ALLIANCE RESEARCH

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**31 March 2014**

# Company Update

## Malaysian Airline System — Sell

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


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**12-month upside potential**

| | |
|---|---|
| Previous target price | 0.23 |
| Revised target price (RM) | 0.16 |
| Current price (as at 28 Mar) | 0.205 |
| Capital upside (%) | -22.0 |
| Net dividends (%) | 0.0 |
| Total return (%) | -22.0 |

**Key stock information**

| | |
|---|---|
| Syariah-compliant? | Yes |
| Market Cap (RM m) | 3,425.7 |
| Shares outstanding (m) | 16,710.8 |
| Free float (%) | 29.6 |
| 52-week high / low (RM) | 0.41 / 0.21 |
| 3-mth avg volume ('000) | 45,835.8 |
| 3-mth avg turnover (RM m) | 12.9 |

**Share price performance**

| | 1M | 3M | 6M |
|---|---|---|---|
| Absolute (%) | -19.6 | -33.9 | -38.8 |
| Relative (%) | -20.8 | -33.3 | -41.5 |

**Share price chart**


Source: Bloomberg

| **Major shareholders** | **%** |
|---|---|
| Khazanah Nasional | 69.4 |

# Turnaround may take longer than expected

**We are wary that MAS' business turnaround may take longer than expected as the tragic MH370 incident may potentially lead to yield compression and/or decline in passenger load in the near term. With management's attention rightly focused on search and recovery operation, we are concern that management may lose focus on its business turnaround strategies, particularly its cost-cutting exercise. As such, we reaffirm our SELL recommendation with a revised TP of RM0.16, based on 1x FY14 P/B.**

## MH370 incident could potentially hurt consumer confidence

- The Malaysian government has officially declared Flight MH370 to be lost, with its last location estimated to be in the Indian Ocean, west of Perth, Australia. Reasons for the initial flight diversion remains unanswered as the wreckage has yet to be found.
- We are wary that Malaysian Airline's (MAS) corporate image may have been hurt by the tragic incident. The damage to MAS' corporate image would be exacerbated by a potential lawsuit by families of the affected passengers.
- As such, we are concern that MAS may experience yield compression and/or decline in passenger load in the near term following the incident as passengers may shun MAS-operated flights, although the cause of the tragedy remains unknown amid on-going investigation. This is especially so for flights which are: (1) operated on B777s aircrafts, and/or (2) bound for China.

## Unlikely to turn around in the near term

- In light of the recent turn of events, we do not think MAS will be able to turn-around in the near term as management's attention will rightly be focused towards search and recovery of the wreckage of Flight MH370. To recap, MAS has reported a core net loss of RM1.1bn in FY13, as yields collapsed amidst significant capacity addition while unit cost remained elevated despite achieving a significantly higher load factor from its "load active, yields passive" strategy in FY13.
- We believe the culprit lies in MAS' sticky cost structure. The "load active, yields passive" strategy does not seem feasible, if unit cost does not decease in tandem with the resulting higher load factor.
- However, back-peddling on its "load active, yields passive" strategy now does not seem possible now, as MAS would need to keep fare low in order to attract passengers following the MH370 incident. We are concern that strategies to turnaround the company, particularly the cost-cutting exercise, may likely take a back seat as management's attention is focused on the more important search and recovery operation.

## Impact on earnings

- We are cutting our FY14-FY15 earnings forecasts by 106.7% and 24.3% respectively, in order to reflect: (1) 5% decrease in international yields in FY14, followed by a recovery in FY15 as consumer confidence returns, and (2) other housekeeping changes.
- We are also introducing our FY16 earnings forecast for the first time.

## Valuation and recommendation

- We are reaffirming our SELL recommendation on MAS with revised TP of RM0.16, based on 1x FY14 P/B. To recap, we have previously based our TP on the exercise price of its last 4-for-1 rights issue at RM0.23, as we have previously believed it to be a key price support level for MAS.
- We continue to be cautious of MAS' earnings prospect going forward as we expect its business turnaround will take longer than expected, following the tragic MH370 incident amid challenging operating environment. We also expect costs relating to the search and recovery operation to eventually make its way into consensus earnings forecasts.

