

AIRLINES FINANCIAL MONITOR

KEY POINTS

JUNE 2017 – JULY 2017

- ➔ Initial airline financial results from Q2 2017 have been more robust than earlier in the year, and suggest that the squeeze on profit margins from higher costs and weak yields peaked in Q1.
- ➔ Meanwhile, having trended downwards since 2013, the latest monthly data suggest that passenger yields have now started to trend upwards. Exchange rate-adjusted yields were broadly unchanged from their year-ago level in May.
- ➔ Global airline share prices fell in July, driven by a decline in the North America index. Having seen airline shares outperform global equities over the past year, July's decline appears, in part, to reflect profit taking by investors.
- ➔ Brent crude oil prices rose back above US\$50/bbl in July, and ended the month nearly 10% higher than they started it. Nonetheless, the futures market remains consistent with just a modest increase in prices over the medium term.
- ➔ Passenger and freight demand growth posted their strongest first half of the year since 2005 and 2010 respectively. The seasonally-adjusted passenger load factor remained broadly stable close to an all-time high over the same period, while the freight load factor recovered to its highest level in more than two and a half years.
- ➔ The pick-up in global trade is helping to support premium passenger demand, particularly to, from and within Asia Pacific. Premium revenues have risen in year-on-year terms on key routes to and from the region so far in 2017.

Financial indicators

Global airline shares fell in July for the first time since March, amid signs of profit taking

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Jul 31st	% change on		
		one month	one year	start of year
World airlines	139.0	-3.2%	+31.8%	+16.6%
Asia Pacific airlines	116.0	-0.4%	+8.8%	+23.3%
European airlines	125.3	-0.8%	+54.8%	+45.4%
North American airlines	172.2	-7.6%	+35.9%	+1.6%
FTSE All World \$	122.2	+2.6%	+14.8%	+13.1%

- ➔ Global airline share prices fell by 3.2% in July – the first monthly fall since March. Having risen by nearly 15% over the previous three months, and having outperformed the global equity index over the past year, the monthly decline in airline shares is likely to reflect a degree of profit taking by investors.



- ➔ The European and Asia Pacific share price indices both registered modest declines in July (<1%), but the biggest fall was seen in the North America index (-7.6%). The latter has now risen by less than 2% since the start of 2017, although given that mid-2016 marked the peak of investor concerns about pressure on unit revenues, the index still stands nearly 36% higher than a year ago.

The initial financial results from Q2 indicate that the squeeze on profit margins peaked in Q1

Airline Financial Results

Number of airlines in sample	Regions	Q2 2016		Q2 2017	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
12	North America	17.5%	4,727	16.7%	4,602
6	Asia-Pacific	3.9%	348	4.6%	626
6	Europe	6.4%	712	9.0%	1,180
24	Sample total	12.7%	5,787	13.2%	6,408

- ➔ The initial airline financial results from Q2 2017 have been robust, and provide the clearest sign that the squeeze on airline profit margins – from weak yields and higher costs – peaked in the first quarter.

- ➔ Indeed, whereas the industry-wide EBIT margin fell in year-on-year terms in Q1 2017, our small sample of 24 airlines indicates that the margin increased to 13.2% in Q2 2017, up from 12.7% in Q2 2016.

- ➔ The EBIT margin fell slightly for North American carriers in year-on-year terms, but the region has continued to post the strongest financial results.

¹ % of revenues ² US\$ million
Sources: The Airline Analyst, IATA

Free cash flow fell in Q2 from a year ago, reflecting a decline in cash flow from operations

Airline Cash Flow¹

Number of airlines in sample	Regions	Q2 2016			Q2 2017		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
12	North America	24.5%	13.7%	10.8%	18.2%	13.6%	4.6%
2	Asia-Pacific	15.5%	23.3%	-7.7%	10.2%	34.6%	-24.4%
5	Europe	13.2%	10.0%	3.2%	16.2%	9.0%	7.3%
19	Sample total	20.9%	13.2%	7.7%	17.3%	13.6%	3.6%

