Network Rail Limited

Interim financial statements

Six months ended 30 September 2013

Company registration number 4402220

Contents

Financial highlights

	Unaudited six months ended 30 September 2013 £m	**Unaudited six months ended 30 September 2012 restated £m**	Variance £m	Variance %
Revenue	**3,267**	**3,167**	100	3%
Net operating costs excluding depreciation and amortisation	**(1,345)**	**(1,244)**	(101)	8%
Net operating costs	**(2,068)**	**(1,940)**	(128)	7%
Operating profit	**1,199**	**1,227**	(32)	(3%)
Profit after tax	**861**	**563**	298	53%
Net cash from operating activities	**1,894**	**1,430**	464	32%
Capital expenditure	**2,743**	**2,064**	679	33%

	Unaudited 30 September 2013 £m	**Audited 31 March 2013 £m**	Variance £m
Net borrowings	**30,611**	**30,358**	253
Net assets	**8,956**	**8,013**	943
Property, plant and equipment – the railway network	**47,933**	**46,411**	1,522
Investment property	**829**	**751**	78

Commentary

Summary

New platforms, new lifts, new information systems, new concourses, new footbridges, new track; all have featured as record investment has been ploughed into Britain's railways over the past six months. The railway continues to experience tremendous growth and we are responding to that demand through the biggest sustained investment programme since Victorian times. With a million more trains and half a billion more passengers than 10 years ago our railways are all but full. We are squeezing all we can out of the existing network but new railway lines must be built if Britain's vital rail arteries are not to get completely clogged, stifling economic recovery and impacting upon millions of rail users.

We have become better at managing incidents on the network and we are working more closely with customers and suppliers to achieve improved outcomes for the industry. Train performance remains at high levels and the condition of our assets remains on an improving trajectory. Nevertheless, we are seeing the impact of relentless traffic growth, massive capital expenditure and a sequence of other events causing delays to trains and increases in cost. We have also lost the benefit of the improvement in performance seen during the Olympic Games in summer 2012. As a result passenger train performance has fallen from 91.7% last year to 90.7%, on a moving annual average basis.

We have already recognised that the regulatory train performance targets will not be met this year and we will be facing a financial penalty from our regulator in respect of long distance train performance. We will also not be achieving our efficiency challenge, especially on the cost of carrying out infrastructure renewals. Performance and financial targets remain the key focus of management and several initiatives are under way to achieve improvements in the second half of the year.

Investment

In the final year of this control period, we are investing record sums in renewing existing infrastructure as well as investing in new capacity and capability. Capital expenditure of £2,743m is one third higher than in the same period last year and we have been working with our supply chain and customers to address the resource and access implications that this brings.

In six months we have renewed over 300 kilometres of track and 150 switches and crossings. We have ramped up our expenditure on signalling, structures, telecommunications, electrification and property assets. Significant progress has been made at Reading and Birmingham New Street stations, with both seeing new concourses brought into use. Following completion of the first phase of the Thameslink Programme, redevelopment of London Bridge Station is now well under way and the first phase of the new concourse is progressing to plan. Many more modest but important enhancement projects have been delivered offering benefits such as better facilities at stations, longer platforms, better freight access, new signalling and new line side fencing.

Revenues

The majority of Network Rail’s turnover increases annually in line with the Retail Price Index (RPI), in accordance with the regulatory settlement. Against this, the first six months of the year saw a £35m increase in compensation payments to operators for missed train performance or for increased access associated with our investment programme. Overall, turnover increased by £100m (3.2%) to £3,267m.

Borrowings

The seven bonds issued during the half year raised £2,550m, of which £1,283m was used to refinance maturing debt. The balance was used to finance our investment programme and will be serviced from the return we earn on the regulatory asset base.

Net borrowings have increased by £253m from £30,358m at the year end to £30,611m. The increase was less than expected due to favourable movements in working capital and valuations. Cash and cash equivalents increased by £462m in the same period to £3,968m.

Assets

The value of the railway network increased to £47,933m from £46,411m at 31 March 2013. The increase reflects £2,743m of capital investment in the infrastructure, depreciation of £764m and a downwards revaluation of £457m.

