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Institute for Management and Business Research (IMBRe)
Universiti Utara Malaysia

ARE WE DOING FINE? A CASE OF MALAYSIAN AIRLINE SYSTEM BERHAD

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This case was written by Rohani Md Rus and Nur Adiana Hiau Abdullah, Universiti Utara Malaysia. It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

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Opening Paragraph

Amir, an independent financial consultant, just came out from a meeting with the major shareholders. In the meeting on 7th January 2013, the shareholders raised a concern relating to their investment in the Malaysian Airline System Berhad (MAS). After two business turnaround plans, they wondered whether it was worth to continue holding their investment in MAS because it seemed that the business turnaround plans worked only in the short rather than long run. Moreover, information from the 2006 to 2012 annual reports did not suggest a healthier performance of MAS. They did not understand if the losses were caused by operating, financial or both leverages. Furthermore, the profit and loss statements showed a downward trend which raised concern on the sustainability of MAS in the long run. Although MAS had its own team to look at this matter, the major shareholders would like to have an independent assessment by an individual not related to MAS. Hence, Amir was consulted to provide a report on the liquidity, leverage and profitability analysis, as well as the business turnaround plans of MAS from the period 2006 to 2012. The analysis must be presented in the next meeting, which is scheduled on 14th January, 2013.

Company Background

Malaysian Airline (MAS) was a major airline in Malaysia. It was listed on Bursa Malaysia under the name Malaysia Airlines System Berhad. As a national carrier, MAS operates flights from Kuala Lumpur International airport to various destinations throughout Malaysia, Asia and some major destinations in the world. In 2013, MAS had 28 subsidiaries[1] with 25 of them fully owned by Malaysia Airlines System Bhd. Some of these subsidiaries were Firefly, MAS Wings and freighter fleet operated by MAS Cargo which managed freighter flights and aircraft cargo-hold capacity for all MAS passenger flights. MAS had diversified into related industries and sectors, including aircraft ground handling, aircraft leasing, aviation engineering, air catering and tour operator. In addition, MAS also provided aircraft maintenance, aircraft handling services, repair and overhaul to other companies. Malaysian Airlines System Berhad (MAS) had been awarded with more than 100 awards in the last ten years because of its excellent service. The most notable award was World's Best Cabin Crew which was awarded in 2001 to 2004, 2007, 2009 and 2012 by Skytrax[2].

MAS had gone through many turbulences. One of them was the September 11 terrorist attack in which the demand for travelling by aircrafts went down drastically (MAS Annual Report, 2002). September 11, 2001 set the beginning of the crisis in the airlines industry throughout the world where during that year an unexpected decline in traffic and sales had occurred in most carriers. As a result, the industry suffered losses amounting to USD7.7 billion (Air Transport Association Economic Report, 2002). It took four years to recover from the crisis and some of the airlines companies filed bankruptcy.

The growth of low cost carriers (LCC) and higher cost of oil and fuel in 2005 were another problem faced by MAS. During that period, the operation cost had exceeded operation revenue. The cost of oil and fuel that continued to increase really hit hard on MAS. MAS was not able to sustain and it incurred losses in 2005. Furthermore, environmental factors such as earthquakes, tsunamis and floods that occurred in Japan (2011), had also reduced the demand of travelling by air. All these incidences had forced MAS to take necessary action in order to remain in business.

[1] https://en.wikipedia.org/wiki/Malaysia_Airlines
[2] https://en.wikipedia.org/wiki/Malaysia_Airlines

MAS Recovery Plan

In order to sustain, MAS came up with recovery plans which were executed in 2006 to 2012 as follows:

i. business turnaround plan 1
ii. business turnaround plan 2.

