

Moody's downgrades Kemble's notes to B3 from B2, maintains negative outlook

Search ratings, research...



London, December 13, 2023 -- Moody's Investors Service (Moody's) has today downgraded to B3 from B2 the backed senior secured rating of the GBP400 million medium term notes due 2026, issued by Thames Water (Kemble) Finance PLC (Kemble). The outlook remains negative.

The rating action on Kemble follows additional scrutiny from the Water Services Regulation Authority (Ofwat) on recent dividend payments by Kemble's core operating subsidiary Thames Water Utilities Ltd. (Thames Water, Corporate Family Rating: Baa2 stable), on which Kemble relies for its debt service.

RATINGS RATIONALE

Today's rating action on Kemble reflects Moody's view that the risk of a disruption to dividend payments by Kemble's core operating subsidiary Thames Water has increased, despite Thames Water not currently being in breach of any explicit lock-up conditions under its financing structure nor licence.

This reflects continuing high scrutiny of Thames Water's financial resilience, which will weigh on lender appetite in the context of Kemble's forthcoming refinancing needs, likely to the detriment of the availability and/or cost of capital for the holding company. While shareholders have reiterated their support for Thames Water, further equity injections remain subject to conditions and may fall short of what is needed to underpin the credit quality of the holding company in the context of a challenging turnaround and heightened political and regulatory scrutiny.

Regulatory scrutiny and social expectations that may have an adverse impact on a company's access to capital markets is a key social risk consideration under Moody's approach for assessing environmental, social and governance (ESG) risks. Accordingly, the rating agency has changed its social risk issuer profile score for Kemble to S-5 from S-4.

Under current licence conditions, regulated water and wastewater companies may not, without Ofwat's consent, pay dividends (or make similar distributions, including through upstream loans) while their credit rating is Baa3 (or equivalent), with a negative outlook, or lower by any one credit rating agency. As announced in March 2023, the regulator decided to raise this threshold to Baa2 (or equivalent), with a negative outlook, from April 2025.[1] The higher rating requirement will serve to trap cash at an earlier point as the credit quality of an operating water company deteriorates. The lock-up will be subject to a three months grace period, during which companies may seek to persuade Ofwat that their financial resilience is not at risk.



Related Entities

Read Next

asked Thames Water to provide details of its decision to pay a dividend of GBP37.5 million in October this year, which would have been earmarked to support Kemble's ongoing debt service payments. The regulator asked for the information to be provided during December and will use it to assess compliance with the new dividend policy licence condition. Ofwat can impose penalties of up to 10% of relevant turnover, if a company is in breach of its licence conditions, but will have to consider, among other things, that any penalty is proportionate to the circumstances of the case.

Ofwat's guidance on the more stringent licence conditions around distributions includes that dividend payments may be acceptable, where companies can evidence significant improvement under an ongoing recovery plan or where they can demonstrate that it may be in the best interest of customers, including, for example, where the prospect of a distribution being permitted may assist with attracting new equity during a turnaround period. However, the increasing scrutiny of Thames Water's distributions reduces the likelihood of a reliable cash flow stream to Kemble, on which the company relies for its debt service.

The likelihood of a formal dividend block, which will increase with the new licence rating trigger becoming effective on 1 April 2025, will also be influenced by factors including progress in Thames Water's ongoing turnaround programme and Ofwat's 2024 price review. The turnaround is being supported by the company's shareholders who provided a GBP500 million equity injection in March 2023 and have agreed to provide a further GBP750 million over the remainder of the current AMP7 regulatory price control period which runs to March 2025. The additional equity is, however, subject to "preparation and production of a business plan that underpins a more focused turnaround that delivers targeted performance improvements for customers, the environment and other stakeholders over the next three years and is supported by appropriate regulatory arrangements".[2] Shareholders have also indicated further support of around GBP2.5 billion over the next regulatory period (1 April 2025-31 March 2030), with final amounts dependent upon Ofwat's final determination expected in December 2024.

Liquidity and financial strategy at Kemble will determine, how long the holding company may be able to withstand a (temporary) distribution block if it were to occur. Kemble is obliged to make reasonable endeavours to maintain sufficient cash to cover for 12 months of interest payments, and the group has a track record of a prudent cash management policy through maintaining cash reserves and/or liquidity facilities. Liquidity is currently supported by a GBP150 million revolving credit facility at Kemble. The facility, which matures in November 2027, is sized to cover 18 months of interest payments. In addition, Moody's estimates that the company held around GBP20 million of cash at September 2023. The GBP37.5 million dividend payment from Thames Water, received in October, will be applied to service ongoing interest payments, but would cover only approximately half of the total annual interest requirement on external Kemble debt.

Considering Kemble's ongoing interest payments, existing cash and available undrawn amounts under facilities are unlikely to fully support repayment of a GBP190 million bank loan maturing in April 2024, unless Thames Water can continue to make distributions. Because of the further tightened regulatory scrutiny of Thames Water's distributions, Moody's believes that the uncertainty around the operating company's ability to make necessary distributions has increased materially.



Related Entities

Read Next

payments, reflecting existing cash reserves at Kemble. While Kemble's debt service has remained assured by this element of cash reserves, these are being exhausted and – absent additional liquidity – future dividend payments from Thames Water would need to be sized to cover Kemble's interest cost in full.

