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DWR Cymru (Financing) UK PLC

Primary Credit Analyst:
Julien Bernu, London + 442071767137; Julien.Bernu@spglobal.com

Secondary Contact:
Matan Benjamin, London + 44 20 7176 0106; matan.benjamin@spglobal.com

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DWR Cymru (Financing) UK PLC

Credit Highlights

None

Overview

Key strengths	Key risks
Focus on low-risk, U.K. water regulated monopoly activities.	Marked reduction in allowed return for the current regulatory period (April 2020-March 2025).
Transparent, credit-supportive regulatory framework that results in financial stability during regulatory periods.	Relatively high capital intensity as a proportion of operating cash flows, limiting debt reduction prospects over the current regulatory period.
Greater financial flexibility provided by the non-for-profit status of its parent company, and lower gearing than industry peers.	More challenging operating efficiency targets under the new regulatory period, potentially leading to financial penalties and greater cash flow volatility.
Various structural features designed to increase cash flow certainty for debtholders.	

Tougher operating conditions expected for the current regulatory period. Based on the company's business plan, we believe that Dwr Cymru Cyfyngedig (Welsh Water), along with the rest of the sector, will operate under tougher conditions over the current regulatory period (AMP7), that runs from April 2020 to March 2025. Welsh Water will face an average 9% reduction (in real terms) in customer bills compared with AMP6, while earning lower returns, with a reduced allowed cost of capital of 1.92% (assumed retail price index [RPI] of 3%), versus 3.53% in the previous regulatory period. This relates to the regulator's chief goal to provide customers with better service at lower costs (see "Ofwat's Final Determination Leaves U.K. Water Companies' Credit Quality Under Duress," published on Dec. 17, 2019)

Resilience in the face of the COVID-19 pandemic. We consider Welsh Water as relatively hardy against the effects of the pandemic, given the essential service the company provides and the regulated nature of its activities. We expect a significant reduction in water consumption for non-household (NHH) customers, and lower-than-anticipated revenue coupled with rising bad debts as a result. As of December 2020, Welsh Water expected a 16% reduction in demand from NHH customers and a 1% increase in household revenues, leading to a projected net reduction in revenues against initial expectations of £21 million for the fiscal year ending in March 2021, along with bad debts of about £4 million-£7 million annually until 2022/2023. However, the regulatory framework for the sector includes mechanisms enabling water companies to compare actual revenue in any specific year with the amount allowed under the FD. There is a two-year lag between any over/under-collection and the subsequent true-up, so any under-collection in 2020/2021 should be offset by an increase in allowed revenue in 2022/2023. Therefore, the effect on credit metrics will mainly be temporary.

At the same time, we note that water companies could struggle to meet operational targets this year given disruptions to their operations and extreme weather conditions and, as a result, could be subject to penalties. It remains to be seen if the regulators acknowledge the unique circumstances companies have faced as a result of the pandemic and relax the targets for the year.

The reintroduction of subordinated debt into the capital structure provides an additional buffer to senior secured creditors. Welsh Water issued £300 million of senior secured (class B) debt along with £200 million of subordinated (class C) debt in February 2020, offered at competitive rates of 1.375% and 1.625%, respectively. We note that Welsh

Water did not have any outstanding class C debt in its capital structure since the repayment of its last outstanding class C notes in 2010. See "Dwr Cymru (Financing) UK Ltd. Subordinated 'BBB' Rating Assigned Stable Outlook," published on Feb. 1, 2020). We believe that the issuance of subordinated debt provides an additional buffer for the credit metrics and rating on the senior secured class B debt. The class C debt offers loss absorption capacity to senior secured creditors--being structurally subordinated to class B debt, with an option to defer interest payments--and cannot create an event of default for the senior secured debt. At this stage, we apply our current targets for the ratings without debt class distinctions. This is because we consider the relatively low amount of class C debt (at approximately 5% of total reported debt) in Welsh Water's existing capital structure, coupled with a relatively shorter tenor, suggesting subordinated notes may not be a permanent part of the capital structure. We would make distinctions in our targets for both classes should we observe a significant increase in the quantum of class C debt in the capital structure.

Outlook

The stable outlook on Welsh Water's senior secured and subordinated debt reflects our view that the company has sufficient headroom in AMP7 to keep its funds from operations (FFO) to debt significantly above 6% for both classes and debt to EBITDA significantly below 9x on a consolidated basis.

Downside scenario

We could lower the ratings on Welsh Water's senior secured class B debt and subordinated class C debt if its FFO-to-debt ratio doesn't maintain enough headroom above 6% and debt to EBITDA below 9x on a prolonged basis. This could occur during the current regulatory period if Welsh Water does not deliver on its business plan or incurs a significantly greater amount of penalties on its outcome delivery incentives (ODI) than we currently project. Although not envisioned at this stage, we could also lower our ratings if we were to notice that credits metrics were more severely affected than our expectations with the absence of near-term recovery.

