

AIRLINES FINANCIAL MONITOR

KEY POINTS

FEBRUARY 2017 - MARCH 2017

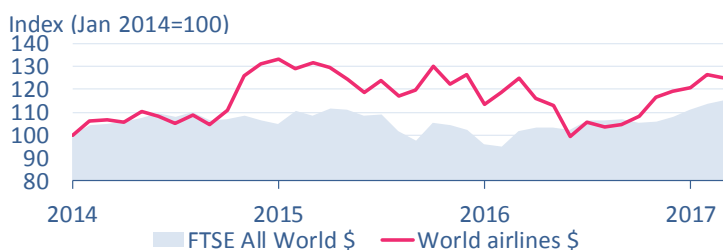
- ➔ Despite an improved performance by European carriers, the latest financial results for Q4 2016 confirm a second quarter of modest easing in industry-wide profitability – albeit from historically high levels.
- ➔ Global airline share prices fell by 1.5% in March, unwinding recent gains, with a correction in the North American index more than offsetting modest gains in Europe and Asia Pacific.
- ➔ Brent crude oil prices fell substantially in March, ending ~6.4% lower, at \$US52.40/bbl. Oil prices are 30% higher compared with a year ago and are still expected to rise only gradually over the next 2-3 years.
- ➔ Although still well down on their year-ago level, average passenger yields are showing preliminary indications of having possible bottomed, after falling steadily for around 4 years.
- ➔ The momentum that passenger and freight demand carried into 2017 may be starting to wane, although the data are always more volatile at this time of the year. The industry-wide passenger load factor remains steady at historical highs a record high, while the freight load factor has eased a little after a strong recovery in 2016.
- ➔ Premium airfares continue to hold up better than those of the economy cabin, supporting airline finances.

Financial indicators

Global airline share price index unwound some of its recent gains in March

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Mar 31st	% change on		
		one month	one year	start of year
World airlines	124.6	-1.5%	0.0%	+4.6%
Asia Pacific airlines	105.6	+1.1%	-7.6%	+12.2%
European airlines	95.4	+3.1%	-12.8%	+10.7%
North American airlines	165.5	-6.3%	+7.1%	-2.4%
FTSE All World \$	115.0	+1.0%	+12.8%	+6.4%



Source: Thomson Reuters Datastream

- ➔ Global airline share prices fell by 1.5% in March, partly unwinding recent gains. The global index is now unchanged from a year ago, while global equities overall are up ~13% over the same period.
- ➔ This month's decline was driven by US airline share prices which fell by 6.3% and are 2.4% lower than the start of the year. However, over a 12 month period, North American airline shares remain the clear standout performer, currently up a robust 7.1%.
- ➔ The Asia-Pac and Europe airline indices gained 1.1% and 3.1% respectively in the month and have both increased at a double-digit rate since the start of 2016. Even so, both are still solidly lower compared with their levels of a year ago.

Industry-wide profits eased for a second quarter, albeit from a high level

Airline Financial Results

Number of airlines in sample	Regions	Q4 2015		Q4 2016	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
17	North America	14.6%	4,651	11.4%	1,917
21	Asia-Pacific	8.5%	2,686	10.0%	1,106
14	Europe	3.1%	907	1.3%	1,340
5	Latin America	6.1%	-4,562	8.0%	188
5	Others	7.4%	49	16.1%	12
62	Sample total	9.3%	3,731	8.3%	4,563

¹ % of revenues ² US\$ million

Note: Includes Air New Zealand, Comair Limited, Qantas Airways, Regional Express, Virgin Australia, China Southern and Cathay Pacific half-year results.

Sources: The Airline Analyst, IATA

- ➔ The latest Q4 financial results confirm a successive quarter of decline, although margins remain robust.
- ➔ The EBIT margin in our sample of 62 airlines eased by one percentage point compared with a year ago, to 8.3%. The decline in the margin for North American and European airlines outweighed the gains in other regions. (Note that the large Latin America net post-tax loss figure for Q4 2015 relates to a one-off loss item relating to exchange rates.)

