glas
Glas Cymru Cyfyngedig

Investor Report

For the quarter ended 31 December 2015

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General overview and business update

This quarterly Investor Report covers the three month period ending 31 December 2015. 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 (unaudited)

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

	9 months to 31 December 2015 £m	**9 months to 31 December 2014 £m**	**Change**
Revenue	554	562	-1%
Operating costs	(224)	(216)	4%
Business rates refund	20	-	
EBITDA (before IRE)	**350**	**346**	
Net interest (excluding indexation)	(72)	(63)	
Capital expenditure (before grants and contributions)	(192)	(256)	

General overview and business update (continued)

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the nine months to 31 December 2015 is £4 million higher than the comparative period last year –a business rates rebate of £20 million has offset the increase in operating costs of £8m and the reduction in revenue following Ofwat's PR14 price determination.

Revenue in the nine months to 31 December 2015 was £554 million, as compared to £562 million in the nine months to 31 December 2014. There has been an overall price decrease driven principally by the RPI+K adjustment allowed by Ofwat (reduction of 1%) .

Operating costs (excluding depreciation and infrastructure renewals expenditure and including business rates refund) of £204 million (2014: £216 million) are lower in comparison with the same period last year. £20 million of business rates rebates resulting from the company's challenge of the 2005 water networks assessment has been offset by the impact of general inflation together with increases in operating costs relating to insurance, employment costs, contractors costs, Retail change programme costs and bad debt.

Net interest payable in the period (excluding fair value movements) was £72 million (2014: £63 million), excluding an indexation charge on index-linked debt of £13 million (2014: indexation charge £19 million). Net interest payable in 2014 included an £8 million accounting profit on lease termination.

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

£m	**31 December 2015**	**31 March 2015**
Net debt	2,842	2,885
Regulatory capital value	4,954	4,832
'Financial reserves'	**2,112**	**1,947**
Regulatory gearing	57.4%	59.7%

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 57% as at 31 December 2015 and 'financial reserves' (RCV less net debt) are £2.1 billion.

General overview and business update (continued)

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £192 million (2014: £256 million). Of that £192 million, £109 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £149 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 for the five years to 31 March 2020. These projected ratios are derived from Glas Cymru's 2015 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 are better than the "trigger" and "default" 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.

Credit ratings

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

Bond Class	Moody's	S&P	Fitch
A*	A3 (+ve)	A	A
B	A3 (+ve)	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA (BB/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 Moody's A3 rating was placed on positive outlook on 27 February 2015.

Financing and liquidity

As at 31 December 2015, undrawn credit facilities and cash (excluding the debt service reserve account deposits of £82 million) amounted to £360 million, including undrawn EIB, KfW and revolving credit facilities of £150 million. In line with prudent policies approved by the board, cash is invested in AAA rated liquidity funds and bonds, The Royal Bank of Scotland (as the group's account bank) and additional banks subject to minimum short-term rating criteria of A1/P1/F1.

Gearing and distribution policy

The Board has approved a regulatory gearing policy (being the ratio of net debt to regulatory capital value) of around 60%. The Board is continuing its customer distribution policy as it is likely that there will be headroom to make distributions while maintaining gearing at 60%. A customer rebate of £6 million to fund social tariffs for financially disadvantaged customers has already been transferred to the Customer Payments Account for the year ended 31 March 2016 and is included in the “Transfers to ‘customer reserves’” of £68 million for the year on page 9 of this report.

Proposed restructuring of the Glas Cymru Group

On 8 January 2016 secured creditors gave unanimous support to the proposal to restructure the Glas group. The restructuring will enable a new holding company to be established as the parent of Glas Cymru Cyfyngedig and will also be a company limited by guarantee (“not-for-profit”). The new company will be prohibited from paying dividends or making other distributions to its members, but will sit outside the operational and financial covenants of the current Glas group’s financing arrangements (together with any subsidiaries).

