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Malaysia: Trends & Developments

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MALAYSIA

Trends and Developments

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Introduction

As recently as April 2022, foreigners entering Malaysia were still facing certain requirements and restrictions, including even quarantine in certain circumstances. Such restrictions obviously impacted demand for air travel. The industry's performance has been shaped not only by the extensive COVID-19 lockdowns but also by pre-existing trends. Specifically, airlines in Malaysia began to exhibit signs of sluggish growth as early as 2018 and 2019, hinting at underlying issues beyond the pandemic's influence.

Key players in the industry, including the long-established Malaysia Airlines, have had to navigate these turbulent times strategically. Notably, Malaysia Airlines successfully implemented an English-law Scheme of Arrangement with most of its operating lessors early during the pandemic. This was an unprecedented move for a non-English carrier, forming part of a broader strategy to mitigate its liabilities. AirAsia X opted for a Malaysian-law Scheme of Arrangement, and with the support of its creditors, AirAsia X obtained a haircut of over 99% of its existing debts at the time.

Interestingly, this challenging period also witnessed the emergence of two new airlines: SKS Airways and MYAirline. Launched in January 2022, SKS Airways operates regional flights. In contrast, MYAirline, a low-cost carrier with its inaugural flight in December 2022, seems to target the same market segment as AirAsia, creating direct competition.

Market Recovery

With the full opening of borders and resumption of operations post-COVID-19, Malaysia's air passenger traffic grew by 123.6% year-on-year in 1Q23, translating to 19.4 million passengers. This is equivalent to 73% of the pre-pandemic passenger traffic in 1Q19. Passenger traffic grew steadily in 2022, with December recording the highest passenger movements since February 2020, amounting to 74.1% of 2019 levels. The number of international air traffic rights approved by the Malaysian Aviation Commission also increased by 246.1% year-on-year in 1Q23, demonstrating a steady revival of the international market. At the airport level, Kuala Lumpur is the fourth most connected airport in ASEAN behind only Singapore, Bangkok and Manila. Malaysian airlines have attributed this recovery to an unexpectedly swift capacity recovery and stronger-than-anticipated load factors.

Foreign carriers have recently commenced new flights and/or added additional flights into Malaysia, and Malaysian carriers such as AirAsia, AirAsia X and Batik Air have added new international routes to their network and increased flight frequencies. Domestically, Firefly has also increased its flight frequencies to various destinations.

New Carriers

The appearance of two new operators on the Malaysian aviation scene is news for a country that has not seen any new scheduled carriers in some years, and which boasts a population of only 34.3 million. Both these operators see the potential in Malaysia and have ambitious plans: SKS Airways has committed to leasing ten Embraer E195 jets, and will be the aircraft's first South-East Asian operator in January 2024. MYAirline, on the other hand, reached a milestone of 1 million passengers in June 2023, merely six months into operations, and has just launched its first international route to Bangkok.

Timing appeared to be a key factor for both SKS Airways and MYAirline. Aircraft lease rates were at their lowest in January 2021, and both airlines were able to leverage those lower rates to lock in their leasing commitments early, before rates started climbing again. In a sign of the quickly improving market, AirAsia has recently announced its intention to lease 15 more aircraft to meet travel demand from China. MYAirline, which has announced high load factors for its flights, aims to operate a fleet of 20 aircraft by the end of 2023.

Leasing into Malaysia

Malaysia has ratified the Capetown Convention and has incorporated it into domestic law via the International Interests in Mobile Equipment (Aircraft) Act 2006. This gives some comfort to lessors, particularly those who are entering the Malaysian market for the first time. It is encouraging to note that there have been a few new lessors (both for commercial as well as private/business aviation) who have recently made their first foray into Malaysia – and are currently supporting commercial as well as private operators.

Other lessors who have prior dealings with either Malaysia Airlines and/or AirAsia X, and may therefore have been involved in their recent restructurings, are still leasing into Malaysia (including leases to other carriers). From discussions with counsel for several large lessors, it appears that Malaysia is considered a "secure jurisdiction" and that lessors are assured by the fact that no lessor has been prevented from repossessing its assets before, or has even faced any difficulties in attempting to do so. The Civil Aviation Authority of Malaysia is also seen as being open to engagement, and has been helpful to lessors in the past.

