AIRLINES FINANCIAL MONITOR

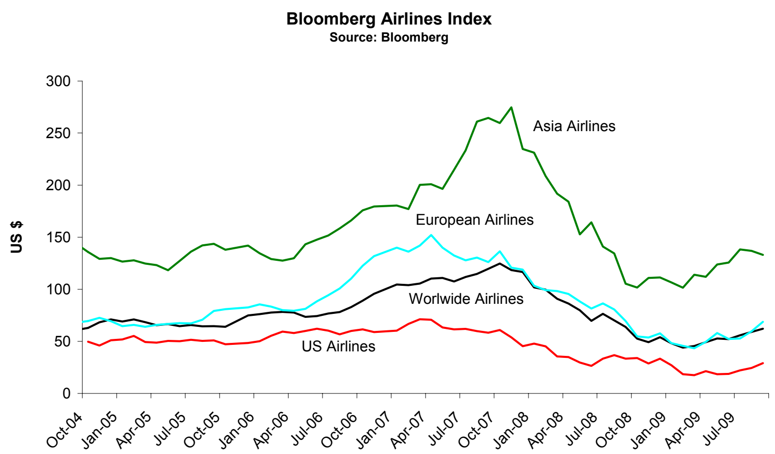
KEY POINTS

August-September 2009

- Equity investors boost airline stocks but airlines cautious adding further $3.5 billion to cash cushion;
- After H1 losses in excess of $6 billion, current forecast implies airlines may lose a further $4-5 billion in H2;
- Jet fuel prices averaged $76 a barrel in the third quarter, up $14 on the first half of the year levels;
- Traffic demand is down on last year but so far in Q3 passengers are up 3% and freight is up 6% on Q2;
- With capacity flat through the year so far this has brought load factors back to pre-recession levels;
- However, an expanded fleet and lower aircraft utilisation means the capacity threat to yields remains.

Financial indicators

Equity investors boost airline stocks but airlines add a further $3.5bn to cash cushion



- Investors looked more favourably at airline stocks during September, as signs emerged of an upturn in this highly cyclical sector. Worldwide airline equity prices were up 5% during the month, outperforming the market for the first time this year.
- Airlines took the opportunity of more receptive financial markets to raise a further $3bn of debt and $0.5bn of equity. So far this year $18bn of cash has been raised from capital markets – a sign of caution not optimism.

Second quarter results diverge between Americas and airlines in Asia and Europe

In US $ Million

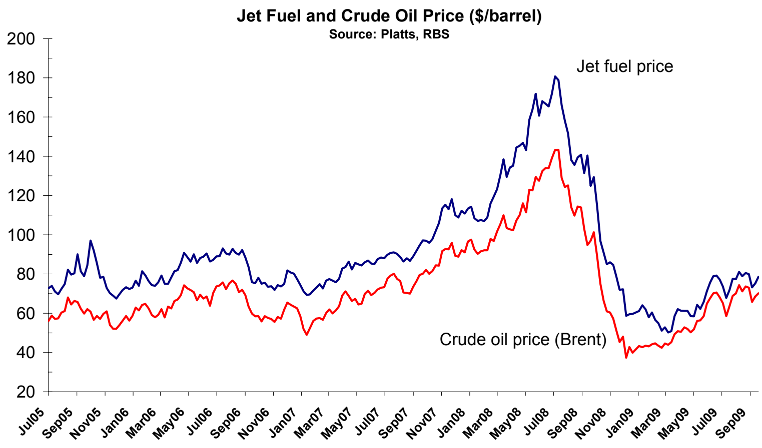
# Airlines		Q2 2008		Q2 2009*	
		Operating	Net post-tax	Operating	Net post-tax
25	North America	606	(215)	1,129	(316)
14	Europe	1,464	489	(707)	(1,122)
21	Asia-Pacific	445	(1,019)	(938)	(1,354)
4	Latin America	(73)	5	31	485
4	Middle-East	2	7	(11)	20
68	**Sample total**	2,444	(733)	(495)	(2,287)

*Alitalia, Eva Airways, SpiceJet, Shandong Op. Profit not included.
Hainan Net Profit not included*

- Losses for the airlines industry as a whole got worse in the second quarter, with 68 major airlines reporting net losses of $2.3bn, following $4bn in Q1.
- EU and Asian airlines had the worst H1 accounting for around $5bn of industry losses; US losses were moderated by much larger capacity cuts.
- Q3 results start to be released this month. Traffic volumes and load factors were improving during the quarter but yields remained weak and oil prices rose $10/b from Q2.

