



The Cockpit View (Issue #12)

OVERWEIGHT (Unchanged)

The big oil relief (Part II)

- Asia Pacific airlines are all net beneficiaries of lower fuel prices, but the quantum varies across the group.
- Hedging ratio is declining, industry becoming more geared to lower jet fuel prices.
- LONG Chinese and Taiwanese carriers, and fundamental BUYs on AirAsia and Cebu. SHORT Thai Airways and Tigerair.

What's New

We have compiled a matrix on the impact of fuel price movement to Asia Pacific airlines' earnings after netting off for fuel hedges. This is a good indicator of which airlines are the most operationally leveraged to lower fuel prices.

The Verdict

Airlines with the least fuel hedging is benefiting nicely in the current environment of lower oil prices. Chinese mainline carriers top the beneficiary list as they do not hedge fuel. We can expect their FY15 profits to soar on a YoY basis. They are followed by carriers that have hedged small portions such as the Taiwanese carrier Asiana, and Cebu and Qantas. For carriers that have hedged a higher portion of their fuel requirements, such as THAI Airways and All Nippon Airways, they will benefit much less.

Hot Stocks of the Week

Korean based airlines were the outperformers last week with solid gains at Asiana and Korean Air. This is more of catch-up play as both stocks were punished on the MERS outbreak earlier in the second quarter. Fears of the outbreak have subsided and the market has reassessed the risk-reward for airlines stocks.

The underperformers were Singapore Airlines and Garuda Indonesia. Both have released fairly satisfactory results, but the market was jittery on the management's forward outlook statements.

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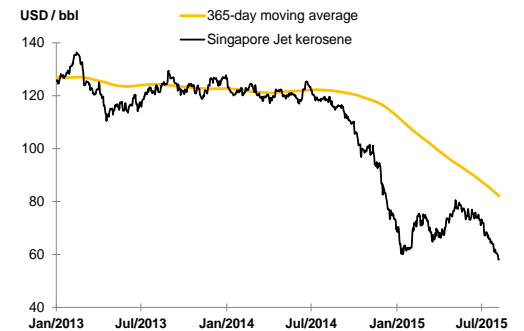
Bloomberg Asia Pacific Airline Index



Current trend: **Rangebound**

Spot	Last week	Last month	YTD (2014)
204	208	202	142
	+2.5%	+2.9%	+45.8%

Jet fuel price



Current trend: **Declining fast**

Spot	YTD	2014
USD58.1/bbl	USD71.0/bbl	USD112.4/bbl

Our recent reports

1. Thai Airways - 2Q15 Expect THB10b loss SELL, Target price: THB12.0 (7 Aug)
2. AirAsia - The underdog will have its day BUY, Target price: MYR2.32 (7 Aug)
3. Bangkok Air - Earnings show turnaround BUY, Target price: THB28.0 (6 Aug)

Assessing the fuel price impact by airlines

The table below shows the fuel consumption, fuel cost as a percentage of revenue, existing fuel hedges and impact of USD10/bbl lower fuel price to earnings for all the listed Asia Pacific airlines.

