CREDIT OPINION
6 February 2025

Update

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RATINGS

Yorkshire Water Services Finance Limited

Domicile	United Kingdom
Long Term Rating	Baa2
Type	Senior Secured - Underlying - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Yorkshire Water Services Finance Limited / Yorkshire Water Finance plc

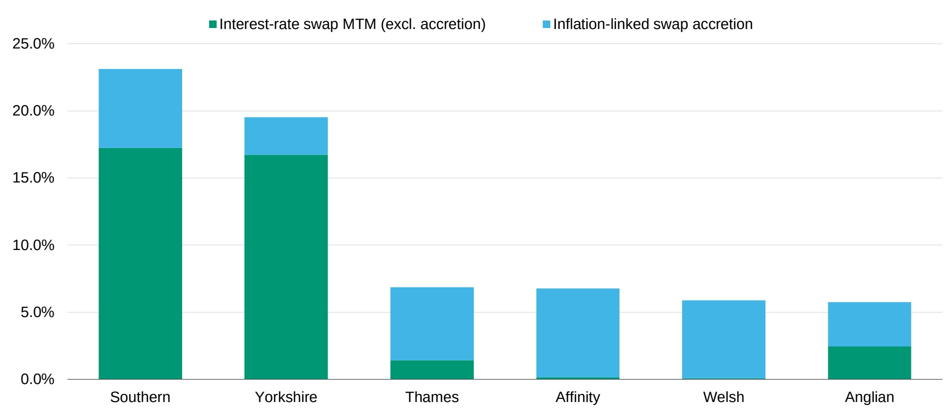
Update following outlook change to stable

Summary

Yorkshire Water Services Finance Limited (Baa2 stable) and Yorkshire Water Finance plc (Baa2/Ba1, stable, for senior and junior debt issuance, respectively) are the financing subsidiaries of Yorkshire Water Services Limited (Yorkshire Water), which guarantees all issuance. Yorkshire Water's credit quality is supported by the company's position as a monopoly provider of essential water and sewerage services and a regulatory settlement that provides cost allowances for the next regulatory period (1 April 2025 – 31 March 2030, known as AMP8) in line with the company's request. We believe that the final determination would allow Yorkshire Water to achieve an adjusted interest coverage ratio (AICR) of around 1.6-1.7x on average over AMP8, despite potential annual performance penalties of up to £20 million, and maintain average gearing, measured as net debt to regulatory capital value (RCV) at or below 70%, if it spends in line with its cost allowances.

However, credit quality is constrained by Yorkshire Water's long-dated derivatives portfolio. The company remains exposed to sizeable mark-to-market losses (MTM), which would rank ahead of principal and interest on senior debt in a default scenario, if creditors demanded payment acceleration. At March 2024, the company reported overall MTM liabilities of £1.8 billion (or £1.3 billion credit value-adjusted), equivalent to just under 20% (around 14%) of the company's Regulatory Capital Value (RCV). This is a significant reduction compared with a high of £3.0 billion (39%) in March 2022.

Exhibit 1
MTM liability for interest-rate derivatives, including inflation-linked swaps, as percentage of RCV
As at March 2024



Most interest rate derivatives rank super-senior, although pari passu ranking is possible. Companies may report their overall MTM value as adjusted for credit risk, which reduces the reported obligation.
Source: Companies' annual performance reports 2023/24, Moody's Ratings

In October 2022, Yorkshire Water announced that one of its holding companies would repay £941 million of intercompany loans to the operating company. Although part of this will be reinvested to reduce pollution from storm overflows, the company has committed to start the next regulatory period (AMP8) with regulatory gearing no higher than 72%, subject to certain caveats, compared to 78% based on management's previous plans. The reduced gearing and an expectation that the company will maintain gearing at or below 70% going forward also supports credit quality.

Credit strengths

» Monopoly position for the provision of water and wastewater services in Yorkshire

» Well-established and transparent regulatory regime

Credit challenges

» Increasingly challenging regulatory targets, leading to performance penalties in the current regulatory period and the likelihood of this to continue into the next regulatory period

» Large mark-to-market liability under long-dated derivatives portfolio that would rank ahead of senior creditors in an event of default, if creditors demand payment acceleration

» Swap re-profiling means interest cover covenant protects a weaker Moody's Adjusted Interest Coverage Ratio (AICR)

Rating outlook

The outlook is stable, reflecting our expectation that, despite a deterioration in the sector's business risk profile and a tightening of our ratio guidance in November 2024, Yorkshire Water's final determination provides sufficient flexibility for the company to maintain key credit ratios commensurate with the current rating levels.

Factors that could lead to an upgrade

We could consider an upgrade, if Yorkshire Water appeared likely to achieve an AICR consistently above 1.6x and net debt/RCV sustainably below 68%. Any potential upgrade would have to be underpinned by (1) a financial policy that supports maintaining such lower gearing despite a financial structure that allows leverage at much higher levels; as well as (2) a level of holding company debt that continues to decrease relative to the RCV, and a derivative exposure that is gradually managed down.

Factors that could lead to a downgrade

The ratings could be downgraded if Yorkshire Water appeared unlikely to achieve an AICR of at least around 1.4x on average over AMP8 or gearing, measured by net debt to RCV, exceeded 75%. In addition, downward rating pressure could result from (1) material increases in mark-to-mark valuation of Yorkshire Water's swaps, (2) the adoption of a more aggressive financial policy, including from an increase in holding company debt, which carried sizeable refinancing risk and could impede future shareholder support, (3) a significant increase in business risk for the sector as a result of legal and/or regulatory changes leading to a further reduction in the stability and predictability of regulatory earnings, which in each case are not offset by other credit-strengthening measures, or (4) unforeseen funding difficulties, including failure to maintain a sustained forward-looking liquidity runway of at least 12 months.

Key indicators

Exhibit 2
Yorkshire Water Services Limited

	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25 Forecast	AMP8 average Forecast
Adjusted Interest Coverage Ratio	0.9x	1.0x	0.7x	0.7x	0.7x-0.9x	1.6x-1.7x
Net Debt / Regulated Asset Base	78.7%	73.7%	72.0%	69.3%	72%-74%	68%-70%
FFO / Net Debt	6.2%	6.4%	5.8%	6.2%	6% - 8%	8%-9%
RCF / Net Debt	6.2%	6.1%	5.2%	5.3%	5%-7%	7%-8%

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. For definitions of Moody's most common ratio terms, please see the accompanying User's Guide. Although the CMA's redetermination has affected AMP7 cash flow starting only in the 2022-23 financial year, Moody's AICR adjusts for reprofiling and reflects the benefit of the redetermination from the 2020-21 financial year. Moody's Forecast reflects our view and not the view of the issuer.
Source: Moody's Financial Metrics™ and Moody's Ratings' forecast

Profile

With an RCV of £9.1 billion as of March 2024, Yorkshire Water is the fifth largest of the 10 water and sewerage companies in England and Wales. Yorkshire Water provides drinking water to over 5 million people and 140,000 local businesses over an area of around 14,294 square kilometres encompassing the former county of Yorkshire and part of North Derbyshire in Northern England.

