

# AVIATION

**Maintain NEUTRAL**

**Zoom out to appreciate the long term potential**

## KEY INVESTMENT HIGHLIGHTS

- **MAHB's passenger traffic for Malaysian operations declined by -27.6%yoy to 18.4m in 1QCY20**
- **Decline in the international sector growth of -32.4%yoy for MAHB's Malaysian operations outpaced the domestic sector during 1QCY20**
- **Huge capacity cuts by AAGB (Trading SELL; TP:RM0.54) and AAX (Trading SELL; TP:RM0.03) dragged overall passenger growth at klia2 by -31.7%yoy**
- **The flight resumption patterns established in China may offer some guidance to the rest of the world, just as China's strict containment measures have also provided cues to efforts elsewhere**
- **Maintain NEUTRAL on the aviation sector with MAHB (BUY;TP:RM5.13) as our top pick**

### MAHB passenger traffic declined by -27.6%yoy in 1QCY20.

March 2020 traffic data for MAHB's Malaysian operations declined by a whopping -63.6%yoy to 3.2m passengers, a level not seen since 2009. This brings the 1QCY20 passenger traffic numbers to 18.4m, representing a -27.6%yoy growth. Such growth momentum was already expected as the Covid-19 outbreak caused airlines to announce temporary flight suspensions. Moreover the implementation of the movement control order (MCO) in Malaysia which began from 18 March 2020 has prohibited citizens from leaving the country while non-citizens are allowed to leave, giving more ground for airlines to further cancel routes.

**Domestic airlines impacted.** Domestic traffic at Malaysian airports recorded a -22.4%yoy drop in 1QCY20. Flight operations of domestic sectors will continue subject to conditions and travel restrictions set by the Government of Malaysia from time to time during the MCO. Nevertheless, we opine that permission to board flights during the MCO will be given to passengers with valid reasons. As such, there is no incentive for airlines to actively operate within this period. For instance, Malaysia Airlines Berhad (MAB) has halted all interstate operations in Peninsular Malaysia (which connects Kuala Lumpur to Kuala Terengganu, Kota Bharu, Penang, Kuantan, Johor, Alor Setar and Langkawi) for the first time due to poor passenger load factor. Nevertheless, its sister company, Firefly will maintain its operations in Peninsular Malaysia albeit at a very low frequency.

**International passenger growth contraction exceeded domestic passenger growth.** Although decline in the international sector growth of -32.4%yoy for MAHB's Malaysian operations outpaced the domestic sector's drop during 1QCY20, international passenger movements continued to retain more than 50% of the passenger mix. Other airports (which exclude KLIA Main Terminal and klia2) recorded the largest decline in international passenger growth during the quarter of -40.9% partially due to the non-ASEAN flights. Recall that under MAHB's hub and spoke model aims to bring global traffic to smaller airports and vice versa. Airports under this strategy include Langkawi International Airport accommodates flights of TUI Airways from Birmingham and Qatar Airways from Doha.

### COMPANY IN FOCUS

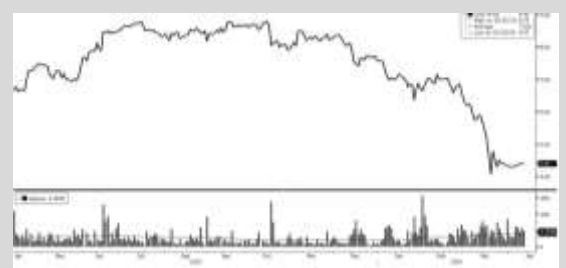
#### Malaysia Airports Holding Berhad

Maintain **BUY** | Revised Target price: RM5.13

Price @ 10<sup>th</sup> April 2020: RM4.40

- China's aviation industry has seen a resumption in domestic flights, offering hopes of recovery for others
- Expecting a strong rebound in FY21 assuming that the Covid-19 pandemic has subsided by then
- Currently trading at a PE ratio of 15.2x (compared to the five-year average PE ratio of 63.9x)

