

AIRLINE BUSINESS CONFIDENCE INDEX

JULY 2011 SURVEY

KEY POINTS

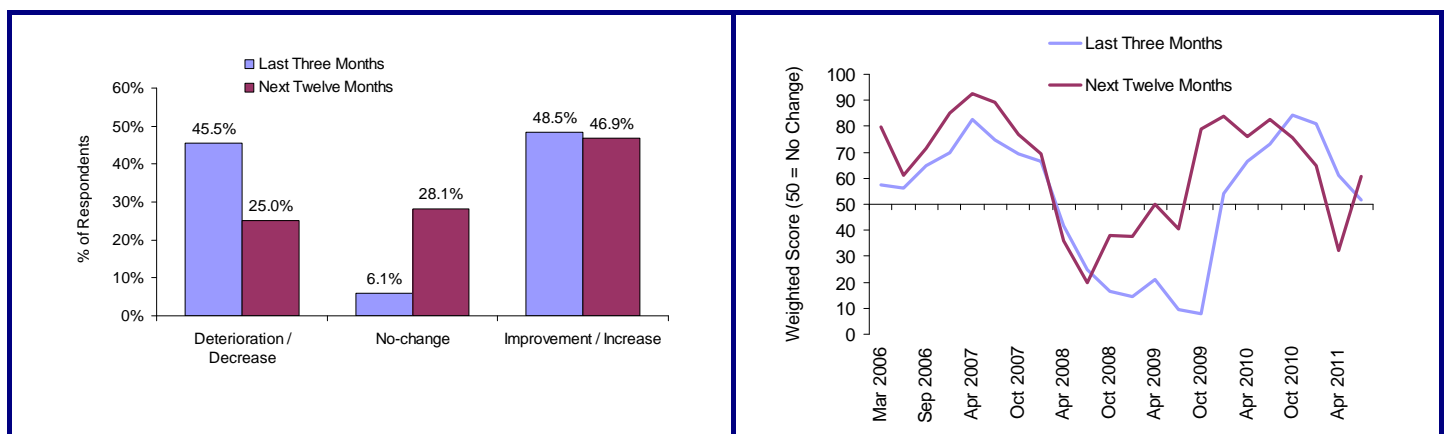
- Results from IATA's quarterly survey conducted in July show that while profit margins have continued to be squeezed in the second quarter, there has been some recovery in the outlook for profitability in the 12 months ahead. The sharp dip in confidence seen in the April survey was driven by expectations of further escalation in fuel prices and the demand shocks due to events in the Middle East, North Africa and Japan also dampened sentiment. While fuel prices remain high, expectations of further sharp increases have dissipated and traffic demand remains strong, helping to drive the pick up in sentiment on future profitability. The extent of improvement in reported profitability continued to moderate during the second quarter of 2011 as margins were squeezed. Almost 46% of respondents reporting deteriorating profitability – up from a third in April.
- The low level of confidence in future profitability expressed in April was more consistent with levels last seen in 2008 when the industry was in double-digit loss. In June IATA revised down its forecast for 2011 industry profits to US\$4.0 billion – down but still in positive territory. The less bearish outlook on profits expressed in this July survey looks more consistent with the revised industry forecast.
- Both cargo and passenger demand continued to improve during the second quarter of 2011. Increases in passenger demand were reported by 74% of respondents and 69% on the cargo side of the business. These are up slightly on the proportions reported in April. Expectations for further improvements in demand over the 12 months also ticked up in the latest survey on hopes of strengthening economic growth. Airlines expect that the current expansion of air travel and air freight markets has further to run.
- While both passenger and cargo transport businesses saw improving yield performance during the second quarter of 2011, the trend is flattening. With demand-supply conditions weakening and concerns that markets may not bear further fare/rate rises, prospects for yields over the year ahead look flat. With over 80% of respondents reporting increased input costs during Q2, clearly high fuel costs have impacted financial performance. However, while cost pressures will persist, expectations of large further increases over the year ahead have moderated considerably.
- On balance, industry employment continued to expand in the second quarter of 2011 as operations increased to cater to growing demand. Further expansion is expected over the year ahead.

