

AIRLINES FINANCIAL MONITOR

KEY POINTS

MAY – JUNE 2018

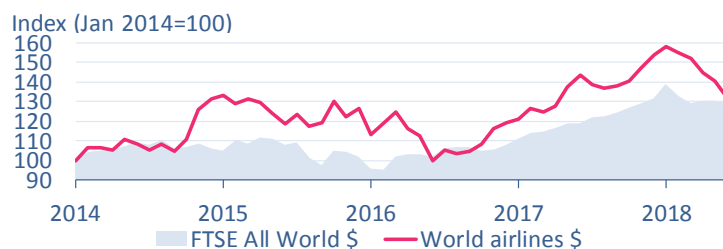
- The latest financial data from the industry show that airline profitability was strengthening in Q1 2018 compared to the same quarter a year ago, while cash flow generation in the industry also picked up.
- That said, global airline share prices fell for the fifth consecutive month in June, which indicates that forward-looking investors expect more difficult conditions ahead than was the case in Q1. The global airline share price index has now fallen by 14.3% since the start of the year, compared to a 1.7% decline in the global equity index.
- Oil prices have trended upwards since early-2017 and are a key reason why airline shares are underperforming the market. The price of jet fuel is currently sitting just above US\$90/bbl – around 55% higher than it was a year ago.
- The global average passenger yield has tracked broadly sideways since early-2017. However, yields in the less price-sensitive premium-class cabin have trended upwards over much of the past year, which reflects the fact that airlines have been able to pass on higher input costs to a greater extent than in the economy cabin.
- Passenger demand has continued to trend upwards and freight volumes have picked up in the past few months too. A rising passenger load factor is helping to boost unit revenues in the face of the sideways trend in yields.

Financial indicators

Airline shares continue to lag behind global equities, falling for the 5th month in a row in June

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Jun 29th	% change on		
		one month	one year	start of year
World airlines	131.6	-6.4%	-8.3%	-14.3%
Asia Pacific airlines	119.1	-7.6%	+2.3%	-8.7%
European airlines	126.1	-5.2%	-0.2%	-12.8%
North American airlines	155.8	-4.9%	-16.4%	-15.8%
FTSE All World \$	129.3	-0.8%	+8.5%	-1.7%



Source: Thomson Reuters Datastream

- Global airline share prices fell by 6.4% in June – their fifth consecutive monthly decline. The wider equity market also fell during the month, but the global airline share price index has continued to underperform, reflecting investor concerns about the impact of higher fuel prices on industry profitability.
- The decline in the global airline index in June reflected month-on-month falls in all three regional indices that we track, led by Asia Pacific (-7.6%) and European airline shares (-5.2%).
- The North America index posted the smallest decline over the month (-4.9%) but the index has fallen the most since the start of 2018 and relative to a year ago. This reflects ongoing investor concerns of the impact of rising capacity growth in the region.

Airline financial performance picked up in Q1 2018, driven by European carriers

Airline Financial Results

Number of airlines in sample	Regions	Q1 2017		Q1 2018	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
33	North America	7.7%	2,057	7.3%	2,342
32	Asia-Pacific	6.6%	2,390	6.2%	2,327
15	Europe	-2.3%	-1,174	1.9%	69
7	Latin America	6.3%	125	7.7%	192
7	Others	1.4%	50	3.1%	162
94	Sample total	4.9%	3,448	5.6%	5,092

- The ongoing pressure on airline equities has been despite a pick-up in airline financial performance in Q1 2018 relative to the same period in 2017. The EBIT margin in our sample of 94 airlines increased to 5.6%, up from 4.9% a year ago.
- The improvement at an industry-wide level was driven by a pick-up in performance in Europe (although the first quarter of the year is a seasonally weak period for airline profitability in the region), as well as a stronger showing from airlines based in Latin America.