Exhibit 3
Yorkshire Water's service area

Source: Moody's Ratings

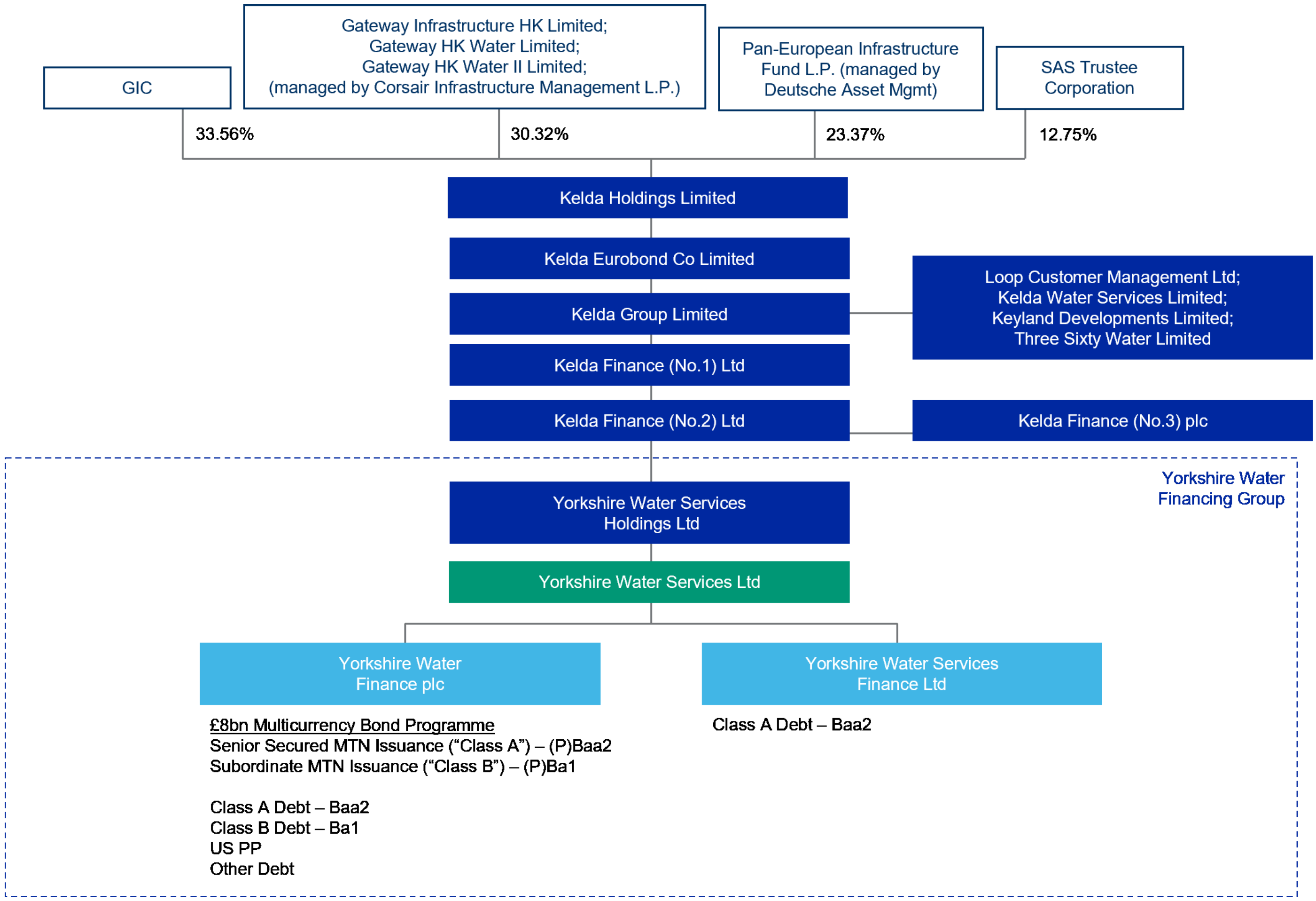
Exhibit 4
Price control summary

	UK water	
Regulator/Price Control	Ofwat / AMP7	Ofwat / AMP8
Term of price control	April 2020 - March 2025	April 2025 - March 2030
Allowed return (appointee, vanilla CPIH-real)	3.20%	4.03%
Regulatory Capital Value		£9.1 billion (March 2024)

The AMP7 allowed return was set by the CMA as part of a redetermination upon appeal by Yorkshire Water. The original Ofwat allowed appointee WACC for AMP7 was 2.96%
Source: Ofwat

Kelda Group Limited, the parent company of the Yorkshire Water group, is ultimately owned by GIC Special Investments Pte Limited, the private equity investment arm of the Government of Singapore; Corsair Infrastructure Partners, as a custodian for a number of infrastructure investment funds; Deutsche Asset Management's infrastructure investment arm; and SAS Trustee Corporation, the trustee of certain New South Wales public-sector superannuation schemes.

Exhibit 5
Simplified organisational structure



Source: Company reports, Moody's Ratings

Detailed credit considerations

Deterioration in the sector's business risk profile amid growing public, political and regulatory scrutiny

There has been a material and sustained weakening of credit quality for nearly all UK water companies amid continued public scrutiny and heightened political and regulatory focus. Across the sector, previous decisions, such as prioritising affordability and shareholder distributions, have contributed to underinvestment and exacerbated the sector's exposure to changing weather patterns, population growth and shifting expectations. Regulatory targets have become more demanding and penalties for those that fall short have continued to rise. With widespread investigations ongoing, fines for UK water companies breaching environmental legislation are likely to increase further.

In addition, the perception that the water sector is "broken" has prompted a government-initiated strategic review, which aims to improve the regulatory environment and create a stable backdrop to attract investment. However, the review results in greater short-term uncertainty for the sector until it is completed and any potentially credit positive recommendations are successfully implemented.

Given the above considerations, we changed our assessment of the stability and predictability of the regulatory environment for the UK water sector under our rating methodology to A from Aa in November 2024.

We believe that the predictability and supportiveness of the regime has reduced despite the final determination for the next regulatory period resulting in a more positive outcome for the sector than the draft determination. This assessment reflects a continuing trend of negative public perception resulting in more regulatory powers, an increased focus on enforcement action, demanding targets, greater penalties for operational underperformance and growing regulatory complexity that, in turn, result in higher cash flow volatility and leaner returns. All of these factors are leading to an environment that is less supportive of the water utilities' operations and, therefore, credit negative.

Improved final determination, but ongoing focus on financial resilience

On 19 December 2024, Ofwat published its final determination for AMP8. Yorkshire Water's final tariff settlement was materially improved from the draft received in July 2024. The company received cost allowances in line with its request and while it may still incur performance penalties, the exposure is reduced from the draft stage.

