# PALIO (NO 2) LIMITED

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

**Registered Number 07314940**

## DIRECTORS AND ADVISORS

**Directors**
A G Charlesworth (resigned 19 May 2017)
J Pritchard
D M Hardy (appointed 19 May 2017)

**Company secretary**
P Naylor

**Company registered office**
1 Kingsway
London
WC2B 6AN
England

**Auditor**
Deloitte LLP
Statutory Auditor
London
United Kingdom

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

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## STRATEGIC REPORT

### Principal activities

The principal activity of Palio No 2 ("the Company") is to invest in a PPP infrastructure project.

### Business review

The Company currently holds 26% interest in Modus Services (Holdings) Limited. During the year, the Company continued to receive revenues from its investment in the form of interest on subordinated loans and dividends. The Company reports a profit after tax for the year of £5,787,000 (2015: £4,323,000) and a negative movement in investment at fair value of £409,000 (2015: negative movement of £2,075,000).

The Company meets the definition in IAS 28 (May 2011) Investments in Associates and Joint Ventures of a venture capital organisation or similar entity and upon initial recognition has designated its investment in joint venture and associates at fair value through profit or loss. The Company therefore measures its interest in joint ventures and associates at fair value in accordance with IAS39 Financial Instruments: Recognition and Measurement and IFRS 13 Fair Value Measurement, with changes in fair value recognised in profit or loss in the period of the change.

The Company's joint venture is held at fair value in the statement of financial position with movement recorded through the Income Statement as explained in note 2. In order to determine the fair value of these investment, the Company takes into consideration the fair value of the underlying portfolio companies and intermediate holding companies.

There have been no events subsequent to 31 December 2016 which require adjustment of or disclosure in the financial statements or notes thereto.

### Going concern

The Directors have considered the use of the going concern basis in the preparation of the financial statements in light of current market conditions and concluded that it is appropriate. In reaching this conclusion, the Directors have specifically considered the Company's activity and forecast over the next 12 months and the Company's relationships with its immediate parent. More information is provided in Note 2 to the financial statements.

### Principal risks and uncertainties

The principal risk faced by the Company is credit risk in relation to its investment. Credit risk is mitigated by the Company holding investment in PPP projects, which are supported by central and local government bodies.

### Key performance indicators

The key performance indicator for the Company is the net assets attributable to shareholders, as detailed on page 6 of the financial statements.

### Future developments

In 2017 the Directors do not foresee any changes in the business or the underlying project.

On behalf of the Board

DHardy

D M Hardy
**Director**
1 August 2017

**DIRECTORS' REPORT**

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

Palio (No 2) Limited (the "Company") is a limited company incorporated in England. The Company is wholly owned by JLIF Limited Partnership, the limited partner of which is JLIF LuxCo 2 S.á.r.l. The limited partner is an indirectly wholly owned subsidiary of John Laing Infrastructure Fund Limited. The Company invests in PFI/PPP infrastructure projects in the UK.

**Results and dividends**

The Directors have declared and paid interim dividends of £6,097,000 (2015: £6,399,000) in respect of the year ended 31 December 2016. The Directors recommended that no final dividend be paid (2015: £nil).

**Directors**

The Directors who served throughout the year, were as follows:

A G Charlesworth (resigned 19 May 2017)

J Pritchard

D M Hardy (appointed 19 May 2017)

**Employees**

The Company had no employees during the year (2015: none).

**Auditor**

Each of the persons who is a Director at the date of approval of this report confirms that:

- as far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that he ought to have taken as a Director in order to make himself 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 provision of section 418 of the Companies Act 2006.

Deloitte LLP was appointed auditor at a meeting of the Board of Directors. Deloitte LLP has indicated their willingness to be reappointed as auditor and appropriate arrangements have been put in place for them to be deemed reappointed as auditor in the absence of an Annual General Meeting.

On behalf of the Board

DHardy

D M Hardy
**Director**
/ August 2017

**DIRECTORS' RESPONSIBILITIES STATEMENT**

The Directors are responsible for preparing the Annual 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 International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 company and of the profit or loss of the company for that period. (In preparing these financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the 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 company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PALIO (NO 2) LIMITED**

We have audited the financial statements of Palio (No 2) Limited for the year ended 31 December 2016 which comprise the Income Statement, the Statement of Financial Position, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 20.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union.

