Aviation

MAVCOM Proposes to Peg Airport Tariffs to CPI

NEUTRAL

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Maintain NEUTRAL on the aviation sector. Malaysian Aviation Commission (MAVCOM), in its newly-released (on 14 March 2023) *Second Consultation Paper on the Long-Term Framework for the Regulation of Aviation Services Charges*, proposes to raise airport tariffs based on CPI with effect from Regulatory Period 1 (RP1) (2024-2026). While this certainly is better than none in its *First Consultation Paper*, we are doubtful this could raise enough cash for AIRPORT (MP; TP: RM6.80) for capex purposes, particularly, for airport expansion and maintenance.

Pegging airport tariffs to CPI. MAVCOM, in its newly released (on 14 March 2023) Second Consultation Paper on the Long-Term Framework for the Regulation of Aviation Services Charges, proposes to raise airport tariffs based on CPI with effect from RP1, vs. none in the *First Consultation Paper* revealed back in Aug 2022. However, this is just a second consultation framework and not cast in stone as the Commission is also seeking feedback from stakeholders. Specifically, MAVCOM has proposed to raise tariff for passenger service charge (PSC) under RP1 in : (i) 2024 - Domestic, Asean and non-Asean to RM11.76 (+6.9%), RM37.1(+5.7%) and RM78.03 (+6.9%); (ii) 2025 - Domestic, Asean and non-Asean to RM12.03 (2.3%), RM38.27 (+3.2%) and RM79.83 (+2.3%); and (iii) 2026 - Domestic, Asean and non-Asean to RM12.32 (+2.4%), RM39.19 (+2.4%) and RM81.74 (+2.4%). For illustration purposes, *ceteris paribus*, the proposed PSC rate is expected to raise our FY24 net profit for AIRPORT by 5%. MAVCOM's view is consistent with the *First Consultation* paper that cost-based approaches to setting tariffs would be impractical for RP1 when demand is low and uncertain as the sector continues its slow recovery, hence demand over the course of RP1 will continue to be below pre-pandemic trends, meaning that average costs will likely be higher than those seen prior to the pandemic. As such, there is a significant risk of understating or overstating AIRPORT's average costs. This could result in a significant increase in tariffs. We believe the framework is to ensure that the airport operator does not take advantage of its dominant market position to either offer substandard service quality or charge exorbitant tariffs. The Commission proposes to reassess the timing of this transition prior to the start of RP2. Nevertheless, in our view, MAVCOM has to set a reasonable tariff rate given the urgency for airport expansion and maintenance capex in Malaysia to enable AIRPORT to accumulate the required cash for capex purposes.

Loss accumulation and recovery mechanisms explained back loading AIRPORT's cash flows. In anticipation that AIRPORT is expected to incur losses following the slow recovery for air travel post pandemic, MAVCOM proposed two mechanisms. MAVCOM proposes to apply a loss capitalisation mechanism (LCM) in RP1. The LCM will allow AIRPORT to recover 90% of any efficient loss it incurs in RP1. The Commission will estimate the loss in each year of RP1 individually, before considering the cumulative losses over the whole period. This loss or gain does not refer to AIRPORT's accounting profit, such as its EBIT. Rather, the loss refers to the difference between: (a) an estimate of the revenue that AIRPORT would require over RP1 to cover its prudent and efficient costs (the allowed revenue); and (b) the revenue that AIRPORT will actually earn over RP1 from the imposition of aviation service charges (the actual revenue). Essentially, actual revenue will be based on AIRPORT's total airport operations revenue which includes both aeronautical and non-aeronautical revenue. The Commission proposes that the losses are recovered over a period of 10 years starting in Year 1 of RP2.

Illustration of LCM. For illustration purposes, assuming that over RP1, AIRPORT's reveal that it incurred operating costs of RM200m and depreciation of RM500m, suppose the Commission estimates that AIRPORT should be allowed a return of a further RM500m (to reflect a reasonable rate of return on the unrecovered cost of invested capital). In this case, AIRPORT's allowed revenue for RP1 would be RM1.2b, which is the sum of its operating costs, depreciation, and allowed return on capital. That is, MAVCOM estimates that AIRPORT would need to earn RM1.2b over RP1 to cover its costs. At the start of RP2, MAVCOM would compare this total allowed revenue for RP1 with AIRPORT's actual revenue for RP1. Assuming AIRPORT actually earns RM1.3b over RP1, which it earned RM100m more that it required to cover its costs. In this case, AIRPORT would be entitled to retain 10% of the gain (i.e., RM10m) but would be required to return 90% of the gain (i.e., RM90m) to customers via proportionately lower charges over the 'payback' period. Conversely, assuming AIRPORT actually earns RM1b over RP1, which is RM200m less than it required to cover its costs. In this case, AIRPORT would be required to bear 10% of this loss (i.e., RM20m) but would be entitled to recover 90% of the loss (i.e., RM180m) from customers through proportionately higher charges over the 'payback' period.

Capex not subject to loss sharing ratio. As opposed to the First Consultation paper, MAVCOM in the Second Consultation paper proposed that if AIRPORT wishes to undertake certain high priority investment over RP1, it can ask the Commission to allow this capex to be recovered in full in RP2 (where it cannot be recovered in RP1). The proposed capex would not be subject to the loss sharing ratio in the LCM.

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen) 1-Yr. Fwd.	Core EPS (sen) 2-Yr. Fwd.	Core EPS Growth 1-Yr. Fwd.	Core EPS Growth 2-Yr. Fwd.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net. Div. (sen) 1-Yr. Fwd.	Net Div Yld (%) 1-Yr. Fwd.
Stocks Under Coverage																	
CAPITAL A BHD	UP	0.800	0.670	-16.3%	3,329	Y	12/2023	2.6	3.8	-96.5%	48.3%	30.9	20.8	NM	NM	0.0	0.0%
MALAYSIA AIRPORTS HOLDINGS BHD	MP	6.81	6.80	-0.1%	11,299	Y	12/2023	27.8	31.0	28.5%	11.7%	24.5	21.9	1.5	6.1%	12.0	1.8%

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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