Signs of a structural improvement in airlines' financial health?

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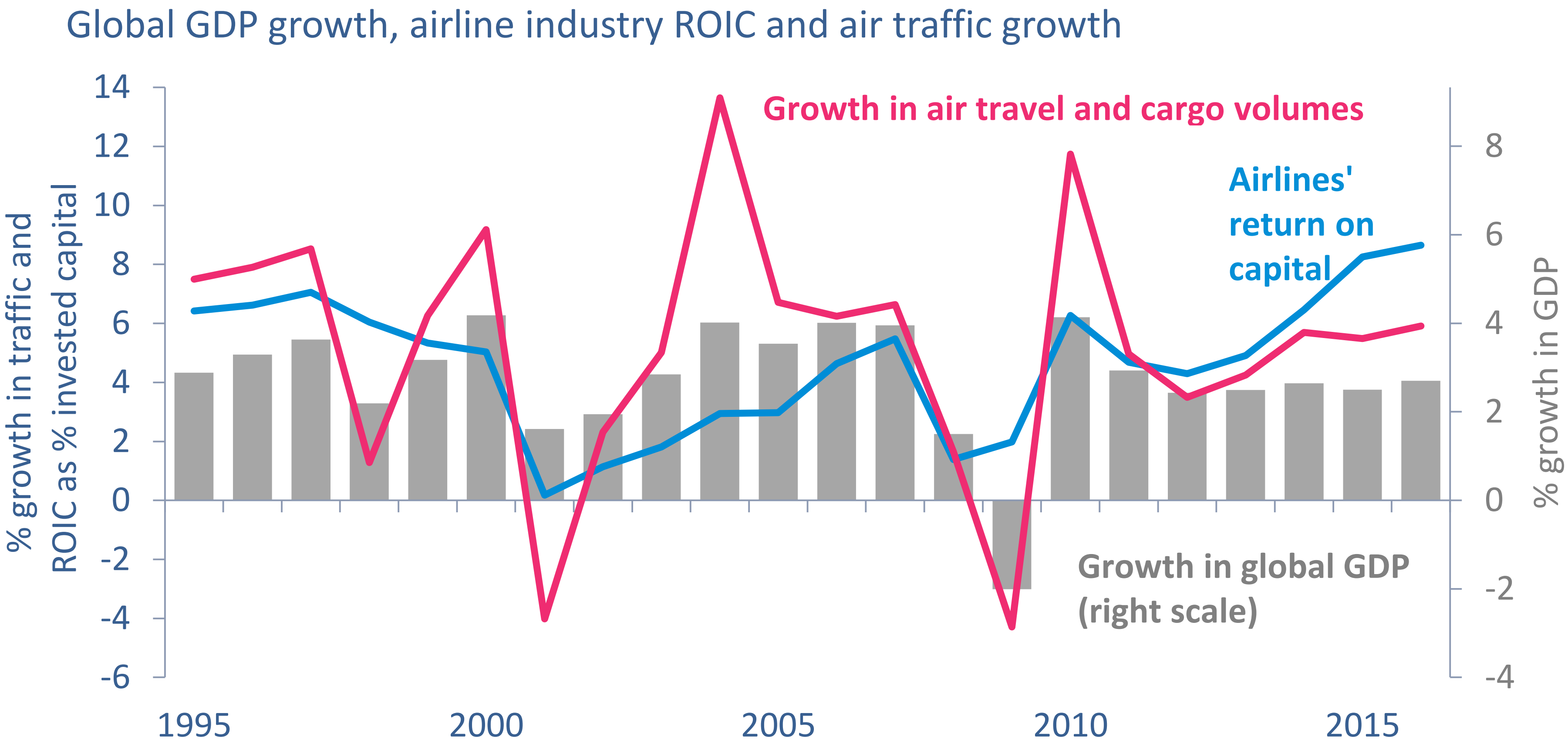
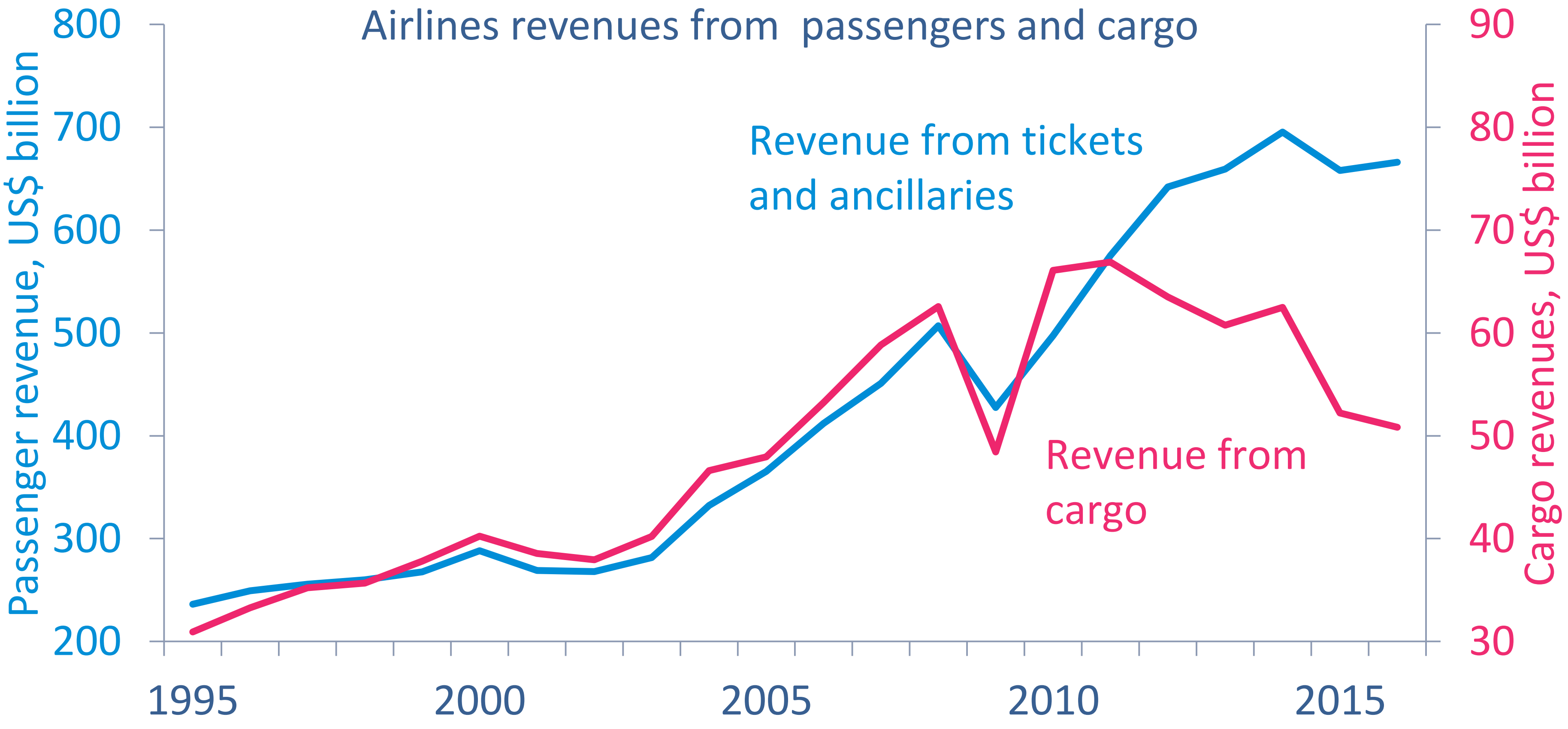
Structural not cyclical gains (or just cheap fuel)?