Asia Pacific airlines' fuel price movement impact matrix

Company Name <i>alphabetical order</i>	Fuel used (m bbl)	Fuel as % revenue	Fuel hedges / exposure (Jet kerosene unless otherwise stated)	Latest 12M profit (local currency)	USD10/bbl lower fuel. (Chg to net income)
Air China	39.8 (f)	34.1%	No hedges	CNY3,817m	CNY2,471 (+65%)
Air New Zealand	8.0	24.9%	57% in 2Q15 at USD83.3/bbl (Brent + WTI) 53% in 3Q15 at USD72.7/bbl (Brent + WTI) 35% in 4Q15 at USD61.2/bbl (Brent + WTI) 4% in 1Q16 at USD64.5/bbl (Brent + WTI) Also bought PUTs, can potentially reduce cost	NZD255m	NZD63m (+25%)
AirAsia	5.8	40.8%	50% in 2Q15 at USD88/bbl 50% in 3Q15 at USD84/bbl 50% in 4Q15 at USD84/bbl	MYR347m	MYR114m (+33%)
AirAsia X	3.6	47.0%	54% in 2015 at USD88.26/bbl	(MYR487m)	MYR77m (>> big)
All Nippon Airways	32.9 (f)	20.5%	70% in FY15 (Mar yr end), price not disclosed 35% in FY16 (Mar yr end), price not disclosed 15% in FY17 (Mar yr end), price not disclosed	JPY44.1b	JPY10.3b (+23%)
Asia Aviation	2.8	41.2%	50% in 2Q15 at USD88/bbl 50% in 3Q15 at USD84/bbl 50% in 4Q15 at USD84/bbl	THB551m	THB498m (+90%)
Asiana Airlines	16.0	32.7%	8.4% in 2015, price not disclosed	KRW169b	KRW171b (+101%)
Bangkok Airways	1.3	30.0%	73% in 2Q15 at USD98/bbl 70% in 3Q15 at USD92/bbl 50% in 4Q15 at USD70/bbl	THB904m	THB156m (+17%)
Cathay Pacific	41.7	38.0%	53% in 2015 at USD113/bbl (Brent) 37% in 2016 at USD110/bbl (Brent) 33% in 2017 at USD102/bbl (Brent)	HKD3,251m	HKD1,489m (+46%)
Cebu Air	5.1	40.4%	28% in 2015 at USD105.5/bbl 19% in 2016 at USD82.75/bbl	PHP5,756m	PHP1,679m (+29%)
China Airlines	14.9 (f)	41.0%	Does hedge but no information, assume 25%	TWD3,826m	TWD3,528 (+92%)
China Eastern	37.5 (f)	32.6%	No hedges	CNY5,186m	CNY2,326m (+45%)
China Southern	43.1 (f)	34.7%	No hedges	CNY3,982m	CNY2,677m (+67%)
EVA Airways	13.2 (f)	42.7%	Does hedge but no information, assume 25%	TWD1,616m	TWD3,123m (+193%)
Garuda Indonesia	9.5	33.1%	27% in 2015, price not disclosed	(USD134m)	USD69m (>> big)
Hainan Airlines	n/a	n/a	Not available, but assume not hedged.	CNY3,338m	n/a
Japan Airlines	26.1 (f)	19.9%	40% in FY15 (Mar yr end), price not disclosed 15% in FY16 (Mar yr end), price not disclosed 5% in FY17 (Mar yr end), price not disclosed	JPY166.9b	JPY29.3m (+18%)
Korean Air Lines	32.6	25.7%	30% in 2015, price not disclosed	(KRW457b)	KRW266b (>> big)
Nok Air	1.2	36.0%	55% in 2015 at USD85/bbl	(THB511m)	THB406m (>> big)
Qantas Airways	33.3 (f)	30.8%	30% in 1H15, price not disclosed	(AUD2,405m)	AUD385m (>>big)
Singapore Airlines	37.3	34.2%	46.3% in FY16 (Mar yr end) at USD99.3/bbl 4.0% in FY16 (Mar) at USD102/bbl (Brent)	SGD350m	SGD278m (+79%)
THAI Airways	17.7 (f)	40.0%	75% in 2Q15 at USD99/bbl (Brent) 80% in 3Q15 at USD98/bbl (Brent) 80% in 4Q15 at USD 95/bbl (Brent)	(THB84.0b)	THB2,9m (small)
Tiger Airways	1.6 (f)	39.4%	40% in FY16 (Mar yr end) at USD64.42/bbl	(SGD201m)	SGD14m (>> big)
TransAsia Airways	0.8 (f)	29.4%	3% in 1H15, price not disclosed	TWD194m	TWD251m (+130%)
Virgin Australia	9.0 (f)	27.5%	72% in 1Q15 (Brent), price not disclosed	(AUD325m)	AUD101m (>> big)

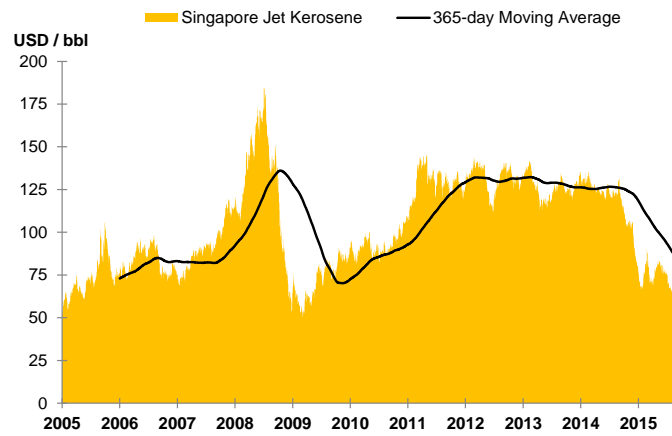
(f) = our forecast based on average fuel price and average exchange rates

