Glas Cymru Cyfyngedig

Investor Report

For the quarter ended 31 December 2011

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General overview and business update

This quarterly Investor Report covers the three month period ending 31 December 2011. 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.

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 9 months ended 31 December are as follows:

	9 months to 31 December 2011 £m	9 months to 31 December 2010 £m	Change
Turnover	520	501	+4%
Operating costs	201	197	+2%
EBITDA (before infrastructure renewals expenditure)	**319**	**304**	**+5%**
Net interest (excluding indexation)	72	76	
Capital expenditure (before grants and contributions)	175	172	

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 2011 is slightly higher than the comparative period last year – Ofwat's RPI & K price increases are largely responsible for the rise in income of some £19 million while operating costs have increased marginally due in part to a rise in the bad debt charge.

Turnover in the nine months to 31 December 2011 was £520 million, as compared to £501 million in the nine months to 31 December 2010. The increase is a reflection of the overall price increase of 3.4% (being the RPI+K adjustment required by Ofwat). During the period, 11,500 domestic customers switched to metered charging (2010: 8,000).

Operating costs (excluding depreciation and infrastructure renewals expenditure) were £201 million (2010: £197 million) and have increased by 2%, with inflationary increases (£9m) and a rise in bad debt charge (£3m) being offset by savings in insurance (£1m), IT costs (£3m), power (£1m) and ongoing efficiency initiatives.

Net interest payable in the period (excluding fair value movements) was £111 million (2010: £107 million), including an indexation charge on index-linked debt of £39 million (2010: £31 million).

As at 31 December 2011, 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 2011**	**31 March 2011**
Net debt	2,665	2,668
Regulatory capital value	4,135	3,980
'Financial reserves'	**1,470**	**1,312**
Regulatory gearing	64.4%	67.0%

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 64.4% as at 31 December 2011 and 'financial reserves' (RCV less net debt) have exceeded £1.4 billion.

General overview and business update cont'd

Capital investment programme

Capital investment (including infrastructure renewals expenditure) was £175 million before grants and contributions (2010: £172 million). Of that £175 million, £98 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £120 million is classed as capital maintenance. We have invested £411 million to date into our AMP5 capital programme; during the five year regulatory period to 2015 we plan to invest £1.3 billion to safeguard drinking water quality, protect our environment from pollution, improve customer service and deliver further cost savings.

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 2011 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 2012, the projected ratios will be updated to reflect Glas Cymru's 2012 business plan.

Ofwat – proposed licence changes

On 21 December 2011, Ofwat published proposals to modify the licences of all water and sewerage undertakers in advance of the next price review. Ofwat's intention is to change companies' licences to make them more flexible in terms of the way price limits are set – instead of licences specifying that Ofwat will set a single price limit for five years, Ofwat wants to be able to specify the nature, form, length and number of price limits it sets, and believes that this flexibility would allow it to make determinations that best incentivise companies to respond efficiently, innovatively and sustainably to the challenges they face. A copy of the proposed licence changes is available on our website www.dwrcymru.com under "Investors" and on the Ofwat website. The closing date for responses is 29 February 2012.

Credit ratings

The strong credit quality of the business is reflected in credit ratings which are now the highest in the water sector. The ratings of the company's bonds are as follows:

Bond Class	Moody's	S&P	Fitch
A*	A3	A	A
B	A3	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA (B3/B/-), revert to their higher underlying ratings of A3/A/A by Moody's Investor Service (Moody's), Standard & Poor's (S&P) and Fitch Ratings (Fitch) respectively.

General overview and business update cont'd

Credit ratings cont'd

On 14 June 2011 S&P reaffirmed Glas Cymru's ratings and removed the negative outlook, reflecting their assessment of the company's progress against Ofwat's Final Determination following the 2009 Price Review and the positive impact of bringing the outsourced operational contracts back in house. On 14 September 2011 Moody's corporate family rating of Dŵr Cymru Cyfyngedig was reaffirmed as A3. On 11 January 2012 Fitch reaffirmed Dŵr Cymru's credit ratings with stable outlook.

Financing and liquidity

As at 31 December 2011, undrawn credit facilities and cash (excluding the debt service reserve account) amounted to £456 million, including undrawn revolving credit and European Investment Bank facilities of £140 million and £75 million respectively.

