UK Registered № 119499988

# Dŵr Cymru (Financing) UK plc

## Annual report and financial statements
## for the period ended 31 March 2020


UK registered office
Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

# Contents Page

# Strategic report

The Directors present the Strategic Report of Dŵr Cymru (Financing) UK plc for the period ended 31 March 2020.

**Principal activity**
The principal activity of Dŵr Cymru (Financing) UK plc (the Company) is that of an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig (DCC). The Company exists for that purpose alone and generates profit by charging a one basis point margin on all financing on-lent to DCC. The Company has no employees and has no business relationships with any other group entities.

DCC is the only trading subsidiary in the Whole Business Securitisation of the Glas Cymru Holdings Cyfyngedig Group (the Group) and its principal activities are the supply of water and the treatment and disposal of waste water under the Instrument of Appointment made by the Secretary of State for Wales under the Water Act 1989.

The Directors intend for the Company, indirectly, to have a positive impact on the community and the environment, existing as it does to provide financial support to DCC to meet its strategic goals.

**Business review**

Incorporation and background
The Company was incorporated on 16 April 2019 and is a wholly-owned subsidiary of Dŵr Cymru (Holdings) Limited, a company incorporated, registered and domiciled in Wales in the United Kingdom (registered number 03954867). Details of the Company's share capital and voting rights are disclosed in note 14 to the financial statements.

The Company replaces a fellow Group company, Dŵr Cymru (Financing) Limited (DCFL), which was incorporated in the Cayman Islands (registered number 108127) but also registered in Wales in the UK (registered number FC23222). The company was UK resident for tax purposes, however there could be a perception in the media that a water company's link to the Cayman Islands is related to tax affairs.

On 1 August 2019 assets and liabilities of DCFL were transferred into Dŵr Cymru (Financing) UK plc. The transaction was effected between wholly-owned subsidiaries of the ultimate holding company, Glas Cymru Holdings Cyfyngedig, with the sole purpose being to bring about the removal of the Cayman Islands link. The Company took on DCFL's assets and liabilities and place in the Group's ring-fenced Whole Business Securitisation, and DCFL began the process of being wound up on 9 September 2019.

Performance to 31 March 2020
The Company commenced trading on 1 August 2019 and these financial statements therefore reflect eight months of activity to 31 March 2020. On 1 August 2019 the Company received a capital contribution amounting to £57,433,000, being the net fair value of assets and liabilities transferred from DCFL (see note 17 for further details). The profit before taxation amounted to £20,071,000, principally reflecting changes in the fair value of derivative financial instruments (a gain of £27,159,000).

In February 2020 the Company raised £500,000,000 of bond finance; £300,000,000 at a fixed rate of 1.375% and £200,000,000 at a fixed rate of 1.625% (swapped to RPI via separate instruments), the proceeds of which have been on-lent to Dŵr Cymru Cyfyngedig. The Bonds (and related swaps) will mature on 31 March 2033 and 31 March 2026 respectively.

As at 31 March 2020 net assets stood at £85,567,000; these represent issued share capital and premium totalling £3,083,000, a capital contribution reserve of £57,433,000 and the profit for the period of £21,495,000.

The Company has a special £135,000,000 liquidity facility which is a requirement of the Company's bond covenants; it can only be drawn in the event that the Company is in default of its covenants and unable to pay its interest bills. The facility is renewable on a rolling five-year evergreen basis (next renewal due 3 April 2024).

The current ratings of the Company's bonds are summarised in the following table:

| Bond class | Moody's | S&P | Fitch |
|---|---|---|---|
| **A** | A2 | AA | A |
| **B** | A3 | A- | A |
| **C** | Baa2 | BBB | BBB+ |

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.

Future developments
The Company has secured adequate financing for DCC to allow it to continue in operation for the foreseeable future including through the current period of economic uncertainty during the COVID-19 pandemic and is in the process of renegotiating its revolving credit facilities, the cost of which has not been materially affected by the pandemic.

The Directors do not anticipate making any changes to the Company's purpose or activities.

Principal risks and uncertainties
The principal risks faced by the Company are an inability to meet its debt servicing costs as they fall due and non-compliance with covenants. These are inextricably linked to DCC's ability to make interest and principal payments of the on-lent financing; the Company's principal risks and uncertainties are therefore integrated with the principal risks and uncertainties of the Group; these are disclosed within the Group's annual report which does not form part of this report (a copy can be obtained from the Company Secretary at the registered address of Pentwyn Road, Nelson, Treharris, Mid Glamorgan CF46 6LY).

The Company also monitors its derivatives portfolio closely to ensure that hedges operate as intended. The most recent review, conducted as at 31 March 2020, identified that the terms of a £192,000,000 floating-to-fixed rate swap were not an exact match for any of the Company's floating rate instruments but that it provides an effective economic hedge against the Company's floating rate loans from the European Investment Bank.

In addition, the Company's net asset position is sensitive to movements in the fair value of derivative financial instruments. For example, a negative swing of over £82,000,000 in the value of derivatives at 31 March 2020 would have been needed to put the Company in a net liabilities position. The Directors do not foresee any practical issues in the event that this were to happen, since their intention is for the Company to hold all such instruments to maturity when their fair values will reach zero.

Financing risk management objectives and policies are set out in note 1 to the financial statements, with related disclosures made in note 13.

**Key performance indicators, trends and non-financial information**
The Company is required under its Common Terms Agreement with bondholders to publish an Investor Report on a quarterly basis which confirms compliance with key financial covenants, namely pre and post capital maintenance interest cover ratios. The latest Investor Report, prepared for the three months to 30 June 2020, forecast significant headroom within these covenanted ratios and continued compliance through to the end of the forecast period in March 2025.

The Directors of the Group manage its operations on an overall basis. For this reason, the Company's Directors believe that analysis using other key performance indicators is neither necessary nor appropriate for an understanding of the development, performance or position of the activities of Dŵr Cymru (Financing) UK plc. The development, performance and position of the Group, which includes the Company, are discussed within the Group's annual report.

**Events after the financial period-end**
Covid 19
On 11 March 2020 the World Health Organisation declared the coronavirus outbreak to be a pandemic and the virus has continued to spread throughout the UK after 31 March 2020.

The Company is not directly affected by the pandemic, having no need to source financing in the short-to-medium term and having only one customer, DCC. The potential for indirect impact is DCC's ability to service the debt on-lent by the Company. The Directors of the Group have taken into account the estimated impact of the pandemic on the valuation of the Group's consolidated and DCC's entity balance sheet as at 31 March 2020, concluding that the pandemic poses no significant threat to the viability of the Group or DCC and that they will be able to continue their activities for the foreseeable future. See also "going concern" in the notes to the financial statements on page 14.

Brexit
For the UK as a whole Brexit was a high-profile issue throughout the period to 31 March 2020 and the Group committed much time and effort to assessing its potential impact, in particular that of a "no deal" Brexit on the operational water and sewerage business. The Directors are not aware of any related issues arising or likely to arise which may impact on the carrying value of the Company's debt. The Directors do not consider that Brexit is likely to have a material impact on the activities of the Company.

**S172(1) statement**

Section 172 of the Companies Act 2006 requires Directors to take into consideration the interests of stakeholders in their decision-making. The Directors, who are also directors of DCC (which utilises the financing raised by the Company) as well as the Group's ultimate parent company Glas Cymru Holdings Cyfyngedig (GCHC or Glas Cymru), have regard to the interests of the Group's employees and other stakeholders, including the impact of its activities on the community, the environment and the Group's reputation, when making decisions.

The Directors are mindful of the purpose of the Company and its intrinsic link to DCC's long-term vision and is focused on promoting the long-term success of the Company, in particular given its role in providing finance to DCC as the custodian of assets over the long term to enable the delivery of essential services to customers.