# SNAPSHOT OF FINANCIAL AND VALUATION METRICS

**Figure 1 : Key financial data**

| FYE 31 Dec | FY12 | FY13 | FY14F | FY15F | FY16F |
|---|---|---|---|---|---|
| Revenue (RM m) | 13,286.6 | 14,548.2 | 15,268.0 | 16,190.9 | 16,704.2 |
| EBITDAR (RM m) | 1,907.7 | 1,432.6 | 1,080.4 | 1,618.5 | 1,711.6 |
| EBIT (RM m) | (188.3) | (736.6) | (803.8) | (117.5) | (51.7) |
| Pretax profit (RM m) | (424.8) | (1,152.8) | (1,291.1) | (579.8) | (516.6) |
| Reported net profit (RM m) | (432.6) | (1,173.7) | (1,313.6) | (592.6) | (528.5) |
| Core net profit (RM m) | (806.6) | (1,099.4) | (1,313.6) | (592.6) | (528.5) |
| EPS (sen) | (6.1) | (8.7) | (7.9) | (3.5) | (3.2) |
| Core EPS (sen) | (11.4) | (8.1) | (7.9) | (3.5) | (3.2) |
| Alliance / Consensus (%) | | | 153.7 | 278.5 | 369.5 |
| Core EPS growth (%) | 38.0 | 28.3 | 3.4 | 54.9 | 10.8 |
| P/E (x) | N/A | N/A | N/A | N/A | N/A |
| EV/EBITDA (x) | 5.0 | 9.0 | 13.2 | 8.7 | 8.1 |
| ROE (%) | (69.2) | (46.3) | (117.4) | (140.2) | 498.7 |
| Net gearing (%) | 348.5 | 195.7 | 356.6 | 478.2 | 638.3 |
| Net DPS (sen) | - | - | - | - | - |
| Net dividend yield (%) | - | - | - | - | - |
| BV/share (RM) | 0.64 | 0.24 | 0.16 | 0.11 | 0.08 |
| P/B (x) | 0.3 | 0.8 | 1.3 | 1.8 | 2.5 |

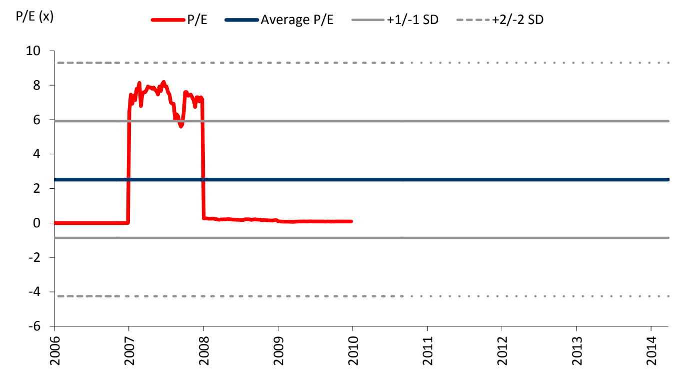
*Source: Alliance Research, Bloomberg*

**Figure 2 : Earnings revision**

| | Previous EPS Sen | Revised EPS Sen | Change % |
|---|---|---|---|
| 2014F | (3.8) | (7.9) | -106.7% |
| 2015F | (2.9) | (3.5) | -24.3% |

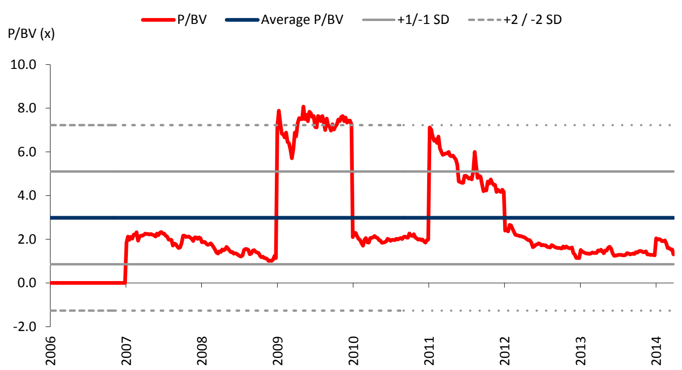
*Source: Alliance Research*

**Figure 3 : 12-month forward P/E trend**




*Source: Alliance Research, Bloomberg*

**Figure 4 : 12-month forward P/B trend**




*Source: Alliance Research, Bloomberg*

**Figure 5 : Peer comparison**

| Company | Call | Target price (RM) | Share price (RM) | Mkt Cap (RM m) | EPS Growth (%) | | P/E (x) | | P/BV (x) | | ROE (%) | | Net Dividend Yield (%) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | CY14 | CY15 | CY14 | CY15 | CY14 | CY15 | CY14 | CY15 | CY14 | CY15 |
| Malaysia Airports | Buy | 9.80 | 8.00 | 10,916.8 | 19.9 | 5.9 | 23.4 | 22.1 | 1.8 | 1.5 | 11.7 | 17.7 | 2.0 | 2.3 |
| AirAsia | Neutral | 2.43 | 2.53 | 7,036.8 | -3.3 | 16.3 | 11.4 | 9.8 | 1.2 | 1.1 | 14.9 | 12.1 | 2.5 | 2.2 |
| MAS | Sell | 0.16 | 0.21 | 3,425.7 | 3.4 | 54.9 | N/A | N/A | 1.3 | 1.8 | -117.4 | -140.2 | 0.0 | 0.0 |
| AirAsia X | Neutral | 0.75 | 0.79 | 1,872.6 | -227.2 | 416.2 | -37.9 | 12.0 | 1.3 | 1.1 | 12.2 | 16.3 | 0.0 | 0.0 |
| **Average** | | | | | -233.4 | 352.7 | -76.3 | 30.2 | 1.5 | 1.4 | -6.3 | -7.4 | 1.7 | 1.7 |

