Interim management report

Cadent
Your Gas Network

Quadgas MidCo Limited

Report for the six months ended 30 September 2018

Highlights:

- Continued strong performance with operating profit before exceptionals of £370m (2017: £320m), total operating profit of £361m (2017: £312m)
- Continued focus on investment with capital investment of £350m (2017: £280m)
- Strong balance sheet with a net asset position of £5,473m (2017: £5,402m)
- Finance raised of £295m and £350m of private placement notes and public bonds respectively

This interim management report has been prepared for the Group. The Group comprises Quadgas MidCo Limited, Cadent Gas Limited, Cadent Finance Plc, Cadent Services Limited and Quadgas Finance Plc.

Operations

The Group's principal activity during the period was the ownership of and operation of regulated gas distribution networks. The Group plays a vital role in connecting millions of people safely, reliably and efficiently to the gas they use.

We own and operate four of the eight regional gas distribution networks in Great Britain. Our networks comprise approximately 131,000 kilometres (81,400 miles) of gas distribution pipeline and we transport gas from the gas national transmission system to around 11 million consumers on behalf of 40 gas shippers.

In the first half of the year, the Group delivered higher revenue largely due to an increase in our price controlled revenues and the impact of IFRS 15. Operating costs have remained broadly consistent due to lower staff costs offset by a slight increase in property taxes and rates. The Group is also expected to deliver its regulatory outputs and continue to deliver targeted efficiencies.

For the full year, the Group, remains on track to deliver stable returns with an ongoing focus on delivering a safe and reliable service to our customers.

Long-term strategy and business objectives

In our most recent annual report and financial statements, we reported the Group's objective to deliver performance for customers and shareholders, and improve that performance such that we deliver comparable performance to industry benchmarks as we move towards the next price control period. It is about engaging with our communities, being a responsible business, safeguarding customers, and having a motivated workforce with the right skills and the right opportunities to develop careers within the organisation and the industry more broadly.

To achieve this, the Group continues to focus on improving the efficiency and effectiveness of its operations through innovation and an ongoing performance improvement agenda. Alongside value for money, customers also need safe and reliable networks and good customer service, which sets out the foundation for the critical, non-financial success factors for the long-term performance of the Group.

Results for the six months ended 30 September 2018

A summary of the key financial results is set out in the table below.

	Six months ended 30 September 2018 £'m	Six months ended 30 September 2017 £'m	Movement £'m
Revenue	965	909	56
Operating profit – Before exceptional items	370	320	50
Operating profit	361	312	49
Profit before tax – Before exceptional items & remeasurements	243	181	62
Profit before tax	231	164	67
Capital investment	350	280	70

Revenue

Total group revenue for the period was £965 million (2017: £909 million) comprising £925 million (2017: £885 million) of regulated allowed revenue and £40 million (2017: £24 million) from non-regulated activities. The £40 million increase in regulated allowed revenue is mainly driven by an increase in the inflation factor included within the agreed Ofgem pricing model. The £16 million increase in non-regulated activities is primarily due to the adoption of IFRS 15 impacting the timing of the recognition of diversion income – please see the impact of new accounting standards section below for more detail.

Operating profit

Operating profit for the period was £361 million (2017: £312 million), with revenue of £965 million (2017: £909 million) offset by £604 million (2017: £597 million) of operating costs. Depreciation and amortisation have remained consistent with the prior period with staff costs falling slightly through a lower head count offset by general inflationary pressures across our cost base.

Capital investment

Capital investment was £350 million (2017: £280 million) comprising £6 million of intangible assets and £344 million of tangible assets. Tangible assets additions are mainly comprised of £292 million of plant and machinery and £44 million of assets in the course of construction. The large increase in additions in the period is due to ramping up of our major capital works programmes including the HS2 diversions activity.

Financial position

Net assets increased by 1.3% to £5,473 million (31 March 2018: £5,402 million). The main movements in the balance sheet items were property, plant and equipment and intangible fixed assets totalling £166 million arising from capital investment offset by depreciation and amortisation. The retirement benefit asset relating to the Group's UK Pension Scheme at 30 September 2018 was £622 million (31 March 2018: £507 million), an increase of £115 million from 31 March 2018. This increase reflects the increase in the underlying discount rate, updates to demographic assumptions based on more recent data offset by higher inflation.

As per Note 10, the Group has net debt of £9,112 million (31 March 2018: £8,976 million). On 30 August, Quadgas Finance Plc issued £295 million private placement notes with maturities between 2030 and 2033. On 17 September, Quadgas Finance Plc issued a £350 million public bond maturing in 2029. The proceeds raised were on-lent to Quadgas MidCo Limited and used to repay and service existing debt. The Group continues to have at its disposal sufficient undrawn, committed borrowing facilities at competitive rates for the medium term.

Cash flow

Net cash inflow from operating activities for the six months ended 30 September 2018 was £420million (2017: £404 million), with a higher operating profit partly offset by changes in working capital.

