capital A

RE: Aviation Divestment

Dear Capital A Berhad shareholder,

I am pleased to inform you that on 25 April, 2024, Capital A has signed a sale and purchase agreement to divest our aviation businesses subject to all requisite approvals. This strategic move is a deliberate and deeply considered initiative aimed at unlocking and enhancing shareholder value meaningfully for Capital A shareholders.

The sale and purchase agreement is for the proposed divestments of AirAsia Aviation Group Limited and AirAsia Berhad (collectively AirAsia Aviation) to AirAsia Group Sdn Bhd (AirAsia Group), which is to be AirAsia X Berhad (AirAsia X)'s new listed holding company following the AirAsia X's internal reorganisation. Further details on this initiative will be disclosed in upcoming circulars to be published on Bursa Malaysia. Rest assured, we are dedicated to keeping you well-informed about its progress at every step and I have no doubt that the AirAsia X team is committed to the same.

Personally, I believe this proposed divestment is a unique and time-sensitive opportunity to elevate our aviation business to the next level. Elevating the aviation business by divesting it may sound paradoxical or reactive, but in truth I believe it will be a watershed moment for the aviation industry.

In this letter, I will address key concerns and questions you may have on this proposed divestment. Given the potential impact of this divestment on the regional aviation landscape, it is imperative that we try our best to ensure all shareholders understand the motivations underlying the proposal.

Why AirAsia and AirAsia X were separate

Understanding the historical context of this proposal is essential for appreciating its necessity. When Kamarudin and I took over the AirAsia airline back in 2001, we had a clear vision – a low-cost airline model prioritising simplicity and cost-efficiency, anchored on operating a uniform fleet of narrowbody aircraft optimised for short-haul flights.

This simplicity-focused approach allowed significant savings in training, maintenance, spare

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parts, and operational processes – such as our cornerstone 25-minute turnaround time, which enhanced aircraft utilisation and revenue. And the model proved effective, enabling AirAsia's rapid expansion across the region and making air travel affordable and accessible, especially to secondary cities previously unserved by air. AirAsia successfully reshaped air travel in Asean forever.

However, there was one thing we could not do with AirAsia at the time: fly medium haul. Narrowbody aircraft did not have enough range to operate medium-haul routes; diversifying the fleet to include a substantial number of widebodies in order to compete meaningfully would have compromised our fleet homogeneity and all the benefits we rely on from it.

Therefore, in 2007 we introduced AirAsia X as a separate airline group to capture the medium-haul market, adhering to our foundational principles of simplicity-driven, low-cost and efficient operations. The idea was AirAsia X can also have its uniform fleet of aircraft that can operate medium-haul routes. And the goal was to replicate our short-haul success in the medium-haul segment, fostering a symbiotic relationship between the two airline groups for traffic interchange.

However, the medium-haul operations faced unique challenges – it needed widebody aircraft like the Airbus A330-300 which, despite their longer range, brought higher operating costs and complexities. The structural separation of AirAsia and AirAsia X also limited synergies, affecting AirAsia X's performance relative to AirAsia.

Unlike AirAsia, AirAsia X met with mixed results in trying to disrupt medium-haul air travel as AirAsia did with short-haul flying.

Game-changing aircraft

Today, the latest in aircraft technology is accelerating the convergence of the short-haul and medium-haul models. Years ago, we could not have both AirAsia and AirAsia X in a single entity before due to aircraft limitations– it would have meant injecting complexity into the business model by having a mixed-type fleet.

But now the industry stands at a unique crossroads. The advent of game-changing aircraft in the Airbus A321LR and A321XLR marks a transformative moment that blurs the lines between what constitutes short-haul and medium-haul operations. These aircraft can fly further than previous narrowbodies, and with greater efficiencies, presenting an unprecedented opportunity

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to unify AirAsia and AirAsia X operations without the complexities previously anticipated with a mixed fleet.

