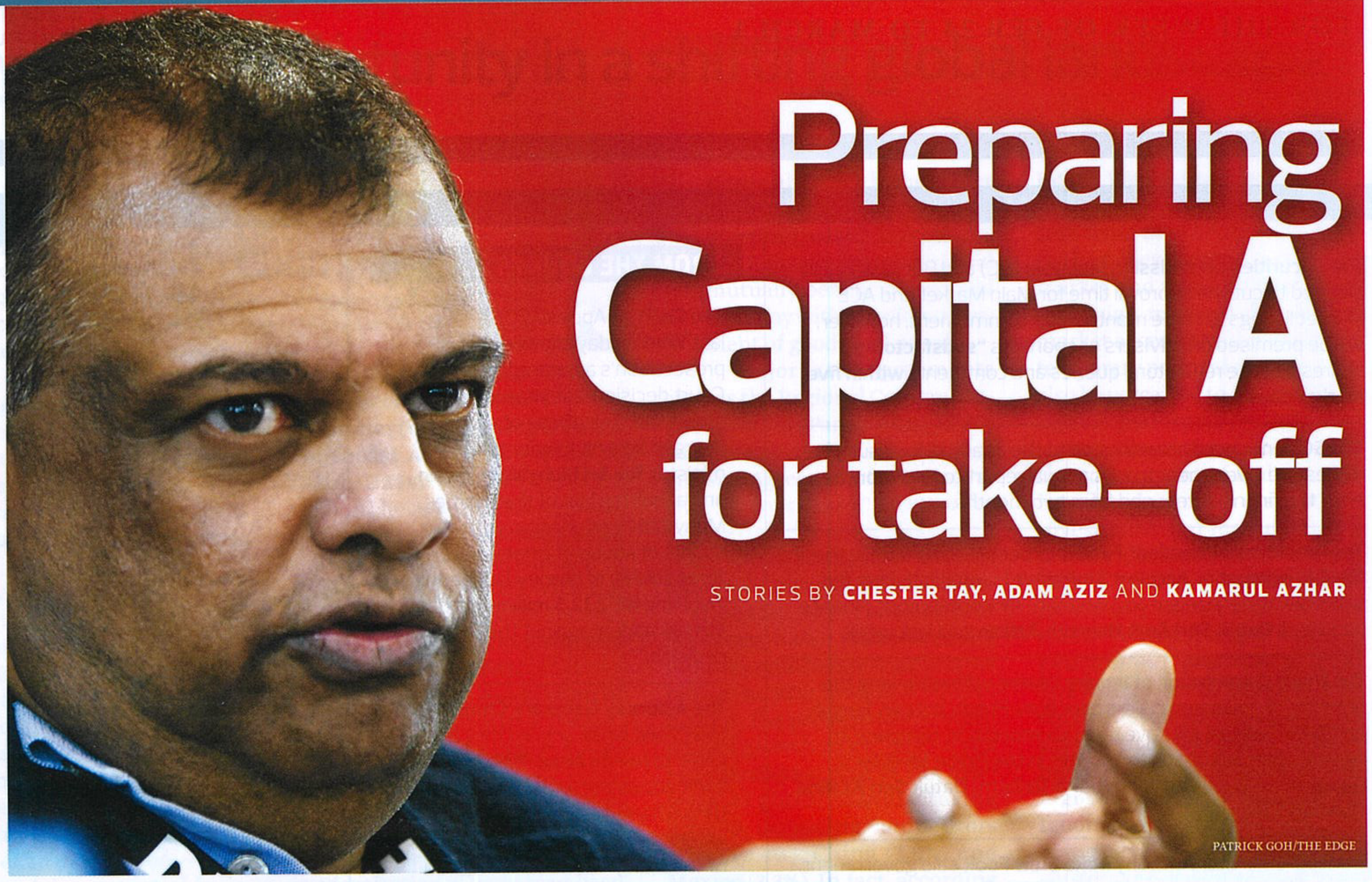
COVER STORY 1



Preparing Capital A for take-off

STORIES BY **CHESTER TAY, ADAM AZIZ** AND **KAMARUL AZHAR**

PATRICK GOH/THE EDGE

Prior to running an airline, Tan Sri Tony Fernandes was known as an executive with an international recording company. What the public may be less aware of is that the larger-than-life entrepreneur is a fellow of the Association of Chartered Certified Accountants as well as the Institute of Chartered Accountants in England and Wales.

