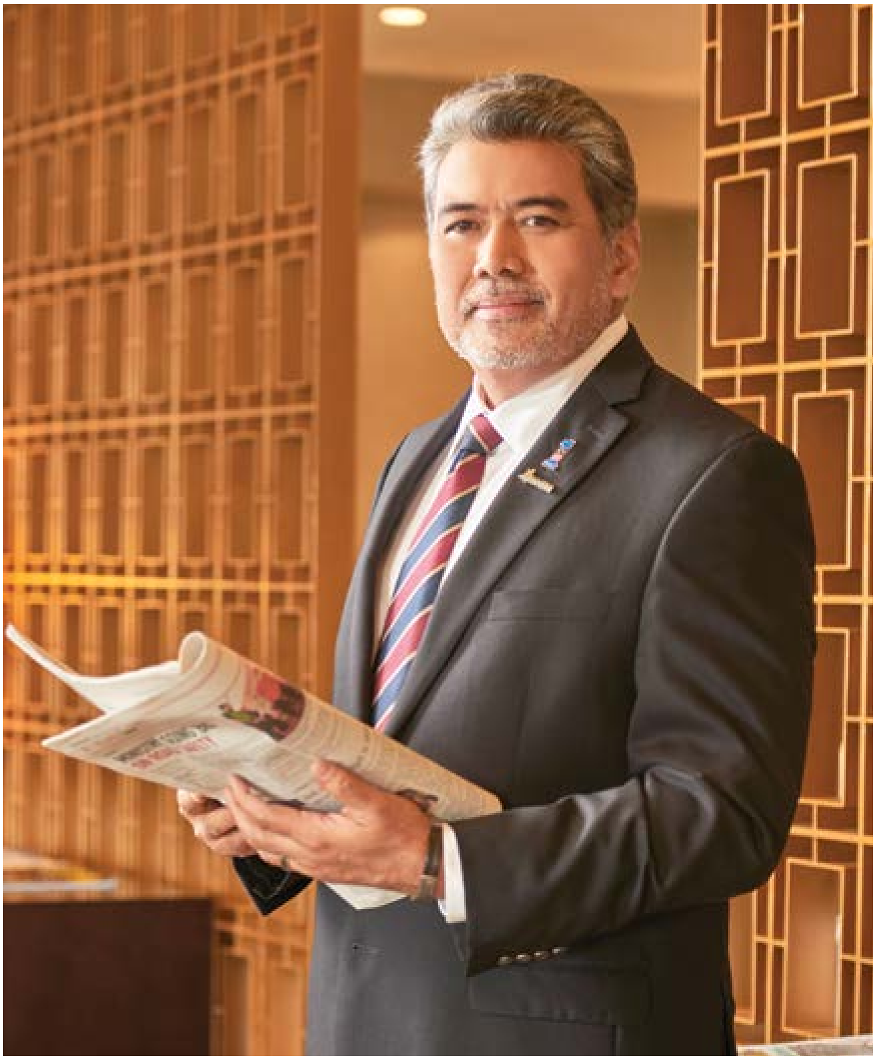
MANAGEMENT DISCUSSION AND ANALYSIS

DATUK MOHD BADLISHAM GHAZALI
MANAGING DIRECTOR



2017 was a good year for the aviation industry and Malaysia Airports Holdings Berhad (Malaysia Airports or the Group) leveraged on the good growth momentum gained by higher international and domestic passenger movements to reinforce its position as a key regional airport hub. I am pleased to report that we turned in stronger performances on the operational and financial fronts for the financial year ended 31 December 2017 (FY2017) – our good results underpinned by our strategic focus, a highly capable talent pool, and a culture of continuous improvement and innovation across the Group. It is especially heartening to note that many of the strategic priorities that we had rolled out in 2016 under our five-year business plan 'Runway to Success 2020', began to bear fruit in 2017. This attests to the effectiveness of our strategic blueprint and the worthy efforts of our diligent workforce and partners within the airport community.

As Malaysia Airports propels forward toward achieving its vision of becoming 'The Global Leader in Creating Airport Cities', I am confident that we are today in a much stronger position to fulfil our aspirations. I present here the finer details of Malaysia Airports operational and financial performance for the financial year ended 31 December 2017 (FY2017).

FINANCIAL PERFORMANCE

In FY2017, the Group turned in a stronger financial performance against the previous financial period with sustained growth in passenger and aircraft movements continuing to impact the Group's earnings for the better. The year saw the Group's earnings before interest, tax, depreciation and amortisation (EBITDA) rising by 11.8% to RM1,910.9 million on the back of an 11.5% rise in revenue to RM4,652.3 million. The stronger performance was all the more noteworthy given the challenging market conditions that the Group's respective operations faced in the year under review.

MANAGEMENT DISCUSSION AND ANALYSIS

The Group's Malaysia operations posted revenue of RM3,429.1 million in FY2017, up by 10.6% over the preceding year. Meanwhile, revenue from the Group's operations in Turkey rose by 13.2% to RM1,085.7 million, on the back of a 5.6% improvement in passenger traffic at Istanbul Sabiha Gokcen International Airport (ISG). Included in the revenue for the Turkey operations was RM57.9 million in respect of construction revenue relating to the boarding hall expansion of ISG. The year also saw the revenue from the Group's facilities management and maintenance operations* in Doha, Qatar increasing by 19.9% to RM137.6 million in FY2017.

Malaysia Airports' good performance in FY2017 was attributable to steady growth in both our airport and non-airport operations. The Group's airport operations recorded revenue growth of 9.8% to RM4,296.8 million, mainly driven by higher revenue from the aeronautical and non-aeronautical segments. Supported by strong passenger growth, aeronautical revenue grew by 9.3% to RM2,253.6 million against FY2016, while the non-aeronautical segment registered robust revenue growth of 10.4% to touch RM2,043.2 million. This year-on-year revenue growth underscores the strength of our core airport operations as well as the proactive initiatives we have brought into play to grow our business in tandem with our partner airlines' route development efforts.

The stronger performance was all the more noteworthy given the challenging market conditions that the Group's respective operations faced in the year under review.

* *refers to project and repair maintenance business segment*

MANAGEMENT DISCUSSION AND ANALYSIS

Non-aeronautical revenue per passenger in Malaysia rose by 4.6% to RM16.45 per passenger driven by stronger sales registered by the concessionaires and retailers. Retail and commercial revenue continued to achieve double-digit growth of 15.4% and 11.3% to touch RM853.7 million and RM734.6 million respectively. Sales per passenger stood at RM24.1 in FY2017. This represents an increase of 13.9% compared to FY2016 - a growth rate higher than that of passenger traffic movements at 8.6%. Meanwhile for KL International Airport (KLIA), we had registered RM46.4 and RM30.0 sales per passenger at the Main Terminal and klia2 respectively for the same period.

For the year in review, revenue from the Group's non-airport operations grew 14.4% to RM297.6 million, mainly on the back of contributions from the hotel, agriculture and facilities management and maintenance operations* business.

refers to project and repair maintenance business segment

The Group surpassed its headline financial Key Performance Indicator for EBITDA of RM1,796.6 million by 6.4%. EBITDA for the Malaysia operations rose by 11.6% to RM1,116.1 million while EBITDA for the Turkey operations for the same period rose by 8.6% to RM780.9 million.

The year's double-digit revenue growth also led to an 82.4% increase in the Group's profit before tax (PBT) of RM334.5 million, despite a 6.8% increase in costs. The higher costs were mainly due to the increase in costs of inventories sold, user fees, repair and maintenance costs, employee benefit expenses as well as the provision for doubtful debts. The PBT of our Malaysia operations grew 27.4% to RM611.9 million in FY2017, while our Turkey operations registered a loss before tax of RM287.5 million. The Qatar operations chalked up a PBT of RM10.1 million. The Group's net earnings increased by a stellar 224.0% to RM237.1 million over the same period.

Malaysia Passenger Service Charge

On 1 January 2017, the Passenger Service Charge (PSC) was revised and a new rate introduced for passengers travelling to ASEAN destinations. The PSC now has three categories - Domestic at RM11.00, ASEAN at RM35.00 and International at RM73.00. The lower PSC for ASEAN destination was introduced by the Malaysian government to promote further growth in tourism traffic within ASEAN. Our PSC remains competitive and is one of the lowest compared to other airports in the region.

The Marginal Cost Support for PSC (MARCS PSC) is the compensation for the difference between the actual PSC and the benchmark PSC by the government as per the provisions of the Operating Agreement (OA) that we signed with the government of Malaysia in February 2009. Under the OA, benchmark PSC rates are revised every five years. The second tariff cycle revision took effect on 12 February 2014. Shortfalls if any, has been addressed by the MARCS provision.

We remain supportive of any efforts to drive passenger traffic, including in instances where lower charges may be potentially effective. We have also been assured that the charging structure and approach will be reconsidered, should the lower PSC not result in a corresponding increase in passenger traffic.

Liquidity

As at the end of FY2017, the Group's net debt position improved by 22.0% to RM2,977.8 million on the back of improved operating cash flows from our Malaysia and Turkey operations. Cash and cash equivalents, and available for sale investments (including quoted bonds and unit trusts) too rose by 45.9% to RM2,571.5 million. The Group's current cash and cash equivalents are sufficient to meet our working capital, borrowings and interest payments as well as capital expenditure needs over the next 12 to 18 months.

