



Still waters run deep

TONY HOOPER, GROUP
TREASURER OF PENNON
GROUP TALKS TO MICHELLE
PERRY.

PHOTOGRAPHER: ROGER HARRIS

As a life source, water has proved its worth to Tony Hooper who has forged a successful and varied career in water companies in the public and private sector for the last three decades.

Starting out as an accountant – a path many treasurers follow – Hooper qualified as a member of the Chartered Institute of Public Finance and Accountancy (CIPFA) in 1984 aged 26. He provides not only the perfect example of the evolving role of a treasurer in the 21st century, but also shows how a qualification is only what the holder makes of it. Hooper is an ACT member through his company's corporate membership.

Despite holding the CIPFA accountancy qualification – a qualification traditionally closely tied to the public sector – he is now the group treasurer of the publicly listed water and waste management company Pennon Group plc, a FTSE 250 group with assets in excess of £2bn and a market capitalisation of over £1bn.

He has been with the group through its long and arduous transformation from local authority, the South West Water Authority, and non-tax paying entity, to a wholly privatised, UK-based publicly listed company.

In 1988 Hooper began preparing the financial groundwork for the shift to privatisation when he was seconded to a small privatisation

unit within South West Water where he had responsibility for financial modelling and reporting.

A year later Pennon Group plc emerged and Hooper took up the role of Group Taxation Manager in the newly formed group finance department.

"On privatisation I decided to move to look after taxation. From a local authority perspective it was quite onerous because local authorities simply don't do corporation tax. So it was moving the entire entity from a tax-exempt position to being taxed. A lot of work went into that."

For the next decade he was submerged in the complex world of taxation, including qualifying as a full member of the Chartered Institute of Taxation in 1994, which he says set him in good stead for his current role of Group Treasurer which continues to encompass tax. During this time he worked alongside Tony Charles, his predecessor, providing him with a clear insight into what was to come.

"We had worked very closely together as there was a lot of overlap between treasury and tax, whether it was selling assets under a finance lease or developing investment opportunities. Tony and I would speak regularly to decide whether a transaction was practical to do and added value to the organisation," he explains.

On Charles' departure Hooper was offered the opportunity to become Group Treasurer. He has retained responsibility for tax and has also recently taken insurance under his wing as well, leaving him with a potentially unfortunate acronym if his roles – treasury, tax and insurance – are placed in the wrong order.

"I've been in that role for over three years now. I have to say it's been very worthwhile

Takeover Target

As a FTSE 250 company Pennon is a prime target for takeover bids. The water company has seen off a number of bids over the years but as Group Treasurer Tony Hooper points out you never know when the next one might crop up.

Last year Guy Hands' investment fund Terra Firma considered bidding for Pennon, owner of South West Water. But Hands saw the £1bn takeover opportunity rejected in May 2004.

The water and waste business took soundings from some of its biggest shareholders before rejecting the approach, worth about 800p a share, from Terra Firma.

At the time Pennon said the Terra Firma offer "failed to recognise the entire strategic value" of the group.

A complex situation arose around the bid as Hands began competing against Pennon to buy the £200m landfill assets of the Shanks Group.

Utility analysts hinted that Pennon was chasing Shanks as a defensive manoeuvre.

Through its Viridor Waste business, which has been one of the main profit drivers for the group, Pennon is already engaged in landfill.

Pennon lost its bid for Shank's UK landfill assets to Terra Firma. The Shanks assets will go to Waste Recycling Group, bought by Terra Firma in 2003.

Terra Firma Capital Partners grew out of Nomura's Principal Finance Group (PFG) established by Guy Hands in 1994. The group is a private equity organisation with offices in London and Frankfurt.

The rise of private equity takeovers is an increasingly worrying issue for corporate treasurers and a point recently highlighted at the ACT annual conference last month.

having a tax background. To understand complicated tax issues you have to break every transaction down to the very lowest level. That's been very useful in taking on treasury, as there are a number of tax privileged transactions around where it's very helpful to have one person with two hats," Hooper says.

The tax position of the company has also shaped the nature of its borrowing strategy, explains the Treasurer. Unusually for a FTSE 250 business, much of the group's borrowing comes not from the bond market, but by raising finance through selling the company's plants and machinery through finance leases.

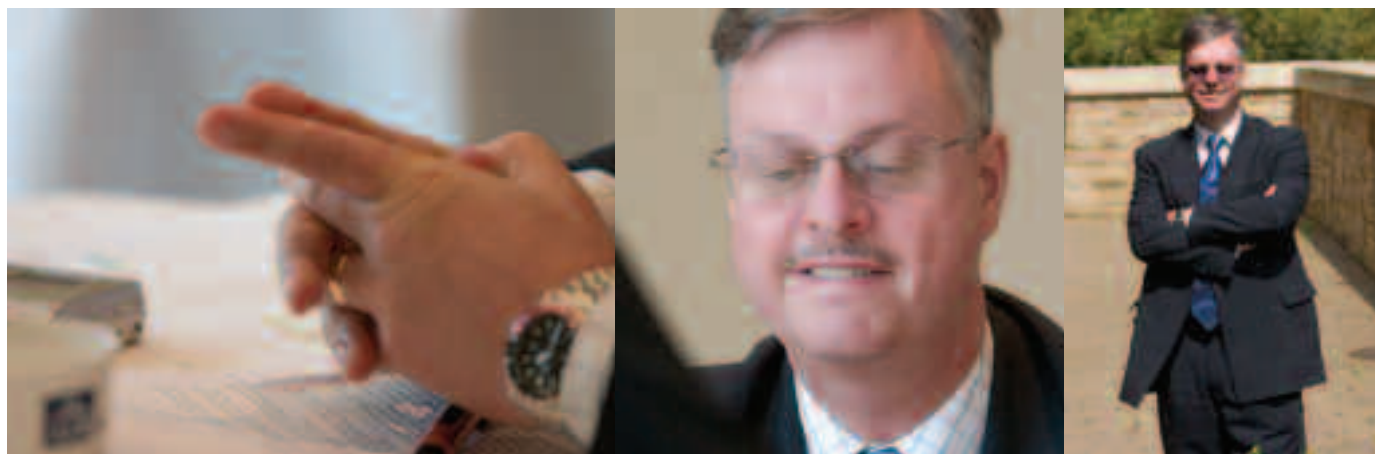
"It's unusual. Half of our borrowings, around £500m, are in the form of finance leases that have been in place since the 1990s. It's not typical of our peers in the water sector; certainly not typical of other FTSE 250 companies that raise money from debt capital markets," he says.

