

AIRLINES FINANCIAL MONITOR

KEY POINTS

JUNE – JULY 2018

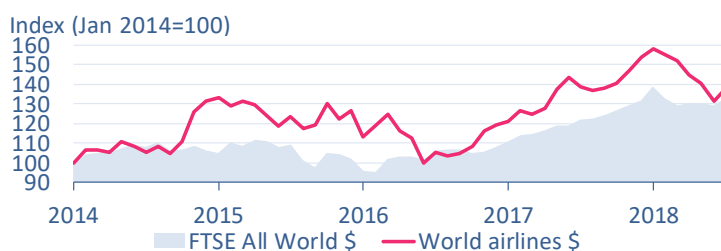
- The initial Q2 2018 data point to a moderate squeeze on airline profitability compared to the same quarter a year ago. However, industry-wide cash flow generation increased this quarter compared with Q2 2017.
- Global airline share prices rose for the first time since January and outpaced developments in the overall global equity index. The improvement in the airline share price index was dominated by North America, with modest gains in Europe & Asia Pacific. Airline shares are still 10% lower than at the beginning of this year.
- Oil prices eased slightly again in July, but the upward trend remains in place. Jet fuel prices dipped back below US\$90/bbl this month, but remain almost 40% higher than their level of a year ago.
- Notwithstanding rising input costs, there are signs of renewed downward pressure on passenger yields. Yields in the less price-sensitive premium-class cabin have generally proven to be more resilient than the economy cabin, despite signs of weakness in May.
- Passenger demand carried solid momentum into the peak Northern Hemisphere summer period, but freight demand is showing signs of some moderation.

Financial indicators

Global airline shares rose in July for the first time since January, outperforming global equities

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Jul 31st	% change on		
		one month	one year	start of year
World airlines	138.0	+4.8%	-0.7%	-10.2%
Asia Pacific airlines	119.9	+0.7%	+3.4%	-8.1%
European airlines	127.7	+1.3%	+1.9%	-11.7%
North American airlines	171.2	+9.9%	-0.6%	-7.5%
FTSE All World \$	133.0	+2.9%	+8.8%	+1.2%



Source: Thomson Reuters Datastream

- Global airline share prices rose by 4.8% in July – their first monthly increase since January. Having underperformed the wider equity market during the previous three months, July saw global airline shares outperform global equities by almost 2 percentage points (a 4.8% vs 2.9% increase in the month).
- The increase in the global airline index in July was driven by a surge in North America (9.9%). This appeared to reflect optimism on the part of investors that strong economic momentum in the US will help airlines to counter the impact of higher fuel prices.
- The Asia Pacific and European indices both registered modest increases in July, although less favorable supply/demand conditions for cargo and the impact of ATC strikes in Europe have both taken a toll since the start of the year.

Moderate decline in airline profitability in Q2 2018, driven by North American airlines

Airline Financial Results

Number of airlines in sample	Regions	Q2 2017		Q2 2018	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
14	North America	16.6%	4,714	12.1%	3,214
10	Asia-Pacific	2.5%	342	2.5%	387
10	Europe	10.4%	2,575	10.2%	2,279
7	Latin America	6.6%	-136	0.1%	-223
1	Others	4.5%	-37	10.5%	-18
42	Sample total	11.6%	7,458	9.2%	5,639

¹% of revenues ²US\$ million

Note: Includes half-year results of Cathay Pacific Airways, Royal Jordanian and Transavia

Sources: The Airline Analyst, IATA

- The initial releases of airline financial data for Q2 2018 point to a moderate squeeze on airline profitability relative to the same period in 2017 – consistent with the results of our latest Business Confidence [survey](#). The EBIT margin in our sample of 42 airlines fell to 9.2%, from 11.6% a year ago.
- The deterioration at an industry-wide level was driven by a broad-based decline in performance in North America, mainly reflecting higher fuel costs. By contrast, airline profitability in Europe and Asia Pacific was broadly unchanged from that in Q2 2017.

