

**UK HIGHWAYS M40 (HOLDINGS) LIMITED**

**ANNUAL REPORT  
AND  
FINANCIAL STATEMENTS FOR THE YEAR ENDED  
31 DECEMBER 2016**



**Registered Number 2939644**

**ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

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**DIRECTORS AND ADVISORS**

**Directors**

I R Gethin

N Rae

D Bradbury

C Corpetti

**Company Secretary and registered office**

T Hedges

(appointed 30 November 2016)

8 White Oak Square

London Road

Swanley

Kent

BR8 7AG

United Kingdom

**Auditor**

Deloitte LLP

Chartered Accountants and Statutory Auditor

London

United Kingdom

**Principal bankers**

HSBC

8 Canada Square

London

E14 5HQ

## STRATEGIC REPORT

The Directors submit their Strategic Report for the year ended 31 December 2016.

## BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The principal activity of the Company is to act as a holding company, with a single subsidiary UK Highways M40 Limited.

The principal activity of the Group is to carry on the business of the design, financing, construction and operation of the property and undertaking known as the M40 motorway, junctions 1 to 15, pursuant to and in accordance with the terms of an agreement with Her Majesty's Secretary of State for Transport (the "contract") which was signed by UK Highways M40 Limited, a wholly owned subsidiary, on 8 October 1996. The Group commenced trading on 6 January 1997. The concession period is 30 years. Construction completed on 9 March 1999 when the operational phase of the contract commenced.

### *Business and Financial Performance*

Income and expenditure have been broadly in line with the Board's expectations. Turnover is linked to traffic volumes in a non-linear way; the charging mechanism is such that volume changes have to be significant to impact materially on reported turnover. Risks to turnover from normal traffic fluctuations are therefore seen to be relatively small. All operational costs are on fixed long-term contracts and risks to these costs are perceived as being small.

## PRINCIPAL RISKS

### *Interest Rate Risk & Liquidity Risk*

The Group is highly geared and therefore has interest rate swap agreements in place which match the senior loan amounts outstanding at any one time, thereby mitigating any risk to interest rate fluctuations. The Group has adopted a prudent approach to liquidity management by maintaining sufficient cash and liquid resources to meet its obligations as they fall due.

### *Credit Risk & Performance of Sub-contractors*

The Directors manage this risk through close involvement in the operations of the project and regular monitoring of performance. The client has the ability to levy financial penalties in the event that performance standards are not met or the road is not fully available at busy times of traffic usage. These risks are mitigated by the Group as the contract allows these deductions to be passed down to sub-contractors.

## KEY PERFORMANCE INDICATORS

The Group's operations are managed under the supervision of its shareholders and funders and are largely determined by the detailed terms of the DBFO contract which stipulates the monitoring of the key performance criteria on operational activities detailed in the following sections.

This year's traffic volumes on the M40 have increased by 1.2% for cars and 3.6% for HGVs over the same period last year. In the prior year, traffic volumes increased by 4.3% for cars and 5.8% for HGVs.

Penalty points are awarded by the client for poor or substandard performance, as stipulated in the contract, and these are monitored regularly by the Board. The project consistently produces acceptable results and few penalty points are accumulated at any time.

### *Health & Safety Performance*

Health and safety reports are provided at every board meeting and are reviewed regularly by Directors. The Board considers any events which would indicate a pattern for further review and action if required. The health and safety of the project is considered to be satisfactory.

### *Forecasts*

The Board regularly reviews costs and traffic levels against forecasts and accident statistics are compared against benchmarks. Traffic is monitored against independent forecasts provided by our advisors and costs are measured against both our own budgets and benchmarked against similar sub-contracts on other projects. An independent traffic reforecast was commissioned in 2016, the results of which have been incorporated into the traffic projections going forward.

### *Lifecycle*

The Company is responsible for all lifecycle costs on the project. The Directors manage this through close involvement in the project and regular monitoring of its performance. Regular surveys are done on the condition of the road and a full review of lifecycle forecasts is done every three years.

The required major maintenance accrual at the year end has reduced to £10.2m (2015: £26.6m) for the following two reasons. Firstly, significant major maintenance costs were incurred during the year, £12.9m (2015: £2.4m), and secondly, the quantum and timing of the remaining major maintenance was revised during the year. The revised projections were reviewed by an independent third party. The impact on the results is explained in the Directors' Report.

**STRATEGIC REPORT (continued)**

**FUTURE DEVELOPMENTS**

The Directors are not aware, at the date of this report, of any major changes in the Group's activities in the next year.

On behalf of the Board

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

Neil Rae  
Director

27 March 2017

## **DIRECTORS' REPORT**

The Directors submit their Annual Report and the audited financial statements for the year ended 31 December 2016.

## **RESULTS AND DIVIDENDS**

The results for the year are set out on page 7. Profit before taxation is £18.6m (2015: £7.8m). The increase in profit before taxation is due to the change in required maintenance accrual at the year end, as explained further in the Strategic Report.

During the year the Company paid a dividend of £6,023,000 (2015: £7,800,000).

