Gunung banking on mini-hydro projects in Perak

BY ISABELLE FRANCIS

Gunung Capital Bhd, which derives the bulk of its income from transporting National Service trainees, is going into mini-hydro projects — deemed an uncharted territory for many local public-listed companies — in a big way.

For a start, the group is investing RM200 million in two mini-hydro projects in Perak that have an installed capacity of 10MW each. The investment will be funded by the issuance of sukuk via Gunung Hydro Sdn Bhd (GHSB), which was established last September as a 70:30 joint venture (JV) between Gunung and Perak Hydro Renewable Energy Corp Sdn Bhd (PHREC) to develop the mini-hydro projects.

Gunung executive chairman and CEO Datuk Syed Abu Hussin Hafiz Syed Abdul Fasal believes the projects are bankable, thanks to the upward revision in the industry's feed-in tariff (FIT) rate to 24 sen per kWh that will provide an internal rate of return (IRR) of 14%.

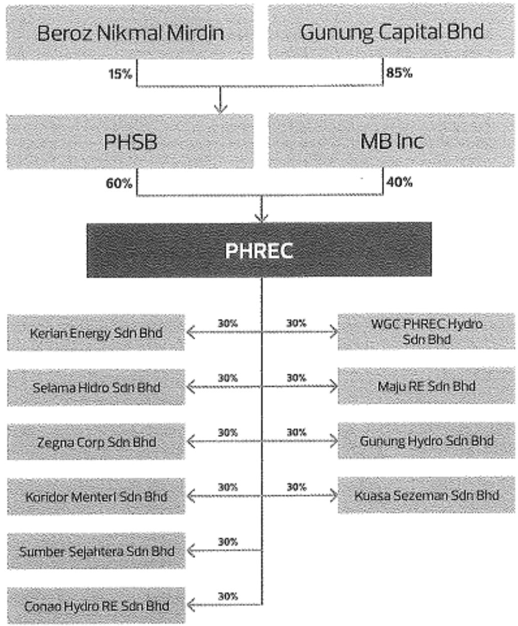
"Before the SEDA (Sustainable Energy Development Authority) Act was enacted in 2011, the mini-hydro business was not viable, given its IRR of 10% and below. This explains why it was progressing so slowly in this country," Syed tells The Edge in a recent interview.

Syed: Gunung was looking for a long-term concession. So we approached the Perak government and they referred us to Perak Hydro Renewable Energy Corp.

According to him, prior to the Act, which determines the FIT for renewable energy such as solar and hydro, Tenaga Nasional Bhd was paying only about 17 sen per kWh for power generated by mini-hydro dams.

"Before SEDA, it was very difficult to make a business case and to raise financing. But with the FIT in place, it makes more sense because of the higher IRR," Syed points out.

Group structure



In fact, Gunung tightened its grip on the business last month by acquiring an 85% stake in Pusaka Hijau Sdn Bhd (PHSB) — which in turn owns 60% of PHREC — for RM9 million. The Perak government owns the remaining 40% in PHREC.

The rationale for Gunung's investment in PHREC is the latter's exclusive water rights agreement to build, operate and own 25 mini-hydro dams with an estimated combined installed capacity of 176MW for 21 years in the state. So far, PHREC has established 10 JVs involving 10 hydro dams (see chart).

"Gunung was looking for a long-term concession. So we approached the Perak government and they referred us to PHREC," explains Syed.

He expects the two mini-hydro projects to generate cash by 2016 and estimates their annual revenue at RM16.7 million and cash flow at RM8 million based on the company's initial investment of RM200 million. The concession is for 21 years.

Syed says Gunung is also looking at acquiring 100% ownership of a few greenfield projects, which are expected to contribute an additional installed capacity of 57MW. Eventually, the company plans to have access to some 240MW of hydropower in Perak.

