AIRLINES FINANCIAL MONITOR

KEY POINTS — AUGUST 2017 – SEPTEMBER 2017

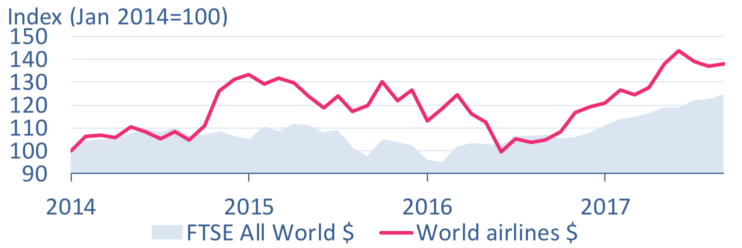
- The more complete financial data from Q2 show that the year-on-year decline in profit margins was quite small for the industry in aggregate, and actually masked strong increases in the case of European and Latin American carriers. North American airlines again posted the widest profit margins, albeit slightly narrower than a year ago.
- Industry-wide passenger yields posted positive, albeit very modest, year-on-year growth in July for the second month in a row. Passenger yields have continued to trend higher at an annualized rate of around 3.5%.
- Global airline share prices rose by 0.9% in September, driven by a gradual recovery in the North American index following two sharp monthly declines. By contrast, European and Asia Pacific airline shares both fell modestly.
- Oil prices have trended higher in recent months, reflecting supply constraint on the part of OPEC and Russia, as well as a weaker US dollar. The price of Brent crude rose to a 26-month high of US$58.50/bbl during September.
- Passenger and freight volumes both grew robustly in year-on-year terms in August, although the seasonally-adjusted (SA) upward trend in the former has moderated. The SA passenger load factor remains at a historically high level, while the SA freight load factor rose to a three-year high in August.
- Stronger global trade conditions are helping to support demand for premium class travel, particularly to/from Asia. Premium's share of passenger revenues rose to 26.3% in the first seven months of 2017, from 26.0% a year ago.

Financial indicators

Global airline shares rose in month-on-month terms in Sept. for the first time since June

Airline Share Prices

US$ indices (Jan 2014=100)	Index Sep 29th	% change on one month	% change on one year	% change on start of year
World airlines	**138.2**	**+0.9%**	**+32.0%**	**+16.0%**
Asia Pacific airlines	117.4	-1.1%	+18.1%	+24.8%
European airlines	130.4	-0.6%	+62.0%	+51.3%
North American airlines	163.7	+3.0%	+25.0%	-3.5%
FTSE All World $	**124.6**	**+1.8%**	**+16.4%**	**+15.3%**



Source: Thomson Reuters Datastream

- Global airline share prices rose by 0.9% in September – the first month-on-month increase since June. Airline shares underperformed the global equity market again in September, but they have still far outperformed the global index over the past year.
- The increase in global airline share prices in September was driven by a gradual recovery in the North American index after two sharp monthly declines. (Note that North American airline shares have since jumped by more than 5% in early-Oct following guidance of a solid Q3 for unit revenues).
- By contrast, the Asia Pacific and European share price indices both saw modest declines during September (-1.1% and -0.6%, respectively).

Small year-on-year decline in industry-wide margin in Q2, but a wide spread at regional level

Airline Financial Results

Number of airlines in sample	Regions	Q2 2016 EBIT margin[1]	Q2 2016 Net post-tax profit[2]	Q2 2017 EBIT margin[1]	Q2 2017 Net post-tax profit[2]
35	North America	15.5%	5,300	14.5%	5,177
31	Asia-Pacific	7.4%	2,324	4.6%	2,163
11	Europe	4.2%	467	7.0%	978
5	Latin America	0.7%	10	4.3%	-213
3	Others	10.2%	76	8.6%	65
85	**Sample total**	**9.8%**	**8,177**	**9.0%**	**8,170**