Sources: Respective airlines, Bloomberg, Maybank KE

Jet fuel at five-year low

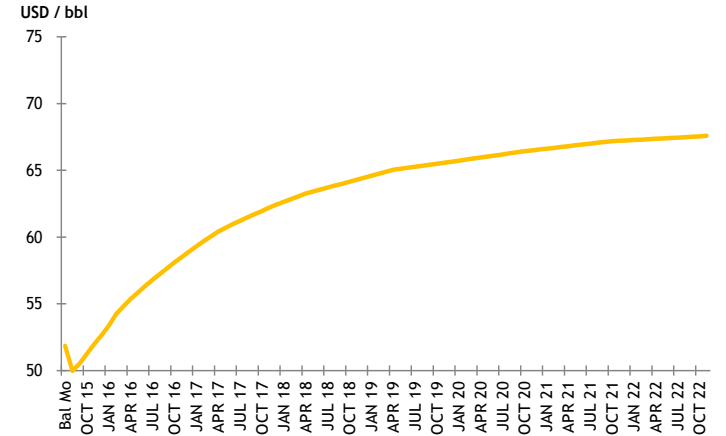
The graphs below show the jet fuel price since 2005 and also the Brent futures curve. The 365-day moving average jet fuel price is at the lowest level since 2009 and based on the current futures curve, it is likely to surpass the levels within the next 3-4 months. Suffice to say that oil prices are at low levels, which are tremendously beneficial for the industry.

Singapore jet kerosene and 365-day moving average



Source: Bloomberg

Brent crude futures curve (7 Aug 2015)

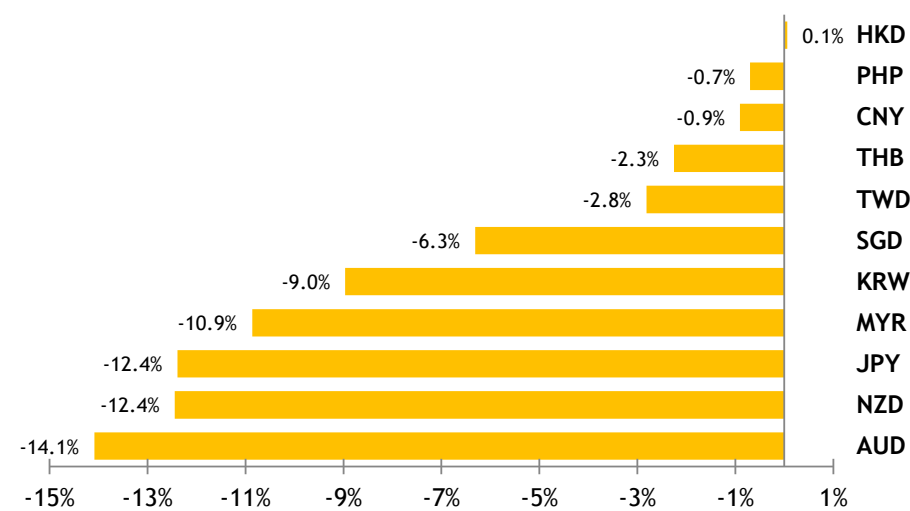


Source: Bloomberg

Currency crimps some of the lower fuel price benefits

All major Asia Pacific currencies have depreciated against the USD in 2015. This will negate some of the benefits of lower jet fuel prices because it is USD denominated. In addition, many other airlines' operating costs are denominated in USD, such as the cost of aircraft, maintenance and USD loans. The degree of impact varies depending on the airline as some have USD exposure on its revenues, which will help to offset the cost impact.

