat to complete the latest price review cycle in 2014/15. Ofwat 'determined' price limits in December 2014 and we discuss future prices below. In line with the plans we published in December 2013, it is now confirmed that we will be investing £3.8 billion between 2015 and 2020 to deliver the services customers and stakeholders told us were most important. We will need to borrow an additional £1.3 billion from lenders to do this.

We have completed our preparations to effectively deliver our plan, ensuring high levels of customer service at reduced prices, environmental protection and fair returns for investors.

You can find out full details of our plans at:

www.yorkshirewater.com/blueprint

Delivering YW's capital investment programme

We invest significant capital expenditure to add to and replace our plant and equipment. The price limits set by Ofwat every five years take into account the level of capital expenditure expected to be incurred during the relevant period and the associated funding costs and operating costs.

In 2014/15 we have continued to govern closely the effective delivery of our capital programme. A Board Capital Investment Committee (BCIC) with delegated power from The Board monitors the capital programme delivery and provides strategic direction.

YW's Capital expenditure in the year was £286m (2014: £356m) as they successfully completed their capital programme for AMP5. YW delivered all regulatory outputs on time and as forecast in the Final Business Plan for the period 2010 to 2015, with the exception of one multi-agency sewer flooding study. The impact of this is partially offset by the over-delivery of sewer flooding outputs. Both are immaterial and will not result in a financial adjustment by Ofwat. The four forecast serviceability measures have been confirmed as 'stable', with the stretching Enhanced Level of Service pollution, DG2 low pressure and DG5 Other causes flooding measures all exceeding the requirements of the 2009 Final Determination.

As with previous investment periods, if YW were unable to deliver their capital investment programme at expected expenditure levels, were unable to secure the expected level of efficiency savings, or the programme fell behind schedule, profitability might suffer because of a need for increased capital expenditure. Ofwat may also factor such failure into future price reviews by seeking to recover amounts equivalent to the "allowed costs" of any parts of the programme that are not delivered. Our ability to meet regulatory output targets and environmental performance standards could also be adversely affected by such failure, which may result in penalties imposed by Ofwat of an amount up to 10% of turnover or other sanctions.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

Managing our credit ratings

In May 2015, Standard and Poor's announced that it held the rating of our Class A debt at A-, Stable and our Class B debt at BBB, Stable.

In March 2015, Moody's downgraded our corporate family rating to Baa2 from Baa1, our Class A debt to Baa1 from A3, and our Class B debt to Ba1 from Baa3. Moody's noted that, in their view, notwithstanding that YW's final determination was largely in-line with its business plan submissions and the track record of solid operational performance, that the credit quality continues to be pressured by the portfolio of inflation-linked derivatives and the deterioration in the mark-to-market value of that derivatives portfolio. See the 'Managing financial risk' section for more details.

In February 2015, Fitch announced that it held the rating of our Class A debt at A, Negative Outlook and moved the rating of our Class B debt to BBB+, Stable (from BBB+, Negative Outlook).

Governing our borrowing requirements

Our treasury operations are controlled centrally by a treasury department which operates on behalf of all companies in the Group and is controlled by the ultimate parent company. Activities are carried out in accordance with approved board policies, guidelines and procedures. Treasury strategy is designed to manage exposure to fluctuations in interest rates, preclude speculation and to source and structure the Group's borrowing requirements.

We use a combination of fixed capital, retained profits, long term loans, finance leases and bank facilities to finance our operations. Any funding required is raised by the Group treasury department in the name of the appropriate company, operating within the debt covenants. Subject to the restrictions required by the Whole Business Securitisation (explained above), funds raised may be lent to or from the company at commercial rates of interest. Cash surplus to operating requirements is invested in short term instruments with institutions having a long term rating of at least A-/A-/A3 and a short term rating of at least A1/F1/P1 issued by Standard and Poor's, Fitch and Moody's respectively.

Further details on the borrowings positions can be found in note 13 of the statutory financial statements.

Managing financial risk

Our executive team (Kelda Management Team, 'KMT') receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The operation of the treasury function is governed by policies and procedures, which set out guidelines for the management of interest rate risk, foreign exchange risk, exposure to fluctuations in the rate of inflation and the use of financial instruments. We actively maintain a broad portfolio of debt, diversified by source and maturity and designed to ensure we have sufficient available funds for operations. Treasury policy and procedures are incorporated within our financial control procedures.

Our operations expose us to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk. Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

arising from the primary financial instruments used to finance the group's activities. The interest rate swaps and cross currency interest rate swaps are held at an amortised cost of £nil and had a net positive mark to market value of £34.9m (2014: negative value of £79.3m).

YW turnover is linked to the underlying rate of inflation (measured by RPI) and as such is subject to fluctuations in line with changes in the rate of inflation. In addition, the % of net debt to RCV is a key covenanted ratio of the WBS. RCV is linked to RPI so negative inflation, without management, could breach this ratio despite YW being profitable. To mitigate this risk we maintain levels of index linked debt and swaps. The swaps are an arrangement such that interest is both payable and receivable on a notional amount of £1,289.0m. In the case of the index linked swaps, six month LIBOR is receivable and interest is payable at fixed amounts plus RPI. Movements in RPI are also applied to the debt. The maturity of the swaps ranges from 2026 to 2063. Therefore, as RPI reduces and income reduces, the interest charge will also reduce or in the case of gearing, as RCV reduces, the value of debt also reduces. With long term expectations of LIBOR at historically low levels, the swaps held by YW gave rise to an out of the money mark to market value of £2,076.8m (2014: £1,532.0m) at the year-end date. The Mark to Market value of the swaps will move with the long term market expectations of LIBOR. Included within the terms of the derivatives are mandatory breaks at 2018, 2020, 2023 and 2025. Management has strong plans in place to manage the breaks and at 5 June 2015 had successfully removed the breaks relating to 2018. Action to remove the remaining breaks is planned in the next few years. See note 20 for actions taken since the year end.

We are exposed to commodity price risk, especially energy price risk, as a result of our operations. We aim to manage this risk by fixing contract prices where possible and operating within an energy purchasing policy that is designed to manage price volatility risk.

Our insurance team work to ensure that we manage and mitigate our exposure to costs from public liabilities and damage to our assets.

See note 19 of the statutory financial statements for more details on the financial derivatives held by the Group.

Preparing for increasing competition in the water industry

The Water Act 2014 received Royal Assent in May 2014. The Act aims to reform the water industry to make it more innovative and responsive to customers and to increase the resilience of water supplies to natural hazards such as drought and floods.

In 2017 it will introduce greater freedom for businesses, charities and public sector customers in England to choose their retailer of water and waste water services. This will connect with the existing retail market in Scotland. We have been making the necessary preparations to manage the opportunities and risks presented by the Water Act 2014 reforms.

Increasing retail competition increases the application of the Competition Act 1998 to our business and the wider water industry. We are well underway in separating our business retail activities from the rest of our Yorkshire Water business, for example we established a separate function called Yorkshire Water Business Services in 2014/15. We will be

Kelda Finance (No. 1) Limited
Strategic Report
for the year ended 31 March 2015

implementing the necessary preparations and controls to ensure compliance, fair trading practices and to maximise the opportunities of this new market.

The Water Act 2014 also introduces measures beyond retail separation, including abstraction licence reform and water trading. These are discussed in the Water Efficient Regions SBO section.

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

FINANCIAL PERFORMANCE

Key financial performance indicators

| | Year ended 31 March 2015 | Year ended 31 March 2014 |
|---|---|---|
| | £m | £m |
| Operating profit from continuing operations | 396.3 | 340.2 |
| EBITDA (note 3) | 617.7 | 575.1 |

Operating profit is disclosed in the income statement on page 40.

Results for the year

The result for the year shows an operating profit from continuing operations of £396.3m (2014: £340.2m), which is principally generated by Yorkshire Water's regulated water business. In the year there has been a significant movement in the finance income and costs which has had an adverse impact of £694.5m on the reported position. Further details are given in the next section.

Exceptional finance (costs)/ income for the year

Exceptional finance (costs)/income comprise the following:

| | Year ended 31 March 2015 | Year ended 31 March 2014 |
|--|---|---|
| | £m | £m |
| Included in finance (costs)/income: | | |
| Movement on fair value of index linked swaps | (369.9) | 298.2 |
| Movement on fair value of finance lease interest rate swaps | (8.6) | 5.9 |
| Movement of fair value of combined cross currency interest rate swaps and associated bonds | 4.2 | (0.3) |
| Movement of fair value of fixed to floating interest rate swaps and associated bonds | 4.8 | (5.2) |
| | (369.5) | 298.6 |

The movement in the fair value of index linked swaps is a result of swaps which were taken out by the Group during 2007/08. These swaps hedge 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 31 March 2015 resulted in a £1,858.3m liability (2014: £1,446.4m).

Of the year on year movement of £411.9m, a charge of £61.6m (2014: £15.6m) relating to RPI accretion has been recognised within finance costs, a charge of £369.9m (2014: £298.2m credit) has been recognised as an exceptional finance cost and the remaining £19.6m (2014: £Nil) was cash paid. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves have not been met.

The movement in the fair value of finance lease swaps is a result of floating to fixed interest rate swaps taken out by the Group 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,

Kelda Finance (No. 1) Limited

Strategic Report

for the year ended 31 March 2015

which at 31 March 2015 resulted in a £24.2m liability (2014: £15.7m). The year on year increase of the liability of £8.6m (2014: £5.9m) has been recognised as an exceptional finance cost. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves were no longer met. The interest charged or credited to the income statement in relation to these swaps is shown in note 6.

Exceptional finance income include the fair value movement of various combined cross currency interest rate swaps which were nominated as fair value through profit and loss on inception. The combined cross currency interest rate swaps have been valued at the reporting date at fair value. In line with IAS 39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2015. The net impact of the fair value movement of the cross currency swaps and the associated bonds has resulted in a £4.2m credit (2014: £0.3m charge) to the income statement.

Exceptional finance income also includes the fair value movement of fixed to floating interest rate swaps which were nominated as fair value through profit and loss on inception. These fair value interest rate swaps have been valued at the reporting date at fair value. In line with IAS 39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2015. The net impact of the fair value movement of the fixed to floating interest rate swaps and the associated bonds has resulted in a £4.8m credit (2014: £5.2m charge) to the income statement.

Revaluation of property, plant and equipment

The Group's infrastructure assets were revalued at 31 March 2015. This valuation has been incorporated into the financial statements and the resulting revaluation adjustment taken to the revaluation reserve after deducting a provision for deferred tax. The revaluation during the year ended 31 March 2015 resulted in a net revaluation surplus of £187.8m after deferred tax.

Kelda Finance (No. 1) Limited

Strategic Report


for the year ended 31 March 2015

Principal risks

| Strategic risk | Controls |
|---|--|
| Failure to protect colleagues and the public from harm We play a critical role in protecting the safety, health and wellbeing of our customers, colleagues and contract partners. | <ul style="list-style-type: none"> • Health and safety culture, systems and processes • Internal audit and external assurance • Emergency response and escalation • Stakeholder engagement and influencing • Customer insight and feedback • Training and development • Regulatory monitoring and reporting • Internal monitoring and measurement • Day to day management controls • Financial business planning • Forecasting and long term planning • ISO certified integrated management systems • Dynamic risk management culture and systems |
| Failure to deliver enough clean, safe drinking water We supply an average of 1.27 billion litres of water to Yorkshire consumers each day, it is imperative that this remains a safe, high quality and reliable service. | |
| Failure to manage waste water The effective maintenance and operation of our sewer network and waste water treatment works is essential to ensure a healthy environment, avoid pollution and play our part in mitigating flooding. | |
| Failure to protect and manage our impact on the environment In continually interacting with the natural environment we safely abstract and discharge to the water environment and manage substantial land holdings and emissions to the atmosphere. | |
| Breach of legal or regulatory compliance We're highly regulated and non-compliance presents the risk of fines, enforcement action, increased scrutiny and ultimately licence revocation. | |
| Failure to deliver our customer promise Through consultation we know what our customers expect of us. Failure to deliver our commitments presents risks to regulatory compliance, reputation and our licence to operate. | |
| Poor execution and delivery of strategy, systems or process Poor execution of essential strategies, systems and processes would compromise our ability to operate efficiently and effectively to deliver our services and our business plan. | |
| Inability to respond to external threats / opportunities Climate change, population growth and other sustainability mega-trends threaten our long-term ability to affordably maintain essential services. | |
| Failure to achieve financial sustainability Our operations expose us to a variety of financial risks that include the effects of changes to debt market prices, interest rates, revenue and competition. | |

Kelda Finance (No. 1) Limited
Strategic Report
for the year ended 31 March 2015

The Strategic Report was approved by the board of directors on 14 July 2015 and signed on its behalf by:

A handwritten signature in black ink, appearing to read 'R Flint', with a long horizontal stroke extending to the right.

Richard Flint
Chief Executive
14 July 2015

Kelda Finance (No. 1) Limited

Directors' Report

for the year ended 31 March 2015

The directors present their annual report and the audited consolidated financial statements for the Group for the year ended 31 March 2015. The Directors' Report should be read in conjunction with the Strategic Report.

Financial results for the year

The loss for the year was £105.5m (year ended 31 March 2014: £476.0m profit). Kelda Finance (No. 1) Limited (the Company) paid £78.4m (year ended 31 March 2014: £155.3m) of cash dividends. Further comments on the financial performance can be found in the strategic report on page 22.

Incorporation

Kelda Finance (No. 1) Limited was incorporated on 11 May 2012 in England and Wales. On 24 June 2012, Kelda Finance (No. 2) Limited, a wholly owned subsidiary of Kelda Finance (No. 1) Limited, acquired the Yorkshire Water Services Holdings Limited group of companies in exchange for shares issued to Kelda Group Limited.

Principal activities

The principal activities of the Group are the supply of clean water and the treatment and disposal of waste water. Yorkshire Water Services Limited (Yorkshire Water or YW), the Group's regulated utility business in the UK, is responsible for both water and waste water services.

The principal activity of the Company is to be a holding company within the Kelda Holdings Limited group, and is expected to continue to be so for the foreseeable future.

Business review

A review of the development and performance of the business of the Group, including strategy, the financial performance during the year, key performance indicators forward-looking statements and a description of the principal risks and uncertainties facing the Group are set out in the Strategic Report on pages 1 to 25.

The purpose of this annual report is to provide information to the Group's stakeholders and contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this report should be construed as a profit forecast

Directors

The directors, who served during the year and up to the date of signing of these financial statements, including any changes, are shown below:

| | |
|------------------------|------------------------------|
| Elizabeth (Liz) Barber | |
| Richard Flint | |
| Stuart McFarlane | (resigned 31 December 2014) |
| Chantal Forrest | (appointed 31 December 2014) |

The Company had directors' and officers' liability insurance in place throughout the

Kelda Finance (No. 1) Limited

Directors' Report (continued)

for the year ended 31 March 2014

financial year and up to the date of approval of the financial statements. By virtue of the articles of association, the Company had also provided indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

The details of the directors serving at the year end are shown below.

Richard Flint. Appointed to the board on 1 April 2010. He was appointed as Group Chief Executive to the board of the parent company Kelda Holdings Limited in March 2010. Richard was appointed as Chief Operating Officer of Yorkshire Water in September 2008 and Chief Executive with effect from 1 April 2010. He was director of the water business unit from 2003. Previously, he held a number of senior operational positions in Yorkshire Water.

Elizabeth (Liz) Barber. Appointed to the board on 9 December 2010. Appointed as Group Finance and Regulation Director to the board of Kelda Holdings Limited in November 2010, now Group Director of Finance, Regulation and Markets. Liz joined the Group from Ernst & Young (EY) where she held a number of senior roles, including leading the firm's national water team and the assurance practice across the North Region. She had been with EY since 1987 and in that time worked with some of the largest companies in the UK. Liz holds two non-executive positions, she was appointed as a lay member of the Council and as trustee of Leeds University in 2013 and to the board of KCOM Group PLC in April 2015.

Chantal Forrest. Appointed to the board on 31 December 2014. Chantal joined Yorkshire Water on 1 December 2014 as Group Company Secretary. She was previously Company Secretary and General Counsel at Electricity North West.

Research and development

The Group undertakes a programme of research in pursuit of improvements in service and operating efficiency. During the year, £5.0m (2014: £8.7m) was committed to research and development, including £5.0m (2014: £8.4m) on non-current assets.

