Eurowings is managed largely independent of the Network Airlines, so as not to dilute the structural cost advantages of the point-to-point model. At the same time it benefits from belonging to one of the world's largest aviation groups and its wide range of aviation services; from economies of scale in fleet purchases, for instance, and the maintenance competence of Lufthansa Technik.

Aviation Services are seizing growth opportunities and being developed accordingly

With the Aviation Services companies, the Lufthansa Group has several global leaders in their respective markets. In order to build on their successful positioning and deliver profitable growth, Aviation Services are permanently adapting their business models to changing value chains and competitive environments. Lufthansa Technik will increasingly shift its value added towards intelligent maintenance management by means of data-based products and services, for instance, and invest more in digital innovations to improve its product portfolio. Expansion will target attractive, synergetic segments that increase the appeal of the Lufthansa Group's digital environment. Miles & More is developing its third-party business, for example, whereas AirPlus is growing in the lucrative market for payment and billing services for business travel.

Aviation Services will be scrutinised continuously for their value contribution and developed with a clear focus. The Lufthansa Group regularly reviews the attractiveness of individual market segments, their current competitive position, the future revenue potential of the segments and the synergies realised by them, and, in particular, the value contribution for the airlines. At the level of the segments it may make sense to develop companies in the Aviation Services segment within or outside the Lufthansa Group using a differentiated approach or with partners, in order to ensure their long-term growth and sustainable profitability.

FINANCIAL STRATEGY AND VALUE-BASED MANAGEMENT

Financial strategy aims to increase Company value

The financial strategy of the Lufthansa Group seeks to increase its Company value in a sustainable manner. It will concentrate on three dimensions: increasing profitability, focusing the use of capital and safeguarding financial stability.

C06 FINANCIAL STRATEGY

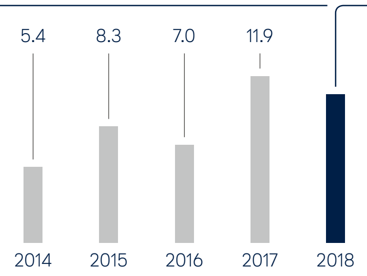
Sustainable increase of Company value

	Improve profitability	Focus capital allocation	Maintain financial stability
Focus	– Sustainable value generation – Intense cost management	– Continuous shareholder participation – Balanced investment level – Working capital management	– Stabilise investment grade rating – Hedging of financial risks – Access to different forms of funding and maintaining appropriate liquidity
Target	– Adjusted ROCE – Adjusted EBIT margin	– Capital expenditure – Dividend	– Adjusted net debt/Adjusted EBITDA

C07 DEVELOPMENT OF ADJUSTED ROCE (AFTER TAXES)

in %

2018
10.6



T009 CALCULATION OF ADJUSTED ROCE AND COST OF CAPITAL[1]

in €m	**2018**	2017	Change in %
Revenue	35,844	35,579	1
Other operating income	2,349	2,714	-13
Operating income	**38,193**	**38,293**	**0**
Operating expenses	35,393	35,153	1
Result from equity investments	174	157	11
EBIT	**2,974**	**3,297**	**-10**
Adjusted EBIT	**2,836**	**2,969**	**-4**
Interest on liquidity	68	178	-62
Taxes (assumption 25% of EBIT + Interest on liquidity)	-761	-869	12
Cost of capital[2]	-860	-832	-3
EACC	**1,422**	**1,774**	**-20**
ROCE[3] in %	**11.1**	**13.2**	**-2.1 pts**
Adjusted ROCE[4] in %	**10.6**	**11.9**	**-1.3 pts**
Balance sheet total	38,213	35,778	7
Non-interest bearing liabilities			
of which liabilities from unused flight documents	3,969	3,773	5
of which trade payables, other financial liabilities, other provisions	6,381	5,988	7
of which advance payments, deferred income, other non-financial liabilities	2,755	2,281	21
of which others	4,099	3,741	10
Capital employed	21,009	19,995	5
Average capital employed	**20,502**	**19,824**	**3**
WACC in %	4.2	4.2	–

[1] The figures for 2017 and 2018 include effects from the first-time application of new accounting standards and other accounting changes. Details can be found on ↗ **p. 29f.** of this Annual Report.
[2] WACC x Average capital employed.
[3] (EBIT + Interest on liquidity – 25% taxes)/Average capital employed.
[4] (Adjusted EBIT + Interest on liquidity – 25% taxes)/Average capital employed.

