Yorkshire Water Financing Group

Investors Report

For the period ended 31 March 2018

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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 audited Yorkshire Water Services Ltd (“YW” or the “Company”) Annual Report and Financial Statements (“AR&FS”) and YW’s Annual Performance Report (“APR”) for the year ended 31 March 2018.

2. Business overview

YW has made good progress over the past year towards the delivery of its five-year business plan for the period 2015 to 2020. The Company has further improved its operational and financial performance as well as the quality of customer services provided. YW’s focus continues to be on the affordable, efficient and safe delivery of excellent customer services, while fulfilling the Company’s environmental and social responsibilities.

As the Company moves towards the end of the current five-year regulatory period, YW remains focussed on ensuring that the commitments it has made to its customers are delivered as promised. Whilst there has been strong operational performance in many areas during 2017/18, in other areas performance has not quite reached the level which YW’s customers expect. For the next two years and into the next regulatory period, YW has formulated a series of transformation plans, backed by significant resources and investment, which aims to move the Company to become one of the leaders in the water sector. These transformation plans are based on what the Company knows to be the key areas for its customers, these being lower leakage levels, fewer pollution incidents, a reduction in sewer flooding and minimising interruptions to water supply. The YW board has already taken the decision to invest £230m over the next four years to deliver these plans. For further information see section 4: 2017/18 operational performance - Business transformation.

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

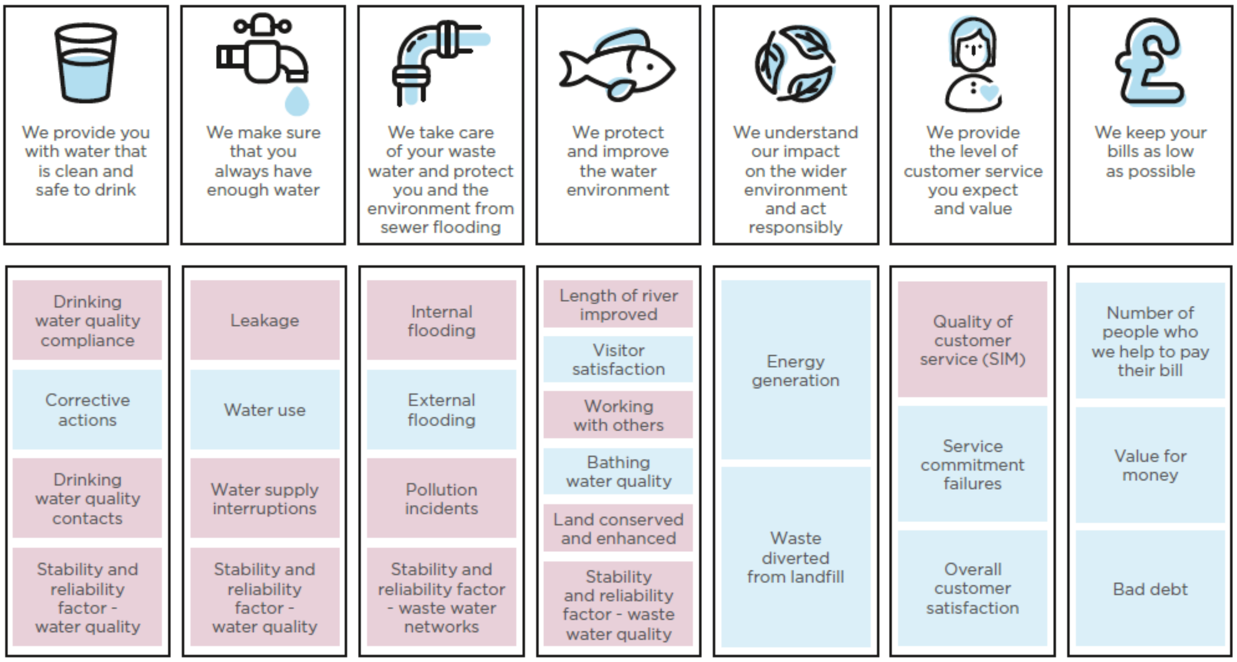
YW’s vision is ‘taking responsibility for the water environment for good’ and this vision, together with the associated six strategic business objectives (“SBO’s”) captures the Company’s ambition to go beyond its regulatory requirements and its commitment to long-term sustainability.

The essence of YW’s vision is doing what is right for its customers, colleagues, partners, the environment and its 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 that are measured by twenty-six Performance Commitments. These Customer Outcomes and Performance Commitments were shaped and agreed through engagement with over 30,000 of YW's customers and with the Company's stakeholders and regulators. These Performance Commitments set the levels of service that the Company is working to achieve up to 2020.

The regulatory regime in which YW operates includes financial and reputational Outcome Delivery Incentives if YW under or over performs against a number of the Company's Performance Commitments. Where financial incentives have been agreed, they become applicable only when the Company reaches defined levels of service. YW's seven Customer Outcomes and twenty-six Performance Commitments are shown below. The fourteen Performance Commitments that have a reward or penalty attached to them (ie an Outcome Delivery Incentive) are highlighted in pink.



