As Thames Water sinks, Macquarie Group continues its unstoppable rise

The Australian operation has been widely blamed for the crisis at Britain's biggest water company, but its profits - and its executives' pay - show no sign of slowing

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In the UK it will soon be possible to leave your rented home, travel on a motorway en route to the airport and get on a plane, all of which are leased, owned or managed by Macquarie Group.

But as Macquarie's reach into the framework of British life expands, it is the plight of one of its former utilities that is drawing attention to the stewardship of the prominent asset manager.

Six years after the Australian company sold its remaining stake in Thames Water, the consequences of a high debt load accumulated under its watch, and arguably inadequate investment, are clearly visible.

There are regular leaks of raw sewage, polluting waterways, affecting farms and households, and killing birds and fish.

In the past fortnight, Thames Water chief executive Sarah Bentley has abruptly resigned while government officials have held emergency talks amid concerns over the water company's ability to continue operating.

On Monday, Thames said it had secured £750m in funding from shareholders to run to March 2025, and it would need a further £2.5bn over the following five years. Bosses said extreme weather had put "unprecedented pressure" on its network.

The crisis engulfing Britain's largest water utility serving 15 million people is raising serious questions over whether the UK should expand its relationship with the "Macquarie way".

Dividend payout

Macquarie's ties to the UK are deep, given it was set up as a subsidiary to the British merchant bank Hill Samuel & Co in 1969, before obtaining an Australian banking licence in the 1980s.

Its robustness now stands in stark contrast to the ill health of Thames Water, which is showing the strains of an increase in debt from £3.4bn to £10.8bn during the Macquarie consortium-led ownership from 2006 to 2017.

Macquarie says it supported the utility to invest more than £11bn in its network, representing the highest per customer investment level of all water companies in England and Wales. "That level of investment exceeds annual investment levels both before and since our ownership," it says.

Meanwhile, Macquarie has enjoyed near uninterrupted profit growth over more than a decade to become a global heavyweight in infrastructure and funds management, commodities trading and investment banking, and has no obvious single competitor.

It can compete with Goldman Sachs on an investment banking deal at the same time as it spars with BP over gas trading in the US, and jostles with the Commonwealth Bank for Australian home loans.

"They are not limited in what they do; they are always looking to capitalise on whatever opportunities present themselves," says Omkar Joshi, chief investment officer at Sydney-based Opal Capital Management.

"The main thing that really drives them is an entrepreneurial culture. They deploy capital to different opportunities and, in reality, many of them won't work - but some of them will work really well."

Macquarie has had enormous success buying public infrastructure and placing it in their funds. It can then charge fees, and receive dividends for its part-ownership, as well as enjoy any increase in the asset price.

Estimates have put dividends paid to underlying investors, including itself, for Thames Water at £2.7bn over the 11-year period it oversaw the asset.

"The dividend yield to equity shareholders earned from our funds' investment was in line with listed UK water utility companies," Macquarie says.

"At all times during our ownership the regulated entity of Thames Water maintained an investment grade credit rating."

Winter storms

Macquarie is well known for taking advantage of volatile markets. In the aftermath of the global financial crisis, it bet big on non-investment grade loans, known as junk debt. The debt was cheap, but the quality was decent and the returns turned out to be excellent.

While that part of the business was pared back when the opportunity faded, Macquarie's commodities trading unit has since grown to generate well over half the company's earnings, aided by rising prices linked to the Russian invasion of Ukraine.

In the US, Macquarie is accused of manipulating the price of natural gas to profit from winter storms that froze large swathes of the country in early 2021. Its energy business buys natural gas and moves it along pipelines and grids, typically from areas where usage is low to high-demand markets.

A lawsuit filed by the Kansas attorney general alleges that Macquarie bought gas at an inflated price in a bid to influence key benchmarks for setting prices - an allegation the Australian company denies. Macquarie is seeking to have the matter dismissed.

Macquarie has previously said it helps move gas to markets facing extreme weather conditions to relieve pressure on households.

The winter storm trading period turned out to be significant for Macquarie, boosting its overall profit with a reported windfall of at least A$270m (£140m).

Millionaire's factory

The group has long been tagged the "millionaire's factory", but the descriptor now severely underplays the riches its staff can generate for shareholders, and themselves.

The head of Macquarie's commodities and global markets division, Nick O'Kane, earned A$57.6m last financial year. The previous year his pay was A$36m.

His pay packet far exceeds even that of the company's chief executive, Shemara Wikramanayake, who is the highest paid CEO in Australia with A$32.8m over a 12-month period.

It may seem odd that the CEO is not always the highest paid employee at Macquarie, but it makes sense for a performance-obsessed company that rewards executives who drive profits.

Martin Stanley, Macquarie's former head of asset management, whose division oversaw Thames Water transactions, earned A$19.6m in 2021, the year he stepped down from the role. Stanley nows lives in a £2.5m house with swimming pool in Suffolk in the UK.

Macquarie has a reputation in the analyst community for being a "black box", given it is difficult to analyse the details of its disparate business units, let alone forecast returns. The profit drivers also jump around from year to year.

"There is an element of trust that it will meet its forecasts, which it invariably does," says one analyst.

Thames debts

Thames Water is now the most indebted water company rated by Standard & Poor's, with leverage exceeding 80%, most of which accrued under Macquarie's tenure. More than half the company's debt is inflation-linked, as at the end of last year, which does not bode well for this current period of escalating costs.

Critics point to the privatisation of the UK water industry more than three decades ago, which was supposed to usher in a new era of investment, more competitive bills and improved water quality, as the source of the problem.

Groups such as the Macquarie consortium came in and used securitisation models - which allow the owners to unlock more financing - to raise the debt-to-equity ratio to levels unanticipated at privatisation.

"From what I can see it seems that this is absolutely the root of the problem," says Kate Bayliss, of the economics department at Soas, University of London.

"We had such a naive and benign perspective of what we thought the private sector would do when the regulations were conceptualised … Financial wizardry is seen as a good thing, but it's impenetrable, near impossible to understand the structures from the outside."

Macquarie sold its final stake in Thames in 2017, the same year it snapped up the government's Green Investment Bank for £2.3bn despite concerns taxpayers were being shortchanged.

Its exit from Thames Water proved to be well timed. Days after the sale was announced in March 2017, the utility was hit with a then record fine of £20.3m linked to huge leaks of untreated sewage for offences in 2013 and 2014.

A judge described the environmental breaches as "wicked", while noting a "continual failure to report incidents" and "history of non-compliance".

In the ensuing years the leaks at Thames Water have continued, its financial position has worsened and political pressure has increased.

"They had impeccable timing," says Bayliss. "They are very good at what they do."

Macquarie was then allowed to wade back into the UK water industry in 2021, buying a majority stake in the troubled Southern Water. But, five years on, its links to Thames are still apparent.

After Bentley's departure, existing directors Alastair Cochran and Cathryn Ross were hastily promoted to become joint chief executives. Not only is Ross a former CEO of industry regulator Ofwat, which scrutinised Thames' financial position, but since 2019 she has also held a directorship on the board of National Gas Transmission, the £7.5bn gas network and metering business bought by a consortium led by Macquarie from National Grid last year.

Meanwhile, former Aviva chairman Sir Adrian Montague, has been brought in as Thames' new chair, replacing Ian Marchant. Since 2017, he has been chairman of Cadent, Britain's biggest gas distribution network which is owned by a consortium led by Macquarie.

Additional reporting by Alex Lawson