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 auditor's 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 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 Company's affairs as at 31 December 2016 and of its profit for the year ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; 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 the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is 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 obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and 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, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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**
Statutory Auditor
London, United Kingdom
1 August 2017

## INCOME STATEMENT
**for the year ended 31 December 2016**

| | Notes | **2016** **£'000s** | 2015 £'000s |
|---|---|---|---|
| Interest Income | | 323 | 323 |
| Dividend Income | | 6,097 | 6,399 |
| Net loss on investments at fair value through profit or loss | 8 | (409) | (2,075) |
| **Operating income** | | **6,011** | 4,647 |
| **Operating profit** | 4 | **6,011** | 4,647 |
| Net finance costs | 5 | (323) | (323) |
| **Profit before tax** | | **5,688** | 4,324 |
| Tax credit/(charge) | 6 | 99 | (1) |
| **Profit for the year** | | **5,787** | 4,323 |

All results are derived from continuing operations.

There are no items of Other Comprehensive Income in both the current and preceding year, and therefore no separate Statement of Comprehensive Income has been presented.

## STATEMENT OF FINANCIAL POSITION
**as at 31 December 2016**

| | Notes | 2016 £'000s | 2015 £'000s |
|---|---|---|---|
| **Non-current assets** | | | |
| Investments at fair value through profit or loss | 8 | 45,487 | 45,896 |
| **Total non-current assets** | | **45,487** | 45,896 |
| **Total assets** | | **45,487** | 45,896 |
| **Current liabilities** | | | |
| Trade and other payables | 10 | (312) | (312) |
| **Total current liabilities** | | **(312)** | (312) |
| **Non-current liabilities** | | | |
| Loans and borrowings | 11 | (3,226) | (3,226) |
| Deferred tax liabilities | 12 | (420) | (519) |
| **Total non-current liabilities** | | **(3,646)** | (3,745) |
| **Total liabilities** | | **(3,958)** | (4,057) |
| **Net assets** | | **41,529** | 41,839 |
| **Equity** | | | |
| Share capital | 13 | 26 | 26 |
| Retained earnings | 14 | 41,503 | 41,813 |
| **Total equity** | | **41,529** | 41,839 |

The financial statements of Palio (No 2) Limited, registered number 07314940, were approved by the Board of Directors and authorised for issue on / August 2017. They were signed on its behalf by:

DHardy

D M Hardy
**Director**

## STATEMENT OF CHANGES IN EQUITY
**for the year ended 31 December 2016**

| | Notes | Share capital £'000s | Share premium account £'000s | Retained reserves £'000s | Total equity £'000s |
|---|---|---|---|---|---|
| | | **Statement of Changes in Equity in 2016** | | | |
| Balance at 1 January 2016 | 13 & 14 | 26 | - | 41,813 | 41,839 |
| Profit for the year | 14 | - | - | 5,787 | 5,787 |
| **Total comprehensive income for the year** | | - | - | **5,787** | **5,787** |
| Dividend paid | 7 | - | - | (6,097) | (6,097) |
| **Balance at 31 December 2016** | | **26** | - | **41,503** | **41,529** |

| | Notes | Share capital £'000s | Share premium account £'000s | Retained reserves £'000s | Total equity £'000s |
|---|---|---|---|---|---|
| | | Statement of Changes in Equity in 2015 | | | |
| Balance at 1 January 2015 | 13 & 14 | 26 | - | 43,889 | 43,915 |
| Profit for the year | 14 | - | - | 4,323 | 4,323 |
| Total comprehensive income for the year | | - | - | 4,323 | 4,323 |
| Dividend paid | 7 | - | - | (6,399) | (6,399) |
| Balance at 31 December 2015 | | 26 | - | 41,813 | 41,839 |

## CASH FLOW STATEMENT
**for the year ended 31 December 2016**

| | 2016 £'000s | 2015 £'000s |
|---|---|---|
| **Profit from operations** | 6,011 | 4,647 |
| **Adjustments for:** | | |
| Net loss on investments at fair value through profit or loss | 409 | 2,075 |
| **Operating cash flows before movements in working capital** | 6,420 | 6,722 |
| **Cash inflow from operations** | **6,420** | 6,722 |
| **Net cash inflow from operating activities** | **6,420** | 6,722 |
| **Financing activities** | | |
| Dividends paid - equity shareholders | (6,097) | (6,399) |
| Interest paid | (323) | (323) |
| **Net cash outflow from financing activities** | **(6,420)** | (6,722) |
| **Net result in cash and cash equivalents** | - | - |
| **Cash and cash equivalents at beginning of the year** | - | - |
| **Cash and cash equivalents at end of year** | - | - |

Cash and cash equivalents comprise cash and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets is approximately equal to fair value.

