

SECTOR UPDATE

Aviation – Malaysia

Taking Off From The International Runway

With Malaysia officially shifting to the endemic phase, we envisage that the aviation sector will progressively resurrect its pre-pandemic earnings dynamics. We expect both MAHB and CAPITALA to deliver a net profit turnaround in 2022, and prefer MAHB for its attractive valuations and event catalysts. Meanwhile, concerns on the Russia-Ukraine war and inflationary pressures have manageable direct impacts and can be effectively transferred to end-consumers. Maintain MARKET WEIGHT.

WHAT'S NEW

- Borders reopening a key milestone for the aviation sector.** Malaysia's international borders will be fully reopened from 1 April onwards to resurrect the tourism sector, after a near two-year closure. While the abolishment of several cumbersome safety protocols such as mandatory PCR test and mandatory quarantine apply only to fully vaccinated international travellers, we foresee a surge in air travel activities and foreign visitorship to Malaysia. Coupled with resilient domestic leisure demand, this will fuel CAPITALA A (CAPITALA) and Malaysia Airport's (MAHB) earnings recovery throughout 2022-23.
- Anticipating passenger traffic volume to chart a strong recovery to 53%/93% of pre-pandemic levels in 2022/23 respectively.** For 2022, we assume that domestic and international traffic volume recovers to 65% and 41% of 2019's volume. This is premised on: a) rising optimism about the short-lived impact of the Omicron variant and the locals' mobility behaviour graduating into the endemic stage, b) pent-up travel demand amid higher retail spending and consumers' accumulated savings, and c) harmonising of entry coordination and border-crossing requirements within the ASEAN region.
- Prominent earnings recovery in sight, MAHB's valuations still at a bargain.** With the recovery of passenger traffic, we are forecasting a net profit turnaround for both CAPITALA and MAHB for 2022. For MAHB, we estimate that earnings will recover close to 2019 levels as early as 2023. MAHB is also currently trading at attractive valuations of 7.9x FY23 EV/EBITDA, well below its pre-pandemic five-year mean of 10x EV/EBITDA.
- Modest impacts from Russia-Ukraine geopolitical tension.** We deem the direct impact from the Russia-Ukraine war to be minimal, given that tourist arrival from both countries accounted for merely 0.4% of Malaysia's total tourist arrivals in 2019, while the potential revenue loss for MAHB's Sabiha Gokcen International Airport (ISG) is manageable at only about 2-3% of 2022's total revenue. Meanwhile, while the war has elevated jet fuel price to a multi-year high, CAPITALA's airlines operations will be able to pass on costs via fare rise or fuel surcharge without significantly impacting demand.

ACTION

- Maintain MARKET WEIGHT.** The aviation sector is the primary beneficiary of the borders reopening; our top pick is MAHB.
- Upgrade MAHB to BUY with a higher target price of RM7.52** after raising our passenger traffic assumptions for 2022-23 by 3% and 6% respectively. We value MAHB's Malaysian operations at 10x 2023 EBITDA (mean) and derive an SOTP valuation of RM7.52. We also like MAHB for its event catalyst of formulating a new operating agreement (OA) with potentially more favourable concession terms.
- Maintain HOLD on CAPITALA with target price of RM0.72**, based on 2023's SOTP. Despite expecting the easing of travel restrictions and resumption of flights to boost meaningful recovery from 2Q22 onwards, our concern lays in the group's PN17 status which will continue to impact investors' sentiment until the issue is resolved. Meanwhile, the group will also require more time to restore its financial health and ensure its book value deficit of -RM0.80/share (as of 4Q21) turns profitable.

