

Interim management report

Quadgas MidCo Limited

Report for the six months ended 30 September 2019

Highlights:

- Continued strong performance with operating profit before exceptionals of £477m (September 2018: £370m), total operating profit of £435m (September 2018: £361m)
- Continued focus on investment with capital investment of £420m (September 2018: £350m)
- Strong balance sheet with a net asset position of £4,382m (March 2019: £4,199m)

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 an increase in diversion income recognised under IFRS 15.

Operating costs have decreased due to lower pass through costs including shrinkage and exit capacity costs, as well as lower staff costs. The Group is also expected to deliver its regulatory outputs and continue to deliver targeted efficiencies through its transformation programmes.

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 shared our vision to set standards all of our customers love and others aspire to (with customers being defined as our consumers, suppliers and shipper). We are continuing through our transformation journey to develop a customer first approach that has an ethos of constantly maintaining availability of gas supplies to our customers by developing appropriate techniques and using innovative ways to achieve this goal. As we do so, we will also push the boundaries in our role in supporting the safety of customers in the home, helping alleviate fuel poverty, support those who are most vulnerable, essentially making our services more accessible to all types of customer.

To achieve this, Cadent Gas Limited (Cadent), our regulated business, will continue looking for ways to optimise performance. In 2019/20 we'll continue to work closely with Ofgem to develop a RIIO-2 framework which will create value for customers and stakeholders. Cadent has submitted a draft business plan in July 2019, with subsequent submissions made in October 2019, with the final plan being submitted in December 2019. The performance of our regulated business will be underpinned by continued investment so we can make sure we deliver a safe, reliable and affordable service for our customers.

Quadgas MidCo Limited

Interim Management Report (continued)

Results for the six months ended 30 September 2019

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

	Six months ended 30 September 2019 £'m	Six months ended 30 September 2018 £'m	Movement £'m
Revenue	1,040	965	75
Operating profit – Before exceptional items	477	370	107
Exceptional items	(42)	(9)	(33)
Operating profit	435	361	74
Profit before tax – Before exceptional items & remeasurements	340	243	97
Profit before tax	265	231	34
Capital investment	420	350	70

Revenue

Total Group revenue for the period was £1,040 million (2018: £965 million) comprising £962 million (2018: £925 million) of regulated allowed revenue and £78 million (2018: £40 million) from non-regulated activities. The £37 million increase in regulated allowed revenue is mainly driven by an increase in the inflation factor included within the agreed Ofgem pricing model and the recovery of higher business rates from FY 17/18. The £38m increase in non-regulated revenues is mainly as a result of higher capital contribution income in relation to the ongoing HS2 project.

Operating profit

Operating profit for the period was £435 million (2018: £361 million), with revenue of £1,040 million (2018: £965 million) offset by £605 million (2018: £604 million) of operating costs. Operating costs have decreased due to lower pass through costs including shrinkage and exit capacity costs as well as lower staff costs partially offset by higher depreciation and amortisation as a result of having a higher asset base.

Exceptional items and remeasurements

Included within operating profit are exceptional items of £42m. As part of Cadent's drive to improve the efficiency of our operations, Cadent announced on 13 May 2019 that it was offering a voluntary redundancy programme for all managers and staff. Restructuring costs totalling £30m have been recognised, of which £26m relates to the redundancy programme (provision of £7m and additional pension liability of £19m). An additional £12m exceptional items have also been recognised in relation to separation activities; principally IT systems.

Remeasurements of £33m have been recognised within finance costs in relation to the remeasurement of derivatives. This is due to changes in the mark-to-market values of index-linked swaps, which have been affected by inflation and interest rate assumptions.

Quadgas MidCo Limited

Interim Management Report (continued)

Capital investment

Capital investment was £420 million (2018: £350 million) comprising £26 million of intangible assets and £394 million of tangible assets. Tangible assets additions are mainly comprised of £346 million of plant and machinery and £36 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, plus an increase of £27 million due to adoption of IFRS 16 'Leases' (IFRS 16).