Business Turnaround Plan 1 (2006-2007)

Business Turnaround Plan 1 (BTP 1) was implemented by Malaysian Airlines System Berhad (MAS) on 27 February 2006 to overcome cash and profit crisis during the financial year of December 2005. During this period costs had increased substantially by 28.8 percent or RM2.3 billion, primarily due to escalating fuel prices. Other costs such as handling and landing fee, aircraft maintenance and overhaul charges, Widespread Assets Unbundling (WAU) charges and leases had also increased. The plan was carried out as MAS forecasted that it would have suffered a major loss of RM1.7 billion for financial year ended 2006 if it did not implement the recovery plan by April 2006 (The MAS Way: Business Turnaround Plan, 2006).

The first action taken by MAS in the BTP1 plan was to sell off their corporate headquarters in Kuala Lumpur in order to retain cash of RM1.5 billion to encounter cash crisis in 2005 (MAS Annual Report, 2006). Then, in 2006 MAS cut unprofitable routes and focused on profitable core network. Manpower was also being cut to match the new network. From a loss of RM1,264,787,000 (MAS Annual Report, 2005), MAS forecasted that the strategy would reduce the losses to RM620 million in 2006. In 2007, MAS focused on improving their efficiency and capabilities. The company estimated that there would be an improvement of RM670 million, hence providing a profit of RM50 million (MAS annual report, 2006). In 2008, MAS focused on new growth opportunities. This strategy was expected to result in a profit of RM500 million in that particular year.

The BTP1 results in 2006 showed a great improvement where MAS managed to exceed the target in Quarter 1 (Q1) to Quarter 4 (Q4). For the last two quarters of 2006, MAS managed to make a net profit that helped reduced its annual losses (MAS Annual Report, 2006). Consequently, MAS financial performance was better than the BTP1 target where its primary objective of financial survival in 2006 had been achieved. This achievement was reflected in MAS share price increasing from RM2.60 to RM6.00. In 2007, the Malaysian Airlines System Berhad profit boosted up to RM852,743 million. This was again exceeded the expectation of BTP1. At the end of 2007, MAS had RM4.4 billion in its cash balances.

Business turnaround Plan 2 (2008 -2012)

In 2008, MAS took another step to boost its profit by implementing the business turnaround plan 2 (BTP2). This measure was taken as competition was stiff during that time where only the strongest airlines could survive. The industry had estimated that more than 400 new aircrafts will hit the skies of Asia Pacific, India and Middle East in 2007 and another 400 plus was expected in 2008. Increase in the number of airlines might erode the yield and profit margin of MAS. Thus, to secure its future success, the BTP 2 aimed to become the World's Five Star Value Carrier. The plan was based on five key thrusts: wining customer, mastering operational excellence, financing and aligning the business on profit and loss (P&L), unleashing talents and capabilities and winning coalitions. The philosophy behind the BTP2 was "aiming and planning for the best, assuming the worst".

However, the year 2009 did not flourish as MAS expected it to be. The International Air Transport Association (IATA) declared 2009 as the toughest year in the history of aviation, worse than the post September 11 incident and Severe Acute Respiratory System (SARS) (IATA annual report, 2009). The chairman of Malaysian Airlines System Berhad also commented that 2009 was extremely challenging for the aviation industry (MAS annual report, 2009). During this year, the industry recorded a 3.5 percent declined in passenger traffic and a 10.1 percent decline in freight traffic (IATA annual report, 2010). This phenomenon had badly affected MAS and for the year 2009 MAS recorded an operating loss of RM614,793 million. However, with the mark-to-market derivative gain of RM1.16 billion, the company was able to record a full year positive net income after tax (NIAT) of RM493 million.

Financial Highlight

The year 2005 to 2012 showed an improvement in operating revenue except for 2009. However, operating expenditure during those times exceeded the operating revenue except for the year 2007. In the airline industry, high growth in expenditure was not a good sign as it would mean an increase in the company losses. The year 2011 witnessed operating expenditure reached its highest in the amount of RM16.2 billion. As far as profits were concerned, it had improved from a loss of RM133.7 million in 2006 to a positive of RM840.9 million in 2007. Profit remained to be positive from the year 2008 to 2010, but by 2011 MAS experienced a huge loss of RM2.5 billion. In terms of the changes in MAS capital structure, in 2010 MAS issued right issues for 1,671,078,120 ordinary shares of RM1 each with an issuance price of RM1.60 (MAS, 2010). The proceed was to be used to acquire 25 aircrafts, to support working capital, to pay bank borrowing and expenses related to the right issues offering.