As part of its involvement in the PR19 price review process, the joint Board of directors of GCHC and DCC (the Board) had particular regard to cost and availability of funding for the Group's investment programme over the five-year period 2020 to 2025 and the longer term. This price review process allowed the Board to reflect on how it engages with its stakeholders, which in respect of the Company include investors and rating agencies.

The Board is directly involved in engaging with the views of investors. Formal communications with bondholders are subject to Board approval, and members of the Board attend the Group's annual investor meeting held in July every year, where investors have the opportunity to ask questions of members of the Board.

While the Company's activities mean that it has a limited range of stakeholders, on pages 20 to 23 of the Strategic Report in the Glas Cymru 2019-20 Annual Report and Accounts, a copy of which is available to view at http://www.dwrcymru.com/en/Reading_Room_Library/Company-Reports.aspx), details are set out of the Group's principal stakeholders, how and why we engage and the outcomes of those engagement processes. The relevance of each stakeholder group may increase or decrease depending on the matter or issue in question, so the Board seeks to consider the needs and priorities of each stakeholder group during its discussions and as part of its decision-making.

By order of the Board.

N Williams

N Williams
**Company Secretary**

30 September 2020

# Directors' report

The Directors have pleasure in presenting their annual report to the shareholder, together with the audited financial statements for the period ended 31 March 2020 on pages 10 to 30.

**Directors**

The Directors who served during the period since incorporation and up to the date of signing the financial statements are as shown below. The Directors benefited from qualifying third party indemnity provisions in place during the financial period.

| | |
|---|---|
| C Jones | (resigned 15 May 2020) |
| P Perry | |
| P Bridgewater | (resigned 31 December 2019) |
| P M Davis | (appointed 1 January 2020) |

**Going concern**

The Directors have prepared cash flow forecasts which indicate that the Company will have sufficient funds to meet its liabilities as they fall due – this takes into account the ability of Dŵr Cymru Cyfyngedig (DCC) to service the debt on-lent by the Company. Further details of the forecasts, including upside and downside scenarios and the potential financial impact of Covid-19, can be found under "going concern" in the notes to the financial statements on page 14. It is therefore appropriate to prepare the accounts on the going concern basis.

**Dividends**

No dividend was declared or paid during the period to 31 March 2020.

**Political donations**

The Company made no political donations and incurred no political expenditure during the period to 31 March 2020.

**Taxation**

All tax payable by the Company is paid to HMRC in the UK.

**Engagement with stakeholders**

Details of how the Directors have engaged with the Company's stakeholders and with regards to its only business relationship, which is with DCC, during the period ended 31 March 2020 are set out within the Strategic Report on pages 1 to 3.

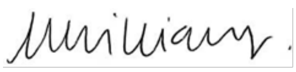
**Disclosure of information to auditor**

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**Independent auditor**

KPMG LLP will be proposed as auditor of the Company for the financial year ending 31 March 2021 and a resolution relating to this appointment will be put to the Company's shareholder.

By order of the Board.



N Williams
**Company Secretary**
Registered office:
Pentwyn Rd,
Nelson,
Treharris,
Mid Glamorgan,
CF46 6LY

30 September 2020

# Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial period. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic report and a Directors' report that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Independent auditor's report to Dŵr Cymru (Financing) UK plc

**1 Our opinion is unmodified**
We have audited the financial statements of Dŵr Cymru (Financing) UK plc ("the Company") for the period ended 31 March 2020 which comprise the Income statement, Balance sheet, Statement of changes in equity, Cash flow statement and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 31 March 2020 and of its profit for the period from 16 April 2019 (date of incorporation) to 31 March 2020;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union and
- have been prepared in accordance with the requirements of the Companies Act 2006.

***Basis for opinion***
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the Directors on 12 November 2019. The period of total uninterrupted engagement is for the one financial period ended 31 March 2020. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

**2 Key audit matters: our assessment of risks of material misstatement**
Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

- **Going concern**

*Refer to Directors' report and note 1 (accounting policies).*

***The risk***

**Disclosure quality**

The financial statements explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Company.

That judgement is based on an evaluation of the inherent risks to the Company's business model and how those risks might affect the Company's financial resources or ability to continue operations over a period of at least 12 months from the date of approval of the financial statements.

The risks most likely to adversely affect the Company's available financial resources over this period is the impact of COVID-19 uncertainty on operations of Dŵr Cymru Cyfyngedig, a company under common control of the Company's ultimate controlling party Glas Cymru Holdings Cyfyngedig, who is the counterparty to the Company's intra-group receivables balances. The primary risks to Dŵr Cymru Cyfyngedig are the potential effect on customers and cash collections, the availability of debt and other financing arrangements.

The risk for our audit was whether those risks were such that they amounted to a material uncertainty that may have cast significant doubt over the Company's ability to continue to operate as a going concern, in particular, the risk was that Dŵr Cymru Cyfyngedig was not able to make its repayments of the intercompany debt. Had they been such, then that fact would have been required to have been disclosed.

***Our response***

Our procedures included:

- **Our sector experience:** We critically assessed the Directors' going concern assessment, including the reasonableness of the key assumptions, such as unemployment levels (against market publications and analysis in respect of the impact of COVID-19), bad debt charges and revenue reductions, used by the Company and Dŵr Cymru Cyfyngedig in their cash flow forecasts and the level of severe but plausible downside sensitivities applied using our experience of the sector.
- **Funding assessment:** We evaluated the level of headroom there was on covenants for the Group compared to the Directors' severe but plausible downside scenario.
- **Sensitivity analysis:** We considered sensitivities over the level of available financial resources indicated by the financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively; this included increase in forecast of debtor defaults, reductions in non-household customers and an increase in operating costs.
- **Assessing transparency**: We assessed the accuracy and completeness of the matters covered in the going concern disclosure by assessing the reasonableness of the risks and uncertainties specified by the disclosure against our findings from our evaluation of the Directors' assessment of going concern.

***Our results***

We found the going concern disclosure without any material uncertainty to be acceptable.

- **Transfer of assets and liabilities from Dŵr Cymru (Financing) Limited**

*Refer to notes 2 and 17 (financial disclosures)*

***The risk***

During the financial year, the Company acquired the assets and liabilities from Dŵr Cymru (Financing) Limited, replacing that Cayman Island entity as the financing vehicle of the Glas Cymru Holdings Cyfyngedig group. The transfer was effected between wholly-owned subsidiaries of the ultimate holding company, Glas Cymru Holdings Cyfyngedig, with the sole purpose being to bring about the removal of the Cayman Islands link.

There is a judgement whether this transfer from Dŵr Cymru (Financing) Limited of assets and liabilities constituted a business under IFRS 3 or merely assets and liabilities. The impact of this judgement is significant because, if it was a business combination due to this being a common control transaction, the acquired assets and liabilities would be recognised at the previous carrying amounts that existed in Dŵr Cymru (Financing) Limited. If it is not a business combination, all assets and liabilities acquired require recognition at fair value, which could give rise to a material difference.

***Our response***

Our procedures included:

- **Accounting analysis:** We assessed the Directors' judgement as to whether the assets and liabilities acquired from Dŵr Cymru (Financing) Limited constituted a business under IFRS 3 against the requirements of the accounting standard and assessed the resulting impact on the recognition of assets and liabilities; and

- **Assessing transparency:** We assessed the adequacy of the disclosures in the financial statements in relation to the transfer.

***Our results***

We found the judgement of the Directors that the assets and liabilities acquired from Dŵr Cymru (Financing) Limited did not constitute a business under IFRS 3 to be appropriate and hence the accounting applied by the Directors for the transfer of assets and liabilities to be acceptable.

**3 Our application of materiality and an overview of the scope of our audit**

Materiality for the financial statements as a whole was set at £21.5m determined with reference to a benchmark of total assets of £4,339m (of which it represents 0.5%).

We agreed to report to the Audit Committee any corrected or uncorrected misstatements exceeding £1.075m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Company was undertaken to the materiality level specified above and was all performed at the company's head office in Nelson, Treharris.

