

LIQUID ASSETS

THE THAMES WATER TREASURY TEAM HAS DEVELOPED A HOLISTIC AND INCLUSIVE APPROACH TO MANAGING EXTERNAL STAKEHOLDERS. AUSTIN MATTHEWS EXPLAINS

Effective bank relationship management is of vital importance to every treasurer, but there are other critical relationships that require the attention of the treasury team of any major corporate. Thames Water is an organisation that has a diverse selection of financial market stakeholders and managing the requirements of each of these is a considerable challenge. Over the past few years, the Thames treasury team has turned a necessity into a strength by learning how to effectively balance these interests to allow the company to stay agile in the financial markets in the midst of a very challenging environment.

In common with a number of the major water companies in the UK, Thames Water operates under a whole business securitisation (WBS) capital structure. This effectively means the following:

- ◆ A clear set of security and guarantee arrangements are in place to ensure the position of bondholders and lenders is protected;
- ◆ A range of financial and operational covenants exist to govern the operation of the business and uses of cash flow;
- ◆ Strong liquidity needs to be maintained at all times

with several different facilities and a separate debt-service reserve; and

- ◆ Higher level of gearing can be maintained while retaining a strong investment-grade credit rating, as the covenant, guarantee and security arrangements restrict the activities and uses of cash generated by the business.

As the UK's largest water company, with the biggest investment programme in the industry (£4.6bn over the period 2010-15), the relationship banking group is vital to Thames in providing the liquidity that underpins the capital structure and further credit capacity to support funding and hedging plans.

This is only a part of the picture, however. The treasury team of seven, led by group treasurer Andrew Beaumont, has many other relationships to manage. The heavily structured nature of the business, combined with the scale of outstanding debt obligations (c.£9bn gross debt as at 30 September 2012) and ongoing future funding requirements, mean that regular communication with bondholders, the security trustee and the credit rating agencies must also be of paramount importance.

Bond and other debt-holders

Thames Water has been highly active since returning to the capital markets in 2006, issuing over £7bn of bonds with maturities from 2013 to 2062.

While conventional wisdom may have it that there is limited direct interaction between bond investors and the issuer, this methodology has fast become outdated, particularly in an issuance-heavy sector such as the water industry. Beaumont and assistant treasurer – corporate finance, Antonia Butler, are in regular communication with the large institutional investors who regularly buy Thames paper and often speak directly to inform them of developments in water industry regulation or company-specific matters.

Added to this, Thames produces a twice-annual investors' report primarily aimed at bondholders. "We have increasingly found that bond investors welcome the opportunity to keep up with important developments within the company and the industry," says Beaumont. "There is a balance to strike here as clearly investors have only limited available time to invest in 'non-deal' credit work. They seem to

appreciate this approach, however, and the fact that the company is willing to engage throughout the year and not just when it is looking to raise funding."

A new dimension has been added in the past year with Thames' first venture into the US private placement (USPP) market, introducing new investors to its WBS structure. When an amendment to the Thames' Intercreditor Deed was recently proposed, Beaumont held a conference call with USPP investors to fully explain the amendment and what impact it would have for debt-holders. This process led to several of the USPP holders voting for the changes, which were passed in late December at no cost to Thames. "Private debt-holders are key to the secured debt structure," says Butler. "The relationship is bilateral and their support is important as their votes really do count."

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Security trustee

Within Thames' capital structure, the security trustee's role is to act to represent the interests of the secured lenders. Accordingly, it is vital that the company maintains a strong working relationship with the trustee.

Within the past year, Thames has faced various issues that have necessitated amendment to finance documents and therefore consultation with the security trustee. As an example, Thames finance documents include minimum counterparty rating levels for a range of activities (cash management bank, committed facility provider and swap counterparty). During 2012, the credit ratings of a number of banking counterparties fell below the minimum rating level, creating a need to either replace counterparties, seek waivers from the trustee or amend documents. This created a need for discussions with the security trustee to develop workable solutions.

The security trustee must be consulted about any proposed change to any finance document

The lesson here is a simple one – the security trustee must be consulted about any proposed change to any finance document – no matter how trivial it might appear to the company. “A friendly and open dialogue with the trustee helps when tackling more complex issues,” says Butler. “Communication on this basis means you get to understand what else might be going on with the trustee and use new information to the company's benefit.”

Credit rating agencies

On the face of it, the UK-regulated water industry

represents a stable proposition for bond investors given the repetitive nature of cash flows allied with spending programmes that are agreed in advance on a five-year cycle with the regulator, Ofwat. This does not mean that the company can take its relationships with the credit rating agencies lightly, however. In line with other regular issuers, maintenance of a strong investment-grade credit rating is fundamental. Accordingly, it is important to ensure that the agencies are regularly informed on issues ranging from possible temporary use bans through operational performance (including Thames' part in supporting the 2012 London Olympics) to macro issues such as increased competition in the water industry.

Having held the group treasurer post for seven years, Beaumont has seen the importance of strong engagement with the agencies first-hand. “We have been lucky enough to gain a host of opportunities to engage with the agencies, from balance sheet restructuring, through M&A activity to establishing credit ratings at a subordinated level to facilitate high-yield bond issuance. In this, I have learned that early engagement is essential, alongside a willingness to share information, regardless of whether it may be deemed credit ‘positive’ or ‘negative’, as it is critical to avoid surprises.” Butler comments: “Over the past few years, we have provided the agencies

with our insights on technical and industry issues. We really appreciate the well-informed two-way dialogue between Thames and the agencies – it can only be beneficial to the ratings process.”

Facing the future

Looking forward at Thames there are considerable challenges to face. Funding requirements will remain at a high level as the company looks to invest in the water infrastructure of London, much of which still dates back to Victorian times. Delivering this will be a challenge in a world where bank credit capacity is becoming more constrained.

Also, the regulatory environment in which the company operates is likely to change and develop over the medium term, bringing possible deregulation and increased competition. Facing these challenges will, says Beaumont, “demand that we maintain the best relationships we can with our key stakeholders. It might be that some of the issues we face might not, if taken at face value, be regarded as credit-positive from the perspective of bond investors or rating agencies, but this doesn't mean we can avoid the need for excellent communication.”

VIEW FROM STUART SIDDALL

Stuart Siddall is the current CFO of Thames Water and former CEO of the ACT. He comments: “Too many companies treat the rating agencies like an investor. Companies need to understand their rating and the drivers that are of special interest to the agencies. They shouldn't be surprised if they are downgraded when operational results do not match expectations. Companies should be absolutely open and honest with the agencies and develop a trusting relationship with them.”



Austin Matthews is assistant treasurer – operations at Thames Water