Airlines Financial Monitor

December 2019-January 2020

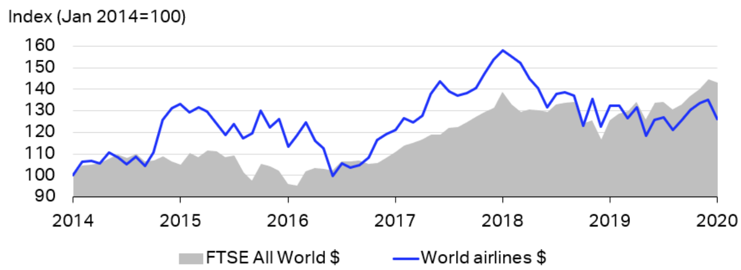
Key points

- The initial Q4 2019 financial results indicate a moderate improvement in industry-wide profitability, driven by the North American airlines. Looking ahead, the coronavirus outbreak – which continues to evolve – will have an impact on the financial performance of the industry. (Our COVID-19 initial impact assessment contains further details.)
- Global airline share prices declined sharply in January due primarily to the coronavirus outbreak. While the Asia Pacific airline index was impacted the most, being at the centre of the outbreak, airline share prices in other regions also came under pressure amid fears of the outbreak spreading globally.
- Global passenger yields increased in December amidst an improved performance in both economy and premium class yields. Nevertheless, global yields trended downwards in the full year of 2019 compared to the prior year.
- Oil prices declined materially following the coronavirus outbreak in China. In the coming period, the shutdown of manufacturing activities in China and subsequent impact of the outbreak on global economic activity will likely exert a drag on global oil demand and weigh on prices.
- In seasonally adjusted terms, air passenger demand ticked up while freight demand stabilized in December. However, air passenger demand growth softened in 2019 and air freight volumes contracted.

Coronavirus weighed on airline stock performance in January

Airline Share Prices

US$ indices (Jan 2014=100)	Index Jan 31st	% change on one month	one year	start of year
World airlines	**126.0**	**-6.8%**	**-4.7%**	**-6.8%**
Asia Pacific airlines	97.7	-11.1%	-16.7%	-11.1%
European airlines	106.0	-6.3%	-4.6%	-6.3%
North American airlines	159.9	-4.8%	-3.1%	-4.8%
FTSE All World $	**142.9**	**-1.2%**	**+13.8%**	**-1.2%**



Source: Thomson Reuters Datastream

- Global airline share prices declined sharply in January due to the coronavirus outbreak. Investor worries about global air travel demand was highlighted amid travel restrictions and flight cancelations. The past SARS epidemic experience and sharp decline in demand during that time also affected investor sentiment towards airline shares.
- The Asia Pacific airline index was impacted the most (-11.1%mom), being at the centre of the outbreak. North American and European airlines have limited direct exposure to China. However, their share prices also came under pressure as investors feared that the virus could spread, and air travel from the rest of Asia and other continents could be affected.

Industry-wide profitability improved moderately in Q4 2019

Airline Financial Results

Number of airlines in sample	Regions	Q4 2018 EBIT margin[1]	Q4 2018 Net post-tax profit[2]	Q4 2019 EBIT margin[1]	Q4 2019 Net post-tax profit[2]
12	North America	9.4%	2,753	10.0%	3,416
5	Asia-Pacific	10.0%	818	8.8%	744
5	Europe	-6.6%	-467	-0.2%	-102
2	Latin America	3.1%	-189	6.2%	6
2	Others	14.2%	-308	17.3%	141
26	**Sample total**	**8.3%**	**2,607**	**9.0%**	**4,205**

[1]% of revenues [2]US$ million
Sources: The Airline Analyst, IATA

- The initial financial data for Q4 2019 point to a higher industry-wide operating profit margin compared to the same period a year ago. The larger sample for North American airlines is more representative of the region overall and show that they continue to be the strongest performer, recording a double-digit EBIT margin. Solid passenger demand together with lower fuel costs continue to be supportive for the bottom-line.
- However, looking ahead, the coronavirus outbreak will have an impact on air travel demand (see our latest impact assessment) and weigh on airline financial performance in the period ahead. Exactly how this situation will play out remains uncertain at this stage.