**NOTES TO THE FINANCIAL STATEMENTS**
**for the year ended 31 December 2016**

## 1 GENERAL INFORMATION

The Financial Statements of Palio (No 2) Limited have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU").

## 2 SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Basis of accounting

The financial statements have been prepared on the historical cost basis, except that the following assets and liabilities are stated at their fair values: derivative financial instruments and financial assets classified at their fair value through profit or loss. The principal accounting policies are set below.

The Company has not adopted during the year any new and revised International Financial Reporting Standards interpretations and amendments. At the date of approval of these financial statements, the Company has not applied the following new and revised IFRS standards that have been issued but are not yet effective and have not yet been adopted by the EU:
IFRS 9 Financial Instruments
IFRS15 Revenue from Contracts with Customers
IFRS16 Leases
IFRS 2 (amendments) Classification and Measurement of Share-based Payment Transactions
IAS 7 (amendments) Disclosure Initiative
IAS 12 (amendments) Recognition of Deferred Tax Assets for Unrealised Losses
IFRS 10 and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Company in future periods. The Directors intend to perform a detailed analysis of the potential impact of these standards on the Company and its investments during 2017.

A summary of the principal accounting policies adopted by the Directors, which have been applied consistently throughout the current and preceding year, is shown below.

**Sub debt debtors**
Under IFRS, sub debt debtors of amounts owed by investments have been included within the fair value of the investment to which it relates and the debtor has been classified to investments. Consequently, the interest revenue associated to the sub debt debtor is reported within Operating Income in the Income Statement.

**Investments in joint ventures and associates**
The Company meets the definition in IAS 28 (May 2011) Investments in Associates and Joint Ventures of a venture capital organisation or similar entity and upon initial recognition has designated its investment in joint venture and associates at fair value through profit or loss. The Company therefore measures its interest in joint ventures and associates at fair value in accordance with IAS39 Financial Instruments: Recognition and Measurement and IFRS 13 Fair Value Measurement, with changes in fair value recognised in profit or loss in the period of the change.

**Deferred tax**
The deferred tax liability is adjusted annually as gains or losses arise on the fair value of the subordinated debt interest income.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.2 Going concern

Having reviewed the Company's investment portfolio including the associated future cash requirements and forecast receipts, the Directors are satisfied that they have a reasonable expectation that the Company will have access to adequate resources to continue in existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

The Company has an investment in one operational non-recourse PPP Project company which yield annual interest, dividends and loan repayments. The cash flow from the project yield comfortably covers the Company's expected cash flow requirements for overheads and targeted dividend distribution policy.

The Company has sufficient financial resources together with public sector long-term contracts across a range of Infrastructure projects. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully.

The Directors, at the time of approving the financial statements, are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future, a period of not less than 12 months from the date of this report. Thus, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

### 2.3 Revenue recognition

**(i) Interest income**

Interest income is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time-apportioned basis, using the effective interest rate of the instrument concerned as calculated at the acquisition or origination date. Interest income is recognised gross of withholding tax, if any.

**(ii) Dividend income**

Dividend income is recognised when the Company's right to receive the payment has been established (provided that it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably). Dividend income is recognised gross of withholding tax, if any, and only when paid by the PPP project company.

**(iii) Gains on investments at fair value through profit or loss**

Gains or losses that arise from the movement in the fair value of investments are presented separately from interest income and dividend income above.

Revenue excludes the value of intra-group transactions and VAT.

### 2.4 Cash and cash equivalents

Cash and cash equivalents comprise cash balances, deposits held on call with banks and other short-term highly liquid deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand are included as a component of cash and cash equivalents for the purpose of the cash flow statement. Deposits held with original maturities of greater than three months are included in other financial assets.

### 2.5 Borrowing costs

All borrowing costs are recognised in the Income Statement in the period in which they are incurred.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.6 Taxation

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

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

The tax currently payable is based on taxable profit for the year. Taxable profit differs from 'profit before tax' as reported in the Income Statement because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the Statement of Financial Position date.

Deferred tax
Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the Statement of Financial Position liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of other assets and liabilities (other than in a business combination) in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

### 2.7 Financial instruments

Financial assets and financial liabilities are recognised on the Company's Statement of Financial Position when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised when the contractual rights to the cash flows from the instrument expire or the asset is transferred and the transfer qualifies for derecognition in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS13 'Fair Value Measurement'.

