Kelda Finance (No.1) Limited

Condensed Interim Financial Statements

Registered number 08066326

For the six months ended 30 September 2020

Contents

Information to accompany the Condensed Consolidated Interim Financial Statements

The consolidated results for Kelda Finance (No.1) Limited for the six month period ended 30 September 2020 are presented in this report.

These interim statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

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

Group Condensed Consolidated Statement of Profit and Loss

For the six month period ended 30 September 2020

	Note	**Unaudited six month period ended 30 September 2020 £m**	Restated[1] Unaudited six month period ended 30 September 2019 £m
Group revenue		**547.0**	539.3
Operating costs before exceptional items		**(414.5)**	(407.7)
Exceptional items	2	**(20.9)**	(2.3)
Group operating profit		**111.6**	129.3
Finance income		**28.3**	30.0
Finance costs		**(105.3)**	(122.2)
Fair value costs	6	**(256.1)**	(338.7)
Loss before taxation		**(221.5)**	(301.6)
Tax credit	3	**42.8**	51.9
Loss for the period		**(178.7)**	(249.7)

Group Condensed Consolidated Statement of Other Comprehensive Income

For the six month period ended 30 September 2020

	Unaudited six month period ended 30 September 2020 £m	Unaudited six month period ended 30 September 2019 £m
Loss for the period	**(178.7)**	(249.7)
Gains/(losses) on cash flow hedges taken to equity	**6.1**	-
Deferred tax on cash flow hedges	**(1.1)**	-
Total comprehensive expense for the period	**(173.7)**	(249.7)

[1] Restated see note 1.

Group Condensed Consolidated Statement of Financial Position

As at 30 September 2020

	Note	Unaudited at 30 September 2020 £m	Restated[1] Audited at 31 March 2020 £m
Non-current assets			
Intangible assets		**169.2**	171.9
Property, plant and equipment		**7,836.3**	7,794.1
Right of use assets		**55.6**	61.0
Derivative financial assets	6	**277.4**	290.7
Trade and other receivables		**1,136.4**	1,140.4
		9,474.9	9,458.1
Current assets			
Inventories		**4.6**	3.4
Trade and other receivables		**296.5**	284.4
Tax assets		**2.4**	2.4
Cash and cash equivalents	5	**196.0**	289.5
		499.5	579.7
Total assets		**9,974.4**	10,037.8
Current liabilities			
Trade and other payables		**(346.0)**	(389.7)
Lease liabilities		**(3.7)**	(4.1)
Deferred grants and contributions on depreciated assets		**(11.8)**	(10.8)
Short term borrowings	5	**(443.2)**	(370.8)
		(804.7)	(775.4)
Non-current liabilities			
Long term borrowings	5	**(5,523.1)**	(5,603.8)
Long term payables		**(4.6)**	(3.0)
Lease liabilities		**(87.5)**	(91.2)
Derivative financial liabilities	6	**(2,494.9)**	(2,258.2)
Deferred grants and contributions on depreciated assets		**(483.3)**	(484.1)
Provisions		**(0.4)**	(0.4)
Deferred tax liabilities		**(340.4)**	(389.5)
		(8,934.2)	(8,830.2)
Total liabilities		**(9,738.9)**	(9,605.6)
Net assets		**235.5**	432.2
Equity			
Share capital	9	**-**	-
Hedging reserve		**2.7**	(2.3)
Revaluation reserve		**79.9**	79.9
Retained earnings		**152.9**	354.6
Total equity		**235.5**	432.2

[1]Restated see note 1.

