AmInvestment Bank

Sector report
14 May 2020

TRANSPORTATION & LOGISTICS

Covid-19 pandemic poses unprecedented challenges

UNDERWEIGHT
(Downgraded)

AmInvestment Bank
www.amequities.com.my
03-2036 2240

Rationale for report: Sector update

Investment Highlights

- We downgrade our call on the transportation & logistics sector to **UNDERWEIGHT** (from NEUTRAL) as it has become increasingly clear that the damage inflicted by the Covid-19 pandemic to the sector is no mere dent but destruction of varying degrees to different segments. It has resulted in a steep contraction in port throughput, a total collapse in demand for air travel and disruption to logistics services, particularly international mails and parcels.

- **Ports:** The segment has been hit at both the demand and supply sides. On the demand side, the pandemic has hurt global consumption and investment, resulting in lower shipping volumes and hence container throughput at the ports. On the supply side, global manufacturers have been operating with sub-optimal utilisation as their suppliers along the supply chain have been affected in varying degrees by the pandemic. Lower factory production has translated to less cargoes handled at the ports. In fact, the ports have also suffered a disruption on the supply side, i.e. backlogs at the ports as some stevedores and truck drivers are unable to return to work.

- We project container throughput to contract by 15% at **Westports (HOLD, RM3.81)** and 10% at ports of **MMC Corporation (BUY, RM1.13)** in FY2020F. This will be consistent with: (1) the steep swing in global GDP growth from +2.9% in 2019 to -3.0% in 2020F as Fund (IMF); projected by International Monetary and (2) a 10% contraction in demand for global container shipping in 2020F as projected by Copenhagen-based shipping consultant Sea-Intelligence ApS, dragged down largely by the Asia-Europe and trans-Pacific trades; and (3) the deteriorating world PMI outlook (Exhibit 1).

- However, on a brighter note, we project container throughput at **Westports** and ports of **MMC Corporation** to bounce back by +10% and +8% respectively (from a low base) in 2021F, assuming that by then the pandemic will have been significantly contained or vaccines will have been developed and made available, resulting in a recovery in global GDP projected at +5.8% by the IMF. We are more inclined to be in the “u-shaped recovery camp” as far as seaport container throughput is concerned. We only expect container throughput to recover to the pre-Covid-19 level in 2022F (Exhibit 4 & 5).

- Over the longer term, we view positively the outlook for ports in the region (Malaysia included), underpinned by rising investment in the manufacturing sector that generates tremendous inbound (feedstock) and outbound (finished product) throughput for ports. There have been significant relocations of the manufacturing base by multi-national companies out of China to other parts of the world including the region as they rethink geographical diversification/supply chain concentration risk, coupled with the rising labour and land costs in China and the volatile US-China relation.

- **Air travel:** The global air travel industry has come to a complete halt as countries across the globe have imposed restrictions on air travel since Mar 2020 (Exhibit 6) to contain the spread of Covid-19. While certain countries are now easing lockdowns and reopening their economies gradually, they are not rushing into restarting cross-border air travel. According to popular real-time flight tracker FlightRadar24, commercial flights worldwide plunged 73.7% YoY in Apr 2020 (Exhibit 7). Locally, the Malaysian Aviation Commission (Mavcom) in end-Mar 2020 slashed its 2020 air passenger traffic grow forecast for Malaysia to -36% to -38% (from +4% to +5% previously). We project passenger volume for **AirAsia (SELL, RM0.43)** to shrink by 35% YoY in FY20F, followed by a 25% rebound in FY21F from a low base (again, assuming that by then the pandemic will have been significantly contained or vaccines will have been developed and made available).

- We are also more inclined to be in the "u-shaped recovery camp" as far as air travel demand is concerned. Even if countries are to gradually ease restrictions on air travel, passengers may not jump back into air travel immediately. We anticipate domestic air travel will first recover, followed by cross-border, longer-haul air travel (assuming that countries are to do away with the 14-day quarantine for cross-border air travel).