Industry cash flow generation increased in Q2 2018, thanks largely to Nth & Latin America

Airline Cash Flow¹

Number of airlines in sample	Regions	Q2 2017			Q2 2018		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
11	North America	18.1%	13.4%	4.6%	19.1%	11.1%	8.0%
3	Asia-Pacific	11.8%	28.3%	-16.5%	14.7%	29.4%	-14.7%
6	Europe	19.7%	10.2%	9.6%	16.7%	13.5%	3.2%
4	Latin America	8.8%	5.9%	2.9%	21.6%	12.1%	9.6%
24	Sample total	17.9%	13.2%	4.8%	18.2%	13.0%	5.3%

¹ % of revenues

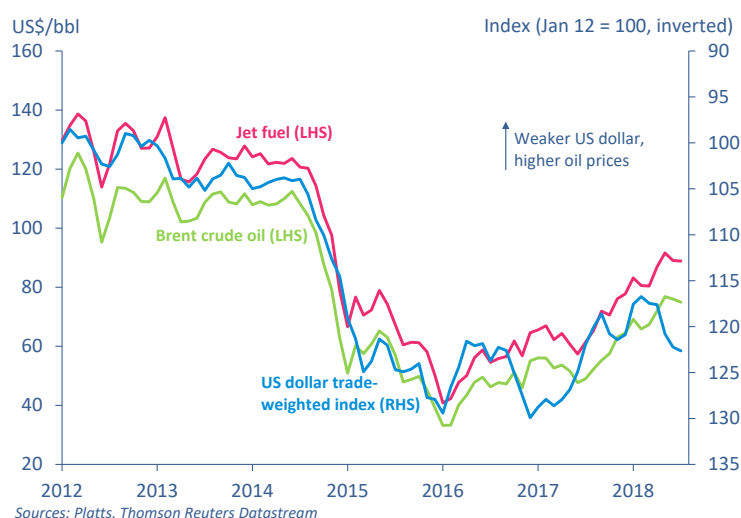
² From operating activities

Sources: The Airline Analyst, IATA

- ➔ Despite the moderate step-down in profitability, our smaller sample of 24 airlines from Q2 2018 shows that industry free cash flow (FCF) actually increased compared to the same period a year ago (to 5.3% of revenues, up from 4.8% a year ago).
- ➔ This reflected a combination of a small increase in net cash flow from operations (to 18.2% of revenue in our sample, from 17.9% in Q2 2017), and a modest easing in capex spending (to 13.0%).
- ➔ The improvement in the industry-wide FCF outcome was driven by airlines in the Americas, with Latin America in our sample seeing a big jump in net cash flow from operations relative to a year ago.

Fuel costs

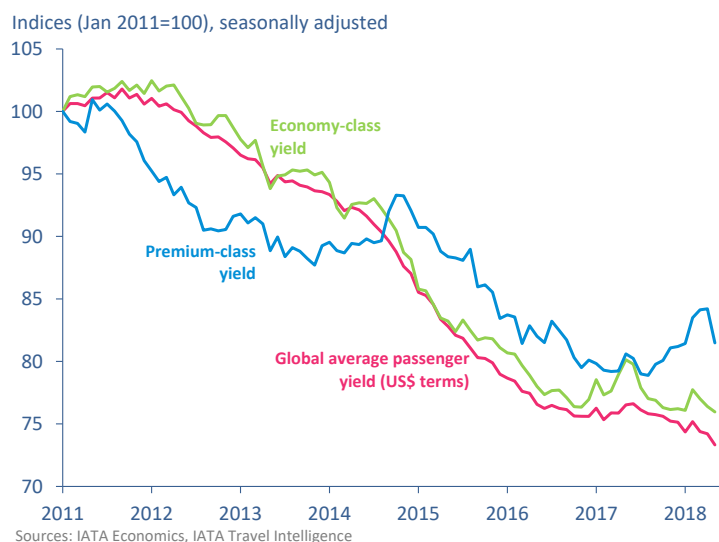
Jet fuel prices fell back again in July but remain around 38% higher than their year-ago level



- ➔ The upward trend in global oil prices since early-2017 has been driven by a combination of a gradual reduction in oil inventories, as well as geopolitical developments.
- ➔ Oil prices have fallen back slightly in recent months, reflecting the impact of an announced supply increase by Saudi Arabia as well as a stronger US dollar. Having risen as high as US\$94/bbl in May, the price of jet fuel is currently back around US\$89/bbl. However, to put the pressure on airline input costs into perspective, this is still around 38% higher than its year-ago level.
- ➔ The oil futures curve continues to point to a moderate decline in oil prices over the coming year or two.

