

Announcement of Periodic Review: Moody's announces completion of a periodic review of ratings of Dwr Cymru Cyfyngedig

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London, 23 July 2020 -- Moody's Investors Service ("Moody's") has completed a periodic review of the ratings of Dwr Cymru Cyfyngedig and other ratings that are associated with the same analytical unit. The review was conducted through a portfolio review in which Moody's reassessed the appropriateness of the ratings in the context of the relevant principal methodology(ies), recent developments, and a comparison of the financial and operating profile to similarly rated peers. The review did not involve a rating committee. Since 1 January 2019, Moody's practice has been to issue a press release following each periodic review to announce its completion.

This publication does not announce a credit rating action and is not an indication of whether or not a credit rating action is likely in the near future. Credit ratings and outlook/review status cannot be changed in a portfolio review and hence are not impacted by this announcement. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key rating considerations are summarized below.

The A3 corporate family rating (CFR) of Dwr Cymru Cyfyngedig (Welsh Water) is supported by (1) its low business risk profile as the monopoly provider of essential water and sewerage services across most of Wales and parts of Herefordshire and Cheshire, with stable and predictable cash flows generated under a transparent and well-established regulatory regime; (2) a low level of gearing around 60%, calculated as the group's consolidated net debt to regulatory capital value (RCV); (3) the not-for-dividend status of Welsh Water's ultimate parent company, Glas Cymru Holdings Cyfyngedig, which allows Welsh Water to manage the distribution of its profits in order to maintain the company's publicly stated gearing target of 60% net debt to RCV; and (4) the decision by the Welsh Government not to implement retail competition for incumbent water companies operating wholly or mainly in Wales in April 2017, which evidenced a cautious approach to market reform.

Despite strong fundamentals, the company's rating is constrained by a challenging settlement for the current five-year regulatory period (AMP7), which commenced in April 2020 and included a significant cut in allowed returns as well as tough cost efficiency and performance targets.

The A3 rating of the senior notes issued by Dwr Cymru (Financing) UK Plc reflects their senior position in the cash flow waterfall, but also that the quantum of the junior notes within the structure, at roughly 5-7% of aggregate senior and junior debt, is modest while the tenor of the notes, around six years, implies that they may not be a permanent part of the capital structure. The limited proportion of junior debt, in particular, means that they offer limited loss-absorption capacity for senior creditors, relative to sector peers with highly-covenanted financing structures.

The Baa2 rating of the junior notes, two notches below Welsh Water's A3 CFR, reflects (1) their subordinated position relative to the senior debt, which ranks ahead in the cash flow waterfall; and (2) the limited decision-making ability of junior note holders so long as senior debt remains outstanding. The two-notch differential takes into account Moody's view that the senior and junior classes of debt have similar probabilities of default but the loss severity for the junior tranche will be significantly greater, post any default.

This document summarizes Moody's view as of the publication date and will not be updated until the next periodic review announcement, which will incorporate material changes in credit circumstances (if any) during the intervening period.

The principal methodology used for this review was Regulated Water Utilities published in June 2018. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

This announcement applies only to EU rated and EU endorsed ratings. Non EU rated and non EU endorsed ratings may be referenced above to the extent necessary, if they are part of the same analytical unit.

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