## **SHARE CAPITAL**

Details of the authorised and issued share capital are shown in note 18.

## **DIRECTORS**

The Directors who served throughout the year are shown on page 1.

## **DIRECTORS' INTERESTS**

No Director has, or has held at any time during the year, any interest in the share capital of the Company.

No Director has a service contract with or receives any remuneration from the Company. No Director has, or had during the year, any personal interest in any significant or material contract with the Company.

There have been qualifying third party indemnity provisions in place for the benefit of the Directors during the year. These provisions remain in force at the reporting date.

## **FINANCIAL INSTRUMENTS**

The Company's activities expose it to a number of financial risks including credit risk, interest rate risk and liquidity risk. These risks are further explained in the strategic report.

## **AUDITORS**

### **Disclosure of information to the auditor**

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware, and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

### **Auditor**

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and Deloitte LLP will therefore continue in office.

On behalf of the Board



Neil Rae  
Director  
27 March 2017

## DIRECTORS' RESPONSIBILITIES STATEMENT

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of the profit or loss of the Group for that year.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and parent Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and parent Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and parent Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF UK HIGHWAYS M40 (HOLDINGS) LIMITED

We have audited the group and parent company financial statements of UK Highways M40 (Holdings) Limited for the year ended 31 December 2016 which comprise the consolidated statement of comprehensive income, the consolidated and Company statement of financial position, the consolidated cash flow statement, the consolidated and Company statement of changes in equity and the related notes 1 to 22. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and parent Company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of our audit work,

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared are consistent with the financial statements; and
- The Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Jacqueline Holden FCA (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom

27 March 2017

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
Turnover	4	34,889	34,030
Net operating costs		<u>(10,916)</u>	<u>(21,000)</u>
<b>Operating profit</b>	5	<b>23,973</b>	13,030
Net interest payable	8	(5,341)	(5,210)
<b>Profit on ordinary activities before taxation</b>		<b>18,632</b>	7,820
Tax on profit on ordinary activities	9	(3,704)	(1,505)
<b>Profit for the financial year</b>		<b>14,928</b>	6,315
<b>Other comprehensive (loss)/income</b>			
Cash flow hedge (loss)/gain for the year		(1,360)	2,193
Tax relating to other comprehensive (loss)/income	9	137	(626)
<b>Total comprehensive income for the year</b>		<b>13,705</b>	7,882

The statement of comprehensive income has been prepared on the basis that all operations are continuing operations.

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
<b>Fixed assets</b>			
Tangible assets	12	36,229	39,756
Investments maturing after more than one year	13	<u>26,275</u>	<u>37,170</u>
		<b>62,504</b>	<b>76,926</b>
<b>Current assets</b>			
Investments maturing within one year	13	12,715	5,334
Debtors- due within one year	14	27,771	27,468
- due after one year	14	982	734
Cash at bank and in hand		<u>13,526</u>	<u>16,898</u>
		<b>54,994</b>	<b>50,434</b>
<b>Current liabilities</b>			
<b>Creditors:</b> amounts falling due within one year	16	(25,696)	(37,807)
<b>Net current assets</b>		<u>29,298</u>	<u>12,627</u>
<b>Total assets less current liabilities</b>		<u>91,802</u>	<u>89,553</u>
<b>Creditors:</b> amounts falling due after more than one year	16	(85,476)	(90,909)
<b>Net assets / (liabilities)</b>		<u>6,326</u>	<u>(1,356)</u>
<b>Capital and reserves</b>			
Called up share capital	18	3,550	3,550
Hedging reserve	18	(8,938)	(7,715)
Profit and loss account	18	11,714	2,809
<b>Total equity / (deficit)</b>		<u>6,326</u>	<u>(1,356)</u>

The consolidated financial statements of UK Highways M40 (Holdings) Limited, registered number 2939644, were approved by the Board of Directors and authorised for issue on 27 March 2017. They were signed on its behalf by:



Neil Rae  
Director  
27 March 2017

COMPANY STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2016

	Notes	2016 £'000	2015 £'000
<b>Fixed assets</b>			
Investments	13	3,500	3,500
<b>Current assets</b>			
Debtors			
- due within one year	14	828	773
- due after more than one year	14	8,112	8,565
Cash at bank and in hand		5	6
		<u>8,945</u>	<u>9,344</u>
<b>Current liabilities</b>			
<b>Creditors:</b> amounts falling due within one year	16	(671)	(617)
<b>Net current assets</b>		<u>8,274</u>	<u>8,727</u>
<b>Total assets less current liabilities</b>		<u>11,774</u>	<u>12,227</u>
<b>Creditors:</b> amounts falling due after more than one year	16	(8,112)	(8,565)
<b>Net assets</b>		<u>3,662</u>	<u>3,662</u>
<b>Capital and reserves</b>			
Called up share capital	18	3,550	3,550
Profit and loss account	18	112	112
<b>Total equity</b>		<u>3,662</u>	<u>3,662</u>

The financial statements of UK Highways M40 (Holdings) Limited, registered number 2939644, were approved by the Board of Directors and authorised for issue on 27 March 2017. They were signed on its behalf by:



