

Company Registration No. 07900320

FIRST MTR SOUTH WESTERN TRAINS LIMITED

Annual Report and Financial Statements

For the Year ended 31 March 2019

FRIDAY



T8K00ZSX

TC1

20/12/2019

#9

COMPANIES HOUSE

First MTR South Western Trains Limited

Contents	Page
Strategic report	2
Directors' report	9
<i>Statement of directors' responsibilities</i>	11
Independent auditor's report	12
Profit and loss account	15
Statement of comprehensive income	15
Balance sheet	16
Statement of changes in equity	17
Notes to the financial statements	18

First MTR South Western Trains Limited

Strategic Report

The directors, in preparing this strategic report, have complied with s414C of the Companies Act 2006. The company is registered in England and Wales and is a subsidiary of First Rail Holdings Limited by virtue of a 70% shareholding. MTR Corporation Limited (MTR) has a non-controlling interest of 30%.

Principal activities

The company holds the South Western Rail franchise until 18 August 2024. After this period, the Secretary of State has the right to extend the contract up to 21 June 2025.

The company operates passenger rail services on some of the busiest routes in the country, providing over 1,800 services each weekday. The franchise covers urban, suburban, regional and long-distance services to passengers in south west London and southern counties of England and Island Line services on the Isle of Wight, as well as providing connectivity to the ports and airports in the region.

Business review

In the year, our turnover increased to £1,108.5m (2018: £650.5m, 32 weeks trading), a like for like 6% passenger growth. Growth rates across the industry continue to be affected by UK macroeconomic uncertainty, modal shift due to lower fuel prices and changing working practices, while our network has experienced challenges from strike action and the effect of rail infrastructure works.

During the year we were affected by the national rail industry decision to defer the December 2018 timetable changes, a significant and unforeseen change in circumstances which meant we could not deliver our additional services and other passenger benefits as originally scheduled under our franchise plans. Most of these timetable changes were deferred to May 2019 with further incremental changes in December 2019 and our plans are being developed to ensure successful implementation of this major step change in benefits to our customers.

The company is focussed on working with the Department for Transport (DfT), Network Rail and other industry partners to deliver more capacity and better customer experiences to drive sustainable patronage growth. Key initiatives in the year have revolved around the delivery of Committed Obligations and other plans, including:

- Introduction of SMART card, as a replacement to paper ticket, available for over 99% of customer journeys;
- Establishment of new gatelines at an additional 7 stations;
- Accessibility improvements at stations and improved Passenger Assist programme;
- Sustainability to the very heart of the franchise; and
- Automated Delay Repay, making it easier for customers to claim compensation.

Management have prepared updated financial forecasts for the franchise. Due to the range of uncertainties facing the franchise the company has made provision for an onerous contract for £145.9m, which is the maximum unavoidable loss under the Franchise Agreement, over the remaining life of the franchise to 17 August 2024.

The operating loss was £137.8m (2018: £9.6m profit from 32 weeks trading). The operating loss includes the charge during the year of £145.9m in respect of an onerous contract provision relating to the forecast losses to be made to the end of the franchise.

We believe the delivery of our £1.2bn transformation, focusing on the delivery of significant customer benefits through further increased capacity, additional services, quicker journey times, new and refurbished trains, improved station facilities, roll out of smart ticketing and improved customer information are the right ones for our passengers and communities. We are confident that they will drive a considerable acceleration in our annual patronage and revenue growth over time. Certain commercial and contractual changes have been discussed with DfT and recognised in part during the year, but we remain engaged in discussions with the DfT in relation to their effects over the longer term.

First MTR South Western Trains Limited

Strategic Report (continued)

Future outlook

We have continued to invest in passenger convenience including initiatives to promote contactless payment, online and mobile ticketing and travel information improvements and other technology to streamline and enhance our operations and responsiveness to customers and other stakeholders. Meanwhile our commitment to the safety of our passengers, our employees and all third parties interacting with our business remains unwavering. Our approach to safety is focussed on innovative technology, external assurance and our behavioural change programme, Be Safe, all of which have made further progress in the year towards ensuring we are always operating to the highest standards.

At stations we are delivering additional car parking spaces, as well as new and upgraded customer information screens, and improved waiting, retail and interchange facilities.

In September 2018 the UK Government established the Williams Rail Review to look at the structure of the whole rail industry and the way passenger rail services are delivered. The independent review will make recommendations for reform that prioritise passengers' and taxpayers' interests. The review's findings and recommendations will be published in a government white paper. Reform is expected to begin in 2020.

There is considerable uncertainty about a number of factors affecting the performance of our franchise, including infrastructure reliability, timetabling delays and industrial action. We are in discussions with the DfT regarding potential commercial and contractual remedies in respect of these uncertainties, which are discussed in the Going Concern section below.

As a result, we have taken the decision to set aside an amount of £145.9m in respect of these potential future losses. We will continue to deliver our plans, which are the right ones for our customers and include a new fleet of suburban trains.

Our performance levels were challenging during the 2018 calendar year, reflecting historic infrastructure issues dating from before we took over the franchise in August 2017. We are working with Network Rail on plans to return service to levels that our customers expect, as set out in the independent review by Sir Michael Holden. The improvements made as part of these plans have helped lead to arrest the deterioration in performance since January.

Our customers have also faced considerable disruption to their journeys due to unnecessary and as yet unresolved RMT industrial action. We have guaranteed that a guard with safety critical competencies will be rostered on every train, no guards will lose their job because of these changes, and reminded our stakeholders that the company will want more guards in future since our plans call for more services to be introduced. The company remains focused on delivering a resolution of the industrial dispute in the interests of our passengers.

Existing fleets are being completely refitted and refreshed, and an additional set of 18 fully refurbished trains will be re-introduced to the London-Portsmouth route in the next financial year. In 2020 we will begin introducing a fleet of 90 suburban trains manufactured by Bombardier, which with the timetable changes, introduction of Class 442 trains and seating reconfiguration on Class 444/450 trains is providing a 46% increase in peak capacity on London routes.

The May 2019 timetable change resulted in 300 additional train services a week for customers across the network, many of which have been introduced following extensive consultations and feedback sessions with local stakeholders and customers. Further incremental enhancements are planned for future timetables in December 2019 and beyond.

First MTR South Western Trains Limited

Strategic Report (continued)

Going concern

Since year end the company has continued to be loss-making and current forecasts indicate that losses will exceed the amount of the onerous contract provision within 12 months from the date of approval of these accounts. The company is dependent upon funding from the ultimate parent company and MTR Corporation Limited, who have re-affirmed their commitments made under the Funding deed, which are limited to funding already provided of £30m under the agreed funding commitment and £40m of parent company support as set out in note 16, and future parent company support of £47m as well as the £15m performance bond (note 20). The directors have made enquires and understand that the ultimate parent company and MTR Corporation Limited have adequate resources to be able to provide this financial support, which is forecast to be utilised within 12 months from the date of approval of these accounts.

We are in discussions with the DfT regarding potential commercial and contractual remedies in respect of the uncertainties affecting the performance of the franchise, including infrastructure reliability, timetabling delays and industrial action. Whilst these discussions are constructive they remain ongoing and the outcome and therefore the impact on the company's ability to continue operating the franchise throughout the going concern period is at this stage uncertain. In the directors' view, potential outcomes include:

- the company being asked to submit proposals for a short term management contract for the continued operation of the franchised train services; and
- termination of the contract within the next 12 months and the services being transferred to a publicly owned operator.

After making enquiries and considering the above facts, the directors have concluded that there is a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern and that, therefore, the company may be unable to realise its assets and discharge its liabilities in the normal course of business. Further details are set out in note 1 to the financial statements.

Nevertheless, having considered the uncertainties described above alongside the company's forecasts, the existence of support from the parent companies and the current status of discussions with the DfT, and after making enquiries, the directors have a reasonable expectation that the discussions with the DfT will have a positive conclusion, and that the company will continue to operate for the foreseeable future, and have therefore continued to prepare the financial statements on a going concern basis.

