

## American Airlines Group

# Cost trend encouraging; valuation still expensive

Reiterate Rating: UNDERPERFORM | PO: 12.00 USD | Price: 15.36 USD

## AAL is executing on costs, but valuation is still expensive

AAL's 4Q23 and 2024 unit costs beat our expectations, and we estimate that the 2024 upside is coming from the airline's change in its distribution strategy. We think this is something the company could highlight at its upcoming March 4 investor day. While costs are better, near-term unit revenue expectations are a bit softer than expected, leading us to lower our 1Q24E EPS but raise full year 2024E EPS. On our higher forecasts, we raise our Price Objective to \$12 from \$10 but maintain our Underperform rating on relatively high valuation (5.3x 2024E EBITDAR vs DAL/UAL at 4.8x/4.2x).

## New distribution strategy driving unit costs

80% of AAL's bookings now come through its website, mobile app or NDC (New Distribution Capability) channels, up from 55%/69% in 2019/2022. AAL was the first mover into the NDC channels, benefitting unit costs. As a percentage of passenger revenues, AAL's distribution costs are 110bps below 2019 vs DAL just 10bps below and UAL 20bps below (pre-recent accounting change). We estimate this distribution strategy has driven a 150bps benefit to unit costs vs 2019 and a 50bps benefit in 2024 guidance vs 2023. As a result, 4Q23 unit cost growth of 4.2% beat our 6% forecast while 2024 unit cost guidance of +0.5-3.5% at the midpoint was better than our +3% estimate.

## Weaker unit revenues vs peers could be a comp issue

AAL's 1Q24 unit revenue guidance of -3.5% to -5.5% was lower than our/Visible Alpha consensus of -2.4%/-3.2% and our 1Q24 unit revenue forecasts at DAL/UAL of -0.7%/-0.2%. We believe this could be attributed to a stronger benefit from LUV's operational disruptions last holiday given the network overlap (though this benefit was never quantified by AAL) as well as Latin America softness. For 2024, we continue to expect modestly slower unit revenue growth for AAL (-1.5%) vs DAL/UAL (both -1%).

## Premium valuation keeps our rating at Underperform

The better cost outlook coupled with a slightly better revenue cadence throughout 2024 raises our 2024E EPS to \$2.65 from \$2.08, which is in the lower half of the \$2.25-3.25 full year outlook. Our 1Q24E EPS is now \$(0.17) from \$0.07 due to the weaker unit revenue outlook, but our forecast is at the better end of the \$(0.15)-(0.35) outlook. Given AAL's 10%/26% valuation premium to DAL/UAL, we maintain our Underperform but raise our price objective to \$12 from \$10 (still based on 5x 2024E EBITDAR).

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.53	2.65	2.65	2.66	2.10
GAAP EPS	0.25	1.21	2.65	2.66	2.10
EPS Change (YoY)	NM	400.0%	0%	0.4%	-21.1%
Consensus EPS (Bloomberg)			2.22	3.18	4.05
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	29.0x	5.8x	5.8x	5.8x	7.3x
GAAP P/E	61.4x	12.7x	5.8x	5.8x	7.3x
EV / EBITDA*	14.0x	9.2x	9.3x	9.5x	10.0x
Free Cash Flow Yield*	-3.3%	10.6%	17.1%	6.5%	4.1%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

26 January 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	10.00	12.00
2024E Rev (m)	54,187.6	54,710.1
2025E Rev (m)	56,328.1	56,851.4
2026E Rev (m)	NA	58,853.7
2024E EPS	2.08	2.65
2025E EPS	1.77	2.66
2026E EPS	NA	2.10

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### Stock Data

Price	15.36 USD
Price Objective	12.00 USD
Date Established	25-Jan-2024
Investment Opinion	C-3-9
52-Week Range	10.86 USD - 19.08 USD
Mrkt Val (mn) / Shares Out (mn)	11,428 USD / 744.0
Free Float	98.5%
Average Daily Value (mn)	564.83 USD
BofA Ticker / Exchange	AAL / NAS
Bloomberg / Reuters	AAL US / AALQ
ROE (2024E)	NA
Net Dbt to Eqty (Dec-2023A)	NA
ESGMeter <sup>TM</sup>	High

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Timestamp: 26 January 2024 05:00AM EST

