Excellence in Business Reporting: 1st Story

ISSUES | MARCH 26, 2013 12:12 PM

1MDB: Giant ponzi scheme or strategic investment fund?

STORY BY
JOSE BARROCK
JOSE@KINIBIZ.COM

One opposition MP describes it as the biggest ponzi scheme the nation has ever seen. Some may consider that a bit much but when one examines the trail of of deals made by 1 Malaysia Development Bhd, including RM20 billion in bonds and acquisition of dubious assets and even more dubious partners, there is plenty – and we mean plenty – to worry about. In the first of a series of articles we look at how it was set up, and its first questionable deal.

Mohd Hazem Abd Rahman

Last week 1 Malaysia Development Bhd (1MDB) a government owned entity closely linked to premier Najib Razak, had a change at the helm— Hazem Abdul Rahman has now taken over the chief executive officer role from Shahrol Azral Ibrahim Halmi, who has joined the Performance Management and Delivery Unit (Pemandu).

Surprisingly, no announcements were made, and it was via a news report that the update was disseminated.

For a high-profile government-owned body which has made billions of ringgit in investments and issued large amounts of bonds we would have expected more.

At about the same time last week, Bloomberg reported that 1MDB had issued US$3 billion (about RM9.4 billion) in debt papers, on March 19 on the quiet. According to Bloomberg 1MDB already has issued RM10.8 billion in debt papers, taking total bonds issued to over RM20 billion.

"It's a wonder why things are so opaque at 1MDB...they should just announce the change, announce a bond issue, announce anything material. It's not very good being so secretive. When it's a government-owned unit, there is a need for transparency," a market watcher said.

In July last year it was the same, 1MDB issued US$1.75 billion in 10 year debt papers, with yields just shy of six percent, and strangely enough guaranteed by International Petroleum Investment Co or Ipic, an Abu Dhabi government investment fund.

A fund manager added, “God knows what they are doing there (at 1MDB), so much in debt papers have been issued...and it’s clearly Najib’s baby... wonder what will happen after he steps down or is no longer in power?” the fund manager added.

Much of what 1MDB does is often shrouded in secrecy, and leaves many questions unanswered. Why did it issue bonds at such a favourable rate to buyers? Who is PetroSaudi and what has it to do with it 1MBD? Why the Middle East investors?

Why is 1MDB getting government land cheaply and then bringing in foreign partners to develop it? Why the tax concession for developers who undertake projects on these land? Why buy power assets, some of them about to expire?

But to understand all that, one needs to venture back in time and analyse the history of 1MDB, which is in itself quite interesting.

The colourful history of 1MDB

1MDB came about from the formation of Terengganu Investment Authority (TIA) back in the tail end of February, 2009, as a sovereign wealth fund to ensure the economic development of the East Coast state was sustainable and the economic well-being of the people of Terengganu safeguarded.

Low Taek Jho

Playing a key role, it seems were the Sultan of Terengganu, Sultan Mizan Zainal Abidin, Menteri Besar of Terengganu, Ahmad Said, Ramli Shahul Hamid the managing director of Eastern Pacific Industries Corp Bhd, a Terengganu based company, largely controlled by the state, officials of Goldman Sachs and Low Taek Jho (Jho Low), the whizkid dealmaker, who shot to fame later, after his highflying ways and links to Paris Hilton came to light. Low is known to be close to Rosmah Mansor, wife of prime minister Najib.

Najib, who was the deputy premier back then in January 2009, had announced the formation of TIA three days before the Kuala Terengganu by-election, with a capital injection of RM10 billion.

This RM10 billion figure although not openly divulged, was derived from Terengganu receiving only about RM6 billion in oil royalty from the Federal government from 2000 to 2008, when the figure the east coast state was supposed to have received was to the tune of RM16 billion. To recap, the Federal Government had cut oil royalty payments when the state fell to PAS in 2000.

After much wrangling the TIA, it was agreed, would be set up with RM11 billion in funds, RM5 billion from the Federal Government guaranteeing TIA's bond issue, and another RM6 billion from state controlled oil major Petroliam Nasional Bhd (Petronas), via the securitization of oil royalty.

The plan was for the fund to be modelled after the Mubadala Development Co, the sovereign wealth fund of Abu Dhabi.

TIA was the first state sovereign wealth fund, and initially was slated to set a new, high benchmark on how a state should control its finances.

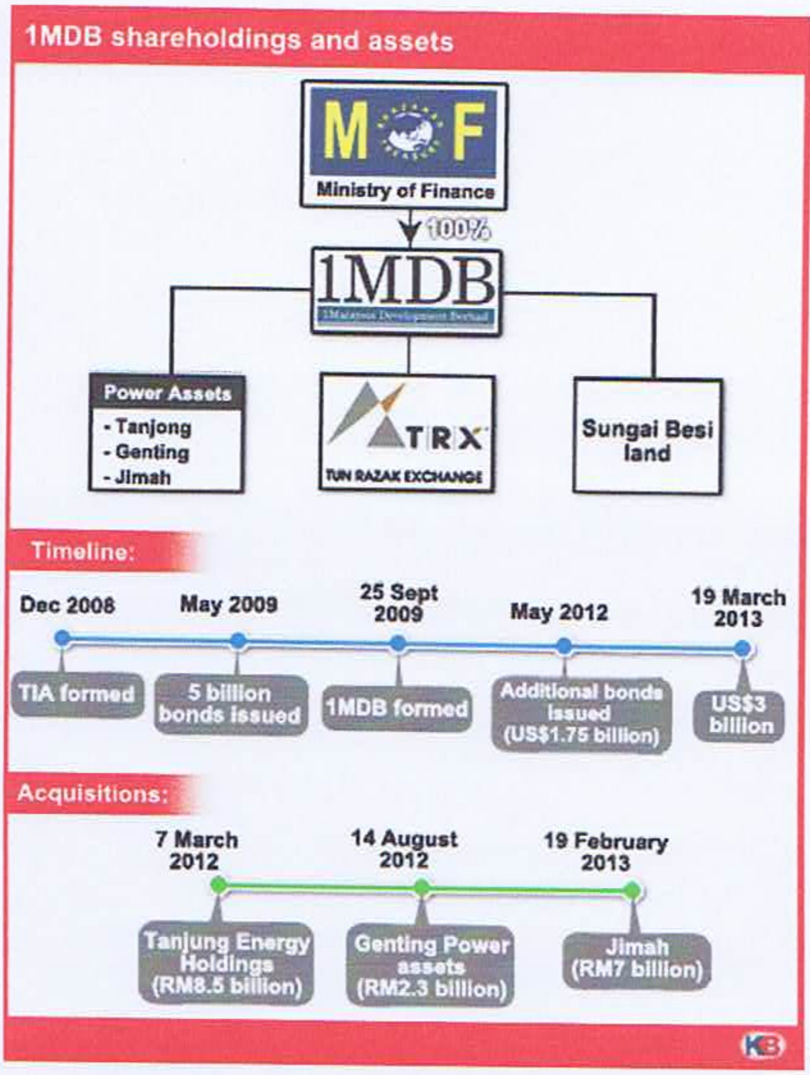
After Barisan Nasional won Terengganu in 2008, then premier, Abdullah Ahmad Badawi had sought to reappoint Idris Jusoh the Menteri Besar, but the appointment was opposed by Sultan Mizan. The Sultan opted instead for Ahmad Said.