Events after the balance sheet date

In October 2018, the High Court handed down a judgement involving the Lloyds Banking Group's defined benefit pension schemes, concluding that the schemes should equalise benefits for men and women in relation to guaranteed minimum pension benefits. See note 11 for further details.

On 30 October 2018, the Group listed the USPP notes that it issued in September 2018 on the London Stock Exchange.

On the 8 November 2018, National Grid Plc announced its decision to exercise the options over the remaining 39% investment in Quadgas HoldCo Limited (an indirect parent company of Quadgas MidCo Limited) with an expected completion date of June 2019, subject to regulatory approvals. The option over 25% of the investment in Quadgas HoldCo Limited was entered into on 1 May 2018 and the 14% option in the investment entered into at the time of the original sale of the majority stake in March 2017. Post completion, 100% of the investment in Quadgas HoldCo Limited will be owned by the consortium company – Quadgas Investment Bidco Limited.

On Friday 30 November 2018, Ofgem initiated discussions with Cadent Gas Limited in relation to its concerns over interruptions performance across our networks. Discussions are at an early stage and the Company will continue to cooperate with Ofgem on this matter.

Related party transactions

There have been no material changes in the related party transactions described in the last annual report.

Key performance indicators

As set out in our most recent annual report, we monitor our performance implementing our strategy with reference to clear targets set for key performance indicators (KPIs). These KPIs are applied on a Group wide basis. Performance in the six months ended 30 September 2018, where available as some are annual figures, and the targets are set out in the table below, together with the prior year performance data for the period to 31 March 2018 and the six month period to 30 September 2017. The source of data and calculation methods used are consistent with those disclosed in the 2018 annual report and financial statements.

Strategic priorities	KPIs	Definition	Performance
Delivering a safe and reliable network	**Safety**	**Lost time injuries frequency rate** Any injury to employee or contractor resulting in time off work (injuries per million hours worked).	**2018/19 half year: 0.94** **2017/18: 0.94** **2017/18 half year: 1.24** **(Target: Less than 0.9)** [1]
	Reliability	**Network reliability** Reliability of company's gas network as a percentage against the internal target. The targets set by Ofgem are on an individual gas distribution network basis.	**2018/19 half year: Full year measure** **2017/18: 99.996%** **2017/18 half year: Full year measure** **(Target: Higher than 99.999%)**
	Kilometres of network replaced	**Kilometres of network replaced** Number of kilometres of main pipe replaced.	**2018/19 half year: 846km** **2017/18: 1,625km** **2017/18 half year: 834km** **(Full year target: Higher than 1,771km[3])**
Performing for our customers and communities	**Customer satisfaction**	**Customer satisfaction** Our score in customer satisfaction surveys. Ofgem set a baseline target.	**2018/19 half year: 8.54** **2017/18: 8.49** **2017/18 half year: 8.60** **(Target: Higher than 8.30[2])**
	Complaints	**Complaints handling** Our score in complaints handling.	**2018/19 half year: 4.08** **2017/18: 7.13** **2017/18 half year: 8.12** **(Full year target: Less than 11.57[2])**

[1] Both target and actual is an annual 12-month rolling number
[2] Figures represent our baseline targets set by Ofgem for reward or penalty under RIIO.

[3] Our programme has been developed to deliver our output of length replaced across all of our networks economically and sustainably over the eight year RIIO period rather than on an individual year basis.

Further details of our priorities are disclosed on page 2 of the Annual Report and Financial Statements 2017/18.

Impact of new accounting standards

IFRS 9 ‘Financial Instruments’ and IFRS 15 ‘Revenue from Contracts with Customers’ are applicable to reporting periods beginning on or after 1 January 2018, and have therefore been adopted by the Group for the period commencing 1 April 2018.

In line with the assessment disclosed in the Group’s Annual Report and Accounts for the year ended 31 March 2018, the adoption of IFRS 9 ‘Financial Instruments’ did not give rise to material transitional adjustments (see note 1 for more detail).

IFRS 15 provides a single, principles-based approach to the recognition of revenue from contracts with customers, focussing on the identification of performance obligations in a contract and requiring revenue to be recognised when or as those performance obligations are satisfied. We have adopted IFRS 15 on a modified retrospective basis and accordingly we have not restated prior year comparatives for the effect of IFRS 15 but have instead restated our 1 April 2018 opening reserves for the full cumulative impact of adopting this standard. The impacts on the Group’s results for the period are a cumulative adjustment to increase equity at 1 April 2018 by £14m, and an increase in revenue of £16m for the six months ended 30 September 2018 which reflects a change in recognition of diversion contributions. Note 1 also provides details of our adoption of IFRS 15 ‘Revenue from Contracts with Customers’.

