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

Quarterly Aviation Industry Performance

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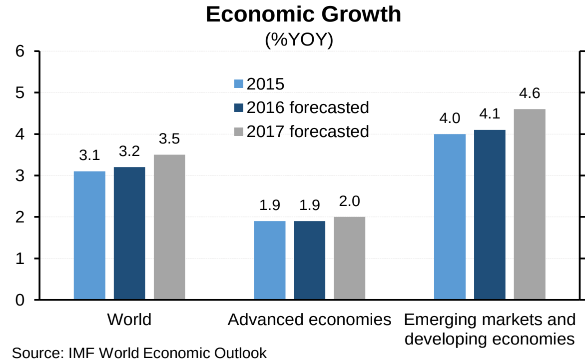
Global recovery still sluggish in 2016



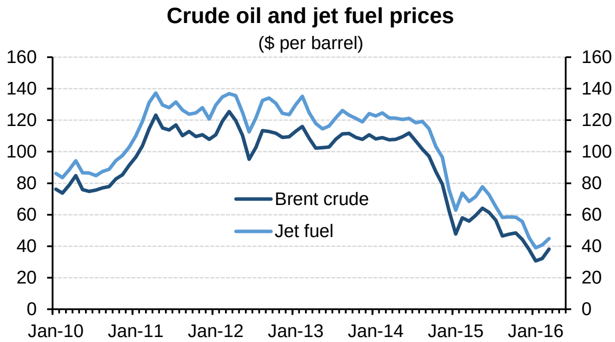
Source: IMF World Economic Outlook

World economic growth in 2016 is expected to remain modest, though global recovery is projected to strengthen next year. The International Monetary Fund (IMF) projects global growth to reach 3.2% this year, broadly in line with last year, reflecting a slow and fragile recovery. Nevertheless, global growth is projected to pick up to 3.5% in 2017, driven primarily by emerging economies.

The outlook for emerging economies will remain generally weak this year, though prospects are expected to improve next year. This reflects slowing growth of oil exporters as oil prices decline, a slowdown in China, deep recessions in Brazil and Russia, and weak growth in some Latin American and Middle East countries due to low commodity prices or geopolitical issues. Nevertheless, some emerging economies in Asia, particularly India, will see strong growth. In 2017, growth is projected to strengthen based on expectations that conditions in stressed economies will gradually start to normalize.

Meanwhile, growth in advanced economies is projected to remain flat at about 2% over the next two years. Growth in the world's largest economy, the US, is expected to remain modest. Europe and Japan, meanwhile, continue to experience persistently weak growth despite aggressive central-bank actions that have pushed rates into negative territory. Given the current environment of weak growth, downside risks to the global outlook are now more pronounced.

Oil prices edge up slightly in 1Q2016



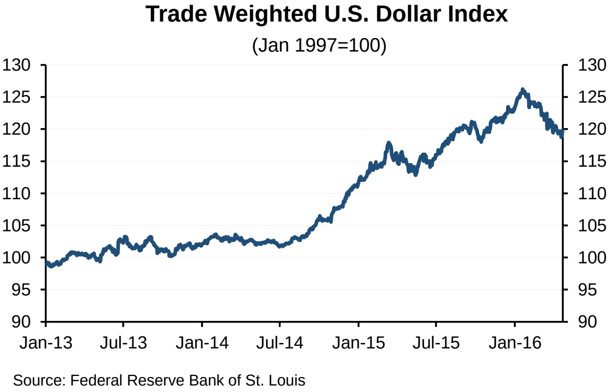
Source: EIA (Energy Information Administration)

Oil prices edged up slightly in early 2016, after having dropped to their lowest in 12 years. Brent crude prices, an international benchmark, fell to $30 per barrel in January – the lowest level seen since end-2003. Brent prices have since increased by some $8 per barrel, reaching $38 by the end of the quarter.

Demand and supply fundamentals continue to support low oil prices, despite the recent rally. Global oil market are substantially oversupplied – despite falling production in the US, while fuel demand has remained weak on the back of modest global economic growth. The recent rally has been driven by market expectations of a possible freeze in production levels. OPEC members (Organization of Petroleum Exporting Countries) and Russia met in Doha in April as part of efforts to cap production, but the talks ended with no deal. At the same time, Iran is seeking to boost crude production and exports after years of sanction.

Jet fuel prices saw a similar decline, and are now more than 30% lower than their levels last year. According to IATA (The International Air Transport Association), airlines' spending on fuel globally will represent around 21% of total operating costs in 2016, compared to 27% last year. IATA states that lower fuel costs continue to feed into lower airfares, helping to stimulate demand. IATA projects that further falls in air fares are likely to be seen in 2016, as hedging contracts unwind and the decline in oil prices seen around the end of last year feeds through.

US dollar weakens in recent months

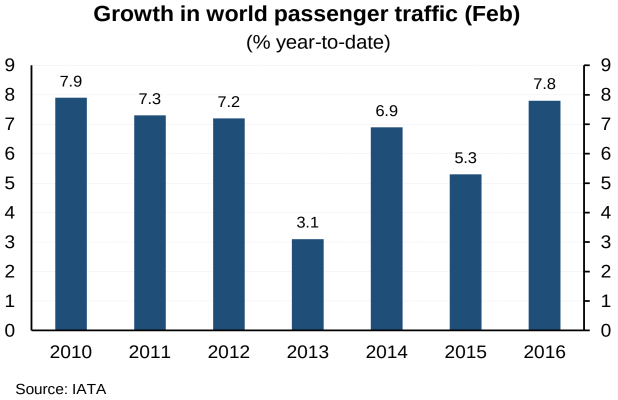


Emerging market currencies have seen a partial recovery since late January, owing to a weaker dollar and firmer oil prices. After strengthening strongly over much of 2014 and 2015, the US dollar fell in early 2016 on the back of weaker-than-expected growth in the US economy and expectations of a slower pace in interest rate hikes.

