Tideway - Holdco Group

Investor Report H2 2016/17

10 July 2017

Notice

IMPORTANT NOTICE

This Investor Report is being distributed by Bazalgette Tunnel Limited ("BTL" or "the Borrower") (as 'Holdco Group Agent') on behalf of each Obligor pursuant to the Common Terms Agreement (CTA).

This Investor Report contains forward looking statements that reflect the current judgment of the management of the Obligors regarding conditions that it expects to exist in the future. Forward looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will occur in the future and, accordingly, are not guarantees of future performance. Management's assumptions rely on its operational analysis and expectations for the operating performance of each of the Obligor's assets based on their historical operating performance and management expectations as described herein. Factors beyond management's control could cause events to differ from such assumptions and actual results to vary materially from the expectations discussed herein. Investors are cautioned that the assumptions and forecast information included herein are not fact and should not be relied upon as being necessarily indicative of future results and are cautioned not to place undue reliance on such assumptions and forecast information. It should also be noted that the information in this Investor Report has not been reviewed by the Obligors' auditors.

BASIS OF PREPARATION

Investor Reports relate to the performance of the Holdco Group which includes Bazalgette Holdings Limited ("BHL" or "Holdco"), Bazalgette Finance plc ("Finco"), BTL, and Thames Tideway Tunnel Limited ("TTT Co"). This Investor Report comments on the historical financial performance of the Holdco Group for the period to 31 March 2017.

Defined terms used in this document have the same meanings as set out in the Master Definitions Agreement unless otherwise stated.

Contents

Overview

This Investor Report provides an update of Tideway’s activities for the period to 31 March 2017. It covers business, regulatory and financing developments. This Investor Report should be read in conjunction with the Annual Report for year ended 31 March 2017.

2016/17 Highlights:

- Regulatory Capital Value £502.1m as at 31 March 2017
- Zero major injuries
- Mobilisation of main drive sites for tunnelling three to five months early
- >2,300 STEM education volunteering hours and >4,100 community volunteering hours
- 27 apprentices working across the programme
- 11 sites supported by a Community Liaison Working Group (CLWG) with 34 working group meetings held
- 37 per cent female staff
- Fully financed through the construction period including £700m 35-year European Investment Bank (EIB) loan and £450m of bond issues

Business Update

Health, Safety and Wellbeing

- There were no major injuries recorded during the year, which was a significant achievement, however we did have some lost time incidents, including one AFR-7[(1)] . We are committed to continuing to find ways to do things safer, healthier and better in the years to come.
- To date, over 7,000 employees and contractors have attended the Employer Project Induction Centre programme, including approximately 4,500 in 2016/17. This includes people working on Tideway and from other interested companies

Vision, Legacy and Reputation

- In total, the parties to our Alliance provided around 2,300 STEM[(2)] volunteering hours. Our Skills and Employment Plan was endorsed by 14 London boroughs and we ran a successful pre-employment pilot for 30 local residents, who took part in a four-week training programme. This resulted in 15 placements for work experience and 12 moving into jobs
- We established the new Thames Skills Academy with the Port of London Authority, the Company of Watermen and Lightermen and Transport for London
- We successfully launched our public art and heritage interpretation strategies. Following a competitive process, we now have 23 artists commissioned across the project

Company and People

- Tideway recognises the importance of diversity, since diverse organisations have been shown to make better decisions and have higher performance. Gender diversity is a key performance indicator for us and we finished the financial year with 37 per cent female staff
- Overall it was a successful year, with a variety of people initiatives delivering benefits. This was reflected in our 2016 employee survey, which included Tideway, CH2M, agency and sub-contractors. Employee engagement increased from 59 per cent to 63 per cent and enablement from 59 per cent to 67 per cent, indicating that we are improving and that our people feel valued and empowered
- Tideway finalised the implementation of the Tideway Information Management programme. This has changed the way Tideway works and treats its information, giving us an open, straightforward, collaborative approach to information management that is also auditable and complies with our obligations

(1) Accident Frequency Rate. AFR-7: *12-month rolling average, per 100,000 hours worked, of injuries which occurred as a result of work activities and resulted in more than seven days lost time for the individual involved*

