

Yorkshire Water Services Limited

Rating Type	Rating	Outlook	Last Rating Action
Class A senior secured rating	A	Stable	Affirmed 4 July 2017
Class B senior secured rating	BBB+	Stable	Affirmed 4 July 2017
Click here for full list of ratings			

Financial Summary

(GBPm)	Mar 2016	Mar 2017	Mar 2018F	Mar 2019F
Gross Revenue	976	1,003	1,031	1,073
Operating EBITDA (Before Income From Associates)	545	559	574	614
FFO Margin (%)	30.5	34.3	34.1	37.1
FFO Fixed Charge Coverage (x)	2.3	2.5	2.6	2.9
FFO Adjusted Net Leverage (x)	8.5	8.2	9.0	8.6
Source: Fitch				

On 4 July 2017 Fitch Ratings affirmed Yorkshire Water Services Limited's (Yorkshire Water) debt-raising vehicles' senior secured debt at 'A/BBB+'. The Outlooks for both classes of debt are Stable.

The affirmations and Stable Outlooks reflected adequate financial metrics and Fitch's expectation that Yorkshire Water's economic gearing will reduce to around 69% net debt/regulatory asset value (RAV) for its class A debt and to around 77% for its class B debt by the end of the price control from April 2015 to March 2020 (AMP6). The ratings also take into account Yorkshire Water's solid financial and regulatory performance, and the secured nature of the group's financing structure and the high cost of its existing debt compared to peers.

Yorkshire Water is the regulated, monopoly provider of water and wastewater services that supplies 4.9 million people in the former county of Yorkshire and part of north Derbyshire. The vehicles are programme issuer Yorkshire Water Services Bradford Finance Limited, exchange issuer Yorkshire Water Services Odsal Finance Limited and Yorkshire Water Services Finance Limited's (YWSF).

Key Rating Drivers

Operational and Financial Restructuring: Fitch views management's structured reassessment of the Yorkshire Water group's financing and operations as positive. The changes will result in the company's capital structure retaining more flexibility by reducing leverage and financing costs, which should place the company in a better position to affront challenges arising from the price control starting in April 2020 (AMP7), including a potential lower cost of capital and subsequent erosion of cash flow generation.

Yorkshire Water has recently carried out a swap restructuring of index-linked swaps already embedded in its capital structure, which will result in financing cost savings and a reduction of around GBP270 million in the swaps' mark-to-market liability. This is positive, as it will help to improve the company's interest cover. In addition, proceeds of GBP195 million from the drawdown of a bank loan at Kelda Finance No.2 (HoldCo) have been injected into Yorkshire Water (as a reduction of HoldCo's liability to Yorkshire Water).

The company recently sold its contract operations in Northern Ireland as part of its plan for disposal of non-regulated activities, and it is also in the process of selling its non-regulated business, Kelda Water Services; we expect the proceeds from the sales to be injected into Yorkshire Water.

Deleveraging Expected: Fitch expects the company to reduce gearing to around 69% net debt/RAV for its class A debt and 77% for its class B debt over AMP6 to levels comfortable for the current ratings (our forecast gearing differs from the company's forecast as we calculate economic gearing which takes into account adjustments for total expenditure (totex) outperformance). We expect the company to achieve this through the board-approved steps mentioned above, retention of dividends upstreamed to HoldCo (as well as to ultimate shareholders) and the use of totex outperformance generated over the course of AMP6.

Improved Interest Cover: For FY17 (ending 31 March 2017), Fitch forecasts post-tax and post-maintenance interest cover (PMICR) of 1.3x for class A debt and 1.2x for senior debt for AMP6, both of which are below our guidelines of 1.5-1.6x for class A and of 1.2-1.3x for senior debt. However, we expect PMICR to be comfortably within our guidelines for the remainder of AMP6 as a result of the positive effect on financing costs from the swap restructuring.

Totex Outperformance Anticipated: In our view, Yorkshire Water is well positioned to achieve totex outperformance over AMP6, given its track record in regulatory and operational performance. Two years into the current price control, efficiency initiatives and newly implemented processes have enabled the company to secure a high proportion of targeted operational cost savings while the capital programme is on track to deliver the capex outperformance also targeted by the company.

