

26 September 2014 | Sector Update

Aviation Sector

Maintain NEUTRAL

Capacity rationalization may pave the way towards yield recovery

INVESTMENT HIGHLIGHTS

- **Weaker Jul-Aug 2014 total airport passenger traffic amid the slowdown in the capacity growth of domestic carriers as well as the fallouts of MH17 incident.**
- **Lower jet fuel bodes well for the bottomline of airline operators.**
- **We have BUY calls on AirAsia and AirAsia X while are NEUTRAL on MAHB and MAS.**
- **We expect more rational competition among the airlines going forward hence may help fare yield to recover.**
- **Maintain NEUTRAL stance on the aviation sector.**

Airport traffic dropped in Jul-Aug 2014. Year-to-date, the accumulated MAHB's total airports passenger traffic registered a growth of 7.9%yoy. Nevertheless, amid the fallouts of MH17 and MH340 earlier, the Jul-Aug 2014 total traffic of KLIA's international passenger traffic dropped -7.5%yoy. In spite of the strong passenger growth in 1H14, we now expect the full year 2014 passenger traffic growth would likely fall short of the prior management's guidance of 7%yoy. Instead, the actual growth figure may be closer to our current estimate of 5.7%yoy. The potential capacity cut by MAS and slower capacity growth by AirAsia may weigh down on MAHB's traffic growth prospect for 4Q14.

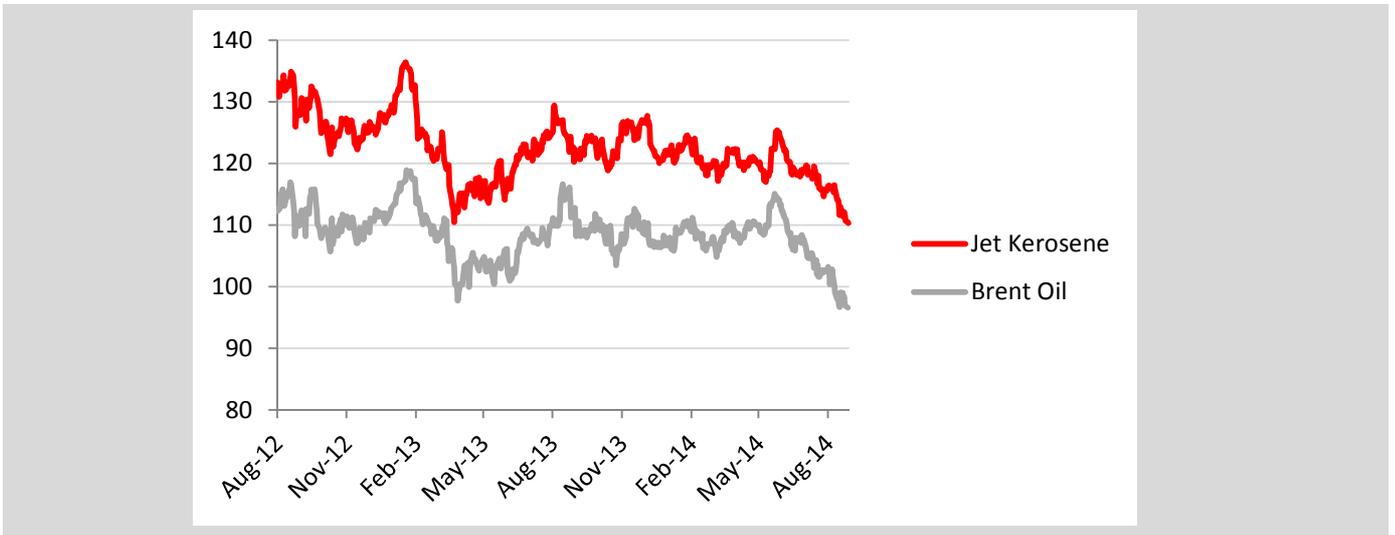
Jet fuel bill may ease on lower average price. As of 25 September 2014, Singapore jet kerosene spot price was down by -10.4%yoy at USD109.62/b (Figure 1). Industry report suggested that the slump in crude oil price was attributable to mixed factors notably the ampleness of US shale oil supply and the weaker growth prospect for China economy. Most of global airlines have reduced their fuel hedging exposures in reaction to the falling price and waning volatility in crude oil market. As the peak travelling season in final quarter looms, we expect the domestic carriers would benefit from lower fuel expenditure should the trend of lower fuel price continues.

