

KDN : PP 10744/05/2013 (033520)

**28 MAY 2014**



# Sizing Up The Impact Of MH370

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# A. MH370 ~ A PLACE IN TIME

## An international tragedy

- In the words of the Prime Minister, “The disappearance of MH370 on March 8 has been one of the most extraordinary events ever to befall Malaysia—and one of the world’s greatest aviation mysteries.” (source: Letter to Asian Wall Street Journal, May 13, 2014).
- From the manner in which the plane disappeared, to the techniques used to search for the plane, the MH370 is unprecedented. It has also triggered one of the world’s largest peacetime search operations, involving 26 different countries.
- MH370 is not a Malaysian tragedy. It is an international tragedy as the stakeholders cut across borders. It is a cause for self assessments and extensive reviews so that the painful episode will not repeat itself.

## Not about the money, it is about lessons learnt

- This report is not about the dollars and cents. The human loss is irreplaceable and the authors of this report share in the anguish of the families and acquaintances of those on the plane.
- The importance of this tragedy is in the lessons that can be learnt, not only for Malaysia, but also the rest of the world. The gaps are clear in several areas:
  - Aircraft security. While the search for the plane continues, it is clear that MH370 exposes weaknesses in the security of air travel that need to be addressed, especially in the area of aircraft tracking. Focus must now be on the communication avionics, which include the transponders, Aircraft Communications Addressing and Reporting Systems (ACARS), blackboxes and emergency locator transmitters.
  - Airport security. Security on the ground is also under scrutiny given lapses in immigration control. Indeed, society is already benefiting in the form of safer air travel. Air Asia has announced that it will start screening passports with Interpol’s Stolen and Lost Travel Documents (SLTD) database in a move to prevent passengers from using stolen or lost travel documents.
  - Emergency response. In the area of emergency response, there is plenty to be learnt, from the speed of the reaction to the handling of the media. Malaysia does not have the experience dealing with a calamity of the scale that is posed by MH370. An area identified for improvement by the Prime Minister is communications, which was admittedly not prioritized by the authorities in the first few days after the plane disappeared.

## Sizing up the impact helps in future readiness

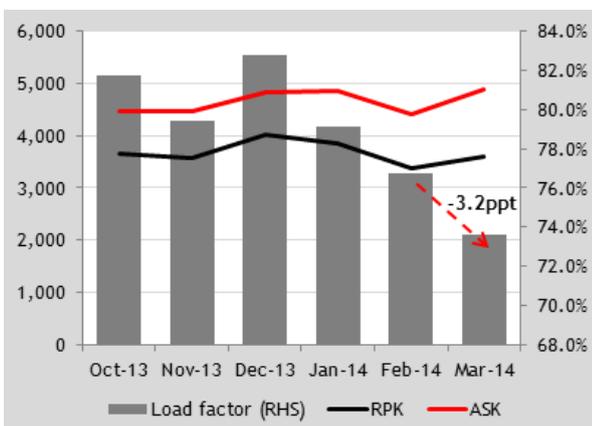
- This impact study is an evaluation of where Malaysia stands and what it needs to recover from the setback. The impact is both, short-term and long-term.
- Quantification would be outright impossible in some areas. For example, how much is goodwill lost between the two old friends of Malaysia and China?
- The important thing is to recover from this painful episode, move forward and be better prepared for similar episodes in the future. MH370 will not be forgotten. It will always have a place in time.

# B. TRAGIC EPISODE FOR MALAYSIA AIRLINES

## i. IMPACT ON MAS OPERATIONS

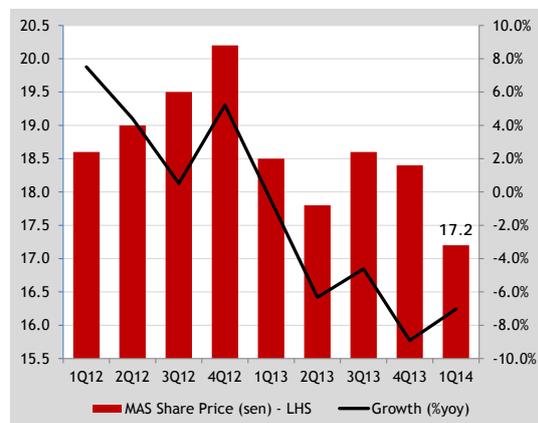
- In 2005, the market share of MAS in Malaysia’s aviation sector was >60%. Then, competition heated up with the emergence of AirAsia and other well-funded Middle East airlines. Most of the price-sensitive leisure travelers switched to the low cost carriers while the corporate travelers opted for the Middle East airlines which offer more modern fleet. Today, the market share of MAS has fallen to less than 30%.
- In a massive *kitchen sinking* exercise in 2011, MAS recognized a heavy impairment loss of RM1.1b. In order to reboot its financial health, MAS was granted a lifeline with a financial package amounted to RM9.0b from its shareholders. The total fund was utilized to shore up its capital base and for fleet renewal, including six A380 aircraft acquisitions.
- As part of its business turnaround plan, MAS adopted the “load active, yield passive” strategy to regain its lost market share, with full knowledge of the costs involved. However, the aviation market is dynamic. The entry of a second domestic LCC - Malindo Air into the congested Malaysia market further intensified competitions among the three domestic airlines. All domestic carriers wanted to retain their market share and offered a deep discount on ticket fare. They all suffered from domestic overcapacity and decline in yield.
- It was heartbreaking and unfortunate that MH370 went missing while MAS was intensifying its efforts to turn around its business. The fallout from the incident is evidenced by MAS’ operational performance in March, which shows a drastic cut in its international passenger load factor by -3.2%-point (Chart 1). We expect the impact of MH370 on MAS to be more pronounced from 2Q14 onwards.
- Out of respect for the families of the lost MH370 passengers, MAS had withdrawn itself from the popular Malaysia travel campaign - MATTA Fair, which is its vital sales channel. The impact was reflected in MAS 1Q14 financial results, which revealed that ticket forward sale in 1Q14 declined by -12%qoq and -8%yoy separately despite the growth in capacity of +18%yoy. The shortfall in forward sale will have to be inevitably covered by more aggressive marketing campaign and deeper fare discount. This will exert even more pressure on the fare yield, which has been bashed down over FY13.

Chart 1: MAS Monthly Passenger Traffic and Load Factor



Source: MAS, MIDFR

Chart 2: MAS Quarterly Yield

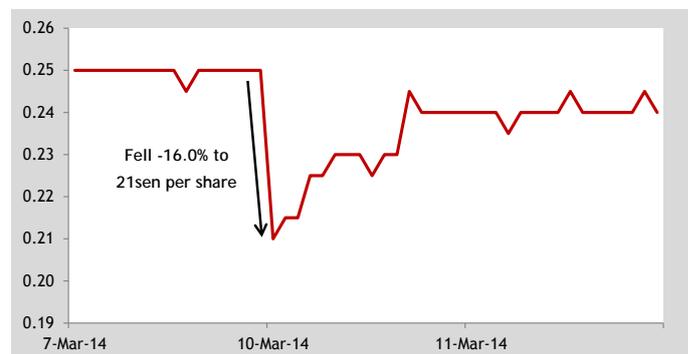


Source: MAS, MIDFR

## ii. IMPACT ON SHARE PRICES

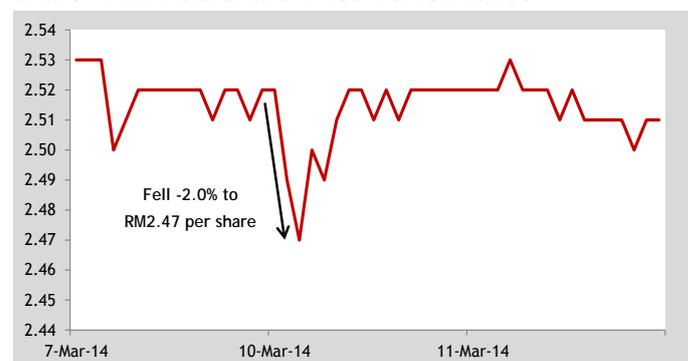
- In the stock market, the first trading day after MH370 went missing was Monday, 10 March 2014. That day MAS share price reacted immediately and fell by as much as -16% to an all-day low of RM0.21 against the preceding Friday's closing price of RM0.25. This is a typical share price reaction for any airline hit by a major catastrophe. Nonetheless, MAS share price was able to recoup some of the losses in the afternoon session and it closed the day at RM0.24. Total volume traded was 385m shares, the highest in 6 months.
- The share price of AirAsia fell -2.0% from Friday's closing of RM2.52 to an intraday low of RM2.47 during the first trading session. It recovered in the afternoon and closed at RM2.52. Total traded volume was 6.7m shares, only slightly higher than that in the preceding trading day of 5.5m shares. The impact on AirAsia share prices was the least among aviation stocks, likely to be due to its competitive relationship with MAS.
- Malaysia Airports Holdings Berhad (MAHB) share price also fell significantly on Monday by -4.9% to RM7.97, as compared with Friday's closing price of RM8.38. As was the case with the other two aviation stocks, the share price rebounded and closed at RM8.24, only slightly lower than the closing price in the previous trading day. Total volume traded was 3.5m shares, triple than on Friday of 1.1m shares. It is apparent that any deterioration in MAS operation after the MH370 incident will hit MAHB via lower collection of passenger service charge revenue due to lower passenger movement at KLIA terminals.

