FitchRatings

Corporates

Water/Wastewater Utility
United Kingdom
Full Rating Report

Dwr Cymru (Financing) Ltd

Ratings

Foreign Currency

Class A bonds senior secured[a]	A
Class B bonds senior secured	A
Class C bonds senior secured[b]	BBB+

[a] Subject to MBIA bond policy; the rating of MBIA was withdrawn by Fitch on 26 June 2008. Therefore, the (wrapped) class A bonds are rated at the same level as the (unwrapped) class B bonds at 'A'.
[b] There are no class C bonds outstanding. The rating for class C debt of the bond programme is maintained at 'BBB+' to indicate at what level Fitch would expect to rate prospective issuance, if any.

Outlooks

Class A bonds senior secured	Stable
Class B bonds senior secured	Stable
Class C bonds senior secured	Stable

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Related Research

Applicable Criteria

- *Corporate Rating Methodology (August 2010)*

Other Research

- *Ofwat's Final Determination - Broadly Ratings Neutral (May 2010)*
- *2011 Outlook: UK Water Sector (January 2011)*

Rating Rationale

Not-for-Profit Organisation: Dwr Cymru Cyfyngedig (Dwr Cymru) is the sixth-largest of the UK regulated monopoly providers for water and wastewater services by regulated asset value (RAV). It is a not-for-profit organisation, which makes it unique amongst UK utility companies as there is no shareholder pressure to pay dividends, and consequently it can reinvest all its financial surpluses into the business for the benefit of customers. Dwr Cymru (Financing) Ltd (Dwr Financing) is Dwr Cymru's debt-raising vehicle.

Ratings Drivers: Important drivers for the ratings are the UK water sector's supportive and transparent regulatory framework and the secured nature of the group's financing structure, which benefits from structural enhancements, including trigger mechanisms and debt service reserve liquidity. In addition, the management has set target gearing at around 70% net debt/RAV.

Middle-Ranking Performer: Fitch Ratings perceives Dwr Cymru as a middle-ranking company in terms of operating and capital expenditure performance. The final determination provides for some challenges, in particular in terms of operating expenditure. As a result, the management decided to take day-to-day operations of water and wastewater plant, which was previously operated by contractors, back in-house and to restructure the organisation. The company has made good progress with regard to the regulator's efficiency challenge, although some cost pressures relating to operating expenditure are likely to materialise towards the end of the Asset Management Plan 5 (AMP5, period extending from April 2010 to March 2015).

Financial Metrics in Line: Fitch forecasts pension-adjusted net debt/RAV between 65% and 70% for the combined class A and class B debt for the period to March 2015. Post-maintenance and post-tax interest cover ratio (PMICR) is expected to range between 1.5x-1.6x. While gearing provides for increasing headroom in comparison to Fitch's ratio guidelines, PMICR forecasts are at adequate levels. Class C debt has been repaid in full and, therefore, no forecast metrics are provided.

What Could Trigger a Rating Action

Regulatory Performance and Gearing: No rating movements are foreseen at this stage. For positive rating action a sustainable reduction in target gearing below 60% together with a visible improvement in regulatory performance would be required. Similarly, for negative rating action a marked deterioration in operating and regulatory performance or adverse changes to the regulatory framework would have to occur.

Liquidity and Debt Structure

As of December 2010, the company had GBP204m in cash and cash equivalents available, as well as GBP100m of undrawn committed revolving credit facilities. These mature in September 2011 and June 2012, but are expected to be renewed in the near term. In addition, the European Investment Bank recently committed GBP100m of long-term financing. This funding position will provide sufficient liquidity for capital expenditure and operating requirements for the remainder of the price control period. In accordance with transaction documentation, the group also maintains a GBP135m reserve liquidity facility, which would be available in circumstances of financial distress.

Key Contents

Glossary of Water Sector Terms

AMP4	Asset Management Plan 4 covering April 2005 to March 2010
AMP5	Asset Management Plan 5 covering April 2010 to March 2015
COPI	Construction Output Price Index used for RAV
DWI	Drinking Water Inspectorate
IDOK	Interim Determination of "K"
OPA	Overall Performance Assessment
RPI	Retail Price Index used for "K" and index-linked debt
RAV	Regulatory Asset Value
SIM	Service Incentive Scheme
STW	Sewage treatment works
WASC	Water and sewage company
WTW	Water treatment works

Overview of Business and Operational Profile

Operations

Dwr Cymru is the sixth largest of the UK regulated monopoly providers for water and wastewater services in terms of RAV. The company's service area is the third largest amongst the water and sewage companies (WASCs), comprising Wales and some adjoining areas of England.

Figure 1

Service Area

Source: Dwr Cymru

The company supplies around 816 million litres (Ml) of water each day, of which approximately 650Ml are treated and made available to 1.2m households and over 100,000 business customers in the service area, using a network of 645 service reservoirs, 73 water treatment works and over 27,000km of water mains. The remainder, approximately one quarter of the total water abstracted by Dwr Cymru, is transferred untreated to Severn Trent Water Limited under a bulk supply agreement.

Dwr Cymru also collects and treats the water that customers have used, returning it to the environment through rivers and coastal outlets. For such purposes a sewer network of 16,000km, 1,861 pumping stations and 3,200 combined sewer overflows are operated and maintained.

Figure 2
Dwr Cymru's Key Business Statistics

Water supply		Wastewater	
Population served (m)	2.9	Population served (m)	3.1
Properties served (m)	1.3	Properties served (m)	1.3
Volume domestic h'holds (%)	92	Of which domestic (m)	1.2
Of which metered (%)	31	Of which commercial (m)	0.1
Volume Commercial (%)	8		
Of which metered (%)	90	Size of supply area (km2)	21,874
Number of customers >50Ml pa	116	Length of sewers (km)	16,130
Number of customers >5Ml pa	1,194	No. of STWs	833
Size of supply area (km^2)	21,300	Sludge disposal	
Length of mains (km)	27,219	Volume discharged agricultural (%)	88
No. of WTWs	73	Volume discharged at landfill (%)	8
No. of main reservoirs	65	Volume discharged at incineration (%)	n.a
Reservoir capacity (Ml)	461,950	Volume discharged at other (%)	4
Average daily supply (Ml/d)	647		
From groundwater (%)	3	No. of wastewater pumping stations	1,861
From rivers (%)	25	Vol. wastewater treated daily (Ml/d)	558
From reservoirs (%)	71		

Source: Dwr Cymru; based on FY10 data

Residential customers accounted for around GBP498.2m or 72.4% of revenue in the financial year ending in March 2010 (FY10). The balance of turnover (GBP190.0m or 27.6%) is represented by commercial clients and non-appointed income, of which GBP17.1m/2.5% relate to the 19 customers with turnover of above GBP500,000. Overall, the company has a well-diversified customer profile.

Management Strategy

Dwr Cymru's board is committed to deliver excellent service to customers and minimise bills in the long term. This primary objective is monitored using key performance indicators related to water quality, environmental aspects, customer service, health and safety as well as financial and regulatory measures.

In this context, the board decided that a target gearing around 70% will enable the company to efficiently fund the investment programme for AMP5.

Ownership

Glas Cymru Cyfyngedig (Glas Cymru) is the ultimate parent of Dwr Cymru. As a company limited by guarantee, Glas Cymru has no share capital and therefore no shareholders. Individuals are appointed as members of Glas Cymru who will carry out the normal corporate governance duties of shareholders, but they do not receive dividends, or have any other financial interest in the company. Members will, inter alia, attend the annual general meeting and speak and vote on matters at these meetings. They also vote on the appointment, or reappointment of Glas Cymru's directors and auditors.

Hence, the key role of the members of Glas Cymru is to ensure that the business remains focused on its primary purpose of providing high quality water and sewage services to the communities served by Dwr Cymru.

All surpluses generated are retained within the business, which provides the group with substantial financial flexibility (in comparison to peers). The board of directors may decide from time to time to charge customers less than regulator-allowed tariff increases (also called "customer dividends"). This was the case during the price control period extending from April 2005 to March 2010 (Asset Management

Plan 4, AMP4). Following an assessment of the regulatory settlement for AMP5 the board of directors decided to abandon customer dividends for the time being and invest surpluses rather into projects that facilitate a more economic and sustainable operation of services for the long term. Dwr Cymru is operated solely for the benefit of its customers.

Business Model

From 2001-2010 Dwr Cymru had outsourced most of day-to-day operations to contractors, ie, United Utilities Operating Services (UUoS) mainly for water operations, Kelda Water Services (Kelda Water) mainly for sewage operations, and Veolia Water for income and billing services. Dwr Cymru itself had only around 180 employees to attend to strategic functions, including the administration of outsourcing and capital delivery contracts.

After publication of the final determination of tariffs for the period to March 2015 Dwr Cymru considered the updated tender offers from its outsourcing partners and compared them with the target costs implied in the final determination. The company was not able to reach agreement with UUoS and Kelda Water in relation to an extension of the contracts. As a result, 1,093 employees transferred back from UUoS to Dwr Cymru on 1 April 2010 and subsequently 476 from Kelda Water on 1 May 2010, bringing most of the day-to-day operations back in-house. A major restructuring of the organisation is underway, including a phased reduction in the headcount by 350 employees, in order to implement efficiencies prescribed by Ofwat (the regulator for the UK water sector).

