Airlines Financial Monitor

October- November 2020

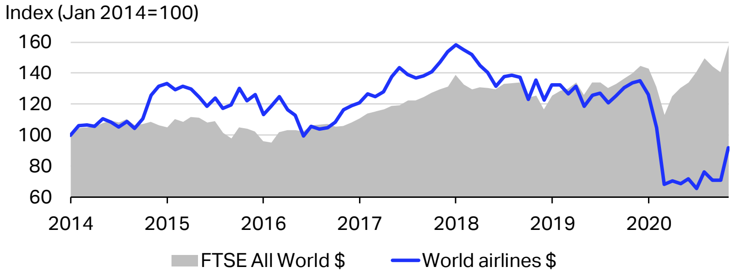
Key points

- The latest third quarter financial data confirmed that the negative impact of COVID-19 continue to weigh on airline industry financial performance. Although air travel reopened in the third quarter, this was not reflected in financial results as the recovery in travel demand was limited.
- The global airline share price index rallied in November following positive news about vaccine developments. Looking forward, this news is positive for future air travel demand. However, airlines will continue to suffer from modest demand and covid-related travel restrictions until vaccines become widely available and they are expected to burn through cash in 2021.
- Oil and jet fuel prices went up in December on the back of vaccine news and stronger demand in Asia. However, the near-term outlook for global jet fuel demand is uncertain as governments are inclined to keep travel restrictions in place.
- The recovery in demand continued for both passenger and cargo markets in October. That said, passenger volumes are pressured by renewed COVID-19 outbreaks, while air cargo drivers remained strong.

Airline shares soared with vaccine news

Airline Share Prices

US$ indices (Jan 2014=100)	Index Nov 30th	% change on one month	one year	start of year
World airlines	**91.8**	**+29.7%**	**-31.4%**	**-32.2%**
Asia Pacific airlines	79.4	+20.9%	-25.8%	-27.8%
European airlines	77.8	+44.5%	-27.1%	-31.3%
North American airlines	113.9	+26.1%	-33.7%	-32.1%
FTSE All World $	**157.9**	**+12.3%**	**+12.9%**	**+9.2%**



Source: Thomson Reuters Datastream

- Airline shares rallied in November following positive news about vaccine developments. Global airline share price index went up by almost 30% month-on-month, outperforming wider equity index more than twice.
- European carriers share prices increased the most in November despite the resurgence of the virus and new lockdown measures. News regarding COVID-19 vaccines being ready to be rolled out in Europe were reflected positively in European airline shares. Similarly, in North America and Asia-Pacific, airline shares experienced robust monthly performance with vaccine developments. Nevertheless, the outlook for 2021 remains uncertain as the distribution of vaccine will be a key challenge going forward.

Airline industry continue to report deep losses in Q3 2020

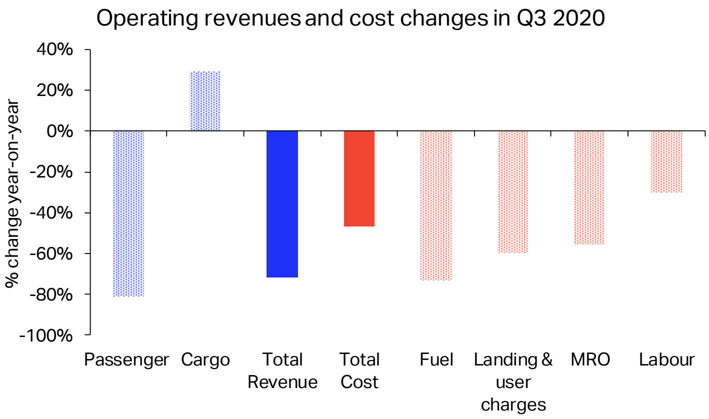
Airline Financial Results

Number of airlines in sample	Regions	Q3 2019 EBIT margin[1]	Q3 2019 Net post-tax profit[2]	Q3 2020 EBIT margin[1]	Q3 2020 Net post-tax profit[2]
13	North America	13.7%	4,919	-91%	-12,291
29	Asia-Pacific	6.3%	485	-41%	-5,647
12	Europe	17.0%	5,747	-48%	-7,651
8	Latin America	11.2%	2	-94%	-1,772
3	Others	24.2%	193	-47%	-87
65	**Sample total**	**12.7%**	**11,346**	**-61%**	**-27,448**