Valuation of assets

The Group has adopted an accounting policy of valuation in respect of certain categories of fixed assets (infrastructure assets, residential properties, non-specialised properties and rural estates) which are held in the balance sheet at valuation (less accumulated depreciation), based on their existing use value.

In the year ended 31 March 2015 the infrastructure assets in Yorkshire Water have been subject to a revaluation. As a result the carrying value of the infrastructure assets was increased by £234.6m and the resulting surplus taken to the revaluation reserve together with an associated deferred tax impact of £46.8m.

Certain categories of the Group's land and buildings were valued by independent qualified valuers in March 2014. As a result of the valuation carried out at 31 March 2014 the carrying value of land and buildings was increased by £17.2m and the resulting revaluation surplus taken to the revaluation reserve together with an associated deferred tax impact of £3.4m. As a result of the same revaluation certain properties were impaired and an impairment loss of £0.9m was recognised in the profit and loss. As at 31 March 2015 the

Kelda Finance (No. 1) Limited

Directors' Report *(continued)*

for the year ended 31 March 2014

directors do not consider that there has been any material change in the carrying value of these assets.

Further details are provided in note 10 to the financial statements.

The policy of holding these assets at valuation rather than historic cost has no impact on bank covenants or on distributable reserves. The policy is intended to better reflect the value of those asset classes in the financial statements. These assets will be revalued on a periodic basis, to coincide with valuations required for future Ofwat Price Reviews.

Diversity and human rights

We are committed to equality of opportunity for all. By valuing and respecting all of our people we will increase our knowledge, get the best out of colleagues and widen our future talent pool. Diversity and inclusion makes good sense.

We have formed a new Diversity & Inclusion Group that includes representatives from across the business and our contract partners. The Group has started by prioritising three areas: Gender, Ability and Ethnicity. The Group is working in partnership with external organisations to deliver a range of tangible outputs including raising awareness and engaging with audiences including the ex-services and disadvantaged schools.

We aim to achieve the National Equality Standard by 2020, the first industry recognised national standard for equality, diversity and inclusion. We are using the standard to benchmark our approach and identify future improvements.

Below we provide an overview of YW's diversity statistics as it was on 31 March 2015 and 31 March 2014.

| Gender | Male | | Female | |
|---------------------|-----------------|------------------|----------------|----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Statutory directors | 7 (77.8%) | 7 (63.6%) | 2 (22.2%) | 4 (36.4%) |
| Senior managers | 16 (69.6%) | 19 (76.0%) | 7 (30.4%) | 6 (24.0%) |
| Total employees | 1769 (77.8%) | 1,790 (76.8%) | 506 (22.2%) | 542 (23.2%) |

We have changed our methodology in 2015 to ensure accuracy and clarity. To enable comparison we provide 2014 figures using the new methodology, making the figures different to those reported in the 2014 annual report.

| Ethnicity | White | | Black and Minority Ethnic (BME) | | Not disclosed | |
|---------------------|-----------------|-----------------|--|--------------|----------------------|----------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Statutory directors | 9 (100.0%) | 11 (100.0%) | 0 (0.0%) | 0 (0.0%) | 0 (0.0%) | 0 (0.0%) |
| Senior managers | 22 (95.7%) | 24 (96.0%) | 1 (4.3%) | 1 (4.0%) | 0 (0.0%) | 0 (0.0%) |
| Total employees | 1907 (82.7%) | 1918 (82.2%) | 86 (3.7%) | 83 (3.6%) | 314 (13.6%) | 331 (14.2%) |

Kelda Finance (No. 1) Limited
Directors' Report (continued)
for the year ended 31 March 2014

| Age | Year | 16-25 | 26-35 | 36-45 | 46-55 | 56-65 | 66-75 |
|---------------------|------|---------------|----------------|----------------|----------------|----------------|--------------|
| Statutory directors | 2015 | 0 (0.0%) | 0 (0.0%) | 0 (0.0%) | 3 (33.3%) | 5 (55.6%) | 1 (11.1%) |
| | 2014 | 0 (0.0%) | 0 (0.0%) | 2 (18.2%) | 3 (27.3%) | 4 (36.4%) | 2 (18.2%) |
| Senior managers | 2015 | 0 (0.0%) | 2 (8.7%) | 11 (47.8%) | 10 (43.5%) | 0 (0.0%) | 0 (0.0%) |
| | 2014 | 0 (0.0%) | 1 (4.0%) | 9 (36.0%) | 14 (56.0%) | 1 (4.0%) | 0 (0.0%) |
| Total employees | 2015 | 127 (5.5%) | 518 (22.5%) | 575 (24.9%) | 720 (31.2%) | 359 (15.6%) | 8 (0.3%) |
| | 2014 | 133 (5.7%) | 556 (23.8%) | 614 (26.3%) | 707 (30.3%) | 318 (13.6%) | 5 (0.2%) |

Our Human Rights Policy recognises the rights set out in the International Bill of Human Rights, and the principles described in the UN Global Compact. As well applying to our immediate employees, we actively manage and monitor our supply chains to ensure working practices are consistent with our policy. The policy can be found at:
<http://www.keldagroup.com/media/2497/e5-human-rights-policy.pdf>

Employees and employment policies

The Group continues to place an importance on ensuring a positive working environment for all colleagues and a culture of open, honest internal communications and feedback. The Group's Values provide the framework for the consistent behaviours expected from colleagues.

Colleague engagement takes place using a range of channels including regular operational 'hubs' for over 900 operational employees, the intranet, 'Team Talks' and 'Talk Back' sessions with line managers and directors, annual business plan cascades, 'people leader' events to cascade key business performance messages and quarterly 'Post Your Views' surveys. All line managers are encouraged to develop and implement action plans with their teams, taking accountability for developing colleague morale, engagement and trusted relationships.

To further promote successful employee relations, collective bargaining arrangements are in place with the Group's recognised trade unions – UNISON, GMB and Unite. In addition, Communication and Consultation forums take place across the Group, comprising elected union and non-union employees meeting regularly with directors and senior managers to share performance information and discuss health and safety issues. These meetings also provide an opportunity to seek employee views which can then be taken into account in decision making.

The Group is committed to providing a diverse and inclusive working environment which reflects its customer base and is committed to equality of opportunity for all. A director-sponsored Diversity and Inclusion Working Group actively drives progress in this area; ensuring the policy is reviewed regularly, setting targets, monitoring progress and ensuring that the aspirations of the Group are been met. The Group has three prioritised areas of focus, Gender, Ability and Ethnicity, these have been identified as key areas of focus to help us become a more diverse and inclusive employer and better reflect our customer base.

Kelda Finance (No. 1) Limited

Directors' Report (continued)

for the year ended 31 March 2014

During the last year the Group has focused its recruitment activities so that they are attracting colleagues from all walks of life and experiences to encourage even greater innovation and creativity. They proactively identify roles within the business that could be particularly suitable for individuals with different level of physical and mental attributes. They support a guaranteed interview scheme for Ex-service people. Over the next AMP they have committed to sponsoring 100 females with their personal and professional development.

The Group has a big role to play in addressing skills shortages, particularly when it comes to Engineering and the STEM subjects. The Group proactively supports national Women in Engineering day by running a number of events with girls from local schools.

Our commitment to Diversity, Equality and Inclusion is demonstrated by YW's aspiration to be the first Water company to achieve the National Equality Standard. Diversity and inclusion principles underpin all of YW and the group's work and the services it provides.

The Group aims to attract, select, develop and retain the best talent to meet the needs of the business. There is a strong commitment to developing the pipeline of technical talent, understanding future skills requirements to meet the Group's evolving needs and the continued use of the talent framework which discusses aspirations, skills and development needs at all levels. During the next AMP the Group will recruit 160 Apprentices and 100 Technical Trainee roles so that they have a strong pipeline of talent for the future and that they are making a difference to the unemployment of young people. The Group works in partnership with a number of schools across the region to ensure that we help young people become more employable when they leave school and that they have a better chance of gaining employment. The Group provides a wide range of development tools, including in-house and accredited programmes to help all employees develop the necessary skills, knowledge, values and experience to realise their performance potential. The Group also recognises the important role of mentoring and over 150 colleagues are in mentoring relationships either internally or externally.

Key to achieving operational excellence and delivering out-performance is ensuring that every individual understands their role and how they can make a difference while feeling valued for their contribution. The Group is committed to rewarding the right performance and provide salary and benefits packages which are designed to be competitive. Performance related pay gives colleagues at all levels the opportunity to share in the success of the business, through quarterly or annual bonus payments linked to the achievement of individual and business plan targets.

Health and safety

It is essential that the Group work to prevent harm and protect health across all stages of its business operations, environments and communities.

We drive a Plan – Do – Check – Act continuous improvement cycle which is underpinned by the following principles:

- Strong and active leadership from the top down
- Employee engagement and involvement
- Assessment and review.

We maintain a clear focus on meeting the needs of our people, stakeholders, customers and other members of the public and strive for continual improvement, by:

Kelda Finance (No. 1) Limited

Directors' Report (continued)

for the year ended 31 March 2014

- Complying with our duties under the Health and Safety at Work etc Act 1974 and all other relevant legislation
- Identifying hazards and mitigating risks to levels as low as reasonably practicable
- Managing all our activities by seeking to eliminate injuries, incidents and ill health and minimise any consequences that might arise in the event of any incident
- Providing training, monitoring, supervision and leadership to ensure the competence of employees and compliance with our Occupational Health and Safety (OH&S) policies and procedures
- Assessing and monitoring the OH&S systems and performance of our suppliers, partners and contractors to ensure their competence
- Continually reviewing and challenging our performance, and setting ourselves objectives
- Aiming to meet all of the above at an affordable cost to our customers.

We use an Occupational Health & Safety Management System (OHSMS) to help ensure compliance with the standards and expectations of the Health and Safety Executive. We aim to certify to the Occupational Health and Safety Assessment Series (OHSAS) 18001 standard in 2015/16. In March 2015 an external auditor completed the first of two required assessments, concluding that our system is fit for purpose and identifying areas for development. We continue to deliver a programme of improvements to our system and practices.

The OHSMS is a live and dynamic system that we continually review and improve in line with our understanding of business risks, performance, incidents, injuries, inspections and audits. The system consists of an integrated framework that links the following elements:

- Applicable health and safety legislation
- Corporate policy outlining our commitment to continually improve
- Management standards to provide governance and assurance that risk controls are identified, established and effective
- Management procedures to address specific legislative needs and business risks
- Continual risk identification, assessment and escalation processes
- Provision of adequate and competent resources and supervision
- Safe implementation of work activities through planning, effective risk controls and compliance with safe working and business procedures
- Performance evaluation through KPI measurement, inspection and audit
- Continual improvement through management review and corrective action.

The OHSMS is designed to make it easy for leaders to integrate health and safety requirements and expectations into their day to day routine business activities and in return be successful in delivering excellent business performance through operational excellence, employee engagement and above all safe and healthy people and places to work. It is a live and dynamic system and is continually reviewed and improved as the Group understands and learns from its business risks, performance, incidents, injuries, inspections and audits.

Political donations

The Group does not support any political party and does not make what are commonly regarded as donations to any political party or other political organisations. However the definition of “donations” in the Political Parties Elections and Referendums Act 2000 covers a number of activities which form part of the necessary relationship between the

Kelda Finance (No. 1) Limited

Directors' Report (continued)

for the year ended 31 March 2014

Group and stakeholders. This includes promoting the Group's activities at the main political parties' annual conferences.

As part of its stakeholder engagement programme the Group incurred expenditure of £2,500 (2014: £16,000) in such activities.

Independent auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office.

The independence and objectivity of the external auditors is considered on a regular basis, with particular regard to the level of non-audit fees.

The Group has adopted an auditor independence policy which establishes procedures and guidance under which the Group's relationship with its external auditors is governed so that the audit committee is able to satisfy itself that there are no factors which may, or may be seen to, impinge upon the independence and objectivity of the audit process.

Financial instruments

Details are provided in note 19 of the financial statements and note 20 sets out the changes made post year end to some of the financial instruments.

Future developments

Future events are dealt with in the Strategic Report on pages 1 to 25.

Annual general meeting

Kelda Finance (No. 1) Limited has dispensed with the requirement to hold an annual general meeting.

Going concern

After making enquiries, the directors have a reasonable expectation, given the nature of the regulated water services business, that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group has £825.4m (2014: £650.3m) of undrawn committed borrowing facilities (note 13) and has a robust business model with positive cash flows projected for the next 25 years. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

Disclosure of information to auditors

Each director in office at the date of this report confirms that, to the best of their knowledge:

- The financial statements give a true and fair view of the assets, liabilities, financial position and loss of the Group; and
- The Strategic Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

Each director in office at the date of this report confirms that:

Kelda Finance (No. 1) Limited

Directors' Report *(continued)*

for the year ended 31 March 2014

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

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 prepared the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101). 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 group and the company and of the profit or loss of the group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether IFRSs as adopted by the European Union and applicable UK Accounting Standards, including FRS 101 have been followed, subject to any material departures disclosed and explained in the group and parent company financial statements respectively;
- notify its shareholders in writing about the use of disclosure exemptions, if any, of FRS 101 used in the preparation of the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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 the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

As it is entitled to do by the Companies Act 2006, the board has chosen to set out in the Strategic Report the following matters required to be disclosed in the Director's Report in respect of the year ended 31 March 2015;

- (a) the use of financial instruments;
- (b) particulars of any important events affecting the Company which have occurred since the end of the financial year;
- (c) an indication of likely future developments in the business of the Company;

Kelda Finance (No. 1) Limited
Directors' Report *(continued)*
for the year ended 31 March 2014

- (d) an indication of the activities of the company in the field of research and development; and
- (e) a breakdown of the Company's greenhouse gas emissions.

On behalf of the board



Chantal Forrest

Director
14 July 2015

Registered address: Western House, Halifax Road, Bradford, BD6 2SZ

Kelda Finance (No. 1) Limited

Corporate Governance Report

for the year ended 31 March 2015

Corporate governance

Throughout the year the board remained accountable to the Group's shareholders for maintaining standards of corporate governance.

Kelda Finance (No. 1) Limited is part of the Kelda Holdings Limited group of companies. All corporate governance relating to the Kelda Holdings Limited group is detailed in the Annual Report and Financial Statements of that company, a copy of which is available from the company secretary.

The board of directors

The Board held meetings when it is considered appropriate or where business needs required. The Board held six meetings during the period.

At the end of the year, the Board comprised three directors.

Liz Barber
Richard Flint
Chantal Forrest

Internal control and risk management

An on-going process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing the significant risks faced by the Group and this has been in place for the year under review and up to the date of approval of the annual report and financial statements. Strategic, financial, commercial, operational, social, environmental and ethical risks fall within the scope of this process. The process is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss.

The Group has comprehensive and well defined control policies with clear structures, delegated authority levels and accountabilities.

The Group's risk management process aims to be comprehensive, systematic and continuous, and based on constant monitoring of business risk. The key features of the process include the following:

- The principal risks facing the Group are identified and recorded in a strategic risk register aligned to business unit risk registers. All risks are managed at an appropriate level through the risk register hierarchy and have stated controls, owners and action plans where necessary. There is clear allocation of management responsibility for risk identification, recording, analysis and control;
- Risk assessment is completed with the use of strategic risk impact and probability scales and results plotted to enable prioritised action;
- Risks are monitored for any increases or decreases in risk position taking into account internal and external factors and appropriate treatment plans in place. All movements in strategic risk position are reported to the executive management team known as Kelda Management Team (KMT) monthly;
- KMT meet quarterly to review the Group's strategic risk position in detail and carry out a PESTLE analysis (political, economic, social, technological, legal and environmental).

Kelda Finance (No. 1) Limited
Corporate Governance Report (continued)
for the year ended 31 March 2015

- This acts as a prompt for KMT to discuss, assess and develop action plans relating to external trends, issues or opportunities;
- The Board Audit Committee reviews and monitors the effectiveness of the risk management process, systems, controls and resources on behalf of the board. Anthony Rabin as the chairman of the Group Audit Committee reports to the Kelda Holdings Ltd board;
- Business units are required to report annually on principal business risks and the operation of control mechanisms; and
- The internal audit department provides objective assurance and advice on risk management and control, and monitors the risk management process. An update on the risk and assurance position is provided at each audit committee meeting.

