YorkshireWater

# Yorkshire Water Financing Group

# Investors Report

*For the period ended 30 September 2017*

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- This report is being distributed in fulfilment of a document, the Common Terms Agreement dated 24 July 2009 (as amended and restated on 3 August 2010, 13 December 2011, 26 September 2012 and 11 March 2014, and as further amended and restated on 15 July 2015) (the “CTA”), which governs the obligations of the Company to the holders of bonds issued under the Programme and other Secured Creditors. Capitalised terms used but not defined in this report shall have the meaning ascribed to them in the Master Definitions Agreement (the “MDA”) dated 24 July 2009 (as amended and restated on 3 August 2010, 13 December 2011, 26 September 2012 and 11 March 2014, and as further amended and restated on 15 July 2015). This report is directed to, and intended for, existing Secured Creditors of the YW Financing Group. No other persons should act or rely on it. The Company makes no representation as to the accuracy of forecast information (or any other information in this report, other than as set out in the CTA). These forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forecasts.
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- A copy of this report may be obtained at www.keldagroup.com.

# Contents

## 1. General

The information provided in this report is sourced primarily from the unaudited Yorkshire Water Services Ltd ("YW or the "Company") Interim Report and Financial Statements ("YW Interims") for the six months ended 30 September 2017.

## 2. Business review

YW has continued to make good progress in the first half of the 2017-18 financial year and is meeting most of its performance commitment targets. The Company has identified the areas where performance is not satisfactory and is taking action.

YW has taken a number of steps to improve its customer service and Ofwat's Service Incentive Mechanism ("SIM") position, in particular by looking to reduce the need for its customers to contact the Company when it's not necessary for them to do so. As a result, the number of unwanted customer contacts is falling, whilst the number of customers switching to the Company's digital channels, such as webchat and free call back facilities, is increasing. YW's customers are responding to these innovations in service and the Company believes that it is one of the few utilities to offer guaranteed call backs within a ten minute slot.

YW's strong focus on improving health and safety across the Company continues to make progress. Although much remains to be done, YW's lost time injury rate continues to fall and as a result of strong management attention with the reporting of incidents and near misses continues to show improvement. These are indicative of a growing health and safety culture within the organisation.

The last few months has seen the publication of Ofwat's proposed approach to the 2019 price review. This new methodology, to be confirmed in December, makes it clear that YW, along with the rest of the sector, faces some substantial challenges over both the last few years of this regulatory period and the full five years of the next. The new methodology introduces comparative performance regulation in order to emulate the workings of a competitive market. As in a normal market, companies with exceptional performance and which show ambition and innovation in their business plans stand to receive significantly enhanced rewards. Those with poor performance and weak plans are likely to be penalised.

The other significant change is that companies hoping to achieve the most enhanced status – "exceptional" in Ofwat's terminology – will need to achieve high levels of performance from the beginning of the five year period rather than by the end. This in turn means that to achieve exceptional status, companies will in effect need to be demonstrating high levels of performance across the last two years of the current period, irrespective of their current performance commitments. YW has looked in detail at the opportunity which this new approach presents to the Company and is currently considering how the Company's operational plans for the next two years might need to be amended to reflect these and also what the implications might be for our business plan submission to Ofwat in 2018.

YW's implementation of new Systems, Applications and Products ("SAP") based business processes across the whole of the Company are progressing well. These new processes will give the Company a strong foundation to significantly enhance performance across the next investment period and into the future.

On 29 November 2017 YW announced the commencement of a multimillion pound investment plan to transform the Company's operational performance which will enable it to become a top performer in the water industry. The ambitious plan aims to dramatically reduce leakage levels, significantly reduce pollution incidents and considerably reduce the time customers lose supply during planned or unplanned interruptions. These operational performance improvements are planned to be delivered before the start of the next five year investment period that commences on 1 April 2020.

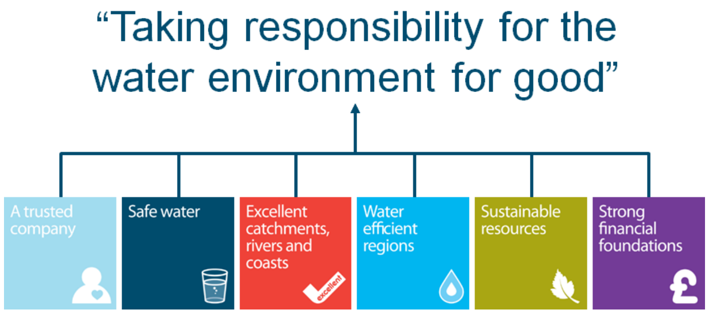
The investment plan is linked to a new long term and ambitious strategy for YW, which is set to be published in January 2018, as part of the Company's continuing dialogue with its customers and stakeholders regarding how the Company will fundamentally change its services for the future. At the heart of this strategy is a renewed focus on core water and waste water services within the Kelda Group (YW's parent company) and the strategy includes plans to dispose of Kelda's non-regulated activities - Kelda recently sold its contract operations in Northern Ireland and further non-regulated disposals are expected by the end of the 2017/18 financial year.

