Glas Cymru Cyfyngedig

# Investor Report

# For the quarter ended 31 December 2014

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# Contents

## General overview and business update

This quarterly Investor Report covers the three month period ending 31 December 2014. 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 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 2014 £m** | **9 months to 31 December 2013 £m** | **Change** |
|---|---|---|---|
| Revenue | 562 | 554 | +1% |
| Operating costs | 216 | 222 | -3% |
| **EBITDA** (before infrastructure renewals expenditure) | **346** | **332** | |
| Net interest (excluding indexation) | 63 | 64 | |
| Capital expenditure (before grants and contributions) | 256 | 265 | |

## 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 2014 is £14m higher than the comparative period last year.

Revenue in the nine months to 31 December 2014 was £562 million, as compared to £554 million in the nine months to 31 December 2013. The increase includes the impact of an overall price increases of 2.0% (being the RPI+K adjustment allowed by Ofwat).

Operating costs (excluding depreciation and infrastructure renewals expenditure) at £216 million (2013: £222 million) have reduced in comparison with the same period last year; a reduction of 3% principally due to business rates (£1m), savings arising from IT contract insourcing (£1m) and additional costs in the prior period necessary to maintain operations during the failure of the Daniel Contracting Limited business (£4m).

Net interest payable in the period (excluding fair value movements) was £82 million (2013: £87 million), including an indexation charge on index-linked debt of £19 million (2013: £23 million). An accounting profit of £8m has been recognised following the termination of finance leases.

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

| **£m** | **31 December 2014** | **31 March 2014** |
|---|---:|---:|
| Net debt | 2,828 | 2,821 |
| Regulatory capital value | 4,505 | 4,468 |
| **'Financial reserves'** | **1,677** | **1,647** |
| Regulatory gearing | 62.8% | 63.1% |

On Glas Cymru's acquisition of Welsh Water in May 2001, gearing stood at 93%. Since then the financial position of the group has improved steadily, such that gearing has fallen to 62.8% as at 31 December 2014 and 'financial reserves' (RCV less net debt) are nearly £1.7 billion.

## General overview and business update cont'd

### Capital investment programme

Capital investment (including infrastructure renewals expenditure) was £256 million before grants and contributions (2013: £265 million). Of that £256 million, £137 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £119 million is classed as capital maintenance. During the five year regulatory period to 2015 we will have invested £1.5 billion to safeguard drinking water quality, protect our environment from pollution, improve customer service and deliver further cost savings.

On 3 February 2015 the group completed the acquisition of hydro assets from Infinis Hydro 1 Limited for a consideration of £19.7 million. The acquisition will almost double the group's generation from renewable sources.

### 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 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 9 and 10). 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. The investor report for the quarter ending 31 March 2015 will contain forecasts for the next 5 year regulatory period to 2020.

### Credit ratings

The strong credit quality of the business is reflected in credit ratings which are now the highest in the UK utility sector. The ratings of the company's bonds are shown in the table below. All ratings have stable outlook.

| 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 (B/Ba2/-), 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.

The ratings of our Class A and B bonds have been affirmed as A/A/A3 with a stable outlook by Fitch, Standard and Poor's and Moody's on 31 July 2014, 1 September 2014, and 2 December 2014 respectively.

### Financing and liquidity

As at 31 December 2014, undrawn credit facilities and cash (excluding the debt service reserve account deposits of £77 million) amounted to £350 million, including undrawn EIB and revolving credit facilities of £270 million. In line with prudent policies approved by the board, cash is invested in AAA-rated liquidity funds and bonds, and banks subject to minimum short-term rating criteria of A1/P1/F1.

## General overview and business update cont'd

Dŵr Cymru (Financing) Limited 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. The facility is split equally between four providers: BNP Paribas, HSBC, J P Morgan and National Australia Bank.

During November 2014 the company finalised a further £230 million facility with the European Investment Bank ('EIB'). The company subsequently cancelled £50 million of revolving credit facilities, reducing the facilities to £120 million as a result; these facilities remain available until 2019/20. The first tranche of the EIB loan, £80 million, was drawn on 15 December 2014; a further £80 million was drawn on 15 January 2015.

### **2014 Price Review**

On 12 December Dŵr Cymru received its Final Determination from Ofwat on the company's business plan for 2015-2020. The company has decided to accept the Final Determination which sets the price limits that the company can charge customers for their water and wastewater services between 2015 and 2020 and also the service targets that the company is expected to deliver.