During the reporting year, the Group Audit Committee reviewed the effectiveness of the risk management process, the effectiveness of internal audit and the effectiveness of the external audit process on behalf of the Group. The Committee has also separately considered the control environment and control activities which the Board can rely on for disclosures in the Annual Report.

In addition to the process outlined above, the Group is also subject to: independent external audits which were reported to the executive team and the Audit Committee; an extensive budget and target-setting process; a quarterly reporting and forecasting process reviewing performance against agreed objectives; appropriate delegated authority levels; established financial policies and procedures; and other risk management policies and procedures such as health and safety and environmental policies.

The directors present their annual report and the audited consolidated financial statements for the Group for the year ended 31 March 2015. The Directors' Report should be read in conjunction with the Strategic Report.

Independent auditors' report to the members of Kelda Finance (No. 1) Limited

Report on the Group financial statements

Our opinion

In our opinion the financial statements, defined below:

- give a true and fair view of the state of the Group's affairs as at 31 March 2015 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The Group financial statements (the "financial statements"), which are prepared by Kelda Finance (No. 1) Limited, comprise:

- the Group balance sheet as at 31 March 2015;
- the Group income statement and Group statement of comprehensive income/(loss) for the year then ended;
- the Group cash flow statement for the year then ended;
- the Group statement of changes in equity for the year then ended; and
- the notes to the Group financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Adequacy of information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Independent auditors' report to the members of Kelda Finance (No. 1) Limited (continued)

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the statement of directors' responsibilities set out on pages 33 and 34, 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 and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). 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 Group'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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the annual report and financial statements (the "Annual Report") to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Independent auditors' report to the members of Kelda Finance (No. 1) Limited (continued)

Other matters

We have reported separately on the Company financial statements of Kelda Finance (No. 1) Limited for the year ended 31 March 2015.

Arif Ahmad

Arif Ahmad (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
14 July 2015

Kelda Finance (No. 1) Limited

Group income statement

for the year ended 31 March 2015

| | Note | Year ended 31 March 2015 £m | Year ended 31 March 2014 £m |
|---|------|--------------------------------------|--------------------------------------|
| Revenue | | 1,006.1 | 976.7 |
| Operating costs | 3 | (609.8) | (636.5) |
| Operating profit | | 396.3 | 340.2 |
| Finance income before exceptional items | 6 | 85.1 | 81.7 |
| Exceptional finance income | 4 | 9.0 | 304.1 |
| Total finance income | | 94.1 | 385.8 |
| Finance costs before exceptional items | 6 | (294.0) | (264.2) |
| Exceptional finance costs | 4 | (378.5) | (5.5) |
| Total finance costs | | (672.5) | (269.7) |
| (Loss)/profit from continuing operations before taxation | | (182.1) | 456.3 |
| Tax credit | 7 | 76.6 | 19.7 |
| (Loss)/profit attributable to owners of the parent | | (105.5) | 476.0 |

All material activities in the current year and prior year relate to continuing operations. Group revenue is derived principally from UK regulated water services.

Kelda Finance (No. 1) Limited

Group statement of comprehensive income

for the year ended 31 March 2015

| | Note | 2015 £m | 2014 £m |
|---|------|----------------|------------|
| (Loss)/profit for the year | | (105.5) | 476.0 |
| Other comprehensive income: | | | |
| Items that will not be reclassified to profit or loss: | | | |
| Gains on revaluation: | | | |
| Gains on revaluation of land and buildings before taxation | 10 | - | 17.2 |
| Gains on revaluation of infrastructure assets before taxation | 10 | 234.6 | - |
| Taxation | 7 | (46.8) | 36.1 |
| Other comprehensive income for the year, net of tax | | 187.8 | 53.3 |
| Total comprehensive income for the year | | 82.3 | 529.3 |

Kelda Finance (No. 1) Limited

Group balance sheet

as at 31 March 2015

| | Note | 2015 £m | 2014 £m |
|---|------|------------------|------------------|
| Non-current assets | | | |
| Intangible assets | 9 | 14.2 | 14.2 |
| Property, plant and equipment | 10 | 6,782.1 | 6,471.8 |
| Derivative financial assets | 19 | 67.8 | - |
| Trade and other receivables | 12 | 1,256.9 | 1,265.0 |
| | | 8,121.0 | 7,751.0 |
| Current assets | | | |
| Inventories | 11 | 1.3 | 0.8 |
| Trade and other receivables | 12 | 188.3 | 185.7 |
| Tax assets | | 5.0 | - |
| Cash and cash equivalents | 13 | 37.0 | 30.2 |
| | | 231.6 | 216.7 |
| Total assets | | 8,352.6 | 7,967.7 |
| Current liabilities | | | |
| Trade and other payables | 14 | (493.4) | (459.8) |
| Tax liabilities | | - | (4.0) |
| Borrowings | 13 | (140.1) | (285.5) |
| Financial liabilities | 19 | - | (5.7) |
| Deferred grants and contributions on depreciated assets | | (2.8) | (2.8) |
| | | (636.3) | (757.8) |
| Non-current liabilities | | | |
| Borrowings | 13 | (4,678.7) | (4,481.4) |
| Trade and other payables | 14 | (31.4) | (44.3) |
| Financial liabilities | 19 | (1,739.3) | (1,415.1) |
| Deferred grants and contributions on depreciated assets | | (48.9) | (50.9) |
| Provisions for other liabilities and charges | 15 | (0.7) | (0.7) |
| Deferred income tax liabilities | 16 | (489.7) | (493.3) |
| | | (6,988.7) | (6,485.7) |
| Total liabilities | | (7,625.0) | (7,243.5) |
| Net assets | | 727.6 | 724.2 |
| Equity attributable to owners of the parent | | | |
| Ordinary shares | 18 | - | - |
| Hedging reserve | | (13.2) | (13.2) |
| Revaluation reserve | | 201.6 | 13.8 |
| Retained earnings | | 539.2 | 723.6 |
| Total equity | | 727.6 | 724.2 |

The financial statements on pages 40 to 89 were approved by the board of directors on 14 July 2015 and signed on their behalf by:


Chantal Forrest
Director

Kelda Finance (No. 1) Limited

Group statement of changes in equity

for the year ended 31 March 2015

| | <i>Note</i> | Ordinary shares | Hedging reserve | Revaluation reserve | Retained earnings/ (accumulated losses) | Total equity |
|---|-------------|----------------------------|----------------------------|--------------------------------|--|-------------------------|
| | | £m | £m | £m | £m | £m |
| At 1 April 2013 | | - | (13.2) | 1,013.7 | (650.5) | 350.0 |
| Reduction in capital | | - | - | (1,013.7) | 1,013.7 | - |
| Profit for the year | | - | - | - | 476.0 | 476.0 |
| Dividends paid | 8 | - | - | - | (155.3) | (155.3) |
| Other movements | | - | - | - | 0.2 | 0.2 |
| Total included in the Group statement of comprehensive income | | - | - | 13.8 | 39.5 | 53.3 |
| At 1 April 2014 | | - | (13.2) | 13.8 | 723.6 | 724.2 |
| Loss for the year | | - | - | - | (105.5) | (105.5) |
| Dividends paid | | - | - | - | (78.4) | (78.4) |
| Other movements | | - | - | - | (0.5) | (0.5) |
| Total included in the Group statement of comprehensive income | | - | - | 187.8 | - | 187.8 |
| At 31 March 2015 | | - | (13.2) | 201.6 | 539.2 | 727.6 |

A reduction in capital of a subsidiary in the year ended 31 March 2014 resulted in the transfer of £1,013.7m of revaluation reserve to accumulated losses. The revaluation surplus is classified as fully distributable.

Kelda Finance (No. 1) Limited
Group cash flow statement
for the year ended 31 March 2015

| | Note | 2015 £m | 2014 £m |
|--|------|----------------|------------|
| Cash flows from operating activities | 20 | 623.3 | 586.2 |
| Income taxes received | | 17.5 | 2.5 |
| Interest paid | | (255.6) | (241.2) |
| Net cash generated from operating activities | | 385.2 | 347.5 |
| Cash flows from investing activities | | | |
| Interest received | | 84.3 | 78.5 |
| Proceeds on disposals of property, plant and equipment | | 1.4 | 7.1 |
| Purchases of property, plant and equipment | | (268.4) | (375.5) |
| Capital grants and contributions | | 21.2 | 11.9 |
| Net cash used in investing activities | | (161.5) | (278.0) |
| Cash flows from financing activities | | | |
| Dividends paid | 8 | (78.4) | (155.3) |
| Borrowings raised (net of fees) | | 89.7 | 129.8 |
| Repayments of borrowings | | (199.3) | (44.5) |
| Repayment of obligations under finance leases and hire purchase agreements | | (28.9) | (8.2) |
| Net cash used in financing activities | | (216.9) | (78.2) |
| Net increase/(decrease) in cash and cash equivalents | | 6.8 | (8.7) |
| Cash and cash equivalents at the beginning of the year | | 30.2 | 38.9 |
| Cash and cash equivalents at the end of the year | 13 | 37.0 | 30.2 |

Kelda Finance (No. 1) Limited

Notes to the Group financial statements

for the year ended 31 March 2015

1. Authorisation of financial statements

The Group's financial statements for the year ended 31 March 2015 were authorised for issue by the board of directors on 14 July 2015 and were signed on the board's behalf by Chantal Forrest, Company Secretary and Director. Kelda Finance (No. 1) Limited is a limited company incorporated and domiciled in England and Wales.

2. Accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Basis of accounting

The consolidated financial statements of Kelda Finance (No. 1) Limited have been prepared on the going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, IFRIC interpretations and those parts of the Companies Act 2006 applicable to companies reporting under IFRS as they apply to the financial statements of the Group for the year ended 31 March 2015.

The consolidated financial statements have been prepared under the historical cost convention except for certain categories of property, plant and equipment which are held at valuation, all derivative financial instruments and financial assets which have been measured at fair value.

The preparation of financial statements in conformity with IFRSs requires the use of certain accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed on page 52.

Basis of consolidation

The Group financial statements consolidate the financial statements of Kelda Finance (No. 1) Limited and its subsidiaries. The results of undertakings acquired or sold are consolidated for the periods from the date of acquisition or up to the date of disposal. Acquisitions of subsidiaries are accounted for under predecessor accounting principles. Intra-group balances, and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

On 24 June 2012 the Group acquired the Yorkshire Water Services Holdings Limited group of companies in exchange for shares issued to Kelda Group Limited. The Group applied predecessor accounting principles to the initial consolidation of its results to 31 March 2013, incorporating assets and liabilities upon acquisition at their existing book values in the financial statements of the entities under common control. Business combinations under common control are accounted for in the consolidated financial statements prospectively from the date the Group obtained the ownership interest. The Group has maintained the reserves structure of the companies acquired.

Foreign currencies

On an individual company basis, individual transactions denominated in foreign currencies are translated into functional currency at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency at the rates ruling at the balance sheet date.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Profits and losses on both individual foreign currency transactions during the period and monetary assets and liabilities are dealt with in the income statement.

Revenue

Revenue comprises charges to customers for water, waste water and environmental services, excluding value added tax. Revenue excludes inter-company sales.

Revenue is not recognised until the service has been provided to the customer. Revenue relates to charges due in the period, excluding any amounts paid in advance. Revenue for measured water charges includes amounts billed plus an estimation of the amounts unbilled at the period end. The accrual is estimated using a defined methodology based upon daily average water consumption, which is calculated based upon historical billing information.

Net operating costs

Net operating costs include the following:

Rental income

Rental income arising on investment properties is accounted for on a straight line basis over the lease term on ongoing leases.

Other operating income

Profit relating to the sale of commercial and residential properties to third parties is included within other operating income, which is part of operating costs.

Finance income

Interest receivable is recognised as the interest accrues using the effective interest method that is the rate that exactly discounts estimated future cash receipts and payments through the expected life of the financial instrument to the net carrying amount of the financial assets.

Dividends payable

Interim and final dividends payable are recognised on approval of the dividend.

Dividends receivable

Dividends receivable are recognised when the owners' right to receive the revenue is established.

Research and development expenditure

Research expenditure is written off in the income statement in the period in which it is incurred.

Development expenditure is charged to the income statement except where the expenditure meets the criteria for recognition as an internally generated intangible asset as outlined in IAS 38 'Intangible assets'. Where the recognition criteria are met, intangible assets are capitalised and amortised over their useful economic lives from the date of commissioning.

Taxation

Current tax

Current tax for the current period is, to the extent unpaid, recognised as a liability. If the amount already paid in respect of the current period exceeds the amount payable, the excess is recognised as an asset.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Deferred tax

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes with the following exceptions:

- where the deferred income tax liability arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised, except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Current and deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly in equity in which case the current or deferred tax is reflected in equity.

Goodwill and intangible assets

Goodwill represents the excess of the fair value of the consideration paid for a business over the fair value of the identifiable assets and liabilities acquired after costs incurred directly in relation to the transaction. Goodwill is capitalised and subject to an impairment review, both annually and when there are indications that the carrying value may not be recoverable.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Property, plant and equipment

Residential properties, non-specialised properties and rural estates held within land and buildings are held at valuation. Infrastructure assets are also held at valuation (see note 10). Other property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment.

Freehold land is not depreciated. Depreciation is charged on property, plant and equipment on a straight line basis over their estimated useful economic lives, or the estimated useful economic lives of their individual major components, from the date of commissioning.

Useful economic lives are principally as follows:

| | |
|--------------------------------------|---------------|
| Buildings | 25 - 60 years |
| <i>Plant and equipment</i> | |
| Fixed plant | 5 - 40 years |
| Vehicles, mobile plant and computers | 3 - 10 years |
| <i>Infrastructure assets</i> | |
| Water mains and sewers | 40 -125 years |
| Earth banked dams and reservoirs | 200 years |

Assets in the course of construction are not depreciated until commissioned.

In the UK regulated water services business, infrastructure assets comprise a network of systems being mains and sewers, impounding and pumped raw water storage, reservoirs, dams and sea outfalls. The opening balance for infrastructure assets in Yorkshire Water on transition to IFRS was calculated with reference to the estimated fair value of the infrastructure network as a whole at 1 April 2004. Subsequent expenditure is classified as operating expenditure or capital and accounted for appropriately.

Infrastructure assets, residential properties, non-specialised properties and rural estates are held at valuation with external valuations being undertaken on a periodic basis. An interim valuation is booked in the intervening years if there has been a material change. Residual values and depreciation rates are reviewed on revaluation. On sale of a revalued asset, the revaluation reserve is recycled to the income statement.

In respect of borrowing costs relating to qualifying assets for which the capitalisation date is on or after 1 January 2009, the Group capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Prior to this date the Group recognised all borrowing costs as an expense immediately. This change in accounting policy was due to the adoption of IAS 23 'Borrowing costs'.

Impairment of property, plant and equipment and goodwill

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable. Useful lives and residual values are reviewed annually. Where adjustments are required, these are made prospectively.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Impairment on goodwill is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount is less than the carrying amount, an impairment loss is recognised. When an entity is disposed of, any goodwill associated with it is included in the carrying amount of the operation when determining the gain or loss on disposal.

Accounting for leases

Finance leases

Assets which are financed by leasing agreements that transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised, at the lower of the fair value of the leased property and the present value of future lease payments, in property, plant and equipment and the corresponding capital cost is shown as an obligation to the lessor in borrowings. Depreciation is generally charged to the income statement over the shorter of the estimated useful life and the term of the lease. If the operational life of an asset is longer than the lease term, and the agreement allows an extension to that term, the asset may be depreciated over its operational life. The capital element of lease payments reduces the obligation to the lessor and the interest element is charged to the income statement over the term of the lease in proportion to the capital amount outstanding. Any arrangement fees or other direct costs incurred on a finance lease are capitalised and amortised over the length of the lease.

Operating leases

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Lease payments are charged to the income statement on a straight line basis over the term of the lease.

Government grants and contributions

Government grants and contributions in respect of property, plant and equipment are deferred and credited to the income statement by instalments over the expected economic lives of the related assets. Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

Government grants and contributions received in respect of an item of expense during the year/period are recognised in the income statement on a systematic basis in line with the cost that it is intended to compensate.

Government grants which can be allocated against an individual asset are included as part of the carrying value of the asset. Government grants which cannot be allocated to individual assets are held as deferred income and released to the income statement over the life of the grant.