Industry-wide free cash flow generation was stronger in Q3 than a year ago

Airline Cash Flow[1]

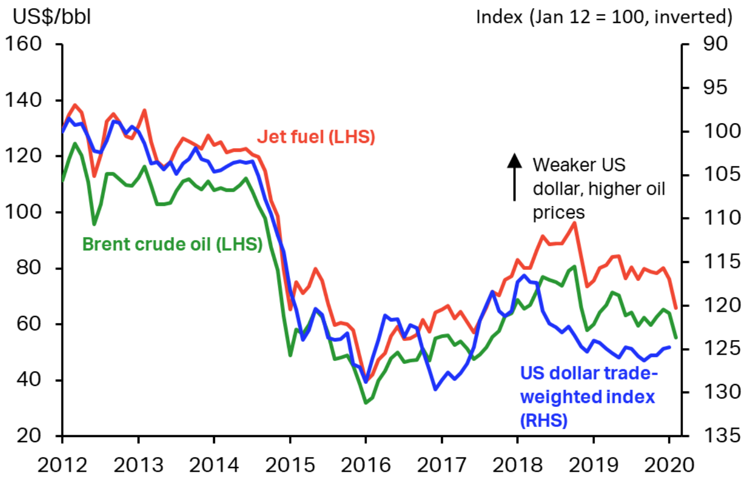
Number of airlines in sample	Regions	Q3 2018 Net cash flow[2]	Q3 2018 Capex	Q3 2018 Free cash flow	Q3 2019 Net cash flow[2]	Q3 2019 Capex	Q3 2019 Free cash flow
14	North America	9.5%	9.1%	0.4%	12.9%	8.7%	4.2%
24	Asia-Pacific	12.6%	12.7%	0.0%	11.2%	10.3%	0.9%
10	Europe	6.4%	10.7%	-4.3%	12.2%	11.3%	0.9%
6	Latin America	6.3%	7.7%	-1.3%	12.4%	8.5%	3.9%
3	Others	9.2%	11.3%	-2.1%	20.5%	9.5%	11.0%
57	**Sample total**	**9.4%**	**10.3%**	**-0.9%**	**12.4%**	**9.7%**	**2.7%**

[1]% of revenues [2]From operating activities
Sources: The Airline Analyst, IATA

- Since the initial Q4 2019 sample is too small, we use the final sample of airlines for Q3 2019. The results indicate that the industry-wide free cash flow (FCF) in Q3 2019 was higher than a year ago, with improvement widespread across regions. Overall, better net cash flow from operations and controlled capital spending supported stronger industry wide FCF flow generation.
- North American airlines outperformed other regions in terms of FCF generation. The European carriers showed a turnaround compared to the previous year, driven by higher cash flow generation from operating activities and despite higher capital spending. Latin American airlines showed a marked improvement, as the increase in cash flow outweighed a rise in capital spending. For airlines in Asia-Pacific, controlled capital spending balanced the impact of weaker bottom-line figures.

Fuel costs

Oil prices declined sharply in January amid concerns regarding global growth

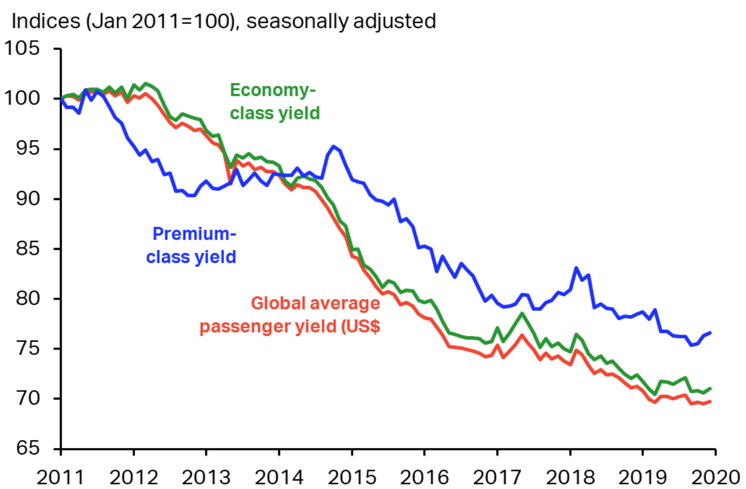


Sources: Platts, Thomson Reuters Datastream, as of Feburary 14th

- Oil prices declined materially following the coronavirus outbreak in China. This was the sharpest decline in Brent crude oil and jet fuel prices since Q4 2018.
- At the time of writing this report, the price of Brent crude oil stands at US$57.3/bbl and the jet fuel price is at US$67.5/bbl, down 14% and 18%, respectively compared to the start of 2020.
- In the coming period, the shutdown of manufacturing activities in China and subsequent impact of the virus outbreak on global economic activity will likely exert a drag on global oil demand and weigh on prices. Nevertheless, a possible extension of OPEC's production cuts could limit further falls.

