

Kemble Water Finance Limited

| Rating Type | Rating | Outlook | Last Rating Action |
|-----------------------|--------|---------|--------------------------|
| Long-Term IDR | BB- | Stable | Affirmed 31 January 2018 |
| Senior secured rating | BB | | Affirmed 31 January 2018 |

[Click here for full list of ratings](#)

Financial Summary

| (GBPm) | Mar 2016 | Mar 2017 | Mar 2018F | Mar 2019F |
|-------------------------------|----------|----------|-----------|-----------|
| Gross Revenue | 2,040 | 2,027 | 2,126 | 2,223 |
| Operating EBITDAR Margin (%) | 55.9 | 53.9 | 49.7 | 51.1 |
| FFO Margin (%) | 31.5 | 30.5 | 27.9 | 30.0 |
| FFO Fixed Charge Coverage (x) | 2.1 | 1.8 | 2.3 | 2.5 |
| FFO Adjusted Leverage (x) | 11.2 | 10.3 | 11.7 | 11.2 |

Source: Fitch

Fitch Ratings affirmed Kemble Water Finance Limited's Long-Term Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook and its senior secured rating at 'BB' in January 2018. The agency also affirmed Thames Water (Kemble) Finance PLC's (TWKF) GBP400 million and GBP175 million senior secured bond issues at 'BB', which are guaranteed by Kemble Water.

The affirmation and Stable Outlook reflect the adequate dividend capacity of Thames Water Utilities Limited (Thames Water or OpCo) in comparison with the debt service requirements of Kemble, and its adequate credit metrics for the remainder of the price control from April 2015 to March 2020 (asset management plan 6; AMP6).

The ratings also take into account Thames Water's position in the lower half of Fitch's rated peer group in terms of regulatory and operational performance, as the main operating subsidiary of the group, as well as the structurally and contractually subordinated nature of the holding-company financing at the Kemble level.

Kemble Water is a holding company of Thames Water Utilities Limited, the regulated monopoly provider for water and wastewater services in London and the surrounding areas

Key Rating Drivers

Adequate Dividend Cover: For the remainder of AMP6, Fitch forecasts dividend cover mainly above 2.5x, although for the year ended 31 March 2018 (FY18) dividend cover is projected to be weak as we expect the operating company to only distribute sufficient funds to service holding-company debt and not to pay distributions to shareholders.

This is due mainly to materially higher capital expenditure in the early years of the price control and expected underperformance of total expenditure (totex) compared to previous expectations of totex outperformance. If there are any developments that would restrict dividend cover for longer, especially an operational underperformance, a downgrade would be considered.

Adequate Credit Metrics: We forecast Kemble Water will maintain economic gearing below 90% pension-adjusted net debt/regulatory asset value (RAV) over AMP6 and average post-maintenance and post-tax interest cover (PMICR) at around 1.2x. Our forecast gearing differs from the company's forecast as we calculate economic gearing taking into account adjustments for totex out/underperformance.

For FY17 Fitch calculates Kemble's dividend cover at 2.4x, pension adjusted net debt/RAV at 89.5%, and PMICR at 1.26x. These financial ratios differ from Kemble Water's investor report. Fitch adjusts cash interest to reflect non-cash debt movements resulting from certain index-linked swaps by removing those with pay-down provisions.

Incremental Debt at HoldCo: The GBP850 million of debt at the holding level represents around 6% of RAV and incurs an annual finance charge of around GBP58 million on average for FY18 to FY20. We expect the dividend stream from the OpCo for the remainder of the price control to allow servicing of the debt. We see modest refinancing risk from the maturity of the GBP400 million bond in April 2019 due to management's prudent approach in managing liquidity. We expect refinancing plans to be in place well in advance of the bond's maturity.

Underperformance Anticipated: Fitch expects Thames Water to underperform totex targets over AMP6. Lower than previously expected outperformance in the fast money allowance of totex (opex) and higher than expected underperformance in the slow money allowance of totex (capex) results in net totex underperformance. The higher spending is driven by the need to improve regulatory performance, especially in leakage and customer services, additional investment in water mains replacement and increasing IT capabilities. Fitch's forecast includes underperformance of GBP100 million and GBP70 million for totex and retail business respectively in nominal terms.