Fitch's forecasts include operating cost outperformance of GBP50 million and capex and infrastructure renewals expenditure outperformance of GBP140 million, in nominal terms over AMP6.

Regulatory Performance as Expected: Yorkshire Water has continued to improve its regulatory performance in FY16 and we expect it to continue improving in FY17. Stability and reliability measures were stable across all four of the company's key asset categories. The company met its leakage target and the Service Incentive Mechanism (SIM) score, which reflects customer satisfaction, slightly improved from 82 to 82.6.

However, drinking water compliance was slightly below target, and pollution and sewer flooding performance measures, although within targets, have also deteriorated slightly. Overall, compared to its peers, we view Yorkshire Water as a middle ranking performer in the sector.

Sale of Non-Household Retail Business: Yorkshire Water is to sell its non-household retail business (Three Sixty), which represents around 15% of its total retail revenues and around 1% of company's total revenues, with completion likely in March 2018. In our view, the sale is likely to be neutral for the ratings and should enable the company to focus on improving services for its household customers.

We currently consider counterparty risk as low, given the arrangements stipulated in the market code for non-household retail supply, which should mitigate counterparty risk. Yorkshire Water will continue to look after its household customers, which represent around 90% of its customer base.

Rating Derivation Relative to Peers

Rating Derivation versus Peers	
Peer Comparison	<p>Yorkshire Water Services Limited is one the regulated monopoly providers of water and wastewater services in England and Wales. The company's senior secured ratings and credit metrics reflect the highly geared nature of the company's secured covenanted structure versus peers such as United Utilities Water Limited (senior unsecured: A-/Stable) and Wessex Water Services Limited (senior unsecured: A-/Stable), which have lower leverage and are not covenanted secured structures. Yorkshire Water's financing structure benefits from structural enhancements, including trigger mechanisms (such as dividend lock-up provisions tied to financial, positive and negative covenants) and debt service reserve liquidity.</p> <p>The company's higher ratings compared to similar peers with covenanted structures, such as Southern Water Services (Finance) Ltd (A-/BBB/Stable), reflects stronger credit metrics and a more robust financial and regulatory performance.</p>
Parent/Subsidiary Linkage	Parent/subsidiary linkage is applicable but given the regulatory, structural and contractual ring-fenced structure of the group it does not affect the ratings.
Country Ceiling	No Country Ceiling constraint was in effect for these ratings.
Operating Environment	No operating environment influence was in effect for these ratings.
Other Factors	None.
Source: Fitch	

Rating Sensitivities

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:

- Positive rating action is unlikely for both classes of debt, given the highly geared capital structure.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Class A debt gearing above 70% and/or PMICR materially below 1.5x on a sustained basis
- Class B debt gearing above 80% and/or PMICR materially below 1.2x on a sustained basis
- Deterioration in operational or regulatory performance
- Regulatory decisions that may materially impact cash flow generation such as moving additional parts of the value chain away from RAV-based regulation or swapping RPI indexation for CPI indexation

Liquidity and Debt Structure

Adequate Liquidity: As of 30 September 2017, the company had GBP68.8 million in cash and cash equivalents and 266 million in available undrawn committed bank facilities maturing in October 2018. This funding position provides sufficient financial resources for operating requirements, debt maturities and dividends beyond March 2019. The group also has access to GBP239.8 million of debt service reserve liquidity and GBP80 million of operating and maintenance reserve liquidity, dedicated standby lines that would be available during times of financial distress.

During October 2017, the company refinanced its bank facilities and replaced them with a GBP560 million bank facility maturing in October 2022, of which GBP345m is undrawn.