MAS restructuring should lead to industry-wide yield revival. Khazanah unveiled its 12-points plans to revamp MAS operation in late August 2014. Under the new restructuring plan, MAS would trim its staff force by 30% and re-negotiate all the existing supply contracts with its vendors. Capacity rationalisation is also on the cards. MAS may cut 10-15% of its routes possibly by the end of FY14. As such, we view that the capacity cutback may help trigger industry-wide yield recovery after the excessive capacity expansion in 2013.

Indonesia agreed to open up Jakarta for ASEAN open sky. After almost 5 years of delay, Indonesia finally inked the ASEAN Multilateral Agreement on Air Services (MAAS) to liberalise the aviation market for Jakarta. Under the agreement, ASEAN airlines are now allowed to fly without capacity and pricing restrictions to Jakarta. We opine that this would allow for higher traffic growth and cheaper fare among the ASEAN capital cities. Manila has yet to join the air liberalisation agreement but we are confident that it will follow suit before the deadline of December 2015. Overall, we view this latest development to deliver net neutral impact on AirAsia as its Indonesian associate is already operating in the city for years. Next year, it was reported that another four Indonesian cities shall set to liberalise their aviation market, namely Medan, Surabaya, Denpasar and Makassar. This would be the game-changer for the regional airlines as it allows for the opening up of new routes hence higher air traffic growth.

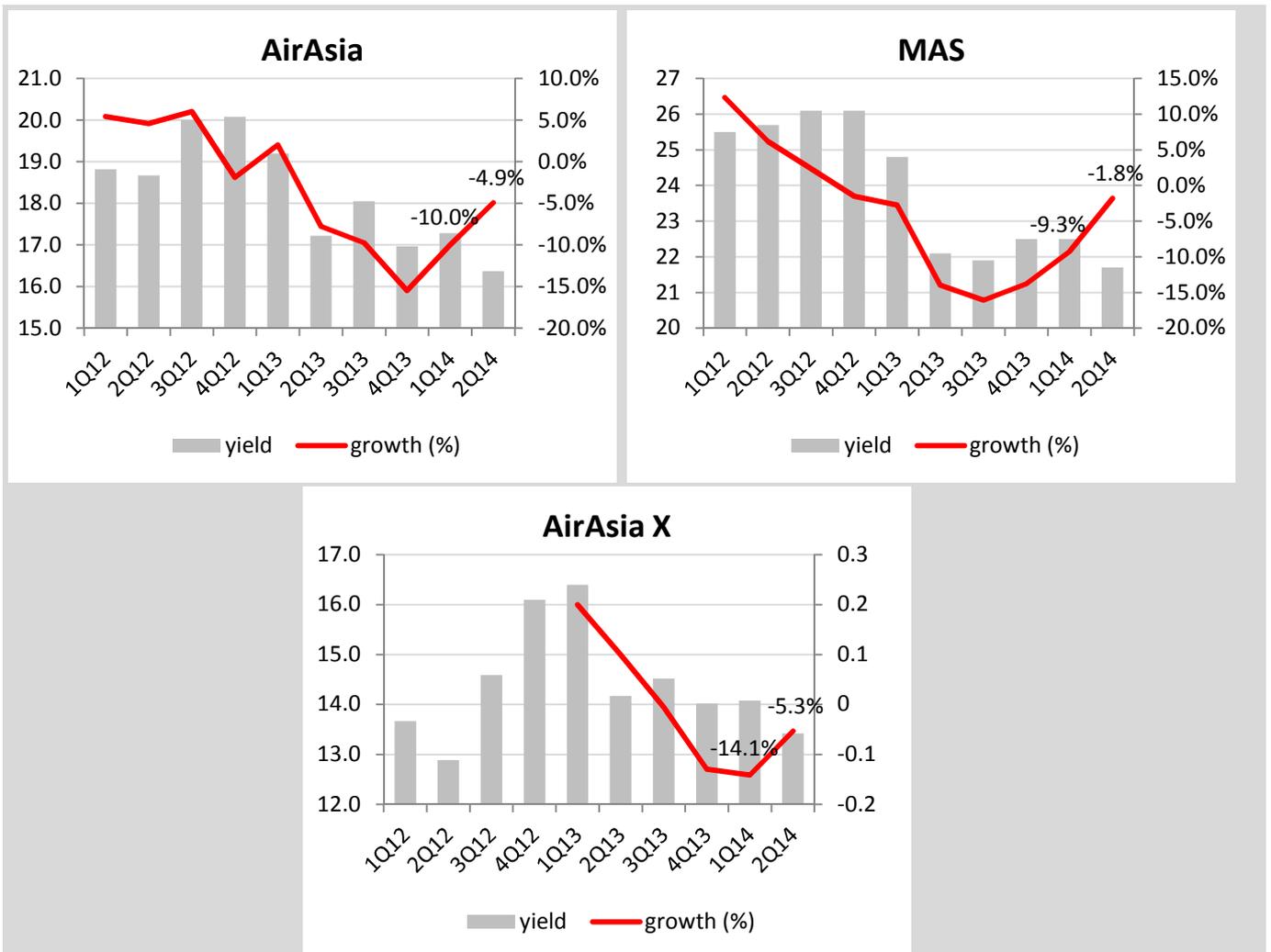
Maintain NEUTRAL stance on aviation sector. After the excessive capacity expansion since mid-FY13, we believe that the fare yield is set to recover in 4Q14. Moreover, airlines would also benefit from lower fuel bills in view of the easing jet kerosene price. We reiterate **NEUTRAL** stance on aviation sector. Our top pick is **AirAsia (BUY, TP: RM2.94)** due to its undemanding FY15-PER of 8.5x against its 5-year historical average of 11.3x. Furthermore, we have a **BUY** call on **AirAsia X (RM0.96)**, as well as **NEUTRAL** on both **MAS (RM0.27)** and **MAHB (RM8.04)**. 

