

# A Well-Oiled Money Machine

*Petronas is a state-owned oil company with a difference. By operating in countries its international rivals have shunned or have been barred from entering, the Malaysian company has built a formidable portfolio of overseas assets that account for over 75% of its revenues*

By Leslie Lopez/KUALA LUMPUR

WHEN A MALAYSIAN cabinet minister once complained during a top-level meeting that Petroliam Nasional executives were ignoring his directives, Prime Minister Mahathir Mohamad jumped to the national oil company's defence. Chiding the minister, Mahathir bluntly told the gathering of top policy-makers—according to one participant in the meeting—to “leave Petronas alone.”

In a country where state-owned companies and politically connected businesses are at times better known for scandals and mismanagement, Petronas stands apart. And in the developing world—where major state oil companies like Indonesia's Pertamina often distinguish themselves by the sheer audacity of their patronage and opaque financials—Petronas is a flush, sure-footed example of an integrated approach to natural-resource management; something Malaysia has not been able to replicate, for instance, in its widely criticized forestry sector.

“I think it's because we don't have any other agenda apart from the national agenda,” says Petronas President Hassan Marican to the REVIEW in a rare interview.

Now, however, Petronas faces fresh challenges. With Malaysia's oil reserves dwindling and few new domestic discoveries on tap, Petronas must expand its operations abroad to grow. At the same time, Petronas will have to navigate an impending leadership transition in Malaysia, where Mahathir—the company's chief protector—has

declared that he will retire in October and hand power to his deputy, Abdullah Ahmad Badawi. With Mahathir gone, some bankers and government officials worry that Abdullah could face pressure from businessmen and politicians to tap Petronas' wealth to supplement the state budget or as a source of patronage.

With Malaysia's manufacturing base under the constant threat of erosion by the irrepressible rise of China as a magnet for regional foreign-investment dollars, pressure from the bean-counters may intensify, the thinking goes.

Petronas' track record, though, suggests that Malaysia's new leadership would do well to emulate Mahathir's hands-off approach. Largely shielded from political interference, the often-hermetic company has melded professional management and innovative business strategies to become a national oil company that makes money instead of squandering it. Over the last five years, Petronas has averaged more than \$5.5 billion in annual net profits on revenues of almost \$18 billion and amassed cash reserves of as much as \$17 billion, according to the company's latest audited financial statements. By contrast, Indonesia's Pertamina earned \$566 million on revenues of \$16.3 billion in 2000.

That war chest should be further rein-

forced by the current climb of world crude oil and refined-product prices due to the threat of armed conflict in Iraq. It is from this fairly comfortable position that Mahathir suggested in February that Islamic nations consider using the threat of curtailed oil supplies and higher fuel prices as a weapon to dissuade the United States from attacking the regime of Saddam Hussein.

Foreign investors know better than to listen to such rhetoric. They have ploughed some 40 billion ringgit (\$10.5 billion), into Petronas' joint ventures in

## GLOBAL AMBITIONS

- Petronas operates in 32 countries outside Malaysia
- Its overseas operations, including exports, account for more than 75% of its revenues
- This is likely to increase in future as Malaysia's oil reserves begin to run out

everything from oil exploration to refineries and petrochemical plants. In addition to being a strong regional player in refined-product sales, Petronas has been a leading proponent of large and financially complicated liquefied-natural-gas projects. That strategy has made it one of the most important sellers of LNG in Japan, Taiwan and South Korea.

Unlike most state oil companies in the developing world, Petronas has made its overseas ventures work, operating in countries its international rivals have shunned or have been barred from entering. It has turned strife-torn, terrorist-ridden Sudan into a net oil-exporting nation, for example. It's also pumping oil in Iran, Algeria, Turkmenistan, Pakistan and China where political risk or anti-Western sentiment have frightened off many bigger players.

The strategy has paid off: Overseas operations, including domestic oil exports, accounted for 76% of Petronas' revenues. To minimize political risk in operating in some of these countries, Petronas picks strong partners. In Sudan for instance, the company is in partnership with China National Oil Corp. and Sudan's National Oil Company, Sudapet, while in Iran it has a tie-up with France's TotalFinaElf, which has a strong relationship with the country.

Still, Petronas' biggest immediate problem is Malaysia's declining oil reserves. Barring new discoveries, Hassan says that the country will be a "net importer of oil in less than 20 years" if the current production rate of roughly 630,000 barrels per day is maintained.

Petronas estimates Malaysia's currently recoverable oil reserves at 4 billion barrels, though the country may have total reserves four times that amount, mainly offshore in the South China Sea. "Our challenge is to find the technology to make it feasible to tap the oil in place," says Hassan.

In the meantime, Petronas has focused on finding more oil and other new business opportunities overseas. While the company has reaped healthy returns on refining and other downstream investments, its oil search hasn't been as encouraging. Only 22% of Petronas' total oil-and-gas reserves are located abroad. And oil and gas pro- ►►



duced from its international operations amount to less than 10% of what flows from its domestic operations.

