

# Dwr Cymru (Financing) Ltd

## Update

### Ratings

#### Foreign Currency

Class A Bonds senior secured <sup>a</sup>	A
Class B Bonds senior secured	A
Class C Bonds senior secured <sup>b</sup>	BBB+

<sup>a</sup> Subject to MBIA bond policy; the rating of MBIA was withdrawn by Fitch on 26 June 2008.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'.

<sup>b</sup> 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 12	31 Mar 11
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	2,674.0
RAV (GBPm)	4,171.5	3,971.9
Pension adjusted net debt/RAV (%)	64.9	67.3
PMICR (x)	1.5	1.7

### Key Rating Drivers

**Low Business Risk:** Important factors for the ratings are the UK water sector's supportive and transparent regulatory framework, which provides earnings visibility until the end of the price control period in March 2015, improving operating and regulatory performance and the covenanted and secured financing structure of the group. The latter benefits from structural enhancements, including trigger mechanisms and debt service reserve liquidity.

**Not-for-Profit Organisation:** Dwr Cymru Cyfyngedig (Dwr Cymru or Welsh Water) is one of the ten regulated monopoly providers for water and wastewater services and the sixth-largest by regulated asset value (RAV). Dwr Cymru 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.

**Improved Regulatory, Operational Performance:** The company met its regulatory targets for the financial year ending 31 March 2012 (FY12) for most categories. It did not meet targets in the area of pollution incidents and marginally did not meet expectations for serviceability for sewerage non-infrastructure. However, the company has invested in these areas in order to improve performance, and the agency expects that serviceability for sewerage non-infrastructure will move from marginal to stable in the short to medium term.

Dwr Cymru has indicated that it expects to meet its leakage targets for FY13 as well as improve its Service Incentive Mechanism (SIM) score, which measures customer satisfaction.

**Cost Pressures Erode Outperformance:** Increasing cost pressures over the remainder of the price control related to power costs, doubtful debt, Carbon Reduction Commitment tax, the adoption of private sewers, and inflationary pressures will make it difficult for the company to achieve meaningful outperformance. Although these cost pressures should be partially offset by savings due to the in-sourcing of activities and efficiency initiatives implemented by management, the agency expects a gradual reduction in outperformance until 2015.

**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.

### Rating Sensitivities

**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 sustained increase in leverage to above 73% and/or 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 28 February 2013 the company had GBP215m 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.

### Related Research

[Rating EMEA Regulated Network Utilities \(August 2012\)](#)

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

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Peer Group

Issuer	Country
<b>Class A bonds:</b>	
<b>'A'/Stable Outlook<sup>a</sup></b>	
Anglian Water Services Financing Plc <sup>b</sup>	UK
Yorkshire Water Services Bradford Finance Limited <sup>c</sup>	UK
Dwr Cymru (Financing) Ltd <sup>d</sup>	UK
<b>Class B bonds:</b>	
<b>'A'/Stable Outlook<sup>a</sup></b>	
Dwr Cymru (Financing) Ltd <sup>d</sup>	UK

<b>Class B bonds:</b>	
<b>'BBB+'/Stable Outlook<sup>a</sup></b>	
Anglian Water Services Financing Plc <sup>b</sup>	UK
Yorkshire Water Services Bradford Finance Limited <sup>c</sup>	UK

<b>Class C bonds:</b>	
<b>'BBB+'/Stable Outlook<sup>a</sup></b>	
Dwr Cymru (Financing) Ltd <sup>d</sup>	UK

- <sup>a</sup> Senior secured bond ratings
- <sup>b</sup> Financing vehicle for Anglian Water Services Limited
- <sup>c</sup> Financing vehicle for Yorkshire Water Services Limited
- <sup>d</sup> Financing vehicle for Dwr Cymru Cyfyngedig

Senior Secured Rating History Dwr Cymru (Financing) Ltd

Date	Class A <sup>a</sup>	Class B/C
14 Mar 2013	'A' St.	'A'/BBB+ St.
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

