

18 July 2019 | Sector Update

Aviation

Maintain POSITIVE

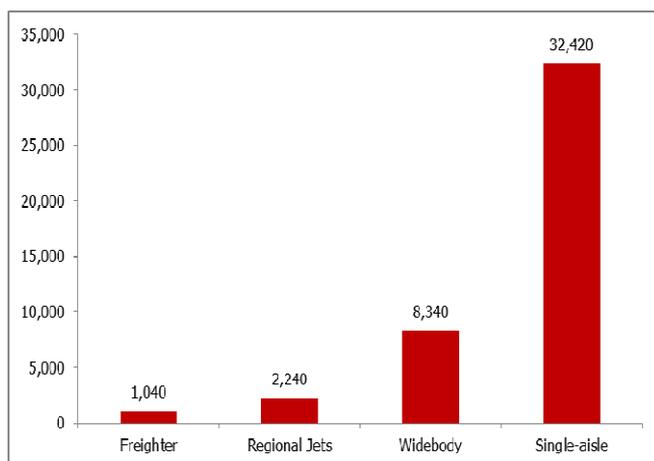
The nation's aerospace industry is set to take off

KEY HIGHLIGHTS

- Airlines worldwide will need nearly 44,040 new planes valued at USD6.81t
- Total MRO spending is expected to rise to USD116b by 2029, up from USD81.9b in 2019 driven by fleet growth of 42.5% for that period
- ASEAN to be an agent of growth in MRO spending amidst expectation of higher air travel demand within Asia especially in ASEAN, prompting low cost carriers to bump up capacity
- Malaysia's exports of aircraft parts and components have almost quadrupled from RM2.23 billion in 2012 to a record high of RM8.49 billion in 2018
- MAHB is the key agent of Malaysia's aerospace industry growth via the development of KLIA Aeropolis and the regeneration of Subang Airport
- Maintain POSITIVE on the Aviation Sector

Airlines worldwide will need nearly 44,040 new planes valued at USD6.81t. The aerospace industry which consists of Maintenance Repair and Overhaul (MRO), aero-manufacturing, systems integration and engineering and design is an important sector to drive the growth in aviation. Rising demand for air travel is keeping production lines at aircraft, engine, and component manufacturers busy. Relatively lower oil prices compared to pre-2014 levels, along with the willingness of airlines to spend on upkeep, are resulting in delayed retirements of older jets, which in turn provide more business for the MRO industry because of their additional servicing needs.

Figure 1: Airplane Deliveries 2019-2038



Source: Boeing

Table 1: New airplane deliveries by region 2019-2038

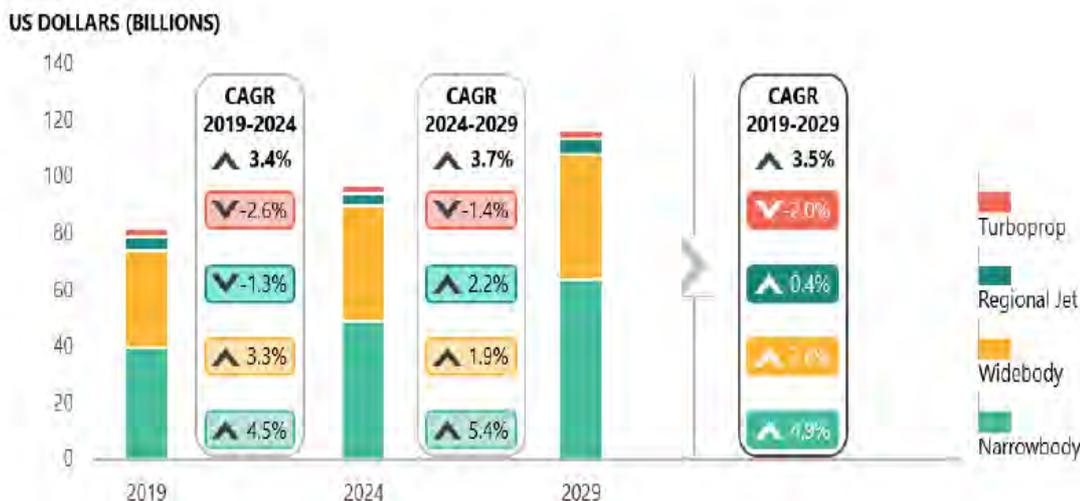
Category	No. of deliveries	Services Market Value (USD't)
Asia-Pacific	17,390	3.48
North America	9,130	1.87
Europe	8,990	1.98
Middle East	3,130	0.79
Latin America	2,960	0.50
Russia and Central Asia	1,280	0.27
Africa	1,160	0.22
Total	44,040	9.10

