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Glas Cymru Cyfyngedig

Investor Report

For the quarter ended 31 December 2005

Important Notice

This report is being distributed in fulfilment of a finance document, the Common Terms Agreement. It is directed to, and intended for existing investors in the company. No other persons should act or rely on it. The company makes no representation as to the accuracy of forecast information. This report should not be relied on as a guide to future performance, and should not be relied on in deciding whether to undertake future investment in the company. It should be noted that the information in this report has not been reviewed by the company's auditors.

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General overview & business update

This quarterly investor report covers the three month period ending 31 December 2005. The Investor Report is a requirement of the Common Terms Agreement (CTA), which governs the company's obligations to its bond holders and other financial creditors. The report enables assessment of the company's past financial performance, together with its compliance with the covenants stipulated by the CTA.

The data in this report is drawn from the company's accounting records, applying the accounting policies as per the company's statutory accounts, but is presented in a modified form for investors as required by the CTA.

Financial Performance

Financial performance over the nine month period was broadly in line with expectations with gearing (net debt/regulatory capital value) at 31 December 2005 of some 80% (as compared to some 93% on the acquisition of Welsh Water in May 2001).

Summary financial results for the nine month period ended 31 December 2005 are as follows:

	Period to 31 December 2005 £m	Period to 31 December 2004 £m	Change
Turnover	414.3	368.1	+13%
Operating costs	161.5	155.7	+4%
EBITDA	**252.8**	**212.4**	+19%
Net interest (excluding indexation and amortisation)	97.1	92.6	
Capital expenditure (before grants and contributions)	167.0	189.5	

Operating profit before interest, tax, depreciation and amortisation (EBITDA) increased by some 19% to £253 million (2004: £212 million) due primarily to the increase in prices of 17.3% allowed by the price control for the year, offset to some extent by the higher 'customer dividend' for the year of £18 per customer (2004: £9 per customer).

Turnover in the nine months to 31 December 2005 was £414 million, as compared to £368 million in the nine months to 31 December 2004. The increase reflects the RPI+K increase in prices of 17.3% allowed by Ofwat less the increase in the 'customer dividend' for the year from £9 per customer to £18 per customer. In the 9 month period to 31 December 2005, 23,000 domestic customers switched to metered charging (2004: 26,000).

Operating costs (excluding depreciation and infrastructure renewals expenditure) were £162 million (2004: £156 million). Around 70% of operating costs are accounted for by the competitively procured operating contracts, which came into effect on 1 April 2005.

Net interest payable in the period (excluding fair value movements) was £111million (2004: £106 million), including an indexation charge on index linked debt of £12 million (2004: £12 million).

Capital Investment Programme

Capital investment (including infrastructure renewals expenditure) was £167 million before grants and contributions (2004: £190 million). Expenditure to date is in-line with Welsh Water's £1.2 billion AMP4 capital investment programme to deliver regulatory targets for service and environmental improvements.

Prospective Financial Ratio Tests

As required by the CTA to demonstrate compliance with prospective financial ratio tests (regulatory asset ratio and interest cover ratios), this report includes projected ratios up to 31 March 2010. These projected ratios are derived from Glas Cymru's business plan (which has been prepared by the company) and are in the format specified by the CTA. On this basis, the prospective financial ratios exceed the "trigger levels" as defined in the CTA (see pages 11 to 14). It should be noted that the company's business plan and the projected ratios have not been reviewed by the company's auditors and the reader's attention is drawn to the important notice at the front of this document.

Financing

On 31 March 2005, following approval by the Security Trustee, Dwr Cymru (Financing) Ltd (DCFL) called and cancelled the £100 million Class D1 bonds.

On 15 April 2005 Moody's announced an upgrade to the rating of the Class C1 and Class C2 bonds from Baa3 to Baa2.

On 29 April 2005, DCFL entered into a seven year revolving credit banking facility with Fortis Bank for £75 million. DCFL followed this on 9 May 2005 by signing a five year facility for £305 million with a group of banks comprising The Royal Bank of Scotland, Barclays, HSBC, Bayerische Landesbank, ING and Sumitomo Mitsui Banking Corporation (Europe). These banking facilities give the Company flexible access to funds at rates competitive with the prevailing rates available in the bond market. The previous £150 million syndicated bank facilities were cancelled on the same day.

