

04 October 2019

Aviation

Seat Belt Sign On

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NEUTRAL



We downgrade Aviation from OVERWEIGHT to NEUTRAL. While we like Malaysia Airports Holdings Berhad (MAHB) as an attractive play on the propensity for air travel in the region due to rising per capita income, the stock has risen 32% over a 52-week period and is currently trading at rich valuations of 26x on FY19E EPS and 22x on FY20E EPS. However, there is potential earning or rating upgrade catalysts upon the release of the final consultation paper on the implementation of Regulated Asset Base (RAB) in early October. Separately, AirAsia is expected to face near-term tough operating environment of intense competition, higher operating costs due to the sale-and-lease-back of aircrafts and sustained high jet fuel price over the medium term. AIRASIA, our TP is RM1.70 based on 10x FY20E EPS, at a discount to average forward PER of 11x of global peers to reflect AirAsia's relatively smaller market capitalization. TP for MAHB is RM8.70 based on 22x FY20E EPS, which is at a 20% discount to regional peers average to reflect MAHB's relatively smaller market capitalization.



Malaysia Airports Holdings Berhad (MAHB) is well-entrenched because (i) of its monopolistic position as an airport operator in Malaysia, while (ii) earnings downside in the aeronautical segment under the operating agreements is protected. The government of Malaysia and MAHB signed operating agreements on 12 February 2009 which provide a framework for the airport operations. A key component under the operating agreements lies in the Marginal Cost Support Sums (MARCS) system which would compensate MAHB for reduction in aeronautical (Passenger Service Charge or 'PSC') resulting in PSC rate being lower than the benchmark rate as per the OA due to governmental instructions. MAHB continues to register steady passenger traffic (including ISG) growth of 7.5% for YTD 8M19 (+9.2% for Malaysian operation and +3.1% for Turkey operation YoY-Ytd), which we believe is on track to meet our target of 4.3%.

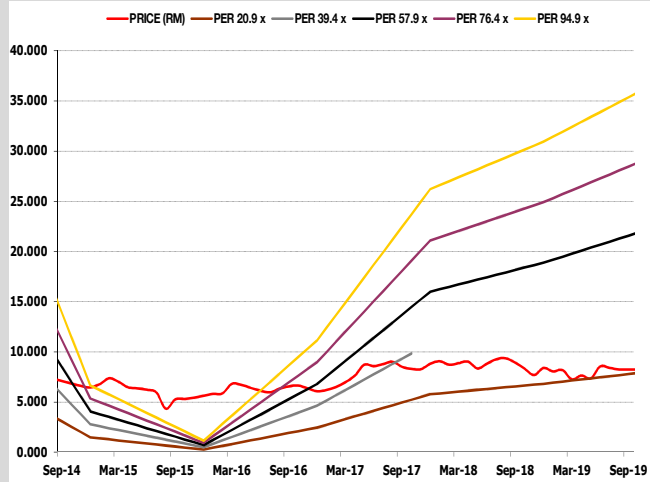
Tough operating environment for AirAsia. The group expect load factors to remain solid and fares to hold steady in 2H19. There are nascent signs indicating that higher supply of seats is potentially outstripping passenger demand growth which are leading to competitive fare war. Recall, 2Q19 load factor 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 for 40% of total cost) and its planes 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 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. Hedging is in place for FY19-21 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.

RAB framework a potential re-rating catalyst for Malaysia Airport. MAHB is an attractive play on the stronger demand for air travel and airlines' expansion initiatives but without the direct risk exposure to rising fuel prices. Recall, MAVCOM's third consultation paper release of RAB which proposed a WACC of 10.88% compared to MAHB's 12.7% but higher than consensus of 8%, and a preliminary approved CAPEX of RM5.0b under the first review period (RP1) from Jan 2020-Dec 2022. This means that under RP1, MAHB has to ensure no cost overrun on its capex programme and targets set by Mavcom are not exceeded.

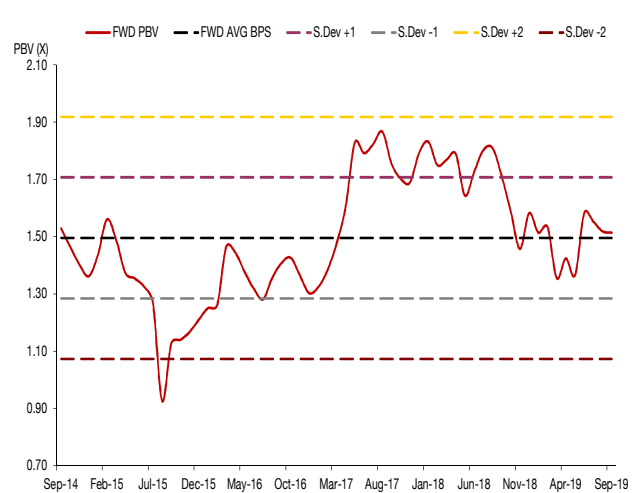
Downgrade from OVERWEIGHT to NEUTRAL. While we like Malaysia Airports Holdings Berhad (MAHB) as an attractive play on the propensity for air travel in the region due to rising per capita income, the stock has risen 32% over a 52-week period and is currently trading at rich valuations of 26x on FY19E earnings and 22x on FY20E earnings. There is potential earning or rating upgrade catalysts upon the release of the final consultation paper on the implementation of RAB in early October. Separately, AirAsia is expected to face near-term tough operating environment of intense competition, higher operating costs due to the sale-and-lease-back of aircrafts and sustained high jet fuel price over the medium term.



