AVIATION

***Maintain* POSITIVE**

Flying to greater heights even before VMY2020

KEY INVESTMENT HIGHLIGHTS

- **MAHB (BUY; TP: RM8.98) passenger traffic (excluding ISG) grew by +6.1%yoy in FY19**
- **Bulk of the growth for FY19 came from non-KLIA passenger growth (contributed more than 60% 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 recorded higher average load factor of 77.1%**
- **International passenger traffic growth in KLIA2 exceeds KLIA Main Terminal and is expected to continue with the commencement of VMY2020.**
- **Maintain POSITIVE on the aviation sector**

MAHB passenger traffic grew by +5.6%yoy in 2019. MAHB saw its full year 2019 passenger movement increased by +5.6%yoy which includes ISG. This translates to a total of 140.6m passengers. For MAHB's airports in Malaysia, passenger traffic grew by +6.1%yoy to 105.2m which exceeded our full year estimates by 2.6%. This is the first time that MAHB's passenger traffic in Malaysia breached the 100m mark. We note that the bulk of the absolute increase was contributed by passenger traffic at airports other than KLIA Main Terminal and KLIA2 which saw an annual increase of more than 3.0m passengers in 2019.

Solid domestic traffic growth. Domestic traffic at Malaysian airports recorded a solid growth of +9.5%yoy in 2019, rebounding from previous low performance whereby the domestic passenger traffic has been experiencing a decline for more than a year prior to January 2019. The increase recorded in 2019 was substantially higher than +0.4%yoy increase in the preceding year.

Load factor for international traffic was higher than domestic traffic. We note that the international passengers in Malaysia only grew by +3.0%yoy in 2019, partly due to capacity shift from international to domestic sector. Notwithstanding this, the international sector continued to retain more than 50% of the passenger market share. Furthermore, considering the international average load factor at 77.1%, at 4.3 percentage points higher than the domestic load factor, indicating the inherent demand for international travel remained resilient. The growth of international traffic was supported by the airlines' additional frequencies, direct connectivity and also contribution by new routes that were not operated previously. For instance, Qatar Airways' flights commenced flights from Doha to Langkawi in October 2019, part of MAHB's hub-and-spoke model which aims to bring global traffic to smaller airports and vice versa. We believe that the inclusion of a new international airline to Langkawi will definitely spur the Visit Malaysia 2020 campaign by increasing the number of tourists into Langkawi. In 2019, 12 new airlines began new operations or completed full year new operations over 2018 into MAHB's Malaysia airports. Looking ahead, MAHB is targeting 3 new airlines services to operate from KLIA Main terminal in 2020 as the airport continues to boost its connectivity to become an aviation hub in the region.

COMPANY IN FOCUS

Malaysia Airports Holding Berhad
Maintain **BUY |** Revised Target price: RM8.98
Price @ 10th January 2020: RM7.05

- Total passenger traffic exceeded estimates in FY19
- VMY2020 and visa-free entry for China and India tourists to lend support to passenger growth
- Expecting passenger traffic to reach 110.8m passengers in 2020

Share price chart

AirAsia Group Berhad
Maintain **BUY |** Unchanged Target price: RM2.04
Price @ 10th January 2020: RM1.71

- Prudent hedging policy to shield AAGB from any volatility in Brent crude oil price
- Expected to gain from lower amount of interest beyond the fifth year of the lease term.
- Passenger load factor to remain intact despite the departure levy