This evolution in aircraft technology allows us to reconsider our operational and business model. The A321LR and A321XLR means we can expand our network and fly longer distances without the need for widebody aircraft, enabling us to operate a single type of aircraft across both short and medium-haul routes.

By leveraging the capabilities of the A321LR and A321XLR, we can explore new markets and destinations that were previously beyond the reach of traditional narrowbody operations, without incurring the higher operational costs associated with widebody aircraft. This strategic flexibility opens up significant growth opportunities, enabling us to expand our mission of making air travel accessible to all to a wider geography.

In other words, with a fleet of these new aircraft, we will be able to bring the successful AirAsia model to medium-haul operations without the challenges that came with operating widebodies. We gain flexibility in utilising aircraft across longer and shorter routes. A plane landing in Kuala Lumpur from Chitose can still turn around in 25 minutes and fly again on shorter domestic flights; that would not be possible with a widebody.

Sceptics may point out that the A321LR and A321XLR will have approximately 100 seats less than a widebody A330. Then again, the cost savings on the trip cost per flight far outweighs the lower passenger revenue – the margins are expected to be significantly higher according to information from Airbus. This is of course subject to actual operational performance when these aircraft go live later this year.

While it may seem counter-intuitive, the lower seating capacity works in our favour. With fewer seats to fill and a better yield on the capacity and load we do have, we gain freedom and flexibility to build our network to our strengths, which is to open up unique destinations and fly to secondary cities that no one else flies to. That was key to the AirAsia success in short-haul and the opportunity has arrived to do it again for medium-haul operations.

I must stress that this plan is not a reaction to the new aircraft from Airbus. Rather, it has been on our minds for many years. The only missing piece was the aircraft that could bridge both short-haul and medium-haul, which we now will have. AirAsia and AirAsia X had been working closer together since before the pandemic, sharing resources for mutual gain from routes, rights and even office space.

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Bringing together both airline groups through this proposed divestment is therefore a culmination of this progressive alignment between both as we seek to create a truly Asean airline group.

Flying higher, together

In the larger picture, bringing together AirAsia Aviation and AirAsia X in a single entity proposed to be AirAsia Group will mean that all AirAsia-branded airlines are now in a single entity. We will formally become the largest low-cost airline in ASEAN, which will elevate our brand visibility and allow us to deliver more value to our passengers. We expect this move to improve our fleet, network, schedule, and revenue management efficiencies due to the enhanced scale of operations.

It is a win-win proposition for both Capital A and AirAsia X shareholders. From the Capital A perspective, this proposed divestment is all about growth. Our ambition is to build a low-cost carrier network to rival what we see from the likes of Emirates and Qatar Airways – a profitable, low-cost version. The plan is to progressively phase out other aircraft as we replace them with A321LRs and A321XLRs, creating a single-type fleet that can reach the entire world, either directly or with 1-stop.

Over the next five years, we plan to leverage this new range into connecting Asean to Europe, Africa, Central Asia and North America. While we have already connected Asean to Asia, we can deepen that network significantly with this new aircraft.

My dream is that we would be reaching every continent by the time I retire in five years' time. And as we bring Asean to the world and the world to Asean, this will obviously bring significant opportunities to the rest of our aviation services businesses as well as Teleport and MOVE Digital.

From the AirAsia X perspective, this proposed transaction is also all about growth - as things stand, AirAsia X cannot grow at a time when its competitors are expanding. AirAsia X is on the precipice of critical stagnation at a time when post-pandemic travel recovery tailwinds are fuelling the growth of its competitors.

Covid-19 plunged the industry into an unprecedented crisis, compelling AirAsia X to hibernate its scheduled flights operations. In this period, AirAsia X recalibrated and underwent financial restructuring that led to a debt restructuring process initiated in October 2020 and successfully completed in March 2022, following the lodgement of the resulting court sanction.

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But among the necessary manoeuvres for survival was the deferment of AirAsia X's orderbook, which now casts a long shadow on its growth prospects, delaying fleet renewal and expansion crucial for its competitive edge in the rapidly evolving aviation landscape.