The final determination allowed appointee return is 4.03% (CPIH-deflated, compared with 3.72% at draft determinations and 3.20% in the current period). This remains below the company's request of 4.5% at the draft determination representation stage (midpoint in a range of 4.15-4.85%), but Yorkshire Water will also receive an overall £11 million business plans reward (in 2022/23 prices) as part of its AMP8 revenue allowance.

As previously announced by Ofwat, with effect from 1 April 2025, the rating trigger resulting in a cash lock-up under the licence will be raised to Baa2/BBB negative from Baa3/BBB- negative currently. The definition of "issuer credit rating" that Ofwat considers relevant for the rating trigger includes Moody's Class A rating, currently at Baa2 stable.

Additional licence changes, which have applied since 17 May 2023, will allow the regulator to also take enforcement action where companies do not link their dividend payments to operational performance or fail to be transparent about their dividend policy.

While Ofwat did not include further dividend restrictions related to specified gearing thresholds in its final determinations for AMP8, it confirmed that it would continue to assess further strengthening of the regulatory ring-fence to ensure adequate financial resilience. The regulator said it will continue to focus on work in this area during 2025.

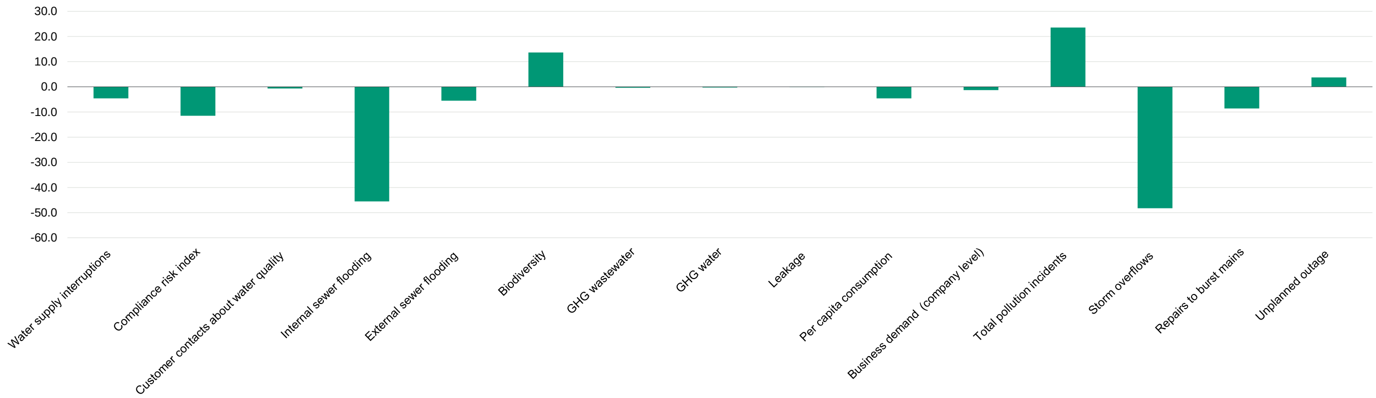
Operational performance below regulatory expectations in AMP7 and expected penalties during AMP8

Yorkshire Water has historically been a relatively strong operating performer, earning material rewards under outcome delivery incentives (ODIs) in AMP6. In AMP7, however, Yorkshire Water's operational performance – in line with many of its peers – has fallen increasingly short of regulatory expectations, which have become more demanding. The company incurred aggregate net penalties of £37 million (in 2017/18 prices) over the first three years, which are cash effective in this period.

In addition, Yorkshire Water reported £35 million (in 2017/18 prices) of ODI penalties in FY2023/24, excluding customer service, for which it tended to earn a small penalty of £2.5-3.5 million per year historically. Penalties are concentrated in areas of internal sewer flooding, water quality and supply interruptions. ODI penalties incurred in the last two financial years of AMP7 will carry over into AMP8 with a two-year lag.

Ofwat's final determination for AMP8 includes 24 common performance commitments, which apply to all companies. Based on the revised performance targets and incentive rates at final determinations, we estimate that Yorkshire Water could incur up to £20 million of annual penalties on average under the outcome delivery incentives (ODI) framework, if it performed in line with its representations. This has improved from estimated penalties of around £30 million per year at the draft determination stage. The largest penalties would be incurred for sewer flooding (internal and external) and storm overflows as well as smaller penalties for water quality and mains bursts, but offset by rewards in total pollution incidents and biodiversity. For Yorkshire Water to be able to earn rewards on pollution incidents, the company will need to achieve a step change in performance for the first year of AMP8 compared with its expected outturn in the last year of the current period, which was heavily affected by adverse weather.

Exhibit 6
Expected total forecast ODI penalties over AMP8, if company performs in line with forecast expectations
Amounts in £ millions (in 2022/23 prices)



Only shows common ODIs with an estimated reward or penalty over the period and excludes customer, developer and business/retail service measures. There is an aggregate sharing mechanism, whereby incentive impact of more than +/-3 percentage points on RORE is shared 50% with customers and more than 5 percentage points is shared 90%.
Source: Ofwat final determination, company's representations, Moody's Ratings

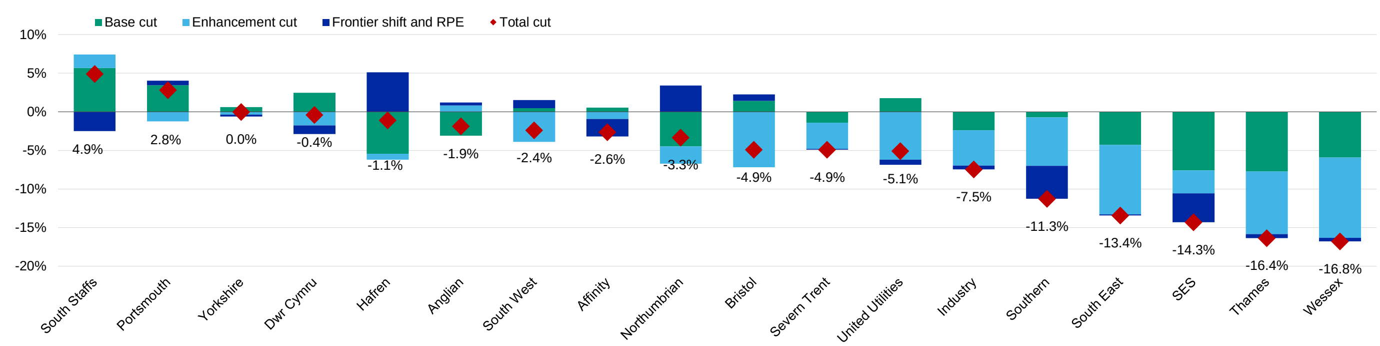
Penalties could increase significantly, if the company's performance remained in line with current levels or in the context of severe weather events. However, severe under(or out-)performance will be subject to additional sharing mechanisms as well as a sector-wide adjustment, where the industry's median performance materially diverges from a neutral position.

