Dŵr Cymru Welsh Water

Investor Report

For the six months ended 31 March 2021

Important Notice

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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 six-monthly Investor Report covers the six-month period ended 31 March 2021. 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.

Please note that following the receipt of formal creditor approval on 17 March 2021 to a STID proposal issued by the Company on 1 March 2021, the issuance of this Investor Report has changed from being quarterly to six-monthly, covering periods to 31 March and 30 September.

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.

Financial performance (unaudited)

Summary financial results for the year ended 31 March are as follows:

	Year to 31 March 2021 £m	Year to 31 March 2020 £m	Change %
Turnover	776	777	-
Operating costs	(328)	(324)	1%
EBITDA[1]	**448**	**453**	(1%)
Exceptional items	(34)	(10)	
Net interest (excluding indexation)	(97)	(116)	
Capital expenditure (before grants and contributions)	(371)	(481)	

Operating profit before interest, tax, depreciation, amortisation, infrastructure renewals expenditure and exceptional items (EBITDA) for the year to 31 March 2021 was £5 million lower than last year.

Turnover in the year to 31 March 2021 was broadly in line with the prior year: an increase of 1.4% in the average household bill has been offset by reductions in consumption and the decision to suspend standing charges to businesses that were closed during the UK-wide lockdown (note that Ofwat's revenue cap mechanism allows under-recoveries of revenue to be recovered in future years).

[1] Before infrastructure renewals expenditure and exceptional items.

General overview and business update (continued)

Financial performance (unaudited) (continued)

Operating costs (excluding depreciation, amortisation, infrastructure renewals expenditure and exceptional items) of £328 million were £4 million (1%) higher than last year. This represents broadly stable performance reflecting general inflationary cost pressures partially offset by savings from ongoing efficiency initiatives. In addition, many of the new ways of working introduced in response to the pandemic have delivered sustainable cost savings.

Exceptional items totalling £34 million represent additional costs incurred as a direct result of the COVID-19 pandemic: due to their size and nature these have been disclosed separately. The costs include additional bad debt charges (£13 million); personal protective equipment (£8 million), additional National Grid charges (£3 million) and the incremental cost of putting in place increased hygiene measures and deep cleaning (£6 million).

Net interest payable in the period of £97 million (excluding non-cash indexation and fair value movements on interest rate swaps) was £19 million lower than last year (2020: £116 million); the impact of lower RPI inflation on index-linked debt has been partially offset by interest charges on a higher level of borrowings.

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

£m	**31 March 2021**	**31 March 2020**
Regulatory capital value	6,010	5,906
Net debt	3,622	3,528
'Financial reserves'	**2,388**	**2,378**
Regulatory gearing	60.3%	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 is 60% and 'financial reserves' (RCV less net debt) are £2.4 billion as at 31 March 2021. An increase in gearing by 0.6% during the year to 31 March 2021 is mainly the impact of a higher level of debt being only partially offset by RPI inflation on the regulatory capital value.

Capital investment programme

Capital investment (including infrastructure renewals expenditure) before grants and contributions totalled £371 million (2020: £481 million), £110 million lower than last year reflecting the start of the new five-year "AMP7" capital programme (the planning and delivery cycle is such that investment tends to be at its lowest in the first year and to peak in year five).

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 2025. These projected ratios are derived from Glas Cymru's 2021 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 9 and 10). It should be noted that the Group's business plan and the projected ratios have not been reviewed by the Company's auditor and the reader's attention is drawn to the important notice at the front of this document.

Impact of COVID-19 pandemic on projected ratios

The three Investor Reports we have published since the COVID-19 outbreak was confirmed as a pandemic by the World Health Organisation have contained narrative estimates of the impact of the pandemic on our financial forecasts. In this report we have included forecasts (on pages 9 and 10) which incorporate our estimates of the financial impact of COVID-19; as noted above, these have been extracted from Glas Cymru's 2021 financial plan which was approved by the Board in March 2021.

Our COVID-19 impact modelling has been informed by external reports including those by the Office for Budget Responsibility which published updated coronavirus analysis on 3 March 2021. Our plan reflects a continuation of social distancing in early 2021 with gradual lifting of restrictions thereafter. Unemployment is assumed to peak at around 7% in 2021, recovering to pre-pandemic levels by 2025; CPIH fell to a low in late 2020 and recovers to the government's long-term target of 2% in 2024. The impact on turnover in 2020-21 was a £37 million net shortfall in revenues compared to our regulatory allowance (a reduction in non-household demand was partially offset by increases in household revenues) which we forecast recovering in 2022-23 under Ofwat's regulatory revenue mechanism. COVID-19-related pressure on the Group's cost base is expected on the bad debt charge (estimated £4-7 million per annum through to 2022-23) and delays in the delivery of cost efficiencies (circa £7 million in 2021-22). Reduced cash flows will impact on key financial metrics, in particular interest cover ratios. However, forecast gearing and interest covers retain an appropriate level of headroom within the trigger levels specified in borrowing covenants and indicative levels required to maintain the Group's current credit ratings.