**i) Financial assets**
The Company classifies its financial assets in the following categories: fair value through profit or loss and loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

**a) Investments at fair value through profit or loss**
Investments at fair value through profit or loss are designated upon initial recognition as financial assets at fair value through profit or loss. The Company's policy is to fair value both the equity and subordinated debt investments in PPP assets together. Subsequent to initial recognition, the investments are measured on a combined basis at fair value with changes recognised within operating income in the Income Statement.

The Company's investments comprises both equity and debt. Both elements are exposed to the same primary risk, being performance risk. This performance risk is taken into consideration when determining the discount rate applied to the forecast cash flows. In determining fair value we have considered observable market transactions and have measured fair value using assumptions that market participants would use when pricing the asset including assumptions regarding risk. The debt and equity are considered to have the same risk characteristics. As such the debt and equity form a single class of financial instrument for the purposes of disclosure. The Company measures its investment as a single class of financial asset at fair value in accordance with IFRS 13 'Fair Value Measurement'.

**Investments in joint ventures and associates**
The Company meets the definition in IAS 28 (May 2011) Investments in Associates and Joint Ventures of a venture capital organisation or similar entity and upon initial recognition has designated its investment in joint ventures and associates at fair value through profit or loss. The Company therefore measures its interests in joint ventures and associates at fair value in accordance with IAS39 Financial Instruments: Recognition and Measurement and IFRS 13 Fair Value Measurement, with changes in fair value recognised in profit or loss in the period of the change.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

**2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**b) Loans and receivables**
Trade receivables, loans and other receivables that are non-derivative financial assets and that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and other receivables'. Loans and other receivables are measured at amortised cost using the effective interest method, less any impairment. They are included in current assets, except where maturities are due in greater than 12 months after the Statement of Financial Position date which are classified as non-current assets. The Company's loans and receivables comprise 'trade and other receivables' and 'cash and cash equivalents' in the Statement of Financial Position.

**ii) Financial liabilities and equity**
Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

**a) Equity instruments - Share capital**
The nominal amount of shares issued is included in the share capital account.

**b) Equity instruments - Share Premium**
The balance of proceeds received net of direct issue costs is recorded as share premium.

**c) Financial liabilities**
Financial liabilities are classified as other financial liabilities, comprising of:
- Loans and borrowings are recognised initially at fair value of the consideration received, less transaction costs. Subsequent to initial recognition, loan and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the Period of the borrowings on an effective interest basis.
- Other non-derivative financial instruments are measured at amortised cost using the effective interest method less any impairment losses.

**iv) Fair value estimation**
The fair value of financial instruments that are not traded in active markets is derived in one of two ways:

**a) Investments at fair value through profit or loss**
Fair value is calculated by discounting future cash flows, from investments in both equity (dividends and equity redemptions) and subordinated loans (interest and repayments), to the Company at an appropriate discount rate. The basis of discount rates are long run average government bond rates adjusted for an appropriate premium to reflect PPP specific risk. Risk premia are then added to this adjusted base gilt rate depending on the phase of the project. The discount rates that have been applied to the investments at 31 December 2016 were in the range of 7.02% to 9.00% (31 December 2015: 7.19% to 8.46%). Refer to note 8 for details of the areas of estimation in the calculation of the fair value.

**b) Loans and receivables, borrowings and payables**
Loans and borrowings are held at amortised cost.
The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values.

**3 CRITICAL ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS**

In the application of the Company's accounting policies, which are described in note 2, the Directors are required to make judgements, estimates and assumptions about the fair value of assets and liabilities that affect reported amounts. 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 year or in the year of the revision and future years if the revision affects both current and future years.

**Investments at fair value through profit or loss**

Fair values for those investments for which a market quote is not available are determined using the income approach which discounts the expected cash flows at the appropriate rate.

Estimates such as future cash flows are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. These cash flows also contain various assumptions, most significantly the inflation rate, deposit rate and tax rates used in forecasting the expected cash flows for each period. Sensitivities to these critical assumptions and their impact on the fair value of investments at fair value through profit and loss is disclosed in note 8.

In determining the discount rate, management applies their judgement in determining the appropriate risk-free rates and specific risks, and considering the evidence of recent transactions. Management deems the discount rate to be one of the most significant unobservable inputs and any change in it could have a material impact on the fair value of the investments. Underlying assumptions and discount rates are disclosed in note 8.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 4 OPERATING PROFIT

The operating profit is attributable to the principal activity of the Company, all of which was carried out in the United Kingdom.