On 6 July 2011 Dŵr Cymru (Financing) Limited issued £120 million B6 series index-linked bonds with a maturity date of 2048 (as a tap of the £140 million existing B6 issue) to provide funding for Welsh Water's AMP5 investment programme.

On 15 September 2011 Dŵr Cymru (Financing) Limited drew down £25 million of a £100 million facility with the European Investment Bank.

The Company continues to adopt a prudent policy for investing cash and short term cash deposits. Counterparties for short term cash deposits (of up to one month) are generally placed with AAA rated liquidity funds, UK clearing banks with a minimum rating of A/A2/A and other banks with a minimum long term credit rating of A+/A1/A+ from S&P, Moody's and Fitch. Longer term deposits over one month are limited to counterparties that are rated AAA/Aaa/AAA by S&P, Moody's and Fitch.

Private Sewers

On 1 October 2011 Dŵr Cymru Cyfyngedig assumed responsibility for managing the private sewers network in its operational area. The transfer of 17,000kms of private sewers and drains has nearly doubled the size of the network. Little information is available to judge the condition of these sewers – and any attributable value – but they are typically expected to be poor and below the standard of assets that the industry is generally required to operate. Arrangements have yet to be finalised with regard to the recovery of additional expenditure associated with this transfer. The regulatory treatment is expected to be via existing regulatory methods, at the 2014 price review or an earlier interim determination of the price control. As far as possible, it is expected that the performance of these new assets will be ring-fenced so as not to distort the assessment of the underlying performance of the business.

Corporate Governance

Glas Cymru held its regular half-year meeting with members on 9 December 2011 in Llanelli. No formal business was conducted at the meeting.

Investors

If you would like a one-to-one meeting with the Finance Director and/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 2011 £m	9 months ended 31 December 2011 £m	9 months ended 31 December 2010 £m
Turnover	174.1	519.9	501.3
Less: operating expenses	(69.5)	(201.4)	(197.1)
Earnings before interest, taxation, depreciation and amortisation	104.6	318.5	304.2
Working capital movements	(3.5)	(23.6)	27.4
Non bond-related interest paid	(0.7)	(3.7)	1.1
Interest capitalised in accordance with IAS 23	(2.4)	(6.1)	(5.7)
Interest received	1.0	3.6	4.4
Net operating cash flow and interest received	99.0	288.7	331.4
New borrowings:			
Class B bonds	-	128.1	-
European Investment Bank	-	25.0	75.0
Utilisation of reserves:			
Cash transferred to capex reserve	(2.6)	(103.9)	(106.4)
Cash utilised from capex reserve	27.3	103.6	86.9
Net cash utilised from other reserves	-	-	0.1
Capital expenditure:			
Net profit on disposal of assets	0.1	0.1	0.1
Infrastructure renewals expenditure	(21.5)	(53.1)	(32.3)
Non-infrastructure maintenance	(15.6)	(49.8)	(43.3)
Enhancement expenditure	(28.7)	(73.7)	(114.1)
Net cash flow after capital expenditure, new borrowings and reserve drawings	58.0	265.0	197.4
Transfer to debt service payments account	(26.1)	(92.6)	(107.6)
Transfer to insurance proceeds ledger	-	-	(8.5)
Principal repayments	(4.6)	(11.5)	(119.7)
Net cash flow after debt service	27.3	160.9	(38.4)
Free cash balances brought forward	213.2	79.6	223.0
Free cash balances carried forward	240.5	240.5	184.6

Consolidated debt service payments

	Payments due & made in 3 months ending 31 December 2011 £m	Amount accrued 31 December 2011 £m
Liquidity facility:		
Liquidity facility commitment fee	-	-
Interest on senior debt:		
Finance lease interest payments	-	49.1
A1 interest payments	-	15.5
A4 interest payments	-	3.2
A5 interest payments	-	1.0
A6 interest payments	-	1.0
B1 interest payments	-	16.5
B3 interest payments	-	1.9
B4 interest payments	-	1.1
B5 interest payments	-	0.2
B6 interest payments	-	2.0
European Investment Bank loan interest payments	1.1	0.2
KfW IPEX-Bank GmbH loan interest payments	0.1	-
Revolving credit facility commitment fees	0.2	-
Miscellaneous fees	0.3	0.4
	1.7	92.1
Interest rate swaps	3.1	-
Senior interest payments	4.8	92.1
Total debt service payments	4.8	92.1