#### Share price chart



#### AirAsia Group Berhad

Maintain **Trading SELL** | Unchanged Target price:

RM0.54

Price @ 10<sup>th</sup> April 2020: RM0.73

- Temporary suspension of all flights by MAA from 28 March to 21 April 2020
- Other businesses such as Teleport will be impacted due to constraint in belly space capacity
- Only assistance announced by the Government for airlines is the rebate for landing and parking fees

#### Share price chart



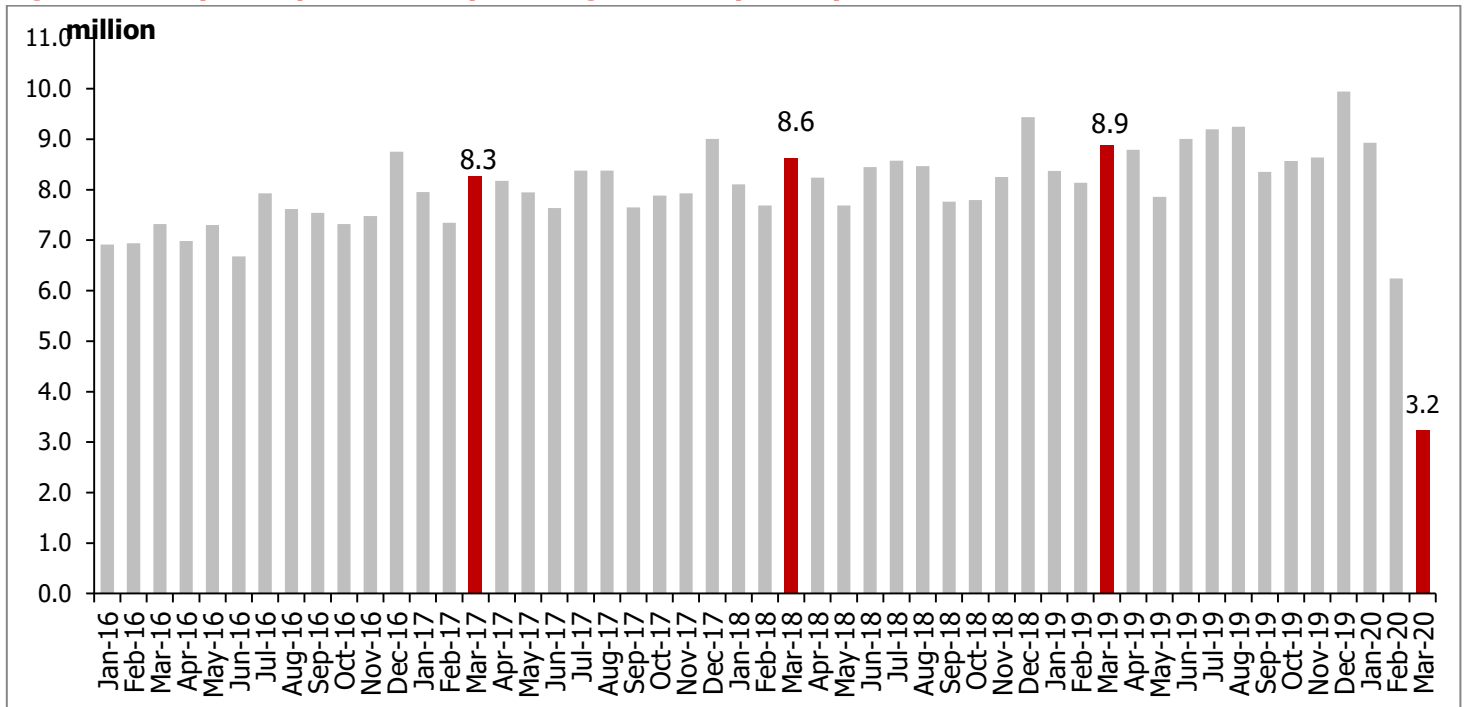
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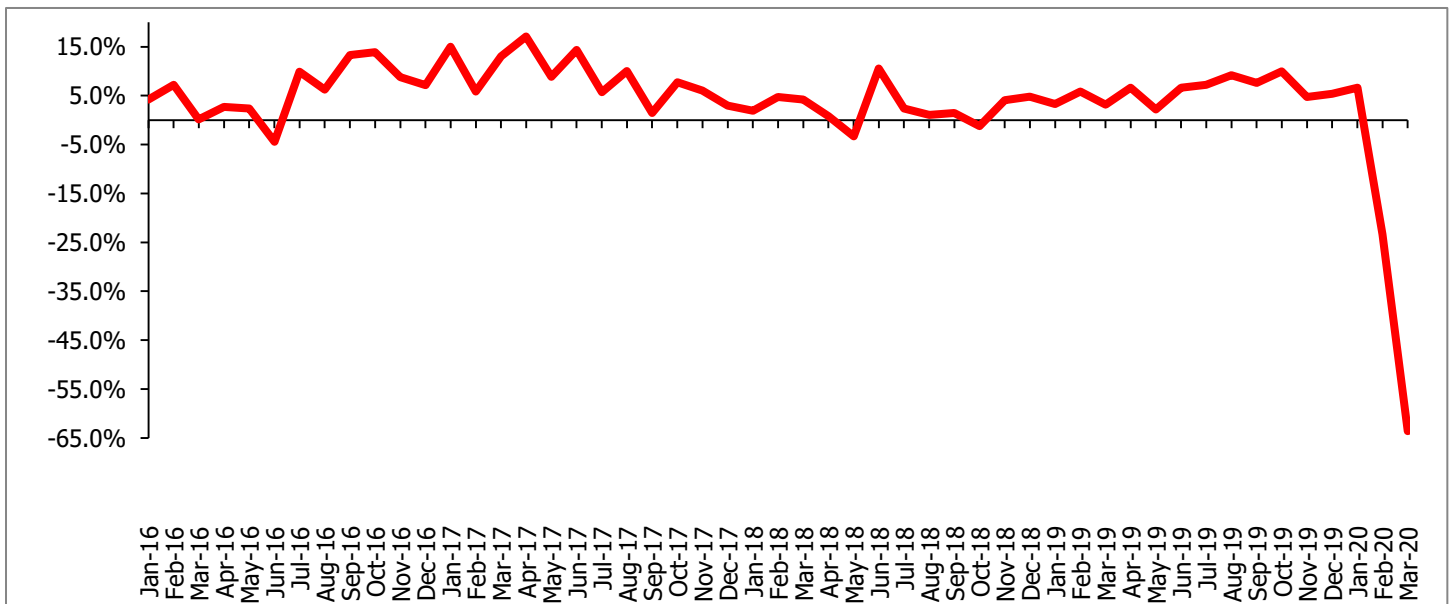
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**Figure 1: Malaysia Airports Monthly Passenger Traffic (million)**



