JUST ADD WATER

JANE PILCHER OF ANGLIAN WATER EXPLAINS THE HIGHLY LEVERAGED RESTRUCTURING THAT PAVED THE WAY FOR THE WATER FIRM THIS JUNE TO RAISE €650M VIA THE BOND MARKETS.

Owned by AWG Plc, a broadly based utility and infrastructure management services group, Anglian Water is the fourth largest of the 10 water and sewerage companies in England and Wales by asset base and largest by geography, with 4.2 million water and 5.5 million waste water customers. In July 2002, it embarked on a highly leveraged restructure. Here are some of the highlights.

BACKGROUND. The highly leveraged restructuring took place to enable the firm to maintain its position as one of the leading water and sewerage companies in the UK and to return capital to shareholders. Consequently, a new 'ring-fenced' financing group was set up to separate Anglian Water financially and operationally from the rest of the AWG group. The ringfenced structure offers significant benefits, providing better access to the long-term debt markets and, through reducing the proportion of the capital funded by equity, an opportunity to significantly reduce the cost of capital, thereby enhancing shareholder returns. In August 2002, AWG returned £500m to its shareholders following the restructuring of Anglian Water.

Features more akin to securitisations and project finance were introduced in the refinancing to enable solid investment grade ratings to be supported, which were necessary to enable efficient funding costs. Unlike a true securitisation, the credit risk of Anglian Water continues to be primarily that of the underlying business.

RING-FENCED FINANCING. All public debt within the AWG group was novated into the 'ring-fenced' financing group and £1.7bn of new debt issued. Restructuring resulted in a gearing ratio of about 85% (this measures debt as a percentage of regulated asset value, the asset value used by the water regulator in setting price limits).

In completing the restructure, managing relationships with debt investors and banks took on a higher degree of importance and a commitment was made to have regular meetings and updates going forward. The company's objectives were realigned and the number one objective changed to meeting lenders' requirements.

Anglian Water continues to be equity owned and dividends can only be paid if all debt covenants are met, and are projected to be met. Hence, a real alignment of stakeholders was achieved, with a company-wide bonus scheme also introduced to ensure that all employees are incentivised to meet all covenants. Anglian Water has high leverage but this is offset by enhanced bondholder protection compared with standard corporate issuers. Protection includes covenants and security, strictly controlled dividend policies with an independent board of directors and intermediate holding companies

Since the restructuring, we have kept to our commitment to keep debt investors and banks informed about the company. Shortly after the results announcement last November, we arranged a non-deal roadshow and gave a presentation to a group of investors and a number of one-to-one meetings were held at roadshows in London, Edinburgh, Glasgow, Paris and the Netherlands.

▪ BOX 1
Bond summary

LAUNCH DATE 20 June 2003

ISSUER Anglian Water Services Financing Plc

RATING A- (Standard & Poors), A3 (Moodys), A- (Fitch)

AMOUNT e650m

COUPON 4.625%

MATURITY 7 October 2013

RE-OFFER VERSUS SWAPS Mid swaps+85bp

BOOKRUNNERS Barclays Capital, BNP Paribas, The Royal Bank of Scotland

CO-MANAGERS Danske Bank, Dresdner Bank, HSBC, Bayerische Hypo-und Vereinsbank, ING, JP Morgan

USE OF PROCEEDS Capital expenditure

The water industry in the UK is highly regulated and capital-intensive. Prices are set every five years and in the current pricing period (2000-2005), Ofwat, the water regulator, allowed sector capex requirements of £16.5bn, with Anglian Water allowed £1.6bn to enable it to deliver its obligations.

In May 2003, we proposed that Anglian Water approach the bond markets to raise finance sufficient to meet all its funding requirements through to the end of the current regulatory pricing period (March 2005). At the time, the capital markets were in good shape, with a strong demand for corporate paper in the post-Iraq war period, and there had been strong performance in our bonds since the restructure in July 2002. Both the sterling and euro markets were available to us, we decided that the choice of market would be left until just before launch so we could go to the most appropriate market.

BEAUTY PARADES. Eight of our core banking group were invited to pitch to lead our forthcoming issue.
A selection/scoring system was used so they could be assessed against each other. Of high importance in this were the credit research desks at each bank, which were critical to us to assist with investor education. Although Anglian Water had issued 18 bonds already and our name was well-known in the sterling markets, it was not so well-known in Euroland, and our restructuring was quite a complicated issue to explain to some of the investors.

