Network Rail Limited

Condensed interim financial statements

Six months ended 30 September 2014

Company registration number 4402220

Contents

Financial highlights

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Variance £m	Variance
Revenue	**3,122**	**3,267**	(145)	(4%)
Net operating costs excluding depreciation and amortisation	**(1,346)**	**(1,345)**	(1)	-
Net operating costs	**(2,155)**	**(2,068)**	(87)	(4%)
Operating profit	**967**	**1,199**	(232)	(19%)
Profit before tax	**321**	**751**	(430)	(57%)
Net cash from operating activities	**975**	**1,894**	(919)	(49%)
Capital expenditure	**2,896**	**2,743**	153	6%

	Unaudited 30 September 2014 £m	Audited 31 March 2014 £m	Variance £m
Net borrowings	**35,044**	**32,987**	2,057
Net assets	**8,580**	**8,182**	398
Property, plant and equipment – the railway network	**52,359**	**49,833**	2,526
Investment property	**937**	**856**	81

Commentary

Summary

These half year results are the first results of the new five year control period and represent a steady start to an important period in the history of the railway network. When Network Rail set out its plans for the control period it committed to make the railway safer, more reliable, have greater capacity and be cheaper to run.

Efficiencies delivered during the two previous control periods, as well as the financial framework in which Network Rail operates, have enabled the Office for Rail Regulation (ORR) to reduce the prices that we charge train operating companies for the use of our network during this control period. This has affected our revenue recorded in these half year results and consequently the group's profitability, to the benefit of train operating companies and government. Network Rail continues to strive to deliver efficiencies in operating costs. Despite inflation, net operating costs (excluding depreciation) have remained at the same level as a year ago. The increase in net operating costs is almost entirely attributable to an increased depreciation charge, a result of the larger fixed asset base.

Our business plan recognised that our delivered train performance would be behind regulatory targets for the first two years of the control period. The year-end target that we have set ourselves is 91.1% of passenger trains arriving on time and we are currently running approximately 1% behind this target. Network Rail has initiated a number of improvement plans across the network to improve train performance, but some of these plans will take time to have an impact.

Investment

Over the five years of the control period we have committed to investing £25bn in the railway network. So far this year we have spent £1.3bn on renewals of the network and £1.6bn on enhancements. These volumes of work are lower than we had planned, but we expect to deliver the work we have not done during this half year later in the control period.

Some of our current large projects include the Thameslink programme, work on our network for Crossrail, the Northern Hub, electrification programmes and, in Scotland, the Borders rail project and improving the network between Scotland's biggest cities.

We continue to develop the network for freight including electrifying the freight corridor from Southampton to the Midlands.

Revenues

Ordinarily, annual increases in Network Rail's turnover are broadly in line with the Retail Price Index, except where the year signals the start of a new control period. Revenue in the six months to September was £145m lower than for the corresponding period last year, the final year of the previous control period. The reduction in revenue is largely a consequence of the ORR setting a lower allowed return for Network Rail in the new control period. The net impact of the performance regimes gave rise to income of £11m, compared to compensation payments of £26m in the comparative period.

Borrowings

As part of Network Rail's formal reclassification to the public sector an arrangement was agreed whereby funding will be provided by the Department for Transport (DfT) in the form of a loan facility. As a result, from 4 July 2014, Network Rail borrows directly from the UK Government,

and no longer issues debt in its own name.
Net borrowings have increased to finance continued capital investment by £2,057m from £32,987m at the year end to £35,044m at 30 September 2014. The increase comprises additional commercial paper issued of £348m and borrowings of £1,150m on the new facility provided by the DfT. Cash and cash equivalents decreased by £492m in the same period to £761m. Compared to last year, there was a significant fall in net cash generated by operating activities. This is primarily a result of large movements in working capital balances and the ORR's decision to reduce our revenue.

Assets

The value of the railway network increased to £52,359m from £49,833m at 31 March 2014. Capital investment in the infrastructure totalled £2,896m in the period, depreciation of £851m was charged and the network was valued upwards by £477m.