Figure 1: Jet Kerosene price (USD/b) vs Brent Crude Oil price (USD/b)



Source: Bloomberg, MIDFR

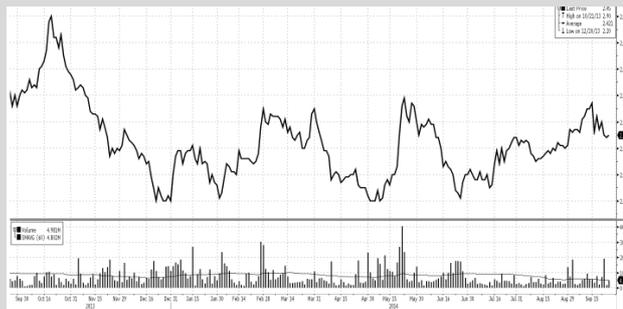
Figure 2: Yield trend, Rev/RPK (sen)



Source: Companies, MIDFR

DAILY PRICE CHART

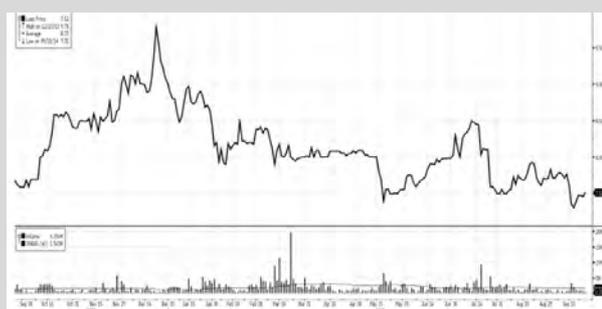
AirAsia



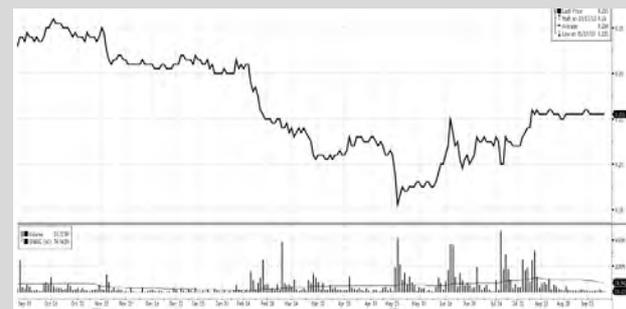
AirAsia X



MAHB



MAS



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	<i>Negative</i> total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.