

AIRLINES FINANCIAL MONITOR

KEY POINTS

June 2016 – July 2016

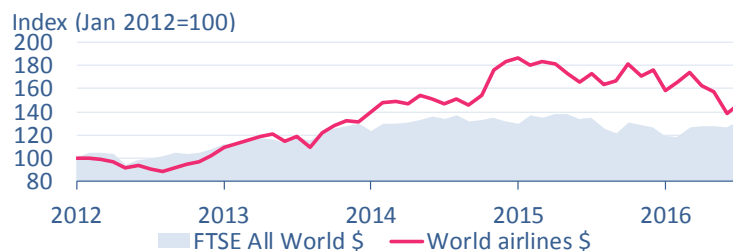
- The initial financial results from Q2 2016 point to another solid quarter for industry profitability and cash flow;
- Global airline share prices increased by 5.9% in July, but they remain well down on where they started the year;
- Brent crude oil prices fell back sharply in July, driven largely by a near-term glut in supply. The futures curve has shifted down in recent weeks, with oil prices now expected to remain below \$55/bbl for the foreseeable future;
- Yields have fallen by around 6.5% year-on-year in constant exchange rate terms in 2016. Ongoing downward pressure on yields is expected to provide further stimulus to demand during the rest of the year;
- The premium segment continues to offer an important buffer for overall airline financial performance. Premium airfares have held up better than their economy counterparts on many of the main premium routes so far this year;
- The global air passenger market grew solidly in annual terms during H1 2016. That said, the upward trend has eased in recent months on the back of modest economic growth and cumulative impacts of terrorist attacks;
- The latest freight volumes data point to an improvement from the weak conditions seen earlier in 2016. But familiar headwinds persist, and low freight loads are keeping downward pressure on cargo yields and revenues.

Financial indicators

Global airline share prices increased in July following a torrid few months

Airline Share Prices

US\$ indices (Jan 2012=100)	Index Jul 29th	% change on		
		one month	one year	start of year
World airlines	147.2	+5.9%	-14.8%	-16.5%
Asia Pacific airlines	82.8	+4.8%	-14.9%	-5.6%
European airlines	167.1	+2.6%	-23.1%	-28.4%
North American airlines	308.8	+7.9%	-12.4%	-18.4%
FTSE All World \$	132.0	+4.2%	-2.4%	+4.2%



Source: Thomson Reuters Datastream

- Global airline share prices rose by 5.9% in July. North American and Asia Pacific carriers saw the biggest increases (7.9% and 4.8% respectively), alongside a more modest rise for European airlines.
- Uncertainty following the 'Brexit' vote, along with lingering impacts from ongoing terrorist attacks, has added to existing investor concerns about the impact of falling unit revenues on industry profitability. So while the pick-ups in share prices in July were a welcome relief following a torrid few months, the bigger picture is that global airline shares still ended the month more than 16% below their level at the start of 2016. All told, global airline shares have underperformed the wider equity market by a sizeable margin so far in 2016.

The initial financial results from Q2 2016 indicate that EBIT margins remain solid

Airline Financial Results

Number of airlines in sample	Regions	Q2 2015		Q2 2016	
		EBIT margin ¹	Net post- tax profit ²	EBIT margin ¹	Net post- tax profit ²
11	North America	16.8%	5,614	17.3%	4,342
3	Asia-Pacific	3.0%	171	5.3%	281
6	Europe	6.7%	876	7.5%	980
2	Latin America	4.2%	29	2.7%	53
22	Sample total	13.0%	6,690	13.6%	5,656

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

- The initial financial results from Q2 2016 point to another solid quarter for profitability.
- Net post-tax profits in our sample in Q2 2016 were 15% lower than in Q2 2015, but the EBIT margin edged up to 13.6%. The initial results are slightly ahead of the signs from our latest Business Confidence survey, which indicated that year-on-year profitability fell slightly during Q2 2016. However, a clearer picture will emerge as more Q2 results are released over the coming months.

