

11 July 2019 | Sector Update

## Aviation

**Maintain POSITIVE**

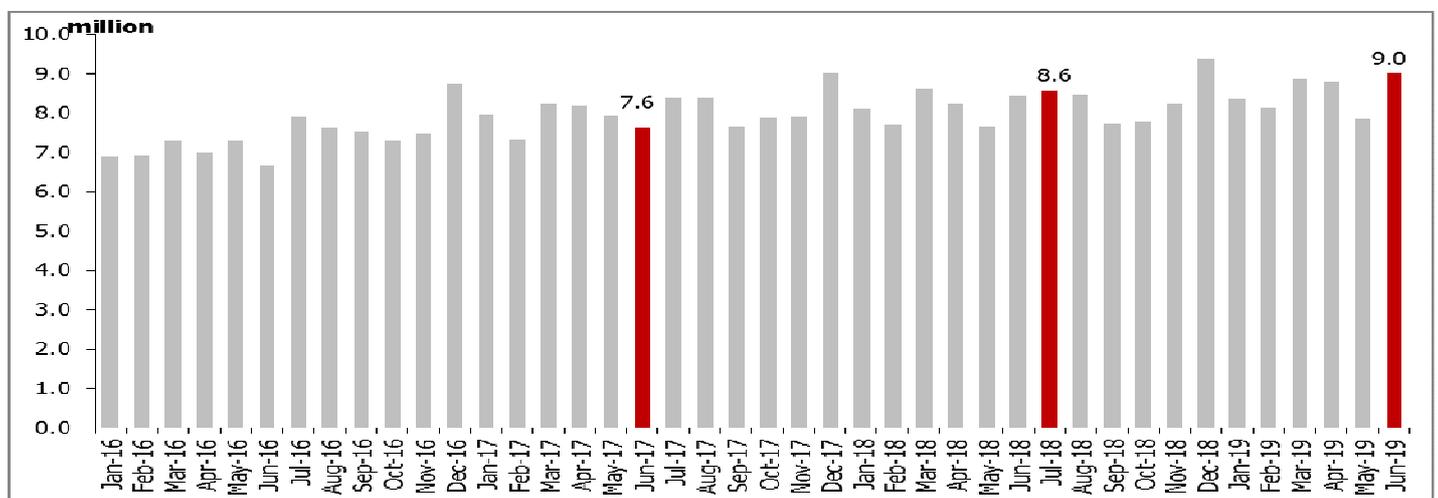
*Ascending smoothly to a higher altitude*

### KEY HIGHLIGHTS

- **MAHB (BUY; TP: RM9.43) passenger traffic (excluding ISG) grew by +4.7%yoy in 1HCY19**
- **Bulk of the growth for 1HCY19 came from non-KLIA passenger growth (contributed more than 70% of the growth), supported by MAHB's hub-and-spoke strategy**
- **Although growth in domestic passengers exceeded the growth in international passengers, international passenger movements continued to retain above 50% of passenger mix.**
- **Passenger traffic growth in klia2 exceeds KLIA Main Terminal**
- **Increased connectivity to moderate the effects of the departure levy set to be imposed in September 2019 for outgoing international passengers**
- **Expansion risk for MAHB under RAB framework mitigated by its manageable net gearing of below 0.5x.**
- **Maintain POSITIVE stance on aviation sector**

**Higher connectivity bolstered growth at other airports.** June 2019 traffic data for MAHB's Malaysian reached 9.0m passengers, translating to a +6.7%yoy growth. The last time passenger traffic numbers breached 9.0m was in December 2018. This brings the 1HCY19 passenger traffic numbers for Malaysian operations to 51.1m, representing a +4.7%yoy growth and constitutes 49.9% of our full year passenger growth estimate of 102.5m in 2019. Bulk of the increase in passenger traffic during 1HCY19 came from other airports (i.e. excluding KLIA Main Terminal and klia2) which contributed more than 70% to the expansion. We opine that the growth in non-KLIA airports was supported by MAHB's hub-and-spoke model which aims to bring global traffic to smaller airports and vice versa. For example, Britain's TUI Airways and Kazakhstan's Sunday Airlines have been operating from the Langkawi International Airport since late last year. Meanwhile, existing airlines such as Malindo Air have commenced its Langkawi-Phuket route in late March this year. As for ISGA, the total passenger traffic in 1HCY19 grew +3.4%yoy bringing the total cumulative 1HCY19 passenger traffic for MAHB to 67.9m passengers