Neil Rae  
Director  
27 March 2017

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Notes	Share Capital £'000	Hedging Reserve £'000	Profit and Loss Account £'000	Total Equity £'000
<b>Balance as at 1 January 2015</b>		<u>3,550</u>	<u>(9,282)</u>	<u>4,294</u>	<u>(1,438)</u>
<b>Year ended 31 December 2015</b>					
Profit for the year		-	-	6,315	6,315
<i>Other comprehensive income:</i>					
Cash flow hedge gains arising in the year		-	2,193	-	2,193
Tax relating to other comprehensive income		-	(626)	-	(626)
Total comprehensive income for the year		-	1,567	6,315	7,882
Dividends paid	10	-	-	(7,800)	(7,800)
<b>Balance as at 31 December 2015</b>		<u>3,550</u>	<u>(7,715)</u>	<u>2,809</u>	<u>(1,356)</u>
<b>Year ended 31 December 2016</b>					
Profit for the year		-	-	14,928	14,928
<i>Other comprehensive income:</i>					
Cash flow hedge losses arising in the year		-	(1,360)	-	(1,360)
Tax relating to other comprehensive income		-	137	-	137
Total comprehensive income for the year		-	(1,223)	14,928	13,705
Dividends paid	10	-	-	(6,023)	(6,023)
<b>Balance as at 31 December 2016</b>		<u>3,550</u>	<u>(8,938)</u>	<u>11,714</u>	<u>6,326</u>

**COMPANY STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Notes	Share Capital £'000	Profit and Loss Account £'000	Total Equity £'000
<b>Balance as at 1 January 2015</b>		<u>3,550</u>	<u>113</u>	<u>3,663</u>
<b>Year ended 31 December 2015</b>				
Profit and total comprehensive income for the year		-	7,799	7,799
Dividends paid	10	<u>-</u>	<u>(7,800)</u>	<u>(7,800)</u>
<b>Balance as at 31 December 2015</b>		<u>3,550</u>	<u>112</u>	<u>3,662</u>
<b>Year ended 31 December 2016</b>				
Profit and total comprehensive income for the year		-	6,023	6,023
Dividends paid	10	<u>-</u>	<u>(6,023)</u>	<u>(6,023)</u>
<b>Balance as at 31 December 2016</b>		<u>3,550</u>	<u>112</u>	<u>3,662</u>

**CONSOLIDATED CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
<b>Cash flows from operating activities</b>			
Cash generated from operations	22	10,114	19,014
Taxation paid		(2,690)	(2,323)
<b>Net cash inflow from operating activities</b>		<b>7,424</b>	<b>16,691</b>
<b>Investing activities</b>			
Interest received		304	184
EIB bond matured		5,400	-
Current asset investment matured/(deposited)		1,000	(5,000)
<b>Net cash generated/(used) from investing activities</b>		<b>6,704</b>	<b>(4,816)</b>
<b>Financing activities</b>			
Interest and other financing costs paid		(4,928)	(5,751)
Equity dividends paid		(6,023)	(7,800)
Repayment of secured loan		(6,158)	(4,456)
Repayment of loan notes		(391)	(338)
<b>Net cash used in financing activities</b>		<b>(17,500)</b>	<b>(18,345)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(3,372)</b>	<b>(6,470)</b>
Cash and cash equivalents at beginning of year		16,898	23,368
<b>Cash and cash equivalents at end of year</b>		<b>13,526</b>	<b>16,898</b>

Notes to the financial statements for the year ended 31 December 2016

**1 ACCOUNTING POLICIES**

These financial statements have been prepared in accordance with FRS 102 "The Financial reporting Standard applicable in the UK and Republic of Ireland" ("FRS 102") and the requirements of the Companies Act 2006.

The Company exists to hold investments in its subsidiary, UK Highways M40 Limited, that provides services under a private finance agreement. The subsidiary is set up as a Special Purpose Company under non-recourse arrangements and therefore the Company has limited its exposure to the liabilities. In the event of default of the subsidiary, the exposure is limited to the extent of the investment it has made.

The financial statements have been prepared on the historical cost convention, modified to include the revaluation of certain financial instruments at fair value. The financial statements are prepared in Sterling, which is the functional currency of the Company. Monetary amounts in these financial statements are rounded to the nearest £'000. A summary of the principal accounting policies adopted are set out below.

a) Going concern

The Directors have reviewed the Group's forecasts and projections, taking into account future cash requirements and forecast receipts, which show the Group can continue to meet its debts as they fall due.