Airlines generating higher free cash flow in Q2 2016, despite higher capital investment

Airline Cash Flow¹

Number of airlines in sample	Regions	Q2 2015			Q2 2016		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
11	North America	20.9%	12.1%	8.8%	24.6%	13.4%	11.2%
4	Europe	17.9%	10.3%	7.6%	18.1%	13.6%	4.5%
3	Others	19.9%	14.1%	5.7%	21.2%	24.6%	-3.4%
21	Sample total	20.3%	11.9%	8.4%	23.2%	14.2%	9.1%

¹ % of revenues² From operating activities

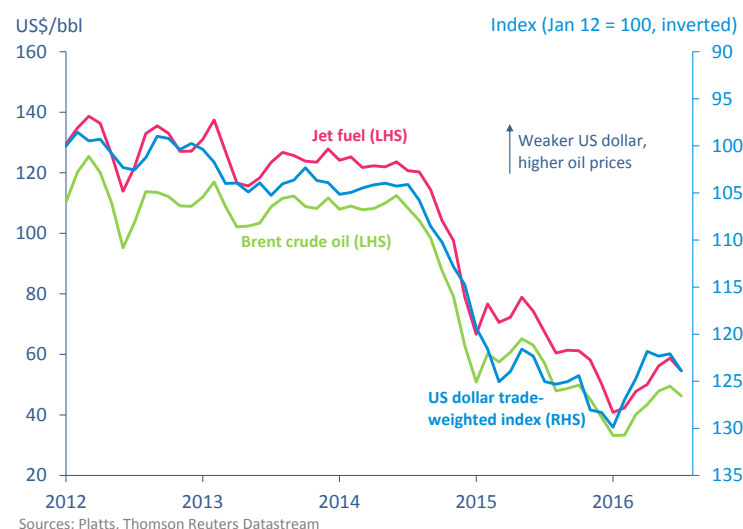
Sources: The Airline Analyst, IATA

→ The initial cash flow metrics from Q2 2016 also show improvement compared to the same period in 2015. Net cash flow in our sample rose to 23.2% of revenues in Q2 2016, from 20.3% a year ago.

→ In aggregate, airlines in all regions of our sample increased capital expenditure as a share of revenues over the period, but not to the same extent as the pick-up in net cash flow. As a result, free cash flow also rose, from 8.4% of revenues to 9.1%. This gives airlines more flexibility to repair balance sheets by paying down debt.

Fuel costs

Brent crude prices fell back sharply in July

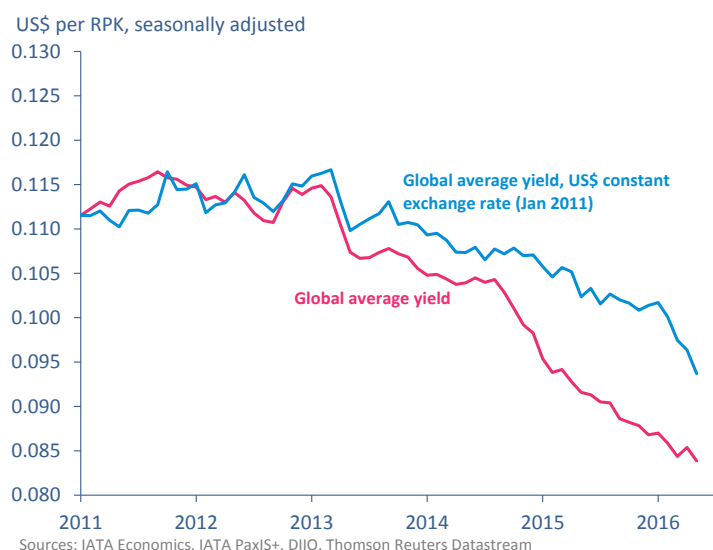


→ Brent crude oil prices fell back sharply during July, ending the month below US\$43/bbl – the lowest level since early-April. The sell-off follows the rally in oil prices seen during the first half of 2016, and has been driven by a near-term glut in supply and a tick-up in the US dollar. The oil futures curve has shifted down over the past month, with the market now expecting oil prices to remain below US\$55/bbl over the next three years or so.

→ Oil prices ended the month of July 22% lower year-on-year. However, the annual comparison is becoming less favorable: levels in early-August are currently around 12% lower than August 2015.

Yields and premium revenues

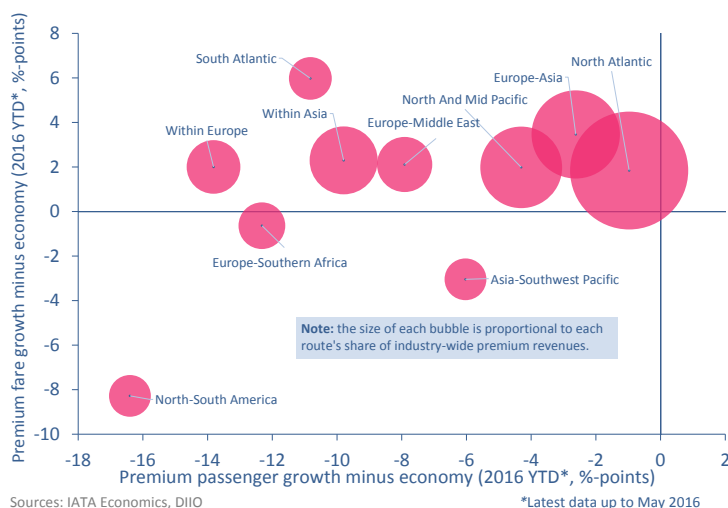
Industry-wide yields continue to trend downwards