(2) STEM: *Science Technology Engineering Mathematics*

Investment Programme

- **General**
  - Mobilised in nine out of 24 sites
  - Consents and site access working well
  - Main drive sites at Carnwath Road (West), Kirtling Street (Central) and Chambers Wharf (East) mobilised between three and five months earlier than the original schedule
  - Construction schedule in line with the regulatory baseline
- **West**
  - Started on Carnwath Road, Hammersmith Pumping Station and Putney Embankment Foreshore
  - BMB has started strengthening the river wall as well as shaft and acoustic shed piling at Carnwath Road
  - TBM factory acceptance testing during May/June
  - Piling started at Hammersmith Pumping Station
  - Putney Embankment Foreshore slipway delivered ahead of schedule
- **Central**
  - Started on Kirtling St, Blackfriars Bridge Foreshore, Victoria Embankment
  - 70% of shaft diaphragm wall now built at Kirtling St (following varying ground conditions)
  - Blackfriars new pier opened in October 2016, cycle superhighway diverted
  - TBMs procured in December 2016
  - Tattershall Castle relocated (including UXO[1] disposal)
  - Counter's Creek solution developed
- **East**
  - Started on Chambers Wharf, Greenwich Pumping Station and King Edward Memorial Park
  - Chambers Wharf cofferdam nearly complete
  - Greenwich utilities diverted and drive site preparation underway
  - TBMs have been ordered

Carnwath Road construction site

Diaphragm walling at Kirtling Street

Cofferdam at Chambers Wharf

(1) UXO - Unexploded Ordnance

Financing Activity

Over the period to 31 March 2017 we have continued to de-risk our financing plan, further increasing our liquidity position and locking-in financing costs:

- On 5 December 2016, we issued a £100m index-linked bond. The bond has a deferred purchase date of December 2018, and a maturity date of 2040
- We locked in the cost for the period to 2051 of £80m notional value of the EIB loan, which will be drawn in RPI-linked format
- We entered into hedging transactions to lock-in the cost for the period to 2030-2032 on a RPI basis of the remaining £380m notional value of the EIB loan

As at March 2017, the balance of equity was £370.4m and shareholder loans was £529.3m, which include the injection of £56.5m in equity and £84.7m draw on the shareholder loan in the period, as well as £12.2m repayment of principal on 31 March 2017.

In line with our strategy to fund the early stages of our investment programme using our shareholders' funds, our £1bn revolving credit facility (RCF) remained undrawn during the period.

As at 31 March 2017, we had total liquidity in excess of £2.8bn, comprising £315.9m of cash, £348bn of committed and undrawn capital from our shareholders, the £1bn undrawn RCF, £700m EIB loan and £450m bonds.

Post year-end, we signed a £100m index-linked loan with a 30-month deferred drawing in 2019 which will mature in 2049. Following this, we priced a £125m index-linked bond with deferred purchase date of July 2019 and a maturity date of 2049.

Historical Financial Performance

During the year ended 31 March 2017, Tideway reported a loss of £34.2m (2015/16: £nil) with no dividends paid or proposed. We did not recognise any taxable profits in the period and therefore have no corporation tax charges.

We do not consider that the reported loss in the year reflects our business performance, as it results from the movement in the fair value in the Holdco Group's financial instruments.

Allowable Costs

For the year ended 31 March 2017, our Allowable Project Spend(1) is marginally lower than the Allowable Costs(2), as our Allowable Costs include the timing of accruals and unwinding of prepayments of items, including insurance contracts and the GSP. At 31 March 2017, costs of £545.9m were capitalised within the asset under construction in the Statement of Financial Position within the accounts. This represents £384.7m costs during the year and £161.2m for the prior period to 31 March 2016.

Direct Costs

Direct costs are primarily the Main Works Contract costs. They also include the system integrator contract and the contract with Volkerstevin Ltd to provide services and works for the removal and replacement of piers and the relocation of marine vessels.

Indirect costs

The largest indirect cost is resource costs of £60.3m. This represents the cost to employ circa 450 average FTEs either employed or contracted by the Borrower. The other indirect costs include information systems, insurance, payment for the GSP, office and other running costs.

Excluded costs

The Excluded Costs(3) (on an accruals basis) for the year ended 31 March 2017 were £36.7m. These comprise £29.3m of shareholder loan interest, £5.4m of financing costs and £2.0m of interest.

Analysis of costs and cash outflows, FY 16/17	Costs £m	Timing differences £m	Cash outflows £m
Total allowable costs	348.0	(7.5)	340.5
Total excluded costs	36.7	53.1	89.8
Total	**384.7**	**45.6**	**430.3**
Cum. as of 31/03/16	**161.2**		
Total	**545.9**		

Allowable costs, FY 16/17	£m
Direct costs	**262.6**
Resources	60.3
Other indirect costs	25.1
Indirect costs	**85.4**
Total	**348.0**

(1) Allowable Project Spend - Allowable Project Spend (on a cash basis) is added to our RCV
(2) Allowable Costs - Costs stated on an accruals basis, which form part of the Allowable Project Spend (and are added to our RCV) when the underlying assets or liabilities are cash settled
(3) Excluded Costs – Costs stated on an accruals basis which will be Excluded Project Spend (and not added to our RCV) when the underlying assets or liabilities are cash settled

Historical Financial Performance (cont.)

Fair value measurements and valuation

During the year, BTL entered into long-term swaps with commercial banks to hedge the interest rate for tranches one to eight of the £700m EIB loan we secured in May 2016. The swaps fix finance costs for BTL's regulatory period in a cost-effective manner and ensure that we benefit from low-cost financing.