Glas notes principal balance reconciliation

	Credit rating[1]	Opening balance 1 October 2011 £m	Repayment £m	Indexation £m	Closing balance 31 December 2011 £m
Finance leases		741.8	(0.1)	-	741.7
Class A bonds[2]					
A1 notes	A3/A/A	350.0	-	-	350.0
A4 notes		353.4	-	4.3	357.7
A5 notes		115.0	-	1.4	116.4
A6 notes[3]		117.4	-	1.4	118.8
Class B bonds					
B1 notes	A3/A/A	325.0	-	-	325.0
B3 notes		171.5	-	2.1	173.6
B4 notes		101.5	-	1.2	102.7
B5 notes		58.7	-	0.7	59.4
B6 notes		280.1	-	2.4	282.5
European Investment Bank loan		231.2	(4.4)	-	226.8
KfW IPEX-Bank GmbH loan		35.0	-	-	35.0
Local authority loans		1.8	(0.1)	-	1.7
		2,882.4	(4.6)	13.6	2,891.4

[1] **Moody's/S&P/Fitch.**
[2] **Guaranteed by MBIA rated B3/B/-. Class A bond ratings default to their higher underlying ratings of A3/A/A.**
[3] **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 £18.8m reflects the principal accrual on the index-linked swap.**

Glas bank account movements

	Opening balance 1 October 2011 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 December 2011 £m
Free cash balances:					
Receipts account	45.6	-	192.8	(229.8)	8.6
Payments account	195.1	-	405.3	(361.3)	239.1
Other bank accounts	(27.5)	1.0	562.1	(542.8)	(7.2)
	213.2	1.0	1,160.2	(1,133.9)	240.5
Debt service payments account:					
Debt service ledger	57.1	-	26.1	(4.8)	78.4
Insurance proceeds ledger	8.5	-	-	-	8.5
	65.6	-	26.1	(4.8)	86.9
Capex reserve account	25.0	-	2.6	(27.3)	0.3
	303.8	1.0	1,188.9	(1,166.0)	327.7

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	577	603	649	684	717
Operating expenditure (before exceptional costs)	(213)	(229)	(231)	(267)	(266)
Pre capital maintenance cash flows	364	374	418	417	451
Capital maintenance expenditure	(98)	(150)	(146)	(189)	(124)
Post capital maintenance cash flows	266	224	272	228	327
Net interest (excluding indexation)	(130)	(127)	(128)	(124)	(113)
Capital expenditure	(122)	(97)	(137)	(152)	(225)
Customer rebates	(23)	(25)	(25)	(27)	(28)
Pre-financing cash flows	(9)	(25)	(18)	(75)	(39)
Interest payable on senior debt:					
Finance leases	32	34	46	43	14
Class A	44	37	36	41	40
Class B	34	32	33	34	33
MBIA financial guarantee fees	5	4	4	4	4
Interest rate swaps	4	8	-	(8)	10
Authorised loans	5	8	8	7	2
Less interest receivable	(10)	(7)	(12)	(9)	(3)
Total net senior debt interest	114	116	115	112	100
Interest payable on junior debt:					
Class C	13	10	10	10	10
Other	3	2	2	2	3
Total interest payable	130	128	127	124	113
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 2011 business plan)

(See important notice at the front of the document)	Actual	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**
Income	677	695	715	729	739
Operating expenditure	(265)	(278)	(281)	(285)	(291)
Pre capital maintenance cash flows	412	417	434	444	448
Capital maintenance expenditure	(97)	(179)	(210)	(186)	(176)
Post capital maintenance cash flows	315	238	224	258	272
Net interest (excluding indexation)	(132)	(123)	(119)	(121)	(124)
Capital expenditure	(131)	(101)	(135)	(110)	(77)
Pre-financing cash flows	52	14	(30)	27	71
Interest payable on senior debt:					
Finance leases	(2)	12	17	24	30
Class A	41	40	40	40	40
Class B	37	38	39	39	39
MBIA financial guarantee fees	4	4	4	5	5
Interest rate swaps	41	24	11	1	(2)
Authorised loans	2	7	9	15	15
Less interest receivable	(4)	(2)	(1)	(3)	(3)
Total net senior debt interest	120	123	119	121	124
Interest payable on junior debt:					
Class C (including £6m premium on early redemption)	9	-	-	-	-
Other	3	-	-	-	-
Total interest payable	132	123	119	121	124
Senior interest cover pre capital maintenance (trigger 2.0; default 1.6)	3.4	3.4	3.6	3.7	3.6
Total interest cover pre capital maintenance	3.1	3.4	3.6	3.7	3.6
Senior interest cover post capital maintenance (trigger 1.0)	2.6	1.9	1.9	2.1	2.2
Total interest cover post capital maintenance	2.4	1.9	1.9	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 2011 business plan)