[1] % of revenues *[2] US$ million*

Note: Includes half-year results of Air China, Cathay Pacific, China Eastern Airlines, China Southern Qantas, and Shandon Airlines

Sources: The Airline Analyst, IATA

- The industry-wide EBIT margin in our sample of 85 airlines fell slightly to 9.0% in Q2 2017, from 9.8% in the same quarter of 2016. The latest results show that the squeeze on profit margins from weak yields and higher costs eased from that seen in Q1.
- As before, the sample total masked a wide regional spread: the EBIT margin fell slightly for carriers in North America and Asia Pacific in year-on-year terms in Q2, although the former group continued to post the strongest results. By contrast, airlines in Europe and Latin America reported wider profit margins, helped in part by the improved economic backdrops in both regions.

Free cash flow fell in Q2 from a year ago, amid a wide spread in regional performance

Airline Cash Flow[1]

Number of airlines in sample	Regions	Q2 2016 Net cash flow[2]	Q2 2016 Capex	Q2 2016 Free cash flow	Q2 2017 Net cash flow[2]	Q2 2017 Capex	Q2 2017 Free cash flow
16	North America	24.3%	13.9%	10.4%	18.2%	14.1%	4.1%
21	Asia-Pacific	22.5%	26.9%	-4.5%	18.3%	22.7%	-4.4%
8	Europe	12.2%	14.7%	-2.5%	17.0%	9.4%	7.6%
4	Latin America	7.0%	4.7%	2.3%	9.2%	7.3%	1.9%
3	Others	29.7%	7.5%	22.2%	29.8%	10.1%	19.7%
52	**Sample total**	**20.4%**	**16.9%**	**3.5%**	**17.7%**	**15.1%**	**2.6%**

[1] *% of revenues* [2] *From operating activities*

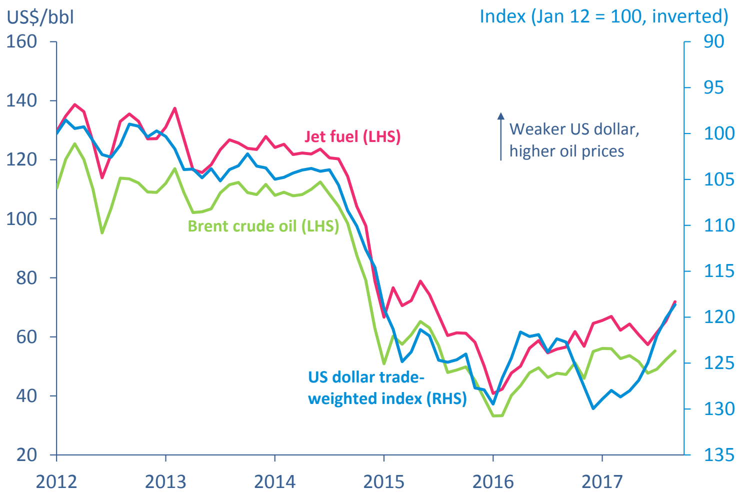
Note: Includes half-year results of China Southern Airlines and Shandong Airlines

Sources: The Airline Analyst, IATA

- Based on our sample of 52 airlines, industry-wide free cash flow (FCF) fell to 2.6% of revenues in Q2 2017, down from 3.5% in the same period of 2016.
- The fall in FCF was driven in large part by a decline in net cash flow from operations, to 17.7% of revenues in Q2 from just over 20% a year ago. This reflected declines in North America and Asia Pacific, but European airlines were a notable exception.
- The decline in net cash flow from operations was partly offset by lower capital expenditure: capex in our sample dropped in year-on-year terms in Q2, to 15.1% of revenues, from 16.9% a year ago.