YW's performance against its Performance Commitments and Outcome Delivery Incentives for the twelve months to 31 March 2018 are shown in section 4: 2017/18 operational performance.

YW's new long term business strategy - 'Not Just Water'

YW has recently consulted with its customers and stakeholders over the Company's new long term strategy - 'Not Just Water'. YW has spoken with over 26,000 of its customers and stakeholders to ensure that its plans are closely aligned to their long-term aspirations.

YW has set out to find out more about the Company's impact on the Yorkshire region and its people; to better understand the Company's diverse customer base and the part that water plays in their lives. YW has also looked carefully at wider trends such as the impact of a growing population and changes to the climate. YW's new long term strategy sets the context for the Company's detailed business plan for the next five-year investment cycle from 2020 to 2025, known as Asset Management Period 7 ("AMP7").

YW's Five Big Goals

YW's new strategy includes Five Big Goals that will shape everything that the Company will do in the future. To measure the Company's progress in working towards these Five Big Goals the Company is in the process of agreeing a new set of Performance Commitments that its customers, stakeholders and regulators want YW to prioritise beyond 2020. The Five Big Goals are:

1. **CUSTOMERS**: We will develop the deepest possible understanding of our customers' needs and wants and ensure that we develop a service tailored and personalised to meet those needs.
2. **WATER SUPPLY**: We will always provide you with enough safe water, we will not waste water and always protect the environment.
3. **ENVIRONMENT**: We will remove surface water from our sewers and recycle all waste water, protecting the environment from sewer flooding and pollution.
4. **TRANSPARENCY**: We will be a global benchmark for openness and transparency.
5. **BILLS**: We will use innovation to improve service, eradicate waste and reduce costs so no one need worry about paying our bill. We will not waste money.

Resilience and sustainability are imperatives within our new strategy

Central to YW's new long term strategy is the need for change. As a company whose core business fundamentally relies on financial, natural and social resources, YW knows that there are major challenges to the resilience of the Company's essential water and waste water services. These include climate change, population growth and resource constraints.

To help the Company make sure that its decision-making addresses with these challenges, the Company is using the concept of 'the six capitals'. YW is working to apply the six capitals to enhance the Company's resilience and sustainability by informing its risk management, decision making and investment choices. Considering positive and negative impacts and dependencies across all the capitals, rather than just thinking about financial capital, improves the Company's understanding of how to make decisions that result in a balanced impact and which also takes into account risk and value, so that more long term sustainable approaches can be targeted.

FINANCIAL CAPITAL
Our financial health and efficiency

MANUFACTURED CAPITAL
Our pipes, treatment works, offices and IT

NATURAL CAPITAL
The materials and services we rely on from the environment, especially water

HUMAN CAPITAL
Our workforce's capabilities and wellbeing

INTELLECTUAL CAPITAL
Our knowledge and processes

SOCIAL CAPITAL
Our relationships and customers' trust in us

Removal of the YW subsidiaries incorporated within the Cayman Islands

YW is very aware of the challenges made by the public and its stakeholders that water companies need to do more to improve transparency regarding how their finances are structured. One of the areas of concern involved water companies using offshore financing subsidiaries to raise the funds required for use in their operational and capital investment programmes. To address these concerns, during October 2017, YW committed publically that its Cayman Islands financing companies, which deliver no tax advantage, would be removed. YW received the necessary clearance from HMRC, Ofwat and its creditors in June 2018. Steps are being taken to implement these changes and these will be completed during the remainder of 2018.

4. 2017/18 operational performance

As at the end of the 2017/18 financial year YW has delivered on twenty-two out of the twenty-six Performance Commitments agreed with its customers and stakeholders at the beginning of the 2010-15 period. A strong performance has been delivered in a number of areas, such as supply interruptions and internal sewer flooding. However this strong performance has been balanced by disappointing results in the areas of leakage, overall customer service and water quality.

The Company deployed significant resources and investment in the last quarter of the 2017/18 financial year and commenced its transformation plans to make substantial reductions in leakage. However, the extreme cold weather conditions experienced in the first week of March resulted in a spike in burst water mains that meant the Company's target was not achieved. These additional resources, combined with the widespread application of new network monitoring techniques, will remain deployed as part of our plans to achieve a step change in operational and customer service performance over the next two years and into AMP7 and beyond. For more information on YW's transformation plans see the section on page 10 titled 'Business transformation plan. Further adverse weather conditions could further impact the Company's ability to meet its target and may result in costs additional to those ordinarily expected by the Company.

The year-end position on customer service, as measured by the water industry Service Incentive Mechanism ("SIM") score also showed a mixed position. A very strong performance on managing customer service on billing, where YW ranks as number one in the water sector, is balanced by significantly lower results for how YW deals with clean and waste water customer service issues. This is clearly an issue which the Company will be addressing as part of its transformation plan.

