Dŵr Cymru Welsh Water

Investor Report

For the quarter ended 31 December 2018

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References to the "Company", "Dŵr Cymru" and "Welsh Water" in this document relate to Dŵr Cymru Cyfyngedig, the sole operating company in the whole business securitisation formed by the Glas Cymru Anghyfyngedig group. References to "Glas Cymru" and the "Group" refer, respectively, to Glas Cymru Anghyfyngedig and the group of which it is the parent.

Contents

General overview and business update

This quarterly Investor Report covers the three-month period ended 31 December 2018. 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 is 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 Dec 2018 £m	**9 months to 31 Dec 2017 £m**	**Change**
Turnover	586	571	+3%
Operating costs	(252)	(233)	+8%
EBITDA (before infrastructure renewals expenditure)	**334**	**338**	**-1%**
Net interest (excluding indexation)	(69)	(67)	
Capital expenditure (before grants and contributions)	(346)	(306)	

Operating profit before interest, tax, depreciation, infrastructure renewals and amortisation (EBITDA) for the nine months to 31 December is £4 million lower than the comparative period last year.

Revenue in the nine months to 31 December 2018 was £586 million, as compared to £571 million in the nine months to 31 December 2017. This increase relates to price and consumption increases partially offset by customers switching to a metered supply or social tariff.

Operating costs (excluding depreciation and infrastructure renewals expenditure) of £252 million (2017: £233 million) have increased by £19 million compared to the prior period. This remains largely attributable to costs associated with the record-breaking long spell of warm, dry weather during the summer: additional expenditure was needed to ensure continued supply to customers, in particular the cost of water tankering and pumping around the network, increased sludge treatment expenditure resulting from higher concentration of sewage and greater monitoring of rivers because of elevated pollution risk.

General overview and business update (continued)

Net interest payable in the period (excluding fair value movements) was £110 million (2017: £110 million) including an indexation charge on index-linked debt of £41 million (2017: £43 million).

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

£m	**31 December 2018**	**31 December 2017**
Net debt	3,184	3,040
Regulatory capital value	5,664	5,445
'Financial reserves'	**2,480**	**2,405**
Regulatory gearing	56.2%	55.8%

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 2018 and 'financial reserves' (RCV less net debt) have risen to £2.5 billion.

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contribution was £346 million (2017: £306 million).

PR19 business plan submission

On 31 January we received Ofwat's initial assessment of our business plan for 2020-2025, which has been classified as "slow track" along with a majority of other companies in the industry. We will make a further submission to Ofwat in April and expect to receive draft determinations on our plans in July, ahead of a final determination being published in December.

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 to 31 March 2020. These projected ratios are derived from Glas Cymru's 2019 financial plan (which has been prepared by the Group) 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 8 and 9). It should be noted that the Group'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.

General overview and business update (continued)

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[1]	A2	AA	A
B	A2 neg	A neg	A

On 26 June 2018, S&P confirmed the rating of the Company's bonds as A, but with negative outlook. On 13 September 2018, Moody's confirmed the rating as A2, but with negative outlook.

Financing and liquidity

As at 31 December 2018, the Company's undrawn credit facilities and cash totalled £614 million. This includes revolving credit facilities amounting to £170 million.

The European Investment Bank loan facility of £250 million was fully drawn on 17 December 2018.

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%. In March 2017 the Company issued a consultation to customers on distributions during the period to 31 March 2020. This consultation is taken into account when the Board determines distributions. Further details of the consultation are available on the Company's website, www.dwrcymru.com.

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[1] The credit ratings of the Company's class A bonds, which are guaranteed by Assured Guaranty Europe plc ("AG") (A2/AA/NR), carry the higher of either Glas or AG's rating; Moody's and S&P therefore revert to the higher AG rating but Fitch reflects the underlying rating of the Glas bonds.

Consolidated cash flow (unaudited)

	3 months ended 31 December 2018 £m	9 months ended 31 December 2018 £m	9 months ended 31 December 2017 £m
Revenue	194.6	586.3	570.5
Less: operating expenses	(87.9)	(252.5)	(232.5)
Earnings before interest, taxation, depreciation and amortisation	106.7	333.8	338.0
Working capital movements	(4.2)	(1.9)	(20.8)
Non bond-related interest paid	(0.5)	(1.8)	(3.1)
Interest capitalised in accordance with IAS 23	(6.3)	(15.4)	(12.2)
Interest received	1.0	3.4	3.1
Net operating cash flow and interest received	96.7	318.1	305.0
New borrowings			
Authorised loan facility	-	-	60.0
European Investment Bank	250.0	250.0	-
Utilisation of reserves:			
Cash transferred to capex reserve	(384.9)	(691.6)	(101.5)
Cash utilised from capex reserve	134.9	441.6	100.9
Net cash utilised from other reserves	1.8	5.4	18.4
Capital expenditure:			
Net profit on disposal of assets	0.1	0.8	1.2
Infrastructure renewals expenditure	(23.2)	(72.4)	(69.9)
Non-infrastructure maintenance	(56.5)	(171.8)	(171.1)
Capital expenditure	(37.5)	(101.7)	(66.3)
Net cash flow after capital expenditure, new borrowings and reserve drawings	(18.6)	(21.6)	76.7
Transfer to debt service payments account	(35.0)	(107.0)	(91.7)
Principal repayments	(4.8)	(18.3)	(18.0)
Net cash flow after debt service	(58.4)	(146.9)	(33.0)
Free cash balances brought forward	172.1	260.6	58.7
Free cash balances carried forward	113.7	113.7	25.7

