midf RESEARCH

13 March 2018 | Sector Update

Aviation Sector

***Maintain* POSITIVE**

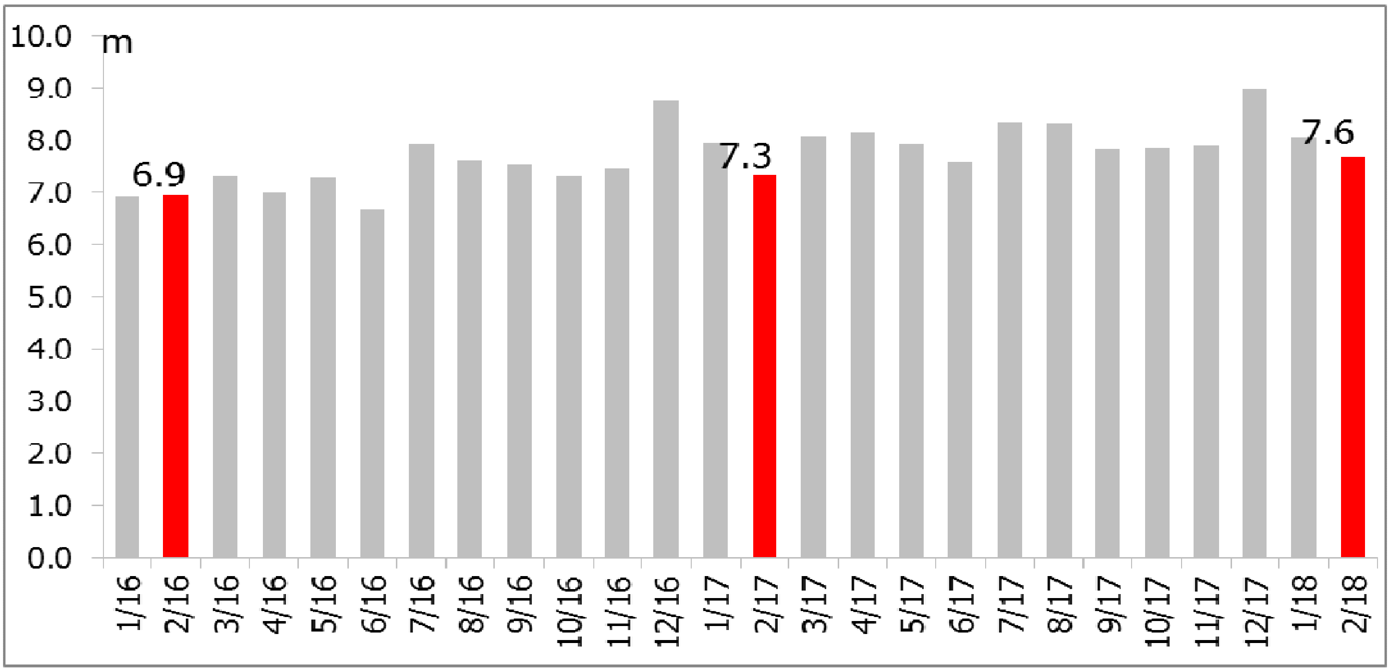
Upbeat domestic demand, a sweet spot for LCCs

INVESTMENT HIGHLIGHTS

- *MAHB's passengers grew by +4.7%yoy in February 2018*
- *International passengers grew +11.5%yoy, a positive trend*
- *Travel demand to stay intact*
- *Low cost airlines to benefit from higher passenger traffic*
- *POSITIVE for the sector*