PEER COMPARISON

Subsector/Company	Ticker	Rec	Price @ 28 Mar 22 (RM)	Target Price (RM)	Market Cap (US\$m)	EV/EBITDA 2023F (x)	Yield 2023F (%)	PE 2023F (x)
Capital A Berhad	CAPITALA MK	HOLD	0.655	0.72	646	3.8	0.0	2.5
Malaysia Airports Holdings	MAHB MK	BUY	6.45	7.52	2,538	7.4	1.7	19.1

Source: UOB Kay Hian

MARKET WEIGHT (Maintained)

SECTOR RECOMMENDATION

Sub-sectors	Recommendation
Airport	OVERWEIGHT
Airlines	MARKET WEIGHT

Source: UOB Kay Hian

MAHB'S SOTP VALUATION

(RMm)	2023
Malaysian Operations 2023 EBITDA	1,285
EV/EBITDA (x)	10.0
Enterprise value	12,852
Net debt	-2,596
ISG Fair value (WACC: 9.0%)	1,875
Equity Value	12,479
No. of Shares (m)	1,659
Equity Value (RM)	7.52

Source: UOB Kay Hian

CAPITALA'S SOTP VALUATION

	2023
CAPITALA Book Value (RMm)	(1,988)
Add Fair Value of Super App (RMm)	4,180
Add Fair Value of BigPay (assuming 25% share for BigPay, CAR of 8%, valuation @2.0x loan)	625
SOTP (RMm)	2,817
Number of Shares (m)	3,898
Fair Value Per Share (RM)	0.72

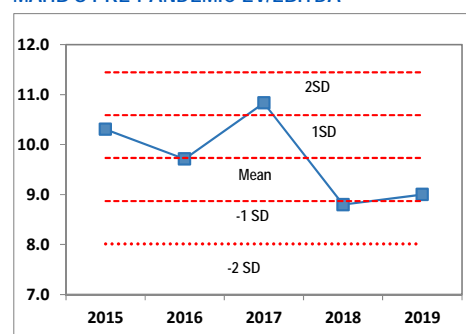
Source: UOB Kay Hian

MAHB'S PAX TRAFFIC ASSUMPTIONS

Malaysia	----- Pax traffic assumption (as a % of 2019) -----			
	2019	2021	2022E	2023E
International	53234	3%	41%	90%
Domestic	51855	9%	65%	96%

Source: UOB Kay Hian

MAHB'S PRE-PANDEMIC EV/EBITDA



Source: UOB Kay Hian

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ESSENTIALS

- Industry-wide operating income improved in 4Q21; clearer skies ahead.** With further resumption of flights and gradual improvement in passenger traffic, pressure on both CAPITALA and MAHB's operating profitability eased in 4Q21 with narrowing losses of 69% and 80% yoy respectively. We forecast that MAHB's passenger traffic volume will recover to 53% and 93% of pre-COVID levels in 2022-23 respectively (refer to table on the right). For CAPITALA, we estimate that the passengers carried and load factors to recover to >80% of pre-COVID-19 levels in 2023.
- International travel a substantial earnings booster for MAHB and CAPITALA.** International travel demand particularly in the ASEAN region is essential to CAPITALA's load factor and passenger traffic recovery (accounted for >40% of AirAsia Malaysia's passengers carried in 2019). As for MAHB, the international travel demand is crucial as passenger service charges (PSC) for international traffic is more than 3x and 5x of domestic traffic in Malaysia's airport and Turkish airport (ISG) respectively, besides contributing meaningfully to non-aeronautical revenue such as royalties from duty-free shopping. We expect MAHB to be the main beneficiary of borders reopening, given that international visitors accounted for >50% of Malaysian airports' pre-pandemic patronage.
- MAHB: Formulation of new OA and DA-LLA remains as a major re-rating catalyst.** To note, MAHB has received the authorities' approval on the new OA's principal terms and is currently awaiting MAVCOM to conduct economy review on the PSC based on financial & benchmark fundamentals. The finalisation of the new OA is expected to be concluded by 2Q22. Meanwhile, MAHB is also in the final stage of negotiation with the government on the Development Agreement and land Lease Agreement (DA-LLA) for KLIA's Aeropolis Digital Free Trade Zone. We expect the new OA to have more favourable terms such as adjustment of airports' PSC which is well below regional's benchmark rate. Based on our sensitivity analysis, a RM1 increase to MAHB's current blended PSC of about RM45 will potentially increase 2% of its 2023 EBITDA.
- MAHB: General closure of Ukraine and Russia air space a temporary disruption to ISG's recovery.** To note, the flights between Istanbul SGIA, Ukraine and Russia are temporarily disrupted due to the geopolitical conflicts. For MAHB, our channel checks revealed that passenger movements to and from Russia and Ukraine account for about 8-10% of total international passengers via ISG. Assuming a reduction of 7-8% of total international passengers in ISG if all flights to/from Russia and Ukraine are cancelled for the remainder of 2022, potential earnings impact for MAHB is manageable at only about 2-3% of total revenue and about 5% of group's EBITDA. We deem that this will likely be offset by resilient air traffic recovery following the global economic reopening and travel relaxations.
- CAPITALA: Resumption of more international routes as regional travel restrictions ease.** AirAsia is poised to resume more flights in its core markets in Malaysia, Thailand, the Philippines and Indonesia following progressive borders reopening in the ASEAN region. The group is also eyeing to introduce and increase its flight frequencies to some of Asia's most popular international destinations including Bali, Manila, Bangkok, Ho Chi Minh City, and Phuket starting April. We deem that the swift reopening of regional borders and pent-up leisure demand will accelerate CAPITALA's earnings recovery, while the capacity will be largely supported by the group's current 75 aircraft in operations (38% of its total fleet of 200 aircraft).
- CAPITALA: Fuel headwinds may compound margins weaknesses, but higher fares shall buffer.** With the recovery in global economic activity and supply disruption from the Russia-Ukraine war, jet fuel prices which usually command about 20-30% of airlines' operating costs have been surging >75% ytd and exceeded >US\$135 per barrel to near a 14-year high. We deem that this sustained high fuel prices may put upward pressure on AirAsia's airline costs, but this will be largely buffered by higher fares. Our channel checks revealed that AirAsia reintroduced fuel surcharge for all its domestic and international flights to transfer the cost to end-consumers in order to offset the incremental fuel costs.