Financial position

Net assets increased by 4% to £4,382 million (March 2019: £4,199 million). The main movements in the balance sheet items were property, plant and equipment and intangible fixed assets totalling £253 million arising from capital investment offset by depreciation and amortisation. An increase in net assets of £2m resulted from the adoption of IFRS 16 during the period.

The Group operates pension arrangements for employees many of whom are members of Section C of the defined benefits section of the National Grid UK Pension Scheme (NGUKPS) which is closed to new entrants. Membership of the defined contribution scheme is offered to all new employees. On an IAS 19 basis the defined benefits pension scheme is in a net asset position of £848 million at 30 September 2019 (March 2019: £690 million). This increase is due to gains on the scheme assets and additional deficit contributions paid into the scheme in the period of £40m, offset by a decrease in discount rate.

As per Note 10, the Group has net debt of £9,472 million (March 2019: £9,221 million). On 12 July 2019, Quadgas Midco Ltd refinanced its outstanding debt facilities extending the maturity to 2024 (previously 2022). This included repaying the existing syndicated term loan of £218m and drawing a new syndicated term loan of £220m. The undrawn Revolving Credit Facility was replaced with a new facility with a maturity date of 2024, as was the liquidity facility. 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 2019 was £418 million (September 2018: £420 million), with a higher operating profit being offset by changes in working capital and additional tax paid.

Events after the balance sheet date

On 10 October 2019, Cadent Finance Plc issued a 16 year fixed rate bond with a notional value of £300,000,000 and a coupon of 2.25% under its £6bn Euro Medium Term Note Programme, this bond is guaranteed by and proceeds were on lent to Cadent Gas Limited.

On 11 October 2019, Cadent Finance Plc repurchased and cancelled £400,000,000 notional value of notes, under a Tender Offer launched on 1 October 2019. The notes repaid were part of the £650m 2021 maturity notes issued in 2016, this leaves £250m of this issue outstanding.

Related party transactions

On 27 June 2019, National Grid Plc exercised the options over the disposal of the further 14% interest in Quadgas HoldCo Limited (an indirect parent company of Cadent Gas Limited) and on 28 June 2019, National Grid Plc exercised the options over the disposal of the remaining 25% interest in Quadgas HoldCo Limited. Post completion, 100% of the share capital in Quadgas HoldCo Limited is now owned by the consortium company Quadgas Investments BidCo Limited.

At the balance sheet date of 30 September 2019 National Grid Plc are no longer considered a related party. There were no material related party transactions or balances with National Grid Plc between 1 April 2019 and the final sale date of the 28 June 2019. There have been no other material changes in the related party transactions described in the last Annual Report and Financial Statements.

Quadgas MidCo Limited

Interim Management Report (continued)

Impact of new accounting standards

IFRS 16 'Leases' is applicable to reporting periods beginning on or after 1 January 2019, and has therefore been adopted by the Group for the period commencing 1 April 2019.

In line with the assessment disclosed in the Group's Annual Report and Financial Statements for the year ended 31 March 2019, the adoption of IFRS 16 'Leases' resulted in the recognition of £26m right-of-use assets and £23m lease liabilities (after adjustments for prepayments recognised as at 31 March 2019). Overall net assets have increased by £2m and net current liabilities are £6m lower due to the presentation of a portion of the liability as a current liability. In addition to this, the Group continues to recognise lease liabilities and assets of £6m relating to pre-existing finance lease liabilities recognised under IAS 17 as at 31 March 2019.

Profit after tax has decreased by £0.3m for the six month period ended 30 September 2019 as a result of adopting the new standard.

Operating cash flows have increased and financing cash flows decreased by approximately £3m as repayment of the principal portion of the lease liabilities is classified as cash flows from financing activities.

The Group's activities as a lessor are not material. However, some additional disclosures will be required for the Annual Report and Financial Statements for the year ending 31 March 2020.

Quadgas MidCo Limited

Interim Management Report (continued)

Key performance indicators

To enable us to achieve the standard of service we aspire to, we monitor our performance in 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 2019 (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 year to 31 March 2019 and the six month period to 30 September 2018.

