

AIRLINES FINANCIAL MONITOR

KEY POINTS

JANUARY 2017 - FEBRUARY 2017

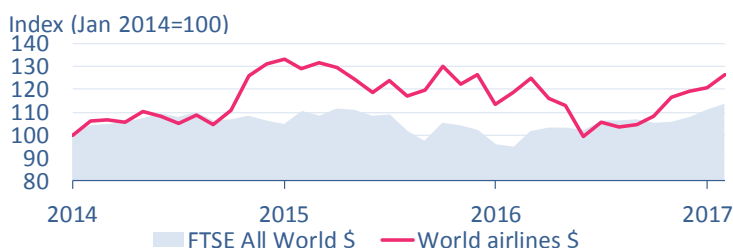
- The latest financial results for Q4 2016 show that the decline in profitability, which began in the third quarter of 2016, continued across most regions in the fourth quarter, albeit from historically high levels.
- Global airline share prices continued their positive start to 2017 during February, outperforming the wider global equity market, as expectations for airlines profits improve, particularly in the US.
- Brent crude oil prices have been broadly stable since December, and traded within a very tight band of \$US55-57/bbl during February. Oil prices are still expected to rise only gradually over the years ahead.
- Average passenger yields in US\$ terms continue to fall, but the recent strength of the US\$ may be disguising signs of a stabilization or slowing of this down-trend.
- Passenger and freight demand both carried momentum into the New Year. The industry-wide passenger load factor remains stable at a record high, and the freight load factor has continued to recover.
- Premium fares generally held up better than those of the economy cabin in 2016, and premium's share of revenues increased on a number of key routes. This has helped to support airline financial performance.

Financial indicators

Global airline share prices continued their positive start to 2017 during February

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Feb 28th	% change on		
		one month	one year	start of year
World airlines	126.5	+4.6%	+6.8%	+6.2%
Asia Pacific airlines	104.4	+3.6%	-2.7%	+11.0%
European airlines	92.5	+3.7%	-10.3%	+7.4%
North American airlines	176.7	+6.0%	+17.8%	+4.2%
FTSE All World \$	113.9	+2.7%	+19.8%	+5.4%



Source: Thomson Reuters Datastream

- Global airline share prices rose by 4.6% in February, their sixth consecutive monthly increase and ahead of the wider global equity market (2.7%).
- All three regional indices that we track increased in February. European airlines gained another 3.7% over the month, following similar-sized gains in January and December. The Asia-Pac index rose by a similar rate, taking its gain since that start of the year to 11.0%. Meanwhile, having dipped by 1.7% in January, the North American index jumped by 6.0%.
- Airline shares have risen by a solid 6.8% over the past year. However, this has been driven entirely by the North American index (up 18%) where market expectations about profitability have improved the most.

Industry-wide profits declined 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
16	North America	14.6%	4,652	11.4%	1,918
15	Asia-Pacific	13.2%	1,627	12.3%	1,467
8	Europe	5.9%	883	4.9%	1,127
4	Latin America	5.6%	-4,546	8.3%	133
4	Others	10.8%	37	1.0%	14
47	Sample total	12.3%	2,653	10.2%	4,659

¹ % of revenues ² US\$ million

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

Sources: The Airline Analyst, IATA

- The latest financial results from Q4 show a second successive quarter of decline, although margins remain at historically high levels.
- The EBIT margin in our sample of 47 airlines eased by two percentage points compared with a year ago, to 10.2%. The EBIT margin dipped in all regions except Latin America. (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 declines slightly in Q4 2016, as net cash flow falls and capex edges up

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%
9	Asia-Pacific	21.3%	26.2%	-5.0%	18.4%	28.9%	-10.5%
5	Europe	3.2%	11.9%	-8.7%	6.1%	11.9%	-5.7%
3	Latin America	11.5%	4.0%	7.5%	10.0%	10.1%	-0.1%
2	Others	24.5%	6.9%	17.6%	16.0%	21.9%	-5.9%
34	Sample total	10.2%	15.4%	-5.2%	9.3%	15.7%	-6.4%