Although he initially opposed the Sultan's choice, Abdullah backed down, leaving Ahmad Said as the Menteri Besar of Terengganu.

There were reports of threats that Sultan Mizan was prepared to dissolve the state assembly if a motion of no-confidence was called against Ahmad Said, as planned by Idris Jusoh and his supporters.

The main difference between the two was that Ahmad Said was more Terengganu centric, as opposed to Idris Jusoh who was closer to the Federal Government and willing to play ball with it.

As soon as the first RM5 billion was raised via bond issues supported by the Federal Government, the melee started. Both Ahmad Said and the Federal Government wrestled for control of the funds— while the charter had it that TIA should be run by professionals.



Terengganu however had to concede, as it could not do without the Federal Government's support—- and hence gave up TIA.

One of the key problems that TIA faced was that it had no track record. Since TIA had no track record it would need the Federal Government's guarantee to raise funds to have lower cost of funding.

In a nutshell, without the Federal Government support the plan for TIA would literally not work.

Thus since TIA could not stand alone, it was taken over by the Federal Government, and renamed 1MDB.

Terengganu's plan for TIA was all but shattered, and plans such as building the Bidong Resort in Terengganu—- a project at a cost of some RM6 billion— have since been forgotten.

The statement from the Prime Minister's office said that TIA, "is being expanded to a federal entity called 1MDB with the aim of investing billions of ringgit in energy, real estate and hospitality sectors in the country."

1MDB took over the cash already raised by TIA.

This new entity was much more interesting than TIA and its plans much more interesting than resorts and Terengganu based businesses. Critics of 1MDB have had a field day, poking holes in the company's business plans and ventures, and even its partners.

One partner especially stands out.

Who is PetroSaudi International Ltd?

Among 1MDB's first ventures was partnering PetroSaudi International Ltd, in September 2009— in a joint venture 1MDB-PetroSaudi International. 1MDB held 40 percent equity interest while PetroSaudi held the remainder.

According to sources, at the outset itself things started going wrong. Certain quarters say PetroSaudi instead of injecting funds worth US$1.5 billion, had injected an oil reserve in the Caspian Sea valued at US$1.5 billion, while 1MDB injected actual cash of US$1 billion.

Then 1MDB cashed out of the JV and converted its US$1 billion in equity to a US$1.2 billion debt with an 8.75 percent coupon. (See following articles)

There have also been some who question the founder of PetroSaudi, Sheikh Tarek Essam Ahmad Obaid, saying he only surfaced on Google after 2009 when the deal with 1MDB came about. They say that he is not a prince as others so vehemently say he is.

According to some sources PetroSaudi was set up to partner TIA, which was supposed to be dealing with Terengganu's oil royalty— hence its name "PetroSaudi" in the first place.

There are also others who say that there are two PetroSaudi International companies. One the Saudi based one, and the other a company registered in the Seychelles.

Thus the only thing that seems certain about PetroSaudi is that it has garnered its fair share of sceptics. Some of PetroSaudi's deals have also been under scrutiny.

In 2010, PetroSaudi had also made a general offer for UBG Bhd (formerly Sarawak Chief Minister Taib Mahmud's Utama Banking Group Bhd) at RM2.50 a share, when it took over Abu Dhabi Kuwait Malaysia Investment Corp's 52.62 percent in UBG.

Considering UBG had majority control of Putrajaya Perdana Bhd and Loh & Loh Corp Bhd, PetroSaudi forked out some RM1.5 billion to privatise the three companies. Among the directors of UBG was also Jho Low, and it was very well known back then that this deal was his.

Shahrol Halmi

It is understood that Jho Low and Shahrol, the former head of 1MDB had their fair share of differences, and did not see eye to eye on many things.

Meantime, 1MDB is in debt to the tune of over RM20 billion going by public records. It has acquired power assets for some RM12.5 billion, lent Petro Saudi some RM3.7 billion, and obtained government land for which it has big plans.

1MDB did not reply to questions sent by *KiniBiz*.

Excellence in Business Reporting: 2nd Story

ISSUES | MARCH 27, 2013 12:41 PM

1MDB's colourful family and friends

STORY BY

AIDILA RAZAK

AIDILA@KINIBIZ.COM

In the second of a series of articles on government fund 1Malaysia Development Fund, KiniBiz takes a look at some of the key players involved in its set up and running. It's a wide, varied lot with a range of interests and geographical spreads. In subsequent articles we will examine specific issues in greater detail.

1Malaysia Development Bhd (1MDB) may have received flak for lack of transparency, but critics may not be able say it has no checks and balances. According to its website, 1MDB has a "triple-tier" corporate governance structure– the board of advisors, board of directors and senior management. Sitting on top of the pile is Prime Minister Najib Abdul Razak, who is chairperson for the board of advisors.

But before there was 1MDB, there was Terengganu Investment Authority. And behind the fruition of TIA, was the close relationship between the Terengganu Sultan Mizan Zainal Abidin, the King at the time, and a young man who will later become a household name.

The whizkid dealmaker

Low Taek Jho

In his early thirties, wheeler-dealer Taek Jho Low is perhaps most popularly known for hitting the New York gossip rags after splashing a fortune on cases of Louis Roedre Cristal with celebrities including heiress Paris Hilton.

Hilton, however, was not the only celebrity he rubbed shoulders with. He claims to be friends with Oscar nominee Leonardo di Caprio and Jamie Foxx–the latter of whom reportedly sang a "flirty" number with prime minister's wife Rosmah Mansor at an event in the Big Apple.

It is unclear if the New York party scene was where Rosmah and Low got close. But the Penang born-whiz kid's connections with the wealthy worldwide were forged even before Rosmah started calling herself first lady of Malaysia.

Low–or J Low as he was at one point referred to–is son to founder of engineering company MWE Larry Low. Like most children of the rich in Malaysia, he was packed off to a top UK boarding school in his teens.

