

AIRLINES FINANCIAL MONITOR

KEY POINTS

October 2016 – November 2016

- The latest financial results from Q3 2016 continue to indicate another solid quarter for industry profitability, although there are ongoing signs that momentum in the profitability cycle has weakened;
- Global airline share prices jumped by 7.5% in November, driven by a 16.4% increase for North America carriers;
- Brent crude oil prices recently reached a 17-month high, following the agreement by OPEC to restrict oil supplies. The oil market is gradually rebalancing, with prices expected to trend upwards modestly in the coming years;
- While passenger yields edged down in September, the intense downward pressure on yields has eased since earlier in 2016, in keeping with the change in the trend of oil prices seen over the period;
- The premium segment continues to be an important buffer for airline financial performance. While premium traffic growth has lagged, premium airfares have held up better than those in economy on many routes so far this year;
- Annual growth in passenger volumes remains broadly in line with its 10-year average. Despite easing in October, the seasonally-adjusted load factor remained above the 80%-mark;
- Air freight volumes have been boosted by a stronger-than-expected peak season in 2016, with traffic up more than 8% year-on-year in October. The freight load factor has rebounded from its early-2016 low.

Financial indicators

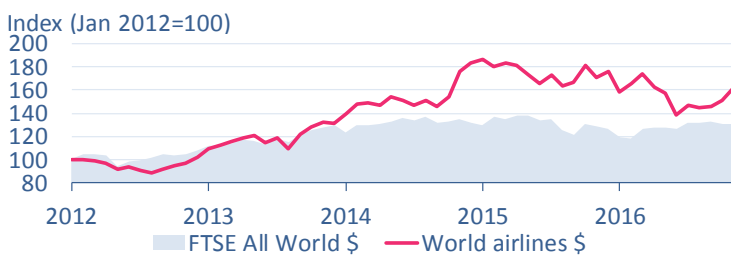
Global airline share prices jumped by 7.5% in November, led by a surge in North America

Airline Share Prices

US\$ indices (Jan 2012=100)	Index Nov 30th	% change on		
		one month	one year	start of year
World airlines	162.6	+7.5%	-4.6%	-7.8%
Asia Pacific airlines	75.5	-0.6%	-9.3%	-13.9%
European airlines	172.2	+2.2%	-21.5%	-26.2%
North American airlines	395.6	+16.4%	+6.3%	+4.5%
FTSE All World \$	131.1	+0.6%	+1.6%	+3.6%

→ Global airline share prices jumped by 7.5% in November – the biggest monthly increase since October 2015. This was led by carriers in North America, whose index surged by 16.4% during the month, in part reflecting investor confidence that airlines will be able to halt the declines in unit revenues during 2017. By contrast, the Asia Pacific share index fell for the fourth month in a row (-0.6%) and European airline shares increased by a more modest 2.2%.

→ Global airline shares have lagged behind the wider global equity market so far this year. But with share prices now up by more than 30% since their June low, the margin of underperformance has narrowed in recent months.



Source: Thomson Reuters Datastream

Industry-wide financial performance remains solid, but momentum has eased

Airline Financial Results

Number of airlines in sample	Regions	Q3 2015		Q3 2016	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
18	North America	19.6%	6,521	17.2%	4,421
23	Asia-Pacific	8.4%	637	10.6%	2,271
15	Europe	17.5%	5,706	18.4%	5,979
7	Latin America	6.3%	-522	7.4%	206
4	Others	10.1%	39	11.7%	107
67	Sample total	15.7%	12,381	15.6%	12,984

→ The latest results from Q3 2016 show that industry-wide financial performance remains robust by historical standards. However, with operating conditions becoming more challenging, there are ongoing signs that momentum has weakened.

→ The EBIT margin in our sample of 67 airlines edged down to 15.6% in Q3 2016, from 15.7% in the same period in 2015. Profit margins dropped in North America, reflecting volatile fuel and labor costs, but remained solid nonetheless. Margins increased modestly in the other regions, with the pick-up in Asia Pacific helped by a good Q3 for air freight.

¹ % of revenues ² US\$ million

Note: Includes Easyjet, Flybe and Kenya Airways half-year results.

Sources: The Airline Analyst, IATA

Free cash flow edges up in Q3 2016, as capex falls by more than cash from operations

Airline Cash Flow¹

Number of airlines in sample	Regions	Q3 2015			Q3 2016		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
15	North America	14.9%	9.9%	5.0%	14.0%	9.7%	4.3%
16	Asia-Pacific	14.5%	20.0%	-5.5%	13.7%	13.5%	0.3%
12	Europe	6.7%	8.0%	-1.3%	4.3%	8.1%	-3.8%
6	Latin America	2.2%	12.3%	-10.1%	7.5%	5.8%	1.7%
3	Others	17.2%	8.5%	8.7%	14.2%	11.4%	2.8%
52	Sample total	11.5%	10.7%	0.7%	10.5%	9.5%	1.0%

¹ % of revenues

² From operating activities

Note: Includes Easyjet, Flybe and Kenya Airways half-year results.