¹% of revenues

²From operating activities

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

Sources: The Airline Analyst, IATA

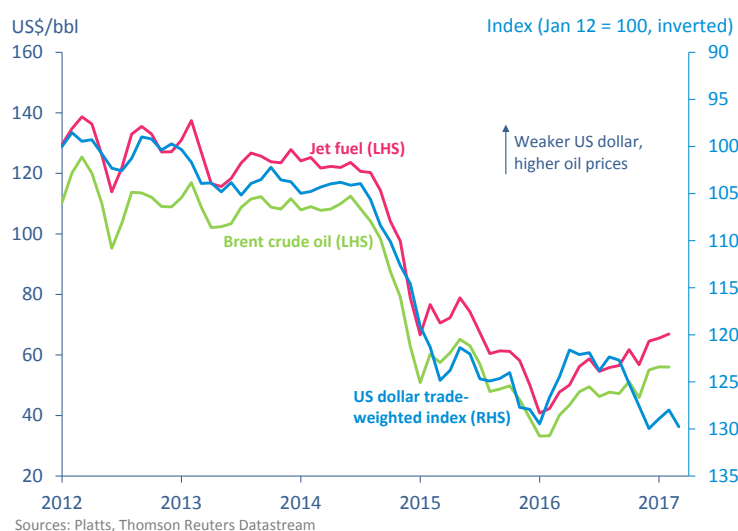
→ Net cash flow from operations in our sample of 34 airlines fell modestly in Q4 2016 compared with a year ago (down around 1pp to 9.3% of revenues). Q4 is a seasonally weak period and these levels are still historically high.

→ Capital expenditure in the sample edged up over the same period (to 15.7% of revenue, from 15.4% in Q4 2015). As a result of this, plus seasonally weak cash flow from the business, free cash flow turned negative after the positive results of Q3.

→ Free cash flow positions fell compared with a year ago in North America, Latin America and Asia Pacific, but rose in Europe.

Fuel costs

Brent oil price has remained stable, trading in a tight band around US\$55-57/bbl in February



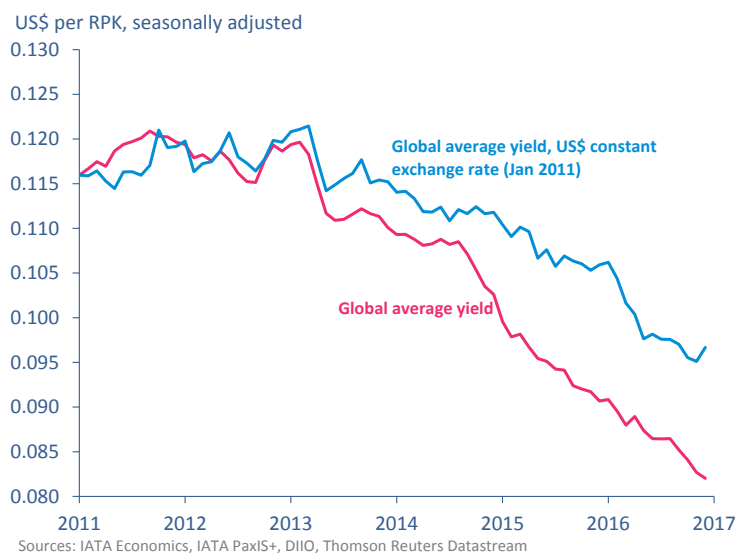
→ Oil prices were very stable during February, with the price of Brent crude trading in a tight band of US\$55-57/bbl over the month. The spot price of a barrel of jet fuel edged up and averaged its highest level since July 2015.

→ Oil prices rose sharply in December 2016 following the decision by OPEC and non-OPEC countries alike to limit production. The impact of this decision outweighed the dampening impact of the strengthening in the US dollar over the period.

→ A rebalancing in the oil market is underway. But financial markets are still only pointing to only a modest rise in oil prices over the next 2-3 years. Prices are expected to remain below US\$60/bbl over this period.

Yields and premium revenues

A turning point for industry yields?

