Airlines Financial Monitor

August-September 2020

Key points

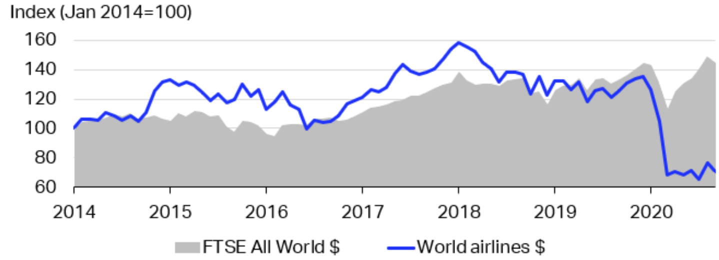
- Initial Q3 financial results show that airlines continued to suffer from subdued travel demand. Based on the results available so far, the cash burn rate slowed in Q3 compared to Q2 with the help of cost cutting measures and robust cargo revenues. However, airlines are expected to continue to burn cash through 2022 as revenues are likely to remain soft.
- The global airline share price index declined in September after a short-lived rebound in August. Concerns regarding a second wave of COVID-19 cases and the potential for a new round of travel restrictions were the main reasons behind the sell-off.
- Oil and jet fuel prices have ticked up recently on hurricane-related supply disruptions but the overall outlook for global oil demand in the near-term is still very fragile.
- Both passenger and cargo demand continued to recover in August. However, the pace of recovery remains gradual and passenger demand continues to lag the rise in seat capacity. Global base passenger yields declined in August as airlines sought to improve weak travel demand with price stimulation in the economy cabin.

Financial indicators

Airline shares lost value in September with the resurgence of Covid cases

Airline Share Prices

US$ indices (Jan 2014=100)	Index Sep 30th	% change on one month	% change on one year	% change on start of year
World airlines	**70.9**	**-7.0%**	**-43.4%**	**-47.6%**
Asia Pacific airlines	66.2	-5.0%	-35.3%	-39.8%
European airlines	54.7	-17.4%	-38.0%	-51.6%
North American airlines	89.4	-2.0%	-45.7%	-46.7%
FTSE All World $	**144.3**	**-3.4%**	**+8.4%**	**-0.2%**



Source: Thomson Reuters Datastream

- The global airline share price index declined in September after a short-lived rebound in August. Concerns about a second wave of COVID-19 cases and the potential for a new round of border closures were the main reasons behind the sell-off in airline shares.
- European airlines were the worst performer among all regions as some countries in Europe started to impose travel restrictions with rising Covid cases. In addition, concerns that the government may not offer further support weighed on North American airline shares.
- Overall, airline shares declined by more than the wider equity index in the first three quarters of the year as air travel is one of the sectors most affected by the pandemic. Although wider equity markets returned close to their levels at the beginning of the year, airline stocks have not recovered (down 47.6% over the year-to-date).

Airlines continue to report losses in initial Q3 releases

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]
27	North America	12.2%	5,512	-77%	-11,682
32	Asia-Pacific	8.3%	2,418	-39%	-6,585
12	Europe	8.2%	1,771	-113%	-8,719
8	Latin America	4.2%	-342	-229%	-3,449
5	Others	7.2%	49	-46%	-293
84	**Sample total**	**9.7%**	**9,408**	**-71%**	**-30,728**

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

Sources: The Airline Analyst, IATA

- Our final sample of Q2 2020 financial results confirmed that airlines in all regions were severely impacted by the pandemic. The North America region reported the largest net loss while on the positive side, some Asia Pacific airlines returned to profitability with the help of their cargo business following large losses in Q1. Strong cargo yields also boosted the profitability of cargo-only airlines in North America.
- The initial Q3 financial results of North American carriers show that airlines continued to suffer from low travel demand in what is typically a seasonally strong quarter. However, the cash burn rate slowed compared to Q2 with the help of cost cutting measures and strong cargo revenues.

