

## The London Tunnels

### Hidden reserves

Opportunity knocks at Kingsway Exchange Tunnels to participate in the proposed rejuvenation of a singular and significant national asset and its vast blank canvas for potentially lucrative commercial display. The prospect of a major visitor attraction based on heritage and culture in unusual confines begs comparison with the development of the London Eye, which was also challenging but has arguably over delivered. With full commercial launch not till 2027, protracted project risks such as execution and further funding are inevitable (planning approval is expected at the 11 July London Borough of Camden committee meeting). However, our high-level assumptions about possible year 1 returns at various attendance levels and if the site were in the hands of a content or theme park owner suggest a marked premium to the current share price.

### In plain sight

Despite being kept secret for decades, which is part of their appeal, the Kingsway Exchange Tunnels, which are being acquired by the company, present well with 8,300 square metres of floor space and large diameter tunnels over a mile long in total. In addition to the resonance of distinctive wartime and espionage associations (James Bond, no less) with abundant original artefacts, the site offers huge scope for experiential leisure, for example attractions based on blockbuster films, and digital art via visual and interactive technology. For 2028, the first full year of operation, target attendance is c 1.7 million (with design capacity of three million).

### Light at the end

Assuming a successful £30m placing immediately following the Listing (irrevocable commitments for £25m) and receipt of planning permission (expected soon after recent City of London Corporation approval), the next 12 months or so will see preparation for construction and fitting out, set to complete by 2027. During the first phase ahead of closure, Explorer Tours will allow visitors to see the Tunnels in their current state and promote venue awareness as well as generate useful income. Management envisages a debt raising of a further c £120m during 2025 to 2027+.

### Operationally geared

Our application of industry margins to the target attendance at £30 per ticket gives EBITDA of £27.7m in 2028 with a rise of c 17% on 10% more visitors and more than doubling at £40 per ticket thanks to enriched content from an IP owner driving 25% higher attendance.

### Valuation: Creating value

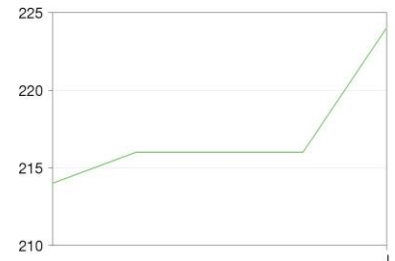
On Merlin Entertainments' 2019 EV/EBITDA exit multiple of 12x, that target attendance EBITDA shows an equity value of £182m (EV £332m less £30m placing and £120m debt). However, this is not discounted for the time and risks during completion.

Travel and leisure

2 July 2024

**Price** 224p  
**Market cap** £147m

#### Share price graph



#### Share details

Code	TLT
Listing	Euronext Amsterdam
Shares in issue	65.5m
Net debt at 9 June 2024	£18.8m*

\*Reduced by conversion of £6.8m bond on listing.

#### Business description

The London Tunnels is aiming to develop a major heritage and cultural attraction in central London on the site of the historic Kingsway Exchange Tunnels, which it has agreed to purchase. Full commercial launch is targeted for 2027 (c 1.7 million visitors in 2028).

#### Bull

- Huge landmark site with compelling history and high media interest in a popular location.
- Very considerable scope to develop in growth areas of experiential leisure and digital art.
- Attractive to potential operating partners, eg content owners and theme parks.

#### Bear

- Awaiting imminent planning permission from London Borough of Camden following recent City of London Corporation approval. Further funding will be required for completion.
- Execution risk of complex project with potential cost and time overrun.
- No trading record and uncertainty of long-term financial estimates.

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## Company description: Planned major visitor attraction

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London Tunnels is newly established to seize an opportunity to acquire an exceptional asset in terms of its history (World War 2 location of the Special Operations Executive and considered inspiration for James Bond's 'Q Branch') and likely visitor appeal as both a heritage and cultural destination. Management is confident that it can develop Kingsway Exchange Tunnels in central London either independently or with partner operators (eg content owners and theme parks) into a 'must-see' visitor attraction on a par with the London Eye, the city's most recent such addition and evidently successful (3.5 million visitors pa in 2018 before COVID-19). The site is extensive with a series of tunnels over a mile long in total, 30 metres deep and up to 7.6 metres in diameter, allowing clear scope for revitalisation by way of heritage and cultural experiences, facilitated by digital displays. As its first step in implementing its strategy, London Tunnels will purchase Kingsway Exchange Tunnels on a 100-year leasehold basis and surface-level properties, including 39 Fumival Street and 31-33 High Holborn, for c £20m.