The determined roll out, companywide, of the Company's health and safety strategy is making good progress, and has achieved a wide level of engagement with YW's colleagues across the business. It is pleasing that the Company is seeing positive improvements in the level of reporting of both incidents and near misses as this is indicative of both an improving awareness of health and safety issues and the development of a more open culture.

YW's performance against its twenty-six Performance Commitments is provided below. For further information regarding these Performance Commitments, together with Company's performance highlights in relation to the additional SBO commitments that measures the Company's aspiration to go beyond the delivery of the seven Customer Outcomes and twenty-six Performance Commitments, can be found within the Company's AR&FS for the year ended 31 March 2018 and YW's 2017/18 APR – both of which can be found on the 'Our reports' section YW website (see https://www.yorkshirewater.com/reports).

2017/18 Performance Commitment and Outcome Delivery Incentive performances

YW's performance against its twenty-six Performance Commitments for the twelve months to 31 March 2018 are shown overleaf. The fourteen Performance Commitments that that have an associated Outcome Delivery Incentive are highlighted in pink.

Outcome	Performance Commitment	Unit	Target	2017-18 Performance	Commitment met?
We provide you with water that is clean and safe to drink	Drinking water quality compliance	%	100%	99.953%	No
	Drinking water corrective actions	Nr	≤ 6	4	Yes
	Drinking water quality contacts	Nr	≤ 6,108	8,100	No
	Stability and reliability - water quality	Classification	Stable in 2020	Stable	Yes
We make sure that you always have enough water	Leakage	Ml/d	≤ 297.1	300.3	No
	Water use	Litres per head per day	≤ 141.5	135.9	Yes
	Water supply interruptions	Time	< 12 minutes	6 minutes, 58 seconds	Yes
	Stability and reliability factor - water networks	Classification	Stable in 2020	Stable	Yes
We take care of your waste water and protect you and the environment from sewer flooding	Internal flooding	Nr	≤ 1,919	1,682	Yes
	External flooding	Nr	≤ 10,487	9,296	Yes
	Pollution incidents - serious	Nr	≤4	3	Yes
	- minor	Nr	≤ 211	202	Yes
	Stability and reliability factor - waste water networks	Classification	Stable in 2020	Stable	Yes
We protect and improve the water environment	Bathing water quality	Nr	≥ 15	18	Yes
	Working with others	Nr	≥ 3	12	Yes
	Visitor satisfaction	Survey	Published annually	96%	Yes
	Land conserved and enhanced	Hectares	≥ 11,689 by 2020	11,479	Yes
	Length of river improved	km	≥ 440 by 2020	Programme commenced	Yes
	Stability and reliability factor - waste water quality	Classification	Stable in 2020	Stable	Yes
We understand our impact on the wider environment and act responsibly	Waste diverted from landfill	%	≤ 95%	99.4%	Yes
	Renewable energy generation	%	≤ 12%	11.4%	No
We provide the level of customer service you expect and value	SIM	Score	Year-on-year improvement	84.3	Yes
	Overall customer satisfaction	%	Average 2015-20 performance to be better than average in 2010-15	94% (water) 89% (waste water)	Yes
	Service commitment failures	Nr	Average 2015-20 performance to be less than average last 3 years of 2010-15	12,203	Yes
We keep your bills as low as possible	Number of people who we help to pay their bill	Nr	Published annually	28,853	Yes
	Cost of bad debt to customers	%	≤ 3.16%	3.10%	Yes
	Value for money	%	Average 2015-20 performance to be better than average last 3 years of 2010-15	76% (water) 79% (waste water	Yes

The four areas where YW fell short of its Performance Commitments during 2017/18 were in the areas of drinking water quality compliance, drinking water quality contacts, leakage and renewable energy generation. Details of how YW is investing to improve performance in all four of these areas are provided below.

Drinking water quality compliance

Ensuring the quality of YW's drinking water supply is at the highest quality is consistently ranked as the number one priority by the Company's customers and the DWI has set the Company the highest possible target of achieving 100% compliance. YW's approach to improving water supply runs from source to tap and the Company is continuing its long-term catchment management initiatives for improving the quality of raw water entering YW's water treatment works. YW also works closely with landowners and the farming community to reduce the level of pesticides entering rivers from which the Company abstracts some of the water it treats and supplies.

At the end of 2017, YW brought into service a fully upgraded treatment process at its site at Rivelin Water Treatment Works which is improving and securing the drinking water supply to the City of Sheffield. YW has also been undertaking proactive replacement of lead pipework and the long-term trend in the levels of this key health parameter in water continues to drop. However, for other parameters, a small increase in issues within private pipework in customer's properties has led to a minor deterioration in the overall compliance figure to 99.953%.

