Appendix 13e:

Financeability analysis - Appointee

YorkshireWater

Contents

1. Objective

To ensure that the Company is financeable on both a notional balance sheet and actual balance sheet basis.

This document focuses on the financeability of the Appointee business as a whole. Further testing has been undertaken on a price control basis, which can be found in Appendix [x] – Financeability testing per price control.

2. Method

i) Determine the key financial ratios to be tested
ii) Determine the targets (on both a notional and actual basis) against which the above key financial ratios will be tested
iii) Calculate the key financial ratios on both a notional and actual basis
iv) Compare the calculated ratios against the target levels

Further detail on each of these stages is provided below.

a. Key financial ratios to be tested

Within Ofwat's PR19 methodology there are included a number of financial ratios and we have reported all of these within App10.

We have chosen to focus our financeability analysis on the following three key ratios:

- Gearing
- Adjusted interest cover (on both an Ofwat and Ratings Agency basis)
- Funds from operations ("FFO") to debt (on both an Ofwat and Ratings Agency basis)

We have focused on these three ratios as these are the applicable ratios included within the covenants of our bonds and are also the ratios most commonly referenced by the Ratings Agencies. On this basis we believe they are the most relevant ratios when assessing our financeability.

b. Target ratios

When assessing our notional financeability, we have considered our financial ratios against the targets required to achieve a rating between A and BBB grade, as these are the ratings used within the business plan methodology to determine the notional cost of debt.

Based on ratings guidance provided by Moody's and S&P, we have set a target for adjusted interest cover ratio of 1.50 times and FFO to debt of 9.0%.

When assessing our actual financeability, we have considered our financial ratios against the targets required to safely maintain our current rating.

For the principal adjusted interest cover ratio this equates to a target of 1.30 times and for FFO to debt this equates to a target of 6.0%.

c. Ratio calculation

Ratios have been calculated using both Ofwat's financial model and our own financial model as follows:

- Notional ratios – all calculated using Ofwat's financial model, though some adjustments have been made to the ratio calculations (see below)
- Actual ratios – the majority of ratios were calculated using Ofwat's financial model; however our own model was used to calculate our covenanted ratios (see below for further details)

We have made one amendment to Ofwat's financial model within the results presented in the table below and App10, which impacts the alternative calculation of the adjusted ICR. The amendment we made changed the sign in line 178 of the "Analysis Appointee" tab.

The output from our financial model has been reconciled to the output from Ofwat's financial model to ensure the output is consistent between the two models. A comparison of the output from the two models is shown below:

Ofwat model vs YW model Key ratio comparison	Notional Ofwat model	Notional YW model	Actual Ofwat model	Actual YW model
Adjusted ICR (Ofwat basis)	2.25	2.29	2.03	2.06
FFO to debt (Ofwat basis)	10.0%	10.12%	7.79%	7.89%
Adjusted ICR (Moody's methodology)	1.58	1.58	1.42	1.43
FFO to debt (S&P methodology)	9.21%	9.19%	6.16%	6.17%
Adjusted ICR (YW senior covenanted)	n/a	n/a	1.42	1.42

The analysis above shows that the results for both the Ratings Agency ratios and our own covenanted ratios are very similar. There is a small difference between the Ofwat ratios, which is due to the inclusion of £6m additional revenue within the YW model arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat's model.

The following alternative calculations have been included within Ofwat's model to determine the key ratios for our financeability assessment (on both a notional and actual basis):

- Adjusted interest cover (Moody's) – This is the same as Ofwat's adjusted interest cover (alternative) calculation, except for the following adjustment:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat's model.

- Adjusted interest cover (Covenanted) – This is the same as Ofwat's adjusted interest cover (alternative) calculation, except for the following adjustments:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat's model.
  - Working capital movements in year

- FFO to debt (S&P) – This is the same as Ofwat's FFO to debt (alternative) calculation, except for the following adjustment:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat's model.

- Gearing – This is the same as Ofwat's gearing calculation, except for the following adjustment:
  - RCV re-calculated based on year end nominal rather than average nominal

d. Comparison to target

Please see results section below for a comparison of the calculated ratios to the target level.

3. Results

The table below summarise the results of the financeability analysis undertaken.