PROFITABILITY OUTLOOK

How has profitability changed? How do you expect it to change over the next twelve months?

a) July 2011 survey

b) Compared to previous surveys



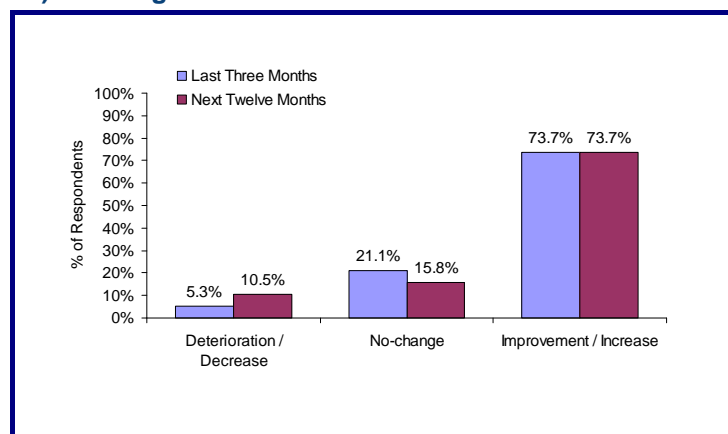
- Expectations about prospects for profitability over the year ahead improved in our July survey on the back of a positive outlook for traffic demand growth and reduced fears of further significant rises in fuel costs. The depressed outlook expressed in our April survey came at a time when fuel prices had risen to \$140 per barrel and the industry was being affected by demand shocks due to events in the Middle East, North Africa and Japan. In April more than half of respondents expected a deterioration of profitability and only a fifth expected improvement. The situation has reversed in our July survey with 47% expecting improvement versus the quarter who see a worse picture going forward. Respondents expect stronger traffic in the second half of the year as the effects of the demand shocks in the first half tail off. There is also optimism about the broader economic outlook. The price of fuel remains a concern, as does the potential for increased capacity entering the market to soften further upward yield movement. The balance of views on the outlook for profits over the 12 months ahead (with 50 representing no-change, and values above 50 signaling a greater balance of positive views) sits at 60.9 – back above the 50 ‘no change’ line, indicating stable or even improving conditions. Regionally, 60% of European respondents see improvement ahead, those from the Americas see stability, while those in the Asia Pacific are more bearish citing ongoing fuel price concerns and continued demand impacts in the wake of the Japanese earthquake and tsunami.
- The extent of improvement in reported profitability moderated further during the last quarter. While almost half of respondents reported improved profitability during Q2 2011, a similar proportion reported poorer results – up from a third in April’s survey. Margins have been squeezed in Q2 by rising fuel prices at a time when the pace and scope for further yield increases is reducing. Continued demand growth helped the revenue picture for airlines in many regions, driving better financial performance. Respondents from the Asia Pacific are the main exception where demand has taken a significant hit in the aftermath of the Japanese earthquake and tsunami. A majority of respondents from Europe and the Americas reported improvements in profitability while more than 80% of those from the Asia Pacific saw declining profitability during the quarter. On a weighted average basis, the score for profitability over the previous three months is 51.5 – indicating stability.

DEMAND GROWTH

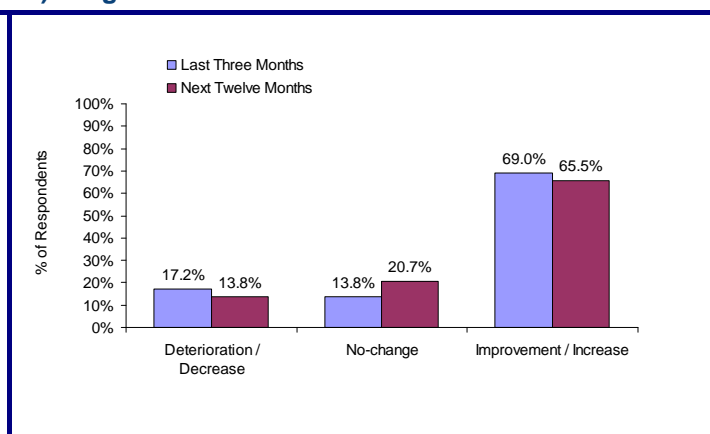
- A significant majority of respondents continued to report improved traffic volumes on both the passenger and cargo sides of the business during the second quarter of 2011. The outlook over the next 12 months remains for further expansion, with an uptick in outlook reported in the July survey compared to April. By May this year air travel (measured by revenue passenger kilometers) was 4% higher than the level seen at the beginning of the year. In this latest survey, 74% of respondents reported increased passenger traffic during Q2 2011. This is up from the 65% reported in our April survey. Air travel markets are still expanding – although the annualized pace of growth has halved to 4% since Q4 2010 compared to the more rapid rebound seen earlier in the post-recession recovery. The outlook for passenger traffic over the 12 months ahead remains positive with over 70% expecting increases over that period on the back of continued demand growth and capacity expansion. The weighted average score has ticked up again to 81.6 with respondents on balance seeing traffic strength in the second half of 2011.