Inventories

Inventories are stated at the lower of cost and net realisable value less any provision necessary to recognise damage and obsolescence. Cost includes labour, materials and an appropriate proportion of overheads.

Provisions

Provision is made for self insured claims incurred but not reported and other known liabilities which exist at the period end as a result of a past event.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Financial instruments

Cash and cash equivalents

Cash equivalents include short term deposits with original maturity within 3 months. For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents net of outstanding bank overdrafts held with the same counterparty where there is a legal right and intention to offset.

Trade and other receivables

Trade receivables are initially recognised at fair value, and subsequently remeasured at amortised cost, net of any allowance for impairment.

Invoices for unmeasured water charges are due on predetermined dates, irrespective of date of receipt. Other trade receivables generally have 7-30 day payment terms. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Trade and other payables

Trade payables are initially recognised at fair value, and subsequently remeasured at amortised costs.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at fair value less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at either;

- (i) amortised cost using the effective interest method. Gains and losses arising on repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in investment income and finance costs; or
- (ii) fair value at the measurement date. The movement in the fair value of the loan or borrowing is recognised in the income statement. The fair values of the borrowings are determined by reference to quoted prices in active markets for identical assets or liabilities that the company can access at the measurement date.

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value at the balance sheet date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either (1) hedges of the fair value of recognised assets or liabilities or (2) cash flow hedges.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Cash flow hedge

The portion of the gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity. Any ineffective portion is immediately recognised in the income statement. The gains or losses that are recognised in equity are transferred to the consolidated income statement in the same period in which the hedged cash flows affect the consolidated income statement. In the event the hedged item is no longer expected to occur or the hedge relationship ceases to be effective, accumulated gains or losses held in the cash flow hedge reserve are immediately recognised in the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any such derivative are immediately recognised in the income statement.

Employee benefits

(a) Pension plans

The Group accounts for its pensions in accordance with IAS 19 (revised) 'Employee Benefits'.

(i) Defined contribution scheme

The Group operates two defined contribution schemes for those members of staff who are not members of its defined benefit scheme. Two pension plans exist under which the Group pays a fixed contribution into a separate entity which operates the schemes. The other provides the employees with a lump sum on retirement, with which they then invest in an annuity. Other than this contribution, the Group has no further legal or constructive obligation to make further contributions to the scheme.

Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

(ii) Defined benefit scheme

A majority of the Group's employees participate in the Kelda Group Pension Plan (KGPP), a group defined benefit pension scheme as described in note 17 of the financial statements. The KGPP is a Group defined benefit plan such that the risks are shared between various entities under the control of the Kelda Holdings Group of companies. As there is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with IAS 19 'Revised' to individual Group entities, the Kelda Finance (No. 1) Limited Group recognises a cost equal to its contribution payable for each accounting period.

Share capital

Ordinary shares are classified as equity.

Segmental reporting

The Group's primary reporting format is by business segment and its secondary format is by geographical segment. A segment is a component of the Group which can be distinguished separately as providing a product or service within a particular environment which is subject to risks and rewards that are different from those of other segments. The Group has identified a single business segment, being that of UK Regulated Water Services (Yorkshire Water).

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

Exceptional items

Exceptional items are items which derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually or, if of a similar type, in aggregate need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

The Group estimates the fair value as the price it would receive to sell an asset or pay to transfer a liability in an orderly transaction, between the market participants.

Fair value estimation

The fair value of any financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cashflows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate and currency swaps is calculated as the present value of the estimated future cashflows. The fair value calculations have been adjusted to incorporate own and counter-party credit risk.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate to their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

Principal areas of judgement

The directors consider the principal areas of judgement in the financial statements to be:

- Fair value of financial instruments

The Group's accounting policy for financial instruments is detailed on page 50 to 51. In accordance with IFRS 13 financial instruments are recognised in the financial statements at fair value. The fair value of financial instruments that are not traded on an active market is determined using a discounted cash flow valuation technique. Management uses its judgement to make assumptions relating to future cash flows, mainly based on forward interest rates from observable yield curves at the end of the reporting period, counter-party funding adjustments and contract interest rates, discounted at a rate that reflects own or counter-party credit risk. The fair value of financial instruments would be £15.0m higher or lower were the counter-party funding assumption to change by 10 basis points. The fair value of financial instruments would be £12.1m higher or lower were the credit curve assumption to change by 10 basis points.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

2. Accounting policies (continued)

- Property, plant and equipment

The Group's accounting policy for property, plant and equipment (PPE) is detailed on page 48 of the financial statements. Estimated useful economic lives of PPE are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Historically, only minor changes to estimated useful lives have been required.

Certain categories of PPE are held at valuation based on value in use. Value in use is determined using a discounted cashflow model which requires management to make subjective judgements concerning the cash flows, growth rates and discount rates of the cash generating units under review. The Group is required to evaluate the carrying value of PPE for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable.

- Provision for doubtful debts

At each balance sheet date, the Group evaluates the collectability of trade receivables and records provisions for impairment of receivables based on experience including, for example, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ for the estimated levels of recovery, which could impact operating results positively or negatively. As at 31 March 2015 current trade receivables were £120.0m (2014: £116.2m) before provision for impairments.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

2. Accounting policies (continued)

New standards and interpretations

The following standards have been adopted by the Group for the first time for the financial year beginning 1 April 2014 and do not have a material impact on the Group:

- Amendment to IAS 32 'Financial instruments presentation - offsetting financial assets and liabilities'
- Amendments to IFRS 10, IFRS 12 and IAS 27 for investment entities
- Amendments to IAS 36 'Impairment of assets'
- Amendment to IAS 39 'Financial instruments: Recognition and measurement'
- Amendments to IFRS 10, 11 and 12 on transition guidance
- IFRS 10 'Consolidated financial statements'
- IFRS 11 'Joint arrangements'
- IFRS 12 'Disclosures of interests in other entities'
- IAS 27 (revised) 'Separate financial statements'
- IAS 28 (revised) 'Associates and joint ventures'
- IFRIC 21 'Levies'

The following standards, interpretations and amendments to existing standards are effective for annual periods starting on or after 1 January 2015 and have not been early adopted by the Group:

- Amendment to IAS 19 'Employee benefits'
- Annual improvements 2012 cycle amending IFRS 2, IFRS 3, IFRS 8, IFRS 9, IFRS 13, IFRS 15, IAS 16, IAS 38, IFRS 9, IAS 37 and IAS 39.
- Annual improvements 2013 cycle amending IFRS 1, IFRS 3, IFRS 13 and IAS 40.

The following standards, interpretations and amendments to existing standards are not yet effective and have not been early adopted by the Group:

- Amendment to IFRS 11 'Joint arrangements'
- Amendment to IAS 16 'Property, plant and equipment'
- IFRS 14 'Regulatory deferral accounts'
- Amendments IAS 27
- Amendments to IFRS 10 and IAS 27
- Annual improvements 2014 cycle amending IFRS 5, IFRS 7, IAS19 and IAS34.

The Group is still considering the implications of applying these standards and interpretations to the Group's financial statements.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

3. Operating costs

| | 2015 £m | 2014 £m |
|---|--------------|--------------|
| Own work capitalised | (36.1) | (36.0) |
| Raw materials and consumables | 29.0 | 30.0 |
| Other external charges | 278.8 | 280.2 |
| Staff costs (note 5) | 107.0 | 110.3 |
| Depreciation of property, plant and equipment (note 10) | | |
| On owned assets | | |
| - UK infrastructure | 36.3 | 58.0 |
| - other assets | 179.2 | 170.7 |
| On assets held under finance lease | | |
| - UK infrastructure | 1.4 | 1.4 |
| - other assets | 7.3 | 7.7 |
| Operating lease rentals - minimum lease payments | | |
| - plant and equipment | 1.9 | 2.2 |
| - other | 1.5 | 1.4 |
| Amortisation of grants and contributions | (2.8) | (2.9) |
| Research and development | - | 0.3 |
| Movement of fair value of energy contracts (note 19) | (6.4) | 6.4 |
| Impairment of trade receivables | 19.9 | 18.4 |
| Profit on disposal of property, plant and equipment | (2.2) | (5.9) |
| Other operating income | (5.0) | (5.7) |
| | 609.8 | 636.5 |

Earnings before interest, tax, depreciation and amortisation (EBITDA) excluding exceptional items, as quoted in the key financial performance indicators of the Group on page 22, is calculated as follows:

| | 2015 £m | 2014 £m |
|---|--------------|--------------|
| Group operating profit | 396.3 | 340.2 |
| Add back depreciation and amortisation of capital grants (as above) | 221.4 | 234.9 |
| EBITDA | 617.7 | 575.1 |

Auditors' remuneration

Services provided by the Group's auditors are analysed as follows:

| | 2015 £m | 2014 £m |
|--|------------|------------|
| Fees payable to the Group's auditors for the audit of the parent company and consolidated financial statements | - | - |
| Fees payable to the Group's auditors for other services: | | |
| - The audit of the Company's subsidiaries pursuant to legislation | 0.2 | 0.2 |
| - Fees for other services | - | 0.1 |
| | 0.2 | 0.3 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

4. Exceptional finance income/(costs)

Exceptional items comprise:

| | 2015 £m | 2014 £m |
|--|----------------|--------------|
| Included in finance income | | |
| Movement of fair value of index linked swaps | - | 298.2 |
| Movement of fair value of finance lease interest rate swaps | - | 5.9 |
| Movement of fair value of combined cross currency interest rate swaps and associated bonds | 4.2 | - |
| Movement of fair value of fixed to floating interest rate swaps and associated bonds | 4.8 | - |
| | 9.0 | 304.1 |
| Included in finance costs | | |
| Movement of fair value of index linked swaps | (369.9) | - |
| Movement of fair value of finance lease interest rate swaps | (8.6) | - |
| Movement of fair value of combined cross currency interest rate swaps and associated bonds | - | (0.3) |
| Movement of fair value of fixed to floating interest rate swaps and associated bonds | - | (5.2) |
| | (378.5) | (5.5) |

The movement in the fair value of index linked swaps is a result of swaps which were taken out by the Group during 2007/08. These swaps hedge 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 31 March 2015 resulted in a £1,858.3m provision (2014: £1,446.4m).

Of the year on year movement of £411.9m, a charge of £61.6m (2014: £15.6m) relating to RPI accretion has been recognised within finance costs, and a charge of £369.9m (2014: £298.2m credit) has been recognised as an exceptional finance cost and the net remaining amount of £19.6m (2014: £nil) was cash paid. This has been included in the income statement as the specific circumstances which would allow it to be held in reserves have not been met.

The movement in the fair value of finance lease swaps is a result of floating to fixed interest rate swaps taken out by the Group 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 31 March 2015 resulted in a £24.2m liability (2014: £15.7m). The year on year increase of the liability of £8.6m (2014: decrease of £5.9m) has been recognised as an exceptional finance cost (2014 : income). This has been included in the income statement as the specific circumstances which would allow it to be held in reserves were no longer met. The interest charged or credited to the income statement in relation to these swaps is shown in note 6.

Exceptional finance costs include the fair value movement of various combined cross currency interest rate swaps which were nominated as fair value through profit and loss on inception. The combined cross currency interest rate swaps have been valued at the reporting date at fair value. In line with IAS 39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2015. The net impact of the fair value movement of the cross currency

Kelda Finance (No. 1) Limited
Notes to the Group financial statements *(continued)*
for the year ended 31 March 2015

4. Exceptional finance income/(costs) (continued)

swaps and the associated bonds has resulted in a £4.2m credit (2014: £0.3m charge) to the income statement.

Exceptional finance costs also include the fair value movement of fixed to floating interest rate swaps which were nominated as fair value through profit and loss on inception. These fair value interest rate swaps have been valued at the reporting date at fair value. In line with IAS 39, the financial instruments to which the swaps relate have also been measured at fair value at 31 March 2015. The net impact of the fair value movement of the fixed to floating interest rate swaps and the associated bonds has resulted in a £4.8m credit (2014: £5.2m charge) to the income statement.

5. Directors and employees

| | 2015 Number | 2014 Number |
|---|----------------|----------------|
| Average monthly number of people employed by the Group | | |
| UK regulated water services | 2,309 | 2,415 |

| | 2015 £m | 2014 £m |
|--------------------------------|--------------|------------|
| Total employment costs: | | |
| Wages and salaries | 75.5 | 78.6 |
| Social security costs | 7.2 | 7.2 |
| Other pension costs | 24.3 | 24.5 |
| | 107.0 | 110.3 |

Directors' emoluments

| | 2015 £m | 2014 £m |
|--|------------|------------|
| Aggregate emoluments | 1.6 | 1.9 |
| Employer contributions to money purchase pension schemes | - | 0.1 |
| | 1.6 | 2.0 |

The amounts in respect of the highest paid director are as follows:

| | 2015 £m | 2014 £m |
|----------------------|------------|------------|
| Aggregate emoluments | 0.7 | 1.1 |

All executive directors have service agreements which are terminable by the Group on 12 months' notice.

During the year, two (2014: two) directors were contributory members of the Kelda Group Pension Plan, a defined benefit scheme. The accrued pension benefit of the highest paid director in 2014/15 was £0.2m (2014: £0.1m).

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

6. Finance income and finance costs before exceptional items

| | Year ended 31 March 2015 £m | Year ended 31 March 2014 £m |
|---|--------------------------------------|--------------------------------------|
| Finance income | | |
| Interest receivable on bank deposits | 1.4 | 0.2 |
| Interest receivable from index linked swaps | 8.6 | 7.8 |
| Interest receivable from cross currency interest rate swaps | 12.7 | 11.6 |
| Interest receivable on loans to Group companies | 62.4 | 62.1 |
| Finance income before exceptional income | 85.1 | 81.7 |
| Exceptional finance income (note 4) | 9.0 | 304.1 |
| Total finance income | 94.1 | 385.8 |
| Finance costs | | |
| Interest payable on guaranteed bonds | 179.6 | 195.6 |
| Interest payable on US Dollar bonds | 11.5 | 11.5 |
| Interest payable on AUS Dollar bonds | 2.0 | 1.6 |
| Amortisation of issue costs in respect of bonds | 1.1 | 1.1 |
| Finance costs for bonds | 194.2 | 209.8 |
| Bank loans and overdrafts | 13.4 | 16.2 |
| Bank loans under Kelda Finance facility | 3.0 | 2.9 |
| RPI accretion on index linked swaps | 61.6 | 15.6 |
| Interest payable on index linked swaps | 40.4 | 39.5 |
| Finance leases | 6.7 | 7.1 |
| Commitment fees and miscellaneous interest | 5.5 | 3.7 |
| Finance costs before capitalisation of interest | 324.8 | 294.8 |
| Interest capitalised | (30.8) | (30.6) |
| Finance costs net of interest capitalised | 294.0 | 264.2 |
| Exceptional finance costs (note 4) | 378.5 | 5.5 |
| Total finance cost | 672.5 | 269.7 |

For more information on guaranteed and US Dollar bonds refer to note 13. For details of exceptional finance costs see note 4.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

7. Tax credit

| | 2015 £m | 2014 £m |
|--|---------------|---------------|
| Current tax | | |
| UK corporation tax at 21% (2014: 23%) | 0.3 | 0.3 |
| Adjustments in respect of prior periods | (26.5) | (11.6) |
| Total current tax from continuing operations | (26.2) | (11.3) |
| Deferred tax | | |
| UK (credit)/charge for temporary differences arising and reversing in the year | (63.9) | 76.3 |
| Effect of change in tax rates | 3.0 | (36.1) |
| Adjustments in respect of prior periods | 10.5 | (48.6) |
| Total deferred tax on continuing activities (note 16) | (50.4) | (8.4) |
| Total tax credit on (loss)/profit from ordinary activities | (76.6) | (19.7) |
| Tax relating to items credited to other comprehensive income | | |
| Deferred tax: | | |
| Effect of change in rate of deferred tax on revaluation reserve | - | (39.5) |
| Revaluation of fixed assets | 46.8 | 3.4 |
| Tax charge/(credit) in the Group statement of comprehensive income | 46.8 | (36.1) |

The differences between the total current and deferred tax credit shown and the amount calculated by applying the rate of corporation tax of 21% (2014: 23%) to the (loss)/profit on ordinary activities before tax is as follows:

| | 2015 £m | 2014 £m |
|--|---------------|---------------|
| (Loss)/profit from continuing operations before taxation | (182.1) | 456.3 |
| Current and deferred tax on Group (loss)/profit on ordinary activities at the standard UK tax rate | (38.3) | 104.9 |
| Effects of: | | |
| Expenses not deductible for tax purposes | 5.5 | 4.7 |
| Income not taxable | (3.4) | (2.9) |
| Change in tax rate | 3.0 | (36.1) |
| Adjustments in respect of prior periods | (16.0) | (60.2) |
| Group relief received free of charge | (27.4) | (30.1) |
| Group current and deferred tax credit for the year | (76.6) | (19.7) |

The Finance Act 2013 introduced a reduction in the rate of corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015. These rates are substantively enacted and, therefore, are used in preparing these financial statements. No further changes to the corporation tax rate have been announced.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements *(continued)*
for the year ended 31 March 2015

7. Tax credit (continued)

The deferred tax credit for the year relates to the following:

| | 2015 £m | 2014 £m |
|--|---------------|--------------|
| Accelerated depreciation for tax purposes | (33.4) | (103.0) |
| Fair value adjustment of infrastructure assets | 55.5 | (2.6) |
| Financial instruments | (72.5) | 97.3 |
| Rollover relief | - | (0.1) |
| Deferred tax credit | (50.4) | (8.4) |

8. Dividends

| | 2015 £m | 2014 £m |
|------------------------|-------------|--------------|
| Total dividends | 78.4 | 155.3 |

During the year, dividends of £78.4m, £0.78m per share (2014: £155.3m, £1.55m per share), were declared and cash settled.