Drinking water quality contacts

Overall, YW's customer contacts relating to water quality have reduced compared to the previous year with a total 2017/18 figure of 8,100 (2016/17: 9,093). This outcome represents an approximate 18% reduction since the beginning of AMP6. Whilst this improvement wasn't enough to meet YW's extremely challenging Performance Commitment, the Company's ongoing initiatives continue to reduce the number of contacts that it receives.

Leakage

Leakage is the amount of water lost from YW's network including when water is transported between the treatment works and customer homes and businesses. YW actively measures, monitors and reduces leakage levels as it is the dominant source of water waste. The Company has almost halved its leakage levels since 1995 but narrowly missed its Performance Commitment for this year which was to ensure that leakage is no higher than an average of 297.1 million litres a day throughout the year.

The Company was on track to meet its leakage target until December 2017. The extreme cold weather conditions in the latter part of 2017/18 resulted in a rise in leakage and despite the Company deploying significant additional resources during this period YW narrowly missed this Performance Commitment.

Renewable energy generation

Electricity accounts for approximately 64% of YW's operational carbon emissions and is one of the Company's main operating cost. YW works hard to minimise its electricity consumption and to maximise the amount of energy that the Company generates. In 2017/18, YW supplied 11.4% of its energy needs through self-generated energy. This was a two year high compared with 2015/16 & 2016/17 where the Company's self-generation was 11.3% & 10.4% respectively. However, this year's performance fell marginally short in achieving the Company's Performance Commitment of generating 12% of its energy needs from renewable sources.

YW expects to meet its 12% target in 2018/19 and continues to grow its long-term energy generation capacity and the Company's aim is to achieve 17% by 2020. YW has already commenced the construction of a £72m sludge treatment and anaerobic digestion facility at its Knostrop treatment works in Leeds, with completion expected in 2019. YW is also developing a framework contract for the supply of solar power to several of the Company's sites.

Business transformation plan

The way in which YW provides services to its customers is a key feature of the Company's transformation plan. During the year, YW has spent a significant amount of time talking to its customers and getting their views on the service that the Company provides both now and in the future. It was clear from this engagement that although YW's customers are broadly content with the current service they receive, they believe that YW's performance could be much improved in areas which mean the most to them – these being in the areas of leakage, minor pollution incidents and sewer flooding instances.

Although YW's customers like the Company's performance on interruptions to supply, where the Company is one of the leaders in the sector, they still think YW could do better. Based on this feedback YW has decided to make a significant investment of £230m in service improvement and has created a new directorate within the business called 'Business Transformation'. This additional investment aims to:

(i) reduce YW's leakage levels by 40% by 2025;
(ii) reduce YW's minor (category three) pollution incidents by 40%;
(iii) reduce YW's sewer flooding by 70% by 2021; and also
(iv) minimise YW's average per property minute interruption time to two minutes by 2021.

These new commitments have not only been promoted by YW's customers but have also been strongly supported by its stakeholders such as the Yorkshire Forum for Water Customers.

YW has already started to implement these transformation plans with significant recruitment of front-line leakage inspectors already being made. YW is also using new leakage detection technologies, including use of satellite technology, to locate leaks in the areas of Halifax, Keighley and Shipley, the deployment of 600 new network listening devices in the Huddersfield area and via the use of drones on the York to Selby trunk main.

5. 2017/18 financial performance

For the 2017/18 financial year YW has delivered a good set of financial results underpinned by continuing investment in its assets and improvement to its operational and environmental performance. The 2017/18 key financial performance indicators are as follows:

	2016/17	2017/18
Revenue	£1,003.1m	£1,026.7m
EBITDA[1]	£563.2m	£577.1m
Operating profit[1]	£317.3	£273.0
Net interest payable[2]	£213.5m	£216.9m
Capital expenditure[1]	£378.6m	£426.7m
Net debt[3]	£3,773.6m	£4,101.9m

[1] *Excludes exceptional items in relation to the December 2015 floods.*
[2] *Excludes exceptional fair value income and exceptional fair value charges.*
[3] *Net debt is as reported in YW's AR&FS and includes accounting adjustments such as fair valuation adjustments and discounted cashflows.*

YW's 2017/18 financial results are consistent with, and represent the delivery of, a strong financial performance against the first three years of the Company's five-year business plan. The key financial performance highlights include:

- An increase in revenue to £1,026.7m (2016/17: £1,003.1m) largely due to the inflationary annual price increases to customer bills.
- Operating costs are tightly managed. Total costs of £745.6m (2016/17: £717.3m) were in line with the Company's plan except for increased operating costs relating to the dry 2017 summer and the cold weather conditions in March 2018. Additional operating costs also resulted from the implementation of YW's transformation plans.
- Exceptional costs of £8.1m are associated with operational mitigation for assets damaged in the 2015 flood for which insurance payments were received in 2016/17.