The revised structure will enable the new holding company to incorporate one or more new subsidiaries for the purpose of establishing or acquiring additional businesses. Those new businesses or ventures will be funded using Dwr Cymru’s financial surpluses subject to an indexed cap of £100 million. The proposal still requires approval under a scheme of arrangement governed by The Companies Act 2006 involving the High Court and Glas Members. We expect this process to conclude in March 2016.

Consolidated cash flow (unaudited)

	9 months ended 31 December 2015 £m	9 months ended 31 December 2015 £m	9 months ended 31 December 2014 £m
Revenue	185.7	553.5	562.1
Less: operating expenses	(81.8)	(204.0)	(215.7)
Earnings before interest, taxation, depreciation and amortisation	**103.9**	**349.5**	**346.4**
Working capital movements	(11.5)	9.6	5.0
Non bond-related interest paid	(0.5)	(1.6)	(1.7)
Interest capitalised in accordance with IAS 23	(2.5)	(4.6)	(6.1)
Interest received	1.0	4.9	2.3
Net operating cash flow and interest received	**90.4**	**357.8**	**345.9**
New borrowings			
European Investment Bank	-	-	80.0
Utilisation of reserves:			
Cash transferred to capex reserve	(5.4)	(11.7)	(117.2)
Cash utilised from capex reserve	29.1	86.7	87.1
Net cash utilised from other reserves	1.5	5.2	-
Capital expenditure:			
Infrastructure renewals expenditure	(14.2)	(45.9)	(50.8)
Non-infrastructure maintenance	(11.2)	(68.4)	(67.9)
Enhancement expenditure	(46.5)	(79.1)	(136.4)
Net cash flow after capital expenditure, new borrowings and reserve drawings	**43.7**	**244.6**	**140.7**
Transfer to debt service payments account	(29.6)	(138.3)	(94.4)
Principal repayments	(4.7)	(44.3)	(68.8)
Net cash flow after debt service	**9.4**	**62.0**	**(22.5)**
Free cash balances brought forward	45.9	(6.7)	22.5
Free cash balances carried forward	**55.3**	**55.3**	**-**

Consolidated debt service payments (unaudited)

	Payments due & made in 3 months ending 31 December 2015 £m	Amount accrued 31 December 2015 £m
Liquidity facility:		
Liquidity facility commitment fee	0.1	0.1
Interest on senior debt:		
Finance lease interest payments	-	48.9
A1 interest payments	-	15.6
A4 interest payments	-	3.4
A5 interest payments	-	1.1
A6 interest payments	-	1.0
B1 interest payments	-	16.7
B3 interest payments	-	2.0
B4 interest payments	-	1.2
B5 interest payments	-	0.2
B6 interest payments	-	1.4
European Investment Bank loan interest payments	1.2	0.5
KfW IPEX-Bank GmbH loan	0.2	-
Miscellaneous fees	-	0.1
Total debt service payments	**1.5**	**92.2**

Glas notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 October 2015 £m	Repayment £m	Indexation £m	Closing balance 31 December 2015 £m
Finance leases		507.2	-	-	507.2
Class A bonds[2]					
A1 notes	A3/A/A	350.0	-	-	350.0
A4 notes		394.2	-	3.9	398.1
A5 notes		126.4	-	3.2	129.6
A6 notes[3]		131.0	-	1.3	132.3
Class B bonds					
B1 notes	A3/A/A	325.0	-	-	325.0
B3 notes		191.3	-	1.8	193.1
B4 notes		111.5	-	2.8	114.3
B5 notes		65.4	-	0.7	66.1
B6 notes		308.5	-	(0.4)	308.1
European Investment Bank loan		413.3	(4.7)	0.6	409.2
Local authority loans		0.9	-	-	0.9
		2,924.7	(4.7)	13.9	2,933.9

[1] Moody's/S&P/Fitch.
[2] Guaranteed by MBIA rated BB/Ba2/-. 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 £32.3m reflects the principal accrual on the index-linked swap.