The Directors therefore, at the time of approving the financial statements, have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements.

b) Basis of consolidation

The Group financial statements comprise a consolidation of the financial statements of UK Highways M40 (Holdings) Limited and its subsidiary undertaking UK Highways M40 Limited. The financial statements of each company in the Group are prepared to 31 December.

c) Tangible Fixed Assets and Depreciation

Tangible fixed assets comprise:

- (i) leasehold properties and improvements, being the depots covered by the Concession Agreement.
- (ii) infrastructure assets, being that section of the M40 road covered by the Concession Agreement (the "Project Road") together with its associated landscaping and over/under bridges.
- (iii) other assets, including fixed electrical and mechanical equipment, plant and machinery and fixtures and fittings.

d) Leasehold properties

These were handed over to the Group at nil value. Improvements to the leasehold properties are recorded at cost and are depreciated upon commissioning, over the remaining life of the leasehold or concession, whichever is the shorter.

e) Infrastructure assets

The Group has been established to provide services under certain private finance agreements with Her Majesty's Secretary of State for Transport. Under the terms of these Agreements, the Secretary of State (as grantor) controls the services to be provided by the Group over the contract term. Based on the contractual arrangements the Group has classified the project as a service concession arrangement, and has accounted for the principal assets of, and income streams from, the project in accordance with FRS 102, Section 34.12 Service Concession Arrangements. The Group has chosen to adopt the transitional arrangements available within FRS 102, Section 35.10 (i) and as such the service concession arrangement has continued to be accounted for using the same accounting policies being applied at the date of transition to FRS 102 (1 January 2014). The nature of the asset has therefore not changed and will continue to be recognised as a tangible fixed asset.

The Project Road was handed over to the Group at nil value. All expenditure on the Project Road specified in the Concession Agreement as related to increased capacity is treated as additions, which are included at cost less depreciation.

Depreciation is charged on additions over the life of the concession pro rata to usage. Annual depreciation is a function of the proportion of traffic for the year over the total estimated traffic for the period of the concession.

Notes to the financial statements for the year ended 31 December 2016 (continued)

1 ACCOUNTING POLICIES (continued)

f) Other assets

Depreciation is calculated on a straight line basis in order to write down the costs of assets to their estimated residual value over

Mechanical and electrical equipment	10 years
Plant, machinery and other equipment	3-10 years
Fixtures and fittings	3-5 years

g) Fixed Asset Investments

Fixed asset investments are held at cost (including accrued interest income on zero coupon bonds) less provision for any impairment. Cost includes rolled up notional interest which is calculated on a sum of the digits method reflecting the economic benefits received by the Company.

h) Turnover

Turnover is derived entirely in the United Kingdom and is recognised net of VAT, to the extent that the Group obtains the right to consideration in exchange for its performance. Revenue is earned based on the number of vehicles using the road during the year on the contractually agreed rates, and is recognised as earned.

i) Cash

Cash and cash equivalents comprise cash at bank and in hand and short term deposits with original maturity of less than three months.

j) Major Maintenance Accrual

Accrual for major maintenance of the Project Road is based on the expenditure required to maintain the Project Road in the condition laid down in the Concession Agreement. The charge made in the year reflects the costs to be borne by the Group in making good the wear and tear sustained by the road in the year. Cash expenditure is charged against the balance sheet provision as and when incurred, and to the extent that cash expenditure exceeds the amount provided to date, the balance is disclosed as a prepayment or accrual.

The annual cost of repair is calculated with reference to the expenditure required over the life of the Concession to maintain the Project Road to the specified standard and the annual traffic movements which give rise to the wear and tear. The annual cost of repair to structural and other assets is calculated with respect to the duration of the concession. The future cost has been discounted at a rate of 8.0% (2015: 8.0%). The unwinding of the discount is recognised in the income statement with other finance costs.

k) Financial assets

The Group has elected to apply the provisions of Section 11 'Basic Financial Instruments' and Section 12 'Other Financial Instruments Issues' of FRS 102 to all of its financial instruments.

Financial assets are recognised in the Group's statement of financial position when the Group becomes party to the contractual provisions of the instrument.

Financial assets are classified into specific categories. The classification depends on the nature and purpose of the financial assets and is determined at the time of recognition.

Basic financial assets, which include trade and other receivables and cash and bank balances, are initially measured at transaction price including transaction costs and are subsequently carried at amortised cost using the effective interest method, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Notes to the financial statements for the year ended 31 December 2016 (continued)

1 ACCOUNTING POLICIES (continued)

k) Financial assets (continued)

*Loans and receivables*

Trade debtors, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment.

Interest is recognised by applying the effective interest rate, except for short term receivables when the recognition of interest would be immaterial. The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the debt instrument to the net carrying amount on that initial recognition.

*Impairment of financial assets*

Financial assets, other than those held at fair value through profit and loss, are assessed for indicators of impairment at each reporting end date.

Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been affected. The impairment loss is recognised in profit or loss.

*Derecognition of financial assets*

Financial assets are derecognised only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership to another entity.

l) Financial liabilities

Basic financial liabilities are initially measured at transaction price, unless the arrangement constitutes a financing transaction, where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest. Other financial liabilities classified as fair value through profit or loss are measured at fair value.

*Other financial liabilities*

Other financial liabilities, are initially measured at fair value, net of transaction costs. They are subsequently measured at amortised cost using the effective interest rate method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability to the net carrying amount on initial recognition.

*Derecognition of financial liabilities*

Financial liabilities are derecognised when, and only when, the Group's obligations are discharged, cancelled, or they expire.

m) Derivatives

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to fair value at each reporting end date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

A derivative with a positive fair value is recognised as a financial asset, whereas a derivative with a negative fair value is recognised as a financial liability.