Dŵr Cymru's business plan committed to keep average household bills at least 1% below inflation between 2015 and 2020 whilst also investing £1.5 billion it its extensive network of assets and helping up to 100,000 customers who struggle to pay their bills.

The Board has also decided to set a regulatory gearing target (being the ratio of Net Debt to Regulatory Capital Value) of 60% for the next five years to 31 March 2020 ("AMP6"). The reduction from the previously published target of 70% to 60% primarily reflects the impact on cash coverage ratios arising from the reduction in the return on capital to 3.7% for the wholesale business.

## Consolidated cash flow

| | 9 months ended 31 December 2014 £m | 9 months ended 31 December 2013 £m |
|---|---|---|
| Revenue | 562.1 | 553.8 |
| Less: operating expenses | (215.7) | (222.2) |
| **Earnings before interest, taxation, depreciation and amortisation** | 346.4 | 331.6 |
| Working capital movements | 5.0 | 15.9 |
| Non bond-related interest paid | (1.7) | (1.3) |
| Interest capitalised in accordance with IAS 23 | (6.1) | (8.1) |
| Interest received | 2.3 | 5.7 |
| **Net operating cash flow and interest received** | 345.9 | 343.8 |
| **New borrowings** | | |
| European Investment Bank | 80.0 | 75.0 |
| **Utilisation of reserves:** | | |
| Cash transferred to capex reserve | (117.2) | (158.5) |
| Cash utilised from capex reserve | 87.1 | 52.4 |
| **Capital expenditure:** | | |
| Net profit on disposal of assets | - | (0.1) |
| Infrastructure renewals expenditure | (50.8) | (59.3) |
| Non-infrastructure maintenance | (67.9) | (84.9) |
| Enhancement expenditure | (136.4) | (113.0) |
| **Net cash flow after capital expenditure, new borrowings and reserve drawings** | 140.7 | 86.9 |
| Transfer to debt service payments account | (94.4) | (115.6) |
| Principal repayments | (68.8) | (14.1) |
| **Net cash flow after debt service** | (22.5) | (42.8) |
| Free cash balances brought forward | 22.5 | 97.7 |
| **Free cash balances carried forward** | - | 54.9 |

## Consolidated debt service payments

| | Payments due & made in 3 months ending 31 December 2014 £m | Amount accrued 31 December 2014 £m |
|---|---|---|
| **Liquidity facility:** | | |
| Liquidity facility commitment fee | 0.1 | - |
| | | |
| **Interest on senior debt:** | | |
| Finance lease interest payments | - | 46.1 |
| A1 interest payments | - | 15.7 |
| A4 interest payments | - | 3.5 |
| A5 interest payments | - | 1.1 |
| A6 interest payments | - | 1.0 |
| B1 interest payments | - | 16.7 |
| B3 interest payments | - | 2.1 |
| B4 interest payments | - | 1.2 |
| B5 interest payments | - | 0.2 |
| B6 interest payments | - | 1.5 |
| European Investment Bank loan interest payments | 1.2 | 0.2 |
| Revolving credit facility commitment fees | 0.5 | - |
| Miscellaneous fees | 0.3 | 0.1 |
| | | |
| **Total debt service payments** | 2.1 | 89.4 |

## Glas notes principal balance reconciliation

| | Credit rating[1] | Opening balance 1 October 2014 £m | New issues | Repayment £m | Indexation £m | Closing balance 31 December 2014 £m |
|---|---|---|---|---|---|---|
| Finance leases | | 516.2 | - | - | - | 516.2 |
| **Class A bonds[2]** | | | | | | |
| A1 notes | A3/A/A | 350.0 | - | - | - | 350.0 |
| A4 notes | | 389.8 | - | - | 2.2 | 392.0 |
| A5 notes | | 124.9 | - | - | (0.2) | 124.7 |
| A6 notes[3] | | 129.5 | - | - | 0.8 | 130.3 |
| **Class B bonds** | | | | | | |
| B1 notes | A3/A/A | 325.0 | - | - | - | 325.0 |
| B3 notes | | 189.2 | - | - | 1.0 | 190.2 |
| B4 notes | | 110.2 | - | - | (0.1) | 110.1 |
| B5 notes | | 64.8 | - | - | 0.3 | 65.1 |
| B6 notes | | 306.1 | - | - | 2.4 | 308.5 |
| European Investment Bank loan | | 265.8 | 80.0 | (6.9) | - | 338.9 |
| KfW IPEX-Bank GmbH loan | | 35.0 | - | - | - | 35.0 |

| | | | | | |
|---|---|---|---|---|---|
| Local authority loans | 1.0 | - | - | - | 1.0 |
| | 2,807.5 | 80.0 | (6.9) | 6.4 | 2,887.0 |