Recent and expected change in traffic volumes

a) Passenger



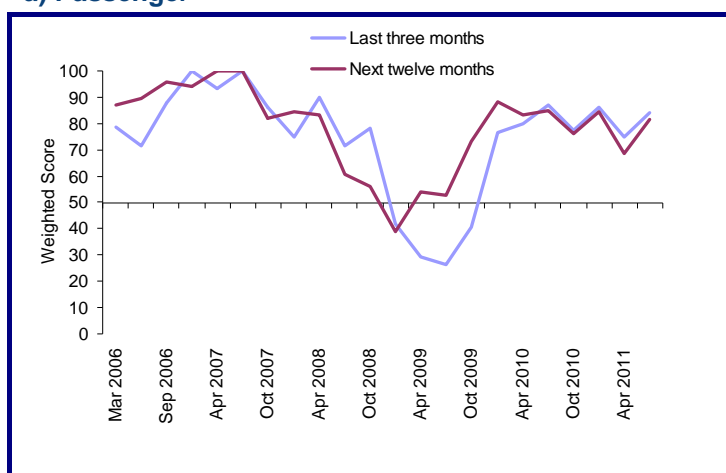
b) Cargo



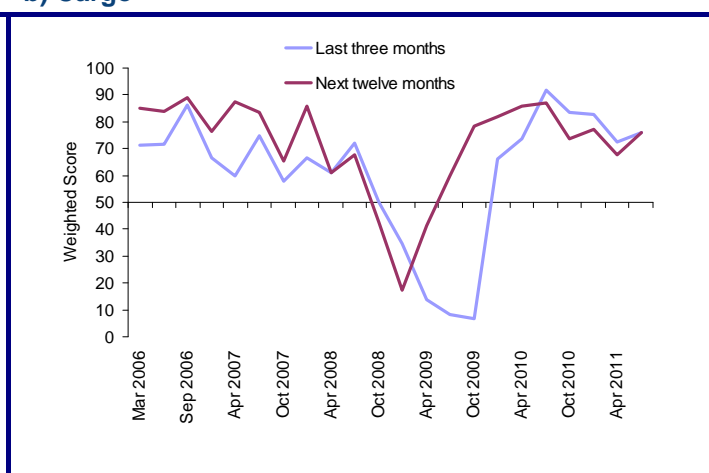
➤ Almost 70% of respondents reported stronger cargo traffic in the last quarter, up from the 59% reported in April's survey. Freight traffic has been volatile in the early months of 2011, however by May the level of air freight volumes (measured by freight tonne kilometers performed) was 2% higher than the start of the year and looks to be growing at an annualized rate of close to 4%. With world trade growing at around 6% there remains the scope for an acceleration in freight traffic during the second half of 2011. Respondents indicate they think that further expansion is likely with 66% expecting an improvement in demand over the next 12 months. At a weighted average level of 75.9, confidence in the likelihood of further significant gains in freight volumes is lower than peaks seen leading up to the end of the inventory restocking cycle last year, but is still positive. While the balance of responses from across the major regions indicate expansion ahead, those from the Americas are the most positive, with those in Asia slightly less so – partly a factor of the disruptive effects on supply chain shipments of the Japanese earthquake and tsunami.