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).	2019/20 half year: 1.10 2018/19: 1.13 2018/19 half year: 0.94 (Target: Less than 0.9) ¹
	Kilometres of network replaced	Kilometres of network replaced Number of kilometres of main pipe replaced.	2019/20 half year: 879km 2018/19: 1,701km 2018/19 half year: 846km (Full year target 2019/20: Higher than 2,121km) ³
Performing for our customers and communities	Customer satisfaction	Customer satisfaction Our score in customer satisfaction surveys. Ofgem set a baseline target.	2019/20 half year: 8.72 2018/19: 8.58 2018/19 half year: 8.54 (Target: Higher than 8.30) ²
	Complaints	Complaints handling Percentage of complaints handled within 1 day	2019/20 half year: 71% 2018/19: 75% 2018/19 half year: 73%

¹ Both target and actual is an annual 12-month rolling number

² Figures represent our baselines targets set by Ofgem for rewards 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 in the Annual Report and Financial Statements 2018/19.

Delivering our 2019/20 Priorities

Our programme of organisational transformation is continuing. In the first half of the year we have progressed towards separation of our systems and certain processes from National Grid, as well as introducing new systems which will improve operational performance and deliver better outcomes for our customers.

As part of our transformation we are moving to a more depot-centric operational structure, empowering our regional teams to work more closely together and importantly be closer to our customers. We are devolving responsibility to enable them to make local decisions and drive the best possible experience and outcomes for our customers and the communities we serve.

We have further affirmed our commitment to support the communities and customers that we serve by establishing a community fund, in which we are investing 1.25% of our post-tax profits. In the first half of the year we have set up a dedicated project team to manage this process; so far approving £1.4m of funding to chosen charities, to enable them to take action against fuel poverty. We have also chosen a charity partner to manage the fund going forwards.

Quadgas MidCo Limited

Interim Management Report (continued)

Delivering our 2019/20 Priorities (continued)

A step change in approach to managing reactive interventions for multi-occupancy (MOBs) has realised an improved customer outcome of keeping 66% of all buildings on gas rather than disconnection compared to 25% last year. This has been achieved in a number of ways, however, the introduction of new innovative technology such as bypass systems and localised isolations have had a significant positive impact. We are continually exploring new ways of working, not just from an engineering perspective but also regarding enhancing the welfare of our customers if we do need to disconnect them for safety reasons and we continue working closely with the Energy Industries Council (EIC) and other manufacturers to provide better solutions.

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 2019. A detailed explanation of the risks and how the Group seeks to mitigate the risks, can be found on pages 6 to 11 of the Annual Report and Financial Statements for the year ended 31 March 2019. Below is a summary of our key risks as at 30 September 2019:

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

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 2018/19 audit process, Deloitte LLP have been re-appointed as auditor of the Quadgas HoldCo Limited Group and its subsidiaries including Quadgas MidCo Limited.

Quadgas MidCo Limited

Interim Management Report (continued)

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 Braithwaite
Director
21 November 2019

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 2019 with the exception of the following changes to the Board:

- On 28 June 2019 Jianmin Bao was appointed as Director of Quadgas MidCo Limited.
- S Fennell and E B Fidler were both appointed as Directors of Quadgas MidCo Limited (Alternate Directors as at publication of the Quadgas MidCo Limited Annual Report and Financial Statements).

By order of the Board,



M Braithwaite
Director
21 November 2019

Independent review report to Quadgas MidCo Limited

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 2019 which comprises the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of financial position, the Consolidated 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

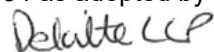
Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

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 2019 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union.