- On the demand side, multiple surveys have showed that only about 60% passengers are ready to travel again within the next six months (we believe, that is assuming no increases in fares). On the supply side, airlines may not be able to immediately ramp up their schedules due to limitations on routes (due to varying degrees of border reopening by different countries), a longer turnaround time (due to stricter safety standard operating procedure or SOP) and a cap on the load factor (to effect social distancing in the cabin) that inevitably translates to higher fares. According to a research by the International Air Transport Association (IATA), with a cap on the load factor, airlines will have to raise fares as much as 54% to remain profitable.

- Low-cost carriers, **AirAsia** included**,** will struggle if they have to substantially raise the fares in order to cushion the negative impact from the load factor cap, as their passengers are highly price-sensitive. We maintain our view that **AirAsia's** key strategy of aggressively growing its top line (to mitigate the high cost structure arising from the recent aircraft sale-and-leaseback scheme) has been thwarted by the collapse and the expected long and winding recovery road of the air travel market.

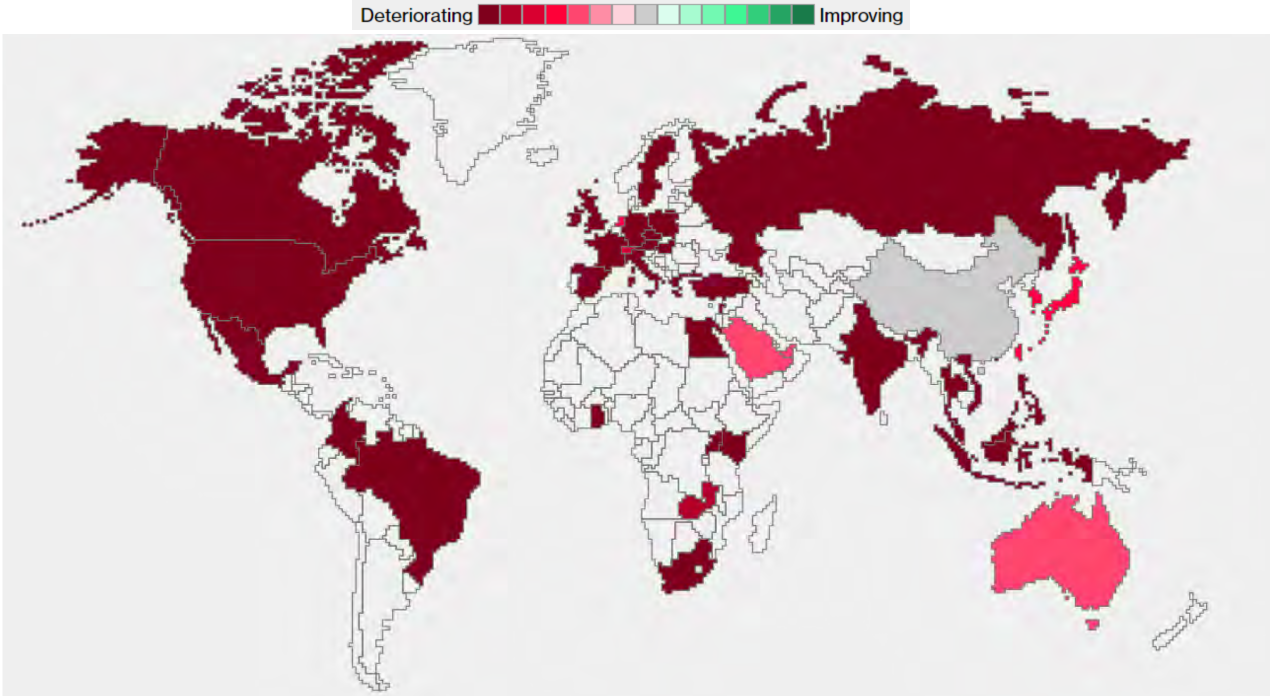
- **Logistics:** We believe the parcel delivery segment is a winner of the current situation as the pandemic and the resultant social distancing accelerate the change in shopping habits of consumers from physical to online channels. Based on research data by e-commerce ecosystem player Commerce.Asia, the value of merchandise sold via e-commerce in Malaysia surged 149% YoY in 1Q2020 amidst the pandemic. The growth in e-commerce sales translates to rising volumes of parcels handled by parcel delivery companies such **Pos Malaysia (SELL, RM0.58)** and **GDex (Unrated)**. However, the sector has low entry barriers. A crowded playing field (with 116 players as at March 2020) has given rise to cut-throat competition resulting in severe squeeze in margins. Meanwhile, in order to achieve better economies of scale, players are expanding their capacity. For instance, **Pos Malaysia** plans to double its daily automated parcel processing capacity, currently at 500K, by 2025.