Free cash flow negative in Q4 2016, but broadly in line with Q4 2015

Airline Cash Flow¹

Number of airlines in sample	Regions	Q4 2015			Q4 2016		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
15	North America	9.5%	14.8%	-5.3%	8.2%	14.4%	-6.1%
12	Asia-Pacific	18.2%	21.5%	-3.3%	16.8%	24.1%	-7.3%
8	Europe	2.7%	11.2%	-8.4%	3.2%	10.2%	-7.1%
4	Latin America	13.0%	18.0%	-5.0%	10.7%	8.9%	1.8%
2	Others	24.5%	6.9%	17.6%	16.0%	21.9%	-5.9%
41	Sample total	9.1%	14.8%	-5.8%	8.1%	14.2%	-6.1%

¹ % of revenues

² From operating activities

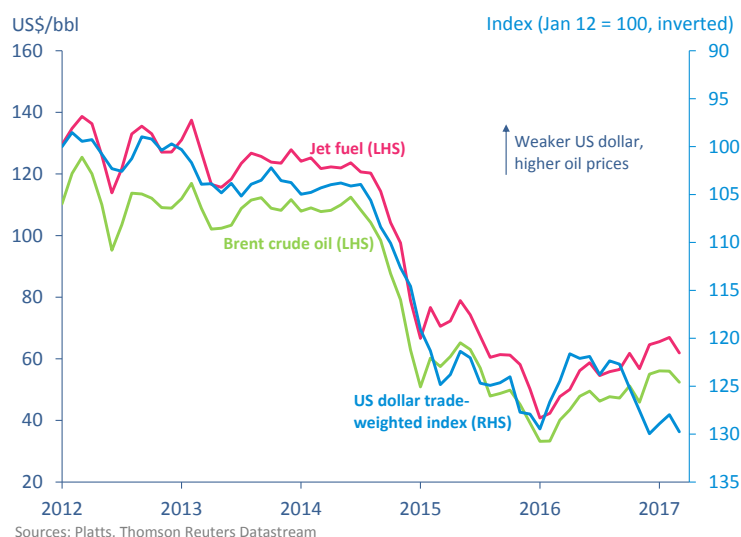
Note: Includes Air New Zealand, Comair Limited, Qantas Airways, Regional Express and Virgin Australia half-year results.

Sources: The Airline Analyst, IATA

- Of the 41 airlines reporting data, net cash flow from operations fell moderately – by 1pp, to a still robust 8.1% of revenue – in 2016Q4 compared with 2015Q4. We again note that Q4 is a seasonally weak period for the industry overall.
- Capital expenditure was a little lower than a year ago (down 0.6pp to 14.2% of revenue), leaving free cash flow almost unchanged from Q4 2015.
- Latin America was the only region with a positive free cash flow outcome, mainly due to a significant drop in capex.

Fuel costs

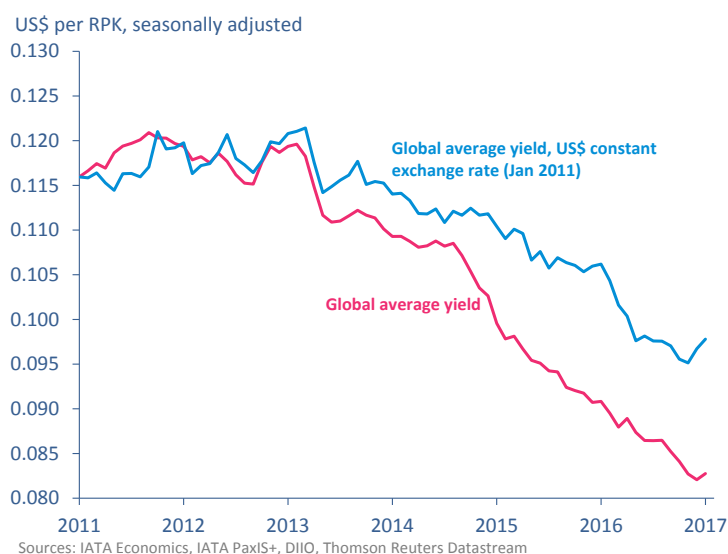
Brent oil price fell back in March, ending at US\$52/bbl



- After a very steady month in February, the benchmark Brent oil price fell sharply in the early part of March, mid-month, losing ~5%. The oil price has stabilized in the period since to end the month at US\$52.40/bbl, around 6.4% lower than its level at the end of February.
- Notwithstanding this significant shift, and clear indications that a rebalancing in the oil market is underway, financial markets views over the medium to long term oil price outlook were little changed. A modest increase in oil prices, to around \$US60 is expected over the coming years.
- The US\$ pared recent losses, rising to around 130 on a trade-weighted basis, broadly unchanged from its level at the end of last year.

