Senior Term Loan Facility Agreement

Actual Construction Period Cash Flow Test

For the period:
1 October 2016 to 31 December 2016

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Actual Construction Period Cash Flow Test

Background

Mercia has a Waste Management Services Contract ("WMSC") with the Councils. Mercia secured planning consent for a new facility and re-negotiated the WMSC for the design, construction and operation of an Energy from Waste ("EfW") plant over the remainder of the WMSC, due to expire in 2023. Financial close was reached in May 2014.

In order to ensure the funding solution demonstrated Value for Money ("VfM"), the Councils used their Prudential borrowing powers to debt fund Mercia's EfW Plant.

Based on a capital structure of 85% debt and 15% equity, the Councils issued a senior loan facility.

Within the Senior Term Loan Facility Agreement ("STLFA"), the Councils included an Actual Construction Period Cash Flow Test ("ACPCFT"). This test is carried out on a quarterly basis following financial close (the first quarter ending 30 September 2014) and is used to determine whether:

"*Actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds… the amount of Operating Cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the Base Case Financial Model*."

Should a shortfall occur, Mercia will be required to remedy this shortfall by means of an equity injection equal to the amount of the shortfall in accordance with the contractual documentation.

Mercia operate the local council recycling collections and the landfill site, as well as the construction of the new EfW plant.

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

Scope of review

Deloitte has reviewed the calculation provided by Mercia for the ACPCFT. In doing so Deloitte has:

- Agreed the terms of the calculation to the STLFA;
- Agreed the "model" Operating Cash generated during the period to the Base Case Financial Model;
- Agreed the actual Operating Cash generated during the period to management information;
- Re-performed the calculation of the ACPCFT; and
- Compared the senior term loan facility draw downs against those forecast in the Base Case Financial Model.

We have not received any technical reports for the period 1 October 2016 to 31 December 2016.

Summary of results

The result of the ACPCFT performed by Mercia for the period under review is an Excess Cash Flow amount as at 31 December 2016 of £3,186k, which has increased by £2,135k from the Cash Flow flow test in the previous period.

This shows that from 1 May 2014 to 31 December 2016, the operations have produced £3,186k more than was forecast in the Base Case Financial Model, which is a further increase in Excess Cash Flow from Q1 2016, following four consecutive periods of under-performance against the modelled forecast, up to and including Q4 2015.

Based on the above, the ACPCFT for the quarterly period under review would be satisfied. In completing our work set out above, we have not identified any inconsistencies between Mercia's calculation and the underlying information.

Calculation

Actual Construction Period Cash Flow Test

Metric (£000)	May – Sep 14	Oct – Dec 14	Jan - Mar 15	Apr - Jun 15	Jul - Sep 15	Oct - Dec 15	Jan - Mar 16	Apr - Jun 16	Jul - Sep 16	Sep - Dec 16
Base case financial model										
b/f cash attributable to Ops	4,254	4,793	7,051	9,123	11,246	13,203	15,388	17,482	19,801	22,115
Gross revenue	18,603	10,448	10,847	11,813	12,374	10,627	11,140	12,046	12,640	10,861
Operating costs	(14,893)	(8,111)	(8,320)	(8,961)	(9,253)	(8,590)	(8,821)	(9,439)	(9,671)	(8,775)
Changes in working capital	(1,212)	320	(18)	(252)	(37)	451	138	134	(216)	359
Cell preparation assets	(612)	0	0	0	(632)	0	0	0	0	0
Corporation tax	(1,346)	(400)	(437)	(477)	(494)	(303)	(363)	(423)	(439)	(318)
Total change	**539**	**2,258**	**2,072**	**2,122**	**1,957**	**2,185**	**2,094**	**2,319**	**2,314**	**2,127**
c/f cash attributable to Ops	**4,793**	**7,051**	**9,123**	**11,246**	**13,203**	**15,388**	**17,482**	**19,801**	**22,115**	**24,242**
Actuals										
b/f cash attributable to Ops	4,637	6,480	11,674	10,423	12,333	14,218	15,655	17,860	20,197	23,165
Gross revenue	19,688	13,341	10,578	11,929	12,091	10,523	11,091	13,078	12,487	8,991
Operating costs	(15,557)	(8,588)	(8,509)	(9,372)	(9,682)	(8,916)	(9,245)	(9,812)	(9,847)	(6,409)
Changes in working capital	(1,392)	1,363	(3,018)	(171)	(131)	(341)	358	(928)	332	1,683
Cell preparation assets	(333)	(286)	0	0	(189)	0	0	0	0	0
Corporation tax	(563)	(636)	(302)	(476)	(204)	171	0	0	(4)	(3)
Total change	**1,843**	**5,194**	**(1,252)**	**1,910**	**1,885**	**1,437**	**2,204**	**2,338**	**2,968**	**4,262**
c/f cash attributable to Ops	**6,480**	**11,674**	**10,423**	**12,333**	**14,218**	**15,655**	**17,860**	**20,197**	**23,165**	**27,428**
Variance	**1,304**	**2,936**	**(3,324)**	**(212)**	**(72)**	**(748)**	**110**	**20**	**654**	**2,135**
Excess cash flow a/c b/f	383	1,687	4,623	1,299	1,087	1,015	267	377	396	1,050
Excess cash flow a/c c/f	**1,687**	**4,623**	**1,299**	**1,087**	**1,015**	**267**	**377**	**397**	**1,050**	**3,186**