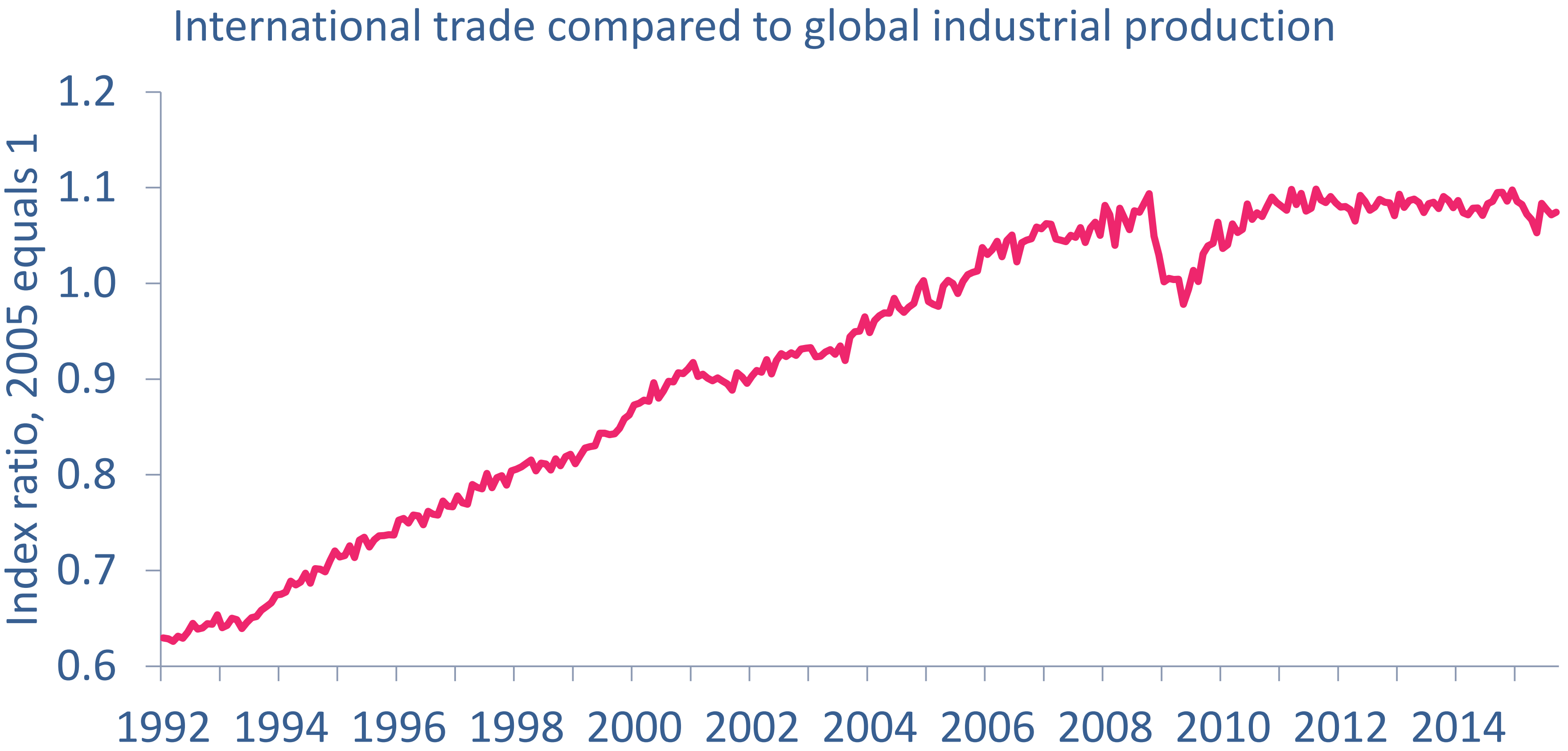
Source: ICAO, McKinsey, EIU, IATA

Travel business very strong, cargo very weak



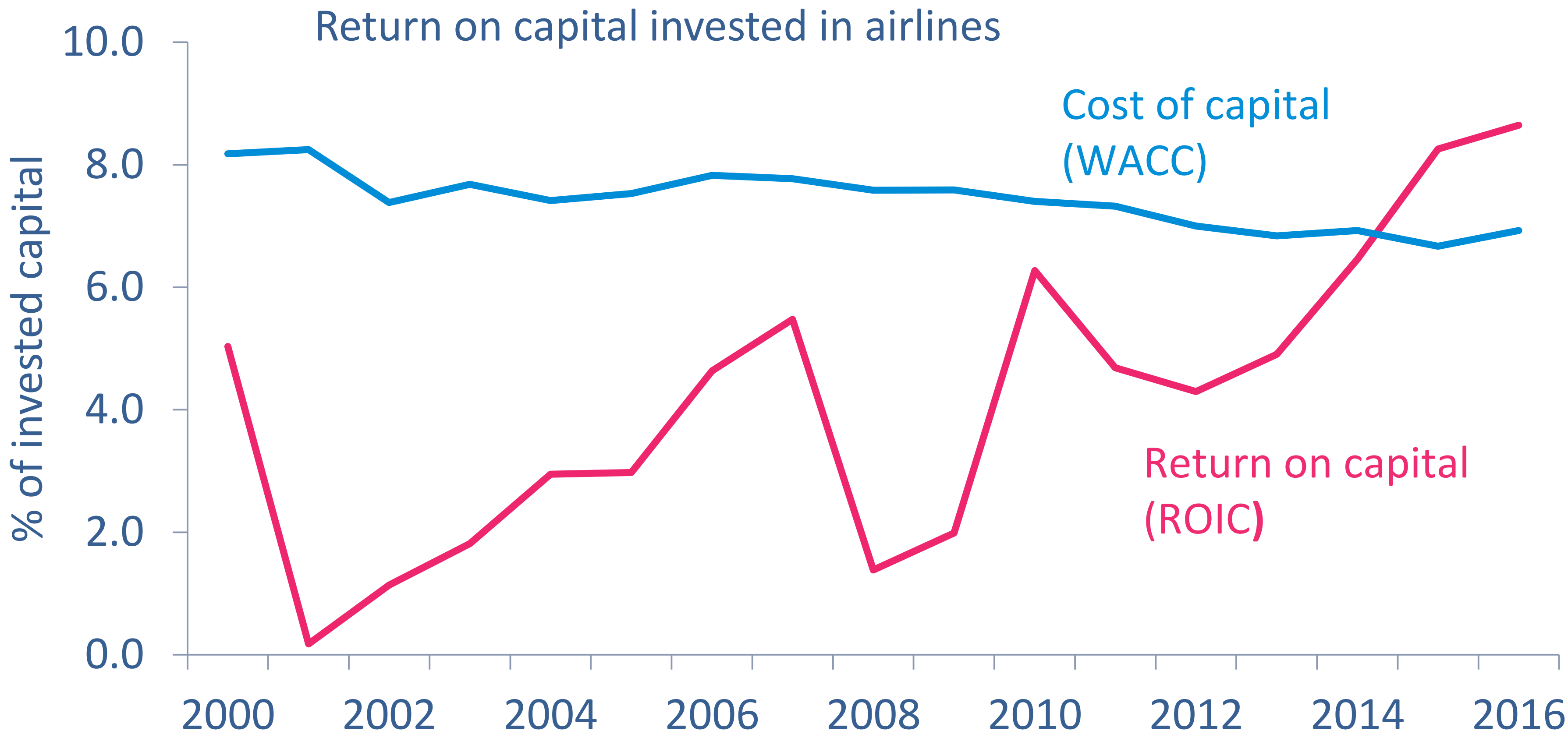
Source: ICAO, IATA

Not all structural change is good



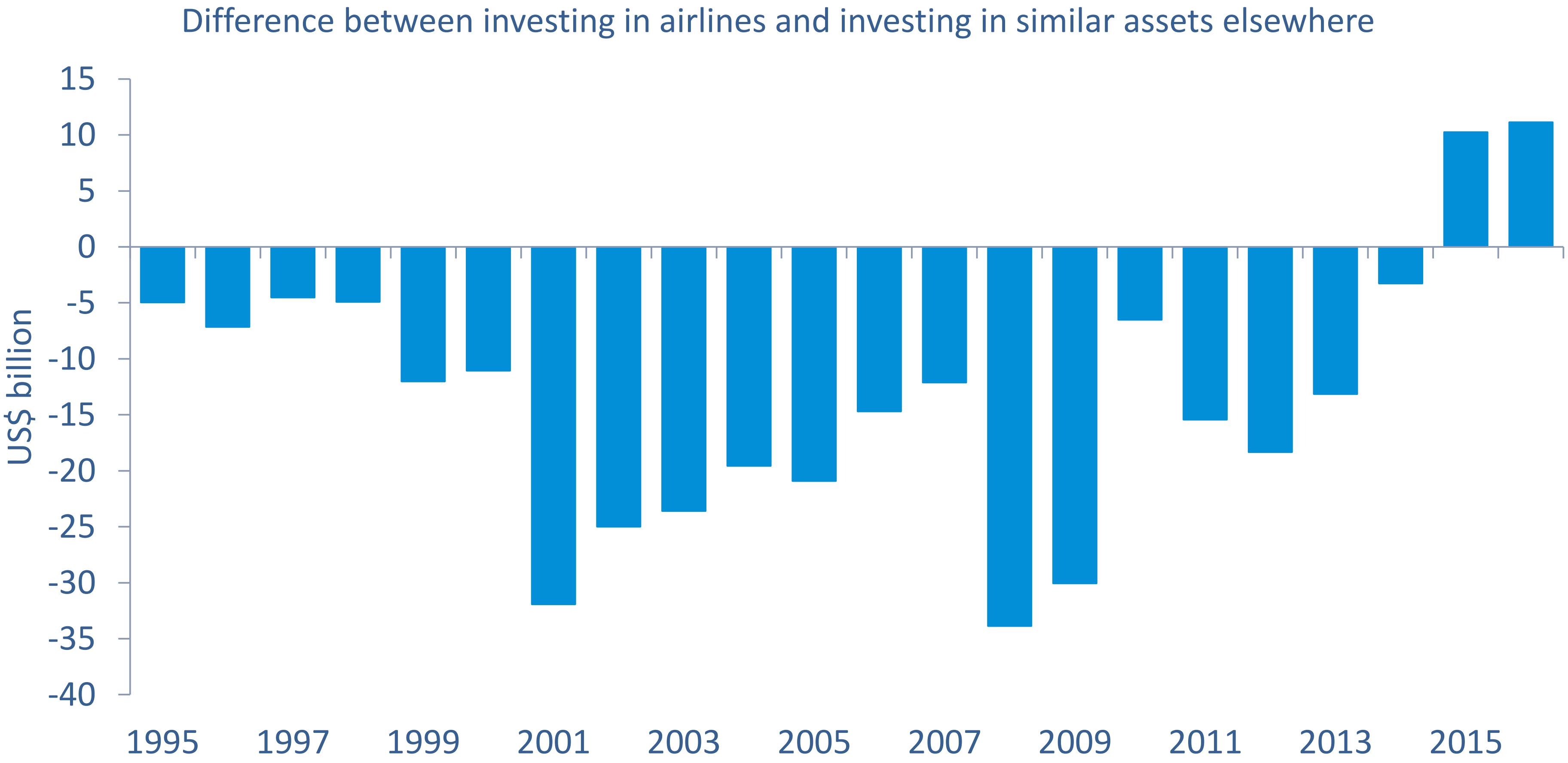
Source: Netherlands CPB

Airline investors paid a 'normal' return for 1st time



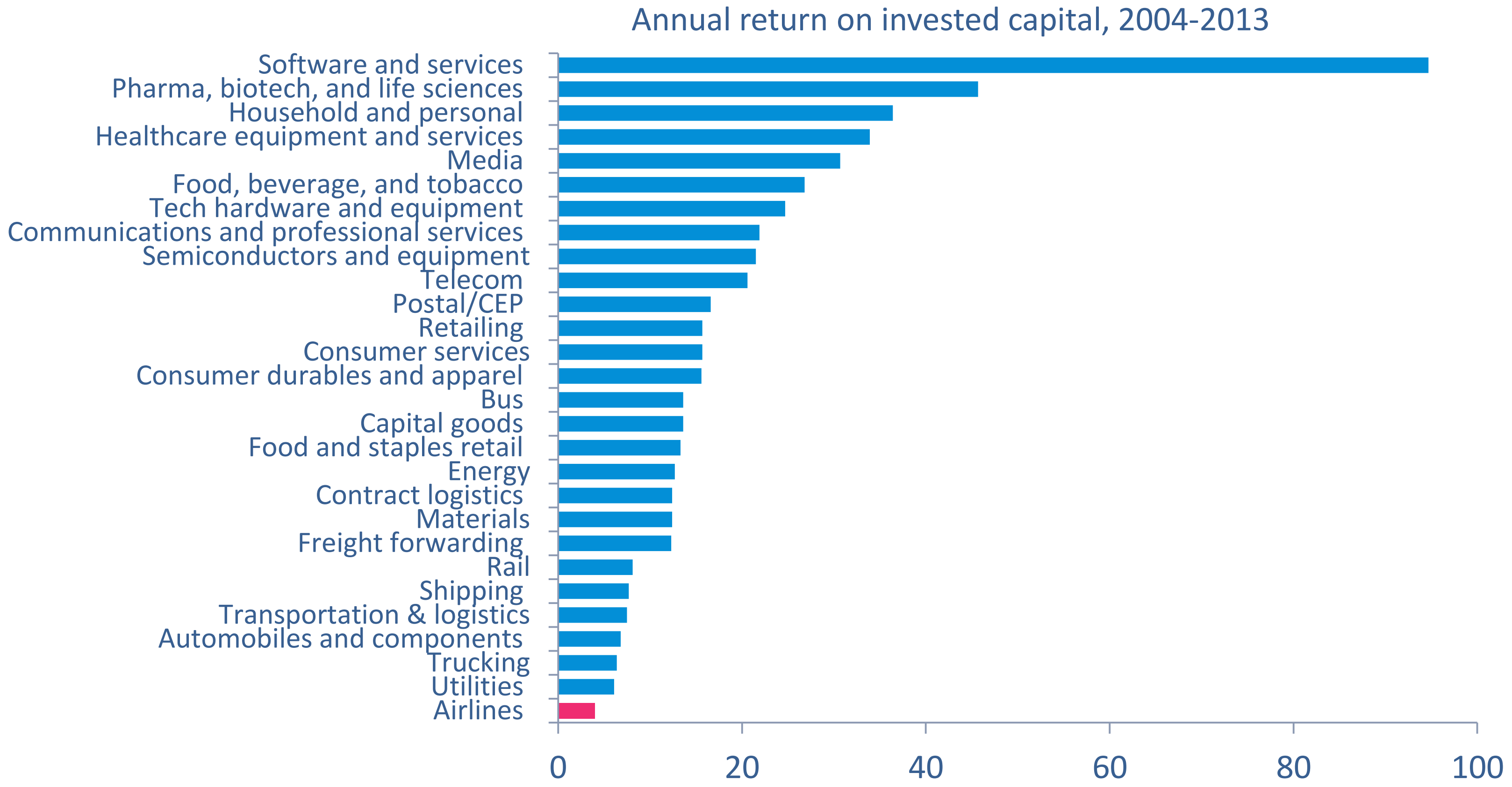
Source: McKinsey, IATA

Ending decades of investor capital destruction (?)



