Investor Report

For the quarter ended 30 June 2020

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References to the "Company", "Dŵr Cymru" and "Welsh Water" in this document relate to Dŵr Cymru Cyfyngedig, the sole operating company in the whole business securitisation formed by the Glas Cymru Anghyfyngedig group. References to "Glas Cymru" and the "Group" refer, respectively, to Glas Cymru Anghyfyngedig and the group of which it is the parent.

Contents

General overview and business update

This quarterly Investor Report covers the three-month period ended 30 June 2020. 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 is 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 2020 £m	**3 months to 30 June 2019 £m**	**Change %**
Turnover	185	193	(4%)
Operating costs	(76)	(78)	(3%)
Atypical items	(7)	-	
EBITDA (before infrastructure renewals expenditure)	**102**	**115**	**(11%)**
Net interest (excluding indexation)	(29)	(26)	
Capital expenditure (before grants and contributions)	(92)	(115)	

Operating profit before interest, tax, depreciation, amortisation and infrastructure renewals expenditure (EBITDA) for the three months to 30 June 2020 was £13 million lower than the comparative period last year.

Revenue in the three months to 30 June 2020 was £8 million lower than last year principally as a result of reduced overall water usage during the country's lockdown due to COVID-19.

Operating costs (excluding depreciation, amortisation, infrastructure renewals expenditure and atypical items) of £76 million were £2 million lower than the same period last year reflecting a contraction of retail activities and the temporary closure of our visitor centres, both due to COVID-19.

Financial performance (unaudited) (continued)

Atypical items totalling £7 million relate mainly to COVID-19 (principally personal protective equipment and deep cleaning) with the remainder reflecting ongoing remedial work in the wake of Storm Dennis.

Net interest payable in the period (excluding fair value movements) was £37 million (2019: £32 million) including an indexation charge on index-linked debt of £8 million (2019: £6 million).

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

£m	**30 June 2020**	**30 June 2019**
Net debt	3,591	3,374
Regulatory capital value	5,906	5,777
'Financial reserves'	**2,315**	**2,403**
Regulatory gearing	60.8%	58.4%

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 is 61% and 'financial reserves' (RCV less net debt) are £2.3 billion as at 30 June 2020. An increase in gearing by 1.6% during the 12 months to 30 June 2020 is the result of atypical costs, discretionary capital investment and a low level of RPI inflation (1%) on the regulatory capital value.

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contributions was £92 million during the three months (2019: £115 million), £23 million lower than last year reflecting the start of the new five-year "AMP7" capital programme (the planning and delivery cycle is such that investment tends to be at its lowest in the first year and to peak in the year five).

General overview and business update (continued)

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 to 31 March 2025. These projected ratios are derived from Glas Cymru's 2020 financial plan[1] (which has been prepared by the Group) 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 11 and 12). It should be noted that the Group's business plan and the projected ratios have not been reviewed by the company's auditor and the reader's attention is drawn to the important notice at the front of this document.

Impact of Covid-19 pandemic on projected ratios

As noted in the Investor Report for the quarter ended 31 March 2020, the biggest factor currently impacting on our financial forecasts is the coronavirus pandemic : our assessment of this remains materially unchanged from that report. As part of the UK Government's ongoing assessment of the situation, the Office for Budget Responsibility (OBR) published a coronavirus analysis and reference scenario on 14 April 2020 (updated 14 July), its central scenario predicting a large but broadly temporary shock to the economy and public finances. Public borrowings and unemployment are expected to rise throughout 2020 with a gradual return close to pre-Covid-19 budgeted levels by 2022. The OBR scenario assumed a three-month lockdown and a further three months with partial lifting of restrictions, however the impact will depend upon the timing of further measures, with localised restrictions currently being used to curb the spread of the virus in identified "hot spots".

On May 7 2020 the Bank of England (BoE) published its Monetary Policy Report and Interim Financial Stability Report assessing the UK economy and financial system's resilience to the impact of Covid-19. The BoE, like the OBR, recognises the reduction in jobs and income caused by Covid-19 and has responded by keeping interest rates low to support households and businesses, and by helping banks to expand lending.