The revaluation movement includes a £1,348m inflation increase, reduction of £1,308m determined by the Office of Rail Regulation in respect of tax as set out in their Final Determination of outputs and funding for 2014-19, reversal of £285m by the Office of Rail Regulation of the previously reported adjustment for missed regulatory outputs and £782m of other adjustments in accordance with regulatory accounting guidelines.

Risks and Uncertainties

The principal risks and uncertainties affecting the business activities of the group were set out on pages 30 and 31 of the annual report and accounts for the year ended 31 March 2013, 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;
- Operating the railway;
- Maintaining the railway;
- Improving the railway;
- Finance; and
- People.

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 2013 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

The Office of Rail Regulation has published their Final Determination of outputs and funding for 2014-19. This sets a challenge for us in terms of achievement of demanding outputs as well as living within tough financial constraints, in other words doing more for less, while at the same time continuing to improve safety. We will be considering our position on the Determination over the next few months and will be responding formally in February 2014.

Statement of directors' responsibilities

The directors confirm that this condensed consolidated interim financial information has been prepared in accordance with IAS 34 as adopted by the European Union and that the interim management report includes a fair review of the information, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed consolidated interim financial information 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 of the financial year 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 and Accounts for the year ended 31 March 2013. Since that report there have been two changes to the board composition in that Graham Eccles resigned as a director on 18 July 2013 and Chris Gibb was appointed a non-executive director on 12 November. It was also announced that Mark Carne will be joining Network Rail on 6 January 2014 before taking over from David Higgins on 1 April 2014. A list of current directors is available on the group's website: www.networkrail.co.uk

By order of the board

Patrick Butcher
Group finance director
20 November 2013

Independent review report

to Network Rail Limited

Introduction

We have been engaged by the company to review the condensed consolidated set of financial statements in the half-yearly financial report for the six months ended 30 September 2013, which comprises the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated balance sheet, the consolidated cash flow statement and related notes. 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 consolidated set of financial statements.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The condensed consolidated 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 consolidated set of financial statements in the half-yearly financial report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of the Disclosure and Transparency Rules of the Financial Conduct Authority and for no other purpose. We do not, in producing this report, 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.

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 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. 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.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated set of financial statements in the half-yearly financial report for the six months ended 30 September 2013 is 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.

PricewaterhouseCoopers LLP

Chartered Accountants
London

20 November 2013

Notes

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.

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 2013 **Results pre debt and derivative revaluations £m**	**Debt and derivative revaluations £m**	**Total £m**	Unaudited six months ended 30 September 2012 restated* £m	Audited year ended 31 March 2013 restated* £m
Revenue	2	**3,267**	**-**	**3,267**	3,167	6,197
Net operating costs	3	**(2,068)**	**-**	**(2,068)**	(1,940)	(3,990)
Operating profit		**1,199**	**-**	**1,199**	1,227	2,207
Property revaluation movements and profits on disposal		**28**	**-**	**28**	20	(3)
Total profit from operations		**1,227**	**-**	**1,227**	1,247	2,204
Investment revenue	4	**9**	**-**	**9**	9	19
Other gains and losses	4	**-**	**194**	**194**	66	(43)
Finance costs	4	**(679)**	**-**	**(679)**	(702)	(1,433)
Profit before tax		**557**	**194**	**751**	620	747
Tax	5	**149**	**(39)**	**110**	(57)	(70)
Profit after tax for the period		**706**	**155**	**861**	563	677

*The comparatives have been restated for adoption of IAS 19 (revised) “Employee Benefits”

Consolidated statement of comprehensive income

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 restated £m	Audited year ended 31 March 2013 restated £m
Profit for the period	**861**	563	677
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
(Loss)/gain on revaluation of the railway network	**(457)**	903	(352)
Actuarial losses on defined benefit pension schemes	**(32)**	(130)	(550)
Tax relating to components of other comprehensive income	**240**	(136)	268
Total items that will not be reclassified to profit or loss	**(249)**	637	(634)
Items that may be reclassified to profit or loss			
Gains/(losses) on movement in fair value of hedging derivatives	**207**	(15)	71
Reclassification of balances in the hedging reserve to the income statement	**163**	46	18
Tax relating to components of other comprehensive income	**(39)**	-	(36)
Total items that may be reclassified subsequently to profit or loss	**331**	31	53
Other comprehensive income/(expense) for the period	**82**	668	(581)
Total comprehensive income for the period	**943**	1,231	96