Risks and Uncertainties

The principal risks and uncertainties affecting the business activities of the group were set out on pages 26 to 29 of the annual report and accounts for the year ended 31 March 2014, a copy of which is available on the group's website www.networkrail.co.uk

The group's key risks and uncertainties are summarised under the headings of:

- Safety;
- Performance;
- Value

In the view of the board, the key risks and uncertainties for the remaining six months of the financial year continue to be those set out in the above section of the 31 March 2014 annual report and accounts. In particular it should be noted that the autumn and winter seasons provide additional performance risks, due to increases in weather-related and track adhesion-related delays. The critical accounting judgements and key sources of uncertainties relating to these interim financial statements are set out on pages 15 and 16.

Outlook

This is an important period for the railway network. Demand for rail continues to grow as our railway continues to be the fastest growing in Europe, as well as its safest. To respond to that growth we will be investing some £25bn by 2019 in growing and expanding the network to provide a better and improving service to passengers and freight services.

For the 4.5 million daily users having a reliable and punctual service, every day, is the most important thing. We are currently behind our plan and are instigating a swathe of initiatives to redress this key area.

While we have the safest railway in Europe for our passengers, our workforce safety is not where we want it to be and this area will continue to attract internal focus.

Increasing capacity on a complex network, at the same time as keeping it running safely, reliably and punctually every day, is the challenge we face. We have clear strategies to deliver the improvements required in the months and years ahead.

Statement of directors' responsibilities

The directors confirm that this condensed consolidated interim financial information has been prepared in accordance with International Accounting Standard ("IAS") 34 as adopted by the European Union and that the interim management report includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and

- material related-party transactions in the first six months and any material changes in the related-party transactions described in the last annual report.

The directors of Network Rail Limited are listed in the Network Rail Limited annual report for the year ended 31 March 2014. Since that report, there have been three changes to the board composition in that Lawrence John Haynes and Michael Graham Firth resigned as non-executive directors on 18 July 2014 and Sharon Emma Flood was appointed as a non-executive director on 25 August 2014. A list of current directors is available on the group's website: www.networkrail.co.uk

By order of the board

Mark Carne
Chief executive
26 November 2014

Independent review report

to Network Rail Limited

Report on the condensed consolidated interim financial statements

Our conclusion

We have reviewed the condensed consolidated interim financial statements of Network Rail Limited for the six months ended 30 September 2014. Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

This conclusion is to be read in the context of what we say in the remainder of this report.

What we have reviewed

The condensed consolidated interim financial statements, which are prepared by Network Rail Limited, comprise:

- the consolidated balance sheet as at 30 September 2014;
- the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- the consolidated cash flow statement for the period then ended;
- the consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the condensed consolidated interim financial statements.

As disclosed in note 1, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, ‘Interim Financial Reporting’, as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

What a review of condensed consolidated financial statements involves

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 Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

Independent review report (continued)

to Network Rail Limited

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) 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.

We have read the other information contained in the condensed consolidated interim financial statements and considered whether it contains any apparent misstatements or material inconsistencies with the information.

Responsibilities for the condensed consolidated interim financial statements and the review

Our responsibilities and those of the directors

The condensed consolidated interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the condensed consolidated financial statements in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express to the company a conclusion on the condensed consolidated interim financial statements based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure and Transparency Rules of the Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP

Chartered Accountants
London

26 November 2014

Notes

(a) The maintenance and integrity of the Network Rail website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

	Notes	**Unaudited six months ended 30 September 2014 £m**	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Revenue	2	**3,122**	3,267	6,333
Net operating costs	3	**(2,155)**	(2,068)	(4,332)
Operating profit		**967**	1,199	2,001
Property revaluation movements and profits on disposal		**76**	28	96
Total profit from operations		**1,043**	1,227	2,097
Investment revenue	4	**7**	9	20
Other gains and losses	4	**33**	194	304
Finance costs	4	**(762)**	(679)	(1,386)
Profit before tax		**321**	751	1,035
Tax	5	**(40)**	110	221
Profit after tax for the period		**281**	861	1,256