Cuts in operating costs are not sufficient to compensate for the revenue losses

Airline Operating Revenues & Costs

Number of airlines in sample	Regions	Q2 2020 vs Q2 2019 (Year-on-year change)			
		Passenger Revenues*	Cargo Revenues*	Total Revenues	Total Operating Costs
26	North America	-90%	0%	-71%	-42%
30	Asia Pacific	-76%	48%	-63%	-64%
12	Europe	-95%	30%	-85%	-51%
8	Latin America	-95%	11%	-85%	-40%
3	Middle East	-97%	17%	-80%	-65%
79	**Sample total**	**-89%**	**17%**	**-73%**	**-48%**

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

Airline Operating Costs Details

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
26	North America	-82%	-22%	-58%	-54%	-89%
30	Asia Pacific	-71%	-16%	-39%	-57%	-70%
12	Europe	-91%	-50%	-60%	-85%	-85%
8	Latin America	-90%	-58%	-11%	-75%	-78%
76	**Sample total**	**-83%**	**-31%**	**-54%**	**-73%**	**-83%**

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

- Airlines in all regions reported a sharp decline in passenger revenues on the widespread fleet grounding in Q2 2020. Passenger revenues in our sample of airlines declined by 89% year-on year in Q2. Asia-Pacific airlines performed relatively better than other regions with the recovery in China domestic market.
- On the other hand, the demand for time sensitive cargo shipments - including PPE - was strong in Q2. Moreover, cargo yields were supported by the limited belly cargo capacity. A number of airlines used passenger aircraft to operate cargo-only flights and cargo revenues in our sample of airlines improved by 17% year-on-year.
- Unsurprisingly in this business environment airlines have focused on cutting operating costs. However, the decline in costs was not enough to compensate for the revenue loss. Variable costs such as fuel expenses and landing fees fell in parallel with the revenue loss. However, c. 50% of airline costs are fixed or semi-fixed, at least in the short-run. Airlines undertook various initiatives to reduce these costs but the overall year-on-year decline in operating costs was 48% vs a 73% decline in operating revenues.

Industry-wide free cash outflow in Q2 2020

Airline Cash Flow[1]

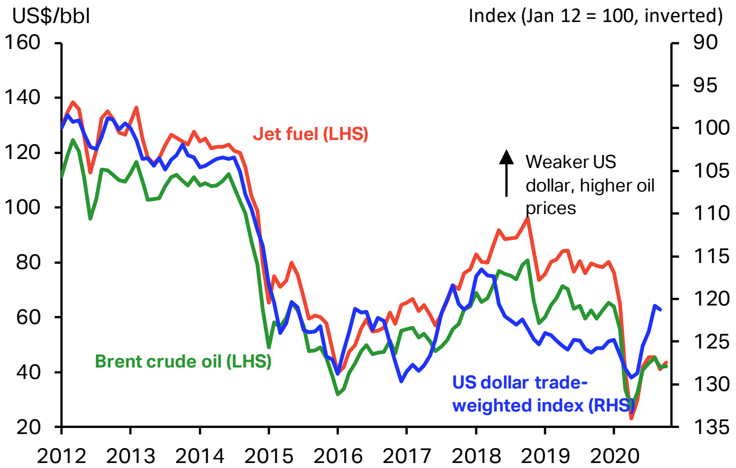
Number of airlines in sample	Regions	Q2 2019			Q2 2020		
		Net cash flow[2]	Capex	Free cash flow	Net cash flow[2]	Capex	Free cash flow
13	North America	17.3%	10.4%	6.9%	-23.1%	18.7%	-41.8%
26	Asia-Pacific	11.7%	8.9%	2.7%	-29.5%	16.0%	-45.5%
8	Europe	11.3%	10.4%	0.9%	-63.1%	20.0%	-83.1%
5	Latin America	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, to 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, the free cash outflow increased to 52% of revenues which indicates cash raised so far from capital markets and government assistanc could be depleted quickly if outflow continues at this pace.