That is likely to change however given that the group will now begin paying corporation tax from this year. "In the past we've concentrated our borrowing in the finance lease sector but in the future we will look elsewhere," Hooper explains.

The transition to the new financial reporting regime under international financial reporting standards (IFRS), hasn't plunged Pennon into too much turmoil either, affecting the group's borrowing structure perhaps less than other listed companies.

"In our borrowings we have been fortunate enough to ensure that our covenant testing continues to work. There are a number of companies that have had to renegotiate borrowings and covenants because of IFRS. But we've been fortunate to





have frozen GAAP so we've been able to continue to test covenants under UK GAAP even though we've moved into IFRS," explains Hooper.

That said, the Treasurer hasn't been exempt from the pain of *IAS 39 Financial Instruments: Recognition and Measurement*, the controversial and arguably weak rule on accounting for financial instruments.

"That's the area that's been most complex for us because the vast majority of our borrowing is on a floating variable interest rate," says Hooper.

To protect the company against volatility of interest rates the group has negotiated a fixed rate on at least half of the debt on an ongoing basis.

"We have put in place swaps to protect ourselves against volatility. It's an issue that now results in the transaction being recognised through the accounts. Under IAS 39 you are obliged to mark to market the swap and then decide what proportion of the swap needs to be taken through the profit and loss account, or directly to balance sheet by reserves. It's been quite a significant task for us," he explains.

For a treasury team of only four people including himself looking after the whole group – which includes Viridor, Pennon's non-regulated business, a nationwide waste disposal company – they have had their work cut out for them over the past few years.

Still technology newly implemented in the company because of IAS 39 will save the team a great deal of time and effort.

"We've invested in a new system that will assist us in marking to market. In the past we've marked to market our swaps by ringing around the banks and asking them to value the swap at a point in time.

"In the future the system will look at the yield curve and do the discounting of the derivative to calculate what the mark to market value is. We will be able to obtain that

Financial Outlook

The water and waste business revealed group operating profit up 7.3% to £136.3m in its annual results for 2004.

South West Water was up 6.6% to £118.9m but it was the waste management group that really kept the company afloat. Viridor's profits rose 18.8% to £22.7m before goodwill.

Pre-tax profit rose 6.2% to £78.8m, while earnings per share (before deferred tax) climbed 4.9% to 57.7p.

The company said trading was "in line with expectations" with South West Water on track to outperform the current regulatory contract. The group has submitted its final 2005-2010 business plan to Ofwat, the water and waste regulator. Under the price controls, South West Water will be allowed to raise its water and sewage bills by 25% in real terms between 2005 and 2010.

Viridor Waste showed strong growth in profits from landfill and power generation.

"We have made excellent progress," said Chairman Ken Harvey on presenting the results in March. "These strong results demonstrate further profitable growth in South West Water and Viridor Waste, affirming our strategy once again of focusing on these two key businesses."

In June 2003 Pennon acquired waste management business Churngold Holdings Limited for £19.8m. Thames Waste Management Limited was acquired just after the year end, on 6 April 2004, for £30.5m (£28.4m net of cash). The group has made seven acquisitions for a total consideration of £104m since 2001/02.

Net debt for the group was £1,074.1m, an increase of £85.5m since 31 March 2003. Gearing, being net borrowing to shareholders' funds, was 119% (2003 – 111%). Interest cover was maintained at 2.4 times.

information much more readily without having to rely on bank counterparties to do it; allowing us to play 'what ifs'. Technology will help to inform the board and assist with strategic plans," explains Hooper.

Although little keeps Hooper awake at night – a positive sign since he already spends 10 hours a day in the office and often has to work Saturday mornings – he's alert to the cyclical nature of the debt market, especially since Pennon is an habitual borrower and its borrowing sources will in the future radically change.

"It's relatively easy to raise money from the banking sector at the moment. There's a wall of money that's on offer. Margins are tight. But these things come in cycles. It wasn't that long ago that companies found it difficult to raise finance because of structural subordination. It will become more and more difficult to obtain funding," he says.

Pennon has already had some experience of a changing marketplace when a larger rival swallowed up one of its relationship banks. But he says for the moment it's not a major concern as he ensures his banking relationships are varied and broadly spread.

The incoming tide of regulatory, accounting and legislative change is sufficient to keep the Exeter-based Group Treasurer on his toes. But if that wasn't enough he also faces potential takeover bids. "We're a FTSE 250 so we're always on the radar," acknowledges Hooper. It's not just the FTSE 250, private equity is rumoured to have at least 70 of the FTSE 100 companies as potential targets.

Could this be the calm before the storm? Well, if so, Hooper is well equipped and experienced. And after all, we always need water.