Fitch Ratings

Corporates
Utilities - Non US
United Kingdom

Yorkshire Water Finance Plc; Yorkshire Water Services Finance Limited

In March 2023, Fitch Ratings affirmed Yorkshire Water Services Finance Limited (YWSF) and Yorkshire Water Finance Plc's (YWF) senior secured class A debt ratings at 'A-' and subordinated class B debt rating at 'BBB-' with Stable Outlooks. YWSF and YWF are financing companies of Yorkshire Water Services Limited operating company (Yorkshire Water or YWS).

The rating affirmation and Stable Outlook consider the group's commitment to restore about GBP940 million of equity at YWS, largely by receiving repayments of legacy intercompany loans before the financial year ending in March 2027 (FYE27), resulting in an updated financial policy to target maximum regulatory gearing at YWS of 72% by FYE25.

The ratings also consider the operational and regulatory performance of YWS, and the secured nature of the group's financing structure. The latter benefits from structural enhancements, including trigger mechanisms (gearing and interest coverage covenants) and debt service reserve liquidity.

Key Rating Drivers

Gearing Headroom to Improve: Fitch expects adequate gearing headroom by FY25, mainly due to a gradual repayment of GBP940 million intercompany loans at YWS. This will largely support financial resilience through reduced debt funding requirements, while GBP100 million will be used to fund investment into the reduction of storm overflow spills. We forecast Yorkshire Water's adjusted class A net debt to regulated capital value (RCV) of about 70% against our negative rating sensitivity of 72%.

The Kelda corporate group publicly committed to the UK's water regulation authority (Ofwat) to repay its intercompany loans between Kelda Eurobond (borrower) and YWS (lender) following Ofwat's investigation on compliance of its intercompany loans with its license requirements. Kelda expects to repay its intercompany loans in three tranches across price control period ending March 2025 (AMP7) and ending March 2030 (AMP8): GBP400 million FY24 (GBP100 million higher than agreed representing acceleration of commitment), balance GBP100 million in FY25 and the remaining GBP440 million in FY27.

Class B Deleveraging: We forecast YWS to maintain ample net debt to RCV headroom for the class B debt against our negative rating sensitivity of 82%, with strong cash and nominal PMICRs, on reduced class B debt, and comfortable headroom for class A debt. This may be positive for the class B debt rating if confirmed in the AMP8 business plan.

Weaker, but Comfortable PMICRs Expected: About 60% of YWS's total debt is inflation-linked (IL), partly through swaps in FY22. While IL debt provides a hedge to RCV that grows with inflation over time, we expect the higher accretion on the IL debt and swaps to contribute to weak nominal post-maintenance interest cover ratio (PMICR), reflecting overall cost of debt. However, we forecast average AMP7 class A nominal PMICR above our negative rating sensitivity of 1.7x.

We expect AMP7 average class A cash PMICR above our negative rating sensitivity of 1.4x, but regular accretion paydowns is expected to weaken interest coverage towards the end of AMP7.

Ratings

Debt Ratings

Senior Secured Debt - Long-Term Rating	A-
Subordinated Long-Term Rating	BBB-

2035 Climate Vulnerability Signal: 14

Click here for the full list of Ratings

Applicable Criteria

Corporate Rating Criteria (October 2022)

Sector Navigators: Addendum to the Corporate Rating Criteria (May 2023)

Parent and Subsidiary Linkage Rating Criteria (June 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (April 2021)

Exposure Draft: Climate Vulnerability in Corporate Ratings Criteria (June 2023)

Related Research

Global Corporates Macro and Sector Forecasts – June 2023

Ofwat's Tighter Licence Conditions Negative for UK Water Holdcos (May 2023)

What Investors Want to Know: UK Water Companies (April 2023)

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Totex Underperformance Expected: We expect YWS to underperform its total expenditure (totex) allowance by GBP340 million across AMP7, almost equally split between operating expenditure (opex) and capex underperformance. YWS is investing about GBP180 million (GBP80 million expected to be recovered through the cost-sharing mechanism) in combined storm overflows (CSOs) to improve environmental outcomes and reduce penalties. These investments, which are within our expectations, aim to meet a minimum 20% reduction in average number of discharges from CSOs by 2025 against 2021 base year.

