COVER STORY

Well on TRACK

Khazanah Nasional Bhd managing director Datuk Azman Mokhtar looks pleased at the state of government-linked companies. Ever since he took charge of the transformation process, there has been marked improvement in the performance of the GLCs. The reform programme is on track and is going strong, he tells **Leela Barrock** and **P Gunasegaram.**

***The Edge*: Four of the eight Khazanah companies underperformed the KLCI. What does this mean for GLC transformation? Is this a fair way of assessing the performance of the companies?**

Azman: The state of the GLC programme, we are very pleased to report, is strong with considerable momentum behind it. Earnings are forecast by consensus to be up 70% this year, more than three times the national average and market capitalisation has increased by more than 83% for the 20 largest GLCs or RM121 billion since the programme started. The GLC Transformation Interim Report 2007 also highlights that there has been significant progress beyond the financial indicators, in that, there has been a marked improvement in operating performance as well as a broadening of the benefits to all stakeholder groups, including customers, employees, suppliers and the local and bumiputera community. Hence, when we measure the performance of the GLCs — principally their financial performance and shareholder value creation — we also measure their operating and stakeholder value creation. The programme is about a third way through on a 10-year journey and thus far it's well on track and there have been many success stories.

The four companies you referred to are TM (Telekom Malaysia Bhd), MAS (Malaysian Airline System Bhd), Proton (Holdings Bhd)and Tenaga (Nasional Bhd). We are not unduly worried. In some cases, we believe that the shares are undervalued and fundamentals are strong and not fully reflected in the share price. In any case, Khazanah is principally an absolute return investment house where our main KPI (key performance indicator) is absolute rather than relative return. Over the last 3½ years, we are averaging returns of more than 20% per annum which we think is good and out-punching the risk frontier that we are willing to accept.

Absolute return in terms of what?

Net worth, which is basically total assets minus total liabilities at market value. The most important financial KPI is actually how our net worth is growing in absolute terms rather than relative to a benchmark. In any case, the topic of benchmarks for relative return is a big and unsettled one — that is, which benchmark are we talking about.

The KLCI is a benchmark, whether that should be the benchmark is another matter. For example, we do not invest in oil and gas and palm oil. These two sectors have done very well but we are basically not mandated to invest in them...

You cannot invest in palm oil? That is not an option open to you?

We don't, because among the government-linked investment companies there is sector concentration and focus. Nor do we do oil and gas.

So you can't invest in terms of the broad KLCI?

As mentioned, we have certain sector, geography and asset class focus and it would not wholly reflect the broad KLCI. To get technical about it, a proper performance attribution of relative investment performance would need to construct a synthetic benchmark index of the sectors and asset classes that we are mandated to invest in. This we track internally with some intensity and we are happy that the portfolio is, by and large, doing well. In any case as mentioned, our main measure is absolute returns for an acceptable level of risk and on that score at 20% + per annum, we are overall, happy.

In respect of the four companies identified as having underperformed the KLCI, for MAS and Tenaga at single digit or near single digit PEs (price earnings ratios), we believe this reflects more the sector uncertainties than the strong fundamental progress that the respective CEOs have made. That is not to say the sector overhangs should not be addressed — indeed they need to — regulatory and industry structure for Tenaga, and the tough operating, fuel and competitive environment for aviation. We have various plans that we will roll out on both these fronts in 2008.

Telekom Malaysia — unlocking value

What about TM?

Actually, 18 months ago we had a thorough review of the business and it reinforced the view of how tough this business was in the fixed or wire-line area. The fixed line business was actually declining at a pretty alarming rate of about 7% per annum. The good news is, we sat down, rolled up our sleeves and we did something we call PIP (Performance Improvement Programme). So, fast forward, the latest results have been quite encouraging. From minus 7% decline, it is growing a modest 2% or so — that's a big swing in one year. It is actually very good if you consider that all around the world, fixed line carriers are actually declining. Seven per cent was high. Datuk Seri Abdul Wahid Omar (TM CEO) and the FixedCo (the company which will take over the fixed-line business under TM's proposed demerger) CEO-designate, Datuk Zamzamzairani Mohd Isa, and team have not only managed to arrest (the decline) but they have also shown (growth), although it's early days yet to see if this is sustainable.

Secondly, for Celcom, for the mobile business, it's always great, intense and, I would say, even fun competition. Again, the latest results from some intense work over the last 18 months of the PIP have been quite encouraging at Celcom. Do note that for some perspective, we should also remember that whether we are discussing Proton or Celcom or TM, or some of the UE (United Engineers) companies, recognise that some of these have major legacy issues. Like Celcom, how do you go to battle when your cost base is two to three times higher than others? This was not our doing. We are still fighting law suits and we have RM600 million plus legacy arbitration (award against us)...

