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Glas Cymru Cyfyngedig

Investor Report

For the quarter ended 30 June 2015

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General overview and business update

This quarterly Investor Report covers the three month period ending 30 June 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

Summary financial results for the three months ended 30 June are as follows:

	3 months to 30 June 2015 £m	3 months to 30 June 2014 £m	Change
Revenue	181	186	-3%
Operating costs	(71)	(75)	-5%
Business rates refund	20	-	
EBITDA (before IRE)	**130**	**111**	
Net interest (excluding indexation)	(21)	(13)	
Capital expenditure (before grants and contributions)	(56)	(87)	

General overview and business update cont'd

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the three months to 30 June 2015 is £19 million higher than the comparative period last year – business rates rebates are largely responsible for the reduction in operating costs by some £20 million.

Revenue in the three months to 30 June 2015 was £181 million, as compared to £186 million in the three months to 30 June 2014. There has been an overall price increase of 2.0% (being the RPI+K adjustment allowed by Ofwat).

Operating costs (excluding depreciation and infrastructure renewals expenditure) of £71 million (2014: £75 million) are lower in comparison with the same period last year; the impact of general inflation has been more than offset by savings arising from IT contract insourcing and on-going operational cost efficiencies. In addition, £20 million of business rates rebates have arisen from the company's challenge of the 2005 water networks assessment.

Net interest payable in the period (excluding fair value movements) was £21 million (2014: £13 million), excluding an indexation charge on index-linked debt of £4 million (2014: £8 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	**30 June 2015**	**31 March 2015**
Net debt	2,881	2,884
Regulatory capital value	4,884	4,831
'Financial reserves'	**2,003**	**1,947**
Regulatory gearing	59.0%	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 59% as at 30 June 2015 and 'financial reserves' (RCV less net debt) exceed £2 billion.

General overview and business update cont'd

Capital investment programme

Capital investment (including infrastructure renewals expenditure) was £56 million before grants and contributions (2014: £87 million). Of that £56 million, £18 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £38 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 (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 Moody's A3 rating was placed on positive outlook on 27 February 2015. The company's policy is to target to maintain ratings at an "A" grade.

Financing and liquidity

As at 30 June 2015, undrawn credit facilities and cash (excluding the debt service reserve account deposits of £36 million) amounted to £315 million, including undrawn EIB and revolving credit facilities of £190 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 banks subject to minimum short-term rating criteria of A1/P1/F1.

Since the quarter end, on 15 July 2015 a £35 million loan has been repaid as part of a liability management exercise. The loan was originally due to be repaid in 2017.

General overview and business update cont'd

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 will consider its customer distribution policy for the headroom to balance regulatory gearing to 60% later this financial year. A customer rebate of £6.2 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.

Consolidated cash flow

	3 months ended 30 June 2015 £m	3 months ended 30 June 2014 £m
Revenue	181.3	186.4
Less: operating expenses	(50.9)	(74.9)
Earnings before interest, taxation, depreciation and amortisation	130.4	111.5
Working capital movements	(40.8)	11.5
Non bond-related interest paid	(0.6)	(0.6)
Interest capitalised in accordance with IAS 23	(1.2)	(1.1)
Interest received	1.3	1.0
Net operating cash flow and interest received	89.1	122.3
Utilisation of reserves:		
Cash transferred to capex reserve	(3.5)	(2.3)
Cash utilised from capex reserve	27.5	29.3
Net cash utilised from other reserves	1.6	-
Capital expenditure:		
Net profit on disposal of assets	-	(0.1)
Infrastructure renewals expenditure	(15.7)	(20.1)
Non-infrastructure maintenance	(25.3)	(28.1)
Enhancement expenditure	(18.6)	(34.5)
Net cash flow after capital expenditure, new borrowings and reserve drawings	55.1	66.5
Transfer to debt service payments account	(30.7)	(38.0)
Principal repayments	(2.3)	(59.6)
Net cash flow after debt service	22.1	(31.1)
Free cash balances brought forward	(6.7)	22.5
Free cash balances carried forward	15.4	(8.6)

Consolidated debt service payments

	Payments due & made in 3 months ending 30 June 2015 £m	Amount accrued 30 June 2015 £m
Liquidity facility:		
Liquidity facility commitment fee	0.3	0.1
Interest on senior debt:		
Finance lease interest payments	8.2	45.9
A1 interest payments	-	5.1
A4 interest payments	-	3.3
A5 interest payments	-	1.1
A6 interest payments	-	0.3
B1 interest payments	-	5.5
B3 interest payments	-	2.0
B4 interest payments	-	1.2
B5 interest payments	-	0.2
B6 interest payments	-	1.4
European Investment Bank and KfW loan interest payments	1.4	1.3
MBIA wrapping fees	4.4	(3.3)
Miscellaneous fees	0.1	0.3
Total debt service payments	**14.4**	**64.4**

