

Dwr Cymru (Financing) Ltd

Update

Ratings

Foreign Currency

Class A bonds senior secured	A
Class B bonds senior secured	A
Class C bonds senior secured	BBB+

Outlooks

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

Financial Data

Dwr Cymru Cyfyngedig

	31 Mar 2012	31 Mar 2011
Revenue (GBPm)	695.0	676.7
Operating EBITDA (GBPm)	422.5	412.1
Operating EBITDA Margin (%)	60.8	60.9
Pension adjusted net debt (Class A and B) (GBPm)	2,708.2	2,676.0
RAV (GBPm)	4,171.3	3,921.0
Pension adjusted net debt/RAV (%)	64.9	67.3
PMICR (x)	1.5	1.7

Key Rating Drivers

Not-for-Profit Organisation: Dwr Cymru Cyfyngedig (Dwr Cymru or Welsh Water) is the sixth-largest of the regulated monopoly providers for water and wastewater services by regulated asset value (RAV) in England and Wales. It is a not-for-profit organisation, which makes it unique among its peers 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.

Supportive Regulatory Framework: Important factors 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.

Operating Performance Meets Expectations: Fitch Ratings perceives Dwr Cymru as a middle-ranking performer in the industry. Its performance currently meets the agency's expectations. During the first two years of the regulatory price control, financial results improved due to the in-sourcing of main operating activities in 2010 and good progress with the efficiency initiatives devised by management. As a follow on, the company recently decided to also take the billing and income activities back in-house, previously outsourced to Veolia.

Regulatory Performance Improving: The company's performance data for the year ending 31 March 2012 (FY12) as reported to the Water Services Regulation Authority (Ofwat) shows that it has met most of its regulatory targets including for leakage. However, it has not met targets in the area of pollution incidents as well as marginally not meeting expectations for serviceability for sewerage non-infrastructure. The company is incurring additional investment in these areas in order to improve performance.

Adequate Forecast Credit Metrics: Fitch forecasts pension-adjusted net debt/RAV to move towards 60% for the combined class A and class B debt for the period to March 2015. Post-maintenance and post-tax interest cover (PMICR) is expected to range between 1.5x and 1.6x. While gearing provides for increasing headroom in comparison with Fitch's ratio guidelines, PMICR forecasts are at adequate levels.

What Could Trigger a Rating Action

Leverage and Regulatory Performance: No rating movements are foreseen at this stage. For positive rating action a sustainable reduction in target leverage to below 60% together with a visible improvement in regulatory performance would be required. For a 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

Adequate Liquidity: As of 30 June 2012, the company had GBP282m in cash and cash equivalents available, as well as GBP215m of undrawn committed banking facilities. This funding position should provide sufficient liquidity for capex and operating requirements for the rest of AMP5.

In accordance with transaction documentation, the group also maintains a GBP135m reserve liquidity facility, which would be available in the event of financial distress.

Related Research

[Future Price Limits for the UK Water Sector \(May 2012\)](#)

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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
^c Financing vehicle for Yorkshire Water Services Limited
^d Financing vehicle for Dwr Cymru Cyfyngedig

Senior Secured Rating History
Dwr Cymru (Financing) Ltd

Date	Class A ^a	Class B/C
21 Mar 2012	'A' St.	'A'/BBB+ St.
23 Mar 2011	'A' St.	'A'/BBB+ St.
30 Oct 2009	'A' St.	'A'/BBB+ St.
17 Mar 2009	'A' St.	'A'/BBB+ St.
27 Jun 2008	'A' St.	'A'/BBB+ St.
7 Apr 2008	'AA' Neg.	'A'/BBB+ St.
6 Feb 2008	'AAA' RWN	'A'/BBB+ St.
17 Jan 2008	'AAA' St.	'A'/BBB+ St.
21 Dec 2007	'AAA' RWN	'A'/BBB+ St.
16 Feb 2006	'AAA' St.	'A'/BBB+ St.
27 May 2005	'AAA' St.	'A'-/BBB' St.