Glas bank account movements (unaudited)

	Opening balance 1 October 2015 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 December 2015 £m
Free cash balances:					
Receipts account	50.8	-	188.0	(228.9)	9.9
Payments account	(11.0)	-	420.6	(369.8)	39.8
Other bank accounts	6.1	1.0	379.9	(381.4)	5.6
	45.9	1.0	988.5	(980.1)	55.3
Debt service payments account:					
Debt service ledger	44.9	-	29.2	(1.5)	72.6
Insurance proceeds ledger	8.5	-	0.4	-	8.9
	53.4	-	29.6	(1.5)	81.5
Capex reserve account	77.5	-	5.4	(29.1)	53.8
Customer payments account:					
Customer rebate ledger	2.5	-	-	(1.5)	1.0
	179.3	1.0	1,023.5	(1,012.2)	191.6

Interest cover ratio (ICR) – 5 years to 31 March 2020 (unaudited)

(See important notice at the front of the document)	Projection Year to 31 March 2016 £m	Year to 31 March 2017 £m	Year to 31 March 2018 £m	Year to 31 March 2019 £m	Year to 31 March 2020 £m
Income	748	758	771	784	799
Operating expenditure	(302)	(305)	(307)	(305)	(310)
Pre capital maintenance cash flows	**446**	**453**	**464**	**479**	**489**
Capital maintenance expenditure	(198)	(206)	(217)	(220)	(227)
Post capital maintenance cash flows	**248**	**247**	**247**	**259**	**262**
Net interest (excluding indexation and capitalisation)	(119)	(124)	(128)	(131)	(135)
Capital expenditure	(135)	(148)	(153)	(110)	(101)
Transfers to 'customer reserves'[1]	(68)[2]	(52)	(44)	(95)	(105)
Pre-financing cash flows	**(74)**	**(77)**	**(78)**	**(77)**	**(79)**
Interest payable on senior debt:					
Finance leases	6	8	8	10	11
Class A	41	42	42	42	43
Class B	42	43	43	44	44
MBIA financial guarantee fees	6	6	6	6	6
Interest rate swaps	22	22	20	18	17
Authorised loans	6	6	13	15	18
Less interest receivable	(4)	(3)	(4)	(4)	(4)
Total interest payable	**119**	**124**	**128**	**131**	**135**
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	3.7	3.7	3.6	3.7	3.6
Interest cover post capital maintenance (trigger 1.0)	2.1	2.0	1.9	1.9	1.9

[1] This is 'headroom' to balance gearing to the Glas Board's target of around 60% (see page 10). It represents amounts that may be returned to customers or used to fund additional investment for the benefit of customers.
[2] This figure includes £6 million transferred to the Customer Payments Account to fund social tariffs in the year.

Regulatory asset ratio (RAR) – 5 years to 31 March 2020 (unaudited)

(See important notice at the front of the document)	As at 31 March 2016 £m	Projection As at 31 March 2017 £m	As at 31 March 2018 £m	As at 31 March 2019 £m	As at 31 March 2020 £m
Senior gross debt:					
Finance leases	505	456	446	436	421
Class A	1,043	1,018	1,031	1,041	1,054
Class B	792	815	837	861	884
Net interest accrual on senior debt	48	50	51	51	53
Authorised loans	708	869	964	1,065	1,168
Total senior gross debt	**3,096**	**3,208**	**3,329**	**3,454**	**3,580**
Less: cash balances and authorised investments	(108)	(100)	(100)	(100)	(100)
Total net debt	**2,988**	**3,108**	**3,229**	**3,354**	**3,480**
Regulatory capital value (RCV)	**4,981**	**5,182**	**5,388**	**5,591**	**5,796**
Reserves (RCV less total net debt)	**1,993**	**2,074**	**2,159**	**2,237**	**2,316**
Regulatory asset ratio:					
RAR (trigger 90%; default 95%)	60%	60%	60%	60%	60%

