

UK Registered N<sup>o</sup> FC23222  
Cayman Islands Registered N<sup>o</sup> 108127

## Dŵr Cymru (Financing) Limited

Directors' report and financial statements  
for the year to 31 March 2010

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## Directors' report and business review

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The directors have pleasure in presenting their annual report to the shareholder, together with the audited financial statements for the year to 31 March 2010 on pages 5 to 20.

### Principal activity

The principal activity of the company is that of an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig.

### Results for the year

The loss on ordinary activities before taxation amounted to £7,450,000 (2009: loss of £24,123,000). No dividend was declared or paid during the year (2009: £nil).

### Business Review

The company continues to act as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig ("DCC"), the only trading subsidiary in the Glas Cymru group.

In spite of continuing difficult conditions in the banking and capital markets, the company raised £140 million of additional finance via a bond issue in March 2010 to help fund DCC's capital investment programme in AMP5, the regulatory period running from 1 April 2010 to 31 March 2015.

In addition, the company retained a high degree of undrawn liquidity at 31 March 2010, totalling £420 million, available to be drawn and on-lent to DCC. The company has a committed syndicated revolving credit facility of £305 million from a syndicate of banks comprising Royal Bank of Scotland plc, Barclays Bank plc, Bayerische Landesbank, HSBC Bank plc, Ing Bank N.V., Norddeutsche Landesbank Girozentrale and Sumitomo Mitsui Banking Corporation Europe Limited. This facility was available to be drawn until 30 September 2011. In addition, the company retains a bilateral facility of £40 million with Fortis Bank S.A./N.V., available to be drawn until 30 June 2012.

On 7 May 2010, in view of the very high level of available liquidity (£669 million), the level of undrawn revolving credit facilities was reduced to £100 million, and on 3 June 2010 Dŵr Cymru (Financing) Limited agreed to repurchase £113 million of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up rate of 90% and settlement will be made in cash on 7 June 2010.

The current ratings of the company's bonds are summarised in the following table:

<b>Bond Class</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Fitch</b>
<b>A</b>	A3	A	A
<b>B</b>	A3	A	A
<b>C</b>	Baa2	BBB+	BBB+

The rating of the Class A bonds, which have the benefit of a financial guarantee from MBIA, are the higher of the underlying ratings of these bonds (A3/A/A) and the rating of MBIA (B3/BBB+/-). On 8 March 2010 Standard & Poor's placed Glas' ratings on negative outlook, reflecting their assessment of the potential impact of Ofwat's Final Determination following the 2009 Price Review.

There has been a significant downward reduction in the spread differential to Government gilts during the year across the water sector, reflecting an easing of the difficult credit conditions over the last year. Glas bonds continue to trade at spread differentials generally below those of equivalent water sector bonds of similar maturities.

### Principal Risks and Uncertainties

From the perspective of the company, the principal risks and uncertainties are integrated with the principal risks of the group and are not managed separately. Accordingly, the principal risks and uncertainties of the Glas Cymru Group, which include those of the company, are disclosed on within the group's annual report which does not form part of this report.

## **Directors' report and business review cont'd**

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### **Key Performance Indicators ('KPIs')**

The directors of the Glas Cymru Cyfyngedig Group manage the group's operations on an overall basis. For this reason, the company's directors believe that analysis using KPIs is neither necessary nor appropriate for an understanding of the development, performance or position of the business of Dŵr Cymru (Financing) Limited. The development, performance and position of the group, which includes the company, are discussed within the group's annual report which does not form part of this report.

### **Directors**

The directors, who served throughout the year, were C A Jones and N C Annett.

### **Auditors**

PricewaterhouseCoopers LLP acted as auditors to Dŵr Cymru (Financing) Limited for the financial statements for the year ended 31 March 2010. As part of the audit process each director has confirmed, as at the date of the financial statements, that as far as the director is aware (a) there is no relevant audit information of which the company's auditors are unaware, and (b) they have taken steps to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

PricewaterhouseCoopers LLP have expressed their willingness to continue as auditors and a resolution for their reappointment will be considered at the 2010 annual general meeting.

By order of the Board

**R G Curtis**

Company Secretary

**4 June 2010**

## **Directors' responsibilities for the financial statements**

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The Directors are responsible for preparing the annual report and the company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare company financial statements for each financial year. They have elected to prepare the company financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU.

The Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Company and of the performance for that period; the Companies Act 2006 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a directors' report that complies with that law and those regulations.

By order of the Board

**R G Curtis**  
Company Secretary

**4 June 2010**

# Independent auditors' report to the members of Dŵr Cymru (Financing) Limited

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We have audited the financial statements of Dŵr Cymru (Financing) Limited for the year ended 31 March 2010 which comprise the Income Statement, the Statement of Changes in Shareholder's Equity, the Balance Sheet, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

## Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2010 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Stephen W Harrison (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Cardiff  
4 June 2010

## Income statement for the year ended 31 March 2010

	Note	£'000	2010 £'000	£'000	2009 £'000
<b>Financing costs:</b>					
- Interest payable and similar charges	2a	(93,006)		(89,871)	
- Interest receivable	2a	93,174		90,063	
- Fair value losses on derivative financial instruments	2b	(7,618)		(24,315)	
			(7,450)		(24,123)
<b>Loss before taxation</b>			(7,450)		(24,123)
Taxation credit	4	2,052			6,754
<b>Loss for the year</b>			<b>(5,398)</b>		<b>(17,369)</b>

	Note	£'000	2009 £'000	£'000	2008 £'000
Profit after tax excluding fair value losses on derivative financial instruments			87		138
Impact of fair value losses on derivative financial instruments (including taxation effect)	2b		(5,485)		(17,507)
<b>Loss for the year</b>			<b>(5,398)</b>		<b>(17,369)</b>

All operations are continuing.

The company has no other recognised gains or losses in the period (2009: nil) and accordingly a statement of comprehensive income has not been presented.

## Statement of changes in shareholder's equity for the year ended 31 March 2010

	Share capital £'000	Retained earnings £'000	Total reserves £'000
At 31 March 2008	30	(38,195)	(38,165)
Loss for the year	-	(17,369)	(17,369)
<b>At 31 March 2009</b>	<b>30</b>	<b>(55,564)</b>	<b>(55,534)</b>
Loss for the year	-	(5,398)	(5,398)
<b>At 31 March 2010</b>	<b>30</b>	<b>(60,962)</b>	<b>(60,932)</b>

## Balance sheet at 31 March 2010

	Note	2010 £'000	2009 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Deferred tax asset	11	24,817	22,765
Financial assets:			
- loans to group undertakings	5	<u>1,819,208</u>	<u>1,823,175</u>
		<b>1,844,025</b>	<b>1,845,940</b>
<b>Current assets</b>			
Financial assets:			
- loans to group undertakings	5	134,525	5,052
- derivative financial instruments	9	4,415	11,788
Cash and cash equivalents	6	<u>1,064</u>	<u>883</u>
		<b>140,004</b>	<b>17,723</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	7	(62)	(138)
Financial liabilities:			
- borrowings	8	(134,476)	(4,914)
- derivative financial instruments	9	<u>(10,349)</u>	<u>(1,442)</u>
		<b>(144,887)</b>	<b>(6,494)</b>
<b>Net current (liabilities)/assets</b>		<b>(4,883)</b>	<b>11,229</b>
<b>Non-current liabilities</b>			
Financial liabilities:			
- borrowings	8	(1,819,208)	(1,823,175)
- derivative financial instruments	9	<u>(80,866)</u>	<u>(89,528)</u>
		<b>(1,900,074)</b>	<b>(1,912,703)</b>
<b>Net liabilities</b>		<b>(60,932)</b>	<b>(55,534)</b>
<b>Shareholder's equity</b>			
Called up share capital	12	30	30
Deficit		<u>(60,962)</u>	<u>(55,564)</u>
<b>Total reserves</b>		<b>(60,932)</b>	<b>(55,534)</b>

The financial statements on pages 5 to 20 were approved by the Board of directors on 4 June 2010 and were signed on its behalf by:

**N C Annett**  
Managing Director

**C A Jones**  
Finance Director

## Cash flow statement for the year ended 31 March 2010

	Note	2010 £'000	2009 £'000
<b>Cash flows from operating activities</b>			
Interest received		93,174	90,299
Interest paid		(93,082)	(90,103)
<b>Net cash inflow from operating activities</b>		<u>92</u>	<u>196</u>
<b>Net cash inflow before financing activities</b>		92	196
<b>Cash flows from financing activities</b>			
Net repayment of intercompany loan		(135,536)	(20,390)
Long-term loans received		140,000	25,000
Long-term loans repaid		(4,375)	(4,375)
<b>Net cash generated from financing activities</b>		<u>89</u>	<u>235</u>
<b>Increase in net cash and cash equivalents</b>	13	181	431
Net cash and cash equivalents at 1 April		883	452
<b>Net cash and cash equivalents at 31 March</b>	6	<u>1,064</u>	<u>883</u>