AIRPORT Fwd PER Band

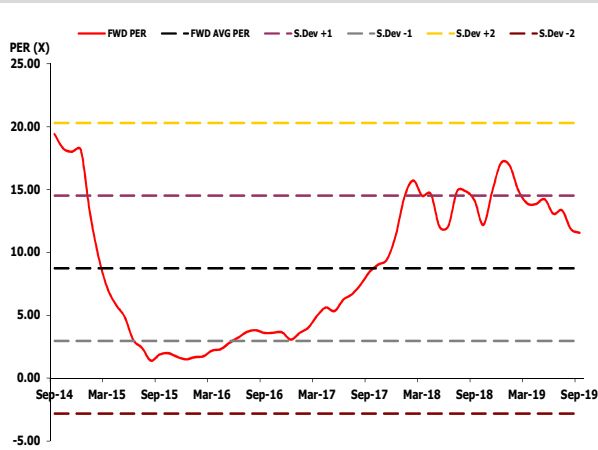


AIRPORT Fwd PBV Band

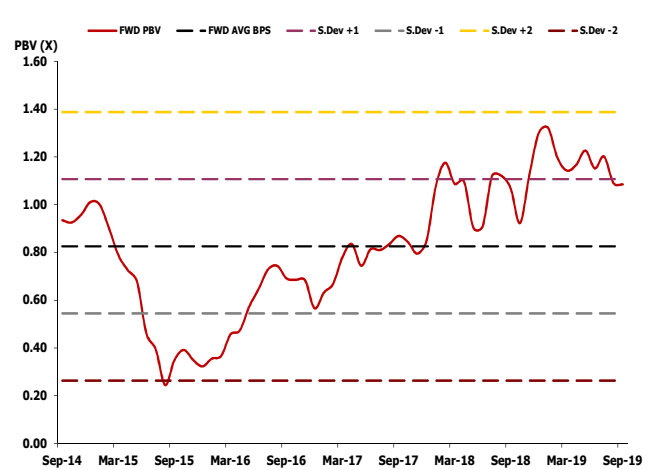


Source: Bloomberg, Kenanga Research

AIRASIA Fwd PER Band



AIRASIA Fwd PBV Band



Source: Bloomberg, Kenanga Research

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Peer Comparison - Airlines

Name	Local Currency	Last Price	Market Cap	Shariah Compliant	Current	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)		Net Div.Yld.1 (%)	Target	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.	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%	49.7%	1.70	MP	
MALAYSIA AIRPORTS HLDGS BHD	MYR	8.75	14,517.9	N	12/2019	7.9%	4.5%	-22.1%	16.9%	81.0	36.0	30.3	1.8	1.8	6.1%	1.7%	8.70	MP	
Simple Average						9.5%	6.7%	-27.1%	28.7%	45.7	25.6	20.6	1.3	1.4	6.0%	25.7%			
CONSENSUS NUMBERS																			
Low-Cost Carriers:																			
AIRASIA X BHD	MYR	0.170	705.2	Y	12/2019	2.6%	8.2%	-171.8%	-1722.4%	N.A.	N.A.	N.A.	1.2	1.7	-47.1%	0.0%	0.154	SELL	
ASIA AVIATION PCL	THB	3.08	14,938.0	N	12/2019	7.7%	8.3%	430.7%	120.9%	213.5	40.2	18.2	0.7	0.7	2.1%	2.5%	3.94	NEUTRAL	
CEBU AIR INC	PHP	94.00	56,486.2	N	12/2019	14.9%	7.5%	131.9%	10.8%	14.4	6.2	5.6	1.3	1.2	20.4%	6.0%	118.11	BUY	
EASYJET PLC	GBp	1,057.50	4,200.5	N	09/2019	7.4%	5.5%	-3.7%	7.0%	11.7	12.2	11.4	1.8	1.3	10.1%	0.0%	1,131.55	NEUTRAL	
GOL LINHAS AEREAS INTEL-ADR	USD	15.88	2,779.9	N	12/2019	21.6%	10.3%	214.4%	95.4%	N.A.	5.5	2.8	N.A.	N.A.	-6.5%	2.6%	24.91	BUY	
JETBLUE AIRWAYS CORP	USD	16.92	5,012.8	N	12/2019	6.0%	7.3%	205.4%	21.2%	26.7	8.7	7.2	1.0	0.9	11.7%	0.0%	20.59	NEUTRAL	
RYANAIR HOLDINGS PLC	EUR	10.00	11,127.5	N	03/2020	8.5%	4.8%	-7.1%	22.8%	12.6	13.5	11.0	2.2	2.2	14.8%	0.7%	11.00	NEUTRAL	
SOUTHWEST AIRLINES CO	USD	54.49	29,289.3	N	12/2019	2.2%	7.0%	-7.7%	15.3%	11.9	12.9	11.2	2.8	2.3	22.9%	1.3%	60.37	BUY	
VIRGIN AUSTRALIA HOLDINGS LT	AUD	0.160	1,351.2	N	06/2020	0.4%	0.8%	-593.5%	-326.7%	N.A.	N.A.	N.A.	2.3	8.9	-7.0%	0.0%	0.148	SELL	
Full-Service Carriers:																			
