



Analyst Report

Chris Norris and Alex Sadowski, April 2016



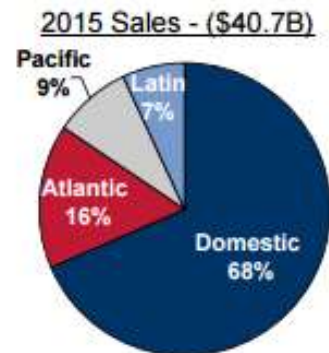
Recommendation

We issue a “BUY” recommendation for Delta Air Lines Inc. (DAL) with a target price of \$61/share. As of 4/21/2016, the company’s share price was \$44.97/share, with our DCF and terminal EBITDA multiple analyses indicating a potential upside of approximately 36% (Appendix A). Our analysis uses the assumptions that DAL’s WACC is 8.9%, perpetuity growth rate is 2%, and an exit EV/EBITDA multiple of 7.0x. Please refer to Appendices B and C for a further detailed free cash flow calculation and calculations of cost of equity and cost of debt.

Our recommendation is in line with the consensus of other analysts at major Wall Street firms, as indicated in the outline of target pricing and recommendations in Appendix D.

Company Profile

Delta Air Lines Inc. (DAL) is an airline that provides transportation for passengers both domestically and internationally. Delta was the world’s largest airline after its merger with Northwest Airlines in 2008 but has since fallen to be the third largest after additional consolidation in the industry. Delta currently services 328 airports in 57 countries. 2015 revenue was \$40.7 billion with 85% coming from passenger transportation, with cargo contributing 2% and 13% from other. By geography, the United States accounted for 68% of revenue, followed by the Atlantic region with 16%, the Pacific region with 9% and Latin America with 7%. The company is part of the SkyTeam global alliance, participating in profit sharing in trans-Atlantic joint ventures with Air France-KLM, Alitalia and Virgin Atlantic. These partnerships help reduce earnings volatility in a highly cyclical industry where margins and earnings are constantly under pressure.



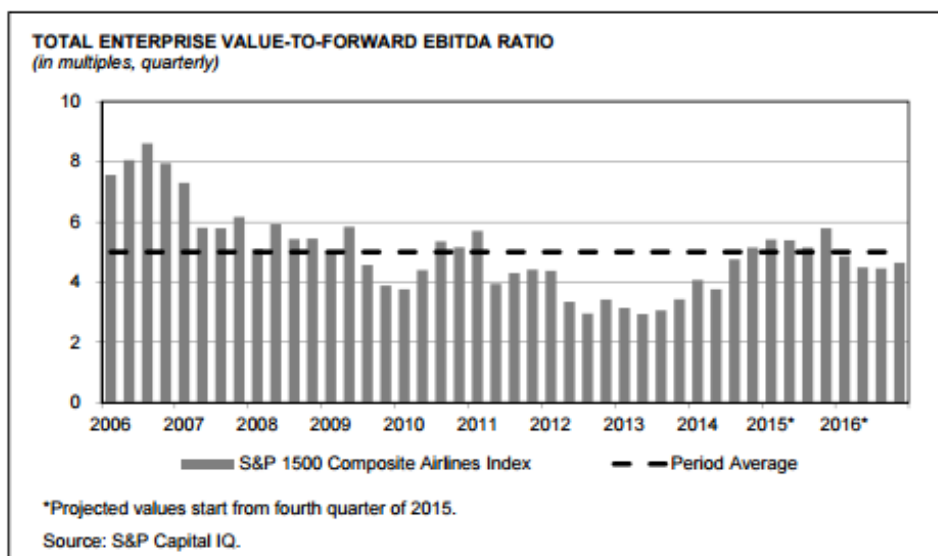
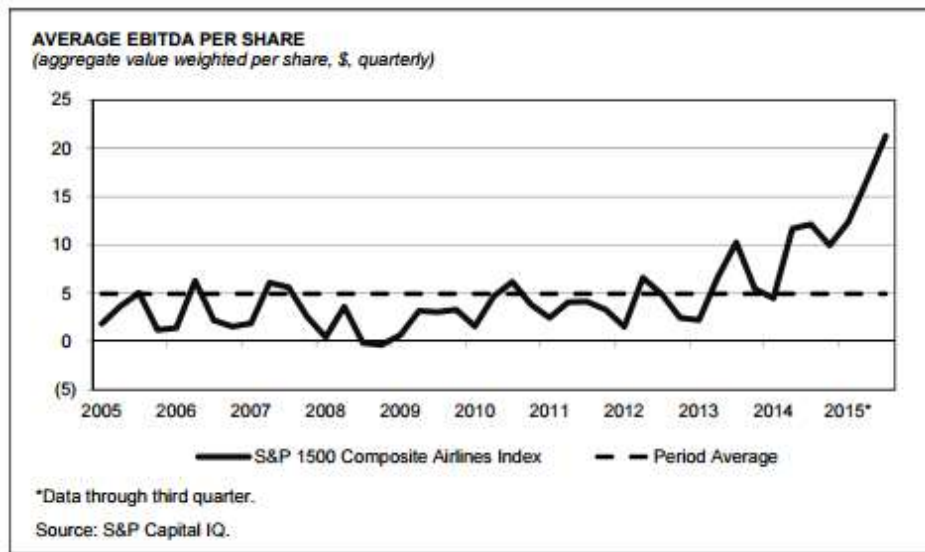
Airline Industry