Catch-up of capital investment in AMP7 will prepare for step-up in AMP8

Over the first three years of the current regulatory period, Yorkshire Water invested significantly less than its totex allowance, particularly with respect to its enhancement expenditure, which aims to improve service for customers. The company attributed this to the time required to plan and implement its relatively large investment programme under the Water Industry National Environment Plan (WINEP).[1] Capital investment has stepped up significantly during FY2023/24 and further scaling up is planned for FY2024/25 in order to ensure that all WINEP requirements can be met by the end of AMP7 in line with regulatory requirements.

Investment requirements will increase significantly in AMP8, including on WINEP, compared with AMP7. Yorkshire Water's AMP8 final determination allowed £8.3 billion overall total expenditure (totex, after adjustments for frontier shift efficiency and real price effects), compared with around £5.4 billion totex allowances received during AMP7 under the redetermination by the Competition and Markets Authority (all in £2022/23 prices). The company is one of only three to receive an allowance at or above the amount requested.

Exhibit 7
Yorkshire Water received one of the best outcomes on cost allowances
Cost reduction as % of requested amount



Efficiency challenge calculated as cost difference between final determination and company's request divided by company's request.
Source: Ofwat's final determinations

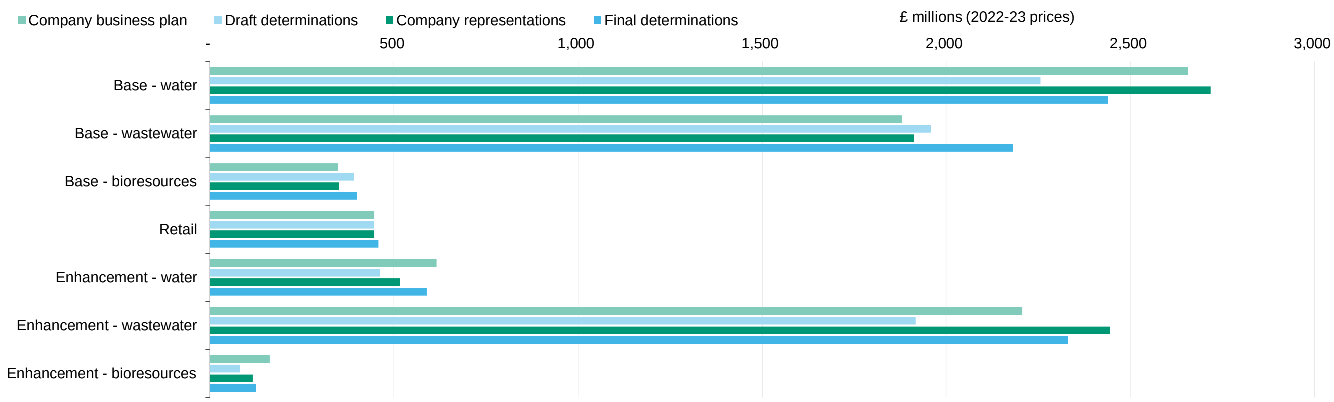
Base allowances (after adjustments) are just under £5.4 billion, £32 million or 0.6% above the company's request as well as 26% above base cost allowances for the current period and 9% above actual base costs spent over the last five years. The additional allowance reflects a network reinforcement cost adjustment to facilitate population growth and new housing, which would have to be returned to customers if it is not used.

Enhancement allowances are just under £3 billion, roughly £33 million or 1.1% lower than Yorkshire Water's request (after adjustments), and split £576 million for water and £2.4 billion for wastewater activities, including bioresources. The main disallowances relate to investment for storm overflows, albeit the shortfall is reduced from the draft determination.

Exhibit 8

Overall final determination allowances are in line with company's ask at representation stage

Amounts are presented before frontier shift and real price effects adjustments



Overall totex allowances (before adjustments for frontier shift efficiency and real price effects) for Yorkshire Water are £8,525 million in aggregate. The adjustment for frontier shift efficiency and real price effects reduces the overall totex allowances by £180 million to £8,345 million.
Source: Ofwat's final determination

Given its cost allowances are in line with the company's request, we expect Yorkshire Water to spend in line with the final determination allowances. However, we also believe that there is some flexibility within current ratings to accommodate an element of overspend.

We understand that Yorkshire Water is at an advanced stage of preparing its supply chain capabilities, and we expect the company to be able to manage the step up in AMP8 capital investment, also in the context of the ramp-up in the investment programme over the final years of this regulatory period. Capital investment for FY 2024/25 is expected to be around £800-850 million, compared with average annual capital spend of £1.1 billion (in outturn prices) forecast for AMP8 under the final determination.

Ongoing pollution investigations pose risk of material fines

In November 2021, the UK government's Environment Agency (EA) and Ofwat launched parallel investigations into more than 2,000 sewage treatment works across all wastewater companies in England, "after new checks led to water companies admitting that they could be releasing unpermitted sewage discharges into rivers and watercourses." In November 2022, Ofwat confirmed that it had opened enforcement cases against six companies, including Yorkshire Water. This was subsequently extended to all wastewater companies.

In December 2023, the regulator notified Yorkshire Water and two of its peers of its provisional findings and, on 6 August 2024, published its draft conclusions to impose financial penalties of around 7% of wastewater turnover or ca. £47 million on Yorkshire Water.[2]

If confirmed as fines, the amount will have to be paid into HM Treasury's Consolidated Fund and would either have to be funded from shareholder equity or will otherwise eat into the companies' cash reserves and increase net debt. The regulator may consider a company-proposed alternative regulatory settlement instead of a financial penalty payment, including compensation to customers (via bill reductions) or remediation of failure, if appropriate. Given that the investigation has been widely trailed, our forecast assumptions have already included the likelihood of such a penalty occurring. Nevertheless, the penalties are a reflection of heightened regulatory scrutiny, which increases the risk of cash flow volatility for the sector.

In addition to Ofwat's investigation, all wastewater companies operating in England are also subject to a parallel investigation by the Environment Agency (EA). We do not expect the EA to conclude its investigation before 2025, but its fines follow sentencing guidelines[3] and are unlimited, particularly for repeat or deliberate offenders.

Following changes to the definition of serious pollution incidents, Yorkshire Water's environmental performance assessment dropped to 2 stars in 2021 (from 4 stars in 2020), was assessed 3 stars in 2022 and fell back to 2 stars in 2023, which is defined as requiring improvement.[4] The company reported 5 serious pollution incidents (this is classified as red; prior year was 3 incidents and classified as amber) out of 26 total pollution incidents and has among the lowest self-reporting rates.

