Babcock stains a promising record - day five

Last spring I had the pleasure of watching a magpie raise her chicks five metres from my living room window. Apart from the rather amusing flying lessons, the expectant look the youngsters gave mum when she returned to the nest always made me chuckle. No thanks or appreciation, simply ‘what’s for dinner?’.

As the Babcock & Brown share price plummeted on 12 June, our research director Greg Hoffman would call out a new low every 10 minutes and look at me like a magpie chick waiting for a worm. After I told him I didn’t know it well enough too many times, he went off in search of alternatives.

All of the Babcock-related securities were down significantly. How about the unsecured notes (BNBG), he asked? Same problem. B&B Wind? Yeah, it’ a possibility but it needs to be cheaper. B&B Power? Alinta assets, no thanks. B&B Infrastructure? Hang on, doesn’t that own Dalrymple Bay Coal Terminal? I worked on a bid for that at Macquarie – it’s a sensational asset. I’ll take a look.

Something simpler please

So, in the search for a simpler alternative unfairly tainted by the Babcock brush, I downloaded the latest annual report for **Babcock and Brown Infrastructure** (BBI). I was in for a shock.

This fund listed in 2002 with Dalrymple Bay as its only asset. In 2003, it bought interests in two power stations and a wind farm. In 2004, it added a New Zealand energy and gas business, a submarine cable linking power grids in the US and a gas transporter operating in the Isle of Man, Channel Islands, Portugal and the UK. In 2006 it gobbled up PD Ports, WestNet Rail, NorthWestern Energy in the US, a Belgian water container business and failed in a bid for GasNet. In 2007 it teamed up with Singapore Power, **B&B Power** and **B&B Wind** in the highly competitive auction for Alinta and bought separate ports businesses in Spain, Belgium and Italy.

Phew. That was enough for me, I didn’t need to turn past page seven. Whatever happened to cheap German or Japanese property that no-one else wants?

When I read the prospectus in 2004, I grudgingly gave these overpaid bankers the benefit of the doubt. The case studies of investments they’d made included a bunch of German apartments where the rent more than covered the debt repayments and all maintenance costs, and Japanese property that was generating enough cash flow to do the same. Both asset classes looked unloved and cheap. They were also gaining valuable expertise in renewable energy – particularly wind – long before it became trendy and, at that point, I’d have been prepared to call it a somewhat impressive track record.

Not so good with others’ money

It was established with their own money, though. Since the float, Babcock has become the

steward of more than $70bn of other people’s money and, as you’ve read above, its approach has been quite different.

That’s a shame (to say the least for the people whose money it is). Someone inside Babcock obviously has the skills to identify assets that are cheap. It wouldn’t have generated 70% profit growth a year but, with discipline and patience, they could have generated excellent long-term returns (imagine what they could be doing with a nice large pile of cash right now). If there’s to be a recovery it will require a return to the strategy that was once extremely successful.

Note: Babcock made an important announcement today regarding its debt facilities. We'll discuss it on day 7 - downside risks.