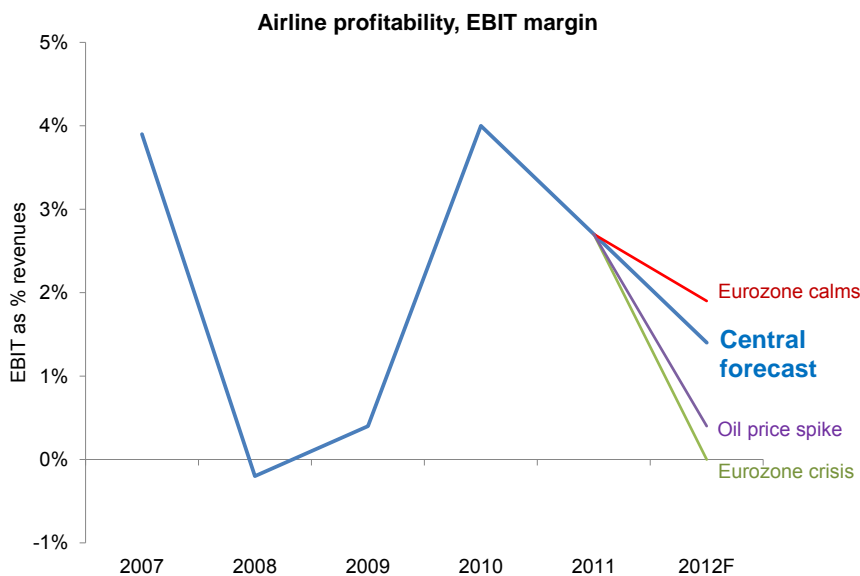


# FINANCIAL FORECAST

June 2012

## PROFIT RISKS SKEWED TO THE DOWNSIDE

- Our forecast for airline industry profits is unchanged in this quarterly update. We continue to expect net post-tax profits for the whole industry to fall from \$7.9 billion in 2011 to \$3 billion in 2012, which is just 0.5% of revenues. However, both the regional composition and the risks to the central forecast have altered.
- Since the last forecast air travel volumes continued to expand strongly, at a above-trend pace, while air freight volumes have shown tentative signs of turning up from the lows of late last year. Jet fuel and oil prices have fallen. We have revised our Brent crude oil price forecast in line with the consensus forecast to an average of \$110/b for 2012, down from the previous forecast of \$115/b. However, this is not entirely good news. Oil prices are weaker because of concerns about the Eurozone. We now base our forecast on the market's view that the Eurozone sovereign debt crisis will intensify, weakening economic growth in the region further in the second half of this year.



Source: IATA

- The regional composition of the forecast has changed significantly, with US and Latin American airlines expected to generate more profit this year, offset by larger losses in Europe and smaller profits in Asia-Pacific. Moreover, risks to our central forecast have risen with turmoil in the Eurozone threatening a banking crisis, of a much larger scale than assumed in the central forecast. Neither can risks to oil prices, from supply disruptions in the Middle East, be dismissed. These risks to airline profits remain skewed to the downside.

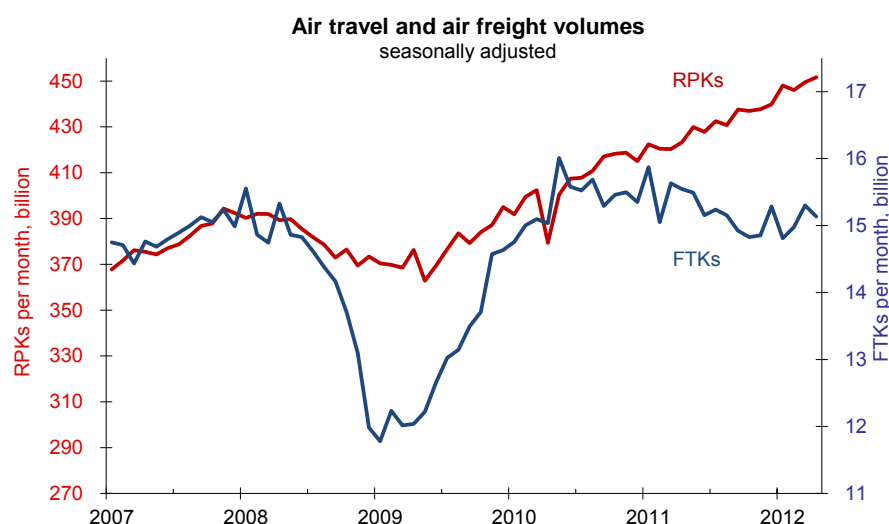
System-wide global commercial airlines	EBIT margin, % revenues				Net profits, \$ billion			
	2009	2010	2011	2012F	2009	2010	2011	2012F
<b>Global</b>	<b>0.4%</b>	<b>4.0%</b>	<b>2.9%</b>	<b>1.4%</b>	<b>-4.6</b>	<b>15.8</b>	<b>7.9</b>	<b>3.0</b>
<b>Regions</b>				<b>Central forecast</b>				<b>Central forecast</b>
North America	1.2%	4.7%	2.9%	2.2%	-2.7	4.1	1.3	1.4
Europe	-2.2%	1.9%	0.9%	0.0%	-4.3	1.9	0.5	-1.1
Asia-Pacific	2.8%	6.0%	5.3%	2.2%	2.6	8.0	4.9	2.0
Middle East	-1.5%	3.6%	3.4%	1.7%	-0.6	0.9	1.0	0.4
Latin America	2.8%	5.0%	2.3%	2.8%	0.5	0.9	0.3	0.4
Africa	-1.2%	1.6%	0.8%	0.0%	-0.1	0.1	0.0	-0.1

