

24 September 2019

AirAsia Group Berhad

Tough Operating Environment

By Raymond Choo Ping Khoo | pkchoo@kenanga.com.my

Tell-tale signs of intense competition, higher operating costs due to the sale-and-lease-back of aircrafts and sustained high jet fuel price are pointing towards a tough operating environment over the medium term. Downgrade FY19E/FY20E net profit by 46%/32%. Our TP is cut from RM2.20 (SoP-based) to RM1.70 based on 10x FY20E EPS. Downgrade our call from OP to MP.

Tough operating environment ahead. There are nascent signs indicating that higher supply of seats is potentially outstripping passenger demand growth which are leading to competitive fare war. Recall, 2Q19 load factor was commendable (2Q19 load factor at 85%, versus 86% in 2Q18). However, the higher supply of seats, coupled with competitive pressure have capped AirAsia's RASK (revenue per ASK) growth at 4% YoY, which far trailed the 15% growth in CASK (cost per ASK). Separately, we expect a tough operating environment over the short to medium term due to the sustained high jet fuel price (accounts 40% of total cost) and planes which are now leased vs. owned previously. We note that the maintenance costs spiked up in 2Q19 (+105% YoY) due to accounting treatment for the aircrafts under sales and leaseback arrangements which also contributed to the hike in CASK. As such, we expect tough operating environment to persist over the medium term. We expect maintenance cost to be higher than expected in 2H19 upon gradual disposal of the group's remaining 39 aircrafts as at June 2019 to 5 by end 2019. Elsewhere, the sustained weakness in MYR vs. USD could impact the group's earnings because 70% of operating cost is USD-denominated.

High jet fuel cost sustained, accounts for 40% of total cost. Hedging in place for FY19-21F but for Brent, rather than jet fuel. The group have also hedged 70% and 85% of fuel requirement for 3Q and 4Q 2019 at average Brent hedge prices of US\$62/bbl and US\$60.77/bbl, respectively and hedged 73% for FY20 at USD60.22 per barrel and FY21 19% at USD59.45/bbl. The Brent price of crude oil is currently trading at US\$64/bbl, and has averaged around US\$62/bbl so far in the 3Q. However, jet fuel is up 14% YTD to USD75.7/bbl.

Outlook. The group expect load factors to remain solid and fares to hold steady in 2H19. However, we expect tough operating environment to persist in 3Q19 and 4Q19 no thanks to: (i) high maintenance cost due to accounting treatment for aircrafts under sales and leaseback arrangements, and (ii) sustained high jet fuel price. The group planned a net fleet growth of 20 aircraft across AOCs. AirAsia expects to receive its first A321neo in November which is more fuel efficient, has longer range on top of additional 50 seats. The group will continue its focus on digital initiatives. Teleport (logistics business) is expected to see encouraging growth due to efforts to seek tie-ups with different airlines, as well as SMEs. AirAsia.com is being developed as a full-fledged one-stop travel and lifestyle platform whilst BigPay will be rolled out in multiple markets in ASEAN.

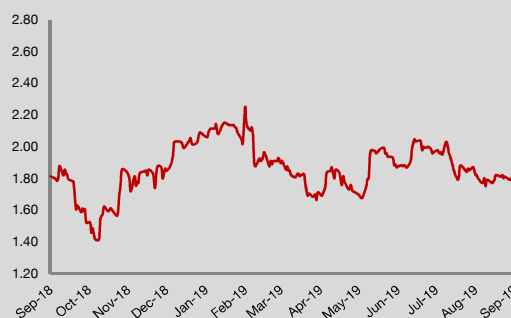
Slashed our FY19E/FY20E forecasts by 46%/32%. The downgrades are mainly due to: (i) higher maintenance cost assumption, (ii) higher aircraft lease cost, and (iii) raised jet fuel price assumption.

Downgrade from OP to MP. Correspondingly, our TP is cut from RM2.20 to RM1.70 based on 10x FY20E EPS (+0.5SD above 5-year historical forward mean), which is at a discount to average forward PER of 11x of global peers like Ryanair and Southwest Airlines to reflect AirAsia's relatively smaller market capitalization. Downgrade from OP to MP. **Risks include** lower-than-expected RASK and higher-than-expected fuel costs, and higher-than-expected operating costs.