Deleveraging under regulatory pressure

The phasing of AMP7 spending contributed to a reduction in leverage from 78% in March 2020 to 69% in March 2024. In addition, in October 2022, Yorkshire Water announced that one of its holding companies, Kelda Eurobond Co Limited, would downstream £941 million to Yorkshire Water in repayment of intercompany loans dating from the group's acquisition in 2008. This resolved a previously undisclosed investigation by Ofwat into whether the loans were in breach of Yorkshire Water's licence conditions (see Yorkshire Water Services Limited – Deleveraging under regulatory pressure, 14 October 2022).

Under “undertakings” given by Yorkshire Water to Ofwat, £300 million of the intercompany loans must be repaid by June 2023, a further £200 million by March 2025 and the remainder, approximately £440 million, by March 2027. In June 2023, Yorkshire Water received £400 million via partial repayment of the intercompany loan, followed by £100 million in May 2024, with the remaining receivable balance now reduced to £437 million and required to be received by March 2027.

Taking into account these measures, Yorkshire Water must reduce is net debt/RCV, calculated on a regulatory basis, to no higher than 72% by April 2025, subject to certain caveats. Specifically, Yorkshire has undertaken to “achieve a gearing level on the regulatory basis of no higher than 72% by 1 April 2025 (subject to external factors beyond the control of YWS and beyond the existing regulatory expectation that all water companies manage their financial resilience to ensure they can withstand economic and cost shocks, excluding any agreed early start investment for AMP8 and also to exclude any accelerated investment in AMP7 as a result of the request by the Secretary of State and Defra in October 2022).” As at March 2024, Moody's-adjusted gearing was 69%, and we forecast gearing of just under 72% for March 2025, post-midnight adjustment for regulatory true-ups.

Yorkshire Water has also undertaken to complete a financial structure review by April 2025, at which point it must provide Ofwat with an update on findings and recommendations and “an update on the gearing level and an overview of likely gearing post 2025.”

Minimal holding company debt

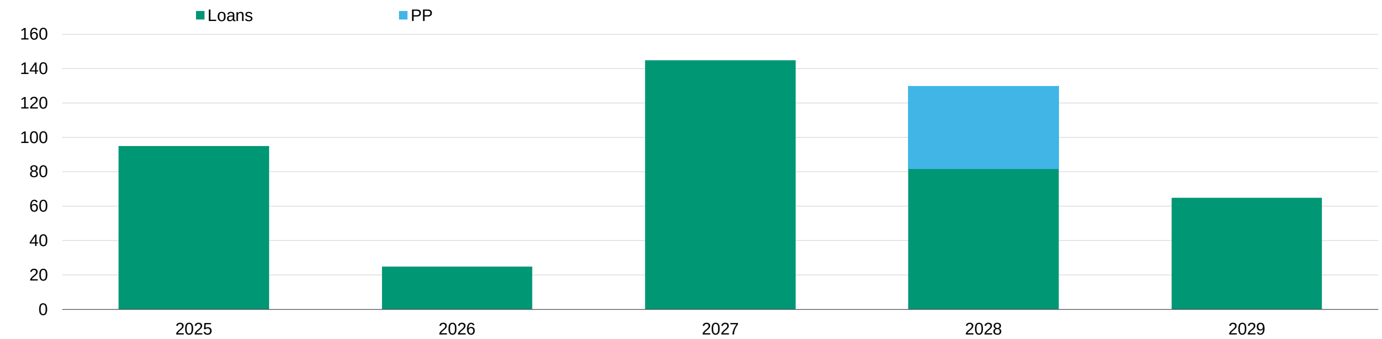
Within the wider Kelda group, around £460 million of external debt has been raised at holding companies outside the financial and regulatory ring-fence of Yorkshire Water. The outstanding amount is equivalent to roughly 5% of Yorkshire Water's RCV at March 2024, a small portion compared with peers.

The nearest maturity relates to two floating rate loans with an aggregate amount of £95 million due in December 2025. The company previously extended maturities for these instruments (from May 2024 to Dec 2025) but may not be able to do so again. Assuming ongoing distributions from the operating company at a 3% dividend yield, we would expect Yorkshire Water's dividend payments during FY2024/25 and FY2025/26 to be sufficient to cover repayments of these near-term maturities.

Exhibit 9

Holding company debt maturities as at March 2024

Amounts in £ millions



Presented as calendar years.

Source: Kelda Water Finance (No 2) Limited's annual reports

With limited additional equity requirements, beyond the commitment agreed with Ofwat in 2022, Yorkshire Water may be able to sustain a small portion of holding company debt in the medium term. However, as investment needs continue to grow, likely requiring equity injections in future periods, investor appetite for holding company debt could reduce.

Swaps could reduce recovery for senior creditors, but MTM has fallen materially since 2022

Yorkshire Water's borrowing costs are relatively high because of inflation swaps entered into at the time of the acquisition in 2008, many of which extend to the mid-2040s or beyond. Under these swaps, Yorkshire Water receives an amount linked to SONIA and pays a fixed coupon, while accruing an amount linked to RPI that must be paid to the counterparty at fixed intervals or at maturity of the swap, depending on the instrument.

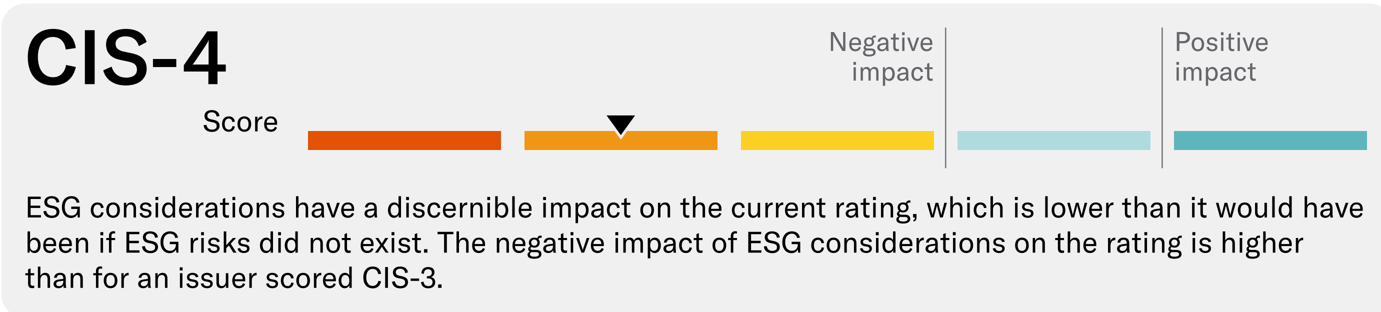
As interest rates fell from 2008 to 2022, receipts under these swaps declined while payments remained constant. As a result, net financing costs rose and the discounted value of expected future cash flow became increasingly negative. As of March 2022 the MTM on these swaps had reached approximately £3.0 billion, 39% of RCV. This is important to the credit quality of the company's senior debt because, in a default scenario, if creditors demand payment acceleration, Yorkshire Water would be required to make a termination payment based on swap counterparties' assessment of their total losses, which is likely to be close to the MTM at that time. Under the company's finance documents, this payment would rank ahead of principal and interest on senior debt and would materially reduce senior debt recovery.[5]

However, the rise in market interest rates since March 2022 as well as the company terminating early a number of RPI-linked swaps with original maturity in 2026 and a notional amount of £177 million have reduced the MTM significantly. As at March 2024, the overall MTM was £1.8 billion or just under 20% of RCV, and slightly reduced to £1.7 billion (or 18% of RCV) by September 2024. In its annual financial statements for March 2024, the company reported this as adjusted for credit value at £1.3 billion (~14% of RCV). Although it remains material, the reduction in the MTM is positive for senior creditors.

