Airlines Financial Monitor

July-August 2020

Key points

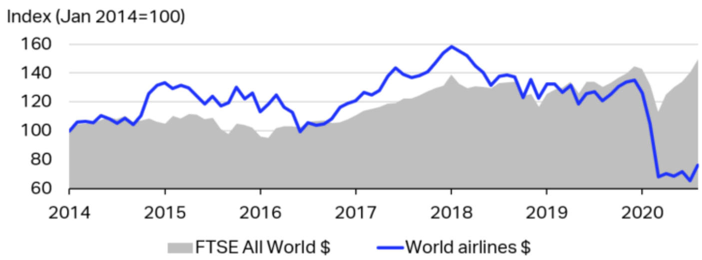
- The latest second quarter financial data confirmed that the airline industry had its worst quarterly financial performance. Although airlines took steps to limit their losses by taking cost cutting measures and focusing on cargo business as an additional source of revenue, operating losses increased sharply resulting in a substantial drain on cash.
- The world airlines share price index rose in August, but is still over 40% down on the year so far. Its monthly performance outpaced wider equity markets for the first time since the beginning of the pandemic amidst positive news related to quick COVID-19 testing and vaccine development.
- Oil and jet fuel prices prices rebounded recently with the supply disruptions but the outlook for global oil demand is still fragile indicating the recent rally in prices could be temporary. Fuel prices are still substantially lower than last year.
- Both passenger and cargo demand continued their gradual recovery in August. However, the pace of recovery in passenger demand lagged the rise in seat capacity, likely increasing cash burn of airlines. Restarting the network in response to weak and varying travel demand patterns continues to be a challenge for airlines.

Financial indicators

Airline shares rose in August outpacing wider equity markets

Airline Share Prices

US$ indices (Jan 2014=100)	Index Aug 31st	% change on one month	one year	start of year
World airlines	**76.3**	**+16.3%**	**-36.9%**	**-43.6%**
Asia Pacific airlines	69.7	+12.9%	-32.0%	-36.6%
European airlines	66.5	+15.6%	-18.3%	-41.2%
North American airlines	91.2	+19.9%	-43.3%	-45.6%
FTSE All World $	**149.3**	**+6.1%**	**+14.4%**	**+3.3%**



Source: Thomson Reuters Datastream

- Airline shares have been under pressure since the beginning of COVID-19 crisis, as air travel is among the hardest hit industries by the pandemic. Airline stocks have not recovered in line with wider equity markets (year-to-date performance -43.6% vs +3.3%) even after the restart of the industry, as new quarantine measures and rising covid cases in some regions prevented the recovery of air travel demand.
- However, the month of August was an exception. Airline stocks rose in all regions, outperforming wider equity markets. This was mainly stemming from the news related to a possibility of quick COVID-19 testing and an optimism regarding early development of vaccine. North American airlines were the best performer among all regions as the possibility of additional governmental financial support supported airline stocks in this region. Looking forward, the recovery path of travel demand and the ability of the industry to adjust to this will determine the course of airline shares.

Airlines losses rose substantially in Q2

Airline Financial Results

Number of airlines in sample	Regions	Q2 2019 EBIT margin[1]	Q2 2019 Net post-tax profit[2]	Q2 2020 EBIT margin[1]	Q2 2020 Net post-tax profit[2]
15	North America	13.7%	4,967	-198%	-12,648
31	Asia-Pacific	8.3%	2,380	-39%	-6,514
11	Europe	8.2%	1,745	-113%	-8,637
8	Latin America	4.2%	-342	-229%	-3,449
5	Others	6.6%	38	-49%	-310
70	**Sample total**	**10.0%**	**8,788**	**-97%**	**-31,558**

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

Sources: The Airline Analyst, IATA

- The latest sample (71% of global RPKs) of Q2 financials confirmed the severe impact of the pandemic on airline industry. The quarterly net post-tax loss surpassed the annual industry-wide loss in 2008 financial crisis.
- Losses were widespread across regions despite the implementation of stringent cost cutting programs.The North America region reported the largest net loss. On slightly positive news, some Asia Pacific airlines turned to profitability after posting large losses in Q1 by reorganizing their cargo business and benefiting from high cargo yields. However, the sustainability of this source of income is uncertain since cargo yields would ease as competitor airlines are also shifting their focus on cargo business.

