



Investor Report

For the quarter ended 30 September 2016

Important Notice

This report is being distributed in fulfilment of a document, the Common Terms Agreement (CTA), which governs the company's obligations to its bond holders and other financial creditors. It is directed to, and intended for, existing investors in the company. No persons should act or rely on it (except as provided in the CTA). The company makes no representation as to the accuracy of forecast information or any other information in this report (other than as set out in the CTA). These forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forecasts. This unaudited report should not be relied on as a guide to future performance, and should not be relied on in deciding whether to undertake future investment in the company. For the purposes of the financial promotions regime under the Financial Services and Markets Act 2000, this report is given on the basis of the exemption provided in Article 69 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as it relates to bonds which are already admitted to trading on a relevant market).

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General overview and business update

This quarterly Investor Report covers the six month period ending 30 September 2016. The Investor Report has been prepared to comply with the specific requirements of the Common Terms Agreement (CTA) which governs the company's obligations to its bondholders and other financial creditors.

The financial information in this report is drawn from the company's accounting records, applying the accounting policies as per the company's statutory accounts, but is presented in a modified form for investors as required by the CTA.

Business performance including key performance indicators for operations and customer service are reported in the company's annual report and accounts. These are available on the company's website (www.dwrcymru.com).

Financial performance (unaudited)

Summary financial results for the six months ended 30 September are as follows:

	6 months to 30 September 2016 £m	6 months to 30 September 2015 £m	Change
Revenue	375	368	+2%
Operating costs	(152)	(142)	+7%
Exceptional items (rates refund)	-	20	
EBITDA (before IRE)	223	246	-9%
Net interest (excluding indexation)	(51)	(49)	
Capital expenditure (before grants and contributions)	(161)	(123)	

General overview and business update (continued)

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the six months to 30 September 2016 is £23 million lower than the comparative period last year – excluding the business rates rebate of £20 million in 2015, the £7 million increase in revenue in the current period largely offsets a £10 million increase in operating costs.

Revenue in the six months to 30 September 2016 was £375 million, as compared to £368 million in the six months to 30 September 2015.

Operating costs (excluding depreciation, infrastructure renewals expenditure and exceptional items) of £152 million (2015: £142 million) are higher in comparison with the same period last year; increases in salaries, IT, power, operational contractor costs and investment in our Customer-Led Success and Brand Builder campaigns have been partially offset by a reduction in the bad debt charge and other ongoing efficiencies.

Net interest payable in the period (excluding fair value movements) was £56 million (2015: £48 million) including an indexation charge on index-linked debt of £5m (2015: credit of £1m). £1 million interest was received last year on the backdated £20 million rates refund.

The regulatory gearing (the ratio of net debt to regulatory capital value) of the company was as follows:

£m	30 September 2016	30 September 2015
Net debt	2,855	2,824
Regulatory capital value	5,094	4,916
'Financial reserves'	2,239	2,092
Regulatory gearing	56.0%	57.4%

On Glas Cymru's acquisition of Welsh Water in May 2001, gearing stood at 93%. Since then the financial position of the group has improved steadily, such that gearing has fallen to 56% as at 30 September 2016 and 'financial reserves' (RCV less net debt) have risen to over £2.2 billion.

General overview and business update (continued)

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £161 million (2015: £123 million). Of that £161 million, £99 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £127 million is classed as capital maintenance.

Prospective financial ratio tests

As required by the CTA to demonstrate compliance with prospective financial ratio tests (regulatory asset ratio and interest cover ratios), this report includes projected ratios for the five years to 31 March 2020. These projected ratios are derived from Glas Cymru's 2016 financial plan (which has been prepared by the company) and are in the format specified by the CTA. On this basis, the prospective financial ratios are better than the "trigger" and "default" levels as defined in the CTA (see pages 9 and 10). It should be noted that the company's business plan and the projected ratios have not been reviewed by the company's auditors and the reader's attention is drawn to the important notice at the front of this document.

Credit ratings

The strong credit quality of the business is reflected in credit ratings which remain the highest in the UK utility sector. The ratings of the company's bonds are shown in the table below.

Bond Class	Moody's	S&P	Fitch
A*	A3 (+ve)	A	A
B	A3 (+ve)	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA (CCC/Ba2/-), revert to their higher underlying ratings of A3/A/A by Moody's Investor Service (Moody's), Standard & Poor's (S&P) and Fitch Ratings (Fitch) respectively.

The Moody's A3 rating has been placed on positive outlook since 27 February 2015. On 15 September 2016, both Fitch and Standard and Poor reaffirmed the credit rating of the company's bonds as A with stable outlook.