## Principal accounting policies

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### **Basis of Preparation**

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and those parts of the Companies Act 2006 applicable to reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments to fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

The preparation of financial statements to conform to generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

### **Accounting policies for the year ended 31 March 2010**

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been applied consistently to all the years presented.

### **Cash and cash equivalents**

Cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and typically include cash in hand and deposits with banks or other financial institutions, less any overdrafts.

### **Financial liabilities**

Debt is initially measured at fair value, which is the amount of the net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

### **Financial assets**

Financial assets represent held to maturity investments that are non-derivative, with fixed or determinable payments and fixed maturities of over three months at the date of acquisition, which the group intends to hold until maturity. In addition, financial assets represent loans to group companies that the company makes in its capacity as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig.

Financial assets are held at amortised cost.

### **Derivative financial instruments**

Derivative instruments utilised by the company are interest rate and inflation swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the group.

Derivatives are recognised initially and subsequently re-measured at fair value.

During the year to 31 March 2010, none of the company's derivatives qualified for hedge accounting under IAS 39 (2009: none). These instruments are carried at fair value through profit or loss with changes in fair value being recognised immediately in the income statement.

## Principal accounting policies cont'd

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### Deferred taxation

Deferred corporation tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised in respect of all temporary differences. Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and tax losses, to the extent that they are regarded as recoverable. They are regarded as recoverable where, on the basis of available evidence, there will be suitable taxable profits against which the future reversal of the underlying temporary differences can be deducted. The carrying value of the amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all, or part, of the asset to be utilised.

Deferred corporation tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates that have been substantially enacted at the balance sheet date (2010 and 2009: 28%).

## Financing risk management objectives and policies

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Treasury activities are managed at a group level within a formal set of treasury policies and objectives, which are reviewed regularly and approved by the Board. The policy specifically prohibits any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the "Security Trustee"). The risk is further mitigated by limiting exposure to any one counterparty. We use financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, to raise finance and manage risk from our operations.

### Credit risk

The group has a prudent policy for investing cash and short term bank deposits ("cash investments"). Counterparties for cash investments must meet minimum short term and/or long term credit ratings as published by Standard & Poor's ("S&P"), Moody's Investor Service Limited ("Moody's") and Fitch Ratings Limited ("Fitch"). The minimum short term rating, for cash deposits of up to one year, is A1/P1/F1 and the minimum long term rating, for cash deposits over one year, is A+/A3/A+ each for S&P, Moody's and Fitch respectively. The Board reviews counterparties for cash investments annually and the credit limit assigned to each.

The group has continued to follow a cautious policy for investing cash deposits as a response to the situation in the banking market. In consequence, all new cash investments must meet the minimum long term rating and have a maximum investment period of one month. The maximum cash investment with a single counterparty was £142m (2009: £69m).

### Interest rate risk

The group hedges at least 85% of its total outstanding financial liabilities, including finance leases, into either index-linked or fixed rate obligations. For this purpose interest rate liabilities on floating rate liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework, under which revenues and the regulatory asset value are indexed also expose the group to inflation risk. Subject to market constraints and Board approval, the group therefore may seek to raise new debt through index linked instruments or to enter into appropriate hedging transactions.

The company analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. All of the company's borrowings of £1,954m as at 31 March 2010 (2009: £1,828m) were fixed as index-linked, after taking into account the company's interest rate and RPI swaps. The company therefore considers overall interest rate exposure at the balance sheet date to be minimal. The 'hedges' established to manage these risks are economic in nature, but do not satisfy the specific requirements of IAS 39 in order to be treated as hedges for accounting purposes.

### Refinancing risk

Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of currencies, instruments, type and maturities. Our policy is to ensure that the maturity profile does not impose an excessive strain on our ability to repay loans. Under this policy, no more than 20% of the principal of group borrowings of £2,912m can fall due in any 24 month period.

