



Tideway

Tideway HoldCo Group Investor report

11 July 2016

Notice

IMPORTANT NOTICE

This Investor Report is being distributed by Bazalgette Tunnel Limited (as 'Holdco Group Agent') on behalf of the Holdco Group pursuant to the Common Terms Agreement.

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 Tunnel Limited. This Investor Report comments on the historical financial performance of the Holdco Group for the period up to 31 March 2016.

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

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Key facts about Tideway

- The Thames Tideway Tunnel will be a major new sewer, which is urgently needed to protect the tidal River Thames from pollution
- Health, safety and the wellbeing of our people and the public are paramount – we intend to work safely or not at all
- It is being delivered by Tideway, a newly created regulated company
- We are working closely with our local stakeholders in delivering the tunnel
- The tunnel is being financed by the private sector, giving more than 1.7 million UK pensioners an indirect investment in Tideway
- We aim to deliver the project to the right quality, ahead of time and below budget, for the benefit of the environment, local stakeholders, Thames Water's bill payers, and investors
- The tunnel is the largest project in the water sector since the construction of Sir Joseph Bazalgette's interceptor sewers in the 1860s

Route of the tunnel



Map key

- | | | | | |
|------------------------------------|--------------------------|-------------------------------|----------------------------------|--|
| Main tunnel drive tunnel site | Main tunnel | 1 Acton Storm Tanks | 9 Cremorne Wharf Depot | 17 Chambers Wharf |
| Main tunnel reception site | Connection Tunnels | 2 Hammersmith Pumping Station | 10 Chelsea Embankment Foreshore | 18 Earl Pumping Station |
| CSO site | Lee Tunnel | 3 Barn Elms | 11 Kirtling Street | 19 Deptford Church Street |
| Short connection tunnel drive site | Proposed drive direction | 4 Putney Embankment Foreshore | 12 Heathwall Pumping Station | 20 Greenwich Pumping Station |
| Long connection tunnel drive site | West works site | 5 Domay Street | 13 Albert Embankment Foreshore | 21 King Edward Memorial Park Foreshore |
| System modifications | Central works sites | 6 King George's Park | 14 Victoria Embankment Foreshore | 22 Bekesbourne Street |
| | East works site | 7 Carnwath Road Riverside | 15 Blackfriars Bridge Foreshore | 23 Abbey Mills Pumping Station |
| | | 8 Falconbrook Pumping Station | 16 Shad Thames Pumping Station | 24 Beckton Sewage Treatment Works |

Vision and strategy

- Our vision is reconnecting London, and Londoners, with the River Thames.
- We have developed the following strategy to deliver our objectives:

Health, Safety and Wellbeing

We are targeting zero fatalities or serious injuries, off-site or on-site. We will achieve this by setting new standards for health, safety and wellbeing (HSW). This is the right thing to do for those involved, as well as improving productivity and reducing the chance of delays or stoppages.

Company and People

A high-performing, motivated and engaged workforce will deliver better value and help us recruit and retain people.

Schedule Cost & Quality

We want to deliver the Thames Tideway Tunnel safely and at the earliest time. Finishing earlier will reduce cost, benefiting bill payers and investors, and deliver environmental benefits more quickly.

Financing

We aim to deliver efficient financing and financial risk management, which minimises our cost of capital and supports our investment grade credit rating.

Vision, Legacy & Reputation

We want to create a supportive environment for delivering the tunnel and build a positive reputation with our stakeholders. Looking after our neighbours and stakeholders reduces the scope for delays, so we can deliver the tunnel's benefits as soon as possible.

Overview

This Investor Report provides an update of Tideway's activities for the period from Licence Award in August 2015 to the end of the financial year on 31 March 2016. It covers in particular business, regulatory and financing developments.

Key Developments in 2015/16

- Established the largest new regulated water company since the industry's privatisation and secured £2.3bn of capital. Licence awarded by Ofwat in August 2015
- Established a clear vision and values, reflecting the legacy we aim to leave for London. "Reconnecting London, and Londoners, with the River Thames"
- Established our transformational health, safety and wellbeing programme. No injuries or lost time incidents in 2015/16. Industry recognition for our Employee Project Induction Centre programme – innovative training designed to ensure we work safely, with over 2,500 employees, contractors and other stakeholders attending
- Formed the Tideway Alliance and started delivery. Incentive framework established for all delivery partners to work together collaboratively. Started work in West, Central and East areas, with the delivery schedule on track
- Had our first Revenue Statement submission accepted by Ofwat and following year end received our first payment from Thames Water's wastewater customers
- Community Liaison Working Groups launched. Actively developing relationships with our neighbours – more than 20 meetings held across the West, Central and East areas
- Financing locked-in after year end: secured a £700m EIB loan and £350m delayed drawdown bond issues

