Sector Update | Monday, 30 January 2023

AVIATION

Maintain **NEUTRAL**

Brighter future at last, but largely priced in

KEY INVESTMENT HIGHLIGHTS

- **MY passenger traffic recovered to 68% in Dec-22 and 50% for CY22**
- **Chinese tourists might not return immediately**
- **Better operating environment for the airlines as they reinstate capacities**
- **CY23 MY passenger traffic recovery was revised down to 85% from 95% due to slower return of MAA's aircraft, but expect stronger growth from CY24F onwards as local carriers rebuild their fleets**
- **56 out of 68 foreign carriers have returned as at end-CY22**
- **Downgraded MAHB to NEUTRAL (TP: RM7.45) and maintain NEUTRAL on Capital A (RM0.70) with higher TPs**

Dec-22 passenger traffic. Malaysia Airport Holdings Berhad's (MAHB) network of airports concluded the year by reporting the highest monthly passenger traffic since Feb-20. The 6.8m total pax recorded in Dec-22 translates into a recovery of 68% (domestic: 81%, international: 56%) relative to its Dec-19 level. The year-end holiday season has largely supported the notable +31.1%mom growth in traffic with the domestic segment being partially lifted by the launch of the country's second low-cost carrier (LCC), MYAirline. Encouragingly, the 2.9m international pax is the highest ever recorded since Malaysia reopened its international borders in Apr-22. The passengers mix in Dec-22 stood at 58:42 for domestic and international segments respectively, inching closer to the pre-pandemic mix of about 50:50.

CY22 passenger traffic. For the full-year, MY's passenger traffic grew to 52.6m pax, outperforming the Malaysian Aviation Commission's (MAVCOM) best-case scenario forecast of 47.2m - 49.0m pax for CY22. This marked a 50% recovery (domestic: 69%, international: 31%) relative to CY19 level, which was in line with our estimates as we have projected the domestic/international segments to recover to 70%/30% last year. The domestic segment's recovery momentum continued in CY22 since the lifting of interstate travel ban in Oct-21 as local carriers gradually reinstate capacities. Meanwhile, the international segment's recovery from Apr-22 onwards was spearheaded by the ASEAN region due to the delayed reopening of key Asia Pacific markets including Japan, Hong Kong, and Taiwan in 4QCY22 (refer to Chart 2).

COMPANY IN FOCUS

Malaysia Airports Holdings Berhad

Downgrade to **NEUTRAL** | Revised TP: RM7.45

Price @ 27th January 2023: RM7.26

- Key beneficiary of China's reopening.
- Have likely reached breakeven and recorded profits in 4QFY22
- To resume paying dividends in FY23F.

Share Price Chart

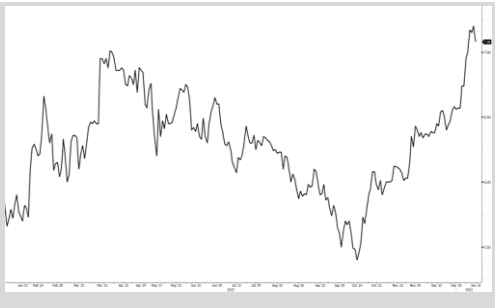

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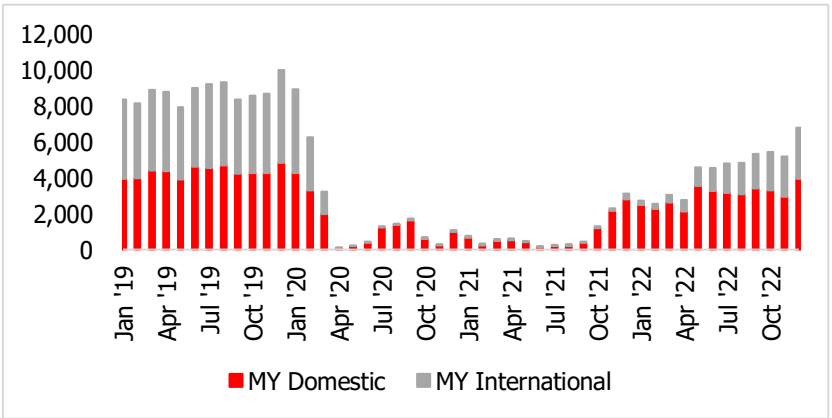
Chart 1: MAHB MY Pax ('000)



