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Did 1MDB get a good price for Edra?

BY **BEN SHANE LIM**

1Malaysia Development Bhd (1MDB) will make a loss by disposing of Edra Global Energy Bhd for RM9.83 billion to China General Nuclear Power Corp Ltd (CGN). However, that has more to do with the fact that 1MDB grossly overpaid for the power assets in the first place.

In fact, all things considered, 1MDB appears to have extracted a fair price from the Chinese despite coming from a weak bargaining position.

As a guide, Tenaga Nasional Bhd's (TNB) share price had taken a beating in the last few months on fears that it would pay too much for Edra. And when it was reported a few weeks ago that TNB's offer was RM8 billion, the market response was fairly muted because the stock price had already priced in the risks from any acquisition of Edra.

But since 1MDB confirmed that TNB had lost out to CGN, TNB's share price rallied by 4.5% to close at RM13.60 last Friday.

Hence, if TNB's shareholders are happy that it didn't pay RM8 billion for Edra, then the RM9.83 billion bid from CGN can't be too bad for 1MDB.

In fact, the price that CGN is paying is in line with valuations that Edra was hoping to achieve from its original plan to list, says one industry source with knowledge of the matter.

It is difficult to check Edra's earnings, since it has yet to file its financials for the year ended March 2015 with the Companies Commission of Malaysia.

However, it is believed that Edra was sold to CGN at between 7.5 times and 8.5 times EV/Ebidta (enterprise value over earnings before interest, depreciation, tax and amortisation).

Note that Moody's last week published a report stating that CGN's rating would not be affected by the acquisition of Edra.

"The cash acquisition may tighten CGN's weak liquidity and further increase the debt balance to the group. The acquired assets carries high business risks, as they operate in cyclical, emerging economies with political risks and less transparent regulatory environments.

This is partly mitigated by the earnings from Edra's operating projects, which will balance the incremental debt to support the acquisition, (and) maintain CGN's combined pro-forma metrics at its current rating level," wrote Moody's.

While it appears to be a fair deal for 1MDB, will it be good for the power sector or Malaysian consumers?

After all, the sale of power assets to foreigners has drawn much flak. Before the sale of Edra, foreign ownership in power generation assets has never exceeded 49%.

But having TNB take over the power assets might not necessarily have been a better alternative either. After all, it would have effectively been a left to right hand transaction since TNB is 29.66% controlled by Ministry of Finance-owned Khazanah Nasional Bhd.

Secondly, if TNB took over Edra, it would have increased TNB's market share of power generation from around 44% to over 62.9%. Allowing the national utility, which already monopolises the transmission and distribution of electricity in Peninsular Malaysia, to dominate market share in electricity generation is not healthy for competition.

In fact, allowing a foreign competitor like CGN to enter the local generation market and compete with TNB might bode well for consumers as it could drive down generation costs.

Of course, this raised the question of whether Malaysia should allow foreigners to own power assets at all, since it would allow money to be taken out of the country. At the same time, it puts strategic national assets in foreign hands.

For starters, the current generation of IPPs no longer make fat margins and favourable terms enjoyed by the first-generation IPPs, which has often drawn public criticism.

Today, the internal rate of return (IRR) for power projects is capped to single digits. Hence, even if the Chinese were to take on new power projects, the returns would not be that high anyway.

Take for example Project 4B, the 2,000MW to 2,400MW combined cycle gas turbine (CCGT) power plant project that was awarded to Edra. The Chinese will now be the ones to develop the power project. While 1MDB is seen as giving away the new power project to foreigners, it is worth noting that the conditions imposed on Project 4B is very strict.

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According to industry sources, Project 4B's tariffs must be in line with that of TNB's 1,070MW CCGT Prai power plant of 34.7 sen per kWh. This tariff is expected to generate an IRR in the low single digits for TNB.

Hence, Malaysia's electricity consumers are not beholden to the Chinese. In fact, CGN may well find it very challenging to operate in Malaysia where non-bumiputera controlled IPPs have been having a tough time competing for new power projects.

Take for example the Genting group, which has effectively given up competing for new power projects in Malaysia, preferring instead to bid for projects abroad. Likewise, YTL Power International Bhd has also been much more successful in winning new power projects abroad, in countries like Indonesia, Singapore and Jordan.

It is also important to note that CGN will have to inject billions into Edra to take on the local power projects, effectively bringing money into Malaysia first, before it can repatriate returns once the project is completed.

Furthermore, CGN will not have any control of Malaysia's electricity market since all the power purchase agreements already determine what Edra can charge for generating electricity.

Last but not least, the Malaysian government can take back the power assets from CGN if there is any sign the Chinese company poses a threat to the grid or national security.

In a nutshell, the disposal of Edra to the Chinese isn't a bad deal. However, this deal need not have happened if 1MDB had not got itself into such a big financial mess in the first place. E