## 3. Business strategy

YW is a regulated water and waste water company that provides some of life's most essential services and the Company is a custodian of the region's natural environment and critical infrastructure. YW is regulated by three main authorities to act in the best interests of the society that YW serves: the Office of Water Services ("Ofwat"), the Environment Agency ("EA"), and the Drinking Water Inspectorate ("DWI").

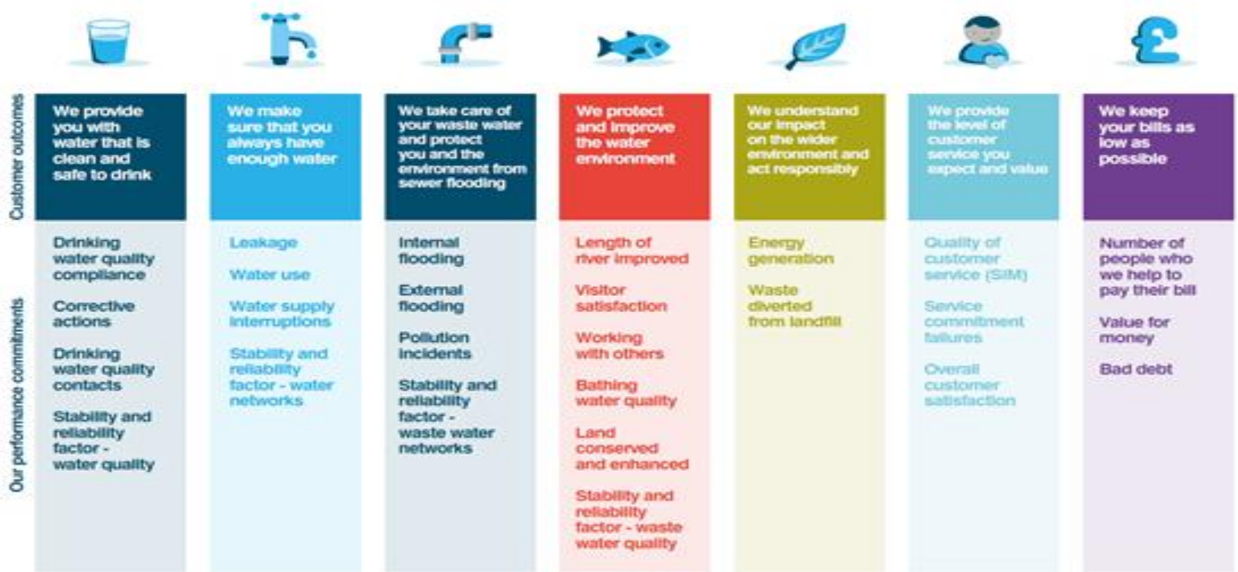
### Company vision and six Strategic Business Objectives

YW's vision is 'taking responsibility for the water environment for good'. YW's vision and six strategic business objectives ("SBOs") captures YW's ambition to go beyond its regulatory requirements and encapsulates the Company's commitment to long-term sustainability. The essence of YW's vision is doing what is right for its customers, colleagues, partners, the environment and investors, both in the short and long-term. This holistic and integrated approach is critical to the sustainability of YW's essential water and waste water services and of YW's business.




### Putting YW's customers' priorities at the heart of its strategy

Central to YW's strategy is the delivery of its customers' priorities, defined in seven Customer Outcomes - measured by twenty-six Performance Commitments. These Performance Commitments were shaped and agreed through engagement with over 30,000 of YW's customers and with the Company's regulators. YW's Performance Commitments set the levels of service that the Company is working to achieve across a range of activities that customers and regulators have confirmed are a priority for YW; for example, further reducing both pollution incidents and leakage levels.



## Outcome Delivery Incentives

The national regulatory regime in which YW operates includes financial and reputational Outcome Delivery Incentives if YW under or over perform against some of these Performance Commitments. Where financial incentives have been agreed, they become applicable only when the Company reaches defined levels service. YW's performance to date against its Outcome Delivery Incentives is shown in section 4: 'YW Outcome Delivery Incentives – reported performance.

## Working towards YW's six Strategic Business Objectives

YW's strategy goes beyond delivering the regulatory Performance Commitments and Customer Outcomes. To ensure long-term sustainability, YW manages a programme of activity that drives the Company towards its vision and six SBOs. The Company's SBO framework includes a suite of annual targets on activities that drive the Company towards medium-term milestones and long-term deliverables.

YW's SBOs shape everything that the Company does and encompass all YW's material issues as a business: environmental, financial and social. YW's six SBOs are as follows:

A trusted company

**Trusted company –** The way we do business means our products, services and promises are trusted by all our stakeholders, now and in the future.

Safe water

**Safe water –** We work safely and we protect public health by ensuring drinking water is always safe to drink and waste water never harms customers or communities at any point in the process.

Excellent catchments, rivers and coasts

**Excellent catchments, rivers and coasts –** We maintain and improve the water environment from source to sea, and influence others to do the same.

Water efficient regions

**Water efficient regions –** We ensure water needs are met now and in the future by using water wisely and inspiring others to do the same.

Sustainable resources

**Sustainable resources –** We are efficient and effective now and in the future, with an industry leading workforce, zero waste and a responsible supply chain.

Strong financial foundations

**Strong financial foundations –** We deliver services to customers at a price they are willing and able to pay, while providing investors with returns that attract long-term investment.