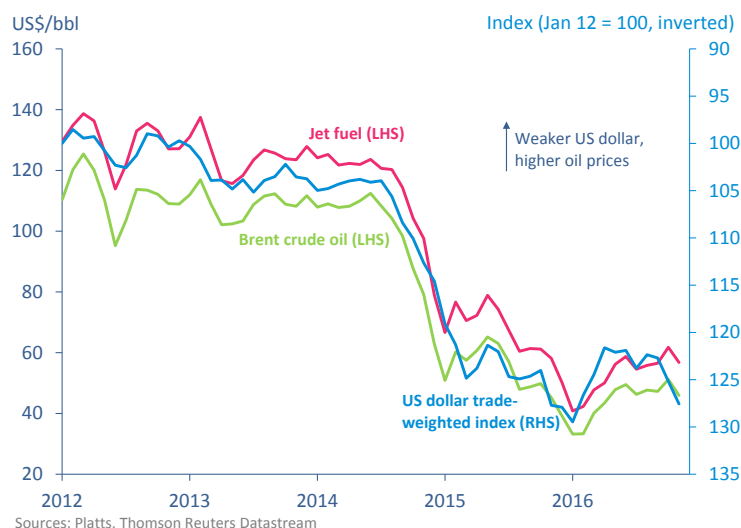
Sources: The Airline Analyst, IATA

→ Net cash flow in our sample of 52 airlines eased to 10.5% of revenues in Q3 2016, from 11.5% in the same period last year. Net cash flow (ie, cash from operations) fell in N.America, Asia-Pac and Europe, but rose in our sample of Latin American carriers.

→ Capital expenditure in our total sample eased slightly as a share of revenues in Q3 2016 compared to the same quarter in 2015. As a result, free cash flow in Q3 edged up to 1.0% of revenues from 0.7% a year ago. Free cash flow allows airlines to return cash to investors or to repair their balance sheets by paying down debt.

Fuel costs

OPEC agreement to cut oil supply has pushed crude prices to a 17-month high

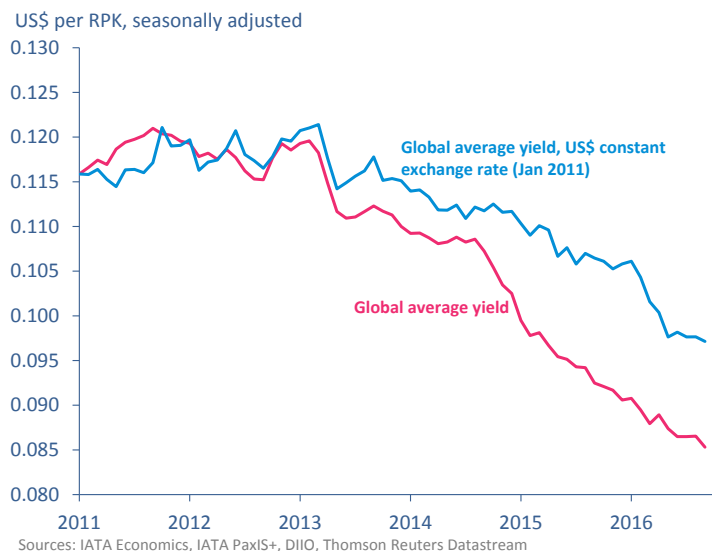


→ Uncertainty surrounding the recent OPEC meeting has dominated crude oil markets in recent weeks. Brent crude oil prices fell below US\$44/bbl in early-November, driven by a strengthening in the US dollar and uncertainty as to whether a plan for OPEC to limit supply would be agreed. But oil prices rebounded following the meeting, particularly following signs that non-OPEC suppliers will also act to limit supply. At the time of writing, oil prices were at a 17-month high, 30% above the low-point reached in mid-November.

→ A rebalancing in the oil market is slowly taking place. But for now, the futures market is still pricing in a very weak upward trend in oil prices over the coming years, with prices remaining relatively low (below US\$58/bbl) until 2020.

