AIRLINES FINANCIAL MONITOR

KEY POINTS

SEPTEMBER – OCTOBER 2018

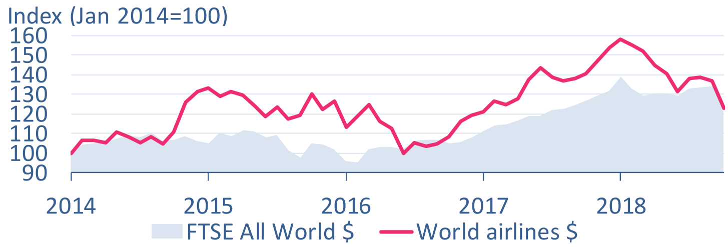
- The initial airline financial releases for Q3 2018 indicate that the squeeze on profit margins from higher input costs persisted into the quarter, and point to a modest decline in free cash flow generation relative to Q3 2017 as well.
- Global airline share prices fell by 10.1% in October – the biggest monthly decline since June 2016. Investor concerns over the impact of rising costs on industry profitability mean that the global airline share price index has underperformed the wider equity market by some margin since start-2018.
- Oil and jet fuel prices both reached four-year highs during October, but have fallen back sharply since. At the time of writing, the Brent crude benchmark is around 20% lower than its early-October peak at around US$69/bbl.
- Global passenger yields have continued to edge higher in recent months (recall that our series covers base fares only). The premium cabin has provided a useful buffer for airline financial performance over the past year or so.
- The industry-wide passenger load factor remains elevated by historical standards, although passenger demand momentum weakened in Q3. Meanwhile, although the upward trend in freight demand remains moderate, cargo yields are still holding up.

Financial indicators

Global airline shares fell sharply in October, underperforming the wider equity market again

Airline Share Prices

US$ indices (Jan 2014=100)	Index Oct 31st	% change on one month	% change on one year	% change on start of year
World airlines	**123.2**	**-10.1%**	**-12.4%**	**-19.8%**
Asia Pacific airlines	106.1	-8.2%	-12.3%	-18.6%
European airlines	101.3	-12.5%	-26.4%	-29.9%
North American airlines	162.6	-11.5%	+1.0%	-12.1%
FTSE All World $	**124.0**	**-7.6%**	**-2.5%**	**-5.7%**



Source: Thomson Reuters Datastream

- Global airline share prices fell by 10.1% in October – their biggest monthly decline since June 2016 – alongside a wider fall in global equities.
- All three regional airline sub-indices fell during the month, led by declines in Europe and North America (-12.5% and -11.5%, respectively). The Asia Pacific index fell by 8.2% over the course of the month.
- The global airline share price index has now fallen by 19.8% since the start of 2018, and by 12.4% relative to a year ago. The underperformance of airline shares relative to global equities over both periods reflects investor concerns about the impact of rising costs on airline financial performance.

Initial airline financial results from Q3 2018 point to an ongoing squeeze on margins

Airline Financial Results

Number of airlines in sample	Regions	Q3 2017 EBIT margin[1]	Q3 2017 Net post-tax profit[2]	Q3 2018 EBIT margin[1]	Q3 2018 Net post-tax profit[2]
12	North America	14.7%	4,968	11.6%	4,144
4	Asia-Pacific	17.4%	1,209	13.5%	914
8	Europe	19.0%	4,912	16.6%	4,901
3	Latin America	9.8%	81	1.4%	-27
27	**Sample total**	**16.5%**	**11,170**	**13.5%**	**9,932**

[1] *% of revenues* [2] *US$ million*

Sources: The Airline Analyst, IATA

- The initial airline financial data for Q3 2018 indicate that the squeeze on airline profit margins that was evident earlier in the year continued into the quarter. The EBIT margin for our sample of 27 airlines fell to 13.5% of revenues in Q3 2018, from 16.5% a year ago, while net post-tax profits were also around $1.2bn lower.
- European airlines posted the widest margin (16.6%) during the key period of demand over the northern hemisphere summer. Nonetheless, upward pressure on operating costs contributed to a broad-based decline in the EBIT margin in all regions relative to Q3 2017.

