Tideway - Holdco Group

Investor Report H1 2018/19

19 December 2018

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). BTL trades as “Tideway”.

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”) and BTL. This Investor Report comments on the historical financial performance of the Holdco Group for the period to 30 September 2018.

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 the Holdco Group's activities for the period to 30 September 2018. It covers business, regulatory and financing developments. This Investor Report should be read in conjunction with the Interim Report and Financial Statements for the six months ended 30 September 2018.

H1 2018/19 Highlights:

- In the past six months Tideway has made good progress towards its ambition to safely deliver the Thames Tideway Tunnel project (TTT) at the right quality and to best value.
- We continue to develop our approach to health, safety and wellbeing and are pleased to report that we have had no life changing injuries to date.
- We have mobilised on 20 of our 21 sites with the final one due to start in 2019 and taken delivery of three of the six Tunnel Boring Machines (TBMs).
- Main tunnelling has started with our TBM, Millicent, beginning her journey from Kirtling Street to Carnwath Road.
- Total project costs for the six months to 30 September were £325.3m which brings the total cumulative cost to £1,480.2m.
- Tideway continues to make good progress managing financial risk and during the period an additional £325m of term debt was raised making Tideway the largest corporate issuer of sterling green bonds on the London Stock Exchange.
- The debt issue means Tideway has now reached a point of financial resilience where sufficient funding has been secured to cover construction costs.
- On 1 August 2018, Tideway announced that Mathew Duncan will be joining the Board as Chief Financial Officer and Mathew joined Tideway on 19 November 2018.

Business Update

Health, Safety and Wellbeing

- There were no major (life-changing) injuries during the six-month period ended 30 September 2018. However, there were nine lost-time injuries during the 2.4 million hours worked in the period, five of which resulted in over seven days lost time.
- Tideway remains focused on improving industry standards for Health, Safety and Wellbeing and in response to the increase in lost-time injuries we have implemented targeted stand downs across the project, undertaken reviews into the higher risk activities and implemented the appropriate organisational changes.
- Tideway continues to look at ways of improving health and wellbeing and has embraced the 'Mates in Mind' charity to develop a mental health and wellbeing programme specific to construction.

Vision, Legacy and Reputation

- Tideway and its contractors continue to engage with communities surrounding our construction sites.
- In May, the Mayor of London launched his new workplace inclusivity network at our Chambers Wharf site, underlining our commitment to diversity within our own workforce.
- We are making strong progress in delivering our legacy commitments with one of the success stories being the training of new apprentices. At 30 September a total of 113 apprenticeships had been created across the Tideway Alliance.
- At the Evening Standard Business Awards in June we were delighted to win the Corporate Citizen of the Year award in recognition of our sustainability work, notably our partnership with Thames21.
- Tideway collaborated with the BBC to document the first three years of the project (including the construction of the Lee Tunnel), resulting in a successful three-part BBC2 documentary series 'The Five Billion Pound Super Sewer', which aired in July and August 2018, reaching audiences of around 1.9m people.

Company and People

- The first half of the year has also seen a refresh of the Tideway operating model in line with the organisational changes made to realign the project to support effective delivery.
- In a continuation of our support for individual development Tideway launched an online learning portal in 2018. The portal offers wide ranging content from Ashridge Business School including on-line training activities and suggested reading lists.
- Gender diversity continues to be a key performance indicator for Tideway and female staff currently represent 34% of headcount. This year we are giving increased focus on improving the number of females in more senior positions within the company, through training, coaching and mentoring.

