

AIRLINES FINANCIAL MONITOR

KEY POINTS

JULY 2017 – AUGUST 2017

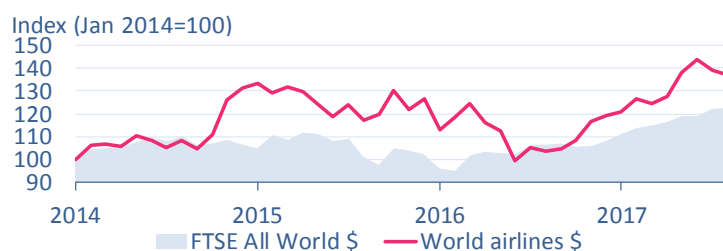
- The latest airline financial results indicate that the squeeze on profit margins from higher costs and weak yields continued into Q2 2017, although the pressure on margins has eased from that seen in Q1. Moreover, the sample total masks a wide spread in performance at a regional level, with Europe in particular improving strongly.
- Industry-wide passenger yields in June were slightly higher than a year ago (0.1%); even so, this was the fastest annual pace since late-2013. Passenger yields have continued to trend higher in recent months, albeit modestly.
- Global airline share prices fell in August for the second month in a row. The decline was driven by a fall in North America, partly reflecting the impact of Hurricane Harvey, but European and Asia Pacific airline shares rose solidly.
- The hurricane season in the Gulf of Mexico also caused some volatility in oil prices during August. Nonetheless, the Brent oil price ended the month broadly in line with where it started it (~US\$52/bbl).
- Passenger and freight volumes both posted robust year-on-year growth rates in July. The seasonally-adjusted passenger load factor remained close to an all-time high, although the freight load factor has fallen back slightly in SA terms in recent months.
- The stronger global trade backdrop is helping to support premium passenger demand, particularly to, from and within Asia. Premium's share of industry-wide revenues increased to 27.0% in H1 2017, from 26.5% a year ago.

Financial indicators

Global airline shares fell for the second month in a row in August, driven by North America

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Aug 31st	% change on		
		one month	one year	start of year
World airlines	137.0	-1.4%	+32.1%	+15.0%
Asia Pacific airlines	118.8	+2.4%	+13.9%	+26.2%
European airlines	131.2	+4.7%	+63.6%	+52.2%
North American airlines	158.8	-7.7%	+26.5%	-6.3%
FTSE All World \$	122.5	+0.2%	+14.9%	+13.3%



Source: Thomson Reuters Datastream

- Global airline share prices fell by 1.4% in August – the second consecutive monthly decline. August was also the second month in a row in which airline shares underperformed global equities. (It is worth noting, however, that airlines shares have still far outperformed global equities over the past year.)
- There was a wide spread in regional performance: the monthly decline in the global airline index was driven by a fall in North America; this partly reflected the disruptive impact of Hurricane Harvey as well as some renewed signs of pressure on unit revenues.
- By contrast, the Asia Pacific and European share price indices both increased over the month (rising 2.4% and 4.7%, respectively).

Financial performance continued to be squeezed in Q2, but the pressure has eased from 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
15	North America	17.1%	4,767	16.3%	4,678
28	Asia-Pacific	7.3%	2,001	4.3%	1,859
8	Europe	4.5%	482	8.6%	1,164
5	Latin America	0.7%	10	4.3%	-213
3	Others	10.2%	76	8.6%	65
59	Sample total	10.2%	7,336	9.5%	7,553

¹ % of revenues ² US\$ million

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

Sources: The Airline Analyst, IATA

- The industry-wide EBIT margin in our sample of 59 airlines fell to 9.5% in Q2 2017, from 10.2% in Q2 2016. The latest results indicate that the squeeze on profit margins from weak yields and higher costs continued at an industry-wide level into Q2, although the pressure has eased from Q1.
- The sample total masked wide differences at a regional level: the EBIT margin fell slightly for North American carriers in year-on-year terms in Q2, but the region continued to post the strongest financial results. European and Latin American airlines reported increased profit margins, helped in part by improved economic conditions in both regions.