The Group does not hold or issue derivative financial instruments for speculative purposes.

## Notes to the financial statements for the year ended 31 December 2016 (continued)

**1 ACCOUNTING POLICIES (continued)****m) Derivatives (continued)***Hedge accounting*

The Group designates certain hedging instruments, including derivatives, embedded derivatives and non-derivatives, as either fair value hedges or cash flow hedges.

At the inception of the hedge relationship, the Group documents the relationship between the hedging instrument and the hedged item along with risk management objectives and strategy for undertaking various hedge transactions. At the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item.

*Cash flow hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income.

The gain or loss relating to the ineffective portion is recognised immediately in profit or loss, and is included in the 'other gains and losses' line in this item.

Amounts previously recognised in other comprehensive income and accumulated in equity are reclassified to profit or loss in the periods when the hedged item is recognised in the profit or loss in the same line of the income statement as the recognised hedged item. However when the forecast transaction that is hedged results in the recognition of a non-financial asset or liability, the gains and losses previously accumulated in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability concerned.

**n) Taxation**

The tax expense represents the sum of the tax currently payable and deferred tax.

*Current tax*

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using rates that have been enacted or substantially enacted by the reporting end date.

*Deferred tax*

Deferred tax liabilities are generally recognised for all timing differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits. Such assets and liabilities are not recognised if the timing difference arises from goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting end date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the profit and loss account, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when the Group has a legally enforceable right to offset current tax assets and liabilities and the deferred tax assets and liabilities relate to taxes levied by the same tax authority.

**2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

In the application of the Group's accounting policies, the Directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

## Notes to the financial statements for the year ended 31 December 2016 (continued)

**2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)***Critical judgements*

The following judgements (apart from those involving estimates) have had the most significant effect on amounts recognised in the financial statements.

*Hedge accounting*

The Directors consider the Group to have met the criteria for hedge accounting; the Group has therefore recognised fair value movements on derivatives in effective hedging arrangements through other comprehensive income as well as the deferred tax thereon.

*Key sources of estimation uncertainty*

The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are outlined below.

*Valuation of derivative financial instruments*

The Directors use their judgement in selecting a suitable valuation technique for derivative financial instruments. All derivative financial instruments are valued at the market to market valuation provided by the derivative counterparty. In these cases, the Group uses valuation techniques to assess the reasonableness of the valuation provided by the derivative counterparty. These techniques use a discounted cash flow analysis based on market observable inputs derived from similar instruments in similar and active markets. The negative fair value of derivative financial instruments at the balance sheet date was £11,414,000 (2015: £10,064,000). The Directors do not consider the impact of own credit risk to be material.

*Major maintenance accrual*

The Directors use their judgement to estimate both the value of major maintenance work still to be completed and expected traffic levels over the remaining concession. Third party advice is periodically sought to support these judgements. The Directors also have to judge a suitable discount factor to apply to the calculation. When determining a suitable discount factor, the Directors have considered typical discount rates applied to companies with similar risk profiles and the level of expected major maintenance expenditure remaining to the end of the concession.

*Depreciation*

Depreciation on infrastructure assets is charged over the concession pro rata to usage. As such, the Directors judgement of expected traffic levels over the remaining concession (as supported by third party projections) determines the value of this charge.

Notes to the financial statements for the year ended 31 December 2016 (continued)

**3 COMPANY PROFIT AND LOSS ACCOUNT**

As permitted by section 408 of the Companies Act 2006, the profit and loss account of the Company has not been included in the financial statements. The profit after taxation incurred in the financial statements of the Company was £6,023,000 (2015: profit £7,799,000).

**4 TURNOVER**

Turnover in the year is analysed as follows:

	Group 2016 £'000	Group 2015 £'000
Shadow tolls	30,609	29,572
Variation income (additional works)	4,156	4,419
Other revenue	124	39
	<b>34,889</b>	<b>34,030</b>

Turnover relates wholly to amounts paid under the Concession Agreement in the United Kingdom.

**5 OPERATING PROFIT**

Operating profit is stated after charging:

	Group 2016 £'000	Group 2015 £'000
Fees payable to the Group's auditor for the audit of the annual accounts	16	16
Fees payable to the Group's auditor and its associates for other services – Taxation services	5	5
Major maintenance (see note 16)	(5,568)	5,191
Operational costs	11,998	11,431
Other operating charges	938	863
Depreciation and amortisation	3,527	3,494

**6 DIRECTORS' REMUNERATION**

The Directors did not receive any remuneration during the year or the previous year. Fees are due to the shareholding companies for the services of the Directors. The amounts were £54,420 (2015: £53,780) per shareholding, a total of £108,840 (2015: £107,560).

**7 STAFF NUMBERS AND COSTS**

The Group had no employees during the year (2015 - nil).