Source: McKinsey, IATA

And awful relative performance



Source: McKinsey

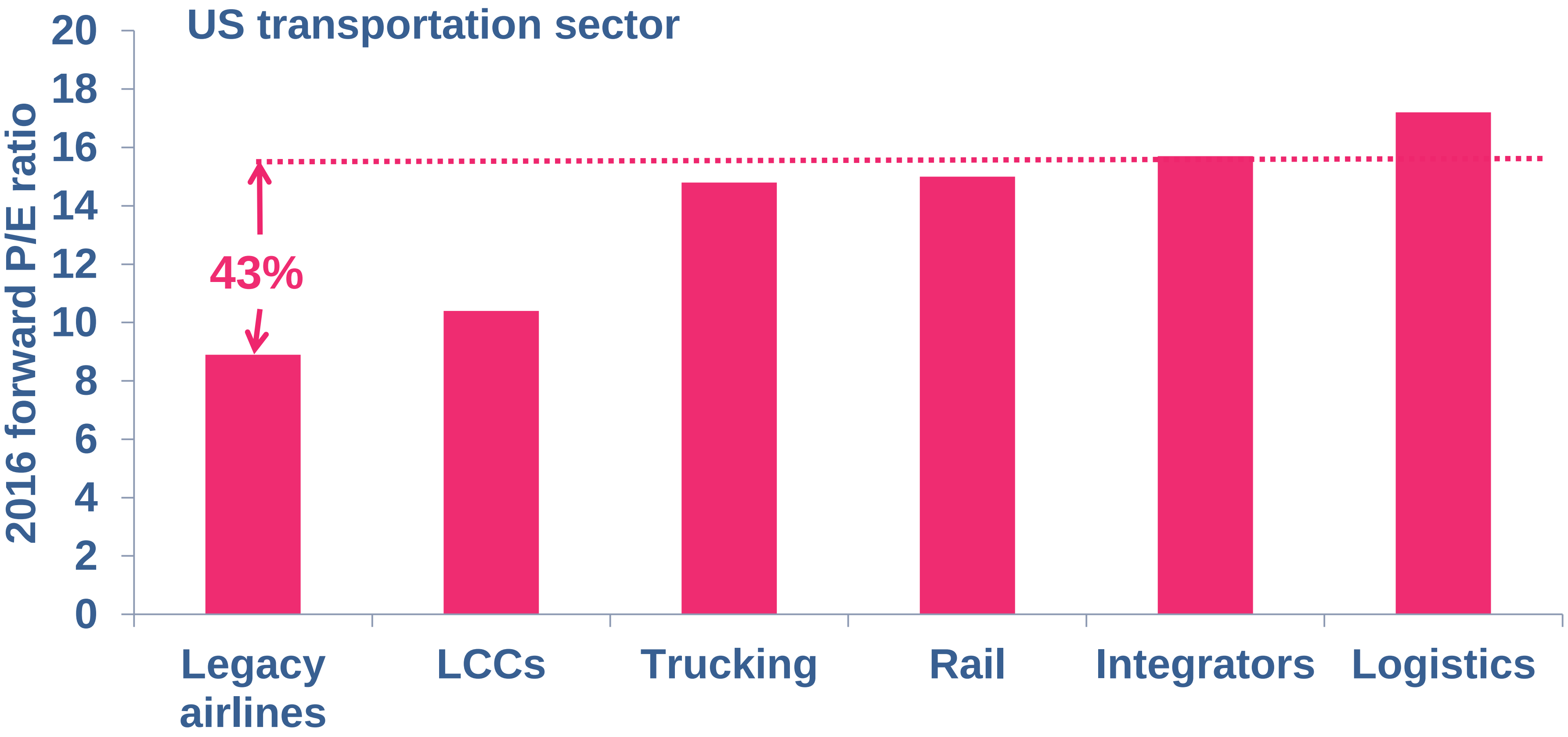
Debt finance markets still sceptical of change

AA+/-	
A+/-	
BBB+/-	ANZ, Qantas, Lufthansa, Ryanair, Southwest, Alaska, Westjet
BB+/-	Delta, American, United, Allegiant, Spirit, BA, Turkish, LATAM
B+/-	Air Canada, Hawaiian, JetBlue, Avianca, GOL, SAS, Virgin Australia

$\left.\begin{array}{l}\text{AA+/-}\\ \text{A+/-}\\ \text{BBB+/-}\end{array}\right\}$ Investment grade

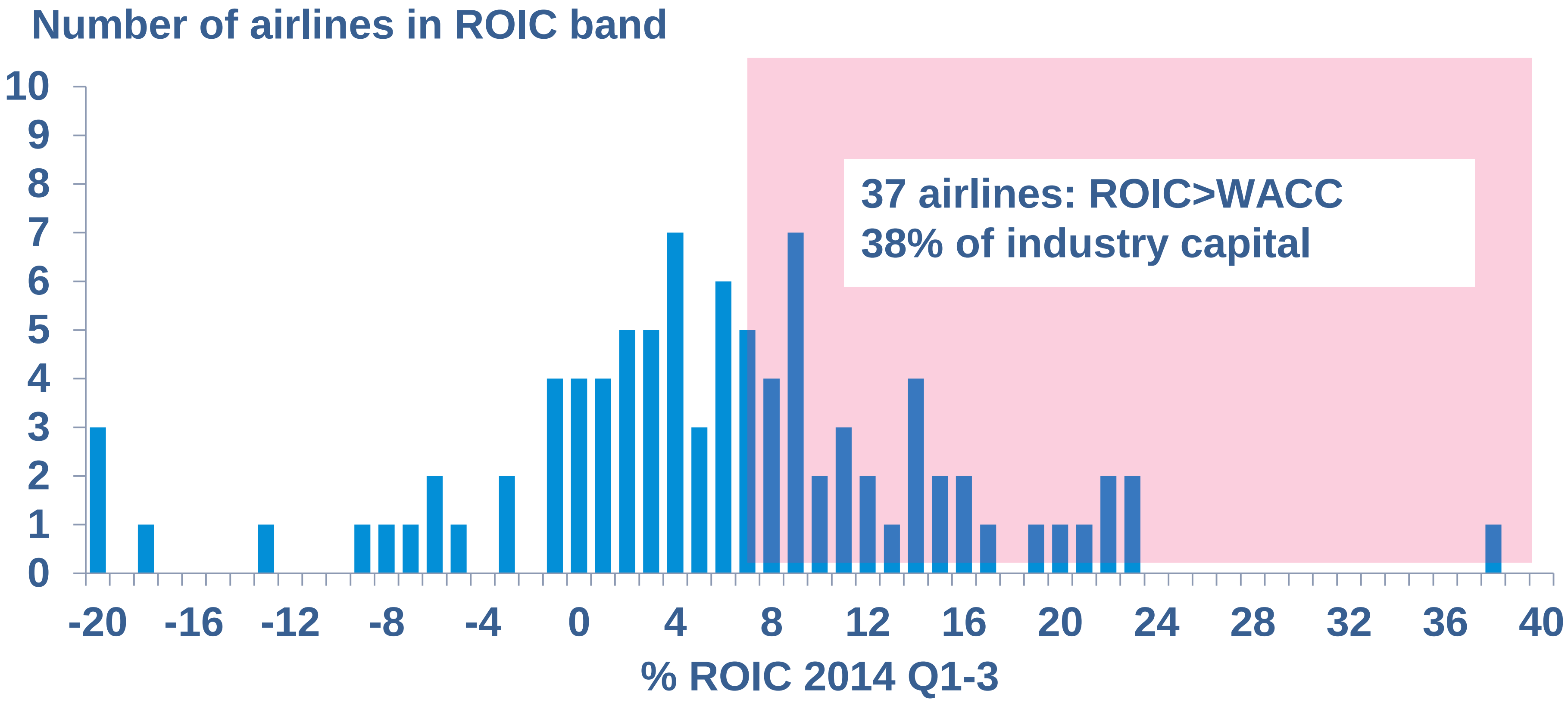
Source: S&P, Airfinance Journal December 2015