### Kingsway Exchange Tunnels – a talent to intrigue

From the spectre of vast, deep underground shelters to the enduring resonance of wartime London and Cold War James Bond associations, the Tunnels have broad appeal even before the projected development. They comprise two parallel tubes, each about 1,200 feet long, with a diameter substantially greater than that of a typical London Underground tunnel, supplemented by four shorter tunnels at right angles and three deep access shafts. As a measure, the main twin tunnels were built to provide emergency accommodation during air raids for 8,000 people on two levels, albeit never used for this as the Blitz campaign had tempered by their completion in March 1942. The lateral tunnels date from the early 1950s as extra space for the site's post-war use as a long-distance public telephone exchange until 1980 as well as a secure government communications centre. Since 1990 the site has been maintained and managed by British Telecom wholly for storage; there is continued connection to mains power, water and sewerage. Total floor space is of the order of 8,300 square metres.

### Tunnel vision

With effectively a blank canvas on an epic scale, management has evolved a twin-pronged strategy to make the best of its unique asset. Heritage and culture are its drivers for redevelopment of the tunnels with a celebration of their significance to the history of the UK combined with the supply of a matchless space for digital exhibitions:

- **Heritage:** showcasing with original artefacts and digital display wartime London, notably during the Blitz and from early 1944 as the home of MI6 offshoot, the Special Operations Executive, whose mission via sabotage and subversion was, as ordered by Churchill, 'to set Europe ablaze.' This espionage theme was then fruitfully perpetuated by the location's apparent inspiration for Ian Fleming's Q Branch and its head, James Bond (Q) and in real life its prominent role as a crucial secret government communications centre during the Cold War. Courtesy of the first transatlantic telephone cable (TAT 1) from 1956, this included a passage for the Hot Line between the US and USSR presidents, most famously during the Cuban Missile Crisis in 1962. The site is believed also to have been a reserve in the 1980s to the government war bunker complex below Whitehall (code name PINDAR).

Arguably less glamorous but still of considerable significance to the nation was the Tunnels' use for civil defence and Port of London Authority staff towards the end of World War 2, as a repository for the Public Record Office (until 1951) and from 1954 as Kingsway Trunk Exchange, handling 15% of London's long-distance telephone traffic, according to Subterranea Britannica. With over 200 Post Office staff, this was effectively 'a city under a city.'

- **Culture:** in cooperation with media partners, museums and universities and with state of the art visual and interactive technology, the company proposes, for example, the creation of a digitally imagined world below London, attractions based on blockbuster films/franchises, travels to global landmarks and digital art exhibitions.

As an illustration, the opening in June 2023 by Warner Bros. of Studio Tour Tokyo – The Making of Harry Potter, its largest such indoor attraction and the first in Asia, shows the willingness of content owners to invest (\$280m). The longevity of a successful franchise's appeal is endorsed by the popularity of Studio Tour London 12 years after its opening and indeed after the release of the final film, 'Deathly Hallows – Part 2', ie 'continued strong attendance' per Warner Bros. Discovery's Q323 earnings release and over 17 million visitors to date. On a broader front, the opportunity to exploit its intellectual property is manifest across the Warner Bros. estate, with parks in Abu Dhabi (the world's biggest indoor theme park), Gold Coast, Australia and Madrid. Merlin Entertainments has been similarly active using intellectual property as a central element of its attractions. In April 2022 it opened 'JUMANJI – The Adventure' at Gardaland Resort in Italy, the first ride to be opened as part of a multi-territory exclusivity agreement with Sony Pictures Entertainment, to develop and operate attractions, rides, lands, retail outlets and themed hotel rooms based on the studio's 'Jumanji' film franchise. This was followed at Merlin's Chessington World of Adventures Resort in May 2023.