The Impact of Recent Court Decisions

The Cape Town Convention, previously untested in Malaysian courts, was recently invoked during the proceedings related to AirAsia X's Scheme of Arrangement. The court established that this scheme constitutes an "insolvency-related event" under Article XI of the Protocol of the Cape Town Convention. This conclusion was based on the following factors: (i) the scheme was formulated in the context of an insolvency procedure; (ii) the scheme was also a collective arrangement in that it was "concluded on behalf of creditors generally or such classes of creditors as collectively represent a substantial part of the indebtedness"; and (iii) the court's approval was required for its implementation.

The court concluded that in the event the debtor chooses not to terminate the agreement when an insolvency-related event has occurred or the creditor does not exercise its right to repossess the aircraft, the obligations under the agreement, including the obligations to pay the rentals, can only be modified by the debtor with the creditor's consent. However, the court then went on to state that the proposed scheme, or rather the AirAsia X proposed haircut, was merely seeking to compromise the lessors' claims for damages (and not attempting to modify the terms of the lease) and in this instance, AirAsia X did not therefore require the consent of the lessors in respect of the proposed haircut on the lessors' claims.

The court's decision, namely that the scheme was an insolvency-related event under the Cape Town Convention, is the key point for lessors moving forward. This presumably provides a more definitive trigger for Events of Default, offering greater certainty for lessors concerned about a potentially troubled airline. It is also noteworthy that AirAsia X voluntarily offered to return any aircraft that lessors wished to repossess, guaranteeing that it would not resist terminating those leases. Ultimately, there were no forcible repossessions in relation to any of the AirAsia X aircraft, nor have there been any forcible repossessions of aircraft in Malaysia in recent history. It appears that both lessees and lessors prefer to come to an amicable solution, even when a lessor may already have secured the necessary court orders.

A New Airline Group in the Making?

Both AirAsia X Berhad ("AirAsia X") and Capital A Berhad ("Capital A"), the parent company of AirAsia, are currently classified as Practice Note 17 ("PN17") companies. AAX fell into PN17 status on 27 October 2021, while Capital A was declared a PN17 company on 14 January 2022, after each company faced negative shareholders' equity. The primary obligation of any listed issuer that has been classified as a PN17-listed issuer is to regularise its financial condition within 12 months of the date it is classified as a PN17 company. A PN17 company will need to submit its regularisation plan within that 12-month period, to either the Securities Commission (if the plan involves a significant change in the company's business direction or policy) or to Bursa Malaysia Berhad ("Bursa") (if the plan does not involve a significant change in the business direction or policy of the company – in which case the company would further need Bursa's approval to implement the plan). If a PN17-listed issuer fails to comply with any part of its obligations to regularise its condition within the applicable timeframes, that company's listed securities may be suspended from trading and the company will be delisted.

Being classified as a PN17 company does not amount to a moratorium on payments, nor does it mean that a company is insolvent. There is no restriction that prevents a PN17 company from entering into new facilities and/or taking on new/additional debt obligations. By way of illustration, both AirAsia X and Capital A have been continuing their operations since their classification as PN17-listed issuers, including operating flights and continuing other activities, as well as continuing some of their aircraft leases. More importantly, their PN17 status did not prevent AirAsia X and Capital A from observing their financial obligations, including paying their existing leases (in some cases, restructured leases), and maintaining their headcount and payroll as well as other operational expenses.

Various announcements have been made in relation to the purported regularisation plans. Tony Fernandes of Capital A stated in November 2022 that "[T]he plan envisaged will entail the disposal of Capital A's aviation businesses, namely AirAsia Berhad and AirAsia Aviation Group Limited, to AirAsia X Berhad (AAX) [...]. Capital A will be rebranded as an aviation services and digital group, post the disposal and distribution exercises. We envision a separate spin-off listing in the future for the aviation services businesses of Capital A once the PN17 status is resolved."

Also in November 2022, Benyamin Ismail, the AirAsia X CEO, announced that "The strategy being formulated is expected to entail a proposed acquisition of Capital A Berhad's aviation arm, AirAsia Berhad (AAB) and AirAsia Aviation Group Limited (AAAGL), comprising AAAGL's respective shareholdings in AirAsia Indonesia, AirAsia Philippines and AirAsia Thailand. Following the acquisition, AAB, AAAGL and AAX will form a consolidated aviation group, subject to the approval of our stakeholders and relevant regulatory authorities [...]. While all airlines under the consortium will remain separate with regard to the operations, the acquisition of the short-haul airlines under one consolidated group will create synergies with AAX's mid-range operations."

It therefore appears that both Capital A and AirAsia X were on the same path, in terms of a plan to regularise their respective PN17 status.