Share price chart

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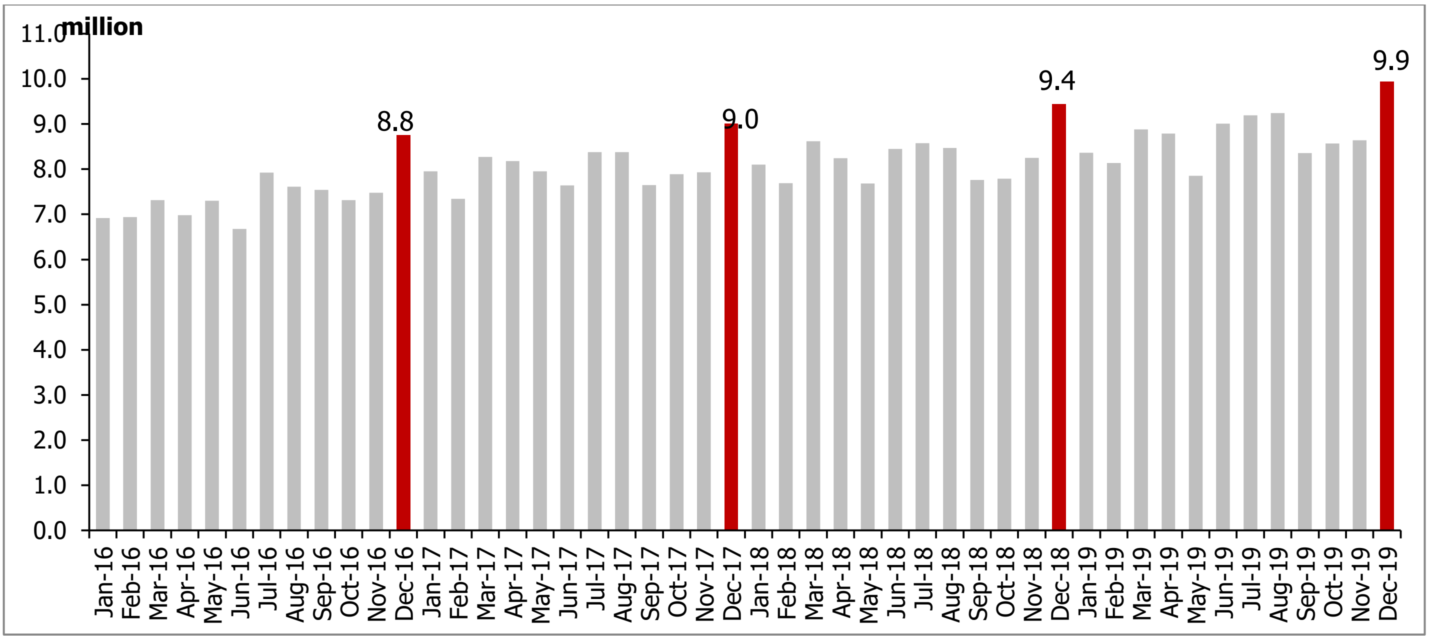
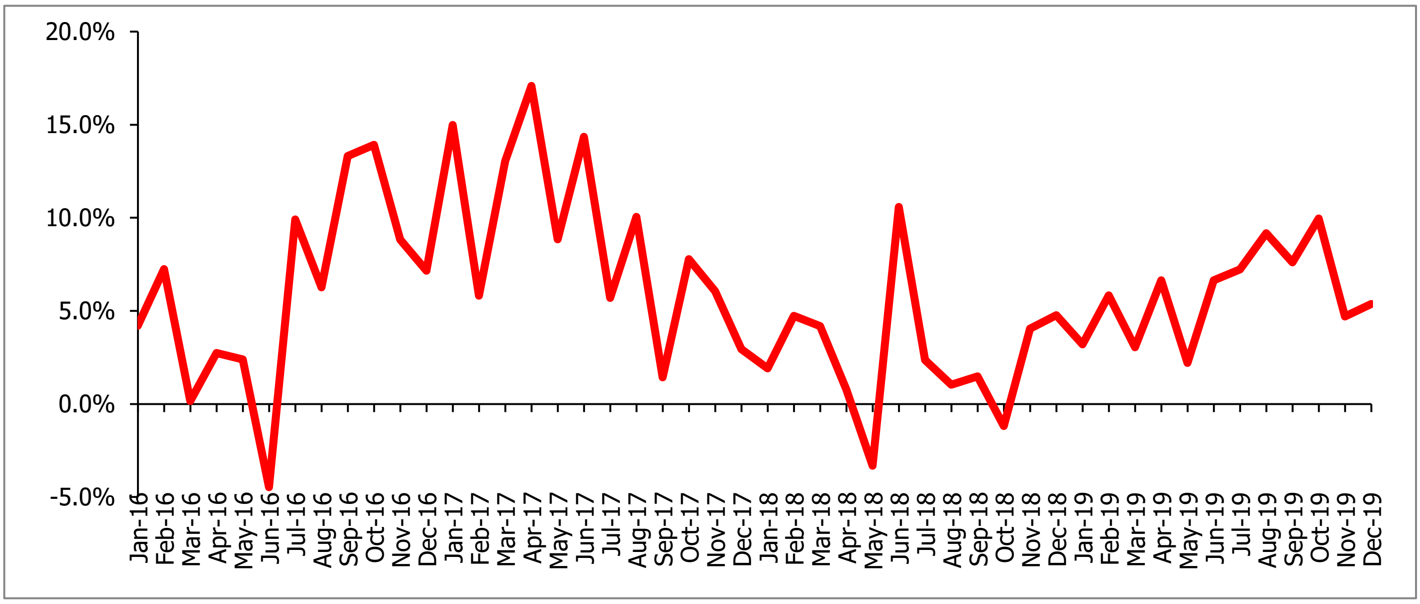
Figure 1: Malaysia Airports Monthly Passenger Traffic (million)



