Dŵr Cymru
Welsh Water

Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

Tel: +44 (0)1443 452300
Fax: +44 (0)1443 452323
Web site: www.dwrcymru.com

Heol Pentwyn
Nelson
Treharris
Morgannwg Ganol
CF46 6LY

Ffôn: +44 (0)1443 452300
Ffacs: +44 (0)1443 452323
Safle gwe: www.dwrcymru.com

Sian Phipps

Committee Clerk

National Assembly for Wales Enterprise and Learning Committee

Cardiff Bay

Cardiff CF99 1NA

9 September 2010

Dear Sian

Role of social enterprises

Further to your letter of 20 July, I enclose some background material ahead of our attendance at the Enterprise and Learning Committee at 9.30am on 22 September. The first attachment is the presentation I gave at Voice10 in February earlier this year, the Social Enterprise Coalition's annual conference which was held in Cardiff and sponsored by the Welsh Assembly Government.

The key points I would draw out of this presentation for the Committee are:

1. While Welsh Water is a social enterprise - in the sense that since 2001 the Company has been owned, managed and financed in the interests of its customers with the single purpose of providing an essential public service to those customers and looking after what is a £25 billion and long term industry for future generations of customers - day to day, we operate exactly in line with any other company that has shares listed on the London Stock Exchange.

2. We have demonstrated that by operating in this way in the regulated water industry we have no difficulty raising finance for our continuing large capital investment programme and indeed our record shows that we can raise this capital more efficiently than other regulated water companies (see attachment 2).

3. Glas Cymru's acquisition of Welsh Water in 2001 funded by a £1.9 billion bond issue (still the UK's largest non-financial bond issue) would not have been possible without the strong and public support of both the Welsh Assembly Government and the National Assembly for Wales; that continued and cross party support continues to matter in all sorts of ways, including investor perceptions to do with "political risk", progressing capital schemes "on the ground", helping us to provide the best possible service to our customers during for example droughts, and support for social tariffs.

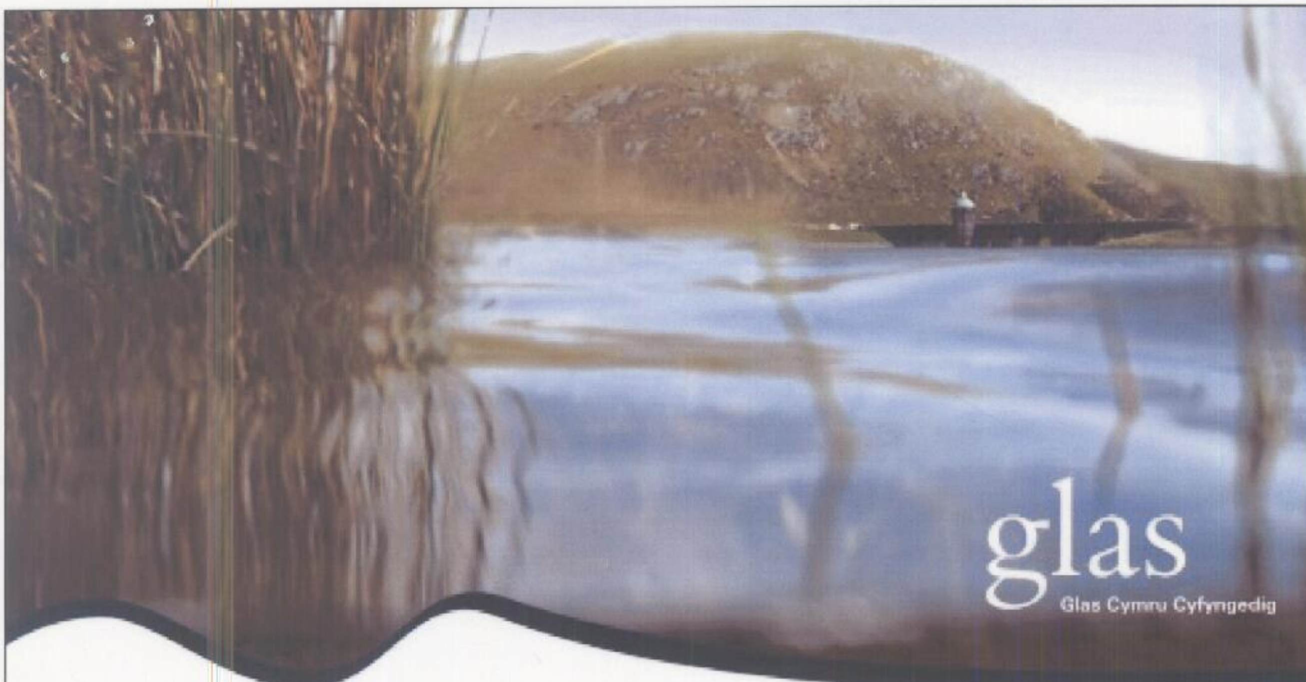
4. To date no other privatised water company has adopted our "not for profit" model, although it has recently been recommended for Scotland Water by the Scottish Futures Trust (see attachment 3), but I do not believe this is due to any lack of institutional or political support for our model.

