# Yorkshire Water Services Ltd

*Interim Report and Financial Statements*

For the six months ended 30 September 2016

Registered number: 2366682

Taking responsibility for the water environment for good

# Contents

# Chairman's Statement

In what is my first update as chairman of Yorkshire Water, I am pleased to report that at a time of significant change in the water and sewerage sector, operational performance across the business has remained strong during the first half of 2016/17.

During the first six months of the year management has driven considerable internal transformation to ensure that Yorkshire Water was ready to enter the shadow business retail market which opened in October 2016. We are on course to deliver a seamless transition to full market opening this coming April.

Against this backdrop of change, my fellow directors and I have been continuing to work closely with shareholders and the senior executive team to explore the risks and opportunities to the business presented by this and other proposed changes in the regulatory pipeline. I and my fellow directors are confident that we are on track to achieve our business plan for the period 2015 to 2020.

To this end the Board has been carrying out a strategic review of the short, medium and long-term direction of the business which is already helping to shape our thinking as we prepare for the forthcoming PR19 price review.

Over the coming months through engagement with our regulators, customers and other stakeholders, we will develop our future investment plans further to achieve the right balance between customer expectations, environmental improvement and prices.

**Anthony Rabin**
**Chairman**

# Business Review

## Chief Executive's Review

Overall business performance for the first six months of the year has been strong, with Yorkshire Water currently meeting or exceeding 21 of its 26 operational, service and environmental performance commitments.

Good progress continues to be made on delivery of the company's Blueprint 2020 change programme, with final approval recently given for a major overhaul of the company's business and technology systems. This key enabling initiative will deliver significant operational and financial benefits over the current five-year AMP programme and beyond.

Working with our Trade Unions, we are also in the process of implementing a transformational programme of activity to further improve standards of safety across the business. This is being led by our new Director of Health, Safety and Wellbeing, Mark Nishapati, who joined the business in October. Mark brings with him a wealth of experience from the oil and gas sector, having previously worked with BG Group plc, part of Royal Dutch Shell plc.

Other highlights for the first half of the year include:

- Water quality compliance remains high, however the number of customer contacts is above target. This was as a result of a major water contamination issue in Thorne, near Doncaster, caused by the actions of a third party business customer;
- The number of Category 1 and 2 pollution incidents in the region remains better then plan;
- Stability and reliability measures (previously known as serviceability) remain stable across all four of the key asset categories;
- Overall customer satisfaction remains high and we are currently ahead of our business plan target for the year as measured by Ofwat's Service Incentive Mechanism (SIM survey);
- We remain on course to achieve our leakage reduction target;
- We became the first water company in the UK to achieve the prestigious National Equality Standard (NES) which recognises best practice in the area of equality, diversity and inclusion;
- Our annual satisfaction survey showed that an overwhelming 97% of visitors continue to enjoy the recreational experiences we provide at our reservoirs;
- The £31m Hull waste water treatment works project saw all planned improvements necessary to manage odour and compliance risk completed by 31 May 2016 and the works performed well under elevated seasonal loading;
- Approval has been given for, and work has started on, major drinking water quality improvements at Rivelin (£25m) and Irton (£17m) water treatment works; and
- The £72m Knostrop sludge and energy project, approved in 2015/16 is currently in detailed design and construction is on track.

This strong performance was delivered against the backdrop of major change in the water sector with the opening of the Shadow Market for non-household retail competition on 3 October 2016.

During the year we have delivered major organisational, operational and cultural changes to Yorkshire Water's wholesale operations to ensure the business can service the needs of multiple retail operators in the future.

We will continue to work closely with MOSL (Market Operator Services Ltd) and Ofwat to ensure we are ready to make a seamless transition to full market opening in April 2017.

# Business Review

In the meantime, we are preparing to transfer all of Yorkshire Water's business customer accounts to Three Sixty – a new business created by Yorkshire Water's parent company, Kelda, which is competing to provide retail services to businesses across the UK.

**Richard Flint**
**Chief Executive**

# Business Review

## Financial Performance

On 23 June 2016, the United Kingdom voted to leave the European Union ('Brexit'). This vote has resulted in uncertainty in economic and political spheres. Whilst much of the economic impact is still unknown for Yorkshire Water, we are expecting minimal impact of the exit to affect the day-to-day operations and operating profit of the business. We have however seen a significant movement of fair values held on the balance sheet for financial instruments, in particular the index linked swaps. This movement is as a result of the impact of interest rates which have fallen, increasing the negative fair values of the index linked swaps. More information is provided in notes 2 and 8.