Debt Maturities and Liquidity at September 2017

Debt Maturities*	(GBPm)
2018	94.1
2019	125.9
2020	427.5
2021	41.0
2022	168.6
After 2022	4,083.2
Total debt	4,940.5
Liquidity Analysis	(GBPm)
Unrestricted cash	68.8
Committed banking facilities	490.0
Available undrawn portion	266
Total Liquidity	334.8
Fitch Forecasted FCF (post dividend)	-131.2
Short-term debt	94.1
Liquidity score [x]	1.5
*As at financial year end	
Source: Fitch	

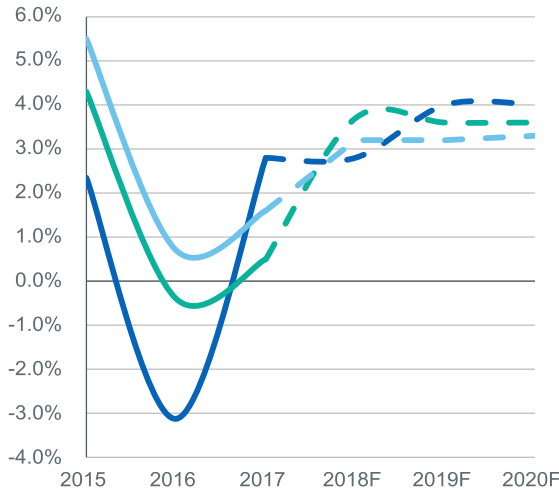
Trends and Forecasts

Yorkshire Water Services Limited.

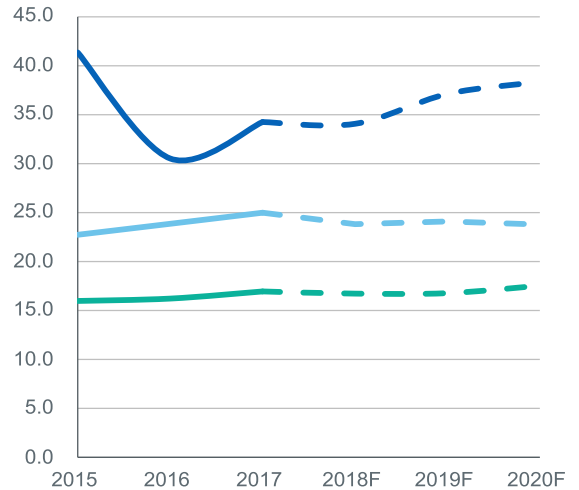
— A Median

— Utilities Median

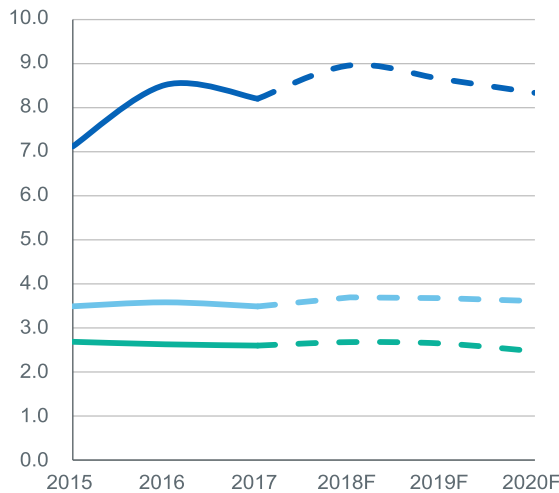
Revenue Growth (%)



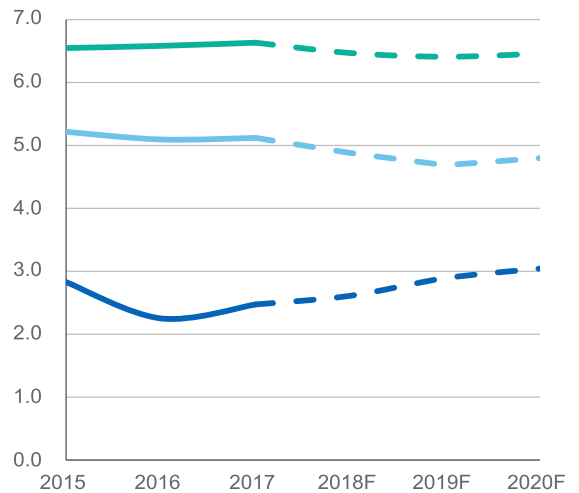
FFO Margin (%)



