midf RESEARCH

11 April 2018 | Sector Update

Aviation Sector

***Maintain* POSITIVE**

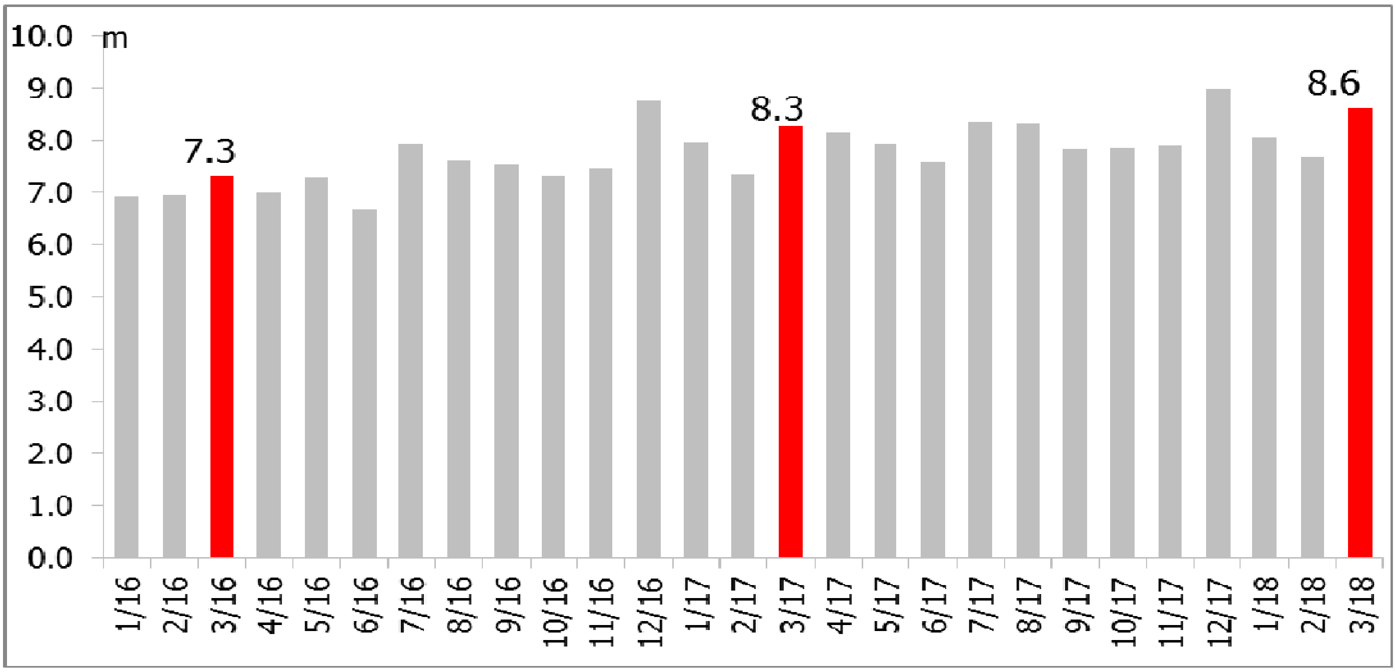
Traffic growth proved to be resilient in 1Q18

INVESTMENT HIGHLIGHTS

- ***MAHB's passengers grew by +6.5%yoy in March 2018***
- ***1Q18 passengers traffic in Malaysia airports charted growth of +3.35%***
- ***International passengers grew +12.4%yoy, an encouraging sign***
- ***Reiterate our POSITIVE view on the sector***

