



The Board of Directors
Equity Partners Infrastructure Company No 1 Limited
PO Box 3376
AUCKLAND 1140

31 October 2011

Independent Appraisal Report regarding proposed sale of 1.24% Indirect Shareholding in Thames Water

1. PricewaterhouseCoopers (PwC) has been engaged by the Directors of Equity Partners Infrastructure Company No 1 Limited (EPIC or the Company) to prepare an independent appraisal report (the Report) in relation to the proposed sale of EPIC's indirect shareholding in Thames Water Limited (Thames Water) (the Proposed Transaction) for EPIC shareholders (the Shareholders).

Background

2. EPIC is operating in an environment that has changed considerably since the Company's establishment in 2007, particularly as a consequence of the global financial crisis (GFC). Despite reasonable underlying performance by EPIC's two main investments, recent deleveraging in combination with volatile currency markets has reduced the cash income received by EPIC from its investments and increased the Company's gearing to an unsustainable level.
3. As a result, EPIC's Directors (the Board or the Directors) commissioned a strategic review seeking a way forward that would reduce the Company's risk profile, whilst still maximising shareholder value.
4. Following the Strategic Review, EPIC has decided to pursue the sale of its 1.24% indirect stake in Thames Water, to facilitate repayment of maturing debt and provide EPIC with greater liquidity and improved financial flexibility.
5. Based on the expected sale price for the Company's Thames Water shareholding, the Proposed Transaction is likely to constitute a "major transaction" as defined in Section 129 of the Companies Act 1993. It therefore needs shareholder approval by way of a special resolution supported by 75% of those Shareholders entitled to vote and voting on the matter.

Purpose of Report

6. The Directors of EPIC requested that PwC prepare an independent appraisal report assessing the merits of the Proposed Transaction, to assist them with informing EPIC shareholders about the Proposed Transaction and other options that have been considered. This Report will be provided to Shareholders by the Company notwithstanding that there is no statutory requirement to do so.
7. To prepare the Report we considered the "value implications" of the Proposed Transaction (i.e. is the price that is expected to be obtained reasonably consistent with "fair market value"); together with a range of other factors, in particular:
 - Relevant factors influencing the saleability (and therefore the expected price) for EPIC's shareholding in Thames Water;
 - What other feasible options are available to enable the Company to address the issues it faces; and
 - What happens if the Proposed Transaction does not proceed?



8. The Directors have requested that we provide this letter (the Summary Letter) summarising the Report which will be sent to Shareholders in conjunction with the Notice of Meeting seeking Shareholder approval for the Proposed Transaction. The Report will be made available to Shareholders via the Company's website (www.epam.co.nz) and also will be available in hard copy form free of charge from the Company upon request. The Report contains background information on EPIC and its current position, a more extensive summary of the Proposed Transaction, background information on Thames Water including the ownership structure, our detailed assessment of the Proposed Transaction and our analysis of the range of options available to EPIC. The Summary Letter is a summary only and is intended to be read in conjunction with the Report and accordingly Shareholders are encouraged to read the Report in full.
9. Each Shareholder's circumstances and investment objectives will be different. It is therefore not possible to advise what the specific impact of the Proposed Transaction will be for each individual Shareholder nor prescribe what action an individual Shareholder should take in response. Our advice is necessarily general in nature and is intended to assist each Shareholder to form their own opinion as to the implications of the Proposed Transaction for them and what action they should take given their respective circumstances.

Declarations, Qualifications, Disclaimer and Restrictions

10. This Summary Letter and the Report should be read in conjunction with the statements and declarations set out in Appendix A regarding our independence, qualifications, restrictions on the use of this Summary Letter, reliance on information, general disclaimer, limitation of liability and our indemnity.

Independence

11. PwC New Zealand is the statutory auditor of EPIC. We do not believe that our role as auditor of EPIC compromises our independence or presents a conflict of interest.
12. Thames Water was previously a PwC UK audit client, but is no longer one. PwC UK currently carry out a range of non-audit advisory and tax engagements for Thames Water. We do not consider that these roles give rise to any conflict or independence issues, given the fact that although Thames Water is the subject of the Proposed Transaction, it will not be a party to it.

Note

13. All monetary amounts herein are expressed in New Zealand currency (NZD) and are stated exclusive of Goods and Services Tax (GST), unless indicated to the contrary. Generally references to "year" should be taken as referring to EPIC's financial years ending on 31 March. For example, references to the "2011 year" refer to the financial year ended 31 March 2011. A glossary of abbreviations is contained in Appendix B.

