FitchRatings

Corporates
Water/Wastewater Utility
United Kingdom

Dwr Cymru (Financing) UK Plc

Ratings

Debt Ratings

Senior Secured Debt - Long-Term Rating	A
Subordinated Long-Term Rating	BBB+

Click here for the full list of ratings

Fitch Rating's affirmation of Dwr Cymru (Financing) UK Plc's (Dwr) debt ratings reflects its expectation that the financial profile of operating company and guarantor Dwr Cymru Cyfyngedig's (Welsh Water) will remain commensurate with the ratings for the five-year price control ending March 2025 (AMP7).

We expect Dwr to maintain comfortable gearing headroom against our negative rating sensitivities across class A, B and C debt. This headroom should also absorb weak average cash and nominal post-maintenance interest coverage ratios (PMICRs) for AMP7.

The ratings also consider the operational and regulatory performance of Welsh Water, its target gearing of 60%, and the secured nature of the group's financing structure. The latter benefits from structural enhancements, including trigger mechanisms (gearing and interest coverage covenants) and debt service reserve liquidity.

Key Rating Drivers

Inflation-Linked Debt Offsets Inflation Benefit: Dwr has about 80% of its total debt inflation-linked (IL), higher than the Fitch-rated UK water sector average of about 60%. While IL debt provides a hedge against regulated capital value (RCV) that grows with inflation over time, we expect the higher accretion to the IL debt from inflation to contribute to weak nominal PMICRs, reflecting the rising total cost of debt. Dwr's rating sensitivities for gearing were previously tightened in recognition of the extended weakness in PMICRs.

Inflation Mismatch: We expect higher inflation will boost shadow RCV, which is 50% indexed to the consumer price index (CPIH) and 50% to the retail price index (RPI). Additions to RCV for AMP7 are indexed entirely to CPIH. However, all of Dwr's IL debt is indexed to RPI, which creates an inflation benchmark mismatch.

Comfortable Gearing Headroom: We forecast net debt/RCV for the class A and B notes at 53.3% and the class C notes at 65.4% by the financial year ending March 2025 (FY25) against our negative rating sensitivities of 65% and 74%, respectively.

Depleted PMICR Headroom: We expect depleted PMICR headroom for class A and B debt, with forecast average cash PMICR of about 1.2x and nominal PMICRs of about 1.7x for AMP7, against our negative rating sensitivities of 1.5x and 1.7x, respectively. We forecast an average cash PMICR of about 1.2x and nominal PMICR of about 1.5x for class C debt, which is commensurate with negative rating sensitivities of 1.2x and 1.5x, respectively, although with no headroom.

Totex Under-Performance Expected: We expect Welsh Water to underperform its total expenditure (totex) allowance by 12.9% across AMP7 with operating expenditure (opex) and capex underperformance of 12.2% and 13.8% respectively. Welsh Water is investing about GBP100 million in combined storm overflows to improve environmental outcomes and reduce penalties. These investments, which are within our expectations, are aimed at improving performance in water supply interruptions, water quality (multi-stakeholder initiatives to reduce phosphate), and wastewater asset health.

Energy Mostly Hedged for AMP7: We assume the impact from higher-than-expected energy prices to be neutral on opex for AMP7, supported by the group's self-sufficiency in 24% of its power requirements, with the rest about 85% hedged for FY24-FY25. The rolling hedge position will contribute to overall higher energy costs but is likely to be offset by regulatory cost-sharing and higher allowances through IL totex.

Applicable Criteria

Corporates Recovery Ratings and Instrument Ratings Criteria (April 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (May 2023)

Corporate Rating Criteria (October 2022)

Related Research

Global Corporates Macro and Sector Forecasts (March 2023)

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Net ODI Penalties Assumed: We forecast GBP50 million-55 million of net cash outcome delivery incentives (ODIs) penalties (nominal) related to operational performance in AMP7. In the first two years of AMP7, Welsh Water incurred penalties mainly in water supply interruptions and water quality. Despite its sector-leading performance for internal sewer flooding in 2022, Welsh Water lagged other regulated UK water companies in Ofwat's (the UK water service regulation authority) overall performance category.