Given the strong liquidity position of the Company and the change in the prevailing rates of interest in the capital markets since May 2001, notice was given on 16 May 2005 for the call and early redemption on 30 June 2005 of the following bond series:

- US$286 million (£200 million) Class A3, expected maturity March 2008
- £100 million Class B2, expected maturity March 2008
- £125 million Class C2, expected maturity March 2008

This repurchase of bonds was financed from existing cash resources and by an initial draw-down under the financing facilities of £192 million.

On 22 July 2005 the Group agreed a new £30 million long life asset lease facility with a leasing subsidiary of Lloyds TSB. £22 million of this facility was drawn down on 29 July 2005.

On 20 October 2005 further lease facilities of £30 million and £10 million were agreed with leasing subsidiaries of The Royal Bank of Scotland and Alliance & Leicester respectively. Lease drawdowns in the three months to 31 December 2005 were £55 million, including these new facilities.

On 5 December 2005, we completed a £100 million loan facility with the European Investment Bank ("EIB") to fund capital investment in AMP4. This facility is available to be drawn in the 18-month period to 5 June 2007.

As at 31 December 2005, we had undrawn EIB, revolving credit and lease facilities of £418 million, giving the company a high degree of liquidity.

In July/August 2005 and January 2006, we executed £587 million of inflation (RPI) swaps with banks to hedge the interest rate exposure of an equivalent amount of finance leases. The effect of the swaps is to fix the weighted average real interest rate of these leases at some 1.6% plus the lessors' interest margin. These swaps have a range of maturities of 13 to 34 years.

As a result of these inflation swaps the company's inflation linked debt exposure has increased to approximately 50% of its gross debt.

On 10 February 2006 we gave notice for the call and redemption of the Class A2 £100 million floating rate notes on their expected maturity date of 31 March 2006. The redemption of these bonds will be funded from our revolving credit banking facilities.

Cryptosporidium in North Wales

On 29 November 2005, Dwr Cymru Welsh Water, on the recommendation of the Outbreak Control Team, issued a Boil Water Notice to customers supplied with water from its Cwellyn water treatment works. The Notice was introduced because studies suggested that Llyn Cwellyn could be a possible source of the cryptosporidiosis outbreak in Gwynedd and Anglesey. In total, 231 people were diagnosed with cryptosporidiosis in the area over a period of some two months.

Dwr Cymru was a member of the Outbreak Control Team from the start of the outbreak and provided detailed information on the water supply routes and the results of water treatment testing at and around Llyn Cwellyn. Records show that the water treatment works has been functioning normally and that there has been no breach of water quality standards.

However, as a further safeguard, Dwr Cymru has installed additional (ultra violet) treatment to water supplies from Llyn Cwellyn. As soon as the new equipment was working properly, the Outbreak Control Team was confident that the water supply could no longer be a possible source of any illness and the Boil Notice was lifted on 30 January 2006.

Dwr Cymru has made an ex gratia payment of £25 to all customers affected by the Boil Notice (totalling some £750,000). The payment is for the inconvenience that has been experienced and for the additional energy costs that customers have incurred by having to boil water from the tap for drinking and for food preparation purposes. The payment should not be interpreted as an acceptance by Dwr Cymru that its water supply or treatment is the cause of the outbreak.

Outsourcing of operations

No material contractual issues have occurred during the period.

Following a competitive tendering exercise, Hyder Consulting have been appointed as Network Development Consultants. This contract, which has a value of some £1.5 million a year, commenced on 1 January 2006 and can run for up to 14 years.

Customer service, water quality and environmental quality

In September, Ofwat published its Annual Report on Levels of Service for the Water Industry in England and Wales for the year to 31 March 2005. On Ofwat's "Overall Performance Assessment", Welsh Water was ranked joint first, with Yorkshire Water, compared to second last year. This performance reflects a sustained commitment to improving services for customers. Prior to its acquisition by Glas Cymru, Welsh Water was ranked seventh in 2000/01.