Investment Programme - Overview

- We have ordered all six of our TBM and taken delivery of two of the TBMs in the Central area for driving from Kirtling Street to Chambers Wharf and from Kirtling Street to Carnwath Road, and one in the West area driving from Carnwath Road to Acton Storm Tanks.
- The TBM for the Frogmore Connection Tunnel in the West has passed factory acceptance testing and is due for delivery in early 2019. The remaining two TBMs for the main tunnel from Chambers Wharf to Abbey Mills Pumping Station and for the Greenwich Connection Tunnel in the East are due for delivery in early 2020.
- Marine logistics are increasingly important for Tideway's delivery programme. A navigational risk assessment has been undertaken and a marine logistics working group established to coordinate activities between sites.
- Following significant progress on the project and now having mobilised on 20 of our 21 sites, Tideway has identified several cost pressures in the programme. The most significant of these are the previously reported engineering challenges at Blackfriars; the cofferdam construction at King Edward Memorial Park, together with the associated programme prolongation at that site; cofferdam construction at Albert Embankment and various challenges at our shafts across the East area sites. Taken together with general cost pressure across the programme, this has substantially eroded available contingency.
- To mitigate the cost pressures Tideway has begun to implement cost saving measures in partnership with our contractors and remains focussed on achieving the baseline target. These cost saving measures include working with our Main Works Contractors to eliminate overlap, taking measures to increase productivity, undertaking value engineering and delivering overhead savings.
- Total project costs for the six-month period were £325.3m which brings the total cumulative cost to £1,480.2m.
- Post period end, in November 2018, our tunnel boring machine, Millicent, started on her journey from Kirtling Street to Carnwath Road, marking the start of a 5km subterranean journey – and the start of main tunnelling on the Tideway project.

Investment Programme - West

- All seven site works are progressing well.
- The second TBM (Charlotte), has passed the factory acceptance testing and is due for delivery in the early 2019.
- At the **Carnwath Road Riverside** main drive site, the main shaft excavation is complete to base depth and the base plug poured. In addition, the river wall strengthening and site infrastructure, including piling and construction of the conveyor foundations to support spoil removal from the tunnel excavations, are also complete.
- At **Hammersmith Pumping Station**, shaft excavation and the inlet channel flume installation works are complete with the flume having commenced operations in July 2018.
- At **Dormay Street**, the breaking out of the shaft guide walls and the shaft excavation works have commenced whilst the strengthening of the river walls is progressing well.

TBM Charlotte undergoing tests at Morgan Sindall, Staffordshire

Hammersmith Pumping Station

Carnwath Road Riverside

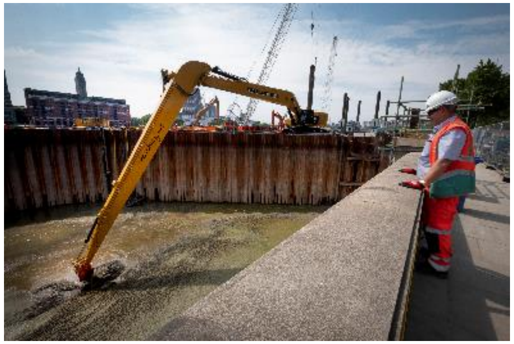
Dormay Street

Investment Programme - Central

- Significant progress across all eight sites.
- At the **Kirtling Street** main drive site, both TBMs (Millicent and Ursula) were received onsite, assembled and lowered into the shaft adits and tunnelling has now commenced.
- At **Blackfriars**, works have progressed to overcome significant engineering challenges caused by the proximity of two large Victorian gas mains. The initial results from the damage assessment conducted, suggest that the gas main line may not require diversion. Final damage assessment results are expected by end of the year.
- At **Victoria Embankment**, we have completed the sheet pile cofferdam to facilitate the construction of the drop shaft associated structures. In addition, the existing gas mains found within the embankment following initial damage assessments have been decommissioned with the reinstatement and commissioning of the new main line planned for completion in 2018.
- At **Albert Embankment**, the construction of a sheet piled cofferdam was completed along with works to divert several important utilities at the site.

Lowering of TBM Millicent at Kirtling Street

Victoria Embankment



Blackfriars Bridge Foreshore

Kirtling Street

Investment Programme - East

- At **Chambers Wharf**, the main drive site, the cofferdam and diaphragm walls were completed. The shaft excavation and the installation of the acoustic enclosure commenced following the completion of remediation and archaeological works.
- The cofferdam construction at **King Edward Memorial Park** Foreshore is taking longer than planned, due to unexpected ground conditions which requires additional piles. This has resulted in the planned resequencing of works to alleviate the programme impact.
- At **Greenwich Pumping Station**, the construction of the shaft and acoustic enclosure has commenced and work on the Combined Sewer Outflow (CSO) diaphragm wall is progressing well. Additionally, the houseboats within the jetty area have been relocated allowing the river works to progress with marine pile installation ongoing.
- At **Deptford Church Street**, a major milestone was achieved with completion of the shaft diaphragm wall ahead of forecast.
- At **Earl Pumping Station**, works for the shaft diaphragm wall have commenced with construction of the cut-off wall.
- Tideway expects to mobilise on the **Abby Mills Pumping Station** site in 2019.