- On the other hand, **Pos Malaysia** has suspended its international mail and parcel services to most of its destinations for more than four weeks due to the cancellation of flights and airport closures. The disruption to global logistic supply chain has also hurt **Pos Malaysia's** other business units such as the international segment (which handles direct entry or transshipment of mails/parcels from other countries), logistics segment (which provides haulage services, warehousing and distribution services) and aviation segment (which includes cargo and ground handling and in-flight catering). Again, we are more inclined to expect only a gradual recovery in these business units as their customers may not have survived the current downturn, and even if they do, they could have scaled down their operations permanently.

- We project **Pos Malaysia's** mail volume to drop by 35% in FY20F (vs. a contraction in the teens in FY19 based on our estimates). We expect the decline in commercial mail volume to accelerate further with businesses stepping up on cost-cutting initiatives and business consolidation amid the economic downturn.

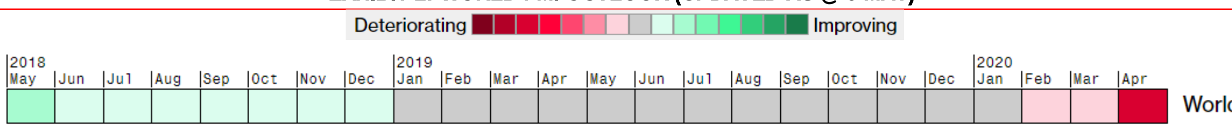
- Our top pick within the sector is **MMC Corporation**. While we are mindful of the soft patch ahead amidst a major slump in the world economy as well as world trade in the aftermath of the Covid-19 pandemic, we believe the recent selldown on **MMC Corporation** has been overdone. We see value in **MMC Corporation** with its port business being valued at 11x forward P/E on a stand-alone basis (see Exhibit 12 for our sum-of-parts valuation for **MMC Corporation**).

EXHIBIT 1: GLOBAL PMI ACTIVITY (MOM CHANGES)



