FINANCIAL ANALYSIS

_Financial results

Weak market conditions and a difficult competitive environment during 2003 have led to lower Shuttle yields and revenues despite higher truck volumes. Operating revenue was 5% lower than 2002 at £566 million. Operating costs were held stable. The operating profit was £170 million. Interest charges, which averaged 4.9%, were £7 million higher compared to the 2002 figure which benefited from a £17 million non-recurring reduction. The underlying loss for 2003 was £148 million. A £115 million exceptional profit was generated from financial operations. The net result was a £34 million loss before an impairment charge of £1.3 billion arising from the application of IAS36 (equivalent to FRS11) at 31 December 2003.

To make a valid comparison between 2003 and 2002 in both sterling and euros, the operating results for 2002 have been restated at the exchange rate used for the 2003 results (£1=€1.435) as set out in the table below.

_Turnover

Operating revenue fell by 5% to £566 million. Revenue from Shuttle Services fell by 11% to £309 million at constant exchange rates, principally due to the impact of lower average yields from the truck and car businesses which offset increased carryings in the truck business. Railways revenue increased slightly to £232 million as a result of inflation, and remains protected until November 2006 by payments under the provisions of the Minimum Usage Charge in the Railway Usage Contract. The Minimum Usage Charge payment accounted for £77 million of the total Railways revenues in 2003.

Revenue of £25 million was generated from non-transport activities in 2003, including retail and telecoms revenues and proceeds of £7 million from the sale of land in the UK.

Other income of £18 million largely comprises the release of provisions for large scale maintenance. The increase in this non-cash item offsets increased operating costs during 2003 relating to the mid-life refit of the shuttle fleet.

At £584 million, total turnover for the year was 4% lower than 2002.

_Operating profit

The operating profit of £170 million was down 18%. Operating costs were stable at £259 million, with increases in insurance premiums and maintenance costs relating to the mid-life refit of the Shuttle fleet offset by cost reductions including energy costs. The increase in cost of sales reflects the value of land stocks disposed of during the year.

At £146 million, depreciation and provisions increased by £5m compared to 2002 as a result of higher Tunnel depreciation charges.

_Interest charges

Net interest costs in 2003 were £318 million, reflecting an average interest rate of 4.9%. The increase compared to 2002 reflects a £17 million non-recurring reduction to 2002 interest charges as a result of financial operations concluded during that year. The reduction in 2003 interest charges resulting from debt repurchases contributed to an underlying improvement of £10 million in interest charges in 2003 compared to 2002.

_Net result

The net result before impairment charge was a loss of £34 million.

The exceptional profit for the period of £115 million comprised the profit arising from three UK leasing company acquisitions, and the profit generated from the repurchase of debt at a substantial discount to face value with the cash proceeds of such transactions.

Impairment charge

The valuation of the Group's assets has been carried out in accordance with IAS36 (equivalent to FRS11) which compares the net book value of assets with the discounted future value of cash flows. The result of this valuation is an impairment charge of £1.3 billion. This non-cash item has been recorded in the profit and loss account and reduces shareholders funds at 31 December 2003 by the same amount. This impairment charge has no impact on the Group's liquidity position or its loan covenants.

The net loss of £1,334 million for the year after impairment charge compared to a profit of £302 million in 2002.

_Cash flow and interest cover

Cash flow from operating activities was £315 million in 2003. The majority of the reduction, compared to 2002 was due to lower Shuttle revenues, with the balance accounted for by exchange rate movements and working capital movements.

Net capital expenditure fell from £41 million in 2002 to £25 million in 2003 resulting in net cash flow from operating activities after capital expenditure of £290 million.

Interest cover after capital expenditure (which measures cash flow after capital expenditure as a proportion of the net interest charge due) was 90%. This compares with the 2002 result of 102% which included a non-recurring benefit of £17 million from financial operations

The £20 million net receipts from financial operations result from the UK leasing company transactions. The £67 million change in financial assets and liabilities reflects cash spent on debt repurchases in 2003.

