Shariah Compliant

Airlines

Malaysia

Capital A (CAPITALA MK)

Still approaching cruising altitude

BUY

Share Price	MYR 0.63
12m Price Target	MYR 0.84 (+34%)
Previous Price Target	*MYR 1.29*

Maintain BUY with a lower TP of MYR0.84 (-35%)

Higher fares and lower lease rates have more than compensated for the weaker MYR and still high oil prices. We now forecast CAPITALA's return to profitability to be delayed by a year to FY24E only due to slower-than-expected redeployment of aircraft. Although we cut our SOP-based TP to MYR0.84 from MYR1.29, CAPITALA still offers >30% upside potential. On another note, CAPITALA assured us that there will not be another rights and/or debts will not be converted into new shares.

Challenges remain in the current post-COVID world...

First, the MYR has weakened past MYR4.50 against the USD. USD denominated expenses traditionally accounted for 60-70% of expenses. Second, jet fuel prices remain relatively high. Fuel traditionally accounted for 30-50% of expenses. Third, backlogs at MRO service providers have delayed the redeployment of aircraft. Fourth, there is still no clarity as to when China, a major source of passengers, will lift its zero COVID policy and allow it citizens to travel freely again.

... but CAPITALA is very much alive and flying

First, fares have not only remained high but climbed even higher in 2Q22. In fact, IAA's average fare/stage length hit a new record in 2Q22. Many airlines cut supply during the COVID-19 pandemic and this translated into higher fares after demand started recovering in the current post-COVID world. Second, aircraft lease rates are meaningfully lower in the current post-COVID world. We estimate that CAPITAL stands to save a whopping c.MYR860m p.a.

Return to profitability to be deferred to FY24E

We widen our FY22E core net loss from MYR2.44b to MYR2.89b, now forecast FY23E core net loss of c.MYR700m versus core net profit of c.MYR250m previously, and trim our FY24E net profit by c.MYR100m to MYR268m. Our revised FY24E net profit forecast of MYR268m is similar to our previous FY23E net profit forecast of MYR254m. Essentially, we now expect CAPITALA's return to profitability to be delayed by a year only due to the slower-than-expected redeployment of aircraft. In this report, we also updated CAPITALA's ESG milestones for its FY21 AR (page 3).

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	3,274	1,836	7,349	13,402	16,409
EBITDAR	(1,492)	(967)	(253)	2,427	3,330
Core net profit	(3,484)	(2,759)	(2,890)	(697)	268
Core FDEPS (sen)	(104.2)	(72.9)	(47.0)	(10.6)	5.5
Core FDEPS growth(%)	nm	nm	nm	nm	nm
Net DPS (sen)	0.0	0.0	0.0	0.0	0.0
Core FD P/E (x)	nm	nm	nm	nm	11.4
P/BV (x)	nm	nm	nm	nm	nm
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	(71.7)	(89.8)	(445.6)	64.5	(20.7)
ROAA (%)	(15.3)	(13.8)	(14.9)	(3.9)	1.6
EV/EBITDAR (x)	nm	nm	nm	9.5	5.9
Net gearing (%) (incl perps)	nm	nm	nm	nm	nm
Consensus net profit	-	-	(1,599)	113	424
MKE vs. Consensus (%)	-	-	(88.3)	(715.3)	(36.8)

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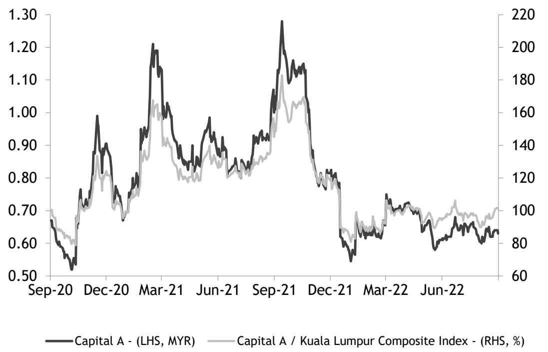
Company Description

AirAsia Group is Asia's foremost low cost carrier with operations in Malaysia, Thailand, Indonesia, Philippines and India.

Statistics

52w high/low (MYR)	1.28/0.55
3m avg turnover (USDm)	0.7
Free float (%)	49.5
Issued shares (m)	4,162
Market capitalisation	MYR2.6B
	USD566M
Major shareholders:	
Tune Air Sdn Bhd	12.4%
Tune Live Sdn. Bhd.	12.2%
Positive Boom Ltd.	8.0%

Price Performance



	-1M	-3M	-12M
Absolute (%)	1	3	(37)
Relative to index (%)	7	6	(31)

Source: FactSet

Other companies mentioned in this report:-

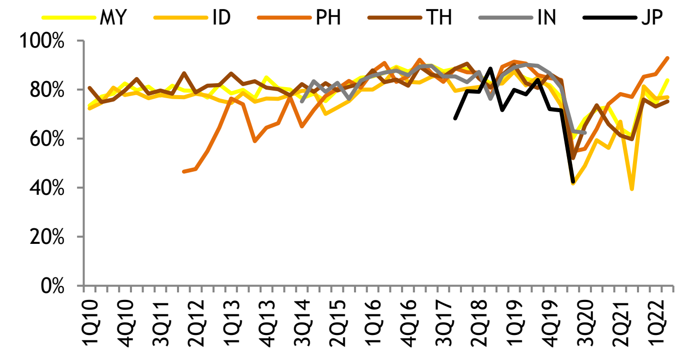
1. **Batik Air Malaysia (Unlisted)**
2. **Garuda Indonesia (GIAA IJ, CP: IDR222, Not Rated)**
3. **Philippine Airlines (Unlisted)**
4. **PAL Holdings (PAL PM, CP: PHP5.50, Not Rated)**
5. **Thai Airways International (THAI TB, THB2.56, Not Rated)**
6. **MYAirline (Unlisted)**
7. **Genting (GENT MK, Buy, CP: MYR4.36, TP: MYR5.25)**
8. **Bursa Malaysia (BURSA MK, Hold, CP: MY6.25, TP: MYR6.26)**

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- Asia's leading low cost carrier with highest market share, largest fleet size and most extensive route network.
- Operates in 5 countries after exiting Japan, which provides unrivalled route network reach.
- Lowest unit cost airline in the world. Management is very ambitious, cost conscious and forward-thinking.
- Growing middle class in Asia fuelling growth in demand for air travel.
- Won the coveted 'World's Best LCC' award for a record 13 times in a row by Skytrax.

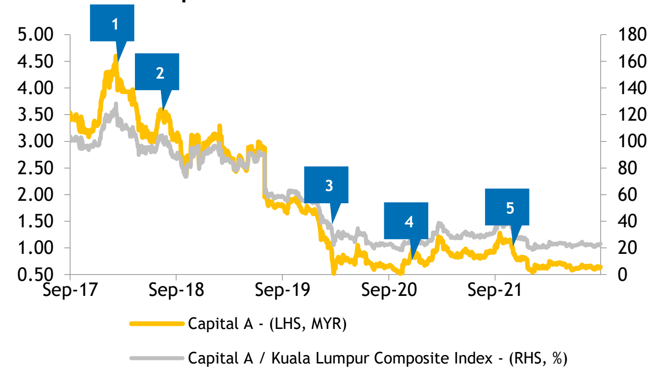
AirAsia passengers load factor by country



Source: Company

Price Drivers

Historical share price trend



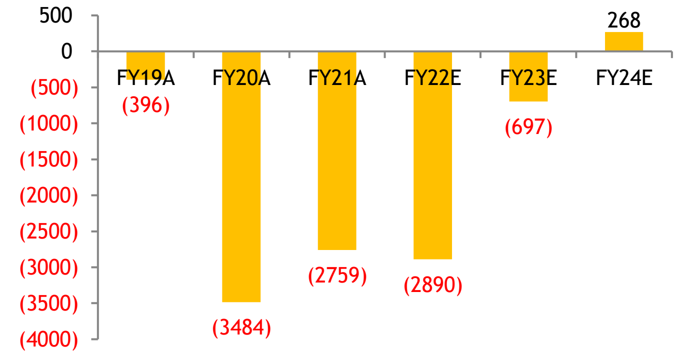
Source: Company, Maybank IBG Research

1. CAPITALA announced record dividends which provided a catalyst to its share price.
2. Market de-rated following the outcome of the 14th General Election.
3. COVID-19 pandemic struck Malaysia. CAPITALA grounded most of its fleet in late-Mar 2020.
4. Pfizer, Moderna and AstraZeneca announced that they have developed effective COVID-19 vaccines.
5. CAPITALA classified as a PN17 listed issuer by Bursa Malaysia.