Compared to previous surveys

a) Passenger



b) Cargo

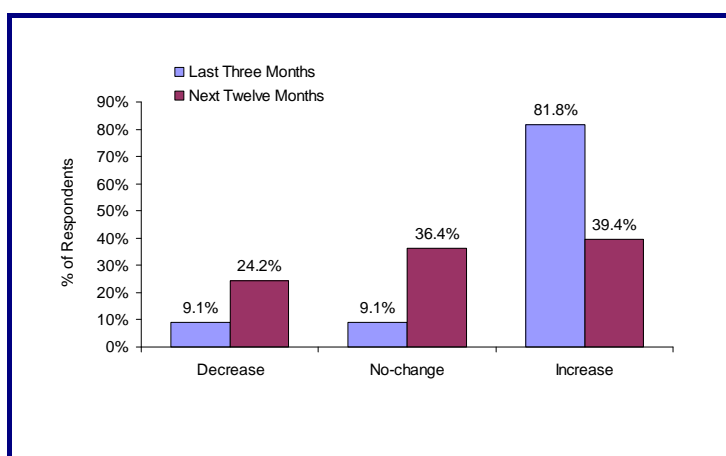


INPUT COSTS

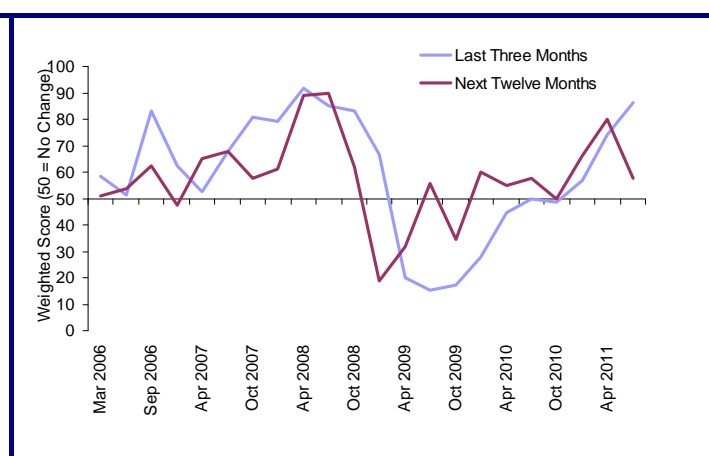
➤ The overwhelming majority of respondents reported increasing input costs during Q2 2011, driven largely by the dramatic rise in the price of fuel. Jet fuel prices peaked during the quarter at \$140 per barrel and while they fell back somewhat after that, the average price for the quarter was still in the vicinity of \$133 per barrel – nearly 50% higher than the average level the same quarter a year before. Fuel represents around 29% of operating costs for airlines and any movement in the price has a large impact on overall input costs. As such, the weighted average score for input unit costs climbed sharply in our July survey to 86.4 – a similar level to that seen during the fuel price spike of mid-2008.

How have your unit input costs changed? How do you expect them to change over the next twelve months?

a) July 2011 survey



b) Compared to previous surveys



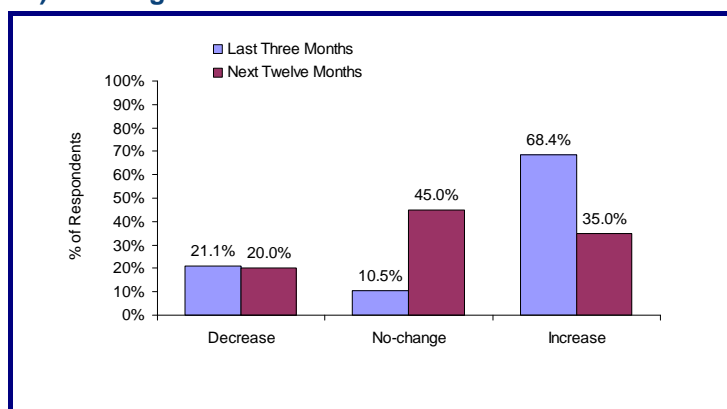
➤ However expectations for further rises in input costs over the 12 months ahead have fallen back. Although fuel prices remain high, they have fallen from their April peak and airlines do not expect another significant step up in the price level. The weighted average score for expectations going forward sits at 57.6 indicating more stability in input costs is expected. While the high cost of fuel remains the major concern for respondents from all regions, several report expectations of driving down unit costs going forward through renegotiation of contracts with vendors and scale economy effects of expanding operations are also evident.