FFO Adjusted Net Leverage (x)



FFO Fixed Charge Cover (x)



Note: Including Fitch expectations
Source: Fitch

Definitions

Revenue Growth: Percentage growth in revenues since previous reporting period.
 FFO Margin: FFO divided by Revenues.
 FFO Adjusted Net Leverage: Total Debt with Equity Credit + Lease equivalent Debt + Other off Balance Sheet Debt - Readily Available Cash & Equivalents divided by Funds From Operations [FFO] + Gross Interest (Paid) - Interest Received + Preferred Dividends (Paid) + Operating Lease Expense for Capitalised Leased Assets.
 FFO Fixed Charge Cover: FFO + Gross Interest paid minus interest received + Preferred Dividends paid + Operating Lease Expense for Capitalised Leased Assets divided by Gross Interest Paid + Preferred Dividends Paid + Operating Lease Expense for Capitalised Leased Assets.

Key Assumptions

Fitch's key assumptions within our rating case for the issuer include:

- regulated revenues in line with the final determination of tariffs for April 2015 to March 2020, ie assuming no material over- or under-recoveries;
- cumulative operating expenditure outperformance of GBP56 million in nominal terms over the five-year period;
- retail costs in line with allowances;
- non-regulated EBITDA of around GBP2.5 million a year
- retail price inflation of 3.1% for FY17, and 3% thereafter up to 2020;
- capex and infrastructure renewal expenditure outperformance of GBP140 million in nominal terms over the five-year period;
- around GBP2 million of EBITDA reduction a year from FY18 as a result of the sale of the non-household retail business;
- no outperformance related to Outcome Delivery Incentives as the company has deferred them to AMP7.