Deloitte LLP

Statutory Auditor

London, United Kingdom

21 November 2019

Quadgas MidCo Limited

Consolidated income statement

Six months ended 30 September 2019

	Notes	Six months ended 30 September 2019 (Unaudited)		Six months ended 30 September 2018 (Unaudited)	
		£m	£m	£m	£m
Revenue			1,040		965
Operating costs before exceptional items			<u>(563)</u>		<u>(595)</u>
Operating profit					
Before exceptional items		477		370	
Exceptional items	4	<u>(42)</u>		<u>(9)</u>	
Total Operating profit			435		361
Finance income	5		10		8
Finance costs					
Before exceptional items and remeasurements	5	(147)		(135)	
Exceptional items and remeasurements	4	<u>(33)</u>		<u>(3)</u>	
Total interest payable and similar charges			(180)		(138)
Profit before tax					
Before exceptional items and remeasurements		340		243	
Exceptional items and remeasurements		<u>(75)</u>		<u>(12)</u>	
Total profit before tax			265		231
Tax					
Before exceptional items and remeasurements		(66)		(47)	
Exceptional items and remeasurements		<u>14</u>		<u>3</u>	
Total tax	6		(52)		(44)
Profit after tax					
Before exceptional items and remeasurements		274		196	
Exceptional items and remeasurements	4	<u>(61)</u>		<u>(9)</u>	
Profit for the period			<u>213</u>		<u>187</u>

The results above relate to continuing operations.

Quadgas MidCo Limited

Consolidated statement of comprehensive income

Six months ended 30 September 2019

	Six months ended 30 September	
	2019	2018
	£'m	£'m
	(Unaudited)	(Unaudited)
Profit for the period	<u>213</u>	<u>187</u>
Other comprehensive income		
Items that will not be reclassified to profit or loss:		
Remeasurements of post-employment benefit obligations	126	57
Tax on items that will not be reclassified to profit or loss	<u>(21)</u>	<u>(1)</u>
Total items that will never be reclassified to profit or loss	<u>105</u>	<u>47</u>
Items that may be reclassified subsequently to profit or loss:		
Net losses in respect of cash flow hedges	(6)	-
Net gains/(losses) in respect of cost of hedging reserve	3	(4)
Amortisation of cost of hedging reserve	3	3
Total items that may be reclassified subsequently to profit or loss	<u>-</u>	<u>(1)</u>
Other comprehensive income for the period	<u>105</u>	<u>46</u>
Total comprehensive income for the period	<u>318</u>	<u>233</u>

The results above relate to continuing operations.

Quadgas MidCo Limited

Consolidated statement of financial position

As at 30 September 2019

	Notes	As at 30 September 2019 £'m (Unaudited)	As at 31 March 2019 £'m (Audited)
Non-current assets			
Intangible assets		4,162	4,146
Property, plant and equipment	8	11,214	10,977
Pension and other post-retirement benefit assets	11	848	690
Other non-current assets		23	44
Derivative financial instruments	9	41	8
Total non-current assets		16,288	15,865
Current assets			
Inventories		10	10
Trade and other receivables		229	219
Current asset investments	9	21	339
Cash and cash equivalents	9	22	12
Total current assets		282	580
Total assets		16,570	16,445
Current liabilities			
Trade and other payables		(556)	(560)
Borrowings	10	(32)	(66)
Current tax liabilities		(6)	(56)
Provisions		(22)	(15)
Total current liabilities		(616)	(697)
Non-current liabilities			
Derivative financial liabilities	9	(75)	(38)
Borrowings	10	(9,449)	(9,476)
Deferred tax liabilities		(1,941)	(1,928)
Provisions		(74)	(80)
Accruals and deferred income		(33)	(27)
Total non-current liabilities		(11,572)	(11,549)
Total liabilities		(12,188)	(12,246)
Net assets		4,382	4,199
Equity			
Share capital		1	1
Share premium account		-	-
Cash flow hedge reserve		2	8
Cost of hedging reserve		5	(1)
Retained earnings		4,374	4,191
Total equity		4,382	4,199

The consolidated financial statements on pages 10 to 26 were approved for issue by the Board of Directors on 21 November 2019 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 2019

	Share Capital £'m	Share Premium Account £'m	Cashflow hedge reserve £'m	Cost of hedging reserve £'m	Retained Earnings £'m	Total £'m
At 1 April 2019	1	-	8	(1)	4,191	4,199
Initial application of IFRS 16	-	-	-	-	2	2
Profit for the period	-	-	-	-	213	213
Other comprehensive income/(loss) excluding amortisation of cost of hedging reserve	-	-	(6)	3	105	102
Amortisation of cost of hedging reserve	-	-	-	3	-	3
Total comprehensive income for the period	-	-	(6)	6	318	318
Equity dividends	-	-	-	-	(137)	(137)
At 30 September 2019 (Unaudited)	1	-	2	5	4,374	4,382

