AIRLINE BUSINESS CONFIDENCE INDEX

JULY 2018 SURVEY

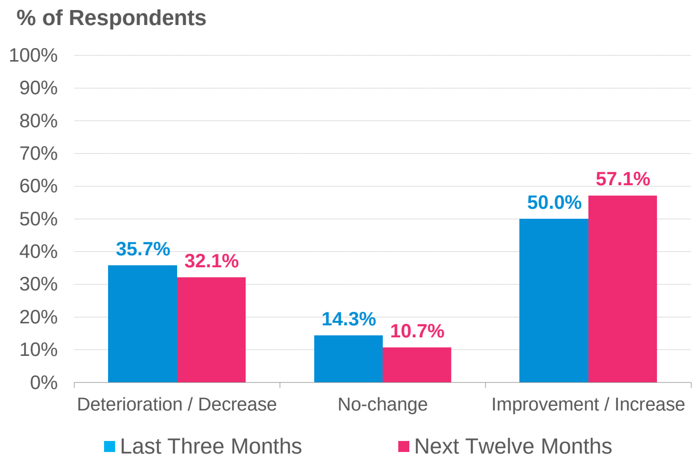
KEY POINTS

- The results of our latest survey of airline CFOs and Heads of Cargo, conducted in early-July, suggest that the squeeze on airline operating profit margins intensified during Q2 2018.
- This is consistent with increased reports of higher input costs, mainly reflecting developments in jet fuel prices. Many of our respondents (54%) expect to see further increases in input costs over the year ahead.
- The majority (57%) expect their level of profitability to improve further over the coming 12 months, however, which reflects the fact that passenger and freight yields are expected to partly offset further increases in input costs.
- The positive outlook for profitability also reflects confidence about the strength of the demand outlook, particularly on the passenger side of the business; 84% of respondents expect passenger volumes to rise over the year ahead – the second highest proportion in ten years.
- The outlook for cargo demand has softened slightly in the past two surveys, which partly reflects uncertainty caused by the recent pick-up in global trade tensions. Nonetheless, the majority (58%) of our respondents expect air freight volumes to rise further over the year ahead.
- Encouragingly, 43% reported an increase in employment levels in Q2 relative to the same period a year ago, and more than 50% of respondents expect to increase employment levels further over the next 12 months.

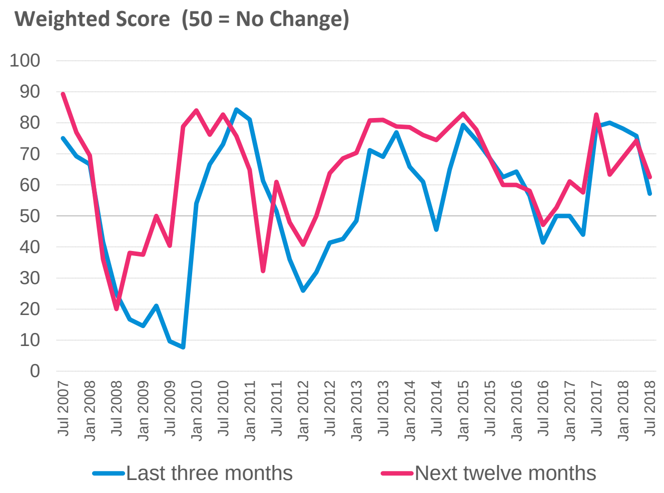
PROFITABILITY OUTLOOK

How has profitability changed? How do you expect it to change over the next twelve months?