Consolidated statement of comprehensive income

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Profit for the period	**281**	861	1,256
Other comprehensive income/(expense):			
Items that will not be reclassified to profit or loss			
Gain/(loss) on revaluation of the railway network	**477**	(457)	(1,813)
Remeasurement of defined benefit scheme obligations	**(34)**	(32)	140
Tax relating to components of other comprehensive income that will not be reclassified to profit or loss	**(86)**	240	320
Total items that will not be reclassified to profit or loss	**357**	(249)	(1,353)
Items that may be reclassified to profit or loss			
(Loss)/gain on movement in fair value of hedging derivatives	**(361)**	207	172
Reclassification of balances in the hedging reserve to the income statement	**62**	163	218
Tax relating to components of other comprehensive income that may be reclassified to profit or loss	**59**	(39)	(124)
Total items that may be reclassified subsequently to profit or loss	**(240)**	331	266
Other comprehensive income/(expense) for the period	**117**	82	(1,087)
Total comprehensive income for the period	**398**	943	169

Consolidated statement of changes in equity

	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2014	**1,380**	**249**	**78**	**6,475**	**8,182**
Profit for the period	**-**	**-**	**-**	**281**	**281**
Revaluation of the railway network	**477**	**-**	**-**	**-**	**477**
Transfer of deemed cost depreciation from revaluation reserve	**(37)**	**-**	**-**	**37**	**-**
Decrease in deferred tax liability on the railway network	**(86)**	**-**	**-**	**(8)**	**(94)**
Remeasurement of defined benefit scheme obligations	**-**	**-**	**-**	**(34)**	**(34)**
Deferred tax on actuarial losses	**-**	**-**	**-**	**8**	**8**
Decrease in fair value of hedging derivatives	**-**	**-**	**(361)**	**-**	**(361)**
Deferred tax on all hedging reserve movements/retained earnings	**-**	**-**	**59**	**-**	**59**
Reclassification of balances in the hedging reserve to the income statement	**-**	**-**	**62**	**-**	**62**
Balance at 30 September 2014 (Unaudited)	**1,734**	**249**	**(162)**	**6,759**	**8,580**

	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2013	2,890	249	(188)	5,062	8,013
Profit for the period	-	-	-	861	861
Impact of change in tax rate	159	-	(25)	(17)	117
Revaluation of the railway network	(457)	-	-	-	(457)
Transfer of deemed cost depreciation from revaluation reserve	(62)	-	-	62	-
Decrease in deferred tax liability on the railway network	104	-	-	(12)	92
Remeasurement of defined benefit scheme obligations	-	-	-	(32)	(32)
Deferred tax on actuarial losses	-	-	-	6	6
Increase in fair value of hedging derivatives	-	-	207	-	207
Deferred tax on all hedging reserve movements/retained earnings	-	-	(14)	-	(14)
Reclassification of balances in the hedging reserve to the income statement	-	-	163	-	163
Balance at 30 September 2013 (Unaudited)	2,634	249	143	5,930	8,956

Consolidated statement of changes in equity (continued)

	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2013	2,890	249	(188)	5,062	8,013
Profit for the year	-	-	-	1,256	1,256
Impact of change in tax rate	159	-	(9)	(17)	133
Revaluation of the railway network	(1,813)	-	-	-	(1,813)
Transfer of deemed cost depreciation from revaluation reserve	(84)	-	-	84	-
Decrease in deferred tax liability on the railway network	228	-	-	(17)	211
Remeasurement of defined benefit scheme obligations - restated	-	-	-	140	140
Deferred tax on actuarial loss - restated	-	-	-	(33)	(33)
Increase in fair value of hedging derivatives	-	-	172	-	172
Deferred tax on all hedging reserve movements/retained earnings	-	-	(115)	-	(115)
Reclassification of balances in the hedging reserve to the income statement	-	-	218	-	218
Balance at 31 March 2014 (Audited)	1,380	249	78	6,475	8,182