Consolidated statement of changes in equity

	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**
Actuarial losses on defined benefit pension schemes	**-**	**-**	**-**	**(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**

	Revaluation Reserve £m	Other Reserve £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2012	3,123	249	(241)	4,786	7,917
Profit for the period - restated	-	-	-	563	563
Impact of change in tax rate	57	-	3	(15)	45
Revaluation of the railway network	903	-	-	-	903
Transfer of deemed cost depreciation from revaluation reserve	(29)	-	-	29	-
Increase in deferred tax liability on the railway network	(201)	-	-	(7)	(208)
Actuarial losses on defined benefit pension schemes - restated	-	-	-	(130)	(130)
Deferred tax on actuarial gains - restated	-	-	-	30	30
Decrease in fair value of hedging derivatives	-	-	(15)	-	(15)
Deferred tax on all hedging reserve movements/retained earnings	-	-	(3)	-	(3)
Reclassification of balances in the hedging reserve to the income statement	-	-	46	-	46
Balance at 30 September 2012 (Unaudited)	3,853	249	(210)	5,256	9,148

Consolidated statement of changes in equity (continued)

	Revaluation Reserve £m	Other Reserve £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2012	3,123	249	(241)	4,786	7,917
Profit for the period - restated	-	-	-	677	677
Impact of change in tax rate	55	-	(10)	(6)	39
Revaluation of the railway network	(352)	-	-	-	(352)
Transfer of deemed cost depreciation from revaluation reserve	(27)	-	-	27	-
Decrease in deferred tax liability on the railway network	91	-	-	(6)	85
Actuarial loss on defined benefit pension schemes - restated	-	-	-	(550)	(550)
Deferred tax on actuarial loss - restated	-	-	-	134	134
Increase in fair value of hedging derivatives	-	-	71	-	71
Deferred tax on all hedging reserve movements/retained earnings	-	-	(26)	-	(26)
Reclassification of balances in the hedging reserve to the income statement	-	-	18	-	18
Balance at 31 March 2013 (Audited)	2,890	249	(188)	5,062	8,013

Consolidated balance sheet

	Note	**Unaudited 30 September 2013 £m**	Unaudited 30 September 2012 £m	Audited 31 March 2013 £m
Assets				
Non-current assets				
Intangible assets		**69**	70	69
Property, plant and equipment – the railway network	6	**47,933**	45,342	46,411
Investment property		**829**	876	751
Derivative financial instruments	9	**764**	585	697
Finance lease receivables		**3**	4	3
Interest in joint venture		**11**	8	12
		49,609	46,885	47,943
Current assets				
Inventories		**153**	161	157
Finance lease receivables		**1**	1	2
Trade and other receivables		**702**	744	776
Current tax assets		**3**	9	9
Derivative financial instruments	9	**10**	129	256
Cash and cash equivalents	7	**3,968**	2,686	3,506
		4,837	3,730	4,706
Total assets		**54,446**	50,615	52,649
Current liabilities				
Trade and other payables		**(4,030)**	(2,496)	(3,394)
Current tax liabilities		**-**	-	-
Borrowings	7	**(2,539)**	(2,588)	(4,120)
Derivative financial instruments	9	**(207)**	(321)	(23)
Provisions		**(41)**	(7)	(8)
		(6,817)	(5,412)	(7,545)
Net current liabilities		**(1,980)**	(1,682)	(2,839)
Non-current liabilities				
Borrowings	7	**(31,545)**	(28,142)	(29,354)
Derivative financial instruments	9	**(480)**	(843)	(608)
Other payables		**(2,693)**	(2,978)	(2,953)
Retirement benefit obligation		**(1,359)**	(820)	(1,267)
Deferred tax liabilities		**(2,596)**	(3,272)	(2,909)
		(38,673)	(36,055)	(37,091)
Total liabilities		**(45,490)**	(41,467)	(44,636)
Net assets		**8,956**	9,148	8,013

