AIRLINES FINANCIAL MONITOR

KEY POINTS

NOVEMBER – DECEMBER 2018

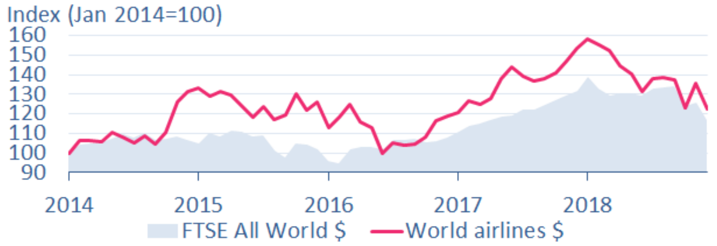
- The final financial results from Q3 indicate a further squeeze on airline profit margins resulting from higher input costs last year. Free cash flow generation also declined moderately in the quarter.
- Equity markets have been volatile in recent months. Global airline share prices fell by almost 10% in December, offsetting the similarly sized increase observed in November as market sentiment on airlines moved with oil prices and recession risk.
- The Brent Crude oil price is currently around $US60/bbl, ~30% lower compared to the values seen during the price peak in early October. Jet fuel prices are trending close to $US78/bbl.
- Base fare passenger yields have continued to come under downward pressure. That said, yields in the less price-sensitive premium cabin have trended upwards recently, helping airlines to recover part of the pick-up in unit costs.
- Industry-wide revenue passenger kilometers rose by 6.2% year-on-year in November, whereas freight volumes stopped growing. Capacity has not slowed with traffic, and therefore load factors are falling.

Financial indicators

Airlines shares fell by 20% over the course of 2018, underperforming the wider equity market

Airline Share Prices

US$ indices (Jan 2014=100)	Index Dec 31st	% change on one month	% change on one year	% change on start of year
World airlines	**122.7**	**-9.4%**	**-20.1%**	**-20.1%**
Asia Pacific airlines	110.9	-2.5%	-15.0%	-15.0%
European airlines	102.6	-5.6%	-29.0%	-29.0%
North American airlines	153.0	-16.5%	-17.3%	-17.3%
FTSE All World $	**116.6**	**-7.1%**	**-11.3%**	**-11.3%**



Source: Thomson Reuters Datastream

- Alongside broader volatility in the global equity market, the world airline share price index fell by 9.4% in December to levels last seen two years ago.
- All three regional airline sub-indices declined during the month, led by North America (-16.5%). The Europe and Asia Pacific indices fell by 5.6% and 2.5%, respectively.
- Global airline share prices fell by ~20% over the course of 2018, compared to an 11.3% fall in the global equity market. The underperformance of airline shares across much of 2018 mainly reflected investor concerns about the impact of rising costs on airline financial performance. However, the sharp fall in oil prices in late-2018 contributed to airline shares outperforming during Q4.

Q3 EBIT margin fell across all regions vs the same period in 2017

Airline Financial Results

Number of airlines in sample	Regions	Q3 2017 EBIT margin[1]	Q3 2017 Net post-tax profit[2]	Q3 2018 EBIT margin[1]	Q3 2018 Net post-tax profit[2]
36	North America	12.8%	5,484	9.9%	4,663
29	Asia-Pacific	11.4%	2,353	6.4%	1,316
15	Europe	20.2%	6,901	17.4%	6,827
11	Latin America	9.9%	674	3.8%	-103
6	Africa & Middle East	5.7%	292	1.8%	158
97	**Sample total**	**14.2%**	**15,704**	**10.7%**	**12,861**

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

Sources: The Airline Analyst, IATA

- The latest financial data confirm that the downward pressure on airline profit margin was still present across the regions in Q3. The EBIT margins for our sample of 97 airlines dipped to 10.7% in Q3 2018, down from 14.2% in Q3 2017. This was a larger year-on-year decline than seen in Q2.
- The Q3 EBIT margin fell across all regions vs the same period in 2017. European airlines registered the widest EBIT margin (17.4%) during the key period of demand over the northern hemisphere summer. Initial financial results from Q4 2018 show mixed performance so far.

