Powergen's team brings securitisation success

Graham Wood of Powergen pieces together the events that led to Powergen's securitisation programme in which teamwork played a key role.

Powergen has always recognised the benefit to be gained from effective team working, and indeed its values statement is "working together, working better". Powergen's customer receivables securitisation programme proved an ideal opportunity to put this theory into practice, with both internal and external team working.

Powergen's strategy

Following its acquisition of LG&E Energy in 2000, Powergen's balance sheet significantly moved from about £2bn of debt to more than £5bn, with a gearing of almost 70%. After announcement of the acquisition in February, the US regulatory process meant that it would take nine months to secure the necessary approvals for the transaction to complete. This gave Powergen Treasury plenty of time to plan its financing and refinancing strategy for the acquisition.

The objectives of Powergen's balance sheet management strategy were quickly identified – namely, to reduce debt and the burden of the interest charge which would become the third biggest item in the P&L. These objectives were driven by Powergen's strategy to position itself for further corporate activity in both the UK and the US.

Advantages of securitisation

Early on in the process, Powergen identified the possible advantages of a receivable securitisation programme. About four programmes had already been done in the electricity sector, but the technique was not exactly sweeping through the utility market. Securitisation as a general term can take several forms, but in the context of utility receivables, the approach is to raise money using a US commercial paper (CP) conduit company. This company is rated A1+/P1, because it enjoys the benefit of the security against the cashflows generated by the receivables. The resulting funding is therefore rolling short-term in nature, and closely priced to Libor reflecting the strong credit rating of the conduit. Where the debt is secured against true receivables, the money raised is accounted for by a process called 'linked presentation', which allows the cash raised to reflect the borrowing against future receivables, with the result that there is no increase in net debt.

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In Powergen's case, it was clear the new acquisition would result in a credit rating downgrade, to a short-term rating of A2/P2. The securitisation programme therefore offered two advantages; first, a significant amount of money would be raised without increasing net debt, and, second, this would be priced at levels that Powergen would not be able to achieve with its own credit rating.

Graham Wood

Establishing working relationships

Given such potential advantages, Powergen Treasury set about seeking to maximise the amount of funding that could be raised in this way. This marked the start of Treasury's close working with Powergen's Retail team and as a result it was possible to identify gas and telecoms receivables as well as electricity which potentially could be securitised. Later, when working with the bank, it also became clear that funds could also be raised against future receivables, increasing the size of the programme, although this element would not be accounted for in the same way and therefore would increase net debt.

Having decided to proceed, Powergen held a beauty contest to choose an arranging bank. Several banks had experience of electricity receivables and Bank of America won a close fought contest. Immediately a project working team was established, with representatives from Treasury, the bank, Powergen Retail, respective lawyers and Powergen's accountants. The process of negotiating the facility was to take almost six months in the end, and the successful relationships developed within the team were a key factor.

Early challenges

Early attention had to be given to structural, customer and investor considerations. The nature of Powergen was such that three separate companies would be selling receivables and it was clear, as a result of the electricity regulators proposals to separate distribution businesses from retail businesses, that further changes would have to be made to the Powergen Group. It was also very important to Powergen retail that customers should not be affected in any way. As a result, Powergen's billing processes remain unchanged and the customer continues to pay into the same Powergen bank accounts.

Consideration was also given to investor concerns. The Powergen bank lenders and bondholders could have been sensitive to the implied subordination that securitisation could bring. In anticipation of such a programme, Powergen had negotiated suitable clauses in the negative pledges of its banking covenants to allow such a securitisation. On announcement of the programme, there was some reaction from bondholders in Powergen UK, but they were re-assured by the fact that the Powergen Group would benefit as a whole as a result of the programme.

