

Registered number: 07314940

PALIO (NO 2) LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2021

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PALIO (NO 2) LIMITED

COMPANY INFORMATION

Directors	K Rahuf P J Harding
Registered number	07314940
Registered office	3rd Floor, South Building 200 Aldersgate Street London EC1A 4HD
Independent auditor	KPMG LLP Chartered Accountants 15 Canada Square London E14 5GL

PALIO (NO 2) LIMITED

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PALIO (NO 2) LIMITED

**STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2021**

Principal activities

The Directors present the Strategic Report and financial statements for the year ended 31 December 2021. The principal activity of Palio (No 2) Limited ("the Company") is to invest in PPP infrastructure projects.

Business review

The Company currently holds 26% interest in Modus Services (Holdings) Limited.

During the year, the Company received its revenue from its investment in the form of interest on subordinated debt loans. The Company reports a loss after tax for the year of £2,116,000 (2020: £2,317,000) including a negative movement in investments at fair value of £7,464,000 (2020: negative movement of £7,135,000).

Principal risks and uncertainties

The principal risk faced by the Company is credit risk in relation to its investment. Credit risk is mitigated by the Company holding an investment in PPP projects, which are supported by central and local government bodies. Credit risk is subsumed within the overall Company's performance risk. Please refer to note 13 for further details on the Company's financial instruments and risks, including credit risk.

Key performance indicators

The key performance indicators for the Company are primarily client and financially focused; including those listed below:

- tracking the performance and delivery of the services in conjunction with the KPIs set by the local authorities;
- the progress of the individual project companies;
- the comparison of actual cash flow costs to those that have been forecast;
- the value of investments held in the company portfolio in association with the expected future cash flows; and
- that all operational projects are performing within restrictions of all project documentation.

The key performance indicator for the Company is the net assets attributable to shareholders, being £23,792,000 (2020: £31,256,000), as detailed on page 13 of the financial statements.

PALIO (NO 2) LIMITED

**STRATEGIC REPORT (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2021**

Future developments

The Directors of the Company are not aware of any circumstances by which the principal activity of the Company would alter or cease and remain committed to the business of holding investments and will continue to manage its existing and any new investments in the future.

This report was approved by the board and signed on its behalf.



K Rahuf
Director

Date: 05 October 2022

PALIO (NO 2) LIMITED

**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2021**

The Directors present their report and the financial statements of Palio (No 2) Limited for the year ended 31 December 2021.

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Results and dividends

The loss for the year, after taxation, amounted to £2,116,000 (2020 - £2,317,000).

Dividends of £5,348,000 were paid during the year (2020: £4,817,000). The Directors do not propose a final dividend (2020: None).

The Company's results for the year are set out on Page 12 of the financial statements.

Directors

The Directors who served during the year were:

K Rahuf

P J Harding (appointed 15 October 2021)

A R J Thakrar (resigned 15 October 2021)

Going concern

The financial statements have been prepared on a going concern basis which the Directors consider to be appropriate for the following reasons.

Financial projections indicate that sufficient funds will be generated by the operating activities of the Company to enable ongoing obligations to be met as they fall due; with consideration being given to a period of at least 12 months from the date of approval of the Financial Statements.

As the Company has income streams which are substantially backed by the UK Government, the Directors have considered that no severe but plausible downside event would prevent the Company from being able to meet its liabilities as they fall due.

Further, whilst the Company is in a net current liability position, the parent has indicated its intention to continue to make available such funds as are needed and does not intend to seek repayment of any amounts payable to them for at least the next twelve months from the date of approval of financial statements. As with any company placing reliance on other group entities for financial support, the Directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Due to the ongoing uncertainty around the UK economy, in particular inflation, the value of the pound and interest rates mainly caused by the market's reaction to the mini-budget and subsequently the reaction of both the mortgage lenders and Bank of England, the Directors have reassessed the going concern assumption of the Company. The Company only has indirect exposure through its investments in the associates (see Note 16) due to the external loans held by those companies that are subject to fixed and floating interest rates.

The Directors do not consider this to have any significant impact on the going basis of preparation of the financial statements because the Company's associates have long term interest rate swap agreements in place that mitigate interest rate risk of its floating rate borrowings.

The Directors have also considered the COVID-19 pandemic and potentially lower valuations of investments but do not consider this to have any significant impact on the going concern basis of preparation of the financial statements.