_Profit and Loss Account

£ million	2003 actual	2002 restated	2003/2002 % change	2002 reported
Exchange rate €/£	1.435	1.435		1.573
Shuttle Services	309	349	-11%	333
Railways	232	227	+2%	217
Transport activities	**541**	**576**	**-6%**	**550**
Non-transport activities	25	21	+20%	20
Operating revenue	**566**	**597**	**-5%**	**570**
Other income	18	12		11
Total turnover	**584**	**609**	**-4%**	**581**
Cost of sales	(9)	(2)		
Operating costs	(259)	(259)	0%	(247)
Operating margin	**316**	**348**	**-9%**	**334**
Depreciation and provisions	(146)	(141)		(140)
Operating profit	**170**	**207**	**-18%**	**194**
Interest	(318)	(311)		(299)
Underlying losses	**(148)**			**(105)**
Exchange losses	(1)			(21)
Exceptional profit	115			428
Net loss before impairment charge	**(34)**			**302**
Impairment charge	(1,300)			
Net loss after impairment charge	**(1,334)**			

_Cash Flow Statement

£ million	2003 actual	2002 reported
Exchange rate €/£	1.419	1.537
Net cash flow from operations	315	348
Capital expenditure (net)	(25)	(41)
Cash flow after capital expenditure	**290**	**307**
Net interest paid in cash	(278)	(248)
Net increase in financial assets	(1)	–
Net receipts from exchange rate hedging	–	2
Net receipts from financial operations	20	9
Net cash flow from change in financial assets and liabilities	(67)	10
Net equity receipts	–	1
(Decrease) / increase in cash balances	**(36)**	**81**
Interest cover before capital expenditure	98%	116%
Interest cover after capital expenditure	90%	102%

FINANCIAL ANALYSIS

_Financing

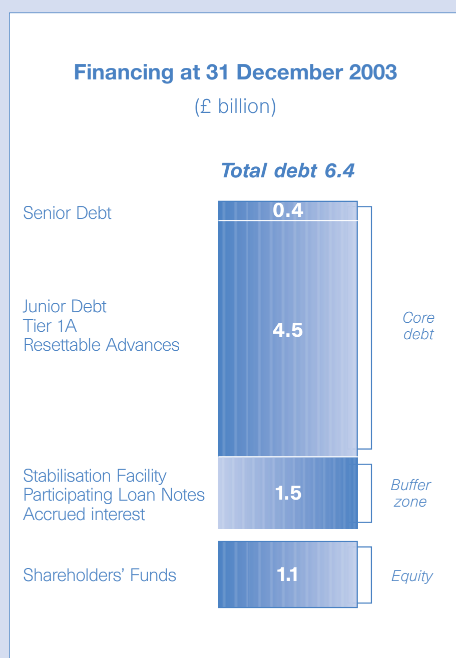
Eurotunnel's funding falls into three main parts – Core Debt, a Buffer Zone, and equity.

The Core Debt totalling £4.9 billion comprises £0.4 billion of Senior and 4th Tranche Debt, £3.3 billion of Junior Debt and £0.7 billion of Tier 1A Debt, and £0.5 billion of Resettable Advances.

No debt repayments are due before 2006. Junior Debt repayments are scheduled to commence in 2007 with a repayment of £33 million.

The Buffer Zone of £1.5 billion includes £508 million drawings under the Stabilisation Facility, which is available to meet interest payments which cannot be paid in cash during 2004 and 2005. The Stabilisation Advances carry 0% interest until 2006. Eurotunnel is able to convert the Stabilisation Advances' outstanding at the end of 2005 into shares in order to assist the Company in managing its financial position following the end of the Stabilisation Period. In view of the current outlook and the attractive terms of conversion, the Group expects to recommend to shareholders the conversion of all these Advances although the final decision does not need to be taken until 2005. This Zone also includes the Participating Loan Notes (PLN) which carry 1% fixed interest until 2006.