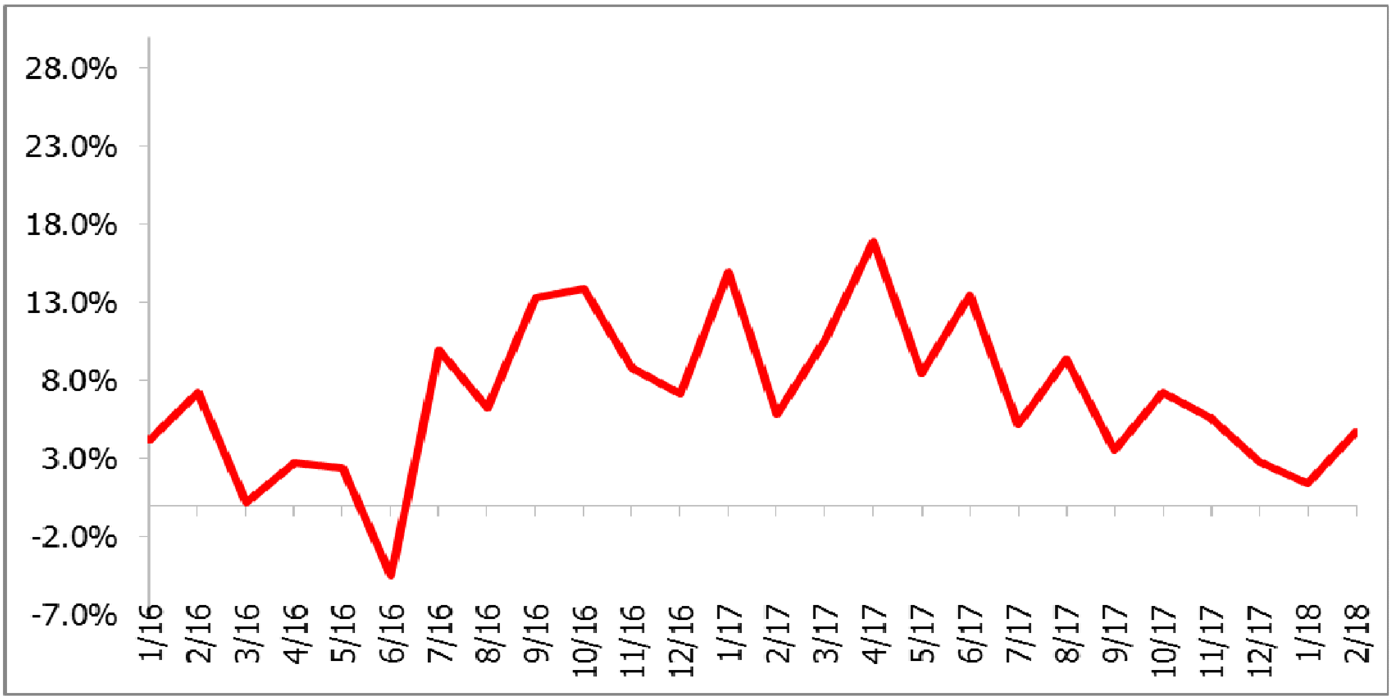
Travel demand to stay intact. We are encouraged to see that passengers' traffic in February came at a total growth (excluding ISG) of +4.7%yoy. As we expected, it was higher than January passengers' traffic growth of +1.5%yoy as Chinese New Year holiday shifted to February this year. Cumulatively, total passenger traffic (MAHB) YTD grew favourably by +3.2%yoy. Subsequent to this positive trend, we expect 2QFY18 passengers' number to climb higher.

Figure 1: Malaysia Airports: Monthly Passenger Traffic (Million)