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

- Our latest sample of Q3 2020 results confirms that negative impact of the pandemic on airline financials persists. Airlines in all regions posted another quarter of net loss since the travel demand recovery was limited. While North American airlines reported the largest net loss, losses in Asia-Pacific were the lowest. Airlines in this region benefitted from the recovery in large domestic markets and the strong cargo business with lucrative yields.
- Looking forward, news related to vaccine developments are positive and will support air travel demand once the vaccines become widely available. However, until then airlines will continue to suffer from modest demand and covid-related travel restrictions unless testing replaces quarantine requirements. The challenge especially in the first half of 2021 will continue to be matching lower revenues with inflexible cost structure. Hence, airlines might burn through cash in 2021.

Strong cargo revenues partially compensate the loss in passenger revenues



Airline Operating Costs Details

Number of airlines in sample	Regions	Operating Costs* Q3 2020 vs Q3 2019 (Year-on-year change)				
		Fuel	Employee	Maintenance & Engineering	Landing fees & user charges	Selling & distribution
14	North America	-75%	-26%	-50%	-50%	-82%
23	Asia Pacific	-77%	-29%	-54%	-69%	-72%
12	Europe	-68%	-35%	-60%	-58%	-72%
8	Latin America	-77%	-54%	-44%	-68%	-64%
3	Middle East	-83%	-44%	-31%	-72%	-69%
60	**Sample total**	**-73%**	**-30%**	**-56%**	**-60%**	**-76%**

*Sub categories are included in the sample if reported

Sources: The Airline Analyst, IATA

- Airlines in all regions continue to report sharp decline in passenger revenues in Q3 2020 despite the moderate recovery in passenger demand. Passenger revenues in our sample of airlines declined year-on year by 81% in Q3, sharper than the decline in demand since airlines tried to stimulate demand by lowering fares.
- On the other hand, cargo revenues were strong. Cargo revenues in our sample of airlines improved year-on-year by 29% since the demand for cargo rebounded in Q3 with the revival of economic activity. Moreover, cargo yields remained high since the recovery in belly cargo capacity was limited in Q3 and conversion of passenger aircrafts to cargo aircrafts was not sufficient to compensate the loss in belly cargo capacity.
- Reducing operating costs was the main target during this outbreak. However, the decline in operating costs (-47% in our sample) was much lower than the loss on the revenue side. While the decline variable costs such as fuel and selling distribution in parallel to the loss in revenues, the reduction in landing fees and user charges was modest. Hence, airlines took initiatives to reduce their fixed or semi-fixed,i.e. employment costs reduced by 29% in 3Q20 compared to 3Q19.

Industry-wide cash burn continues in Q3

Airline Cash Flow[1]

Number of airlines in sample	Regions	Q3 2019			Q3 2020		
		Net cash flow[2]	Capex	Free cash flow	Net cash flow[2]	Capex	Free cash flow
11	North America	12.5%	8.8%	3.7%	-69.0%	19.8%	-88.8%
20	Asia-Pacific	9.2%	8.7%	0.5%	-19.1%	4.8%	-23.9%
8	Europe	9.8%	10.1%	-0.3%	-60.8%	11.9%	-72.7%
6	Latin America	12.4%	8.5%	3.9%	-46.6%	14.3%	-60.9%
3	Others	31.9%	7.6%	24.2%	-28.6%	26.6%	-55.2%
48	**Sample total**	**11.2%**	**9.1%**	**2.1%**	**-53.3%**	**13.6%**	**-66.9%**

