

Trouble in MENA

by Michelle Teo

Popular uprisings in the Middle East and North Africa have turned an area brimming with opportunity for companies such as Hyflux, Boustead and Rotary Engineering into a very risky place. How badly are they affected? And, how are they reacting?

Olivia Lum doesn't seem at all concerned about the battering Hyflux's shares have suffered recently when she turns up for the company's results briefing. Hyflux has lost about 12% of its market value, or some \$240 million, in a mere fortnight on worsening turmoil in Libya that could put its US\$100 million (\$127 million) seawater-desalination plant in Tobruk in jeopardy, and derail negotiations for two other desalination projects in Tripoli and Benghazi worth some \$1 billion. When the founder and CEO of Hyflux takes the microphone, she reveals the reason for her nonchalance.

Hyflux has zero exposure to Libya, she says. The proposed desalination plants in Tripoli and Benghazi haven't actually been awarded, while the Tobruk plant was only secured in November. "We're in the midst of signing the final contract to start work. Fortunately, or unfortunately, we have not started work. So, we have no investment in Libya." Located in the east of Libya, Tobruk is among the cities that have slipped from the grasp of Muammar Gaddafi, the strongman who seized power four decades ago. "Together with the two big projects under negotiation, it is definitely going to be delayed," Lum says.

The irony isn't lost on analysts and reporters who have been following Hyflux's progress in the Middle East and North Africa (MENA) region. The company has two major projects in neighbouring Algeria, including the world's largest seawater-desalination plant at Magtaa, which it secured in 2008. Since then, it has struggled to come up with the second act for its expansion in the region. In 2009, it seemed to have hit pay dirt with negotiations getting off the ground for the desalination plants in Libya. But, nothing came of the talks for months. Eventually, Hyflux secured the

smaller project in Tobruk. It was to have been the harbinger of greater things to come in Libya. Now, it looks like a bullet that Hyflux was lucky to have dodged.

As for the projects in Algeria, which are nearing completion, Lum is careful to temper expectations. So far, there haven't been demonstrations or riots and the government is stable. "Our side is not affected at all, and we still have a lot of people travelling there, including Sam Ong," Lum says, referring to Hyflux's deputy CEO, who was scheduled to leave for Algeria the day after the Feb 23 briefing. Instead of emphasising the headline value of these two projects of roughly US\$700 million, Lum stresses that Hyflux's investment is only about \$60 million, with the rest of the financing coming from Algeria-based lenders.

Yet, even amid all the social and political turmoil, Lum still can't resist sounding a little hopeful about the prospects for Hyflux in the MENA region. "No government will want to mess around with water," she tells *The Edge Singapore*. "It's very natural that whichever government comes along, this is going to be the right infrastructure they should focus on. Every government wants affordable water."

Hyflux is just one of a number of Singapore companies that have used MENA as a springboard for fast growth. For a few years now, the region has been attracting significant foreign investment and companies that market their expertise in developmental infrastructure such as water and waste-treatment facilities, or that are eager to tap the booming oil-and-petrochemicals industry. And, like Hyflux, other companies that have ventured into the region are now discovering the risks that come with the opportunities.

Infrastructure engineering company **Boustead Singapore** spent last week trying to get all its foreign staff in Libya out and home safely. The company announced soon after the unrest started the evacuation from the country, where it is in a joint venture with a Libyan government-owned construction company to build a township in Al Marj, east of the capital, Tripoli. The project was announced in August 2007 and DBS Vickers estimates that

Boustead still has some \$200 million of contract value unrecognised.

Late last year, **Boustead** restructured the JV from its initial 65% stake to 35% when it became clear that the project was going to be a drag, slowed by political red tape and delayed payments. The company reported a net loss of \$1.1 million from the project in its 3QFY2011 results, and said it would no longer recognise revenue or profits from the project.

It is unclear at this point if the township will be completed, although the onus is now on the majority JV partner, General Construction and Building Co, which will also be putting up any funds that are needed.

Keith Chu, vice-president for corporate marketing and investor relations at **Boustead**, says the company may have to make additional provisions in the future, but adds that any impact cannot be calculated at this point, owing to the volatility of the situation. DBS analyst Yeo Kee Yan expects earnings impact from the MENA crisis to be minimal.

