Moody's Investors Service

Global Credit Research
Credit Opinion
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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-2007	Mar-2006	Mar-2005
Ned Debt / RAV	**73.4%**	**77.6%**	**80.4%**
Adjusted ICR	**1.5x**	**1.4x**	**1.1x**
FFO Net Interest Cover	**2.7x**	**2.6x**	**2.1x**
FFO / Net Debt	**9.1%**	**8.9%**	**6.3%**
RCF / Net Debt	**9.1%**	**8.9%**	**6.3%**
RFC / Capex	**88.7%**	**97.4%**	**54.4%**

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 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 company. In the fiscal year 2006/07, Welsh Water reported revenues of GBP 578 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 Whole Business Securitization transactions (such as Anglian Water Services 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 (there is only a limited number of large customers - approximately 4% of the company's revenue base - eligible to choose alternative supplies). Revenues' stability and predictability is further supported by (i) the high proportion (72%) of total revenues stemming from households, which reduces exposure to economic volatility and business trends, and (ii) the fact that around 80% of Welsh Water's domestic revenues derive from unmeasured fixed charge supplies. 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 the ratio of funds from operations less regulatory capital charges to net cash interest (adjusted interest cover) around 1.5x post-customer rebates and 1.7x pre-customer rebates, and the ratio of net adjusted debt to regulated asset value (RAV) around 73% at 31 March 2007. 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 the WBS 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 WBS transactions (such as Anglian Water Services in 2002 or Southern Water Services in 2003) as the protection offered by financial covenants is less required in 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 GBP 86 million of cash and cash equivalents as well as (iv) GBP 345 million of undrawn committed bank facilities available at 30 June 2007. Moody's regards those sources of funds as largely sufficient to cover the group's needs over the next 12 months, including limited short-tem debt repayments. The rating agency adds that additional comfort is taken from the existence of a GBP 150 million 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 so as to demonstrate a net adjusted debt to RAV ratio around 70% by the end of the current regulatory period.

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 reduce and maintain its leverage at around 70%

What Could Change the Rating - Up

Ongoing deleveraging, resulting in a further reduction of the ratio of net adjusted debt to RAV below 65%