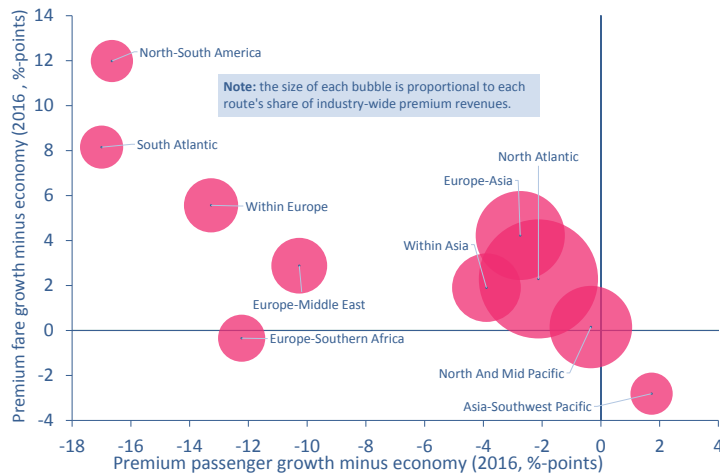


→ Industry-wide passenger yields have trended downwards since late-2014, and fell by 8.8% in 2016 compared to the previous year. Last year's development came alongside upward trends in oil and jet fuel prices – along with rising labor costs in some key markets.

→ Given that the yield data are denominated in US\$, the significant swings in that currency over the past 2-3 years impacts the results. Correcting for this effect, the constant exchange rate series (the blue line on the chart) shows that yields increased in seasonally adjusted (SA) terms in December for the first time in six months.

→ Nonetheless, it remains to be seen whether the latest data mark a turning point in the downward trend for yields, and there is a lot of variation by market.

The premium traffic segment continues to support overall airline financial performance



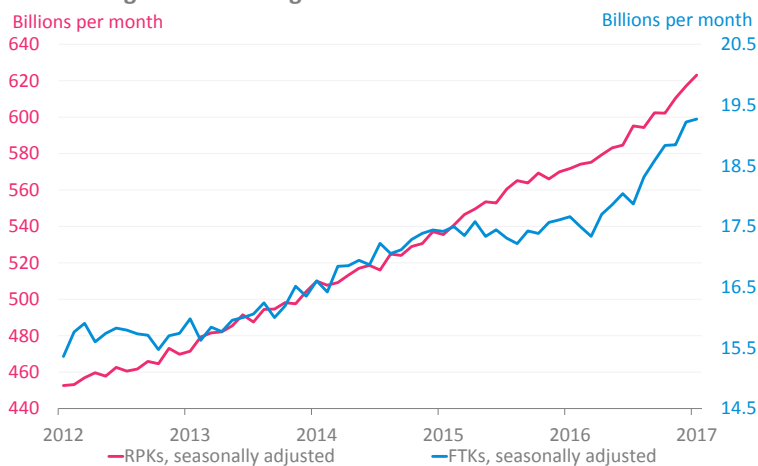
Sources: IATA Economics, DIIQ

- ➔ Annual growth in premium passenger traffic typically lagged behind its economy counterpart on the top-10 premium international markets in 2016. (The only exception was traffic on the market between Asia and the Southwest Pacific.)
- ➔ 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.
- ➔ Despite having fallen by 7% on average on the key routes in 2016, premium airfares generally held up better than those in economy last year. As a result, premium's share of revenues increased on the important Transatlantic and Europe-Asia markets, and this has helped to support airlines' overall financial performance.

Demand

Passenger & freight traffic both carry strong momentum into 2017

Air Passenger and Air Freight Volumes



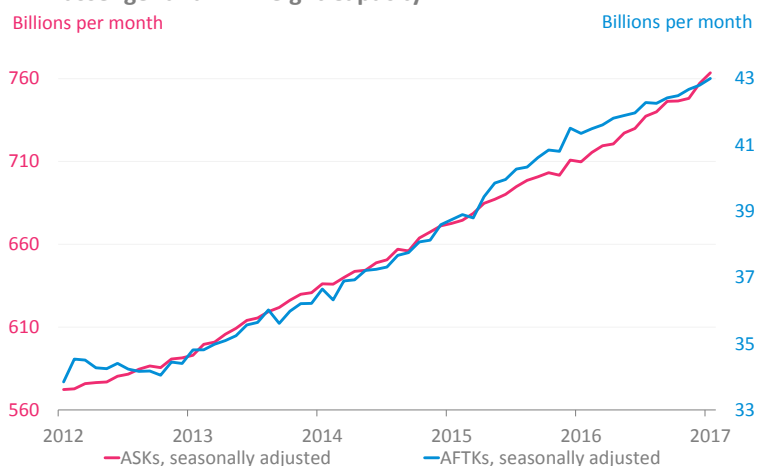
Source: IATA Monthly Statistics

- ➔ Annual growth in industry-wide passenger traffic accelerated to 9.6% year-on-year in January – its fastest pace since April 2011. We estimate that the relatively early timing of Chinese New Year may account for 0.5 percentage points of the annual growth rate in January, but the bigger picture is that the trend in SA traffic has strengthened into 2017.
- ➔ Annual growth in global FTKs also made a robust start to 2017 (6.9% year-on-year in January). The timing of Chinese New Year is always a complicating factor for freight traffic at the start of each calendar year, but the upward momentum in SA traffic appears to have continued.