Financial Data

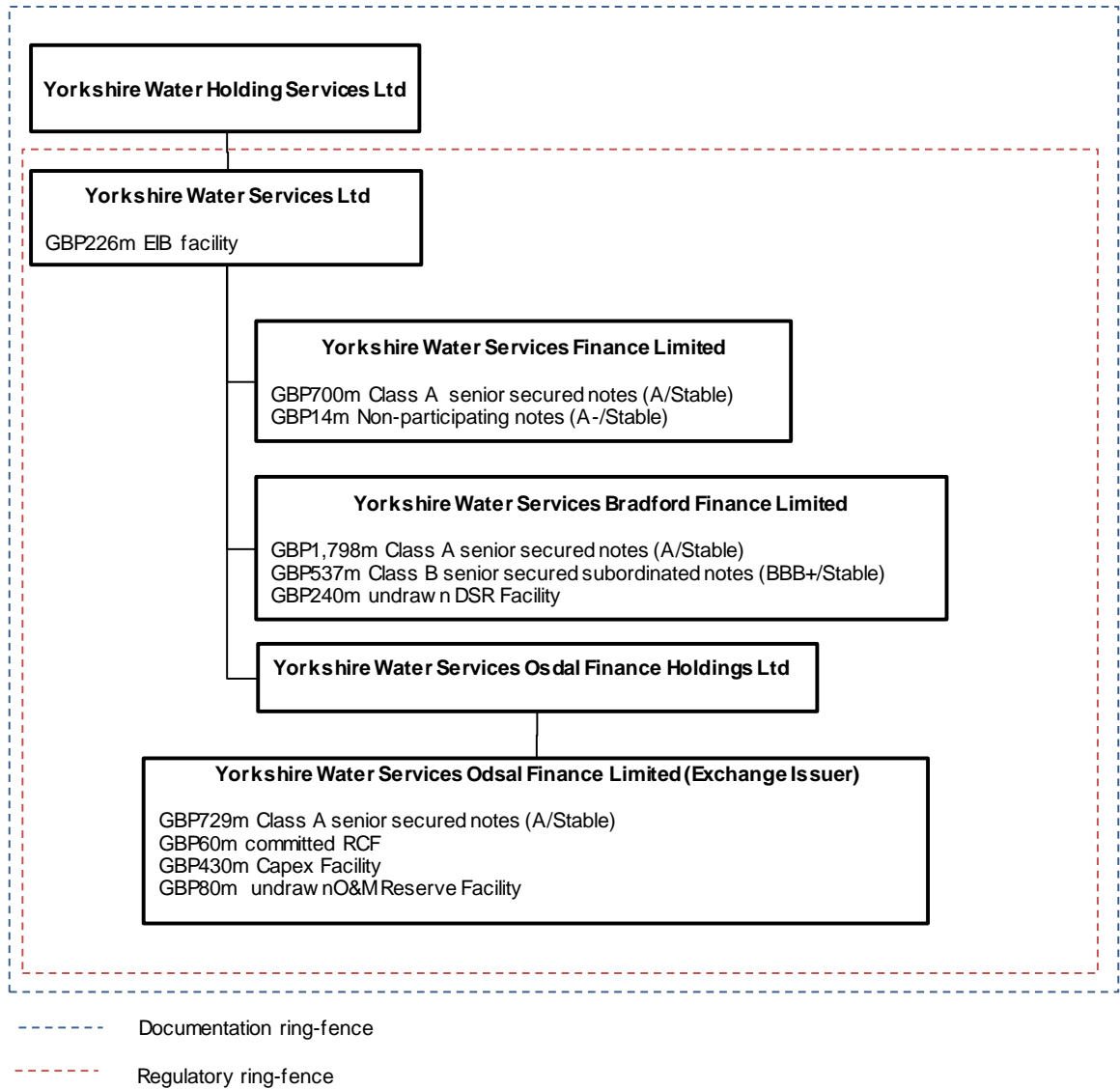
(GBPm)	Historical		Forecast	
	Mar 2016	Mar 2017	Mar 2018F	Mar 2019F
SUMMARY INCOME STATEMENT				
Gross Revenue	976	1,003	1,031	1,073
Revenue Growth (%)	-3.1	2.8	2.8	4.0
Operating EBITDA (Before Income From Associates)	545	559	574	614
Operating EBITDA Margin (%)	55.8	55.7	55.6	57.2
Operating EBITDAR	548	561	575	616
Operating EBITDAR Margin (%)	56.1	55.9	55.8	57.4
Operating EBIT	269	282	279	311
Operating EBIT Margin (%)	27.6	28.1	27.0	29.0
Gross Interest Expense	-255	-294	-298	-293
Pretax Income (Including Associate Income/Loss)	212	-363	-266	22
SUMMARY BALANCE SHEET				
Readily Available Cash and Equivalents	24	230	35	34
Total Debt With Equity Credit	4,565	4,949	5,124	5,284
Total Adjusted Debt with Equity Credit	4,590	4,963	5,139	5,299
Net Debt	4,541	4,719	5,089	5,250
SUMMARY CASH FLOW STATEMENT				
Operating EBITDA	545	559	574	614
Cash Interest Paid	-235	-232	-216	-209
Cash Tax	3	0	-6	-7
Dividends Received Less Dividends Paid to Minorities (Inflow/(Out)flow)	0	0	0	0
Other Items Before FFO	-14	16	0	0
Funds Flow From Operations	298	344	351	398
Change in Working Capital	23	-12	-5	-5
Cash Flow From Operations (Fitch Defined)	321	332	346	394