It is at Harrow, and later Wharton School of Business that baby-faced Low would became tight friends with people with deep pockets from the Arab world.

The combination of wealthy friends and well-to-do family landed Low with capital of US$25 mil–seed money for his very own private equity fund, the Wynton Group.

Some have speculated that these are among Low's business associates who picked up the RM5 billion bonds issued by TIA, much to the ire of deprived local bankers. 1MDB has never disclosed who the debt papers went to. It is unclear what Low got for lining up the investors.

On 1MDB's part, it said that Low's role in 1MDB is "zero". It stressed that 1MDB's dealings with foreign investors are on a government-to-government level without intermediaries.

One of Low's friends, however, went further than buying the debt papers.

The Abu Dhabi connection

TIA was to be modeled on the Abu Dhabi investment company Mubadala Development Company (Mubadala). And Mubadala officials played a significant role in getting the Terengganu sultan on board. Low brought Mubadala into the picture.

Khaldoon Khalifa al Mubarak

One mubadala official is CEO Khaldoon Khalifa al-Mubarak. His involvement in TIA would last past the later conversion of TIA from a state fund to a national fund.

In 2009, Khaldoon, who succeeded former Thai PM Thaksin Shinawatra as chairperson of Manchester City football club when Abu Dhabi United Group partly took over, was appointed onto 1MDB's board of advisors.

A seat on the advisory board was not all it got. Mubadala in Oct 2012 signed a deal with 1MDB to work on the RM26 billion Kuala Lumpur International Financial District, later re-christened Tun Razak Exchange.

Keeping Khaldoon company on the board is a fellow Middle-Easterner, Sheikh Hamad Jassim al-Thani.

The Qatari PM

Sheikh Hamad is the prime minister of Qatar. He was appointed as special advisor to 1MDB, on the same level as prime minister Najib who sits as chairperson of the advisory board.

Sheikh Hamad

He was appointed following a memorandum of understanding between 1MDB and Qatar Investment Authority (QIA) in May 2010. Sheikh Hamad is CEO of QIA.

Four days after the MOU, news reports indicate that QIA will partner 1MDB in developing Bandar Malaysia–a 196-hectare development taking place at the former military airport at Sungai Besi.

The Middle East connection has led critics to finger Low in the deal, which saw the land go to 1MDB for an alleged discount of more than RM3 billion, only to later benefit the Qatari developers. Low denies that he had anything to do with the Sungai Besi project.

But the Arab-link does not stop there.

The Saudi prince and his friend

One of 1MDB's more controversial friends is PetroSaudi International. The independent oil and gas company company, reportedly incorporated in the Seychelles in 2005 formed a joint-venture with 1MDB in 2009. 1MDB later pulled-out of the joint-venture but converted its US$1 bil investment in the venture into Islamic debt papers for PetroSaudi.

Unlike the other Arab players linked to 1MDB, neither Sheikh Tarek Assem Obaid or Prince Turki Abdullah al-Saud are on the boards of 1MDB. But Petaling Jaya Utara MP Tony Pua believes that as co-founders of Saudi royal family-linked PetroSaudi, they have gained handsomely from their ties to 1MDB. KiniBiz will delve into this further in the next articles in this series.

PetroSaudi has offices in the UK, Saudi Arabia and Switzerland. News reports state that its UK operations was incorporated there in 2010.

It has also reportedly signed memoranda of understanding with Ghana's and Nigeria's national oil companies. It also previously held stakes in Paraguayan oil company CDS but sold it off in 2009 and has business dealings with Petrolers de Venezuela SA.

Prince Turki bin Abdullah bin Abdul-Aziz

Prince Turki, the seventh son of King Abdullah is the head of boards of directors for several Saudi funds. However, it is CEO and founder Tarek who is in the driver's seat.

Pre-Petro Saudi, the duo were seen together at Riyadh-based company al-Obayya, reportedly owned by Prince Turki. Tarek was quoted in a news report speaking on behalf of the company in 2004. According to al-Obayya's website, it helps businesses wanting to operate in the Gulf.

Tarek, 37, was also part of Genii Capital, a private equity company. One of his partners in Genii was Renault F1 Team chairperson Gerard Lopez. In May 2010, Tarek became part of Team Renault. Genii Capital's subsidiary is Lotus F1 Team.

While the camera shy Tarek leads the charge for PetroSaudi, the royal links have built its image–at least in Malaysia. Tarek credited the royal family when PetroSaudi stepped in to charter planes to generously lift Malaysians out of crisis-hit Egypt in 2011.

Tarek is also generous in his personal capacity. A centre for surgery at the Mayo Clinic is named after his parents after he made a donation of US$10 million in 2011.

Interestingly, PetroSaudi's website is identical with the website to another company purportedly also founded by Tarek in 2005 — Murtuza Oil Mining Company. The companies also share exactly the same addresses and telephone numbers as PetroSaudi in Switzerland, UK and Saudi Arabia.

1MDB is also not the only company in Malaysia that PetroSaudi is involved in. In January 2010, the company bought stakes in UBG Bhd linked to Sarawak chief minister Abdul Taib Mahmud. It spent RM1.12 billion for the stakes and eventually took it private. On the board of UBG was Jho Low.

The second richest man in France

If birds of a feather flock together, so do the wealthy. Also on the board of advisors is France's second richest man and the 10th richest man in the world according to Forbes, Bernard Arnault.

The soon-to-be-knighted Arnault controls luxury goods group Louis Vuitton Moet Hennessy. Arnault's inclusion as 1MDB advisor was hailed by PM Najib as a positive, although it could have others scratching their heads.

Arnault, however, is not without controversy. He has been reported in the British media as having close ties to former first family, the Blairs when Tony Blair was prime minister. He had been photographed holidaying with them and had hosted the Blair children at his lavish digs. In 2010, Blair took up the post of advisor for Louis Vuitton Moet Hennessy.

Luxury and glamour in the world of textiles

Ashvin Valiram

While he may not be in the same league as Arnault, Ashvin Valiram, who is 1MDB director, is from the same industry. A third generation owner of the textile company Valiram Group, he is credited for taking the Batu Road business into what he terms the world of "luxe glam".

At 41, Ashvin made a name for himself by bagging distribution deals for luxury brands from Cartier to Ferragamo. The Valiram Group has also launched its own brand, Flow, for women with curves who want to "glorify their femininity" .

PM Najib in welcoming him to the board said he was chosen for his entrepreneurial spirit. In the world of "luxe glam" being a successful entrepreneur also means working the socialite scene. Ashvin often appears in the society pages, photographed at launches and parties alongside celebrities like the Kardashian sisters.