Source: ICAO data 2009-10. IATA estimates for regions in 2010. IATA estimates for 2011 and forecasts for 2012.

Note: bankruptcy reorganization costs are excluded.

## AIR TRAVEL VOLUMES GROWING ABOVE TREND

- Were it not for the economic weakness from the Eurozone anticipated in the second half of 2012, recent developments in air travel and freight markets would have led to a more positive outlook. Global RPKs continued to expand at an above trend rate of 6% during the first part of this year, showing no sign of slowdown. Moreover, air freight, having contracted during much of 2011, is now starting showing signs of turning up in some markets.

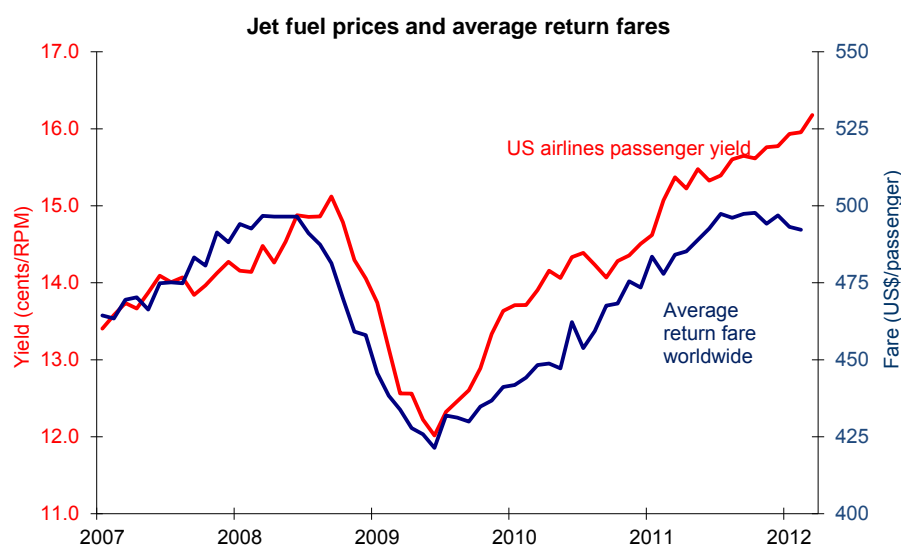


Source: IATA

- Market strength varies and is expected to continue to vary across markets. The stronger passenger markets are linked to Asia, South America and the Middle East. On freight markets the upturn is narrowly based with Middle Eastern airlines seeing the majority of the volume gains.

## FUEL PRICES AND AIRLINE YIELDS WEAKEN

- A strong economy in 2010 allowed airlines to offset the impact of rising fuel costs with firmer yields. Airline profit margins and cash flows were squeezed sharply by rising fuel prices in the first quarter of 2011 and then again in the first quarter of 2012. US airlines have continued to improve yields, but there has been downward pressure elsewhere, leading to stronger US profits in 2012Q1 but weaker profits elsewhere.