Yields and premium revenues

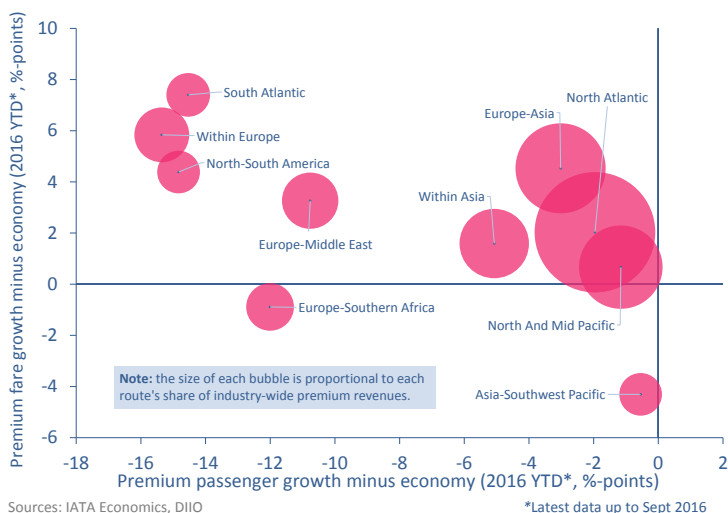
Intense downward pressure on underlying yields has eased



→ The global average yield in reported US dollar terms has trended downwards since late-2014. This trend had paused in seasonally-adjusted terms during the middle of 2016, in keeping with the change in the trend in fuel prices seen over the period. Yields edged down in September 2016 (the latest data available), although it is too soon to know if this represents the resumption of the downward trend or just monthly volatility.

→ In any case, the intense downward pressure on underlying yields (ie, expressed in constant exchange rate terms – the blue line on the chart) has eased from that seen earlier in the year.

The premium traffic segment is an important buffer for airline financial performance

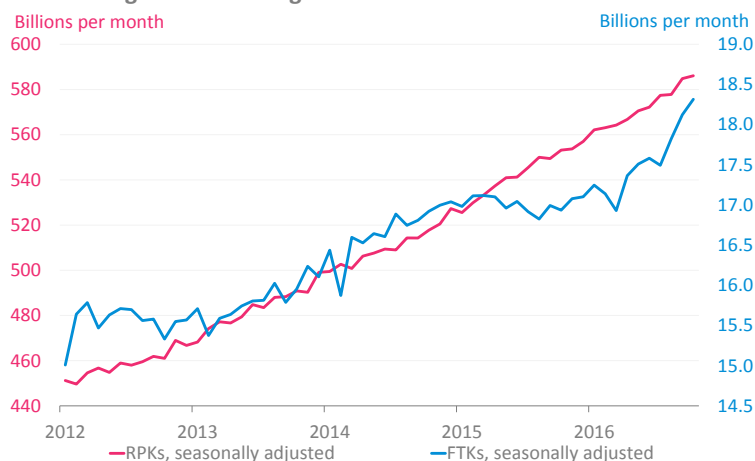


- ➔ Growth in premium international passenger traffic has lagged behind that of economy traffic in each of the top-10 premium markets so far in 2016. O-D premium international journeys accounted for 5.2% of the global total over the first nine months of 2016, down from 5.5% a year ago.
- ➔ However, as has been the case for some time, premium fares have held up better than their economy counterparts on the majority of such routes. In fact, premium's share of revenues has *risen* slightly so far this year on the North Atlantic and Europe-Asia markets (which accounted for nearly 40% of industry-wide premium revenues combined last year). All told, the high-yielding premium segment continues to offer an important buffer for airline financial performance.

Demand

Robust upward trend for passenger traffic, alongside another strong month for freight

Air Passenger and Air Freight Volumes

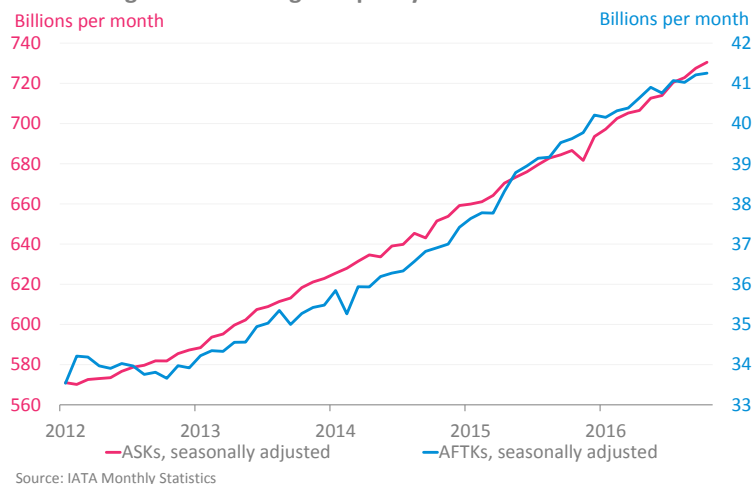


- ➔ Annual growth in industry-wide passenger traffic eased back to 5.8% year-on-year in October after a short-lived pick-up in September. Passenger growth remains broadly in line with its 10-year average pace, and the upward trend in seasonally-adjusted traffic remains solid.
- ➔ Meanwhile, annual growth in air freight volumes rose to an 18-month high in October (8.2% year-on-year), reflecting a stronger-than-expected start to the peak season in 2016. European and Asia Pacific airlines accounted for more than three-quarters of the annual increase in freight traffic.