AirAsia X's Airbus A33neo orders are hampered by reliability issues beleaguering the aircraft's Rolls Royce engines which leads to anticipated delays. This predicament not only disrupts AirAsia X's operational plans but also dampens its competitive stance in an industry where timeliness and efficiency are paramount. Its own orders of A321XLR, which can fuel strong growth, will only come in 2026, if not delayed further.

This is why the proposed acquisition of Capital A's aviation business emerges as a strategic imperative for AirAsia X. Through the acquisition, AirAsia X gains access to Capital A's aircraft orderbook with an ongoing, immediate delivery timeline – AirAsia X can then pursue immediate growth opportunities as part of AirAsia Group.

Of course, you may wonder why we need AirAsia X when we can do it ourselves within Capital A. The short answer: speed. AirAsia X already has many medium haul routes, approvals and slots in hand and that will enable us to get going much, much faster than if we were to start applying for the same today.

Flying higher as Asean's biggest LCC

Post-transaction, we expect to achieve cost savings by consolidating our engineering and ground handling contracts. This move is expected to utilise the combined negotiating power and operational efficiencies of a larger entity. Through such strategic consolidation, we will strive to reduce costs and improve our financial management, allowing us to potentially provide more competitive pricing for our customers.

An essential pillar of the proposed exercise is optimising our human capital management. This will involve further integrating our employee base to reinforce a shared corporate culture and operational goals. We will plan for targeted training and development, aligning roles and responsibilities to drive high productivity and service excellence, which in turn contributes to operational resilience and an enhanced customer experience.

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The combined entity will also enjoy a strengthened credit profile, enabling us to secure better terms from lenders and suppliers. A stronger credit position is a key component of our long-term financial health and stability. By including more institutional investors in our shareholder base, we also intend to deepen our financial resources, providing a solid foundation for future capital investments and increasing the financial robustness of the group.

Finally, we expect the acquisition to enhance our fundraising capacity. This should position us to access capital markets more effectively, allowing us to pursue responsible and strategic growth opportunities.

Building on our successes

As we look forward to further growth post-exercise, we have clear priorities and strategies to build further on where we are today.

On the AirAsia Aviation side, in 2023 we brought 190 aircraft out of storage and operated 160 aircraft. With 22 more aircraft to reactivate and the addition of 9 new A321neo aircraft in 2024, we anticipate that all our aircraft will be operational by June 2024. By then, we also expect to have begun the operations of our latest airline, Cambodia AirAsia in May. On the AirAsia X side, it brought its number of operational aircraft from 7 aircraft in 2022 to 16 in 2023, with 2 more aircraft rejoining the operations by June 2024.

In terms of network plans, our strategy is two-fold: to enhance network connectivity, aiming for significantly higher fly-through traffic and to ensure the maintenance of a reliable network. This will be achieved through implementing afternoon firebreaks for operational recovery and maintaining a stable schedule. These steps are integral to providing our customers with a seamless travel experience and strengthening our position in the market.

Improving our On-Time Performance (OTP) is another critical area of focus. In 2024, we aim to increase our OTP to 88%, up from 79% in 2023. We intend to achieve this by addressing air traffic control issues, weather delays, and technical challenges that have historically impacted our performance. This initiative is fundamental to enhancing operational efficiency and customer satisfaction.

Our ancillary revenue strategies show a robust plan for growth. We've seen substantial ancillary income growth driven by dynamic product pricing and the introduction of innovative products like Fastpass and ZoneUp. Furthermore, the launch of a newly enhanced AirAsia travel insurance offering cashless hospital admission services, alongside the introduction of "The Next

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Big Thing" initiative, highlights our commitment to enhancing customer value through diversified service offerings.

Enhancing the passenger experience is pivotal in our strategy. We plan to enhance the booking experience through MOVE by March, ensuring a seamless process for our customers. Efforts to improve the check-in process, baggage checking, and visa checks will minimise wait times for our passengers. Additionally, we're focused on elevating the airport customer experience by ensuring exceptional service delivery from our front-line staff. These efforts are complemented by a revamp of the inflight commission and tier structure to improve onboard sales.

