Airlines Financial Monitor

September-October 2020

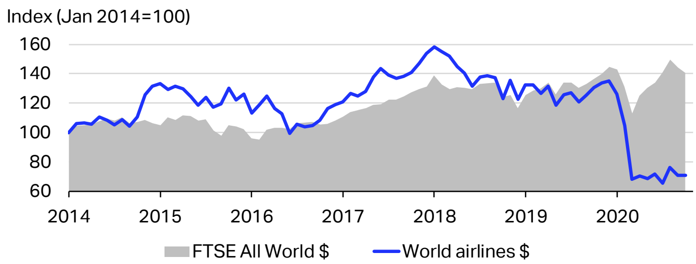
Key points

- Although the second quarter was the peak of the financial hit to airlines, third quarter results did not show much improvement. Airlines continue to suffer from subdued travel demand and covid-related travel restrictions. Looking forward, airlines are expected to burn through cash for some time due to the soft revenue outlook and inflexible cost base with high fixed costs.
- The global airline share price index was stable in October ahead of the COVID-19 vaccine news in November. Resurgence of COVID-19 cases and new travel restrictions affected European airline shares most.
- Oil and jet fuel prices ticked up in November on the back of vaccine news and announcements about supply cuts by main producers. However, the outlook for global oil demand remains fragile since the resurgence of COVID-19 cases suppresses near-term demand.
- The recovery in demand continued for both passenger and cargo markets in September. That said, passenger volumes are pressured by renewed COVID-19 outbreaks, while air cargo drivers remained strong. The lack of air cargo capacity also means that cargo load factors remain close to record-high values.

Airline shares had been stable ahead of the vaccine news in November

Airline Share Prices

US$ indices (Jan 2014=100)	Index Oct 30th	% change on one month	one year	start of year
World airlines	**70.7**	**-0.3%**	**-45.8%**	**-47.7%**
Asia Pacific airlines	65.7	-0.8%	-38.1%	-40.3%
European airlines	53.8	-1.7%	-45.8%	-52.5%
North American airlines	90.3	+1.0%	-46.5%	-46.2%
FTSE All World $	**140.6**	**-2.6%**	**+2.9%**	**-2.8%**



Source: Thomson Reuters Datastream

- Airline share price movements were muted ahead of the stock market rally in November when successful vaccine trials were announced. Global airline share price index fell by a modest 0.3% month-on-month in October, and remained almost 50% lower compared to the pre-COVID period. The wider equity index dropped by a more significant 2.6% but year-to-date it continues to significantly outperform airline shares.
- European carriers remained the weakest performer in October. Their share value fell by 1.7%, after a large 17.4% decline in September. Airlines in the region have been adversely impacted by the resurgence of the virus and reimposition of travel restrictions. In North America, airline shares went up slightly following the announcement that the number of passengers screened in a single day in the US topped one million for the first time since COVID-19 infections began to spike.

Airlines net losses still large in the third quarter

Airline Financial Results

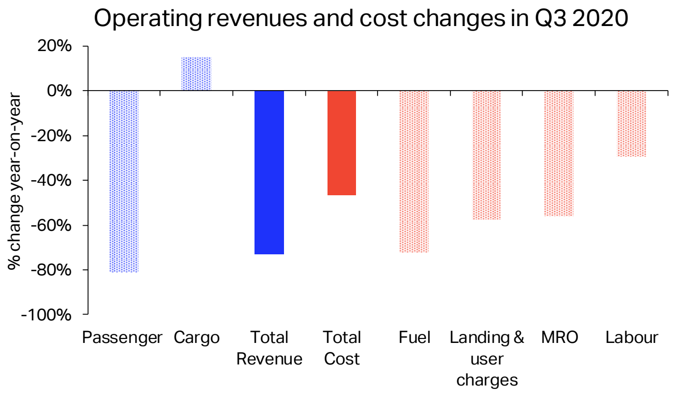
Number of airlines in sample	Regions	Q3 2019 EBIT margin[1]	Q3 2019 Net post-tax profit[2]	Q3 2020 EBIT margin[1]	Q3 2020 Net post-tax profit[2]
13	North America	13.7%	4,919	-91%	-12,291
15	Asia-Pacific	7.0%	494	-39%	-3,521
10	Europe	16.9%	5,464	-48%	-7,546
5	Latin America	10.9%	79	-94%	-1,148
3	Others	24.2%	193	-47%	-87
46	**Sample total**	**13.3%**	**11,149**	**-63%**	**-24,593**

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

Sources: The Airline Analyst, IATA

- The initial sample of Q3 2020 financial results shows that airlines in all regions posted another quarter of net loss due to the modest travel demand recovery in the summer quarter, which is seasonally the strongest period in normal times.
- Profitability remained negative in all regions but improved compared to lockdown period of Q2. North America reported the largest net loss. On the positive side, losses in Asia-Pacific moderated with the recovery in large domestic markets and the strong cargo business.
- Looking forward, airlines will continue to suffer from modest demand and covid-related travel restrictions, unless testing replace quarantine requirements. Hence, airlines may burn through cash for some time amid this soft revenue outlook and inflexible cost structure with high proportion of fixed costs.