Source: MAHB, MIDFR

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



Source: MAHB, MIDFR

**Klia2 recorded passenger growth of -31.7%yoy in 1QCY20.** Klia2 saw a -31.7%yoy passenger contraction, recording a decrease of 2.6 million passengers in 1QCY20. The magnitude of declines for the international and domestic sector at klia2 did not differ much, declining -32.8%yoy and -29.4%yoy respectively. Due to the Covid-19 pandemic, AirAsia Group Berhad (AAGB) has temporarily suspended all international and domestic flights operated under AirAsia Malaysia (MAA) from 28 March to 21 April 2020 while AirAsia X Berhad (AAX) has decided to temporarily hibernate most of its aircraft at its hub in Kuala Lumpur from 28 March to 31 May 2020. MAA and other airlines under AAGB such as Thai AirAsia (TAA) have already shown reduction in the number of flights by -2.3%yoy and -10.4%yoy respectively in the month of February 2020 even before the MCO was implemented. Therefore, April is set to be another round of larger declines in overall passenger growth at klia2 with the MCO only ending on 28 April 2020.

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

Airport	1QCY19	1QCY20
KLIA Main Terminal	+0.1	-1.9
Klia2	+0.1	-2.6
MASB	+0.8	-2.6
Total absolute change in annual passenger traffic	+1.0	-7.1

Source: MAHB

**Table 2: No. of monthly flights in February 2020**

Airlines	Feb-19	Feb-20	%yoy change
MAA	17,289	16,889	-2.3%
TAA	11,122	9,962	-10.4%

Source: OAG Flight Schedule Analyser

**Domino effect on AAGB's other businesses.** As a consequence from AAGB's grounded fleet, 2QFY20 earnings will take a larger hit than what was expected previously due to the aforementioned flight suspension. In addition, other businesses such as AAGB's logistics arm, Teleport will also be impacted due to the constraint in the belly space capacity. Nevertheless, Teleport will still be utilizing some passenger aircraft to transport special cargo such as medical aid and protective equipment to selected destinations without making any configurations. We also do not discount the possibility that Teleport will leverage on the direct interline agreement with Lufthansa Cargo as the German airline has started operating passenger aircraft for cargo transport. AirAsia.com will also bear the brunt as the online travel platform offers products such as holiday packages insurance and flights from other airlines. Based on our preliminary analysis, we expect overall revenue of both Teleport and AirAsia.com to drop below RM400m and RM20m in FY20, respectively due to the temporary suspension and reduction of flights by AAGB and its related airlines.

**Financial assistance for airlines.** Thus far, the only assistance announced by the government of Malaysia is the rebate for landing and parking fees by Malaysia Airports Holdings Berhad. With MAA's fleet grounded at airports in Malaysia, parking fees is what AAGB will have to bear the most. However, we opine that the decline in travel demand will largely outweigh the benefit of the landing and parking fees rebate. Meanwhile, Bloomberg quoted that officials have been evaluating recommendations which include setting up a vehicle to take over the debt of local carriers in Malaysia including AAGB. Mergers between local carriers have also been brought forward. Breaking down AAGB's debt as at 31 December 2019, pure borrowings of AAGB are manageable at less than RM428m while the lease liabilities are at RM12.0b as majority of their fleet are leased. Thus far, we understand that AAGB will be delaying the delivery of six A321neos and six A320neos in FY20 in lieu of renewing its lease contracts at possibly cheaper lease rates for aircraft that are expiring this year. Notwithstanding this, we still believe that some form of financial assistance from the government is needed to ease the financial burden of AAGB especially with Visit Malaysia Year 2020 cancelled. It is crucial to keep airlines afloat in light of the pandemic with hopes that Malaysian aviation sector will emerge stronger once the situation recovers.

