9 May 2019 | Strategy

Is there still love for the transportation sector?

FBM KLCI: 1,633.55

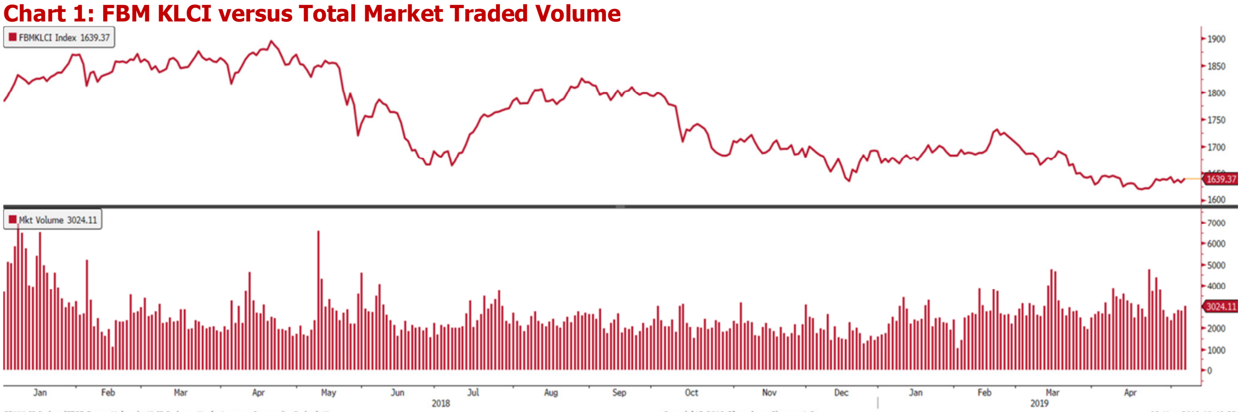
Examining velocity levels of transportation related stocks

- **FBM KLCI has been on a downward trend so far this year with a YTD loss of less than 4.0%**
- **KL Transportation Index remains as one of the outperformers amongst the sectors**
- **Recommending a trading strategy to focus on velocity and volatility**
- **Airlines and conglomerates involved in ports are the most suitable for a "trading" strategy**
- **Other sub-sectors such as airports and logistics should be used as "bullets" or "opportunist" trading strategies**
- **Maintain NEUTRAL on overall transportation sector but selectively positive on ports and aviation sub sectors**

How has the overall market behaved so far

FBM KLCI on a downward trend so far this year. So far in 2019, the FBM KLCI has peaked at 1,730 points on 21 February 2019 before tapering to the 1,620-1,640 points level, pointing to a year-to-date loss of less than 4.0%. In tandem with the benchmark index remaining range bound, we note that the overall market volume in the first four months of 2019 is -7.4% lower than what was seen in the same period last year, partly attributable to the pre-election hype in 2018. Similar to the amount of the volume traded, the average daily value trade (ADTV) is also lower so far in 2019, at a daily average of RM1.7bn this year compared to RM2.1bn in the same period last year.

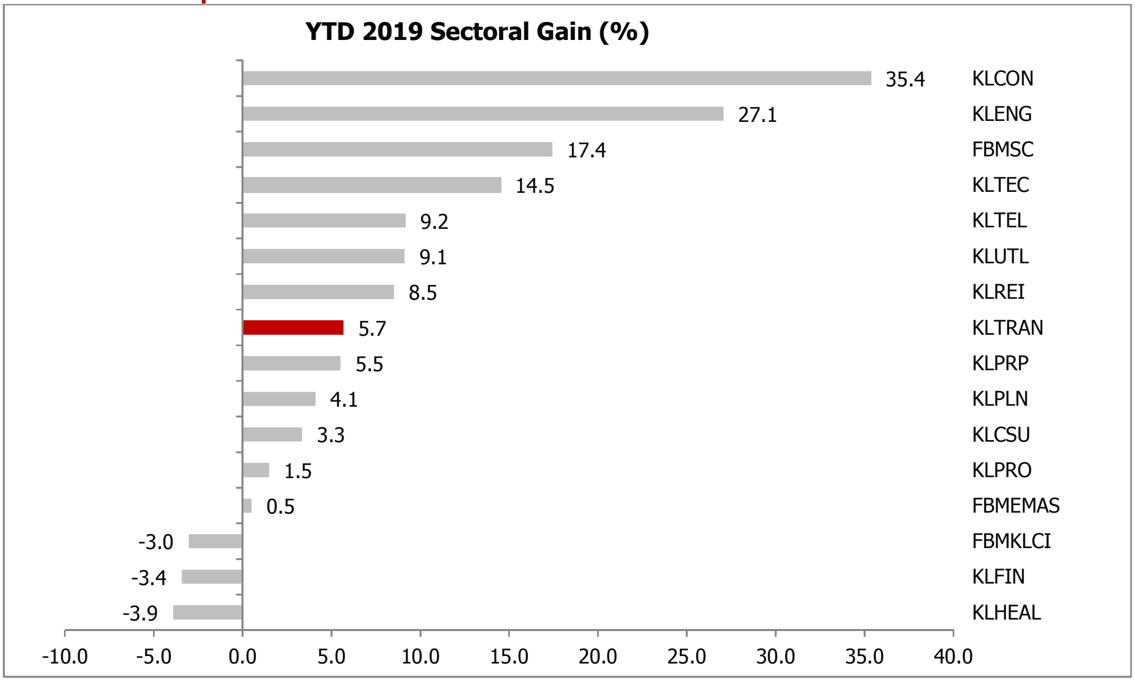
Chart 1: FBM KLCI versus Total Market Traded Volume