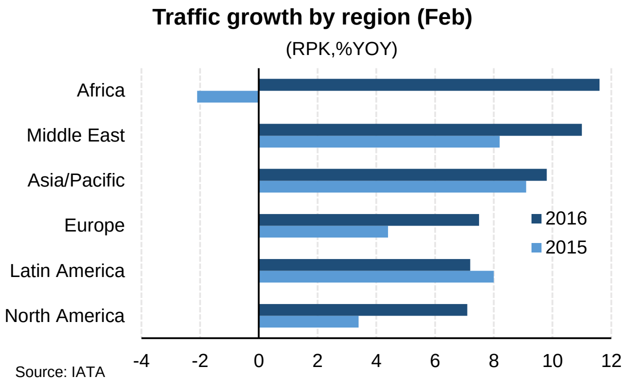
The international nature of the aviation industry means airlines are exposed to currency fluctuation risk. The main foreign currency exposure for airlines is the US dollar, since a large proportion of airline costs – including fuel, aircraft purchase and lease payments – are typically priced in US dollars. Subsequently, many carriers need to convert domestic currency into dollars each year to meet their obligations. This means that a stronger US dollar raises the local currency cost of servicing the US dollar-denominated costs for airlines, and vice-versa.

Although lower oil prices contributed to the decline in airfares during 2015, this was somewhat distorted by the rise in the value of the dollar. The strong appreciation in the US dollar in 2015 exaggerated the downward trend in airfares. According to IATA, average global airfares reported in US dollar terms fell by around 12% in 2015 compared to the previous year. Adjusting for the currency impact shows that airfares declined by a smaller 4.5% year-on-year (at constant prices).

Strong start to 2016 for global air travel



Despite modest global economic growth, 2016 is set to be another strong year for global air travel. World passenger traffic accelerated to 7.8% in February 2016 (year-to-date) – its strongest start to the year since 2010. IATA expects growth in passenger traffic to reach a 6-year high of 7% this year. The outlook for 2016 reflects the stimulus for air travel growth provided from lower oil prices, which is likely to offset subdued underlying demand conditions.



The improvement in passenger traffic at the start of 2016 was experienced across all regions – except Latin America. This takes into account both international and domestic traffic growth.

In the Asia-Pacific region, the world's largest aviation market, the upward trend remains strong. Slower growth in many of the region's economies have been partly offset by an increase in the number of direct airport connections within the region over the past 12 months or so, which has helped stimulate demand by affording time savings for passengers. In China, where overall economic growth is slowing, resilient consumer spending continues to support air travel. Meanwhile, India remains the fastest growing domestic aviation market in the world, propelled by strong economic growth rates – India overtook China as the fastest growing major economy in 2015.

In the Middle East, traffic growth has been supported by ongoing network and fleet expansion. The Middle East leads all regions in capacity growth, as carriers in the region invest in new and larger aircraft. That said, capacity growth continues to exceed the double-digit growth in traffic, and passenger load factors in the region – a measure of capacity utilization – have trended downwards.

North American carriers continue to lose market share to the geographically well-positioned Middle Eastern airlines. During 2015, Middle East carriers overtook North American carriers in terms of international traffic. International traffic in North America registered the slowest growth amongst all regions at the start of 2016, though this is partly due to the region's carriers focusing more on the stronger and much larger domestic market.

In Europe, traffic has recovered from the disruptions seen at the end of last year, but the economic backdrops remains fragile. International traffic in the region picked-up at the start of 2016, following airline strikes and shutdown of Transaero in Russia. Nonetheless, The European region remains the largest in terms of international traffic.

In Latin America, passenger traffic growth remains under pressure from economic difficulties in the region's biggest economies – notably Brazil. The Brazilian economy remains in recession, and domestic traffic is contracting. On the other hand, international traffic in the region continues to show a strong upward trend.

Traffic growth in Africa showed a strong rebound from last year. African carriers carry just 3% of industry-wide international traffic, but posted the strongest growth in international operations amongst all regions. This partly reflects the rebound from the dire performance of last year, but also indicates efforts from African carriers to rationalize networks and regain market share to and from the African continent.

Airline profits end 2015 on strong note

Airlines Financial performance (sample)*

Region	Net profit (US $ billion)		
	4Q2014	4Q2015	Change
World	**4.1**	**7.2**	**3.1**
North America	2.5	4.4	1.8
Asia-Pacific	1.1	2.3	1.2
Europe	0.1	1.0	0.9
Latin America	0.3	-0.5	-0.9
Africa & Middle East	0.04	0.03	-0.01

Source: IATA
*Note: Sample survey of 68 airlines.

The financial performance of airlines during 4Q2015 improved in all regions – except Latin America. Lower fuel costs helped drive the year-on-year increase in airlines' profits globally. The strongest results were posted by North American carriers, who continue to play a key role in driving the improvement in the industry's financial performance in recent years. Some improvements were also witnessed in Asia-Pacific and Europe. But in Latin America, profits were down compared to the previous year as challenging domestic economic conditions continue to take a toll on carriers in the region.

Net profits of the world's airlines are estimated to have reached a record $33 billion in 2015 as a whole. This year, IATA projects net profits will rise further to $36 billion.