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Results Review

Malaysian Airline System — Sell

Aviation | *Bloomberg Ticker: MAS MK | Bursa Code: 3786*

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12-month upside potential

Previous target price (RM)	0.30
Revised target price (RM)	0.23
Current price (as at 20 Aug)	0.34
Capital upside (%)	-32.3
Net dividends (%)	0.0
Total return (%)	-32.3

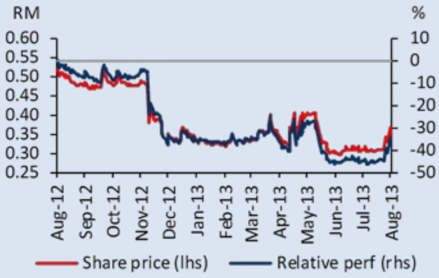
Key stock information

Syariah-compliant?	Yes
Market Cap (RM m)	5,681.7
Shares outstanding (m)	16,710.8
Free float (%)	29.6
52-week high / low (RM)	0.52 / 0.30
3-mth avg volume ('000)	61,354.2
3-mth avg turnover (RM m)	19.8

Share price performance

	1M	3M	6M
Absolute (%)	9.7	-15.0	7.9
Relative (%)	13.0	-13.7	-0.2

Share price chart



Source: Bloomberg

2QFY13: Yield pressure continues

MAS 1HFY13 core net loss of RM549.2m continues to disappoint both ours and consensus expectation. Despite substantial improvement in load factor, MAS financial performance was dragged down by lower yield arising from the management's "load active yield passive" strategy. We expect yield to remain under pressure as management remains adamant in following through with this strategy, with the aim of achieving a 85% load factor. With yield under pressure and an appreciating USD, we expect MAS business turnaround to take longer than expected and to continue to suffer losses. As such, we maintain our SELL rating for MAS with a revised TP of RM0.23.

Results continue to disappoint amidst yield pressure

- Despite impressive operational statistics, MAS's 2QFY13 results were still in negative territory with core net loss of RM201.6m (vs. loss of RM221.3m in 2QFY12). The core net loss was calculated after excluding the (1) RM94m gain on disposal of redelivered aircrafts arising from the "Residual Value Sharing" scheme, and (2) unrealised foreign exchange loss of RM68.3m.
- This brings 1HFY13 core net loss to RM549.2m (-7.3 y-o-y,) which was below ours and consensus estimates.
- Revenue increased by 11.2% y-o-y to RM6,983.3m in 1HFY13, due to higher passenger traffic (+23.0% y-o-y) amidst capacity increase (+15.0% y-o-y).
- The slower topline growth vis-à-vis traffic growth was mainly due to lower passenger yield (-9.8% y-o-y). To put it in perspective, SIA and Thai Airways had only reported a yield decrease of 3% and 4% in 2QCY13 respectively.
- Management remains adamant on their "load active, yield passive" strategy", and will continue to do so until their load factor reaches 85%.
- Cost/overall ATK reduced by 1.3% y-o-y to RM1.94. This was mainly driven by (1) the utilisation of new aircrafts which are more fuel-efficient, (2) lower fuel price (-5.0% y-o-y), and (3) reduction in staff costs.
- This results in only a marginal 7.6% improvement in 1HFY13 core net loss, despite the overall load factor increasing 4.1ppts to 76.0% in 1HFY13.
- We expect the adoption of a "load active, yield passive" strategy, similar to a low-cost carrier, to continue to weigh down on MAS profitability going forward.

Key takeaways from conference call

- Management remains optimistic that the strong operational statistics will continue in 2HFY13. However, we caution that this may not translate into improved profitability given that we believe that this will be at the expense of lower yield.
- Management also guided that Penerbangan Malaysia Bhd will sell another 17 aircrafts that will be re-delivered in 2HFY13. Under the "Residual Value Sharing" (RVS) scheme, MAS is entitled to 80% of the profit from the sale of the redelivered aircrafts. As such, we believe this will alleviate its cash level in 2HFY13.