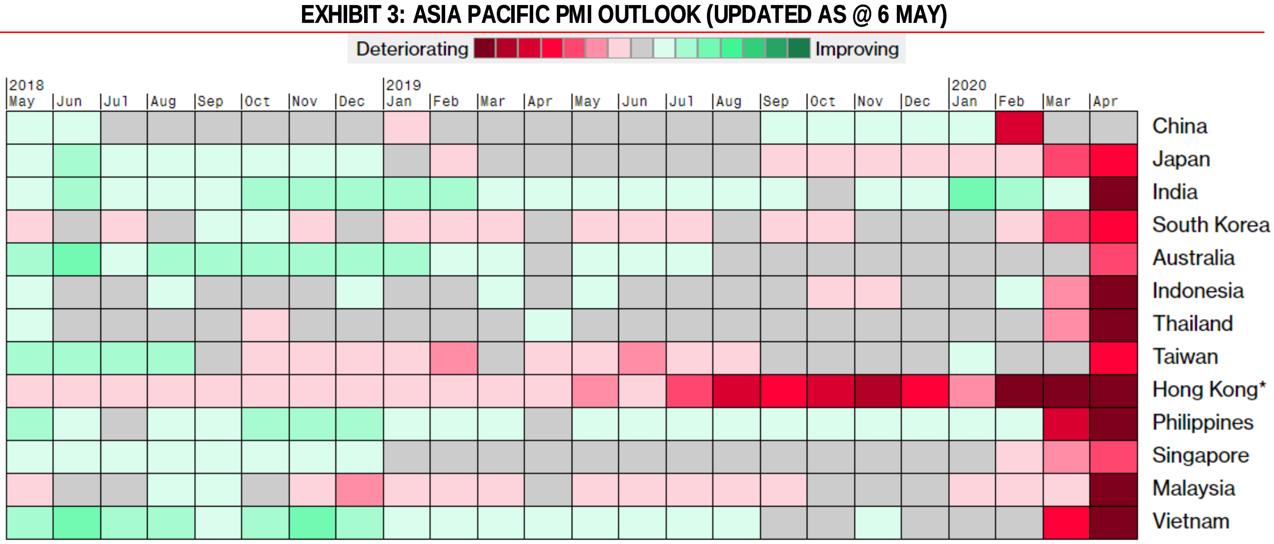
Source: Bloomberg

EXHIBIT 2: WORLD PMI OUTLOOK (UPDATED AS @ 6 MAY)



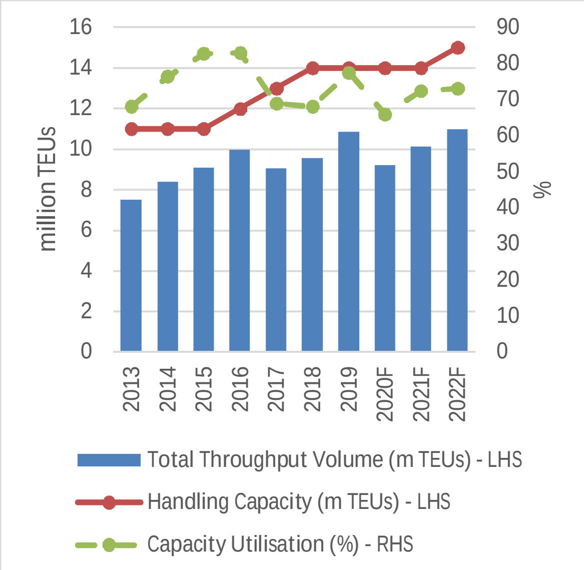
Source: Bloomberg

EXHIBIT 3: ASIA PACIFIC PMI OUTLOOK (UPDATED AS @ 6 MAY)



