FitchRatings

Corporates
Wastewater Utility
United Kingdom

Dwr Cymru (Financing) UK Plc

Fitch Ratings' affirmation of Dwr Cymru (Financing) UK Plc's (DWR) debt ratings reflects its expectation that the financial profile of the operating company Dwr Cymru Cyfyngedig (Welsh Water), which guarantees DWR's debt, will remain commensurate with the ratings for the five-year price control ending March 2025 (AMP7) and includes a provisional overview of the trend expected for AMP8 (price control April 2025 to March 2030).

Fitch expects DWR to maintain adequate net debt/regulated capital value (RCV) headroom against its negative rating sensitivities across class A and B, and class C debt in AMP7. This headroom is sufficient to offset expected weak average cash and nominal post-maintenance interest coverage ratios (PMICR).

The ratings also consider the sound operational and regulatory performance of Welsh Water, its conservative target net debt/RCV of 60%, and the secured nature of the group's financing structure.

Key Rating Drivers

Large Gearing Headroom in AMP7: We forecast net debt/RCV for the class A and B notes at about 52%, and the class C notes at about 63% for the financial year to end-March 2025 (FY25), compared with 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 PMICRs 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 average cash PMICR of about 1.2x and nominal PMICR of about 1.6x for class C debt, which is commensurate with negative rating sensitivities of 1.2x and 1.5x, respectively, although with no headroom.

Ambitious AMP8 Business Plan: Welsh Water's draft AMP8 business plan for price review 2024 (PR24) includes a GBP5 billion (real 2022/2023) total expenditure (totex) programme targeting significant environmental improvements and operational efficiencies, which is almost 70% higher than that of AMP7. This plan is based on Ofwat's early-view weighted average cost of capital (WACC) of 3.3%, and notional company gearing of 55%. Funding for the plan is expected to come from higher customer bills, retained earnings and additional debt.

Inflation-Linked Debt Offsets Inflation Benefit: DWR has 84% of its total debt linked to inflation (IL), higher than the Fitch-rated UK water sector average of about 60%. While IL debt provides a hedge against RCV that grows with inflation over time, we expect the higher accretion to IL debt from inflation to contribute to weak nominal PMICRs, reflecting the rising total cost of debt.

Inflation Mismatch: The entirety of DWR's IL-debt portfolio is indexed to the retail price index (RPI), which creates an inflation mismatch compared with its RCV. AMP7 RCV indexation is 50% RPI-linked and 50% plus capital additions-linked to the consumer price index (CPIH), moving to 100% CPIH-linked in AMP8.

Net ODI Penalties Assumed: We forecast around GBP40 million of cumulative net cash outcome delivery incentives (ODI) penalties (nominal) related to operational performance across FY24 and FY25. In the first three years of AMP7, Welsh Water incurred cumulative penalties of GBP30 million, mainly in water supply interruptions, water quality and leakage. Despite its sector-leading performance for internal sewer flooding in 2023, Welsh Water lagged behind other regulated UK water companies in Ofwat's overall performance category.

Ratings

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

Click here for the full list of ratings

2035 Climate Vulnerability Signal:14

Applicable Criteria

Sector Navigators – Addendum to the Corporate Rating Criteria (November 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (October 2023)

Corporate Rating Criteria (November 2023)

Related Research

Spotlight: UK Water Business Plans (October 2023)

Spotlight: Kemble Water (August 2023)

Ofwat's Tighter Licence Conditions Negative for UK Water Holdcos (May 2023)

What Investors Want to Know: UK Water Companies (April 2023)

Analysts

Sagar Nadkarni
+44 20 3530 1289
sagar.nadkarni@fitchratings.com

Disha Kalsi
+44 20 3530 1319
disha.kalsi@fitchratings.com

Self-Reported Incorrect Regulatory Findings: Upon conclusion of Ofwat's investigation into the misreporting of data on leakage and per-capita consumption (PCC) Ofwat imposed a nominal penalty of only GBP1, and directed it to pay GBP40 million to benefit customers. This decision considers the proactive steps taken by management, including the announcement of a GBP30 million redressal package in March 2023 and the commitment to further investments exceeding regulatory allowances for increased number of leakages and higher PCC.