The third part of the financing structure is the Shareholders' funds, which at 31 December 2003 totalled £1.1 billion after the impairment charge. On 31 December 2003, the outstanding Equity Notes were redeemed by the issue of 1.01 new Eurotunnel Units for each Note held. As a result, a total of 183,134,565 new Eurotunnel Units were issued, representing approximately 7.75% of the existing issued ordinary share capital of Eurotunnel. The new Units, which have the same rights as the Units currently in issue, were admitted to listing and trading in London, Paris and Brussels.



1. Based on the £508 million Stabilisation Advances that were outstanding on 31 December 2003, such conversion would lead to the creation of 426 million new Units at a fixed conversion rate of £1.19 (at a sterling/euro exchange of €1.419). This would represent 14% of the total number of shares in issue following conversion of the equity notes at the end of the year. This would reduce interest charges by approximately £28 million per annum from 2006.
Fully diluted share capital on the above basis would be 2,972 million Units.

_Financial operations

During 2003, Eurotunnel acquired three UK leasing companies, generating £25 million cash for debt reduction. With these proceeds, and the proceeds remaining from last year's leasing transactions, Eurotunnel repurchased or repaid £155 million of debt reducing interest charges by approximately £5 million per annum.

_Financial situation

2003 saw a significant decline in revenues due largely to lower yields, as operators sought to maintain volumes in markets where growth had slowed significantly.

Eurotunnel is actively exploring how the fundamental structural problems in the cross-Channel rail industry can be addressed. This would involve the realignment of incentives of the parties concerned and changes to the financial structure of the cross-Channel rail industry necessary to further develop rail freight and passenger rail traffic.

This project, which aims to improve the financial position of the Group by putting in place a stable financial structure for the benefit of the shareholders, has not been reflected in the December 2003 accounts, in particular in the calculation of the valuation of the Group's fixed assets.

The implications of the financial projections, which reflect the 2003 result and current perspectives of the Group, are as follows:

LIQUIDITY POSITION

- Eurotunnel's liquidity position remains solid until the end of 2005, as interest which cannot be paid in cash can be settled by way of Stabilisation Advances which bear no interest until 2006.

- As stated above the Group now expects to recommend to shareholders the conversion of all these Stabilisation Advances into Units, although the final decision does not need to be taken until 2005.

UNCERTAINTIES

Going concern basis

The going concern assumption depends on the Group's ability to put in place a refinancing plan or, if not, to obtain an agreement with the lenders under the existing Credit Agreements prior to 2007.

Asset value

The valuation of the Group's assets has been carried out in accordance with IAS36 (equivalent to FRS11 in the United Kingdom), which compares the net book value of the assets to the value of the discounted future operating cash flows.

The application of this standard at 31 December 2003, on the basis of the assumptions described below, gives rise to a value in use £1.3 billion lower than the net book value of the assets. This value in use corresponds to an implicit discount rate of 7.0%. As a result, an impairment charge of £1.3 billion has been recorded in the accounts.

The impairment charge recorded in the accounts reduces shareholder funds at 31 December 2003 and will reduce the future depreciation charge by approximately £17 million per annum.

The increase in the implicit discount rate (7.0%) compared to 2002 (6.0%) reflects lower projected cash flows in the light of the 2003 results and the consequences of these lower projected cash flows on the sustainable level of debt, together with higher market interest rates.

The implicit discount rate has been derived in accordance with the standard using the Adjusted Present Value (APV) methodology on the basis of the Group constituting a single income generating unit. This methodology requires assumptions to be made for both the operating cash flows and future level of debt of the Group over the life of the Concession as well as for the market interest rate.

The value in use has been calculated in the context of the going concern uncertainty and on the basis of operating cash flows which assume no changes to existing contracts. The calculations also assume a level of debt £1.3 billion lower than the current level of debt which would imply an equivalent increase in the level of equity.

Within the assumption of no changes to existing contracts, all other things being equal, other foreseeable levels of debt would not lead to an implicit discount rate of greater than 7.5%.

Relatively small changes in the assumptions used would lead to material changes in the value in use. A variation of 0.1% in the implicit discount rate corresponds to a change in the value in use of the assets of approximately £160 million.