**4 We have nothing to report on going concern**
The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company’s financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements (“the going concern period”).

Our responsibility is to conclude on the appropriateness of the Directors’ conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if we have anything material to add or draw attention to in relation to the Directors’ statement in note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company’s use of that basis for a period of at least 12 months from the date of approval of the financial statements.

We have nothing to report in this respect.

**5 We have nothing to report on the Strategic report and Directors’ report**
The Directors are responsible for the Strategic report and Directors’ report together with the financial statements. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the Strategic report and Directors’ report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the Strategic report and the Directors’ report;
- in our opinion the information given in those reports for the financial period is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

**6 We have nothing to report on the other matters on which we are required to report by exception**
Under the Companies Act 2006, we are required to report to you if, in our opinion:
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors’ remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

**7 Respective responsibilities**

***Directors’ responsibilities***
As explained more fully in their statement set out on page 5, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

***Auditor’s responsibilities***
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor’s report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

# Independent auditor’s report to Dŵr Cymru (Financing) UK plc (continued)

A fuller description of our responsibilities is provided on the FRC’s website at www.frc.org.uk/auditorsresponsibilities.

*Irregularities – ability to detect*
We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Company’s regulatory and legal correspondence and discussed with the Directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

The Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Whilst the Company is subject to many other laws and regulations, we do not identify any others where the consequences of non-compliance alone could have a material effect on amounts or disclosures in the financial statements. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the Directors and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

**8 The purpose of our audit work and to whom we owe our responsibilities**
This report is made solely to the Company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company’s members those matters we are required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company’s members, as a body, for our audit work, for this report, or for the opinions we have formed.

**James Ledward (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP**
Chartered Accountants
3 Assembly Square
Britannia Quay
Cardiff
CF10 4AX

30 September 2020

# Income statement for the period ended 31 March 2020

| **Continuing activities** | Note | **Period ended 31 March 2020 £000** |
|---|---|---|
| Financial income | 4 | **16,273** |
| Financial expenses | 4 | **(23,361)** |
| Fair value gains on derivative financial instruments | 4 | **27,159** |
| **Operating profit** | 5 | **20,071** |
| **Profit before taxation** | | **20,071** |
| Taxation | 6 | **1,424** |
| **Profit for the period** | | **21,495** |

The Company has no other recognised gains or losses in the period and accordingly a statement of comprehensive income has not been presented.

The notes on pages 14 to 30 form part of these financial statements.

## Balance sheet as at 31 March 2020

| | Note | 31 March 2020<br>£000 |
|---|---|---|
| **Assets** | | |
| **Non-current assets** | | |
| Deferred tax | 7 | **1,441** |
| Other financial assets: | | |
| - loans to group undertakings | 8 | **3,795,238** |
| - derivative financial instruments | 12 | **92,198** |
| | | **3,888,877** |
| **Current assets** | | |
| Cash and cash equivalents | 9 | **216** |
| Other financial assets: | | |
| - loans to group undertakings | 8 | **402,164** |
| - derivative financial instruments | 12 | **46,103** |
| - other receivables | | **1,916** |
| | | **450,399** |
| **Total assets** | | **4,339,276** |
| **Liabilities** | | |
| **Current liabilities** | | |
| Trade and other payables | 10 | **(2,899)** |
| Other financial liabilities: | | |
| - borrowings | 11 | **(401,194)** |
| - derivative financial instruments | 12 | **(14,878)** |
| | | **(418,971)** |
| **Net current assets** | | **31,428** |
| **Non-current liabilities** | | |
| Other financial liabilities: | | |
| - borrowings | 11 | **(3,550,487)** |
| - derivative financial instruments | 12 | **(287,807)** |
| | | **(3,838,294)** |
| **Total liabilities** | | **(4,257,265)** |
| **Net assets** | | **82,011** |
| **Equity** | | |
| Share capital | 14 | **50** |
| Share premium | 14 | **3,033** |
| Capital contribution reserve | 14 | **57,433** |
| Retained earnings | | **21,495** |
| **Total equity** | | **82,011** |

The financial statements on pages 10 to 30 were approved by the Board of Directors on 30 September 2020 and were signed on its behalf by:

P M Davis
**Director**

UK Registered No 119499988

## Statement of changes in equity for the period ended 31 March 2020

| | Share capital £000 | Share premium £000 | Capital contribution reserve £000 | Retained earnings £000 | Total equity £000 |
|---|---|---|---|---|---|
| On incorporation | - | - | - | - | - |
| Issue of share capital | **50** | **3,033** | - | - | **3,083** |
| Capital contribution | - | - | **57,433** | - | **57,433** |
| Profit for the period | - | - | - | **21,495** | **21,495** |
| **At 31 March 2020** | **50** | **3,033** | **57,433** | **21,495** | **82,011** |

# Cash flow statement for the period ended 31 March 2020

| | Note | Period ended 31 March 2020 £000 |
|---|---|---|
| **Cash flow from operating activities** | | |
| Interest received | | **114,601** |
| Interest paid | | **(114,397)** |
| **Net cash flow from operating activities** | | **204** |
| | | |
| **Cash flow from financing activities** | | |
| Issue of shares | | **12** |
| Loan issued to group undertakings | | **(494,369)** |
| Loan repaid by group undertaking | | **15,568** |
| Bond issue | | **500,000** |
| Bond issue costs | | **(5,631)** |
| Long-term loans repaid | | **(15,568)** |
| **Net cash flow from financing activities** | | **12** |
| | | |
| **Increase in cash and cash equivalents** | 15b | **216** |
| | | |
| Cash and cash equivalents at beginning of period | | - |
| | | |
| **Cash and cash equivalents at 31 March** | 9 | **216** |

# Notes to the financial statements

**1. Principal accounting policies**

**Basis of preparation**
Dŵr Cymru (Financing) UK plc (the Company) is a public limited company incorporated, domiciled and registered in England and Wales in the UK. The registered number is 11949988 and the registered address is Pentwyn Road, Nelson, Treharris, Mid Glamorgan CF46 6LY. The Company is part of a group headed by Glas Cymru Holdings Cyfyngedig (the Group) and it exists solely to act as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig, a regulated water and sewerage undertaker and fellow group company.

The Company has listed debt in issue on the Bourse de Luxembourg, an EU-regulated market; a management responsibility statement signed on behalf of the Directors has been appended to these financial statements.

The principal accounting policies adopted in the preparation of these financial statements are set out below.

The Company's financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the European Union and the parts of the Companies Act 2006 applicable to reporting under IFRS (Adopted IFRS). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value through profit or loss. The presentational currency of these accounts is GBP and all balances are shown rounded in £000.

**First-time adoption of IFRS**
The Company was incorporated on 16 April 2019 and has applied IFRS 1 in preparing its financial statements in accordance with Adopted IFRS for the first time. The accounting policies set out below have been applied in preparing the financial statements for the period ended 31 March 2020.

On 1 August 2019 the Company received assets and liabilities from a fellow group company, Dŵr Cymru (Financing) Limited (see note 17) which have been fair valued at the transfer date and thereafter in accordance with relevant Adopted IFRS (see estimates and judgements section below).

**Changes in accounting policies and disclosures**
At the date of approval of these financial statements, the following Standard and Amendments, which have not been applied in these financial statements, were in issue but not yet effective:

**Standard**
- IFRS 17 – Insurance Contracts

**Amendments**
- Conceptual framework
- IFRS 3 – Business Combinations (clarification of definition of business)
- IAS 1 – Presentation of Financial Statements (update to definition of material and classification of a liability as current or non-current)
- IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors (update to definition of material)
- IFRS 7 – Financial Instruments: Disclosures (issues relating to IBOR reform)
- IFRS 9 – Financial Instruments (issues relating to IBOR reform)
- IAS 39 – Financial Instruments: Recognition and Measurement (issues relating to IBOR reform)

The Directors anticipate that the adoption of this Standard and Amendments in future periods will have no material impact on the financial statements of the Company.