Glas notes principal balance reconciliation

	Credit rating[1]	Opening balance 1 April 2015 £m	Repayment £m	Indexation £m	Closing balance 30 June 2015 £m
Finance leases		507.2	-	-	507.2
Class A bonds[2]					
A1 notes	A3/A/A	350.0	-	-	350.0
A4 notes		395.1	-	(0.5)	394.6
A5 notes		128.6	-	(0.1)	128.5
A6 notes[3]		131.3	-	(0.1)	131.2
Class B bonds					
B1 notes	A3/A/A	325.0	-	-	325.0
B3 notes		191.7	-	(0.2)	191.5
B4 notes		113.4	-	(0.1)	113.3
B5 notes		65.6	-	(0.1)	65.5
B6 notes		304.9	-	4.7	309.6
European Investment Bank loan		416.6	(2.3)	-	414.3
KfW IPEX-Bank GmbH loan		35.0	-	-	35.0
Local authority loans		0.9	-	-	0.9
		2,965.3	(2.3)	3.6	2,966.6

[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 £31.2m reflects the principal accrual on the index-linked swap.

Glas bank account movements

	Opening balance 1 April 2015 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 30 June 2015 £m
Free cash balances:					
Receipts account	80.3	-	205.3	(232.3)	53.3
Payments account	(92.4)	-	439.5	(390.0)	(43.0)
Other bank accounts	5.5	1.3	167.4	(169.1)	5.1
	(6.6)	1.3	812.2	(791.4)	15.4
Debt service payments account:					
Debt service ledger	11.1	-	30.7	(14.4)	27.4
Insurance proceeds ledger	8.5	-	-	-	8.5
	19.6	-	30.7	(14.4)	35.9
Capex reserve account	128.8	-	3.5	(27.4)	104.9
Customer payments account:					
Customer rebate ledger	6.2	-	-	(1.6)	4.6
	148.0	1.3	846.4	(834.9)	160.8

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

(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 £6.2 million transferred to the Customer Payments Account to fund social tariffs in the year.

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

(See important notice at the front of the document)	Projection As at 31 March 2016 £m	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

	3 months ended 30 June 2015 £m	3 months ended 30 June 2014 £m
Revenue	181.3	186.4
Operating expenditure	(50.9)	(74.9)
EBITDA	130.4	111.5
Infrastructure renewals expenditure	(14.8)	(20.5)
Depreciation	(47.1)	(44.2)
Operating profit	68.5	46.8
Interest payable	(23.2)	(14.4)
Indexation of index-linked debt	(3.6)	(8.3)
Interest receivable	2.5	1.0
Fair value gains on financial instruments	51.0	1.7
Profit before tax	95.2	26.8
Taxation	-	-
Profit after tax	95.2	26.8

Statement of comprehensive income

	3 months ended 30 June 2015 £m	3 months ended 30 June 2014 £m
Profit for the period	95.2	26.8
Actuarial (loss)/gain in the pension scheme	-	-
Movement on related deferred tax asset	-	-
Total recognised gains for the period	95.2	26.8

Balance sheet

	At 30 June 2015		At 31 March 2015	
	£m	£m	£m	£m
Fixed assets		3,672.1		3,679.0
Current assets and liabilities:				
Debtors and prepayments	455.4		539.1	
Creditors and accruals	(510.1)		(638.7)	
		(54.7)		(99.6)
Total assets less current liabilities		3,617.4		3,579.4
Financing liabilities:				
Bonds	(2,009.2)		(2,005.5)	
Finance leases	(507.2)		(507.2)	
Bank loans (EIB, KfW)	(449.3)		(451.6)	
Other	(0.9)		(0.9)	
	(2,966.6)		(2,965.2)	
Net interest accrual	(75.1)		(66.6)	
	(3,041.7)		(3,031.8)	
Cash and cash equivalents:				
Receipts account	53.3		80.3	
Payments account	(43.0)		(92.4)	
Capex reserve account	104.8		128.8	
Debt service payments account	35.9		19.6	
Customer payments account	4.6		6.2	
Other bank accounts	5.1		5.5	
	160.7		148.0	
Net debt		**(2,881.0)**		**(2,883.8)**
Derivative financial instruments		(371.1)		(422.1)
Provisions for liabilities and charges		(56.9)		(60.1)
Net assets before deferred tax		**308.4**		**213.4**
Deferred tax		(219.8)		(219.8)
Net assets/(liabilities)		**88.6**		**(6.4)**
Net assets excluding derivative financial instruments		*459.8*		*415.7*