Still, Hassan maintains that "our overseas push has helped in branding Petronas as a truly global company" and is counting on the strategy as 3 major source of future revenue. Rushing in where Western rivals have feared to tread, Petronas has already established itself as the developing world's most aggressive foreign investor, with operations in 32 countries. The overseas expansion began with 3 modest exploration venture in nearby Vietnam in 1990, followed by an initial foray into Africa.

Slipstreaming on Mahathir's activist brand of diplomacy—which cast Malaysia as a champion of the Third World and an exporter of capital arid corporate expertise—Petronas first turned to post-apartheid South Africa. According to senior government officials, Mahathir's strong support for Nelson Mandela's presidency in 1994 was reciprocated two years later when Mandela's government tacitly backed Petronas in its 1995 bid to acquire a 30% stake in South Africa's biggest oil refiner and marketing company, Engen.

Petronas succeeded, eventually buying 3 controlling stake in Engen for \$775 million. The Engen purchase gave Petronas control of 18% and 27% of South Africa's refining capacity and retail-fuel market,

respectively. Engen's operations now contribute almost 20% to the Malaysian oil company's total annual revenue.

Petronas has also nailed down exploration and production deals in strife-torn Sudan, turning Sudan into a net oil exporter for the first time in 1999. "We earned our stripes as an international player after Sudan," says Hassan. "We got noticed by Exxon because it took us just over two years to complete a 1,500-kilometre pipeline for transportation and export of oil."

Such successes have led to new opportunities. Just months after its success in Sudan, for example, Hassan received a call from a business associate at ExxonMobil Corp. with an offer to join the United States giant in a \$3.5 billion pipeline venture in Chad, another often unstable African state. Petronas bought a 30%

interest in the project, which will be operational in July.

At home, Petronas must find a way to ensure the relative independence it has enjoyed under Mahathir for 22 years endures when Abdullah assumes the premiership. "The problem is that there are so few fat cows around," says a chief executive of a Malaysian bank. "His [Abdullah's] challenge will be to keep the wolves at bay."

Keeping Petronas free of politics is crucial to the Malaysian economy, according to some independent analysts. "The company is strong and the management has delivered," says Alan Greene, a bond strategist with Barclays Capital in Singapore. Greene and others contend that overt government interference in the oil company's management could jeopardize Petronas' strong international credit

CROWN JEWEL: Petronas' oil-and-gas complex in Kertih, Terengganu



## GLOBAL PRESENCE

Petronas operates in 32 countries outside Malaysia



rating—BBB+ from Standard & Poor's—and make it more expensive for other Malaysian companies to raise funds abroad. Petronas is currently Malaysia's largest issuer of debt securities, raising more than \$7 billion through bond issues over the past decade.

To be sure, Petronas hasn't been totally immune to government demands for financial help in the past. Twice—in 1984 and 1989—Mahathir used the oil company's money to save scandal-ridden Bank Bumiputra from collapse. Petronas injected a total of 3.3 billion ringgit into the bank after had-loan provisions nearly wiped out the state-owned bank's capital.

More recently, Petronas has played the role of property developer for the government. The oil company now owns mega-projects like the mammoth development in Kuala Lumpur that includes the Petronas Twin Towers, the world's

tallest buildings. And it's building and operating Malaysia's new \$5.7-billion administrative capital, Putrajaya, 25 kilometres south of Kuala Lumpur.

Hassan defends these diversions from the oil and gas business as national necessities. He argues that the bailouts of Bank Rumiputra—which has since merged with another local bank and is now known as Bumiputra-Commerce—pre-empted a possible meltdown of Malaysia's financial system in the 1980s. What's more, he says that Petronas eventually recouped much of its investment because many of Bank Bumiputra's bad loans were secured by Hong Kong property assets that soared in value in the 1990s.

Hassan also defends the oil company's diversification into property. He says the Petronas Twin Towers project has proved a commercial success that has also helped raise property values in central Kuala

Lumpur. Space at the Twin Towers is currently valued at 1,500 ringgit per-square-foot, a five-fold increase compared to when the project opened in the mid-1990s, says Hassan.

The expertise Petronas obtained from participating in the building of the Twin Towers helped the company build Putrajaya. "Putrajaya was completed with home-grown talent and is now operating on a commercial basis," says Hassan, adding that the "real harvest to our investment [in Putrajaya] will come in the next few years when we take some parcels of the development public by listing them on the stockmarket."

But Petronas has also found itself at the centre of a major domestic political dispute after the federal government ordered the company to stop making oil-royalty payments to the Terengganu state government in 2000. The move came after Malaysia's leading opposition party, Parti Islam SeMalaysia, or Pas, won control of the state's legislature for the first time in a 1999 election.

Pas, which espouses Islamic-oriented social and economic policies, is suing Mahathir's government and Petronas for allegedly breaching an agreement between Petronas and the Terengganu state government signed in 1975.

The suit has raised concerns over production-sharing contracts Petronas has signed with other business partners. Hassan declines to comment on the Terengganu dispute, which is now before a Malaysian court. ■