**Accounting policies for the period ended 31 March 2020**
The principal accounting policies adopted in the preparation of these financial statements are set out below.

**Going concern**
The financial statements have been prepared on a going concern basis which the Directors consider to be appropriate for the following reasons.

The Directors have prepared cash flow forecasts for a period of ten years from the date of approval of these financial statements which indicate that, taking accounts of reasonably possible downsides, the Company will have sufficient funds to meet its liabilities as they fall due for that period; these funds will be realised through the servicing of on-lent debt to a fellow subsidiary company, Dŵr Cymru Cyfyngedig (DCC), by that company.

**1. Principal accounting policies (continued)**

**Going concern (continued)**

The Company is not directly affected by the coronavirus pandemic, having no need to source financing in the short-to-medium term and having only one customer, DCC, the Group's main trading entity. The potential for indirect impact is DCC's ability to service the debt on-lent by the Company. The Directors of the Group have taken into account the estimated impact of the pandemic on the valuation of the Group's consolidated and DCC's entity balance sheet as at 31 March 2020 and its forecasts through to March 2023, concluding that the pandemic poses no significant threat to the viability of the Group or DCC and that they will be able to continue their activities for the foreseeable future.

The Group currently has strong liquidity, with cash and cash equivalents of £534m as at 29 September 2020 as well as £180m of undrawn revolving credit facilities.

<u>Group forecasts (including the Company and DCC)</u>

The Group has prepared a baseline plan which reflects a view of the estimated impact of the COVID-19 pandemic on the Group through to March 2025.

This baseline plan reflects social distancing continuing through the autumn, with gradual lifting of restrictions. Unemployment is assumed to be around 10%, recovering to pre-pandemic levels by 2023; CPIH falls to an average of 1.0% during 2020 and recovers to the government's long-term target of 2% by April 2021. The estimated impacts on turnover in 2020/21 is a £19m reduction in non-household revenues of £172m (11%, demand-driven) and £10m of reductions in other revenues e.g. from construction activity (25%) – a net reduction of £29m (however under regulatory mechanisms lost revenues are recoverable in future years).

This baseline plan has then been subject to a further severe but plausible scenario, which assumes an additional drop in CPIH below 1%, recovering to 2% by March 2023 and unemployment at around 12%. Consequential impacts on the Group's cost base are greater pressure on bad debts (circa £9m per annum through to 2022/23) and delays in the delivery of cost efficiencies in 2020/21 (£9 million), as well as further reductions in revenues (an additional drop in non-household revenues by £3m/2% partially offset by an extra £2m/1% rise in household revenues).

Reduced cash flows would impact on key financial metrics, in particular interest cover ratios. In the extreme downside scenario, gearing and interest covers retain significant headroom within the trigger levels specified in borrowing covenants; and whilst the reduced cash flows weaken our financial metrics, they remain within rating agencies' guidance for our current ratings.

The Company and group cash flow forecasts give the Directors confidence that the Company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months form the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

**Cash and cash equivalents**

Cash and cash equivalents include highly liquid investments readily convertible into known amounts of cash which are subject to an insignificant risk of change in value. Such investments normally mature less than three months from the date of acquisition, and typically include cash in hand and deposits with banks or other financial institutions.

**Other financial assets**

<u>Loans to group undertakings</u>

Loans to group undertakings represent loans to group companies that the Company makes in its capacity as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig. These have been recognised initially at fair value, having regard to the market value of such instruments, and subsequently at amortised cost.

<u>Other receivables</u>

Other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

# Notes to the financial statements (continued)

**1. Principal accounting policies (continued)**

**Derivative financial instruments**
Derivative instruments utilised by the Company are interest rate and inflation swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the Company and the Glas Cymru Holdings Cyfyngedig group (the Group) as a whole.

Derivatives are recognised initially and subsequently re-measured at fair value. The fair values of derivative financial instruments are provided by swap counterparties. The Bloomberg financial dataset platform allows management to perform an independent valuation of these contracts which is then compared to the counterparty confirmations; management makes an adjustment for the Company's own credit risk using this valuation tool to extract an average of traded bond spreads at the balance sheet date.

During the period to 31 March 2020, none of the Company's derivatives qualified for hedge accounting under IFRS 9. These instruments are carried at fair value through profit or loss with changes in fair value being recognised immediately in the income statement.

**Trade and other payables**
Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

**Other financial liabilities: borrowings**
Debt is initially measured at fair value, which is the amount of the net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

**Taxation**
Current taxation is corporation tax in the United Kingdom based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

**Deferred taxation**
Deferred corporation tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised in respect of temporary differences. Deferred tax assets are recognised for deductible temporary differences, carry-forward of unused tax assets and tax losses, to the extent that they are regarded as recoverable. They are regarded as recoverable where, on the basis of available evidence, there will be suitable taxable profits against which the future reversal of the underlying temporary differences can be deducted. The carrying value of the amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all, or part, of the asset to be utilised.

Deferred corporation tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on the tax rates that have been substantively enacted at the balance sheet date (2020: 19%).

Interest rate swaps where deferred tax is recognised are held to the maturity of the corresponding borrowing. Deferred tax credits in respect of these instruments will be recovered as the carrying amount of the liability is recovered/settled.

## 1. Principal accounting policies (continued)

**Financing risk management objectives and policies**

Treasury activities are managed at Group level within a formal set of treasury policies and objectives, which are reviewed at least annually and approved by the Board. The policy specifically prohibits any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the "Security Trustee"). The risk is further mitigated by limiting exposure to any one counterparty. We use financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, to raise finance and manage risk from our operations.

**Credit risk**

The Company has a prudent policy for investing cash and short-term bank deposits, set by the bond documentation within the Common Terms Agreement. Deposits can be placed with the Company's Account Bank for overnight risk only. Deposits of up to one year can be placed with counterparties that have a minimum short-term rating of A1/P1/F1 from Standard & Poor's, Moody's and Fitch Ratings respectively, or with the Account Bank as instant access deposits. Deposits of over one year should be placed with counterparties that carry a minimum rating of AA-/Aa3/AA-. In practice, the Company has adopted a more prudent approach to cash management and deposits are placed for a maximum of 35 days.

The policies contained within the Group's bond documentation determine that all borrowings raised through the Company are immediately on-lent to the operating company, Dŵr Cymru Cyfyngedig (DCC), on an arm's length basis. The book value of total Company borrowings at 31 March 2020 amounted to £3,952m. Cash and cash equivalents in the Company of £0.2m cannot be used for regulated retail, water, wastewater or other commercial operations within the Group and all other transactions within the Company are on a strict cost-pass-through basis.

Concentration of the Company's credit risk centres on DCC's ability to service the on-lent debt; the Company periodically reviews DCC's cash flow forecasts and credit ratings and has regard to current and forward-looking macro-economic factors that may impact thereon. DCC has consistently had the highest credit ratings in the water sector for a number of years and, as at 31 March 2020, the ratings attaching to the on-lent financial instruments were as follows:

| | Carrying value | | Credit rating | |
|---|---|---|---|---|
| | £000 | Moody's | S&P | Fitch |
| **Class A bonds** | 1,528,547 | A2 | AA | A |
| **Class B bonds** | 2,072,172 | A3 | A- | A |
| **Class C bonds** | 198,576 | Baa2 | BBB | BBB+ |
| **Term loans** | 152,386 | - | - | - |
| | 3,951,681 | | | |

**Interest rate risk**

The Company is part of a whole business securitisation (WBS) comprising parent holding companies Glas Cymru Anghyfyngedig, Glas Cymru (Securities) Cyfyngedig, Dŵr Cymru (Holdings) Limited and Dŵr Cymru Cyfyngedig. Under the Common Terms Agreement with bondholders, the WBS group hedges at least 85% of its total outstanding financial liabilities, including lease obligations, into either index-linked or fixed rate obligations. For this purpose, floating rate interest liabilities are hedged through a combination of derivative instruments and cash balances. Cash flow risk is minimised as a consequence of the regulatory framework, under which revenues and the regulatory asset value are also index-linked. Subject to market constraints and Board approval, the group therefore may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

The Company analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated at group level taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Of total borrowings of £3,952m as at 31 March 2020, none related to floating rate debt. The Group and Company therefore consider overall interest rate exposure at the balance sheet date to be minimal.