ESG considerations

Yorkshire Water Services Finance Limited's ESG credit impact score is CIS-4

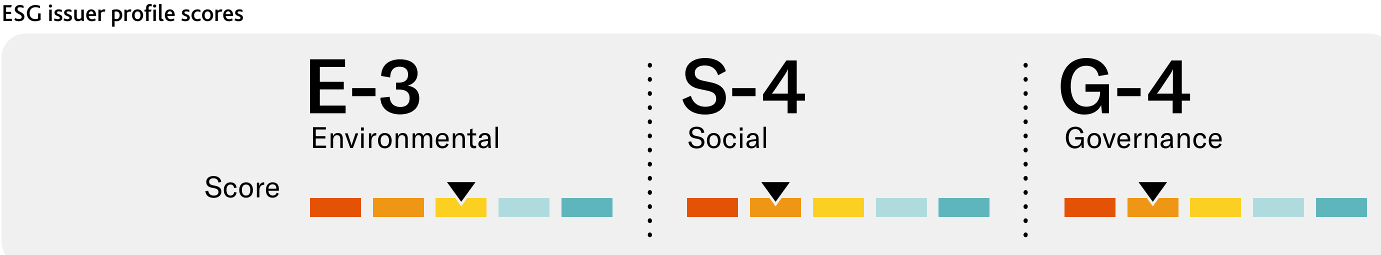
Exhibit 10
ESG credit impact score



Source: Moody's Ratings

The **CIS-4** ESG Credit Impact Score for Yorkshire Water indicates that ESG considerations have a negative impact on current credit quality and that the rating is lower than it would have been if these risks did not exist. The **CIS-4** score largely reflects high social and governance as well as moderate environmental risks. The overall credit impact score also recognises mitigating factors, in particular the regulated nature of water companies' activities and their investment requirements, including a forward-looking allowance for efficient cost. However, as investment needs grow to tackle climate change and population growth, the resulting increase in regulated assets and their remuneration will have to continue to be supported by the regulatory tariff framework in order to avoid negative credit implications in the future.

Exhibit 11
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Yorkshire Water's **E-3** score is largely associated with the company's sewerage operations. Treatment of sewage carries environmental risk, and failures can result in fines and reputational damage. In particular, discharges from combined sewers can affect beaches and bathing waters. In November 2021, Ofwat and the Environment Agency announced a “major investigation” into sewage treatment works, and in March 2022 enforcement cases were opened against Yorkshire Water and four other companies, albeit recently extended to all wastewater companies in England and Wales. In December 2023, three companies, including Yorkshire Water, were notified of provisional findings and, in August 2024, Ofwat published its provisional decision to potentially fine the company for 7% of wastewater turnover or around £47 million. On the drinking water side, shortages are likely to grow more acute with climate change, increasing investment needs for UK water companies. However, these pressures are likely to be lower in the north of England than in other regions.

Social

Yorkshire Water's **S-4** score reflects elevated risk that public concern over environmental, social or affordability issues could lead to adverse regulatory or political intervention. While the risk is common to all regulated utilities, it is particularly acute for UK water companies, with public perception at an all-time low and heightened scrutiny over operational performance and dividend payments.

Materially growing investment requirements to improve environmental performance and increase drought resilience will require bills to rise, exacerbating affordability concerns.

Governance

Yorkshire Water's **G-4** score reflects the company's highly leveraged financial structure and extensive use of derivatives, including restructurings and amendments, which reflects a greater tolerance for financial risk than many investment-grade utilities. The Kelda Holdings group that owns Yorkshire Water has additional debt, equivalent to around 5% of Yorkshire Water's RCV, which must be serviced by distributions from Yorkshire Water. Financial covenants do, however, limit the ability of the holding company to extract cash in downside scenarios, although these protections have been somewhat eroded by the use of derivatives. Yorkshire Water's credit quality is also protected by regulatory mechanisms designed to preserve the independence of the operating companies, including the requirement that independent directors represent the largest single group on the board. In addition, the company's licence prescribes maintenance of a minimum credit profile. The ongoing EA investigation into sewage treatment works raises moderate risks associated with compliance and reporting.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

Yorkshire Water has an excellent liquidity profile. At 30 September 2024, Yorkshire Water had access to a combination of cash and committed undrawn revolving credit facilities totalling £882.4 million. This comprised £710 million undrawn credit facilities (£630 million revolving credit facilities, maturing in November 2029; and a £80 million bilateral facility, maturing in July 2027) and £172.4 million of cash and cash equivalents. Following the period end, in October 2024, Yorkshire Water received £100 million proceeds from a CPI-linked bond issuance, and also tapped three existing bonds in January 2025, raising £250 million in aggregate. These sources are sufficient to cover the company's operating, investment and refinancing needs for a period of at least 24 months from September 2024. There are also no major near term debt maturities, with the next major repayment linked to a £300 million bond in November 2026.

Liquidity is further supported by a £182 million rolling five-year evergreen debt service reserve guarantee issued by Assured Guaranty UK Limited (A1 stable) and a £120 million O&M reserve. These would be available to the company to service debt in the event of a standstill being declared following a breach of covenants.

Structural considerations

Debt structural features provide additional creditor protection…

Yorkshire Water's creditors benefit from a covenant and security package that is designed to insulate the company's creditworthiness from that of its shareholders and improve creditors' protection in a default scenario. The overall covenant and security package is similar to that of comparable highly leveraged financing transactions.

Additional event risk protection provided by the bond covenant and security package includes, inter alia, restrictions on acquisitions and disposals (subject to limited defined exceptions), a dividend lock-up coming into effect if senior gearing increases above 85% of RCV or senior adjusted interest coverage falls persistently below 1.2x (both calculated under the company's covenant definitions), and limitations on non-core activities. In addition, creditors have step-in rights if certain trigger events occur.

The transaction documents also include (1) a first-ranking fixed charge over the shares in the company, plus first-ranking fixed and floating charges over all the assets, rights and undertakings of Yorkshire Water; and (2) the agreement by financial creditors to give up their individual rights to petition for insolvency proceedings. We recognise that the benefit of the security provided to bondholders is limited because of the regulated and essential nature of the services provided by Yorkshire Water as governed by its licence and the Water Industry Act 1991.

