AIRLINES FINANCIAL MONITOR

KEY POINTS

DECEMBER 2017 – JANUARY 2018

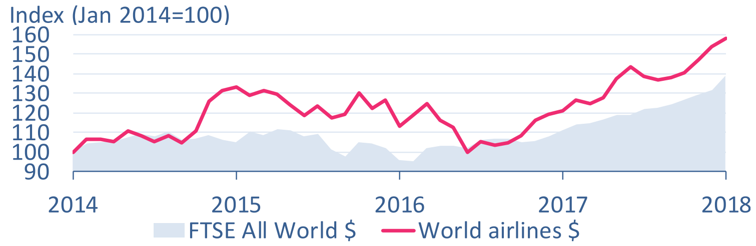
- The initial airline financial results from the final quarter of 2017 indicate that the industry-wide EBIT profit margin remained broadly unchanged during Q4 relative to the same period in 2016, at a robust 10.7% of revenues.
- Global airline share prices rose by 2.9% in January, with increases in Europe and Asia offsetting a modest decline in N.America. The airline index has fallen broadly in line with the global equity market during the early-Feb sell-off.
- Industry-wide passenger yields in late-2017 were largely unchanged in year-on-year terms. We forecast passenger yields to rise modestly in 2018 alongside a strengthening in global economic activity and rises in key input costs.
- Oil prices rose to a three-year high during January, but fell back sharply in early-February driven by record-high levels of oil production in the US. At the time of writing, the Brent crude oil price is currently around $63/bbl.
- Passenger and freight volumes grew by 7.6% and 9.0% respectively in 2017 as a whole and are both carrying solid momentum into 2018. The passenger load factor posted a record high for a calendar year in 2017 (81.4%), while the freight load factor climbed by 2.5 percentage points compared to 2016.
- Stronger global trade conditions have helped to support premium-class demand. Premium's share of total international passenger revenues increased to 27.0% in the first 11 months of 2017, up from 25.9% a year ago.

Financial indicators

Global airline shares rose in January, but have not been immune to the wider equity sell-off

Airline Share Prices

US$ indices (Jan 2014=100)	Index Jan 31st	% change on one month	one year	start of year
World airlines	**158.0**	**+2.9%**	**+30.7%**	**+2.9%**
Asia Pacific airlines	138.6	+6.3%	+37.5%	+6.3%
European airlines	152.3	+5.4%	+70.7%	+5.4%
North American airlines	181.8	-1.7%	+9.1%	-1.7%
FTSE All World $	**138.8**	**+5.5%**	**+25.1%**	**+5.5%**



Source: Thomson Reuters Datastream

- The global airline share price index ended January 2.9% higher than where it began the year. Robust increases in European and Asia Pacific airline share prices offset a modest decline in North America.
- North American airline shares rallied in early to mid-January but sold off sharply towards the end of the month.
- Airline share prices have not been immune to the wider sell-off in global equity markets seen in early-February. At the time of writing, the global airline share price index is around 8% below its end-Jan level – broadly in keeping with the performance of the global equity market over the same period.

EBIT margin was broadly unchanged in year-on-year terms in the final quarter of 2017

Airline Financial Results

Number of airlines in sample	Regions	Q4 2016 EBIT margin[1]	Q4 2016 Net post-tax profit[2]	Q4 2017 EBIT margin[1]	Q4 2017 Net post-tax profit[2]
11	North America	11.1%	1,988	10.6%	5,169
4	Asia-Pacific	10.6%	717	11.6%	754
2	Europe	8.0%	140	7.7%	143
17	**Sample total**	**10.9%**	**2,845**	**10.7%**	**6,066**

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

Sources: The Airline Analyst, IATA

- The initial releases of financial data from the final quarter of 2017 indicate that the industry-wide EBIT margin was broadly unchanged in Q4 compared to the same period a year ago, at a robust 10.7%.
- A more complete picture will emerge as more airlines report data over the coming months, but the initial data reaffirm signs that industry profitability stabilized in H2'17 from weakness earlier in the year.
- The regional pattern is similar to that seen in the previous quarter, with a modest decline in operating margin for North American carriers being offset in part by a moderate increase in Asia Pacific margins.