→ The average global yield in reported US dollar terms has fallen by around 9% year-on-year so far this year (the latest data go up to end-May and exclude taxes, fees and surcharges). Adjusting for distortions from earlier gains in the dollar, we estimate that global yields fell by approximately 6.5% in constant exchange rate terms in early-2016. Given the sharp fall in the dollar at the start of 2016, the distortions have started to reverse in recent months' data.

→ The downward trend in seasonally-adjusted yields remains in place. Further stimulus to demand is likely to come through during the rest of 2016 from lagged impacts of prior falls in oil prices, and wider trends in the market.

Premium fares continue to hold up, offering a buffer for financial performance on key routes

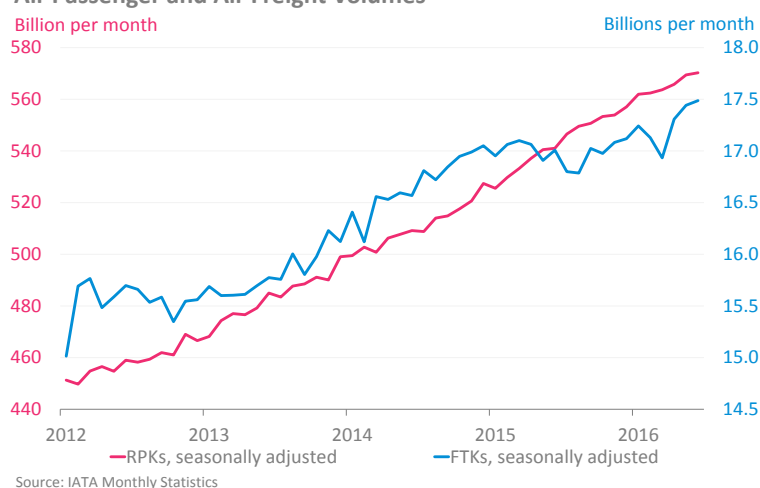


- ➔ Premium international passenger traffic growth has continued to lag behind that of economy. O-D premium international journeys accounted for 5.5% of the total over the first five months of 2016, from 5.9% in the same period a year ago.
- ➔ Nonetheless, premium fares have held up better than those in economy on the majority of the key premium 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 between them in 2015). With industry yields coming under pressure, the high-yielding premium segment offers an important buffer for overall airline financial performance.

Demand

Ongoing moderation in upward trend for passenger traffic; welcome trend for freight

Air Passenger and Air Freight Volumes

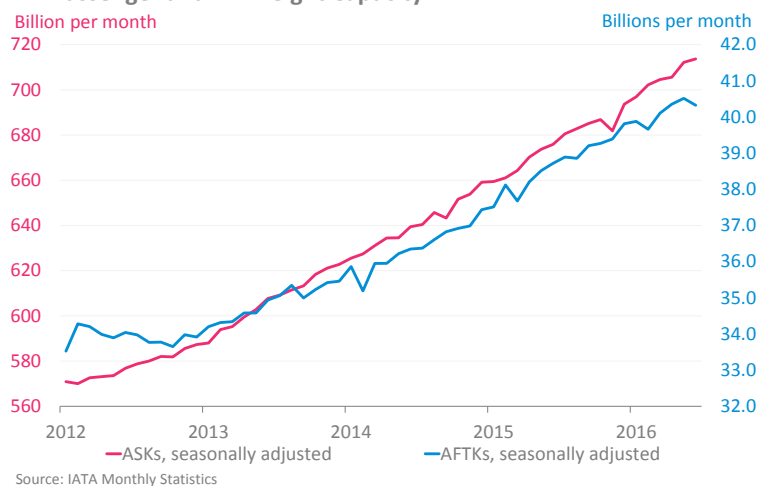


- ➔ The global passenger market grew solidly in annual terms in the first half of 2016, with growth broadly in line with the average pace seen over the past decade. That said, the upward trend in seasonally adjusted passenger volumes has moderated since January, in the face of moderate global economic growth and the ongoing and cumulative impacts of recent high-profile terrorist attacks.
- ➔ Meanwhile, the latest freight data point to an improvement from the weak conditions seen earlier this year. However, the outlook for air freight continues to face significant headwinds, including broader weakness in global trade.