Source: Boeing

Trends in MRO spending. Total MRO spending is expected to rise to USD116b by 2029, up from USD81.9b in 2019. This is driven by fleet growth of 42.5% during the 10-year period coupled with technological advancements. Between 2019 and 2024, the MRO market will grow at a CAGR of 3.4%, increasing MRO spend to USD96.9 billion from USD82.0b. Meanwhile, the market in the next five years will accelerate slightly on average by 3.7% annually as the new-generation aircraft reach the stage when life-limited parts need replacement and the number of other scheduled maintenance events rises. As such, the annual average growth rate for the global MRO market is expected to be 3.5% for the 2019 to 2029 period.

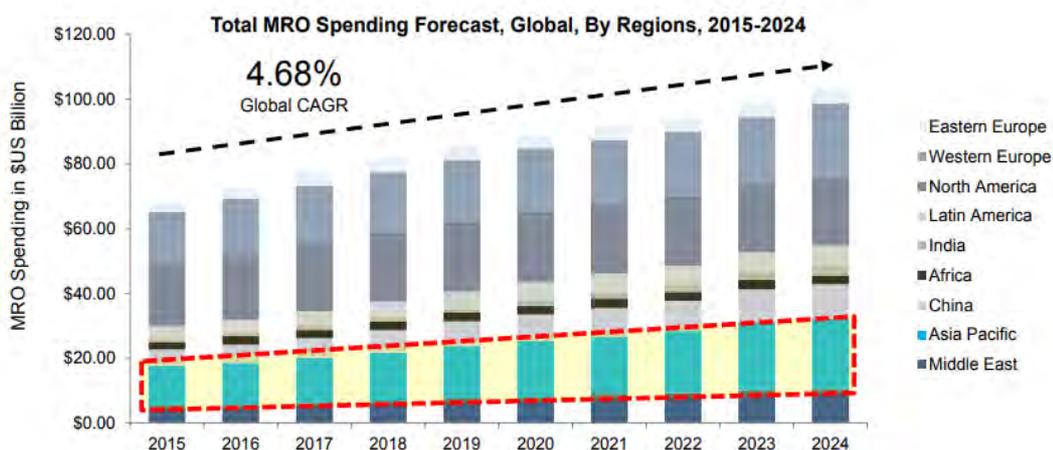
ASEAN to be an agent of growth in MRO spending. Throughout 2019 to 2029, narrowbodies are expected to make up the majority of MRO market share at more than 50%, followed by widebodies, regional jets and turboprops. The trend for narrowbodies is already prevalent in ASEAN with AirAsia Group Berhad's placing 253 orders for Airbus' A321neo model, making AirAsia the world's largest customer for the model. The preference of narrowbodies comes by amidst expectation of higher air travel demand within Asia especially in ASEAN, prompting low cost carriers to bump up capacity. Air travel across Southeast Asia is growing by around 10% a year, due to rising consumer affluence as well as continuous efforts to liberalise air traffic regulations. It is expected that the middle class population in the region will rise from 29% in 2010 to 65% by 2030. This means, almost half a billion people would have sufficient disposable income to travel. Henceforth, it is inevitable that Asia Pacific will have the second largest MRO spending after Western Europe by the end of 2024. For 2018 alone, ASEAN recorded around USD14b worth of aircraft parts and related services, almost matching Japan's USD16.7b.