Consolidated debt service payments (unaudited)

	Payments due and made in 3 months ended 31 December 2018 £m	Amount accrued 31 December 2018 £m
Liquidity facility:		
Liquidity facility commitment fee	0.1	0.1
Interest on senior debt:		
Finance lease interest	-	51.8
A1 bond interest	-	15.8
A4 bond interest	-	4.0
A5 bond interest	-	1.3
A6 bond interest	-	1.0
B1 bond interest	-	16.9
B3 bond interest	-	2.4
B4 bond interest	-	1.5
B5 bond interest	-	0.3
B6 bond interest	-	1.6
B7 bond interest	-	7.0
European Investment Bank loan interest	1.1	0.5
KfW IPEX-Bank GmbH loan interest	0.3	-
Revolving credit facility commitment fees	0.1	-
MBIA wrapping fees	-	(1.1)
	1.6	103.1
Interest rate swaps	-	-
Total debt service payments	1.6	103.1

Dŵr Cymru notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 October 2018 £m	New Issues £m	Repayment £m	Indexation £m	Closing balance 31 December 2018 £m
Finance leases		435.9	-	-	-	435.9
Class A bonds[2]						
A1 notes	A2/AA/A	350.0	-	-	-	350.0
A4 notes		426.0	-	-	5.4	431.4
A5 notes		136.5	-	-	3.8	140.3
A6 notes[3]		141.6	-	-	1.4	143.0
Class B bonds						
B1 notes	A2neg/Aneg/A	325.0	-	-	-	325.0
B3 notes		206.7	-	-	2.5	209.2
B4 notes		120.5	-	-	3.4	123.9
B5 notes		70.8	-	-	1.0	71.8
B6 notes		336.0	-	-	2.0	338.0
B7 notes		300.0	-	-	-	300.0
European Investment Bank/KfW loans		500.4	250.0	(4.8)	2.4	748.0
Local authority loans		0.4	-	-	-	0.4
		3,349.8	250.0	(4.8)	21.9	3,619.9

[1] Moody's/S&P/Fitch.

[2] Guaranteed by Assured Guaranty Europe plc rated A2/AA/NR. Class A bond ratings default to their higher underlying ratings of A2/AA/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 £43.0m has been recognised in this table.

Dŵr Cymru bank account movements (unaudited)

	Opening balance 1 October 2018 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 December 2018 £m
Free cash balances:					
Receipts account	69.6	-	192.4	(198.3)	63.7
Payments account	102.3	-	573.5	(627.0)	48.8
Other bank accounts	0.2	1.0	509.4	(509.4)	1.2
	172.1	1.0	1,275.3	(1,334.7)	113.7
Debt service payments account:					
Debt service ledger	44.6	-	35.0	(1.6)	78.0
Capex reserve account	-	-	384.9	(134.9)	250.0
Customer payments account:					
Customer rebate ledger	3.7	-	-	(1.8)	1.9
	220.4	1.0	1,695.2	(1,473.0)	443.6

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	Actual Year to 31 March 2017 £m	Actual Year to 31 March 2018 £m	Projection Year to 31 March 2019 £m	Projection Year to 31 March 2020 £m
Income	750	747	758	786	787
Operating expenditure	(277)	(313)	(315)	(331)	(306)
Pre capital maintenance cash flows	**473**	**434**	**443**	**455**	**481**
Base maintenance	(208)	(229)	(257)	(287)	(235)
Post capital maintenance cash flows	**265**	**205**	**186**	**168**	**246**
Net interest paid (excluding indexation and capitalisation)	(113)	(120)	(140)	(143)	(145)
Enhancement expenditure	(48)	(88)	(101)	(106)	(139)
Customer Distributions[1]	(13)	(36)	(63)	(71)	(85)
Pre-financing cash flows	**91**	**(39)**	**(118)**	**(152)**	**(123)**
Interest payable on senior debt:					
Fixed interest swap	10	10	10	9	7
Finance lease RPI swaps	7	13	25	21	13
Finance lease interest	6	3	3	4	9
A1 Bonds	21	21	21	21	21
B1 Bonds	22	22	22	22	22
B7 Bonds	-	-	2	8	8
Index-linked bonds	43	43	42	44	45
Wrapping fees	4	4	5	5	5
Term-loan interest	6	8	13	13	19
Interest receivable	(6)	(4)	(3)	(4)	(4)
Net interest payable	**113**	**120**	**140**	**143**	**145**
Interest cover pre capital maintenance (trigger 2.0, default 1.6)	4.2	3.6	3.2	3.2	3.3
Interest cover post capital maintenance (trigger 1.0)	2.3	1.7	1.3	1.2	1.7

[1] This figure is the total value of revenue foregone in order to fund social tariffs in the year as well as additional discretionary expenditure on behalf of customers, referred to together as “Customer Distributions”.