As for digital art exhibitions, 'Van Gogh Exhibit: The Immersive Experience' typifies their growing appeal and scope. Since 2017 there have been more than five million visitors to this touring exhibition, which is currently at about 20 locations worldwide including a key site in London. Its counterpart for Monet is similarly popular with very positive reviews in London since its opening there in September 2023. The company is pleased to have newly established a relationship with Refik Anadol, who is widely recognised for his innovative media works and large-scale public installations. He was the first artist to project his works on the Sphere in Las Vegas and his first major solo exhibition in the UK opens in February at the Serpentine North Gallery.

- **Hospitality:** opportunity to re-create London's deepest licensed bar, which operated in the Tunnels under Post Office ownership.

With the full commercial launch not expected until 2027 the above is necessarily work in progress and subject of course to funding.

#### **Explorer Tours as an imminent taster**

Reflecting the innate lure of a leading historic site, the company is soon to launch guided Explorer Tours, which will allow visitors to experience the Tunnels in their unrestored state, along with original artefacts. Obvious comparisons are the Paris Catacombs, which attract 550,000 visitors annually to a 1.5km tour of its 11,000 square metre site, and London Transport Museum's tours of 'forgotten' historical Underground stations. Maybe as a fitting counterpart, the Berlin Underworlds Association has been organising tours of its WW2 and Cold War shelters for the past 25 years.

## **The journey**

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Notwithstanding the variables inherent in such an undertaking, London Tunnels has a clearly defined development schedule, marked by potential stumbling blocks, such as planning approval and funding. A planning application has been submitted (November 2023) with the outcome due at a London Borough of Camden committee meeting on 11 July. Management is hopeful as approval was recently given by the City of London Corporation. However, before that is known, a placing is planned for up to 90 days after the Listing to raise £30m, which should allow continued progress over the next year at least until much more significant funding (the company estimates c £120m) for construction.

As per Exhibit 1, the largest budgeted expense over the next year or so is the balance of payment for the leasehold titles to the Tunnels (£9.5m) by the end of June 2025 and capex of £7.9m for an additional surface-level property in order to create a larger visitor entrance. Further extensive preparatory work to validate the project is expected to cost c £5m this year, assuming the receipt of planning permission and placing proceeds. Additional income should come from the start soon of the aforementioned Explorer Tours at up to £60 for an adult as well as useful promotion. These will continue until stripping out gets underway next year.

Subject to further funding estimated at c £120m and to be received periodically from 2025, full redevelopment of the Tunnels should then proceed in earnest, as detailed in Exhibit 1. A key variable in costing is the extent to which the venture is developed independently by the company, since over 50% of estimated costs concern fitting out and installing technology for the provision of content. The technology is intended to be leased.

### Exhibit 1: Projected timing

Company estimate of required funding over next 1 to 2 years **£20–30m**:

- design, validation, costing etc £5m
- balance of purchase of Tunnels by end June 2025 + further property £18m

#### Met by:

**Q124** Convertible bond issue and subscription raising £7m  
Debt/Equity Exchange of £5m at Subscription £2 per share

+

**Q224** **Placing to raise £30m**

**Q324** **Decision on planning application expected from London Borough of Camden on 11 July (Approval by City of London Corporation in June 2024).**

#### Assuming receipt of planning permission + completion of placing

**2024** Detailed design, validation, costing etc

#### Further funding required, assuming lease of c £80m technology (estimated c £120m periodically from 2025 to at least 2027)

**2025 + 2026** Stripping out and construction:

- removal of plant and fittings to make way for installation of planned heritage, cultural and hospitality experiences
- expansion of lift shaft (from c 5 to c 9 metres in diameter)
- demolition and rebuild of 39 Furnival Street to create space for reception, café, retail and facilities for visitors and power and ventilation plant

**H127** Pre-launch marketing, recruitment and training

**H227** Launch and commercial operation

Source: Prospectus

## Management

In its current form, the company has understandably minimal employees. As the project develops, it will recruit experience in developing, launching and operating a large-scale visitor attraction. The extent depends on whether the Tunnels are operated by the company or by partners.

- **Founder and CEO and the major shareholder: Angus Murray** is the founder and managing principal of Castlestone Management, a US registered investment adviser since 2001. He was president of the US operations of Macquarie Bank from 1997 to 2000.

- **Chief Operations Officer: Katharine Leo** has over 40 years' experience in finance, including asset management, fund administration, risk assessment and regulatory compliance. She has held senior roles at Castlestone Management.

