Wide of the Mark on BEPPA

Just last week I mentioned one short-term ‘arbitrage’ was going to work out well for the Value Fund. What was that about the best laid plans?

The idea was to buy BBI EPS securities before the Babcock and Brown Infrastructure recapitalisation, vote in favour of the deal, wait until they were converted into new Prime Infrastructure securities and then sell them at a premium when they started trading again on 24 November (today).

It all went perfectly until the bit about selling them at a premium. The securities relisted this morning and immediately started trading at an 11% discount to the $5.08 offer price. They closed at $4.15, 18% underwater.

At that last traded price, we’re 6% underwater on the fund’s investment (assuming an option over the old Alinta electricity assets, which has been granted to BBI EPS holders, is worth nothing). And I thought getting the deal voted through was going to be the difficult bit.

My numbers indicated the $5.08 offer price was at least 20% less than the securities were worth. Presumably those acting for 'cornerstone investor' Brookfield, which contributed 40% of the total equity, and the institutions that also participated in the capital raising, thought the same thing.

We could all be wrong. The new Prime Infrastructure is much more conservatively leveraged than its predecessor. But it still has plenty of debt and that means relatively small variations in total value can have a large impact on the equity value of its assets.

But there might also be other reasons driving today’s selloff, completely unrelated to the underlying value. Of the 352 million securities now on issue, 55 million are held by former BEPPA holders. Approximately 100% of the BEPPAs changed hands in the six months leading up to the recapitalisation and many ended up the hands of hedge funds trying to do exactly what I was trying to do – sell them for a profit not that long after we bought them.

There were only 3.7 million securities traded today, approximately 1% of the issued capital. That means there isn’t enough volume for the former BEPPA holders to all dump their shares at once. I’m happy to turn it into a core holding for the fund. The assets are excellent, the current price is attractive and, while there might be potential conflicts of interest down the track, I’m more than happy to have a savvy operator like Brookfield involved. Perhaps many of my fellow arbitrageurs don’t (or can’t) feel the same way.