**8 NET INTEREST PAYABLE**

	Group 2016 £'000	Group 2015 £'000
<b>Interest receivable and similar income</b>		
Interest receivable on bank deposits	243	239
Interest on EIB zero coupon bonds	1,886	1,989
	<b>2,129</b>	<b>2,228</b>
<b>Interest payable and similar charges measured at amortised cost</b>		
Interest payable on bank loans and overdrafts	(3,989)	(4,283)
Interest payable on shareholder loan notes	(1,351)	(1,390)
Other finance costs - unwinding of discount on major maintenance accrual	(2,130)	(1,765)
	<b>(7,470)</b>	<b>(7,438)</b>
Net interest payable	<b>(5,341)</b>	<b>(5,210)</b>

Notes to the financial statements for the year ended 31 December 2016 (continued)

9 TAX ON PROFIT ON ORDINARY ACTIVITIES

	Group 2016 £'000	Group 2015 £'000
<u>Analysis of tax charge for the year</u>		
<b>Current tax</b>		
UK corporation tax	(3,819)	(1,675)
Prior year adjustment	4	-
<b>Total current tax</b>	<b>(3,815)</b>	<b>(1,675)</b>
<b>Deferred tax</b>		
Origination and reversal of timing differences	92	170
Effect of changes in tax rates	19	-
<b>Total deferred tax</b>	<b>111</b>	<b>170</b>
<b>Total tax charge on profit on ordinary activities</b>	<b>(3,704)</b>	<b>(1,505)</b>
<b>Other comprehensive income items</b>		
Deferred tax current year credit/(charge)	137	(626)
	<b>137</b>	<b>(626)</b>

*Factors affecting tax charge for the current year*

For the year ended 31 December 2016, the UK rate of 20% is applied.

The Finance (No 2) Act 2015, which provides for reductions in the main rate of corporation tax from 20% to 19% effective 1 April 2017 and to 18% effective 1 April 2020, was substantively enacted on 26 October 2016. Subsequently, the Finance Act 2016, which provided a further reduction in the main rate of corporation tax to 17% effective 1 April 2020, was substantively enacted on 6 September 2016. These rate reductions have been reflected in the calculation of deferred tax at the balance sheet date.

The differences between the total tax shown above and the amount calculated by applying the blended rate of UK corporation tax to the profit before tax are as follows:

	Group 2016 £'000	Group 2015 £'000
Profit on ordinary activities before taxation	<b>18,632</b>	7,820
Profit on ordinary activities multiplied by the blended rate of corporation tax in the UK of 20% (2015 - 20.25%)	<b>(3,727)</b>	(1,583)
<b>Effects of:</b>		
Prior year adjustment	4	-
Change in corporation tax rate	19	78
<b>Total tax charge on profit on ordinary activities</b>	<b>(3,704)</b>	<b>(1,505)</b>

10 DIVIDENDS

	Group 2016 £'000	Group 2015 £'000
<b>Equity shares</b>		
Final paid	(2,090)	(4,100)
Interim paid	(3,933)	(3,700)
	<b>(6,023)</b>	<b>(7,800)</b>

## Notes to the financial statements for the year ended 31 December 2016 (continued)

## 11 FINANCIAL INSTRUMENTS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
<b>Carrying amount of financial assets</b>				
Debt instruments measured at amortised cost	31,526	35,898	8,945	9,344
Equity instruments measured at cost less impairment	-	-	3,500	3,500
	<b>31,526</b>	<b>35,898</b>	<b>12,445</b>	<b>12,844</b>
<b>Carrying value of financial liabilities</b>				
Measured at amortised cost	97,694	117,039	8,783	9,182
	<b>97,694</b>	<b>117,039</b>	<b>8,783</b>	<b>9,182</b>
Amounts relating to cash flow hedges reclassified from equity to profit and loss in the period	-	-	-	-

## 12 TANGIBLE FIXED ASSETS

	Short Leasehold Properties and Improvements £'000	Infrastructure Assets £'000	Other Assets £'000	Total £'000
<b>Cost</b>				
At 1 January 2016	828	85,011	765	86,604
At 31 December 2016	<b>828</b>	<b>85,011</b>	<b>765</b>	<b>86,604</b>
<b>Depreciation</b>				
At 1 January 2016	(488)	(45,595)	(765)	(46,848)
Charge for the year	(31)	(3,496)	-	(3,527)
At 31 December 2016	<b>(519)</b>	<b>(49,091)</b>	<b>(765)</b>	<b>(50,375)</b>
<b>Net book value</b>				
At 31 December 2016	<b>309</b>	<b>35,920</b>	<b>-</b>	<b>36,229</b>
At 31 December 2015	340	39,416	-	39,756

Included within infrastructure asset costs is £9,332,000 (2015: £9,332,000) of interest capitalised during the construction phase. The net book value of interest capitalised is £3,941,000 (2015: £4,325,000).

The Group has the right to the benefits derived from the operation of the Concession fixed assets throughout the term of the Concession, but in certain instances has no legal title to those assets. The Group's subsidiary has an obligation to maintain the Concession fixed assets throughout the Concession period and to hand them back to the Secretary of State at the end of the Concession in an agreed condition.