¹ % of revenues ² US\$ million
 Note: Includes half-year results of Flybe and Easyjet
 Sources: The Airline Analyst, IATA

Higher net cash flow drove an increase in free cash flow at an industry level in Q1 2018

Airline Cash Flow¹

Number of airlines in sample	Regions	Q1 2017			Q1 2018		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
15	North America	14.9%	15.3%	-0.4%	19.8%	13.1%	6.7%
17	Asia-Pacific	16.4%	14.4%	2.1%	13.8%	13.8%	0.0%
8	Europe	20.4%	13.8%	6.6%	25.2%	21.9%	3.3%
7	Latin America	5.9%	6.5%	-0.6%	4.7%	6.8%	-2.2%
4	Others	12.3%	14.9%	-2.6%	10.9%	19.3%	-8.4%
51	Sample total	15.3%	14.2%	1.1%	18.1%	14.3%	3.8%

¹% of revenues

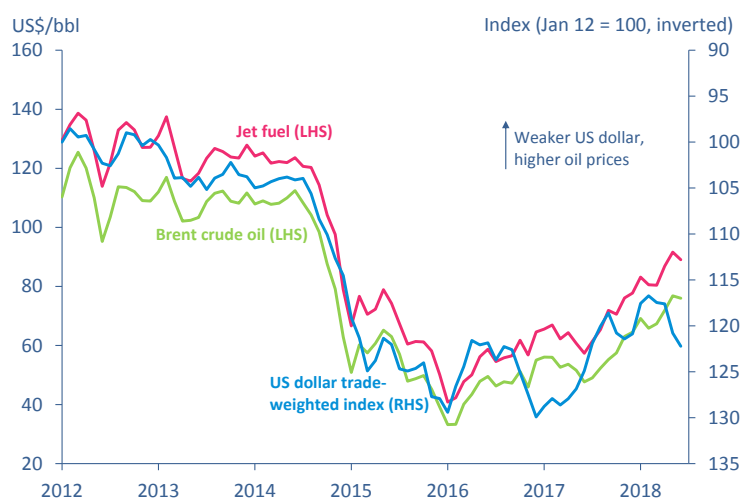
²From operating activities

Sources: The Airline Analyst, IATA

- ➔ Moreover, our sample of 51 airlines shows that industry free cash flow (FCF) also improved in Q1 2018 compared to the same period a year ago (to 3.8% of revenues, up from 1.1% a year ago).
- ➔ This mainly reflected an increase in net cash flow from operations (to 18.1% of revenue in our sample, from 15.3% in Q1 2017), offset by a small 0.1 percentage point increase in capex (to 14.3%).
- ➔ The industry-wide outcome continued to mask a range in performance at the regional level. The biggest turnaround in FCF was in North America, while the modest decline in European airline FCF was driven by a sizeable increase in capex in the region (to 21.9% of revenues, from 13.8%).

Fuel costs

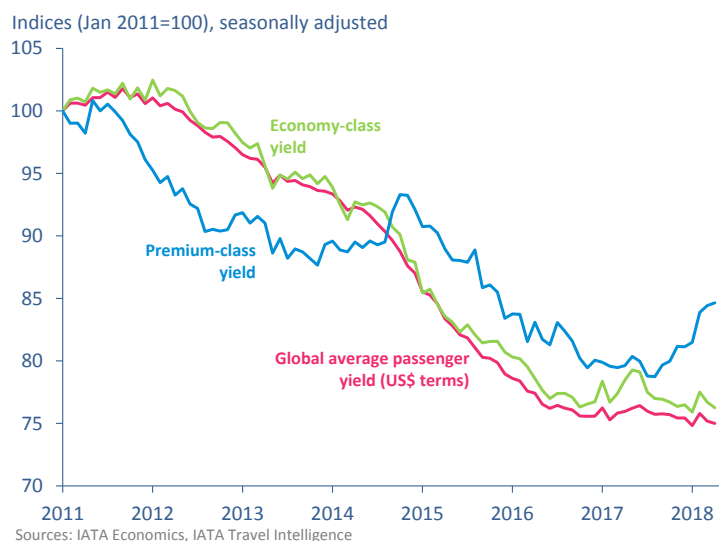
Jet fuel prices fell back during June but remain around 55% higher than their year-ago level



- ➔ Global oil prices have trended upwards since early-2017, driven by a combination of a gradual reduction in oil inventories amid robust demand and tighter supply conditions, as well as geopolitical developments.
- ➔ The price of jet fuel breached US\$90/bbl in May for the first time since November 2014, but fell back in mid-June as major oil producers agreed to increase crude output. Nonetheless, jet fuel climbed again towards the end of the month and remains around 55% higher than it was a year ago.
- ➔ The oil futures curve has shifted up in recent months, but it is still consistent with a moderate decline in oil prices over the coming years.

