



Dŵr Cymru
Welsh Water

Investor Report

For the quarter ended 30 June 2017

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General overview and business update

This quarterly Investor Report covers the three-month period ended 30 June 2017. 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 three months ended 30 June are as follows:

	3 months to 30 June 2017 £m	3 months to 30 June 2016 £m	Change
Revenue	190	188	+1%
Operating costs	(77)	(77)	-
EBITDA (before IRE)	113	111	+2%
Net interest (excluding indexation)	(24)	(26)	
Capital expenditure (before grants and contributions)	(91)	(74)	

General overview and business update (continued)

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the three months to 30 June 2017 is £2 million higher than the comparative period last year.

Revenue in the three months to 30 June 2017 was £190 million, as compared to £188 million in the three months to 30 June 2016.

Operating costs (excluding depreciation, infrastructure renewals expenditure and exceptional items) of £77 million (2016: £77 million) are in line with the same period last year.

Net interest payable in the period (excluding fair value movements) was £34 million (2016: £27 million) and included an indexation charge on index-linked debt of £10 million (2016: £1 million). On a cash basis, excluding indexation, net interest payable was £24 million (2016: £26 million).

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

£m	30 June 2017	30 June 2016
Net debt	2,965	2,817
Regulatory capital value	5,294	4,983
'Financial reserves'	2,329	2,166
Regulatory gearing	56.0%	56.5%

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 June 2017 and 'financial reserves' (RCV less net debt) have risen to £2.3 billion.

General overview and business update (continued)

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £91 million (2016: £74 million). Of that £91 million, £49 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £65 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 three years to 31 March 2020. These projected ratios are derived from Glas Cymru's 2017 financial plan 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*	A2	A	A
B	A2	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by Assured Guaranty Ltd (A/Baa2/-), 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.

On 22 November 2016 Moody's upgraded Welsh Water's rating from A3 (pos) to A2, reflecting their assessment of the company's latest operational and financial results and forecasts, in particular the Board's target to maintain gearing at around 60%. On 14 July 2017, Standard and Poor's annual credit update reaffirmed the credit rating of the company's bonds as A with stable outlook.

Financing and liquidity

As at 30 June 2017, undrawn credit facilities and cash (excluding the debt service payments account deposits of £24 million) amounted to £506 million. This includes undrawn European Investment Bank loans and revolving credit facilities totalling £400 million.

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 company'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 March 2017 the Company issued a consultation to customers on 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 June 2017	3 months ended 30 June 2016
	£m	£m
Revenue	189.8	188.3
Less: operating expenses	(77.0)	(76.7)
Earnings before interest, taxation, depreciation and amortisation	112.8	111.6
Working capital movements	(7.8)	12.8
Non bond-related interest paid	(0.7)	(0.5)
Interest capitalised in accordance with IAS 23	(3.2)	(0.8)
Interest received	1.0	1.1
Net operating cash flow and interest received	102.1	124.2
New borrowings		
European Investment Bank/ KfW IPEX-Bank	60.0	70.0
Utilisation of reserves:		
Cash transferred to capex reserve	(42.1)	(73.7)
Cash utilised from capex reserve	41.5	32.6
Net cash utilised from other reserves	16.4	1.7
Capital expenditure:		
Net profit on disposal of assets	0.4	-
Infrastructure renewals expenditure	(24.2)	(16.5)
Non-infrastructure maintenance	(31.3)	(25.4)
Capital expenditure	(40.5)	(29.5)
Net cash flow after capital expenditure, new borrowings and reserve drawings	82.3	83.4
Transfer to debt service payments account	(27.8)	(39.0)
Principal repayments	(9.8)	(9.8)
Net cash flow after debt service	44.7	34.6
Free cash balances brought forward	58.7	39.3
Free cash balances carried forward	103.4	73.9

Consolidated debt service payments (unaudited)

	Payments due and made in 3 months ended 30 June 2017 £m	Amount accrued 30 June 2017 £m
Liquidity facility:		
Liquidity facility commitment fee	0.2	0.1
Liquidity facility renewal and agency fee	0.2	-
Interest on senior debt:		
Finance lease interest payments	-	50.2
A1 interest payments	-	5.4
A4 interest payments	-	3.7
A5 interest payments	-	1.2
A6 interest payments	-	0.3
B1 interest payments	-	5.7
B3 interest payments	-	2.2
B4 interest payments	-	1.3
B5 interest payments	-	0.2
B6 interest payments	-	1.5
European Investment Bank loan interest payments	1.0	0.3
KfW IPEX-Bank GmbH loan interest payments	0.1	-
Miscellaneous fees	0.1	0.1
	1.6	72.2
Interest rate swaps	2.6	-
Total debt service payments	4.2	72.2

