midf RESEARCH

11 January 2018 | Sector Update

Aviation Sector

***Maintain* POSITIVE**

Sustained growth from all corners

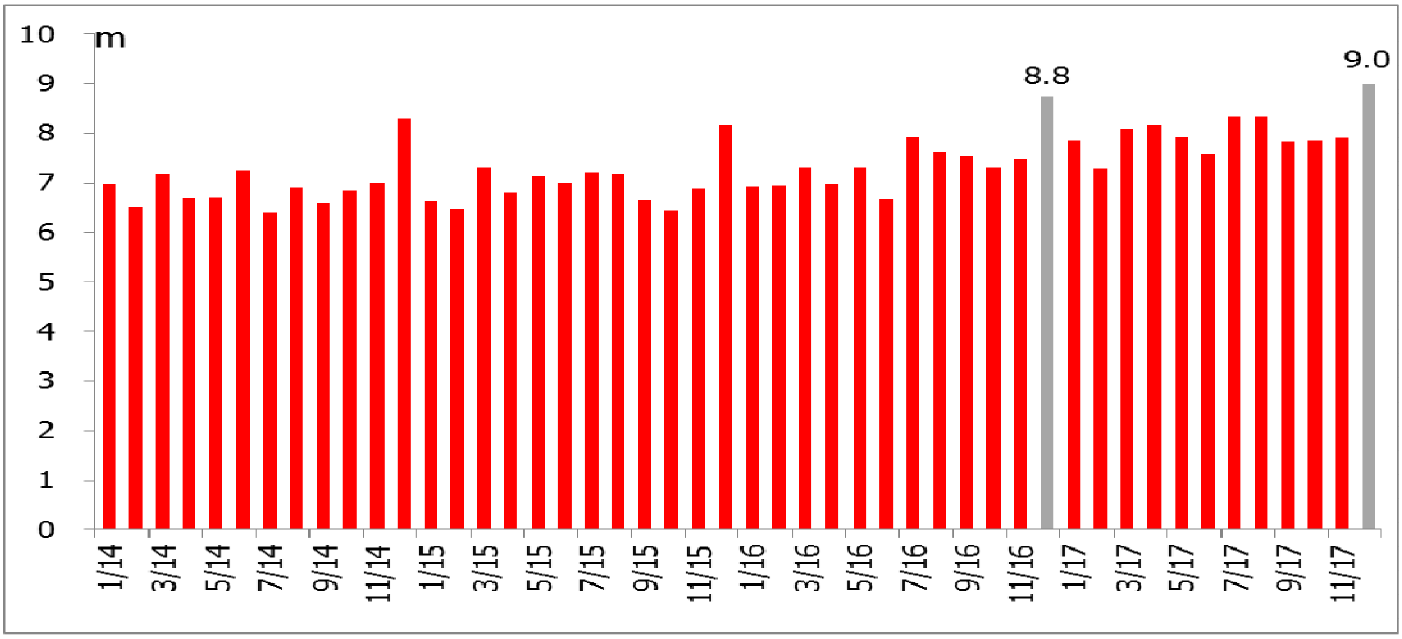
INVESTMENT HIGHLIGHTS

- *Total passenger movements for MAHB increased by +7.8% in 2017*
- *International passengers' market share exceeded 50% in 2017*
- *Growth momentum to taper down, but maintain a healthy pace*
- *POSITIVE for the sector*