YIELD ENVIRONMENT

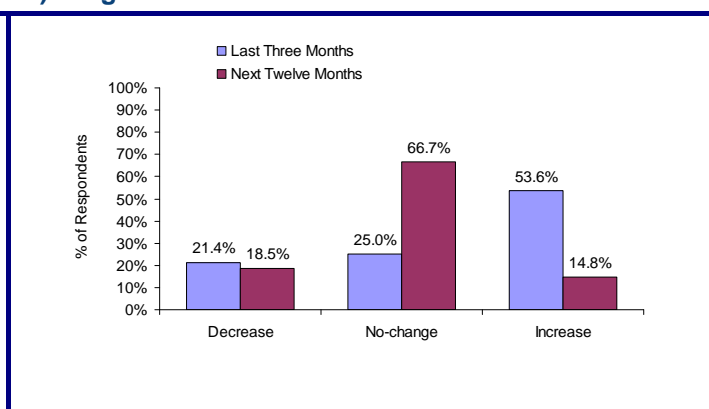
- Both passenger and cargo transport businesses saw improving yield performance during the second quarter of 2011, although the proportions reporting this are either flat or declining. Much of the yield increases seen this year have been the results of efforts to recoup soaring fuel costs. However load factors are down on their 2010 peaks and, with demand-supply conditions weakening, prospects for significant further yield increases are waning. Just over 68% of respondents reported passenger yield increases in Q2 2011 – down from the 75% in April. Overall, on a weighted average basis, the score for yield performance over the last quarter was 73.7 – turning to point back in the direction of the 50 ‘no change’ mark for the first time since recovery began in late 2009.
- Looking ahead, 45% of respondents see a stabilization of passenger yields over the year ahead. In our July survey the weighted average score for passenger yields going forward sits slightly above the 50 ‘no-change’ line at 57.5. Yield-boosting fuel surcharges are being held rather than increased (and in some cases reduced) while increasing capacity may reduce scope for underlying fare rises if passenger load factors fall as a result. IATA’s own forecast is for a 3% increase in passenger yields over the course of 2011 – half the rise seen in 2010.

