FINANCIAL TIMES

Managed by Macquarie: the Australian group with a grip on global infrastructure

The investment management company was a pioneer in turning public utilities into lucrative assets, but does that model make for good policy?

Shemara Wikramanayake, chief executive of Macquarie, which has become known for its investments in public infrastructure, such as UK water companies © FT montage/Bloomberg

By Gill Plimmer in London and Nic Fildes in Sydney
June 27 2023

Buried in the ground, far out of sight, exists a sprawling web of copper and steel pipes that are integral to keeping homes across the world running smoothly.

Whether they are filling British taps with water, transporting gas across the southern US or acting as underground broadband ducts beneath remote parts of Spain, the common denominator is likely to be Macquarie, the Australian financial services company that has become quietly ubiquitous in global infrastructure.

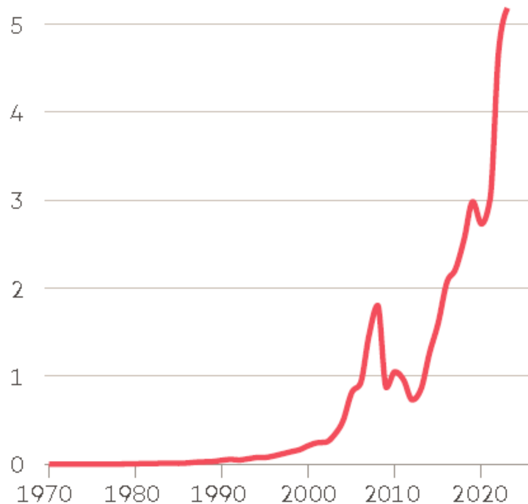
Macquarie's rise from a far-flung, three-person operation in the 1960s to the largest infrastructure asset manager in the world is a remarkable one. Overall, it has $590bn assets under management and is also a global commodities trading giant, a leading corporate adviser on mergers and acquisitions — and a rapidly growing player in Australia's powerful retail banking industry.

With such outsized success has come increased scrutiny of an enigmatic company that would prefer to downplay its influence.

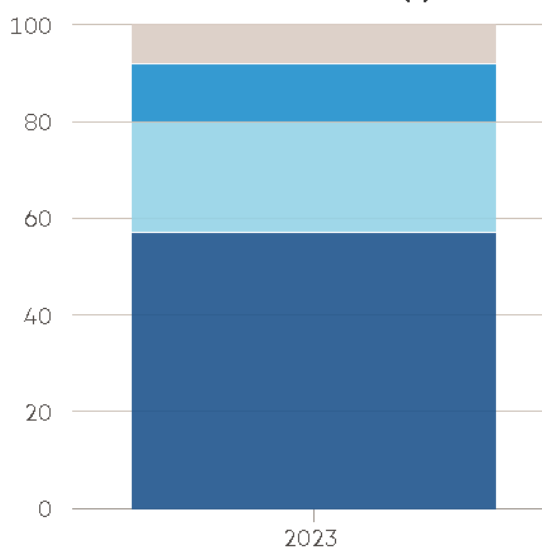
As Macquarie has grown in stature, the company has been derisively nicknamed the "Vampire Kangaroo" — an Antipodean twist on the infamous name given to imperious investment bank Goldman Sachs — because of its reputation for buying essential public infrastructure, increasing its debt and paying out handsome sums to shareholders. This lucrative strategy, first pioneered in the 1990s, became so popular it got its own name: the Macquarie model.

Strong rise in earnings at Macquarie

Profit attributable to ordinary equity holders (A$bn)



Divisional breakdown (%)



Breakdown: Macquarie Capital, Banking and Financial Services, Macquarie Asset Management, Commodities and Global Markets

FINANCIAL TIMES

Source: Company reports

Now, decades after governments first started to sell off crucial public assets, the robust financial health of Macquarie and its peers contrasts starkly with the standing of indebted utilities that many believe are failing to meet the needs of growing populations. This has led critics — even some inside the industry — to question whether using private finance in essential state monopolies is in the public interest.

It has become especially controversial in the UK, where Macquarie's decades-long history of investments in the country's large private water monopolies has dragged its name into growing public outrage over pollution and sewage in rivers and coastal waters.

"We have in the past 30 years been handing many of our crucial infrastructure assets to private investors, while the risks remain with the public," says Peter Folkman, a former council member of the British Private Equity and Venture Capital Association who teaches at Alliance Manchester Business School.