As are equity markets



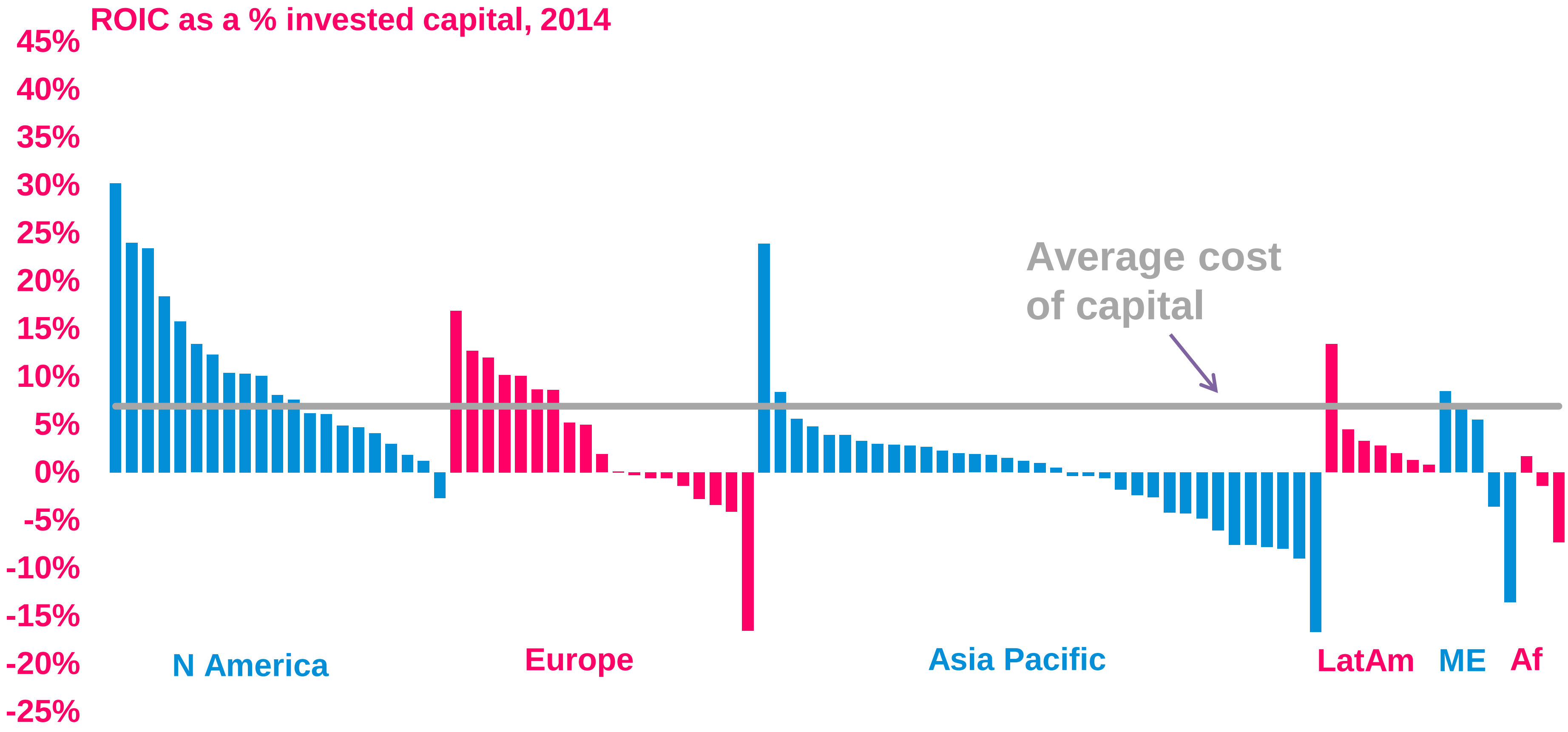
Source: Datastream

ROIC improvement in 2014 was narrowly based



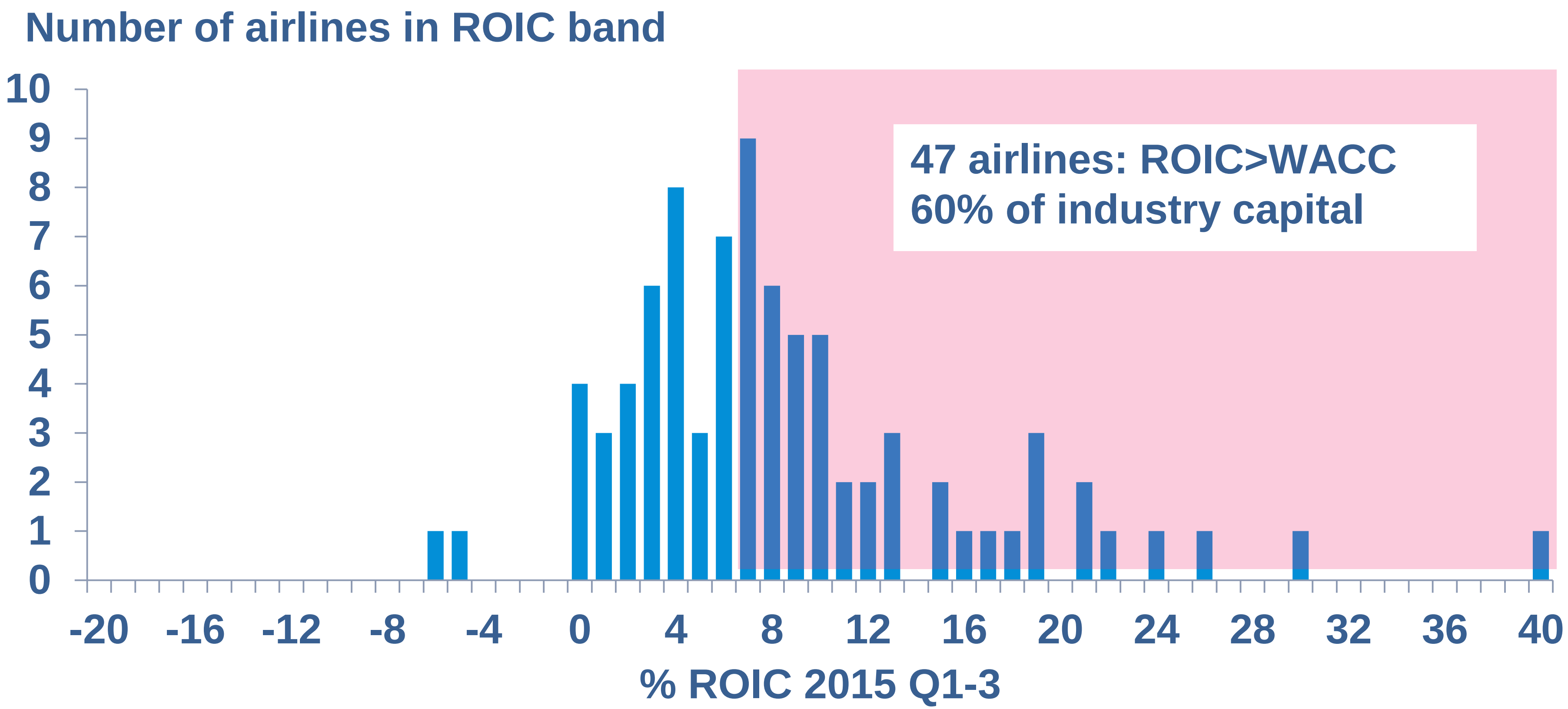
Source: The Airline Analyst, IATA Economics

ROIC>WACC concentrated mostly in US in 2014



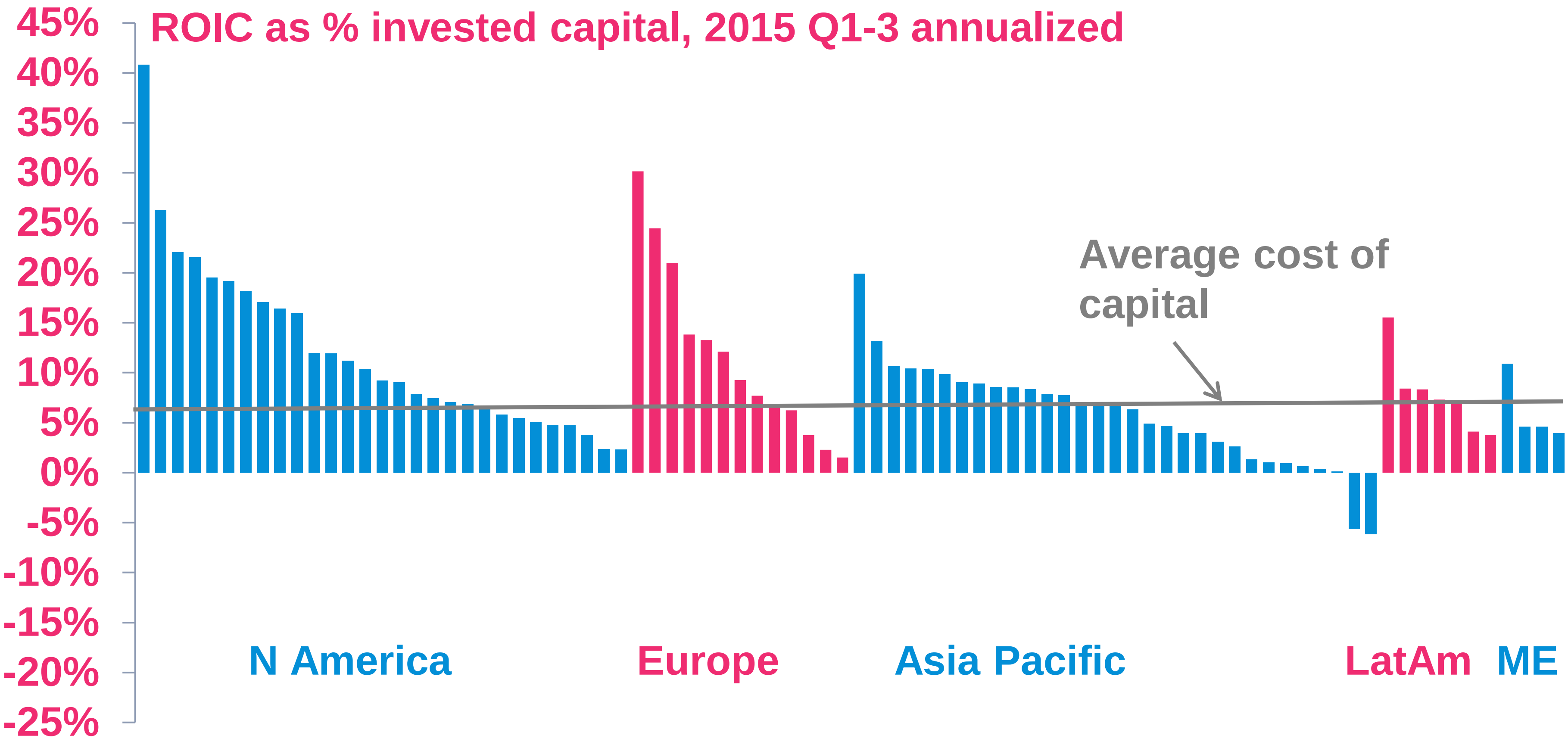
Source: The Airlines Analyst, IATA Economics