Chart 3: MAS Share Price Performance



Source: Bloomberg, MIDFR

Chart 4: Air Asia Share Price Performance



Source: Bloomberg, MIDFR

Chart 5: MAHB Share Price Performance



Source: Bloomberg, MIDFR

### iii. FINANCIAL COSTS - INSURANCE, COMPENSATION, LOGISTICS ETC

- The MH370 incident involved 239 passengers including 12 crew members. Although MAS has not allocated a financial provision for any expenses arising from the incident, we believe that the financial losses will be recognized in its operational expense.
- For our financial impact assessment on MAS, we have not included the loss of hull and aircraft machinery, the potential of higher insurance amount based on the court ruling, and the loss of opportunity cost due to MH370. We have listed nine financial expenses, including salvage wreckage, insurance compensation, rental of communication center, accommodation, logistics cost, earnest insurance payment, caretaker services, litigation cost and other technical support.
- The biggest outlay is estimated to be the salvage wreckage, at an estimated amount of USD150m, followed by insurance compensation of USD41.8m. The Montreal Treaty decrees that any airline which is involved in an air accident will be liable to pay up to USD175k per passenger, even if it is not a fault of the airline. Advance payment of USD5k had already been distributed to the dependents of lost passengers to meet their economic needs. The amount of monetary aid will be recovered from the insurance proceed. The total direct financial costs to MAS, based on our initial assessment is USD212.1m for the MH370 incident.

Table 1: Estimated financial costs of MH370's incident

No.	Itemized expenses	Description	Amount (USD'm)
1	Salvage wreckage	To retrieve the black box from the seabed of Indian Ocean with depths of more than 10k feet. We higher 1.5 times of the salvage costs than the USD100m of the similar AF447's salvage cost due to the tougher conditions.	150.0
2	Insurance compensation	USD175k compensation amount to 239 lost passenger's the next of kin	41.8
3	Rental of communication center	Assuming 50 times rental of meeting venue with the families of lost passengers	0.3
4	Accommodation	Accommodation provided to the families of lost passengers in KL and Beijing	0.4
5	Logistics cost	Arrangement of return flight from Beijing to KL for the 50 families member, potential return flight from KL-Perth, and other hotel transfer	3.0
6	Ernest insurance payment	MAS already gave the earnest insurance payment of USD5k each to the 239 dependent of lost passengers	1.2
7	Caretaker services	Caretakers assigned for each family of lost passenger	0.5
8	Litigation cost	Hiring of lawyer and court fee	10.0
9	Other technical support	Including satellite image, consultation cost, and etc.	5.0
Total amount (USD'm)			212.1

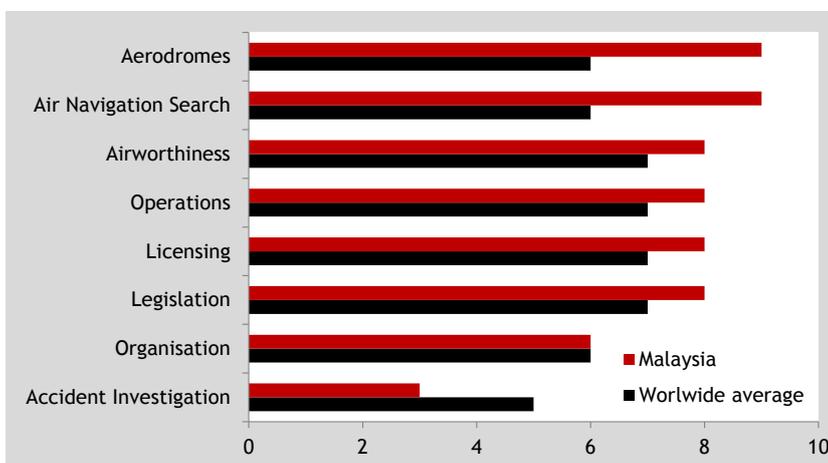
# C. SECTORAL DAMAGE

## i. AVIATION INDUSTRY

- Prior to the MH370 incident, Malaysia aviation industry is relatively free from any major incident with the last two major incident reported was in 1995 and 1977. It has an excellent safety record and has been rated as “Category 1” in FAA’s International Aviation Safety Assessment Program (IASA) for its compliance with International Civil Aviation Organization (ICAO) aviation safety standards. According to Aviation Safety Network (ASN), Malaysia’s level of effective implementation of ICAO standard has been on par or even better than the worldwide average. The disappearance of MH370 has indeed been a tragedy for Malaysia aviation industry but it is important to note that the excellent historical safety record proved that MH370 loss was not really contributed by lacking in safety standard in Malaysia aviation industry as a whole.

- Using the total passenger movements (TPM) numbers as proxy, Malaysia aviation industry has expanded over the years with a 5-years CAGR of 10.9% from 2008 to 2013. 2013 was particularly a good year for Malaysia aviation industry as it recorded 18.4%yoy growth to 79.6m TPM. Prior to the MH370 incident it was expected that the growth momentum to continue in 2014 on the back of Visit Malaysia Year 2014. We believe that the unexpected incident is going to have a negative impact on the TPM growth for 2014 especially on the TPM from China.

Chart 6: Effective Implementation Level of ICAO audit areas\*



\*Carried out during 28/6/05 - 7/7/05

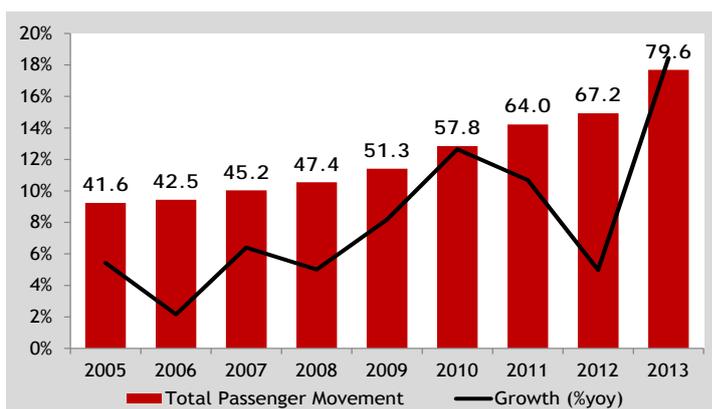
1= Not Implemented / 10 = Fully implemented

Source: ASN

- On the back of envelope calculations by assuming TPM growth for 2014 would be at its 5-year CAGR of 10.9%, the TPM for 2014 is projected to be at 88.26m before the MH370 incident. Taking an assumption of 30% drop in China-based TPM and 5% drop in other foreign-based TPM, the total TPM for 2014 could eventually be lower by approximately 3.3m which translated into a lower TPM growth of 6.7%yoy compared to the initial target of 10.9%.

- By applying the same assumption as above, a drop in TPM would result in total revenue loss in term of passenger service charge (PSC) in circa RM109m based on the charge of RM65 PSC per international movement. This is after the consideration of a drop of approximately 1.68m in passenger international departure movement in 2014.

Chart 7: Annual Total Passenger Movement (mil people)



Source: MAHB

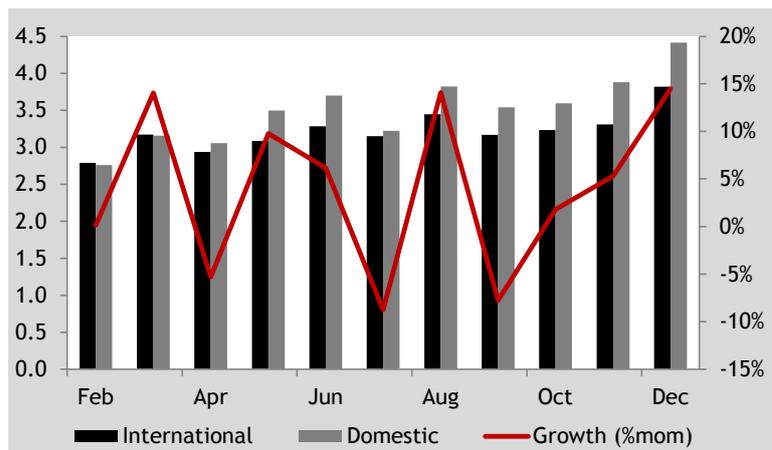
Table 2: Total Passenger Movement Performance (Jan - April 2014)

Total Passenger Movement	Jan-April		Growth (%yoy)
	2014	2013	
International	13.4	11.8	14.2
Domestic	13.9	11.7	19.0
Total	27.3	23.4	16.6

Source: MAHB

- The TPM numbers have recorded a positive +16.6%yoy growth for the first four month of 2014 even on the back of the MH370 incident. According to MAHB, there was some decline in the growth rates towards the last 10 days of March most probably attributed to the MH370 incident. Nevertheless, we are still confident on the growth prospect of aviation industry in Malaysia even though it could be cap at a lower growth due to this incident.