Industry cash flows eased vs a year ago, mostly due to lower net cash flow generation

Airline Cash Flow[1]

Number of airlines in sample	Regions	Q3 2017 Net cash flow[2]	Q3 2017 Capex	Q3 2017 Free cash flow	Q3 2018 Net cash flow[2]	Q3 2018 Capex	Q3 2018 Free cash flow
16	North America	10.5%	11.9%	-1.4%	9.4%	9.3%	0.1%
24	Asia-Pacific	16.4%	13.3%	3.1%	13.4%	12.2%	1.2%
12	Europe	10.3%	6.6%	3.7%	6.4%	9.7%	-3.3%
8	Latin America	13.9%	4.9%	9.0%	5.0%	6.2%	-1.2%
4	Africa & Middle East	15.2%	9.9%	5.2%	6.0%	20.5%	-14.6%
64	**Sample total**	**11.9%**	**10.1%**	**1.8%**	**9.0%**	**9.9%**	**-0.9%**

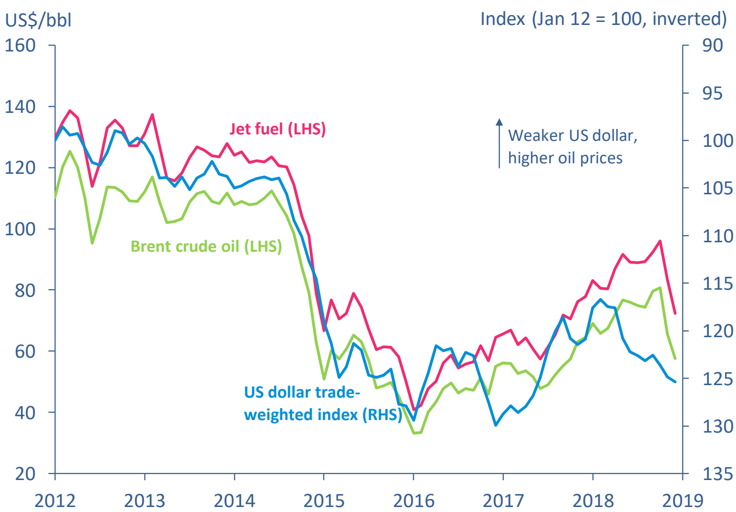
[1] *% of revenues* [2] *From operating activities*

Sources: The Airline Analyst, IATA

- Our sample of 64 airlines indicates a decline in industry-wide net and free cash flow in Q3 2018 compared to the same period a year ago.
- Overall, airlines in our sample saw free cash flow decline to -0.9% of revenues in Q3 2018, down from +1.8% a year ago. The fall was driven by a ~3.0pp reduction in net cash flow generation. Capex spend remained broadly unchanged vs last year at just below 10% of revenues.
- Across all the regions, net cash flow as a percentage of revenues was lower versus the same period a year ago. Free cash flow fell into negative territory in Europe, Lat.Am, Africa and ME.

Fuel costs

Oil prices currently 30% down on their October 2018 peak

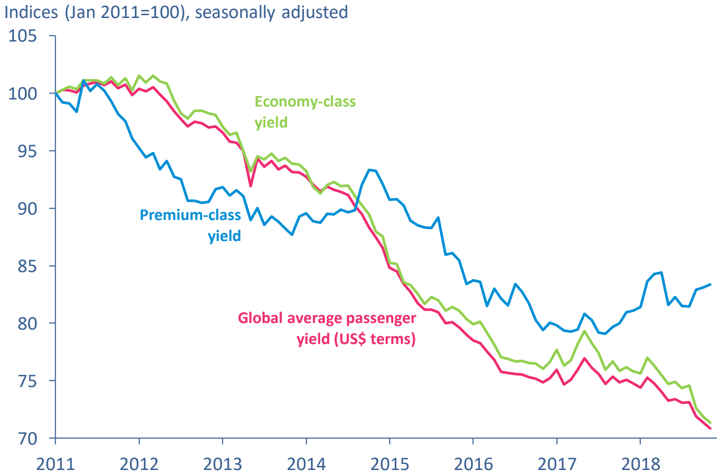


Sources: Platts, Thomson Reuters Datastream

- Crude oil and jet fuel prices trended upwards across much of 2018, supported in large part by supply cuts on the part of Opec and Russia.
- The trend in oil prices has been less clear in recent months. Prices fell sharply in late-2018 as market concerns shifted to oversupply, but have recovered partially in recent weeks amid signs of further supply cuts.
- The current price of Brent is around US$60/bbl, which is ~30% lower compared to values seen during the price peak in early October and ~12% lower than a year ago. Jet fuel prices are close to US$78/bbl.