Strong cargo revenues partially compensates the loss in passenger revenues

Airline Revenues

Number of airlines in sample	Regions	Q2 2020 vs Q2 2019 (Year-on-year change)		
		Passenger Revenues*	Cargo Revenues*	Total Revenues
15	North America	-91%	1%	-85%
29	Asia Pacific	-76%	48%	-63%
11	Europe	-95%	30%	-85%
8	Latin America	-95%	11%	-85%
3	Middle East	-97%	17%	-80%
66	**Sample total**	**-89%**	**32%**	**-79%**

* Included in the sample if reported
Sources: The Airline Analyst, IATA

- Airlines in all regions reported sharp decline in passenger revenues as the groundings affected whole industry in Q2. Passenger revenues in our sample of airlines declined year-on year by 89% in Q2 2020. Asia-Pacific airlines performed relatively better than other regions with the support of recovery in China domestic market.
- On the other hand, cargo revenues were strong as demand for time sensitive shipments was alive. Carriers in some regions converted passenger aircrafts to cargo aircraft to benefit from this. However, this was not enough to compensate the decline in the belly capacity and yields remained high.

Airline Operating Costs

Number of airlines in sample	Regions	Operating Costs* Q2 2020 vs Q2 2019 (Year-on-year change)				
		Fuel	Employee	Maintenance & Engineering	Landing fees & user charges	Selling & distribution
15	North America	-86%	-27%	-58%	-54%	-89%
29	Asia Pacific	-70%	-15%	-39%	-57%	-70%
11	Europe	-91%	-50%	-60%	-85%	-85%
8	Latin America	-90%	-58%	-11%	-75%	-78%
63	**Sample total**	**-85%**	**-34%**	**-54%**	**-73%**	**-83%**

*Sub categories are included in the sample if reported
Sources: The Airline Analyst, IATA

- Airlines focused on cutting operating costs in this unusual business environment. As the decline in fuel expenses and other variable costs were not enough to offset the revenue loss, airlines took initiatives to reduce labor costs and discretionary spending. Airlines also took various measures such as employee voluntary unpaid leaves to reduce employee costs, but overall year-on- year decline in operating costs was limited to 52% vs 79% decline in operating revenues.

Industry-wide free cash outflow in Q2 2020

Airline Cash Flow[1]

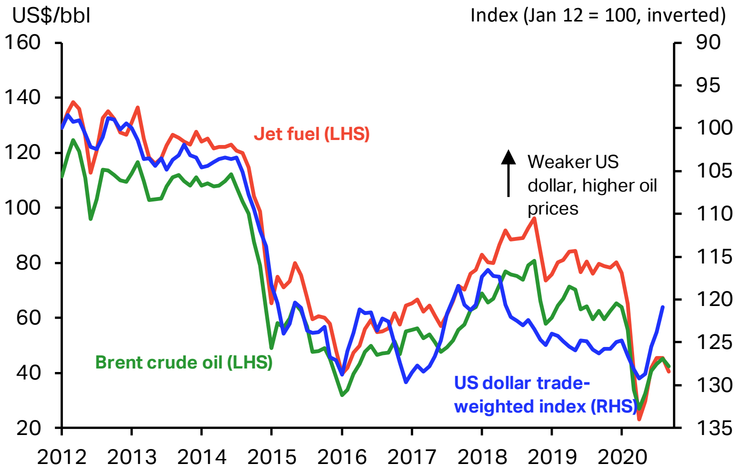
Number of airlines in sample	Regions	Q2 2019			Q2 2020		
		Net cash flow[2]	Capex	Free cash flow	Net cash flow[2]	Capex	Free cash flow
13	North America	17.3%	10.4%	6.9%	-23.1%	18.7%	-41.8%
26	Asia-Pacific	11.7%	8.9%	2.7%	-29.5%	16.0%	-45.5%
8	Europe	11.3%	10.4%	0.9%	-63.1%	20.0%	-83.1%
5	Latin America	7.8%	9.1%	-1.3%	-19.4%	24.2%	-43.6%
5	Others	18.0%	12.0%	6.0%	-25.8%	6.8%	-32.6%
57	**Sample total**	**13.4%**	**9.9%**	**3.5%**	**-34.5%**	**17.6%**	**-52.1%**

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

- Our latest Q2 2020 sample shows that the industry-wide net cash outflow from operating activities accelerated (35% of revenues).
- Airlines in all regions limited their capital expenditures by deferring aircraft deliveries and cancelling capital spending projects. However, capital expenditures increased to c. 18% of revenues due the sharp fall in revenues. As a result, free cash outflow increased to 52% of revenues which indicates cash raised so far from governments and capital markets could be depleted quickly if outflow continue at this pace.