Financial Metrics

- Best financial indicator is core net profit ex disposal gains, forex and fair value changes, and deferred taxation.
- Still forecast FY22E/FY23E core net loss as passengers carried will be limited by measured aircraft redeployment.
- Forecast FY24E to generate net profit on passengers carried recovering and average fares rising.
- Sensitive to fuel price movement, a USD1 per barrel change in fuel price will move earnings by MYR10m-MYR30m.
- Balance sheet as at end-4Q21 in a net debt position of MYR1.11b if ex-finance lease liabilities.

Core net profit/(loss) (MYRm)



Source: Company (historical), Maybank IBG Research (forecasts)

Swing Factors

Upside

- Policy changes – visa requirement relaxations and tourist friendly events drive passenger traffic growth.
- Less competition – COVID-19 pandemic has caused competitors to reduce capacity and raise prices.
- Financial assistance - will enable CAPITALA to fill temporary liquidity gaps and survive.

Downside

- Exogenous events – SARS; MH370, MH17 & AK8501 tragedies; and COVID-19 negatively impacted passenger traffic growth.
- Fuel prices – they are volatile and there is no certainty that they will be hedged at low levels.
- Weak MYR – 60-70% of operating costs are USD denominated.

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Risk Rating & Score[1]	32.1 (High)
Score Momentum[2]	-3.3
Last Updated	16 Mar 2022
Controversy Score[3] (Updated: 4 Feb 2022)	2 - Customer Incidents, Business Ethics Incidents, Governance Incidents

Business Model & Industry Issues

- Being an airline, CAPITALA may not be deemed as environmentally friendly but it operates Airbus A320 family aircraft which are already fuel efficient. It will gradually replace its entire fleet with the even more fuel efficient A321neo aircraft.
- As at end-FY21, only 35% of staff are female but this is not entirely unexpected as operational functions (e.g. engineering) tend to be filled by males.
- An especially positive point is that CAPITALA supported staff that were laid off during the COVID-19 pandemic and even established an academy to retrain staff in technology and IT.
- To be sure, some senior managers have made headlines for the wrong reasons but to be fair, no misconduct has been proven to date. However, CAPITALA's decision to enter and exit Japan twice raised eyebrows.
- In all, we rate CAPITALA's ESG credentials as moderate. CAPITALA was included in the FTSE4GOOD Bursa Malaysia Index in Dec 2020.

Material E issues

- As at end-FY21, operated 168 Airbus A320, 40 Airbus A320neo, 4 Airbus A321neo and 1 Airbus A330ceo.
- Will gradually replace entire fleet with Airbus A321neo which is 10-15% more fuel efficient than the Airbus A320.
- Carbon intensity ratio (CIR) was up 7% YoY to 94gCO^2/RPK in FY21 due to less RPK flown.
- Fuel consumption/100RPK was up 7% YoY to 3.78 litres in FY21 due to shorter stage lengths.
- CIR and fuel efficiency to normalise as RPK and stage length recover due to the COVID-19 pandemic easing.
- Targets carbon neutral growth (relative to 2019 as the base line year) and net zero CO^2 emissions by 2050.
- Plans to incorporate sustainable aviation fuel and introduce carbon offsetting options.
- Partners TRAFFIC to raise awareness of illegal wildlife trafficking in the aviation sector.

Material S issues

- Trained 71% of staff on-line to recognise the signs of human trafficking on board and respond appropriately.
- Hosted its first international webinar, "The Role of Airline Staff as Frontliners in the Fight Against Human Trafficking" and joined ICAO's Anti-Trafficking Working Group.
- Flew 410 rescue and repatriation flights to bring >15,000 individuals home in FY20.
- MYR10.5m spent on training staff in FY21 (-22% YoY) despite the group having generated a huge net loss.
- Launched Redbeat Academy in Oct 2020 to retrain staff in technology and IT.
- As at end-FY21, only 35% of staff is female. Skewed by males in operational functions (e.g. engineering).
- Through AirAsia Foundation, supported 28 social enterprises benefitting >10,000 individuals as at end-FY21.

Key G metrics and issues

- BOD comprises Non-Independent Executive Chairman (NIEC), Non-Independent Executive Director & Chief Executive Officer (NIED & CEO), Non-Independent Non-Executive Director (NINED) and 3 Independent Non-Executive Directors (INED). Independent Directors made up 50% of its BOD size, meeting the minimum of Malaysian Code on Corporate Governance's recommendation.
- Only 1 of the 6 BOD members is a woman, Surina Binti Shukri, short of the 30% recommendation. She is an INED.
- Major shareholders, Tune Air and Tune Live are represented on the BOD by the NIEC and NIED & CEO.
- There are 3 BOD committees (i.e. Audit, Nomination & Remuneration and Risk Management).
- The Audit and Nomination & Remuneration Committees are chaired by INEDs.
- The Risk Management Committee, however, is chaired by the NINED.
- FY21 directors' remuneration surged 170% YoY despite generating heavy losses still.
- Ernst & Young PLT is the independent auditor since 2017. The predecessor was PricewaterhouseCoopers PLT.
- Fined by Malaysian Aviation Commission for charging processing fees in FY19 and FY20 (MYR2.2m total) and advertising misleading airfares in FY18 (MYR160k).
- Fined by Malaysia Competition Commission for entering into a collaboration agreement with Malaysia Airlines (MYR10m) in FY14.
- India's Central Bureau of Investigation (CBI) filed a case against the NIED & CEO over alleged violation of norms in getting international flying licenses in FY18.
- The NIED & CEO has not responded to the CBI's case to date.
- The NIEC and NIED & CEO were implicated in a bribery case involving Airbus in FY20. Both were later cleared.
- Ventured into Japan twice. AirAsia Japan consumed >MYR400m in investments but never generated an annual profit. AirAsia Japan filed for bankruptcy in Oct 2020.

[1]***Risk Rating & Score*** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. [2]***Score Momentum*** - indicates changes to the company's score since the last update - a negative integer indicates a company's improving risk score; a positive integer indicates a deterioration. [3]***Controversy Score*** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

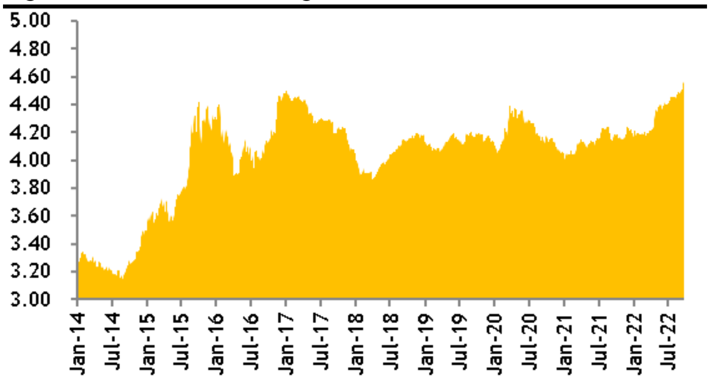
Challenges remain in the current post-COVID world…

If one were to take a cursory look at the cost drivers for airlines, one would be forgiven for believing that the operating environment for CAPITALA's 4 airlines - Malaysia AirAsia (MAA), Indonesia AirAsia (IAA), Philippine AirAsia (PAA), Thai AirAsia (TAA) - remains challenging even post-COVID. **First**, the MYR has weakened past MYR4.50 against the USD due to a hawkish US Federal Reserve Board which has been hiking the Federal Funds Rate to battle inflation. To be honest, this is a concern as USD denominated expenses traditionally accounted for 60-70% CAPITALA's airlines expenses (Fig. 1).