Our updated forecasts consider higher net ODI penalties related to incorrect regulatory reporting for leakage and per capita consumption (PCC) for 2020 and 2021. Welsh Water reported its finding in May 2023 following an internal review of its leakage and PCC. In addition, Fitch adjusted Welsh Water's revenue allowance down by GBP15 million in FY23 to reflect customer rebate following this reporting error.

Financial Summary

(GBPm)	2021	2022	2023F	2024F
Gross revenue	778	807	863	904
Total cash PMICR (x)	1.7	1.4	0.9	1.1
Senior cash PMICR (x)	1.7	1.5	0.8	1.0
Total nominal PMICR (x)	1.8	1.5	1.4	1.6
Senior nominal PMICR (x)	1.8	1.8	1.7	1.7
Total pension adjusted net debt/shadow RCV (%)	60.1	58.5	62.7	64.1
Senior pension adjusted net debt/shadow RCV (%)	57.6	50.1	50.0	51.8

F = Forecast
Source: Fitch Ratings, Fitch Solutions

Rating Derivation Relative to Peers

Welsh Water could make discretionary customer distributions, reducing post-maintenance cash flows, or reinvest its free cash flow (FCF) into the business for the benefit of customers, making it unique among its peers. This is mitigated by the lack of need to pay dividends and by its long-standing conservative gearing policy of 60%, which is among the lowest in the sector.

Dwr's senior secured (class A and class B) and subordinated (class C) ratings of 'A'/Stable and 'BBB+'/Stable, respectively, reflect the company's more conservative gearing profile and its secured covenanted structure compared with the standard corporate structure of its peer United Utilities Water Limited (BBB+/Stable; senior unsecured debt: 'A-').

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- For class A and B debt: forecast gearing comfortably and consistently below 57%, cash PMICR above 1.7x and nominal PMICR above 1.9x
- For class C debt: forecast gearing comfortably and consistently below 59%, cash PMICR above 1.4x and nominal PMICR above 1.6x

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- A marked deterioration in operating and regulatory performance or adverse changes to the regulatory framework
- For class A and B debt: forecast gearing approaching 65%, cash PMICR below 1.5x and nominal PMICR below 1.7x
- For class C debt: forecast gearing approaching 74%, cash PMICR below 1.2x and nominal below 1.5x
- Insufficient forecast gearing headroom to compensate for weak cash and nominal PMICRs

Liquidity and Debt Structure

Strong Liquidity: As at 30 September 2022, Welsh Water had cash and cash equivalents of GBP511 million and access to GBP200 million of undrawn revolving credit facilities (RCFs). Fitch expects negative FCF of around GBP186 million for FY23 with no bond maturities within AMP7.

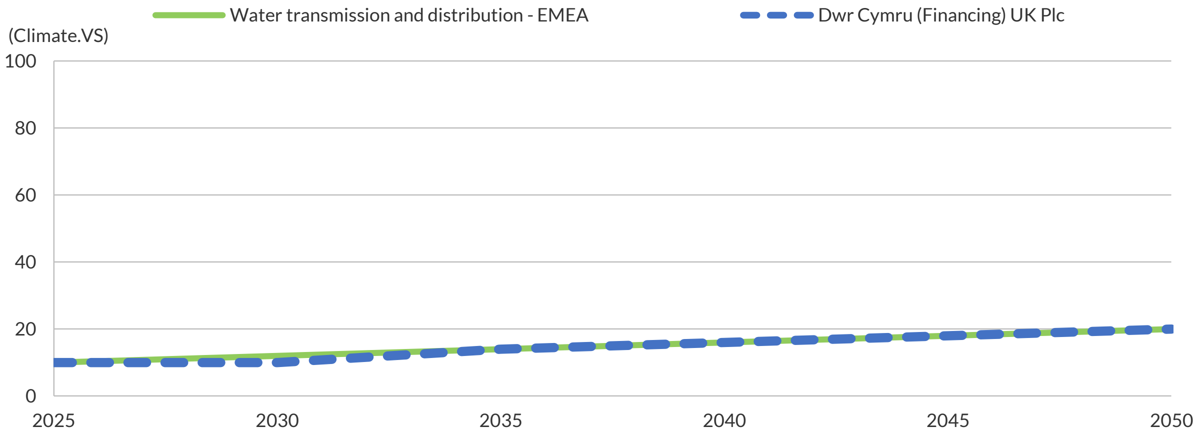
Climate Vulnerability Considerations

We are currently in consultation with our stakeholders on a proposal to support consistency and transparency in the way Fitch Ratings identifies and addresses potentially credit-relevant climate risks in its credit rating process. This would include adding the section below to all Rating Reports. To learn more about the approach, and provide feedback, please see 'Climate Vulnerability in Corporate Ratings – Discussion Paper' or contact climate.vsfeedback@fitchratings.com.