Free cash flow fell slightly in Q2 from a year ago, although regional performance varied

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
15	North America	24.3%	13.9%	10.4%	18.2%	14.0%	4.2%
18	Asia-Pacific	17.2%	17.2%	0.0%	14.3%	16.8%	-2.5%
7	Europe	13.5%	15.5%	-2.0%	18.6%	8.5%	10.1%
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%
47	Sample total	19.6%	14.4%	5.2%	17.1%	13.1%	4.0%

¹% of revenues

²From operating activities

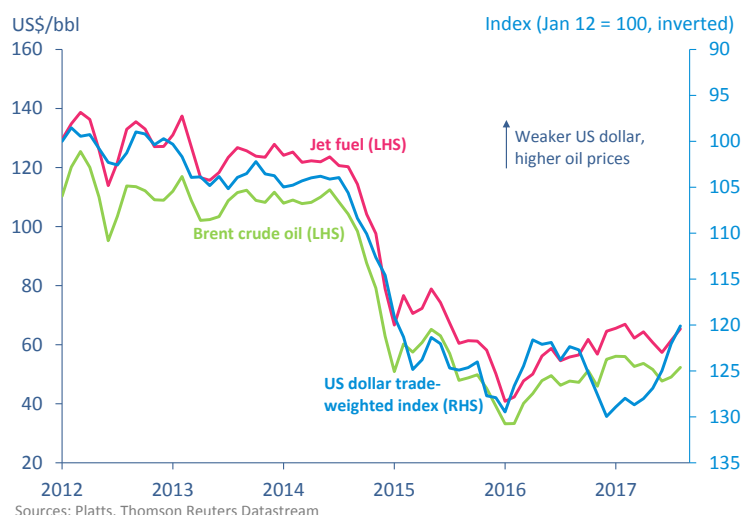
Note: Includes half-year results of China Southern Airlines and Shandong Airlines

Sources: The Airline Analyst, IATA

- The latest data from our sample of 47 airlines show that industry-wide free cash flow (FCF) fell to 4.0% of revenues in Q2 2017, down from 5.2% in the same period of 2016.
- The fall in FCF was driven in the main by a decline in net cash flow from operations, to 17.1% of revenues in the quarter from nearly 20% a year ago. European airlines were the notable exception, with net cash flow increasing in the quarter.
- Capital expenditure in our sample fell slightly in year-on-year terms in Q2, to 13.1% of revenues, from 14.4% in Q2 2016.

Fuel costs

Oil prices tracked sideways during August but have risen to a five-month high in September

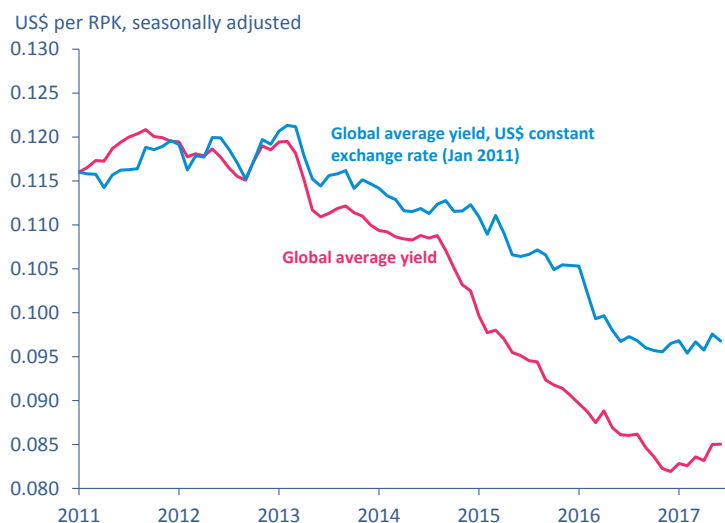


Sources: Platts, Thomson Reuters Datastream

- The hurricane season in the Gulf of Mexico caused some volatility in oil prices during August. Nonetheless, the Brent oil price ended the month broadly in line with where it started it (~US\$52/bbl).
- Oil prices climbed in early September, however, reflecting the recent weakness of the US dollar as well as further signs that OPEC are committed to constraining supply; at the time of writing, oil prices stood close to a five-month high. (As we have noted *before*, the weaker US dollar has shielded non-US airlines from the pick-up in oil prices since reaching a multi-year low in early-2016.)
- As has been the case for some time, the futures market continues to point to oil prices remaining relatively stable over the medium term (<US\$55/bbl until mid-2020).

