

# Yorkshire Water Services Limited

## Update

### Ratings

#### Yorkshire Water Services Bradford Finance Limited

Senior secured class A bonds	A
Senior subordinated class B bonds	BBB+

#### Yorkshire Water Services Odsal Finance Limited

Senior secured class A bonds	A
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#### Yorkshire Water Services Finance Limited

Participating bonds	A
Non-participating bonds	A-

### Outlooks

Yorkshire Water Services Bradford Finance Limited	
Senior secured class A bonds	Stable
Senior subordinated class B bonds	Stable

### Financial Data

#### Yorkshire Water Services Limited.

	31 Mar 15	31 Mar 14
Revenue (GBPm)	1,014.1	984.2
Operating EBITDA (GBPm)	622.1	596.8
Operating EBITDA margin (%)	61.3	60.6
Pension-adjusted net debt (Class A and B) (GBPm)	4,558.1	4,651.7
RAV (GBPm)	5,587.5	5,569.6
Pension adjusted net debt (Class A and B) /RAV (%)	81.6	83.5
Class A and B PMICR (x)	1.42	1.33

### Related Research

[Fitch Revises Yorkshire Water's Senior Secured Class A Debt Outlook to Stable; Affirms Ratings \(February 2016\)](#)

[Fitch Affirms Kelda Finance's Bond at 'BB+' \(February 2016\)](#)

[UK Water Sector Flooded by Signalled Reforms \(January 2016\)](#)

[2016 Outlook: EMEA Utilities \(December 2015\)](#)

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### Key Rating Drivers

**Expected to Meet Guidelines:** Fitch Ratings' revision of the Outlook on the Yorkshire Water Services Limited group's class A debt, to Stable from Negative, in February 2016 reflects the agency's expectation that the company will meet the net debt/regulated asset value (RAV) guidelines for the rating, despite slightly weak interest cover for the rating in the near term.

**Class A Interest Cover Weak:** We forecast post-tax and post-maintenance interest cover (PMICR) to be weak for the class A debt for price control AMP6 (1 April 2015-31 March 2020). Fitch expects PMICR to average 1.44x for class A debt, compared with a rating guideline of 1.5x-1.6x, and 1.3x for class B debt, against a rating guideline of 1.2x-1.3x. The low Class A interest coverage results from Yorkshire Water's high cost of embedded debt and the low regulatory cost of capital for the price control.

**Operational Outperformance Likely:** Fitch expects the company to outperform capex and opex targets over AMP6 based on its track record, new processes and the implementation of identified efficiencies. We believe the company will start outperforming its capex targets early in the price control period. Fitch's forecasts include operating cost outperformance of GBP50m and capex outperformance of GBP130m in nominal terms over AMP6.

**Expected Deleveraging:** Fitch expects the company to reduce gearing to below 70% net debt/RAV for its class A debt and 80% for its class B debt over AMP6, which is commensurate with the agency's rating guidelines for the ratings. Yorkshire Water will therefore have more financial flexibility within its covenanted and secured financing structure to absorb costs related to exceptional events.

**Solid Regulatory Performance:** Yorkshire Water is a middle-ranking performer in the sector. Yorkshire Water reported stable asset serviceability for all asset categories for its networks for financial 2015 (March year-end), met most of its regulatory targets including leakage, and improved pollution incident measures. It also improved its Service Incentive Mechanism score, which reflects customer satisfaction, to 85 from 76 over AMP5.

### Rating Sensitivities

**Positive Action Unlikely:** Positive rating action is unlikely for both classes of debt, due to the highly geared capital structure. Class A debt gearing above 70% and PMICR substantially below 1.5x, and Class B debt gearing above 80% and PMICR substantially below 1.2x could lead to a downgrade. Deterioration in operational or regulatory performance and/or regulatory decisions such as moving additional parts of the value chain away from RAV-based regulation or swapping RPI indexation for CPI indexation would be negative for the rating.

### Liquidity and Debt Structure

**Adequate Liquidity:** At 30 September 2015, Yorkshire Water had available GBP32.5m in cash and GBP440m of undrawn, committed bank facilities maturing in October 2018. This funding position provides sufficient financial resources for operating requirements, debt maturities and dividends beyond March 2017.

The group also has access to GBP239.8m of debt service reserve liquidity, GBP65.6m of operating and maintenance reserve liquidity, and dedicated standby lines that would be available during times of financial distress.