Let me know if you would like any further background before the Committee meets on 22 September, otherwise I and my colleague Mike Davis, our Planning and Regulation Director, will see you then.

Yours ever

Nigel.

Nigel Annett
Managing Director



Glas Cymru and the water industry in Wales

Tuesday 2 February 2010

voice10

SOCIAL ENTERPRISE COALITION

glas
Glas Cymru Cyfyngedig

From the City to Ystrad Mynach...

- Investment banking for 10 years
- Privatisation of water industry in 1989
- Planning Director Welsh Water
- "Customer Trust" was "pinko talk" in 1994
- Failure of Hyder "multi-utility" in 1999
- Glas Cymru in 2001

glas
Glas Cymru Cyfyngedig

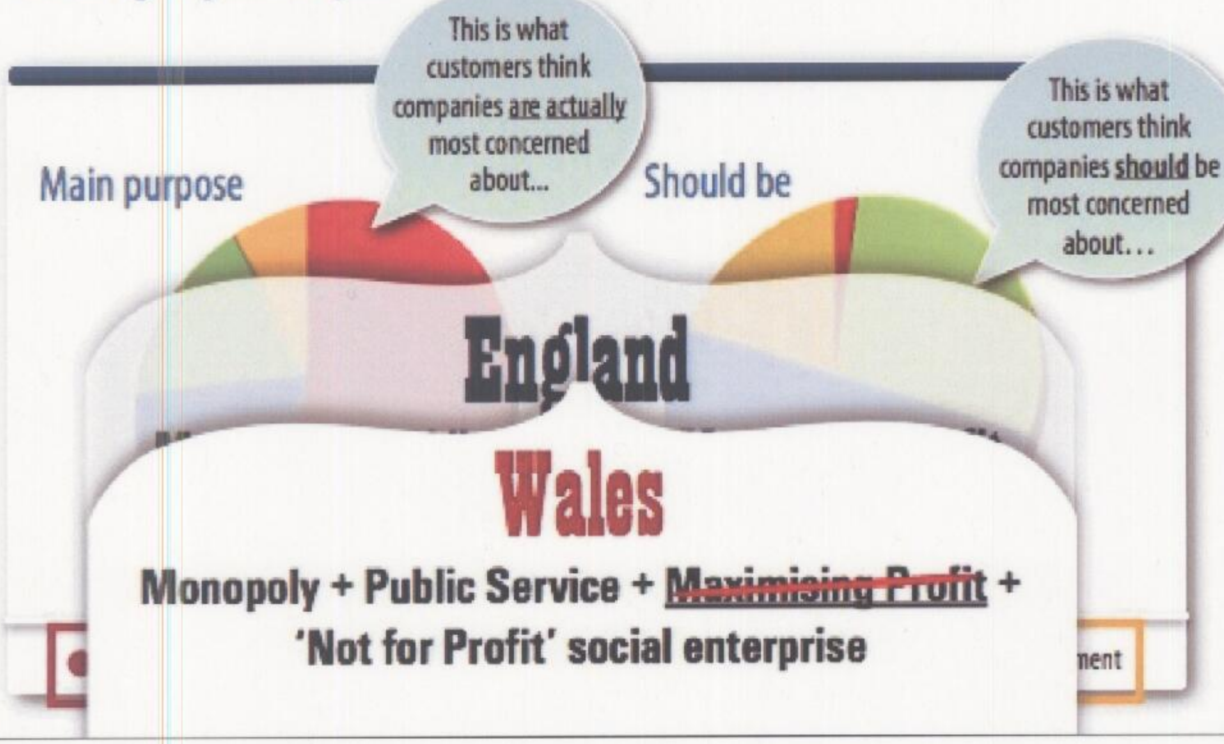
Dŵr Cymru Welsh Water is a large enterprise...