Gearing policy

The Board has approved a regulatory gearing policy (being the ratio of net debt to regulatory capital value) of around 60%.

General overview and business update (continued)

Customer rebates

Welsh Water's corporate structure enables surpluses to be applied for the benefit of customers. The Board seeks to return value to customers while maintaining gearing at around 60% and preserving strong credit ratings and financial resilience for the longer-term benefit of customers. Since 2001, Glas Cymru has applied over £440m in total which continues to be invested for the benefit of customers. Given the outcome of the PR19 regulatory price review, combined with the exceptional costs incurred during the pandemic and continued uncertainty, the Company is limited this year in its ability to apply surpluses for the benefit of customers but will continue to support the social tariff programme with a contribution of £11m in the year to 31 March 2022.

Credit ratings

The strong credit quality of the business is reflected in credit ratings which remain amongst the highest in the UK water 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	A3	A-	A
C	Baa2	BBB	BBB+

On 5 March 2021 S&P confirmed the respective ratings of the Group's senior bonds as A- and the junior bonds as BBB). On 26 January 2021 Fitch confirmed the rating of the Group's senior bonds as A and of the junior bonds as BBB+. On 2 March 2021 Moody's confirmed Dŵr Cymru Cyfyngedig's corporate family rating as A3 and the rating of the junior bonds as Baa2. All rating outlooks are stable.

Financing and liquidity

As of 31 March 2021 the Company's undrawn credit facilities and cash totalled £409 million, including debt service reserve account funds (£34 million) and revolving credit facilities (£200 million). All of the Company's revolving credit facilities have been renewed during the year to March 2021, each for two years with a one-year extension option. Three of the four facilities have been increased by £10 million, increasing the total facility size from £170 million to £200 million. As of the date of this report all facilities remain undrawn.

In line with prudent policies approved by the Board, cash is invested in AAA-rated liquidity funds and bonds, National Westminster Bank (as the Group's Account Bank) and additional banks that are subject to minimum short-term rating criteria of A1/P1/F1. The Group also has an undrawn special liquidity facility of £135 million which is available to be drawn in the event of a standstill being declared by the Security Trustee. The facility is provided on a rolling five-year 'evergreen' basis.

On 31 March 2021 the Group repaid £325 million of Class B (series B1) bonds with a fixed coupon of 6.907% which matured on that date. Following Board approval on 4 March 2021 and investor roadshows held in late March, on 31 March 2021 the Group successfully priced £300 million of subordinated (junior, series C4) bonds at a fixed rate of 2.375%. Formal issuance and cash drawdown took place on 9 April 2021.

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[1] The credit ratings of the Company's class A bonds, which are guaranteed by Assured Guaranty (UK) Ltd ("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 credit rating but Fitch reflects the underlying rating of the Glas bonds. Assured Guaranty UK Ltd was established in March 2021 when the Group split the operations of Assured Guaranty Europe S.A. The credit ratings of Assured Guaranty (UK) Ltd were unchanged by the reorganisation.

Consolidated cash flow (unaudited)

	6 months ended 31 March 2021 £m	Year ended 31 March 2021 £m	Year ended 31 March 2020 £m
Revenue	391.3	776.2	777.3
Less: operating expenses	(174.8)	(327.6)	(324.0)
Less: exceptional items	(16.7)	(33.5)	(10.5)
Earnings before interest, taxation, depreciation, and amortisation	199.8	415.1	442.8
Working capital movements	25.8	27.7	12.6
Non-bond-related interest paid	(2.4)	(4.8)	(4.7)
Interest capitalised in accordance with IAS 23	(3.8)	(11.3)	(14.4)
Interest received	2.2	5.1	5.9
Net operating cash flow and interest received	221.6	431.8	442.2
New borrowings:			
Lease liabilities	-	-	1.3
Class B bonds	-	-	300.0
Class C bonds	-	-	200.0
Intercompany loan	-	-	2.8
Utilisation of reserves:			
Cash transferred to capex reserve	(518.8)	(730.8)	(419.0)
Cash utilised from capex reserve	518.8	730.8	549.0
Net cash utilised from other reserves	5.5	12.0	12.0
Capital expenditure:			
Net profit on disposal of assets	-	0.1	0.4
Infrastructure renewals expenditure	(33.5)	(83.0)	(96.1)
Non-infrastructure maintenance	(80.8)	(161.5)	(198.2)
Capital expenditure	(70.4)	(136.5)	(160.7)
Net cash flow after capital expenditure, new borrowings and reserve drawings	42.4	62.9	633.7
Transfer to debt service payments account	(62.5)	(150.0)	(150.0)
Principal repayments	(348.0)	(387.8)	(41.3)
Net cash flow after debt service	(368.1)	(474.9)	442.4
Free cash balances brought forward	528.1	634.9	192.5
Free cash balances carried forward	160.0	160.0	634.9