9. Intangible assets

| | Goodwill £m |
|---|----------------|
| Cost and net book value at 31 March 2015 and 31 March 2014 | 14.2 |

Goodwill arose on the transfer into Yorkshire Water of the trade and net assets of The York WaterWorks Limited on 1 April 2000. The directors do not believe this should be impaired as it relates to assets which are still in continuing use within the business.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

10. Property, plant and equipment

| | Land and buildings £m | Infrastructure assets £m | Plant and equipment £m | Under construction £m | Group total £m |
|---|-----------------------------|--------------------------------|------------------------------|-----------------------------|----------------------|
| Cost or valuation | | | | | |
| At 1 April 2014 | 1,733.1 | 3,553.6 | 2,954.7 | 436.9 | 8,678.3 |
| Additions at cost | - | 14.7 | 19.2 | 285.7 | 319.6 |
| Grants and contributions | - | - | - | (18.4) | (18.4) |
| Transfers on commissioning | 75.5 | 159.0 | 188.3 | (422.8) | - |
| Revaluation | - | 74.3 | - | - | 74.3 |
| Disposals | (12.3) | - | (67.7) | - | (80.0) |
| At 31 March 2015 | 1,796.3 | 3,801.6 | 3,094.5 | 281.4 | 8,973.8 |
| Accumulated depreciation | | | | | |
| At 1 April 2014 | 447.1 | 122.6 | 1,636.8 | - | 2,206.5 |
| Revaluation | - | (160.3) | - | - | (160.3) |
| Charge for the year | 34.2 | 37.7 | 152.3 | - | 224.2 |
| Disposals | (11.2) | - | (67.5) | - | (78.7) |
| At 31 March 2015 | 470.1 | - | 1,721.6 | - | 2,191.7 |
| Net book amount at 31 March 2015 | 1,326.2 | 3,801.6 | 1,372.9 | 281.4 | 6,782.1 |

During the year the Group capitalised borrowing costs amounting to £30.8m (2014: £30.6m) on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings of 3.94% (2014: 3.97%).

| | Land and buildings £m | Infrastructure assets £m | Plant and equipment £m | Under construction £m | Group total £m |
|---|-----------------------------|--------------------------------|------------------------------|-----------------------------|----------------------|
| Cost or valuation | | | | | |
| At 1 April 2013 | 1,635.1 | 3,418.6 | 2,786.8 | 469.1 | 8,309.6 |
| Additions at cost | 63.3 | 124.6 | 137.6 | 58.9 | 384.4 |
| Grants and contributions | - | - | - | (11.8) | (11.8) |
| Transfers on commissioning | 24.0 | 10.4 | 44.4 | (78.8) | - |
| Revaluation | 14.6 | - | - | - | 14.6 |
| Disposals | (3.9) | - | (14.1) | (0.5) | (18.5) |
| At 31 March 2014 | 1,733.1 | 3,553.6 | 2,954.7 | 436.9 | 8,678.3 |
| Accumulated depreciation | | | | | |
| At 1 April 2013 | 421.1 | 63.2 | 1,502.9 | - | 1,987.2 |
| Revaluation | (2.6) | - | - | - | (2.6) |
| Impairment | 0.9 | - | - | - | 0.9 |
| Charge for the year | 30.7 | 59.4 | 147.7 | - | 237.8 |
| Disposals | (3.0) | - | (13.8) | - | (16.8) |
| At 31 March 2014 | 447.1 | 122.6 | 1,636.8 | - | 2,206.5 |
| Net book amount at 31 March 2014 | 1,286.0 | 3,431.0 | 1,317.9 | 436.9 | 6,471.8 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

10. Property, plant and equipment (continued)

Assets included above held under finance leases amount to:

| | Land and buildings £m | Infrastructure assets £m | Plant and equipment £m | Group total £m |
|---|-----------------------------|--------------------------------|------------------------------|----------------------|
| Cost | 108.6 | 71.3 | 181.4 | 361.3 |
| Accumulated depreciation | (37.1) | (27.1) | (138.6) | (202.8) |
| Net book amount at 31 March 2015 | 71.5 | 44.2 | 42.8 | 158.5 |
| Net book amount at 31 March 2014 | 73.3 | 45.5 | 48.4 | 167.2 |

The Group's infrastructure assets were valued at 31 March 2015. These valuations were performed in accordance with IAS 16 'Property, Plant and Equipment' which requires that assets subject to a policy of revaluation should be carried at their fair value less any subsequent accumulated depreciation and accumulated impairment losses.

IAS 16 allows, where market based evidence of fair value is not available due to the specialised nature of the items of property plant and equipment, an entity to estimate fair value using an income approach. Having considered the requirement of IAS 16, Management concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a UK water company is a two-step approach:

- Estimating the business value in use ('VIU'), using a discounted cash flow ('DCF') model excluding outperformance against Ofwat's targets to determine the business enterprise value. Excluding forecast outperformance against the regulatory allowance is a proxy for excluding any goodwill that a purchaser would pay for the business. The enterprise value was then cross-checked against the Regulatory Capital Value ('RCV'); and
- Allocating the VIU of the business (less relevant working capital balances) to individual classes of tangible fixed assets.

Such valuations were incorporated into the financial statements and the resulting revaluation adjustments taken to the revaluation reserve. This resulted in an increase in the valuation, before tax of £234.6m.

Certain categories of the Group's land and buildings are also held at valuation, on the basis of existing use, and were valued by independent qualified valuers in March 2014.

The valuations were undertaken in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors in the UK by the following surveyors:

| | |
|---------------------------|--------------------------------|
| Non-specialist properties | DTZ Debenham Tie Leung Limited |
| Rural estates | Carter Jones LLP |
| Residential properties | Savills (L&P) Limited |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

10. Property, plant and equipment (continued)

These external valuations will be re-performed on a periodic basis. An interim valuation is booked in intervening years based on directors' valuations. As a result of the valuation carried out at 31 March 2014 the carrying value of land and buildings was increased by £17.2m and the resulting revaluation surplus taken to the revaluation reserve together with an associated deferred tax impact of £3.4m. As a result of the same revaluation certain properties were impaired and an impairment loss of £0.9m was recognised in the profit and loss. The calculations carried out at 31 March 2014 have been reviewed at 31 March 2015 by the directors, who concluded that current book values are not materially different to current market values.

If the revalued assets were stated on a historical cost basis, the historic cost before depreciation would be £3,573.3m (2014: £3,320.1m).

Categories of assets revalued are as follows:

| | Revalued amount £m | Historical cost basis £m |
|--|--------------------------|--------------------------------|
| Infrastructure assets | 3,801.6 | 2,323.8 |
| Non-specialist properties | 18.1 | 15.2 |
| Rural estates | 59.0 | 0.5 |
| Residential properties | 3.0 | - |
| Net book amount of asset revalued | 3,881.7 | 2,339.5 |

Analysis of the net book value of revalued land and building is as follows:

| | Revalued amount £m | Historical cost basis £m |
|---|--------------------------|--------------------------------|
| 31 March 2013 | 67.5 | 17.1 |
| Additions to revalued assets | 0.4 | 0.4 |
| Valuation surplus recognised during the year (net of impairment) | 16.3 | - |
| Disposal of revalued assets | (1.5) | (0.3) |
| Aggregate depreciation | (0.7) | (0.4) |
| 31 March 2014 | 82.0 | 16.8 |
| Disposal of revalued assets | (1.1) | (0.6) |
| Transfer to the profit and loss account in respect of additional depreciation incurred on revaluation | (0.8) | (0.5) |
| 31 March 2015 | 80.1 | 15.7 |

Analysis of the net book value of revalued infrastructure assets is as follows:

| | Revalued amount £m | Historical cost basis £m |
|------------------------|--------------------------|--------------------------------|
| At cost | 3,801.6 | 3,544.8 |
| Aggregate depreciation | - | (1,221.0) |
| 31 March 2015 | 3,801.6 | 2,323.8 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

11. Inventories

| | 2015 | 2014 |
|-------------------------------|------|------|
| | £m | £m |
| Raw materials and consumables | 1.3 | 0.8 |

12. Trade and other receivables

| | 2015 | 2014 |
|--|---------|---------|
| | £m | £m |
| Amounts falling due within one year: | | |
| Trade receivables | 120.0 | 116.2 |
| Provision for impairment of trade receivables | (28.0) | (26.2) |
| Prepayments and accrued income | 69.9 | 65.5 |
| Amounts owed by Group companies | 17.7 | 19.5 |
| Other tax and social security | 7.4 | 6.9 |
| Other receivables | 1.3 | 3.8 |
| | 188.3 | 185.7 |
| Amounts falling due after more than one year: | | |
| Amounts owed by Group companies | 1,256.9 | 1,265.0 |

All receivables are reviewed regularly to assess any associated credit risk. There are no significant concentrations of credit risk. Any impairment considered necessary has been made to the amounts included above. See note 19 for further details of credit risks associated with financial instruments.

Amounts owed by Kelda Group companies within one year and after more than one year include £256.0m (2014: £264.1m) in respect of the fair value of index linked swaps at the date of novation from Saltaire Water Limited to Yorkshire Water in August 2008 and £1,009.0m (2014: £1,009.0m) of upstream loans to Kelda Eurobond Limited.

Trade receivables can be analysed as follows:

| | 2015 | 2014 |
|--|-------|-------|
| | £m | £m |
| Main charges trade receivables: | | |
| Past due but not impaired | 80.2 | 78.7 |
| Past due and impaired | 26.5 | 24.9 |
| Other trade receivables: | | |
| Past due but not impaired | 11.8 | 11.3 |
| Past due and impaired | 1.5 | 1.3 |
| | 120.0 | 116.2 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

12. Trade and other receivables (continued)

The ageing of trade receivables classed as past due but not impaired is as follows:

| | 2015 £m | 2014 £m |
|--|-------------|-------------|
| Main charges trade receivables: | | |
| Less than one year overdue | 53.3 | 53.6 |
| Between one and two years overdue | 15.2 | 13.9 |
| Between two and three years overdue | 6.5 | 6.0 |
| Between three and four years overdue | 2.9 | 2.8 |
| More than four years overdue | 2.3 | 2.4 |
| Other trade receivables: | | |
| Less than one year overdue | 11.8 | 11.3 |
| | 92.0 | 90.0 |

The ageing of trade receivables classed as past due and impaired is as follows:

| | 2015 £m | 2014 £m |
|--|-------------|-------------|
| Main charges trade receivables: | | |
| Less than one year overdue | 10.3 | 10.2 |
| Between one and two years overdue | 6.0 | 5.4 |
| Between two and three years overdue | 4.2 | 3.7 |
| Between three and four years overdue | 3.2 | 2.9 |
| More than four years overdue | 2.8 | 2.7 |
| Other trade receivables: | | |
| Less than one year overdue | 1.5 | 1.3 |
| | 28.0 | 26.2 |

The movement in the provision for impairment of trade receivables is as follows:

| | 2015 £m | 2014 £m |
|------------------------------|-------------|-------------|
| Provision brought forward | 26.2 | 25.5 |
| Provision for impairment | 19.9 | 18.4 |
| Amounts written off | (18.1) | (17.7) |
| Provision at 31 March | 28.0 | 26.2 |

In all cases, the fair value of trade and other receivables is considered to be the carrying value as stated above.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

13. Financing

(i) Cash and cash equivalents

| | 2015 £m | 2014 £m |
|---------------------------|-------------|-------------|
| Cash and cash equivalents | 23.3 | 27.5 |
| Short-term deposits | 13.7 | 2.7 |
| | 37.0 | 30.2 |

At 31 March 2015, the Group had available £825.4m (2014: £650.3m) of undrawn committed borrowing facilities.

(ii) Borrowings

| Current : | 2015 £m | 2014 £m |
|--|--------------|--------------|
| Bank borrowings | 41.0 | 191.6 |
| Bank borrowings under Kelda Finance facility | 65.0 | 65.0 |
| Finance lease liabilities | 34.1 | 28.9 |
| | 140.1 | 285.5 |

| Non-current : | 2015 £m | 2014 £m |
|--|----------------|----------------|
| Bank borrowings | 277.1 | 306.2 |
| Fixed rate guaranteed bonds due in less than 5 years | 722.4 | 447.9 |
| Fixed rate guaranteed bonds due in more than 5 years | 1,778.6 | 1,898.5 |
| Index linked guaranteed bonds due in more than 5 years | 1,208.7 | 1,193.7 |
| Fixed rate US Dollar bonds due in less than 5 years | 28.2 | 29.4 |
| Fixed rate US Dollar bonds due in more than 5 years | 285.8 | 236.7 |
| Fixed rate AUS Dollar bonds due in more than 5 years | 28.3 | 27.3 |
| RPI uplift on index linked swaps | 149.7 | 107.7 |
| Finance lease liabilities | 199.9 | 234.0 |
| | 4,678.7 | 4,481.4 |

Fixed rate guaranteed bonds due in less than 5 years are made up of:

6% guaranteed bonds 2017 £448.5m (2014: £447.9m)

These bonds are repayable in one sum on 19 August 2017. The interest is charged at 6%.

6% guaranteed bonds 2019 £273.9m (2014: £273.6m)

These bonds are repayable in one sum on 21 August 2019. Interest is charged at 6%.

Fixed rate guaranteed bonds due in more than 5 years are made up of:

6.5876% guaranteed bonds 2023 (Exchange bonds) £211.8m (2014: £197.0m)

These bonds are repayable in one sum on 21 February 2023. Interest is charged at 6.5876%.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

13. Financing (continued)

5.375% guaranteed bonds 2023 (Stranded bonds) £4.5m (2014: £4.3m)

These bonds are repayable in one instalment on 21 February 2023. Interest is charged at 5.375%.

5.5% guaranteed bonds 2027 (Stranded bonds) £6.4m (2014: £6.3m)

These bonds are repayable in one instalment on 28 May 2027. Interest is charged at 5.5%.

6.454% guaranteed bonds 2027 (Exchange bonds) £135.5m (2014: £124.6m)

These bonds are repayable in one sum on 28 May 2027. Interest is charged at 6.454%.

6.6011% guaranteed bonds 2031 (Exchange bonds) £255.0m (2014: £262.9m)

These bonds are repayable in one sum on 17 April 2031. Interest is charged at 6.6011%.

6.625% guaranteed bonds 2031 (Stranded bonds) £0.7m (2014: £0.7m)

These bonds are repayable in one sum on 17 April 2031. Interest is charged at 6.625%.

5.5% guaranteed bonds 2037 £195.2m (2014: £182.2m)

These bonds are repayable in one instalment on 28 May 2037. Interest is charged at 5.5%.

6.375% guaranteed bonds 2039 £304.8m (2014: £305.3m)

These bonds are repayable in one sum on 19 August 2039. The interest is charged at 6.375%.

5.75% guaranteed bonds 2020 £197.1m (2014: £196.7m)

These bonds were taken out on 6 February 2013 and are repayable in one sum on 17 February 2020. The interest is charged at 5.75%.