Financeability Summary analysis	Notional Target	Notional Ratio	Actual Target	Actual Ratio
Gearing		62.9%		78.3%
ICR (Ofwat basis)	1.50	2.25	1.30	2.03
FFO:Debt (Ofwat basis)	9.00%	10.04%	6.00%	7.79%
ICR (Moody's)	1.50	1.58	1.30	1.42
FFO:Debt (S&P basis)	9.00%	9.21%	6.00%	6.16%
ICR (YW covenanted)	n/a	n/a	1.20	1.42

Further detail is provided below, including the results for each of the five years of the AMP, together with the average across the AMP. In accordance with Ofwat's guidance the key figure used in our assessment is the average figure for each ratio.

a. Notional financeability

The table below shows the output of notional financeability testing conducted within Ofwat's financial model and shown within App10:

Notional ratios Ofwat model	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		60.9%	62.5%	63.6%	64.0%	63.7%	62.9%
ICR (Ofwat basis)	1.50	2.37	2.25	2.23	2.18	2.22	2.25
FFO:Debt (Ofwat basis)	9.00%	10.53%	9.96%	9.89%	9.79%	10.06%	10.04%
ICR (Moody's)	1.50	1.61	1.59	1.57	1.56	1.57	1.58
FFO:Debt (S&P basis)	9.00%	9.73%	9.15%	9.05%	8.93%	9.19%	9.21%
ICR (YW covenanted)	n/a	n/a	n/a	n/a	n/a	n/a	n/a

The analysis shows that:

- Average ratios are above target for all ratios
- Ofwat's ratios are comfortably above the target level
- The Moody's ICR is above target in all years tested
- S&P's FFO to debt is below target in one year, but the average is above target

Whilst the analysis above shows that Ratings Agency ratio might fall below target in one year, this will not necessarily have an impact on credit ratings as the levels are trigger levels and not default levels. Other factors would come into the assessment such as: trend, reason for cost shock; management response; mitigation put in place; exceptional nature of shock.

b. Actual financeability

The table below shows the output of actual financeability testing conducted within Ofwat's financial model and shown within App10:

Actual ratios Ofwat model	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		77.5%	78.2%	78.7%	78.8%	78.4%	78.3%
ICR (Ofwat basis)	1.30	2.10	2.00	1.98	2.02	2.05	2.03
FFO:Debt (Ofwat basis)	6.00%	7.94%	7.63%	7.65%	7.74%	7.96%	7.79%
ICR (Moody's)	1.30	1.43	1.41	1.39	1.44	1.45	1.42
FFO:Debt (S&P basis)	6.00%	6.22%	6.00%	6.07%	6.16%	6.34%	6.16%
ICR (YW covenanted)	1.20	1.72	1.43	1.31	1.32	1.33	1.42

The analysis shows that:

- Average ratios are above target for all ratios
- Ofwat's ratios are comfortably above the target level
- The Moody's ICR is above target in all years tested
- S&P's FFO to debt is above target in all years tested
- Our covenanted ICR is above target in all years tested

In addition to the above, we also tested the full suite of our covenanted interest cover ratios against target, within our own financial model. The results of this are shown below:

Actual ratios YW model	Target	FY21	FY22	FY23	FY24	FY25	Average
ICR (YW covenanted Class A, trigger)	1.30	2.00	1.67	1.53	1.53	1.53	1.65
ICR (YW covenanted Senior, trigger)	1.10	1.73	1.43	1.32	1.32	1.32	1.42
ICR (YW covenanted Class A average, trigger)	1.40	1.74	1.58	1.53	1.53	1.62	1.60
ICR (YW covenanted Senior average, trigger)	1.20	1.49	1.36	1.32	1.32	1.37	1.37
ICR (YW covenanted Class A, default)	1.00	2.00	1.67	1.53	1.53	1.53	1.65

The analysis shows that:

- Ratios are above target for all ratios in all years tested
- There is considerable headroom to the default level

4. Conclusion

A summary of the results above is shown in the table below.

Financeability Summary analysis	Notional Target	Notional Ratio	Actual Target	Actual Ratio
Gearing		62.9%		78.3%
ICR (Ofwat basis)	1.50	2.25	1.30	2.03
FFO:Debt (Ofwat basis)	9.00%	10.04%	6.00%	7.79%
ICR (Moody's)	1.50	1.58	1.30	1.42
FFO:Debt (S&P basis)	9.00%	9.21%	6.00%	6.16%
ICR (YW covenanted)	n/a	n/a	1.20	1.42

Forecast ratios are above the target level in all cases; therefore we can conclude that the Company is financeable at the Appointee level on both a notional and actual basis.