



Investor Report

For the quarter ended 31 December 2010

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Contents

	Page
General overview and business update	1
Consolidated cash flow	5
Consolidated debt service payments	6
Glas notes principal balance reconciliation	7
Glas bank account movements	8
Interest cover ratio (ICR) – 5 years to 31 March 2010	9
Interest cover ratio (ICR) – 5 years to 31 March 2015	10
Regulatory asset ratio (RAR) – 5 years to 31 March 2010	11
Regulatory asset ratio (RAR) – 5 years to 31 March 2015	12
Income statement	13
Statement of comprehensive income	13
Balance sheet	14

General overview and business update

This quarterly Investor Report covers the three month period ending 31 December 2010. The Investor Report has been prepared to comply with the specific requirements of the Common Terms Agreement (CTA), which governs the company's obligations to its bondholders and other financial creditors.

The financial information 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. Investors are also referred to the unaudited interim report and accounts which are published concurrently with this Investor Report.

Business performance including key performance indicators (KPIs) for operations and customer service are reported in the company's annual report and accounts. These are available on the company's website (www.dwrcymru.com).

Financial performance

Summary financial results for the nine months ended 31 December are as follows:

	9 months to 31 December 2010 £m	9 months to 31 December 2009 £m	Change
Turnover	501	511	-2%
Operating costs	197	196	+1%
EBITDA (before infrastructure renewals expenditure)	304	315	-3%
Net interest (excluding indexation)	76	86	
Capital expenditure (before grants and contributions)	172	270	

General overview and business update cont'd

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the nine months to 31 December 2010 is slightly lower than the comparative period last year – price reductions have driven the reduction in income of some £10 million yet, while the economic environment continues to be challenging, operating costs have remained stable.

Turnover in the nine months to 31 December 2010 was £501 million, as compared to £511 million in the nine months to 31 December 2009. The reduction is a reflection of the overall price reduction of 1.0% (being the RPI+K adjustment required by Ofwat). During the period, 8,000 domestic customers switched to metered charging (2009: 15,000).

Operating costs (excluding depreciation and infrastructure renewals expenditure) were £197 million (2009: £196 million); insurance, pension and IT cost increases have been offset by operational cost and power cost savings.

Net interest payable in the period (excluding fair value movements) was £107 million (2009: £68 million), including a £6 million premium on early redemption of £113 million of Class C1 bonds and an indexation charge on index-linked debt of £31 million (2009: credit of £18 million). Indexation for the year to March 2010 was based on the movement in the Retail Prices Index (RPI) from July 2008 (216.5) to July 2009 (213.4); as inflation was negative over this period, this resulted in a credit to the income statement.

As at 31 December 2010, nearly all borrowings are at fixed or index-linked rates of interest (in part through the use of RPI swaps), which means that the company is insulated from volatility in market interest rates.

The regulatory gearing (the ratio of net debt to regulatory capital value) of the company was as follows:

£m	31 December 2010	31 March 2010
Net debt	2,668	2,669
Regulatory capital value	3,901	3,737
'Financial reserves'	1,233	1,068
Regulatory gearing	68%	71%

On Glas Cymru's acquisition of Welsh Water in May 2001, gearing stood at 93% (net debt/RCV). Since then, the financial position of the group has been steadily improved, such that gearing has fallen to 68% as at 31 December 2010 and 'financial reserves' (RCV less net debt) have exceeded £1 billion. The company's policy is to operate at a gearing level of around 70%.

General overview and business update cont'd

Capital investment programme

Capital investment (including infrastructure renewals expenditure) was £172 million before grants and contributions (2009: £270 million). Of that £172 million, £64 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £118 million is classed as capital maintenance.

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 2015. These projected ratios are derived from Glas Cymru's 2010 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 10 and 12). 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. For the investor report covering the period to 31 March 2011, the projected ratios will be updated to reflect Glas Cymru's 2011 business plan.

Credit ratings

Moody's Investor Service ("Moody's"), Standard and Poor's ("S&P") and Fitch Ratings ("Fitch") have all reviewed their credit ratings of MBIA UK Insurance Limited ("MBIA") and, as a consequence, their rating of the company's Class A Bonds, which are guaranteed by MBIA. As of 8 February 2011, the credit ratings of MBIA were B3 and B from Moody's and S&P respectively, and MBIA is no longer rated by Fitch.

