Airlines Financial Monitor

September-October 2019

Key points

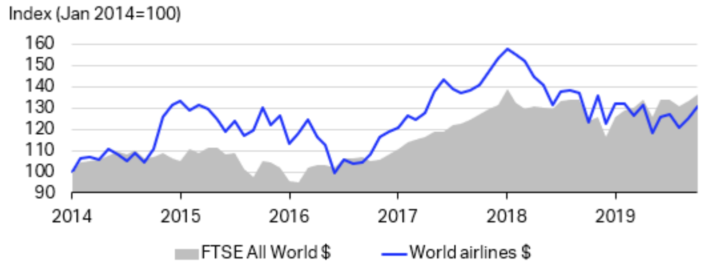
- The initial Q3 2019 airline financial data showed that the industry-wide financial performance improved on the back of a better performance in North America. On the other hand, profit margins moderated in both the Europe and Asia Pacific regions.
- The global airline share price index outperformed global equities with the support of European airlines in October but the year to date performance of the global airline index continues to lag the overall global equity market.
- Global passenger yields declined in September reflecting declines in both economy and premium class yields. Fuel prices remained relatively stable in October as expectations of softer global growth outweighs geopolitical risks.
- In seasonally adjusted terms, air passenger demand maintained its moderate growth trend while freight demand continued to decline. Both passenger and freight capacity expanded in September.

Financial indicators

Global airlines outperformed global equities in October, led by European airlines

Airline Share Prices

US$ indices (Jan 2014=100)	Index Oct 31st	% change on one month	one year	start of year
World airlines	**130.5**	**+4.2%**	**+6.0%**	**+6.4%**
Asia Pacific airlines	106.1	+3.8%	+0.0%	-4.3%
European airlines	99.2	+12.4%	-2.1%	-3.3%
North American airlines	168.8	+2.5%	+3.8%	+10.3%
FTSE All World $	**136.7**	**+2.7%**	**+10.3%**	**+17.2%**



Source: Thomson Reuters Datastream

- The global airline equity index continued its recent upward trend this month (+4.2%) with the lead of European airlines (+12.4%). However, the year-to-date performance still lags global equities (+6.4% vs +17.2%) due in part to a number of disruptive events that have impacted airlines throughout the year.
- The European airline index has risen in the last two months despite headwinds arising from airline collapses and strikes. The North American airline index, which has been the best performer so far this year, lagged the wider equity market this month, as initial 3Q19 results pointed to rising cost pressures. On the other hand, Asia Pacific airline shares rose as US-China trade talks raised investor optimism, coming despite disrupted operations in Hong Kong.

Improved profitability in Q3, but mainly due to the North American airlines

Airline Financial Results

Number of airlines in sample	Regions	Q3 2018 EBIT margin[1]	Q3 2018 Net post-tax profit[2]	Q3 2019 EBIT margin[1]	Q3 2019 Net post-tax profit[2]
11	North America	11.6%	4,155	13.5%	4,798
6	Asia-Pacific	13.4%	1,116	10.7%	898
5	Europe	19.0%	2,845	17.3%	2,299
4	Latin America	5.9%	-39	10.7%	68
2	Others	15.4%	55	16.7%	85
28	**Sample total**	**13.1%**	**8,132**	**13.7%**	**8,148**

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

- The initial releases of airline financial data for Q3 2019 indicate a moderate improvement in industry-wide profitability compared to the prior year but this is partly due to the over-representation of North American airlines in our current sample.
- Similar to the first half of the year, North America remains the strongest performer with the support of strong travel demand in the region. EBIT margins also improved compared to the prior year despite rising non-fuel costs. Having said that, margins both in Europe and Asia Pacific weakened compared to a year ago as unit revenues declined faster than unit costs.
- Looking forward, although fuel prices are at a manageable level for airlines, rising capacity in 2020 is expected to be a challenge for maintaining yields and therefore profitability.

Industry-wide free cash flow generation is lower compared to a year ago

Airline Cash Flow[1]