3.625% guaranteed bonds 2029 £266.2m (2014: £227.9m)

These bonds were issued on 1 August 2012 are repayable in one instalment on 1 August 2029. The interest is charged at 3.625%.

4.965% Class B guaranteed bonds 2033 £101.5m (2014: £86.2)

These bonds were issued in May 2013 and are repayable in one instalment on 12 December 2033. The interest is charged at 4.965%.

3.54% guaranteed bonds 2029 £99.9m

These bonds were issued on 30 October 2014 and are repayable in one instalment on 30 October 2029. The interest is charged at 3.54%.

Index linked guaranteed bonds due in more than 5 years are made up of:

3.3066% index linked guaranteed bonds 2033 (Exchange bonds) £147.0m (2014: £166.6m)

These bonds are repayable in one instalment on 29 July 2033. The interest is charged at 3.3066% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

2.718% index linked guaranteed bonds 2039 £324.9m (2014: £322.2m)

These bonds are repayable in one instalment on 30 December 2039. The interest is charged at 2.718% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

13. Financing (continued)

2.16% % index linked guaranteed bonds 2041 £53.4m (2014: £52.8m)

These bonds are repayable in one instalment on 30 December 2041. The interest is charged at 2.16% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.8225% index linked guaranteed bonds 2050 £80.7m (2014: £67.6m)

These bonds are repayable in one instalment on 1 February 2050. The interest is charged at 1.8225% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.462% index linked guaranteed bonds 2051 £159.8m (2014: £115.4m)

These bonds are repayable in one instalment on 1 August 2051. The interest is paid at 1.462% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.758% index linked guaranteed bonds 2054 £105.7m (2014: £86.1m)

These bonds are repayable in one instalment on 1 February 2054. The interest is charged at 1.758% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.46% index linked guaranteed bonds 2056 £159.8m (2014: £118.0m)

These bonds are repayable in one instalment on 1 August 2056. The interest is paid at 1.46% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.709% index linked guaranteed bonds 2058 £124.2m (2014: £98.8m)

These bonds are repayable in one instalment on 1 February 2058. The interest is charged at 1.709% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

1.803% index linked guaranteed bonds 2042 £53.2m (2014: £52.4m)

These bonds were issued on 22 May 2012 are repayable in one instalment on 22 May 2042. The interest is charged at 1.803% multiplied by an index ratio and the principal amount is increased semi-annually in line with the retail price index.

The Group has an early repayment option on all of the above bonds, subject to the agreement of the issuer.

Fixed rate US Dollar bonds

During the financial year ended 31 March 2012 the Yorkshire Water Services group of companies raised \$455m of US bonds in tranches with durations of 7, 10, 12 and 15 years, incurring fixed rate interest charges at rates from 3.18% to 5.07%, as follows:

- \$30m fixed rate bonds expiring in 2018 carrying fixed rate interest at 3.18%; and
- \$115m fixed rate bonds expiring in 2021 carrying fixed rate interest at 3.77%.

The above bonds were issued on 13 December 2011.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

13. Financing (continued)

- \$15m fixed rate bonds expiring in 2019 carrying fixed rate interest at 3.18%;
- \$40m fixed rate bonds expiring in 2022 carrying fixed rate interest at 3.77%;
- \$75m fixed rate bonds expiring in 2022 carrying fixed rate interest at 5.07%;
- \$150m fixed rate bonds expiring in 2023 carrying fixed rate interest at 3.87%; and
- \$30m fixed rate bonds expiring in 2024 carrying fixed rate interest at 3.87%.

The above bonds were issued on 5 January 2012.

The Group hedges the fair value of the dollar bonds 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 sterling floating rate interest payments (see note 19 for more details).

Fixed rate Australian Dollar bonds

In May 2013 Yorkshire Water Services Bradford Finance Limited raised AU\$50m of Australian dollar fixed rate bonds. These are repayable in one lump sum on 15 August 2023 and attract interest at 5.875%.

Bank loans

Bank loans within long term borrowings relates to facilities held with European Investment Bank, repayable as £29.4m (1 - 2 years), £116.3m (2 - 5 years) and £131.4m (more than 5 years).

Short and long term bank loans are held in sterling and bear interest at normal commercial rates. The weighted average interest rates associated with the bank loans were 3.94% (2014: 3.97%).

(iii) Finance leases

| | Minimum lease payments | Minimum lease payments |
|---|-------------------------------|------------------------|
| | 2015 | 2014 |
| | £m | £m |
| Amounts payable under finance leases: | | |
| No later than 1 year | 49.4 | 42.5 |
| Later than 1 year and no later than 5 years | 160.7 | 194.4 |
| Later than 5 years | 100.7 | 131.6 |
| | 310.8 | 368.5 |
| Less: future finance charges on finance lease liabilities | (76.8) | (105.6) |
| Present value of lease obligations | 234.0 | 262.9 |
| Amount due for settlement within 12 months | 34.1 | 28.9 |
| Amount due for settlement after 12 months | 199.9 | 234.0 |
| | 234.0 | 262.9 |

All lease obligations are denominated in sterling.

The weighted average lease term is 10.0 years (2014: 11.0 years). For the year ended 31 March 2015 the average effective borrowing rate was 1.8% (2014: 1.8%). All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

14. Trade and other payables

| | 2015 | 2014 |
|--|--------------|--------------|
| | £m | £m |
| Amounts falling due within one year: | | |
| Trade payables | 56.8 | 52.8 |
| Capital payables | 68.4 | 64.4 |
| Social security and other taxes | 1.9 | 1.9 |
| Receipts in advance | 55.5 | 56.7 |
| Amounts owed to Group companies | 10.8 | 7.9 |
| Interest payable | 107.1 | 103.7 |
| Deferred income | 161.9 | 161.9 |
| Other payables | 31.0 | 10.5 |
| | 493.4 | 459.8 |
| Amounts falling due after more than one year: | | |
| Interest payable | 30.0 | 42.7 |
| Other payables | 1.4 | 1.6 |
| | 31.4 | 44.3 |

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs. The directors consider that the carrying amount of trade and other payables approximate to their fair value.

Amounts owed to group companies are in relation to trading balances and are repayable on demand.

15. Provisions for other liabilities and charges

| | £m |
|---|------------|
| At 31 March 2015 and at 1 April 2014 | 0.7 |

Certain subsidiaries of the Group operate a self-insurance policy. Provisions relate to estimated liabilities relating to self-insured claims, including an estimate for claims incurred but not reported.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

16. Deferred tax liabilities

| | Accelerated capital allowances £m | Fair value adjustment of infrastructure assets £m | Fair value adjustment of land and buildings £m | Roll-over relief £m | Financial instruments £m | Total £m |
|--|--|---|--|---------------------------|--------------------------------|--------------|
| At 1 April 2013 | 560.3 | 45.3 | 303.6 | 0.8 | (372.2) | 537.8 |
| Transfer on capitalisation of revaluation reserve | - | 303.6 | (303.6) | - | - | - |
| (Credit)/charge to income statement | (103.0) | (2.6) | - | (0.1) | 97.3 | (8.4) |
| (Credit)/charge to equity | - | (39.5) | 3.4 | - | - | (36.1) |
| At 1 April 2014 | 457.3 | 306.8 | 3.4 | 0.7 | (274.9) | 493.3 |
| Adjustment to classification | 47.3 | (47.3) | - | - | - | - |
| (Credit)/charge to income statement | (33.4) | 55.5 | - | - | (72.5) | (50.4) |
| (Credit)/charge to equity | - | 46.8 | - | - | - | 46.8 |
| At 31 March 2015 | 471.2 | 361.8 | 3.4 | 0.7 | (347.4) | 489.7 |

17. Pensions

(i) Defined benefit scheme

The parent group sponsors a UK pension scheme, called the Kelda Group Pension Plan (KGPP). This scheme was previously sponsored by Kelda Group Limited (formerly Kelda Group plc) before its acquisition by Saltaire Water Limited. The KGPP has a number of benefit categories providing benefits on a defined benefit basis and a defined contribution basis.

The majority of members paid contributions over the year ended 31 March 2015 at rates of 5%, 6%, 7%, or 8.5% of pensionable pay (depending on benefit category). The majority of members pay contributions through a salary sacrifice arrangement. The Group contributed 14.6% of pensionable pay. The Group also paid lump sum deficit contributions of £1m per month in the year to 31 March 2015.

An accrual for unfunded benefits of £3.9m (2014: £3.2m) has been included in the Group's financial statements at 31 March 2015.

The sponsoring employer of the KGPP is Kelda Group Limited, a subsidiary of Kelda Holdings Limited. As there is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole as measured in accordance with IAS 19 (Revised) to individual Group entities, Kelda Finance (No. 1) Group recognises a cost equal to the contributions made by its subsidiaries.

Details of the major assumptions and scheme assets and liabilities of the KGPP can be found below.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

17. Pensions (continued)

(ii) Major assumptions

Pension contributions are determined with the advice of independent qualified actuaries, Mercer Limited, on the basis of annual valuations using the projected unit credit method.

| | 2015 % | 2014 % |
|---|-----------|-----------|
| Inflation (RPI) | 2.95 | 3.35 |
| Rate of increase in salaries | 3.95 | 4.35 |
| Discount rate for scheme liabilities | 3.30 | 4.55 |
| Life expectancy for a male pensioner aged 60 (in years) | 26.6 | 26.6 |
| Projected life expectancy at age 60 for male aged 40 (in years) | 28.5 | 28.6 |

(iii) Scheme assets and liabilities

Scheme assets are stated at their bid values at the respective balance sheet dates.

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class.

| | 2015 £m | 2014 £m |
|-------------------------------------|------------|------------|
| Fair value of scheme assets | | |
| Equities | 203.7 | 242.9 |
| Bonds | 290.8 | 325.3 |
| Property | 74.8 | 82.4 |
| Other | 739.1 | 417.7 |
| Total value of assets | 1,308.4 | 1,068.3 |
| Present value of scheme liabilities | (1,395.9) | (1,161.3) |
| Pension liability | (87.5) | (93.0) |

(iv) Defined contribution scheme

The Group ran two defined contribution schemes for its employees. These were closed to new members on 30 September 2007 and replaced by one defined contribution scheme on 1 October 2007. The total charged to the income statement for the defined contribution schemes for the year ended 31 March 2015 was £2.0m (2014: £1.7m).

18. Ordinary shares

| | 2015 £ | 2014 £ |
|---|-----------|-----------|
| Issued and fully paid: 100 (2014: 100) Ordinary shares of £1.00 each | 100 | 100 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments

The disclosures below exclude short term receivables and payables which are primarily of a trading nature and expected to be settled within normal commercial terms.

Net debt and financial liabilities comprise the following:

| | 2015 Less than one year £m | 2015 More than one year £m | 2015 Total £m | 2014 Less than one year £m | 2014 More than one year £m | 2014 Total £m |
|---|---|---|------------------------------|---|---|------------------------------|
| Financial assets: | | | | | | |
| Fixed to floating interest rate swaps | - | 39.0 | 39.0 | - | - | - |
| Combined cross currency interest rate swaps | - | 28.8 | 28.8 | - | - | - |
| | - | 67.8 | 67.8 | - | - | - |
| Financial liabilities: | | | | | | |
| Finance lease interest swaps | - | (24.2) | (24.2) | - | (15.7) | (15.7) |
| Index linked swaps | - | (1,708.6) | (1,708.6) | - | (1,338.7) | (1,338.7) |
| Combined cross currency interest rate swaps | - | (6.5) | (6.5) | - | (30.7) | (30.7) |
| Energy derivative | - | - | - | (5.7) | (0.7) | (6.4) |
| Fixed to floating interest rate swaps | - | - | - | - | (29.3) | (29.3) |
| | - | (1,739.3) | (1,739.3) | (5.7) | (1,415.1) | (1,420.8) |
| Net debt: | | | | | | |
| Cash and short term deposits | 37.0 | - | 37.0 | 30.2 | - | 30.2 |
| Loans receivable from Group companies | - | 1,009.0 | 1,009.0 | - | 1,009.0 | 1,009.0 |
| Borrowings | (140.1) | (4,678.7) | (4,818.8) | (285.5) | (4,481.4) | (4,766.9) |
| | (103.1) | (3,669.7) | (3,772.8) | (255.3) | (3,472.4) | (3,727.7) |

Cash and short term deposits were invested with a range of counterparties; either AAA rated sterling liquidity funds or banks with a rating of at least long term A, short term A1/P1, in accordance with approved investment guidelines.

The Group has made a provision for the mark to market loss of £1,858.3m (2014: £1,446.4m) on index linked swaps. £1,708.6m (2014: £1,338.7m) is shown as index linked swaps as in the table above; the remaining £149.7m (2014: £107.7m) is shown within borrowings in note 13.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

(a) Interest rate risk profile of financial assets and liabilities

The interest rate risk profile of the Group's financial assets and liabilities at 31 March 2015 is below. This includes interest payable or receivable in the period as well as the principal repayments. It is assumed that LIBOR and indexation remain constant at the year end position.

Period ended 31 March 2015

| | Within 1 year £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m | Total £m |
|---|------------------------|--------------------|--------------------|--------------------|--------------------|-------------------------------|----------------|
| Financial liabilities and borrowings | | | | | | | |
| Fixed rate | | | | | | | |
| Bank loans | 36.8 | 35.7 | 34.6 | 23.7 | 23.1 | 27.5 | 181.4 |
| Guaranteed bonds | 134.4 | 134.4 | 559.2 | 107.4 | 571.1 | 2,302.5 | 3,809.0 |
| US Dollar bonds | 11.3 | 11.3 | 11.3 | 39.4 | 10.4 | 284.4 | 368.1 |
| Other interest rate swaps | 3.1 | 3.2 | 3.2 | 3.3 | 3.3 | 29.0 | 45.1 |
| Finance lease swaps | 2.3 | 2.2 | 2.0 | 1.9 | 1.9 | 20.7 | 31.0 |
| | 187.9 | 186.8 | 610.3 | 175.7 | 609.8 | 2,664.1 | 4,434.6 |
| Floating rate | | | | | | | |
| Index linked guaranteed bonds | 24.7 | 24.7 | 24.7 | 24.7 | 24.7 | 1,753.7 | 1,877.2 |
| US Dollar bonds | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 78.8 | 84.8 |
| Guaranteed bonds | 9.6 | 9.6 | 9.6 | 9.6 | 9.6 | 312.3 | 360.3 |
| Bank loans | 6.5 | 6.9 | 85.1 | 19.3 | 19.0 | 118.8 | 255.6 |
| Combined cross currency interest rate swaps | 7.4 | 7.4 | 7.4 | 7.4 | 7.4 | 19.0 | 56.0 |
| Index linked swaps | 51.4 | 31.8 | 116.5 | 57.2 | 31.8 | 1,656.9 | 1,945.6 |
| Fair value interest rate swaps | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 106.5 | 151.5 |
| Finance leases | 49.4 | 113.6 | 11.7 | 15.6 | 20.1 | 100.6 | 311.0 |
| | 159.2 | 204.2 | 265.2 | 144.0 | 122.8 | 4,146.6 | 5,042.0 |
| Non-interest bearing financial liabilities | | | | | | | |
| Trade payables | 56.8 | - | - | - | - | - | 56.8 |
| Other payables | 261.1 | - | - | - | - | - | 261.1 |
| | 317.9 | - | - | - | - | - | 317.9 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

Period ended 31 March 2014

| | Within 1 year £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m | Total £m |
|---|------------------------|--------------------|--------------------|--------------------|--------------------|-------------------------------|----------------|
| Financial liabilities and borrowings | | | | | | | |
| Fixed rate | | | | | | | |
| Bank loans | 264.9 | 36.8 | 35.7 | 34.6 | 23.7 | 50.6 | 446.3 |
| Guaranteed bonds | 133.7 | 133.7 | 133.7 | 558.4 | 106.7 | 2,859.9 | 3,926.1 |
| US Dollar bonds | 11.3 | 11.3 | 11.3 | 11.3 | 39.4 | 294.8 | 379.4 |
| Other interest rate swaps | 3.1 | 3.2 | 3.2 | 3.3 | 3.3 | 29.0 | 45.1 |
| Finance lease swaps | 2.3 | 2.0 | 1.6 | 1.4 | 1.3 | 15.1 | 23.7 |
| | 415.3 | 187.0 | 185.5 | 609.0 | 174.4 | 3,249.4 | 4,820.6 |
| Floating rate | | | | | | | |
| Index linked guaranteed bonds | 23.9 | 23.9 | 23.9 | 23.9 | 23.9 | 1,749.5 | 1,869.0 |
| US Dollar bonds | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 79.1 | 84.6 |
| Guaranteed bonds | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 | 198.2 | 230.7 |
| Bank loans | 3.5 | 4.3 | 5.5 | 6.2 | 21.1 | 159.6 | 200.2 |
| Combined cross currency interest rate swaps | 7.4 | 7.4 | 7.4 | 7.4 | 7.4 | 25.2 | 62.2 |
| Index linked swaps | 32.0 | 32.0 | 133.9 | 93.3 | 32.0 | 1,899.0 | 2,222.2 |
| Fair value interest rate swaps | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 | 86.6 | 124.6 |
| Finance leases | 42.5 | 49.9 | 115.0 | 12.7 | 16.8 | 131.6 | 368.5 |
| | 124.5 | 132.7 | 300.9 | 158.7 | 116.4 | 4,328.8 | 5,162.0 |
| Non-interest bearing financial liabilities | | | | | | | |
| Trade payables | 52.8 | - | - | - | - | - | 52.8 |
| Other payables | 238.9 | - | - | - | - | - | 238.9 |
| | 291.7 | - | - | - | - | - | 291.7 |

(b) Financial risks

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide benefits to stakeholders, returns to owners and to maintain an optimal capital structure. In order to do this, the Group will consider the amount of debt and assets held and their liquidity.