International Financial Reporting Standards (IFRS)

On 22 September 2005, Glas Cymru published its "IFRS adoption document". The main effects of the adoption of IFRS are on non cash items, including deferred tax, changes in the current value of derivatives and the depreciation of infrastructure assets.

Glas Cymru purchases financial instruments to achieve economic hedges in respect of its borrowings so that a high proportion of its borrowings are at fixed interest rates. The introduction of the new International Accounting Standards (IFRS) requires specific tests to be met in order to achieve hedge accounting for purposes of the financial statements. As the current hedges achieve economic effectiveness and comply with our hedging policy, the financial instruments have not been reconfigured to satisfy the requirements of IFRS. Accordingly, the balance sheet includes the fair market value of swaps with the change in value between balance sheet dates recognised in the income statement. For the nine months ended 31 December 2005, this means that a £52 million non-cash "book loss" (2004: £19 million loss) has been charged to the income statement. Over the life of the interest rate swaps, these fair value adjustments will reverse and reduce to zero.

At 31 December 2005, the balance sheet includes a provision for deferred tax of £379 million (Dec 2004: £379 million) reflecting the temporary differences between the carrying value and tax base of the group's assets and liabilities. IFRS, unlike UK GAAP, does not permit the discounting of deferred tax liabilities. Consequently, IFRS has increased the reported deferred tax provision by some £300 million. The Group does not expect these provisions to crystallise into significant actual tax liabilities in the foreseeable future.

Corporate Governance

Glas Cymru held its regular half-year review meeting with members on 9 December 2005. There was no formal business conducted at the meeting.

Investor Meetings

The company is always happy to meet with any individual investor on request to discuss this investor report and the performance of the company in general.

Consolidated cashflow

	3 months ended 31 Dec 2005	9 months ended 31 Dec 2005	*9 months ended 31 Dec 2004*
	£m	£m	*£m*
Turnover	139.1	414.3	*368.1*
Less: operating expenses	(55.3)	(161.5)	*(155.4)*
Earnings before interest, taxation, depreciation and amortisation	83.8	252.8	*212.7*
Working capital movements	(6.2)	(47.1)	*(5.4)*
Non bond related interest received /(paid)	(0.1)	(0.3)	*1.3*
Interest received	1.2	8.9	*11.6*
Net operating cashflow and interest received	78.7	214.3	*220.2*
New borrowings:			
Finance leases	54.0	109.4	*254.0*
Authorised loan facilities	(50.2)	65.2	*35.0*
Utilisation of reserves:			
Cash transferred to capex reserve	(35.1)	(91.0)	*(86.0)*
Cash utilised from capex reserve	38.7	143.3	*123.2*
Cash utilised from other reserves	5.8	17.3	*8.5*
Capital expenditure:			
Sale proceeds from disposal of assets	0.5	0.6	*0.6*
Infrastructure renewal expenditure	(11.3)	(32.1)	*(36.7)*
Non-infrastructure maintenance	(12.5)	(35.5)	*(40.7)*
Enhancement expenditure	(35.6)	(101.2)	*(126.3)*
Net cashflow after capital expenditure, new borrowings and reserve drawings	33.0	290.3	*351.8*
Transfer to debt service payment account	(23.0)	(118.3)	*(111.2)*
Principal repayments	-	(425.1)	*(73.5)*
Termination cost on early redemption of swap	-	-	*(6.9)*
Net cashflow after debt service	10.0	(253.1)	*160.2*
Free cash balances brought forward	(18.7)	244.4	*139.1*
Free cash balances carried forward	(8.7)	(8.7)	*299.3*