Issues Facing EPIC

14. Dividend income has declined significantly following the suspension of dividend payments by EPIC's second largest investment, Moto. As a result, EPIC has a negative cash flow with its dividend income being insufficient to cover operating expenses and financing costs, resulting in a shortfall that needs to be funded. In our view, this situation is unlikely to alter for at least another 12 months.
15. EPIC's current borrowing facilities with NAB expire on 30 April 2012. NAB previously sought a \$14.0m reduction in the facility which was to be funded by either a capital raising or sale of assets. Neither of these was able to be completed within the required timeframe and instead EPIC was granted a waiver by NAB subject to PGC, the ultimate parent of EPIC's Manager, agreeing to make a payment of \$14m to NAB in return for a pro rata participation in the NAB facilities. PGC's support was provided to enable EPIC to undertake an orderly sale process or capital raising, and was not intended to constitute long term funding.



16. Convertible loan notes issued to the Torchlight Fund in March 2011 to fund EPIC's participation in Moto's capital raising were also not intended to provide long term funding. The convertible loan notes have steeply escalating coupon rates every six months to encourage repayment, and therefore need to be repaid or replaced with more appropriate and cost effective long term funding.
17. EPIC's current financial position is not sustainable and the Company will need to take action to address its negative cash flow, the escalating coupon rate on the convertible loan notes, and the impending expiry of its bank loan facilities which must be repaid or renegotiated.

The Proposed Transaction

18. Following a market testing exercise undertaken by MIRA(E)L, EPIC has received an expression of interest from an undisclosed international third party investor to divest its largest investment, a 1.24% indirect stake in Thames Water. MIRA(E)L is part of the Macquarie Group and has extensive experience in relation to the operation and management of Thames Water, its investors, and provisions of the Shareholders' Agreements that govern such sales.
19. We have been advised that a non-binding offer has been submitted by a third party investor interested in acquiring a specific minority interest in Thames Water. We are advised that MIRA(E)L is also aware of certain other KWIHL shareholders that are interested in selling their shares at the price indicated by the third party investor and accordingly has offered EPIC the potential opportunity to sell its 1.24% indirect interest in Thames Water as part of this larger transaction. It is expected that EPIC will receive a pro rata proportion of the total price to be paid by the third party investor for its 1.24% indirect shareholding.
20. MIRA(E)L has informed EPIC that a non-binding agreement has been executed with the third party investor confirming the price and total level of shareholding that it is seeking to acquire pursuant to the offer described above. However, as any sale by EPIC, and other existing Thames Water shareholders, is subject to the pre-emption processes pursuant to the Shareholders' Agreements, a binding sale agreement does not exist. The pre-emption processes are expected to take 4 – 6 weeks each once the sale notices have been issued. There is a risk that existing shareholders do not exercise their pre-emptive rights and the third party investor subsequently decides not to proceed or seeks to materially alter the terms. In this event, EPIC would need to find an alternative buyer or accept the revised terms offered.
21. In order to provide a degree of flexibility to cater for potential uncertainty, the Board is seeking Shareholder approval to sell the Company's 1.24% indirect investment in Thames Water at a price no less than £34.0m (the Minimum Price). The Minimum Price reflects the assessed fair value of EPIC's Thames Water shareholding as reported in EPIC's financial statements as at 31 March 2011. The Minimum Price is less than the non-binding offer price that has been negotiated with the new third party investor.
22. Any sale of EPIC's Thames Water shareholding will be subject to:
 - Approvals by EPIC shareholders and NAB prior to settlement;
 - Compliance with the terms of the Shareholders' Agreements; and
 - Execution of a share sale and purchase agreement by the new third party investor following the outcome of the pre-emption processes (assuming EPIC's shares are not acquired pursuant to the pre-emption processes).
23. Assuming the above conditions are met, the Proposed Transaction is expected to be completed by 31 December 2011.