Over in the oil-and-petrochemicals sector, oil-tanking specialist Rotary Engineering has also been in the spotlight for its work in the Middle East. It is building a refinery tank farm in Jubail, Saudi Arabia, and recently scored a win in Fujairah, one of the emirates making up the UAE. Together, the two countries make up 91% of its current order book of \$922.3 million, the bulk of which is from Saudi Arabia. The Jubail project also contributed about 65% of revenue, or nearly \$458 million, for FY2010.

Chia Kim Piow, chairman and managing director of Rotary, says the likelihood of civil unrest seems remote for now, especially since the Saudi government pledged to spend billions of dollars on improving education, infrastructure and healthcare in the country. On the other hand, the fact that protests, political parties and labour unions are banned in the oil-rich kingdom makes it hard to gauge popular discontent. At any rate, Chia figures the projects that Rotary is undertaking in Saudi Arabia are too important for the country to shelve. "It's such a big project," he says, referring to Saudi Aramco TOTAL Refining and Petrochemical Co's Jubail refinery project that's worth an estimated US\$10 billion. "They are more concerned than us to carry on with the job."

Bigger players more diversified

The MENA region has also been a magnet for investment from some of Singapore's bigger companies. For instance, Sembcorp Industries owns 60% of the roughly US\$1 billion Salalah independent water and power plant in Oman,

which is due to be completed and operational next year. There's also a 15-year contract to supply water and power from the facility to the Omani government. In the UAE, Sembcorp owns 40% of the US\$1.7 billion Fujairah independent water and power plant, which is already operational and supplies power and water on a fixed-price basis. "Traditionally relatively stable countries, they have so far not been affected by the recent instability in the Middle East. Nonetheless, we continue to monitor the situation in the region," says a company spokesman.

CIMB Research analyst Lim Siew Khee notes that MENA contributes 10% to Sembcorp's utility earnings. She believes the UAE and Oman are not expected to see a regime change, given the large foreign population in the former and loyalty to the monarch in the latter. However, "any regime change could result in loss of control of the independent water and power plants and affect group earnings", she cautions.

Elsewhere, Keppel Corp has \$3.2 billion worth of wastewater- and solid-waste-treatment facilities in Qatar under its infrastructure division. Keppel will operate and maintain the facilities for 10 and 20 years, respectively. Also in Qatar, Keppel Offshore & Marine has a shipyard facility jointly developed with the Qatar Gas Transport Co. The offshore and marine division also has an associate company that does shipbuilding, conversions and repairs in the UAE.

Meanwhile, the group's property unit, Keppel Land, is in a JV with Saudi Economic and Development Co to develop luxury seafront residences in the Red Sea city of Jeddah in Saudi Arabia. The project is expected to cost some SAR3 billion (\$1 billion).

DBS notes that any impact on Keppel from the unrest, in the case of the wastewater- and solid-waste-treatment facilities, will be minimal, as the company had already provided for losses and cost overruns last year owing to delays. At the same time, the infrastructure division is still a small unit, and contributions to profits are less than 5%. From the company's perspective, a Keppel spokesman would only say that it "has business continuity plans in all the countries where we operate".

Elsewhere, CapitaLand has been forced to write off \$59.1 million on its Raffles City Bahrain project for FY2010. "We decided to freeze the project in Bahrain at the foundation level and our four staff there are safe," says chief financial officer Olivier Lim. Meanwhile, wholly owned subsidiary The Ascott Group only manages and does not own properties in the Middle East, including in Bahrain, Qatar and

the UAE. The region only contributed about 3% of The Ascott Group's FY2010 revenues of \$749 million.

Are heavyweights like Keppel, Sembcorp and CapitaLand better able to navigate the troubled MENA region than their mid-sized peers? Analysts say it isn't a company's size but the proportion of its exposure that counts. "Even if you have deep pockets, if 80% of your projects are there, you can stay put and not generate any growth, and just stagnate," says DBS Vickers' Tan Ai Teng, who tracks Sembcorp, Hyflux, **Boustead** and Sound Global. "When things are not that great in MENA, you must have other growth angles to go forward." Tan points out that with their diversified businesses, companies like Sembcorp and **Boustead** have other business lines that will help cushion the impact of any failure in MENA.