Figure 2: Growth of Global MRO Spend, 2019-2029



Source: Oliver Wyman

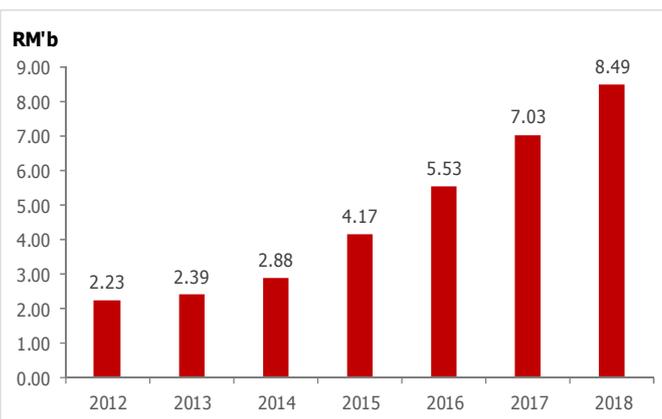
Figure 3: Total MRO Spending Forecast



Source: Frost & Sullivan

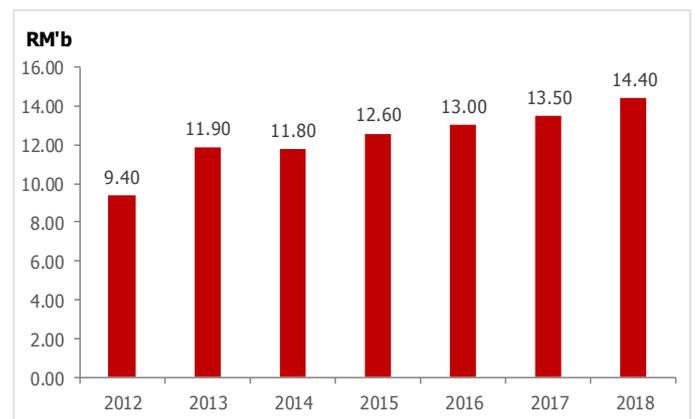
How is Malaysia facilitating and benefiting from the growth of the aerospace industry. With ASEAN being a vital agent for MRO activities in Asia, Malaysia is bound to benefit from the growth in the aerospace industry. In fact, Malaysia's exports of aircraft parts and components have almost quadrupled from RM2.23 billion in 2012 to a record high of RM8.49 billion in 2018, maintaining a contribution of more than 1.0% to Malaysia's total trade value for the past eight years. The growth was mainly driven by expansion of aerospace manufacturing activities which also translated to the increase of revenue of Malaysia's aerospace industry. Locally manufactured aerospace products for export mainly include fan cowl, fan casing, thrust reverser, forward leading edge, aircraft door, avionics equipment and carbon brakes. In terms of investments, 11 aerospace projects with total investments of RM16.3m were approved in 2018 of which 41% were foreign investments which are expected to generate a total of 2,442 employment opportunities. The continued growth of this sector is aligned with the milestones charted by the Second Malaysia Aerospace Industry Blueprint (2015-2030) which aims to generate annual revenue of RM55.2b and create more than 32,000 high income jobs.

Figure 4: Exports of aircraft parts and components (CAGR)



Source: Department of Statistics Malaysia

Figure 5: Total revenue of aerospace industry in Malaysia



Source: National Aerospace Industry Coordinating Office

MAHB being one of the major agents of growth for Malaysia's aerospace industry. We believe Malaysia Airports Holdings Berhad (MAHB) (**BUY; TP:RM9.43**), as Malaysia's largest airport operator, is one of the key agents in driving the growth in Malaysia's aerospace industry. It is diversifying via the development of Aeropolis as noted in the second thrust of its 'Runway To Success 2020' business plan. The objective of Aeropolis is to stimulate economic activities and aerospace is one of the mediums identified aside from logistics and leisure segments to be developed within 115 acres allocated for the KLIA Aerotech Park and also 58 acres at the Subang Aerotech Park.

Subang Aerotech Park to be a priority in the immediate term. Out of the 58 acres for allocated for Subang Aerotech Park, circa 34.7 acres will be granted the rights to sublease for the JV company formed between MAHB and BP Aerotech (Subang) Sdn Bhd ("BP Aerotech"). Another 7 acres of land in the Subang Aerotech Park has been allocated for UK-based Senior Aerospace UPECA's built-to-suit facility announced in March 2018. A capital expenditure of roughly RM40m has been allocated for the Subang Aerotech Park which is expected to be fully completed in the next two years. As such, we do not expect any meaningful earnings accretion within this time period. However, once completed, MAHB will gain in terms of non-aeronautical rental revenue through leasing activities with aerospace related companies. In 2018, rental revenue contributed around 41.0% of MAHB's non-aeronautical segment from Malaysian operations. On a longer term, the Subang Aerotech Park will equip MAHB to attract more aerospace related activities in Malaysia as 4,000 new aircraft are expected to be delivered to the ASEAN region by 2037.