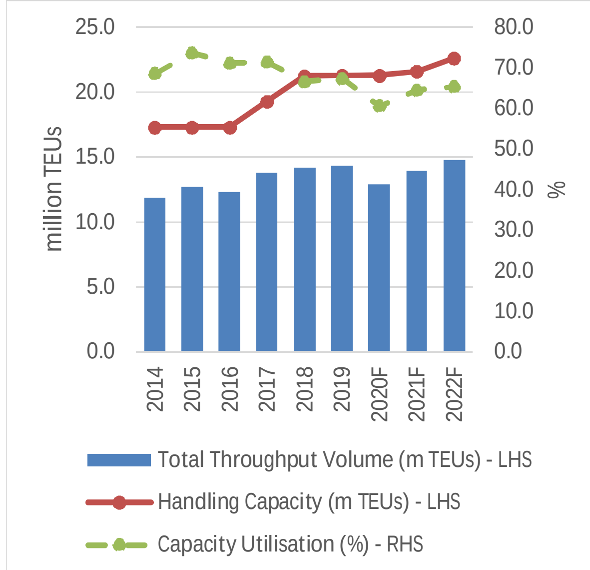
Source: Bloomberg

EXHIBIT 4: WESTPORTS CONTAINER THROUGHPUT



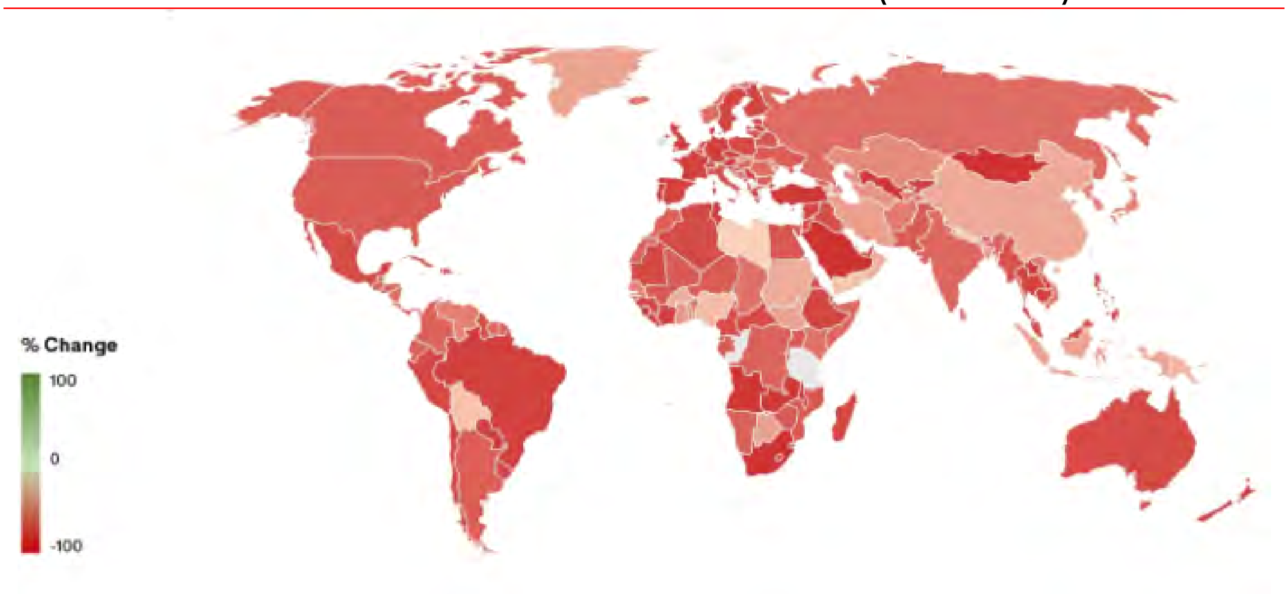
Source: Company, AmInvestment Bank Bhd

EXHIBIT 5: MMC CONTAINER THROUGHPUT



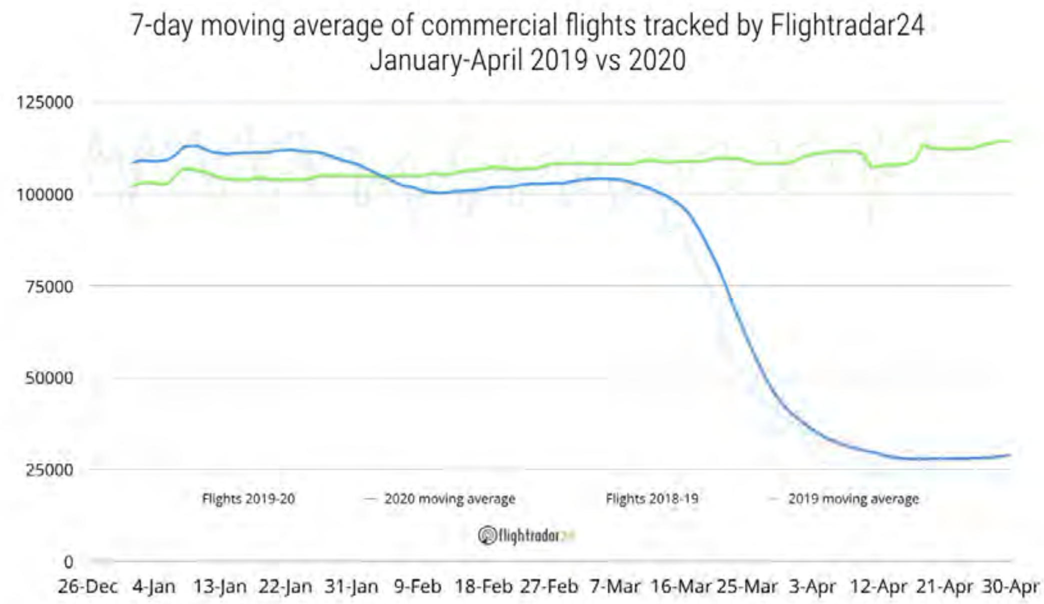
Source: Company, AmInvestment Bank Bhd

EXHIBIT 6: CHANGE IN FLIGHTS COMPARED TO PREVIOUS YEAR (WEEK OF 11 MAY)