Capacity

Upward trend in passenger capacity remains strong, but has eased for freight

Air Passenger and Air Freight Capacity



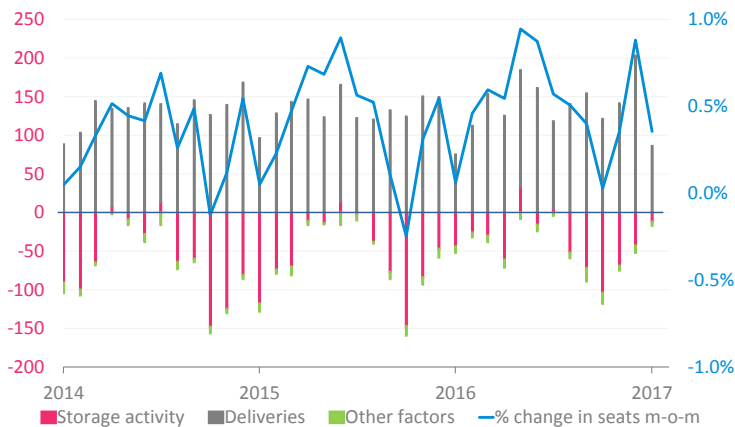
Source: IATA Monthly Statistics

- ➔ Industry-wide available seat kilometres increased by 8.0% year-on-year in January. After a brief pause during the third quarter of 2016, the upward trend in SA passenger capacity has resumed.
- ➔ On the freight side, available freight tonne kilometres, increased by 3.5% year-on-year in January. The SA upward trend in capacity has moderated since the middle of last year.

Modest rise in number of available seats in January, after a strong December

Airline Fleet Development

Change in operating fleet (a/c per month)

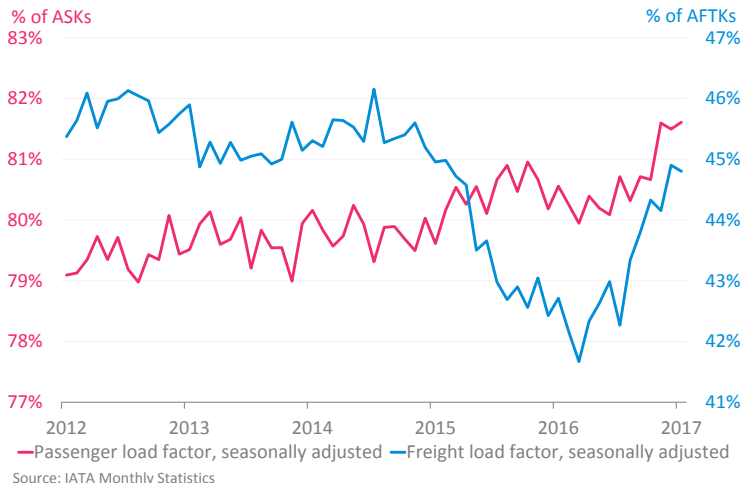


Source: Ascend

- The number of available seats in the global airline fleet increased by 0.4% month-on-month in January, and by 6.7% compared with Jan 2016.
- The timing of holiday periods, particularly in China, can affect aircraft delivery schedules at the start of each year. 86 new aircraft were delivered in January – well down on the 203 delivered in December, but still ahead of those seen in January 2016 (75).

Passenger load factor remains stable at a record high, alongside a rebound in freight loads

Load Factors - Passenger and Freight



Source: IATA Monthly Statistics

- The passenger load factor registered its highest annual average outcome on record in 2016, and has remained elevated into 2017. The load factor edged up in SA terms in January, and has been stable around an all-time high for the past three months.
- The moderation in the upward trend in freight capacity growth, combined with the robust upward trend in demand, has underpinned a rebound in the SA industry-wide freight load factor. The load factor has risen by three percentage points since its low in early-2016, and is now closing in on the 45% level that was typical over the 2012-2014 period.

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 9th March 2017

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