Key Performance Indicators

The key non-financial performance indicators are as follows:

Train operating performance was below targeted levels in 2018/19 with our industry standard public performance measure (PPM) moving average score standing at 82.3% (2018: 84.3%). PPM is determined by the number of trains which arrive at destination within the individual train operating company benchmark target. This performance figure was impacted by severe weather conditions and infrastructure related issues.

In the latest independent Transport Focus National Rail Passenger Spring Survey, the company achieved 78% (2018 80%) customer satisfaction against a target of 80% (2018: 85%). The decrease in score was predominantly due to punctuality and reliability scores declining.

The company's average headcount in the year increased to 5,074 (2018: 5,036), an increase of 1%.

First MTR South Western Trains Limited

Strategic Report (continued)

Principal risks and uncertainties

To deliver our strategy, it is important that we understand and manage the risks that faces the company. We have a risk management methodology which we use throughout the business to allow us to identify and manage the principal risks which could:

- adversely impact the safety and security of the company's employees, customer and/or assets;
- have a material impact on the financial or operational performance of the company;
- impede achievement of our strategic objectives and financial targets; and/or
- adversely impact the company's reputation or stakeholder expectations.

The company's principal risks are set out below. These risks have been assessed considering their potential impact (both financial and reputational), the likelihood of occurrence and any change to this compared to the prior year and the reduced risk after the implementation of controls.

Rail franchise agreements

The company is required to comply with certain conditions as part of its rail franchise agreement. If it fails to comply with these conditions, it may be liable to penalties including the potential termination of the rail franchise agreement. This would result in the company losing the right to continue operating the affected operations and consequently, the related revenues or cash flows. The company may also lose some or all of the amounts set aside as security for its performance bond and the season ticket bond. Throughout the franchise there will be significant change including major infrastructure work, re-signalling as well as the introduction of new trains, which will require careful planning and management. Failure to manage these risks adequately in accordance with our plans could result in financial and reputational risk to the company.

Compliance with franchise conditions are closely managed and monitored on a monthly basis by senior management and procedures are in place to minimise the risk of non-compliance.

Information technology (IT)

Our business relies on information technology in all aspects of its operations. Any significant disruption or failure, caused by external factors, denial of service, computer viruses or human error could result in a service interruption, accident or misappropriation of confidential information (including credit card and personal data). Process failure, security breach or other operational difficulties may also lead to revenue loss or increased costs, fines, penalties or additional insurance requirements. Prolonged failure of our sales website could also adversely affect revenues.

Continued successful delivery and implementation of our IT transformation plan required to improve yield management and drive future growth. Failure to properly manage the implementation of new IT systems may result in increased costs and/or lost revenue.

We focus on asset management and further enhanced our IT security processes and procedures to mitigate this risk.

Data security (including cyber security & GDPR)

All business sectors are targeted by increasingly sophisticated cyber security attacks. Across our business we are seeing increased use of mobile and internet sales channels which gather large amounts of data and therefore the risk of unauthorised access to, or loss of, data in respect of employees or our customers is growing. A failure to comply with the General Data Protection Regulation (GDPR), which came into force in May 2018, could result in significant penalties and could have adverse impact on consumer confidence in our business.

We have threat detection systems across our business but continue to remain vigilant to security improvements when identified.

First MTR South Western Trains Limited

Strategic Report (continued)

Political and regulatory issues

Our business is subject to numerous laws and regulations covering a wide range of matters including health and safety, equipment, employment (including working time, wage and hour, mandatory breaks and holiday pay), competition and anti-trust, data protection and security, bribery and corruption, environment, insurance coverage, consumer protection, and other operational issues. Failure to comply could have financial or reputational implications, result in increased litigation and claims and have a negative impact on the Company. These laws and regulations are constantly subject to change, the impact of which could include increased compliance costs and/or a reduction in operational flexibility and efficiency.

To help mitigate the risk of legislative or regulatory changes the Company and FirstGroup plc have embedded operating policies and procedures to ensure compliance with existing legislation and regulation. FirstGroup actively engages with the relevant bodies and policy makers to help ensure that we are properly positioned to respond to any proposed changes.

Competition

Our main competitors include private car and other public and private transport operators across our network. Emerging technologies such as Uber, ride sharing apps and price comparison websites make access to alternative solutions easier. Increased competition can result in lost business, revenue and reduced profitability. The Company continues to focus on service quality and performance as priorities in making our service attractive to passengers and other customers. In addition, we work with local and national bodies to promote measures aimed at increasing demand for our services.

Customer service

Our revenues are at risk if we do not continue to provide the level of service expected by customers. Payments from our new customer compensation mechanism are also exclusively driven by the performance of our train service. Ongoing engagement with customers and community stakeholders takes place across our network, including through 'meet the manager' events, customer panels, consultations and local partnerships. The Board also monitors customer service KPIs to ensure that strict targets are being met.

Pension scheme funding

The company primarily participates in a defined benefits pension scheme, Railways Pension Scheme ("RPS", or "the Scheme"). Future cash contribution requirements may increase or decrease based on financial markets, notably investment returns/valuations, the rates used to value the liabilities and through changes to life expectancy. Under UK Rail franchise agreements, the company is not responsible for any residual deficit at the end of a franchise so there is only short-term cashflow risk within our franchise.

At the previous year-end, we noted that The Pensions Regulator (TPR) had been in discussion with the Scheme regarding the assumptions used to determine the Scheme's funding requirements. Discussions are ongoing. The possibility remains of changes to contributions that could impact all rail operators sponsoring this industry-wide scheme.

TPR and the DfT had requested that the Rail Delivery Group (RDG) coordinate the Train Operators' involvement in an industry wide review of scheme funding. The RDG, comprising participants from each of the large owning groups, has been seeking to develop a framework which meets TPR, DfT, RPS and RDG objectives.

There has been continuing engagement between the key parties during the year, and efforts to develop a framework to take forward to a formal consultation are ongoing.

Management continues to believe that the protections contained within current franchise agreements will allow the Scheme to continue with its current funding strategy in the short-term. Nevertheless, TPR believes that a higher level of funding is required in the longer term, and our parent company has been engaged with the industry-wide project to consider the funding of the Scheme.

Management continues to believe that an approach that meets TPR's key objectives whilst maintaining stability and fairness, and retaining protection against unacceptable risk, for both operators and scheme members is achievable.

First MTR South Western Trains Limited

Strategic Report (continued)

Employee costs and relations

Labour costs represent a significant component of the Company's operating costs. Labour shortages, or low unemployment rates, could hinder the Company's ability to recruit and retain qualified employees leading to a higher than expected increase in the cost of recruitment, training and other staff costs. Industrial action could adversely impact customer service and have a financial impact on the Company's operation. To mitigate this risk, the Company seeks to structure its recruitment and retention policies, training schemes and working practices. Our employees are key to service delivery and therefore it is important that good employee relations are maintained. Our working practices include building communication and engagement with trade unions and the wider workforce. Examples of this engagement include regular leadership conferences, employee surveys and the presence of an Employee Director (voted for by the employees to represent them) on the company's board.

Fuel costs

Fuel prices and supply levels can be influenced significantly by international, political and economic circumstances. If fuel supply shortages were to rise because of national strikes, world supply difficulties, disruption of refining capacity or oil imports the resultant higher fuel prices and disruption to services could adversely impact the Company's operating result. To mitigate the risks of rising fuel costs the Company works with FirstGroup plc who regularly enter into forward contracts to buy fuel at fixed prices. In addition, the Company seeks to limit the impact of unexpected fuel price rises through efficiency and pricing measures.

Compliance, litigation and claims, health and safety

Our operations are subject to a wide range of legislation and regulation. Failure to comply can lead to litigation, claims, damages, fines and penalties. The Company has three main risks: third party injury and other claims arising from general operations, employee injuries and property damage. A higher volume of litigation and claims can lead to increased costs and reputational impact.