Under its licence, Dwr Cymru is required to have at its disposal sufficient financial and managerial resources to carry on the regulated activities at all times (including any investment programme necessary to fulfil its obligations under the instrument of appointment). Therefore, the outsourcing contracts had been structured in a way that Dwr Cymru would be able to take operations back in-house at a later stage, including staff and support plant. This facilitated a smooth transition without disruptions to its services to the public.

The company retained Veolia Water as income and billing partner following the retender process.

Across the UK water sector most of capital expenditure is outsourced to contractors, which equally applies to Dwr Cymru.

Regulatory Performance

Drinking water quality was reported to be in compliance with applicable standards in 99.96% of samples in the first nine calendar months of 2010, compared with 99.95% during the same period of 2009 (data relates to mean zonal compliance).

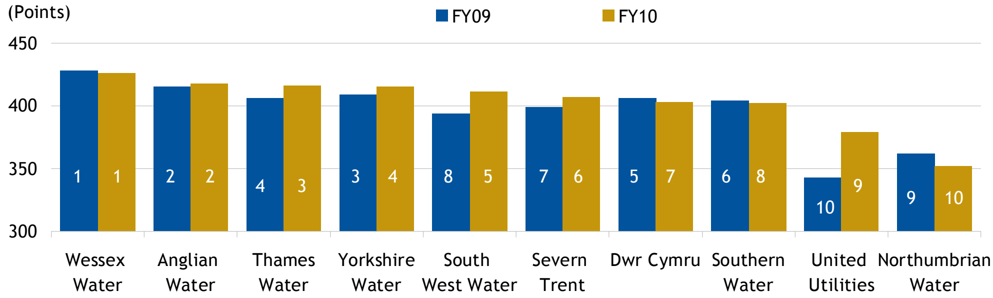
Dwr Cymru is confident that performance against indicators employed by the Drinking Water Inspectorate (DWI) will improve as a capital programme of approximately GBP200m is delivered during AMP5 to upgrade water treatment works (WTWs). Schemes at Cwellyn and Rhiwgoch have already been completed during FY10 ahead of schedule. Until the whole programme is completed, the risk associated with a gradual deterioration in the quality of raw water is being mitigated at a number of WTWs by additional ultraviolet treatment installed as a precautionary measure to protect against the threat to public health posed by cryptosporidium.

In addition, Dwr Cymru completed in 2010 the 10-year Section 19 programme that had been agreed with the DWI to improve the water quality throughout the supply network, in particular iron and manganese compliance (the presence of these components are among the most frequent causes of discoloured water at customers' taps). This encompassed the refurbishment of iron water mains.

In terms of the overall performance assessment (OPA), which is a blended indicator benchmarking water companies with regard to key services provided to consumers and environmental impact, Dwr Cymru was ranked number seven in FY10. The main area where the OPA indicated weaknesses in FY10 was the impact on customers from sewer flooding, which causes concern to a number of companies in the sector. While the underlying score for the OPA has increased from 394 in FY08 to 403 in FY10, the relative ranking dropped from rank five in FY09 to rank seven. This shows that peers in the sector achieved more progress towards regulatory targets over the period.

Figure 3

Overall Performance Assessment/Rankings



Source: Regulatory reporting

After using the OPA for 10 years, Ofwat established that performance as measured by this tool has reached acceptable levels across the sector. Therefore, the regulator decided to seek new measures that capture how well companies adapt to meet consumers' expectations. The target is to focus on customer service, ie, get things right the first time and resolve complaints quickly and effectively. Applicable measures have been introduced for FY12. They will be aggregated through a scoring system and provide for reputational and financial incentives under the service incentive mechanism (SIM). To anticipate these changes Dwr Cymru has been working closely with its income and billing services provider, Veolia Water, to monitor performance against the measures that form part of the SIM and adapt processes, where required.

Surveys so far indicate good performance in terms of the qualitative component of the SIM, ie, how satisfied consumers are with the quality of service when talking to a telephone agent or receiving a written response. In turn, performance related to the quantitative measures needs to improve. In the past Dwr Cymru communicated to customers that they should contact the call centre in case of queries or to register a change of address. A proportion of those calls is categorised as "all lines busy and calls abandoned" or "unwanted telephone contacts", which under the SIM are viewed as a failure to meet customers' expectations. Dwr Cymru will, therefore, in the future offer an increasing number of web-based solutions/procedures, eg, to notify a change of address, in order to avoid unnecessary contacts.

The company's service area overall receives higher rainfall than most parts of the UK, 1,436mm compared to a UK average figure of 1,126mm. However, looking at averages hides geographical disparities. Across Anglesey, the borders of Wales and Herefordshire, rainfall is largely in line with the UK average, while Snowdonia and Brecon record extremes of rainfall. The resulting supply of water resources does not match local demand. High population densities can predominantly be found in the south or northeast of Wales, and are often reliant on river regulation schemes. Additionally, low rainfall across coastal areas coincides with large increases in population in tourist areas during the peak summer months.

As a result, Dwr Cymru reports marginal deficits in two of its water resource zones under dry-year annual average conditions and in one zone under critical peak conditions. This is reflected in Ofwat's security-of-supply index in which the company has been maintaining a Band B ranking (marginal deficits) for a number of years, even though improvements of the supply/demand balance have been accomplished over time. Dwr Cymru reduced leakage over AMP4 in line with the regulator's targets from 224Ml/d to 195Ml/d, increased capacity of a WTW in the North Eryri Ynys Mon zone and upsized a trunk main to allow for greater capacity of water transfers to Vowchurch, all efforts to better match supply and demand across the region.

Ofwat expects Dwr Cymru to improve the security-of-supply ranking to Band A (no deficit in any zone) by FY14. Schemes that are included in its capital programme target water efficiency (eg, an increase of metering across the region), additional transfer capacity between water resources zones and continued reduction of leakage.

Available water resources across Dwr Cymru's operating area are forecast to remain broadly stable. However, implementation of the EU Habitat's Directive through the Environment Agency Wales will reduce the amount of water that can be abstracted from rivers. The impact of applicable restrictions is not anticipated until 2016 and will require significant investment in the next price control period to maintain adequate security of supply.

Figure 4

Dwr Cymru's Asset Serviceability

	FY06	FY07	FY08	FY09	FY10
Water infrastructure	Improving	Improving	Improving	Stable	Stable
Water non-infrastructure	Stable	Stable	Stable	Marginal	Marginal
Sewage infrastructure	Stable	Marginal	Stable	Stable	Stable
Sewage non-infrastructure	Stable	Stable	Stable	Stable	Stable
Ofwat comments	Worse than industry average sewage infrastructure collapses and blockages.	Better than industry average WTW samples with coliforms.	Worse than industry average WTW samples with coliforms.	Worse than industry average WTW samples with coliforms.	Worse than industry average sewage infrastructure collapses and blockages.
		Worse than industry average sewage infrastructure collapses and blockages.	Worse than industry average sewage infrastructure collapses and blockages.	Worse than industry average sewage infrastructure collapses and blockages.	Worse than industry average STW compliance.

Source: Ofwat

The company reported stable asset serviceability in FY10 for all asset categories apart from water non-infrastructure. Asset serviceability is measured by the trend in the number of actual incidents on the company's networks, such as regulatory compliance failures at WTWs and sewage treatment works (STWs) for above-ground assets, and burst water mains and sewer collapses for underground assets. Ofwat targets setting price limits at a level that allows for sufficient maintenance, so that services can be provided to consumers for the long term. Shortcomings in this area can prove to be sticky and will provide for financial penalties at the next price review. Therefore, additional focus is required here, given the marginal asset serviceability of water non-infrastructure, worse than industry average STW compliance, as well as sewage infrastructure collapses and blockages.

Review of FY05-FY10 Profile

For each five-year period (quinquennium), Ofwat determines allowances for operating expenditure, depreciation, return on capital, tax and capital expenditure for each water company. The resulting revenue requirement is broken down through a charging scheme into metered and unmetered tariffs for residential and business customers on an annual basis.

Revenue

Dwr Cymru's appointed turnover rose by 4.8% to GBP681.8m in FY10 (FY09: GBP650.4m), which is broadly in line with the allowed price increase in percentage terms for that year of 5.2% (representing the real allowed price increase of 2.2%, also called "K factor", plus retail price index (RPI) of 3%). Turnover was GBP28m lower (FY09: GBP27m lower) than Ofwat allowances. This is due to a voluntary abatement of part of the allowed tariff increases determined by Ofwat, representing the so-called customer dividend that was implemented by Dwr Cymru for AMP4.

Operating Expenditure

Figure 5 highlights that Dwr Cymru's performance in comparison to regulatory targets started at a high in FY06 and weakened throughout the five-year period. It should be noted that the performance in terms of "Underspent/(overspent) stripping out power" is quoted somewhat too favourably. Under the previously existing outsourcing agreements for water and wastewater operations, part of the price risk for power procurement had been transferred to one of the contractors. Therefore, to strip out the total overspent on power is not accurate, while it would be difficult to determine the proportion that was effectively paid for by Dwr Cymru.