"Macquarie was one of the first to realise how the steady and predictable cash flows from infrastructure investments could be levered to produce very attractive returns to equity investors," he says. "But as a public policy, it's questionable."

A well-honed playbook

Named after the British army officer credited with transforming what was then the penal colony of New South Wales into a free settlement, Macquarie evolved into a global behemoth valued at A$71bn ($48bn) thanks in part to its flagship infrastructure financing model.

Macquarie stepped in as governments privatised assets to shift debts off their balance sheets and turned to private capital to raise finance for new projects. In the process, it helped transform infrastructure into an asset class, a tradable financial product, highly attractive to investors.

“If you don’t attract private sector investors, the state has to do it all,” says Simon Montague of the Global Infrastructure Investor Association. “Bill-payers or taxpayers will ultimately be funding investment, whoever raises the finance.”

Today, Macquarie’s investment portfolio includes everything from toll roads and car parks, to airports, ports and aircraft, bridges and battery storage, solar and wind farms, fibre networks and data centres, hospitals and specialist disability homes.

Its supporters credit the company with creating a framework that has drawn much-needed finance to the structures and facilities that keep society ticking — and, most recently, government-backed renewables, including the nascent hydrogen, bioenergy and carbon capture markets.

Macquarie led the acquisition of the Chicago Skyway toll bridge in 2004. The deal marked the first time an American toll road passed from public hands into private operation © Karen Bleier/AFP/Getty Images

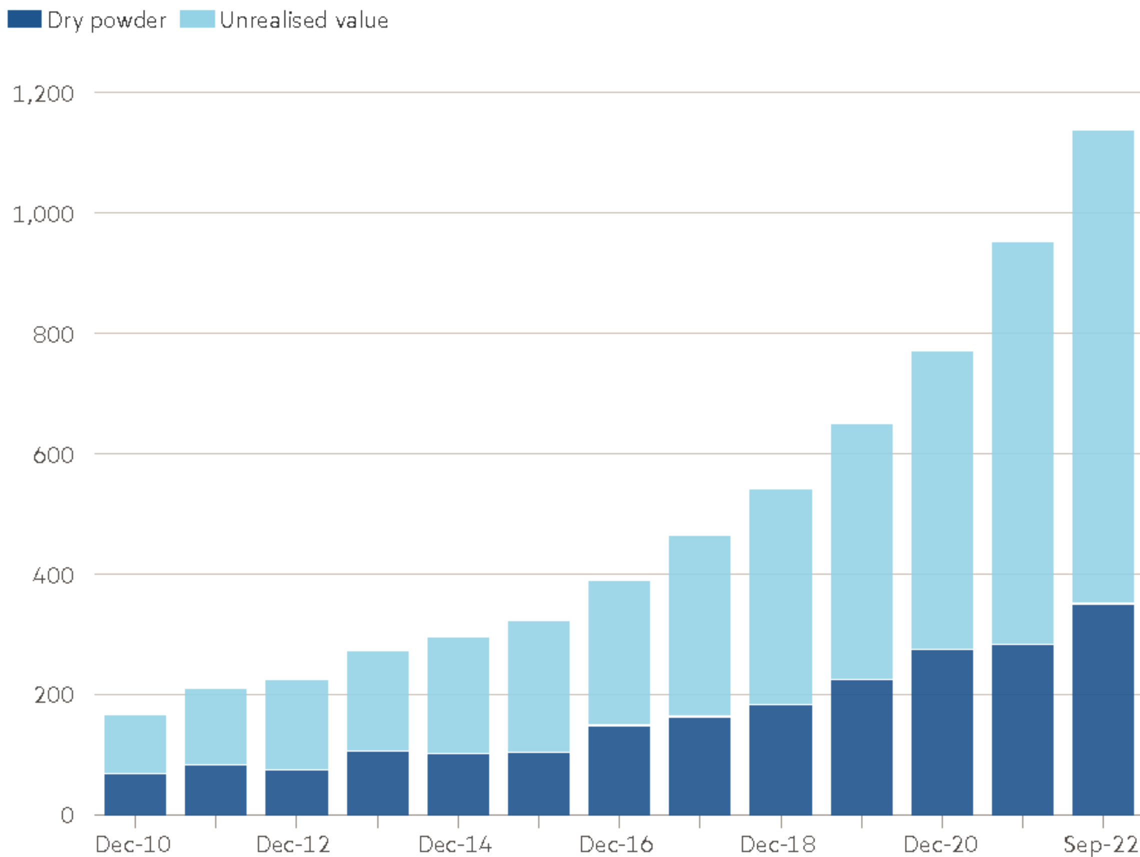
The UK was among the countries that embraced the privatisation of critical infrastructure most enthusiastically, particularly with regard to essential monopolies such as water.