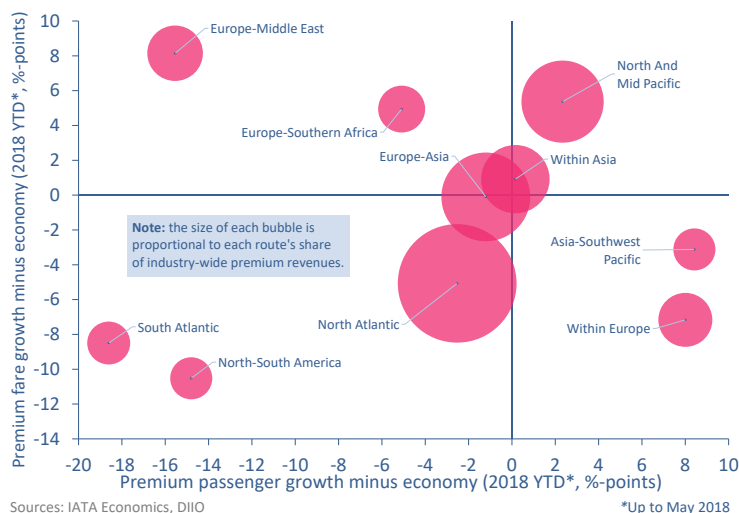
Yields and premium revenues

Divergent trends in premium and economy-class passenger yields remain



- ➔ Despite rising input costs, there are increasing signs of renewed downward pressure on passenger yields. Note that the yield data presented here relate to developments in the 'base' airfare only and exclude revenue from surcharges and ancillary services. These additional sources of passenger revenue – as well as higher load factors – are helping to support unit revenues.
- ➔ Meanwhile, having trended upwards since mid-2017, yields in the premium-class cabin also showed signs of weakness in May. This looks to have been felt reasonably evenly across major markets and may reflect the impact of increased trade tensions. Given the importance of premium travel to industry financial performance, we will continue to monitor developments closely.

Int'l premium traffic share remains stable, albeit with considerable regional variation

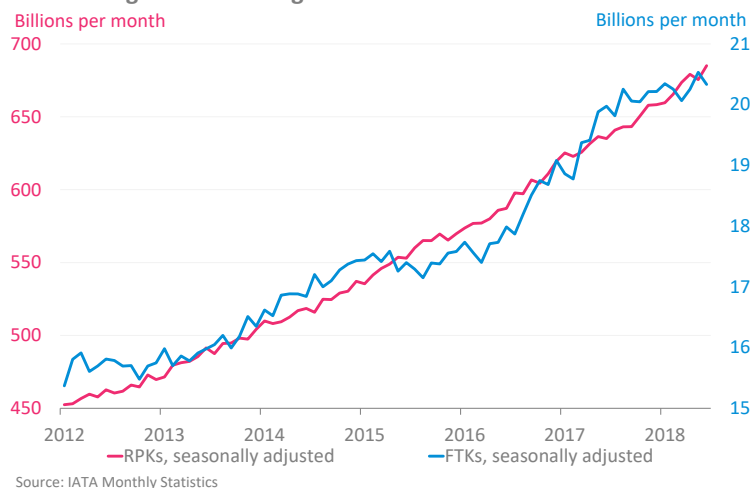


- ➔ Premium-class passengers accounted for 5.4% of total international origin-destination traffic in the first five months of 2018 – unchanged from the share seen in the same period of 2017.
- ➔ As we have noted before, premium passenger growth has continued to modestly lag its economy counterpart on the two-largest premium markets in terms of revenue – the North Atlantic and Europe-Asia. The underperformance of the premium cabin has been more stark on routes to/from South America, as well as between Europe and the Middle East.
- ➔ However, this has been offset in part by stronger showings for premium-class demand to, from and within Asia, and within Europe.

