S&P Global Ratings

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Tear Sheet:

Deutsche Lufthansa AG

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Primary contact

Varvara Nikanorava
Frankfurt
49-69-33-999-172
varvara.nikanorava
@spglobal.com

Secondary contact

Izabela Listowska
Frankfurt
49-693-399-9127
izabela.listowska
@spglobal.com

Lufthansa is on track to meet its 2024 adjusted EBIT guidance of €1.4 billion-€1.8 billion, which lags the €2.7 billion reported in 2023. Earnings in the first nine months suffered from: labor strikes (negative EBIT impact of about €450 million in the first half), flight irregularities (negative EBIT impact of about €220 million in the third quarter), increased personnel cost due to higher headcount and wages post the collective labor agreements (CLAs), and rising fees and charges across the aviation network. Our revised 2024 base-case corresponds to the mid-range of Lufthansa's EBIT guidance and translates to S&P Global Ratings-adjusted EBITDA of €3.9 billion-€4.0 billion (€4.6 billion in 2023). We forecast mid-single-digit revenue growth for the passenger airlines business, incorporating Lufthansa's lowered capacity guidance to 91% of the pre-pandemic base (from 94% initially), a robust load factor of around 84% (82.9% in 2023), and a 3%-4% drop in revenue per available seat kilometer (RASK). We understand that the pressure on yields has somewhat eased in the recent months. At the same time, we expect maintenance, repair, and overhaul (MRO) segment (Lufthansa Technik) should boost group earnings this year. In the first nine months, Lufthansa Technik reported a record-high adjusted EBITDA of €605 million (adjusted EBIT of €486 million), surpassing 2023's first nine months' €575 million, because the increasing number of flights generates more demand for maintenance and repair services. We now expect Lufthansa Technik will achieve higher adjusted EBITDA in 2024 than last year's €785 million.

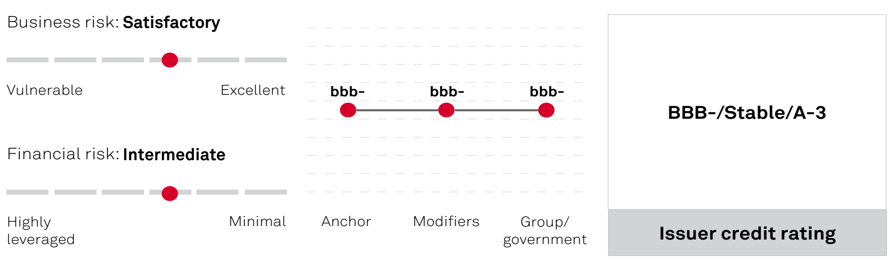
Our base case is for a recovery in EBITDA and cash flows in 2025. We assume continued sound underlying demand for leisure travel across Lufthansa's European short-haul and international long-haul routes (confirmed by solid booking trends for the winter months, according to Lufthansa) despite macroeconomic and geopolitical uncertainties. We think an increase in real incomes and high employment rates in the EU will lend support to gradually strengthening consumer spending. The premium leisure segment (typically one of Lufthansa's most profitable) should continue to outperform others. Our forecast also reflects a moderate pick-up in corporate travel, which still significantly lags leisure travel. That said, visibility beyond the next couple of months is low given persistent short-term booking trends, albeit these have improved toward year end. Furthermore, our view of a recovery in EBITDA is based on the following factors:

- Higher labor cost visibility and potential for productivity improvements combined with lower risk of further performance-affecting strikes after Lufthansa concluded CLAs for vast majority of its workforce.

- Increased focus on MRO, which enjoys sound medium-term prospects as industry-wide capacity remains tight. Military and defense also offer significant growth potential.
- Accelerating deliveries of new 30%-more-cost-efficient aircraft, which will back Lufthansa's unit cost and premium product offerings.
- Continuation of stringent capacity management, which should prop up load factors and unit revenue.
- New turnaround program that aims to add €1.5 billion by 2026, combining revenue growth and cost reduction. We believe, however, that it might take time for the group to reap the full benefits of that program as some gains could be consumed by general cost inflation.