Fuel costs

Jet fuel and crude oil price stable in August

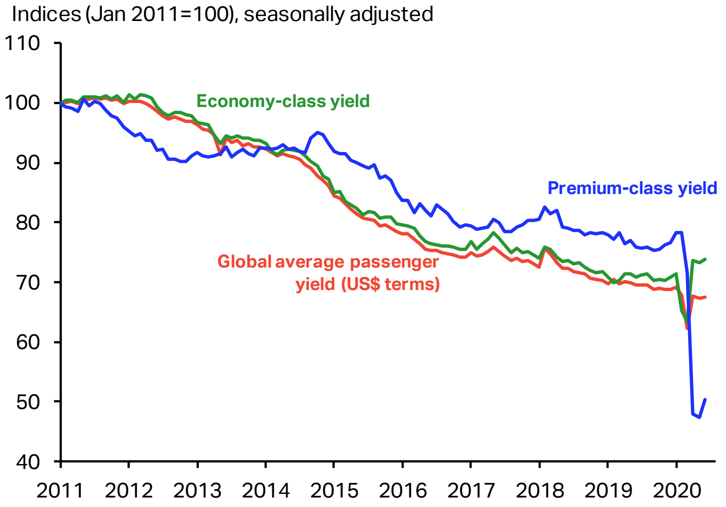


Sources: Platts, Thomson Reuters Datastream, as of September 17th

- Oil and jet fuel prices were stable in August and declined slightly at the beginning of September due to the concerns regarding oil demand. However, prices have rebounded recently with the supply disruptions. At the time of writing, both Brent crude oil and the jet fuel price were US$42/bbl and US$40/bbl, respectively.
- Looking forward, the outlook for global oil demand is still fragile in the wake of pandemic indicating the recent rally in prices with supply concerns could be temporary. Indeed, OPEC revised its global oil demand outlook for 2020 downwards to 90.2 million barrels per day, down 400 thousand barrels per day from the previous month’s estimate and indicates year-on-year contraction of 9.5 million barrels per day.

Global Yields

Global base passenger yields weakened in annual terms



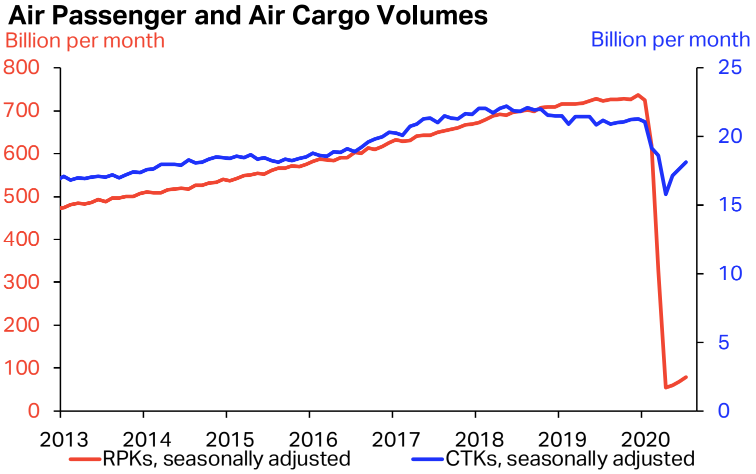
Sources: IATA Economics, DDS

- Global base passenger yields (in US$, excluding surcharges and ancillary revenues) rose slightly (0.1% month-on-month) in June as demand recovered slowly following the re-opening of air travel with the lifting of border restrictions.
- Although the yield data during the lockdown period should be interpreted with caution due to the dramatic fall in tickets being sold, the decline in premium yields was sharper than for the economy cabin. Economy class yields trended upwards following the initial fall with the support of repatriation flights and last minute bookings. However, global average passenger yields in US$ terms were still 3.0% below their level a year ago.

Demand

Gradual recovery in passenger and cargo demand continued

Air Passenger and Air Cargo Volumes



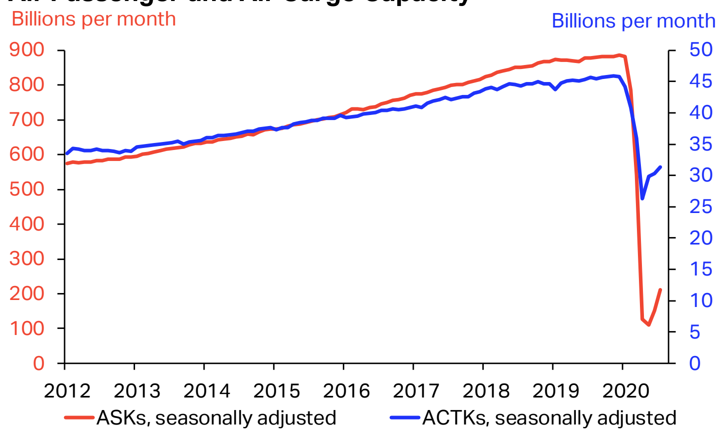
Source: IATA Monthly Statistics

- Air travel demand continued to recover in July driven by the improvement in large domestic markets and within Europe routes. While seasonally adjusted RPKs picked up for the third consecutive month, in year-on-year terms improvement is gradual. Passenger demand decline year-on-year by 79.8% in July vs. 86.6% fall in the previous month.
- Air cargo demand improved (2.6% month-on-month) for another month similar to the pace seen in the previous month. Improvement in manufacturing activity supports air cargo demand. However, the improvement in air cargo is weaker than expected due to capacity shortage. CTKs were down 13.5% in July compared with the same period of previous year.