Peer Group

Issuer	Country
<b>Yorkshire Water Services Bradford Finance Limited<sup>a</sup></b> Class A bonds <sup>b</sup> : 'A'/Stable Class B bonds <sup>d</sup> : 'BBB+'/Stable	<b>United Kingdom</b>
<b>Dwr Cymru (Financing) Ltd<sup>c</sup></b> Class A and B bonds <sup>b</sup> : 'A'/Stable Class C bonds <sup>d</sup> : 'BBB+'/Stable	<b>United Kingdom</b>
<b>Anglian Water Services Financing Plc<sup>e</sup></b> Class A bonds <sup>b</sup> : 'A'/Negative Class B bonds <sup>d</sup> : 'BBB+'/Negative	<b>United Kingdom</b>

<sup>a</sup> Financing vehicle for Yorkshire Water Services Limited (Yorkshire Water)  
<sup>b</sup> Senior secured bond ratings  
<sup>c</sup> Financing vehicle for Dwr Cymru Cyfyngedig (Dwr Cymru)  
<sup>d</sup> Senior subordinated bond ratings  
<sup>e</sup> Financing vehicle for Anglian Water Services Limited

Rating History

Date	Class A	Class B	Outlook
23 Feb 16	A	BBB+	Stable
25 Feb 15	A	BBB+	Negative
27 Feb 14	A	BBB+	Negative
16 Jan 13	A	BBB+	Stable
24 Feb 12	A	BBB+	Stable
01 Mar 11	A	BBB+	Stable
29 Jul 09	A	BBB+	Stable
01 Jul 09	A	BBB+	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Fitch revised the outlook for the UK water sector to stable from negative for 2016 following the start of the new five-year regulatory price control review, AMP6, on 1 April 2015. We expect companies to be able to deliver both the minimum outputs set by the regulator within the allowed regulatory revenues and the challenging efficiencies embedded in the price control.

Uncertainties regarding proposed reforms increase the business risk of the water sector, which we view now as more closely aligned with regulated UK gas and electricity network businesses.

Financial Risks

Key drivers of financial performance are the cost of capital (at an all-time low of 3.74%) compared to companies' funding costs, and total expenditure and retail business performance compared to allowances. Fitch believes total expenditure targets leave some room for manoeuvre, while most licence holders are likely to overspend on retail.

Peer Group Analysis

Bond ratings/Outlook	Anglian Water		Yorkshire Water		Dwr Cymru	
	Class A: A/Negative	Senior: BBB+/ Negative	Class A: A/Stable	Class B: BBB+/ Stable	Class A+B: A/Stable	Class C: BBB+/ Stable
<b>Credit metrics (Averages from April 2015 to March 2020, AMP6)</b>						
Forecast pension adjusted net debt/RCV (%)	Reducing to 70%	Reducing to 80%	Reducing to 70%	Reducing to 80%	Below 60	n.a.
Forecast PMICR (x)	1.5-1.6	1.3	1.4	1.3	1.4	n.a.
<b>Recent performance</b>						
Leakage targets not met (year)	FY11		FY10 and FY11		FY11	
Asset serviceability not stable	Marginal for sewerage infrastructure		All Stable		Marginal water infrastructure	
Asset serviceability not stable			All stable			
FY15						
Service incentive mechanism	85/100		85/100		82/100	
FY15 (points)						
<b>Fitch view</b>						
Regulatory performance	Above average		Middle ranking		Middle ranking	
- In the case of Anglian Water the term "senior" is used to define the consolidated position of class A and class B debt - Dwr Cymru's class A + B debt is equivalent to the other transactions' class A debt only, and its class C debt is equivalent to the other transactions' class B debt. At present there is no class C debt outstanding Source: Fitch, companies, Ofwat (the economic regulator for the water and sewerage industry in England and Wales)						

Key Credit Characteristics

In addition to a significant reduction in the cost of capital, total expenditure will be benchmarked at the top quartile, representing a more demanding target for capital expenditure. Ofwat is pursuing progressive targets for the retail price controls, eliminating protection from RPI and implementing catch-up efficiency targets using an average cost to serve, which does not fully reflect each company's operating cost base.

Ofwat is working towards opening the retail sector to competition for non-household business, which it expects to start in April 2017 in England, allowing water companies to compete over the provision of services such as customer care, billing and meter reading. The Welsh government has stated that it will monitor the costs and benefits of the reform in England to inform its future policy for water companies located wholly or mainly in Wales

Fitch does not expect the impact of retail competition on the water companies to be significant as only 1%-2% of company revenues relate to retail services and because we expect the number of new entrants to the retail segment to be low.

