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Research Update:

U.K.'s Dwr Cymru Debt Ratings Raised On De-Leveraging And Favorable Ownership Structure

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Rationale

On Dec. 18, 2007, Standard & Poor's Ratings Services raised to 'A' from 'A-' its long-term senior secured debt rating on the (Class B) bonds issued by the U.K.-based special-purpose vehicle Dwr Cymru (Financing) Ltd. (Dwr Cymru). At the same time, the long-term subordinated debt rating on the entity's (class C) bonds was raised to 'BBB+' from 'BBB'. In addition, the 'AAA' senior secured debt rating on its Class A asset-backed bonds guaranteed by MBIA U.K. Insurance Ltd. (AAA/Stable/--) were affirmed. 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.

The rating action reflects Glas Cymru's sustained trend of de-leveraging, enhanced by its ownership structure, which is unique among water companies and insulates the company from shareholder pressures to gear up its balance sheet, and the company's public commitment to target a 70% level of net debt to regulated asset value (RAV). Although Glas Cymru's gearing is still relatively aggressive, the debt coverage ratios are markedly stronger than at the time of the refinancing in 2001, while creditors continue to benefit from the protective features of the financing structure. Total net debt to RAV at Sept. 30, 2007, was about 73%, compared with 93% 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.

The upgrade reflects Standard & Poor's expectation that the trend of lower gearing will continue. Glas Cymru has secured funding for its capital expenditure program for this regulatory period ending on March 30, 2010. Within the same timeframe, the capital structure is expected to improve further as cash flows, after customer rebates, strengthen. Looking ahead in its 25-year Strategic Direction Statement, which was published in November 2007, the company's management has committed to an optimum stable gearing level of about 70%.

Glas Cymru's benign ownership structure is a distinguishing feature in general and relative to other water industry corporate securitization transactions. Glas Cymru is a nonprofit organization, controlled by 'members' with no financial interest in the company. This eliminates potential pressure for dividends and other shareholder returns.

The 'A' rating on Dwr Cymru's senior secured (class B) bonds, and the 'BBB+' rating on its subordinated (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. The ratings continue

to be underpinned by the strong and stable cash flows produced by Welsh Water's monopoly water and wastewater business, strong liquidity, and the overall covenant package, as well as the competitively priced long-term outsourcing plan. These strengths are offset by the risk related to a relatively aggressive--albeit strengthening--capital structure, negative yet improving discretionary cash flows, and only moderate debt-protection measures. An additional constraining factor is the risk associated with periodic tariff resets, though the regulatory environment for U.K. water utilities remains generally supportive.

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 £99.8 million at Sept. 30, 2007. Undrawn, unconditional available bank facilities totaled £345 million at the same date.

Ratings List

	To	From
Ratings raised		
Dwr Cymru (Financing) Ltd.		
Senior secured debt	A	A-
Subordinated debt	BBB+	BBB
Ratings Affirmed		
Dwr Cymru (Financing) Ltd.		
Senior secured debt*	AAA	

*Guaranteed by MBIA U.K. Insurance Ltd.

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