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Summary:

Dwr Cymru (Financing) Ltd.

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The 'A' ratings on the senior secured (class B) bonds and the 'BBB+' ratings on the junior (class C) bonds issued by the special-purpose vehicle Dwr Cymru (Financing) Ltd. reflect various structural features designed to enhance cash flow certainty for bondholders and the underlying credit quality of Dwr Cymru Cyfyngedig (Welsh Water), the U.K.-based regulated water and wastewater business owned by nonprofit Glas Cymru Cyfyngedig (Glas Cymru). The guaranteed 'AA/Watch Neg' long-term debt ratings on the senior secured (class A) bonds issued by Dwr Cymru (Financing) Ltd. reflect the unconditional and irrevocable guarantee provided by MBIA Assurance S.A. (AA/Watch Neg/--) or MBIA U.K. Insurance Ltd. (AA/Watch Neg/--) of payment of scheduled interest and principal on the bonds.

Rating strengths include the liquidity mandated within the group's financial structure, a strong overall covenant package, and strict limitations on business activities. The ratings are underpinned by the stability provided by Welsh Water's monopoly water and wastewater business. Further support is provided by the continuous trend of deleveraging and management's commitment to target net debt to regulated asset value (RAV) of about 70%. At the same time, the nonprofit ownership structure and lack of shareholders eliminate pressure to leverage the balance sheet through shareholder distributions. The senior debt is protected from junior debt, which is subordinated and cannot force a default of the senior debt.

These strengths are offset by the risk related to an aggressive--albeit strengthening--capital structure, negative discretionary (i.e. prefinancing) cash flows, and only moderate debt--protection measures. Additional constraining factors are the ongoing need to raise debt to finance capital expenditures and the risk associated with periodic regulatory reviews and tariff resets every five years.

Welsh Water has made steady progress with the financial and operational targets set for this regulatory period through March 31, 2010, by the water and sewerage regulator in English and Wales, the Office of Water Services (Ofwat). Although Welsh Water's capital expenditure program is similar in size to that of the previous regulatory period, the group has decided to accelerate investment to improve security of supply and water quality. Glas Cymru has substantially prefunded its capital requirements for this regulatory period.

Glas Cymru's debt-protection measures are moderate but increasingly stronger than expected at the time of Dwr Cymru (Financing) Ltd.'s £1.9 billion refinancing of Welsh Water. Total net debt to RAV at March 31, 2008, was about 72%, compared with 93% at refinancing in May 2001. Standard & Poor's Ratings Services expects that senior interest coverage before and after capital maintenance will remain well above the trigger levels of 2.0x and 1.1x, respectively, through the end of this regulatory period. In its 25-year "Strategic Direction Statement," published in November 2007, Glas Cymru's management committed to further decreasing leverage to an optimum level of about 70% (net debt to RAV).

Liquidity

Strong liquidity, as mandated by the borrowing documents, is a central feature of Glas Cymru's financial structure, and, consequently that of Dwr Cymru (Financing) Ltd.'s. Covenants relating to liquidity include a requirement to

have sufficient cash and bank lines for the next 12 months of capital expenditures. The steady, predictable operating cash flow stream produced by Welsh Water and minimal near-term debt maturities provide further support. The next expected bond redemption maturity is £125 million of subordinated class C bonds in March 2011. In addition, a £150 million liquidity facility at Dwr Cymru (Financing) Ltd. is available in case Welsh Water were unable to pay its interest bills during a standstill period. Actual liquidity, in the form of cash and cash equivalents, was £124 million at March 31, 2008. Undrawn committed bank facilities totaled £345 million at the same date.

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