It is this background in accounting that gave Fernandes an edge in charting Capital A Bhd's exit from Practice Note 17 (PN17) status that it landed into in July 2020. He knew all too well that Capital A needed a way to wipe off its accumulated losses to exit PN17.

Given the size of the accumulated losses, or negative shareholders' equity, and restrictions on capital raising, the selling of the aviation business to associate company AirAsia X Bhd was widely expected.

The unorthodox part about its restructuring exercise is the carving out of Capital A's brands — including its best known, the AirAsia brand — for US$1.15 billion (RM5.44 billion) and injecting them into an entity called Capital A International (CapAI) — for an eventual listing in New York via a special purpose acquisition company (SPAC). As payment, CapAI will issue US$1 billion worth of its shares and take over a US$150 million loan from Capital A.

Supporters deem the monetisation of the AirAsia brand and other brands under the Capital A umbrella as "revolutionary" in the local and regional context. For Fernandes, it was the PN17 situation that forced him to turn the crisis into an opportunity.

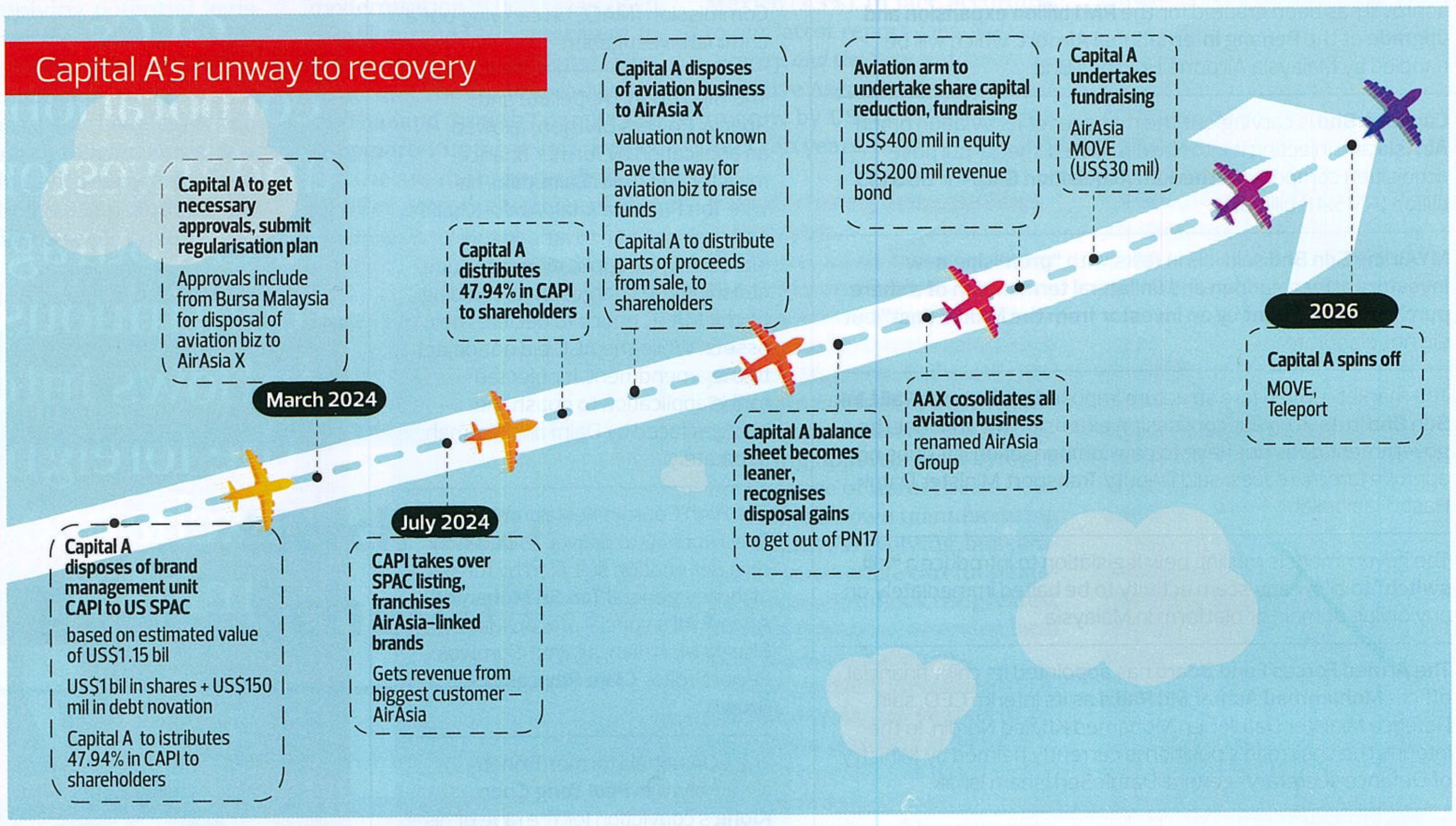
"We need to get out of PN17. That is the honest answer," he says during an interview at Capital A's RedQ in Sepang on Feb 26. "Would I have kept the brand in AirAsia [Capital A] if not for PN17? Probably. But then, would I have gone on and developed and monetised it? Probably not.