Second, jet fuel prices recently hit a high of >USD160/bbl in mid-Jun 2022 due to Western nations sanctioning Russian oil for Russia's invasion of Ukraine (Fig. 2). Though jet fuel prices have eased to c.USD110/bbl lately due to fears that the hawkish Federal Reserve Board's actions will ultimately lead to a global recession and thus, less demand for crude oil and jet fuel, jet fuel prices remain relatively high by historical standards. Fuel has almost always been the single largest expense for airlines. Fuel traditionally accounted for 30-50% of CAPITALA's airlines expenses.

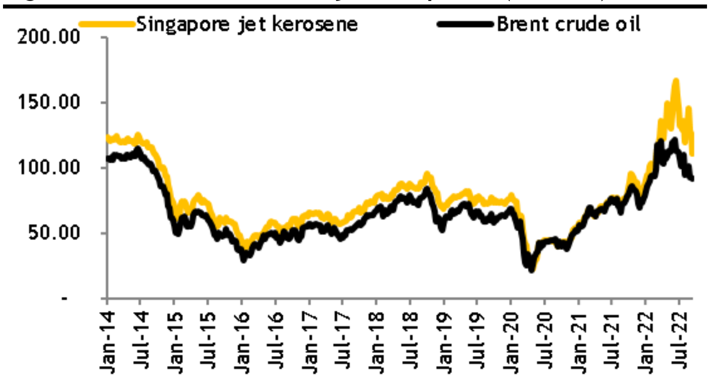
Third, a shortage of spare parts and labour coupled with a surge in airlines wanting to redeploy aircraft post-COVID have cause backlogs at maintenance, repair and operations (MRO) service providers. For CAPITALA, it had to revise down its fleet redeployment plan (Fig. 3 & 4). **Fourth**, there is still no clarity as to when China, a major source of passengers for 3 of CAPITALA's 4 airlines, will lift its zero COVID policy and allow Chinese to travel abroad freely again. Chinese destinations accounted for 11%/13%/25% of MAA/PAA/TAA 2019 available seat kilometres (ASK).

Figure 1: USD/MYR exchange rate



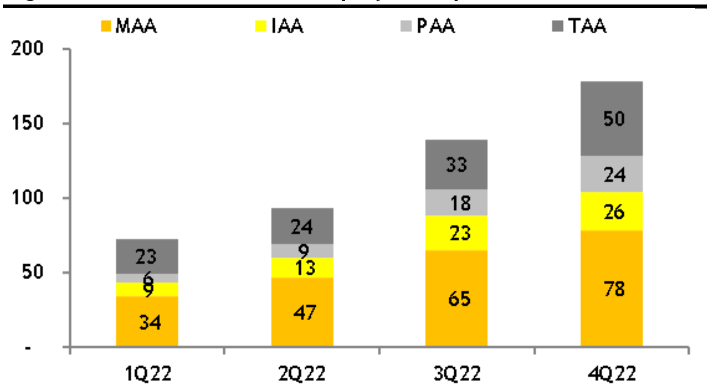
Source: Bloomberg

Figure 2: Brent crude oil and jet fuel prices (USD/bbl)



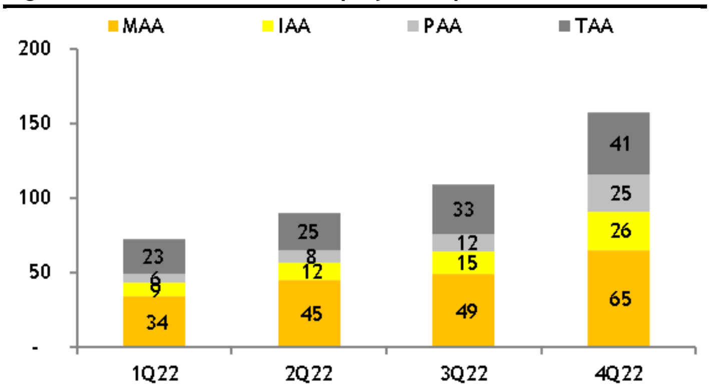
Source: Bloomberg

Figure 3: CAPITALA fleet redeployment plan as at end-1Q22



Source: Company

Figure 4: CAPITALA fleet redeployment plan as at end-2Q22



Source: Company

Figure 5: 2019 percentage of ASK allocated to Chinese destinations by airline

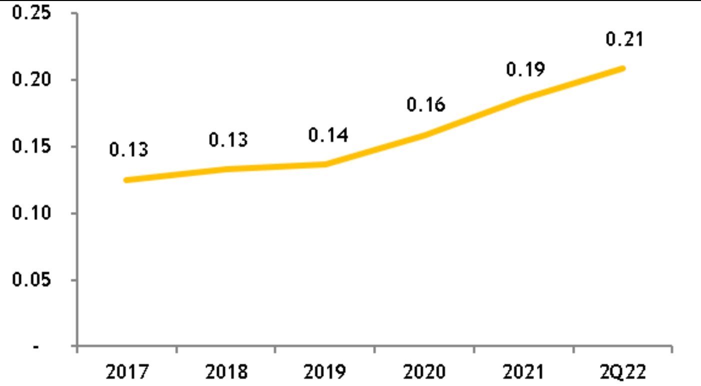
Airline	% of ASK
MAA	11%
IAA	0
PAA	13%
TAA	25%

Source: Company

… but CAPITALA is very much alive and flying

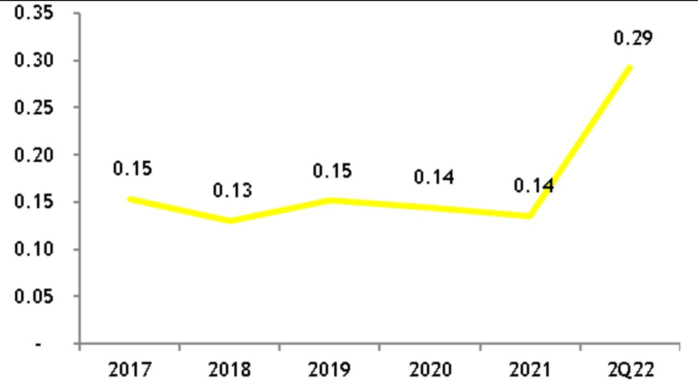
Yet, we are actually turning more optimistic on CAPITALA's 4 airlines' outlook due to higher fares and lower aircraft lease rates. **On higher fares**, fares were high in 2020 and 2021 due to lower capacity as the COVID-19 pandemic grounded many aircraft. That said, airlines generated heavy losses then as they still incurred fixed costs like salaries and aircraft leases. That said, fares remained high and climbed even higher in 2Q22 even though a lot of capacity was returned due to many ASEAN countries reopening their borders then (Fig. 6 to 10). In fact, IAA's average fare/stage length hit a new record of MYR0.29/km in 2Q22 (Fig. 7).