¹ % of revenues

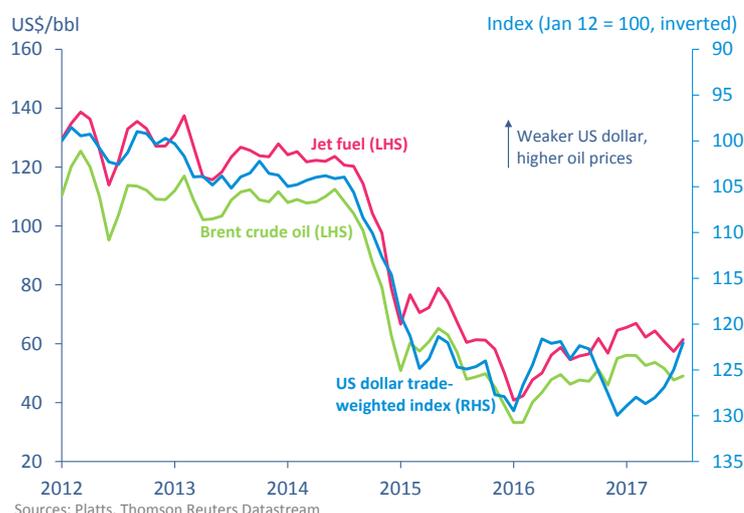
² From operating activities

Sources: The Airline Analyst, IATA

- The latest data from our sample of 19 airlines show that industry-wide free cash flow (FCF) fell to 3.6% of revenues in Q2 2017, down from 7.7% in the same period of 2016.
- The fall in FCF was driven by a modest decline in net cash flow from operations, to 17.3% of revenues in the quarter from nearly 21% a year ago.
- Capital expenditure in our sample actually increased in year-on-year terms in Q2, to a robust 13.6% of revenues, driven by higher capex in Asia Pacific.

Fuel costs

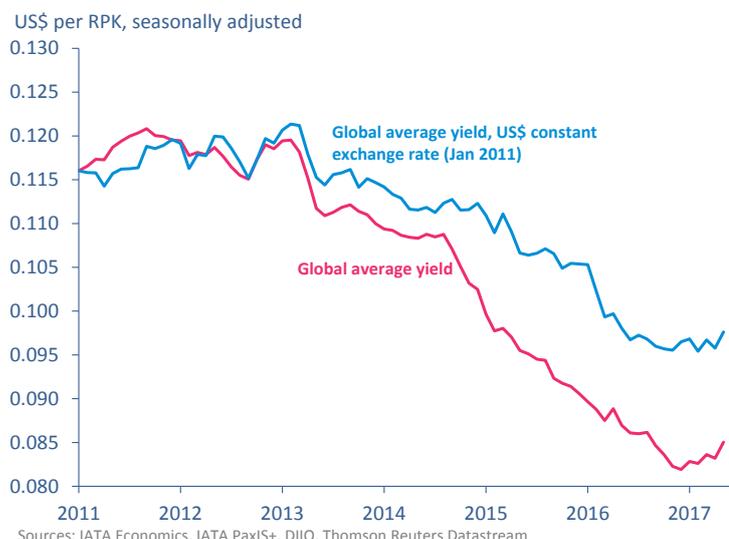
Oil and jet fuel prices recover above US\$50/pb in July, driven by declines in US inventories



- Brent oil prices rose back above US\$50/bbl during July and ended the month nearly 10% higher than they were at the end of June.
- The price of oil has been on a downward trend since the start of 2017, mainly reflecting the resilience of US shale production. However, the increase in July came alongside declines in US oil inventories as well as signs that OPEC and other large oil producers will continue, and possibly extend, their efforts to constrict oil supply. The recent weakness of the US dollar may also be starting to translate into upward pressure on prices.
- The futures market remains consistent with just a modest increase in prices over the medium-term.