As at the year's end, the Group's total assets stood at RM22,495.6 million while total liabilities amounted to RM13,486.5 million including some RM5,549.3 million in respect of borrowings. The Group's next debt repayment relating to the Senior Sukuk of RM250.0 million is due on 6 September 2018.

Capital Management

In FY2017, the Group continued to maintain its AAA credit rating with Ratings Agency Malaysia as well as its A3 credit rating with Moodys, with both citing a stable outlook for the Group. The Group's gross debt to equity ratio also improved to 0.63 times in FY2017 as compared to 0.64 times in FY2016. The Group continues to strictly observe the financial covenants in terms of compliance against funding requirements and internal guidelines.

ECONOMIC PROFIT

The Economic Profit Statement is a measure of value created by a business during a single period and reflects the returns made by a company over its cost of capital. It is typically provided on a voluntary basis. In FY2017, the Group recorded and economic loss of RM675.3 million as compared to the RM662.0 million recorded in the previous year. This was primarily due to higher operating earnings and weighted average cost of capital.

TRAFFIC PERFORMANCE

Passenger Traffic Movements

In FY2017, total passenger movements for the Group's network of airports (including ISG in Turkey) increased by 7.9% to reach 128.0 million movements – the highest passenger movements ever recorded by Malaysia Airports. We registered 59.8 million passenger movements in terms of international passenger traffic, a year-on-year increase of 13.2%, and 68.2 million passenger movements on the domestic sector, a 3.6% increase in comparison to FY2016.

In FY2017, our airports in Malaysia registered 96.6 million passenger movements representing an 8.6% surge in growth over FY2016's 88.9 million passengers. This is a new record and a key milestone in that we have exceeded the 90 million-passenger movement mark for the first time.

It is encouraging to note that passenger traffic was mainly driven by the international sector which recorded 49.5 million passenger movements, an increase of 14.2% over FY2016. The international component of the overall passenger traffic has been steadily increasing from about 40% in the late 1990s to 51% in 2017. This is the first time that the international traffic has exceeded the domestic traffic. Overall international growth in Malaysia was contributed by both local and foreign carriers. 35 airlines registered double or triple digit increases including AirAsia X, Malindo Air, China Airlines, All Nippon Airways, Shanghai Airlines, Xiamen Airlines, Saudi Arabian Airlines, Ethiopian Airlines, Eva Air, Indonesia AirAsia, Indonesia AirAsia X, Lion Air, Pakistan International Airlines, Regent Airways, Shenzhen Airlines, Silk Air, SriLankan Airlines, Thai AirAsia, Thai International Airways, Vietjet, AirAsia Zest, Oman Air and Air Astana.

We also experienced double-digit growth for international passengers for South Asia, South East Asia and North East Asia sectors. There were incremental contributions on the international passenger front for passenger nationalities from China, Indonesia, India, Korea, Taiwan, Singapore, Thailand, the United Kingdom, the United States, Australia, Russia, Germany, Canada, Spain, Netherlands, Japan, New Zealand, Vietnam and the Philippines.

MANAGEMENT DISCUSSION AND ANALYSIS

The increase in international passenger traffic was driven mainly by visa relaxation measures for Chinese and Indian tourists, an increase in Umrah traffic and tourism promotions. The cultural similarities between the peoples of China, India and Malaysia continue to be a good drawing card and a key driver in passenger growth for Chinese and Indian tourists. In August 2017, the world's first proof-of-concept (POC) for Hajj pre-clearance was done at KLIA in collaboration with the government of the Kingdom of Saudi Arabia. The POC was a success and proved that by conducting pre-clearance at the point of departure, the immigration process in Saudi Arabia would be significantly shortened thus providing great benefits to the passengers. This G2G initiative is expected to be operationalised upon the finalisation of the agreement between the two governments.

The year's higher international passenger growth also received a boost from relatively low oil prices, plus the readjustment of the Ringgit valuation which made Malaysia a preferred and less expensive tourist destination.

Despite a month-on-month decline in Malaysia's domestic sector growth from July 2017 onwards, the domestic sector registered 47.2 million passenger movements with 3.3% growth in FY2017. Domestic demand for air travel remained steady based on a high average load of

75.1%, the highest since 2012. The lower domestic growth was partly due to the reduction in airlines' seat capacity in the second half of FY2017, as well as increasing connectivity due to the introduction of direct international flights by airlines at our other international airports such as Kota Kinabalu, Pulau Pinang and Langkawi.

The year saw KLIA hub recording 58.6 million passengers, an 11.2% rise over the 52.6 million passengers registered in FY2016. The KLIA Main Terminal handled 28.3 million passengers, 10.8% higher than FY2016's 25.5 million passengers, while klia2 handled 30.3 million passengers, a growth of 11.6% over the preceding year's 27.1 million passengers.

KLIA and Kota Kinabalu International Airport (BKI) were among the airports that registered double-digit growth in passenger movements. Other airports that also registered positive growth were Pulau Pinang, Kuching, Langkawi, Kota Bharu, Melaka, Tawau and Bintulu. In FY2017, a total of 16 airlines registered passenger growth of more than 20% at KLIA.

In Turkey, ISG recorded a 5.6% rise in passenger traffic to 31.3 million passengers in FY2017 – the first time that total passenger numbers at ISG surpassed the 30 million mark. Following moderate growth in the previous year, passenger traffic at ISG began to pick up momentum after February 2017. The international sector recorded monthly double-digit growth from June 2017 onwards. On the whole, international and domestic traffic at ISG increased by 8.5% and 4.3% respectively in FY2017. 96.0% of the overall traffic was contributed by three major carriers, namely, Pegasus Airlines, Turkish Airlines and Anadolujet. Pegasus Airlines, Qatar Airways and Flynas registered more than 20% growth for international passengers.

Aircraft Movements

Overall commercial aircraft movements for airports in Malaysia increased by 4.5% in FY2017 to 848,112 commercial aircraft movements. International movements increased by 11.1% while movements in the domestic sector increased by 0.7%. The overall average load factor for FY2017 was 76.0%, the highest achieved since 2012. Despite the high increase in international aircraft movements, average load factor for the international sector was at an all-time high of 77.0%.

Cargo Movements

Overall cargo movements increased by 8.0% in FY2017 to 956,616 metric tonnes, the first positive growth since 2014. International cargo movements increased by 10.3% while the domestic sector recorded a 0.6% decline.

RUNWAY TO SUCCESS 2020

In 2016, Malaysia Airports formally launched its five-year business plan 'Runway to Success 2020' (RtS2020) guided by our vision of becoming 'The Global Leader in Creating Airport Cities'. The RtS2020 business plan encapsulates our business goals and our vision for the future. It sets out how we intend to create a sustainable business that delivers growth and allow us to capitalise on future opportunities, providing a firm financial base from which to expand and make further investments.

The plan has two main thrusts – to strengthen our core airport business, and to expand and diversify our operations. This calls for us to strengthen KLIA's position as an established hub amongst ASEAN and improve the total airport experience for all our stakeholders. Our mandate will also see us developing KLIA Aeropolis, leveraging on KLIA's substantial land bank to develop a thriving airport city that will serve as an economic enabler not only for Malaysia but also the region. Finally, we are to set our sights on increasing our international footprint.

A governance structure has been implemented to ensure the smooth roll out of RtS2020. For a start, four working committees have been established. They are:

- KUL Hub
- Total Airport Experience (TAE)
- Aeropolis
- International Expansion

To ensure we meet our business objectives, our Transformation Management Office division has been tasked with ensuring that all our planned initiatives are integrated and implemented in a cohesive manner across the entire Group.

We believe that RtS2020 is key to ensuring sustainable growth not only for Malaysia Airports but also for the nation's aviation industry. While we forge ahead to create a better future, we will give careful consideration in balancing our economic ambitions with societal and environmental responsibilities.

To date RtS2020 has provided Malaysia Airports with clear strategies that aim to directly strengthen our financial performance. For example, under the KUL Hub strategy is the Route Development programme where it calls for us to drive passenger traffic growth from target markets such as China, India and ASEAN through engaging with airlines, participating in trade forums, as well as collaborating with key agencies such as Tourism Malaysia and state government authorities. Likewise, our non-aeronautical business has been strengthened by the Total Airport Experience (TAE) strategy that includes strategic retail campaigns such as KULinary - which promotes the top F&B outlets at KLIA through a collaboration with an independent food network media, and KUL Dad - a shopping campaign in conjunction with Father's Day celebration. As part of TAE, service enhancement initiatives were also carried out to improve basic services such as check-in, security screening, immigration, baggage handling and washroom cleanliness. These serve at increasing passenger 'dwell time' at our airports through more efficient passenger processing.

The remaining two strategies under RtS2020, namely KLIA Aeropolis and International Expansion have longer-term gestation periods and it will be a while before any financial benefits materialise. Nevertheless, strong foundations have already been laid for both these initiatives with KLIA Aeropolis and International Expansion on track to deliver financial upside in due course.