"RWN" denotes Rating Watch Negative, "St." denotes Stable Outlook and "Neg." denotes Negative Outlook
^aSubject to MBIA bond policy; the rating of MBIA was withdrawn by Fitch on 26 June 2008.

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

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

Related Criteria

Corporate Rating Methodology (August 2012)

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

The draft Water Bill was published by the government in July 2012 for pre-legislative scrutiny. It takes forward some of the policy objectives initially set out in the Water White Paper in December 2011, including reforming the market for business customers. However, the Welsh government may not follow the lead of Westminster in all respects and has indicated its intention to publish a Water Strategy for Wales for consultation in the winter.

The Water White Paper highlighted that water supplies are already under stress in some parts of the country. In the coming years, the combined effects of climate change and a growing population are likely to put increasing pressure on rivers, lakes and aquifers. To safeguard security of supply and protect the environment for the long term, the water sector will need to use all the adaptation and mitigation means available. These include using a catchment-based approach to preserve water quality, limiting abstractions from water bodies to sustainable levels, increasing the connectivity of supply networks, and using media campaigns to encourage customers to use water wisely. Also on the government's agenda for the water sector is to improve the range and quality of services to customers.

Financial Risks

When the final determination of tariffs for the period April 2010 to March 2015 was published, Fitch identified doubtful debt, costs related to the adoption of private sewers and pension deficit repair as items that would probably generate cost pressures (with the former two potentially mitigated through a re-opener mechanism, if applicable thresholds are exceeded). Meanwhile, the government has turned the carbon reduction commitment into a levy, an additional expense that is not funded through tariffs, and the construction output price index, to which the capital programme is effectively linked, provides for challenges to meet unit costs assessed by the regulator. But there is also good news. Companies continue to outperform the cost of debt and benefit from the moderate-to-high levels of retail price inflation. In terms of energy costs most companies have been able to achieve significant outperformance for the five-year period.

Peer Group

	Anglia Water ^a		Yorkshire Water		Dwr Cymru ^b	
Class A:	Senior:	Class A:	Class B:	Class A + B:	Class C:	
'A'	'BBB+'	'A'	'BBB+'	'A'	'BBB+'	
	Stable		Stable		Stable	

Credit metrics

Forecast pension adjusted net debt/RCV (%)	71-73	80-82	74	83-84	63-65	n.a
Forecast PMICR (x)	1.6-1.8	1.3-1.4	1.5-1.6	1.3-1.4	1.5-1.6	n.a
Financial flexibility	Adequate		Adequate		Adequate	

Recent performance

Leakage targets not met (year)	FY11	FY10 & FY11	FY11
Infrastructure asset serviceability for FY11 that was not stable	Marginal for sewage	Marginal for water	
Infrastructure asset serviceability for FY12 that was not stable as reported by companies	Marginal for sewage	Marginal for water	Marginal for sewage non-infrastructure
Service incentive mechanism FY12 (points)	79/100	77/100	78/100

Fitch view

Regulatory performance	Above Average	Above Average	Middle Ranking
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^a In the case of Anglian Water the term "senior" is used to define the consolidated position of class A and class B debt.
^b 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. At present there is no class C debt outstanding.
Source: Fitch, companies, Ofwat (the economic regulator for the water and sewerage industry in England and Wales)

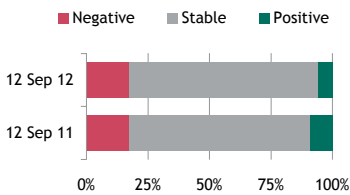
Key Credit Characteristics

Water companies in the UK operate as regional monopoly service providers in a supportive regulatory framework. In preparation for the next price review, Ofwat is consulting on changes to the regulatory regime that will facilitate an increased focus on customer service, bolder incentives and an environmentally more sustainable business model – eg through broader use of water trading and targeting outcomes. However, the consultation leaves a lot of detail open as to how the changes will be implemented, so a conclusive judgement on the credit dynamics of the water sector post March 2015 is not possible at this stage.

Distribution of Sector Outlooks

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;
- deposit balances to be remunerated at 1.5%.