Figure 5

Dwr Cymru's AMP4 Operating Costs

Outturn prices (GBPm)	FY06	FY07	FY08	FY09	FY10	Average
June return data						
Final determination PR04	224.7	230.3	238.3	244.3	242.8	236.1
Dwr Cymru	205.5	220.0	227.3	260.6	289.1	240.5
Underspent/(overspent)	19.2	10.3	11.0	-16.2	-46.3	-4.4
Pension deficit repair allowance	0	0	0	0	0	0
Exceptionals					-29.5	
Adjusted comparison						
Final determination PR04	224.7	230.3	238.3	244.3	242.8	236.1
Dwr Cymru	205.5	220.0	227.3	260.6	259.6	234.6
Underspent/(overspent)	19.2	10.3	11.0	-16.2	-16.8	1.5
Overspent on power	-4.3	-10.9	-5.1	-16.6	-8.9	-9.2
Underspent/(overspent) stripping out power	**23.5**	**21.2**	**16.1**	**0.4**	**-7.9**	**10.7**

Source: Dwr Cymru

The following expenditure items contributed to the reported operating cost movements.

Power Costs

Total power costs increased significantly over the five-year period, from GBP26.4m in FY06 to GBP41.3m in FY09, falling to GBP33.6m in FY10. This was a trend generally observed in the sector. During AMP4 the market experienced unprecedented volatility in energy prices, a circumstance for which water companies were not quite prepared. Most of them were hedging supplies for up to two years, because liquidity and market pricing further out appeared to be unattractive or not available as derivative markets were not sufficiently established.

When prices then soared in 2007 they had to contract supplies at unfavourable rates for unhedged positions towards the end of AMP4.

As a result, companies have explored options to reduce their exposure to power prices for AMP5. Strategies look at both volume and price. Dwr Cymru entered into ISDA framework agreements for energy derivatives and supply contracts for physical delivery to make use of the full range of hedging instruments. In May 2011 the company had hedged/contracted around 68% of its external baseload power requirements for the five-year period, ie, all capacity for FY11 and a declining proportion of demand for subsequent years, at average prices that range below Ofwat allowances forming part of price limits.

Furthermore, Dwr Cymru is implementing energy efficiency measures, investing in renewable energy and energy-efficient equipment, eg, the introduction of advanced sludge digestion at three sites plus working towards this at one extra site in order to replace energy-intensive sludge drying plants and other large-scale sludge treatment processes. This will deliver significant operating efficiencies and reduce the carbon footprint at the same time. Overall, it is reasonable to assume that power costs will be a noteworthy source of outperformance for Dwr Cymru over the period to March 2015.

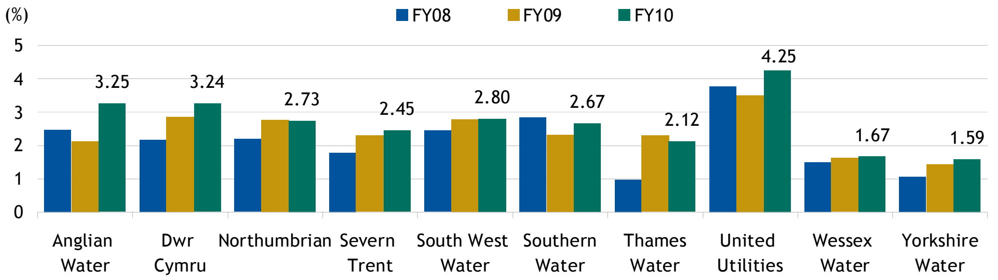
Doubtful Debt

Doubtful debt has nearly tripled over the five-year period in absolute terms (FY06: GBP7.6m; FY08: GBP13.4m; FY10: GBP22.3m). Regulatory reporting shows that the age profile of Dwr Cymru's outstanding revenue continues to rise, while the economic environment remains challenging, and water companies have no sanction to disconnect supplies to non-paying domestic customers.

Figure 6

Doubtful Debt in Proportion to Revenues

The impact of the recession



Source: Regulatory reporting

The numbers in Figure 6 are influenced by accounting policies. For example, some companies have ceased to recognise turnover to customers who have a history of non-payment extending two years. Therefore, the doubtful debt charge of Dwr Cymru at 3.24% for FY10 is not necessarily comparable with the 1.67% reported by Wessex Water Services Limited (Wessex Water, IDR of 'BBB+'/Stable, senior unsecured debt instrument rating of 'A-') for the same year.

It is more meaningful to look at the year-on-year movements. These are largely driven by the economic environment, the socio-demographic characteristics of the population in a service area and the level of sophistication in terms of companies' debt collection procedures.

Dwr Cymru continues to work closely with its billing and income contract partner, Veolia Water, to track and manage the doubtful debt position. Endeavours centre on using the existing debt collection software, Tallyman, to build up sufficient history with regard to customer behaviour to become more sophisticated in deploying the most efficient means of collection for a particular customer. In some cases Dwr Cymru has contracts in place with local authorities and social landlords, so that they collect the bills on the company's behalf. These bodies need to collect the rent, so that it represents little additional effort to administer the water bill. As of 31 March 2011 this applied to around 67,000 households, representing clientele that is more likely to be at risk of non- or late-payment.

As a preventative measure Dwr Cymru has introduced discounted tariffs for customers who struggle to pay their bills. The tariff "Welsh Water Assist" caps the bills of household customers on low incomes and with particular needs at GBP228. The company estimates that around 17,000 households are eligible for this tariff. Another assistance tariff "Water Direct" grants a GBP25 rebate to customers that agree to pay their water bill through a direct deduction from benefits. In addition, there is a "Customer Assistance Fund" of GBP5m, run with the help of the Citizens Advice Bureau, which helps customers that have fallen into arrears with their bills.

Ofwat did put in place a notified item for doubtful debt for AMP5, meaning there is the potential to apply for additional revenue entitlement under a reopener mechanism if the debt collection environment does not improve and applicable materiality thresholds are reached. However, to achieve a change in price limits the company must demonstrate that the deterioration in debt performance is due to economic circumstances rather than poor debt collection processes. Fitch takes the view that it may prove difficult for companies to build a case to recover the additional costs through tariffs.

Business Rates

Business rates charged by local authorities soared from GBP18.9m in FY06 to GBP26.7m in FY10. This expenditure is mostly not controllable by companies. Ofwat recognised this circumstance and provided for a corresponding increase in allowances.

As the regulator for water does not employ any direct pass-through mechanism, the allowance determined on a forecast basis is bound to deviate from the actual expenditure. However, the risk of overspending on business rates is perceived to be limited.

Exceptional Items

When the outsourcing agreements with UUoS and Kelda Water were terminated, a provision of GBP28.4m was booked and GBP1.1m of expenditure was incurred, relating to restructuring of the organisation, a large part of which accounts for the cost of a phased reduction in headcount.

New Operating Expenditure Initiatives

Dwr Cymru identified a number of measures that will drive efficiencies over AMP5 in order to meet Ofwat's efficiency challenge.

Some details relating to these initiatives can be given as follows.

- While the day-to-day operations of Dwr Cymru were executed by UUoS and Kelda Water (2001-2010), the outsourcing contractors received a profit margin and incentive income relating to key performance indicators for which target thresholds had been agreed. Following termination of these contracts associated margins are retained within the business.
- As part of the capital expenditure programme, Dwr Cymru will invest in energy-efficient plant and equipment that will allow a reduction of volumes of externally purchased power. With regard to the price component of energy purchases, it should be noted that the company incurred rather high power costs in FY09, the year which was used by Ofwat for benchmarking purposes. It received an allowance reflecting equivalent implicit pricing as part of the tariff

settlement for 2010-15, subject to ongoing and catch-up efficiencies. As a result, substantial savings were realised for FY11 supplies. For subsequent years only a proportion of power has been procured to date. Hence, the company's performance against the specified target can only be established as power exposure is closed out over time.

- From FY12 Dwr Cymru will incur additional costs of about GBP3m a year from the Carbon Reduction Commitment Energy Efficiency Scheme, which is a new obligation imposed by the government that was not reflected in the tariff settlement.
- Following the decision to bring day-to-day operations back in-house, Dwr Cymru examined options for the prospective organisational set-up. In the process, the company identified around 350 jobs that will be cut over AMP5 (to be achieved through a combination of retirement, natural turnover and selective voluntary severance). These are fairly substantial changes. On the one hand, bringing operations back in-house eliminated the need for doubling certain managerial functions, where the contractor and Dwr Cymru both needed to have oversight to administer the contractual arrangements and monitor regulatory performance. On the other hand, new/more flexible working practices are implemented and plant and equipment are upgraded over time, so that remote monitoring frees up human resources.
- In the normal course of business key supply contracts were renegotiated at the beginning of the price control. In addition, the progressive upgrade and replacement of legacy IT systems and equipment is a key enabler for ongoing efficiencies. Such IT investment is spread over a number of years and started in FY07 (with GBP90m of schemes completed during AMP4).