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

Rating factor	Status <sup>a</sup>	Trend
Operations	Average	Neutral
Market position <sup>b</sup>		
Finances	Average	Neutral
Governance	Average	Neutral
Geography <sup>b</sup>		

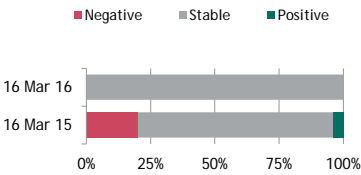
<sup>a</sup> Relative to water sector peers  
<sup>b</sup> Monopolistic business – does not apply  
 Source: Fitch

Related Criteria

Corporate Rating Methodology (August 2015)

## Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

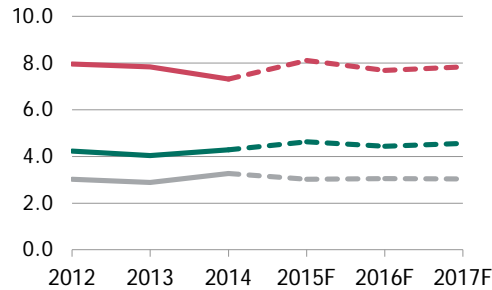
- regulated revenues in line with the final determination for AMP6;
- cumulative operating expenditure outperformance of GBP50m in nominal terms over AMP6;
- retail costs in line with allowances;
- non-regulated annual EBITDA of around GBP2.5m; Retail price inflation of 1.3% for FY16, 2% for FY17 and 2.5% thereafter;
- Capex outperformance of GBP130m in nominal terms in AMP6.
- 2015F refers to financial year ending 31 March 2016

## Definitions

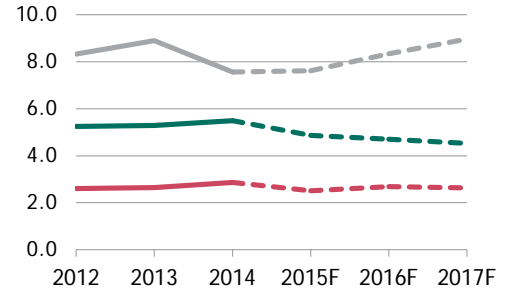
- Leverage:** Debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover:** FFO plus interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FFO profitability:** FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format" Special Report, dated 25 November 2009 and available at [www.fitchratings.com](http://www.fitchratings.com).

Yorkshire Water Services Limited  
Source: Company data; Fitch

## Leverage including Fitch expectations



## Interest Cover including Fitch expectations



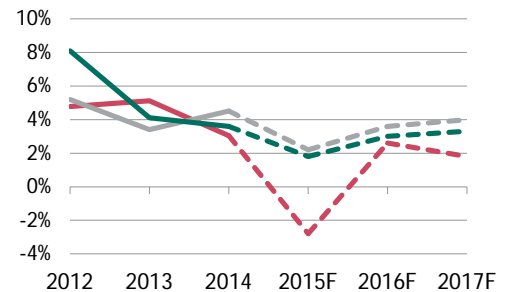
## Debt Maturities and Liquidity at 30 Sep 15

Debt maturities (GBPm)	(GBPm)
2016	11.3
2017	184.7
2018	244.2
2019	48.0
After 2019	4,215.8
Cash and equivalents	32.8
Undrawn committed facilities	440.0

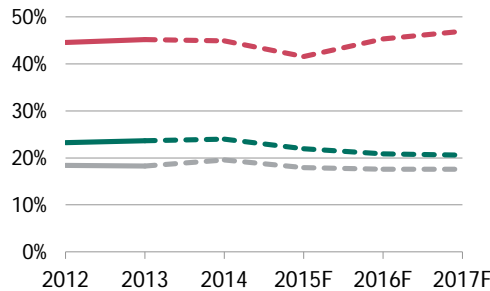
Facilities due October 2018

Source: Company

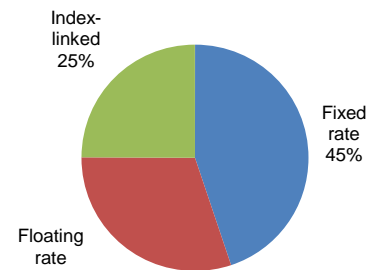
## Revenue Growth including Fitch expectations