## Financials

Given the absence of a trading record and the period of construction, we highlight in Exhibit 2 the potential returns in the first full year of commercial operation (2028) with three attendance scenarios and if the business were in the hands of an owner/operator of intellectual property or theme parks. Notwithstanding a venue design capacity of three million visitors annually, management is targeting 1.72 million to ensure a quality experience and to avoid overcrowding. Assuming 1.89 million visitors pa, the leverage of 10% higher footfall predictably converts into a markedly higher EBITDA margin. By contrast, while three million visitors would materially enhance the top line, management thinks that a hike in operating costs would stymie margin gain.

Ancillary income, notably retail and F&B, is also of course a determinant but management focus looks to be on ensuring optimum ticket pricing.

**Exhibit 2: Financial scenarios for 2028 (first full year of commercial operation)**

Year end 31 December	Attendance 25% lower than target	Target attendance	10% attendance uplift	Design capacity	IP owner/operator
<b>Revenue</b>					
Visitors	1.29m	1.72m	1.89m	3.0m	2.15m
Ticket price	£30	£30	£30	£30	£40
<b>Ticket sales</b>	<b>£38.7m</b>	<b>£51.6m</b>	<b>£56.7m</b>	<b>£90.0m</b>	<b>£86.0m</b>
Ancillary (retail, F&B, sponsorship, functions etc)	£7.7m	£10.0m	£11.0m	£18.0m	£21.5m
<b>Total</b>	<b>£46.4m</b>	<b>£61.6m</b>	<b>£67.7m</b>	<b>£108.0m</b>	<b>£107.5m</b>
<b>EBITDA – adjusted</b>	<b>£16.7m</b>	<b>£27.7m</b>	<b>£32.5m</b>	<b>£51.8m</b>	<b>£59.1m</b>
<b>Margin</b>	<b>36%</b>	<b>45%</b>	<b>48%</b>	<b>48%</b>	<b>55%</b>
<b>Peer EBITDA margins (before central costs)</b>		<b>2018</b>	<b>2019</b>	<b>2023</b>	
Midway Attractions (Merlin)		38%	36%	N/A	
Parks, Experiences + Products (Disney)		37%	38%	36%	
Cedar Fair*		35%	34%	29%	
Studios (Warner Bros. Discovery)		N/A	N/A	18%	
	<b>2012</b>				
London Eye	52%				

Source: Edison Investment Research, LSEG, company websites. Note: \*After central costs.

Comfortably the leading city tourism destination in Europe by way of bed nights, the world's most visited city by digital nomads and the third most popular destination on TikTok are diffuse testimony to London's appeal, both globally and domestically. While not downplaying the timeless draw of landmark sites, innovation and diversity, as famously displayed in the 2012 Olympics, have ensured a stream of new attractions, which of course foster repeat custom. The proposed offering of the Tunnels, as described, plays into this. A target of 1.72 million annual visitors sits happily with established, successful paid London attractions such as the Tower of London (2.9 million visitors a year), Madame Tussauds (2.5m), The Making of Harry Potter studio tour (2m) and most notably the London Eye (3.5m). We note also that in the decade before the pandemic, visits to the City of London's Attractions, which include St Paul's, the Tower of London, Tower Bridge Museum and the Barbican, increased by over 40% to 7.4m pa. Significantly, although close to key source markets in the West End, South Bank and the British Museum, there is no large attraction near the Tunnels.

As for ticketing, notwithstanding the impact of inflation indexation by 2028, a notional price of £30 also looks reasonable in the context of competing attractions, for example, the Tower of London at £35 and the London Eye and Madame Tussauds at £29. Enriching the content in the Tunnels by way of digital art exhibitions should allow for a meaningful rise in pricing, as appropriate.

Our EBITDA margin assumptions are taken from the accounts of attraction and theme park operators, with 45% as a base on the target 1.72 million attendance. While the likes of Midway Attractions may benefit from scale (116 sites worldwide in 2019, which we have used as latest not distorted by the pandemic) and are not directly comparable (principally SEA LIFE, Madame Tussauds, LEGOLAND, Dungeons, Eye), the company can operate with minimal employees, hence our use of an EBITDA margin premium. It is reasonable to note that the London Eye alone reportedly achieved a 52% profit margin in 2012.