"So, we take the positive side. From the shareholders' standpoint, you still have aviation, you pay a branding fee, so you lose a bit of income there, but then you get it back in a [stronger group]," says the 59-year-old, who together with Datuk Kamaruddin Meranun acquired AirAsia for RM1 in 2002.

"Basically, by selling the brand for RM4 billion, you strengthen the retained earnings by RM4 billion. So, you have a brand that is worth zero, you sell it for RM4 billion, your earnings ... it is purely an accounting treatment."

Capital A, then known as AirAsia Group Bhd, triggered the PN17 criteria in July 2020 after its external auditor Ernst & Young PLT issued an unqualified audit opinion with material uncertainty in relation to the company's ability to continue as a going concern in respect of its audited financial statements for the financial year ended Dec 31, 2019 (FY2019), and that its shareholders' equity on a consolidated basis was 50% or less than its share capital. In FY2020, its consolidated shareholders' equity fell below 25% of its share capital, triggering another PN17 criterion.

To exit PN17, Capital A needs regulatory approval for its restructuring plan. As it is, the extended deadline for it to come up with such a plan is June 30 this year. But the group will need to get its house in order first.



Monetising brands via SPAC

Capital A announced the deal that would see Aetherium Acquisition Corp, a SPAC listed on the Nasdaq, acquire CapAI in a business combination in November last year. On Feb 28 this year, the group announced that it had finalised the business combination agreement with Aetherium to have CapAI listed in US equity markets.

"CapAI leverages the expansion, management and licensing of the AirAsia brand, and serves as a dynamic global marketing catalyst for Asean brands. The transaction also offers investors a gateway to participate in a fast-growing economic hub, on track to become the world's fourth-largest economy by 2030," Capital A said in the Feb 28 statement.

Capital A will distribute up to 51% of the CapAI shares received from the carving out of Brand AA Sdn Bhd to its entitled shareholders. Following the listing of CapAI in New York, a 47.9% stake will be owned by Capital A shareholders, 46.1% by Capital A and the remaining 6% by Aetherium.

