Airlines

Stress testing airlines for a corporate travel shutdown

Industry Overview

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Equity
United States
Airlines

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Stress tests show the quality at DAL and LUV

With US corporate travel activity coming to a halt, we have stress-tested our airline models for a near term shut down in business travel and have presented three scenarios of trough revenue declines (-25%, -50%, -75%). While this type of shock is meaningfully disruptive to near term earnings and 45% of the US airlines generate negative EPS in 1H20 in the middle scenario, the pace of the recovery off trough will be key and we assume a gradual recovery in travel patterns through year end. Our analysis shows that high quality names like Neutral-rated DAL and LUV have less downside earnings risk than peers given the margin profiles and balance sheets. In addition, we do not see Underperform-rated AAL breaking its $2B liquidity covenant in our down -75% scenario.

Difficult to parse out corporate vs leisure

We originally set out on this exercise to sensitize the impact of losing the corporate travel customer. In the US airline industry, the general rule of thumb is that the airplane is typically evenly split between corporate and leisure customers with corporate about two-thirds of revenues given the higher price points. However, in a scenario where corporate travel deteriorates, airlines will look to steal leisure customers, which typically hold in much better in downturns. As such, our stress tests assume a total revenue hit across the entire domestic network as opposed to just sensitizing to corporate travel.

Scenario assumptions; fuel now a meaningful tailwind

We outline three scenarios that assume domestic revenues trough at -25%/-50%/-75% (see inside for full details on our scenario analysis). This analysis is meant to be a guide post given the rapidly changing demand environment, and we note that fuel, which is about 25% of total operating costs, has become a meaningful tailwind to our airline earnings sensitivities. So far, LUV, JBLU and ALK have already discussed expectations for March, and the airlines anticipate a mid-teens sequential unit revenue slowdown from February trend. As such, our Scenario 1 is most similar to what the airlines are currently seeing. If the environment deteriorates, Scenarios 2 and 3 become more feasible.

Negative 1H20 earnings for many airlines; none for 2020

In Scenario 1, EPS actually come in ahead of our current estimates given the recent move in fuel. while Scenarios 2 and 3 would result in EPS 25% and 36% below our current models. In our worst case scenario, most airlines generate negative EPS in 1H20 with the exception of DAL, LUV and ALGT, but all airlines still make money on the year.

Industry leverage not as big of a risk as expected

We currently estimate just 2.0x net leverage across our US airlines coverage in 2020. In Scenarios 2 and 3, we estimate industry net leverage would only increase about a half a turn with AAL and SAVE the most at risk. This is not as much as we expected and is still well below the 8.0x net leverage in 2008. For AAL, we currently estimate year end net leverage of 5.0x and estimate this could go to 6.0x in Scenario 3. However, even in this scenario, we do not see AAL breaking its $2B liquidity covenant. For SAVE, we estimate net leverage going from 2.9x in our current model to 4.1x in our worst case scenario.

Refer to important disclosures on page 8 to 10. Analyst Certification on page 7. Price Objective Basis/Risk on page 5.
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Analyzing a corporate travel shutdown

With US corporate travel activity coming to a halt, we have stress-tested our airline models for a near term shut down in business travel and have presented three scenarios of trough revenue declines (-25%, -50%, -75%). While this type of shock is meaningfully disruptive to near term earnings and 45% of the US airlines generate negative EPS in 1H20 in the middle scenario, the pace of the recovery off trough will be key and we assume a gradual recovery in travel patterns through year end. Our analysis shows that high quality names like Neutral-rated DAL and LUV have less downside earnings risk than peers given the margin profiles and balance sheets. In addition, we do not see Underperform-rated AAL breaking its $2B liquidity covenant in our down -75% scenario.

Difficult to parse out corporate vs leisure

We originally set out on this exercise to sensitize the impact of losing the corporate travel customer. In the US airline industry, the general rule of thumb is that the airplane is typically evenly split between corporate and leisure customers with corporate about two-thirds of revenues given the higher price points. However, in a scenario where corporate travel deteriorates, airlines will look to steal leisure customers, which typically hold in much better in downturns. As such, our stress tests assume a total revenue hit across the entire domestic network as opposed to just sensitizing to corporate travel.