Fuel costs

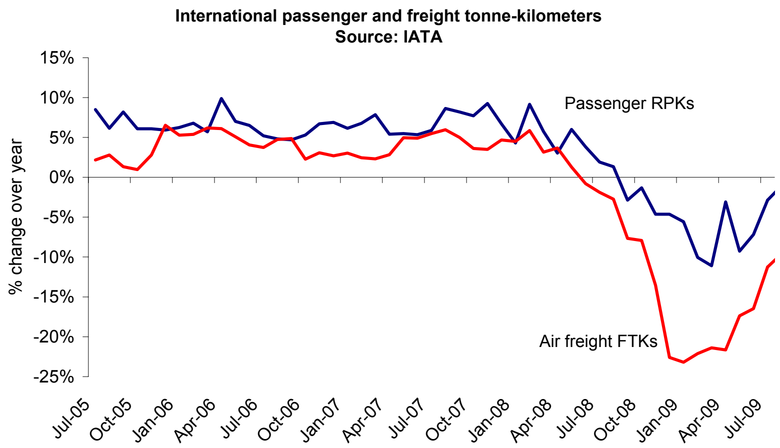
Jet prices average $76/b in Q3, up $10/b from second quarter levels



- Oil and jet fuel prices have moved broadly sideways over the past few months, largely because commodity markets had anticipated stronger economic growth earlier in the year. Moreover, the crack spread has narrowed further from its normal 25% to 11% in Q3 as excess refinery capacity persists.
- Nonetheless, oil and jet fuel prices are $10/b higher in Q3 than in Q2 and $14 up on H1. This rise in fuel costs will be a significant offset to any bottom line benefits from improved traffic volumes.

Demand

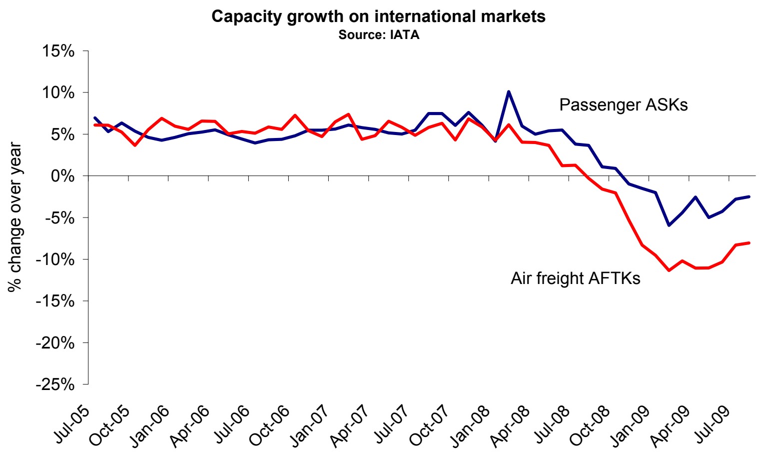
Travel and freight volumes rise strongly in Q3 but will the pace of improvement last?



- The improvement in both passenger numbers and freight volumes from Q1 lows accelerated in the first 2 months of Q3 with seasonally adjusted levels for passenger kilometres flown up 3% on Q2 and freight volumes up 6%.
- This upturn has been driven by the recent rise in economic growth, following the massive government and central bank stimulus packages. Forecasters are getting more positive on Q4 but it is still not clear whether economic recovery will continue to strengthen or fizzle out in 2010.