## 13 FIXED ASSET INVESTMENTS

	Group	Company Interest in Group Undertakings £'000
<b>Cost</b>		
At 1 January 2016	42,504	3,500
Interest	1,886	-
Matured in the period	(5,400)	-
At 31 December 2016	<b>38,990</b>	<b>3,500</b>
<b>Net book value</b>		
At 31 December 2016	<b>38,990</b>	<b>3,500</b>
At 31 December 2015	42,504	3,500

Notes to the financial statements for the year ended 31 December 2016 (continued)

13 FIXED ASSET INVESTMENTS (continued)

	Group	
	2016	2015
	£'000	£'000
Fixed asset - investments maturing after more than one year	26,275	37,170
Current asset - investment maturing within one year	12,715	5,334
	<b>38,990</b>	<b>42,504</b>

The Company's subsidiary undertaking, UK Highways M40 Limited, holds EIB zero coupon bonds which are used to fund major maintenance works on the motorway as and when they fall due. The fourth of these bonds matured in 2016 with the remaining three maturing at specified intervals through to 2021.

The interest in respect of these bonds is being recognised in the profit and loss account, even though no interest is received in cash, to spread the receipt of interest over the life of the bonds. The interest is being rolled up into the investments and will be realised in cash when the bonds mature.

The Company's only subsidiary undertaking is UK Highways M40 Limited, which is wholly owned and whose only activity is the design, building, finance and operation of the M40 motorway.

HSBC, acting as Security Trustee, has a registered mortgage over the whole of the share capital of UK Highways M40 Limited.

14 DEBTORS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
<b>Amounts falling due within one year</b>				
Amounts owed from group undertakings	-	-	376	382
Unsecured loan notes	-	-	452	391
Other taxation	528	-	-	-
Current asset investment	18,000	19,000	-	-
Prepayments and accrued income	9,243	8,468	-	-
	<b>27,771</b>	<b>27,468</b>	<b>828</b>	<b>773</b>
<b>Amounts falling due after one year</b>				
Unsecured Loan notes	-	-	8,112	8,565
Deferred tax asset (note 15)	982	734	-	-
	<b>982</b>	<b>734</b>	<b>8,112</b>	<b>8,565</b>

As at 31 December 2016 the Group had £15,000,000 on twelve month deposit with an interest rate of 0.46% maturing in November 2017, and £3,000,000 on four month deposit with an interest rate of 0.25% maturing in March 2017.

During the year the Company was repaid £390,770 (2015: £338,000) on its loan notes from its subsidiary, UK Highways M40 Limited. Interest on the remaining loan notes is charged at 15% per annum and they are re-payable by 1 May 2026, or before if funds allow.

15 DEFERRED TAX

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
<b>Deferred tax asset</b>				
Balance as at 1 January	734	1,190	-	1
Credited/ (charged) to the profit and loss account during the year	111	170	-	(1)
Credited/ (charged) to other comprehensive income during the year	137	(626)	-	-
<b>Balance as at 31 December</b>	<b>982</b>	<b>734</b>	<b>-</b>	<b>-</b>

Notes to the financial statements for the year ended 31 December 2016 (continued)

15 DEFERRED TAX (continued)

	Group	
	2016	2015
	£'000	£'000
The balance provided at 17% (2015: 18%) comprises:		
Other timing differences	(849)	(960)
Tax relating to other comprehensive income	1,831	1,694
	<u>982</u>	<u>734</u>
The balance is payable:		
Within one year	88	91
After one year	894	643
	<u>982</u>	<u>734</u>

The deferred tax liability in relation to other timing differences set out above is expected to reverse over the concession length and relates to a difference in accounting and taxation treatment of certain expenses.

The deferred tax asset in relation to the interest rate swap liability is expected to affect profit or loss over the period to maturity of the interest rate swap.

16 CREDITORS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
<b>Amounts falling due within one year</b>				
Bank loans (note 17)	6,530	6,158	-	-
Trade creditors	343	410	219	226
Unsecured shareholder loan notes (note 17)	452	391	452	391
Corporation tax	1,442	938	-	-
Related party payable - consortium relief	622	-	-	-
Other taxation and social security	-	675	-	-
Major maintenance accrual	10,237	26,624	-	-
Accruals and deferred income	6,070	2,611	-	-
	<u>25,696</u>	<u>37,807</u>	<u>671</u>	<u>617</u>
<b>Amounts falling due after more than one year</b>				
Bank loans (note 17)	65,950	72,280	-	-
Unsecured shareholder loan notes (note 17)	8,112	8,565	8,112	8,565
Derivative financial instruments	11,414	10,064	-	-
	<u>85,476</u>	<u>90,909</u>	<u>8,112</u>	<u>8,565</u>

*Derivative financial instruments*

In 2008, as part of its interest rate management and in accordance with the terms of its credit agreement, the Group entered into a 16 year interest rate hedging agreement to be applied to the future borrowings of the Group under the loan facility. This swap agreement with Lloyds Bank fixes the interest rate at 3.98% to 31 March 2025. The interest rate swaps settle on a semi-annual basis with the floating rate being six months LIBOR. The Group will settle the difference between the fixed and floating interest rate on a net basis.

