Babcock shares as good as worthless

Babcock & Brown's share price was 15.5 cents when markets closed for the 2008 year. It last traded yesterday at 38.5 cents, an increase of 148% (having been as high as 49 cents during the day). The optimism is beyond me.

The company is going to limp on for a while yet, that much is clear. Babcock's banking syndicate has agreed to a restructure of the company, suspended covenants on its debt facilities and converted the interest payable on the facilities to a 'Pay If You Can' basis (where do I get myself a loan like that?). They think the business is worth more as a going concern than in liquidation and they're right. Some of its most valuable assets – the management contracts relating to its $70bn of listed and unlisted funds – would be worthless in the event of liquidation.

But the probability of existing shareholders getting something out of it is close to zero. Part of the deal is a capital restructure, 'which is expected to include a debt for equity swap, acceptable to the banking syndicate'. So the banks are going to convert some of their debt into ordinary shares. Fair enough.

The problem is that Babcock owes some $3bn, dwarfing its current $143m implied equity value by a factor of 20 to 1. So any swap of debt for equity is going to mean the debt holders end up with close to 100% of the equity and existing shareholders an extremely small percentage of a large number of shares. Put simply, the banks are going to take the equity and then manage it as they see fit.

That makes buying shares today a risky business indeed.