

11 January 2019 | Sector Update

Aviation

Maintain POSITIVE

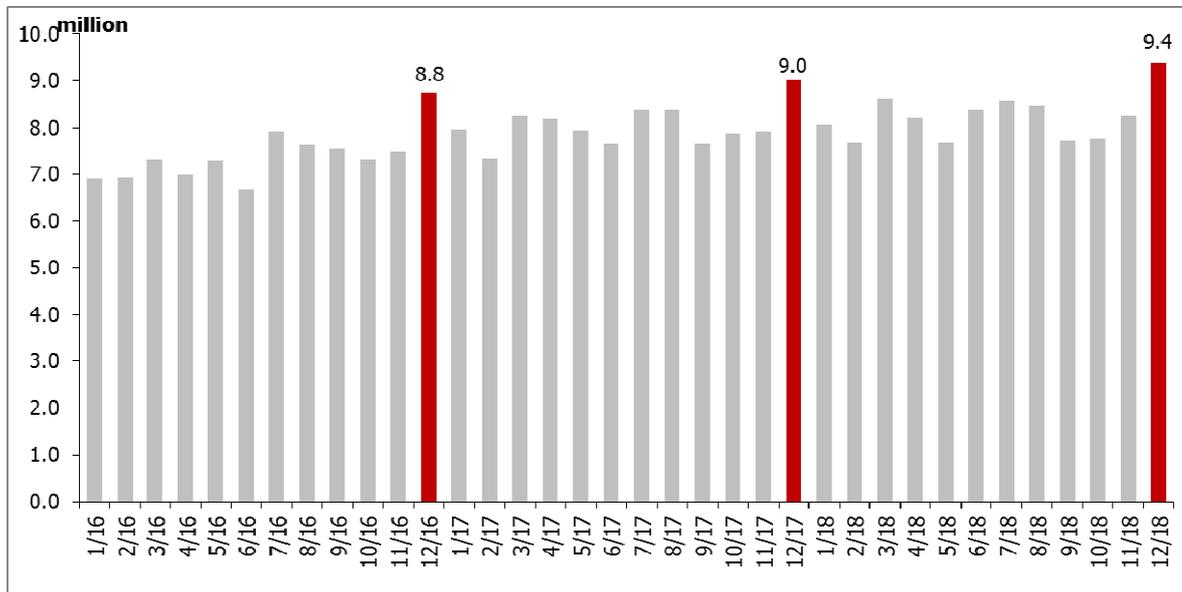
klia2 piloting passenger growth

KEY HIGHLIGHTS

- **MAHB passenger traffic (including ISG) grew by +4.0%yoy in 2018**
- **Bulk of the growth came from klia2 passenger growth (+5.3%yoy), mostly contributed by AAGB**
- **International passenger mix remained above 50% since January 2017**
- **Passenger growth expected to reach 3.5% in 2019**
- **Maintain POSITIVE stance on aviation sector**

MAHB passenger traffic grew by +4.0%yoy in 2018. As December's traffic snapshot came in to conclude the 2018 statistics, MAHB saw its 2018 passenger movement increase by +4.0%yoy which includes ISG. This accounted for a total of 133.1m passengers. For MAHB airports in Malaysia, passenger traffic grew by +2.5%yoy to 99.0m for the whole of 2018 which was only 1.0m short of our estimates of 100.0m. We note that the bulk of the increase was contributed by passenger traffic at klia2 (more than 50%) with more than 90% carried by AirAsia Group Berhad (AAGB).

Figure 1: Malaysia Airports Monthly Passenger Traffic (million)

