FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Deutsche Lufthansa AG at 'BBB-'; Outlook Stable

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Fitch Ratings - Barcelona - 30 Oct 2024: Fitch Ratings has affirmed Deutsche Lufthansa AG's (Lufthansa) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook. Fitch has also affirmed the senior unsecured rating at 'BBB-' and subordinated debt at 'BB'.

The affirmation reflects Lufthansa's strong position in the global aviation industry as the largest European airlines group in terms of fleet and revenues. The group also benefits from its leading position in cargo and maintenance, repair and overhaul (MRO) that helps offset business cyclicality. The rating considers the subdued profitability at Lufthansa Airlines as well as the group's moderate EBITDAR net leverage and strong liquidity.

The industrial action in 1H24, softer yields and delays in aircraft deliveries will drive net leverage higher in 2024, but it will remain within the rating sensitivities (1.8x vs. 2.5x). However, we expect profitability to gradually improve thanks to the normalisation of operations after signing of the collective labour agreements (CLAs) and cost-cutting initiatives, leading to the group's credit metrics remaining commensurate with current rating sensitivities over the medium term.

KEY RATING DRIVERS

Robust Business Profile: Lufthansa has a worldwide leading market position, supported by a diverse multi-brand network and multi-hub strategy across major European cities. Its world-leading cargo and MRO segments provide significant synergies and help mitigate market cyclicality. In particular, Lufthansa Technik (MRO) continues to benefit from delayed aircraft deliveries and ongoing issue with Pratt & Whitney's geared turbofan (P&W GTF) engines.

Profit Hit in 2024: Lufthansa Airlines' performance has been particularly hit in 2024 by the labour dispute (mostly in 1Q24), some weakness in yields (potentially an ongoing issue) and operational inefficiencies due to delayed aircraft deliveries. This led the company to revise its 2024 EBIT guidance to EUR1.4 billion-EUR1.8 billion compared with EUR2.7 billion in 2023 and initial 2024 guidance of stable against 2023.

Our 2024 EBITDAR forecast is EUR3.7 billion (EUR4.6 billion in 2023), but we expect 2025 EBITDAR to partially recover, despite our assumption of slightly weaker yields in 2025 and unchanged fuel price expectations. The expected improvement will mostly come from the company's cost-cutting measures along with profit growth at Cargo and Technik. Historically weaker profitability for Lufthansa compared with its main peers has been sufficiently offset by a more conservative capital structure, in our view.

Normalised Labour Relations: Lufthansa's 1H2024 performance was affected by a strike from various employee groups that had a negative impact on profit of EUR450 million. The company has now negotiated CLAs covering 42,000 employees across group airlines including pilots, cabin crew and ground operations unions. The CLA includes an average salary increase of around 16% in three stages and a ban on strikes until 2026. We view these CLA agreements as positive for the company as it increases visibility over the coming years and enhances planning.

Temporary Leverage Spike: Lufthansa's Fitch-adjusted EBITDAR gross and net leverage was comfortably within the sensitivity at end-2023 at 2.9x and 1.3x, respectively. However, the profit decline in 2024 will lead to EBITDAR gross leverage spiking at 3.7x, exceeding our negative sensitivity of 3.5x, while net leverage will remain comfortably within the sensitivity. We anticipate that EBITDAR gross leverage will return within the sensitivity in 2025, with net leverage in the range of 1.8-2.0x during 2024-2026 (vs. 2.5x threshold).

Prudent Financial Policy: Lufthansa is committed to maintaining its adjusted net debt (including net pension liability) to adjusted EBITDA (as reported by the company) ratio below 3.5x and in general to retaining its investment-grade rating. The management has successfully maintained this ratio well below the target, achieving 1.7x in 2023 and 1.9x by end-September 2024. The company's target leverage broadly translates into Fitch's negative sensitivity for EBITDAR net leverage for the 'BBB-' rating.

Wider Industry Risks Remain: Our forecasts include conservative assumptions to account for risks related to operational constraints (delays in aircrafts deliveries and slower capacity uptick), demand fatigue and slightly increasing unit costs (driven largely by staff costs following signed CLAs, emission reduction costs and general inflation). Lufthansa is not meaningfully affected by the P&W GTF engine issues.