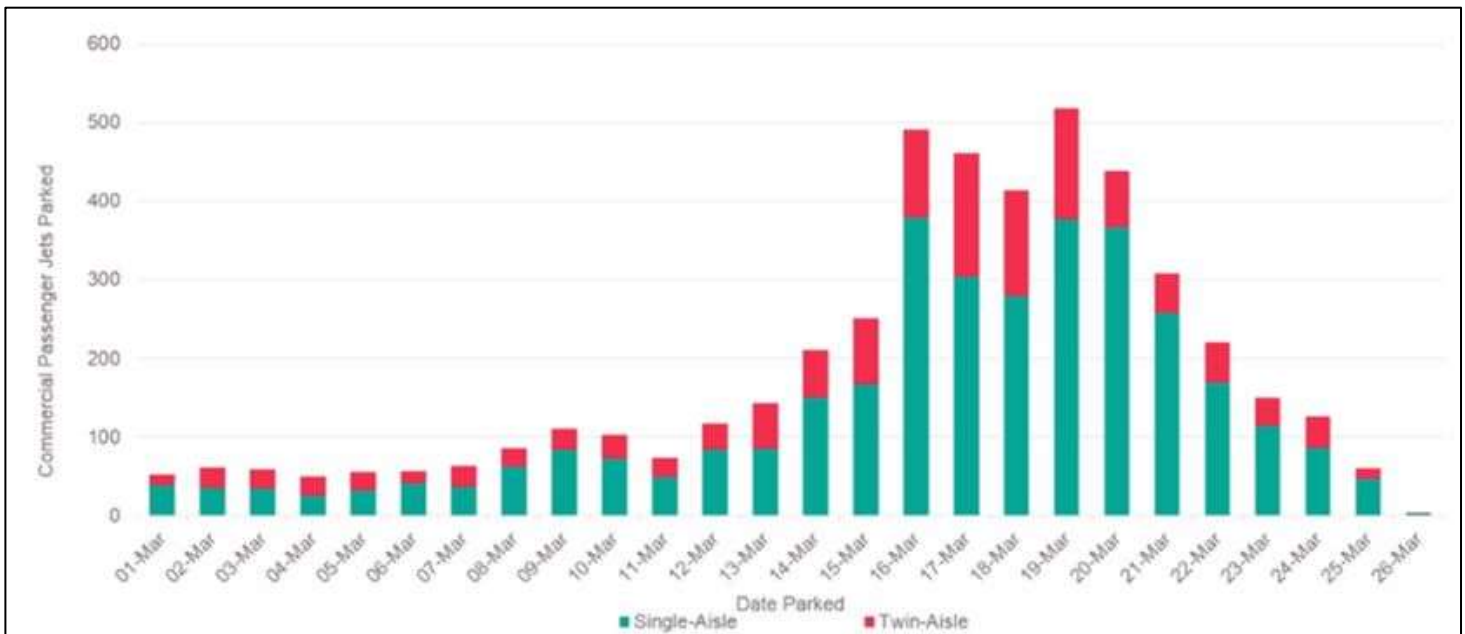
**Table 3: Comparison of Airlines' Cash Buffers and Leverage**

Airlines	Cash & Equivalents (USD'm)	Estimated Cash Buffer Duration (months)	Net Debt/ Equity (%)
China Southern	167	<1	203
China Eastern	217	<1	192
Asiana Airlines	168	1	793
Air China	1,155	1-3	117
All-Nippon Airways	1,168	2-3	39
Air Asia X	75	2-4	2,683
AirAsia Group	633	5-10	354
IndiGo	1,362	9-13	18
Cathay Pacific	1,908	5-8	131