Passenger revenues remains weak in Q3 whole cargo revenues strong



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	-83%	-26%	-50%	-50%	-82%
11	Asia Pacific	-79%	-28%	-54%	-69%	-86%
10	Europe	-67%	-34%	-61%	-57%	-73%
5	Latin America	-71%	-50%	-36%	-59%	-44%
3	Middle East	-75%	-44%	-31%	-72%	-69%
43	**Sample total**	**-72%**	**-29%**	**-56%**	**-58%**	**-77%**

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

- Airlines in all regions reported sharp decline in passenger revenues despite the modest recovery in capacity in Q3 2020 compared to the Q2 2020. Passenger revenues in our sample of airlines declined year-on year by 89% in Q3, sharper than the decline in demand since airlines tried to stimulate demand by lowering fares.
- On the other hand, demand for cargo was strong in Q3 since the economic activity rebounded following the lock-down period. Nevertheless cargo yields soared due to the limited belly cargo capacity. As a result, cargo revenues in our sample of airlines improved year-on year by 15%.
- Airlines focused on cutting operating costs in this unusual business environment. However, the decline in operating costs (46% in our sample) were not enough to compensate the revenue loss . Variable costs such as fuel expenses and selling distribution costs declined in parallel to the revenue loss. Decline in landing fees and user charges was moderate compared to Q2 as a However, c. 50% of airline costs were fixed or semi-fixed. Hence, airlines took initiatives to reduce these costs such as employee voluntary unpaid leaves.

Industry-wide cash burn continues in Q3

Airline Cash Flow[1]

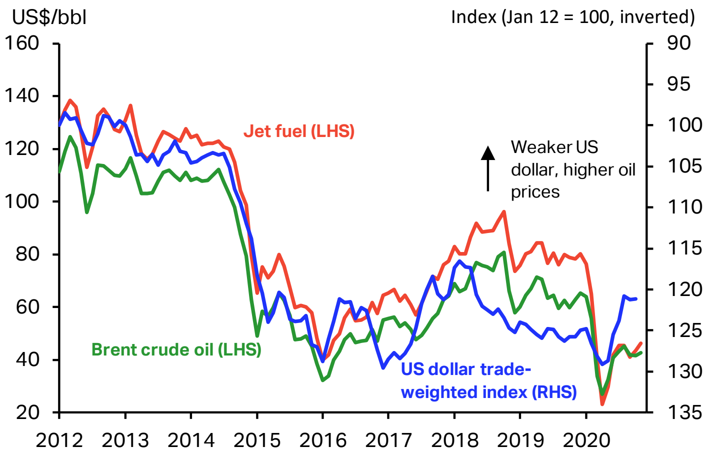
Number of airlines in sample	Regions	Q3 2019			Q3 2020		
		Net cash flow[2]	Capex	Free cash flow	Net cash flow[2]	Capex	Free cash flow
11	North America	12.5%	8.8%	3.7%	-69.0%	19.8%	-88.8%
7	Europe	10.0%	10.1%	0.0%	-54.2%	10.7%	-65.0%
4	Latin America	13.3%	8.2%	5.2%	-60.1%	16.4%	-76.5%
5	Others	19.2%	3.8%	15.4%	-14.3%	9.7%	-24.0%
27	**Sample total**	**11.9%**	**9.1%**	**2.8%**	**-61.6%**	**15.9%**	**-77.6%**

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

- Our initial Q3 2020 sample shows that the industry-wide net cash outflow from operating activities accelerated (62% of revenues). Airlines continue to struggle to match revenue loss by cutting costs due to the high proportion of fixed costs.
- Airlines limited capital expenditures by deferring aircraft deliveries and cancelling projects. However, capital expenditures rose to 16% of revenues due to the sharp decline in revenues. As a result, free cash outflow had been 78% of revenues, which indicates that some airlines might need further support from governments and capital markets in the coming quarters.