Chart 8: Monthly Total Passenger Movement (mil people)

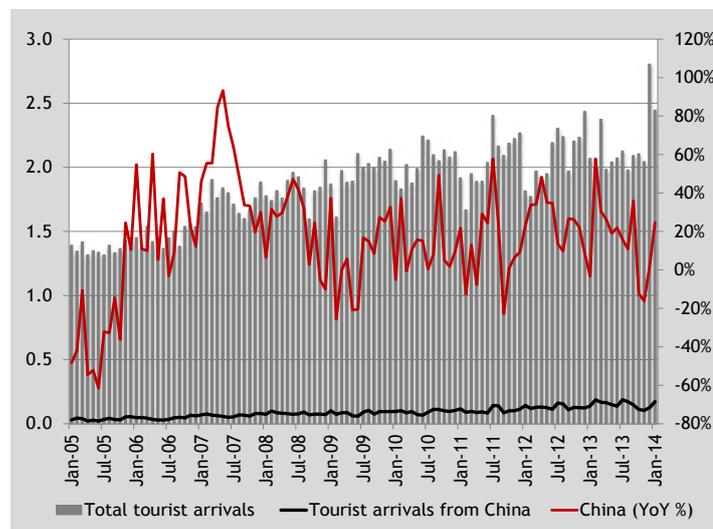


Source: MAHB

ii. TRAVEL/TOURISM INDUSTRY

- Prior to the MH370 incident, the Malaysian Ministry of Tourism had a target of 28 million tourists (8.9%yoy growth) for its 2014 Visit Malaysia Year and with an average of 2.33 million tourists per month, Malaysia surpassed the monthly target in January 2014 with 2.45 million tourists which would have signaled a further upside to the number of tourists in the following months specifically during school holidays.
- Historically, the top three countries that make up the bulk of Malaysia’s tourists arrivals are Singapore (50%), Indonesia (10%), and China (7%). In January 2014, these three countries posted a 16.2%, 14.1%, and 24.7%YoY growth respectively. It is to be noted that the significant growth was due to a positive response from the Visit Malaysia Year 2014 promotion.
- The number of Chinese tourists has been steadily increasing since 2005, exhibiting trends of seasonality specifically during the month of February and July, attributable to winter and summer

Chart 9: Tourist arrivals in Malaysia (mil people)



Source: CEIC, MIDFR

holidays respectively. In 2013, the number of tourists from China grew by 15%YoY.

- With an 8.9%YoY growth target set by the Malaysian Board of Tourism for total number of tourists in 2014 and 7% of it would be from China, it is expected that 1,950,859 tourists are of Chinese nationals. The actual number of Chinese tourists in January surpassed the expected monthly average by 6%.

Chart 10: Hotel occupancy rate in selected states (%)

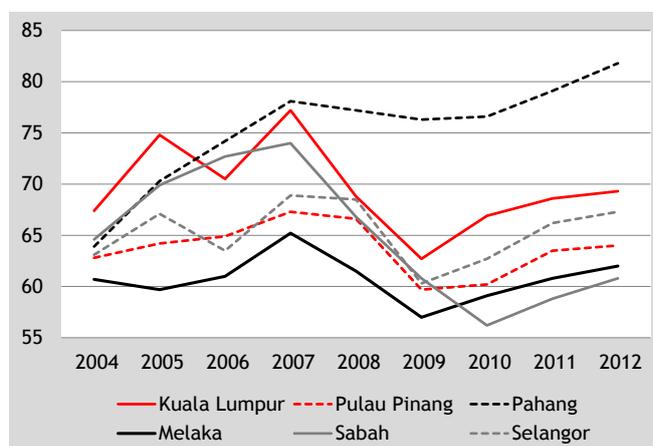
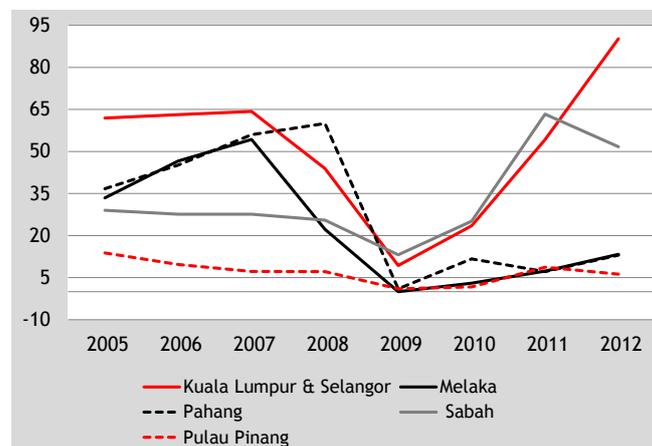


Chart 11: States visited by tourists from China (%yoy)



Source: CEIC, MIDFR

- However, due to the MH370 incident, nearly 30% of Chinese nationals have cancelled their flight bookings for 2014. Assuming a 30-50% drop in arrivals from China, 2H14 might see a significantly lower number of tourists from China, especially during the month of July which could range from 103,000 to 143,000.
- Over the recent years, the three states visited by the majority of tourists from China are Kuala Lumpur, Selangor, and Melaka. These states registered a steady increase in their rate of hotel occupancy since the financial crisis in 2009. However, despite a sharp increase in the number of Chinese tourists specifically in Kuala Lumpur from 2009 to 2012, the increase in the city’s hotel occupancy rate only registered a moderate increase, indicating that the number of Chinese tourists does not have a significant impact on occupancy rate in major tourists’ hotspots. This would be in line with the fact that Chinese nationals only take up 7% of Malaysia’s total tourists arrivals.

Table 3: Number of tourist arrivals

Year	Total tourist arrivals	Total Chinese tourist arrivals
2008	22,052,488	949,864
2009	23,646,191	1,019,756
2010	24,577,196	1,130,261
2011	24,714,324	1,250,536
2012	25,032,708	1,558,785
2013	25,715,460	1,791,423
2014 (f)	28,004,136	1,960,290
Jan 2014 (f)	2,333,678	163,357
Jan-14	2,447,397	172,396

Source: CEIC, Malaysian Board of Tourism, MIDFR

# D. GOVERNMENT IN THE SPOTLIGHT

## i. THE INEVITABLE MONETARY CONSEQUENCES

### *Search and Rescue Cost*

- In respect of the search and rescue (SAR) cost, the expenses are expected to be higher than that for Air France 447 which cost 115 Euros / USD160m over a 2 year period. This is in view that it is the largest search in aviation history.
- Contributing to the search mission are three countries, Malaysia, China and Australia.
  - China has not indicated any amount for the exercise, but we believe it will be spending the most amount based on the number of search assets that the country has mobilized;
  - Australia has pledged to contribute up to USD89.9 million (RM272.3 million) which has been indicated as the ceiling cost for the search of the missing plane. Thus far, Australia has spent USD50 million for its 1st phase of search and will be continuing into the 2nd phase of search which will cost USD60 million.
  - We gather that Malaysia will be sharing the cost with Australia. For now, the cost on Malaysia is minimal and manageable with the incurrance of cost for deployment of assets.
- The percentage of sharing of the total SAR cost has yet to be determined. Assuming a 50:50 sharing of the total expenses of RM272.3 million (including procurement cost of assets to be deployed for the search), the cost will turn out to circa RM136.0 million for Malaysia which is expected to be funded by tax revenue. We believe the search will be a protracted one with the black box pings having turned silent.
- Government will not be providing funding to MAS which is incurring operational losses and the potential rise in expenses due to claim settlements and other related expenses for MH370.