We have a very strong focus on safety and it is one of our five values. The company self-insures third party and employee injury claims up to a certain level commensurate with the historical risk profile. We purchase insurance above these limits from reputable global insurance firms. Claims are managed by experienced claims handlers. Non-insured claims are managed by FirstGroup plc's dedicated in-house legal teams with external assistance as appropriate.

Disruption to infrastructure/operations

Across our network, we are experiencing greater and more frequent adverse weather disruption impacting our service levels. Severe weather can reduce profits, for example through lower demand for our services, increased costs and business disruption. We have severe weather action plans and procedures to manage the impact on our operations.

The threat from terrorism is enduring and continues to exist. Public transport continues to be regarded as an attractive and viable target. Across our business, we take all reasonable steps to help guard against such activity on the services we operate. An attack, or threat of attack, could lead to reduced public confidence in the public transportation, and/or specifically in our security and safety record and could reduce demand for our service, increase costs and security requirements and cause operational disruption.

The company has a Head of Security who is responsible for improved security awareness, the application of good practice in the implementation of security measures, and the development and training of our employees so that they can respond effectively to any perceived threat or incident.

Environment and climate change

Environmental and climate change issues are key issues facing the transport sector and have the potential to carry significant risks. We are well positioned to mitigate against these risks through our environmental and sustainability strategy. The company continues to build on the prestigious international standards for environmental and energy management by maintaining certification to ISO 14001:2015 and ISO 50001:2011. Contracts and projects with suppliers with significant environmental risk are now evaluated by our Sustainability team.

First MTR South Western Trains Limited

Strategic Report (continued)

Economic conditions including Brexit

Changing economic conditions affect our business in different ways. A less positive economic outlook affects the number of train journeys taken by passengers in the UK. Any changes in the economic activity may impact upon the passenger numbers and hence our operations. A less positive economic outlook, or a disruptive exit from the EU could have a negative impact on our business in terms of reduced demand and reduced opportunities for growth. Improving economic conditions may also result in a tightening of labour markets resulting in employee shortages, pressure to increase pay, or affect the availability of public funding for transport services. The same factors could also affect our key suppliers.

To mitigate these risks, we continue to focus on building revenue streams and controlling costs to ensure we remain competitive.

Approved by the Board of Directors
And signed by order of the board



Kevin Gardner
Director

19 December 2019

Capital House
25 Chapel Street
London
NW1 5DH

First MTR South Western Trains Limited

Directors' report

The directors have pleasure in submitting their annual report and the audited financial statements for the year ended 31 March 2019.

In accordance with s414C of the Companies Act 2006 the directors have opted to disclose certain components in the strategic report which otherwise would be required to be disclosed in the Directors' report under section 416.

Matters included in the Strategic report

In accordance with s414C of the Companies Act 2006, included in the Strategic Report is information relating to the future development and going concern of the business which would otherwise be required by Schedule 7 of the "large and medium sized companies and groups (accounts and reports) regulations 2008" to be contained in a Directors' report.

Directors

The directors who held office during the year and up to the date of signing the accounts are as follows:

H Clancy
J Long
S Montgomery
C Burrows
K Gardner
A James
M Nelson
A Mellors

The following director resigned during the year, K McPhail (18 January 2019). There were no new directors appointed during the year. Since the end of the year, J Reynolds resigned on the 21 June 2019 and C Donaldson resigned on 8 December 2019.

Donations

The company has not made any donations to a registered political party, or other political organisation in the year.

Employee consultation

Communication with employees is affected mainly through regular briefing and negotiating meetings between the directors, the senior management and employee representatives on the central and depot negotiating committees. The briefing meetings enable senior management to consult employees and to ascertain their views on matters likely to affect their interests. We also hold regular focus groups on pertinent issues. Our annual employee survey allows us to receive direct feedback from the employees in terms of their engagement with the business. This then leads into our action plans to build on our strengths and to address any weaknesses. Our Reward & Recognition schemes also seek to increase employee engagement.

Disabled persons

The company recognises its obligations to give disabled people full and fair consideration for all vacancies within the statutory medical requirement, which must be met for certain grades of staff. Wherever reasonable and practicable, the company will retain newly disabled employees and at the same time provide full and fair opportunities for the career development of disabled people.

Financial risk management objectives and policies

The company's principal financial assets are bank balances and trade debtors. The company's credit risk is primarily attributable to its trade debtors. The amounts presented in the balance sheet are net of provisions for doubtful debts.

First MTR South Western Trains Limited

Directors' report (continued)

Financial risk management objectives and policies (continued)

The company has no significant concentration of credit risk, with exposure spread over a large number of customers. The credit risk on liquid funds is limited because the counterparties are banks.

Liquidity within the company has remained strong throughout the current year due to the nature of the rail industry with the vast majority of turnover transactions paid for in advance. This is demonstrated in cash and ring-fenced cash balances in note 15. Certain risks, for example, fuel price, are hedged on a group basis. The company does not enter directly into any derivative financial instruments. As set out more fully in the going concern statement in the Strategic report on page 4, there is a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern.

Financial matters

The results for the year are given in the profit and loss account on page 15.

No dividends were declared during, or after the year (2018: £nil).

Under FRS 102 the company has taken advantage of several reduced disclosures. Further information is available within the principal accounting policies section. This position has been agreed with the company's immediate controlling entity.

Directors' indemnities

The company's parent company has made qualifying third-party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

Auditor information

Each of the persons who is a director at the date of approval of this report confirms that:

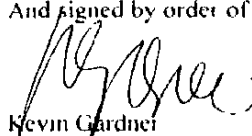
- as far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and
- the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provision of s418(2) of the Companies Act 2006.

Auditor

The company has passed an elective resolution dispensing with the requirement to appoint an auditor annually. Deloitte LLP have indicated their willingness to continue as auditor of the company and are therefore deemed to be reappointed for a further term.

Approved by the Board of Directors
And signed by order of the board


Kevin Gardner
Director

19 December 2019

Capital House
25 Chapel Street
London
NW1 5DH

First MTR South Western Trains Limited

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accountancy standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that year. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

First MTR South Western Trains Limited

Independent auditor's report to the members of First MTR South Western Trains Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2019 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of First MTR South Western Trains Limited (the 'company') which comprise:

- the Profit and Loss Account;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 23.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material uncertainty related to going concern

We draw attention to note 1 in the financial statements, which indicates that the current status of discussions with the DfT, along with other matters as set out in note 1, indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

First MTR South Western Trains Limited

Independent auditor's report to the members of First MTR South Western Trains Limited (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the Report and Financial Statements, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- The information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

First MTR South Western Trains Limited

Independent auditor's report to the members of First MTR South Western Trains Limited (continued)

Matters on which we are required to report by exception

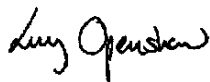
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's 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 and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Lucy Openshaw FCA (Senior Statutory auditor)

for and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

19 December 2019
Date.....

First MTR South Western Trains Limited

Profit and Loss Account

Year ended 31 March 2019

		2019 £'000	2018 £'000 (32 weeks trading)
	Notes		
Turnover	2	1,108,526	650,500
Operating costs			
- General	3	(1,100,425)	(640,854)
- Exceptional	4	(145,900)	-
Total operating costs		(1,246,325)	(640,854)
Operating (loss)/profit		(137,789)	9,646
Net interest payable	8	(776)	(1,043)
(Loss) / Profit on ordinary activities before taxation	9	(138,575)	8,603
Tax credit/(charge) on (loss) profit on ordinary activities	10	1,627	(1,627)
(Loss)/Profit for the financial year		(136,948)	6,976

All activities relate to continuing operations.