Hopefully, when we sit down one year from now, we will hardly talk about these "legacy issues". When we started some three years ago, we had identified 11 (companies) in Khazanah out of the 50-odd major companies that needed restructuring. We have addressed or completely solved some nine out of the 11 to date. The two that are still pending resolution are Proton and Malaysia Airports; more on these later.

ABDUL GHANI ISMAIL/THE EDGE

With TM, with encouraging results coming through from the PIP, the demerger plan which has, by and large, been well received by the market and our overseas investments and the upcoming public-private partnership for broadband, there is every reason to look forward with great excitement. You may have noticed, for example, earlier this week, in Indonesia, that the Abu Dhabi-based carrier, Etisalat, has bought a 16% stake in Excelcomindo from the local Indonesian party. This values the company at roughly 2.4 times what we paid for it three years ago. That was one of our first foreign deals, and we are pleased that with this transaction, the water mark of the valuation of our latent assets has risen significantly and it also vindicates the decision to aggressively expand a few years ago.

What about the synergy if you keep them (the fixed line and mobile business) together? There is a lot of talk of convergence?

We've done the detailed numbers and we're very much convinced that the benefits of a demerger significantly outweigh any downside. This is especially so as there has been good progress in the organic transformation work under PIP.

So, they were ready to demerge because we see them as fundamentally (having) quite different DNA and quite different businesses. One, (there is) very clear domestic focus with fixed line and broadband agenda, which is very important on its own. And the other is basically what has emerged as a significant regional mobile player with a footprint in nine countries with a 37-million plus subscriber base and growing very fast.

For the RegionCo (the mobile business, both local and international), for example, the next stage is to look at the revenue and cost synergies. Before this, they were operating generally on their own. So, for example, we can and should be buying SIM cards and network equipment together. All this has not been done yet.

Now we will have two companies and they are operating in their own distinct areas of focus, but they can still do their collaboration on a B-to-B (business-to-business) basis. In any case, the two companies are still controlled by Khazanah. They are managed and governed by the board.

Do you plan to bring in a strategic partner into the mobile side?

We have said that we are considering. There has been a lot of interest.

Vodafone is one of the names that keeps coming up.

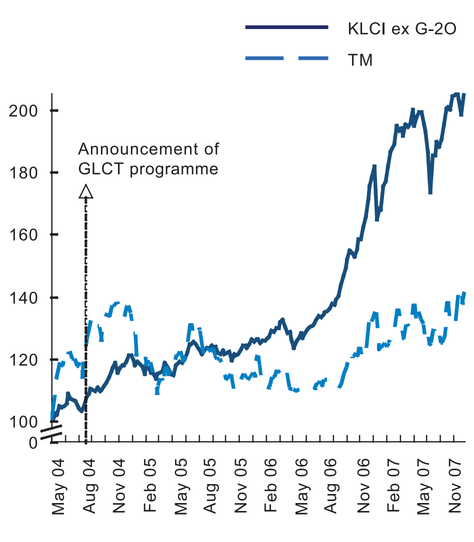
There are many names and almost without exception there is a lot of interest but we are yet to make a decision.

So you think the shareholder link is sufficient to enable collaboration?

The respective boards and management will decide, based on the strategy and business and industry rationale that an active shareholder

TSR INDEX

Telekom Malaysia
TSR has fallen below KLCI average
Rebased TSR Index



HISTORICAL PERFORMANCE

FY December 31	2005	2006	YTD Q3 2007
Net profit RM Mn	811.3	2,068.8	1955.2
Market capitalisation RM Mn	32,387.0	33,122.0	33,366.0
ROE Percent	4.2	10.6	12.7*
Asset/equity x	2.1	2.1	2.1
Operating margin Percent	12.5	15.3	13.4
Asset turnover x	35.0	40.0	41.0*
Interest cover x	2.6	4.0	2.6
Effective tax rate Percent	43.7	26.5	18.0

like us will help set. It is logical that the fixed line will work with Celcom in this market to bundle products, for example. Ultimately, the industry logic itself, the way they are structured now allows them to be unleashed. It allows each company to move in a manner more appropriate to themselves with processes and DNA more appropriate and customised for themselves. Managing regionally, for example, would mean different HR policies or procurement policies.

Are you open to a foreign CEO in Telekoms? This industry develops very fast and you may need someone who can keep on top of developments.

We are now putting (the companies), on the next platform, more focused platforms. This will be the next wave of what GLC transformation is all about. So, what kind of CEO will drive this next generation of GLCs will, as always, depend on what is required to do the job.