*Other reserves of £249 include the vesting reserve of privatisation

Consolidated balance sheet

	Note	**Unaudited 30 September 2014 £m**	Unaudited 30 September 2013 £m	Audited 31 March 2014 £m
Assets				
Non-current assets				
Intangible assets		**68**	69	68
Property, plant and equipment – the railway network	6	**52,359**	47,933	49,833
Investment property		**937**	829	856
Derivative financial instruments	9	**405**	764	637
Finance lease receivables		**-**	3	1
Other receivables		**121**	-	135
Interest in joint venture		**31**	11	27
		53,921	49,609	51,557
Current assets				
Inventories		**196**	153	173
Finance lease receivables		**1**	1	2
Trade and other receivables		**1,227**	702	915
Current tax assets		**-**	3	4
Derivative financial instruments	9	**3**	10	11
Cash and cash equivalents	7	**761**	3,968	1,253
		2,188	4,837	2,358
Total assets		**56,109**	54,446	53,915
Current liabilities				
Trade and other payables		**(3,437)**	(4,030)	(3,886)
Borrowings	7	**(3,998)**	(2,539)	(2,707)
Derivative financial instruments	9	**(160)**	(207)	(277)
Provisions		**(64)**	(41)	(143)
		(7,659)	(6,817)	(7,013)
Net current liabilities		**(5,471)**	(1,980)	(4,655)
Non-current liabilities				
Borrowings	7	**(31,870)**	(31,545)	(31,308)
Derivative financial instruments	9	**(395)**	(480)	(387)
Other payables		**(3,715)**	(2,693)	(3,297)
Retirement benefit obligation		**(1,332)**	(1,359)	(1,237)
Deferred tax liabilities		**(2,558)**	(2,596)	(2,491)
		(39,870)	(38,673)	(38,720)
Total liabilities		**(47,529)**	(45,490)	(45,733)
Net assets		**8,580**	8,956	8,182

Consolidated balance sheet (continued)

	Unaudited 30 September 2014 £m	Unaudited 30 September 2013 £m	Audited 31 March 2014 £m
Equity			
Revaluation reserve	**1,734**	2,634	1,380
Other reserve	**249**	249	249
Hedging reserve	**(162)**	143	78
Retained earnings	**6,759**	5,930	6,475
Total equity	**8,580**	8,956	8,182

This interim financial report was approved by the board of directors on 26 November 2014.

It was signed on its behalf by:

Mark Carne (Chief executive)

Consolidated cash flow statement

	Note	**Unaudited six months ended 30 September 2014 £m**	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Cash flows from operating activities				
Cash generated from operations	8	**1,316**	2,269	3,771
Interest paid		**(345)**	(379)	(1,077)
Income tax received		**4**	4	4
Net cash generated from operating activities		**975**	1,894	2,698
Investing activities				
Interest received		**7**	9	20
Purchases of property, plant and equipment		**(3,239)**	(2,855)	(6,263)
Proceeds on disposal of investment property		**5**	1	41
Capital grants received		**378**	54	227
Capital element of finance lease receipts		**1**	-	(15)
Investment in joint ventures		**(4)**	1	2
Net cash flows used in investing activities		**(2,852)**	(2,790)	(5,988)
Financing activities				
Repayment of borrowings		**(600)**	(1,283)	(3,975)
New loans raised		**2,098**	2,550	5,104
Collateral (repaid to)/received from counterparties		**(106)**	91	(143)
Cash flow on settlement of derivatives		**1**	-	-
Net cash from financing activities		**1,393**	1,358	986
Net (decrease)/increase in cash and cash equivalents		**(484)**	462	(2,304)
Cash and cash equivalents at beginning of the period		**1,202**	3,506	3,506
Cash and cash equivalents at the end of the period		**718**	3,968	1,202

Cash and cash equivalents comprise:

Short-term bank deposits, commercial paper and money market deposits	**761**	3,968	1,253
Bank overdrafts	**(43)**	-	(51)
	718	3,968	1,202

Notes to the interim financial statements

Six months ended 30 September 2014

1. General information

This condensed consolidated interim financial information does not comprise statutory financial statements within the meaning of Section 434 of the Companies Act 2006. Statutory financial statements for the year ended 31 March 2014 were approved by the board of directors on 11 June 2014 and delivered to the Registrar of Companies. The auditors' report on these financial statements was unqualified, did not contain an emphasis of matter paragraph, and did not contain a statement under Section 498 of the Companies Act 2006.