Yields and premium revenues

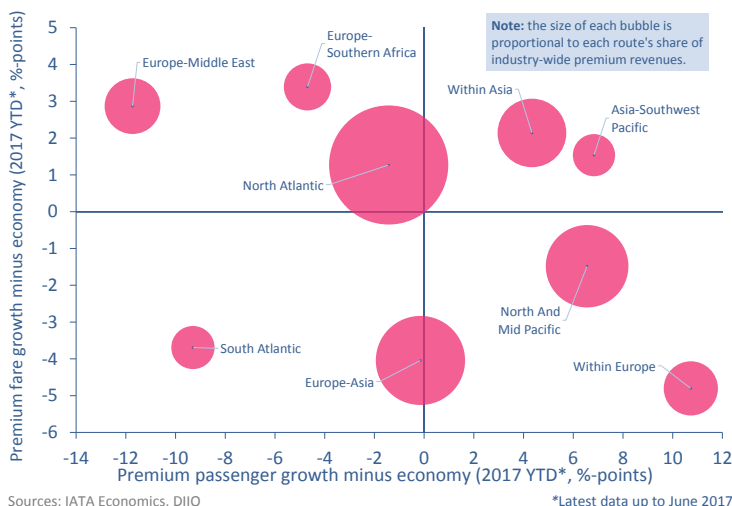
Industry-wide passenger yields have continued to trend upwards, albeit modestly



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

- Passenger yields have continued to trend upwards, albeit modestly, in recent months.
- The turnaround in the long-standing downward trend reflects a number of factors, including a stronger global economic backdrop, as well as upward pressure on some key input costs in a number of countries, including labor.
- The recent weakness in the US dollar means that the unadjusted yield exaggerates the upward trend in underlying yields in recent months. Nonetheless, when measured in constant exchange rate terms, passenger yields in June were 0.1% higher than in June 2016 – the strongest year-on-year growth rate since late-2013. Moreover, when measured on this basis, yields have trended upwards at an annualized pace of around 4% since early-2017.

Pick-up in global trade conditions is helping to support premium passenger demand

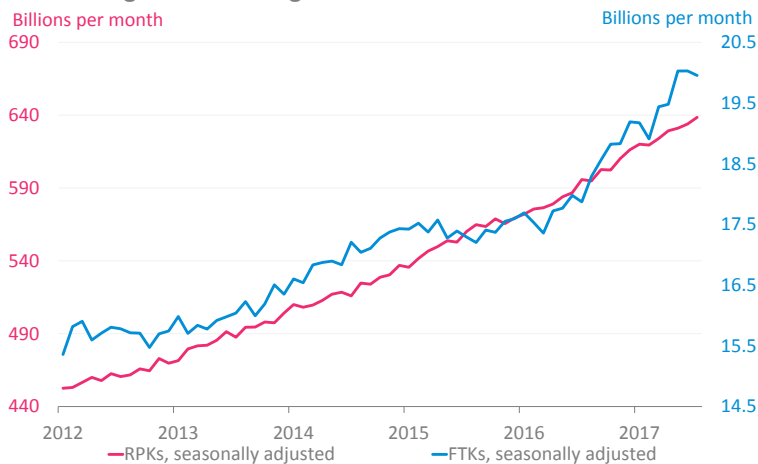


- ➔ Premium passenger demand growth was stronger than economy demand during H1 2017 in a number of markets, particularly across the Pacific and Within Asia. This is consistent with the recent pick-up in global trade conditions, which tends to correlate well with premium travel demand. By contrast, premium demand lagged behind its economy counterpart in a number of cases, notably between Europe and the Middle East.
- ➔ There was a spread in airfare performance too. All told, premium's share of total passengers was stable at 5.4% during H1 2017 compared to the same period in 2016. Nonetheless, premium's share of revenues rose to 27.0%, from 26.5%, over the same period.

Demand

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

Air Passenger and Air Freight Volumes

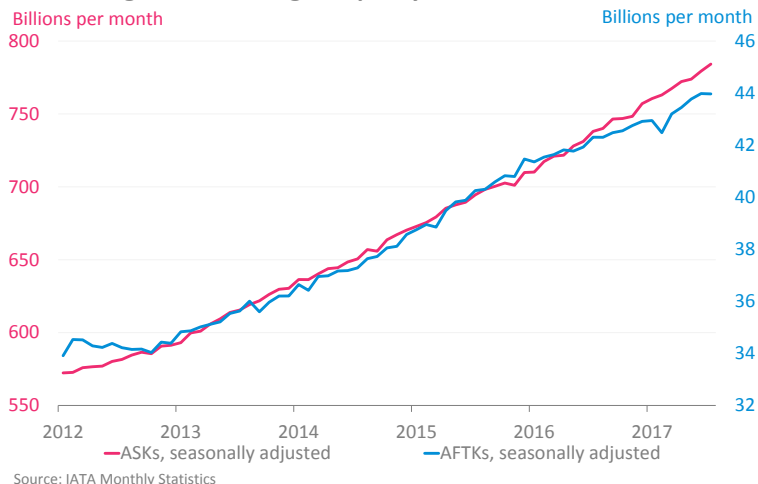


- ➔ Global passenger volumes grew by a robust 6.8% year-on-year in July 2017 – the first summer peak month.
- ➔ Passenger demand remains on track to grow solidly in 2017 as a whole. However, the exceptionally supportive demand backdrop looks to have moderated.
- ➔ Meanwhile, global freight volumes posted double-digit annual growth for the fourth time in five months in July (11.4%). The pick-up in freight volumes has been consistent with the typical pattern seen at the start of upturns in the economic cycle. However, indicators suggest that annual FTK growth may be nearing a peak.