It should be driven by what is required to deliver the business results. If you are operating in this market principally, for example, and you are dealing with a lot of government and regulation and all that, you need to be culturally sensitive. Just like if you are operating in Indonesia or China or India, same thing. Like in Indonesia, our CEO for Excelcomindo is an Indonesian who used to run Indosat while our CEO at Lippo Bank is a Dutchman who used to work for Rabo Bank. The chairmen for both companies are senior corporate figures from Malaysia. It's a combination that has worked very well. In Malaysia, in the semi-conductor industry, we have an émigré Malaysian of Chinese origin who has returned as CEO, with a Malaysian Malay, with considerable technology and financial experience as chairman — again this has, by and large, worked well. Likewise, if you are running, say, UDA, where the business requirement will require a lot of understanding and immersion into the government and bumiputera business community, then being familiar with that landscape is a prerequisite.

Over and above the immediate business imperative, at Khazanah, developing local and in particular bumiputera and Malay talent is an objective in itself and we carry these national aspirations on a merit-based system that is internalised. That is the kind of template that we subscribe to. That is the kind of capacity-building that we do.

MAS – tough conditions ahead

With regard to MAS, is there any particular reason you can pinpoint for its underperformance?

Partly liquidity. In general, we are gradually reducing our stakes in our companies when the time is right, but we will do it in an orderly fashion. But, as an active investment house, we owe it first to our shareholders to create some value first before you go and sell. For MAS, the turnaround is coming through.

By how much would you consider reducing the stake?

We are not dogmatic about that. We are open. We have not made any decision about that. Recognise that we have 69.34% of the shares.

Would you go below 50%?

We could. If you look at some of our strategic companies, we are in the region of 30s to 40s in Tenaga and Telekom. In fact, over a period of time, that would be the more efficient way to do it. We don't need to own that much. By and large, in the case of MAS, the organic turnaround has been very good.

BLOOMBERG

You think there is a lot more potential in MAS?

Very much so. I think it has earned the right to go to the next level. In two years, Idris (Datuk Idris Jala, MAS managing director) and his team have done an impressive turnaround and now he needs and will do the transformation, grow it, taking it to another level.

Is there a chance of better co-operation between AirAsia and MAS?

…he laughs … shrugging … I thought I heard you say tiff between the two… tiff is a four letter word *lah*! Basically, our position has always been that there is a lot of room for both to be national champions. My first public speech as Khazanah MD mentioned this. MAS has certain advantages as an incumbent carrier, such as routes that they have developed and invested in over many years while AirAsia has presumably many other inherent advantages by being in their market segment. AirAsia also enjoys many privileges, it should be noted, including their own terminal being built for them, special landing charges and so on. Should we collaborate more? The answer is yes.

Can you?

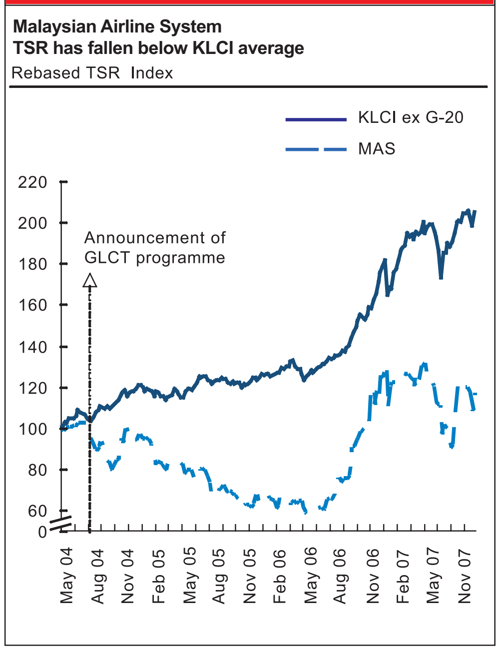
The MRO (maintenance, repair and overhaul), for example. Idris has offered Tony (Datuk Tony Fernandes, CEO of AirAsia) terms to do repair work on some of their fleet on a long-term basis that we feel are more than reasonable. But he may not find the terms to be competitive. But we are trying, we've said 'come, use the excess capacity that we have in the country'.

The right to vary prices, for example; again, AirAsia started straight away with a variable pricing model, and rightly so. For the domestic business, the ruling was a few years back that MAS couldn't vary our price nor our capacity. The moment we hit 75% load factor, for example, we had to mount an additional flight, whether the flight could be profitable or not, or even if the flight would only be profitable at, say, 120% load factor. Airline seats are, of course, a perishable, the moment the flight takes off. We wanted the right to vary prices and capacity like anyone else and when we could not do this, the government then decided to underwrite the P+L of the domestic business. Over the years, when some felt that this was not right, we said, 'that's ok', we are more than happy to take the P+L so long as we have the same right to vary price and compete, no more, no less and no worries. Then AirAsia said that they wanted some or most of the domestic routes, and the routes were given. However, some routes were subsequently returned to us and interlining — that is, hard connecting AirAsia's domestic network into the international network of MAS, thus allowing customers and the nation to benefit as promised — has still not happened.