PALIO (NO 2) LIMITED

**DIRECTORS' REPORT (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2021**

Consequently, the Directors consider that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

Financial risk management

The Company's management of financial risks including interest rate, credit, performance and liquidity risk during the year are detailed in note 13.

Cash flow statement

No cash flow statement is presented for the year ended 31 December 2021 (2020: none), as no cash flows have been paid or received by the Company.

Future developments

Details of future developments are included in the Strategic Report.

Disclosure of information to auditor

Each of the persons who are Directors at the time when this Directors' report is approved has confirmed that:

- so 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 ought to have been taken as a Director in order to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

The auditor, KPMG LLP, will be proposed for reappointment in accordance with the Companies Act 2006.

This report was approved by the board and signed on its behalf.



K Rahuf
Director

Date: 05 October 2022

PALIO (NO 2) LIMITED

**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE STRATEGIC REPORT, THE
DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

The Directors are responsible for preparing the strategic report, directors' report and the financial statements, in accordance with applicable law.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Accounting Standards in conformity with the requirements of Companies Act 2006 and applicable law.

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 period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and prudent;
- state whether they have been prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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 enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

PALIO (NO 2) LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PALIO (NO 2) LIMITED

Opinion

We have audited the financial statements of Palio (No 2) Limited (the "Company") for the year ended 31 December 2021 which comprise the Statement of total comprehensive income, the Statement of financial position, the Statement of changes in equity and the related notes including accounting policies in note 1.

In our opinion the accompanying financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2021 and of its loss for the year then ended;
- have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including FRC Ethical Standards. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements (the "going concern period").

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period.

Our conclusions based on this work:

- we consider that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified, and concur with the Directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

PALIO (NO 2) LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PALIO (NO 2) LIMITED

Fraud and breaches of laws and regulations - ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included:

- Enquiring of management as to the Company's policies and procedures to prevent and detect fraud as well as enquiring whether management have knowledge of any actual, suspected or alleged fraud;
- Reading minutes of meetings of those charged with governance; and
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks through out the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, we perform procedures to address the risk of management override of controls, in particular the risk that management may be in a position to make inappropriate accounting entries. On this audit we do not believe there is a fraud risk related to revenue recognition because the Company's revenue streams are simple in nature with respect to accounting policy choice, and are easily verifiable to external data sources or agreements with little or no requirement for estimation from management. We did not identify any additional fraud risks.

We also performed procedures including identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included all post year end closing journals.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience through discussion with management (as required by auditing standards) and discussed with management the policies and procedures regarding compliance with laws and regulations.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related company legislation) and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of noncompliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation. We identified the following areas as those most likely to have such an effect: anti-bribery, money laundering and GDPR compliance recognising the financial nature of the Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore, if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

PALIO (NO 2) LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PALIO (NO 2) LIMITED

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remains a higher risk of non-detection of fraud, as this may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

Strategic Report and Directors' Report

The Directors are responsible for the Strategic report and the Directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you 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 these respects.

PALIO (NO 2) LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PALIO (NO 2) LIMITED

Respective responsibilities

Responsibilities of directors

As explained more fully in their statement set out on page 7, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; 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 they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.


Auditors responsibilities

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. 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 fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities

The purpose of this report and restrictions on its use by persons other than the Company's members, as a body

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.



Matthew Williams (Senior Statutory Auditor)
for and on behalf of
KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL

Date: 05/10/2022

PALIO (NO 2) LIMITED

**STATEMENT OF OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2021**

	Note	2021 £000	2020 £000
Investment income	6	5,671	5,141
Fair value loss on investment		(7,464)	(7,135)
Loss from operations		<u>(1,793)</u>	<u>(1,994)</u>
Finance expense		(323)	(323)
Loss before tax		<u>(2,116)</u>	<u>(2,317)</u>
Total comprehensive loss		<u><u>(2,116)</u></u>	<u><u>(2,317)</u></u>

The notes on pages 16 to 31 form part of these financial statements.

There are no other items of comprehensive income other than the profit for the year, therefore a separate Statement of Other Comprehensive Income has not been prepared.