The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA, revert to their higher underlying ratings of A3/A/A by Moody's, S&P and Fitch respectively. The strong credit quality of the business is reflected in credit ratings which are now the highest in the water sector, despite a challenging Final Determination:

Bond Class	Moody's	S&P	Fitch
A	A3	A	A
B	A3	A	A
C	Baa2	BBB+	BBB+

Moody's corporate family rating of Dŵr Cymru Cyfyngedig is A3, one of the strongest ratings in the industry.

On 18 October 2010 S&P reaffirmed Glas' ratings and negative outlook, reflecting their assessment of the potential impact of Ofwat's Final Determination following the 2009 Price Review.

General overview and business update cont'd

Financing and liquidity

As at 31 December 2010, undrawn revolving credit facilities and cash (excluding the debt service reserve account) amounted to £204 million, giving the company a high degree of liquidity.

The European Investment Bank has approved a further £100 million of funding to finance the AMP5 capital programme, and we expect to sign this facility shortly. The company has given notice to redeem the remaining £12.1 million of Class C1 Bonds at par on their expected maturity date of 31 March 2011.

Termination of outsourced contracts

On 9 February 2010 Welsh Water announced its intention to restructure the business by terminating the outsourced operational contracts with United Utilities Operational Services (UUOS) and Kelda Water Services (KWS) and by implementing a phased headcount reduction of around 300 people. In accordance with TUPE legislation, on 1 April 2010 1,093 UUOS employees transferred to Welsh Water, followed by 476 KWS employees on 1 May 2010. Overall operating performance in the period to 31 December 2010 has remained good, with levels of service measures generally being at or around the levels achieved in recent years, notwithstanding the process of transition that has taken place.

Pension scheme transfers

On 20 October 2010, a bulk transfer of assets with a value of £26 million was made into the DCWW Pension Scheme from the KWS Pension Scheme, being the accrued benefits of 192 ex-KWS employees who elected to transfer their past service benefits. On 8 December 2010, £129 million of assets were transferred into the DCWW scheme from the United Utilities pension schemes (UUPS and ESPS schemes - £123 million and £6 million respectively), being the accrued benefits of 652 ex-UUOS employees who elected to transfer their past service benefits.

This investor report does not recognise any IAS 19 asset or liability in respect of these transfers. In the event that the IAS 19 valuation differs from the actuarial valuation at the date of transfer, any differences will be taken to the income statement for the year to 31 March 2011.

Investors

If you would like a one-to-one meeting with the Finance Director or the Treasurer, please contact Gina Cardwell (telephone 01443 452768) or send an e-mail request to investors@dwrcymru.com.

Consolidated cash flow

	3 months ended 31 December 2010 £m	9 months ended 31 December 2010 £m	9 months ended 30 December 2009 £m
Turnover	167.2	501.3	511.1
Less: operating expenses	(67.2)	(197.1)	(196.2)
Earnings before interest, taxation, depreciation and amortisation	100.0	304.2	314.9
Working capital movements	17.4	27.4	(11.8)
Non bond-related interest paid	(2.1)	1.1	(1.4)
Interest capitalised in accordance with IAS 23	(1.7)	(5.7)	-
Interest received	1.7	4.4	3.0
Net operating cash flow and interest received	115.3	331.4	304.7
New borrowings:			
European Investment Bank	-	75.0	-
KfW IPEX-Bank GmbH	-	-	35.0
Utilisation of reserves:			
Cash transferred to capex reserve	(2.8)	(106.4)	(162.7)
Cash utilised from capex reserve	27.7	86.9	162.7
Net cash utilised from other reserves	-	0.1	21.7
Capital expenditure:			
Net costs of disposal of assets	0.1	0.1	0.1
Infrastructure renewals expenditure	(9.4)	(32.3)	(51.3)
Non-infrastructure maintenance	(20.2)	(43.3)	(96.0)
Enhancement expenditure	(25.9)	(114.1)	(115.3)
Net cash flow after capital expenditure, new borrowings and reserve drawings	84.8	197.4	98.9
Transfer to debt service payments account	(40.2)	(107.6)	(106.6)
Transfer to insurance proceeds ledger	(8.5)	(8.5)	
Principal repayments	(3.4)	(119.7)	(4.4)
Net cash flow after debt service	32.7	(38.4)	(12.1)
Free cash balances brought forward	151.9	223.0	95.4
Free cash balances carried forward	184.6	184.6	83.3