Assessment of Options Available to EPIC

24. There are five options available to consider in relation to the financial issues immediately facing EPIC:
 - Do Nothing (or “status quo”);
 - Renegotiation of Funding;
 - Capital Raising;
 - Sale of Moto investment; and
 - Sale of Thames Water indirect shareholding.
25. Under the status quo, EPIC will be unable to repay the NAB facilities by 30 April 2012 and in our opinion the option of doing nothing is not a viable alternative for the Board.
26. It is unlikely that NAB (or any other bank) would be willing to provide EPIC with long term funding matching the quantum and on similar terms to those it currently has given the level of leverage this would represent, and the fact that the Company has negative operating cash flow and is therefore unable to fully service debt under the status quo. Accordingly, we do not consider that renegotiation of EPIC’s debt funding, either with NAB or through alternative providers, is likely to be feasible. EPIC needs to materially reduce its current debt level to reduce financing costs and improve operating cash flow.
27. A capital raising would enable EPIC to repay debt and thereby reduce (or eliminate) its financing costs. A capital raising could take the form of a pro rata rights issue to existing Shareholders and / or a placement to certain existing or new shareholders.
28. In order for EPIC to raise the substantial amount of new capital required, we believe it is likely that a rights issue would need to be priced at a discount, especially given recent Shareholder sentiment together with EPIC’s share price performance and illiquidity, to motivate Shareholders to take up their rights. Shareholders who do not elect or are unable to participate would have their ownership position diluted. We believe a placement of shares to existing or new shareholders would also require a discount. Furthermore, EPIC’s unlisted status would restrict the ability of certain investors to participate. Accordingly, whilst a capital raising is technically feasible, there are a number of practical and commercial difficulties and Shareholders are at risk of suffering considerable value loss should the Company undertake a discounted rights issue or placement of new capital.
29. A sale of EPIC’s 17.49% stake in Moto at around, or in excess of, the current book value of \$45m would repay a substantial proportion of EPIC’s outstanding net debt. It would also realise an investment that is not currently paying any dividends and we do not expect this to alter in the near term. Moto may even require additional capital from its shareholders, hence there is some attraction in the Company pursuing this option.
30. An informal market sounding resulted in only one offer from a related party for EPIC’s 17.49% stake in Moto, received in June 2011. The offer was considered reasonable by the Board in terms of value, however, the offer was structured as a staged transaction with a number of conditions and did not provide the Company with certainty around being able to meet its debt repayment obligations. Following due consideration of the offer, the Board decided to retain EPIC’s stake in Moto in favour of seeking a ‘cleaner’ exit in respect of its stake in Thames Water.
31. Given the timeframe that EPIC must work to in terms of addressing its debt repayment obligation, the fact that it has already attempted to find a purchaser for its Moto stake, and certain restrictions within the Moto shareholders’ agreement that affect the saleability of the shareholding, we do not believe that a fresh attempt at realising this investment represents a realistic option for the Company at the present time.



32. We have evaluated the Minimum Price for Thames Water stipulated as part of the Proposed Transaction that Shareholders are being asked to approve relative to recent comparable trading multiples for UK water utilities and comparable recent transaction data for the UK water sector. We have compared the implied enterprise value (EV) relative to Thames Water's regulated capital value (RCV), which is a standard metric used to cross-check the primary discounted cash flow (DCF) valuation approach used in this industry. While noting that this value metric reflects a number of company and transaction specific attributes which need to be considered when comparing multiples (such as RCV growth, regulatory performance, operational efficiencies, and shareholding acquired), the analysis indicates that the EV / RCV multiple implied by the Minimum Price is fair and reasonable.
33. A sale of the Thames Water stake at or above the Minimum Price will enable EPIC to repay most, if not all, of its debt including the Convertible Notes and depending on the sale price actually achieved and the level of debt repaid, may leave the Company in a position where it has surplus funds available.
34. In this eventuality, the Company may be able to consider other infrastructure-related investment opportunities consistent with its updated strategy per the Strategic Review. At present, EPIC is precluded from considering any investment opportunities as it has no financial flexibility.
35. Other options identified for EPIC from the Strategic Review that could be considered following completion of the Proposed Transaction include an internalisation of its management function, which may find favour with investors who are showing a preference for internally managed investment vehicles; as well as the prospect of a partial share buyback that would provide a degree of liquidity for Shareholders. Sale of the Thames Water investment also opens up the prospect that the Company could seek a listing of its shares on the NZX to provide Shareholders with better liquidity.