Our own Covid-19 impact modelling has been informed by these reports as well as by a more focused exercise commissioned by Water UK, specific to the water industry in England and Wales, which envisages two key scenarios:

1) Shortened peak: following an initial peak in April 2020, successful implementation of non-pharmaceutical interventions (NPIs) including testing, contact tracing, quarantine of cases and social distancing dampen the spread until a vaccine is available in 12 to 18 months' time. Antibody testing may enable a proportion of the population with immunity to return to the workforce. In this scenario, the estimated impact on the economy is a 4% drop in 2020/21 GDP, with unemployment peaking at 7% during 2020/21 and a period of some 18 months for the economy to recover.

2) Longer peak: weaker adoption of NPIs leads to a more prolonged peak in cases over summer 2020 (May to June). Variability in the success of the implementation of NPIs leads to ongoing but smaller peaks in the disease until the development of a vaccine in 12 to 18 months' time. In this scenario, the estimated impact on the economy is an 8% drop in 2020/21 GDP, with unemployment peaking at 8% during 2020/21 and a period of some two and half years for the economy to recover.

[1] The financial plan was prepared in February 2020 and does not reflect any estimate of the financial impact of the coronavirus epidemic.

Prospective financial ratio tests (continued)

Impact of Covid-19 pandemic on projected ratios (continued)

The biggest risks to revenues are in 2020/21: a decrease in non-household demand during lockdown and subsequent ongoing social distancing restrictions could have an adverse revenue impact of between £9 million (5% of non-household revenues) and £14 million (8%). However, this would be offset by increases in household revenues of £7 million to £10 million and the net impact on revenues would be relatively small. The most difficult risk to quantify is the impact of business failures i.e. those organisations which may not restart after lockdown is lifted. We have assumed a wide range of between 4,000 businesses (10% of closed businesses) and 18,000 (45%). This could result in a revenue loss of between £5 million and £17 million.

We expect to incur cash costs of around £5 million (predominantly PPE) during 2020/21, and have assumed that there will be some ongoing costs in future years of some £3 million per annum.

Our cost base will also be impacted by a higher level of bad and doubtful debts: by examining historical data, we have established a correlation between our bad debt charge and levels of unemployment, albeit there has been a two-year lag between changes in unemployment levels and their impact on the charge. We have prudently assumed that, in light of the scale of the expected increase in unemployment in this recession, increases in unemployment will have an immediate impact on cash collection and the bad debt charge. The OBR estimates that the unemployment rate will rise from 3.8% in 2019/20 to 7.3% in 2020/21, fall to 6.0% in 2021/22 and fall further to 4.5% in 2022/23. Our scenarios assume that these forecasts could be 1% lower or 2% higher. We therefore estimate that in the most severe downside scenario the bad debt charge in 2020/21 could be as high as £39 million compared our 2020 plan forecast of £19 million, as high as £34 million in 2021/22 (2020 plan: £18 million) and as high as £28 million in 2022/23 (2020 plan: £17 million).

In either of these scenarios we would experience a significant drop in revenues and an increase in costs, with high levels of unemployment being likely to impact on our collections performance over the next 12 to 24 months. Nevertheless we are well-placed to absorb the impact of these financial stresses and will retain our strong liquidity position. It is also important to note that revenue lost in 2020/21 would be recoverable under regulatory mechanisms in 2022/23.

Reduced cash flows would impact on our key financial metrics, in particular interest cover ratios. However, in the most severe downside scenario, gearing and interest covers retain significant headroom within the trigger levels specified in our borrowing covenants; and whilst the reduced cash flows weaken our financial metrics, in our opinion they remain within the ranges for our current ratings.

General overview and business update (continued)

Credit ratings

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

Bond class	Moody's	S&P	Fitch
A[1]	A2	AA	A
B	A3	A-	A
C	Baa2	BBB	BBB+

On 30 January 2020 Fitch confirmed the rating of the Company's bonds as A and amended the outlook from negative to stable. On 20 December 2019 Moody's announced that they were placing most of the UK water sector companies that they rate "on review for downgrade" following the 16 December 2019 publication of the 2020-2025 Final Determinations by the regulator. This included placing "on review for downgrade" the corporate family rating of Dŵr Cymru Cyfyngedig and the class B senior secured debt – which was subsequently downgraded to A3 with a stable outlook on 7 February 2020. Also on 7 February 2020, S&P downgraded the class B senior secured debt to A- and revised the outlook to stable. The class A bonds (which are subject to a financial guarantee from Assured Guaranty (Europe) plc) are unaffected by this action.