Source: Bloomberg

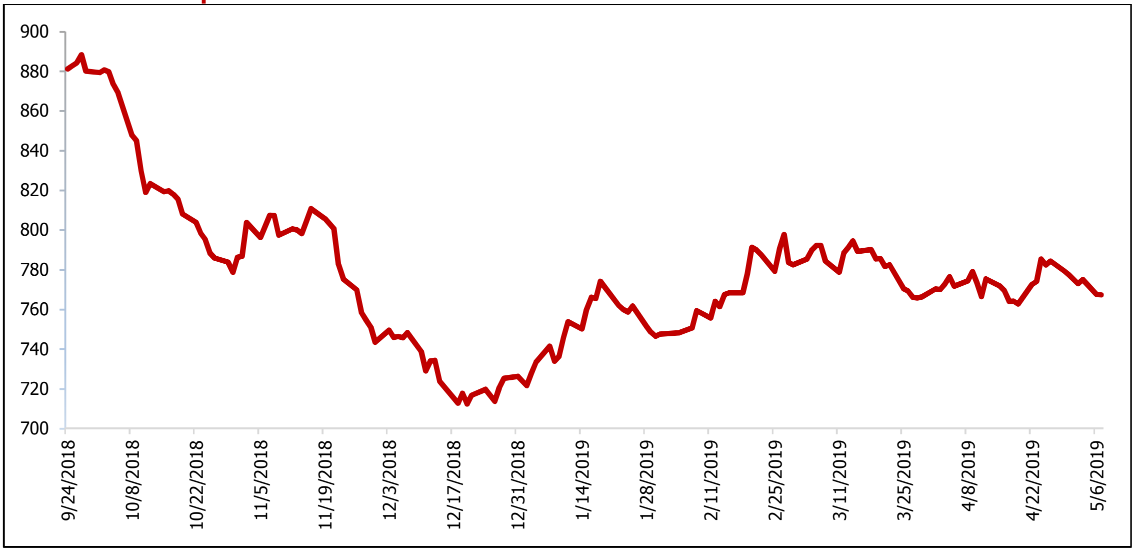
Meanwhile KLTRAN has been inching higher. So far in 2019, only two sectors have underperformed the local benchmark while 12 sectors outperformed with KL Construction Index leading gainers with a 35.4% year-to-date gain. Although sectors such as transportation have only gained 5.7% so far this year, this is an improvement from last year's 17.5% decline in 2018.