### Liquidity risk

The group maintains committed banking facilities in order to provide flexibility in the management of the group's liquidity.

Under the Common Terms Agreement which governs the group's obligations to its bond holders and other financial creditors, the group is required to have cash available to fund operations for a duration of 18 months. As at 31 March 2010, the group had committed undrawn borrowing facilities of £420m (2009: £420m) and cash and cash equivalents (excluding debt service payments account) of £238m (2009: £124m). On 15 April 2010 the group drew down the £75m balance of its EIB facility, and on 7 May 2010 reduced its undrawn revolving credit facilities to £100m following the Board's conclusion that these were surplus to requirements.

There is also a special liquidity facility of £150m; this is required in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

## Financing risk management objectives and policies cont'd

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### Capital risk management

The group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as linked to movements in the Retail Price Index and determined by Ofwat.

The Board considers that it is in the best long-term interests of Welsh Water's customers to continue to reduce the level of gearing, with a view to achieving further reductions in its cost of finance. The Board intends ultimately to reduce gearing to around 70% and to maintain it at that level, but recognises that the recent economic recession will prevent this in the short term.

In respect of the risks detailed above, further quantitative disclosures are provided in note 10.

## Notes to the financial statements

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### 1. Segmental information

The company's business is solely to act as an investment company providing long-term funding for the activities of Dŵr Cymru Cyfyngedig and therefore it operates in a single segment.

### 2. Finance costs

#### a) Net interest before fair value losses on derivative financial instruments

	2010 £'000	2009 £'000
Interest payable on loans	(93,006)	(89,871)
Interest receivable:		
- intercompany	93,171	90,034
- external	3	29
	<u>93,174</u>	<u>90,063</u>
Net interest receivable before fair value adjustments	<u>168</u>	<u>192</u>

#### b) Fair value losses on derivative financial instruments

Whilst the company employs an economically effective policy using interest rate and currency swaps, this policy does not satisfy the stringent hedge accounting criteria of IAS 39. Consequently, the company's interest rate and inflation swaps are fair valued at each balance sheet date with the movement (net gain or loss) disclosed in the income statement. Over the life of these swaps, providing that there is an effective match, these fair value adjustments will reverse and reduce to zero. (See note 9 in respect of derivative financial instruments held on the balance sheet).

	2010 £'000	2009 £'000
Fair value losses on index-linked and interest rate swaps	(7,618)	(24,315)
Deferred tax effect at 28% (2009: 28%) of fair value losses	2,133	6,808
	<u>(5,485)</u>	<u>(17,507)</u>

### 3. Loss before taxation

#### Services provided by the company's auditor

Audit fees of £5,000 (2009: £5,000) have been borne by a fellow group company.

### 4. Taxation

	2010 £'000	2009 £'000
Deferred tax		
- Current year movements	(2,052)	(6,754)
Taxation credit	<u>(2,052)</u>	<u>(6,754)</u>

## Notes to the financial statements cont'd

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### 4. Taxation cont'd

The tax for the period is the same as (2009: the same as) the standard rate of corporation tax in the UK (2010 and 2009: 28%):

	2010 £'000	2009 £'000
Loss before tax	<u>(7,450)</u>	(24,123)
<b>Total taxation credit</b>		
Loss before tax multiplied by the corporation tax rate in the UK of 28% (2009: 28%)	<u>(2,052)</u>	(6,754)

### 5. Financial assets

	2010 £'000	2009 £'000
<b>Non-current</b>		
Loans to group undertakings	<u>1,819,208</u>	1,823,175
<b>Current</b>		
Loans to group undertakings	<u>134,525</u>	5,052

### 6. Cash and cash equivalents

	2010 £'000	2009 £'000
Short-term deposits	<u>1,064</u>	883

The interest rate on the short-term deposit as at 31 March 2010 was 0.4% (2009: 0.4%) and this deposit had a maturity of 1 day (2009: 16 days).

The company has a prudent policy for investing cash and short term bank deposits ("cash investments"). Counterparties for cash investments must meet minimum short term and/or long term credit ratings as published by S&P, Moody's and Fitch. The minimum short-term rating, for cash deposits of up to one year, is A1/P1/F1 and the minimum long term rating, for cash deposits over one year, is AA-/A3/AA- each for S&P, Moody's and Fitch respectively. The Board reviews counterparties for cash investments annually and the credit limit assigned to each.