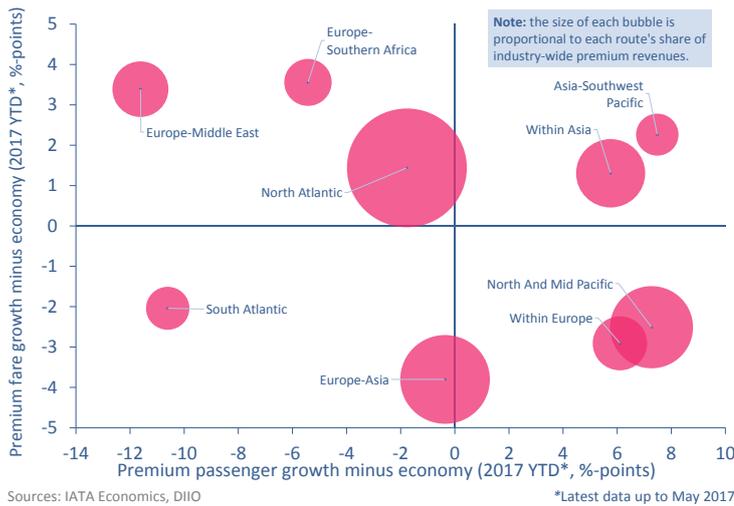
Yields and premium revenues

Industry-wide passenger yields appear to be trending upwards modestly



- Having shown signs of bottoming out in late-2016, the latest monthly data indicate that passenger yields have started to trend upwards modestly. When measured in constant exchange rate terms, passenger yields in May were broadly unchanged from their year-ago level – the strongest year-on-year growth rate in more than four years.
- The turnaround in the long-standing downward yield trend reflects a combination of factors, including a pick-up in global economic activity, as well as upward pressure on some key input costs, including labour, in a number of countries.
- All told, signs that passenger yields are improving are helping to underpin investors' confidence about airline financial performance over the year ahead.

Improvement in global trade conditions is helping to underpin premium passenger demand

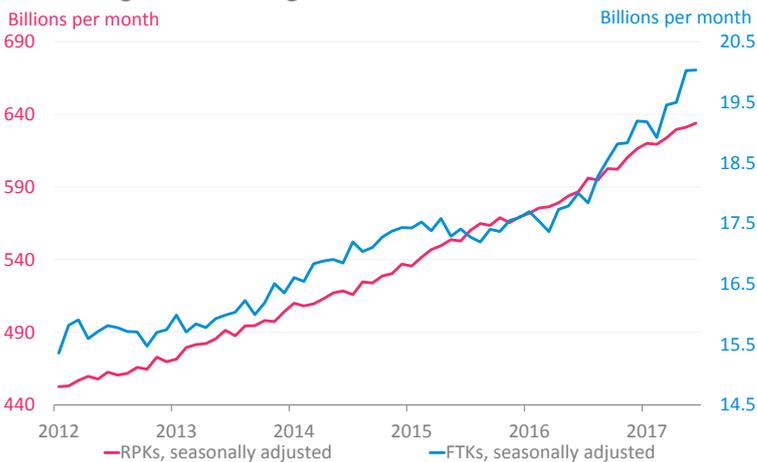


- ➔ There has been a wide spread in premium performance by market in 2017 so far. Premium demand growth has been stronger than economy in a number of markets, particularly across the Pacific and Within Asia. This ties in with the recent improvement in global trade conditions, which tends to correlate well with premium travel demand. On the other hand, premium demand, has been relatively weaker in other cases, notably between Europe and the Middle East.
- ➔ There has also been a spread in airfare performance too: premium airfares have held up better than those in the economy cabin in a number of cases – notably the North Atlantic – but have lagged in others (eg, Europe-Asia).

Demand

Passenger and freight demand growth both post multi-year highs in the first half of 2017

Air Passenger and Air Freight Volumes

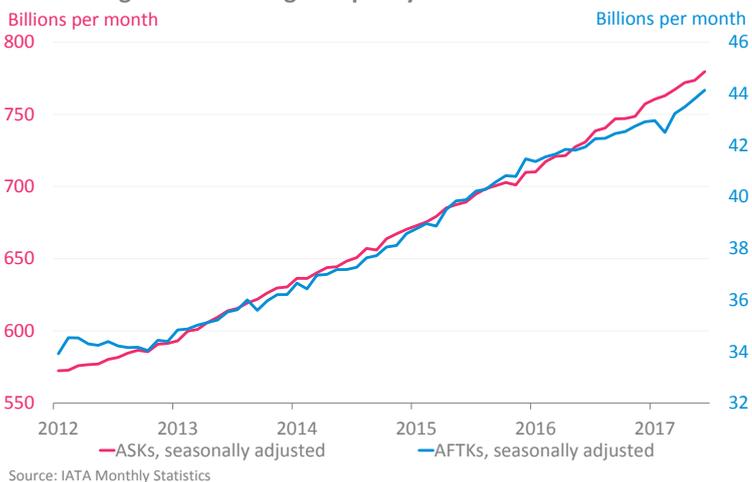


- ➔ Global passenger volumes grew by 7.9% year-on-year in H1 2017 – the fastest growth seen in the first half of a year since 2005.
- ➔ The strong start to the year for passenger demand has been driven by a brighter global economic backdrop and stimulus from lower airfares. That said, the SA trend has moderated over recent months, in line with a softening in the exceptionally supportive demand conditions.
- ➔ Meanwhile, global freight volumes grew by 10.4% year-on-year in H1 2017 – the fastest pace for the period since 2010. However, industry drivers indicate that the best of the cyclical growth upturn may have passed.

