

Domestic demand to drive Malaysia's air travel recovery in 2020

BY KANG SIEW LI

Demand for domestic air travel in Malaysia will recover faster from the fallout of the Covid-19 pandemic than international flights, industry executives say. However, the recovery rate is unlikely to be significant until the Movement Control Order is lifted and people feel confident about travelling again.

Brendan Sobie, an aviation consultant at Sobie Aviation, says a recovery in domestic air travel will begin this year, although it will be "a very slow one until the [partial] lockdown comes to an end and confidence in travel returns".

He cites China's domestic air travel, which showed the first signs of recovery in March after a 10-week coronavirus lockdown. However, domestic passenger numbers are still down 70% from pre-Covid-19 levels.

Sobie is optimistic that domestic air travel in Malaysia could see growth in 2021 above 2019 levels, if proper promotions are put in place to encourage people to fly.

"In the short term, I don't think this is going to happen because people will remain cautious about the virus and there are many attractive places within Peninsular Malaysia that you can go to by car. But once you get past that phase and you want to venture a bit further to Sabah and Sarawak, for example, there is a great opportunity for the two states to promote themselves to help fill the void and get airlines back in the air," he says, adding that Malaysia is in the fortunate position of having a domestic market.

Edward Clayton, managing partner at PwC Strategy & (M) Sdn Bhd, notes that domestic passenger traffic could return to 75% to 80% of 2019 levels by the end of the year. The forecast is based on the assumption that the majority of Malaysians move to green zones and that the government shifts the MCO from being implemented across the country to that in specific areas that are declared as infectious.

The three major airlines in Malaysia, namely Malaysia Airlines Bhd (MAS), AirAsia Group Bhd and Malindo Airways Sdn Bhd, have resumed domestic flight operations from last month after grounding most of their planes following the MCO in March.

But the international passenger market's recovery is forecast to take longer.

While the international sector is expected to pick up pace next year, the lost ground will not be fully regained until at least 2022 or 2023, Sobie said at a recent webinar entitled "The impact of Covid-19 on the Malaysian air transportation industry" and hosted by the EU-Malaysia Chamber of Commerce and Industry.

Clayton, also a speaker at the event, concurs, saying he does not see people making quick trips abroad anytime soon as long as the compulsory two-week quarantine and possible isolation when travellers arrive in a country are in place.

"A 2015 US study shows that the average length of stay in a trip is 6.6 days. Only 10% of international passengers travel more than two weeks and 2% more than one month. But if you have to undergo a 14-day quarantine upon arrival in a country and another 14 days upon returning home, that is already a month. Never mind what

2019 passenger traffic

| AIRPORTS IN MALAYSIA | DOMESTIC (MIL) | INTERNATIONAL (MIL) | TOTAL (MIL) |
|--------------------------------|----------------|---------------------|----------------|
| KLIA | 17.397 | 44.928 | 62.326 |
| MAHB airports (excluding KLIA) | 34.505 | 8.337 | 42.842 |
| Senai | 3.625 | 0.645 | 4.27 |
| Total | 55.527 | 53.91 | 109.438 |

SOBIE AVIATION

2019 passengers transported by Malaysian carriers

| AIRLINE | TRAFFIC (MIL) |
|-------------------|---------------|
| AirAsia | 35 |
| Malaysia Airlines | 14 |
| Malindo Air | 7 |
| AirAsia X | 6.1 |
| Firefly | 1.1 |
| MASwings | 0.9 |
| Total* | 64.1 |

* The 64 million included 27.8 million domestic Malaysia and 36 million international to/from Malaysia.

The balance (a few hundred thousand) were carried on fifth freedom routes.

MAHB AND SENAI AIRPORT

you really wanted to do on the ground.

"Until then, the only people who are going to travel are those repatriated back to their home countries, foreign workers and students. Tourists will not travel and business people will carry on their meetings through video conferencing."

What does this mean for Malaysia Airports Holdings Bhd (MAHB)? Its cross-subsidisation model of costs between international and domestic passengers is now broken, says Clayton.

Essentially, MAHB will mostly rely on passenger service charges from domestic passengers between now and year-end, and this could create major cash flow issues for the airport operator because the PSC rates for domestic flights are lower than those for international flights, he adds.

He also does not see any investor wanting to invest in MAHB's airports at this point in time, as part of the government's move to liberalise the local airport sector.

"No investor would want to come up with a strong valuation of MAHB's airports in the next six to nine months because they just don't know what the airport passenger traffic is going to look like. I was actually in the process of [negotiating] buying Sydney Airport when the 9/11 terrorist attacks happened and the whole transaction went on hold for six months because it was impossible to value an airport in a situation like that."