Consolidated balance sheet (continued)

	Unaudited 30 September 2013 £m	Unaudited 30 September 2012 £m	Audited 31 March 2013 £m
Equity			
Revaluation reserve	**2,634**	3,853	2,890
Other reserve	**249**	249	249
Hedging reserve	**143**	(210)	(188)
Retained earnings	**5,930**	5,256	5,062
Total equity	**8,956**	9,148	8,013

This interim financial report was approved by the board of directors on 20 November 2013.

It was signed on its behalf by:

Patrick Butcher (Director)

Consolidated cash flow statement

	Note	**Unaudited six months ended 30 September 2013 £m**	Unaudited six months ended 30 September 2012 £m	Audited year ended 31 March 2013 £m
Cash flows from operating activities				
Cash generated from operations	8	**2,269**	1,763	3,749
Interest paid		**(379)**	(333)	(1,038)
Income tax received/(paid)		**4**	-	(8)
Net cash generated from operating activities		**1,894**	1,430	2,703
Investing activities				
Interest received		**9**	8	20
Purchases of property, plant and equipment		**(2,855)**	(2,159)	(4,693)
Proceeds on disposal of investment property		**1**	24	39
Capital grants received		**54**	64	137
Capital element of finance lease receipts		**-**	1	2
Investment in joint ventures		**1**	(2)	(6)
Net cash flows used in investing activities		**(2,790)**	(2,064)	(4,501)
Financing activities				
Repayment of borrowings		**(1,283)**	(362)	(1,203)
Repayment of obligations under finance leases		**-**	-	(1)
New loans raised		**2,550**	1,870	4,751
Collateral received from/(repaid to) counterparties		**91**	5	323
Cash flow on settlement of derivatives		**-**	(79)	(452)
Net cash from financing activities		**1,358**	1,434	3,418
Net increase in cash and cash equivalents		**462**	800	1,620
Cash and cash equivalents at beginning of the period		**3,506**	1,886	1,886
Cash and cash equivalents at the end of the period		**3,968**	2,686	3,506

Notes to the interim financial statements

Six months ended 30 September 2013

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 2013 were approved by the board of directors on 5 June 2013 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 2013, 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

In preparing this condensed set of financial statements, comparative amounts have been restated to reflect the adoption of IAS19 (revised) 'Employee Benefits'.

Accounting policies

In the current financial year, the group has adopted the amendments to IAS 1 "Presentation of Items of Other Comprehensive Income", IAS 19 (revised 2011) "Employee Benefits" and IFRS 13 "Fair Value Measurements". Otherwise the same accounting policies, presentation and methods of computation are followed in the condensed set of financial statements as applied in the group's latest annual audited financial statements for the year ended 31 March 2013.

The amendments to IAS1 require items of other comprehensive income to be grouped by those items that may be reclassified subsequently to profit or loss and those that will not be reclassified, together with their associated income tax. The amendments have been applied retrospectively, and hence the presentation of items of comprehensive income have been restated to reflect the change.

IAS 19 (revised 2011) and the related consequential amendments have impacted the accounting for the group's defined benefit scheme, by replacing the interest cost and expected return on plan assets with a net interest charge on the net defined benefit liability. For the current period, the profit before tax is £21m lower and other comprehensive income £21m higher than it would have been prior to the adoption of IAS 19 (revised 2011). For the year ending 31 March 2013 the restated profit is £22m lower and other comprehensive income £22m higher than previously reported. As the group has always recognised actuarial gains and losses immediately there has been no effect on the prior year defined benefit obligation.

IFRS 13 has impacted the measurement of fair value for certain assets and liabilities as well as introducing new disclosures, as set out in note 10.

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 2013 Network Rail Limited annual report and accounts. This can be found in the directors' report on pages 30-31. There are also further details on funding and financial risk management note 26 on pages 127-132 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 112-115 of the Network Rail Limited annual report and accounts 2013, 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 2013 Retail Prices Index (published in December 2013). This is estimated at 3.00% and for every 10 basis points variance from that forecast the regulatory asset base, on which the valuation is based, will vary by £45m.