## Notes to the financial statements cont'd

### 7. Other payables

	2010 £'000	2009 £'000
Accrued interest payable	<u>62</u>	<u>138</u>

### 8. Financial liabilities – borrowings

	2010 £'000	2009 £'000
<b>Current</b>		
Bonds	125,556	539
European Investment Bank loans	<u>8,920</u>	<u>4,375</u>
	<u>134,476</u>	<u>4,914</u>
<b>Non-current</b>		
Bonds	1,681,253	1,676,300
European Investment Bank loans	<u>137,955</u>	<u>146,875</u>
	<u>1,819,208</u>	<u>1,823,175</u>

A security package was granted by Dŵr Cymru Cyfyngedig (DCC), as part of the company's bond programme for the benefit of holders of senior bonds and other senior financial creditors.

The obligations of DCC are guaranteed by the company, Glas Cymru (Securities) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

- i) A first fixed and floating security over all of DCC's assets and undertakings, to the extent permitted by the Water Industry Act, other applicable law and its licence; and
- ii) fixed and floating security given by the guarantors referred to above which are accrued on each of these company's assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

## Notes to the financial statements cont'd

### 9. Derivative financial instruments

All derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. As such, movements in their fair values are taken to the Income Statement (see note 2b). The fair values of all derivative financial instruments held by the company are the result of mark-to-market pricing by the issuing counterparties and as such fall within level 1 of the fair value hierarchy set out in IFRS 7.

2010	Fair values	
	Assets £'000	Liabilities £'000
<b>Current</b>		
Index-linked swaps	4,415	(1,508)
Interest rate swaps	-	(8,841)
	<u>4,415</u>	<u>(10,349)</u>
<b>Non-current</b>		
Index-linked swaps	-	(44,473)
Interest rate swaps	-	(36,393)
	-	<u>(80,866)</u>
<b>Total</b>	<u>4,415</u>	<u>(91,215)</u>
2009	Fair values	
	Assets £'000	Liabilities £'000
<b>Current</b>		
Index-linked swaps	4,382	(1,442)
Interest rate swaps	7,406	-
	<u>11,788</u>	<u>(1,442)</u>
<b>Non-current</b>		
Index-linked swaps	-	(27,604)
Interest rate swaps	-	(61,924)
	-	<u>(89,528)</u>
<b>Total</b>	<u>11,788</u>	<u>(90,970)</u>

The notional values of the swaps are: interest rate swaps - £192m (2009: £192m); index-linked swaps - £100m (2009: £100m).

In accordance with IAS 39, "Financial instruments: recognition and measurement", Dŵr Cymru (Financing) Limited has reviewed all contracts for embedded derivatives that are required to be accounted for separately if they do not meet certain requirements set out in the standard. Dŵr Cymru (Financing) Limited has no such embedded derivatives as per IAS 39.

#### Index-linked swaps

The index-linked swaps have the effect of index-linking the interest rate on £100 million of fixed rate bonds by reference to the retail price index ("RPI").

The principal terms are as follows:

Indexed notional amount:	£109.4 million
Swap maturity:	47 years
Interest rate:	1.35% (indexed by RPI)

## Notes to the financial statements cont'd

### 10. Financial risk management

The policies of the group in respect of financial risk management are included in the accounting policies note on page 10. The numerical financial instrument disclosures as required by IFRS 7 are set out below

#### a) Interest rate risk

The effective interest rates at the balance sheet dates were as follows:

	2010	2009
<b>Assets:</b>		
Cash and cash equivalents	0.4%	0.4%
Amounts owed by group undertakings	5.2%	5.2%
<b>Liabilities:</b>		
Bonds	5.3%	5.6%
European Investment Bank loans	1.0%	2.1%

Other receivables and payables are non-interest bearing.

The effective interest rates ignore the effect of the interest rate swaps set out in note 9.