Industry-wide free cash flow falls slightly in Q3, driven by higher capex in North America

Airline Cash Flow[1]

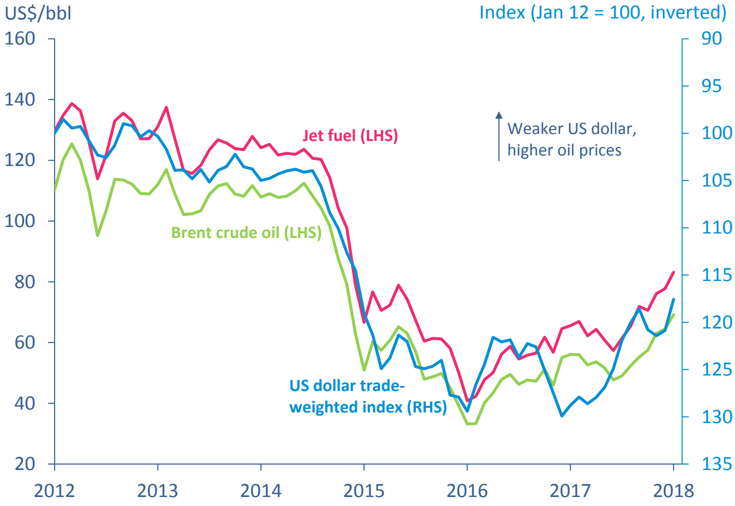
Number of airlines in sample	Regions	Q3 2016 Net cash flow[2]	Q3 2016 Capex	Q3 2016 Free cash flow	Q3 2017 Net cash flow[2]	Q3 2017 Capex	Q3 2017 Free cash flow
15	North America	14.0%	9.3%	4.7%	10.3%	11.9%	-1.6%
15	Asia-Pacific	13.8%	14.3%	-0.5%	12.0%	11.1%	0.9%
9	Europe	4.9%	8.3%	-3.5%	11.4%	7.7%	3.7%
4	Latin America	8.0%	5.9%	2.1%	14.2%	5.1%	9.1%
1	Others	3.4%	3.0%	0.5%	10.2%	4.3%	5.9%
44	**Sample total**	**10.9%**	**9.5%**	**1.4%**	**11.1%**	**10.1%**	**1.0%**

[1] % of revenues *[2] From operating activities*
Note: Includes half-year results of Easyjet and Flybe
Sources: The Airline Analyst, IATA

- Note that we do not yet have enough cash flow data from Q4 available to produce a meaningful sample. In Q3 2017, industry-wide free cash flows (FCF) fell slightly to 1.0% of revenues, compared to 1.4% a year ago. This small decline was driven entirely by an increase in capex (to 10.1%); indeed, net cash flow from operations also rose slightly (to 11.1%).
- Most regions saw modest year-on-year declines in capex, but these were more than offset in the sample total by a pick-up in North America. There was a wide spread in net cash flow performance by region. The measure rose strongly for European and Latin American airlines, but fell for those registered in Asia Pacific and North America.