Consolidated debt service payments (unaudited)	Payments due and made in 6 months ended 31 March 2021 £m	Amount accrued 31 March 2021 £m
Liquidity facility:		
Liquidity facility commitment fee	0.3	0.3
Interest on senior debt:		
Finance lease interest	6.2	47.0
A1 bond interest	21.0	-
A4 bond interest	8.0	-
A5 bond interest	2.6	-
A6 bond interest	4.5	-
B1 bond interest	22.4	-
B3 bond interest	4.8	-
B4 bond interest	2.9	-
B5 bond interest	0.5	-
B6 bond interest	3.3	-
B7 bond interest	7.5	-
B8 bond interest	4.1	-
European Investment Bank loan interest	2.1	0.9
KfW IPEX-Bank GmbH loan interest	0.3	-
Revolving credit facility commitment fees	0.4	-
VAT on lease payments	1.2	-
Miscellaneous fees	0.1	-
	92.2	48.2
Interest rate swaps	13.6	-
RPI bond swaps	(27.4)	-
Creditor payments	0.1	-
Senior interest payments	78.5	48.2
Interest on junior debt:		
C3 bond interest	3.3	-
RPI bond swaps	(4.9)	-
	(1.6)	-
Total debt service payments	76.9	48.2

Dŵr Cymru notes principal balance reconciliation (unaudited)

	Credit rating[1]	Opening balance 1 October 2020 £m	New issues £m	Repayment £m	Indexation £m	Closing balance 31 March 2021 £m
Lease liabilities		411.4	-	(0.2)	-	411.2
Class A bonds[2]						
A1 notes[3]	A2/AA/A	352.1	-	-	3.2	355.3
A4 notes		448.5	-	-	5.6	454.1
A5 notes		143.8	-	-	3.9	147.7
A6 notes[3]		149.1	-	-	1.8	150.9
Class B bonds						
B1 notes	A3/A-/A	325.0	-	(325.0)	-	-
B3 notes		217.6	-	-	2.7	220.3
B4 notes		126.9	-	-	3.5	130.4
B5 notes		74.5	-	-	0.9	75.4
B6 notes		351.0	-	-	0.6	351.6
B7 notes		300.0			-	300.0
B8 notes[3]		301.7	-	-	2.8	304.5
Class C bonds						
C3 notes[3]	Baa2/BBB/BBB+	201.1	-	-	1.9	203.0
Intercompany loan from Dŵr Cymru Holdings Limited		2.8	-	-	-	2.8
European Investment Bank/KfW loans		696.3	-	(22.7)	1.4	675.0
Local authority loans		0.3	-	(0.1)	-	0.2
		4,102.1	-	(348.0)	28.3	3,782.4

[1] Moody's/S&P/Fitch.
[2] Guaranteed by Assured Guaranty UK Ltd rated A2/AA/NR. Class A bond ratings for Fitch therefore default to their higher underlying ratings of A2/AA/A.
[3] The class A1, A6, B8 and C3 notes were issued at a fixed rate and swapped to an effective index-linked rate; cumulative indexation has been recognised in this table.

Dŵr Cymru bank account movements (unaudited)

	Opening balance 1 October 2020 £m	Interest received £m	Deposits £m	Payments £m	Closing balance 31 March 2021 £m
Free cash balances:					
Receipts account	56.4	-	422.6	(406.0)	73.0
Payments account	471.6	-	997.3	(1,382.0)	86.9
Other bank accounts	0.1	2.2	1,189.8	(1,192.0)	0.1
	528.1	2.2	2,609.7	(2,980.0)	160.0
Debt service payments account:					
Debt service ledger	48.2	-	62.5	(76.9)	33.8
Capex reserve account	-	-	518.8	(518.8)	-
Customer payments account:		-			
Customer rebate ledger	5.5	-	15.0	(5.5)	15.0
	581.8	2.2	3,206.0	(3,581.2)	208.8

