



Airlines Financial Monitor

December 2018 – January 2019

Key points

- Financial markets continue to be uncertain about the prospects for airline earnings, following the fall in oil prices, with swings of airline share prices both up and down in recent months. During January airline share prices moved up in line with the market.
- Financial performance started to show signs of improvement in first releases of 2018Q4 data. The US airlines experienced a much slower decline in operating margins, with a fall of 0.8% in the year to Q4, compared to falls of almost 3% in Q2 and Q3.
- Crude oil and jet fuel prices have been volatile recently; the former hovers currently around ~US\$66/bbl, about 24% higher than in the beginning of the year, the latter is ~US\$82/bbl. Current prices are still well below their peak seen in early October (~US\$85/bbl & US\$99/bbl for crude oil and jet fuel, respectively), but investors are not sure whether that is good or bad for airline earnings. The coming year will be an important test for the sustainability of airline profitability.
- There was a modest rise in base fare yields in January, but the trend has been downwards. That is not true for premium segment yields, through which airlines did recover some of the earlier rise in fuel and other costs. Ancillaries have been another mechanism for cost recovery, but these revenues are not in our data. Guidance on yields for Q1 was positive, at least in the US.
- One development adding to investor uncertainty about earnings sustainability is the peaking of load factors in early 2018. Load factors and aircraft utilization have improved substantially and made a major contribution to the improvement in profitability. As demand and traffic slowed last year, both passenger and freight load factors started to fall.

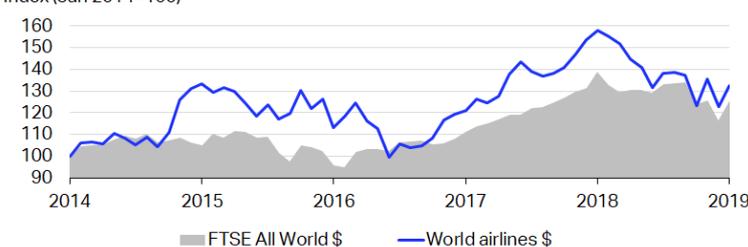
Financial indicators

Financial markets still uncertain about prospects for airline earnings

Airline Share Prices

US\$ indices (Jan 2014=100)	Index Jan 31st	% change on		
		one month	one year	start of year
World airlines	132.2	+7.7%	-16.3%	+7.7%
Asia Pacific airlines	117.3	+5.8%	-15.3%	+5.8%
European airlines	111.1	+8.3%	-27.1%	+8.3%
North American airlines	165.0	+7.9%	-9.2%	+7.9%
FTSE All World \$	125.6	+7.7%	-9.5%	+7.7%

Index (Jan 2014=100)



Source: Thomson Reuters Datastream

- The global airline share price index remains volatile amongst changing investor sentiment regarding the outlook for oil prices and the health of global economy. It ended Jan 7.7% higher than where it began the year, moving broadly in line with the wider equity market.
- The ups and downs of airline share prices, over the past few months, suggests that investors are not sure whether the fall in jet fuel costs is a good or a bad thing for airline earnings. The worry is that lower fuel costs will lead to a surge in capacity, rather than the rational caution seen in recent years.
- Price-earnings multiples are already at levels reflecting the scepticism of the market. The coming year should provide an important test of earnings sustainability.

Squeeze on profit margins slowed in the final quarter of 2018

Airline Financial Results

Number of airlines in sample	Regions	Q4 2017		Q4 2018	
		EBIT margin ¹	Net post-tax profit ²	EBIT margin ¹	Net post-tax profit ²
10	North America	10.1%	5,169	9.3%	2,850
4	Asia-Pacific	11.6%	754	9.5%	630
4	Europe	-1.2%	89	-4.1%	-351
18	Sample total	9.4%	6,012	8.2%	3,129

¹ % of revenues ² US\$ million

Sources: The Airline Analyst, IATA

- First releases of financial data from the final quarter of 2018 indicate that the industry-wide EBIT margin fell in Q4 compared to the same period a year ago. Nonetheless, 8.2% is still a historically good profit margin and there were signs of improvement.
- Data is more complete for the US airlines and that showed a significant slowdown in the profit squeeze, with a 0.8% fall in EBIT margin over the year to Q4, compared to falls of almost 3% points in Q2 and Q3.
- Spot fuel prices fell sharply in Q4, helping to ease cost pressures. However, there were falls in yields and unit revenues. Guidance for 2019Q1 was more positive.