Financing and liquidity

As at 30 June 2020 the Company's undrawn credit facilities and cash totalled £765 million, including debt service payment funds (£24 million) and revolving credit facilities (RCFs) (£170 million). The four revolving credit facilities are all bilateral and due to expire during 2020. On 15 May 2020 a £60 million RCF was renewed for two years with an option to extend for a further year. On 6 August 2020 a £20 million RCF was renewed and increased to a £30 million facility which will be available for two years, again with a one-year extension option. The remaining two RCFs are expected to be renewed on similar terms to these as they fall due during the year.

In line with prudent policies approved by the Board, cash is invested in AAA-rated liquidity funds and bonds, National Westminster Bank (as the group's Account Bank) and additional banks that are subject to minimum short-term rating criteria of A1/P1/F1.

The Group also has an undrawn special liquidity facility of £135 million which is available to be drawn in the event of a standstill being declared by the Security Trustee. The facility is provided on a rolling five-year 'evergreen' basis.

[1] The credit ratings of the Company's class A bonds, which are guaranteed by Assured Guaranty (Europe) plc ("AG") (A2/AA/NR), carry the higher of either Glas or AG's rating; Moody's and S&P therefore revert to the higher AG rating but Fitch reflects the underlying rating of the Glas bonds.

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%.

The Company's not-for-shareholder business model means that distributions are made for the benefit of customers. In March 2017 the Company issued a consultation to customers on such distributions during the period to 31 March 2020. This consultation has been taken into account when the Board determines distributions (contributions to social tariffs and discretionary capital investments). Further details of the consultation are available on the Company's website (www.dwrcymru.com).

In line with this policy, on 5 June 2020 the Company announced that it will provide £11 million of contributions to social tariffs over the year to 31 March 2021 to its lowest-earning customers, in total helping nearly 130,000 customers with their bills.

Consolidated cash flow (unaudited)

	3 months ended 30 June 2020 £m	3 months ended 30 June 2019 £m
Revenue	184.8	193.1
Less: operating expenses	(82.5)	(77.5)
Earnings before interest, taxation, depreciation and amortisation	102.3	115.6
Working capital movements	(5.5)	7.3
Non bond-related interest paid	-	(2.8)
Interest capitalised in accordance with IAS 23	(3.4)	(3.7)
Interest received	1.8	1.4
Net operating cash flow and interest received	95.2	117.8
Utilisation of reserves:		
Cash transferred to capex reserve	(102.5)	(7.9)
Cash utilised from capex reserve	102.5	119.7
Net cash utilised from other reserves	3.7	3.0
Capital expenditure:		
Infrastructure renewals expenditure	(26.1)	(21.2)
Non-infrastructure maintenance	(38.6)	(52.2)
Capital expenditure	(37.3)	(38.7)
Net cash flow after capital expenditure, new borrowings and reserve drawings	(3.1)	120.5
Transfer to debt service payments account	(37.5)	(49.9)
Principal repayments	(31.6)	(24.6)
Net cash flow after debt service	(72.2)	46.0
Free cash balances brought forward	634.9	192.5
Free cash balances carried forward	562.7	238.5

Consolidated debt service payments (unaudited)	Payments due and made in 3 months ended 30 June 2020 £m	Amount accrued 30 June 2020 £m
Liquidity facility:		
Liquidity facility commitment fee	0.3	0.1
Interest on senior debt:		
Lease liability payments	12.6	-
Lease interest	-	50.5
A1 bond interest	-	5.1
A4 bond interest	-	3.8
A5 bond interest	-	1.2
A6 bond interest	-	1.1
B1 bond interest	-	5.5
B3 bond interest	-	2.3
B4 bond interest	-	1.3
B5 bond interest	-	0.3
B6 bond interest	-	1.6
B7 bond interest	-	1.8
B8 bond interest	-	1.0
European Investment Bank loan interest	3.0	0.1
KfW IPEX-Bank GmbH loan interest	0.2	0.1
Revolving credit facility commitment fees	0.2	-
Assured Guaranty wrapping fees	4.7	(3.5)
VAT on lease payments	2.5	-
Miscellaneous fees	0.1	-
	23.6	72.3
Interest rate swaps	2.4	-
RPI bond swap	(1.9)	-
Senior interest payments	24.1	72.3
Interest on junior debt:		
C3 bond interest	-	0.8
Total debt service payments	24.1	73.1

