

Delta Air Lines, Inc. (NYSE: DAL)

Sector: Industrials



Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
\$66.39	\$51.88	\$60.79	\$43.81	11.5	\$36.8 B	2.16%	1.27

Business Description

Delta Air Lines is the world's largest airline. They provide scheduled air transportation for passengers and cargo domestically, internationally, sometimes through joint ventures. Delta operates in two segments: primarily through its airline services, but also has operations in refinery. The company buys and maintains aircraft to transport people all over the world. It sells airfares to all types of consumers but its profits are driven through contracts with corporations for company travel. The company was founded in 1924 and is headquartered in Atlanta, Georgia.

Industry Trends

Delta operates in the airline industry. Global air traffic increased 8% last year due to strong economic conditions which indicates a very strong market. The airline industry has undergone significant changes in the past two decades marked by consolidation which has returned the industry to strong profitability. Currently, major domestic airlines have engaged in pricing wars as excess capacity has increased, meaning the airlines have needed to cut prices in order to fill the extra seats they have available. This, along with a brief surge in fuel prices in the last quarter, has decreased operating margins in the industry. The industry looks to increase margins in 2018 as airlines look to cut non-fuel related expenses and take advantage of strong global demand.

Investment Thesis

Our investment thesis is based on Delta's key competitive advantages which will allow them to outcompete their competitors. Even with stronger market positioning and better financial health, Delta is undervalued compared to its competitors. Some examples of Delta's competitive advantage include: industry: industry-leading regional monopolies, innovative segmentation, and up gauging. The company's management has positioned the company well and has announced initiatives to increase free cash flow into the foreseeable future. Delta plans to return 70% of future cash flows to shareholders which drives our financial valuation.

compete with Delta on an international level. American Airlines and United Continental both compete with Delta domestically and internationally, however, they have a much smaller market capitalization and smaller passenger volume per year. FedEx and UPS can also be classified under the Delta competitor list due to the revenue stream produced from cargo air transportation. Due to the fact that such an insignificant portion of Delta's revenue is generated through cargo transportation, we do not see these competitors as a major threat for the passenger air transportation industry.

Competitive Advantages

Delta's competitive advantages lie in the ability to consistently maintain higher margins than its competitors. Delta owns the Monroe Refinery, giving them a cost advantage of approximately 5 cents per gallon on jet fuel. They also focus heavily on attracting the corporate traveler segment, which again provides higher margins and is less prone to price fluctuations. Delta's industry leading customer service helps to maintain and grow their customer base in the United States and internationally while their partnership with American Express helps to instill high value for corporate and retail clients. It is important to note that Atlanta airport, the world's largest hub, is dominated by Delta Airlines. This hub is incredibly efficient and within a 2 hour drive for 80% of the United States population. Furthermore, Delta purchases many of its airplanes used, while its main competitors purchase most new, giving Delta the flexibility to convert fixed costs into variable costs due to the lower purchase price of these aircrafts. Lower fixed costs and higher variable costs enable Delta to quickly and efficiently scale up or down to meet demand; this is a major advantage in times of low passenger volume.

Risks

Increasing fuel costs: A sharp increase in fuel prices would adversely affect Delta's business and stock price because the company does not fully hedge its oil purchases. Airlines can't not immediately offset increasing oil prices with higher fares so this remains a concern in the short term.

Excess Capacity: As airlines have bought more and more planes, they have more seats available for sale. This has led to decreasing fare prices as the airlines look to fill the extra planes they have available. Delta is looking to offset this by increasing its share of business class seats which have much higher margins than economy.

Geopolitical events: Events such as terrorist attacks have proven to hurt the airline industry dramatically. Also, Delta operates joint ventures around the world and has to worry about political events that could hurt operations around the world.

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Sources: Bloomberg, Delta 10-K, Delta 2017 Investor Presentation

Valuation Assumptions

WACC: 9.9%
Avg. 5 year Rev Growth Rate: 3.8%
2020 FCF Projection: 4.7B

Key Financials

ROA: 11.24%
ROE: 31.27%
ROIC: 17.39%
EBIT: \$6.929 B

Corporate Social Responsibility

Donations: Delta donated 1% of net profits donated to nonprofits in education, wellness, and military/veteran causes.

Hurricane Relief: Donated \$3.7 million to hurricane and earthquake relief efforts.

Joint Ventures: Have partnered with its joint ventures around the world to build homes in Mexico and China.

Competitive Analysis

Delta Airlines is the world's largest airline by passenger volume and the industry leader for passenger air transportation. Although Southwest Airlines is the largest domestic competitor, they cannot