Upside scenario

We would consider raising the ratings on Welsh Water's senior secured class B debt and subordinated class C debt if FFO to debt markedly and consistently exceeded 7% and debt to EBITDA were significantly below 8x, with the company also demonstrating above-average operating performance.

Our Base-Case Scenario

Assumptions

- Revenue based on approved tariffs until the end of the current regulatory period, AMP7 (March 31, 2025), and inflated as per our in-house RPI and consumer price index (CPI) assumptions of 2.2% and 1.8% in 2021, 2.7% and 1.9% in 2022, and 3.1% and 1.9% in 2023 (year-end).
- Reduction in projected revenues of about £25 million for the fiscal year ending in March 2021 due to the COVID-19 pandemic. Lost revenues are recoverable under regulatory mechanism with a two-year lag.
- Adjusted EBITDA margins of approximately 53% over AMP7, lower at the start of the period due to the pandemic fallout limiting the delivery of cost efficiencies, and revenue under-collection.
- No outperformance on totex against an already tight regulatory allowance, as per the company's track record.
- A backloaded capital expenditure (capex) program averaging about £370 million a year over AMP7.
- A net penalties position on ODI of about £24 million at this stage, based on the company's ODIs and projections for AMP7.
- Average dividends (social tariff contributions) of £15 million per year over AMP7. These contributions are customer rebates and represent revenues foregone by the company by not applying the full price cap on charges available to it.
- Debt to regulatory capital value (RCV) to remain around 60% for AMP7.

Key metrics

DWR Cymru (Financing) UK PLC--Key Metrics*

	2020a	2021e	2022f	2023f
FFO to debt (%)	4.8	5.0-6.0	6.0-7.0	6.0-7.0
FOCF to debt (%)	(5.1)	(5)-0	(5)-0	(5)-0
Debt to EBITDA (x)	10.0	9.0-9.5	8.5-9.0	8.5-9.0

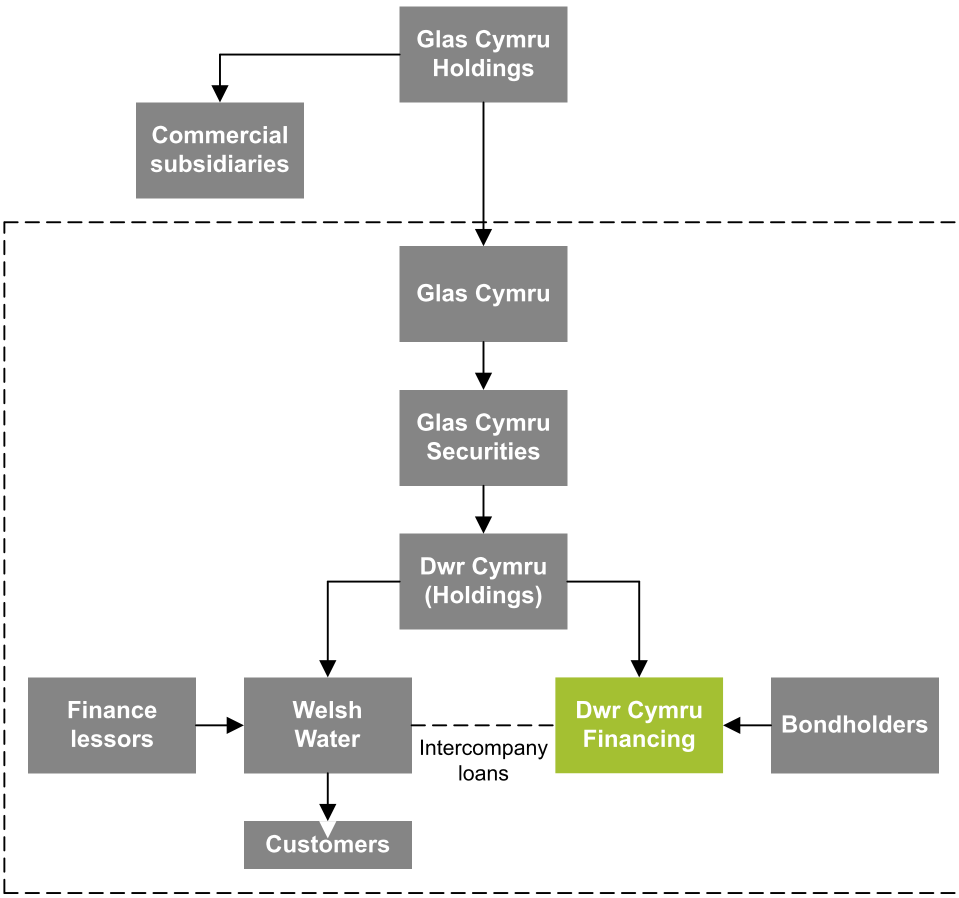
*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow.

Company Description

Welsh Water is the sixth largest of the 10 regulated water and sewerage companies in England and Wales, based on its RCV of £5.9 billion as of March 31, 2020. It supplies water and wastewater services to 3.1 million people across most of Wales and some adjoining areas of England.