Figure 6: MAA average fare/stage length (MYR/km)



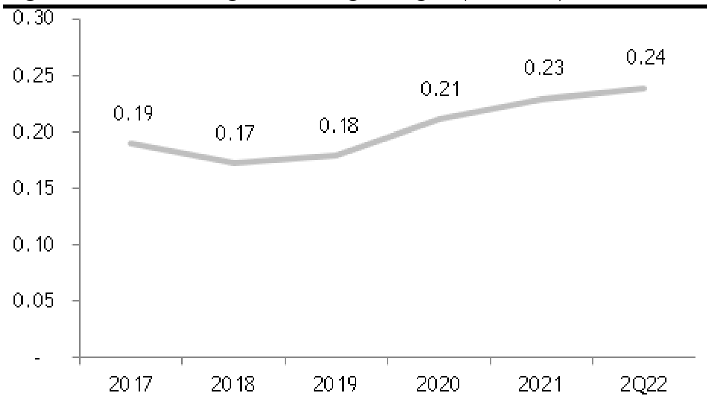
Source: Company, Maybank IBG Research (MIBG)

Figure 7: IAA average fare/stage length (MYR/km)



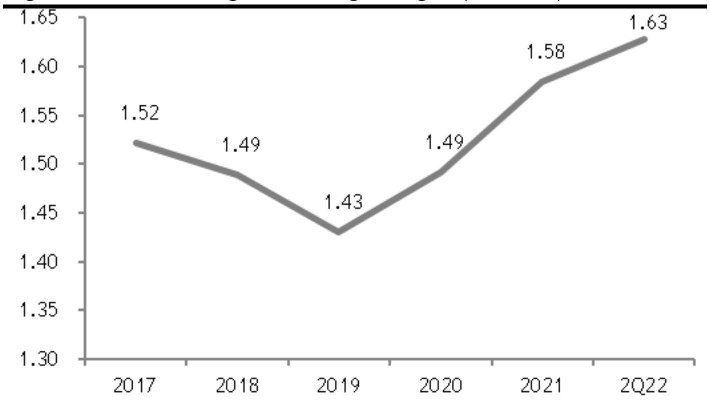
Source: Company, MIBG

Figure 8: PAA average fare/stage length (MYR/km)



Source: Company, MIBG

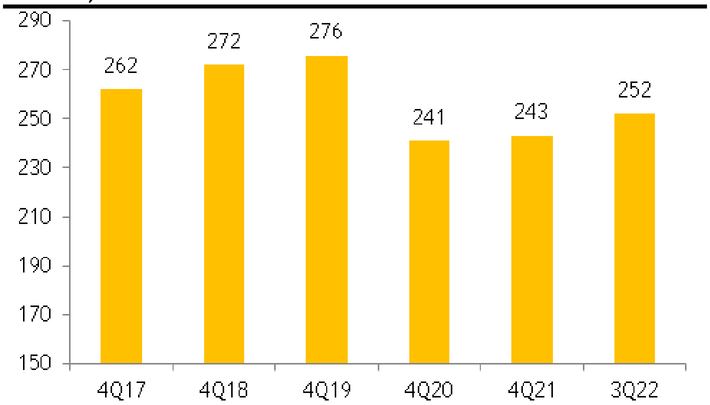
Figure 9: TAA average fare/stage length (THB/km)



Source: Company, MIBG

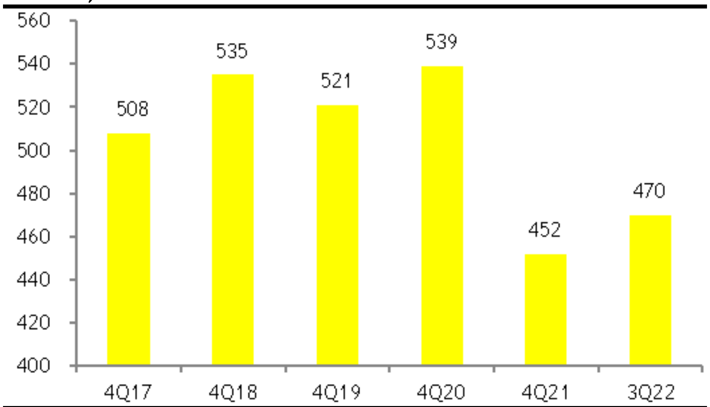
To be sure, higher jet fuel prices have caused airlines to raise fares across the board. That said, another major reason why fares have continued to rise is less competition relative to pre-COVID times. In Malaysia, Indonesia, Philippines and Thailand, there are now 9%/10%/9%/27% fewer aircraft relative to end-2019 due to most airlines (Malaysia: Batik Air Malaysia, Indonesia: Garuda Indonesia, Philippines: Philippine Airlines of PAL Holdings, Thailand: Thai Airways International) reducing their fleet size as a result of less demand brought about by the COVID-19 pandemic (Fig. 10 to 13).

Figure 10: Fleet size of Malaysian airlines (including parked aircraft)



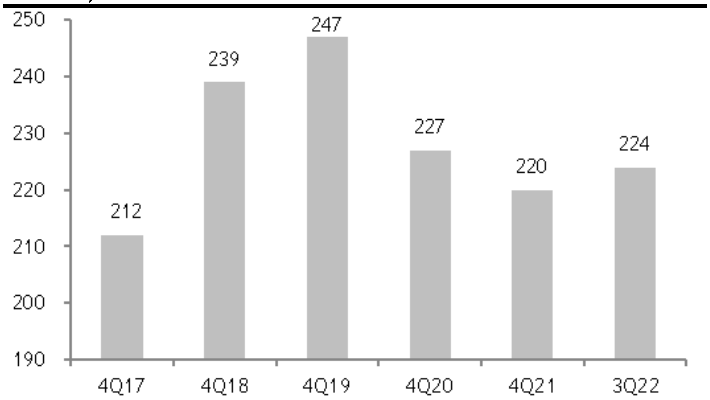
Source: Planespotters

Figure 11: Fleet size of Indonesian airlines (including parked aircraft)



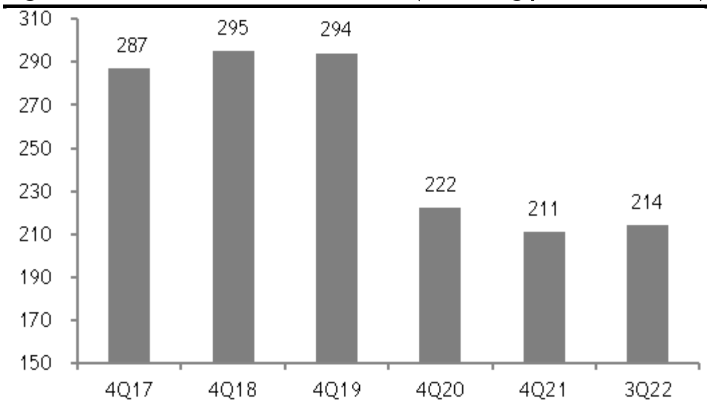
Source: Planespotters

Figure 12: Fleet size of Philippine airlines (including parked aircraft)



Source: Planespotters

Figure 13: Fleet size of Thai airlines (including parked aircraft)

