

AIRLINES FINANCIAL MONITOR

KEY POINTS

April 2016 – May 2016

- ➔ Global airline share prices fell by 3.0% in May, and have now fallen by nearly 11% since the start of the year;
- ➔ However, the latest financial results continue to indicate a robust Q1 2016 for industry profitability;
- ➔ Brent crude oil prices broke through the \$50/bbl mark at the end of May, although the market still expects prices to remain at reasonably low levels for the foreseeable future (below \$55/bbl until mid-2018);
- ➔ Airfares have fallen by around 5% year-on-year in constant exchange rate terms in 2016 so far. But with oil prices up more than 80% since January, the stimulus to demand from lower airfares is likely to fade in H2 2016;
- ➔ Premium airfares continue to offer an important buffer for overall airline financial performance, and have held up better than their economy counterparts on many of the key premium routes so far this year;
- ➔ Disruption from the Brussels terrorist attacks weighed on annual growth in air passenger traffic in April, although the global market has made a robust start to 2016 this year to date;
- ➔ Annual growth in freight volumes jumped to 3.2% in April, as the one-off boost to air freight from disruption at US west coast seaports in Q1 2015 dropped out of the annual comparison. However, rising capacity and low freight loads are keeping intense pressure on cargo yields and revenues.

Financial indicators

Global airline share prices continue to underperform the wider equity market

Airline Share Prices

US\$ indices (Jan 2012=100)	Index May 31st	% change on		
		one month	one year	start of year
World airlines	157.3	-3.0%	-9.3%	-10.8%
Asia Pacific airlines	81.5	-5.2%	-18.4%	-7.2%
European airlines	215.9	-0.7%	+1.1%	-7.5%
North American airlines	320.4	-2.8%	-7.9%	-15.4%
FTSE All World \$	127.7	-0.2%	-7.2%	+0.9%

- ➔ Global airline share prices fell by 3.0% during May, and ended the month nearly 11% below their level at the start of the year. Asia Pacific airlines saw the biggest month-on-month fall (-5.2%), while North American and European carriers saw more modest declines (-2.8% and -0.7% respectively).

- ➔ Amid ongoing investor concerns about the impact of declining unit revenues on industry profitability, airline shares have now underperformed the wider equity market for three consecutive months. In fact, since the start of 2016, global airline shares have lagged behind the FTSE Global All Cap index by nearly 12%.



Source: Thomson Reuters Datastream

The latest financial results continue to indicate a robust Q1 2016 for industry profitability

Airline Financial Results

Number of airlines in sample*	Regions	Q1 2015		Q1 2016	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
16	North America	12.3%	2,946	15.1%	3,080
25	Asia-Pacific	6.4%	591	7.4%	865
14	Europe	-3.2%	-346	-1.9%	-935
6	Latin America	8.0%	-114	9.2%	438
4	Middle East	5.2%	1,256	8.7%	1,962
65	Sample total	5.9%	4,333	8.1%	5,410

- ➔ In spite of recent declines in airline share prices, the latest financial results continue to point to a robust start of the year for industry profitability. Net post-tax profits in Q1 2016 in our sample are around 25% above those seen in Q1 2015.

- ➔ The strongest financial results were once again posted by North American airlines (who are seeing improved free cash flows too). By contrast, as is usual in Q1, European airlines in our sample posted a modest operating loss, albeit smaller than a year ago.

