MOODY'S INVESTORS SERVICE

ISSUER COMMENT
29 June 2023

Send Your Feedback

RATINGS

Thames Water Utilities Ltd.

Corporate Family Rating	Baa2
Outlook	Stable

Thames Water Utilities Finance Plc

Backed Senior Secured MTN	(P)Baa1
Backed Senior Secured	Baa1
Backed Subordinate MTN	(P)Ba1
Backed Subordinate	Ba1
Outlook	Stable

Thames Water (Kemble) Finance PLC

Backed Senior Secured	B1
Outlook	Negative

Source: Moody's Investors Service

Analyst Contacts

Stefanie Voelz +44.20.7772.5555
VP-Sr Credit Officer
stefanie.voelz@moodys.com

Neil Griffiths-Lambeth +44.20.7772.5543
Associate Managing Director
neil.griffiths-lambeth@moodys.com

Thames Water Utilities Ltd.

CEO resignation likely to increase scrutiny, but strong liquidity supports credit quality

Summary

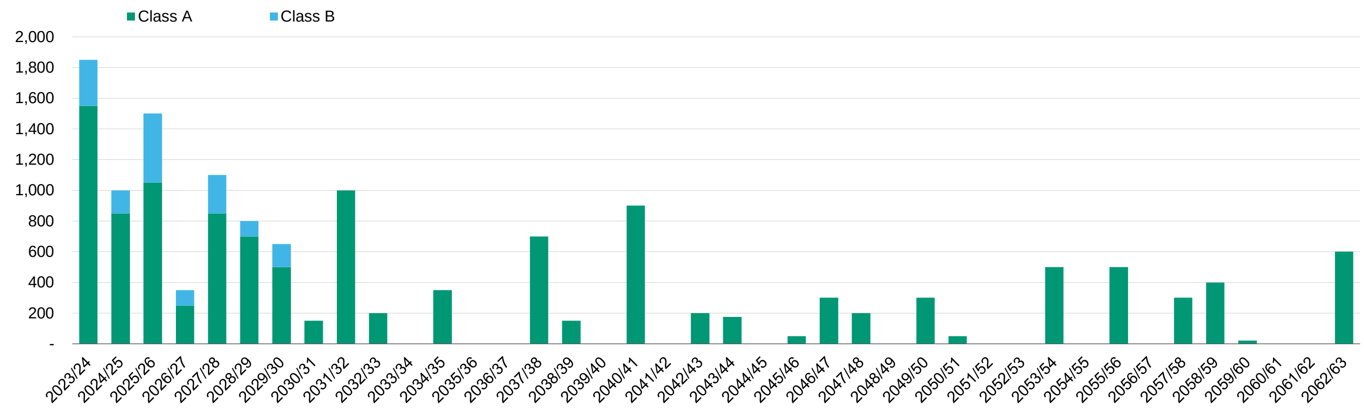
On 27 June 2023, Thames Water Utilities Ltd. (Thames Water, CFR: Baa2 stable) announced that Sarah Bentley has resigned as Chief Executive Officer of the company and will step down with immediate effect. Alastair Cochran, CFO of the company, and Cathryn Ross, Strategy and Regulatory Affairs Director, will jointly assume the role of interim CEO, with continuing support from Sarah Bentley until a replacement has been found.

Sarah Bentley joined Thames Water in September 2020 and had been instrumental to the implementation of the initial phase of the company's eight-year turn-around programme, aimed at improving the company's performance.

As part of its turn-around programme, Thames Water announced, in June 2022, an increase to its investment programme by £2 billion to £11.5 billion for the current regulatory period, which runs from 1 April 2020 to 31 March 2025. This is expected to be supported by additional equity injections of £1.5 billion from its existing shareholders. £500 million were received, as planned, on 30 March 2023, and the company "is continuing to work constructively with its shareholders in relation to the further equity funding expected to be required to support Thames Water's turnaround and investment plans".