Modest decline in industry free cash flow generation relative to Q3 2017

Airline Cash Flow[1]

Number of airlines in sample	Regions	Q3 2017 Net cash flow[2]	Q3 2017 Capex	Q3 2017 Free cash flow	Q3 2018 Net cash flow[2]	Q3 2018 Capex	Q3 2018 Free cash flow
13	North America	9.9%	11.5%	-1.6%	9.1%	8.7%	0.4%
7	Europe	9.6%	8.1%	1.5%	6.3%	8.8%	-2.6%
2	Latin America	2.6%	5.3%	-2.7%	-8.3%	5.4%	-13.7%
22	**Sample total**	**9.7%**	**10.2%**	**-0.5%**	**7.8%**	**8.7%**	**-0.9%**

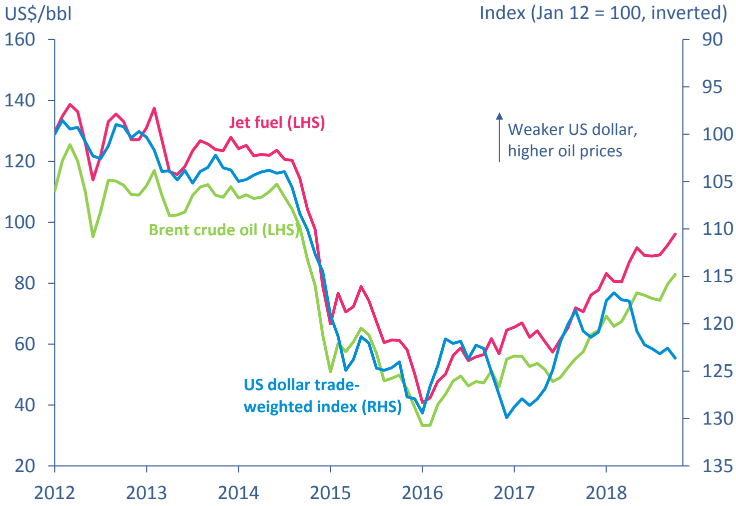
[1] % of revenues *[2] From operating activities*

Sources: The Airline Analyst, IATA

- The initial sample of 22 airlines reporting cash flow data from Q3 2018 also shows a modest deterioration in industry-wide net and free cash flow compared to the same period a year ago.
- In aggregate, airlines in our sample saw free cash flow decline to -0.9% of revenues in Q3 2018, from -0.5% a year ago. This was driven by a 1.9pp reduction in net cash flow generation, offset in large part by a decline in capex over the period.
- Regional performance varied, with North America the only group to post positive free cash flow generation in the quarter. That said, it is still early days, and a clearer picture will become available as more airlines report over the coming months.

Fuel costs

Oil and jet fuel prices reached four-year highs in October but have fallen back sharply since

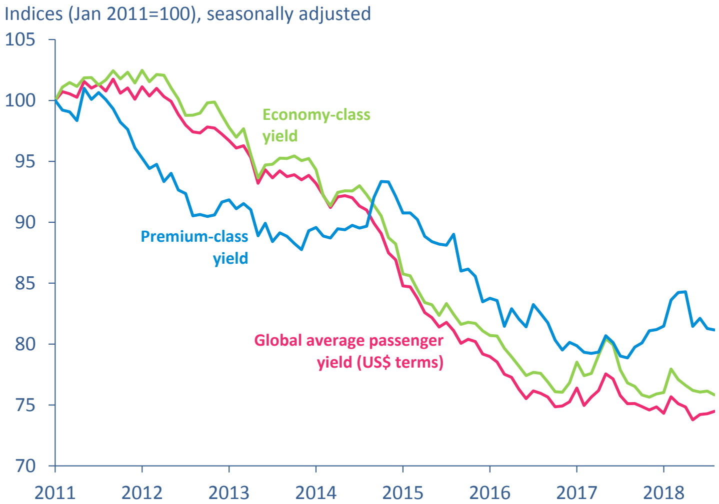


Sources: Platts, Thomson Reuters Datastream

- Crude oil and jet fuel prices rose to their highest levels in around four years in October, driven in large part by concerns about the impact of US sanctions on Iran on global supply.
- That said, oil prices have fallen back sharply since, as the market has reassessed near-term supply/demand dynamics. Indeed, oil markets posted their longest ever losing streak in early-November, with the Brent crude benchmark price falling for 10 out of 11 trading sessions.
- At the time of writing, Brent is around 20% lower than its early-October peak at around US$69/bbl. To be clear, this is still around 8% higher than it stood a year ago. Nonetheless, there has been a big turnaround from the >50% annual growth rates seen just a month ago.

