ALAFCO Aviation Lease and Finance Company K.S.C.P.

Quarterly Aviation Industry Performance

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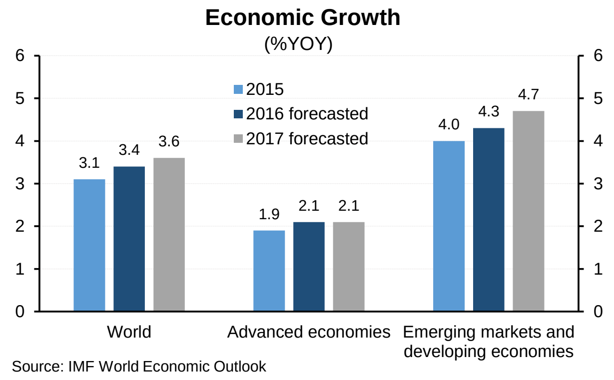
Gradual recovery in global growth

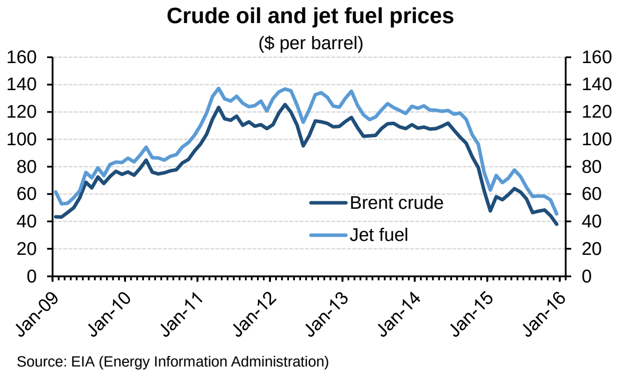


Global economic growth is expected to see a gradual pick-up over the next two years, following subdued activity in 2015. The International Monetary Fund (IMF) projects global growth to rise steadily to 3.4% and 3.6% in 2016 and 2017 from 3.1% last year, reflecting an improvement in emerging markets – after five consecutive years of declining growth – and a modest, uneven recovery in advanced economies.

The outlook for global growth is supported by the expected improvement in emerging markets – despite the ongoing slowdown in China. This primarily reflects a gradual improvement in countries currently in economic distress – notably Brazil, Russia and some countries in the Middle East. In China, growth is expected to slow to 6.3% and 6% in 2016 and 2017, from 6.9% last year – primarily reflecting weaker investment growth as the economy continues to rebalance. Meanwhile, growth in advanced economies is expected to see a modest to steady recovery – supported by low oil prices and easy financial conditions.

Global growth could be derailed by China's rebalancing, lower commodity prices and US monetary policy. Faster-than-expected slowdown in Chinese economic activity, lower prices for oil and other commodities, and prospects of a gradual tightening in monetary policy in the United States have titled the risks to the global outlook to the downside.

Oil prices at lowest in over a decade

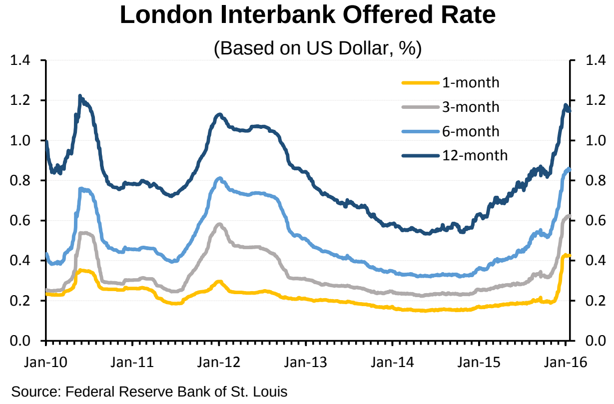


Oil prices dropped to $38 per barrel at the end of 2015 – its lowest level since mid-2004. Brent crude prices, an international benchmark, averaged $52 per barrel in 2015, down from $99 in the previous year. After climbing by some $16 per barrel in the first half of 2015, oil prices slipped by $26 per barrel by year-end.

Oil prices have continued to drop amid weak global demand and unrelenting oversupply. Slower economic growth – especially in China – have weighed on oil prices, while expectations of an over-supplied market have continued to exert downward pressure on prices. Crude prices were further exacerbated by OPEC's (Organization of Petroleum Exporting Countries) refusal to cut production levels, following the group's meeting on December 4th 2015.

Jet fuel prices also saw a similar decline. According to IATA (The International Air Transport Association), airlines globally spent $180 billion on fuel in 2015 – representing some 27% of total operating costs, compared to 32% in the previous year. IATA projects that airlines' fuel bill will remain low based on assumptions that record oil inventories will prevent oil prices from rising significantly in 2016, although stronger economic growth should pull prices up from current levels. IATA states that lower fuel prices have led to a significant fall in the real cost for passengers, and hence lower fares.

Interest rates rise faster in 4Q2015

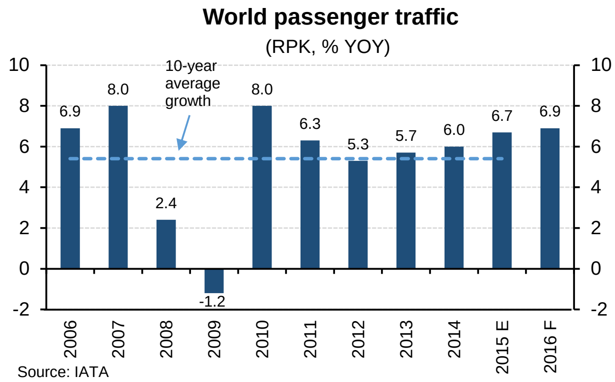


Interbank rates rose significantly at the end of 2015, reaching 6-year highs. The London Interbank Rate (LIBOR) is a benchmark rate that leading global banks charge each other. The 3-month Libor – the most commonly quoted rate – almost doubled during 4Q2015. The 3-month rate climbed from 0.32 at the beginning of the fourth quarter to 0.61 by year-end, reaching its highest level since mid-2009.