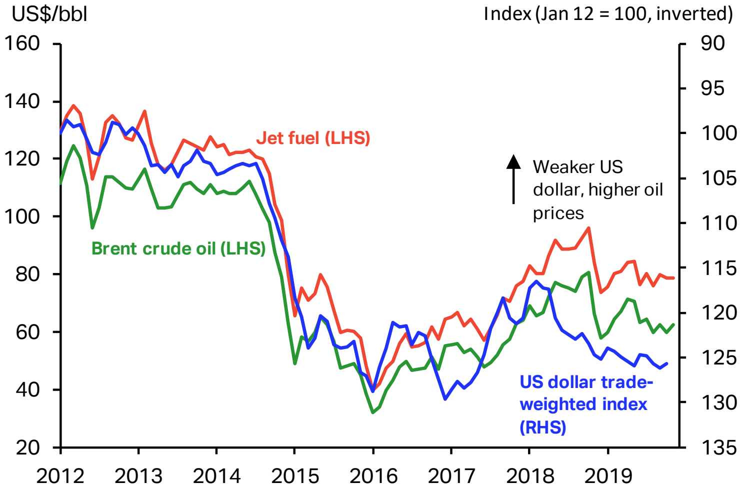
Number of airlines in sample	Regions	Q2 2018 Net cash flow[2]	Q2 2018 Capex	Q2 2018 Free cash flow	Q2 2019 Net cash flow[2]	Q2 2019 Capex	Q2 2019 Free cash flow
15	North America	19.8%	11.4%	8.4%	19.0%	10.3%	8.7%
29	Asia-Pacific	15.1%	14.6%	0.5%	12.0%	11.8%	0.2%
11	Europe	20.3%	13.7%	6.6%	16.1%	10.8%	5.3%
6	Latin America	8.6%	10.7%	-2.1%	5.6%	9.0%	-3.4%
3	Others	29.3%	24.6%	4.7%	30.0%	11.7%	18.3%
64	**Sample total**	**17.9%**	**13.0%**	**4.9%**	**15.5%**	**10.8%**	**4.7%**

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

- As our initial sample for 3Q2019 is too small to be representative, we reproduce the final sample of airlines for Q2 2019. This indicates that industry-wide free cash flow (FCF) generation is slightly lower compared to the same period a year ago. Although capital spending was lower in Q2 2019, free cash flow as a percentage of revenues declined to 4.7%, stemming from the fall in net cash flow from operations.
- North American airlines outperformed in terms of cash flow generation. Solid bottom-line results and lower capital spending resulted in improved free cash flow generation for the region. Similarly, for airlines in Asia Pacific, Europe and Latin America, the decline in capital spending was a balancing factor to limit the impact of weaker net income figures in Q2 2019. However, it was not enough to fully compensate for the lower cash flow generation in the FCF outcome.

Fuel costs

Brent oil and jet fuel price movements remain relatively muted

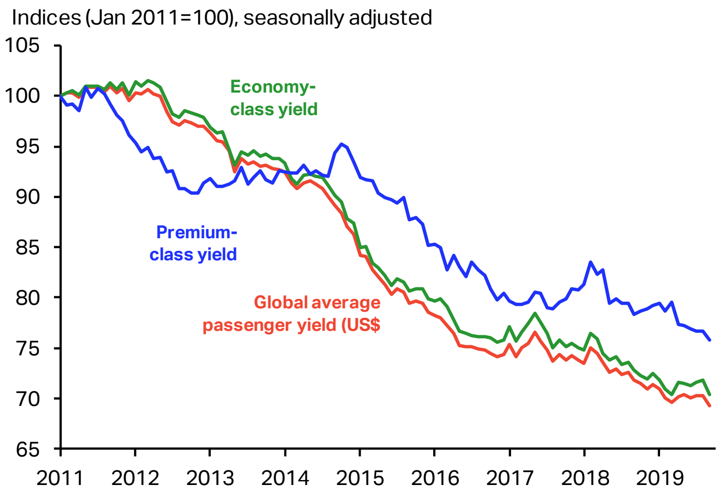


Sources: Platts, Thomson Reuters Datastream, as of November 14th

- Softening demand and relatively strong production figures continue to weigh on the global oil price offsetting production cuts by the OPEC+ group of countries helping to keep oil prices relatively stable.
- At the time of writing this report, the price of Brent crude oil hovers around US$62/bbl and the jet fuel price is at US$77/bbl.
- Looking forward, the U.S. Energy Information Administration and International Energy Agency both lowered their 2020 oil-demand forecasts last month. Escalation in geopolitical tensions is still a key risk factor on the supply side but a weaker global economic outlook is expected to weigh on oil prices in 2020.

