

Dwr Cymru (Financing) Ltd

Update

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^a Subject to MBIA bond policy; the rating of MBIA was withdrawn by Fitch on 26 June 2008.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 the level (if any) at which Fitch would expect to rate prospective issuance.

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 11	31 Mar 10
Revenue (GBPm)	676.7	688.2
Operating EBITDA (GBPm)	412.1	422.5
Op. EBITDA/revenue (%)	60.9	61.4
Pension adjusted net debt (Class A and B) (GBPm)	2,676.0	2,550.0
RAV (GBPm)	3,921.0	3,738.0
Pension adjusted net debt/RAV (%)	68.2	68.2
Adjusted PMICR (x)	1.7	2.3

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.

Operating Performance Meets Expectations: Fitch Ratings perceives Dwr Cymru as a middle-ranking company in terms of operating and capital expenditure performance. The company is on track to meet its 20% target of real reduction in operating costs for the period from April 2010 to March 2015 (Asset Management Plan 5, or AMP5).

While rises in bad debt and inflationary increases continue to put pressure on operating costs, Dwr Cymru's in-sourcing of service contracts as part of the company's restructuring, and ongoing efficiency initiatives, particularly for power costs (it has forward-purchased around 60% of its foreseen power requirements for the remainder of AMP5), are helping the company to progress towards its targets, although cost challenges are still expected.

Adoption of Private Sewers: Fitch does not expect the current ratings to be affected as a consequence of the transfer of private sewers but assumes that the company will be able to recover the additional costs, which have been incorporated in the agency's forecasts. The transfer of 17,000 kilometres of private sewer networks to Dwr Cymru took place in October 2011. The company will consider applying for an interim determination of K (IDoK) to the regulator in order to recover the additional costs incurred.

Adequate Forecast Credit Metrics: Fitch forecasts pension-adjusted net debt/RAV to move towards 65% 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 to 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 December 2011, the company had GBP328m in cash and cash equivalents available, as well as GBP215m of undrawn committed revolving credit facilities (RCFs). Dwr Cymru obtained a new facility of GBP140m in May 2011 (replacing GBP100m facilities) and also a further GBP100m credit facility from the European Investment Bank, of which GBP25m has been drawn.

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

[Owat's Final Determination Broadly Ratings Neutral \(May 2010\)](#)

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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	Class B/C
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

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 2011)

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Some water companies failed to meet leakage targets in FY10 and FY11 due to unusually harsh winter conditions, and are facing additional costs to fix an unprecedented number of burst pipes and leaks and avoid possible fines by the regulator. Climate change and water abstraction restrictions are some of the other risks faced by the industry.

Financial Risks

The Carbon Reduction Commitment, which was turned into a levy, will be an additional cost faced by companies from 2012 as it is not funded by the regulator. Additionally, some costs related to the transfer of private sewers, which happened in October 2011, will also have to be funded by the companies if applications to recover any material costs through an interim determination of K (IDoK) during the current price control are not successful.

However, companies are benefiting from additional headroom in leverage and PMICR credit metrics due to persistently high inflation and low cost of debt, with the resulting additional financial flexibility either retained by the companies or distributed to shareholders. For its forecasts for water and sewage companies in England and Wales, Fitch assumes inflation to fall to the Bank of England's target levels towards the latter years of AMP5.

Peer Group

	AWS		YWS		Dwr Cymru ^a	
	Class A: 'A'	Class B: 'BBB+'	Class A: 'A'	Class B: 'BBB+'	Class A + B: 'A'	Class C: 'BBB+'
	Stable		Stable		Stable	
Forecast pension adjusted net debt/RAV (%)	73-74	82-83	73-74	83-84	Moving towards 65	n.a
Forecast PMICR (x)	1.5-1.7	1.3-1.4	1.5-1.8	1.3-1.5	1.5-1.6	n.a
FY11 pension adjusted net debt/RAV (%)	71.4	80.5	67.3	76.7	68.2	n.a
FY11 PMICR (x)	1.8	1.5	1.6	1.4	1.7	n.a
Financial flexibility	Adequate		Adequate		Adequate	

^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. At present there is no class C debt outstanding.
 Source: Fitch, companies

Key Credit Characteristics

Dwr Cymru's water sector peers operate as regional monopoly service providers in a supportive and transparent regulatory framework. In addition to the risks mentioned above, doubtful debt is likely to continue to present some challenges for companies in the medium term. However, most companies are likely to continue to outperform the cost of debt, with the most efficient companies also likely to outperform regulatory opex and capex allowances.