Business update

Health, Safety and Wellbeing

- We are pleased to report that we did not have any significant incidents during the period. We introduced a new health, safety and wellbeing strategy, “Right Way”
- In late summer 2015, we established the Transforming Health and Safety Group (THSG). This group looks at how we can make a difference to on-site activities through staff and operatives involved in the day-to-day leadership of health and safety, with appropriate support and challenge from senior management
- As part of the first stages of the transformational HSW programme, this year we established the Employee Project Induction Centre (EPIC). To the end of March 2016 2,549 employees and contractors from 150 different organisations have attended the course

Regulation

- On 24 August 2015 Ofwat granted Tideway its Licence
- In the Water 2020 decision document published by Ofwat in May 2016, it is specifically stated that Tideway will retain RPI to 2030 and that Ofwat will consider transitioning Tideway to RPI post-2030 in accordance with the approach adopted for wholesale activities

Vision, Legacy and Reputation

- Establishing Tideway’s vision and identity was a key part of our work this year. Our vision of “Reconnecting London, and Londoners, with the River Thames” defines what we want to achieve
- Engaging communities and stakeholders is a key priority. The quarterly Thames Tideway Tunnel Forum is independently chaired and has brought together officer representatives of the directly affected London boroughs and other statutory consultees since 2008. Now with a number of sub groups, it is a very effective way of exchanging information and creating a consensus on project-wide issues in a timely and cost-efficient manner. Also, in the past year Tideway held more than 20 Community Liaison Working Group meetings for the three main sites, with a number of further smaller meetings for specific residents
- Tideway aims to leave lasting benefits for London and our legacy programme will make this aspiration a reality. The Tideway Alliance has developed a Skills and Employment Plan, together with a more wide-reaching Legacy Plan. This defines our commitments under five themes - Environment, Health and Safety, Economy, People and Place

Our delivery plan

- Working closely with our contractors, we developed plans to unlock opportunities to de-risk the delivery of the tunnel against the regulatory baseline schedule and complete the tunnel at the earliest, safe time. The ambition of starting tunnelling earlier and subsequently handing over the tunnel earlier should de-risk the programme and drive cost savings against the regulatory baseline of £3.1bn, benefiting both investors and Thames Water’s customers, as well as delivering environmental benefits sooner and reducing community disruption
- Our first site works began in December 2015, ahead of schedule, with the works at Blackfriars to relocate the Millennium Pier
- After year end and in support of our earlier schedule ambitions, we have mobilised early on each of our three main tunnel drive sites, with the establishment of offices and facilities, site surveys and investigations, and some temporary works. These activities should allow the early commencement of main construction works later in the year



Financing activity

- At licence award in August 2015, Tideway's shareholders committed £1.3bn of capital in the form of equity (40%) and shareholder loans (60%). Tideway also entered into a £1bn, 10 year revolving credit facility (RCF) with a consortium of six banks. This facility remained undrawn over the year
- Following licence award, the Group received an investment grade credit rating of Baa1 from Moody's and the RCF was rated BBB+ by Fitch
- As at 31 March 2016, a net £342.5m was received from shareholders. This was in the form of £138.3m of equity and £204.2m of net shareholder loans
- At 31 March 2016, we had total liquidity in excess of £2bn, comprising £0.1bn of cash, £0.9bn of committed and undrawn capital from shareholders and the £1bn undrawn RCF. This provides liquidity significantly in excess of our 18 months target
- In May Tideway published its first Prospectus, and Moody's and Fitch assigned Baa1 and BBB+ credit ratings to our financing vehicle Bazalgette Finance plc
- Post year end we have entered into financing transactions which further improve our liquidity and help lock-in financing costs
 - On 12 May we closed a £700m 35-year loan with the EIB;
 - On 2 June we issued four index-linked bonds totalling £100m. The bonds have got deferred purchase dates of June 2020 and June 2021, and maturity dates of 2048 and 2054. These bonds have been assigned Baa1 and BBB+ credit ratings.
 - On 15 June we issued three index-linked bonds totalling £250m. The bonds have got deferred purchase dates of June 2018, June 2019, and June 2020; and maturity dates of 2050, 2051 and 2052, respectively. These bonds have been assigned Baa1 and BBB+ credit ratings.