Figure 7

Operating Cost Efficiencies to be Achieved by March 2015

Identified potential savings	Target savings (GBPm)	Status
Profit margin and key performance indicator incentives.	8	Accomplished following termination of the outsourcing agreements with UUoS and Kelda Water.
Power savings (including advanced sludge digestion).	14	Only a proportion of power requirements has been procured to date; progressive purchase of remaining AMP5 requirements will take place over time; careful monitoring of market movements is required.
Carbon reduction commitment levy on power.	-3	New obligation put in place by the government.
Manpower efficiencies.	12	Phased reduction of 350 employees over AMP5.
Procurement and other cost efficiencies.	6	Largely accomplished.
Total	**37**	

Target savings are quoted in 2007/08 prices
Source: Dwr Cymru

Capital Expenditure

Figure 8 indicates that Dwr Cymru has spent more on capital expenditure over AMP4 than allowed in the final determination. However, actual efficiencies implemented during AMP4 can be quantified in the range of GBP25m-50m or 2%-3% of the executed programme, in view of the following circumstances.

The company delivered outputs representing GBP83m of AMP5 schemes already in FY10. Those relate to the upgrading of water treatment works and advanced sludge digestion schemes.

Ofwat logged down the company's RAV by GBP60m, which to a large extent relates to delivering less kilometres of mains refurbishment under the Section 19 programme at higher unit costs than included in the final determination. The regulator also attributed an uplift of GBP45m to compensate for the difference between the construction output price index (COPI) and RPI over the five-year period.

Figure 8

Dwr Cymru's AMP4 Capital Expenditure

Outturn prices (GBPm)	FY06	FY07	FY08	FY09	FY10	Average
Final determination PR04	322.1	318.8	303.1	266.1	216.4	285.3
Dwr Cymru	232.0	262.1	297.5	339.6	332.0	292.6
Underspent/(overspent)	90.1	56.7	5.5	-73.5	-115.6	-7.3

Source: Dwr Cymru

New Capital Expenditure Initiatives

In anticipation of the efficiency challenge of AMP5, the management team of Dwr Cymru has pursued the following measures:

- revaluation of supply chain processes;
- focus on design and delivery in terms of new plant; and
- focus on unit costs in terms of the maintenance programme.

Financing Costs

Figure 9 indicates that Dwr Cymru achieved a significantly lower cash cost of interest for FY10 than peers. The company has in place some index-linked swaps that pay out inflation annually (as opposed to accretion of inflation with pay-down at maturity). With RPI having reverted to more than 5%, the cash cost of its debt is therefore likely to rise in FY11.

Figure 9

WASCs' Debt Profile

(%)	FY10 accrued interest expense	FY10 cash interest expense	FY10 % of index-linked net debt	FY10 (pension-adjusted) net debt/RAV
Dwr Cymru[a]				
Class A + B	3.61	3.98	39 (+27)	68.2
Class A + B + C	3.82	4.18	37 (+26)	71.6
Anglian Water				
Class A	5.31	4.85	70.3	70.6
Class A + B	5.43	5.02	61.6	80.5
Southern Water				
Class A	5.14	4.57	68.1	74.4
Class A + B	5.41	4.89	60.9	83.1
Yorkshire Water				
Class A	5.34	4.61	74.1	64.7
Class A + B	n.a.	n.a.	n.a.	n.a.

[a] Dwr Cymru has 37% of debt that accrues the RPI indexation. The above percentage in brackets denotes additional index-linked exposure where indexation is paid out annually rather than accrued. In addition, Dwr Cymru's class A + B debt is equivalent to the other transactions' class A debt only, and its class C debt is equivalent to the other transactions' class B debt
Source: Company reporting

Dwr Cymru's Final Determination for 2010-2015

For operating expenditure the company was attributed with 2.9% annual catch-up efficiencies for water services and 2.2% for wastewater services. The combined position of around 2.6% for operating expenditure implies the least efficient position in the industry. However, power costs had a significant influence on the benchmarking data and these costs are effectively reset for the new price control period. In addition, the management has implemented a range of measures and made good progress towards meeting the efficiency challenge for operating expenditure, although some cost pressures are likely to materialise towards the end of the regulatory period.

For capital expenditure Dwr Cymru received a capital incentive scheme (CIS) score of 105% for water services and 106% for wastewater services, which reflects the company's track record in capital delivery (the lower the score, the more competitive the business plan of a company in comparison with its peers). This result matches the capital expenditure catch-up efficiency assessment, which indicates that limited additional improvements are required in comparison to the average WASC. Where practical, these targets have been built into agreements with contractors.

The company was awarded GBP2m of positive OPA and revenue adjustments. This included a reward of around GBP5m for capital expenditure outperformance as well as GBP3m for good performance under the OPA during AMP4, offset by penalties of GBP5m under the CIS and GBP2m for shortfalling. Most companies received penalties under the CIS regime. Aggregate performance income of GBP2m places Dwr Cymru as a middle-ranking company.

Fitch perceives Dwr Cymru overall as a middle-ranking company in terms of operational and regulatory performance. The final determination clearly provides some challenges. However, the in-sourcing of day-to-day operations and restructuring of the organisation not only provides for risks but also opportunities, eg, cost pressures imposed by the regulator will allow the management to get buy-in from staff and unions to implement new working practices and the management may reconsider the choice of key performance indicators and underlying drivers.

Figure 10

Rating Issues Register

Issue	Fitch view	Likelihood, timescale, rating impact	More information
Efficiency targets for AMP5			
For operating expenditure Dwr Cymru was attributed with 2.9% annual catch-up efficiencies for water services and 2.2% for wastewater services. The combined position of around 2.6% for operating expenditure implies the least efficient position in the industry.	The company has implemented a range of measures and made good progress in meeting the efficiency challenge for operating expenditure, although some cost pressures are likely to materialise towards the end of the regulatory period.	Likelihood: Fitch expects Dwr Cymru to achieve a large proportion of the operating expenditure targets set by Ofwat. Timescale: In particular relevant for FY14 and FY15. Rating impact: None at present.	New Operating Expenditure Initiatives

Source: Fitch

Fitch Assumptions for the Illustrative Projections

The financial forecast included below reflects the Fitch base case, which in many respects is based on regulatory assumptions and conservative estimates. Since publication of the final determination in November 2009 there has been some reporting on outturn figures, including RPI or development of doubtful debt. Financing assumptions were used that reflect the funding structure of Dwr Cymru.

The following considerations were important to derive the financial forecasts.

Restructuring Costs

In FY10 Dwr Cymru provided for restructuring costs of GBP28.4m, which reflect expenses for the termination of outsourcing contracts with UUoS and Kelda Water as well as subsequent initiatives to establish a new organisational structure that targets implementing Ofwat's prescribed efficiencies. The cash flow impact of these measures is reflected in the forecast as and when respective expenditure is expected to occur.

Adoption of Private Sewers

The adoption of private sewers will go ahead during AMP5. The financial forecast includes a reasonable level of expenditure in terms of operating costs and capital investment for FY12 to FY15. The company will gather information on the state of the infrastructure as well as resulting maintenance and investment requirements and apply for a reopener, also called interim determination of K (IDOK). The cash flow projections assume that tariff increases will reflect the outcome of the IDOK in FY15. This circumstance is clearly visible in terms of post-maintenance and post-tax interest cover (PMICR). During FY12 to FY14 PMICR ranges at fairly low levels as the additional expenditure reduces post-maintenance cash flow, the numerator of the ratio. In FY15 this position is rectified with additional revenues granted to recover the costs.

Power

Dwr Cymru has procured around 68% of its power requirements for the period to March 2015. Considering the pricing achieved on those purchases and using the forward curve for power to estimate costs for remaining capacity that needs to be contracted, Fitch has attributed sizeable outperformance in comparison to regulatory assumptions.

Carbon Reduction Commitment Energy Efficiency Scheme

From FY12 the company will incur additional costs of about GBP3m a year from the Carbon Reduction Commitment Energy Efficiency Scheme. Those were not reflected in tariffs and will not be passed on to consumers.

Pension Deficit

The combined pension schemes of the group, including obligations to employees that were transferred to Dwr Cymru from UUoS and Kelda Water following termination of the outsourcing agreements, are relatively well funded in comparison to other companies in the sector. The next actuarial valuation for the overall position will take place for the balance sheet date 31 March 2011.

Fitch has assumed pension deficit repair payments ranging GBP4m-5m above Ofwat allowances from FY13, when the revised schedule that will be agreed with trustees becomes effective. This is in line with Fitch's view that Ofwat allowances compensating for 50% of the established pension deficit will require companies to contribute some funding from shareholder resources. Considering information provided by the management, deficit repair payments in the range of GBP6m-7m per annum may turn out to be too high.

Doubtful Debt

Fitch reduced EBITDA by 0.5% of turnover for FY11 and FY12 and 0.25% for FY13 and FY14 to reflect the impact of economic conditions. This represents Fitch's standard sensitivity for companies in the sector.

Conclusions of Illustrative Projections

Given that all class C debt has been repaid in full, forecast financial ratios for the two classes of debt (class A + B debt representing the senior tranche and class C debt representing the junior tranche) are identical. The rating for class C debt of the bond programme is maintained at 'BBB+' to indicate at what level Fitch would expect to rate prospective class C debt issuance, if any.