A new accounting standard, IFRS 16 ‘Leases’, comes into effect on 1 January 2019 and will apply to the Group from 1 April 2019. The standard will primarily impact the treatment of the operating leases held by the Group, with these leases being recognised on the balance sheet. Work is ongoing to assess the full impact of the new standard. The Group, however, has not yet concluded on the value of right-of-use assets and lease liabilities that will be recognised on adoption, or on how they will impact the Group's income statement or cash flow classification. By way of indication, the Group had gross operating lease commitments of £19m at 31 March 2018. This does not reflect the discounting of commitments to present value, as required by IFRS16.

Risks and uncertainties

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance over the remaining six months of the financial year and could cause actual results to differ materially from expected and historical results. The Directors do not consider that the principal risks and uncertainties have changed since the publication of the annual report for the year ended 31 March 2018. A detailed explanation of the risks and how the Group seeks to mitigate the risks, can be found on pages 7 to 11 of the Annual Report and Financial Statements for the year ended 31 March 2018. Below is a summary of our key risks as at 30 September 2018:

- Safety, health, environment and security
- Failure to protect consumers’ interests
- Failure to effectively manage assets and maintain network reliability
- Failure to comply with legal and regulatory requirements or failure to deliver regulatory outputs
- Cyber breach or critical system failure
- Failure to secure critical skills and engagement
- Disruptive forces and regulatory responses

Going concern

As stated in note 1 to the financial statements, the Directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Auditor

Following the completion of the 2017/18 audit process, Deloitte LLP have been re-appointed as auditor of the Quadgas HoldCo Limited Group and its subsidiaries including Quadgas MidCo Limited.

Cautionary statement

This Interim Management Report (IMR) has been prepared solely to provide additional information to shareholders to assess the Group's strategies and the potential for those strategies to succeed. The IMR should not be relied on by any other party or for any other purpose.

The IMR contains certain forward-looking statements. These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this report but such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

By order of the Board,

M W Braithwaite
Director
12 December 2018

Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE

Quadgas Midco Limited

Responsibility statement

The half year financial information is the responsibility of, and has been approved by, the Directors. The Directors confirm that the financial information has been prepared in accordance with IAS 34 as issued by the International Accounting Standards Board and as adopted by the European Union.

The Directors of Quadgas MidCo Limited are as listed in the Quadgas MidCo Limited Annual Report and Financial Statements for the period ended 31 March 2018 with the exception of the following changes to the Board:

- On 20 July 2018, Stuart Calvin Humphreys was appointed as Director of Quadgas MidCo Limited. On the same day, Andrew Jonathan Agg resigned as Director of Quadgas MidCo Limited.

- On 23 August 2018, Hua Su was appointed a Director of Quadgas MidCo Limited . On the same day Jianmin Bao resigned as Director of Quadgas MidCo Limited.

- On 29 October 2018, Christopher Bennett, Stuart Humphreys, Lucy Shaw and Christopher Waters resigned as Directors of Quadgas MidCo Limited.

- On 28 November 2018, Martin Bradley resigned as a Director of Quadgas MidCo Limited. On the same day, Mark Mathieson was appointed a Director and Richard Greenleaf was appointed as an alternate Director of Quadgas MidCo Limited.

- On 29 November 2018, Eduard Fidler was appointed a Director of Quadgas MidCo Limited. On the same day Aoife Mcmenamin resigned as a Director of Quadgas MidCo Limited.

By order of the Board,

M W Braithwaite
Director
12 December 2018

Independent review report to Quadgas Midco Limited

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2018 which comprises the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of financial position, Consolidated the statement of changes in equity, the Consolidated cash flow statement and related notes 1 to 14. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Financial Reporting Council. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors.

As disclosed in note 1, the annual financial statements of the company are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Financial Reporting Council for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2018 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union.

Deloitte LLP

Deloitte LLP
Statutory Auditor
London, United Kingdom
12 December 2018

Quadgas Midco Limited

Consolidated income statement

Six months ended 30 September 2018

	Notes	Six months ended 30 September 2018 (Unaudited) £m	£m	Six months ended 30 September 2017 (Unaudited) £m	£m
Revenue			**965**		909
Operating costs			**(595)**		(589)
Operating profit					
Before exceptional items		**370**		320	
Exceptional items	4	**(9)**		(8)	
Total Operating profit			**361**		312
Finance income	5		**8**		-
Finance costs					
Before exceptional items and remeasurements	5	**(135)**		(139)	
Exceptional items and remeasurements	4	**(3)**		(9)	
Total interest payable and similar charges			**(138)**		(148)
Profit before tax					
Before exceptional items and remeasurements		**243**		181	
Exceptional items and remeasurements		**(12)**		(17)	
Total profit before tax			**231**		164
Tax					
Before exceptional items and remeasurements		**(47)**		(34)	
Exceptional items and remeasurements		**3**		3	
Total tax	6		**(44)**		(31)
Profit after tax					
Before exceptional items and remeasurements		**196**		147	
Exceptional items and remeasurements		**(9)**		(14)	
Profit for the period			**187**		133

The results above relate to continuing operations.