## Sustainability is an imperative within YW's strategy

Through YW's twenty-five year planning process the Company monitors a range of external influences that are shaping its business and services. YW uses this insight to shape the Company's strategy and plans to ensure that it is effectively preparing for the long-term to strengthen the Company's resilience and ensure its ongoing ability to deliver the Customer Outcomes and SBOs. The latest and best evidence repeatedly shows increasing pressure from a range of factors including climate change, population growth and resource constraints.

To help YW deal with these pressures the Company is embedding the concept of the five 'Capitals' (shown below), into its longer-term business planning processes. This will help the Company ensure the affordability and resilience of its essential public services for current and future generations to come.

The five Capitals are the valuable assets that are critical to the success of any organisation. By considering both the positive and negative impacts, and dependencies, across the five Capitals helps an organisation improve its understanding of inherent risk, value and trade-offs so that more sustainable approaches can be targeted.

| Financial Capital | Manufactured Capital | Natural Capital | Human Capital | Social Capital |
|---|---|---|---|---|
| e.g. Cash, shares, debt | e.g. Buildings, infrastructure, treatment works | e.g. Water, minerals, air | e.g. Our people's health, knowledge and skills | e.g. Relationships, partnerships, trust |

Effective management of these five Capitals by YW will help to ensure the resilience of the Company's business.

### Removal of the YW subsidiaries incorporated within the Cayman Islands

YW has three subsidiaries that, although wholly and exclusively resident in the UK for tax purposes, were at the time of the implementation of the YW whole business securitisation (July 2009) incorporated within the Cayman Islands. These three companies are:

- Yorkshire Water Services Bradford Finance Limited;
- Yorkshire Water Services Odsal Finance Limited; and
- Yorkshire Water Services Odsal Finance Holdings Limited.

These three companies were incorporated within the Cayman Islands because at the time of the YW whole business securitisation it was not possible for a UK company (ie YW) to issue public bonds to repay debt provided by investors to help finance the company's acquisition. These restrictions are now no longer applicable to YW and therefore the reason for YW having Cayman Island incorporated subsidiaries no longer applies. During October 2017 YW commenced the process to remove these Cayman companies with several of its advisers to consider, amongst other areas, the corporate, accounting, taxation and legal steps necessary to complete this process.

## 4. YW's Outcome Delivery Incentives – reported performance

Central to YW's strategy is the delivery of its customers' priorities, defined in seven Customer Outcomes which are measured via the Company's 26 Performance Commitments. These Performance Commitments set the levels of service that the Company is working to achieve across a range of activities that customers and regulators have confirmed are a priority for YW; for example, further reducing pollution incidents and leakage.

The national regulatory regime in which YW operates includes financial and reputational Outcome Delivery Incentives ("ODIs") if YW under or over performs against some of these Performance Commitments. Where financial incentives have been agreed, they become applicable only when the Company reaches defined levels of service. YW's reported performance against its ODIs is shown in the table below:

| ODIs | Unit | 2015/16 performance | 2016-17 Performance Commitment | 2016-17 Performance |
|---|---|---|---|---|
| Drinking water quality | % | 99.954 | ≥ 99.960 | 99.962 |
| Drinking water contacts | Nr | 10,007 | ≤ 8,120 | 9,093 |
| Leakage | Ml/d | 285.1 | ≤ 297.1 | 295.2 |
| Water supply interruptions | Time | 12.53 | ≤ 12.49 | 9.47 |
| Length of river improved | Nr | Preparations commenced | ≥ 440km by 2020 | Programme commenced |
| Solutions delivered by working with others | Nr | 4 | ≥ 3 | 5 |
| Amount of land conserved and enhanced | Hectares | 11,466 | ≥ 11,736 Ha by 2020 | 11,492 |
| Internal sewer flooding incidents | Nr | 1,842 | ≤ 1,898 | 1,769 |
| Pollution incidents - category 3 | Nr | 180 | ≤ 224 | 207 |
| Customer service - Service Incentive Mechanism (SIM) | Score | 82.6 | Year-on-year improvement | 83.4 |
| Water network stability and reliability factor | Category | Stable | Stable in 2020 | Stable |
| Water quality stability and reliability factor | Category | Stable | Stable in 2020 | Stable |
| Sewer network stability and reliability factor | Category | Stable | Stable in 2020 | Stable |
| Waste water quality stability and reliability factor | Category | Stable | Stable in 2020 | Stable |

## 5. Financial performance for the six months ended 30 September 2017

YW's performance in the six months to September 2017 is in line with the Company's plan and is underpinned by continuing investment in its assets and improvement to its operational and environmental performance.

On 23 June 2016, the United Kingdom voted to leave the European Union. This vote has resulted in uncertainty in economic and political spheres. Whilst much of the economic impact is still unknown for YW, to date the Company has experienced minimal impact on the day-to-day operations and operating profit of the business.

