Safe landing

BAA'S TREASURY TEAM TELL **GRAHAM BUCK** HOW THE AIRPORTS OPERATOR HAS COME THROUGH A CHALLENGING PERIOD.

PHOTOGRAPHER: ROGER HARRIS

Five years ago Spanish construction group Ferrovial successfully led a consortium that acquired Heathrow's owner BAA for €16bn in a highly leveraged takeover battle. As the group's chief financial officer José Leo (pictured bottom right) notes, the period since then has been a perfect storm, with a series of challenges in addition to the central task of reducing the group's debt load. Scarcely had the ink dried on the deal than police uncovered a terrorist plot to blow up transatlantic planes with home-made liquid bombs in August 2006.

"It dramatically changed the dynamics of the business," says Leo. Security at airports on both sides of the Atlantic was immediately tightened up and the group hired an additional 1,200 staff to meet the new requirements.

The takeover also coincided with the Office of Fair Trading launching an inquiry into the ownership of UK airports, which concluded that BAA should give up two of its three London airports and divest itself of either Edinburgh or Glasgow. A sale of Gatwick followed in 2009 for £1.5bn to US-based investment fund Global Infrastructure Partners (which also operates London's City airport).

The group continues to argue that divestment is a disproportionate remedy that has also hampered its efforts to refinance the £12bn debt that went onto Ferrovial's balance sheet when it acquired BAA and to deal with the effects of the credit crunch. "People talk about the debt load, but it's not actually the principal issue," says Leo. "More important has been reassuring the markets and all of our stakeholders, including the government, that BAA has appropriate finances in relation to its size."

The task of reassuring the markets that the group could successfully meet the challenges was helped by its appointment in June 2009 of Fred Maroudas (main picture) as director of treasury. Together, Leo and Maroudas have been winning the confidence of investors and taking advantage of the steady improvement in market conditions.

This year will see further changes as Ferrovial's status changes from majority shareholder in BAA (with 55.9%) to minority shareholder. Last October Ferrovial announced it would sell off 10% of BAA shares, thereby taking its holding below 50%, which lifts the need to consolidate BAA's debt on the Ferrovial balance sheet. The sale is likely to be completed by the summer, with infrastructure funds, sovereign wealth funds and pension fund investors all reportedly in the running.

Leo initially trained with Arthur Andersen and joined Ferrovial in 1995 as CFO of its main construction and engineering arm Agroman – the group that is building the new Terminal Two at Heathrow, due to open in 2014. After eight years he transferred to Ferrovial Telecomunicaciones, which the group had developed during the telecoms boom of the late 1990s, as managing director before moving to the UK as CFO of Amey. The support services group had been acquired by Ferrovial in 2003 and had as its two main customers the Highways Agency and Network Rail, so Leo was a natural choice to be BAA's CFO following the 2006 acquisition.

Maroudas says: "Well before I joined the treasury team three years later, José had initiated the approach to gain the confidence of the markets, which have come to recognise the strength of BAA's covenant and liquidity. He hired an experienced head of investor relations and made the role much more professional. He also understood the importance of an equity injection from the shareholders, so the ratings agencies share that confidence."

Maroudas describes his own career path as "unusual". He started out as a journalist on a local paper, but quickly moved to the City as banking lawyer for the law firm Lovells, before going on to project finance with BZW and Dresdner Kleinwort Benson.

"My move into treasury came in 1997 as part of the Treasury PFI taskforce set up by the incoming Labour government and tasked with getting private finance into infrastructure projects. This led to my working with Railtrack, which I joined just three weeks before it went under – although I was fully aware of its fragile position."

He moved to the government-sponsored bid vehicle for the organisation that became its successor, Network Rail, and, having arranged the financing, moved over to a treasury role. "I'd describe NR as an interesting, and reasonably successful, experiment," says Maroudas. "It had its drawbacks, but successfully met the challenge of developing a model that adopted the disciplines of a private sector company while omitting the conflicts, such as the perception that there has to be a balance between profit and safety. Its philosophy is very different from Railtrack's; it's all about the infrastructure and running it efficiently. Key to the improvement has been process engineering and how you can improve things. It's an approach that has also been adopted by BAA."

Leo and Maroudas stress that BAA's debt needs to be viewed with a sense of proportion. "A simplistic, yet helpful analogy is with a residential mortgage," suggests Maroudas. "For example, would you regard £200,000 as an excessive amount? Yes, probably, if it relates to a terraced house in the North East, but not if it's a property in a prime location, such as Eaton Square in London."