# iQprofile<sup>SM</sup> American Airlines Group

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	2.5%	5.7%	7.5%	6.9%	5.8%
Return on Equity	NM	NM	NM	NM	NM
Operating Margin	3.3%	5.7%	7.1%	6.2%	5.0%
Free Cash Flow	(373)	1,207	1,953	739	464

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	5.7x	2.0x	2.7x	2.7x	3.2x
Asset Replacement Ratio	1.1x	1.2x	1.4x	1.8x	1.6x
Tax Rate	31.7%	26.8%	25.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	0.8x	1.4x	2.1x	2.2x	2.1x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	48,972	52,788	54,710	56,851	58,854
% Change	63.9%	7.8%	3.6%	3.9%	3.5%
Gross Profit	3,586	4,970	5,882	5,731	5,417
% Change	273.9%	38.6%	18.3%	-2.6%	-5.5%
EBITDA	4,104	6,267	6,198	6,047	5,733
% Change	NM	52.7%	-1.1%	-2.4%	-5.2%
Net Interest & Other Income	(1,421)	(1,912)	(1,422)	(1,062)	(1,013)
<b>Net Income (Adjusted)</b>	<b>381</b>	<b>1,907</b>	<b>1,905</b>	<b>1,912</b>	<b>1,509</b>
<b>% Change</b>	<b>NM</b>	<b>401.0%</b>	<b>-0.1%</b>	<b>0.4%</b>	<b>-21.1%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	127	822	1,857	1,860	1,461
Depreciation & Amortization	2,300	2,254	2,299	2,504	2,771
Change in Working Capital	1,149	904	337	155	145
Deferred Taxation Charge	59	300	619	620	487
Other Adjustments, Net	(1,462)	(477)	0	0	0
Capital Expenditure	(2,546)	(2,596)	(3,160)	(4,400)	(4,400)
<b>Free Cash Flow</b>	<b>-373</b>	<b>1,207</b>	<b>1,953</b>	<b>739</b>	<b>464</b>
<b>% Change</b>	<b>NM</b>	<b>NM</b>	<b>61.8%</b>	<b>-62.2%</b>	<b>-37.2%</b>
Share / Issue Repurchase	(21)	0	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(2,683)	(2,896)	(3,535)	(2,900)	(3,519)

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	586	681	1,598	2,437	883
Trade Receivables	2,138	2,026	2,097	2,179	2,255
Other Current Assets	12,545	10,865	8,384	5,407	3,928
Property, Plant & Equipment	38,294	38,574	39,435	41,331	42,960
Other Non-Current Assets	11,153	10,912	10,293	9,673	9,186
<b>Total Assets</b>	<b>64,716</b>	<b>63,058</b>	<b>61,807</b>	<b>61,026</b>	<b>59,212</b>
Short-Term Debt	4,739	4,941	4,941	4,941	4,941
Other Current Liabilities	16,757	17,121	17,548	17,807	18,050
Long-Term Debt	38,948	35,722	32,187	29,286	25,768
Other Non-Current Liabilities	10,071	10,476	10,476	10,476	10,476
<b>Total Liabilities</b>	<b>70,515</b>	<b>68,260</b>	<b>65,152</b>	<b>62,510</b>	<b>59,234</b>
<b>Total Equity</b>	<b>(5,799)</b>	<b>(5,202)</b>	<b>(3,345)</b>	<b>(1,484)</b>	<b>(23)</b>
<b>Total Equity &amp; Liabilities</b>	<b>64,716</b>	<b>63,058</b>	<b>61,807</b>	<b>61,026</b>	<b>59,212</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Airlines

## Company Description

American Airlines Group is the holding company for American Airlines. Together with wholly owned and third-party regional carriers operating as American Eagle, the airlines operate an average of nearly 6,700 flights per day to 350 destinations in 50 countries from its hubs in Charlotte, Chicago, Dallas/Fort Worth, Los Angeles, Miami, New York, Philadelphia, Phoenix and Washington, D.C. and partner gateways, including in London, Madrid, Seattle/Tacoma, Sydney and Tokyo.

## Investment Rationale

AAL's elevated leverage compared to peers drives our Underperform rating. We see a long road for balance sheet repair coming out of the pandemic with management focused on gross debt reduction rather than net debt reduction. Higher fuel prices and inflationary cost pressures makes it difficult to generate meaningful free cash flow in the near term.