Yields and premium revenues

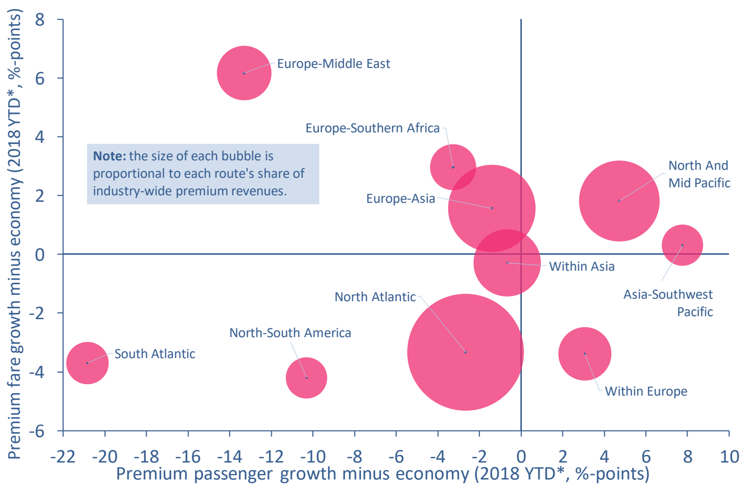
Trends in premium and economy cabin passenger yields continue to diverge



Sources: IATA Economics, IATA Travel Intelligence

- Global base passenger yields (ie, excluding surcharges and revenue from ancillary services) have been under downward pressure over the recent months.
- The decline is consistent with the observed squeeze on airline profit margins`` in mid-2018 and softening momentum in global economic expansion. We will continue to monitor developments closely over the coming months.
- As we have noted before, premium-class yields are holding up better than those in the economy cabin. This reflects the fact that premium-class demand is typically less price-sensitive than economy, which allows airlines to offset higher input costs to a greater extent.

International premium traffic and revenue shares remain stable towards the end of the year

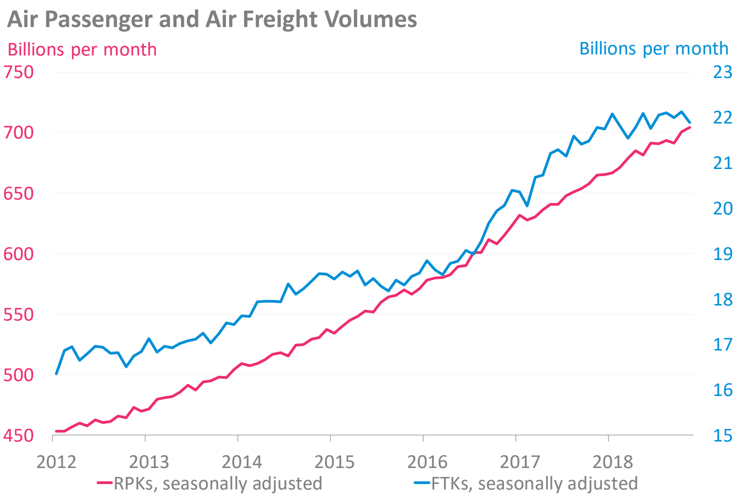


Sources: IATA Economics, DIIO *Up to October 2018

- Premium-class passengers accounted for 5.1% of total international origin-destination traffic in the first ten months of 2018. This proportion was down from 5.2% in the same period a year ago.
- Premium-class passengers accounted for 29.8% of total passenger revenues between Jan and Nov 2018, about 0.1pp less versus the same period a year ago.
- Premium passenger demand has grown faster than its economy counterpart this year to date on a handful of markets, most visibly on the Asia-Southwest Pacific, Within Europe, and North and Mid Pacific markets. In terms of premium fares relative to economy, the Europe-Middle East market was the top performer, followed by Europe-Southern Africa.