Source: MAHB, MIDFR

Chinese tourists might not immediately return. According to MAVCOM, routes to China accounted for c.10% of MY's passenger traffic in CY19. The dismantling of its strict zero-Covid policy has materialised earlier than expected, but the return of Chinese tourists to Malaysia might be staggered as: (i) China is experiencing mass Covid infections, (ii) China-bound travelers are still required to present negative PCR tests, (iii) passport renewal and visa approval process might take time and (iv) airlines are still reinstating their capacities. For instance, Malaysia AirAsia (MAA), which operated 138 average weekly China-bound flights prior to the pandemic, is only utilising c.50% of its fleet, hence it is currently flying 4x weekly to 3 destinations (Kunming, Nanning, and Shenzhen) as compared to 24 destinations in CY19. For 1QCY23F, MAA plans to ramp it up to 12x weekly as it obtains more routes approval. MAHB reported that it is currently receiving c.16 daily flights from China, up from 10 the first week after its reopening.

However, airlines are in a better position now. As depicted in Chart 6, jet fuel crack spread started widening in 2QCY22 to an average of USD30 per barrel when most airlines resumed their operations during a period of lesser refinery production. Historically, the price premium for jet fuel over crude oil averaged at c.17% or equivalent to about USD10 per barrel. Recently, the crack spread has widened slightly to USD35 per barrel, likely due to China's reopening, but we expect it to eventually be narrower as the refining capacity recovers. Nonetheless, jet fuel prices are still elevated at current levels, hence airfares might temporarily be higher relative to pre-Covid levels as the fuel surcharges imposed by airlines remain in place. MAA guided for its current fuel surcharges (domestic routes: RM10, international routes: RM25-60) to only be abolished if jet fuel price were to fall to USD75 per barrel. Another factor that could support the higher airfares is lower aircraft availability given that Malaysian carriers have collectively shrunk its fleet by almost -20% or approximately 41 aircraft since the pandemic hit (refer to Table 1). Expectation of a stronger MYR against USD is another catalyst for the local carriers given that >50% of their operating expenses are denominated in USD. Our economists are expecting Ringgit to average at USDMYR4.30 and end the year at USDMYR4.23. Moreover, the relatively lower aircraft lease rates could temporarily give the local carriers some room to breathe while they ramp up capacities.

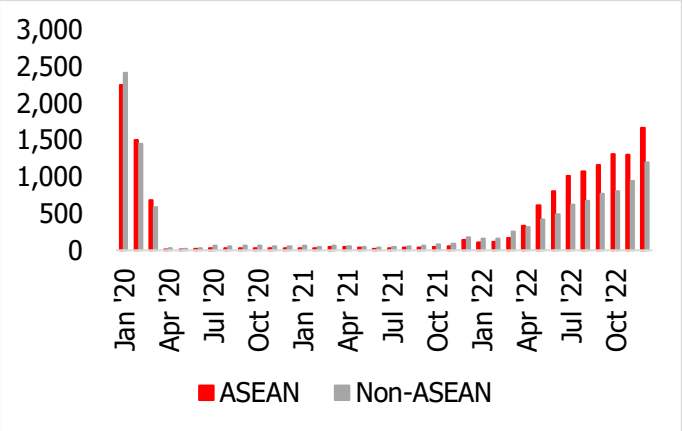
Outlook. MY passenger traffic recovery is expected to be mainly supported by the reactivation of MAA's remaining 50% aircraft that have yet to receive airworthiness certificates. This is crucial given that MAA historically had a market share of c.40% in terms of passengers carried. Nonetheless, we remain wary of the lingering maintenance, repair, and overhaul (MRO) constraints attributed to the long queues at the facilities also and partly due to parts supply chain issues. Additionally, fleet restoration services are costly, averaging at USD0.3m per aircraft for AirAsia. Domestic traffic would be partially lifted by MYAirline, which currently utilises a small fleet of 4 aircraft to serve 8 local destinations. MAVCOM has forecasted for MYAirline to push the average monthly domestic traffic closer to 4.0m pax. The newly launched LCC had set a target of tapping into the ASEAN region in 2QCY23F and adding 46 aircraft to its fleet over the next 5 years. Meanwhile, the international tourism will be in the limelight this year as the non-ASEAN subsegment catches up. The Northeast Asia sector that has recently reopened collectively contributed c.25% of the international pax at KLIA in CY19. More aircraft being reinstated into service as well as the return of foreign carriers should support the strengthening travel demand. 8 more foreign carriers have resumed their operations in Malaysia last year, bringing the total operating foreign carriers to 56 out of 68. In the longer term, MY passenger traffic is expected to continue growing as local carriers increase their flight frequencies and introduce new routes, supported by the delivery of their aircraft orders (refer to Table 2).