(ii) Investment property: Jones Lang LaSalle provided independent valuations of 13 one-off individual properties. The balance of the estate was valued under the Beacon method by splitting the portfolio into homogeneous classes of property and areas. Jones Lang LaSalle 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 in the Network Rail Limited annual report and accounts 2013.

(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 expected rate of return on assets, 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 27 in the Network Rail Limited annual report and accounts 2013. The discount rate has remained at 4.4% and the RPI assumption at 3.3%. 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 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 debt issuances. A key judgement is in relation to the highly probable future issuances. At 30 September 2013 Network Rail has deferred derivative assets with a fair value of £295m in equity to use against highly probable and expected future issuances. Interest rate swaps with a liability fair value of approximately £4m are due to start before 31 March 2014.

2. Revenue

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 £m	Audited year ended 31 March 2013 £m
Franchised track access and grant income	**3,106**	3,017	5,893
Freight revenue	**31**	29	48
Property rental income	**118**	109	233
Other income	**12**	12	23
	3,267	3,167	6,197

The effect of the performance regimes on the results of the group was a net expense of £35m (six months to 30 September 2012: net income of £6m).

3. Net operating costs

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 restated £m	Audited year ended 31 March 2013 restated £m
Employee costs*	**961**	865	1,789
Own costs capitalised	**(313)**	(287)	(653)
Other external charges (including infrastructure maintenance costs)	**846**	782	1,686
Other operating income and recoveries	**(149)**	(116)	(242)
Net operating costs before depreciation	**1,345**	1,244	2,580
Depreciation and other amounts written off non-current assets	**764**	737	1,491
Capital grants amortised	**(41)**	(41)	(81)
Net operating costs	**2,068**	1,940	3,990

*The average number of employees (including executive directors) in the six months ended 30 September 2013 was 34,984 (six months ended 30 September 2012: 34,864). Annualised average cost per employee, including pension contributions and employer's NI, was £54,939 (six months ended 30 September 2012: £49,621 restated).

Research and development expenditure in the six months was £178,000 (six months ended 30 September 2012: £250,000)

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

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 restated £m	Audited year ended 31 March 2013 restated £m
Investment revenue			
Interest receivable on investments and deposits	**9**	9	19
Total investment revenue	**9**	9	19
Finance costs			
Interest payable on borrowings	**(715)**	(748)	(1,510)
Defined benefit pension schemes net interest cost	**(27)**	(16)	(32)
Total borrowing costs	**(742)**	(764)	(1,542)
Less: capitalised interest	**63**	62	109
Total finance costs	**(679)**	(702)	(1,433)
Other gains and losses			
Net ineffectiveness arising from cash flow hedge accounting	**-**	-	(5)
Fair value (loss)/gain on fair value hedges	**(409)**	(62)	308
Fair value gain/(loss) on carrying value of fair value hedged debt	**429**	48	(304)
Net decrease/(increase) in fair value of non-hedge accounted debt	**40**	(12)	3
Gain/(loss) on derivatives not hedge accounted	**134**	92	(45)
Total other gains and losses	**194**	66	(43)

5. Tax

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 restated £m	Audited year ended 31 March 2013 restated £m
Current tax:			
Current tax on profits	**4**	-	11
Less advance corporation tax (ACT) set-off	**(2)**	(2)	(4)
Total current tax	**2**	(2)	7
Deferred tax:			
Current year charge	**148**	147	146
Effect of rate change	**(260)**	(88)	(83)
Adjustments in respect of prior years	**-**	-	-
Total deferred tax	**(112)**	59	63
Total tax	**(110)**	57	70

The rate used for the purposes of deferred tax in these financial statements is 20% (September 2012: 23%) 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 a minimal 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 2012	43,112
Additions	5,050
Transfer from investment property	92
Depreciation charge for the year	(1,491)
Revaluation in the year	(352)
At 31 March 2013	**46,411**
Additions	2,743
Depreciation charge for the period	(764)
Revaluation in the period	(457)
At 30 September 2013	**47,933**

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 (September 2012: 30 years).