Performance Needs Improving: For FY17, Thames Water has reported stable asset health for water non-infrastructure assets and sewerage infrastructure and non-infrastructure assets, but water infrastructure assets continue as marginal. The company did not meet its targets for leakage, security of supply and internal sewage flooding, but met targets for drinking water quality, supply interruptions and pollution incidents. Although the company improved its score on the service incentive mechanism which measures customers' satisfaction, to 77.26 from 76.74 in FY16, the company is still lagging behind peers in customer service.

Ratings Pressure From 2019: The new price control methodology which will apply from April 2020 (PR19) is credit-negative for the sector as it will increase both financial and business risks. The regulator's low view on the cost of capital of 2.4% will reduce the water companies' cash-flow generation ability despite the recent rise in UK inflation.

Companies that are lagging regulatory and operational performance targets, likely including Thames Water, may struggle to achieve significant additional cash flow from outperformance of totex and Outcome Delivery Incentives to offset pressure on credit metrics. We will reflect that in our ratings once we have better visibility on business plans post 2020.

Renewed Management and Shareholders: We view as positive the management changes implemented since 2016 as we expect the new management will take a more proactive, transparent and focused approach and will implement new initiatives and processes in order to improve the company's operational and regulatory performance. There has also been a number of changes to the composition of the group's shareholders, leading to more than two-thirds of the shareholder base being made up of pension funds.

Index-Linked Swaps: Thames Water has a portfolio of index-linked swaps with a notional amount of GBP1.5 billion embedded in its capital structure, which do not contain breaks. Around GBP700 million of those swaps contain five-year pay-down provisions of accretion of swap notional and the timing of such payments is spread across each year. In our view these swaps do not have the same cash-enhancing effect as long-dated index-linked bonds. Therefore, Fitch has conservatively removed the benefit of these swaps from the calculation of PMICR.

Rating Derivation Relative to Peers

| Rating Derivation versus Peers | |
|--------------------------------|---|
| Peer Comparison | Kemble Water Finance Limited is a holding company of Thames Water Utilities Limited (NR), one of the regulated, monopoly providers for water and wastewater services in England and Wales. The weaker rating compared to peers such as Osprey Acquisitions Limited (BB/Stable) and Kelda Finance (No.2) Limited (BB/Stable) reflects Kemble's weaker operating and regulatory performance as well as weaker credit metrics. |
| Parent/Subsidiary Linkage | Parent/subsidiary linkage is applicable but given the structural and contractual ring-fenced structured of the group it does not constrain 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

- Rating upside is limited. A higher rating for the holding company would be contingent on Thames Water materially reducing its regulatory gearing and substantially improving its performance.

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

- A sustained drop of expected dividend cover below 2.5x, increase of gearing above 90% and/or decrease of post-maintenance and post-tax interest cover below 1.05x
- Possibility of a dividend lock-up at Thames Water
- A marked deterioration in operational and regulatory performance at Thames Water or a material change in business risk of the UK water sector

Liquidity and Debt Structure

Adequate Liquidity: Kemble mainly relies on upstreamed dividends in order to service its debt payments. As of 31 September 2017, Kemble Water held GBP28.4 million in unrestricted cash and cash equivalents and access to GBP65 million of a committed, undrawn revolving credit facility maturing in 2022, compared with an annual finance charge of around GBP58m. The next debt maturity is a GBP400 million bond maturing in April 2019.

Debt Maturities and Liquidity at 30 September 2017

| Liquidity Summary | Original |
|--|-------------------|
| | 30 September 2017 |
| (GBPm) | |
| Total Cash & Cash Equivalents | 28.4 |
| Short-Term Investments | 0.0 |
| Less: Not Readily Available Cash and Cash Equivalents | 0.0 |
| Fitch-defined Readily Available Cash and Cash Equivalents | 28.4 |
| Availability under Committed Lines of Credit | 65.0 |
| Total Liquidity | 93.4 |
| Plus: Fitch Forecasted 2018 FCF (post dividend) | n.a. |
| Total Projected 2018 Liquidity | 93.4 |
| Liquidity Score | n.a. |
| Source: Fitch, Company filings | |

| Scheduled Debt Maturities | Original |
|--|-------------------|
| | 30 September 2017 |
| (GBPm) | |
| 31 March 2018 | 0.0 |
| 31 March 2019 | 0.0 |
| 31 March 2020 | 400.0 |
| 31 March 2021 | 0.0 |
| 31 March 2022 | 250.0 |
| Thereafter | 200.0 |
| Total Debt Maturities | 850.0 |
| Source: Fitch Ratings, Inc., Company filings | |

