

Malaysia Aviation

Precious cargo

NEUTRAL

[Unchanged]

AirAsia X may be beneficiary of high air cargo rates

In this report, we flag direct beneficiaries of air cargo rates that have been reaching for the sky (pun intended) as a result of the on-going COVID-19 pandemic. Private air cargo operators like MAS Kargo and Raya Airways have been generating large profits with only a handful of planes. Our research reveals that hitherto battered AirAsia X could be the next listed beneficiary of high air cargo rates. Note that we do not cover AirAsia X and thus, have no estimates or rating on the company.

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Air cargo rates are sky high due to COVID-19

Air cargo rates are at multi-year, if not record, highs. This is due to less belly cargo capacity, supply chain disruptions and higher demand for e-commerce and personal protective equipment - all caused by COVID-19 - that have driven the recent rally in air cargo rates. In fact, air cargo rates appear to be tracking the number of new COVID-19 cases worldwide higher. Compare and contrast this to glove prices which have been easing due to oversupply concerns despite the still raging COVID-19 pandemic and gloves being a necessary personal protective equipment. In summary, we opine that air cargo rates are direct beneficiaries of the aforementioned disruptions caused by the on-going COVID-19 pandemic.

MAS Kargo and Raya Airways generating large profits

Thanks to surging air cargo rates, **MAS Kargo (Not Listed)** and **Raya Airways (Not Listed)** have been generating large profits. In FY18A, MAS Kargo generated only MYR33.2m in net profit and Raya was loss-making. In FY20A, MAS Kargo generated a whopping MYR351.1m in net profit and Raya generated MYR99.7m in core net profit. Yet, air cargo rates climbed even higher in FY21A suggesting that both companies generated even higher profits in FY21A. In our view, Raya is especially noteworthy given that it operates only 4 very old planes and yet managed to generate nearly MYR100m in core net profit in FY20A and likely generated even more profits in FY21A.

AAX to be the next listed air cargo play?

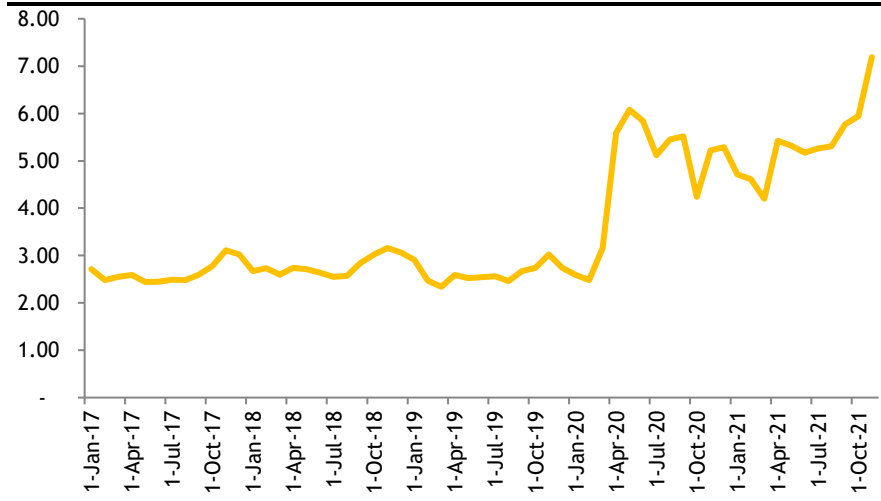
Emerging from a debt restructuring, **AirAsia X (AAX MK, CP: MYR0.06, Not Rated)** is now effectively debt free. AAX also managed to reduce the monthly lease rate payable to lessors for its A330-343s by c.60%. For added flexibility, AAX will not have to pay lessors if it does not fly over the next 2 years. Going forward, AAX will reduce its fleet size to 13 but it will still be more than 3x that of Raya and pivot from passenger to cargo. On 26 Jan 2022, AAX announced a major new air logistics partnership with **GEODIS (Not Listed)** to provide air cargo capacity. Currently, 5 planes are operational. Going forward, AAX expects to have 13 planes operational by mid-2022. AAX believes that it can be profitable with only 6 planes operational.