Kemble's B3 rating assumes continued shareholder support for the operating company, Thames Water, and additional equity injections to improve its operational and financial performance. Equity support for Thames Water benefits lenders to the holding company directly by supporting the turnaround and reducing the risk of a distribution block but also indirectly because of the – in Moody's view – implied willingness to provide support to the holding company, should it be necessary. Kemble's own senior secured financing structure includes a fixed charge over all of the investments by Kemble Water Finance Limited, including in its shares in its finance subsidiary Thames Water (Kemble) Finance PLC as well as its shares in Thames Water Limited, the intermediate holding company owning Thames Water Utilities Holdings Limited and the Thames Water group. Therefore, any event of default under Kemble debt, would allow Kemble creditors to enforce their share security and take over ownership of the operating company group. This would cause shareholders to lose the investment made to date in the operating company. At the same time, Moody's notes that support to the holding company may not prevent creditors from potentially incurring a loss.

More broadly, Kemble's rating continues to reflect (1) the low business risk of its key operating subsidiary, Thames Water; and (2) very high leverage at the Kemble group level, up to 90% of Thames Water's regulatory capital value (RCV). It also takes into account the higher probability of default that creditors at the holding company level are facing and the higher severity of loss in an actual default scenario because of holding company creditors' structural and contractual subordination to operating company creditors.

RATING OUTLOOK

The outlook is negative, reflecting the increased risk of dividend payments from Thames Water to Kemble being constrained as well as heightened uncertainty around the successful execution of the turn-around programme and Kemble's ability to meet its forthcoming refinancing needs without a significant increase in its funding costs over time.

Moody's could change the outlook to stable upon a strengthening of the business or financial risk profile of the operating company and/or sizeable liquidity support at the holding company, including from additional shareholder commitment, that would allow it to sustain a multi-year dividend block.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

Given the current negative outlook as well as the deeply subordinated nature, structurally as well as contractually, of the Kemble notes in the context of the operating group's financing structure and regulatory protections, Moody's does not expect any upward rating pressure for the Kemble notes.

Kemble's rating could be downgraded further if the holding company failed to refinance its near-term maturities; the ratings of Thames Water were downgraded; or the risk of a dividend lock-up at the operating company increased further.



Related Entities

Read Next

which owns Thames Water through intermediate holding companies including Thames Water Limited. Thames Water is the largest of the ten water and sewerage companies in England and Wales by both RCV (GBP19 billion at March 2023) and the number of customers served. It provides drinking water to around nine million customers and sewerage services to around 15 million customers in London and the Thames Valley. Kemble is ultimately owned by a consortium of national and international infrastructure and pension funds, the largest being OMERS (31.8%) and the Universities Superannuation Scheme (19.7%).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moody.com/rating-definitions>.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on <https://ratings.moody.com>.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

This rating is solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website <https://ratings.moody.com>.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

At least one ESG consideration was material to the credit rating action(s) announced and described above. Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit



Related Entities

Read Next

REFERENCES/CITATIONS

[1] https://www.ofwat.gov.uk/wp-content/uploads/2022/07/Decision_document_financial_resilience_proposals.pdf

[2] <https://www.londonstockexchange.com/news-article/BA18/shareholder-funding-update/16033297>

Please see <https://ratings.moody's.com> for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the issuer/deal page on <https://ratings.moody's.com> for additional regulatory disclosures for each credit rating.

Stefanie Voelz

VP - Senior Credit Officer

Infrastructure Finance Group

Moody's Investors Service Ltd.

One Canada Square

Canary Wharf

London, E14 5FA

United Kingdom

JOURNALISTS: 44 20 7772 5456

Client Service: 44 20 7772 5454

Paul Marty

Associate Managing Director

Infrastructure Finance Group

JOURNALISTS: 44 20 7772 5456

Client Service: 44 20 7772 5454

Releasing Office:

Moody's Investors Service Ltd.

One Canada Square

Canary Wharf

London, E14 5FA

United Kingdom

JOURNALISTS: 44 20 7772 5456

Client Service: 44 20 7772 5454

Related Entities

[Thames Water \(Kemble\) Finance PLC](#)

Related Entities

Read Next

Read Next

OUTLOOK

Regulated Water Utilities – United Kingdom: 2023 Outlook - Turns negative amid macroeconomic pressures

16 Jan 2023 Moody's Investors Service

SECTOR COMMENT

Regulated Water Utilities – United Kingdom: Ofwat's tightening of ring-fence positive for OpCos, but negative for HoldCos

23 Mar 2023 Moody's Investors Service

SECTOR COMMENT

Regulated Water Utilities – United Kingdom: PR24 methodology increases risk for weak performers

16 Dec 2022 Moody's Investors Service

SECTOR IN-DEPTH

Regulated Water Utilities – UK: Enhancement expenditure set to rise materially over the next 25 years

16 Oct 2023 Moody's Investors Service

SECTOR IN-DEPTH

Regulated Water Utilities – United Kingdom: Ofwat's DPC framework – construction risk will weigh on project credit quality

18 Oct 2022 Moody's Investors Service

SECTOR IN-DEPTH

Regulated Water Utilities – UK: Bad reputation is not wholly deserved

16 Oct 2023 Moody's Investors Service



Related Entities

Read Next

DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the credit rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from \$1,000 to approximately \$5,000,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service, Inc. and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Charter Documents - Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY100,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