MANAGEMENT DISCUSSION AND ANALYSIS

KUL* HUB

(KUL is the IATA code for KLIA)*

In line with our efforts to strengthen our core airport business and achieve our RtS2020 ambitions, we are leveraging on our KUL Hub strategy and global passenger traffic uptrends to establish KLIA as the preferred hub for ASEAN. KLIA's central location within the Asia-Pacific region, its combined terminal capacity of 75 million passengers per annum (mppa), its three independent runway system that are set to improve the efficiency of flight operations, and its competitive cost structure, are all factors that give our flagship airport a strategic advantage within the region. KUL also continues to benefit from sustained economic expansion in Asia's emerging markets, and China's deepening relationships with the region.

The presence of klia2, the second terminal of KLIA will ensure we are able to cater for future growth. With three independent airport runways and the addition of the new KL Air Traffic Control Centre (KL ATCC), KLIA will soon be able to move beyond its capacity of handling 78 flight movements per hour to handling up to 108 flight movements per hour.

To strengthen connectivity at KLIA, we continue to engage with our airline partners and ensure we implement mutually beneficial arrangements. In 2017, we engaged with over 50 airlines, with the goal of fostering and supporting network growth in Malaysia by soliciting prospective airlines to begin their operations at KLIA. These efforts led to an increase in international routes and frequencies across Asia, the Middle East and Africa. In order to engage more closely with our airline partners and other stakeholders at KLIA, our Airline Marketing division relocated their office to Level 3 in KLIA.

Introduced the KLIA-klia2 Terminal Transfer service **Free 24/7 shuttle service**

Engaged with **over 50 airlines**, with the goal of fostering and supporting network growth in Malaysia

Another key imperative under the KUL Hub initiative is to improve connectivity and streamline transfers between the two terminals in KLIA. In view of the rising demand for inter-terminal transfers, we introduced the KLIA-klia2 Terminal Transfer service. Travellers with connecting flights now have the convenience of moving from one terminal to the other via a free 24/7 shuttle service. The free shuttle service route also includes a stop at the Long-Term Car Park and can be enjoyed by everyone - not just travelling passengers. By offering passengers a seamless and smoother journey between terminals, we are not only improving the passenger experience at KLIA, but also contributing towards the growth of our airline partners at both terminals. We also began to implement more automated processes in 2017, such as self bagagge drop (SBD) facility. In March 2018, 15 SBD counters in klia2 became operational. These initiatives will be strengthened further during the course of 2018.

The year in review saw Malaysia Airports continuing to collaborate with stakeholders such as the Ministry of Tourism, Tourism Malaysia, state tourism boards, Ministry of Transport, Malaysian Aviation Commission and related parties through joint missions and joint marketing programmes to draw foreign airlines into Malaysia and KLIA. We also entered into a collaboration with Tourism Malaysia to establish a joint marketing fund to support marketing campaigns by airlines and travel industry players so as to promote inbound tourism from India, China and Europe.

On top of this, we have lent support to various events to put the Malaysia Airports and KLIA brands at top of mind of our target audiences. These included aviation-related forums such as Routes Asia 2017 in Okinawa, World Routes 2017 in Barcelona, and ITB Asia 2017 in Singapore. We also participated in travel trade events such as World Travel Mart events in Pulau Pinang, Singapore and London where we were able to expand our sphere of influence.

Moving forward, we will continue to focus our efforts on enhancing airport efficiencies so as to promote seamless connectivity and facilitate the growth of our partner airlines.

AIR SERVICES DEVELOPMENT

As an airport operator, we are committed to building a strong and mutually beneficial relationship with all our airline partners so that they are able to increase their connectivity into Kuala Lumpur and other airports operated by Malaysia Airports. In 2017, we continued to intensify our engagement with airlines by inviting potential airlines to begin operations at KLIA. We also managed to collaborate with existing partner airlines to extend their network or increase their flight frequencies.

As a result of these concerted efforts, five new airlines came on board KLIA in 2017 while a familiar face, Philippine Airlines from Manila, returned. The five new airlines included Lucky Air from Kunming, Himalaya Airlines from Kathmandu, US-Bangla Airlines from Dhaka, Batik Air from Jakarta and JC Cambodia from Phnom Penh. Kota Kinabalu International Airport (BKI) saw the arrival of Xiamen Airlines from Fuzhou, Thai Smile from Bangkok, and Batik Air from Jakarta. On top of this, Langkawi International Airport welcomed

China Southern Airlines from Guangzhou. Meanwhile, Miri Airport attracted Xpress Air flying from Pontianak.

We are also pleased to see airlines such as Uzbekistan Airways and Saudi Airlines making the decision to modernise their fleet, not only to manage the increasing growth of passengers but also to ensure greater comfort for their passengers. The year also saw the international seat capacity at KLIA and regional international airports growing by 11.5%, whilst passenger movements from China and India at KLIA increased by 18.2%. China, India and ASEAN have always been our priority markets due to their growth potential and we continue to increase our efforts to expand our network to secondary cities in China, India and ASEAN.

Existing airlines also opened new routes and increased their flight frequencies to cater to growing demand, thus driving the growth of passenger traffic through our terminals. Malaysia Airlines came in strong with its new expansion plan to open five new destinations from KLIA including Nanjing, Wuhan, Fuzhou, Chongqing and Surabaya. Malindo Air continued with its expansion to launch new destinations operating from KLIA, namely, Dhaka, Jeddah (via Ahmadebad), Guangzhou, Haikou, Chittagong, Brisbane (via Denpasar), Chennai, Phnom Penh and Bangalore. At klia2, AirAsia resumed its expansion plans adding new destinations to its offering including Bhubaneswar, Sihanoukville, Nha Trang and Davao.

AirAsia X launched its maiden long-haul service from Kuala Lumpur to Honolulu via Osaka while both Oman Air and Shanghai Airlines increased their daily flights to Kuala Lumpur from Muscat and Shanghai respectively from once daily to twice daily. Apart from KLIA, Malindo Air opened new routes from Penang to Singapore and Hat Yai, while introducing a new service from Kota Kinabalu to Taipei. AirAsia also introduced two new services from Kuching, namely Pontianak and Shenzhen.

We continue to work closely with our airline partners on market intelligence and traffic forecasts as well as provide carriers with the chance to market their services through Airlink, a special section of the KL Lifestyle magazine. We are consistently upgrading users' experience of FlyKLIA, our interactive experience-sharing portal that showcases the travel experiences of airport users in Malaysia. To increase awareness of the portal, we introduced the "My Passport to Brag" campaign which offered prizes ranging from flight tickets

MANAGEMENT DISCUSSION AND ANALYSIS

and Sama-Sama Hotel stays, to the use of the KLIA Premier Access service as well as shopping vouchers at the Mitsui Outlet Park KLIA , Eraman and Express Rail Link.

In view of the good response from airlines to the Airline Incentive Programme (AIP) II, we extended the incentive programme for another three years effective 1 January 2018. Under the AIP III, all participating airlines receive a waiver of landing charges and are accorded the benefits of a productivity-driven reward scheme and marketing support. The AIP is proving to be a useful mechanism in attracting airlines to operate from airports under the management of Malaysia Airports. Member airlines continue to receive some of the most affordable aeronautical and landing charges in the region even with the latest fee revisions.

TOTAL AIRPORT EXPERIENCE

Malaysia Airports' Total Airport Experience (TAE) pillar is a key strategic priority to enrich the airport experience. It underlines our commitment to continuously improve service standards across our operations. This is in line with our mission to 'Create Joyful Experiences by Connecting People and Businesses' and our target of placing KLIA among the top airports in the Airports Council International's Airport Service Quality (ASQ) listing. The ASQ is the world-renowned and globally established benchmarking programme which measures passengers' satisfaction whilst they travel through an airport. By continuing to set our sights on world class standards and implementing the same, we are well on our way to enhancing the airport experience across all touch points for all stakeholders.

Passengers are the core of the TAE, while retailers and airlines also define and support the overall airport experience. The TAE strategy encompasses enhancing the passenger journey across all touch points, addressing passenger experience gaps as well as enriching the airport experience with unique and memorable experiences. It also calls for us to deliver better airport-airline and airport-retailer relationships as well as transform Malaysia Airports into a customer-centric organisation. In designing the TAE, some 40 initiatives have been identified across the passenger journey to enhance the passenger experience.

To serve the increasingly sophisticated needs of passengers who are no longer awed by world-class infrastructure alone, it becomes increasingly important for an airport operator to place a high priority on ensuring that airport users have a satisfying experience at every touch point within the airport. To this end, we have rolled out several initiatives to provide our visitors with world class services and facilities.

The KUL VIP access is a premium door-to-gate service that offers departing and arriving passengers the option to access fast track lanes for check-in, customs and immigration, transportation services, as well as buggy and concierge services. As at end 2017, nearly 23,000 passengers had enjoyed the KLIA Premier Access service which is part of the overall KUL VIP Access service.

As mentioned earlier, travellers with connecting flights can now avail themselves of the new KLIA-klia2 Terminal Transfer service which provides a free 24/7 shuttle service, including the option

of stopping off at the Long-Term Car Park. We are confident that as we ramp up awareness on the availability of this service, it will contribute to the increase in transfer passengers for our airline partners. This service is a precursor to what we, as an airport operator, would like to ultimately offer to our passengers – namely, an airside transfer facility that will enable the interlining between full service and low-cost carriers.

We continue to undertake a major maintenance and overhaul programme for KLIA's Aerotrains to provide better reliability and service to our passengers. With passenger numbers at KLIA on the rise, we have activated full time shuttle bus services as another people mover mode between the main terminal and satellite building to augment the Aerotrain services.