The loyalist

Lodin Wok Kamaruddin

1MBD chairperson Lodin Wok Kamaruddin has spent his career in defence-related companies and funds. He has been chief executive of Lembaga Tabung Angkatan Tentera (LTAT) since Aug 1982 and became group managing director of Boustead Holdings in 1991.

Incidentally, Najib was defence minister from 1990 to 1995 and from 1999 to 2008. The close professional ties have led to Lodin being widely viewed as a Najib loyalist.

Lodin took over as 1MDB chairperson from now Sime Darby chief Bakke Salleh in Dec 2009. The change of guards raised speculation that something was amiss but 1MDB claimed that its intention was always to tap into expertise of professionals in government-linked companies.

It said that this is with the understanding that these individuals would return to their companies once their tasks are completed. Bakke returned to Felda, while Employee Provident Fund's (EPF) Azlan Zainol also did not stay in 1MDB.

Some familiar faces

Nor Mohamed Yakcop

Among the foreigners on the board of advisors are a couple of familiar faces. They are Minister in the Prime Minister's Department Nor Mohamed Yakcop and former chief secretary Mohd Sidek Hassan.

Nor Mohamad was also Finance Minister II from 2004 to 2009 but is mostly remembered for his time in Bank Negara Malaysia, where he spent 32 years from 1962.

He has been accused of being part of the currency speculation scandal in the early 1990s, with losses to BNM estimated to be as high as RM30 billion. No action was known to be taken against him, while Nor Mohamad has refused to respond to media queries on the matter.

Mohd Sidek Hassan

Meanwhile, Mohd Sidek, who is now chairman of Petronas, was accused of hanky panky when his daughter and son-in-law won most of the feed-in tariff quotas from the Ministry of Energy, Green Technology, and Water.

The ministry has, however, refuted claims of rigging or preferential treatment. It said that the bidding was done online and award was done automatically on a first-come, first-serve basis, without human intervention.

The managers

Shahrol Halmi

If there was someone who would know the 1MDB story back to front, it would be former CEO Shahrol Halmi. His departure from 1MDB on the quiet for the Performance Management and Delivery Unit (Pemandu) has already raised eyebrows.

A former Accenture consultant, Shahrol was with TIA from when the outfit was a team of five people. He joined Accenture in 1995 and worked on the public service sectors, financial services and oil and gas.

It still unclear why he has moved from a power player like 1MDB to an oversight and management body like Pemandu.

But Shahrol's notable achievements have been in transformation programmes, including one executed in the EPF. Pemandu's role in transforming the government and economy may indicate a fit. He remains as director of 1MDB.

Mohd Hazem Abd Rahman

1MDB's partnership deals and acquisitions, which have come under question, were also done under Shahrol's watch. Hazem Abdul Rahman, who has replaced him as CEO, only joined in August 2012, after the deals were done and dusted.

Prior to 1MDB, Hazem was managing director of Sime Darby's unit Auto ConneXions Sdn Bhd. Interestingly, Auto ConneXions under Hazem had brought in armoured Land Rovers for distribution. It is unclear how many were actually sold.

He is said to have extensive experience in corporate turnovers and strategy and spent 17 years in various industries including power and equities.

Excellence in Business Reporting: 3rd Story

ISSUES | MARCH 28, 2013 11:53 AM

1MDB loans to PetroSaudi put nearly RM6 billion at risk

STORY BY

P. GUNASEGARAM

GUNA@KINIBIZ.COM

In the third part of its series on 1Malaysia Development Bhd, KiniBiz examines its annual accounts and comes up with some conclusions. For the first three years of its existence, it has merely financed its former

partner in a joint venture since abandoned, PetroSaudi International Ltd – to the tune of nearly RM6 billion. The question is why.

Tony Pua

DAP MP Tony Pua says 1Malaysia Development Bhd is a giant ponzi scheme whereas 1MDB describes itself as a strategic development company.

"As a strategic enabler for new ideas and new sources of growth, 1MDB leads in market-driven initiatives to help transform Malaysia into a thriving economy," its website says.

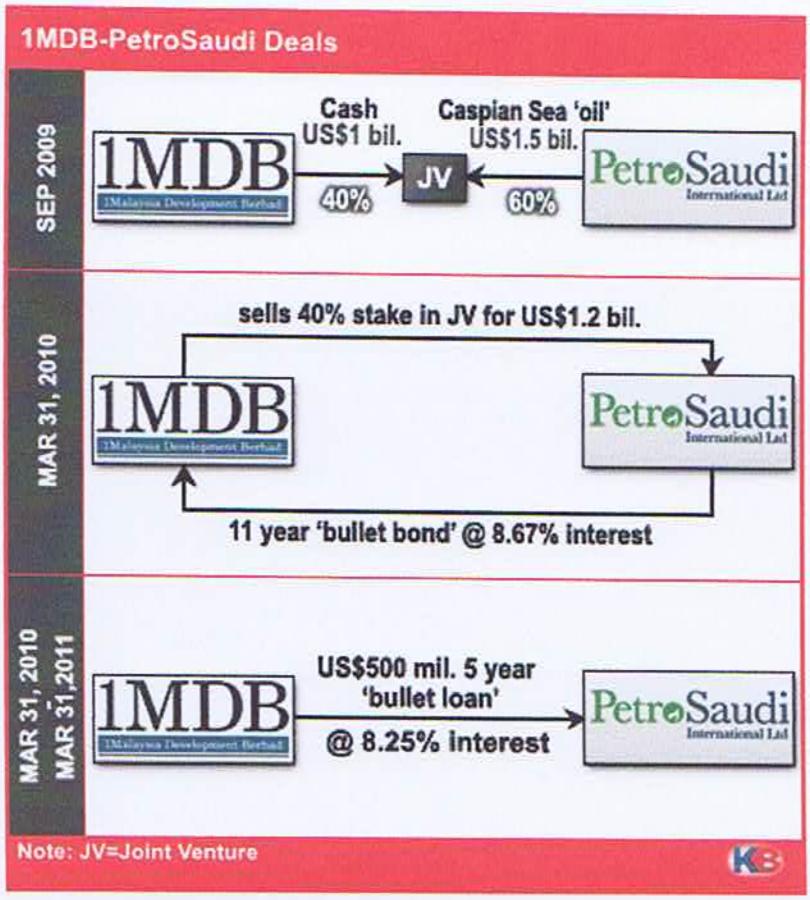
Pretty lofty words but the problem is that 1MDB has not been very articulate about how it wants to achieve its aims. Since setting up in 2009, it has not publicly reported its results.