Redress Package Included into Forecasts: The redressal package of GBP30 million comprises GBP15 million refunded to customers in FY24 and GBP15 million to reduce the RCV at the start of AMP8 through the midnight adjustment. Furthermore, as part of the investigation, the regulator has identified underperformance payments amounting to GBP9.4 million for FY21 and FY22. These payments are to be accounted for in the ODI penalties for AMP7, and have been factored into our existing forecast of ODI penalties.

Totex Underperformance Expected: We expect Welsh Water to underperform its totex allowance by 12.2% across AMP7, with operating expenditure (opex) and capex underperformance of 14.5% and 9.3%, 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 (such as 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, with about 85% hedged for FY25. Welsh Water benefits from self-generating about 22% of its power requirements in FY23 with the target to reach 35% by FY25.

Financial Summary

(GBPm)	2021	2022	2023	2024F	2025F
Gross revenue	778	807	841	919	926
Total cash PMICR (x)	1.7	1.4	1.0	1.0	1.1
Senior cash PMICR (x)	1.7	1.5	0.9	1.0	1.0
Total nominal PMICR (x)	1.8	1.5	1.7	1.7	1.4
Senior nominal PMICR (x)	1.8	1.8	1.6	1.9	1.5
Total pension adjusted net debt/shadow RCV (%)	60.1	58.5	58.3	61.0	63.0
Senior pension adjusted net debt/shadow RCV (%)	57.6	50.1	49.8	50.4	52.3

F — Forecast
Source: Fitch Ratings, Fitch Solutions

Rating Derivation Relative to Peers

Welsh Water could make discretionary customer distributions, reduce post maintenance cash flow, 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 (classes A and B) and subordinated (class C) debt 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 (IDR: 'BBB+'/Stable; senior unsecured debt: 'A-'). DWR benefits from structural enhancements, including trigger mechanisms (gearing and interest coverage covenants) and debt service reserve liquidity.

Rating Sensitivities

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

- For class A and B debt: net debt/RCV comfortably and consistently below 57%, combined with cash PMICR above 1.7x and nominal PMICR above 1.9x
- For class C debt: net debt/RCV comfortably and consistently below 59%, combined with 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: net debt/RCV approaching 65%, combined with cash PMICR below 1.5x and nominal PMICR below 1.7x
- For class C debt: net debt/RCV approaching 74%, combined with cash PMICR below 1.2x and nominal below 1.5x
- Insufficient net debt/RCV headroom to compensate for weak cash and nominal PMICRs

Liquidity and Debt Structure

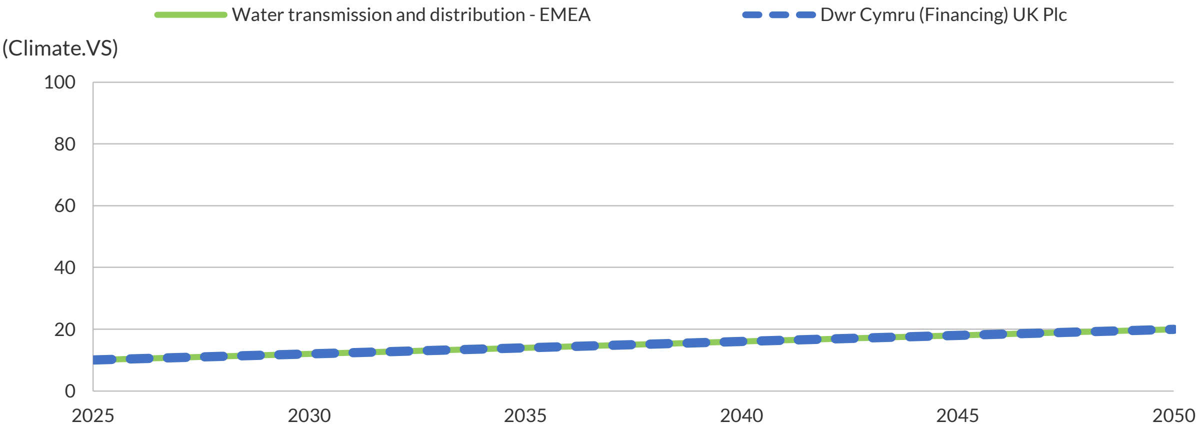
Strong Liquidity: As at 30 September 2023, Welsh Water had cash and cash equivalents of GBP306.5 million and access to GBP200 million of undrawn revolving credit facilities (RCFs) maturing in November 2024. The RCF has been upsized to GBP400 million with GBP80 million drawn and expires in February 2027. Fitch expects negative FCF of around GBP109 million for FY24.