Statement of comprehensive income

For the Year ended 31 March 2019

	£'000	2019 £'000	£'000	2018 £'000
(Loss) / Profit for the financial year		(136,948)		6,976
Actuarial (loss) due to scheme assets and liabilities	(82,200)		(51,900)	
Actuarial gain due to rail franchise adjustment	82,200		51,900	
Total comprehensive (expense)/income result for the year		(136,948)		6,976

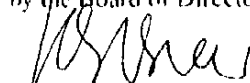
First MTR South Western Trains Limited

Balance Sheet

As at 31 March 2019

	Notes	£'000	2019 £'000	£'000	2018 £'000
Fixed assets					
Intangible assets	11		1,009		1,339
Tangible assets	12		35,516		15,534
			<u>36,525</u>		<u>16,873</u>
Current assets					
Stocks	13	4,576		2,614	
Debtors	14	175,047		126,022	
Cash at bank and in hand	15	226,896		140,485	
		<u>406,519</u>		<u>269,121</u>	
Creditors: amounts falling due within one year	16	(394,859)		(246,906)	
Provisions for liabilities and charges: amounts falling due within one year	17	(78,637)		(1,836)	
Net current liabilities			<u>(66,977)</u>		<u>20,379</u>
Total assets less current liabilities			<u>(30,452)</u>		<u>37,252</u>
Creditors: amounts falling due after more than one year	16		(30,000)		(30,000)
Provisions for liabilities and charges: amounts falling due after one year	17		(68,814)		-
Net (liability)/assets excluding pension liability			<u>(129,266)</u>		<u>7,252</u>
Pension liability	22		-		-
Net (liability)/assets			<u>(129,266)</u>		<u>7,252</u>
Financed by:					
Capital and reserves					
Called up share capital	19				-
Profit and loss account			<u>(129,266)</u>		<u>7,252</u>
Shareholder's funds			<u>(129,266)</u>		<u>7,252</u>

The financial statements of First MTR South Western Trains Limited, (registered number 07900320) were approved by the Board of Directors on 19 December 2019 and were signed on its behalf by:


Kevin Gardner
Director

First MTR South Western Trains Limited

Statement of changes in equity

Year ended 31 March 2019

	Called up share capital £'000	Profit and loss account £'000	Total £'000
Balance at 1 April 2017	-	-	-
Total comprehensive income/(expense) for the financial year	-	6,976	6,976
Share-based payments	-	276	276
	<hr/>	<hr/>	<hr/>
Balance at 31 March 2018	-	7,252	7,252
Total comprehensive (expense) for the financial year	-	(136,948)	(136,948)
Share-based payments	-	430	430
	<hr/>	<hr/>	<hr/>
Balance at 31 March 2019	<hr/>	<hr/>	<hr/>
	-	(129,266)	(129,266)

First MTR South Western Trains Limited

Notes to the financial statements Year ended 31 March 2019

1. Principal accounting policies

The following accounting policies have been applied consistently throughout the current and preceding year.

(a) General information and basis of accounting

First MTR South Western Trains Limited is a private company limited by shares incorporated in the United Kingdom under the Companies Act and registered in England and Wales. The registered office address is 4th Floor Capital House, 25 Chapel Street, London, United Kingdom, NW1 5DH.

The functional currency of the company is considered to be pounds sterling because that is the currency of the primary economic environment in which the company operates.

(b) Basis of preparation

The financial statements have been prepared under a historical cost convention and on a going concern basis as described in the Strategic Report on page 4, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

The Company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its financial statements. Exemptions have been taken in relation to share-based payments, financial instruments, presentation of a cash-flow statement, intra group transactions and remuneration of key management personnel.

(c) Going concern

Since year end the company has continued to be loss-making and current forecasts indicate that losses will exceed the amount of the onerous contract provision within 12 months from the date of approval of these accounts. The company is dependent upon funding from the ultimate parent company and MTR Corporation Limited, who have re-affirmed their commitments made under the Funding deed, which are limited to funding already provided of £30m under the agreed funding commitment and £40m of parent company support as set out in note 16, and future parent company support of £47m as well as the £15m performance bond (note 20). The directors have made enquires and understand that the ultimate parent company and MTR Corporation Limited have adequate resources to be able to provide this financial support, which is forecast to be utilised within 12 months from the date of approval of these accounts.

We are in discussions with the DfT regarding potential commercial and contractual remedies in respect of the uncertainties affecting the performance of the franchise, including infrastructure reliability, timetabling delays and industrial action. Whilst these discussions are constructive they remain ongoing and the outcome of them and, therefore the impact on the company's ability to continue operating the franchise throughout the going concern period is at this stage uncertain. In the directors' view, potential outcomes include:

- the company being asked to submit proposals for a short term management contract for the continued operation of the franchised train services; and
- termination of the contract within the next 12 months and the services being transferred to a publicly owned operator.

After making enquiries and considering the above facts, the directors have concluded that there is a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern and that, therefore, the company may be unable to realise its assets and discharge its liabilities in the normal course of business

Nevertheless, having considered the uncertainties described above alongside the company's forecasts, the existence of support from the parent companies and the current status of discussions with the DfT, and after making enquiries, the directors have a reasonable expectation that the discussions with the DfT will

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

have a positive conclusion, and that the company will continue to operate for the foreseeable future, and have therefore continued to prepare the financial statements on a going concern basis.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

1 Principal accounting policies (continued)

(d) Intangible fixed assets and amortisation

Intangible fixed assets are stated at cost, net of amortisation and any provision for impairment.

Amortisation is provided to write off the cost less residual value of intangible fixed assets over the shorter of their estimated useful economic lives or the duration of the franchise. Our amortisation policy is as follows:

Computer Software	- 3 to 5 years straight-line/duration of franchise
-------------------	--

(e) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment.

Depreciation is provided to write off the cost less residual value of tangible fixed assets over the shorter of their estimated useful economic lives or the duration of the franchise. Our depreciation policy is as follows:

Plant and equipment	- 3 to 10 years straight-line/duration of franchise
Assets under construction	- Nil

(f) Leases

All leases are operating leases and the rental charges are taken to the profit and loss account on a straight-line basis over the life of the lease.

(g) Grants and subsidies

Capital grants relating to tangible fixed assets are treated as a creditor and released to the profit and loss account over the expected useful lives of the assets concerned. All other grants are credited to the profit and loss account as the related expenditure is incurred.

(h) Stocks

Stocks are valued at weighted average cost. Provision is made for obsolete and slow moving or defective items where appropriate.

(i) Financial assets and liabilities

All financial assets and liabilities are measured at transaction price (including transaction cost).

(j) Taxation

UK corporation tax is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

The taxation liability is reduced wholly or in part by the surrender of losses by group undertakings. The tax benefits arising from group relief are recognised in the financial statements of the surrendering undertaking.

The credit for taxation is based on the loss for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is not provided on temporary differences arising from the revaluation of fixed assets where there is no commitment to sell the asset. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

1 Principal accounting policies (continued)

(k) Pension costs

Company Specific Schemes

The company operates a defined benefit scheme, which is held in separately administered funds.

The amounts charged to operating profit regarding the defined benefit scheme are the current service costs and gains and losses on settlements and curtailments. They are included as part of staff costs. Past service costs are recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested. Where changes to the benefits in payment on defined benefit pension schemes require a change in scheme rules or ratification by the Trustees, the change is recognised as a past service charge or credit in the income statement. Where changes in assumptions can be made without changing the Trustee agreement these are recognised as a change in assumption in other comprehensive income. The interest cost on the net pension scheme liability is shown in net interest receivable/(payable). Actuarial gains and losses are recognised immediately in the statement of comprehensive income.

Pension scheme assets are measured at fair values and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of related deferred tax, is presented separately after other assets on the face of the balance sheet.

The company also operates a defined contribution scheme for all qualifying members. Expenses from the schemes are charged to the profit and loss account.