Group Condensed Consolidated Statement of Financial Position (continued)

As at 30 September 2020

The condensed interim financial statements, that are unaudited, were approved by the Board of Directors on 25 November 2020 and signed on its behalf by:

C Johns
Director

Group Condensed Consolidated Statement of Cash Flows

For the six month period ended 30 September 2020

	Note	**Unaudited six month period ended 30 September 2020 £m**	Unaudited six month period ended 30 September 2019* £m	Audited year ended 31 March 2020* £m
Cash flows from operating activities	7	**290.8**	303.0	547.0
Income taxes paid		**(9.8)**	(13.1)	(14.2)
Interest paid	8	**(127.8)**	(141.1)	(180.6)
Net cash generated from operating activities		**153.2**	148.8	352.2
Cash flows from investing activities				
Interest received	8	**72.7**	61.6	58.5
Proceeds on disposals of property, plant and equipment		**0.9**	1.8	2.2
Purchases of property, plant and equipment		**(260.1)**	(250.8)	(529.3)
Net proceeds from disposal of operations		**-**	-	3.4
Net cash used in investing activities		**(186.5)**	(187.4)	(465.2)
Cash flows from financing activities				
Dividends paid	4	**(23.0)**	(29.6)	(74.4)
Borrowings raised (net of fees)		**(6.0)**	355.7	947.9
Repayment of borrowings		**(19.0)**	(292.9)	(516.0)
Repayments of obligations under lease liabilities		**(1.0)**	(13.1)	(16.4)
Receipt of loan from parent company		**4.1**	4.1	9.9
Amounts paid upon restructure of inflation linked swaps		**(15.3)**	-	-
Net cash from financing activities		**(60.2)**	24.2	351.0
Net (decrease)/increase in cash and cash equivalents		**(93.5)**	(14.4)	238.0
Cash and cash equivalents at the start of the period		**289.5**	51.5	51.5
Cash and cash equivalents at the end of the period	5	**196.0**	37.1	289.5

*Contributions and grants received have been presented as operating cash flows in 2019/20 as these credits are released to operating costs over the useful economic life of the non-current assets to which they relate. They were presented as investment cash flows in prior periods. Comparatives from the year ended 31 March 2020 and the six month period ended 30 September 2019 have been restated increasing operating cash flows by £27.3m and £12.1m respectively and decreasing investing cash flows by the same amount.

Group Condensed Consolidated Statement of Changes in Equity

For the six month period ended 30 September 2020

	Ordinary shares £m	**Hedging reserve £m**	**Revaluation reserve £m**	**Retained earnings £m**	**Total equity £m**
At 31 March 2020	-	**(2.3)**	**79.9**	**354.6**	**432.2**
Loss for the period	-	**-**	**-**	**(178.7)**	**(178.7)**
Other comprehensive income	-	**5.0**	**-**	**-**	**5.0**
Dividends paid (note 4)	**-**	**-**	**-**	**(23.0)**	**(23.0)**
At 30 September 2020	**-**	**2.7**	**79.9**	**152.9**	**235.5**

	Ordinary shares £m	Share premium £m	Revaluation reserve £m	Retained earnings £m	Total equity £m
At 31 March 2019	-	-	639.8	51.3	691.1
Loss for the period	-	-	-	(249.7)	(249.7)
Shares issued	-	400.0	(400.0)	-	-
Capital reduction	-	(400.0)	-	400.0	-
Dividends paid (note 4)	-	-	-	(29.6)	(29.6)
At 30 September 2019	-	-	239.8	172.0	411.8

Notes to the Condensed Consolidated Interim Financial Statements

For the six month period ended 30 September 2020

1. Basis of preparation and accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The accounting policies, methods of computation and presentation are consistent with those used for the audited financial statements of Kelda Finance (No.1) Limited for the year ended 31 March 2020 except where stated otherwise. The group has not early-adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

These interim financial statements consolidate the results of Kelda Finance (No.1) Limited, Kelda Finance (No.2) Limited, Kelda Finance (No.3) PLC, Yorkshire Water Services Holdings Limited, and its subsidiary companies for the six months ended 30 September 2020.

New standards and interpretations

In September 2019, the IASB issued amendments to IFRS 9, IAS 39 and IFRS 7 in respect of interest rate benchmark reform, effective for periods beginning on or after 1 January 2020. These amendments modify specific hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments affected by the current interest rate benchmarks are amended as a result of the on-going interest rate benchmark reforms.

