

1MDB's 'fantastic' investment strategy?
MalaysiaKini.com
Feb 24, 2014

MP SPEAKS After the expose I made last week with regards to the change of auditors for 1MDB, the company has confirmed in its statement on Feb 21 that it had appointed Deloitte, a Big 4 accounting firm, to complete the audit for the year ended March 31, 2013, saying this was done after "it was mutually agreed with KPMG that the firm would cease to be 1MDB's auditors".

Contrary to being accused of a suspicious move, 1MDB argued that, "This is nothing special or new as it is in line with best market practice where companies decide on its current or future auditors after considering all aspects, including - but not limited to - conflict of interests and other considerations".

1MDB could not be more wrong, or we could perhaps forgive its management of attempting to make light of a very bad situation. There is no "best practice" in this world which says that it is perfectly normal to suddenly change auditors long after the accounts were overdue. Had the change been made well before the end of 1MDB financial year March 2013, there would have been little for us to question the company.

However, when the accounts are significantly delayed by nearly a year, and the auditor quits before it gets finalised, then surely every rakyat has the right to ask for an honest explanation. For example, why couldn't the change of auditors be done only for the March 2014 accounts?

The irony is, *The Star* reported on Aug 2, 2012 that Deloitte managing partner Tan Theng Hooi himself cited that the "failure to release financials on time is not acceptable and may indicate there could be unresolved accounting, management, or other issues in hand", when criticising public listed companies for late publication of financial statements.

In Malaysia, as well as in countries like the United States, public listed companies are given only six to eight weeks to report their quarterly accounts. While 1MDB isn't a listed company, it is a sovereign wealth fund which is of even greater public importance, and it is only required to file its reports once a year! And yet, despite the appointment of KPMG, a top international accounting firm, it is overdue on its financial report by nearly a year.

1MDB gave the excuse that "its new business direction has helped it grown exponentially, requiring consolidation of new subsidiaries into the group" and hence, the delay in its accounts.

The excuse does not hold water because its acquisitions were not any more complicated than many carried out by some of our largest companies on the stock exchange - such as the Sime Darby acquisition of Guthrie and Golden Hope Plantations. And yet, these companies were able to finalise their accounts in a time manner in accordance to the stringent rules set by Bursa Malaysia.

'1MDB's investment makes no sense'

In the same Feb 21 response to my earlier criticisms, 1MDB also defended its mysterious US\$2.32 billion "investment" in Cayman Islands.

1MDB said it had “invested the proceeds with regulated and licensed international fund managers. These fund managers adopt an absolute return strategy of which the primary investment objective is to achieve long-term capital appreciation and/or steady income through investments in listed and/or unlisted companies”.

“A total of US\$200 million (RM658.9 million) has been remitted from the fund to the 1MDB group in Malaysia to service repayment. Out of this, US\$134 million (RM430 million) is from the 5.76 percent cash dividend generated within the first year of the investment period.”

I’d like to thank 1MDB for highlighting the fact that it has received a 5.76 percent return in its first year of investment in the unnamed Cayman Island fund manager. Under normal circumstances, the 5.76 percent return may look acceptable, albeit a little mediocre. However, these are not normal circumstances.

The reason why the US\$2.32 billion was invested in Cayman Islands in the first place is because 1MDB terminated and redeemed its 11-year loan to Petrosaudi International Limited in 2012, when the multi-part loans were to mostly mature in the year 2021. The loan to Petrosaudi, in the form of “Murabaha notes” commanded a guaranteed fixed interest (“profit rate”) of 8.67 percent per annum.

Hence it must be asked, why did 1MDB redeem its loan earning a guaranteed fixed return of 8.67 percent and invest in a fund manager in Cayman Islands which it refuses to name, giving a return of only 5.76 percent? Does that make any financial sense?

However, even if we were to ignore the fact that the Murabaha notes were paying a very profitable 8.67 percent, it must be reminded that 1MDB borrowed all the money used to make the above investments.

The bulk of 1MDB’s borrowings for the above investments were raised in 2009 via an Islamic loan facility, sukuk, where 1MDB had to pay 5.75 percent interest (“coupon rate”).

In layman’s terms, this means that 1MDB is borrowing money at 5.75 percent interest to invest in an anonymous Cayman Islands fund which gave a return of 5.76 percent! Does that make any financial sense?

Worse, 1MDB had offered the above sukuk at a massive 12 percent discount - meaning it only received RM87.92 in loan funds for every RM100 it borrowed. But 1MDB has to pay 5.75 percent interest on the full RM100. Hence, the effective interest rate payable by 1MDB for the sukuk is 6.71 percent.

In layman’s terms, this means that 1MDB is borrowing money at an effective interest of 6.71 percent to invest in an anonymous Cayman Islands fund which gave a return of 5.76 percent. What a fantastic investment strategy!

I look forward to being lectured by any fund manager who can justify the above 1MDB tailor-made investment strategy. The rational thing for 1MDB to do - which it must do - to avoid further embarrassing losses for the rakyat, is for the company to withdraw the funds from this Cayman Island fund-or-fund-manager-which-cannot-be-named to pay off its sukuk debt, guaranteed by the federal government costing 6.71 percent per annum.

Otherwise, the rakyat is forced to speculate if this mysterious US\$2.32 billion investment in the secretive Cayman Island fund was the reason why "it was mutually agreed with KPMG that the firm would cease to be 1MDB’s auditors".

Copyright © 1999-2012 Mkini Dotcom Sdn. Bhd
Source: <http://www.malysiakini.com/news/255240>