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

Commentary

Summary

- The calculation is the result of a methodology agreed between parties (the Councils and Mercia) as per the STLFA signed on 21 May 2014.
- The outcome of the ACPCFT performed by Mercia for the quarter under review is an Excess Cash Flow amount of £3,186k.
- In the period from 1 May 2014 to 31 December 2016, the operations have produced £3,186k more Excess Cash Flow than was forecast for this period in the Base Case Financial Model.
- We note that in the period there has been an over performance against the Base Case Financial Model of £2,135k, following four consecutive periods of under-performance against the modelled forecast up to and including Q4 2015.
- Based on the above, the ACPCFT for the period under review is satisfied. We have not identified any inconsistencies between Mercia's calculation and the underlying information.
- Following four consecutive quarterly periods of under-performance against the modelled forecast, it has been noted that there has now been four successive quarters of over-performance, with an increase in Excess Cash Flow of £2,135k in Q4 2016 following an increase of £654k in the previous quarter.
- Despite revenue falling short of expectation by £1,869k (£8,991k vs. £10,861k), that was more than made up for by positive performance in both operating costs (£2,366k below expectations) and favourable working capital movements (£1,324k better than expectations). Corporation tax has also performed better than expected, with a £3k charge comparing favourably to an expected £318k charge. Combined, these have led to the Excess Cash Flow total of £2,135k.
- From a discussion with Mercia on 20 February 2017, the under performance of revenue and lower operating costs reflects a diversion of materials to the EfW site in order to support commissioning activities. This means lower landfill tax, which goes through both the cost (when Mercia pay the tax) and revenue lines (when it is recharged to Mercia's customers).

Revenue and operating costs down against modelled forecast

- We note that for the quarter under consideration, revenue actuals were 17% below the modelled forecast, and operating costs 27% below the modelled forecast.
- Under performance of revenue has been driven by increasing tonnage being diverted to the EfW plant to support the requisite commissioning activities, which have been ramped up at a greater rate than forecasted.
- The EfW site began commissioning activities in Q3 2016, with minimal volumes diverted from landfill. This continued at a greater level through Q4, and is expected to continue, albeit levelling off, in subsequent quarters. Therefore the depressed revenue and cost lines from landfill will continue into future quarters.

Changes in working capital and corporation tax

- The increase in the Excess Cash Flow amount has been principally driven by favourable movements in Operating Costs and working capital, and the position achieved in respect of corporation tax.
- The favourable movement in working capital in the period is largely a reflection of decreasing trade debtors compared to the modelled forecast (£3,312k vs. £593k), predominantly due to the lack of a landfill tax debtor from customers (see above).
- The favourable position with regards to the Corporation Tax relates to two elements: firstly capitalised interest, which is tax deductible, wasn't forecasted in the model. Secondly, Mercia is adopting a different position on capital allowances, depreciating over a shorter period than was initially forecasted. The second of these elements will balance out over the length of the project.

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

Commentary (continued)

ACPCFT trend

- It has been noted that whilst the Excess Cash Flow amount is still positive at £3,186k (an increase of £2,135k from the previous period), prior to Q1 2016 there were four consecutive periods of under-performance against the modelled forecast (i.e. a negative variance of actuals against the model).
- Mercia stated that there were no significant movements in the pricing of recyclable materials during the period, though Deloitte has not validated this.
- Equally, the recyclable volumes have continued to hold steady; a trend that is expected to continue. Deloitte has not validated this.
- As a result of these factors, operational improvements and the Deed of Rectification, Mercia is projecting a stable or increased Excess Cash Flow Account for the next quarter.
- In any case, should the ACPCFT be failed in subsequent quarters, the process to resolve this has been extracted and included in Appendix 2.

Senior Term Facility Loan draw downs

Actuals vs Forecast in the Financial Model

The table below shows the actual Senior Term Facility Loan draw downs against those forecast in the financial model.