Chambers Wharf progress

The design and manufacture of the two east TBMs, Selina and Annie, is currently under way in Germany and they are due for delivery in early 2020.

Deptford Church Street

Chambers Wharf

King Edward Memorial

Financing Activity

During the six month period ended 30 September 2018, we raised an additional £325m of new term debt, via four bond issuances under our multi-currency bond programme and placed with several major institutional investors:

- A £150m deferred draw index-linked (RPI) green bond was closed in April. The bond has a deferral period of four years and final maturity is 2032
- A £75m deferred draw index-linked (CPI) green bond was closed in May. The bond has a deferral period of four years and final maturity is 2052
- Two £50m deferred draw index-linked (RPI) green bonds were closed in May. The bonds have deferral periods of four and five years and final maturity is 2049

We have also continued the implementation of our green bond strategy, with Tideway now being the largest corporate issuer of sterling green bonds with £775m of bonds listed on the London Stock Exchange.

As at 30 September 2018, we had received £1,274m from shareholders, which was the full commitment at Licence Award, in line with our equity-first approach to financing. This was in the form of £509.7m in equity and £764.5m of shareholder loans. Part of the shareholder loans have since been repaid and the balance at 30 September 2018 was £713m. A Restricted Payment of £30m was paid in September, comprising £28.7m interest and £1.3m repayment of the shareholders' loan.

In June 2018, we drew the first of our deferred purchase bonds, the £100m 0.688% index-linked bond maturing in 2050 and in July 2018 we drew the first tranche of the EIB loan of £80 million. Post period end, in December 2018, we drew the second deferred bond, the £100m 0.249% Index-linked Bonds due 2040.

As at 30 September 2018, we had total liquidity of £3.1bn, comprising £833m of cash, the £750m undrawn RCF, £620m undrawn under the EIB loan, £800m of bonds and a £100m loan. This, combined with expected revenue collection, provides liquidity significantly in excess of our 18-month target, including all debt requirements to System Acceptance.

Further to the issuance of the first Green Bond in November 2017, Tideway undertook to report annually on the allocation of bond proceeds and on the impact of the project. This is done through Tideway's Green Bond Report 2018, published on our website.

Both Moody's and Fitch investment grade credit ratings of Baa1 and BBB+ were affirmed during the period.

Following the successful debt raising in the period to 30 September 2018, post period end we cancelled a further £250m of our RCF in December 2018.

Historical Financial Performance

During the six month period ended 30 September 2018, the Holdco Group reported a profit of £3.2m (2017: £13.7m profit) with no dividends paid or proposed (2017: £nil). We do not consider that the reported profit in the period reflects our business performance, as it results from the movement in fair value in the Holdco Group's derivative financial instruments.

Allowable Costs

For the six month period ended 30 September 2018, our Allowable Project Spend (1) is lower than the Allowable Costs (2) as our Allowable Costs includes the timing of accruals and the unwinding of prepayments of items such as insurance contracts and the Government support Package. At 30 September 2018, costs of £1,480.2m were capitalised within the asset under construction in the Statement of Financial Position. This represents £325.3m of costs during the period and £1,154.9m brought forward from prior periods.

Direct Costs

The direct costs incurred in the period have increased compared with the same period in 2017, reflecting the increased level of construction having successfully mobilised on 20 of our 21 sites and ordered all six of our TBMs.

Indirect Costs

Indirect costs have reduced compared with 2017, reflecting cost savings from lower resources and exceptional office move costs in the previous period.

Excluded Costs

Excluded Costs (3) (on an accruals basis) for the six month period ended 30 September 2018 were £42.2m (2017: £26.5m). These comprise £41.7m of interest payable (including shareholder loans), £3.2m of costs which mainly relate to debt financing activities such as bank fees, legal advice and rating agency fees, partly offset by £2.7m interest receivable.

