

Senior Term Loan Facility Agreement

Actual Construction Period Cash Flow Test

For the period:
1 January 2015 to 31 March 2015



Important notice

Deloitte LLP (“Deloitte”) is acting for Worcestershire County Council (“WCC”) and the County of Herefordshire Council (“CoHC”) (together “the Councils” or the “Clients”) on the terms set out in the engagement letter dated 13 November 2014 (the “Engagement Letter”) in connection with the financial advisory services in relation to the Senior Term Loan Facility Agreement (“STLFA” or “Agreement”) with Mercia Waste Management Limited (“MWM” or “Mercia”) (in total, the “Project”) and no one else and will not be responsible to anyone other than the Clients for providing advice in relation to the Project.

This document, which has been prepared by Deloitte, comprises the written materials/slides for the purpose of providing a presentation to the Clients envisaged in the Engagement Letter.

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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 a Waste to Energy (“WtE”) 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 VfM, the Councils used their prudential borrowing powers to debt fund Mercia’s WtE 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.

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;
- Compared the senior term loan facility draw downs against those forecast in the Base Case Financial Model.

We have not been provided with any technical reports to review for the period to 31 March 2015.

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 March 2015 is £1,299k.

This shows that in the period from 1 May 2014 to 31 March 2015, the operations have produced £1,299k more than was forecast for this period in the Base Case Financial Model.

Based on the above, the ACPCFT for the 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
Base case financial model			
<i>b/f cash attributable to Ops</i>	4,254	4,793	7,051
Gross revenue	18,603	10,448	10,847
Operating costs	-14,893	-8,111	-8,320
Changes in working capital	-1,212	320	-18
Cell preparation assets	-612	0	0
Corporation tax	-1,346	-400	-437
Total change	539	2,258	2,072
Actuals			
<i>b/f cash attributable to Ops</i>	4,637	6,480	11,674
Gross revenue	19,688	13,341	10,578
Operating costs	-15,557	-8,588	-8,509
Changes in working capital	-1,392	1,363	-3,018
Cell preparation assets	-333	-286	0
Corporation tax	-563	-636	-302
Total change	1,843	5,194	-1,252
Difference	1,304	2,936	-3,324
Excess cash flow a/c b/f	383	1,687	4,624
Excess cash flow a/c c/f	1,687	4,624	1,299

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement. ¹ Includes the January 2015 Unitary Payment.

Commentary

Commentary

- The calculation is the result of a methodology agreed between parties (the Councils and Mercia) which accords with the STLFA signed on 21 May 2014.
- Mercia explained that the gross cash received by Mercia from the Councils for the period to 31 December 2014 was more than expected due to the early payment (by a couple of days) of the Unitary Charge (£3.4m, in late December 2014).
- Mercia contended that *“this is not “extra” cash, but normal operating cash received a few days early. The Council payments usually arrive in the first few days of the month, but in December the payment arrived on 31 December. If the definitions are to be followed strictly, we would be denied access to this cash until such time as the next Cash Flow Test is due”*.
- The calculation shown on page 4 follows the Senior Term Facility Loan Agreement and as a result of this, does not discount this additional payment and the test showed a large positive difference in the December 2014 test.
- Since the subsequent payments were received as normal, the test shows a large negative difference for the period to 31 March 2015 (of £3.3m).
- The net result still leaves an excess cash flow balance of £1,299k as at 31 March 2015. In line with the stipulations of the STFLA, this is the balance in the Excess Cash Flow Account.
- There are small differences (c£6.5k) between Deloitte’s and Mercia’s variance against model numbers on gross revenue and operating costs.

Variance against model (£k)	Deloitte ¹	Mercia ²	Difference
Gross revenue	-269	-276	-7
Operating costs	-189	-182	7

The differences are reflective of a differing treatment of interest received – the Deloitte calculation includes the number in gross revenue whereas Mercia’s calculation nets it against operating costs.

The differences are equal and opposite (allowing for rounding) and do not affect the overall cash flow position.

- In discussions between Deloitte, the Councils and Mercia on the May 2014 to September 2014 ACPCFT, Deloitte suggested that Mercia perform a reconciliation of the carried forward cash attributable to operations to the actual total cash balance in bank. Mercia now performs this as part of their test.

Notes: {1} Difference between the actuals and model numbers for the quarter to 31 March 2015 (see slide 4); {2} From Mercia’s cash flow notice (see slide 7).

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
Model			
Facility A	5,241	2,341	1,725
Facility B	18,898	8,426	6,190
Total	24,139	10,767	7,916
Actual			
Facility A	4,576	-	1,713
Facility B	16,532	-	6,187
Total	21,108	-	7,900
Difference	-3,031	-10,767	-16

Facility A is the amortising loan. Capital repayment begins in the quarter ended 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 ended 31 December 2023.

From discussion with Mercia management, the lack of draw down in October 2014 to December 2014 period reflects both a delay in the WtE build (meaning less cash was required for the WtE build) and the lower than expected capital expenditure in non-WtE build (meaning that more cash can be used on the WtE build).

Appendix 1

Mercia's calculation (£000)

Cash Flow Test Calculation

	1 Jan 15 to 31 Mar 15 ACTUAL	1 Jan 15 to 31 Mar 15 MODEL
Profit Before Depreciation and Tax	2,069	2,527
Working Capital Movement (Operating)	-3,018	-18
Cell Preparation Assets	-	-
Corporation Tax (Cash)	-302	-437
Operating Cash Flow	-1,252	2,072

Excess Cash Flow

	1 January to 31 March 2015		
	Actual	Model	Var
Operating Cash Opening Balance	11,674	7,051	4,624
Operating Cash Flow (as above)	-1,252	2,072	(3,324)
Operating Cash Closing Balance	10,423	9,123	1,299

Mercia's cash flow notice

<i>Excess Cash – Opening Balance (Dec 2014)</i>	4,624
<i>Gross Revenue</i>	-276
<i>Operating Costs</i>	-182
<i>Changes in Working Capital</i>	-3001
<i>Corporation Tax</i>	+134
<i>Total</i>	-3,325
<i>Excess Cash – Closing Balance (Mar 2015)</i>	1,299

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 mapping to the description in the Senior Term Loan Facilities Agreement (see page 4).

Appendix 2

Extracts from Senior Term Loan Facility Agreement

"Actual Construction Period Cashflow Test" means the quarterly test to be carried out on each Actual Construction Period Cashflow Testing Date, in relation to the preceding quarter period to determine whether:

- (a) actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds;
- (b) 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 Cashflow Testing Date" means each Quarter Date following Financial Close, up to and including Completion;

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

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

"Actual Construction Period Excess Cashflow 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 Cashflow Test;

"Base Case 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;

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; plus
- (b) interest earned on all cash accounts (other than the Distribution Account); plus
- (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 that Financial Year, as reflected in the operating cashflow 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 cost 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; and
 - (e) development costs,
- and in all cases, the equivalent lines thereafter in each Approved Budget and each Approved Financial Model;

- (b) 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.



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