Glas Cymru Cyfyngedig

Investor Report

For the quarter ended 30 June 2016

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General overview and business update

This quarterly Investor Report covers the three month period ending 30 June 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 three months ended 30 June are as follows:

	3 months to 30 June 2016 £m	3 months to 30 June 2015 £m	Change
Revenue	188	181	+4%
Operating costs	(77)	(71)	+8%
Exceptional items	-	20	
EBITDA (before IRE)	**111**	**130**	**-15%**
Net interest (excluding indexation)	(26)	(21)	
Capital expenditure (before grants and contributions)	(74)	(56)	

General overview and business update (continued)

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the three months to 30 June 2016 is £19 million lower than the comparative period last year – excluding the business rates rebate of £20 million in 2015, the £7 million increase in revenue in the current period has more than offset the increase in operating costs of £6m.

Revenue in the three months to 30 June 2016 was £188 million, as compared to £181 million in the three months to 30 June 2015.

Operating costs (excluding depreciation, infrastructure renewals expenditure and exceptional items) of £77 million (2015: £71 million) are higher in comparison with the same period last year; increases in salaries, insurance, IT, operational contractor costs and our Retail change programme have been partially offset by a reduction in the bad debt charge and other ongoing efficiencies.

Net interest payable in the period (excluding fair value movements and indexation) was £26 million (2015: £21 million). The increase in the charge is principally due to timing differences in interest receipts and swap payments; in addition, £1 million interest was received last year on the backdated £20 million rates refund. The indexation charge on index-linked debt amounted to £2 million (2015: £4 million) reflecting the movements in retail price indices.

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

£m	**30 June 2016**	**30 June 2015**
Net debt	2,817	2,881
Regulatory capital value	4,983	4,884
‘Financial reserves’	**2,166**	**2,003**
Regulatory gearing	56.5%	59.0%

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 30 June 2016 and ‘financial reserves’ (RCV less net debt) have risen to £2.2 billion.

General overview and business update (continued)

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £74 million (2015: £56 million). Of that £74 million, £41 million is reported as capital maintenance as defined in the CTA, while for regulatory purposes £56 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*	A3 (+ve)	A	A
B	A3 (+ve)	A	A

*The credit ratings of the company's Class A Bonds, which are guaranteed by MBIA (CCC/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 has been placed on positive outlook since 27 February 2015.

Financing and liquidity

As at 30 June 2016, undrawn credit facilities and cash (excluding the debt service payments account deposits of £48 million) amounted to £364 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, the Company has received confirmation from the European Investment Bank that a further £250 million of funding for capital projects in the five years to 31 March 2020 is unaffected by the EU Referendum vote.

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.

On 17 May 2016 the company drew £70 million, being the final tranche of the previous EIB facility.

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 July 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 30 June 2016 £m	3 months ended 30 June 2015 £m
Revenue	188.3	181.3
Less: operating expenses	(76.7)	(50.9)
Earnings before interest, taxation, depreciation and amortisation	111.6	130.4
Working capital movements	12.8	(40.8)
Non bond-related interest paid	(0.5)	(0.6)
Interest capitalised in accordance with IAS 23	(0.8)	(1.2)
Interest received	1.1	1.3
Net operating cash flow and interest received	124.2	89.1
New borrowings		
European Investment Bank	70.0	-
Utilisation of reserves:		
Cash transferred to capex reserve	(73.7)	(3.5)
Cash utilised from capex reserve	32.6	27.5
Net cash utilised from other reserves	1.7	1.6
Capital expenditure:		
Net profit on disposal of assets	-	-
Infrastructure renewals expenditure	(16.5)	(15.7)
Non-infrastructure maintenance	(25.4)	(25.3)
Capital expenditure	(29.5)	(18.6)
Net cash flow after capital expenditure, new borrowings and reserve drawings	83.4	55.1
Transfer to debt service payments account	(39.0)	(30.7)
Transfer to insurance proceeds ledger	-	-
Principal repayments	(9.8)	(2.3)
Net cash flow after debt service	34.6	22.1
Free cash balances brought forward	39.3	(6.7)
Free cash balances carried forward	73.9	15.4

Consolidated debt service payments (unaudited)

	Payments due and made in 3 months ended 30 June 2016 £m	Amount accrued 30 June 2016 £m
Liquidity facility:		
Liquidity facility commitment fee	0.1	0.1
Interest on senior debt:		
Finance lease interest payments	(0.2)	48.5
A1 interest payments	-	5.4
A4 interest payments	-	3.5
A5 interest payments	-	1.1
A6 interest payments	-	0.3
B1 interest payments	-	5.7
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	1.3	0.4
KfW IPEX-Bank GmbH loan	0.1	-
MBIA wrapping fee	-	(3.3)
Miscellaneous fees	0.1	-
	1.4	**66.7**
Interest rate swaps	2.4	-
	3.8	**66.7**
Total debt service payments	**3.8**	**66.7**