	Share Capital £'m	Share Premium Account £'m	Cashflow hedge reserve £'m	Cost of hedging reserve £'m	Retained Earnings £'m	Total £'m
At 1 April 2018	1	-	12	1	5,396	5,410
Profit for the period	-	-	-	-	187	187
Other comprehensive income/(loss) for the period excluding amortisation of cost of hedging reserve	-	-	-	(4)	47	43
Amortisation of cost of hedging reserve	-	-	-	3	-	3
Total comprehensive income for the period	-	-	-	(1)	234	233
Equity dividends	-	-	-	-	(170)	(170)
At 30 September 2018 (Unaudited)	1	-	12	-	5,460	5,473

The cash flow hedge reserve in relation to the cross-currency interest rate swap contracts will be recycled to the income statement over the life of the hedged items.

Quadgas MidCo Limited

Consolidated statement of cash flows

Six months ended 30 September 2019

	Six months ended 30 September 2019 £'m (Unaudited)	Six months ended 30 September 2018 £'m (Unaudited)
Cash flows from operating activities		
Total operating profit	435	361
Adjustments for:		
Exceptional items	42	9
Depreciation, amortisation and impairment	191	182
Increase in inventories	(1)	-
Decrease in trade and other receivables	5	14
Decrease in trade and other payables	(23)	(24)
Capital contribution income	(55)	(16)
Changes in provisions	(3)	2
Loss on disposal of property, plant and equipment	-	(1)
Changes in pensions and other post-retirement obligations	(45)	(52)
Cash flows relating to exceptional items	(15)	(5)
	<hr/>	<hr/>
Cash generated from operations	531	470
Tax paid	(113)	(50)
	<hr/>	<hr/>
Net cash inflow from operating activities	418	420
	<hr/>	<hr/>
Cash flows from investing activities		
Purchases of intangible assets	(22)	(6)
Purchases of property, plant and equipment	(365)	(300)
Capital contributions	50	59
Disposals of property, plant and equipment	-	-
Interest received	2	1
Net decrease in financial investments	318	71
	<hr/>	<hr/>
Net cash (used in) investing activities	(17)	(175)
	<hr/>	<hr/>
Cash flows from financing activities		
Proceeds received from loans	520	708
Repayment of loans	(611)	(646)
Repayment of obligations under leases liabilities	(4)	-
Interest paid	(152)	(136)
Dividends paid to shareholders	(137)	(170)
	<hr/>	<hr/>
Net cash (used in) financing activities	(384)	(244)
	<hr/>	<hr/>
Net increase in cash and cash equivalents	17	1
	<hr/>	<hr/>
Cash and cash equivalents at beginning of period	3	14
	<hr/>	<hr/>
Net cash and cash equivalents at end of period	<u>20</u>	<u>15</u>
	<hr/> <hr/>	<hr/> <hr/>
Comprising - Cash	22	17
- Overdraft	<u>(2)</u>	<u>(2)</u>
	20	15

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

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 2019 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'.

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 2019, 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 2019.

The half year financial information has been prepared in accordance with the accounting policies expected to be applicable for the year ending 31 March 2020 and consistent with those applied in the preparation of the accounts for the year ended 31 March 2019, with the exception of the adoption of IFRS 16. The Group has applied IFRS 16 'Leases' for the first time during the period coming into effect on 1 April 2019. As required by IAS 34, the nature and effect of these changes are disclosed below.

IFRS 16 'Leases'

The Group adopted IFRS 16 'Leases' from 1 April 2019. In accordance with the transition provisions in the Standard, the Group has applied the simplified transition approach and has not restated comparative amounts for the year prior to first adoption.

