Tideway - Holdco Group

Investor Report H1 2017/18

19 December 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). 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"), 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 30 September 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 six month period to 30 September 2017. 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 2017.

H1 2017/18 Highlights:

- We continue to develop our approach to transformational health, safety and wellbeing, with no major injuries
- Mobilised 17 of 21 sites, with preparations for the start of tunnelling progressing well
- Total project costs for the six month period were £282.6m, taking the total costs to September 2017 to £828.5m (all in 2014/15 prices)
- Extended our liquidity to cover the period until System Acceptance by raising £600m of additional debt (£225m RPI-linked debt, £75m CPI-linked bond and £300m US Private Placement notes) to the £1.15bn raised in the last financial year
- The growing confidence in the execution of our financing and delivery plans resulted in a downward trajectory of Tideway's credit margin during the period
- Post period-end, we priced a £250m Fixed Rate Green Bond with a maturity date of 2027 and a £200m Limited Index-linked Green Bond with a maturity date of 2042

Business Update

Health, Safety and Wellbeing

- There were no major injuries recorded during the period, which was a significant achievement, however there were three lost-time injuries, one of which resulted in over seven days lost time. We remain focussed on delivering HSW to achieve our transformational aspirations.
- With more sites mobilising during the period, our 'Rightstart' programme, which aims to reduce the number of incidents, has been essential in ensuring the implementation of identified standards designed to prevent incidents that typically occur at the start of major projects.

Vision, Legacy and Reputation

- As at the end of the period, 79% of our commitments for delivering lasting project benefits, from realising jobs and skills to keeping our carbon were on track, which is an improvement of 4% over the period. Details of our commitments can be found in our Legacy Statement, which is published on our website. Additionally, throughout the period great progress has been made across community relations, development, and volunteering.
- With on-site construction activity ramping up significantly over the period, our work to liaise with affected communities has increased. Community liaison working groups have been established at all live sites, with more than 20 meetings held in the six months from April. Additionally, community information centres are open weekly at Chambers Wharf and Carnwath Road Riverside, with one due to open at the third main drive site Kirtling Street before the end of 2017.

Company and People

- Tideway's intent to increase effectiveness and improve decision-making is being supported through the roll-out of the Tideway Operating Model that clarifies the roles of the Client (BTL), Project Manager (CH2M) and Main Works Contractors. This has led to some organisational changes to realign activities to the appropriate part of the organisation.
- Gender diversity is a key objective for Tideway with female staff currently representing 36% of headcount.
- The head office move was successfully conducted at the end of October. The new office will facilitate increased collaboration between individuals and teams as well as improving movement to sites along the river by improved proximity to drive sites.

Delivery Overview

- **General**
  - Mobilised in 17 out of 21 sites, with two additional sites mobilised in November
  - 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**
  - Five of the seven sites are successfully mobilised, with King George's Park and Acton Storm Tanks mobilised in November 2017
  - Tunnel Boring Machine (TBM) has passed factory acceptance testing and was delivered late November
  - At Carnwath Road Riverside main drive site, commenced riverwall strengthening and site infrastructure, including piling and completion with the main shaft excavation
  - Shaft and culvert piling works are complete at Hammersmith Pumping Station
- **Central**
  - Six of the eight sites are successfully mobilised, and both TBMs ordered are under construction
  - At the Kirtling Street main drive site, the diaphragm walling for the shaft was completed. In addition, the excavation of the shaft has started with soil being taken by river, main jetty construction is underway to support TBM arrival by river, and the acoustic shed has been built
  - Commenced work on Blackfriars Combined Sewer Overflow (CSO) interception
- **East**
  - All six sites have now been mobilised
  - Chambers Wharf cofferdam has been completed and the diaphragm walling has commenced
  - Cofferdam construction at King Edward Memorial Park Foreshore has begun and is ahead of schedule
  - Detailed design of the TBM is nearing completion

TBM Rachel making her journey to Carnwath Road by river

TBM Rachel arrived at Carnwath Road

Carnwath Road construction site

Financing Activity

During the six month period ended 30 September 2017, we continued to de-risk our financing plan by raising £600m of new term debt, further increasing our liquidity position and locking in financing costs:

- A 30-year £100m deferred draw index-linked loan was closed in April
- A 15-year £300m US Private Placement was priced in June and funded in September
- A 32-year £125m deferred draw index-linked bond was priced in July
- A 30-year £75m CPI linked bond was priced and drawn in August

As at 30 September 2017, the balance of shareholder equity was £489.8m and shareholder loan was £694.3m, which include the injection of £119.4m in shareholder equity and £179.2m drawn on the shareholder loan in the six month period, as well as £14.2m repayment of principal on 30 September 2017

As at 30 September 2017, we had total liquidity in excess of £3.15bn, comprising £0.7bn of cash, £0.05bn of committed and undrawn capital from shareholders and £2.375bn committed and undrawn debt

Post period-end, we priced a £250m Fixed Rate Green Bond with a maturity date of 2027 and a £200m Limited Index-linked Green Bond with a maturity date of 2042

Historical Financial Performance

During the six months period ended 30 September 2017, Tideway reported a profit of £13.7m (2016/17: £30.3m loss) with no dividends paid or proposed (2016/17: £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 financial instruments.

Allowable Costs

For the six months period ended 30 September 2017, our Allowable Project Spend(1) is 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 Government Support Package (GSP). At 30 September 2017, costs of £828.5m were capitalised within the asset under construction in the Statement of Financial Position within the accounts. This represents £282.6m of costs during the period and £545.9m brought forward from prior periods.

Direct Costs

Direct costs are primarily the Main Works Contract costs. They also include the system integrator contract. The direct costs incurred in the period have increased significantly compared with 2016, reflecting the commencement of construction activities.