Financial metrics demonstrate that gearing in terms of pension-adjusted net debt/RAV will provide for increasing headroom in comparison to ratio guidelines of up to 73% for the existing senior secured rating of 'A'. In turn, interest cover in terms of PMICR is commensurate with this rating level, considering ratio guidance of 1.5-1.6x and the necessity to look at five-year average ratios (in this case 1.53x) to reflect the impact and recovery of expenditure related to the adoption of private sewers.

It should, furthermore, be noted that Dwr Cymru is expected to start generating positive free cash flow towards the end of AMP5. This is unique in the industry and is a reflection of the financial flexibility created by the management through deleveraging the financial structure over time.

Figure 11

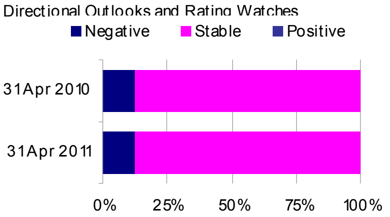
Illustrative Projections

	Actual AMP4					Forecast AMP5				
Outturn prices (GBPm rounded)	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**
RPI for indexation of RAV (%)	2.36	4.82	3.77	-0.38	4.45	4.00	2.50	2.50	2.50	2.50
Summary cash flow statement										
EBITDA	**339.2**	**350.5**	**388.9**	**390.4**	**422.5**	**410.6**	**415.5**	**421.4**	**429.5**	**462.1**
Tax	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consolidated cash interest	-132.6	-67.2	-196.9	-119.8	-112.8	-139.8	-138.3	-137.3	-137.4	-137.8
Pension deficit repair and other non-cash P&L items	0.0	-2.2	-10.1	0.6	-1.7	-1.7	-1.8	-6.4	-6.5	-6.7
Funds flow from operations	**205.5**	**281.1**	**181.9**	**271.2**	**308.0**	**269.1**	**275.4**	**277.7**	**285.5**	**317.6**
Working capital	-31.3	-18.1	-16.7	31.5	-12.0	-29.0	-25.0	-9.0	-3.0	-3.0
Cash flow from operations	**174.2**	**263.0**	**165.2**	**302.7**	**296.0**	**240.1**	**250.4**	**268.7**	**282.5**	**314.6**
Capex	-214.3	-250.5	-270.7	-357.3	-347.3	-244.3	-275.1	-331.5	-285.9	-261.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	**-40.1**	**12.5**	**-105.5**	**-54.6**	**-51.3**	**-4.2**	**-24.7**	**-62.8**	**-3.4**	**53.6**
Receipts from asset disposals	0.8	0.0	0.8	-0.8	-0.4	0.0	0.0	0.0	0.0	0.0
Restructuring costs	0.0	0.0	0.0	0.0	0.0	-12.9	-10.0	-3.0	-2.0	0.0
Cash required	**-39.3**	**12.5**	**-104.7**	**-55.4**	**-51.7**	**-17.1**	**-34.7**	**-65.8**	**-5.4**	**53.6**
Gearing calculations										
Closing net debt class A + B	-2,229.9	-2,303.8	-2,400.0	-2,496.5	-2,542.2	-2,719.6	-2,796.0	-2,891.2	-2,924.4	-2,899.3
Closing net debt class A + B + C	-2,354.9	-2,428.8	-2,525.0	-2,621.5	-2,667.2	-2,719.6	-2,796.0	-2,891.2	-2,924.4	-2,899.3
50% of reported pension deficit	-4.6	-3.8	0.0	-7.8	-7.8	-7.8	-7.8	-7.8	-7.8	-7.8
Pension adjusted net debt class A + B	-2,234.5	-2,307.6	-2,400.0	-2,504.3	-2,550.0	-2,727.4	-2,803.8	-2,899.0	-2,932.2	-2,907.1
Pension adjusted net debt class A + B + C	-2,359.5	-2,432.6	-2,525.0	-2,629.3	-2,675.0	-2,727.4	-2,803.8	-2,899.0	-2,932.2	-2,907.1
Closing RAV	**3,042.0**	**3,310.0**	**3,529.0**	**3,574.0**	**3,738.2**	**3,921.0**	**4,075.6**	**4,240.0**	**4,387.3**	**4,507.7**
Pension adjusted net debt class A + B/RAV (%)	**73.5**	**69.7**	**68.0**	**70.1**	**68.2**	**69.6**	**68.8**	**68.4**	**66.8**	**64.5**
Pension adjusted net debt class A+ B + C/RAV (%)	**77.6**	**73.5**	**71.6**	**73.6**	**71.6**	**69.6**	**68.8**	**68.4**	**66.8**	**64.5**
Interest cover calculations										
EBITDA	339.2	350.5	388.9	390.4	422.5	410.6	415.5	421.4	429.5	462.1
Regulatory depreciation	-152.0	-156.0	-169.0	-186.0	-189.1	-202.4	-209.6	-214.9	-220.3	-225.8
Tax	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension adjustment	0.0	0.0	0.0	0.0	0.0	-1.7	-1.8	-6.4	-6.5	-6.7
Post maintenance cash flow	**186.1**	**194.5**	**219.9**	**204.4**	**233.4**	**206.5**	**204.1**	**200.1**	**202.7**	**229.6**
Class A + B consolidated cash interest	-113.7	-115.4	-115.0	-112.1	-101.6	-132.1	-138.3	-137.3	-137.4	-137.8
Class A + B + C consolidated cash interest	-126.8	-125.6	-125.2	-122.4	-111.9	-139.8	-138.3	-137.3	-137.4	-137.8
Class A + B PMICR	**1.64**	**1.69**	**1.91**	**1.82**	**2.30**	**1.56**	**1.48**	**1.46**	**1.48**	**1.67**
Class A + B + C PMICR	**1.47**	**1.55**	**1.76**	**1.67**	**2.09**	**1.48**	**1.48**	**1.46**	**1.48**	**1.67**

Dwr Cymru's class A + B debt is equivalent to the other transactions' class A debt only, and its class C debt is equivalent to the other transactions' class B debt
Definitions of financial ratios used in the transaction documents differ from credit metrics applied by Fitch
Source: Fitch

Dwr Cymru: Class A + B —— Utilities Median —— Developed BBB+ Median —— Source: Company data; Fitch.

Distribution of Sector Outlooks
UK Water and Wastewater
Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

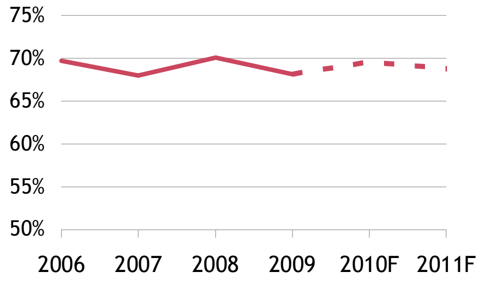
- newly raised debt to be priced at 6.10% for class B debt; at present there is no intention to raise new class A or class C debt; and
- deposit balances to be remunerated at 1.5%.

2010F refers to March 2011.

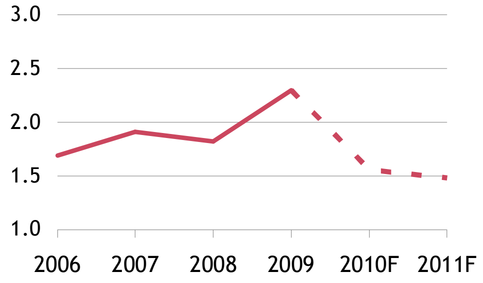
Definitions

- Leverage: debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus interest paid plus preferred dividends plus rental expense.
- Interest cover: FFO plus interest paid plus preferred dividends divided by interest paid plus preferred dividends.
- FCF/revenue: FCF after dividends divided by revenue.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report, see Fitch's "Interpreting the New EMEA and Asia-Pacific Credit Update Format", dated 25 November 2009 and available at www.fitchratings.com.