Dwr Cymru (Financing) UK PLC is a financing vehicle ultimately owned by Glas Cymru Holdings Cyfyngedig (Glas Cymru), a Welsh non-profit company. Glas Cymru is controlled by members with no financial interest in the company. The financial beneficiaries of outperformance are primarily the customers through social tariffs and rebates and reinvestments of profits into the asset base and, to a lesser extent, investors, although the latter also bear some underperformance risk. This unique ownership structure distinguishes Glas Cymru from other U.K. water utilities because it eliminates pressure to pay dividends and other forms of shareholder returns.

Dwr Cymru (Financing) UK PLC Ownership Structure



Peer Comparison

Table 1

DWR Cymru (Financing) UK PLC--Peer Comparison				
Industry sector: Water				
	DWR Cymru (Financing) UK PLC	**Yorkshire Water Services Finance Ltd.**	**Anglian Water Services Financing PLC**	**Southern Water Services (Finance) Ltd.**
	--Fiscal year ended March 31, 2020--			
(Mil. £)				
Revenue	779.2	1,063.4	1,330.6	868.8

Table 1

DWR Cymru (Financing) UK PLC--Peer Comparison (cont.)

Industry sector: Water

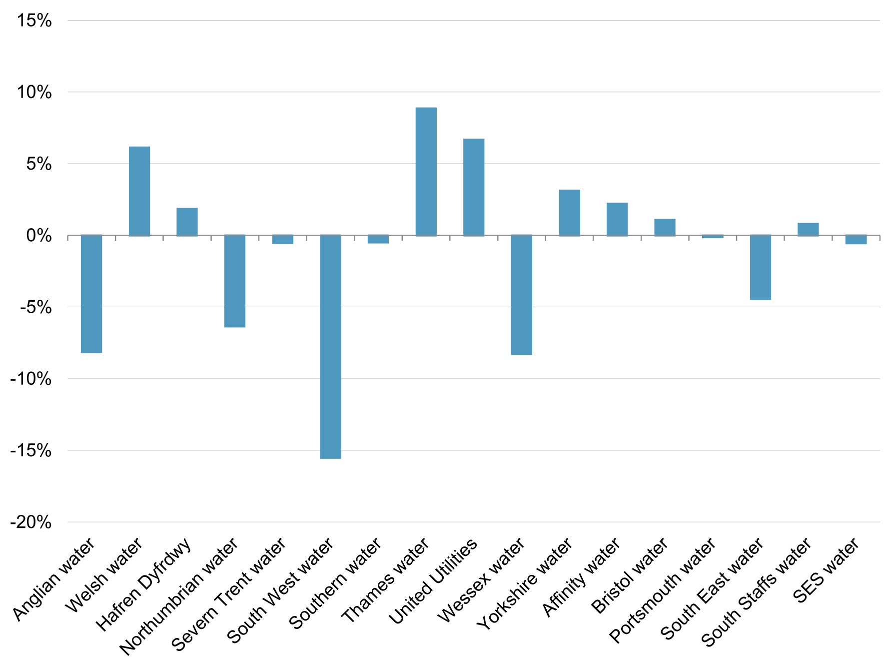
	DWR Cymru (Financing) UK PLC	Yorkshire Water Services Finance Ltd.	Anglian Water Services Financing PLC	Southern Water Services (Finance) Ltd.
EBITDA	353.4	537.8	676.0	468.4
Funds from operations (FFO)	169.2	303.6	289.8	311.4
Interest expense	173.1	190.3	346.2	187.1
Cash interest paid	143.9	190.4	250.4	118.9
Cash flow from operations	205.0	397.1	347.9	382.3
Capital expenditure	383.1	469.1	382.5	480.2
Free operating cash flow (FOCF)	(178.1)	(72.0)	(34.6)	(97.9)
Dividends paid	0.0	110.0	67.8	9.0
Discretionary cash flow (DCF)	(178.1)	(182.0)	(102.4)	(106.9)
Cash and short-term investments	667.4	262.4	1,048.1	129.3
Debt	3,518.5	5,497.1	6,419.3	3,483.9
Equity	1,144.0	692.2	1,581.2	1,323.3
Adjusted ratios				
EBITDA margin (%)	45.4	50.6	50.8	53.9
Return on capital (%)	0.8	4.3	3.9	5.1
EBITDA interest coverage (x)	2.0	2.8	2.0	2.5
FFO cash interest coverage (x)	2.2	2.6	2.2	3.6
Debt/EBITDA (x)	10.0	10.2	9.5	7.4
FFO/debt (%)	4.8	5.5	4.5	8.9
Cash flow from operations/debt (%)	5.8	7.2	5.4	11.0
FOCF/debt (%)	(5.1)	(1.3)	(0.5)	(2.8)
DCF/debt (%)	(5.1)	(3.3)	(1.6)	(3.1)

Our ratings on Welsh Water are at the higher end of peers we rate, considering the significant deleveraging the group implemented over the past 20 years (net debt to RCV was at 93% in 2001), its lowest gearing level in the industry and its non-for-profit status resulting in the absence of pressure from shareholders for dividend distributions.