*Source: Alliance Research, Bloomberg* *Share price date: 28 Mar 2014*

## Malaysian Airline System — Financial Summary — Price Date: 28 March 2014

**Balance Sheet**

| FY 31 Dec (RM m) | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| PPE | 12,853.6 | 14,615.2 | 14,709.7 | 13,919.4 | 13,786.0 |
| Intangible Assets | 153.9 | 149.1 | 139.1 | 124.0 | 103.8 |
| Associates & JV | 125.0 | 152.3 | 172.7 | 193.2 | 213.6 |
| Inventories | 331.2 | 253.8 | 265.8 | 269.1 | 276.3 |
| Receivables | 1,572.3 | 2,619.4 | 2,700.1 | 2,803.6 | 2,861.2 |
| Other assets | 106.6 | 194.9 | 194.9 | 194.9 | 194.9 |
| Deposit, bank and cash | 2,148.5 | 3,870.6 | 3,060.3 | 2,598.8 | 2,961.1 |
| **Total Assets** | **17,291.1** | **21,855.3** | **21,242.8** | **20,103.1** | **20,397.0** |
| LT borrowings | 8,090.3 | 10,359.3 | 11,383.1 | 10,776.3 | 10,839.2 |
| ST borrowings | 1,458.2 | 1,407.3 | 1,008.3 | 1,008.3 | 1,008.3 |
| Payables | 4,230.2 | 5,222.3 | 5,559.4 | 5,795.9 | 5,959.7 |
| Other liabilities | 1,374.4 | 814.2 | 652.1 | 574.0 | 1,164.8 |
| **Liabilities** | **15,153.1** | **17,803.2** | **18,602.9** | **18,154.5** | **18,972.0** |
| Share capital | 3,342.2 | 1,671.1 | 1,671.1 | 1,671.1 | 1,671.1 |
| Reserves | (2,717.2) | 864.7 | (552.4) | (1,248.5) | (1,777.1) |
| **Shareholders' equity** | **625.0** | **2,535.7** | **1,118.7** | **422.6** | **(106.0)** |
| Perpetual sukuk | 1,498.2 | 1,498.2 | 1,498.2 | 1,498.2 | 1,498.2 |
| Minority interest | 14.8 | 18.2 | 23.1 | 27.9 | 32.8 |
| **Total Equity** | **2,138.0** | **4,052.1** | **2,639.9** | **1,948.7** | **1,425.0** |
| **Total Equity and Liabilities** | **17,291.1** | **21,855.3** | **21,242.8** | **20,103.1** | **20,397.0** |

**Cash Flow Statement**

| FY 31 Dec (RM m) | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| Pretax profit | (424.8) | (1,152.8) | (1,291.1) | (579.8) | (516.6) |
| Depreciation and amortisation | 580.2 | 904.2 | 924.3 | 926.0 | 953.3 |
| Change in working capital | (713.7) | (757.8) | (397.7) | (434.1) | (1,055.5) |
| Net interest paid | (299.3) | (362.6) | (507.6) | (482.8) | (485.4) |
| Tax paid | (4.3) | (13.7) | (17.7) | (7.9) | (7.1) |
| Others | 588.3 | 641.6 | 998.3 | 948.1 | 2,313.8 |
| **Operating Cash Flow** | **(273.6)** | **(741.1)** | **(291.4)** | **369.5** | **1,202.6** |
| Capex | (4,763.7) | (3,701.7) | (2,497.7) | (459.4) | (1,296.7) |
| Others | 973.6 | 1,087.1 | 1,457.5 | 338.8 | 497.0 |
| **Investing Cash Flow** | **(3,790.1)** | **(2,614.6)** | **(1,040.2)** | **(120.6)** | **(799.7)** |
| Issuance of shares | - | 3,074.8 | - | - | - |
| Changes in borrowings | 5,274.1 | 2,000.0 | 624.8 | (606.9) | 62.9 |
| Dividend & distributions paid | (35.2) | (105.0) | (103.5) | (103.5) | (103.5) |
| Others | - | (2.2) | - | - | - |
| **Financing Cash Flow** | **5,238.8** | **4,967.6** | **521.3** | **(710.4)** | **(40.6)** |
| Net cash flow | 1,175.2 | 1,611.9 | (810.3) | (461.5) | 362.3 |
| Deposits pledged with banks | 14.5 | 124.7 | 124.7 | 124.7 | 124.7 |
| Beginning cash | 958.8 | 2,134.0 | 3,745.9 | 2,935.6 | 2,474.1 |
| **Ending cash** | **2,148.5** | **3,870.6** | **3,060.3** | **2,598.8** | **2,961.1** |