## FFO Profitability including Fitch expectations

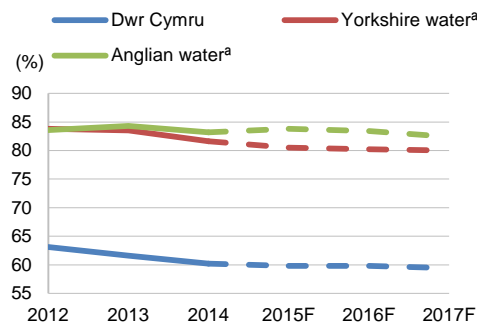


## Debt Structure FY15



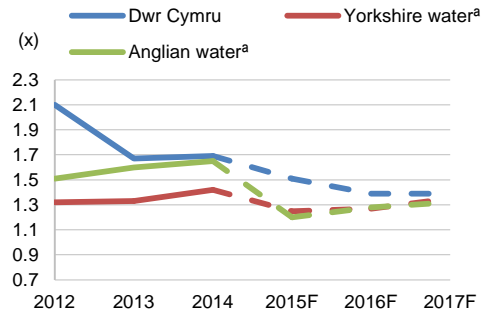
Source: Company

## Pension Adjusted Net Debt/RAV



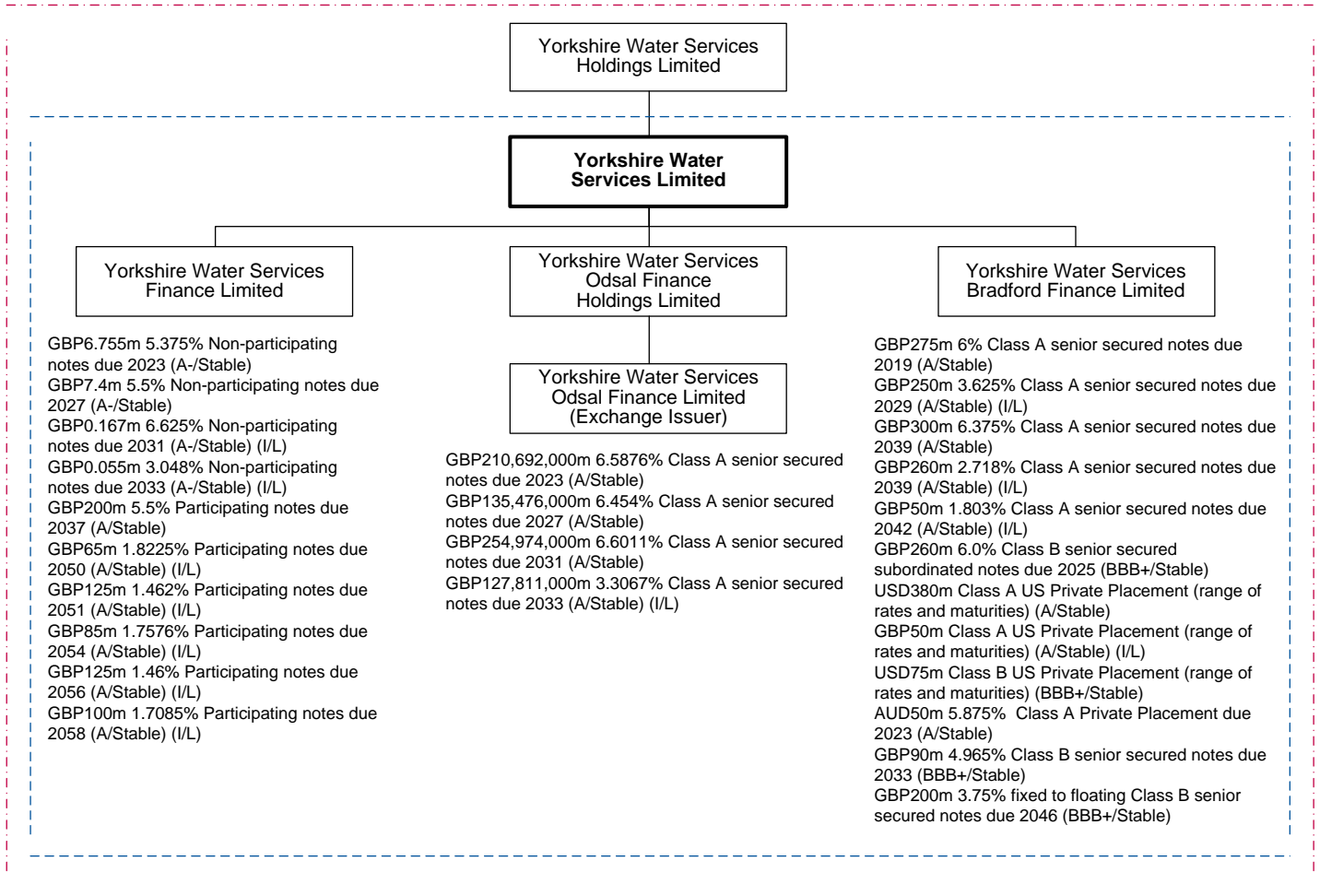
<sup>a</sup> Class A + B debt  
Source: Fitch