PALIO (NO 2) LIMITED
REGISTERED NUMBER: 07314940

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2021

	Note	2021 £000	2020 £000
Assets			
Non-current assets			
Investment at fair value through profit or loss		27,330	34,794
Total assets		<u>27,330</u>	<u>34,794</u>
Liabilities			
Non-current liabilities			
Loans and borrowings	11	3,226	3,226
Current liabilities			
Trade and other liabilities	10	312	312
Total liabilities		<u>3,538</u>	<u>3,538</u>
Net assets		<u>23,792</u>	<u>31,256</u>
Issued capital and reserves			
Share capital	12	26	26
Retained earnings		23,766	31,230
Total shareholder funds		<u>23,792</u>	<u>31,256</u>

The financial statements on pages 12 to 31 were approved and authorised for issue by the board of directors and were signed on its behalf by:



K Rahuf

Director

Date: 05 October 2022

The notes on pages 16 to 31 form part of these financial statements.

PALIO (NO 2) LIMITED

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2021**

	Share capital £000	Retained earnings £000	Total equity £000
At 1 January 2021	26	31,230	31,256
Total Comprehensive income for the year			
Loss for the year	-	(2,116)	(2,116)
	-	(2,116)	(2,116)
Total comprehensive income for the year			
Dividends paid (Note 12)	-	(5,348)	(5,348)
	-	(5,348)	(5,348)
Total contributions by and distributions to owners			
	-	(5,348)	(5,348)
At 31 December 2021	26	23,766	23,792

The notes on pages 16 to 31 form part of these financial statements.

PALIO (NO 2) LIMITED

FOR THE YEAR ENDED 31 DECEMBER 2020

	Share capital £000	Retained earnings £000	Total equity £000
At 1 January 2020	26	38,364	38,390
Comprehensive income for the year			
Loss for the year	-	(2,317)	(2,317)
Other comprehensive income	-	-	-
	<u>-</u>	<u>(2,317)</u>	<u>(2,317)</u>
Total comprehensive income for the year	<u>-</u>	<u>(2,317)</u>	<u>(2,317)</u>
Dividends paid (Note 12)	-	(4,817)	(4,817)
Contributions by and distributions to owners	-	-	-
	<u>-</u>	<u>(4,817)</u>	<u>(4,817)</u>
Contributions by and distributions to owners	<u>-</u>	<u>(4,817)</u>	<u>(4,817)</u>
At 31 December 2020	<u><u>26</u></u>	<u><u>31,230</u></u>	<u><u>31,256</u></u>

The notes on pages 16 to 31 form part of these financial statements.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

General information

Palio (No 2) Limited (the 'Company') is a limited company incorporated in England and Wales. The Company's registered office is at 3rd Floor, South Building, 200 Aldersgate Street, London, EC1A 4HD. The Company's principal activity is set out within the Strategic Report shown on page 3. These financial statements are presented in pounds sterling, being the currency of the primary economic environment in which the Company operates. All amounts are rounded to the nearest £'000.

1. Accounting policies

1.1 Basis of preparation

These financial statements have been prepared and approved by the directors in accordance with applicable law and International Accounting Standards in conformity with the requirements of the Companies Act 2006 ("adopted IFRSs"). A summary of the principal accounting policies, all of which have been applied consistently throughout the current are set out below.

The financial statements are prepared on the historical cost basis except certain financial assets and financial liabilities measured at fair value.

1.2 Going concern

The financial statements have been prepared on a going concern basis which the Directors consider to be appropriate for the following reasons.

Financial projections indicate that sufficient funds will be generated by the operating activities of the Company to enable ongoing obligations to be met as they fall due; with consideration being given to a period of at least 12 months from the date of approval of the Financial Statements.

As the Company has income streams which are substantially backed by the UK Government, the Directors have considered that no severe but plausible downside event would prevent the Company from being able to meet its liabilities as they fall due.

Further, whilst the Company is in a net current liability position, the parent has indicated its intention to continue to make available such funds as are needed and does not intend to seek repayment of any amounts payable to them for at least the next twelve months from the date of approval of financial statements. As with any company placing reliance on other group entities for financial support, the Directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Due to the ongoing uncertainty around the UK economy, in particular inflation, the value of the pound and interest rates mainly caused by the market's reaction to the mini-budget and subsequently the reaction of both the mortgage lenders and Bank of England, the Directors have reassessed the going concern assumption of the Company. The Company only has indirect exposure through its investments in the associates (see Note 16) due to the external loans held by those companies that are subject to fixed and floating interest rates.