<sup>a</sup> Subject 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 <sup>a</sup>	Trend
Operations	Average	Neutral
Market position <sup>b</sup>		
Finances	Average	Neutral
Governance	Average	Neutral
Geography <sup>b</sup>		

<sup>a</sup> Relative to peer group

<sup>b</sup> 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 Water White Paper, published in December 2011, emphasises that water supplies are already under stress in some parts of the country. In order to safeguard security of supply and protect the environment for the long term, the water sector will need to use all 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 connectivity of supply networks, employing media campaigns to encourage customers to use water wisely, and improving the range and quality of services to customers.

The draft Water Bill, published in July 2012, takes forward some of the policy objectives set out in the Water White Paper, including reforming the market for business customers. However, the Welsh government may decide not to follow the lead of Westminster in all respects and has indicated its intention to publish a Water Strategy for Wales for consultation later in the year.

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. 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, continues to run below forecast and can make it difficult to meet unit costs assessed by Ofwat in some parts of the capital programme. But there is also good news. Companies continue to outperform the cost of debt and benefit from moderate levels of retail price inflation. In terms of energy costs most companies have achieved considerable outperformance for the five-year period.

Peer Group

	Anglian Water <sup>a</sup>		Yorkshire Water		Dwr Cymru <sup>b</sup>		
	Stable	Stable	Stable	Stable	Stable	Stable	
	Class A: 'A'	Senior: 'BBB+'	Class A: 'A'	Class B: 'BBB+'	Class A + B: 'A'	Class C: 'BBB+'	
Credit metrics							
Forecast pension adjusted net debt/RCV (%)	71-74	82-83	73	82-83	62-64	n.a	
Forecast PMICR (x)	1.5-1.7	1.3-1.4	1.5-1.6	1.2-1.3	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	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	Top Half		Middle Ranking		Middle Ranking		

<sup>a</sup> In the case of Anglian Water the term "senior" is used to define the consolidated position of class A and class B debt

<sup>b</sup> 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)

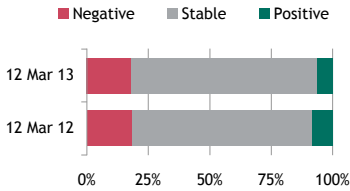
Key Credit Characteristics

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. However, after the various consultations, there have so far been few firm decisions and the detail of implementation regarding targeted changes has largely been left open. Consequently, a judgement on credit dynamics of the water sector after 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%.
- RPI to revert to 2.5% in the medium term.

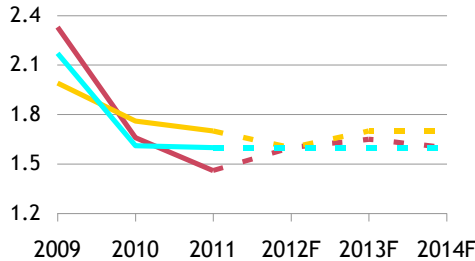
Note: 2011 refers to March 2012.

### Definitions

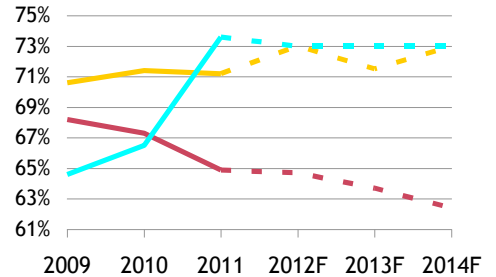
- Leverage: debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus interest paid plus preferred dividends plus rental expense.
- Interest cover: FFO plus interest paid plus preferred dividends divided by interest paid plus preferred dividends.
- 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](http://www.fitchratings.com).

