FitchRatings

FITCH AFFIRMS DWR CYMRU'S SENIOR SECURED DEBT AT 'A'

Fitch Ratings-London-14 March 2013: 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 on 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 2012 (FY12) and expectations of some further improvement for the remainder of the regulatory price control ending in March 2015. Other important factors for the ratings are the UK water sector's supportive and transparent regulatory framework which provides earnings visibility until the end of the price control period in March 2015, and the covenanted and secured financing structure of the group, which benefits from structural enhancements, including trigger mechanisms and debt service reserve liquidity.

KEY RATING DRIVERS
-Adequate Credit Metrics:
Fitch forecast pension-adjusted net debt/RAV is expected to move towards 60% 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.

-Improved Regulatory and Operational Performance:
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 two years of the new regulatory period, Asset Management Plan 5 (AMP5), has improved as a consequence of the in-sourcing of day-to-day activities (including its billing and collection activities) that the company has carried out since 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.

The company met its regulatory targets for year ending 31 March 2012 (FY12) for most categories, including leakage, with some visible improvement in the areas of customer services. However, it did not meet targets in the area of pollution incidents and marginally did not meet expectations for serviceability for sewerage non-infrastructure. The company has invested in these areas in order to improve performance, and the agency expects that serviceability for sewerage non-infrastructure will move from marginal to stable in the short to medium term. The company has indicated that it expects to meet its leakage targets for FY13 as well as improve its Service Incentive Mechanism (SIM) score, which measures customer satisfaction.

- Cost Pressures Eroding Further Outperformance:
During the first two years of AMP5, Dwr Cymru has managed to achieve considerable opex outperformance. Increasing cost pressures during FY13 and the remainder of the price control related to power costs, doubtful debt, CRC tax, business rates and inflationary pressures will make it more difficult for the company to achieve further outperformance during the remainder of AMP5,

although these would still be partially offset by the savings achieve due to the in-sourcing of activities and efficiency initiatives implemented by management. The agency expects a gradual reduction in outperformance until 2015.

-Not-for-Profit Organisation:
Dwr Cymru is a not-for-profit organisation, which makes it unique among its peers as there is no shareholder pressure to pay dividends, and consequently it can reinvest all its financial surpluses into the business for the benefit of customers. Dwr Cymru (Financing) Ltd (Dwr Financing) is Dwr Cymru's debt-raising vehicle.

RATING SENSITIVITIES
Positive: Future developments that may potentially lead to positive rating action include:
- A sustainable reduction in target leverage to below 60% together with a visible improvement in regulatory performance.

Negative: Future developments that could lead to a downgrade:
- A marked deterioration in operating and regulatory performance or adverse changes to the regulatory framework.
- A sustainable increase in target leverage to above 73%.

LIQUIDITY AND DEBT STRUCTURE
As of 28 February 2013, the company had GBP215m in cash and cash equivalents available, as well as GBP215m of undrawn committed revolving and EIB credit facilities. 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. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

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 Rating Methodology', dated 08 August 2012 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=684460