Financial Times Sport

AirAsia CEO pledges to prove airline's critics wrong

Tony Fernandes rejects highly critical report by analysts of budget carrier's accounting practices

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Ben Bland in Hong Kong JUNE 28 2015

A catastrophic crash at his Indonesian airline, the relegation of his English football team, an embarrassing exit from Formula One motor racing and now an attack on accounting practices at AirAsia, the crown jewel of his business empire.

It has been a punishing year for ebullient Malaysian entrepreneur Tony Fernandes, who is battling to keep alive his dream to build an Asian low-cost carrier that can match the success of Southwest Airlines in the US and Ryanair in Europe.

Mr Fernandes has rejected a highly critical report by GMT, an independent equity research firm, that alleges AirAsia is "teetering on default". The company's shares have lost nearly a quarter of their value since the GMT report was released on June 10 and are languishing at a five-year low.

GMT claimed in the report that Malaysia-listed AirAsia has inflated group profits by recording earnings derived from leasing aircraft to its troubled, minority-owned associate airlines in Indonesia and the Philippines.

At the same time, the parent group has had to extend ever more credit to these associate airlines as their losses mounted because of tough competition from dominant incumbents, GMT alleged.

With the Indonesian and Philippines' airlines unable to repay the parent, receivables owed to AirAsia by its associates, joint ventures and related parties jumped to Rm2.5bn ($665m) in 2014, from just Rm1.3bn in the previous year, according to GMT, leaving the group with a net debt-to-equity ratio of 263 per cent, the highest among its regional peers.

"Don't be fooled by AirAsia's fancy marketing," wrote Gillem Tulloch, the founder of Hong Kong-based GMT, in the June 10 report. "Real profits have collapsed and AirAsia now needs a recapitalisation that will dilute existing shareholders by more than 100 per cent." He complained about limited financial disclosures by AirAsia, Asia's largest budget airline, saying management gave the impression of having "something to hide".

AirAsia CEO Tony Fernandes © Bloomberg

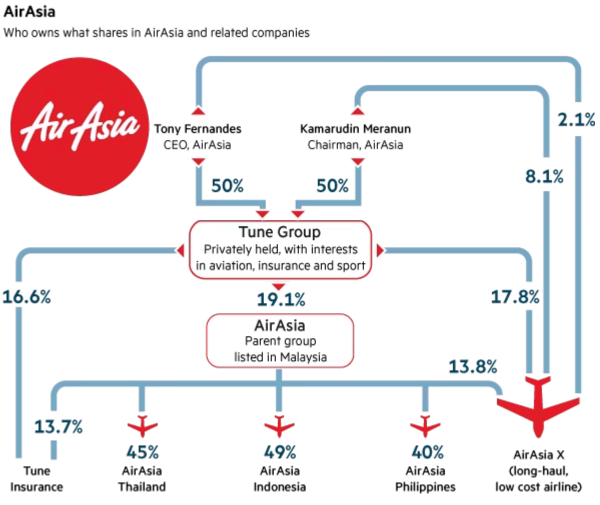
Mr Fernandes, a former accountant who co-founded the airline in 2001 when he and his partners bought a tiny, lossmaking Malaysian carrier for Rm1 ($0.27), has been rattled by the attack.

But the company has dismissed GMT's allegations, insisting that it has a "good business outlook", is "rich in assets" and has a "strong balance sheet".

It said AirAsia planned to address concerns about its associate airlines by injecting a total of $72.9m of new share capital into the Indonesian and Philippine units, alongside its local partners. AirAsia also plans to raise at least another $100m for each associate by issuing convertible bonds to new investors.

"We're a professionally run airline," said Mr Fernandes, AirAsia group chief executive, in a Financial Times interview during a trip to Indonesia and the Philippines to rally staff.

He insisted that AirAsia is not at risk of default and has no need for a rights issue at the group level.



FT graphic. Sources: companies; GMT Research

"This [GMT] report is rubbish," said Mr Fernandes. "We're doing extremely well. Frankly I've been disappointed with the equity market. They've known us for 14 years and there's nothing in that report that hasn't been disclosed already."

Mr Fernandes, whose Tune Group is AirAsia's largest shareholder, added: "It's preposterous to suggest that there's any intention to hide. The fact that we're so transparent allowed them to write that report. We declared far more than we needed to."