The group's operating performance is average to low compared with the rest of the sector. Welsh Water is notably among the bottom three companies whose cumulative wholesale totex (based on operating and capital expenditures) was higher than its regulatory allowance during AMP6 (this includes discretionary capex in lieu of shareholder distributions amounting to £186 million), while it incurred a modest penalty (£3.14 million) on its outcome delivery incentives. This is nonetheless weaker than the industry average of a £2.7 million net rewards position. The group's overall assessment of efficiency and effectiveness of service delivery is considered average (middle 50%) by the regulator.

Chart 2

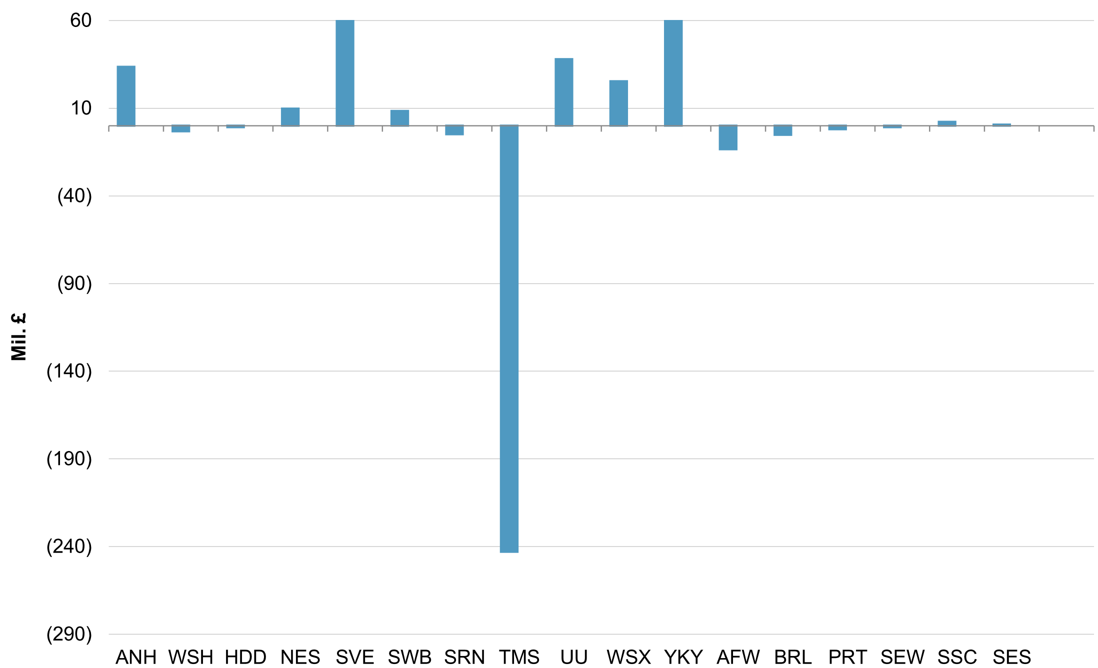
Totex Performance Over AMP6
Actual spending against regulatory allowance



Source: Ofwat. Note: Negative numbers represent outperformance, positive figures represent underperformance.

Chart 3

Accumulated ODI Reward/Penalties Over AMP6



ODI--Outcome delivery incentives. Source: Ofwat, respective annual reports.

Table 2

Overall Assessment Of Efficiency And Effectiveness Of Service Delivery

	Total expenditure		Outcomes								
	Wholesale	Residential retail	Customer service	Meeting performance commitments	Earning financial incentives	Leakage	PCC	Supply interruptions	Water quality contacts	Internal sewer flooding	Pollution incidents
Better performance											
Northumbrian Water	-	-		▲	-	-	-	▲	▲	-	-
Wessex Water	-	-		-	▲	-	-	▼	▼	-	-
Bristol Water	-	-		▲	▲▲	▲	-	▲	▲	-	-
South Staffs Water	▲	-		▲	▲	-	-	-	-	-	-
Average performance											
Anglian Water	-	-		▼	▼▼	-	-	▼	-	-	-
Dŵr Cymru	-	-		-	-	-	-	-	-	▲	▲
Severn Trent Water	-	-		-	-	▼	-	-	-	-	-
South West Water	-	-		-	▼	-	-	-	-	▼	-
United Utilities	-	-		▼	▼	-	-	-	-	-	▼
Yorkshire Water	-	-		▲	-	▲	-	-	-	-	▲
Portsmouth Water	-	-		-	-	-	-	-	-	-	-
South East Water	▲	-		-	-	▼	-	-	-	-	-
SES Water	-	-		▲	-	-	-	▲▲	-	-	-
Poorer performance											
Hafren Dyfrdwy	-	-		-	-	-	-	-	-	-	-
Thames Water	-	-		-	-	-	-	-	-	-	-
Southern Water	▼	-		▼	-	-	-	▼	-	▲	-
Affinity Water	▼	-		▼	-	-	-	▼	-	-	-

Top 25%
Middle 50%
Bottom 25%

▲▲ Improved by 2 quartiles
▲ Improved 1 quartile
- No quartile change
▼ Deteriorated 1 quartile
▼▼ Deteriorated 2 quartiles

Source: Ofwat.