Asia Pacific major currencies movement against USD in 2015 YTD

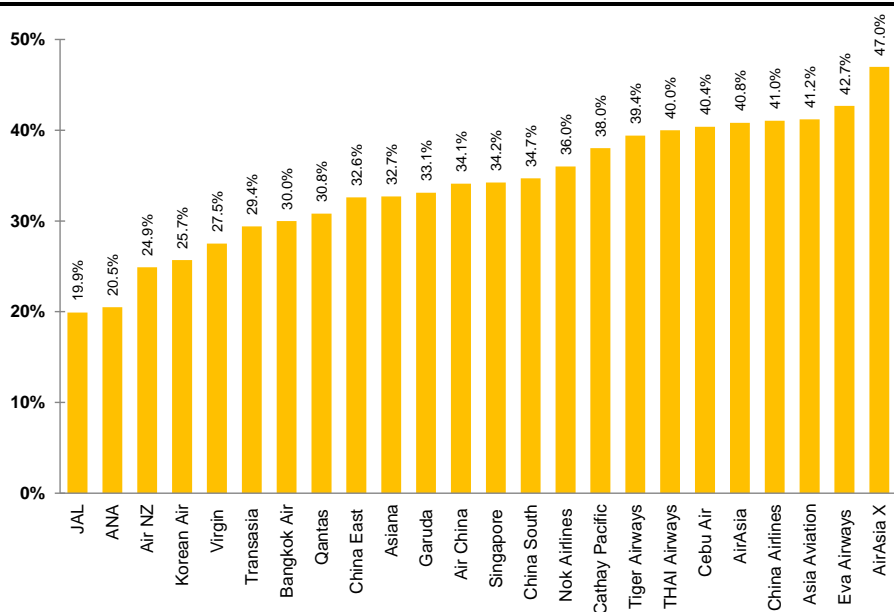


Source: Bloomberg

Factors contributing to fuel sensitivity

There are three factors that influence airlines’ sensitivity towards fuel. The first is average stage length; the further you fly implies more fuel required, and hence the greater the sensitivity. Second is the composition of their cargoes as a percentage of overall capacity. Cargo operations carry very low overheads. As such, cargo’s fuel cost component is 1.5-2.0x higher than in the passenger business. Third is overhead, which varies depending on the make-up of their fleet and country of operations.

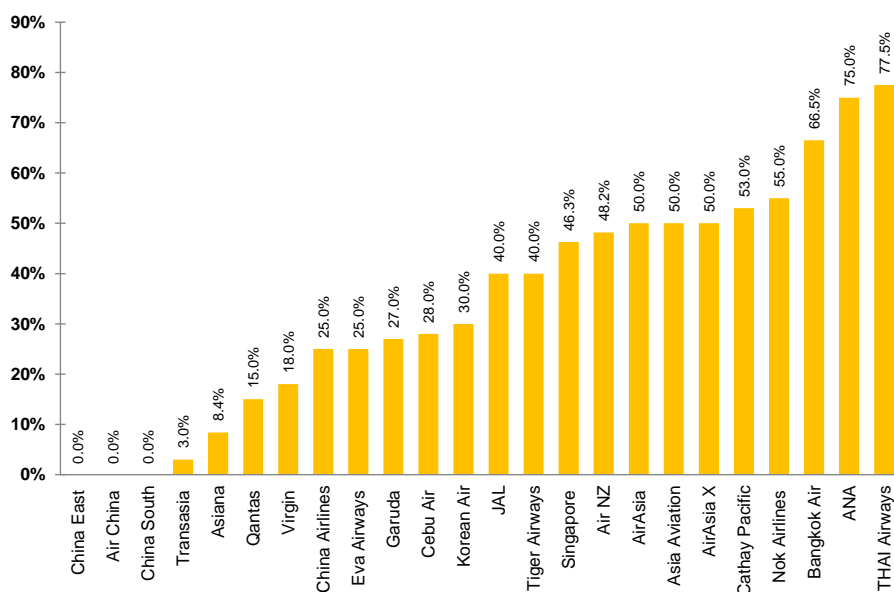
Fuel cost as percentage of revenue for Asia Pacific airlines



Sources: Respective airlines, Maybank KE

Hedge ratio: By hedging fuel, airlines basically reduce the volatility of fuel price fluctuations to their cost structure. The table below illustrates the latest available fuel-hedge ratio for Asia Pacific airlines.

Fuel-hedge ratio of Asia Pacific airlines (Jun 2015)



