

AIRLINES FINANCIAL MONITOR

KEY POINTS

May 2016 – June 2016

- The latest financial results continue to point to a robust Q1 2016 for industry profitability. Cash flow metrics from the first quarter also improved relative to the same period a year ago, despite higher capital investment;
- Nonetheless, uncertainty following the 'Brexit' vote has taken a heavy toll on airline shares, particularly in Europe;
- Brent crude oil ended June slightly below \$50/bbl and broadly unchanged from where it started the month. The market still expects prices to remain reasonably low for the foreseeable future (<\$60/bbl for the next three years);
- Yields have fallen by around 6% year-on-year in constant exchange rate terms in 2016 so far. But with oil prices up more than 80% since January, the downward influence on yields from lower oil prices is likely to wane;
- Premium airfares have held up better than their economy counterparts on many of the key premium routes so far this year, and the segment continues to offer an important buffer for overall airline financial performance;
- The global air passenger market has made a robust start to 2016 this year to date, although demand conditions have eased in recent months and annual growth in traffic remained unchanged at a 16-month low of 4.6% in May;
- With the wider global trade backdrop remaining weak, annual growth in freight volumes dropped to 0.9% in May. Rising freight capacity and low freight loads are keeping intense pressure on cargo yields and revenues.

Financial indicators

Brexit has taken a heavy toll on airline share prices, particularly in Europe

Airline Share Prices

US\$ indices (Jan 2012=100)	Index Jun 30th	% change on		
		one month	one year	start of year
World airlines	139.0	-11.6%	-16.0%	-21.1%
Asia Pacific airlines	79.0	-3.0%	-16.9%	-9.9%
European airlines	162.9	-24.6%	-21.3%	-30.2%
North American airlines	286.3	-10.6%	-13.4%	-24.4%
FTSE All World \$	126.6	-0.8%	-5.6%	+0.0%

- Global airline share prices dropped by 11.6% in June, to end the month more than 21% below their level at the start of the year. The 'Brexit' vote hit European airline share prices the hardest; their 24.6% month-on-month fall was the biggest monthly decline since September 2001. North American and Asia Pacific carriers also saw declines (-10.6% and -3.0% respectively).

- The uncertainty of the Brexit vote, along with lingering impacts from recent terrorist attacks, has only added to existing investor concerns about the impact of falling unit revenues on profitability. All told, global airline shares made the worst start to a year since 2008, and have underperformed the wider equity market by 21% so far in 2016.



Source: Thomson Reuters Datastream

The latest financial results continue to indicate a robust Q1 2016 for industry profitability

Airline Financial Results

Number of airlines in sample*	Regions	Q1 2015		Q1 2016	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
39	North America	11.1%	3,476	13.7%	3,801
25	Asia-Pacific	6.4%	591	7.4%	865
15	Europe	-3.3%	-378	-2.0%	-965
7	Latin America	7.4%	-82	8.5%	391
6	Middle East	5.1%	1,190	8.7%	1,958
92	Sample total	5.8%	4,797	8.0%	6,050

- While financial markets have marked down their expectations of *future* industry financial performance, the latest financial results continue to point to a robust start to the year for profitability. Net post-tax profits in Q1 2016 in our sample are more than 25% above those seen in Q1 2015, representing an average EBIT margin of 8.0%.

- While the strongest financial results were once again posted by North American airlines, EBIT margins increased in all regions compared to the first quarter of 2015.

¹ % of revenues ² US\$ million

*Includes easyJet & FlyBe half-year results, and Emirates & Precision Air annual results

Sources: The Airline Analyst, IATA

Airlines' free cash flow has increased, despite higher capital investment

Airline Cash Flow¹

Number of airlines in sample*	Regions	Q1 2015			Q1 2016		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
15	North America	28.1%	16.4%	11.7%	31.8%	19.0%	12.7%
21	Asia-Pacific	11.2%	14.2%	-3.1%	14.5%	13.1%	1.4%
11	Europe	13.0%	10.2%	2.7%	13.8%	12.9%	1.0%
6	Latin America	11.0%	9.2%	1.9%	2.4%	7.6%	-5.2%
3	Middle East	14.0%	22.6%	-8.6%	16.1%	20.1%	-4.0%
56	Sample total	16.8%	13.8%	3.0%	18.5%	14.9%	3.6%