During the six months ended 30 September 2017, the Company restructured a portion of its portfolio of index-linked swaps, increasing the semi-annual interest receipt leg of the swaps in question by £9.7m (£19.3m per annum) for the next fifteen years. The first of these semi-annual receipts was received on 21 August 2017. Had this transaction to reduce cash interest costs not been implemented, the Company's gearing would have been 4.0% lower at 30 September 2017. This and other balance sheet strengthening measures undertaken in the six months ended 30 September 2017 resulted in Moody's moving the outlook on the Company's credit ratings from negative to stable on 4 July 2017.

| | **Six months ended 30 September 2017 £m** | Six months ended 30 September 2016 £m |
|---|---|---|
| **Turnover** | **515.2** | 506.5 |
| **Operating profit** | **148.0** | 147.8 |
| **EBITDA** | **295.1** | 285.4 |
| **Exceptional income / (cost)** | **(4.2)** | 0.1 |
| **Regulatory net debt** | **4,751.6** | 4,630.1 |

The key financial performance highlights for the six months ended 30 September 2017 include the following:

- Turnover increased by 1.7% to £515.2m due to the inflationary impact on prices.
- Operating profit before exceptional items has increased by 0.1% to £148.0m compared to the comparable period last year and operating costs have increased by 2.4% to £367.2m. The primary reason for this is an increase in depreciation (£7.8m) due to the on-going capital programme.
- EBITDA has increased, when compared to the comparable period last year to £295.1m, a 3.4% increase. This is as a result of the movements in turnover and strong control over operating costs.
- Exceptional costs relate to the flooding incident that occurred in December 2015. In this six month period the Company has incurred £4.2m operational costs associated with the assets damaged in this event.
- During the six month period to 30 September 2017, net interest payable and similar charges before exceptional items was £116.5m, (30 September 2016: £96.0m). The increase is predominantly a result of additional debt raised in the second half of the 2016/17 financial year to finance the Company's operational and capital expenditure programme, together with the impact of inflation.
- At 30 September 2017, total net debt stands at £4,048.6m (31 March 2017: £3,773.6m) which is primarily as a result of additional debt raised to fund the index linked swap restructuring transaction detailed above. Net debt includes £817.9m of amounts owed from other group companies (31 March 2017: £1,009.0m). Funds raised elsewhere within the Kelda Group were used to repay part of this loan.

## 6. Regulatory update – the 2019 price review

Although YW's Board maintains its focus on operational and financial performance during the current price review period to 31 March 2020, it is also closely engaged in formulating the Company's response to the methodology for the 2019 price review process. On 11 July 2017 Ofwat published a consultation on the methodology for the 2019 price review ("PR19") for the water and wastewater monopoly service providers in England and Wales titled "Delivering Water 2020: Consulting on our methodology for the 2019 price review". The methodology sets out:

- Ofwat's expectations and requirements for companies preparing their business plans to meet the needs of their customers from 2020 to 2025 and beyond;
- how these expectations form the basis for the tests that Ofwat will use to assess company business plans;

- the approach that Ofwat will use if its needs to intervene in those plans to ensure that companies deliver the step change required by customers; and
- how Ofwat's assessment will flow through into companies' price limits, service commitments and the wider incentive framework.

The draft methodology is a significant departure from previous approaches by Ofwat and the Board is considering the strategic implications for the Company. YW responded to this consultation prior to the closing date of 30 August 2017 and subsequently on 27 October 2017 Ofwat announced that its final methodology for PR19 will be published on 13 December 2017.

YW continues to involve its customers, stakeholders and regulators in the development of the PR19 process with a view to further transforming the region's future relationship with its customers, water and the environment and to deliver the necessary progress towards the Company's customers and stakeholder's long-term needs and goals. YW remains on track against the PR19 key milestones which include, inter alia:

(i) submitting the Company's draft water resources management plan which sets out how YW intends to provide a secure and sustainable supply of water to its customers over a statutory 25-year period from 2020 to 2045, and

(ii) a submission to the DWI which explains how the Company will address any future water quality challenges it has identified.

## 7. Director changes

As YW prepares its business plan for PR19 the Company's Board will play a key role as part of the assurance process, ensuring that its plans are robust and deliverable and in the last six months there have been some notable changes to the Board.

Following the retirement from the Board of Baroness Kath Pinnock at the end of her term of office on 31 August, Andrew Wyllie CBE was appointed as an independent non-executive director of YW from 1 September 2017. Andrew is Chief Executive of Costain Group Plc and was a non-executive director of Scottish Water from April 2009 to April 2017. Andrew is a Chartered Engineer, a Fellow of the Royal Academy of Engineering and a Vice President of the Institution of Civil Engineers. Prior to joining Costain as Chief Executive in 2005, Andrew worked for Taylor Woodrow where he was the Managing Director of the construction business and a member of the Group Executive Committee.

During September 2017 Charlie Haysom retired from his role as Director of Service Delivery. At the same time, Pamela Doherty re-joined the YW Board replacing Charlie Haysom in that role. Pamela joined YW in 2002 and was appointed Head of Human Resources in June 2010 having previously developed her career in the electricity supply and retail industries. Pamela was appointed as Director of Human Resources and Health and Safety on 27 April 2011 and was an executive director of YW between April 2011 and March 2015 when she stepped down from the Board following her appointment as Managing Director of Kelda Water Services.