The condensed consolidated interim financial statements are prepared in accordance with the Disclosure and Transparency Rules of the United Kingdom Financial Conduct Authority and International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union.

This condensed consolidated interim financial information has been reviewed, not audited. The condensed consolidated interim financial information should be read in conjunction with the annual report and accounts for the year ended 31 March 2014, which have been prepared in accordance with IFRSs as adopted by the European Union. A copy of this document is available on the group's website: www.networkrail.co.uk

Accounting policies

The accounting policies adopted in this condensed set of financial statements are consistent with those set out in the annual financial statements for the year to 31 March 2014.

The following amendments to standards have been applied for the first time for the financial year beginning 1 April 2014 and do not have a material impact on the interim financial information:

- IFRS 10, 'Consolidated financial statements'
- IFRS 11, 'Joint arrangements'
- IFRS 12, 'Disclosures of interests in other entities'
- IAS 27 (revised 2011) “Separate Financial Statements”
- IAS 28 (revised 2011) “Associates and Joint Ventures
- Amendments to IAS 32 on financial instruments asset and liability offsetting
- Amendment to IAS 36 “Impairment of Assets” on recoverable amount disclosures
- Amendment to IAS 39 “Financial Instruments: Recognition and Measurement” on novation of derivatives and hedge accounting
- Amendments to IFRS 10, 11 and 12 on transition guidance
- Amendments to IFRS 10, 12 and IAS 27 on consolidation for investment entities
- IFRIC 21 “Levies”

Going concern

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the interim financial statements.

Business segments

No segmental analysis is provided because the group operates one class of business, that of managing the national rail infrastructure and undertakes that class of business in one geographical segment, Great Britain.

Critical accounting judgements and key sources of uncertainty

The principal risks managed by Network Rail are unchanged from those set out in the 31 March 2014 Network Rail Limited annual report and accounts. This can be found in the directors' report on pages 26-29. There are also further details on funding and financial risk management in note 25 on pages 133-140 of these accounts.

(i) Property, plant and equipment – the railway network: the estimate of the fair value of the railway network is based on an income approach using the regulatory asset base, which equates to the discounted future cash flow associated with the network, adjusted for the net present value of any variances from the Office of Rail Regulation's determination included in the group's business plan. The methodology of the valuation and critical judgements therein are discussed in detail in Note 12 on pages 117-120 of the Network Rail Limited annual report and accounts 2014, and remain largely unchanged. The additional critical judgement at interim is to forecast the inflation to be applied to the regulatory asset base. Inflation is applied using the November 2014 Retail Prices Index (published in December 2014). This is estimated at 2.64%. For every 10 basis points variance from that forecast, the regulatory asset base, on which the valuation is based, will vary by £50m.

(ii) Investment property: Jones Lang LaSalle provided independent valuations of 13 one-off individual properties and value the balance of the estate under the Beacon method by splitting the portfolio into homogeneous classes of property and areas. The external chartered surveyors independently assessed the appropriate yield to be adopted within each of these classes and areas. This enabled the directors to estimate fair values by applying the provided yields to the net rental income from these properties, in accordance with a standard UK investment property valuation. The method of calculation is the same as set out in Note 13 on page 120 of the Network Rail Limited annual report and accounts 2014.

(iii) Retirement benefit obligations: the group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 (revised 2011) 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 26 on pages 141 to 144 of the Network Rail Limited annual report and accounts 2014. The discount rate has been reduced to 4.0% and the Retail price Index and Consumer price index assumptions reduced to 3.1% and 2.1% respectively. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the group and the members, respectively.

(iv) Provisions: provisions are recognised when the group has a present obligation as a result as a result of a past event, and it is probable that the group will be required to settle the obligation.   Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

(v) Hedge Accounting: Network Rail's hedging strategy aims to achieve a known fixed rate on current and future borrowings. A key judgement is in relation to the highly probable future borrowings. At 30 September 2014 Network Rail deferred derivative liabilities with a fair value of £212m in equity to use against highly probable and expected future borrowings. Interest rate swaps with a net asset fair value of approximately £18m are due to start before 31 March 2015.

