Macquarie Asset Management

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Dear Macquarie stakeholder,

Macquarie Asset Management's involvement in the UK water sector

Following the media coverage of recent developments at Thames Water, some of which has referenced Macquarie's part-ownership of the company between 2006 and 2017, I wanted to write to share our perspective.

We value an open public debate about how best to build and maintain the infrastructure our communities want. However, many of the references to Macquarie's involvement in Thames Water are inaccurate, mischaracterise our stewardship of the company and oversimplify a complex and evolving situation in the UK water sector.

We are deeply committed to the active management and long-term stewardship of the businesses we manage for the benefit of all stakeholders, including the communities they serve. Our investment approach is defined by investing in and growing businesses to leave them stronger than when we initially begin partnering with them.

We first invested in Thames Water in 2006 shortly before the start of the global financial crisis. At that point, investment models across the sector used higher levels of leverage. As macro-economic conditions changed, that model needed to change. So, from 2009 until our exit in 2017, we supported the company to reduce its leverage while continuing its record programme of investment.

Similarly, as part of our entry into Southern Water in 2021, we provided an additional £1.1 billion of equity to reduce the debt of the company and support a step-change in the pace of investment.

In the rest of this letter, we address the key points that have been raised over the past week in relation to our historical ownership of Thames Water and current stake in Southern Water.

Thames Water

Thames Water, like other water companies in the UK, face several complex challenges. These include modernising a network of Victorian-era water and waste-water infrastructure which required and continues to require multi-decade investment in order to meet community expectations; a legacy problem of a combined waste-water and storm water management system that often overwhelms the network, resulting in stormwater overflows and pollution incidents that rightly concern the public; changing demands from a growing population, urbanisation, climate change, and a loss of water-absorbing natural processes.

Between 2006 and 2017, we supported the company to start confronting these challenges:

- **A step-change in investment.** We supported the company to invest over £11 billion in its network, equivalent to over £1 billion a year during our ownership – 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 (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.

- **Delivering operational improvements.** Thames Water's investment programme over the period delivered significant improvements in water quality (ranked amongst the sector's best), reduced water leakage by 22% (the second best improvement in the sector), and reduced pollution incidents by 75% compared to 2006. This investment programme was delivered while achieving the third lowest customer bills for water and waste-water in England and Wales (in 2016).

- **Proportionate use of debt to support investment.** During our part-ownership, Thames Water more than doubled its regulated asset base from c.£6 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. At all times during our ownership the regulated entity of Thames Water maintained an investment grade credit rating. As noted above, from 2009 onwards we supported the company in reducing the ratio of debt to the value of the company's assets.

- **Equity returns in line with the sector.** 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 (pension funds, insurance companies, and other savers who depend on the income and require a return for the risk they are taking) 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).

- **Improving environmental performance.** All pollution incidents are deeply regrettable and profoundly disruptive to the local communities they impact. Pollution incidents reduced over the course of our investment, achieving a 3-star out of the maximum 4-star rating from the UK Environment Agency in 2017. We supported the company to initiate the Thames Tideway sewage system upgrade – a generational construction programme to build a 25km super sewer in London. When leakages and pollution events occurred, as they notably did in 2013 (which was subject to a fine for the company in 2017), we held ourselves accountable and worked with the company to learn from them and implement remedial actions, leading to top quartile performance within two years.

When we sold our 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. Thames Water fulfilled all of its regulated licence conditions at all points during our period of part-ownership.

Southern Water

In late 2021, Macquarie-managed funds acquired a majority stake in Southern Water, which provides essential services to millions of water and waste-water customers in the south of England.

We invested £1.1 billion in equity to recapitalise the company, as part of a planned change of ownership and direction, reducing leverage and facilitating a step-change in investment to c.£2 billion over the regulatory period to 2025, equivalent of c.£1,000 per property in the company's catchment area. We are now working with Southern Water to invest even further during this regulatory period.

Following our investment in Southern Water, which was publicly supported by the sector regulator, the company committed to reduce pollution and leaks, maintain customer bills in line with inflation in this regulatory period, and to improve customer service.

At the outset of our investment into Southern Water we acknowledged that the operational transformation would take time. That said, positive initial progress has already been made. We will continue to support the company through sector-wide challenges, including managing significant pressure from cost inflation and higher funding costs.

We hope this letter helps clarify our historical role and future intentions for the UK water sector. We believe passionately that we have been, are and will continue to be a positive influence in the improvement of the UK water sector and will be happy to answer any further questions you might have.