Dŵr Cymru notes principal balance reconciliation (unaudited)

Credit rating ¹	Opening balance 1 April 2017 £m	New Issues £m	Repayment	Indexation £m	Closing balance 30 June 2017 £m
Finance leases	446.5	-	-	-	446.5
Class A bonds²					
A1 notes	A2/A/A	350.0	-	-	350.0
A4 notes		406.5	-	1.6	408.1
A5 notes		132.2	-	(0.5)	131.7
A6 notes ³		135.1	-	1.1	136.2
Class B bonds					
B1 notes	A2/A/A	325.0	-	-	325.0
B3 notes		197.4	-	0.8	198.2
B4 notes		116.6	-	(0.4)	116.2
B5 notes		67.5	-	0.3	67.8
B6 notes		316.9	-	3.5	320.4
European Investment Bank loans		461.7	60.0	(9.8)	515.1
Local authority loans		0.6	-	-	0.6
		2,956.0	60.0	(9.8)	3,015.8

¹ Moody's/S&P/Fitch.

² Guaranteed by Assured Guaranty Ltd rated A/Baa2/-. Class A bond ratings default to their higher underlying ratings of A2/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 £36.2 has been recognised in this table.

Dŵr Cymru bank account movements (unaudited)

	Opening balance 1 April 2017 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 30 June 2017 £m
Free cash balances:					
Receipts account	71.4	-	198.1	(210.5)	59.0
Payments account	(12.8)	-	535.7	(478.6)	44.3
Other bank accounts	0.1	1.0	275.4	(276.4)	0.1
	<u>58.7</u>	<u>1.0</u>	<u>1,009.2</u>	<u>(965.5)</u>	<u>103.4</u>
Debt service payments account:					
Debt service ledger	-	-	27.8	(4.2)	23.6
Capex reserve account					
	(0.6)	-	42.1	(41.5)	-
Customer payments account:					
Customer rebate ledger	4.0	-	15.4	(16.4)	3.0
	<u>62.1</u>	<u>1.0</u>	<u>1,094.5</u>	<u>(1,027.6)</u>	<u>130.0</u>

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

	Actual			Projection	
	Year to 31 March 2016 £m	Year to 31 March 2017 £m	Year to 31 March 2018 £m	Year to 31 March 2019 £m	Year to 31 March 2020 £m
(See important notice at the front of the document)					
Income	750	747	759	785	806
Operating expenditure	(277)	(313)	(325)	(324)	(319)
Pre capital maintenance cash flows	473	434	434	461	487
Capital maintenance expenditure ¹	(149)	(161)	(182)	(182)	(182)
Post capital maintenance cash flows	324	273	252	279	305
Net interest (excluding indexation and capitalisation)	(113)	(120)	(131)	(143)	(144)
Capital expenditure ¹	(107)	(156)	(159)	(239)	(171)
Increase in 'customer reserves' ²	(13) ³	(36) ³	(80)	(96)	(87)
Pre-financing cash flows	91	(39)	(118)	(199)	(97)
Interest payable on senior debt:					
Finance leases	6	3	10	12	12
Class A	44	44	42	42	43
Class B	42	42	43	44	44
Assured Guaranty Ltd financial guarantee fees	4	4	5	5	5
Interest rate and RPI swaps	17	23	24	22	18
Authorised loans	6	8	10	21	26
Less interest receivable	(6)	(4)	(3)	(3)	(4)
Total interest payable	113	120	131	143	144
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	4.2	3.6	3.3	3.2	3.4
Interest cover post capital maintenance (trigger 1.0)	2.9	2.1	1.9	2.0	2.1

¹ The projected split between capital and maintenance expenditure assumes a steady level of maintenance activity from 2017 onwards.

² Projected values are forecast 'headroom' in the 2017 financial plan to balance gearing to the 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 and, in 2017, the value of discretionary expenditure for the benefit of customers.