Fuel costs

Brent oil prices rose to a 26-month high during September

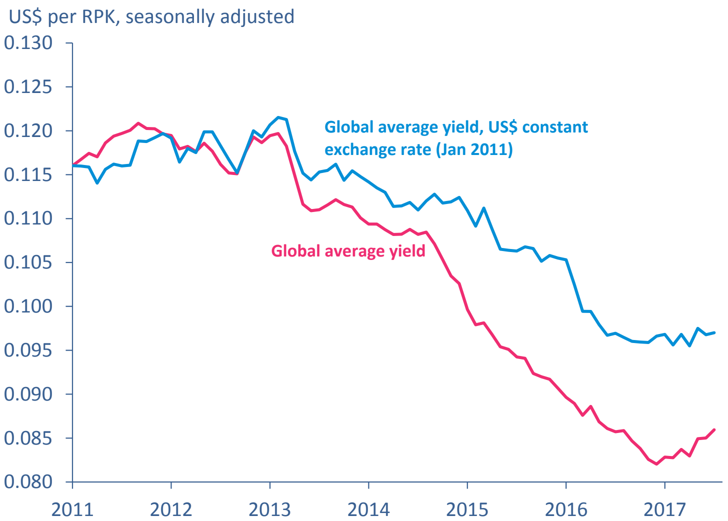


Sources: Platts, Thomson Reuters Datastream

- Global oil prices have trended higher in recent months, reflecting a combination of a weaker US dollar as well as ongoing supply constraint on the part of OPEC and Russia (the latest reports suggest that production cuts could be extended until the end of 2018). A threat by Turkey to cut an Iraqi oil pipeline drove the Brent oil price to a 26-month high of US$58.50/bbl during September.
- With demand for oil expected to remain robust, developments in oil prices will be shaped by the net impact of reduced supply from traditional producers and increasing supply from US shale oil producers.
- For now, and as has been the case for some time, the futures market points to oil prices remaining broadly stable at or around current levels over the next four years.

Yields and premium revenues

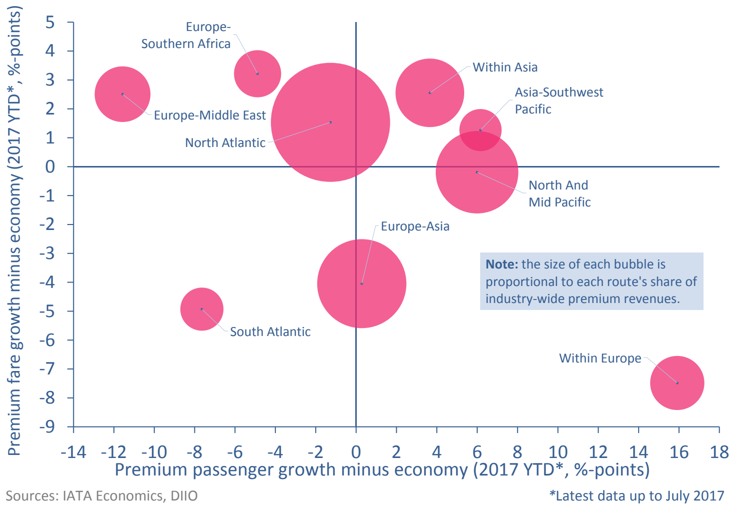
The modest upward trend in industry-wide passenger yields has continued



Sources: IATA Economics, IATA PaxIS+, DIIO, Thomson Reuters Datastream

- The turnaround in the long-standing downward trend in passenger yields has continued. As we have noted before, this reflects a number of factors, including a strong demand backdrop, helped by a pick-up in global economic conditions, as well as upward pressure on some key input costs, including labor.
- The declines seen in the US dollar this year mean that the unadjusted yield series has exaggerated the upward trend in underlying yields. Nonetheless, when measured in constant exchange rate terms, passenger yields in July posted year-on-year growth for the second month in a row (albeit modest, 0.1%).