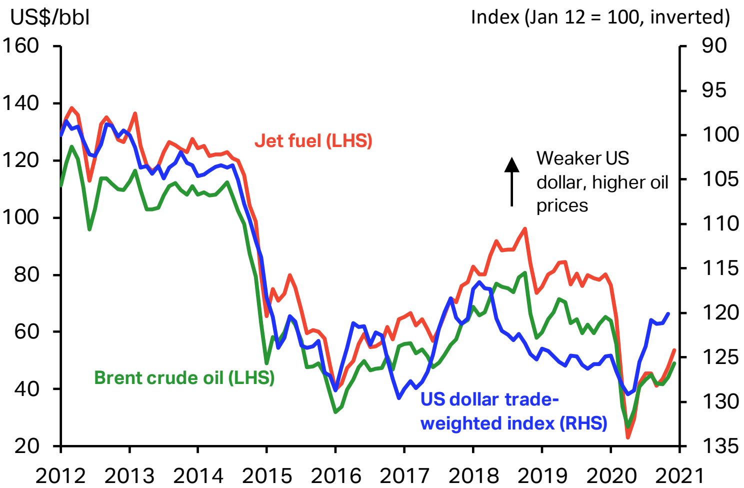
[1]% of revenues [2]From operating activities

Sources: The Airline Analyst, IATA

- Our latest Q3 2020 sample shows that the industry-wide net cash outflow from operating activities accelerated to 53% of revenues since airlines were not able to compensate revenue loss by reducing their costs due to the high proportion of fixed costs.
- Airlines in all regions restricted their capital expenditures by deferring aircraft deliveries and cancelling projects. However, capital expenditures rose to 14% of revenues with the weakening in revenues. As a result, free cash outflow rose to 67% of revenues. Hence, some airlines might need further support for survival. Extension of relief measures from governments or additional funding might be asked in the coming quarters.

Fuel costs

Oil and jet fuel price rose in December with recovery in demand

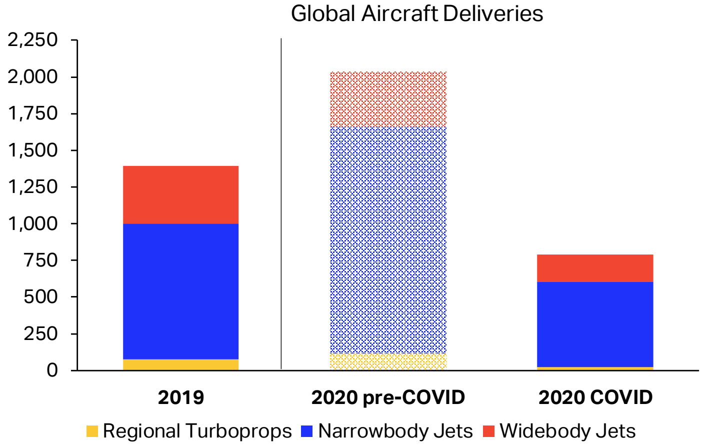


Sources: Platts, Refinitiv Eikon Datastream, as of December 10th

- Oil and jet fuel price strengthened in December. Positive news flow about vaccines, stronger oil demand from Asia and relaxation of lockdowns in some European countries before holiday season were supportive for the prices. In addition to the developments on demand side, OPEC+ group keeps tight limits on production.
- Despite the recent strengthening in prices, three major oil agencies (the International Energy Agency, U.S. Energy Information Administration and Organization of Petroleum Exporting Countries) revised down their 2021 oil demand outlook. Jet fuel demand is not expected to recover quickly as governments are inclined to keep travel restrictions in place until vaccines become widely available.