Key Assumptions

Fitch's key assumptions within our rating case for Thames Water include:

- Regulated revenues in line with the final determination of tariffs for AMP6, ie assuming no material over- or under-recoveries
- Combined totex underperformance of around GBP100 million in nominal terms for FY18 to FY20
- Underperformance in retail costs of around GBP70 million above allowances for FY18 to FY20
- Unregulated EBITDA of around GBP10 million a year
- Retail price inflation of 3% from 2018 onwards
- Limited impact on cash-flow generation from outcome delivery incentives (ODIs), given that financial rewards and penalties will be taken into account as part of the next price review

We have included GBP40 million of penalties related to ODIs in FY18 given that the company has agreed to return this to customers earlier.

Fitch's key assumptions for Kemble Water include:

- Incremental debt at the holding-company level based on pension adjusted net/debt to RAV of 90% or below for the whole group
- Average annual finance charge at holding company level of around GBP58 million from FY18 to FY20

Financial Data

| (GBPm) | Historical | | Forecast | |
|---|------------|----------|-----------|-----------|
| | Mar 2016 | Mar 2017 | Mar 2018F | Mar 2019F |
| SUMMARY INCOME STATEMENT | | | | |
| Gross Revenue | 2,040 | 2,027 | 2,126 | 2,223 |
| Revenue Growth (%) | 2.3 | -0.6 | 4.9 | 4.6 |
| Operating EBITDA (Before Income From Associates) | 1,130 | 1,077 | 1,040 | 1,118 |
| Operating EBITDA Margin (%) | 55.4 | 53.1 | 48.9 | 50.3 |
| Operating EBITDAR | 1,141 | 1,093 | 1,057 | 1,136 |
| Operating EBITDAR Margin (%) | 55.9 | 53.9 | 49.7 | 51.1 |
| Operating EBIT | 632 | 539 | 561 | 620 |
| Operating EBIT Margin (%) | 31.0 | 26.6 | 26.4 | 27.9 |
| Gross Interest Expense | -776 | -927 | -508 | -526 |
| Pretax Income (Including Associate Income/Loss) | -4 | -670 | 53 | 94 |
| SUMMARY BALANCE SHEET | | | | |
| Readily Available Cash and Equivalents | 564 | 97 | 112 | 88 |
| Total Debt With Equity Credit | 11,305 | 11,482 | 12,062 | 12,452 |
| Total Adjusted Debt with Equity Credit | 11,467 | 11,839 | 12,197 | 12,593 |
| Net Debt | 10,741 | 11,385 | 11,950 | 12,364 |
| SUMMARY CASH FLOW STATEMENT | | | | |
| Operating EBITDA | 1,130 | 1,077 | 1,040 | 1,118 |
| Cash Interest Paid | -482 | -634 | -428 | -439 |
| Cash Tax | -2 | -1 | 0 | 0 |
| Dividends Received Less Dividends Paid to Minorities (Inflow/(Out)flow) | 0 | 0 | 0 | 0 |
| Other Items Before FFO | -113 | 56 | -19 | -11 |