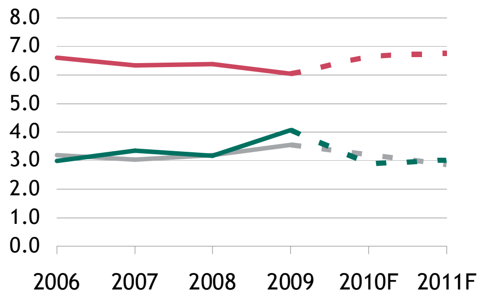
Pension Adjusted Net Debt/Regulatory Capital Value
including Fitch expectations



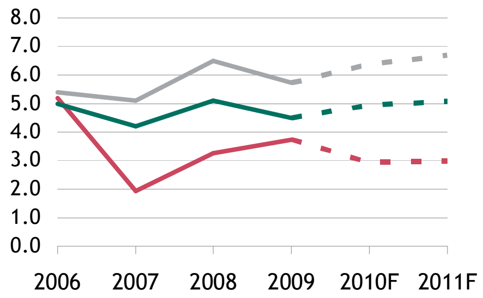
Post-Maintenance and Post-tax Interest Cover
including Fitch expectations



Leverage
including Fitch expectations



Interest Cover
including Fitch expectations

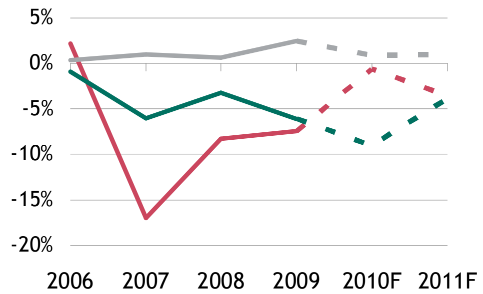


Debt Maturities and Liquidity at 31 March 2010

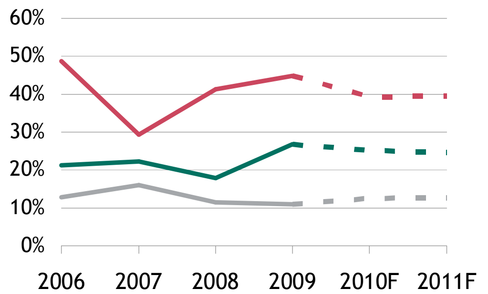
Debt maturities	(GBPm)
2011	200)
2012	25
2013	31
2014	36
After 2014	2,620
Cash and equivalents	248
Undrawn Committed Facilities (maturing September 2011 or beyond)	200

Source: Dwr Cymru

FCF/Revenues
including Fitch expectations



FFO Profitability
including Fitch expectations



Capex/CFO
including Fitch expectations

Peer Group

Issuer	Country
Class A bonds: 'A'/Stable Outlook[a]	
Anglian Water Services Financing Plc[b]	UK
Yorkshire Water Services Bradford Finance Limited[c]	UK
Dwr Cymru (Financing) Ltd[d]	UK
Class B bonds: 'A'/Stable Outlook[a]	
Dwr Cymru (Financing) Ltd[d]	UK
Class B bonds: 'BBB+'/Stable Outlook[a]	
Anglian Water Services Financing Plc[b]	UK
Yorkshire Water Services Bradford Finance Limited[c]	UK
Class C bonds: 'BBB+'/Stable Outlook[a]	
Dwr Cymru (Financing) Ltd[d]	UK

[a] Senior secured bond ratings
[b] Financing vehicle for Anglian Water Services Limited
[b] Financing vehicle for Yorkshire Water Services Limited
[d] Financing vehicle for Dwr Cymru Cyfyngedig

Senior Secured Rating History

Dwr Cymru (Financing) Ltd

Date	Senior secured Class A + B	Senior secured Class C	Outlook
23 Mar 2010	'A'	'BBB+'	Stable
30 Oct 2009	'A'	'BBB+'	Stable
17 Mar 2009	'A'	'BBB+'	Stable
16 Feb 2006	'A'	'BBB+'	Stable
27 May 2005	'A-'	'BBB'	Stable
13 Jan 2003	'A-'	'BBB'	Stable
30 Mar 2001	'A-'	'BBB'	Stable

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends Dwr Cymru Cyfyngedig

Rating factor	Status[a]	Trend
Operations	Average	Neutral
Market position[b]		
Finances	Average	Neutral
Governance	Average	Neutral
Geography[b]		

[a] Relative to peer group
[b] Not applicable due to regional monopoly status
Source: Fitch

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Many companies are experiencing either deteriorating raw-water quality in some catchments, or restrictions on abstraction volumes to comply with environmental standards. Climate change is also expected to lead to more severe weather patterns, including more frequent occurrences of heavy rainfall and extended dry periods. To safeguard security of supply, the industry is working towards a sustainable way of running operations. It is therefore investigating mitigation and adaptation options that could fundamentally change processes in the medium to long term.

Financial Risks

Costs relating to the adoption of private sewers, the impact of economic conditions on sales to large industrial customers, doubtful debt or pension contributions, and the efficiency challenge embedded in the regulatory settlement from 26 November 2009 pose challenges to the industry.

Peer Group Analysis

	AWS		YWS		Dwr Cymru[a]	
Bond ratings	Class A: 'A'	Class B: 'BBB+'	Class A: 'A'	Class B: 'BBB+'	Class A + B: 'A'	Class C: 'BBB+'
Outlook	Stable		Stable		Stable	
Credit metrics						
Forecast pension adjusted net debt/RAV (%)	73-74	82-83	73-74	83-84	65-70	65-70
Forecast PMICR (x)	1.5-1.6	1.3-1.4	1.5-1.8	1.3-1.5	1.5-1.6	1.5-1.6
Financial flexibility	Adequate		Adequate		Adequate	
Efficiency challenge for 2010-2015						
Operating expenditure catch-up efficiencies (% per annum)	0.6		0.1		2.6	
Pro forma CIS ratios (%)[b]	102		96		105	

[a] Dwr Cymru's class A + B debt is equivalent to the other transactions' class A debt only, and its class C debt is equivalent to the other transactions' class B debt
[b] The lower this ratio, the more competitive the company's business plan for capital expenditure
Source: Fitch, companies

Key Credit Characteristics

Water and sewage companies in the UK operate as regional monopoly service providers in a supportive regulatory framework. Ofwat's final pricing determination of tariffs for 2010-2015 builds on an established methodology that provides for good cash flow visibility. Companies are likely to continue to outperform the cost of debt assumed within price limits, and Fitch expects allowances for electricity costs to provide some opportunities for outperformance, counterbalancing challenges highlighted as financial risks above.

Overview of Companies

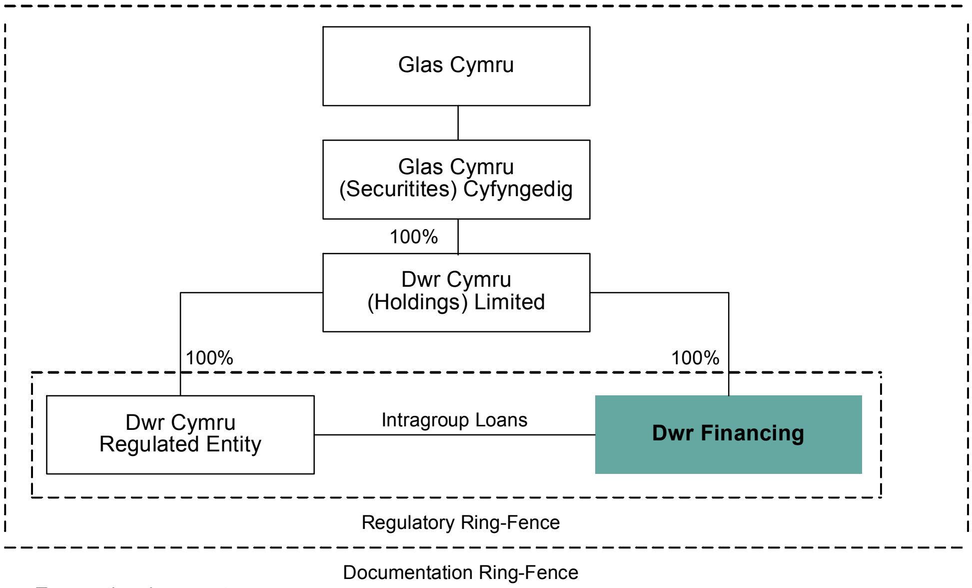
- **Anglian Water Services Limited** (AWS) is performing well in terms of operating and capital maintenance efficiencies and has an excellent track record in regulatory reporting.
- **Yorkshire Water Services Limited** (YWS) has been one of the most efficient operators in the UK water sector. Historically, it achieved very good results in the regulator's benchmarking studies, but in FY10 the company missed leakage targets and reported marginal asset serviceability for water infrastructure.
- **Dwr Cymru Cyfyngedig** is a middle-ranking company in the industry. The final determination provides for some challenges, which mostly centre on operating expenditure. The management has already made efficiency gains through the retendering of a number of supply contracts, it will cut 350 jobs over AMP5 and it in-sourced day-to-day operations (reducing contractor margins).

Group Structure Diagram

The group is owned by Glas Cymru, a company limited by guarantee which was formed with the sole purpose of owning, financing and managing Dwr Cymru. The group has no shareholders.

Figure 12

Group Structure



Source: Transaction documents

Financing Structure

Funding is mainly raised through Dwr Financing, a company specifically incorporated to act as a bond issuance vehicle. Respective financing is passed on to Dwr Cymru through intragroup loans.

Dwr Financing, an entity which on a standalone basis has no creditworthiness, assigned the benefit of the intragroup loans to the security trustee in order to give the bondholders and other creditors of Dwr Financing recourse to Dwr Cymru. Dwr Financing also has in place committed liquidity reserve facilities (GBP135m as of 31 March 2011), so that it could carry on with debt service of the group for at least 12 months even if the operating company had insufficient funds.

Creditors to Dwr Cymru and Dwr Financing signed up to a common terms agreement, which ensures that all of them benefit from the same covenants, security and voting mechanisms, subject to tranching into senior class A and class B notes, and junior class C notes and coordinated/supervised through a trustee. In case of a default of the regulated entity under the financing arrangements, a standstill period of 18 months would apply, which is expected to allow parties to find a solution to difficulties faced by the business before a special administrator may be appointed; intervention of regulators should always be a last resort.