¹ % of revenues

² From operating activities

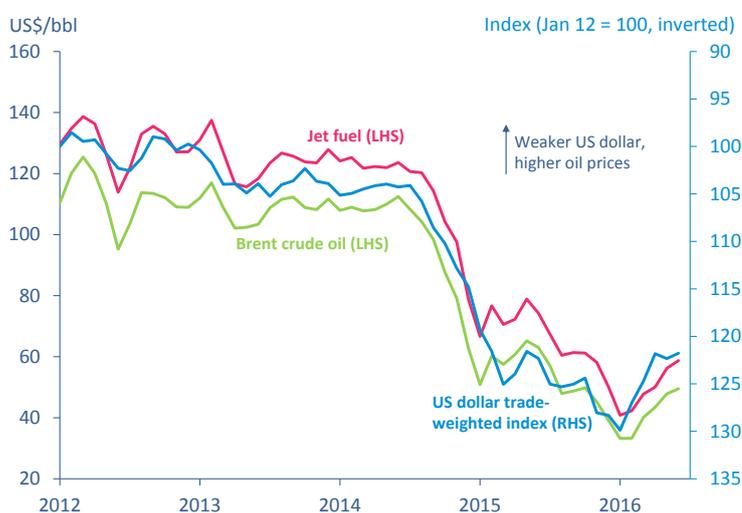
*Includes Emirates, Wizz air, Singapore Airlines & All Nippon Airways annual results

Sources: The Airline Analyst, IATA

- Cash flow metrics also improved during the first quarter of the year. With the exception of Latin America, net cash flow from operations measured as a proportion of revenues increased in all regions in year-on-year terms in Q1 2016. Net cash flow in our sample rose to 18.5% of revenues in Q1 2016, from 16.8% a year ago.
- Airlines have increased capital expenditure as a share of revenues over the same period, but not to the same extent. As a result, free cash flow also increased, from 3.0% of revenues to 3.6%. This gives airlines more flexibility to repair balance sheets by paying down net debt.

Fuel costs

Brent crude remained around the US\$50/bbl mark during June

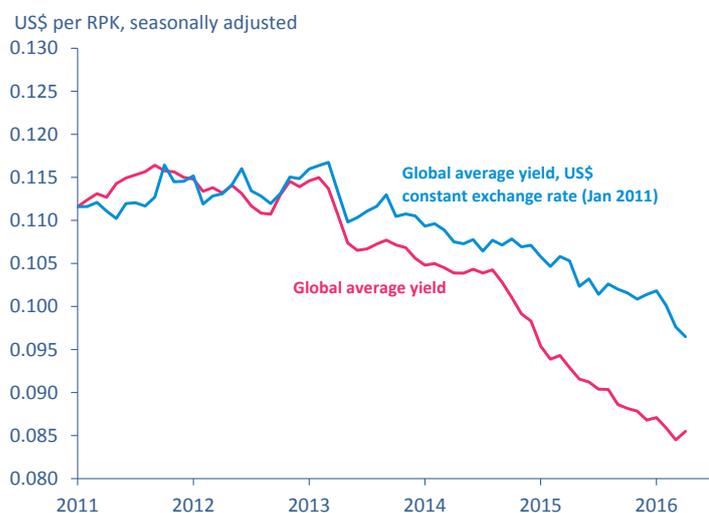


Sources: Platts, Thomson Reuters Datastream

- The price of a barrel of Brent crude oil ended June just below the US\$50/bbl mark and broadly unchanged from where it started the month.
- Despite rallying since the start of the year, oil prices in June were still 21% lower than the same month in 2015. The oil futures curve has ticked up slightly, but the market still expects oil prices to remain at reasonably low levels for the foreseeable future (below US\$60/bbl over the next three years). That said, the annual comparison is going to become less favorable in the near future, with the year-on-year growth rate set to move back into positive territory at the end of July.

Yields and premium revenues

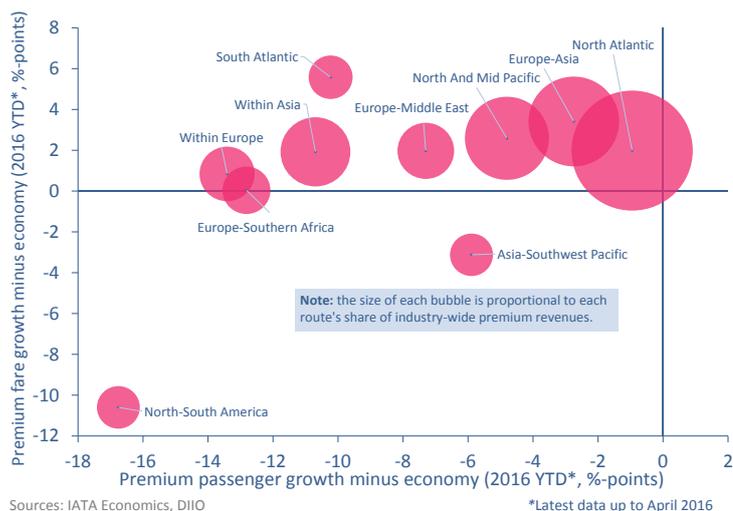
Yields well down on a year ago, but tentative signs of an easing in the downward trend