### Key financial performance indicators

The results for the 6 month period are reported in line with FRS 102 with comparatives. The key performance indicators are set out below:

| | **Unaudited 6 months ended 30 September 2016** | Unaudited 6 months ended 30 September 2015 |
|---|---|---|
| Profit and loss indicators | | |
| Turnover (£m) | **506.5** | 493.5 |
| Operating profit before exceptional item (£m) | **147.8** | 156.9 |
| Exceptional income (£m) | **0.1** | - |
| EBITDA (£m) | **285.4** | 285.2 |
| Capital Expenditure (£m) | **175.5** | 98.5 |
| Balance sheet indicators | **Unaudited as at 30 September 2016** | Audited as at 31 March 2016 |
| Total Adjusted Net debt (£m) (Note 7) | **3,700.5** | 3,551.7 |
| Gearing: Adjusted net debt to Regulatory Capital Value (RCV)* | **77.3%** | 77.9% |

*Ofwat's Key performance indicators for the water industry, definitions available at: http://www.ofwat.gov.uk/regulating/compliance/reportingperformance/kpi

Turnover increased by 2.6% to £506.5m (6 months ended 30 September 2015: £493.5m) which is as a result of higher trade effluent charges and a slight increase in volume used by measured customers for the six month period.

Operating profit has reduced in the period by 5.8% to £147.8m compared to the comparable period last year (6 months ended 30 September 2015: £156.9m). Operating costs have increased by 6.6% (from £336.6m to £358.7m). The primary reasons for this is the planned increase in infrastructure repair and maintenance (£12.8m), and an increase in depreciation (£9.3m) due to the on-going capital programme.

EBITDA has increased when compared to the comparable period last year to £285.4m from £285.2m, a 0.1% increase. This is as a result of the movements in turnover and additional operating costs set out above, excluding depreciation.

# Business Review

Exceptional income is the net amount of income and costs relating to the flooding incident that occurred in December 2015. In this six month period the company has received a further £10.0m from the insurance claim and incurred £9.9m of operational costs associated with the assets damaged in the event. Since the balance sheet date, the total insurance claim has been agreed at £56m.

During the six month period to 30 September 2016, net interest payable and similar charges before exceptional items was £96.0m, (30 September 2015: £90.1m). The modest increase arises from the increase in net debt.

Capital expenditure in the six month period to September 2016 was £175.5m (30 September 2015 £98.5m), a 78.2% increase. This is to be expected as we are now into the second year of the new investment period and a higher proportion of the capital programme has moved from feasibility and design into the construction phase of delivery.

During the six month period to 30 September 2016, total net debt has increased to £3,700.5m (31 March 2016: £3,551.7m) which reflects the raising of external debt to offset the utilisation of the capital facility to finance the capital programme. Net debt at 30 September 2016 includes £1,009.0m of amounts due from group companies (31 March 2016: £1,009.0m). Based on an RCV value of £5,980.5m, senior adjusted net debt to RCV at September 2016 is 77.3% (31 March 2016: 77.9%). The level of gearing is forecast to be maintained at similar levels throughout the financial year in accordance with the company's on-going strategy to improve its financial strength.

As required by FRS 102 the fair value of the financial instruments is now recognised on the balance sheet and the movement in the valuation is recognised in the profit and loss account. The significant movement in the six months ended 30 September 2016 is in relation to the fair value of the index linked swaps as set out in note 2.

£94.7m of distributions have been made to the parent company during the period (6 months ended 30 September 2015: £43.4m), of which £35.3m (6 months ended 30 September 2015: £34.7m) was distributed to Kelda Eurobond Co Ltd in order to allow Kelda Eurobond Co Ltd to make an interest payment and loan repayment on their loan from Yorkshire Water. Net distributions made to fund group costs were £14.0m (6 months ended 30 September 2015: £8.7m). Distributions of £45.4m have been made to the ultimate shareholders of the Kelda group.

## Principal Risks and Uncertainties

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

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

Further detail on the risks and uncertainties is included in the Annual Report and Financial Statements for the year ended 31 March 2016.