MARKET PERFORMANCE ↓

Price : **RM1.81**
Target Price : **RM1.70** ↓

Share Price Performance



KLCI 1,592.93
YTD KLCI chg -5.8%
YTD stock price chg -10.9%

Stock Information

Shariah Compliant No
Bloomberg Ticker AAGB MK Equity
Market Cap (RM m) 6,049.0
Shares Outstanding 3,342.0
52-week range (H) 2.25
52-week range (L) 1.37
3-mth avg daily vol: 10,810,510
Free Float 52%
Beta 1.5

Major Shareholders

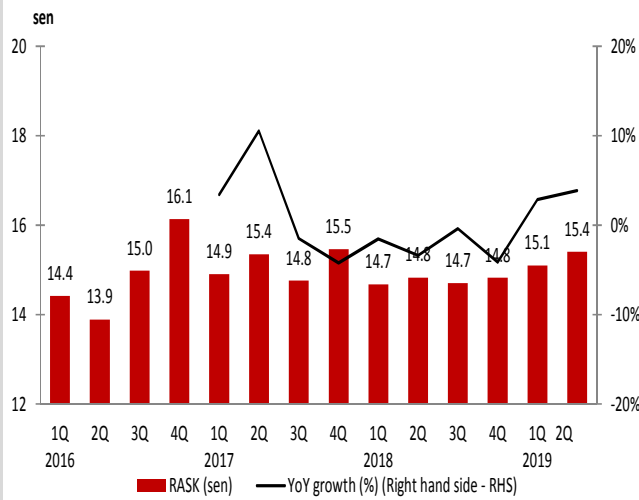
Tune Live Sdn Bhd 16.7%
Tune Air Sdn Bhd 15.5%
Employees Provident Fund 6.5%

Summary Earnings Table

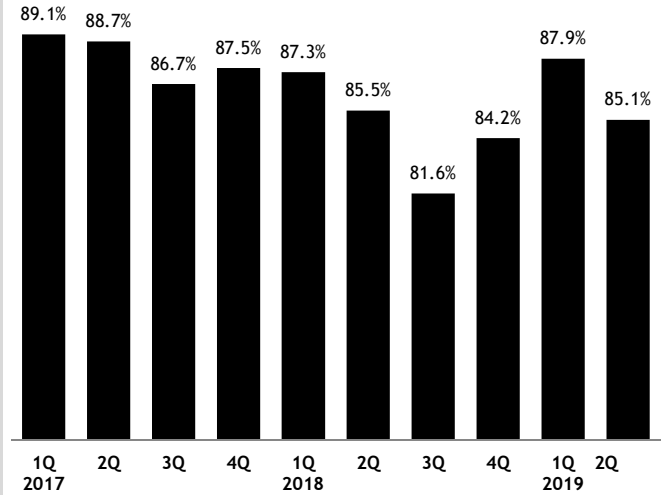
FY Dec (RM'm)	2018A	2019E	2020E
Turnover	10,603	11,791	12,848
PBT	1,364.7	417.0	585.8
Net Profit (NP)	1,980.0	396.2	556.5
Core NP	583.9	396.2	556.5
Consensus (NP)	-	422.2	636.2
Earnings Revision	-	-46%	-32%
Core EPS (sen)	17.5	11.9	16.7
Core EPS growth (%)	(60.7)	(32.2)	40.5
NDPS (sen)	52.0	90.0	5.0
BVPS (RM)	2.35	1.66	1.78
Core PER (x)	10.4	15.3	10.9
PBV(x)	0.8	1.1	1.0
Net Gearing (%)	N.Cash	N.Cash	N.Cash
Net Div. Yield (%)	28.7	49.7	2.8

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Revenue / ASK (sen) (RASK)