The FY22 revenue-weighted Climate Vulnerability Score (Climate.VS) for Dwr for 2035 is 14 out of 100, suggesting low exposure to climate-related risks in that year. This score is in line with the sector average for water/ wastewater utilities. For further information on how Fitch perceives climate-related risks in the utilities sector, see Utilities – Long-Term Climate Vulnerability Scores Update.

Climate.VS Evolution

As of Dec. 31, 2022



Source: Fitch Ratings

Liquidity and Debt Maturities

Liquidity Analysis

(GBPm)	2023F	2024F	2025F
Available liquidity			
Beginning cash balance	504	262	63
Rating-case FCF after acquisitions and divestitures	-186	-112	-84
Total available liquidity (A)	**318**	**150**	**-22**
Liquidity uses			
Debt maturities	-56	-88	-90
Total liquidity uses (B)	**-56**	**-88**	**-90**
Liquidity calculation			
Ending cash balance (A+B)	262	63	-112
Revolver availability	200	200	0
Ending liquidity	**462.0**	**262.5**	**-111.5**
Liquidity score (x)	9.3	4.0	-0.2

F – Forecast.
Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig

Scheduled debt maturities (GBPm)	Original 31 Mar 2022
2023	56
2024	88
2025	90
Thereafter	3,550
Total	**3,783**

Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig

Key Assumptions

- Allowed weighted average cost of capital in AMP7 of 1.92% (RPI-based) and 2.92% (CPIH-based)
- RCV is 50% RPI-linked and 50% CPIH-linked plus capital additions since FY21
- RPI of 10.8% for FY23, 8% for FY24 and 3.9% for FY25
- CPIH of 8.5% in FY23, 6% in FY24 and 2.8% in FY25
- Allowed totex of around GBP3.1 billion in nominal terms (net of grants and contributions) over AMP7
- Average pay-as-you go rate of 56% and average run-off rate of 4.77% for AMP7
- Totex underperformance of 12.9% over AMP7
- Cash ODI-related penalties of GBP50 million-55 million over FY23-FY25