The Directors do not consider this to have any significant impact on the going basis of preparation of the financial statements because the Company's associates have long term interest rate swap agreements in place that mitigate interest rate risk of its floating rate borrowings.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

1. Accounting policies (continued)

The Directors have also considered the COVID-19 pandemic and potentially lower valuations of investments but do not consider this to have any significant impact on the going concern basis of preparation of the financial statements.

Consequently, the Directors consider that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

1.3 Investment income

Revenue is measured at the fair value of the consideration received or receivable.

Interest income

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. It is recognised when it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably.

Dividend income

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

1.4 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term liquid investments with original maturities of three months or less, and bank overdrafts.

The Company holds no cash or cash equivalents and has not held any cash or cash equivalents during the year, and therefore there have been no cash transactions during the year. All transactions have been conducted through related party non-cash transactions. As such, no cash flow statement has been prepared.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

1. Accounting policies (continued)

1.5 Taxation

The tax expense represents the sum of tax currently payable.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from the net profit as reported in the statement of profit and loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax

Deferred tax is calculated on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax base used in the computation of taxable loss, and is accounted for using the Statement of Financial Position liability method. Deferred tax liabilities are generally recognised for all temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax asset is reviewed at each Statement of Financial Position date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

1.6 Investments in joint ventures and associates

The Company meets the definition of a venture capital organisation or similar entity and upon initial recognition has designated its investment in joint ventures and associates at fair value through profit or loss. Changes in fair value are recognised in profit or loss in the period of the charge.

1.7 Borrowings

Borrowing are recognised initially at fair value, net of transaction costs and subsequently measured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period.

1.8 Trade and other liabilities

Trade and other liabilities are financial liabilities with fixed or determinable payments that are not quoted in an active market. Payables are recognised initially at fair value less transaction costs, if any. These are subsequently measured at amortised cost using the effective interest method. Given the nature of payables, however, and the short time length involved between their origination and settlement, their amortised cost is generally materially the same as their fair value at the date of origination.

1.9 Receivables

Receivables are measured at amortised cost using the effective interest method, less any impairment. They are included in current assets, except where maturities are in greater than 12 months after the Statement of Financial Position date which are classified as non current assets.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

1. Accounting policies (continued)

1.10 Share capital

Ordinary shares are classified as equity.

1.11 Expenses

All expenses are accounted for on an accruals basis. The Company's fees, finance costs and all other expenses are charged through the statement of profit and loss and other comprehensive income.

1.12 Dividends

Dividends are recognised when they become legally payable. In the case of interim dividends to equity shareholders, this is when paid. In the case of final dividends, this is when approved by the shareholders at an annual general meeting.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

2. Critical accounting judgements and key estimation uncertainty

In the application of the Company's accounting policies, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

Estimates

Related party loans

The Company's loan agreement with Fenton UK 3 Limited carry an interest rate of 10%, and is secured on the investment of the Company. On inception of the loan, the interest rate was determined with reference to market rate at that date. The Directors have considered whether the market rate for such debt, or the specific credit risk of the loan (with reference to the performance of the investment), have materially changed - and concluded they have not.

Therefore, the Directors conclude that book value of the loan in these financial statements still approximates to the fair value at the statement of Financial Position date.

Investments

The fair value of the investment in aggregate is calculated by discounting total future cash flows from the investments. Where the interest rate of the debt element of the investment is considered not to reflect market rates at the date of valuation, then in order to separately disclose the fair value of the debt a market debt rate is determined and applied to the separate debt cash flows.

The principal drivers of internally prepared valuations are therefore:

- i) expected future net cash flows; and
- ii) the discount rate to be applied.

Future cash flows involve a degree of uncertainty in terms of their amount and timing. Cash flows in the underlying investments are exposed to risks in relation to deductions that may be made by the relevant procuring party in relation to performance conditions and inflation.

(i) Future cash flows are the future distributions expected to be received by the Company from its investments. Future distributions involve a degree of uncertainty in terms of their amount and timing as cash flows in the underlying Investments are exposed to risks, for example, in relation to deductions that may be made by the relevant Government Authority in relation to performance conditions and macroeconomic changes. These cashflows are based on the latest financial model available for each investment. These are updated for actual figures periodically and, for levered investments, reviewed by senior debt providers; as such these provide the most reliable estimate of future cash flows. The Investment Manager updates these financial models for the latest macroeconomic forecasts to ensure consistency across the Company's portfolio.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

2. Critical accounting judgements and key estimation uncertainty (continued)

If the expected future net cash flows were decreased or increased by 10%, with all other variables held constant, the impact on the value of financial assets would be £2,844,000 (2020: £3,605,000) loss/gain respectively.