But last year ROIC improvement spread



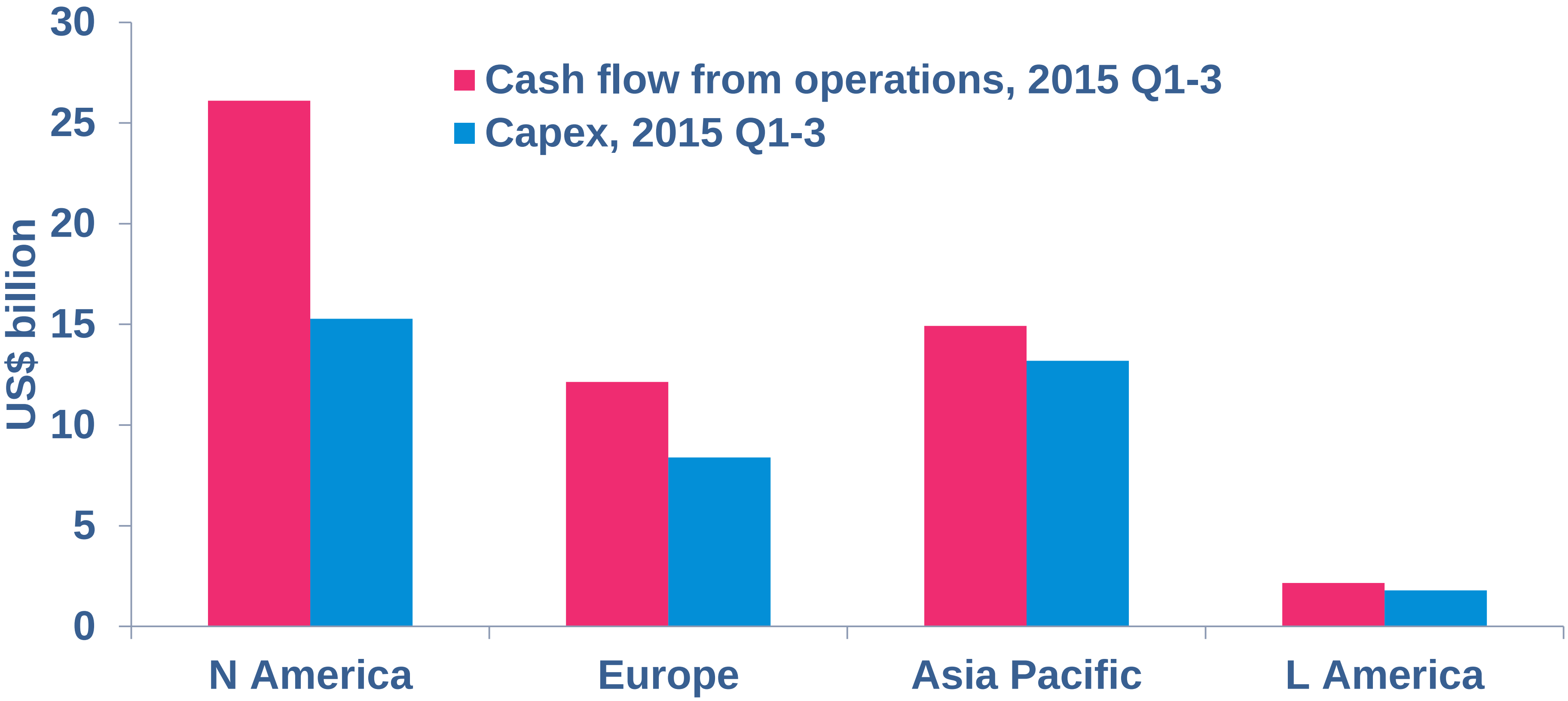
Source: The Airline Analyst, IATA

Returns rose in US, Europe and spread to Asia



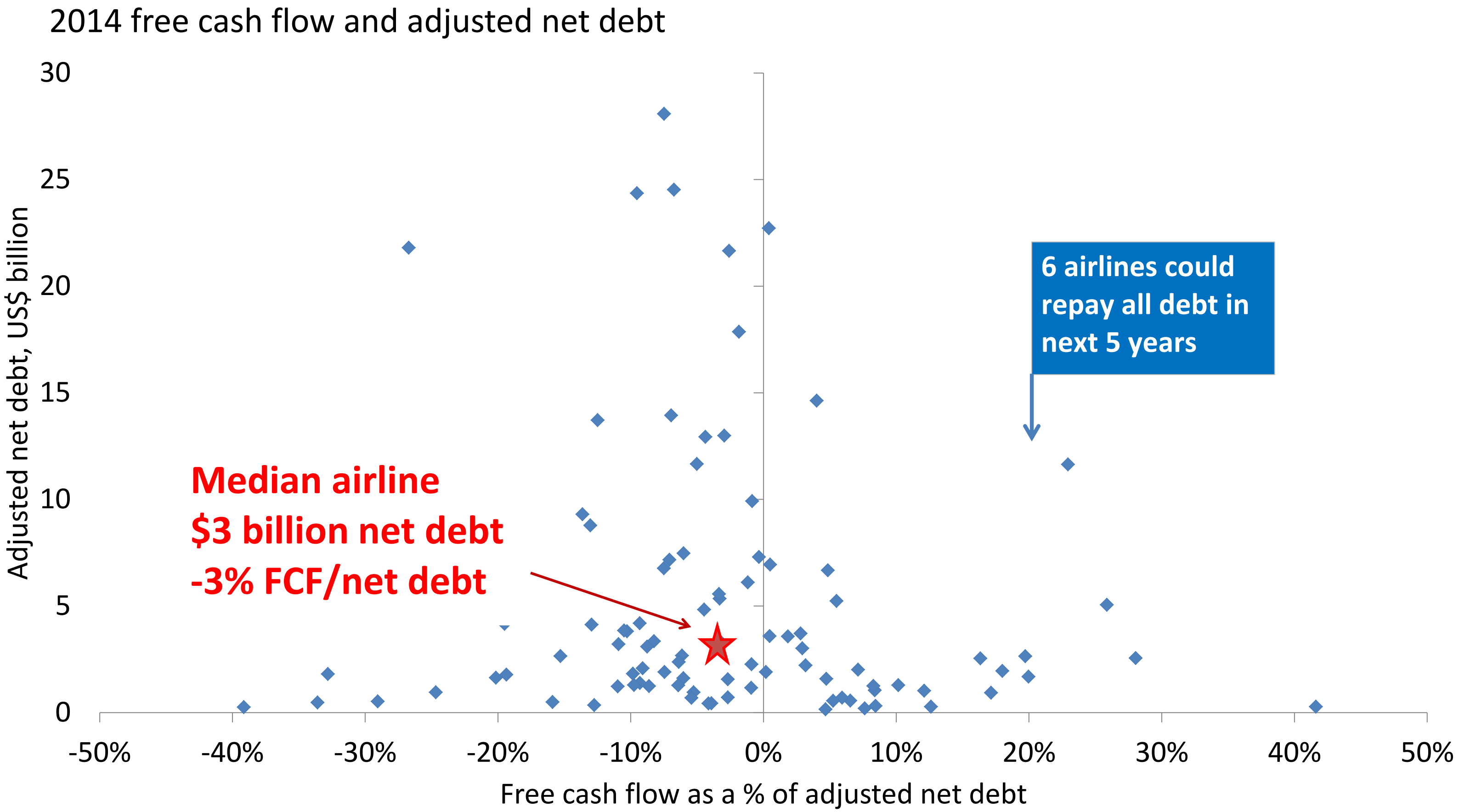
Source: The Airlines Analyst, IATA Economics

Unprecedented FCF in the US



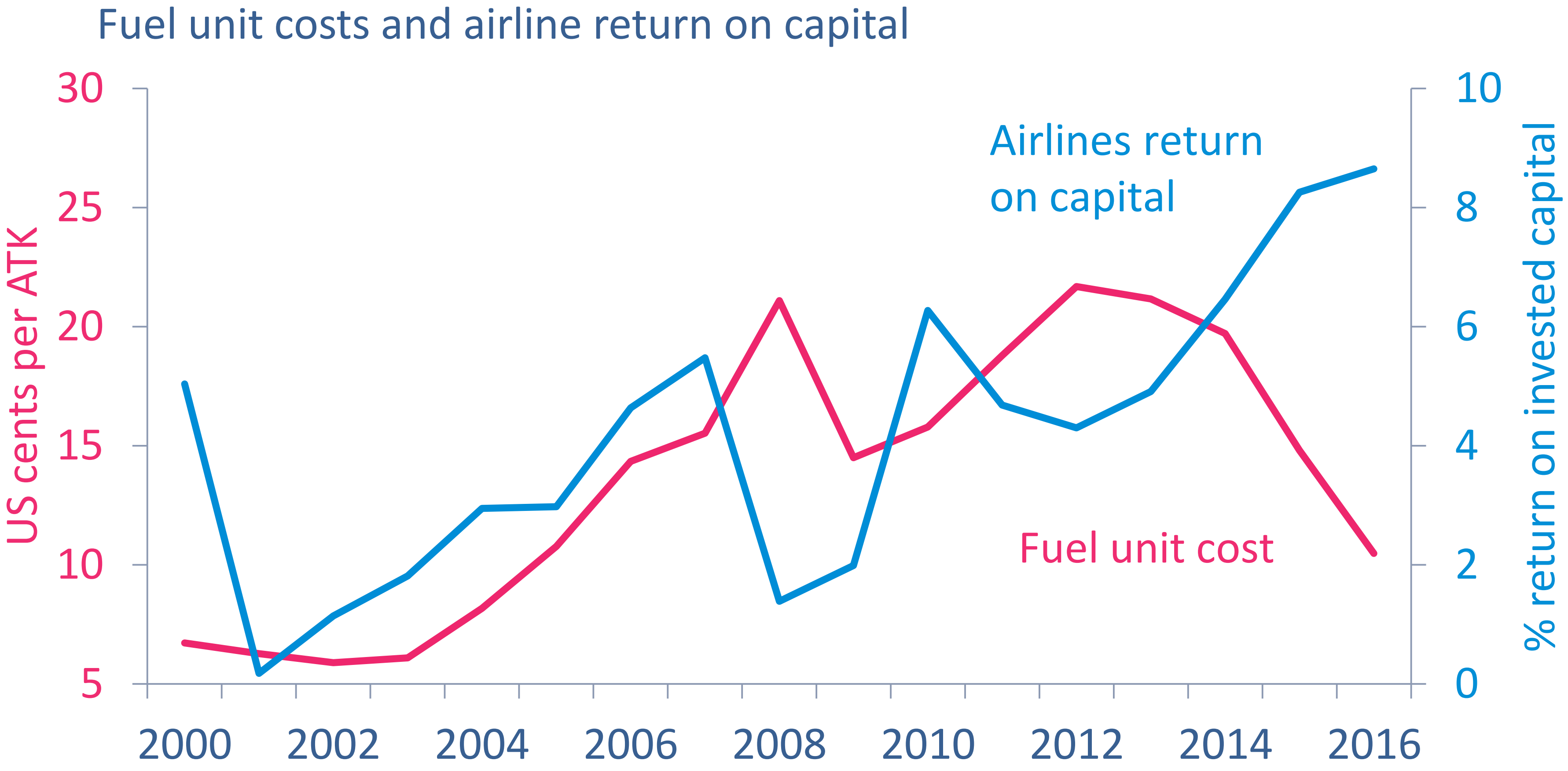
Source: The Airline Analyst, IATA Economics

Allowing significant balance sheet repair for some



Source: The Airline Analyst, IATA

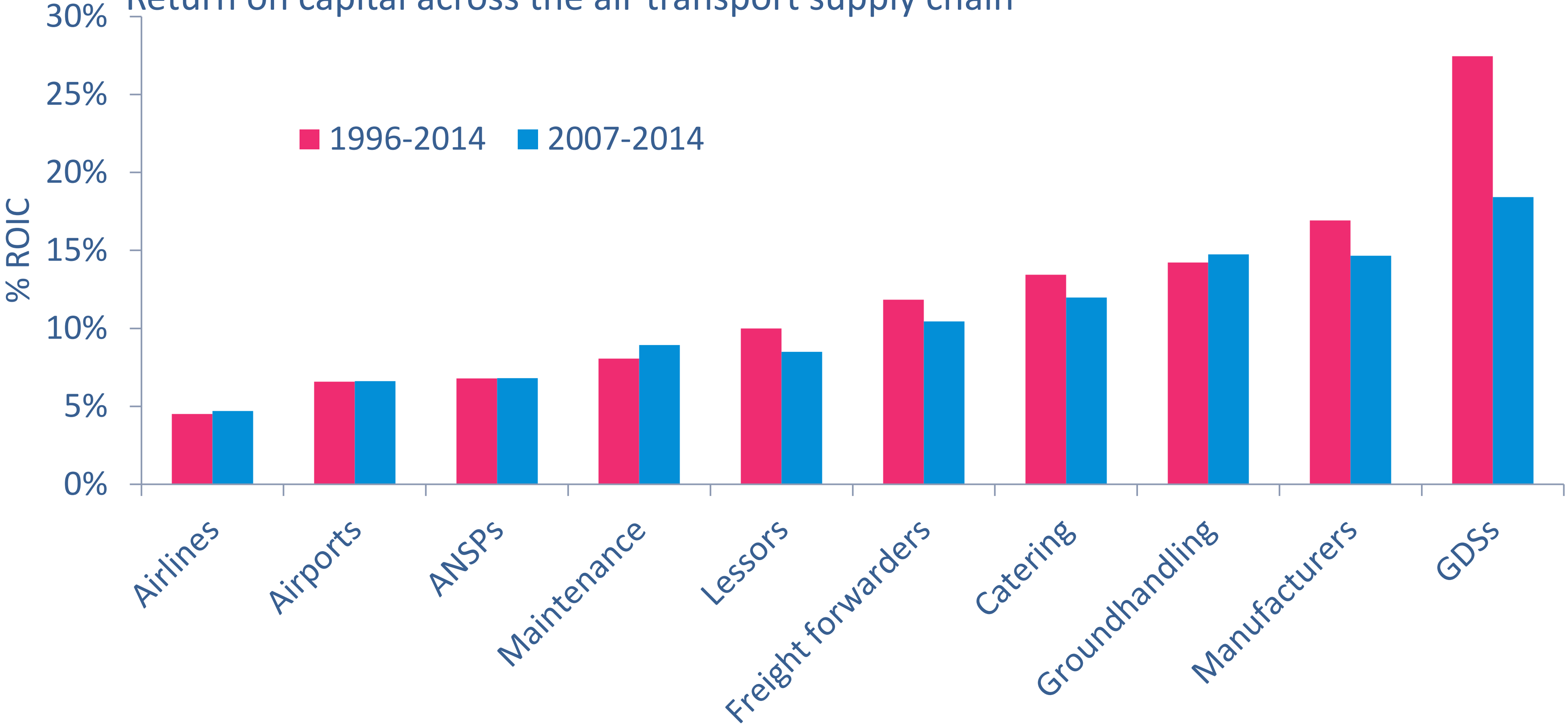
It's not just cheap fuel



Source: ICAO, McKinsey, IATA

Suppliers mostly generate much better returns

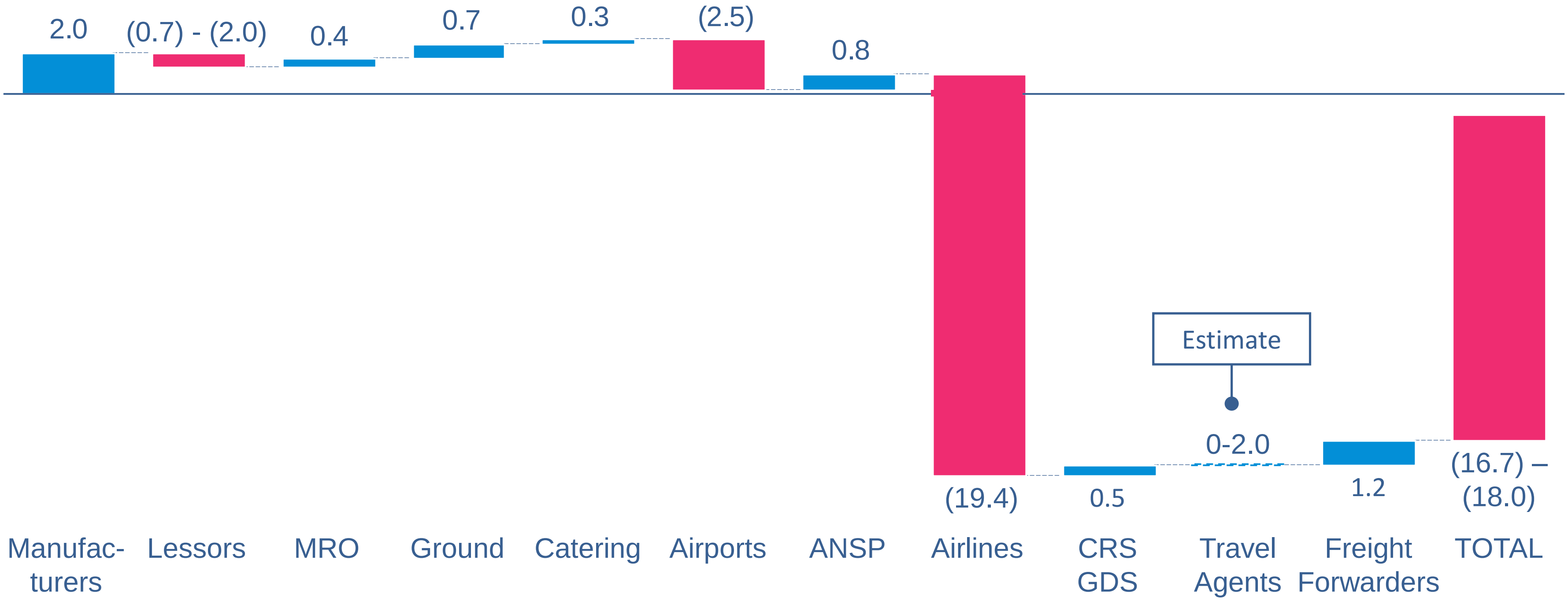
Return on capital across the air transport supply chain