- The movements in revenue and operating costs has resulted in a decrease in operating profit which (excluding exceptional items) was £281.1m in 2017/18 (2016/17: £285.8m). Including exceptional items, operating profit was £273.0m (2016/17: £317.3m).
- Net interest payable before exceptional items has increased to £216.9m (2016/17: £213.5m) primarily due to increases in inflation (RPI) leading to higher amounts being charged on the Company's inflation linked financial instruments. This increase was almost offset by increased interest income resulting from the actions YW has taken to lower its net interest costs and to manage its borrowing requirements.

In addition to the above, YW has in place measures to mitigate its electricity price pressure up to and including 31 March 2020. These include wholesale price hedging through a combination of forward purchasing (stepped hedge in advance of delivery) together with electricity prices being hedged by financial instruments. For the 2015-2020 period the following has been put in place:

- 100% of 2015/16 and 2016/17 prices were purchased forward through supplier agreement; and
- 100% of 2017/18 through to 2019/20 prices have been hedged through financial instrument solutions.

YW is currently reviewing a number of options to mitigate its electricity price pressures for the AMP7 period.

6. Regulatory update

In December 2017, Ofwat published its final methodology for the 2019 Price Review: Delivering Water 2020. The methodology sets out:

- Ofwat's expectations and requirements for companies preparing their AMP7 business plans to meet the needs of their customers from 2020 to 2025 and beyond.
- How these expectations will form the basis for how Ofwat will assess company business plans.
- The approach that Ofwat will use if it needs to intervene in those plans to ensure that companies deliver the step change required by customers.
- How the Ofwat assessment will flow through into companies' price limits, service commitments and the wider incentive framework.

On 3 July 2018, Ofwat published its decision on its consultation "Putting the sector back in balance". The decision outlines new requirements for companies to consider and include in their 2019 business plan submissions. Ofwat's decision publication largely confirms the position set out in its initial consultation paper, published on 26 April 2018. The conclusions in the decision document are materially unchanged from the consultation paper in relation to the three areas of focus: (i) sharing of perceived financing outperformance; (ii) dividend policies; and (iii) performance-related executive pay. The main decision areas were:

- Ofwat expects companies with a high level of gearing to propose 'high gearing outperformance' sharing mechanisms in their business plan submissions. Under Ofwat's proposed 'illustrative' mechanism, companies with debt of 70% or higher of their regulatory capital value ("RCV") will have to share a portion of the perceived benefit derived from higher gearing.
- Ofwat's stated that 'high gearing outperformance' mechanisms proposed by companies can include a transition period where there is convincing evidence that this is in their customers' interest.

YW is progressing well in the development of its 2019 Price Review business plans for submission in September 2018 and the Company continues to be on track against the key milestones and publication requirements. To date, the key submissions have been:

- YW's water resource and bioresource RCV allocations has been submitted to Ofwat;
- YW's drinking water quality plan has been submitted to the DWI; and
- the Company's draft performance definitions and indicative cost adjustment claims have been submitted to Ofwat.

7. Director changes

YW's Board continues to play a key role in the preparation of the Company's 2019 Price Review business plan, ensuring that the Company's plans are robust and deliverable. In support of this process there have been a number of changes to the Board during 2017/18.

- 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.
- Following the retirement from the Board of Baroness Kath Pinnock at the end of her term of office on 31 August 2017, 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 having assumed a new role within the business as Director of AMP7 Business Readiness. At the same time, Pamela Doherty re-joined the YW Board replacing Charlie 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, a sister company of YW.
- 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 of Kelda Holdings Ltd - 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 a regulated water 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, which is in line with Ofwat's Board Leadership Transparency and Governance Principles.

8. Permitted Subsidiaries acquired pursuant to a Permitted Acquisition

There were no Permitted Subsidiaries acquired pursuant to a Permitted Acquisition during the twelve months to 31 March 2018.

9. Regulated capital investment

YW invests significant capital expenditure to add to, replace, maintain and enhance its assets and its infrastructure. 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.

YW has continued to govern the effective and efficient delivery of its investment programme to protect and enhance the services that the Company provides to its customers and to improve the water environment in which the Company operates. YW continues to enhance its investment approach by integrating its management of both operational and capital expenditure via a total expenditure (totex) approach.

Capital expenditure for the twelve months to 31 March 2018 was £426.7m (2016/17: £378.6m). During the third year of AMP6 YW reported an underspend against the business plan capital expenditure programme of £23.4m due largely to rephasing of capital projects into later periods. 2017/18 capital expenditure included £18.4m (2016/17: £8.0m) related to the 2015 flood remediation.

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 and during the year, YW entered into an IT Framework Agreement with a number of IT providers. This framework covers various workstreams and will provide the Company with access to a range of expertise to meet its future IT requirements.

There were no other significant outsourcing activities that took place during 2017/18.

11. Financing

During 2017/18 Kelda Group has strengthened YW's balance sheet via the successful disposal of most of its non-core Kelda businesses, the available net proceeds being injected into YW to lower its gearing levels.