Yields and premium revenues

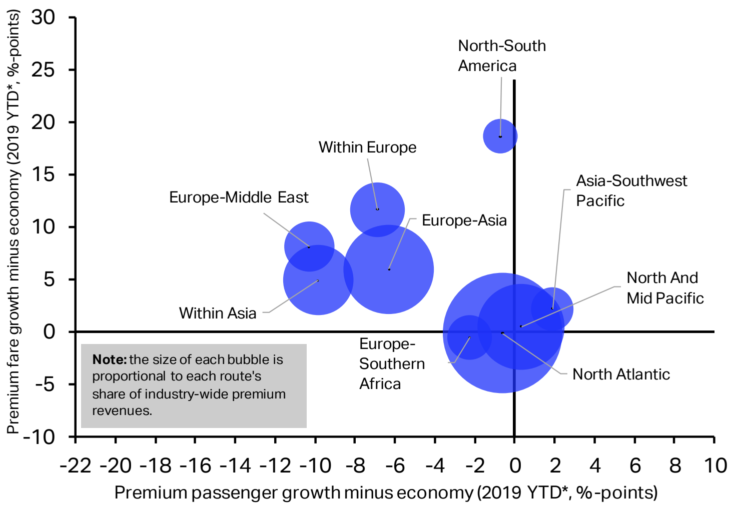
Global passenger yields decline, with both softer economy & premium cabin yields



Sources: IATA Economics, IATA Travel Intelligence

- Global passenger yields declined in September due to declines in both economy and premium class yields. Economy cabin yields fell by 1.4% compared to August, the largest monthly decline in the last 17 months. Premium yields fell by a more modest 0.9%. Note that the yield data are reported in US$ and exclude surcharges and the revenue that airlines generate from ancillary services.
- In the past year, the softer economic backdrop together with trade tensions has been putting downward pressure on yields. Global yields have fallen by ~4% compared to its level of a year ago. Looking ahead, slowing economic growth together with the planned capacity increases in some regions is likely to place further pressure on yields in the coming months.

International premium traffic and revenues are in line with that of a year ago



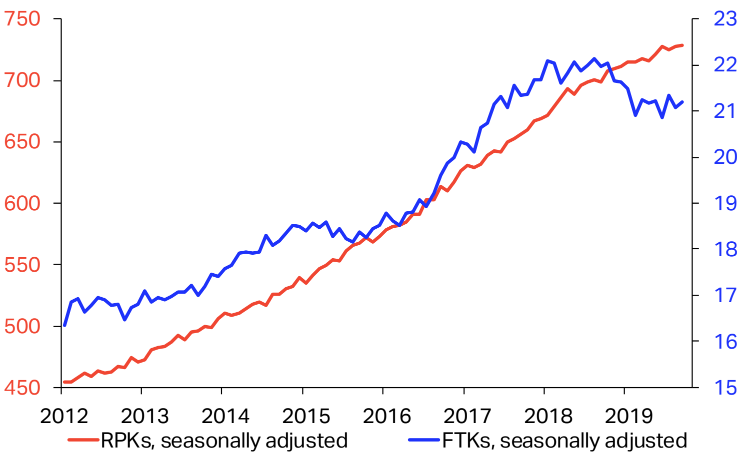
Sources: IATA Economics, DIIO *Up to August 2019

- Premium-class passengers accounted for 5.0% of total international origin-destination traffic in the first eight months of 2019. This proportion was marginally lower (down 0.1ppt) compared to the same period a year ago.
- In terms of revenue, premium-class passengers represented 30% of total international revenues over the first eight months of 2019, up half a percentage point on the outcome in 2018.
- Similar to July, premium passenger traffic grew faster than its economy counterpart only on Asia-Southwest Pacific and North and Mid Pacific international routes as global weakness in trade continues to weigh on business travel. The largest outperformance of premium fares (vs economy) has been in the North-South America and Within Europe markets.

Demand

Volumes moved sideways for passenger traffic and ticked up for freight

Air Passenger and Air Freight Volumes



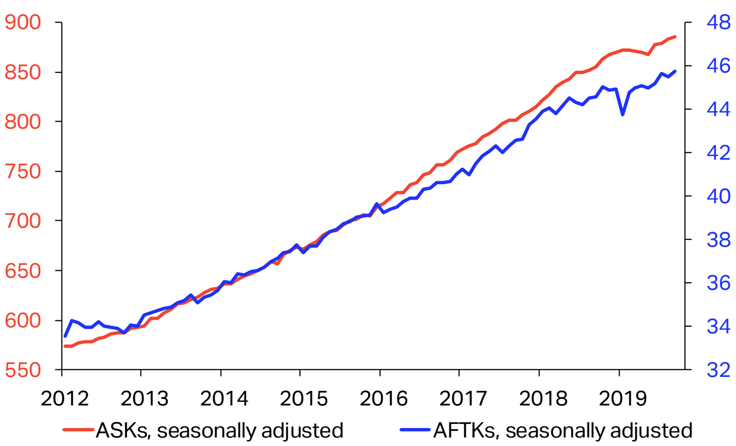
Source: IATA Monthly Statistics

- Seasonally adjusted (SA) revenue passenger kilometres (RPKs) trended sideways in September, following the moderate trend observed since Q2 2018. The weaker demand pace has been in line with slowing momentum in the global economy, declining world trade activity and various political and geopolitical tensions across regions.
- SA freight tonne kilometres (FTKs) lifted slightly on a month-on-month basis, sustaining the broadly flat trend in volumes that emerged after the sharp decline in late-2018 and early-2019. The global backdrop for air freight is still one of uncertainty.