To reflect operational gearing and for the sake of prudence, we have shown how a shortfall of, say, 25% in target attendance (ie 1.29 million visitors), however unlikely, might affect EBITDA.

In the shaded column in Exhibit 2, we indicate the potential value of the business to a content owner/operator, such as Warner Bros., which could likely price significantly higher (we show £40) by filling the Tunnels with their own established IP such as Harry Potter and other studios' material. The benefit of the expected material lucrative incremental revenue would be enhanced by not having to pay licensing fees, as is the case with the site run independently, and scope for considerably higher merchandise across that group's franchises.

## Valuation

The unique aspect of the Tunnels project does not make for easy comparison with listed companies. Apart from the lack of direct peers, there is the protracted phase of construction with attendant risks of execution and funding.

We have therefore looked at the prospective/year 1 EV/EBITDA multiples of certain companies with similar businesses to apply to the respective attendance scenarios. The estimated £120m debt during initial commercial operation and planned £30m equity placing are deducted to derive an equity value. For our valuation, we have chosen the 2019 exit multiple (12x) of Merlin as the operator of London Eye and thus arguably the nearest equivalent to London Tunnels.

The terminal value even to an IP owner/operator, as indicated, is dwarfed by a high-level estimate, provided to the company, of c £1bn for current day replacement construction costs and fees etc excluding land purchase and VAT.

We emphasise that these equity values are undiscounted, therefore not taking account of the time to completion nor the aforementioned risks.

<b>Exhibit 3: Valuation based on scenarios for 2028 (first full year of operation)</b>						
£m	Target attendance	10% attendance uplift	Attendance 25% lower than target	Design capacity	IP owner/operator	
<b>Attendance pa</b>	<b>1.72m</b>	<b>1.89m</b>	<b>1.29m</b>	<b>3.00m</b>		<b>2.15m</b>
Estimated EBITDA in 2028*	27.7	32.5	16.7	51.8		59.1
<b>Implied EBITDA based on prospective multiple:</b>						
Merlin 2019 exit multiple** 12x	332	390	200	622		709
Six Flags*** 11x	305	358	184	570		650
Cedar Fair*** + Brighton Pier Group 8x	222	260	134	414		473
United Parks & Resorts 7x	194	228	117	363		414
<b>Less:</b>						
Estimated debt	(120)	(120)	(120)	(120)		(120)
New equity	(30)	(30)	(30)	(30)		(30)
<b>Equity value:</b>						
Merlin exit	182	240	50	472		559
Six Flags***	155	208	34	420		500
Cedar Fair*** + Brighton Pier Group	72	110	(16)	264		323
United Parks & Resorts	44	78	(33)	113		264
Source: LSEG. Note: Prices as at 1 July 2024. *See Exhibit 2. **On historical 2018 earnings. ***On individual valuations before planned 'merger of equals.'						

## Sensitivities

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- Further funding will be needed, albeit periodically and at clearly defined stages.
- Planning permission for the development of the site, including expansion of the lift shaft, stripping out and demolition of 39 Furnival Street, to create a satisfactory visitor facility has yet to be received. An application was submitted in November 2023 and the result is expected at a London Borough of Camden committee meeting on 11 July 2024 (City of London Corporation gave approval recently).
- The company has yet to generate any revenue or trade but this is the nature of the project and initial revenues are expected soon from Explorer Tours.
- Sole operational location.
- Cost and time for removal of asbestos. While it should be safe to access the Tunnels for Explorer Tours, which avoid areas of high asbestos presence, construction cannot start until full clearance.
- Structural integrity may be affected by age (the Tunnels were built from 1940 to 1942 and expanded from 1950 to 1954).
- Execution risk: complex engineering, construction and purpose-built technology are required, plus a potential cost and time overrun.
- While requiring minimal employees checks fixed costs, there may be undue reliance on key staff, with the challenge of retention. Operational management has yet to be recruited, but this should begin on receipt of planning approval.
- The business may not attract sufficient visitors.
- Visual, audio and interactive technologies are subject to constant change and may thus require continued investment.
- There is a reliance on third parties, for example in planning, engineering and design as well as general management and accounting.

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