midf RESEARCH

Corporate Update | Tuesday, 07 January 2020

AirAsia Group Berhad

(5099 | AAGB MK) Main | Consumer Products & Services

Current hedging strategy to buffer geopolitical shocks

***Maintain* BUY**

***Unchanged* Target Price: RM2.04**

KEY INVESTMENT HIGHLIGHTS

- **Geopolitical turmoil involving the U.S and Iran saw Brent crude oil closed at the highest level in more than seven month**
- **Brent crude oil price could rise further if tensions prolong**
- **Prudent hedging strategy to prevent higher fuel costs**
- **If Brent reaches USD75-80pb, the increase in fuel costs would only be 13.8% compared to 25.8% under a fully unhedged scenario**
- **Earnings estimates unchanged**
- **Maintain BUY with unchanged TP of RM2.04 per share**

Geopolitical turmoil impacting oil market. Geopolitical turbulence dominated headlines late last week following a U.S airstrike near Baghdad airport. The airstrike rattled markets including commodities, pushing the Brent crude oil price by nearly USD3.00pb on last Friday to settle at USD68.60pb, a level not seen since September 2019. An escalation of tensions in the Middle East could disrupt the flow of crude and push oil prices further as both Iraq and Iran pumped more than 6.7m barrels per day in December 2019, representing more than one-fifth of total OPEC output. Recent developments noted that Iraqi lawmakers have approved a bill to expel U.S forces from the country. Other possible scenario could be the harassment of commercial shipping in the Gulf by Iran and the launch of its military exercises to temporarily disrupt crude shipping flow especially at the Strait of Hormuz.

AAGB to be well-geared for further geopolitical shocks. We opine that there might be an increase in the amount of jet fuel consumed this year by AAGB as we do not discount the possibility that it will be adding more capacity and routes in conjunction with the Visit Malaysia Year 2020 (VMY2020). Nevertheless, AAGB's prudent hedging strategy means it could weather the expected rise in oil prices. In FY20, AAGB is hedging 72.8% of Brent crude oil price at USD60.22pb. Assuming if the geopolitical tensions between the Middle East and the U.S prolong, pushing the Brent crude oil price up to around USD75-USD80pb, we estimate that the unhedged portion of fuel costs could decrease by -1.0%yoy or RM3.0m in FY20. Meanwhile, we expect AAGB's total fuel cost to be +13.8%yoy higher in FY20, which does not vary much from the percentage increase in expected jet fuel consumed of +9.5%yoy during the same year. Under a situation where none of AAGB's fuel requirements were hedged, we estimated that the total fuel cost could increase as much as +25.7%yoy (assuming that Brent crude price were to hit USD75pb). In contrast, a 100% hedge on its oil requirements would result in only a +9.4%yoy rise in AAGB's total fuel cost in FY20. Nevertheless, it would be important to have a buffer in a situation where Brent crude oil price could go below the hedged amount. Hence, we reiterate that AAGB's current hedging strategy serves as a tool to prevent fuel costs from inching higher.

RETURN STATISTICS	
Price @ 6th Jan 2020 (RM)	1.68
Expected share price return (%)	+21.43
Expected dividend yield (%)	+7.10
Expected total return (%)	**+28.53**

SHARE PRICE CHART

Share price performance (%)	Absolute	Relative
1 month	-0.6	-2.4
3 months	-1.2	-3.0
12 months	-17.0	-12.8

KEY STATISTICS	
FBM KLCI	1,597.76
Syariah compliant	Yes
Issue shares (m)	3341.97
Estimated free float (%)	52.02
Market Capitalisation (RM'm)	5,614.52
52-wk price range	RM1.64 - RM2.25
Beta vs FBM KLCI (x)	1.60
Monthly velocity (%)	8.00
Monthly volatility (%)	16.62
3-mth average daily volume (m)	7.05
3-mth average daily value (RM'm)	12.47
Top Shareholders (%)	
Tune Live Sdn Bhd	16.73
Tune Air Sdn Bhd	15.45
Employees Provident Fund Board	6.54

Analyst(s)
ADAM Mohamed Rahim
adam.mrahim@midf.com.my
03-2772 1686

Table 1: AAGB's fuel hedging details

Period	FY17	FY18	FY19F	FY20F (Current Hedge)	FY20F (No Hedge)	FY20F (Full Hedge)
Hedge Ratio (%)	77.25	14.0	65.3	72.8	0.0	100.0
Average Hedge Cost (USDpb)	60.0	70.6	77.2	75.8	0.0	75.8
Average Jet Fuel Price (USDpb)	67.0	89.0	75.0	87.0	87.0	87.0
% Change in jet fuel consumed ('000 barrels)	51.8	14.1	9.5	9.5	9.5	9.5
% Change in jet fuel price	15.5	32.8	-15.3	15.4	15.4	12.7
% Change in total fuel cost	73.7	38.5	-0.2	13.8	25.7	9.4

Souce: AAGB, MIDFR, Bloomberg

Impact to earnings. No changes are made to our earnings estimates.

Target price. We are maintaining our **target price** of **RM2.04 per share**. Our target price is derived via pegging our FY20F EPS of 13.6sen to an unchanged target PER of 15x. The target PER is premised on AAGB's regional peers which are trading at a 12-month trailing PER of 15x on average.

Maintain BUY. While earnings in FY19 thus far were below our expectations, it was due to the accounting effect of MFRS16. We believe that Air Asia's operation continue to remain sound. We continue to like Air Asia as the company continues enhance its cost structure, along with its efforts of rationalising revenue and cost via digitalisation efforts. Our positive outlook on the AAGB also hinges on: 1) its more prudent hedging policy 2) stable operations with added capacity and 3) continuous improvement to drive its non-airline ancillary business.

Meanwhile, the adoption MFRS 16 will be a headwind in the next coming years as the majority of AAGB's fleet are leased. Nonetheless, AAGB is expected to gain from lower amount of interest beyond the fifth year of the lease term. We opine that passenger growth in Malaysia to remain intact despite the departure levy which took effect in September 2019 as the levies gazetted are lower than regional peers such as Thailand and Hong Kong. As for low cost carriers such as AAGB, the percentage of departure levy from the total ticket price is still immaterial at around 1.6% on average for normal fares. All in, we maintain our **BUY** call with an unchanged **target price** of **RM2.04 per share**. Risks to our call are: (i) lower-than-expected travel demand and (ii) unfavourable revision of passenger service charges especially for klia2.

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	**2017A**	**2018A**	**2019E**	**2020F**	**2021F**
Revenue	**9,709.7**	**10,638.3**	**10,974.9**	**11,669.0**	**12,511.1**
EBITDA	3,024.8	1,803.7	2,195.0	2,333.8	2,752.4
EBIT	2,160.8	1,218.9	482.9	746.8	963.4
PBT	2,087.8	1,335.2	265.6	604.9	751.4
Reported Net Profit	1,571.4	1,695.4	199.2	453.7	563.6
Core Net Profit	**1,307.9**	**543.6**	**199.2**	**453.7**	**563.6**
Core EPS (sen)	39.1	16.3	6.0	13.6	16.9
Core EPS growth (%)	-4.7	-58.4	-63.4	127.8	24.2
PER (x)	4.3	10.3	28.2	12.4	10.0
Net Dividend (sen)	12.0	64.0	102.0	12.0	12.0
Net Dividend Yield (%)	7.1	38.1	60.7	7.1	7.1

Source: Company, MIDFR
*Note: *Special dividend of RM0.40 and two interim dividend of RM0.12 per share in FY18*
*** Includes special dividend of RM0.90 to be paid on 29 August 2019*

DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
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.