Climate Vulnerability Considerations

Fitch uses Climate Vulnerability Signals (Climate.VS) as a screening tool to identify sectors and Fitch-rated issuers that are potentially most exposed to credit-relevant climate transition risks and, therefore, require additional consideration of these risks in rating reviews. Climate.VS range from 0 (lowest risk) to 100 (highest risk). For more information on Climate.VS, see Fitch's Corporate Rating Criteria.

The FY23 revenue-weighted Climate.VS for DWR for 2035 is 14 out of 100, suggesting low exposure to climate-related risks in that year. This is line with sector average score of water/ wastewater utility sector.

Climate.VS Evolution
As of Dec 31, 2022



Source: Fitch Ratings

Liquidity and Debt Maturities

Liquidity Analysis

(GBPm)	2024	2025F
Available liquidity		
Beginning cash balance	364	109
Rating case FCF after acquisitions and divestitures	-138	-109
Debt issued	150	
Total available liquidity (A)	**376**	**0**
Liquidity uses		
Debt maturities	-267	-141
Total liquidity uses (B)	**-267**	**-141**
Liquidity calculation		
Ending cash balance (A+B)	109	-141
Revolver availability	320	400
Ending Liquidity	**429**	**259**
Liquidity score (x)	2.6	2.8

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

Scheduled debt maturities (GBPm)	31 March 2023
2024	267
2025	141
2026	703
Thereafter	3,422
Total	**4,533**

Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Ofwat's final determinations financial model and PR24 business plan used as a main information source
- Allowed WACC in AMP7 of 1.9% (RPI-based) and 2.9% (CPIH-based)
- Broadly 50% of the RCV RPI-linked and another 50% plus capital additions CPIH-linked from FY21 to FY25, with RCV then 100% CPIH-linked for AMP8
- RPI of 8.3% for FY24 and 4.1% for FY25
- CPIH of 6.2% in FY24 and 2.8% in FY25
- Allowed totex of around GBP3.4 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 4.8% for AMP7
- Totex underperformance of 12.2% over AMP7
- Net cash ODI-related penalties of around GBP40 million cumulatively over FY24-FY25