With the situation in MENA still uncertain, diversification counts more than ever now. "Uncertainty is the issue here," stresses DMG & Partners' Selena Leong. "The dangerous part about this is that it's very contagious and you never know - even if a government steps down peacefully and a new one takes over, you still have the issue of political uncertainty. What if they change policies?" Leong adds that companies run the risk of work stoppage and the region becoming bad for business should the unrest spread. "Saudi Arabia is lucky because it's rich, but so is Bahrain," she says. "But, at the end of the day, business is about risk. As long as you know the company is in good hands, they are aware of the risks and actively managing it, that's the most you can expect."

Weighing their options

What are companies exposed to the MENA region planning to do next? Chia of Rotary maintains that the region is still a key market for his company, and he isn't about to abandon the opportunities there, although he's definitely going to be more cautious. "We are already very selective. We're going to neutral places - Saudi Arabia, the UAE," he says. "You've got to be there. Mitigating risks doesn't mean you don't do anything." CIMB analyst Yeo Zhi Bin, is keeping his "outperform" call on Rotary with a price target of \$1.28, based on nine times FY2012 earnings, although he acknowledges that, should the unrest spill over to Saudi Arabia or the UAE, "the stock stands to lose".

Boustead plans to be more careful about any investment opportunities in MENA in the future. It still has ongoing projects in the region, albeit in relatively calmer places, including building a \$21 million water-recycling

plant in Abu Dhabi. However, these are done on a turnkey basis, meaning that **Boustead** is paid progressively as each stage is completed. **Boustead's** Chu adds that, since the company is technically a subcontractor under the major MNCs, should work be halted, it would still have to be compensated for work done.

Boustead also says it has been refocusing on business development in Asia-Pacific since the credit crunch hit two years ago, although it still has up to 15% of its revenues from the MENA region. Still, the turn of events in Libya and elsewhere undoubtedly came as a surprise. Chu concedes that the firm "would certainly have to re-assess any major business development opportunities in that region and will only take up future contracts in countries which we see as economically and politically stable, and through a turnkey engineering contract".

As for Hyflux, Lum says the company has been refocusing on Asia, particularly China, where it has built up a good track record in the area of build-operate-transfer (BOT) water- and wastewater-treatment facilities for both municipal and industrial use. In fact, Hyflux had announced a slew of new projects in China totalling US\$76 million in recent weeks.

The company stopped taking on new projects in China for a while because China's BOT projects are often too small for project financing, and having too many of them pressured the company's balance sheet. As such, Hyflux wanted to develop a robust funding structure before taking on new projects. "We stopped for a while only for municipal investments, but business development is always there," Lum explains. Now, Hyflux has tied up with Japanese financial institutions such as JBIC, JGC and Mitsui as backers and is ready to push farther into China. "Because of this fluid situation in MENA, we will want to look at China even more intensely," she says.

Still, Hyflux has no plans to pull out of MENA, Lum adds, noting that it's still one of the key emerging markets that hold significant opportunities for the company. The region contributed 60% of revenue for FY2010, which was 9% higher y-o-y at \$569.7 million, resulting in 18% more earnings that total \$88.5 million. "When we first went to China, everybody said it was a risky market, but today, everybody says it's the best market," she says.

Analysts aren't as sanguine as Lum, though. While failing to get its projects in Libya off the ground quickly may have been a blessing in disguise, the company will now have to work harder to replenish its order book, as the more

than \$1 billion worth of projects are not likely to materialise. Kim Eng has downgraded the stock to a "sell", with a price target of \$1.59 to account for a higher risk premium, and because its FY2010 results were below expectations.

But, CIMB analyst Gary Ng maintains his "outperform" call on Hyflux, with a price target of \$2.71. "We believe its sell-down in recent days is overdone, considering the group has made it clear it is beefing up operations in China in the near term, not MENA," he writes in a Feb 24 report. "Its JV with Mitsui should

facilitate growth in China, while opportunities for tariff increases could boost its operations and maintenance income."

Lum isn't worried about Hyflux's prospects at all. "There are so many tenders in the world," she says with a smile. "Water shortages will not become better." But like every other company with a foothold in the MENA region, Lum is likely to spend the next few days, or weeks even, watching history unfold and reassuring investors that the company isn't too heavily exposed to the risks there.