Chart 2: KL Transportation Index vs Peers



Source: Bloomberg, MIDFR

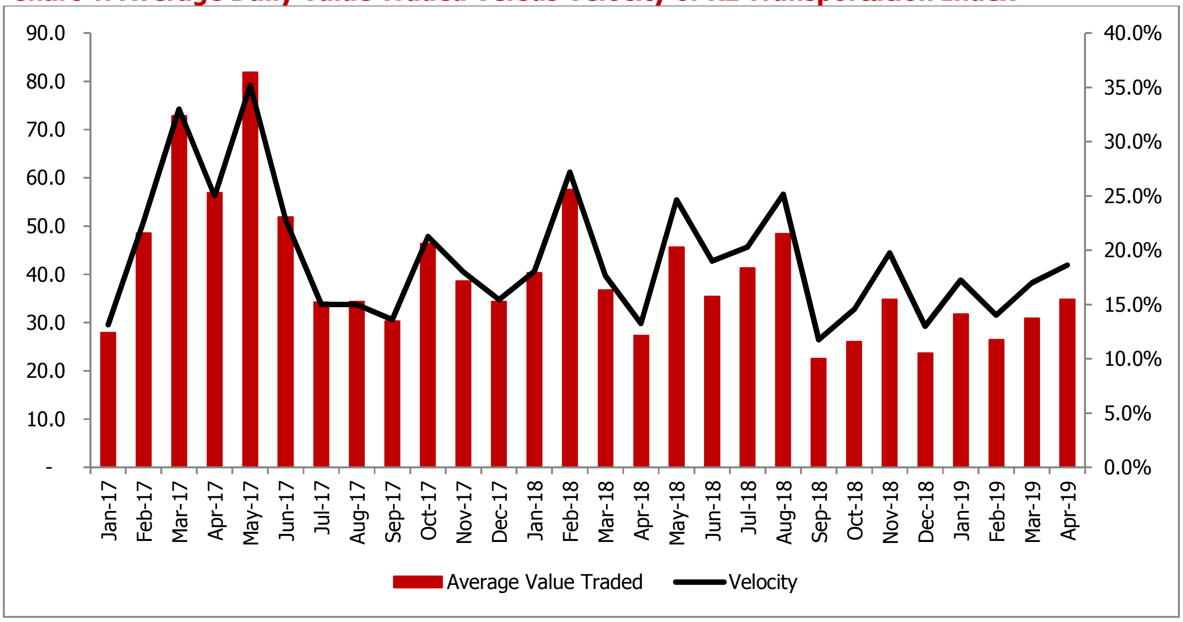
Chart 3: KL Transportation Index Performance



Source: Bloomberg

Comparison of ADTV thus far. The average daily value trade (ADTV) of the KL Transportation Index is also lower so far in 2019, at a daily average of above RM123.8m this year compared to above RM161.8m in the same period last year. Nonetheless, the velocity of the index has been gradually increasing for the past three months.

Chart 4: Average Daily Value Traded Versus Velocity of KL Transportation Index



Source: Bloomberg, MIDFR
Note: KL Transportation Index commenced from 24 September 2018. Historical velocity and average value traded prior to that was calculated using the members of the index.

TRADING STRATEGY

Therefore the question is where would the market going in the near term and where would opportunities arise, in our local bourse especially in the transportation sector? We opine that uncertainties would continue to be on the cards, with external risks playing an important factor in determining the movement of the Malaysian Ringgit, as well as demand for exports and imports. Hence, we opine that that with further certainty on the external front will only be seen at the end of 2Q CY 2019 the earliest, at least from the outcome of the U.S-China trade talks this week despite President Trump's threat to increase in tariffs on this Friday to 25% from 10% for USD200b worth of Chinese goods.