We continue to upgrade our facilities at KLIA for the convenience of passengers and visitors. Apart from improving and opening additional suraus or Muslim prayer rooms, we are also currently undertaking a major refurbishment project for 224 washrooms at KLIA. This project is expected to be fully completed by 2020. It will see new user-friendly toilets being equipped with features such as automatic hand dryers, built-in bidets and floor blowers which will allow for easier maintenance. As at the end of 2017, we had finished refurbishing a total of 13 washrooms.

Malaysia is a country rich with diverse cultures and attractions. In support of our tourism industry, we collaborated with several state tourism bodies under our Joyful Malaysia initiative to showcase our local culture, cuisine and destinations. The initiative which began in January 2017 saw a tourism showcase from the various states in Malaysia being highlighted every month. Through collaborations with various government agencies and retail partners, we also rolled out our Proudly Malaysian and KULinary initiatives which aimed to provide visitors with memorable moments at our airports through immersive experiences.

We are extremely appreciative of the support shown by government agencies in helping us achieve our mission of creating a joyful experience for airport users. Tourism Malaysia's launch of the Chinese Affairs Travellers Help Desk at KLIA makes it the first airport in Southeast Asia to do so. This will help greatly in facilitating the arrival of tourists from China into Malaysia. The KLIA Immigration Department's move to reconfigure its immigration counters and install counter guiding lights in an effort to reduce long queues is another case in point. Initiatives such as these are certainly helping us meet the common goal of creating a seamless and memorable travelling experience for our passengers.

The inflow of tourists into Malaysia also bodes well for our retail partners with retail sales growing vibrantly at all our international airports. In 2017, we partnered with Alipay to provide cashless convenience to travellers and have seen a considerable rise in sales from Alipay transactions at KLIA thus far. More than 60% of outlets in both terminals at KLIA are transacting via Alipay.

To stay competitive and market-relevant, we have embarked on a Big Data Analytics (BDA) and Digitalisation initiative in partnership with a Canada-based provider of Enterprise Information Management (EIM) products and services. This initiative is a revolutionary step in our pursuit of a greater competitive advantage, greater customer experience, optimal productivity and higher operational efficiency.

The RtS2020 blueprint calls for us to evolve from being a compliant airport to being a proactive airport, and ultimately a real-time airport. By leveraging BDA, we aim to move towards insightful decisions based on real time data analytics. Our BDA implementation rides on Unified Digital Platform with an emphasis on a 'single source of truth'. The first phase implementation of the BDA covers several areas and will involve the implementation of continuous service improvements in specific areas. These include reducing congestion and optimising the queue check-in time, security and immigration processes; providing alerts and communication to airlines and passengers on wait times at various touch points for efficient journey planning; as well as providing inputs to agencies on the expected passenger volumes for effective resource planning.

Other areas will involve the implementation of an airport-wide incident management system to improve the operations response time; facilities improvement based on passenger dwell time analytics; as well as passenger profiling for airport operations and commercial improvement. BDA will also cover the monitoring and replenishment of trolleys as well as financial analytics, while according passengers a journey-based experience on omni-channel mobile apps.

We expect to complete Phase 1 of BDA implementation (which will initially cover KLIA) by the end of 2018. Phase 2, which will kick off at the end of 2018, will involve the extension of BDA to other international airports in Malaysia. We are also embarking on a collaborative effort with multiple airport stakeholders to implement an Airport Collaborative Decision-Making (ACDM) platform. This will enable allocation of airport resources and facilities in real time by multiple stakeholders, resulting in seamless and efficient airport operations.

The development of this Unified Digital Platform will enable Malaysia Airports to differentiate engagement with passengers and other customers, drive operational efficiency, enable passenger productivity and experience, as well as drive new and existing revenue streams. Structured and unstructured data that are fed to the digital platform from various existing systems will be analysed with machine learning and artificial intelligence. This will provide insights for better decision making to enhance the passenger experience as well as business and operational excellence.

As an airport operator, our role is not limited to providing and maintaining infrastructure. We are also a service organisation. In order to emerge as a service leader, we must re-imagine the airport experience for all airport users and stakeholders. The one thing that will truly set us apart from others would be our commitment to service excellence. Our goal should always be to uphold standards that are nothing short of excellent in catering to all our passengers. To this end, our Customer Experience Management unit continues to spearhead the revamp of our customer service model while frontline staff continue to be given training and the tools to better engage with customers. These employees are expected to be more mobile and visible at key touch points of the passenger journey and are to serve as 'ambassadors' not only for Malaysia Airports, but also the country.

Following its opening in 1998, KLIA continues to garner a host of awards and accolades for its position as one of the best airports in the region if not the world. Every year since 2011, the ACI has included KLIA in its Director General's 'Roll of Excellence' for Airport Service Quality (ASQ) in recognition of this airport's good ranking among the top airports by size or region. In 2017, however, KLIA dropped out of the Top 10 ranking to garner 12th place as several new airports, namely Shenzen, Shanghai Hongqiao and Taipei Taoyuan, had entered the fray in the more than 40 million passengers per annum category. Moving forward, KLIA aims to strengthen its efforts to regain its place among the Top 10 airports for 2018 under the ASQ by leveraging on the TAE which is a key strategy for us to take our service levels up several notches.

AEROPOLIS

A major part of the Aeropolis initiative is KLIA Aeropolis which underscores Malaysia Airport's efforts to diversify our business by developing our own airport city of logistics and aviation parks together with world-class business and leisure facilities. We envisage KLIA Aeropolis as an ecosystem development that is synergistic with the airport business and aligned with Malaysia's development agenda.

KLIA is steadily evolving from being a major transportation interchange into a maturing centre of economic activity. By bolstering KLIA's functional core as an airport, the KLIA

Aeropolis development will propel further domestic economic growth and enable KLIA to emerge as a regional economic enabler. We will leverage our strategic location within the Asia Pacific region which boasts one of the fastest growing air traffic growth rates, our readily available land bank and our competitive costs to do business. These attributes, coupled with the fact that the GDP growth of ASEAN is expected to double to approximately USD5 trillion by 2020, bodes well for KLIA Aeropolis.

The development of KLIA Aeropolis, which is expected to take place over the next 14 to 24 years, is expected to attract some RM7 billion in investments. The development encompasses three key clusters:

– Aerospace & Aviation,
– Air Cargo & Logistics, and
– MICE* & Leisure

** Meetings, Incentives, Conventions & Events*

These clusters are synergistic to the larger airport system and will serve to benefit the aviation supply chain as a whole. These three clusters are also aligned to the national development agenda specifically the Malaysia Aerospace Industry Blueprint (2015-2030), the Logistics Trade and Facilitation Masterplan (2015-2020) and the Kuala Lumpur Tourism Master Plan (2015-2025). The KLIA Aeropolis Master Plan which was completed in 2016 has earmarked about 60% out of the total 22,000-acre land bank for airport and aeronautical use.

In 2017, we made good strides forward by way of all three clusters of the KLIA Aeropolis initiative.

The Subang Regeneration initiative is part of the **Aerospace & Aviation** cluster development. Subang is already a mature aerospace ecosystem with several successful catalytic developments. The regeneration initiative is expected to create a spillover effect into KLIA Aeropolis.

Among the first developments will be the 60-acre Subang Aerotech Park which will include the development of manufacturing and office facilities for Skyways Technics and Senior UPECA. Skyways Technics caters to the Asia Pacific market specifically for spare parts, component repair, and aircraft on ground services for ATR & Bombardier CRJ aircraft, while Senior UPECA is part of the Senior group of companies who is an international manufacturer of high technology components and systems and a supplier to Boeing, Airbus and other major aerospace customers. These developments are expected to complete by the end of 2018.

We achieved a significant milestone under the **Air Cargo & Logistics** cluster with the ground breaking of KLIA Aeropolis DFTZ Park. Housing a host of facilities for centralised customs clearance, warehousing and logistics to facilitate double digit growth of trans-shipment air cargo volumes, it will ultimately position KLIA Aeropolis as a leading eCommerce trans-shipment hub in the region. Our strategic collaboration with Cainiao Network, the logistics arm of the Alibaba group sets the KLIA Aeropolis DFTZ Park apart as the first electronic world trade platform or eWTP hub outside of China. Meanwhile, Pos Aviation and Lazada Express have already commenced operations in 2017 of their regional e-commerce distribution centre at the KLIA Air Cargo Terminal 1 (KACT 1) - the facility that used to be the Low-Cost Carrier Terminal (LCCT).

Under the **MICE & Leisure** cluster, Mitsui Outlet Park KLIA Sepang (MOP) completed its second development phase which encompassed another 60 new stores on top of Phase 1's current 128 stores. A third and final phase of construction is planned for completion in 2021 when the park will host 260 shops over 46,000 square metres. Upon completion, MOP will potentially be one of the largest outlet malls in Southeast Asia.

MOP is developed and managed through MFMA Development Sdn Bhd, a joint venture between Mitsui Fudosan Co. Ltd. and Malaysia Airports. Not only do the new shops under Phase 2 broaden the selection of brands and product categories at the MOP, shoppers can also look forward to some "first in Malaysia" stores such as The Beauty Laboratory by Shiseido and Hummer bags store. The expansion also introduced more premium brands into the MOP and enabled shoppers to explore new ambient experiences with its Sky Walk, River Walk and Forest Walk themes.