# Profit and Loss Account

For the six months ended 30 September 2016

| | Note | Unaudited six months ended 30 September 2016 £m | 30 September 2015 £m |
|---|---|---|---|
| **Turnover** | | **506.5** | 493.5 |
| Operating costs | | **(358.7)** | (336.6) |
| Exceptional income | | **0.1** | - |
| **Operating profit** | | **147.9** | 156.9 |
| Interest receivable and similar income before exceptional items | | **50.6** | 46.9 |
| Exceptional fair value income | 2 | **79.8** | 106.1 |
| Total interest receivable and similar income | | **130.4** | 153.0 |
| Interest payable and similar charges before exceptional items | | **(146.6)** | (137.0) |
| Exceptional fair value charges | 2 | **(685.4)** | (20.1) |
| Total interest payable and similar charges | | **(832.0)** | (157.1) |
| **(Loss)/profit on ordinary activities before tax** | | **(553.7)** | 152.8 |
| Tax on (loss)/profit on ordinary activities | 3 | **130.0** | (7.0) |
| **(Loss)/profit for the period** | | **(423.7)** | 145.8 |

All of the above results relate to continuing activities.

# Balance Sheet

As at 30 September 2016

| | Note | Unaudited as at 30 September 2016 £m | Audited as at 31 March 2016 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets | | **48.0** | 29.0 |
| Tangible assets | | **6,903.0** | 6,871.2 |
| Investments | | **0.1** | 0.1 |
| | | **6,951.1** | 6,900.3 |
| **Current assets** | | | |
| Stocks | | **2.4** | 2.0 |
| Debtors (including £1,419.2m after more than one year (31 March 2016: £1,339.6m)) | | **1,628.2** | 1,537.3 |
| Cash at bank and in hand | | **49.9** | 24.0 |
| | | **1,680.5** | 1,563.3 |
| **Creditors:** amounts falling due within one year | | **(399.3)** | (374.5) |
| **Net current assets** | | **1,281.2** | 1,188.8 |
| **Total assets less current liabilities** | | **8,232.3** | 8,089.1 |
| **Creditors:** amounts falling due after more than one year | *5* | **(7,323.6)** | (6,541.2) |
| **Provisions for liabilities** | | | |
| Deferred tax liability | | **(269.4)** | (399.2) |
| Other provisions | | **(0.5)** | (0.7) |
| | | **(269.9)** | (399.9) |
| **Net assets** | | **638.8** | 1,148.0 |
| **Capital and reserves** | | | |
| Called up share capital | | **10.0** | 10.0 |
| Revaluation reserve | | **205.8** | 205.8 |
| Hedging reserve | | **1.6** | (8.1) |
| Profit and loss account | | **421.4** | 940.3 |
| **Total shareholders' funds** | | **638.8** | 1,148.0 |

# Statement of Changes in Equity

For the six months ended 30 September 2016

| | Note | Called up Share capital £m | Revaluation reserve £m | Cash Flow Hedge reserve £m | Profit and loss account £m | Total Shareholders' funds £m |
|---|---|---|---|---|---|---|
| Balance at 1 April 2015 | | 10.0 | 201.0 | - | 794.4 | 1,005.4 |
| **Total comprehensive income/(expense) for the year** | | | | | | |
| Profit for the financial year | | - | - | - | 236.2 | 236.2 |
| Other comprehensive income/(expense) for the year | | - | 5.1 | (8.1) | - | (3.0) |
| Total comprehensive income/(expense) for the year | | - | 5.1 | (8.1) | 236.2 | 233.2 |
| Transfer | | - | (0.3) | - | 0.3 | - |
| Other | | - | - | - | 0.3 | 0.3 |
| **Transactions with owners recorded directly in equity** | | | | | | |
| Dividends | | - | - | - | (90.9) | (90.9) |
| **Balance at 31 March 2016** | | 10.0 | 205.8 | (8.1) | 940.3 | 1,148.0 |
| **Total comprehensive income/(expense) for the period** | | | | | | |
| Loss for the financial period | | - | - | - | (423.7) | (423.7) |
| Other comprehensive income/(expense) for the period | | - | - | 9.7 | - | 9.7 |
| Total comprehensive income/(expense) for the period | | - | - | 9.7 | (423.7) | (414.0) |
| Other | | | | | (0.5) | (0.5) |
| **Transactions with owners recorded directly in equity** | | | | | | |
| Dividends | 4 | - | - | - | (94.7) | (94.7) |
| **Balance at 30 September 2016** | | 10.0 | 205.8 | 1.6 | 421.4 | 638.8 |

# Notes to the Financial Statements

For the six months ended 30 September 2016

For the year ended 31 March 2016, the Company prepared its financial statements in compliance with Financial Reporting Standard 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102"). This interim report has been produced on the same basis.