During 2017/18 YW has also reduced its net interest costs via a number of projects that resulted in changing the terms of a number of its inflation linked swaps and also by lowering its gearing levels by, amongst other things, the retention of dividend that would have been paid to its ultimate shareholders. During twelve months to 31 March 2018 YW has also:

- repaid £260m outstanding on a bond at its maturity in April 2017;
- renewed its revolving credit facility ("RCF") in October 2017 with a syndicate of eight banks at more favourable rates. The available amount was increased from £490m to £560m to provide additional liquidity for the Company;
- renewed its liquidity facilities in March 2018, with seven banks, for a further twelve months;
- terminated two finance leases on 31 March 2018 before the start of secondary rental periods;
- completed a transaction to recoupon a proportion of the Company's inflation linked swap portfolio at a debt cost of £250m. The terms of the swaps were amended to increase interest receivable by £19.3m per annum for the next fifteen years with the first semi-annual amount of £9.7m being received August 2017; and
- completed a second transaction to restructure and extend a proportion of the Company's inflation linked swap portfolio. The terms of the swaps were amended to increase interest receivable by £10.4m per annum for ten years with the first semi-annual amount of £5.2m being received February 2018.

In addition to the above during the twelve months to 31 March 2018 Kelda Finance (No.2) Ltd, a holding Company of YW, raised £195m of debt that was subsequently injected into YW.

Since 31 March 2018, YW has completed the following transactions:

- In July 2018, YW completed a transaction to restructure a proportion of the Company's inflation linked swap portfolio. The terms of swaps were amended and restructured to extend those swaps with a mandatory break date of February 2020 by ten and a half years and to increase interest receivable by £10m for two years (with £5m receivable semi-annually from August 2018) and then to reduce net interest payable by £21.1m for a further ten years (with £10.6m receivable semi-annually from August 2020).
- During July 2018, YW entered into two facility agreements for a total of £75m of new loans with a tenor of thirteen years. These loans were drawn in July 2018.

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	5 December 2017
Moody's	Baa1 (negative)	Ba1 (negative)	Baa2 (negative)	19 December 2017
S&P	A- (stable)	BBB (stable)	N/A	2 June 2017

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

On 5 December 2017, Fitch affirmed the Yorkshire Water Financing Group's Class A rating of 'A' and Class B rating of 'BBB+' both with a stable outlook.

During July 2017, Moody's affirmed the Corporate Family Rating of YW at 'Baa2' and affirmed the Yorkshire Water Financing Group's Class A and Class B rating at 'Baa1' and 'Ba1' respectively, while moving the associate outlooks for those ratings from negative to stable. Moody's stated that their rationale for the change in outlook was due to their 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. On 19 December 2017, Moody's affirmed its ratings, as noted above, but moved the associated outlooks from stable to negative. This change in outlook followed Ofwat's publication of its final methodology for the 2019 Price Review.

On 22 May 2018, Moody's issued an update for the water sector following an Ofwat consultation published on 26 April 2018. This consultation included finance cost sharing proposals particularly relevant to companies with gearing in excess of 60% of RCV. Whilst Moody's amended the outlook for four UK water groups from stable to negative, there was no change to the Corporate Family Rating of YW or the Yorkshire Water Financing Group's Class A and Class B rating.

The credit rating reports for all three of the rating agencies that assign credit ratings to the Yorkshire Water Financing Group can be found within the 'Investor Centre' section of the Kelda Group website at www.keldagroup.com.

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.

The dividend policy is currently under review, to ensure greater transparency and compliance with regulatory guidelines.

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.

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

During October 2017, YW entered into a new revolving credit bank facility ("RCF") totalling £560m. This new facility replaced the existing Capex and RCF bank facilities that totalled £490m. The new RCF matures in October 2022 and YW has the option to extend this date by a further one (and then another further one) year. At 31 March 2018, £220m was drawn on the RCF (2016/17: Capex Facility £25m; nil RCF). There was a one-off financing fee of £1.7m associated with the new RCF.

During March 2018 YW Financing Group renewed its operating and maintenance bank liquidity facility ("O&M") at £90m (2016/17: £80m). The O&M is a twelve month standby facility for the funding of YW's operating and maintenance expenditure. The increase to the O&M facility is due to the planned increase in operational and maintenance expenditure associated with planned improvements to customer service to take place throughout the twelve months to 31 March 2019. At 31 March 2018 there were no amounts drawn on this facility (2016/17: nil).

Also during March 2018, the YW Financing Group renewed its debt service reserve bank liquidity facility ("DSR") at £189m (2016/17: £239.8m). The DSR is a twelve month standby facility for funding the YW's interest expense. The reduction to the DSR facility is due to the reduction to interest costs forecast for the twelve months to 31 March 2019 following actions taken during the 2016/17 financial year and the first five months of 2017/18 as detailed in section 11 - Financing. At 31 March 2018 there were no amounts were drawn on this facility (2016/17: nil).

15. Non-Participating YWSF Bond Reserve Account

The balance on the Non-Participating YWSF Bond Reserve Account at 31 March 2018 was £1.4m.