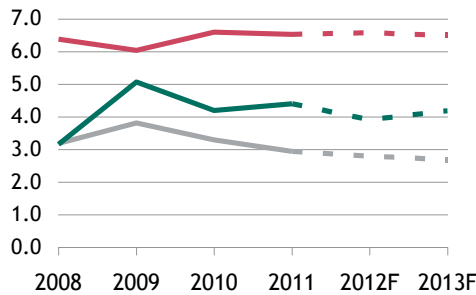
Note: 2011 refers to March 2012.

Definitions

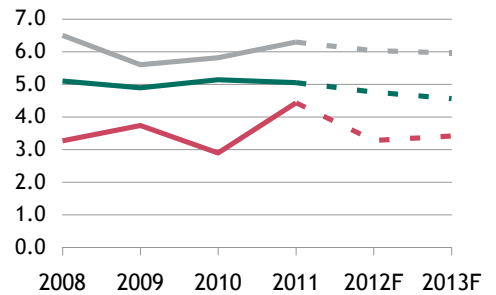
- Leverage:** debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus interest paid plus preferred dividends plus rental expense.
- Interest cover:** FFO plus interest paid plus preferred dividends divided by interest paid plus preferred dividends.
- 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.

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

Leverage including Fitch expectations



Interest Cover including Fitch expectations



Debt Maturities and Liquidity at 31 March 2012

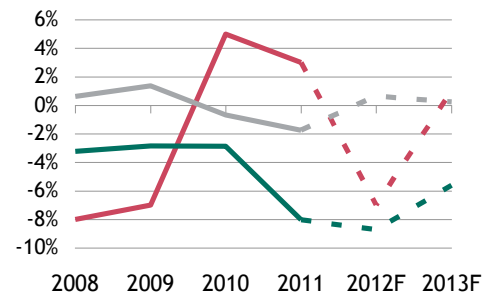
Debt maturities	(GBPm)
FY13	25.2
FY14	28.9
FY15	72.8
After 2015	2,765.4
Cash and equivalents	282.2
Undrawn Committed Facilities	215.0

of which GBP75m EIB facility, available for drawing until March 2014 and maturing over long term
of which GBP140m RCF(GBP50m due May 2017 and GBP90m due May 2018)

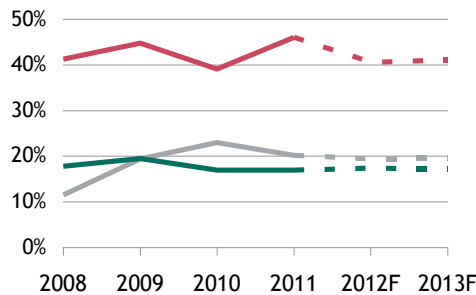
^a As of 30 June 2012

Source: Dwr Cymru

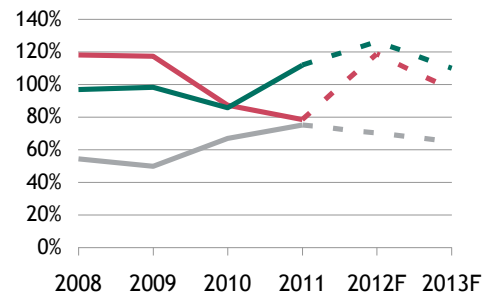
FCF/Revenues including Fitch expectations



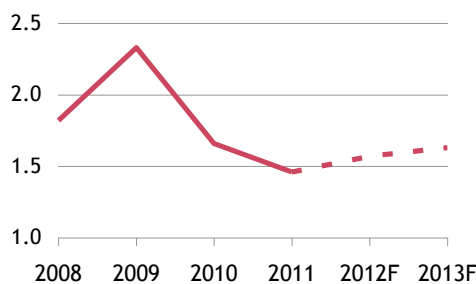
FFO Profitability including Fitch expectations