a) July 2018 survey



b) Compared to previous surveys



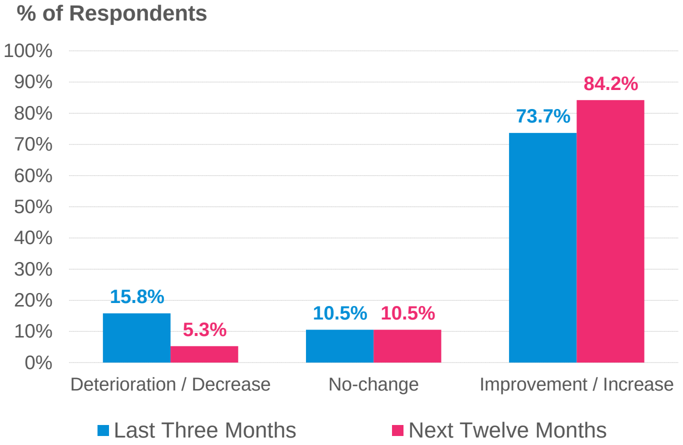
- The results of our latest survey of airline CFOs and Heads of Cargo, conducted in early-July, suggest that the squeeze on airline profit margins from higher input costs intensified in Q2 2018. Half of the respondents reported that profitability increased in annual terms in Q2, but this was the lowest proportion since April 2017. As a result, while the backward-looking weighted-average score remained above the 50-mark that is consistent with no change, it fell sharply from the previous quarter.
- The majority of respondents (57%) continue to expect profits to increase over the next 12 months, helped by a robust backdrop for demand as well as steps taken to improve efficiencies. However, the proportion reporting that they expect to see a deterioration in the year head jumped to its highest level since October 2016 (32%, from 12% last time), with many respondents expecting to see a further squeeze from higher input costs.

DEMAND GROWTH

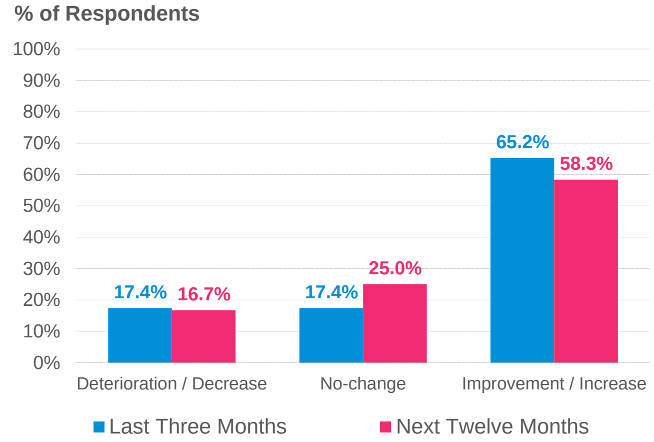
- The July survey results point to ongoing momentum in passenger demand. Nearly three-quarters of respondents reported an increase in passenger volumes in Q2, which was down slightly from the previous survey but still above the average over the past five years (67%). All told, the weighted-average backward-looking score fell back slightly from the April survey but remains at an elevated level.
- The vast majority of our respondents (84%) reported that they expect a further increase in passenger volumes over the year ahead – the second highest proportion in the last decade. With just 5% of respondents expecting a *fall* in demand, the forward-looking weighted-average score increased slightly and remains very high.
- Meanwhile, almost two-thirds (65%) of respondents reported a rise in air cargo volumes in Q2 compared with a year ago – broadly unchanged from the previous survey. Despite the recent pick-up in trade tensions between the US and China, a number of respondents noted that demand conditions remained strong on the key markets across the Pacific and Atlantic.
- That said, the forward-looking weighted-average score for cargo demand has softened slightly in the past two surveys. This ties in with a moderation in the upward trend in freight demand following the peak of the growth cycle last year, but may also reflect greater uncertainty caused by the trade tariffs. 17% of respondents reported that they expect volumes to decline over the coming year – the highest proportion since October 2012.