Models currently factor in some impact from COVID-19

As earnings estimates remain a moving target given continued uncertainties from COVID-19, we are leaving our 2020 forecasts unchanged from our update last week. Our models currently assume a modest impact to domestic revenues (we cut domestic revenues by 10% for four months of 1H20), but with the corporate travel restrictions and the growing list of cancelled conferences and events, we note this could prove conservative. We do not assume any capacity cuts outside of what has already been announced. Internationally, our DAL, AAL, and UAL models contemplate a 50% reduction to Pacific revenues and a 20% reduction to Atlantic revenues for four months of 1H20 with a gradual recovery through year end. The fuel curve in our models is the forward curve as of March 3, 2020, which implied an average Brent crude price of $56/barrel compared to today's much lower levels of $43/barrel.

Table 1: BofA current 2020 estimates by airline

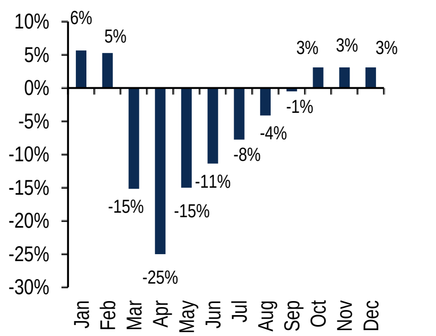
	Capacity					RASM					CASM-ex					Fuel Price / Gallon					EPS					2020 Net
	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	Leverage
DAL	4.5%	2.4%	4.1%	2.9%	3.5%	-1.6%	-8.8%	-5.4%	-2.2%	-4.7%	3.0%	2.5%	2.1%	2.6%	2.5%	$1.87	$1.67	$1.67	$1.94	$1.78	$0.95	$1.76	$2.11	$1.44	$6.25	1.7x
AAL	1.3%	2.0%	3.3%	5.4%	3.0%	-1.2%	-8.9%	-5.8%	-2.0%	-4.6%	3.4%	2.1%	2.1%	0.0%	1.9%	$1.89	$1.71	$1.71	$1.99	$1.82	$0.23	$0.75	$0.85	$1.14	$2.96	5.0x
UAL	1.1%	-1.2%	2.2%	4.1%	1.5%	-2.8%	-9.1%	-7.4%	-3.0%	-5.7%	2.2%	3.8%	1.4%	-1.1%	1.5%	$1.88	$1.70	$1.69	$1.97	$1.81	$0.52	$2.10	$2.75	$2.60	$7.98	2.7x
LUV	-2.0%	-1.5%	-1.5%	7.0%	0.5%	2.4%	-6.5%	-1.8%	-2.8%	-2.3%	6.9%	7.1%	7.9%	-3.4%	4.4%	$1.92	$1.72	$1.71	$1.99	$1.84	$0.65	$0.89	$0.96	$1.36	$3.84	-0.1x
ALK	4.0%	2.6%	2.5%	2.9%	3.0%	0.7%	-7.3%	-2.0%	-0.3%	-2.4%	3.0%	0.3%	1.8%	2.6%	1.9%	$2.01	$1.82	$1.82	$2.11	$1.94	$0.28	$1.91	$2.74	$1.53	$6.44	0.8x
JBLU	2.5%	2.0%	9.0%	10.0%	5.9%	0.2%	-8.0%	-5.1%	-4.6%	-4.5%	2.5%	0.3%	-3.9%	-3.9%	-1.4%	$1.95	$1.79	$1.73	$2.02	$1.87	$0.16	$0.41	$0.78	$0.61	$1.95	1.5x
SAVE	15.0%	15.0%	20.0%	19.0%	17.3%	-5.6%	-7.4%	-5.3%	-3.5%	-5.4%	4.1%	1.1%	-0.6%	1.4%	1.5%	$1.92	$1.74	$1.73	$2.01	$1.85	$0.31	$1.56	$1.49	$1.09	$4.46	2.9x
HA	9.0%	5.0%	6.0%	6.0%	6.5%	-8.1%	-10.4%	-5.4%	-3.5%	-6.8%	-3.0%	0.8%	0.4%	1.6%	0.0%	$1.90	$1.69	$1.69	$1.97	$1.81	$0.29	$0.62	$1.64	$0.67	$3.21	1.5x
ALGT	16.0%	7.0%	15.0%	8.5%	11.5%	-2.6%	-7.9%	-4.0%	-1.8%	-4.1%	-1.2%	-0.7%	-1.7%	-1.0%	-1.1%	$1.97	$1.79	$1.79	$2.07	$1.90	$4.54	$4.33	$3.63	$4.23	$16.72	1.8x