- Sixth largest of the ten regulated water and sewerage companies
- 1.2 million household customers, 100,000 business customers
- Urban South and North East, otherwise rural with long coastline
- 80 water treatment works, 28,000km of water mains
- 850 wastewater treatment works, 19,000km of sewers
- Investing £250 million every year
- Employs assets worth £25 billion - £20,000 per customer
- Assets per customer is around 30% higher than industry average
- Average customer bill still higher than average - but gap closing quickly

glas
Glas Cymru Cyfyngedig

A problem with legitimacy...

Tackling legitimacy...



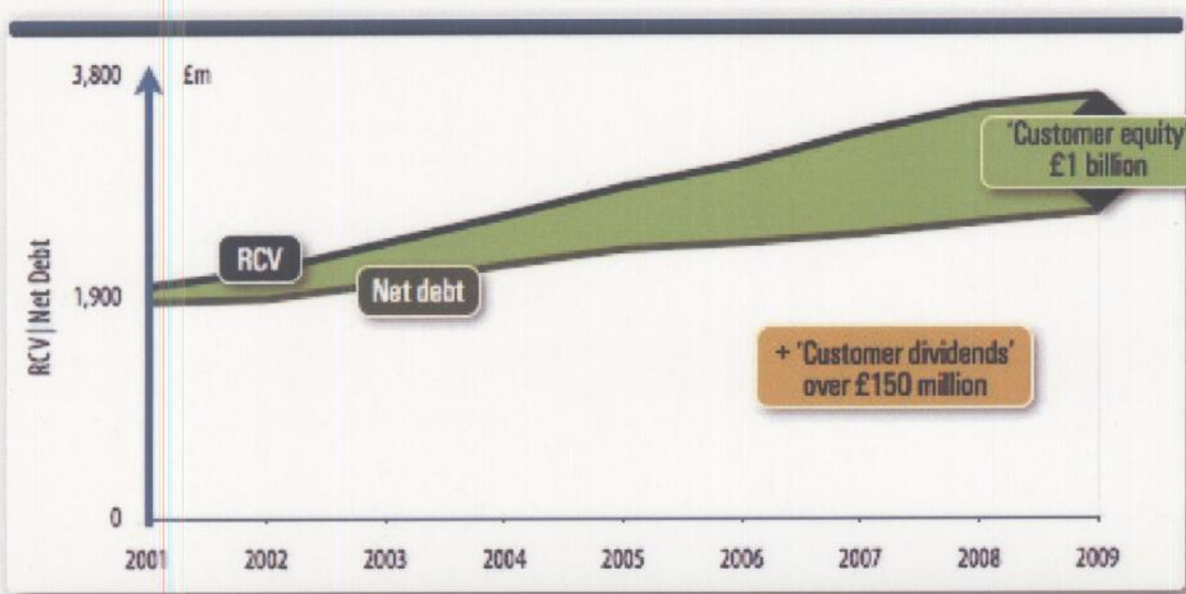
Glas Cymru is a social enterprise...

- Company Limited by Guarantee under the Companies Act
- Formed in 2000 to make offer for Dŵr Cymru
- Members carry out normal corporate governance role of shareholders
- Compliance with "Combined Code" of London Stock Exchange
- Single purpose company - better value services to customers
- Key is cutting cost of financing assets and investment
- £1.9 billion bond issue in May 2001 - over £1 billion raised since then
- CLG structure - "means to an end" - low cost long term financing

A social enterprise can finance efficiently...