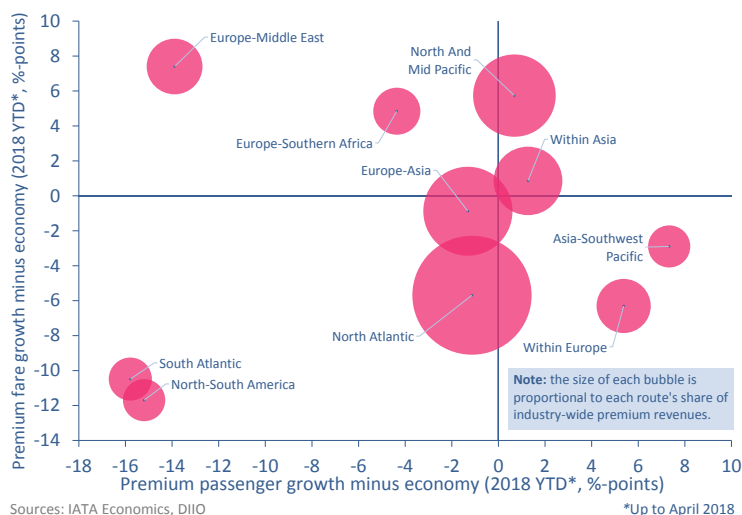
Yields and premium revenues

Divergent trends in premium and economy-class passenger yields



- ➔ The global average passenger yield has tracked broadly sideways in seasonally adjusted (SA) terms since early-2017, which largely mirrors developments in the economy-class cabin.
- ➔ Yields in the premium-class cabin have trended upwards since mid-2017, however. Premium-class demand is less price sensitive than its economy counterpart, which has allowed airlines to pass through higher fuel costs onto premium passengers to a greater extent than in economy.
- ➔ Recall that the passenger 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 are helping to support the robust financial performance of the industry.

Int'l premium traffic share stable from that of a year ago, amid a lot of regional variation

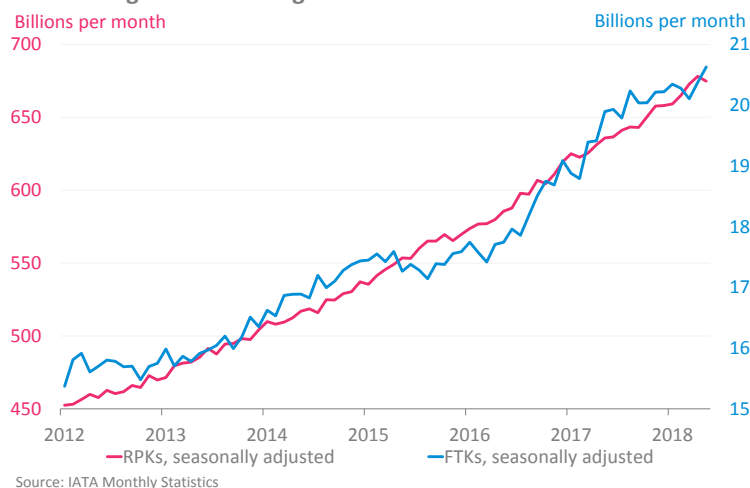


- ➔ Premium-class passengers accounted for 5.4% of total international origin-destination traffic in the first four months of 2018 – unchanged from the share seen in the same period of 2017.
- ➔ Premium passenger growth has continued to lag behind its economy counterpart on the two-largest premium markets in terms of revenue – the North Atlantic and Europe-Asia – albeit modestly. The underperformance has been more marked 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 and freight volumes are both trending upwards again

