Thames Water – Factsheet

August 2023

Introduction

Following recent widespread media commentary on Thames Water, much of which referenced Macquarie's period of part-ownership (2006-2017), the Q&A below addresses some of the issues raised and mischaracterisations of Macquarie's stewardship of the company.

Appendix 1 sets out data which supports the points addressed in the Q&A below.

Background

Britain's water industry was privatised in 1989, a decision which was made by the government partly to attract the increased investment required to meet EU environmental standards and upgrade the UK's network of Victorian water and wastewater infrastructure.

After a period as a listed company, Thames Water was acquired by German utility RWE in 2001, before funds led by Macquarie Asset Management ("Macquarie") invested for an eleven-year period from 2006-2017. Today, Thames Water is owned by a consortium of investors, details of Thames Water's current governance can be found here.

Thames Water, like other water companies in the UK, faces several complex challenges. These include modernising a network of Victorian-era pipes; a legacy problem of a combined sewage and storm water management system that often overwhelms the network, and pollution incidents that have attracted intense public scrutiny. Each of these factors contributes to an ongoing need for high levels of sustained investment to facilitate network upgrades and a broader system redesign.

Q&A

When did Macquarie invest in Thames Water?

Macquarie's asset management division raised several diversified infrastructure funds and a portion of the capital from those funds was used to acquire Thames Water from German Utility RWE for £2.3 billion in October 2006. The two main funds used to acquire Thames Water were Macquarie European Infrastructure Fund (a €1.5 billion fund) (MEIF) and Macquarie European Infrastructure Fund II (a €4.2 billion fund) (MEIF II). These funds, together with other Macquarie-managed funds, accounted for £1.1billion of the purchase price and together made up c.48% of the ownership of Thames Water in 2006. The remainder of the equity capital was provided by international funds investing directly into Thames Water on their own behalf. Some of these investors remain owners of Thames Water today.

Who were the investors in Macquarie's managed funds?

Macquarie's asset management division invests on behalf of clients, with the ultimate beneficiaries of any dividends and asset appreciation at Thames Water accruing largely to a mixture of UK, European and other international pension funds, sovereign wealth funds and insurance companies.

Macquarie also has a policy of investing directly in its own funds to provide alignment with its fund investors. Of the lead funds invested in Thames Water, approximately 1% of the capital was provided directly by Macquarie.

What was the valuation of Thames Water upon Macquarie's acquisition?

Thames Water was acquired for an enterprise value of £8.5 billion comprising c. £2.3 billion in equity and c. £6.2 billion in third-party debt. The proceeds were paid to RWE by the acquiring consortium upon completion of the sale. At the time of acquisition, the Regulated Asset Base of Thames Water was c. £6.5billion.

When did Macquarie's managed funds divest from Thames Water?

Between 2006 and 2017, Macquarie-managed funds gradually sold down their stakes in Thames Water. MEIF's shares were sold in two separate transactions in 2011 and 2012. In 2017, MEIF II, together with two other managed funds, sold Macquarie's remaining 26.3% stake in Thames Water. For a significant portion of Macquarie's involvement with the business, Macquarie-managed funds accounted for c.48% of the ownership.

What returns were achieved by Macquarie's managed funds?

Annual gross total returns to the Macquarie-managed funds were between 12-13%. The returns achieved were commensurate with the baseline allowed nominal equity return of c.10% from Ofwat in the two price reviews which covered the majority of the period of Macquarie's part-ownership.

What investment occurred during Macquarie's investment period?

Macquarie supported the company to invest over £11 billion in its network, equivalent to over £1 billion a year during its ownership – the highest per customer investment level of all water companies in England and Wales during that period. That level of investment exceeded annual investment levels both before and since Macquarie's ownership (adjusted for inflation): it is almost two-and-a-half times the annual investment levels under public ownership, and one-and-a-half times what was achieved following privatisation throughout the 1990s and early 2000s.

Upon the sale of Macquarie's final stake in the company in 2017, the Regulated Asset Base of Thames Water had grown to £12.9 billion as a result of this investment (compared to £6.5 billion in 2006).

Was investment funded through debt and customer bills?