During a standstill Dwr Financing would draw upon the liquidity reserve facilities to procure funds for ongoing interest payments for all secured creditors of the group.

Glas Cymru, Glas Cymru (Securities) Cyfyngedig and Dwr Cymru (Holdings) Limited guarantee Dwr Cymru's financial obligations (including the intragroup loans that have been assigned for the benefit of Dwr Financing's creditors). Additionally, Dwr Cymru (Holdings) Limited has pledged the shares in the regulated entity for the benefit of the secured creditors. Because most assets of Dwr Cymru cannot be given as collateral/represent protected land, the shares in the operating company are the best piece of collateral available in this transaction. The share pledge can be enforced at the instruction of the secured creditors, even during a standstill.

In a situation where the secured creditors decided at any point to instruct the trustee to pursue enforcement action, a detailed waterfall would apply for distribution of recovered funds, reflecting inter alia subordination of debt tranching into senior class A and class B, and junior class C obligations.

Important Covenants of the Financing Structure

Figure 13 includes two stages of intervention that reflect early warning signals and increasing concerns over reported performance.

Figure 13
Financial Covenants

	Net debt/RAV (%)		PMICR (x)		Net cash flow/cash interest (x)	
Tranche	Trigger event	Event of default	Trigger event	Event of default	Trigger event	Event of default
Class A + B			< 1.0			
Class A + B + C	> 90	> 95			< 2.0	< 1.6

Definitions of financial ratios used in the transaction documents differ from credit metrics applied by Fitch
Source: Transaction documentation

Trigger Events

There are numerous circumstances in addition to those in Figure 13 that are included in the definition of a trigger event, a non-exhaustive but representative list of which is provided under Additional Trigger Events below.

Consequences of a trigger event include an automatic dividend lock-up (which also would prohibit prospective customer dividends), additional information rights and remedial action, the possibility of commissioning an independent review of operational problems through technical advisors, consultation with Ofwat and the right to appoint additional non-executive directors if the relevant trigger event has not been remedied within an agreed timetable. Such action can be sought by the secured creditors through their voting rights and would be pursued by the trustee guided by instructions received from the secured creditors.

Events of Default

Furthermore, there are additional circumstances to those in Figure 13 that are included in the definition of events of default, a non-exhaustive but representative list of which is provided under Additional Events of Default below.

The occurrence of an event of default starts an 18-month standstill period, which automatically brings in place a trigger event, including applicable remedies. Additionally, a third-party cash manager administers from this point payments of the company in accordance with the waterfall included in the transaction documentation. During the standstill period the trustee may only enforce security over the shares in Dwr Cymru, if so instructed by the secured creditors.

To enforce acceleration of outstanding obligations, the secured creditors would have to vote to end the standstill period first. However, this appears to be a very unlikely prospect, as a special administrator would be appointed by the regulator or the secretary of state. The main focus then is to secure continuance of services to consumers. At that point secured creditors would lose the intervention rights/additional control that they have under the combined trigger and standstill regime.

Additional Trigger Events

- The (shadow) credit rating of class A or class B bonds by any two rating agencies falls to 'BBB' or below, or for class C bonds below investment grade.
- Failure by Dwr Cymru to pay the monthly instalment into the debt service payment account within 30 days following the date when such payment was scheduled to be made.
- Estimated capital expenditure over a quinquennium exceeds Ofwat's price control assumptions by 10% or more.
- Operating cash flow available to fund capital expenditure, authorised credit facilities designated to fund capital expenditure, and all amounts standing to the credit of the reserve accounts, do not cover the next 12 months' forecast net capital expenditure on the date which is one month before the applicable calculation date.
- Dwr Financing draws down its liquidity reserve facility.
- An enforcement order which can reasonably be expected to lead to a loss of Dwr Cymru's licence or a material fine being levied against Dwr Cymru.
- Circumstances leading to a special administration order.
- Termination of Dwr Cymru's licence.
- Occurrence of a Dwr Cymru event of default.
- Failure to comply with remedial action agreed with the security trustee.

Additional Events of Default

- Non-payment, insolvency or insolvency-proceedings.
- Group change of control.
- Effectiveness of transaction documents (including security) ceases.
- Dwr Cymru has failed to comply with its obligations as required under the outsourcing policy.
- Change of the nature of the business.
- Following notice of the termination of its licence, Dwr Cymru fails to put in place an approved transfer scheme by a date less than two years prior to the expiration of such notice.
- The (shadow) credit rating of class A or class B bonds by any two rating agencies falls below investment grade.

Key Debt Instruments

Figure 14

Dwr Cymru (Financing) Limited

Amount, coupon rate	Maturity	ISIN	Ranking	Rating
GBP350m, 6.015%, fixed rate, MBIA bond policy	31 March 2028	XS0128311023	Class A	'A' stable outlook
GBP265m, 3.514%, index-linked, MBIA bond policy	31 March 2030	XS0128311700	Class A	'A' stable outlook
GBP85m, 3.512%, index-linked, MBIA bond policy	31 March 2031	XS0129065362	Class A	'A' stable outlook
GBP100m, 4.473%, fixed rate, MBIA bond policy	31 March 2057	XS0275787728	Class A	'A' stable outlook
GBP325m, 6.907%, fixed rate	31 March 2021	XS0128311965	Class B	'A' stable outlook
GBP128.6m, 4.377%, index-linked	31 March 2026	XS0128313318	Class B	'A' stable outlook
GBP75m, 4.375%, index-linked	31 March 2027	XS0129065446	Class B	'A' stable outlook
GBP140m, 1.859%, index-linked	31 March 2048	XS0497839570	Class B	'A' stable outlook
GBP50m, 1.375%, index-linked	31 March 2057	XS0276278891	Class B	'A' stable outlook

All of these instruments are secured debt obligations
The information above is intended as summary information only. It is not intended to and cannot be a substitute for detailed analysis of the bond documents and consultation with legal counsel
Source: Fitch

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	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original	31 Mar 2007 GBPm Original	31 Mar 2006 GBPm Original
Summary Balance Sheet					
ASSETS					
Cash and Marketable Securities	248	138	124	157	14
Accounts Receivable/Trade Debtors	40	37	42	32	27
Inventory	0	0	0	0	0
Other Current Assets	99	83	83	62	59
Property, Plant & Equipment	3,412	3,235	3,070	2,950	2,840
Intangible Assets	0	0	0	0	0
Other Non-current Assets	371	371	372	371	371
TOTAL ASSETS	**4,169**	**3,864**	**3,691**	**3,572**	**3,312**
LIABILITIES					
Short-term Debt (inc. CPLTD)	144	13	13	9	128
Accounts Payable/Trade Creditors	21	27	16	12	27
Provisions	276	245	254	316	331
Other Short-term Liabilities	118	112	125	151	94
Other Long-term Liabilities	64	63	59	55	51
Long-term Secured Debt	2,724	2,705	2,594	2,495	2,229
Long-term Unsecured Debt	0	0	0	0	0
TOTAL LIABILITIES	**3,347**	**3,164**	**3,060**	**3,039**	**2,859**
EQUITY					
Minority Interest/Minorities	0	0	0	0	0
Equity Capital & Reserves	822	700	631	533	452
TOTAL LIABILITIES & EQUITY	**4,169**	**3,864**	**3,691**	**3,572**	**3,312**
Adjusted Gross Debt	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
Debt Schedule					
DEBT PRIORITY					
Lease Liabilities	884	892	843	767	740
Secured	1,985	1,826	1,764	1,738	1,617
Unsecured	0	0	0	0	0
Convertible	0	0	0	0	0
Subordinated	0	0	0	0	0
Total Debt	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
Off-Balance Sheet Debt	0	0	0	0	0
Total Adjusted Debt	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
Non-recourse + Equity Hybrid Component	0	0	0	0	0
Total Adjusted Debt with Equity Credit	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
Adjusted Liabilities~~	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
DEBT SOURCE					
Bank	37	3	3	3	4
Capital Markets	1,947	1,823	1,761	1,735	1,613
Other	884	892	843	767	740
TOTAL DEBT	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
DEBT MATURITY					
Less than 1 Year	144	13	13	10	128
1 To 2 Years	26	144	12	5	0
2 To 5 Years	147	93	172	60	27
More than 5 Years	2,551	2,469	2,410	2,431	2,201
TOTAL DEBT	**2,868**	**2,718**	**2,606**	**2,505**	**2,357**
Unrestricted Cash & Deposits	248	138	124	157	14
CURRENT DEBT NET OF CASH	**(103)**	**(125)**	**(111)**	**(148)**	**114**
TOTAL DEBT NET OF CASH	**2,621**	**2,580**	**2,483**	**2,347**	**2,343**
TOTAL ADJUSTED DEBT NET OF CASH	**2,621**	**2,580**	**2,483**	**2,347**	**2,343**
Adjusted Liabilities Net of Cash	**2,621**	**2,580**	**2,483**	**2,347**	**2,343**
Restricted Cash & Deposits	0	0	0	0	0

~ includes Restricted Cash
~~ Total Adjusted Debt with Equity Credit plus Debt-like Pref. Stock