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Source: IATA PaxIS,  
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- As always with oil prices the outlook is not clear. The recent sharp fall is on fears of weak demand as a result of the Eurozone crisis, which we have partially built into our central forecast. However, with sanctions about to be applied to Iran, concerns about supply disruptions remain. This may prevent further weakness in prices during the second half of this year. Although oil prices are currently below \$100/b, they were above \$120/b earlier this year. The current consensus forecast is that Brent oil prices will average \$110/b this

year, which we have incorporated into this forecast. At the same time the yield environment appears to be softening, with the exception of the US domestic market.

## ASSET UTILIZATION HAS BEEN KEPT HIGH

- Asset utilization in passenger markets has been good, so far. High asset utilization in the capital intensive airline industry is a key driver of profitability, as long as this is not achieved by discounting. Through 2011 airlines sustained high load factors and aircraft utilization on passenger markets. This supported cash flow and profitability, in the face of high fuel costs and weakening economic growth.
- But during the first quarter of this year breakeven load factors rose in many markets, as fuel costs increased while yields fell. US airlines did not face this situation, because unchanged capacity generated record load factors and the conditions for further gains in yield. First quarter profits for this region improved as a result. However, yields came under downward pressure in passenger markets outside the US and on freight markets, where load factors and supply-demand conditions were softer. Profitability in these markets fell during the first quarter.



- Keeping asset utilization high without undermining yields will be increasingly challenging on passenger markets this year. Freight already felt this pressure last year, with a fall in load factors. Aircraft deliveries have been relatively flat during recent years, partly due to production difficulties. This year there is an acceleration of new capacity being delivered. At the same time the economic environment is likely to cause growth in traffic volumes to slow. Air travel markets have not yet slowed, but we expect a weaker second half to the year as a result of further problems in the Eurozone, damaging confidence. Air freight markets are showing signs of bottoming out, but the upturn is narrowly based around the Middle Eastern airlines. We have revised upward our passenger forecast but downgraded our forecast for cargo volumes. The net impact in the table below shows tonne kilometers flown slowing from 4.1% growth in 2011 to 3.5% this year.

System-wide global commercial airlines	Traffic (RTK), % change over year				Capacity (ATK), % change over year			
	2009	2010	2011	2012F	2009	2010	2011	2012F
<b>Global</b>	-4.3	10.4	4.1	3.5	-3.5	5.2	5.3	3.3
<b>Regions</b>				Central forecast				Central forecast
North America	-6.3	9.9	1.7	0.5	-5.6	3.9	2.8	0.1
Europe	-7.7	5.0	6.7	2.3	-5.4	1.5	8.5	2.8
Asia-Pacific	-2.2	12.6	2.4	3.9	-4.8	5.8	4.3	3.3
Middle East	9.5	20.0	8.6	14.1	11.1	15.8	10.6	13.3
Latin America	0.0	14.5	9.8	6.0	1.4	9.6	8.2	6.6
Africa	-5.4	15.0	-0.7	4.2	-1.5	9.5	2.5	5.2

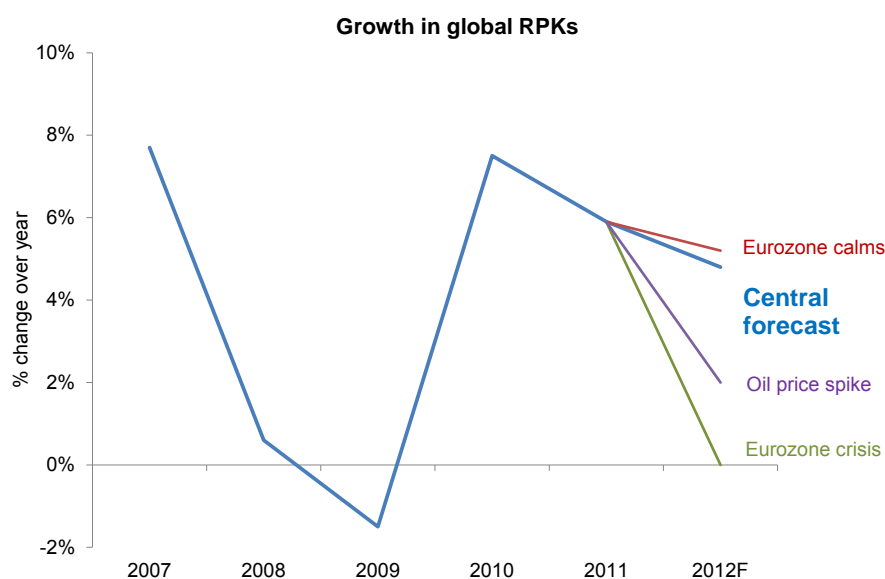
Source: ICAO data to 2009. IATA 2010-11 estimates, 2012 forecasts. Dom. and int. traffic. Includes pax and cargo by weight.