Source: Company Filings, Bloomberg Intelligence

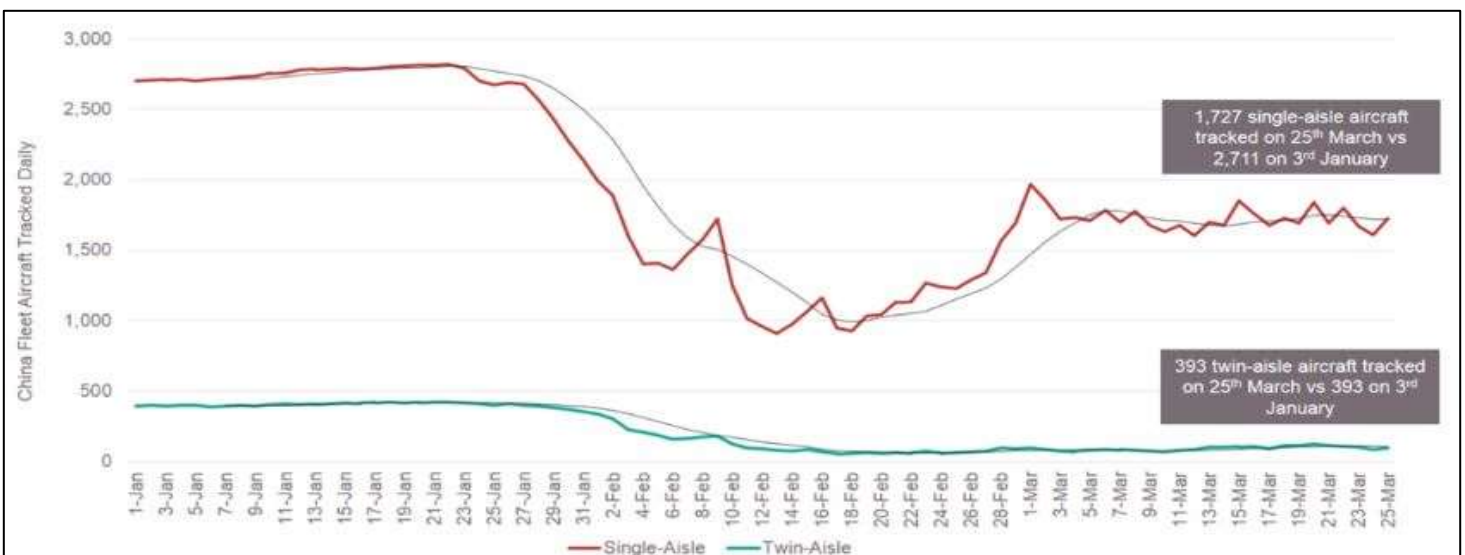
**Light at the end of the tunnel?** It is no doubt that 2020 will be one of the worst years for the aviation industry due to the Covid-19 pandemic. Globally, the number of scheduled flights is now down by -59.0%yoy while seat capacity has fallen from 109.0m to just 39.0m as of 6 April 2020 with almost 4,700 commercial jets parked since the start of March 2020. Notwithstanding this, there has been positive indicators coming from the first casualty of the Covid-19 outbreak, China. For example, China’s domestic flights rose by about a fifth in March 2020 from the previous month but that was still less than half the flights before the shutdowns due to the coronavirus, showing the sector is recovering