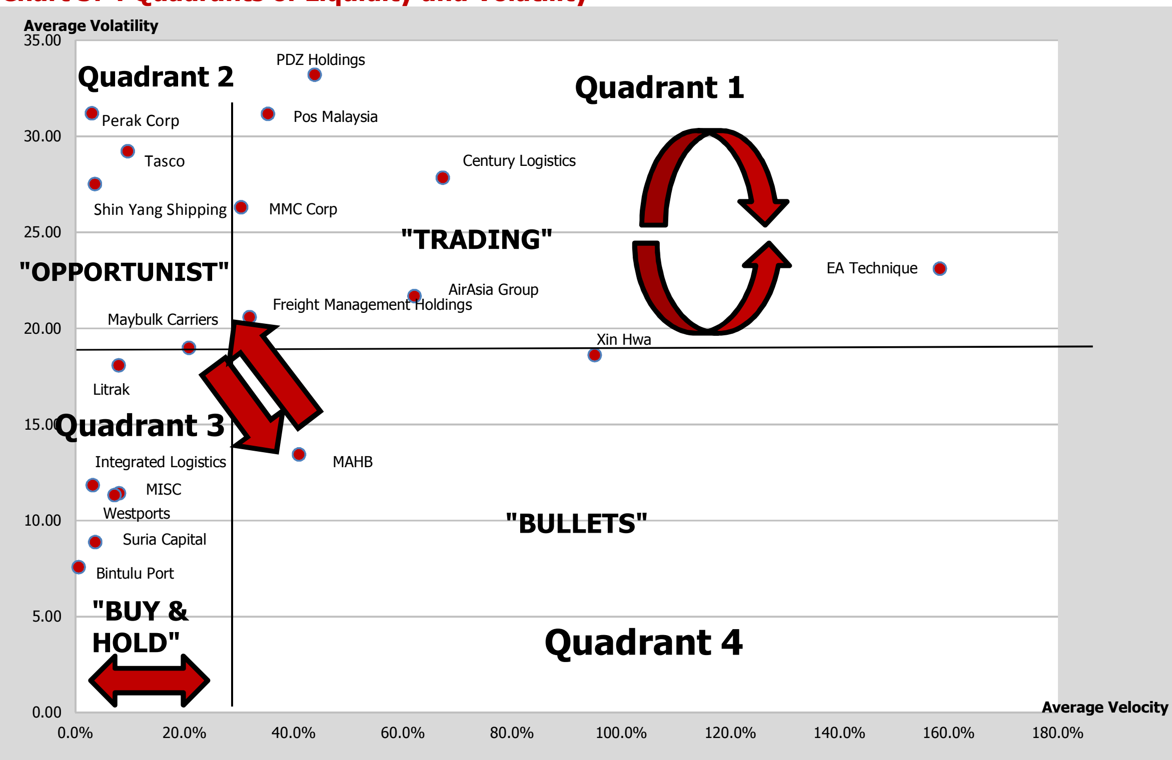
Meanwhile, a current flattish market in the near team doesn't bode well for a buy and hold strategy. With challenging corporate earnings growth in the near term, companies might hold off providing generous dividends until the later quarters of the year. In light of the challenges of deriving returns for the portfolio, we would recommend a trading strategy based on the following two measures (refer to our earlier strategy report published on 19 Feb 2019, "A tactical velocity play to whither uncertainty"):

a. Velocity – we have used the share turnover velocity (which is a ratio of traded share turnover to market capitalization) as a measure of liquidity of stock. Traded share turnover is calculated by summing up the total value of each trade (share price x traded volume).

b. Volatility – the volatility of share price movements which is the measure of risk in price movements calculated from the standard deviation of day-to-day logarithmic price change.

Analysing the listed companies listed in Bursa Malaysia for the two measures, from the month of January to April 2019, we then constructed a two by two matrix and would like to propose the following trading strategy based on the four quadrants (refer to our Strategy report dated 18 February 2019 for information related to the quadrant).

Chart 5: 4 Quadrants of Liquidity and Volatility



Source: Bloomberg, MIDFR

<u>Quadrant 1 – High Velocity + High Volatility = "TRADING"</u>
This "Trading" quadrant describes stocks that would be prime for active trading strategy, due to their characteristics of having a relatively have high liquidity and high price volatility.

We note **AirAsia Group Berhad (AAGB) (BUY;TP:RM3.11)** is a suitable stock to execute the trading strategy**.** Jet fuel spot price has increased by more than 15.0% since early this year amidst geopolitical factors surrounding Iran. Nonetheless, we opine that this will be partially mitigated by AAGB's prudent hedging policy and possible increase in production by OPEC members to make up for the end of waivers to purchase Iranian oil. AirAsia Group Berhad (AAGB) has hedged ~50% of its jet fuel expenses at an average of USD79.40pb for 2019. We opine that this hedging policy will provide a shield to the volatility of oil prices in 2019.

Overall AirAsia Group's preliminary load factor in 1QFY19 stands at 88% which we expect to be sustainable moving forward with its digitalization initiatives which includes: (i) application of data analytics for predictive maintenance which could lead to a potential savings of USD0.04m per aircraft annually, (ii) firming up its logistics arm (Teleport) by eliminating the various layers in traditional air cargo fulfilment process from 138 hours to just 12 hours and (iii) AirAsia.com, the airlines' online platform which will be further strengthened by its dynamic fare adjustment mechanism which is able to predict the purchasing power of a visitor according to the search trend.

Chart 6: Singapore Jet Kerosene Price (USD per barrel)

Source: Bloomberg

Table 1: AAGB's hedging policy

Period	1QFY19	2QFY19	3QFY19	4QFY19
Current Hedge Ratio (%)	53	52	52	51
Average Hedge Cost (USD-jet kerosene)	80.57	78.23	76.23	76.68

Source: AAGB

MMC Corp Berhad (BUY; TP:RM1.37), is another stock to be included under the trading strategy. While the termination of the Pan Borneo Highway PDP puts a dent on its construction orderbook, we understand that the company is actively bidding for a few large scale infrastructure projects which could act as a buffer for its construction orderbook. The target is one to two projects a year with an individual value ranging from RM250m to RM500m. It is also notable that the estimated orderbook of around RM9.0b under the absence of PBH is nearly 5.0x the construction revenue in FY18.