The MOP project, which is expected to create an estimated 2,577 jobs and a Gross National Income (GNI) impact of RM220.1 million by 2020, will also be the largest outlet establishment by Mitsui Fudosan. We see this joint venture as a pacesetter for the development of KLIA Aeropolis which is expected to boost the confidence of investors and developers in terms of the commercial potential of KLIA land. In developing KLIA Aeropolis, our aim was to maintain a 'capital expenditure-light' approach modelled on the development of the MOP joint venture which entails Mitsui Fudosan owning a 70% stake and Malaysia Airports, the remainder.

MANAGEMENT DISCUSSION AND ANALYSIS

Malaysia Airports continues to actively engage with the relevant governmental agencies, private sector organisations and task forces or councils to drive the KLIA Aeropolis cluster agenda. Today, we are an active participant of the following platforms:

- **The DFTZ Performance Improvement Taskforce (PITForce)** which includes MDEC, MITI, POS Aviation and Customs that has oversight for improving the service levels and facilitation of air cargo movement at KLIA.

- **The DFTZ Investment & Promotion Taskforce** which is co-chaired by MDEC and MIDA, and includes INVESTKL and Invest Selangor, that is responsible for attracting industry players and investors into the DFTZ.

- **The National Logistics Taskforce**, co-chaired by ministers of the Ministry of Transport and the Economic Planning Unit which serves as a steering committee to address and achieve the initiatives set forth in the National Logistics and Trade Facilitation Masterplan.

- **The Malaysia Aerospace Council**, chaired by the Minister of MITI which serves to address and achieve the initiatives set forth in the Malaysia Aerospace Industry Blueprint 2015-2030.

INTERNATIONAL EXPANSION

One of our strategic priorities under RtS2020 is to increase our international footprint by building a balanced portfolio of investments beyond Malaysia, from equity acquisitions to management contracts. We believe that the wealth of experience we have garnered from managing a variety of airports from short take-off and landing strips to single runway airports and the three-runway hub that is KLIA, gives us a unique edge in our industry. By strategically investing, growing and diversifying our assets overseas, we will be able to establish continuous revenue streams while contributing to overall value accretion.

The Istanbul Sabiha Gokcen International Airport or ISG is Istanbul's second airport and the main focus of our operations outside Malaysia. This business, which remains an attractive investor value proposition and growth story, gives us the opportunity to play a lead role in crafting the long-term success of an invaluable strategic asset. With our full acquisition of ISG, Malaysia Airports became the first Asian company to own a European airport.

We remain optimistic and hopeful of our overseas operations in Turkey. In 2017, there were signs of a recovery at ISG following a very challenging 2016 where Turkey was plagued by a series of terrorism incidents and an attempted coup. Overall, FY2017 passenger traffic grew by 5.6% compared to the previous year to reach 31.3 million passengers, thereby surpassing the 30 million-passenger mark for the first time. Growth came on the back of an 8.5% rise in international passengers while the international passenger load factor improved by 9 percentage points (from 68% in FY2016 to 77% in FY2017). This was in line with the increase in the number of international arrivals to Istanbul, an 18% increase in FY2017 in comparison with FY2016.

Over the course of the year, 19 new routes consisting of both international and domestic routes were launched. ISG welcomed one new scheduled airline, Air Manas, in June 2017. This service connects ISG in Istanbul to Bishkek five times a week. ISG also welcomed three new charter airlines: Iraqi Airways commenced a three-times a week service to Baghdad in June 2017; Fly Baghdad commenced a three-times a week service to Baghdad in October 2017; while Utair commenced a once a week service to Vladikavkaz, Russia in November 2017. The airport received a further boost in October 2017 when Emirates received approval from the Turkish authority, DHMI to reinstate its operations at ISG in 2018.

For 2017, several key initiatives and milestones were undertaken to ensure the mid and long-term success of ISG. This included the commissioning of international to domestic passenger airside transfer facilities; and the completion of two fast rapid exit taxiways which increased runway capacity from 32 flight movements per hour to 40 flight movements per hour.

Extension works on the domestic boarding hall project which began in May 2017 are scheduled for completion in July 2018. This extension includes an additional four passenger boarding bridges and 20 bus gates which will provide the terminal an

additional capacity of 8 million passengers per annum (mppa). This will increase the terminal's current passenger capacity from 33 mppa to 41 mppa. Other initiatives centred on the expansion of check-in facilities, improvements to the queuing system and upgrades to the baggage handling capacity. The year also saw the completion of a new domestic mezzanine access to help fast track passengers, staff and crew members. This helped reduce congestion at security check points and increase commercial spaces. In November 2017, together with our stakeholders and duty free operator, Setur, we kicked-start an initiative to develop a new layout and walk-through concept for arriving passengers at the duty free shops. This improvement to the total airport experience will be completed by the end of the first quarter in 2018.

The completion of major projects, a second runway and metro connection are on track for completion by the end of 2018. The second runway will almost double ISG's existing capacity and allow more carriers to take off and land during the peak morning period.

There have also been some changes to our senior management line up in ISG. Please join me in welcoming on board ISG's new Chief Executive Officer and Chief Financial Officer, Ersel Goral and Fikret Comert, who joined us in September 2017 and December 2017 respectively. The management change is also in line with our aspiration to strengthen the international expansion pillar which forms one of the key pillars of RtS2020 as we position ourselves for the next phase of growth. We are confident that ISG's strategic location, its enhanced infrastructure offerings together with its new management line up will give it a strong competitive edge as it moves forward. We remain optimistic about ISG's future growth and will focus our efforts on optimising revenue and improving operational efficiency, as well as making the right investments to ensure the long-term success of the business.

Malaysia Airports currently has several management consultancy contracts in Qatar. The year saw the scope of works for one of our major facilities management contracts for Hamad International Airport (HIA) being upgraded while we received a 2+3-year extension for an IT systems maintenance support contract. These developments attest to the airport owner's confidence in our management ability. Today, Malaysia Airports owns 49% in the joint venture that manages HIA with the remainder held by the Watad Group. HIA was voted a five-star airport by Skytrax and the 6th best in the world at the 2017 World Airport Awards. The airport handles about 30 million passengers a year.

In February 2018, Malaysia Airports signed a Share Purchase Agreement to divest of its 11% equity stake in Rajiv Gandhi Hyderabad International Airport to GMR Airports Limited for a cash consideration of USD76.0 million (approximately RM295.3 million). The disposal provides an opportunity for the Group to unlock its investment in the airport at an attractive value. The gain arising from the disposal is estimated to be RM255.1 million. Based on the investment made in 2002, the total cost of investment for the 11% stake was approximately RM40.2 million. The disposal is expected to be completed by 30 April 2018 subject to an extension of up to 1 December 2018.

MOVING FORWARD FOR RtS2020

With the fundamentals of RtS2020 taking shape in its second year of implementation, we are already planning to take it to the next level. Moving forward into 2018, RtS2020 strategies will be operationalised within the respective business areas and processes, in order to ensure that the execution of the strategies are more focused and streamlined, whereby clear accountability and key performance indicators can be identified for more effective results. The operationalisation of RtS2020 will encompass nine focus areas.

They are:

- Improving service levels
- Cost optimisation
- Driving aeronautical business
- Strengthening non-aeronautical business
- Unlocking potential through Aeropolis
- Strengthening the foundation for international business
- Building human capital capabilities
- Enhancing brand visibility
- Strategic direction of non-core businesses

AIRPORT IMPROVEMENTS

We continue to bring into play a policy of continual improvement for our facilities to ensure all our airports are running in an optimal manner.

Stronger than expected traffic growth at KLIA has required the acceleration of capacity planning at KLIA Main Terminal. Efforts are currently underway towards planning for expansion including the commissioning of a capacity assessment study in partnership with an international aviation organisation. Additionally, we are focusing on optimising utilisation of both KLIA Main Terminal and klia2 to ease capacity constraints especially with regards to peak-time slots, check-in counters utilisation and aircraft parking.

Following the Government's approval of the upgrading and expansion project for the Sultan Ismail Petra Airport in Kota Bharu (KBR), the RM483.0 million project kicked off in 2017 and is scheduled for completion in 2020. Upon its completion, KBR will have the capacity to accommodate 4.0 mppa in comparison to its existing 1.5 mppa capacity. The project will entail the installation of a new baggage handling system; new passenger boarding bridges; dedicated customs, immigration, and quarantine facilities; open bays to facilitate ATR and jets; construction of a multi-storey car park; and airport fire and rescue service station.

Construction works on the new Mukah Airport was approved by the government at an estimated project cost of RM436.0 million. Works began in July 2017 and are scheduled for completion by August 2020. This will allow Mukah Airport to accommodate Code 3C (ATR 72) type of aircraft, with a terminal capacity of 250,000 passengers per annum. The airport will also be equipped with a new VVIP room, government staff quarters as well as new facilities for an air traffic control tower.

The Kota Kinabalu International Airport in Sabah is currently undergoing upgrading works. An in-line hold baggage screening system (ILHBS) costing RM18.0 million is currently being installed. The ILHBS will facilitate more timely and efficient baggage security screening. The project kicked off in September 2017 and will be completed in July 2018.