Interest cover ratio (ICR) – 5 years to 31 March 2025 (unaudited)

(See important notice at the front of the document)	Actual Year to 31 March 2021 £m	Projection Year to 31 March 2022 £m	Year to 31 March 2023 £m	Year to 31 March 2024 £m	Year to 31 March 2025 £m
Income	788	805	843	829	840
Operating expenditure	(359)	(319)	(323)	(310)	(317)
Pre capital maintenance cash flows	**429**	**486**	**520**	**519**	**523**
Base maintenance	(212)	(205)	(205)	(164)	(155)
Post capital maintenance cash flows	**217**	**281**	**315**	**355**	**368**
Net interest paid (excluding indexation and capitalisation)	(108)	(95)	(90)	(92)	(94)
Enhancement expenditure	(122)	(162)	(217)	(188)	(170)
Customer rebates	(31)	(15)	(13)	(10)	(8)
Pre-financing cash flows	**(44)**	**9**	**(5)**	**65**	**96**
Interest payable:					
Fixed interest swap	11	9	9	10	10
Lease liability RPI swaps	8	16	14	14	15
Lease liability interest	5	5	5	5	3
A1 Bonds	8	9	9	9	9
B1 Bonds	22	-	-	-	-
B7 Bonds	8	8	8	8	8
Other index-linked bonds	43	47	46	47	48
RPI-linked senior bond	(3)	(5)	(5)	(5)	(5)
RPI-linked junior bond	(3)	(6)	(6)	(6)	(6)
Wrapping fees	5	5	5	5	6
Term-loan interest	5	10	9	9	9
Other fees	4	1	1	1	1
Interest receivable	(5)	(4)	(5)	(5)	(4)
Net interest payable	**108**	**95**	**90**	**92**	**94**
Senior interest cover pre capital maintenance (trigger 2.0, default 1.6)	3.9x	4.8x	5.4x	5.3x	5.2x
Senior interest cover post capital maintenance (trigger 1.0)	2.0x	2.8x	3.3x	3.6x	3.7x
Total interest cover pre capital maintenance (trigger 2.0, default 1.6)	4.0x	5.1x	5.8x	5.6x	5.6x
Total interest cover post capital maintenance (trigger 1.0)	2.0x	3.0x	3.5x	3.9x	3.9x

Regulatory asset ratio (RAR) – 5 years to 31 March 2025 (unaudited)

(See important notice at the front of the document)	Actual As at 31 March 2021 £m	Projection As at 31 March 2022 £m	As at 31 March 2023 £m	As at 31 March 2024 £m	As at 31 March 2025 £m
Senior gross debt:					
Lease liabilities	411	379	378	173	95
Class A bonds[1]	1,108	1,134	1,167	1,202	1,234
Class B bonds[1]	1,382	1,411	1,436	1,460	1,512
Authorised loans	675	640	604	538	473
Net interest accrual on senior debt	52	44	39	15	6
Total senior gross debt	**3,628**	**3,608**	**3,624**	**3,388**	**3,320**
Less: cash and cash equivalents	**(209)**	**(454)**	**(399)**	**(149)**	**(100)**
Total senior net debt	**3,419**	**3,154**	**3,225**	**3,239**	**3,220**
Junior net debt:					
Class C bonds[1]	203	508	522	537	554
Total net debt	**3,622**	**3,662**	**3,747**	**3,776**	**3,774**
Regulatory capital value (RCV)	**6,010**	**6,186**	**6,349**	**6,497**	**6,629**
Customer Reserves (RCV less total net debt)	**2,388**	**2,524**	**2,602**	**2,721**	**2,855**
Senior gearing	**56.9%**	**51.0%**	**50.8%**	**49.9%**	**48.6%**
Total gearing/RAR	**60.3%**	**59.2%**	**59.0%**	**58.1%**	**56.9%**

[1] For the purpose of calculating regulatory gearing, cumulative indexation relating to the class A1, A6, B8 and C3 notes is included above; these were issued at fixed rates and swapped to effective index-linked rates. Similar assumptions have been made in respect of forecast bond issuances.