The amendments allow the group to assume that the economic relationship between the hedged debt and hedging derivative remains in place, despite the uncertainties around this process. The GBP London Inter-bank Offered Rate (LIBOR) is the interest rate benchmark to which the group's hedging relationships are significantly exposed. All the fair value hedging relationships are directly affected by the reform. The amounts of debt held as hedged items in these relationships are: £430m of sterling denominated fixed rate debt; $410m of US dollar (USD) denominated fixed rate debt; and $50m of Australian dollar (AUD) denominated fixed rate debt. In total, the notional amount of interest rate and cross currency swaps that are included in fair value hedge relationships and exposed to GBP LIBOR is £721.5m.

The group has closely monitored the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators (including the Financial Conduct Authority (FCA) regarding the transition away from LIBOR to the Sterling Overnight Index Average Rate (SONIA). In response to the announcements, the group has set up an interbank offered rates (IBOR) transition programme, the aim of the programme is to understand where IBOR exposures are within the business and prepare and deliver on an action plan to enable a smooth transition to alternative benchmark rates.

Estimates and Judgements

The estimates and judgements applied in preparing these financial statements are consistent with those applied in the consolidated annual report and financial statements for the year ending 31 March 2020.

Restatement

In line with 31 March 2020 year end, there has been a presentational change in terms of accounting for movements on derivatives. Adopting the 'single line of account' policy under IAS 1, the interest and fair value income is

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

1. Basis of preparation and accounting *(continued)*

presented within finance costs and fair value charges, where it was previously presented as part of interest receivable. The following table demonstrates the presentational adjustment to September 2019 balances previously reported.

The following adjustments are required to ensure all gains and losses on derivatives that are not in hedge accounting relationships are reported as appropriate in a single line item in the income statement; and to ensure that where a derivative is in a hedge accounting relationship the "realised" portion of the derivative gains and losses is reported in the same income statement line item as the hedged transaction.

	Reported September 2019 £m	**Adjustment September 2019 £m**	**Restated September 2019 £m**
Finance income	61.7	(31.7)	30.0
Fair value income	52.2	(52.2)	-
Total interest receivable and similar income	113.9	(83.9)	30.0
Interest payable and similar charges before fair value movements	(153.9)	31.7	(122.2)
Fair value charges	(390.9)	52.2	(338.7)
Interest receivable and similar income before fair value movements	(544.8)	83.9	(460.9)
Net total	**(430.9)**	**-**	**(430.9)**

There has also been a presentational change in terms of the final balance of derivative assets and liabilities reported as at 31 March 2020. There has been a reclassification of several instruments from derivative liabilities to derivative assets, resulting in a £124.1m increase in derivative assets and a corresponding increase to derivative liabilities. There has been no impact on net assets as a result of this reclassification.

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

2. Exceptional items

	Unaudited for the period ended 30 September 2020 £m	Unaudited for the period ended 30 September 2019 £m
Included in operating profit		
Extreme weather events	**1.9**	2.3
Transformation activity	**4.5**	-
Competition and Markets Authority Final Determination referral	**5.5**	-
Covid-19	**9.0**	-
Net total	**20.9**	2.3

3. Taxation

	Unaudited six month period ended 30 September 2020 £m	Unaudited six month period ended 30 September 2019 £m
Current tax charge	**(7.5)**	(3.6)
Total current tax charge	**(7.5)**	(3.6)
Deferred tax credit	**50.3**	55.5
Total tax credit	**42.8**	51.9

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

4. Dividends paid

	Unaudited six month period ended 30 September 2020 £m	Unaudited six month period ended 30 September 2019 £m
Cash dividends	**23.0**	29.6
Total dividends	**23.0**	29.6

