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Aviation Sector (Airlines)

Maintain POSITIVE

Malaysian Aviation Commission Bill 2015 Passed

INVESTMENT HIGHLIGHTS

- The Parliament yesterday passed a bill for the setting up of the Malaysian Aviation Commission.
- Among others, the new Commission will have oversight of the economic aspects of the aviation industry.
- We are positive on the new Commission as it would help ensure that the industry remains sustainable, profitable and efficient.
- Maintain POSITIVE on the aviation sector with a BUY call on AAX and AirAsia while we are NEUTRAL on MAHB.

Malaysian Aviation Commission Bill 2015

Setting up of a new aviation commission. The Parliament of Malaysia passed a new bill, the 'Malaysian Aviation Commission Bill 2015', which paves the way for the setting up of a new commission known as the Malaysian Aviation Commission ("MAC").

Our View. While there are 2 existing main bodies overseeing the aviation industry, the Ministry of Transportation ("MOT") and the Department of Civil Aviation ("DCA"), we believe the addition of MAC would provide a more structured path to boost the growth of the aviation industry (Table 1). The newly-established MAC focuses on the economic aspects of the aviation industry, different from the DCA's role which covers air traffic management, airworthiness, flight operations, aviation security, etc. On the other hand, the MOT focuses on ensuring all rules in air transport/aviation are in accordance with the International Civil Aviation Organisation ("ICAO") and implementing infrastructural projects to meet the demands of air transport.

New avenue for application and renewal of licensing. The MAC will take over from the MOT (via the DCA) for the issuance and renewal of air service licenses (scheduled services) and permits (non-scheduled services). In addition, MAC will also be responsible to administer, allocate and manage air traffic rights and slot allocations. These approvals can be suspended or revoked by MAC should non-compliance be found.

Our View. We believe the MAC would better position Malaysia to take advantage of the implementation of the ASEAN Open Sky policy under the AEC. Furthermore, on the back of a tragic year for the Malaysian aviation industry, we believe the commission could also improve consumer confidence towards the aviation sector.

Healthier competition will benefit all players. The new bill entails several clauses aimed at promoting healthy competition among airlines such as: i) Preventing agreements between enterprises which restrict or distort competition (collusion); ii) abuse of a dominant position by an enterprise (anti-monopoly) ; iii) mergers that diminish competition (antitrust); iv) reviewing the aviation service market for actions which prevents, restricts or distorts competition. One of the main objectives of the MAC is to encourage effective competition which allows Malaysian carriers to maintain their ability to compete effectively in a sustainable, profitable, efficient and fair manner.

Our View. While we believe that the likelihood of M&A or collusive activity is slim, MAC could regulate air fares or excessive capacity expansion to prevent instances of fare dumping, price wars and overcapacity issues as seen in recent years. This would bode well for airline players in the form of higher yields and better load factors.

Proper channel for consumers to lodge complaints. Complaints pertaining to any aviation service may be lodged by a consumer to MAC which may establish a committee to hear and determine an appropriate compensation.

Our View. We are positive that the protection of consumer rights is highlighted. The move would help keep airlines on their toes with regards to issues such as flight delays, cancellations and poor services. This would not only help in boosting consumer sentiment but also the competitiveness of airlines.

Aviation players consulted in setting up the commission. We are positive of the fact that AirAsia, along with other Malaysian aviation players were invited by the Government to share their thoughts and opinions on the commission on matters such as jurisdiction, the members of the commission, etc. The AirAsia Group’s management were very supportive of the setting up of the commission as it would help to ensure transparency and a level playing field among industry players.

Avoiding aviation woes experienced by neighbouring countries. Overall, we are positive on the setting up of the MAC as it increases the aviation industry standards and would help reduce the probability of incidences such as travel bans imposed by foreign countries which would be disruptive for the entire industry. However, enforcing the measures in the bill would be the key to its success.