Injected into CapAI, Brand AA is the registered proprietor of all the rights to the AirAsia trade name and brand image (AirAsia brand), as well as a portfolio of other trademarks and intellectual property. It is principally involved in the management of the brand and portfolio.

Brand AA is entitled to collect a royalty fee based on the revenue generated by the airline operating companies (AOCs) in relation to its affiliates' aviation businesses, Capital A said in the announcement.

The royalty fee rate is set at 0.5%, 1% and 1.5%, according to the group. AirAsia X Bhd (AAX) will pay 0.5% in royalty fee to Brand AA, while Thai AirAsia X Co Ltd will pay 1.5%. Meanwhile, AirAsia Bhd, Thai AirAsia Co Ltd, PT Indonesia AirAsia and Philippines AirAsia Inc will pay 1% in royalty fee to Brand AA.

On a proforma basis, and without taking into account Capital A's proposed regularisation plan, the proposal to inject the brands into Brand AA will reduce the group's accumulated losses to RM4.43 billion, from RM8.93 billion.

At the same time, the group's share capital will decline to RM6.64 billion, from RM8.66 billion, while its negative shareholders' equity will improve to RM3.24 billion, from RM5.73 billion, on a proforma basis.

To exit PN17, Capital A's shareholders' equity must be at least 25% of its share capital. Therefore, the listing of CapAI in New York alone would not lift the group out of PN17 status.

Capital raising after selling aviation business to AAX

This is why Capital A is also selling its aviation business to AAX, which will create a separate, standalone aviation group tentatively called AirAsia Group Bhd.

"So, one of the reasons why we have to sell the aviation business is to at least be clean. At least then, we can go and talk to Malaysian banks, raise equity and whatever. That is our big argument with Bursa. My hands are tied, but I can't raise capital from aviation," says Fernandes.

On Jan 8, Capital A entered into a non-binding letter of offer with AAX for the proposed disposal of AirAsia and AirAsia Aviation Group Ltd (AAAGL) for a disposal consideration to be agreed upon by the parties at a later date. AAAGL operates passenger airline services, providing air transport through its subsidiaries in Indonesia, Thailand, Cambodia and the Philippines.

The selling of the aviation business to AAX is critical to capital raising, says Fernandes.

"We can't do it [capital raising] as a PN17 company ... After we sign the S&P [sale and purchase agreement], we have to get shareholders' approval, which will take a couple of months, then court approvals for capital reduction, and then raise US$300 million or US$400 million of equity," he continues.