Sources: IATA Economics, IATA PaxIS+, DIIO, Thomson Reuters Datastream

- The average global yield in reported US dollar terms has fallen by around 9% year-on-year so far this year (the latest data go up to end-April and exclude taxes, fees and surcharges). Adjusting for distortions from earlier gains in the dollar, we estimate that global yields fell by approx. 6% in constant exchange rate terms in early-2016. Given the sharp fall in the dollar at the start of 2016, the distortions should ease over the months ahead.
- The global average yield ticked up in seasonally-adjusted terms in April. It is too soon to call the end in the recent downward trend. But with oil prices now up around 80% since their January low, the downward influence on yields from lower oil prices is likely to wane.

Premium fares are holding up, and offer a buffer for financial performance on key routes



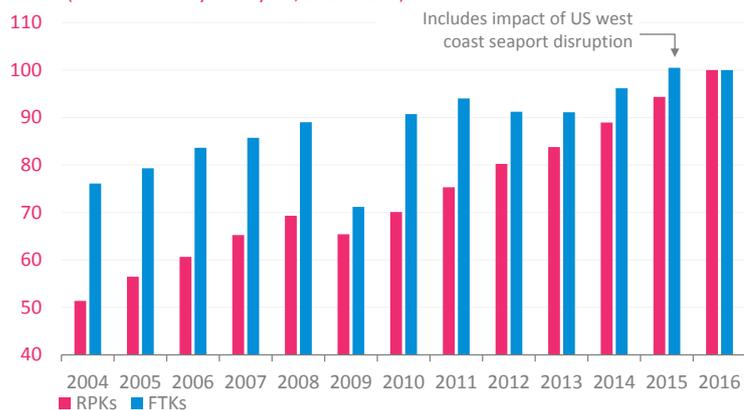
- ➔ Premium international passenger traffic growth continues to lag behind that of economy. O-D premium international journeys accounted for 5.5% of the total over the first four months of 2016, from 5.9% in the same period a year ago.
- ➔ That said, premium fares have held up better than those in economy on eight of the top-10 premium routes by revenue. In fact, premium's share of revenues has *increased* slightly on the key North Atlantic and Europe-Asia markets (which accounted for 25% and 14% of industry-wide premium revenues in 2015 respectively). In the current environment of downward pressure on yields, the high-yielding premium segment offers an important buffer for overall airline financial performance.

Demand

Robust start to the year for pax volumes, as further signs that freight trend has stalled

Air Passenger and Air Freight Volumes

Index (sum of Jan-May each year, 2016 = 100)



- ➔ Adjusting for the leap year, passenger traffic in 2016 so far has grown in line with the average pace seen over the past decade. That said, demand conditions have eased in recent months, partly attributable to disruption following the Brussels terrorist attacks, but also the ongoing subdued economic backdrop. Annual growth in global traffic remained unchanged at 4.6% in May – its slowest pace since January 2015.
- ➔ Annual growth in industry-wide air freight volumes dropped back to 0.9% in May. The wider global trade backdrop remains subdued. It is increasingly evident that the upward trend in seasonally-adjusted volumes that was a feature during the second half of 2015 has stalled.