Capacity

Both passenger and freight capacity increased in September

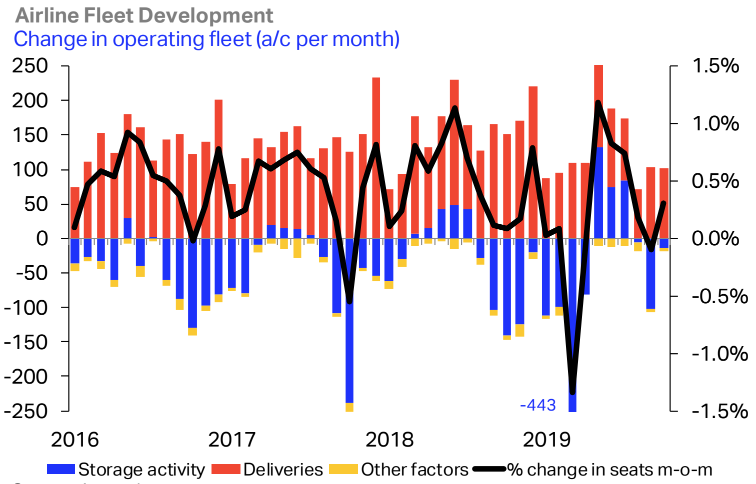
Air Passenger and Air Freight Capacity



Source: IATA Monthly Statistics

- SA industry-wide available seat kilometres (ASKs) increased for another month and are currently trending upwards at a 3.3% annualized rate over the third quarter. In year-on-year terms, capacity expanded at an equivalent rate (3.3%).
- Following a modest fall in August, SA available freight kilometres (AFTKs) picked up in September and are currently trending upwards at ~5% annualized rate over the past three months. In year-on-year terms, freight capacity rose by 2.1%.
- Capacity growth for both passenger and freight segments remains, on average, weaker compared to 2018 outcomes as airlines have been adjusting their operations to counter the weaker demand backdrop.

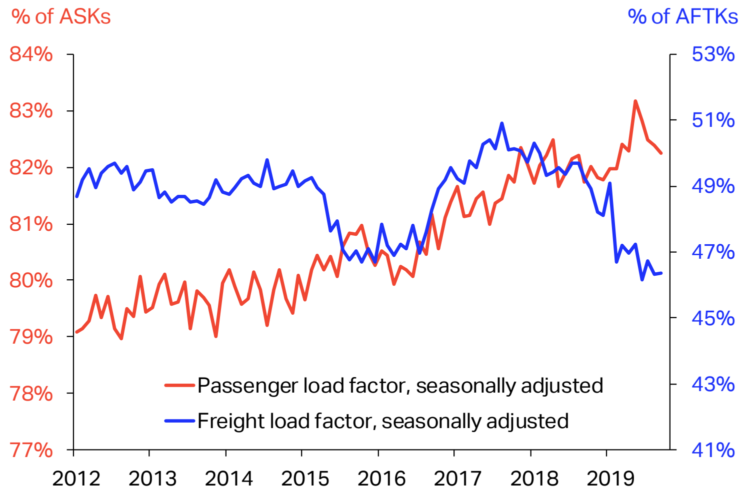
Recovery in seat capacity follows the plateau in September



Source: Ascend

- 101 aircraft were delivered in October, while only 14 returned to storage – the second lowest number this year. Consequently, month-on-month growth in the number of seats in the global airline fleet picked up to 0.3%, following a plateau in September.
- In annual terms, the number of seats expanded by 2.8%, a pace broadly in line with the outcomes observed over the past six months but well below the 2018 average (~5.5%).
- Overall, the number of aircraft delivered year-to-date (as of October) remains lower than that seen over the same period last year (1003 vs 1337). That said, the trend will likely reverse in 2020 as delayed Max 737 deliveries return.

Passenger load factor eased slightly while freight load factor ticked up



Source: IATA Monthly Statistics

- The seasonally adjusted passenger load factor softened to 82.3% in September, down from 82.4% in the previous month as capacity expanded slightly faster than demand, in month-on-month terms. That said, the bigger picture is that the passenger load factor remains high by historical standards.
- On the freight side, the load factor ticked up modestly this month to 46.4%. Despite that, the downward trend which emerged in mid-2017 remains firmly in place. Indeed, the load factor is currently almost 3ppt below the level observed in September 2018 and is one of the weakest outcomes recorded throughout 2019.

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