Fuel costs

Brent oil prices reached a three-year high in Jan, before falling back sharply in early-Feb

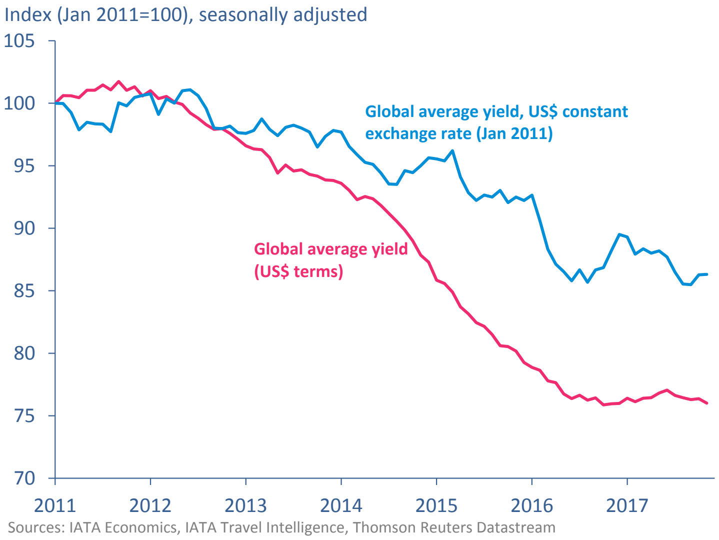


Sources: Platts, Thomson Reuters Datastream

- Brent crude oil prices climbed to a three-year high during January, continuing the upward trend that started in mid-2017 that has been supported by OPEC-led production cuts and a weaker US dollar.
- That said, oil prices fell sharply at the start of February alongside broader volatility in financial markets and amid rising levels of oil production in the US. At the time of writing, Brent crude is around 10% lower than its Jan-peak at around $63/bbl.
- The net impact of reduced supply from OPEC and other traditional producers and increasing supply from US tight-oil producers will be one of the key drivers of oil prices in the coming years. For now, the futures market remains consistent with a modest decline in oil prices from current levels, to around US$57/bbl in early-2020.

Yields and premium revenues

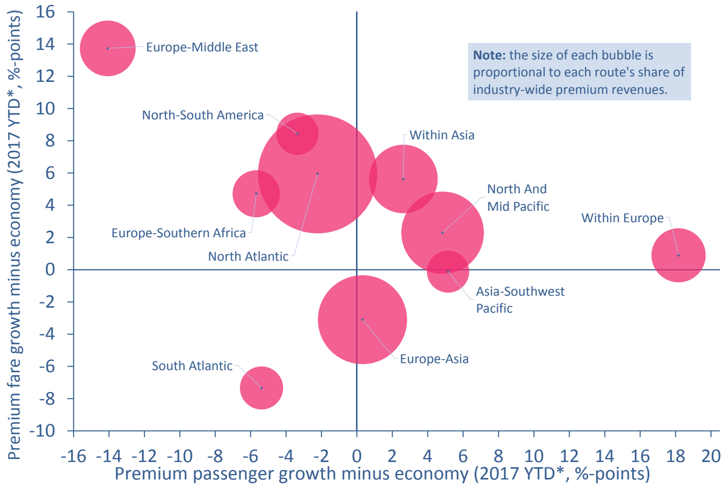
With upward pressure on key input costs, we forecast pax yields to rise modestly in 2018



Sources: IATA Economics, IATA Travel Intelligence, Thomson Reuters Datastream

- The long-standing downward trend in passenger yields started to level off during the middle of 2016. Yields in exchange-rate adjusted terms trended downwards modestly during the second half of 2017, but the key point is that yields remain broadly unchanged in year-on-year terms.
- The change in trend in the yield series has come alongside a strengthening in the global economic backdrop, as well as upward pressure on some key input costs, including oil and labor.
- Notwithstanding recent financial market volatility, with global economic growth expected to remain robust, and given the impact of higher input costs, we forecast industry-wide passenger yields to rise modestly during 2018.