Dŵr Cymru notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 April 2020 £m	New issues £m	Repayment £m	Indexation £m	Closing balance 30 June 2020 £m
Lease liabilities		424.1	-	(12.5)	-	411.6
Class A bonds[2]						
A1 notes[3]	A2/AA/A	351.1	-	-	1.7	352.8
A4 notes		446.8	-	-	0.8	447.6
A5 notes		145.3	-	-	(0.8)	144.5
A6 notes[3]		148.5	-	-	0.6	149.1
Class B bonds						
B1 notes	A3/A-/A	325.0	-	-	-	325.0
B3 notes		216.8	-	-	0.4	217.2
B4 notes		128.3	-	-	(0.7)	127.6
B5 notes		74.2	-	-	0.1	74.3
B6 notes		346.8	-	-	1.8	348.6
B7 notes		300.0			-	300.0
B8 notes[3]		300.9	-	-	1.5	302.4
Class C bonds						
C3 notes[3]	Baa2/BBB/BBB+	200.6	-	-	1.0	201.6
Intercompany loan from Dŵr Cymru Holdings Limited		2.8	-	-	-	2.8
European Investment Bank/KfW loans		721.6	-	(19.1)	1.2	703.7
Local authority loans		0.3	-	-	-	0.3
		4,133.1	-	(31.6)	7.6	4,109.1

[1] Moody's/S&P/Fitch.
[2] Guaranteed by Assured Guaranty (Europe) plc rated A2/AA/NR. Class A bond ratings for Fitch therefore default to their higher underlying ratings of A2/AA/A.
[3] The class A1, A6, B8 and C3 notes were issued at a fixed rate and swapped to an effective index-linked rate; cumulative indexation has been recognised in this table.

Dŵr Cymru bank account movements (unaudited)

	Opening balance 1 April 2020 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 30 June 2020 £m
Free cash balances:					
Receipts account	62.9	-	193.1	(200.5)	55.5
Payments account	582.6	-	531.0	(606.6)	507.0
Other bank accounts	(10.6)	1.8	186.6	(177.6)	0.2
	634.9	1.8	910.7	(984.7)	562.7
Debt service payments account:					
Debt service ledger	10.4	-	37.5	(24.1)	23.8
Capex reserve account	-	-	102.5	(102.5)	-
Customer payments account:					
Customer rebate ledger	11.0	-	1.0	(3.7)	8.3
	656.3	1.8	1,051.7	(1,115.0)	594.8

Interest cover ratio (ICR) – 5 years to 31 March 2025 (unaudited)

(See important notice at the front of the document)	Projection[1] Year to 31 March 2021 £m	Year to 31 March 2022 £m	Year to 31 March 2023 £m	Year to 31 March 2024 £m	Year to 31 March 2025 £m
Income	807	828	824	832	839
Operating expenditure	(299)	(307)	(311)	(311)	(317)
Pre capital maintenance cash flows	**508**	**521**	**513**	**521**	**522**
Base maintenance	(209)	(205)	(205)	(164)	(155)
Post capital maintenance cash flows	**299**	**316**	**308**	**357**	**367**
Net interest paid (excluding indexation and capitalisation)	(130)	(106)	(105)	(107)	(108)
Enhancement expenditure	(157)	(174)	(187)	(191)	(198)
Pre-financing cash flows	**12**	**36**	**16**	**59**	**61**
Interest payable on senior debt:					
Fixed interest swap	10	10	10	10	10
Lease liability RPI swaps	17	16	16	15	14
Lease liability interest	6	7	6	6	4
A1 Bonds	9	9	9	9	9
B1 Bonds	22	-	-	-	-
B7 Bonds	8	8	8	8	8
Other index-linked bonds	47	48	49	51	52
RPI-linked senior bond	(5)	(5)	(5)	(5)	(4)
RPI-linked junior bond	(3)	(3)	(3)	(3)	(3)
Wrapping fees	5	5	5	6	6
Term-loan interest	18	16	15	15	16
Interest receivable	(4)	(5)	(5)	(5)	(4)
Net interest payable	**130**	**106**	**105**	**107**	**108**
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	3.9x	4.9x	4.9x	4.9x	4.8x
Interest cover post capital maintenance (trigger 1.0)	2.3x	3.0x	2.9x	3.3x	3.4x

[1] The financial plan was prepared in February 2020 and does not reflect any estimate of the financial impact of the coronavirus epidemic.