Phase 1 of the Langkawi International Airport (LGK) development involving the construction of 600 carpark lots was completed in December 2017. Meanwhile, construction works for Phase 2 is ongoing. Phase 2 will involve the extension of LGK's terminal and kerbside over a 12-month period. Upon completion of these works amounting to some RM69.3 million, LGK will be capable of accommodating 4.0 mppa as opposed to its current 1.5 mppa capacity. The project aims to enhance the comfort level of the passengers by enlarging the terminal floor and check-in counter areas. It will also see the inclusion of three additional gates, an enlarged holding lounge and public concourse, plus a much bigger commercial area.

MANAGEMENT DISCUSSION AND ANALYSIS

PERFORMANCE OF AIRPORT OPERATIONS

The Group's subsidiary, Malaysia Airports (Sepang) Sdn. Bhd. is responsible for managing and operating the largest airport in Malaysia, namely KLIA. In FY2017, KLIA handled a total passenger movements of 58.6 million, added eight new passenger carriers, handled more than 386,054 total commercial aircraft movements, and managed approximately 37.7 million bag movements. The airport's fastest growing routes include Karachi, Kaohsiung, Danang, Madinah and Muscat all of which have double digit or more growth rates. On top of these fast-growing routes, KLIA has established links to new cities such as Davao, Sihanouk, Nanjing, Chittagong, Honolulu and Jeju, among others.

For its commitment to upholding quality and productivity measures, KLIA continues to win many awards in the area of technical and operational excellence. In FY2017, KLIA received the Gold Award at the International Quality & Productivity Convention 2017 in Indonesia, the 3-Star Gold Award at the MPC Annual Productivity & Innovation Conference 2017 in Genting Highlands, and the Gold Award at the Regional Team Excellence Convention 2017 in Putrajaya.

Malaysia Airports Sdn. Bhd. or MASB manages and operates all the Group's airports in Malaysia except for KLIA. This includes four international airports, 15 domestic airports and 18 Short Take-off and Landing Ports (STOL ports).

In FY2017, MASB handled 38.1 million passenger movements at all its airports, connected passengers from 51 international destinations and 22 domestic routes, and managed more than 462,058 aircraft movements.

MASB registered high year-on-year growth of 14.7% in international passenger movements in FY2017, as well as established new links to many new cities. MASB's continued emphasis on safety and security measures was reflected in the robust enhancement and optimisation plan that it has developed to address passengers' and customers' needs. MASB ensures that all airports under its management are managed efficiently and has continuously been successful in maintaining its ISO 9001:2015, ISO 14001:2004 and OHSAS 18001:2007 certification. For its continuous efforts in maintaining an excellent quality management system, the company was awarded the SIRIM Quality Award.

In FY2017, MASB's commitment to delivering best-in-class travelling experiences for passengers was lauded when Langkawi International Airport became the world's 3rd Best Airport in its category for the third time (i.e. 2016, 2014 and 2013) during ACI's 2016 ASQ Awards.

The Group's Engineering division is responsible for the maintenance of our airport infrastructure to ensure we continue to offer the most efficient and secure services to airport users. In managing our assets, the division takes into account changing needs in relation to products, asset performance and stakeholder demands.

Malaysia Airports' equipment is monitored based on an Asset Replacement Masterplan (ARM) that reflects industry best practices. In ensuring exemplary service levels, the ARM prioritises the importance of properly functioning equipment and airport infrastructure. Linked to the life cycle cost (LCC) structure of the airport's specialised systems, the ARM enables us to optimise cost and repair over the useful life of a piece of equipment and determine when it is due for replacement.

One of the perennial challenges faced is the issue of managing assets that have reached the end of their design life as this ultimately leads to the scarcity of parts on-shelf, longer delivery lead time and higher financial impact. These factors in turn may lead to critical asset breakdowns which will have an adverse impact on airport operations. To mitigate such instances, the engineering maintenance team is focused on keeping our assets performing at an optimal level and meeting stakeholders' demands for high service levels. The division has set in place various strategic plan and initiatives so that it can readily respond to asset management challenges and demands.

To keep abreast of the latest technological advancements and ensure it is ready to tackle all asset-based challenges, the division is focused on capacity building programmes. Every year, the condition of the Group's infrastructure and development needs are discussed at our engineering seminar which is attended by engineering staff from across the Group. To keep up to date on the latest developments, we also maintain contact with industry leaders and participate in product presentation sessions.

In 2017, a total of 27 various product presentations were conducted. Aside from this, an asset replacement programme was developed for critical assets such as the baggage handling system, aerotrain, airfield ground lightings, fire vehicles, air conditioning system and people movers.

In terms of capacity building measures, our engineers were also exposed to advanced quantitative analytical methods for better decision making. This involved the use of computing capabilities to analyse and solve complex problems. On top of this, our engineering personnel undergo annual engineering competency assessments that reflect the real work at site and the knowledge required for each engineering position. The results of these assessments are used as the basis for future training programmes.

In managing its assets, Malaysia Airports remains committed to a green airport strategy, which mandates that we actively look for opportunities to redefine the boundaries of our expertise while being innovative and creative. The Energy Performance Contract (EPC) is a case in point. The EPC challenges existing and conventional ways of doing business in which value creation and cost reduction are simultaneously unlocked. The Group's inaugural EPC project, encompassing 1,449 units of high-mast lighting at KLIA and Penang International Airport (PEN), recorded a reduction in power consumption by 78% which will translate into a total cost saving of RM6.8 million over the next five years.

In our quest to position Malaysia Airports as the future leader for green airports, Kota Kinabalu International Airport (BKI) underwent EnMS ISO 50001 certification as part of a pilot project. The plan-do-check-act model of EnMS ISO 50001 readily integrates with the Group's present energy management system. Carbon reduction initiatives at BKI - verified and recognised by SIRIM Malaysia - have reduced electricity usage by 720,000 kWh which is equivalent to 386 tonnes of carbon emission. Participating airports are expected to improve their energy performance significantly while they achieve direct savings in the utility cost in future.

As part of our green reliability engineering asset management efforts, Langkawi International Airport (LGK) and Tawau Airport (TWU) are focusing on the replacement of high efficient chillers at the airports. In line with our Energy Management Policy which emphasises energy efficiency of new systems and equipment, we have embarked on several system upgrade projects at KLIA. These projects involve the installation of high efficient motors for baggage handling system, the replacement of refrigerants for pre-conditioned air, the replacement of LED lights at various critical areas, and the installation of electric vehicle charging stations, among other things.

Malaysia Airports' efforts in promoting green technology were recognised internationally when KLIA was awarded the Platinum award for airport in its category at the 12th ACI Asia Pacific Green Airport Recognition 2017 event in Doha. 2017 also saw us receiving the accolade for 'Best Green Reliability Programme' at the Uptime Awards 2017 event in Florida, USA.

MANAGEMENT DISCUSSION AND ANALYSIS

COMMERCIAL PERFORMANCE

The Group's Commercial Services division is responsible for the airports' retail areas. It is tasked with reviewing and improving the mix of retailers and service providers to boost overall retail revenue per passenger. The division also devises marketing campaigns to drive retail sales and business strategies to grow retail concessions whilst diversifying its income portfolio by creating new revenue streams.

Today, the division continues to enhance the commercial value and airport retail experience by taking into account industry best practices and value accretive business opportunities. This entails exploring creative measures to increase commercial revenue and the average spend per passenger in the midst of evolving retail environment.

Commercial Services revenue grew 13% in FY2017 on the back of strong royalty performance at KLIA and the various MASB airports. KLIA sales went up by 24% with KLIA Main Terminal reaching the RM1 billion mark for the first time in October 2017 while MASB sales too strengthened by 23% year on year. The strong growth in revenue and sales were mainly due to increased rental income revenue and high retail spending resulting from favourable travel sentiments, especially from the North East and South Asia markets.

The government-to-government initiative relating to visa relaxation, new and aggressive routes expansion from China's main cities to KLIA and other international airports, proved fruitful and this was reflected in the higher airport retail spend. Malaysia also benefited from the political tensions between China and South Korea over the THAAD missile crisis as Chinese travellers sought alternative destinations. This is apparent with Langkawi International Airport (LGK) and Kota Kinabalu International Airport (BKI) recording double-digit sales growth of 33% and 46% respectively, fuelled by the growing spend from Chinese passengers. LGK's lure as an attractive destination made it an easy choice for any tourists and BKI's achievement was a testament to the successful collaboration we had with the Sabah State Tourism.

Capitalising on these developments, efforts were made to ensure exciting commercial value proposition was in place, enticing passenger spending which resulted in sales per passenger (SPP) at KLIA and MASB recording double-digit growth of 12% and 17% respectively. The sales/sqm grew by more than 25% year-on-year within KLIA and MASB airports with perfume and cosmetics, liquor and tobacco being the most purchased products.

Commercial Services is adopting a two-pronged approach to make strong strides forward. The first involves Business-to-Business (B2B) engagement with partners aimed at improving performance and communications while the second focuses on Business-to-Customers (B2C) engagement to meet the expectations of our discerning and seasoned travellers at each touch point of their journey.