The company also has access to £4.4 billion of cash and committed credit lines as at March 2023, which we estimate will be sufficient, together with planned equity injections, to support all the company's liquidity needs until the end of the current regulatory period , including around £2.8 billion of debt maturities in FYs 2023/24 and 2024/25. This strong liquidity position and shareholder commitment to date continues to support current credit quality.

Exhibit 1
Thames Water - OpCo debt maturities as at 30 September 2022
Amounts in £ millions



Source: Investor Reports

Nevertheless, Sarah Bentley's surprise resignation this week will increase the focus on Thames Water in the context of continuing operating challenges and the ongoing investigation by water regulator Ofwat as well as the Environment Agency on wastewater treatment performance, which is affecting the entire industry. However, during her time at Thames Water she build up a new executive team with significant experience, which will be able to continue the turn-around programme of the company.

Ofwat continues to engage with Thames Water on a prioritised basis with respect to the company's financial resilience. The regulator assesses financial resilience of companies "in the round and over time", in order to ensure that customer service remains guaranteed even if circumstances change. Ofwat highlighted more highly leveraged companies, including Thames Water, whose net debt to RCV has been in the range of 80-85%, as having less financial flexibility to offset challenges presented by increasing investment needs as well as weaker performance.

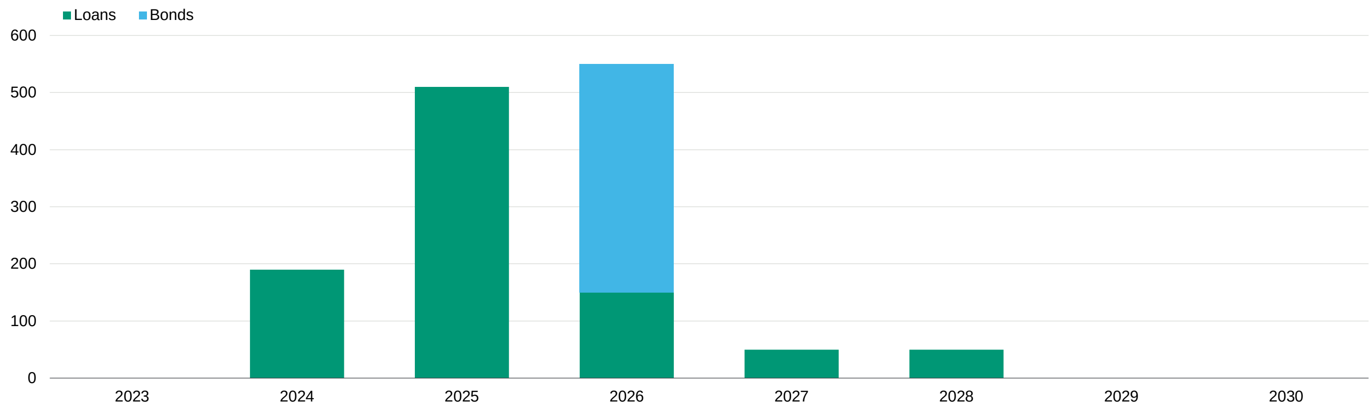
As part of the regulator's duty to protect the interests of consumers, we also expect contingency planning, should a licenced entity no longer be able to fulfil its functions. However, grounds for special administration (as explained in detail below), are limited to severe breaches of licence obligations or insolvency, neither of which would appear to be triggered at this point in time. Indeed, in the context of recent press coverage around Thames Water, Ofwat noted that "the company has strong liquidity" and "the sector is continuing to attract international capital and is especially attractive to long-term investors".

Kemble debt most at risk

We maintain a negative outlook on Thames Water (Kemble) Finance PLC (Kemble, senior secured debt rated B1), the finance subsidiary of Kemble Water Finance Limited, which owns Thames Water through a number of intermediate holding companies. This reflects the increased risk of a distribution block being triggered under Thames Water's licence, when new and tighter rating trigger levels become effective from 1 April 2025. The likelihood of an actual lock-up will be influenced by (1) Thames Water's ongoing turn-around programme, which aims to improve the operating company's performance; (2) Ofwat's 2024 price review for the five-year regulatory period, which will commence on 1 April 2025, and associated cost efficiency and performance challenges; and (3) the operating company's overall financial flexibility.