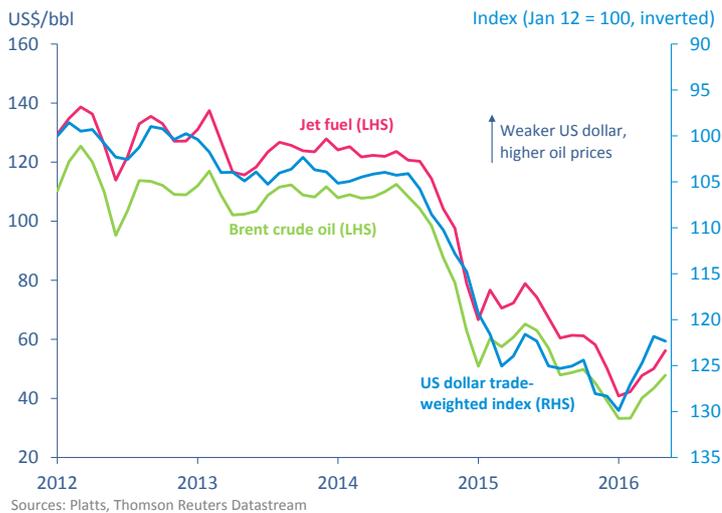
¹ % of revenues ² US\$ million

*Includes easyJet half-year results & Emirates annual results

Sources: The Airline Analyst, IATA

Fuel costs

Brent crude breaks through the US\$50/bbl mark, but the market is not expecting a surge anytime soon

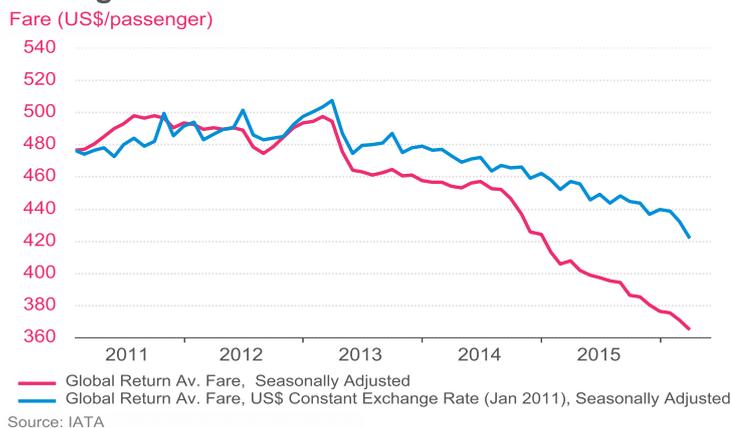


- ➔ Crude oil prices rose further during May, driven by a combination of short-term supply disruption and a weaker US dollar. The price of a barrel of Brent crude oil broke through US\$50/bbl at month-end for the first time since October 2015.
- ➔ To be clear, oil prices in May were still 27% lower than the same month in 2015. Moreover, the market still expects oil prices to remain at reasonably low levels for the foreseeable future (below US\$55/bbl until mid-2018 according to the latest forward curve). Nonetheless, the annual comparison is going to become less favorable over the coming months, with the year-on-year growth rate set to move back into positive territory in August.

Yields and premium revenues

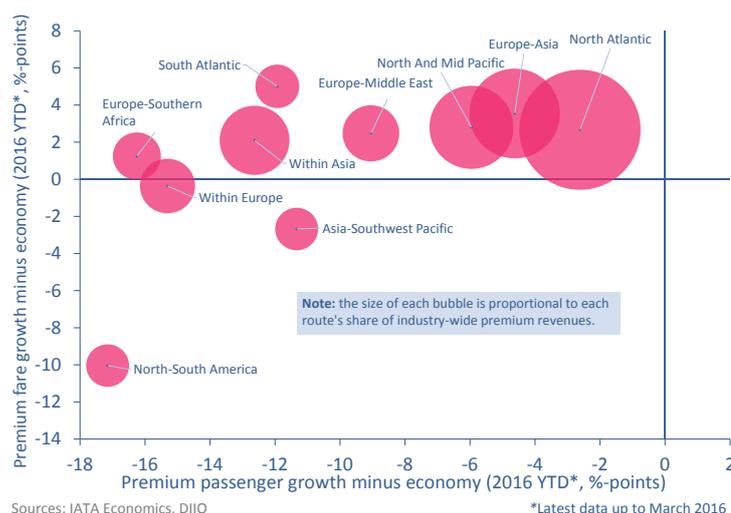
Falling fares, but the biggest stimulus to demand from oil prices appears to be behind us

Average Return Fare Worldwide



- ➔ Average global fares in reported US dollar terms (excluding taxes, fees and surcharges) have fallen by around 9% year-on-year so far this year (latest data to end-March). Adjusting for the impact of earlier gains in the dollar, we estimate that airfares fell by around 5% in constant exchange rate terms in early-2016. However, given the sharp fall in the dollar in recent months, the distortions caused by its prior strength will ease over the months ahead.
- ➔ Airfares are expected to decline further in the near future as prior declines in jet fuel prices feed through. That said, with oil prices now up more than 80% since their January low, the stimulus to demand from lower airfares is likely to fade in the second half of 2016.