gradually. Figure 4 illustrates that single-aisle aircraft in China (usually operated for domestic flights) have rebounded from their lows in mid-February 2020. Although this just may be applicable for domestic flights, the resumption of air services in China especially in Hubei provide hope for the rest of the world that this current crisis is manageable. It’s been just over two months since the downturn in air traffic in China, as the grip of the virus took hold. In comparison, countries such as the U.K and even Malaysia is just two to four weeks into the significant suspension of flight services.

**Figure 3: Number of commercial jets parked since the start of March 2020**




Source: Cirium Fleets Analyzer

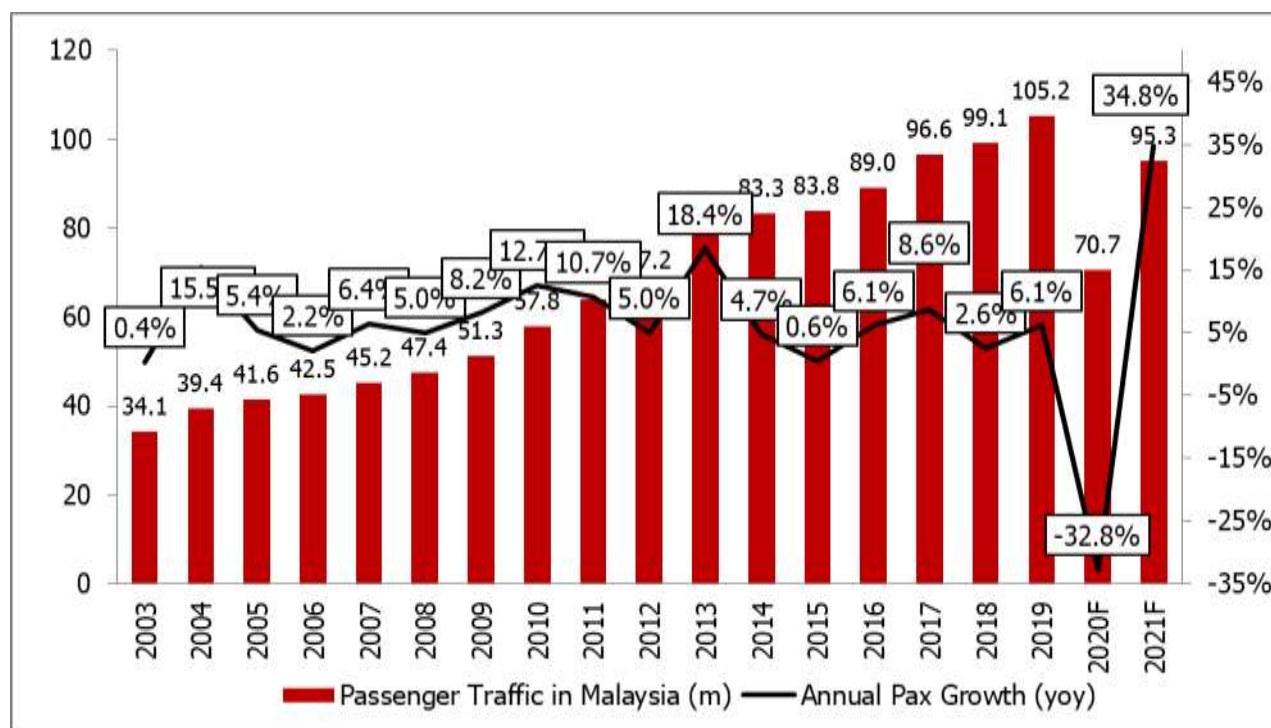
**Figure 4: China fleet aircraft tracked daily**