Business Risk

Strong regulatory framework. Our assessment of Welsh Water's business risk profile as excellent reflects the stable and predictable revenue and cash flow streams from the low-risk regulated water and wastewater businesses, Welsh Water's natural monopoly in its service area, and a generally supportive and transparent regulatory framework. (see "Why We See The Regulatory Framework For U.K. Utilities As Supportive," published Sept. 26. 2017).

AMP7 will be challenging operationally due to its greater focus on performance commitment and environmental impact. We believe that the regulatory period that started in April 2020 will be challenging, with more focus on performance, particularly customer-related and environmental performance commitments. Based on the final determination, Welsh Water will be subject to an ODI range of -1.03%-0.61%, with a 9% real reduction in average bills.

Under its FD, Welsh Water faces challenging performance commitments. These include--among others--at least a 15% leakage reduction from the level of the last regulatory period, a 58% reduction in water supply interruptions by 2024-2025 to five minutes, and a reduction in internal and external sewer flooding incidents by 2024-2025 (33% and 25% reduction per 10,000 connections, respectively). Welsh Water's operating performance against its regulatory targets is currently average to low, based on its net penalty position incurred in the previous regulatory period (AMP6).

We expect the company to improve some of its performance indicators, especially on customer services; Welsh Water topped the industry based on the new measurement of customer and developer experience (C-Mex and D-Mex respectively) for AMP7 over 2019/2020 (shadow year, with no incentives/penalties applied to companies). However, we believe this may not offset the pressure on other performance commitments over AMP7 and consider that the company will likely end up in a net penalty position during AMP7, projected at £24 million to date.

Sub-par profitability continues to weigh on the ratings. Aside from what we consider as tough operating conditions for the current regulatory period, our credit metrics illustrate Welsh Water's below-average profitability compared with the rest of the sector. This is illustrated by the relative underperformance of its retail activities, which have historically posted sub-par profitability. This is notably because Welsh Water operates in less densely populated and more rural areas than most of its peers, putting a strain on its cost to serve. It also has about 130,000 vulnerable customers on reduced tariffs, far more than any of its peers.

Financial Risk

Credit metrics are expected to be resilient over AMP7 at the current ratings level. Our ratings on Dwr Cymru (Financing)'s debt remain constrained by Welsh Water's relatively weak credit metrics. Although slightly recovering from the very low levels achieved by the end of the previous regulatory period on the back of a heavily frontloaded capex program, we project our FFO-to-debt metrics to be commensurate with the current rating level. As such, we expect adjusted FFO to debt and debt to EBITDA to be above 6% and below 9x respectively on a consolidated basis on average over AMP7.

High capital intensity limits the prospects for debt reduction. In line with the rest of the sector, Welsh Water has relatively high capital intensity (relative to its operating cash flows) due to large capex programs (£1.9 billion in AMP6, £1.8 billion-£1.9 billion over AMP7), which limits the prospects for debt reduction over the current regulatory period.

Large capex programs also carry execution risks in our view. Welsh Water's totex was 6% higher than its regulatory allowance over AMP6, mainly driven by excess capex. While this was part of the group's strategy to reinvest its income in the business to benefit customers instead of paying dividends to shareholders, this still counts as an overspend for the regulator. Over AMP7, we expect the pressure to remain, with an allowed totex approximately 6% lower than what the company requested in its business plan submission. This mainly relates to enhancement expenditures, although base and maintenance expenditures receive more funding than requested.

Low gearing and unique ownership structure support the group's overall credit quality. We believe that Welsh Water's lower existing net debt to RCV (60%) compared with the rest of the sector is positive for its credit quality. We project reported debt to remain around 60% of the company's RCV during this period. This is partly because Welsh Water historically had a longer RCV run-off rate than peers, which kept customers' bills down and insured a long-term build-up of the RCV, hence limiting the upward pressure on its debt ratio. In addition, our ratings take into account the unique ownership structure of the group--being ultimately owned by Glas Cymru, a Welsh non-profit company--which eliminates the pressure for shareholder distributions and increased leverage.

Despite cheaper funding costs, high cost of embedded debt continues to constrain financial resilience. Welsh Water has a relatively high cost of embedded debt, mainly due to relatively long-dated high-rate fixed debt issuances and the larger proportion of RPI-linked financing in its capital structure,with about 70% of total reported debt either swapped to RPI or RPI-linked as of March 2020. This includes the completion of £850 million swap notionals swapping fixed rate coupons on its A1, B8, and C3 bonds to RPI index-linked in 2020. We note that this proportion is above what the regulator had assumed for the sector in designing AMP7 (33% of embedded debt expected to be index linked, and no new debt RPI linked). This has historically resulted in large (non-cash) interest costs on the back of rising inflation rates. We project that Welsh Water will be able to take advantage of the current low interest rates and reduce its cost of debt, as highlighted by its 2020 bond issuances to refinance its expensive debt maturing in 2021. However, we continue to believe that indexation accruals, which we incorporate into our FFO calculations, will remain sizable and limit any material reductions in the company's cost of debt. In addition, remaining portions of expensive debt are maturing after the end of AMP7 and this is therefore unlikely to significantly bolster its credit metrics, in our opinion.