Total Non-Operating/Non-Recurring Cash Flow	72	74		
Capital Expenditure	-250	-317		
Capital Intensity (Capex/Revenue)	25.6	31.6		
Common Dividends	-91	-139		
Net Acquisitions and Divestitures	0	0		
Other Investing and Financing Cash Flow Items	-1	-26	-169	-88
Net Debt Proceeds	-63	282	175	160
Net Equity Proceeds	0	0	0	0
Total Change in Cash	-11	206	-196	-1
DETAIL CASH FLOW STATEMENT				
FFO Margin (%)	30.5	34.3	34.1	37.1
Calculations for Forecast Publication				
Capex, Dividends, Acquisitions and Other Items Before FCF	-268	-382	-548	-466
Free Cash Flow After Acquisitions and Divestitures	53	-50	-202	-73
Free Cash Flow Margin (After Net Acquisitions) (%)	5.4	-5.0	-19.5	-6.8
COVERAGE RATIOS				
FFO Interest Coverage (x)	2.3	2.5	2.6	2.9
FFO Fixed Charge Coverage (x)	2.3	2.5	2.6	2.9
Operating EBITDAR/Interest Paid + Rents (x)	2.3	2.4	2.6	2.9
Operating EBITDA/Interest Paid (x)	2.3	2.4	2.7	2.9
PMICR	1.2	1.3	1.3	1.4
LEVERAGES RATIOS				
Total Adjusted Debt/Operating EBITDAR (x)	8.4	8.8	8.9	8.6
Total Adjusted Net Debt/Operating EBITDAR (x)	8.3	8.4	8.9	8.6
Total Debt with Equity Credit/Operating EBITDA (x)	8.4	8.9	8.9	8.6
FFO Adjusted Leverage (x)	8.6	8.6	9.0	8.7
FFO Adjusted Net Leverage (x)	8.5	8.2	9.0	8.6
Net debt/RAV class A and class B (%)	79.1	78.4	80.3	79.5

How to Interpret the Forecast Presented

The forecast presented is based on the agency's 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 to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's 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's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch 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's own internal deliberations, where Fitch, 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 may update the forecast in future reports but assumes no responsibility to do so.

Simplified Group Structure Diagram



Source: As at September 2017 - Fitch Company

Peer Financial Summary

Company	Date	Rating/ Senior Debt*	Gross Revenue (GBPm)	Operating EBITDA (Before Income From Associates) (GBPm)	FFO Margin (%)	FFO Fixed Charge Coverage (x)	FFO Adjusted Net Leverage (x)
Yorkshire Water Services Limited.	2019F		1,073	614	37.1	2.9	8.6
	2018F		1,031	574	34.1	2.6	9.0
	2017	A	1,003	559	34.3	2.5	8.2
	2016	A	976	545	30.5	2.3	8.5
Anglian Water Services Ltd.	2019F		1,274	662	46.2	2.7	10.0
	2018F		1,232	635	52.1	2.9	9.1
	2017	A	1,227	674	49.9	3.6	6.9
	2016	A	1,185	634	48.1	3.5	7.3
Wessex Water Services Limited	2019F		559	318	38.3	3.9	7.2
	2018F		543	307	39.0	4.3	7.3
	2017F		528	294	38.6	4.2	7.2
	2016	A-	521	335	48.8	5.0	5.9
United Utilities Water Limited	2019F		1,862	1,033	42.3	5.8	7.7
	2018F		1,802	994	42.0	5.7	7.8
	2017	A-	1,680	971	44.3	5.5	7.6
	2016	A-	1,692	945	42.8	5.1	7.3
Southern Water Services Limited	2019F		849	526	45.9	2.8	8.1
	2018F		829	518	48.3	3.0	7.8
	2017	A-	810	504	49.3	3.2	7.0
	2016	A-	804	518	48.3	3.2	7.3

Source: Fitch

*Senior Secured rating for Yorkshire Water, Anglian Water, Southern Water
Senior Unsecured rating for Wessex Water, United Utilities Water