Aircraft Deliveries

Airlines have been postponing deliveries to reduce cash burn



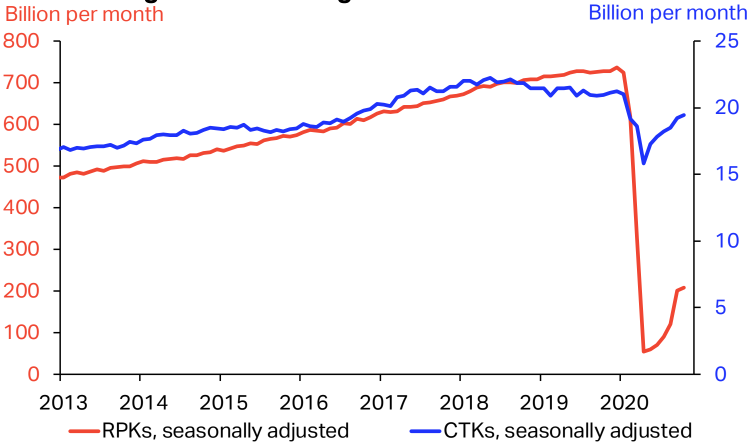
Source: ASCEND

- Throughout the year, airlines have been negotiating with manufacturers for postponements of scheduled deliveries to reduce their cash outflow. In 2020, airlines are estimated to take delivery of ~800 aircraft, which is more than half of the number originally planned before the COVID-19 crisis started. Looking forward, the investment appetite for new aircraft is likely to remain subdued. Airlines are currently scheduled to take delivery of approximately 1300 new aircraft in 2021 – a similar number as in 2019. However, in light of the challenging industry outlook, carriers might consider further cancellations or deferrals.

Demand

The recovery in air passenger remains slow, while air cargo continues to improve

Air Passenger and Air Cargo Volumes



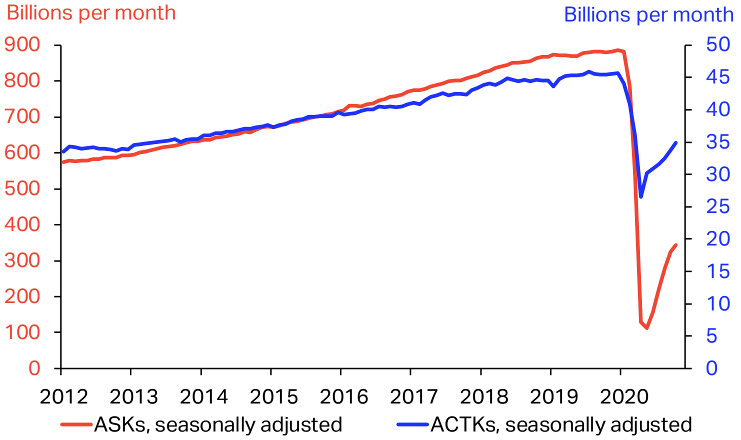
Source: IATA Monthly Statistics

- Seasonally adjusted (SA) revenue passenger-kilometres (RPKs) continued to improve in October. However, the month-on-month pace of growth (3.5%) slowed down compared to previous months. RPKs remained 70.6% below last year levels, a slight improvement compared to September (-72.2% year-on-year). The recovery was driven by domestic markets. With the exception of Latin America, international markets overall did not improve due to new COVID-19 outbreaks especially in Europe.
- Air cargo demand also continued to grow albeit at a slower pace in October. SA cargo tonne-kilometres (CTKs) increased month-on-month by 1.1% on top of 4.1% rise in September. Overall, CTKs are 6.2% below their levels a year ago. However, robust manufacturing activity and rebound in global trade are supportive for air cargo.

