



Moody's Investors Service

Issuer Comment: **Moody's: Welsh Water's operational restructuring has no rating impact**

Global Credit Research - 11 Feb 2010

Moody's Investors Service said today that the A3 ratings of Dwr Cymru Cyfyngedig (Welsh Water) and its funding vehicle Dwr Cymru (Financing) Limited (Class A and B notes, with a small residual amount of Class C notes rated Baa2) are unlikely to be affected by the announced restructuring, which is aimed at meeting the efficiency targets set by the UK Water industry's Regulator, Ofwat.

As outlined in Moody's initial analysis on Welsh Water published in April 2001, the rating agency took a neutral view on Welsh Water's outsourcing strategy when the company entered into a refinancing transaction that resulted in a highly-leveraged funding structure. This reflects Moody's opinion that the outsourcing contracts had not achieved a significant risk transfer in respect of certain operational risks and the risks associated with the comparative competition and efficiency analysis that the Regulator applies, as Welsh Water retained the ultimate responsibility for fulfilling the regulatory and statutory obligations under its licence.

Whilst taking the operations back in-house will be a major task for Welsh Water, Moody's expects disruptions to the company's day-to-day business to be limited given that the existing outsourcing contracts already incorporated provisions for Welsh Water to accommodate this move.

On 9 February 2010, Welsh Water announced that it would undertake a corporate restructuring that will result in the company transferring staff, who are currently operating under an outsourcing agreement with United Utilities, back to Welsh Water within the next couple of months. Kelda Water Services, with which discussions are still ongoing, will in the meantime continue to operate Welsh Water's wastewater assets.

Over the next regulatory period from 1 April 2010 to 31 March 2015, Welsh Water faces efficiency targets set by Ofwat that will require a 20% reduction in operational costs. Moody's understands that the company intends to achieve this target primarily by implementing new technologies and reducing the amount and cost of energy to be procured. The company also expects a phased reduction in staff numbers by 300 over the next five years.

Dwr Cymru Cyfyngedig ("Welsh Water") is the sixth-largest UK water utility by regulatory capital value (RCV), providing water and sewerage services to approximately 1.2 million households and over 100,000 business customers in a region that covers most of Wales and certain adjoining areas of England. Welsh Water's ultimate parent company is Glas Cymru Cyfyngedig, a not-for-profit organisation. In fiscal year 2008/09, Welsh Water had an RCV of GBP3,574 million and reported revenues of GBP657 million and operating profits of GBP155 million.

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