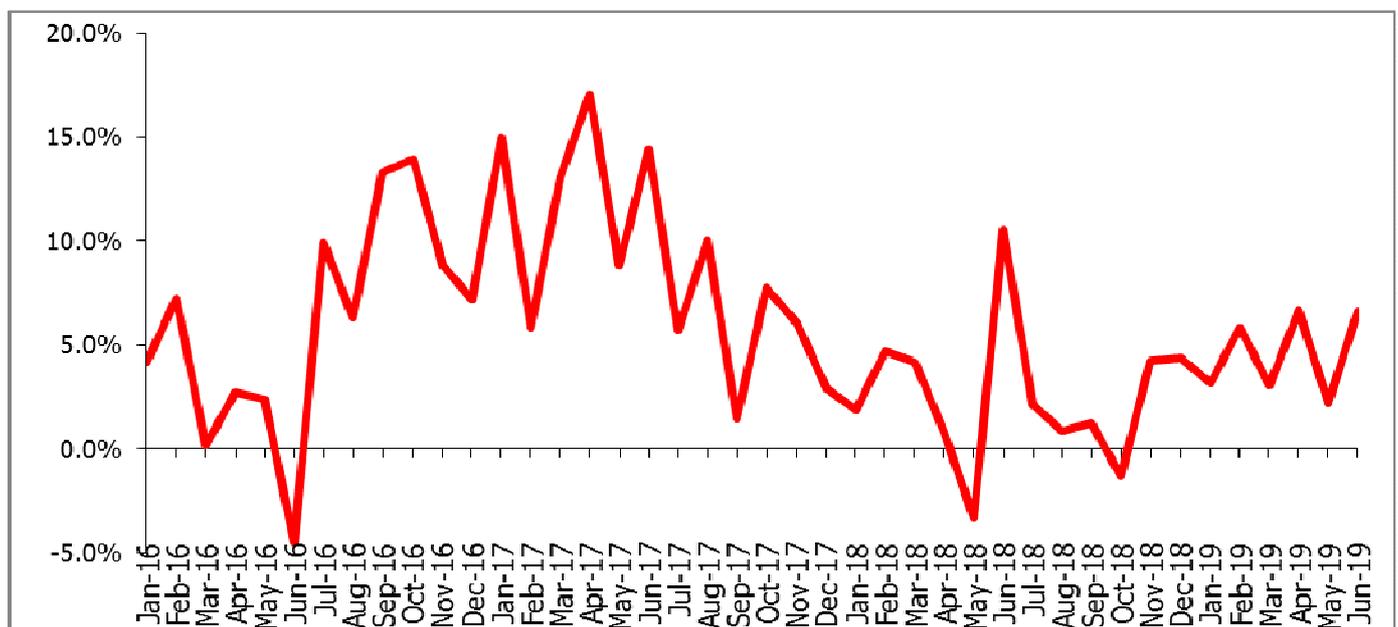
**Figure 1: Malaysia Airports Monthly Passenger Traffic (million)**



Source: MAHB, MIDFR

**Festive season boosted air travel demand for both domestic and international.** Domestic traffic at Malaysian airports recorded a robust growth of +8.2%yoy in 1HCY2019 to hit 25.1m passengers, versus the -0.9%yoy decline in the preceding year. This was mainly attributable to June’s domestic passenger movement which registered a record high of 4.6m passengers. It was notable that the Aidilfitri holidays fell on 5<sup>th</sup> and 6<sup>th</sup> June 2019 which coincided with the second week of school holidays, propelling a higher level of demand for air travel. Meanwhile, the international traffic at Malaysian Airports grew at a measurable pace of +1.6%yoy to hit 26.0m passengers in 1HCY19. Nevertheless, this level of international passenger numbers has never been observed before for the first half of the year. The occurrence of summer holidays for the United States and certain cities in Germany such as Berlin was an underpinning factor for the growth in international traffic.

**Figure 2: Malaysia Airports Monthly Passenger Traffic (growth%oyoy)**



Source: MAHB, MIDFR

**International passenger mix remains favourable at above 50%.** Although growth in the domestic sector outpaced the international sector for 1HCY19, international passenger movements continued to retain more than 50% of the passenger mix. MAHB targets to bring in 10 new airlines to Malaysia, especially to its five main airports. Air Arabia began its flight services to KLIA Main Terminal in early July 2019 while Qatar Airways will be extending its Doha-Penang services to Langkawi in October 2019. We believe the stronger mix of international passengers could be maintained. This bodes well for MAHB in terms of the higher passenger service charges (PSCs) collected for international passengers.