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

5. Analysis of net debt

	Unaudited at 30 September 2020 £m	Audited at 31 March 2020 £m
Cash and cash equivalents:		
Cash at bank and in hand	**(87.5)**	(71.7)
Short term deposits	**(108.5)**	(217.8)
	(196.0)	(289.5)
Short term borrowings:		
Bank loans	**123.2**	50.8
Other borrowings	**320.0**	320.0
	443.2	370.8
Long term borrowings:		
Bank loans	**772.9**	864.6
Fixed rate guaranteed bonds & private notes due within 5 years	**218.4**	218.8
Fixed rate guaranteed bonds & private notes due after 5 years	**2,694.2**	2,687.9
Index linked guaranteed bonds due after 5 years	**1,401.8**	1,387.4
Floating rate guaranteed bonds & private notes due after 5 years	**74.4**	74.4
Fixed rate USD guaranteed private notes due in less than 5 years	**330.6**	343.2
Fixed rate AUD guaranteed bonds due after 5 years	**30.8**	27.5
	5,523.1	5,603.8
Net debt (excluding amounts owed by parent entities)	**5,770.3**	5,685.1
Amounts owed by parent entities	**(1,144.6)**	(1,148.6)
Total net debt	**4,625.7**	4,536.5

The bank loans stated above include £79.4m included in short term borrowings and £378.1m included in long term borrowings held at Kelda Finance (No.2) Limited. All other borrowings are held within the Yorkshire Water Services Holdings Limited group of companies.

As at 30 September 2020, amounts owed by parent entities include £209.6m, (31 March 2020: £213.6m) in respect of an amount that reflected the fair value of inflation linked swaps at the date of novation from Saltaire Water Limited to Yorkshire Water in August 2008, and £743.9m (31 March 2020: £743.9m) in relation to an upstream loan to Kelda Eurobond Co Limited. Also included is a loan to Kelda Eurobond Co Limited of £191.1m (31 March 2020: £191.1m) held at Kelda Finance (No.2) Limited.

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

6. Derivative assets and liabilities

	Unaudited as at 30 September 2020 £m	Restated[1] Audited as at 31 March 2020 £m
Derivative assets:		
Cross currency interest rate swaps	**75.1**	88.8
Inflation linked swaps	**113.7**	124.1
Energy derivatives	**3.5**	-
Fixed to floating interest rate swaps	**85.1**	77.8
	277.4	290.7
Derivative liabilities:		
Cross currency interest rate swaps	**(3.3)**	(6.7)
Inflation linked swaps	**(2,466.4)**	(2,223.7)
Energy derivatives	**(0.2)**	(3.2)
Finance lease interest swaps	**(25.0)**	(24.6)
	(2,494.9)	(2,258.2)

	Unaudited for the period ended 30 September 2020 £m	Restated[1] Unaudited for the period ended 30 September 2019 £m
Interest payable and similar charges		
Movement in fair value of cross currency interest rate swaps	**(10.6)**	27.4
Movement in fair value of debt associated with cross currency interest rate swaps	**9.4**	(26.4)
Movement in fair value of inflation linked swaps	**(252.2)**	(335.1)
Movement in fair value of energy derivatives	**0.4**	(1.5)
Movement in fair value of fixed to floating interest rate swaps	**5.0**	24.6
Movement in fair value of debt associated with fixed to floating interest rate swaps	**(6.3)**	(23.0)
Movement in fair value of finance lease interest rate swap	**(1.8)**	(4.7)
	(256.1)	(338.7)

[1] Restated see note 1.

Notes to the Condensed Consolidated Interim Financial Statements (continued)

For the six month period ended 30 September 2020

6. Derivative financial assets and liabilities *(continued)*

Cross currency interest rate swaps

The group hedges the fair value of the USD borrowings using a series of interest rate and foreign currency swaps that in combination form cross currency interest rate swaps, swapping USD principal repayments into sterling and fixed rate USD interest payments into floating rate sterling interest payments. These swaps are recognised at a fair value asset of £75.1m at 30 September 2020 (31 March 2020: £88.8m asset). Hedge accounting has been applied and the currency basis is included in the hedge designation and it is a source of ineffectiveness.

