

29 May 2014 | Strategy

## Some thoughts on MAS restructuring

*Introduce BLA to help solve the conundrum*

Syed Muhammed Kifni

smkifni@midf.com.my

### NOMENCLATURE: MALAYSIA AIRLINES & MAS

- In a recent interview,

The Wall Street Journal (WSJ) asked PM Najib Razak the following question: “Bankruptcy has been mentioned in some quarters as a solution to Malaysia Airlines’ problems. What’s your view of that?” *[emphasis added]*

The prime minister responded: “Well, different modalities have been suggested. But we have to look at it from all angles, bearing in mind that MAS is a government-linked company. It’s not a private company, so there are certain repercussions in what you want to do in terms of how it is being received by the employees and the general public.” *[emphasis added]*

- The above was an example of a wrong question answered right.
- **Firstly**, according to Skytrax, there are only seven (7) airlines in the world that are 5-star rated which represents the highest quality ranking standard for a commercial airline. It is important to note that the key factor behind Skytrax’s 5-Star Airline Rating is “the airline’s ability to deliver a truly consistent and high quality of Product and Service” with great emphasis on “the Quality of front-line service an airline provides.” Our national flag carrier, Malaysia Airlines, is a 5-star airline. Hence we reckon being labeled 5-star is certainly not a problem that anyone wishes not to have. *[emphasis added]*
- The 5-star rating was accorded to the airline, Malaysia Airlines, and not the airline company.
- **Secondly**, Malaysian Airline System Berhad (MAS) is an airline company. It is also a government-linked company (GLC). Nowadays, most GLCs are profit churning entities but MAS is among the few exceptions. Recently, MAS reported another quarterly loss in 1Q14 and we expect more losses in coming quarters. The MH370 episode only added to the misery. In fact, the airline company has recorded cumulative net losses totaling -RM3.22b during the past 10 years (2004-2013). It is a near perennial problem for MAS, and which is a difficult one to solve, in spite of the numerous restructuring exercises in the past.

### SOCIAL PRECONDITIONS IN MAS RESTRUCTURING

- The added difficulty is because, as in the PM’s own words, MAS is “not a private company, so there are certain repercussions in what you want to do in terms of how it is being received by the employees and the general public.” We are in agreement with the PM that the right solutions to MAS conundrum would have to be looked at “from all angles” on condition that they are palatable to both the employees and the general public.
- And our views are that, (i) Malaysia Airlines’ reputation with among the best “front-line” service in the world must be safeguarded and even improved upon, but (ii) MAS must undergo a complete “back-end” overhaul, chiefly to cut costs and rightsizing, in order to make it sustainably competitive in the increasingly cutthroat airline world.
- The former is a non-issue and we reckon it would endear to all stakeholders particularly the general public. However, the latter may involve actions that are not palatable especially to the employees. Moreover, it may

also inadvertently come in conflict with the former as both Malaysia Airlines and MAS are generally viewed as one of the same.

## INTRODUCE THIRD PARTIES TO SOLVE THE CONUNDRUM

- Both Malaysia Airlines and MAS could no longer afford to be one of the same. Hence, in our opinion, the key to a successful MAS restructuring must involve the introduction of third parties. The third parties will break the exclusivity of 'Malaysia Airlines is MAS' (and vice versa) relationship.
- This is important as the inclusion of third parties into the relationship equation would allow MAS undergo a complete back-end overhaul with limited unintended consequences to Malaysia Airlines' front-line service. Furthermore, the net overall impact on the employment situation would be rather benign with the participation of third parties. Moreover, breaking up the exclusivity will even be income generating (from royalty fee) to MAS.

## SOME THOUGHTS

- Our thoughts are as follow:

### BRAND LICENSE AGREEMENT

- Malaysian Airline System (MAS) shall enter into Brand License Agreements (BLAs) with (i) Malaysia Air Domestic & Regional Berhad (MDR), and (ii) Malaysia Air International Berhad (MAI).

*Note: Malaysia Air Domestic & Regional Berhad and Malaysia Air International Berhad are fictitious company names not registered with the Suruhanjaya Syarikat Malaysia (SSM).*

- The BLAs are with respect to non-exclusive, non-transferable licenses by MAS, the licensor, for MDR and MAI, the licensees, to operate Scheduled Air Services (SAS) under the brand name, logo and livery of "Malaysia Airlines", including the use of other trademarks and logos owned by MAS such as, but not limited to, "www.malaysiaairlines.com", "Enrich" and "Golden Holidays".
- For MDR, the SAS is in relation to (i) domestic routes within Malaysia, as well as (ii) regional routes originating from Malaysia to other ASEAN countries, Hong Kong, Macau, China (southern provinces - to specify), Bangladesh, India (eastern states - to specify) and Sri Lanka.
- For MAI, the SAS is in relation to international routes originating from Malaysia to all destinations other than those accorded to MDR in above.
- The annual BLA royalty fee payable to MAS would be 1.5 per cent of the consolidated revenue per audited financial statements per annum for each financial year of MDR and MAI respectively.
- The BLA would be for an initial term of five (5) years and may be extended by the licensee subject to mutual agreement of the parties, both licensor and licensee, prior to the expiry of the term.

### PRECEDENTS

- Brand licensing agreement is not unusual in the aviation industry. The proposed BLAs in above are similar to the brand licensing agreements signed respectively between AirAsia Berhad (the brand owner) and AirAsia X Berhad / PT Indonesia AirAsia / Thai AirAsia Co. Ltd. / Thai AirAsia X Co. Ltd. / AirAsia Inc. (Philippines) / AirAsia (India) Pvt. Ltd.

## BENEFITS

- MDR and MAI would be able to commence operations on a clean slate and not be subjected to MAS' legacy issues, e.g. workers union, unfavourable procurement contracts.
  - MDR and MAI could maintain lower cost operations while meeting customers' expectations and ensuring profitability.
  - MAS would be able to undertake the necessary rightsizing exercise to get back into the pink of health knowing that MDR and MAI are there to help fill-up the vacuum particularly, as stated above, with regard to the social preconditions.
  - MAS shall benefit from the 1.5 per cent annual royalty fees to be paid by MDR and MAI.
- Most importantly, Malaysia Airlines would arguably become stronger as it will be supported by the added cumulative strengths from the synergistic alliances and competitive rivalries between its three (3) airline companies, namely MDR, MAI and MAS. 

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).  
 (Bank Pelaburan)  
 (A Participating Organisation of Bursa Malaysia Securities Berhad)

## DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.