Consolidated debt service payments

	Payments due & made in 3 months ending 31 Dec 2005 £m	Amount accrued 31 Dec 2005 £m
Liquidity facility:		
Liquidity facility commitment fee	0.3	0.1
Senior interest payments:		
Finance lease interest payments	-	36.5
A1 interest payments	-	16.0
A2 interest payments	1.2	-
A4 interest payments	-	2.6
A5 interest payments	-	0.8
B1 interest payments	-	17.0
B3 interest payments	-	1.6
B4 interest payments		0.9
EIB loan	0.4	0.1
Authorised loan interest	0.6	0.5
Authorised loan facilities' commitment fees	-	0.1
Miscellaneous fees	-	-
	2.5	76.2
Interest rate swaps	1.8	-
MBIA fees	-	(1.1)
Finance lease Principal (Nett)	0.5	-
Finance lease, VAT on payment	0.1	-
Senior interest payments	4.9	75.1
Junior debt:		
C1 interest payments	-	7.7
Total debt service payments	4.9	82.8

Glas notes principal balance reconciliation

	Credit rating	Opening balance 1 Oct 2005 £m	New Issues £m	Repayment £m	Indexation £m	Closing balance 31 Dec 2005 £m
Finance leases		686.9	54.7	(0.7)		740.9
A1 notes	AAA/Aaa	350.0				350.0
A2 notes		100.0				100.0
A3 notes		-				-
A4 notes		291.6			2.5	294.1
A5 notes		93.3			1.0	94.3
B1 notes	A-/A3	325.0				325.0
B2 notes		-				-
B3 notes		141.9			1.0	142.9
B4 notes		82.3			0.8	83.1
C1 notes	BBB/Baa2	125.0				125.0
C2 notes		-				-
D notes	n/a	-				-
Local authority loans		4.0				4.0
Authorised loan drawdowns		150.4		(50.2)		100.2
		2,350.4	54.7	(50.9)	5.3	2,359.5

Glas bank account movements

	Opening balance 1 Oct 2005 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 Dec 2005 £m
Free cash balances:					
Receipts account	4.3		135.7	(96.3)	43.7
Payments account	(26.6)		304.6	(334.5)	(56.5)
Other bank accounts	3.6	1.2	273.1	(273.8)	4.1
	(18.7)	1.2	713.4	(704.6)	(8.7)
Debt service payment account:					
Debt service ledger	58.7		23.0	(4.9)	76.8
	58.7		23.0	(4.9)	76.8
Capex reserve account	7.3		35.1	(38.7)	3.7
Customer payments account:					
Customer rebate ledger	11.6		-	(5.8)	5.8
	58.9	1.2	771.5	(754.0)	77.6

Interest cover ratio (ICR) – Actuals to 31 March 2005

	Actual			
	Period to 31 Mar 2002 £m	Year to 31 Mar 2003 £m	Year to 31 Mar 2004 £m	Year to 31 Mar 2005 £m
Income	406.1	462.9	481.2	505.6
Operating expenditure	(183.8)	(204.0)	(210.4)	(210.3)
Pre capital maintenance cashflows	222.3	258.9	270.8	295.3
Capital maintenance expenditure	(82.1)	(137.3)	(111.0)	(85.7)
Post capital maintenance cashflows	140.2	121.6	159.8	209.6
Net interest (excluding indexation)	(104.8)	(119.4)	(124.3)	(122.7)
Capital expenditure	(98.0)	(124.7)	(148.7)	(142.0)
Customer rebates	-	-	(11.5)	(11.5)
Pre-financing cashflows	(62.6)	(122.5)	(124.7)	(66.6)
Interest payable on senior debt:				
Finance leases	8.7	12.6	12.8	12.5
Class A	43.2	47.0	46.4	50.0
Class B	30.5	33.8	36.3	37.8
New debt	-	-	-	-
MBIA wrap fees	4.3	4.9	4.8	4.7
Interest & currency swaps	2.9	9.9	15.1	8.3
Authorised loans	-	-	-	0.5
Less interest receivable	(12.9)	(16.8)	(17.6)	(19.1)
Total net senior debt interest	76.7	91.4	97.8	94.7
Interest payable on junior debt:				
Class C	16.9	18.5	18.1	19.5
Class D	9.0	8.0	6.8	5.8
Other	2.2	1.5	1.6	2.7
Total interest payable	104.8	119.4	124.3	122.7
Senior interest cover pre capital maintenance (trigger 2.0; default 1.6)	2.9	2.8	2.8	3.1
Total interest cover pre capital maintenance	2.1	2.2	2.2	2.4
Senior interest cover post capital maintenance (trigger 1.1)	1.8	1.3	1.6	2.2
Total interest cover post capital maintenance	1.3	1.0	1.3	1.7