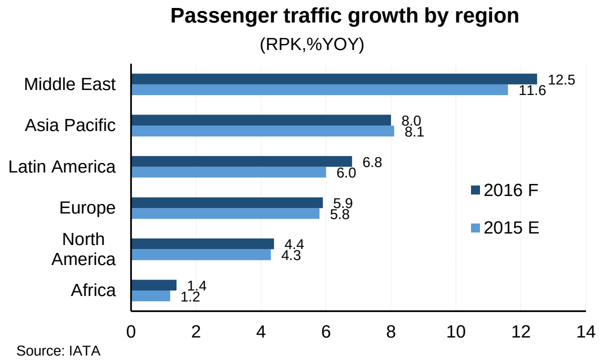
In December 2015, the US Federal Reserve lifted policy interest rates from the zero lower bound. The federal funds rate represents the interbank lending rate for U.S. financial institutions. After 7 years of accommodative monetary policy in the US, the Federal Reserve raised the overnight interbank lending rate from near zero to between 0.25% and 0.5% based on signs of a stronger US economy. The Fed had put interest rates near zero during the financial crisis in December 2008 to help stimulate the economy.

Any rise in interest rates will have an impact on financing costs, but such a small rise may not be particularly significant. As interest rates move up, financing costs increase. For the aviation industry, interest rates impact the cost of aircraft acquisition. Airlines or aircraft lessors may pass on the cost of higher interest rates in the form of higher fares or higher lease rates. But unless there is a significant further rise in interest rates, the recent hike in rates is not expected to have a major impact on aircraft financing.

Global air travel to accelerate in 2016



World passenger traffic is projected to continue to grow faster this year, following robust growth in 2015. IATA expects global air travel to accelerate for the fourth consecutive year to almost 7% in 2016, well above the average growth rate of 5.4% recorded over the past decade.



The improvement in passenger traffic is broadly expected across all regions. This is likely to be driven by the expected pick-up in global economic growth in 2016, in addition to low fuel prices.

The Middle East is expected to lead the growth in global air travel. Nevertheless, in terms of actual market size, the region accounts for around 9% of global traffic – coming in fourth after Asia, Europe and North America. The Middle East also continues to lead growth in capacity, as carriers in the region invest in new and larger aircraft. Non-oil growth will support high economic growth rates, though lower oil prices and geopolitical issues will weigh on the region's outlook.

The Asia-Pacific region – the world's largest aviation market – will continue to rapidly grow its market share. This is largely due to the fact that the region continues to lead world economic growth. Apart from China, India and the rest of emerging Asia are generally projected to continue to grow at a robust pace. But even though China is experiencing slower growth, it remains one of the world's fastest growing aviation markets. It currently accounts for around one-third of Asia Pacific's total traffic. Market outlooks suggest that China may overtake the US as the world's largest aviation market over the next two decades.

Despite economic weakness in several large Latin American countries, carriers in the region have seen relatively solid growth. The past several years have seen significant mergers between Latin American carriers, resulting in more stable, competitive airlines. Nevertheless, weakness in key economies – mainly Brazil and Argentina – and harsh regulations have made Latin America one of the world's most difficult and expensive regions for airlines to operate in.

Advanced economies – namely Europe and North America – continue to lose market share to faster growing aviation markets. North American and European flag carriers, in particular, have been losing market share to the geographically well-positioned Middle East airlines. Nevertheless, it is also important to note that the aviation market of advanced economies is more mature and saturated – unlike Asia and the Middle East – partly explaining the relatively lower growth rates.

Traffic growth in Africa remains the weakest amongst all regions. The continent's largest economy, Nigeria, will continue to suffer from low oil prices. Nevertheless, given the region's ongoing urbanization and high economic growth rates, there is still much potential for Africa's aviation market.

Airline profits soar to all-time high

Airlines Financial performance

Region	Net profit (US $ billion)		
	2014	2015 E	2016 F
World	**17.3**	**33.0**	**36.3**
North America	11.2	19.4	19.2
Europe	2.9	6.9	8.5
Asia-Pacific	2.1	5.8	6.6
Middle East	0.9	1.4	1.7
Latin America	0.2	-0.3	0.4
Africa	0.0	-0.3	-0.1

Source: IATA

Net profits of the world's airlines are estimated to have soared to a record $33 billion in 2015, and are forecast to improve further this year. IATA projects net profits to rise to another record of $36 billion in 2016 – though this represents a smaller increase than last year, as the financial benefit of lower fuel prices will have been absorbed.

Though the overall picture is positive, financial performance varied amongst regions. North American carriers posted the strongest financial results, accounting for more than half of global net profits – thanks to consolidation and lower fuel costs. There has also been some improvements in Europe and Asia-Pacific. On the other hand, Latin America and Africa have seen weak financial performances, with both regions posting net losses in 2015.

US carriers have been focusing on revenue and profit maximization, rather than increasing capacities in recent years. Airlines undertook mergers and acquisitions, fleet and network rationalization and capacity discipline over the past couple of years. And more recently, lower fuel prices have provided the additional boost to earnings of US carriers.□