Conclusions

36. EPIC needs to address its pending debt repayment obligations in the most effective and expedient way possible in order to maximise shareholder value. Failure to address this issue is likely to result in a materially worse outcome for Shareholders and hence the status quo is not a viable option for the Company.
37. Debt markets have changed significantly since EPIC was established. This coupled with EPIC's negative cash flow following Moto's suspension of dividends means that in our assessment EPIC will be unable to secure alternative term debt funding on terms comparable to its existing bank facility.
38. In our opinion, any equity capital raising whether by way of a pro rata rights issue or placement would need to be priced at a discount to the current value of the Company's shares and would be value dilutive for Shareholders unable or unwilling to participate. Accordingly, Shareholders' interests are likely to be best served by realising assets at around their fair value, if achievable.
39. EPIC has two major investments that could be realised in order to materially reduce EPIC's indebtedness – a 17.49% investment in Moto and a 1.24% indirect shareholding in Thames Water. An offer for EPIC's Moto investment was rejected by the Board as it contained a number of conditions and did not provide the required level of certainty of funding ahead of the 30 April 2012 bank repayment deadline. We do not believe it is feasible to commence a fresh attempt to divest the Moto stake at the present time.
40. EPIC is seeking Shareholder approval to sell its 1.24% indirect shareholding in Thames Water for no less than the Minimum Price pursuant to the Proposed Transaction. In our opinion the Minimum Price is fair and reasonable given it reflects EPIC's pro rata share of the 31 March 2011 reported "fair value" for this investment and it is broadly consistent with comparable EV / RCV multiples for other listed UK water utilities and the EV / RCV multiples evidenced by comparable recent transactions in the UK water sector.
41. Accordingly, the Proposed Transaction comprising the sale of EPIC's interest in Thames Water for no less than the Minimum Price is, in our opinion, a reasonable and appropriate course of action given all the circumstances faced by EPIC.



42. Importantly, we note that as at the date of this Report, the Proposed Transaction does not constitute a binding commitment for the sale of the Company's indirect 1.24% shareholding in Thames Water. Consequently, Shareholders need to be aware that even if the Proposed Transaction is approved there is no certainty that it will proceed, and that there will be a sale of the Thames Water stake at, or in excess of, the Minimum Price. However, we believe that the Company's pursuit of this transaction represents the best course of action open to it, given all the circumstances confronting EPIC.

43. In the event that the Proposed Transaction does not proceed, then the Company will have less than five months before expiry of its debt facilities in order to find an alternative solution. In our view, this would be a near untenable position for the Directors, given they have already explored the feasible options. The Board would have little alternative but to consider some form of discounted capital raising, which in all likelihood would transfer a substantial ownership position and control of EPIC to the new capital provider(s). This would in effect, be equivalent to existing investors selling a substantial proportion of their indirect participation in Thames Water and Moto. However, we believe the outcome for Shareholders is likely to be materially worse in this eventuality, given the pressure that the Company would be under due to the pending debt maturity, which would manifest itself in a much larger value transfer from the Shareholders to the new investors providing the fresh capital.

Yours faithfully

PricewaterhouseCoopers

A handwritten signature in black ink, appearing to read "David Bridgman", with a horizontal line extending to the right.

David Bridgman
Partner

A handwritten signature in black ink, appearing to read "Eric Lucas", with a horizontal line extending to the right.

Eric Lucas
Partner

Appendix A – Statement of Independence, Disclaimer, Restrictions, Limitation of Liability, and Indemnity

Qualifications

This Summary Letter and our Report have been prepared by the Corporate Finance division of PricewaterhouseCoopers, which provides advice on mergers, acquisitions and divestments, valuations, independent expert's reports and appraisals, financial investigations and strategic corporate advice.

The Partners responsible for the Report are David Bridgman M.Com, LLB, CA and Eric Lucas BA (Hons), FCA, both of whom have extensive experience in relation to corporate restructurings and the preparation of independent expert's reports for the benefit of investors.

Independence

PricewaterhouseCoopers considers itself independent of EPIC in relation to the Proposed Transaction.

Our fee for preparation of this report is based on the time required for its completion, and it is not contingent on the success or implementation of the Proposed Transaction.

We are not, and do not intend to be, a director, officer, or employee of, EPIC.

In addition to this Summary Letter and our Report we have provided the following advice and reports to EPIC during the last three years:

- Analysis of EPAM Value Report – June 2009; and
- EPAM Due Diligence Report – June 2009.

PricewaterhouseCoopers New Zealand is the statutory auditor of EPIC.

Scope, Disclaimer and Restrictions

The purpose of this Summary Letter and our Report is to advise the Directors of the EPIC Board about the Proposed Transaction and its likely future impact on the Company and its shareholders.

The Summary Letter and Report are prepared solely for this purpose and should not be used or relied upon for any other purpose.

The statements and opinions expressed in this Summary Letter and our Report are based on information available as at the date of the Report.