#### b) Liquidity risk

2010	Within 1 year £'000	1 - 2 years £'000	2 - 5 years £'000	> 5 years £'000	Total £'000
<b>Assets:</b>					
Cash and cash equivalents	1,064	-	-	-	1,064
Financial assets - loan to group undertakings	134,525	14,039	44,726	1,760,443	1,953,733
	<u>135,589</u>	<u>14,039</u>	<u>44,726</u>	<u>1,760,443</u>	<u>1,954,797</u>
<b>Liabilities:</b>					
Bonds	125,556	573	1,828	1,678,852	1,806,809
European Investment Bank loans	8,920	13,466	42,898	81,591	146,875
Other payables	62	-	-	-	62
	<u>134,538</u>	<u>14,039</u>	<u>44,726</u>	<u>1,760,443</u>	<u>1,953,746</u>

The Bonds maturing within 1 year are £125 million of subordinated bonds with an expected maturity date of 31 March 2011. If these Bonds are not redeemed on or before 31 March 2011, the interest rate will step-up from a fixed rate of 8.174% to a floating 3-month LIBOR interest rate plus a margin 5.75%. On 3 June 2010 the company agreed to repurchase £113 million of Class C1 bonds following a tender offer to bond holders. The amount repurchased represents a take-up rate of 90% and settlement will be made in cash on 7 June 2010.

2009	Within 1 year £'000	1 - 2 years £'000	2 - 5 years £'000	> 5 years £'000	Total £'000
<b>Assets:</b>					
Cash and cash equivalents	883	-	-	-	883
Financial assets - loan to group undertakings	5,052	134,478	42,174	1,646,523	1,828,227
	<u>5,935</u>	<u>134,478</u>	<u>42,174</u>	<u>1,646,523</u>	<u>1,829,110</u>
<b>Liabilities:</b>					
Bonds	539	125,557	1,773	1,548,970	1,676,839
European Investment Bank loans	4,375	8,921	40,401	97,553	151,250
Other payables	138	-	-	-	138
	<u>5,052</u>	<u>134,478</u>	<u>42,174</u>	<u>1,646,523</u>	<u>1,828,227</u>

## Notes to the financial statements cont'd

### 10. Financial risk management cont'd

#### c) Fair values

The following table sets out the fair value of the company's financial assets and liabilities, other than the fair value of derivative financial instruments, which are set out in note 9.

	2010		2009	
	Book value £'000	Fair value £'000	Book value £'000	Fair value £'000
Fair value of other financial assets:				
- cash and cash equivalents	1,064	1,064	883	883
- finance assets - loans to group undertakings (note 5)	1,953,733	2,183,859	1,828,227	1,754,405
Fair value of other financial liabilities:				
- European Investment Bank loans (note 8)	146,875	146,875	151,250	151,250
- bonds (note 8)	1,806,809	2,036,922	1,676,839	1,603,017
- other payables (note 7)	62	62	138	138

#### d) Borrowing facilities

The company has the following undrawn committed borrowing facilities available at 31 March, in respect of which all conditions precedent had been met at that date:

	2010 £'000	2009 £'000
Expiring in less than 1 year:		
- term loan facility	75,000	-
Expiring in more than 1 year:		
- revolving credit facilities	345,000	345,000
- term loan facility	-	75,000
	<b>345,000</b>	<b>420,000</b>
	<b>420,000</b>	<b>420,000</b>

The company also has a special liquidity facility of £150 million, which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through the operating cash flow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would arise in the event that the company defaults on its debt financing covenants. No such covenant defaults have occurred during the year. The facility is renewable on an annual basis. All of the above facilities, including the liquidity facility, are at floating rates of interest.

In view of the strong liquidity position, £245m of revolving credit facilities were cancelled on 7 May 2010.

#### e) Capital risk management

##### Gearing ratios (group)

	2010 £m	2009 £m
Total borrowings	(2,912)	(2,759)
Less: cash and cash equivalents	249	139
Net debt	(2,663)	(2,620)
RCV	3,737	3,626
Total capital	1,074	1,006
Less: unamortised bond costs	(6)	(5)
Total capital per bond covenants	1,068	1,001
Gearing ratio	71%	72%

While the company has no capital requirements, as set out on page 11 the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt with the Ofwat-determined RCV.