Source: McKinsey for IATA

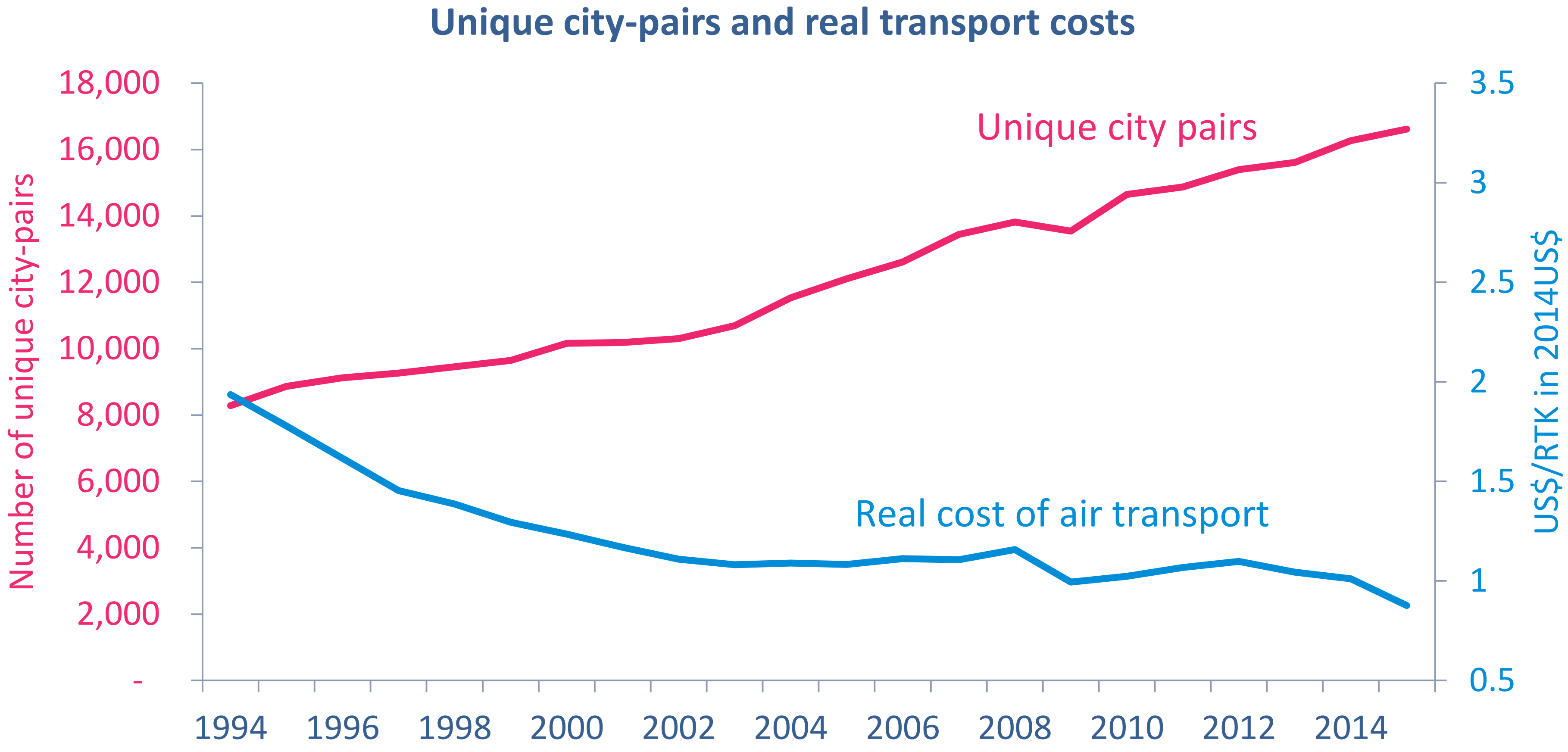
But this is not the main issue for airline earnings