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Business model the same as that of first generation IPPs

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Financing a non-issue

The common perception is that hydro dam projects require heavy initial capital outlay. The Bakun Hydroelectric Dam in Sarawak, which was built at a cost of RM7.4 billion, comes to mind. This is perhaps why investors tend to shy away from such investments.

In Perak's case, the cost of developing its mini-hydro projects with an estimated combined installed capacity of 240MW could be as much as RM2.4 billion based on an average cost of RM10 million per MW.

However, PHREC managing director Beroz Nikmal Mirdin maintains that the business is viable in Perak. "A lot of the identified sites are already making money," he says.

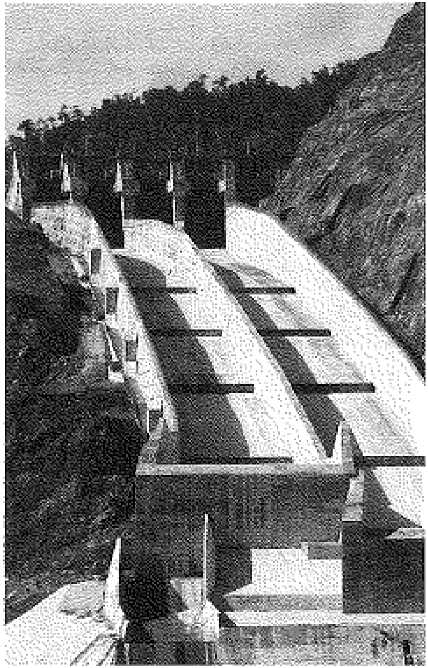
Beroz, who owns 15% of Pusaka Hijau, was vice-president of investments at Khazanah Nasional Bhd and was instrumental in setting up MyPower, a government agency tasked with improving the efficiency of the power industry. He was also chief engineer at Tenaga and on several ad-hoc committees, including the Bakun technical team.

Meanwhile, Gunung's executive director Iskandar Ibrahim says financing for the projects is a non-issue because, for one, the group only has to fork out 15% of the total cost of constructing the hydro plants.

Financiers would also be comforted by the fact that Gunung's mini-hydro business model is similar to that of a first-generation independent power producer, where Tenaga must take up all the capacity generated by the power plant.

"Gunung's cost will be RM200 million [for the two first sites] and another RM330 million for other sites based on its effective interest of 15% in the respective JV companies," remarks Iskandar.

ABDUL GHANI ISMAIL/THE EDGE



Investors shy away from investing in hydropower dams because of the heavy capital outlay. Bakun dam was built at a cost of RM7.4 billion.

"We are confident that our JV partners, that is the operators, can secure financing because they have signed PPAs (power purchase agreements) with Tenaga."

Although only seven of Gunung's JVs or associates with an estimated installed capacity of 58MW have secured FIT approval and PPAs, Iskandar says it is only a matter of time before the rest secure theirs.

The fact that RM100 million of GHSB's sukuk is to be subscribed for by the arranging investment bank is perhaps an indication that financiers are receptive to such investments. Gunung and other institutions will take up the remaining RM100 million of the sukuk, according to Iskandar.

"We already have support letters from a bank for the RM200 million. Everything has been completed and the financing has been arranged. The only thing outstanding is a power system study to be submitted to Tenaga," says Ibrahim.

Moving forward, the mini-hydro business will be Gunung's core business, although it will still be involved in transport.

According to Syed, the company has reaped RM12 million in profit a year from transporting National Service trainees since 2011. However, its agreement with the government is up for renewal next year.

"We are definitely looking forward to negotiating a renewal," remarks Syed.

In FY2012 ended Dec 31, Gunung posted a net profit of RM13.67 million or 12.47 sen a share on the back of RM79 million in revenue. Cash generated from operations was RM26.66 million.

In the quarter ended June 30, net profit was RM4.83 million on revenue of RM23.49 million while net cash flow from operations was RM13.06 million.

The mini-hydro projects will indeed greatly transform the group, which had moved away from trading latex concentrates in 2010. E