Source: MAHB, MIDFR

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



Source: MAHB, MIDFR

KLIA2 recorded passenger growth of 3.9%yoy in 2019. KLIA2 saw a +3.9%yoy passenger growth, recording a net increase of 1.3 million passengers in 2019. While the passenger growth seen in KLIA2 was similar to KLIA Main Terminal, KLIA2 contributed more to the absolute increase of total passenger traffic in MAHB's airports in Malaysia during the same year. KLIA2 saw a 21.0% contribution to the annual increase of 6.1m passengers last year compared to KLIA Main Terminal's contribution of 18.0%. Apart from that, KLIA2 saw a higher growth in international traffic of +3.8%yoy in 2019 compared to the +2.4%yoy growth recorded at KLIA Main Terminal. With KLIA2 seeing more growth in international traffic, LCCs would have been a beneficiary as international passengers command higher revenue in terms of ticket prices and ancillary items. In addition, we opine that the pent-up demand for international travel will place LCCs such as AirAsia Group Berhad (AAGB) and AirAsia X (AAX) at a significant advantage over its competitors given the companies' ability to leverage on its network of airlines operators in South East Asia while constantly introducing and retaining optimal routes coupled with strategies to drive cost lower i.e. digitalisation and aircraft with fuel efficient technology. Henceforth, we are expecting load factors to be above 80.0% for both AAGB and AAX in 2019.

Table 1: Absolute increase/decrease in annual passenger traffic at MAHB's airport in Malaysia (million)

Airport	FY17	FY18	FY19
KLIA Main Terminal	2.8	-0.2	1.1
KLIA2	3.1	1.6	1.3
MASB	1.7	1.0	3.7
Total absolute change in annual passenger traffic	7.7	2.5	6.1

Souce: MAHB

Hedging policies to shield LCCs from oil price volatility. 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.

Table 2: 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

Geopolitical instability in the Middle East to have minimal impact on passenger traffic in Malaysia. Following the recent geopolitical turmoil between the U.S and Iran, airlines such as Germany's Lufthansa, Air France, Singapore Airlines and Malaysia Airlines have rerouted flights to avoid airspace over Iran and Iraq. The rerouting of flight will lead to longer flight durations and higher operating costs in terms of jet fuel consumed. However, it is important to note that the percentage of Malaysia's international passengers travelling to and from Europe and the Middle East (only including Amman, Baghdad, Basra and Tehran) is very minimal at around 2.5% of total international passenger traffic based on 2018 statistics. Therefore, we do not foresee any major disruption in passenger traffic if travelling demand from the said areas was to decline as demand from North East Asia and South Asia is expected to pick up further this year due to one-year visa exemption for tourists from China and India in tandem with VMY2020. Moreover, load factors in Asia Pacific have been on an upward trend in the past few years. As for LCCs such as AAGB and AAX, we see no issue at all as these airlines do not have routes requiring their aircraft to fly over the Iraqi and Iranian airspace.