Consolidated debt service payments

	Payments due & made in 3 months ending 31 December 2010 £m	Amount accrued 31 December 2010 £m
Liquidity facility:		
Liquidity facility commitment fee	0.3	0.1
Interest on senior debt:		
Finance lease interest payments	-	50.7
A1 interest payments	-	15.7
A4 interest payments	5.9	3.0
A5 interest payments	1.9	1.0
A6 interest payments	-	1.0
B1 interest payments	-	16.6
B3 interest payments	3.6	1.8
B4 interest payments	2.1	1.0
B5 interest payments	0.4	0.2
B6 interest payments	1.3	0.7
European Investment Bank loan interest payments	0.9	0.2
KfW IPEX-Bank GmbH loan interest payments	0.2	-
Miscellaneous fees	-	0.1
	16.6	92.1
Interest rate swaps	3.1	-
Senior interest payments	19.7	92.1
Interest on junior debt:		
C1 interest payments	-	0.6
	-	0.6
Total debt service payments	19.7	92.7

Glas notes principal balance reconciliation

	Credit rating ¹	Opening balance 1 October 2010 £m	Repayment £m	Indexation £m	Closing balance 31 December 2010 £m
Finance leases		883.5	-	-	883.5
Class A bonds²					
A1 notes	A3/A/A	350.0	-	-	350.0
A4 notes		336.3	-	4.3	340.6
A5 notes ³		107.9	-	1.4	109.3
A6 notes ⁴		111.7	-	1.5	113.2
Class B bonds					
B1 notes	A3/A/A	325.0	-	-	325.0
B3 notes		163.2	-	2.1	165.3
B4 notes ³		95.2	-	1.2	96.4
B5 notes		55.9	-	0.7	56.6
B6 notes		143.7	-	0.7	144.4
Class C bonds					
C1 notes	Baa2/BBB+/BBB+	12.1	-	-	12.1
European Investment Bank loan		218.6	(3.4)	-	215.2
KfW IPEX-Bank GmbH loan		35.0	-	-	35.0
Local authority loans		2.1	-	-	2.1
		2,840.2	(3.4)	11.9	2,848.7

¹ Moody's/S&P/Fitch ratings.

² Guaranteed by MBIA rated B3/B/-. Class A bond ratings default to their higher underlying ratings of A3/A/A.

³ The indexation credit reflects the charge for the three months to 30 September 2010 plus the correction of an error in the previous quarter's charge.

⁴ The class A6 notes (£100m) were issued at a fixed rate of 4.473% but swapped into an effective index-linked rate of 1.35%. Cumulative indexation of £13.2m reflects the principal accrual on the index-linked swap.

Glas bank account movements

	Opening balance 1 October 2010 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 December 2010 £m
Free cash balances:					
Receipts account	45.3	-	178.1	(174.6)	48.8
Payments account	123.7	-	347.3	(336.4)	134.6
Other bank accounts	(17.1)	1.7	328.8	(312.2)	1.2
	151.9	1.7	854.2	(823.2)	184.6
Debt service payments account:					
Debt service ledger	52.1	-	40.2	(19.7)	72.6
Insurance proceeds ledger	-	-	8.5	-	8.5
	52.1	-	48.7	(19.7)	81.1
Capex reserve account	44.4	-	2.8	(27.7)	19.5
	248.4	1.7	905.7	(870.6)	285.2

Interest cover ratio (ICR) – 5 years to 31 March 2010

(See important notice at the front of the document)

	Actual				
	Year to 31 March 2006 £m	Year to 31 March 2007 £m	Year to 31 March 2008 £m	Year to 31 March 2009 £m	Year to 31 March 2010 £m
Income	576.5	602.7	648.6	684.2	716.5
Operating expenditure (before exceptional costs)	(213.2)	(228.6)	(230.8)	(266.9)	(265.7)
Pre capital maintenance cash flows	363.3	374.1	417.8	417.3	450.8
Capital maintenance expenditure	(98.1)	(150.2)	(146.2)	(189.1)	(124.0)
Post capital maintenance cash flows	265.2	223.9	271.6	228.2	326.8
Net interest (excluding indexation)	(129.9)	(127.0)	(127.5)	(124.3)	(113.4)
Capital expenditure	(122.3)	(96.7)	(136.7)	(152.3)	(225.0)
Customer rebates	(23.0)	(24.7)	(25.7)	(27.0)	(28.3)
Pre-financing cash flows	(10.0)	(24.5)	(18.3)	(75.4)	(39.9)
Interest payable on senior debt:					
Finance leases	31.9	33.7	45.8	42.6	14.3
Class A	43.6	36.9	36.4	41.2	40.4
Class B	33.5	32.4	33.2	34.0	33.5
MBIA financial guarantee fees	4.7	3.6	3.7	3.6	4.0
Interest rate swaps	4.2	7.7	(0.2)	(7.9)	9.9
Authorised loans	5.4	8.5	8.3	7.2	1.8
Less interest receivable	(9.7)	(7.4)	(12.2)	(8.6)	(3.4)
Total net senior debt interest	113.7	115.4	115.0	112.1	100.4
Interest payable on junior debt:					
Class C	13.1	10.2	10.2	10.3	10.2
Class D	-	-	-	-	-
Other	3.1	2.2	2.3	1.9	2.8
Total interest payable	129.9	127.8	127.5	124.3	113.4
Senior interest cover pre capital maintenance (trigger 2.0; default 1.6)	3.1	3.3	3.6	3.7	4.5
Total interest cover pre capital maintenance	2.8	2.9	3.3	3.4	4.0
Senior interest cover post capital maintenance (trigger 1.0)	2.3	2.0	2.4	2.0	3.3
Total interest cover post capital maintenance	2.0	1.8	2.1	1.8	2.9