Its accounts since setting up in late February 2009 to the year ended Mar 31, 2011, show a different picture to what the website paints and indicates that the profits made to date are largely paper gains which have no impact on cash flow, raising serious questions over utilisation of large funds raised.

A ponzi scheme?

If not for some paper transactions and revaluations, 1MDB would not have reported any profits, which no doubt led to Pua's assertion that it was a Ponzi scheme.

In May 2009, 1MDB issued bonds of RM5 billion via an Islamic facility at such favourable rates to those who took them up that it raised many questions among those in the finance industry at the time. (KiniBiz deals with the various bond issues in an article tomorrow.)



Because these bonds were issued at a discount to the par or nominal value, 1MDB actually raised RM4.40 billion and not RM5 billion. The first investment that it made was in Sept 2009 when it put in US$1 billion for a 40 percent stake in a US$2.5 billion joint-venture with PetroSaudi International Ltd.

This venture, according to the joint press release, will "seek, explore, and participate in business and economic opportunities which result in the enhancement and promotion of the future prosperity and long-term sustainable economic development of Malaysia. It is expected to actively make investments in the renewable energy sector."

The JV was supposed to bring investments into Malaysia from the cash-rich Middle East but the initial investments did not at all pan out in that way with funds moving in the opposite direction.

While 1MDB put in US$1 billion (about RM3.49 billion then) into the JV, PetroSaudi injected an asset for US$1.5 billion, Pua points out, which was an oil reserve in the Caspian Sea. That was not renewable energy and that certainly did not mean investments into Malaysia.

If anything, it looked like 1MDB was bankrolling PetroSaudi's attempts to develop the Caspian sea oil reserve. But according to its accounts, on 31 Mar 2010 (incidentally, the last day of its accounts for the financial year), 1MDB sold the 40 percent stake in the JV, 1MDB PetroSaudi Limited which was incorporated in the British Virgin Islands, back to PetroSaudi.

The sale was made for US$1.2 billion (RM4.14 billion), giving 1MDB a handsome gain of US$200 million (or about RM650 million at exchange rates then). But there was a catch – PetroSaudi issued debt of a like amount for the sale – IMDB received no cash.

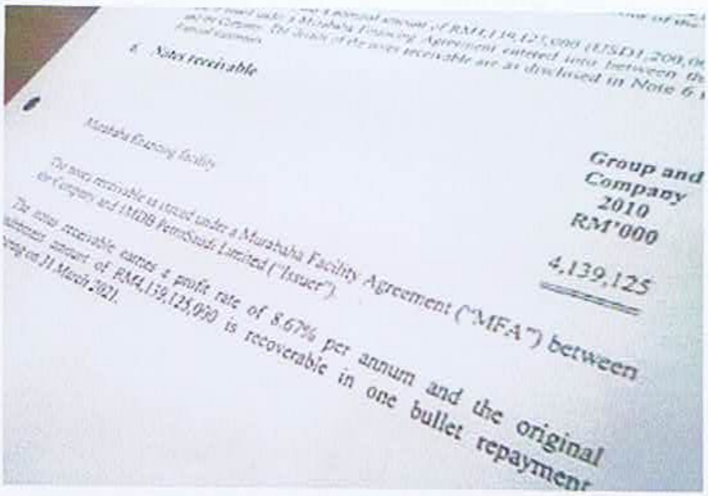
That's not all, while the notes carry a so-called profit rate (equivalent to interest rate) of a good 8.67 percent, it will be repaid in one lump sum only 11 years later on Mar 31, 2021. The loan was guaranteed by PetroSaudi itself.

Questions, questions

The questions that arise: Why did it exit the JV? How did it make a gain of RM650 million on the investment in just six months? Why did 1MDB not insist on cash payment and instead accept an 11-year bullet repayment bond? Why does PetroSaudi, supposedly owned by those with deep pockets, need the loan?

Effectively, almost all of the RM4.4 billion barring some RM260 million that 1MDB raised through bonds was used to finance PetroSaudi! That's hardly a strategic investment even though the two percentage point difference between what 1MDB receives from the loan and what it has to pay its own bondholders brings in recurrent income.

While auditors KPMG did not qualify the accounts for the period from incorporation of 1MDB (Feb 27 2009) to Mar 31, 2010, they emphasised that the fair value of the loan to PetroSaudi depended on "certain assumptions" which are "critical". The accounts did not show the assumptions but said that the fair value of the debt ranged from RM3.86 billion to RM5.04 billion.



For the period to Mar 31, 2010, 1MDB reported a pre-tax profit of RM425 million but if not for the "gain" of RM650 million on the disposal of the 40 percent stake in the joint venture with PetroSaudi it would have made a loss of RM225 million.

For the year to Mar 2011, 1MDB said it made a profit of RM544 million but even that is because of a revaluation of a piece of land that it acquired from the government at RM194 million and subsequently revalued to RM1.02 billion for a gain of RM827 million. If not for that 1MDB would have reported a loss of RM283 million.

Increased loans to 1MDB

But even more worrisome is that 1MDB increased its loans to PetroSaudi by a further RM1.57 billion through a US$500 million facility carrying an interest rate of 8.25 percent a year. This will be repaid in a bullet payment in Mar 2015. Incredibly, 1MDB's exposure to PetroSaudi has increased to RM5.71 billion from RM4.14 billion.

As at Mar 2011, 1MDB had loans of RM6.69 billion. That means that over 85% of the money that it had borrowed were simply on lent to PetroSaudi, not for the short term, but for long period of 11 years for RM4.14 billion and five years for RM1.57 billion. Of every ringgit that 1MDB borrowed, 85 sen went to PetroSaudi!

And since 1MDB raised no further bonds during this period, the increased lending to PetroSaudi came from term loans and other borrowings which effectively meant that 1MDB was lending long term with short-term money.

It becomes obvious why Pua calls it a ponzi scheme – PetroSaudi is paying interest to 1MDB for the loan it took from 1MDB to buy 1MDB's 40 per cent stake in the JV, 1MDB PetroSaudi. That's bad enough. And 1MDB, further down the road is lending more money to PetroSaudi which can use the money to pay interest to 1MDB, which means compounding the problem.

Why is 1MDB raising funds for PetroSaudi? And can we be sure that PetroSaudi will pay back the sums in bullets, one maturing in five years and one in 11 years? Recall that 1MDB has no recourse to anything else but a guarantee from PetroSaudi for this. Everything so far has revolved around PetroSaudi.


If PetroSaudi, for any reason cannot pay back the debts, 1MDB, is dead. It is simply inconceivable that a national strategic development fund can risk public money like this – and to the tune of nearly RM6 billion with interest yearly accumulating at the rate of nearly RM500 million a year.