“People like owning essential monopolies because, in the absence of close regulation, they can extract high profits,” says Jon Moulton, a private equity veteran and founder of Better Capital. “Given that no one wants to suffer the potentially ugly consequences of a bankruptcy . . . regulators [which set the amount the monopolies can charge customers] normally allow prices to rise so that the risk of having high debt levels is very low for investors.”

As governments opened up to the idea of transferring public assets into private hands, Macquarie’s investments fanned out across the world, such as the Chicago Skyway toll bridge in 2004. At the time, it was the largest infrastructure privatisation deal in US history and the first time one of the country’s toll roads passed into private operation.

By that point, Macquarie had developed a well-honed playbook: it uses a standard private equity model, which creates infrastructure funds by raising cash from large-scale investors, such as pension and investment groups.

These provide the equity portion of the funding used to buy a particular asset, such as a water or power company, a road, or gas or telecoms network, for example. The balance is then borrowed from the large global banks or private debt funds.



Macquarie's income, as the manager of the funds invested in various assets, comes from management and performance fees tied to the fund's returns. After acquisition, the stable cash flows generated by the asset provide the security for further borrowing, allowing Macquarie to significantly increase the indebtedness of the acquired company.

This provides funding which can either be used to invest in the business or to enhance investor returns through dividend payments and early repayment of the loans made by investors as part of the initial deal.

Folkman, who is himself a private equity investor, points out the risk: "Given the incentives and investor objectives they choose to take the money out rather than reinvesting in the business." The result, Folkman says, can be ageing assets loaded with debt.

But Paul Jarvis, managing editor at Partnerships Bulletin, which reports on public-private partnerships, defends the industry: "Obviously it is more expensive to raise private finance than for the government to pay for infrastructure directly, but the fact is that states aren't going to put all these projects on their balance sheets.

"And although a lot of fuss is made about the negative cases, the majority of projects are running as originally planned and are delivering the services as needed."

Troubled waters

Macquarie first dipped its toe into the UK's waters in 2003, with its shortlived acquisition of South East Water.

After buying the company for £386mn from the French conglomerate Bouygues, Macquarie sold its final stake three years later for £665mn. During that period, debt — some of which was raised via a Cayman Islands subsidiary — increased more than fourfold from £87mn to £458mn.

The increase in borrowing was used to pay investors more than £60mn in dividends as well as to pay off most of the costs of acquiring the company so that the final sales price was mostly profit.

Although this was a win for investors in Macquarie's funds, which benefited from the returns guaranteed from providing an essential daily service, it was a loss for customers because a greater proportion of their bills — up from 8.7 per cent of turnover in 2002 to 14 per cent in 2006 — began to go towards paying the interest on debt.

"This is part of a pattern for investors," says Kate Bayliss, an infrastructure finance expert from Soas, University of London. "Macquarie [and other private equity investors] move in and change the corporate structure. They refinance the assets, hiking up the debt and reducing the equity investment. Sometimes part of the acquisition cost is allocated to the company purchased."

Protesters on Tankerton beach in Kent demonstrate against Southern Water's sewage discharges. The pollution of rivers and seas has led to a backlash against the privatisation of utilities © Chris J Ratcliffe/Getty Images

Macquarie repeated exactly the same strategy, but for bigger stakes, when it and its co-investors acquired Thames Water, which now has 15mn customers in London and the Thames Valley, from German utility RWE for £4.8bn in 2006.

One of the Macquarie consortium's first acts was to arrange for Thames Water to pay a £656mn dividend in a year in which profits were just £241mn. Within six years, the group of companies managed by Macquarie had recovered all the money it and co-investors had spent on the acquisition, by borrowing against its assets and paying out dividends.

By the time Macquarie sold its final stake in Thames Water in 2017, the company had spent £11bn from customer bills on infrastructure. But far from injecting any new capital in the business — one of the original justifications for privatisation — £2.7bn had been taken out in dividends and £2.2bn in loans.