Yields and premium revenues

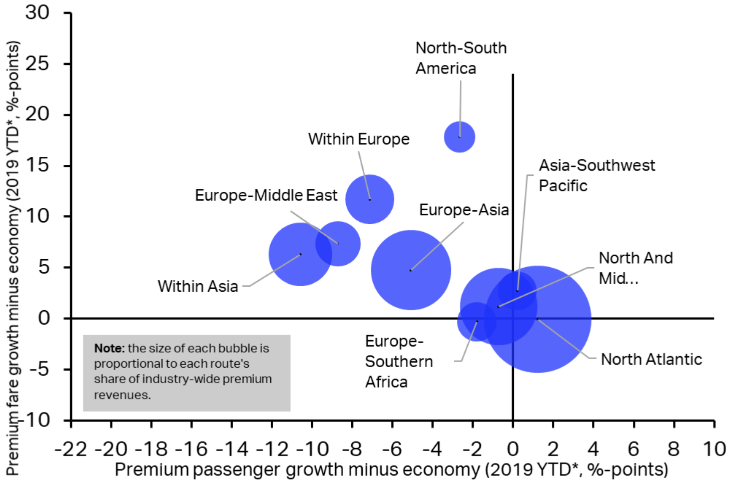
Premium class yields improved sharply in December



Sources: IATA Economics, IATA Travel Intelligence

- Global base passenger yields (denominated in US$, excluding surcharges and ancillary revenues) rose in December on an improved performance by both economic and premium class yields.
- Despite the improvement in the last quarter of the year, total base fare yields (seasonally adjusted) trended downwards overall in 2019 compared to the prior year.
- Economy and premium class yields are respectively 7.4% and 3.7% lower compared to the same period a year ago. This partly reflects softer growth in air passenger volumes due to slower global economic activity and weaker international trade.

Total international premium revenues continue to grow marginally vs a year ago



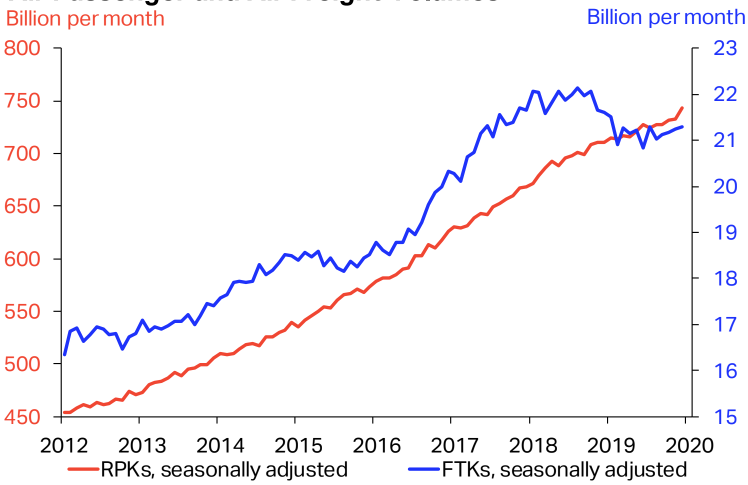
Sources: IATA Economics, DIIO *Up to November 2019

- Premium-class passengers accounted for 5.0% of total international origin-destination traffic between January-November 2019. This proportion was marginally lower (down 0.2ppt) compared to the same period a year ago. On the revenue side, the share of premium-class passengers improved by 0.5 ppt to 30.5% of total international revenues.
- According to the latest available November data, despite the signs of stabilization in business confidence and US-China trade talks at that time, the situation remained unchanged in most markets. Premium passenger traffic growth continued to outpace its economy counterpart in the North Atlantic and Asia-Southwest Pacific markets. On the revenue side, the largest outperformance of premium fares (vs economy) remained in the Nth-Sth America and Within Europe markets.

Demand

2019 was less supportive to air passenger and air freight demand

Air Passenger and Air Freight Volumes



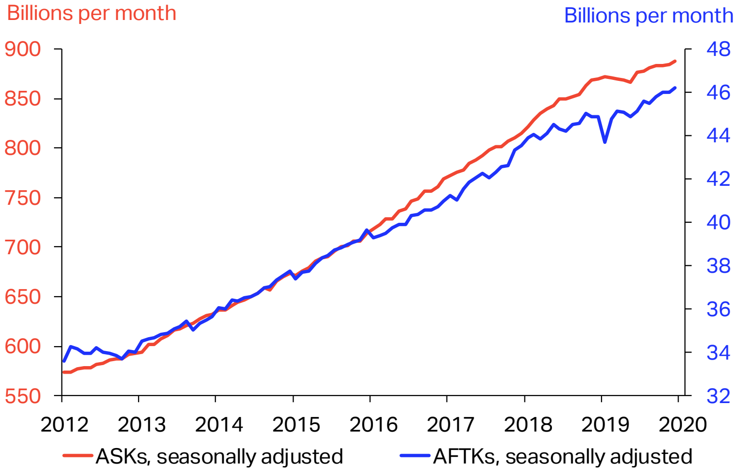
Source: IATA Monthly Statistics

- Seasonally adjusted (SA) revenue passenger kilometres (RPKs) picked up in December, contrasting with a more moderate upward trend that emerged around Q2 2018. Despite that, the bigger picture remains that air passenger demand growth softened in 2019 (4.2% year-on-year) compared to 2018 (7.3%), amidst slower economic growth and elevated uncertainty.
- Industry-wide SA freight tonne kilometres (FTKs) trended higher for another month but remained below the levels observed in Dec 2018. As for the passenger market, trade wars between the US and China – associated with uncertainty and weak overall demand – hit the air cargo business. As a result, FTKs contracted by 3.3% in 2019 – the worst annual performance since the Global Financial Crisis in 2009 (-9.7%).