They suggest three factors determine whether a company's level of debt is appropriate. First is the level of gearing, and BAA's is in line with other secured utilities. Second is affordability and (as with a mortgage) whether the company can afford to service the debt. Third is the dependability of the cashflow.

"Both BAA and Heathrow have been able to withstand the worst recession ever experienced by the aviation industry," says Maroudas. "We've also had disruption from the Icelandic volcanic ash cloud, a series of airline strikes, including British Airways' protracted dispute, and two successive winters when the UK suffered the worst conditions on record. Throughout, our interest cover ratios have remained robust and we've never come anywhere near default."

The improved market conditions in the latter half of 2009 enabled BAA to launch a series of offerings, starting with a £700m sterling Class A bond, which was priced on the day that the Dubai debt crisis broke, and swiftly followed by a £235m index-linked A bond.

"People only invest in index-linked debt when they are comfortable with the borrower's credit quality," says Maroudas. "So it was a huge vote of confidence in BAA and represented the biggest inflation-linked bond since the start of the credit crunch."

The spring of 2010 was marked by volatility from Greece's sovereign debt crisis and uncertainty over the outcome of Britain's general election. BAA returned to the markets in late July with a strategy of tapping its constituent parts to demonstrate it wasn't overly reliant on any single funding source.

A series of financings commenced with a £625m Class B bank loan, which brought Barclays, Bank of America Merrill Lynch and Deutsche Bank into BAA's banking group.

"This instilled confidence in the market and we followed with a Class A €500m transaction, which was BAA's first approach to the euro market since the acquisition," says Maroudas. "We followed up with an innovative Holdco financing, combining a £325m high-yield bond with a £175m loan tranche. It was the first time that any utility had deliberately set out to attract a combination of high-yield bond investors, investment-grade loan investors, infrastructure investors and banks."

Leo says that among the main challenges still faced by BAA is convincing the government that a third runway is essential for the continued success of both Heathrow and London. The plan, along with that for adding a second runway at Stansted, was shelved when the coalition government opposed expansion and BAA is now focusing its main investment on upgrading Heathrow's facilities.

"There is a need for greater capacity if the capital is to retain its role as the world's leading financial centre," says the CFO. "The government has shown that it understands the importance of infrastructure, but its need to please the electorate also ranks high on the agenda. Inevitably the debate will reopen at some point, though, and we will again make our case for a third runway as it is the best solution."

Leo adds that another major challenge for the aviation industry generally is achieving a balance between environmental and economic concerns "although great strides have already been made in developing quieter and more fuel-efficient jets".

Given the range of challenges and the complexity of the group's financing arrangements, BAA operates with a relatively lean treasury team.

"Our front office is only eight strong, including me," says Maroudas. "We have a treasury manager, a funding manager, the head of debt investor relations, a systems manager, an analyst and dealer plus a PA, with four additional individuals in the back office. I'm also hugely supportive of the ACT, and although the past year has been ridiculously busy four of the team have been studying for the exams. All bar two are ACT or MCT-qualified and I regret to admit one of the exceptions is me – my excuse is that I was already fairly senior in my career before starting as a treasurer – although I'd strongly recommend it as pretty well essential to anyone joining."

Fred Maroudas's quick-fire quotes

WORDS YOU MOST OFTEN SAY TO YOUR CFO?
Markets looking choppy again…

WORDS YOU MOST OFTEN SAY TO YOUR TEAM?
Do you agree?

DOES A DOUBLE DIP OR GROWTH LIE AHEAD?
Slow growth, but with severe risk on the downside.

DEBT OR EQUITY? Debt, naturally.

FIXED OR FLOATING INTEREST RATE? Fixed.

BIGGEST SUCCESS IN YOUR CAREER? Helping restore investor confidence in BAA and bringing it back to the markets.

DEAL YOU ARE MOST PROUD OF? Last year's BAA Holdco refinancing.

MOST VALUABLE PART OF THE ACT QUALIFICATIONS? The grounding it provides across the whole range of treasury activities.

REASON FOR ATTENDING ACT EVENTS? Keeping up to speed with what our peers are doing.

BLACKBERRY OR IPHONE? Blackberry, but I'm still trying to break the habit…

Graham Buck is a reporter on The Treasurer.
editor@treasurers.org