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

	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
(See important notice at the front of the document)					
Senior gross debt:					
Finance leases	456	446	405	394	382
Class A	1,012	1,024	1,034	1,051	1,068
Class B	1,008	1,023	1,042	1,059	1,076
Net interest accrual on senior debt	55	57	59	60	61
Authorised loans (including assumed borrowings to balance gearing to around 60%)	407	462	685	885	1,012
Total senior gross debt	2,938	3,012	3,225	3,449	3,599
Less: cash balances and authorised investments	(92)	(65)	(100)	(100)	(100)
Total net debt	2,846	2,947	3,125	3,349	3,499
Regulatory capital value (RCV)	4,983	5,217	5,352	5,554	5,758
Shadow RCV	4,950	5,184	5,368	5,629	5,881
Customer Reserves (Shadow RCV less total net debt)	2,104	2,237	2,243	2,280	2,382
Regulatory asset ratio (trigger 85%; default 95%)					
RAR	57.1%	56.4%	58.4%	60.3%	60.8%
Shadow RAR	57.5%	56.8%	58.2%	59.5%	59.5%

For planning purposes, and for considering the level of headroom available for Customer Distributions, we have used a "Shadow RCV". This is the RCV reported above as published by Ofwat in FD14 and uplifted by our inflation assumptions, adjusted for other factors we consider are likely to impact on the RCV during the period.

For the purpose of calculating regulatory gearing, cumulative indexation 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 June 2017 £m	3 months ended 30 June 2016 £m
Revenue	189.8	188.3
Operating expenditure	(77.0)	(76.7)
EBITDA	112.8	111.6
Profit on disposal of fixed assets	0.4	-
Infrastructure renewals expenditure	(21.9)	(16.1)
Depreciation	(67.3)	(60.5)
Operating profit	24.0	35.0
Interest payable	(25.3)	(26.9)
Indexation of index-linked debt	(9.6)	(1.5)
Interest receivable	1.0	1.1
Fair value gains/(losses) on financial instruments	17.8	(30.4)
Profit/(loss) before tax	7.9	(22.7)
Taxation	-	-
Profit/(loss) after tax	7.9	(22.7)

Statement of comprehensive income (unaudited)

	3 months ended 30 June 2017 £m	3 months ended 30 June 2016 £m
Profit/(loss) for the period	7.9	(22.7)
Actuarial loss in the pension scheme	-	-
Movement on related deferred tax asset	-	-
Items that will not be reclassified to the profit or loss:		
Revaluation of property, plant and equipment	-	-
Related deferred tax	-	-
Total comprehensive income/(expense)	7.9	(22.7)

Statement of changes in reserves (unaudited)

	3 months ended 30 June 2017 £m	3 months ended 30 June 2016 £m
Reserves at start of period	1,212.3	1,181.9
Revaluation (net of tax)	-	-
Profit/(loss) for the period	7.9	(22.7)
Actuarial loss (net)	-	-
Reserves at end of period	1,220.2	1,159.2

Balance sheet (unaudited)

	At 30 June 2017		At 31 March 2017	
	£m	£m	£m	£m
Fixed assets		5,184.4		5,184.7
Current assets and liabilities:				
Debtors and prepayments	477.3		570.2	
Creditors and accruals	(667.8)		(763.8)	
		<u>(190.5)</u>		<u>(193.6)</u>
Total assets less current liabilities		4,993.9		4,991.1
Financing liabilities:				
Bonds	(2,053.6)		(2,047.2)	
Finance leases	(446.5)		(446.5)	
Bank loans (EIB, KfW)	(515.1)		(461.7)	
Other	(0.6)		(0.6)	
		<u>(3,015.8)</u>		<u>(2,956.0)</u>
Net interest accrual	(78.8)		(55.7)	
		<u>(3,094.6)</u>		<u>(3,011.7)</u>
Cash and cash equivalents:				
Receipts account	59.0		71.4	
Payments account	44.3		(12.8)	
Capex reserve account	-		(0.6)	
Debt service payments account	23.6		-	
Customer payments account	3.0		4.0	
Other bank accounts	0.1		0.1	
		<u>130.0</u>		<u>62.1</u>
Net debt		(2,964.6)		(2,949.6)
Derivative financial instruments		(300.8)		(318.6)
Provisions for liabilities and charges		(104.8)		(107.1)
Net assets before deferred tax		1,623.7		1,615.8
Deferred tax		(403.5)		(403.5)
Net assets		1,220.2		1,212.3