Figure 6: Layout of Subang Aerotech Park



Source: MAHB

Figure 1: Major components of Subang Aerotech Park

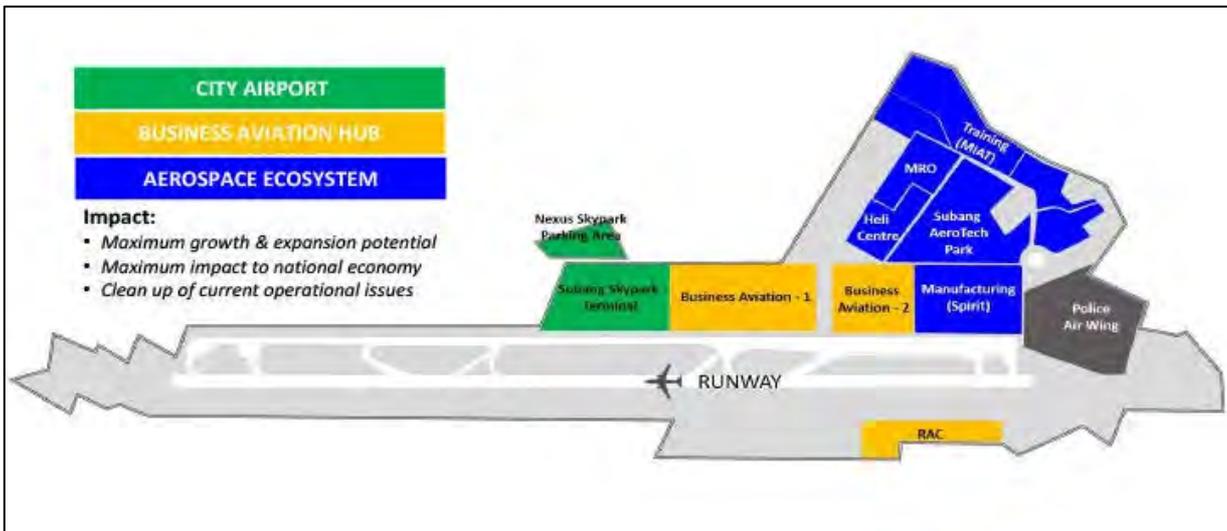
Component	Remarks
MRO Centre	Component and engine MRO for helicopters, rotary wings. Existing companies include Global Turbine Asia, Skyways Technics and Galaxy Aerospace
Aerospace and High Tech	Manufacturing aero structures, components, tools and jigs
Centralised Logistics Center	Logistics solution provider for aerospace players which includes a requirement for bonded warehouses
Commercial Offering	Food and beverages

Source: MAHB

Subang Aerotech is just a fraction of Subang Airport’s mature aerospace ecosystem. In addition to Subang Aerotech Park, MAHB also aspires to grow Subang Airport’s aerospace ecosystem by turning the cargo complex currently occupied by DHL and Raya Airways into MRO facilities when these two freight operators relocate to Sepang by the end of 2021. We believe that such plans would enable Subang Airport to serve the growing needs for business jet MRO and aircraft management with more than 1,500 business jets calling Asia Pacific home. Moreover, factors such as: i) the congestion and high cost in more matured hubs such as Hong Kong and Singapore and ii) the lack of ready infrastructure in other growing markets such as Indonesia and the Philippines makes a strong case for the redevelopment of Subang Airport into a business aviation hub.

Major international companies have already shown interest in Subang Airport. French jet manufacturer, Dassault Aviation has chosen Subang Airport for the construction of its MRO hub in Southeast Asia instead of Singapore’s Seletar Airport due the space availability for expansion. Other companies such as Airbus plans to add the value of its supply, source and MRO operations in Malaysia to RM2.24b per annum by 2023 amidst the robust demand for aircraft in ASEAN. As such, we view that MAHB is on the right track to attract more international companies into Malaysia which would provide ample opportunities for Subang Airport.