When the Singapore sector is opened up…

That is another one. We're not anti-competition or anti-public. But bear in mind that fleets are planned based on certain commitments; otherwise, everything is a moving target. There was a deadline to roll out and liberalise it by a certain date. All Asean countries have an agreed timetable for liberalisation commencing January 2009. Now, Malaysia and Singapore have agreed to partially liberalise this ahead of schedule. But good luck, we are more than happy to compete but let's compete on good terms.

TSR INDEX



HISTORICAL PERFORMANCE

FY December 31	2005	2006	YTD Q3 2007
Net profit RM Mn	(1,143.9)	(136.4)	609.5
Market capitalisation RM Mn	3,559.2	5,865.2	7,653.0
ROE Percent	(58.2)	(20.7)	38.3*
Asset/equity x	3.1	3.7	3.4
Operating margin Percent	(9.7)	(2.3)	5.6
Asset turnover x	189.6	189.0	247.3*
Interest cover x	n.m.	n.m.	17.2
Effective tax rate Percent	(2.8)	(83.0)	9.2

There are a lot of complaints about the service levels on MAS though.

MAS is one of the five airlines in the world with five-star status in terms of superior product and service. While MAS continues to do very well on things like cabin crew service, there are other areas that it could do better — on time performance and on ground service, for example. When you are in turnaround mode, you have to worry about your cash flow but when you are managing for growth and cementing yourself in to a certain position… Let's look at it. In how many industries can we actually be a significant player globally? Plantations is one of them and oil and gas is one of them. I would submit that airlines is another area because the Western airlines are not particularly strong. Our service is world-class, pilots are world-class, our crew is world-class, our engineers are world-class. For MAS, our financial management was bad but it has improved tremendously.

We're not taking anything away from Idris, we think he has done a fantastic turnaround job. But you agree that in the next phase, MAS is looking at growth. So would he still be the right person then for MAS?

Very much so. It would be stereotyping Idris to say that he is a man who can only do turnaround. He can do that and more. He has a track record of building businesses, not just turnarounds.

Of course, our style of management at Khazanah is "macro-managing"; so we will continue to support and continue to check. So, for example, you talked about the service. There is a limit to cost-cutting before you start hitting certain customer segments. It's about being clever. Idris has a vision of full service but with cost management. His reading is that with the coming onslaught, we will move into a different phase of competition where only the lean will survive and you have to be very focused.

I think MAS is well placed but it is a tough industry.

The long and short of it is, in that kind of competition that we expect, (we have to see) how good are you at yield management, load management, how adept are you at doing alliances and alliances can come in many forms, for example, the B-to-B merger that KLM and Air France have done. They have done very well. On the cost side, you have to be really ruthless and focused without eating away on the revenue side. MAS will have to find an equilibrium as we move from managing for survival to managing for growth.

Proton — giving management a chance

What do you think are Proton's realistic chances of surviving on its own?

I think the Proton story is… when I first came in three years ago, it was 3% of our portfolio and perhaps 30% of our issues. Before the announcement that the talks (with VW) were called off, it was 1.4% or thereabouts of our portfolio and still about 30% of our issues. After the announcement, it is 0.8% of our portfolio and….

ABDUL GHANI ISMAIL/THE EDGE

And 90% of your problems?

He laughs… no lah, more like under 5% of the issues as it is not a Proton, or Khazanah issue per se, it's a national issue. It's about 20 over years of industrial policy. In this case, we continue to believe that Proton needs to work out a workable strategic alliance because scale matters, technology matters, efficiency and distribution reach matters.

When we started in the early 1980s, there were some 64 car companies in the world. Today, there are 15. Trend-wise, it's likely to be single digit in the next few years. So, our view remains that we need a strong strategic alliance. Proton has certain strengths, not just the hardware but also the reach in Afta (Asean Free Trade Area) and the engineering strength. Now the decision is to (allow) the management to do its existing business turnaround or plan. The government wants to give them more time in order to see further down the road… what next. The inorganic options will be further down the road.

CONTINUES NEXT PAGE

COVER STORY

'Any partner has to add value'

FROM PREVIOUS PAGE

Inorganic options?
Alliance.

Would Khazanah take the lead in this again?
There is a decision-making process, it is not our usual process because this is no longer an investment issue, it is a national issue. We continue to be part of the process and we continue to offer ideas and suggestions.