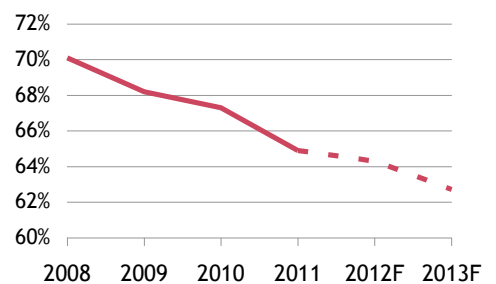
Capex/CFO including Fitch expectations



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



Pension Adjusted Net Debt/Regulatory Capital Value including Fitch expectations



Dwr Cymru Cyfyngedig
FINANCIAL SUMMARY

	31 Mar 2012 GBPm Original	31 Mar 2011 GBPm Original	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original
Profitability					
Revenue	695	677	688	657	623
Revenue Growth (%)	2.70	(1.67)	4.72	5.51	7.77
Operating EBIT	233	228	258	229	229
Operating EBITDA	423	412	423	390	389
Operating EBITDA Margin (%)	60.79	60.90	61.39	59.40	62.43
FFO Return on Adjusted Capital (%)	12.12	11.24	11.50	12.23	12.05
Free Cash Flow Margin (%)	2.95	5.42	(7.45)	(8.28)	(16.94)
Coverages (x)					
FFO Gross Interest Coverage	3.21	2.83	3.65	3.23	1.87
Operating EBITDA/Gross Interest Expense	2.15	2.31	3.96	2.24	2.28
FFO Fixed Charge Coverage (inc. Rents)	3.21	2.83	3.65	3.23	1.87
FCF Debt-Service Coverage	0.74	1.09	0.25	0.53	0.46
Cash Flow from Operations/Capital Expenditures	1.27	1.14	0.85	0.85	0.61
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/Operating EBITDA	6.98	6.59	6.79	6.96	6.70
Total Debt Less Unrestricted Cash/Operating EBITDA	6.27	6.35	6.20	6.61	6.38
Debt Leverage Including Rentals (x)					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	0	0	0	0	0
Gross Lease Adjusted Debt/Operating EBITDAR	6.98	6.59	6.79	6.96	6.70
Gross Lease Adjusted Debt /FFO+Int+Rentals	6.35	6.66	6.76	6.50	6.68
FCF/Lease Adjusted Debt (%)	0.70	1.35	(1.79)	(2.00)	(4.05)
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	6.87	6.41	6.79	6.96	6.68
Liquidity					
(Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%)	243.15	312.37	281.19	149.68	102.44
Balance Sheet Summary					
Cash and Equivalents (Unrestricted)	299	97	248	138	124
Restricted Cash and Equivalents	0	0	0	0	0
Short-Term Debt	77	22	144	13	13
Long-Term Senior Debt	2,872	2,694	2,724	2,705	2,594
of which subordinated debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	2,949	2,716	2,868	2,718	2,606
Off-Balance-Sheet Debt	0	0	0	0	0
Lease-Adjusted Debt	2,949	2,716	2,868	2,718	2,606
Fitch- identified Pension Deficit	24	12	6	5	0
Pension Adjusted Debt	2,974	2,728	2,874	2,723	2,606
Cash Flow Summary					
Operating EBITDA	423	412	423	390	389
Gross Cash Interest Expense	(145)	(144)	(116)	(130)	(208)
Cash Tax	3	2	0	0	0
Associate Dividends	0	0	0	0	0
Other Items before FFO (incl. interest receivable)	40	(6)	2	28	1
Funds from Operations	320	264	308	289	182
Change in Working Capital	8	27	(12)	14	(17)
Cash Flow from Operations	328	290	296	302	165
Total Non-Operating/Non-Recurring Cash Flow	0	0	0	0	0
Capital Expenditures	(257)	(253)	(347)	(357)	(271)
Dividends Paid	(50)	0	0	0	0
Free Cash Flow	21	37	(51)	(54)	(106)
Net (Acquisitions)/Divestitures	0	0	0	0	0
Net Equity Proceeds/(Buyback)	0	0	0	0	0
Other Cash Flow Items	(52)	(35)	10	(42)	(30)
Total Change in Net Debt	(31)	2	(41)	(97)	(135)
Working Capital					
Accounts Receivable Days	21	21	21	22	22
Inventory Days	0	0	0	0	0
Accounts Payable Days	53	37	33	29	22

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