Financial summary

Table 3

DWR Cymru (Financing) UK PLC--Financial Summary

Industry sector: Water					
	--Fiscal year ended March 31--				
	2020	**2019**	**2018**	**2017**	**2016**
(Mil. £)					
Revenue	779.2	781.6	756.7	743.6	743.2
EBITDA	353.4	361.7	352.1	361.7	408.4
Funds from operations (FFO)	169.2	183.9	164.3	213.4	266.2
Interest expense	173.1	184.6	187.2	153.7	132.6
Cash interest paid	143.9	132.7	132.9	124.6	128.9
Cash flow from operations	205.0	233.7	218.8	217.2	245.8
Capital expenditure	383.1	403.0	351.1	271.2	220.0
Free operating cash flow (FOCF)	(178.1)	(169.3)	(132.3)	(54)	25.8
Discretionary cash flow (DCF)	(178.1)	(169.3)	(132.3)	(54)	25.8
Cash and short-term investments	667.4	501.1	288.5	100.6	135.1
Gross available cash	667.4	501.1	288.5	100.6	135.1
Debt	3,518.5	3,340.6	3,147.0	2,954.2	2,852.8
Equity	1,144.0	1,233.6	1,244.3	1,115.9	1,081.8
Adjusted ratios					
EBITDA margin (%)	45.4	46.3	46.5	48.6	55.0
Return on capital (%)	0.8	1.6	1.9	2.7	4.9
EBITDA interest coverage (x)	2.0	2.0	1.9	2.4	3.1
FFO cash interest coverage (x)	2.2	2.4	2.2	2.7	3.1
Debt/EBITDA (x)	10.0	9.2	8.9	8.2	7.0
FFO/debt (%)	4.8	5.5	5.2	7.2	9.3
Cash flow from operations/debt (%)	5.8	7.0	7.0	7.4	8.6
FOCF/debt (%)	(5.1)	(5.1)	(4.2)	(1.8)	0.9

Table 3

DWR Cymru (Financing) UK PLC--Financial Summary (cont.)

Industry sector: Water

	--Fiscal year ended March 31--				
	2020	**2019**	**2018**	**2017**	**2016**
DCF/debt (%)	(5.1)	(5.1)	(4.2)	(1.8)	0.9

Reconciliation

Table 4

DWR Cymru (Financing) UK PLC--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. £)

	--Fiscal year ended March 31, 2020--				
DWR Cymru (Financing) UK PLC reported amounts					
	Debt	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
Reported	3,694.8	30.1	156.5	353.4	206.1
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	2.1	--
Cash interest paid	--	--	--	(143.9)	--
Reported lease liabilities	424.1	--	--	--	--
Postretirement benefit obligations/deferred compensation	67.0	--	2.2	--	--
Accessible cash and liquid investments	(667.4)	--	--	--	--
Capitalized interest	--	--	14.4	--	--
Nonoperating income (expense)	--	6.2	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	(1.1)
Indexation	--	--	--	(42.4)	--
Total adjustments	(176.3)	6.2	16.6	(184.2)	(1.1)
S&P Global Ratings' adjusted amounts					
	Debt	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	3,518.5	36.3	173.1	169.2	205.0