Historical financial performance

- Tideway capitalises costs that meet the capitalisation criteria for assets under construction and revenue is reported as deferred income during the construction phase
 - During the period £161.2m of costs were capitalised as “Asset under Construction” within the Statement of Financial Position. These include £118.9m of allowable costs and £42.3m of excluded costs

Main works costs

- The main works contract costs are split between three regional contracts, West, Central and East, for the design and construction of the main tunnel. All three main works contracts are based on the New Engineering Contract (NEC3) Option C Target Price with Activity Schedule terms and conditions. The costs incurred in the period include contractors’ staff, design, consents and preliminary costs to support the “Right Start” readiness and mobilisation at the three main drive sites

Other direct costs

- The other direct costs of £14.1m mainly consist of £10.8m of marine vessel relocation and design costs. These costs relate to a contract with VolkerStevin Ltd to provide services and works for the removal and replacement of piers and the relocation of marine vessels. Also within other direct costs are £1.7m of third party costs for the management, monitoring and mitigation of the impact of construction on third parties

Indirect costs

- The largest indirect cost is the resource costs of £31.1m. This represents the cost to employ the circa 400 FTEs either employed or contracted by the Company. The other indirect costs include information systems, insurance, payment for the GSP, office and other running costs

Analysis of costs and cash outflows	Costs £m	Timing differences £m	Cash outflows £m
Direct costs	69.0	(11.6)	57.4
Indirect costs	49.9	43.0	92.9
Total allowable costs	118.9	31.4	150.3
Total excluded costs	42.3	19.5	61.8
Total	161.2	50.9	212.1

Allowable costs	£m
Main works costs	54.9
Other direct costs	14.1
Direct costs	69.0
Resources	31.1
Other indirect costs	18.8
Indirect costs	49.9
Total	118.9

Historical financial performance (cont.)

- During the period ended 31 March 2016, Tideway reported a profit of £nil and no dividends were paid or proposed. Tideway did not recognise any taxable profits in the period and has no corporation tax liability
- Tideway's regulatory capital value was zero at licence award. On 31 March 2016, it was £151.3m
- During the period Tideway received funds of £342.5m from shareholder injections. This was in the form of equity (£138.3m) and net shareholder loans (£204.2m). The cash outflows of £212.1m included £160.3m related to the delivery of our investment programme. The balance of £51.8m reflects working capital movements
- In order to provide a return to its shareholders during the construction period, Tideway makes distributions through payment of interest and repayment of principal on its shareholder loans. These payments are set to provide a sustainable growth profile, while maintaining an appropriate headroom to our financing covenants over the construction period. In March 2016, £10.5m was distributed to our shareholders via interest and repayment of principal
- Post period end, Tideway received the following shareholder injections:
 - £107.1m on April 1st, in the form of £42.8m equity and £64.3m of shareholder loans; and
 - £111.6m on July 1st, in the form of £44.7m equity and £66.9m of shareholder loans

Ratios

We confirm that in respect of this Investor Report dated 11 July 2016, 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 Common Terms Agreement (the Agreement):

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

Other reportable matters

Significant management and board changes

- In March 2016, the Board appointed one Non-Executive Director, Moira Turnbull-Fox, to replace Andrew Freeman as the DIF Shareholder Director
- On 2 January 2015 Celia Carlisle, General Counsel, and Julie Thornton, Head of Human Resources, joined the Executive Committee
- On 29 June 2015 Steve Howells resigned as Head of HSSE, and was replaced by Stuart Pollard. On 6 June 2016 Steve Hails was appointed as HSW Director and member of the Executive Committee
- Other than those outlined above, there have not been any other board or relevant management changes since Licence Award

Acquisitions and disposals

- We confirm that we have not made any material acquisition or disposal

Current Hedging Position

- As of 31 March 2016, none of the Holdco Group companies had entered into any hedging transaction
- Post year-end the group entered into hedging transactions to lock-in the cost for the period to 2030 on a RPI basis of £240m notional value of the EIB loan

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 Common Terms Agreement.

Mark Corben,

A handwritten signature in black ink, appearing to read 'Mark Corben', written in a cursive style.

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 7, Overview
Regulatory and business update	Page 7, Overview Page 8, Business Update
Capital Expenditure	Page 11, Historical Financial Performance
Financing	Page 10, Financing Activity
Acquisitions or Disposals	Page 14, Other Reportable Matters
Current Hedging Position	Page 14, Other Reportable Matters
Ratios	Page 13, Ratios