AIR CHINA LTD-H	HKD	7.14	125,830.6	N	12/2019	5.5%	7.8%	15.4%	18.6%	17.1	14.8	12.5	1.0	0.9	9.0%	1.7%	8.46	BUY	
AIR NEW ZEALAND LTD	NZD	2.70	3,031.6	N	06/2020	3.1%	2.9%	10.1%	14.8%	11.2	10.2	8.9	1.5	1.5	13.8%	8.1%	2.69	NEUTRAL	
ANA HOLDINGS INC	JPY	3,745.00	1,305,126.4	N	03/2020	3.4%	6.8%	-3.2%	11.3%	11.8	12.2	10.9	1.1	1.0	9.4%	2.1%	3,925.00	NEUTRAL	
ASIANA AIRLINES	KRW	5,400.00	1,194,670.6	N	12/2019	-0.6%	3.9%	-195.6%	177.4%	N.A.	N.A.	21.0	0.9	0.9	-10.0%	0.0%	5,200.00	BUY	
CATHAY PACIFIC AIRWAYS	HKD	10.12	39,810.5	N	12/2019	-1.5%	5.7%	-17.5%	35.0%	17.0	20.6	15.2	0.6	0.6	3.9%	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	0.8	2.4%	0.0%	10.50	NEUTRAL	
CHINA EASTERN AIRLINES CO-H	HKD	3.96	87,728.2	N	12/2019	9.3%	9.5%	109.4%	23.2%	32.5	15.5	12.6	0.9	0.8	7.6%	0.8%	4.80	BUY	
CHINA SOUTHERN AIRLINES CO-H	HKD	4.87	82,776.3	N	12/2019	8.9%	11.0%	78.4%	21.0%	28.6	16.0	13.2	0.8	0.8	6.9%	1.3%	5.81	BUY	
EVA AIRWAYS CORP	TWD	13.80	66,979.3	N	12/2019	3.0%	5.1%	-22.1%	14.9%	10.2	13.1	11.4	1.0	0.9	9.7%	3.6%	19.23	NEUTRAL	
GARUDA INDONESIA PERSERO TBK	IDR	550.00	14,237,616.9	Y	12/2019	13.2%	7.4%	271.2%	70.8%	N.A.	215,460.3	126,183.1	1.2	2.2	9.6%	0.0%	521.38	NEUTRAL	
HAINAN AIRLINES HOLDING CO-A	CNY	1.85	31,178.1	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%	-24.5%	6.5%	7.8	10.4	9.7	1.0	0.9	9.6%	3.3%	4,700.00	BUY	
JET AIRWAYS INDIA LTD	INR	33.70	3,828.2	N	03/2019	10.2%	-40.7%	-21.5%	11423.3%	N.A.	N.A.	14.8	N.A.	N.A.	44.0%	N.A.	N.A.	SELL	
KOREAN AIR LINES CO LTD	KRW	23,750.00	2,252,560.1	N	12/2019	0.2%	3.6%	-44.9%	283.2%	N.A.	N.A.	15.0	0.8	0.9	-15.9%	1.0%	31,750.00	BUY	
QANTAS AIRWAYS LTD	AUD	6.21	9,752.8	N	06/2020	2.9%	2.2%	9.9%	6.9%	10.9	10.0	9.3	2.8	2.6	27.5%	4.4%	6.49	BUY	
SINGAPORE AIRLINES LTD	SGD	9.24	10,950.6	N	03/2020	4.1%	4.1%	13.0%	7.3%	16.0	14.2	13.2	0.9	0.8	5.7%	3.7%	10.52	BUY	
THAI AIRWAYS INTERNATIONAL	THB	9.10	19,863.2	N	12/2019	3.2%	5.5%	-187.0%	-303.0%	N.A.	N.A.	N.A.	1.2	1.2	-34.5%	0.4%	8.08	SELL	
VIRGIN AUSTRALIA HOLDINGS LT	AUD	0.160	1,351.2	N	06/2020	0.4%	0.8%	-593.5%	-326.7%	N.A.	N.A.	N.A.	2.3	8.9	-7.0%	0.0%	0.148	SELL	