Source: Cirium Fleets Analyzer

**Maintain NEUTRAL on the sector.** While the movement control order (MCO) will adversely impact international passenger traffic, we believe that such sacrifice is of utmost importance in containing the Covid-19 pandemic. As such, we continue to reaffirm our view that the passenger traffic will see a nascent recovery in 2HCY20 provided that the Covid-19 pandemic subsides. Our basis for the upside in 2HCY20 comes after airlines in China such as Air China has filed domestic schedules for the week-long May holidays that offer similar capacity to 2019 levels, a remarkable sign of planned domestic aviation recovery. The flight resumption patterns established in China may offer some guidance to the rest of the world, just as China's strict containment measures have also provided cues to efforts elsewhere. Henceforth, **MAHB (BUY; TP:RM5.13)** remains as our top pick for the aviation sector as we believe that Malaysia's containment efforts will likely flatten the rate of infection, enabling MAHB's passenger traffic Malaysia to hit the 70.7m mark in 2020 before recovering in 2021. Meanwhile, we maintain our **Trading SELL** call on both **AAGB** and **AAX** as we believe the compiling headwinds will remain a sentiment drag. 

**Figure 5: Malaysia Airports Passenger Traffic Forecast**



Source:  
Company MIDFR

## PEER

### COMPARISON TABLE

Stock	FYE	Recommendation	Price @ 9-Mar-20	Target Price (RM)	EPS (sen)		PER (x)		Net DPS (sen)		Net Divd Yield (%)	
					FY20E	FY21F	FY20E	FY21F	FY20E	FY21F	FY20E	FY21F
MAHB	Dec	BUY	4.40	5.13	14.8	29.4	29.8	15.0	0.0	14.0	0.0	3.2
AAGB	Dec	Trading SELL	0.73	0.54	-15.4	6.8	-4.7	10.7	0.0	2.0	0.0	2.0
AAX	Dec	Trading SELL	0.07	0.03	-5.9	-2.4	-0.9	-2.3	0.0	0.0	0.0	0.0

Source: Company MIDFR

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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

<b>BUY</b>	Total return is expected to be >10% over the next 12 months.
<b>TRADING BUY</b>	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.
<b>NEUTRAL</b>	Total return is expected to be between -10% and +10% over the next 12 months.
<b>SELL</b>	Total return is expected to be <10% over the next 12 months.
<b>TRADING SELL</b>	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

<b>POSITIVE</b>	The sector is expected to outperform the overall market over the next 12 months.
<b>NEUTRAL</b>	The sector is to perform in line with the overall market over the next 12 months.
<b>NEGATIVE</b>	The sector is expected to underperform the overall market over the next 12 months.