In the near-term, we also expect the ports and logistics segment to benefit from the Penang Port's full year contribution underpinned by economic activity in the Northern region of Peninsular Malaysia. We also note that Port of Tanjung Pelepas' (PTP) role as a transhipment hub would not be directly susceptible should the trade spat between U.S and China worsen as it mainly caters for intra-Asia trade lanes. Moreover, the impending IMO 2020 sulphur cap in January next year could spur support for the transhipment volumes especially at PTP as shipping liners want to mitigate higher operating expenses from more expensive fuel.

Over a longer term horizon, we believe that PTP's land availability will be an advantage over the Ports of Singapore. PTP is at the final stages of getting the approval to expand into phase 3 of the free zone with a size 168 acres. The tenure of the lease agreement with companies setting up warehouses usually lasts for 30 years with an agreement to commit to a certain level of container throughput. We opine that the development of the free zones could attract more MNCs to shift its warehouse operations to PTP and eventually this will also include container volume. Latest occupants include the Volkswagen Regional Parts centre that commenced operations in October 2018, occupying 0.6m sq ft. Henceforth, we remain optimistic that container throughput at PTP will grow by +5.0%yoy in FY19 and will remain the bulk of contribution to the ports and logistics segment.

Table 2: PTP Free Zone Expansion Plan

Free Zone Phase	Completed by	Acre	Local Cargo Generation (TEUs)
1-2	2000	422	253,200
3	2020	168	100,800
4 & 5	2025	395	237,000
Total	-	985	591,000

Source: MMC Corp

We recommend stocks sitting in this quadrant for inclusion into a trading portfolio. With ample liquidity and a healthy newsflow driven price volatility, a trading portfolio would be ideal to generate returns amidst a "flattish" movement of the benchmark indices. Liquidity would support ease of trading movement and the newsflow would provide the incentive to take trading position towards sell "high" and buy "low" investment decision process.

Quadrant 2 – Low Velocity + High Volatility = "OPPORTUNIST"

This "Opportunist" quadrant describes stocks that are relatively have low traded volume and highly volatile price movements. Stocks sitting in this quadrant includes **TASCO (TRADING BUY, TP :RM1.82).**

Tasco Berhad's traction will come from its position in the cold chain subsidiary (Tasco Yusen Gold Cold) which separates it from other companies who are focusing either on express delivery (which is quite saturated with new entries at the moment) or their traditional core logistics business such as trucking and conventional warehousing. Our positive stance on Tasco is also predicated on the proposed divestment of TYGC's 30% stake to Japan Overseas Infrastructure Investment Corporation for Transport and Urban Development (JOIN) (pending shareholders' approval) could result in annual interest savings of approximately RM4.6m in addition to leveraging on JOIN's global network.

Table 3: Comparison between TYGC and its local competitors

No.	Major Cold Chain Logistics Company	FYE	Revenue (RM'm)	PBT (RM'm)	PAT (RM'm)	Revenue Rank	PBT Rank	PAT Rank
1	Tasco Yusen Gold Cold Sdn Bhd*	30 Nov '17	98.7	12.2	9.8	1	1	1
2	NL Cold Chain Network (M) Sdn Bhd	31 Dec '17	45.9	(6.1)	(6.1)	2	5	5
3	Gerimis Baiduri Sdn Bhd	31 Dec '17	44.9	2.3	1.6	3	2	2
4	Teh Cheeta **	31 Dec '17	28.1	(0.2)	(0.8)	4	4	4
5	Integrated Cold Chain Logistics Sdn Bhd	31 Dec '17	27.9	1.0	0.6	5	3	3