### *Opportunity loss of income from inbound Chinese tourists*

- The disappearance of MH370 remains a mystery and is unprecedented in the history of Malaysia's aviation sector. The unexpected incident is certain to impact tourism revenue to the extent of affecting the number of tourist arrivals in particularly from China and tourist spending.
- Before the MH370 saga, the percentage of China tourist arrivals in Malaysia has been rising, increasing up to 7.0% in 2013.
- Prior to the MH370 incident, on the back of envelope calculations, assuming the percentage of China tourist arrivals remains at 7.0% and a target for total tourist arrivals of 28 million for 2014, 1.96 million of China tourists are expected to arrive this year.
- Against a target of 1.96 million China tourist arrivals, a drop of 30-50% of the expected arrivals is likely. Taking an assumption of a 30-50% decline in arrivals, the number of China tourists to Malaysia after MH370 incident could eventually be lower at 1.0 million or 1.4 million arrivals for 2014. Meanwhile, for non-China Tourist we expect a 5% decline (a drop by 1.3 million tourist) in arrivals in 2014 leading to estimated arrivals of 24.7 million.
- Based on the spending by tourist from 2010 to 2013, the average spending by per tourist is in circa RM2,400. Assuming a spending of RM2,400 per tourist, a drop of 30-50 % of China tourist arrivals and a decline in 5% arrival of non China tourist works out to be a loss in tourist receipts of between RM4.46

Table 4: Tourist Arrivals and Revenue

Year	Tourist Arrivals (million)	Growth in Tourist Arrivals (%yoy)	Tourist Receipts (RM'm)	Growth in Tourist Receipts (%yoy)	Receipts per Tourist (RM)
1998	5.56	n.m	8,600	n.m	1,547
1999	7.93	42.6	12,300	43.0	1,551
2000	10.22	28.9	17,300	40.7	1,693
2001	12.78	25.0	24,200	39.9	1,894
2002	13.29	4.0	25,800	6.6	1,941
2003	10.58	-20.4	21,300	-17.4	2,013
2004	15.70	48.4	29,700	39.4	1,892
2005	16.43	4.6	32,000	7.7	1,948
2006	17.55	6.8	36,300	13.4	2,068
2007	20.97	19.5	46,100	27.0	2,198
2008	22.05	5.2	49,600	7.6	2,249
2009	23.65	7.3	53,400	7.7	2,258
2010	24.58	3.9	56,500	5.8	2,299
2011	24.71	0.5	58,300	3.2	2,359
2012	25.03	1.3	60,600	3.9	2,421
2013	25.72	2.8	65,440	8.0	2,544
2014f	28.00	8.9	76,000	16.1	2,714
2020f	36.00	n.m	168,000	n.m	4,667
Average (2011-2013)	25.15	n.a	61,447	n.a	2,442
CAGR (2011 - 2013)	n.a	1.3	n.a	3.9	n.a

\*Tourist Arrivals and Receipts for 2014 and 2020 represent Tourism Malaysia's targets 2007 and 2014 are Visit Malaysia Years  
Source: Tourism Malaysia, MIDFR

Table 5: Percentage of China Tourist Arrivals

	2010	2011	2012	2013
China Tourist Arrivals (a)	1,130,261	1,250,536	1,558,785	1,791,423
Total Tourist Arrivals (b)	24,577,196	24,714,324	25,032,708	25,715,460
Percentage of China Tourist Arrivals to total Arrivals (a/b)	4.6%	5.1%	6.2%	7.0%

Source: Tourism Malaysia, MIDFR

billion to RM5.42 billion for 2014. The decline in tourist receipts is expected to cause a loss in sales and service taxes to the Government as shown in Table \_\_\_\_.

- It is an unfortunate time for Malaysia with the occurrence of this incident in 2014 but Malaysia is not alone as seen from the Korean ferry incident which has claimed many more lives. We believe that the efforts to continue searching for the missing plane will instill confidence back on Malaysia and arrival of tourists.

**Table 6: Overall financial implication to the Federal Government**

	Cost	Assumptions
Search and Rescue (SAR)	RM136 million	<ul style="list-style-type: none"> <li>2 years search duration.</li> <li>Sharing of total cost of RM272.3 million (USD89.9 million) on 50:50 basis with Australia.</li> <li>Total cost of RM272.3 million is assumed to include cost for deployment of assets.</li> </ul>
Loss of Sales Tax @ 10%	RM542 million	<ul style="list-style-type: none"> <li>1 year's lost of sales tax.</li> <li>Assuming drop in China and Non China tourist arrivals of 0.96m and 1.30m respectively and a spending of RM2,400 per tourist.</li> </ul>
Loss of Services Tax @ 6%	RM325 million	<ul style="list-style-type: none"> <li>1 year's lost of services tax.</li> <li>Assuming drop in China and Non China tourist arrivals of 0.96m and 1.30m respectively and a spending of RM2,400 per tourist.</li> </ul>
Total	RM1,003 million	

Source: xx, MIDFR

## ii. SIZING UP THE INTANGIBLES:

### a. Image and Reputation

- Show of confidence. Since the start of the incident, Malaysia has been spearheading the search and rescue mission to recover the missing MH370. This is despite having zero track record in handling such incident on an international level. We view this as a show of confidence portrayed by countries such as United States or Australia, who could have assumed the role instead. Japanese premier Shinzo Abe also appreciates that Prime Minister Datuk Seri Najib Tun Razak has been assuming the strong leadership in a difficult situation.
- Upholding transparency. Half way through the search mission, the transport ministry released the preliminary report on MH370 as well as recordings of conversation between the cockpit and KL air traffic control. The report entailed topics such as the steps taken by the authorities on the day of the disappearance, the plane's cargo manifest and light history. Also, in a recent note, more information is being prepared to be release for public consumption. They would contain data communication logs and the technical description of the analysis. We view that the move helps to alleviate the concern that informations are being withheld. This should help to further instill credibility in the Malaysian government.
- Negative impact may be short-lived. Countless obstacles are encountered throughout the entire rescue mission, which inadvertently aggravated the situation further. As a result, numerous quarters have made negative allegations on the way the situation is being handled. However, we view that the some of these allegations are rather short-lived as we believe that they could be emotion-induced. In a recent article, the Straits Times reported that "sympathy towards Chinese families of passengers aboard missing flight MH370 has begun to wane, with social media users focusing their attention on recent happenings around the globe". This is contrary to the initial weeks of the ordeal when the news made headline worldwide.

## b. MH370 vs Korean Ferry

Table 7: Overview comparison between MH370 and MV Sewol tragedies

	MH370	MV Sewol
Nature of incident	International air travel	Domestic sea travel
Location of tragedy	Yet to be determined although currently narrowed to the south Indian Ocean	Off the coast of South Korea, heading to Jeju Island
Countries involved in search & rescue operations	26 countries	South Korea with limited participation from U.S. Offer for assistance from Japan was refused
Causes	Yet to be determined as wreckage not yet found at time of publication	Overloading, causing ship to tip to starboard

Source: Various, MIDFR

- It is indeed an unfortunate period, where just over a month after the disappearance of MH370, another public mass transportation mishap occurred - the South Korean ferry, MV Sewol. To date, 286 passengers have been confirmed dead with 18 more passengers still unaccounted for (as of time of publishing). Although these two tragedies happened in different circumstances and still remains unresolved, a comparison between the two tragedies could shed some light on how the Malaysian Government handled the situation. We also acknowledge the fact that the different responses given by the two governments involved could be a benchmark for comparisons in the future.
- International assistance to the crisis. Within a few hours of the confirmed disappearance, Malaysian officials along with its international counterparts staged a massive search in the Gulf of Thailand area (which of course was subsequently shifted to other parts of the globe). However, in comparison with the MV Sewol incident, the South Korean authorities declined special assistance given by the Japan Coast Guards and did not approve one of the U.S. rescue helicopters.
- Criticisms. For the case of MV Sewol, criticisms were raised regarding the regulatory enforcement in place which could have led to the sinking (indirect cause) of the ferry. In addition, the ferry crew was also criticized for not ensuring the safety of the passengers first. They were eventually arrested and charged with negligence of duty. However, for the case of MH370, despite criticisms were thrown at lax airport customs for allegedly allowing passengers with reported stolen passports to board the plane, further investigations refuted the possibilities that the illegal passengers could have caused the disappearance of the plane.
- Display of ownership/responsibility. In-line with East Asian display of responsibility in an adverse event, ex-Prime Minister Jung Hong-won resigned, accepting responsibility for the incident. Being respectful, we argue that the Prime Minister post in the republic is ceremonial and serves as the second for the President - unlike the Prime Minister post in Malaysia which acts as the Head of Government.

## c. International Goodwill

- Global reconnaissance. Despite a slow start, the search and rescue operation (SAR) for MH370 began on the South China Sea with the Malaysian and Vietnamese authorities jointly searching in the Gulf of Thailand area. As time progresses and new information are being divulged, the search area expanded

to the surrounding region. The search area shifted downward to the Southern Indian Ocean after new piece of information suggest that the plane has flew along the South Corridor. By then, the SAR has involved participation by 26 countries around the globe.