| | | | | |
|---|--------|--------|-------|------|
| Funds Flow From Operations | 642 | 618 | 594 | 668 |
| Change in Working Capital | 1 | -29 | -19 | -11 |
| Cash Flow From Operations (Fitch Defined) | 643 | 589 | 575 | 657 |
| Total Non-Operating/Non-Recurring Cash Flow | 0 | 0 | | |
| Capital Expenditure | -1,175 | -1,172 | | |
| Capital Intensity (Capex/Revenue) | 57.6 | 57.8 | | |
| Common Dividends | 0 | 0 | | |
| Net Acquisitions and Divestitures | 0 | 0 | | |
| Other Investing and Financing Cash Flow Items | 10 | 391 | -165 | -263 |
| Net Debt Proceeds | 532 | -275 | 580 | 390 |
| Net Equity Proceeds | 0 | 0 | 0 | 0 |
| Total Change in Cash | 10 | -467 | 15 | -24 |
| DETAIL CASH FLOW STATEMENT | | | | |
| FFO Margin (%) | 31.5 | 30.5 | 27.9 | 30.0 |
| Calculations for Forecast Publication | | | | |
| Capex, Dividends, Acquisitions and Other Items Before FCF | -1,175 | -1,172 | -976 | -807 |
| Free Cash Flow After Acquisitions and Divestitures | -532 | -583 | -400 | -151 |
| Free Cash Flow Margin (After Net Acquisitions) (%) | -26.1 | -28.8 | -18.8 | -6.8 |
| COVERAGE RATIOS | | | | |
| FFO Interest Coverage (x) | 2.1 | 1.8 | 2.4 | 2.5 |
| FFO Fixed Charge Coverage (x) | 2.1 | 1.8 | 2.3 | 2.5 |
| Operating EBITDAR/Interest Paid + Rents (x) | 2.3 | 1.7 | 2.4 | 2.5 |
| Operating EBITDA/Interest Paid (x) | 2.3 | 1.7 | 2.4 | 2.5 |
| PMICR (x) | 1.36 | 1.26 | 1.16 | 1.25 |
| LEVERAGES RATIOS | | | | |
| Total Adjusted Debt/Operating EBITDAR (x) | 10.1 | 10.8 | 11.5 | 11.1 |
| Total Adjusted Net Debt/Operating EBITDAR (x) | 9.6 | 10.7 | 11.4 | 11.0 |
| Total Debt with Equity Credit/Operating EBITDA (x) | 10.0 | 10.7 | 11.6 | 11.1 |
| FFO Adjusted Leverage (x) | 11.2 | 10.3 | 11.7 | 11.2 |
| FFO Adjusted Net Leverage (x) | 10.6 | 10.2 | 11.6 | 11.1 |
| Net debt/RAV (%) | 88.3 | 89.5 | 88.4 | 87.3 |
| Source: Fitch, Company Reports | | | | |

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.

Rating Navigator

Kemble Water Finance Limited

Corporates Ratings Navigator EMEA Regulated Networks

| Factor Levels | Sector Risk Profile | Operating Environment | Business Profile | | | | | Financial Profile | | | Issuer Default Rating |
|---------------|---------------------|-----------------------|-------------------------------------|--------------------|------------------------|------------|------------|-----------------------------|---------------------|-----------------------|-----------------------|
| | | | Management and Corporate Governance | Sector Positioning | Regulatory Environment | Asset Base | Operations | Profitability and Cash Flow | Financial Structure | Financial Flexibility | |
| aaa | | | | | | | | | | | AAA |
| aa+ | | | | | | | | | | | AA+ |
| aa | | | | | | | | | | | AA |
| aa- | | | | | | | | | | | AA- |
| a+ | █ | █ | | | | | | | | | A+ |
| a | █ | █ | | | | | | | | | A |
| a- | █ | █ | █ | █ | █ | █ | | | | | A- |
| bbb+ | █ | █ | | | | | | | | | BBB+ |
| bbb | █ | █ | █ | █ | █ | █ | █ | | | | BBB |
| bbb- | █ | █ | | | | | | | | | BBB- |
| bb+ | █ | █ | | | | | | █ | | | BB+ |
| bb | █ | █ | | | | | | █ | | | BB |
| bb- | █ | █ | | | | | | | | █ | BB- Stable |
| b+ | █ | █ | | | | | | | █ | | B+ |
| b | █ | █ | | | | | | | █ | | B |
| b- | █ | █ | | | | | | | █ | | B- |
| ccc | | | | | | | | | | | CCC |
| cc | | | | | | | | | | | CC |
| c | | | | | | | | | | | C |
| d or rd | | | | | | | | | | | D or RD |

Operating Environment

| | | | |
|-----|----------------------|----|---|
| aa- | Economic Environment | a | Strong combination of countries where economic value is created and where assets are located. |
| a+ | Financial Access | a | Strong combination of issuer-specific funding characteristics and the strength of the relevant local financial market. |
| | Systemic Governance | aa | Systemic governance (eg rule of law, corruption, government effectiveness) of the issuer's country of incorporation consistent with 'aa'. |
| b- | | | |
| ccc | | | |