Increasing profitability

Sustainable value creation in the Company

The Lufthansa Group applies a value-based system of management. At its centre is the profitability of the Company. This is measured by reference to Adjusted EBIT. In order to embed profitability in all decision-making processes, performance-related pay for managers is tied to the financial performance of the Company. ↗ **Remuneration report, p. 84ff.**

The adjusted return on capital employed (Adjusted ROCE) is measured for the Lufthansa Group and the individual companies. If Adjusted ROCE exceeds the weighted average cost of capital (WACC), the Company is creating value.

In 2018, the Lufthansa Group had an Adjusted ROCE after tax of 10.6%. It was 1.3 percentage points down on the previous year and significantly above the WACC of 4.2%. The Company therefore added value again in 2018.

Improved cost management contributes to structural increase in profitability

Greater cost discipline, increasing process simplification and productivity improvements are intended to lift structural profitability. Unit costs at the passenger airlines, adjusted for fuel costs and exchange rates, are to be reduced by 1% to 2% per year. Cost-cutting measures are also implemented on a continuous basis in Aviation Services.

Focused use of capital

Dividend policy aims for continuous distributions

Shareholders should participate directly in the Company's success. The dividend policy provides for a regular dividend payout ratio of 10% to 25% of consolidated EBIT. In addition to the regular dividend payment, the dividend policy also allows for shareholders to participate in particularly positive performance by the Company by means of a special dividend or share buy-back.

The Executive Board and Supervisory Board will table a proposal at the Annual General Meeting on 7 May 2019 to distribute a dividend of EUR 0.80 per share to shareholders for the financial year 2018. This represents a total dividend of EUR 380m or 12.8% of EBIT for 2018.

Balanced investment to modernise the fleet

Going forward, the Lufthansa Group will continue to invest steadily in the renewal of its fleet, in-flight and ground products and infrastructure. The aircraft ordered for the period until 2025 serve mainly to replace older models. Market opportunities arising in the short and medium term can nonetheless be exploited by activating reserve aircraft or procuring used aircraft. This makes the investment profile more balanced and increases focus on the deployment of capital. It also increasingly creates greater room for manoeuvre regarding any further consolidation activity. Regular capital expenditure is financed from the Company's own cash flow. The aim is also to generate significantly positive free cash flow. ↗ **C13 Primary, secondary and financial investments, p. 34.**

Gross capital expenditure (without expenditure on equity investments) rose by 8% to EUR 3,757m in 2018. This was largely due to higher primary investment in down payments and final payments for aircraft, aircraft components and overhauls of aircraft and engines.

Safeguarding of financial stability

Investment grade ratings secure financial room for manoeuvre

Investment grade ratings for the Company's debt secure its financial flexibility. Deutsche Lufthansa AG holds an investment grade rating from the rating agencies. Standard & Poor's gives Deutsche Lufthansa AG a rating of BBB– (positive outlook), while Moody's gives it a rating of Baa3 (stable outlook) and Scope Ratings gives it a rating of BBB– (positive outlook). The Lufthansa Group also strives to secure its investment grade rating over the long term.

T010 DEVELOPMENT OF RATINGS

Rating/outlook	**2018**	2017	2016	2015	2014
Standard & Poor's	BBB–/ positive	BBB–/ stable	BBB–/ negative	BBB–/ stable	BBB–/ stable
Moody's	Baa3/ stable	Baa3/ stable	Ba1/ stable	Ba1/ positive	Ba1/ positive
Scope Ratings	BBB–/ positive	BBB–/ positive	BBB–/ stable		

Adjusted net debt/Adjusted EBITDA serves as an indicator of the Company's ability to service its debts

The ratio of Adjusted net debt/Adjusted EBITDA is used to measure the Group's ability to service its debts. By using Adjusted net debt, the ratio also includes pension provisions as well as classic net indebtedness.

From 2019 onwards, when the new accounting standard for leases is introduced (IFRS 16), it will also include financial obligations from the Group's leases (and for property and aircraft).

At the end of 2018, the ratio was 1.8. Although this was 0.3 points up on the previous year (previous year: 1.5), it is still comfortably within the target corridor for gearing of under 3.5.

T011 ADJUSTED NET DEBT/ADJUSTED EBITDA[1]

	2018 in €m	2017 in €m	Change in %
Net indebtedness[2]	3,242	2,637	23
Pension provisions	5,865	5,116	15
Adjusted net debt	**9,107**	**7,753**	**17**
Adjusted EBIT	2,836	2,969	-4
Depreciation and amortisation	2,180	2,040	7
Adjusted EBITDA	**5,016**	**5,009**	**0**
Adjusted net debt/ Adjusted EBITDA	**1.8**	**1.5**	**17**

[1] The figures for 2017 and 2018 include effects from the first-time application of new accounting standards and other accounting changes. Details can be found on ↗ **p. 29f.** of this Annual Report.