That additional RM1.57 billion in loans to PetroSaudi is enough for just about three years of interest payment, if the principal sum is to be used only for interest payments.

Perhaps one saving grace could be that there is at least a spread that 1MDB is getting from using the proceeds of its borrowings and on-lending to PetroSaudi to give a profit from holding financial securities.

Alas, even that has not worked out right. Its income from holding financial instruments amounted to RM343 million for the year to Mar 2011 but costs were RM333 million, giving a net gain of a meagre RM10 million. But this was wiped out many times over by derivative losses of over RM250 million to give a net loss for holding financial instruments of RM242 million.

Paper profits

For roughly the first two years of its operations, 1MDB has made profits only because of a gain on a transaction and a revaluation. Otherwise it would have been in the red.

And it has had no achievements to speak off in this period. It has merely put funds it raised through a favourably priced RM5 billion bond issue and more into PetroSaudi. Why? Is PetroSaudi part of a scheme to suck money out of 1MDB and leave it high and dry?

One thing for certain, there is too little information on PetroSaudi and to put so much of our money with them is asking for trouble. 1MDB needs to do some explaining and so far it has not.

Pua, who is a member of the Parliamentary Public Accounts Committee, said the committee questioned 1MDB officials about Petrosaudi but little was forthcoming. "We questioned them about Petrosaudi and asked for documents but all they gave us was press releases," he said in an interview.

For the year ended Mar 31, 2012, abbreviated accounts indicate that 1MDB made a profit of RM44.7 million but as we saw that can be quite meaningless. Detailed accounts for the year ended Mar 2012 are not available but are likely to prove interesting.

Meantime, its borrowings rose to RM7.82 billion as at end-Mar 2012, an increase of about RM1.13 billion a year ago.

To sum up, 1MDB had nothing to show for its first three years of existence and earned the dishonour of simply funnelling more than four out of every five ringgit it borrowed to PetroSaudi.

And by no stretch of even the most expansive imagination can one conclude that this is the work of a strategic development company that leads in market-driven initiatives to help transform Malaysia into a thriving economy.

Excellence in Business Reporting: 4th Story

ISSUES | MARCH 29, 2013 11:52 AM

Up to RM4 billion in bond pricing losses

STORY BY

P. GUNASEGARAM

GUNA@KINIBIZ.COM

Even before it had any business, 1Malaysia Development Bhd or 1MDB's first move was to raise money, issuing RM5 billion in bonds, subsequently taking it up to RM20 billion. The deals caused a fluster because of attractive yields. Preliminary calculations indicate 1MDB could have lost as much as RM4 billion through mispricing. Question is, was it deliberate?

Preliminary calculations by KiniBiz with the help of bond specialists show that mispricing of 1Malaysia Development Bonds could have been as high as 20% of the total bonds involved, or some RM4 billion on bonds issued or in the process of issue of some RM20 billion

Bond issues made by 1Malaysia Development Bhd (IMDB) have raised substantial interest because of their attractive interest rates. But investors have found to their chagrin that they are unable to subscribe and the bonds are issued to a select club instead through private placements.

"I would have loved to get my hands on those bonds," one bond trader said.

Basically what happen is that the bonds are priced to yield more than the market rates. And because these bonds are long term, they yield higher interest rates over many years. Once they are on the market, the prices adjust to yield returns with comparable securities, giving windfall gains to those who got in on the first floor.

It's just yet another example of financial shenanigans that routinely take place in the world today with big name investment banks associated with them and working hand-in-hand with the issuers.

For this to happen, the transactions need to take place in private with as little of the terms as possible coming into public hands so that few notice the mispricing. The secondary trading too often takes place under veils of secrecy to stop prying eyes from discerning how much the players have made.

Bonds are financial instruments that need to be handled with care because there is one variable that can send their values tumbling – or rising. That is interest rates. If a bond is priced to yield more than comparable yields, the value of the bond can be considerably different.

Just altering the effective interest rate to yield two percentage points more than comparable bonds can result in a RM5 billion 10-year bond being mispriced by RM1 billion or more.

And the longer the term of the bond the greater the possibility of mispricing the bonds. If you misprice the bonds, the value can be off by 20 percent or more. On RM5 billion that amounts to one billion ringgit. On RM20 billion, it could account for as much as RM4 billion or more.

1MDB raised RM5 billion in Malaysian currency bonds in May 2009, US$1.75 billion (RM5.55 billion) in May 2012 and US$3 billion (RM9.3 billion) to make a total of RM19.85 billion, just shy of RM20 billion (see table).

The first was arranged by local investment bank AmInvestment Bank Group.

The second, arranged by Goldman Sachs, was issued to part finance 1MDB's RM8.5 billion acquisition of Tanjong Energy, which holds power ventures, from tycoon Ananda Krishnan. It was jointly guaranteed by 1MDB and International Petroleum Investment (IPIC), a unit of the Abu Dhabi government. The last is yet to be confirmed but was reported by Bloomberg.

When 1Malaysia Development Bhd, then Terengganu Investment Authority or TIA, raised money via bonds in May 2009, it did with a real bang. Two things stood out – the effective interest rate was considered rather attractive for the buyer and it had the longest tenure of any local bond at 30 years. And it was safe because it was explicitly guaranteed by the Malaysian government.

Just as it got local investors excited, it disappointed them. Bond traders said the bonds were privately placed and no local institution had access to them. This mouthwatering bond was apparently not accessible to most. The list of those who took the bonds were never disclosed.

The coupon rate of the RM5 billion bonds was 5.75% a year payable semi-annually. On top of that, the bond was issued at roughly a 12 percent discount to its par value, which increased the yield. According to the 1MDB annual report, the yield was 6.71%.

There was one problem with this bond though. There was no comparable bond with that tenure. Even government securities went out only as far as 20 years. Cagamas bonds, which have no explicit government guarantee, traded at around 5.28% then, with Malaysian government bonds trading at around 50 basis points less, at about 4.8%.

Bond analysts say a 25-30 basis point premium to government bonds is okay for a bond with an explicit government guarantee. Adding another 30 basis points for 10 years more in tenure would give a fair yield of around 5.4%. Instead, the effective annual rate was 6.71 per cent while the coupon rate was 5.75 percent.

Using a bond calculator, the bond price would have been undervalued by about 20% (see table on mispricing).

That means those who obtained the bond at that price and then subsequently sold it on the secondary market would have made about RM1 billion on the RM5 billion face value of the bond.

In its books, 1MDB as at Mar 31 2010, some 10 months after the deal, listed the carrying value of the bonds at RM4.39 billion while the fair value was listed at RM5.26 million, a valuation gap of RM870 million.