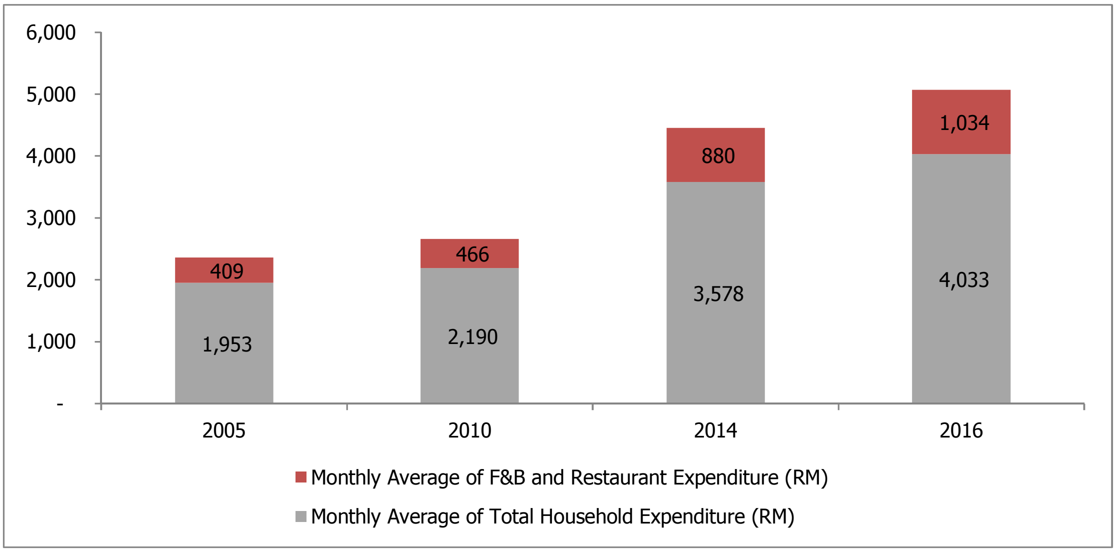
Source: Companies Commission of Malaysia

Note: * Combined financial information is based on: (i) combined audited financial statements of Gold Cold Transport Sdn Bhd (GCT) and Gold Cold Integrated Logistics (GCIL) for the FYE November 2017; and (ii) audited financial statement of GCIL for the FYE 31 December 2017

** * Combined financial information is based on: (i) combined audited financial statements of Teh Cheeta Transport (M) Sdn Bhd, The Cheeta Frozen Food Sdn Bhd and Teh Cheeta (M) Sdn Bhd (GCIL) for the FYE 31 December 2017.

Based on latest available data from the Department of Statistics Malaysia, the monthly average of household expenditure has experienced a strong growth from RM1,953 in 2005 to RM4,033 in 2016, and this is expected to continue. Moreover, the monthly average in F&B and restaurant spending remained above 20% of the monthly average of total household expenditure. The growth in spending for restaurants and fast food shown should translate into higher demand in cold supply chain services for the transportation of raw ingredients. Such prospects would bode well for TYGC as one of its key customers is QSR Brands (M) Holdings Bhd, Malaysia's largest fast-food operator with around 1,080 KFC and Pizza Hut restaurants in Malaysia.

Chart 7: Monthly Average of Total Household Expenditure and F&B and Restaurant Expenditure in Malaysia



Source: Department of Statistics Malaysia

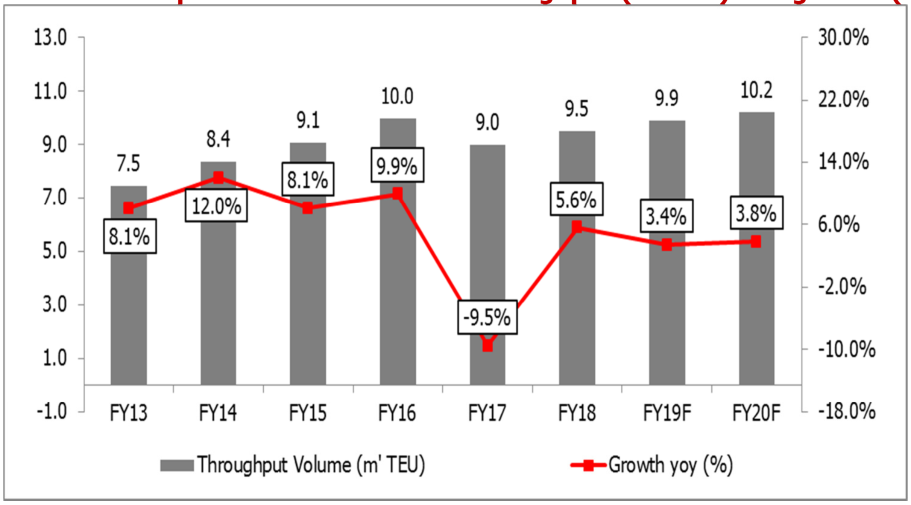
All of these are great stocks to be included in the portfolio, but due to low liquidity, investors have to scan the market sentiment and wait for an opportunistic time to buy these stocks, wishing for Lady Luck to show herself. An example would be the emergence of irrational sellers looking for a quick exit, selling the stock at lower prices.