## PMICR



<sup>a</sup> Class A + B debt  
Source: Fitch

Figure 1  
**Simplified Group Structure Diagram**  
 As at March 2016



--- Regulatory ring-fence  
 - - - Documentation ring-fence  
 I/L – Index-Linked

Source: Transaction documents - March 2016

Figure 2  
**Yorkshire Water Services Limited — Forecast Financial Information**

(GBPm)	Historical			Fitch forecast		
	31 Mar 13	31 Mar 14	31 Mar 15	31 Mar 16	31 Mar 17	31 Mar 18
<b>Summary income statement</b>						
Gross revenue	936	984	1,014	985	1,011	1,029
Revenue growth (%)	4.8	5.1	3.0	-2.9	2.6	1.8
Operating EBITDA	565	597	622	575	626	636
Operating EBITDA margin (%)	60.3	60.6	61.3	58.3	61.9	61.7
Operating EBITDAR	565	597	622	575	626	636
Operating EBITDAR margin (%)	60.3	60.6	61.3	58.3	61.9	61.7
Operating EBIT	332	330	350	306	353	359
Operating EBIT margin (%)	35.4	33.6	34.6	31.0	34.9	34.8
Gross interest expense	-289	-278	-308	-251	-278	-286
Pretax income	186	142	136	120	143	145
<b>Summary balance sheet</b>						
Readily available cash	32	29	35	30	30	30
Total debt with equity credit	4,465	4,589	4,526	4,692	4,927	5,011
Total adjusted debt with equity credit	4,465	4,589	4,526	4,692	4,848	5,011
Net debt	4,433	4,560	4,491	4,662	4,818	4,981
<b>Summary cash flow statement</b>						
Operating EBITDA	565	597	622	575	626	636
Cash interest	-225	-221	-235	-277	-229	-221
Implied interest cost (%)	5.0	4.9	5.1	4.9	4.8	4.5
Cash tax	3	2	18	-2	-8	-6
Associate dividends less distributions to NCI				0	0	0
Other Items before FFO	74	66	-12	63	68	74
Funds flow from operations	417	444	394	409	458	483
FFO margin (%)	44.5	45.1	38.9	41.5	45.3	46.9
Change in working capital	16	9	0	-5	-5	-5
Cash flow from operations (Fitch defined)	433	453	394	404	453	478
Total non-operating/non-recurring cash flow						
Capital expenditure	-389	-380	-264			
Capital intensity (capex/revenue) (%)	41.6	38.6	26.0			
Common dividends	-257	-167	-94			
Net acquisitions & divestitures	2	7	4			
Capex, dividends, acquisitions & oth. items before FCF	-644	-539	-354	-486	-551	-567
Free cash flow after acquisitions & divestitures	-211	-86	41	-82	-98	-90
Free cash flow margin (after net acquisitions) margin (%)	22.5	-8.8	4.0	-8.3	-9.7	-8.7
Other investing and financing cash flow items	-54	-42	-69	0	0	0
Net debt proceeds				-82	-98	-90
Net equity proceeds				0	0	0
Total change in cash	24	-4	7			
<b>Coverage ratios (x)</b>						
FFO interest coverage	2.5	2.6	2.3	2.5	2.7	2.6
FFO fixed charge coverage	2.5	2.6	2.3	2.5	2.7	2.6
Operating EBITDAR/gross interest expense + rents	2.0	2.1	2.0	2.3	2.3	2.1
Operating EBITDA/gross interest expense	2.5	2.7	2.7	2.3	2.3	2.1
<b>Leverage ratios (x)</b>						
Total adjusted debt/operating EBITDAR	7.9	7.7	7.3	8.2	7.7	7.9
Total adjusted net debt/operating EBITDAR	7.8	7.6	7.2	8.1	7.7	7.8
Total debt with equity credit/operating EBITDA	7.9	7.7	7.3	8.2	7.7	7.9
FFO adjusted leverage	8.1	7.8	8.3	8.2	7.9	8.0
FFO adjusted net leverage	8.0	7.8	8.3	8.2	7.8	7.9