- China in focus. Out of 239 passenger onboard the plane, some 152 of them are from China. This led us to believe that the relentless support given by these countries represent an effort to boost tie with China. This could be in view of the emerging superpower status. There could also be potential economic benefit spillover given that China is on track to replace the United States to become the world's largest economy.

Figure 1: P-8 Poseidon



Source: online media

Figure 2: Ocean Shield



Source: online media

- Direct asset deployment. Throughout the SAR, numerous aircrafts and vessels were deployed by these countries to speed up the rescue effort. This is also serves as an opportune time to display to the world the technology advancement that each of the countries possessed. A notable aircraft i.e. Boeing P-8 Poseidon, the most advanced search aircraft in the world with its unrivaled surveillance capabilities, was deployed by the U.S. to help in the search and rescue operation. During the search, it covered 1,200 square nautical miles a days with the capacity for covering more. The Ocean Shield was also deployed by the Australian Defense to detect underwater “pings”. These are also a display of the technology owned by the superpowers.
- Malaysia not left out. Despite limited technology know-how, the Malaysian government has also sent out numerous military assets to participate in the SAR. Moreover, in show of support, Malaysian companies also offered their assistance. Petronas had provided a towed deep-water sonar and a remote-operated vehicle while Sapure-Kencana has extended the usage of its multi beam echo sounder.

Figure 3: Lockheed P-3 Orion



Source: online media

Figure 4: KD Pahang



Source: online media

- Indirect foreign assistance - satellite data. Apart from direct form of assistance, aid also arrives in the form of satellite data crunching and analysis. Inmarsat helped track the final route of the missing airliner MH370 through cutting-edge methodology which has never been done before. Satellite imagery is also being made available by Tomnod for the public to help with the search through crowdsourcing.

#### d. Stature

- Media coverage. The story on the disappearance of flight MH370 has definitely been covered extensively by global news agencies; none more so than CNN (Cable News Network). The table below

Table 8: List of assets deployed in the Southern Indian Ocean

Country	Asset Deployed	
	Aircraft	Vessel
Malaysia	Two Royal Malaysian Air Force Lockheed C-130 Hercules	Royal Malaysian Navy vessels: <ul style="list-style-type: none"> <li>• KD Kasturi</li> <li>• KD Selangor</li> <li>• KD Terengganu</li> <li>• KD Lekiu</li> <li>• KD Pahang</li> <li>• KD Kelantan</li> </ul>
Australia	Three Royal Australian Air Force P3 Orion maritime surveillance aircraft	Royal Australian Navy HMAS Success - Durance class multi-product replenishment oiler
New Zealand	One New Zealand Air Force P3 Orion maritime surveillance aircraft	
United States	One US Navy P-8 Poseidon next-generation maritime surveillance aircraft	
People's Republic of China	Two Chinese Ilyushin IL-76s multi-purpose four-engine strategic airlifter	Two amphibious transport docks One destroyer, One frigate, One supply ship One rescue ship from the Chinese navy Four ship-borne helicopters Five ships from the country's maritime authorities, One bulk carrier One icebreaker
Indonesia	Three	Eight
United Arab Emirates	One UAE military C-17 Globemaster III and a Bombardier Dash-8	-
United Kingdom	-	HMS Echo - multi-role hydrographic survey ships from Royal Navy, heading to SAR site
Japan	Two Japan Self Defence Force Lockheed C-130 Hercules transport aircraft Two P-3C Orion patrol planes	
South Korea	One P-3 Orion Maritime Surveillance One C-130 from the South Korea Air Force	
India	One P-8 Poseidon long range maritime surveillance aircraft One Lockheed C-130J Hercules special operations aircraft with electro-optic and infra-red sensors	
Others	Two ultra-long range commercial jets and one Bombardier Global Express jet	One Merchant ship - Norwegian automobile carrier St. Petersburg

shows the viewership of CNN, Fox News Channel and MSNBC for the period before and after the flight disappearance. The increase in viewership from this incident has inadvertently generated publicity for Malaysia and has increased the stature of the country. Even U.S. President, Barack Obama has praised the Malaysian Government for its effort in handling the crisis.

- Positive comments from global leaders. Despite the complexity involved in the search and rescue operations, Malaysia has definitely handled the situation as best as the amount of available information would permit. The table below summarizes the various praises given by regional and global leaders towards the search and rescue efforts led by Malaysia during the early days of the incident. These comments reaffirm Malaysia's dedication in ensuring closure to the incident.

Table 9: Viewership comparison pre and post MH370 incident

Stations	CNN	Fox News	MSNBC
Pre-incident (30 Dec 2013 to 6 March 2014)	97k	220k	141k
Post-incident (7 March 2014 to 26 March 2014)	196k	245k	127k

Note: The viewership is based on the 25-54-year old target audience  
Source: Nielsen Live

Table 10: Praises given by global leaders

Country	Comments
Australia	"It's been tremendous to see the international co-operation here. We have regular military co-operation with the United States, New Zealand and Malaysia, but to see also the co-operation with us from China, from Japan, from Korea is really heartening and it demonstrates that in a humanitarian cause the nations of this region can come together for the betterment of humanity" - Tony Abbot, Prime Minister of Australia
United States of America	"The Malaysian government is working tirelessly to recover the aircraft and investigate exactly what happened ... I can't speak for all the countries in the region, but I can say that the United States and other partners have found the Malaysian government eager for assistance and fully forthcoming with us in terms of the information that they have" - Barack Obama, President of the United States of America
Austria	"Austria was satisfied with all the efforts of the Malaysian government and the other nations" - Tan Sri Pandikar Amin Mulia, Dewan Rakyat Speaker commenting on remarks made by Christophe Ceska, Austrian ambassador to Malaysia
South Korea	"It is a tough time for the Malaysian people and its government but authorities are doing its best at handling this crisis ... The (Malaysian) authorities have been very responsible at this time ...Everybody is doing their best ..." - South Korean ambassador Mr Cho Byungjae.

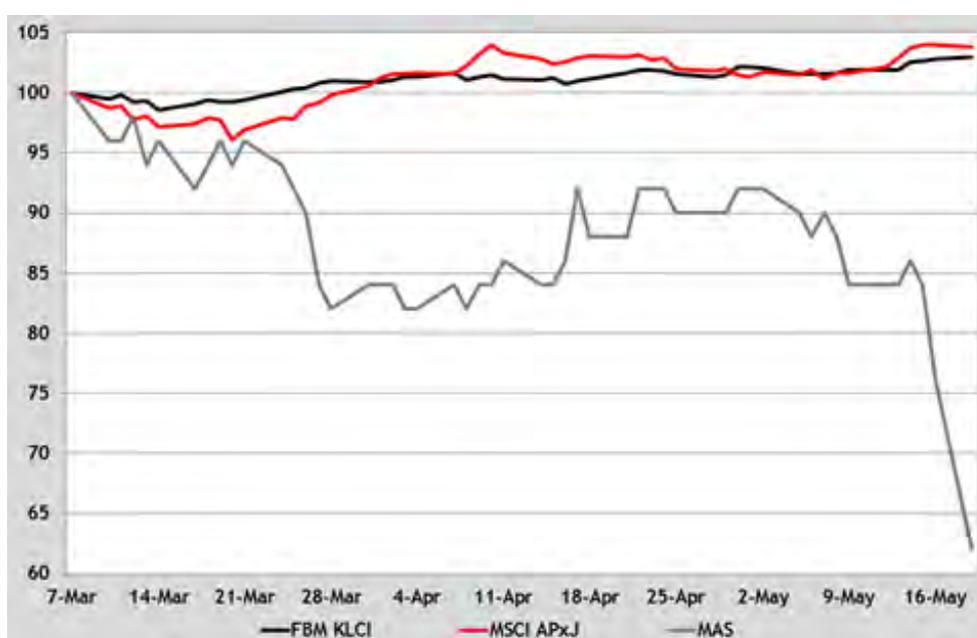
Sources: Various media, MIDFR

# E. BROADER ECONOMIC IMPACT

## i. SENTIMENT AND CONFIDENCE

- Initial worries over the impact of MH370 disappearance on the domestic equity market sentiment proved unfounded. This is attested by the absence of material divergence post-MH370 incident with regard to the relative performance of the local benchmark FBM KLCI vis-à-vis the regional barometer MSCI Asia-Pacific ex-Japan (MSCI APxJ). In fact the FBM KLCI marginally outperformed the MSCI APxJ during the initial weeks pursuant to the aircraft disappearance. As at the time of writing, investors' confidence remained buoyant with the FBM KLCI chalking new all-time high levels. The recently released better-than-expected 1Q14 GDP figures of 6.2% validated the largely muted equity market reaction to the MH370 incident.