Fuel costs

Oil and jet fuel price rose in November on news about COVID-19 vaccine

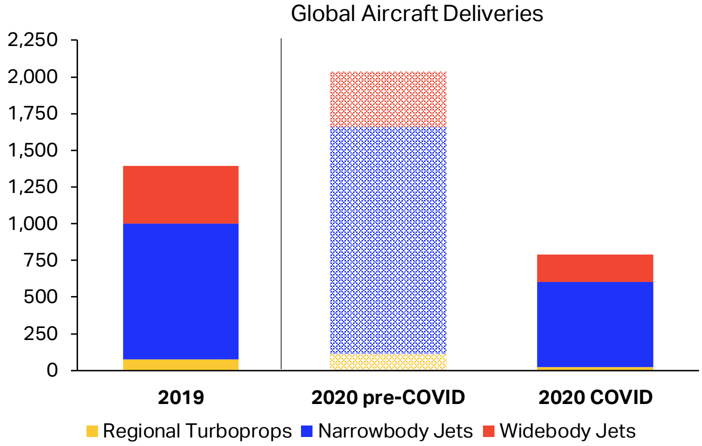


Sources: Platts, Refinitiv Eikon Datastream, as of November 20th

- Oil and jet fuel price picked up in November despite the resurgence of the virus and new restrictions. There were multiple factors influencing the upward price movement. Democrats in the US will likely not gain majority in the Senate, which reduced chances of any dramatic clean-energy movement in the country. News about availability of efficient vaccine bolstered investors' hopes about fuel demand recovery. Finally, OPEC+ group announced possible extension of supply cuts.
- Despite the price increase this month, the International Energy Agency (IEA) remains cautious about the near-term demand outlook. It estimates that fuel consumption will not be significantly impacted by vaccine in the first half of 2021.

Aircraft Deliveries

Airlines have been postponing deliveries to reduce cash burn

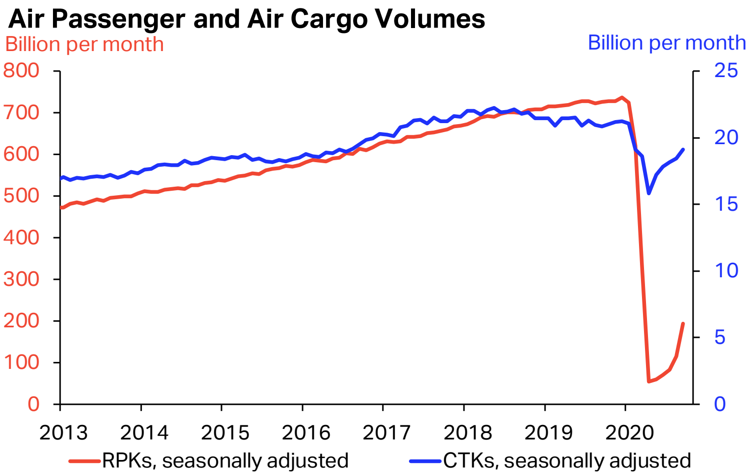


Source: ASCEND

- 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 transport continues, but drivers are more favourable for cargo

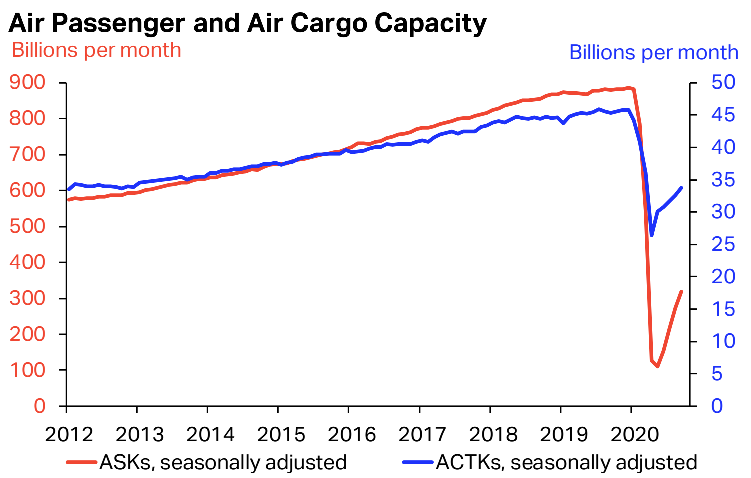


Source: IATA Monthly Statistics

- Seasonally adjusted revenue passenger-kilometres (RPKs) rose sharply in September. That said, actual RPKs were 72.8% below last year levels, only a slow improvement from the 75.2% year-on-year decline in August, and mostly driven by domestic markets. Recent renewed COVID outbreaks – notably across Europe – will put further pressures on that recovery.
- Air cargo demand also improved in September. Actual cargo tonne-kilometres (CTKs) were down 8.0% in September, following a 12.1% fall in August. Manufacturing activity and export orders have rebounded fast, and there are signs of a busy peak season for cargo due to strong ecommerce demand. Limited capacity however remains a key challenge.