In line with the assessment disclosed in the Group's Annual Report and Financial Statements for the year ended 31 March 2019, the adoption of IFRS 16 'Leases' resulted in an overall increase in net assets of £2m, predominantly made up of the recognition of £26m right-of-use assets and £23m lease liabilities. Net current liabilities are £6m lower due to the presentation of a portion of the liability as a current liability. In addition to this, the Group continues to recognise lease liabilities and assets of £6m relating to pre-existing finance lease liabilities recognised under IAS 17 as at 31 March 2019.

Profit after tax has decreased by £0.3m for the period ended 30 September 2019 as a result of adopting the new rules.

Operating cash flows have increased and financing cash flows decreased by approximately £3m as repayment of the principal portion of the lease liabilities is classified as cash flows from financing activities.

The Group's activities as a lessor are not material. However some additional disclosures will be required for the Annual Report and Financial Statements for the year ended 31 March 2020.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

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

In line with the standard, short-term leases (less than 12 months) and low value leases (less than £3,500) will continue to be recognised on a straight-line basis as an expense in profit or loss. The expected amount of short-term leases for the year ended 31 March 2020 is £1m and low value leases is £0.1m.

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 2019):

	IAS 17 carrying amount 31 March 2019 £m	Adjustments to recognise right of use assets and lease liabilities £m	IFRS 16 carrying amount 1 April 2019 £m
Property, plant and equipment	10,977	26	11,003
Borrowings < 1 year	(66)	(6)	(72)
Borrowings > 1 year	(9,476)	(17)	(9,493)
Trade and other receivables	219	(1)	218
Retained earnings	4,191	2	4,193

On adoption of IFRS 16, the group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 Leases. These liabilities were measured at present value of the remaining lease payments, discounted using the Cadent's incremental borrowing rate applied to the lease liabilities as of 1 April 2019.

The table below presents a reconciliation from operating lease commitments disclosed at 31 March 2019 to lease liabilities recognised at 1 April 2019.

	£m
Operating Lease commitments disclosed under IAS 17 at 31 March 2019	27
(Less): short-term leases recognised on a straight-line basis as expense	(1)
Effect of discounting	(4)
Finance lease liabilities recognised under IAS 17 as at 31 March 2019	6
Add: adjustments as a result of a different treatment of extension and termination option and embedded leases	1
Lease liability recognised as at 1 April 2019	29

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

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.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

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 2019 £m	Six months ended 30 September 2018 £m
Exceptional items included within operating costs:		
Separation activities (i)	(12)	(8)
Restructuring costs (ii)	(30)	(1)
	<u>(42)</u>	<u>(9)</u>
Remeasurements included within finance costs:		
Net losses on derivative financial instruments (iii)	(33)	(3)
	<u>(75)</u>	<u>(12)</u>
Total included within profit before tax	(75)	(12)
Included within taxation:		
Tax on separation activities	2	2
Tax on restructuring costs	6	-
Tax on remeasurements	6	1
	<u>14</u>	<u>3</u>
Total exceptional and remeasurements after tax	(61)	(9)
Analysis of total exceptional items and remeasurements after tax		
Total exceptional items after tax	(34)	(7)
Total remeasurement after tax	(27)	(2)
	<u>(61)</u>	<u>(9)</u>

- (i) As a result of the acquisition of Cadent Gas Limited by the company from National Grid Plc, a number of separation activities have arisen, which are exceptional by nature as this is not in the ordinary course of the business.
- (ii) The Group is undergoing a reorganisation exercise. These activities are infrequent and exceptional in nature and will continue into the second half of the financial year, so are financially material. On the 13 May 2019 Cadent Gas Limited announced a voluntary redundancy programme for all managers and staff. Costs of £26m associated with this have been included within restructuring costs.
- (iii) Net losses on derivative financial instruments comprise gains and losses arising on derivative financial instruments reported in the income statement. These exclude gains and losses for which hedge accounting has been effective, which have been recognised directly in other comprehensive income or which are offset by adjustments to the carrying value of debt.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