The group hedges the fair value of an AUD bond using a combined interest rate and foreign currency swap, swapping AUD principal repayments into sterling and fixed rate AUD interest payments into floating rate sterling interest payments. The swap is recognised at a fair value liability of £3.3m at 30 September 2020 (31 March 2020: £6.7m liability). Hedge accounting has been applied and the currency basis is included in the hedge designation and it is a source of ineffectiveness.

Inflation linked swaps

The group holds a number of inflation linked swaps, with a notional value of £1,289.0m. There are three cash flows associated with these inflation linked swaps:

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

Interest payments and receipts are accrued in the profit and loss account. The RPI bullet accumulated at the balance sheet date has been discounted using an appropriate rate applied to the specific life of the future accretion paydowns of the inflation linked swaps. This is accrued in the profit and loss account and recognised within financial assets and liabilities. The RPI bullet accrued to 30 September 2020 was £212.9m (31 March 2020: £222.3m) which has been reduced by £66.4m (31 March 2020: £69.3m) when discounted to present value.

With six month LIBOR and applicable discount rates continuing at low levels in the short term, the group's portfolio of inflation linked swaps gave rise to a net fair value liability of £2,352.7m (31 March 2020: £2,099.6m net liability) at 30 September 2020. Included in this amount, £146.5m (31 March 2020: £154.0m) represents the discounted value of the RPI bullet accrued to 30 September 2020.

Energy derivative

The group holds energy price swaps, which hedge the group's exposure to energy price risk by exchanging the day ahead index price of energy for a fixed price. The net movement of £6.5m (six months to 30 September 2019: £1.5m), in the derivative from a liability of £3.2m to a net derivative asset of £3.3m, has been recognised predominantly in the statement of other comprehensive income (£6.1m) with the remaining balance (£0.4m) recognised in the

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

6. Derivative financial assets and liabilities *(continued)*

statement of profit or loss (six months to 30 September 2019: in the statement of profit or loss within fair value income and charges).

Fixed to floating Interest rate swaps

The group holds £430.0m notional value (31 March 2020: £430.0m) of fixed to floating rate interest swaps. These swaps are recognised as a fair value asset of £85.1m at 30 September 2020 (31 March 2020: £77.8m asset). Hedge accounting has been applied. In line with IFRS 9, the financial instruments to which these fixed to floating interest rate swaps relate to have also been adjusted for the hedged interest rate risk at 30 September 2020. The net impact of the fair value movement of the fixed to floating interest rate swaps and the associated bonds has resulted in £1.3m of expense (six month period ended 30 September 2019: £1.6m income) to the profit and loss account. This represents the ineffectiveness in the hedge relationship due to factors such as credit risk.

Finance lease interest swaps

The group holds £45.0m notional value (31 March 2020: £45.0m) of floating to fixed rate interest swaps that have been taken out by the company to hedge against movements in the 12 month GBP LIBOR interest rates applicable to floating rate finance leases. The finance lease swaps hedge the movement in interest rates by receiving interest based on 12 month LIBOR and accruing interest payable at a fixed rate. These swaps are recognised at a fair value liability of £25.0m at 30 September 2020 (31 March 2020: £24.6m liability). Hedge accounting has not been applied. Of the increase in the liability of £0.4m in the six month period, £1.8m has been recognised in the profit and loss account as a fair value expense (six month period ended 30 September 2019: £4.7m expense). This is offset by £1.4m relating to payments made on finance lease swap interest during the period.