Financing and liquidity

As at 30 September 2016, undrawn credit facilities and cash (excluding the debt service payments account deposits of £37 million) amounted to £345 million. This includes undrawn KfW and revolving credit facilities of £210 million and is sufficient to fund the business for the next 3 years. In addition, the Company has received confirmation from the European Investment Bank that a further £250 million of funding for capital projects in the five years to 31 March 2020 is unaffected by the EU Referendum vote.

In line with prudent policies approved by the board, cash is invested in AAA-rated liquidity funds and bonds, the Royal Bank of Scotland (as the group's account bank) and additional banks subject to minimum short-term rating criteria of A1/P1/F1.

General overview and business update (continued)

Gearing and distribution policy

The Board has approved a regulatory gearing policy (being the ratio of net debt to regulatory capital value) of around 60%. In July 2016 the Company issued a consultation to customers on the future distributions during the period to 31 March 2020. This consultation will be taken into account when the Board determines future distributions. Further details of the consultation are available on the Company's website www.dwrcymru.com

Consolidated cash flow (unaudited)

	3 months ended 30 September 2016 £m	6 months ended 30 September 2016 £m	6 months ended 30 September 2015 £m
Revenue	186.3	374.6	367.8
Less: operating expenses	(75.1)	(151.8)	(122.2)
Earnings before interest, taxation, depreciation and amortisation	111.2	222.8	245.6
Working capital movements	(26.0)	(13.2)	21.1
Non bond-related interest paid	(0.5)	(1.0)	(1.0)
Interest capitalised in accordance with IAS 23	(3.0)	(3.8)	(2.1)
Interest received	1.0	2.1	3.8
Net operating cash flow and interest received	82.7	206.9	267.4
New borrowings			
European Investment Bank	-	70.0	-
Utilisation of reserves:			
Cash transferred to capex reserve	(2.2)	(75.9)	(6.3)
Cash utilised from capex reserve	19.1	51.7	57.6
Net cash utilised from other reserves	0.8	2.5	3.7
Capital expenditure:			
Infrastructure renewals expenditure	(22.8)	(39.3)	(31.7)
Non-infrastructure maintenance	(30.3)	(55.7)	(57.2)
Capital expenditure	(24.9)	(54.4)	(32.6)
Net cash flow after capital expenditure, new borrowings and reserve drawings	22.4	105.8	200.9
Transfer to debt service payments account	(21.1)	(60.1)	(108.7)
Principal repayments	(2.3)	(12.1)	(39.6)
Net cash flow after debt service	(1.0)	33.6	52.6
Free cash balances brought forward	73.9	39.3	(6.7)
Free cash balances carried forward	72.9	72.9	45.9

Consolidated debt service payments (unaudited)

	Payments due and made in 3 months ended 30 September 2016 £m	Amount accrued 30 September 2016 £m
Liquidity facility:		
Liquidity facility commitment fee	0.1	0.1
Interest on senior debt:		
Finance lease interest payments	-	50.2
A1 interest payments	-	10.5
A4 interest payments	7.0	-
A5 interest payments	2.2	-
A6 interest payments	-	0.7
B1 interest payments	-	11.2
B3 interest payments	4.2	-
B4 interest payments	2.5	-
B5 interest payments	0.5	-
B6 interest payments	2.9	-
European Investment Bank loan interest payments	0.2	0.9
Release of insurance fund	8.5	-
MBIA wrapping fee	-	(2.2)
Miscellaneous fees	0.3	0.1
	28.4	71.5
Interest rate swaps	3.4	-
	31.8	71.5
Total debt service payments	31.8	71.5

Glas notes principal balance reconciliation (unaudited)

	Credit rating ¹	Opening balance 1 July 2016 £m	New Issues £m	Repayment £m	Indexation £m	Closing balance 30 September 2016 £m
Finance leases		455.8	-	-	-	455.8
Class A bonds²						
A1 notes	A3/A/A	350.0	-	-	-	350.0
A4 notes		399.3	-	-	0.1	399.4
A5 notes		128.9	-	-	(0.9)	128.0
A6 notes ³		132.7	-	-	-	132.7
Class B bonds						
B1 notes	A3/A/A	325.0	-	-	-	325.0
B3 notes		193.7	-	-	0.2	193.9
B4 notes		113.8	-	-	(0.9)	112.9
B5 notes		66.3	-	-	0.1	66.4
B6 notes		310.7	-	-	3.6	314.3
European Investment Bank loan		467.7	-	(2.3)	1.8	467.2
Local authority loans		0.7	-	-	-	0.7
		2,944.6	-	(2.3)	4.0	2,946.3

¹ Moody's/S&P/Fitch.

² Guaranteed by MBIA rated Ba2/CCC/-. Class A bond ratings default to their higher underlying ratings of A3/A/A.