Net ODI Penalties Assumed: We forecast GBP35 million-40 million of net cash outcome delivery incentives (ODI) penalties (nominal) related to operational performance in AMP7. In the first two years of AMP7, YWS incurred penalties mainly in internal sewer flooding, water supply interruptions and water quality, and lagged behind other regulated UK water companies in Ofwat's overall performance category. YWS only achieved 57% of its performance commitments in 2021/22.

Subordinated Debt Rating: As YWF's class B debt is subordinated to class A debt and sizeable super-senior IL swap liabilities, we do not expect the recovery of class B debt to be above average in an event of default scenario and hence do not apply the one-notch sector-specific recovery uplift in the class B debt rating.

Reduced but Sizeable MTM Liability: YWS's negative mark-to-market (MTM) liability on IL swaps was reduced to GBP1.8 billion at end-September 2022 (about 24% of RCV) from about GBP3 billion (about 41% of RCV) from end-March 2022, mainly reflecting higher RPI and interest-rate expectations. Despite the reduction, YWS's exposure remains one of the largest in the UK water sector.

In our rating case, we do not assume crystallisation of the MTM liability nor do we adjust our debt to include it. The MTM liability would only crystallise in the event of a non-payment under the swaps, which we view as unlikely.

Swap Breaks Managed: YWS proactively manages its IL swap breaks and accretion pay-downs. IL swap breaks due in 2023 have been extended by 5-17 years and regular accretion paydowns avoid a documentary super-senior trigger event covenant of 6% RCV. If total accretion to notional value exceeds 6% of RCV, the amount above 6% would equal the accretion paydown.

Borrowing Through Swaps: Fitch treats re-couponing benefit funded through tenor extensions on out-of-money swaps as borrowing through swaps and adjusts its forecast net debt by the cumulative amount of the benefits received. Total debt adjustment amounts to about 2% of shadow RCV at FYE25.

Standalone Assessment under PSL: Fitch rates YWS on a standalone basis using the stronger subsidiary/weaker parent approach under its Parent and Subsidiary Linkage (PSL) Rating Criteria. This assessment reflects 'insulated' legal ring-fencing as underlined by a well-defined contractual framework, and tight financial controls imposed by Ofwat and designed to support YWS's financial profile. We view access and control as overall 'porous' as YWS operates with separate cash management and a mixture of external and intercompany funding.

Financial Summary

	Mar 21	Mar 22	Mar 23F	Mar 24F	Mar25F
Class A net debt/RCV (%)	70.5	67.9	68.4	68.7	69.7
Total senior net debt/RCV (%)	78.4	74.5	74.2	71.9	72.8
Class A cash PMICR (x)	1.7	1.4	1.5	1.6	1.7
Senior cash PMICR (x) (class A & B)	1.5	1.3	1.3	1.5	1.6
Class A nominal PMICR (x)	1.6	1.5	1.9	2.7	2.2
Senior nominal PMICR (x) (class A & B)	1.5	1.4	1.9	2.6	2.0

Note: Forecasts assume equity contribution of GBP300m in YWS in FY24F and GBP200m in FY25F, as compared to current expectation of GBP400m in FY24F and GBP100m in FY25F.
Source: Fitch Ratings, Fitch Solutions, YWS

Rating Derivation Relative to Peers

YWS's class A senior secured 'A-'/Stable rating reflects the highly geared nature of the company's secured covenanted structure, with gearing of about 70% at end of AMP7 compared with peer United Utilities Water Limited's (BBB+/Stable; senior unsecured debt: A-) lower gearing of about 63.2%, and its standard corporate structure. YWS's financing structure benefits from structural enhancements, including trigger mechanisms (such as class A dividend lock-up of 75%, senior gearing dividend lock-up of 85%, interest cover covenants) and debt-service reserve liquidity.

The non-participatory notes issued by YWSF are rated 'BBB+'/Stable, one notch lower than class A debt rating. The non-participatory note holders did not accept exchange for class A unwrapped bonds, and do not benefit from the YWS's share pledge. However, they benefit from other creditor protections and structural features of the overall covenant package from YWS and YWSF.