The audit fee for Palio (No 2) Limited of £2,536 (2015: £2,220) has been borne by JLIF Limited Partnership who will not seek recovery from the Company.

The Company had no employees other than directors for the year or preceding year. There was no directors' remuneration for the year or preceding year.

## 5 FINANCE COST

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| Interest expense on loans from immediate parent company | **323** | 323 |
| **Total finance cost** | **323** | 323 |

## 6 TAX

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| **Current Tax** | | |
| UK Corporation tax | - | - |
| **Total Current Tax** | - | - |
| **Deferred Tax** | | |
| Origination and reversal of timing differences | (24) | 1 |
| Changes to tax rates and laws | (75) | - |
| **Total Deferred tax** | **(99)** | 1 |
| **Total charge/(credit) on profit on ordinary activities** | **(99)** | 1 |
| **Factors affecting tax charge for the year:** | | |
| Profit on ordinary activities before taxation | **5,688** | 4,324 |
| Profit on ordinary activities multiplied by the rate of corporation tax in the UK of 20% (2015: 20.25%) | 1,138 | 876 |
| Effect of: | | |
| Non-taxable UK dividends received | (1,220) | (1,296) |
| Net loss on investments at FV through profit or loss | 82 | 420 |
| Origination and reversal of timing differences | (24) | 1 |
| Changes to tax rates and laws | (75) | - |
| Total tax (credit)/charge for the year | **(99)** | 1 |

Since 1 April 2015, the main UK corporation tax rate is 20% and will reduce to 19% from 1 April 2017. The UK Finance Bill enacted in September 2016 reduced the UK Corporation Tax rate from 19% to 17% from April 2020.

Deferred taxes at the Statement of Financial Position date have been measured using the enacted rates and reflected in these financial statements.

## 7 DIVIDENDS

| | **2016** | 2015 |
|---|---|---|
| The following interim dividends have been paid during the year: | **£'000s** | £'000s |
| Interim dividend paid | 6,097 | 6,399 |

The Company paid £107.61 per share on 31 March 2016 and £126.90 per share on 30 September 2016 (2015: £120.00 per share on 31 March 2015 and £126.13 per share on 30 September 2015).
The Directors do not recommend payment of a final dividend (2015: £nil).

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 8 INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| Opening balance | **45,896** | 47,971 |
| Dividends received from investments* | **(6,097)** | (6,399) |
| Interest received from investments* | **(323)** | (323) |
| Unwind of discount rate and other movements* | **5,221** | 4,300 |
| Discount rate movement* | **790** | 347 |
| **Carrying amount at 31 December** | **45,487** | 45,896 |

*Net loss on investments at fair value through profit or loss for the year ended 31 December 2016 is £409,000 (2015: loss of 2,075,000).

The Ultimate Parent Company's Investment Advisor has carried out fair market valuations of the investments as at 31 December 2015. The Directors have satisfied themselves as to the methodology used, the discount rates applied and the valuation. The investments are all investments in PPP projects and are valued using a discounted cash flow methodology. The valuation techniques and methodologies have been applied consistently with the methodology used to value the Investments since the launch of the ultimate parent company John Laing Infrastructure Fund Limited in 2010. Discount rates applied range from 7.02% to 9.00% (2015: 7.19% to 8.46%).

The following economic assumptions were used in the discounted cash flow valuations:

| | **2016** | 2015 |
|---|---|---|
| Inflation rates - | | |
| UK | **2.75%** | 2.75% |
| Deposit interest rates (UK) | **1% for 2017 and rising to 2.75% from 2020** | 1% for 2016 rising to 3.25% from 2019 |

The changes to the main rate of corporation tax for UK companies announced in the Finance Act 2014 were substantively enacted by the UK Government on 17 July 2014. The main corporation tax rate was reduced by 1% to 19% from 1 April 2017.

The fair value of the PPP investments would be an estimated £2.3 million higher or £2.1 million lower (2015: estimated £2.3 million higher or £2.1 million lower) if the discount rate used in the discounted cash flow analysis were to differ by 1% from that used in the fair value calculation.

The fair value of the PPP investments would be an estimated £1.1 million higher (2015: £1.0 million higher) if the inflation rate used in the discounted cash flow analysis was an absolute 1% higher than that used in the fair value calculation, and £1.2 million lower (2015: £1.2 million lower) if the inflation rate was an absolute 1% lower. The inflation rate assumed for all future years from 31 December 2016 was 2.75% (2015: 2.75%).