Financial Data

Dwr Cymru Cyfyngedig

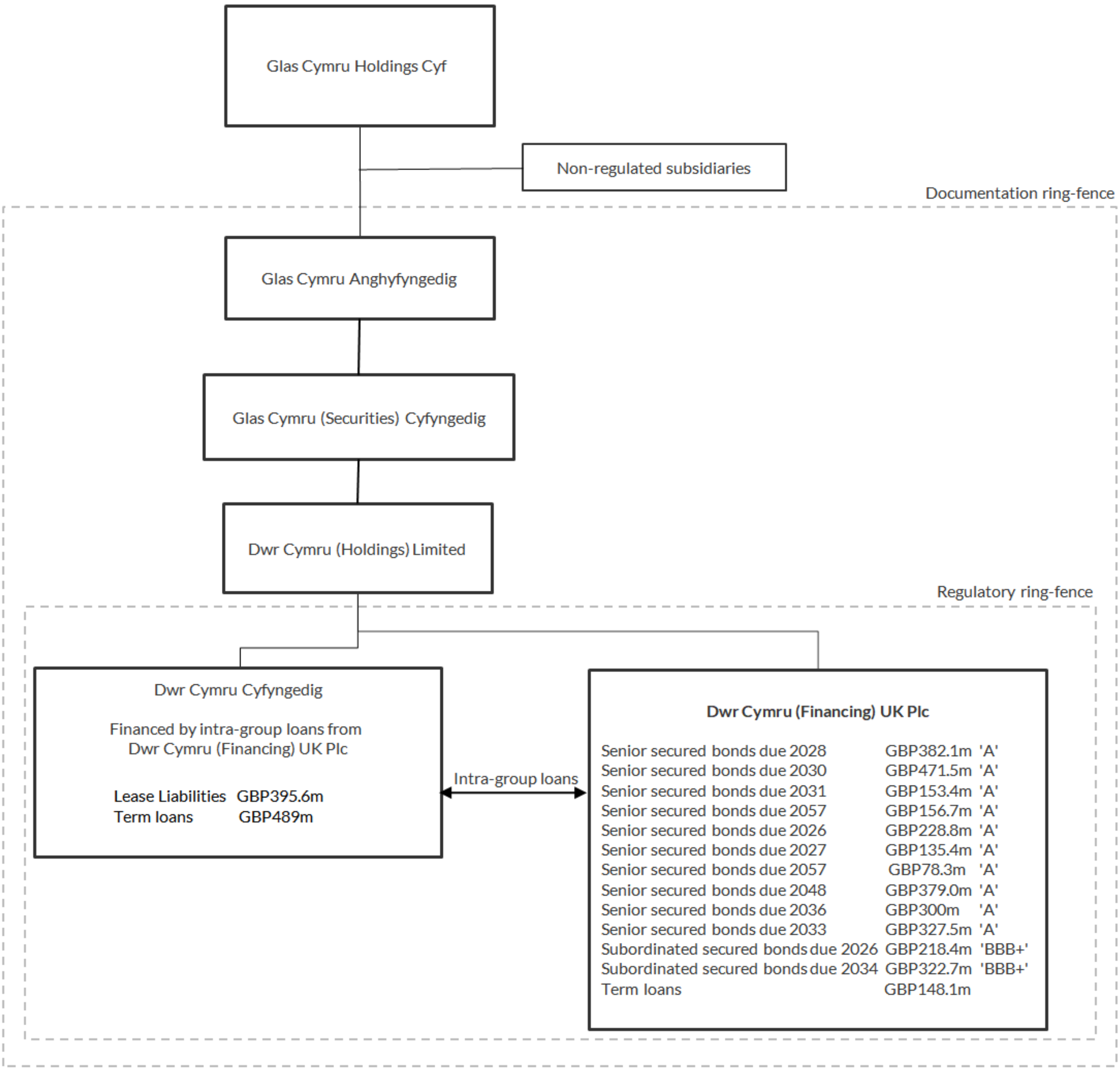
	Historical			Forecast		
(GBPm)	2020	2021	2022	2023	2024	2025
Summary income statement						
Gross revenue	779.2	778.3	807.0	863.0	904.0	910.2
Revenue growth (%)	-0.1	0.1	4.0	6.9	4.8	0.7
EBITDA before income from associates	389.8	374.9	466.3	397.3	448.3	454.0
EBITDA margin (%)	50.0	48.2	57.8	46.0	49.6	49.9
Gross interest expense	-146.9	-126.1	-296.5	-121.4	-126.5	-128.8
Summary balance sheet						
Net debt	3,466.0	3,570.0	3,776.4	4,364.0	4,772.5	5,014.1
Shadow RCV	5,906.0	6,010.0	6,460.0	6,961.4	7,442.4	7,664.8
Summary cash flow statement						
EBITDA	389.8	374.9	466.3	397.3	448.3	454.0
Cash interest paid	-119.3	-108.0	-117.5	-121.4	-126.5	-128.8
Cash tax	2.1	2.5	2.3	0.0	0.0	0.0
Dividends received less dividends paid to minorities (inflow/outflow)	—	—	—	0.0	0.0	0.0
Other items before FFO	-4.2	-3.1	-3.4	0.0	0.0	0.0
Funds flow from operations	274.5	271.4	351.8	275.9	321.8	325.1
FFO margin (%)	35.2	34.9	43.6	32.0	35.6	35.7
Change in working capital	-1.4	7.4	27.1	-5.0	-3.0	-1.0
Cash flow from operations (Fitch-defined)	273.1	278.8	378.9	270.9	318.8	324.1
Total non-operating/nonrecurring cash flow	—	-33.5	—	—	—	—
Capex	-455.0	-304.2	-336.2	—	—	—
Capital intensity (capex/revenue) (%)	58.4	39.1	41.7	—	—	—