Capacity

Upwards trend in passenger and freight capacity, despite slowdown vs 2018

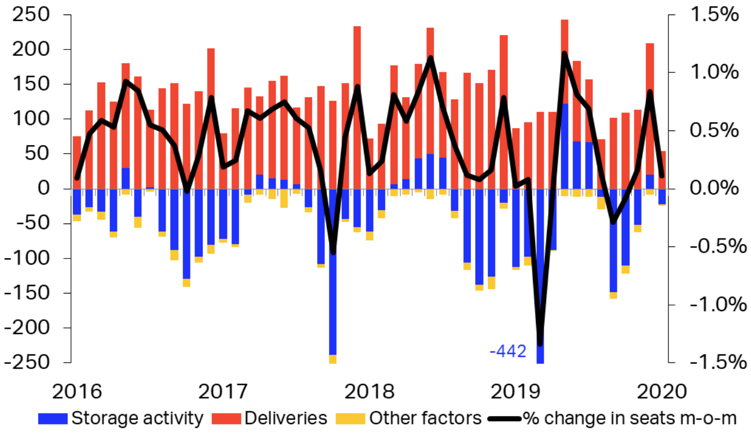
Air Passenger and Air Freight Capacity



Source: IATA Monthly Statistics

- SA available seat kilometres (ASKs) ticked up in the last month of the year. The trend in passenger capacity in 2019 has generally softened compared to 2018.
- With disciplined capacity management from the airlines – and the Max grounding – air passenger capacity (3.4%) grew slower than demand throughout most of the year, both at the industry level and across the regions.
- SA available freight tonne kilometres (AFTKs) also increased in December, prolonging the upward trend started in Q2 2019. In 2019, AFTKs grew by 2.1% year-on-year, a slowdown in pace from the 5.2% rate seen in 2018.

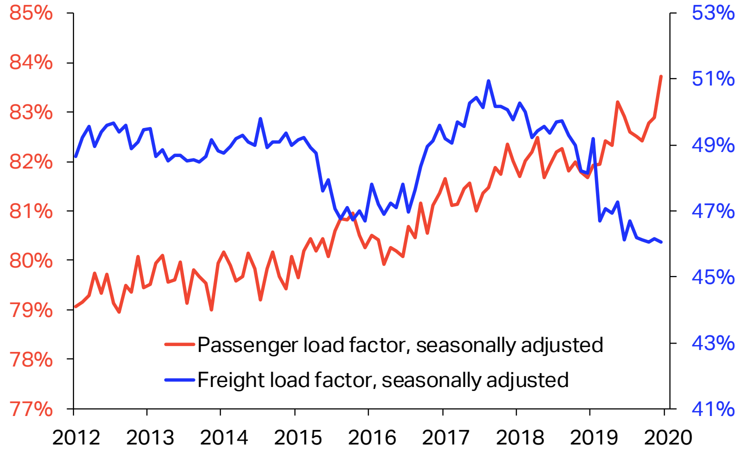
Aircraft deliveries slump in January, but seat capacity continues to grow



Source: Ascend

- Starting from the end of January, the Coronavirus outbreak is impacting air traffic demand to, from and within China, with travel restrictions, flights cancellations and significant short-term uncertainty.
- Having said that, industry-wide seat capacity remained marginally higher in January 2020 compared to December 2019 as the impact of the outbreak has not been fully reflected in the capacity. The year-on-year growth for the month (2.2%) was also in line with that of the past six months.
- Aircraft deliveries slowed to 54 in January, compared with 87 aircraft in the same month in 2019 and 22 aircraft returned to storage in January.

Passenger and freight load factors followed diverging trend in 2019



Source: IATA Monthly Statistics

- The industry-wide passenger load factor lifted 1.9 ppts to 82.3% in December. Capacity growth remained slower than that of demand throughout 2019, pushing the passenger load factor up 0.7 ppt to 82.6%. The SA load factor rose to a new historically high level in December and continued trending broadly upwards.
- This contrasts with the industry-wide freight load factor, which retreated by 2.7 ppts in December, and 2.6 ppts in 2019 as a whole. In seasonally adjusted terms, the load factor is currently on a flat trend, following a lengthy deterioration which started around Q3 2018.

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