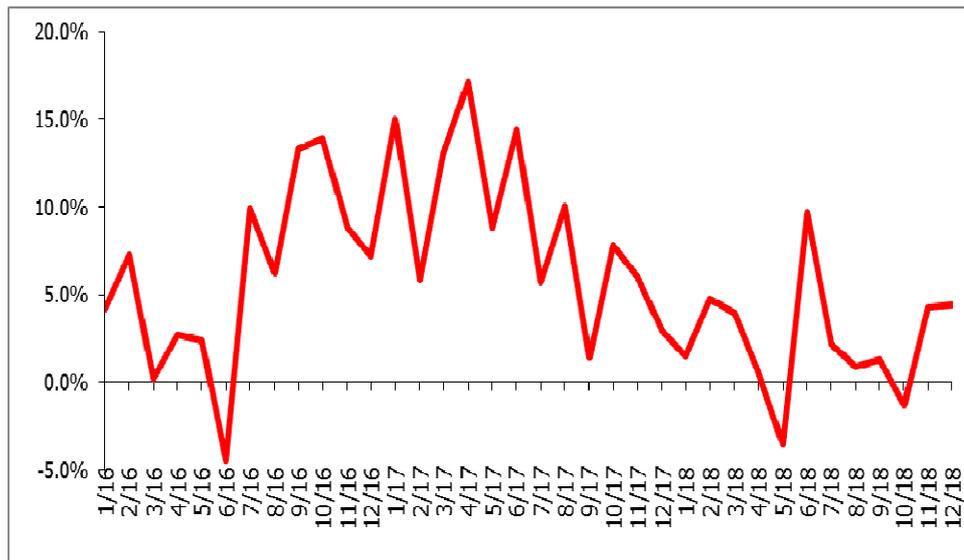


Source: MAHB, MIDFR

Robust international traffic growth. Domestic traffic at Malaysian airports recorded a modest growth of +0.4%yoy in 2018, lesser than +3.2%yoy increase in the preceding year. The main reason was the shift of airlines seat capacity by some local carriers from domestic to international sectors. As such, the international traffic of airports in Malaysia grew at a stronger pace of +4.5%yoy to reach 51.6m passengers in 2018. We opine that the strength in international traffic in 2018 was partly supported by MAHB's efforts to attract 13 new airlines such as Citylink Garuda Indonesia, Condor Flugdienst from Germany and Indian low-cost airline, IndiGo Airlines.

Looking ahead, MAHB targets to bring in 10 new airlines to Malaysia, especially to its five main airports. The stronger mix of international passengers bodes well for MAHB in terms of the higher passenger services collected; RM35 for non-Asean and RM73 for beyond Asean.

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



Source: MAHB, MIDFR

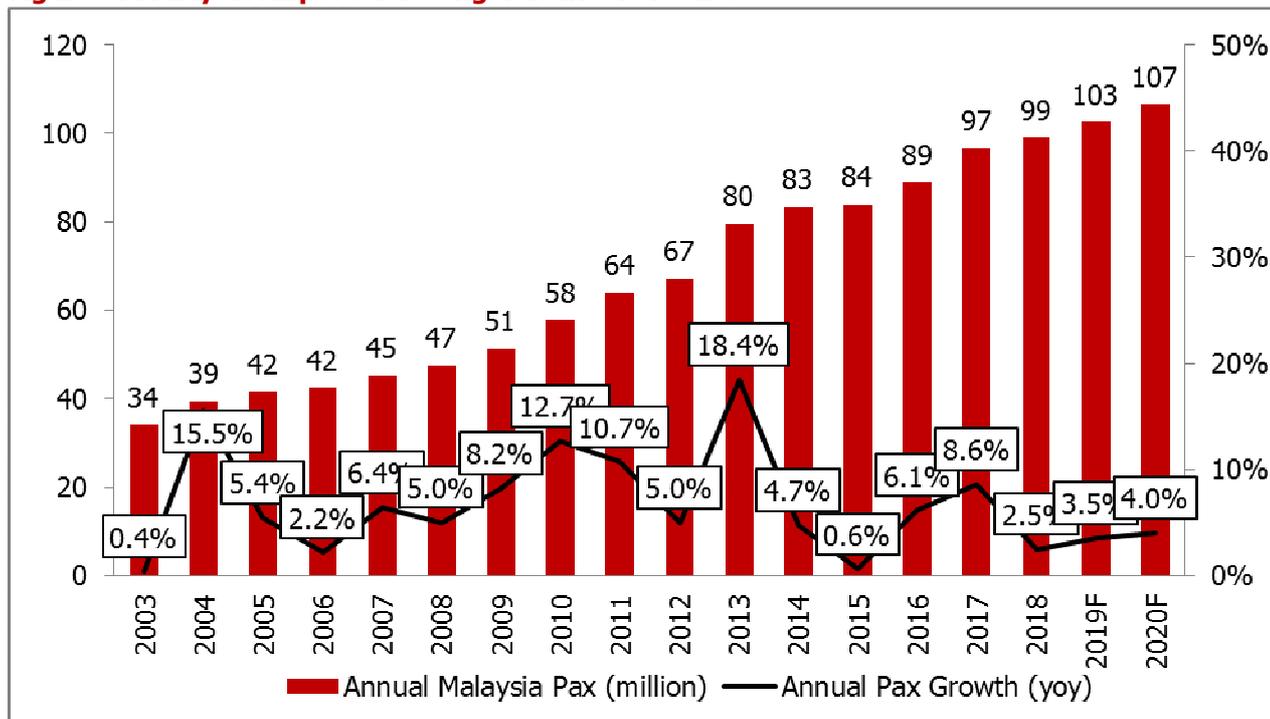
Klia2 saw a higher passenger growth of 5.3%yoy. Klia2 saw higher passenger growth recording a net increase of 1.6 million passengers for year 2018 (+5.3%yoy). As international passenger movements continued to retain more than 50% market share since January 2017, LCCs are set to benefit as international passengers command higher revenue in terms of ticket prices and ancillary items. In addition, we opine that the pent-up demand for international travel will place LCCs such as AirAsia Group Berhad (AAGB) and AirAsia X at a significant advantage over its competitors given the companies' ability to leverage on its network of airlines operators in South East Asia while constantly introducing and retaining optimal routes couples with innovative strategies to drive cost lower i.e. digitalisation.

