Normalization of airline profitability not yet widespread or secure

February 2016

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Airline investors paid a ‘normal’ return for 1st time

Return on capital invested in airlines

Cost of capital (WACC)

Return on capital (ROIC)

Source: McKinsey, IATA
Yes, these are record profits for the industry

Source: ICAO, IATA
But the starting point is extremely low
Relatively few airlines driving industry profitability

Number of airlines in ROIC band

47 airlines: ROIC > WACC
60% of industry capital

Source: The Airline Analyst, IATA
Level of profits is clearly not ‘excessive’ even in US

US Pre-tax profits, year to Q3 2105

% operating revenues

Source: A4A
‘Normalization’ is not widespread across regions

Operating profit margins by region, 2016 vs 2010

% revenues

-5%  0%  5%  10%  15%

N America  Europe  Asia Pacific  Middle East  Latin America  Africa

Source: ICAO, IATA
Or across business sectors

Airlines revenues from passengers and cargo

Revenue from tickets and ancillaries

Revenue from cargo

Source: ICAO, IATA
Moreover balance sheets take time to strengthen

2014 free cash flow and adjusted net debt

Adjusted net debt, US$ billion

Free cash flow as a % of adjusted net debt

Median airline
$3 billion net debt
-3% FCF/net debt

6 airlines could repay all debt in next 5 years

Source: The Airline Analyst, IATA
Debt finance markets sceptical

<table>
<thead>
<tr>
<th>Investment grade</th>
<th>Airlines</th>
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<td>AA+/-</td>
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<td>BBB+/-</td>
<td>ANZ, Qantas, Lufthansa, Ryanair, Southwest, Alaska, Westjet</td>
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Source: S&P, Airfinance Journal
As are equity markets

US transportation sector

2016 forward P/E ratio

Legacy airlines  LCCs  Trucking  Rail  Integrators  Logistics

Source: Datastream

www.iata.org/economics
The role of low fuel prices is not clear-cut

Fuel unit costs and airline return on capital

Source: ICAO, McKinsey, IATA
Airlines are now better utilizing their assets

Breakeven and achieved load factor (LF)

Source: ICAO, IATA
Airlines are improving the productivity of capital

Source: ICAO, McKinsey, IATA
We still have issues in the supply chain

Return on capital across the air transport supply chain

% ROIC


Source: McKinsey for IATA

www.iata.org/economics
But this is not the main issue for airline earnings

Average yearly economic profit, USD billion, 2007-2014

Source: McKinsey for IATA
Consumers have been the major beneficiaries

Unique city-pairs and real transport costs

Source: ICAO, Boeing, OAG, IATA
But equity investors have lost their shirts!

Source: McKinsey, IATA
This is an opportunity to create resilience

- Progress so far needs to be defended strongly
- Normal not excessive airline profits
- Narrowly based improvement so far
- Investors need to be paid to risk their capital
- Balance sheets take longer to repair than P&L
- Improvement due to more than low fuel prices
- Structural gains in asset utilization and capital productivity
- Better asset utilization dependent on network cooperation
- Better capital productivity dependent on ancillaries development
- FCF opportunity to create more resilient business models and finances
- Regulatory environment also key to resilience