Quadrant 3 – Low Velocity + Low Volatility = "BUY and HOLD"

This quadrant describes stocks that are relatively have low traded volume and less price movements. Stocks sitting in this quadrant includes **WESTPORTS (BUY, TP RM4.09), LITRAK (NEUTRAL, TP: RM4.08).**

We favour Westports due to: (i) lower transhipment tariffs amongst its peers such as Port of Tanjung Pelepas and Port of Singapore even after taking into account of the second phase of tariff hike in March 2019; and (ii) the extension of the Ocean Alliance to 10 years (initially 5 years) until 2027 will mitigate the effects from the reshuffling of alliances profoundly seen in FY17. Contribution from intra-Asia trade lanes will continue to remain robust underpinned by ASEAN's economic growth of 5.1% in 2019 based on IMF's latest projections. On a longer term horizon, Westport's CT10-CT19 expansion plan is expected to increase capacity by roughly 50% to approximately 30m TEUs per annum by 2040. This would allow Westports' to compete more effectively for transhipment volumes against Ports of Singapore which has plans to raise capacity from to 65m TEU by 2040. More importantly, Westports its payout ratio has been maintained at 75% despite the heavy capital expenditure from 2015 to 2017 for the CT8-CT9 expansion. We believe that this could be sustained in the near future due to the demand for containerised trade.

Chart 8: Westports annual container throughput (m' TEU) and growth (% yoy)



Source: Company, MIDF

Meanwhile for LITRAK, its prospect have become uncertain following the announcement that the Government has started negotiations with Gamuda to acquire four highway concessions that Gamuda has majority stake in. Amongst these four are SPRINT and LDP (100% owned by LITRAK) which Gamuda has a 52% and 43.6% effective stake respectively. The exercise is expected to take six months which hopefully could be concluded at a reasonable pricing for the parties involved. Meanwhile, it is possible that the concession assets could be valued based on DCF methodology which takes into account of future cash flows.

In its latest 9MFY19 results, the slight 0.5%yoy increase in its net prfot was adided by the lower amortisation of highway development expenditure for 9MFY19. Since FY17, LDP and Sprint amortises its highway development expenditure (HDE) using forecasted traffic volume instead of revenue. The accounting practice is common for infrastructure assets. Apart from that, earnings were lifted by the -17.7%yoy drop in finance costs during the period under review pursuant to repayment of borrowings in April 2018.

Nonetheless LITRAK is still deemed a defensive play with decent dividends yield of 7.0% for FY20 while trading at a PER of 9.8x (below its 5-year average of 13.9x), which translates to an earnings yield of 10.2%, implying an attractive spread of 6.6% against the latest 5-year Malaysian Government Securities yield of 3.6%. Rerating catalyst would be from a reasonable offer by the government if it takes over the whole concession of LDP and LITRAK.

We recommend stocks sitting in this category for a BUY and HOLD strategy, considering the makeup of the stocks in this quadrant, from a mixture of dividend play and also companies have a strong strategic shareholder with a growth upside. The low velocity also indicates a relatively tightly held shareholding structure and low float. Therefore, a situation of pessimistic and weak market sentiment, will present an opportunity to add the stock into an investor portfolio. And it would also act as the defence against portfolio value erosion.