Yields and premium revenues

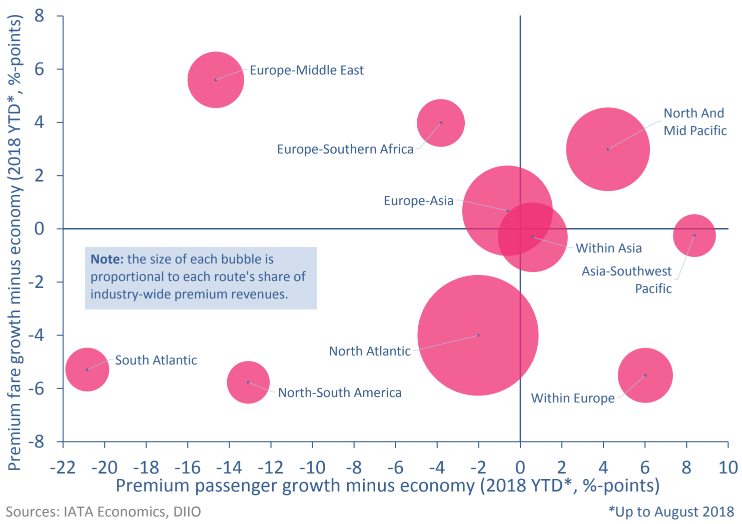
Divergence between premium and economy-cabin passenger yields has persisted



Sources: IATA Economics, IATA Travel Intelligence

- Global passenger yields in US dollar terms have continued to move a little higher in recent months, as airlines try to offset some of the pressure from rising input costs through revenues.
- The gap between the premium and economy cabin yields – which started to widen around the middle of 2017 – has persisted in the latest monthly data. Yields in the premium cabin are around 3% higher than a year ago.
- Recall that the data in our chart reflect developments in the 'base' airfare only and exclude revenue that airlines generate from surcharges and ancillary services.

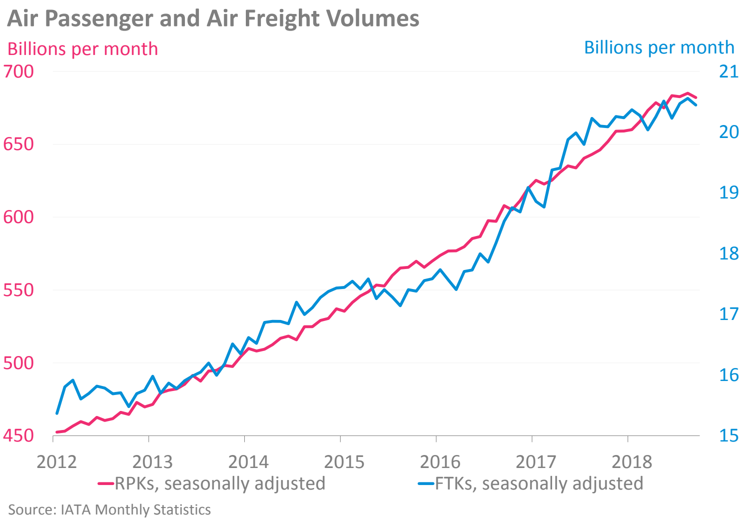
International premium traffic and revenue shares remain stable over the year-to-date



- Premium-class passengers accounted for 5.1% of total international origin-destination traffic in the first eight months of 2018. This proportion was unchanged from the same period a year ago.
- In terms of revenue, premium-class passengers accounted for 29.6% of total passenger revenues over the first eight months of 2018, broadly unchanged from the outcome for the same period a year ago.
- As we have noted before, premium passenger demand has grown faster than its economy counterpart this year to date most visibly on the Asia-Southwest Pacific and Within Europe markets. The largest outperformance of premium fares relative to economy has been in the Europe-Middle East market.

