The initial data for Q1 2018 indicate a pick-up in airline financial performance relative to the same period a year ago. The improvement was broad-based, with every region except Europe posting a widening in their EBIT margin.

Despite these signs, global airline share prices fell by 4.8% in April, and underperformed the wider equity market by the widest margin in 10 months. The decline in April was led by North America, where investor concerns of the impact of rising capacity and fuel prices have seen airline shares fall by nearly 12% since the start of the year.

Oil prices rose to their highest level since late-2014 in April, driven by tighter market supply and geo-political tensions. At the time of writing, the Brent crude oil price is currently around 50% higher than a year ago.

The seasonally adjusted trends in passenger and freight demand have diverged in recent months. While industry-wide passenger capacity is still growing broadly in line with demand, slower freight demand has seen the freight load factor slip back of late.

In an illustration of the importance of the premium-class cabin for airline finances, the premium cabin accounted for 5.4% of total international origin-destination passenger traffic, and just over 30% of revenues, in Jan-Feb combined.

Airline shares underperformed global equities in April by the widest margin in 10 months

Airline Financial Results

<table>
<thead>
<tr>
<th>Region</th>
<th>Q1 2017 EBIT margin</th>
<th>Q1 2017 Net post-tax profit</th>
<th>Q1 2018 EBIT margin</th>
<th>Q1 2018 Net post-tax profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>7.7%</td>
<td>1,482</td>
<td>7.9%</td>
<td>1,548</td>
</tr>
<tr>
<td>Asia-Pacfic</td>
<td>9.4%</td>
<td>963</td>
<td>9.9%</td>
<td>1,469</td>
</tr>
<tr>
<td>Europe</td>
<td>-2.2%</td>
<td>-316</td>
<td>-2.4%</td>
<td>-315</td>
</tr>
<tr>
<td>Latin America</td>
<td>-13.6%</td>
<td>-73</td>
<td>-12.8%</td>
<td>-71</td>
</tr>
<tr>
<td>Sample total</td>
<td>6.5%</td>
<td>2,056</td>
<td>6.8%</td>
<td>2,631</td>
</tr>
</tbody>
</table>

Sources: The Airline Analyst, IATA

Airline share prices fell by 4.8% in April – the third monthly decline in a row – which left them 5.8% lower than where they started the year. The global airline share price index underperformed the wider equity market by the widest margin in 10 months.

The decline in the global airline index in April was led by a 7.1% fall in North America. Airline shares in the region have now fallen by almost 12% since the start of the year, driven by investor concerns of the impact of rising capacity growth and fuel prices.

European and Asia Pacific airline shares both also fell in April (by 5.7% and 1.3%, respectively), although both indices remain more than 25% higher than they were a year ago.

Despite the downbeat equity market performance, the initial financial results from Q1 2018 actually point to an improvement in industry-wide financial performance relative to the same period a year ago. The EBIT margin in our sample of 26 airlines increased to 6.8%, up from 6.5% a year ago.

Every region with the exception of Europe registered a modest annual improvement in their profit margin. (Note that the first quarter of the year is always a weak period for airline European airline profitability.)

The increase in net post-tax profits in our sample was driven by airlines based in Asia Pacific, helped in part by continued robust freight yield performance.

Source: Thomson Reuters Datastream

IATA Economics: www.iata.org/economics
Net cash flow returned to double-digit territory in Q4 2017, supporting higher free cash flow

We do not yet have enough data to create a representative sample of free cash flow (FCF) for Q1 2018. Nonetheless, our sample from Q4 2017 showed an improvement in free cash flow in annual terms late last year. (Recall that FCF tends to be negative during the final quarter of each year.)

The outcome in Q4 reflected a combination of both an increase in net cash flow from operations (to 10.8% of revenue, from 8.4%) as well as a moderate decline in capex spending.

As usual, the industry-wide estimate masked a range in performance at the regional level. Negative FCF outcomes in North America & Europe were mostly offset by positive outcomes elsewhere.

