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Malakoff's latest asset disposal to pare down its RM15bil debt

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WITHIN the corporate Malaysia circle, the high indebtedness of companies linked to billionaire Tan Sri Syed Mokhtar Albukhary is widely known and have been much discussed.

One such company under his stable is Malakoff Corp Bhd, in which Syed Mokhtar owns the single largest shareholding of 38.44% indirectly via MMC Corp Bhd.

Malakoff, which is Malaysia's largest independent power producer, carried a total debt of RM15.2bil as at end-2018, against cash and cash equivalents worth much lower at RM1.52bil

Using its gearing ratio to illustrate, for every RM1 in shareholders' equity, Malakoff is liable to pay RM2.36 in total borrowings.

On a glance, the highly-geared Malakoff may appear weak in terms of its balance sheet, if one ignores the group's asset backing.

However, Malakoff's high leverage is actually understandable, given the nature of its utility/infrastructure business which is typically capital-intensive.

A breakdown of its debt portfolio shows that 99.8% of Malakoff's RM15.2bil borrowings are secured, with more than half of the total debt have maturity of five years and above.

According to the group's 2018 annual report, nearly 86% of the total debt is denominated in ringgit, hence removing exposure to unfavourable foreign exchange fluctuations.

Over the years, Malakoff has been consistently paring down its debt. For context, its gross gearing ratio has fallen from 4.4 times in 2014 to 2.36 times in 2018.

The group plans to lower the gearing ratio further to 1.91 times, through the recent proposed disposal of its entire 50% stake in an Australia-based wind farm.

On Oct 29, Malakoff announced that its indirect wholly owned unit, Skyfirst Power Sdn Bhd, had entered into an agreement to sell its stake in the 420MW Macarthur Wind Farm project, which is the largest wind farm in the Southern Hemisphere.

The sale will be done at A$356.85mil (RM1.02bil), with a net gain on disposal of RM546mil.

"The proposed disposal will increase Malakoff's reserves for investments in future power and water projects.

"In addition, the proposed disposal will immediately reduce the company's borrowings and its gearing ratio," stated Malakoff in a recent Bursa Malaysia filing.

Post-disposal of Macarthur Wind Farm, which is expected to be completed by the first quarter of 2020, Malakoff's total borrowings will reduce to RM13.37bil from RM15.2bil previously.

Analysts are positive on this deal, although it will result in short-term earnings dip for Malakoff.

Kenanga Research estimates the company could face a 21% fall in earnings based on the RM56.6mil contributions from Macarthur Wind Farm in the financial year of 2018 (FY18).

However, it described the disposal price tag as "a good offer".

"The loss of RM56.6mil earnings stream is also fairly close to the new add-on earnings of RM47.5mil (based on FY18) from the additional stakes in Saudi Shuaibah water and power assets which were acquired last month.

"Furthermore, Malakoff paid US$70mil for the additional Saudi assets with 10 years remaining concession periods while it expects to post RM546mil disposal gains from this Macarthur Wind Farm divestment, which seems like a good tradeoff," says Kenanga Research in an earlier note.

UOB Kay Hian Malaysia Research calls the disposal price of RM4.9mil per MW as fair for renewable energy.

"In a parallel renewable energy comparison, Malaysia's recent large-scale solar tender (LSS 3) projects cost RM3.5mil to RM4mil per MV. In addition, the stake sale values Macarthur at 18 times 2018 net profit, a fair valuation for a fairly low risk concession based asset," it says.

The research house points out that, while the billion-ringgit wind farm deal is earnings neutral, the resulting interest cost savings will be able to offset Malakoff's loss of income.

"As the proceeds of A$356.85mil will go towards repayment of debt (based on an effective interest rate of 6%), the proposed disposal of Macarthur will be earnings neutral. The absence of net profit contribution of RM56.6mil will be offset by lower interest cost of RM63mil," it adds.

Meanwhile, TA Securities Research, which is largely positive on the deal, says its optimism will be boosted if Malakoff embarks on capital recycling using the sales proceeds.

"We believe the group should ideally plough back sale proceeds into new investments. Furthermore, if the group secures brownfield assets, this would immediately plug the substantial earnings gap arising from Macarthur's disposal," it says.

Malakoff's management has previously indicated that it is actively looking to venture further into the power and water businesses in the Middle East and North Africa region as well as the South-East Asian markets.

Currently, Malakoff has an effective generating capacity of 5,910MW from its six power plants.

Meanwhile, the group's international assets include power and water ventures in Saudi Arabia, Algeria, Bahrain, Oman and Australia, with an effective capacity of 798MW of power and 544,375 m3/day of water desalination.

Through its wholly-owned subsidiary, Teknik Janakuasa Sdn Bhd, Malakoff has involvements in operation & maintenance services locally and in Saudi Arabia, Algeria, Kuwait, Oman and Indonesia.

TA Securities Research points out that Malakoff's management has previously expressed its intentions to expand beyond conventional power generation in Malaysia.

"To recap, the group has been active on the mergers and acquisitions front lately, starting with the acquisition of 94% stake in Alam Flora Sdn Bhd and followed by the purchase of an additional 12% stake in Shuaibah Phase 3," it says.

For perspective, the completion of Alam Flora acquisition has been further delayed to Jan 31, 2020. Upon completion, the group will be able to expand into the waste management and environment-related sector through Alam Flora.

On July 11, Malakoff announced it would be acquiring Khazanah Nasional's entire stake in Desaru Investments (Cayman Isl) Ltd (DIL) for US$70mil, thereby increasing its stake in the Saudi Shuaibah power and water assets.

Prior to the sale, Khazanah, through DIL, holds a 40% equity interest in the consortium known as Malaysian Shoaiba Consortium Sdn Bhd while Malakoff, via Malakoff Gulf Ltd, holds 40% and Tenaga Nasional Bhd, through its subsidiary Independent Power International Ltd, holds the remaining 20% stake.

Malakoff remains a popular counter among analysts, with nine "buys" against two "hold" recommendations, based on latest *Bloomberg* data.

The 12-month consensus target price is RM1 as compared with a closing price of 85 sen on Nov 1. Malakoff's price-to-earnings ratio is 14.54 times.

Year-to-date, the stock is up by 6.25%, outperforming the FBM KLCI which declined by 5.75%.