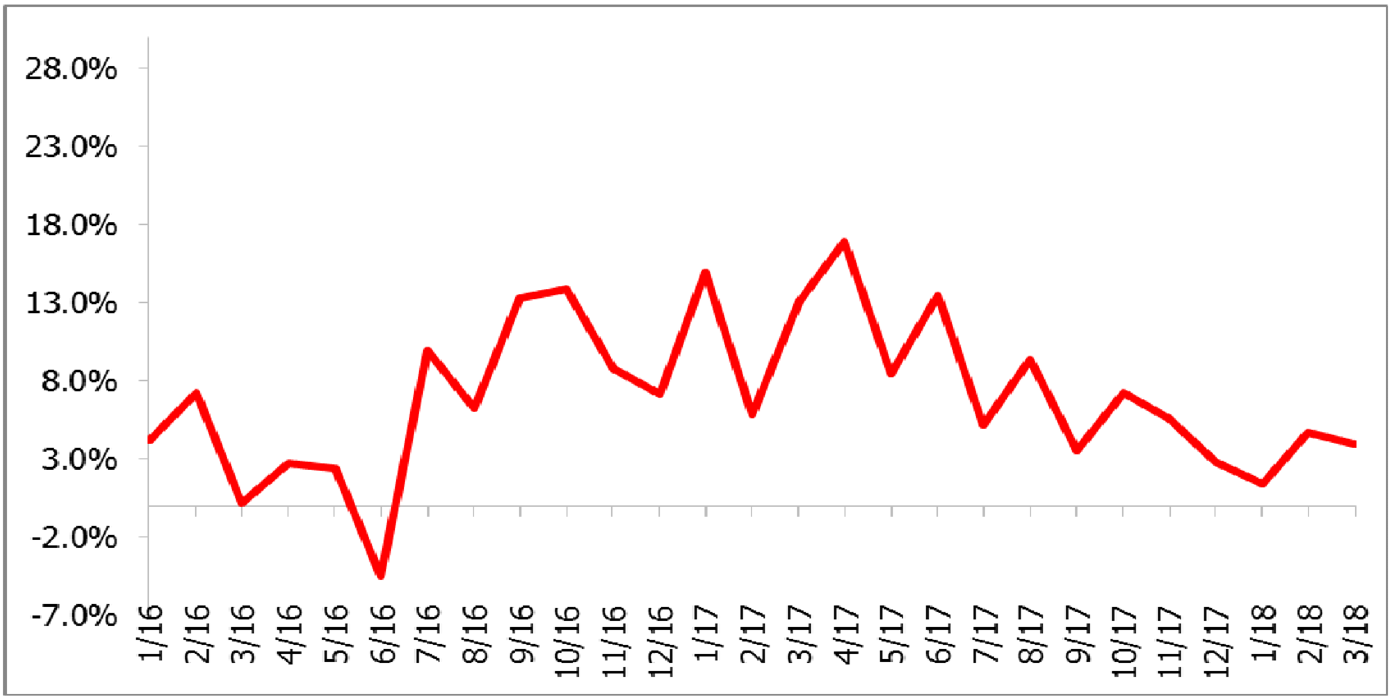
March traffic data showed a +6.45%yoy growth for the month. This is broadly in line with historical March passenger traffic where average traffic growth over the past four years was +6.54%yoy. International passengers continued to drive up the airport traffic, registering +12.4%yoy. Excluding ISG, international passengers' traffic was up by +13.5%yoy. In comparison to last year, growth was higher by +1.1ppts yoy. We believe this was attributable to improving consumer sentiment coupled with the increased in aircrafts movements for the international sector, growing by +9.4%yoy. Meanwhile for domestic sector, passengers' traffic climbed +1.6%yoy which was comparatively lower from last month. As a result, it did not come as a surprise that domestic aircraft movements continued to experience contraction of -2.1%yoy.

Figure 1: Malaysia Airports Monthly Passenger Traffic (million)



Source: MAHB, MIDFR

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



Source: MAHB, MIDFR

A positive sign for the year… For 1Q18, the passenger traffic numbers posted a yearly growth of 6.9%yoy. Overall, international and domestic passengers' traffic recorded growth of +11.8%yoy and +2.7%yoy respectively. The passengers' growth in the international sector coincided with +11.2%yoy increase of international aircraft movements. Meanwhile, domestic sector aircraft movements contracted by -2.4%yoy, driven by domestic capacity withdrawal at airports in Malaysia. However, excluding ISG, 1Q18 passengers' traffic in Malaysia airports grew of +3.4%yoy. Overall, airports in Malaysia began the year on a positive note, recording 1Q18 passengers' traffic of 24.4m. This constitutes 24% of our full year passengers estimates in 2018.