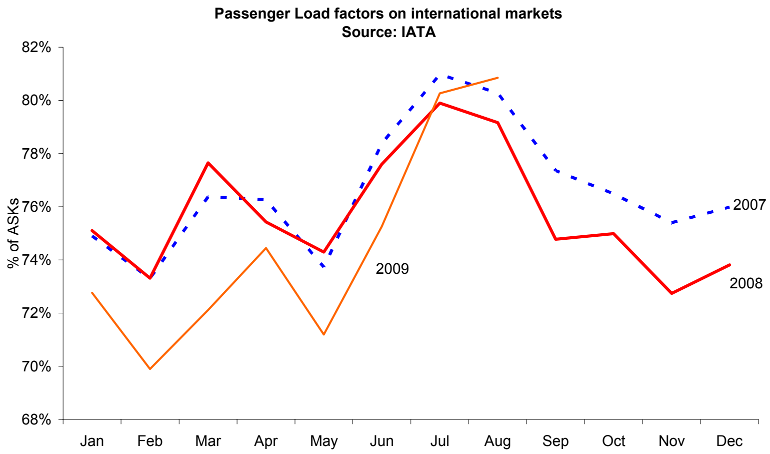
Capacity

Capacity was kept flat throughout this year but upside risks in months ahead



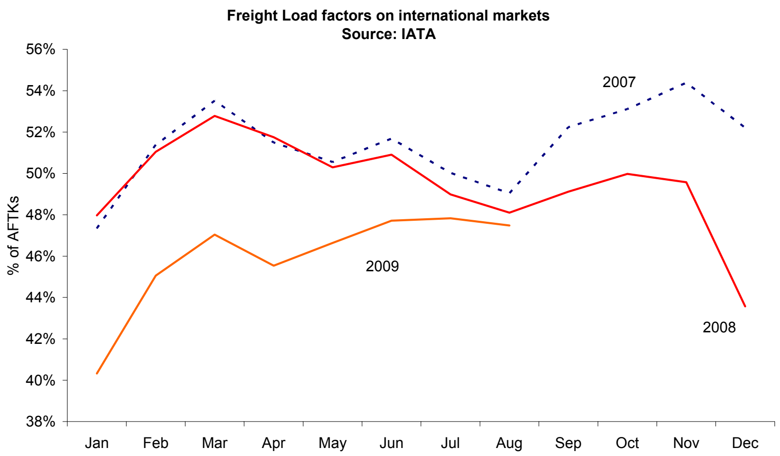
- As a comparison with the chart above shows, airlines have not been able to keep pace with the first half slump in demand causing a sharp rise in excess capacity on most international markets.
- However, passenger and freight capacity – seasonally adjusted – has been kept flat throughout the year. In the next few months the year-on-year numbers will turn positive just because of the comparison with cuts last year. If announced winter cuts go through growth should be limited, but there are upside risks due to low utilisation.

Passenger load factors improve sharply but aircraft utilisation is very low



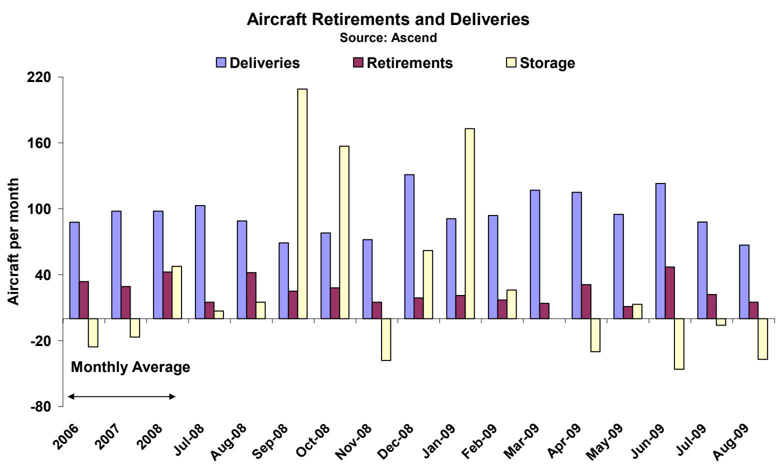
- Airlines may not have been able to quickly resize, except in US domestic markets, but having kept capacity flat so far this year the improvement in passenger demand has fed straight through to improved load factors.
- In the past two months passenger load factors have risen sharply and are now higher than in the previous two years.
- Better load factors normally mean better profits. However, while aircraft are full they are not being flown as intensively. Average hours flown are down 2-3% for B747s and B777s, which will raise unit costs.