To support the strategy, we undertook an all-round review of each of the five international airports and developed a Reset Strategy for all Retail and F&B offerings. Once completed, a new retail mix and an enriched premium proposition with an array of world-renowned brands and local influence will be introduced. Each airport will introduce five distinctive zones for customers' shopping and dining pleasure. These will include Duty Free Zones, retail entertainment, boutiques, 'sense of place' and F&B zones boasting new and fresh concepts.

We are also providing a platform and additional channel for established Bumiputera retailers and small and medium enterprises (SMEs) to explore and expand their businesses at our international airports, providing Bumiputera entrepreneurs with opportunities in the retail segment so they could gain retailing and operations experience, ultimately building brand presence in an international setting.

The Bumiputera platform has been a proven success as the percentage of Bumiputera retailers operating at all international airports stands at 40%. In 2017, five outlets were added to the Bumiputera retailers' portfolio. Government agencies such as MITI and TERAJU continue to play their roles in strengthening the support for Bumiputera retailers, by providing them business advisory services as well as training and development. As part of our corporate responsibility in an effort to develop local entrepreneurs, we collaborated with Federal Agriculture Marketing Authority (FAMA) in setting up the first AgroBazaar in the country to showcase export ready Malaysian products from about 35 local entrepreneurs.

On the B2C front, we are collaborating with Alipay, the world's largest online and mobile platform to promote cashless convenience to tourists from China. In 2017, some 65.4% and 59.6% of the outlets at KLIA Main Terminal and klia2 respectively were transacting via Alipay. Alipay's payment capability has enabled our retailers to reach the growing numbers of Chinese tourist, allowing the customers to pay for their transactions securely in Chinese Yuan without having to be concerned about fluctuating exchange rates.

Innovatively, we have introduced the Chinese Traveller Welcome Pack as part of Total Airport Experience initiative that includes information about special promotions, transit and baggage facilities, local city tours, fast track airport access and many more. Tourists from China would just need to present their passports to redeem the Welcome Pack at the Chinese Helpdesk and Customer Experience counters at both terminals in KLIA.

MANAGEMENT DISCUSSION AND ANALYSIS

KLIA maintains its status as a world-class airport and world-class shopping destination. As an international shopfront for both tourists and Malaysians, it provides the best of both worlds by showcasing a variety of world-renowned and the best of local brands at an international stage. Marketing communication utilising both traditional and digital communication platforms was developed to reinforce the position.

To this end, FY2017 saw the successful roll out of thematic and tactical campaigns supported by other festivities and marketing initiatives to reinforce our airports' position as credible lifestyle destinations. In conjunction with Malaysia Airports' silver jubilee celebration, Commercial Services launched the 25th Anniversary Shopping Campaign with total prizes worth over RM2.5 million. The campaign received overwhelming response with about 170,000 contest entries and contest sales receipts amounting to RM135.6 million.

Malaysia Airports (Niaga) Sdn. Bhd. or MA (Niaga), better known by the brand Eraman Malaysia, is the largest travel retail and duty-free company in Malaysia and commands 50% of the klia2 total retail business. Operating more than 50 retail and F&B outlets as well as six kiosks, MA (Niaga) offers a wide range of world-class and exclusive products including premium chocolates, liquor, wine and spirits, skincare, fragrances and tobacco products throughout their locations in Malaysia.

MA (Niaga) registered strong growth in FY2017 as a result of higher passenger movements at all international airports in Malaysia coupled with varied retail offerings as well as strong marketing and promotion campaigns especially the Eraman Shopping Extravaganza. The unrelenting demand for duty free merchandise continued to rise and together with a stronger Ringgit stimulated sales at the company's duty-free outlets, particularly KLIA and Kota Kinabalu International Airport. MA (Niaga) recorded double digit revenue growth of 15.5% to RM856.3 million, its highest revenue since its inception. This was a tremendous result coming back from the loss-making years of 2014 and 2015.

The perfumes and cosmetics category together with the confectionery category led the way in sales for FY2017, registering double digit growth on the back of favourable passenger movements as well as strong marketing partnerships and collaboration with major international financial players such as Alipay and Union Pay International. By August 2017, all retail and F&B outlets under MA (Niaga) were able to perform transactions via Alipay. MA (Niaga) also had close collaboration with its brand principals which helped drive strong sales growth for perfumes and cosmetics as well as confectionery categories.

Running for the second consecutive year, the Eraman Shopping Extravaganza "Buy & Win" Contest, with its offer of bigger and better prizes of three luxury cars, designer handbags and shopping vouchers worth RM1 million, attracted more than 300,000 entries and contributed double-digit growth to Eraman's coffers. In conjunction with MA (Niaga)'s 25th Anniversary in 2018, the company will be embarking on a brand refresh initiative which will encompass a revamp of its website, uniforms and stores as well as expansion and major renovation works.

PERFORMANCE OF NON-AIRPORT OPERATIONS

The Group's non-airport operations encompass our hotel, agriculture and horticulture, property management as well as fixed assets and facilities management businesses.

The Group's hotel activities fall under the ambit of KL Airport Hotel Sdn. Bhd. Sama-Sama Hotel KL International Airport, which overlooks KLIA, is KL Airport Hotel Sdn. Bhd.'s five-star flagship property. The company also operates two airside transit hotels, namely Sama-Sama Express KLIA and Sama-Sama Express klia2, while providing a service called KLIA Premier Access. These facilities extend the Sama-Sama signature hospitality to transit passengers and provide travellers with an opportunity to refresh and relax after or before a flight. Included in its revenue streams were also Meetings, Incentives, Conferencing and Exhibitions (MICE) business, as well as major international sports events.

In FY2017, Sama-Sama Hotels closed total sales amounting to RM98.0 million with a 14.4% growth against last year's sales of RM85.6 million.

Our Sama-Sama Hotels continue to garner prestigious accolades and awards at the international level attesting to the high service levels they accord their customers. In FY2017, Sama-Sama Hotel KL International Airport was hailed 'Best Airport Hotel Global 2017' and 'Best Business Hotel in Asia 2017' at the Haute Grandeur Global Hotel Awards event as well as received the Best Revenue Hotel Award at Worldhotels Conference. The hotel was also named one of the 'Best Companies to Work for in Asia 2017' at the HR Asia Awards event. At the World Luxury Hotel Awards event, the hotel was accorded the title 'Luxury Hotel – Country' and 'Luxury Airport Hotel – Regional'. The year also saw Sama-Sama Express KLIA winning the Airside Transit Hotel Global award while Sama-Sama Express klia2 won the 'Eco/Green Hotel – Country' title.

Our agriculture and horticulture arm, MAB Agriculture-Horticulture Sdn. Bhd. (MAAH), is mainly involved in the cultivation and management of mature oil palm (5,545.4 hectares), coconut (126.8 hectares) and landscape activities at KLIA (896.4 hectares). During the year under review, this ISO9001:2008-certified company focused its efforts on managing some 1,145.0 hectares of immature oil palm areas (i.e. 17.1% of the total oil palm area of 6,690.4 hectares) located at KLIA, Sibu, Miri and Bintulu. These green areas not only provide recurring revenue, but they also help mitigate the effect of noise pollution as well as provide a pleasant view of the surrounding areas.

In FY2017, sales of oil palm fresh fruit bunches (FBB) accounted for 99.3% of MAAH's total turnover, whilst coconut and landscape activities made up the remaining 0.7%. MAAH expects to make positive contribution to the Group's overall revenue in FY2018, given the higher yield projected and improvements in the Crude Palm Oil (CPO) price.

Malaysia Airports Consultancy Services Sdn. Bhd. (MACS), has an accomplished track record both at home and abroad. The company took on and successfully delivered on its first international project in Cambodia more than 20 years ago. Over the course of FY2017, MACS was rebranded to correspond with its mission of providing consultancy services beyond the aviation industry and national borders. The company's primary focus today is to provide multimodal transport expertise from the technical and consultancy perspectives. These include trading in airport specialised systems, services monitoring, and IT specialised systems.

In FY2017, MACS participated in tenders for technical and consultancy services for the Airport Authority of India as well as Malaysia's Suruhanjaya Perkhidmatan Awam Darat (SPAD). MACS is today an accredited ICAO Aviation Security Training Centre and an ACI Global Training Hub for the Asia Pacific region. Other than the scheduled Airport Training Programme conducted at the Group's Global Training Hub for the Asia Pacific Region (i.e. Malaysia Airports Training Centre), MACS conducted eight batches of on-the-job-training for some 114 employees of the Oman Airports Management Company.

MACS is currently the exclusive distributor of the ADB Airfield Solution for Malaysia in the area of Airfield Ground Lighting Systems. Through its 13-year partnership with ADB in the Asia Pacific region, MACS has benefited from technology transfers, among other things. The company also continues to play a role as a consultant and service provider managing the ASQ programme for KLIA. This programme, which measures customer satisfaction in 33 areas, saw MACS conducting face-to-face interviews with 3,400 airport users passing through both terminals in KLIA in FY2017. MACS also continues to serve as a consultant and service provider to the Kota Kinabalu International Airport, Kuching International Airport and Sultan Abdul Aziz Shah Airport, Subang.

MACS received MS 1900:2015 certification from SIRIM QAS in relation to Syariah management and is now collaborating with MA (Niaga) Sdn. Bhd. to offer its expertise in Syariah and halal compliance services.