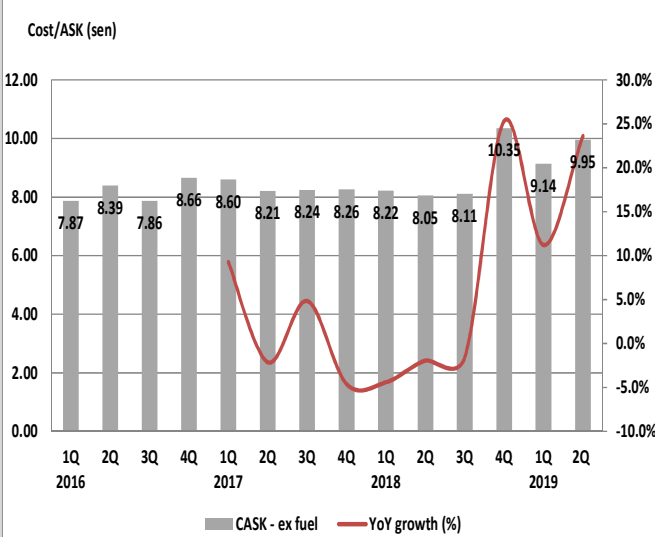


Seat load factor

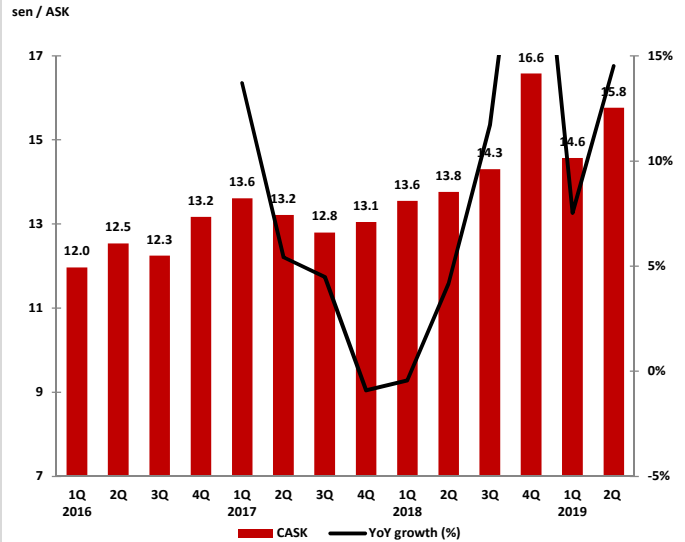


Source: Bloomberg, Kenanga Research

CASK-ex fuel

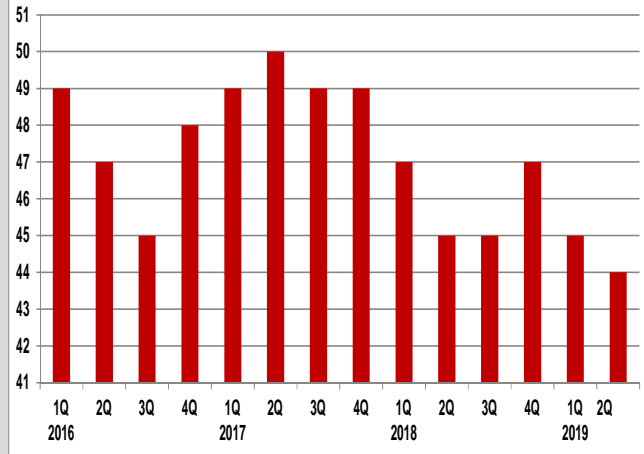


CASK

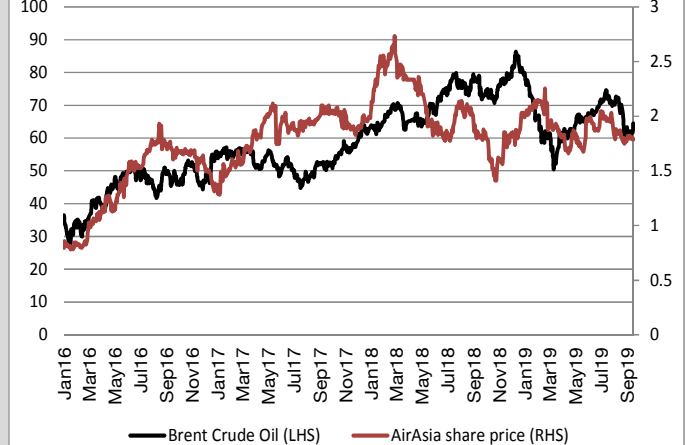


Source: Bloomberg, Kenanga Research

Ancillary income per pax



Brent crude price vs AirAsia share price



Source: Bloomberg, Kenanga Research

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Income Statement

FY Dec (RM m)	2017A	2018A	2019E	2020E
Revenue	9,709.7	10,603	11,791.3	12,848.
EBITDA	3,024.8	1,799.7	2,352.9	2,591.4
Depre. & Amort	(864.0)	(591.4)	(1,406)	(1,421)
Operating Profit	2,160.8	1,208.3	946.6	1,170.2
PBT	2,087.8	1,364.7	417.0	585.8
Net Profit	1,628.8	1,980.0	396.2	556.5
Core Net Profit	1,486.0	583.9	396.2	556.5