Model	May - Sep 14	Oct - Dec 14	Jan - Mar 15	Apr - Jun 15	Jul - Sep 15	Oct - Dec 15	Jan - Mar 16	Apr - Jun 16	Jul - Sept 16	Oct - Dec 16	Cumulative
Model											
Facility A	5,241	2,341	1,725	5,633	3,205	4,249	2,355	2,448	861	551	**28,609**
Facility B	18,898	8,426	6,190	20,288	11,490	15,241	8,382	8,699	2,957	1,832	**102,404**
Total	**24,139**	**10,767**	**7,915**	**25,921**	**14,695**	**19,490**	**10,737**	**11,147**	**3,818**	**2,383**	**131,013**
Actual											
Facility A	4,576	-	1,713	2,375	3,289	4,746	5,180	5,626	-	2,021	**29,527**
Facility B	16,532	-	6,187	8,581	11,883	17,145	18,715	20,324	-	7,300	**106,666**
Total	**21,108**	**-**	**7,900**	**10,956**	**15,172**	**21,891**	**23,895**	**25,950**	**-**	**9,321**	**136,193**
Difference	**(3,031)**	**(10,767)**	**(15)**	**(14,965)**	**477**	**2,401**	**13,158**	**14,803**	**(3,818)**	**6,937**	**5,180**

Facility A is the amortising loan. Capital repayments begin in the quarter ending 30 June 2017 following the end of the construction period. Facility B is the bullet loan which is forecast to be repaid in the quarter ending 31 December 2023.

From discussions with Mercia management, the lack of a draw down in the quarters 1 October 2014 to 31 December 2014 and 1 July 2016 to 30 September 2016 reflects both a delay in the EfW build (meaning less cash was required for the EfW build) and the lower-than-expected capital expenditure in non-EfW build (meaning that more of the cash can be used on the EfW build). Overall the actual loan drawdowns are still expected to match those forecast in the model.

From discussions with Mercia management, the draw downs against the facilities are higher in Q4 2016 compared to the modelled forecast as a result of timing differences between the programme and the milestones assumed in the model. As such there has been an increase in draw downs compared to the modelled forecasts.

Source: Mercia; Financial Model

Appendix 1

Mercia's calculation (£000)

	1 Oct 16 to 31 Dec 16 ACTUAL	1 Oct 16 to 31 Dec 16 MODEL
Profit Before Depreciation and Tax	**2,582**	**2,086**
Working Capital Movement (Operating)	**1,683**	**359**
Corporation Tax (Cash)	-3	-318
Operating Cash Flow	**4,262**	**2,127**

Excess Cash Flow	**1 Oct to 31 Dec 2016**		
	Actual	Model	Var
Operating Cash Opening Balance	23,166	22,116	1,050
Operating Cash Flow (as above)	4,262	2,127	2,135
Operating Cash Closing Balance	**27,428**	**24,242**	**3,186**

Mercia's cash flow notice

Excess Cash – Opening Balance (Sep 2016)	*1,050*
Gross Revenue	*-1,869*
Operating Costs	*+2,365*
Changes in Working Capital	*+1,325*
Corporation Tax	*+315*
Total	*+2,136*
Excess Cash – Closing Balance (Dec 2016)	*3,186*

Source: Mercia; Mercia also provided the workings behind this calculation so that the calculation could be reconciled to the company's trial balance and so it could be presented in a manner mirroring the description in the Senior Term Loan Facilities Agreement (see page 4).

Appendix 2

Extracts from Senior Term Loan Facility Agreement

"**Actual Construction Period Cash Flow Test**" means the quarterly test to be carried out on each Actual Construction Period Cash Flow Testing Date, in relation to the preceding quarter to determine whether: actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds the amount of Operating Cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the Base Case Financial Model;

"**Actual Construction Period Cash Flow Testing Date**" means each Quarter Date following Financial Close, up to and including Completion;

"**Actual Construction Period Cash Flow Shortfall**" has the meaning given to it in clause 15.9 (Actual Construction Cash Flow Test);

"**Actual Construction Period Cash Flow Remedy Amount**" means the minimum amount necessary following a failure by the Borrower of the Actual Construction Period Cash Flow Test, to pass such test;

"**Actual Construction Period Excess Cash Flow Amount**" means the amount of Operating Cash generated in any quarter during the Construction Period which is greater than the amount required to satisfy the Actual Construction Period Cash Flow Test; and

"**Base Cash Financial Model**" means the computer model, agreed between the Lenders and the Borrower at Financial Close, as amended from time to time by agreement between the Lenders and the Borrower and delivered pursuant to paragraph 11.1 (Part I – Initial Conditions Precedent) of Schedule 3;

"**Current Assets**" means:

a) cash held by the Borrower;
b) any balance on the Debt Service Reserve Account;
c) any balance on the Maintenance Reserve Account;
d) any prepayments received;
e) amounts owed to the Borrower and/or the amounts of any accounts receivable (in each case from trade debtors or HMRC in respect of VAT);
f) amounts in respect of deferred taxes;
g) inventory; and
h) any cell preparation assets.