Conclusion

Looking through all the financial statements as presented in Exhibit 1 and Exhibit 2, Amir knew that he had to do a thorough analysis to enable the major shareholders understood about the problem that MAS was facing. This would include analyzing the restructuring exercises, calculating the liquidity, leverage and profitability ratios as well as doing leverage analysis such as the degree of operating leverage, financial leverage and combined leverage from 2006 to 2012. Furthermore, Amir had to evaluate whether or not MAS business turnaround plans helped in improving its financial situation.

Exhibit 1

Balance Sheet of Malaysian Airlines System Berhad as at financial year ended 31 December

	2005	2006	2007	2008*	2009*	2010*	2011	2012
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Non-current assets								
Aircraft, property, plant and equipment	2,223,558	2,411,537	2,061,118	2,464,823	3,149,827	7,663,357	9,073,907	12,853,554
Investments	172,701							
Investments in subsidiaries	351,815							
Investments in associates		67,461	58,447	73,268	78,976	101,804	120,043	125,044
Other investments		102,701	66,325	64,946	53,952	54,604	54,599	57,038
Investments in a jointly controlled entity					1,798	2,360		
Intangible assets	25,314	80,362	103,162	106,253	110,041	137,732	151,757	153,912
Other receivables		425,270	316,255	485,925	386,537	442,575	343,582	313,473
Prepaid lease payments on land		91,824	17,613	17,431				
Deferred tax assets	92,503	41,828	4,007	1,348	34,026	3,495	765	1,021
Negotiable instruments of deposits			340,000	250,000				
Total non-current assets	2,865,891	3,220,983	2,966,927	3,463,994	3,815,157	8,405,927	9,744,653	13,504,042
Current assets								

Inventories	454,720	385,769	365,266	379,730	384,916	430,849	362,267	331,164
Trade and other receivables	1,829,508	1,823,784	1,807,949	1,861,129	1,383,831	1,372,186	1,268,154	1,258,872
Tax recoverable					15,645	19,436	8,865	6,057
Negotiable instruments of deposits			485,000	795,000	287,466	139,206	101,073	
Cash and bank balances	1,179,409	1,584,699	4,434,338	3,571,743	2,664,859	2,085,451	1,014,464	2,148,478
Derivative financial instruments								42,505
Non-current assets held for sale		10,647	2,501					
Total current assets	3,463,637	3,804,899	7,095,054	6,607,602	4,736,717	4,047,128	2,754,823	3,787,076
	2005	**2006**	**2007**	**2008**	**2009***	**2010***	**2011**	**2012**
Current liabilities	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Sales in advance of carriage	1,455,794	1,202,060	1,563,394	1,222,410	1,451,401	1,677,346	1,705,943	1,663,026
Deferred revenue					225,135	232,823	205,307	224,036
Trade and other payables	2,815,108	2,515,703	3,006,391	2,408,825	2,081,639	2,240,044	2,643,899	2,343,126
Provisions		347,714	681,828	817,703	902,295	934,967	1,188,165	1,330,001
Borrowings		1,050,000		433,411	315,518	293,867	1,379,411	1,458,237
Derivative financial instruments					584,788	108,080	9,820	13,940
Taxation	22,033	20,457	4,432	5,001	3,696	3,614	1,437	533
Total current liabilities	4,292,935	5,135,934	5,256,045	4,887,350	5,564,472	5,490,741	7,133,982	7,032,899
Financed by								
Share capital	1,253,244	1,253,244	1,670,992	1,671,002	1,671,078	3,342,156	3,342,156	3,342,156
Reserves	769,370	620,181	2,263,901	2,514,696	-971,385	182,010	-2,299,648	-2,717,202
Perpetual Sukuk								1,498,190
	2,022,614	1,873,425	3,934,893	4,185,698	699,693	3,524,166	1,042,508	2,123,144
Non-controlling interests					11,869	13,078	13,639	14,847
Minority interest	13,152	15,246	11,056	11,278				
Total equity	2,035,766	1,888,671	3,945,949	8,382,674	711,562	3,537,244	1,056,147	2,137,991
Non-current liabilities								
Borrowings			859,672	985,577	2,004,062	3,414,913	4,290,583	8,090,293
Derivative financial instruments					271,778	10,155	18,566	29,716
Deferred tax liabilities	827	1,277	315	1,693		2	198	219
Total non-current liabilities	827	1,277	859,987	987,270	2,275,840	3,425,070	4,309,347	8,120,228
Total Liabilities	4,293,762	5,137,211	6,116,032	5,874,620	7,840,312	8,915,811	11,443,329	15,153,127
Total non-current liabilities and equity	2,036,593	1,889,948	4,805,936	9,369,944	2,987,402	6,962,314	5,365,494	10,258,219