16. Authorised Investments

Authorised Investments at 31 March 2018 were:

	Liquidity funds £m	**Non-Participating YWSF Bond Reserve £m**	**Swap collateral account £m**	**Total £m**
Commonwealth Bank of Australia	-	1.4	-	**1.4**
Goldman Sachs Asset Management Sterling Liquidity Fund	0.8	-	-	**0.8**
HSBC Liquidity Fund	14.7	-	-	**14.7**
National Australia Bank	-	-	11.9	**11.9**
Total	**15.5**	**1.4**	**11.9**	**28.8**

17. Ratios

The YW Financing Group confirms that in respect of the Calculation Date on 31 March 2018, 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	31/03/2018 Actual	31/03/2019 Forecast	31/03/2020 Forecast
Class A RAR	67.2%	68.4%	68.0%
Senior RAR	75.6%	76.5%	75.8%

As at 31 March 2018 YW's Financing Group's Senior RAR was 75.6% (2016/17: 76.8%) which includes £250m of funding raised during the year that was used to improve interest receivable on an inflation linked swap by £19.3m per annum (see section 11: Financing). Both Senior RAR and Class A RAR would have been 3.9% lower had this transaction not taken place.

Test Period	31/03/2018 Actual	31/03/2019 Forecast	31/03/2020 Forecast
Class A ICR	3.41x	3.96x	3.79x
Class A Adjusted ICR	3.41x	3.96x	3.79x
Senior Adjusted ICR	2.90x	3.57x	3.42x
Class A Average Adjusted ICR	3.40x	3.72x	3.72x
Senior Average Adjusted ICR	2.98x	3.30x	3.30x
Conformed Class A Adjusted ICR	1.81x	1.98x	1.81x
Conformed Senior Adjusted ICR	1.54x	1.79x	1.63x
Conformed Class A Average Adjusted ICR	1.75x	1.87x	1.87x
Conformed Senior Average Adjusted ICR	1.53x	1.65x	1.65x

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

The YW Board and its ultimate shareholders are committed to ensuring compliance with the YW Financing Group's covenanted financial ratios and also, where possible and appropriate, to maintain its current ratings via, amongst other things, the retention of distributions to the Company's ultimate shareholders.

The ratios contained within the tables above are based on the Company's agreed position that no further distributions are made by YW to its ultimate shareholders from 1 April 2018 to 31 March 2020 inclusive which is in accordance with the Company's preparations for its AMP7 business plan. It should be noted that distributions from YW will continue to be made to (i) fund inter-company interest payments; (ii) fund external interest payments due on debt issued by Kelda Finance (No.2) Ltd and Kelda Finance (No.3) PLC; and (iii) to service Kelda Group Ltd head office costs.

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	598.2	604.7	608.3
Class A Debt Interest	£m	175.6	152.7	160.7
Class A ICR	**times**	**3.41**	**3.96**	**3.79**
Net Cash Flow	£m	598.2	604.7	608.3
Less CCD and IRC	£m	0.0	0.0	0.0
Adjusted Cash Flow divided by	£m	598.2	604.7	608.3
Class A Debt Interest	£m	175.6	152.7	160.7
Class A Adjusted ICR	**times**	**3.41**	**3.96**	**3.79**
Net Cash Flow	£m	598.2	604.7	608.3
Less CCD and IRC	£m	0.0	0.0	0.0
Adjusted Cash Flow divided by	£m	598.2	604.7	608.3
Senior Debt Interest	£m	206.6	169.2	177.9
Senior Adjusted ICR	**times**	**2.90**	**3.57**	**3.42**
Year 1 Class A Average Adjusted ICR	times	2.83	3.41	3.41
Year 2 Class A Average Adjusted ICR	times	3.41	3.96	3.96
Year 3 Class A Average Adjusted ICR	times	3.96	3.79	3.79
Class A Average Adjusted ICR	**times**	**3.40**	**3.72**	**3.72**
Year 1 Senior Average Adjusted ICR	times	2.46	2.90	2.95
Year 2 Senior Average Adjusted ICR	times	3.90	3.57	3.57
Year 3 Senior Average Adjusted ICR	times	3.57	3.42	3.42
Senior Average Adjusted ICR	**times**	**2.98**	**3.30**	**3.30**
Net Cash Flow	£m	598.2	604.7	608.3
Less Depreciation	£m	(255.7)	(253.5)	(213.7)
Less IRE not already deducted in the calculation of Net Cash Flow or Depreciation	£m	(71.3)	(85.4)	(116.2)
Fast/Slow Adjustment	£m	47.2	36.9	12.1
Adjusted Cash Flow divided by	£m	318.4	302.7	290.5
Class A Debt Interest	£m	175.6	152.7	160.7
Conformed Class A Adjusted ICR	**times**	**1.81**	**1.98**	**1.81**
Net Cash Flow	£m	598.2	604.7	608.3
Less Depreciation	£m	(255.7)	(253.5)	(213.7)
Less IRE not already deducted in the calculation of Net Cash Flow or Depreciation	£m	(71.3)	(85.4)	(116.2)
Fast/Slow Adjustment	£m	47.2	36.9	12.1
Adjusted Cash Flow divided by	£m	318.4	302.7	290.5
Senior Debt Interest	£m	206.6	169.2	177.9
Conformed Senior Adjusted ICR	**times**	**1.54**	**1.79**	**1.63**