Recent and expected change in traffic volumes

a) Passenger

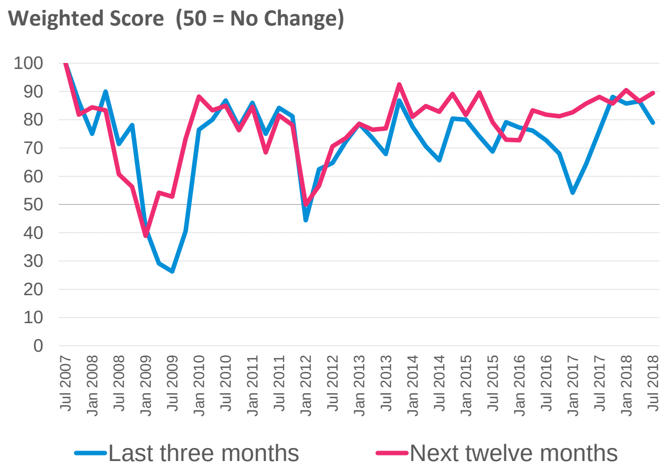


b) Cargo

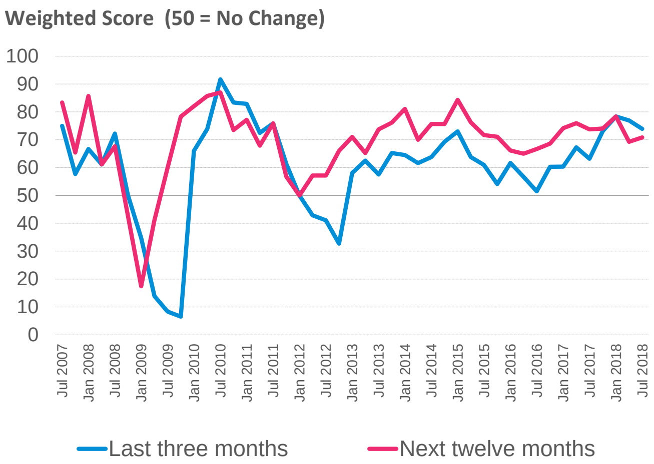


Compared to previous surveys

a) Passenger



b) Cargo

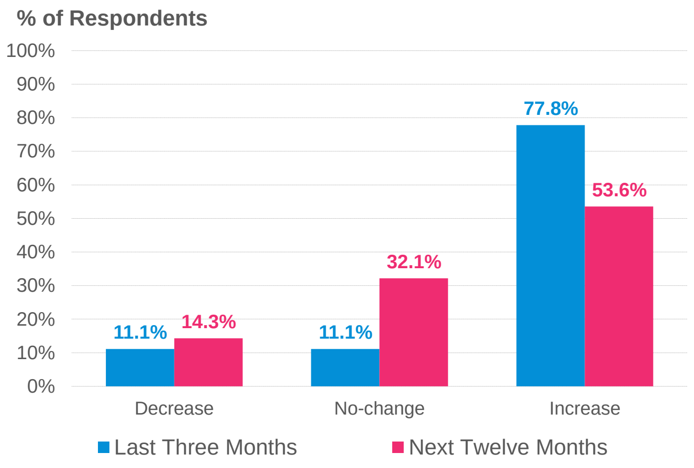


INPUT COSTS

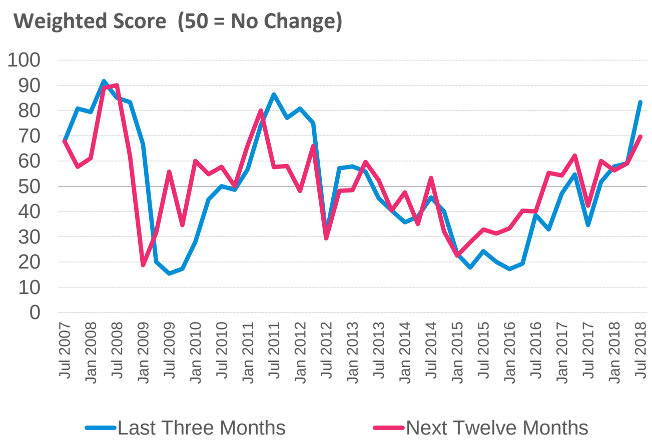
- 78% of respondents reported an increase in unit input costs in Q2 2018 compared to the same period a year ago – the highest proportion in seven years. Higher fuel prices were identified as the key driver of the increase in input costs by many respondents, with a number of European respondents pointing to higher operational costs from air traffic control strikes too. With just 11% reporting a decrease in input costs, the backward-looking weighted-average score jumped to its highest level since July 2011.
- The forward-looking weighted-average score has also continued to trend higher. Many of the 54% of respondents who expect input costs to rise further over the year ahead cited expected trends in fuel prices. However, as in recent surveys, a number of airlines mentioned that they are implementing initiatives aimed at improving operational efficiencies to help offset the upward pressure from fuel costs.

