Industry Financial Health – narrowly based and facing challenges

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Chief Economist, IATA
2016 another year of above WACC returns

Return on capital invested in airlines

Cost of capital (WACC)

Return on capital (ROIC)

Source: McKinsey, IATA
Profits cycle now showing signs of peaking

Airline industry average EBIT margin

Source: IATA using The Airline Analyst, PaxIS+ and Platts data
Widening asset utilization gap driving returns

Breakeven and achieved weight load factor

Source: ICAO, IATA
Better capital productivity also driving returns

Capital productivity and operating margins

Source: McKinsey, ICAO, IATA
Margins now less leveraged to economic cycle?

World airline EBIT margin and global GDP growth

% change over previous year, EBIT as % revenues


ΔEBIT/ΔGDP =1.3x
=2.2x
=3.6x
=0.7x

EBIT margin
GDP growth

Source: IMF World Economic Outlook

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Industry totals hide enormous diversity

2015 ROIC = adjusted EBIT/revenue * revenue/invested capital

Source: IATA calculations from The Airline Analyst
It’s largely N America driving industry results

Net post-tax profit margins

2015 2016

N America 10% 10%
Europe 4% 3%
Asia Pacific 2% 2%
Middle East 1% 1%
Latin America 0% -2%
Africa 0% 0%
Parts of Europe also performing well but not elsewhere

Return on invested capital by region

North America
Europe
Asia Pacific
Latin America

Source: IATA calculations from The Airline Analyst
Balance sheets show the diversity of financial health

Adjusted net debt/EBITDAR by region

- Latin America
- Asia Pacific
- Europe
- North America

Source: IATA calculations from The Airline Analyst
And performance is uneven across markets

Revenues from passengers and cargo

Source: ICAO, IATA
Globalization paused and threatened?

World trade/IP ratio vs. measure of global supply chains

Index (Oct 2008=100)

Sources: IATA, Netherlands CPB, OECD-WTO TiVA database
Air travel growth has surprised on the upside

IATA forecasts of global RPK growth

% change over previous year

Source: IATA Economic Performance of the Airline Industry issues from 2012-2015
But world stuck in a low economic growth path

IMF forecasts of global economic growth (using market exchange rates)

Source: IATA using forecasts from IMF World Economic Outlook issues 2013-2016

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Price stimulation from LCC entry in significant markets

Sources: IATA using SRS Analyser data
Significant price stimulation from fuel cost pass-through

Average return fare and Brent crude oil prices

Source: IATA using PaxIS+ and Haver data
But lackluster economic cycle now seems to be slowing

Global economic cycle indicators

International trade growth
Global industrial production growth
Global business confidence index

Source: IATA using Netherlands CPB and Markit data

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World awash with savings and short of investment

US 10 year Treasury yield and 10 year TIPS real yield

10-year Treasury yield
10-year TIPS real yield

Source: IATA using data from Haver
Central banks continue to print money

Central bank assets

Source: IATA using data from Haver

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Asset price valuations back to pre-GFC levels or more

US Treasury yields, house prices and equity values

Source: IATA using data from Haver
Debt continues to grow, despite Global Financial Crisis

Outstanding debt of non-financial sector, % of GDP

Developed economies

Developing economies

Source: IATA using data from BIS
Only the consumer is keeping US GDP growth positive

Source: IATA using data from Haver
Can payrolls keep growing while corporate profits shrink?

US fixed investment growth and change in non-farm payrolls

% change over previous year

Corporate profits growth

Non-farm payrolls

Recessions

Source: IATA using data from Haver
World economy (and aviation markets) at a cross-roads

- Central banks creating asset bubbles not economic growth
- Dangerous levels of indebtedness
- Brexit, support for populism, symptoms of rising inequality
- Two main scenarios:
  - Pessimistic: renewed debt deflation + protectionism; supply-side damage
  - Optimistic: incumbent governments respond to threats from populism and embrace reflationary policies
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