Rail Franchise adjustment

In calculating the company's pension obligation in respect of the Railway Pension Scheme (RPS), the company's total pension deficit in accordance with FRS 102 Section 28 has been calculated. This deficit is reduced by a 'franchise adjustment' which is that portion of the deficit which is projected to exist at the end of the franchise and for which the company is not required to fund. The franchise adjustment, which has been calculated by FirstGroup's actuaries, is offset against the present value of the RPS liabilities so as to fairly present the financial performance, position and cash flow of the company's obligations. Allowance is also made in the preparation of the financial statements for the cost sharing nature of the benefit and, in particular, only 60% of the total profit and loss charge and balance sheet position are attributed to the company and recognised in the accounts.

(l) Turnover

Turnover primarily includes amounts attributable to the train operating companies (TOCs), predominantly based on modals of route usage, by the Rail Settlement Plan in respect of passenger receipts. Turnover from non-passenger receipts include car park revenue, commission on ticket sales and other sundry income.

(m) Future ticket deferral

Attributable share of income from season tickets or railcards is deferred within creditors and is recognised in the profit and loss account over the period covered by the season ticket or railcard. Income from advanced purchase and other ticket types is recognised in the profit and loss account on the date of travel.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

1 Principal accounting policies (continued)

(n) Provisions

Provisions are recognised when the company has a present obligation as a result of a past event and it is probable that the company will be required to settle the obligation at the balance sheet date and are discounted to present value where the effect is material. Provisions are split between those falling due within one year and those falling greater than one year.

(o) Share-based payments

The company's ultimate parent issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of share that will eventually vest and is adjusted for the effects of non-market-based vesting conditions.

Fair value is measured by use of a Black-Scholes model or other appropriate valuation models. The expected life used in the model has been adjusted based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

(p) Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reporting amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge, actual results may ultimately differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

In the process of applying the company's accounting policies as described above, management have made the following judgements and estimates that have the most significant effect on the amounts recognised in the financial statements.

i) Critical accounting judgements

Defined benefit pension arrangements

The company operates a Railways Pension Scheme (RPS). RPS is a defined benefit pension scheme which covers the whole of the UK rail industry. In contrast to the pension schemes operated by most businesses the RPS is a shared cost scheme which means that costs are formally shared 60% employer 40% employee. The company only recognises amounts in relation to its share of costs in the profit and loss account statement. The RPS is partitioned into sections and the company is responsible for the funding of these sections whilst it operates the relevant franchise.

At the end of the franchise term, responsibility for funding the relevant section of the scheme, and consequentially any deficit or surplus existing at that date, is passed to the next franchisee. At each balance sheet date a franchise adjustment is recognised against the FRS 102 Section 28 net pension asset or liability to reflect that portion expected to pass to the next franchisee.

As there is no requirement to make contributions to fund the current deficit, it is assumed that all of the current deficit will be funded by another party and hence none of that deficit is attributable to the current franchisee. In respect of the future service costs, there is currently no pension obligation in respect of those costs. When the costs are recognised in the profit and loss account, the extent to which the committed contributions fall short determines the amount that is to be covered by contributions of another party in future, which is recognised as an adjustment to service cost in the profit and loss account.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

1 Principal accounting policies (continued)

i) Critical accounting judgements (continued)

Defined benefit pension arrangements (continued)

Under circumstances where contributions are renegotiated, such as following a statutory valuation, an adjustment will be recognised in the profit and loss account, whilst changes in actuarial assumptions continue to be recognised through Other Comprehensive Income (OCI). The Directors consider this to be the most appropriate interpretation of FRS102 Section 28 to reflect the specific circumstances of the RPS where the franchise commitment is only to pay contributions during the period in which we run the franchise.

An alternative approach would involve not limiting the measurement of the service cost through the recognition of an income statement franchise adjustment, but recognising all changes in the franchise adjustment as a reimbursement right in Other Comprehensive Income (OCI). For the year ended 31 March 2019 the impact of this alternative approach would be an increase in costs of £20.1m (2018: £12.8m) in the profit and loss account and a credit to OCI of £16.5m (2018: £22.7m). In addition, the balance sheet would reflect a surplus of £6.3m (2018: £9.9m). Since the franchise contract only refers to the contribution requirements during the franchise term, and not any reimbursement rights, in the Directors' view contributions are shared with the next franchisee and therefore the treatment of the arrangement as contribution-sharing is considered the most appropriate.

The UK schemes retirement benefit obligations are discounted at a rate set by reference to market yields at the end of the reporting period on high-quality corporate bonds. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The most significant criteria considered for the selection of bonds include the issue size of the corporate bonds, quality of the bonds and the identification of outliers which are excluded. Management follows actuarial advice from a third party when determining these judgements. Another key judgement is the longevity of members. We take specialist advice on this from our actuarial advisors which aims to consider the likely experience taking into account each scheme's characteristics. Our approach is to review these assumptions following completion of their funding valuations, and more frequently only if appropriate to do so.

The Pension Regulator (TPR) has been in discussions with the Railways Pension Scheme (the Scheme) regarding the long term funding strategy of the Scheme. Whilst TPR believes that a higher level funding is required in the long term, it is not possible at this stage to determine the impact to ongoing contribution requirements. The carrying amount of the company's retirement benefit obligations at 31 March 2019 was a liability of £nil (2018: £nil). Further details are set out in notes 20 (Contingent liabilities) and 21 (Pension liability).

ii) Key issues of estimation uncertainty

Contract and franchise accounting

Estimates are made on an ongoing basis about the recoverability of amounts due and the carrying value of assets and liabilities including the profitability of the franchise contract, arising from the company's franchise and long-term contracts. Regular forecasts are compiled on the outcome of these types of accounting estimates and contracts, which requires assessments and estimates relating to the expected level of profitability and in the cases where options exist, the life of the contract or franchise.

The useful economic life of assets is determined by reference to the length of the franchise and matched to the franchise end date. The residual value of the assets is determined by their condition at the franchise end date and the amount of maintenance that has been carried out during the period of operation.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

1 Principal accounting policies (continued)

ii) Key issues of estimation uncertainty (continued)

Contract and franchise accounting (continued)

The company has a number of contractual relationships including those with the DfT and Network Rail which given their complexity and duration can be sensitive to changes in future assumptions. Due to the regulated nature of the rail industry, disputes and claims typically arise with such bodies as well as other TOCs where one or more TOC has access to shared infrastructure such as railway lines. Management is required to estimate the amount receivable and also payable taking account of the information available at the time.

Onerous contract provision

The company has a number of contractual commitments in respect of the franchise agreement. FRS 102 requires a provision to be made for an onerous contract where it is probable that the future economic benefits to be derived from the contract are less than the unavoidable costs under the contract. In order to determine the amount of any contract provision it is necessary to forecast future financial performance and then apply an appropriate discount rate to determine a net present value. The estimation of both the forecasts and the discount rate involves a significant degree of judgement. Actual results can differ from those assumed in the forecasts and there can be no absolute assurance that the assumptions used will hold true.

The franchise contract provision is sensitive to a change in the assumptions used, most notably to passenger revenue growth and amounts recoverable for strike amelioration. The contract provision of £145.9m is the maximum unavoidable loss under the Franchise Agreement. These factors make it impractical to provide sensitivity analysis on one single measure and its impact on the onerous contract provision.

2. Turnover

Turnover represents the amounts receivable for services supplied to customers during the year and includes amounts receivable for tendered services and concessionary fare schemes.

The whole of the turnover derives from the company's principal activities within the United Kingdom. The company has one principal class of business, namely, the provision of passenger transport services.