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Summary Income Statement

	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original	31 Mar 2007 GBPm Original	31 Mar 2006 GBPm Original
SUMMARY INCOME STATEMENT					
Revenue*	688	657	623	578	554
Cost of Goods Sold	266	267	234	228	214
GROSS PROFIT	**423**	**390**	**389**	**351**	**339**
Selling, Distribution & Administrative Expenses	0	0	0	0	0
Other Operating Expenditure**	0	0	0	0	0
Presentational only: L-T Rentals (incl. in SG&A above)	0	0	0	0	0
Operating EBITDAR	**423**	**390**	**389**	**351**	**339**
Depreciation & Amortisation	164	161	160	131	125
Non-recurring, non-operational and non-recourse income***	(30)	(1)	1	0	1
Associate Income/Loss	0	0	0	0	0
Other Income/Expense	0	0	0	0	0
EBIT	**228**	**228**	**230**	**219**	**215**
Interest Income	3	9	12	7	10
Interest Expense	107	174	171	157	157
Non-interest Financial Income/Charges	(1)	(1)	(29)	(2)	(3)
PBT	**124**	**62**	**42**	**68**	**65**
Taxation	1	(15)	(55)	(13)	0
Minorities	0	0	0	0	0
NET INCOME	**123**	**77**	**97**	**81**	**64**
Extraordinary Items/Accounting Changes	(2)	(8)	1	(1)	1
NET INCOME AFTER EXTRAORDINARY ITEMS (before dividends)	122	69	98	81	65

Summary Cash Flow

	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original	31 Mar 2007 GBPm Original	31 Mar 2006 GBPm Original
SUMMARY CASH FLOW					
Operating EBITDAR	**423**	**390**	**389**	**351**	**339**
Cash Interest Paid, Net of Interest Income	113	120	197	67	133
Cash Tax Paid	0	0	0	0	1
Associate Dividends	0	0	0	0	0
Other Changes before Funds From Operations****	(2)	18	(10)	(2)	0
FUNDS FROM OPERATIONS	**308**	**289**	**182**	**281**	**206**
Working Capital	(12)	14	(17)	(18)	(31)
CASH FLOW FROM OPERATIONS	**296**	**302**	**165**	**263**	**174**
Non-Operational Cash Flow***	0	0	0	0	0
Capital Expenditure	347	357	271	251	214
Dividends Paid	0	0	0	0	0
FREE CASH FLOW	**(51)**	**(54)**	**(106)**	**13**	**(40)**
Receipts from Asset Disposals	(0)	(1)	1	0	1
Business Acquisitions	0	0	0	0	0
Business Divestments	0	0	0	0	0
Exceptional & Other Cash Flow Items	0	0	0	0	0
NET CASH IN/OUTFLOW	**(52)**	**(55)**	**(105)**	**13**	**(39)**
Equity Issuance/(Buyback)	0	0	0	0	0
FX movement	0	0	0	0	0
Other Items Affecting Cash Flow****	11	(42)	(31)	(17)	(25)
NET CASH FLOW AVAILABLE FOR FINANCING	**(41)**	**(97)**	**(135)**	**(5)**	**(65)**
OPENING TOTAL DEBT NET OF CASH	**2,580**	**2,483**	**2,347**	**2,343**	**2,278**
Net Debt Increase/(Decrease)	41	97	135	5	65
CLOSING TOTAL DEBT NET OF CASH	**2,621**	**2,580**	**2,483**	**2,347**	**2,343**

* Net of Sales, Royalty & Other Operational Taxes
** Excludes Depreciation & Amortisation
*** Analyst Estimate
**** Balancing Item

Dwr Cymru Cyfyngedig

Ratio Analysis

	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original	31 Mar 2007 GBPm Original	31 Mar 2006 GBPm Original
EARNINGS/PROFITABILITY					
Revenue Growth (%)	4.72	5.51	7.77	4.43	n.a.
Gross Profit/Revenues (%)	61.39	59.40	62.43	60.64	61.28
Op. EBITDAR/Revenues (%)	61.39	59.40	62.43	60.64	61.28
EBIT/Revenues (%)	33.16	34.72	36.84	37.92	38.77
Pre-Tax Profit/Revenues (%)	18.05	9.46	6.76	11.76	11.65
Profit after tax/Revenues (%)	17.93	11.69	15.59	14.08	11.64
Effective Tax Rate (%)	0.64	0.00	0.00	0.00	0.16
Profit after tax/Average Equity (%)	16.32	9.34	7.23	13.80	14.26
Return on Average Assets (%)	5.73	6.64	7.38	6.93	6.67
FFO Return on Adjusted Capital (%)	11.24	13.53	10.89	14.42	12.89
Free Cash Flow Margin (%)	(7.45)	(8.28)	(16.94)	2.16	(7.24)
COVERAGES					
FFO/Gross Interest Expense and Preferred Dividends (x)	3.89	2.66	2.07	2.79	2.31
FFO Fixed Charge Cover (x)	3.89	2.66	2.07	2.79	2.31
(Op. EBITDAR-Capex)/Gross Fixed Charges(x)	0.70	0.19	0.69	0.64	0.80
Op. EBITDAR/Net Fixed Charges (x)	4.09	2.36	2.45	2.34	2.31
FFO/Interest Expense Net of Interest Income (x)	3.98	2.74	2.15	2.88	2.40
Free Cash Flow Debt Service Coverage (x)	0.22	0.64	0.36	1.02	0.41
Net Fixed Charges Cover (x)	2.44	1.35	1.20	1.40	1.41
LEVERAGE					
Total Adjusted Debt/Op. EBITDAR (x)	6.79	6.96	6.70	7.15	6.95
Total Adjusted Debt Net of Cash/Op. EBITDAR(x)	6.20	6.61	6.38	6.70	6.91
Adjusted Liabilities Net of Cash/Op. EBITDAR (x)	6.20	6.61	6.38	6.70	6.91
Adjusted Net Leverage/FFO (x)	6.37	5.68	7.29	5.45	6.65
Adjusted Leverage/FFO (x)	6.92	5.88	7.39	5.72	6.51
Free Cash Flow/ Adjusted Liabilities (%)	(1.79)	(2.00)	(4.05)	0.50	(1.70)
CFO/Total Debt Net of Cash (%)	11.30	11.72	6.65	11.20	7.44
CFO/Adjusted Liabilities Net of Cash (%)	11.30	11.72	6.65	11.20	7.44
Total Adjusted Debt/Total Adjusted Capitalisation (%)	77.72	79.51	80.51	82.45	83.90
FINANCIAL STRUCTURE					
Secured and Lease Debt/Total Debt (%)	100.00	100.00	100.00	100.00	100.00
Current Debt/Total Debt (%)	5.03	0.48	0.49	0.39	5.44
Off-Balance Sheet Debt/Total Adjusted Debt (%)	0.00	0.00	0.00	0.00	0.00
Total Debt Net of Cash/Tangible Equity (%)	318.76	368.34	393.45	440.33	517.97
PENSION ADJUSTED RATIOS					
Mixed Scheme Pension Liability	0.00	0.00	0.00	0.00	0.00
Pension Adjusted Net Leverage	6.20	6.60	6.36	6.68	6.88
Pension Adjusted Net Coverage	4.05	0.00	0.00	2.32	2.29
Pension Adjusted Net Coverage (Implied)	0.00	0.00	0.00	0.00	0.00
Implied Interest Cost	0.00	0.00	0.00	0.00	0.00
Pension Adjusted Gross Coverage	3.96	2.32	2.05	2.29	2.26
Pension Adjusted Gross Coverage (Implied)	0.00	0.00	0.00	0.00	0.00
WORKING CAPITAL CYCLE					
Average Inventory Processing Period (days)	0.00	0.00	0.00	0.00	0.00
Average Receivables Collection Period (days)	20.63	22.10	21.65	18.66	18.07
Gross Cash Cycle (days)	20.63	22.10	21.65	18.66	18.07
Average Payables Payment Period (days)	32.56	29.41	22.07	31.29	45.65
Cash Conversion Cycle (days)	(11.93)	(7.31)	(0.42)	(12.63)	(27.58)
ADDITIONAL INFORMATION					
Depreciation	165.90	162.80	161.70	132.70	126.90
Amortisation	(1.50)	(1.40)	(1.50)	(1.40)	(1.50)
Capital Expenditure/Depreciation (x)	2.09	2.19	1.67	1.89	1.69
CFO/Capital Expenditure (x)	0.85	0.85	0.61	1.05	0.81
Interest Capitalised	0.00	0.00	0.00	0.00	0.00
Hire/Lease/Rent Costs for Current Assets	0.00	0.00	0.00	0.00	0.00
Hire/Lease/Rent Costs for Long-term Assets	0.00	0.00	0.00	0.00	0.00
Contingent Liabilities	0.00	0.00	0.00	0.00	0.00
Operating Exceptionals in Operating Costs	0.00	0.00	0.00	0.00	0.00
Staff cost/Revenues (%)	1.85	1.93	1.89	1.90	1.82
R&D (net)/Revenues (%)	0.07	0.08	0.08	0.07	0.07

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