(ii) Discount rates are based on a risk-free rate adjusted by an appropriate premium to reflect the specific risks of the investment. The risk-free rate is derived from UK government bond rates for the 24-month average yield-to-maturity matching individual investment life. A discount rate premium is then calculated considering multiple factors pertaining to the specific risk of the investment, including base infrastructure risk, construction risk (if applicable), duration risk due to an extended project life, sector specific risks, and any project specific risks.

The discount rate used for the 2021 valuation was 5.75% (2020: 5.75%). If the discount rate used in the valuation was increased or decreased by 100 bps, the impact on the value of the financial assets would be a loss/gain respectively of £866,000/£919,000 (2020: £1,309,000/£1,396,000).

The estimate of fair value may vary from the price achieved in an actual sale as potential acquirers may use different valuation criteria for their own strategic reasons.

In addition, the following economic assumptions were used in the discounted cash flow valuations:

UK inflation rate	4.10% for 2022, long term 3%
UK deposit interest rates	0.25% for 2022, long term 1%
UK corporation tax	19% for 2022, long term 25%

Judgements

The Company meets the definition of a venture capital organisation hence in accordance to IAS 28 Investments in Associates and Joint Ventures, the Company has designated its investment in its associates, as listed in note 16, at fair value through profit or loss upon initial recognition. The Company therefore measures its interest in its associate at fair value in accordance with IFRS 9 Financial Instruments and IFRS 13 Fair Value Measurement, with changes in fair value recognised in profit or loss in the period of the change.

Deferred tax

The Company has not recognised deferred tax on the temporary difference between the fair value of the investment and its tax base because the Directors are of the view that the fair value of the subordinated debt component of the investment approximates to its nominal value and so any movement in fair value is attributable to the equity component only. In this case there would be no taxation arising because the value of the equity component will be realised through the receipt of non-taxable dividends and/or by a sale for which reliefs from taxation will be available.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

3. International financial reporting standards ("IFRS") - adoption of new and revised standards

Standards, interpretations and amendments to published statements

There are no new or amended standards effective this year that have had a material impact on these financial statements.

A number of UK-adopted IFRSs have been issued but are not yet effective and have not been applied in these financial statements. The Directors do not expect that, when effective, they will have any material impact on the financial statements in future periods.

International Financial Reporting Standards ("IFRSs") issued but not yet effective

The Company has not early adopted any standards that have been issued but are not yet effective.

4. Operating profit

The operating profit of the Company is attributable to the principal activity of the Company, all of which was carried out in the United Kingdom.

Audit fees for both the current and prior year are borne by the ultimate parent company, Fenton Holdco Limited. These amounted to £5,200 in the year (2020: £5,100). There were no non-audit services received during the year.

5. Directors' remuneration

No staff were directly employed by the Company (2020 - None).

No directors received any remuneration for services to the Company during the year (2020 - None). The Company is managed by secondees from third parties. No recharge for services rendered has been made during the year (2020 - None).

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
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6. Investment income

	2021	2020
	£000	£000
Dividend income	5,348	4,818
Interest income	323	323
	5,671	5,141

During the year there were dividends of £5,348,000 received (2020: £4,818,000).

7. Finance expense

Recognised in profit or loss

	2021	2020
	£000	£000
Interest expense on loans from immediate parent company	323	323
Total finance expense	323	323

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

8. Investments at fair value through profit or loss

	2021	2020
	£000	£000
Opening net book value	34,794	41,928
Additions	-	-
Repayment of principal and interest	(323)	(323)
Movement in accrued interest	323	324
Fair value loss	(7,464)	(7,135)
	<u>27,330</u>	<u>34,794</u>

The investment comprises a debt element and an equity element as follows:

	2021	2020
	£000	£000
Debt	3,308	3,308
Equity	<u>24,022</u>	<u>31,486</u>
Total	<u>27,330</u>	<u>34,794</u>

The debt element carries a coupon rate of 10% (2020: 10%) and is repayable in 2025.

