



This High-Yield Stock's Big Brazilian Bet Is on the Brink of Falling Apart

Description

Brookfield Asset Management Inc. (TSX:BAM.A)([NYSE:BAM](#)) has earned a reputation as being one of the world's best value investors. The company seeks out situations where there's market dislocation, so it can swoop in and buy top-tier assets at fantastic prices.

One of its recent exploits was last year's decision to take advantage of Brazil's economic and political upheaval to seal a deal for a stake in the nation's largest gas utility. However, the company apparently struck such a good deal that it drew too much attention, and now a Brazilian court has halted the transaction.

Drilling down into the deal

Last September, Brookfield Asset Management's infrastructure arm **Brookfield Infrastructure Partners L.P.** ([TSX:BIP.UN](#))([NYSE:BIP](#)) announced that it had joined institutional clients of its parent company to acquire a 90% stake in Nova Transportadora do Sudeste (NTS) from Brazilian oil giant **Petrobras**.

The consortium would pay US\$5.2 billion for the stake with Brookfield Infrastructure anticipating that it would invest a minimum of US\$825 million for a 20% stake. However, it would later increase its planned investment up to US\$1.2 billion for a 28% stake in the business.

The draw for Brookfield and its institutional clients was that NTS served the core economic regions of the country under long-term ship-or-pay gas transportation agreements. Because of the structure of these contracts, there was no volume risk and the revenues had inflation indexation, meaning the system generates equity-like returns with bond-like risk.

Brookfield saw the transaction as a "once-in-a-lifetime" deal. In fact, the economics were so good that Brookfield Infrastructure recently [increased its distribution by double-digits](#), pushing its yield up to nearly 5% in anticipation that it would soon close the transaction.

Back to the auction block?

Apparently, however, the court agreed that Brookfield was getting a steal of a deal. That's after a federal judge in the country granted an injunction against the transaction, saying it wasn't sufficiently advertised to foster competing bids. The implication is that if more would-be buyers knew about the auction, it would have resulted in a higher price and therefore not quite the deal that Brookfield and its investors were able to strike. Though, it is worth noting that [the auction was never a closely held secret](#).

It's unclear at the moment what this court ruling means for Brookfield, which had expected to close the transaction early this year. In fact, it had already completed an equity offering to finance its portion of the deal and increased its payout in anticipation of the increased earnings. As a result, a long delay could have an impact on the company's financial results this year.

According to a report by *Bloomberg*, Brookfield is working with bankers who control Brazilian bank Itau Unibanco to join it in the deal. Those talks could result in Brookfield Infrastructure shrinking its stake in the entity back down to the original 20% and might even force the company to raise its offer to incorporate the value a competing bidder might pay. Meanwhile, under a worst-case scenario, NTS could go back on the auction block.

This incident would not be the first time Brookfield has had issues closing a transaction. In 2015, the company agreed to acquire Australian port-and-rail company Asciano, which would have resulted in it investing US\$2.8 billion for a 55% stake. However, a competing bid emerged, which forced it to rework the entire transaction to include the rival in its consortium, dropping Brookfield's investment down to US\$350 million.

While Brookfield ended up investing less than it initially anticipated, it still was able to participate in the transaction in a meaningful way, which helped drive growth in 2016. The hope is that the NTS transaction will have a similarly successful outcome.

Investor takeaway

Brookfield Infrastructure Partners saw the recent economic and political turmoil in Brazil as an opportunity to acquire a great asset for an excellent value. It would seem that others agree and that the deal just might turn out to be too good to be true. If that's the case, it could force the company to pay up or bring on another partner to avoid losing a transaction that it expected would be a major driver of growth in 2017.

CATEGORY

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Date

2025/08/02

Date Created

2017/02/13

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