Rating Sensitivities

Factors that May, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Class A: adjusted net debt to RCV below 67%, cash and nominal PMICRs above 1.6x and 1.8x, respectively.
- Class B: total senior adjusted net debt to RCV below 77%, total senior cash and nominal PMICRs above 1.3x and 1.6x, respectively, and substantial elimination of the negative MTM swap liability.

Factors that May, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Class A: adjusted net debt to RCV above 72%, cash and nominal PMICRs below 1.4x and 1.7x, respectively.
- Class B: total senior adjusted net debt to RCV above 82%, total senior cash and nominal PMICRs below 1.2x and 1.5x, respectively.

Liquidity and Debt Structure

Adequate Liquidity: As at FYE22, YWS held about GBP28.5 million of unrestricted cash and cash equivalents and undrawn committed revolving credit facility (RCF) of GBP560 million. In July 2023 the RCF was replaced with GBP570 million with an ability to increase by up to GBP90 million, maturing November 2027, with two one-year extensions up to November 2029. In addition, a bilateral RCF of GBP80 million is also available with three-year maturity plus three, one-year extensions.

In addition, YWS benefits from a designated debt service reserve liquidity facility of GBP170 million (committed undrawn) increased to GBP182 million in March 2023, sized to cover 12 months of interest payments (including hedge payments), together with a committed undrawn operating and maintenance reserve facility of GBP90 million, increased to GBP120 million in March 2023 - both only available upon trigger event. Debt of GBP149 million matures in FY24, of which GBP34 million was repaid in April 2023, with the remaining GBP115 million due in FY24.

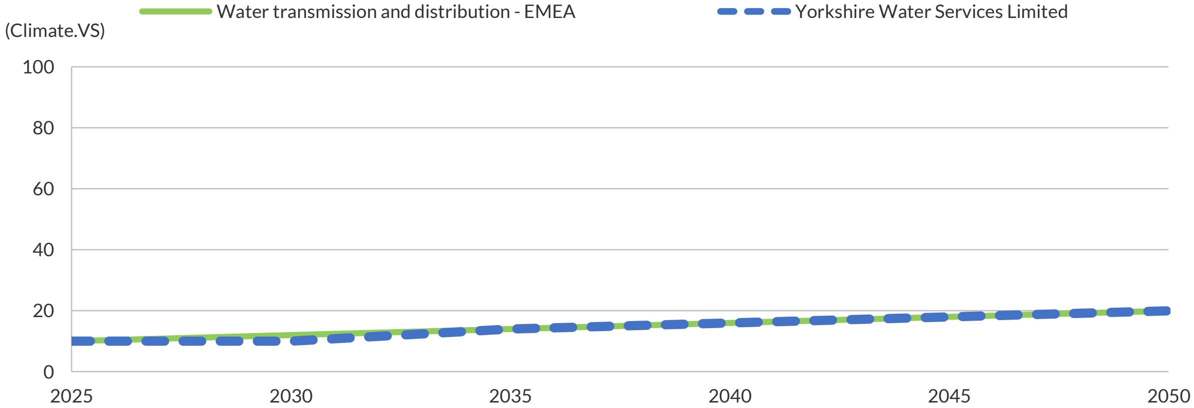
Climate Vulnerability Considerations

Fitch has published a Criteria Exposure Draft describing its approach to assessing Climate Vulnerability for Corporates. In this report, we describe our proposal to use Climate Vulnerability Signals (Climate.VS) as a screening tool to identify sectors and Fitch-rated issuers that are potentially most exposed to credit-relevant climate transition risks and, therefore, require additional consideration of these risks in rating reviews.

The FY22 revenue-weighted Climate Vulnerability Signal (Climate VS) for YWS for 2035 is 14 out of 100, suggesting low exposure to climate-related risks in that year. This is line with sector average signal of the water/wastewater utility sector.