[1] **Moody's/S&P/Fitch.**
[2] **Guaranteed by MBIA rated B/B3/-. 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 £30.3m reflects the principal accrual on the index-linked swap.**

## Glas bank account movements

| | Opening balance 1 October 2014 £m | Interest received £m | Deposits £m | Payments £m | Closing balance 31 December 2014 £m |
|---|---|---|---|---|---|
| **Free cash balances:** | | | | | |
| Receipts account | 62.7 | - | 196.1 | (194.7) | 64.1 |
| Payments account | (51.6) | - | 389.8 | (407.8) | (69.6) |
| Other bank accounts | 5.2 | 0.9 | 445.6 | (446.2) | 5.5 |
| | 16.3 | 0.9 | 1,031.5 | (1,048.7) | - |
| **Debt service payments account:** | | | | | |
| Debt service ledger | 37.5 | - | 32.7 | (2.1) | 68.1 |
| Insurance proceeds ledger | 8.5 | - | - | - | 8.5 |
| | 46.0 | - | 32.7 | (2.1) | 76.6 |
| **Capex reserve account** | - | - | 107.0 | (27.0) | 80.0 |
| | 62.3 | 0.9 | 1,171.2 | (1,077.8) | 156.6 |

## Interest cover ratio (ICR) – 5 years to 31 March 2015 (based on 2014 business plan)

| (See important notice at the front of the document) | Actual | | | | Projection |
|---|---|---|---|---|---|
| | 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 | 716 | 737 | 742 |
| Operating expenditure | (265) | (273) | (295) | (296) | (304) |
| **Pre capital maintenance cash flows** | 412 | 422 | 421 | 441 | 438 |
| Capital maintenance expenditure | (97) | (169) | (202) | (185) | (174) |
| **Post capital maintenance cash flows** | 315 | 253 | 219 | 256 | 264 |
| Net interest (excluding indexation) | (132) | (140) | (102) | (124) | (135) |
| Capital expenditure | (131) | (84) | (122) | (155) | (156) |
| **Pre-financing cash flows** | 52 | 29 | (5) | (23) | (27) |
| **Interest payable on senior debt:** | | | | | |
| Finance leases | (2) | 9 | (4) | 5 | 31 |
| Class A | 41 | 39 | 40 | 44 | 40 |
| Class B | 37 | 40 | 41 | 42 | 43 |
| MBIA financial guarantee fees | 4 | 4 | 4 | 4 | 5 |
| Interest rate swaps | 41 | 45 | 12 | 29 | 13 |
| Authorised loans | 2 | 4 | 12 | 2 | 7 |
| Less interest receivable | (5) | (5) | (7) | (6) | (4) |
| **Total net senior debt interest** | 118 | 136 | 98 | 120 | 135 |
| **Interest payable on junior debt:** | | | | | |
| Class C (including £6m premium on early redemption) | 9 | - | - | - | - |
| Other | 4 | 4 | 4 | 4 | - |
| **Total interest payable** | 131 | 140 | 102 | 124 | 135 |
| | | | | | |
| Senior interest cover pre capital maintenance (trigger 2.0; default 1.6) | 3.4 | 3.1 | 4.3 | 3.7 | 3.2 |
| Total interest cover pre capital maintenance | 3.1 | 3.0 | 4.1 | 3.6 | 3.2 |
| Senior interest cover post capital maintenance (trigger 1.0) | 2.6 | 1.9 | 2.2 | 2.1 | 2.0 |
| Total interest cover post capital maintenance | 2.4 | 1.8 | 2.2 | 2.0 | 2.0 |