- Regulated monopoly providing a public service
- Heavyweight, non-executive board - strong incentives and disciplines
- Full disclosure against regulatory benchmarks - measurable industry
- Quarterly investor reports including forecasts
- Cannot diversify into unrelated activities
- CLG structure "locks in" key credit quality features
- Legitimacy because we are a "not for profit customer corporation"
- Alignment of interests - less regulatory and political risk

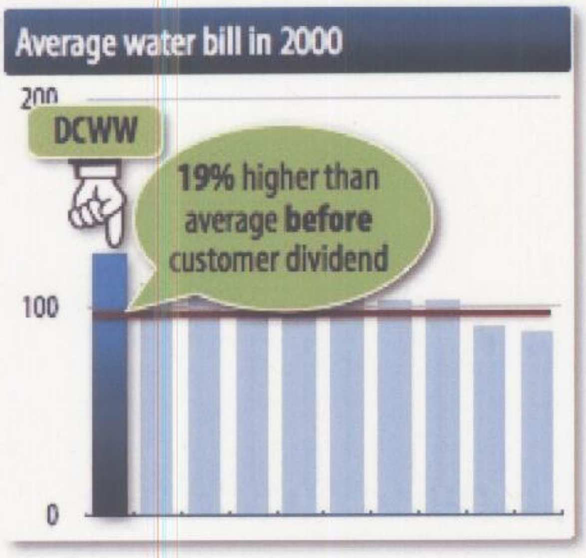
Growth in 'customer equity'

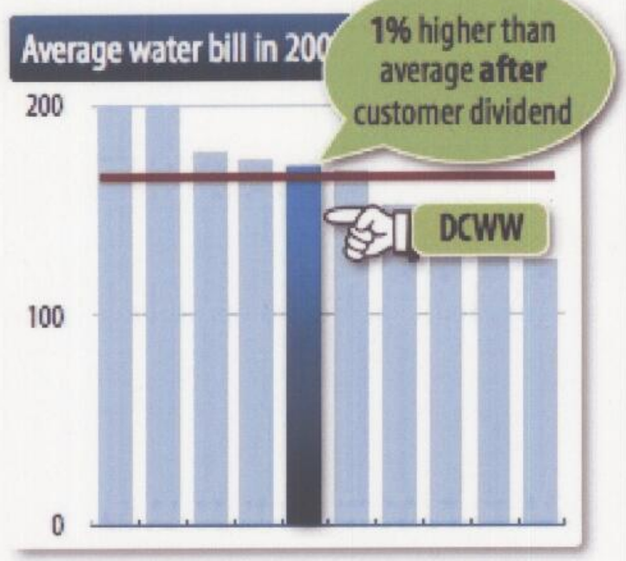


Glas Cymru and the water industry in Wales

glas

Customer bills





Glas Cymru and the water industry in Wales

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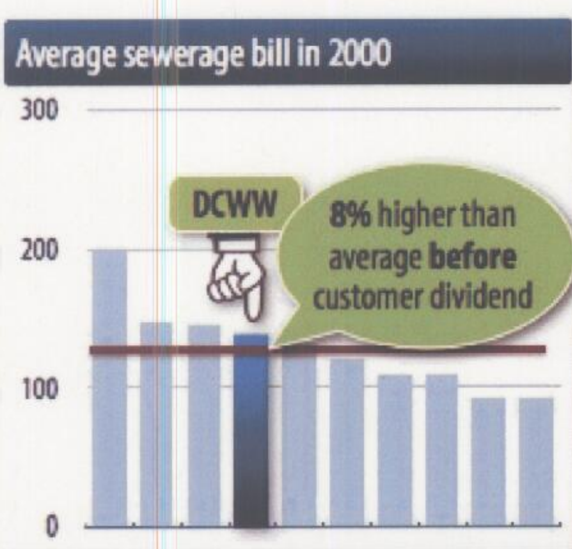
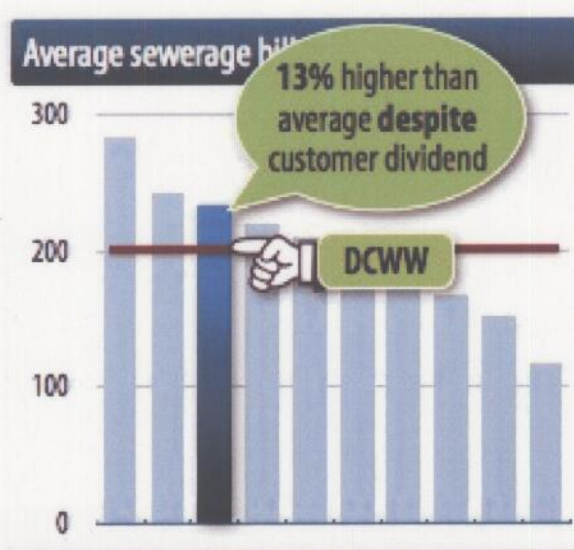
Customer bills