When monitoring capital risk, the Group considers its interest cover measures and its gearing and the ratio of net debt to RCV.

Centrally managed funds are invested entirely with counterparties whose credit rating is 'A-' or better.

Maximum exposure relating to financial assets is represented by carrying value as at the balance sheet date.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

19. Financial instruments (continued)

Credit risk

The Group has some exposure to credit risk through the holding of receivables on the year end balance sheet. These can be split into main charges receivables and other trade receivables.

Risks associated with main charges receivables include limits on the Group's ability to restrict supply. However, this does not apply to all receivables. The credit risk is mitigated by introducing payment plans, providing advice and support to customers where this is viable and where it is considered necessary, using legal procedures to reclaim outstanding debts.

Risks associated with other trade receivables are mitigated by credit checks performed on customers before they are supplied, the cessation of supply to customers who are a high credit risk and payment in advance where this is deemed necessary.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value. The amounts presented in the balance sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

The Group's objective is to manage the risk by minimising the amount of overdue debt at any time. The Group manages the risk by timely review of the ageing profile and employing specific staff to monitor and collect these debts. The risk is measured by monitoring of overdue receivables.

In respect of credit risk arising from the other financial assets of the Group – which comprise cash, investments in the equity of other companies such as joint ventures and other receivables and financial assets in relation to concession arrangements – the Group's exposure to credit risk arising from default of the counterparty, with a maximum exposure equal to the carrying value of these instruments.

At 31 March, the maximum exposure to credit risk for the Group and Company is represented by the carrying amount of each financial asset in the statement of financial position:

| | Group 2015 £m | Company 2015 £m | Group 2014 £m | Company 2014 £m |
|--|------------------------------|--------------------------------|------------------------------|--------------------------------|
| Cash and short term deposits (see note 13) | 37.0 | - | 30.2 | - |
| Trade and other receivables (see note 12) | 1,445.2 | - | 1,450.7 | - |
| Financial assets | 67.8 | - | - | - |
| Investments | - | 778.4 | - | 778.4 |

Liquidity risk

Liquidity risk is the risk that the Group will not have the level of liquid funding available to meet its requirements. Maintaining an inadequate amount of liquidity and being unable to access the debt markets when required exposes the Group to the risk of being unable to finance its functions, whilst maintaining excess liquidity potentially exposes the Group to the risk of inefficient funding costs.

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

19. Financial instruments (continued)

The Group looks to manage its liquidity by ensuring debt is held with a range of durations and the maturity profile is actively managed by the Group's treasury function. Existing bank covenants require the Group to keep a combination of available cash and banking facilities sufficient to cover anticipated capital expenditure, operating costs and interest costs for the succeeding 12 months. This is a rolling requirement. The Group extend the requirement to cover all other future outgoings. Further facilities are not expected to be required within the next year to comply with the above policy.

At 31 March 2015 the Group had £862.4m of available liquidity (2014: £680.5m) which comprised £37.0m available cash and short term deposits (2014: £30.2m) and £825.4m of undrawn committed borrowing facilities (2014: £650.3m).

The maturity profile on page 74 represents the forecast future contractual principal and interest cashflows in relation to the Group's financial liabilities and derivatives on an undiscounted basis. There is no material risk to the timing or value of payment of the amounts disclosed with the exception of changes to the RPI and LIBOR forecasts.

Market risk

Market risk is the risk that movements in market conditions, including inflation and interest rates will impact materially on the Group financial performance. The Group's exposure to market risks primarily results from its financial arrangements and the economic return which it is allowed on the regulatory capital value (RCV).

The Group uses a variety of financial instruments, including derivatives, in order to manage the exposure to these risks.

The Group's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The Group's floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swap contracts to hedge these exposures where appropriate.

The sensitivity of the Group's interest and borrowings to the above risks can be summarised as follows:

| | 2015 | 2014 |
|---|---------------|-----------|
| Impact on profit before tax | £m | £m |
| 1% increase in RPI leading to a decrease in profit | (28.6) | (43.0) |
| 1% decrease in RPI leading to an increase in profit | 28.6 | 43.0 |
| 1% increase in LIBOR leading to an increase in profit | (9.0) | 6.5 |
| 1% decrease in LIBOR leading to a decrease in profit | 8.5 | (6.5) |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements *(continued)*
for the year ended 31 March 2015

19. Financial instruments (continued)

(c) Fair values of financial assets and financial liabilities

The information set out below provides information about how the Group determines fair values of various financial assets and financial liabilities.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

Fair value of the Group's financial assets and financial liabilities that are measured at fair value on a recurring basis

Some of the Group's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used).

| Financial assets/ financial liabilities | Fair value as at 31 March | | Fair value hierarchy | Valuation technique(s) and key input(s) | Significant unobservable input(s) | Relationship of unobservable inputs to fair value |
|---|---|--|----------------------|--|---|---|
| | 2015 | 2014 | | | | |
| 1) Interest rate swaps, combined cross-currency swaps, fixed rate bonds, indexed linked swaps | Assets – £67.8m; Liabilities (designated for hedging) – £550.2m; and Liabilities (not designated for hedging) – £861.8m | Assets – £Nil Liabilities (designated for hedging) – £456.0m ; and Liabilities (not designated for hedging) – £1,446.4m | Level 2 | Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates, discounted at a rate that reflects own or counter-party credit risk. | | |
| 2) Interest rate swaps | Liabilities (not designated for hedging) – £1,020.7m | Liabilities (not designated for hedging) – £Nil | Level 3 | Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates, discounted at a rate that reflects the credit risk of various counterparties. | <ul style="list-style-type: none"> Counter-party cost of funding assumption. Assumptions relating to long-term credit beyond observable curves. | Unobservable inputs contribute on average to 17% of the fair value of level 3 instruments, equalling a total of £212.1m of the fair value included in the financial statements. |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

The following table provides the fair values of the Group's financial assets and liabilities at 31 March:

| | 2015 Level 1 £m | 2015 Level 2 £m | 2015 Level 3 £m | 2014 Level 1 £m | 2014 Level 2 £m |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Primary financial instruments financing the Group's operations | | | | | |
| Financial assets held at amortised cost | | | | | |
| Cash and short term deposits | (37.0) | - | - | (30.2) | - |
| Derivative financial assets designated as Fair Value Through Profit and Loss | | | | | |
| Fixed to floating interest rate swap assets | - | (39.0) | - | - | - |
| Cross-currency interest rate swaps | - | (28.8) | - | - | - |
| Financial liabilities designated as Fair Value Through Profit and Loss | | | | | |
| Fixed rate interest rate swaps in respect of finance leases | - | 24.2 | - | - | 15.7 |
| Combined cross currency interest rate fair value swaps (US dollar and AU dollar) | - | 6.5 | - | - | 30.7 |
| Fixed rate US dollar bonds | - | 313.9 | - | - | 266.1 |
| Fixed rate AU dollar bonds | - | 28.3 | - | - | 27.3 |
| Fixed rate sterling bonds | 266.2 | 201.4 | - | 231.1 | 86.9 |
| Fixed to floating interest rate swaps | - | - | - | - | 29.3 |
| Index linked swaps | - | 837.6 | 1,020.7 | - | 1,446.4 |
| Energy derivative | - | - | - | 6.4 | - |
| Financial liabilities held at amortised cost | | | | | |
| Fixed rate sterling bonds | 2,546.8 | 18.8 | - | 2,356.0 | - |
| Index linked sterling bonds | 393.8 | 1,032.1 | - | 1,042.5 | 105.8 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

Reconciliation of Level 3 fair value measurements of financial liabilities:

| | RPI swaps £m | Total £m |
|--------------------------|-----------------|----------------|
| Balance at 1 April 2014 | - | - |
| Total gains or losses: | | |
| - in profit or loss | 203.2 | 203.2 |
| Settlements | (19.6) | (19.6) |
| Transfers into Level 3 | 837.1 | 837.1 |
| Balance at 31 March 2015 | 1,020.7 | 1,020.7 |

The following table shows the sensitivity of fair values to reasonably possible alternative assumptions as at 31 March 2015:

| | Reflected in profit or loss | |
|---|-----------------------------|------------------------------|
| | Favourable change £m | Unfavourable change £m |
| Level 3 financial instrument assumptions: | | |
| 10 basis point change in counter-party funding assumption | 15.0 | (15.0) |
| 10 basis point change to credit curve assumption | 12.1 | (12.1) |

Inflation linked swaps

Under the inflation linked swaps disclosed above, YW has contracted to pay a fixed real rate on an inflation accreting notional and in return receives 6 month GBP LIBOR on a semi-annual basis. The contractual obligations of 61 of the 80 inflation linked swaps require YW to pay the inflation accretion of the notional amount at maturity as a single “bullet” payment. The remaining 19 require YW to make periodic payments of the inflation accretion on the notional amount throughout the life of each swap. The 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”), the first of which are effective in February 2018, and subsequently in February 2020, February 2023, and February 2025. Under the MTC the inflation linked swaps will automatically be terminated for a cash settlement amount at each MTC date unless both YW and the respective counterparty agree to extend the MTC date or restructure the existing transactions.

As at 31 March 2014, YW held a portfolio of 80 inflation linked swaps with a total fixed notional of £1,289 million and total fair value liability of £1,446 million.

As at 31 March 2015, YW held 70 inflation linked swaps with a total notional of £1,289 million and a total fair value of £1,858 million, of this £452 million of the total notional of the portfolio was subject to MTCs. The increase in the liability position during the year was predominately driven

Kelda Finance (No. 1) Limited

Notes to the Group financial statements (continued)

for the year ended 31 March 2015

19. Financial instruments (continued)

by a decrease in 6m GBP LIBOR as the amount receivable by YW on the LIBOR leg of the inflation linked swaps decreased and the lower nominal discount rates acted to worsen the inflation linked cash flows, especially the principal accretion element. This was slightly offset by the pay down of accretion as part of the transaction (noted below) to remove the MTC dates of £19.6m and a decrease in forward inflation rates.

Reflecting the increased complexity involved in valuing the inflation linked swap portfolio swaps (noted below), a new model has been developed to determine the fair value. Amongst other enhancements it assists in creating a more detailed calculation of the increased long term credit risk and the funding valuation adjustment elements of the calculation. £256.1m of the total fair value as at 31 March 2015 relates to the credit risk adjustment and funding valuation adjustment. Reflecting this model and the inputs involved some of the inflation linked swaps are now considered a level 3 valuation under IFRS13 and disclosed accordingly.

Movements in the fair value of index linked swaps in respect of borrowings of £411.9m were recognised in the income statement (2014: £282.6m). Of this movement a charge of £369.9 (2014: credit of £298.2m) is recognised in exceptional finance income, a charge of £61.6m (2014: £15.6m) is recognised in finance costs to accrue for the RPI bullet payment on the swaps and the remaining £19.6m was cash paid.

Interest rate swaps

Income from the movement in fair value of combined cross currency interest rate swaps of £53.0m was recognised in the income statement (2014: £49.7m charge), offset by the change in fair value of the associated bonds of £48.8m (2014: £49.4m). Of the change in fair value of associated bonds, £47.8m (2014: £43.0m) relates to Fixed US Dollar bonds. The remaining £1.0m (2014: £6.4m) change in fair value relates to the movement between the fair value of AUS Dollar bonds of £33.7m when issued during the year and the fair value of £28.3m at 31 March 2015 (2014: £28.4m).

Movements in the fair value of fixed to floating interest rate swaps of £68.3m was recognised in the income statement (2014: £22.0m), offset by the change in fair value of the associated bonds of £63.5m (2014: £16.8m). £38.1m (2014: £13.8m) of change in fair value of associated bonds relates to the 3.625% 2029 guaranteed bonds with a fair value of £266.2m (2014: £227.9m) at 31 March 2015. £15.2m (2014: £3.0m) change in fair value of associated bonds relates to the 4.965% 2033 Class B guaranteed bonds with a fair value of £101.5m (2014: £86.2) at 31 March 2015. The remaining £10.2m change in fair value of associated bonds relates to the 3.54% 2029 guaranteed bond issued during the year with a fair value of £99.9m at 31 March 2015. These bonds were valued at £89.7m (net of issue costs) when issued. All interest rate swaps have maturity dates in excess of five years.

Movements in the fair value of fixed rate swaps in respect of finance leases of a charge of £8.6m were recognised in the income statement as an exceptional item (2014: £5.9m credit).

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

(d) Hedges

The Group's policy is to hedge interest rate risk within approved board policies and guidelines.

Interest rate swaps are used to manage interest rate exposure under a policy that requires at least 85% of Yorkshire Water and Kelda Holdco Limited net debt to be fixed or index linked. At the financial year end the proportions were 110% and 105% respectively (2014: 110% and 105%).

Hedging of floating rate interest due on borrowings

The Group has a number of borrowing facilities with a number of counterparties on which interest is linked to LIBOR. It is therefore exposed to changes in LIBOR which could have a material effect on interest costs from year to year and over time.

In order to manage its exposure to movements in LIBOR, the Group has entered into a number of floating rate to index linked swaps and also a floating interest rate to fixed interest rate swap.

The nominal value of index linked swaps total £1,289.0m and have an average life of 25 years. The nominal value of the floating interest rate to fixed interest rate swaps is £45.0m with a remaining life of 16 years.

The hedging instruments are not a perfect cash flow hedge against changes in LIBOR as the dates and amounts of the swaps vary in some cases to the borrowings which they hedge.

Hedging of interest due under finance leases

The Group has a number of finance leases with a number of counterparties lasting from inception for periods up to 33 years. In most cases interest payable under the lease is set once a year in late March or early April based on 12 month LIBOR. The Group is therefore exposed to changes in 12 month LIBOR which could have a material effect on interest costs from year to year and over time. £59.2m of leases are reset semi-annually based on 6 month LIBOR.

In order to fix the interest cost on a proportion of its net debt, the Group has entered into a number of floating to fixed interest rate swaps.

The hedging instrument no longer meets the criteria to classify for hedge accounting as the cash flow hedge was assessed to be ineffective.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

Fair value hedges

Combined cross currency interest rate swap contracts, exchanging fixed rate interest for floating rate interest on the Group's US Dollar bonds, are designated and effective as fair value hedges in respect of interest rates and foreign currency risk. The Group has made a recognised and asset of £28.8m (2014: £23.1m provision) for the mark to market gain in the fair value of the combined cross currency interest rate swap instruments. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate movements and foreign currency exposure, the carrying amount of the bonds was adjusted for a fair value loss of £29.1m (2014: £43.0m gain) which was included in the income statement at the same time that the fair value of the combined cross currency interest rate swap was included in the income statement.