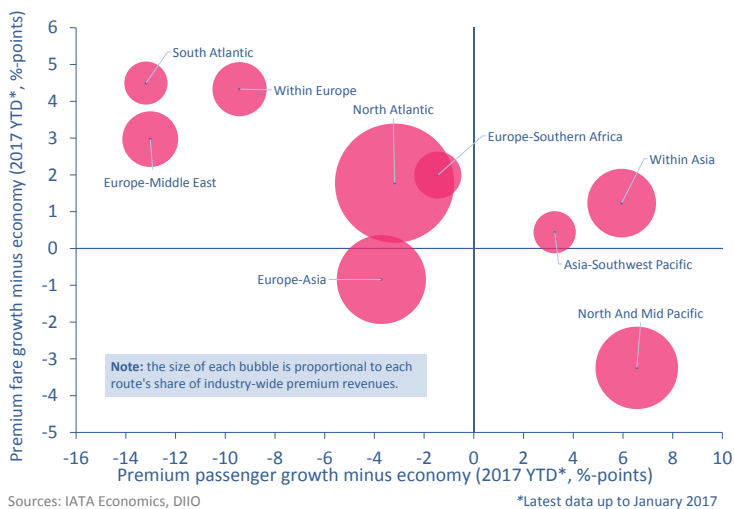
Yields and premium revenues

Further signs of a possible turning point for industry yields



- Last month we noted the tentative uptick in the (seasonally adjusted) constant exchange rate measure of passenger yields. This month we saw another upward movement in this series – as well as the first upwards shift in the non-adjusted series since April last year.
- Although too early to be certain, both of these developments give a little more confidence that passenger yields have bottomed and may start drifting higher, alongside the trend increase observed in some key input costs.
- Even so, yields are still well down compared with their year-ago levels; down 9% yoy in the headline measure and down 8% in constant exchange rate terms.

Premium traffic remains an important contributor to airline financial performance

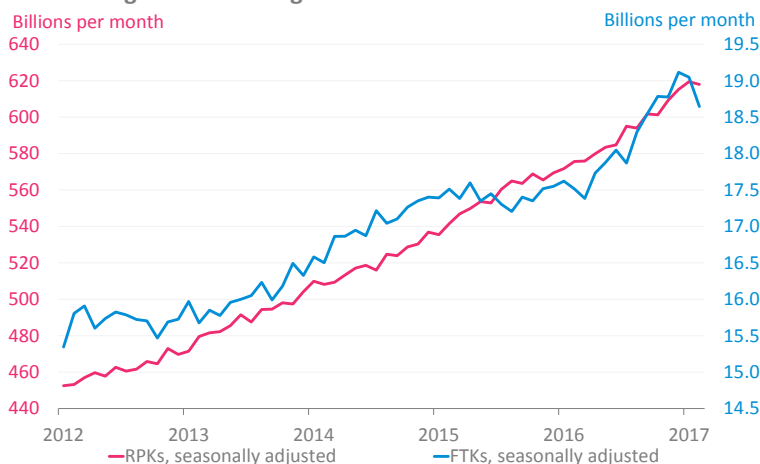


- ➔ Annual growth in premium passenger traffic lags its economy counterpart in seven of the top 10 premium markets. The exceptions are Within Asia, Asia-Southwest Pacific and routes on the North and Mid-Pacific markets.
- ➔ Premium O-D international journeys accounted for 5.2% of the global total over last year as a whole, down from 5.6% in 2015.
- ➔ However, premium airfares have generally held up better than those in the economy cabin. Of the top 10 premium markets, in only two (Europe-Asia and North and Mid Pacific) markets did the premium fares underperform economy. This highlights the importance of premium cabin revenues to support overall financial performance.

Demand

The strong momentum in pax and freight traffic has waned although growth remains strong

Air Passenger and Air Freight Volumes

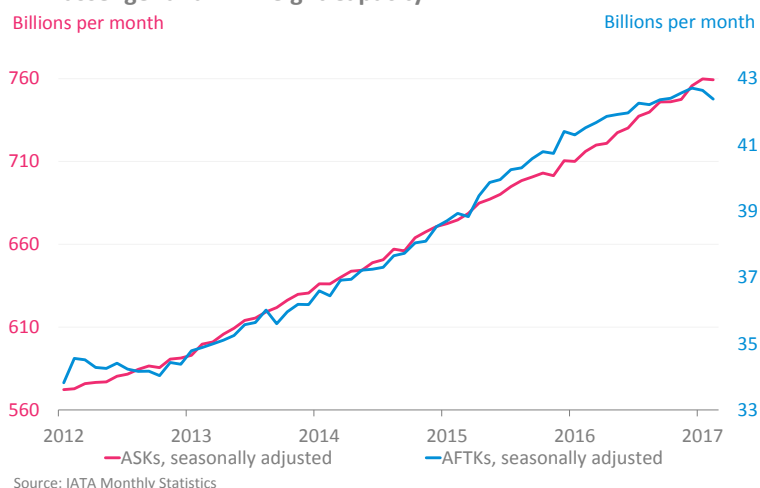


- ➔ The clear upward trends in both the passenger and freight volume data in H2 2016 and into the start of this year has waned. In seasonally-adjusted terms, the level of RPKs was relatively unchanged in Feb while the level of FTKs fell.
- ➔ Even so, the year-on-year growth rate comparison remains favorable; RPKs were up 4.8% and FTKs 8.4% year-on-year in February – around 8.6% and 12.0% respectively allowing for the extra day in February 2016.
- ➔ As always at this time of year, the data are disrupted more than usual and it is too early to call an end to the strong upwards trend – we will be seeking a clearer signal from upcoming data.