THE Sun

£20 bills cuts are on tap..

WELSH WATER is to slash £20 from every customer's bill - at a cost of £27 million.

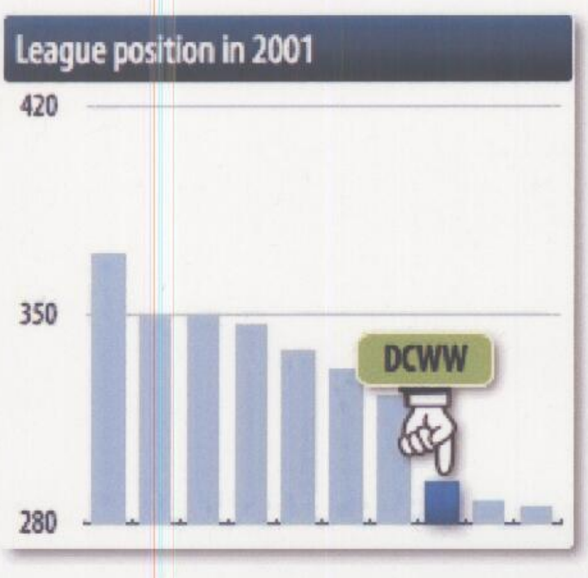
DAILY Mirror

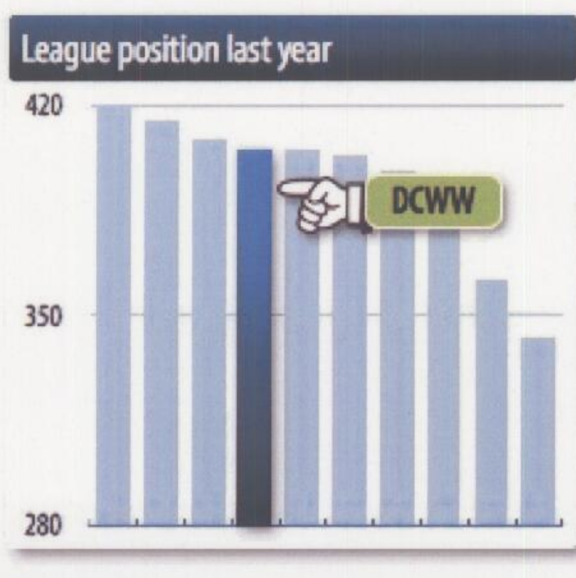
WELSH WATER'S
1.3 million customers are sharing a £27 million dividend after another bumper year.
The £20 per customer pay-out takes the five year total to £100m.
The company raised the pay-out after doubling profits to £33m despite a £30m increase in spending on the network to £269m and hitting its target for cutting leaks.

Glas Cymru and the water industry in Wales

glas
Glas Cymru Cyfyngedig

Overall Performance Assessment





We are trustees of the water industry in Wales...

- Few things more important than safe drinking water and sanitation
- Single purpose that everyone believes in - customers, not shareholders
- Legitimacy - being "not for profit" we are trusted
- Incentives and disciplines just a strong as for other companies
- Affordable - low cost of asset finance is (more or less) all that matters
- Freedom to "do the right thing" for our industry and its customers
- Retain and attract talent - who can offer a more worthwhile vocation?

