FitchRatings

FITCH AFFIRMS DWR CYMRU'S SENIOR SECURED DEBT AT 'A'/'BBB+'

Fitch Ratings-London-21 March 2012: Fitch Ratings has affirmed Dwr Cymru (Financing) Ltd's (Dwr Financing) senior secured ratings for its class A debt and class B debt (both wrapped and unwrapped) at 'A' and its class C debt at 'BBB+'. The Outlooks for the senior secured ratings are Stable. The company has redeemed all its existing Class C debt and therefore, the affirmation of the class C debt of the bond programme at 'BBB+' indicates the level at which Fitch would expect to rate any prospective issuance.

Dwr Financing is the debt-raising vehicle of Dwr Cymru Cyfyngedig (Dwr Cymru or Welsh Water). Dwr Cymru is one of the ten appointed water and sewerage companies (WaSC) in England and Wales and the sixth-largest by regulated asset value (RAV).

The affirmation reflects Dwr Cymru's improved regulatory and operational performance for financial year ending March 2011 (FY11), the company's solid financial position and the supportive and transparent regulatory framework under which the company operates, administered by The Water Services Regulation Authority (Ofwat). The company has a covenanted and secured financing structure, which benefits from structural enhancements including debt service reserve liquidity and security over the shares in Dwr Cymru. Due to the company's not-for profit status, it does not pay any dividends, which enables it to retain or reinvest any financial surpluses into the business for the benefit of customers.

Fitch forecast pension-adjusted net debt/RAV is expected to move towards a range between 63% and 65% for the combined Class A and Class B debt for the period to March 2015. Post-maintenance and post-tax interest cover (PMICR) is expected to range between 1.5x and 1.6x. While gearing provides for increasing headroom in comparison to Fitch's ratio guidelines, PMICR forecast are at adequate levels. The improved credit metrics reflect continued higher levels of outturn inflation and certain operational expenditure (opex) outperformance achieved by the company.

Dwr Cymru is a middle ranking performer in the industry and its performance currently meets the agency's expectations. Regulatory and operational performance during the first year of the new regulatory period, Asset Management Plan 5 (AMP5), has improved as a consequence of the in-sourcing of day-to-day activities that took place in 2010 and good progress with the efficiency initiatives implemented by management. However, the company needs to continue improving its performance during the remainder of AMP5.

Dwr Cymru has met its regulatory targets for FY11 for most categories with some visible improvement in the areas of customer services and asset serviceability, but has fallen short or failed to meet regulatory targets for leakage, security of supply and pollution incidents. The company is incurring additional investment in these areas in order to improve performance, and has indicated that it expects to meet leakage targets for FY12 (to be confirmed when regulatory reporting is published later in the year).

Actual opex outperformance for FY11 was achieved mainly through the termination of the out-sourced operational contracts, and outperformance of power costs. However, the company is experiencing cost pressures related to bad debt and leakage/severe weather events.

The transfer of 17,000km of private sewer networks to Dwr Cymru took place in October 2011. The company is considering several methodologies in order to recover the additional costs incurred, including an application for an interim determination of K (IDoK) to the regulator. Fitch has adopted a conservative approach and assumed that the company will not apply for an IDoK, in which case the capital expenditure related to the transferred private sewers would be logged up after

2015, and subsequently the company would be remunerated for this expenditure through the RAV while the operational costs will have to be borne by the company.

As of 29 February 2012, the company had GBP354m in cash and cash equivalents available, as well as GBP215m of undrawn committed revolving and EIB credit facilities. The cash balance was strengthened by GBP120m of a class B index-linked bond (tap of the existing Class B issue maturing 2048) issued in July 2011. This funding position will provide for sufficient liquidity for capital expenditure and operating requirements for the remainder of AMP5. In accordance with transaction documentation, the group also maintains a GBP135m reserve liquidity facility which would be available in times of financial distress.

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Additional information is available on www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Corporate Ratings Methodology', dated 12 August 2011 is available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647229