Hedging policies to shield LCCs from oil price volatility. We are estimating Brent crude oil price to record an average of USD75pb in CY19, higher than the average of USD72pb seen CY18. Notwithstanding this, we opine that the recent dip in oil prices during 4QFY18 has given the opportunity for airlines to restructure their hedging strategies moving forward. For example, AirAsia Group Berhad (AAGB) has hedged 48% of its fuel expenses at USD67.24pb(Brent) while AirAsia X has hedged 25% of jet fuel prices at USD85pb for the same period. We opine that this hedging policy will provide a shield to the volatility of oil prices in 2019.

Regulatory changes to take shape in 2019. Negotiations for the operating agreement is expected to be finalised in the next two to three months and will probably feature five airport zones instead of two currently. This will give room for fresh funds to be injected via joint-ventures with new stakeholders to develop the airports. Meanwhile, the Regulated Asset Base (RAB) framework is scheduled to come into effect by mid-2019. The framework entails MAHB to potentially undertake some of the capital expenditure for airport upgrades. We believe that once both of these are finalized, the Government would then carry out the Airport REIT exercise which targets to raise RM4b by selling a 30% stake in the REIT to private investment institutions. Thus far, the only change we can ascertain from the REIT exercise is that change of party that MAHB pays the user fees from the government to the REIT company.

Maintain POSITIVE on the sector. The prospect of the aviation sector is bright coming into 2019. The extension of the visa relaxation for Chinese passengers until end of this year should sustain the passenger growth. Other growth factors would include direct connectivity seen from international airlines flight straight to locations such as Langkawi. As such we believe LCCs such as AirAsia will continue recording higher passengers in 2019. This will also benefit MAHB. We strongly believe that MAHB passenger numbers can surpass the 100m mark in 2019, while maintaining a relatively conservative growth rate of 3.5%. We reiterate our **BUY** call on MAHB with a **TP of RM9.88 per share** as it is a proxy to Malaysia's inbound/outbound travel industry, being Malaysia's largest airport operator. We also continue to favour **AAGB (BUY; TP:RM3.48)**, being a growth driver for MAHB's passenger growth via klia2 indicated by its strong load factor above 80% for 9MFY18. Moreover, AAGB continues enhance its cost structure, along with its efforts of rationalising revenue and cost via digitalisation efforts.

Figure 3: Malaysia Airports Passenger Traffic Forecasts



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 <i>rise</i> 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 <i>fall</i> 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.