Capacity

Pax and freight capacity are both trending upwards in line with, or slower than, demand

Air Passenger and Air Freight Capacity

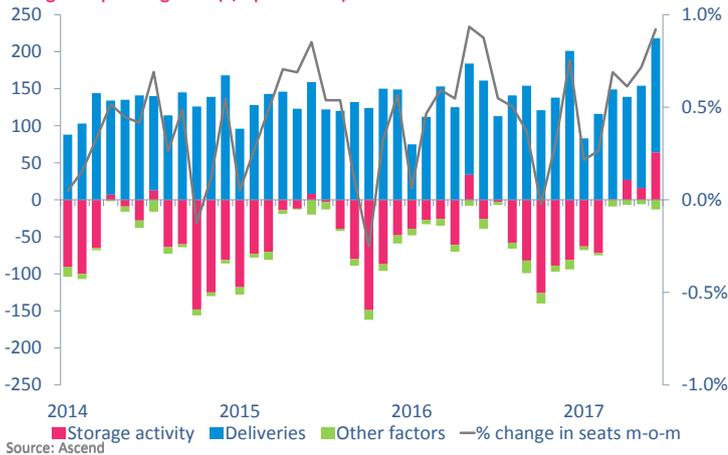


- ➔ Industry-wide available seat kilometres (ASKs) increased by 6.1% year-on-year in H1. In SA terms, ASKs and RPKs have trended upwards at broadly similar annualized growth rates over the past three months or so.
- ➔ Available freight tonne kilometres (AFTKs) grew by 3.6% in H1 2017 compared to the same period a year ago. The SA trend has strengthened: AFTKs have been trending upwards at an annualized rate of around 9% over the past three months. However, this has still lagged behind the strong upward trend in FTKs over the same period.

Net storage activity underpins a solid increase in available seats in June

Airline Fleet Development

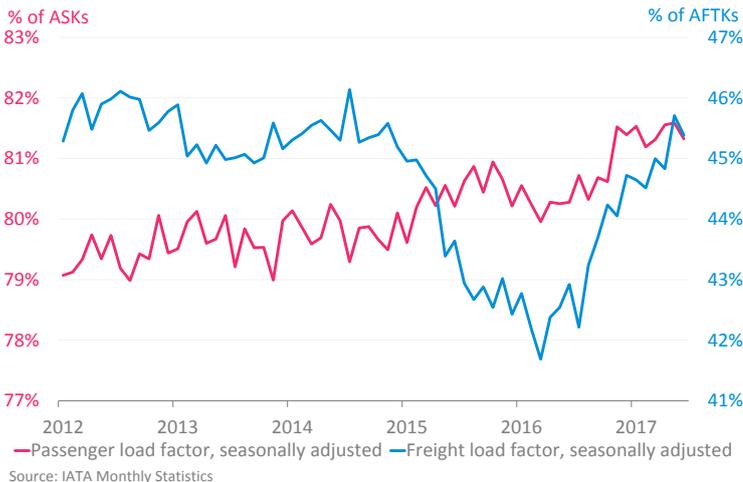
Change in operating fleet (a/c per month)



- The number of available seats in the global airline fleet increased by 0.9% month-on-month in June. (Note that the month-on-month growth rate typically peaks in the middle of the year ahead of the peak summer period for demand.) All told, the number of seats in service in June was 6.0% higher than the same month a year ago.
- 154 new aircraft were delivered in June, down from 161 in June 2016. 25 fewer aircraft were delivered in the first half of 2017 compared to the same period in 2016 (751 versus 776).
- Storage activity made the biggest net change to the fleet size for at least three years in June. 142 aircraft re-entered service from storage – broadly unchanged from the case in June 2016. However, just 78 aircraft were taken from service and put into storage, compared to 166 in June 2016.

Passenger load factor close to an all-time high, alongside ongoing recovery in freight loads

Load Factors - Passenger and Freight



- The seasonally-adjusted passenger load factor remained relatively stable close to an all-time SA record high throughout H1 2017. All regions except the Middle East registered year-on-year increases in passenger loads during the period. Sustained high achieved load factors are continuing to support airline financial performance.
- The industry-wide freight load factor continued to recover in SA terms during the first half of the year. Despite falling slightly in June, the load factor is currently around four percentage points higher than its low-point in early-2016.

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