Interest cover ratio (ICR) – 5 years to 31 March 2015 (based on 2010 business plan)

	Projections				
	Year to 31 March 2011 £m	Year to 31 March 2012 £m	Year to 31 March 2013 £m	Year to 31 March 2014 £m	Year to 31 March 2015 £m
(See important notice at the front of the document)					
Income	675	676	684	693	701
Operating expenditure	(277)	(269)	(269)	(271)	(275)
Pre capital maintenance cash flows	398	407	415	422	426
Capital maintenance expenditure	(139)	(163)	(171)	(155)	(146)
Post capital maintenance cash flows	259	244	244	267	280
Net interest (excluding indexation)	(127)	(122)	(125)	(126)	(124)
Capital expenditure	(137)	(91)	(94)	(72)	(49)
Pre-financing cash flows	(5)	31	25	69	107
Interest payable on senior debt:					
Finance leases	13	22	31	37	39
Class A	38	39	39	39	40
Class B	37	38	38	38	38
MBIA financial guarantee fees	4	4	4	4	4
Interest rate swaps	23	14	5	(1)	(3)
Authorised loans	4	6	12	13	12
Less interest receivable	(2)	(1)	(4)	(4)	(6)
Total net senior debt interest	117	122	125	126	124
Interest payable on junior debt:					
Class C	10	-	-	-	-
Total interest payable	127	122	125	126	124
Senior interest cover pre capital maintenance (trigger 2.0; default 1.6)	3.4	3.3	3.3	3.3	3.4
Total interest cover pre capital maintenance	3.1	3.3	3.3	3.3	3.4
Senior interest cover post capital maintenance (trigger 1.0)	2.2	2.0	2.0	2.1	2.2
Total interest cover post capital maintenance	2.0	2.0	2.0	2.1	2.2

Regulatory asset ratio (RAR) – 5 years to 31 March 2010

(See important notice at the front of the document)

	Actual				
	As at 31 March 2006 £m	As at 31 March 2007 £m	As at 31 March 2008 £m	As at 31 March 2009 £m	As at 31 March 2010 £m
Senior gross debt:					
Finance leases	740	767	842	892	884
Class A	742	856	875	902	896
Class B	553	611	623	637	774
Net interest accrual on senior debt	29	84	56	54	55
Authorised loans	60	135	131	151	182
Authorised loan facility	120	-	-	-	-
Total senior gross debt	2,244	2,453	2,527	2,636	2,791
Less: cash balances and authorised investments	(14)	(158)	(124)	(139)	(249)
Total senior net debt	2,230	2,295	2,403	2,497	2,542
Class C	125	125	125	125	125
Interest accrual on junior debt	-	10	-	-	-
Local authority loans	4	4	3	3	2
Total net debt	2,359	2,434	2,531	2,625	2,669
Regulatory capital value (RCV)	3,042	3,310	3,529	3,626	3,737
Reserves (RCV less total net debt)	683	876	998	1,001	1,068
Regulatory asset ratio:					
RAR (Senior)	73%	69%	68%	69%	68%
RAR (Senior + C) (trigger 90%; default 95%)	77%	73%	72%	72%	71%
RAR (Total debt)	78%	74%	72%	72%	71%

Regulatory asset ratio (RAR) – 5 years to 31 March 2015 (based on 2010 business plan)