The fair value of the PPP investments would be an estimated £0.6 million higher or £0.6 million lower (2015: estimated £0.7 million higher or £0.7 million lower) if the deposit rates used in the discounted cash flow analysis were to differ by 1% from that used in the fair value calculation. The deposit rates assumed for all future years from 31 December 2015 were 1% for 2015, gradually rising to 2.75% from 2020.

Details of investments recognised at fair value through profit or loss were as follows:

| | **% holding 31 December 2016** | | % holding 31 December 2015 | |
|---|---|---|---|---|
| **Investment** | **Equity** | **Subordinated loan stock** | Equity | Subordinated loan stock |
| Modus Services (Holdings) Limited | **26.0%** | **26.0%** | 26.0% | 26.0% |

There are no future loan stock or capital commitments on investments held at fair value through profit or loss.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 9 TRADE AND OTHER RECEIVABLES

The Company had no trade or other receivable as at 31 December 2016.

## 10 TRADE AND OTHER PAYABLES

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| Accruals and deferred income | **81** | 81 |
| Amounts owed to parent company | **231** | 231 |
| Balance at 31 December | **312** | 312 |

## 11 LOANS AND BORROWINGS

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| **Non-current liabilities** | | |
| Loan from parent company | **3,226** | 3,226 |
| Balance at 31 December | **3,226** | 3,226 |

The loan from Parent Company is repayable in line with repayments schedules. Interest is charged on an arm's length basis at a fixed rate of 10%.

The carrying amount of these liabilities approximates their fair value.

## 12 DEFERRED TAX LIABILITY

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| **Non-current liabilities** | | |
| Deferred Tax Liability | **420** | 519 |
| Balance at 31 December | **420** | 519 |

An initial deferred tax liability has been recognised on the subordinated debt interest income included in the fair value of the investments. The deferred tax liability is adjusted annually as gains or losses arise on the fair value of the subordinated debt interest income.

## 13 SHARE CAPITAL

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| Issued and fully paid | | |
| 26,001 (2015: 26,001) ordinary shares of £1 each | **26** | 26 |

The Company is authorised to issue an unlimited number of shares.

At present, the Company has one class of ordinary shares which carry no right to fixed income.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 14 RETAINED EARNINGS

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| Opening balance | **41,813** | 43,889 |
| Net profit for the year | **5,787** | 4,323 |
| Dividends paid | **(6,097)** | (6,399) |
| Balance at 31 December | **41,503** | 41,813 |

## 15 TRANSACTIONS WITH RELATED PARTIES

As a wholly owned subsidiary of John Laing Infrastructure Fund Limited, the Company has taken advantage of the exemption under IAS 24 (revised), 'Related party disclosures' not to provide information on related party transactions with other undertakings within the John Laing Infrastructure Fund Limited Group. Note 19 gives details of how to obtain a copy of the published financial statements of John Laing Infrastructure Fund Limited.

The following transactions took place between the Company and its joint ventures during the year:

| | **2016** | 2015 |
|---|---|---|
| | **£'000s** | £'000s |
| **Modus Services (Holdings) Limited** | | |
| Cash received | | |
| Subordinated loan interest | 323 | 323 |
| Dividends | 6,097 | 6,399 |
| Income statement | | |
| Subordinated loan interest | | |
| Dividends | 323 | 323 |
| Balance due | 6,097 | 6,399 |
| Subordinated loan | | |
| Subordinated loan interest | 3,226 | 3,226 |
| | 81 | 81 |

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 16 FINANCIAL INSTRUMENTS

### CAPITAL RISK MANAGEMENT

**Capital management**

The Company manages its capital to ensure that it is able to continue as a going concern while maximising the return to the shareholder through the optimisation of the debt and equity balance. The Company's overall strategy remains unchanged from 2015.

The capital structure of the Company consist of net debt less cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in note 14.

The Company aims to deliver its objective by investing available cash and using leverage whilst maintaining sufficient liquidity to meet ongoing expenses and dividend payments.

**Gearing ratio**

As at the reporting date, the Company had outstanding debt of £3.2m (2015: £3.2m) which represented a gearing ratio of 7% (2015: 7% ).

### FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks: market risk (including foreign currency exchange rate risk, interest rate risk and inflation risk), credit risk, liquidity risk, and capital risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance. The Company's investment entities use derivative financial instruments to hedge certain risk exposures.

