Airlines Financial Monitor

June–July 2019

Key points

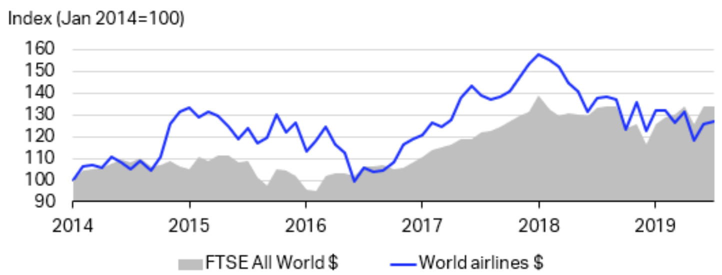
- Second quarter financial performance improved in the N American region, which is dominating the relatively small sample of airlines that have reported so far. Profit margins are still falling in Europe and, outside India, in much of the Asia Pacific region.
- The regional differences in financial outcomes have been reflected in the diverging equity performances. Global airline share prices moved up in July (+1.1%) led by North American airlines, but have underperformed the FTSE All World Index for most of this year.
- Global passenger yields showed signs of stabilizing with a small rise in May, following an improvement in the previous month. Cost pressures from fuel prices have diminished (at least for airlines with low hedging ratios).
- In seasonally adjusted (SA) terms, passenger load factors have improved significantly in recent month, but the cargo business has seen load factors fall further.

Financial indicators

Global airline share index rose slightly in July

Airline Share Prices

US$ indices (Jan 2014=100)	Index Jul 31st	% change on one month	% change on one year	% change on start of year
World airlines	**127.0**	**+1.1%**	**-7.9%**	**+3.5%**
Asia Pacific airlines	107.7	-0.6%	-10.1%	-2.8%
European airlines	83.0	-5.5%	-35.0%	-19.1%
North American airlines	170.4	+3.1%	-0.5%	+11.3%
FTSE All World $	**133.9**	**+0.1%**	**+0.7%**	**+14.8%**



Source: Thomson Reuters Datastream

- Global airline share prices continued to move up in July (+1.1%), but year-to-date (YTD) performance is still behind the global equity markets (+3.5% vs+14.8%).
- The regional differences in financial outcomes have been reflected in diverging equity performances. North American airlines performed the best among all regions in July as the earnings outlook is stable. Nevertheless, YTD performance fell short of wider equity markets stemming from the concerns related to the impact of trade policies on airlines.
- On the other hand, the European airlines index maintained its downward trend with weaker earnings results from some major airlines in Q2 2019. Asia Pacific airlines index was relatively stable with moderately better Q2 financial results compared to the prior year.

Improved industry-wide profitability in Q2 but driven by N America

Airline Financial Results

Number of airlines in sample	Regions	Q2 2018 EBIT margin[1]	Q2 2018 Net post-tax profit[2]	Q2 2019 EBIT margin[1]	Q2 2019 Net post-tax profit[2]
10	North America	12.0%	2,907	13.4%	4,549
5	Asia-Pacific	4.2%	264	5.3%	366
7	Europe	9.7%	2,041	8.9%	1,588
3	Latin America	6.0%	55	5.8%	-4
25	**Sample total**	**10.3%**	**5,267**	**10.9%**	**6,499**

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

- The initial releases of airline financial data for Q2 2019 point to an improved industry-wide profitability compared to the prior year, but this was driven by the over-representation of N American airlines in our sample. In North America, airlines reported improved margins reflecting better unit revenues. On the cost side, lower oil prices were supportive. In Asia Pacific, overall profitability improved, as well, but it was driven by performance in India, distorted by recent events.
- By contrast, profitability of European airlines declined in the face of falling fares with the competition from low cost carriers and rising fuel bill as opposed to North American airlines. In Latin America, there was a high variation in the performance of carriers. Although some carriers reported better unit revenues and benefitted from low fuel prices, their outcome was offset by the negative bottom-line figure of one major player.