Dwr Cymru Cyfyngedig ("Welsh Water") GBP140m 38yr Index-Linked

Dŵr Cymru Welsh Water

On Friday, 19 March 2010, Welsh Water, the sixth-largest UK regulated water utility, issued GBP140m 1.859% Index-Linked notes due March 2048

This transaction represents the tightest print in the sector since 2008 with a spread of G+125bps and a coupon of 1.859%

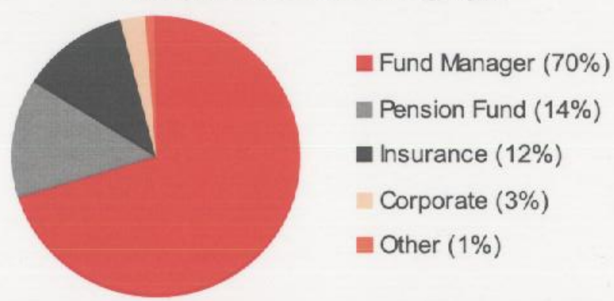
The 38 year maturity is also the longest seen since the market was re-opened in June 2009 and the exact 2048 maturity was driven by specific investor feedback

HSBC was Bookrunner and Joint Lead Manager on this transaction

Terms and Conditions

Issuer:	Dwr Cymru (Financing) Limited
Issue rating:	A3/A/A
Size:	GBP140m
Pricing Date:	19 March 2010
Settlement Date:	31 March 2010
Maturity:	31 March 2048
Re-offer spread:	G+125bps (vs. UKTI 0.75% 2047)
Coupon:	1.859%
Price:	100.00
WBS Covenants:	*Interest Cover:*
	Senior ICR (trigger 2.0; default 1.6);
	Senior ICR post maintenance spend (trigger 1.1);
	Net Debt/RAV:
	RAR (Senior +C) (trigger 90%; default 95%)
Denomination:	GBP50k + 50K
Listing:	Luxembourg Stock Exchange
HSBC role:	Bookrunner

Allocation Breakdown by Type



Execution Highlights

- Dwr Cymru Cyfyngedig ("Welsh Water") is the sixth-largest UK water utility by regulatory capital value, providing water and sewerage services in the most of Wales and certain adjoining areas of England
- The company's financing is arranged through a whole business securitisation ("WBS") which limits leverage
- Following two days of investor meetings in London, Welsh Water received overwhelmingly positive feedback about their unique not-for-profit model and commitment to de-gearing
- This positive momentum gave the company confidence to announce a new IL transaction with a guidance of G+125bps
- The 38 year maturity is the longest seen since the market was re-opened by Yorkshire Water in June last year and the exact 2048 maturity was driven by specific investor feedback (hedging long-dated liabilities)
- Longer-dated maturities are also attractive for issuers due to the inverted index-linked Gilt curve (i.e. a lower yield at longer maturities)
- Although it remains a niche market we continue to see new investors participate in index-linked transactions although the larger anchor accounts are becoming more selective
- Real money inflation investors are still looking for a premium over conventionals for index-linked transactions and Welsh Water paid 35bps new issue concession compared with their outstanding 2021s and 2028s which were trading at G+90bps
- However, given the 35bps yield differential between the 2027 and 2047 Index-Linked Gilts, the company paid no yield premium for the additional maturity
- This transaction sets a new benchmark for UK regulated utility index-linked issuance with the lowest coupon, lowest spread and longest maturity since 2008

HSBC

Herald Scotland

Thursday 9 September 2010

Futures Trust argues for £3.5bn privatisation of Scottish Water

Steven Vass, Deputy Business Editor

Share 0 comments

18 Jul 2010

The Scottish Futures Trust (SFT) has proposed a £3.5 billion semi-privatisation of Scottish Water to reduce the need for public spending cutbacks in other areas, the Sunday Herald can reveal.

Following a lengthy investigation into the nation's water provider dating back to last year, the SFT has produced a report for the Scottish Government on how it could be funded in future. The report, which is likely to cause serious tension between Government ministers, argues that moving Scottish Water to a private not-for-profit ownership model along the lines of Oxfam, Network Rail or Welsh water provider Glas Cymru is a "viable alternative" to state ownership.