How have your unit input costs changed? How do you expect them to change over the next twelve months?

a) July 2018 survey



b) Compared to previous surveys

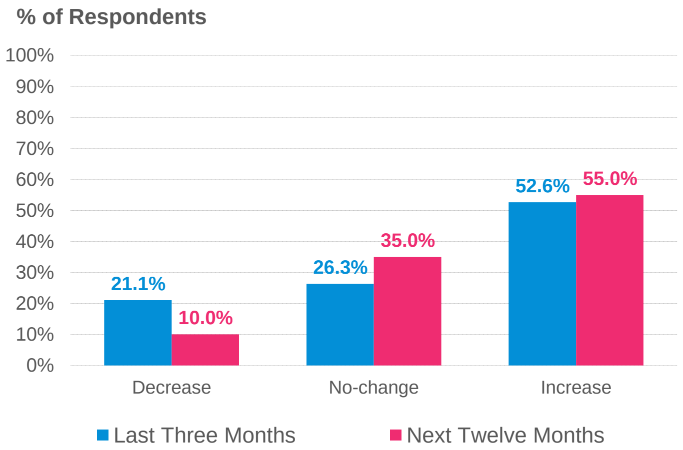


YIELD ENVIRONMENT

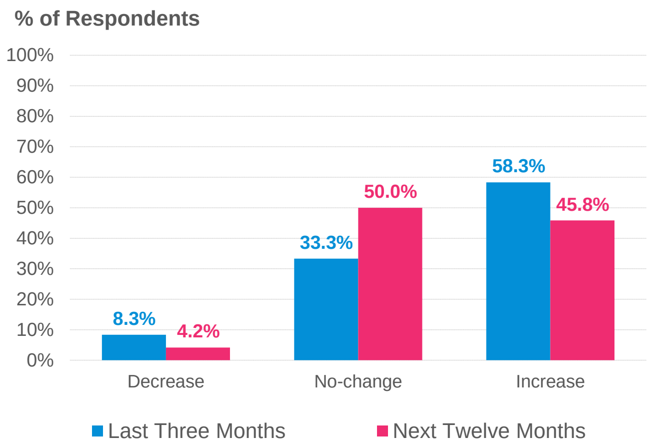
- 53% of our respondents reported higher passenger yields in Q2 2018 compared to a year ago, down from 68% last quarter but still well above the average proportion seen over the past five years. The upward trend in the backward-looking score has paused over the past year, though, which is consistent with expectations of a bigger squeeze on profit margins in Q2. Looking forward, 55% of respondents expect to increase passenger yields in the next 12 months, in part as a response to the expected upward trends in input costs.
- Meanwhile, following the ramp-up in cargo yields in H2 2017, 58% of respondents reported an annual increase in freight yields in Q2 2018 – the highest proportion since October 2010. In contrast to the slight softening in the outlook for freight volumes, the proportion of respondents who expect freight yields to decline over the next 12 months fell to an eight-year low of 4%.