We remain POSITIVE on the aviation sector. After an underwhelming year in 2014, we expect a less hostile operating environment in 2015. Despite the potentially softer travel demand arising from inflationary pressures, we believe the reprieve in lower fuel costs could provide an earnings kicker as well as other measures taken to mitigate the impact such as profit maximization (higher base fares, ancillary yield and focusing fleet deliveries on associates) and cost rationalisation (decreasing cabin crew, route rationalization and increasing efficiencies). Within our coverage, we have BUY calls on AirAsia (TP: RM3.70) and AAX (ex-rights TP: RM0.49) while we are NEUTRAL on MAHB (TP: RM7.53).

Table 1: Functions of Establishments with Purview over the Aviation Sector

| Governing Body | Ministry of Transport (“MOT”) | Department of Civil Aviation (“DCA”) | Malaysian Aviation Commission (“MAC”) |
|------------------|--|--|--|
| Functions | <ul style="list-style-type: none"> • To plan and review the policies relating to air services from time to time. • To expand the international air services network through air negotiations. • To ensure the planning, building and maintenance of airport infrastructure in accordance with the specified standards. • To ensure that all existing rules and regulations in air transport / aviation are in accordance with the guidelines stipulated by the International Civil Aviation Organisation (“ICAO”). | <ul style="list-style-type: none"> • To promote enhancement to organizational and system capacity. • Strengthen the regulatory framework for civil aviation governance. • Assertion of world class safety for aviation operations. • Assurance for security in the aviation environment. • Encourage and uphold sustainability of the aviation industry. • DCA has overview over air traffic management, airworthiness, flight operations, management services, air traffic inspectorate, aviation security, airport standard, air transport and the Malaysian Aviation Academy. | <ul style="list-style-type: none"> • To regulate economic matters relating to the civil aviation industry. • To provide a mechanism for the protection of consumers. • To provide a mechanism for dispute resolution between the provider of aviation services. • To administer, allocate and manage air traffic rights. • To monitor slot allocation for airlines or other aircraft operators. • To administer and manage public service obligations. • To facilitate and coordinate matters of interest to the Malaysian civil aviation industry between the providers of aviation services and government agencies, locally and internationally. • To perform other function that is incidental or consequential to any functions under this Act. |

Sources: Malaysian Aviation Commission Bill 2015, MIDF

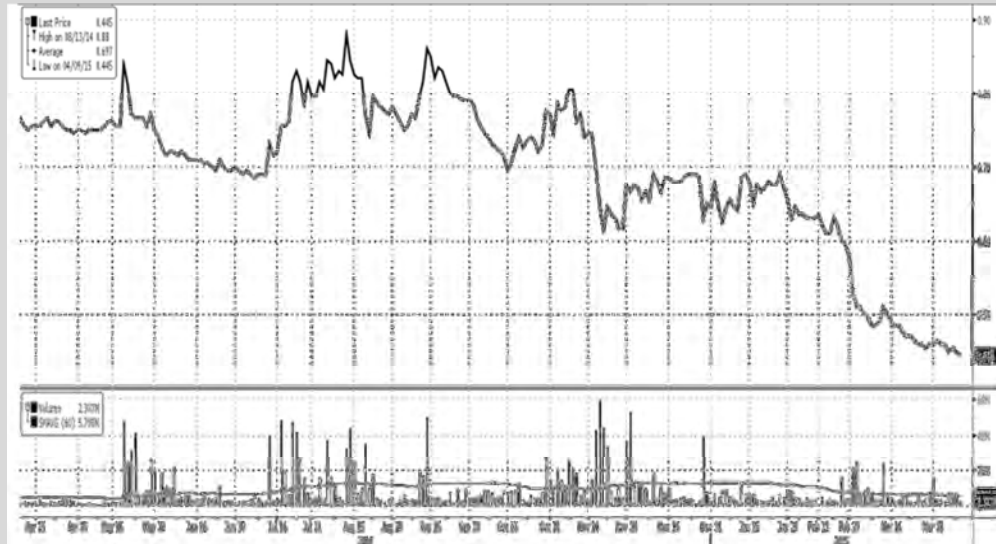
Table 2: Membership of the Commission

| Position | Appointment |
|---|---|
| Executive Chairman | Appointed by the Prime Minister |
| Two Federal Government Representatives | 1) Secretary General of the MOT 2) Director General of the Economic Planning Unit (“EPU”) |
| Not less than 4 but not more than 6 other members | Appointed after consultation with the Prime Minister, who possesses experience or shown capacity and professionalism in matters relating to economics, finance, aviation, business, admin, etc. |