Industry free cash flows turned negative in Q3, reflecting the squeeze on margins

Airline Cash Flow¹

Number of airlines in sample	Regions	Q3 2017			Q3 2018		
		Net cash flow ²	Capex	Free cash flow	Net cash flow ²	Capex	Free cash flow
16	North America	10.5%	11.9%	-1.4%	9.4%	9.3%	0.1%
24	Asia-Pacific	16.4%	13.3%	3.1%	13.4%	12.2%	1.2%
12	Europe	10.3%	6.6%	3.7%	6.4%	9.7%	-3.3%
8	Latin America	13.9%	4.9%	9.0%	5.0%	6.2%	-1.2%
4	Others	15.2%	9.9%	5.2%	6.0%	20.5%	-14.6%
64	Sample total	11.9%	10.1%	1.8%	9.0%	9.9%	-0.9%

¹% of revenues

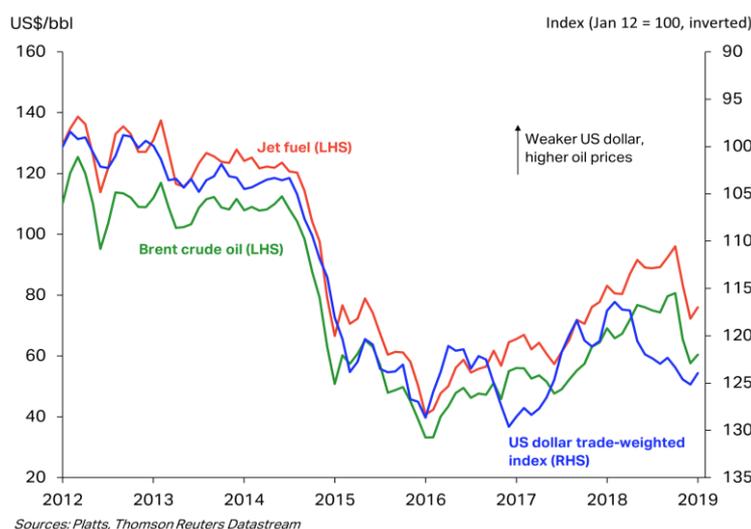
²From operating activities

Sources: The Airline Analyst, IATA

- In Q3 2018, industry-wide free cash flows (FCF) turned negative, compared to a positive 1.8% a year ago. The fall was mostly driven by a ~3pp reduction in net cash flow generation, reflecting the squeeze on profits.
- Note that we do not yet have enough cash flow data from Q4 2018 available to deliver a meaningful sample. On the basis of the limited information available, there appears to be a drop in both net cash flow and capex compared to the same period a year ago.

Fuel costs

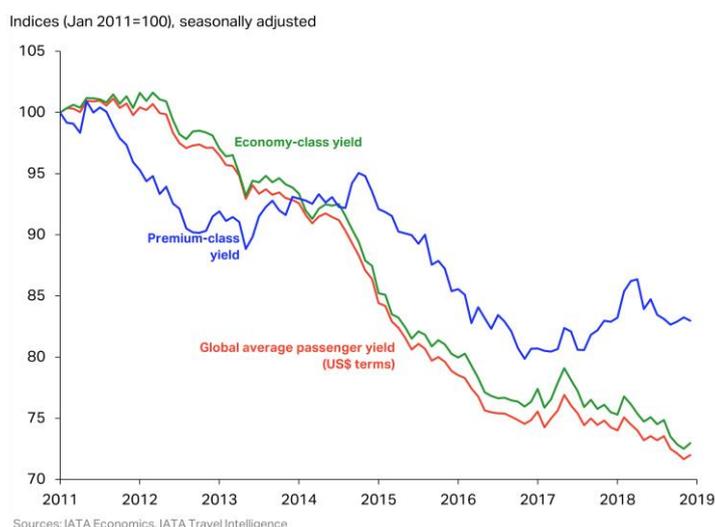
Oil and jet fuel prices remained at relatively low levels in January



- Having trending higher for almost three years, rising oil supplies and an inability of OPEC to impose sufficient cuts led oil and jet fuel prices to fall sharply at the end of last year.
- The monthly data in the chart hide the volatility that there has been from week to week. Most recently prices rose following supply cuts from OPEC countries and the potential impact of sanctions against Venezuela.
- At the time of writing this report, the price of Brent crude oil hovers around US\$66/bbl. Jet fuel price is close to US\$82/bbl. Both remain well below their October peak. Check out our [Jet Fuel Price Monitor](#) to monitor weekly oil price developments.