In 2015, the highly leveraged UK water companies, including Yorkshire Water, introduced a new supplementary interest cover covenant, designed to reflect regulatory changes in the revenue building block approach for tariff-setting purposes. The definition of Yorkshire Water's supplementary covenant is slightly different from that of its highly leveraged peers. Whereas Anglian Water's or Thames Water's supplementary covenant replaces the previous regulatory capital charges (infrastructure renewals charge and current cost depreciation) with the new RCV depreciation under Ofwat's totex approach, Yorkshire Water also deducts the funded portion of infrastructure renewal expenditure not included in operating expenditures in its statutory financial statements, as well as a "fast/slow adjustment" that would reverse excess revenue allowances compared with expected cost assumptions at the final determination. We believe that Yorkshire Water's supplementary covenant most closely resembles the creditor protection that was intended with the original interest cover covenant.

...but benefit weakened by swap arrangements

Between 2017 and 2020, Yorkshire Water executed several swap amendments and restructurings through which it will increase its swap receipts by £160 million over AMP7 and £127 million over AMP8.[6] In exchange, the maturity of these out-of-the-money swaps was extended so that Yorkshire will make additional cash payments in the 2030s and 2040s equivalent to the amount received plus an implied funding cost.[7]

Under Yorkshire Water's financing structure, the swap re-profiling reduces interest costs by around £30-35 million until March 2028 and £20-25 million between March 2029-30.

In our view this undermines creditor protection. Financial ratio trigger events and events of default are intended to protect the position of creditors, including when the company's financial profile weakens for reasons outside of its control. Bringing forward cash flow using swaps does not improve the credit quality of the company, but by bolstering covenant financial metrics may prevent a trigger event when one might otherwise have occurred. Without the benefit of the restructurings and amendments, Yorkshire Water would have had very limited headroom to its trigger event threshold during AMP7.

The amendments and restructurings also reduce net debt, because cash is received and the corresponding liability is not included in common definitions of debt. We estimate that Yorkshire Water will have received a cumulative £210 million from swap restructurings by the end of AMP7, growing to ca. £360 million by the end of AMP8 (equivalent to around 2.2-2.8% of RCV, respectively).

Moody's AICR excludes cash flow associated with the swap restructurings and amendments. Although we regard the probable future payments resulting from swap restructurings as debt-like, we do not include them in Moody's-adjusted net debt because the company does not disclose them separately from the contingent mark-to-market liabilities on its other swaps.

The senior secured bonds and subordinated debt are rated Baa2 and Ba1 respectively

The Baa2 rating of the senior secured (Class A) bonds reflects the strength of the debt protection measures for this class of debt and other pari passu indebtedness, and their senior position relative to the Class B bonds in the cash waterfall and post any enforcement of security.

The Ba1 rating of the subordinated (Class B) bonds of Yorkshire Water Finance plc reflects the same default probability in addition to our expectation of a heightened loss severity for the Class B debt following any default, given its subordinated position within the financing structure.

However, in a default scenario, if creditors demand payment acceleration, Yorkshire Water would be required to make a termination payment based on swap counterparties' assessment of their total losses, which is likely to be close to the MTM at that time. This payment would rank ahead of principal and interest on senior debt and would reduce the recovery on Class A and Class B debt. The ratings, therefore, also factor in the sizeable super-senior obligations, which limit the benefit applied to Class A debt, in particular, in the context of its ranking within the capital structure.

Rating methodology and scorecard factors

Yorkshire Water's Baa2 rating reflects the application of our Regulated Water Utilities rating methodology. The scorecard-indicated outcome is currently depressed by weak cash flow based metrics and the forward-view remains slightly below the assigned rating for the senior secured debt due to lower business risk scores. Credit quality remains underpinned by solid liquidity and shareholder support, and the ratings of the individual classes of debt reflect their ranking in the cash flow waterfall.

Exhibit 12

Rating methodology scorecard

Yorkshire Water Services Limited

Regulated Water Utilities Industry [1][2]	Current FY 3/31/2024		Moody's AMP8 Forward View As of February 2025 [3]	
Factor 1 : Business Profile(50%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Environment	Aa	Aa	A	A
b) Asset Ownership Model	Aa	Aa	Aa	Aa
c) Cost and Investment Recovery (Sufficiency & Timeliness)	A	A	Baa	Baa
d) Revenue Risk	Aa	Aa	Aa	Aa
e) Scale and Complexity of Capital Programme & Asset Condition Risk	Aa	Aa	Baa	Baa
Factor 2 : Financial Policy (10%)				
a) Financial Policy	B	B	B	B
Factor 3 : Leverage and Coverage (40%)				
a) Adjusted Interest Coverage Ratio (3 Year Avg)	0.8x	Caa	1.6x - 1.7x	Baa
b) Net Debt / Regulated Asset Base (3 Year Avg)	71.6%	Ba	68% - 70%	Baa
c) FFO / Net Debt (3 Year Avg)	6.1%	Ba	8% - 9%	Ba
d) RCF / Net Debt (3 Year Avg)	5.5%	Ba	7% - 8%	Baa
Rating:				
Scorecard-Indicated Outcome Before Notch Lift		Ba2		Baa3
Notch Lift		1		0.5
a) Scorecard-Indicated Outcome		Ba1		Baa3
b) Actual Rating Assigned				Baa2/Ba1

(1) All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. (2) As at 31/03/2024. (3) This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate any significant acquisitions or divestitures.

Source: Moody's Financial Metrics™

Ratings

Exhibit 13

Category	Moody's Rating
YORKSHIRE WATER SERVICES FINANCE LIMITED	
Outlook	Stable
Bkd Senior Secured -Dom Curr	Baa2
Underlying Senior Secured -Dom Curr	Baa2