A. Highest passenger traffic recorded in FY17.

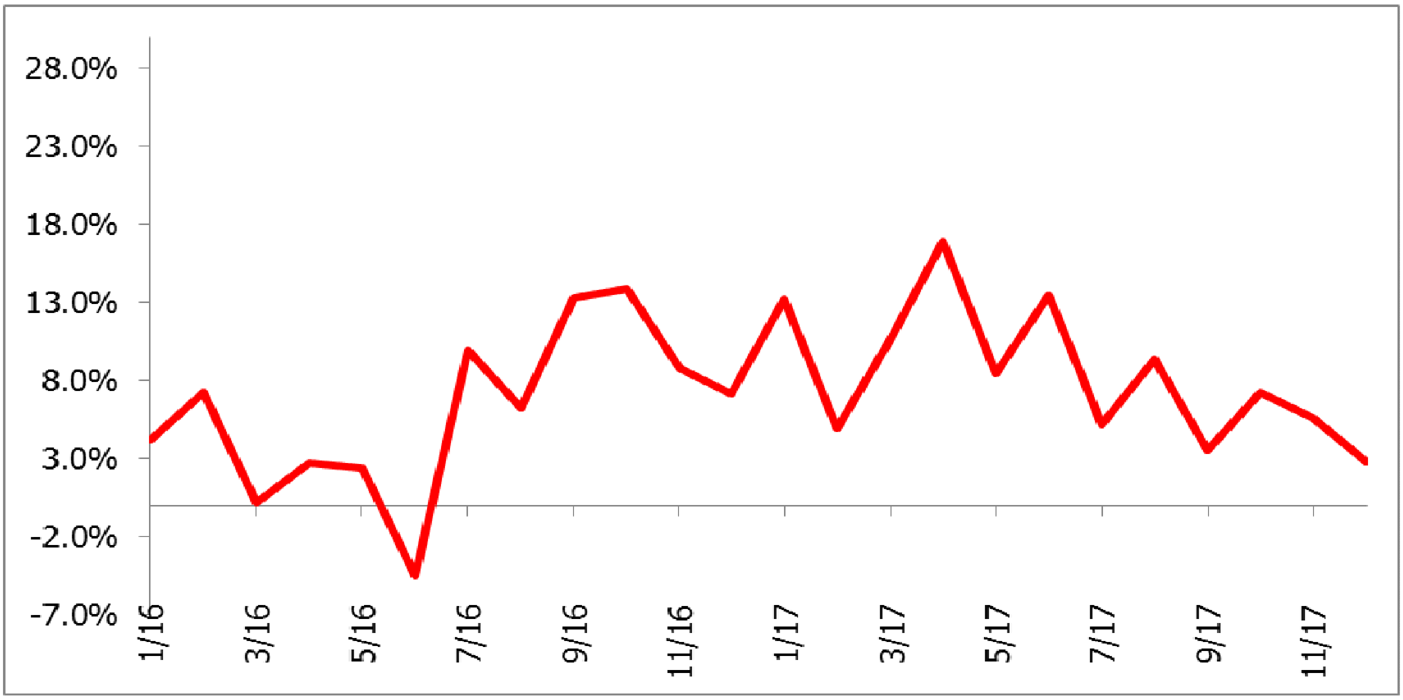
As the traffic snapshot came in to conclude 2017 numbers, MAHB saw its passenger movement moved up by +7.8%yoy, accounting for a total of 127.9m. In December alone, the airport operator recorded 9.0m passengers, the highest since December 2016. The positive deviation was largely steered by international passengers, recorded at 59.7m. This was an increase of +13.1%yoy in comparison to domestic traffic growth at+3.5%yoy. We view the upbeat demand for international air travels in 2017, was primarily due to visa relaxation for Chinese and India tourists. Considering the visa-free programme to continue in 2018, we believe the international traffic numbers will again see contribution in traffic numbers by China, India and South East Asia sectors. Recall that passengers from the aforementioned countries and region make up 75% of MAHB's international traffic.