Investments are generally restricted on their ability to transfer funds to the Company under the terms of the senior funding arrangement for that investment. Significant restrictions include:

- Historic and projected debt service and loan life cover ratios exceed a given threshold;
- Required cash reserve account levels are met;
- Senior lenders have agreed the current financial model that forecasts the economic performance of the company;
- Project performance is in compliance with the terms of its senior funding arrangements; and
- Senior lenders have approved the annual budget for the Company.

A list of joint ventures and associates of the Company can be found in note 16 of these financial statements.

The loss on investments of £7,464,000 (2020: £7,135,000) has been included in the Statement of Comprehensive Income. Movements in fair value are attributed to the equity portion of the investment.

The Directors have satisfied themselves as to the methodology used, the discount rates applied and the valuation. Further detail is given in note 13.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

9. Tax expense

9.1 Income tax recognised in profit or loss

Current tax

The reasons for the difference between the actual tax charge for the year and the standard rate of corporation tax in the United Kingdom applied to losses for the year are as follows:

	2021 £000	2020 £000
Loss for the year	(2,116)	(2,317)
Loss before income taxes	(2,116)	(2,317)
Tax using the Company's domestic tax rate of 19% (2020: 19%)	(402)	(440)
Non-taxable dividend income	(1,016)	(915)
Fair value movement on investment not subject to taxation	1,418	1,355
Total tax expense	-	-

Changes in tax rates and factors affecting the future tax charges

The March 2021 Budget announced a proposed increase in corporation tax rates with a corporation tax rate of 25% applying with effect from 1 April 2023. This will increase the Company's future current tax charge accordingly.

10. Trade and other payables

	2021 £000	2020 £000
Accruals	312	312
Total trade and other liabilities	312	312
Less: current portion - accruals	(312)	(312)
Total non-current position	-	-

The carrying amount of these liabilities approximates their fair value.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

11. Loans and borrowings

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortised cost.

	2021	2020
	£000	£000
Loans from shareholders	3,226	3,226
	3,226	3,226
Current		
Total loans and borrowings	3,226	3,226

Loans from shareholders represent a single tranche of unsecured borrowings from the parent company Fenton UK 3 Limited. The loan is repayable in line with repayment schedules and interest is charged at 10%. The loans will be repaid by December 2028.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
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12. Share capital

Authorised

	2021 Number	2021 £000
Shares treated as equity		
Ordinary shares of £1.00 each	26,000	26
	<u>26,000</u>	<u>26</u>

The dividends for the year ended 31 December 2021 amounted to £5,348,000 being £205.69 per ordinary share (2020: £4,817,000 being per £185.26 per ordinary share).

13. Financial instruments

Capital risk management

The Company manages its capital to ensure that it is able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Company is not subject to any externally imposed capital requirements.

Categories of financial instruments

	2021 £000	2020 £000
Financial assets		
Fair value through profit and loss		
Investments	27,330	34,794
	<u>27,330</u>	<u>34,794</u>
Financial liabilities at amortised cost		
Borrowings	3,226	3,226
Trade and other liabilities	312	312
	<u>3,538</u>	<u>3,538</u>

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

13. Financial instruments (continued)

Financial risk management

Risk management objectives

The directors provide advice to the Company on all risks faced and manage the financial risks relating to the operations of the Company through internal risk reports which analyse the exposures faced by degree and magnitude of risk consequences. These risks include market risk, credit risk and liquidity risk.

Market risk

The Company's activities expose it primarily to the financial risks of interest rates and performance risk.

Interest rate sensitivity analysis

The Company has limited exposure to interest rate risk because of the loan held with Fenton UK 3 Limited has a fixed interest rate of 10.00%.

Performance risk management

Performance risk management refers to the risk that the underlying project companies will not perform in line with expectations, and as such the Company will not receive forecast cash flows as expected. This risk is mitigated through the contractual structure of the projects, whereby deductions or non-performance are passed down to the facilities manager, operations and maintenance provider or construction subcontractors.

Inflation risk management

The investment has part of its revenue and some of its costs linked to a specific inflation index at inception of the project. This creates a natural hedge, meaning a derivative does not need to be entered into in order to mitigate inflation risk.