Sector Positioning

| | | | |
|------|--|-----|---|
| a | Operation Type | bbb | Local or regional monopoly asset owners, regional monopoly asset operators. |
| a- | Non-Regulated Earnings (% of Total Earnings) | a | up to 10% |
| bbb+ | | | |
| bbb | | | |
| bbb- | | | |

Asset Base

| | | | |
|------|---------------------------------|-----|---|
| a | Diversification | bbb | Limited diversification by geography without regulatory diversification; regional utility. |
| a- | Critical Mass | a | Critical mass in one regulated asset; does not affect efficiency of operations (cost base, customer base, key personnel). |
| bbb+ | Asset Quality and Residual Life | bbb | Mid-range asset quality not affecting opex and capex requirements compared with peers. The residual life of regulatory assets is average. |
| bbb | | | |
| bbb- | | | |

Profitability and Cash Flow

| | | | |
|------|-----------------------------|-----|---|
| bbb | Return on Capital | bbb | Return on capital comparable with the regulatory benchmark. |
| bbb- | Volatility of Profitability | bb | Less stability and predictability of profit than utility peers. |
| bb+ | Investment Cycle | bbb | Investment cycle position and dividend policy contributing to negative free cash flow. Moderate flexibility in smoothing capex plans. |
| bb | | | |
| bb- | | | |

Financial Flexibility

| | | | |
|------|---|-----|--|
| bbb- | Financial Discipline | bb | Financial policies in place but flexibility in applying them could lead to temporarily exceeding downgrade guidelines. |
| bb+ | Liquidity | bbb | One-year liquidity ratio above 1.25x. Well spread debt maturity schedule but funding may be less diversified. |
| bb | FFO Fixed-Charge Cover | bb | 2.0x |
| bb- | FX Exposure | aa | No material FX mismatch. |
| b+ | PMICR: (CFO - Maintenance Capex)/Interest | bb | 1.1x |

Management and Corporate Governance

| | | | |
|------|------------------------|-----|--|
| a | Management Strategy | a | Coherent strategy and good track record in implementation. |
| a- | Governance Structure | a | Experienced board exercising effective checks and balances. Ownership can be concentrated among several shareholders. |
| bbb+ | Group Structure | bbb | Some group complexity leading to somewhat less transparent accounting statements. No significant related-party transactions. |
| bbb | Financial Transparency | bbb | Good-quality reporting without significant failings. Consistent with the average of listed companies in major exchanges. |
| bbb- | | | |

Regulatory Environment

| | | | |
|------|--|-----|--|
| a+ | Independence, Transparency, Licensing, Ring-Fencing, Concessioning | a | Transparent frameworks with strong track record and multi-year predictable tariffs set by independent regulators; little political risk. |
| a | Cost and Investment Recovery | bbb | Less demanding licensing and ring-fencing provisions; moderate concession renewal risk. |
| a- | | a | Tariff setting with challenge mechanisms that may marginally limit cost and investment recovery, with little regulatory lag. |
| bbb+ | Volume and Price Risk | a | High insulation from price and volume risk, little revenue under-recovery. |
| bbb | | | |