Also during September 2017 Scott Auty, Andrew Dench and Michael Osborne were all appointed as non-executive directors to the YW Board. All three are existing directors of Kelda Holdings Limited and representatives of three shareholders – Pan-European Infrastructure Fund L.P., GIC and Gateway Infrastructure Investments L.P., Gateway UK Water L.P., and Gateway UK Water II L.P. (managed by Corsair Infrastructure Management L.P.). Ofwat's expectation is that by and large a unitary board will operate and acknowledges that investors (who own the business) have a legitimate place on the Board of the regulated company, although the number of investor representatives should be no greater than the number of independent non-executive directors (excluding the independent chair). The YW Board comprises of an independent chair, four independent non-executive directors, three investor representative non-executive directors and four executive directors and therefore aligns with Ofwat's Board Leadership Transparency and Governance Principles that were published in January 2014.

- Scott Auty is a Director of Deutsche Asset Management's infrastructure business, Europe, based in London and is responsible for the origination and execution of infrastructure investment opportunities as well as the ongoing management of the acquired assets. He is a member of the Investment Committee for the two European infrastructure funds managed by Deutsche AM. Prior to joining Deutsche AM's infrastructure business in 2005, Scott started his career at N M Rothschild & Sons' investment banking division where he was a specialist in the Utilities and Natural Resources sectors.

- Andrew Dench is a Senior Vice President in GIC's Infrastructure team, based in London. He is responsible for the ongoing management of GIC's global infrastructure portfolio and is also a non-executive director on boards for TIGF (Gas Transportation and Storage, France), Duquesne Light and Power (Electricity Transportation and Distribution, US) and Greenko (Renewal Generation, India). Prior to joining GIC, Andrew was CFO of Electricity North West and Deputy CEO / CFO Veolia Water, UK, Ireland & Northern Europe. While at Veolia, he was a non-executive director of Affinity Water (formerly Veolia Water). Andrew started his career in the investment banking division of Morgan Stanley where he was focused on project finance, M&A, utilities and the natural resources sector.
- Michael Osborne is a Principal at Corsair Infrastructure Management, a business unit of Corsair Capital. He is also a director of Itínere Infraestructuras, S.A., a toll road operator in Spain. Michael has 15 years of experience in infrastructure finance at Ernst & Young, Citi and Corsair.

In July 2017 Ray O'Toole was appointed as senior independent non-executive director of YW. Ray has been an independent non-executive director of YW since 27 June 2014.

## 8. Permitted Subsidiaries acquired pursuant to a Permitted Acquisition

There were no Permitted Subsidiaries acquired pursuant to a Permitted Acquisition during the six months to 30 September 2017.

## 9. Regulated capital investment

YW invests significant capital expenditure to add to, replace and maintain its plant and equipment. The price limits set by Ofwat every five years considers the level of capital and operating expenditure expected to be incurred during the relevant period together with the associated funding costs.

During the six months to 30 September 2017 YW has delivered £182.0m of capital investment (2016: £175.5m) to protect and enhance the services YW provides to its customers and improve the water environment in which the Company operates. This increase is expected as the Company is now midway through the AMP6 investment period.

## 10. Outsourcing

YW continues to monitor and comply with its Outsourcing Policy as detailed under the Common Terms Agreement which states, amongst other things, that YW will act as a reasonably prudent water and sewerage undertaker and in accordance with good industry practice.

YW is in the process of entering into an IT Framework Agreement with a number of IT providers. This framework will cover various workstreams and aims to provide the Company with access to a range of expertise to meet its future IT requirement. It is intended that the Framework Agreement will initially cover a five year period with an option for the parties to extend it for a further three years.

## 11. Financing

During June 2017 YW completed a transaction to recoupon a proportion of the Company's index linked swap portfolio. The swaps in question were amended so as to increase interest receivable on the receipt leg of the swaps by £19.3m per annum for the next 15 years, being £9.7m receivable semi-annually, with the first semi-annual amount of £9.7m being received August 2017. As a result of the recouponing transaction, the fair value of the index linked swap portfolio reduced by £239.9m on 22 June 2017, being the date of completion of the transaction.

Also during June 2017, Kelda Finance (No.2) Ltd, a holding Company of YW, raised £195m of debt which was subsequently injected into YW thus allowing de-leveraging of the Yorkshire Water Financing Group. This transaction, combined with the aforementioned index linked swap recouponing transaction, has enabled YW to reduce its running interest costs, further enhance the Company's robust capital structure and create greater headroom under the YW Financing Group's financial covenants.

On 17 October 2017 YW announced its intention to further reduce its borrowing costs and simplify its finances as part of a long term drive to enhance services for the Company's customers. YW is putting plans in place to further reducing its gearing levels towards 70% by 2020, reducing the Company's interest costs and to provide further investment in improvements to the services YW provides to its customers, both in the next two years and also over the longer term. Further measures are also being taken to reduce YW's annual interest costs and to strengthen its balance sheet.

YW's £490m capex and working capital facilities held within the Yorkshire Water Financing Group were both due to expire October 2018, however both were refinanced during October 2017 and have been replaced with a single revolving credit facility ("RCF") to be used for general corporate purposes. The new RCF, that takes advantage of the current favourable market conditions for borrowers, has been sized at £560m and was signed on 24 October 2017 and the prepayment and cancellation of the old facilities and drawdown under the new facility took place on 25 October 2017. The new RCF is for five years (ie to 24 October 2022) with options to extend the facility for a further one year or two years.