Our 2024 base case indicates a potential temporary underperformance against our rating threshold of S&P Global Ratings-adjusted funds from operations (FFO) to debt of at least 45%. The group has embarked on a fundamental fleet transformation program under which it will take delivery of 250 more fuel-efficient and less noisy aircraft over time. This will weigh on cash flows and balance-sheet deleveraging, in our view. Lufthansa's lower-than-previously-expected 2024 EBITDA is now unlikely to absorb cash outflows for capex and shareholder remuneration, leading to an increase in S&P Global Ratings-adjusted debt at year-end. This might result in adjusted FFO to debt falling temporarily short of our rating guidance in 2024. That said, we anticipate a turnaround in credit measures in 2025 thanks to a clear EBITDA recovery to €4.4 billion-€4.8 billion (similar to the 2023 base of €4.6 billion). Although, we assume that gross capex will stay high at about €3.0 billion in 2025, the expected improvement in EBITDA should be more than sufficient to cover it, as well as dividend distribution, which we think will stay consistent with Lufthansa's prudent dividend policy of a 20%-40% payout ratio of net income. Accordingly, we forecast the group's adjusted debt will start decreasing gradually from 2025. With that, Lufthansa should regain headroom under its adjusted FFO to debt, which we expect to reach at least 50% in 2025.

Ratings Score Snapshot



Recent Research

- Industry Credit Outlook Update Europe: Transportation, July 18, 2024
- Deutsche Lufthansa AG, June 3, 2024

Company Description

Lufthansa is the fourth-largest airline in the world, with operations out of main hubs in Frankfurt, Munich, Zurich, Vienna, and Brussels, under the brands Lufthansa Airlines, SWISS, Austrian Airlines, and Brussels Airlines. In addition, the group's passenger business encompasses point-to-point airlines, like Eurowings, Discover, Air Dolomiti, and Edelweiss. Lufthansa generates about 75% of its EBIT from its passenger airline businesses--its nonpassenger segments such as MRO and airfreight/cargo the remaining 25%.

Lufthansa is one of the largest global network carriers and one of two leading airline groups in Europe. It also has a No. 1 market position in Germany, and its regional brands are well established. It maintains dominant market shares at its Frankfurt, Munich, Zurich, Brussels, and Vienna hubs, notwithstanding fierce competition, while its wealthy catchment area (Germany and Switzerland, in particular) typically generates solid demand for travel. Before the pandemic, the share of flights outside Europe for Lufthansa's Network Airlines was about 70% as measured by RPK, of which half came from long-haul flights to and from the Americas (mainly the U.S.).

As of Sept. 30, 2024, Lufthansa's fleet comprised 731 aircraft (versus 721 aircraft at end-2023). As of Dec. 31, 2023, the average age of the aircraft in the fleet was 13.4 years (previous year: 13.1). The airline continues to modernize its fleet with 253 aircraft on order and purchase options for an additional 161 at year-end 2023.

On July 3, 2024, the European Commission’s competition authority approved Deutsche Lufthansa AG’s planned acquisition of a 41% stake in ITA Airways through a €325 million capital increase, which will flow directly to ITA Airways. The acquisition is consistent with Lufthansa's strategy to focus on its core passenger airline business. With the planned transaction, Lufthansa will expand its presence in the third largest airline market in Europe, while enhancing its short-haul network feeding the hub in Rome and broadening its access to premium leisure and business travel destinations out of point-to-point Milan Linate airport. The transaction is due to close in early 2025.

Outlook

The stable outlook reflects our expectation that economic or geopolitical conditions will not deteriorate unexpectedly or sharply, supporting resilient demand for air travel and ticket fares and translating into weighted-average adjusted FFO to debt of above 45% over the next two years.