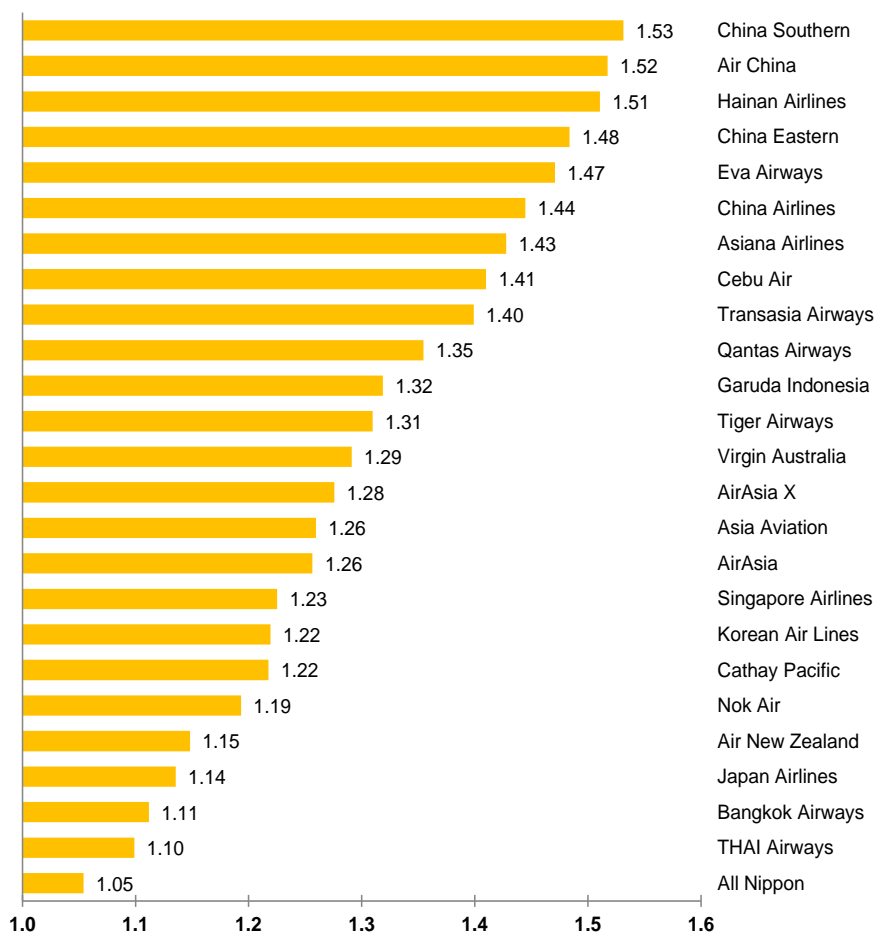
Sources: Respective airlines, Maybank KE

Who benefits most from lower fuel price?

The graph below shows the operating leverage of fuel price movement to the airlines' profit margin (before tax). The way to read this graph is for every 1% drop in fuel prices, the profit margin (before tax) will expand by the quoted sum.

We plot our graph based on the latest available information provided by the airlines and prevailing foreign exchange rates relative to USD. Our analysis assumes yields, load factors and all else remain the same.

Asia Pacific airlines' operational leverage to 1% drop in fuel price



Sources: Respective airlines, Bloomberg, Maybank KE

The Chinese mainland carriers are the most leveraged to lower fuel prices as they purchase fuel on the spot market. They are followed by carriers that have hedged small portions, such as China Airlines, EVA Air, Asiana, Cebu Pacific and Qantas. For carriers that have hedged a higher portion of their fuel requirements, the benefit will be much less.