Financial Data

(GBPm)	2021	2022	2023	2024F	2025F
Summary income statement					
Gross revenue	778	807	841	919	926
Revenue growth (%)	0.1	4.0	4.3	9.2	0.7
EBITDA before income from associates	375	466	448	429	461
EBITDA margin (%)	48.2	57.8	53.2	46.7	49.8
Gross interest expense	-126	-297	-532	-115	-126
Summary balance sheet					
Shadow RCV	6,010	6,460	7,161	7,465	7,703
Readily available cash and equivalents	209	502	364	146	151
Debt	3,831	4,238	4,541	4,700	5,002
Net debt	3,622	3,736	4,177	4,553	4,850
Summary cash flow statement					
EBITDA	375	466	448	429	461
Cash interest paid	-108	-118	-147	-115	-126
Cash tax	3	2	1	—	—
Dividends received less dividends paid to minorities (inflow/outflow)	—	—	—	—	—
Other items before FFO	-3	-3	11	—	—
FFO	271	352	325	315	335
FFO margin (%)	34.9	43.6	38.7	34.2	36.2
Change in working capital	7	27	-6	-17	5
CFO (Fitch-defined)	279	379	320	298	340
Total non-operating/nonrecurring cash flow	-34	—	—	—	—
Capex	-304	-336	-413	—	—
Capital intensity (capex/revenue) (%)	39.1	41.7	49.1	—	—
Common dividends	—	—	—	—	—
FCF	-59	43	-94	—	—
FCF margin (%)	-7.6	5.3	-11.1	—	—
Net acquisitions and divestitures	0	1	0	—	—
Other investing and financing cash flow items	-3	19	33	-238	-188