Source: MAHB, MIDFR

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



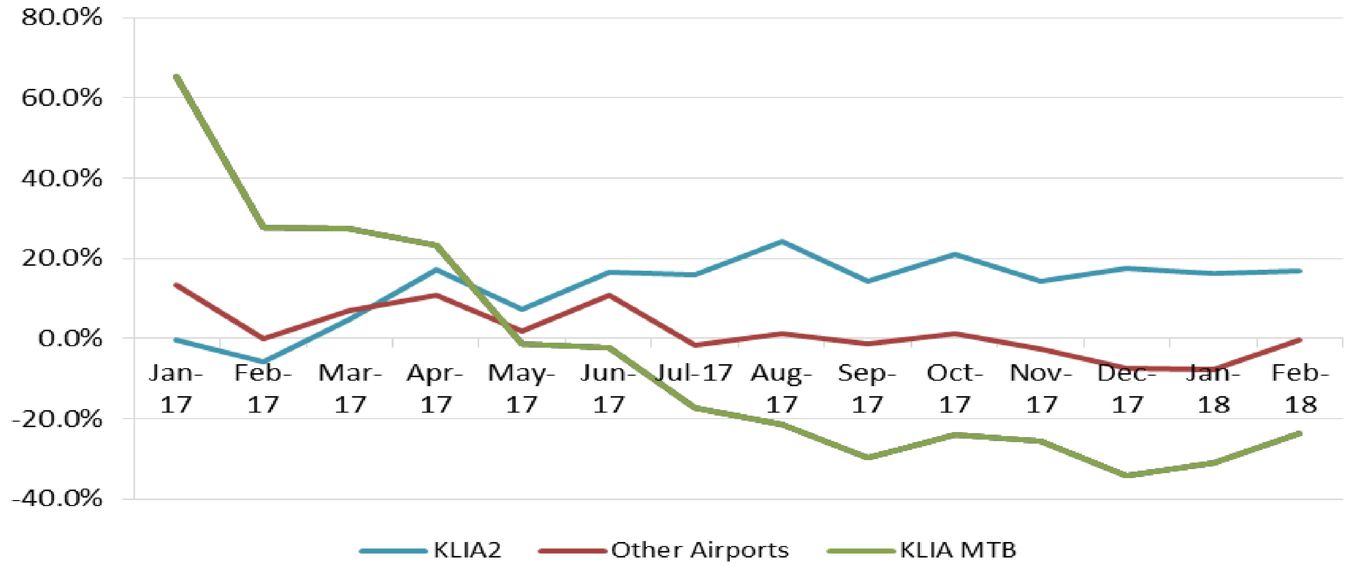
Source: MAHB, MIDFR

Revenue expected to be driven by international passengers. In February, the passenger traffic in airports operated by MAHB continued to show positive trend. We noted that international passengers sustained its growth momentum, with the latest February data showing the overall traffic from the said segment grew by +11.4%yoy. We believe that the growth was good as the traffic was largely driven by higher-value international passengers, which would lend support to aeronautical and non-aeronautical revenue. Notably, Malaysia Airports Holdings Berhad (MAHB) has reported a +15.4%yoy surge in retail revenue to RM853.7m for full year 2017. Higher traffic of international passengers has contributed to stronger spending per passenger at both Kuala Lumpur International Airport (KLIA) and KLIA2.

Crude oil price expected to trade range bound. Our Oil & Gas analyst expect crude oil to trade range bound in the immediate term. It is noteworthy that price of crude oil has averaged at USD56.8/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. While we believe there is present risk of crude oil price trending higher, the imposition of fuel surcharge in 2QFY18 is unlikely due to the risk that it might affect consumer sentiment. Additionally, we are of the view that the risk of higher than expected operational expenses will be mitigated by airlines capacity expansion and higher utilization rate of aircrafts.

Low cost airlines benefiting from higher passenger traffic. In terms of domestic passenger traffic, the overall numbers showed a contraction of -1.3%yoy in February (excluding ISG). However, we noted that the contraction was mostly due to considerable drop of domestic passengers in KLIA MTB. This was due to capacity withdrawals of major airlines, as well as changing pattern of domestic travel which favours low-cost domestic flights. Accordingly, KLIA2 displayed a contrarian trend of domestic traffic showing growth of +16.9%yoy in February. Recall that monthly growth of domestic traffic in KLIA2 averaged at +12.2%yoy in FY17. Considering AirAsia's share of the domestic traffic at KLIA is now 66%, compared to 55% a year ago, the positive trend of domestic traffic will leave AirAsia to benefit in 2QFY18. We recall that AirAsia also represents a large percentage of capacity usage in KLIA2. While overcapacity could be a concern, we believe that it is easier for an LCC to prevail in any capacity battle due to Malaysia's domestic market that is generally price sensitive.