Climate.VS Evolution

As of Dec. 31, 2022



Source: Fitch Ratings

Liquidity and Debt Maturities

Yorkshire Water Services Limited

Liquidity analysis (GBPm)	2023F	2024F	2025F
Available liquidity			
Beginning cash balance	29	112	-369
Rating case FCF after acquisitions and divestitures	-154	-331	-251
Debt issued during FY23	*650*		
Total available liquidity (A)	**525**	**-220**	**-619**
Liquidity uses			
Debt maturities	-413	-149	0
Total liquidity uses (B)	**-413**	**-149**	**0**
Liquidity calculation			
Ending cash balance (A+B)	112	-369	-619
Revolver availability	480	650	650
Ending liquidity	**591.5**	**281.4**	**30.7**
Liquidity score (x)	0.9	2.9	Not meaningful

F – Forecast
Source: Fitch Ratings, Fitch Solutions, YWS

Scheduled Debt Maturities

(GBPm)	2022
2023	413
2024	149
2025	0
2026	0
2027	302
Thereafter	2,744
Total	**3,608**

Note: Forecasts assume an equity contribution of GBP300m in YWS in FY24F and GBP200m in FY25F, as compared to current expectation of GBP400m in FY24F and GBP100m in FY25F.
Source: Fitch Ratings, Fitch Solutions, YWS

Key Assumptions

Fitch's Key Assumptions within Our Rating Case for the Issuer:

- Ofwat's final determination financial model (after the Competition and Markets Authority outcome) is used as a main information source.
- Allowed wholesale weighted average cost of capital (WACC) of 2.12% (RPI-based) and 3.12% (CPIH-based) in real terms.
- Fifty percent of RCV is RPI-linked and another 50% plus capital additions is CPIH-linked, since FY21.
- RPI of 10.8% for FY23, 8% for FY24 and 3.9% for FY25.
- CPIH of 8.5% in FY23, 6% in FY24 and 2.8% in FY25.
- Fitch case assumes totex underperformance of about GBP340 million across AMP7.
- Net nominal cash ODI penalties of about GBP35 million-40 million for AMP7.
- Equity injections from Kelda to YWS of GBP500 million in 2023-2025.

Financial Data

(GBPm)	2021	2022	2023F	2024F	2025F
Summary income statement					
Gross revenue	1,101	1,119	1,223	1,298	1,342
Revenue growth (%)	3.5	1.6	9.3	13.4	3.4
EBITDA before income from associates	565	576	579	605	629
EBITDA margin (%)	51.3	51.5	47.4	46.6	46.9
EBITDA after associates and minorities	565	576	579	605	629
EBITDAR	565	576	579	605	629
EBITDAR margin (%)	51.3	51.5	47.4	46.6	46.9
EBIT	241	242	199	212	228
EBIT margin (%)	21.9	21.7	16.3	16.3	17.0
Gross interest expense	-167	-174	—	—	—
Pre-tax income including associate income/loss	18	-353	289	280	282
Summary balance sheet					
Readily available cash and equivalents	198	29	29	29	29
Debt	5,704	5,798	6,379	6,642	6,857
Lease-adjusted debt	5,704	5,798	6,379	6,642	6,857
Net debt	5,506	5,770	6,350	6,614	6,829
Summary cash flow statement					
EBITDA	565	576	579	605	629
Cash interest paid	-146	-160	-144	-135	-141
Cash tax	-14	-15	-4	-2	-20
Dividends received less dividends paid to minorities (inflow/outflow)	—	—	—	—	—
Other items before funds from operations (FFO)	-4	-4	—	—	—
FFO	446	437	506	522	508
FFO margin (%)	40.5	39.1	41.4	40.2	37.8
Change in working capital	32	18	-12	—	—
Cash flow from operations (CFO) (Fitch-defined)	478	455	494	522	508
Total non-operating/non-recurring cash flow	-15	—	—	—	—
Capex	-447	-384	—	—	—
Capital intensity (capex/revenue) (%)	40.6	34.3	—	—	—
Common dividends	-45	-53	—	—	—
Free cash flow (FCF)	-30	19	—	—	—
FCF margin (%)	-2.8	1.7	—	—	—
Net acquisitions and divestitures	—	—	—	—	—
Other investing and financing cash flow items	—	—	-426	68	36
Net debt proceeds	-64	-189	581	264	215
Net equity proceeds	—	—	—	—	—
Total change in cash	-90	-170	—	—	—
Leverage ratios (x)					
Class A net debt/RCV (%)	70.5	67.9	68.4	68.7	69.7
Total senior net debt/RCV (%)	78.4	74.5	74.2	71.9	72.8
EBITDA leverage	10.1	10.1	11.0	11.0	10.9
EBITDA net leverage	9.8	10.0	11.0	10.9	10.9
EBITDAR leverage	10.1	10.1	11.0	11.0	10.9
EBITDAR net leverage	9.8	10.0	11.0	10.9	10.9
EBITDAR net fixed-charge coverage	5.6	4.8	8.4	7.4	6.2
FFO-adjusted leverage	10.4	10.4	11.1	11.0	11.3
FFO-adjusted net leverage	10.1	10.4	11.0	11.0	11.2
FFO leverage	10.4	10.4	11.1	11.0	11.3
FFO net leverage	10.1	10.4	11.0	11.0	11.2