(See important notice at the front of the document)	Actual	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
Senior gross debt:					
Finance leases	742	735	723	707	662
Class A	922	949	965	977	989
Class B	796	818	832	842	851
Net interest accrual on senior debt	56	56	56	60	62
Authorised loans	248	234	321	308	280
Total senior gross debt	2,764	2,792	2,897	2,894	2,844
Less: cash balances and authorised investments	98	(57)	(90)	(84)	(78)
Total senior net debt	2,666	2,735	2,807	2,810	2,766
Local authority loans	2	2	1	1	1
Total net debt	2,668	2,737	2,808	2,811	2,767
Headroom under gearing policy[1]	118	167	180	247	327
	2,786	2,904	2,988	3,058	3,094
Regulatory capital value (RCV)	3,980	4,148	4,269	4,368	4,420[2]
Reserves (RCV less total net debt)	1,312	1,411	1,461	1,557	1,653
Regulatory asset ratio:					
RAR (Senior) (trigger 90%; default 95%)	67%	70%	70%	70%	70%
RAR (Total debt)	67%	70%	70%	70%	70%

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

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

Income statement (unaudited)

	3 months ended 31 December 2011 £m	9 months ended 31 December 2011 £m	9 months ended 31 December 2010 £m
Turnover	174.1	519.9	501.3
Operating expenditure	(69.5)	(201.4)	(197.1)
EBITDA	104.6	318.5	304.2
Infrastructure renewals expenditure	(19.6)	(50.5)	(27.2)
Depreciation	(37.7)	(112.3)	(106.9)
Profit on disposal of fixed assets	0.1	0.1	0.1
Operating profit	47.4	155.8	170.2
Interest payable	(23.5)	(75.6)	(74.6)
Premium on redemption of Class C1 bonds	-	-	(5.9)
Indexation of index-linked debt	(13.6)	(39.0)	(30.7)
Interest receivable	1.0	3.9	4.6
Fair value losses on financial instruments	(54.6)	(184.4)	(32.9)
Loss before tax	(43.3)	(139.3)	30.7
Taxation	-	35.0	18.2
(Loss)/profit after tax	(43.3)	(104.3)	48.9

Statement of comprehensive income (unaudited)	3 months ended 31 December 2011 £m	9 months ended 31 December 2011 £m	9 months ended 31 December 2010 £m
Loss for the period	(43.3)	(104.4)	48.9
Actuarial loss in the pension scheme	-	(20.6)	(0.1)
Movement on related deferred tax asset	-	5.1	-
Total recognised losses for the period	(43.3)	(119.9)	48.8

Balance sheet (unaudited)

	At 31 December 2011		At 31 March 2011	
	£m	£m	£m	£m
Fixed assets		3,270.9		3,244.3
Current assets and liabilities:				
Debtors and prepayments	225.3		494.9	
Creditors and accruals	(256.7)		(539.7)	
		(31.4)		(44.8)
Total assets less current liabilities		3,239.5		3,199.5
Financing liabilities:				
Bonds	(1,886.2)		(1,718.1)	
Finance leases	(741.7)		(741.8)	
Bank loans (EIB, KfW)	(261.8)		(248.0)	
Other	(1.7)		(1.9)	
	(2,891.4)		(2,709.8)	
Net interest accrual	(101.8)		(56.7)	
	(2,993.2)		(2,766.5)	
Cash and cash equivalents:				
Receipts account	8.6		67.8	
Payments account	239.1		28.2	
Capex reserve account	0.3		-	
Debt service payments account	86.9		18.7	
Other bank accounts	(7.2)		(16.4)	
	327.7		98.3	
Net debt		**(2,665.5)**		**(2,668.2)**
Derivative financial instruments		(344.9)		(160.4)
Provisions for liabilities and charges		(57.2)		(38.9)
Net assets before deferred tax		**171.9**		**332.0**
Deferred tax		(245.6)		(285.8)
Net assets		**(73.7)**		**46.2**