Demand

Upward trends in passenger and freight traffic have moderated in recent months

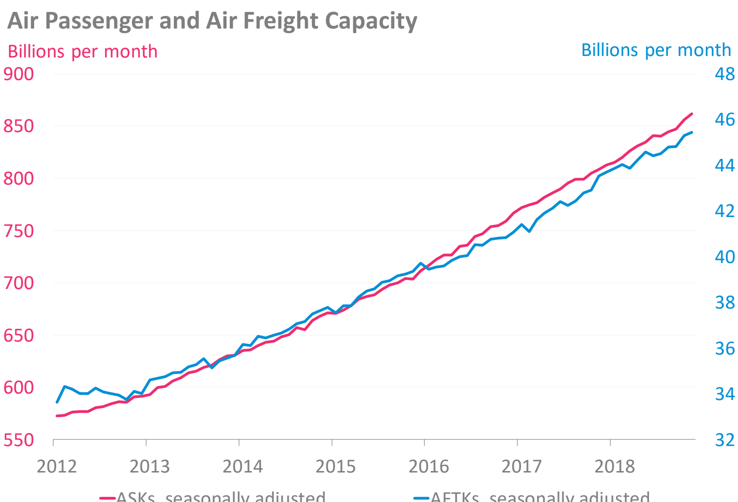


Source: IATA Monthly Statistics

- Industry-wide revenue passenger kilometres (RPKs) grew by 6.2% year-on-year in November.
- That said, the upward traffic trend has softened over the past six months. The recent moderation in industry-wide RPK growth has come alongside ongoing signs that the pace of global economic expansion is slowing.
- Industry-wide freight tonne kilometres (FTK) were unchanged in year-on-year terms in November. However, the loss of upward momentum in the seasonally adjusted (SA) FTK series towards the end of 2018 appears to illustrate the increasing headwinds to freight demand from renewed signs of weakness in global economic activity and key demand drivers.

Capacity

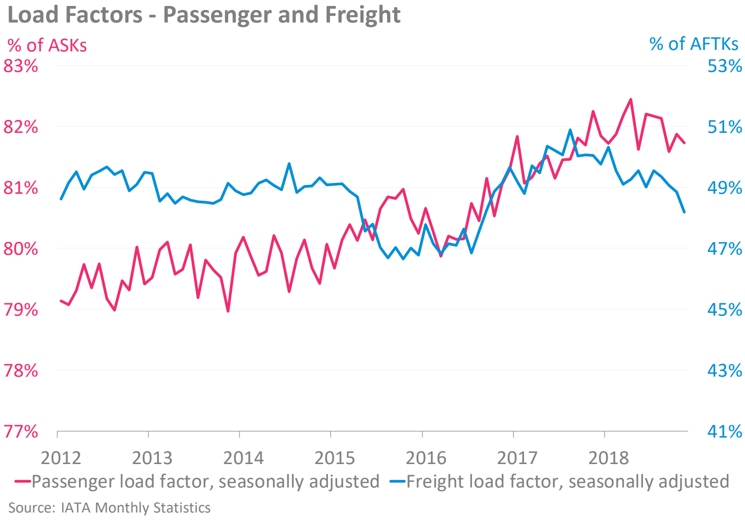
Capacity continues to outpace both passenger and freight demand in November



Source: IATA Monthly Statistics

- Industry-wide available seat kilometers (ASKs) grew by 6.8% year-on-year in November, continuing to trend upwars at a faster pace than SA RPKs.
- Meanwhile, available freight tonne kilometers (AFTKs) increased by 4.3% year-on-year in November – marking the ninth consecutive month of annual capacity growth outpacing that of demand.

Both air passenger and freight load factor trended downwards into 2019



- The industry-wide passenger load factor fell in year-on-year terms in November for only the third time in two years, to 80.0%. In seasonally adjusted (SA) terms (in the chart), the load factor also ticked down moderately to 81.7%. A modest downward trend has become apparent in recent months.
- On the freight side, the industry-wide load factor dropped by 2.2pp compared to November 2017 and has continued to trend downwards in seasonally adjusted terms.

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