Revision to earnings and valuation. Relative to 2019 levels, we now expect MY passenger traffic in CY23F to recover to 85% (domestic: 90%, international 80%) from 95% (domestic: 100%, international: 90%) previously. The downward revision is mainly due to slower than expected return of MAA's operational aircraft which had missed its initial target of 65 operational aircraft by end-CY22 (actual end-CY22: 53). However, we are expecting stronger traffic growth from CY24F onwards as Malaysian carriers rebuild their fleets as early as 2QCY23F. As for MAHB's Turkish operations, the key changes are the upward revision of TY international pax for CY23F-CY25F as the sector has fared better than expected, surpassing its 2019 level by 10% in CY22. Details of the adjustments are outlined in Tables 4 and 5. Post-adjustments, our DCF-derived TP for **MAHB** was revised upwards to **RM7.45** (from RM6.90) mainly due to the reduction of its current beta from 1.3 to 1.2. The share price has rallied by +12% since the announcement of China's reopening, hence we downgrade our call from BUY to **NEUTRAL** as we believe that the positives have been largely priced in. No adjustments were made to our earnings/losses estimates for Capital A pending its results release in Feb-23, but our TP was revised up to **RM0.70** (from RM0.59) as we rollover our valuation base year and peg its FY24F EPS to PE of 8.0x. We maintain **NEUTRAL** on Capital A as the stock currently trades at forward PE of 8.4x, at par with its pre-pandemic mean.

Maintain NEUTRAL. The future is brighter at last for the aviation sector as China presses on with its reopening. We should expect to see an improving international passenger mix this year, which should help the aviation players rebuild their profitability given that they are high-yield passengers. Note that we expect **MAHB (NEUTRAL, RM7.45)** to return to the black

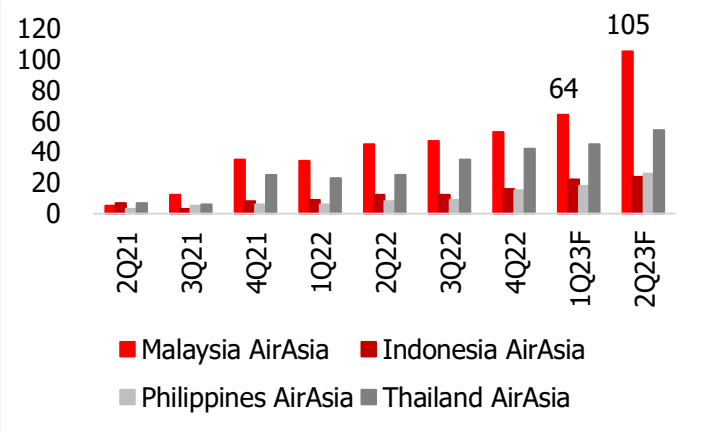
this year, while **Capital A (NEUTRAL, RM0.70)** should be reporting narrowing losses. Our guarded optimism on the latter is mainly concerning the high maintenance costs to bring back approximately 83 aircraft to the sky this year and we opine that there could be a downward revision to its target of full fleet utilisation by 2QCY23F. Potential upsides for the sector include: (i) faster-than-expected return of Chinese tourists and (ii) local carriers rebuilding their fleets, while the downside risks are: (i) prolonged period of experiencing MRO constraints and (ii) the resurgence of another Covid-19 variant.