Common dividends	—	—	—	—	—	—
Free cash flow	-181.9	-58.9	42.7	—	—	—
Net acquisitions and divestitures	0.6	0.2	0.8	—	—	—
Other investing and financing cash flow items	0.2	—	20.2	—	—	—
Net debt proceeds	312.0	-387.8	231.2	792.0	64.0	67.0
Net equity proceeds	—	—	—	0.0	0.0	0.0
Total change in cash	130.9	-446.5	294.9	-232.1	-14.2	-14.9
Leverage ratios (x)						
Total pension adjusted net debt/shadow RCV (%)	59.4	60.1	58.5	62.7	64.1	65.4
Senior pension adjusted net debt/shadow RCV(%)	56.0	57.6	50.1	50.0	51.8	53.3
FFO leverage	9.4	10.1	8.3	11.7	10.5	10.5
FFO net leverage	7.7	9.5	7.2	11.0	9.9	10.0
Calculations for forecast publication						
Capex, dividends, acquisitions and other items before FCF	-454.4	-337.5	-335.4	-457.0	-431.0	-408.0
FCF after acquisitions and divestitures	-181.3	-58.7	43.5	-186.1	-112.2	-83.9
FCF margin after net acquisitions (%)	-23.3	-7.5	5.4	-21.6	-12.4	-9.2
Coverage ratios (x)						
Senior cash PMICR (x)	1.0	1.7	1.5	0.8	1.0	1.0
Senior nominal PMICR (x)	1.6	1.8	1.8	1.7	1.7	1.5
Total cash PMICR (x)	1.0	1.7	1.4	0.9	1.1	1.0
Total nominal PMICR (x)	1.6	1.8	1.5	1.4	1.6	1.4
FFO interest coverage	3.3	3.5	4.0	3.3	3.5	3.5
Additional metrics						
CFO-capex/debt (%)	-5.0	-0.7	1.1	-4.0	-2.4	-1.8
CFO-capex/net debt (%)	-6.1	-0.7	1.3	-4.3	-2.5	-1.9
CFO/capex (%)	60.0	91.7	112.7	59.3	74.0	79.4