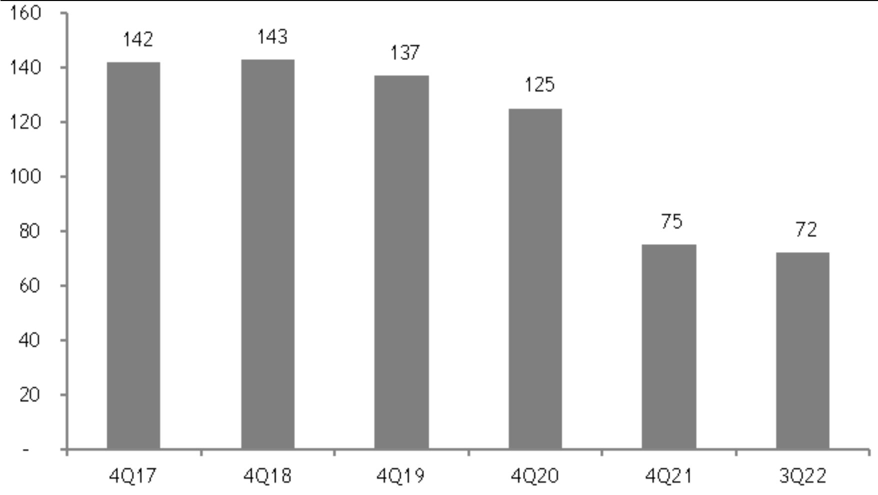


Source: Planespotters

In fact, we believe 1 reason why IAA's average fare/stage length hit eye watering levels in 2Q22 is because Indonesia's national carrier, Garuda Indonesia, reduced its fleet size by almost 50% during the COVID-19 pandemic (Fig. 14). On closer inspection, most of the aircraft it returned to lessors/disposed/stored were narrow body Boeing B737s which are well known as the traditional rivals of Airbus A320s (Fig. 15). Recall that CAPITALA's 4 airlines are almost entirely comprised of Airbus A320s. Thus, we gather that IAA enjoyed less competition from Garuda Indonesia on the routes that it flew and commanded higher fares in 2Q22.

With that in mind, perhaps it is not entirely surprising that CAPITALA is considering growing IAA's fleet size from 25-26 aircraft to 36-37 aircraft. We note that while Philippine Airlines and Thai Airways International also greatly reduced their fleet sizes by 17% and 43% respectively, most of the aircraft they returned to lessors/disposed/stored were wide body Boeing B747s, Boeing B777s, Airbus A330s, Airbus A350s and Airbus A380s which do not directly compete with CAPITALA's Airbus A320s. This explains why PAA and TAA's average fare/stage length did not rise as much as IAA's in 2Q22.

Figure 14: Garuda Indonesia fleet size (including parked aircraft)



Source: Planespotters

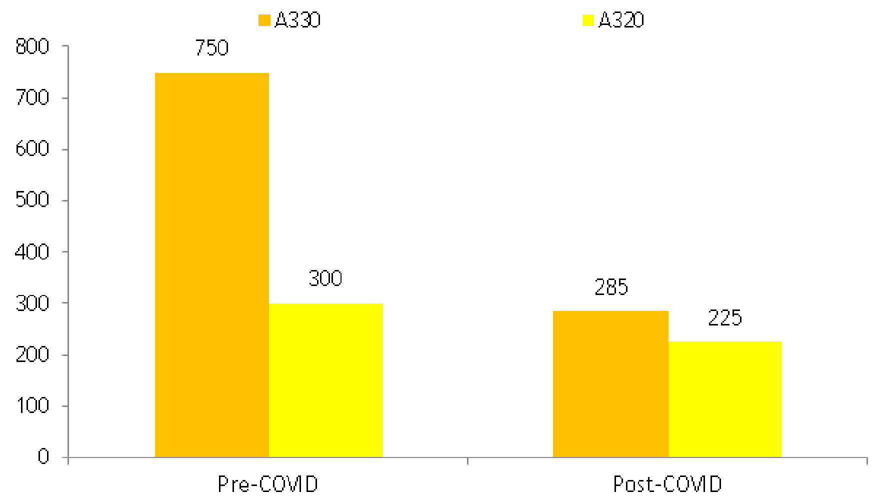
Figure 15: Model and number of aircraft that exited Garuda Indonesia's fleet from 2020

Model	Manufacturer	Number of aircraft
ATR72	Regional Transport Airplanes	10
B737	Boeing	36
B747	Boeing	1
B777	Boeing	2
CRJ-1000ER	Bombardier	16
A330	Airbus	2
Total		**67**

Source: Planespotters

On lower aircraft lease rates, they have been falling post-COVID as demand for aircraft is not expected to be as strong relative to pre-COVID times. We understand that average monthly lease rates for Airbus A320s are on average down c.25% relative to pre-COVID times to c.USD225k (Fig. 16). While we understand that average monthly lease rates for Airbus A330s are on average down a wider c.60% relative to pre-COVID times to c.USD285k, this is because demand for wide body Airbus A330s is not recovering as strongly as that for narrow body Airbus A320s.

Figure 16: Average monthly lease rates of selected Airbus models (USD'000)



Source: Company, AirAsia X, MIBG

Our understanding is that while demand for flights is recovering, it is demand for short haul flights operated by narrow body aircraft that is recovering faster than long haul flights operated by wide body aircraft ostensibly due to the reduced risk of contracting COVID-19 on short haul flights. Whatever the rationale, we estimate that the lower Airbus A320 lease rates translates into annual lease rate savings of c.USD0.9m ((USD300k/month – USD225k/month) X 12 months). Extrapolated over CAPITALA's 213 aircraft currently, we estimate that CAPITALA stands to save a whopping c.MYR860m p.a. (Fig. 17).

Figure 17: Potential leasing savings p.a. by airline

Airline	Aircraft	Lease rate savings p.a. (USDm)	Lease savings p.a. (USDm)	USD/MYR	Lease savings p.a. (MYRm)
	A	B	C=AXB	D	E=CXD
MAA	105	0.9	94.5	4.50	425.3
IAA	25	0.9	22.5	4.50	101.3
PAA	24	0.9	21.6	4.50	97.2
TAA	59	0.9	53.1	4.50	239.0
	213		**191.7**		**862.7**

Source: MIBG

Essentially, the higher fares and lower aircraft lease rates enable CAPITALA's flights to be profitable. To be sure, they will not be immediately apparent in CAPITALA's group earnings yet as it still has to pay the leases of grounded aircraft. But as more aircraft are redeployed, CAPITALA will be driven closer to profitability as the number of active and thus, profitable aircraft overtake the number of parked and thus, loss generating aircraft.

Return to profitability to be deferred to FY24E

Based on the revised assumptions we detailed below, we widen our FY22 core net loss estimate for CAPITALA from MYR2.44b to MYR2.89b largely because airlines hesitated raising airfares in 1Q22 when jet fuel prices began to spike. Airlines only began raising airfares and imposing fuel surcharges in Mar 2022. We also now forecast FY23E core net loss of c.MYR700m versus core net profit of c.MYR250m previously. This is largely due to the slower-than-expected redeployment of MAA's aircraft (Fig. 4). Finally, our revised FY24E net profit of MYR267.8m is very similar to our previous FY23E net profit forecast of MYR253.7m. Essentially, we now expect CAPITALA's return to profitability to be delayed by a year due to the slower-than-expected redeployment of MAA's aircraft.

- **MAA passengers carried -** We raise our FY22E assumption from 14.8m to 17.5m as per management's latest guidance. That said, we lower our FY23E/ FY24E assumption from 38.3m/38.3m to 26.3m/35.0m. The latter is due to the slower-than-expected redeployment of aircraft as per Fig. 4. Note that there is still a 9% deficit between our previous and revised FY24E assumption. Recall that Chinese destinations accounted for 11% of MAA's 2019 ASK.

  There are increasing signs that China may lift its zero COVID policy and reopen its borders soon. In Aug 2022, China allowed Malaysian airlines to increase their flight frequencies to China from 1/week to 15/week. China also recently allowed Hong Kong to ease quarantine requirements. Macau also recently announced that China will also allow Mainland Chinese to resume visiting Macau in Nov 2022 (visitors from outside Mainland China will still be subject to 7 days hotel quarantine).