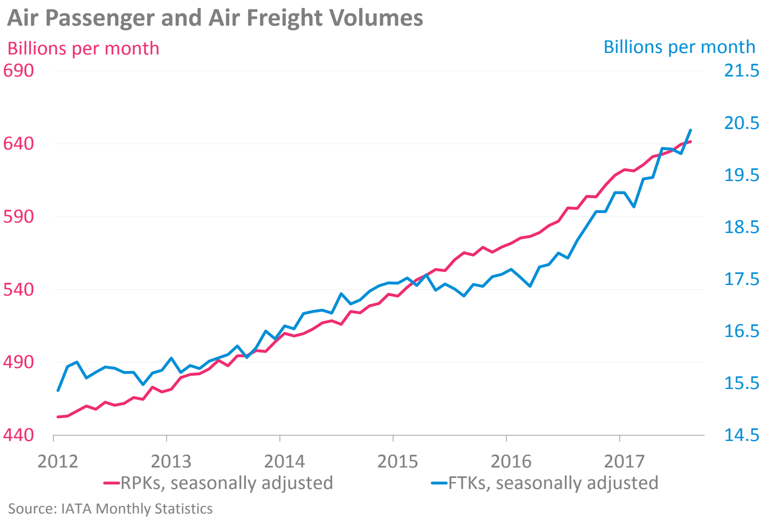
A stronger global trade backdrop is helping to support demand for premium class travel



- The stronger global trade backdrop has helped to support premium passenger demand growth so far in 2017, particularly on markets to, from and within the key manufacturing region of Asia. By contrast, premium demand has lagged behind economy in a number of cases, most notably between Europe and the Middle East. (The latter may reflect less demand for O-D travel to the Middle East region, as well as the impact of the ban of personal electronic devices in early 2017.)
- All told, premium's share of total passengers was stable at 5.3% during the first seven months of 2017 compared to the same period a year ago. However, premium's share of revenues rose to 26.3%, from 26.0%, over the same period.

Demand

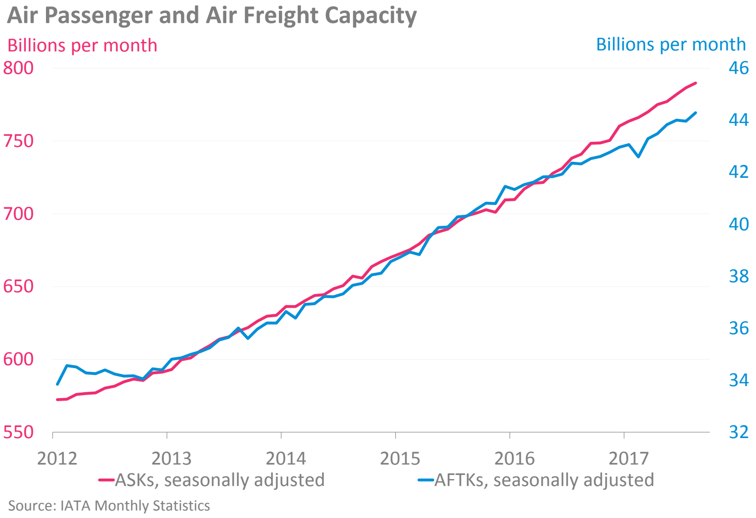
Passenger and freight demand both grew robustly in year-on-year terms in August



- Industry-wide revenue passenger kilometres grew by 7.2% year-on-year in August.
- 2017 is on course to be another year of above-trend RPK growth. However, the recent easing in demand drivers suggests that passenger traffic will continue to trend upwards at a more moderate pace into 2018 than we have seen in the recent past
- Meanwhile, global freight volumes posted double-digit annual growth for the fifth time in six months in August (12.1%). Indicators continue to suggest that that the cyclical upturn in air freight growth may be nearing a peak. However, with the SA trend remaining robust, the data are not yet showing this impact.