Income statement (unaudited)

	6 months ended 31 March 2021 £m	Year ended 31 March 2021 £m	Year ended 31 March 2020 £m
Revenue	391.3	776.2	777.3
Operating expenditure	(174.8)	(327.6)	(324.0)
Exceptional items	(16.7)	(33.5)	(10.5)
EBITDA	**199.8**	**415.1**	**442.8**
Profit on disposal of fixed assets	-	0.1	0.4
Infrastructure renewals expenditure	(27.3)	(74.4)	(96.5)
Depreciation	(165.8)	(333.1)	(315.1)
Operating profit	**6.7**	**7.7**	**31.6**
Interest payable	(38.2)	(102.0)	(122.3)
Indexation of index-linked debt	(28.2)	(37.0)	(49.0)
Interest receivable	2.1	4.8	6.1
Fair value gains/(losses) on financial instruments	80.0	39.4	(18.1)
Profit/(loss) before tax	**22.4**	**(87.1)**	**(151.7)**
Taxation	(5.7)	13.8	2.0
Profit/(loss) after tax	**16.7**	**(73.3)**	**(149.7)**

Statement of comprehensive income (unaudited)

	6 months ended 31 March 2021 £m	Year ended 31 March 2021 £m	Year ended 31 March 2020 £m
Profit/(loss) for the period	16.7	(73.3)	(149.7)
Actuarial profit/(loss) on defined benefit scheme liability	55.3	(1.3)	(0.9)
Movement on related deferred tax asset	(10.5)	0.3	0.2
Items that will not be reclassified to the profit or loss:			
Revaluation of property, plant and equipment (net of tax)	(9.7)	23.2	79.9
Total comprehensive profit/(loss)	**51.8**	**(51.1)**	**(70.5)**

Statement of changes in reserves (unaudited)

	6 months ended 31 March 2021 £m	Year ended 31 March 2021 £m	Year ended 31 March 2020 £m
Reserves at start of period	1,135.2	1,238.1	1,308.6
Profit/(loss) for the period	16.7	(73.3)	(149.7)
Actuarial profit/(loss) on defined benefit pension scheme liability (net of tax)	44.8	(1.0)	(0.7)
Revaluation of property, plant and equipment (net of tax)	(9.7)	23.2	79.9
Reserves at end of period	**1,187.0**	**1,187.0**	**1,238.1**

Balance sheet (unaudited)

	At 31 March 2021		At 31 March 2020	
	£m	£m	£m	£m
Fixed assets		**6,012.4**		**5,940.4**
Current assets and liabilities:				
Debtors and prepayments	586.4		592.0	
Creditors and accruals	(944.1)		(878.7)	
		(357.7)		(286.7)
Total assets less current liabilities		**5,654.7**		**5,653.7**
Financing liabilities:				
Bonds	(2,693.2)		(2,984.3)	
Lease liabilities	(411.2)		(424.1)	
Bank loans (EIB, KfW)	(675.0)		(721.6)	
Other	(3.0)		(3.1)	
	(3,782.4)		(4,133.1)	
Net interest accrual	(52.4)		(53.1)	
	(3,834.8)		(4,186.2)	
Cash and cash equivalents:				
Receipts account	73.0		62.9	
Payments account	86.9		582.6	
Capex reserve account	-		-	
Debt service payments account	33.8		10.4	
Customer payments account	15.0		11.0	
Other bank accounts	0.1		(10.6)	
	208.8		656.3	
Net debt		**(3,626.0)**		**(3,529.9)**
Derivative financial instruments		(262.5)		(301.8)
Provisions for liabilities and charges		(106.2)		(102.5)
Net assets before deferred tax		**1,660.0**		**1,719.5**
Deferred tax		(473.0)		(481.4)
Net assets		**1,187.0**		**1,238.1**

To: Deutsche Trustee Company Limited

4 June 2021

Dear Sirs

Common Terms Agreement dated 10 May 2001 between Dŵr Cymru Cyfyngedig, ("DCC") and the Deutsche Trustee Company Limited (the "DCC Security Trustee" and the "Issuer Security Trustee") ("the Common Terms Agreement")

Capitalised terms not defined in this certificate have the meaning given to them in the Common Terms Agreement.

We refer to the Common Terms Agreement and pursuant to Paragraph 1.5 of Schedule 3 of that Agreement hereby confirm that as of today's date, DCC is in compliance with the RAR, the Historical RAR, the Historical Senior RAR, the Projected RAR, the Projected Senior RAR and the Historical ICR, the Historical Senior ICR and the Projected Senior ICR (together the "**Ratios**").

The calculations of the ratios are set out on pages 9 to 10 of the Investor Report issued on today's date.

We also confirm that in the period to 31 March 2021:

(a) no DCC Potential Event of Default, DCC Event of Default, Potential Trigger event or Trigger Event has occurred; and

(b) DCC's insurances are being maintained in accordance with:

- (i) Paragraph 4.2.1 of Schedule 3 of the Common Terms Agreement; and
- (ii) the provisions of each DCC Finance Lease

Yours faithfully

for and on behalf of Dŵr Cymru Cyfyngedig

P D Perry
Director

P M Davis
Director