Today, MACS is embracing a strategy of creating a business presence in certain regions (i.e. the Middle East and Southeast Asia) to secure high value projects with higher revenues and profit margins for the long-term. Via its subsidiary, Malaysia Airports Consultancy Services Middle East LLC (MACS ME), MACS continues to explore business opportunities arising in Qatar and other Middle East countries as well as within other target market regions i.e. India and ASEAN countries. MAC's involvement in conferences and exhibitions such as the LIMA Exhibition 2017 and ACI Airport Exchange 2017 Oman saw potential clients approaching MACS to collaborate on airport projects.

Our asset and facilities management services arm, Urusan Teknologi Wawasan Sdn. Bhd (UTW), has built a name for itself on the facilities management and facilities consultancy and advisory services front for some 19 years now. An ISO 9001:2008, ISO 14001:2004 and OHSAS 18001:2007 certified company, UTW has provided services to a list of prestigious clients. Beyond the Malaysia Airports Group, the company has successfully secured contracts for KLCC Twin Towers & Tower 3, Masjid As-Syakirin KLCC, Maxis Tower, Exxon Mobil Tower, Sepang International Circuit, Airbus Helicopters Malaysia, Port of Tanjung Pelepas and Mitsui Outlet Park KLIA .

UTW continues to play an important role in helping KLIA by providing high quality airport experiences to stakeholders through its involvement in the delivery of effective green solutions, the equipment life cycle replacement programme, as well as KLIA's reengineering and continuous improvement initiatives.

FY2017 saw UTW clinch major awards from KLCC Urusharta for the second year running. These included the categories of Best Contractor for Operation & Maintenance, Best Team Leader, Demonstrated Knowledge of Services and Best Individual Attitude.

SAFETY AND SECURITY

Safety and security are key issues at the heart of the global aviation industry and which continue to impact upon passenger confidence. We are proud to say that KLIA fully complies with the International Civil Aviation Organisation's (ICAO) Standards and Recommended Practices (SARPs) under the Universal Security Audit Programme, which is conducted by ICAO auditors. Nonetheless, given the security-related incidents at airports around the world, the importance of security to our business has become even more paramount. These incidents at other airports provide us some insights into the failings of certain security approaches and show us what we can do to strengthen our own security strategies.

We continue to receive good feedback on our safety and security measures. In an evaluation exercise carried out by the Key Points Audit Team by the Chief Government Security Office in December 2017, we were informed that the overall security level at KLIA was in full compliance with the seven major criteria specified in the guidelines. As such, our Aviation Security Division (AVSEC) received an excellent (5 stars) rating. On top of this, all Chief Aviation Security Officers (CASOs) who have undergone an interview by the Department of Civil Aviation (DCA) in 2017 have been endorsed and certified as CASO and found competent to perform duties at their respective airports.

In December 2017, AVSEC in collaboration with the Eastern Sabah Security Command (ESCOMM) conducted a table top exercise at the Sandakan Airport. The tabletop exercise aimed to streamline preparations and assess the ability and capability of the agencies involved in handling security threats and aggression at the airport. This exercise will be carried out on a regular basis and will encompass full-scale advanced training session to deal with incidents of violence which involve all stakeholders at the airport including airline operators and authorities. Aside from this, AVSEC also successfully conducted the Act of Aggression Exercise at klia2.

The year in review saw a significant drop in the overall reported crime cases taking place within the landside and airside areas as compared to the previous year. Crime prevention initiatives undertaken by AVSEC together with the Royal Malaysia Police, especially at the landside areas of our airports, prevented major security incidents and security breaches from happening. The AVSEC team's efforts also saw a huge reduction in reported baggage pilferage cases as compared to previous years. Baggage theft and pilfering reduced to 117 cases against a total of 41 million pieces of luggage handled in FY2017 as compared to 156 cases against a total 36.6 million pieces of luggage handled in FY2016.

MANAGEMENT DISCUSSION AND ANALYSIS

As at December 2017, there was a total of 151,596 prohibited items such as blades, scissors, knives and tools confiscated from passengers, as compared to 125,106 items in December 2016. This 21.2% increase in the detection of prohibited items reflects the increased efficiency and alertness of AVSEC staff in carrying out their duties. The other contributing factor is the continuous in-service training provided to AVSEC personnel to enhance their work efficiency and level of security awareness in the detection of prohibited items.

Malaysia Airports continues to make technology investments in surveillance and screening apparatus to ensure that we provide a secure airport environment. We continue to ramp up controls in airport staff screening process and vehicle movements at the landside area. We also continue to undertake stringent risk management initiatives designed to improve our response to any crises that may emerge, whether natural or man-made. These measures include bolstering our Business Continuity Management strategies for both terminals in KLIA and other MASB airports, as well as fine-tuning emergency response plans for floods at affected airports.

We are also mindful of the fluid nature of Turkey's geopolitical situation and have taken steps to enhance security in and around ISG. We continue to ramp up collaboration with the government of Turkey to strengthen all round security at our airport.

Malaysia Airports' Airport Fire and Rescue Service (AFRS) division, which manages all airport rescue and firefighting at our airports, had planned and executed 75 Aerodrome Emergency Exercises throughout all airports and achieved a 100% completion rate of the Aerodrome Emergency Exercise (AEX) requirements. In addition, AFRS has successfully maintained this 100% completion track record for the past three years.

51 new AFRS recruits successfully completed the compulsory seven months Basic Aircraft Fire Fighting Training Course at the Malaysia Airports Training Centre in Pulau Pinang. The new recruits, comprising both executives and non-executives, were subsequently deployed to fire stations around Peninsula Malaysia, Sabah and Sarawak in order to meet the manpower requirements for airport operations.

BUSINESS RISKS

As Malaysia Airports moves forward amidst difficult market and operating conditions, we are aware of certain risks that we may be exposed to as a result of local operating conditions or global uncertainties that could impact our operational and financial performance. These key risks as well as the respective risk mitigation strategies are spelt out in the Statement on Risk Management and Internal Control that can be found in the relevant section of this Annual report.

OUTLOOK

As we venture forth into a new financial year, we do so with a quiet confidence. Following the upswing in global economic activity that began in 2016 and which continues to strengthen, global growth is forecast to rise to 3.9% in 2018 from 3.7% in 2017. The emerging markets are expected to drive global market growth supported by the developed economies, but at a more gradual pace.

On the domestic front, after a stronger-than expected performance in 2017 of 5.9% growth in GDP, Malaysia's economic prospects are expected to moderate in 2018 to a growth rate of between 5.0% to 5.5%, essentially unchanged from the average rate of expansion witnessed in 2013 to 2017. Malaysia's robust economy has been attributed to private sector spending and the continued strong performance in exports.

On the industry front, IATA forecasts a growth rate of 6.0% for global scheduled passenger traffic in 2018 (in terms of revenue passenger kilometres). The ACI's global forecast which is based on airport passenger movements, is slightly higher at 6.1%. The forecast for passenger growth in the Asia Pacific region is expected to be higher. Air travel will continue to be driven by economic factors especially per capita income, business confidence and trade. The competition, supply and cost factors do play a role as they determine the availability of seats and fare level. It is assumed that fuel costs (the single largest airline cost at 20% to 40%) will remain close to current prices.

Based on prevailing economic conditions and the additional airlines seat capacity offered, passenger traffic for Malaysia in 2018 is expected to grow at 6.3% with international and domestic passenger traffic growing at 8.3% and 4.2% respectively. Apart from the economic factors, the estimates take into account the airlines immediate schedule filings and aircraft purchases. The forecast model also took into account some additions in air travel brought about by the impending 14th general elections, as was the case during the past elections.

Malaysia is expected to continue benefiting from the visa relaxation for Chinese and Indian tourists. The 2018 traffic numbers are again expected to be mainly contributed by China, India and Southeast Asia sectors which currently make up 75% of international traffic. The China and India sectors are likely to continue with their double-digit growth in 2018. With higher international traffic expected, the current portion of 20% transfers at KLIA will likely increase but marginally. The growing travelling local population combined with increase in the per capita income will further support air travel growth. Passenger growth prospect for ISG, however, is expected to remain moderate in 2018.

A NOTE OF APPRECIATION

Malaysia Airports' achievement today is definitely the result of the hard work and dedication of a number of parties whom I would like to acknowledge.

I wish to convey my heartfelt appreciation to our valued shareholders, customers, suppliers, business partners, federal and state governments, agencies, and regulators as well as our joint venture partners and associate companies. Thank you for your unswerving trust and confidence in Malaysia Airports, as well as for extending us your firm support and cooperation.

My sincere gratitude goes to the members of our Board of Directors for their wise counsel and astute insights in helping Malaysia Airports navigate a clear path through the year's challenges and opportunities. My deep appreciation also goes to my colleagues in the senior management team, as well as all our loyal employees in Malaysia and Turkey for their diligence and commitment to excellence. I appreciate your remarkable tenacity in rising above the challenges of our business and industry and look forward to working together with all of you to surmount all challenges and seize meaningful opportunities.

As we venture forth, I call upon the team at Malaysia Airports to continue doing our best to grow our business, deliver commendable results and strengthen our position. As we step forward with a keen focus on achieving our ambition I call upon all our stakeholders to continue lending us your support. Thank you.

DATUK MOHD BADLISHAM GHAZALI
Managing Director