Would you consider taking it private?
The short answer is yes but report that carefully. Generally, we believe in being listed because it gives public scrutiny and that is good, it drives performance.

Proton is worth a lot more than its share price, though.
Well, you can value it as a going concern or the break-up valuation.

Would you sell down to a local player?
The issue of local or foreign, to me, any partner has to add value. If there is no value addition, then there is no point. It also has to tie in with the aspirations of the industrial structure and policy. To be fair to Datuk Syed Zainal (Proton MD), he should be fairly judged on this current model, the Persona, because the previous ones were from the previous management.

Do you feel that the government's Proton/VW's decision impinges on your ability to make sound corporate decisions?
The way to look at it is, in the last years, we have been given adequate support by the government. I'd like to think that we are doing it in a manner without any special privileges. Really there is not much, if any, interference. Certain regulatory outcomes are in our favour and some are not.

Malaysia Airports — plan with government

Malaysia Airports...
The proposed financial restructuring is with the government. That is a question of what is the right model of capital structure for some of the assets. Operationally, they are doing reasonably well and continue to win customer awards and recognition of their products.

Would it be desirable to have relocated the LCCT (low-cost carrier terminal) at Subang?
The issue of Subang... the country made a decision to have KLIA (Kuala Lumpur International Airport at Sepang) and so KLIA had to be utilised properly. The LCCT sector in Malaysia has outgrown Subang and it would take significant investment to turn Subang into the desired LCC hub. Even then, the location may not be desirable and the connectivity issue as mentioned earlier will continue to be unresolved. We have to stand firm on our long-run decisions, otherwise you lose the agglomeration effect.

The Time dotCom deal

The Time dotCom deal, the minister is saying that spectrum reassignment is subject to his approval and the withdrawal of a category of spectrum.
We are seeking clarification, we are not clear what was said and what was reported. What we do know is that the WiMax business currently is pretty small for Time dotCom. Recognise that the whole deal with DiGi is part of an overall rationalisation and our view of what the whole telecommunications sector ought to be. This is a 10 to 12-year-old issue from the Renong days. It went into CDRC (Corporate Debt Restructuring Committee), Danaharta, UEM. We are solving several things at once. Firstly, our commercial view is that in the current state of the market, anything more than three players, it's difficult to make it work economically. At the same time, there's a national broadband agenda where DiGi has a six million subscriber base which does not have access to a broadband platform. This has now been addressed. Of course, there are some who say that this is now going to compete against Celcom. We say fine, let us compete. Because in this case we are rationalising the whole sector. At the same time, Telenor has to sell down their stake in compliance with the shareholding limit as what it is in law. (The deal) fits in with all that. The end outcome of the deal is, DiGi gets spectrum, TdC will concentrate on a different market segment within this overall thing. TM will roll out national broadband, for example. And we took a stake in DiGi instead of cash.

Tenaga Nasional's mistreatment

Tenaga is mistreated by the government. Concession holders are allowed to pass their costs on to Tenaga but Tenaga is not allowed to do so and neither does it subsidise it.
Tenaga has done a lot but it is a work in progress. What has been achieved on the organic side, Datuk Seri Che Khalib Mohamad Noh (CEO of Tenaga) and his team have delivered some real impressive numbers with the controllable costs. And then a lot of value creation or destruction is on the regulator side, that is, tariffs for example, or how you plant up.

When Tenaga was listed in 1993, there was the Electricity Supply Act. And there was a tariff formula, the CPI-M + Y formula.

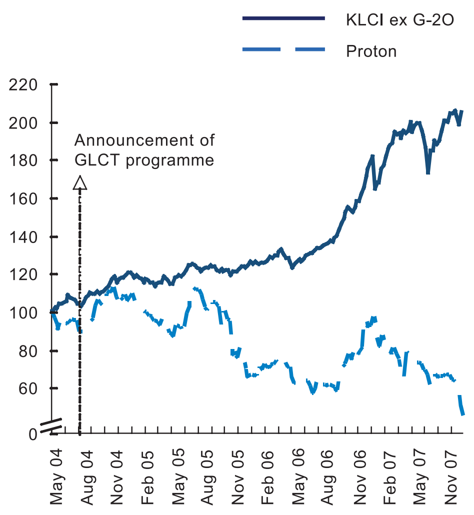
CPI (consumer price index), you base your tariff partly on inflation. M is an efficiency factor which basically says no free ride, no free lunch. They benchmark, you must achieve so much efficiency, if you fail to achieve whatever the act says, then you don't get (an adjustment). Y is the fuel and IPP (independent power producers) cost pass-through. There was a fuel-cost pass-through — I believe it was on for three or four quarters. In the fourth quarter, the government decided to do away with the formula. From that time on, Tenaga had essentially faced increasing costs by virtue of whatever concession they had signed with the IPPs and on the other end the inability to pass through the cost.