The proposal to sell Capital A's aviation

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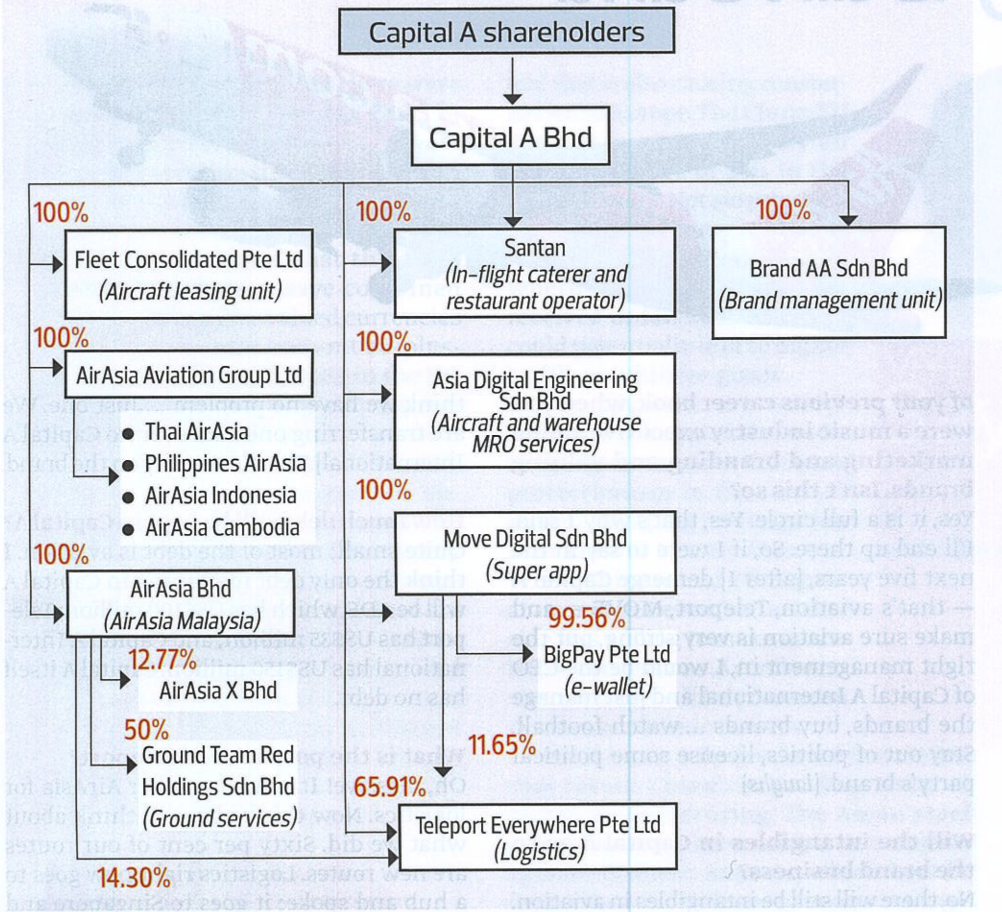
CURRENT STRUCTURE



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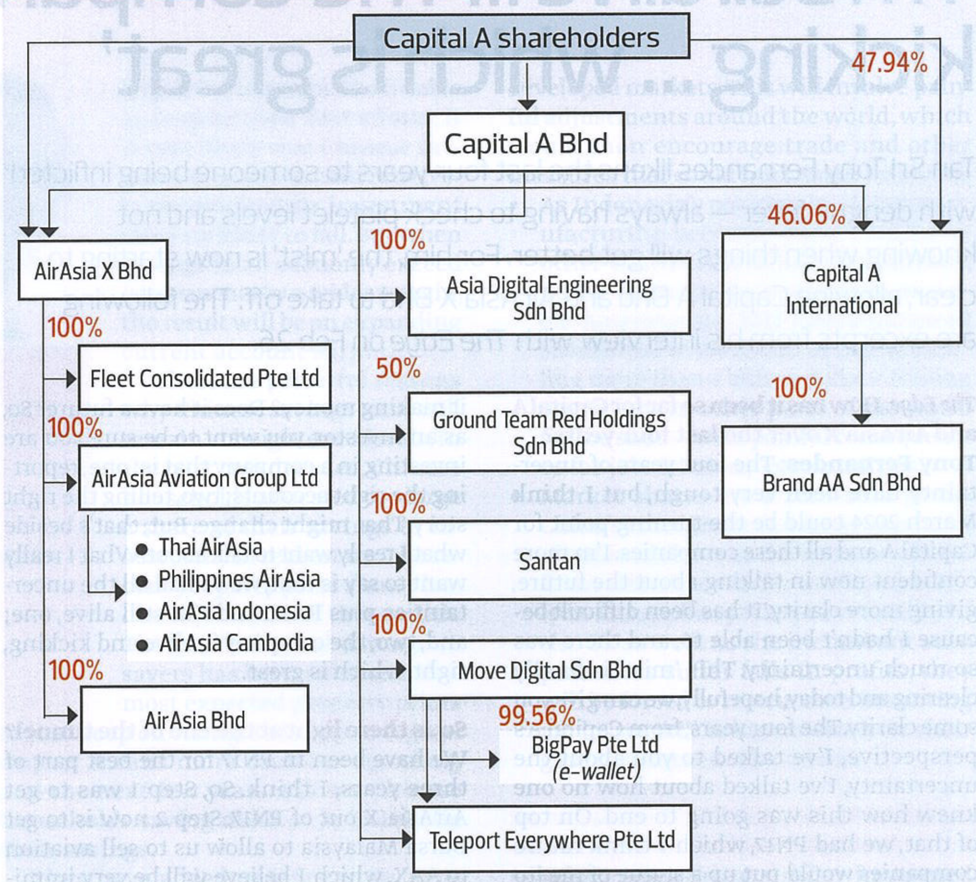