MALAYSIA AIRPORTS: MONTHLY PASSENGER TRAFFIC (MILLION)



Source: MAHB, MIDFR

MALAYSIA AIRPORTS: MONTHLY PASSENGER TRAFFIC (GROWTH %YOY)



Source: MAHB, MIDFR

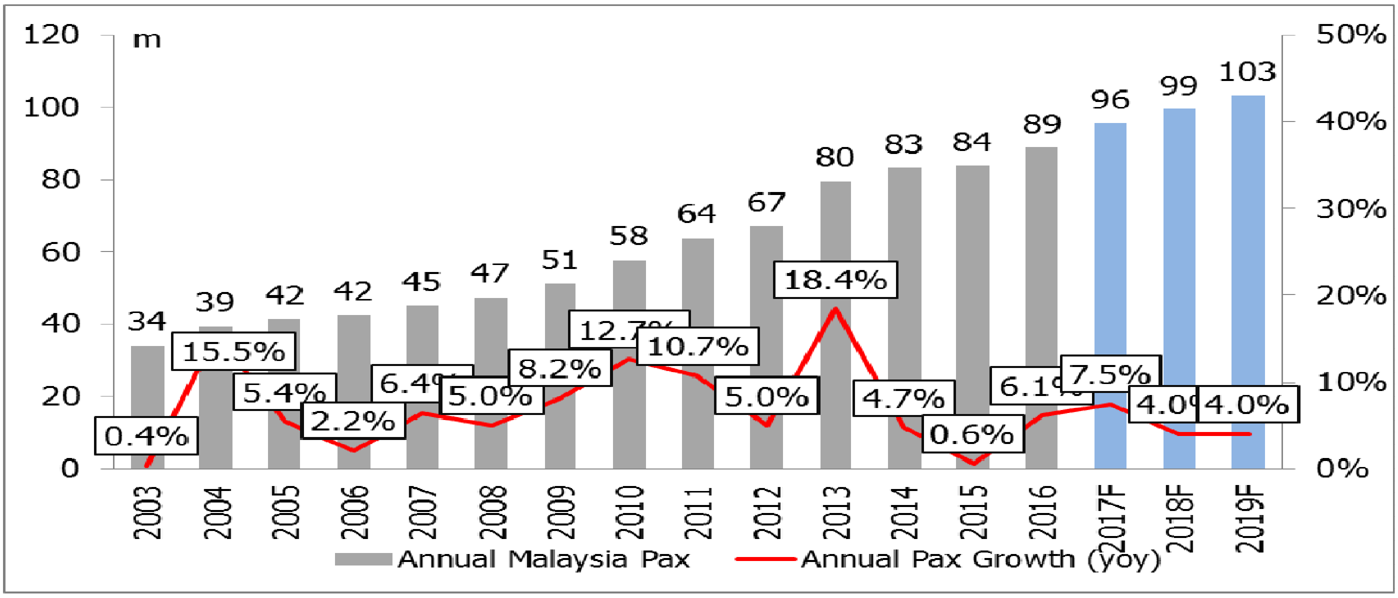
Load factor remained healthy despite the increase in aircraft movement... It is worth noting that the average load factor for international sector hit an all-time high of 77.0%, despite international aircraft movements staging double-digit growth of +12.8%. Given these positive trend, we opine the demand for international sector will remain strong, providing additional head room for airlines companies to grow. The improved load factors were mainly driven by the LCCs, AirAsia and AirAsia X, both added significant seat capacities but yet still able to maintain load factors at above 80%. We believe LCCs such as AirAsia and AirAsia X will continue to benefit from this trend, leveraging on its network of airlines operators in the South East region along with its low-cost business model. We view the pent-up demand for international air travels will place AirAsia and AirAsia X at a significant advantage over its competitors, given the companies' aggressive expansionary initiatives in the regional and international routes coupled with its inventive strategies of driving cost lower.

...but challenges remains. Airlines will possibly face higher operating cost that will be driven by the rise of global crude oil prices in CY18. IATA expects Brent crude price to be around USD60, while jet fuel price to be around USD74 a barrel in CY18. This translates to an average growth of +9.7%yoy since the beginning of CY17. However, we opine airlines are unlikely to impose a fuel surcharge due to the risk of affecting consumer sentiment. While we believe the upsurge in crude price to remain below <US$100, we opine the impact will be largely absorbed by airline capacity expansion and better competitive environment. We will not be surprised to see average fares to trend higher following the suspension of routes and reduction in frequencies by certain airlines, signalling that there could be less irrational fare discounting in the industry.