This has been a source of great problem for them. All the time, there was always a question of whether they were efficiently run or not. And we know it could have been more efficiently run. In the last three years, Che Khalib has increased the efficiency quite significantly,

RAYMOND KHOR/THE EDGE

TSR INDEX

Proton Holdings
TSR has fallen below KLCI average
Rebased TSR Index

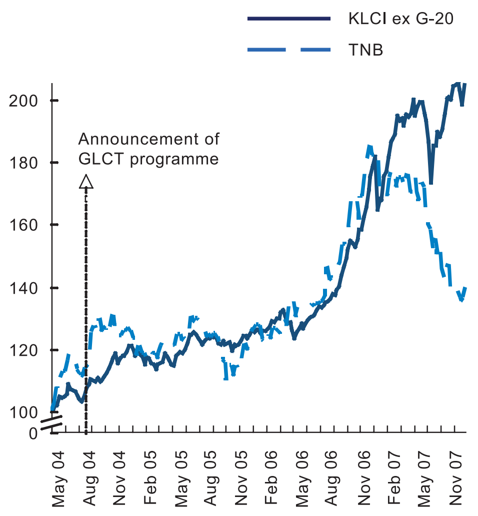


HISTORICAL PERFORMANCE

FY March 31	2005	2006	2007	YTD Q1 2008
Net profit RM Mn	442.4	46.4	(589.5)	(46.8)
Market capitalisation RM Mn	4,283.9	3,130.5	3,652.3	3,295.3
ROE Percent	7.6	0.8	(11.3)	3.6*
Asset/equity x	1.5	1.4	1.3	1.3
Operating margin Percent	9.1	0.4	(12.0)	(3.9)
Asset turnover x	96.1	93.8	70.7	65.8*
Interest cover x	16.7	0.8	(16.5)	12.0
Effective tax rate Percent	n.m.	n.m.	4.6	0.2

TSR INDEX

Tenaga Nasional
TSR is below KLCI average
Rebased TSR Index



HISTORICAL PERFORMANCE

FY August 31	2005	2006	YTD 2007
Net profit RM Mn	1,280.0	2,126.9	4,061.1
Market capitalisation RM Mn	32,011.6	46,704.8	38775.1
ROE Percent	8.0	10.9	16.9
Asset/equity x	3.9	3.4	2.8
Operating margin Percent	16.5	19.4	23.8
Asset turnover x	29.9	31.3	34.4
Interest cover x	2.2	2.6	4.2
Effective tax rate Percent	27.3	21.6	14.7

the numbers are there. These are independent numbers from the energy commission and other sources. The issue now is a broader national issue around subsidy management. There is clearly an issue of gas prices, it is a depleting resource. Essentially, Tenaga is also subsidising end consumers.

Recently, the deputy prime minister has come out to very clearly clarify that any increase in gas prices will come simultaneously with a corresponding increase in tariff. In other words, a full pass-through.

But that cost pass-through is only for any adjustment in Petronas' price.
DPM was responding to some queries about gas price and partly because people were asking after some statements that had spooked the market.

We got our tariff increase which we believe we deserve because we earned the right to that. We have shown that we are not hiding behind inefficiency. What you can control you have done, you have your house in order.

But we think the time has come when we need a very clear industry framework. How do you plant up? In the power industry, five years is considered short term. We need an energy policy — how much thermal should we use, how much hydro. And I think we should even at least also look at nuclear.

Twenty-five years ago we had a very clear four-fuel policy. Now it is not as clear.

(We must also decide) how do we price electricity for example, whether some part of it is a fuel pass-through. We've been working on this.

That could be the reason for the low PEs Tenaga has.
Agreed. The whole regulatory framework is not entirely clear. We had a good framework under the Electricity Supply Act and the Grid Code.

If you look at this whole thing... in a lot of countries, it is the norm that a lot of long-term contracts get renegotiated. In some cases, they have charged windfall taxes, not necessarily in the power sector.

If Tenaga is struggling... this year we made RM4-odd billion; we still have to raise another couple of billion because the cash flow is minus RM2 billion. Previously, Tenaga was making RM1.5 billion to RM2 billion. That is why we are tracking economic profit rather than just accounting profit. In terms of economic profit (which imputes a capital cost), Tenaga is still negative.