Demand

Passenger volumes are carrying momentum into summer, but the freight trend has moderated

Air Passenger and Air Freight Volumes

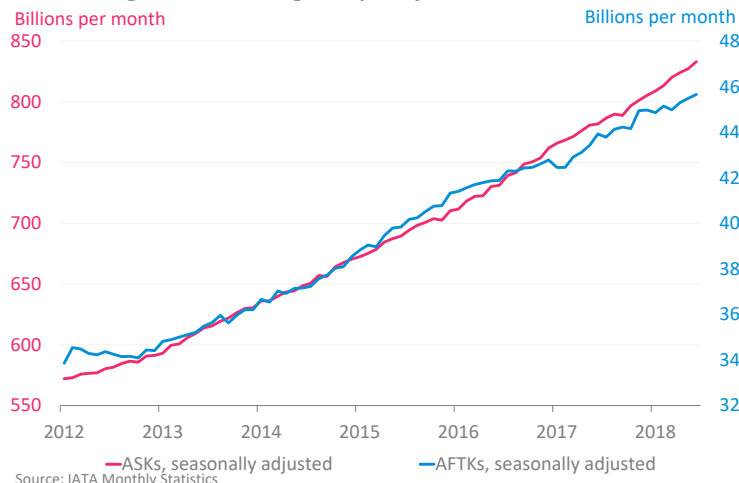


- ➔ Industry-wide revenue passenger kilometres (RPKs) grew by 7.8% year-on-year in June 2018 – up from 6.0% in both April and May. After a 0.5% monthly fall in May, RPKs rebounded by 1.4% in June relative to the previous month. The key point is that passenger demand was carrying solid momentum in SA terms coming into the peak period for demand during the northern hemisphere summer.
- ➔ Year-on-year growth in industry-wide freight tonne kilometres (FTKs) slowed to 2.7% in June – almost half its five-year average pace. Disruption at Nippon Cargo may have affected the result, but the bigger picture is that freight volumes have continued to trend upwards at a more moderate pace than was the case in H1 2017.

Capacity

Freight capacity is growing more slowly than that of passengers, but still more than demand

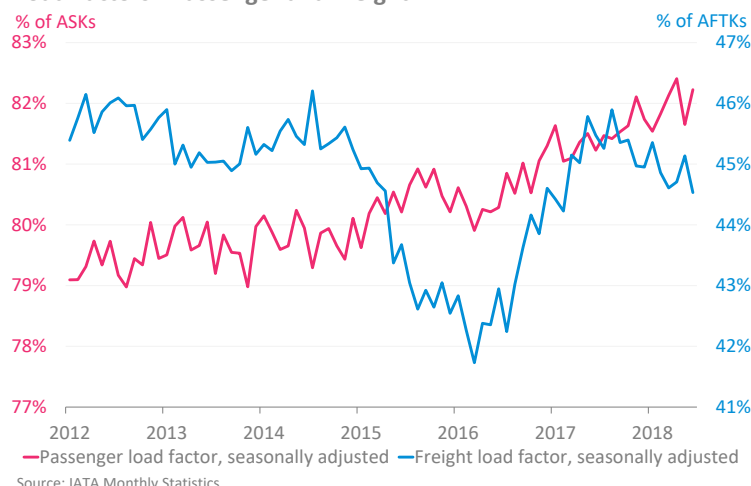
Air Passenger and Air Freight Capacity



- ➔ Industry-wide available seat kilometres (ASKs) grew by 6.5% year-on-year in June. The upward trend in demand has started to outstrip that of capacity once again.
- ➔ It is the reverse situation for air freight, however. While the upward trend in freight capacity has slowed over the past six months or so, it is continuing to trend upwards at a slightly faster annualized pace than demand. All told, available freight tonne kilometres (AFTKs) rose by 4.1% year-on-year in June 2018.

The divergent trend in the passenger and freight load factors has continued

Load Factors - Passenger and Freight



- ✈ The passenger load factor increased by 1.0 percentage point in June compared to a year ago, taking it to 82.8% – a record high for the month. In SA terms, the load factor remains close to the all-time high reached in April. Higher passenger loads are helping to support unit revenues in the face of ongoing weakness in passenger yields.
- ✈ By contrast, the freight load factor has continued to trend downwards in SA terms, with the series currently back to levels last seen in early-2017. The industry-wide freight load factor fell by 0.7 percentage points in June 2018 compared to the same month a year ago.

IATA Economics
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