Source: Authors compilation based on MAS Annual Report 2006 to 2012; *Restated balance sheet

Exhibit 2

Income Statement of Malaysian Airlines System Berhad as at financial year ended 31 December

	2005	2006	2007	2008	2009*	2010*	2011	2012
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Operating revenue	**8,850,810**	**12,978,044**	**14,630,231**	**15,035,303**	**11,340,910**	**12,978,396**	**13,653,894**	**13,286,612**
Operating expenditure	**(10,329,390)**	**(13,608,981)**	**(14,357,514)**	**(15,198,257)**	**(12,220,304)**	**(13,409,127)**	**(16,197.154)**	**(14,117,447)**
Other operating income	231,097	310,216	288,242	466,001	264,601	607,163	247,527	469,799
Gain on sale of properties		83,351	104,935	2,410				
Residual value sharing on sale of aircraft by Penerbangan Malaysia Berhad		35,629	209,333					
(Loss)/Profit from operations	**(1,247,483)**	**(201,741)**	**875,227**	**305,457**	**(614,793)**	**176,432**	**(2,295,733)**	**(361,036)**
Fair value change of derivatives						164,251	60,660	(17,216)
Unrealised foreign exchange (loss)/gain						62,174	(129,115)	189,968
Derivative gain					1,163,133			
Share of results of associated companies	12,119	27,789	12,570	19,974	13,381	27,728	25,332	22,602
Share of results of jointly controlled entity					(1,741)	(10,147)	(14,604)	(23,860)
Compensation for domestic rationalization		650,000						
Domestic rationalisation expenses and redundancy expenses		(517,803)						
Finance costs	(5,813)	(32,899)	(46,886)	(60,770)	(68,148)	(138,402)	(159,424)	(235,259)
(Loss)/Profit before taxation	**(1,241,177)**	**(74,654)**	**840,911**	**264,661**	**491,832**	**282,036**	**(2,512,884)**	**(424,801)**
Taxation	(20,011)	(60,618)	(29,590)	(19,086)	31,116	(44,690)	(8,441)	(5,937)
Profit for the year from discontinued operations		1,535	41,422	122				
(Loss)/Profit for the year	**(1,264,787)**	**(133,737)**	**852,743**	**245,697**	**522,948**	**237,346**	**(2,521,325)**	**(430,738)**

	2005	2006	2007	2008	2009*	2010*	2011	2012
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
(Loss)/Profit attributable to: Non-controlling interests						2,877	2,663	1,849
Minority interest	(3,599)	2,695	1,325	1,385	2,909			
(Loss)/Earnings per share attributable to equity holders of the company (cents): Basic for (loss)/profit for the year	(100.90)	(9.80)	58	14.6	25.3	7.2	(75.50)	(12.90)
Diluted for (loss)/profit for the year**		(9.80)	54.2	14.6	24.9	7.2	(75.50)	(12.90)

Source: Authors complication based on MAS Annual Report 2006 to 2012; *Restated income statement; **Diluted for (loss)/profit for the year into consideration the dilutive effects of all potential ordinary shares i.e. Share options granted to employees

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