In addition, the liquidity and financial strategy at Kemble company level will determine how long the holding company may be able to withstand a (temporary) distribution block. Kemble's liquidity is currently supported by a £150 million revolving credit facility at Kemble, which is sized to cover 18 months of interest payments and will mature in November 2027. In addition, we estimate that the company held just under £40 million of cash at March 2023. The next major repayment relates to a £190 million loan due in April 2024.

Exhibit 2
Kemble - HoldCo debt maturities as at 30 September 2022
Amounts in £ millions



Source: Investor Reports

Special administration regime overview

In consideration of the essential public services performed by the regulated water companies, a special regime has been designed by the legislators to deal with instances of actual or likely insolvency and actual or likely serious failure to fulfil statutory duties.

For regulated water companies in England, the Water Industry Act 1991 enables the UK Government or Ofwat with the consent of the Government to apply to the Court to make a Special Administration Order in relation to a regulated water company in the following circumstances:

» there has been, or is likely to be, a breach by the company of its principal duties as water and sewerage undertaker or of an enforcement order and the breach is serious enough to make it inappropriate for the company to continue to hold its licence;

» the company is, or is likely to be, unable to pay its debts;

» the company is unable or unwilling to participate adequately in arrangements certified by the Government or Ofwat as being necessary in connection with the replacement of the company as an undertaker upon termination of its licence;

» in a case, in which the Secretary of State has certified that it would be appropriate for him to petition for the winding-up of the company under Section 124A of the Insolvency Act, it would be just and equitable, as mentioned in that section, for the company to be wound up if it did not hold a licence.

Once a petition for Special Administration has been presented, the company cannot be wound up, no legal proceedings may be commenced or continued against the company or its property. The secured creditors of a water company cannot therefore appoint an administrative receiver.

The Special Administration Order appoints a Special Administrator for the following purposes:

» to transfer to one or more regulated companies as a going concern as much of the company's business and assets as is necessary to ensure that its statutory functions may be properly carried out; and

» to carry out those functions, pending the transfer.

The Special Administrator is charged with inter alia managing the affairs, business and property of the company for the achievement of the purposes of the Special Administration Order in such manner as protects the respective interests of its members and creditors.

A key responsibility of the Special Administrator is to prepare a proposal for the transfer of the company's undertaking as a going concern. Unlike a normal administrator, a Special Administrator is not required to obtain the consent of the company's creditors to the transfer scheme. The transfer scheme may provide for the novation of the water company's liabilities to a new water undertaker. The original terms and conditions of the outstanding debt could be changed as part of the transfer scheme.

No Special Administration has ever been granted in respect of a water company and therefore there is no precedent of this procedure being applied and its actual working. The creditors of a water company would initially be exposed to the risk that their claim could be subordinated and deferred, if such measure should be needed to continue the delivery of the essential public service obligations.

As for their ultimate recovery there would be two possibilities:

» The transfer scheme arranged by the Special Administrator could provide for the claims of existing creditors to be novated to the new licence holder, and therefore their recovery would depend on the terms and conditions of this transfer of liabilities.

» Alternatively, the creditors could be entitled to receive the proceeds of the transfer of the business to the new licence holder(s) according to the order of priority of their claims. Their recovery would depend in this case on the price negotiated by the Special Administrator and on how the whole process had affected the priority of their claims.

The Flood and Water Management Act 2010 included a number of changes to the existing Special Administration regime to bring it more in line with general corporate insolvency principles. According to these changes, a Special Administrator may be allowed to restructure the business as a first step and use the transfer of business to new owners only as a means of last resort if a rescue is not achievable. Effectively, the Special Administrator, once appointed, remains in charge of restructuring or transferring the business in the best interest for customers, which – from a creditor's point of view – remains unchanged.

REPORT NUMBER 1374501

MOODY'S
INVESTORS SERVICE