Operations

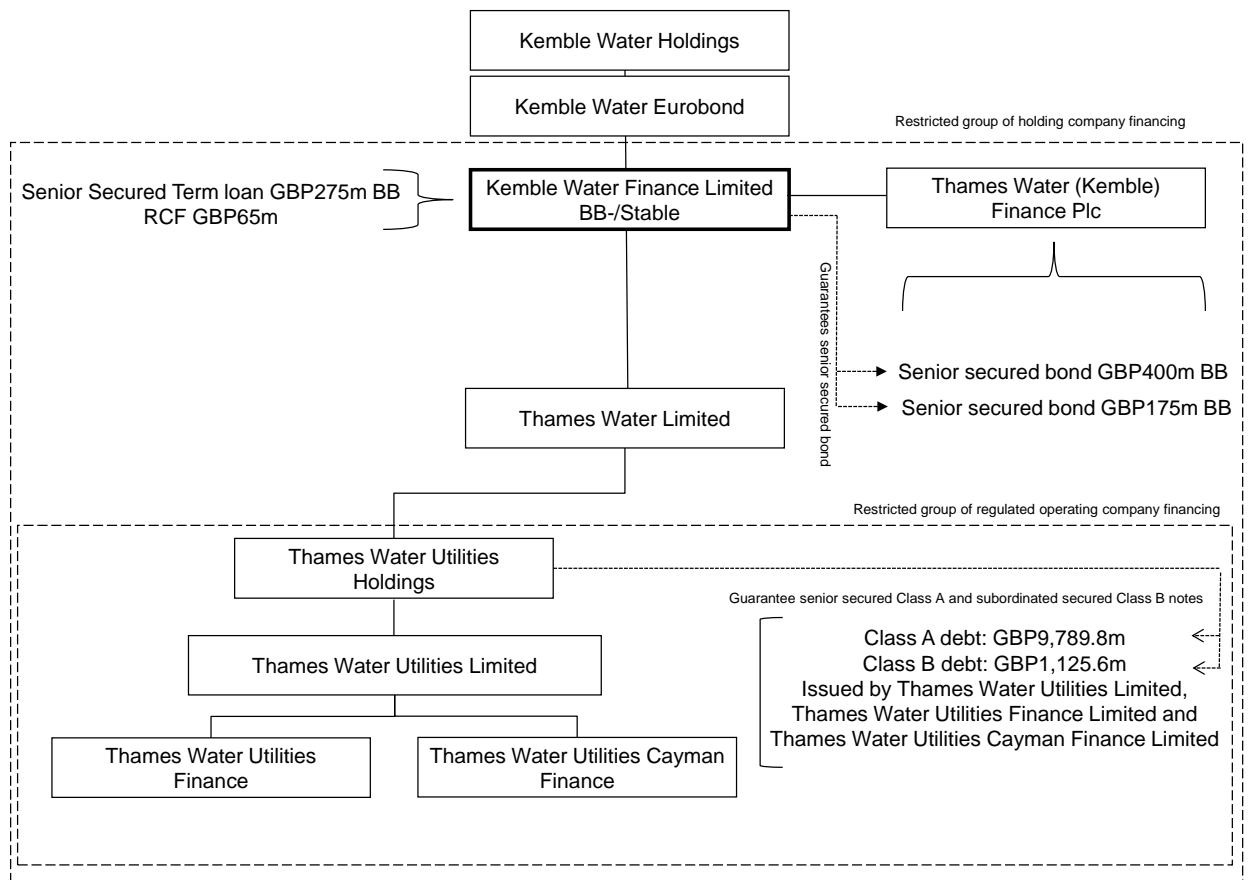
| | | | |
|------|----------------------|-----|---|
| bbb+ | Performance Measures | bb | Underperformance on key measures with financial and/or legal implications. |
| bbb | Counterparty Risk | bbb | Medium counterparty risk; medium collection rates for water suppliers. Some exposure to cyclical industries and/or customers. |
| bbb- | | | |
| bb+ | | | |
| bb | | | |

Financial Structure

| | | | |
|-----|-----------------------------------|-----|--------|
| bb- | Lease-Adjusted FFO Gross Leverage | ccc | >10.0x |
| b+ | Lease-Adjusted FFO Net Leverage | ccc | >9.5x |
| b | Net Debt/Asset Base | b | 90% |
| b- | | | |
| ccc | | | |

How to Read This Page: The left column shows the three-notch band assessment for the overall Factor, illustrated by a bar. The right column breaks down the Factor into Sub-Factors, with a description appropriate for each Sub-Factor and its corresponding category.

Simplified Group Structure Diagram



Source: Fitch and Kemble Investor report FY03/17

Peer Financial Summary

| Company | Date | Rating | Gross Revenue (GBPm) | Operating EBITDAR Margin (%) | FFO Margin (%) | FFO Fixed Charge Coverage (x) | FFO Adjusted Net Leverage (x) |
|------------------------------|------|--------|----------------------|------------------------------|----------------|-------------------------------|-------------------------------|
| Kemble Water Finance Limited | 2017 | BB- | 2,027 | 53.9 | 30.5 | 1.8 | 10.2 |
| | 2016 | BB- | 2,040 | 55.9 | 31.5 | 2.1 | 10.6 |
| | 2015 | BB- | 1,994 | 57.4 | 31.5 | 1.8 | 9.6 |
| Greensands UK Ltd | 2017 | B+ | 810 | 62.6 | 35.7 | 2.4 | 8.3 |
| | 2016 | B+ | 804 | 64.7 | 35.3 | 2.5 | 8.3 |
| | 2015 | B | 826 | 67.2 | 37.5 | 2.6 | 7.7 |
| Kelda Finance (No.2) Limited | 2017 | BB | 1,003 | 55.9 | 32.9 | 2.3 | 8.7 |
| | 2016 | BB | 976 | 56.1 | 29.0 | 2.1 | 9.0 |
| | 2015 | BB | 1,007 | 62.0 | 39.9 | 2.7 | 7.5 |
| Osprey Acquisitions Limited | 2017 | BB | 1,235 | 54.5 | 28.2 | 2.3 | 10.3 |
| | 2016 | BB | 1,194 | 53.0 | 26.2 | 2.1 | 10.7 |
| | 2015 | BB | 1,254 | 58.0 | 31.8 | 2.4 | 9.1 |