**Income Statement**

| FY 31 Dec (RM m) | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| **Revenue** | **13,286.6** | **14,548.2** | **15,268.0** | **16,190.9** | **16,704.2** |
| **EBITDAR** | **1,907.7** | **1,432.6** | **1,080.4** | **1,618.5** | **1,711.6** |
| Depreciation & amortisation | (580.2) | (904.2) | (924.3) | (926.0) | (953.3) |
| Aircraft lease charges | (1515.8) | (1265.0) | (960.0) | (810.0) | (810.0) |
| Net interest expense | (235.3) | (436.6) | (507.6) | (482.8) | (485.4) |
| Associates & JV | (1.3) | 20.4 | 20.4 | 20.4 | 20.4 |
| **Pretax profit** | **(424.8)** | **(1,152.8)** | **(1,291.1)** | **(579.8)** | **(516.6)** |
| Taxation | (5.9) | (16.1) | (17.7) | (7.9) | (7.1) |
| Minority interest | (1.8) | (4.8) | (4.8) | (4.8) | (4.8) |
| **Net profit** | **(432.6)** | **(1,173.7)** | **(1,313.6)** | **(592.6)** | **(528.5)** |
| **Core net profit** | **(806.6)** | **(1,099.4)** | **(1,313.6)** | **(592.6)** | **(528.5)** |

**Key Statistics & Ratios**

| FY 31 Dec (RM m) | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| **Growth** | | | | | |
| Revenue | -2.7% | 9.5% | 4.9% | 6.0% | 3.2% |
| EBITDAR | 1043.0% | -24.9% | -24.6% | 49.8% | 5.8% |
| Pretax profit | 92.0% | -291.2% | -9.1% | 85.4% | 56.0% |
| Net profit | 83.1% | -171.4% | -12.0% | 55.1% | 10.9% |
| Core EPS | 38.0% | 28.3% | 3.4% | 54.9% | 10.8% |
| **Profitability** | | | | | |
| EBITDAR margin | 14.4% | 9.8% | 7.1% | 10.0% | 10.2% |
| Net profit margin | -3.3% | -8.1% | -8.6% | -3.7% | -3.2% |
| Effective tax rate | -1.4% | -1.4% | -1.4% | -1.4% | -1.4% |
| Return on assets | -2.5% | -5.4% | -6.2% | -2.9% | -2.6% |
| Return on equity | -69.2% | -46.3% | -117.4% | -140.2% | 498.7% |
| **Leverage** | | | | | |
| Total debt / total assets (x) | 0.55 | 0.54 | 0.58 | 0.59 | 0.58 |
| Total debt / equity (x) | 4.50 | 2.92 | 4.74 | 6.14 | 8.51 |
| Net debt / equity (x) | 3.49 | 1.96 | 3.57 | 4.78 | 6.38 |

**Key Drivers**

| | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| Passenger yield (sen/RPK) | 27.0 | 23.2 | 22.3 | 23.2 | 23.2 |
| Passenger ASK (m) | 51,224.0 | 60,179.0 | 67,400.4 | 69,422.4 | 71,505.1 |
| Passenger load factor (%) | 74.5% | 80.5% | 80.1% | 80.1% | 80.1% |
| Cargo yield (sen/LTK) | 87.1 | 81.1 | 81.1 | 81.1 | 81.1 |
| Cargo ATK (m) | 2,689.1 | 2,827.5 | 2,568.7 | 2,493.2 | 2,538.5 |
| Cargo load factor (%) | 70.1% | 70.4% | 70.4% | 70.4% | 70.4% |
| Cost per ATK (sen) | 193.6 | 189.9 | 192.3 | 192.7 | 192.7 |

**Valuation**

| FY 31 Dec (RM m) | 2012A | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|
| EPS (sen) | (6.1) | (8.7) | (7.9) | (3.5) | (3.2) |
| Core EPS (Sen) | (11.4) | (8.1) | (7.9) | (3.5) | (3.2) |
| P/E (x) | N/A | N/A | N/A | N/A | N/A |
| EV/EBITDAR (x) | 5.0 | 9.0 | 13.2 | 8.7 | 8.1 |
| Net DPS (sen) | - | - | - | - | - |
| Net dividend yield | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| BV per share (RM) | 0.64 | 0.24 | 0.16 | 0.11 | 0.08 |
| P/B (x) | 0.3 | 0.8 | 1.3 | 1.8 | 2.5 |

# 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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