Source: BofA Global Research estimates

Scenario analysis: flex domestic revs -25%, -50%, -75%

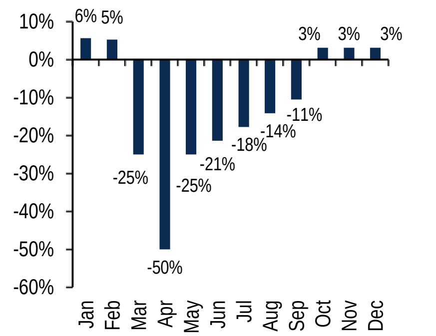
To help gauge the impact of a corporate slowdown in the domestic US market, we created three scenarios that assume domestic revenues bottom in April at -25%, -50%, and -75% with a gradual recovery through the end of 3Q20 and keeping our current 4Q20 assumptions. As a comparison, LUV, JBLU and ALK have already discussed expectations for March, and the airlines anticipate a mid-teens sequential unit revenue slowdown from February trend. As such, our Scenario 1 is most similar to what the airlines are currently seeing. If the environment deteriorates, Scenarios 2 and 3 become more feasible.

Chart 1: Scenario 1: domestic total revenue trajectory



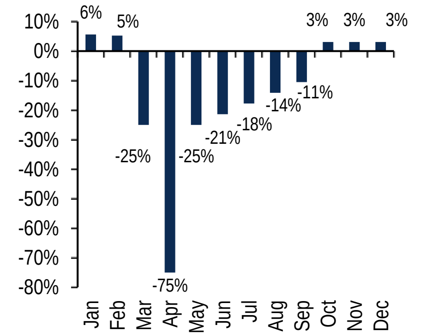
Source: BofA Global Research estimates

Chart 2: Scenario 2: domestic total revenue trajectory



Source: BofA Global Research estimates

Chart 3: Scenario 3: domestic total revenue trajectory



Source: BofA Global Research estimates

Scenario 1: trough revenues -25%; EPS *ahead* of our current forecasts

In our first scenario, we assume domestic revenues decline 15% in March, bottom in April at -25%, and recover through the end of 3Q20 (we leave our 4Q20 revenue assumptions unchanged). We estimate the airlines trim capacity in 1Q with more meaningful cuts taking effect in 2Q and 3Q. For international revenues, we leave our current assumptions unchanged (a 50% reduction in Pacific revenues and 20% reduction in Atlantic revenues for four months of 1H20).

On the cost side, we assume the airlines are largely able to lower costs with the lower capacity through hiring freezes, retiring older aircraft rather than performing costly maintenance events, etc. The one area where we assume less flexibility is salaries & wages. We assume 1Q salaries & wages are completely fixed at this point and estimate the airlines can capture 50% of the savings from lower capacity in 2Q and 66% of the expected savings in 3Q. Finally, we flow through the current fuel curve for the full year (implies Brent crude prices of $43/barrel).

The fuel savings from incorporating the current curve helps offset some of the revenue weakness in 1H20, and actually results in full year 2020E EPS *above* our current estimates across the US airlines.