*Peers are denominated in their respective local currencies

Source: Bloomberg, Kenanga Research

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Peer Comparison-Airports

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%	49.7%	1.70	MP	
MALAYSIA AIRPORTS HLDGS BHD	MYR	8.75	14,517.9	N	12/2019	7.9%	4.5%	-22.1%	16.9%	81.0	36.0	30.3	1.8	1.8	6.1%	1.7%	8.70	MP	
Simple Average						9.5%	6.7%	-27.1%	28.7%	45.7	25.6	20.6	1.3	1.4	6.0%	25.7%			
CONSENSUS NUMBERS																			
Low-Cost Carriers:																			
AIRPORTS OF THAILAND PCL	THB	73.75	1,053,570.4	N	09/2019	5.6%	8.1%	4.6%	8.5%	41.9	40.0	36.9	7.1	6.7	17.5%	1.4%	79.08	BUY	
AUCKLAND INTL AIRPORT LTD	NZD	9.13	11,059.3	N	06/2020	2.8%	8.1%	-47.2%	7.2%	21.1	40.0	37.3	1.8	1.8	4.5%	2.5%	8.47	SELL	
BEIJING CAPITAL INTL AIRPO-H	HKD	7.04	30,489.5	N	12/2019	-4.2%	-8.9%	-20.4%	-29.2%	10.6	13.3	18.9	1.1	1.1	9.4%	3.0%	7.66	NEUTRAL	
FLUGHAFEN WIEN AG	EUR	37.70	3,166.8	N	12/2019	6.2%	2.3%	17.8%	5.7%	23.1	19.6	18.5	2.6	2.4	13.3%	3.1%	39.84	NEUTRAL	
FLUGHAFEN ZURICH AG-REG	CHF	179.00	5,495.6	N	12/2019	3.9%	1.4%	26.5%	2.7%	23.1	18.3	17.8	2.4	2.5	12.3%	3.9%	189.93	NEUTRAL	
GRUPO AEROPORT DEL PACIFIC-B	MXN	190.64	106,949.0	N	12/2019	7.1%	14.2%	8.1%	12.2%	21.2	19.6	17.5	6.3	5.5	26.3%	4.6%	208.16	NEUTRAL	
GRUPO AEROPORT DEL SURESTE-B	MXN	309.77	92,931.0	N	12/2019	9.4%	14.6%	9.5%	9.6%	18.6	17.0	15.5	3.1	2.8	17.4%	2.7%	342.31	NEUTRAL	
GRUPO AEROPORTUARIO DEL CENT	MXN	116.46	45,858.6	N	12/2019	1.4%	5.0%	13.4%	10.3%	16.1	14.2	12.9	5.6	4.6	35.1%	4.1%	133.50	BUY	
GUANGZHOU BAIYUN INTERNATI-A	CNY	21.26	43,993.8	N	12/2019	3.9%	10.4%	-14.7%	37.2%	39.0	45.7	33.3	2.9	2.8	6.0%	0.7%	19.54	BUY	
JAPAN AIRPORT TERMINAL CO	JPY	4,645.00	392,393.3	N	03/2020	1.9%	14.3%	-75.7%	47.1%	11.9	48.8	33.2	2.3	2.2	4.9%	0.9%	5,566.67	NEUTRAL	
KOBENHAVNS LUFTHAVNE	DKK	5,840.00	45,832.7	N	12/2019	N.A.	N.A.	N.A.	N.A.	41.5	N.A.	N.A.	15.6	N.A.	N.A.	N.A.	N.A.	SELL	
MALAYSIA AIRPORTS HLDGS BHD	MYR	8.75	14,517.9	N	12/2019	8.9%	6.9%	-17.8%	11.8%	21.7	26.4	23.6	1.7	1.6	6.8%	2.1%	9.18	BUY	
SYDNEY AIRPORT	AUD	8.01	18,091.4	N	12/2019	3.5%	4.7%	-3.8%	20.0%	48.6	50.5	42.1	N.A.	N.A.	-191.9%	4.9%	8.38	SELL	
TAV HAVALIMANLARI HOLDING AS	TRY	23.38	8,493.5	N	12/2019	-23.4%	-6.6%	-52.5%	45.3%	5.8	12.3	8.5	1.4	1.4	13.7%	5.4%	33.45	BUY	

*Peers are denominated in their respective local currencies

Source: Bloomberg, Kenanga Research



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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