The financial risks of the Company's investments are hedged at the inception of a project. The various types of financial risk are managed as follows:

Market risk - interest rate risk

The Company's interest rate risk arises on the floating rate deposits. The Company does not have borrowings issued at variable rates and therefore is not subject to interest rate risk on its liabilities.

Each PPP investment hedges its interest rate risk at the inception of a project. The PPP investment is bank financed, with variable rate debt which are swapped into fixed rate by the use of interest rate swaps.

The fluctuations in interest rates impact the return from floating rate deposits and hence the income from investments at fair value through profit or loss. A 1% increase or decrease represents Management's assessment of the reasonable possible change in interest rates.

For a sensitivity analysis of investments at fair value through profit or loss, refer to Note 8.

Market risk - inflation risk

The investment has part of its revenue and some of its costs linked to a specific inflation index at inception of the project. This creates a natural hedge, meaning a derivative does not need to be entered into in order to mitigate inflation risk.

For a sensitivity analysis of investments at fair value through profit or loss, refer to Note 8.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 16 FINANCIAL INSTRUMENTS (CONTINUED)

### FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk

Credit risk is managed by the Company's parent. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to customers.

The Company's parent mitigates its risk on cash investments and derivative transactions by only transacting with banking counterparties with high credit ratings assigned by international credit rating agencies (a minimum of Standard and Poor's A-1).

The Company's investments receive revenue from government departments, public sector or local authority clients. Therefore these projects are not exposed to significant credit risk.

The performance risk arises from the PPP investments' inability to pay the forecast distributions as the Company relies on its PPP investments projects companies to perform adequately and return the expected yields.

Several factors could hinder this ability such as poor operational performance, exceptional expenditures, major maintenance overspend or an event that would affect the PPP project company's cover ratios. The Company's PPP investments are also dependent on the performance of their main operational contractors. The Company regularly monitors the contractors' concentration and financial strength.

Given the above factors, the Board does not consider it appropriate to present a detailed analysis of credit risk.

Liquidity risk

The Company adopts a prudent approach to liquidity management by maintaining sufficient cash and available committed facilities to meet its obligations. Due to the nature of its investments (PPP projects) the timing of cash outflows is reasonably predictable and, therefore, is not a major risk to the Company.

The Company's liquidity management policy involves projecting cash flows in major currencies and assuming the level of liquid assets necessary to meet these.

Capital risk

The Company's capital structure comprises intercompany debt and equity (refer to the Statement of Changes in Equity). As at 31 December 2016 the Company had no recourse debt (2015: nil).

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

**16 FINANCIAL INSTRUMENTS (CONTINUED)**

**Financial instruments by category:**

| | 31 December 2016 | | | | |
|---|---|---|---|---|---|
| | **Cash and bank balances** | **Loans and receivables** | **Financial assets at FVTPL*** | **Financial liabilities at amortised cost** | **Total** |
| Levels | 1 | 1 | 3 | 1 | |
| | **£'000s** | **£'000s** | **£'000s** | **£'000s** | **£'000s** |
| **Non-current assets** | | | | | |
| Investments at fair value through profit or loss (Level 3) | - | - | **45,487** | - | **45,487** |
| **Total financial assets** | - | - | **45,487** | - | **45,487** |
| **Current liabilities** | | | | | |
| Trade and other payables | - | - | - | **(312)** | **(312)** |
| **Non-current liabilities** | | | | | |
| Interest bearing loans and borrowings | - | - | - | **(3,226)** | **(3,226)** |
| **Total financial liabilities** | - | - | - | **(3,538)** | **(3,538)** |
| **Net financial instruments** | - | - | **45,487** | **(3,538)** | **41,949** |

| | 31 December 2015 | | | | |
|---|---|---|---|---|---|
| | Cash and bank balances | Loans and receivables | Financial assets at FVTPL* | Financial liabilities at amortised cost | Total |
| Levels | 1 | 1 | 3 | 1 | |
| | £'000s | £'000s | £'000s | £'000s | £'000s |
| Non-current assets | | | | | |
| Investments at fair value through profit or loss (Level 3) | - | - | 45,896 | - | 45,896 |
| Total financial assets | - | - | 45,896 | - | 45,896 |
| Current liabilities | | | | | |
| Trade and other payables | - | - | - | (312) | (312) |
| Non-current liabilities | | | | | |
| Interest bearing loans and borrowings | - | - | - | (3,226) | (3,226) |
| Total financial liabilities | - | - | - | (3,538) | (3,538) |
| Net financial instruments | - | - | 45,896 | (3,538) | 42,358 |

** FVTPL = Fair value through profit or loss*

The above table provides an analysis of financial instruments that are measured subsequent to their initial recognition at fair value as follows:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs to the asset or liability that are not based on observable market data (unobservable inputs).