"**Current Liabilities**" means:

a) amounts owed by the Borrower and/or the amounts of any accounts payable (in each case to trade creditors or HMRC in respect of National Insurance and VAT);
b) the amount of any accruals or provisions made;
c) the amount of any deferred tax liability;
d) any cell restoration liabilities;
e) any aftercare liabilities; and
f) liabilities in respect of Corporation Tax

Source: Senior Term Loan Facility Agreement

Appendix 2 (continued)

Extracts from Senior Term Loan Facility Agreement

"**Gross Revenue**" means, at any Ratio Testing Date and without double counting, the sum of:

a) operating revenue including the Unitary Payment, any interim service payments (if applicable) and any actual or guaranteed third party income, but excluding, for the avoidance of doubt, the Bullet Payment;
b) interest earned on all cash accounts (other than the Distribution Account);
c) damages;
d) insurance Proceeds to the extent received as compensation for loss of revenue;
e) income earned on Authorised Investments (other than any Authorised Investments in respect of the Distribution Account, if any);
f) rebates of Tax actually received or projected to be received in the latest Approved Budget; and
g) all other income or proceeds of a revenue nature from whatever source;

Assumed in the Approved Financial Model to be receivable by the Borrower in the period commencing with such Ratio Testing Date and terminating on the Final Repayment Date or, in respect of any Ratio Testing Period ended on that Ratio Testing Date, all such revenues actually received during such Ratio Testing Period;

"**Operating Cash**" means:

a) gross Revenue; less
b) operating costs; plus or minus
c) changes in Working Capital; less
d) corporation Tax.

In each case, in respect of the Financial Year, as reflected in the operating cash flow calculation in the Approved Financial Model;

"**Working Capital**" means Current Assets minus Current Liabilities

Source: Senior Term Loan Facility Agreement

"Operating Costs" means, without double counting any of those costs, and including any VAT thereon, costs identified as, or as the case may be, falling within the category of:

a) costs and expenses of administering, maintaining and operating the Borrower, SWSL and BWL and the Project including, without limitation, all operating costs accrued prior to, or arising after Financial Close relating to the Borrower's, SWSL's and BWL's existing operations under, or related to, the Waste Management Services Contract all costs relating to Environmental Matters and the costs of complying with the requirements of Environmental Laws and the terms and conditions of Environmental Authorisations (together in all cases with any applicable VAT thereon which is irrecoverable VAT);

b) the costs of insurance premia (other than in relation to insurances covering the construction and commissioning of the Plant) and all property and occupation charges and rates to which the Project may be subject (together in each case with any applicable VAT thereon which is irrecoverable VAT);

c) sums payable by the Borrower under the terms of the Project Documents to which it is a party, other than in relation to construction and commissioning of the Plant (together with any applicable VAT thereon which is irrecoverable VAT);

d) taxes payable (excluding VAT other than "output tax" within the meaning of Section 24(2) of the Value Added Tax Act 1994) other than in relation to the construction and commissioning of the Plant;

e) development costs; and

f) in all cases, the equivalent lines thereafter in each Approved Budget and each Approved Financial Model.

The Borrower may only withdraw sums from the Excess Cash Flow Account:

i. to meet Project Costs at any time on or after the Take-Over Date, but prior to Completion; or

ii. to transfer any amount standing to the credit of Excess Cash Flow Account on Completion to the Distribution Account, provided that no Event of Default is continuing.

Appendix 2 (continued)

Extracts from Senior Term Loan Facility Agreement

Actual Construction Period Cash Flow Test

a) On each Actual Construction Period Cash Flow Testing Date, the Borrower will provide evidence satisfactory to the Lenders (acting reasonably) that the Actual Construction Period Cash Flow Test has been satisfied.

b) Where there is a failure by the Borrower to satisfy the Actual Construction Period Cash Flow Test on any Actual Construction Period Cash Flow Testing Date (an “**Actual Construction Period Cash Flow Shortfall**”):

   i. The Borrower shall serve a Standby Equity Funding Notice on each Shareholder pursuant to clause 4.2 (Standby Equity Funding Notice) of the Equity Agreement and through such notice request that each Shareholder contribute Equity in an amount equal to its Standby Contribution in accordance with clause 4.1 (Provision of Standby Equity) of the Equity Agreement; and

   ii. in the event that [*Shareholder A*] fails to contribute Equity in accordance with clause 15.10(b)(i) above, the Borrower or the Security Agent shall be entitled to make a claim under the Equity Guarantee ([*Shareholder A*]) for an amount equal to [*Shareholder A’s*] Standby Contribution of the Actual Construction Period Cash Flow Remedy Amount within the relevant period that such Equity is required to be paid pursuant to clause 8.1(b) ([*Shareholder A’s parent*] Guarantee) of the Equity Agreement.

Source: Senior Term Loan Facility Agreement

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