Chart 2: MAHB ASEAN & Non-ASEAN Pax ('000)



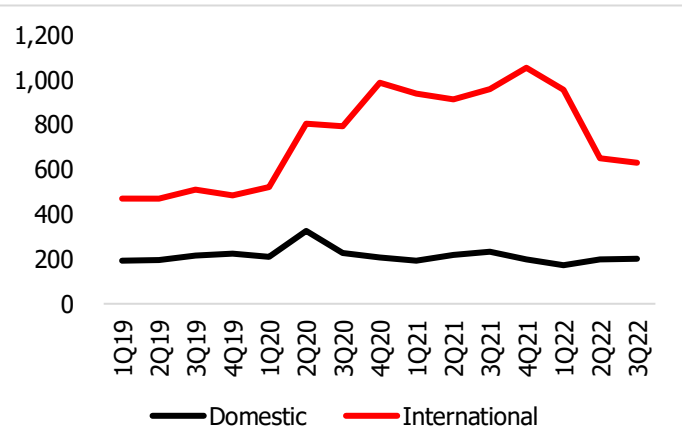
Source: MAHB, MIDFR

Chart 3: AirAsia's Fleet Plan



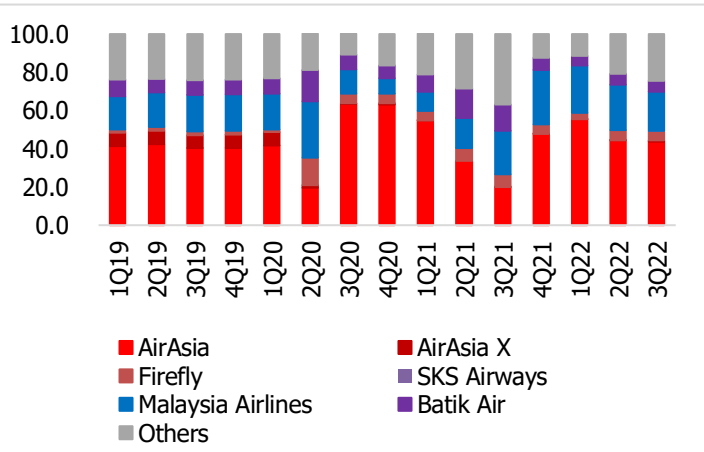
Source: MAHB, MIDFR

Chart 4: Average Fares of Malaysian Carries (RM)



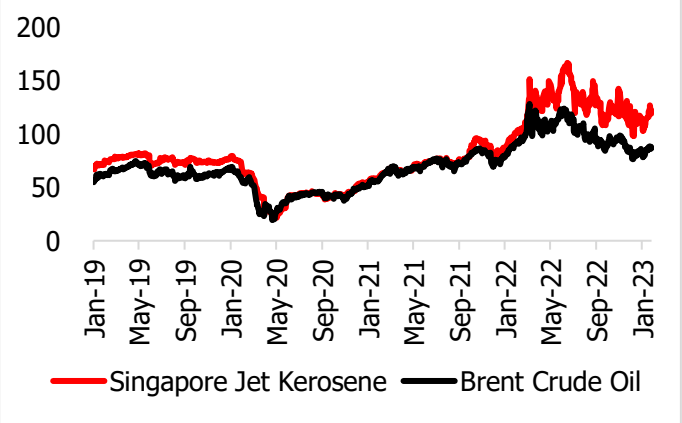
Source: MAVCOM, AirportIS, MIDFR

Chart 5: MY Passenger Market Share (%)



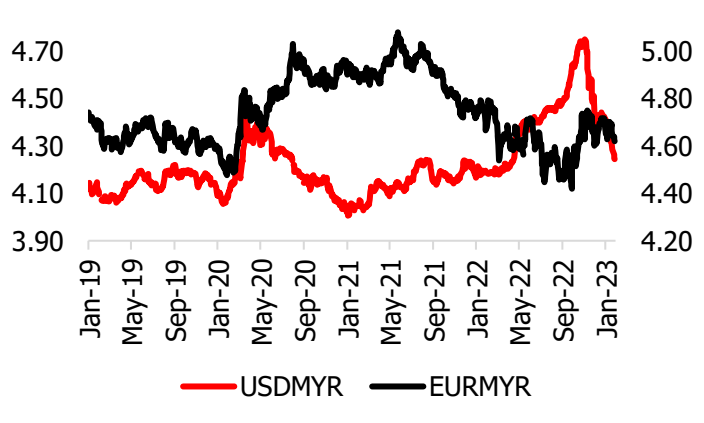
Source: MAVCOM, AirportIS, MIDFR

Chart 6: Crude Oil vs. Jet Fuel Prices (USD/barrel)



