EDHEC Infrastructure & Private Assets Research Institute

PRESS RELEASE

January 3, 2024

Thames Water: What Could Investors Have Known Beforehand?

What the data shows about Thames Water and
how to benchmark risks in infrastructure investment

A new research publication from EDHEC Infrastructure & Private Assets Research Institute, entitled "Low Tide," asks what investors in Thames Water would have learned about the risk of their investment and its likely market value had they compared its characteristics to market and peer group data.

Presented as a large utility epitomising the "stable and predictable" cash flows of the infrastructure asset class, the investment in Thames Water was impaired by almost 30% in December, an abrupt and unexpected loss of approximately GBP1.5bn for investors including UK, Japanese and Canadian pension plans. Only nine months earlier, in March 2022, some investors were still increasing the valuations, but for such a large water utility to lose so much value so fast, the investment must in fact have been mispriced for several years.

The research shows that a straightforward comparative analysis reveals the emergence of a high-risk, low-return profile that should have raised at least three red flags:

- **Red flag #1**: The company should have been expected to take on too much risk as it faced 'twisted' incentives in the shape of an extremely low weighted average cost of capital imposed by the regulator.
- **Reg flag #2**: The company created not only a structure to extract a lot of cash but also a huge debt pile – it should have been clear from 2016 onwards that there will be no payout for many years.
- **Red flag #3**: Thames Water's exposure to key risk factors was always high compared to its peers and increased over time: this implied a much higher discount rate and lower value than what was reported until the company's value was brutally reduced by 30% last year.

The research shows that benchmarking the key characteristics of the asset would have provided a much better understanding of its risk profile. Using a comparable set of what a typical company with the same characteristics as Thames Water is like in terms of risk factor exposure, duration and likelihood of dividend payouts, the paper shows that that the firm is likely to have lost between 30 and 50% of its value over the past decade.

Commenting on the paper, Tim Whittaker, Research Director at the EDHEC Infrastructure Institute and Head of Data Collection said: "This case study underscores the importance of a relative/comparative view in assessing asset valuation and risk. Investors in Thames/Kemble Water, rather than isolating their focus, could have benefited from a comparative approach. Identifying red flags sooner and achieving a better assessment of the risks involved would have been possible through a broader comparative view."

The research publication can be accessed here.

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About the EDHEC Infrastructure & Private Assets Research Institute

Since 2019, and with the support of the Monetary Authority of Singapore (MAS), the EDHEC Infrastructure & Private Assets Research Institute has been developing ground-breaking research to document the risks and financial performance of investments in unlisted infrastructure equity and debt, as well as the climate impacts and risks of these essential assets.

The indices and benchmarks produced by the EDHEC Infrastructure & Private Assets Research Institute are recognised by the European Securities and Markets Authority (ESMA) and used by investors representing USD 400bn in infrastructure assets under management. The data produced by the institute is grounded in modern financial theory and the principles of fair value accounting, which are key pillars of sound financial risk management.

Through its work, the institute has shown that it is possible to measure market dynamics in private and illiquid markets and produce credible measures of the risk-adjusted performance of private assets that makes them comparable to other asset classes. The same data is used by policy makers and prudential authorities including the G20, the OECD, IAIS, and more.

Since 2023, new research efforts have allowed this financial database to be complemented with a unique set of climate data for unlisted infrastructure, which is at the heart of the climate transition, since it represents more than 60% of total Scope 1, 2, and 3 greenhouse gas emissions. Whether it involves a dedicated green taxonomy or measurement of the exposure and quantification of transition and physical risk at the sub-asset level, the granularity, depth, and quality of the EDHEC Infrastructure & Private Assets Research Institute data make it a unique reference point for public and private decision-makers.