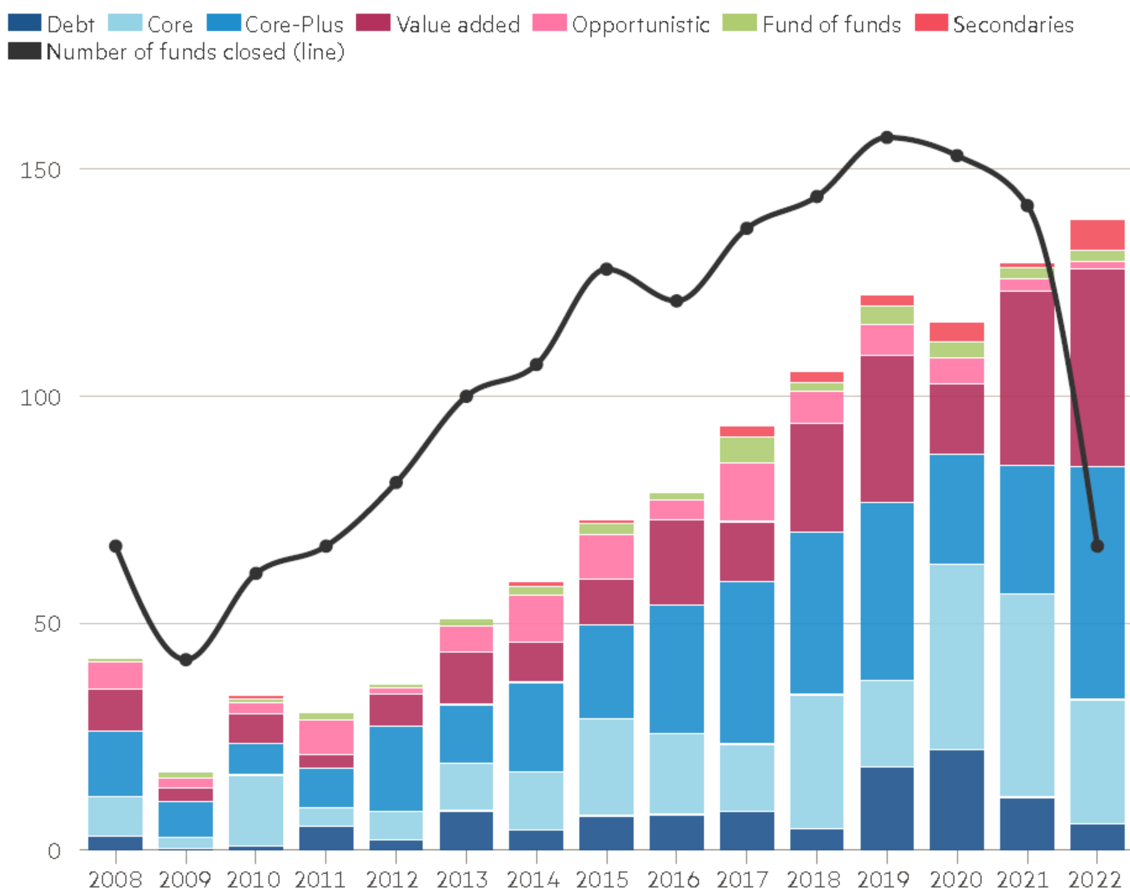
Meanwhile, the pension deficit grew from £18mn in 2006 to £380mn in 2017. Thames Water's debt also increased steeply from £3.4bn in 2007 to £10.8bn at the point of sale, a sum still being paid off with interest by customers long after Macquarie has moved on. Just weeks after Macquarie sold its final stake in the business in 2017, Thames Water received a £20mn fine for river pollution.

Bayliss compares this to buying a house, where the stability of the revenue flow from customer bills enables the financiers to purchase the company and take a mortgage against it. “The difference is that unlike homebuyers who pay the mortgage, they transfer the mortgage back to the company so it’s the customers who pay the interest.”

Such practices are common to private equity structures, but when the underlying companies are utilities there is an added tension: the decision over how much they can charge customers to pay for investment — both for day-to-day running and improvements — is made by the regulators who oversee monopolies. With demanding shareholders on one side and price restrictions on the other, it is the investment in the underlying infrastructure that is often sacrificed.