The movement in fair value of these financial instruments is recognised in the Income Statement because under IAS 23 these do not represent current borrowing costs incurred for financing the project and so, unlike our other expenditure, cannot be capitalised.

Tax

We have made a `disregard election` to HMRC effective 1 April 2016, which means that any gains or losses arising from the movement in the fair value will be disregarded for current tax purposes.

A corporation tax charge of £nil was recognised in the period, which reflects the position that the Holdco Group did not have any taxable profits.

Cash flow

The cash inflows of £633.3m include proceeds of £348.3m from shareholder loans, £232.1m from shareholder equity, £35.5m of working capital inflows and £17.5m of transfers from short-term deposits. The working capital inflows include £32.1m of regulated revenue received from Thames Water and £3.3m of other inflows, including interest and payment for other services provided to Thames Water.

The cash outflows of £430.3m include £384.7m of investment in the construction of the tunnel, £24.1m of shareholder loan repayments and working capital outflows of £21.5m.

At 31 March 2017, the Holdco Group's borrowings were £529.3m in the form of shareholder loans. In addition to the secured loan for £700m with the EIB and the deferred bond issuances of £450m completed during the year, the Group had access to a £1.0bn RCF. At 31 March 2017, both the RCF and EIB loan were undrawn.

Net cash	£m
Balance 01/04/16	**112.9**
Proceeds from shareholder loans	348.3
Proceeds from equity	232.1
Revenue	32.1
Transfer from/(to) short term deposits	17.5
Other	3.3
Cash Inflows	**633.3**
Construction of the tunnel asset	(384.7)
Working capital outflows	(21.5)
Repayment of shareholder loans	(24.1)
Cash Outflows	**(430.3)**
Balance 31/03/17	**315.9**

Ratios

We confirm that in respect of this Investor Report dated 31 March 2017, by reference to the most recent Financial Statements that we are obliged to deliver in accordance with paragraph 1 (Financial Statements) of Part A (Information Covenants) of Schedule 3 (Holdco Group Covenants) of the CTA:

a) the Senior RAR(1) in respect of the relevant Test Period is equal to 0%; this is below the 5% threshold set out in the CTA and therefore we are not required to report FFO ICR(2) and Average FFO ICR

We confirm that the above Ratio has been calculated in respect of the Test Period(s) or as at the Test Dates for which it is required to be calculated under the CTA.

Description of ratios
(1) Senior RAR measures at a test date, the ratio of Senior Net Indebtedness to RCV
(2) FFO ICR measures in respect of a test period, the ratio of Net Cash Flow to Senior Debt Interest

Other Reportable Matters

Significant management and board changes

In January 2017, the Board appointed one Non-Executive Director, Andrew Cox, to replace Christoph Holzer as Allianz Shareholder Director of BHL.

Other than the outlined above, there have not been any other board or relevant management changes in the period.

Acquisitions and disposals

Aside from the transfer of assets from TTT Co to BTL on 31 March 2017 (and the related release of TTT Co as a Guarantor pursuant to the STID Proposal passed on the same date), there has been no acquisition or disposal of Subsidiaries, Subsidiary Undertakings or interest in any Permitted Joint Venture by any member of the Holdco Group and any company or business or material asset disposal by any member of the Holdco Group.

Current Hedging Position

During the period, BTL entered into hedging transactions to lock-in the cost for the period from the drawdown of the loan to 2031-2032 on a RPI basis of £380m notional value of the EIB loan.

Our £700m EIB loan has been fully locked into RPI format during the course of the year, either through hedging or by locking in tranches directly with the EIB.

Confirmation

We confirm that:

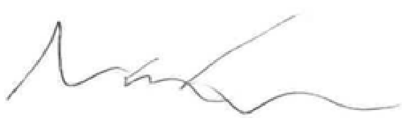
a) no Default or Trigger Event has occurred and is continuing;

b) the Borrower is in compliance with the Hedging Policy;

c) the statements set out in this Investor Report are accurate in all material respects; and

d) the insurances are being maintained in accordance with paragraph 28 (Insurance) of Part C (General Covenants) of Schedule 3 (Holdco Group Covenants) to the CTA.

Mark Corben,



Chief Financial Officer

For and on behalf of Bazalgette Tunnel Limited as Holdco Group Agent

Appendix

The table below summarises the requirements of the Investor Report and references in this document

Requirement	Reference
General overview	Page 4, Overview
Regulatory and business update	Page 5, Business Update Page 6, Investment Programme
Capital Expenditure	Pages 8-9, Historical Financial Performance
Financing	Page 7, Financing Activity
Acquisitions or Disposals	Page 11, Other Reportable Matters
Current Hedging Position	Page 11, Other Reportable Matters
Ratios	Page 10, Ratios