Downside scenario

We could lower the rating if passenger demand, yield levels, and consequently Lufthansa's EBITDA fall short of our expectations, such that adjusted FFO to debt deteriorates below 45% with limited prospects of improvement. This could occur if unexpectedly intensified inflationary pressures curb consumer confidence and travel affordability, or if geopolitical tensions escalate, dampening travel demand. A large debt-funded acquisition resulting in credit measures falling lastingly short of our guidelines might also trigger a downgrade. We could also lower the rating if Lufthansa is unable to achieve an EBITDA margin of about 13%. This might lead us to reassess its business risk profile to fair, from satisfactory currently.

Upside scenario

We could raise our ratings if Lufthansa improves adjusted FFO to debt to about 60% on a sustainable basis or recovers its profitability, such that its adjusted EBITDA margin increases and stays at least 15% (from about 13% in 2023), commensurate with our satisfactory assessment of its business risk profile. This could happen if the group's earnings and operating cash flow exceed our base-case scenario and are sufficient to absorb Lufthansa's high capex. We would expect this to be underpinned by a prudent financial policy that prioritizes the sustainability of improved ratios over shareholder remuneration.

Key Metrics

Deutsche Lufthansa AG--Key Metrics*

Mil. €	2022a	2023a	2024f	2025f
Revenue	32,770	35,442	35,000-37,000	37,000-39,000
EBITDA	3,722	4,631	3,900-4,000	4,400-4,800
EBITDA margin (%)	11.4	13.1	11.0%-11.5%	11.5%-12.5%
Funds from operations (FFO)	3,026	3,948	3,100-3,300	3,500-3,800
Debt	7,150	6,891	7,300-7,500	6,800-7,100
Adjusted ratios				
Debt to EBITDA (x)	1.9	1.5	1.8-2.0	1.4-1.6
FFO to debt (%)	42.3	57.3	43.0-45.0	50.0-55.0

Financial Summary

Deutsche Lufthansa AG--Financial Summary

Period ending	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	2018a	2019a	2020a	2021a	2022a	2023a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	35,844	36,424	13,589	16,811	32,770	35,442
EBITDA	5,502	4,663	(2,599)	(25)	3,722	4,631
Funds from operations (FFO)	4,526	3,465	(2,747)	(413)	3,026	3,948
Interest expense	441	408	410	453	510	667
Cash interest paid	306	189	229	287	408	591
Operating cash flow (OCF)	4,494	4,154	(2,434)	355	4,806	4,641
Capital expenditure	4,075	3,693	1,230	1,290	2,323	3,449
Free operating cash flow (FOCF)	419	461	(3,664)	(935)	2,483	1,192
Discretionary cash flow (DCF)	57	34	(3,698)	(2,185)	2,462	1,154
Cash and short-term investments	3,235	3,385	5,460	7,666	8,301	8,265
Gross available cash	3,235	3,385	5,460	7,666	8,301	8,265

Deutsche Lufthansa AG--Financial Summary

Debt	9,855	10,813	15,871	12,424	7,150	6,890
Common equity	9,823	10,506	1,637	4,740	8,724	9,959
Adjusted ratios						
EBITDA margin (%)	15.3	12.8	(19.1)	(0.1)	11.4	13.1
Return on capital (%)	16.2	9.6	(27.7)	(13.7)	7.8	17.3
EBITDA interest coverage (x)	12.5	11.4	(6.3)	(0.1)	7.3	6.9
FFO cash interest coverage (x)	15.8	19.3	(11.0)	(0.4)	8.4	7.7
Debt/EBITDA (x)	1.8	2.3	(6.1)	(497.0)	1.9	1.5
FFO/debt (%)	45.9	32.0	(17.3)	(3.3)	42.3	57.3
OCF/debt (%)	45.6	38.4	(15.3)	2.9	67.2	67.4
FOCF/debt (%)	4.2	4.3	(23.1)	(7.5)	34.7	17.3
DCF/debt (%)	0.6	0.3	(23.3)	(17.6)	34.4	16.7

