11 April 2019 | Sector Update

# Aviation

***Maintain* POSITIVE**

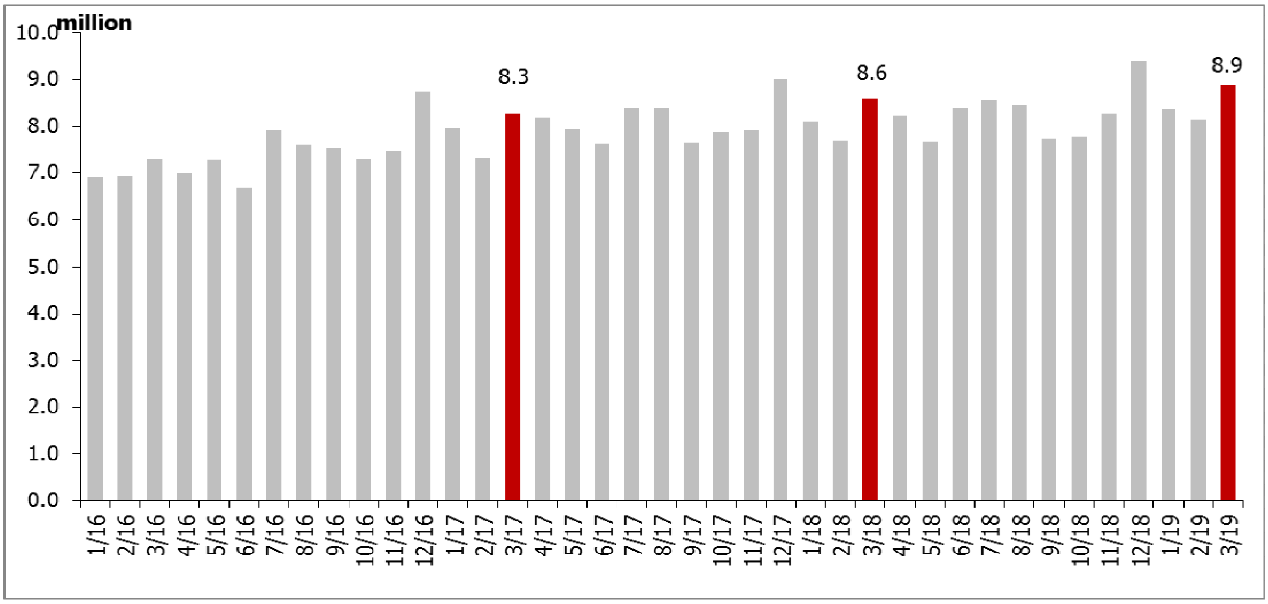
***Domestic Traffic Soars While International Traffic Remains Strong***

## KEY HIGHLIGHTS

- **MAHB passenger traffic (excluding ISG) grew by +3.9%yoy in 1Q19 after passenger numbers hit the highest ever for the month of March.**
- **Bulk of the growth came from non-KLIA passenger growth supported by MAHB's hub-and-spoke strategy**
- **Potential new flights from Malaysia to Singapore's Seletar Airport Passenger to shore up passenger growth at Subang Airport**
- **Increased connectivity to moderate the effects of the departure levy set to be imposed in June 2019 for outgoing international passengers**
- **Maintain POSITIVE stance on aviation sector**

**Higher connectivity bolstered growth at other airports.** March 2019 traffic data for Malaysian operations increased by +3.1%yoy to reach 8.9m passengers, the highest ever recorded for the month of March. This brings the 1Q19 passenger traffic numbers to 25.4m, representing a +3.9%yoy growth and constitutes 24.6% of our full year passenger growth estimate in 2019. Bulk of the increase in passenger traffic during the quarter came from other airports (i.e. excluding KLIA Main Terminal and klia2) which contributed more than 80% 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, Langkawi International Airport accommodates flights of TUI Airways from Birmingham starting from December 2018. As for ISGA, the total passenger traffic in 1Q19 grew by the roughly the same pace as MAHB's airports in Malaysia at a tune of +3.7%yoy.