The 'hedges' established to manage these risks although economic in nature do not satisfy the specific requirements of IFRS 9 in order to be treated as hedges for accounting purposes.

# Notes to the financial statements (continued)

**1. Principal accounting policies (continued)**

**<u>Financing risk management objectives and policies</u>**

**Refinancing risk**
Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of instruments, types and maturities. Our policy is to ensure that the maturity profile does not impose an excessive strain on our ability to repay loans. Under this policy, no more than 20% of the principal of borrowings of £3,952m can fall due in any 24 month period.

In February 2020 the Company raised £500m of bond finance; £300m at a fixed rate of 1.375% and £200m at a fixed rate of 1.625% (swapped to RPI via separate instruments). This provides for the refinancing of £325m of Class B1 bonds which are due to mature in March 2021 as well as funding the group's investment programme for the five-year regulatory period to March 2025. The newly-issued bonds will mature on 31 March 2033 and 31 March 2026 respectively.

**Liquidity risk**
The Company maintains committed banking facilities in order to provide flexibility in the management of the group's liquidity. Under the Common Terms Agreement which governs obligations to bondholders and other financial creditors, the WBS group is required to have cash available to fund operations for a duration of 12 months. As at 31 March 2020, the group had committed undrawn borrowing facilities of £170m and net cash and cash equivalents (excluding debt service payments account) of £657m. The undrawn facilities of £170m of revolving credit facilities are available until November 2020.

As at 31 March 2020 there was also a special liquidity facility of £135m; this is required in order to meet certain interest and other obligations that may not be funded through operating cash flow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants. The facility has been provided by an insurance provider and is renewable on a rolling five-year evergreen basis (next renewal due 3 April 2024).

**Capital risk management**
The Company's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the Company operates (as a provider of financing to Dŵr Cymru Cyfyngedig), the Company monitors capital on the basis of the group's gearing ratio. This is calculated as net debt (as defined in borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Prices Index and determined by Ofwat. As at 31 March 2020 gearing was 60%.

**Financial instruments: concentration of risk and counterparty risk**
The Company uses a floating-to-fixed interest rate swap and fixed-to-RPI swaps which achieve the desired economic effect but which are not exact hedges under IFRS 9. These are fair-valued at the balance sheet date, with changes in fair value recognised through profit or loss. The fair values incorporate adjustments for both counterparty and the Company's own credit risk (see estimates and judgements section below).

These swaps are significantly 'out of the money' (from the Company's perspective), therefore there is no risk that the counterparty will be unable to meet its obligations in the foreseeable future. In the event of swaps being 'in the money' from the Company's perspective the counterparty is obliged to post collateral. There is no requirement to post collateral on the part of the Company if the swaps are 'out of the money'.

All swaps are held in sterling and as such are not exposed to significant geographical, currency or market risk outside of the UK.

In respect of the risks detailed above, further quantitative disclosures are provided in note 13.

## 2. Accounting estimates and judgements

Accounting judgement: transfer of assets and liabilities from fellow group company

During the period, the Company received the assets and liabilities of a fellow group company in order to take over its role in the group; the significant accounting judgement made in these financial statements is therefore the conclusion that the transfer did not constitute a transfer of trade and assets and was therefore not a business combination under IFRS 3.

Dŵr Cymru (Financing) UK plc was incorporated on 16 April 2019 and on 1 August 2019 the assets and liabilities of Dŵr Cymru (Financing) Limited were transferred into the Company; both entities are wholly-owned subsidiaries of Dŵr Cymru (Holdings) Limited.

Dŵr Cymru (Financing) Limited was incorporated in 2001 on the formation of Glas Cymru in order to provide long-term funding for the activities of Dŵr Cymru Cyfyngedig. It was registered in the Cayman Islands as well as in the UK, although the company has always been UK-resident for tax purposes. The sole purpose of the transaction was to remove the link to the Cayman Islands, following reports in the media criticising other companies' perceived tax-related connections. The company entered voluntary liquidation on 9 September 2019.

Dŵr Cymru (Financing) Limited had no employees and existed solely as the Glas Cymru group's financing vehicle; as such, the contracted terms of the funding it received were obtained only as a consequence of being an integral part of the wider group. The activities of Dŵr Cymru (Financing) Limited therefore did not constitute a business as defined by IFRS 3 (Business Combinations) and the transaction is outside the scope of that standard. As a result, at the time of the transfer, each asset and liability has been recognised under the relevant standards, being IFRS 9 (Financial Instruments) and IAS 12 (Income Taxes). The consideration for the novation of the assets and liabilities was made via the transfer to Dŵr Cymru (Financing) Limited of a promissory note with a value of £3,033,000 giving rise to a net gain of £57,433,000. This has been recognised as a capital contribution during the period.

Accounting estimate: derivative financial instruments

In accordance with IFRS 13 Fair Value Measurement trading and treasury derivatives of the Company are categorised into different levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
- Level 3: inputs for the asset or liability not based on observable market data (that is, unobservable inputs).

All of the Company's derivatives are categorised at Level 2 and as at 31 March 2020 were valued as follows:

- Assets: treasury derivatives £138.3m
- Liabilities: treasury derivatives £302.7m

Treasury derivatives relate to interest rate swap contracts and are recorded on the balance sheet at fair value. These have all been assessed as Level 2.

Level 2 debt investments are valued using a discounted cash flow approach, which discounts the contractual cash flows using discount rates derived from observable market prices of other quoted debt instruments of the counterparties. An adjustment factor is applied to the counterparty swap valuations to take into account the Company's own credit risk. This adjustment is calculated using the Bloomberg financial dataset valuation model and is derived from an average of the Company's fixed rate bond price at the balance sheet date. A 10% change in the adjustment for own credit risk would increase or reduce the period-end liability by £5.9m.

### 3. Segmental information

The Company's activity is solely to act as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig and therefore it operates in a single segment.

### 4. Net financial income

| | 2020 |
|---|---|
| | £000 |
| **Financial income:** | |
| - intercompany | **16,273** |
| | |
| **Financial expenses:** | |
| - interest payable | **(23,361)** |
| | |
| Fair value gains on derivative financial instruments before indexation | **27,159** |
| | |
| **Net financial income** | **20,071** |

Whilst the Company employs an economically effective policy using interest rate and currency swaps, this policy does not satisfy the stringent hedge accounting criteria of IFRS 9. Consequently, the Company's interest rate and inflation swaps are fair valued at each balance sheet date with the movement (net gain or loss) disclosed in the income statement. Over the life of these swaps, providing that there is an effective match, these fair value adjustments will reverse and reduce to zero. (See note 12 in respect of derivative financial instruments held on the balance sheet.)

The Company has on-lent to Dŵr Cymru Cyfyngedig (DCC) certain fixed rate bond liabilities and fixed-to-index-linked derivatives as single combined index-linked instruments. The indexation element of the fair value movement in the derivative values has been included in "interest payable" in the above analysis in order to match the intercompany financial income with the external interest payable.

### 5. Operating profit

**Services provided by the Company's auditor**
Audit fees of £45,000 have been borne by a fellow Group company.

### 6. Taxation

| | 2020 £000 |
|---|---|
| **Corporation tax** | |
| - group relief received | **(17)** |
| **Deferred tax** | |
| - current period credit | **1,441** |
| **Taxation** | **1,424** |

| | 2020 £000 |
|---|---|
| **Profit before taxation** | **20,071** |
| Profit before taxation multiplied by the corporation tax rate in the UK of 19% | **(3,813)** |
| Effect of: | |
| Release of fair value adjustments – not deductible for tax | **(1,364)** |
| Fair value movements on derivatives on which deferred tax not provided | **6,601** |
| **Taxation credit** | **1,424** |

A UK corporation tax rate of 19% (effective 1 April 2020) was substantively enacted on 17 March 2020, reversing the previously enacted reduction in the rate from 19% to 17%. Deferred tax at 31 March 2020 has been calculated at 19%.