Demand

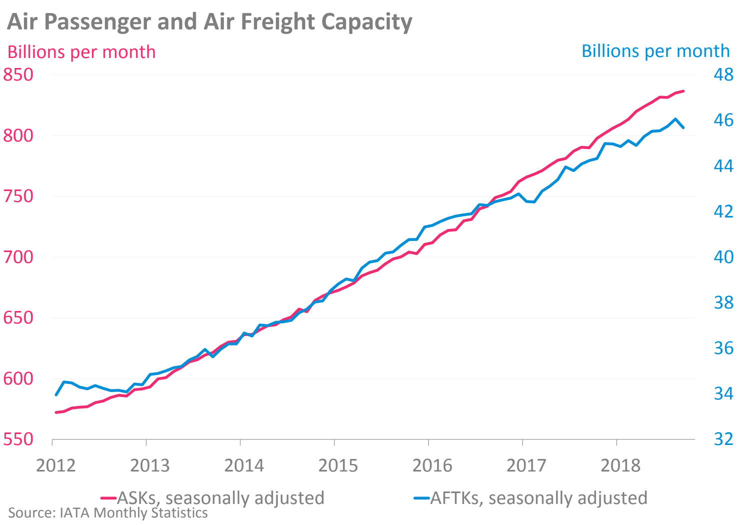
Passenger demand momentum has weakened, alongside ongoing modest freight trend



- Year-on-year growth in industry-wide revenue passenger kilometres (RPKs) slowed to an eight-month low of 5.5% in September.
- The slowdown in RPK growth from 6.4% in August may partly reflect weather-related disruption – particularly Typhoon Jebi in Japan. Nonetheless, it is important to note that the upward trend in seasonally adjusted (SA) traffic has moderated over the course of Q3.
- Meanwhile, industry-wide FTKs increased by 2.0% year-on-year in September, and by the same pace in the third quarter as a whole. As we have argued before, the current period of slower growth is typical with the pattern normally seen after inventory-led upturns in the past.

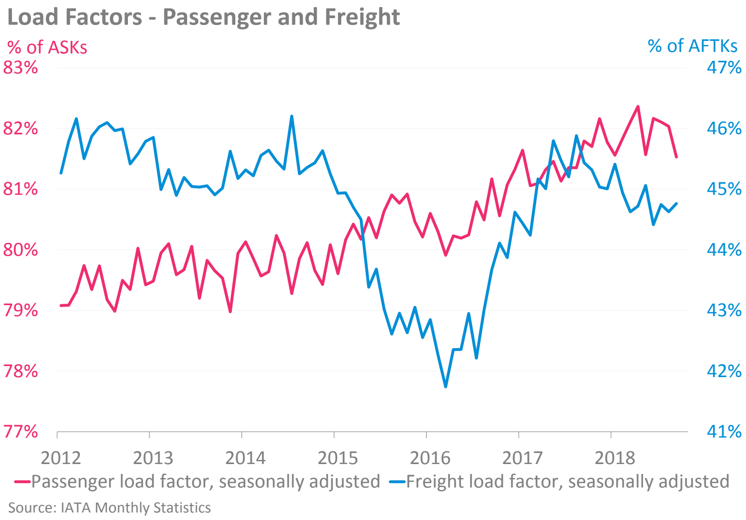
Capacity

Capacity currently outpacing demand for passengers, but now broadly in line for freight



- Industry-wide available seat kilometres (ASKs) grew by 5.8% year-on-year in September.
- Passenger demand is continuing to trend upwards in seasonally adjusted terms at a slightly faster rate than capacity.
- As for freight, available freight tonne kilometres (AFTKs) grew by 3.2% year-on-year in September, and by 3.9% in Q3 as a whole. Annual growth in freight capacity has now outpaced that of demand for seven consecutive months.

Air passenger and freight load factors have diverged over the past year



- The industry-wide passenger load factor fell in annual terms in September for the first time in eight months (by 0.3 percentage point relative to the record-September high that was recorded last year).
- In SA terms (as show on the chart), the load factor remains elevated albeit slightly below the record highs seen in early-2018.
- For freight, faster capacity growth compared to demand saw the industry-wide load factor fall by 0.5 percentage point compared to September 2017.
- That said, capacity and demand are now both currently trending upwards in SA terms at a similar pace, and freight yields still look to be holding up.

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14th November 2018

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