

TOPIC 19 - DIVERSIFICATION INTO RENEWABLE ENERGY BY LISTED COMPANIES

It is estimated that in Malaysia, we have approximately 30,000 MW of installed capacity of which 81% are powered by gas, coal and diesel. The balance 19% are powered by renewable sources.

In recent years, a few listed companies have diversified into renewable energy (**RE**) business namely solar, mini-hydro and biogas to take advantage of earning concession revenue income from the Feed-in Tariff (**FiT**) system in Malaysia.

DIVERSIFICATION PROVIDES A STABILITY OF REVENUE THAT COULD BE AGGREGATED INTO THE REVENUE FROM EXISTING BUSINESS OF THE LISTED COMPANY

So, what is the main reason for such listed companies diversifying into RE or creating a division in investing into RE sector? The main purpose is that this may allow such listed companies to report the concession revenue during the concession period. In a way, the concession revenue will provide a form of hedge against their other business which may generate higher returns but exposed to the typical business risks.

Each RE type provides different rates of return. In this article, I wish to share the returns from various renewable energy types in Malaysia as analysed from some published information obtained by going through public announcements

BUSINESS MODEL

First of all, there are few models of RE business, which are

- i. as a project owner of RE plant,
- ii. acting as a contractor for setting up a RE plant (**EPCC**), and
- iii. project owner and also acting as a contractor

A project owner earns income from recurrent sales of power generated from the RE plant to electricity distributor like Tenaga Nasional Berhad (**TNB**) and Sabah Electricity Sdn. Bhd. (**SESB**), where the revenue is dependent on the size of plants owned and the FiT rate. Profit from each RE plant, will be realised over time after commencement. Sustainability is reasonably certain as the duration of RE power purchase agreement (REPPA) is 21 years both for solar PV and minihydro and 16 years for biogas and biomass.

An EPCC contractor earns income from construction and commissioning of an RE plant, where the income is based on project basis. Profit from each project is realised once the project is completed in one to three years. Sustainability is subjected to ability to get more EPCC job in future. However, the benefit of this model is that the financing period is short as EPCC contractor shall get payment once the project is completed.

VENTURING INTO SOLAR AND MINI HYDRO PROVIDES STABILITY OF REVENUE BUT WITH A SACRIFISE AS IT IS LIKELY THAT IT DOES NOT CONTRIBUTE MUCH NET CASH FLOW DURING THE LOAN PERIOD

- i. From the table, we can see that the payback period for solar and mini hydro project is on average above 9 years, for solar and mini hydro. Hence, if the projects are funded by debt, we shall not expect much contribution in the free cash flow during the loan repayment period.
- ii. From analysis, we noticed that the payback is fastest for Biogas.

Payback Period (year) ⁽³⁾					
	1-2	3-4	5-6	7-8	9 and above
Solar PV					
Minihydro					
Biogas					

Notes:
 1. Computed by dividing construction cost by estimated annual revenue.

Prepared by Asia Equity Research

EXAMPLES OF COMPANY DIVERSIFIED INTO RE AND PAYING A PREMIUM TO GAIN IMMEDIATE ACCESS INTO THE BUSINESS

Pasukhas Group Berhad (Pasukhas)

Pasukhas whose core business is specified industries and civil contractor business (covering designing, system integration, fabrication, installation, construction, testing and commissioning of electrical and mechanical works) had diversified into renewable energy by acquiring a company with completed 2.8 MW annual capacity (3.2 MW installed capacity) mini hydro power plant at Sungai Rek, Kelantan. Total purchase consideration for the entire deal was approximately RM 27 million, funded by private placement and rights issue. This works out to be approximately RM 10 million per MW, on the higher end range compared with a newly constructed power plant.

Probably, the incentive for such action is that this shall provide an immediate and quick entry into the business, as we know that securing a power purchase agreement requires considerable amount of time.

Mudajaya Group Berhad (Mudajaya)

Mudajaya whose core business segments of engineering, procurement, construction, commissioning (EPCC), property management and trading & manufacturing had diversified into renewable energy by acquiring a company awarded for a 10MW solar PV project at Gebeng, Pahang. Total purchase consideration for the entire deal was approximately RM 15 million for a 60% equity stake in the company. This works out approximately RM 2.5 million per MW paid as premium for the project. This works out to be premium of approximately RM 2.5 million per MW but as the entry was made during the time when the solar rate was high, it still works out to be profitable venture.

HOW FINANCIAL STRATEGY COULD AFFECT THE RETURN OF EQUITY

In my opinion, the method of financing the RE business will affect the key financial returns as illustrated below: -

- i. If the listed companies' priority of venturing into RE is to **get stability in future revenue and profit**, they are likely to finance the construction cost via private placement or rights issue. This will provide reported revenue, profits and cash flow but it comes with a sacrifice in dilution of equity shares by the promoters and **lower return of equity** (i.e. which may mean a sacrifice in share price)
- ii. If the listed companies' priority of venturing into RE is to **maximise return of equity**, then **maximizing debt financing** should be the priority. Essentially, the listed company shall maximize the positive difference between the yield from the RE plant compared with the funding cost.

CONCLUSION

As the main priority of any listed company is to maximize shareholders' value, I would foresee the follows: -

- i. More companies will try to venture into biogas or biomass as it provides the highest return at the moment relative to solar PV and minihydro.
- ii. The industry trend is moving towards to more companies aggregating the size and quantity of their power plants so that debt instruments such as sukuk and bonds could be used to fund their power plants to maximize the return of equity.

The author wishes to declare that the author and Asia Equity Research do not have any share ownership in any of the companies discussed prior to this and until current date. This article is prepared by Ong Tee Chin, CFA, FRM, and represents the view of the author. He can be contacted at general@aer.global for any further enquiries on the contents of this article.