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, although in FY11 it missed leakage targets and reported less than stable serviceability for its underground sewerage network.

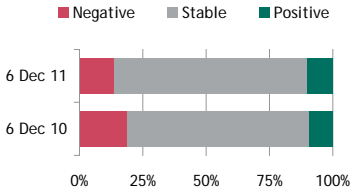
Yorkshire Water Services Limited (YWS) – historically has achieved very good results in the regulator's benchmarking studies, but in FY11 the company missed leakage targets and reported marginal asset serviceability for water infrastructure.

Dwr Cymru Cyfyngedig – is a middle-ranking company in the industry. Overall the company's regulatory performance is good, although in FY11 it missed leakage targets and fell short of meeting Ofwat's requirements for security of supply.

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%.

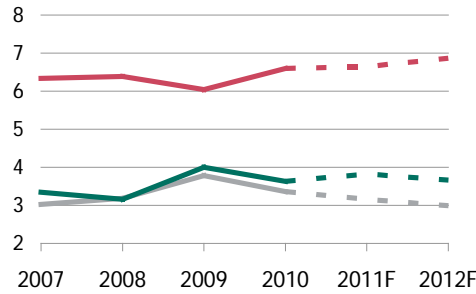
Note: 2011F refers to March 2012.

Definitions

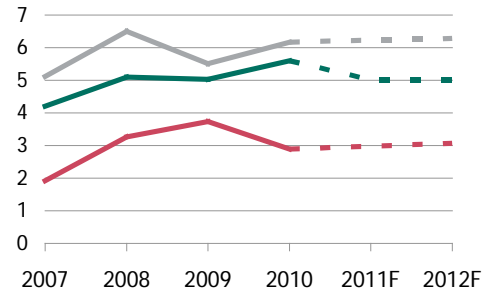
- Leverage:** debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus interest paid plus preferred dividends plus rental expense.
- Interest cover:** FFO plus interest paid plus preferred dividends divided by interest paid plus preferred dividends.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



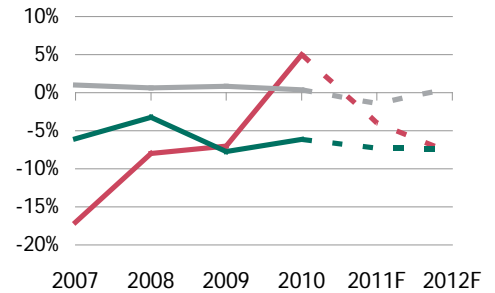
Debt Maturities and Liquidity at 31 March 2011

Debt maturities	GBPm
FY12	19
FY13	20
FY14	27
FY15	72
After FY15	2,628
Cash and equivalents ^a	328
Undrawn committed facilities ^a	215
of which GBP75m EIB facility, available for drawing until September 2012 and maturing over long term	
of which GBP140m RCF due May 2016	

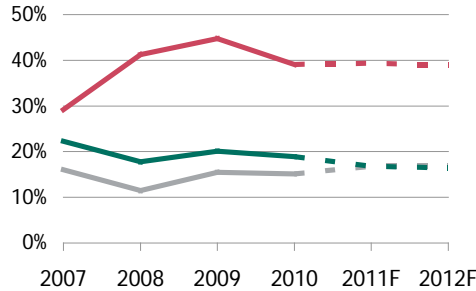
^a As of December 2011

Source: Dwr Cymru

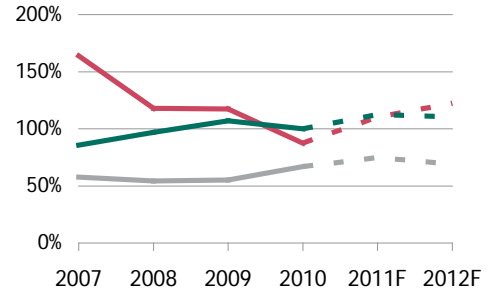
FCF/Revenues including Fitch expectations



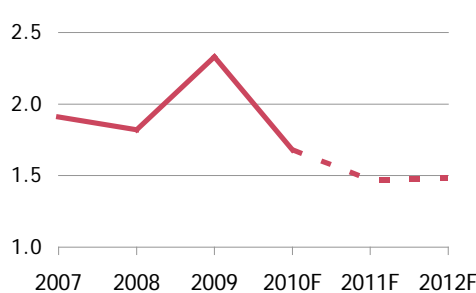
FFO Profitability including Fitch expectations



