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Glas Cymru Anghyfyngedig

Investor Report

For the quarter ended 31 December 2016

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General overview and business update

This quarterly Investor Report covers the three month period ending 31 December 2016. 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 2016 £m	**9 months to 31 December 2015 £m**	**Change**
Revenue	563	554	+2%
Operating costs	(233)	(224)	+4%
Exceptional items (rates refund)	-	20	
EBITDA (before IRE)	**330**	**350**	-6%
Net interest (excluding indexation)	(74)	(72)	
Capital expenditure (before grants and contributions)	(253)	(192)	

General overview and business update (continued)

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the nine months to 31 December 2016 is £20 million lower than the comparative period last year – excluding a business rates rebate of £20 million in 2015, the £9 million increase in revenue in the current period offsets a £9 million increase in operating costs.

Revenue in the nine months to 31 December 2016 was £563 million, as compared to £554 million in the nine months to 31 December 2015.

Operating costs (excluding depreciation, infrastructure renewals expenditure and exceptional items) of £233 million (2015: £224 million) are higher in comparison with the same period last year; increases in salaries, IT, power, operational contractor costs and investment in our Customer-Led Success and Brand Builder campaigns have been partially offset by a reduction in the bad debt charge and other ongoing efficiencies. In the prior period we also received a £20 million business rates rebate in respect of our longstanding challenge of the 2005 rates assessment.

Net interest payable in the period (excluding fair value movements) was £95 million (2015: £84 million) including an indexation charge on index-linked debt of £21m (2015: £12m). £1 million interest was received last year on the backdated £20 million rates refund.

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

£m	**31 December 2016**	**31 December 2015**
Net debt	2,891	2,842
Regulatory capital value	5,155	4,954
‘Financial reserves’	**2,264**	**2,112**
Regulatory gearing	56.1%	57.4%

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 56% as at 31 December 2016 and ‘financial reserves’ (RCV less net debt) have risen to £2.3 billion.

General overview and business update (continued)

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £253 million (2015: £192 million). Of that £253 million, £145 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £199 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 2016 financial 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*	A2	A	A
B	A2	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA (BB/Baa2/-), 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.

On 22 November 2016 Moody's upgraded Welsh Water's rating from A3+ to A2, reflecting their assessment of the company's latest operational and financial results and forecasts, in particular the Board's target to maintain gearing at around 60%. On 15 September 2016, both Fitch and Standard and Poor reaffirmed the credit rating of the company's bonds as A with stable outlook.

Financing and liquidity

As at 31 December 2016, undrawn credit facilities and cash (excluding the debt service payments account deposits of £65 million) amounted to £315 million. This includes undrawn KfW and revolving credit facilities of £210 million and is sufficient to fund the business for the next 3 years. In addition, on 20th January 2017 a further loan facility was signed with the European Investment Bank for £250 million of funding for capital projects.

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.

General overview and business update (continued)

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%. In September 2016 the Company issued a consultation to customers on the future distributions during the period to 31 March 2020. This consultation will be taken into account when the Board determines future distributions. Further details of the consultation are available on the Company's website, www.dwrcymru.com.

Consolidated cash flow (unaudited)

	3 months ended 31 December 2016 £m	9 months ended 31 December 2016 £m	9 months ended 31 December 2015 £m
Revenue	187.9	562.5	553.5
Less: operating expenses	(81.5)	(233.3)	(204.0)
Earnings before interest, taxation, depreciation and amortisation	106.4	329.2	349.5
Working capital movements	(7.9)	(21.1)	9.6
Non bond-related interest paid	(1.3)	(2.3)	(1.6)
Interest capitalised in accordance with IAS 23	(3.4)	(7.2)	(4.6)
Interest received	1.1	3.2	4.9
Net operating cash flow and interest received	94.9	301.8	357.8
New borrowings			
European Investment Bank	-	70.0	-
Utilisation of reserves:			
Cash transferred to capex reserve	(2.7)	(78.6)	(11.7)
Cash utilised from capex reserve	29.4	81.1	86.7
Net cash utilised from other reserves	1.3	3.8	5.2
Capital expenditure:			
Net profit on disposal of assets	(0.1)	(0.1)	-
Infrastructure renewals expenditure	(23.5)	(62.8)	(45.9)
Non-infrastructure maintenance	(22.3)	(78.0)	(68.4)
Capital expenditure	(42.6)	(97.0)	(79.1)
Net cash flow after capital expenditure, new borrowings and reserve drawings	34.4	140.2	244.6
Transfer to debt service payments account	(31.6)	(91.7)	(138.3)
Principal repayments	(4.8)	(16.9)	(44.3)
Net cash flow after debt service	(2.0)	31.6	62.0
Free cash balances brought forward	72.9	39.3	(6.7)
Free cash balances carried forward	70.9	70.9	55.3