7. Net borrowings

	Unaudited 30 September 2013 £m	Unaudited 30 September 2012 £m	Audited 31 March 2013 £m
Net borrowings by instrument			
Cash and cash equivalents*	**3,968**	2,686	3,506
Collateral placed with counterparties	**-**	-	14
Collateral received from counterparties	**(495)**	(86)	(404)
Commercial paper	**-**	(409)	(30)
Bank loans	**(666)**	(674)	(666)
Bonds issued under the Debt Issuance Programme (including unamortised premium, discount and fees)	**(33,418)**	(29,647)	(32,778)
	(30,611)	(28,130)	(30,358)
Movements in net borrowings			
At the beginning of the period	**(30,358)**	(27,282)	(27,282)
Increase in cash and cash equivalents	**462**	800	1,620
Proceeds from borrowings	**(2,550)**	(1,870)	(4,751)
Repayment of borrowings	**1,283**	361	1,203
Repayment of obligation under finance leases	**-**	1	1
Capital accretion	**(89)**	(207)	(485)
Exchange differences	**263**	27	(73)
Movement in collateral placed with counterparties	**(14)**	-	14
Movement in collateral received from counterparties	**(91)**	(5)	(323)
Fair value and other movements	**483**	45	(282)
At the end of the period	**(30,611)**	(28,130)	(30,358)

Net borrowings are reconciled to the consolidated balance sheet as set out below

Cash and cash equivalents*	**3,968**	2,686	3,506
Collateral received from counterparties (included in trade and other payables)	**(495)**	(86)	(404)
Collateral placed with counterparties (included in trade and other receivables)	**-**	-	14
Borrowings included in current liabilities	**(2,539)**	(2,588)	(4,120)
Borrowings included in non-current liabilities	**(31,545)**	(28,142)	(29,354)
	(30,611)	(28,130)	(30,358)

*Includes collateral received from derivative counterparties of £495m (September 2012: £86m, March 2013: £404m)

8. Notes to the cash flow statement

	Unaudited six months ended 30 September 2013 £m	Unaudited six months ended 30 September 2012 £m	Audited year ended 31 March 2013 £m
Profit before tax	**751**	620	747
Adjustments for:			
Property revaluation movements and profits on disposal	**(28)**	(20)	3
Fair value (gains)/losses on derivatives and debt	**(194)**	(66)	43
Finance costs	**679**	702	1,415
Investment revenue	**(9)**	(9)	(19)
Depreciation of the railway network	**764**	737	1,491
Amortisation of capital grants	**(41)**	(41)	(81)
Amortisation of intangible assets	**-**	-	1
Movement in retirement benefit obligations	**33**	13	42
Increase/(decrease) in provisions	**33**	(5)	(4)
Operating cash flows before movements in working capital	**1,988**	1,931	3,638
Decrease/(increase) in inventories	**4**	(36)	(32)
Decrease/(increase) in receivables	**75**	(72)	(106)
Increase/(decrease) in payables	**202**	(60)	249
Cash generated from operations	**2,269**	1,763	3,749

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 face 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 2013		At 30 September 2012		At 31 March 2013	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Bank loans	**(666)**	**(819)**	(674)	(751)	(666)	(868)
Bonds issued under the DIP	**(33,418)**	**(34,206)**	(29,647)	(30,964)	(32,778)	(35,884)
Total	**(34,084)**	**(35,025)**	(30,730)	(32,124)	(33,474)	(36,752)

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 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).

	Unaudited 30 September 2013	Unaudited 30 September 2012	Audited 31 March 2013
Financial assets at fair value through profit and loss			
Level 2			
Derivative financial assets	**774**	714	953
Total assets measured at fair value	**774**	714	953
Financial liabilities at fair value through profit and loss			
Level 1			
Bonds designated as fair value through the profit and loss	**(277)**	(332)	(316)
Level 2			
Derivative financial liabilities	**(687)**	(1,164)	(631)
Total liabilities measured at fair value	**(964)**	(1,496)	(947)

A review of the categorisation of financial instruments 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.