Pick-up in economic and trade conditions has supported premium-class demand in 2017



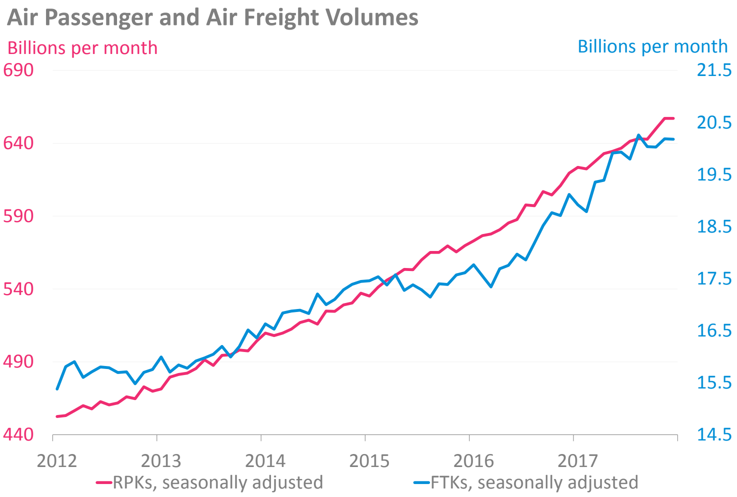
Sources: IATA Economics, DIIO

*Latest data up to November 2017

- The share of international O-D passengers flying in the premium-class cabin increased slightly to 5.3% during the first eleven months of 2017, from 5.2% during the same period of 2016. However, with premium-class fares generally holding up better than those in economy over the period, premium's share of total international revenues increased to 27.0%, up from 25.9%.
- Premium-class demand in 2017 has been supported by the broad-based pick-up in economic and trade conditions, particularly on key markets to, from and within Asia. That said, demand has lagged behind in a number of cases, notably between Europe and the Middle East, where impacts from travel bans and tighter budgets in the Gulf region have taken a toll.

Demand

2017 saw robust demand for both air passenger and freight volumes

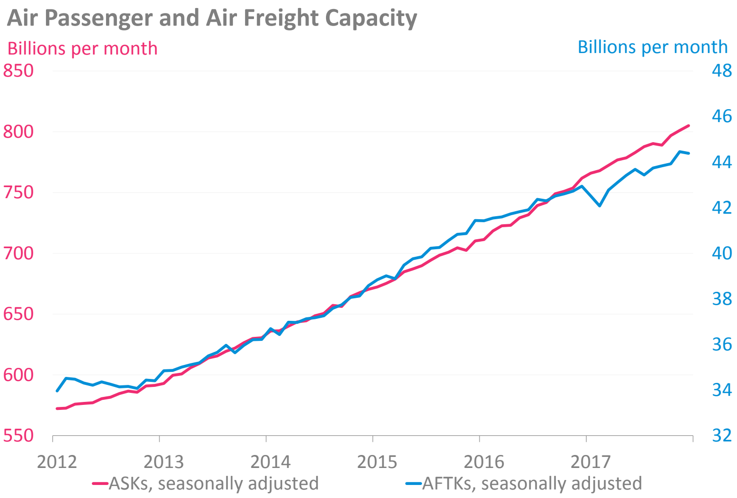


Source: IATA Monthly Statistics

- Industry-wide revenue passenger kilometres (RPKs) increased by 7.6% year-on-year in 2017 as a whole – another year of above-trend growth, well ahead of the ten-year average pace (5.5%).
- RPKs are carrying solid momentum into 2018, alongside buoyant global economic conditions. Nonetheless, we expect a moderate slowdown in passenger growth in 2018 as stimulus to demand from lower airfares fades.
- Meanwhile, industry-wide freight tonne kilometres (FTKs) grew by 9.0% in 2017. Air freight growth outperformed that in wider global goods trade by the widest margin since 2010, driven by the restocking cycle.