Chart 12: Relative Performance since 7-March 2014



Source: Bloomberg, MIDFR

- On the other hand, the fallout from the MH370 incident can be clearly seen by the circa -40% pounding suffered by MAS share price. However, early on, the share price reaction to the tragedy was rather muted with buying support emerging quite early at mere -5% retracement. Arguably, investors were initially expecting a swift search and rescue or recovery efforts. Unfortunately, a quick closure to the incident was not forthcoming as subsequent developments pointed towards lengthy and difficult search efforts. Australian PM Tony Abbott described the search effort as “the most difficult in human history”.
- In a heartbreaking announcement on 23 March, PM Najib Razak revealed to the world that “...according to this new data, flight MH370 ended in the southern Indian Ocean.” In the days that followed, MAS share price broke below a support level held since the aircraft disappearance. It was clear then that the MH370 tragedy, and its associated human and financial costs, may bereft of closure for much longer time than earlier expected. Kim Beazley, Australia’s former defense minister and current ambassador to the United States said the deepwater search effort “could take months, it could take years.”

Chart 13: MAS share broke two support levels since 7-March 2014

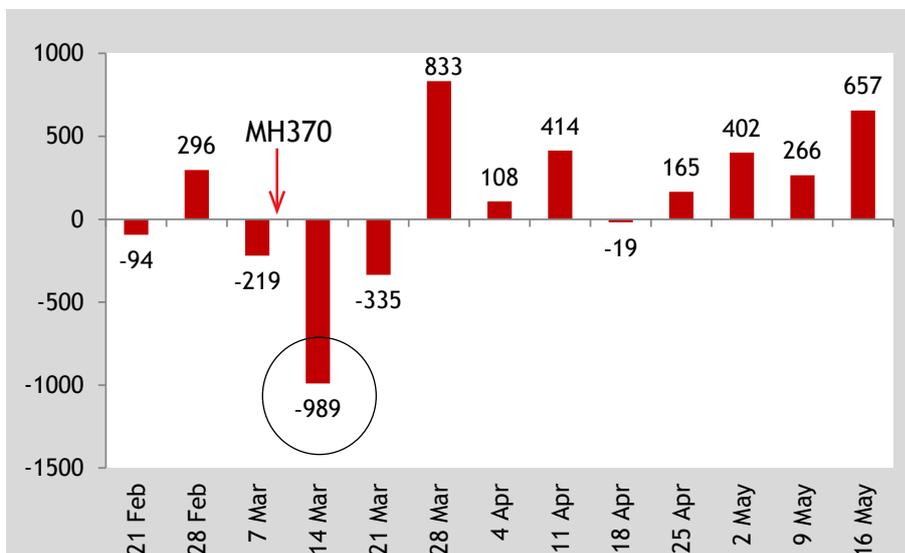


Source: Bloomberg, MIDFR

ii. MONEY FLOW: PORTFOLIO FLOW

- MH370 disappeared on 8 March 2014. In the week succeeding the disappearance, there was a significant selldown by foreign investors on Bursa Malaysia. On a net basis (sales less purchases), foreign investors sold RM989m worth of shares in the open market (i.e excluding off-market deals) during the week ended 16 March. The selldown continued in the following week although the amount abated to RM335m.
- The extent of the selldown was actually exacerbated by the then prevailing market sentiment. Global equity investors were already edgy in days preceding the plane’s disappearance as the indices on Wall Street were trading near their all-time highs, while geopolitical risks were seen rising with the unfolding crisis in the Ukraine. Indeed, foreign investors were already net sellers to the tune of RM219m during the trading week leading up to the fated Saturday March 8.

Chart 14: Foreign purchase (sale) of shares (RM'm/net weekly)



Source: Bloomberg, MIDFR

- Arguably, the disappearance of MH370 only caused a small dent in sentiment and confidence of foreign portfolio investors on Bursa.
  - The size of the selldown was very much manageable relative to that in the past. In August 2013, at the height of investors' concerns over the U.S Federal Reserve's tapering of its asset purchases, the weekly selldown almost hit RM3b.
  - Two weeks after the disappearance of MH370, foreign investors started buying back shares on Bursa.
- In the bond market, foreign investors shrugged off the perceived fallout from MH370. Foreign holdings of Malaysian Government Securities actually rose RM1.4b in March as investors were more interested in the improving fundamentals of the economy, such as the trade balance and industrial production.

### iii. ECONOMIC GROWTH

- The MH370 episode clearly has not caused any dent on Malaysia's economic growth. Any fallout has been outweighed by the various drivers of the economy.
- Economists maintained faith in the Malaysian economy by reaffirming their economic growth forecasts. In actual fact, the consensus forecast of Malaysia's 2014 GDP growth as tracked by Bloomberg actually inched up marginally from 5% pre-MH370, to 5.05% post-MH370 (as shown in Chart \_\_\_). Malaysia's economic forecasts has been buttressed by strengthening exports and resilient domestic demand. Merchandise exports rose 10.8%yoy in 1Q14 while trade surplus hit a 23-month high in February. Meanwhile, domestic demand remained steady with the low interest rate environment, implementation of the various Economic Transformation Programmes (ETPs), low unemployment rate and various initiatives to redistribute income. All these provided the backdrop for a relatively robust first quarter economic performance.

Chart 15: Consensus 2014 GDP growth forecast as tracked by Bloomberg (%)



Source: Bloomberg, Department of Statistics, MIDFR

- 1Q14 GDP growth of 6.2%yoy reaffirmed contentions that MH370 has not caused a dent on economic growth. Indeed, the figure was a big jump from the 5.1%yoy recorded in 4Q13 and significantly surpassed economists' consensus expectation of 5.7% as compiled by Bloomberg. The 1Q14 GDP numbers give important insights as MH370 occurred on March 8 and the incident had direct and indirect impact on 22 days or 24% of the quarter.
- The demand and supply components of GDP that would be intuitively vulnerable to an event risk such

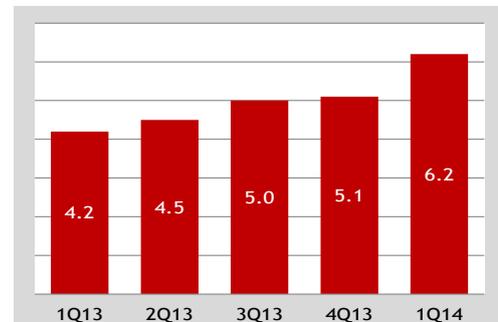
Table 11: GDP Performance in the 1st Quarter of 2014

GDP (%yoy)	4Q13	1Q14	Change (%-point)	Remarks
<i>Demand components</i>				
Private consumption	7.4	7.1	-0.3	Still strong albeit slightly lower growth.
Exports	5.7	7.9	+2.2	Recovery in global demand for E&E and petroleum products.
<i>Supply/Output components</i>				
Manufacturing	5.2	6.8	+1.6	Upsurge in E&E output
Services	6.4	6.6	+0.2	Driven by wholesale/retail trade, business services and communication services.

as MH370 were well-behaved in 1Q14. This means that any fallout from the tragedy in the month of March had been well contained. The performance of the respective components is shown in Table \_\_\_:

- International monetary and development institutions remained upbeat on the economic prospects for Malaysia. In the weeks following MH370, the International Monetary Fund (IMF) and the Asian Development Bank (ADB) raised their macroeconomic forecasts for Malaysia for 2014.
- The IMF raised its Malaysia GDP forecast for 2014 by \_\_\_%-point to 5.2% while the ADB raised its numbers by \_\_\_%-point to 5.1%. These agencies also increased their optimism with respect to Malaysia's current account, which had been a point of concern in 2013. Clearly MH370 has not inhibited these agencies from in raising their expectations towards Malaysia's economy.