Source: Fitch

Reconciliation of Key Financial Metrics

| (GBP Millions, As reported) | 31 Mar 2017 |
|--|---------------|
| Income Statement Summary | |
| Operating EBITDA | 1,077 |
| + Recurring Dividends Paid to Non-controlling Interest | 0 |
| + Recurring Dividends Received from Associates | 0 |
| + Additional Analyst Adjustment for Recurring I/S Minorities and Associates | 0 |
| = Operating EBITDA After Associates and Minorities (k) | 1,077 |
| + Operating Lease Expense Treated as Capitalised (h) | 16 |
| = Operating EBITDAR after Associates and Minorities (j) | 1,093 |
| Debt & Cash Summary | |
| Total Debt with Equity Credit (l) | 11,482 |
| + Lease-Equivalent Debt | 129 |
| + Other Off-Balance-Sheet Debt | 228 |
| = Total Adjusted Debt with Equity Credit (a) | 11,839 |
| Readily Available Cash [Fitch-Defined] | 97 |
| + Readily Available Marketable Securities [Fitch-Defined] | 0 |
| = Readily Available Cash & Equivalents (o) | 97 |
| Total Adjusted Net Debt (b) | 11,742 |
| Cash-Flow Summary | |
| Preferred Dividends (Paid) (f) | 0 |
| Interest Received | 120 |
| + Interest (Paid) (d) | -634 |
| = Net Finance Charge (e) | -514 |
| Funds From Operations [FFO] (c) | 618 |
| + Change in Working Capital [Fitch-Defined] | -29 |
| = Cash Flow from Operations [CFO] (n) | 589 |
| Capital Expenditures (m) | -1,172 |
| Multiple applied to Capitalised Leases | 8.0 |
| Gross Leverage | |
| Total Adjusted Debt / Op. EBITDAR* [x] (a/j) | 10.8 |
| FFO Adjusted Gross Leverage [x] (a/(c-e+h-f)) | 10.3 |
| <i>Total Adjusted Debt/(FFO - Net Finance Charge + Capitalised Leases - Pref. Div. Paid)</i> | |
| Total Debt With Equity Credit / Op. EBITDA* [x] (l/k) | 10.7 |
| Net Leverage | |
| Total Adjusted Net Debt / Op. EBITDAR* [x] (b/j) | 10.7 |
| FFO Adjusted Net Leverage [x] (b/(c-e+h-f)) | 10.2 |
| <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)) | -19.5 |
| Coverage | |
| Op. EBITDAR / (Interest Paid + Lease Expense)* [x] (j/-d+h) | 1.7 |
| Op. EBITDA / Interest Paid* [x] (k/(-d)) | 1.7 |
| FFO Fixed Charge Cover [x] ((c-e+h-f)/(-d+h-f)) | 1.8 |
| <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)) | 1.8 |
| <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 information from company reports. | |