Completion of ITA Acquisition: In July 2024, the European Commission (EC) approved Lufthansa's acquisition of a 41% in ITA Airways (ITA), making it the fifth airline to be integrated into the group. The EC has proposed some antitrust remedies, to which Lufthansa will respond by end-2024 with the aim of starting integration by early 2025. We believe that Lufthansa's market position could be mildly strengthened by the integration of ITA into its network and alliance, while operational synergies are possible.

Lufthansa has the option to proceed with a full takeover of ITA. However, the decision remains at Lufthansa's discretion and is contingent on ITA's performance. Our forecast assumes that Lufthansa will retain its 41% stake with no further share acquisitions before 2026 and few synergies over the forecast horizon.

DERIVATION SUMMARY

Lufthansa is the largest EMEA airlines group by fleet size and revenues and benefits from a strong position in cargo and MRO, mainly in Europe and North America. As a multi-brand group, Lufthansa compares well with IAG and Air France-KLM (AFKLM; BBB-/Stable) due to its diversified hub structure and extensive route network.

AirFrance-KLM is Lufthansa's closest peer due to their strong respective hub positions with geographic proximity. Both companies operate passenger, cargo and MRO businesses, but Lufthansa remains the leader in each. However, Air France-KLM has reported a faster recovery from the pandemic, better profitability and higher geographic diversification globally. We view their business profiles as comparable.

British Airways Plc (BA; BBB-/Stable, SCP bb+) compares well with Lufthansa in terms of its strong hub position in Europe and diversified network. We view Lufthansa's overall business profile as stronger because of its larger size and better business mix. Along with Lufthansa's more robust financial profile, with lower leverage and higher liquidity, this leads to its IDR being one notch above BA's Standalone Credit Profile (SCP).

Turk Hava Yollari Anonim Ortakligi (Turkish Airlines; BB-/Stable) also operates passenger, cargo and MRO businesses but remains a smaller player than the German airline. Lufthansa has a stronger business profile thanks to its more favourable geographic position with a better operating environment. Turkish Airlines is currently rated at the same level as Turkiye's Country Ceiling.

KEY ASSUMPTIONS

- Annual group network and Eurowings capacity down 8% in 2024 compared with 2019 (2023: -16% versus 2019), close to full recovery in 2025 and above 4% in 2026

- Load factor on average at 83% for 2024-2026

- Oil price of USD85/bbl in 2024-2026

- Cargo EBITDA increasing sequentially from 2023 with mid-teens EBITDAR margins

- MRO (Technik) EBITDAR stronger than historically, growing to around EUR1 billion by 2025

- Capex totalling about EUR11 billion during 2024-2026, or EUR3.6 billion on average per year

- Acquisition of 41% of ITA for EUR325 million by the beginning of 2025, without a further stake increase until 2027

- Dividends pay out of 25% of net income for a total of EUR0.9 billion for 2024-2026

- EUR0.5 billion of hybrid debt with 50% equity credit remaining in place

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Downgrade

- EBITDAR margin sustained above 15%

- EBITDAR net leverage below 1.5x and EBITDAR leverage below 2.5x, also backed by a financial policy commensurate with these ratios.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Upgrade

- EBITDAR margin falling consistently below 11%

- EBITDAR net leverage above 2.5x and EBITDAR leverage above 3.5x

- EBITDAR fixed charge coverage sustainably below 2.8x

- Weaker than expected business recovery or aggressive external growth materially beyond our current expectations

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Ample Liquidity: As of 30 September 2024, Lufthansa had EUR8 billion of Fitch-adjusted available liquidity, which included EUR1.4 billion of cash and equivalents and EUR6.6 billion of Fitch-adjusted securities. This is complemented by a EUR2.5 billon sustainability-linked revolving credit facility signed in April 2024 for a three-year tenor with two one-year extension options. Available liquidity is sufficient to cover short-term debt repayment and Fitch-expected moderately negative free cash flow. Lufthansa has a prudent liquidity policy that aims to maintain between EUR8 billion to EUR10 billion of liquidity.

ISSUER PROFILE

Lufthansa is the largest aviation group in Europe and operates the biggest fleet in Europe with 731 aircraft as at end-September 2024. It runs a multi-brand and multi-hub strategy. Lufthansa's other businesses include one of the largest cargo businesses in Europe (Lufthansa Cargo), and the world's leading MRO business. Lufthansa is also a founding member of Star Alliance.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Deutsche Lufthansa AG	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
senior unsecured	LT	BBB-	Affirmed	BBB-
subordinated	LT	BB	Affirmed	BB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Deutsche Lufthansa AG	EU Issued, UK Endorsed

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