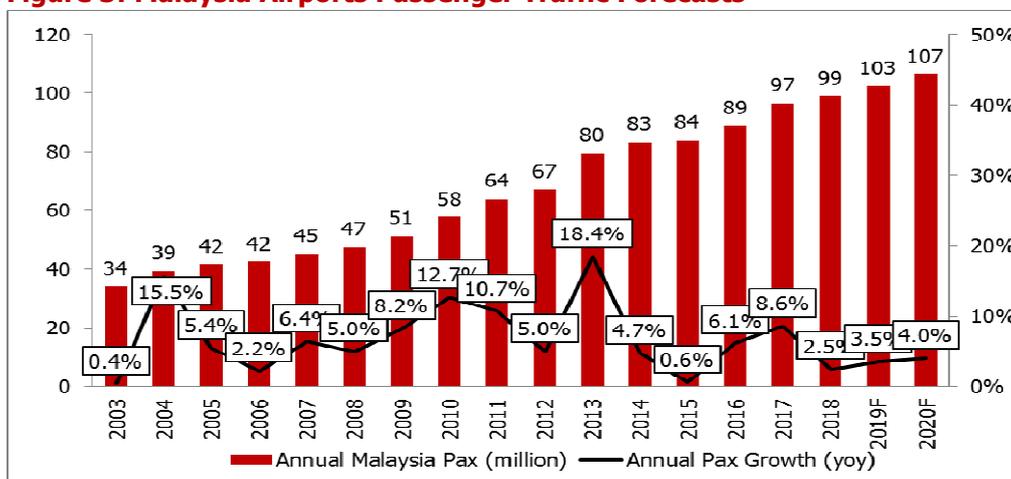
**Headwinds from impending departure levy and higher PSC to be negated by LCCs.** Low cost carriers (LCC) such as **AirAsia Group Berhad (AAGB) (BUY; TP:RM2.92)** and **AirAsia X Berhad (AAX) (NEUTRAL; TP: RM0.22)** will be impacted by: (i) the possibly higher PSCs in 2020 as outlined in MAVCOM’s latest consultation paper and (ii) the impending departure levy for ASEAN and beyond ASEAN destinations will be further tiered into economy, business and first class. Nevertheless, we believe that effects from this would be tempered by the airlines’ ongoing cost optimisation initiatives such as dynamic fare adjustment mechanism via increased digitalisation. Furthermore, in our earlier study ([Regional Clustering To Promote Long Term Sustainability, 15 April 2019](#)) on charges related to departing flights in countries such as Thailand, Hong Kong and Australia indicates that passenger growth was not adversely impacted post-implementation of such charges.

**Passenger traffic growth in klia2 exceeds KLIA Main Terminal.** Passenger traffic growth in klia2 for 1HCY19 of +3.0%yoy outpaced the +1.0%yoy growth seen in KLIA Main Terminal. Although the growth of international passengers beyond ASEAN for klia2 declined by -3.0% in 1HCY19, we believe that this should change as routes operated by AAX especially from Kuala Lumpur to Fukuoka which started in 1QCY19 should mature as the 2020 Tokyo Olympics gets closer. Moreover, AAX's latest partnership with the Western Australia State Government has the potential to bring more holiday makers to and from Perth with increased flight frequencies while not ruling out new routes from international airports such as Penang and Kota Kinabalu.

**Regulatory changes coming into place.** We opine that the latest revised consultation paper indicated with certainty that the Regulated Asset Base (RAB) framework will be implemented according to schedule by January 2020. MAHB's proposed nominal pretax WACC of 12.7% translates into an EBIT derived from the regulated WACC of RM1.06b, which is 35.5% higher than the actual EBIT for the airport services segment of MAHB in FY18 without any RAB. Even if MAVCOM's nominal pretax WACC of 10.9% was applied, the EBIT derived from the regulated WACC is RM903.6m, which is still higher by 15.5%. As such, we believe the same effect would apply for the coming years. Meanwhile, we believe that MAHB's exposure to expansion risk could be cushion due to its manageable net gearing of below 0.5x (as of 31 March 2019) suggesting that it will be able to finance any expansion.

**Maintain POSITIVE on the sector.** The prospect of the aviation sector remains upbeat coming into 2HCY19. We opine that MAHB's innovative efforts such as the Joint International Tourism Development Programme (JITDP) with Tourism Malaysia will facilitate airlines in promoting Malaysia overseas. This in turn would bode well for MAHB's strategy to attract more airlines and increase connectivity which will moderate effects of the international departure levy and possibly higher PSCs. Meanwhile, LCCs such as AAGB and AirAsia X are strengthening their presence in core markets while establishing new hubs in destinations such as Lombok. This will continue to attract higher passengers in 2019 and will benefit MAHB. Overall, we believe that the RAB framework will ensure a fair cost to airport users while maintaining a fair level of returns to MAHB as it increases clarity between revenue and capital investment. Therefore, we strongly believe that MAHB passenger numbers for Malaysian operations can surpass the 100m mark in 2019, while maintaining a relatively conservative growth rate of **3.5%** at approximately **102.5m passengers**. All in, reiterate our **BUY** call on MAHB with a **TP of RM9.43 per share** which is our top pick for the aviation sector.

**Figure 3: Malaysia Airports Passenger Traffic Forecasts**



Source: MAHB, MIDFR

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## 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 <i>rise</i> 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 <i>fall</i> 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.