Operating Margin

FY Dec (RM m)	2017A	2018A	2019E	2020E
Fixed Assets	12,247.5	2,854.0	3,598.7	5,659.7
Int. Assets	554.2	871.0	871.0	871.0
Intangibles	362.6	615.4	615.4	615.4
Other FA	3,354.4	4,978.8	4,978.8	4,978.8
Inventories	68.2	106.3	106.3	106.3
Receivables	1,380.2	1,855.3	2,062.1	2,285.0
Derivatives	829.7	1,021.9	1,021.9	1,021.9
Other CA	246.4	3,118.4	343.1	343.1
Cash	1,882.2	3,348.7	4,954.6	4,122.8
Total Assets	20,925.4	18,769.9	18,552.0	20,004.0
Payables	1,830.7	2,601.9	2,893.2	3,152.6
ST Borrowings	1,953.9	412.6	412.6	412.6
Ot. ST Liability	1,149.8	3,733.7	3,749.9	3,861.7
LT Borrowings	7,354.8	761.4	2,554.2	3,245.6
Ot. LT Liability	2,249.9	5,029.7	5,002.9	5,002.9
Minorities Int.	(2,018)	(1,608)	(1,608)	(1,608)
Net Assets	8,404.5	7,838.7	5,547.3	5,936.7
Share Capital	2,515.4	8,023.3	8,023.3	8,023.3
Reserves	5,889.1	(184.5)	(2,475.9)	(2,087)
Equity	8,404.5	7,838.7	5,547.3	5,936.7

Cashflow Statement

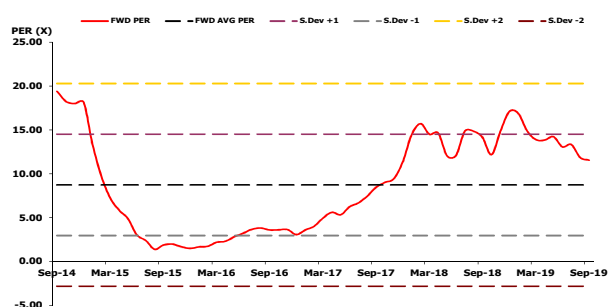
FY Dec (RM m)	2017A	2018A	2019E	2020E
Operating CF	2,835.0	1,980.9	2,364.0	990.6
Investing CF	(691.6)	(516.1)	(113.1)	100.2
Financing CF	(1,012)	(1,336)	(1,796)	(2,066)
Change In Cash	1,132	129.1	455.4	(975.1)
Free CF	2,550.5	1,518.6	2,337.1	914.2