5. Finance income and costs

	Six months ended 30 September 2019	Six months ended 30 September 2018
	£m	£m
Finance income		
Pension interest income	9	8
Interest income from financial instruments	1	-
Finance income	<u>10</u>	<u>8</u>
Finance costs		
Interest expense on financial liabilities held at amortised cost:		
Bank loans and overdrafts	23	30
Other borrowings	89	70
Interest payable on inter-company financing	31	31
Derivatives	4	4
Finance costs	<u>147</u>	<u>135</u>
Remeasurements		
Net gains on derivative financial instruments included in remeasurements:		
Ineffectiveness on derivatives designated as:		
Cash flow hedges	-	-
Derivatives not designated as hedges or ineligible for hedge accounting	33	3
Remeasurements included within finance costs	<u>33</u>	<u>3</u>
Finance costs	<u>180</u>	<u>138</u>
Net finance costs	<u>170</u>	<u>130</u>

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

6. Tax

The tax charge for the period from continuing operations, excluding tax on exceptional items and remeasurements, is £66m (six months to 30 September 2018 £47m). The effective tax rate of 19.4% for the period (six months to 30 September 2018: 19.3%) is based on the best estimate of the annual income tax rate expected for the full year, excluding tax on exceptional items and remeasurement.

The Finance Act 2016 Act reduced the corporate tax rate to 17%. 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 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 2019	Six months ended 30 September 2018
	£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
Interim dividend of 2.69 pence per ordinary share amounting to £137,350,000 was declared and paid on the 27 September 2019	137	-
	<u>137</u>	<u>170</u>

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

8. Property, plant and equipment

	Land and buildings	Plant and Machinery	Assets in the course of construction	Motor vehicles and other equipment	Right of use assets (IFRS 16)	Total
	£m	£m	£m	£m	£m	£m
Cost						
At 1 April 2019	89	11,348	80	124	-	11,641
Initial application of IFRS 16	-	-	-	-	26	26
Additions	3	346	36	8	1	394
Disposals	-	-	-	(1)	-	(1)
Reclassifications	6	35	(48)	2	5	-
At 30 September 2019	98	11,729	68	133	32	12,060
Accumulated depreciation and impairment						
At 1 April 2019	(14)	(602)	-	(48)	-	(664)
Charge for the period	(3)	(163)	-	(14)	(3)	(183)
Disposals	-	-	-	1	-	1
At 30 September 2019	(17)	(765)	-	(61)	(3)	(846)
Net book value:						
At 30 September 2019	81	10,964	68	72	29	11,214
At 31 March 2019	75	10,746	80	76	-	10,977

	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 2019

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 2019				31 March 2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Fair value through profit and loss ('FVTPL') instruments	43	-	-	43	351	-	-	351
Derivative financial instruments	-	41	-	41	-	8	-	8
Liabilities								
Derivative financial instruments	-	(75)	-	(75)	-	(38)	-	(38)
Total	43	(34)	-	9	351	(30)	-	321

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 2019 is £9,902m (31 March 2019: £9,548m).

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.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

10. Net debt

	Six months ended 30 September 2019 £m	Period ended 31 March 2019 £m
Increase/(decrease) in cash and cash equivalents	17	(12)
(Decrease)/increase in financial investments	(318)	178
Increase/(Decrease) in borrowings & related derivatives	95	(345)
Net interest paid on the components of net debt	152	207
Change in net debt arising from cash flows	(54)	28
Changes in fair value of financial assets and liabilities and exchange movements	(26)	(9)
Other non-cash changes (IFRS 16)	(24)	-
Net interest charge on the components of net debt	(147)	(264)
Movement in net debt (net of related derivative financial instruments)	(251)	(245)
Net debt (net of related derivative financial instruments) at the start of the period	(9,221)	(8,976)
Net debt (net of related derivative financial instruments) at the end of the period	(9,472)	(9,221)
Composition of net debt:		
Cash, cash equivalents and financial investments	43	351
Borrowings and bank overdrafts – current	(32)	(66)
Borrowings – non-current	(9,449)	(9,476)
Derivatives	(34)	(30)
Total net debt	(9,472)	(9,221)