Source: Fitch Ratings, Fitch Solutions, Dwr Cymru (Financing) UK Plc

How to Interpret the Forecast Presented

The forecast presented above is based on Fitch Ratings' internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch Ratings to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch Ratings' rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch Ratings' forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch Ratings' own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch Ratings' own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch Ratings may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch Ratings' own internal deliberations, where Fitch Ratings, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch Ratings may update the forecast in future reports but assumes no responsibility to do so. Original financial statement data for historical periods is processed by Fitch Solutions on behalf of Fitch Ratings. Key financial adjustments and all financial forecasts credited to Fitch Ratings are generated by rating agency staff.

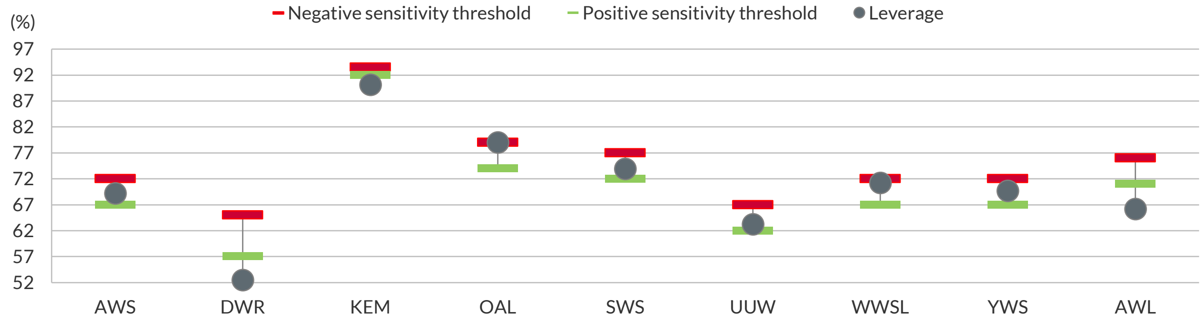
Simplified Group Structure Diagram



Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig, as of March 2022

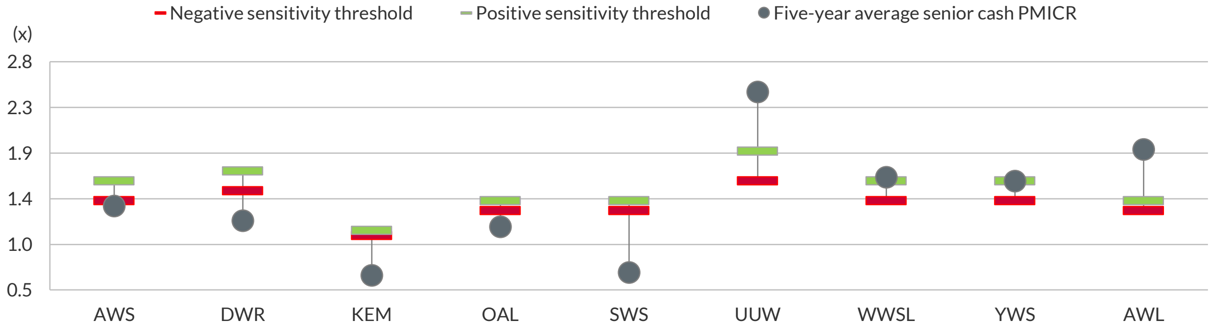
Peer Financial Summary

Rating Headroom by Gearing (FY25)



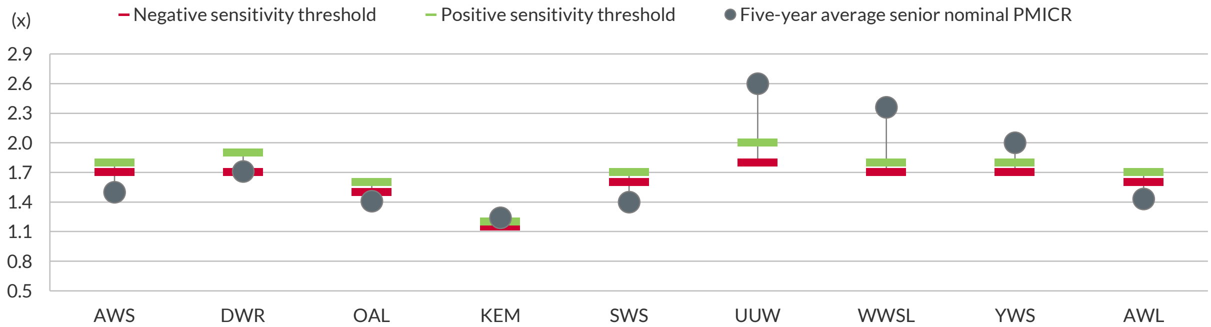
Ratios for AWS, DWR, SWS, YWS and AWL reflect senior class A debt
Source: Fitch Ratings, Fitch Solutions , companies' data

Rating Headroom by Cash PMICR (Five-Year Average)



Ratios for AWS, DWR, SWS,YWS and AWL reflect senior class A interest
Source: Fitch Ratings, Fitch Solutions, companies' data

Rating Headroom by Nominal PMICR (Five-Year Average)



Ratios for AWS, DWR,SWS, YWS and AWL reflect senior class A interest
Source: Fitch Ratings, Fitch Solutions , companies' data

Key

AWS	Anglian Water Services
DWR	Dwr-Cymru (Financing) UK Ltd
OAL	Osprey Acquisition Limited
KEM	Kemble Water Finance Limited
SWS	Southern Water Services
UUW	United Utilities Water Limited
WWSL	Wessex Water Services Limited
YWS	Yorkshire Water Services
AWL	Affinity Water Limited