### 7. Deferred tax asset

Deferred tax is calculated on temporary differences using a tax rate of 19%. The movement in deferred tax is as shown below:

| | 2020 £000 |
|---|---|
| At beginning of period | - |
| Credit to income statement | **1,441** |
| **At 31 March** | **1,441** |
| Deferred tax comprises: | |
| Derivative financial instruments | **1,441** |

Deferred tax assets and liabilities have not been recognised in relation to temporary differences present when the assets and liabilities of Dŵr Cymru (Financing) Limited were transferred to the Company. This is in accordance with the initial recognition exemption within IAS 12 (Income taxes) as this transaction was not a business combination and at the time of the transaction it affected neither accounting profit nor taxable profit. As no deferred tax was recognised initially, then no deferred tax will be recognised subsequently for these temporary differences as the carrying amounts of the assets and liabilities change.

The deferred tax asset recognised in these financial statements comprises deductible temporary differences arising from fair value movements on the interest rate swaps that the Company took out in February 2020 – see Strategic Report and note 12.

As at 31 March 2020, deferred tax was provided at the rate of 19% and is the rate which is expected to apply when the temporary differences reverse.

### 8. Other financial assets – loans to group undertakings

| | 2020 |
|---|---|
| | £000 |
| **Non-current** | |
| Loans to group undertakings | **3,795,238** |
| **Current** | |
| Loans to group undertakings | **402,164** |

Loans to group undertakings represent amounts on-lent to Dŵr Cymru Cyfyngedig, a fellow group company. All financing drawn by the Company is immediately on-lent to DCC at a margin of one basis point; details of the instruments and effective interest rates are set out in note 13.

### 9. Cash and cash equivalents

| | 2020 |
|---|---|
| | £000 |
| Cash at bank and in hand | **216** |
| **Cash and cash equivalents** | **216** |

The effective interest rate on short-term deposits as at 31 March 2020 was 0.8% and these deposits had an average maturity of one day.

### 10. Trade and other payables

| | 2020 |
|---|---|
| | £000 |
| Other payables | **17** |
| Accrued interest payable - intercompany | **1,915** |
| Accrued interest payable | **967** |
| **Trade and other payables** | **2,899** |

### 11. Other financial liabilities - borrowings

| | 2020 |
|---|---|
| | £000 |
| **Current** | |
| Bonds | **372,103** |
| European Investment Bank loans | **29,091** |
| | **401,194** |
| **Non-current** | |
| Bonds | **3,427,192** |
| European Investment Bank loans | **123,295** |
| | **3,550,487** |
| **Total** | **3,951,681** |

### 11. Other financial liabilities – borrowings (continued)

The principal terms of these borrowings as at 31 March 2020 were as shown below:

| Instrument | Type | Rate | Maturity | Nominal £000 | Book value £000 |
|---|---|---|---|---|---|
| **Bonds** | | | | | |
| Class A1 | Fixed | 6.0% | 31 March 2028 | 350,000 | **465,060** |
| Class A4 | Index-linked | 3.5% + RPI | 31 March 2030 | 265,000 | **680,088** |
| Class A5 | Index-linked | 3.5% + RPI (5% collar) | 31 March 2031 | 85,000 | **226,232** |
| Class A6 | Fixed | 4.5% | 31 March 2057 | 100,000 | **157,167** |
| Class B1 | Fixed | 6.9% | 31 March 2021 | 325,000 | **339,759** |
| Class B3 | Index-linked | 4.4% + RPI | 31 March 2026 | 128,600 | **296,946** |
| Class B4 | Index-linked | 4.4% + RPI (5% collar) | 31 March 2027 | 75,000 | **183,910** |
| Class B5 | Index-linked | 1.4% + RPI | 31 March 2057 | 50,000 | **144,776** |
| Class B6 | Index-linked | 1.9% + RPI | 31 March 2048 | 260,000 | **484,462** |
| Class B7 | Fixed | 2.5% | 31 March 2036 | 300,000 | **326,475** |
| Class B8 | Fixed | 1.4% | 31 March 2033 | 300,000 | **295,844** |
| Class C3 | Fixed | 1.6% | 31 March 2026 | 200,000 | **198,576** |
| | | | | 2,438,600 | **3,799,295** |
| **European Investment Bank loans** (amortising) | | | | | |
| 23297 | Floating | 3 month LIBOR + 31 bps | 15 December 2021 | 13,636 | **13,636** |
| 24642 tranche 1 | Floating | 3 month LIBOR + 31 bps | 15 December 2023 | 10,000 | **10,000** |
| 24642 tranche 2 | Floating | 6 month LIBOR + 45 bps | 15 April 2025 | 45,000 | **45,000** |
| 26030 tranche 1 | Floating | 3 month LIBOR + 82 bps | 15 September 2026 | 16,250 | **16,250** |
| 26030 tranche 2 | Floating | 6 month LIBOR +76 bps | 15 December 2028 | 67,500 | **67,500** |
| | | | | 152,386 | **152,386** |
| **Total** | | | | 2,590,986 | **3,951,681** |

A security package was granted by Dŵr Cymru Cyfyngedig (DCC), as part of the Company's bond programme for the benefit of holders of senior bonds and other senior financial creditors.

The obligations of DCC are guaranteed by the Company, Glas Cymru (Securities) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

i) a first fixed and floating security over all of DCC's assets and undertakings, to the extent permitted by the Water Industry Act, other applicable law and its licence; and

ii) fixed and floating security given by the guarantors referred to above which are accrued on each of the Company's assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

### 12. Other financial liabilities - derivative financial instruments

All derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IFRS 9. As such, movements in their fair values are taken to the Income Statement (see note 4). The fair values of derivative financial instruments are arrived at by discounting future cash flows associated with each swap. The swap rate data used for discounting the flows is obtained from a valuation tool using Level 2 techniques for fair value measurement.

| **2020** | **Fair values** | |
|---|---|---|
| | **Assets £000** | **Liabilities £000** |
| **Current** | | |
| Index-linked swaps | 36,094 | (4,869) |
| Interest rate swaps | - | (10,009) |
| Interest rate swaps - intercompany | 10,009 | - |
| | **46,103** | **(14,878)** |
| **Non-current** | | |
| Index-linked swaps | - | (195,609) |
| Interest rate swaps | - | (92,198) |
| Interest rate swaps - intercompany | 92,198 | - |
| | **92,198** | **(287,807)** |
| **Derivative financial instruments** | **138,301** | **(302,685)** |

The notional values of the swaps are: interest rate swaps - £192m; index-linked swaps - £950m.
In accordance with IFRS 9, "Financial instruments", the Directors reviewed all contracts for embedded derivatives that are required to be accounted for separately if they do not meet certain requirements set out in the standard. And confirm that there are none.

**Index-linked swaps**
The index-linked swaps have the effect of index-linking the interest rate on £950m of fixed rate bonds by reference to the Retail Prices Index (RPI).

The principal terms are as follows:

| | |
|---|---|
| Indexed notional amount: | £1,001m |
| Swap maturity: | 19 years |
| Interest rate: | 0.14% (indexed by RPI) |

The Group's activities expose it to a variety of financial risks: market risk (including fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

In accordance with IFRS 13, Fair Value Measurement trading and treasury derivatives of the Group are categorised into different levels;

**Level 1**: Quoted prices (unadjusted) in active markets for identical assets or liabilities
**Level 2:** Inputs other than quoted prices included within Level 1 that are observable for the assets or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
**Level 3**: Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

All of the Company's treasury derivatives are categorised at Level 2 and as at 31 March 2020 were valued as follows:
- Assets: treasury derivatives £138.3m.
- Liabilities: treasury derivatives £302.7m.