There were no Level 2 assets or liabilities during the year (2015: none). There were no transactions between Level 1 and 2, Level 1 and 3 or Level 2 and 3 during the year (2015: none).

**Reconciliation of Level 3 fair value measurement of financial assets and liabilities**

An analysis of the movement between opening to closing balances of the investments at fair value through profit or loss is given in note 8. For financial assets at fair value through profit or loss, changing the discount rate used to value the underlying instruments would alter the fair value.

The investments at fair value through profit or loss, whose fair values include the use of level 3 inputs, are valued by discounting future cash flows from investments in both equity (dividends and equity redemptions) and subordinated loans (interest and repayments) to the Company at an appropriate discount rate. The basis of each discount rate, which is a weighted average cost of capital, is a long run average government bond rates adjusted by an appropriate premium to reflect PPP specific risk, phase of he PPP project and counterparty credit risk. The weighted average discount rate applied was in the range of 7.02% to 9.00% (year ended 31 December 2015: 7.19% to 8.46%). The discount rate is considered the most significant unobservable input through which an increase or decrease would have a material impact on the fair value of the investments at fair value through profit or loss.

The fair value of the PPP investments would be an estimated £2.3 million higher or £2.1 million lower (2015: estimated £2.3 million higher or £2.1 million lower) if the discount rate used in the discounted cash flow analysis were to differ by 1% from that used in the fair value calculation.

For a sensitivity analysis of Financial Assets at fair value through profit or loss, refer to Note 8.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**
**for the year ended 31 December 2016**

## 17 GUARANTEES AND OTHER COMMITMENTS

As at 31 December 2016 the Company had no commitments (2015: no commitments).

## 18 DISCLOSURE - SERVICE CONCESSION ARRANGEMENTS

The Company holds an investment in service concession arrangements in the Government buildings sector. The concession may vary on the obligations required but typically it requires the construction and operation of an asset during the concession period. The concession may require the acquisition or replacement of an existing asset or the construction of a new asset. The operation of the asset may include the provision of facilities management services like cleaning, catering, caretaking and major maintenance. At the end of the concession period on the majority of the concessions the assets are returned to the concession provider. As at 31 December 2016 all the service concessions were fully operational (31 December 2015 - All).

The rights of both the concession provider and concession operator are stated within the specific project agreement. The standard rights of the provider to terminate the project include poor performance and in the event of force majeure. The operator's rights to terminate include the failure of the provider to make payment under the agreement, a material breach of contract and relevant changes of law which would render it impossible for the service company to fulfil its requirements.

| | | | | | Period of concession | | | |
|---|---|---|---|---|---|---|---|---|
| Sector | Company name | Project name | % owned | Short description of concession arrangement | Start date | End date | No. years | Project capex |
| **Government Buildings** | Modus Services Limited | MOD Main Building | 26% | Design, build, finance and operate Ministry of Defence offices in Whitehall. | 04-May-2000 | 03-May-2030 | 30 | Refurbishment of existing buildings costing £416 million. |

## 19 ULTIMATE PARENT UNDERTAKING

The Company's immediate parent entity is the JLIF Limited Partnership, a limited partnership established in England under the Limited Partnership Act 1907, which acts through its General Partner, JLIF (GP) Limited, registered in England. The Company's immediate parent entity is incorporated in Great Britain and registered address is 1 Kingsway, London, WC2B 6AN.

The Company's ultimate parent and controlling entity is John Laing Infrastructure Fund Limited, a company incorporated in Guernsey, Channel Islands. Copies of the financial statements of John Laing Infrastructure Fund Limited are availalable from the its website www.jlif.com.

## 20 INVESTMENTS IN JOINT VENTURE

| Name of Joint Venture | Registered Office Address | Place of Incorporation | Percentage of interest | Financial year end | Net assets / liabilities £000 | Profit & Loss for the year £000 |
|---|---|---|---|---|---|---|
| Modus Services (Holdings) Limited | ** | United Kingdom | 26% | 31/03/2016 | 100 | - |
| Modus Services Limited* | ** | United Kingdom | 26% | 31/03/2016 | (47,434) | 25,208 |

* Indirectly held company
** 46 Charles Street, Second Floor, Cardiff, Wales, CF10 2GE