Consolidated debt service payments (unaudited)

	Payments due and made in 3 months ended 31 December 2016 £m	Amount accrued 31 December 2016 £m
Liquidity facility:		
Liquidity facility commitment fee	0.1	0.1
Interest on senior debt:		
Finance lease interest payments	-	52.0
A1 interest payments	-	15.9
A4 interest payments	-	3.6
A5 interest payments	-	1.2
A6 interest payments	-	1.0
B1 interest payments	-	16.9
B3 interest payments	-	2.1
B4 interest payments	-	1.3
B5 interest payments	-	0.2
B6 interest payments	-	1.4
European Investment Bank loan interest payments	1.2	0.4
KfW IPEX-Bank GmbH loan interest payments	0.1	-
MBIA wrapping fee	0.1	(1.1)
Miscellaneous fees	0.1	0.1
	1.6	95.1
Interest rate swaps	2.5	-
	4.1	95.1
Total debt service payments	4.1	95.1

Glas notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 October 2016 £m	New Issues £m	Repayment £m	Indexation £m	Closing balance 31 December 2016 £m
Finance leases		455.8	-	-	-	455.8
Class A bonds[2]						
A1 notes	A2/A/A	350.0	-	-	-	350.0
A4 notes		399.4	-	-	5.3	404.7
A5 notes		128.0	-	-	3.6	131.6
A6 notes[3]		132.7	-	-	-	132.7
Class B bonds						
B1 notes	A2/A/A	325.0	-	-	-	325.0
B3 notes		193.9	-	-	2.6	196.5
B4 notes		112.9	-	-	3.1	116.0
B5 notes		66.4	-	-	0.8	67.2
B6 notes		314.3	-	-	(1.2)	313.1
European Investment Bank loan		467.2	-	(4.8)	1.4	463.8
Local authority loans		0.7	-	-	-	0.7
		2,946.3	-	(4.8)	15.6	2,957.1

[1] Moody's/S&P/Fitch.
[2] Guaranteed by MBIA rated Ba2/CCC/-. Class A bond ratings default to their higher underlying ratings of A2/A/A.
[3] The class A6 notes (£100m) were issued at a fixed rate of 4.473% and swapped to an effective index-linked rate of 1.35%; cumulative indexation of £32.7m has been recognised in this table.

Glas bank account movements (unaudited)

	Opening balance 1 September 2016 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 December 2016 £m
Free cash balances:					
Receipts account	58.9	-	182.0	(182.9)	58.0
Payments account	8.1	-	440.0	(437.7)	10.4
Other bank accounts	5.9	1.1	275.5	(280.0)	2.5
	72.9	1.1	897.5	(900.6)	70.9
Debt service payments account:					
Debt service ledger	37.0	-	31.6	(4.1)	64.5
Capex reserve account	59.7	-	2.7	(29.4)	33.0
Customer payments account:					
Customer rebate ledger	2.5	-	-	(1.3)	1.2
	172.1	1.1	931.8	(935.4)	169.6

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

(See important notice at the front of the document)	Actual Year to 31 March 2016 £m	Projection 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	750	755	764	775	789
Operating expenditure	(277)	(316)	(310)	(312)	(314)
Pre capital maintenance cash flows	**473**	**439**	**454**	**463**	**475**
Capital maintenance expenditure[1]	(149)	(152)	(156)	(160)	(164)
Post capital maintenance cash flows	**324**	**287**	**298**	**303**	**311**
Net interest (excluding indexation and capitalisation)	(113)	(117)	(123)	(126)	(127)
Capital expenditure[1]	(113)	(201)	(197)	(221)	(201)
Increase in 'customer reserves'[2]	(7)[3]	(174)	(50)	(29)	(95)
Pre-financing cash flows	**91**	**(205)**	**(72)**	**(73)**	**(112)**
Interest payable on senior debt:					
Finance leases	6	9	10	12	12
Class A	44	42	42	42	43
Class B	42	42	43	44	44
MBIA financial guarantee fees	4	5	5	5	5
Interest rate and RPI swaps	17	17	16	15	14
Authorised loans	6	7	12	15	15
Less interest receivable	(6)	(5)	(5)	(7)	(6)
Total interest payable	**113**	**117**	**123**	**126**	**127**
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	4.2	3.8	3.7	3.7	3.7
Interest cover post capital maintenance (trigger 1.0)	2.9	2.5	2.4	2.4	2.4