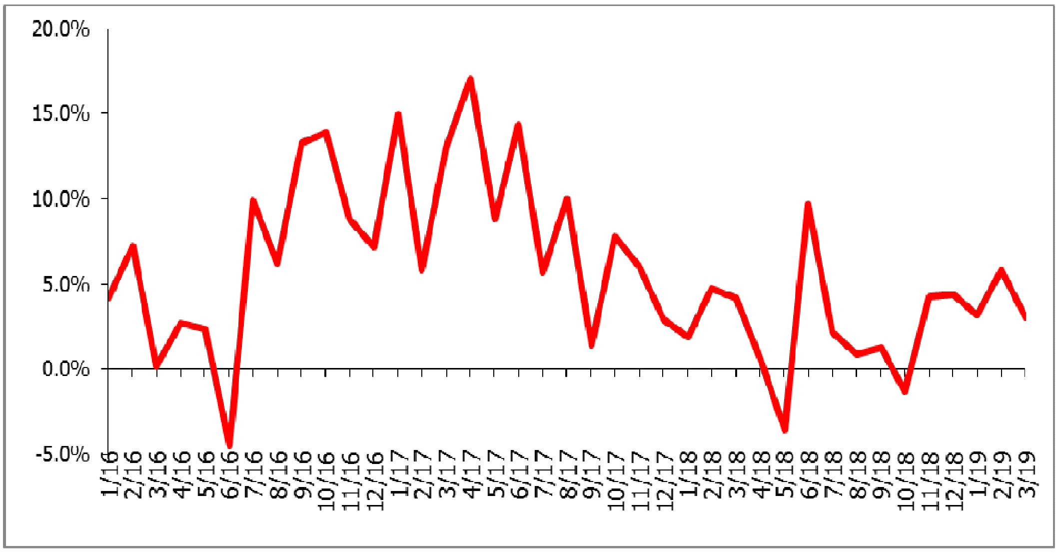
**Figure 1: Malaysia Airports Monthly Passenger Traffic (million)**




*Source: MAHB, MIDFR*

**International traffic growth stood above the high base average in 2H18.** Domestic traffic at Malaysian airports recorded a robust growth of +7.7%yoy in 1Q2019, versus the -3.4%yoy decline in the preceding year. The reason was partly due to the higher seat capacity offered by airlines to match air travel demand especially during the Chinese New Year festive season combined with the school holidays during the quarter. Meanwhile, the international traffic at Malaysian Airports grew at a measurable pace of +0.6%yoy to hit 13.1m passengers. This level of international passenger numbers has never been observed before in the first quarter. We noted that they were disruptions coming from the; (i) temporary suspension of Firefly's operations to Singapore and; (ii) reduced flight frequencies by Indonesian carriers following the incidents related to the Boeing 737 Max 8 aircraft. Nonetheless, international passenger volume in 1Q19 remained above the average high base traffic achieved in 2H18.

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




*Source: MAHB,MIDFR*

**International passenger mix remains favourable above 50%.** Although growth in the domestic sector outpaced the international sector during 1Q19, 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. This will maintain the stronger mix of international passengers which bodes well for MAHB in terms of the higher passenger service charges collected; RM35 for non-ASEAN and RM73 for beyond ASEAN. Meanwhile, LCCs are set to benefit as international passengers command higher revenue in terms of ticket prices and ancillary items. In addition, we opine that the recent grounding of the Boeing 737 Max 8 for Indonesian carriers could pave way for LCCs such as AirAsia Group Berhad (AAGB) to capture market share due to similar routes offered.

**Potential new flights from Malaysia to Singapore's Seletar Airport.** Based on MAHB's guidance, Firefly operates around 4,000 flights on an annualized basis (assuming five to six return flights per day at minimum to and from Singapore) prior to the suspension late last year. As we strongly believe that Firefly would maintain the same flight schedules to Seletar Airport starting late April 2019, international traffic for Subang Airport is expected to increase. This is due to the fact that a majority of international flights at the airport is operated by Firefly which is for the Subang-Singapore route. The resumption of Firefly's flight to Singapore will also pave way for other airlines such as Malindo Airways, which have shown interest.

**Table 1: Top 5 Flight Operators on Kuala Lumpur to Singapore route**

| Operator | Number of Flights |
|---|---|
| AirAsia | 7,766 |
| Malaysia Airlines | 6,448 |
| Silk Air | 5,410 |
| FireFly | ~4,000* |
| Jetstar Asia | 3,108 |