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

11. Retirement benefit schemes

	30 September 2019	31 March 2019
	£m	£m
Present value of funded obligation	(6,305)	(5,981)
Fair value of plan assets	7,157	6,674
	<u>852</u>	<u>693</u>
Present value of unfunded obligations	(4)	(3)
Other post-employment liabilities	-	-
Net asset	<u><u>848</u></u>	<u><u>690</u></u>
Represented by:		
Liabilities	(6,309)	(5,984)
Assets	7,157	6,674
	<u><u>848</u></u>	<u><u>690</u></u>

Key actuarial assumptions

Discount rate – Past service	1.80%	2.40%
Discount rate - Future service	1.85%	2.45%
Rate of increase in salaries – pre April 2013	2.60%	2.75%
Rate of increase in salaries – post March 2013	2.10%	2.15%
Rate of increase in RPI - Past service	3.10%	3.25%
Rate of increase in RPI - Future service	3.00%	3.20%

The net pensions and other post-retirement benefit obligations position, as recorded under IAS19, at 30 September 2019 was a surplus of £848m compared to £690m at 31 March 2019. This increase is due to gains on the scheme assets and additional deficit contributions paid into the scheme in the period of £40m, offset by a decrease in discount rate.

The Chancellor's announcement on 4 September 2019 on the future of the RPI makes it likely that RPI will be aligned with CPIH from 2030 if not earlier. The market response to the announcement created uncertainty about the extent to which this potential change is priced into breakeven inflation rates implied by the gilt markets. In light of this uncertainty, the RPI or CPI inflation assumptions (which are based on breakeven inflation rates) have not been adjusted for the purposes of half year reporting as at 30 September 2019, but these assumptions will be reviewed for year ending 31 March 2020.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

12. Commitments and Contingencies

a) Capital and Other Commitments

At 30 September 2019 there were commitments for future capital expenditure contracted but not provided for £359 million (31 March 2019: £387million). Group undertakings have also entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees. These commitments and contingencies are described in further detail on page 61 of the Annual Report and Financial Statements 2018/19.

b) Environmental claims

An environmental provision has been set up to deal with the costs of statutory decontamination of Cadent Gas Limited's old gas-manufacturing sites and Cadent Services' gas sites. Other claims have arisen from time to time, however none of these have been significant. It is not possible to determine the level of such future claims however, based upon experience, the Directors do not consider a provision necessary.

c) Litigation

Through the ordinary course of operations, the Group is party to various litigation, claims and investigations. The Directors do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on the Group's results of operations, cash flows or financial position.

d) Health and Safety Executive investigation

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 informed the Health and Safety Executive who opened an investigation into this issue. Cadent worked with the Health and Safety Executive as they progressed their investigation. On 11 October 2019, Cadent received confirmation from the Health and Safety Executive that it had completed its investigation and does not intend to take any further action against Cadent in relation to the asset data anomalies.

13. Related party transactions

On 27 June 2019, National Grid Plc exercised the options over the further 14% interest in Quadgas HoldCo Limited (an indirect parent company of Cadent Gas Limited) and on 28 June 2019, National Grid Plc exercised the options over the remaining 25% interest in Quadgas HoldCo Limited. Post completion, 100% of the share capital in Quadgas HoldCo Limited is now owned by the consortium company Quadgas Investments BidCo Limited.

At the balance sheet date of 30 September 2019 National Grid Plc are no longer considered a related party. There were no material related party transactions or balances with National Grid Plc between 1 April 2019 and the sale date of the 28 June 2019. There have been no other material changes in the related party transactions described in the last annual report.

Quadgas MidCo Limited

Notes to the consolidated set of financial statements (continued)

Six months ended 30 September 2019

14. Events occurring after the reporting period

On 10 October 2019, Cadent Finance Plc, a subsidiary of Quadgas MidCo Limited, issued a 16 year fixed rate bond with a notional value of £300,000,000 and a coupon of 2.25% under its £6bn Euro Medium Term Note Programme, this bond is guaranteed by and proceeds were on lent to Cadent Gas Limited.

On 11 October 2019, Cadent Finance Plc repurchased and cancelled £400,000,000 notional value of notes, under a Tender Offer launched on 1 October 2019. The notes repaid were part of the £650m 2021 maturity notes issued in 2016, this leaves £250m of this issue outstanding.