Asia Pacific airlines share price movement

Company Name (alphabetical order)	Bloomberg Ticker	Price 7-Aug	Current share price versus			Comment
			1 week	1 month	1 year	
Air China	753 HK	8.41	8.0%	-4.0%	74.5%	Market excited with its capital raising plans
Air New Zealand	AIR NZ	2.68	1.3%	5.3%	38.2%	n/a
AirAsia	AIRA MK	1.34	-1.5%	3.1%	-44.6%	General weakness of the Malaysian market
AirAsia X	AAX MK	0.21	0.0%	2.5%	-69.7%	n/a
All Nippon	9202 JP	390.9	-1.0%	14.6%	57.9%	1QFY16 results were within market expectations
Asia Aviation	AAV TB	5.05	3.5%	8.4%	10.7%	Analyst upgrade ahead of anticipated strong results
Asiana Airlines	020560 KS	6,370	7.1%	-7.3%	39.2%	Seen as a good play on lower oil prices
Bangkok Airways	BA TB	21.50	0.0%	-2.3%	n.a	n/a
Cathay Pacific	293 HK	18.76	2.3%	2.7%	28.3%	Analyst upgrades ahead of anticipated strong results
Cebu Air	CEB PM	96.60	3.9%	13.8%	68.6%	Analyst upgrade ahead of anticipated strong results
China Airlines	2610 TT	14.35	2.1%	5.5%	42.1%	Chinese stock market recovery
China Eastern	670 HK	6.41	2.9%	24.5%	151.4%	Chinese stock market recovery
China Southern	1055 HK	7.89	2.7%	10.3%	193.3%	Chinese stock market recovery
EVA Airways	2618 TT	22.70	-0.4%	4.6%	62.4%	n/a
Garuda Indonesia	GIAA IJ	423	-3.2%	-2.8%	0.7%	2Q15 results were tad below expectations
Hainan Airlines	600221 CH	5.48	3.4%	27.7%	197.8%	Chinese stock market recovery
Japan Airlines	9201 JP	4,710	0.6%	13.5%	71.9%	1QFY16 results were within market expectations
Korean Air Lines	003490 KS	36,850	5.0%	-12.3%	16.1%	Seen as a good play on lower oil prices
Nok Air	NOK TB	9.10	0.6%	-8.5%	-46.5%	n/a
Qantas Airways	QAN AU	3.77	0.5%	12.5%	188.9%	n/a
Singapore Airlines	SIA SP	10.41	-3.1%	-6.0%	6.1%	1QFY16 results were OK, but market spooked by management's cautious outlook statement
Thai Airways	THAI TB	12.30	-1.6%	-7.5%	-19.6%	Analyst warns of upcoming weak results
Tiger Airways	TGR SP	0.30	-1.7%	0.0%	-11.1%	1QFY16 results were uninspiring
TransAsia Airways	6702 TT	8.66	-2.6%	-2.1%	-22.3%	General market weakness
Virgin Australia	VAH AU	0.44	-1.1%	0.0%	10.1%	
Average			1.1%	3.9%	43.5%	

Sources: Bloomberg, Maybank KE

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The underperformers were Singapore Airlines and Garuda Indonesia. Both have released fairly satisfactory results, but the market was jittery on the management's forward outlook statements.

Asia Pacific airlines valuations

Company Name <i>alphabetical order</i>	Ticker	Our Rating	Price 7-Aug	Target Price	Up / (down)	MCAP (USD b)	PE (x) 2015	2016	EV/EBITDAR (x) 2015	2016	P / Book (x) 2015	2016	ROE (%)	Gearing (x)
Full service carriers														
Air China	753 HK	NR	8.47			20.8	9.3	9.0	8.0	7.7	1.64	1.38	7.8	177
Air New Zealand	AIR NZ	NR	2.68			2.0	8.4	6.5	4.4	3.9	1.68	1.58	14.4	27
All Nippon Airways	9202 JP	NR	389.6			11.0	22.4	19.5	7.8	7.1	1.67	1.51	5.9	62
Asiana Airlines	020560 KS	NR	6400			1.1	7.7	7.9	7.9	7.2	1.24	1.44	n.a	322
Bangkok Airways	BA TB	BUY	21.5	28.0	30.2%	1.3	21.8	18.9	9.3	8.2	1.78	1.61	2.2	(1)
Cathay Pacific	293 HK	UR	18.58			9.4	9.5	8.2	6.2	5.3	1.41	1.28	6.7	86
China Airlines	2610TT	NR	14.30			2.4	8.5	8.7	6.6	6.4	1.46	1.32	7.6	211
China Eastern	670 HK	NR	6.55			19.3	10.1	9.2	9.3	8.5	2.22	1.69	12.4	304
China Southern	1055 HK	NR	8.12			16.9	10.0	8.7	7.4	6.9	1.79	1.54	4.9	219
EVA Airways	2618 TT	NR	22.8			2.8	9.9	10.6	7.1	6.5	1.88	1.69	4.3	143
Garuda Indonesia	GIAA IJ	NR	430			0.8	15.9	10.6	5.2	4.5	0.95	0.81	n.a	80
Hainan Airlines	600221 CH	NR	5.52			10.8	13.8	11.7	6.9	5.9	2.26	2.04	10.1	178
Japan Airlines	9201 JP	NR	4710			13.7	10.3	9.8	5.8	5.3	2.19	1.97	23.5	(33)
Korean Airlines	003490 KS	NR	37000			2.3	13.7	7.6	7.3	7.1	1.04	1.09	1.9	702
Qantas Airways	QAN AU	NR	3.80			6.1	12.4	7.7	5.5	4.5	3.06	2.54	n.a	121
Singapore Airlines	SIA SP	HOLD	10.41	11.75	12.9%	8.8	17.4	13.0	4.5	4.0	0.95	0.86	7.2	(28)
Thai Airways	THAI TB	SELL	12.20	12.0	-1.6%	0.8	52.9	9.8	7.1	6.6	0.58	0.52	12.7	384
TransAsia Airways	6702 TT	NR	8.70			0.2	11.4	n.a	n.a	n.a	0.62	0.56	7.2	102
Virgin Australia	VAH AU	NR	0.44			1.1	16	12.9	6.2	5.6	1.38	1.27	n.a	135
FCC average							12.7	10.6	6.8	6.2	1.57	1.40	8.6	168
Low cost carriers														
AirAsia	AIRA MK	BUY	1.32	2.32	75.8%	0.9	4.6	5.1	8.8	9.2	0.79	0.71	1.4	263
AirAsia X	AAX MK	HOLD	0.21	0.22	4.9%	0.2	n.a	16.1	6.0	4.4	1.05	0.94	n.a	214
Asia Aviation	AAV TB	BUY	5.00	6.50	30.0%	0.7	14.0	10.8	10.2	9.5	1.21	1.09	2.8	21
Cebu Air	CEB M	BUY	96.30	116.0	20.5%	1.3	6.6	6.2	5.6	4.7	2.46	2.14	21.1	139
NOK Air	NOK TB	HOLD	9.10	12.0	31.9%	0.2	1.2	0.7	4.0	3.6	1.51	1.36	n.a	(74)
Tiger Airways	TGR SP	NR	0.30			0.5	18.4	11.8	8.7	7.9	3.5	3.13	n.a	(1)
LCC Average							9.0	8.5	7.2	6.6	1.75	1.56	8.4	93