(GBPm)	2021	2022	2023F	2024F	2025F
Calculations for forecast publication					
Capex, dividends, acquisitions and other items before FCF	-508	-436	-648	-853	-759
FCF after acquisitions and divestitures	-30	19	-154	-331	-251
FCF margin after net acquisitions (%)	-2.8	1.7	-12.6	-25.5	-18.7
Coverage ratios (x)					
Class A cash PMICR	1.7	1.4	1.5	1.6	1.7
Senior cash PMICR	1.5	1.3	1.3	1.5	1.6
Class A nominal PMICR	1.6	1.5	1.9	2.7	2.2
Senior nominal PMICR	1.5	1.4	1.9	2.6	2.0
FFO interest coverage	3.7	3.5	4.0	4.5	4.3
FFO fixed-charge coverage	3.7	3.5	4.0	4.5	4.3
EBITDAR fixed-charge coverage	3.9	3.6	4.0	4.5	4.5
EBITDA interest coverage	3.9	3.6	4.0	4.5	4.5
Additional metrics (%)					
CFO-capex/debt	0.5	1.2	-0.9	-3.0	-1.0
CFO-capex/net debt	0.5	1.2	-1.0	-3.0	-1.0
CFO/capex	106.8	118.6	89.1	72.6	87.7

Note: Forecasts assume equity contribution of GBP300m in YWS in FY24F and GBP200m in FY25F as compared to current expectation of GBP400m in FY24F and GBP100m in FY25F.
Source: Fitch Ratings, Fitch Solutions, YWS

