BrisConnections: Infrastructure's disconnect

Chris Wright

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If you want a microcosm of the bad habits global capital got into as the credit crunch hit, go to Brisbane.

The story of BrisConnections there has everything you need, and its conclusion, unresolved at the time of writing, will have wide-ranging ramifications for the way infrastructure is funded in Australia and beyond.

BrisConnections was set up by Macquarie Capital Group and the construction firms Thiess and John Holland to design, build, operate and finance a A$4.9 billion ($3.53 billion) airport toll road in Brisbane, under a 45-year concession awarded by the state of Queensland in May 2008. BrisConnections floated two months later at A$1 a share, lost 60% of its value in a day and by November had hit one-10th of an Australian cent, the lowest possible price on the Australian Securities Exchange.

The A$1.2 billion flotation, underwritten by Macquarie and Deutsche, used an instalment model in which investors paid A$1 up front, with two more payments to come in subsequent years, meaning they remain on the hook for two instalments that will each cost 1,000 times more than the trading value of the stock today.

How did it get to this? There are many components to the BrisConnections story and they all speak to the way infrastructure has become commonly funded in western markets.

The wrong assets for listed markets

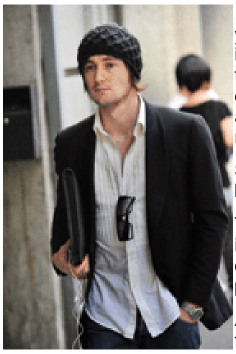
When infrastructure first started to make its way to stock market investors, it was typically when a government sold an operational power plant or road: a tangible asset, throwing off consistent cash, and something you could go and see if you felt so inclined. BrisConnections was typical of a trend to list projects that were not yet built. "Listed markets are a natural home for assets when they're more mature and yielding," says Lachlan Douglas, director of Principle Advisory Services, which structures private market investments for institutional investors. "They don't tend to go a good job of being a home for assets going through significant transformation, and there's no greater transformation than when the thing's being built."

Worse, retail investors, who in Australia had come to see infrastructure as a safe haven, failed to note the difference and thought they were buying a cautious yield play. Nor did they ask where dividends would be coming from when there was no asset yet to generate them: the answer was from borrowings. These things get away in the good times but as BrisConnections was launched at a time of quickly changing attitudes to debt, institutional investors (including Macquarie itself) quickly jumped ship, triggering the share price falls and putting most of the stock into retail hands.

Financial engineering

The source of the dividend was only one example of common financial engineering structures that have since backfired. The most obvious was the instalment method.

Nick Bolton has sold his voting rights to get out of paying instalments



People buying into the flotation knew clearly that there would be three separate payments of A$1 each, a year apart, and while the method is unusual it is certainly not unheard of. The problem was that some small investors in the secondary market did not appear to have realized this and inherited huge obligations when they bought in. One investor spent A$600 on the stock at 0.3 cents a share without realizing that doing so committed him to A$400,000 of subsequent instalment payments. Others are up for millions. So it was that a housewife called Fang He found herself becoming the biggest individual shareholder in the company by mistake.

She was followed more recently by a 26-year-old Melbourne entrepreneur called Nick Bolton, a lank-haired bohemian figure in designer stubble and a beanie.

The sting in the tale was that Bolton used his shares to launch a series of motions to wind up the company in order to get out of paying the later instalments – then at the last moment sold his voting rights to the contracted builder, Leighton, for A$4.5 million and voted all his shares against the very resolutions he had proposed.

At the time of writing it was still not clear if Macquarie and Deutsche were going to pursue small investors for the later instalments, suffering the crushing PR of putting people out of their homes by doing so, or wear the costs of the shortfall on the two scheduled A$390 million raisings themselves by taking the vehicle private.

The separate entity

It has become commonplace to have one entity responsible for a piece of infrastructure, giving out fees to the sponsors. "That created a misalignment of interests between those who were managing the assets and longer-term investors," says Douglas. "Mums and dads thought they were buying to secure yield-oriented assets, and the people supposed to be looking after the money were taking out fees." Macquarie has already gained A$110 million in fees from the venture. Combining all of this with highly geared debt created what Douglas calls "a perfect storm: misinformed investors, misaligned manager, and leverage on an already risky asset."

Classic Macquarie

This model is classic Macquarie, and its method of using separate listed vehicles to house infrastructure or other assets while paying fees into the mother ship looks bereft today – although at least, unlike imitators such as Allco and Babcock & Brown, it's still alive to tell the tale. Macquarie is sponsor, lead arranger and underwriter on the flotation, arranger of a banking syndicate for a bridging loan: it's everywhere. And this deal was full of conflicts: Trevor Rowe, chairman of BrisConnections, is also chairman of Queensland Investment Corp, which put A$25 million of government pension money into BrisConnections, and a director of the stock exchange that approved the structure for listing.

Macquarie, perhaps in a slimmed-down form with many of its listed funds cut adrift, will survive this crisis but BrisConnections is emblematic of the demise of a structure that in better days drove much of the profitability of the whole group. Macquarie declined to comment.

So where does this all lead? Probably to infrastructure finance falling back to the private markets, with more direct involvement of Australia's vast and growing superannuation funds; an end to instalment listed structures; an end to the use of listed markets for developing infrastructure; and greater scrutiny of related parties in complex transactions. But, as always, the real question is: For how long will the lessons be remembered?