## 12. Ratings

YW and its financing subsidiaries have credit ratings assigned by three rating agencies, Fitch Ratings ("Fitch"), Moody's Investors Service ("Moody's") and S&P Global Ratings ("S&P"). The latest published ratings in relation to the YW Financing Group are shown in the table below:

| Rating Agency | Class A rating | Class B rating | Corporate Family Rating | Date of publication |
|---|---|---|---|---|
| Fitch | A (stable) | BBB+ (stable) | N/A | July 2017 |
| Moody's | Baa1 (stable) | Ba1 (stable) | Baa2 (stable) | July 2017 |
| S&P | A- (stable) | BBB (stable) | N/A | June 2017 |

On 2 June 2017 S&P affirmed the YW Financing Group's Class A rating of 'A-' and Class B rating of 'BBB' both with a stable outlook.

On 4 July 2017 Moody's affirmed the Corporate Family Rating of YW at 'Baa2' and affirmed the YW Financing Group's Class A and Class B ratings at Baa1 and Ba1 respectively, whilst moving the associated outlooks for those ratings from negative to stable. Moody's stated that their rationale for the change in outlook was the agency's view that YW's exposure to a persistently lower interest rate environment has reduced in light of the measures that management and the Company's shareholders have been taking and will continue to work on through the current regulatory period.

Also on 4 July 2017 Fitch affirmed the YW Financing Group's Class A rating of 'A' and Class B rating of 'BBB+' both with a stable outlook.

## 13. Surplus

YW's dividend policy is to:

- deliver real growth in dividends recognising the management of economic risks, the continuing need for investment of profits in the business and to pay additional dividends which reflect efficiency improvement, and particularly improvements beyond those assumed in the determination of price limits.
- to pay dividends in respect of the non-regulated business reflecting the profitability of those activities.
- where it is foreseeable that the Company will have sufficient profits available for distribution, to continue to pay annual dividends consistent with this policy. The Company can also pay special dividends as part of any capital reorganisation which the Board concludes to be in the best interests of the Company and complies with its obligations under its licence.

YW's Board and ultimate shareholders are committed to ensuring compliance with its covenanted financial ratios and also, where possible and appropriate, to maintaining its current ratings via, amongst other things, the retention of distributions and other balance sheet strengthening measures as and when it is prudent to do so.

For further information regarding current distribution forecasts see section 18 "Ratios".

## 14. Bank and liquidity facilities held by the YW Financing Group

On 31 March 2017 both the O&M Reserve Facility ("O&M") held at Yorkshire Water Services Odsal Finance Limited ("YWSOFL") and the Debt Service Reserve Liquidity Facility ("DSR") held at Yorkshire Water Services Bradford Finance Limited were renewed for a further twelve months to 30 March 2018 (both facilities are 364 day evergreen agreements). There was a modest increase in the O&M to £80m (previously £70.0m) whilst the DSR remained at the previous level of £239.8m. As at 30 September 2017 there were no balances outstanding on either of these facilities.

As at 30 September 2017, YWSOFL had £204.0m drawn on the Class A Capex Facility (facility size £430m) and £20m drawn on the Class A Working Capital Facility (facility size £60m). As detailed in Section 11 "Financing" both of these facilities were terminated on 25 October 2017 when, on the same date, YWSOFL entered into a new single revolving credit facility ("RCF") to be used for general corporate purposes.

## 15. Non-Participating YWSF Bond Reserve Account

The balance on the Non-Participating YWSF Bond Reserve Account on 30 September 2017 was £1.4m.

## 16. Authorised Investments

Authorised Investments as at 30 September 2017 are shown in the table below.

| | **Liquidity funds £m** | **Non-Participating YWSF Bond Reserve** | **Swap collateral account £m** | **Total £m** |
|---|---|---|---|---|
| Commonwealth Bank of Australia | | 1.4 | | **1.4** |
| Goldman Sachs Asset Management Sterling Liquidity Fund | 28.2 | | | **28.2** |
| HSBC Liquidity Fund | 21.8 | | | **21.8** |
| National Australia Bank | | | 17.9 | **17.9** |
| **Total** | **50.0** | **1.4** | **17.9** | **69.3** |

## 17. Ratios

The YW Financing Group confirms that in respect of the Calculation Date on 30 September 2017, by reference to the most recent financial statements that the YW Financing Group is obliged to deliver in accordance with Paragraph 1 (Financial Statements) of Part 1 (Information Covenants) of Schedule 4 (Covenants) to the Common Terms Agreement, the Ratios are as detailed in the table below.

| Date | 30/09/2017 Actual | 31/03/2018 Forecast | 31/03/2019 Forecast | 31/03/2020 Forecast |
|---|---|---|---|---|
| Class A RAR | 67.7% | 66.9% | 65.5% | 64.6% |
| Senior RAR | 76.2% | 75.3% | 74.5% | 72.4% |

| Test Period | 31/03/2018 Forecast | 31/03/2019 Forecast | 31/03/2020 Forecast |
|---|---|---|---|
| Class A ICR | 3.26x | 3.57x | 3.66x |
| Class A Adjusted ICR | 3.26x | 3.57x | 3.66x |
| Senior Adjusted ICR | 2.78x | 3.27x | 3.35x |
| Class A Average Adjusted ICR | 3.50x | 3.50x | 4.03x |
| Senior Average Adjusted ICR | 3.13x | 3.13x | 3.61x |
| Conformed Class A Adjusted ICR | 1.72x | 1.84x | 1.88x |
| Conformed Senior Adjusted ICR | 1.46x | 1.68x | 1.72x |
| Conformed Class A Average Adjusted ICR | 1.81x | 1.81x | 1.47x |
| Conformed Senior Average Adjusted ICR | 1.62x | 1.62x | 1.34x |

(together the "**Ratios**").