	Six months ended 30 September 2018			Six months ended 30 September 2017		
Analysis of costs and cash outflows, six months ended 30 September 2018, £m	**Costs**	**Timing difference**	**Cash outflows**	**Costs**	**Timing difference**	**Cash outflows**
Total allowable costs	283.1[(2)]	-44.4	238.7[(1)]	256.1	-42.9	213.2
Total excluded costs[(3)]	42.2	-4.9	37.3	26.5	24.3	50.8
Total	**325.3**	**-49.3**	**276.0**	**282.6**	**-18.6**	**264.0**
B/Fwd 31 Mar 2018	**1,154.9**					
Capitalised costs*	**1,480.2**					

Allowable Costs (£m)	Six months ended 30-Sep-18	Six months ended 30-Sep-17
Direct costs	**240.8**	**208.1**
Resources	31.6	32.3
Other indirect costs	10.7	15.7
Indirect costs	**42.3**	**48.0**
Total	**283.1**	**256.1**

(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

* Capitalised Costs is the GAAP measure and aligns to note 6 of the audited annual financial statements

Historical Financial Performance (cont.)

Cash Flow and Cash

As at 30 September 2018, the cash was £723.8m (£833m including short term deposits), which was £21.3m lower than the £745.1m cash at 30 September 2017.

The cash inflows of £153.4m (2017: £693.2m) includes financing cash flows of £180.0m (2017: £375.0m) from proceeds from new borrowings. These proceeds represent draw downs on a £100m index linked bond and £80m of the EIB loan.

The working capital inflows include £22.8m (2017: £16.2m) regulated deferred revenue received from Thames Water and £2.1m (2017: £3.4m) of other inflows including interest and other services provided to Thames Water as part of the project.

The cash outflows of £276.0m (2017: £264.0m) include £319.3m (2017: £282.4m) of investment in the construction of the TTT and £1.3m (2017: £14.2m) repayment of shareholder loan.

External Debt

At 30 September 2018, the Holdco Group's external borrowings were £1,005m. In addition, at 30 September 2018 the Holdco Group had the following undrawn debt facilities: £750m Revolving Credit Facility (RCF), £620m loan with the EIB, and £900m of deferred bonds/loans. A list of Tideway's external debt facilities can be found on page 14.

Net Cash	£m	£m
	six months ended 30 Sep 2018	**six months ended 30 Sep 2017**
Opening Balance	846.4	315.9
Proceeds from shareholder loans	0.0	179.2
Proceeds from Equity	0.0	119.4
Proceeds from Borrowings	180.0	375.0
Deferred revenue	22.8	16.2
Transfer to Short Term Deposits	-51.5	0.0
Other	2.1	3.4
Cash Inflows	**153.4**	**693.2**
Construction of the infrastructure asset	-319.3	-282.4
Working capital movement	44.6	32.6
Repayment of shareholder loan	-1.3	-14.2
Cash Outflows	**-276**	**-264.0**
Closing Balance*	**723.8**	**745.1**

** Excludes short term deposits of £109m.*

Historical Financial Performance (cont.)

Fair value measurements and valuation

Tideway has entered into long-term swaps with commercial banks to hedge the interest rate for tranches one to eight of the £700m EIB loan secured in May 2016 and £70m of the £300m US Private Placement notes secured in September 2017.

These are long-term swaps which we entered into with commercial banks to economically hedge the interest costs of the Holdco Group's debt. The swaps fix finance costs for the Holdco Group'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.

During the year, there was a negative movement of £1m in the fair market value (2017: -£20.5m) of the index-linked swaps; this was primarily driven by higher RPI expectations implied by the real and nominal GILT curves.

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.

We did not recognise any taxable profits in the period (2017/187: £nil) and therefore have no corporation tax charges (2017/18: £nil).