Source: Kenanga Research

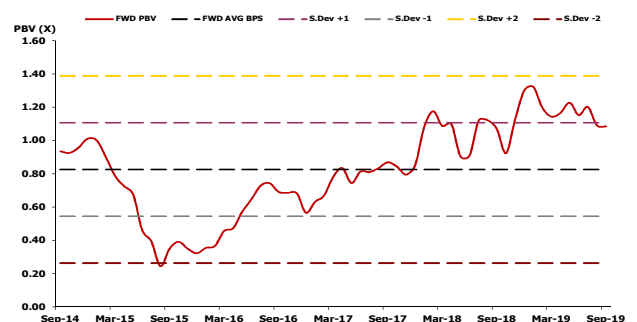
Financial Data & Ratios

FY Dec (RM m)	2017A	2018A	2019E	2020E
Growth				
Turnover	41.8%	9.2%	11.2%	9.0%
EBITDA	8.3%	-40.5%	30.7%	10.1%
Operating Profit	3.8%	-44.1%	-21.7%	23.6%
PBT	22.5%	-34.6%	-69.4%	40.5%
Net Profit /(loss)	0.4%	21.6%	-80.0%	40.5%
Profitability				
EBITDA Margin	31.2%	17.0%	20.0%	20.2%
Operating margin	22.3%	11.4%	8.0%	9.1%
PBT Margin	21.5%	12.9%	3.5%	4.6%
Core Net Margin	16.8%	18.7%	3.4%	4.3%
Eff. Tax Rate	24.7%	-25.4%	5.0%	5.0%
ROA	7.8%	10.5%	2.1%	2.8%
ROE	19.4%	25.3%	7.1%	9.4%
DuPont Analysis				
Net Margin (%)	16.8%	18.7%	3.4%	4.3%
Assets T/O (x)	1.3	0.3	0.3	0.4
Lev. Factor (x)	0.2	0.4	0.9	0.7
ROE (%)	19.4%	25.3%	7.1%	9.4%
Leverage				
Debt/Asset (x)	0.44	0.06	0.16	0.18
Debt/Equity (x)	1.11	0.15	0.53	0.62
Valuations				
EPS (sen)	44.5	17.5	11.9	16.7
NDPS (sen)	24.0	52.0	90.0	5.0
BVPS (RM)	2.41	2.35	1.66	1.78
PER (x)	4.1	10.4	15.3	10.9
Net Div. Yield(%)	13.3	28.7	49.7	2.8
PBV (x)	0.8	0.8	1.1	1.0