Industry-wide free cash flow generation is stable

Airline Cash Flow[1]

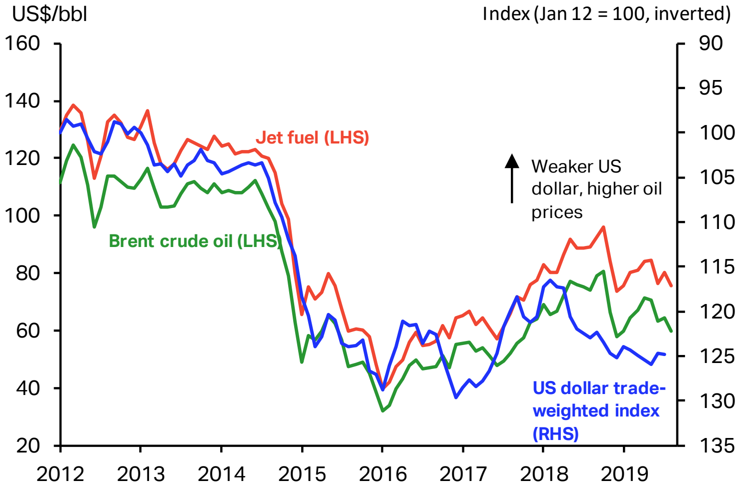
Number of airlines in sample	Regions	Q2 2018			Q2 2019		
		Net cash flow[2]	Capex	Free cash flow	Net cash flow[2]	Capex	Free cash flow
10	North America	19.8%	11.0%	8.7%	18.6%	10.0%	8.6%
2	Asia-Pacific	16.3%	37.0%	-20.7%	14.1%	29.3%	-15.2%
4	Europe	18.7%	15.9%	2.8%	12.4%	9.5%	2.9%
1	Latin America	26.5%	9.7%	16.8%	-1.0%	6.7%	-7.8%
17	**Sample total**	**19.4%**	**13.6%**	**5.8%**	**16.7%**	**10.9%**	**5.8%**

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

- Despite the step-up in profitability, our smaller sample of airline data for Q2 2019 indicates stability in free cash flow (FCF) generation for the whole industry compared to the same period a year ago. The industry-wide free cash flow stayed at 5.8% of revenues in Q2 2019 as decrease in capital expenditures balanced lower net cash flow from operations.
- Despite robust bottom-line figures and lower capital spending, North American airlines reported lower operating cash flow as some airlines had increased pension contributions and had to fulfil lease return requirements. On the other hand, European airlines maintained stable free cash flow generation as reduced capital spending compensated the deterioration in profitability.

Fuel costs

Brent oil and jet fuel prices declined further in July

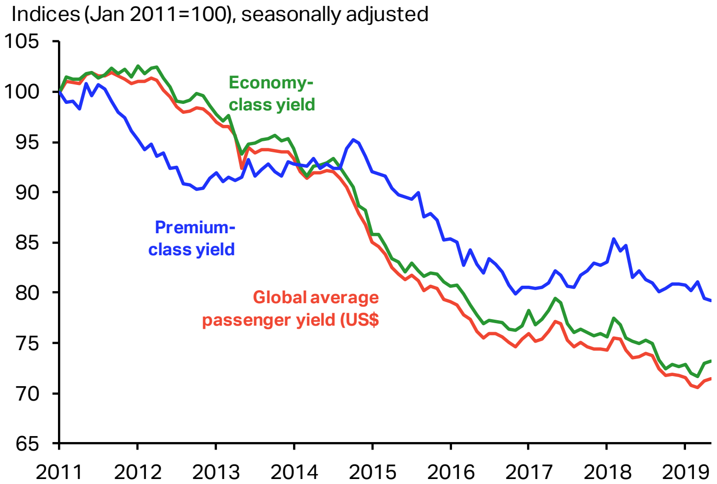


Sources: Platts, Thomson Reuters Datastream, as of August 14th

- Brent crude oil and jet fuel prices fell as simmering US-China trade relations have raised concerns related to global economic growth and oil demand. At the time of writing this report, the price of Brent crude oil hovers around US$60/bbl and the jet fuel reached US$76/bbl, 7% lower compared to the prior month. For more data on oil price developments, check out our weekly Jet Fuel Price Monitor.
- Looking forward, deteriorating global economic backdrop together with trade war uncertainties is likely to put further pressure on oil demand. In addition, production cuts would be less adequate to push up the prices since as global oil inventories remain high.

Yields and premium revenues

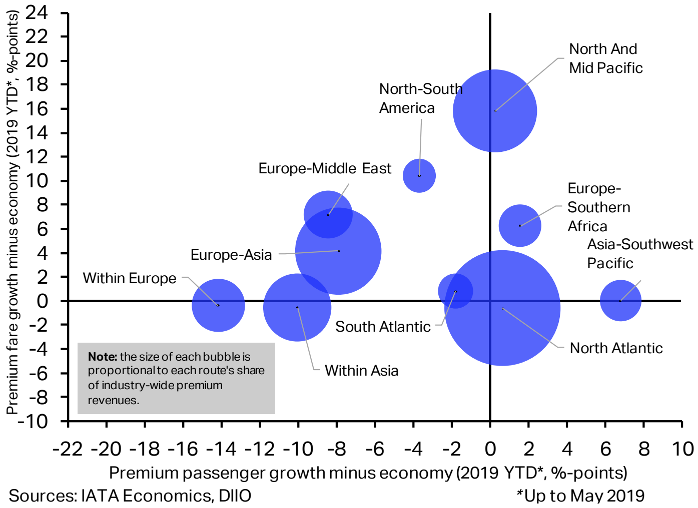
Passenger yields appear to be stabilizing