## Stock Data

Average Daily Volume 36,773,000

## Quarterly Earnings Estimates

	2023	2024
Q1	0.05A	-0.17E
Q2	1.92A	1.53E
Q3	0.38A	0.72E
Q4	0.29A	0.54E

## Price objective basis & risk

### American Airlines Group (AAL)

Our \$12 PO is based on approximately 5x our 2024E EBITDAR. Our target multiple is in line with AAL's legacy peers. We believe the network carriers can trade towards the middle of their historical valuation ranges (4-6x).

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.

## Analyst Certification

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.

### US - Airlines and Cruise Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
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	Air Canada	ACDVF	ACDVF US	Andrew G. Didora, CFA
	Alaska Air Group	ALK	ALK US	Andrew G. Didora, CFA
	Carnival Corporation	CCL	CCL US	Andrew G. Didora, CFA
	Carnival Plc	CUKPF	CCL LN	Andrew G. Didora, CFA
	Delta Air Lines	DAL	DAL US	Andrew G. Didora, CFA
	United Airlines Holdings	UAL	UAL US	Andrew G. Didora, CFA
<b>NEUTRAL</b>				
	Frontier Airlines	ULCC	ULCC US	Andrew G. Didora, CFA
	Norwegian Cruise Line Holdings	NCLH	NCLH US	Andrew G. Didora, CFA
	Royal Caribbean Group	RCL	RCL US	Andrew G. Didora, CFA
	Southwest	LUV	LUV US	Andrew G. Didora, CFA
<b>UNDERPERFORM</b>				
	Allegiant Travel Company	ALGT	ALGT US	Andrew G. Didora, CFA
	American Airlines Group	AAL	AAL US	Andrew G. Didora, CFA
	JetBlue Airways	JBLU	JBLU US	Andrew G. Didora, CFA
	Spirit Airlines	SAVE	SAVE US	Andrew G. Didora, CFA
<b>RSTR</b>				
	Hawaiian Holdings	HA	HA US	Andrew G. Didora, CFA



## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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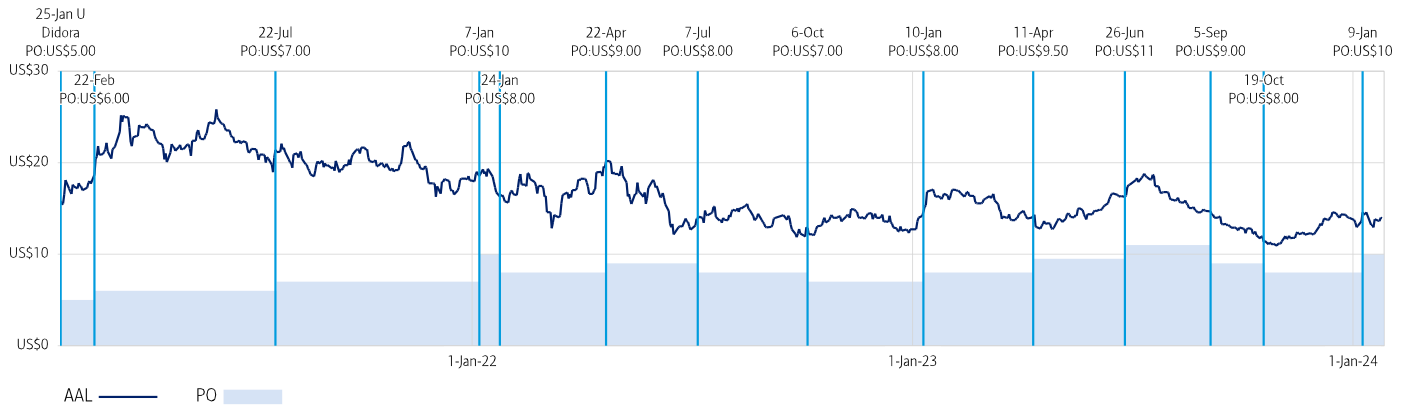
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### American Airline (AAL) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	67	50.38%	Buy	44	65.67%
Hold	31	23.31%	Hold	13	41.94%
Sell	35	26.32%	Sell	17	48.57%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> 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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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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