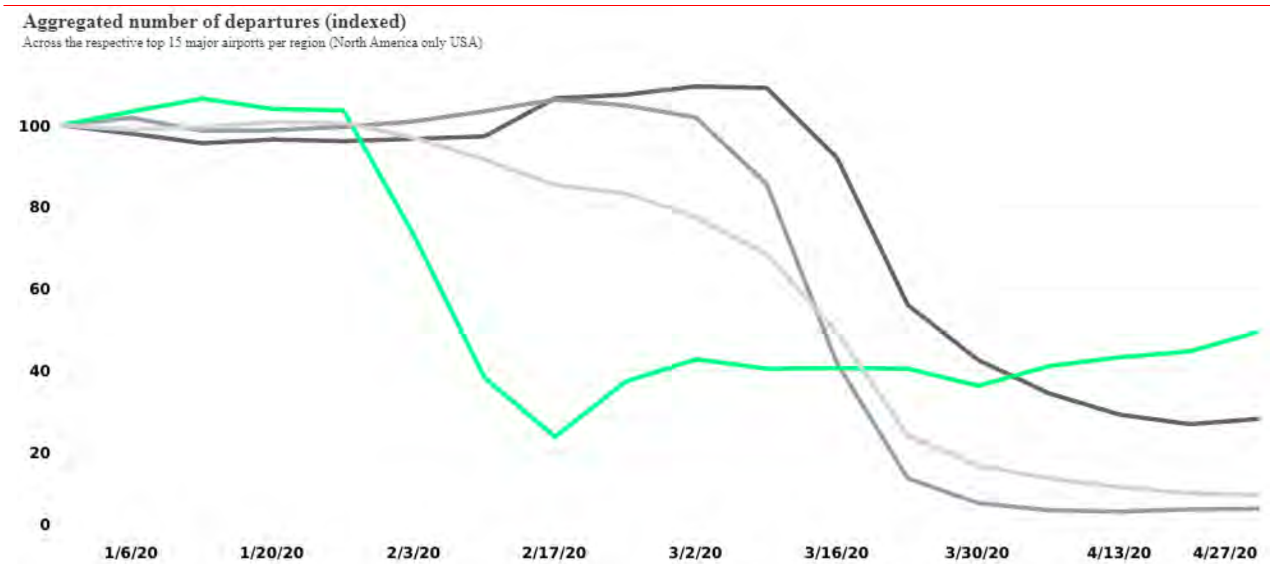
Source: OAG

EXHIBIT 7: GLOBAL COMMERCIAL FLIGHTS TRACKING



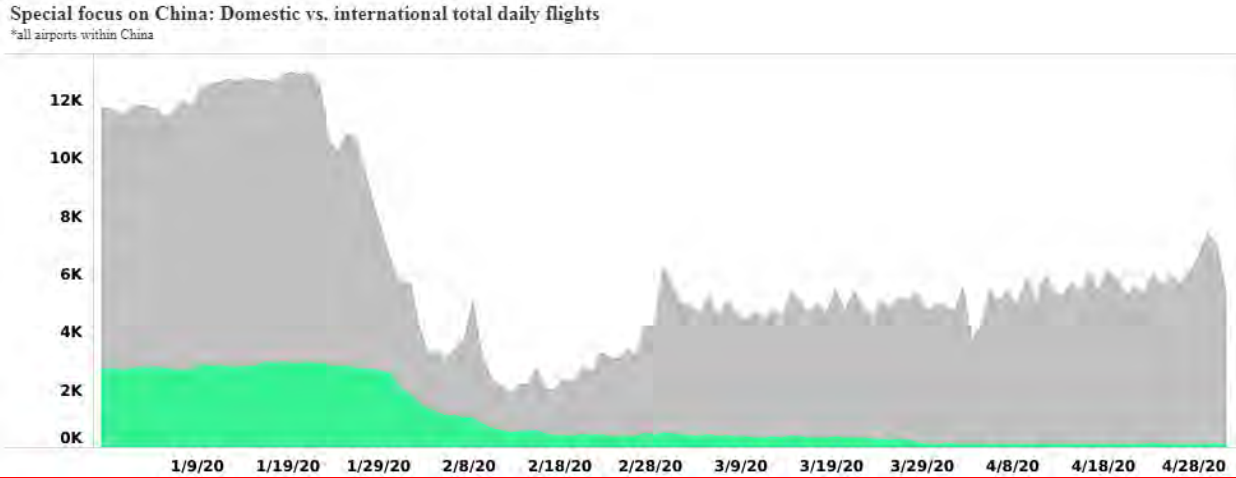
Source: Flightradar24