Trading on these bonds are thin, but the last trade done earlier this month was at a yield of 4.5 per cent which prices the bond at around RM1.20 for a RM1 par value bond. This is an increase of more than a third over the 88 sen that it was issued at in May 2009.

Similarly, we can do the same for the other bonds and the indications are that pricing is off by about 20% in each case, leaving a total mispricing loss of about RM4 billion.

The second bond for US$1.75 billion attracted international financial media attention when it was issued in May last year and was described as a "mysterious private placement" by respected financial review IFR Asia, a unit of Thomson Reuters.

"The jumbo US$1.75 billion deal is one of the biggest privately placed US dollar bonds on record from Asia, and a big payday for sole arranger Goldman Sachs. The few available details, however, have posed more questions than they answer, with rival bankers quick to suggest that 1MDB overpaid for the deal.

"With Malaysian oil major Petronas, which is lower rated at A1 (Moody's) trading at Treasuries plus 185 basis points on May 21 (2012), this means the 1MDB paper was priced 240 basis points back of its nearest comparable in the Malaysian sector," it said.

 IFR Asia added that even if comparison were made with other like-rated oil sector issuers, the trade still was higher by 213 basis points.

A Financial Times blog posed this question: "Bankers are wondering why an Abu Dhabi government investment fund would guarantee what is essentially Malaysian sovereign debt. After all, 1MDB has secured a Malaysian state guarantee in the past. Why is a Gulf emirate, many miles away, guaranteeing this bond?"

Since 1MDB has not revealed pricing and other details for the third and largest bond for US$3 billion or RM9.3 billion, it is only possible to make estimates but the order of magnitude of the losses are likely to be correct, analysts said.

Where does the money come from when a bond is mispriced and how is it possible to make so much upfront, virtually at the time of the issue?

Essentially what happens is that a mispricing of just 200 basis point or two percentage points is reflected in the cash flow that comes back to bondholders over a long time. The mispricing represents the value in current price terms of this stream of cash flows and is an upfront realisation.

If we take the RM5 billion bond, two percent works out to RM100 million a year and over 30 years that amounts to RM3 billion in all

Who makes the money? At the end of the day it will be the intermediaries. But if it is deliberately done, everyone gets a share with the biggest share going to those who initiated and masterminded it.

Excellence in Business Reporting: 5th Story

ISSUES | APRIL 1, 2013 11:39 AM

Will 1MDB's power acquisitions pay off?

STORY BY

JOSE BARROCK

JOSE@KINIBIZ.COM

In our continuing series on 1Malaysia Development Bhd, KiniBiz looks at the fund's power deals and why it is going into them. Analysis shows that payment for the power assets are excessive and reflects a desperate attempt to inject cash-generating assets which will help the fund repay expensive borrowings, now pushing RM20 billion.

1Malaysia Development Bhd's (1MDB) acquisition of power generation assets in quick succession—three large outfits costing RM12.5 billion in a span of 12 months—-raised many questions, and had the market guessing which independent power producer (IPP) would be next on the list.

But then again, so far everything related to 1MDB has raised plenty of questions—with no answers available.

But why IPPs, why not other businesses?

A fund manager explains, "When you have issued so much in debt papers (in this case almost RM20 billion), you need to buy assets with strong cash flow, such as IPPs or NFOs (numbers forecast operators)...since NFOs are frowned upon and are un-Islamic, 1MDB opted for power assets," he explained.

In earlier articles, KiniBiz examined the flawed business model of 1MDB, the people behind 1MDB, its structure and deals which funnelled funds into partner PetroSaudi International Ltd, and bond issues which were mispriced to the tune of billions of ringgit. Today, we look at 1MDB's acquisitions of power generation assets.

Jimah Energy for RM1.7 billion?

Latest on the list of acquisitions, according to Bloomberg, is the 1,400 MW coal fired Jimah Energy Ventures Holdings Sdn Bhd for a staggering RM1.7 billion. While news of this acquisition has circulated, 1MDB true to form has kept mum, meaning it is not clear if the acquisition has been concluded.

Questions sent by KiniBiz earlier were unanswered at press time.

The question is why is 1MDB paying so much, and will 1MDB be able to sustain after buying Jimah Energy Ventures Holdings and forking out RM1.7 billion for the power generation assets?

It was known in the market that a government linked company (GLC) which was eyeing Jimah Energy ventures Holdings had pegged a price tag of about RM1 billion on the Port Dickson based power producer, only a few months ago.

"They (1MDB), according to the press reports, offered RM700 million more...one of the valuations is way off," an analyst said.

A check with the Companies Commission of Malaysia (CCM) indicates that Jimah Energy Ventures Holdings is an investment holding company and wholly owns Jimah Energy Ventures Sdn Bhd (JEV), which owns and operates the power generation assets.

Jimah Energy Ventures Holdings is 65 percent controlled by members of the Negeri Sembilan royal family, namely Tunku Naquiyuddin Tunku Ja'afar and Tunku Mudzaffar Tunku Mustapha, 20 percent by state controlled utility giant Tenaga Nasional Bhd and five percent by Menteri Besar Negeri Sembilan (Diperbadankan), which is possibly like a golden share, and 10 percent by Jimah O&M Sdn Bhd which has the mandate for the operations and maintenance of the power plant and is controlled by individuals Johari Kamil and Zulkifli Ibrahim.

JEV has a 25 year concession starting January 2009 to supply power to Tenaga Nasional. Despite the concession period still having a 21 year duration to run, the RM1.7 billion price tag was frowned upon.

Halim Saad

In the tail end of 2009 it was reported that Halim Saad was looking at buying JEV—and his offer price was in the region of RM700 million.

It was then explained that JEV was operating below its optimum level, resulting in the company not raking in cash as expected, which was the reason why the shareholders of JEV were looking to exit.

Other parties that were reported to be interested back then were Malakoff Bhd, controlled by Syed Mokhtar Albukhary's MMC Corp Bhd, but the bid had been inferior to Halim's.

So what could have nudged JEV's price up by one billion ringgit in four years?

We examined JEV's financials. For its financial year ended December 2011, JEV had non-current assets of RM4.79 billion, current assets amounting to RM1.05 billion, and on the other side of the balance sheet the company had long-term debt commitments of RM5.24 billion and short term liabilities of slightly above RM1 billion.

Interestingly enough JEV suffered an after tax loss of RM105.15 million on the back of RM2.50 billion in revenue for its year ended December 2011.

JEV also had negative reserves of RM399. 44 million for the year ended December 2011.

So RM1.7 billion seems like a high price to pay for a loss making asset. And this comes on the back of one concluded IPP acquisition by 1MDB which came under flak.