Turnover can be analysed as follows:	2019	2018
	£'000	£'000 (32 weeks trading)
Passenger receipts	1,056,394	621,713
Other revenue	52,132	28,787
	<u>1,108,526</u>	<u>650,500</u>

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

3. Operating costs

	2019 £'000	2018 £'000 (32 weeks trading)
Hire of Rolling Stock	191,240	105,067
Station & track access and facilities	99,254	36,430
Other lease costs	2,174	6,005
Raw materials and consumables	69,058	39,767
Staff costs (note 5)	273,274	159,684
Other external charges	206,204	173,385
Net franchise premium payments	250,236	117,672
Intangible asset amortisation (note 11)	907	248
Tangible asset depreciation (note 12)	8,078	2,596
	<u>1,100,425</u>	<u>640,854</u>

4. Other exceptional costs

Exceptional costs of £145.9m were charged to the profit and loss account (2018: £nil). The exceptional costs include a contract provision relating to the profitability of the franchise contract and the forecast losses arising from the company's franchise and long-term contracts.

	2019 £'000	2018 £'000 (32 weeks trading)
Contract Provision (note 17)	<u>145,900</u>	<u>-</u>

Total tax credit relating to the contract provision for the year ending 31 March 2019 was £27.7m.

5. Employee numbers and costs

The average number of persons employed by the company (including directors) during the year was as follows:

	2019 Number	2018 Number
Operations	4,090	3,869
Maintenance	567	494
Customer service	173	176
Other	244	497
	<u>5,074</u>	<u>5,036</u>

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

5. Employee numbers and costs (continued)

The aggregate payroll costs of these persons were as follows:

	2019 £'000	2018 £'000
Wages and salaries	232,163	136,214
Social security costs	24,496	13,603
Pension costs (note 21)	16,615	9,867
	<u>273,274</u>	<u>159,684</u>

6. Directors' remuneration

Certain directors received remuneration from FirstGroup plc, the ultimate parent company, and First Rail Holdings Limited, the immediate parent company, in the current and prior years, details of which are disclosed in their report and accounts. These directors have not performed any qualifying services on behalf of the company during the current and prior year. Details of retirement benefits accruing to these directors under the group defined benefit schemes are detailed in the financial statements of FirstGroup plc.

The remuneration of the directors during the year paid by the company was as follows:

	2019 £'000	2018 £'000
Aggregate emoluments (excluding pension contributions)	<u>460</u>	<u>185</u>

Two directors were members of the company's defined benefit scheme (2018: 2)

	2019 £'000	2018 £'000
The emoluments of the highest paid director amounted to:		
Aggregate emoluments (excluding pension contributions)	<u>274</u>	<u>151</u>
Defined benefit scheme		
Accrued pension at end of year	93	79
Accrued lump sum at end of year	76	64

The highest paid director is entitled to receive shares under the FirstGroup long-term incentive plan. Certain share options were exercised during the year by the highest paid director.

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

7. Share-based payments

Save as you earn (SAYE)

The company's ultimate parent company operates an HMRC approved savings-related share option scheme. The scheme is based on eligible employees being granted options and their agreement to opening a share save account with a nominated savings carrier and to save weekly or monthly over a specified period. Share save accounts are held with Computershare. The right to exercise the option is at the employee's discretion at the end of the period previously chosen for a period of twelve months. Details of the share options outstanding during the year are disclosed in the published financial statements for FirstGroup plc.

Buy as you earn (BAYE)

BAYE enables eligible employees to purchase shares from their gross income. The company provides two matching shares in FirstGroup plc for every three shares bought by employees, subject to a maximum company contribution or shares to a value of £20 per employee per month. If the shares are held in a trust for five years or more, no income tax or national insurance will be payable. The matching shares will be forfeited if the corresponding partnership shares are removed from trust within three years of award.

The Group has allocated the expense amongst its trading subsidiary undertakings based on the number of employees participating in the scheme. The company has recognised a total expense of £0.4m (2018: £0.3m) relating to equity-settled share-based payment transactions.

8. Net interest (payable)/receivable

	2019 £'000	2018 £'000 (32 weeks trading)
<i>Interest payable and similar charges</i>		
Amounts payable to group undertakings	(1,300)	(716)
Bank and other interest payable	(544)	(552)
<i>Interest receivable and similar income</i>		
Bank interest receivable	(1,844)	(1,268)
	1,068	225
Net interest payable	(776)	(1,043)

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

9. (Loss)/Profit on ordinary activities before taxation

(Loss)/Profit on ordinary activities before taxation derives from the company's principal activities within the United Kingdom.

(Loss)/Profit on ordinary activities before taxation is stated after charging/(crediting):

	2019 £'000	2018 £'000 (32 weeks trading)
Auditor's remuneration		
- Deloitte LLP audit fee for the audit of the annual accounts	296	128
- Deloitte LLP audit fee for the audit of prior year accounts	191	-
- Deloitte LLP non-audit fee for other services	15	15
Cost of stock recognised as an expense	69,058	39,767
Rentals payable under operating leases		
- plant and machinery	193,413	110,557
- other operating leases	99,254	98,651
Net rents receivable from property	(6,618)	(5,137)

10. Tax charge on (loss)/profit on ordinary activities

	2019 £'000	2018 £'000 (32 weeks trading)
Current taxation		
- Group relief payable	(1,776)	1,562
- Prior year adjustment	214	-
Total current taxation	(1,562)	1,562
Deferred taxation		
- Origination and reversal of timing differences	103	65
- Prior year adjustment	(168)	-
	(65)	65
Total tax charge on (loss)/profit on ordinary activities	(1,627)	1,627

The standard rate of taxation for the year, based on the UK standard rate of corporation tax, is 19% (2018: 19%). The actual current tax charge for the current and previous year differed from the standard rate of corporation tax for the reasons set out in the following reconciliation:

First MTR South Western Trains Limited

Notes to the financial statements (continued) **Year ended 31 March 2019**

10. Tax charge on (loss)/profit on ordinary activities (continued)

	2019 £'000	2018 £'000 (32 weeks trading)
(Loss)/Profit before tax on ordinary activities	(138,575)	8,603
Tax on Profit on ordinary activities multiplied by standard rate of corporation tax in the United Kingdom (19%) (2018: 19%)	(26,329)	1,635
<i>Factors affecting charge</i>		
- Expenses not deductible for tax purposes	(1)	-
- Unrecognised losses	24,314	-
- Unrecognised temporary differences	354	-
- Prior year adjustments	46	-
- Effect of decrease in tax rate on origination and reversal of timing differences	(11)	(8)
Total tax (credit)/charge on profit on ordinary activities	(1,627)	1,627

The UK Government enacted legislation to reduce the main rate of UK corporation tax to 17% with effect from 1 April 2020.

11. Intangible fixed assets

	Computer Software £'000
Cost	
At 1 April 2018	1,587
Additions	577
At 31 March 2019	2,164
Accumulated amortisation	
At 1 April 2018	248
Charge for year	907
At 31 March 2019	1,155
Net book value	
At 31 March 2019	1,009
At 31 March 2018	1,339

Computer Software is recognised separately as an intangible asset and is carried at cost less accumulated amortisation. Costs include software licenses, website development, costs attributable to the development, design and implementation of the computer software and internal costs directly attributable to the software.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

12. Tangible fixed assets

	Assets under construction £'000	Plant and equipment £'000	Total £'000
Cost			
At 1 April 2018	363	17,815	18,178
Additions	17,812	10,248	28,060
At 31 March 2019	18,175	28,063	46,238
Accumulated depreciation			
At 1 April 2018	-	2,644	2,644
Charge for year	-	8,078	8,078
At 31 March 2019	-	10,722	10,722
Net book value			
At 31 March 2019	18,175	17,341	35,516
At 31 March 2018	363	15,171	15,534

13. Stocks

	2019 £'000	2018 £'000
Spare parts and consumables	4,576	2,614

The directors consider there is no material difference between the balance sheet value of the stocks and their replacement cost.

