

## Frontier Airlines

# 2024 margin outlook appears reasonable with 2025 goal predicated on revenues

Reiterate Rating: NEUTRAL | PO: 7.00 USD | Price: 6.22 USD

## 2024 margin outlook appears reasonable

ULCC guided 2024 pre-tax margins of 3-6%, which slightly exceeded our 3.7% forecast and beat the Visible Alpha consensus of +1% given the carrier's network strategy changes and improving domestic fundamentals. More notably, ULCC reiterated the commitment to returning to double-digit pre-tax margins, and guided to 10-14% in 2025, a goal we believe is lofty given labor headwinds next year (we estimate 7.4% margins). We raise our 2024E EPS/EBITDAR to \$0.64/\$887M from \$0.54/\$825M with our PO now \$7 from \$6 on our higher estimates. We reiterate our Neutral rating.

## 2025 margin goal likely predicated on revenues

ULCC's 2024 stage length adjusted unit cost guidance of -1% to -3% translates into about 2-3% normal unit cost growth, which excludes the effect of any potential labor contracts. We estimate these contracts could be a 4% point unit cost headwind in 2025, leaving the 2025 pre-tax margin goal of 10-14% likely driven by strong revenues. While ULCC is making network changes, we estimate unit revenues need to be up mid-to high-single digits if unit costs are up in the low-single digits to get to the margin goal. We find this unit revenue growth tough to underwrite today given likely further double digit capacity growth. Historically, ULCC has grown unit revenues in the low-single digits with capacity growth of 10-15%.

## Growth strategy continues to evolve

ULCC is focusing 2024 growth efforts on service to higher priced and underserved markets, with bias toward less price-sensitive VFR travel (visiting friends and relatives) and reducing capacity to saturated leisure markets. While these initiatives may prove accretive, we see some risk to the strategy, particularly in underserved markets as ULCC's high-gauge operation could depress load factors and pressure economics.

## Increasing estimates and price objective

Based on ULCC's updated guidance, we raise our 1Q24E EPS to \$(0.16) from \$(0.23), with our 2024 EPS forecast now \$0.64 from \$0.54. For 2024, we estimate unit revenues/unit costs of +2.0%/+2.8% with pre-tax margins of 4.4% towards the middle of guidance. For 2025, we forecast capacity +12.5%, unit revenues +4.4%, and unit costs +3.0% to drive 7.4% pre-tax margins. Our new \$7 price objective continues to be based on 5.0x our 2024E EBITDAR.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(0.08)	0.12	0.64	1.24	1.62
GAAP EPS	(0.17)	(0.06)	0.64	1.24	1.62
EPS Change (YoY)	94.3%	NM	433.3%	93.8%	30.6%
Consensus EPS (Bloomberg)			0.02	0.54	1.13
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	NM	51.8x	9.7x	5.0x	3.8x
GAAP P/E	NM	NM	9.7x	5.0x	3.8x
EV / EBITDA*	74.2x	28.2x	6.5x	3.7x	2.9x
Free Cash Flow Yield*	-8.7%	-21.6%	6.1%	16.5%	20.5%

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

07 February 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	6.00	7.00
2024E Rev (m)	4,123.6	4,145.2
2025E Rev (m)	4,691.6	4,865.5
2026E Rev (m)	NA	5,450.6
2024E EPS	0.54	0.64
2025E EPS	0.99	1.24
2026E EPS	NA	1.62

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### Stock Data

Price	6.22 USD
Price Objective	7.00 USD
Date Established	7-Feb-2024
Investment Opinion	C-2-9
52-Week Range	3.19 USD - 14.03 USD
Mkt Val (mn) / Shares Out (mn)	1,375 USD / 221.1
Free Float	17.6%
Average Daily Value (mn)	16.75 USD
BofA Ticker / Exchange	ULCC / NAS
Bloomberg / Reuters	ULCC US / ULCC.OQ
ROE (2024E)	24.7%
Net Dbt to Eqty (Dec-2023A)	-4.2%
ESGMeter <sup>TM</sup>	Low

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

ULCC: Frontier Airlines

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Timestamp: 07 February 2024 05:00AM EST

# iQprofile<sup>SM</sup> Frontier Airlines

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	-0.7%	0.5%	3.9%	6.7%	7.8%
Return on Equity	-3.3%	5.1%	24.7%	35.1%	32.8%
Operating Margin	-1.4%	-0.1%	3.9%	6.7%	8.0%
Free Cash Flow	(119)	(297)	85	227	281

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	NM	-8.8x	1.7x	1.3x	1.1x
Asset Replacement Ratio	0.9x	1.7x	2.9x	2.1x	2.1x
Tax Rate	42.1%	124.0%	23.0%	23.0%	23.0%
Net Debt-to-Equity Ratio	-65.2%	-4.2%	-19.5%	-31.7%	-40.1%
Interest Cover	-4.1x	-2.0x	NM	NM	NM