Eventually, we decided to appoint three banks which we were confident could lead either a sterling or euro issue. It is always difficult to narrow the banking group down, and particularly for us as all our banks were so supportive during the restructuring. However, in the end, Barclays Capital, BNP Paribas and The Royal Bank of Scotland won the mandate.

MARKETING NEW ISSUE. Ultimately, we decided to launch a euro issue. After conversations with all banks, as well as some key investors, we decided that while a sterling issue was possible, there was more capacity for the amount we wanted to raise in euros. A six-day roadshow was then arranged covering the

▪ **Figure 1**
Roadshow schedule for Anglian Water: 20 investors met at one-on-ones

THE NETHERLANDS:
TUE 10 JUNE

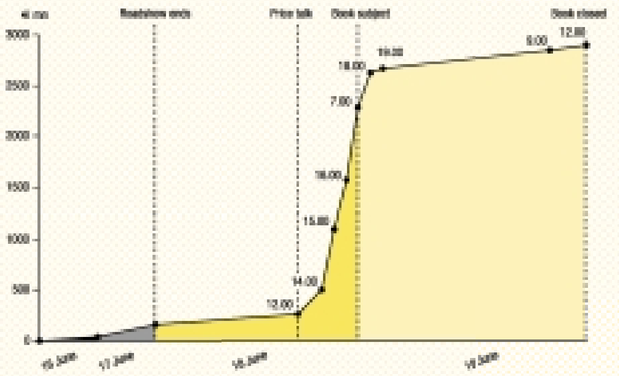
GERMANY:
WED 11 JUNE

ZURICH/PARIS:
MON 16 JUNE

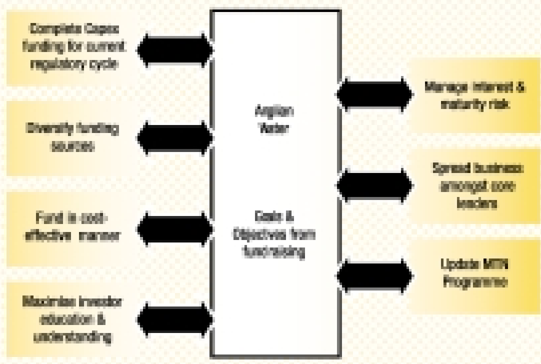
LONDON:
THU 12, FRI 13 JUNE

NORDIC:
TUE 17TH JUNE

▪ **Figure 2**
Book rapidly builds past the €2bn mark



▪ **Figure 3**
Our requirements



'WITHIN HALF AN HOUR OF THE BOOKRUNNERS APPROACHING THE MARKET, WE COULD SEE WE HAD ORDERS FOR THE E500M WE WANTED TO RAISE'

Netherlands, Germany, Switzerland, France, Finland, Denmark and London, with 20 investors met at one-to-one meetings, and seven group presentations and a conference call held. The roadshow material was structured to update UK investors on the company's financial results and operational performance and to increase the awareness of Anglian Water's story with European investors.

Ultimately, we estimate the marketing process resulted in more than 100 new investors. The credit analysts at each of the three banks were also kept busy with follow-up calls and meetings with investors. Undoubtedly, the non-deal roadshow that had been held in November 2002 helped prepare the market, and ultimately many of them participated in the new issue.

The roadshow ended with a final conference call on 18 June 2003, and shortly after we agreed that the bookrunners would go out with spread guidance. An 'e-book-building' system was used to give us greater transparency, and this enabled us to see which investors were placing orders and through which bank. Within half an hour of the bookrunners approaching the market, we could see we had orders for the €500m we wanted to raise.

The spread range was lowered, but still the orderbook grew and grew. Eventually, we closed the book with orders of €2.9bn, and agreed to increase the issue size to €650m. Almost 200 investors placed orders and, as they were scaled back, investors welcomed the increase as they had completed significant credit work.

Feedback from investors as to why they invested in the issue includes:

- they liked the credit;
- it was a bondholder-friendly structure; and
- it was a stable and conservative credit.

Since launch, the bond has traded well, with investors who had been scaled back purchasing additional paper in the secondary markets. This is important to us as a frequent issuer because we want investors to remember that this issue traded well after launch – and, of course, we want them to buy next time.

TIME WELL SPENT. Time spent updating investors on non-deal roadshows is increasingly important for all issuers, and critical for a company like Anglian Water, which has a continuing funding requirement and complex credit story. Increasingly, investors like to take time analysing credit, rather than only seeing companies on deal roadshows when they are put under more pressure.

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