Sources: Bloomberg, Maybank KE

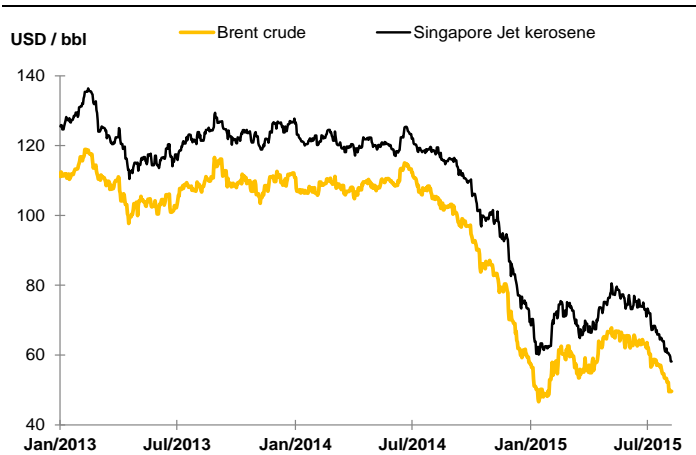
UR = Under Review

NR = Not Rated

* All forward-looking estimates and multiples for companies not under Maybank's coverage, including companies currently under review, are from Bloomberg consensus.