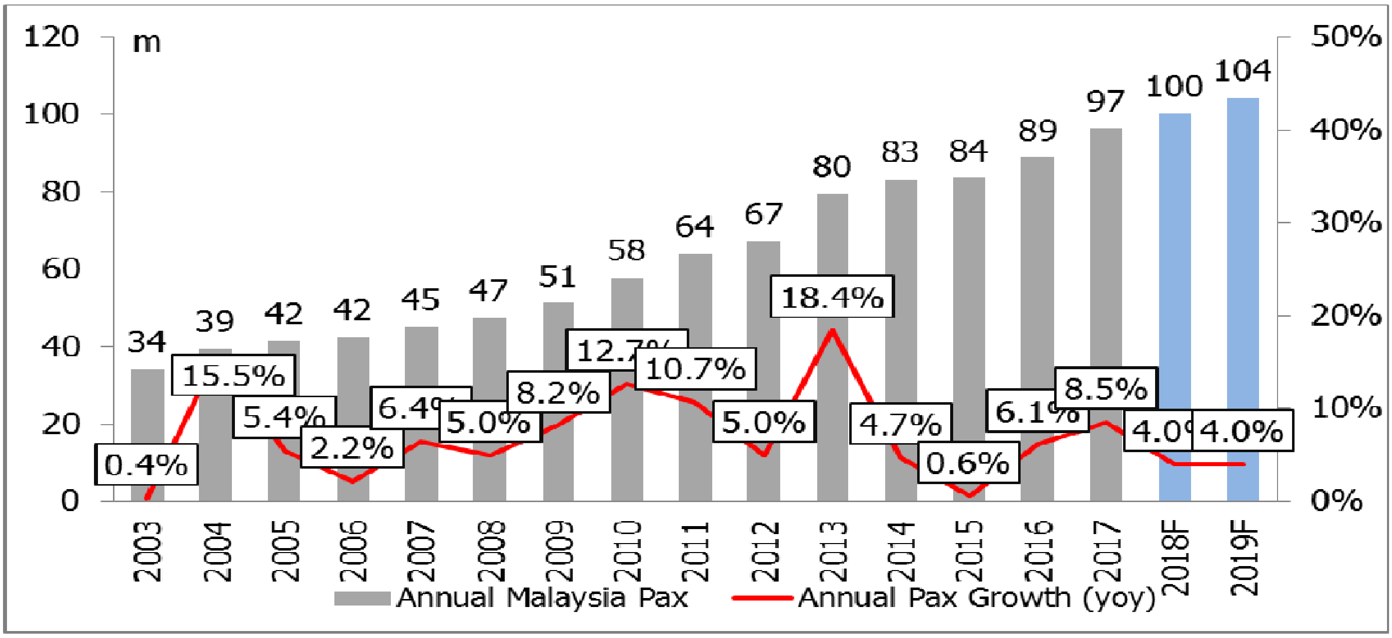
…with more rooms for LCCs. Considering travel demand is expected to continue to grow, we opine any capacity withdrawals should leave more opportunities for LCCs to expand. AirAsia stands to benefit from this gap, given its fleet expansion strategy throughout the next nine years. We expect the withdrawal of major airlines and reduction in frequencies will pave way for AirAsia to capture more market share, especially in the domestic sector. Notably, AirAsia market share is 66% of the domestic traffic at KLIA, showing an improvement of +11.0ppts yoy from last year. Additionally, it is worth to note that monthly growth of domestic traffic in KLIA2 averaged at +12.2%yoy in FY17. For the month of March, domestic passenger traffic grew higher than average at +18.1%yoy. We opine the net addition of +7 more aircrafts into AirAsia's domestic fleet in 2018 is timely, enabling the group to cater for the escalating demand.

Good for AAX. We opine that the +10.7%yoy growth in 1Q18 of KLIA2 international traffic will continue to provide support to AirAsia X, with more routes being introduced in high demand market namely Korea, Japan and China. In addition, the company's frequency addition is expected to further minimize its CASK while at the same time strengthening its ancillary sales in the flights, to improve earnings. We noted that the highest growth in FY17 was in the ancillary segment, at almost +30.0%yoy to RM830.5m.

Coming second quarter, we believe traffic growth to persist due to seasonal factor as well as key event namely the 14th General Election taking place during the period. These happenings are expected to stimulate better domestic traffic in airports under MAHB, which we believe will lead to a rebound in overall domestic traffic growth for airports in Malaysia.

But challenges still linger. While volatility in energy cost is expected, we expect crude oil to trade range bound in the immediate term. It is noteworthy that price of crude oil has averaged at USD58.2/b in the last twelve months. Meanwhile, IATA expect Brent crude price to be around USD60, while jet fuel price to be around USD74 a barrel in CY18. Based on our analysis it is noteworthy that every 1% change in crude oil prices would slash the bottom lines of LCC(s) such as AirAsia by 5%. Although the risk of crude oil price trending higher is inherent, we believe the imposition of fuel surcharge in 2QFY18 is unlikely due to the risk that it might affect consumer sentiment. However, assuming that fuel price reached USD100/b, we opine transferring part of the costs to consumers is likely.

Figure 3: Malaysia Airports Passenger Traffic Forecasts



Source: MAHB, MIDFR

Positive on the sector. We view that the industry in particularly operated by airports and low-cost carriers will sustain its positive earnings momentum based on the encouraging trend of passengers traffic as well as aggressive capacity expansion by the likes of AirAsia and AirAsiaX. Despite the risks of rising fuel prices, we believe both low cost short and medium-long haul business to remain buoyant, underpinned by its continuous improvement in operational cost. Better competitive environment is expected mainly in the domestic segments stemming from capacity withdrawal. Given our optimistic view on the low-cost airlines business, we maintain our **BUY** call for **AirAsia** and **AirAsiaX** with **TP** of **RM4.80** and **RM0.46** respectively. Consequently, MAHB is poised to benefit from these encouraging developments i.e. net addition of aircraft and higher utilization rates by airlines, providing support to aeronautical revenue. Considering overall industry's demand to remain robust in 2QFY18, we continue to like MAHB due to its exclusive exposure to Malaysia travel demand. As such, we recommend investors to accumulate MAHB with a **BUY** call and target price of **RM9.80.**

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

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.