Reconciliation of Key Financial Metrics

(GBP Millions, As reported)	31 Mar 2017
Income Statement Summary	
Operating EBITDA	559
+ Recurring Dividends Paid to Non-controlling Interest	0
+ Recurring Dividends Received from Associates	0
+ Additional Analyst Adjustment for Recurring VS Minorities and Associates	0
= Operating EBITDA After Associates and Minorities (k)	559
+ Operating Lease Expense Treated as Capitalised (h)	2
= Operating EBITDAR after Associates and Minorities (j)	561
Debt & Cash Summary	
Total Debt with Equity Credit (l)	4,949
+ Lease-Equivalent Debt	14
+ Other Off-Balance-Sheet Debt	0
= Total Adjusted Debt with Equity Credit (a)	4,963
Readily Available Cash [Fitch-Defined]	230
+ Readily Available Marketable Securities [Fitch-Defined]	0
= Readily Available Cash & Equivalents (o)	230
Total Adjusted Net Debt (b)	4,733
Cash-Flow Summary	
Preferred Dividends (Paid) (f)	0
Interest Received	0
+ Interest (Paid) (d)	-232
= Net Finance Charge (e)	-232
Funds From Operations [FFO] (c)	344
+ Change in Working Capital [Fitch-Defined]	-12
= Cash Flow from Operations [CFO] (n)	332
Capital Expenditures (m)	-317
Multiple applied to Capitalised Leases	8.0
Gross Leverage	
Total Adjusted Debt / Op. EBITDAR* [x] (a/j)	8.8
FFO Adjusted Gross Leverage [x] (a/(c-e+h-f))	8.6
<i>Total Adjusted Debt/(FFO - Net Finance Charge + Capitalised Leases - Pref. Div. Paid)</i>	
Total Debt With Equity Credit / Op. EBITDA* [x] (l/k)	8.9
Net Leverage	
Total Adjusted Net Debt / Op. EBITDAR* [x] (b/j)	8.4
FFO Adjusted Net Leverage [x] (b/(c-e+h-f))	8.2
<i>Total Adjusted Net Debt/(FFO - Net Finance Charge + Capitalised Leases - Pref. Div. Paid)</i>	
Total Net Debt / (CFO - Capex) [x] ((l-o)/(n+m))	312.5
Coverage	
Op. EBITDAR / (Interest Paid + Lease Expense)* [x] (j/-d+h)	2.4
Op. EBITDA / Interest Paid* [x] (k/(-d))	2.4
FFO Fixed Charge Cover [x] ((c-e+h-f)/(-d+h-f))	2.5
<i>(FFO - Net Finance Charge + Capit. Leases - Pref. Div Paid) / (Gross Int. Paid + Capit. Leases - Pref. Div. Paid)</i>	
FFO Gross Interest Coverage [x] ((c-e-f)/(-d-f))	2.5
<i>(FFO - Net Finance Charge - Pref. Div Paid) / (Gross Int. Paid - Pref. Div. Paid)</i>	
* EBITDA/R after Dividends to Associates and Minorities	
Source: Fitch based on company reports	

Reconciliation of Key Financial Metrics for Yorkshire Water Services Ltd

(GBPm)	31 Mar 17
Interest bearing loans and borrowings Class A	4,151.6
- Cash and equivalents	230.3
= Net debt	3,921.3
+ Pension deficit not funded by customers	0.0
= Pension adjusted net debt Class A (a)	3,921.3
Economic regulatory asset value (b)	6,020.7
Net debt/RAV Class A (%)	65.1
Pension adjusted net debt/regulatory asset value (a/b) x 100	
Operating EBITDA	559.1
- Regulatory Depreciation and adjustment for infrastructure renewals expenditure capitalised	-267.6
- Taxation paid	0.0
- Pensions	0.0
Post maintenance cash flow = EBITDA - regulatory depreciation - tax - pensions (c)	291.5
Class A cash interest (d)	-202.3
Post maintenance interest cover ratio Class A (x)	1.44
Post maintenance cash flow/ cash interest c/d	
Source: Fitch based on company accounts and investor reports	

Reconciliation of Key Financial Metrics for Yorkshire Water Services Ltd

(GBPm)	31 Mar 17
Interest bearing loans and borrowings Class A and Class B debt	4,948.8
- Cash and equivalents	230.3
= Net debt	4,718.5
+ Pension deficit not funded by customers	0.0
= Pension adjusted net debt Class A and Class B (a)	4,718.5
Economic regulatory asset value (b)	6,020.7
Net debt/RAV class A and class B (%)	78.4
Pension adjusted net debt/regulatory asset value(a/b) x 100	
Operating EBITDA	559.1
- Regulatory depreciation and adjustment for infrastructure renewals expenditure capitalised	-267.6
- Taxation paid	0.0
- Pension Deficit	0.0
Post maintenance cash flow = EBITDA - regulatory depreciation - tax – pension deficit (c)	291.5
Class A and class B cash interest (d)	231.7
Post maintenance interest cover ratio Class A and Class B (x)	1.26
Post maintenance cash flow/ cash interest c/d	
Source: Fitch based on company accounts and investor reports	