Fuel costs

Jet fuel and crude oil price remain stable

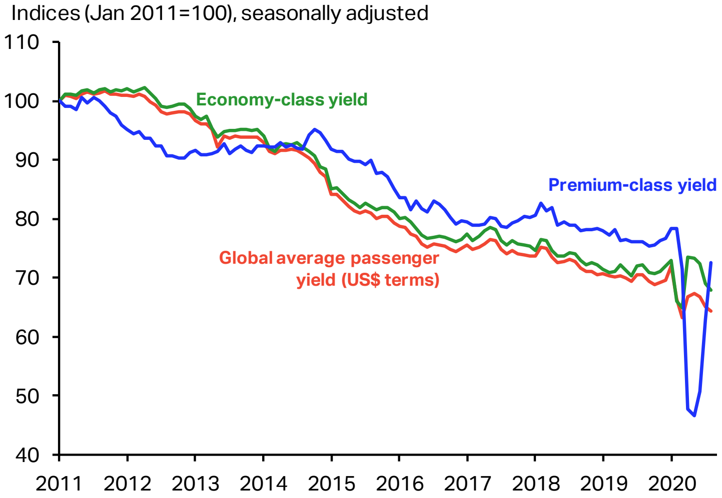


Sources: Platts, Thomson Reuters Datastream, as of October 19th

- Oil and jet fuel prices declined slightly in September with the support of summer holidays and ease of Covid restrictions. However, prices ticked up again in October due to hurricane related supply disruptions. At the time of writing, both Brent crude oil and the jet fuel price were US$42/bbl and US$43/bbl, respectively.
- Looking forward, a second wave of COVID-19 cases and new movement restrictions would slow global oil demand growth. According to the International Energy Agency (IEA) global oil consumption is expected to decline by 8% in 2020. The IEA expects energy consumption will not return to its pre-crisis level until 2023 as COVID-19 has caused an unprecedented disruption in the energy sector.

Global Yields

Global base passenger yields weakened in annual terms



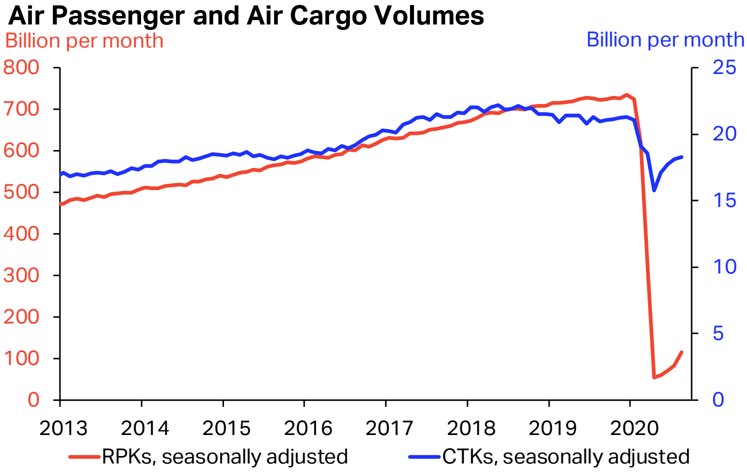
Sources: IATA Economics, DDS

- Global base passenger yields (in US$, excluding surcharges and ancillary revenues) declined by 1.0% month-on-month in August as airlines sought to revive weak travel demand through lower prices.
- Following the sharp fall during the lockdown period, premium yields have rebounded sharply, but are still 5% lower compared to their level of a year ago. Economy class yields, which initially rose with the support of repatriation flights and last-minute bookings, eased as airlines responded to the low demand by cutting fares. Overall, global average passenger yields in US$ terms are c.9% below their level of a year ago.

Demand

Recovery in passenger and cargo demand remains slow

Air Passenger and Air Cargo Volumes



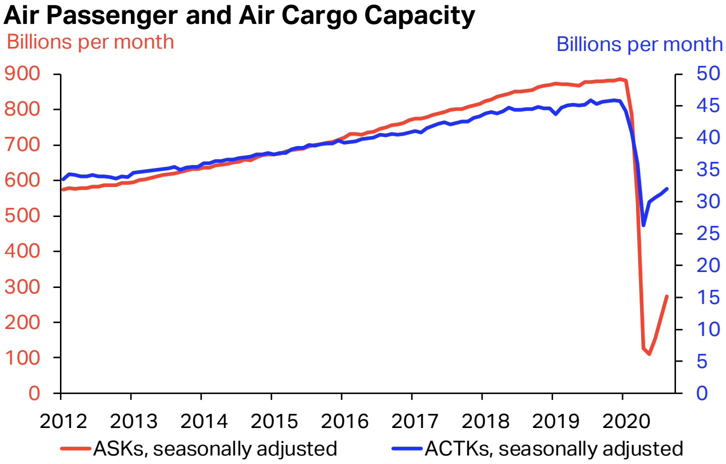
Source: IATA Monthly Statistics

- Air travel demand continued to recover but the pace of that recovery remains slow. While industry-wide seasonally adjusted revenue passenger-kilometres (RPKs) improved for the fourth consecutive month in August, RPKs are still down 75.3% compared to the same period of last year. The improvement compared to July stemmed from the recovery in some of the large domestic and intra-Europe markets.
- Air cargo demand also improved for another month (up 1.6% month-on-month) but the pace of increase slowed. Although the recovery in manufacturing activity supports air cargo demand, the rebound in air cargo volumes is hampered by capacity constraints. Industry-wide cargo tonne-kilometres (CTKs) fell by 12.6% year-on-year in August.