Recent and expected change in yields

a) Passenger

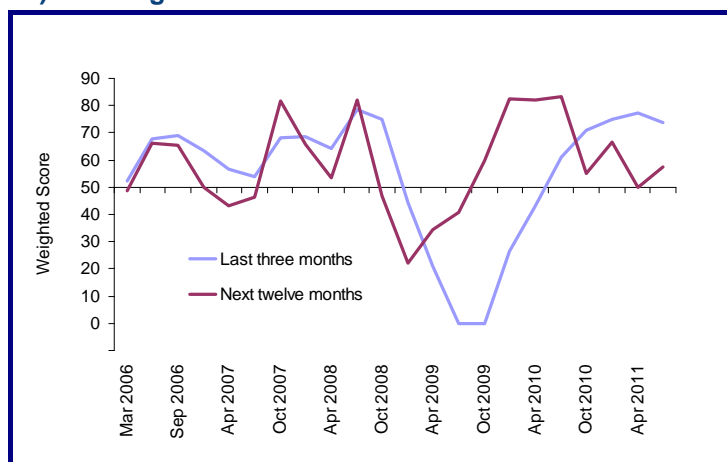


b) Cargo

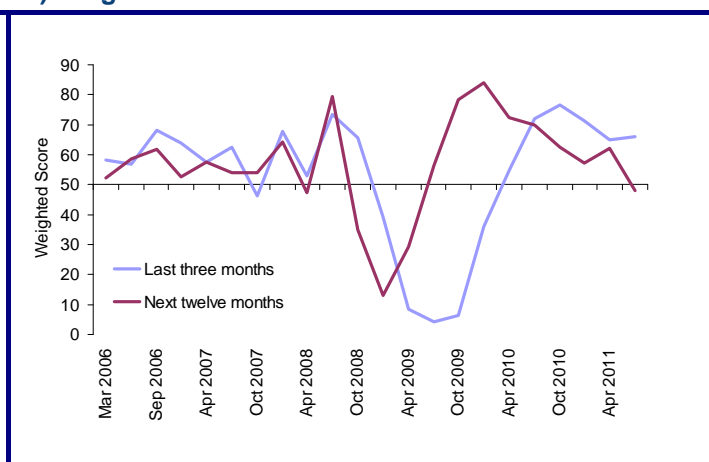


Compared to previous surveys

a) Passenger



b) Cargo



➤ Just over half of respondents to the latest survey reported further increases in cargo yields during the second quarter of 2011. This is a similar rate to that reported in our April survey. The proportion reporting decreases remains at around 20%. The weighted average score has thus remained fairly steady at 66.1. Yields have risen – largely related to recouping additional fuel costs – however competition is also increasing as more capacity enters the market. The level of freight capacity utilization in May this year was 4% points lower than the peak 12 months before, and the trend appears downward. Softening demand-supply conditions are limiting scope for yield increases and, in some cases, driving yield falls. Expectations for cargo yields over the 12 months ahead point largely to stability in yields with two thirds of respondents expecting ‘no change’. In fact the weighed average score for cargo yield movement over the next 12 months sits at 48.1 – more or less on the 50 ‘no change’ mark. A boost to freight traffic from continued world trade growth in the second half of the year may lend support to yield rises – or at least help avoiding falls – if capacity can be utilized appropriately. IATA’s own forecast is for 4% cargo yield growth in the cargo during 2011, following a 15% rebound in 2010.

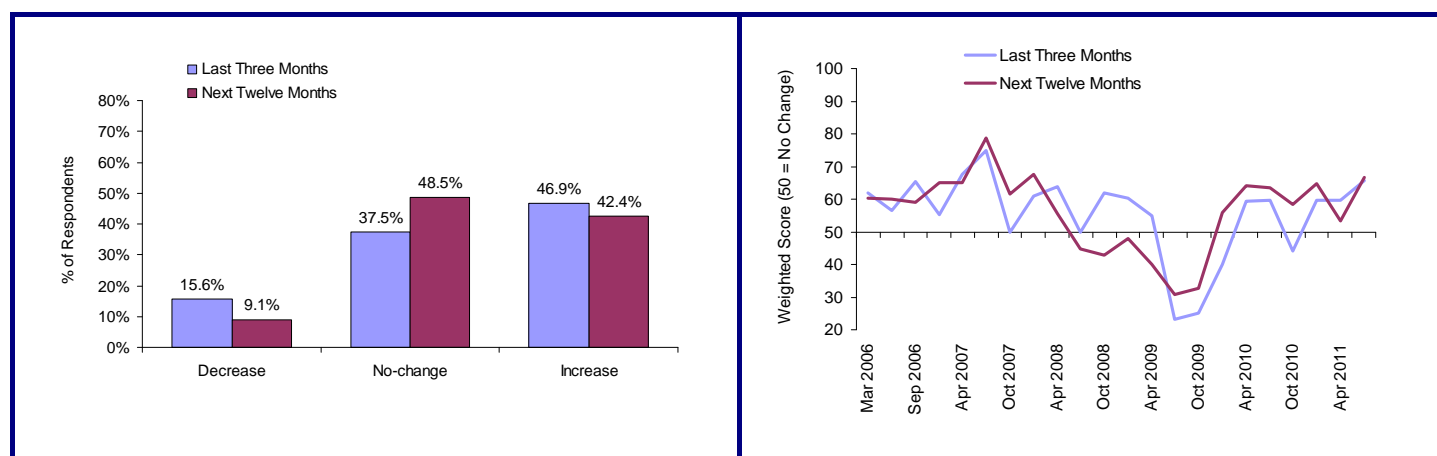
EMPLOYMENT

- The balance of respondents increased employment during Q2 with 47% hiring additional staff and only 16% cutting back. This split shows slightly stronger employment growth compared to the April 2011 survey and as such the weighted average balance of responses ticked up to 65.6. Network expansion or additional capacity introduction continue to drive the increase. A significant proportion – over a third – report no change in employment over the quarter. Regionally, the balance of respondents in the Americas and Asia reported employment increases while in Europe employment was stable.
- The outlook over the next 12 months has ticked up again to 66.7, broadly consistent with levels seen over the last 18 months post-recession. The largest number of respondents – almost half – expect no change in employment over the year ahead, but only 9% expect to cuts. The remainder see increases to support ongoing network expansion and traffic demand increases.

How has your employment level changed? How do you expect it to change over the next twelve months?

a) July 2011 survey

b) Compared to previous surveys



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FURTHER ANALYSIS AND DATA

Access video commentary and chart data related to this briefing through the Enhanced Edition: www.iata.org/business-confidence