Sources: IATA Economics, IATA Travel Intelligence

- In the past two months, global passenger yields appear to be stabilizing, as airlines have been more cautious about adding capacity in the face of deteriorating demand prospects. Note that the yield data excludes surcharges and the revenue that airlines generate from ancillary services.
- Economy class yields went up by moderate 0.2%, following a sharp increase in the prior month. On the other hand, less price sensitive premium cabin yields moved down by another 0.3%. Global average passenger yields in US$ terms were still 2.9% below their level compared to a year ago.

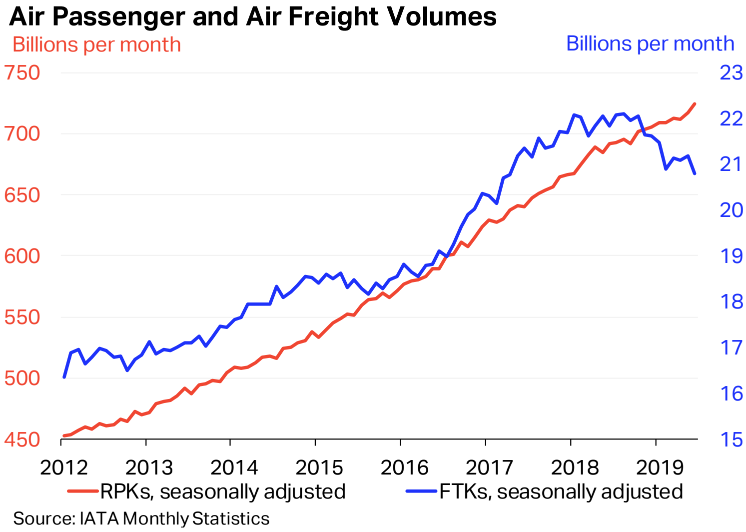
Share of international premium revenue increased



- Premium-class passengers accounted for 3.9% of total international origin-destination traffic between January-May 2019 (4.1% a year ago), while revenues from premium-class passengers improved by 0.3 percentage points to 27.4% of international passenger revenues.
- Premium passenger traffic growth outperformed its economy counterparts in North Atlantic and North-Mid Pacific regions which are the largest premium markets in terms of revenue. Nevertheless, in North Atlantic fare growth lagged economy class. Premium passenger growth also surpassed economy in small size markets of Europe-Southern Africa and Asia-Southwest Pacific. Within Asia and Europe, both premium passenger and fare growth rates were below economy class stemming from the highlighted concerns regarding global trade.

Demand

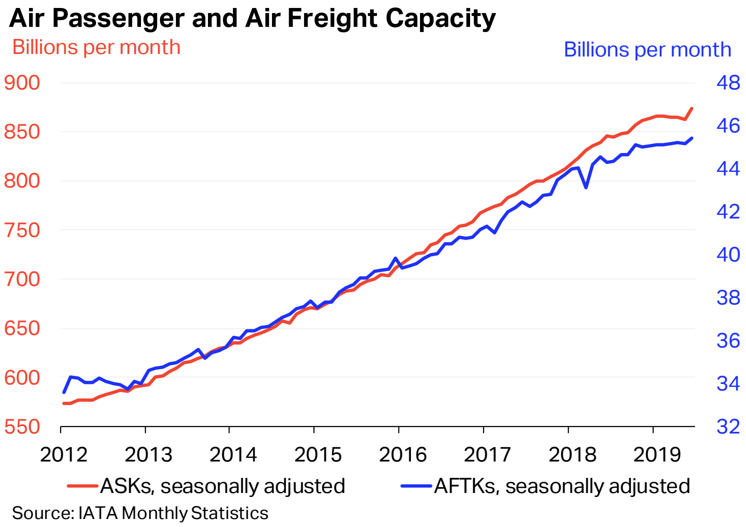
Air passenger demand improves, while freight volumes soften



- In seasonally adjusted (SA) terms, industry-wide revenue passenger kilometres (RPKs) improved in June, continuing the stronger performance of the past two months. Currently, the series indicates year-on-year growth rate of 4.6%, which is below historical average of 5.5% and we remain cautious about the continuation of the trend given the volatility in the monthly data and the downside risks to the global outlook.
- On the other hand, SA air freight tonne kilometres (FTKs) declined after three consecutive monthly increases. The fall came mostly from additional tariff rises in the ongoing US-China trade dispute but also from the moderation in economic growth. We expect freight outlook to be fragile and our latest Business Confidence Survey also confirms that as the expectations of further deterioration more than doubled compared to April survey.