Premium travel continues to offer a buffer for financial performance on key routes



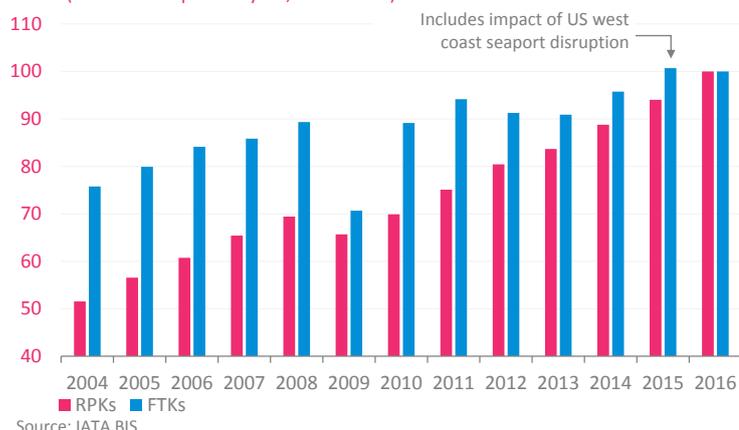
- ➔ Premium international passenger traffic has grown more slowly than its economy counterpart so far this year. O-D premium international journeys accounted for 5.6% of the total in Q1, down from 6.0% in the same period in 2015.
- ➔ That said, premium fares have held up better than those in economy on many of the key premium routes. In fact, premium's share of revenues has *increased* slightly on the key North Atlantic market (which accounted for 25% of industry-wide premium revenues in 2015). In the current environment of downward pressure on yields, the high-yielding premium segment offers an important buffer for overall airline financial performance.

Demand

Robust start to the year for passenger traffic, as freight growth recovers from the soft Q1

Air Passenger and Air Freight Volumes

Index (sum of Jan-Apr each year, 2016 = 100)



- ➔ Annual growth in global passenger traffic slowed to 4.6% in April – its slowest pace since January 2015. The decline was partly attributable to disruption following the Brussels terrorist attacks in March, although the global air passenger market has made a robust start to 2016 in year-on-year growth terms.
- ➔ Having been in negative territory in February and March, annual growth in industry-wide air freight volumes recovered to 3.2% in April. The pick-up reflected the one-off boost to air freight from seaport disruption on the US west coast in early 2015 dropping out of the annual comparison. That said, the wider global trade backdrop remains weak.