Barriers to entry are very high in the airline industry due to the capital intensity of aircraft and the limited space at most airports. The industry has consolidated in recent years after a wave of mergers but still remains highly competitive, particularly when it comes to pricing. The mergers resulted in lower capacity in the industry to better

align with demand. As a result, should demand increase, airlines will be able to increase prices but prices should be able to remain steady if demand falls. Airlines have also begun to charge additional fees for baggage or premium seating in recent years as another way to increase their revenues. Fuel is typically either the first or second largest cost to the airline. This cost has come down dramatically recently, as oil prices have fallen far below their 2011-2014 levels.

With higher revenues and falling costs, industry profitability has been increasing in recent years as seen in the industry EBITDA chart. This increased profitability has not been entirely reflected in stock prices in the industry as their valuations based on EV/EBITDA remain below their historical averages.



Investment Risks

Delta has yet to prove that less debt, better capacity management, and a fleshed out route map, can insulate earnings from the negative demand shocks that come during tough economic times. This is why the shares trade at a discount to other large industrials. Near term, we think Delta will benefit from low fuel prices but a return to higher levels would negatively impact profitability. Other risks to Delta's cost structure include high labor costs due to unionization and its highly regulated environment. On the demand side, there is the risk of the economy, weakening. If the trend in unemployment was to turn, it would negatively affect travel. Other things that can affect demand for air travel are disease epidemics, such as Ebola, and terrorism, such as the recent attacks in Paris and Brussels. With respect to competition, air travel has become a highly commoditized product and there is the risk that competitors can slash prices to gain market share.

Key Takeaways: Q1 2016 Earnings Call

The company's reported were in line with expectations with better than expected EPS results. Additionally, the company has indicated that its Q2 guidance is in line with market expectations. Q1 results were outstanding, especially taking into account that January through March are typically the company's seasonally weakest quarter of the year and additional pressures due to the tragic events in Brussels in late March. The company remains focused on improving its Passenger Revenue Per Available Seat Mile (PRASM), with industry capacity and favorable fuel costs helping drive the company's ability to reach its stated goal. Q1 PRASM declined 4.5% this quarter, primarily due to a strong dollar, falling fuel surcharges, and domestic pricing pressures. There is general sentiment that the restructuring of DAL's international segment with SkyTeam and a strong start to the summer booking period will allow the company to reach an inflection point and attain PRASM in Q2. Despite negative unit revenue growth, DAL remains well positioned when compared to its peers. Positive highlights of the earnings call include:

- \$1.56B of pre-tax profit was the company's 12th consecutive record quarterly result, primarily driven by low fuel prices and solid demand
- 99.4% completion factor and on-time arrival rate of 86.5%, leading the global industry
- Top line revenue remained flat but substantial fuel savings allowed for operating margins to improve by 10 basis points to 18.5% and generate \$1.4B in operating cash flows

APPENDIX A

Bloomberg

Discounted Cash Flow

Ticker	DAL US	Currency	Trading	Summary Analysis	Input Calculation	Output Analysis
Name	Delta Air Lines Inc	Data	Adjusted (If available)			

Summary Analysis													
In Millions of USD	Dec 10 A	Dec 11 A	Dec 12 A	Dec 13 A	Dec 14 A	Dec 15 A	Dec 16 E	Dec 17 E	Dec 18 E	Dec 19 E	Dec 20 E	Dec 21 E	Trend
Revenue (Estimate Comparable)	31,755	35,115	36,670	37,773	40,362	40,704	40,602	42,088	43,447	38,195	38,900	38,693	
% YoY Growth		11%	4%	3%	7%	1%	0%	4%	3%	-12%	2%	-1%	
EBITDA	4,178	3,766	4,165	5,206	7,039	8,443	8,601	8,997	9,171	8,062	8,211	8,167	
% Margin	13%	11%	11%	14%	17%	21%	21%	21%	21%	21%	21%	21%	
Free Cash Flow	3,479	3,644	2,171	(4,301)	3,352	6,243	4,020	3,747	3,566	3,837	3,927	3,481	
% Margin	11%	10%	6%	-11%	8%	15%	10%	9%	8%	10%	10%	9%	

Perpetuity Growth Method						
Current Price (USD)						44.97
Consensus Price Target						62.79
DCF Estimated Value per Share (USD)						61.00
DCF Estimated Upside						36%
Perpetuity Growth						
		1.0%	1.5%	2.0%	2.5%	3.0%
Discount Rate (WACC)	7.9%	63.18	67.28	72.07	77.74	84.57
	8.4%	58.60	62.08	66.10	70.80	76.37
	8.9%	54.61	57.59	61.00	64.95	69.56
	9.4%	51.09	53.67	56.60	59.95	63.82
	9.9%	47.97	50.22	52.75	55.62	58.91
		1.0%	1.5%	2.0%	2.5%	3.0%
	7.9%	41%	50%	60%	73%	88%
	8.4%	30%	38%	47%	57%	70%
	8.9%	21%	28%	36%	44%	55%
	9.4%	14%	19%	26%	33%	42%
	9.9%	7%	12%	17%	24%	31%

EBITDA Multiple Method						
Current Price (USD)						44.97
Consensus Price Target						62.79
DCF Estimated Value per Share (USD)						62.19
DCF Estimated Upside						38%
Terminal EBITDA Multiple						
		4.0x	5.5x	7.0x	8.5x	10.0x
Discount Rate (WACC)	7.9%	43.13	54.02	64.92	75.81	86.70
	8.4%	42.25	52.89	63.54	74.18	84.83
	8.9%	41.39	51.79	62.19	72.59	83.00
	9.4%	40.55	50.72	60.88	71.05	81.22
	9.9%	39.73	49.67	59.61	69.54	79.48
		4.0x	5.5x	7.0x	8.5x	10.0x
	7.9%	-4%	20%	44%	69%	93%
	8.4%	-6%	18%	41%	65%	89%
	8.9%	-8%	15%	38%	61%	85%
	9.4%	-10%	13%	35%	58%	81%
	9.9%	-12%	10%	33%	55%	77%