Further development in PSC charges. Starting January this year, KLIA2 should be charging higher PSC for international passengers amounting to RM73 (vs RM50 in CY17). This was followed by MAVCOM's ruling of equalizing the rate for international departures at all other Malaysian airports. While we observe this development to be positive on MAHB's PSC collection, we noted that MAHB's total throughput only comprised of ~<10.0% international passengers at KLIA2. This implies a lower number of affected passengers in comparison to PSC revision last year. We believe the absolute increment of RM23 would not leave any substantial impact on travel demand, considering that it only accounts for small percentage of the overall travel expenses, especially for long-haul international destination.

Positive on the sector. The prospect for aviation sector looks bright coming into CY18. Despite the challenges such as rising fuel prices, we believe airlines like Air Asia and AAX to remain buoyant, underpinned by its continuous improvement in operational cost coupled with aggressive capacity expansion. Better competitive environment is expected to lead to a more rational pricing regime, increasing airlines average yield. We expect the growth of passengers' traffic to remain in positive territory, driven by higher international passengers. Overall, this is positive for MAHB benefitting from these encouraging developments i.e. net addition of aircraft and higher utilization rates by airlines. Considering that travel demand to remain robust in CY18, we continue to like MAHB as a proxy to Malaysia's resilient inbound/outbound travel industry being the largest airport operator in Malaysia. We think that MAHB will able to see the annual passenger traffic number to surpass the psychological 100 million within 2 years, while only forecasting a relatively conservative growth of 4.0%. As such, we recommend investors to accumulate **MAHB** with a **BUY** call and target price of **RM9.98**.

MALAYSIA AIRPORTS: ANNUAL PASSENGER TRAFFIC (GROWTH %YOY)



Source: MAHB, MIDFR

Mixed performance for airlines, but future earnings most likely stabilize. Air Asia's earnings in 9MFY17 were commendable, recording higher core net profit of RM1.1b. Despite notable increase in operational cost, its 3QFY17 earnings staged a growth of +40.7%yoy to RM375.3m. The group stayed focus of driving operational costs down with multiple initiatives being carried out, with large-scale automation being its central strategy. Meanwhile for its sister company, AirAsia X dipped into the red territory, recording cumulative 9MFY17 core loss of –RM6.45m. Weakening MYR against USD, higher fuel expenses and its doubtful debt provision steered its net profit into a loss. Despite the drop, business was decent for AAX as the demand for long haul LCC appeared stronger for seasonally weaker quarter. Improvement was recorded in almost all segments such as ticket sales, ancillary and freights with at least ~8.0%yoy incremental growth. As such, we opine AAX's business to stay intact in CY18, supported by its ongoing expansion to other routes catering to long-term structural demand. Meanwhile, our CY18 outlook on Air Asia continues to be positive due to its aggressive capacity expansion and inventive strategies to drive cost lower. Given our positive view on both LCCs, we maintain our **BUY** call on **Air Asia (TP: RM4.02)** and **Air Asia X (TP: RM0.43)**.

Tune Protect benefiting from AirAsia's growth. Given our positive view on both AirAsia and AirAsia X, we expect the take-up rate for travel insurance to improve, following the opt-in ruling of MAVCOM in late 2016. Note that the opt-in ruling imposed to travel insurers has led a considerable drop in travel insurance income. Tune Protect was one of the insurers impacted from the new ticket-purchasing structure, leaving adverse effect to its travel insurance business. Recall that Tune Protect TIH has inked exclusive long-term agreements with AirAsia group, which allows it to leverage on the latter's regional growth. As the travel insurance operator continues to enhance its business, a positive progression of AirAsia will become a great proxy to a positive travel insurance earnings contribution. Given our positive view on AirAsia, we reiterate our **BUY** call for Tune Protect with **TP** of **RM1.42**. Tune Protect remains as our top pick in the small-cap insurance universe due to its inventive strategy of operating the business, coupled with its huge database capacity which would bode well with its long-run strategy of achieving cost sustainability

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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.