| Reconciliation of Key Financial Metrics for Kemble Water Finance Limited | |
|--|-----------|
| (GBPm) | 31 Mar 17 |
| Interest bearing loans and borrowings | 11,482 |
| - Cash and equivalents | 97 |
| = Net debt | 11,385 |
| + Pension deficit not funded by customers | 228 |
| = Pension adjusted net debt Class A (a) | 11,614 |
| Economic regulatory asset value (b) | 12,975 |
| Net debt/RAV Class A (%) | 89.5 |
| Pension adjusted net debt/regulatory asset value (a/b) x 100 | |
| Operating EBITDA | 1,077 |
| - Regulatory Depreciation | 548 |
| - Taxation paid | 0 |
| - Pensions | 24 |
| Post maintenance cash flow = EBITDA - regulatory depreciation - tax - pensions (c) | 505 |
| Consolidated cash interest (d) | 402 |
| Post maintenance interest cover ratio (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 | - CORP - other | Other Adjustment | Adjusted Values |
|--|---------------------------------|-----------------------------|----------------|------------------|--------------------|
| Income Statement Summary | | | | | |
| Revenue | 2,027 | 0 | | | 2,027 |
| Operating EBITDAR | 1,134 | -41 | -41 | | 1,093 |
| Operating EBITDAR after Associates and Minorities | 1,134 | -41 | -41 | | 1,093 |
| Operating Lease Expense | 16 | 0 | | | 16 |
| Operating EBITDA | 1,118 | -41 | -41 | -0 | 1,077 |
| Operating EBITDA after Associates and Minorities | 1,118 | -41 | -41 | -0 | 1,077 |
| Operating EBIT | 580 | -41 | -41 | | 539 |
| Debt & Cash Summary | | | | | |
| Total Debt With Equity Credit | 14,553 | -3,071 | -3,071 | | 11,482 |
| Total Adjusted Debt With Equity Credit | 14,681 | -2,842 | -2,842 | | 11,839 |
| Lease-Equivalent Debt | 129 | 0 | | | 129 |
| Other Off-Balance Sheet Debt | 0 | 228 | 228 | | 228 |
| Readily Available Cash & Equivalents | 97 | 0 | | | 97 |
| Not Readily Available Cash & Equivalents | 0 | 0 | | | 0 |
| Cash-Flow Summary | | | | | |
| Preferred Dividends (Paid) | 0 | 0 | | | 0 |
| Interest Received | 120 | 0 | | | 120 |
| Interest (Paid) | -558 | -76 | -76 | | -634 |
| Funds From Operations [FFO] | 694 | -76 | -76 | | 618 |
| Change in Working Capital [Fitch-Defined] | -29 | 0 | | | -29 |
| Cash Flow from Operations [CFO] | 665 | -76 | -76 | | 589 |
| Non-Operating/Non-Recurring Cash Flow | 0 | 0 | | | 0 |
| Capital (Expenditures) | -1,248 | 76 | 76 | | -1,172 |
| Common Dividends (Paid) | 0 | 0 | | | 0 |
| Free Cash Flow [FCF] | -583 | 0 | | | -583 |
| Gross Leverage | | | | | |
| Total Adjusted Debt / Op. EBITDAR* [x] | 12.9 | | | | 10.8 |
| FFO Adjusted Leverage [x] | 12.8 | | | | 10.3 |
| Total Debt With Equity Credit / Op. EBITDA* [x] | 13.0 | | | | 10.7 |
| Net Leverage | | | | | |
| Total Adjusted Net Debt / Op. EBITDAR* [x] | 12.9 | | | | 10.7 |
| FFO Adjusted Net Leverage [x] | 12.7 | | | | 10.2 |
| Total Net Debt / (CFO - Capex) [x] | -24.8 | | | | -19.5 |
| Coverage | | | | | |
| Op. EBITDAR / (Interest Paid + Lease Expense)* [x] | 2.0 | | | | 1.7 |
| Op. EBITDA / Interest Paid* [x] | 2.0 | | | | 1.7 |
| FFO Fixed Charge Coverage [x] | 2.0 | | | | 1.8 |
| FFO Interest Coverage [x] | 2.0 | | | | 1.8 |

*EBITDA/R after Dividends to Associates and Minorities

Source: Fitch, Company Reports

Full List of Ratings

| | Rating | Outlook | Last Rating Action |
|--|--------|---------|--------------------------|
| Kemble Water Finance Limited | | | |
| Long-Term IDR | BB- | Stable | Affirmed 31 January 2018 |
| Senior secured rating | BB | | Affirmed 31 January 2018 |
| Thames Water (Kemble) Finance PLC | | | |
| GBP400 million and GBP175 million senior secured bonds | BB | | Affirmed 31 January 2018 |

Related Research & Criteria

| |
|--|
| Corporate Rating Criteria (March 2018) |
| Parent and Subsidiary Rating Linkage (February 2018) |
| Corporates Notching and Recovery Ratings Criteria (March 2018) |

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| |
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