"So, if anybody were to come in now, they would be seeking to invest at fire-sale prices and that would not be in the interest of current [MAHB] shareholders at all. I would suggest waiting until traf-

fic stabilises if the government does want to proceed with bringing more investors [into the local airport sector]."

Right time to put in the work

The time is now to prepare for the upturn in international travel demand, Sobie says, adding that the inbound tourism market is something Malaysia can pursue given a more coordinated federal strategy, like making sure tourism operators and hotels can survive this period.

"The airlines have to be ready and the right policies would need to be put in place to make sure that Malaysia is at the forefront when international travel returns."

Still, competition will be stiff for the tourist dollar.

"Some airlines will fail in this current operating environment, which would put some countries at a disadvantage in terms of air connectivity. That's why it is important [for Malaysia] to maintain its status as a hub and connectivity so that it can attract inbound tourists as well as those in transit when that market returns," he says.

If done right, Sobie says the inbound market could make up 40% to 50% (from 33% in 2019) of total international passenger traffic, which grew 3% year on year to 53.27 million passengers last year.

"We are also in the right region (Asia), which will remain the fastest-growing part of the world. Outbound China is still going to grow over the long term and that will also benefit markets like Malaysia. So, I don't think prospects [for Malaysia] are all that gloomy."

Who will be the winner post-pandemic?

Sobie believes both the full-service and low-cost carriers (LCCs) will still have a role to play in the long term.

While LCCs are better positioned to take advantage of a price-sensitive post-pandemic market than their full-service competitors, he notes that social distancing rules would restrict the load factor on planes.

"The LCC model can only work on 80% to 90% load factors. Higher airfares (to comply with social distancing rules) would kill the budget model. In Malaysia, MAS' fares have also been extremely competitive in the last several years and thus, there's not as much difference to LCCs."

"I also don't think [the strength of an airline] is about its financial position, but the support it receives from the government during these challenging times. That is the key differentiator among airlines," says Sobie.

"You have some airlines that may have been weak financially going into this crisis, but they would become one of the stronger

ones if they get government support. Basically, any airline — even the relatively stronger ones — that don't get some government support may not be able to survive, especially in a prolonged Covid-19 crisis," he adds.

Sobie says Malaysia was already at a critical juncture even before the crisis struck and was in need of a reset. All six Malaysia-based airlines were unprofitable in 2019 and the market was suffering from overcapacity and irrational competition.

"In the interim, the airlines are bleeding badly, so they need as much support from the government as possible. The competition is also very fierce between hubs in this region. We have seen Singapore and Thailand ready to back a rescue package for their flag carriers. So, if Malaysia doesn't compete in terms of providing support for its airlines, it can lose out in the long run and that is a concern."

Still, consolidation in Malaysia's airline industry is unlikely in the near term as all players are focused on their own issues, says Sobie.

"A lot of the consolidation will be triggered by what Khazanah Nasional Bhd does — how it deals with the eventual sale of MAS. When it is ready to restart that, it has to look at who is still interested because the market has obviously changed. As such, I don't think it (to find a strategic partner) will restart very quickly. It has to relook at all the options in a bigger picture."

Clayton believes that it is not just MAS but airlines around the world that may not survive without state aid. "One question the governments need to ask themselves is do they see airlines as a utility or a luxury? If it is utility, then it is important that they be maintained in a way which allows them to continue to operate moving forward. I would argue that to a large extent in Southeast Asia, airlines are actually utilities. We can't survive without them."

"But one of the key challenges is how do you provide support without creating a perverse incentive. You don't want to over-subsidise to the point where the airline is making more money than they would have done in the real world. So, making sure that the aviation industry is incentivised to innovate is also very important when support structures are developed."

Separately, Tunku Iskandar Tunku Abdullah, group executive chairman of Melewar Group, tells *The Edge* that cash funding to airlines should be in the form of a quid pro quo, for example, advance purchase of heavily discounted airline seats that the government can utilise in future for both Covid-19 and non-Covid-19 purposes such as humanitarian or repatriation travel, or for promotional purposes such as inviting travel agents from overseas and also from the domestic market.

"In this way, it helps the airline with its cash flow but provides tangible value to the government in return for its cash funding," he says.

He adds that MAS, AirAsia and Malindo Air, which are all flying the Malaysian flag and have been playing key roles in providing access for tourists from all over the world to visit Malaysia, deserve to be supported in this unprecedented crisis. "Airlines are crucial for bringing tourists in and all the three airline groups are needed for this to happen."