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

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



### Pension Adjusted Net Debt/Regulatory Capital Value including Fitch expectations



### Debt Maturities and Liquidity at 31 December 2012

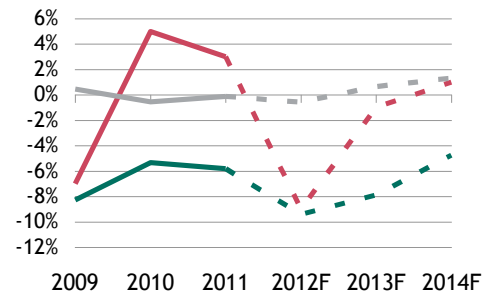
Debt maturities	(GBPm)
FY13	12.0
FY14	33.0
FY15	58.0
After 2015	2,698.0
<b>Cash and equivalents<sup>a</sup></b>	<b>215.0</b>
<b>Undrawn committed facilities<sup>a</sup></b>	<b>215.0</b>

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)

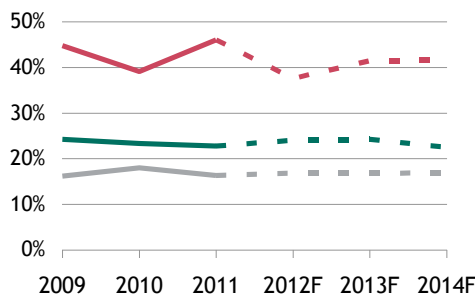
<sup>a</sup> As of 28 February 2013

Source: Dwr Cymru

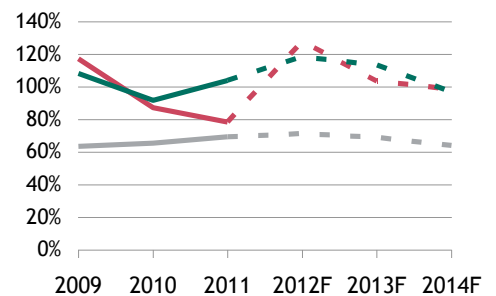
### FCF/Revenues including Fitch expectations



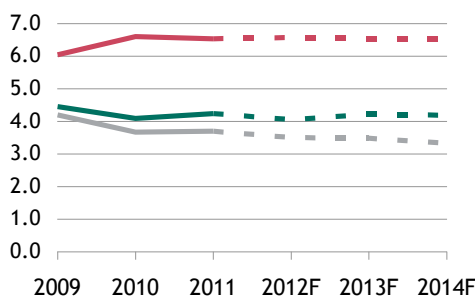
### FFO Profitability including Fitch expectations



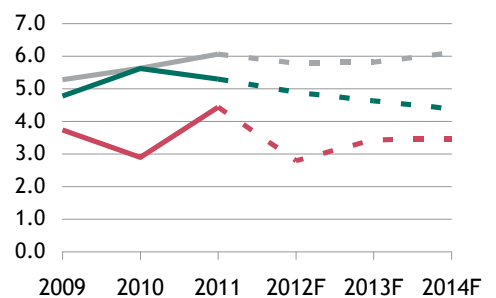
### Capex/CFO including Fitch expectations