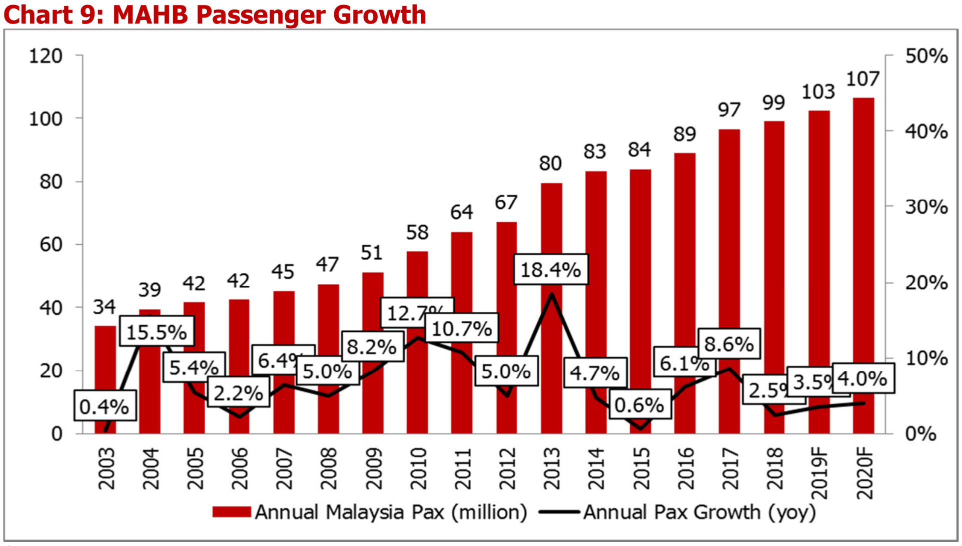
Quadrant 4 – High Velocity + Low Volatility = "BULLETS"

This "Bullets" quadrant describes stocks that are relatively have high liquidity and low price volatility. Stocks sitting in this quadrant mainly include stocks such as **MAHB (BUY, TP:RM8.90).**

For MAHB, we do not believe that the departure levy (RM20 for ASEAN destinations; RM40 for non-Asean countries) will be a dampener on passenger traffic growth. Therefore, we believe that MAHB will be able to maintain its upward trajectory especially in terms of passenger growth. This is amidst the relaxation of visa policies for Chinese and Indian nationals visiting Malaysia. Moreover, other regional peers such as Hong Kong and Thailand which have imposed the departure tax levy did not see any adverse impact on passenger growth post-departure tax implementation. Hence, we reiterate our optimism that MAHB passenger numbers will surpass the 100m mark in 2019, while maintaining a relatively conservative growth rate of 3.5% at 103m.

From a regulatory standpoint, MAHB would be able to source for suitable partners according to the requirements of a particular region with more operating agreements (OA) based on regional groupings. Moreover, adjustments can be made for price cap values, associated tariffs and charging levels according to each regional grouping. This would be based on the capital expenditure which will be provided by MAHB, aligned with the spirit of the upcoming Regulatory Asset Base (RAB) framework. As such, we believe such arrangements would promote further sustainability and flexibility for MAHB's development plans to improve airport and infrastructure.

Chart 9: MAHB Passenger Growth



Source: MAHB, MIDFR

We recommend stocks sitting in this quadrant to be use as "Bullets" or financier for the execution of the "Opportunist" trading strategy, i.e. selected holdings of the stocks in the former quadrant can be sold with the proceeds to be used to acquire stocks in the latter quadrant. And vice versa, since at higher velocity, and lower price volatility, an investor could still get back the shares at reasonable price.

SUMMARY

Maintain NEUTRAL. We are still maintaining NEUTRAL stance on the overall transportation sector. The reason being is that, for the logistics industry, the anticipated higher demand of e-commerce activities will attract more new entrants grabbing market share of current logistic companies through competitive pricing. As such, logistics companies are prompted to not only expand operations to capture the high demand, but also revise their rates offered to customers which comes at a cost of thinner margins. Nevertheless, we are selectively positive on ports and aviation given their strategic location along major trade lanes and aviation hubs combined with the economic prospects of the ASEAN region

Table 4: Summary of stocks featured in this report.

Stock	Call	Last Price (RM)	Target Price (RM)	Dividend per share (sen)	Stock Return (%)	Dividend Yield (%)	Total Return (%)	Average Velocity (%)	Average Volatility (%)	12M Trailing P/E (x)	12M Trailing P/BV (x)
MAHB	BUY	7.30	8.90	14.00	21.9	1.9	23.8	40.9	13.45	18.9	1.5
AirAsia Group	BUY	2.57	3.11	12.00	21.0	4.7	25.7	62.1	21.68	4.2	1.1
MMC Corp	BUY	1.01	1.37	4.00	35.6	4.0	39.6	30.3	26.31	13.8	0.3
Westports	BUY	3.65	4.09	14.70	12.1	4.0	16.1	7.2	11.32	22.7	5.3
Tasco	TRADING BUY	1.39	1.82	4.50	30.9	3.2	34.2	9.6	29.22	17.4	0.8
Litrak	NEUTRAL	4.26	4.08	30.00	-4.2	7.0	2.8	7.9	18.07	9.8	2.4

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.