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							21E	22E	21E	22E	21E	22E
Malaysia Airpor	MAHB MK	2,482	Hold	6.26	6.10	(3)	nm	nm	1.7	2.0	0.0	0.0
CapitalA	AAGB MK	666	Buy	0.69	1.31	91	nm	nm	nm	nm	0.0	0.0
AirAsia X	AAX MK	55	NR	0.06	na	na	na	na	na	na	na	na

Air cargo rates are sky high due to COVID-19

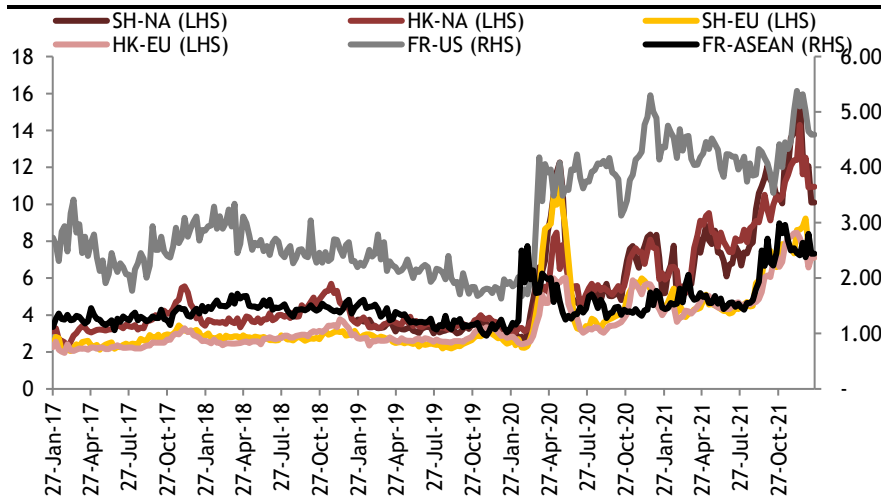
With Malaysia Aviation Group (MAG, Not Listed) having hired Standard Chartered Bank (STAN LN, CP: GBp571.40, Not Rated) to explore strategic options for MAS Kargo Sdn Bhd (MAS Kargo, Not Listed), including potential stake sale to strategic investors, and Raya Airways (Raya, Not Listed) exploring an Initial Public Offering, our interest in these two air cargo operators was piqued. Researching further, we discovered that air cargo rates are at multi-year, if not record, highs (Fig. 1 & 2).

Figure 1: Average air cargo rate (USD/kg)



Source: Drewry

Figure 2: Average air cargo rates on selected routes (USD/kg)



SH = Shanghai, NA = North America, HK = Hong Kong, EU = European Union, FR = Frankfurt, ASEAN = South East Asia

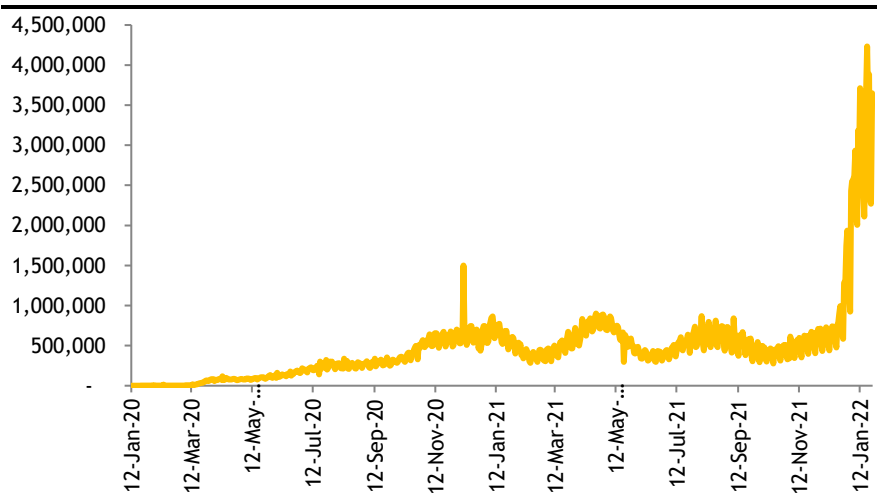
Source: TAC Index

Curiously, Fig.1 and 2 looks ‘awfully’ similar to the number of new COVID-19 cases around the world (Fig. 3) and we thought to ourselves that this apparent correlation could not be a coincidence. We spoke to industry participants about this and discovered that there is indeed a correlation due to:-