	Projections				
	As at 31 March 2011 £m	As at 31 March 2012 £m	As at 31 March 2013 £m	As at 31 March 2014 £m	As at 31 March 2015 £m
(See important notice at the front of the document)					
Senior gross debt:					
Finance leases	874	862	844	822	769
Class A	918	928	939	951	963
Class B	789	799	808	818	828
Net interest accrual on senior debt	55	56	57	59	60
Authorised loans	173	259	246	233	205
Total senior gross debt	2,809	2,904	2,894	2,883	2,825
Less: cash balances and authorised investments	(35)	(127)	(110)	(138)	(161)
Total senior net debt	2,774	2,777	2,784	2,745	2,664
Local authority loans	2	2	2	1	1
Total net debt	2,776	2,779	2,786	2,746	2,665
Headroom under gearing policy ¹	-	5	79	186	195
	2,776	2,784	2,865	2,932	2,860
Regulatory capital value (RCV)	3,854	3,977	4,093	4,189	4,086²
Reserves (RCV less total net debt)	1,078	1,198	1,307	1,443	1,421
Regulatory asset ratio:					
RAR (Senior) (trigger 90%; default 95%)	72%	70%	70%	70%	70%
RAR (Total debt)	72%	70%	70%	70%	70%

¹ Indicative financial headroom while maintaining gearing at the Board's target of 70%.

² RCV at 31 March 2015 anticipates a possible downward adjustment reflecting an assumed movement in COPI relative to RPI during the 5 year period.

Income statement (unaudited)

	3 months ended 31 December 2010 £m	9 months ended 31 December 2010 £m	9 months ended 30 December 2009 £m
Turnover	167.2	501.3	511.1
Operating expenditure	(67.2)	(197.1)	(196.2)
EBITDA	100.0	304.2	314.9
Infrastructure renewals expenditure	(8.7)	(27.2)	(59.0)
Depreciation	(36.4)	(106.9)	(105.2)
Profit on disposal of fixed assets	0.1	0.1	0.1
Operating profit	55.0	170.2	150.8
Interest payable	(22.4)	(74.6)	(88.4)
Premium on redemption of Class C1 bonds	-	(5.9)	-
Indexation of index-linked debt	(11.9)	(30.7)	17.6
Interest receivable	0.6	4.6	2.9
Fair value (losses)/gains on financial instruments	31.5	(32.9)	15.5
Profit/(loss) before tax	52.8	30.7	98.4
Deferred tax			
Current year movements	-	5.6	(23.9)
Adjustment in respect of prior years	-	-	(0.6)
Effect of change in expected tax rate	-	12.6	-
	-	18.2	(24.5)
Taxation	-	18.2	(24.5)
Profit/(loss) after tax	52.8	48.9	73.9

Statement of comprehensive income (unaudited)

	3 months ended 31 December 2010 £m	9 months ended 31 December 2010 £m	9 months ended 30 December 2009 £m
Profit/(loss) for the period	52.8	48.9	73.9
Actuarial loss in the pension scheme	-	(0.1)	(1.1)
Movement on related deferred tax asset	-	-	0.3
Total recognised gains/(losses) for the period	52.8	48.8	73.1

Balance sheet (unaudited)

	At 31 December 2010		At 31 March 2010	
	£m	£m	£m	£m
Fixed assets		3,217.1		3,164.0
Current assets and liabilities:				
Debtors and prepayments	215.5		505.5	
Creditors and accruals	(226.9)		(518.0)	
		(11.4)		(12.5)
Total assets less current liabilities		3,205.7		3,151.5
Financing liabilities:				
Bonds	(1,712.9)		(1,795.0)	
Finance leases	(883.5)		(883.5)	
Bank loans (EIB, KfW)	(250.2)		(181.9)	
Other	(2.1)		(2.2)	
	(2,848.7)		(2,862.6)	
Net interest accrual	(104.1)		(55.7)	
	(2,952.8)		(2,918.3)	
Cash and cash equivalents:				
Receipts account	48.8		77.2	
Payments account	134.6		160.7	
Capex reserve account	19.5		-	
Debt service payments account	81.1		25.6	
Customer payments account	-		0.1	
Other bank accounts	1.2		(14.9)	
	285.2		248.7	
Net debt		(2,667.6)		(2,669.6)
Derivative financial instruments		(205.7)		(172.7)
Provisions for liabilities and charges		(38.0)		(45.4)
Net assets before deferred tax		294.4		263.8
Deferred tax		(334.4)		(352.8)
Net liabilities		(40.0)		(88.8)