## Regulatory asset ratio (RAR) – 5 years to 31 March 2015 (based on 2014 business plan)

| (See important notice at the front of the document) | Actual As at 31 March 2011 £m | Actual As at 31 March 2012 £m | Actual As at 31 March 2013 £m | Actual As at 31 March 2014 £m | Projection As at 31 March 2015 £m |
|---|---|---|---|---|---|
| **Senior gross debt:** | | | | | |
| Finance leases | 742 | 734 | 616 | 571 | 563 |
| Class A | 922 | 950 | 969 | 989 | 1,004 |
| Class B | 796 | 949 | 969 | 988 | 1,013 |
| Net interest accrual on senior debt | 56 | 102 | 99 | 58 | 46 |
| Authorised loans | 248 | 260 | 246 | 307 | 367 |
| **Total senior gross debt** | 2,764 | 2,995 | 2,899 | 2,914 | 2,993 |
| Less: cash balances and authorised investments | 98 | (301) | (157) | (94) | (101) |
| **Total senior net debt** | 2,666 | 2,694 | 2,742 | 2,819 | 2,892 |
| Local authority loans | 2 | 2 | 2 | 2 | 1 |
| **Total net debt** | 2,668 | 2,696 | 2,744 | 2,821 | 2,893 |
| **Regulatory capital value (RCV)** | 3,980 | 4,171 | 4,344 | 4,468 | 4,802[1] |
| **Reserves (RCV less total net debt)** | 1,312 | 1,475 | 1,600 | 1,647 | 1,909 |
| **Regulatory asset ratio:** | | | | | |
| RAR (Senior) (trigger 90%; default 95%) | 67% | 65% | 63% | 63% | 60% |
| RAR (Total debt) | 67% | 65% | 63% | 63% | 60% |

[1] RCV at 31 March 2015 anticipates an adjustment incorporating an assumed movement in COPI relative to RPI during the five-year period.

## Income statement (unaudited)

| | 9 months ended 31 December 2014 £m | 9 months ended 31 December 2013 £m | Year ended 31 March 2014 £m |
|---|---|---|---|
| Revenue | 562.1 | 553.8 | 736.5 |
| Operating expenditure | (215.7) | (222.2) | (296.4) |
| **EBITDA** | 346.4 | 331.6 | 440.1 |
| Infrastructure renewals expenditure | (50.9) | (58.8) | (71.8) |
| Depreciation | (132.5) | (122.1) | (163.8) |
| **Operating profit** | 163.0 | 150.7 | 204.5 |
| Interest payable | (65.4) | (69.8) | (121.9) |
| Indexation of index-linked debt | (19.1) | (23.4) | (38.7) |
| Interest receivable | 2.4 | 5.7 | 6.3 |
| Fair value (losses)/gains on financial instruments | (69.5) | 96.4 | 94.2 |
| **Profit before tax** | 11.4 | 159.6 | 144.4 |
| Taxation | (0.4) | 10.2 | 10.8 |
| **Profit after tax** | 11.0 | 169.8 | 155.2 |

## Statement of comprehensive income (unaudited)

| | 9 months ended 31 December 2014 £m | 9 months ended 31 December 2013 £m | Year ended 31 March 2014 £m |
|---|---|---|---|
| Profit for the period | 11.0 | 169.8 | 155.2 |
| Actuarial (loss)/gain in the pension scheme | (26.2) | 4.6 | 24.9 |
| Movement on related deferred tax asset | 5.4 | (1.7) | (5.8) |
| **Total recognised (losses)/gains for the period** | (9.8) | 172.7 | 174.3 |

## Balance sheet (unaudited)

| | At 31 December 2014 | | At 31 March 2014 | |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Fixed assets** | | 3,606.3 | | 3,526.2 |
| **Current assets and liabilities:** | | | | |
| Debtors and prepayments | 257.6 | | 534.4 | |
| Creditors and accruals | (334.5) | | (615.7) | |
| | | (76.9) | | (81.3) |
| **Total assets less current liabilities** | | 3,529.4 | | 3,444.9 |
| **Financing liabilities:** | | | | |
| Bonds | (1,995.9) | | (1,976.9) | |
| Finance leases | (516.2) | | (571.3) | |
| Bank loans (EIB, KfW) | (373.9) | | (307.6) | |
| Other | (1.0) | | (1.1) | |
| | (2,887.0) | | (2,856.9) | |
| Net interest accrual | (97.4) | | (58.5) | |
| | (2,984.4) | | (2,915.4) | |
| **Cash and cash equivalents:** | | | | |
| Receipts account | 64.1 | | 81.9 | |
| Payments account | (69.6) | | (64.7) | |
| Capex reserve account | 80.0 | | 49.9 | |
| Debt service payments account | 76.6 | | 21.9 | |
| Other bank accounts | 5.5 | | 5.3 | |
| | 156.6 | | 94.3 | |
| **Net debt** | | **(2,827.8)** | | **(2,821.1)** |
| Derivative financial instruments | | (334.4) | | (265.0) |
| Provisions for liabilities and charges | | (40.9) | | (17.6) |
| **Net assets before deferred tax** | | **326.3** | | **341.2** |
| Deferred tax | | (236.3) | | (241.3) |
| **Net assets** | | **90.0** | | **99.9** |