The financial information for the six months ended 30 September 2016 and the equivalent period in 2015 has not been audited.

The interim financial information was approved for issue by the board of directors on 24 November 2016.

### 1. Basis of preparation and accounting policies

The financial information for the six month period ended 30 September 2016 has been prepared in accordance with FRS 104 ‘Interim Financial Reporting’ and the Companies Act 2006. This report should be read in conjunction with the Company’s annual financial statements for the year ended 31 March 2016, which have been prepared in accordance with Financial Reporting Standard 102, the Financial Reporting Standard applicable to the UK and Ireland (FRS 102).

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare group financial statements. This financial information presents information about the Company as an individual undertaking and not about its group. As permitted by FRS 104 a statement of cash flows cumulatively for the current financial year-to-date, with a comparative statement for the comparable year-to-date has not been presented as the Company does not present a statement of cash flows in its year end financial statements.

The financial information for the year ended 31 March 2016, presented in these notes, does not constitute the Company's statutory accounts for that period but has been extracted from the statutory accounts. The accounting policies, methods of computation and presentation are consistent with those published in the annual financial statements for the year ended 31 March 2016, as described in those annual financial statements. The half-yearly financial report should be read in conjunction with these annual financial statements.

No new standards, amendments or interpretations which will have a material impact on the financial statements have been adopted in the period. The principal risks and uncertainties as disclosed in the year end accounts are considered to be consistent with those that are still applicable now.

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

## 2. Exceptional fair value income and charges

| | **Unaudited for the period ended 30 September 2016 £m** | Unaudited for the period ended 30 September 2015 £m |
|---|---|---|
| **Interest receivable and similar income** | | |
| Movement of fair value of combined cross currency interest rate swaps | **38.5** | - |
| Movement in fair value of cross currency debt | **-** | 6.7 |
| Movement of fair value of fixed to floating interest rate swaps | **41.3** | - |
| Movement in fair value of associated bonds | **-** | 17.5 |
| Movement of fair value of finance lease interest rate swap | **-** | 2.1 |
| Movement of fair value of index linked swaps | **-** | 79.8 |
| | **79.8** | 106.1 |
| **Interest payable and similar charges** | | |
| Movement of fair value of index linked swaps | **(614.7)** | - |
| Movement of fair value of finance lease interest rate swap | **(4.4)** | - |
| Movement in fair value of debt associated with fixed to floating interest rate swaps | **(30.4)** | (10.4) |
| Movement in fair value of associated bonds | **-** | - |
| Movement of fair value of combined cross currency interest rate swaps | **-** | (9.7) |
| Movement in fair value of cross currency debt | **(35.9)** | - |
| | **(685.4)** | (20.1) |

The movement in the fair value of index linked swaps is a result of swaps which were taken out by the Company during 2007/08. These swaps 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 30 September 2016 resulted in a £2,285.7m liability (31 March 2016: £1,734.3m liability). Of this, £2,194.3m (31 March 2016: £1,579.5m) is recognised within other financial liabilities (Note 8) and £91.4m (31 March 2016: £154.7m) is recognised within long term borrowings (Note 6). The first 6 months of the financial year has seen the liability on the swaps increase by a further £614.7m.

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

Exceptional finance income includes the fair value movement of various fixed to floating interest rate swaps and combined cross currency interest rate swaps which were designated in fair value hedge relationships. These fair value interest rate swaps have been valued at the reporting date at fair value. In line with FRS102, the financial instruments to which the swaps relate have also been measured at fair value at 30 September 2016. The net impact of the fair value movement of the fixed to floating interest rate swaps and the associated bonds has resulted in a £10.9m credit to the profit and loss account, and the net impact of the fair value movement of the combined cross currency interest rate swaps and cross currency debt has resulted in a £2.6m credit to the profit and loss account.

