

1MDB power assets come full circle

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Three years ago, 1MDB raised eyebrows when it splurged on power assets, paying a generous premium for some of them. Now it looks to sell them, likely at a loss, yet it may not resolve the wider conundrum surrounding the controversy-ridden company.

Late evening on Oct 16, 2015, controversial 1Malaysia Development Bhd (1MDB) officially confirmed that three bidders have submitted “binding and fully funded” offers for its power assets, several years after a controversial acquisition spree which saw it overpay for most of the assets in the first place.

One of the bidders is Malaysia’s biggest power sector player Tenaga Nasional Bhd, who counts the Ministry of Finance (MoF) as a major shareholder through Khazanah Nasional with about 30%, according to a separate statement released the same evening.

1MDB did not disclose the identities of the other two but they are China General Nuclear and Nebras Power, according to sources familiar with the matter.

KINIBIZ attempts to contact China General Nuclear and Nebras Power were unsuccessful. Tenaga Nasional declined to comment on its bid while at publication time 1MDB had not responded to queries sent via email.

1MDB president and group executive director Arul Kanda told KINIBIZ via text that they are unable to confirm the names of the bidders due to confidentiality agreements.

This development comes months after an earlier proposed initial public offering (IPO) for the power assets fell through, a change of heart that seemingly took place in a one-week span – CIMB Group announced that it was appointed advisor for the exercise on March 26 only to further say it was dropped from the role on April 1.

“CIMB has been informed that MoF has decided not to consider a sale of Edra to strategic investors and as such, CIMB’s services as adviser to the potential sale are no longer required,” said the group in a short statement.

In turn the proposed listing of the power assets, held under Edra Global Energy Bhd, was an attempt to monetise the assets following 1MDB's strategic review, the conclusions of which were announced Feb 18.

Whether by IPO or direct sale, however, it is unlikely that 1MDB will be able to recoup its original outlay for the power assets, much less realise any sort of gain. If anything, further write-off on the original costs of acquisition is likely.

And more pressing issues at the heart of the 1MDB controversy would remain unresolved despite a successful divestment.

Billions lost

Over three separate deals in 2012 and 2013, 1MDB paid a total of RM12 billion to consolidate three separate independent power producers (IPPs) into the second largest IPP in Malaysia. It assumed debt of RM6 billion in the process.

However, it grossly overpaid in doing so and it is unlikely that any of the three bidders would be keen on paying a premium for the power assets now – meaning 1MDB will likely end up losing money over the whole exercise.

This casts stark questions on how the company derived the conclusion that it would be expecting proceeds of some RM12 billion from the now-aborted IPO exercise.

In turn, these add to longstanding concerns on why 1MDB decided to overpay by so much for the power assets in the first place, some of which concessions were near-expiry at the point of purchase, especially considering it also had to take over existing debt.

To date, these questions had not been addressed by either 1MDB or its ultimate shareholder the Ministry of Finance. At publication time 1MDB had not responded to KINIBIZ queries sent via email.

Already the self-styled strategic development company [wrote off some RM1.2 billion](#) on this figure – or 10% of its total amount paid – as impairment for goodwill based on its financial year ended March 31, 2013 (FY13) accounts.

While the power assets have evolved somewhat after the acquisitions, relatively little has changed and the touted valuation of circa RM18 billion (or RM12 billion after

taking into account residual debt of RM6 billion) for Edra Global Energy in turn raises questions as to whether it is an overly optimistic expectation.

A notable change is 1MDB's successful bid for the 2,000 MW coal-fired power plant project that it will build for RM11 billion. However, this is still in progress and has not commenced operations.

An immediate comparison emerges to that of Malakoff Corp, which recently returned to listing status on Bursa Malaysia, valued at RM9.3 billion for just 200 MW less in current power generation capacity.

Taking Malakoff's valuation as a benchmark, it is likely that at this point 1MDB's power assets would only be worth slightly more and not nearly double as previously claimed, raising the stark spectre of another massive write-down. KINIBIZ examines the matter further later in this series.