Quadgas MidCo Limited

Consolidated statement of comprehensive income

Six months ended 30 September 2018

	Six months ended 30 September		Six months ended 30 September	
	2018 £'m (Unaudited)	2018 £'m (Unaudited)	2017 £'m (Unaudited)	2017 £'m (Unaudited)
Profit for the period		187		133
Items that will not be reclassified subsequently to profit or loss:				
Remeasurements of post-employment benefit obligations	57		185	
Tax on items that will not be reclassified to profit or loss	(10)		(32)	
Items that may be reclassified subsequently to profit or loss:		47		153
Net (losses)/gains in respect of cash flow hedges	-		13	
Amortisation of cost of hedging reserve	3		-	
Net losses in respect of cost of hedging reserve	(4)		-	
Tax on items that may be reclassified subsequently to profit or loss	-		(2)	
		(1)		11
Other comprehensive income for the period		46		164
Total comprehensive income for the period		233		297

The results above relate to continuing operations.

Quadgas MidCo Limited

Consolidated statement of financial position

As at 30 September 2018

	Notes	**As at 30 September 2018 £'m (Unaudited)**	As at 31 March 2018 £'m (Audited)
Non-current assets			
Intangible assets		5,506	5,514
Property, plant and equipment	8	10,788	10,614
Pension and other post-retirement benefit assets	11	622	507
Other non-current assets		42	50
Derivative financial instruments	9	26	13
		16,984	16,698
Current assets			
Inventories		6	6
Trade and other receivables		222	237
Derivative financial instruments	9	-	5
Current asset investments		90	161
Cash and cash equivalents		17	20
		335	429
Total assets		17,319	17,127
Current liabilities			
Trade and other payables		(515)	(421)
Derivative financial liabilities	9	-	(3)
Borrowings	10	(25)	(53)
Current tax liabilities		(54)	(55)
Provisions		(8)	(17)
		(602)	(549)
Non-current liabilities	9		
Derivative financial liabilities		(19)	(9)
Borrowings	10	(9,201)	(9,110)
Deferred tax liabilities		(1,926)	(1,921)
Provisions		(85)	(78)
Other non-current liabilities		(13)	(58)
		(11,244)	(11,176)
Total liabilities		(11,846)	(11,725)
Net assets		5,473	5,402
Equity			
Share capital		1	1
Share premium account		-	-
Cash flow hedge reserve		12	12
Cost of hedging reserve		-	-
Retained earnings		5,460	5,389
Total equity		5,473	5,402

The consolidated financial statements on pages 9 to 25 were approved for issue by the Board of Directors on 12 December 2018 and were signed on its behalf by:

M Braithwaite
Director
Quadgas MidCo Limited
Company registration number: 10615396

Quadgas MidCo Limited

Consolidated statement of changes in equity

Six months ended 30 September 2018

	Share Capital £'m	Share Premium Account £'m	Cashflow hedge reserve £'m	Cost of hedging reserve £'m	Retained Earnings £'m	Total £'m
Balance at 31 March 2018 (audited)	1	-	12	-	5,389	5,402
Changes due to adoption of IFRS 15 & IFRS 9	-	-	-	1	7	8
Balance at 1 April 2018 (restated)	**1**	**-**	**12**	**1**	**5,396**	**5,410**
Profit for the period	**-**	**-**	**-**	**-**	**187**	**187**
Amortisation of cost of hedging reserve	**-**	**-**	**-**	**3**		**3**
Other comprehensive income for the period	**-**	**-**	**-**	**(4)**	**47**	**43**
Total comprehensive income for the period	**-**	**-**	**-**	**(1)**	**234**	**233**
Dividends	**-**	**-**	**-**	**-**	**(170)**	**(170)**
Balance at 30 September 2018 (Unaudited)	**1**	**-**	**12**	**-**	**5,460**	**5,473**

	Share Capital £'m	Share Premium Account £'m	Cashflow hedge reserve £'m	Cost of hedging reserve £'m	Retained Earnings £'m	Total £'m
Balance at 1 April 2017	4,928	-	-	-	(10)	4,918
Profit for the period	-	-	-	-	133	133
Other comprehensive income for the period	-	-	11	-	153	164
Total comprehensive income for the period	-	-	11	-	286	297
Balance at 30 September 2017 (unaudited)	4,928	-	11	-	276	5,215

The cash flow hedge reserve on interest rate swap contracts will be recycled to the income statement over the life of the hedged items.