Net debt proceeds	-388	231	-78	159	302
Net equity proceeds	—	—	—	—	—
Total change in cash	-450	293	-138	-218	5
Leverage ratios (x)					
Total pension adjusted net debt/shadow RCV (%)	60.1	58.5	58.3	61.0	63.0
Senior pension adjusted net debt/shadow RCV (%)	57.6	50.1	49.8	50.4	52.3
EBITDA leverage	10.2	9.1	10.1	10.9	10.8
EBITDA net leverage	9.7	8.0	9.3	10.6	10.5
FFO leverage	10.2	9.1	9.9	10.9	10.8
FFO net leverage	9.7	8.0	9.1	10.6	10.5
Calculations for forecast publication					
Capex, dividends, acquisitions and other items before FCF	-338	-335	-413	-436	-449
FCF after acquisitions and divestitures	-59	44	-93	-138	-109
FCF margin after net acquisitions (%)	-7.5	5.4	-11.1	-15.1	-11.8

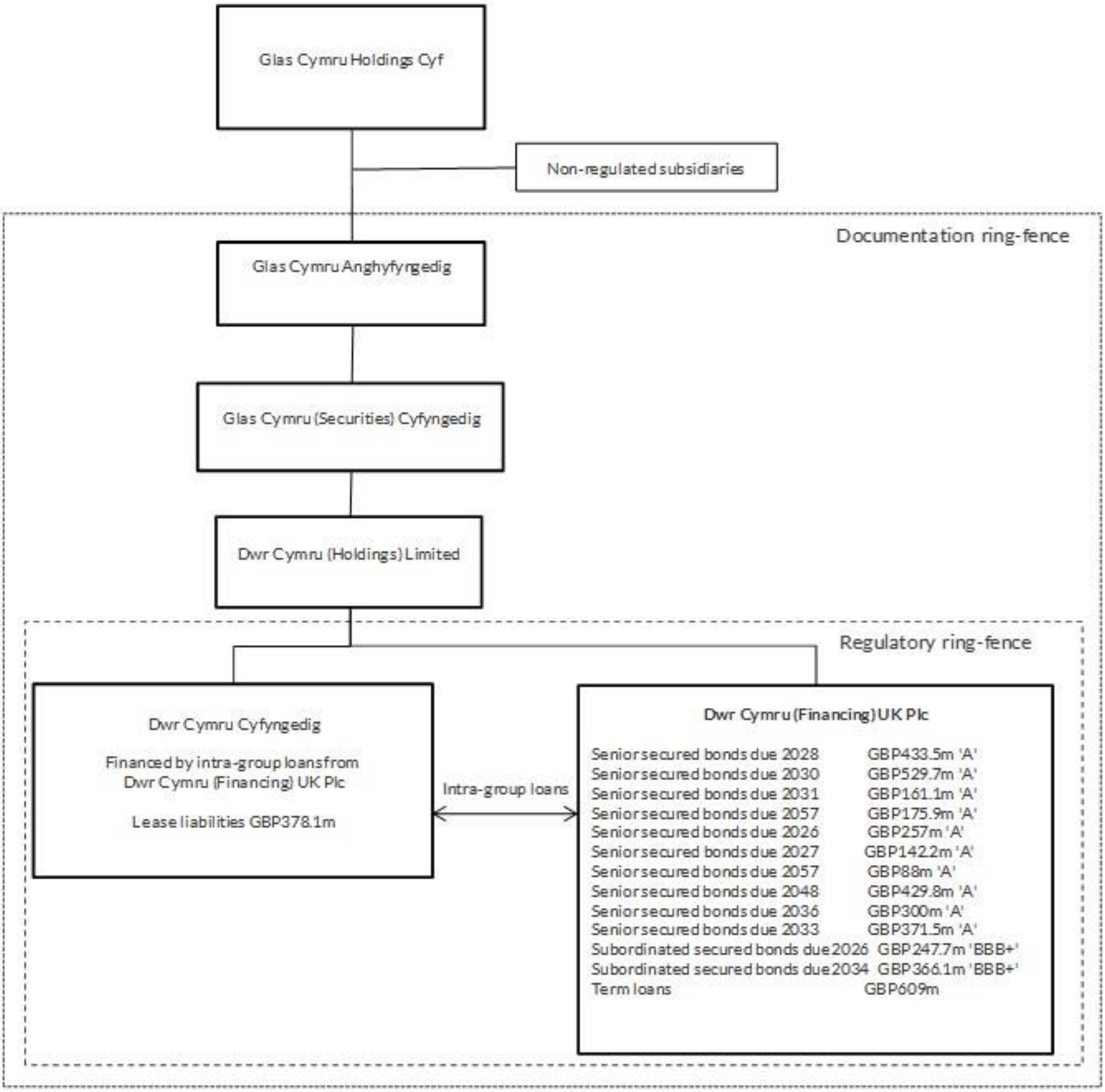
(GBPm)	2021	2022	2023	2024F	2025F
Coverage ratios (x)					
Senior cash PMICR (x)	1.7	1.5	0.9	1.0	1.0
Senior nominal PMICR (x)	1.8	1.8	1.6	1.9	1.5
Total cash PMICR (x)	1.7	1.4	1.0	1.0	1.1
Total nominal PMICR (x)	1.8	1.5	1.7	1.7	1.4
FFO interest coverage	3.5	4.0	3.1	3.7	3.7
EBITDA interest coverage	3.5	4.0	3.0	3.7	3.7
Additional metrics (%)					
CFO-capex/debt	-0.7	1.0	-2.1	-2.9	-2.2
CFO-capex/net debt	-0.7	1.1	-2.2	-3.0	-2.2
CFO/capex	91.7	112.7	77.3	68.3	75.7