How to Interpret the Forecast Presented

The forecast presented above is based on Fitch Ratings' internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch Ratings to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch Ratings' rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch Ratings' forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch Ratings' own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch Ratings' own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch Ratings may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch Ratings' own internal deliberations, where Fitch Ratings, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch Ratings may update the forecast in future reports but assumes no responsibility to do so. Original financial statement data for historical periods is processed by Fitch Solutions on behalf of Fitch Ratings. Key financial adjustments and all financial forecasts credited to Fitch Ratings are generated by rating agency staff.
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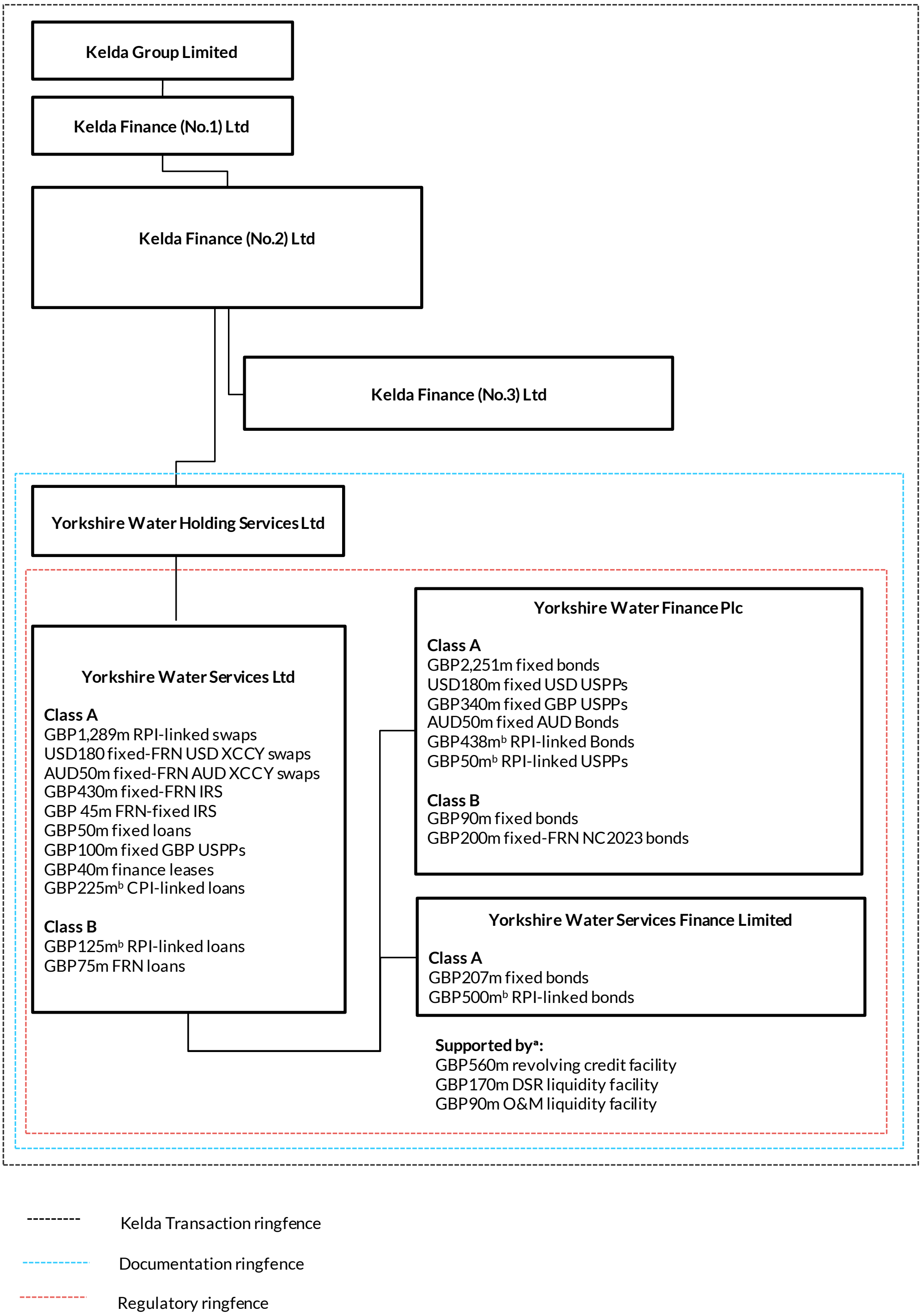
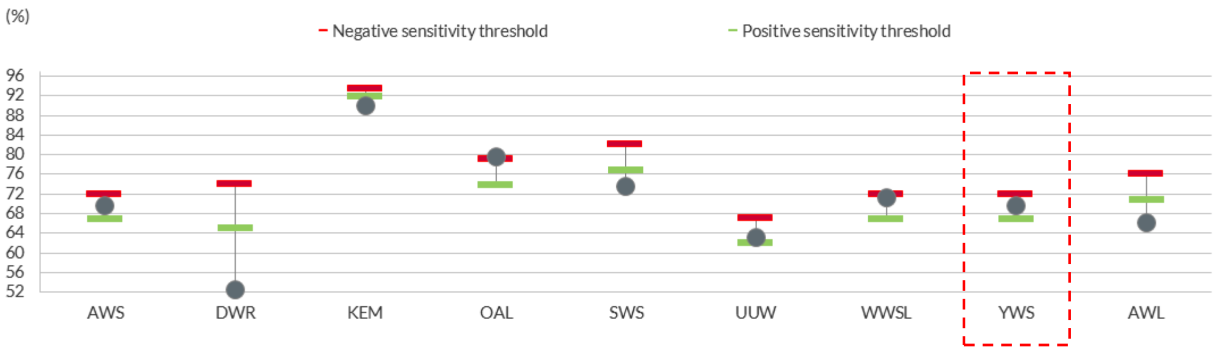
Simplified Group Structure Diagram



[a] Replaced with below facilities:
GBP480m revolving credit facility in Nov 2022
GBP182m DSR liquidity facility in Mar 2023
GBP120m O&M liquidity facility in Mar 2023
[b] Outstanding at time of issue
Source: Fitch Ratings, Fitch Solutions, YWS, September 2022.