Strengthening USD to adversely affect MAS in the coming quarter

- MAS have a natural net short exposure on USD as a significantly high proportion of operating expenditure is USD-denominated, whilst only 5% of its revenue is USD-denominated. In addition, it has RM3.9bn USD-denominated borrowings.
- Despite the significant exposure, management indicate that they will leave the USD exposure unhedged even as USD continues to appreciate (+7.1% YTD).
- As such, we believe MAS bottomline will be severely affected in the coming quarter.

Revised downward earnings forecast

- We are cutting our FY13-FY14 forecasts by 43.7% and 39.9% respectively to reflect (1) the lower revenue yield, and (2) the strengthening USD. We now expect MAS to continue suffering losses and to register a core net loss of RM727.6m and RM382.7m in FY13 and FY14, respectively.
- In addition, we also introduced our FY15 forecasts

Maintain SELL with a lower TP of RM0.23

- We have previously valued MAS based on 6.3x FY14 EV/EBITDAR. However, in light of our earnings cut, the TP would fall to a negative value, as we expect MAS to have a net debt of RM11.1bn in FY14.
- Determining the fundamental value of MAS is a challenging exercise as its loss making streaks makes conventional earnings base valuation method such as P/E and EV/EBITDAR not meaningful. On the other hand, asset base valuation method is also not appropriate as book value fluctuates widely due to its low net asset base and earnings volatility.
- As such, we look at key price support levels for MAS during this turbulent time to determine our target price instead. With the recent 4-for-1 rights issue at RM0.23 per share, we believe could provide a good support level despite a negative fundamental value.
- Our argument is further supported by (1) tightly held shareholding with Khazanah Nasional holding 69% stake, and (2) on-going market talk of privatisation.
- Although the privatisation talk has been ruled out by the PM who is also the chairman of Khazanah Nasional, we can never rule out such possibility in the future.
- In the interim, we recommend investors to stay on the sideline as MAS business turnaround is taking longer than expected, amidst the challenging operating environment. We expect the recent run-up in share price to be short-lived following the PM's denial of any privatisation plan.
- Hence, we keep our SELL recommendation on MAS with a lower TP of RM0.23.

SNAPSHOT OF FINANCIAL RESULTS

Figure 1 : Results commentaries

	2QFY13	2QFY12	% y-o-y change	% q-o-q change	6MFY13	6MFY12	% y-o-y change	Comments
Key financial highlights								
Revenue (RM m)	3,594.3	3,216.7	11.7	6.1	6,983.3	6,282.4	11.2	Revenue growth does not match RPK growth due to yield pressure
Operating profit (RM m)	7.9	(101.9)	107.8	104.8	(157.4)	(408.8)	61.5	Operating profit in 2Q was distorted by RM94m gain from residual value sharing scheme with PMB
Pretax profit (RM m)	(165.9)	(347.7)	52.3	40.4	(444.3)	(517.1)	14.1	
Net profit (RM m)	(176.0)	(349.2)	49.6	36.9	(454.8)	(521.0)	12.7	
Core net profit (RM m)	(201.6)	(221.3)	8.9	42.0	(549.2)	(592.7)	7.3	Below expectation. Yield under pressure
Per share data								
EPS (sen)	(1.3)	(4.9)	73.6	84.4	(9.6)	(10.1)	4.2	
Core EPS (sen)	(1.5)	(3.1)	52.1	85.6	(11.9)	(14.2)	16.4	
Net DPS (sen)	-	-			-	-		
BV/share (RM)	0.19	0.15			0.19	0.15		
Margins								
Pretax (%)	(4.6)	(10.8)	57.3	43.8	(6.4)	(8.2)		
Core net profit (%)	(5.6)	(6.9)	18.4	45.3	(7.9)	(9.4)		
Other highlights:								
Passenger (excl. Firefly)								
RPKs (m)	11,582.6	8,958.3	29.3	13.2	21,810.1	17,733.9	23.0	
ASKs (m)	14,399.1	12,128.2	18.7	7.8	27,756.2	24,143.4	15.0	
Passenger load factor (%)	80.4	73.9	8.9	5.1	78.6	73.5	5.1	
Passenger revenue/RPK (sen)	22.1	25.7	(14.0)	(8.7)	23.1	25.6	(9.8)	Yield decrease due to management's "load active, yield passive" strategy
Cargo								
LTK (m tkm)	506.7	473.7	7.0	10.9	963.7	890.0	8.3	
ATK (m tkm)	696.4	665.4	4.7	5.0	1,359.4	1,288.0	5.5	
Cargo load factor (%)	72.8	71.2	2.2	5.6	70.9	69.1	1.8	
Cargo revenue/ATK (sen)	84.5	90.8	(7.0)	(0.8)	81.8	88.7	(7.8)	
Overall (exl. Firefly)								
LTK (m tkm)	1,547.3	1,283.1	20.6	12.4	2,924.3	2,493.3	17.3	
ATK (m tkm)	1,986.4	1,758.4	13.0	6.8	3,847.1	3,465.0	11.0	
Overall load factor (%)	77.9	73.0	6.7	5.3	76.0	72.0	4.1	
Revenue/overall ATK (RM)	2.32	2.51	(7.3)	(5.6)	2.39	2.52	(5.2)	
Cost/overall ATK (RM)	1.90	1.94	(2.1)	(5.0)	1.94	1.97	(1.3)	
Cost/overall ATK (RM) - ex fuel	1.20	1.21	(1.4)	(4.3)	1.22	1.22	(0.3)	