Regulatory asset ratio (RAR) – 5 years to 31 March 2025 (unaudited)

(See important notice at the front of the document)	Projections				
	As at 31 March 2021 £m	As at 31 March 2022 £m	As at 31 March 2023 £m	As at 31 March 2024 £m	As at 31 March 2025 £m
Senior gross debt:					
Lease liabilities	395	379	378	173	94
Class A bonds[1]	1,121	1,154	1,188	1,223	1,259
Class B bonds[1]	1,091	1,114	1,137	1,162	1,187
New senior bond	309	318	328	343	348
Authorised loans	680	637	592	632	665
Net interest accrual on senior debt	48	45	39	16	6
Total senior gross debt	3,644	3,647	3,662	3,549	3,559
Less: cash and cash equivalents	(298)	(263)	(226)	(100)	(100)
Total senior net debt	3,346	3,384	3,436	3,449	3,459
Junior gross debt:					
Class C bonds	206	212	219	225	232
Total net debt	**3,552**	**3,596**	**3,655**	**3,674**	**3,691**
Regulatory capital value (RCV)	6,076	6,242	6,413	6,568	6,709
Customer Reserves (RCV less total net debt)	2,524	2,646	2,758	2,894	3,018
RAR	58.5%	57.6%	57.0%	55.9%	55.0%
Senior gearing	55.1%	54.2%	53.6%	52.5%	51.6%

[1] For the purpose of calculating regulatory gearing, cumulative indexation relating to the class A1, A6, B8 and C3 notes is included above; these were issued at fixed rates and swapped to effective index-linked rates.

Income statement (unaudited)

	3 months ended 30 June 2020 £m	3 months ended 30 June 2019 £m
Revenue	184.8	193.1
Operating expenditure	(82.5)	(77.5)
EBITDA	**102.3**	**115.6**
Infrastructure renewals expenditure	(23.1)	(21.1)
Depreciation	(84.0)	(76.8)
Operating (loss)/profit	**(4.8)**	**17.7**
Interest payable	(30.7)	(27.2)
Indexation of index-linked debt	(7.6)	(6.5)
Interest receivable	1.6	1.5
Fair value losses on financial instruments	(25.8)	(23.3)
Loss before tax	**(67.3)**	**(37.8)**
Taxation	-	-
Loss after tax	**(67.3)**	**(37.8)**

Statement of comprehensive income (unaudited)

	3 months ended 30 June 2020 £m	3 months ended 30 June 2019 £m
Loss for the period	(67.3)	(37.8)
Actuarial gain/(loss) on defined benefit scheme liability	-	-
Movement on related deferred tax asset	-	-
Items that will not be reclassified to the profit or loss:		
Revaluation of property, plant and equipment (net of tax)	-	-
Total comprehensive loss	**(67.3)**	**(37.8)**

Statement of changes in reserves (unaudited)

	3 months ended 30 June 2020 £m	3 months ended 30 June 2019 £m
Reserves at start of period	1,238.1	1,308.6
Loss for the period	(67.3)	(37.8)
Actuarial gain/(loss) on defined benefit pension scheme liability (net of tax)	-	-
Revaluation of property, plant and equipment (net of tax)	-	-
Reserves at end of period	**1,170.8**	**1,270.8**

Balance sheet (unaudited)

	At 30 June 2020		At 31 March 2020	
	£m	£m	£m	£m
Fixed assets		**5,925.1**		**5,940.4**
Current assets and liabilities:				
Debtors and prepayments	519.6		592.0	
Creditors and accruals	(768.4)		(878.7)	
		(248.8)		(286.7)
Total assets less current liabilities		**5,676.3**		**5,653.7**
Financing liabilities:				
Bonds	(2,990.7)		(2,984.3)	
Lease liabilities	(411.6)		(424.1)	
Bank loans (EIB, KfW)	(703.7)		(721.6)	
Other	(3.1)		(3.1)	
	(4,109.1)		(4,133.1)	
Net interest accrual	(81.3)		(53.1)	
	(4,190.4)		(4,186.2)	
Cash and cash equivalents:				
Receipts account	55.5		62.9	
Payments account	507.0		582.6	
Capex reserve account	-		-	
Debt service payments account	23.8		10.4	
Customer payments account	8.3		11.0	
Other bank accounts	0.2		(10.6)	
	594.8		656.3	
Net debt		**(3,595.6)**		**(3,529.9)**
Derivative financial instruments		(327.7)		(301.8)
Provisions for liabilities and charges		(100.8)		(102.5)
Net assets before deferred tax		1,652.2		1,719.5
Deferred tax		(481.4)		(481.4)
Net assets		**1,170.8**		**1,238.1**