Credit risk management

The Company is exposed to credit risk in respect to its current assets as outlined in the Statement of Financial Position through possible default of the relevant counterparty. The maximum gross exposure to credit risk, before credit enhancements and other mitigates, is represented by the carrying amounts of the financial assets that are carried on the Statement of Financial Position. This risk is mitigated through a combination of diversification of exposures across multiple projects and sectors, the majority of credit counterparties for projects being government, government backed or quasi government bodies, and the presences of collateral and credit enhancements at the project level including charges over, or ownership of, physical assets. This risk is therefore not considered to be significant.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the board of directors, which has built an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate cash reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching maturity profiles of financial assets and liabilities.

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

13. Financial instruments (continued)

The following table details the Company's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up on undiscounted cash flows of financial liabilities based on the earliest date the Company could be required to satisfy borrowing repayments. The table includes principal prepayments on borrowings and settlement of other payables as and when they fall due. Further information regarding the interest payable in future periods is provided in the narrative below:

Liabilities

	Less than 1 year £000	1-2 years £000	3-5 years £000	5+ years £000	Total £000
2021					
Borrowings	-	-	3,226	-	3,226
Trade and other liabilities	312	-	-	-	312
	<u>312</u>	<u>-</u>	<u>3,226</u>	<u>-</u>	<u>3,538</u>
2020					
Borrowings	-	-	-	3,226	3,226
Trade and other liabilities	312	-	-	-	312
	<u>312</u>	<u>-</u>	<u>-</u>	<u>3,226</u>	<u>3,538</u>

Interest payable due in 0-1 years is £323,000 (2020: £323,000) 2-5 years was £1,291,000 (2020: £1,291,000) and due after 5 years was £646,000 (2020: £323,000).

Borrowings comprise amounts borrowed from the parent company, Fenton UK 3 Limited. The carrying value of the loan notes represents the current fair value.

Fair value of financial instruments

The Company holds a number of financial instruments on the statement of financial position at their fair values. The following hierarchy classifies each class of financial asset or liability depending upon the valuation technique applied in determining its fair value.

- (i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities, where inputs are observable;
- (ii) Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) where inputs are directly or indirectly observable; and
- (iii) 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, where the inputs are unobservable.

Investments comprise both debt and equity investments. Both debt and equity investments are considered Level 3 valuation. See note 2.

There have been no transfers between these categories in the current period.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021**

14. Related party transactions

The following transactions took place between the Company and its joint ventures and subsidiaries during the period:

2021

Profit and loss account transactions

	Investment income £'000	Interest expense £'000
Related party		
Fenton UK 3 Limited	-	323
Modus Services (Holdings) Limited	5,671	-
	<u>5,671</u>	<u>323</u>

	Amounts owed by related parties 2021 £'000	Amounts owed to related parties 2021 £'000
<u>Statement of financial position items</u>		
Related party		
Fenton UK 3 Limited	-	3,539
Modus Services (Holdings) Limited	3,308	-
	<u>3,308</u>	<u>3,539</u>

2020

Profit and loss account transactions

	Investment income £'000	Interest expense £'000
Related party		
Fenton UK 3 Limited	-	323
Modus Services (Holdings) Limited	5,141	-
	<u>5,141</u>	<u>323</u>

	Amounts owed by related parties 2020 £'000	Amounts owed to related parties 2020 £'000
<u>Statement of financial position items</u>		
Related party		
Fenton UK 3 Limited	-	3,226
Modus Services (Holdings) Limited	3,308	-
	<u>3,308</u>	<u>3,226</u>

PALIO (NO 2) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
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15. Parent company

The Company's immediate parent company is Fenton UK 3 Limited, a company incorporated in Jersey, with registered office at 44 Esplanade, St Helier, Jersey, JE4 9WG. The Company's ultimate parent and controlling entity, is Fenton Holdco Limited, a company registered in England and Wales, with registered office at 3rd Floor, South Building, 200 Aldersgate Street, London, EC1A 4HD. The Company's results are not consolidated as its parent entities meet the criteria of Investment Entities under IFRS 10.

16. Investments in subsidiaries and joint ventures

Company name	Percentage of shares held	Category	Registered Address
Modus Services (Holdings) Limited	26%	Intermediate holding	46 Charles Street, Second Floor, Cardiff, Wales, CF10 2GE
Modus Services Limited	26%*	Intermediate holding	46 Charles Street, Second Floor, Cardiff, Wales, CF10 2GE

*denotes investment held indirectly

17. Post balance sheet

During the period from the date of the balance sheet to the date these financial statements have been approved, there have been no subsequent events which require disclosure in these financial statements.