Quadgas MidCo Limited

Consolidated cash flow statement

Six months ended 30 September 2018

	Six months ended 30 September 2018 £'m (Unaudited)	Six months ended 30 September 2017 £'m (Unaudited)
Cash flows from operating activities		
Total operating profit	361	312
Adjustments for:		
Exceptional items	9	8
Depreciation, amortisation and impairment	182	176
Changes in working capital	(10)	46
Capital contribution income	(16)	-
Changes in provisions	2	(10)
(Gain)/loss on disposal of property, plant and equipment	(1)	-
Changes in pensions and other post-retirement obligations	(52)	(53)
Cash flows relating to exceptional items	(5)	(8)
Cash generated from operations	470	471
Tax paid	(50)	(67)
Net cash from operating activities	420	404
Cash flows from investing activities		
Purchases of intangible assets	(6)	-
Purchases of property, plant and equipment	(300)	(271)
Capital contributions	59	25
Disposals of property, plant and equipment	-	-
Net disposals / (additions) of short-term financial investments	71	(74)
Interest received	1	-
Net cash used in investing activities	(175)	(320)
Cash flows from financing activities		
Proceeds received from loans	708	165
Repayment of loans	(646)	(119)
Interest paid	(136)	(130)
Dividends paid to shareholders	(170)	-
Net cash used in financing activities	(244)	(84)
Net increase in cash and cash equivalents	1	-
Cash and cash equivalents at beginning of period	14	(15)
Net cash and cash equivalents/(overdraft) at end of period	15	(15)
Comprising - Cash	17	10
- Overdraft	(2)	(25)
	15	(15)

1. Basis of preparation and new accounting standards, interpretation and amendments

The half year condensed financial information covers the six month period ended 30 September 2018 and has been prepared under International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS as adopted by the European Union, in accordance with International Accounting Standard 34 'Interim Financial Reporting' and the Disclosure and Transparency Rules of the Financial Conduct Authority.

The half year financial information does not constitute statutory accounts as defined in Section 434 of the Companies Act 2006. It should be read in conjunction with the statutory accounts for the year ended 31 March 2018, which were prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and as adopted by the EU, and have been filed with the Registrar of Companies. The auditor's report on these statutory accounts was unqualified and did not contain a statement under Section 498 of the Companies Act 2006.

Having made enquiries and reassessed the principal risks, the Directors consider that the Company and its subsidiary undertakings have adequate resources to continue in business, and that it is therefore appropriate to adopt the going concern basis in preparing the half year financial information.

In preparing this half year financial information, the areas of judgement made by management in applying the Quadgas MidCo Limited's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended 31 March 2018.

The half year financial information has been prepared in accordance with the accounting policies expected to be applicable for the year ending 31 March 2019 and consistent with those applied in the preparation of the accounts for the year ended 31 March 2018, with the exception of the adoption of IFRS 9 and IFRS 15. The Group has applied IFRS 9 'Financial instruments' and IFRS 15 'Revenue from contracts with customers' for the first time during the period coming into effect on 1 April 2018. As required by IAS 34, the nature and effect of these changes are disclosed below.

IFRS 9 'Financial instruments'

The Group adopted IFRS 9 from 1 April 2018. In accordance with the transition provisions in the Standard, comparatives have not been restated.

Classification of financial assets

IFRS 9 requires the use of two criteria to determine the classification of financial assets: the entity's business model for the financial assets and the contractual cash flow characteristics of the financial assets. The Standard goes on to identify three categories of financial assets - amortised cost; fair value through profit or loss (FVTPL); and fair value through other comprehensive income (FVOCI).

Under IFRS9 money market funds are now being shown as FVTPL however this change did not result in any adjustment to the accounts in current or prior year.

Impairment

IFRS 9 mandates the use of an expected credit loss model to calculate impairment losses rather than an incurred loss model. Under IFRS 9 it is not necessary for a credit event to have occurred before credit losses are recognised. The new impairment model applies to the Group's financial assets and loan commitments.

For the majority of trade receivables in the Group a detailed provision matrix approach is already applied to establish impairment and this is considered appropriate under IFRS 9. The performance of the assumptions made will continue to be reviewed on an ongoing basis.

An adjustment on transition of £6m was made to other non-current assets relating to a loan to a counterparty that was deemed as impaired under the expected loss model. This has been recognised through retained earnings in line with the standard.

1. Basis of preparation and new accounting standards, interpretation and amendments (continued)

Hedge accounting

The group is now showing cost of hedging in a separate reserve as required under the new standard, and will also be conducting effectiveness tests in a different way, which we anticipate will lead to reduced ineffectiveness.

The group has also taken this opportunity to revise its policies to designate the derivatives, including credit, which will lead to reduced P&L volatility.

On transition, there is a £1m decrease in retained earnings and a £1m increase in the cost of hedging reserve.

	IAS 39 carrying amount 31 March 2018* £m	Adjustments to relating to IFRS 9 transition £m	IFRS 9 carrying amount 1 April 2018* £m
Retained earnings	5,389	(7)	5,382
Cash flow hedge reserve	12	-	12
Cost of hedging reserve	-	1	1
Other non-current assets	237	(6)	231

* The amounts in this column are before the adjustments from the adoption of IFRS 15.