The interest rate swap contract was designated as a hedge of variable interest rate risk of the Group's floating rate borrowings. The hedged cash flows are expected to occur and to affect profit or loss over the period to maturity of the interest rate swap.

The fair value of the derivative financial instrument above comprises the fair value of the interest rate swap designated in an effective hedging arrangement. The change in fair value of the interest rate swap that was recognised in other comprehensive income in the year was a loss of £1,360,000 (2015: gain £2,193,000).

*Major maintenance accrual*

The major maintenance accrual comprises the following elements:

	2016	2015
	£'000	£'000
Balance as at 1 January	(26,624)	(22,062)
Unwinding of discount	(2,130)	(1,765)
Expensed in the year	12,949	2,394
Credit/(charge) for the year	5,568	(5,191)
<b>Balance as at 31 December</b>	<u>(10,237)</u>	<u>(26,624)</u>

## Notes to the financial statements for the year ended 31 December 2016 (continued)

## 16 CREDITORS (continued)

The major maintenance accrual is based on projected future cash flows and has been discounted at a rate of 8.0% (2015: 8.0%), which is considered to be an appropriate rate of discount. Applying a discount rate of 7.0% gives rise to a provision of £12,678,000, and applying a discount rate of 9.0% gives rise to a provision of £7,964,000.

## 17 LOANS AND OVERDRAFTS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Bank loans	72,480	78,438	-	-
Unsecured loan notes	8,564	8,956	8,564	8,956
	<b>81,044</b>	<b>87,394</b>	<b>8,564</b>	<b>8,956</b>
<b>Analysis of debt:</b>				
Debt can be analysed as falling due:				
In one year or less	6,782	6,349	452	391
Between one and five years	30,076	27,941	2,627	2,274
In five years or more	44,186	53,104	5,485	6,291
	<b>81,044</b>	<b>87,394</b>	<b>8,564</b>	<b>8,956</b>

Bank borrowings relate to a term loan facility granted on 8 October 1996 by a banking syndicate with HSBC PLC acting as agent. The facility is secured by way of a first legal mortgage over the leasehold property. The loan is repayable in six monthly instalments based on an agreed percentage of the total amount drawn down. Interest is charged on the facility based on floating LIBOR.

Interest on the outstanding loan notes is charged at 15% per annum and they are repayable by 1 May 2026, or before if funds are available.

## 18 CALLED UP SHARE CAPITAL AND OTHER RESERVES

	Group / Company	
	2016	2015
	£'000	£'000
<b>Ordinary share capital</b>		
<b>Allotted, issued and fully paid:</b>		
3,550,000 ordinary shares of £1 each	3,550	3,550
	<b>No.</b>	<b>No.</b>
<b>Authorised:</b>		
40,000,000 ordinary shares of £1 each	40,000,000	40,000,000

**Other Reserves**

The Group's other reserves are as follows:

The profit and loss reserve represents cumulative profits or losses.

The hedging reserve represents the cumulative portion of gains and losses on hedging instruments deemed effective in hedging variable interest rate risk of recognised financial instruments. Amounts accumulate in this reserve are reclassified to profit or loss in the periods in which the hedged item affects profit or loss or when the hedging relationship ends.

## 19 TRANSACTIONS WITH RELATED PARTIES

	2016	2015
	£'000	£'000
The Group had the following related party transactions during the year:		
Semperian PPP Investment Partners Limited and subsidiaries		
Directors' fees	54	54
Loan note interest charged	675	695
Loan notes owed at 31 December	4,282	4,478
John Laing Infrastructure Fund Limited and subsidiaries		
Directors' fees	54	54
Loan note interest charged	675	695
Loan notes owed at 31 December	4,282	4,478

## Notes to the financial statements for the year ended 31 December 2016 (continued)

**20 ULTIMATE CONTROLLING ENTITY**

The Company is a joint venture between Palio (No.7) Limited (50%), a wholly owned subsidiary of John Laing Infrastructure Fund Limited, and Semperian Subholdings M40 Limited (50%), a wholly owned subsidiary of Semperian PPP Investment Partners Holdings Limited. Both of these companies are registered in England and Wales. The Directors consider there to be no ultimate controlling entity.

**21 SUBSIDIARIES**

Details of the Company's subsidiary at 31 December 2016 are as follows:

Name of undertaking	Country of incorporation or residency	Class of shareholding	% Held direct
UK Highways M40 Limited	United Kingdom	Ordinary shares	100

**22 CASH GENERATED FROM OPERATIONS**

	2016 £'000	2015 £'000
Profit for the financial year	14,928	6,315
Adjustments for:		
Corporation tax	3,704	1,505
Finance costs	7,470	7,438
Investment income	(2,129)	(2,228)
Increase in debtors	(836)	(562)
(Decrease)/increase in creditors	(16,529)	3,072
Movements in deferred income	(21)	(20)
Non-cash expense (depreciation)	3,527	3,494
<b>Cash generated from operations</b>	<b>10,114</b>	<b>19,014</b>