EXHIBIT 8: AGGREGATED NUMBER OF DEPARTURE



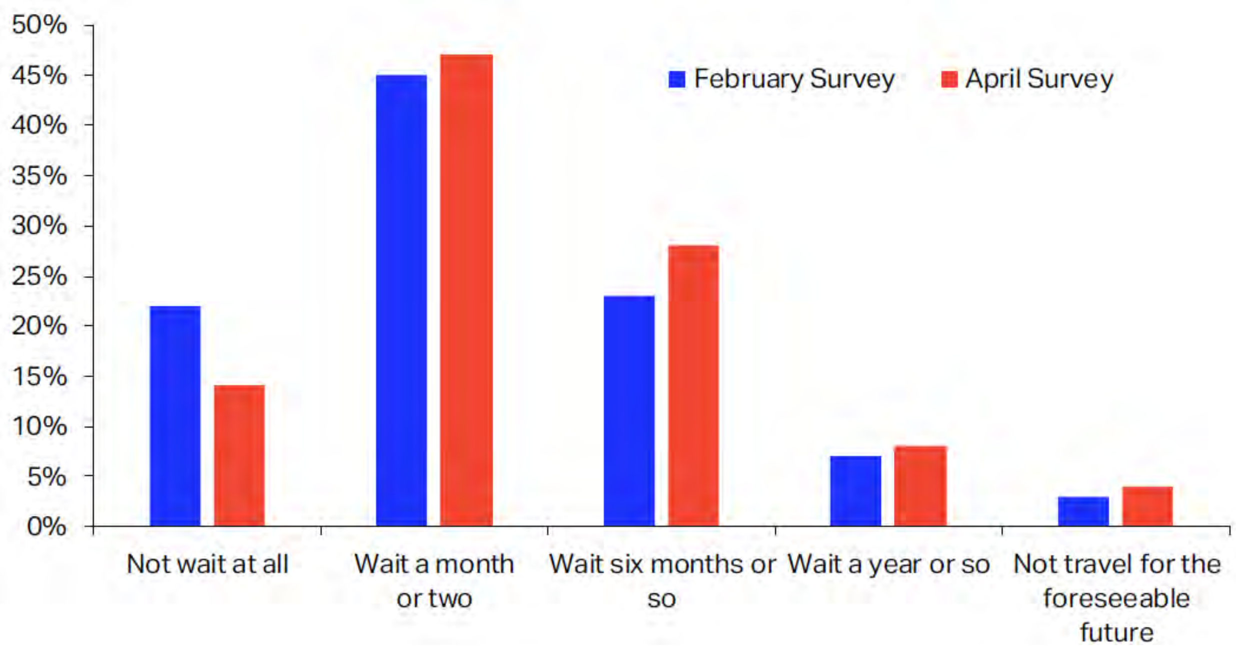
Source: Lufthansa Innovation Hub Analysis, Flightradar24, FlightStats