Note: Shareholding not exhaustive because of absence of details in Capital A's airline business disposal to AirAsia X

business to AAX has been submitted to Bursa Malaysia for approval, says Fernandes. He hopes to obtain the approval this month.

Based on Capital A's aviation segment's revenue of RM11.96 billion in 2023, its 1% royalty fee to CapAI would amount to RM119.65 million, or US$25.19 million.

For AirAsia X Malaysia, its 0.5% royalty fee would amount to RM12.64 million (US$2.66 million), based on 2023 revenue of RM2.53 billion, while Thai AirAsia X would pay RM22.11 million, or US$4.65 million, on RM1.47 billion in revenue.

In total, the three segments would pay RM154.4 million (US$32.51 million) in 2023 royalties to CapAI, compared with a consolidated revenue of RM16.21 billion.

The 'mist' has cleared

The listing of CapAI and the sale of the aviation business to AAX are among Capital A's options to remain listed while paving the way for the aviation business to raise funds for its operations.

The group managed to raise equity during the pandemic, although it was not as much as it wanted. In 2021, it raised RM1.31 billion through private placements and a rights issue of debt securities. In 2023, AAX issued equity worth 7.78% of its enlarged share base to raise RM50 million via a private placement.

As Covid-19 wreaked havoc on air travel, the group shut down AirAsia Japan in 2020 and pared its interest in AirAsia India (it fully exited in 2022). In between, the group doubled down on its non-core businesses. It launched the AirAsia Superapp (now airasia MOVE), started its food delivery service, launched its air freight brand Teleport and attempted to get a digital bank licence for BigPay.

Prior to listing CapAI, Capital A had considered listing its Superapp in the US, but that did not materialise.

In 2022, plans for Capital A to obtain an RM500 million club facility linked to Danajamin Nasional Bhd — it initially eyed RM1 billion from the deal — fell through as the company was not agreeable to the condition that Fernandes and Kamaruddin, its two largest shareholders, be made guarantors of the loan.

"The four years of uncertainty have been very, very tough," says Fernandes, who had just recovered from dengue prior to his interview. "It was never ending — [thinking about] PN17, when is Covid ending, when the borders are opening ... It's like having dengue every day, waiting to see your platelets and waiting to get better.

"But I think 2024 could be a turning point for Capital A and all these companies. The mist is finally clearing."

Clean slate for renewed AirAsia Group

Once the proposal to sell Capital A's aviation business to AAX is approved by Bursa Malaysia, the balance sheet of the aviation business can be leveraged to raise the capital needed for the aviation group to take off.

The sale of the aviation business will further strengthen Capital A's balance sheet and is another step towards the lifting of its PN17 status, says Fernandes. However, the definitive agreement is currently in the works, which means the valuation of the aviation business is not yet available.

"My main focus is to sell the airline to AAX. Then, Cap A is left with four companies — Teleport, Capital A Aviation Services, MOVE and Capital A International. Once we sell the airline, there is no more PN17 for the airline. It is clean, goes and raises capital, off it goes and makes all sorts of money," he says.

Of course, it is not that simple. The group will need approvals from the authorities, its creditors and shareholders first before it can sell its main business. Then, there is a matter of valuation and how AAX will pay for the business.