Capacity

Upward trend in both passenger and freight capacity remains moderate

Air Passenger and Air Freight Capacity

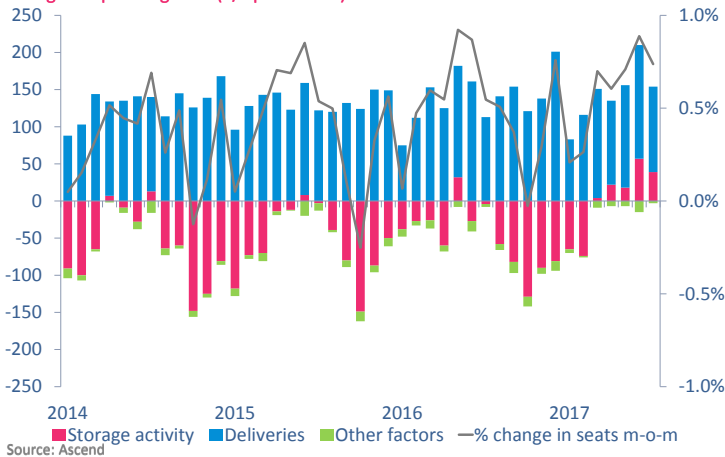


- ➔ Industry-wide available seat kilometres (ASKs) increased by 6.8% year-on-year in July. Having lagged behind demand in SA terms throughout much of 2016, ASKs are currently trending upwards at a broadly similar pace to RPKs.
- ➔ Available freight tonne kilometres (AFTKs) rose by 3.7% year-on-year in July – less than one-third of the corresponding pace of demand. That said, given the month-on-month falls in demand in recent months, AFTKs have trended upwards slightly ahead of FTKs since May.

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

Airline Fleet Development

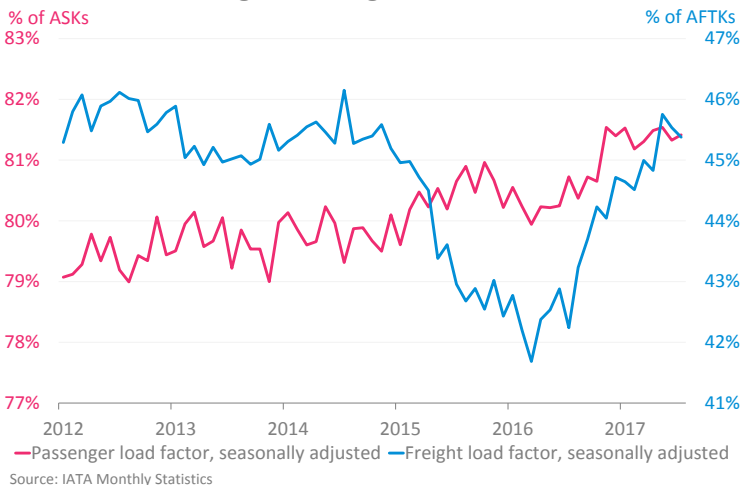
Change in operating fleet (a/c per month)



- The number of available seats in the global airline fleet increased by 0.7% month-on-month in July. All told, the number of seats in service in July was 6.2% higher than the same month a year ago.
- 115 new aircraft were delivered in the month, broadly unchanged from the 113 delivered in July 2016. 24 fewer aircraft were delivered in the first seven months of 2017 compared to the same period in 2016 (865 versus 889).
- Storage activity made another positive contribution to fleet growth this month: 125 aircraft re-entered service from storage, compared to 104 in July 2016. But just 86 aircraft were taken from service and put into storage – the lowest number in at least three years.

Passenger load factor stable near a record high, but minor falls for SA freight loads

Load Factors - Passenger and Freight



- The seasonally-adjusted passenger load factor remains relatively stable and close to an all-time SA record high. The sustained high achieved load factor is continuing to support airline financial performance.
- The industry-wide freight load factor has fallen slightly in SA terms since May. Nonetheless, it remains close to a two-and-a-half year high, nearly four percentage points above its low-point in early-2016.

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