Brookfield Asset Management Inc.: Should it Join CIDB?

Description

Finance Minister Bill Morneau's Advisory Council on Economic Growth's first report is out. Not surprisingly, infrastructure is the key to unlocking Canada's future economic growth.

One of the council's chief recommendations is that the federal government create a focused infrastructure strategy that includes establishing the Canadian Infrastructure Development Bank (CIDB), a crown corporation that would be funded through a combination of federal funds ($40 billion) and institutional investors ($160 billion).

Brookfield Asset Management Inc. (TSX:BAM.A)(NYSE:BAM), with $59 billion in infrastructure assets under management, will obviously be called on by the CIDB to help meet the $160 billion figure.

Brookfield, as a value investor, tries to buy assets on the cheap. It's the "why pay a dollar for something when you can get it for 50 cents?" type of idea.

So, when the federal government, which is notorious for blowing taxpayer money, is proposing that institutional investors such as Brookfield pony up four-fifths of the $200 billion it wants to invest over the next 10 years, you can bet CEO Bruce Flatt and the rest of his team are highly skeptical.

That doesn't mean Brookfield Asset Management, either directly or through **Brookfield Infrastructure Partners L.P.** (TSX:BIP.UN)(NYSE:BIP), won't contribute its fair share. After all, it is Canada's biggest publicly traded alternative asset manager and a big believer in global infrastructure investments.

If it thinks there's money to be made by pitching in, you can bet the cheques will be issued and couriered to Ottawa ASAP. But I'm getting ahead of myself.

First, let's consider what Flatt et al. look for in terms of return on investment.

Brookfield aims for annual returns of 12-15% while maintaining a low-risk profile. That requires going where others won't in order to acquire infrastructure assets at value prices and then turning around and selling them when valuations move higher.

That's why BIP is currently selling its fully valued North American assets and moving them into natural gas and electric utilities in South America, where adjusted funds from operations yields are greater than 13% and rising, requiring low-maintenance capital to keep them pumping out revenue and above-average returns. It's a cliche in the investment business, but Brookfield is the ultimate recycler of capital.

For Brookfield to get involved with CIDB, it's going to need several elements.

First, over 90% of its cash flows are either regulated or contracted to provide stable earnings. Any project it invests in must have predictability of cash flows. Second, it chooses projects that need significant fixed costs up front (higher barrier to entry) with very little future maintenance relying on inflation and GDP growth to increase its margins over time. Lastly, any new infrastructure projects should provide diversification within its four major operating areas: utilities, transport, energy, and communications.

Put all of this together and you've got a good recipe for converting cash flow. Since 2012 BIP has grown its adjusted funds from operations by 124% to US$796 million. It's a big reason why BIP stock has delivered an annual return of 23.5% over the past four years—significantly higher than the TSX at 8.1%.

Brookfield will continue to do what's best for shareholders by making the contrarian moves it feels are necessary to provide the stable returns investors have come to expect from it.

Should it join the CIDB?

Only if it fits into its strict investment criteria detailed above. Somehow, I don't see that happening from a federal government initiative. I hope I'm wrong.

CATEGORY

1. Investing

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2. NYSE:BN (Brookfield Corporation)
3. TSX:BIP.UN (Brookfield Infrastructure Partners L.P.)
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