Cabin cleanliness remains a cornerstone of our passenger experience strategy. A dedicated team is in place to ensure aircraft cleanliness, focusing on toilets, seats, and the replacement of carpets. Through preventive maintenance and deep cleaning at 30-day intervals, we're committed to maintaining the highest standards of hygiene and presentation onboard our aircraft.

Grooming standards across our staff, from cabin crew to engineers and ramp staff, are of paramount importance. A focus on grooming has led to a high grooming net promoter score (NPS), reflecting positively on our brand and enhancing the overall customer experience.

Complementing these strategic areas, several other initiatives have been implemented in 2023 to improve operational efficiency and customer engagement. These include reducing Live Chat wait time from 45 to 9 minutes over three years, introducing a 'flight status' button in the App, enabling real-time notifications for boarding gate, baggage tag, and dynamic flight changes, and promoting user-friendly mobile check-in and digital boarding passes. These contributed to NPS improvement in 2023 and we look forward to building on these successes.

How this affects your shareholding

This is of course a critical question. The short answer is that the proposed exercise will unlock immense value from both AirAsia Aviation and AirAsia X, which we anticipate will uplift your shareholding value significantly.

At the moment, both AirAsia X and AirAsia Aviation are undervalued in the market. The equity value of AirAsia Aviation held by Capital A alone is approximately RM6.8 billion, which is more than double Capital A's market capitalisation of RM2.9 billion when we announced the signing on 25 April 2024. Through this proposed transaction, As shareholders, you will gain direct access to this unlocked value on top of the value in AirAsia X and the remaining businesses in

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Capital A post-transaction.

The value-add extends beyond numbers. As shareholders, you will now have access to a larger airline group including a low-cost carrier group with a time-tested business model that is profitable and resilient. What's more, that time-tested business model is on the brink of expanding to medium-haul routes thanks to the added range from the upcoming new aircraft. As discussed earlier in this letter, the synergies and efficiencies will see the post-exercise group thrive and flourish.

Ultimately, this also means you will be part of Asean aviation history. The proposed transaction will create the world's first low-cost network carrier, fostering an enhanced multi-hub strategy within the region. This will allow us to extend our services beyond Asean, building on the combined AirAsia Group's presence and growing our connections.

Our fleet expansion is secured through to 2035, with a strategy that involves close to 400 aircraft deliveries, ensuring the flexibility to optimise our offerings between narrowbody and widebody planes. This approach promises greater uniformity and synchronisation of service types and quality, aiming to improve customer confidence and satisfaction, which are expected to drive increased revenue potential.

From a brand perspective, this transaction is the next stage of the AirAsia brand's 20-year journey, which has built a strong and loyal following over the two decades with a proven track record of delivering results. Post-transaction, the AirAsia brand will now be much bigger and better.

Open channels

While I have endeavoured to outline the rationale, benefits, and strategic objectives guiding this decision, I acknowledge that not all questions may have been addressed in this letter. As ever, we are committed to transparency and open communications as we navigate this transformative period together.

We value the input and inquiries from our shareholders and stakeholders and encourage you to refer to our resources or get in touch should you have further questions or require additional clarity on any aspects of the proposed divestment.

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Again, I wish to extend my deepest gratitude for your ongoing support and trust in AirAsia. As we embark on this next chapter, our focus remains on unlocking new opportunities, driving innovation, and delivering sustained value to our shareholders and customers alike. Your confidence in our vision fuels our determination to soar to new heights, and we look forward to sharing this exciting journey with you.

Looking ahead, this strategic realignment fortifies our vision to lead the aviation industry into a new era. Thank you for your pivotal role in this journey; together, we're not just reaching for the sky—we're shaping its future.

Kind regards,

Tony Fernandes
Chief Executive Officer
Capital A Berhad
30 April 2024

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