<u>IFRS 15 'Revenue from Contracts with Customers'</u>

On 1 April 2018 the Group adopted IFRS 15, applying the modified retrospective approach. IFRS 15 provides a single, principles-based approach to the recognition of revenue from contracts with customers, focussing on the identification of performance obligations in a contract and requiring revenue to be recognised when or as those performance obligations are satisfied. The impacts on the Group's results for the period are a cumulative adjustment to increase equity at 1 April 2018 by £14m, an increase in revenue of £16m for the six months ended 30 September 2018. This reflects a change to customer contributions received towards altering, diverting or relocating a tangible fixed asset. These customer contributions were included as deferred income and credited on a straight-line basis to the income statement over the estimated useful economic lives of the assets to which they related. Under IFRS 15, the revenue recognition has been revised with the income recognised once the performance obligation (altering, diverting or relocating a tangible fixed asset) has been completed. There is no change to the accounting for customer contributions received for connections which continues to be recognised when the connection has been completed and the performance obligation satisfied. There were no other material changes.

1. Basis of preparation and new accounting standards, interpretation and amendments (continued)

In summary, the following adjustments were made to the amounts recognised in the statement of financial position at the date of initial application (1 April 2018):

	IAS 18 carrying amount 31 March 2018* £m	Adjustments to customer contributions (altering, diverting or relocating a tangible fixed asset) £m	IFRS 15 carrying amount 1 April 2018* £m
Accruals and deferred income (non-current)	(58)	40	(18)
Accruals and deferred income (current)	(133)	(25)	(158)
Deferred tax	(1,921)	(1)	(1,922)
Retained earnings	5,389	14	5,403

* The amounts in this column are before the adjustments from the adoption of IFRS 9.

<u>New accounting standards not yet applied</u>

A new accounting standard, IFRS 16 'Leases', comes into effect on 1 January 2019 and will apply to the Group from 1 April 2019. The standard will primarily impact the treatment of the operating leases held by the Group, with these leases being recognised on the balance sheet. Work is ongoing to assess the full impact of the new standard. The assessment has focused on all of the Group's existing operating and finance leases, as well as considering other contractual arrangements to identify whether they constitute a lease under the definitions of the new standard. Given that the project has not been finalised, it is not possible to disclose the amount of right-of use assets and new lease liabilities that will be recognised on adoption of the standard, or how this will affect the Group's income statement and classification of cash flows.

By way of indication, IFRS 16 will primarily affect the accounting for the Group's operating leases, to which the Group had commitments of £19m at 31 March 2018. This is a gross value and does not reflect a discounting of the commitments to their present value, as required by IFRS 16.

Short term and low-value leases are excluded and will continue to be charged to the income statement on a straight-line basis over the term of the lease. The Group estimates that only a small proportion of the existing operating leases will relate to payments for short-term and low value leases.

IFRS 16 will be adopted on 1 April 2019 and management intend to apply the modified retrospective approach on transition.

2. Segmental analysis

The Directors believe that the whole of the Group's activities constitute one single segment. Operating segments are reported in the manner consistent with internal reporting to the Chief Operating Decision Maker, which has been identified as the Board of Directors.

The Group's country of domicile is the United Kingdom and is the country in which it generates all of its revenue. The Group's assets are all located within the United Kingdom

3. Seasonality

The volumes of gas distributed across network assets are dependent on levels of customer demand which are generally higher in winter months. As a result of this, the amounts reported for the interim period may not be indicative of the amounts that will be reported for the full year due to seasonal fluctuations in customer demand for gas and the impact of weather on demand.

4. Exceptional items and remeasurements

Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are important to an understanding of our financial performance and may significantly distort the comparability of financial performance between periods. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments to the extent that hedge accounting is not achieved or is not effective.

	Six months ended 30 September 2018 £m	Six months ended 30 September 2017 £m
Included within operating costs:		
Separation costs (i)	**(8)**	**(8)**
Restructuring costs (ii)	**(1)**	**-**
	(9)	**(8)**
Included within finance costs:		
Remeasurements		
Net losses on derivative financial instruments	**(3)**	**(9)**
Total included within profit before tax	**(12)**	**(17)**
Included within taxation:		
Tax on separation costs	**2**	**1**
Tax on restructuring	**-**	**-**
Tax on remeasurements	**1**	**2**
	3	**3**
Total exceptional and remeasurements after tax	**(9)**	**(14)**
Analysis of total exceptional items and remeasurements after tax		
Total exceptional items after tax	**(7)**	**(7)**
Total remeasurement after tax	**(2)**	**(7)**
	(9)	**(14)**

(i) As a result of the acquisition of Cadent Gas Limited, a number of separation activities have arisen.

(ii) The company is undergoing a reorganisation exercise as part of the ongoing performance improvement activities.