That said, we believe it wise to assume that the reopening will be gradual. First, China will likely undergo a massive booster vaccination drive before it reopens. There are hopes that China will reopen by Chinese New Year 2023 (commences 22 Jan 2023) but we are unsure if China can boost the majority of its 1.40b population in time. Timing is important as the great majority of Chinese travel overseas only 3 times a year (i.e. Chinese New Year, Labour Day Golden Week in May and National Day Golden Week in October).

Second, we believe that China will not reopen all its airports to international travel lest COVID-19 spreads uncontrollably. In our view, it will likely reopen a handful of airports to international travel initially (e.g. airports in Tier-1 cities of Beijing, Shanghai, Guangzhou and Shenzhen) before reopening airports in Tier-2 and Tier-3 cities to international travel. Third, we believe that China will not hesitate to re-lockdown cities and airports should COVID-19 spread in a particular city.

Thus, we believe that the return of Chinese passengers to ASEAN skies will be gradual and measured throughout FY23 and FY24. In any case, should we be mistaken in our view and China reopens its borders hastily, there will be upside to our MAA passengers carried assumptions which will reinforce our BUY call.

- **IAA passengers carried -** We raise our FY22E assumption from 2.7m to 4.0m as per management's latest guidance. We also raise our FY23E/FY24E assumption from 8.0m/8.0m to 9.5m/11.0m. The latter is because we expect CAPITALA to redirect 10 aircraft from its other 3 airlines, largely MAA, to IAA to capitalise on the high fare environment in Indonesia.

- **PAA passengers carried -** We raise our FY22E assumption from 3.6m to 4.3m as per management's latest guidance. That said, we trim our FY23E/FY24E assumption from 8.6m/8.6m to 7.3m/7.3m. Recall that Chinese destinations accounted for 13% of PAA's 2019 ASK. Like MAA, we assume that there will be a deficit between our previous and revised FY23E/FY24E assumptions as we expect the return of Chinese passengers to be gradual and measured.

- **TAA passengers carried -** We raise our FY22E assumption from 8.8m to 10.0m as per TAA management's latest guidance. That said, we trim our FY23E/FY24E assumption from 19.9m/19.9m to 16.0m/18.0m. This is because TAA is planning to return another 7 aircraft or 1 more than we initially expected to lessors by end-2022.

- **MAA average fare/stage length -** We assume that it will ease a tad from MYR0.21/km in 2Q22 to MYR0.18/km-MYR0.19/km going forward. Batik Air Malaysia took delivery of 11 Boeing B737 MAXs since May 2022 and new airline, MYAirline took delivery of 1 Airbus A320 in Jul 2022. Although the 12 aircraft constitute <5% of all aircraft operated by Malaysian airlines, we gather that it will discourage MAA from raising fares to much higher levels.

- **IAA average fare/stage length -** We assume that it will ease a tad from equiv. MYR0.29/km in 2Q22 to MYR0.24/km-MYR0.25/km going forward. There has been pressure from the Indonesian government to reduce domestic airfares by 15%. This roughly translates into MYR0.24/km-MYR0.25/km going forward. Notwithstanding, MYR0.24/km-MYR0.25/km is still high by historical standards.

- **PAA average fare/stage length -** We assume that it will be maintained at equiv. MYR0.24/km going forward. It does not appear to us that Philippine airlines, whether full service carriers or low cost carriers, will be taking delivery of many aircraft going forward. Thus, we believe average fare/stage length can be maintained at MYR0.24/km.
- **TAA average fare/stage length -** We assume that it will be maintained at THB1.6/km going forward. Recall that there are 27% fewer aircraft in Thailand

today relative to end-2019, the largest percentage decline among the 4 countries that CAPITALA's 4 airlines are based. Coupled with Thailand lifting its Thailand Pass registration scheme (similar to MySejahtera in Malaysia) and health insurance requirement for tourists from 1 Jul 2022, we believe average fare/stage length can be maintained at THB1.6/km.

- **Jet fuel price -** We raise our jet fuel price assumption from USD80/bbl p.a. to USD125/bbl in FY22E and USD110/bbl in FY23E and FY24E. YTD, jet fuel prices have averaged at USD127/bbl. We assume that jet fuel prices will stabilise at USD110/bbl going forward. This assumes brent crude oil price of USD100/bbl plus USD10/bbl crack spread between brent crude oil and jet fuel going forward.

- **Average monthly lease rate -** As alluded to in the two preceding pages, we reduce our average monthly aircraft lease rate assumption from USD300k to USD225k. To be sure, individual monthly aircraft lease rates will differ. Newer aircraft will command higher monthly aircraft lease rates than older aircraft. That said, we expect monthly aircraft lease rates to average at USD225k.

- **Average USD/MYR exchange rate -** We raise our average USD/MYR exchange rate assumption from MYR4.20 p.a. to MYR4.40 in FY22E and MYR4.50 in FY23E and FY24E. YTD, the USD/MYR exchange rate has averaged at MYR4.33. We assume that the USD/MYR exchange rate will stabilise at MYR4.50 going forward.

Figure 18: Major assumptions and estimates

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Revised assumptions and estimates						
MAA passengers carried (m)	35.0	9.1	3.1	17.5	26.3	35.0
IAA passengers carried (m)	8.0	2.2	0.8	4.0	9.5	11.0
PAA passengers carried (m)	8.6	2.0	0.9	4.3	7.3	7.3
TAA passengers carried (m)	22.1	9.5	2.9	10.0	16.0	18.0
MAA average fare/stage length (sen/km)	0.14	0.16	0.19	0.19	0.19	0.18
IAA average fare/stage length (sen/km)	0.15	0.14	0.14	0.24	0.25	0.25
PAA average fare/stage length (sen/km)	0.18	0.21	0.23	0.24	0.24	0.24
TAA average fare/stage length (THB/km)	1.4	1.5	1.6	1.6	1.6	1.6
Jet fuel price (USD/bbl)	76	141	90	125	110	110
Average monthly aircraft lease rate (USD'000)	300	300	300	225	225	225
Average USD/MYR exchange rate	4.14	4.20	4.14	4.40	4.50	4.50
Core net profit/(loss)	(396.0)	(3,483.8)	(2,758.8)	(2,890.2)	(696.5)	267.8
Previous assumptions and estimates						
MAA passengers carried (m)	35.0	9.1	3.1	14.8	38.3	38.3
IAA passengers carried (m)	8.0	2.2	0.8	2.7	8.0	8.0
PAA passengers carried (m)	8.6	2.0	0.9	3.6	8.6	8.6
TAA passengers carried (m)	22.1	9.5	2.9	8.8	19.9	19.9
MAA average fare/stage length (sen/km)	0.14	0.16	0.19	0.15	0.14	0.14
IAA average fare/stage length (sen/km)	0.15	0.14	0.14	0.15	0.15	0.15
PAA average fare/stage length (sen/km)	0.18	0.21	0.23	0.20	0.19	0.19
TAA average fare/stage length (THB/km)	1.4	1.5	1.6	1.5	1.4	1.4
Jet fuel price (USD/bbl)	76	141	90	80	80	80
USD/MYR	4.14	4.20	4.14	4.20	4.20	4.20
Average monthly aircraft lease rate (USD'000)	300	300	300	300	300	300
Average USD/MYR exchange rate	4.14	4.20	4.14	4.40	4.50	4.50
Core net profit/(loss)	(396.0)	(3,483.8)	(2,758.8)	(2,439.2)	253.7	361.5

Source: MIBG

Maintain BUY with lower TP of MYR0.84 (-35%)

Seeing that we now expect CAPITALA's return to profitability to be delayed by a year, we now base our valuation of CAPITALA's aviation business on its FY24E airline net profit versus FY23E airline net profit previously. Given that FY24E is further into the future, we ascribe a lower PER multiple of 8.0x (which is at the lower range of its global peers as detailed on Fig. 20) on its FY24E airline net profit. We previously ascribed a higher PER multiple of 14.0x on its FY23E airline net profit. The end result is that we trim our valuation for CAPITALA's aviation business from MYR0.83/shr to MYR0.74/shr.