Table 2: Scenario 1 model assumptions with implied EPS and net leverage

	Capacity					RASM					CASM-ex					Fuel Price / Gallon					EPS					2020 Net
	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	Leverage
DAL	1.9%	-5.6%	-0.8%	2.9%	-0.6%	-2.6%	-9.7%	-4.3%	-2.2%	-4.8%	4.2%	5.3%	3.5%	2.6%	4.0%	$1.87	$1.28	$1.33	$1.37	$1.46	$0.73	$1.69	$2.40	$2.01	$6.80	1.6x
AAL	-0.1%	-5.2%	-0.1%	5.4%	0.0%	-2.5%	-8.8%	-3.3%	-2.1%	-4.2%	3.9%	4.6%	3.4%	0.5%	3.1%	$1.89	$1.33	$1.37	$1.41	$1.50	($0.09)	$1.08	$1.85	$2.26	$5.08	4.0x
UAL	-2.0%	-5.7%	-0.1%	4.1%	-0.9%	-2.9%	-10.6%	-5.5%	-3.0%	-5.6%	3.8%	5.1%	2.0%	-1.1%	2.4%	$1.88	$1.31	$1.36	$1.40	$1.48	$0.15	$2.35	$4.14	$4.24	$10.88	2.3x
LUV	-1.0%	-5.0%	-2.0%	7.0%	-0.3%	-1.7%	-12.1%	-1.6%	-3.0%	-4.7%	6.0%	8.5%	8.1%	-3.4%	4.6%	$1.93	$1.35	$1.40	$1.44	$1.54	$0.43	$0.63	$1.17	$1.74	$3.94	0.0x
ALK	4.0%	-8.0%	-2.5%	2.9%	-1.0%	-5.3%	-9.2%	-1.9%	-0.2%	-4.1%	2.5%	3.5%	3.1%	2.5%	3.1%	$2.01	$1.42	$1.47	$1.51	$1.60	($0.39)	$1.70	$2.95	$2.34	$6.56	0.9x
JBLU	1.5%	-8.0%	-2.0%	5.0%	-0.9%	-3.8%	-9.0%	-1.1%	-0.1%	-3.5%	2.8%	4.0%	-0.5%	-3.0%	0.7%	$1.95	$1.47	$1.38	$1.42	$1.56	($0.05)	$0.37	$1.00	$1.18	$2.46	1.3x
SAVE	14.0%	-5.0%	5.0%	12.0%	6.3%	-11.3%	-11.8%	-6.2%	-4.0%	-8.3%	4.3%	8.2%	3.5%	2.4%	4.5%	$1.92	$1.35	$1.40	$1.44	$1.54	($0.32)	$0.82	$1.35	$1.70	$3.56	3.2x
HA	6.0%	-9.0%	-3.0%	2.9%	-0.9%	-9.7%	-8.2%	-1.6%	-0.6%	-4.9%	-1.7%	7.8%	4.1%	2.2%	3.0%	$1.90	$1.32	$1.36	$1.40	$1.50	($0.01)	$0.63	$2.02	$1.62	$4.23	1.3x
ALGT	12.0%	-9.0%	-1.5%	2.9%	0.8%	-7.7%	-7.9%	-0.8%	3.3%	-3.2%	0.6%	6.1%	3.7%	0.3%	2.9%	$1.97	$1.41	$1.45	$1.49	$1.59	$2.86	$3.67	$3.75	$6.27	$16.56	1.8x

Source: BofA Global Research estimates

Scenario 2: trough revenues -50%; EPS 25% below our current forecasts

In this scenario, we assume domestic revenues decline 25% in March, bottom in April at -50%, and recover through the end of 3Q20 (again leaving our 4Q20 revenue estimates unchanged). We estimate that just over half of the revenue decline is driven by capacity cuts with the remainder from lower unit revenues. For DAL, UAL, and AAL, we assume a similar impact to total international revenues with just over half of the revenue decline from capacity cuts. Finally, we factor in a similar cost dynamic as in Scenario 1.

This scenario would result in 2020 EPS 25% below our current estimates on average, with the largest cuts at SAVE and HA. We note that under this scenario, while no airline would generate negative earnings for the year given the fuel savings, AAL, JBLU, SAVE, and HA would all generate negative earnings in 1H20.