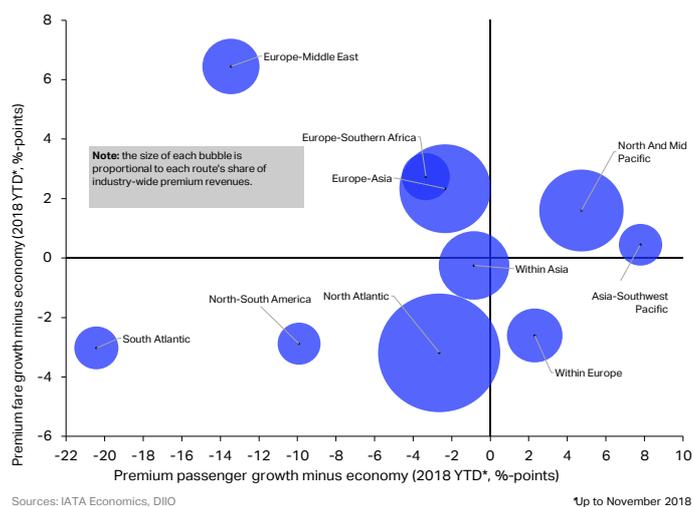
Yields and premium revenues

Airlines were able to partially recover costs through front-cabin yields



- Global 'base fare' passenger yields (i.e., excluding surcharges and the revenue that airlines generate from ancillary services) rose a little in US dollar terms in December.
- Despite that, total base fare yields have trended downwards in seasonally adjusted terms over 2018 and are currently 4% lower compared to the same period a year ago.
- However, premium-class yields have trended upwards as airlines were able to partly recover rising fuel costs in this less price-sensitive segment of the market. That ability seemed to peak in early 2018 and premium class base fare yields declined, though by much less than those in the economy cabins.

Premium class passenger volume and revenue shares in line with a year ago

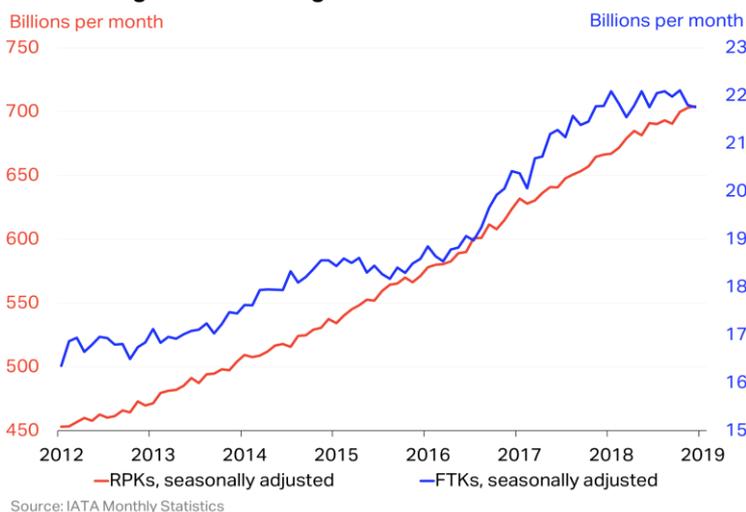


- Premium-class passengers accounted for 5.2% of total international origin-destination traffic over the eleven months to November 2018 but 30.0% of revenues. These shares have been stable over the past year.
- But the experience of airlines by market has been very different. The strongest markets for premium revenues are in the top right-hand quadrant. Pacific markets have been positive for those airlines serving business travel, with an increasing share of premium in total revenues. However, the largest premium market, across the North Atlantic, has seen a shrinking share with both premium base fares and traffic underperforming economy. This reflects the weakness of European business prospects and sluggish financial market activity.