- i. **Less belly cargo capacity due to COVID-19** - passenger planes also carry cargo in their belly. With COVID-19 grounding many passenger planes, belly cargo capacity has been reduced, leading to higher air cargo rates.
- ii. **Supply chain disruptions caused by COVID-19** - lockdowns lead to supply chain disruptions (e.g. trucks unable to cross borders, cargo ships congested at ports), leading to higher demand for air cargo and higher air cargo rates.

- iii. Higher demand for e-commerce and personal protective equipment (PPE) caused by COVID-19 - demand for both has surged due to COVID-19, again, leading to higher demand for air cargo and higher air cargo rates.

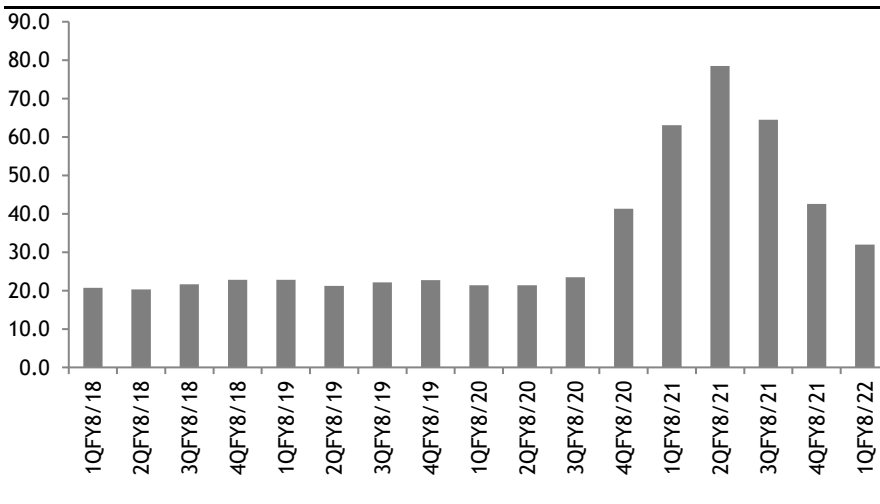
Figure 3: Number of new COVID-19 cases worldwide



Source: World Health Organisation

Compare and contrast this to glove prices which have been easing due to oversupply concerns (Fig. 4) despite the still raging COVID-19 pandemic and gloves being a necessary PPE. Thus, we opine that air cargo rates and thus, air cargo operators are direct beneficiaries of the on-going COVID-19 pandemic.

Figure 4: Blended average glove prices (USD/1,000 pieces)



Source: Top Glove

MAS Kargo and Raya Airways generating large profits

Thanks to surging air cargo rates, the likes of MAS Kargo and Raya have been generating large profits. MAS Kargo operates 3 planes (A330-200F) and rents belly cargo space from sister company, Malaysia Airlines (MAS, Not Listed) to fly to nearly 100 destinations worldwide. Raya operates 4 planes (1 B737-400F and 3 B767-200F) and flies to Malaysia, Indonesia, Singapore, Vietnam and Hong Kong. Interestingly, the average age of Raya’s 4 planes is very old at 35 years.

Figure 5: Selected MAS Kargo financial statistics (MYRm)

	FY18A	FY19A	FY20A
Revenue	1,277.8	1,270.9	1,977.5
EBITDA	48.3	159.1	577.5
Depreciation	(15.0)	(88.8)	(87.7)
EBIT	33.3	70.3	489.8
Net interest expense	(0.1)	(46.1)	(43.1)
Exceptionals	-	-	-
Pre-tax profit	33.2	24.2	446.7
Income tax	(0.0)	156.3	(95.5)
Reported net profit	33.2	180.5	351.1

Source: Companies Commission of Malaysia

Figure 6: Selected Raya Airways financial statistics (MYRm)