Table 3: Scenario 2 model assumptions with implied EPS and net leverage

	Capacity					RASM					CASM-ex					Fuel Price / Gallon					EPS					2020 Net
	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	Leverage
DAL	1.3%	-15.9%	-8.0%	2.9%	-5.4%	-4.1%	-14.2%	-6.3%	-2.2%	-6.6%	4.5%	9.3%	5.6%	2.6%	5.7%	$1.87	$1.28	$1.33	$1.37	$1.46	$0.56	$0.80	$1.88	$2.04	$5.25	2.0x
AAL	-1.0%	-16.7%	-7.6%	5.4%	-5.1%	-4.5%	-14.4%	-5.8%	-2.1%	-6.5%	4.0%	8.0%	4.9%	0.4%	4.3%	$1.89	$1.33	$1.37	$1.41	$1.50	($0.49)	($0.51)	$0.98	$2.26	$2.21	5.5x
UAL	-2.2%	-17.0%	-8.0%	4.1%	-6.0%	-4.6%	-14.2%	-6.0%	-3.1%	-6.8%	3.8%	9.3%	4.1%	-1.1%	3.9%	$1.88	$1.31	$1.36	$1.40	$1.48	($0.33)	$0.38	$3.25	$4.23	$7.54	2.9x
LUV	-1.0%	-18.0%	-7.0%	7.0%	-4.8%	-5.0%	-14.1%	-6.6%	-3.0%	-7.0%	6.0%	14.6%	9.6%	-3.4%	6.1%	$1.93	$1.35	$1.40	$1.44	$1.54	$0.21	$0.19	$0.71	$1.74	$2.83	0.2x
ALK	2.0%	-17.0%	-8.0%	2.9%	-5.2%	-5.7%	-15.2%	-6.4%	-0.2%	-6.7%	3.6%	5.7%	3.3%	2.5%	4.0%	$2.01	$1.42	$1.47	$1.51	$1.60	($0.52)	$0.68	$2.18	$2.34	$4.64	1.2x
JBLU	0.0%	-17.0%	-7.0%	5.0%	-4.8%	-5.7%	-15.0%	-6.1%	-0.1%	-6.5%	3.6%	7.8%	0.6%	-3.0%	2.0%	$1.95	$1.47	$1.38	$1.42	$1.56	($0.17)	($0.07)	$0.64	$1.18	$1.54	1.8x
SAVE	10.0%	-15.0%	-5.0%	12.0%	0.2%	-10.7%	-16.8%	-6.2%	-4.0%	-9.2%	6.5%	13.1%	6.9%	2.4%	6.9%	$1.92	$1.35	$1.40	$1.44	$1.54	($0.39)	($0.03)	$0.98	$1.70	$2.27	3.8x
HA	4.0%	-17.0%	-8.0%	2.9%	-4.6%	-11.0%	-15.2%	-6.6%	-0.6%	-8.1%	-0.8%	11.0%	5.4%	2.2%	4.2%	$1.90	$1.32	$1.36	$1.40	$1.50	($0.22)	($0.32)	$1.23	$1.62	$2.27	2.0x
ALGT	8.0%	-17.0%	-7.0%	2.9%	-3.7%	-7.0%	-14.9%	-5.3%	3.3%	-5.5%	3.1%	10.0%	5.6%	0.3%	4.9%	$1.97	$1.41	$1.45	$1.49	$1.59	$2.58	$1.48	$2.41	$6.27	$12.75	2.3x

Source: BofA Global Research estimates

Scenario 3: trough revenues -75%, EPS -36% lower than current forecasts

In our third scenario, we assume domestic revenues again decline -25% in March, but we forecast a more significant drop-off in revenues in April at -75%. We assume a -25% decline in May with a recovery through the end of 3Q20 (and leave our 4Q20 revenue estimates unchanged). Again, we estimate that just over half of the revenue decline is driven by capacity cuts with the remainder from lower unit revenues. For DAL, UAL, and AAL, we assume a similar impact to total international revenues with just over half of the revenue decline from capacity cuts. Finally, this scenario also contemplates a similar cost dynamic as in Scenarios 1 and 2.

This scenario implies 36% downside on average to our current 2020 EPS estimates. SAVE, HA, and AAL have the most downside risk under this scenario, while DAL and UAL have the least downside risk. We note that all the US airlines except DAL, LUV, and ALGT would generate negative earnings in 1H20 in this scenario, although no airlines would have negative earnings for the full year.

