

**Rating Action: Moody's affirms Welsh Water's A3 CFR on Ofwat decision; changes outlook to positive**

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London, 27 February 2015 -- Moody's Investors Service (Moody's) has today affirmed the A3 corporate family rating (CFR) of Dwr Cymru Cyfyngedig (Welsh Water). Concurrently, the rating agency also affirmed the A3 senior secured ratings of the Class A debt issued by Dwr Cymru (Financing) Limited (which benefits from an unconditional irrevocable financial guaranty policy from MBIA Insurance Corporation, B2 stable) and Class B debt issued by Dwr Cymru (Financing) Limited and guaranteed by Welsh Water. At the same time, the rating agency changed the outlook on all ratings to positive from stable.

This rating action follows Welsh Water's acceptance of the final price determination published by the Water Services Regulation Authority (Ofwat) in December 2014, which sets allowed revenues for the five-year regulatory period commencing on 1 April 2015 (AMP6).

**RATINGS RATIONALE**

"The change in outlook is driven by Welsh Water's commitment to a more prudent financial policy targeting a maximum gearing level of 60% for the next five years, compared with 70% since 2011", said Matthew Huxham, a Moody's Assistant Vice President -- Analyst and lead analyst for Welsh Water. "If in AMP6, the company continues to retain surpluses within the business, it will continue to deleverage below 60% which would support a higher rating".

The announcement of the revisions to the company's financial policy follows a final determination which includes revenues largely in line with those proposed in the company's final business plan. This notwithstanding, Welsh Water will face a tough operational challenge, in particular on retail costs and in relation to certain of its Outcome Delivery Incentives (ODIs).

The company's adjusted interest coverage ratio will weaken as a consequence of the fall in allowed return (from 5.1% real, post-tax to 3.74% in the appointed business) and the company has a relatively high embedded cost of debt. However, Moody's places less emphasis on this ratio for Welsh Water than for peers given that it has no pressure to pay dividends. The rating agency consider that the not-for-profit status of Welsh Water's ultimate parent, Glas Cymru, provides it with significant additional financial flexibility.

The A3 CFR further reflects (1) the group's low business risk profile as monopoly provider of water services operating under a well-established, transparent and predictable regulatory framework; (2) the structural enhancements of the bond covenant and security package; and (3) the protection against increasing business risk resulting from the Welsh Government's policy decision not to implement further competition in the sector in the near term.

Given its moderate leverage, Welsh Water exhibits significant headroom in its financial metrics compared to additional indebtedness trigger levels in its financial metrics. Therefore Welsh Water's A3 rating currently does not incorporate any significant uplift for credit-enhancing features.

**RATING OUTLOOK**

The positive rating outlook reflects Moody's expectation that the Welsh Water's gearing will continue to reduce below 60% net debt to Regulatory Capital Value (RCV) unless it materially increases the scope of customer rebates and discretionary investments not funded by the regulator. This would be consistent with a higher rating.

**WHAT COULD CHANGE THE RATING UP/DOWN**

The ratings could be upgraded once there is greater clarity about Welsh Water's plans for the use of its equity returns and its actual performance compared with the level of expenditure allowed by the regulator and associated performance commitments. Positive rating pressure could arise if the company's gearing trended below 60%.

As the outlook is positive, Moody's does not foresee downward rating pressure arising in the next two years. A

materially unfavourable change in the regulatory framework for the UK Water sector, combined with a change in the Welsh Government's current policy on competition in the sector, could however significantly increase business risk.

The principal methodology used in these ratings was Global Regulated Water Utilities published in December 2009. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

Dwr Cymru Cyfyngedig (Welsh Water) is the sixth-largest of ten water and sewerage companies in England and Wales by Regulated Capital Value (RCV), providing water and sewerage services to approximately 3.2 million people in a region that covers most of Wales and certain adjoining areas of England.

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