Figure 7: Subang Airport Regeneration Concept Plan

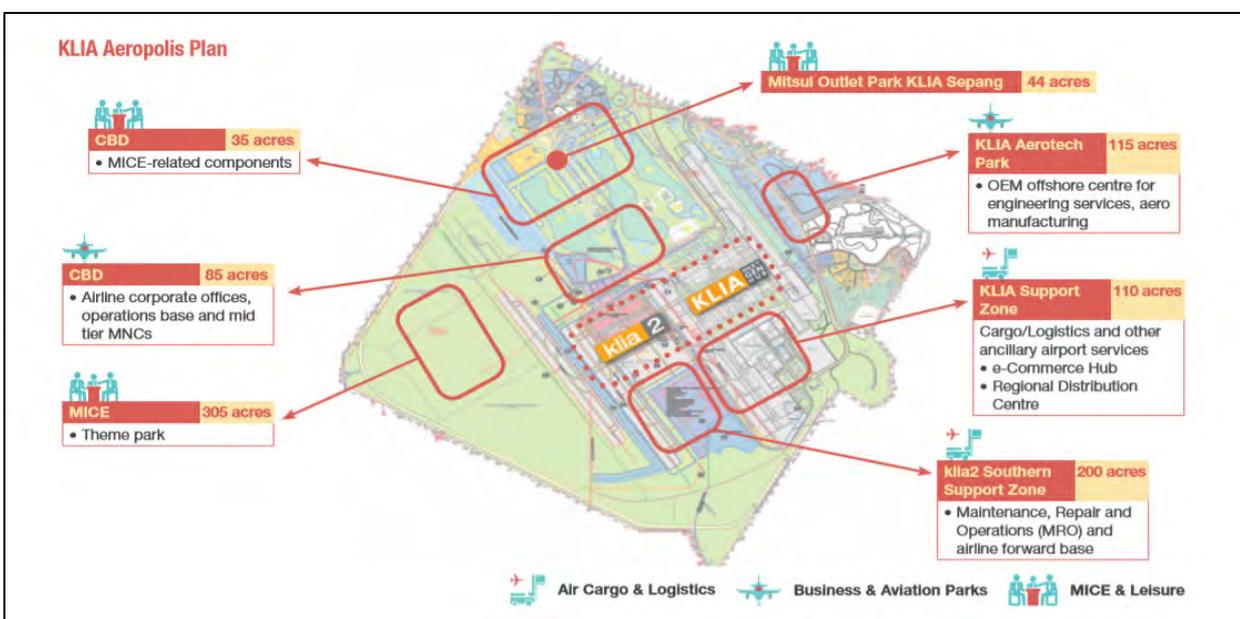


Source: The

Edge Markets

KLIA earmarked for development in the long run. The 115 acres of land has been earmarked for the development of the KLIA Aerotech Park in KLIA Aeropolis. However, this is a pipeline project for the longer term. Conditions would be more favourable if the Government of Malaysia (GoM) grants a 99-year lease which would enable MAHB to go for large scale projects and attract more investors in the wake of other states planning to develop other aerospace industrial parks. According to MAHB, the GoM has given the approval in principle to a 99-year lease for KLIA Aeropolis at end 2016 but the final terms are still being negotiated. Meanwhile for the immediate term, MAHB is developing the aeronautical support Zone 1 of 178 hectares which already includes the Digital Free Trade Zone (DFTZ) e-fulfillment hub.

