1MDB's power asset misadventure

BY BEN SHANE LIM

Malaysia Development Bhd's (1MDB) venture into the energy sector misled from the word go back in 2012, with numerous convoluted and opaque debt issuances as well as several high-profile acquisitions at exorbitant prices. And now, it will end with a RM2.22 billion loss-on-disposal to China's state-owned China General Nuclear Power Corp.

To summarise the debacle, 1MDB borrowed RM21.8 billion and paid RM12.08 billion for its power assets, but sold them for only RM9.83 billion.

There's no two ways about it. 1MDB failed the most fundamental of business tenets — buy low, sell high and keep financing costs cheap.

Prior to the disposal of its energy unit — Edra Global Energy Bhd — 1MDB might have argued that there was more value to be unlocked from the power assets through growth and development of new projects. But now that it has been sold for RM9.83 billion, it is clear that 1MDB's foray into the power business has only been value destructive. At face value, the group has made a loss of RM2.22 billion, and this doesn't even take into account the interest cost for taking on the massive debt.

To make matters worse, the tab is still running.

Even after disposing of Edra, 1MDB is estimated to have at least RM12 billion worth of debts outstanding, debts that were incurred for the power asset business. In layman's terms, it is like selling one's house but not getting enough to settle the housing loan owed to the bank.

Looking back, it is clear why 1MDB's power venture failed. The group took on much more debt than was needed and the cost of the debt was too high. On top of that, there was a currency mismatch as most of the borrowings were in US dollars whereas the assets were denominated in ringgit. It also didn't help that 1MDB overpaid for the assets.

But the coup de grâce to the entire exercise was that 1MDB sucked all the cash out of Edra, leaving it with no room to grow.

The business model was flawed from day one. Specifically, when 1MDB raised US$3.5 billion (RM11.55 billion at the time, based on an exchange rate of 3.3 against the dollar) worth of bonds via Goldman Sachs.

This debt was incredibly expensive, with fees and commissions to Goldman Sachs alone costing US$393 million (RM1.3 billion), or almost 11.23% of the debt raised. This doesn't even include interest cost.

The next problem was that 1MDB borrowed much more than it needed. Apart from the Goldman Sachs bonds, 1MDB raised RM6.17 billion via a bridging loan from local banks. On top of that, it incurred two term loans of RM451.8 million and RM600 million.

Following the acquisitions of the power assets, 1MDB also incurred a US$975 million (RM3.2 billion, based on an exchange rate of 3.3 against the dollar) syndicated term loan from Deutsche Bank, which was used to extinguish Aabar Investment's options to subscribe for up to 49% in an Edra listing.

In total, 1MDB had raised RM21.79 billion in debt. However, the cost of the power asset acquisitions amounted to only RM12.05 billion — RM8.5 billion for Tanjung Energy Plc, RM2.35 billion for Genting Sanyen Power Sdn Bhd and RM1.2 billion for a 75% stake in Jhimah Energy Ventures Sdn Bhd.

The only other known asset that 1MDB has in relation to the debt raised is a US$1.4 billion deposit with Aabar Investments’ parent company, International Petroleum Investment Company (IPIC). The deposit was placed with Aabar in exchange for co-guaranteeing the Goldman Sachs bonds.

It is not clear how much of this deposit is left.

The next problem for 1MDB is that its US dollar-denominated debts have ballooned as the ringgit has depreciated to 4.3 against the greenback.

Note that 1MDB in June this year repaid the Deutsche Bank syndicated loan via a US$1 billion injection by IPIC.

This leaves US$3.5 billion worth of US dollar-denominated debt. Even if 1MDB has its entire US$1.4 billion deposit with Aabar, the fund still has a whopping US$2.1 billion in net US dollar exposure (in relation to the power assets). The depreciation of the ringgit to 4.3 against the US dollar would have created a foreign exchange translation loss of RM2.1 billion.

Note also that this is in a best-case scenario where 1MDB still has the entire US$1.4 billion deposit with Aabar. The actual foreign currency exposure could be much higher.

1MDB didn't make things easier for itself either, when it paid a high price for the power assets — RM3.3 billion in goodwill on acquisition. Its latest financial report shows that as at March 2014, it had written down a cumulative RM1.18 billion worth of the goodwill, leaving RM2.1 billion of goodwill outstanding.

But even after all these missteps, 1MDB still had a chance to redeem itself. In fact, it could not have picked a better time to jump into the power business.

Over the past few years, the local power sector has been going through an aggressive planting-up programme with over 5,000mw of new projects being given out.