Chart 16: GDP growth (%yoy)



Source: Department of Statistics, MIDFR

Table 12: IMF Forecast for Malaysia (Revised on 8-April-2014)

%	2013 (a)	2014 f (pre-MH370)	2014 f (post-MH370)	Change (pp)	2015 (f)
GDP	4.7		5.2		5.0
Current Account Balance	3.8		4.0		4.0
CPI	3.2		3.3		3.9
Unemployment	3.1		3.0	-0.1	3.0

Source: IMF and MIDFR

Table 13: Asian Development Bank Forecast for Malaysia (Revised on 1-April-2014)

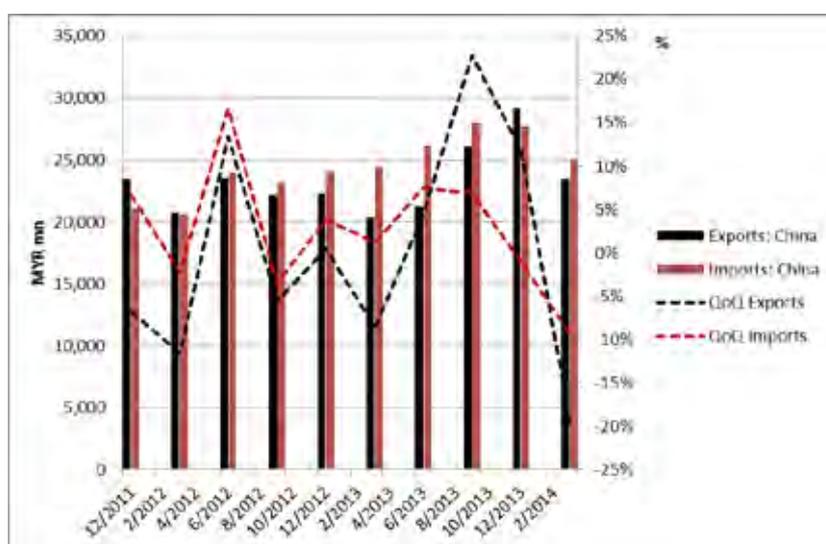
%	2013 (a)	2014 f (pre-MH370)	2014 f (post-MH370)	Change (pp)	2015 (f)
GDP	4.7		5.1		5.0
Current Account Balance	3.8		4.1		4.6
CPI	2.1		3.2		3.5

Source: ADB and MIDFR

#### iv. Economic relations with China

- China has a long relationship with Malaysia and among Asean countries, Malaysia is the first country to establish diplomatic relations with China. In 2013, bilateral trade volume between Malaysia and China hit a new high of USD106b, lifting Malaysia to be China’s largest trading partner among Asean countries. In 2012 China’s direct investment in Malaysia ranked sixth, amounted to RM2b ringgit at the end of 2013 with more than 100 Chinese companies choosing to invest in Malaysia. Last October 2013, Chinese President Xi Jinping, paid a state visit to Malaysia during which Prime Minister Datuk Seri Najib Tun Razak announced the establishment of a comprehensive strategic partnership between China and Malaysia, bringing the bilateral friendly relations to new heights.
- In the past 10 years, bilateral trade between the Malaysia and China has been healthy with 10% p.a average growth. It is also a close partner of China within the framework of the Asean-China Free Trade Agreement (FTA).

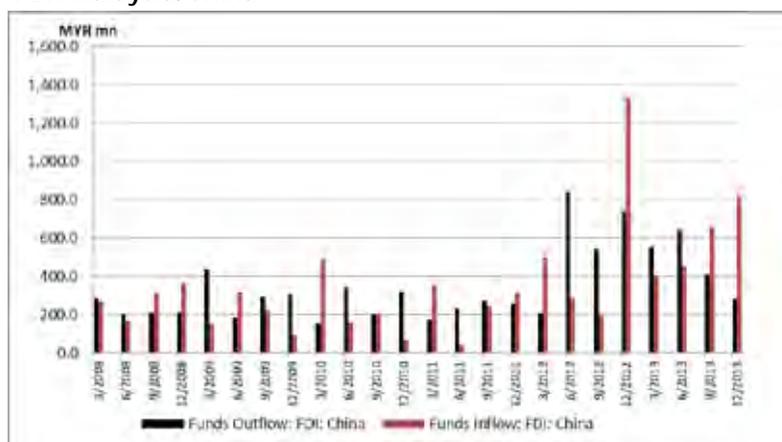
#### Malaysia’s Exports/Imports with China



Source: BNM

- The bilateral trade profile has witnessed a major shift in the past 10 years where commodities are no longer the major source of goods traded, but as much as 50 per cent of trade now comprises manufactured products and other higher value-added goods.

#### FDI: Malaysia/China

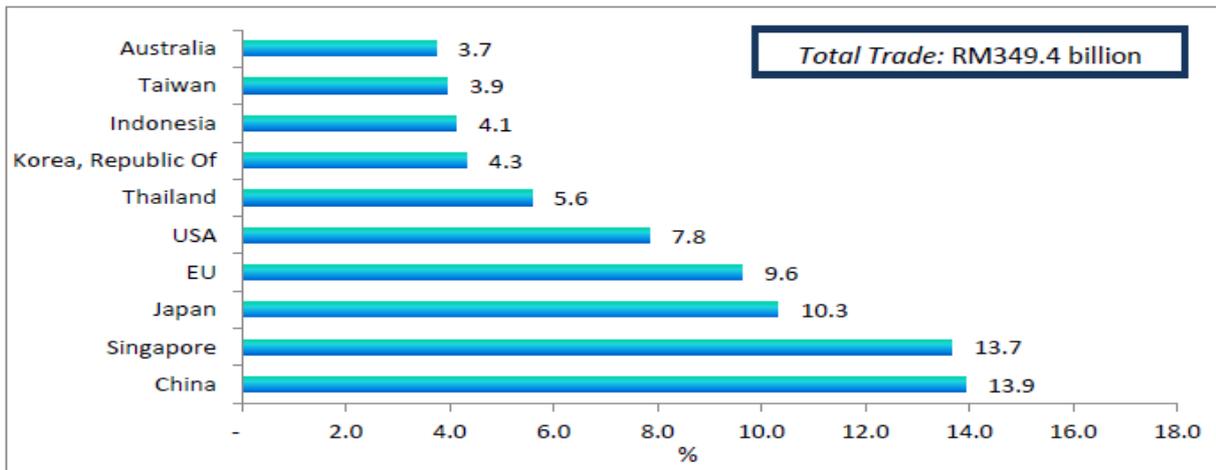


Source: BNM

- Direct investment between the two countries has been more than RM400 mil since 2010. Although direct investments value dipped in 3Q2013, it has picked up again since as Chinese nationals looked for quality asset investments outside of their borders. The Chinese have shown interest in Malaysia as seen in one of the early harvest projects, which involved the import and export of materials for processing at industrial parks in Qinzhou and Kuantan. Tthe other is the operation and expansion of Kuantan Port.

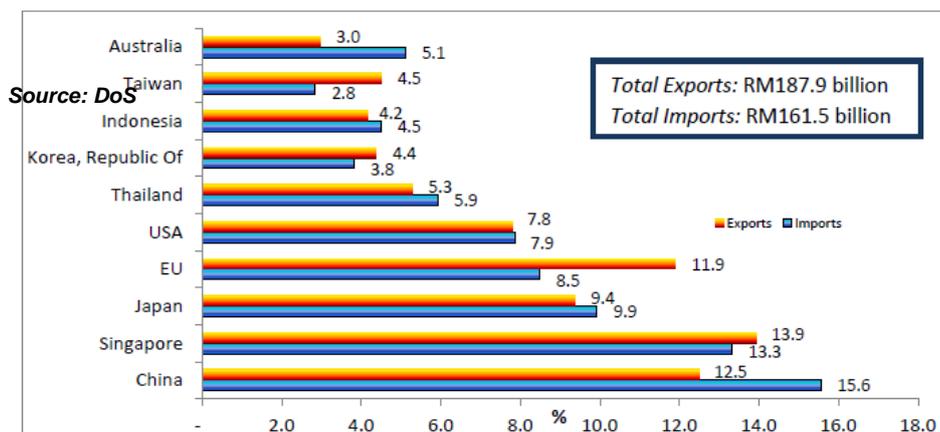
**Malaysia’s trade volume & market share for 1Q2014**

Source: DoS



- Malaysia’s trade with China remains its biggest with market share of 13.9% of the overall total trade.
- Trade with the PRC rose by 8.7% to RM48.62 billion during the first three months of 2014. Exports rose by 15.3% to RM23.49 billion while imports increased by 3.2% to RM25.13 billion. Higher exports to the PRC were due mainly to increase in exports of manufactures of metal, petroleum products as well as E&E products primarily electronic integrated circuits. Major imports from the PRC were E&E products; machinery, appliances and parts as well as chemicals and chemical products.

**Malaysia’s volume of exports & market share for 1Q2014**



# F. CONCLUSIONS

## i. AN EXPENSIVE AFFAIR

- Total monetary cost may exceed half-billion US dollars... As stated earlier, finding the MH370 is arguably the largest search effort in aviation history. Hence the total monetary cost in respect of the effort is expected to be higher than that for Air France 447 which cost €115m (USD160m) over a 2-year period. While in terms on insurance claims, Standard & Poor's estimates the expected losses from MH370 to be between USD250m and USD450m, depending on potential court settlements. Thus the combined monetary outlay (search effort and insurance claims) related to the disappearance of flight MH370 may potentially exceed half-billion US dollars (RM1.6b).

Estimated monetary cost of MH370 disappearance	
Search effort	>USD160m
Insurance claims	USD250-450m
Total	>USD410-610m

- ...but impact on individual countries and companies to be limited. While the percentage of sharing of the total search cost has yet to be determined, we expect Malaysian government to bear circa RM136m of the total cost. Moreover, the credit impact of insurance claims on individual reinsurers would be limited as the losses would be well shared throughout the global aviation insurance and reinsurance markets.