Capacity

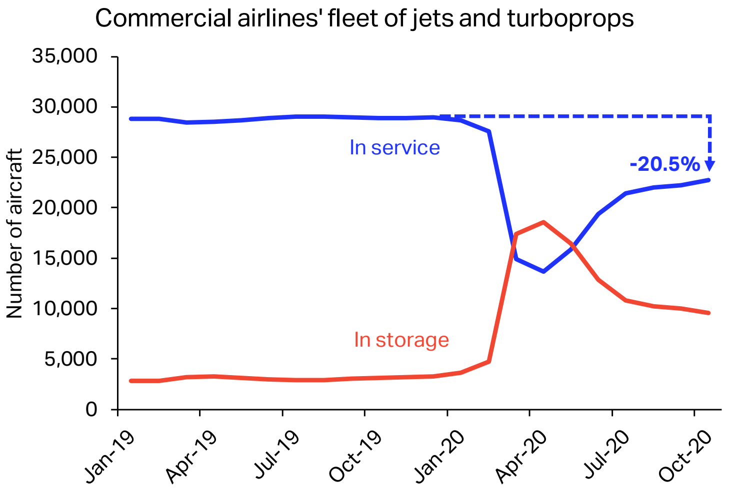
Capacity is also recovering, but the recent rise in COVID cases adds pressures



Source: IATA Monthly Statistics

- Capacity as measured by seasonally adjusted available seat-kilometres (ASKs) grew by 17% month-on-month in September. Having said that, a number of airlines – in particular in Europe and North America – reduced their capacity plans for the rest of the year. Consequently, the year-on-year decline in actual ASKs was mostly unchanged from August (63.0%).
- Air cargo capacity improved in September, with a 3.7% rise in seasonally adjusted available cargo tonne-kilometres (ACTKs) compared to August. This was mostly driven by a modest improvement in belly-hold capacity, as airlines struggle to further expand their freighters fleet and utilization.

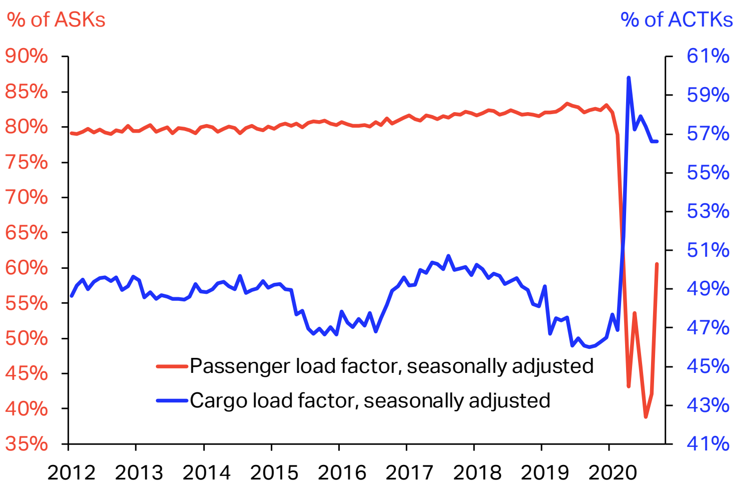
The rebound in the fleet in service has slowed since July



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. But the upwards trend in the fleet in service has softened since July.
- The magnitude of the year-on-year change (20.5% 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.22760 aircraft in use in October, roughly 530 more than in September. In October 2020, there were c. 9550 aircraft stored, three times more than last year.

Passenger load factors improve, while the cargo market remains tensed



Source: IATA Monthly Statistics

- Seasonally adjusted passenger load factors improved for the second consecutive month in September, lifting by around 18 percentage points. At 60.1%, the actual passenger load factors returned to values last seen in February 2020, but remains at record-low levels. This improvement is driven by capacity cuts by airlines for the final part of the year, amid rising global COVID cases.
- Turning to air cargo, the return of manufacturing activity combined with a lack of belly capacity and insufficient freighters fleet size and utilization mean that the market remains tensed. Cargo load factors and yields trended broadly sideways in September, close to record-high values. Looking ahead, they are expected to rise again during the cargo peak season.

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