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Issuer Comment: Moody's: Creation of subsidiary does not impact Welsh Water's ratings

Global Credit Research - 19 Jun 2012

Moody's Investors Service said today that the A3 corporate family rating of Dwr Cymru Cyfyngedig ("Welsh Water") and the A3 senior secured debt ratings of its funding vehicle Dwr Cymru (Financing) Limited (Class A and B notes) are unlikely to be affected by the announced corporate restructuring.

Welsh Water is planning to introduce a new billing system and - to facilitate the process - to establish a new 100%-owned subsidiary. This subsidiary will operate the billing activities that are currently outsourced to Veolia.

Moody's believes that the creation of a subsidiary within the ring-fenced financing structure does not affect Welsh Water's overall consolidated credit quality as represented by the current A3 corporate family rating. It is intended that the newly created subsidiary - whilst not acceding to the security trust and intercreditor deed - will comply with the same terms and restrictions under Welsh Water's existing financing arrangements and also create security over all its assets. The completion of this transaction will be subject to approval by the majority of Welsh Water's creditors, as the company is prohibited from creating any new subsidiaries under the terms of its financing structure.

Welsh Water's A3 corporate family rating consolidates the legal and financial obligations of the company, its funding vehicle Dwr Cymru (Financing) Limited and the three holding companies that are in the ring-fenced group. In line with our approach towards similar transactions (such as Anglian Water, Thames Water or Yorkshire Water), Moody's rating assessment of Welsh Water is the result of the evaluation of (i) the company's low business risk profile, (ii) its financial leverage and (iii) the structural enhancements of the bond covenant and security package. Moody's also takes into account the not-for-profit status of Welsh Water's ultimate parent company, Glas Cymru, which has allowed Welsh Water to significantly reduce leverage since the initial financing structure was put in place in May 2001, and the company's stated policy to maintain current leverage at around 70%.

Welsh Water's A3 corporate family rating does not factor in the same degree of uplift (usually around one notch) as seen in the comparable transactions, given that the protection provided by the financial covenants, particularly the limitations for additional indebtedness and permitted distributions (including customer dividends), is limited at Welsh Water's A3 rating level. We also add that Welsh Water's covenant structure is slightly different from the other transactions as the protection offered by certain financial covenants is less critical for a not-for-profit company without equity shareholders.

On 19 June 2012, Welsh Water announced that it has decided to end its billing and income contract with Veolia and create a new company wholly owned by Welsh Water. The new company, which will be called Dwr Cymru Customer Services Ltd, will have the sole purpose of delivering billing and income collection services to Welsh Water. Veolia and Welsh Water have jointly agreed that the contract will end on 31 July 2012 and the activities will transfer to Welsh Water's new subsidiary on 1 August 2012.

Dwr Cymru Cyfyngedig / Welsh Water is the sixth-largest UK water utility by regulatory capital value ("RCV"), providing water and sewerage services to approximately 1.2 million households and over 100,000 business customers in a region that covers most of Wales and certain adjoining areas of England. Welsh Water's ultimate parent company is Glas Cymru Cyfyngedig, a not-for-profit organisation. At the end of the fiscal year 2011/12, Welsh Water had a RCV of GBP4,171 million and reported revenues of GBP695million and operating profit of GBP191 million.

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