Estimated cost to Malaysian government	
Search effort	RM136m
Loss of Sales Tax @ 10% (in 2014)	RM542m
Loss of Services Tax @ 6% (in 2014)	RM325m
Total	RM1,003m

Estimated opportunity loss to Malaysian economy	
Loss of tourism revenue (in 2014)	RM3.0-4.0b

- Up to RM4.0b opportunity loss of tourism revenue and RM867m loss taxes. Assuming a drop of 30-50% against a target of 1.96 million China tourist arrivals in 2014, the actual arrival number could eventually be lower by 0.6 million or 1.0 million. As the average spending by each China tourist was circa RM2,800 (based on the spending pattern from 2010 to 2012), we are expecting an opportunity loss in Malaysia's tourism revenue of between RM3.0 billion to RM4.0 billion for 2014. Moreover, the loss in tourism revenue may inadvertently result in potential loss of income to the Malaysian government from sales and services taxes in 2014 amounting to RM542m and RM325m respectively.
- As far as goodwill is concerned, it is premature to conclude that MH370 is testament that Malaysia elicits strong international goodwill as reflected by the various assistance given in the search and rescue effort. It is not something that the country should take for granted. To begin with, any genuine goodwill gained is certainly offset by goodwill lost with China, the latter of which carries tremendous weightage in terms of economics and geopolitics. A few points that should not be lost are that some of the apparent "goodwill" would be diluted by the following:
  - Some countries may use the MH370 search and rescue effort to score goodwill with China, and NOT Malaysia;

- Some countries may use the opportunity with the intention of showcasing their technological capabilities;
- Some country may see MH370 as a race to be the first to find the aircraft, elevating its global stature if successful.
- The country's image and reputation was somewhat scarred by the numerous international media reports claiming and blaming, at least initially, the Malaysian government and the airline for releasing imprecise, incomplete, and sometimes inaccurate as well as contradictory information. Under these circumstances, it is noteworthy that Malaysia has been spearheading the search and rescue mission to recover the missing MH370 since day one of the incident despite having near zero track records in handling such situation on an international level.
- Open criticism by the Chinese authorities over Malaysia's handling of the crisis, while unbecoming, would have to be swallowed in order to protect our nation's bilateral interest with the emerging economic power. From another viewpoint, such reproach may be as a result of the Chinese government trying to pander to its emotion-charged domestic audience. However, we view that the sentiment to be rather short-lived. In a recent article, the Straits Times reported that "sympathy towards Chinese families of passengers aboard missing flight MH370 has begun to wane, with social media users focusing their attention on recent happenings around the globe".

## ii. WHAT WE CAN LEARN AS A NATION

### FOREIGN RELATIONS

- Communication confusion which later led to loss of trust... Hundreds of protestors, mainly family members of the Chinese passengers on board ill-fated flight MH370, gathered outside the Malaysian embassy in Beijing on 25 March. They accused Malaysian authorities of concealing information and cheating the families. Some relatives of the passengers also demanded an apology from the Malaysian government for poor handling of the crisis and its "premature" implied conclusion that the aircraft had gone down with no survivors.

Lesson :

*Ineffective communication can lead to loss of trust, even between old friends.*

- ...from an old friend who openly turned sceptic. In a news conference, a Chinese Foreign Ministry spokesman expressed his government's skepticism of the implied conclusion that the aircraft had gone down with no survivors. "We are highly concerned with Malaysia's conclusion, and have demanded full information and the evidence that supports the conclusion," the spokesman said. Chinese authorities pandering to the outburst of anger among its domestic populace in the immediate aftermath of MH370 incident was, diplomatically speaking, regrettable. While the anger is understandable, as most of the MH370 passengers were from China, we nonetheless were expecting a more amiable public decorum from the bureaucrats in Beijing and, by extension, its official media mouthpiece. On the other hand, Malaysia refrained from overtly responding and chose instead to preserve its relationship with China.
- But our well-judged response protects the nation's long-term interests. The situation was dealt aptly by Putrajaya via the diplomatic channels and a high-level delegation was dispatched to meet face-to-face with the families and relatives of the ill-fated passengers in Beijing. The Chinese responded in

kind with its ambassador to Malaysia later putting the blame on Western media for having “published false news” as well as “stoked conflict” and “even spread rumors” to the detriment of China-Malaysian relations. Malaysia’s well-judged reaction was not without its long-term benefits, economics and beyond. Recently, for example, Sinopec decided to go ahead with the purchase of a 15% stake in Progress Energy from Petronas. The final government approval is expected during PM Najib Razak official visit to China in late May. The official visit corresponds with the 40th year anniversary of the re-establishment of diplomatic relationship between Malaysia and China. On another note, Fengyi and Fuwa, the pair of giant pandas on loan from China for 10 years have safely arrived in Malaysia.

Lesson :

*Foreign relations are best dealt via proper diplomatic channels. As in the case of MH370, our refusal to indulge in one-upmanship had managed to limit the bilateral fallout and sooth the tension in in our relationship with China, which is our largest export market.*

#### COMMUNICATION

- Better inter-agency communication to prevent delay in emergency response... In the area of emergency response to an unfolding crisis, there are plenty to be learnt, particularly with regard to the speed of the first reaction. In the case of MH370, it was reported that air traffic controllers took more than 4 hours after the last conversation with the cockpit to activate rescue effort. Meanwhile, the military radar was keeping track of the aircraft movements away from the pre-designated flight route but without raising the red flag. This lack of inter-agency communication calls for the establishment of proper communication protocols between the military and civilian radar centers.

Lesson :

*To establish proper communication protocols between the military and civilian radar centers.*

- ...and defined public communication management to avoid confusion. Furthermore, in the area of public communication, our officials were criticized, at least in the beginning, for the release of contradictory and inaccurate information. For example, The New York Times wrote on what it claimed as our “civilian officials sometimes contradicting military leaders.” In some other countries, an appointed spokesperson generally speaks on behalf of the government while other relevant officials (both civilian and military) are invited only to give presentation at length on specific issues.

Lesson :

*To have an appointed spokesperson to speak on behalf of the government and call for questions at all scheduled press conferences. Other relevant officials (both civilian and military) will only be invited to give presentation at length on specified topics pursuant to its proper deliberations.*

- Practice makes perfect. In spite of the above, according to Ethan Becker, the author of “Mastering Communication at Work: How to Lead, Manage and Influence”, while the public communication of

Malaysian officials was less effective immediately after the aircraft disappearance, it got better as they became more experienced. It was necessary to know how to communicate strongly while remaining calm and in control. On a good note, he said Malaysia dealt with the crisis with its “heart in the right place”.

Lesson :

*Necessary to know how to communicate strongly while remaining calm and in control. Practice makes perfect.*

## SECURITY

- Further improvement in airport security... Security on the ground is also under scrutiny given lapses in immigration control. Indeed, pursuant to the MH370 incident, society is already benefiting in the form of better airport security. Air Asia, for example, has recently announced that it will start screening passports with Interpol’s Stolen and Lost Travel Documents (SLTD) database in a move to prevent passengers from using stolen or lost travel documents.
- ...and aircraft tracking system. While the search for the plane continues, it is clear that MH370 exposes weaknesses in the security of air travel that need to be urgently addressed, especially in the area of aircraft tracking. The main focus of world’s aviation authorities must now be on the improvements in communication avionics, which include the transponders, Aircraft Communications Addressing and Reporting Systems (ACARS), blackboxes and emergency locator transmitters. In addition, the International Civil Aviation Organization (ICAO) is also considering real-time satellite tracking of airliners.

Lesson :

*The communication avionics of modern passenger aircraft is currently lagging behind the technological advancement in telecommunication.*

## LOOKING FORWARD

- “I think history will judge us well”. While there were some initial criticisms on Malaysia’s handling of the MH370 investigation and coordination of the search effort, we are in agreement with Defence Minister Hishamuddin Hussein when he said, “Not many countries could get 26 countries to work together”. Furthermore, he remarked, “I think history will judge us well.” Still, the chapters of MH370 story would have to be chronicled even before we uncover, if ever, the final closure. Looking forward, it is imperative that the contents of the official reports on the MH370 incident is thoroughly researched, well documented and narrated in precise language. As for only what radiates out of our felt sincerity will history judge us well in our leading role to try uncover the hitherto mysterious disappearance of flight MH370.
- A place in time. The mystery of flight MH370 is gradually unfolding, albeit too slowly. This is despite the multinational search effort involving as many as 26 countries. Nevertheless, the most important thing now for us as a nation is to recover from this painful episode, move forward and be better prepared for any parallel misfortunes in the future. MH370 will not be forgotten. It will always have a place in time.

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