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,326	3,590	4,145	4,865	5,451
% Change	61.5%	7.9%	15.5%	17.4%	12.0%
Gross Profit	3,326	3,590	4,145	4,865	5,451
% Change	61.5%	7.9%	15.5%	17.4%	12.0%
EBITDA	19	50	217	382	493
% Change	NM	163.0%	334.8%	76.0%	29.0%
Net Interest & Other Income	0	35	23	31	31
<b>Net Income (Adjusted)</b>	<b>(17)</b>	<b>26</b>	<b>142</b>	<b>276</b>	<b>361</b>
<b>% Change</b>	<b>94.3%</b>	<b>NM</b>	<b>446.1%</b>	<b>94.1%</b>	<b>31.0%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(11)	(8)	142	276	361
Depreciation & Amortization	45	40	56	56	56
Change in Working Capital	38	(75)	47	15	(16)
Deferred Taxation Charge	(8)	0	0	0	0
Other Adjustments, Net	(142)	(186)	0	0	0
Capital Expenditure	(41)	(67)	(160)	(120)	(120)
<b>Free Cash Flow</b>	<b>-119</b>	<b>-297</b>	<b>85</b>	<b>227</b>	<b>281</b>
<b>% Change</b>	<b>NM</b>	<b>-149.3%</b>	<b>NM</b>	<b>168.2%</b>	<b>24.1%</b>
Share / Issue Repurchase	71	140	60	60	60
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	7	57	(66)	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	761	507	546	713	934
Trade Receivables	90	109	109	109	109
Other Current Assets	169	187	187	187	187
Property, Plant & Equipment	226	298	402	466	530
Other Non-Current Assets	3,253	3,857	4,077	4,377	4,677
<b>Total Assets</b>	<b>4,499</b>	<b>4,958</b>	<b>5,321</b>	<b>5,852</b>	<b>6,437</b>
Short-Term Debt	157	266	266	266	266
Other Current Liabilities	1,398	1,423	1,470	1,485	1,469
Long-Term Debt	272	220	154	154	154
Other Non-Current Liabilities	129	161	161	161	161
<b>Total Liabilities</b>	<b>3,990</b>	<b>4,454</b>	<b>4,675</b>	<b>4,930</b>	<b>5,154</b>
<b>Total Equity</b>	<b>509</b>	<b>504</b>	<b>646</b>	<b>922</b>	<b>1,283</b>
<b>Total Equity &amp; Liabilities</b>	<b>4,499</b>	<b>4,958</b>	<b>5,321</b>	<b>5,852</b>	<b>6,437</b>

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

## Company Sector

Airlines

## Company Description

Frontier Airlines is an ultra low-cost carrier headquartered in Denver, Colorado and provides service to 120 airports in the US, Mexico, and the Caribbean. Today, the carrier operates an all Airbus fleet of 110 narrow-body aircraft (all leased with average age of 4 years) and has a commitment to purchase 234 additional aircraft with 130 expected deliveries through 2026.

## Investment Rationale

With 90% of its revenues coming from the leisure consumer, Frontier is exposed to the fastest growing segment of the travel market. That said, a tough domestic airline industry backdrop presents headwinds. While its low cost structure allows the airline to generate profits at lower price points relative to other US airlines, market oversupply and weaker pricing threatens ULCC's margin-generating abilities.

## Stock Data

Average Daily Volume 2,692,915

## Quarterly Earnings Estimates

	2023	2024
Q1	-0.05A	-0.16E
Q2	0.31A	0.45E
Q3	-0.14A	0.09E
Q4	0A	0.25E

## Price objective basis & risk

### Frontier Airlines (ULCC)

Our \$7 price objective is based on approximately 5x our 2024E EBITDAR adjusted for our estimate of a new pilot deal (41 cents to unit costs). This multiple is a discount from ultra-low cost carrier's historical average, reflecting current operational risks and softening demand environment.

Downside risks to our price objective are a slower travel recovery, rising industry supply, and poor operational performance.

## Analyst Certification

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	Air Canada	ACDVF	ACDVF US	Andrew G. Didora, CFA
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	Delta Air Lines	DAL	DAL US	Andrew G. Didora, CFA
	United Airlines Holdings	UAL	UAL US	Andrew G. Didora, CFA
<b>NEUTRAL</b>				
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	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

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

### Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

### Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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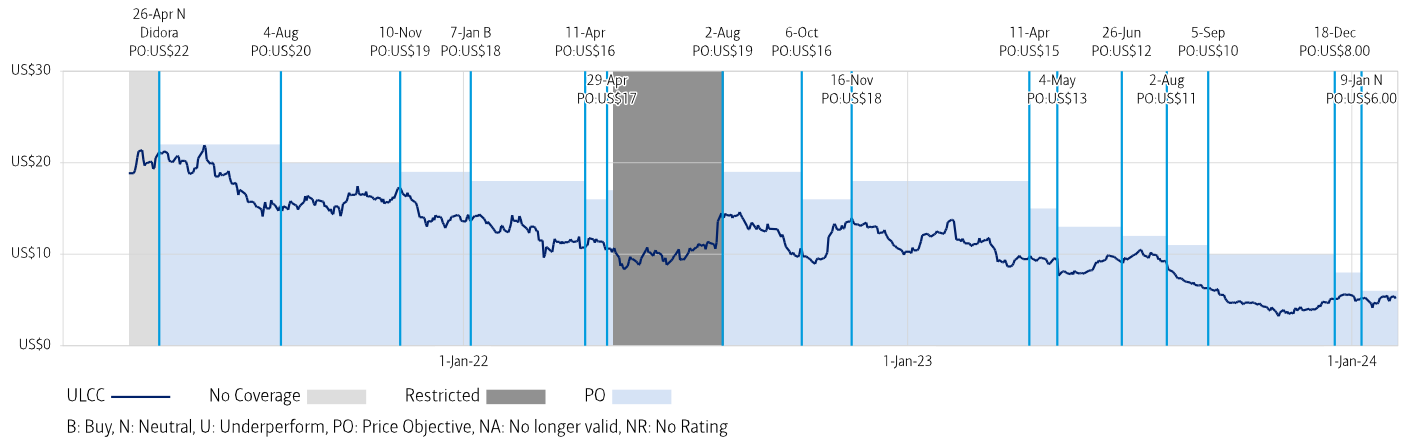
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### Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

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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