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

## 3. Tax on profit on ordinary activities

| | **Unaudited for the period ended 30 September 2016** | Unaudited for the period ended 30 September 2015 |
|---|---|---|
| | **£m** | £m |
| Current tax – current period | **-** | 0.1 |
| Deferred tax – current period | **(130.0)** | 6.9 |
| **Tax (credit)/charge** | **(130.0)** | 7.0 |

## 4. Distributions paid

| | **Unaudited for the period ended 30 September 2016** | Unaudited for the period ended 30 September 2015 |
|---|---|---|
| | **£m** | £m |
| Dividends paid during the period | **94.7** | 43.4 |
| Gross dividend paid | **94.7** | 43.4 |
| Dividends paid to holdings companies to fund payment of interest | **(35.3)** | (34.7) |
| Amounts retained to fund corporate costs | **(14.0)** | (8.7) |
| Available for distribution to ultimate shareholders | **45.4** | - |

## 5. Creditors: amounts falling due after more than one year

| | **Unaudited as at 30 September 2016** | Audited as at 31 March 2016 |
|---|---|---|
| | **£m** | £m |
| Interest-bearing loans and borrowings (note 6) | **452.5** | 562.7 |
| Amounts owed to group undertakings | **4,218.8** | 3,939.4 |
| Other creditors | **16.2** | 15.8 |
| Other financial liabilities (note 8) | **2,225.0** | 1,619.8 |
| Deferred grants and contributions on depreciating fixed assets | **411.1** | 403.5 |
| | **7,323.6** | 6,541.2 |

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

## 6. Interest bearing loans and borrowings

| | Bank loans and overdrafts 30 September 2016 £m | Other loans 30 September 2016 £m | Finance leases 30 September 2016 £m | Total 30 September 2016 £m |
|---|---|---|---|---|
| **Short term borrowings:** | | | | |
| In one year or less or on demand | 38.4 | - | 49.7 | 88.1 |
| **Long term borrowings:** | | | | |
| In more than one year, but not more than two years | 44.9 | - | 12.4 | 57.3 |
| In more than two years, but not more than five years | 107.9 | 8.3 | 22.3 | 138.5 |
| In more than five years | 92.7 | 83.1 | 80.9 | 256.7 |
| | 245.5 | 91.4 | 115.6 | 452.5 |
| Amounts owed to Group companies before fair value adjustment of bonds | | | | 4,067.5 |
| Fair value adjustment of bonds owed to group companies | | | | 151.3 |
| Total borrowings | | | | **4,759.4** |
| Cash at bank and in hand | | | | **(49.9)** |
| Amounts owed from group companies | | | | **(1,009.0)** |
| **Net debt at 30 Sep 2016** | | | | **3,700.5** |

Net amounts owed to group companies include £1,009.0m receivable in relation to loans to parent companies. This is presented within debtor's receivable after more than one year.

Amounts owed to group companies includes loans from other members of the Yorkshire Water financing group relating to bonds originally held by Yorkshire Water Services Finance Limited, subsequently exchanged for bonds held by Yorkshire Water Services Odsal Finance Ltd.

Yorkshire Water raises debt as part of the Yorkshire Water financing group. This group of companies includes Yorkshire Water and its subsidiary companies. Debt covenants covering the financing group include the consolidated external debt of this group of companies. When calculating the consolidated debt position it should be noted that the book value recorded in these accounts on the internal loan relating to the exchanged bonds is higher than the book value recorded in Yorkshire Water Services Odsal Finance accounts by £30.6m (31 March 2016: £31.0m), which accounted for the exchanged bonds at their fair value at the date of exchange.

Net debt includes unamortised issue costs of £13.7m (31 March 2016: £14.1m).

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

## 6. Interest bearing loans and borrowings (continued)

Borrowings repayable in instalments after more than five years include £80.9m (31 March 2016: £81.3m) in respect of finance leases which have expiry dates ranging from 2032 to 2043 and carry interest rates based on 12 month LIBOR and 6 month LIBOR. The finance lease creditors are secured on the underlying assets.

As at 30 September 2016 Yorkshire Water had access to undrawn committed bank facilities totalling £783.75m (31 March 2016: £783.75m), £309.75m of which expire in April 2017 (31 March 2016: £309.75m) and £474.0m expire in October 2018 (31 March 2016: £474.0m). The cash at bank includes £23.6m of ring fenced cash relating to a swap collateral account (31 March 2016: £15.7m).

Of the total net debt, £597.2m (31 March 2016: £597.2m) relates to Class B debt.