Recent and expected change in yields

a) Passenger

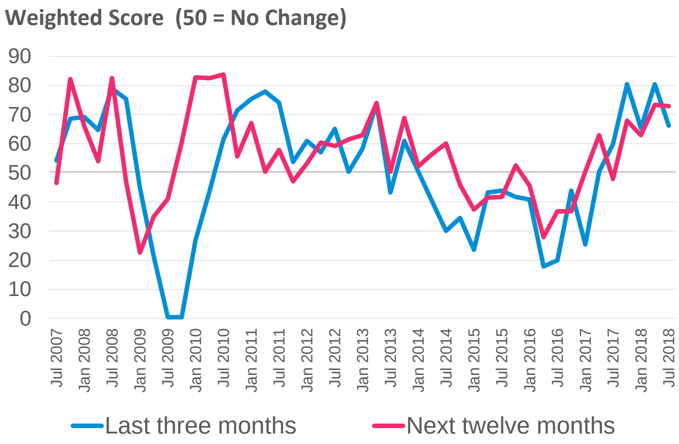


b) Cargo

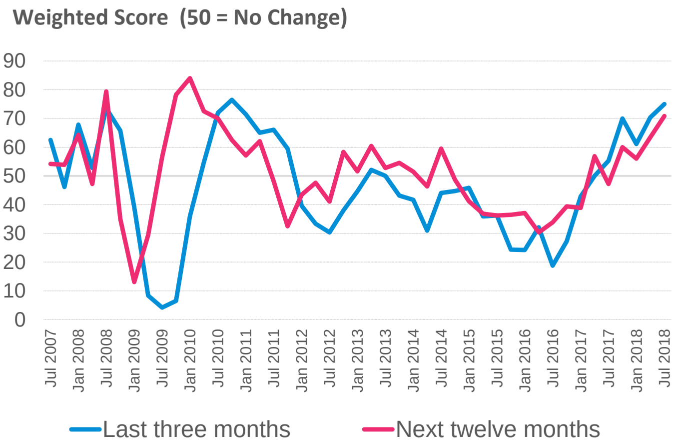


Compared to previous surveys

a) Passenger



b) Cargo

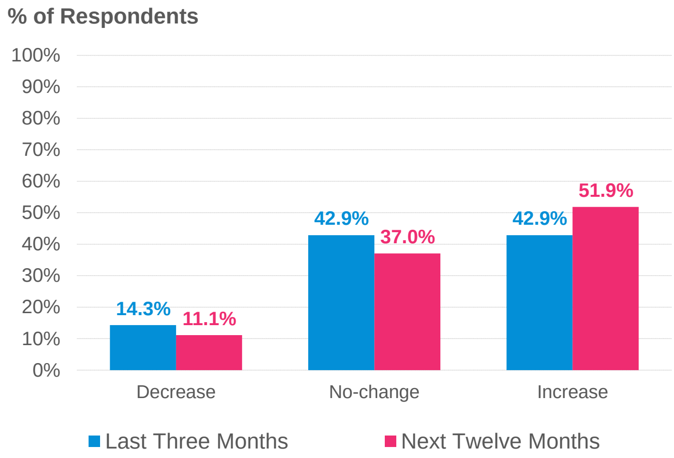


EMPLOYMENT

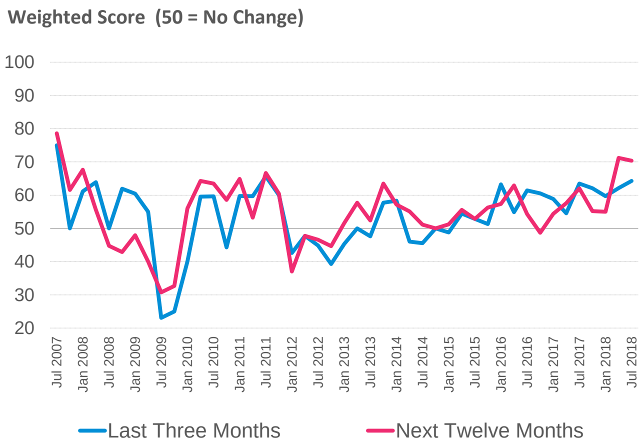
- 43% of survey respondents reported an increase in employment levels in Q2 2018 compared to the same period a year ago, with the same proportion reporting no change. All told, the backward-looking weighted-average score increased slightly from last quarter, taking it to its highest level in seven years.
- Encouragingly, the majority of respondents (52%) expect to add to employment levels over the year ahead, with just 11% of respondents reporting plans to reduce the number of staff – the lowest proportion since October 2013. As a result, the weighted-average forward-looking score remained at an elevated level, well above its long-run average.

How has your employment level changed? How do you expect it to change over the next twelve months?

a) July 2018 survey



b) Compared to previous surveys



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