5. Finance income and costs

	Six months ended 30 September 2018	Six months ended 30 September 2017
	£m	£m
Finance income		
Interest income from pensions	8	-
Finance income	8	-
Finance costs		
Interest expense on financial liabilities held at amortised cost:		
Bank loans and overdrafts	30	99
Other borrowings	70	-
Interest payable on inter-company financing	31	-
Derivatives	4	-
Unwinding of discounts on provisions	-	1
Other interest	-	39
Finance costs	135	139
Remeasurements		
Net gains/(losses) on derivative financial instruments included in remeasurements:		
Ineffectiveness on derivatives designated as:		
Fair value hedges	-	-
Cash flow hedges	-	13
Derivatives not designated as hedges or ineligible for hedge accounting	3	(4)
Remeasurements included within finance costs	3	9
Finance costs	138	148
Net finance costs	130	148

6. Tax

The tax charge for the period from continuing operations, excluding tax on exceptional items and remeasurements and purchase price allocation adjustments, is £51m (six months to 30 September 2017 £42m). The effective tax rate of 19.2% for the period (six months to 30 September 2017: 19.2%) is based on the best estimate of the annual income tax rate expected for the full year, excluding tax on exceptional items and remeasurements and purchase price allocation adjustments.

The Finance Act 2015 (No.2) was enacted on 18 November 2015. The Act reduced the main rate of UK corporation tax to 19% with effect from 1 April 2017 and 18% from 1 April 2020. The Finance Act 2016 received Royal Assent on 15 September 2016. The Act further reduced the corporate tax rate to 17% from 1 April 2020, from the previously enacted 18%. Deferred tax balances forecast to reverse in the period to 31 March 2020 have been provided for at 19%. Deferred tax balances forecast to reverse in the period after 31 March 2020 have been provided for at 17%.

The Finance Act 2018 was enacted on 15 March 2018. The Act introduced new rules to potentially restrict interest deductibility for the accounting periods starting after 31 March 2017. It is not anticipated that there will be any interest restriction in the Group for the foreseeable future.

7. Dividends

	Six months ended 30 September 2018	Six months ended 30 September 2017
	£m	£m
Interim dividend of 3.33 pence per ordinary share amounting to £170,000,000 was declared and paid on the 28 September 2018	170	-
	170	-

8. Property, plant and equipment

	Land and buildings	Plant and Machinery	Assets in the course of construction	Motor vehicles and other equipment	Total
	£m	**£m**	**£m**	**£m**	**£m**
Cost					
At 1 April 2018	83	10,736	20	98	10,937
Additions	**1**	**292**	**44**	**7**	**344**
Reclassifications	**-**	**1**	**(2)**	**1**	**-**
Disposals	-	-	-	-	-
At 30 September 2018	**84**	**11,029**	**62**	**106**	**11,281**
Accumulated depreciation and impairment					
At 1 April 2018	(7)	(293)	**-**	(23)	(323)
Charge for the period	**(3)**	**(155)**	**-**	**(12)**	**(170)**
Disposals	**-**	**-**	**-**	**-**	**-**
At 30 September 2018	**(10)**	**(448)**	**-**	**(35)**	**(493)**
Net book value:					
At 30 September 2018	**74**	**10,581**	**62**	**71**	**10,788**
At 31 March 2018	76	10,443	20	75	10,614

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2018

8. Property, plant and equipment (continued)

	Land and buildings	Plant and Machinery	Assets in the course of construction	Motor vehicles and other equipment	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2017	76	10,180	8	66	10,330
Additions	1	561	18	30	610
Reclassifications	6	(4)	(5)	3	-
Disposals	-	(1)	(1)	(1)	(3)
At 31 March 2018	83	10,736	20	98	10,937
Accumulated depreciation and impairment					
At 1 April 2017	-	-	-	-	-
Charge for the period	(7)	(293)	-	(23)	(323)
Disposals	-	-	-	-	-
At 31 March 2018	(7)	(293)	-	(23)	(323)
At 31 March 2018	76	10,443	20	75	10,614
At 31 March 2017	76	10,180	8	66	10,330

9. Fair value measurement

Certain of the Group's financial instruments are measured at fair value. The following table categorises these financial assets and liabilities by the valuation methodology applied in determining their fair value using the fair value hierarchy described below:

	30 September 2018				31 March 2018			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Assets								
Available-for-sale investments	107	-	-	107	181	-	-	181
Derivative financial instruments	-	26	-	26	-	18	-	18
Liabilities								
Derivative financial instruments	-	(19)	-	(19)	-	(12)	-	(12)
Total	107	7	-	114	181	6	-	187

Financial assets and liabilities in the consolidated statement of financial position are either held at fair value or the carrying value if it approximates to fair value, with the exception of borrowings, which are held at amortised cost.

The estimated fair value of total borrowings using market values at 30 September 2018 is £8,922m (31 March 2018: £9,019m).