Source: Moody's Ratings

Appendix

Exhibit 14
Yorkshire Water Services Limited
Selected peer comparison

	Yorkshire Water Services Limited Baa2/Ba1 Stable			Anglian Water Services Ltd. A3 RUR-DNG			Thames Water Utilities Ltd. Caa3 Stable			Southern Water Services Limited Ba1 RUR-DNG*		
(in GBP million)	FYE Mar-22	FYE Mar-23	FYE Mar-24	FYE Mar-22	FYE Mar-23	FYE Mar-24	FYE Mar-22	FYE Mar-23	FYE Mar-24	FYE Mar-22	FYE Mar-23	FYE Mar-24
Revenue	1,119	1,145	1,227	1,400	1,495	1,627	2,092	2,181	2,401	845	816	887
EBITDA	606	611	649	790	819	862	1,062	1,065	1,287	452	592	295
Total Assets	10,853	11,007	10,869	12,229	12,470	13,539	20,563	22,870	23,748	7,568	7,645	8,596
Regulated Asset Base (RAB)	7,746	8,715	9,132	8,780	9,959	10,676	16,664	18,945	19,947	5,665	6,455	6,798
Total Debt	5,738	6,571	6,379	6,534	7,254	8,366	14,201	16,809	17,803	4,127	4,622	5,382
Net Debt	5,709	6,278	6,329	5,663	6,621	7,361	13,781	14,979	16,528	3,677	4,476	4,766
Net Debt / Regulated Asset Base	73.7%	72.0%	69.3%	64.5%	66.5%	69.0%	82.7%	79.1%	82.9%	64.9%	69.3%	70.1%
Adjusted Interest Coverage Ratio	1.0x	0.7x	0.7x	1.4x	1.4x	1.1x	0.7x	0.5x	0.6x	-0.2x	-0.2x	-0.7x
FFO / Net Debt	6.4%	5.8%	6.2%	8.4%	7.9%	7.5%	4.6%	3.8%	4.3%	0.8%	-2.8%	1.4%
RCF / Net Debt	6.1%	5.2%	5.3%	6.7%	5.4%	6.4%	4.3%	3.5%	3.1%	0.9%	-2.8%	1.4%

All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade. Rating for Yorkshire Water and Southern Water are assigned at the level of the relevant finance subsidiaries.
Source: Moody's Financial Metrics™

Exhibit 15
Yorkshire Water Services Limited
Moody's adjusted debt breakdown

(in GBP million)	FYE Mar-20	FYE Mar-21	FYE Mar-22	FYE Mar-23	FYE Mar-24
As Reported Total Debt	5,598	5,514	5,457	6,070	5,906
Pensions	0	0	0	0	0
Leases	9	0	0	0	0
Non-Standard Adjustments	58	213	281	502	473
Moody's Adjusted Total Debt	5,665	5,727	5,738	6,571	6,379
Cash & Cash Equivalents	(250)	(198)	(29)	(294)	(50)
Moody's Adjusted Net Debt	5,416	5,529	5,709	6,278	6,329

All figures are calculated using Moody's estimates and standard adjustments. Non-standard adjustments add cumulative swap accretion to debt.
Source: Moody's Financial Metrics™

Exhibit 16
Yorkshire Water Services Limited
Moody's adjusted FFO breakdown

(in GBP million)	FYE Mar-20	FYE Mar-21	FYE Mar-22	FYE Mar-23	FYE Mar-24
As Reported Funds from Operations (FFO)	414	480	470	445	548
Leases	3	0	0	0	0
Capitalized Interest	(17)	0	0	0	0
Alignment FFO	(69)	(96)	(214)	(367)	(298)
Unusual Items - Cash Flow	(50)	(28)	0	0	0
Non-Standard Adjustments	33	(12)	109	286	143
Moody's Adjusted Funds from Operations (FFO)	314	344	365	364	393

All figures are calculated using Moody's estimates and standard adjustments. Non-standard adjustment primarily comprise interest payments associated with swaps and adding back annual inflation accretion on index-linked debt to FFO.
Source: Moody's Financial Metrics™

Exhibit 17

Yorkshire Water Services Limited

Selected historical financial data, Moody's-adjusted

(in GBP million)	FYE Mar-20	FYE Mar-21	FYE Mar-22	FYE Mar-23	FYE Mar-24
INCOME STATEMENT					
Revenue	1,063	1,101	1,119	1,145	1,227
EBITDA	564	636	606	611	649
EBITDA margin %	53.0%	57.7%	54.2%	53.4%	52.9%
EBIT	235	313	273	270	274
EBIT margin %	22.1%	28.4%	24.4%	23.6%	22.3%
Interest Expense	259	257	411	583	404
Net income	(49)	34	(195)	(295)	(105)
BALANCE SHEET					
Net Property Plant and Equipment	7,838	8,197	9,222	8,954	9,320
Total Assets	9,661	10,010	10,853	11,007	10,869
Total Debt	5,665	5,727	5,738	6,571	6,379
Cash & Cash Equivalents	250	198	29	294	50
Net Debt	5,416	5,529	5,709	6,278	6,329
Total Liabilities	8,982	9,180	9,756	9,834	9,701
Total Equity	679	830	1,097	1,173	1,169
CASH FLOW					
Funds from Operations (FFO)	314	344	365	364	393
Cash Flow From Operations (CFO)	339	450	403	390	436
Dividends	62	1	15	40	56
Retained Cash Flow (RCF)	251	343	350	324	337
Capital Expenditures	(486)	(437)	(371)	(507)	(631)
Free Cash Flow (FCF)	(209)	12	17	(157)	(250)
INTEREST COVERAGE					
(FFO + Interest Expense) / Interest Expense	2.2x	2.3x	1.9x	1.6x	2.0x
Adjusted Interest Coverage Ratio	1.3x	0.9x	1.0x	0.7x	0.7x
LEVERAGE					
FFO / Net Debt	5.8%	6.2%	6.4%	5.8%	6.2%
RCF / Net Debt	4.6%	6.2%	6.1%	5.2%	5.3%
Regulated Asset Base (RAB)	6,960	7,024	7,746	8,715	9,132
Net Debt / Regulated Asset Base	77.8%	78.7%	73.7%	72.0%	69.3%

All figures are calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Endnotes

1 Ofwat's AMP7 determination included a £772 million allowance for WINEP, significantly less than the company's request of £941 million.

2 https://www.moodys.com/research/Northumbrian-Water-LtdThames-Water-Utilities-LtdYorkshire-Water-Services-Ltd-Ofwats-proposed-Issuer-Comment--PBC_1417752#290612199861c31d1036b185b4e69b75

3 Please see the sentencing council's guidelines for environmental offences effective from 1 July 2014: https://www.sentencingcouncil.org.uk/offences/magistrates-court/item/organisations-illegal-discharges-to-air-land-and-water-unauthorised-or-harmful-deposit-treatment-or-disposal-etc-of-waste/

4 https://www.gov.uk/government/publications/water-and-sewerage-companies-in-england-environmental-performance-report-2023/water-and-sewerage-companies-in-england-environmental-performance-report-2023

5 Yorkshire Water's intercreditor arrangements contain provisions intended to reduce the likelihood of an event of default and, if one were to occur, to allow resolution before enforcement action. In particular, an automatic standstill of up to 18 months follows the occurrence of an event of default (resulting from, for example, non-payment of scheduled payments, maintaining forward-looking liquidity of less than six months, violation of licence terms, rating downgrades from multiple agencies or breach of default financial ratios). The standstill is designed to allow time for secured creditors to pursue options

that could include a sale of the regulated business. During the standstill period, no other enforcement of creditor's rights is allowed, including payment acceleration that would trigger termination payments to swap counterparties.

6 https://www.moodys.com/research/docid--PBC_1236790

7 £11.6 million received in August 2020, as part of a package to mitigate the effect of the coronavirus outbreak on Yorkshire Water's financial covenants, will be effectively repaid over the following seven years.

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