Treasury derivatives relate to interest rate swap contracts and are recorded on the balance sheet at fair value. These have all been assessed as Level 2.

Level 2 debt instruments are valued using a discounted cash flow approach, which discount the contractual cash flows using discount rates derived from observable market prices of other quoted debt instruments of the counterparties.

### 13. Financial risk management

The policies of the Group in respect of financial risk management are included in the accounting policies note on page 17. The numerical financial instrument disclosures as required by IFRS 7 are set out below:

**a) Interest rate risk**

The effective interest rates at the balance sheet dates were as follows:

| | 2020 |
|---|---|
| **Assets** | |
| Cash and cash equivalents | 0.0% |
| Amounts owed by group undertakings | 3.5% |
| | |
| **Liabilities** | |
| Bonds | 4.1% |
| European Investment Bank loans | 1.5% |

Other receivables and payables are non-interest bearing.

The effective interest rates excludes the effect of the interest rate swaps set out in note 12.

**b) Liquidity risk**

| 2020 | < 1 year £000 | 1–2 years £000 | 2-5 years £000 | > 5 years £000 | Total £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 216 | - | - | - | 216 |
| Other financial assets: | | | | | |
| - loans to group undertakings | 462,115 | 109,943 | 319,311 | 4,335,179 | 5,226,548 |
| | 462,331 | 109,943 | 319,311 | 4,335,179 | 5,226,764 |
| **Liabilities** | | | | | |
| Bonds | 432,039 | 85,702 | 264,307 | 4,050,884 | 4,832,932 |
| European Investment Bank loans | 31,191 | 26,345 | 61,000 | 42,650 | 161,186 |
| | 463,230 | 112,047 | 325,307 | 4,093,534 | 4,994,118 |

Bond liabilities and related loans to group undertakings reflect indexed cash flows for index-linked instruments based on a post 31 March 2020 assumption of RPI inflation of 2.5%.

**c) Fair values**

The following table sets out the fair value of the Company's financial assets and liabilities, other than the fair value of derivative financial instruments, which are set out in note 12.

| 2020 | Book value £000 | Fair value £000 |
|---|---|---|
| **Fair value of financial assets** | | |
| - cash and cash equivalents | 216 | 216 |
| - other receivables | 1,916 | 1,916 |
| - loans to group undertakings (note 8) | 4,197,402 | 4,140,150 |
| | 4,199,534 | 4,142,282 |
| | | |
| **Fair value of financial liabilities** | | |
| - European Investment Bank loans (note 11) | 152,386 | 152,386 |
| - bonds (note 11) | 3,799,295 | 3,742,043 |
| - other payables (note 10) | 2,899 | 2,899 |
| | 3,954,580 | 3,897,328 |

### 13. Financial risk management (continued)

**d) Borrowing facilities**

The Company had the following undrawn committed borrowing facilities available at 31 March, in respect of which all conditions precedent had been met at that date:

| | 2020 |
|---|---|
| | £000 |
| **Expiring in less than one year** | |
| Revolving credit facilities | 170,000 |
| | 170,000 |

All of the above facilities are at floating rates of interest.

The Company has a special liquidity facility of £135 million which it is required to maintain in order to meet certain Group interest and other obligations that cannot be funded through the operating cash flow of the Group, in the event of a standstill being declared by the Security Trustee. A standstill would arise in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. The facility is provided by an insurance provider and is renewable on a five-year rolling, evergreen basis (next renewal due 3 April 2024).

**e) Capital risk management**

**Gearing ratios (Group – Glas Cymru Holdings Cyfyngedig)**

| | 2020 |
|---|---|
| | £m |
| Total borrowings | (4,119) |
| Less: cash and cash equivalents | 667 |
| Net debt | (3,452) |
| RCV | 5,906 |
| Total capital | 2,454 |
| Less: unamortised bond costs and A6 bond indexation | (64) |
| Total capital per bond covenants | 2,390 |
| **Gearing ratio** | 60% |

While the Company has no capital requirements, as set out on page 18 the Group monitors its capital structure based on a regulatory gearing ratio which compares its net debt with the Ofwat-determined RCV.

### 14. Share capital and share premium

| | 2020 |
|---|---|
| | £ |
| **Authorised** | |
| 1 ordinary share of £1 | 1 |
| 50,000 ordinary shares of £1 each | 50,000 |
| | 50,001 |
| **Allotted and fully paid** | |
| 1 ordinary share of £1 | 3,032,680 |
| 1 ordinary share of £1 | 1 |
| | 3,032,681 |
| **Allotted and partly paid** | |
| 49,999 ordinary shares of £1 each (£0.25) | 49,999 |
| | |
| | 3,082,680 |

### 14. Share capital and share premium (continued)

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

During the period the Company issued one ordinary share of £1 for a consideration of £1, 49,999 ordinary shares of £1 each partly paid via a consideration of £12,500 and 1 ordinary share of £1 for a consideration of £3,032,680.

On 1 August 2019 the Company received a capital contribution amounting to £57,433,000, being the net fair value of asset and liability transfers from a fellow group company (see note 17).

### 15. Analysis and reconciliation of net funds

Net funds is defined as the value of cash and cash equivalents and the intercompany loan less net accrued interest and total borrowings.

**a) Net funds at the balance sheet date may be analysed as:**

| | 2020 |
|---|---|
| | £000 |
| Cash and cash equivalents | 216 |
| Other financial assets: | |
| - group receivables | 4,197,402 |
| | 4,197,618 |
| Net accrued interest | (966) |
| Debt due after one period | (3,550,487) |
| Debt due within one period | (401,194) |
| | (3,952,647) |
| **Net funds** | 244,971 |

**b) The movement in net funds during the period may be summarised as:**

| | 2020 |
|---|---|
| | £000 |
| Net funds at start of period | - |
| Increase in net cash | 216 |
| Increase in receivables | 420,730 |
| Increase in debt | (196,906) |
| **Increase in net funds arising from cash flows** | 224,040 |
| **Increase in net funds arising from acquisition** (non-cash, see note 17) | 57,433 |
| Amortisation of bond issue premium | 730 |
| Indexation of index-linked debt | (36,266) |
| Movement in accrued interest | (966) |
| **Movement in net funds during the period** | (36,502) |
| **Net funds at the end of the period** | 244,971 |

## 16. Employees and Directors

The emoluments of the Directors are paid by the parent company which makes no recharge to the Company as there are no qualifying services for Dŵr Cymru (Financing) UK plc. Accordingly, the financial statements include no emoluments in respect of Directors.

## 17. Transfer of assets and liabilities

**Summary**

Dŵr Cymru (Financing) UK plc was incorporated on 16 April 2019 and on 1 August 2019 the assets and liabilities of Dŵr Cymru (Financing) Limited (DCFL) were transferred into the Company. DCFL's activities were not standalone in nature and did not constitute a business, therefore the transfer falls outside the scope of IFRS 3 (Business Combinations) and a "common control" exemption is not available (see accounting judgement section in note 2). Assets and liabilities have therefore been fair valued at 1 August in accordance with IFRS 9 (Financial Instruments).

A summary of the 1 August 2019 initial recognition fair values of the assets and liabilities transferred from DCFL to DCF UK is shown below:

| **1 August 2019** | **£m** |
|---|---|
| Derivatives | (185.4) |
| Bonds | (3,362.9) |
| Term loans | (168.0) |
| Intercompany loan from DCC | 3,776.6 |
| Other | 0.1 |
| Total (gross) | 60.4 |
| Consideration | (3.0) |
| Total (net) | 57.4 |

Under IFRS 9, following initial recognition these assets and liabilities will subsequently be valued at amortised cost (with the exception of derivatives, which are fair valued at each balance sheet date).