The return on capital invested should be higher for Tenaga.
Should be higher but at the same time the IPPs are money-making machines, which is great, they are efficient, I am sure. However, is this a sustainable industry when it is so lopsided? And of course Petronas is also (subsidising) and these resources are depleting. And if they are not recovering an economic return against

CONTINUES ON PAGE 90

‘There will be greater visibility’

FROM PAGE 88

the market price, for example…. On top of that recognise also the pricing effects of certain industries. In the 1980s when were looking at FDIs of a certain nature, typically energy hungry, relatively low value add…our industrial rate (for electricity) is still among the lowest in the region. I don’t know why we are subsidising US consumers or foreign labour. These are quite fundamental questions.

Wasn’t Tenaga interested in owning Bakun?
He laughs… The decision has been made, no need to talk lah.

Okay, there are going to be more hydro plants in the Sarawak. Will Tenaga look at those?
That is a space which Tenaga has a lot of skill and experience… the Kenyir Dam, the Pergau Dam…

Was it a balance sheet problem? Was that why Tenaga did not take Bakun?
We have spent the last few years cleaning up Tenaga’s balance sheet and it’s not just tariff increase, it’s also capital management. Now they can and should be looking at some of their traditional space like hydro. This will link to our long-run energy policy, including the use of renewables and the whole Rejang Valley, we should be looking at that. As well as overseas. I think they have earned the right now to go out there and look and carefully choose and rationalise. We went in a fairly measured way into Saudi. That was one of the largest infra projects in the Middle East. And they are doing very well. India is power hungry.

Certainly in traditional areas we will ask for the right to bid. It would make sense for Tenaga if it is capable to bid. But… Bakun was not really on our radar.

Rationalising banking

What’s happening with the Bank Niaga Lippo Bank merger?
We have time to comply, the deadline is by 2010. In the meantime, we are seeking some clarification on regulatory compliance. But it is a good fit, in theory, our two banks. There are no issues. We will make the necessary statements at the right time, as we always do.

On the domestic front, the GLICs have several banks under them. Any move to rationalise within the sector?
The current and next phase (of rationalisation) is all ready and will be market-driven. It should not be discounted if we want regional champions but it will be market-driven.

IDR on target

What is happening at Iskandar Development Region?
We launched this about a year ago and bear in mind that this is a 20-year plan. What was 2007 about? This was the year that we needed to mobilise and have several key deliverables. Number one was we had to create IRDA and the Act was passed through in record time, six months. That was around February. On the investment side, the plan calls for US$105 billion (about RM348 billion) over 20 years. Roughly about half of that is beyond the normal numbers because we are not talking about completely greenfield areas. IDR has and continues to receive investments. So roughly half of US$105 billion (US$50 plus billion) is the incremental investment required.

So, what we report in our projections is, without any intervention of IDR the growth rate would be about 6%. With intervention we are predicting 8%. Two percentage points GDP growth compounded over 20 years is a lot.

Recognise that in August one major deliverable was achieved, to anchor the first wave of investment.

The three Gulf-based investors from Abu Dhabi, Kuwait and Saudi-based investors announced the original investment of US$1.2 billion. We can now inform that the gross development value (GDV) of the area is estimated at 10 times that, US$12 billion.

If you recognise that Iskandar needs an additional US$50-odd billion over 20 years, in August we secured about a quarter of that in one deal.

To do that, you needed to make sure that the incentive and support package (was in place). This is demand-led, so we are structuring this area of 100 million sq ft, 2,200 acres, as a 99- year lease. After 99 years it reverts to us. There are three clocks that are ticking. One is the 99-year lease. Two, we’ve given certain incentives that you need to roll out within a certain number of years in order to obtain the (incentives). If not, there are certain options where we can go back and buy. The third clock is, you must make profits within a certain period to enjoy certain tax breaks.

We scanned over to see who has built a city in the fastest time. Dubai. Not a coincidence that the model we are using is, after studying the Dubai model, 99-year lease, 100 million sq ft, the Gulf-based investors are familiar with it. Of course, there is a lot of liquidity in the Gulf, in Dubai, Abu Dhabi and these are bluechip investors that have well-established direct links to the Fortune 500 Firms because they have brought them to places like Dubai. They are already on their client roster, so they can and they will bring it to IDR.

The whole package of IDR has the incentive support package and the social development track intertwined, and both necessary conditions for success. The Mid-East investors are used to a zero income tax environment although they have high indirect taxes. So, we have structured the package (with this in mind). They and other foreign investors also are not familiar with, say, low-cost housing and FIC requirements. What they do understand is that the land cost is cheap, anything between 30 and 50 times cheaper than Singapore and 20 to 30 to 50 times cheaper than Dubai. So, they said ‘fine, I’ll give you an extra so many ringgit per sq ft’ and this goes to the Social Development fund. The pool of money can be quite successful and it must be managed carefully. We will make sure there is (viable) public housing (as opposed to low-cost clusters) or community colleges. This is the new template we are using to develop the region and it will be a new template potentially for the country.