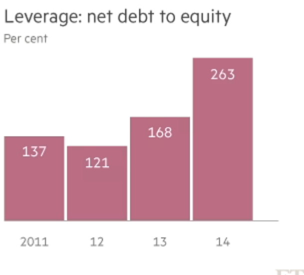
Most analysts have rallied to the defence of AirAsia, arguing that while it is facing short-term difficulties, the group's structure is advantageous. Michael Beer, analyst at Citigroup, says accounting treatments at AirAsia are "among the best".

But Rajani Khetan, analyst at HSBC, shares some of GMT's concerns about AirAsia's large intercompany debts and its business model.

"We not only view AirAsia's recent updates on funding plans for associates with scepticism, but also argue claims of improving prospects are unvalidated," she wrote in a note on June 22.

But she believes the group can reduce its losses, partly by scaling back its fleet expansion plans — AirAsia is one of the biggest customers of Airbus, the jet maker, with more than 300 aircraft on order.

Where did it go wrong for Mr Fernandes, who confidently told the FT just two years ago that to go into the airline business "you've got to have balls or you've got to be insanely stupid"?



Source: GMT Research

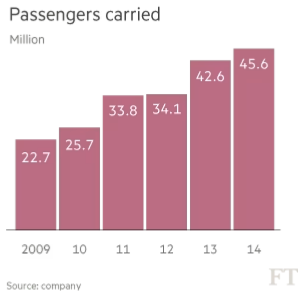
His airline's motto is "now everyone can fly" and it has sought to capitalise on the ability of Southeast Asia's fast-growing middle class to afford cheap flights.

However, expanding AirAsia across the region has involved establishing a corporate structure that complies with local rules that prohibit foreigners from owning majority shareholdings in airlines.

The group therefore took minority stakes in AirAsia-branded businesses in Indonesia, the Philippines and Thailand, as well as new ventures in India and Japan, but exercises de facto control over these companies by leasing aircraft, providing maintenance and extending credit where necessary.

While Mr Fernandes enjoyed success in his home market and Thailand, he has come up against resilient, well-connected rivals in Indonesia and the Philippines.

Losses at the AirAsia businesses in Indonesia and the Philippines mounted at a time when the group was aggressively buying new passenger jets and southeast Asian economies were starting to slow.



Analysts have grown increasingly concerned about airlines expanding too fast in Asia, because it puts pressure on fares and therefore profits. The situation was compounded by a demand shock last year after three high-profile incidents involving aircraft from the region: AirAsia Indonesia flight QZ8501 and Malaysia Airlines' MH370 and MH17.

Shaken, but not deterred, Mr Fernandes is trying to maintain his bullish disposition, arguing that AirAsia's prospects are improving because of cheaper fuel resulting from lower oil prices and the reorganisation of state-owned rival Malaysia Airlines, which could see it scrap routes.

"I love proving people wrong and I'm reinvigorated by this [GMT] report," he said. "But words are cheap. If we perform as we say we will, people will see tremendous value in AirAsia stock."

Fernandes denies losing focus amid sports ventures

An impulsive entrepreneur with a love for sports, Tony Fernandes has moved rapidly into a host of new businesses over the past few years, just as AirAsia's ambitious expansion plans gathered pace, prompting allegations that he lost focus.

In 2010, he and his Malaysian business partner, Kamarudin Meranun, bought a Formula One motor racing team.

In 2011, they acquired Queens Park Rangers, a London football club then in England's Premier League.

Mr Fernandes' Tune Group, which he controls with Mr Meranun, also runs hotel, insurance and music studio businesses. Mr Fernandes, who attended Epsom College, the English boarding school, last year played an important role in the opening of a sister school in Malaysia.

Even some of Mr Fernandes' supporters said he became distracted in recent years, especially as the Caterham Formula One team, which he sold off last year, and QPR, both failed to perform.

"He took his eye off the ball but he was impacted personally by the [AirAsia Indonesia] QZ8501 crash and now he's back and focusing on what is important," said Mohshin Aziz, analyst at Maybank.

Mr Fernandes denied he lost focus but said he decided to reverse an earlier move to step back from the day-to-day running of AirAsia.

"I decided about a year ago that AirAsia needed me more, so I stepped back in and sold off the F1 team," he said. "After the crash, we decided to . . . focus solely on AirAsia and AirAsia X [the Malaysia-listed long-haul, low-cost airline established by Mr Fernandes]."

Earlier this month he appointed Ruben Gnanalingam, a friend and fellow Malaysian businessman, as co-chairman of QPR to lighten his load on the football front, although he said he has no plans to sell the club.

"You're born to do certain things and I love what I'm doing," he said.