The regulatory framework is structured so investments are financed upfront through a combination of equity and debt. Those providers are then repaid over time by future company revenues. The use of equity and debt is encouraged under the regulatory framework to facilitate necessary investments in the network while ensuring customer bills remain affordable. The key regulatory requirement is maintenance of Investment Grade ratings to protect customers - commonly understood at that time to be BBB (but not specified) and underpinned by a dividend lock up if ratings fell below BBB- (now revised to BBB). It should be noted that during Macquarie's ownership period S&P upgraded its rating of the relevant Class A debt to A- in 2010, reflecting Thames' strong operating performance and stewardship under Macquarie's part-ownership.

What were the outcomes of this investment?

Thames Water delivered significant improvements in water quality (ranked amongst the sector's best), reduced water leakage by c. 22% (the second-best improvement in the sector over this time period), and reduced pollution incidents by 75% compared to 2008. Security of supply also increased from 22 to 100 (the maximum possible score). This investment programme was delivered while achieving the third lowest customer bills for water and wastewater in England and Wales at the time of Macquarie's full exit.

What did Macquarie do about pollution incidents during its tenure?

Pollution incidents reduced over the course of Macquarie's investment, with Thames achieving a 3-star rating (out of a maximum of 4) from the UK Environment Agency in 2017. Macquarie supported the company to initiate the Thames Tideway sewage system upgrade – a generational construction programme to build a 25km super sewer in London.

Does Macquarie take responsibility for pollution incidents that did occur?

All pollution incidents are deeply regrettable and profoundly disruptive to the local communities they impact. When leakages and pollution events occurred, as they notably did in 2013 (which was subject to a fine for the company in 2017), Macquarie worked with the company to learn from them and implement remedial actions, leading to top quartile performance within two years and a reduction in pollution incidents of 43% between calendar year 2013 and calendar year 2016.

What has happened to the level of debt at Thames Water?

The Macquarie-led consortium acquired Thames Water with a 6.5x debt-to-EBITDA ratio – comparable to capital structures seen across similar utilities at the time and now. During Macquarie's part-ownership, Thames Water more than doubled its regulated asset base from c.£6.5 billion to c.£13 billion thanks to the record levels of investment in the network. This was partly funded by additional debt, which increased from c.£6 billion to c.£11 billion over the same period. Debt-to-EBITDA stayed broadly constant at 6-7x until the last regulatory period under Macquarie's part-ownership period at which it increased to c. 10x due to a tightening of the regulatory returns, despite a decrease in the ratio of the company's debt to assets over this same period. At all times during Macquarie's investment the regulated entity of Thames Water maintained an investment grade credit rating. Following the Global Financial Crisis, Macquarie supported the company from 2009 to reduce the ratio of debt to the value of its assets.

Was there any reduction of the levels of debt during Macquarie's tenure?

Yes, from 2009 onwards Macquarie supported the company in reducing the ratio of debt to the value of the company's assets. This equated to a c.6% reduction over Macquarie's investment period.

Were there regulatory concerns about the levels of debt?

At all times during Macquarie's investment period, the regulated entity of Thames Water maintained an investment grade credit rating. When Macquarie sold its final stake in Thames Water in 2017, the Thames Water regulated company held investment-grade ratings of A3/Baa3 with Moody's and A-/BBB with S&P, above its Ofwat licence conditions. During Macquarie's tenure, S&P upgraded the rating assigned to the Class A debt to A- in 2010, reflecting the strong operating performance and stewardship since the acquisition from RWE. Thames Water fulfilled all its regulated licence conditions at all points during Macquarie's period of investment.

How much did Macquarie take out of Thames Water in dividends or dividend equivalent payments (such as shareholder loan interest payments)?

Total distributions during Macquarie's economic ownership period was £1.1 billion comprising £879 million in dividends and a further £277 million of interest on shareholder loans. Of this amount, £508 million went to the investors in Macquarie-managed funds. This corresponded to a dividend yield relative to the Regulated Capital Value of the business of 1.2% during Macquarie's part-ownership period – significantly lower than the 3.4% paid out by the listed water companies over the same period. Initial investors in the acquisition of Thames earned a yield on their investment of 5.0% and capital growth of a further c. 7.0% for an overall return of approximately 12.0% during the full period of Macquarie's part-ownership period. This is lower than the average dividend yield on an equivalent investment in the listed UK regulated utilities over the same period (which was 6%). Those listed utilities had an average total shareholder return of 10% per year, slightly lower than the 12% earned on Thames due to their lower level of investment and growth in Regulated Capital Value.