CFO – Cash flow from operations
Source: Fitch Ratings, Fitch Solutions

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.

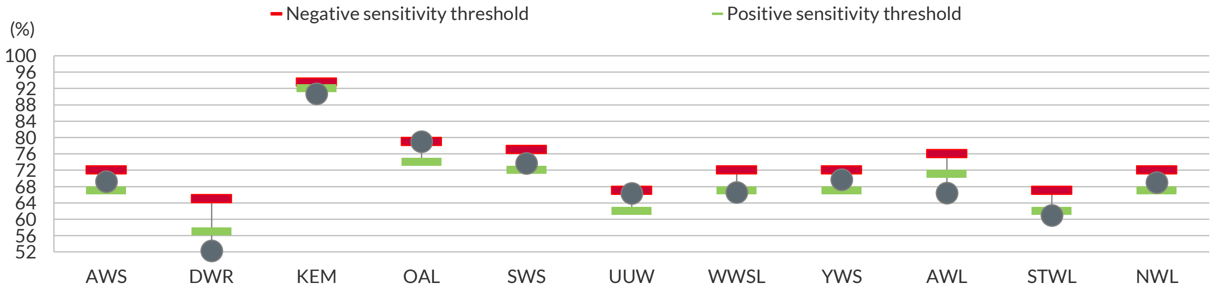
Simplified Group Structure Diagram



Source: Fitch Ratings, Fitch Solutions, Dwr Cymru, as at March 2023

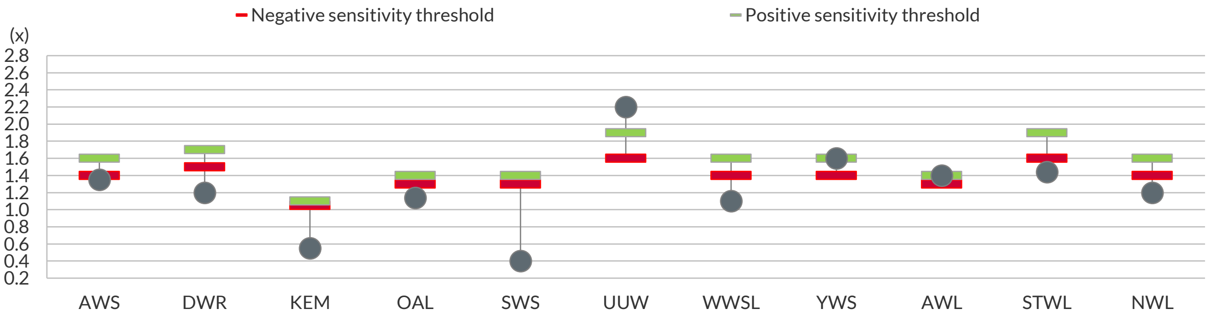
Peer Financial Summary

Rating Headroom by Gearing (FY25)



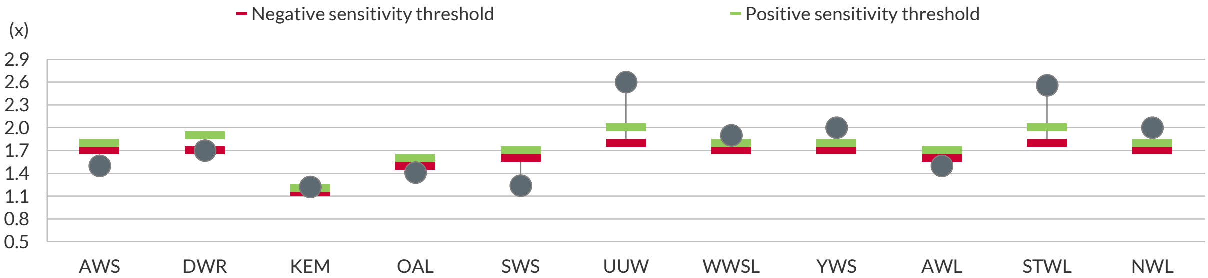
Ratios for DWR, SWS, YWS and reflect senior class A debt, Kemble before the downgrade to CCC
Source: Fitch Ratings, Fitch Solutions , companies' data

Rating Headroom by Cash PMICR (Five-Year Average)



Ratios for DWR, YWS and AWL reflect senior class A interest, Kemble before the downgrade to CCC
Source: Fitch Ratings, Fitch Solutions, companies' data

Rating Headroom by Nominal PMICR (Five-Year Average)



Ratios for DWR,YWS and AWL reflect senior class A interest, Kemble before the downgrade to CCC
Source: Fitch Ratings, Fitch Solutions , companies' data

Key

AWS	Anglian Water Services Limited
DWR	Dwr Cymru (Financing) UK Ltd
KEM	Kemble Water Finance Limited
OAL	Osprey Acquisitions Limited
SWS	Southern Water Services Limited
UUW	United Utilities Water Limited
WW	Wessex Water Services Limited
YWS	Yorkshire Water Services Limited
AWL	Affinity Water Limited
STWL	Severn Trent Water Limited
NWL	Northumbrian Water Limited