Fwd PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

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Peer Comparison

Name	Local Currency	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)		Net Div.Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
						1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.				
AVIATION UNDER COVERAGE																			
AIRASIA GROUP BHD	MYR	1.81	6,049.0	N	12/2019	11.2%	9.0%	-32.1%	40.5%	10.4	15.3	10.9	0.8	1.1	5.9%	2.8%	1.70	MP	
MALAYSIA AIRPORTS HLDGS BHD	MYR	8.61	14,285.6	N	12/2019	0.6%	1.0%	-2.3%	7.4%	39.6	40.5	37.8	1.8	1.7	3.8%	1.7%	8.70	MP	
Simple Average						5.9%	5.0%	-17.2%	23.9%	25.0	27.9	24.3	1.3	1.4	4.9%	2.3%			
CONSENSUS NUMBERS																			
Low-Cost Carriers:																			
AIRASIA X BHD	MYR	0.165	684.4	Y	12/2019	2.6%	8.2%	-171.8%	-1722.4%	N.A.	N.A.	N.A.	1.3	1.8	-42.2%	0.0%	0.154	SELL	
ASIA AVIATION PCL	THB	3.06	14,841.0	N	12/2019	8.8%	9.6%	688.7%	60.8%	212.1	26.9	16.7	0.7	0.7	2.9%	3.0%	4.13	NEUTRAL	
CEBU AIR INC	PHP	92.90	55,825.2	N	12/2019	14.9%	7.7%	128.1%	11.9%	14.2	6.2	5.6	1.3	1.2	20.4%	6.0%	118.11	BUY	
EASYJET PLC	GBp	1,106.50	4,395.1	N	09/2019	7.4%	5.5%	-3.9%	6.9%	12.3	12.8	12.0	1.7	1.3	10.1%	0.0%	1,122.16	NEUTRAL	
GOL LINHAS AEREAS INTEL-ADR	USD	15.53	2,718.6	N	12/2019	21.0%	10.6%	187.5%	78.0%	N.A.	4.7	2.6	N.A.	N.A.	-9.7%	3.4%	25.35	BUY	
JETBLUE AIRWAYS CORP	USD	16.77	4,968.4	N	12/2019	6.2%	7.7%	208.7%	23.0%	26.4	8.6	7.0	1.1	0.9	11.8%	0.0%	20.75	NEUTRAL	
RYANAIR HOLDINGS PLC	EUR	10.09	11,226.6	N	03/2020	8.4%	5.0%	-10.7%	27.7%	12.7	14.2	11.1	2.2	2.1	15.4%	0.7%	10.88	NEUTRAL	
SOUTHWEST AIRLINES CO	USD	54.48	29,283.9	N	12/2019	2.3%	7.5%	-7.6%	16.2%	11.9	12.9	11.1	3.0	2.4	22.9%	1.3%	60.21	BUY	
VIRGIN AUSTRALIA HOLDINGS LT	AUD	0.165	1,393.5	N	06/2020	0.4%	0.8%	-593.5%	-326.7%	N.A.	N.A.	N.A.	2.4	9.2	-7.0%	0.0%	0.148	SELL	
Full-Service Carriers:																			
AIR CHINA LTD-H	HKD	7.11	124,153.6	N	12/2019	5.5%	7.8%	15.4%	18.6%	16.9	14.6	12.3	1.0	1.0	9.0%	1.7%	8.46	BUY	
AIR NEW ZEALAND LTD	NZD	2.69	3,014.7	N	06/2020	3.1%	2.9%	10.1%	14.8%	11.2	10.1	8.8	1.4	1.4	13.8%	8.2%	2.69	NEUTRAL	
ANA HOLDINGS INC	JPY	3,745.00	1,305,126.4	N	03/2020	3.6%	6.9%	-3.1%	12.9%	11.8	12.2	10.8	1.2	1.1	9.5%	2.1%	3,975.00	NEUTRAL	
ASIANA AIRLINES	KRW	5,360.00	1,185,821.2	N	12/2019	-0.6%	3.9%	-195.6%	177.4%	N.A.	N.A.	20.8	0.9	0.9	-10.0%	0.0%	5,200.00	BUY	
CATHAY PACIFIC AIRWAYS	HKD	10.12	39,810.5	N	12/2019	-0.8%	5.8%	0.3%	11.1%	17.0	16.9	15.2	0.6	0.6	4.5%	3.3%	12.43	BUY	
CHINA AIRLINES LTD	TWD	9.21	49,927.3	N	12/2019	-0.9%	3.5%	-70.6%	209.3%	27.9	95.0	30.7	0.9	0.9	2.4%	0.0%	10.50	NEUTRAL	
CHINA EASTERN AIRLINES CO-H	HKD	3.89	86,261.9	N	12/2019	9.4%	9.5%	109.4%	23.2%	32.0	15.3	12.4	0.9	0.8	7.9%	0.8%	4.82	BUY	
CHINA SOUTHERN AIRLINES CO-H	HKD	4.80	81,151.0	N	12/2019	9.0%	10.9%	78.4%	21.0%	28.0	15.7	13.0	0.8	0.8	7.1%	1.3%	5.81	BUY	
EVA AIRWAYS CORP	TWD	13.80	66,979.3	N	12/2019	3.9%	4.1%	-6.7%	-4.1%	10.2	11.0	11.4	1.0	0.9	9.7%	3.6%	19.23	NEUTRAL	
GARUDA INDONESIA	IDR	545.00	14,108,184.1	Y	12/2019	13.1%	7.4%	265.5%	49.3%	N.A.	N.A.	N.A.	1.3	2.6	8.1%	0.0%	517.63	NEUTRAL	
HAINAN AIRLINES HOLDING CO-A	CNY	1.84	31,014.0	N	12/2019	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	0.6	N.A.	N.A.	N.A.	N.A.	SELL	
JAPAN AIRLINES CO LTD	JPY	3,379.00	1,179,368.0	N	03/2020	3.5%	5.1%	-24.3%	6.5%	7.8	10.3	9.7	1.0	1.0	9.6%	3.3%	4,700.00	BUY	
JET AIRWAYS INDIA LTD	INR	33.30	3,782.8	N	03/2019	10.2%	-40.7%	-21.5%	11423.3%	N.A.	N.A.	14.6	N.A.	N.A.	44.0%	N.A.	N.A.	SELL	
KOREAN AIR LINES CO LTD	KRW	23,550.00	2,233,591.1	N	12/2019	0.3%	3.5%	-49.4%	252.8%	N.A.	N.A.	14.6	0.9	0.9	-14.4%	1.0%	32,250.00	BUY	
QANTAS AIRWAYS LTD	AUD	6.26	9,831.4	N	06/2020	2.9%	2.2%	9.9%	6.9%	11.0	10.0	9.4	2.6	2.6	27.5%	4.4%	6.49	BUY	
SINGAPORE AIRLINES LTD	SGD	9.11	10,796.5	N	03/2020	4.1%	4.1%	13.6%	6.8%	15.8	13.9	13.0	0.9	0.8	5.7%	3.7%	10.53	BUY	
THAI AIRWAYS INTERNATIONAL	THB	9.05	19,754.1	N	12/2019	4.0%	5.2%	-227.0%	-526.7%	N.A.	N.A.	N.A.	1.2	1.2	-26.7%	0.3%	8.39	SELL	
VIRGIN AUSTRALIA HOLDINGS LT	AUD	0.165	1,393.5	N	06/2020	0.4%	0.8%	-593.5%	-326.7%	N.A.	N.A.	N.A.	2.4	9.2	-7.0%	0.0%	0.148	SELL	

*Peers are denominated in their respective local currencies

Source: Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