Glas notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 April 2016 £m	New Issues £m	Repayment £m	Indexation £m	Closing balance 30 June 2016 £m
Finance leases		455.8	-		-	455.8
				-		
Class A bonds[2]						
A1 notes	A3/A/A	350.0	-		-	350.0
A4 notes		399.1	-	-	0.2	399.3
A5 notes		129.9	-	-	(1.0)	128.9
A6 notes[3]		132.6	-	-	0.1	132.7
				-		
Class B bonds						
B1 notes	A3/A/A	325.0	-		-	325.0
B3 notes		193.6	-	-	0.1	193.7
B4 notes		114.6	-	-	(0.8)	113.8
B5 notes		66.3	-	-	-	66.3
B6 notes		308.9	-	-	1.8	310.7
				-		
European Investment Bank loan		406.4	70.0	(9.8)	1.1	467.7
Local authority loans		0.7	-	-	-	0.7
		2,882.9	70.0	(9.8)	1.5	2,944.6

[1] Moody's/S&P/Fitch.
[2] Guaranteed by MBIA rated Ba2/BB /-. 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% 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 April 2016 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 30 June 2016 £m
Free cash balances:					
Receipts account	62.9	-	213.5	(259.6)	16.8
Payments account	(31.0)	-	474.0	(393.5)	49.5
Other bank accounts	7.4	1.1	308.1	(309.0)	7.6
	39.3	1.1	995.6	(962.1)	73.9
Debt service payments account:					
Debt service ledger	4.0	-	39.0	(3.8)	39.2
Insurance proceeds ledger	8.5	-	-	-	8.5
	12.5	-	39.0	(3.8)	47.7
Capex reserve account	35.5	-	73.7	(32.6)	76.6
Customer payments account:					
Customer rebate ledger	5.0	-	-	(1.7)	3.3
	92.3	1.1	1,108.3	(1,000.2)	201.5

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 30 June 2016 £m	3 months ended 30 June 2015 £m
Revenue	188.3	181.3
Operating expenditure	(76.7)	(50.9)
EBITDA	**111.6**	**130.4**
Infrastructure renewals expenditure	(16.1)	(14.8)
Depreciation	(60.5)	(47.1)
Operating profit	**35.0**	**68.5**
Interest payable	(26.9)	(23.2)
Indexation of index-linked debt	(1.5)	(3.6)
Interest receivable	1.1	2.5
Fair value (losses)/gains on financial instruments	(50.3)	51.0
(Loss)/profit before tax	**(42.6)**	**95.2**
Taxation	-	-
(Loss)/profit after tax	**(42.6)**	**95.2**

Statement of comprehensive income (unaudited)

	3 months ended 30 June 2016	3 months ended 30 June 2015
	£m	£m
(Loss)/profit for the period	(42.6)	95.2
Reserves at end of period	**(42.6)**	**95.2**

Statement of changes in reserves (unaudited)

	3 months ended 30 June 2016	3 months ended 30 June 2015
	£m	£m
Reserves/(deficit) at start of period	1,081.8	(6.4)
Revaluation (net)	-	-
(Loss)/profit for the period	(42.6)	95.2
Actuarial loss (net)	-	-
Reserves at end of period	**1,039.2**	**88.8**

Balance sheet (unaudited)

	At 30 June 2016		At 31 March 2016	
	£m	£m	£m	£m
Fixed assets		**4,939.2**		**4,947.0**
Current assets and liabilities:				
Debtors and prepayments	435.1		552.8	
Creditors and accruals	(584.0)		(688.3)	
		(148.9)		(135.5)
Total assets less current liabilities		**4,793.6**		**4,811.5**
Financing liabilities:				
Bonds	(2,020.4)		(2,020.0)	
Finance leases	(455.8)		(455.8)	
Bank loans (EIB, KfW)	(467.7)		(406.4)	
Other	(0.7)		(0.7)	
	(2,944.6)		(2,882.9)	
Net interest accrual	(73.8)		(54.8)	
	(3,018.4)		(2,937.7)	
Cash and cash equivalents:				
Receipts account	16.8		62.9	
Payments account	49.5		(31.0)	
Capex reserve account	76.6		35.5	
Debt service payments account	47.7		12.5	
Customer payments account	3.3		5.0	
Other bank accounts	7.6		7.4	
	201.5		92.3	
Net debt		**(2,816.9)**		**(2,845.4)**
Derivative financial instruments		(431.7)		(381.4)
Provisions for liabilities and charges		(70.6)		(71.0)
Net assets before deferred tax		**1,471.1**		**1,513.7**
Deferred tax		(431.9)		(431.9)
Net assets		**1,039.2**		**1,081.8**