

Stance

Overweight

Country

Germany

Industry Class

Airlines

Company

Deutsche Lufthansa AG

Date

12th March 2014

Bloomberg

LHA GY

Company Update

Price	€18.03
Price Target	€21.38
52-week Range	€12.58-19.10
Dividend Yield	n/a
P/E	10.82x
Market Cap	€8.30bln

Events

FY13 results out on 13/03/2014

Investment Thesis before FY13 Results

Deutsche Lufthansa report results for FY13 tomorrow and we remain optimistic about the progress the Group is making both to its top line and margins as it undergoes a cost cutting exercise through its SCORE program which should come to an end in 2015.

We have seen companies like Deutsche Lufthansa, Air France-KLM, EasyJet and Ryanair all post positive traffic figures for February. This comes to show that the airline industry is doing well in an environment of increased optimism as global growth picks up.

We expect a flat sales figure for 2013 and an increase of 3% each year thereafter. The growth rate we are forecasting for 2014 (although better than 2013) is still lower than the growth rate we have seen in previous years and this is mainly due to currency headwinds we have experienced in emerging market currencies at the end of 2013 and the first quarter of 2014. However, going forward, although we are not forecasting a recovery of the devaluated emerging market currencies, nor are we forecasting the same drop against the Euro.

We expect to start seeing the fruits of the SCORE program as operating expenses start to fall in 2014 and 2015 respectively. We have already got confirmation from management towards the end of 2013 that costs are expected to come in lower than what the market was expecting. 2015 is the year of equilibrium for the SCORE program. We assume a leaner Lufthansa beyond 2015.

Our forecasted EPS figure for 2013 is 43c/share which is below consensus of 59c. The reason being we are factoring in a higher negative impact from emerging market currencies than the street.

Conclusion: We are overweight on Deutsche Lufthansa because we have a pro cyclical stance on the markets in general mainly due to an improved economic environment which benefits all sectors mainly pro cyclical ones. Deutsche Lufthansa's business model has been improved thanks to the SCORE program which has already started bearing fruits. For instance, the Group has already started to shift some of its short haul flights from its main carrier to Germanwings, its low cost subsidiary. The cost cutting exercise also involves reducing inefficiencies which will result in an improvement in operating margins going forward. We are confident that Deutsche Lufthansa is heading in the right direction and the outlook management will give will be beneficial for shareholders.

Group Targets

We still believe that managements' forecast of €2.3bln in operating profit in 2015 is too optimistic; we have increased our 2015 operating profit figure to €1.851bln from €1.623bln in our previous report based on more optimistic growth forecasts.

Positioning

We believe that Deutsche Lufthansa should be a satellite holding in a diversified portfolio as Deutsche Lufthansa is a riskier proposition than most stocks in the European market. **Currently Deutsche Lufthansa is one of our top picks** as we believe that a recovery in the European economy and cheaper inputs such as fuel will provide significant tail winds. We expect Deutsche Lufthansa to significantly outperform the market in 2014.

Valuation

We maintain our 1yr price target to €21.38. The price target is calculated using an Earnings Based Model with a forward PE of 12x and an Equity Risk Premium of 8.49%.

Year End Dec (€'mln)	FY 2015 F	FY 2014 F	FY 2013 F	FY 2012A	FY 2011A
Revenue	31,914	30,984	30,082	30,135	28,734
Other operating revenue	1,532	1,494	1,443	1,352	1,112
Operating expenses	31,595	31,249	30,870	30,944	28,809
Operating income	1851	1229	655	543	1037
Interest Expense	530	511	513	486	478
Foreign Expense Losses (Gains)	0	0	0	-43	231
Net non-operating losses (gains)	0	0	-155	-939	-118
Pretax income	1321	718	297	1039	446
Income tax expense	396	215	84	72	157
Income before XO items	925	503	213	967	289
XO net of tax	0	0	0	-36	285
Minority interests	12	12	14	13	17
Net income	913	491	199	990	-13
Number of shares	459.76	459.76	459.40	458.24	457.91
Basic EPS	1.99	1.07	0.43	2.16	-0.03

Source: Company's financial statements, Calamatta Cuschieri estimates

Historical 1 Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
LHA GY	10.09.2013	€13.68	€17.50	Team Coverage	Overweight
LHA GY	02.10.2013	€14.37	€17.50	Team Coverage	Overweight
LHA GY	04.10.2013	€14.45	€18.00	Team Coverage	Overweight
LHA GY	11.11.2013	€14.66	€15.50	Team Coverage	Neutral
LHA GY	27.11.2013	€15.87	€18.65	Team Coverage	Overweight
LHA GY	18.02.2014	€18.40	€21.38	Team Coverage	Overweight
LHA GY	12.03.2014	€18.03	€21.38	Team Coverage	Overweight

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