2. Revenue

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Franchised track access and grant income	**2,947**	3,106	6,020
Freight revenue	**41**	31	52
Property rental income	**121**	118	238
Other income	**13**	12	23
	3,122	3,267	6,333

The effect of the performance regimes on the results of the group was a net income of £11m (six months to 30 September 2013: net expense of £26m). The net income is made of £19m income in respect of the possessions regime and costs of £8m in respect of the performance regime.

3. Net operating costs

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Employee costs*	**969**	961	1,910
Own costs capitalised	**(364)**	(313)	(739)
Other external charges (including infrastructure maintenance costs)	**856**	846	1,873
Other operating income and recoveries	**(115)**	(149)	(233)
Net operating costs before depreciation	**1,346**	1,345	2,811
Depreciation and other amounts written off non-current assets	**851**	764	1,603
Capital grants amortised	**(42)**	(41)	(82)
Net operating costs	**2,155**	2,068	4,332

*The average number of employees (including executive directors) in the six months ended 30 September 2014 was 35,161 (six months ended 30 September 2013: 34,984). Annualised average cost per employee, including pension contributions and employer's NI, was £55,118 (six months ended 30 September 2013: £54,939).

Research and development expenditure in the six months was £360,000 (six months ended 30 September 2013: £178,000).

4. Investment revenue, finance costs and other gains and losses

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Investment revenue			
Interest receivable on investments and deposits	**7**	9	20
Total investment revenue	**7**	9	20
Finance costs			
Interest payable on borrowings	**(804)**	(715)	(1,476)
Defined benefit pension schemes net interest cost	**(26)**	(27)	(54)
Total borrowing costs	**(830)**	(742)	(1,530)
Less: capitalised interest	**68**	63	144
Total finance costs	**(762)**	(679)	(1,386)
Other gains and losses			
Net ineffectiveness arising from cash flow hedge accounting	**(34)**	-	6
Fair value gain/(loss) on fair value hedges	**161**	(409)	(540)
Fair value (loss)/gain on carrying value of fair value hedged debt	**(152)**	429	540
Net decrease in fair value of non-hedge accounted debt	**1**	40	54
Gain on derivatives not hedge accounted	**57**	134	244
Total other gains and losses	**33**	194	304

5. Tax

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Current tax:			
Current tax on profits	**-**	4	4
Less advance corporation tax (ACT) set-off	**-**	(2)	(3)
Total current tax	**-**	2	1
Deferred tax:			
Current period/year charge	**40**	148	233
Effect of rate change	**-**	(260)	(220)
Adjustments in respect of prior years	**-**	-	(235)
Total deferred tax	**40**	(112)	(222)
Total tax	**40**	(110)	(221)

The rate used for the purposes of deferred tax in these financial statements is 20% (30 September 2013: 20%) as this is the rate substantively enacted at the balance sheet date and the rate at which the temporary differences are expected to reverse.

There is no current tax charge in the period due to the utilisation of brought forward losses.

6. Property, plant and equipment – the railway network

	Group £m
Valuation	
At 1 April 2013 (audited)	46,411
Additions	6,873
Transfer to investment property	(35)
Depreciation charge for the year	(1,603)
Revaluation in the year	(1,813)
At 31 March 2014 (audited)	**49,833**
Additions	2,896
Transfer from investment property	4
Depreciation charge for the period	(851)
Revaluation in the period	477
At 30 September 2014 (unaudited)	**52,359**

Given the interdependency of the assets comprising the railway network, the group has concluded that the railway network is a single cash generating unit and that its fair value is the estimated future cash flows that will be generated in perpetuity, discounted at the regulatory cost of capital, as set by the Office of Rail Regulation (ORR) in its Periodic Review.