Average yearly economic profit, USD billion, 2007-2014



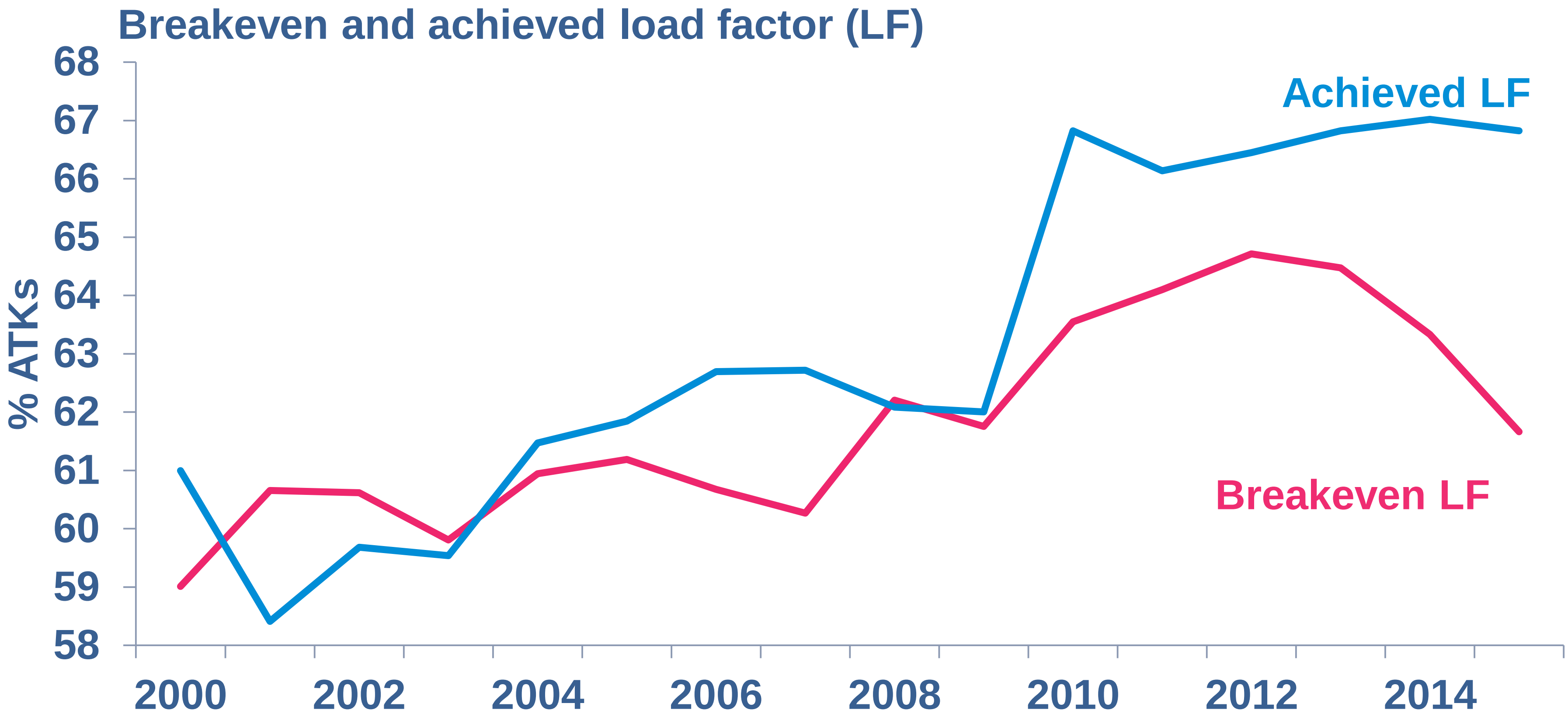
Source: McKinsey for IATA

Most of the value created ends up with consumers



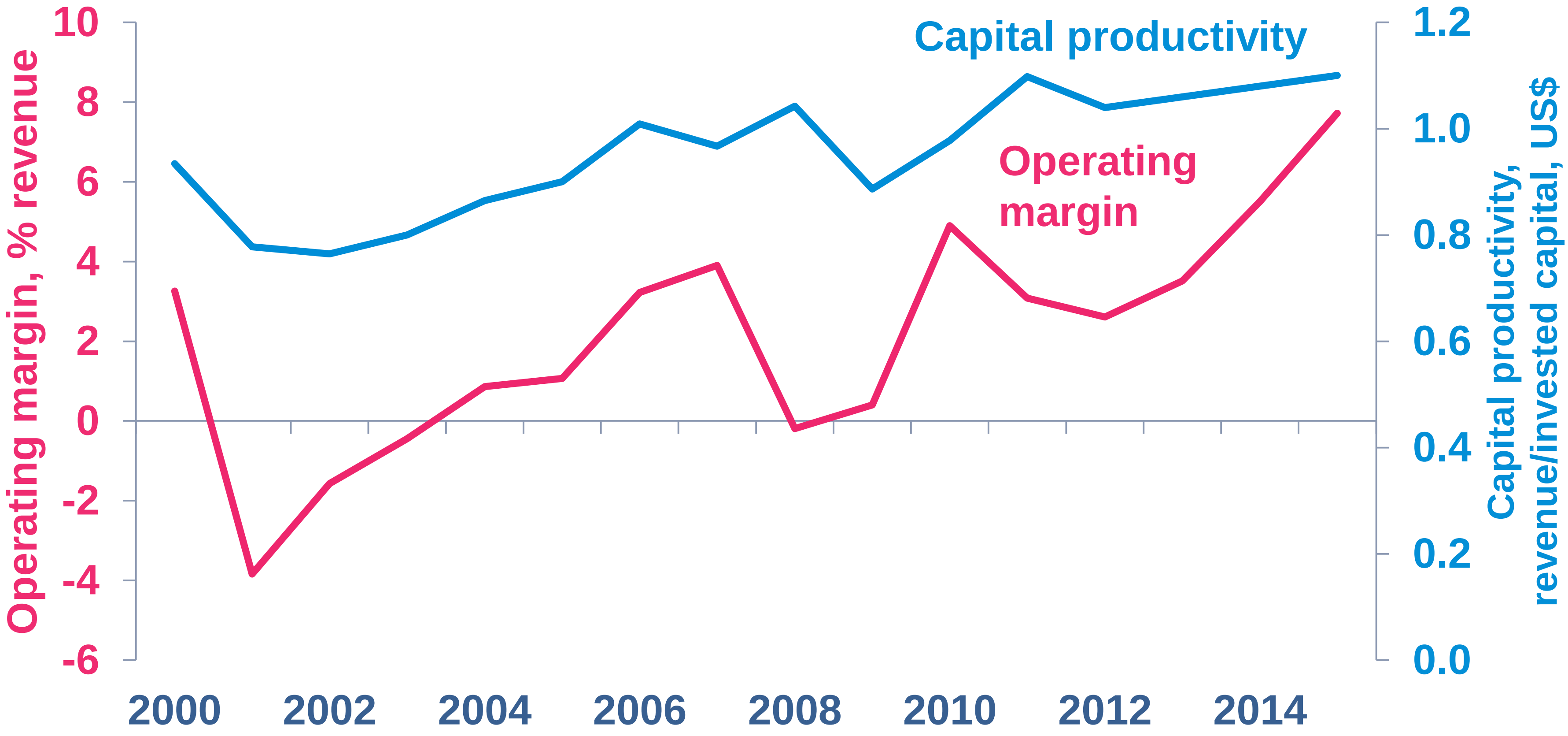
Source: ICAO, Boeing, OAG, IATA

Step change in airlines' asset use since the GFC



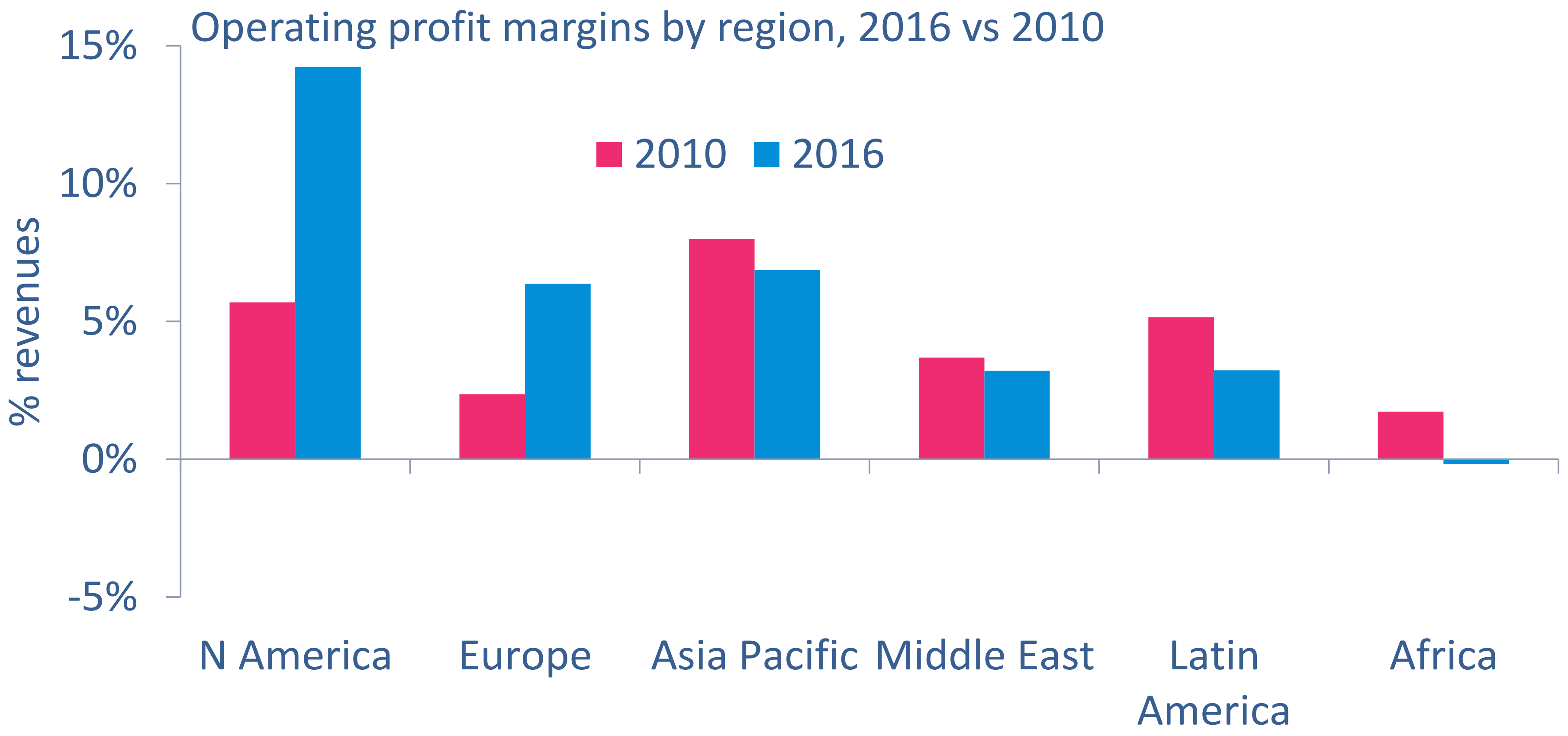
Source: ICAO, IATA

And the productivity of capital is improving



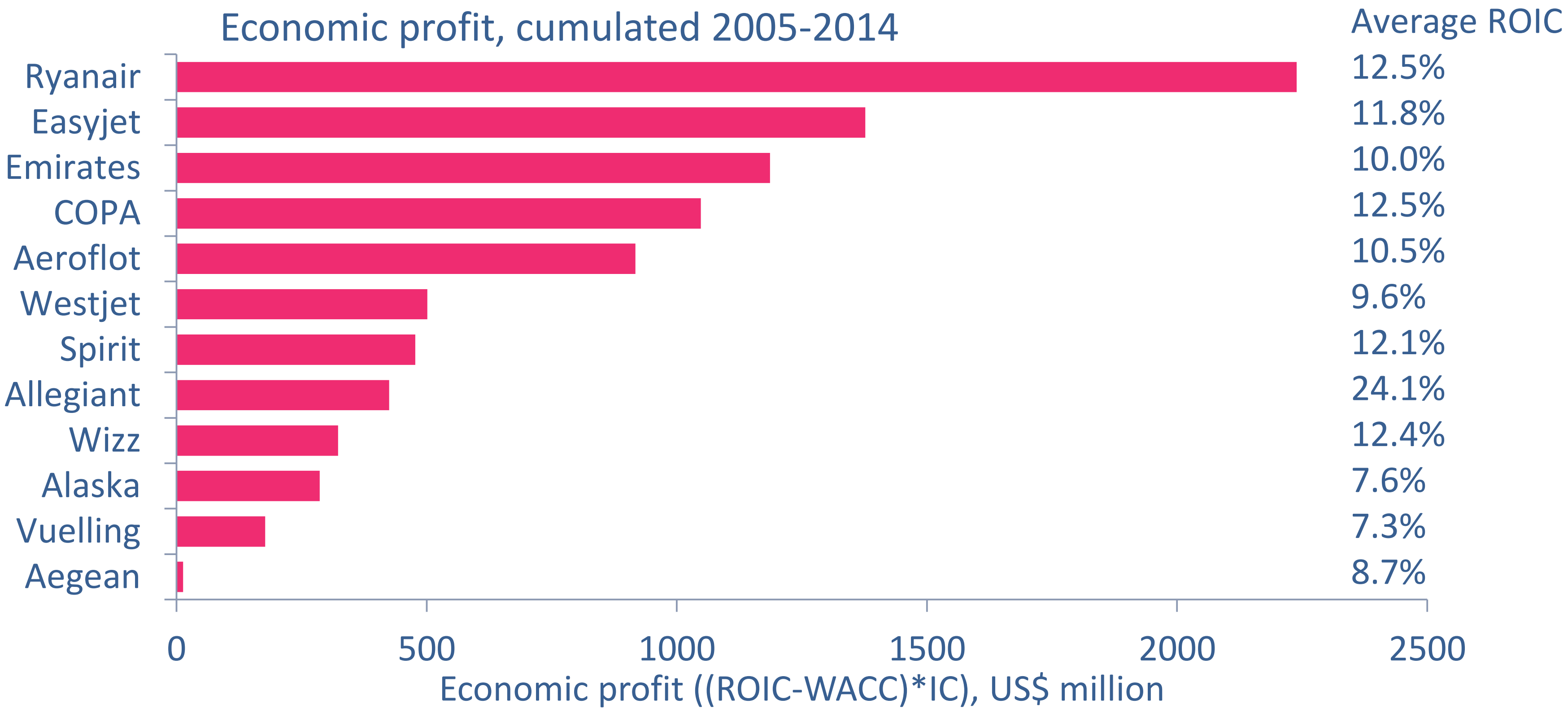
Source: ICAO, McKinsey, IATA

Still driven primarily by the US



Source: ICAO, IATA

Only a few generated economic profits consistently



Source: McKinsey for IATA

What differentiates the few?

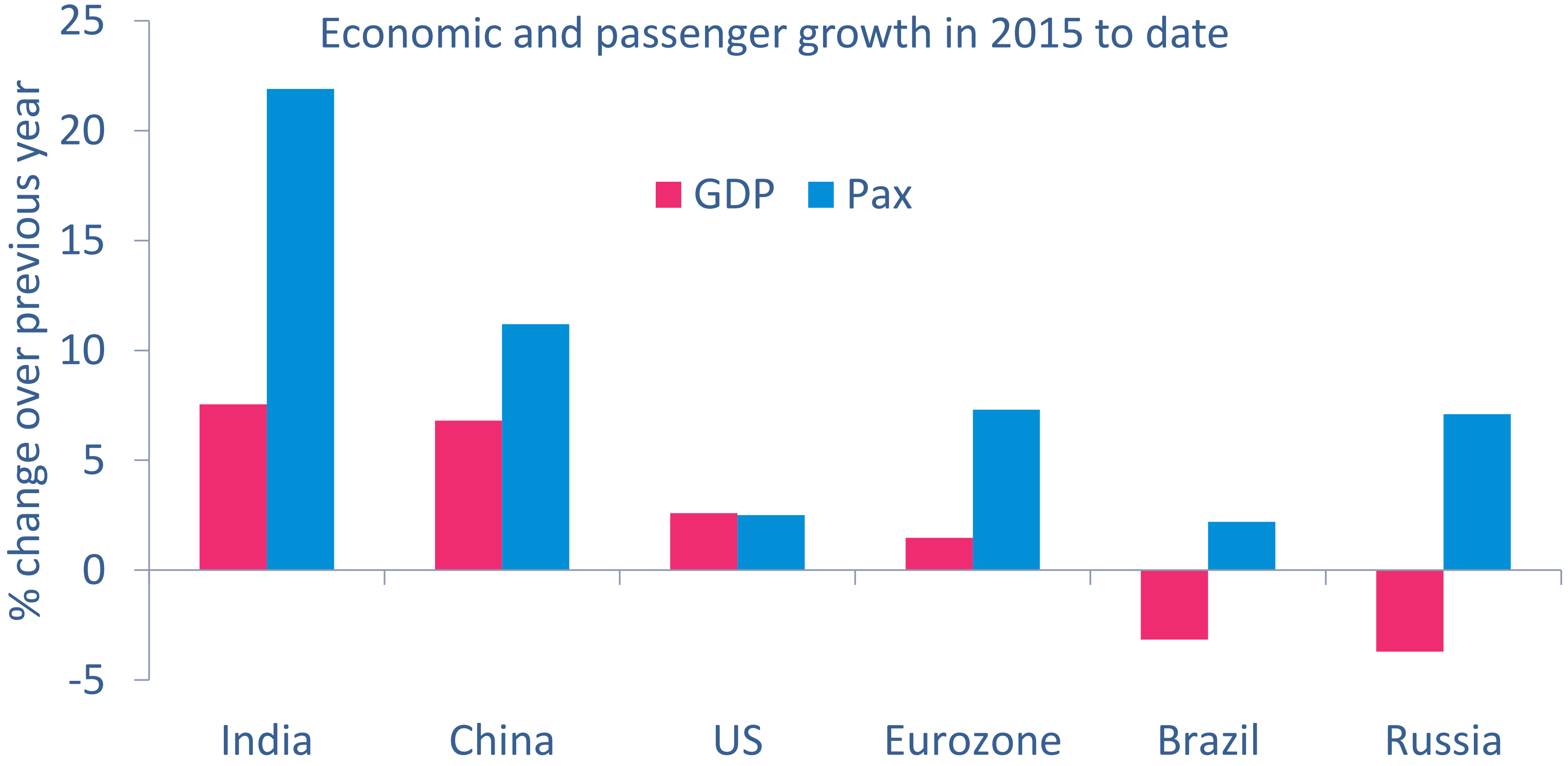
- Route network with time advantages/high QSI
- A brand that consumers value in some way
- Cost advantage versus key competitors
- Less capital?
- Shorter-haul?