“Let’s be clear,” says Folkman, of Alliance Manchester Business School. “If my financial incentive is that I will be paid if I satisfy my investors, then I will do things that will satisfy my investors . . . and that’s the problem. It’s not that you’re wicked, it’s what you’re paid to do.”

Macquarie’s decision to take over Southern Water — another UK water utility facing huge investment challenges — as it teetered on the brink of bankruptcy in 2021 was welcomed by the water regulator Ofwat.



Earlier that year, Southern Water had been fined £90mn for deliberately dumping billions of litres of untreated sewage into the sea between 2010 and 2015. Since taking over as the majority investor from a consortium including JPMorgan Asset Management and UBS Asset Management, Macquarie has pledged to raise transparency, close Cayman Islands subsidiaries at the company and to significantly increase investment in sewage treatment works.

Macquarie says it is a responsible investor. "As custodians of vital businesses which touch every aspect of people's daily lives, we have both a responsibility and an opportunity to ensure that we are actively driving positive change," reads a statement on its website.

But the pollution and water leaks across the sector have given ammunition to critics from all sides of the political and economic spectrum who are concerned over private ownership of crucial public infrastructure, where the government

— and taxpayers — would be forced to take over in the event of any financial or environmental catastrophe.

Now, more than three decades after the regional water authorities were sold off with no debt, the privately owned monopolies are saddled with £62bn in borrowings and regulator Ofwat has raised concerns over their financial stability.

Sir Dieter Helm, a former UK government adviser and professor of economics at Oxford university, warns that instead of privatisation being used as intended, to finance investment and spread the cost long-term, "regulators have allowed [it] to be subverted by widespread financial engineering".

"Now the balance sheets of these big utilities are largely exhausted, and without gaining the benefit of the really good infrastructure that privatisation promised," he adds. "On the contrary, recent evidence from both water and electricity distribution suggests that in some cases not even the necessary capital maintenance has been done."

Expanding empire

With US$200bn of global infrastructure assets now under management, Macquarie remains the biggest player in an area still rife with opportunities.

Since becoming chief executive in 2018, Shemara Wikramanayake, a Macquarie insider who joined just after the 1987 financial crisis, has prioritised climate change and renewable energy for investment as well as digital infrastructure in the form of subsea cables and data centres.

The company's £2.3bn purchase of the UK government's Green Investment Bank in 2017 helped catalyse that vision, and it is now one of the world's largest renewable investors in wind farms and solar power.

A Thames Water tanker in Northend, southern England. When Macquarie sold its final shares in the UK's largest water company, the supplier's debt had ballooned to more than £10bn © Andrew Matthews/PA

With supportive governments worldwide and A$35bn ($23.7bn) of available so-called dry powder — money kept in reserve to spend when opportunities arise — few observers expect Macquarie's influence to diminish, particularly if it is eyeing up the vast amount of investment needed to help the world move on from fossil fuels.

The company says it is mindful of the responsibilities that come with owning assets that people around the world rely upon. "Ageing infrastructure, population growth and the impacts of climate change all necessitate significant, multi-decade investment programmes to upgrade critical infrastructure and redress what can often be many generations of under-investment," Macquarie says.

In committing to these kinds of programmes, active investment managers expect "a reasonable return to match the construction, operational and wider risks they are taking".

But when the public perceives owners to be failing to keep up their end of that deal, it can quickly stir anger. Campaigners recently challenged Southern Water chief executive Lawrence Gosden, the former Thames Water executive appointed by Macquarie, to swim at one of England's effluent-soaked beaches.

Although the pollution long predates Macquarie's involvement in Southern Water, Gosden will join many water company bosses in declining to take a bonus this year, stating the utility has "clearly not met the wider expectations of our customers".

Yet Macquarie's grip on the UK's infrastructure more widely is set to tighten. In January, Macquarie, alongside the British Columbia Investment Management Corporation, bought a 60 per cent stake in the 7,660km gas distribution network in the UK, with ambitious plans to convert them for hydrogen use.

Now, more than three decades after privatisation first became popular, governments are faced with a conundrum: how they can use private finance in infrastructure in a way that delivers adequate returns for shareholders and deliver high quality services for the people — their voters — who are paying for them.

"This is the issue of the decade," says Folkman. "We know we want lots of investment to transition to net zero and even just to repair what's failing. But if we want to make it work for investors as well as the public we need to figure out how to do it better and soon."

Data visualisation by Chris Campbell