Capacity

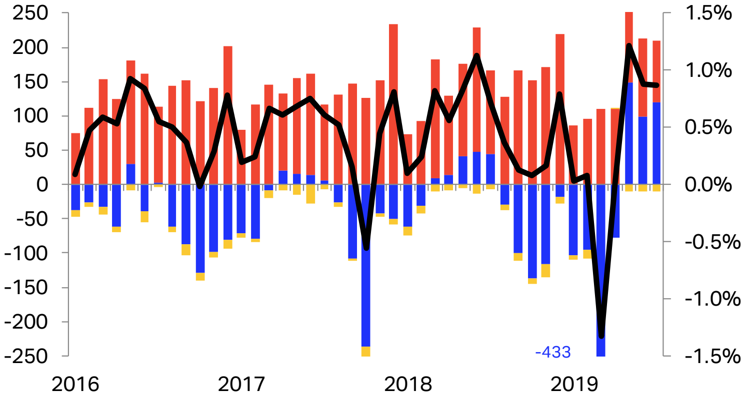
Passenger capacity increased in June



- In seasonally adjusted terms, industry-wide available seat kilometres (ASKs) increased in June as airlines responded to better RPK growth. There has been a sharp change in the trend. Apart from the rise in June, ASK have been held flat in seasonally-adjusted terms since late last year.
- Available freight tonne kilometers (AFTKs) have been following a stable trend in the last six months as airlines were adjusting capacity in response to weaker demand. Although in seasonally-adjusted terms the freight capacity lifted slightly in June, annual freight capacity growth is still low at 2.6% compared to 4.4% a year ago.

Seat capacity continues to recover

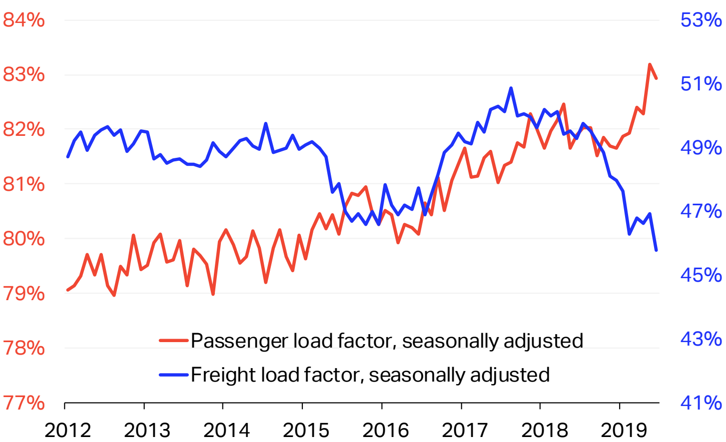
Airline Fleet Development
Change in operating fleet (a/c per month)



Source: Ascend

- The number of available seats in the global airline fleet increased for the third consecutive month (0.9% month-on-month) in July as airlines match the demand in the peak season. Although the decline in seat capacity arising from 737 Max groundings was compensated with strong monthly increases in the last three months, annual growth is still moderate at a pace of 3.3% compared to 5.9% a year ago.
- 91 aircraft were delivered in the month compared to 122 delivered in the same period a year ago. 161 aircraft returned to the fleet from storage while 42 aircraft left the fleet. Hence, net storage activity made a positive contribution to fleet growth.
- All in all, the number of aircraft delivered from the beginning of the year to July was lower than that seen in the same period last year (641 vs 820). Note that on average 748 aircrafts delivered in the first half of the years between 2013-2018.

Passenger and freight load factors further diverged



Source: IATA Monthly Statistics

- The gap between passenger and freight load factors – and the relative fortunes of the passenger and cargo businesses - further widened in June. Despite a modest decline this month from all time high level in May, the industry-wide seasonally adjusted passenger load factor remained close to record high levels at 82.9%.
- By contrast, the seasonally adjusted freight load factor for the industry fell significantly further to 45.8%, which is 3.5 percentage points lower than the level of a year ago.

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