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

(See important notice at the front of the document)

	Actual			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	456	446	436	424	410
Class A bonds[1]	1,012	1,024	1,046	1,071	1,092
Class B bonds	1,008	1,023	1,351	1,373	1,396
Existing loan facilities	407	462	509	745	723
Net interest accrual on senior debt	55	57	52	53	52
Total senior gross debt	**2,938**	**3,012**	**3,394**	**3,666**	**3,673**
Less: cash and cash equivalents	(92)	(65)	(295)	(323)	(144)
Total net debt	**2,846**	**2,947**	**3,099**	**3,343**	**3,529**
Regulatory capital value (RCV)	4,983	5,217	5,468	5,729	5,968
Customer Reserves (RCV less total net debt)	2,137	2,270	2,369	2,386	2,439
RAR	57.1%	56.5%	56.7%	58.4%	59.1%
Shadow RCV[2]	4,950	5,184	5,485	5,803	6,089
Customer reserves	2,104	2,237	2,386	2,460	2,560
Shadow RAR	57.5%	56.8%	56.5%	57.6%	58.0%

[1] For the purpose of calculating regulatory gearing, cumulative indexation 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%.

[2] For planning purposes, and for considering the level of headroom available for Customer Distributions, we have used a “Shadow RCV”. This is the RCV reported above as published by Ofwat in FD14, uplifted by our inflation assumptions and adjusted for other factors we consider are likely to impact on the RCV during the period.

Income statement (unaudited)

	3 months ended 31 December 2018 £m	9 months ended 31 December 2018 £m	9 months ended 31 December 2017 £m
Revenue	194.6	586.3	570.5
Operating expenditure	(87.9)	(252.5)	(232.5)
EBITDA	**106.7**	**333.8**	**338.0**
Profit on disposal of fixed assets	0.1	0.8	1.2
Infrastructure renewals expenditure	(23.5)	(68.9)	(66.7)
Depreciation	(72.6)	(216.0)	(203.6)
Operating profit	**10.7**	**49.7**	**68.9**
Interest payable	(21.1)	(72.4)	(69.7)
Indexation of index-linked debt	(21.9)	(41.2)	(43.1)
Interest receivable	1.1	3.5	3.2
Fair value (losses)/gains on financial instruments	(29.3)	(21.6)	21.2
Loss before tax	**(60.5)**	**(82.0)**	**(19.5)**
Taxation	-	2.9	(4.4)
Loss after tax	**(60.5)**	**(79.1)**	**(23.9)**

Statement of comprehensive income (unaudited)

	3 months ended 31 December 2018 £m	9 months ended 31 December 2018 £m	9 months ended 31 December 2017 £m
Loss for the period	(60.5)	(79.1)	(23.9)
Actuarial gain in the pension scheme	-	14.6	13.4
Movement on related deferred tax asset	-	(2.9)	(2.6)
Items that will not be reclassified to the profit or loss:			
Revaluation of property, plant and equipment	-	119.2	101.3
Related deferred tax	-	(20.2)	(17.2)
Total comprehensive income	**(60.5)**	**31.6**	**71.0**

Statement of changes in reserves (unaudited)

	3 months ended 31 December 2018 £m	9 months ended 31 December 2018 £m	9 months ended 31 December 2017 £m
Reserves at start of period	1,405.6	1,313.5	1,212.3
Loss for the period	(60.5)	(79.1)	(23.9)
Actuarial gain (net of tax)	-	11.7	10.8
Revaluation (net of tax)	-	99.0	84.1
Reserves at end of period	**1,345.1**	**1,345.1**	**1,283.3**

Balance sheet (unaudited)

	At 31 December 2018		At 31 March 2018	
	£m	£m	£m	£m
Fixed assets		**5,644.0**		**5,442.1**
Current assets and liabilities:				
Debtors and prepayments	312.6		587.0	
Creditors and accruals	(523.2)		(799.4)	
		(210.6)		(212.4)
Total assets less current liabilities		**5,433.4**		**5,229.7**
Financing liabilities:				
Bonds	(2,432.6)		(2,397.7)	
Finance leases	(435.9)		(435.9)	
Bank loans (EIB, KfW)	(748.0)		(509.7)	
Other	(0.4)		(0.6)	
	(3,616.9)		(3,343.9)	
Net interest accrual	(109.7)		(57.3)	
	(3,726.6)		(3,401.2)	
Cash and cash equivalents:				
Receipts account	63.7		76.7	
Payments account	48.8		183.7	
Capex reserve account	250.0		-	
Debt service payments account	78.0		1.2	
Customer payments account	1.9		7.3	
Other bank accounts	1.2		0.2	
	443.6		269.1	
Net debt		**(3,283.0)**		**(3,132.1)**
Derivative financial instruments		(287.9)		(266.3)
Provisions for liabilities and charges		(70.4)		(90.2)
Net assets before deferred tax		**1,792.1**		**1,741.1**
Deferred tax		(447.0)		(427.6)
Net assets		**1,345.1**		**1,313.5**