Liquidity and Debt Portfolio – September 2018

Liquidity – September 2018

Facility	Amount (£m)
Cash	833
Committed and undrawn debt	2,270
Total	**3,102**

Debt Portfolio - September 2018

Facility	Nominal amount	Type	Drawdown date	Maturity (CY)
Drawn				
£75m CPI + 0.828%	75	Bond	Aug-17	2047
£300m 2.86%	300	USPP Loan Note	Sep-17	2032
£250m 2.375%	250	Green Bond	Nov-17	2027
£200m CPI+ 0.74%	200	Green Bond	Nov-17	2042
£100m RPI + 0.688%	100	Bond	Jun-18	2050
£80m Tranche 1	80	EIB	Jul-18	2051
Subtotal	**1,005**			
Committed and undrawn				
RCF	750	Revolver	N/A	2025
EIB*	620	Loan	*Various 2019-2022*	2051
£100m RPI + 0.249%	100	Bond	Dec-18	2040
£100m RPI + 0.755%	100	Bond	Jun-19	2051
£125m RPI + 0.192%	125	Bond	Jul-19	2049
£100m RPI + 0.01%	100	Loan	Sep-19	2049
£25m RPI + 1.035%	25	Bond	Jun-20	2048
£50m RPI + 0.787%	50	Bond	Jun-20	2052
£25m RPI + 0.951%	25	Bond	Jun-20	2054
£25m RPI + 1.042%	25	Bond	Jun-21	2048
£25m RPI + 0.954%	25	Bond	Jun-21	2054
£150m RPI + 0.01%	150	Green Bond	Apr-22	2032
£75m CPI + 0.949%	75	Green Bond	May-22	2052
£50m RPI + 0.074%	50	Green Bond	May-22	2049
£50m RPI + 0.174%	50	Green Bond	May-23	2049
Subtotal	**2,270**			
Total	**3,275**			

**The £700m EIB loan consists of ten tranches; eight of which will be drawn in floating rate format and have been synthetically swapped with third parties (details in swap portfolio in appendix) while the remaining two tranches will be drawn in RPI linked format directly from the EIB at RPI + 0.01%.*

Ratios

We confirm that in respect of this Investor Report as of 30 September 2018, 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 13.96%

b) The FFO ICR[(2)] in respect of the relevant Test Period is equal to 5.16

c) The average FFO ICR in respect of the relevant Test Period is equal to 4.63

(together ***the Ratios***)

We confirm that the above Ratios have 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 H1 2018/19

- On 16 July 2018, Tideway announced the appointment to the Tideway Board of Mike Putnam as a new Independent Non-Executive Director.
- Mark Fairbairn who chaired Tideway's Health, Safety, Security and Environmental (HSSE) and Risk Committees since 2015 stepped down as an Independent Non-Executive Director effective 30 September 2018.
- Mike Putnam took over the chair of the Risk Committee and John Holland-Kaye assumed the chair of the HSSE Committee.

Post period end

- Mark Corben, the Chief Financial Officer, has stepped down in November 2018.
- Mathew Duncan joined the Board as Chief Financial Officer in November 2018

There have not been any other board or relevant management changes in the period.

Acquisitions and disposals H1 2018/19

There have not been any acquisitions and disposals in the period.

Current Hedging Position

The current swap portfolio can be found on slide 20 in the appendix.

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.

Mathew Duncan,

Chief Financial Officer

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

APPENDICES

Reference to the CTA

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 6-9, Investment Programme
Capital Expenditure	Pages 11-13 Historical Financial Performance
Financing	Page 10, Financing Activity Appendix
Acquisitions or Disposals	Page 16, Other Reportable Matters
Current Hedging Position	Page 16, Other Reportable Matters Appendix
Ratios	Page 15, Ratios

Swap Portfolio – September 2018

- During FY16/17 Tideway swapped tranches 1-8 of the EIB loan with various banks to index linked (RPI) format and agreed to draw tranches 9-10 in index linked format directly from the EIB
- In September 2017, Tideway swapped £70m notional of the USPP
- The swaps mature in 2030-2032 which is the beginning of Tideway's next regulatory period where the regulatory framework is expected to change to CPIH from RPI

Swap	Facility	Notional (£m)	Effective date	Swap maturity	Interest rate
Swap 1	EIB	80	Jul 2018	Mar 2030	RPI - 0.125%
Swap 2	EIB	80	Jan 2019	Mar 2030	RPI - 0.122%
Swap 3	EIB	80	Jul 2019	Mar 2030	RPI - 0.018%
Swap 4	EIB	80	Jan 2020	Jan 2031	RPI - 0.750%
Swap 5	EIB	80	Jul 2020	Jan 2031	RPI - 0.484%
Swap 6	EIB	80	Jan 2021	Jan 2031	RPI - 0.573%
Swap 7	EIB	80	Mar 2021	Jan 2032	RPI - 0.468%
Swap 8	EIB	60	Jul 2021	Jan 2032	RPI - 0.550%
Swap 9	USPP	70	Sep 2017	Mar 2030	RPI - 0.455%