Why are there references to Macquarie receiving £2.7 billion in dividends and how does this compare to the £1.1 billion above?

The £1.1 billion refers to the actual dividends (£879 million) and interest on shareholder loans (£277 million) paid to shareholders during Macquarie's economic ownership period. The £2.7 billion refers to those dividends plus movements in inter-company amounts and is a misrepresentation of the data.

After consultation with the regulator, auditors and rating agencies, more expensive holding company debt was exchanged for cheaper operating company loans - in doing so, lowering the cost of capital for the company. Ultimately this lower cost of capital supported the level of investment in the business – one of the highest per capita – whilst maintaining some of the lowest bills in the sector.

What is Macquarie's perspective on the level of dividend payments during this period?

The dividend yield to equity shareholders earned from during Macquarie's investment period was below other listed UK utility companies and lower than many other sectors. The average shareholder dividend yield was 1.2% as a percentage of the RCV, compared to 3.2% at an average regulated company over the same period.

By choosing to invest in the network, fund investors received fewer distributions than they would have otherwise.

Appendix 1

Summary - Thames Water Statistics

Category			
Investment	**Unit**	**2007-17**	**2018-22**
Macquarie supported the company to invest over £11 billion in its network, c. 90% of cash generated post financing, equivalent to over £1 billion a year during its ownership – the highest level by any metric including per customer investment level of all water companies in England and Wales during that period.			
Total capex at outturn prices	£m, outturn	11,304	5,799
Average capex at outturn prices	£m, outturn	1,028	1,160
Total capex adjusted for inflation to allow for comparison over time	£m, 2021/22 prices	14,921	6,204
Average capex adjusted for inflation to allow for comparison over time	£m, 2021/22 prices	1,356	1,241
Average capex adjusted for inflation to allow for comparison over time during:			
Pre-privatisation (1984-1988)	£m, 2021/22 prices	392	
Publicly listed company (1989-2001)	£m, 2021/22 prices	704	
RWE ownership (2001-2006)	£m, 2021/22 prices	814	
Regulated Capital Value ("RCV") at the start of the period	£m, outturn	5,890	12,944
Regulated Capital Value ("RCV") at the end of the period	£m, outturn	12,944	16,641
% growth p.a.	%	7.4%	5.2%
Average RCV	£m, outturn	9,806	14,875
Average RCV	£m, 2021/22 prices	12,821	15,903
Average capex / average RCV (outturn)	%	10.5%	7.8%
Average capex / average revenue	%	57.7%	55.6%
Debt	**Unit**	**2007-17**	**2018-22**
During Macquarie's part-ownership, Thames Water more than doubled its regulated asset base from c.£6.2 billion to c.£13 billion thanks to the record levels of investment in the network. This was partly funded by additional debt, which increased from c.£6 billion to c.£11 billion over the same period. The initial leverage of c 6.5x was consistent with listed utilities leverage levels today. At all times during Macquarie's investment the regulated entity of Thames Water maintained an investment grade credit rating. From 2009 onwards we supported the company in reducing the ratio of debt to the value of its assets.			
Opening Group net debt	£m, outturn	6,162	11,530
Opening Group debt-to-RCV	%	94.8%	89.1%
Opening Group debt-to-EBITDA	x	6.6x	11.2x
Closing Group net debt	£m, outturn	11,530	14,648
Closing Group net debt-to-RCV	%	89.1%	88.0%
Closing Group net debt-to-EBITDA	x	11.2x	15.7x
% reduction in net debt-to-RCV	%	5.8%	1.0%
Average Group net debt	£m, outturn	8,629	13,197
Average Group net debt-to-RCV	%	88.7%	88.7%
Closing regulated company (TWUL) net debt	£m, outturn	10,550	13,421
Closing regulated company (TWUL) net debt-to-RCV	%	81.5%	80.6%
Closing regulated company (TWUL) net debt-to-EBITDA	x	10.3x	14.4x
Average regulated company (TWUL) net debt	£m, outturn	7,357	12,170
Average regulated company (TWUL) net debt-to-RCV	%	73.5%	81.9%
Average inflation (RPI) during the period	%	3.0%	3.8%
Credit ratings at end of period for TWUL:			
Moody's (Corporate Family Rating)	Rating	Baa1	Baa2
S&P (Class A/B)	Rating	A- / BBB-	BBB+ / BBB-