Capacity

Both passenger and cargo capacity also picked up in June

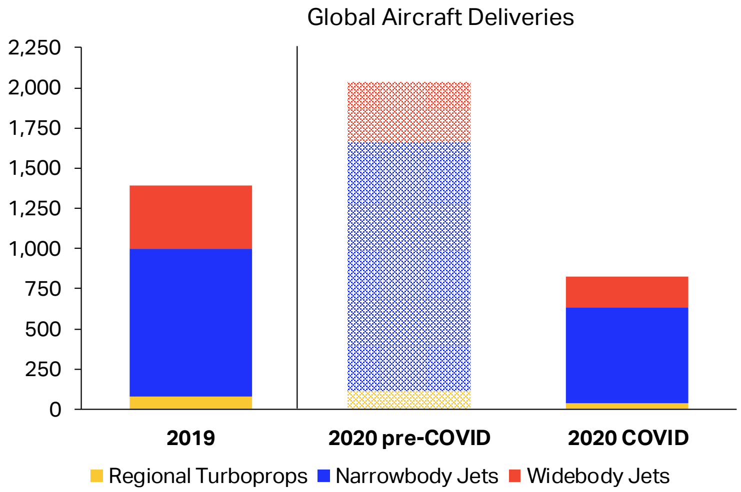
Air Passenger and Air Cargo Capacity



Source: IATA Monthly Statistics

- Passenger capacity continued to improve in July as airlines add more capacity in domestic and intra-Europe markets. Industry-wide available seat kilometres declined year-on-year by 70.1% , substantial improvement compared to 80.1% decline in June. The equivalent seasonally adjusted volumes trended upwards, as well.
- Air cargo capacity posted 3.2% month-on-month growth in July as the capacity crunch resulting from the lack of belly cargo capacity was still present. Industry-wide available cargo tonne-kilometres were down year-on-year by 31.2% modest improvement compared to the previous month.

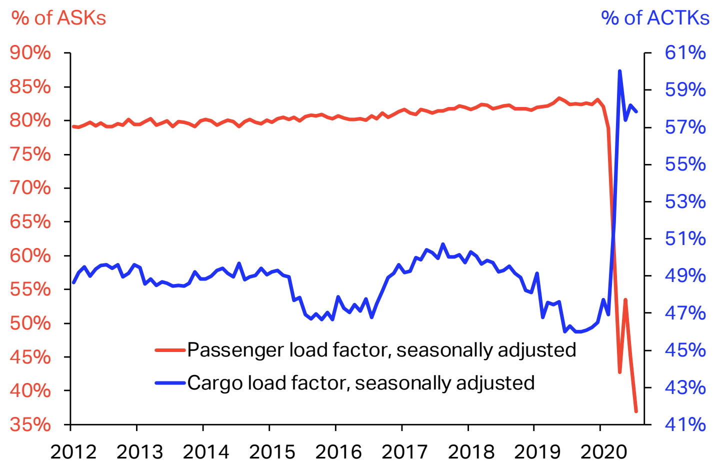
Airlines have been deferring aircraft deliveries for 2020 to limit cash burn



Source: ASCEND

- Airlines have been negotiating with manufacturers to defer their aircraft deliveries for this year to reduce cash burn amidst still weak air travel demand. In January, carriers had scheduled delivery of approximately 2,000 new aircraft for 2020. Eight months later, the number of deliveries plunged by almost 60%, to ~830.
- Overall, there was about 22,300 commercial fleet in service at the and of August, up ~8,600 from the through in April but still significantly below the 2019 average (28,900). About 30% of commercial aircraft still remains in the storage.

Passenger and cargo load factors trend sideways



Source: IATA Monthly Statistics

- The industry-wide seasonally adjusted (SA) passenger load factor fell to record low level as the recovery in passenger demand lagged behind the improvement in capacity. Although airlines are trying to stimulate demand by cutting fares, improvement in passenger confidence will be crucial for demand revival.
- On the cargo side, the SA industry-wide load factor remained close to record high levels (down 0.2ppts vs. June), confirming a significant lack of cargo capacity available in the market. Looking forward, the load factors are expected to ease as airlines bring their passenger fleet back to service, increasing available belly capacity.

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