Are we measuring the right thing?

- Economic losses persisted for 70 years
- No apparent shortage of capital
- Operating cash flow covers leasing cost/depreciation
- Are aircraft really capital?
- Is WACC overstated?
- Are airlines doing better than we think?

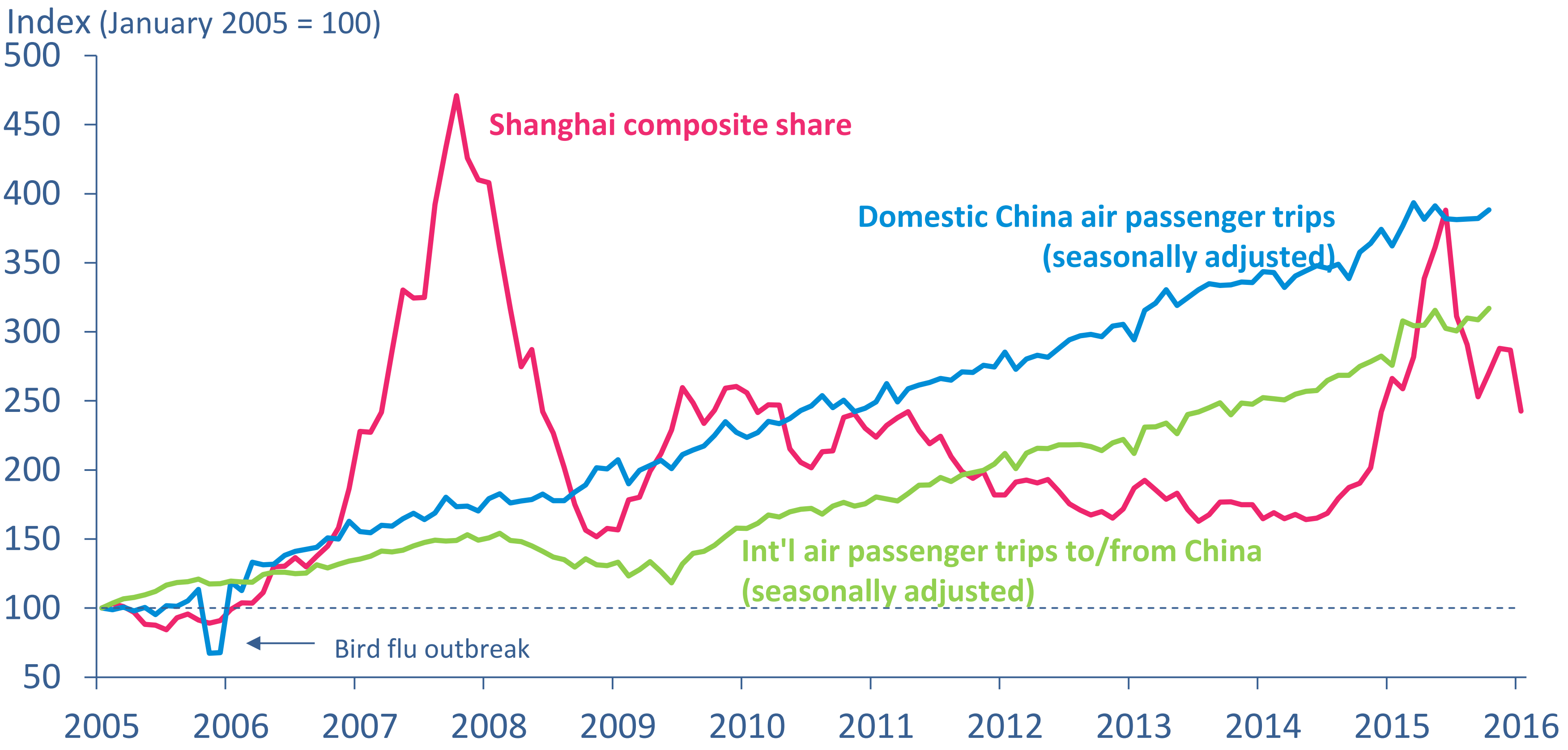
BACK UP SLIDES

Wide variation in travel growth by country



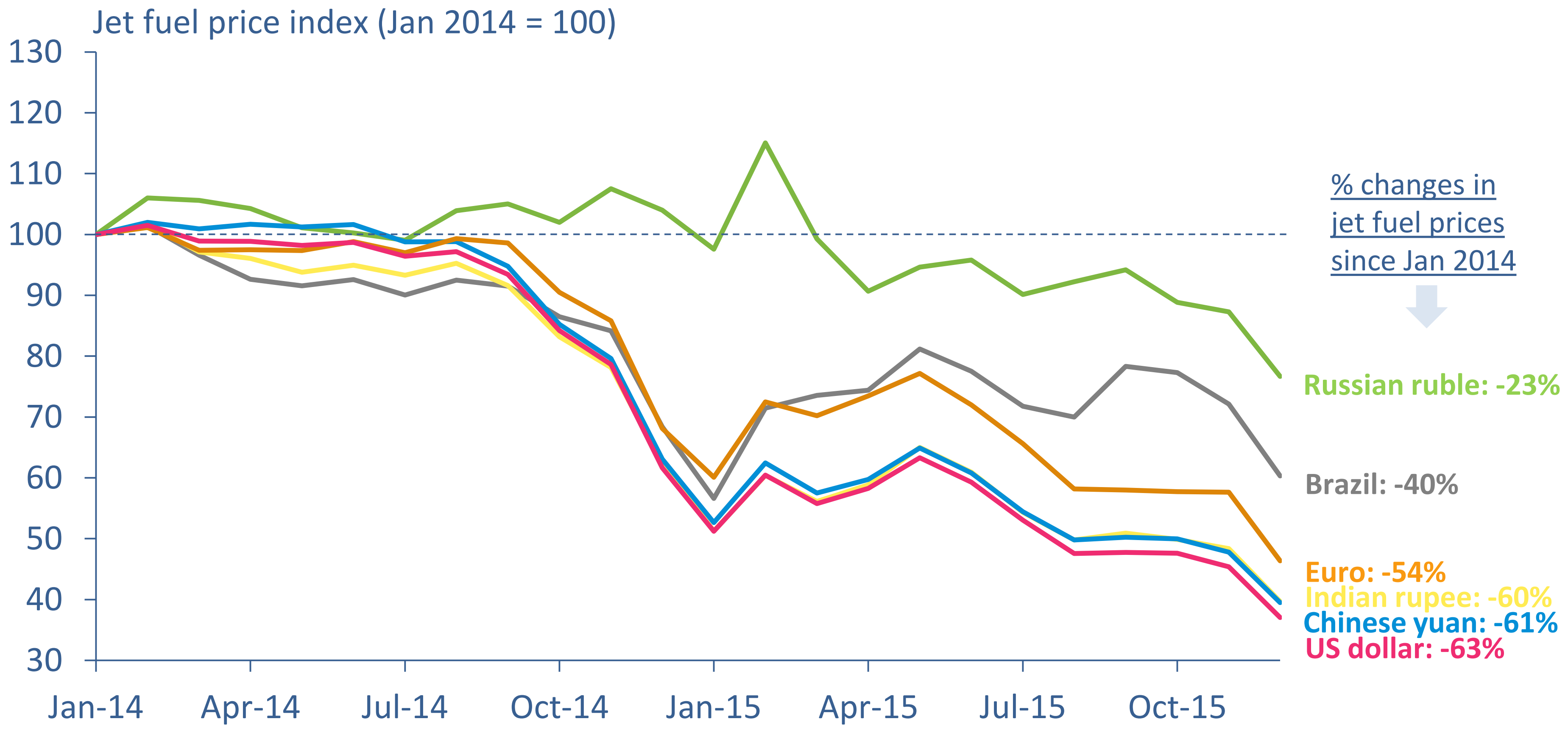
Source: Datastream, IATA Statistics

Equity markets not always a good signal



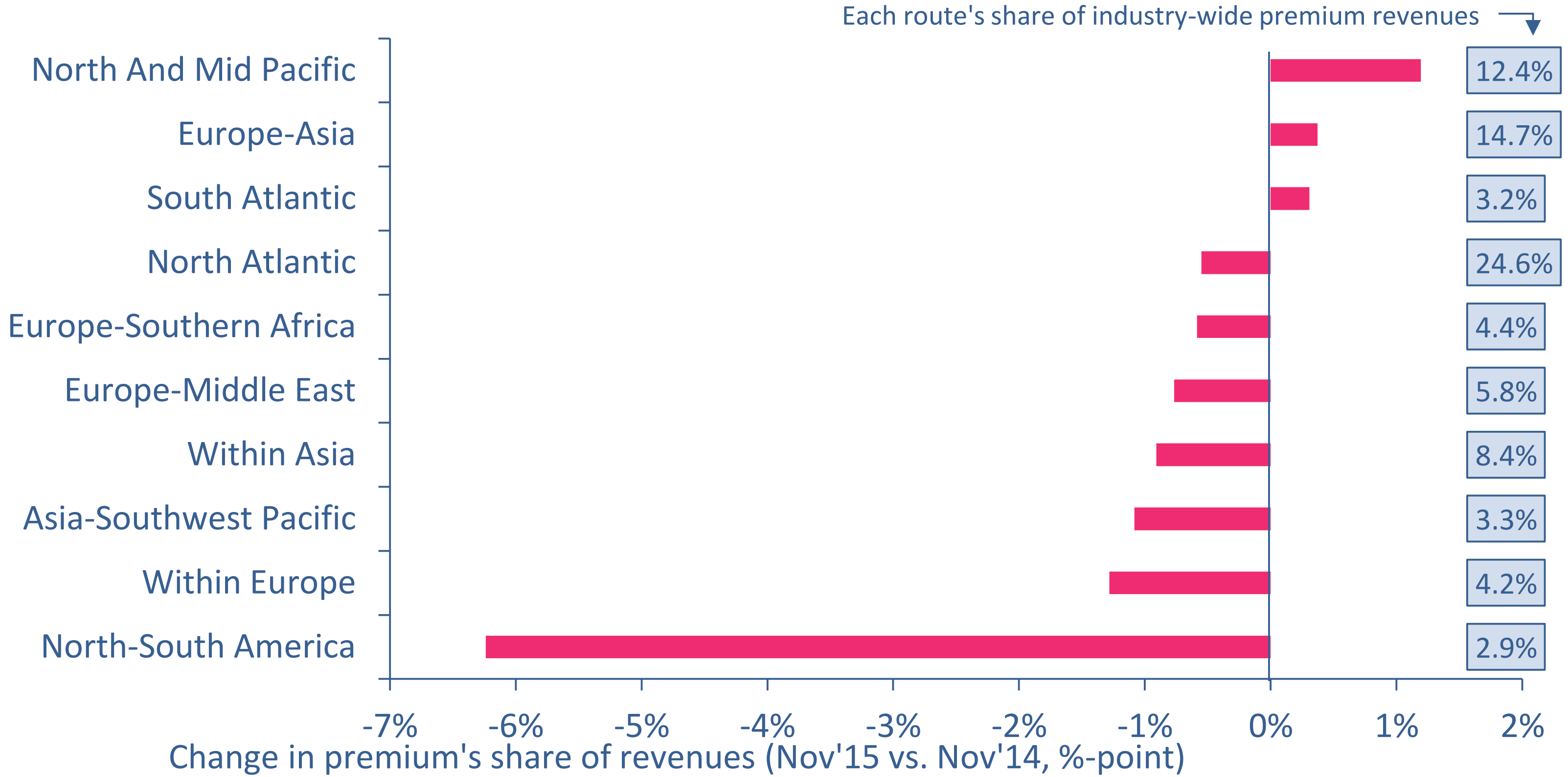
Source: Datastream, IATA

Partly driven by major exchange rate shifts



Source: Datastream

Premium slowing yield decline in some markets



Source: PaxIS+, IATA

Still vast potential in air travel marketes