APPENDIX B

Input Calculation													
	Input	Peers	Px Implied	Tgt Implied	Default	Current Choice	Auto Input Selection						
Weighted Average Cost of Capital		9.0%			8.9%	8.9%	(Perpetuity Growth Method only) (EBITDA Multiple Method only)						
Perpetuity Growth Rate			-1.2%	2.2%	2.0%	2.0%							
Exit Enterprise Value / EBITDA		5.5x	4.5x	7.1x	4.4x	7.0x							
In Millions of USD	Dec 10 A	Dec 11 A	Dec 12 A	Dec 13 A	Dec 14 A	Dec 15 A	Dec 16 E	Dec 17 E	Dec 18 E	Dec 19 E	Dec 20 E	Dec 21 E	Year 5
Revenue (Estimate Comparable)	31,755	35,115	36,670	37,773	40,362	40,704	40,602	42,088	43,447	38,195	38,900	38,693	
% YoY Growth	Edit Row	11%	4%	3%	7%	1%	0%	4%	3%	-12%	2%	-1%	
(-) Cost of Revenue		-	-	-	-	-	-	-	-	-	-	-	-
% of Revenue		0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
(=) Gross Profit		-	-	-	-	-	-	-	-	-	-	-	-
% Margin	Edit Row	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
(-) Operating Expenses/Income		29,088	32,872	34,070	34,225	35,094	34,096	34,011	35,255	36,394	31,994	32,585	32,411
% of Revenue	Edit Row	92%	94%	93%	91%	87%	84%	84%	84%	84%	84%	84%	84%
% YoY Growth			13%	4%	0%	3%	-3%	0%	4%	3%	-12%	2%	-1%
(=) Operating Income		2,667	2,243	2,600	3,548	5,268	6,608	6,592	6,833	7,053	6,201	6,315	6,281
% Margin		8%	6%	7%	9%	13%	16%	16%	16%	16%	16%	16%	16%
(-) Tax on Operating Income		28	-	27	32	1,888	2,428	982	1,222	1,499	1,570	1,466	1,288
% Tax Rate	Edit Row	1%	0%	1%	1%	36%	37%	15%	18%	21%	25%	23%	21%
(=) NOPAT		2,639	2,243	2,573	3,516	3,380	4,180	5,610	5,611	5,555	4,631	4,849	4,993
% Margin		8%	6%	7%	9%	8%	10%	14%	13%	13%	12%	12%	13%
(+) Depreciation & Amortization		1,511	1,523	1,565	1,658	1,771	1,835	2,009	2,164	2,118	1,862	1,896	1,886
% of Revenue	Edit Row	5%	4%	4%	4%	4%	5%	5%	5%	5%	5%	5%	5%
% YoY Growth			1%	3%	6%	7%	4%	9%	8%	-2%	-12%	2%	-1%
(-) Capital Expenditure		1,342	1,254	1,968	2,568	2,249	2,945	3,099	3,136	3,000	2,886	3,013	3,027
% of Revenue	Edit Row	4%	4%	5%	7%	6%	7%	8%	7%	7%	8%	8%	8%
% YoY Growth			-7%	57%	30%	-12%	31%	5%	1%	-4%	-4%	4%	0%
(-) Changes in Net Working Capital		(664)	(1,028)	18	(132)	(3,053)	(534)	(983)	(976)	(1,214)	(1,254)	(943)	(1,025)
% of Revenue	Edit Row	-2%	-3%	0%	0%	-8%	-1%	-2%	-2%	-3%	-3%	-2%	-3%
(+) Changes in Net Long Term Deferred Tax Liabilities		7	104	19	(7,039)	(2,603)	2,639	-1,482	-1,869	-2,319	-1,023	-749	-1,395
% of Revenue	Edit Row	0%	0%	0%	-19%	-6%	6%	-4%	-4%	-5%	-3%	-2%	-4%
(+) Other User Estimated Non-Cash Adjustments													
% of Revenue	Edit Row						0%	0%	0%	0%	0%	0%	0%
(=) Free Cash Flow		3,479	3,644	2,171	(4,301)	3,352	6,243	4,020	3,747	3,566	3,837	3,927	3,481
% Margin	Edit Row	11%	10%	6%	-11%	8%	15%	10%	9%	8%	10%	10%	9%
% YoY Growth			5%	-40%	-298%	-178%	86%	-36%	-7%	-5%	8%	2%	-11%
% of the Free Cash Flow to be discounted								69%	100%	100%	100%	100%	31%
Period for Discount Factor (Mid-Year Convention)								0.35	1.19	2.19	3.19	4.19	4.85
Discount Factor @ 8.9% WACC								0.97	0.90	0.83	0.76	0.70	0.66
Present Value of Free Cash Flow (5 Years)								2,709	3,384	2,958	2,922	2,746	705
EBITDA		4,178	3,766	4,165	5,206	7,039	8,443	8,601	8,997	9,171	8,062	8,211	8,167
% Margin	Edit Row	13%	11%	11%	14%	17%	21%	21%	21%	21%	21%	21%	21%
% YoY Growth			-10%	11%	25%	35%	20%	2%	5%	2%	-12%	2%	-1%