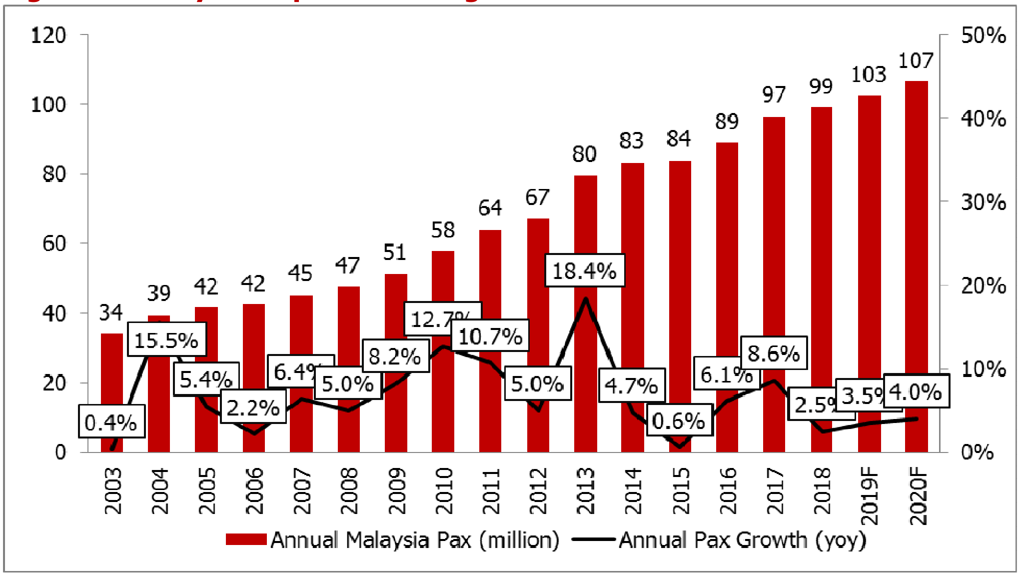
Source: OAG, MAHB guidance
Note: * Assuming five to return flights per day to and from Singapore on an annual basis
Covers the period from March 2018 to February 2019

**Prudent hedging policies to shield LCCs from oil price volatility.** Brent crude oil price has advanced in the recent weeks to reach slightly above USD70pb, not far away from our house view of USD75pb. Notwithstanding this, we believe that a more prudent hedging ratio of ~50% adopted by AAGB and AirAsia X in FY19 will mitigate the volatility in jet fuel prices. Previously in FY17, we noted that AAGB's hedge ratio stood above 50% which resulted in a lower increase of average fuel cost incurred, at circa +13.8%yoy, as compared to the average +20.0%yoy jump in Brent crude oil price. In comparison with FY18 which had an average hedge ratio of below 20%, the increase in average fuel cost incurred almost matched the +30.0%yoy change in Brent crude oil price. Therefore, such hedging policies are apt for the LCCs to provide a shield to the volatility of oil prices in 2019.

**Regulatory changes to take shape.** Negotiations for the operating agreement is expected to be finalised by the end of 2Q19 and will probably feature five airport zones instead of two currently. This will give room for fresh funds to be injected via joint-ventures with new stakeholders to develop the airports. Meanwhile, MAHB has requested for the deferment of the Regulated Asset Base (RAB) framework from mid-2019 to January 2020. The framework entails MAHB to potentially undertake some of the capital expenditure for airport upgrades. We believe that once both of these are finalized, the Government would then carry out the Airport REIT exercise which targets to raise RM4b by selling a 30% stake in the REIT to private investment institutions. Thus far, the only change we can ascertain from the REIT exercise is that change of party that MAHB pays the user fees from the government to the REIT company.

**Maintain POSITIVE on the sector.** The prospect of the aviation sector remains upbeat coming into 2Q19. We opine the extension of the visa relaxation for Chinese passengers until end of this year should sustain the passenger growth. Moreover, we expect MAHB's efforts in not only attracting more new airlines but also offering increased connectivity to moderate the effects of the departure levy set to be imposed in June 2019 for outgoing international passengers. 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. Therefore, we strongly believe that MAHB passenger numbers can surpass the 100m mark in 2019, while maintaining a relatively conservative growth rate of **3.5%** at approximately **103m passengers**. We reiterate our **BUY** call on MAHB with a **TP of RM9.44 per share** as it is a proxy to Malaysia's inbound/outbound travel industry. We also continue to favour **AAGB (BUY; TP:RM3.40)** for its large market share in terms of passengers carried and its resilient load factor of above 80% last year. Moreover, AAGB continues enhance its cost structure, along with its efforts of rationalising revenue and cost via digitalisation efforts.

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




*Source: MAHB, MIDFR*

Adam Mohamed Rahim
adam.mrahim@midf.com.my
03-2772 1686

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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 *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. |