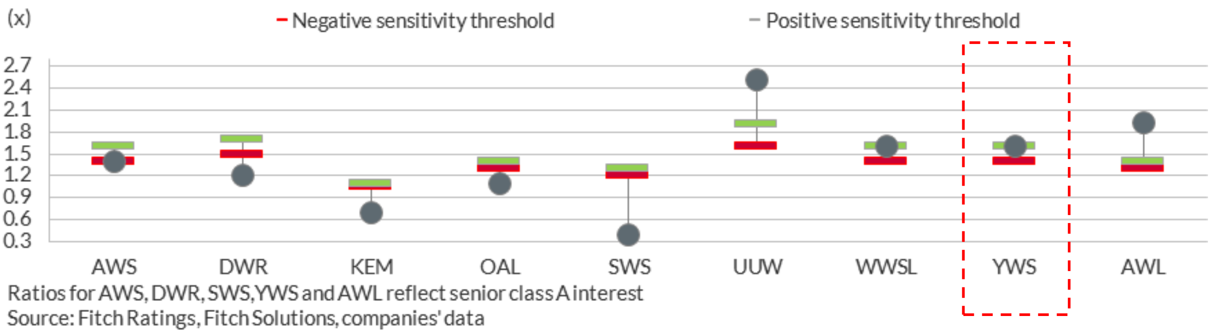
Peer Financial Summary

Rating Headroom by Gearing (FY25)



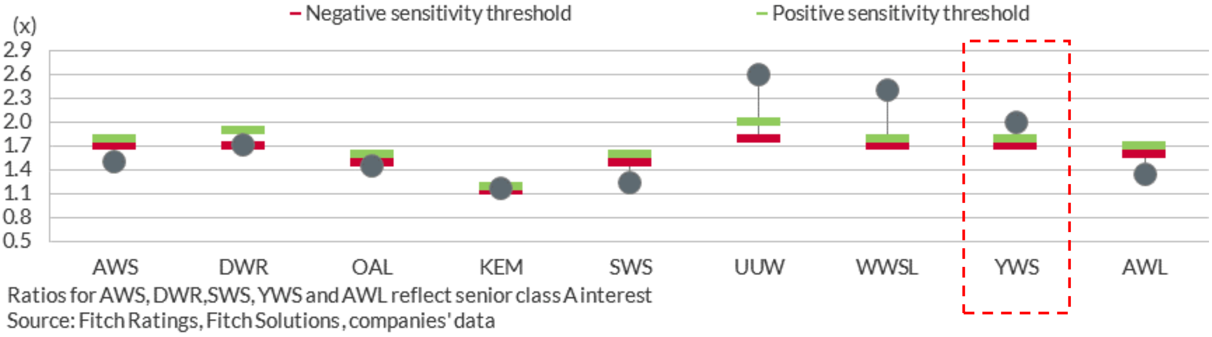
Ratios for AWS, DWR, SWS, YWS and AWL reflect senior class A debt
Source: Fitch Ratings, Fitch Solutions, companies' data

Rating Headroom by Cash PMICR (Five-Year Average)



Ratios for AWS, DWR, SWS,YWS and AWL reflect senior class A interest
Source: Fitch Ratings, Fitch Solutions, companies' data

Rating Headroom by Nominal PMICR (Five-Year Average)



Ratios for AWS, DWR,SWS, YWS and AWL reflect senior class A interest
Source: Fitch Ratings, Fitch Solutions, companies' data

Key

AWS	Anglian Water Services Limited
DWR	Dwr-Cymru (Financing) UK Ltd
KEM	Kemble Water Finance Limited
OAL	Osprey Acquisition Limited
SWS	Southern Water Services Limited
UU	United Utilities Water Limited
WW	Wessex Water Services Limited
YWS	Yorkshire Water Services Limited
AWL	Affinity Water Limited