**How to interpret the forecast presented**

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Source: Fitch



Figure 3

**Reconciliation of Key Financial Metrics for Yorkshire Water Services Ltd**

(GBPm)	31 Mar 15	31 Mar 14
<b>Interest bearing loans and borrowings class A</b>	<b>4,006.1</b>	<b>4,093.0</b>
+ Subordinated debt	0.0	0.0
- Equity credit	0.0	0.0
<b>= Total debt with equity credit</b>	<b>4,006.1</b>	<b>4,093.0</b>
+ Total off-balance sheet debt (8 x long-term leases)	0.0	0.0
= Total lease-adjusted debt	4,006.1	4,093.0
- Cash and equivalents (unrestricted)	35.2	28.5
<b>= Net lease-adjusted debt</b>	<b>3,970.9</b>	<b>4,064.5</b>
+ pension deficit not funded by customers	0.0	0.0
<b>= Pension adjusted net debt class A (a)</b>	<b>3,970.9</b>	<b>4,064.5</b>
<b>Real regulatory asset value (b)</b>	<b>5,587.5</b>	<b>5,569.6</b>
<b>Net debt/RAV class A (%)</b>		
Pension adjusted net debt/regulatory asset value (a/b) x 100	<b>71.1</b>	<b>73.0</b>
<b>Operating EBITDA</b>	<b>623.9</b>	<b>596.3</b>
- Current Cost Depreciation (CCD) & Infrastructure Renewal Charge (IRC)	306.7	295.5
- Taxation paid	0.0	0.0
<b>= EBITDA - CCD &amp; IRC - tax - pensions (c)</b>	<b>317.2</b>	<b>300.8</b>
<b>Class A cash interest (d)</b>	<b>192.6</b>	<b>194.7</b>
<b>Post maintenance interest cover ratio class A (x)</b>		
EBITDA - CCD & IRC - tax - pensions/proxy for cash interest c/d	<b>1.65</b>	<b>1.54</b>

Source: Fitch based on company reports

Figure 4

**Reconciliation of Key Financial Metrics for Yorkshire Water Services Ltd**

(GBPm)	31 Mar 15	31 Mar 14
<b>Interest bearing loans and borrowings class A debt plus class B debt</b>	<b>4,593.3</b>	<b>4,680.2</b>
+ Subordinated debt	0.0	0.0
- Equity credit	0.0	0.0
<b>= Total debt with equity credit</b>	<b>4,593.3</b>	<b>4,680.2</b>
+ Total off-balance sheet debt (8 x long-term leases)	0.0	0.0
= Total lease-adjusted debt	4,593.3	4,680.2
- Cash and equivalents (unrestricted)	35.2	28.5
<b>= Net lease-adjusted debt</b>	<b>4,558.1</b>	<b>4,651.7</b>
+ pension deficit not funded by customers	0.0	0.0
<b>= Pension adjusted net debt class A and class B (a)</b>	<b>4,558.1</b>	<b>4,651.7</b>
<b>Real regulatory asset value (b)</b>	<b>5,587.5</b>	<b>5,569.6</b>
<b>Net debt/RAV class A and class B (%)</b>		
Pension adjusted net debt/regulatory asset value (a/b) x 100	<b>81.6</b>	<b>83.5</b>
<b>Operating EBITDA</b>	<b>623.9</b>	<b>596.3</b>
- CCD & IRC	306.7	295.5
- Taxation paid	0.0	0.0
<b>= EBITDA - CCD &amp; IRC - tax - pensions (c)</b>	<b>317.2</b>	<b>300.8</b>
<b>Class A and class B cash interest(d)</b>	<b>224</b>	<b>225.4</b>
<b>Post maintenance interest cover ratio class A and class B (x)</b>		
EBITDA - CCD & IRC - tax - pensions/proxy for cash interest c/d	<b>1.42</b>	<b>1.33</b>

Source: Fitch based on company reports

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