In preparing this Summary Letter and our Report, we have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of EPIC or any of its related entities. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

In forming our opinions, we have relied on forecasts and assumptions prepared by EPIC and third parties reporting to EPIC (including members of the Macquarie Group) about future events which by their nature are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

The statements and opinions expressed in this Summary Letter and our Report have been made in good faith and on the basis that all relevant information for the purposes of preparing our Report has been provided by EPIC and / or its directors and advisers, and that all such information is true and accurate in all material aspects and not misleading by reason of omission or otherwise.

Accordingly, neither PricewaterhouseCoopers nor its partners, employees or agents, accept any responsibility or liability for any such information being inaccurate, incomplete, unreliable or not soundly based or for any errors in the analysis, statements and opinions provided in this Summary Letter or our Report resulting directly or indirectly from any such circumstances or from any assumptions upon which our Report is based proving unjustified.

Our opinions have been arrived at based on economic, market and other conditions prevailing at the date of this Summary Letter and our Report. Such conditions may change significantly over relatively short periods of time.

We reserve the right, but will be under no obligation, to review or amend our Summary Letter and Report, if any additional information, which was in existence on the date of our Report, was not brought to our attention, or subsequently comes to light.

Limitation of Liability

PricewaterhouseCoopers will accept liability to pay damages for losses arising as a direct result of breach of contract or negligence on our part in respect of services provided in connection with, or arising out of, this engagement but, to the extent permitted by law, any liability of PricewaterhouseCoopers, its partners and staff (whether in contract, negligence or otherwise) shall in no circumstances exceed five times the fees paid in the aggregate in respect of all such services.

We accept no liability to any party other than the addressee, as our client.

Indemnity

EPIC has agreed to indemnify us against claims brought by any third party (which includes but is not limited to EPIC Shareholders and prospective investors). The indemnity covers PricewaterhouseCoopers for any loss or liability suffered or incurred as a result of or in connection with the preparation of this Summary Letter or our Report. The indemnity will not apply to the extent that it has been determined by a Court that there is negligence or misconduct on our part.

Appendix B – Glossary

AMP	:	Asset management plan
AMP5	:	Asset management plan for period 2010 - 2015
Board or the Directors	:	EPIC's board of directors
CIS	:	Capital incentive scheme
DCF	:	Discounted cash flow
DRP	:	Dividend reinvestment plan
EBIT	:	Earnings before interest and tax
EBITDA	:	Earnings before interest, tax, depreciation and amortisation
EPAM	:	Equity Partners Asset Management Limited
EPIC or the Company	:	Equity Partners Infrastructure Company No 1 Limited
EPIM or the Manager	:	Equity Partners Infrastructure Management Limited
EV	:	Enterprise value
FYXX	:	The financial year ended 31 March 20XX
FX	:	Foreign exchange
GBP	:	British pound
GFC	:	Global financial crisis
GST	:	Goods and services tax
IPO	:	Initial public offering
IRR	:	Internal rate of return
KWHL	:	Kemble Water Holdings Limited
KWIHL	:	Kemble Water International Holdings Limited
KWHL SHA	:	KWHL Shareholders' Agreement
KWIHL SHA	:	KWIHL Shareholders' Agreement
Macquarie Group	:	The Macquarie Bank Limited group of companies
Management	:	EPIC management
MEIF I	:	Macquarie European Infrastructure Fund LP
MEIF II	:	Macquarie European Infrastructure Fund II
MIFML	:	Macquarie Infrastructure Funds Management Limited
MIRA(E)L	:	Macquarie Infrastructure and Real Assets (Europe) Limited
Moto	:	Moto International Limited
NAB	:	National Australia Bank Limited
NPAT	:	Net profit after tax
NTA	:	Net tangible assets
NWG	:	Northumbrian Water Group
NZD	:	New Zealand dollar
NZX	:	New Zealand stock exchange
Ofwat	:	UK Water Services Regulation Authority
PGC	:	Pyne Gould Corporation Limited
PwC	:	PricewaterhouseCoopers
RCV	:	Regulated capital value
Report	:	The independent appraisal report in relation to the Proposed Transaction

RPI	:	Retail price index
Shareholders	:	The shareholders of EPIC
Shareholders' Agreements	:	The KWIHL SHA and KWHL SHA, together
Strategic Review	:	The strategic review commissioned by EPIC's Board in October 2010
Summary Letter	:	The summary letter in relation to the Report
Thames Water	:	Thames Water Limited
The Proposed Transaction	:	The proposed sale of EPIC's shareholding in Thames Water
Torchlight	:	Torchlight Fund No. 1 LP
Torchlight Investment Group	:	Torchlight Investment Group Limited
TWUL	:	Thames Water Utilities Limited
UK	:	United Kingdom