Capacity

Upward trend in passenger capacity takes a pause, and the easing continues for freight

Air Passenger and Air Freight Capacity

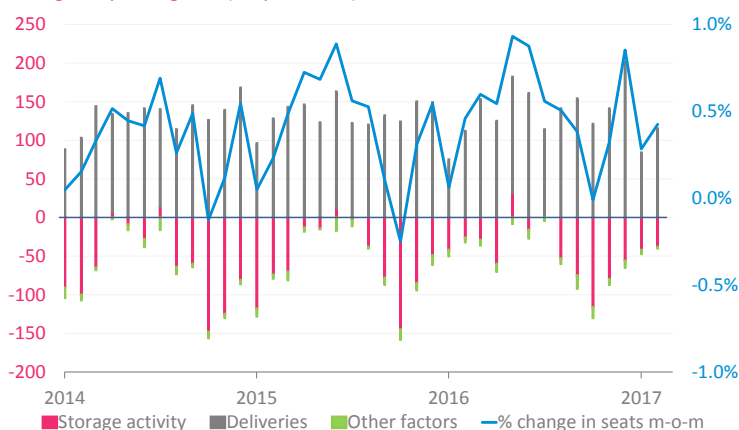


- ➔ Developments in capacity over recent months bear a clear resemblance to the trends observed in demand.
- ➔ In seasonally adjusted terms, the level of industry-wide available seat kilometres (ASKs) has paused its upward trend, and the level of available freight tonne kilometres (AFTKs) has slipped a little lower.
- ➔ In growth terms, ASKs are a sturdy 6% higher compared with their level of a year ago while AFTKs are up a more modest 2%.

Another modest rise in the number of available seats in February

Airline Fleet Development

Change in operating fleet (a/c per month)

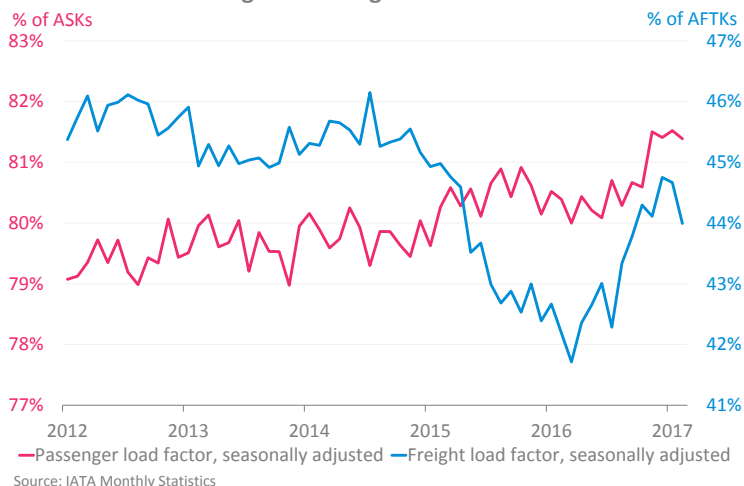


Source: Ascend

- The number of available seats in the global airline fleet increased by 0.3% month-on-month in February, and by 6.4% compared with Feb 2016.
- 115 new aircraft were delivered in February – slightly ahead of those seen in February 2016 (112). The timing of holiday periods, particularly in China, can affect aircraft delivery schedules at the start of each year. Looking across January and February combined, 199 aircraft were delivered in the first two months of 2017, compared to 187 during the same period last year.

Passenger load factor consolidates, but freight loads retrace, some of the recent gains

Load Factors - Passenger and Freight



Source: IATA Monthly Statistics

- So far in 2017, the passenger load factor has consolidated the gains made in late 2016. The PLF was 81.4% in February, the fourth consecutive month at a historically high level.
- The strong recovery in the freight load factor over the course of 2016 has been partly unwound in recent months, as the easing in demand has outweighed the reduction in capacity. The freight load factor has slipped back from a peak of 44.8% in December to 44.0% now.

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