Interest cover ratio (ICR) – Projections to 31 March 2010

(See important notice at the front of the document)	Year to 31 Mar 2005 £m	Year to 31 Mar 2006 £m	Year to 31 Mar 2007 £m	Year to 31 Mar 2008 £m	Year to 31 Mar 2009 £m	Year to 31 Mar 2010 £m
Income	505.6	560	584	612	636	656
Operating expenditure	(210.3)	(226)	(225)	(228)	(232)	(238)
Pre capital maintenance cashflows	295.3	334	359	384	404	418
Capital maintenance expenditure	(85.7)	(107)	(107)	(123)	(122)	(112)
Post capital maintenance cashflows	209.6	227	252	261	282	306
Net interest (excluding indexation)	(122.7)	(138)	(132)	(136)	(137)	(136)
Capital expenditure	(142.0)	(110)	(145)	(136)	(114)	(112)
Customer rebates	(11.5)	(23)	(23)	(23)	(23)	(23)
Pre-financing cashflows	(66.6)	(44)	(48)	(34)	8	35
Interest payable on senior debt:						
Finance leases	12.5	29	30	30	30	30
Class A	50.0	51	35	35	36	36
Class B	37.8	38	32	36	36	36
New debt	0.0	0	0	0	0	0
MBIA wrap fees	4.7	5	4	4	4	4
Interest & currency swaps	8.3	4	4	4	2	2
Authorised loans	0.5	4	17	20	20	19
Less interest receivable	(19.1)	(14)	(2)	(4)	(3)	(3)
Total net senior debt interest	94.7	117	120	125	125	124
Interest payable on junior debt:						
Class C	19.5	19	10	10	10	10
Class D	5.8	-	-	-	-	-
Other	2.7	2	2	2	2	2
Total interest payable	122.7	138	132	137	137	136
Senior interest cover pre capital maintenance (trigger 2.0; default 1.6)	3.1	2.9	3.0	3.1	3.2	3.4
Total interest cover pre capital maintenance	2.4	2.4	2.7	2.8	2.9	3.1
Senior interest cover post capital maintenance (trigger 1.1)	2.2	1.9	2.1	2.1	2.3	2.5
Total interest cover post capital maintenance	1.7	1.6	1.9	1.9	2.1	2.2

Regulatory asset ratio (RAR) – Actuals to 31 March 2005

	Actual			
	As at 31 Mar 2002 £m	As at 31 Mar 2003 £m	As at 31 Mar 2004 £m	As at 31 Mar 2005 £m
Senior gross debt:				
Finance leases	289	382	440	632
Class A	1,003	1,009	1,020	1,031
Class B	561	563	640	646
Net interest accrual on senior debt	49	14	43	32
Authorised loans	-	-	-	35
Total senior gross debt	1,902	1,968	2,143	2,376
Less: cash balances and authorised investments	(383)	(287)	(280)	(325)
Total senior net debt	1,519	1,681	1,863	2,051
Class C	250	250	250	250
Interest accrual on Class C	10	-	-	-
Class D	100	76	56	-
Interest accrual on junior debt	-	-	-	-
Local authority loans	5	5	4	4
Other interest accruals	-	1	-	-
Total net debt	1,884	2,013	2,173	2,305
Regulatory capital value (RCV)	2,125	2,362	2,594	2,843
Reserves (RCV less total net debt)	241	349	421	538
Regulatory asset ratio:				
RAR (Senior)	71%	71%	72%	72%
RAR (Senior + C) (trigger 90%; default 95%)	83%	82%	82%	81%
RAR (Total debt)	89%	85%	84%	81%