Demand

Both passenger and freight traffic have moderated in recent months

Air Passenger and Air Freight Volumes

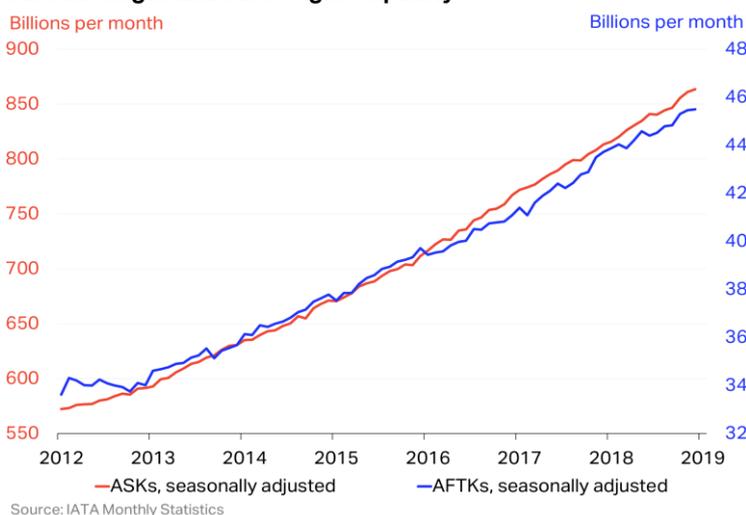


- Year-on-year growth in revenue passenger kilometres eased to 5.3% in December, the slowest pace since the beginning of 2018. The upward traffic trend has moderated in seasonally adjusted terms over the recent months amongst growing signs of slowing global economic expansion.
- For 2018 as a whole, passenger demand rose by 6.5%. Although this was another year of above-trend growth, the pace was still slower compared to 2017 (8.0%).
- Industry-wide freight tonne kilometres (FTKs) ended 2018 0.5% lower than their level a year ago. For the year as a whole, FTKs increased by 3.5% in 2018, down from 9.7% in the previous year. While the slowdown in 2018 partly reflects pull-back from the global inventory restocking cycle in 2017, leading indicators of freight demand have also eased more recently.

Capacity

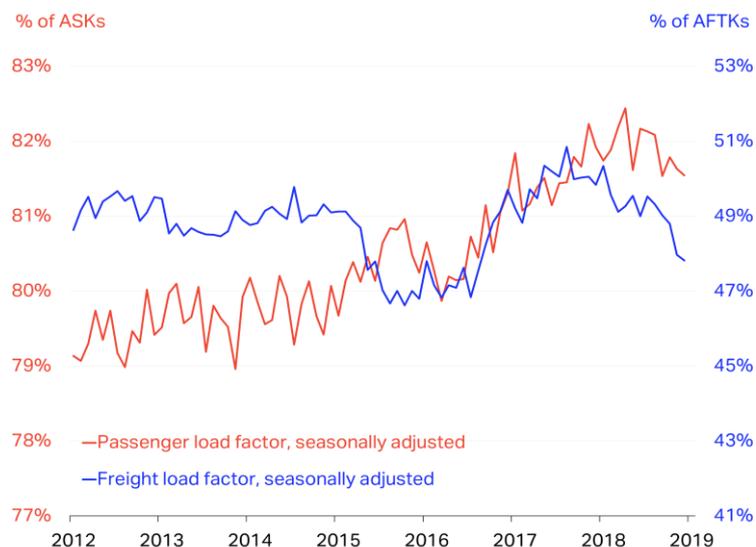
Passenger and freight capacity both outpaced demand in December...

Air Passenger and Air Freight Capacity



- Industry-wide available seat kilometres grew by 6.1% year-on-year in December and in 2018 as a whole.
- In seasonally adjusted terms, the robust upward trend in passenger capacity has softened modestly over the second half of the year. That said, annual capacity growth outpaced that of passenger demand in December.
- On the freight side, available freight tonne kilometres (AFTKs) rose by 3.8% year-on-year in December – the tenth consecutive month in which annual capacity growth has outpaced that of air-cargo demand. For full-year 2018 capacity, AFTKs increased by a solid 5.4% and outperformed the annual growth in FTKs by ~2pp.

Passenger and freight load factors ended 2018 trending downwards...



- December saw the industry-wide passenger load factor (PLF) at 80.4%, falling by 0.6pp vs the same period a year ago. In seasonally adjusted terms, the load factor has been trending downwards since the middle of 2018. For 2018 as a whole however, the PLF increased by 0.3 percentage points compared to 2017 to a record high of 81.9%.
- For freight, the annual industry-wide freight load factor (FLF) ticked down by 0.9 percentage points compared to 2017. Despite cargo yields remaining sound, the load factor continues to trend downwards in seasonally adjusted terms amongst broader signs of global economic slowdown.

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