

**Credit Opinion: Dwr Cymru Cyfyngedig**

**Dwr Cymru Cyfyngedig**

Cardiff, United Kingdom

**Ratings**

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	A3

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**Key Indicators**

**Dwr Cymru Cyfyngedig**

	Mar-08	Mar-07	Mar-06
Net Debt / RAV	70.3%	71.0%	76.9%
Adjusted ICR	1.7x	1.4x	1.4x
FFO Net Interest Cover	3.0x	2.7x	2.5x
FFO / Net Debt	10.5%	9.4%	8.8%
RCF / Net Debt	10.5%	9.4%	8.8%
RCF / Capex	96.0%	88.3%	96.0%

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

**Opinion**

**Company Profile**

Dwr Cymru Cyfyngedig ("Welsh Water") is the sixth-largest UK water utility by regulated asset value ("RAV"), providing water and sewerage services to approximately 1.2 million households and over 100,000 business customers in a region that covers most of Wales and certain adjoining areas of England. Welsh Water's ultimate parent company is Glas Cymru Cyfyngedig ("Glas Cymru"), a not-for-profit organisation. In the fiscal year 2007/08, Welsh Water reported revenues of GBP 623 million.

**Rating Rationale**

The A3 corporate family rating (CFR) consolidates the legal and financial obligations of Welsh Water, its funding vehicle Dwr Cymru (Financing) Limited and the three holding companies that are in the ring-fenced group. In line with its approach towards similar structured transactions (such as Anglian Water Services rated in 2002), Moody's rating assessment of Welsh Water is the result of the evaluation of three main factors, (i) the business risk profile of the company, (ii) its financial metrics and (iii) the structural enhancements of the bond covenant and security package.

Business risk profile: Welsh Water's business risk profile is very low in line with that of the UK water sector as a whole, which is lower than for most other industries, due to its well-established and transparent regulatory framework and lack of real competition. Along with its peers Welsh Water faces relatively challenging efficiency targets and needs to manage an extensive capital programme (GBP1.1 billion in 2002/03 prices) with the related execution risk. Welsh Water had improved its operational performance in recent years and generated a track record of in-line performance with regulatory targets, which provides some mitigation, but ongoing cost pressures, e.g. in relation to rising power costs, will influence the companies performance going forward (its 2006/07

assessment Ofwat ranked Welsh Water in Bands A and B for capital maintenance and operating efficiency in relation to its sewerage services, respectively; however, for its water services Welsh Water was considered as one of the least efficient companies and only ranked in Band C for the two efficiency measures).

In its draft business plan for the period 2010-2015, published in August 2008, Welsh Water forecasts a continuously sizeable capital programme of GBP1.5 billion for AMP5, up from the GBP1.4 billion spent in AMP4 (both in 2007/08 prices), with the main focus on maintenance expenditure. Clearly, the large capital investments will require the company to maintain a prudent approach to its financial structure to ensure its ability to finance these investments. In that respect, Moody's notes Welsh Water's publicly communicated leverage target of 70%.

Moody's rating assessment also takes into account Glas Cymru's sole purpose of acting as a holding company and ensuring that Welsh Water carries out its functions and responsibilities in accordance with the terms of its licence and other applicable statutory requirements.

Financial metrics: The current rating reflects the ongoing strengthening of the company's financial metrics since it adopted a highly leveraged structure in May 2001, resulting in an Adjusted Interest Coverage Ratio (defined by Moody's as Funds from Operations less Regulatory Capital Charges to Net Cash Interest) of around 1.7x post-customer rebates and 1.9x pre-customer rebates, and a ratio of Net Debt to RAV just above 70% at 31 March 2008. The A3 CFR and stable outlook however assume that the absence of dividends due to the not-for-profit status of its ultimate parent company, Glas Cymru, will allow Welsh Water to continue to deleverage so as to demonstrate a net adjusted debt to RAV ratio around 70% by the end of the current regulatory period.

Structural enhancements: the A3 CFR factors in some degree of uplift (albeit not a full notch) stemming from the structural enhancements of Welsh Water's financing structure, including (i) the presence of a liquidity facility of GBP 150 million, (ii) a first ranking fixed charge over the shares in the company and (iii) the agreement by financial creditors to give up their individual rights to petition for insolvency proceedings, which should improve recovery in a default scenario. Moody's however adds that the degree of risk mitigation is lower than in some other similar transactions (such as Anglian Water or Southern Water) as the protection offered by certain financial covenants provided by those issuers is less critical for a not-for-profit company without equity shareholders. Furthermore, the benefit of the security provided to bondholders remains limited by the regulated and essential nature of the services provided by Welsh Water as governed by its licence and the Water Industry Act 1991.

## **Liquidity**

Welsh Water's liquidity profile is very strong, supported by (i) the absence of dividend requirements due to its not-for-profit status, (ii) the stable and predictable cash flows generated by its regulated utility activity allowing it to fund almost entirely its capex needs and customers' rebates from internal sources, (iii) the existence of GBP122 million of cash and cash equivalents as well as (iv) GBP345m of undrawn committed bank facilities available at 30 June 2008. Moody's regards those sources of funds as sufficient to cover the group's needs over the next 12 months, including limited short-term debt repayments and capital investments. The next major debt maturity will occur in March 2011, when the GBP125 million Class C Notes will become due.

We add that additional comfort is taken from the existence of a GBP150m special liquidity facility which would be available to the company in the event of a standstill being declared following a breach of financial covenants.

## **Rating Outlook**

The stable outlook reflects Moody's expectation that the company will continue to deleverage over the current regulatory period and demonstrate leverage around 70% of Net Debt to RAV going forward.

## **What Could Change the Rating - Down**

- A materially unfavourable change in the regulatory framework
- Serious underperformance in operating or capital expenditure
- Significant increases in the sums rebated to customers resulting in the company failing to maintain its leverage at around 70%

## **What Could Change the Rating - Up**

Ongoing deleveraging, resulting in a further reduction of the ratio of Net Debt to RAV below 65%

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