Indirect Costs

The largest Indirect cost is resource costs of £32.3m (2016: £29.9m) which includes the staff cost of those employed directly by the Holdco Group or through framework contracts and the resource costs of our Project Manager CH2M. Other Indirect Costs include non-resource costs such as information systems, office, insurance and third party payments.

Excluded Costs

The Excluded Costs(3) to 30 September 2017 were £26.5m (2016: £17.1m) which largely reflects financing costs such as interest on shareholder loans and costs related to the Holdco Group's debt financing activities such as bank fees, legal advice and rating agency fees.

Analysis of costs and cash outflows, six months ended 30 September 2017	Costs £m	Timing differences £m	Cash outflows £m
Total allowable costs	256.1	(42.9)	213.3
Total excluded costs	26.5	10.1	36.6
Total	**282.6**	**(32.8)**	**249.8**
B/Fwd 31 Mar 2017	**545.9**		
Capitalised Costs*	**828.5**		

Allowable costs, six months ended 30 September 2017	£m
Direct costs	**208.1**
Resources	32.3
Other indirect costs	15.7
Indirect costs	**48.0**
Total	**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 4 of the condensed interim financial statements

Historical Financial Performance (cont.)

Fair value measurements and valuation

BTL 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. 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.

Post period-end BTL entered into £70m inflation linked swaps to partly hedge the US Private Placement notes. Movements in fair value of these swaps have not been accounted for in the Financial Statements for the period.

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 (2016: £nil) and the estimated current tax charge for the period is £nil (2016: £nil).

Cash flow

During the period Tideway received equity and loans from its shareholders totalling £298.4m, and collected £19.6m in revenue, including £16.2m regulated revenue received from Thames Water and £3.4m of other inflows including interest and other services provided to Thames Water.

Drawdowns on the US Private Placement notes and the CPI-linked bond resulted in £375.0m cash inflow.

Investing activities represented the main cash outflow, including £282.4m for the construction of the tunnel partially offset by working capital movements of £32m driven by the significant increase in direct costs.

£14.2m of principal of the shareholders loans was repaid in September.

External Debt

At 30 September 2017 the Holdco Group held external debt of £375.2m (2016: £nil). In addition, the Holdco Group had £2,375m undrawn debt facilities.

Net Cash, six months ended 30 Sep 2017	£m
Net proceeds from shareholder loans and equity	284.4
Revenue	16.2
Other and transfer from/(to) short term deposits	3.4
Proceeds from new borrowings	375.0
Cash Inflows	**679.0**
Construction of the tunnel asset	(282.4)
Working capital movements	32.6
Cash Outflows	**(249.8)**
Change in Net Cash from cash flows	**429.2**
Change in Debt	**(375.2)**
Change in Net Cash	**54.0**

Liquidity and Debt Portfolio – 30 September 2017

Liquidity

Facility	Amount (£m)
Cash	745
Committed equity	50
Committed and undrawn debt	2,375
Total	**3,170**

Debt portfolio

Facility	Nominal amount outstanding or committed (£m)	Type	Drawdown date	Maturity (CY)
RCF	1,000	Revolver	N/A	2025
EIB[(1)]	700	Loan	*Various 2018-2023*	2051
£25m RPI + 1.035%	25	Bond	Jun 2020	2048
£25m RPI + 1.042%	25	Bond	Jun 2021	2048
£25m RPI + 0.951%	25	Bond	Jun 2020	2054
£25m RPI + 0.954%	25	Bond	Jun 2021	2054
£100m RPI + 0.688%	100	Bond	Jun 2018	2050
£100m RPI + 0.755%	100	Bond	Jun 2019	2051
£50m RPI + 0.787%	50	Bond	Jun 2020	2052
£100m RPI + 0.249%	100	Bond	Dec 2018	2040
£100m RPI + 0.01%	100	Loan	Sep 2019	2049
£125m RPI + 0.192%	125	Bond	Jul 2019	2049
£300m 2.86%[(2)]	300	USPP Loan Note	Sep 2017	2032
£75m CPI + 0.828%[(2)]	75	Bond	Aug 2017	2047
Total	**2,750**			

(1) 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 the appendices) while the remaining two tranches will be drawn in RPI linked format directly from the EIB at RPI + 0.01%

(2) Debt drawn during the six months period ended 30 September 2017

Ratios

We confirm that in respect of this Investor Report as at 30 September 2017 (being the Test Date), 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 July 2017 John Holland-Kaye, the Chief Executive Officer of Heathrow Airport Holdings, joined as a Non-Executive Director.

In November 2017 Mark Corben, the Chief Financial Officer, announced that he will step down in 2018.

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

Acquisitions and disposals

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

Current Hedging Position

The current swap portfolio can be found on slide 15 in the appendices.

Post period-end BTL entered into £70m inflation linked swaps to partly hedge the US Private Placement notes.

Confirmation

We confirm that:

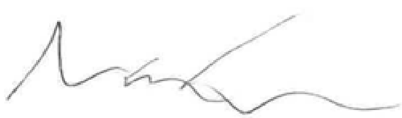
a) no Default or Trigger Event has occurred and is continuing;

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

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, Investment Programme
Capital Expenditure	Pages 8-9, Historical Financial Performance
Financing	Page 7, Financing Activity Page 10, Liquidity and Debt Portfolio - 30 September 2017
Acquisitions or Disposals	Page 12, Other Reportable Matters
Current Hedging Position	Page 12, Other Reportable Matters Page 16, Swap Portfolio - 30 September 2017
Ratios	Page 11, Ratios

Swap Portfolio – 30 September 2017

- 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
- The swaps mature in 2030-2032 which is the beginning of Tideway's next regulatory period where the regulatory framework is scheduled 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%