Chief leads search for new model after copycat strategy fails

Elizabeth Fry

The announcement by Bab-cock & Brown's new chief executive, Michael Larkin, that the company would simplify its business was a tacit admission that its business model - initially developed by compatriot and rival Macquarie - was outdated.

The investment model pioneered by Macquarie involved buying infrastructure assets in sectors such as energy, ports and utilities, before spinning them off into listed satellites and taking fees. This model - in which Babcock & Brown paid top dollar for assets, then became debt-laden - has failed.

Macquarie is also in the process of dismantling the model it founded, as evidenced by the restructuring of its listed fund, Macquarie Airports.

Now, Babcock & Brown is looking for an alternative. Mr Larkin was very clear yesterday that the company still wants to participate in listed and unlisted infrastructure funds - to that end, the strategic review being carried out is all about trying to find a way forward.

Although its high debt levels weighed on Babcock & Brown's business, the market woke up to the fact that its management fees were in danger of evaporating as the value of the assets held by the satellites declined.

Nowhere was this more evident than with Babcock & Brown Power, Australia's biggest-listed electricity producer. Shares in Babcock & Brown Power fell 41 per cent earlier this week after it booked A$425m (US$373m) in writedowns.

Remarkably, it was Babcock & Brown's willingness to compete with Macquarie and try to beat Australia's second largest investment bank at its own game that led to its troubles.

Babcock & Brown and Singapore Power partnered up and started a bidding duel with Macquarie in April 2007 and ended up paying $A8bn for the Australian energy provider, Alinta.

It proved to be a good deal for Macquarie to lose. The Alinta board recommended against Macquarie because of its association with Alinta directors.

The board's decision was questioned, as Macquarie valued Alinta at A$15.45 a share compared to the A$15 per share value of the recommended cash-and-stock bid from Singapore Power and Babcock & Brown.

Macquarie's higher bid was shunned.

Babcock & Brown expected Macquarie to return to the fore with an even higher offer. However, Macquarie backed down.

After winning the bid, Babcock & Brown tipped the lion's share of Alinta's power generation assets and retail assets into Babcock & Brown Power at a high price, forcing it to borrow heavily.

In May, Babcock & Brown Power admitted to a A$275m shortfall in its attempts to refinance short-term debt incurred on Alinta assets and came under relentless short-selling as a result.

This led to an assault on the share prices of the parent. Standard & Poor's placed it on credit watch after Babcock & Brown's share price collapsed, triggering a market capitalisation clause in the group's A$2.8bn debt covenants.

The company's lenders subsequently waived the review clause.

Fonte: Financial Times, London, August 22 2008. Companies & Markets. p. 17.