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Infrastructure stocks hard hit

ANALYSIS: Adele Ferguson | *January 23, 2008*

THE Australian share market's move into bear territory yesterday, losing 7 per cent of its value, indiscriminately slaughtered most stocks. But it saved its biggest punishment for over-gearred, opaque stocks with an exposure to overseas investments.

It is no surprise then that many of Australia's 24 listed infrastructure and utilities stocks were hit harder than the rest of the market. Stocks such as Babcock & Brown Power lost 10.5 per cent, Babcock & Brown Infrastructure lost 11.7 per cent and Babcock & Brown Wind dived 12.1 per cent, while Macquarie Airports lost 9 per cent.

Tony Shepherd, chairman of Transfield Services, which recently spun out Transfield Infrastructure Services Fund, said the recent sell-down in the stock was irrational. "It is on a yield of 11 to 12 per cent tax deferred. All contracts are locked in and PPA (power purchase agreement) backed. The debt is locked in and hedged and they are in essential services," he said.

Transfield Infrastructure Services fell almost 1 per cent yesterday to \$1.61, after trading as high as \$2 in December.

Merrill Lynch analyst Matt Spence said, in the short term, he expected the infrastructure sector would continue to be hampered by continued high credit spreads, rising domestic interest rates and a strong Aussie dollar.

"Although some infrastructure debt packages have been put together in recent months, it would be reassuring to see some listed names successfully refinance," he said.

Mr Spence said companies that were not exposed to merger and acquisition risk or unlikely to take on new debt would continue to outperform. In 2007, Macquarie Communications Group, Babcock & Brown Infrastructure, Duet, APA and Challenger Infrastructure Fund raised capital, and all were trading at a discount. "The market seems to be very sceptical of new deals," he said.

But he said that if the US slid into a recession - which would drive a global slowdown in the second half of 2008 - it could lead to infrastructure out-performance. Infrastructure stocks have had a rough trot in the past year. Over the 12-month period, the Australian Infrastructure Index underperformed the ASX200 by 9.9 per cent. However, in the past couple of weeks it had started to fall at a lesser rate than the overall index. Indeed, yesterday, when the overall market fell 7 per cent, the infrastructure index fell about 4.5 per cent.

Some fared better than others. Those facing imminent debt refinancing were hit hardest, particularly following the credit downgrade of one of the world's biggest monoline insurers Ambac Financial Group, which saw its credit rating drop from AAA by Fitch Ratings to AA.

The credit downgrade raised concerns that the credit crunch could broaden, halting major infrastructure projects across the globe.

The worry is that these downgrades will reduce these companies' ability to insure further bonds, making it more expensive for infrastructure companies to raise debt.

Mitch King, managing director of Lighthouse Infrastructure, said infrastructure stocks that were faring worst were the ones that had been doing too much M&A activity, had too much debt or were managed by an investment bank or fund manager.

He said infrastructure stocks, such as Spark, SP Ausnet and Envestra, fell yesterday, but not nearly as much as the overall market.

"What we are seeing today are winners and losers in infrastructure. Regulated assets such as Spark and SP Ausnet are doing better than the rest of the market because they are defensive stocks. They have strong cashflows and have good yields," he said.

Geoff Frankish, director and head of infrastructure at Goldman Sachs JBWere Asset Management, said some of the negative reaction to infrastructure stocks was not rational.

"The thing that is attractive about infrastructure stocks is certainty. They are defensive assets. They are regulated assets with little price elasticity and so even if there is a downturn they still have strong cashflows," he said.

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