Freight load factors also improving but still low



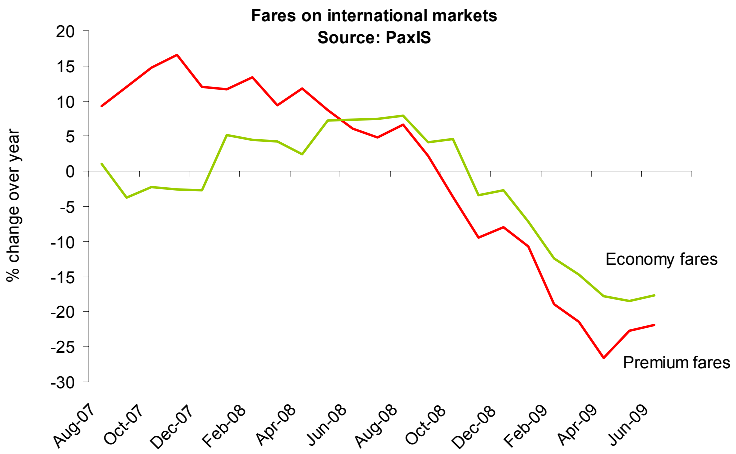
- Supply-demand conditions are also tightening fast for the air freight market as well, with load factors almost back to pre-recession levels. However, at less than 50% these market conditions may still not be strong enough to improve freight rates, which were falling at a rate of 20% in Q2.
- Unlike the passenger fleet, freighters have been retired and parked with 150 leaving the in-service fleet this year. Lower aircraft utilisation may be less of a problem for the air freight sector.

Deliveries of new aircraft slow in August but more taken out of storage



- Deliveries of new aircraft slowed in August but airlines took aircraft out of storage back into the in-service fleet. In fact since the end of the first quarter over 100 aircraft have been taken out of storage, only just exceeded by retirements. Given over 480 aircraft have been delivered the fleet is now 2% larger than at the end of Q1.
- Since capacity – in terms of tonne kilometres flown – has remained flat that means average aircraft hours have fallen a further 2% or so during this period, offsetting some of the bottom line benefits of higher load factors and building up a potential capacity overhang to threaten yields in the months ahead.

Fares and yields beginning to stabilise but remain around 20% down on last year



- Passenger fares on international markets appeared to stabilise in the second quarter, in response to the rising load factors reported above. However, with fares down on average by 20% in Q2, even though passenger numbers started to rise, passenger revenues were still down over a quarter, and freight revenues by more.
- The latest published fare data is June. Higher July and August load factors will have tightened supply-demand conditions further. However, judging by the 20%+ declines in US airline international passenger yields during July and August, as reported by the ATA, any improvement in the third quarter looks likely to have been small.

Data tables

International passenger and freight markets in August

	Aug 09 vs. Aug 08						YTD 2009 vs. YTD 2008					
	RPK Growth	*ASK Growth*	*PLF*	*FTK Growth*	*AFTK Growth*	*FLF*	*RPK Growth*	*ASK Growth*	*PLF*	*FTK Growth*	*AFTK Growth*	*FLF*
Africa	-4.9%	0.0%	74.0	-5.1%	-1.3%	27.3	-8.1%	-4.1%	70.4	-20.0%	-5.5%	25.8
Asia/Pacific	-1.6%	-6.1%	78.6	-9.0%	-10.7%	61.8	-9.9%	-7.5%	72.5	-18.8%	-14.9%	58.4
Europe	-2.8%	-3.7%	82.5	-14.5%	-10.6%	44.9	-6.3%	-4.5%	75.9	-20.0%	-9.5%	44.7
Latin America	-2.3%	1.0%	75.3	3.9%	9.5%	32.2	-2.9%	1.2%	71.8	-14.4%	-3.9%	30.5
Middle East	10.8%	13.8%	77.8	3.0%	7.3%	41.0	8.4%	13.0%	73.0	-3.5%	4.9%	40.4
North America	-2.5%	-4.6%	85.5	-12.1%	-11.2%	35.8	-7.2%	-5.1%	79.0	-20.3%	-10.7%	34.4
Industry	-1.1%	-2.5%	80.9	-9.6%	-8.2%	47.5	-6.0%	-3.6%	74.8	-18.0%	-10.1%	46.0

IATA Economics
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