Regulatory asset ratio (RAR) – Projections to 31 March 2010

(See important notice at the front of the document)	As at 31 Mar 2005 £m	As at 31 Mar 2006 £m	As at 31 Mar 2007 £m	As at 31 Mar 2008 £m	As at 31 Mar 2009 £m	As at 31 Mar 2010 £m
Senior gross debt:						
Finance leases	632	629	625	621	616	609
Class A	1,031	738	746	754	762	770
Class B	646	551	605	610	614	619
Net interest accrual on senior debt	32	37	41	45	47	49
Authorised loans	35	365	364	414	412	386
Total senior gross debt	2,376	2,320	2,382	2,443	2,451	2,433
Less: cash balances and authorised investments	(325)	(26)	(21)	(20)	(20)	(20)
Total senior net debt	2,051	2,294	2,361	2,423	2,431	2,413
Class C	250	125	125	125	125	125
Interest accrual on Class C	-	-	-	-	-	-
Class D	-	-	-	-	-	-
Interest accrual on junior debt	-	-	-	-	-	-
Local authority loans	4	4	4	4	4	4
Total net debt	2,305	2,423	2,490	2,552	2,560	2,542
Regulatory capital value (RCV) [1]	2,843	3,031	3,210	3,364	3,487	3,577
Reserves (RCV less total net debt)	538	608	720	812	927	1,035
Regulatory asset ratio:						
RAR (Senior)	72%	76%	74%	72%	70%	67%
RAR (Senior + C) (trigger 90%; default 95%)	81%	80%	77%	76%	73%	71%
RAR (Total debt)	81%	80%	78%	76%	73%	71%

[1] **as published by Ofwat (RD 07/05) on 22 April 2005**

Income Statement

	3 months ended 31 Dec 2005 (unaudited)	9 months ended 31 Dec 2005 (unaudited)	*9 months ended 31 Dec 2004 (unaudited)*
	£m	£m	*£m*
Turnover	139.1	414.3	*368.1*
Operating expenditure	(55.3)	(161.5)	*(155.7)*
EBITDA	83.8	252.8	*212.4*
Infrastructure renewals expenditure	(12.0)	(31.7)	*(32.8)*
Depreciation	(24.3)	(72.9)	*(66.8)*
Profit on disposal of fixed assets	0.5	0.8	*4.7*
Operating profit	48.0	149.0	*117.5*
Interest payable	(39.2)	(118.8)	*(118.9)*
Interest receivable	1.4	7.7	*12.5*
Fair value (losses)/gains on financial instruments	(18.2)	(52.1)	*(18.6)*
Profit before tax	(8.0)	(14.2)	*(7.5)*
Taxation	-	1.9	*2.6*
Profit after tax	(8.0)	(12.3)	*(4.9)*

Note: all results stated under IFRS

Balance sheet at 31 December 2005

	At 31 Dec 2005 (unaudited)		At 31 March 2005	
	£m	£m	£m	£m
Fixed assets		2,776.9		2,725.3
Current assets and liabilities:				
Debtors and prepayments	95.7		75.6	
Creditors and accruals	(92.4)		(125.2)	
		3.3		(49.6)
Total assets less current liabilities		2,780.2		2,675.7
Financing liabilities:				
Bonds	(1,514.4)		(1,878.8)	
Finance leases	(740.9)		(631.5)	
Authorised loan facilities	(100.2)		(35.0)	
Other	(4.0)		(4.1)	
	(2,359.5)		(2,549.4)	
Net interest accrual	(97.1)		(32.0)	
	(2,456.6)		(2,581.4)	
Cash and cash equivalents:				
Receipts account	43.7		59.6	
Payments account	(56.5)		172.4	
Capex reserves account	3.7		56.0	
Debt service payment account	76.8		1.6	
Customer payments account	5.8		23.1	
Other bank accounts	4.1		12.4	
	77.6		325.1	
Net debt		(2,379.0)		(2,256.3)
Derivative financial instruments		(120.3)		(116.8)
Provisions for liabilities and charges		(10.0)		(17.5)
Net assets before deferred tax		**270.9**		**285.1**
Deferred tax		(378.5)		(380.4)
Net liabilities		(107.6)		(95.3)

Note: all results stated under IFRS