³ The class A6 notes (£100m) were issued at a fixed rate of 4.473% and swapped to an effective index-linked rate of 1.35%; cumulative indexation of £32.7m has been recognised in this table.

Glas bank account movements (unaudited)

	Opening balance 1 July 2016 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 30 September 2016 £m
Free cash balances:					
Receipts account	16.8	-	161.2	(119.1)	58.9
Payments account	49.5	-	351.7	(393.1)	8.1
Other bank accounts	7.6	1.0	178.9	(181.6)	5.9
	73.9	1.0	691.8	(693.8)	72.9
Debt service payments account:					
Debt service ledger	39.2	-	21.1	(23.3)	37.0
Insurance proceeds ledger	8.5	-	-	(8.5)	-
	47.7	-	21.1	(31.8)	37.0
Capex reserve account	76.6	-	2.2	(19.1)	59.7
Customer payments account:					
Customer rebate ledger	3.3	-	-	(0.8)	2.5
	201.5	1.0	715.1	(745.5)	172.1

Interest cover ratio (ICR) – 5 years to 31 March 2020 (unaudited)

	Actual		Projection		
	Year to 31 March 2016	Year to 31 March 2017	Year to 31 March 2018	Year to 31 March 2019	Year to 31 March 2020
	£m	£m	£m	£m	£m
(See important notice at the front of the document)					
Income	750	755	764	775	789
Operating expenditure	(277)	(316)	(310)	(312)	(314)
Pre capital maintenance cash flows	473	439	454	463	475
Capital maintenance expenditure ¹	(149)	(152)	(156)	(160)	(164)
Post capital maintenance cash flows	324	287	298	303	311
Net interest (excluding indexation and capitalisation)	(113)	(117)	(123)	(126)	(127)
Capital expenditure ¹	(113)	(201)	(197)	(221)	(201)
Increase in 'customer reserves' ²	(7) ³	(174)	(50)	(29)	(95)
Pre-financing cash flows	91	(205)	(72)	(73)	(112)
Interest payable on senior debt:					
Finance leases	6	9	10	12	12
Class A	44	42	42	42	43
Class B	42	42	43	44	44
MBIA financial guarantee fees	4	5	5	5	5
Interest rate and RPI swaps	17	17	16	15	14
Authorised loans	6	7	12	15	15
Less interest receivable	(6)	(5)	(5)	(7)	(6)
Total interest payable	113	117	123	126	127
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	4.2	3.8	3.7	3.7	3.7
Interest cover post capital maintenance (trigger 1.0)	2.9	2.5	2.4	2.4	2.4

¹ The projected split between capital and maintenance expenditure assumes a steady level of maintenance activity from 2016 onwards.

² Projected values are forecast 'headroom' in the 2016 financial plan to balance gearing to the Glas Board's target of around 60% (see page 10). It represents amounts that may be returned to customers or used to fund additional investment for the benefit of customers.

³ This figure is the total value of revenue foregone in order to fund social tariffs in the year.

Regulatory asset ratio (RAR) – 5 years to 31 March 2020 (unaudited)

(See important notice at the front of the document)	Actual		Projection		
	As at 31 March 2016 £m	As at 31 March 2017 £m	As at 31 March 2018 £m	As at 31 March 2019 £m	As at 31 March 2020 £m
Senior gross debt:					
Finance leases	456	463	454	443	431
Class A	1,012	1,012	1,022	1,033	1,045
Class B	1,008	1,033	1,053	1,075	1,099
Net interest accrual on senior debt	55	50	51	51	51
Authorised loans (including assumed borrowings to balance gearing to 60%; see page 10)	407	633	732	832	974
Total senior gross debt	2,938	3,191	3,312	3,434	3,600
Less: cash balances and authorised investments	(92)	(100)	(100)	(100)	(100)
Total net debt	2,846	3,091	3,212	3,334	3,500
Regulatory capital value (RCV)	4,983	5,151	5,354	5,556	5,833
Reserves (RCV less total net debt)	2,137	2,060	2,142	2,222	2,333
Regulatory asset ratio:					
RAR (trigger 90%; default 95%)	57%	60%	60%	60%	60%

For the purpose of calculating regulatory gearing, cumulative indexation of £33m relating to the Class A6 notes (£100m) is included above; these were issued at a fixed rate of 4.473% and swapped to an effective index-linked rate of 1.35%.