RM2.3 billion for Genting's power assets

In mid-August last year 1MDB acquired diversified Genting Bhd's power assets held under Mastika Lagenda Sdn Bhd for RM2.3 billion. What was odd was that the Genting concession to supply power to Tenaga Nasional is slated to expire in February 2016.

So why pay RM2.3 billion for an asset that has a concession period of three and a half years left?

Adding salt to the wounds was that Genting in its announcement that it is "expected to record a one-off net gain of approximately RM1.9 billion from the proposed disposals."

Kuala Langat power plant

To recap, Genting had a 720MW gas-fired combined cycle power plant in Kuala Langat, Selangor, and the power plant commenced commercial operations in 1995, supplying electricity to Tenaga Nasional under a 21-year power purchase agreement.

While Genting states clearly that it has submitted a proposal for an extension with the Energy Commission, there seems little reason for 1MDB to pay RM2.3 billion for expiring power generation assets.

1MDB in its announcement said, "The acquisition is a step towards greater efficiency and a more sustainable energy security in the long term, as power availability is critical to maintain investors' confidence and to support the economic growth of the country," That is a lame effort to try and put some strategic merit to the deal.

Mastika Lagenda, a check on the CCM reveals, posted a net profit of RM227.78 million on the back of about RM979 million in sales for its year ended December 2011. This would indicate that the RM2.3 billion price tag is about 10 times the company's earnings for 2011 to give an earnings yield (net earnings as a percentage of purchase price).

While this is above 1MDB's debt cost of 6.1-6.7 percent, cash flow is likely to go negative if repayment of principal is taken into account not to mention the expiry of the concession three years down the line.

Mastika Lagenda had non-current assets of RM656.95 million and current assets of RM526.4 million. On the other side of the balance sheet Mastika Lagenda had short term debts of RM311.12 million, and long term debt commitments of RM124.389 million.

Despite the good balance sheet, Mastia Lagenda's concession ending in three and a half years cannot be ignored, and its balance sheet could look very different once the concessions ends.

Another way of looking at it is— while the company may seem capable of paying finance costs and bank borrowings now, it may not be able to once its concession ends.

With two out of three acquisitions seemingly unwise, we venture on to 1MDB's largest power generation acquisition—that of tycoon Tatparanandam Ananda Krishnan's Tanjong Energy Holdings Sdn Bhd, for a whopping RM8.5 billion.

The acquisition of Tanjung Energy Holdings for RM8.5 billion

At the end of July 2010 Ananda Krishnan privatised Tanjong plc offering RM21.80 per share, for the 53 percent he didn't own in Tanjong, forking out RM4.7 billion in the process. This valued Tanjung at RM8.8 billion.

Tanjong PLC power plants

Company	Location	Power Plant	PPA Expiry	Net/Effective Capacity
Powertek Berhad (PB)	Malaysia	Powertek Pahlawan Panglima	2016 2020 2023	440 MW 330 MW 720 MW
Kuasa Nusajaya (L) Ltd (KNL)	Egypt	Port Said Suez Gulf	2023 2023	683 MW 683 MW
Pendekar Energy (L) Ltd (PEL)	Egypt Bangladesh Bangladesh Bangladesh Pakistan Sri Lanka	Sidi Krir Meghnaghat Haripur NEPC Fauji Kabirwala Ace Horana & Ace Matara	2022 2024 2023 2014 2029 2012	375 MW 248 MW 198 MW 30 MW 36 MW 8 MW
Pendekar Power (Labuan) Ltd (PPL)	Abu Dhabi	Taweelah B	2028	200 MW

Source: Tanjong annual report

Tanjong had two main businesses, numbers forecast operator Pan Malaysian Pools Sdn Bhd and power generation under Tanjong Energy Holdings Sdn Bhd. The company has 13 power generation plants located in Malaysia, the Middle East and North Africa among others.

While several international private equity firms and a consortium led by the Cheng family expressed interest to acquire Tanjong's gaming business, Ananda Krishnan sold it off to a consortium for RM2.1 billion, in August 2011. Among the members of the consortium members were tycoons William Cheng of Lion group, Quek Leng Chan of the Hong Leong group and Lim Kok Thay of Genting group.

Thus when 1MDB acquired Tanjong Energy Holdings for RM8.5 billion in March 2012, many were fuming at how Ananda Krishnan purportedly made a cool, RM1.8 billion in a span of less than two years, asset stripping Tanjong and selling off the assets.

But was it Ananda Krishnan's guile and business acumen that netted him the cool RM1.8 billion, or was it just 1MDB overpaying for assets like it seems to have done on other occasions?

What seems clear is that 1MDB may have overpaid for Tanjong's power assets and could face some difficulty servicing its debts.

Tanjong Energy Holdings name was changed to Powertek Energy Sdn Bhd on August 16 last year. Interestingly enough Powertek Energy is wholly owned by Powertek Investments Holdings Sdn Bhd, which in turn is wholly owned by 1MDB Energy Ltd.

A check on the CCM reveals that Powertek Energy for its financial year ended January 31, 2012, posted a profit after tax of RM515.87 million from RM2.35 billion in revenue. Powertek Energy as at end January last year had non-current asset worth RM6.35 billion and current assets worth RM2.69 billion. The company had long term liabilities of RM4.76 billion and short term debt commitments of RM786.41 million. It is also noteworthy that Powertek Energy had RM3.12 billion in reserves.

Sidi Krir power plant

So the RM8.5 billion acquisition price tag, works out to about 16.5 times FY2012 earnings.

1MDB or an earnings yield (earnings as a percentage of acquisition price) of around six per cent which is still lower than 1MDB's debt cost of between 6.1 and 6.7%.

However not everything will remain status quo. Out of Powertek's three local IPPs, the 440MW Teluk Gong power plant's concession expires in 2016, while Pahlawan Power's 330MW concession expires in 2020 and Panglimas Power's 720 MW concession expires in 2023. They account for some 40% of power-generating capacity. Other concessions around Asia which span from 8MW to 683MW expire between 2012 and 2028.

But then there's talk of 1MDB floating the shares of its power assets, which will unlock the value of its investments. This could happen sometime this year, reports say. But what kind of value will it get for relisting when it overpaid in the first place? And it will still have to maintain a majority stake at considerable cost.

The power acquisitions that have been made certainly seem to be on the expensive side while the one being contemplated, if made at the same price, will be very expensive as well. At best they are desperate attempts to get cash-generating assets to mitigate loan repayment obligations, at worst they represent mispricing to get gains for others.

In either case, they are likely to spell trouble later for 1MDB when it comes time for full repayment.