We continue to value 'airasia SuperApp' and 'teleport' based on their implied valuation using their most recent share sales. While their value in MYR terms has benefitted from a weaker MYR against the USD (MYR0.94/shr versus MYR0.88/shr previously), we think it best to widen our holding company discount from 25% to 50%. With interest rates around the world rising and global equity markets roiling, there is no guarantee that 'airasia SuperApp' and 'teleport's' next share sales will command similar valuations as buy outs will be more expensive to finance and their peers' valuations will have turned more attractive.

As a sanity check, the 50% holding company discount we ascribe to CAPITALA is not dissimilar to the 55% holding company discount we ascribe to Genting. All things considered, we cut our SOP-based TP from MYR1.29 to MYR0.84. Yet, CAPITALA still offers a punchy >30% upside potential. Thus, we maintain our BUY call on CAPITALA. There could be more upside potential should CAPITALA successfully list its aviation and digital businesses at valuations higher than we ascribed. Recall that CAPITALA has plans to list its aviation and digital businesses on the NASDAQ.

Figure 19: CAPITALA valuation

	FY24E	PER (X)	Value	Value/shr	Comment
Airline net profit with RCUIDS interest expenses added back	457.4	8.0	3,659.6	0.61	
AirAsia X			-	-	assume nil
Tune Protect Group			29.8	0.00	14% of market capitalisation
Proceeds from warrants			649.7	0.11	MYR1.00 exercise price
Proceeds from ESOS			112.6	0.02	MYR0.743 exercise price
Aviation business (A)			**4,451.6**	**0.74**	
airasia SuperApp			4,328.6	0.72	96% of USD1.0b valuation
Teleport			1,333.5	0.22	99% of USD300m valuation
Digital business (B)			**5,662.1**	**0.94**	
Total (C=A+B)			**10,113.6**	**1.69**	
(50% discount) (D=CX-50%)			(5,056.8)	(0.84)	
SOP (E=C+D)			**5,056.8**	**0.84**	

Source: MIBG

Figure 20: Peer comparison valuation of leading low cost carriers

Company	Country	Market capitalisation USDm	Last price Local currency	CY23E EPS	CY24E EPS	CY23E PER x	CY24E PER x
Southwest Airlines	United States	18,613	USD31.37	3.25	4.11	9.65	7.63
Ryanair Holdings	Ireland	11,883	EUR10.84	1.44	1.59	7.54	6.84
InterGlobe Aviation	India	8,716	INR1,838	80.40	116.73	22.86	15.75
Spring Airlines	China	7,054	CNY55.02	1.61	2.71	34.09	20.32
AirArabia	United Arab Emirates	2,593	AED2.04	0.23	0.23	9.07	8.87
Vietjet Aviation	Vietnam	2,523	VND110,500	3.734k	4.097k	29.49	26.87
easyJet	United Kingdom	2,467	GBP3.02	0.37	0.54	8.27	5.59
Wizz Air Holdings	Hungary	1,937	GBP17.62	0.78	3.39	22.55	5.20
JET2	United Kingdom	1,841	GBP7.95	1.06	1.23	7.47	6.46
Norwegian Air Shuttle	Norway	589	NOK6.80	0.79	1.18	8.59	5.75
Average						**15.96**	**10.93**

Source: Bloomberg

PN17 status a work-in-progress but shareholders need not fear dilution

While we are still sanguine on CAPITALA's outlook, it remains classified as a PN17 listed issuer due to its negative shareholders' equity position (end-2Q22: -MYR5.5b). It has until early Jan 2023 to submit a regularisation plan to Bursa Malaysia. If Bursa Malaysia approves the regularisation plan:-

- CAPITALA has to complete the implementation of the plan within 6 months from the date the plan is approved by Bursa Malaysia.
- For cases which involve court proceedings, CAPITALA has up to 12 months from the date the plan is approved by Bursa Malaysia to complete the implementation of the plan.
- CAPITALA also has to record a net profit in 2 consecutive quarterly results immediately after the completion of the implementation of the plan.

Only then will CAPITALA no longer be classified as a PN17 listed issuer. Failing which and without Bursa Malaysia's leave, CAPITALA will be delisted from Bursa Malaysia. Thus, we await management's views on how it plans to be no longer classified as a PN17 listed issuer. In Jan 2022, we posited 6 ways that CAPITALA can substantially narrow its negative shareholders' equity (link):-

- waiver of deferred aircraft leases (MYR2.2b as at end-2021, MYR1.8b as at end-2Q22) to be written back to income statement;
- listing of digital assets (i.e. 'airasia SuperApp' and 'teleport') which are currently valued at USD1.2b or MYR5.7b translating into gains on dilution;
- reversal of impairment of right-of-use assets (MYR552m of which MYR229m has been reversed in 2Q22);
- issuance of Redeemable Convertible Unsecured Islamic Debt Securities (MYR974m issued of which MYR197.8m has been converted into ordinary shares); and conversion of warrants (can potentially raise MYR650m but none converted into ordinary shares yet due to the high exercise price of MYR1.00);

- deconsolidate IAA and PAA accounts (shareholders equity as at end-2021 was – MYR1.5b for IAA and -MYR2.6b for PAA); and

- sale of assets (e.g. maintenance, repairs and operations division called Asia Digital Engineering, airlines, fintech division called BigPay)

It appears to us that CAPITALA's auditors have not allowed it to write back the waiver of deferred aircraft leases to its income statement which is a shame because it would have greatly reduced CAPITALA's negative shareholders' equity position.

When we enquired of management's plans, they were cryptic and only mentioned two main points. One, CAPITALA will undergo restructuring and unlock the value of its assets. Two, CAPITALA will not undergo capital dilution (i.e. no more rights issues and/or conversion of debts into ordinary shares).

On the first point, we gather that CAPITALA may consider selling PAA and sell or list 'airasia SuperApp' and 'teleport' as we posited earlier. MAA has historically contributed an overwhelming c.80% to group earnings. IAA is experiencing a positive high fare environment right now. CAPITALA just injected MYR176.3m of equity into TAA in 1Q22. That leaves PAA.

On the second point, we welcome this assurance as this will protect existing shareholders' interest. On another interesting and positive note, CAPITALA stated that it has had consultation sessions with Bursa Malaysia on its draft regularisation plan and has not received major objections from it. This suggests to us that Bursa Malaysia may eventually grant CAPITALA leave to complete its implementation plan beyond the 6/12 months deadline mentioned above.

In any case, if CAPITALA successfully lists its aviation and digital businesses on the NASDAQ, we do not discount the possibility that shares in the aviation and digital businesses will be distributed in specie to CAPITALA shareholders. This will effectively turn CAPITALA into a shell company and its delisting from Bursa Malaysia due to its PN17 classification will be of little concern to shareholders who would have already received shares in the aviation and digital businesses.