Table 4: Scenario 3 model assumptions with implied EPS and net leverage

	Capacity					RASM					CASM-ex					Fuel Price / Gallon					EPS					2020 Net
	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	1Q20	2Q20	3Q20	4Q20	2020	Leverage
DAL	1.3%	-20.9%	-8.0%	2.9%	-6.7%	-4.1%	-17.0%	-6.3%	-2.2%	-7.1%	4.5%	11.6%	5.6%	2.6%	6.2%	$1.87	$1.28	$1.33	$1.37	$1.46	$0.56	$0.34	$1.89	$2.05	$4.81	2.2x
AAL	-1.0%	-21.6%	-7.6%	5.4%	-6.4%	-4.5%	-17.4%	-5.8%	-2.1%	-7.1%	4.0%	9.9%	4.9%	0.4%	4.6%	$1.89	$1.33	$1.37	$1.41	$1.50	($0.49)	($1.20)	$0.98	$2.26	$1.52	6.0x
UAL	-2.2%	-21.6%	-8.0%	4.1%	-7.2%	-4.6%	-17.5%	-6.0%	-3.1%	-7.5%	3.8%	11.2%	4.1%	-1.1%	4.3%	$1.88	$1.31	$1.36	$1.40	$1.48	($0.33)	($0.88)	$3.25	$4.23	$6.28	3.2x
LUV	-1.0%	-22.0%	-8.0%	7.0%	-6.1%	-5.0%	-18.4%	-5.6%	-3.0%	-7.7%	6.0%	16.9%	9.9%	-3.4%	6.6%	$1.93	$1.35	$1.40	$1.44	$1.54	$0.21	($0.16)	$0.76	$1.74	$2.53	0.3x
ALK	2.0%	-22.0%	-8.0%	2.9%	-6.5%	-5.7%	-18.5%	-6.4%	-0.2%	-7.4%	3.6%	7.3%	3.3%	2.5%	4.4%	$2.01	$1.42	$1.47	$1.51	$1.60	($0.52)	$0.18	$2.18	$2.34	$4.13	1.4x
JBLU	0.0%	-21.0%	-7.0%	5.0%	-5.8%	-5.7%	-19.3%	-6.1%	-0.1%	-7.9%	3.6%	9.7%	0.6%	-3.0%	2.3%	$1.95	$1.47	$1.38	$1.42	$1.56	($0.17)	($0.32)	$0.64	$1.18	$1.29	2.0x
SAVE	10.0%	-20.0%	-5.0%	12.0%	-1.1%	-10.7%	-20.1%	-6.2%	-4.0%	-9.9%	6.5%	16.0%	6.9%	2.4%	7.5%	$1.92	$1.35	$1.40	$1.44	$1.54	($0.39)	($0.48)	$0.98	$1.70	$1.81	4.1x
HA	4.0%	-22.0%	-8.0%	2.9%	-5.9%	-11.0%	-18.5%	-6.6%	-0.6%	-8.7%	-0.8%	13.5%	5.4%	2.2%	4.7%	$1.90	$1.32	$1.36	$1.40	$1.50	($0.22)	($0.75)	$1.23	$1.62	$1.83	2.2x
ALGT	8.0%	-22.0%	-7.0%	2.9%	-5.1%	-7.0%	-18.3%	-5.3%	3.3%	-6.1%	3.1%	12.8%	5.6%	0.3%	5.5%	$1.97	$1.41	$1.45	$1.49	$1.59	$2.58	$0.44	$2.41	$6.27	$11.71	2.4x

Source: BofA Global Research estimates

Table 5: Stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
ALK	ALK US	Alaska Air Group	US$ 43.19	B-2-7
ALGT	ALGT US	Allegiant	US$ 118.4	B-1-7
AAL	AAL US	American	US$ 14.75	B-3-7
DAL	DAL US	Delta Air	US$ 43.52	B-2-7
HA	HA US	Hawaiian	US$ 16.85	C-3-7
JBLU	JBLU US	JetBlue	US$ 13.4	B-3-9
LUV	LUV US	Southwest	US$ 43.62	B-2-7
SAVE	SAVE US	Spirit Airlines	US$ 21.41	B-3-9
UAL	UAL US	United Airlines	US$ 46.78	B-1-9

Source: BofA Global Research

Price objective basis & risk

Alaska Air Group (ALK)

Our $51 price objective for ALK is based on approximately 8x 2020E EPS. Our target multiple is at a discount to ALK's recent historical average (10.5x), which we believe is reasonable given where we are in the cycle and ongoing coronavirus concerns.

Upside risks to our price objective are a better pricing environment from a faster than expected economic recovery or lower competitive supply or a significant drop in fuel prices. Downside risks to our price objective are higher fuel prices, general economic weakness, unfavorable government regulation/taxes, safety concerns, integration issues, and terrorism/geopolitical events.

Allegiant Travel Company (ALGT)

For ALGT, our $167 PO is based on approximately 10x 2020E P/E. This is a discount to ALGT's long-term average (15x), which we believe is reasonable given where we are in the cycle, ongoing coronavirus concerns, and risks around ALGT's Sunseeker project.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

American Airlines Group (AAL)

Our $18 PO is based on approximately 6x our 2020E EPS. This target multiple is below the target multiples of the other legacy airlines (8x) and below AAL's recent historical average multiple (7x), which we believe this is appropriate given its higher leverage vs peers and given where we are in the cycle.

