

1MDB's US\$4.5 billion rescue may weigh on Abu Dhabi's investment firm

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The US\$4.5 billion (RM16.9 billion) rescue of a struggling Malaysian state fund is good news for the government in Kuala Lumpur but will load Abu Dhabi's International Petroleum Investment Co (IPIC) with extra debt that may worry investors in its bonds.

Last month IPIC, an investment company owned by Abu Dhabi's government, came to the aid of Malaysia's loss-making 1MDB, whose poor record and US\$11.6 billion of debt are a source of political pressure on Prime Minister Datuk Seri Najib Razak.

IPIC agreed to provide 1Malaysia Development Bhd (1MDB) with US\$1 billion in cash, allowing the Malaysian fund to repay a US\$975 million loan to a global banking syndicate.

The Abu Dhabi firm also agreed to assume US\$3.5 billion of 1MDB debt, and forgive an undisclosed amount of debt owed to IPIC by 1MDB, in exchange for assets which have not been named.

The deal eases a crisis over 1MDB that had weighed on Malaysia's currency and credit rating.

But for IPIC bondholders, the firm faces billions of dollars of new exposure from a deal whose details and commercial rationale have not been fully explained.

IPIC's aid to 1MDB illustrates some of the risks of investing in state-owned companies in the Gulf: although they have the backing of wealthy governments, they are not always completely transparent.

"I think the 1MDB deal has a more or less political motivation behind it... It symbolises the importance of bilateral ties between the GCC (Gulf Cooperation Council) and Malaysia," said Sergey Dergachev, senior portfolio manager for emerging market debt at Union Investment Privatfonds in Germany, which holds IPIC bonds.

Both IPIC and 1MDB declined to comment on details of the rescue or its motivation.

Abu Dhabi and Malaysia have close investment and diplomatic ties, which have strengthened since the global financial crisis.

IPIC has assets totalling US\$68 billion, according to its 2013 annual report, and the implicit backing of Abu Dhabi's wealthy government.

"We think that the debt settlement agreement with 1MDB should have a moderate impact on IPIC's leverage profile," wrote Ali Dhaloomal, Bank of America Merrill Lynch analyst.

He estimated the rescue would boost IPIC's net debt 12% and its net leverage to 8.7 times, not high by international standards from an end-2013 level of 7.8 times.

Liabilities at IPIC and its subsidiaries totalled US\$51 billion at end-2013, according to the annual report.

Nevertheless, the spread between IPIC's outstanding US dollar bond maturing in March 2022 has widened over an April 2021 bond issued by another Abu Dhabi state investor, Mubadala Development, to as much as 52 basis points (bps) on June 12 from 35 bps just before the rescue was announced on May 29; it is now at 46 bps.

One key consideration for investors is whether the need to pay US\$1 billion to 1MDB will prompt IPIC, which has US\$1.75 billion of bonds maturing this November, to issue debt. Many investors believe it will.

"I expect IPIC to return to Eurobond markets later this year," said London hedge fund manager Daniel Broby, predicting an issue of roughly US\$1 billion.

By June 2016, IPIC is to receive assets from 1MDB worth the sum of its aid to the Malaysian firm.

Neither of the firms said what the assets would be, or whether IPIC might stump up more aid if 1MDB cannot repair its finances as hoped.

Fuelling investor uncertainty about IPIC was the unexplained departure in April of Managing Director Khadem al-Qubaisi after eight years at the helm.

His replacement, United Arab Emirates' energy minister, Suhail Mohammed al-Mazrouei, has yet to publicly outline his strategy for the investment firm.

Nevertheless, given the debt market's hunger for scarce Abu Dhabi paper, IPIC may not have a problem issuing bonds this year.

But Dhaloomal at Bank of America Merrill Lynch said he remained 30% underweight on IPIC Eurobonds, which offered limited upside.

Hedge fund manager Broby said that if IPIC came to market, he would "give it a miss unless it's priced attractively". – Reuters, June 25, 2015.

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