However, on 6 December, Capital A announced and clarified that "the proposed plan is not a merger of AirAsia Berhad and AirAsia X, but a potential disposal of Capital A's aviation assets to AirAsia X, in order to form a separate publicly-quoted aviation group comprising six airlines – four short-haul Asean airlines and two medium-haul airlines, namely AirAsia Berhad, Thai AirAsia, AirAsia Indonesia, AirAsia Philippines, AirAsia X and Thai AirAsia X. However, the Company also wishes to clarify that the plan remains a work in progress, and will be subject to multiple approvals including by the Company's Board of Directors, shareholders, and Bursa Malaysia Securities Berhad."

If this scenario materialises, it will be the first time that Malaysia sees such a group – all low-cost carriers, albeit operating in different juridictions within ASEAN. This is different from the Malaysia Airlines Group, where the entire group consists of Malaysian carriers. Tony Fernandes has also suggested parallels with the International Airlines Group (IAG), which owns British Airways, Iberia and Aer Lingus, and has stated that operating as a single company means they can remove a lot of the costs.

Admittedly, there are already existing synergies between the different carriers – hence the existing AirAsia Aviation Group Limited structure, and the two AirAsia X companies in Malaysia and Thailand. As with any other acquisition or merger, various questions arise: how will AirAsia X fund the acquisition of these aviation businesses from Capital A? Will this acquisition include the cargo operations, which are currently operated by Teleport but utilising belly space of various aircraft within the different airlines? Interestingly, Teleport has just announced on 13 July 2023 that it plans to operate ten freighters within the next 18 months, with three freighters delivering in 2023. Capital A currently imposes a fee on AirAsia X and Thai AirAsia X for certain shared services – these services are provided by Capital A entities that are not in the aviation business; however, will this arrangement still make sense once the majority of the revenue, operations and headcount are moved into a different group altogether?

Lessors and financiers will also have to consider what happens to the guarantees that Capital A has issued to guarantee the various obligations of AirAsia as well as of the other airlines in the AirAsia group. Leases and facility agreements that typically contain covenants in relation to changes of shareholding may mean that such a restructuring will be subject to the consent of lessors and financiers too.

In addition, the majority of Capital A's revenue, approximately 64-80% over the past three quarters, is derived from the Aviation business. That being the case, will Capital A be able to convince its shareholders that it is in the best interests of Capital A to dispose of its main source of revenue?

On 3 July 2023 Capital A announced as follows: "Pursuant to paragraph 4.1(c) of PN17 of the Main LR, the Board of Directors of the Company wishes to announce that the Company and the appointed advisers are in the midst of formulating a regularisation plan to address its financial condition" and that Capital A had applied for a further extension of time to 7 October 2023, for the submission of its regularisation plan. This was on top of its announcement on 15 June 2023 that "The Board of Directors of Capital A Berhad wishes to inform that an interim financial review is presently being carried out as part of the evaluation of the PN17 regularisation plan prior to any regulatory submission."

AirAsia X, on 3 July 2023, stated that "The Board of Directors wishes to announce that the Company and the appointed advisers are in the midst of formulating and/or evaluating the proposals to develop the Proposed Regularisation Plan to holistically restructure its business and financial condition", which is a repeat of previous PN17 announcements.

However, on 21 July 2023, AirAsia X announced that they are seeking an upliftment from being classified as a PN17 listed issuer on the basis of its financial performance, specifically three consecutive quarters of net profit for the quarters ended 30 September 2022, 31 December 2022 and 31 March 2023; and that as of 31 March 2023, AirAsia X has also recorded a positive shareholders' equity.

As of now, the Malaysian aviation market and the industry await to see if the acquisition and/or merger between AirAsia X and the aviation business of Capital A, will indeed materialise.

Moving Forward

Whilst AirAsia/AirAsia X are looking into possible consolidation, Malaysia Airlines announced that Q4 2022 saw its best quarterly profit in 20 years. The Malaysia Airlines Group achieved improvements across all its business segments over 2022, and Malaysia Airlines Berhad (the main carrier within the group) saw its revenue triple compared to 2021.

As young upstart MYAirline waits in the wings, and with analysts taking a position that Malaysia was already facing overcapacity even before MYAirline and SKS Airways came onto the scene, there are interesting times ahead for the Malaysian aviation industry. Consumers may look forward to lower fares as the new operators compete with the more established airlines for market share, but overall it is in the interests of all stakeholders, whether passengers, carriers or lessors, for the Malaysian aviation industry to be sustainable over the longer term.

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