[2] In order to calculate net indebtedness, here 50% of the hybrid bond issued in 2015 (EUR 247m) has been discounted. Calculation of net indebtedness ↗ **p. 38.**

Structured risk management minimises finance risks

Integrated risk management, particularly by hedging fuel, exchange rate and interest rate risks, minimises the short-term financial risks for the Lufthansa Group. The hedges smooth price fluctuations by means of rule-based processes. ↗ **Opportunities and risk report, p. 61ff., Notes to the consolidated financial statements, Note 44, p. 164ff.**

Diverse forms of funding ensure liquidity

Optimising the funding mix reduces financing costs, maintains a balanced maturity profile and diversifies the Lufthansa Group's portfolio of creditors. The majority of the aircraft fleet should remain unencumbered and wholly owned by the Lufthansa Group in order to maintain its great financial and operational flexibility.

T012 LUFTHANSA'S CREDIT RATINGS

Standard & Poor's (June 2018)[1]	Long-term: BBB– Short-term: A-3 Outlook: Positive	Moody's Investors Service (September 2018)[1]	Long-term: Baa3 Short-term: N/A Outlook: Stable	Scope Ratings (June 2018)[1]	Long-term: BBB– Short-term: S-2 Outlook: Positive
Strengths		**Strengths**		**Strengths**	
⊕ One of the leading global network carriers with an excellent competitive position and one of the largest route networks world-wide; strong market position at hubs in Frankfurt, Munich, Zurich and Vienna		⊕ One of the largest airlines in the world and a leading position in the European airline sector with a strong diversified route network; Eurowings strategy of point-to-point traffic addresses cost competitiveness		⊕ Global network coverage, diversified route network, member of the global airline alliance Star Alliance and a high share of business travellers with a strong market position at hubs in Frankfurt, Munich, Zurich and Vienna	
⊕ Balanced exposure to high-yielding, premium, and long-haul traffic across its route portfolio; leading domestic market position in Germany; regional brands are well established		⊕ Robust business profile with diversified business segments reduces its exposure to volatility in passenger and cargo business		⊕ Leading position in home market of Germany; competitive advantage in premium market for long-haul traffic	
⊕ Besides the passenger airline business well diversified business profile with leading market positions in maintenance, repair and overhaul (MRO) services as well as airline catering adds stability to Lufthansa Group's earnings		⊕ Diversity of business segments; maintenance, repair and overhaul (MRO) and airline catering business segments deliver stable profit contribution		⊕ Diversified operations (maintenance, repair and overhaul (MRO) and airline catering) with strong market positions mitigating cyclicality risks in passenger and cargo traffic	
⊕ Strong liquidity position		⊕ Strong liquidity position		⊕ Solid liquidity position	
Weaknesses		**Weaknesses**		**Weaknesses**	
⊖ Cost position as a competitive disadvantage		⊖ Profitability of the Airline Group depends on external factors including fuel prices and economic development in Europe		⊖ Cyclicality of the airline industry; Lufthansa Group's profitability below its peers	
⊖ High capital intense business model		⊖ Market position is challenged by Middle-Eastern airlines in the long-haul segment and low-cost carriers in the short-haul segment		⊖ Cost advantages could erode by competitive pressure	

[1] Latest report.

The main financing instruments are aircraft financing and unsecured financing arrangements such as borrower's note loans and publicly traded bonds. Furthermore, the Lufthansa Group has bilateral credit lines with a large number of banks, which serve as an additional liquidity reserve. As of 31 December 2018, these credit lines came to EUR 849m (previous year: EUR 885m) and had not been used.

The Group aims to maintain liquidity of at least EUR 2.3bn at all times, in order to continually manage liquidity and refinancing risks for the Lufthansa Group, especially at times of volatile demand and financial markets.

A total of two Japanese operating lease (JOLCO) transactions were concluded in 2018. This enabled funds amounting to a total of EUR 243m to be raised on favourable terms. These JOLCO deals are repaid continuously over the approximately eleven-year term of the respective contracts.

In September 2018, Deutsche Lufthansa AG renewed its Euro Medium Term Note (EMTN) programme, a form of debt issuance programme. The programme enables the Group to issue bonds on the capital market at very short notice. It is listed on the Luxembourg stock exchange. No bonds were issued in 2018, however.

There were no significant off-balance sheet financing activities last year. However, various Lufthansa Group companies did enter into rental and/or operating lease contracts. These mainly relate to leases for aircraft and property. ↗ **Notes to the consolidated financial statements, Note 20, p. 134ff.**