## 7. Reconciliation of movement in adjusted net debt

| | Audited at 31 March 2016 £m | Cash movements £m | Non cash movements £m | **Unaudited at 30 September 2016 £m** | Unaudited at 30 September 2015 £m |
|---|---|---|---|---|---|
| Short term deposits | 24.0 | 25.9 | - | **49.9** | 41.7 |
| **Cash and cash equivalents** | 24.0 | 25.9 | - | **49.9** | 41.7 |
| Loans due within one year | (45.3) | 6.9 | - | **(38.4)** | (38.2) |
| Finance leases due within one year | (37.3) | 34.6 | (47.0) | **(49.7)** | (37.1) |
| Loans due after one year | (245.4) | - | - | **(245.4)** | (262.4) |
| Finance leases due after one year | (162.6) | - | 47.0 | **(115.6)** | (165.2) |
| Index linked swaps | (154.7) | 76.5 | (13.3) | **(91.5)** | (142.7) |
| **External net debt** | (645.3) | 118.0 | (13.3) | **(540.6)** | (645.6) |
| Amounts owed from parent companies | 1,009.0 | - | - | **1,009.0** | 1,009.0 |
| Amounts owed to subsidiary company | (3,939.4) | (193.4) | (86.0) | **(4,218.8)** | (3,928.8) |
| | (2,930.4) | (193.4) | (86.0) | **(3,209.8)** | (2,919.8) |
| **Total adjusted net debt** | (3,551.7) | (49.5) | (99.3) | **(3,700.5)** | (3,523.7) |

Index linked swaps of £91.5m (31 March 2016: £154.7m) represents £176.0m (31 March 2016: £237.1m) of RPI accretion discounted by £84.5m (31 March 2016: £82.4m) to reflect the net present value of the future liability.

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

## 8. Other financial assets and liabilities

| | **Unaudited as at 30 September 2016 £m** | Audited as at 31 March 2016 £m |
|---|---|---|
| Derivative financial assets: | | |
| Fixed to floating interest rate swaps | **85.6** | 48.5 |
| Combined cross currency interest rate swaps | **80.9** | 42.3 |
| | **166.5** | 90.8 |
| Financial liabilities: | | |
| Finance lease interest swaps | **(29.3)** | (24.9) |
| Inflation linked swaps | **(2,194.3)** | (1,579.5) |
| Combined cross currency interest rate swaps | **(1.2)** | (5.5) |
| Energy swap | **(0.2)** | (9.9) |
| | **(2,225.0)** | (1,619.8) |

*Interest rate swaps*

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

Yorkshire Water holds £430.0m notional value of fixed to floating rate interest swaps. These swaps are recognised at a fair value asset of £85.6m at 30 September 2016 (31 March 2016: £48.5m). Hedge accounting has been applied.

*Cross currency interest rate swaps*

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

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

*Index linked swaps*

The Company holds a number of index linked swaps, with a notional value of £1,289.0m (31 March 2016: £1,289.0m). There are three cash flows associated with the swaps:

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

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

# Notes to the Financial Statements (continued)

For the six months ended 30 September 2016

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

With six month LIBOR and applicable discount rates at historically low levels in the short term, these swaps gave rise to a fair value liability of £2,285.7m at 30 September 2016 (31 March 2016: £1,734.3m). Of this, £91.4m has been recognised within long term borrowings, and represents the discounted value of the RPI bullet accrued to 30 September 2016 (31 March 2016: £154.7m). The remaining £2,194.3m is recognised within other financial liabilities (31 March 2016: £1,579.5m). The RPI bullet accrued to 30 September 2016 was £91.5m (31 March 2016: £154.7m) which has been reduced by £84.5m (31 March 2016: £82.4m) when discounted to present values.

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

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

As at 31 March 2016 Yorkshire Water's portfolio of index linked swaps had a total fixed notional value of £1,289m and a total fair value liability of £1,734.3m. Of this amount approximately 22.7% of the total notional value was subject to MTCs. As at 30 September 2016 Yorkshire Water's portfolio of index linked swaps had a total fixed notional of £1,289m and a total fair value liability of £2,194.3m. Of this amount approximately 22.7% of the total notional of the portfolio was subject to MTCs (with the mandatory breaks occurring in February 2020, February 2023 and February 2025).

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

## 9. Contingent liabilities

On 20 July 2015 an employee of the Company suffered a fatal accident while carrying out their duties. This is currently subject to a Health and Safety Executive investigation. The duration, timing and outcome of this investigation are currently unknown.

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

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