Category			
Distributions	**Unit**	**2007-17**	**2018-22**
The dividend yield to equity shareholders earned from our funds' investment was in line with listed UK water utility companies. The total dividends received by underlying equity investors totalled £1.1 billion between 2006 and 2017 (equivalent to a c. 5% average annual yield on the equity invested by the original underlying investors) This was also only c. 7% of total cash and debt generated over the period before capex and third party interest costs.			
Thames Water			
Regulated company (TWUL) dividends to Kemble Holdings (total) net of HoldCo interest	£m outturn	2,688	242
Regulated company (TWUL) dividends to Kemble Holdings (average p.a.) net of HoldCo interest	£m p.a., outturn	244	48
As % of average RCV	%	2.5%	0.3%
As % of average Regulated Equity[1]	%	6.2%	0.8%
As % of average capex	%	23.8%	4.2%
Group (Kemble Holdings) dividends to shareholders (total)	£m outturn	1,156	–
Group (Kemble Holdings) dividends to shareholders (average p.a.)	£m p.a., outturn	116	–
As % of RCV	%	1.2%	–
As % of Regulated Equity[1]	%	2.9%	–
As % of capex	%	11.3%	–
Industry			
Listed companies' dividend yields (% RCV)	%	3.4%	2.7%
Listed companies' dividend yields (% of Regulated Equity)[1]	%	9.4%	6.8%
Listed companies' dividend yields (% of capex)	%	41.7%	43.4%
Performance	**Unit**	**2007-17**	**2018-22**
Thames Water delivered significant improvements across all of its key KPIs. Water quality was ranked amongst the sector's best, security of supply increased from 22 to 100 (the maximum possible score), water leakage reduced by c. 22% (the second-best improvement in the sector over this time period), and pollution incidents declined by 75% compared to 2008.			
Thames Water Security of Supply Index (SoSI) at the start of the period	#	22	100
Thames Water Security of Supply Index (SoSI) at the end of the period	#	100	100
Improvement by Thames Water over the period	#	78	–
% improvement by Thames Water over the period	%	355%	0.0%
Thames Water leakage at the start of the period[2]	mL/d	862	677
Thames Water leakage at the end of the period[2]	mL/d	677	594
Improvement by Thames Water over the period	mL/d	185	83
% improvement by Thames Water over the period	%	21.5%	12.3%
% improvement by the industry over the period	%	12.8%	5.6%
Average % improvement by the industry over the period	%	8.1%	7.8%
Thames Water average pollutions (Category 1-3)[3,4]	# per 10,000km of sewers	63	27
At start of the period	# per 10,000km of sewers	96	24
At end of the period	# per 10,000km of sewers	24	25
% improvement over the period	%	74.7%	(6.9%)
Thames Water operating efficiency (operating expenses as % of RCV) at the start of the period	%	10.0%	7.7%
Thames Water operating efficiency (operating expenses as % of RCV) at the start of the period	%	7.7%	7.0%
% improvement	%	23.0%	9.8%

1. Note: Assuming notional gearing of 60% of the RCV per current regulatory guidance.
2. Note: Methodology change from 2018 onwards per Ofwat measurement guidance, so absolute figures compared to earlier measures may not be like-for-like.
3. Note: Industry figures unavailable for the periods prior to 2008, and hence 2008 has been used as the baseline.
4. Note: EA data is reported on a calendar year basis (i.e. year ending December) vs the financial year (i.e. year ending March). Data has been aligned to correspond with the closest calendar year end to the financial year.