Source: Fitch Ratings

Fitch Adjusted Financials

(GBPm) 31 Mar 22	Notes and formulas	Reported values	Sum of adjustments	Corp- lease treatment	Other adjustments	Adjusted values
Income statement summary						
Revenue		807				807
EBITDAR		408	140	82	58	548
EBITDAR after associates and minorities	(a)	408	140	82	58	548
Lease expense	(b)	0	82	82		82
EBITDA	(c)	408	58		58	466
EBITDA after associates and minorities	(d) = (a-b)	408	58		58	466
EBIT	(e)	81	58		58	139
Debt and cash summary						
Other off-balance-sheet debt	(f)	0				0
Debt[b]	(g)	4,229	-387	-396	9	3,842
Lease-equivalent debt	(h)	396				396
Lease-adjusted debt	(i) = (g+h)	4,625	-387	-396	9	4,238
Readily available cash and equivalents	(j)	504				504
Not readily available cash and equivalents		0				0
Cash flow summary						
EBITDA after associates and minorities	(d) = (a-b)	408	58		58	466
Preferred dividends (paid)	(k)	0				0
Interest received	(l)	4				4
Interest (paid)	(m)	-118				-118
Cash tax (paid)		2				2
Other items before FFO		-7	4		4	-3
Funds from operations (FFO)	(n)	290	62		62	352
Change in working capital (Fitch-defined)		27				27
Cash flow from operations (CFO)	(o)	317	62		62	379
Non-operating/nonrecurring cash flow		0				0
Capital (expenditures)	(p)	-274	-62		-62	-336
Common dividends (paid)		0				0
Free cash flow (FCF)		43				43
Gross leverage (x)						
EBITDAR leverage[a]	(i/a)	11.3				7.7
FFO adjusted leverage	(i/(n-m-l-k+b))	11.5				7.7
FFO leverage	(i-h)/(n-m-l-k)	10.5				8.3
EBITDA leverage[a]	(i-h)/d	10.4				8.2
(CFO-capex)/debt (%)	(o+p)/(i-h)	1.0%				1.1%
Net leverage (x)						
EBITDAR net leverage[a]	(i-j)/a	10.1				6.8
FFO adjusted net leverage	(i-j)/(n-m-l-k+b)	10.2				6.8
FFO net leverage	(i-h-j)/(n-m-l-k)	9.2				7.2
EBITDA net leverage[a]	(i-h-j)/d	9.1				7.2
(CFO-capex)/net debt (%)	(o+p)/(i-h-j)	1.1%				1.3%
Coverage (x)						
EBITDAR fixed-charge coverage[a]	a/(-m+b)	3.5				2.7
EBITDA interest coverage[a]	d/(-m)	3.5				4.0
FFO fixed-charge coverage	(n-l-m-k+b)/(-m-k+b)	3.4				2.7
FFO interest coverage	(n-l-m-k)/(-m-k)	3.4				4.0

[a] EBITDA/R after dividends to associates and minorities
[b] Includes other off-balance-sheet debt
Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig

Reconciliation of Key Financial Metrics for Dwr Cymru Cyfyngedig Senior Instruments and Class C Debt

(GBPm)	31 Mar 22
Gross interest-bearing loans and borrowings	**4,238**
+ Gross pension deficit	80.7
- Pension deficit expected to be funded by customers (nominal)	-40.4
- Deferred tax impact of pension deficit repair	0
= Total pension-adjusted debt	**4,278**
- Cash and equivalents (unrestricted)	502
= Pension-adjusted net debt (a)	**3,776**
Regulatory asset value (b)	**6,460**
Net debt/regulatory asset value (RAV) (%)	
Pension adjusted net debt/RAV (a/b) x 100	**58.**
EBITDA (reported)	**408.3**
Fitch adjustments	
+ Infrastructure renewal expenditure	61.8
- Exceptional cost	3.8
Fitch-adjusted EBITDA	**466**
- Regulatory depreciation	262
- Taxation paid	0
- Pension deficit repair	0
- PAYG adjustment	-40
Post-maintenance cash flow (PMCF) = EBITDA - regulatory depreciation - tax - pensions (c)	**165**
Net cash interest (d)	**114**
PMICR (x)	
EBITDA - regulatory depreciation - tax - pensions/proxy for cash interest (c/d)	**1.4**
Nominal PMICR (x)	
RCV Indexation	283
Nominal PMCF	448
Net debt Indexation	179
Total Interest	293
Nominal PMCF/total interest	**1.5**

Source: Fitch Ratings

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For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.