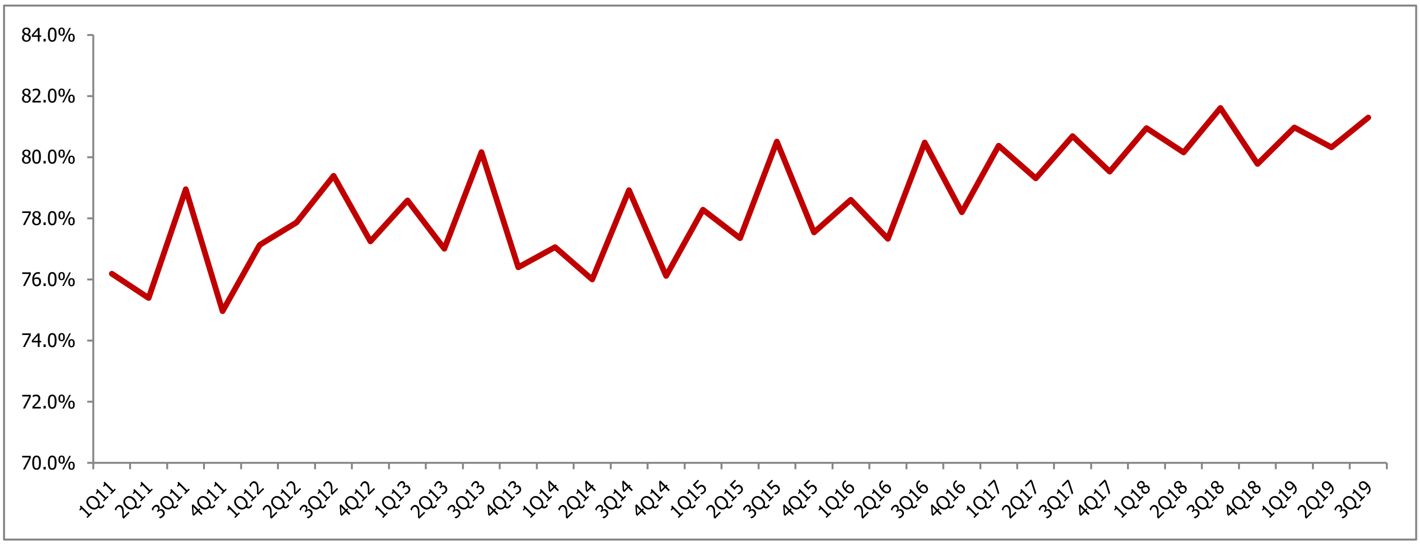
Table 3: International Passenger Movements by Sectors at Kuala Lumpur International Airport

Sectors	No. of passengers in FY18 (million)	Percentage of total international passengers (%)
ASEAN	20.7	47.5
North East Asia	10.6	24.5
Southwest Pacific	2.6	6.0
South Asia	5.4	12.4
Central Asia	0.1	0.2
Africa	0.1	0.2
North America (Honolulu)	0.0	0.1
Middle East (excluding Amman, Baghdad, Basra and Tehran)	2.9	6.7
Middle East (only including Amman, Baghdad, Basra and Tehran)*	0.2	0.4
Europe (including Istanbul)*	0.9	2.1
Total	**43.5**	