The group has a £33.8m combined cross currency interest rate swap contract, exchanging fixed rate interest for floating rate interest on an Australian dollar bond, which was designated as a fair value hedge of fixed rate bonds of the same value. The hedges were at least 95% effective in hedging the fair value exposure to interest rate movements. The Group has made a provision of £6.5m (2014: £7.6m) for the mark to market loss in the fair value of the combined cross currency interest rate swap instruments. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate movements and foreign currency exposure, the carrying amount of the bonds was adjusted for a fair value gain of £5.3m (2014: £6.5m) which was included in the income statement at the same time that the fair value of the combined cross currency interest rate swap was included in the income statement.

The Group has a £250m nominal fixed to floating interest rate swap which is designated as a fair value hedge of fixed rate bonds of the same value. The hedge was at least 95% effective in hedging the fair value exposure to interest rate movements. The Group has recognised an asset of £17.3m (2014: £23.7m loss) for the mark to market gain in the fair value of the fixed to floating interest rate swaps. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate, the carrying amount of the bonds was adjusted for a fair value loss of £19.2m (2014: £13.8m gain) which was included in the income statement at the same time that the fair value of the fixed to floating interest rate swap was included in the income statement.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

19. Financial instruments (continued)

The Group group has a £90m nominal fixed to floating interest rate swap which was designated as a fair value hedge of fixed rate bonds of the same value. The hedge was at least 95% effective in hedging the fair value exposure to interest rate movements. The Group has recognised an asset of £12.5m (2014: £5.6m provision) for the mark to market gain in the fair value of the fixed to floating interest rate swaps. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate, the carrying amount of the bonds was adjusted for a fair value loss of £12.5m (2014: £3.0m gain) which was included in the income statement at the same time that the fair value of the fixed to floating interest rate swap was included in the income statement.

During the year the Group entered into a £90m nominal fixed to floating interest rate swap which was designated as a fair value hedge of fixed rate bonds of the same value. During the year, the hedge was at least 95% effective in hedging the fair value exposure to interest rate movements. The Group has recognised an asset of £9.2m for the mark to market gain in the fair value of the fixed to floating interest rate swaps. The fair value movement in the year has been recognised in the income statement as an exceptional item as the instrument was nominated as fair value through profit and loss on inception in line with the prescribed treatment for fair value hedges. As, during the year and since inception, the hedge was at least 95% effective in hedging the fair value exposure to interest rate, the carrying amount of the bonds was adjusted for a fair value loss of £10.3m which was included in the income statement at the same time that the fair value of the fixed to floating interest rate swap was included in the income statement.

Foreign currency risk management

The Group has a number of long term interest bearing liabilities denominated in foreign currencies; consequently exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising combined cross currency interest rate swaps.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
for the year ended 31 March 2015

20. Post balance sheet event

During the year ended 31 March 2015 YW initiated the process to establish five transactions with three counterparties to restructure a portion of the inflation linked swap portfolio with a total fixed notional of £160m, which removed the MTCs effective in February 2018.

Two of these five transactions remove the MTC date for £44m of the inflation linked swaps with an MTC date effective February 2018 with a compensating increase in the real rate coupon. In addition, £10m of the inflation accretion outstanding was paid down by YW through this process. The completion of these two transactions occurred 2015 on 5 June 2015.

The remaining three transactions also remove the MTC date, but through a different structure for the remaining £116m of the total fixed notional inflation linked swap portfolio with MTCs effective February 2018. As part of this transaction, several inflation linked swaps were transferred into and amalgamated into one single inflation swap with each of the bank counterparties. Subsequently, a portion of the inflation linked cash flows have been novated to a Special Purpose Vehicle with the LIBOR linked cash flows and a portion of the inflation linked cash flows remaining with the transaction counterparty. The overall effect of the transaction was to leave YW party to inflation linked swaps with similar terms but with the removal of the MTC compensated by an increase in the real rate coupon. In addition £25m of the inflation accretion outstanding was paid down by YW through this process. As at 31 March 2015, £20m of the total fixed notional had been novated on similar terms and £19.6m of the inflation accretion outstanding had been paid down by YW. The novation of the inflation linked swaps and the removal of the MTC and compensating increase in the real rate coupon completed on 4 June 2015.

There was no impact on the fair value calculation through the transactions that had occurred at 31 March 2015.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements *(continued)*
for the year ended 31 March 2015

21. Additional cash flow information

Analysis of movement in net debt

| | At 1 April 2013 £m | Non-cash movements £m | Cash movements £m | At 1 April 2014 £m | Non-cash movements £m | Cash movements £m | At 31 March 2015 £m |
|------------------------------------|--------------------------|-----------------------------|-------------------------|-----------------------------|-----------------------------|-------------------------|------------------------------|
| Cash and cash equivalents | 38.9 | - | (8.7) | 30.2 | - | 6.8 | 37.0 |
| Debt due within one year | (265.6) | (28.5) | 37.5 | (256.6) | (46.4) | 197.0 | (106.0) |
| Finance leases due within one year | (8.2) | - | (20.7) | (28.9) | - | (5.2) | (34.1) |
| | (273.8) | (28.5) | 16.8 | (285.5) | (46.4) | 191.8 | (140.1) |
| Debt due after one year | (4,170.5) | 45.9 | (122.8) | (4,247.4) | (144.0) | (87.4) | (4,478.8) |
| Finance leases due after one year | (262.9) | - | 28.9 | (234.0) | - | 34.1 | (199.9) |
| | (4,433.4) | 45.9 | (93.9) | (4,481.4) | (144.0) | (53.3) | (4,678.7) |
| Total net debt | (4,668.3) | 17.4 | (85.8) | (4,736.7) | (190.4) | 145.3 | (4,781.8) |

Net debt does not include financial liabilities which are not considered to be part of the Group's borrowings.

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
as at 31 March 2015

20. Additional cash flow information (continued)

Cash generated by continuing operations as noted in the Group cash flow statement can be derived as follows:

| | 2015 £m | 2014 £m |
|---|--------------|--------------|
| (Loss)/profit from continuing operations before taxation | (182.1) | 456.3 |
| Finance income | (85.1) | (81.7) |
| Finance costs | 294.0 | 264.2 |
| Exceptional finance costs /(income) (non-cash) | 369.5 | (298.6) |
| Movements of fair value of derivative financial instrument (energy contracts) | (6.4) | 6.4 |
| Depreciation and amortisation of capital grants | 221.4 | 234.9 |
| Profit on disposal of property, plant and equipment | - | (5.9) |
| Impairment of property, plant and equipment | - | 0.9 |
| (Increase)/decrease in inventories | (0.5) | 0.4 |
| Decrease in trade and other receivables | 3.5 | 7.1 |
| Increase in trade and other payables | 9.7 | 1.8 |
| Movement in provisions | - | 0.1 |
| Other movements | (0.7) | 0.3 |
| Cash generated from continuing operations | 623.3 | 586.2 |

22. Commitments

| | 2015 £m | 2014 £m |
|------------------------------|------------|------------|
| Contracts placed at 31 March | 279.2 | 331.3 |

The long-term investment programme for the UK regulated water services business, which identified substantial future capital expenditure commitments in the period 1 April 2015 to 31 March 2020, was agreed as part of the Price Review process which was finalised in December 2014.

At 31 March the Group was committed to making the following payments under non cancellable operating leases as set out below.

The Group has entered into commercial leases on certain property, motor vehicles and items of machinery. These leases have an average duration of between 3 and 10 years. There are no restrictions placed on the Group by entering into the leases.

Future minimum rentals payable under non-cancellable operating leases are as follows:

| | 2015 Land and buildings £m | 2015 Other £m | 2014 Land and buildings £m | 2014 Other £m |
|---|-------------------------------------|---------------------|-------------------------------------|---------------------|
| No later than 1 year | 1.6 | 2.3 | 1.3 | 1.9 |
| Later than 1 year and no later than 5 years | 6.2 | 1.6 | 5.9 | 2.4 |
| Later than 5 years | 1.7 | - | 3.1 | - |
| | 9.5 | 3.9 | 10.3 | 4.3 |

Kelda Finance (No. 1) Limited
Notes to the Group financial statements (continued)
as at 31 March 2015

23. Related parties

Compensation of key management personnel (including directors)

| | 2015 £m | 2014 £m |
|--------------------------|------------|------------|
| Short-term benefits | 2.6 | 3.2 |
| Post-employment benefits | 0.4 | 0.1 |
| Termination payments | - | - |
| | 3.0 | 3.3 |

24. Subsidiary companies

| Subsidiary companies | Country of incorporation | Country of tax residence | Class of shares in issue | Proportion of class of share held |
|---|-----------------------------|--------------------------------|--------------------------------|---|
| Water services | | | | |
| Yorkshire Water Services Limited | England & Wales | UK | Ordinary | 100% |
| Holding and finance companies | | | | |
| Kelda Finance (No. 2) Limited | England & Wales | UK | Ordinary | 100% |
| Kelda Finance (No. 3) PLC | England & Wales | UK | Ordinary | 100% |
| Yorkshire Water Services Holdings Limited | England & Wales | UK | Ordinary | 100% |
| Yorkshire Water Services Finance Limited | England & Wales | UK | Ordinary | 100% |
| Yorkshire Water Services Odsal Finance Holdings Limited | Cayman Islands | UK | Ordinary | 100% |
| Yorkshire Water Services Odsal Finance Limited | Cayman Islands | UK | Ordinary | 100% |
| Yorkshire Water Services Bradford Finance Limited | Cayman Islands | UK | Ordinary | 100% |

25. Ultimate controlling party

The Company's immediate parent company is Kelda Group Limited. The ultimate parent company and controlling party is Kelda Holdings Limited, a company registered in Jersey and resident for tax in the UK.

Kelda Eurobond Co Limited, a company registered in England and Wales, is the only UK Group to consolidate these financial statements.

Copies of the consolidated financial statements may be obtained from the Company Secretary, Kelda Eurobond Co Limited, Western House, Halifax Road, Bradford BD6 2SZ.

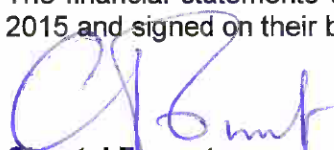
Kelda Finance (No. 1) Limited

Company balance sheet

as at 31 March 2015

| | Notes | 2015 £m | 2014 £m |
|----------------------------------|-------|--------------|--------------|
| Fixed assets | | | |
| Investments | 3 | 778.4 | 778.4 |
| Total assets | | 778.4 | 778.4 |
| Net assets | | 778.4 | 778.4 |
| Capital and reserves | | | |
| Called up share capital | 4 | - | - |
| Profit and loss account | | 778.4 | 778.4 |
| Total shareholders' funds | | 778.4 | 778.4 |

The financial statements on pages 90 to 94 were approved by the board of directors on 14 July 2015 and signed on their behalf by:



Chantal Forrest
Director
Kelda Finance (No. 1) Limited

Registered Number: 08066326

Kelda Finance (No. 1) Limited

Company statement of changes in equity

for the year ended 31 March 2015

| | Note | Called up share capital £m | Profit and loss account £m | Total Shareholders' funds £m |
|-------------------------------|------|----------------------------------|-------------------------------------|---------------------------------------|
| At 1 April 2013 | | - | 778.4 | 778.4 |
| Profit for the financial year | | - | 155.3 | 155.3 |
| Dividends paid | | - | (155.3) | (155.3) |
| At 1 April 2014 | | - | 778.4 | 778.4 |
| Profit for the financial year | | - | 78.4 | 78.4 |
| Dividends paid | | - | (78.4) | (78.4) |
| At 31 March 2015 | | - | 778.4 | 778.4 |

During the year, dividends of £78.4m, £0.78m per share (2014: £155.3m, £1.55m per share), were declared and cash settled with the immediate parent company .

Kelda Finance (No. 1) Limited

Notes to the Company financial statements (continued)

for the year ended 31 March 2015

1. Company accounting policies

Kelda Finance (No. 1) Limited (the "Company") is a company incorporated and domiciled in the UK.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101"). The amendments to FRS 101 (2013/14 Cycle) issued in July 2014 and effective immediately have been applied.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs"), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

In the transition to FRS 101 from old UK GAAP, the Company has made no measurement and recognition adjustments.

The consolidated financial statements of Kelda Holdings Limited have been prepared in accordance with International Financial Reporting Standards and are available to the public and may be obtained from Western House, Halifax Road, Bradford, BD6 2SZ.

In these financial statements, the company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- a Cash flow statement and related notes;
- Comparative period reconciliation for share capital;
- Disclosures in respect of transactions with wholly owned subsidiaries;
- The effects of new but not yet effective IFRSs; and
- Disclosures in respect of the compensation of Key management personnel.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements and in preparing an opening FRS 101 balance sheet at 1 April 2013 for the purposes of the transition to FRS 101.

Measurement convention

The Company's financial statements are prepared on a going concern basis, under the historical cost convention.

Investments in subsidiaries

Investments in subsidiaries are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

Kelda Finance (No. 1) Limited

Notes to the Company financial statements (continued)

for the year ended 31 March 2015

1. Company accounting policies (continued)

Dividends receivable

Dividends receivable are recognised when the shareholders' right to receive the revenue is established.

Dividends payable

Interim dividends payable are recognised on payment of the dividend. Final dividends payable are recognised on approval by shareholders in the annual general meeting.

Share capital

Ordinary shares are classified as equity.

2. Profit attributable to the parent company

The result of the parent company was a profit of £78.4m (2014: £155.3m). Advantage has been taken of the exemption available under section 408 of the Companies' Act 2006 not to present a profit and loss account for the Company alone. The parent company profit and loss account was approved by the board on 14 July 2015.

3. Fixed asset investments

| | Shares in Group undertakings £m |
|--|---------------------------------------|
| Cost at 31 March 2015 and 31 March 2014 | 778.4 |

A list of subsidiaries of the Company can be found on page 89. The directors believe that the carrying value of the investments is supported by their underlying net assets.

4. Called up share Capital

| | 2015 £ | 2014 £ |
|---|------------|------------|
| Issued and fully paid: 100 Ordinary shares of £1.00 each | 100 | 100 |

5. Other information

Details of directors' emoluments are set out in note 5 of the financial statements. No elements related specifically to their work in the Company.

Disclosure notes relating to share capital, auditors' remuneration and financial instruments are included within the financial statements of the Group.

Auditors' remuneration has been borne by Kelda Group Limited.

Kelda Finance (No. 1) Limited
Notes to the Company financial statements (continued)
for the year ended 31 March 2015

6. Ultimate controlling party

The Company's immediate parent company is Kelda Group Limited. The Company's ultimate parent company is Kelda Holdings Limited, a company registered in Jersey and resident for tax in the UK.

The largest UK Group in which the results of the Company are consolidated is headed by Kelda Eurobond Co Limited, a company registered in England and Wales. The smallest UK group in which they are consolidated is headed by Kelda Finance (No. 1) Limited, incorporated in England and Wales.

These consolidated financial statements are publicly available and copies may be obtained from the Company Secretary, Kelda Eurobond Co Limited, Western House, Halifax Road, Bradford, BD6 2SZ.

7. Explanation of transition to FRS 101 from Adopted UK GAAP

As stated in note 1, these are the Company's first financial statements prepared in accordance with FRS 101. The transition date was 1 April 2013.

The accounting policies set out in note 1 have been applied in preparing the financial statements for the year ended 31 March 2015 and the comparative information presented in these financial statements for the year ended 31 March 2014.

In preparing its FRS 101 balance sheet, the Company has not adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (UK GAAP).

Independent Auditors' Report to the members of Kelda Finance (No. 1) Limited for the Company financial statements

Report on the Company financial statements

Our opinion

In our opinion, Kelda Finance (No. 1) Limited's financial statements (the financial statements), defined below:

- give a true and fair view of the state of the Company's affairs as at 31 March 2015;
- 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.

What we have audited

Kelda Finance (No. 1) Limited's financial statements comprise:

- the company balance sheet as at 31 March 2015; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework". In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

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

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Independent Auditors' Report to the members of Kelda Finance (No. 1) Limited for the Company financial statements (continued)

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors' responsibilities set out on page 33, 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 and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual report and financial statements (the "Annual Report") to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

***Independent Auditors' Report to the members of
Kelda Finance (No. 1) Limited for the Company financial statements
(continued)***

Other matter

We have reported separately on the Group financial statements of Kelda Finance (No. 1) Limited for the year ended 31 March 2015.

Arif Ahmad

Arif Ahmad (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
14 July 2015

- (a) The maintenance and integrity of the Kelda Finance No. 1 limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.