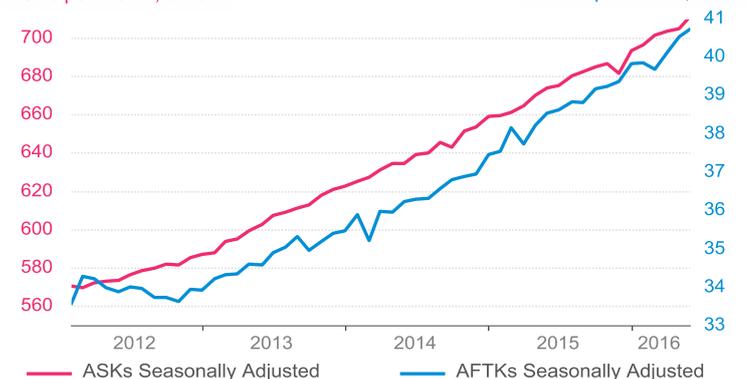
Capacity

Upward trend in passenger and freight capacity has continued

Total Passenger and Freight Capacity

ASKs per month, billion

AFTKs per month, billion

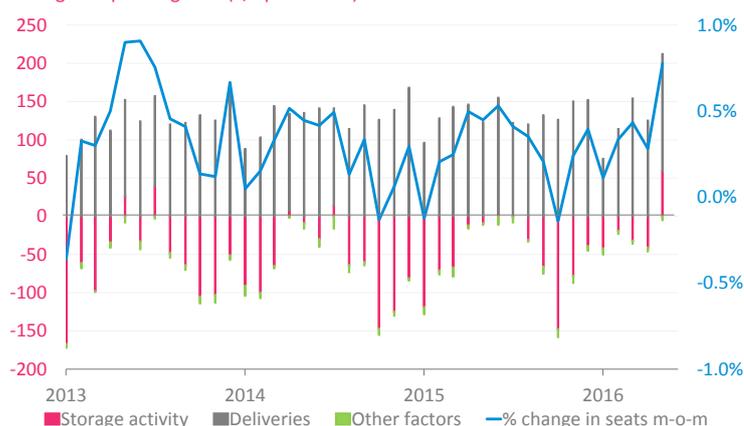


- ➔ Available seat kilometres grew by 5.5% year-on-year in May – the fourth consecutive month in which annual growth in passenger capacity exceeded that of passenger traffic.
- ➔ Industry-wide available freight capacity continued to expand strongly. With ongoing impetus to freight belly capacity from additions to the passenger fleet, annual growth in industry-wide freight capacity has now outstripped annual growth in volumes for 15 consecutive months. Despite their relatively small share, African carriers are at the forefront of the freight capacity growth story, with AFTKs up nearly 23% year-on-year so far in 2016.

Net storage activity makes a solid positive contribution to fleet growth in May 2016

Airline Fleet Development

Change in operating fleet (a/c per month)



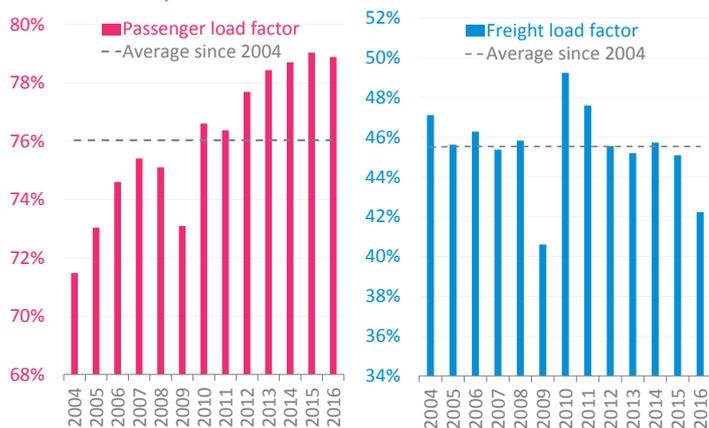
Source: Ascend

- The number of available seats in the global airline fleet jumped by 0.8% in May compared to the previous month, and by 5.6% compared to May 2015.
- 153 new aircraft were delivered in May. Net storage activity made a solid positive contribution to the fleet size. This was driven in the main by fewer aircraft going into storage, as lower oil prices and robust demand have made it economical to keep flying less fuel-efficient aircraft. 73 aircraft were removed from the global fleet in May 2016, compared to 142 that left in May 2015.

Passenger loads remain near record highs, as freight loads remain under pressure

Load Factors - Passenger and Freight

Combined Jan-May load factors over time



Source: IATA Monthly Statistics

- The passenger load factor in the first five months of 2016 combined came in very slightly below that seen in the same period in 2015. The industry has stopped the recent easing in the (seasonally-adjusted) load factor. High achieved passenger loads have helped to support recent financial results in recent years.
- By contrast, the industry freight load factor has averaged 42.2% in the first five months of 2016 – well below the period-average seen over the past decade. This reflects a combination of subdued demand volumes and ongoing fast capacity growth – particularly from passenger belly capacity. Low freight loads are weighing on yields and revenues, and are an ongoing headwind for Asia Pacific carriers, for whom cargo is a key part of their business.

David Oxley
[economics@iata.org](mailto: economics@iata.org)
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