The first US$1.2 billion was for the land?
It was for the land and certain basic infrastructure. This was one major deliverable this year. These (investors) are committed, they are the bluest of blue chips from the Gulf. We are also working on various other key catalyst developments, including a proposed theme park and investors from other key geographies, including China, India, Indonesia and of course Singapore. There is also of course ample and great spin-off benefits to local players of all sizes.

Also recognise that we are bringing in industries, which are net additions to the economy. If you are currently located somewhere else and servicing the region, we will give you tax breaks to relocate here. This is net additions to the economy. If you are a local company and you are doing business in the region, then you will get the same tax breaks. The consortium of three, and the SJIC is also a shareholder, can sell down to the next layer in nine sectors that have been identified. This is our template.

We have to be mindful of supply and demand balance and we will be very mindful of over-supply.

PATRICK GOH/THE EDGE

Another major deliverable during the year was the whole engagement with Singapore. The economic logic of this place has to work within the regional context of how we work together with Singapore. We started with the meeting with the two Prime Ministers. Subsequent to that, the joint ministerial committee has identified areas which can be of mutual benefit, in this case, Smartcard, common CIQ and potential MRT and transportation links. There are many other areas, but this is the first.

How close are you to achieving the first three benefits?
I’m not on the committee per se although we do work at the working level quite extensively. It’s quite encouraging; considerable progress has been made in the last one year.

Is there any collaboration between others in the area such as PTP (Port of Tanjung Pelepas) and SJIC (South Johore Investment Corp)?
Yes, there are. They go on joint marketing. PTP has been very successful and they need more land. There is a fair amount of rationalisation between the parties there, not just PTP.

For us, 2007 was the mobilisation year. A lot of input is going in and some early output is coming out; the new template on how to do your incentive package, the Social Development track.

Will 2008 be the year when you get the big signature? There is a feeling that if you don’t get this in 2008, IDR will fade into obscurity.
Yes, 2008 will be when we are clearing and building the roads; some of the new investments will be coming in the first half. There will be greater visibility. Actually, a year or so out for a project of this scale is actually quite fast mobilisation but yes, naturally, expectations are high.

Going international

On the international level you seem to have gone quiet.
We also see international as bringing people to IDR, for example. Actually, we have been, I would say, moderately active — we are, for example, the joint largest shareholder in Asia Capital Reinsurance with 32%. It’s a reinsurance company with a regional footprint. It’s a start-up that immediately got an A-rating.

What’s your investment in this?
US$200 million. It’s a start-up with a very established management team from Swiss Re.

We also have a 9.9% stake in Infrastructure Development Finance Corp, we are the second largest shareholder, the government of India is the largest. It has a business model that in some ways is not unlike Macquarie Bank’s infrastructure franchise. India has a huge appetite for infrastructure and this is a good vantage point for infrastructure development in India. We invested US$230 million.

The stars next year

What do you think will be your star GLC performers for next year?
This year was the stock-take year for the G-20. Some (of the companies) are already evolving, some of this you can already see, for example, Regionco (TM’s mobile side which is to be demerged from TM). Now, 55% of the business is Malaysian. Very soon, it will be 40% or 30%. This will be a regional company headquartered in Malaysia. The DNA of this company will need to and can change quite significantly for the better. CIMB is already on that path.

MAS, as we discussed just now, will move from survival mode to growth mode. And within that growth mode, they will come into a position of some significance to be among the leaders and we are working out how they will collaborate and work with other major players, for example, in a world of shifting alliances.

In the case of Tenaga, a lot of it will depend on whether we are able to work through the regulations to make sure that we have a sustainable industry. For Tenaga to move to the next level, we have to (do this) and then that will allow them to move to the next level to renewables, such as hydro and into other geographies. If you are moving to other geographies, there are several models. You can own, you can operate, you can do just the technical side. Some of our companies such as Malaysia Airports, because their balance sheet is not solved yet, their financial restructuring is not yet complete. When they go out, they have an asset that is recognised internationally and they manage that. They go out, we’re in Istanbul, we’re in Hyderabad, we’re in Khazakstan, we’re in Delhi. In some cases, we can’t own because the balance sheet cannot take it yet. We do own (in some cases) but we also operate and provide the technical skills.

Thematically, we spent the last years to turn around, clean up and stabilise returns. The next generation is to take them into a position of growth and leadership. At the end of 10 years, our plan is to have several regional champions. By definition even now and definitely then, to be regional champions, you have to be world-class. We’re about one-third way through and as we had submitted earlier this week, the state of the GLC programme is on track and it is strong. E