EXHIBIT 9: CHINA'S DOMESTIC VS INTERNATIONAL TOTAL DAILY FLIGHTS



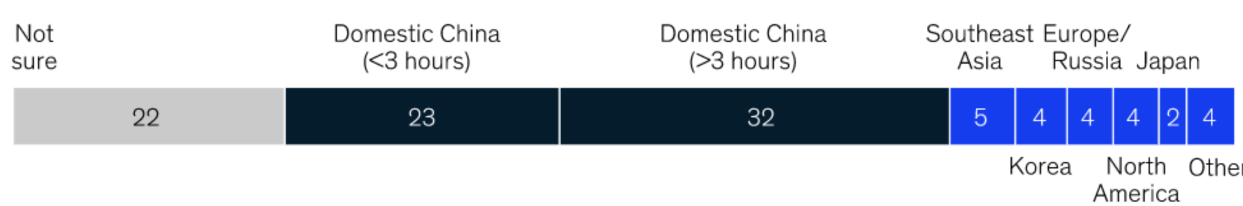
Source: Lufthansa Innovation Hub Analysis, Flightradar24, FlightStats

EXHIBIT 10: SURVEY ON PASSENGERS RETURNING TO TRAVEL



Source: IATA

EXHIBIT 11: PLANNED TRAVEL DISTANCE FOR NEXT LEISURE TRIP AMONG CHINESE (%)



Source: McKinsey & Company

EXHIBIT 12: MMC'S SOP VALUATION

FYE Dec	Value (RM mil)	Basis
Ports & Logistics		
Ports	4,678.2	16x FY21F earnings, a 30% discount to 23x of peers' historical average
Senai Airport	160.0	Book value as at Dec 2018
Engineering & Construction	406.5	Net profit from outstanding orderbook (Exhibit 2), discounted to NPV at a 10% discount rate
Energy & Utilities		
Malakoff (38.4%)	1,728.0	AmBank's FV @ RM1.00 with 10% holding company discount
Gas Malaysia (30.9%)	1,042.7	Consensus FV @ RM2.92 with 10% holding company discount
Aliran Ihsan Resources Berhad	487.0	Acquisition cost
Net Cash/(Debt)	(5,047.3)	As at 31 Dec 2019 (at the company level)
Total Value (RM mil)	**3,455.1**	
No of shares	**3,045.1**	
FV per share	**1.13**	

Source: company, AmInvestment Bank

EXHIBIT 13: VALUATION MATRIX

	Recomm.	Price	FV	Upside	Mkt Cap	FYE	EPS (sen)		EPS growth (%)		P/E (x)		P/B*	ROE*	NDPS*	Div Yield*
		(RM)	(RM)	(%)	(RMmil)		FY20F	FY21F	FY20F	FY21F	FY20F	FY21F	(x)	(%)	(sen)	(%)
AirAsia	SELL	0.73	0.43	-41.1	2,439.7	Dec	-44.1	6.6	239.2	-115.0	-1.7	11.1	0.9	-39.8	0.0	0.0
Pos Malaysia	SELL	1.08	0.58	-46.3	845.4	Dec	-11.5	3.0	-24.3	-126.1	-9.4	36.0	1.7	-14.4	6.0	5.6
Westports	HOLD	3.54	3.81	7.6	12,071.4	Dec	16.5	18.1	-4.6	9.7	21.5	19.6	0.7	16.1	12.4	3.5
MMC Corporation	BUY	0.71	1.13	60.3	2,146.8	Dec	6.8	8.0	-16.0	17.6	10.4	8.8	3.5	2.1	3.8	5.4
Simple Average									**48.6**	**-53.4**	**5.2**	**18.9**	**1.7**			
Weighted Average									**27.0**	**-13.3**	**15.4**	**17.8**	**1.1**			

**FY20*

Source: company, AmInvestment Bank

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