Level 1: Financial instruments with quoted prices for identical instruments in active markets.
Level 2: Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are based directly or indirectly on observable market data.
Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are based on unobservable market data.

10. Net debt

	Six months ended 30 September 2018 £m	Period ended 31 March 2018 £m
Increase in cash and cash equivalents	**1**	30
(Increase) / decrease in financial investments	**(71)**	102
Increase in borrowings & related derivatives	**(62)**	(350)
Net interest paid on the components of net debt	**136**	197
Change in net debt arising from cash flows	**4**	(21)
Changes in fair value of financial assets and liabilities and exchange movements	**(2)**	15
Other non-cash changes	**-**	171
Net interest charge on the components of net debt	**(138)**	(270)
Movement in net debt (net of related derivative financial instruments)	**(136)**	(105)
Net debt (net of related derivative financial instruments) at the start of the period	**(8,976)**	(8,871)
Net debt (net of related derivative financial instruments) at the end of the period	**(9,112)**	(8,976)

Composition of net debt:		
Cash, cash equivalents and financial investments	**107**	176
Borrowings and bank overdrafts	**(9,226)**	(9,158)
Derivatives	**7**	6
Total net debt	**(9,112)**	(8,976)

11. Retirement benefit schemes

	30 September 2018	31 March 2018
	£m	£m
Present value of funded obligation	**(5,927)**	(6,306)
Fair value of plan assets	**6,552**	6,816
	625	510
Present value of unfunded obligations	**(3)**	(3)
Other post-employment liabilities	**-**	-
Net asset	**622**	507
Represented by:		
Liabilities	**(5,930)**	(6,309)
Assets	**6,552**	6,816
	622	507

Key actuarial assumptions		
Discount rate – Past service	**2.85%**	2.60%
Rate of increase in RPI– Past service	**3.25%**	3.15%

The net pensions and other post-retirement benefit obligations position, as recorded under IAS19, at 30 September 2018 was a surplus of £622m compared to £507m at 31 March 2018. The increase in the surplus of £115m primarily reflects the increase in the discount rates in the UK while an increase in the inflation assumption has partially offset this.

The pension surplus at 30 September 2018 attributable to the UK pension plans do not reflect any accounting consequences that may be required as a result of guaranteed minimum pension equalisation (note 14). We will be considering the consequences of the recent Lloyds Banking Group judgement issued by the High Court in the coming months.

12. Commitments and Contingencies

At 30 September 2018 there were commitments for future capital expenditure contracted but not provided for £561m (31 March 2018: £741m). We also have other commitments relating primarily to operating leases and contingencies in the form of letters of credit. These commitments and contingencies are described in further detail on page 57 of the Annual Report and Financial Statements 2017/18.

In early 2018, Cadent identified that a number of high-rise buildings were not on our records and therefore were not part of the 10-year rolling survey programme for long life assets. Cadent immediately implemented a survey recovery programme to resolve the issue as quickly and effectively as possible. The recovery programme was completed on 24 September 2018. Cadent also informed the Health and Safety Executive and Ofgem who opened investigations into this issue. Both of the investigations could result in a financial penalty against Cadent in accordance with the respective guidelines that apply. However, the investigations are at too early a stage for Cadent to provide any indication of the likely outcome. Cadent continues to work with the Health and Safety Executive and Ofgem as they progress their investigations.

Through the ordinary course of our operations, we are party to various litigation, claims and investigations. We do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on our results of operations, cash flows or financial position.

13. Related party transactions

Related party transactions in the six months ended 30 September 2018 were the same in nature to those disclosed on page 71 of the Annual Report and Financial Statements 2017/18. There were no related party transactions in the period that have materially affected the financial position or performance of the Group.

14. Events occurring after the reporting period

In October 2018, the High Court handed down a judgement involving the Lloyds Banking Group's defined benefit pension schemes, concluding that the schemes should equalise benefits for men and women in relation to guaranteed minimum pension benefits. See note 11 above for further details.

On 30 October 2018, the Group listed the USPP notes that it issued in September 2018 on the London Stock Exchange.

On the 8 November 2018, National Grid Plc announced its decision to exercise the options over the remaining 39% investment in Quadgas HoldCo Limited (an indirect parent company of Quadgas MidCo Limited) with an expected completion date of June 2019, subject to regulatory approvals. The option over 25% of the investment in Quadgas HoldCo Limited was entered into on 1 May 2018 and the 14% option in the investment entered into at the time of the original sale of the majority stake in March 2017. Post completion, 100% of the investment in Quadgas HoldCo Limited will be owned by the consortium company – Quadgas Investment Bidco Limited.

On Friday 30 November 2018, Ofgem initiated discussions with Cadent Gas Limited in relation to its concerns over interruptions performance across our networks. Discussions are at an early stage and the Company will continue to cooperate with Ofgem on this matter.