The estimate of the fair value is based on the regulatory asset base (RAB) which is derived from a discounted future cash flow calculation adjusted for the net present value of any variances from the ORR's determination included in the group's business plan. This takes into account: the provisional ORR RAB balance; any regulatory out/under-performance derived by comparing future income and expenditure projections in the group's business plan against the regulatory settlement; assets funded directly by third party contributions rather than RAB funded; and an adjustment to reflect the fact that a subset of this valuation is disclosed separately as investment properties.

In arriving at its valuation of the railway network the group considers what the value of the network would be to a conventionally funded third party, taking into account the expected terms of the regulatory settlement that would apply in those circumstances.

The depreciation charge for any year is calculated using the average carrying value for the year and the estimated remaining weighted average useful economic life of the railway network. The remaining weighted average useful economic life of the railway network was calculated using the engineering assessment of serviceable economic lives of the major categories that comprise the railway network. The estimated remaining weighted average useful economic life of the network is currently 30 years (30 September 2013: 30 years).

7. Net borrowings

	Unaudited 30 September 2014 £m	Unaudited 30 September 2013 £m	Audited 31 March 2014 £m
Net borrowings by instrument			
Cash and cash equivalents*	**761**	3,968	1,253
Collateral placed with counterparties	**218**	-	36
Collateral received from counterparties	**(155)**	(495)	(261)
Commercial paper	**(604)**	-	(255)
Overdrafts	**(43)**	-	(51)
Bank loans	**(474)**	(666)	(469)
Department for Transport facility borrowings	**(1,150)**	-	-
Bonds issued under the Debt Issuance Programme (including unamortised premium, discount and fees)	**(33,597)**	(33,418)	(33,240)
	(35,044)	(30,611)	(32,987)
Movements in net borrowings			
At the beginning of the period	**(32,987)**	(30,358)	(30,358)
(Decrease)/increase in cash and cash equivalents	**(492)**	462	(2,253)
Decrease in overdrafts	**8**	-	(51)
Proceeds from borrowings	**(2,098)**	(2,550)	(5,104)
Repayment of borrowings	**600**	1,283	3,975
Capital accretion	**(228)**	(89)	(298)
Exchange differences	**14**	263	304
Movement in collateral placed with counterparties	**106**	(14)	22
Movement in collateral received from counterparties	**182**	(91)	143
Fair value and other movements	**(149)**	483	633
At the end of the period	**(35,044)**	(30,611)	(32,987)
Net borrowings are reconciled to the consolidated balance sheet as set out below			
Cash and cash equivalents*	**761**	3,968	1,253
Collateral received from counterparties (included in trade and other payables)	**(155)**	(495)	(261)
Collateral placed with counterparties (included in trade and other receivables)	**218**	-	36
Borrowings included in current liabilities	**(3,998)**	(2,539)	(2,707)
Borrowings included in non-current liabilities	**(31,870)**	(31,545)	(31,308)
	(35,044)	(30,611)	(32,987)

*Includes collateral received from derivative counterparties of £155m (30 September 2013: £495m, 31 March 2014: £261m)

8. Notes to the cash flow statement

	Unaudited six months ended 30 September 2014 £m	Unaudited six months ended 30 September 2013 £m	Audited year ended 31 March 2014 £m
Profit before tax	**321**	751	1,035
Adjustments for:			
Property revaluation movements and profits on disposal	**(76)**	(28)	(96)
Fair value gains on derivatives and debt	**(33)**	(194)	(304)
Net interest expense	**755**	670	1,366
Depreciation of the railway network	**851**	764	1,603
Amortisation of capital grants	**(42)**	(41)	(82)
Amortisation of intangible assets	**-**	-	1
Movement in retirement benefit obligations	**35**	33	56
Increase/(decrease) in provisions	**(79)**	33	135
Operating cash flows before movements in working capital	**1,732**	1,988	3,714
(Increase)/decrease in inventories	**(23)**	4	(16)
(Increase)/decrease in receivables	**(297)**	75	(311)
Decrease)/increase in payables	**(96)**	202	384
Cash generated from operations	**1,316**	2,269	3,771

Cash and cash equivalents (which are represented as a single class of assets on the face of the balance sheet) comprise cash at bank, collateral, commercial paper and money market deposits with a maturity of up to three months.