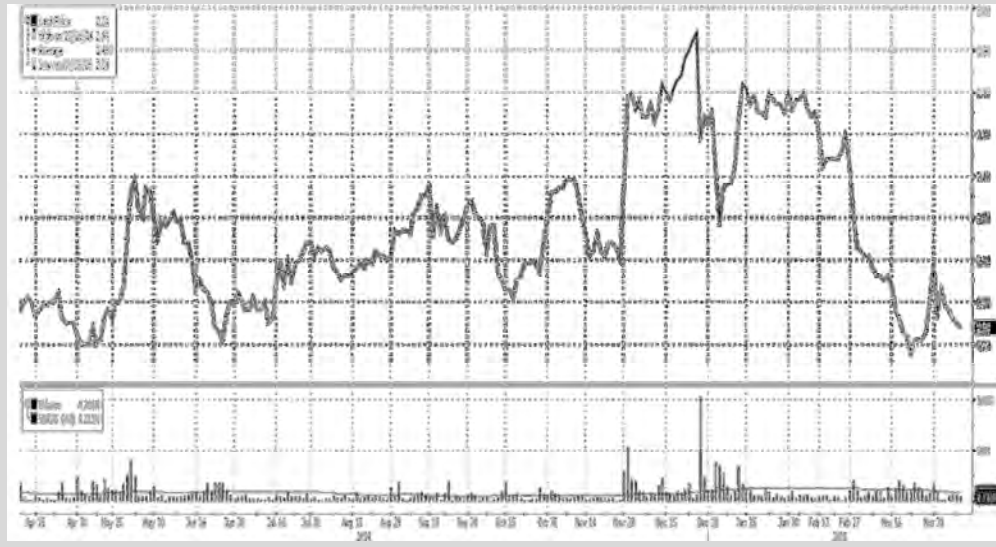
Sources: Malaysian Aviation Commission Bill 2015, MIDF

DAILY PRICE CHART

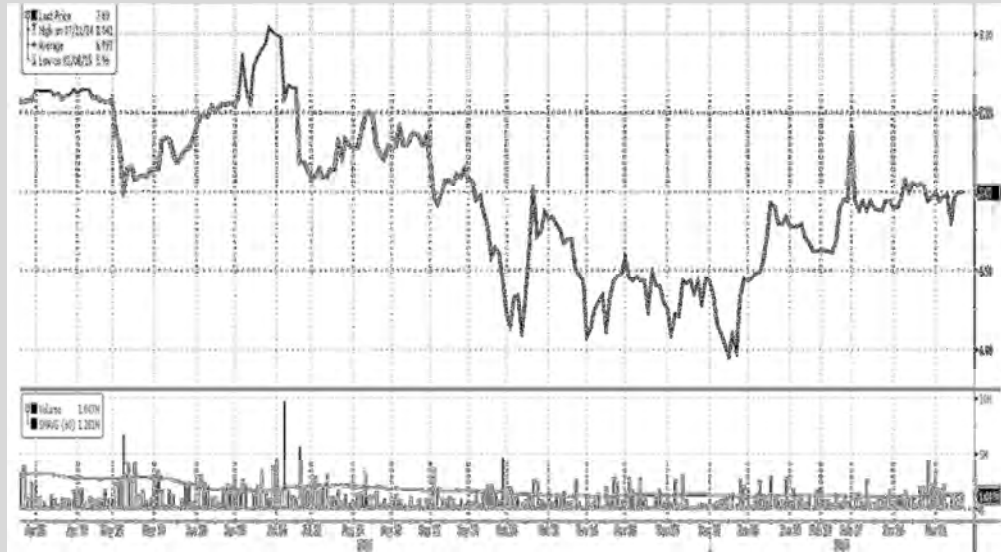
AAX



AirAsia



MAHB



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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. |