The YW Board and its ultimate shareholders continue to be committed to ensuring compliance with the Yorkshire Water Financing Group's covenanted financial ratios and also, where possible and appropriate, to maintaining its current ratings via, amongst other things, the retention of distributions and other balance sheet strengthening measures as and when it is prudent to do so.

The ratios contained within the tables above are based on the assumption that no further distributions are made by the Company to YW's ultimate shareholders to 31 March 2020. This assumption is in accordance with the Company's ongoing strategy of preparing for the possibility of lower allowed returns in PR09 whilst continuing to maintain flexibility to manage the impact of any unforeseen events.

It should be noted that YW's distribution forecasts will be reviewed once greater certainty regarding AMP7 allowed returns is known, which is likely to be by the end of December 2017 after Ofwat has publish its final methodology for PR19 on 13 December 2017. (Note that distributions from YW will continue to be made to fund inter-company interest payments, to fund external interest payments due on debt issued by Kelda Finance (No.2) Ltd and Kelda Finance (No.3) PLC and to service Kelda Group Ltd head office costs).

In addition, the ratios contained within the tables above do not take into account any additional operating expenditure associated with YW's recently published plans to transform its operational performance during the next two years to become a top performer in the water industry (as detailed in Section 2 "Business review"). Nor do the ratios take into account the work that YW is currently undertaking to reduce the Company's running interest costs and further enhance its robust capital structure. These will be reflected within the next published Compliance Certificate and Investors Report for the period ended 31 March 2017 when the impacts of these plans become more certain.

The YW Financing Group confirms that each of the above Ratios has been calculated in respect of each of the relevant periods for which it is required under the CTA and has not breached the Trigger Event Ratio Levels and has not caused Paragraph 17 (Ratios) of Part 2 (Events of Default - Non-YWH) of Schedule 6 (Events of Default) to the CTA to be breached.

For information, the computations of the ratios are as follows.

| Test Period | | Year ending 31/03/2018 Forecast | Year ending 31/03/2019 Forecast | Year ending 31/03/2020 Forecast |
|---|---|---|---|---|
| Net Cash Flow divided by | £m | 587.1 | 630.5 | 668.2 |
| Class A Debt Interest | £m | 180.2 | 176.4 | 182.4 |
| **Class A ICR** | **times** | **3.26** | **3.57** | **3.66** |
| Net Cash Flow | £m | 587.1 | 630.5 | 668.2 |
| Less CCD and IRC | £m | 0.0 | 0.0 | 0.0 |
| Adjusted Cash Flow divided by | £m | 587.1 | 630.5 | 668.2 |
| Class A Debt Interest | £m | 180.2 | 176.4 | 182.4 |
| **Class A Adjusted ICR** | **times** | **3.26** | **3.57** | **3.66** |
| Net Cash Flow | £m | 587.1 | 630.5 | 668.2 |
| Less CCD and IRC | £m | 0.0 | 0.0 | 0.0 |
| Adjusted Cash Flow divided by | £m | 587.1 | 630.5 | 668.2 |
| Senior Debt Interest | £m | 211.3 | 192.7 | 199.3 |
| **Senior Adjusted ICR** | **times** | **2.78** | **3.27** | **3.35** |
| Year 1 Class A Average Adjusted ICR | times | 3.26 | 3.26 | 3.66 |
| Year 2 Class A Average Adjusted ICR | times | 3.57 | 3.57 | 4.15 |
| Year 3 Class A Average Adjusted ICR | times | 3.66 | 3.66 | 4.27 |
| **Class A Average Adjusted ICR** | **times** | **3.50** | **3.50** | **4.03** |
| Year 1 Senior Average Adjusted ICR | times | 2.78 | 2.78 | 3.35 |
| Year 2 Senior Average Adjusted ICR | times | 3.27 | 3.27 | 3.76 |
| Year 3 Senior Average Adjusted ICR | times | 3.35 | 3.35 | 3.73 |
| **Senior Average Adjusted ICR** | **times** | **3.13** | **3.13** | **3.61** |
| Net Cash Flow | £m | 587.1 | 630.5 | 668.2 |
| Less Depreciation | £m | (255.8) | (254.4) | (215.4) |
| Less IRE not already deducted in the calculation of Net Cash Flow or Depreciation | £m | (69.1) | (89.0) | (121.4) |
| Fast/Slow Adjustment | £m | 47.3 | 37.0 | 12.2 |
| Adjusted Cash Flow divided by | £m | 309.4 | 324.0 | 343.6 |
| Class A Debt Interest | £m | 180.2 | 176.4 | 182.4 |
| **Conformed Class A Adjusted ICR** | **times** | **1.72** | **1.84** | **188.8** |
| Net Cash Flow | £m | 587.1 | 630.5 | 668.2 |
| Less Depreciation | £m | (255.8) | (254.4) | (215.4) |
| Less IRE not already deducted in the calculation of Net Cash Flow or Depreciation | £m | (69.1) | (89.0) | (124.4) |
| Fast/Slow Adjustment | £m | 47.3 | 37.0 | 12.2 |
| Adjusted Cash Flow divided by | £m | 309.4 | 324.0 | 343.6 |
| Senior Debt Interest | £m | 211.3 | 192.7 | 199.3 |
| **Conformed Senior Adjusted ICR** | **times** | **1.46** | **1.68** | **1.72** |