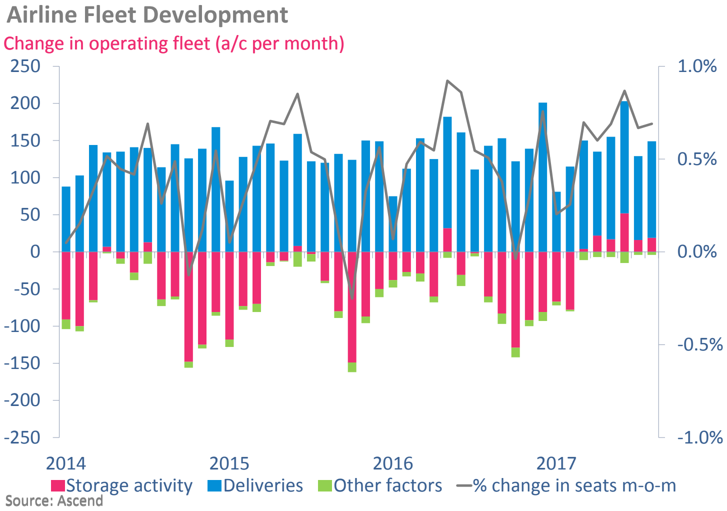
Capacity

Steady upward trends in both passenger and freight capacity have continued



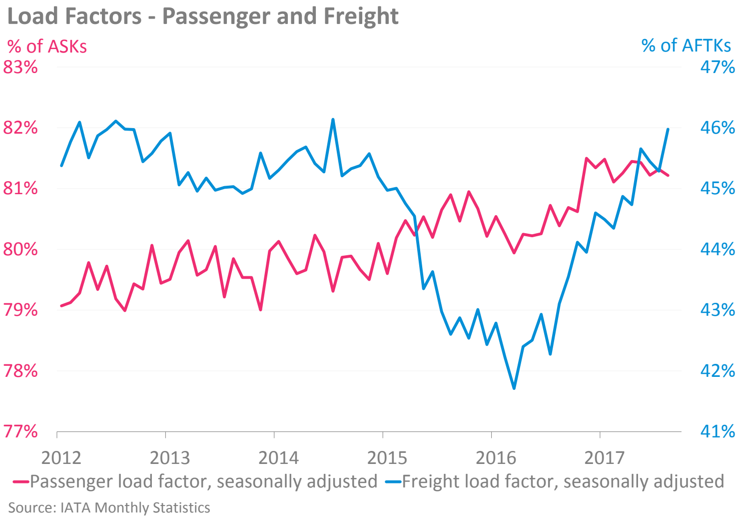
- Industry-wide available seat kilometres (ASKs) increased by 6.3% year-on-year in August. The recent moderation in the upward trend in SA passenger traffic means that capacity is currently trending upwards more quickly than demand.
- Available freight tonne kilometres (AFTKs) grew by 4.7% year-on-year in August – less than half the corresponding pace of demand. Daily utilization rates of widebody freighters are rising, but we have seen less payload capacity added to the fleet so far in 2017 compared to recent years.

Net storage activity once again underpins a solid increase in available seats in August



- The number of available seats in the global airline fleet increased by 0.7% in August compared to the previous month. This left the number of seats in service 6.2% higher than in the same month a year ago.
- 130 new aircraft were delivered in August, a slight reduction from the 143 delivered in August 2016. All told, 43 fewer aircraft were delivered in the first eight months of 2017 compared to the same period a year ago (987 versus 1,030).
- Storage activity made another positive contribution to fleet growth: 115 aircraft re-entered service from storage, but just 96 were put into storage (compared to 154 last August).

Passenger load factor remains at a historically high level, as SA freight load factor increases



- The seasonally-adjusted passenger load factor has fallen back slightly from its record high reached in late-2016, although it remains at a historically elevated level. High achieved load factors are continuing to support airline financial performance.
- The industry-wide freight load factor in August came in 2.8 percentage points higher than where it stood a year ago. In SA terms, the load factor recently increased to a three-year high.

IATA Economics
economics@iata.org
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