Source: Fitch Ratings

Fitch Adjusted Financials

(GBPm)	Notes and formulas	Reported values	Sum of adjustments	Other adjustments	Adjusted values
31 Mar 22					
Income statement summary					
Revenue		1,119			1,119
EBITDAR		576			576
EBITDAR after associates and minorities	(a)	576			576
Lease expense	(b)	0			0
EBITDA	(c)	576			576
EBITDA after associates and minorities	(d) = (a-b)	576			576
EBIT	(e)	242			242
Debt and cash summary					
Other off balance sheet debt	(f)	0			0
Debt	(g)	5,046	753	753	5,798
Lease-equivalent debt	(h)	0			0
Lease-adjusted debt	(i) = (g+h)	5,046	753	753	5,798
Readily available cash and equivalents	(j)	29			29
Not readily available cash and equivalents		0			0
Cash flow summary					
EBITDA after associates and minorities	(d) = (a-b)	576			576
Preferred dividends paid	(k)	0			0
Interest received	(l)	42	-1	-1	41
Interest paid	(m)	-160			-160
Cash tax paid		-15			-15
Other items before funds from operations (FFO)		4	-9	-9	-4
FFO	(n)	447	-9	-9	437
Change in working capital (Fitch-defined)		9	9	9	18
Cash flow from operations (CFO)	(o)	456	-1	-1	455
Non-operating/non-recurring cash flow		0			0
Capex	(p)	-384			-384
Common dividends paid		-53			-53
Free cash flow		20	-1	-1	19
Gross leverage (x)					
EBITDAR leverage[a]	(i/a)	8.8			10.1
FFO-adjusted leverage	(i/(n-m-l-k+b))	8.9			10.4
FFO leverage	(i-h)/(n-m-l-k)	8.9			10.4
EBITDA leverage[a]	(i-h)/d	8.8			10.1
(CFO-capex)/debt (%)	(o+p)/(i-h)	1.4%			1.2%
Net leverage (x)					
EBITDAR net leverage[a]	(i-j)/a	8.7			10.0
FFO-adjusted net leverage	(i-j)/(n-m-l-k+b)	8.9			10.4
FFO net leverage	(i-h-j)/(n-m-l-k)	8.9			10.4
EBITDA net leverage[a]	(i-h-j)/d	8.7			10.0
(CFO-capex)/net debt (%)	(o+p)/(i-h-j)	1.4%			1.2%
Coverage (x)					
EBITDAR fixed-charge coverage[a]	a/(-m+b)	3.6			3.6
EBITDA interest coverage[a]	d/(-m)	3.6			3.6
FFO fixed-charge coverage	(n-l-m-k+b)/(-m-k+b)	3.5			3.5
FFO interest coverage	(n-l-m-k)/(-m-k)	3.5			3.5

[a]EBITDA/R after dividends to associates and minorities
Note: Debt includes other off-balance-sheet debt
Source: Fitch Ratings, Fitch Solutions, YWS

Reconciliation of Key Financial Metrics for Yorkshire Water Services Ltd

(GBPm)	31 Mar 22
Interest bearing loans and borrowings class A and class B debt	5,714
- Cash and equivalents	28.5
= Net debt	5,685
+ Swap re-couponing adjustment	84
= Adjusted net debt class A and class B (a)	**5,770**
Economic regulatory asset value (b)	**7,746**
Net debt/RAV class A and class B (%)	**74.5**
Pension adjusted net debt/regulatory asset value(a/b) x 100	
Operating EBITDA	576
- Regulatory depreciation	-293
- Taxation paid	-15
- Pension deficit	-12
Post maintenance cash flow = EBITDA - regulatory depreciation - pension deficit (c)	**255**
Class A and class B cash interest (d)	**159.9**
50% accretion on IL swaps with 5-year APDs (e)	32
Post maintenance interest cover ratio class A and class B (x)	**1.3**
Post maintenance cash flow/cash interest c/(d+e)	
RCV indexation (f)	341
Total senior interest (g)	416
Nominal post-maintenance interest cover ((c)+(f))/(g) (x)	**1.4**

Source: Fitch Ratings, based on company accounts and investor reports

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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