Fuel costs

Oil prices have continued to trend higher, currently around 50% higher than a year ago

Global oil prices rose to their highest level since late-2014 in April. At the time of writing, the Brent crude benchmark is sitting just below $75/bbl, around 50% higher than a year ago.

Recent gains in oil prices have been driven by a combination of a gradual reduction in global oil inventories on the back of a tightening in supply, as well as heightened geo-political concerns.

That said, the futures curve remains consistent with a modest decline in oil prices from their current levels over the next 12-18 months. Indeed, the current curve points to oil prices falling to around $65/bbl by mid-2020.

Yields and premium revenues

Passenger yields (excl surcharges & ancillaries) rise strongly in monthly terms in February

Having trended sideways in SA terms since late-2016, passenger yields posted their strongest month-on-month rise in at least seven years in February. In US$ terms, yields in February were 1.5% higher than the same month in 2017.

While we would caution against reading too much into one month’s worth of data, the February reading is perhaps the clearest sign yet of the expected upward trend in yields following increases in key airline input costs.

Recall that our yield data relate to developments in the ‘base’ airfare only and exclude revenue from surcharges and ancillary services. Such additional sources of passenger revenue also look to be helping to support the ongoing robust financial performance of the industry.
Premium-class volumes and revenues remain broadly in line with those a year ago

Premium-class passengers accounted for 5.4% of total international origin-destination traffic in January and February combined – unchanged from the share seen in the same period of 2017.

In an illustration of the importance of the premium-class cabin to airline financial performance, premium-class revenues accounted for 30.1% of total international revenues in Jan-Feb; again, this share is broadly unchanged from a year ago.

It is worth noting that the three largest markets in terms of premium revenues have all seen positive growth in premium passenger traffic in annual terms so far in 2018, albeit at slightly slower rates than seen in the corresponding economy cabins.

Demand

Passenger and freight trends have diverged in recent months

Industry-wide revenue passenger kilometres (RPKs) increased by 9.5% year-on-year in March 2018 – the fastest pace in 12 months and well above the five-year average rate (6.8%).

Robust growth in air travel has continued to be supported by the comparatively strong global economic backdrop.

By contrast, annual growth in industry-wide freight tonne kilometres (FTKs) fell to its slowest pace since early-2016 (1.7%). The broader slowdown in the upward trend in demand suggests that the recent period of air freight outperformance relative to global good trade looks to be firmly behind us.

Capacity

Passenger capacity currently rising broadly in line with demand, but freight rising faster

Industry-wide available seat kilometres (ASKs) increased by 6.4% year-on-year in March. Passenger capacity has continued to trend upwards in SA terms in recent months, broadly in line with the similar upward trend in demand.

Meanwhile, available freight tonne kilometres (AFTKs) rose by 4.4% year-on-year in March 2018, down from 6.3% in the previous month.

In a reflection of the recent moderation in the upward trend in freight demand, this was the first time in 20 months that the annual AFTK growth has exceeded that of FTKs.
Strong month for deliveries in March, alongside a boost to the fleet from storage activity too

- The number of available seats in the global airline fleet increased by 0.9% month-on-month in March, and by 5.5% compared to the same month in 2017.
- 172 aircraft were delivered in the month, compared to 145 in the same period a year ago. Altogether, the number of aircraft delivered in the first quarter of 2018 was broadly unchanged from that seen in Q1 last year (337 vs. 340).
- 123 aircraft left the fleet to go into storage in March, although the impact on the total fleet size was more than offset by the 166 aircraft returning to the fleet from storage during the month.

Passenger load factor rose back above 82% in Feb, as freight loads have continued to slip

- The passenger load factor increased by 2.3 percentage points relative to the same month a year ago, taking it to a record high for the month, at 82.4%. The load factor rose back above 82% on an SA basis in March too, for just the second time ever.
- Meanwhile, the industry-wide freight load factor fell in year-on-year terms for the first time since July 2016. The slowdown in the upward trend in freight volumes (FTKs) since mid-2017 has been reflected in a corresponding decline in the SA load factor.

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