Upside risks to our price objective are better than expected pricing, a faster than expected resolution of labor contracts, and a stronger macro backdrop. Downside risks to our price objective are significant moves in fuel, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Delta Air Lines (DAL)

Our $50 PO is based on approximately 8x 2020E EPS. This is a slight discount to DAL's average multiple over the past 10 years (8.5x), which we believe is appropriate given where we are in the cycle and ongoing coronavirus concerns.

Upside risks to our price objective are better than expected pricing and a stronger macro backdrop. Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns, a prolonged government shutdown and terrorism/geopolitical events.

Hawaiian Holdings (HA)

Our $19 PO is based on approximately 6x 2020E EPS, which is below HA's recent historical average P/E multiple (8x) given the headwinds we expect from 1) increased competition on HA's West Coast to Hawaii routes (50% of its revenues) and HA's interisland routes (25% of its revenues), and 2) its Asia Pacific exposure given coronavirus concerns.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Upside risks to our price objective are a better pricing environment from a faster-than-expected economic recovery or lower competitive supply, a significant drop in fuel prices, and better cost controls.

JetBlue Airways (JBLU)

Our $15 PO is based on approximately 7.5x 2020E EPS. This is below its recent historical average multiple (10x), which we believe is appropriate given where we are in the cycle, ongoing coronavirus concerns, and given JBLU's lack of upcoming earnings catalysts.

Upside risks to our price objective are lower fuel prices, better than expected pricing, lower competitive supply, and general economic strength.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Southwest (LUV)

Our $48 PO is based on approximately 12.5x 2020E EPS, 2x turns below LUV's recent historical average multiple given where we are in the cycle and ongoing coronavirus concerns. We believe investors should put a higher multiple on LUV shares relative to the rest of the group given its leverage, high level of unencumbered aircraft, and fuel hedges position it well for later cycle.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Spirit Airlines (SAVE)

Our $30 price objective is based on approximately 7x 2020E EPS. This is below SAVE's recent historical average multiple (11x), which we believe is appropriate considering where we are in the cycle, our expectations for revenue pressure in 2020, recent cost inflation, and ongoing coronavirus concerns.

Upside risks to our price objective are lower fuel prices, better than expected pricing, lower competitive supply, and general economic strength. Downside risks are economic weakness, government regulation and taxation, increased competition including the threat of new entrants, labor issues, safety concerns, terrorism and geopolitical events, changes in equity risk premiums, and overall stock market valuations.

United Airlines Holdings (UAL)

Our $66 PO is based on 8x our 2020E EPS. This is in line with the target multiples of the other legacy airlines and at a slight discount to UAL's historical average multiple (8.5x), which we believe is appropriate given where we are in the cycle and ongoing coronavirus concerns.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns, and terrorism/geopolitical events.

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I, Andrew G. Didora, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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US - Airlines and Cruise Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Air Canada	YAC	AC CN	Andrew G. Didora, CFA
	Allegiant Travel Company	ALGT	ALGT US	Andrew G. Didora, CFA
	Mesa Air Group	MESA	MESA US	Andrew G. Didora, CFA
	Norwegian Cruise Line Holdings	NCLH	NCLH US	Andrew G. Didora, CFA
	United Airlines Holdings	UAL	UAL US	Andrew G. Didora, CFA
NEUTRAL				
	Alaska Air Group	ALK	ALK US	Andrew G. Didora, CFA
	Delta Air Lines	DAL	DAL US	Andrew G. Didora, CFA
	Royal Caribbean Cruises	RCL	RCL US	Andrew G. Didora, CFA
	Southwest	LUV	LUV US	Andrew G. Didora, CFA
UNDERPERFORM				
	American Airlines Group	AAL	AAL US	Andrew G. Didora, CFA
	Hawaiian Holdings	HA	HA US	Andrew G. Didora, CFA
	JetBlue Airways	JBLU	JBLU US	Andrew G. Didora, CFA
	Spirit Airlines	SAVE	SAVE US	Andrew G. Didora, CFA

Disclosures

Important Disclosures

Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2019)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	60	53.57%	Buy	35	58.33%
Hold	23	20.54%	Hold	19	82.61%
Sell	29	25.89%	Sell	13	44.83%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2019)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1560	50.49%	Buy	991	63.53%
Hold	717	23.20%	Hold	461	64.30%
Sell	813	26.31%	Sell	415	51.05%

* Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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