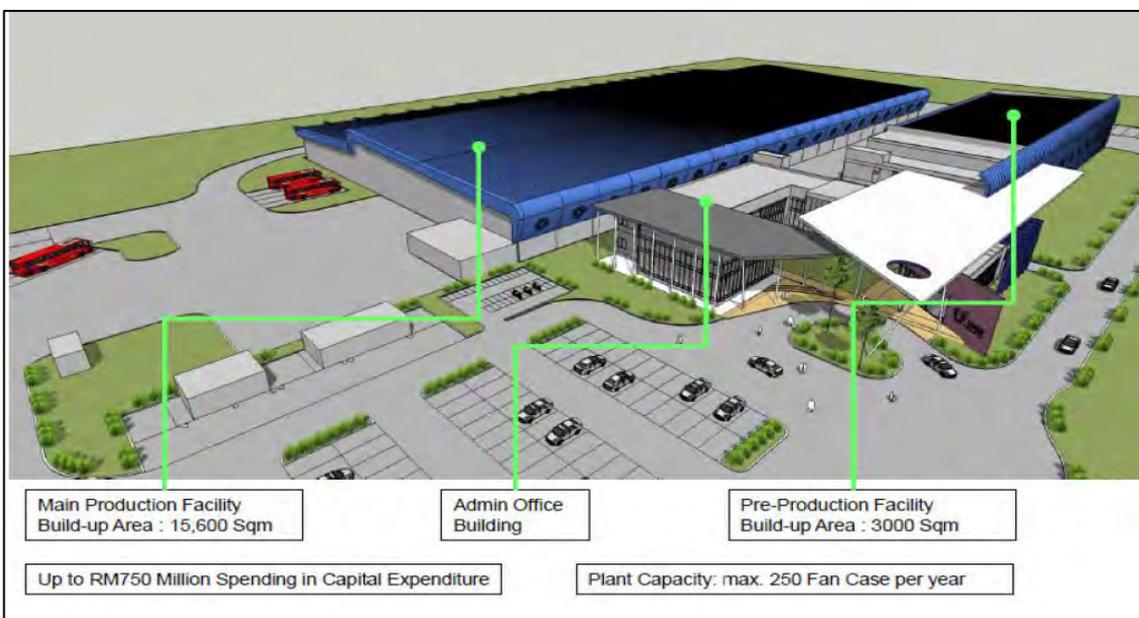
Figure 8: KLIA Aeropolis Plan



Source: MAHB Runway To Success 2020

Other players grabbing a share of the aerospace pie. Meanwhile, UMW Aerospace (UMWA) had invested RM750m (land is leased from the parent company) into an aerospace plant. UMWA has secured a 25+5 year contract to supply fan cases to Rolls Royce's (RR) Trent 1000 / Trent 7000 engine final assembly facility in Seletar, Singapore. The plant commenced operations and delivered its first fan case in 4Q17. UMWA is involved in the manufacturing of the major frontal portion of the fan case, welding of fan blades to its core and assembly of the entire fan case itself with the rest of the parts procured from RR appointed suppliers. These are then transported to RR's Seletar final assembly facility via land transport (6-hour drive). The Trent 1000 engines are supplied for the Boeing 787, while the Trent 7000 is for the Airbus A330 NEO. The plant's stretched capacity could reach up to around 320 units per annum.

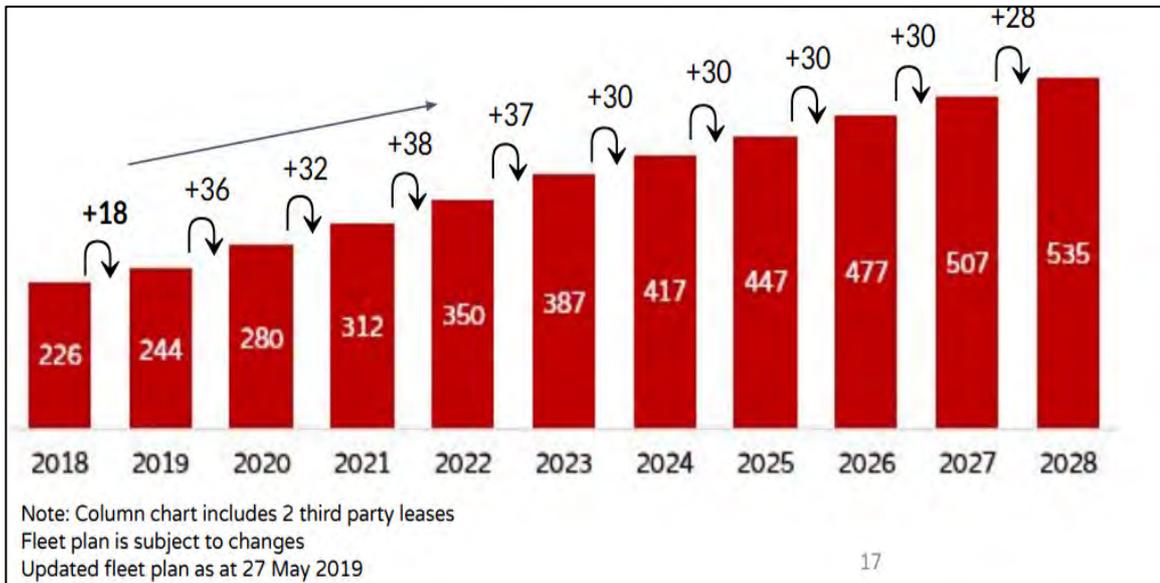
Figure 9: UMW Aerospace Plant Layout



Source: UMW Holdings

Maintain POSITIVE on Aviation sector. We remain optimistic on the aviation sector amidst the potential growth in the aerospace industry. Given the growing demand for commercial aircraft in the Asia Pacific region, we are confident that the aerospace industry in Malaysia will remain vibrant and thriving for many years to come. Moreover, local airlines such as **AirAsia Group Berhad (BUY;TP:RM3.29)** will contribute to the nation's aerospace industry with its long term fleet plan focused on maintaining its lead in ASEAN. Therefore it is crucial for Malaysia to secure more "design and build" work packages and become a "risk sharing partner" with original equipment manufacturers from the early stages of the aircraft's life cycle. We also expect MAHB to be a major beneficiary of a growing aerospace industry given its ample landbanks surrounding KLIA (over 9,000 hectares) and Subang Airport (430 hectares). In the short term, we believe that MAHB will continue to gain from the expected growth in passenger traffic which is expected to surpass the 100m mark for Malaysian operations in FY19.

Figure 10: AirAsia Group Berhad Long Term Fleet Plan



Source: AirAsia Group Berhad

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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.