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BY AHMAD NAQIB IDRIS

KUALA LUMPUR: Khazanah Nasional Bhd posted its first pre-tax loss in 13 years in 2018, amid significant impairment provisions made during the year — a big chunk of which was due to Malaysia Airlines Bhd (MAB) — but hopes to return to profitability in 2019.

The sovereign wealth fund reported a pre-tax loss of RM6.3 billion for 2018, compared to its pre-tax profit of RM2.9 billion in the preceding year, after recording impairments totalling RM7.3 billion — more than triple the RM2.3 billion seen in 2017.

The last time it fell into the red was in 2005, when the fund reported a pre-tax loss of RM831 million.

Khazanah managing director (MD) Datuk Shahril Ridza Ridzuan said the sizeable impairment reflected the drop in market value of the share prices of listed stocks the fund holds, as well as the decline in the fair carrying value of some of its unlisted assets.

"Our performance in 2018 was impacted by several key global and domestic developments in both the economic and social spheres. At the same time, the government initiated a reset of Khazanah, which involved significant changes including a refreshed mandate," he said at the Khazanah annual review yesterday.

The fund received RM2.8 billion in dividends from its investments in 2018, down 9.7% from the RM3.1 billion it recorded in the previous year, while divestment gains halved to RM1.4 billion for the year from RM2.8 billion, reflecting the challenging market conditions during the year.

"Looking ahead into 2019, Khazanah should be able to return to profit, given the fact that the clean-up we did in 2018 has gone through the books. We don't expect any more large impairments that we have to go through again in 2018.

"The provisions are primarily due to Malaysia Airlines Bhd, which accounted for roughly half of the total impairments for 2018," he said.

Its portfolio's realisable asset value (RAV) — or the market value of all equities, securities and cash held — fell to RM136 billion in 2018 from RM157 billion a year ago. In terms of net worth adjusted — which is RAV less total liabilities and adjusted to measure value created — that fell 21.6% to RM91 billion from RM116 billion, weighed by subdued earnings outlook, market volatility and regulatory changes.

Challenging conditions in the airline industry

Shahril said the airline industry is challenging, as he pointed to persistent overcapacity and how airlines in the country, such as the region's leading low-cost airline AirAsia Bhd, are also struggling.

While Malaysia Airlines was a drag on Khazanah's financials for 2018, he justified the fund's investment in the airline by saying that it provides other economic benefits to the country beyond the fund's bottom line. As an example, he cited the connectivity it provides that brings business and leisure travellers into Malaysia, which indirectly contributes to the economy.

However, he said that does not discount the fact that the national airline should be as operationally efficient as possible.

"Quite clearly, the strategy put in place for Malaysia Airlines has not met its objectives. That is a fact we have to acknowledge. The question now is whether it makes sense to continue with the same strategy or do we need to rethink how the airline operates given the challenging environment?

"We are waiting for Malaysia Airlines to complete its review and we will be looking at understanding what that startegy requires," he said.

Drop in TM's market value

Another factor that drove Khazanah into the red was Telekom Malaysia Bhd (TM), which saw a substantial fall in market value following the 83% drop in the group's net profit for 2018, which Shahril attributed to regulatory changes.

(From left) Khazanah Nasional deputy MD Tengku Datuk Seri Azmil Zahruddin Raja Abdul Aziz, Shahril, and the company's chief financial officer Faridah Bakar Ali at Khazanah's annual review in Kuala Lumpur yesterday. **Photo by Shahrin Yahya**

TM registered a 56.9% decline in total returns, the biggest decliner in Khazanah's portfolio, followed by Axiata Group Bhd (-26.9%), CIMB Group Holdings Bhd (-9.3%), Tenaga Nasional Bhd (-7.9%), IHH Healthcare Bhd (-7.6%) and Malaysia Airports Holdings Bhd (-3.3%).

Shahril said the market has priced in the fact that TM will take some time to improve its cost base, following the government's move to bring down consumer pricing as quickly as possible.

As the telecommunications company shifts its pricing to reflect the new regulatory environment, revenue will be affected, he said, but added that profitability will return given time.

Portfolio rebalancing to spread risk concentration

Meanwhile, Shahril said the fund will remain focused on executing its portfolio rebalancing strategy and strengthening its financial position.

He stressed that Khazanah is looking at long-term returns and that it is natural for there to be fluctuations in the market over long periods of time, especially since the fund's portfolio is very much equity-based. "The key thing to focus on is the fact that we are restructuring the portfolio and are geared towards long-term returns," Shahril said.

The portfolio rebalancing, he said, will look at taking out some of the inherent risks in its portfolio, such as the concentration of risk it is facing given that a big chunk of its investments in Malaysia are tied up in just a few companies. So, over time, Khazanah will have a more balanced portfolio spread over more sectors and geographies to mitigate the concentration of risk, and benefit from a more diversified portfolio.

Khazanah is also splitting its portfolio into two — commercial and strategic. The commercial portion targets returns equivalent to inflation plus 3% on a five-year rolling basis. It will comprise public assets such as CIMB, Axiata, IHH and Alibaba.com as well as private assets such as The Holstein Milk Company Sdn Bhd, Sun Life Malaysia, WeLab and Palantir.

The strategic portion is a developmental fund targeting returns equivalent to the 10-year Malaysian Government Securities yield on a five-year rolling basis. It includes strategic assets such as TM, TNB, MAB and PLUS Malaysia Bhd and developmental assets such as Silterra Malaysia Sdn Bhd, Iskandar Investment Bhd, Themed Attractions Resorts & Hotels Sdn Bhd, Pinewood Iskandar Malaysia Studios and Medini Iskandar Malaysia.

Meanwhile, as part of the review of the fund's operational costs, Khazanah is looking at the operations of its international offices and may take steps to improve their operations.

"Some of our offices are quite vital to our operations, like China, for example. We have a lot of investments in the country and a lot of these are private equity investments, so we need people on the ground to ensure those assets are managed well and are creating value for Khazanah as a whole.

"Some of the other offices, for instance in London, may be less important because we will be adopting a more market-driven approach. So, we can do more of the operations out of other offices. As we review our costs and business operations, if there is a cost benefit to us by running the international offices in a different way, we will make those decisions as we go along," he said.

Not in talks with any party for Legoland sale

Meanwhile, when asked if Khazanah had received offers for Legoland Malaysia Resort — following a news report that the fund is looking to sell the theme park — Shahril said Khazanah is not in talks with any party, though the the fund is reviewing all its assets.

"Legoland is not only Ebitda (earnings before interest, taxes, depreciation and amortisation) positive — it's returning a positive profit as well. The time will come when we need to think about reinvesting the capital.

"Everything has a value at the end of the day and if a great valuation comes in, we will look and see whether the capital that can be returned to our books can be better deployed in other areas," he said.