Capacity

Upward trend in passenger capacity has eased in recent months

Air Passenger and Air Freight Capacity

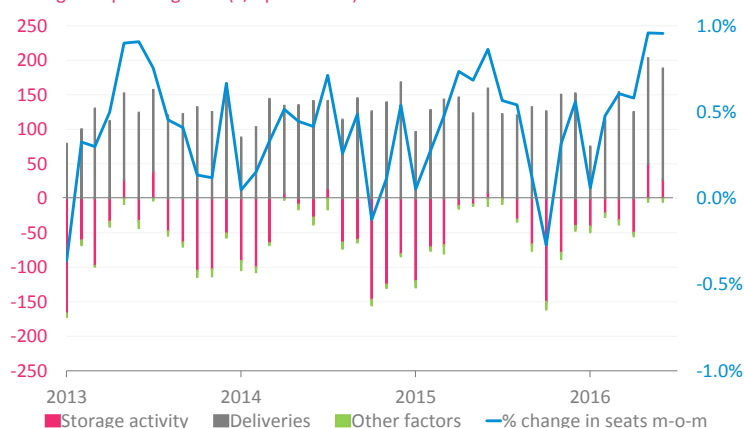


- ➔ Available seat kilometres grew by 5.6% year-on-year in June. However, airlines have slowed the upward trend in capacity growth somewhat in recent months in line with slowing demand.
- ➔ Industry-wide available freight capacity growth has continued to outstrip that of demand; ongoing impetus to freight belly capacity from additions to the passenger fleet mean that annual growth in industry-wide freight capacity has now exceeded annual growth in volumes for 16 consecutive months. Despite their relatively small share of the freight market, African carriers are at the forefront of the freight capacity growth story, with AFTKs up more than 22% year-on-year in H1 2016.

Net storage activity makes another positive contribution to fleet growth

Airline Fleet Development

Change in operating fleet (a/c per month)

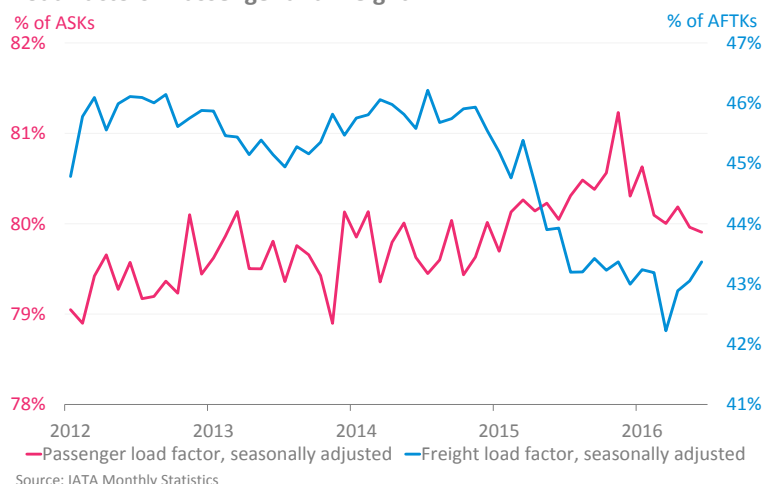


Source: Ascend

- ➔ The number of available seats in the global airline fleet increased by 1.0% in June compared to the previous month, and by 5.6% year-on-year.
- ➔ 161 new aircraft were delivered in June – the highest in a month since December 2014. Net storage activity made another solid positive contribution to the fleet size, driven in the main by fewer aircraft going into storage. Lower oil prices and robust demand have made it economical to keep flying less fuel-efficient aircraft. 79 aircraft were removed from the global fleet in June 2016, compared to 135 that left in June 2015.

Passenger loads have broadly stabilized at a high level, but freight loads remain weak

Load Factors - Passenger and Freight



Source: IATA Monthly Statistics

- ➔ The industry-wide passenger load factor was 79.2% in H1 2016 – just 0.2 percentage points lower than the all-time period high reached in 2015. The industry has managed to keep the seasonally-adjusted load factor broadly stable at around 80% over the past five months. High achieved passenger loads have helped to support robust financial results in recent years.
- ➔ By contrast, the industry freight load factor fell to 42.5% in the first half of 2016 – a record low for the period and 2.3 percentage points lower than in H1 2015. The seasonally-adjusted load factor has recovered somewhat from the lows seen in Q1 2016. But low freight loads are keeping yields and revenues under pressure, and remain a particular headwind for Asia Pacific carriers, for whom cargo is a key part of their business.

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 9th August 2016

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