MAHB'S PASSENGER TRAFFIC MOVEMENT SNAPSHOT



Source: MAHB

MAHB'S CURRENT PSC RATE

PSC for Malaysia	Benchmark (RM/pax)	Gazetted Rates (RM/pax)
International (Non-ASEAN)		
KLIA & other airports	80.00	73.00
klia2	40.00	73.00
International (ASEAN)		
KLIA & other airports	80.00	35.00
klia2	40.00	35.00
BIMP-EAGA, IMT-GT & Secondary (Note 1)	32.00	35.00
Domestic		
KLIA & other airports	11.00	11.00
Klia2	8.00	11.00

Source: MAHB

CAPITALA'S AVIATION ASSUMPTIONS

Year to 31 Dec	2019	2020	2021	2022F	2023F
Pax Carried Growth (%)	16.0	(74.2)	(63.8)	331.4	101.8
Seat Capacity Growth (%)	15.9	(70.5)	(63.8)	247.5	124.0
ASK Growth (%)	13.5	(74.6)	(70.1)	301.1	128.0
Average Net Fares (RM)	228.5	215.0	223.9	242.4	246.2
Yoy % chg	4.2	(5.9)	4.2	8.3	1.5
Average Gross Pax Fares (RM)	179.0	175.0	183.9	198.6	198.6
Yoy % chg	3.9	0.0	5.1	8.0	0.0
Unit Cost Per Seat (RM)	183.7	476.9	657.4	185.3	181.9
Seat Factor (%)	84.6	74.2	74.0	91.9	82.8
Break-even Seat Factor (RM)	80.4	221.8	293.6	76.4	73.9

Source: UOB Kay Hian

JET FUEL & CRUDE OIL PRICES (\$/BARREL)



Source: Platts, Datastream

AIRASIA MALAYSIA'S FUEL SURCHARGE

Routes	Fuel Surcharge (RM)
All domestic routes (within Malaysia)	10
International routes (1-2 hours)	25
International routes (2-3 hours)	35
International routes (3-4 hours)	50
International routes (>4 hours)	60

Source: CAPITALA

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