- Regional variation is large. We expect capacity in the US to grow very little in 2012. Despite a sluggish and mature US market this will allow a further improvement in load factors, supporting improved profitability. By

contrast growth for European airlines is expected to slow to one-third of the 2011 pace, as many of Europe's economies fall deeper into recession. We have increased our forecast for losses in this region.

## LARGE DOWNSIDE RISK TO CENTRAL FORECAST

➤ We see substantial downside risk to this central forecast. Upside is limited. We see a much greater chance of the Eurozone crisis deteriorating beyond the sovereign debt issues built into the central forecast, into a full scale banking crisis. We explored this scenario in our December 2011 forecast and show its implications graphically below and on the front page. A spike in the oil price also cannot be discounted, if the Iran situation leads to supply disruption. The chart below and on the front page emphasize the fragility of the outlook for the airline industry shown in our central forecast.



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Source: IATA

System-wide global commercial airlines	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012F
										Central forecast
<b>REVENUES, \$ billion</b>	322	379	413	465	510	570	476	547	597	631
% change	5.2	17.7	9.1	12.5	9.6	11.7	-16.5	14.9	9.3	5.7
Passenger	249	294	323	365	399	444	374	425	468	498
Cargo	40	47	48	53	59	63	48	66	69	70
Traffic volumes										
Passenger growth, tkp, %	2.3	14.9	7.0	5.0	6.4	1.5	-2.1	7.3	5.9	4.8
Sched passenger numbers, millions	1,849	2,064	2,211	2,325	2,518	2,507	2,479	2,681	2,835	2,966
Cargo growth, tkp, %	3.9	7.9	0.4	4.8	4.8	-1.0	-9.8	18.7	-0.4	0.3
Freight tonnes, millions	33.5	36.7	37.6	40.0	42.0	41.0	40.7	48.0	47.7	47.8
World economic growth, %	2.8	4.2	3.4	4.0	3.8	1.7	-2.3	3.9	2.5	2.1
Passenger yield, %	2.4	2.6	2.7	7.8	2.7	9.5	-14.0	6.1	4.0	1.5
Cargo yield %	2.0	7.4	2.4	5.9	5.5	7.4	-14.2	15.0	5.5	0.0
<b>EXPENSES, \$ billion</b>	323	376	409	450	490	571	474	525	580	623
% change	4.0	16.2	8.9	10.1	8.8	16.5	-16.9	10.7	10.6	7.3
Fuel	44	65	91	117	135	189	125	139	176	207
% of expenses	14	17	22	26	28	33	26	26	30	33
Crude oil price, Brent, \$/b	28.8	38.3	54.5	65.1	73.0	99.0	62.0	79.4	111.2	110.0
Jet kerosene price, \$/b	34.7	49.7	71.0	81.9	90.0	126.7	71.1	91.4	127.5	126.5
Non-Fuel	279	311	318	333	355	382	349	386	404	416
cents per atk (non-fuel unit cost)	38.9	39.5	38.6	38.9	39.3	41.8	39.6	41.6	41.4	41.2
% change	0.3	1.4	-2.1	0.8	0.8	6.4	-5.2	5.1	-0.5	-0.5
Break-even weight load factor, %	61.1	61.9	62.0	61.2	60.9	63.2	62.3	63.1	63.0	64.2
Weight load factor achieved, %	60.8	62.5	62.6	63.3	63.4	63.1	62.6	65.7	64.9	65.1
Passenger load factor achieved, %	71.5	73.4	74.9	76.1	77.7	76.0	76.0	78.4	78.3	79.0
<b>OPERATING PROFIT, \$ billion</b>	-1.4	3.3	4.4	15.0	19.9	-1.1	1.9	21.7	17.2	8.6
% margin	-0.4	0.9	1.1	3.2	3.9	-0.2	0.4	4.0	2.9	1.4
<b>NET PROFIT, \$ billion</b>	-7.5	-5.6	-4.1	5.0	14.7	-26.1	-4.6	15.8	7.9	3.0
% margin	-2.3	-1.5	-1.0	1.1	2.9	-4.6	-1.0	2.9	1.3	0.5

Source: ICAO data to 2009-10. IATA estimates for 2011 and forecasts for 2012. Passenger and freight numbers are global system-wide collected by IATA, including some non-ICAO states. Bankruptcy reorganization charges are excluded.