Capacity

The upward trend in freight capacity has moderated since mid-2016

Air Passenger and Air Freight Capacity

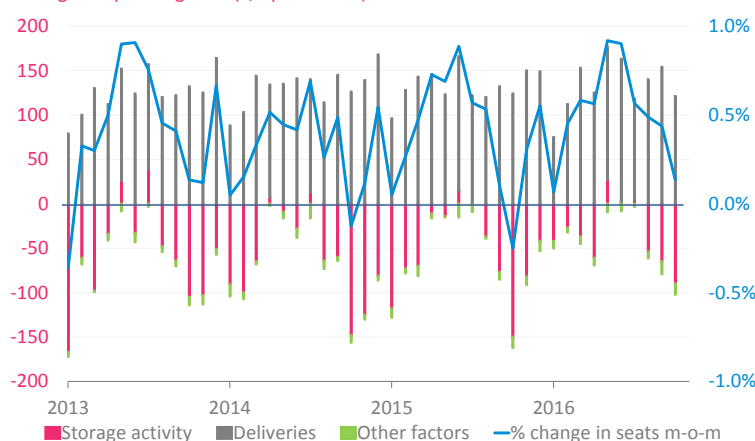


- ➔ Available seat kilometres grew by 6.3% year-on-year in October. Capacity has risen at an annualized pace of 5.7% over the past three months or so – slightly below the pace of demand.
- ➔ The upward trend in available freight tonne kilometres has eased in recent months, in part owing to a slowdown in deliveries to the wide-body passenger fleet in 2016 (particularly in Asia Pacific). Freight capacity grew by 3.6% year-on-year in October, and the annual growth rate has now lagged behind FTK growth for three months in a row.

Net storage activity makes a relatively small negative contribution to fleet size in October

Airline Fleet Development

Change in operating fleet (a/c per month)

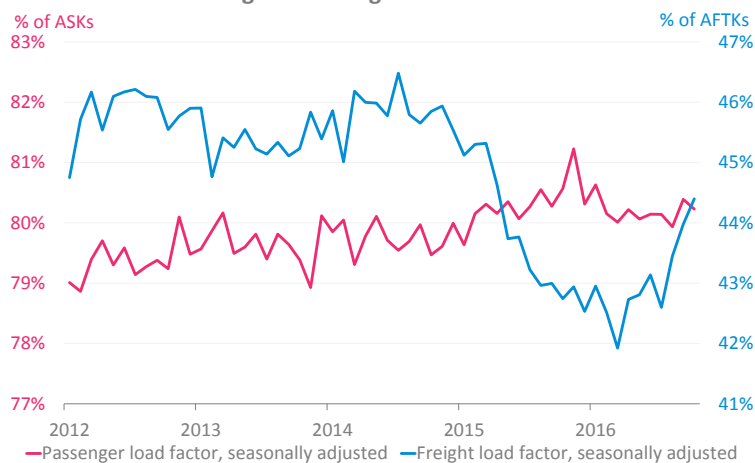


Source: Ascend

- The number of available seats in the global airline fleet increased by 0.1% in October compared to the previous month, and by 6.1% year-on-year.
- 121 new aircraft were delivered in October—slightly fewer than were delivered in October 2015 (124). As is normally the case in October, net storage activity made a negative contribution to the fleet size, driven by an increase in the number of aircraft going into storage relative to September. But the negative contribution was smaller (a net 90 aircraft leaving the fleet) this year than it was in 2014 and 2015.

The freight load factor has risen strongly in seasonally-adjusted terms in recent months

Load Factors - Passenger and Freight



Source: IATA Monthly Statistics

- The industry-wide passenger load factor eased by 0.2 percentage points in seasonally adjusted terms in October, but it remained above the 80%-mark. Compared to October 2015, the load factor increased for the Asia Pacific, Africa and Latin America regions, but fell in Europe, North America, and (most notably) the Middle East.
- The seasonally-adjusted industry-wide load factor has risen by two and a half percentage points since its recent low in early-2016. Freight load factors increased for all regions in year-on-year terms in October 2016 except Africa.

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 14th December 2016

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