Test Period		31/03/2018 Forecast	31/03/2019 Forecast	31/03/2020 Forecast
Year 1 Conformed Class A Average Adjusted ICR	times	1.46	1.81	1.81
Year 2 Conformed Class A Average Adjusted ICR	times	1.81	1.98	1.98
Year 3 Conformed Class A Average Adjusted ICR	times	1.98	1.81	1.81
Conformed Class A Average Adjusted ICR	**times**	**1.75**	**1.87**	**1.87**
Year 1 Conformed Senior Average Adjusted ICR	times	1.26	1.54	1.54
Year 2 Conformed Senior Average Adjusted ICR	times	1.54	1.79	1.79
Year 3 Conformed Senior Average Adjusted ICR	times	1.79	1.63	1.63
Conformed Senior Average Adjusted ICR	**times**	**1.53**	**1.65**	**1.65**

Test Period		31/03/2018 Forecast	31/03/2019 Forecast	31/03/2020 Forecast
Class A Net Indebtedness divided by	£m	4,329.5	4,602.9	4,779.5
RCV	£m	6,446.3	6,733.5	7,031.3
Class A RAR	**%**	**67.2%**	**68.4%**	**68.0%**
Senior Net Indebtedness divided by	£m	4,872.2	5,149.9	5,330.8
RCV	£m	6,446.3	6,733.5	7,031.3
Senior RAR	**%**	**75.6%**	**76.5%**	**75.8%**

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 tables overleaf detail these adjustments.

Net debt	Reference	2017/18
		£m
YW net debt at 31 March 2018	Note 17 to YW's AR&FS	4,101.9
Fair value adjustment of bonds	Note 17 to YW's AR&FS	(80.1)
Amounts owed from group companies	Note 17 to YW's AR&FS	768.8
Intercompany loans to/(from) other members of the YW Financing Group that reverse on consolidation	Note 17 to YW's AR&FS	(25.8)
Unamortised issue costs	Note 17 to YW's AR&FS	11.3
Discount on RPI accretion on inflation linked swaps	Note 18 to YW's AR&FS	96.1
Senior Net Indebtedness		**4,872.2**
of which Class A Net Indebtedness		***4,329.5***

Adjusted Cash Flow	Reference	2017/18
		£m
YW EBITDA excluding exceptional items	Note 3 to YW's AR&FS	577.1
Changes in working capital	Table 1D line 5 of YW's APR	21.1
Net Cash Flow		**598.2**
Less Depreciation	YW FD (inflated to outturn)	(255.7)
Less IRE not already deducted in the calculation of Net Cash Flow or Depreciation:		
- FD allowance	YW FD (inflated to outturn)	(90.8)
- IRE already deducted	Note 26 to YW's AR&FS	19.5
		(71.3)
Fast/Slow Adjustment	YW FD (inflated to outturn)	47.2
Adjusted Cash Flow		**318.4**

Class A / Senior Debt Interest	Reference	2017/18
		£m
YW net interest paid	Table 1D line 10 of YW's APR	137.3
Interest received on subordinated intercompany loans	Note 7 to YW's AR&FS	51.1
Finance lease interest paid in advance	Note 8 to YW's AR&FS	13.9
Loan repayment from YW to YWSOFL recognised as interest in YW Financing Group's interest cover ratios	Note 15 to YWSOFL's AR&FS	6.0
Exclude one-off refinancing fees	See section 14 Bank and liquidity facilities held by the YW Financing Group	(1.7)
Senior Debt Interest		**206.6**
of which Class A Debt Interest		***175.6***

Above totals may not agree due to roundings

The YW Financing Group certifies that on 31 March 2018 the Annual Finance Charge for the twelve months to 31 March 2019 (excluding Finance Lease rental payments) is forecast at £169.2m. The Monthly Payment Amount is forecast at £14.1m.

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

Richard Flint
Chief Executive

Liz Barber
Group Director of Finance, Regulation & Markets

For and on behalf of
YORKSHIRE WATER SERVICES FINANCE LIMITED

Richard Flint
Director

Liz Barber
Director

For and on behalf of
YORKSHIRE WATER SERVICES ODSAL FINANCE LIMITED

Richard Flint
Director

Liz Barber
Director

For and on behalf of
YORKSHIRE WATER SERVICES BRADFORD FINANCE LIMITED

Richard Flint
Director

Liz Barber
Director

Yorkshire Water Financing Group

Investors Report

For the period ended 31 March 2018

For further information regarding this Investors Report please contact:

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