## Notes to the financial statements cont'd

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### 11. Deferred tax asset

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2009: 28%)

The movement in the deferred tax asset is as shown below:

	<b>2010</b>	2009
	<b>£'000</b>	£'000
At 1 April	<b>22,765</b>	16,011
Income statement credit	<b>2,052</b>	6,754
At 31 March	<b>24,817</b>	22,765

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

	<b>2010</b>	2009
	<b>£'000</b>	£'000
Tax losses and other temporary differences	<b>24,817</b>	22,765
<b>Deferred tax asset</b>	<b>24,817</b>	22,765

### 12. Called up share capital

	<b>2010</b>	2009
	<b>£'000</b>	£'000
<b>Authorised</b> 50,000 ordinary shares of £1 each	<b>50</b>	50
<b>Allotted, called up and fully paid</b> 30,000 ordinary shares of £1 each	<b>30</b>	30

## Notes to the financial statements cont'd

### 13. Analysis and reconciliation of net funds

#### a) Net funds at the balance sheet date may be analysed as:

	2010 £'000	2009 £'000
Cash and cash equivalents	1,064	883
Financial assets:		
- Group receivables	<u>1,953,733</u>	<u>1,828,227</u>
	<u>1,954,797</u>	<u>1,829,110</u>
Net accrued interest	(62)	(138)
Debt due after one year	<u>(1,819,208)</u>	<u>(1,823,175)</u>
Debt due within one year	<u>(134,476)</u>	<u>(4,914)</u>
	<u>(1,953,746)</u>	<u>(1,828,227)</u>
<b>Net funds</b>	<u>1,051</u>	<u>883</u>

#### b) The movement in net funds during the period may be summarised as:

	2010 £'000	2009 £'000
Net funds at start of period	883	691
Increase in net cash	181	431
Increase in group receivables	125,506	61,291
Increase in debt	<u>(135,625)</u>	<u>(20,625)</u>
<b>(Decrease)/increase in net funds arising from cashflows</b>	<u>(9,938)</u>	<u>41,097</u>
Amortisation of bond issue premium	539	542
Indexation of index-linked debt	9,491	(41,443)
Movement in accrued interest	<u>76</u>	<u>(4)</u>
<b>Movement in net funds during the period</b>	<u>168</u>	<u>192</u>
<b>Net debt at end of period</b>	<u>1,051</u>	<u>883</u>

### 14. Employees and directors

#### (a) Staff costs

The company had no employees during the year (2009: none).

#### (b) Directors' emoluments

There were no directors' emoluments in the year (2009: none).

## Notes to the financial statements cont'd

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### 15. Contingent assets and liabilities

Under the company's intercompany loan arrangements with Dŵr Cymru Cyfyngedig ("DCC"), DCC is liable for any cash liabilities that may arise to the extent that such cash liabilities are not already included in fixed interest rates under the tranches of the inter-company loan. An amount equal to such cash liabilities is recharged by the company to DCC as fees under the intercompany loan arrangements.

On 10 May 2001, the company had entered into £625 million notional of interest rate swaps. The purpose of these interest rate swaps was to fix the interest rate on an equivalent amount of floating rate bonds issued by the company. The floating rate borrowings and the interest rate swaps were matched and re-charged to DCC as fixed interest tranches of the intercompany loan of the same date.

The company's floating rate bonds, and the related fixed interest tranches of the intercompany loan, were repaid on 31 March 2005 (£100m), 30 June 2005 (£425m) and 31 March 2006 (£100m). The company's interest rate swaps remained in place to hedge other floating rate liabilities of the group, in accordance with the group's hedging strategy.

In April 2007, £433m notional of these interest rate swaps were terminated and, under the provisions of the intercompany loan account, DCC paid fees to the company of £32.5m.

DCC remains liable, under the intercompany loan arrangements, for any future cash liabilities under the remaining interest rate swap of £192m (2009: £192m) notional. As at 31 March 2010, the mark to market value of this interest rate swap was £45m (2009: £55m), and the interest rate and maturity of the swap were 5.67% and 21 years (2009: 5.67% and 22 years) respectively.

### 16. Related party transactions

The company received interest of £93,171,178 (2009: £90,034,407) from Dŵr Cymru Cyfyngedig, another member of the Glas Cymru Cyfyngedig group.

### 17. Directors' and officers' loans and transactions

No loans or credit transactions with any directors, officers or connected persons existed during the year or were outstanding at the balance sheet date.

### 18. Immediate and ultimate holding company

The immediate parent company is Dŵr Cymru (Holdings) Limited and the ultimate holding company and controlling party is Glas Cymru Cyfyngedig, both of which are registered in England and Wales. The largest and smallest group within which the results of the company are consolidated is that headed by Glas Cymru Cyfyngedig, whose consolidated financial statements can be obtained from the Company Secretary at Pentwyn Road, Nelson, Treharris, Mid Glamorgan CF46 6LY.