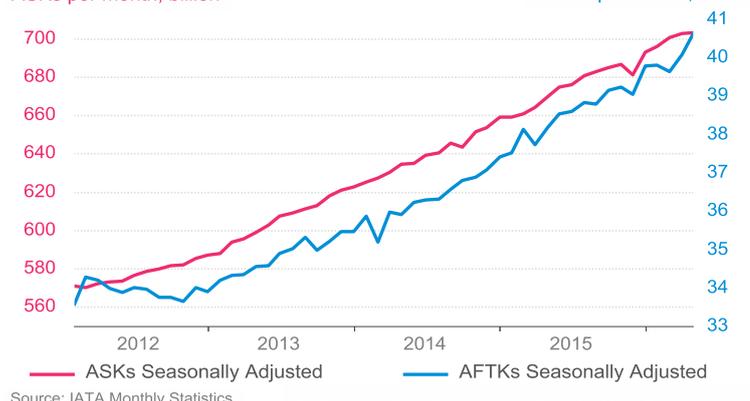
Capacity

Passenger and freight capacity continues to trend upwards

Total Passenger and Freight Capacity

ASKs per month, billion

AFTKs per month, billion

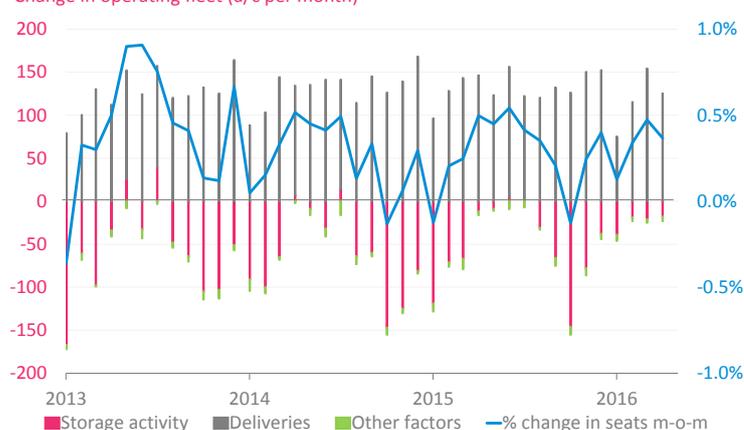


- ➔ Airlines have generally reacted to robust travel demand over the recent past by adding capacity cautiously. Growth in available seat kilometres slowed to 4.9% year-on-year in April, but it was the third consecutive month in which annual growth in passenger capacity exceeded that of passenger traffic.
- ➔ Industry-wide available freight capacity continued to expand strongly and to trend upwards in April. With ongoing impetus to freight belly capacity from additions to the passenger fleet, annual growth in industry-wide freight capacity has now outstripped annual growth in volumes for 14 consecutive months.

The trend of fewer aircraft going into storage continues, driven by lower oil prices

Airline Fleet Development

Change in operating fleet (a/c per month)

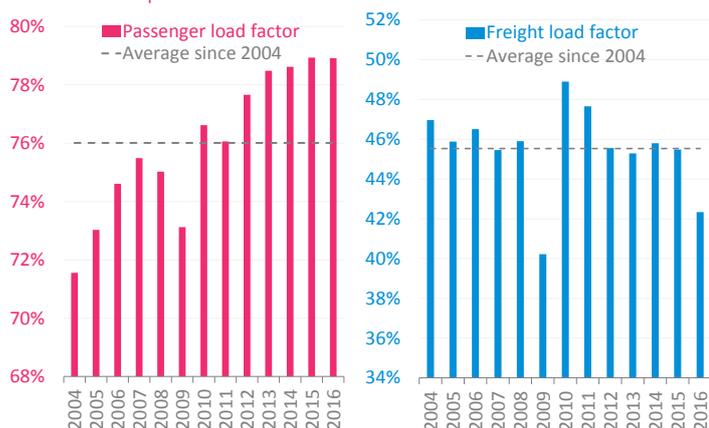


- ➔ The number of available seats in the global airline fleet increased by 0.4% in April compared to the previous month, and by 5.5% compared to April 2015.
- ➔ 125 new aircraft were delivered in April. Net storage activity made a small negative contribution to the fleet size. However, the general trend remains that of fewer aircraft going into storage, as lower oil prices and robust demand have made it economical to keep flying less fuel-efficient aircraft.

The divergence between passenger and freight load factors continues

Load Factors - Passenger and Freight

Combined Jan-Apr load factors over time



Source: IATA Monthly Statistics

- The passenger load factor in the first four months of 2016 combined came in at exactly the same (record) level as it was in Q1 2015. However, seasonally-adjusted loads have slipped in recent months. High achieved passenger loads have helped to support recent financial results, so we will continue to monitor as to whether this marks the start of a downward trend.
- The industry freight load factor has averaged 42.3% in the first four months of 2016 so far – well below the average level seen over the past decade or so and the lowest level since 2009. Low freight loads are keeping intense pressure on freight yields and revenues (an ongoing headwind for Asia Pacific carriers, for whom cargo is a key part of their business).

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