Source: MAHB, MIDFR

**Sectors whereby flights may routes flying over Iran and Iraq*

Figure 3: Bloomberg Asia Pacific Load Factor

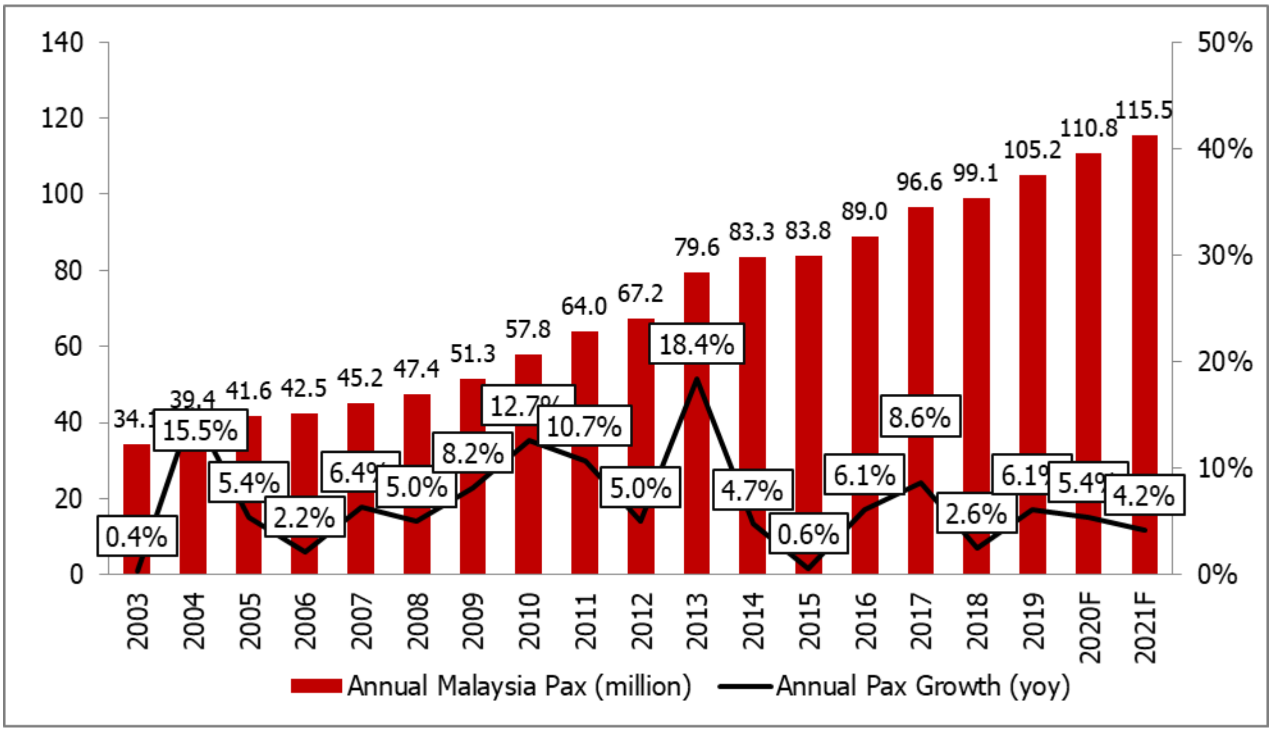


Source: Bloomberg

Regulatory uncertainty remains a headwind in the sector. With the Ministry of Transport's (MOT) plans of merging the Malaysian Aviation Commission (MAVCOM) with the Civil Aviation Authority of Malaysia (CAAM), the implementation of the RAB framework could be possibly derailed. Notwithstanding this, we are of the opinion that a transparent framework like the RAB framework would still need to be incorporated. This is because it inculcates a discipline capex planning while enabling the recoupment of capital expenditure via aeronautical charges. With the fact that the RAB framework shifts the developmental capex obligation from the Government of Malaysia (GoM) to MAHB, we opine that this is a factor to be strongly considered to proceed with the implementation. In the meantime, we also believe that MAVCOM's focus for now would be ensuring the smooth transition of its functions into CAAM in addition to evaluating the next steps for the RAB framework given the situation that CAAM will have to do follow up works if the RAB framework comes into place. Nonetheless in terms of financial impact, we are estimating an earnings growth of more than 10.0% for MAHB in FY20 in the absence of the RAB framework.

Maintain POSITIVE on the sector. We opine that VMY2020 would be a major catalyst to this year's passenger traffic growth, with RM1.1b allocated by the Government of Malaysia (GoM) for the tourism ministry including RM960m to drive awareness and promotion programmes. Furthermore, the GoM's initiative for a 15-day visa free travel for tourists from China and India in 2020 will further support the overall passenger traffic growth as these travellers made up more than 20.0% of passengers in 2019. In the past Visit Malaysia Years, the international traffic growth had been commendable, and the international traffic is likely to get a similar boost from the VMY2020 activities. Therefore, we strongly believe that MAHB passenger numbers for Malaysian operations to reach 110.8m passengers in 2020, with a growth rate of **5.4%**. Our top pick for the aviation sector is **AAGB (BUY; TP:RM2.04**). 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.

Figure 3: Malaysia Airports Passenger Traffic Forecast



Source: Company MIDFR

PEER COMPARISON TABLE

Stock	FYE	Recommendation	Price @ 10-Jan-20	Target Price (RM)	EPS (sen)		PER (x)		Net DPS (sen)		Net Divd Yield (%)	
					FY19E	FY20F	FY19E	FY20F	FY19E	FY20F	FY19E	FY20F
MAHB	Dec	BUY	7.05	8.98	34.4	38.6	20.5	18.3	14.0	14.0	2.0	2.0
AAGB	Dec	BUY	1.71	2.04	6.0	13.6	28.7	12.6	102.0*	12.0	59.6	7.0
AAX	Dec	NEUTRAL	0.16	0.17	-5	1.1	-3.1	14.1	0.0	0.0	0.0	0.0

Source: Company MIDFR

**-Special dividend*

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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.