Peer Comparison

Deutsche Lufthansa AG--Peer Comparisons

	Deutsche Lufthansa AG	International Consolidated Airlines Group S.A.	Delta Air Lines Inc.	United Airlines Holdings Inc.	Air Canada
Foreign currency issuer credit rating	BBB-/Stable/A-3	BBB-/Positive/--	BB+/Positive/--	BB/Stable/--	BB/Stable/--
Local currency issuer credit rating	BBB-/Stable/A-3	BBB-/Positive/--	BB+/Positive/--	BB/Stable/--	BB/Stable/--
Period	Annual	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2023-12-31	2023-12-31	2023-12-31
Mil.	EUR	EUR	EUR	EUR	EUR
Revenue	35,442	29,453	52,516	48,598	14,957
EBITDA	4,631	5,641	8,163	7,135	2,737
Funds from operations (FFO)	3,948	4,317	6,860	5,028	2,118
Interest	667	1,020	1,004	2,041	647
Cash interest paid	591	1,033	1,303	2,101	588
Operating cash flow (OCF)	4,641	5,002	6,486	6,660	2,950
Capital expenditure	3,449	3,516	4,816	6,323	1,062
Free operating cash flow (FOCF)	1,192	1,486	1,670	337	1,888
Discretionary cash flow (DCF)	1,154	1,409	1,554	337	1,888
Cash and short-term investments	8,265	6,806	3,499	13,017	5,858
Gross available cash	8,265	6,806	3,499	13,017	5,413
Debt	6,890	9,608	26,570	23,210	4,117
Equity	9,959	3,278	10,047	8,435	545
EBITDA margin (%)	13.1	19.2	15.5	14.7	18.3
Return on capital (%)	17.3	30.4	14.9	16.1	38.0

Deutsche Lufthansa AG--Peer Comparisons					
EBITDA interest coverage (x)	6.9	5.5	8.1	3.5	4.2
FFO cash interest coverage (x)	7.7	5.2	6.3	3.4	4.6
Debt/EBITDA (x)	1.5	1.7	3.3	3.3	1.5
FFO/debt (%)	57.3	44.9	25.8	21.7	51.5
OCF/debt (%)	67.4	52.1	24.4	28.7	71.7
FOCF/debt (%)	17.3	15.5	6.3	1.5	45.9
DCF/debt (%)	16.7	14.7	5.8	1.5	45.9

Environmental, Social, And Governance

Social factors are a negative consideration in our credit rating analysis. This reflects the correlation of air passenger traffic and Lufthansa's operating performance with health and safety risk. In general, Lufthansa was hard hit by the pandemic, a health and safety risk, and we lowered our rating by four notches. Now that pandemic-related travel restrictions have been lifted, the group has been seeing a significant recovery in European short-haul leisure travel, while business and some long-haul international flights are taking longer to return. In 2023, demand for Lufthansa's flights (as measured in RPKs) recovered to about 84% of the 2019 level from just 30% in 2021 and we anticipate the recovery to continue this year.

Environmental factors are a negative consideration, as is the case for the broader airline industry, reflecting pressures to reduce greenhouse gas emissions. Therefore, Lufthansa will continue upgrading its fleet, which is about 13 years old, with more-fuel-efficient aircraft. This will result in significant cash outflows, but also reduced running costs and environmental impacts over time.

Rating Component Scores

Foreign currency issuer credit rating	**BBB-/Stable/A-3**
Local currency issuer credit rating	**BBB-/Stable/A-3**
Business risk	**Satisfactory**
Country risk	Low
Industry risk	High
Competitive position	Excellent
Financial risk	**Intermediate**
Cash flow/leverage	Intermediate
Anchor	**bbb-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb-**

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011