[1] The projected split between capital and maintenance expenditure assumes a steady level of maintenance activity from 2016 onwards.
[2] Projected values are forecast 'headroom' in the 2016 financial plan 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.
[3] This figure is the total value of revenue foregone in order 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)	Actual 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	456	463	454	443	431
Class A	1,012	1,012	1,022	1,033	1,045
Class B	1,008	1,033	1,053	1,075	1,099
Net interest accrual on senior debt	55	50	51	51	51
Authorised loans (including assumed borrowings to balance gearing to 60%; see page 10)	407	633	732	832	974
Total senior gross debt	**2,938**	**3,191**	**3,312**	**3,434**	**3,600**
Less: cash balances and authorised investments	(92)	(100)	(100)	(100)	(100)
Total net debt	**2,846**	**3,091**	**3,212**	**3,334**	**3,500**
Regulatory capital value (RCV)	**4,983**	**5,151**	**5,354**	**5,556**	**5,833**
Reserves (RCV less total net debt)	**2,137**	**2,060**	**2,142**	**2,222**	**2,333**
Regulatory asset ratio:					
RAR (trigger 90%; default 95%)	57%	60%	60%	60%	60%

For the purpose of calculating regulatory gearing, cumulative indexation of £33m relating to the Class A6 notes (£100m) is included above; these were issued at a fixed rate of 4.473% and swapped to an effective index-linked rate of 1.35%.

Income statement (unaudited)

	3 months ended 31 December 2016 £m	9 months ended 31 December 2016 £m	9 months ended 31 December 2015 £m
Revenue	187.9	562.5	553.5
Operating expenditure	(81.5)	(233.3)	(204.0)
EBITDA	106.4	329.2	349.5
Infrastructure renewals expenditure	(23.6)	(63.7)	(43.2)
Depreciation	(63.6)	(189.2)	(184.1)
Operating profit	19.2	76.3	122.2
Interest payable	(24.3)	(76.9)	(76.5)
Indexation of index-linked debt	(15.6)	(21.1)	(12.9)
Interest receivable	1.1	3.2	4.9
Fair value (losses)/gains on financial instruments	(41.3)	(169.6)	98.1
(Loss)/profit before tax	(60.9)	(188.1)	135.8
Taxation	-	34.1	(26.2)
(Loss)/profit after tax	(60.9)	(154.0)	109.6

Statement of comprehensive income (unaudited)

	3 months ended 31 December 2016 £m	9 months ended 31 December 2016 £m	9 months ended 31 December 2015 £m
Profit for the period	(60.9)	(154.0)	109.6
Actuarial loss in the pension scheme	-	(88.4)	(19.0)
Movement on related deferred tax asset	-	14.4	3.7
Items that will not be reclassified to the profit or loss:			
Revaluation of property, plant and equipment	-	113.6	1152.0
Related deferred tax	-	(6.8)	(230.4)
Total comprehensive (expense)/income	**(60.9)**	**(121.2)**	**1,015.9**

Statement of changes in reserves (unaudited)

	3 months ended 31 December 2016 £m	9 months ended 31 December 2016 £m	9 months ended 31 December 2015 £m
Reserves/(deficit) at start of period	-	1,081.8	(6.4)
Revaluation (net of tax)	-	106.8	921.6
(Loss)/profit for the period	(60.9)	(154.0)	109.6
Actuarial loss (net)	-	(74.0)	(15.3)
Reserves at end of period	**(60.9)**	**960.6**	**1,009.5**

Balance sheet (unaudited)

	At 31 December 2016 £m	At 31 December 2016 £m	At 31 March 2016 £m	At 31 March 2016 £m
Fixed assets		**5,081.9**		**4,947.0**
Current assets and liabilities:				
Debtors and prepayments	274.2		552.8	
Creditors and accruals	(408.7)		(688.3)	
		(134.5)		(135.5)
Total assets less current liabilities		**4,947.4**		**4,811.5**
Financing liabilities:				
Bonds	(2,036.8)		(2,020.0)	
Finance leases	(455.8)		(455.8)	
Bank loans (EIB, KfW)	(463.8)		(406.4)	
Other	(0.7)		(0.7)	
	(2,957.2)		(2,882.9)	
Net interest accrual	(103.2)		(54.8)	
	(3,060.3)		(2,937.7)	
Cash and cash equivalents:				
Receipts account	58.0		62.9	
Payments account	10.4		(31.0)	
Capex reserve account	33.0		35.5	
Debt service payments account	64.5		12.5	
Customer payments account	1.2		5.0	
Other bank accounts	2.5		7.4	
	169.6		92.3	
Net debt		**(2,890.7)**		**(2,845.4)**
Derivative financial instruments		(550.9)		(381.4)
Provisions for liabilities and charges		(155.1)		(71.0)
Net assets before deferred tax		**1,350.7**		**1,513.7**
Deferred tax		(390.1)		(431.9)
Net assets		**960.6**		**1,081.8**