Pressing questions

There may be some justification for the sale now, however. While its accounts for FY15 are delayed, as of the previous financial year 1MDB is sitting on some RM42 billion in borrowings – recouping some cash from the sale of its power assets would help some way towards paring them down.

The proposed monetisation of Edra Global Energy is in turn one of several strategies announced to turn around 1MDB shortly after its current president and group executive director Arul Kanda came into the picture in January 2015.

“We recognise that our debt-financed capital structure is no longer appropriate for the company and intend to take measures to ensure that 1MDB and the standalone entities (Edra and 1MDB's property arm 1MDB Real Estate) are well positioned to service debt and infrastructure obligations,” said Arul on Feb 18.

However, this does not completely resolve the financial conundrum surrounding 1MDB, which is still stuck with more borrowings than it seems able to service.

Let's say 1MDB were to receive the expected RM12 billion proceeds – likely before costs – from the aborted IPO and use the full amount to pare down its debts. This alongside the removal of some RM6 billion in debt associated with the power assets would still leave the company with some RM24 billion in borrowings after selling off a major cash flow source in its power assets.

With the government as the ultimate shareholder of 1MDB, there is justifiable public concern that the burden may ultimately fall to Putrajaya to bear.

Coming back to the proposed sale of 1MDB power assets held under Edra Global Energy, there is now growing concern among some parts of the public on what implications may arise should these power plants, especially those in Malaysia, pass to foreign control.

But are such concerns justified? There has been talk of whether foreigners can, legally, own majority stakes in Malaysian power generation assets. The bidding process for Edra implies they can, though it may not be that simple as whether this is also desirable is in question, which KINIBIZ explores further later in this series.

Will Edra sale resolve 1MDB conundrum?

In turn many pressing questions remain unanswered over 1MDB's trail of power asset acquisitions several years ago – why did it overpay by so much and how were these decisions rationalised?

And what was so strategic about going into the power generation sector when its stated objective was to drive “sustainable, long-term economic development” for the country “by forging strategic global partnerships and promoting direct foreign investment”, in the words of the prime minister in 2009?

While these concerns were raised much earlier by various media [including KINIBIZ](#), they take on a graver undertone on various revelations over the course of 2015 so far, which has hinted at potential criminal wrongdoing at the company over the past few years.

On information now publicly available to Malaysians, it is clear that the 1MDB controversy should see the light of day in court, though the Attorney-General's Chambers (AGC) recently decided against initiating criminal prosecution despite Bank Negara Malaysia's recommendation.

To recap, the central bank's recommendation came following the conclusion of its probe into 1MDB's doings, which found that the company breached the Exchange Control Act 1953 by providing misleading or inaccurate information when procuring permission for overseas transfers amounting to US\$1.83 billion between 2009 and 2011.

Absent a criminal prosecution proceeding initiated by the AGC, however, the central bank remains empowered to take other action against the controversial company.

Among others the Financial Services Act allows Bank Negara to sue an offender even if the offender had not been prosecuted in court or the alleged offence proven in prosecution proceedings. A victorious suit may see a fine imposed of up to three times the amount of non-compliance.

Despite the AGC's strange decision – though perfectly within its discretionary powers – to not to act on what seems to be a clear breach of the Exchange Control Act, there exists a solid case for bringing 1MDB under the microscope in pursuit of the truth behind its shenanigans and mysterious moves over the years.

Ultimately the myriad questions and concerns over 1MDB's doings over the past years, racking up RM42 billion in debt in the process, are a matter of public interest and the public deserves the absolute truth.

Amid issues of mis-governance and potentially criminal wrongdoing, however, 1MDB's existing RM42 billion debt pile remains a very real problem to contend with.

The borrowings require servicing and real billions of ringgit for that purpose – in contrast 1MDB's often touted assets have proven unable to bring in sufficient cashflow to meet its debt requirements as seen in its past annual reports.

In that light the proposed sale of Edra Global Energy may be counterproductive to the longer-term financial health of 1MDB, as disposing of these power assets – 1MDB's only real source of cash flow – would be like killing the cow for the milk.

KINIBIZ examines the matter further along in the series.

Tomorrow: How much are 1MDB's power assets really worth?

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