Liquidity

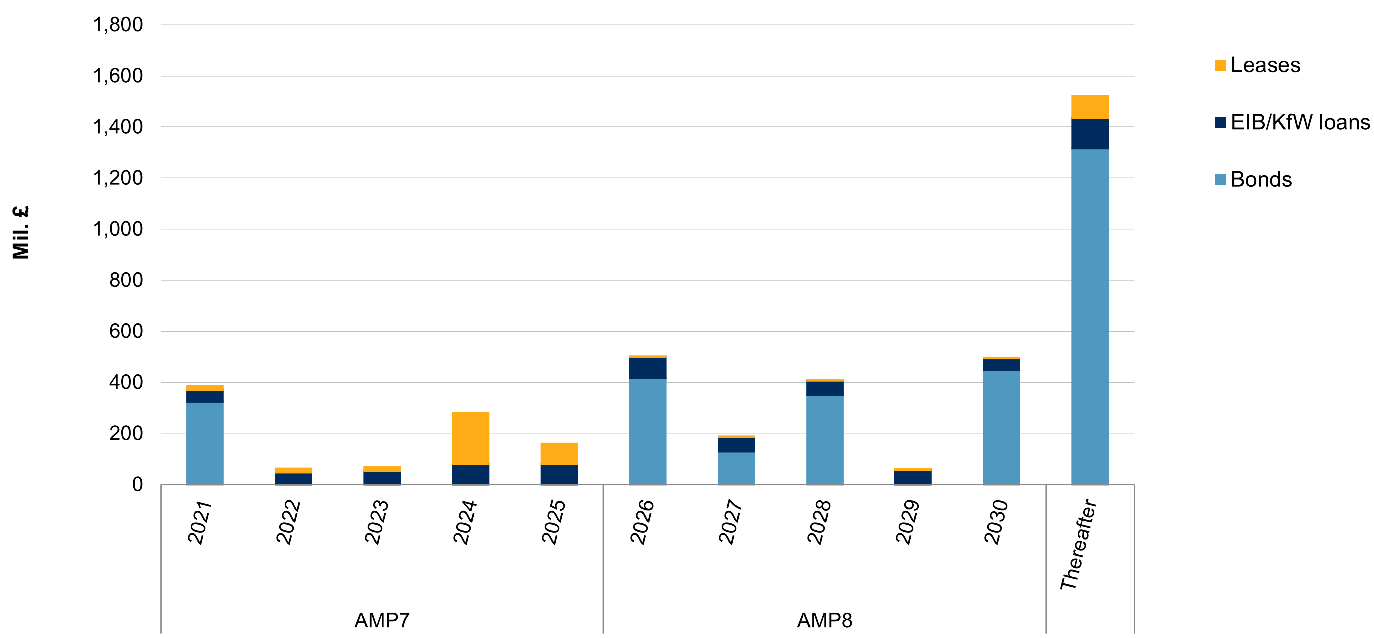
We assess Welsh Water's liquidity position as adequate, supported by our view that the company's liquidity sources will exceed its funding needs by approximately 1.4x in the next 12 months. Our liquidity assessment is further underpinned by Welsh Water's high standing in the capital markets and its good relationship with banks. Its liquidity sources over uses stays positive even if EBITDA were to decline by 10%. Even if EBITDA declined by 15%, covenants would not be breached.

Principal liquidity sources	Principal liquidity uses
Principal liquidity sources in the 12 months from Dec. 31, 2020: • A cash balance of about £569 million; • FFO of about £250 million; and • Access to £200 million of undrawn credit facilities.	Principal liquidity uses in the next 12 months from Dec. 31, 2020: • Upcoming short-term debt maturities of approximately £393 million; and • Expected capex of approximately £340 million.

Debt maturities

Chart 4

Debt Repayment Schedule*



*Year ending March 31. Source: Welsh Water's annual report.

Covenant Analysis

Welsh Water had an internal target to maintain debt below 60% to RCV, reflecting significant headroom to its covenant structure, which sets the default level at 95% and trigger level at 85%. Other default covenants include keeping senior interest coverage pre capital maintenance above 1.6x. The group had comfortable headroom under both its leverage ratio and cash flow coverage ratios as of March 31, 2020 with gearing of 60% and interest coverage of 3.5x.

Environmental, Social, And Governance

As one of the U.K.'s main water and wastewater companies, Welsh Water provides a key service with a significant social impact. This could expose the operator to additional scrutiny from the regulator or Welsh government, to ensure not only high quality and reliability of its network and services, but also affordability for customers. However, we consider the unique structure and governance of the group as limiting these risks and positively contributing to our social and governance factors assessment. This is because Welsh Water is owned by its customers, via its ultimate parent Glas Cymru, a Welsh non-profit company. As a result, we judge its financial policy as significantly more flexible than its peers, in not being influenced by shareholder considerations, which led to significant deleveraging over the past 20 years. Income generated, when not used to reduce the group's gearing, may be returned to customers by way of investments to the existing asset base or through tariff rebates, ultimately resulting in lower customer bills. In addition, Welsh Water has about 130,000 vulnerable customers on reduced tariffs, far more than any of its peers.

In response to ongoing political pressure and negative press coverage, Welsh Water has undertaken a restructuring to close its Cayman Islands incorporated financing subsidiary Dwr Cymru (Financing) Ltd. in 2019, and replace it by the U.K.-based Dwr Cymru (Financing) UK PLC. While we view the transaction as neutral to the company's overall credit quality, with all outstanding obligations transferred from one financing vehicle to the other and without affecting the rights of creditors, we expect it to reduce the complexity of the capital structure in the group and enhance its transparency.

Issue Ratings - Subordination Risk Analysis

Structural features

We rate the debt issued by Welsh Water's financing vehicle, Dwr Cymru (Financing) UK PLC, using our criteria "Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses," published on Feb. 24, 2016. Dwr Cymru (Financing) operates under financial and nonfinancial covenants that support the group's overall credit quality. The ratings on the debt also reflect various structural features (see tables 4 and 5). These are designed to increase cash flow certainty for debtholders, including restricted payment conditions and a covenanted liquidity structure that should, in our opinion, enable Dwr Cymru to manage temporary cash flow shocks.