	FY18A	FY19A	FY20A
Revenue	158.0	197.6	334.1
EBITDA	3.4	37.1	99.8
Depreciation	(18.4)	(28.9)	(30.2)
EBIT	(15.0)	8.2	69.6
Net interest expense	(4.1)	(5.2)	(6.5)
Exceptionals	-	-	(22.0)
Pre-tax profit	(19.1)	3.0	41.1
Income tax	(0.1)	0.0	36.6
Reported net profit	(19.2)	3.0	77.7

Source: Companies Commission of Malaysia

Examining Fig. 5 and 6, it becomes immediately obvious that their fortunes have improved significantly in the last 4 years. In FY18A, MAS Kargo generated only MYR33.2m in net profit and Raya was loss-making. In FY20A, MAS Kargo generated a whopping MYR351.1m in net profit and Raya generated MYR77.7m in net profit (core net profit: MYR99.7m).

Furthermore, air cargo rates climbed even higher in FY21A (Fig. 1). This suggests to us that both companies generated even higher profits in FY21A. MAG CEO, Captain Izham Ismail hinted as such when he was quoted as saying, "Our internal projections are that MAS Kargo could bring in MYR2.7b (+35% YoY) in revenue for FY21A" ([link](#)).

In our view, Raya's financials are more outstanding than that of MAS Kargo given that it operates only 4 very old planes without renting other planes' belly space and yet managed to generate nearly MYR100m in core net profit in FY20A and likely generated even more profits in FY21A.

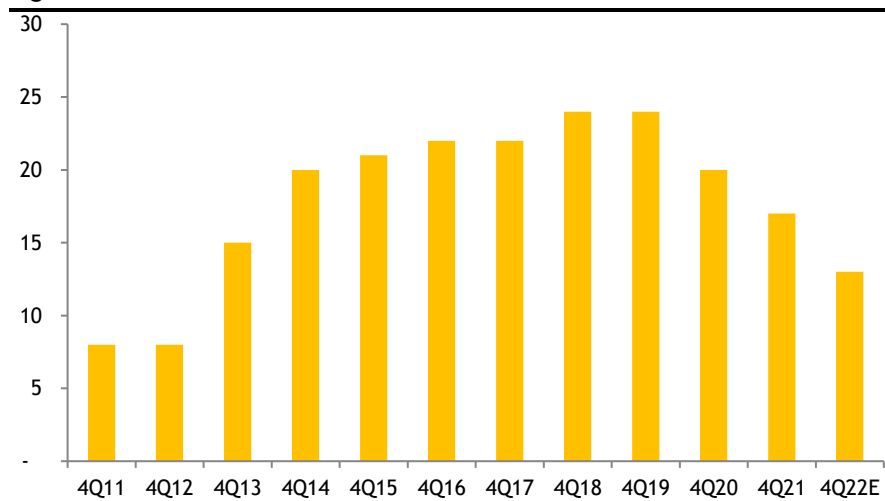
AAX to be the next listed air cargo play?

And then, there is AirAsia X (AAX MK, CP: MYR0.06, Not Rated). AAX had struggled for years as a low cost long haul passenger airline. The COVID-19 pandemic has been especially brutal to it as Malaysia's borders were largely closed for more than 1.5 years. On 29 Oct 2021, it was classified as a PN17 listed issuer after its external auditor Messrs Ernst & Young PLT expressed a disclaimer of opinion on its audited financial statements for the 18-month financial period ended 30 Jun 2021.

Things started turning around on 12 Nov 2021 when its creditors agreed to a restructuring that will allow AAX to pay just 0.5% of liabilities owed of MYR33.7b and end existing contracts. In return, creditors except Airbus (AIR FP, CP: EUR115.64, Not Rated) will receive 20% of EBITDAR above MYR300m from FY23E to FY26E. AAX is now effectively debt free. On 26 Jan 2022, it completed a share capital reduction where its issued share capital was reduced from MYR1.5b to MYR1.5m. The credit was offset against accumulated losses (3Q21: MYR35.3b). Tomorrow (11 Feb 2022), every 10 AAX shares will be consolidated into 1 AAX share. In 1Q22, AAX will execute a rights issue to raise MYR300m and placement of new shares to raise MYR200m.