Source: Fitch Ratings, companies

Fitch Adjusted Financials

(GBPm as of 31 March 2023)	Notes and formulas	Standardised values	Lease treatment	Other adjustments	Adjusted values
Income statement summary					
Revenue		841	—	—	841
EBITDAR	(a) = (c-b)	339	—	109	448
Lease expense for capitalised leased assets	(b)	—	—	—	—
EBITDA	(c)	339	—	109	448
Depreciation and amortisation		-346	—	—	-346
EBIT		-7	—	109	102
Balance sheet summary					
Debt	(d)	4,533	—	8	4,541
Of which other off-balance-sheet debt		—	—	—	—
Lease-equivalent debt	(e)	—	—	—	—
Lease-adjusted debt	(f) = (d+e)	4,533	—	8	4,541
Readily available cash and equivalents	(g)	363	—	1	364
Not readily available cash and equivalents		—	—	—	—
Cash flow summary					
EBITDA	(c)	339	—	109	448
Dividends received from associates less dividends paid to minorities	(h)	—	—	—	—
Interest paid	(i)	-150	—	2	-147
Interest received	(j)	13	—	—	13
Preferred dividends paid	(k)	—	—	—	—
Cash tax paid		1	—	—	1
Other items before FFO		44	—	-33	11
FFO	(l)	247	—	78	325
Change in working capital		-6	—	—	-6
CFO	(m)	242	—	78	320
Non-operating/nonrecurring cash flow		—	—	—	—
Capex	(n)	-335	—	-78	-413
Common dividends paid		—	—	—	—
FCF		-94	—	—	-94
Gross leverage (x)					
EBITDA leverage	d / (c+h)	13.4	—	—	10.1
EBITDAR leverage	f / (a+h)	13.4	—	—	10.1
FFO leverage	d / (l-i-j-k)	11.8	—	—	9.9
FFO adjusted leverage	f / (l-i-j-k-b)	11.8	—	—	9.9
(CFO-capex)/debt (%)	(m+n) / d	-2.1	—	—	-2.1
Net leverage (x)					
EBITDA net leverage	(d-g) / (c+h)	12.3	—	—	9.3
EBITDAR net leverage	(f-g) / (a+h)	12.3	—	—	9.3
FFO net leverage	(d-g) / (l-i-j-k)	10.9	—	—	9.1
FFO adjusted net leverage	(f-g) / (l-i-j-k-b)	10.9	—	—	9.1
(CFO-capex)/net debt (%)	(m+n) / (d-g)	-2.2	—	—	-2.2
Coverage (x)					
EBITDA interest coverage	(c+h) / (-i)	2.3	—	—	3.0
EBITDAR fixed-charge coverage	(a+h) / (-i-b)	2.3	—	—	3.0
FFO interest coverage	(l-i-j-k) / (-i-k)	2.6	—	—	3.1
FFO fixed-charge coverage	(l-i-j-k-b)/(-i-k-b)	2.6	—	—	3.1

CFO – Cash flow from operations
Note: The standardised items presented above are based on Fitch's taxonomy for the given sector and region.
Reported items may not match the Fitch taxonomy, but they are captured into corresponding lines accordingly.
Debt includes other off-balance-sheet debt.
Source: Fitch Ratings, Fitch Solutions, Dwr Cymru Cyfyngedig

Reconciliation of Key Financial Metrics for Dwr Cymru

(GBPm)	31 Mar 23
Gross interest-bearing loans and borrowings	**4,541**
+ Net pension deficit	-
= Total pension-adjusted debt	**4,541**
- Cash and equivalents (unrestricted)	364
= Pension-adjusted net debt (a)	**4,177**
Shadow nominal regulatory asset value (b)	**7,161**
Net debt/regulatory asset value (RAV) (%)	
Pension adjusted net debt/RAV (a / b) x 100	**58.3%**
EBITDA (reported)	**338.9**
Fitch adjustments	
+ Infrastructure renewal expenditure	78.0
- Exceptional cost	-30.8
Fitch adjusted EBITDA	**448**
- Regulatory depreciation	301
- Taxation paid	0
- Pension deficit repair	30
- PAYG adjustment	-14
Post maintenance cashflow (PMCF) = EBITDA - Regulatory depreciation - tax - pensions (c)	**104**
Net cash interest (d)	**134**
Cash post maintenance interest coverage ratio (x)	
EBITDA - regulatory depreciation - tax - pensions / net cash interest (c/d)	**0.8x**
Nominal post maintenance interest coverage ratio (x)	
RCV indexation	716
Nominal PMCF = post maintenance cash flow + RCV indexation (e)	820
Net debt indexation	379
Total Interest = net cash interest + net debt indexation (f)	513
Nominal PMCF/total interest (e/f)	**1.6x**

Source: Fitch Ratings, based on company reports

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

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