**Fair value estimation on initial recognition**

The assets and liabilities identified following the transfer consist of derivatives, term loans, bonds, an intercompany loan and other receivables/payables. These all fall within the scope of IFRS 9 (Financial Instruments) and the Directors have therefore been through an exercise to recognise these at fair value as at 1 August 2019.

Note that as a result of the initial recognition exemption under IAS 12 (Income taxes), no deferred tax has been recognised on temporary differences arising from the novation of loans, bonds or derivative financial instruments.

<u>Liabilities</u>

*Derivatives - £185.4m (net)*

Derivatives consist of a (nominal) £192m floating-to-fixed rate swap and a £100m fixed-to-index-linked rate swap. Counterparty valuations are readily available for these and the Directors have overlaid an adjustment factor to take account of own credit risk as required by IFRS 9. This adjustment has been calculated using the Bloomberg financial dataset valuation model and is derived from an average of the Company's fixed rate bond prices at the balance sheet date. The risk-adjusted total fair value at the acquisition date was £286.6m.

Supplementary notes:

- the £192m floating-to-fixed rate swap has been on-lent to DCC as a standalone instrument. An asset of equal value (£101.3m) has therefore been recognised to reflect this, reported in the financial statements as an intercompany derivative and disclosed separately from the intercompany loan. No additional risk adjustment has been made to this asset – see notes on treatment of on-lent bonds below.
- the £100m fixed-to-index-linked rate swap has been combined with bond liabilities and on-lent to DCC as a single index-linked instrument and forms part of the intercompany loan – see section on on-lent bonds below.

*Bonds - £3,362.9m*

DCFL had various classes of bond tranches in issue on 1 August 2019 (all qualifying as 'senior' debt), most of which are actively traded and in respect of which market values have been obtained from Bloomberg. As at 1 August 2019 the Directors assessed the total fair value liability as amounting to £3,362.9m.

**17. Transfer of assets and liabilities (continued)**

**Fair value estimation on initial recognition (continued)**
*Term loans - £168.0m*
European Investment Bank (EIB) loans were transferred with an outstanding principal value of £168.0m. In determining an appropriate fair value for these loans, the Directors have had regard to the effective interest rate of 1.5% as at 31 March and their expectation that interest rates will remain low for the foreseeable future. The Directors consider that an appropriate discount rate would be the rate at which equivalent debt could be sourced at the balance sheet date; for floating rate debt of this nature, this was considered likely to be around 1.5%. As a consequence, the Directors believe it is appropriate to recognise the EIB loans at a net present value of £168.0m.

Assets
*Intercompany loan to DCC - £3,776.6m (£168.0m + £3,608.6m)*
The transfer has resulted in the Company recognising a loan to Dŵr Cymru Cyfyngedig (DCC) which encompasses the on-lending of all of the derivative and debt liabilities referred to above and is the largest single-value item on the Company's balance sheet.

Approach to risk: IFRS 9 requires the fair value of financial instruments to incorporate an appropriate risk adjustment. The Directors have reviewed Standard and Poor's published cumulative default rates for high grade corporate bonds and note that, at 0.02%, the one-year default rate does not indicate the existence of a material expected credit loss. The Directors also recognise that when investors lend to the Company, they are aware that the Company is part of the whole business securitisation set up to ringfence funding for use in DCC's regulated water and sewerage business, and that the funds are therefore going to be utilised and repaid by DCC; because of this clear link, the Directors consider expected credit loss to be minimal.

EIB term loans: the on-lent EIB term loans are recognised at the same value as their corresponding liabilities.

Bonds: the Company benefits from a one basis point margin applied to all bond coupons and the Directors have added the net present value of this to the fair values of the bonds as at 1 August 2019 in arriving at the fair value of the on-lent asset (discounted at a rate of 1.74%).

There is one exception: one of the bond tranches, £100m of A6 bonds, was issued at a fixed rate of 6% and swapped to an index-linked rate - see derivatives in the liabilities section above - and the combined instrument has been on-lent to DCC as a single index-linked bond. The fair value of the on-lent receivable has been calculated based on the fair value of an equivalent index-linked bond at then-current market rates.

As at 1 August 2019, the relationship between the Company's liabilities and the related assets within its intercompany loan to DCC can be shown as:

| Bond class | Fair value of liability | Net present value of 1bp margin | Fair value of index-linked element (A6 only) | Fair value of intercompany loan |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| A1 | 481.0 | 0.3 | - | 481.3 |
| A4 | 688.3 | 0.4 | - | 688.7 |
| A5 | 228.7 | 0.2 | - | 228.9 |
| A6 | 159.3 | 0.4 | 242.7 | 402.4 |
| B1 | 356.8 | 0.1 | - | 356.9 |
| B3 | 303.0 | 0.1 | - | 303.1 |
| B4 | 187.5 | 0.1 | - | 187.6 |
| B5 | 144.1 | 0.2 | - | 144.3 |
| B6 | 484.3 | 0.8 | - | 485.1 |
| B7 | 329.9 | 0.4 | - | 330.3 |
| **Total** | **3,362.9** | **3.0** | **242.7** | **3,608.6** |

**Subsequent treatment**
Under IFRS 9, the assets and liabilities initially recognised at fair value on 1 August 2019 as set out above are carried thereafter at amortised cost, with the exception of derivatives which are fair valued at each balance sheet date. The Directors have prepared amortisation schedules for all relevant instruments to reflect this approach.

18. **Related party transactions**

During the period to 31 March 2020 a transfer of assets and liabilities took place involving the Company and Dŵr Cymru (Financing) Limited as set out in note 17, above.

Intercompany interest receivable from Dŵr Cymru Cyfyngedig (DCC), another member of the Glas Cymru Holdings Cyfyngedig Group, was £16,273,000 during the period. As at 31 March 2020 the balance outstanding on the intercompany loan to DCC stood at £4,196,393,000. Other outstanding balances as at 31 March 2020 were accrued interest on the loan of £959,000, an accrued swap receipt of £1,915,000 and the closing fair value of the intercompany interest rate swap of £102,207,000.

All borrowings raised by the Company are immediately on-lent to DCC on an arms-length basis. The intercompany loan is subject to the terms and conditions of the whole business securitisation structure of Glas Cymru Anghyfyngedig and its subsidiaries. DCC, in its capacity as debtor, repays such principal and interest as is due on each borrowing on the due date plus a margin of one basis point (0.01%).

As at 31 March 2020 a balance of £50,000 was owed by the parent company, Dŵr Cymru (Holdings) Cyfyngedig.

**19. Immediate and ultimate holding company and controlling party**

The immediate parent company is Dŵr Cymru (Holdings) Limited and the ultimate holding company and controlling party is Glas Cymru Holdings Cyfyngedig, both of which are registered in England and Wales. Registered Office: Pentwyn Road, Nelson, Treharris, Mid Glamorgan, CF46 6LY. The largest and smallest groups within which the results of the Company are consolidated are those headed by Glas Cymru Holdings Cyfyngedig and Glas Cymru Anghyfyngedig respectively (consolidated financial statements can be obtained from the Company Secretary at Pentwyn Road, Nelson, Treharris, Mid Glamorgan CF46 6LY) or by emailing the Company Secretary at company.secretary@dwrcymru.com.

Contact address:
Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

**Dŵr Cymru (Financing) UK plc**

**UK Registered Office:** Pentwyn Road, Nelson, Treharris, Mid Glamorgan, CF46 6LY, United Kingdom

## Management responsibility statement of the Board of Directors

To the best of our knowledge, the financial statements prepared in accordance with the International Financial Reporting Standards as adopted by the European Union give a true and fair view of the assets, liabilities, financial position and profit or loss of Dŵr Cymru (Financing) UK plc (the Issuer).

To the best of our knowledge, the management report includes a fair view of the development and performance of the business and the position of the Issuer, together with a description of the principal risks and uncertainties that we face.

**30 September 2020**

**Director:**

Name: P M Davis