Facility details

The programme is structured as a revolving receivable purchase facility with a term of 364 days, subject to renewal at the option of Powergen and the investors. The programme, totalling £300m, was placed with one of Bank of America's asset backed CP conduits, which are structured as independent special purpose vehicles (SPVs) administered by Bank of America. The conduit enjoys the highest short-term rating available of A1+/P1 by Standard & Poor's and Moody's, respectively. The conduit issues CP at varying maturities in the US asset backed CP market, which has $600bn in outstanding CP, representing roughly 40% of the $1.5trn US CP market.

Under the structure, Powergen's three retail subsidiaries sold their receivables to a SPV in Jersey. A trust was declared over the receivables owned by the SPV in favour of two beneficiaries: a senior interest equal to £300m plus interest granted to the CP conduit investor, and a subordinated interest granted to Powergen. The subordinated interest provides credit enhancement to the senior interest in an amount corresponding to an AA level of credit enhancement according to Standard and Poor's trade receivable methodology.

The structure incorporates a dynamic credit enhancement formula that adjusts up or down in accordance with certain receivable performance ratios monitored by the conduit administrator on a monthly basis. In addition the programme included an advance payment (up to £150m) against future generated receivables (equivalent to up to two months of Powergen sales). At all times, £300m is available, but the balance between current and future receivables changes with this information.

Currently, part of Powergen's receivables business is unregulated, but its regulated business is not allowed to subsidise or support the unregulated businesses, nor can an event of default in the unregulated businesses cause default of its regulated business.

Because of the above, the securitisation programme had to be carefully structured to avoid a scenario in which losses in the unregulated receivable pool could negatively affect the amount realised by the regulated business on its sold receivables. In addition, the trigger events in the transaction, which enable the early amortisation of the transaction, had to be constructed carefully to avoid violating the cross default prohibitions.

Accounting treatment

Powergen reports its accounts in accordance with US GAAP in addition to UK GAAP. As a result Powergen wanted to ensure the securitisation obtained off-balance sheet treatment for the portion of the programme funded against existing receivables under both accounting regimes. While previous securitisations in the UK had achieved dual off-balance sheet treatment, the Powergen programme was complicated in September by the introduction of the US Financial Accounting Standards Board's new policy (FAS 140) governing the accounting of securitisations, in the middle of the structuring process. The programme had to be carefully modified to accommodate the requirements of the new accounting standard.

Covenants

Powergen has various borrowings containing covenants, representations and warranties and other salient conditions. This programme was carefully tailored to fit within these covenants. Of course, a securitisation, by definition, contains requirements not present in typical debt agreements. These arise from the fact that Powergen retains the role of servicing and collection agent for the SPV and the investors. As such, Powergen is obligated to service the receivable portfolio according to its credit and collection policies, provide periodic reports, and generally requires high operating performance from the Retail team.

Teamworking

Teamworking within Powergen, and with the bank and advisers was a key element of the transaction. Fresh advances under the programme are made every month, and the conduit requires information on current receivables to allow it to make an offer each month. Powergen's systems were well developed for its retail needs, but management information did not fully coincide with the bank's requirements. Therefore, some significant system development was necessary, which was carried out quickly by the Retail team. While work is still proceeding to further improve the quality of information to the conduit, significant advances have been made, and the Retail team has benefited from reviewing its performance from a banking perspective, as well as from their own management perspective. Treasury representatives were frequently in the Nottingham Retail offices, liaising with the team to ensure that the documentation being negotiated in London fully reflected the operational requirements.

Future developments

The nature of the funding will continue to require close working between Treasury, Retail, and the Bank of America. Information generated every month by retail flows through Treasury to the bank to allow the funding to occur. Powergen is enjoying steady growth in its customer base, and in time this will allow the programme size to be increased.

It is highly possible that more companies in the energy and utility sectors will consider securitisations in the future. The benefits include off-balance sheet finance, at a very competitive cost, which helped Powergen towards its financing objectives. Furthermore, while there is a significant amount of work required to put the facility together, this has its own benefits in strengthening and encouraging team working within the company. Overall, it has been a very successful deal both in financial and operational performance terms. ■

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