Fitch Adjustment Reconciliation

	Reported Values 31 Mar 17	Sum of Fitch Adjustments	Lease Adjustment	- CORP - other	Other Adjustment	Adjusted Values
Income Statement Summary						
Revenue	1,003	0				1,003
Operating EBITDAR	595	-34	2	-36	-0	561
Operating EBITDAR after Associates and Minorities	595	-34	2	-36	-0	561
Operating Lease Expense	0	2	2			2
Operating EBITDA	595	-36		-36		559
Operating EBITDA after Associates and Minorities	595	-36		-36		559
Operating EBIT	317	-36		-36		282
Debt & Cash Summary						
Total Debt With Equity Credit	5,013	-64		-64	0	4,949
Total Adjusted Debt With Equity Credit	5,013	-50	14	-64		4,963
Lease-Equivalent Debt	0	14	14			14
Other Off-Balance Sheet Debt	0	0				0
Readily Available Cash & Equivalents	230	0				230
Not Readily Available Cash & Equivalents	0	0				0
Cash-Flow Summary						
Preferred Dividends (Paid)	0	0				0
Interest Received	67	-67		-67		0
Interest (Paid)	-238	7		7	-0	-232
Funds From Operations [FFO]	418	-74		-74	-0	344
Change in Working Capital [Fitch-Defined]	-12	0				-12
Cash Flow from Operations [CFO]	406	-74		-74	-0	332
Non-Operating/Non-Recurring Cash Flow	0	74		74	0	74
Capital (Expenditures)	-317	0				-317
Common Dividends (Paid)	-139	0				-139
Free Cash Flow [FCF]	-50	0				-50
Gross Leverage						
Total Adjusted Debt / Op. EBITDAR* [x]	8.4					8.8
FFO Adjusted Leverage [x]	8.5					8.6
Total Debt With Equity Credit / Op. EBITDA* [x]	8.4					8.9
Net Leverage						
Total Adjusted Net Debt / Op. EBITDAR* [x]	8.0					8.4
FFO Adjusted Net Leverage [x]	8.1					8.2
Total Net Debt / (CFO - Capex) [x]	53.6					312.5
Coverage						
Op. EBITDAR / (Interest Paid + Lease Expense)* [x]	2.5					2.4
Op. EBITDA / Interest Paid* [x]	2.5					2.4
FFO Fixed Charge Coverage [x]	2.5					2.5
FFO Interest Coverage [x]	2.5					2.5

*EBITDA/R after Dividends to Associates and Minorities

Source: Source: Fitch based on company reports

Full List of Ratings

	Rating	Outlook	Last Rating Action
Yorkshire Water Services Bradford Finance Limited			
Class A notes	A	Stable	Affirmed 4 July 2017
Class B notes	BBB+	Stable	Affirmed 4 July 2017
Yorkshire Water Services Odsal Finance Limited's			
Class A notes	A	Stable	Affirmed 4 July 2017
Yorkshire Water Services Finance Limited			
Class A notes	A	Stable	Affirmed 4 July 2017
Non-participatory bonds	A-	Stable	Affirmed 4 July 2017

Related Research & Criteria

[Corporate Rating Criteria \(August 2017\)](#)

[Parent and Subsidiary Rating Linkage \(August 2016\)](#)

[Non-Financial Corporates Notching and Recovery Ratings Criteria \(June 2017\)](#)

Analysts

Victoria Munarriz

+44 203 530 1419

victoria.munarriz@fitchratings.com

Vincent Race

+44 203 530 1862

vincent.race@fitchratings.com

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