9. Financial instruments

The fair values of financial assets and liabilities are recognised at the amount at which the instrument could be exchanged for in a current transaction between willing parties, other than in a forced or liquidation sale.

With the exception of bank loans and bonds, the carrying amount of all financial assets and liabilities approximates to their fair value. Bank loans and bonds are initially measured at fair value and subsequently at amortised cost.

The corresponding carrying values and fair values of bank loans and bonds are set out below:

	At 30 September 2014		At 30 September 2013		At 31 March 2014	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Overdrafts	**(43)**	**(43)**	-	-	(51)	(51)
Commercial paper	**(604)**	**(604)**	-	-	(255)	(255)
Bank loans	**(474)**	**(659)**	(666)	(819)	(469)	(617)
Bonds issued under the DIP	**(33,597)**	**(35,711)**	(33,418)	(34,206)	(33,240)	(34,136)
Borrowings issued by Department for Transport	**(1,150)**	**(1,176)**	-	-	-	-
Total	**(35,868)**	**(38,193)**	(34,084)	(35,025)	(34,015)	(35,059)

10. Fair value hierarchy

The following table provides an analysis of assets and liabilities that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 as defined by IFRS 13, based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted price (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The fair value of interest rate and cross currency swaps is calculated as the present value of the estimated future cash flows using yield curves at the reporting date; and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

10. Fair value hierarchy (continued)

	Unaudited 30 September 2014	Unaudited 30 September 2013	Audited 31 March 2014
Level 2			
Derivative financial assets	**408**	774	648
Level 3			
Property, plant and equipment – the railway network	**52,359**	47,933	49,833
Investment properties	**937**	829	856
Assets	**53,704**	49,536	51,337
Level 1			
Financial liabilities designated at fair value	**(761)**	(277)	(762)
Level 2			
Derivative financial liabilities	**(555)**	(687)	(664)
Financial liabilities designated at fair value	**(5,995)**	(5,390)	(5,842)
Liabilities	**(7,311)**	(6,354)	(7,268)
Total	**46,393**	43,182	44,069

Property, plant and equipment

We have classified the valuation of the rail network as Level 3. As explained in note 6, the network's fair value is the estimated future cash flows that will be generated in perpetuity, discounted at the regulatory cost of capital, as set by the ORR in its Periodic Review. The cost of capital at which cash flows are discounted is the key unobservable input in the valuation. The full market cost of capital determined by the ORR is 4.31% for the current control period, arrived at through advice from consultants, comparisons to similar infrastructure assets and discussions with Network Rail.

An increase in the market cost of capital would lead to a decrease in the valuation of the rail network and vice versa. However, the impact would be limited to the current control period as the regulator would re-evaluate the allowed return and reset it to the market rate at the next quinquennial review.

Investment properties

Property valuations are by their nature subjective, as they are made on the basis of assumptions made by the valuer. They too have been classified as Level 3 and the key inputs to the valuations, defined as 'unobservable' by IFRS 13, are analysed in the table below.

		Estimated rental value per sq ft			Equivalent yield		
Valuation technique	**Fair value at 31 September 2014 £m**	**Minimum £**	**Maximum £**	**Weighted average £**	**Minimum %**	**Maximum %**	**Weighted average %**
One-off valuation	126	2.3	88.2	15.1	4.3	10.0	5.7
Beacon method*	811	n/a	n/a	n/a	6.0	12.5	8.8

*The Beacon methodology splits all the properties within the portfolio into 13 homogenous groups. The properties in each group are valued by applying a yield to the annual rent (passing or void) for the property. Yields applied are on the basis that the property is rack rented i.e. the current passing rent received from these properties are in line with market rent. As such, an estimated rental value per square feet for these properties is not available.

All other factors being equal, a higher yield would lead to a decrease in the valuation of a property and an increase in the current or estimated future rental stream would have the effect of increasing the capital value, and vice versa. However, there are interrelationships between the unobservable inputs which are influenced by market conditions, which would impact the changes in fair value.

A review of the categorisation of the assets and liabilities into the three levels is made at each reporting date. There were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into or out of Level 3 fair value measurements in the current or prior years.