Like the injection of the brands into CapAI, it is likely that the selling of the aviation business to AAX will be for shares rather than cash.

As at Sept 30, 2023, AAX had RM119.63 million in deposits, cash and bank balances, while its current lease liabilities amounted to RM98.3 million. The operating profit of the group of RM454.2 million was used as working capital. If AAX pays cash for Capital A's aviation business, it will likely need to raise debt or equity.

Entry of new shareholders?

The expanded balance sheet of the aviation business — AirAsia Group — will be leveraged to raise fresh capital for the group, says Fernandes. He reveals that there will be new shareholders coming in to inject capital into the group.

That could mean that the ongoing proposal is part of a "house-cleaning" exercise to present itself in the best light possible to attract and welcome new major shareholders whom Fernandes says could potentially inject as much as US$400 million into the aviation group.

AAX had a market capitalisation of RM760 million with its closing price of RM1.70 on Feb 29 but it fell to RM620 million on March 1 when the stock fell 20% to RM1.36 after the company reported a sharply lower profit owing to elevated costs despite higher revenue.

In the interview earlier in the week, Fernandes says the group has appointed Citibank and Evercore — an independent investment bank headquartered in New York City — to undertake the capital raising for the aviation group. "The reverse listing of Capital A International, plus the sale of the aviation business, allows us to put in a regularisation plan, to clean up Capital A and put it out of PN17."

While Fernandes does not reveal further details on the regularisation plan, he mentions that the aviation business will issue a "revenue bond" of about US$200 million. The proceeds from the bond will be used to settle some of AAX's lease obligations.

The aviation group will also "securitise" some of its new routes to pay for the revenue bond, he says.

"If you say KK-KL, we make US$1 million, we securitise 20% of that, and every month that revenue goes into a bank, and they take out 20%. That's the first bit of capital raising, before the equity," he adds.

"You must remember I had zero from Malaysian banks, so I'm paying a high interest cost at the moment. That is one of the problems of PN17 — when you are in PN17, no banks will touch you."

Clear skies or turbulence ahead?

While it seems like Capital A has finally found a way out of PN17 status, it still will need to convince regulators and investors.

"Any one-off gains or losses arising from accounting entry is normally not going to be recognised by the authority [as a regularisation plan], because it is not continuous," says Datin Wong Muh Rong, a non-independent, non-executive director of Astramina Group Bhd.

"[Even if] you can recognise the one-off gain in your P&L (profit and loss statement) and offset the accumulated losses, for the company to be considered as having come out of PN17 status, it needs to get the regulator to approve it as the regularisation plan."

Meanwhile, Shukor Yusof, founder and analyst at Endau Analytics, says it will be tough to convince investors at a time when the cost of money is very high, and second, the fact that Capital A is not exactly a big brand in the US. "It is a very complex exercise that management is hoping to pull off. I'm not entirely convinced this is the best way forward for Capital A. But then again, I'm not Tony, who has a fairly good track record of overcoming the odds."

The selling of the aviation business to AAX is also viewed by analysts and fund managers with a dose of scepticism. This is because the long-haul business of AAX could still bleed, especially when the market dynamics change, such as a spike in oil prices or changes to the carbon tax regime.

"The short-haul segment will still be good. But adding the long haul to the short haul will neutralise the whole situation. The short haul will be neutralised by the long haul, therefore becoming less effective," says Loui Low, head of research at Malacca Securities Sdn Bhd.

"The new aviation business is not going to be as attractive as before. But since it is the only public-listed aviation company in Malaysia, there may still be investors attracted to it," he adds, noting that Capital A's remaining businesses are in challenging landscapes.

Credited with revolutionising budget air travel in Asia, it remains to be seen if Fernandes can win enough support for his plan to take flight. Regulatory approval for the lifting of its PN17 status will be the first test of whether there will be clear skies ahead for Capital A and the wider AirAsia group. E