APPENDIX C

Cost of Equity	10.62 %
Risk Free Rate	1.86 %
+ Equity Risk Premium	8.76 %
Beta	1.15
x Country Premium	7.63 %
Expected Market Return	9.49 %
- Risk Free Rate	1.86 %
Market Capitalization	37560.58

Cost of Debt	1.62 %
1 - Effective Tax Rate	63.82 %
Effective Tax Rate	36.18 %
x Total Pre-Tax Cost of Debt	1.67 %
Note Rate x ST Debt to Total Debt	0.15 %
ST Debt to Total Debt	0.18
x Note Rate	0.80 %
+ Bond Rate x LT Debt to Total Debt	1.53 %
LT Debt to Total Debt	0.82
x Bond Rate	1.86 %
x Debt Adjustment Factor	1.52
Total Debt	8451.00
Short Term Debt	1531.00
+ Long Term Debt	6920.00
Credit Rating	BB+
* Using rough approximation for Cost of Debt.	

APPENDIX D

Delta Air Lines, Inc. (DAL) \$44.97
 TARGETS & RATINGS

Last Rpt Date: 14 Apr '16
 100 Day Mean



U.S. Dollar Institutional Investor Banking Relationship

Broker	Analyst	Rating Date	Rating	Price on Rating Date	Tgt Price Date	Tgt Price	Price on Tgt Price Date	Tgt Price Implied Return (%)
Mean		21 Apr '16	Buy (1.09)	44.97	21 Apr '16	63.21	44.97	40.6
BofAML	Andrew G. Didora	20 Apr '16	Buy →	46.60	20 Apr '16	65.00 →	46.60	44.5
Morgan Stanley	Rajeev Lalwani	19 Apr '16	Buy →	46.87	19 Apr '16	65.00 ↓	46.87	44.5
Argus Research	David E. Coleman	18 Apr '16	Buy →	46.55	-	-	-	-
Wolfe Research	Hunter K. Keay	15 Apr '16	Buy →	47.50	15 Apr '16	63.00 ↓	47.50	40.1
UBS	Darryl Genovesi	15 Apr '16	Buy →	47.50	15 Apr '16	60.00 ↑	47.50	33.4
Evercore ISI	Duane Plennigwerth	14 Apr '16	Buy →	48.49	14 Apr '16	68.00 →	48.49	51.2
Buckingham Research	Daniel McKenzie	14 Apr '16	Buy →	48.49	14 Apr '16	65.00 ↓	48.49	44.5
CRT Capital Group	Michael Derchin	14 Apr '16	Buy →	48.49	14 Apr '16	65.00 →	48.49	44.5
Cowen & Company	Helene Becker	14 Apr '16	Buy →	48.49	14 Apr '16	62.00 →	48.49	37.9
Stifel Nicolaus	Joseph W. DeNardi	14 Apr '16	Buy →	48.49	14 Apr '16	65.00 →	48.49	44.5
Stephens Inc	Jack Alkins	14 Apr '16	Buy →	48.49	14 Apr '16	65.00 →	48.49	44.5
Raymond James	Savanthi Syth	14 Apr '16	Overweight →	48.49	14 Apr '16	62.00 ↑	48.49	37.9
Credit Suisse	Julie Yates	14 Apr '16	Buy →	48.49	14 Apr '16	58.00 ↓	48.49	29.0