### Leverage including Fitch expectations

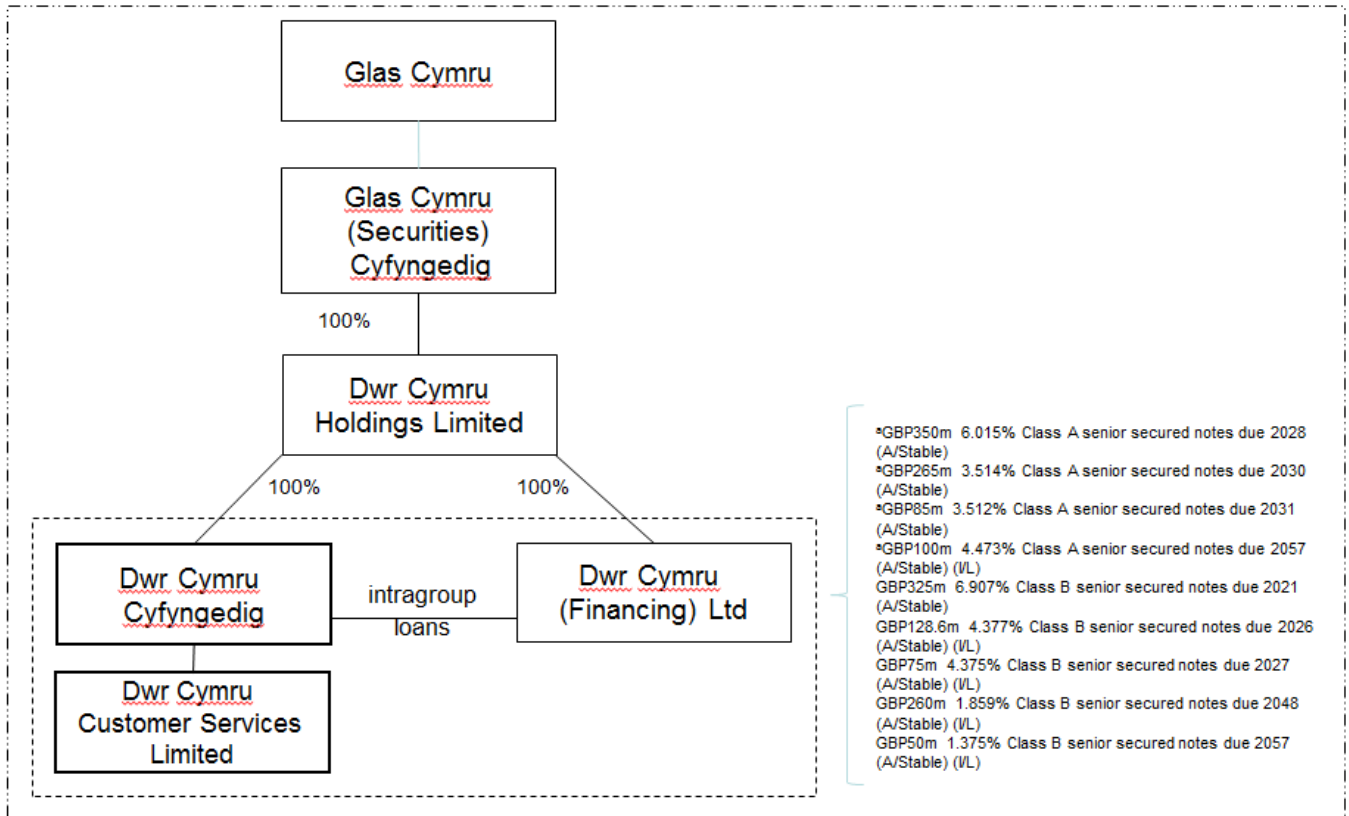


### Interest Cover including Fitch expectations



Appendix 1

Structure Diagram



- - - - - Regulatory ring-fence  
 - . . . . . Documentation ring-fence  
 VL – Index-Linked  
 \* notes guaranteed by MBIA

Source: Transaction documents

**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
<b>Profitability</b>					
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)
<b>Coverages (x)</b>					
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
<b>Debt Leverage of Cash Flow (x)</b>					
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
<b>Debt Leverage Including Rentals (x)</b>					
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)
<b>Debt Leverage Including Leases and Pension Adjustment (x)</b>					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	6.87	6.41	6.79	6.96	6.68
<b>Liquidity</b>					
(Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%)	243.15	312.37	281.19	149.68	102.44
<b>Balance Sheet Summary</b>					
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
<b>Cash Flow Summary</b>					
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
<b>Funds from Operations</b>	<b>320</b>	<b>264</b>	<b>308</b>	<b>289</b>	<b>182</b>
Change in Working Capital	8	27	(12)	14	(17)
<b>Cash Flow from Operations</b>	<b>328</b>	<b>290</b>	<b>296</b>	<b>302</b>	<b>165</b>
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
<b>Free Cash Flow</b>	<b>21</b>	<b>37</b>	<b>(51)</b>	<b>(54)</b>	<b>(106)</b>
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)
<b>Working Capital</b>					
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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