Income statement (unaudited)

	3 months ended 31 December 2015 £m	9 months ended 31 December 2015 £m	9 months ended 31 December 2014 £m
Revenue	185.7	553.5	562.1
Operating expenditure	(81.8)	(204.0)	(215.7)
EBITDA	**103.9**	**349.5**	**346.4**
Infrastructure renewals expenditure	(12.5)	(43.2)	(50.9)
Depreciation	(62.1)	(184.1)	(132.5)
Operating profit	**29.3**	**122.2**	**163.0**
Interest payable	(23.5)	(76.5)	(65.4)
Indexation of index-linked debt	(13.9)	(12.9)	(19.1)
Interest receivable	1.0	4.9	2.4
Fair value gains/(losses) on financial instruments	12.1	98.1	(69.5)
Profit before tax	**5.0**	**135.8**	**11.4**
Taxation	-	(26.2)	(0.4)
Profit after tax	**5.0**	**109.6**	**11.0**

Statement of comprehensive income (unaudited)

	3 months ended 31 December 2015	9 months ended 31 December 2015	9 months ended 31 December 2014
	£m	£m	£m
Profit for the period	5.0	109.6	11.0
Actuarial loss in the pension scheme	-	(19.0)	(26.2)
Movement on related deferred tax asset	-	3.7	5.4
Items that will not be reclassified to profit or loss:			
Revaluation of property, plant and equipment[1]	-	1,152.0	-
Related deferred tax	-	(230.4)	-
Total recognised gains/(losses) for the period	**5.0**	**1,015.9**	**(9.8)**

Statement of changes in reserves (unaudited)

	3 months ended 31 December 2015	9 months ended 31 December 2015	9 months ended 31 December 2014
	£m	£m	£m
(Deficit)/reserves at start of period	-	(6.4)	100.0
Revaluation (net)	-	921.6	-
Profit for the period	5.0	109.6	11.0
Actuarial loss (net)	-	(15.3)	(20.8)
Reserves at end of period	**5.0**	**1,009.5**	**90.2**

[1] The group has decided that a 'fair value' approach to valuing its asset base better reflects the underlying value of the assets than historical cost accounting which understates the assets current value in use. The carrying values of the regulatory assets will be revalued periodically to their economic values at annual intervals starting on 1 April 2015. This change in accounting treatment has given rise to a net revaluation adjustment of £922m which is held in a non-distributable revaluation reserve.

Balance sheet (unaudited)

	At 31 December 2015		At 31 March 2015	
	£m	£m	£m	£m
Fixed assets		**4,806.4**[1]		**3,679.0**
Current assets and liabilities:				
Debtors and prepayments	253.6		539.1	
Creditors and accruals	(342.0)		(638.7)	
		(88.4)		(99.6)
Total assets less current liabilities		**4,718.0**		**3,579.4**
Financing liabilities:				
Bonds	(2,016.6)		(2,005.5)	
Finance leases	(507.2)		(507.2)	
Bank loans (EIB, KfW)	(409.2)		(451.6)	
Other	(0.9)		(0.9)	
	(2,933.9)		(2,965.2)	
Net interest accrual	(99.4)		(66.6)	
	(3,033.3)		(3,031.8)	
Cash and cash equivalents:				
Receipts account	9.9		80.3	
Payments account	39.8		(92.4)	
Capex reserve account	53.8		135.0	
Debt service payments account	81.5		19.6	
Customer payments account	1.0		-	
Other bank accounts	5.6		5.5	
	191.6		148.0	
Net debt		**(2,841.7)**		**(2,883.8)**
Derivative financial instruments		(324.1)		(422.1)
Provisions for liabilities and charges		(70.0)		(60.1)
Net assets before deferred tax		**1,482.2**		**213.4**
Deferred tax		(472.7)		(219.8)
Net assets		**1,009.5**		**(6.4)**

[1] Including revaluation to fair value (see page 12)