On top of that, many power purchase agreements were extended. 1MDB was the benefi-
ciary of these extensions, with an additional 10 years given to its Kuala Langat power plant (Genting Sanyen) as well as a three-year 10-month extension for Powertek’s (formerly Tanjong Energy) 434MW plant in Teluk Gong.

In addition, 1MDB would be awarded up to 4,400MW of conventional thermal power capacity — the 2,000MW coal-fired Project 3B and the 2,000MW-2,400MW combined cycle gas turbine Project 4B — as well as 500MW of solar capacity. With all these projects in hand, how did 1MDB fail to create value?

It all came down to cash. When 1MDB acquired Tanjong Energy, it had an estimated RM2 billion in unrestricted cash. By the time it disposed of Edra, the group would have virtually no cash left.

Without cash to capitalise its new power projects, Edra was caught in a bind. Edra could not even borrow to fund the projects because it was too heavily indebted. Case in point: Edra was forced to dispose of Project 3B, after several lengthy delays, to Tenaga Nasional Bhd for a token sum of RM47 million.

1MDB should have known that in the power business, it is all about having a strong balance sheet to finance the power projects. But even with all the borrowings incurred, it could not find capital to inject into Edra.

Meanwhile, market conditions cannot be blamed for 1MDB’s inability to list Edra either. After all, MMC Corp Bhd managed to list Malakoff Corp Bhd and raise RM3.6 billion in the process.

Looking ahead, 1MDB may have sold its power assets and cut its debt but its problems are far from over.
Edra’s timeline

2012
March
1MDB buys Tenaga Nasional Bhd (TNB) for RM2.2 billion

Aug
1MDB buys a 75% stake in Jima Energy Ventures Sdn Bhd from the Negri Sembilan royal family for RM2.2 billion

Oct
1MDB secures a 10-year extension for Genting Sanyen’s Klang Power Plant until 2026

2013
July
1MDB buys a 75% stake in Jima Energy Ventures Sdn Bhd from the Negri Sembilan royal family for RM2.2 billion

2014
Feb
1MDB is awarded Project 3B — a 2,000MW coal-fired power plant project — after competitive tender

March
1MDB is awarded the rights to develop 500MW of solar power by the Energy Commission

April
1MDB signs a power purchase agreement with Tenaga Nasional Bhd (TNB) for a 50MW solar plant in Kedah

June
1MDB appoints Deutsche Bank and Maybank to jointly coordinate the listing of 1MDB’s power assets, dubbed 1MDB Energy, for RM19 billion

Sept
1MDB Energy initiates RM8.4 billion sukuk issuance to finance Project 3B

Oct
New management team led by Datuk Mark William Ling joins 1MDB Energy

Now
1MDB submits IPO application to Securities Commission Malaysia

Dec
1MDB Energy changes its name to Edra Global Energy Bhd. Plans to issue the RM8.4 billion sukuk are aborted.

2015
Feb
1MDB president Arul Kanda Kandasamy announces a rationalization plan for 1MDB, which includes the disposal of the power assets

March
1MDB revises its listing documents to resubmit to the SC

April
Second informal submission is made to the SC

July
TNB buys Project 3B for RM47 million and subsequently submits an indicative non-binding proposal to acquire Edra’s 13 power assets

Sept
1MDB shortlists four buyers for Edra — TNB, CGN Meya Power Holdings Co Ltd, Qatar’s Nebras Power QSC and Saudi Arabia’s Aljomali group

Oct
China General Nuclear Power Corp’s (CGN) listed subsidiary, CGN Meya, withdraws from the tender to buy Edra. CGN takes its place in the tender.

Nov
CGN wins the bid for Edra with a bid of RM5.83 billion. TNB submits the only other bid of an estimated RM8 billion.
Where did 1MDB go wrong?

1MDBs power asset misadventure

Date: 21 Dec 2015
Circulation: 23,635
Section: Corporate
Article Size: 824 cm²

PR Value: RM 42,564

- DEBTS ASSUMED BY 1MDB TO BUY POWER ASSETS
- HOW THE MONEY WAS SPENT
- SALE OF POWER ASSETS
- DEBT REMAINING

RM 21.79 BIL
GOLDMAN SACHS BONDS
US$3.5 BIL
(RM11.55 BIL @ US$3.3)

RM 5.49 BIL
COMMISSIONS & FEES PAID TO GOLDMAN SACHS PLUS OTHER COSTS
DEPOSIT WITH AABAR
US$1.4 BIL
(RM4.25 BIL @ US$3.3)

EDRA SOLD
RM 9.83 BIL
DEBT PAID OFF

RM 2.2 BIL
LOSS ON DISPOSAL

RM 8.3 BIL
TAIJUN Energy

RM 2.35 BIL
GENTING SANYEN

RM 1.2 BIL
JINMAH Energy Venture