Source: Bloomberg, MIDFR

Chart 7: USDMYR & EURMYR Exchange Rates



Source: Bloomberg, MIDFR

Table 1: Fleet Size of Local Airlines

Airline	Current			Exited Since CY20	Utilisation Rate
	In Service	Parked	Total		
AirAsia Malaysia	56	46	102	3	55%
Airasia X	8	5	13	14	62%
Batik Air/Malindo	24	7	31	5	77%
Firefly	11	2	13	6	85%
Malaysia Airlines	69	4	73	13	95%
MASwings	16	0	16	0	100%
MYAirline	4	0	4	0	100%
Total	**188**	**64**	**252**	**41**	**75%**

Source: Capital A, Planespotters.net

Table 2: Fleet Plan of Local Carriers

Airline	Plan
AirAsia Malaysia	Confirmed a 362 units of Airbus A321neo order to be delivered from CY24F until CY35F.
Batik Air/Malindo	Receiving delivery of 17 units of Boeing 737-8.
Firefly	Targets to add 7 jet aircraft over the next 2 years.
Malaysia Airlines	Receiving delivery of 25 units of Boeing B737 MAX from 2QCY23F until CY26F.
MYAirline	Targets to have 50 aircraft over the next 5 years.

Source: MAHB, Various news sources

Table 3: MAHB Passenger Traffic Assumptions ('000)

Sector	2021A	2022A	2023E	2024F	2025F
Malaysia					
Domestic	9,363	36,095	46,779	54,576	56,135
International	1,360	16,455	42,884	54,610	56,208
ASEAN	538	9,642	22,253	27,817	28,611
Non-ASEAN	822	6,813	20,631	26,793	27,597
Total	**10,723**	**52,550**	**89,663**	**109,185**	**112,343**
Turkey					
Domestic	16,384	15,469	20,633	22,153	22,805
International	8,972	15,712	17,793	18,504	19,216
Total	**25,356**	**31,181**	**38,426**	**40,658**	**42,021**

Source: MAHB, MIDFR

Table 4: Passenger Traffic Recovery or Growth Relative to 2019 Levels

Sector	2023F		2024F		2025F	
	Old	New	Old	New	Old	New
MY domestic	100%	90%	105%	105%	107%	108%
MY international	90%	80%	100%	100%	103%	105%
Total MY	**95%**	**85%**	**102%**	**104%**	**105%**	**107%**
TY domestic	100%	95%	105%	102%	107%	105%
TY international	105%	120%	110%	125%	113%	130%
Total TY	**102%**	**107%**	**107%**	**113%**	**110%**	**117%**

Source: MAHB, MIDFR

Table 5: Revisions to Earnings/Losses and TP

Company	Old Net Profit/Loss (RM'm)		New Net Profit/Loss (RM'm)		Change (%)		Old TP (RM)	New TP (RM)
	FY22E	FY23F	FY22E	FY23F	FY22E	FY23F		
Capital A	-2,791.6	-885.7	-2,791.6	-885.7	0.0%	0.0%	0.59	0.70
MAHB	-198.6	454.6	-146.9	348.8	26.0%	-23.3%	6.90	7.45

Source: MAHB, MIDFR

SECTOR VALUATION MATRIX

Company	Rating	Share Price	TP	PER (X)		ROE (%)		Dividend Yield (%)	
		RM	RM	FY23F	FY24F	FY23F	FY24F	FY23F	FY24F
Capital A	Neutral	0.75	0.70	n.a.	8.6x	n.a.	n.a.	n.a.	n.a.
MAHB	Neutral	7.26	7.45	34.5x	21.6x	4.9%	7.5%	1.2%	2.1%

Source: Bloomberg, MIDFR

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology