

Headline	Who's right about Khazanah's 2018 (under)performance?		
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# Who's right about Khazanah's 2018 (under)performance?

BY CINDY YEAP

Evidently, billion-ringing headline losses were too good an opportunity to gain political mileage to let slip, going by the heated social media exchanges between Economic Affairs Minister Datuk Seri Mohamed Azmin Ali and former prime minister Datuk Seri Najib Razak last week.

When it comes to reported numbers, Najib — who was chairman of Khazanah Nasional Bhd until May 31 last year — is not wrong in saying that the sovereign wealth fund's RM6.271 billion pre-tax losses for 2018 were the first it has reported in over a decade.

Yet, part of the reason for last year's underperformance was Khazanah's portfolio of assets, which was concentrated in a handful of companies it had long invested in. The concentration risk was partly why Khazanah needed to rebalance its portfolio to deliver on its new mandate of growing Malaysia's long-term wealth.

A strategic review of its investments resulted in a RM7.3 billion impairment provision for 2018.

"Roughly half" of the RM7.3 billion impairment was due to Malaysia Airlines Bhd, which

Khazanah nationalised in 2014 after paying RM1.4 billion for the remaining 30% stake it did not own.

Had that sizeable impairment for the loss-making national carrier been deemed necessary in 2017, Khazanah's total impairment that year would have been nearer to RM5.95 billion — more than double the RM2.3 billion it booked that year. An impairment of that size would have wiped out the fund's RM2.896 billion pre-tax profits for 2017 and resulted in two straight years of losses, back-of-the-envelope calculations show.

### Kitchen-sinking?

Khazanah does not expect any large impairments to take place this year, even as Malaysia Airlines goes through another round of strategic review to improve its performance.

"Khazanah should be able to return to profit [in 2019], given the fact that the clean-up we did in 2018 has gone through the books," managing director Datuk Shahril Ridza Ridzuan said on March 5 when presenting the company's annual review. He also provided more details on its dual-basket — strategic and commercial — investment fund structure, objectives and targets.

The sovereign wealth fund will need at least five to seven years to rebalance its portfolio into one that can sustainably provide consistent supplementary income to the government, Shahril told *The Edge* in a recent interview. Apart from supporting the government's developmental goals via its strategic investments, its commercial fund will be more diversified in terms of asset allocation, sector and geography.

As it is, its portfolio concentration risk can also be seen from its so-called net worth adjusted (NWA) value where one-third of the RM25 billion or 21.0% year-on-year decline to RM91 billion as at end-2018 came from two companies — Axiata Group Bhd (-RM5 billion) and Telekom Malaysia Bhd (-RM3.5 billion).

Other sizeable downward NWA adjustments were made for its holdings in Tenaga Nasional Bhd (-RM1.9 billion), IHH Healthcare Bhd (-RM1.9 billion), CIMB Group Holdings Bhd (-RM1.5 billion) and Malaysia Airports Holdings Bhd (-RM200 million). The six made up RM14 billion or 56% of Khazanah's NWA decline.

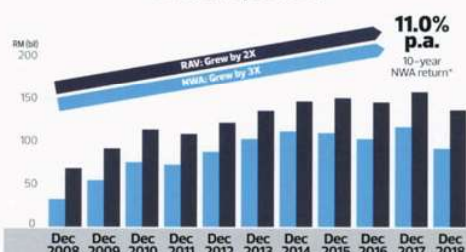
### Domestic factors, deals

While global markets underperformed last year on the back of ge-

## Fewer divestment, lower dividend income and higher impairment in 2018



## Long-term performance remains positive



Realisable asset value (RAW) = market value of all equities, securities and cash held, where no market price is available, a conservative estimate of value is used

Net worth adjusted (NWA) = RAW less total liabilities and adjusted to measure value created

\* 10-year return is based on a compound annual growth rate

opolitical tension and pessimism over growth in emerging markets, Khazanah's portfolio performance was further hampered by domestic developments, including regulatory changes, subdued earnings outlook and market volatility.

To be sure, the headline RM6.271 billion pre-tax losses for 2018 are sizeable.

Still, the RM7.3 billion (non-cash) impairment does not affect Khazanah's cash flow position and capacity to pay RM1.5 billion in dividend for 2018. The fund received RM2.8 billion in dividends and booked RM1.4 billion divestment gains last year, down from RM3.1 billion in dividends and RM2.8 billion divestment gains in 2017.

Khazanah paid RM30 million in dividend in 2005 when it reported a RM831 million pre-tax loss. It paid RM100 million in dividend in 2008 when it reported a RM223 million net loss in 2018. For 2019, the guidance is for "RM1 billion to RM1.5 billion" in dividend.

It is understood that Khazanah's sale of a 16% stake in IHH to Mitsui & Co Ltd for RM8.42 billion, which is targeted to be completed by end-March, is still awaiting foreign regulatory approval. According to Shahril, the proceeds will be used to rebalance its portfolio to generate greater returns for the country.

A separate 26% stake in IHH is up for sale at the right price, as long as it does not destroy the value of the remaining holdings in Khazanah's commercial basket. Other assets in the basket include its holdings in CIMB, Axiata and Alibaba.com as well as private assets such as The Holstein Milk Co, Sun Life Malaysia, WeLab and Palantir.

Meanwhile, assets in its strategic basket are Malaysia Airlines, Telekom Malaysia, Tenaga Nasional, Malaysia Airports and PLUS Malaysia Bhd. Developmental assets such as Silterra Malaysia Sdn Bhd, Iskandar Investment Bhd, Themed Attractions Resorts & Hotels Sdn Bhd (TARH), Pinewood Iskandar Malaysia Studios and Medini Iskandar Malaysia Sdn Bhd are also in this basket where economic benefits to the country also count as returns.

It remains to be seen if UK-listed Merlin Entertainments plc, which makes money from operating Legoland Malaysia on behalf of TARH, would buy a stake in the asset from Khazanah — just like how Mitsui had increased its stake in IHH by buying more shares from Khazanah. Talk of the potential sale of Legoland or an IPO of Khazanah's theme parks had been circulating for some years.

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## Khazanah targeting better cost-efficiency

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While Shahril said Khazanah was “not in talks with anyone and there are no offers on the table” when asked about the sale of Legoland, he did not dismiss the possibility. “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, noting that Legoland is already profitable.

Apart from behaving more like a portfolio manager to derive greater returns on its commercial assets, Khazanah is also targeting better cost-efficiency by cutting its cost-to-realizable asset value (RAV) ratio from 50 basis points in 2018 to 30 to 35 basis points in 2023. Part of this could come as it vacates premium office space at the Petronas Twin Towers in favour of transit-oriented Mercu UEM in KL Sentral. Khazanah, which has a long-term lease for 11,500 sq ft at The Shard in London, also has offices in Istanbul, Beijing, Mumbai and San Francisco.

“Some of our offices are quite vital to our operations, like China, for example ... 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 ... 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,” Shahril said.

If Khazanah succeeds in becoming a significant revenue contributor to the government, there will be more money to improve the people’s well-being and less pressure to raise taxes. For the electorate, tangible benefits from sound public policy should ring truer than fleeting attention on social media. E