Air Passenger and Air Freight Volumes

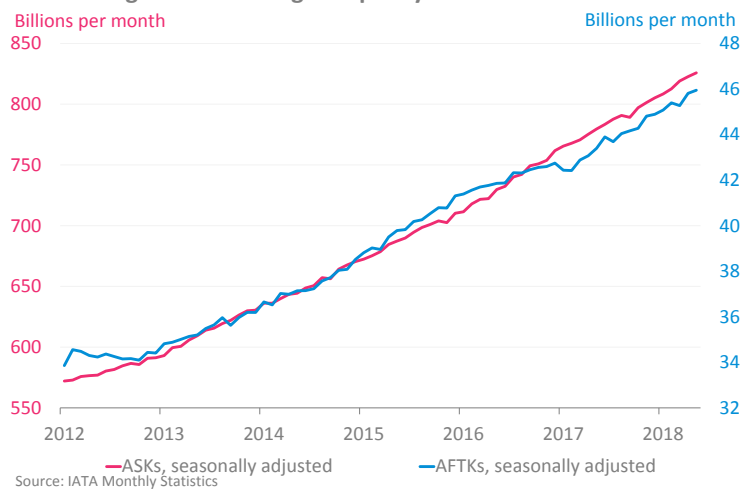


- ➔ Industry-wide revenue passenger kilometres (RPKs) grew by 6.1% year-on-year in May 2018 – up very slightly from 6.0% in April. RPKs fell by 0.5% in SA terms relative to April, which was the largest fall on this basis since November 2015. However, the bigger picture is that the upward trend in SA traffic remains robust coming into the peak period for demand during the summer.
- ➔ Year-on-year growth in industry-wide freight tonne kilometres (FTKs) slowed to 4.2% in May, from 5.2% in April. That said, SA FTKs increased in SA terms for the second month in a row, and FTKs are now broadly back in line with where they would have been had the moderate upward trend in late-2017 been sustained.

Capacity

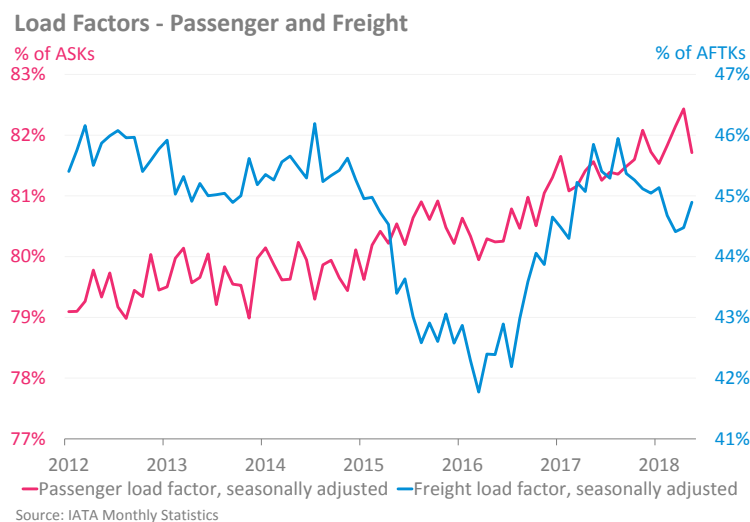
Freight and passenger capacity continue to trend upwards at a similar pace

Air Passenger and Air Freight Capacity



- ➔ Industry-wide available seat kilometres (ASKs) grew by 5.9% year-on-year in May. This was the 18th time in 19 months in which annual passenger capacity growth has lagged behind that of demand. The bigger picture is that passenger capacity and demand are currently trending upwards at a broadly similar pace.
- ➔ Meanwhile, available freight tonne kilometres (AFTKs) rose by 6.2% year-on-year in May 2018, broadly unchanged from 6.1% in the previous month. While FTKs have risen in the past two months (see above), freight capacity has continued to trend upwards at a slightly faster annualized pace than demand.

The trends in passenger and freight load factors have diverged since mid-2017



- The passenger load factor increased by 0.1 percentage points in May compared to a year ago, taking it above 80% in the month of May for the first time on record (80.1%). The load factor fell back in SA terms in May, but remains close to the record high reached in April. The rising passenger load factor is helping to boost unit revenues in the face of the sideways trend in yields.
- Meanwhile, although the load factor has picked up in SA terms in recent months, the industry-wide freight load factor fell by 0.9 percentage points compared to May 2017. The SA series remains around one percentage point lower than the recent peak reached in mid-2017.

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