Income statement (unaudited)

	3 months ended 30 September 2016 £m	6 months ended 30 September 2016 £m	6 months ended 30 September 2015 £m
Revenue	186.3	374.6	367.8
Operating expenditure	(75.1)	(151.8)	(122.2)
EBITDA	111.2	222.8	245.6
Infrastructure renewals expenditure	(24.0)	(40.1)	(30.7)
Depreciation	(65.1)	(125.6)	(122.0)
Operating profit	22.1	57.1	92.9
Interest payable	(25.7)	(52.6)	(53.0)
Indexation of index-linked debt	(4.0)	(5.5)	1.0
Interest receivable	1.0	2.1	3.9
Fair value (losses)/gains on financial instruments	(78.0)	(128.3)	86.0
(Loss)/profit before tax	(84.6)	(127.2)	130.8
Taxation	34.1	34.1	(26.2)
(Loss)/profit after tax	(50.5)	(93.1)	104.6

Statement of comprehensive income (unaudited)

	3 months ended 30 September 2016 £m	6 months ended 30 September 2016 £m	6 months ended 30 September 2015 £m
Profit for the period	(50.5)	(93.1)	104.6
Actuarial loss in the pension scheme	(88.4)	(88.4)	(19.0)
Movement on related deferred tax asset	14.4	14.4	3.7
Items that will not be reclassified to the profit or loss:			
Revaluation of property, plant and equipment	113.6	113.6	1,152.0
Related deferred tax	(6.8)	(6.8)	(230.4)
Total comprehensive (expense)/income	(17.7)	(60.3)	1,010.9

Statement of changes in reserves (unaudited)

	3 months ended 30 September 2016 £m	6 months ended 30 September 2016 £m	6 months ended 30 September 2015 £m
Reserves/(deficit) at start of period	1,039.2	1,081.8	(6.4)
Revaluation (net of tax)	106.8	106.8	921.6
(Loss)/profit for the period	(50.5)	(93.1)	104.6
Actuarial loss (net)	(74.0)	(74.0)	(15.3)
Reserves at end of period	1,021.5	1,021.5	1,004.5

Balance sheet (unaudited)

	At 30 September 2016		At 31 March 2016	
	£m	£m	£m	£m
Fixed assets		5,078.2		4,947.0
Current assets and liabilities:				
Debtors and prepayments	380.7		552.8	
Creditors and accruals	(524.3)		(688.3)	
		(143.6)		(135.5)
Total assets less current liabilities		4,934.6		4,811.5
Financing liabilities:				
Bonds	(2,022.6)		(2,020.0)	
Finance leases	(455.8)		(455.8)	
Bank loans (EIB, KfW)	(467.2)		(406.4)	
Other	(0.7)		(0.7)	
	(2,946.3)		(2,882.9)	
Net interest accrual	(80.6)		(54.8)	
	(3,026.9)		(2,937.7)	
Cash and cash equivalents:				
Receipts account	58.9		62.9	
Payments account	8.1		(31.0)	
Capex reserve account	59.7		35.5	
Debt service payments account	37.0		12.5	
Customer payments account	2.5		5.0	
Other bank accounts	5.9		7.4	
	172.1		92.3	
Net debt		(2,854.8)		(2,845.4)
Derivative financial instruments		(509.6)		(381.4)
Provisions for liabilities and charges		(158.5)		(71.0)
Net assets before deferred tax		1,411.7		1,513.7
Deferred tax		(390.2)		(431.9)
Net assets		1,021.5		1,081.8

Compliance certificate

To: Deutsche Trustee Company Limited

4 November 2016

Dear Sirs

Common Terms Agreement dated 10 May 2001 between Dŵr Cymru Cyfyngedig, ("DCC") and the Deutsche Trustee Company Limited (the "DCC Security Trustee" and the "Issuer Security Trustee") ("the Common Terms Agreement")

Capitalised terms not defined in this certificate have the meaning given to them in the Common Terms Agreement.

We refer to the Common Terms Agreement and pursuant to Paragraph 1.5 of Schedule 3 of that Agreement hereby confirm that as of today's date, DCC is in compliance with the RAR, the Historical RAR, the Historical Senior RAR, the Projected RAR, the Projected Senior RAR and the Historical ICR, the Historical Senior ICR and the Projected Senior ICR (together the "**Ratios**").

The calculations of the ratios are set out on pages 9 to 10 of the Investor Report issued on today's date.

We also confirm that in the period to 30 September 2016:

- (a) no DCC Potential Event of Default, DCC Event of Default, Potential Trigger event or Trigger Event has occurred; and
- (b) DCC's insurances are being maintained in accordance with:
 - (i) Paragraph 4.2.1 of Schedule 3 of the Common Terms Agreement; and
 - (ii) the provisions of each DCC Finance Lease

Yours faithfully

for and on behalf of Dŵr Cymru Cyfyngedig

C A Jones
Director

P J Bridgewater
Director