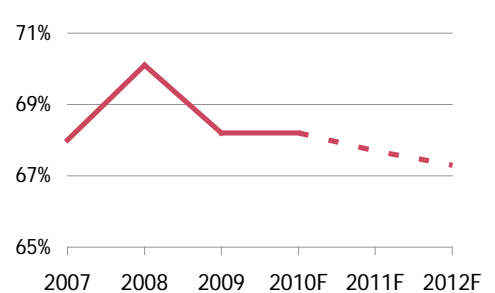
Capex/CFO including Fitch expectations



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 2011 GBPm Original	31 Mar 2010 GBPm Original	31 Mar 2009 GBPm Original	31 Mar 2008 GBPm Original	31 Mar 2007 GBPm Original
Profitability					
Revenue	677	688	657	623	578
Revenue Growth (%)	(1.67)	4.72	5.51	7.77	4.43
Operating EBIT	228	258	229	229	219
Operating EBITDA	412	423	390	389	351
Operating EBITDA Margin (%)	60.90	61.39	59.40	62.43	60.64
FFO Return on Adjusted Capital (%)	12.20	11.24	13.53	10.89	14.42
Free Cash Flow Margin (%)	5.42	(7.45)	(8.28)	(16.94)	2.16
Coverages (x)					
FFO Gross Interest Coverage	2.83	3.65	3.23	1.87	4.79
Operating EBITDA/Gross Interest Expense	2.31	3.96	2.24	2.28	2.23
FFO Fixed Charge Coverage (inc. Rents)	2.83	3.65	3.23	1.87	4.79
FCF Debt-Service Coverage	1.09	0.25	0.53	0.46	1.04
Cash Flow from Operations/Capital Expenditures	1.14	0.85	0.85	0.61	1.05
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/ Operating EBITDA	6.59	6.79	6.96	6.70	7.15
Total Debt Less Unrestricted Cash/ Operating EBITDA	6.35	6.20	6.61	6.38	6.70
Debt Leverage Including Rentals (x)					
Rental Expense	0	0	0	0	0
Gross Lease Adjusted Debt/ Operating EBITDAR	6.59	6.79	6.96	6.70	7.15
Gross Lease Adjusted Debt/ FFO+Int+Rentals	6.66	6.76	6.50	6.68	7.05
FCF/Lease Adjusted Debt (%)	1.35	(1.79)	(2.00)	(4.05)	0.50
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	6.41	6.79	6.96	6.68	7.13
Liquidity					
(Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%)	225.53	236.58	58.86	8.23	203.23
Balance Sheet Summary					
Cash and Equivalents (Unrestricted)	97	248	138	124	157
Restricted Cash and Equivalents	0	0	0	0	0
Short-Term Debt	22	144	13	13	9
Long-Term Senior Debt	2,694	2,724	2,705	2,594	2,495
Subordinated Debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	2,716	2,868	2,718	2,606	2,505
Off-Balance-Sheet Debt	0	0	0	0	0
Lease-Adjusted Debt	2,716	2,868	2,718	2,606	2,505
Fitch- identified Pension Deficit	12	6	5	0	4
Pension Adjusted Debt	2,728	2,874	2,723	2,606	2,509
Cash Flow Summary					
Operating EBITDA	412	423	390	389	351
Gross Cash Interest Expense	(144)	(116)	(130)	(208)	(74)
Cash Tax	2	0	0	0	0
Associate Dividends	0	0	0	0	0
Other Items before FFO (incl. interest receivable)	(6)	2	28	1	5
Funds from Operations	264	308	289	182	281
Change in Working Capital	27	(12)	14	(17)	(18)
Cash Flow from Operations	290	296	302	165	263
Total Non-Operating/ Non-Recurring Cash Flow	0	0	0	0	0
Capital Expenditures	(253)	(347)	(357)	(271)	(251)
Dividends Paid	0	0	0	0	0
Free Cash Flow	37	(51)	(54)	(106)	13
Net (Acquisitions)/Divestitures	0	0	0	0	0
Net Equity Proceeds/ (Buyback)	0	0	0	0	0
Other Cash Flow Items	(35)	10	(42)	(30)	(17)
Total Change in Net Debt	2	(41)	(97)	(135)	(5)
Working Capital					
Accounts Receivable Days	20.80	20.60	20.80	24.73	20.02
Inventory Days	0.00	0.00	0.00	0.00	0.00
Accounts Payable Days	37.00	32.60	36.80	25.11	19.57

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