It says that Scottish Water could be refinanced using private money to repay the £2.75bn debts it currently owes the Scottish Government, to which a further £750 million could be added to the public coffers by increasing its debt levels to typical market levels for water companies.

The report is careful not to rule out maintaining the status quo, which has been jealously protected by successive Scottish administrations, but it strongly signals that it is not the most desirable option.

> The current situation is probably unsustainable for Scottish Water.

David Watt, executive director, Institute of Directors in Scotland

It says: "The need to plan long-term investment, such as upgrading Glasgow's sewer network, will compete for Scottish Government capital funding against other priorities such as schools and roads. Scottish Water currently accounts for 5% of the Scottish Government capital budget but even at current levels of water investment, this will grow to 10% as capital budgets shrink."

It argues that public budget cuts would increasingly mean that the Government's annual £140m Scottish Water handout would be at the expense of essential public services. It also concludes that reducing water investment or increasing customer rates would be unrealistic. These views will run contrary to those of many in the SNP administration, which has repeatedly ruled out the prospect of any change of water ownership.

Although the report does not consider the option of outright privatisation, the favoured alternative, branded "ownership for the people by a public benefit corporation", is to scrap state control and pay interest to private lenders in a similar way to Glas Cymru. It stresses that this would be at levels not much higher than current public borrowing and lower than other private borrowing models such as public-private partnerships (PPP).

"The Company would benefit from the stability of being able to plan infrastructure investment, and investment in more entrepreneurial activities, over longer periods and based on planned programme and business efficiency rather than being constrained by [the Government capital budget]," it says.

David Watt, executive director for the Institute of Directors in Scotland, said: "The current situation is probably unsustainable for Scottish Water. Whether or not you like the status quo, public-sector cuts are coming and the report's different ownership options are welcome.

"While privatisation might be sensible, there is no political appetite for it. On the other hand, it's not the time to be saying that we as the Labour Party or we as the SNP don't believe in change. Political dogma should go out of the window."

Dave Moxham, deputy general secretary of the Scottish Trades Union Congress, strongly disagreed.

He said: "Obviously we haven't seen the report but we remain deeply sceptical that any delivery body along the lines of the Welsh model can maintain sufficient state accountability or sufficient independence from the financial institutions, which would inevitably call the tune in a capital intensive industry like water. Ultimately this would be to the disadvantage of Scottish Water consumers. As soon as KPMG were taken on to do some of the work we expected it would go in this direction."

The Sunday Herald originally revealed that the SFT was investigating alternative ownership structures for Scottish Water six months ago. It is understood that Edinburgh merchant banker Sir Angus Grossart made it a pre-condition for accepting the chairmanship of the SFT when it was set up last year by the SNP to look at alternatives to PPP and review public sector efficiency in Scotland.

With the Scottish Government's capital budget already projected to fall by 12% a year over the next three years, observers are already wondering how this will impact on big projects such as the new £2.3bn Forth Road Bridge and the £842m Southern General hospital in Glasgow. Last year the administration set up an independent budget review panel led by former Scottish Enterprise chief executive Crawford Beveridge to make proposals for how Scotland should cope with the Tory-LibDem national deficit reduction plan.

Beveridge is already on record as saying that Scottish Water privatisation should not be ruled out, and his report could well reinforce the SFT proposals when it is published in the next few weeks.

Although the SFT's favoured model is very close to Glas Cymru, the report makes clear that the structure would not be identical. Unlike the Welsh provider, which was designed to replace its bankrupt private predecessor, Scottish Water's stronger financial footing would mean that it would not have to outsource the majority of its functions to the private sector. It would also be in a position to pay greater dividends.

The SFT acknowledges that the Scottish and UK Governments would have to reach an agreement as to how the debt repayment was divided up, but said that customers would receive dividends in the form of reduced bills.

The report meanwhile rules out mutualisation, the preferred LibDem model, on the grounds that debt-financing protocols are untested and it would cause too many governance problems to give every owner/customer a vote on corporate decisions.

An SFT spokesman said: "The Scottish Futures Trust initiated work to consider the funding future options for Scottish Water in public ownership. The paper sets out clearly the possible options for Scottish Water in public ownership and is an even handed analysis of the benefits and disadvantages of each of the options."