AAX also managed to reduce the monthly lease rate payable to lessors for its A330-343s by c.60%, from USD700k-USD800k, to USD285k. For added flexibility, AAX will not have to pay lessors if it does not fly its A330-343s which is colloquially known as Power By The Hour or PBH over the next 2 years. Going forward, AAX will reduce its fleet size to 13 but it will still be more than 3x that of Raya (Fig. 7) and pivot from passenger to cargo. Currently, 5 planes are operational to cater to charter and cargo demands. Going forward, AAX expects to have 13 planes operational by mid-2022. AAX believes that it can be profitable with only 6 planes operational.

Figure 7: AAX A330-343 fleet size

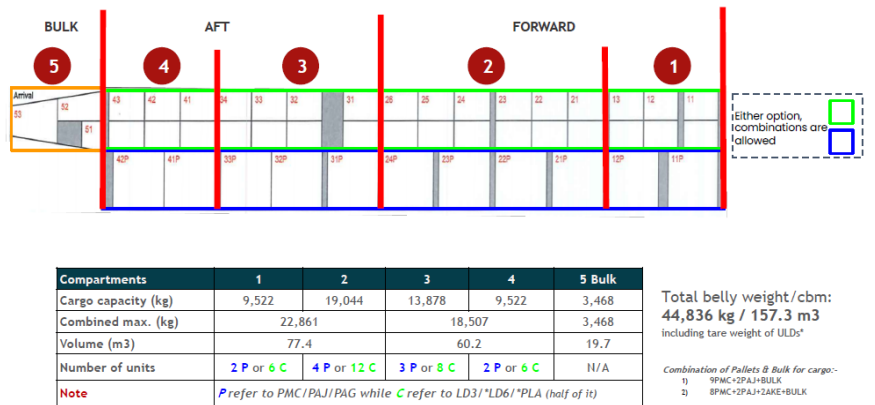


Source: AAX

Each A330-343 can carry 45 tonnes in its belly (Fig. 8). If it is converted into a freighter plane, each A330-343 can carry 60 tonnes of payload. Raya's B737-400F can carry only 20 tonnes of payload and its B767-200F can carry only 40 tonnes of payload. Currently, AAX is partnering 3 freight forwarders on an ad hoc basis, MAERSK (MAERSKA DC, CP: DKK21,600, Not Rated), GEODIS (Not Listed) and Teleport (subsidiary of Capital A (formerly AirAsia Group) (AAGB MK, BUY, CP: MYR0.66, TP: MYR1.31)) and flies to Hong Kong, South Korea, India and Australia, with up to 30x weekly cargo flights:-

- Hong Kong - 17x weekly flights
- Seoul, South Korea - 4x weekly flights
- Bangalore and Mumbai, India - 4x weekly flights
- Sydney, Australia - 5x weekly flights

Figure 8: Belly cargo overview of an A330-343



Source: AAX

On 26 Jan 2022, AAX announced a major new air logistics partnership with GEODIS to provide air cargo capacity. GEODIS is a global supply chain operator with focuses on (i) supply chain optimization, (ii) freight forwarding, (iii) contract logistics, (iv) distribution and express, and (v) road transport. GEODIS’ global network spans 168 countries, employs 41,837 people globally and generated EUR8.4b in revenue in FY20. GEODIS is ranked 7th in the world in its field. It is also the distribution and express leader in France.

The agreement is set to run for an initial period of 6 months commencing from 20 Jan 2022 with further extensions to be contemplated. Under the agreement, AAX will provide regular dedicated scheduled cargo flights between Kuala Lumpur and Hong Kong, Chennai, Shanghai and Sydney. AAX stated that this partnership provides better certainty on plane utilisation and earnings visibility. It also stated that more partnerships will be finalised in coming months.

While AAX stated that it is pivoting to cargo, it will cater to passengers who are flying to destinations that it serves on its cargo routes. In effect, AAX will carry both passengers and cargo to improve profitability. On 31 Jan 2022, AAX announced that it will resume passenger flights between Kuala Lumpur and Sydney on 14 Feb 2022. Sydney is 1 of the destinations that AAX serves on its cargo routes. Thus, it follows that AAX may resume passenger flights between Kuala Lumpur and Hong Kong, Seoul, Bangalore, Mumbai, Chennai and Shanghai.

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