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## Summary:

# Dwr Cymru (Financing) Ltd.

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## Rationale

The 'AAA' long-term debt rating on U.K.-based special-purpose vehicle Dwr Cymru (Financing) Ltd.'s (Dwr Cymru) guaranteed senior secured (class A) bonds is based on the financial guarantee provided by MBIA Assurance S.A. (MBIA; AAA/Stable/--). The 'A-' rating on Dwr Cymru's senior secured (class B) bonds, and the 'BBB' rating on the entity's junior (class C) bonds, reflect a combination of the underlying credit quality of the Dwr Cymru Cyfyngedig (Welsh Water) regulated water and wastewater business in Wales, and various structural features designed to enhance cash flow certainty for bondholders. Dwr Cymru is a special-purpose vehicle for Welsh Water, which is owned by Glas Cymru Cyfyngedig (Glas Cymru), a Welsh nonprofit company, limited by guarantee.

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 also supported by a competitively priced long-term outsourcing plan, and the stability provided by Welsh Water's monopoly water and wastewater business. The senior debt further benefits from the existence of junior debt, which is subordinated and cannot force a default of the senior debt.

These strengths are offset by the risk related to a very aggressive--albeit strengthening--capital structure, negative discretionary cash flows, and only moderate debt–protection measures. Additional constraining factors are the ongoing need to raise debt to finance capital expenditures, the risk associated with periodic tariff resets, and a relatively new procurement policy and ownership incentive structure.

The Glas Cymru group has outperformed its financial and operational objectives and, consequently, is in a stronger overall position than it had originally forecast on completion of Dwr Cymru's £1.9 billion refinancing of Welsh Water in May 2001. Moreover, the regulatory environment for U.K. water utilities remains generally supportive following a recent tariff review by the Office of Water Services (Ofwat), the economic regulator for water and sewerage services in England and Wales. Welsh Water's tariff review is characterized by relatively modest price increases, a capital expenditure program similar in size to that of the previous regulatory period, and manageable efficiency targets.

Glas Cymru's aggressive leverage results in only moderate debt-protection measures, although these are increasingly stronger than the levels expected by Glas Cymru at the time of the refinancing. Total net debt to regulated asset value at March 31, 2007, was about 74%, compared with 93% at refinancing in May 2001. Senior interest coverage before and after capital maintenance was 3.3x and 2.0x, respectively, for the fiscal year ended March 31, 2007--both of which are well above the trigger levels of 2.0x and 1.1x, respectively.

### 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. Covenants relating to liquidity include a requirement to have sufficient cash and bank lines for the next 12 months' enhancement capital expenditures. The steady, predictable net cash flow stream produced by Welsh Water, and minimal near-term debt maturities, provide further support; and there is a £150 million liquidity facility at Dwr Cymru in case Welsh Water is unable to pay its interest bills during a standstill period. Actual liquidity, in the form of cash and cash equivalents, was £158 million at March 31, 2007. Undrawn, unconditional available bank facilities totaled £345 million at the same date.

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