Source: Company, Alliance Research

Figure 2 : Earnings revision

	Previous EPS Sen	Revised EPS Sen	Change %
2013F	-3.0	-5.4	-80.0*
2014F	-1.6	-2.3	-43.8*

*Differs with changes in net profit level due to changes in forecasted share base

Source: Alliance Research

Figure 3 : Key financial data

FYE 31 Dec	FY10	FY11	FY13F	FY14F	FY15F
Revenue (RM m)	13,653.9	13,286.6	14,330.1	13,644.1	14,626.0
EBITDA (RM m)	(264.9)	1,844.7	1,907.3	1,764.6	1,938.8
EBIT (RM m)	(2,364.2)	(188.3)	(395.5)	(27.9)	121.7
Pretax profit (RM m)	(2,512.9)	(424.8)	(724.6)	(379.7)	(228.6)
Reported net profit (RM m)	(2,524.0)	(432.6)	(727.6)	(382.7)	(231.6)
Core net profit (RM m)	(1,299.9)	(922.6)	(727.6)	(382.7)	(231.6)
EPS (sen)	(35.5)	(6.1)	(5.4)	(2.3)	(1.4)
Core EPS (sen)	(18.3)	(13.0)	(5.4)	(2.3)	(1.4)
Alliance / Consensus (%)			n/m	n/m	n/m
Core EPS growth (%)	(702.9)	29.0	58.1	57.9	39.5
P/E (x)	n/m	n/m	n/m	n/m	n/m
EV/EBITDA (x)	(25.6)	6.0	8.3	10.4	9.4
ROE (%)	(242.1)	(69.2)	(25.6)	(16.2)	(11.4)
Net gearing (%)	427.2	348.5	211.8	305.3	332.3
Net DPS (sen)	-	-	-	-	-
Net dividend yield (%)	-	-	-	-	-
BV/share (RM)	0.31	0.19	0.17	0.14	0.12
P/B (x)	1.0	1.7	1.8	2.2	2.6

n/m – not meaningful

Source: Alliance Research, Bloomberg

DISCLOSURE

Stock rating definitions

Strong buy	-	High conviction buy with expected 12-month total return (including dividends) of 30% or more
Buy	-	Expected 12-month total return of 15% or more
Neutral	-	Expected 12-month total return between -15% and 15%
Sell	-	Expected 12-month total return of -15% or less
Trading buy	-	Expected 3-month total return of 15% or more arising from positive newsflow. However, upside may not be sustainable

Sector rating definitions

Overweight	-	Industry expected to outperform the market over the next 12 months
Neutral	-	Industry expected to perform in-line with the market over the next 12 months
Underweight	-	Industry expected to underperform the market over the next 12 months

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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