Restoring Confidence In Babcock & Brown – Day Eight

Making the bull case for Babcock doesn't require the creative mind of a science fiction writer. If the future is remotely like the past and the business continues earning returns on shareholders' equity in excess of 25%, those that buy at the current price will do very well.

Given the current 'crisis of confidence', that proposition might sound ludicrous. But Babcock os not the first investment bank to dust investors' capital in pursuit of a quick buck. And most of the others are not only alive and kicking, but making obscene profits.

Sure, it goes wrong from time to time. But, on average, the returns generated in the investment banking game are exceptional (for staff and shareholders).

Macquarie Group, for example, has churned out its fair share of mediocre products over the years and been through several of its own confidence crises. Yet its return on equity has averaged almost 25% during the past 16 years.

The reason is that investors have incredibly short memories: for all the talk of reputations lost, it seems punters are only too willing to forgive and forget when the latest prospectus arrives in the post. With years of experience in wind and solar energy, Babcock remains extremely well placed to cash in on the current investor enthusiasm for renewable energy.

Given a couple of years and some price recovery in its managed funds, Babcock's current crisis could be long forgotten.

Any buyers out there?

Shareholders could also see a huge upside if Babcock is able to sell assets on its own balance sheet at attractive prices. Selling on investments for a profit has been the major factor in Babcock's profit growth to date. As I've mentioned in previous posts, until they got involved in the infrastructure bubble (is anyone calling it that yet?), they were very good at identifying opportunities in advance of the masses.

It seems unlikely given current market sentiment and the lack of available credit, but if Babcock was able to sell assets at a profit during the next 12 months, it would hush the naysayers (like me) who think they paid too much. It would also give them a war chest with which to pursue further acquisitions – something I'd be a lot more comfortable about in the current distressed environment (now is presumably a great time to be taking cheap assets off the likes of Centro and GPT).

So far, nothing has actually gone disastrously wrong. And it's not impossible to envisage a scenario, three or four years down the track, where the company is firing on all cylinders, money is pouring into the renewable energy sector, and Babcock is standing at the gate collecting its fees and making a motza on investments made in today's distressed environment. There is, however, a lot that needs to go right between now and then.