Capacity

Both passenger and cargo capacity trended upwards

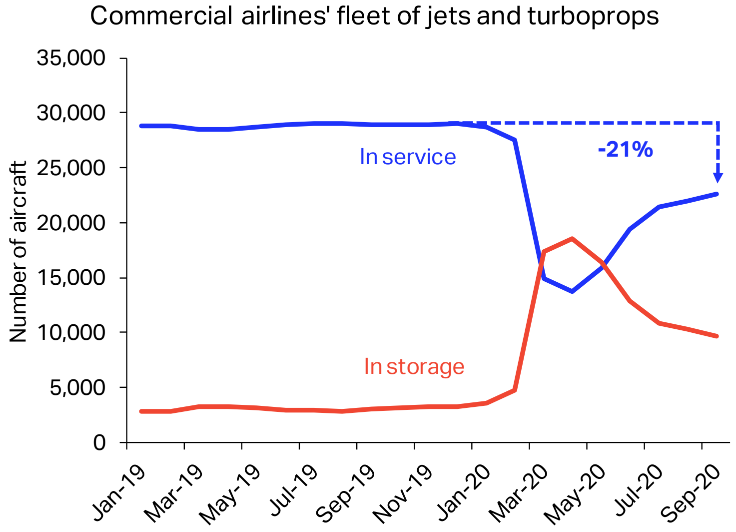
Air Passenger and Air Cargo Capacity



Source: IATA Monthly Statistics

- Airlines continued to return their fleet into service in August and seasonally adjusted air passenger capacity rose by 27% month-on-month. All regions registered a smaller year-on-year capacity contraction compared with July. Industry-wide available seat kilometres were down 63.1% year on year, a 6ppt improvement compared with July.
- Air cargo capacity posted a 2.7% month-on-month rise in August. However, industry-wide available cargo tonne-kilometres were down 29.4% year-on-year as cargo capacity remains limited, due mainly to the scarcity in belly cargo capacity.

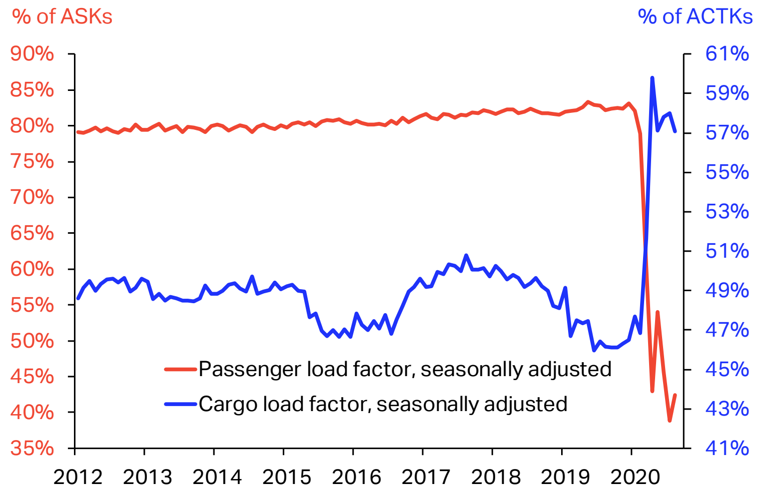
Fleet in service is rising faster than passenger demand



Source: IATA Economics analysis based on data from Cirium Ascend

- Airlines quickly brought capacity back with the restart of the industry in May. As the end of September, the commercial fleet in service rose to c.22,630 aircraft which is up c.8,900 from the lowest level in April. Nevertheless, this is still well below the 2019 average (28,900) as c.30% of commercial aircraft remain in storage.
- The return of the fleet to service has outpaced the recovery in travel demand. Fleet in service is only down by 21% compared to the beginning of this year, as most of the recovery in air travel is in short-haul markets. With short-haul travel likely to recover faster than long-haul, it will be a challenge for airlines to keep fleet costs under control.

Divergent passenger and cargo load factors



Source: IATA Monthly Statistics

- The industry-wide seasonally adjusted (SA) passenger load factor rose slightly in August, but it remained close to record low levels. Although airlines are trying to stimulate demand by cutting fares, the recovery in passenger demand lagged capacity developments. With new waves of COVID-19 cases emerging again, reviving passenger demand - which has already been fragile - will be a challenge for airlines.
- On the cargo side, the SA industry-wide load factor remained close to record high levels (down 0.9 ppts vs. July) due to insufficient cargo capacity. The cargo load factor is likely to ease moderately in coming months as airlines continue to bring their passenger fleet back into service.

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21 October 2020

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