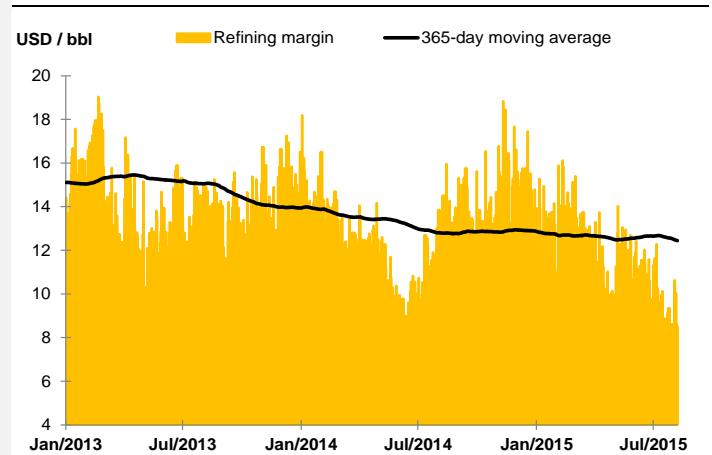
Key graphs that matter

Figure A: Singapore Jet fuel and Brent Crude



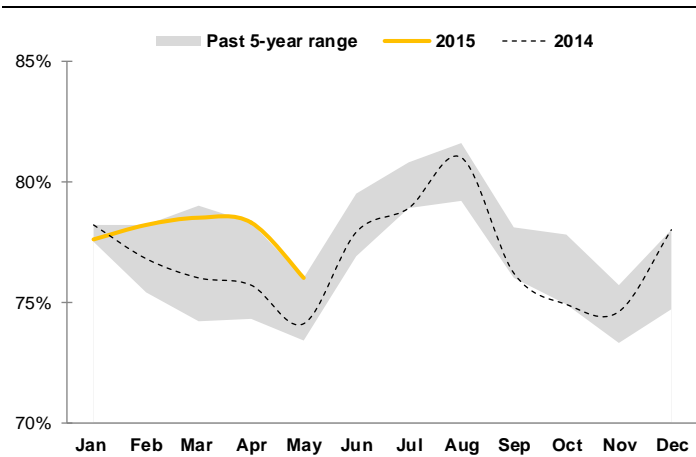
Sources: Bloomberg, Maybank KE

Figure B: Refining margin



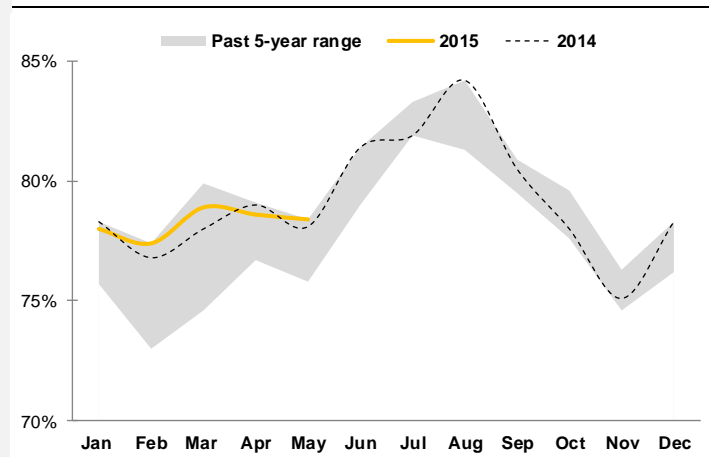
Sources: Bloomberg, Maybank KE

Figure C: Asia Pacific airlines passenger load factor



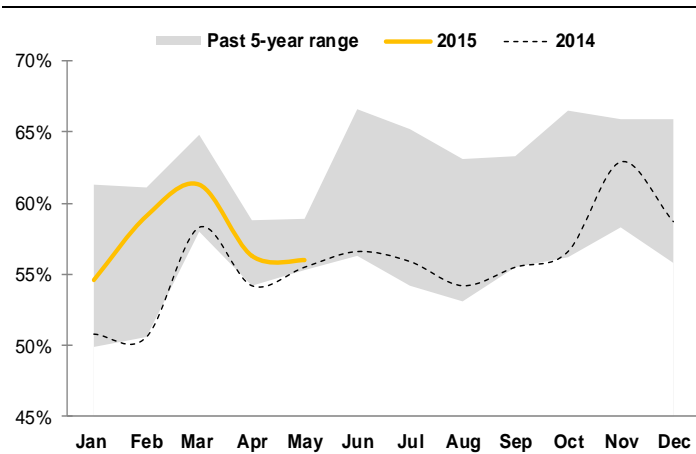
Source: IATA

Figure D: Global airlines passenger load factor



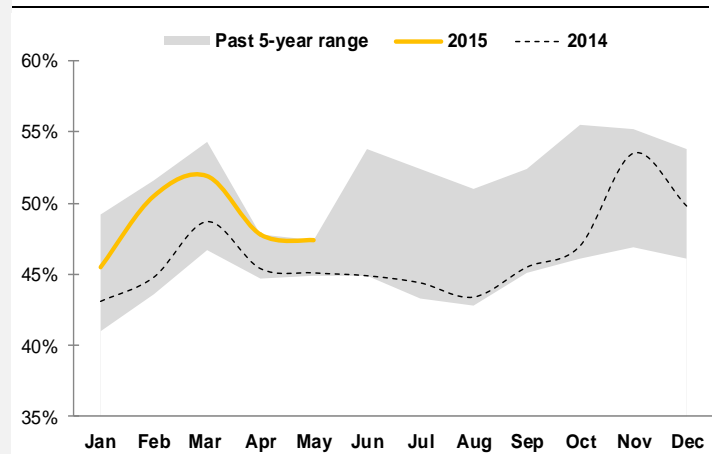
Source: IATA

Figure E: Asia Pacific airlines cargo load factor



Source: IATA

Figure F: Global airlines cargo load factor



Source: IATA

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