14. Debtors

	2019 £'000	2018 £'000
Amounts falling due within one year:		
Trade debtors	72,222	54,828
VAT	18,420	27,929
Other debtors	45,265	27,575
Prepayments and accrued income	39,140	15,690
	175,047	126,022

15. Cash at bank and in hand

	2019 £'000	2018 £'000
Bank deposits	226,896	140,485

Cash and cash equivalents include ring-fenced cash of £217.6m (2018: £126.6m). Under the terms of the franchise agreement, the company can only distribute cash either up to the amount of retained profits or the amount determined by prescribed liquidity ratios. The ring-fenced cash represents that which is not available for distribution or the amount required to satisfy the liquidity ratios at the balance sheet date.

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

16. Creditors:

	2019 £'000	2018 £'000
Amounts falling due within one year		
Trade creditors	56,292	35,134
Amounts owed to group undertakings	28,172	7,408
Group tax relief	-	1,562
Deferred tax	-	65
Other tax and social security	5,604	9,632
Other creditors	127,623	28,785
Accruals and deferred income	177,168	164,320
	<u>394,859</u>	<u>246,906</u>

During the current year subordinated loans totalling £40m (2018: £nil) were drawn down. These are interest-bearing loans, with a fixed rate of 5.5% per annum and no repayment schedule. Amounts included within owed to group undertakings include the loan from FirstGroup plc (70%), £28m and included within other creditors include the loan from MTR Corporation Limited (30%), £12m.

	2019 £'000	2018 £'000
Amounts falling due after more than one year		
Amounts owed to group undertakings	21,000	21,000
Other creditors	9,000	9,000
	<u>30,000</u>	<u>30,000</u>

This relates to the £30m agreed funding commitment (AFC) provided by the shareholders since the commencement of the franchise. This is an interest-bearing loan, with a fixed rate of 5.5% per annum, with annual repayments schedule of £10m from 1 April 2020; £15m from 1 April 2021; and £5m from 1 April 2022.

Amounts owed to group undertakings relates to the loan from FirstGroup plc (70%), £21.0m (2018: £21.0m) and included within other creditors relates to the loan from MTR Corporation Limited (30%), £9.0m (2018: £9.0m).

17. Provisions for liabilities and charges

	Other £'000	Contract Provision £'000	Total £'000
Amounts falling due within one year			
At 1 April 2018	(1,836)	-	(1,836)
Charged to the profit and loss account	(1,551)	-	(1,551)
Utilised in the year	1,836	-	1,836
Transfer from provisions greater than one year	-	(77,086)	(77,086)
At 31 March 2019	<u>(1,551)</u>	<u>(77,086)</u>	<u>(78,637)</u>

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

17. Provisions for liabilities and charges (continued)

	Other £'000	Contract Provision £'000	Total £'000
Amounts falling due after more than one year			
At 1 April 2018	-	-	-
Charged to the profit and loss account	-	(145,900)	(145,900)
Transfer to provisions less than one year	-	77,086	77,086
	<u>-</u>	<u>77,086</u>	<u>77,086</u>
At 31 March 2019	<u>-</u>	<u>(68,814)</u>	<u>(68,814)</u>

The company receives claims from customers and employees for incidents resulting in personal injury. A provision is made for the estimated cost to the company to settle claims for incidents that fall below the insurance deductible.

The onerous contract provision has been established based on updated financial forecasts for this franchise until the initial franchise end date of 17 August 2024. The updates forecasts are based on a number of assumptions, most significantly passenger revenue growth and the impact of Central London Employment and Gross Domestic Product revenue mechanisms, as well as the impact of changes in timetables, capacity and rolling stock. In addition, the effects of infrastructure performance and the ongoing effect from industrial action during the year continue. There is considerable uncertainty about the future impact of the industrial action and the level of strike amelioration receivable from the DfT, and we remain in discussions with the DfT. Based on these forecasts the company considers it has an onerous contract, the value of which is estimated to be £145.9m. Accordingly this amount has been charged to the income statement.

Whilst the onerous contract provision is based upon management's current best estimate, there can be no certainty that actual results will be consistent with those forecasts. The provision is sensitive to the underlying assumptions, most notably to passenger revenue growth and to the extent or timing of impacts from strikes and the recovery of amelioration from the DfT. The £145.9m provision comprises £87.4m parent company support, £15m performance bond, £30m agreed funding commitments and £13.5m of retained earnings, which represents the maximum expense. These factors make it impractical to provide a sensitivity analysis on one single measure and its impact on the onerous contract provision.

18. Called up share capital

	2019 £	2018 £
Authorised		
70 "A" ordinary shares of £1 each	70	70
30 "B" ordinary shares of £1 each	<u>30</u>	<u>30</u>
Allotted, called up and fully paid		
70 "A" ordinary share of £1 each	70	70
30 "B" ordinary share of £1 each	<u>30</u>	<u>30</u>

The A and B ordinary shares of £1 each rank pari passu in respect of entitlements to the profits of the company and on a return of capital. They do not confer any rights of redemption. First Rail Holdings Limited is the holder of the "A" ordinary shares and MTR Corporation (UK) Limited is the holder of the "B" ordinary shares.

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

19. Commitments

Capital commitments

Capital commitments at the end of the year for which no provision has been made are as follows:

	2019 £'000	2018 £'000
Contracted for but not provided	8,500	76,587

These capital commitments have been made as part of our franchise agreement with the DfT

Operating leases

At the balance sheet date, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2019 Land and building £'000	2019 Other £'000	2018 Land and building £'000	2018 Other £'000
Within one year	8,293	317,270	8,293	266,174
In the second to fifth years inclusive	40,802	1,138,856	40,802	1,047,573
After five years	111,403	1,677,254	31,154	335,661
	<u>160,498</u>	<u>3,133,380</u>	<u>80,249</u>	<u>1,649,408</u>

20. Contingent liabilities

The company is party to legal proceedings and claims which arise in the normal course of business. The company takes legal advice as to the likelihood of success of claims and counterclaims. No provision is made where, due to inherent uncertainties, no accurate quantification of any cost, or timing of such cost, which may arise from any of the legal proceedings can be determined.

On 26 February 2019, class action proceedings commenced in the UK Competition Appeal Tribunal (CAT) against the company. Equivalent claims have been brought against Stagecoach South Western Trains and London & South Eastern Railway. It is alleged that the company and the other defendants breached their obligations under competition law, by (i) failing to make available, or (ii) restricting the practical availability of, boundary fares for TfL Travelcard holders wishing to travel outside TfL fare zones. The first substantive hearing, at which the CAT will decide whether or not to certify the class action, has been postponed pending the outcome of an appeal to the Supreme Court in a different class action and is therefore unlikely to occur until late 2020 at the earliest. It is not possible at this stage to determine accurately the likelihood or quantum of any damages and costs, or timings of such damages and costs, which may arise from the proceedings.

FirstGroup plc (70%) and MTR Corporation (30%) have provided performance bonds of £15m (2018: £15m) backed by insurance arrangements, to the Director of Passenger Rail Franchising in support of the franchise obligations of the company.

FirstGroup plc and MTR Corporation Limited have provided support in the form of a 70:30 split subordinated loan facility totalling £87.4 m (2018: £87.4m), which is 50% backed by insurance arrangements to the Director of Passenger Rail Franchising in support of the franchise obligations of the company. As stated in note 16, £40m (2018: £nil) of this loan facility was drawn down during the year to 31 March 2019 with an outstanding balance of £40m at 31 March 2019 (2018: £nil).

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

20. Contingent liabilities (continued)

As stated in note 1, the Pensions Regulator (TPR) has been in discussion with the Railways Pension Scheme (the Scheme) regarding the long-term funding strategy of the Scheme. The Scheme is an industry-wide arrangement, and the Group, together with other owning groups, has been participating in a review of scheme funding led by the Rail Delivery Group. Whilst the review is still ongoing, changes to the current funding strategy are not expected in the short term. Whilst TPR believes that a higher level of funding is required in the long term, it is not possible at this stage to determine the impact to ongoing contribution requirements.