Figure 3: Malaysia Airports: Domestic Passenger Traffic (Growth %YOY)

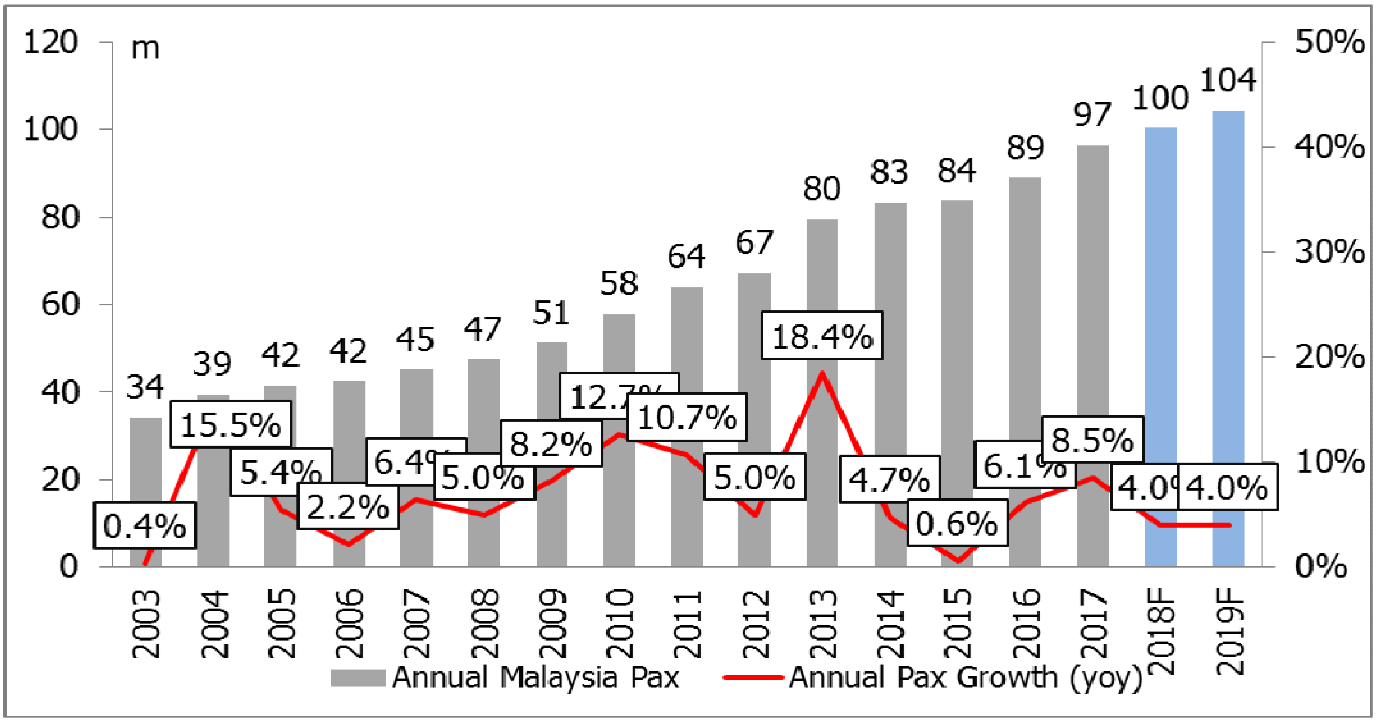


Source: MAHB, MIDFR

Looking at 2QFY18, we are expecting passenger numbers to climb further on the premise of robust travel demand, due to worldwide summer holiday season which starts between late-May and mid-June. Also, it is noteworthy that major local public holiday of Aidilfitri is expected to fall in 2QFY18, boosting demand for domestic travel. In terms of capacity, we believe MAHB, a proxy of Malaysia's travel industry, has sufficient capacity to cater the growing passengers' traffic in the local airports. This will be supported by MAHB's various efforts lined up to improve its daily airport operational efficiencies including baggage flow, immigration queuing time and public amenities, which is expected to improve the "feel good factor" of overall airport experience.

Positive on the sector. We view that the industry particularly operated by airports and low-cost carriers will sustain its positive momentum in 2QFY18 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 and the presence of major public holidays. Considering passengers were generally less sensitive to ticket price during holiday season, this will lead to stable yield. In addition, AirAsia is planning to add another ~30 aircrafts to its fleet this year which will lend further support to the growing numbers of inbound and outbound passengers. 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 as a proxy to Malaysia's resilient inbound/outbound travel industry being the largest airport operator in Malaysia. As such, we recommend investors to accumulate **MAHB** with a **BUY** call and target price of **RM9.80.**

Figure 4: Malaysia Airports: Annual Passenger Traffic (Growth %YOY)



Source: MAHB, MIDFR

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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 *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.