| Test Period | | 31/03/2018 Forecast | 31/03/2019 Forecast | 31/03/2020 Forecast |
|---|---|---|---|---|
| Year 1 Conformed Class A Average Adjusted ICR | times | 1.72 | 1.72 | 1.88 |
| Year 2 Conformed Class A Average Adjusted ICR | times | 1.84 | 1.84 | 1.27 |
| Year 3 Conformed Class A Average Adjusted ICR | times | 1.88 | 1.88 | 1.26 |
| **Conformed Class A Average Adjusted ICR** | **times** | **1.81** | **1.81** | **1.47** |
| Year 1 Conformed Senior Average Adjusted ICR | times | 1.46 | 1.46 | 1.72 |
| Year 2 Conformed Senior Average Adjusted ICR | times | 1.68 | 1.68 | 1.16 |
| Year 3 Conformed Senior Average Adjusted ICR | times | 1.72 | 1.72 | 1.13 |
| **Conformed Senior Average Adjusted ICR** | **times** | **1.62** | **1.62** | **1.34** |

| Test Period | | 30/09/2017 Actual | 31/03/2018 Forecast | 31/03/2019 Forecast | 31/03/2020 Forecast |
|---|---|---|---|---|---|
| Class A Net Indebtedness divided by | £m | 4,280.9 | 4,328.6 | 4,514.7 | 4,583.6 |
| RCV | £m | 6,324.1 | 6,471.8 | 6,792.1 | 7,092.5 |
| **Class A RAR** | **%** | **67.7%** | **66.9%** | **66.5** | **64.6%** |
| Senior Net Indebtedness divided by | £m | 4,820.9 | 4,871.2 | 5,060.6 | 5,133.5 |
| RCV | £m | 6,324.1 | 6,471.8 | 6,792.1 | 7,092.5 |
| **Senior RAR** | **%** | **76.2%** | **75.3%** | **74.5%** | **72.4%** |

Under the terms of the CTA, Compliance Certificates are completed for the whole YW Financing Group and therefore certain adjustments are required to be made to the financial information contained within the financial statements of YW when calculating the current period ratios as reported in the above tables. The table below details these necessary adjustments and reconciles the calculations of Class A Net Indebtedness and Senior Net Indebtedness for the period ended 30 September 2017 against the financial statements of YW for the same period.

| Net debt | Reference | 30 September 2017 |
|---|---|---|
| | | £m |
| Net debt | YW's Interims - note 7 | 4,048.6 |
| Fair value adjustments excluded from debt covenants | YW's Interims - note 7 | (114.9) |
| Subordinated loans to parent companies | YW's Interims - note 7 | 817.9 |
| Intercompany loans to / (from) other members of the YW Financing Group that reverse on consolidation | YW's Interims - note 7 | (28.4) |
| Add back unamortised issue costs | YW's Interims - note 7 | 12.2 |
| Discount on RPI accretion on index linked swaps excluded from debt covenants | YW's Interims - note 8 | 85.3 |
| **Senior Net Indebtedness** | | **4,820.7** |
| ***of which Class A Net Indebtedness*** | | ***4,280.7*** |

*Above totals may not agree due to roundings*

The YW Financing Group certifies that on 30 September 2017 the Annual Finance Charge for the twelve months to 31 March 2018 (excluding Finance Lease rental payments) is forecast at £210.3m. The Monthly Payment Amount is forecast at £17.5m.

This Investors Report also confirms that:

(a) no Default or Potential Trigger Event is outstanding; and

(b) that YW's insurances are being maintained in accordance with:

  (i) the CTA; and

  (ii) the provisions of the Finance Leases.

Yours faithfully

*For and on behalf of*

**YORKSHIRE WATER SERVICES LIMITED**

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**Richard Flint**

**Chief Executive**

..................................................

**Liz Barber**

**Group Director of Finance, Regulation & Markets**

*For and on behalf of*

**YORKSHIRE WATER SERVICES FINANCE LIMITED**

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**Liz Barber**

**Director**

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**Chantal Forrest**

**Director**

*For and on behalf of*

**YORKSHIRE WATER SERVICES ODSAL FINANCE LIMITED**

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**Liz Barber**

**Director**

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**Chantal Forrest**

**Director**

*For and on behalf of*

**YORKSHIRE WATER SERVICES BRADFORD FINANCE LIMITED**

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**Liz Barber**

**Director**

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**Chantal Forrest**

**Director**

# Yorkshire Water Financing Group

# Investors Report

*For the period ended 30 September 2017*

For further information regarding this Investors Report please contact either:


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