Fair value of swaps

The valuation model used by the group to determine the fair value of the swap portfolio as at 30 September 2020 includes a funding valuation adjustment, credit valuation adjustment and debit valuation adjustment to reflect the long term credit risk of the portfolio, which includes instruments with super-senior status as well as non-senior status derivatives. The funding valuation adjustments, credit valuation adjustments and debit valuation adjustments to the valuation represent unobservable inputs that have the potential to materially affect the resultant fair valuation, and therefore require estimation techniques to be adopted by management. Management uses a third party expert to advise on the appropriateness of these assumptions, and have prepared sensitivity analysis in order to evaluate the impact of a reasonably possible range of assumptions on the resultant valuation. The total adjustment made to the valuation as a result of the assumptions adopted in respect of these key inputs was £578.3m (31 March 2020: £537.7m).

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

7. Reconciliation of profit from continuing operations to cash generated by continuing operations

	Unaudited six month period ended 30 September 2020 £m	Unaudited six month period ended 30 September 2019 £m	Audited year ended 31 March 2020 £m
Total loss for the period	**(178.7)**	(249.7)	(22.7)
Tax (credit)/charge	**(42.8)**	(51.9)	31.9
(Loss)/profit from continuing operations before taxation	**(221.5)**	(301.6)	9.2
Finance income	**(28.3)**	(61.7)	(59.8)
Finance costs	**105.3**	153.9	222.6
Net exceptional finance costs	**256.1**	338.7	40.2
Depreciation	**153.2**	147.9	313.1
Profit on disposal of property, plant and equipment	**(0.4)**	(1.6)	(2.1)
Profit on disposal of operations	**-**	-	(3.4)
Amortisation of intangibles	**10.5**	7.8	15.1
Increase in inventories	**(1.1)**	(0.8)	(0.4)
Increase in trade and other receivables	**(29.7)**	(26.2)	(27.8)
Increase in trade and other payables	**30.6**	40.0	25.6
Amortisation of capital grants	**(5.9)**	(5.5)	(10.9)
Capital contributions[1]	**22.0**	12.1	25.6
Cash generated from continuing operations	**290.8**	303.0	547.0

[1] Please see Group Condensed Consolidated Statement of Cash Flows

Notes to the Condensed Consolidated Interim Financial Statements *(continued)*

For the six month period ended 30 September 2020

8. Cash interest

	Unaudited six month period ended 30 September 2020 £m	Unaudited six month period ended 30 September 2019 £m
Cash interest paid:		
External interest on Kelda financing group[1]	**(9.5)**	(11.6)
External interest paid by Yorkshire Water financing group[2]	**(118.3)**	(129.5)
	(127.8)	(141.1)
Cash interest received:		
External interest received by Yorkshire Water financing group	**43.8**	31.7
Interest received from parent entities	**28.9**	29.9
	72.7	61.6

9. Share capital

	Number	**Ordinary shares £**
Closing balance at 30 September 2020 and 31 March 2020	100	100

10. Contingent liabilities

In September 2016 Yorkshire Water received a claim on behalf of personal search companies (PSC) relating to a claim for historical search fees that they have paid to Yorkshire Water for water and drainage reports obtained when buying a house. The claim has been brought pursuant to the Environmental Information Regulations ("EIR") 2004. The PSC as the Claimants in this matter state that the historical fees should not have been paid to Yorkshire Water as the information should have been provided for no fee. Yorkshire Water has adopted the same stance as the rest of the sector in relation to this claim in disagreeing with the interpretation taken on behalf of the PSCs. Formal sets of legal proceedings have been served on Yorkshire Water.

At this stage it is not known if Yorkshire Water would be liable for these claims, the total value to which they could amount, or the timing of any cash flow. As a result of these claims now being formally lodged, a view is currently being taken by Safemove as to the potential value of the claim faced by Yorkshire Water but it is not accepted that Yorkshire Water is liable. The combined claims (against all companies included in the sector) are stated to be in excess of £390m based on the case as currently pleaded. A joint industry approach is being taken to the claims made against each company in the sector.

[1] Kelda financing group is comprised of Kelda Finance (No.2) Limited and Kelda Finance (No.3) PLC

[2] Yorkshire Water financing group is the Yorkshire Water Services Holdings Limited group of companies