Capacity

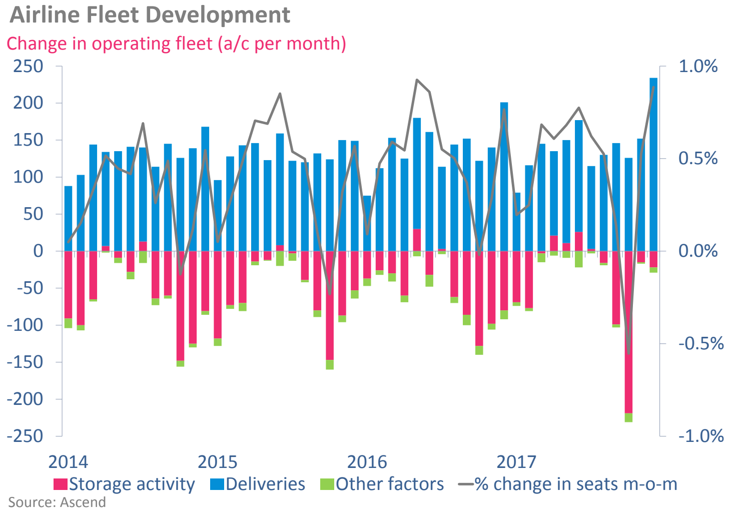
Growth in passenger and freight capacity both lagged behind demand during 2017



Source: IATA Monthly Statistics

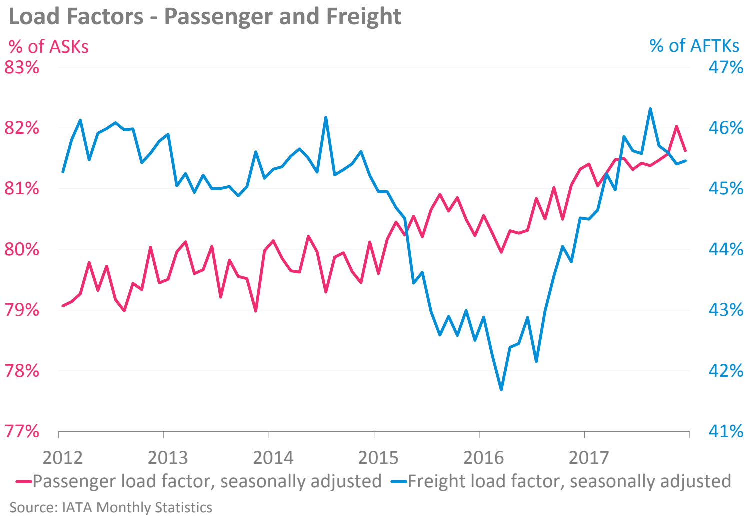
- Industry-wide available seat kilometres (ASKs) trended upwards at a broadly stable rate during 2017. Total ASKs increased by 6.3% in full-year 2017 compared to the previous year.
- Available freight tonne kilometres (AFTKs) grew by 3.0% year-on-year in 2017 – the slowest full-year growth rate since 2012 and just one-third of the corresponding pace of demand. That said, given the pause in the upward trend in SA FTKs seen during the final third of 2017, AFTKs are now trending upwards marginally faster than demand.

A strong month for aircraft deliveries in December, offset in part by storage activity



- The number of available seats in the global airline fleet rose by 0.9% month-on-month in December – its fastest pace since mid-2016. This lifted the year-on-year growth rate to 5.5%.
- 33 more aircraft were delivered in December 2017 compared to the same month in 2016 (234 vs. 201). It is normal to see a spike in aircraft deliveries at year-end; in keeping with the pattern seen a year ago, we expect to see a pronounced drop-off in deliveries made in January.
- Net storage activity made a moderate negative contribution to the fleet size in December, with 149 aircraft being put into storage, and 127 returning into service.

Passenger load factor posts a record full-year high, with a strong rise in freight loads too



- The passenger load factor increased by 0.9 percentage points in 2017 compared to the previous year. This took the load factor to a record high for a calendar year (81.4% of ASKs). Sustained high load factors are helping to pull up unit revenues.
- Meanwhile, the industry-wide freight load factor climbed by 2.5 percentage points in 2017 compared to the previous year, which helped to drive freight yields higher. That said, the SA load factor has fallen back slightly in recent months.

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