Capacity

Air passenger capacity recovers faster than demand

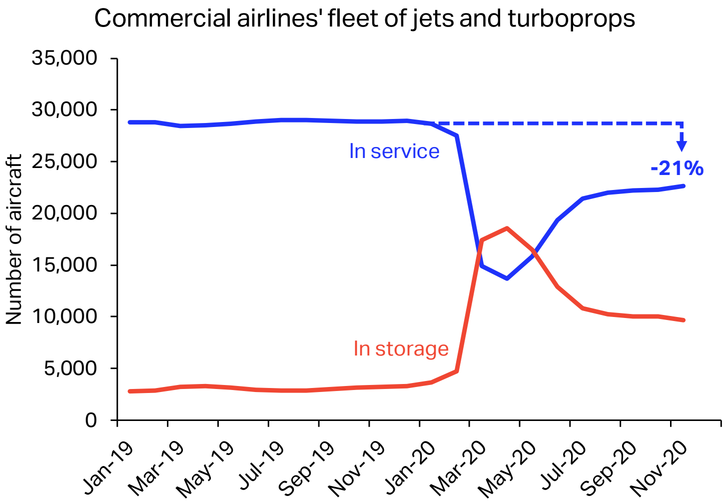
Air Passenger and Air Cargo Capacity



Source: IATA Monthly Statistics

- Air passenger capacity continue to improve in October. Seasonally adjusted available seat-kilometres (ASKs) grew by 5.9% month-on-month. As a result, the year-on-year decline in actual ASKs was 59.9% in October, compared with a 62.3% fall the month before.
- Air cargo capacity improved in September, with a 3.4% rise in seasonally adjusted available cargo tonne-kilometres (ACTKs) compared to prior month. This was mostly driven by an improvement in dedicated freighters' capacity and utilization rates. Improvement in belly cargo capacity has been limited due to new travel restrictions.,Lack of capacity remains as a challenge for faster CTK recovery

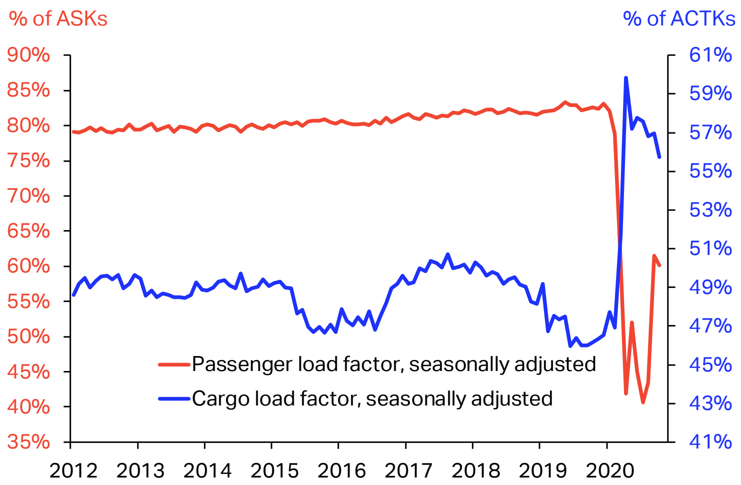
Fleet in service stabilizes



Source: IATA Economics analysis based on data from Cirium Ascend

- After a significant portion of the global aircraft fleet was grounded in April, airlines rapidly increased passenger and freighter capacity as demand started to return.However, the upwards trend in the fleet in service has softened since July.
- The magnitude of the year-on-year contraction (-21% in October) is much smaller than that of RPKs, as airlines focus on aircraft-intensive domestic and short-haul routes, and because of the high demand for freighter aircraft.
- Overall, there were c.22,500 aircraft in use in November, roughly 250 more than in October. There were c. 9800 aircraft stored, about twice more than last year.

Passenger load factor eases, cargo load factor remains elevated



Source: IATA Monthly Statistics

- Seasonally adjusted passenger load factor declined in October as capacity recovered faster than demand. Actual passenger load factor remained close to record-low values, indicating the challenge of turning to profitability for airlines.
- On the air cargo side, seasonally adjusted cargo load factor eased in October. Nevertheless, it remained at elevated levels. Key demand drivers show positive developments for air cargo as manufacturing activity is on the recovery path and export orders are booming. Looking forward, the lack of belly capacity and expected rise in demand during the cargo peak season will put pressure on cargo load factors.

IATA Economics
economics@iata.org

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