21. Pensions liability

Railways Pension Scheme – South Western Railway (including Island line) sections

Defined contribution schemes

The company operates defined contribution retirement benefit schemes for all qualifying employees. The total expense charged to the profit and loss in the period ended 31 March 2019 was £0.5m (2018: £0.4m).

Defined benefit schemes

The company is a member of a defined benefit pension scheme, which is funded. All eligible employees are offered membership of the Railways Pension Scheme (RPS).

Under the terms of the RPS the employer (60%) and the employees (40%) share any fund deficit. The current service pension cost relating to this scheme in the year was £11.5m. (2018: £8.2m).

The scheme is valued triennially, when the cost of the future service is calculated and the funding position established. The last valuation of the scheme was carried out by independent actuaries as at 31 December 2013 by James C Wintle in respect of the costs used in these financial statements. A draft actuarial valuation at 31 December 2016 was completed during 2017 and there was a legal obligation to finalise the valuations and schedules of contributions before the statutory deadline of 31 March 2018. Discussions with the Pensions Regulator, and other stakeholders, in relation to the Pensions Act valuation for all Railway Pensions Schemes for the Train Operating Companies are still ongoing and this process is likely to continue for some time. Until the valuation is complete, the investment strategy and the cash contributions remain unchanged from those agreed as part of the 2013 valuation. The actuarial valuation was updated for 31 March 2019; at this date the market value of the scheme's assets totalled £911.1m (2018: £824.6m). The actuarial value of these assets was sufficient to cover 60% (2018: 64%) of the benefits, which had accrued to the scheme's members.

Contributions are paid to the scheme at rates recommended by the actuaries and the assets of the scheme are held in a separately administered trust. The scheme's assets are held and managed independently of the company's finances by independent investment managers appointed by the trustees of the scheme. The current contribution rate is 8.04% (2018: 8.04%) for employees and 12.06% (2018: 12.06%) for the employer.

The actuarial assumptions used in determining the last full actuarial valuation (31 December 2013) were that the rate of return on investments will be 7.59% per annum; the rate of earnings increase will be 4.23% per annum and the rate of inflation will be (RPI/CPI) 3.2% / 4.2% per annum. The valuation was made using the projected unit method.

Financial assumptions

The main financial assumptions used in this update were as follows:

	2019	2018
Rate of increase in salaries	3.40%	3.05%
Rate of increase of pensions in payment	2.15%	2.05%
Rate of increase of pensions in deferment	2.15%	2.05%
Discount rate	2.40%	2.70%
Inflation assumption - RPI	3.15%	3.05%
Inflation assumption - CPI	2.15%	2.05%

First MTR South Western Trains Limited

Notes to the financial statements (continued)

Year ended 31 March 2019

21. Pensions liability (continued)

Mortality assumptions

The assumptions made for current mortality reflect broadly the current experience. This takes into account size of pension and geographic location. An allowance is made for future improvements, based on information currently available on mortality trends. The post-retirement mortality (life expectancy in years) current rate for pensioners at 65 is 21.1 years (2018: 20.6 years). Future pensioners at aged 65 (45 now), will have a rate of 22.3 years (2018: 21.9 years).

Asset investments

The breakdown of asset fair value by asset type is as follows:

	2019 £'000	2018 £'000
Equities	72,800	65,900
Property	13,400	18,800
Cash Plus	824,900	739,900
	<u>911,100</u>	<u>824,600</u>

The section is invested in Railpen pooled funds. The main investment is in the Growth Pooled Fund, the purpose of which is to invest in a wide range of return-seeking assets across different financial markets and economies to deliver high long term real returns (RPI + 4% pa) over a rolling 5 to 10-year period.

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

21. Pensions liability (continued)

Reconciliation of movements:

	Assets £m	Liabilities £m	Shared Cost £m	Franchise Impact £m	Net £m
At 1 April 2017	-	-	-	-	-
Business acquisition	854.7	(1,246.4)	156.6	235.1	-
Profit and loss account					
Operating					
Service cost	-	(35.7)	14.3	13.2	(8.2)
Admin cost	-	(1.7)	-	-	(1.7)
Total Operating	-	(37.4)	14.3	13.2	(9.9)
Financing	13.5	(19.5)	2.4	3.6	-
Total Income Statement	13.5	(56.9)	16.7	27.8	(9.9)
Amounts paid to/from scheme					
Employer contributions	9.5	-	(3.9)	3.9	9.5
BRASS matching contributions	0.4	-	-	-	0.4
Employee contributions	6.4	-	(2.6)	(3.8)	-
Benefits Paid	(19.4)	19.4	-	-	-
Total	(3.1)	19.4	(6.5)	0.1	9.9
Expected closing position	865.1	(1,283.9)	166.8	252.0	-
Gains/loss					
Change in financial assumptions	-	0.7	(0.3)	(0.4)	-
Return on assets in excess of discount rate	(40.5)	-	16.2	24.3	-
Experience	-	(12.1)	5.5	6.6	-
Total	(40.5)	(11.4)	21.4	30.5	-
At 31 March 2018	824.6	(1,295.3)	188.2	282.5	-

First MTR South Western Trains Limited

Notes to the financial statements (continued) Year ended 31 March 2019

21. Pensions liability (continued)

Reconciliation of movements:

	Assets	Liabilities	Shared Cost	Franchise Impact	Net
	£m	£m	£m	£m	£m
At 1 April 2018	824.6	(1,295.3)	188.2	282.5	-
Profit and loss account					
Operating					
Service cost	-	(51.9)	20.5	19.9	(11.5)
Admin cost	-	(6.4)	2.6	-	(3.8)
Past service gain including curtailments	-	(1.4)	0.6	0.8	-
Total Operating	-	(59.7)	23.7	20.7	(15.3)
Financing	22.2	(34.3)	4.8	7.3	-
Total Income Statement	22.2	(94.0)	28.5	28.0	(15.3)
Amounts paid to/from scheme					
Employer contributions	14.8	-	(6.0)	6.0	14.8
BRASS matching contributions	0.5	-	-	-	0.5
Employee contributions	9.9	-	(3.9)	(6.0)	-
Benefits Paid	(34.4)	34.4	-	-	-
Total	(9.2)	34.4	(9.9)	-	15.3
Expected closing position	837.6	(1,354.9)	206.8	310.5	-
Gains/loss					
Change in financial assumptions	-	(126.6)	50.6	76.0	-
Change in demographic	-	(24.5)	9.8	14.7	-
Return on assets in excess of discount rate	73.5	-	(29.4)	(44.1)	-
Experience	-	(4.6)	2.0	2.6	-
Total	73.5	(155.7)	33.0	49.2	-
At 31 March 2019	911.1	(1,510.6)	239.8	359.7	-

22. Related parties

MTR Corporation Limited, a company registered in Hong Kong, has a 30% non-controlling interest in the company. MTR Corporation Limited provided an AFC and a subordinated loan (note 16). Interest on these loans is charged on an arm's length basis and in accordance with the franchise agreement. MTR Corporation Limited provided no other services in the year. As at 31 March 2019 the company owed MTR Corporation Limited £21.2m (2018: £9.3m).

MTR (UK) Limited, a company registered in England and Wales, and a wholly owned subsidiary of MTR Corporation Limited, provided services totalling £0.9m (2018: £0.7m) during the year. As at 31 March 2019 the company owed MTR (UK) Limited £nil (2018: £nil).

First MTR South Western Trains Limited

Notes to the financial statements (continued) **Year ended 31 March 2019**

23. Ultimate parent company

The directors regard FirstGroup plc, a company incorporated in Great Britain and registered in Scotland, as the ultimate parent and controlling company, which is the smallest and largest group that includes the company's results and for which group financial statements are prepared.

The company's immediate controlling party is First Rail Holdings Limited.

Copies of the accounts of FirstGroup plc can be obtained on request from 8th Floor, The Point, 37 North Wharf Road, Paddington, London, W2 1AF.