In particular, debtholders benefit from:

- Ring-fencing of the financing entity, which is achieved through Dwr Cymru (Financing)'s special-purpose status;
- Significant independent representation on the Dwr Cymru board (six of the nine members); and some business, legal, and regulatory restrictions.
- Three levels of financial covenants (a restricted payment condition, trigger events, and events of default) and an

automatic 18-month standstill period after an event of default. These provide creditors with significant control over Dwr Cymru at an early stage of financial or operational difficulty, or following material changes in business circumstances. The covenants minimize the probability of default and create an additional credit cushion.

- Liquidity facilities of £135 million available to cover a standstill, provided by suitably rated counterparties. These facilities are sufficient to cover finance charges, and are dedicated to drawings if the company enters a standstill. The facilities remain undrawn and the amounts available are unchanged.
- A strong covenant package, including limitations on additional debt, a defined cash waterfall of payments giving senior debt priority, a minimum level of financial performance, and restrictions on distributions.
- Subordination of the class C debt, the nonpayment of which cannot create an event of default for the class A debt.

Dwr issues three types of debt: class A (guaranteed by Assured Guaranty (London) PLC), class B (senior secured--ranking at the same level as class A) and class C (junior and subordinated to class A and B).

- We equalize our rating on class A debt with that on its guarantor, Assured Guaranty (Europe) PLC, rated AA/Stable;
- Class B debt is rated 'A-' based on credit metrics excluding the subordinated debt, and including one notch of uplift for various structural features, in particular the additional protection from the deferral of the subordinated debt interest and principal if the financing group had insufficient cash to make the payments due.
- Class C debt is rated 'BBB' based on credit metrics including senior and subordinated debt.

Table 5

Dwr Cymru bonds

	Rating	As of March 31, 2020 (Mil. £)	Interest rate (%)	Maturity
Class A bonds	AA/Stable			
A1 (swapped to RPI)		351.1	6.015/2.196	2028
A4 (RPI-linked)		446.8	3.514	2030
A5 (LPI-linked)		145.3	3.512	2031
A6 (swapped to RPI)		148.5	4.473/1.35	2057
Class B bonds	A-/Stable			
B1		325	6.907	2021
B3 (RPI-linked)		216.8	4.377	2026
B4 (LPI-linked)		128.3	4.375	2027
B5 (RPI-linked)		74.2	1.375	2057
B6 (RPI-linked)		346.8	1.859	2048
B7		300	2.5	2036
B8 (swapped to RPI)		300.9	1.375/-1.691	2033
Class C bonds	BBB/Stable			
C3 (swapped to RPI)		200.6	1.625/-1.585	2026

Table 6

Dwr Cymru (Financing) UK PLC--Transaction Key Features	
Collateral	Dwr Cymru (Financing) UK Plc's debt is secured by first fixed and floating charges on assets to the extent premitted by the Water Industry Act 1991 and Welsh Water's Instrument of Appointment. Security includes Welsh Water's accounts receivable, contracts, bank accounts, and all assets except protected land. In addition, the other entities in the Glas Cymru structure --Glas Cymru, Dwr Cymru (Holdings) Ltd., and Glas Cymru (Securities) --guarantee Welsh Water's obligations.
Country of origination	U.K.
Financial covenants	Senior and Class C RAR: 95% (actual performance as of March 31, 2020: 60%)
Trigger events	Interest cover pre capital maintenance, trigger 2.0x, default 1.6x (actual performance as of March 31, 2020: 3.5x)
Restricted distribution conditions	Interest cover post capital maintenance, trigger 1.0x
Liquidity facility size (Mil. £)	135
Revolving credit facility (Bil. £)	170

ICR--Interest cover ratio. RAR--Regulated asset ratio.

Ratings Score Snapshot

Senior secured (class B) debt

Issue Rating: A-/Stable/--

Business risk: Excellent

- Country risk: Low
- Industry risk: Very Low
- Competitive position: Excellent

Financial risk: Aggressive

• Cash flow/Leverage: Aggressive

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

Various structural enhancements (+1 notch)

Senior secured (class C) debt

Issue Rating: BBB

Business risk: Excellent

- Country risk: Low
- Industry risk: Very Low
- Competitive position: Excellent

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

Risk of interest deferral a structural subordination (-1 notch)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Utilities: Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses, Feb. 24, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.K. Utilities Confront Regulatory Challenges, Brexit, And COVID-19 Fallout In 2021, Dec. 14, 2020
- Industry Top Trends 2021: EMEA Utilities, Dec. 10, 2020
- U.K. Water Utilities: Was Appealing Ofwat's Determination Worth It?, Oct. 1, 2020
- Why We See The Regulatory Frameworks For U.K. Utilities As Supportive, Sept. 26, 2017

Ratings Detail (As Of March 5, 2021)*	
DWR Cymru (Financing) UK PLC	
Senior Secured	A-
Senior Secured	A-/Stable
Senior Secured	AA/Stable
Subordinated	BBB
Subordinated	BBB/Stable

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings’ credit ratings on the global scale are comparable across countries. S&P Global Ratings’ credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.