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	nm	nm	nm	nm	9.8
Core P/E (x)	nm	nm	nm	nm	9.8
Core FD P/E (x)	nm	nm	nm	nm	11.4
P/BV (x)	nm	nm	nm	nm	nm
P/NTA (x)	(1.6)	(0.7)	(0.4)	(0.3)	(0.4)
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	nm	nm	nm	21.1	47.2
EV/EBITDAR (x)	nm	nm	nm	9.5	5.9
EV/EBIT (x)	nm	nm	nm	28.0	11.4
INCOME STATEMENT (MYR m)					
Revenue	3,274.4	1,836.2	7,349.0	13,402.2	16,409.3
EBITDAR	(1,491.8)	(967.2)	(253.0)	2,426.9	3,329.7
Depreciation	(2,073.0)	(1,820.6)	(1,573.8)	(1,605.8)	(1,605.8)
EBIT	(3,564.8)	(2,816.6)	(1,826.7)	821.1	1,723.9
Net interest income /(exp)	(597.7)	(644.5)	(976.1)	(1,049.3)	(1,009.0)
Associates & JV	(63.5)	(45.2)	(523.6)	(139.0)	(70.9)
Exceptionals	(1,325.2)	(68.7)	(121.0)	0.0	0.0
Pretax profit	(5,551.3)	(3,575.0)	(3,447.4)	(367.2)	644.0
Income tax	(17.8)	(5.0)	(4.6)	(4.6)	(4.6)
Minorities	776.3	729.7	440.8	(324.8)	(371.7)
Reported net profit	(5,111.7)	(2,991.1)	(3,011.2)	(696.5)	267.8
Core net profit	(3,483.8)	(2,758.8)	(2,890.2)	(696.5)	267.8
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	533.3	1,256.8	1,287.0	1,756.5	2,890.0
Accounts receivable	1,537.7	832.5	649.4	649.4	649.4
Inventory	141.4	153.6	153.6	153.6	153.6
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,085.6	933.5	818.8	704.1	589.4
Intangible assets	640.6	833.5	833.5	833.5	833.5
Investment in Associates & JVs	484.1	438.9	675.2	536.3	465.4
Other assets	15,443.1	15,581.2	14,239.3	12,757.2	11,275.1
Total assets	**19,865.8**	**20,029.9**	**18,656.8**	**17,390.5**	**16,856.3**
ST interest bearing debt	4,263.5	4,793.0	3,987.1	4,272.8	4,418.1
Accounts payable	2,508.9	2,308.9	2,308.9	2,308.9	2,308.9
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	9,460.7	11,812.2	14,507.5	13,333.8	12,015.0
Other liabilities	7,203.0	7,539.0	7,530.0	7,524.0	7,524.0
Total Liabilities	**23,435.6**	**26,452.8**	**28,333.9**	**27,439.4**	**26,265.8**
Shareholders Equity	(1,214.3)	(3,382.3)	(6,195.7)	(6,892.3)	(6,624.5)
Minority Interest	(2,355.5)	(3,040.6)	(3,481.4)	(3,156.6)	(2,785.0)
Total shareholder equity	**(3,569.8)**	**(6,422.9)**	**(9,677.1)**	**(10,048.9)**	**(9,409.5)**
Total liabilities and equity	**19,865.8**	**20,029.9**	**18,656.8**	**17,390.5**	**16,856.3**
CASH FLOW (MYR m)					
Pretax profit	(5,551.3)	(3,575.0)	(3,447.4)	(367.2)	644.0
Depreciation & amortisation	2,073.0	1,820.6	1,573.8	1,605.8	1,605.8
Adj net interest (income)/exp	549.9	552.0	726.2	723.0	682.8
Change in working capital	(800.3)	209.2	225.6	(33.8)	(33.8)
Cash taxes paid	(25.3)	(4.6)	(12.9)	(11.2)	(4.6)
Other operating cash flow	1,585.7	320.1	644.6	139.0	70.9
Cash flow from operations	(2,168.2)	(677.7)	(290.1)	2,055.6	2,965.0
Capex	(100.5)	(50.1)	(50.0)	(50.0)	(50.0)
Free cash flow	(3,148.9)	(1,151.6)	(1,204.7)	553.3	1,236.7
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised / (purchased)	0.0	336.5	0.0	0.0	0.0
Change in Debt	(412.5)	733.9	262.0	(1,577.1)	(1,822.6)
Other invest/financing cash flow	589.8	431.3	108.4	41.0	41.0
Effect of exch rate changes	65.0	(69.7)	0.0	0.0	0.0
Net cash flow	(2,026.4)	704.1	30.2	469.5	1,133.5

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	(72.4)	(43.9)	300.2	82.4	22.4
EBITDAR growth	nm	nm	nm	nm	37.2
EBIT growth	nm	nm	nm	nm	110.0
Pretax growth	nm	nm	nm	nm	nm
Reported net profit growth	nm	nm	nm	nm	nm
Core net profit growth	nm	nm	nm	nm	nm
Profitability ratios (%)					
EBITDAR margin	nm	nm	nm	18.1	20.3
EBIT margin	nm	nm	nm	6.1	10.5
Pretax profit margin	nm	nm	nm	nm	3.9
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	nm	nm	nm	nm	1.6
Revenue/Assets (x)	0.2	0.1	0.4	0.8	1.0
Assets/Equity (x)	nm	nm	nm	nm	nm
ROAE (%)	(71.7)	(89.8)	(445.6)	64.5	(20.7)
ROAA (%)	(15.3)	(13.8)	(14.9)	(3.9)	1.6
Liquidity & Efficiency					
Dividend cover (x)	nm	nm	nm	nm	nm
Current ratio (x)	0.3	0.3	0.3	0.3	0.4
Leverage & Expense Analysis					
Asset/Liability (x)	0.8	0.8	0.7	0.6	0.6
Net gearing (%) (incl perps)	nm	nm	nm	nm	nm
Net gearing (%) (excl. perps)	nm	nm	nm	nm	nm
Net interest cover (x)	na	na	na	0.8	1.7
Debt/EBITDAR (x)	nm	nm	nm	7.3	4.9
Capex/revenue (%)	3.1	2.7	0.7	0.4	0.3
Net debt/ (net cash)	13,190.8	15,348.4	17,207.6	15,850.2	13,543.1

Source: Company; Maybank IBG Research

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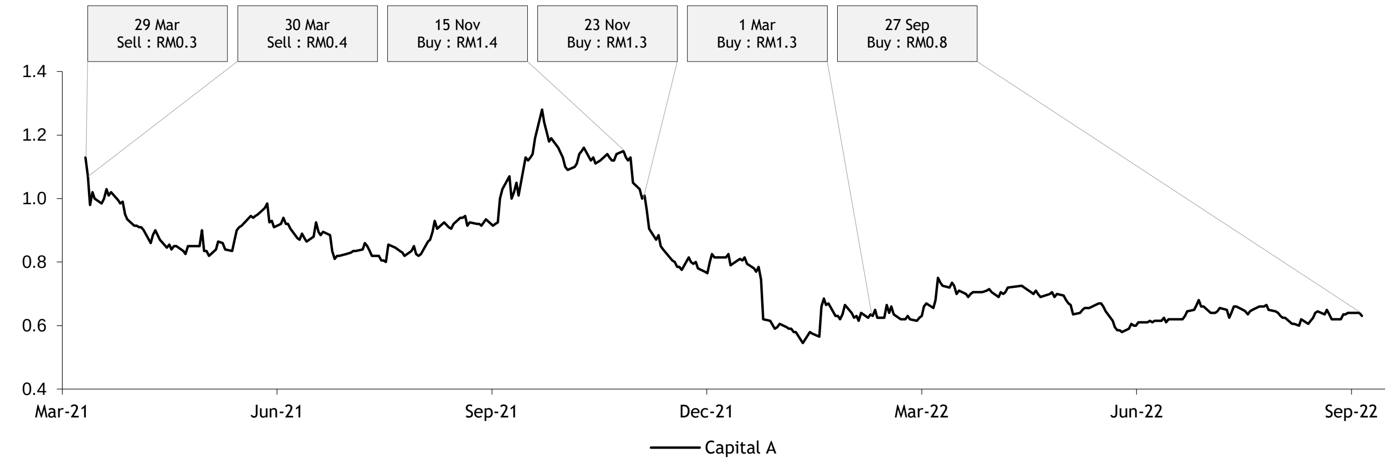

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