# A Tussle Over Power Profits

## The independents make life tough for Tenaga

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ON SEPT. 29, 1992, life came to a standstill across most of peninsular Malaysia when a bolt of lightning struck a key power junction in the national grid. The blackout shut down factories, computers and traffic lights, prompting a fierce public outcry and threats of lawsuits against Tenaga Nasional, at that time the state-owned power monopoly. An inquiry cleared Tenaga of negligence but found that it had failed to maintain a reserve margin of power to deal with a surge in demand.

The finding damaged Tenaga's reputation but it was a blessing for Malaysia's independent power producers (IPPs). To keep pace with the goal of making Malaysia a developed nation by 2020, the government accelerated its efforts to privatize the power sector. It also allowed Tenaga to raise money on the Kuala Lumpur stock exchange. But it wasn't long before things again went awry for Tenaga. In June 1995, a fire destroyed three of its transmission cables to Penang virtually crippling the island for 20 days.

Now, thanks to the IPPs all that is a thing of the past. Altogether, 12 independents have been awarded licenses so far and five of them are in operation. They provide about 30% of the peninsula's power; the rest is produced by Tenaga, which is the peninsula's sole distributor of electricity. How can they meet Malaysia's future power demands?

Enter IPP Bakun. The $6-billion dam project, located in Sarawak State, has the go-ahead from the government and is likely to be generating electricity by 2002 as targeted, despite an environmentalists' court action. The 2,400-megawatt dam, the country's largest-ever power scheme, will be built by a local and international consortium, including the Swiss-Swedish engineering giant ABB Asea Brown Boveri Ltd. Bakun will be developed and operated by Ekran Bhd., owned by Sarawak tycoon Ting Pek Khiing.

Tenaga is to buy 70% of the electricity generated by Bakun, transmitting it to the peninsula through the world's longest underwater electrical cable. During the first five years, Tenaga will buy the power from Bakun for about 6.6 U.S. cents per kilowatt-hour (kwh) - the highest sum paid to any IPP so far. The rate will rise to nearly 6.8 cents per kwh for the remaining 25 years during which Ekran will operate and manage the dam.

Until the turn of the century, the peninsula is slated to produce more electricity than it will consume. This year, for example, total capacity is 10,110 megawatts and peak demand 7,063 megawatts - a comfortable 43% reserve margin. Although the government has warned that reserve margins will shrink drastically from 2000 to 2005, the shortfall is likely to be made up by the Bakun project and the Segari Energy Ventures power project, which became operational on July 1.

Tenaga has big plans for the transmission and distribution of power in the peninsula. It expects to build 146 substations at a cost of some $2.8 billion by 2000. Says Tenaga executive chairman Ani Arope: "Our concerns are to further improve the quality and reliability of supply and to be able to cater to the needs of new customers."

Can Tenaga achieve its aim? Its earnings have been eroded by increasing competition from IPPs. Also, it was forced by the government to buy power from five of the biggest IPPs at rates higher than its own production cost. Tenaga is able to generate electricity at an average of just 3.4 cents per kwh because, unlike the new IPPs, many of its plants are fully depreciated. But in order to meet demand, Tenaga has to buy power from the five IPPs for 5.4 cents to 6.2 cents per kwh.

Further, Tenaga is obliged to buy up to 72% of the power generated by YTL Corp., one of the two biggest IPPs, even if the power is not distributed. YTL managed to secure a lucrative 21-year take-or-pay deal as it was the first IPP in Malaysia and also because the firm's managing director, Francis Yeoh, is a tough negotiator known to be close to the prime minister. The four other IPPs that have agreements with Tenaga are paid only for the electricity that is distributed. Still, the utility is required to pay them a capacity charge, which is compensation for the fixed costs of power generation.

Tenaga is clearly unhappy about the power-sale contracts but it can do nothing legally to rescind them. "Both sides must be able to establish a willing buyer, willing seller relationship," says Ani. "If we don't have that, it would be very difficult to work together." In recent months, Tenaga has been acting tough. It twice rejected power-sale agreement offers by Ekran because it felt they were too high.

"IPPs have taken a toll on Tenaga's profits," says Teoh Kok Lin, an analyst at James Capel & Co. In April 1995, the government rejected Tenaga's request for an automatic tariff hike on consumers based on a formula involving several factors, including inflation. The request was rejected apparently because it came just after national elections and stirred public resentment. As a result, Tenaga's pre-tax profits in fiscal 1995 dipped to $654 million from $792 million the year before.

In March, however, the government approved an 8.3% tariff increase on power consumers across the peninsula, hiking the average price from 8.2 cents to 8.7 cents per kwh. But the increase still fell short of the average 9 cents per kwh that Tenaga had requested. The new tariffs are expected to boost Tenaga's turnover beyond $3 billion this year, up from $2.74 billion in 1995. Still, Tenaga's stock on the Kuala Lumpur exchange has fallen by half over the past two years. After a high of $8.28 in 1994, it is valued now at just over $4.

"There's no way in the near term that Tenaga will be able to catch up with IPPs in profitability," says Lee Kang Lin, an analyst at Arab-Malaysian Securities. "While the stock market index has gone up by more than 30%, Tenaga has only managed about 10%." Meantime, stocks of IPPs are surging because investors are attracted by the firms' lucrative power-sale agreements. A 15% investment return is expected.

How justified are Tenaga's grievances against IPPs? Analysts say that even if the utility had built and controlled all the IPPs, the cost of power production would have remained more or less the same. YTL's Yeoh challenges the widespread impression that he got a sweet deal from the government. "The reverse is also true," he says. "If we cannot produce the power, we'll have to pay Tenaga. People always think that we squeezed Tenaga, but I think Tenaga has the best deal."

Tenaga is clearly the biggest player in a field where demand for power is increasing by 14% to 15% annually and fresh competitors are unlikely until 2000. Says Hisham Hamdan of Peregrine Research: "Tenaga's earnings will generally be poor in the short-term but the downside is limited." IPPs may make hay while the sun shines but in the long run the utility giant could well come up trumps.