

AIRLINE FUEL HEDGING

Hedging relevance to asset financing

Robert J. Kokonis ▪ President & Managing Director
AirTrav Inc ▪ Toronto, Canada ▪ 05 Nov 2024

 AIRLINE ECONOMICS.WEEK

DUBLIN

GROWTH FRONTIERS CONFERENCE

12-15 JANUARY 2025

ST. STEPHENS GREEN + THE RDS, DUBLIN



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Agenda



Introduction to AirTrav

- Airline-fuel context
- Energy prices and forecasts
- Hedging overview
- Hedging perspectives and guidance
- AirTrav – hedging program “health check”

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Introduction to AirTrav Inc. – based in Toronto since 2001, global partner with  **ICF**



Airline Advisory

Economic impact, financial, fleet, forecasting, fuel management, network, loyalty, operational, route evaluations, and strategy for airlines & air transport businesses



Airports Advisory

Air service development, commercial strategies, fuel management, and operational support for owners, operators, regulators and developers



Asset Mgt & MRO

Aircraft search, acquisition support, evaluations, and inspections for airlines, investors, and lessors | Technical advisory for airlines, MROs and OEMs



Transactions

Diligence and related support for investment banks, private equity, and law firms on mergers, acquisitions, recapitalizations, turnarounds, and bankruptcies

AirTrav and our global partner, **ICF** (NASDAQ: ICFI), provide airlines, airports, investors, lessors, owners, maintainers, and related businesses with world-class advisory and transactional support.

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Introduction to AirTrav – President & Managing Director, Rob Kokonis

- 33 years in: Operational finance, asset management, and fuel/carbon areas
- Work with: Network, regional, LCC, ULCC, and cargo airlines
- Top media guest: BBC, Bloomberg, BNN, CNBC, Financial Post, SKIES, WSJ





Introduction to AirTrav – fuel management practice



AirTrav works with aviation, governments, military, maritime shippers, roadhaul operators, pipeline operators, and others

Fuel Practice	Coverage
Environment	Fuel consumption, GHG emissions, and carbon taxation analytics
Hedging	Risk management reviews for fuel and foreign exchange strategies
Infrastructure	Consortia, fuel farm storage, pipelines, hydrant systems
Into-plane	Supplier procurement negotiations and strategy, consortiums
Operational	Efficiency guidance for flight operations, flight planning and dispatch
Supply	Security of supply, and supply chain optimization for airlines and airports
Sustainability	Regulatory policy, carbon credits, SAF uptake agreements, hydrogen analytics


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Airline fuel context – IATA* fuel price perspective

320 airlines
120 countries
83% of global
pax traffic

Fuel expense
in 2024
27% of opex

Each \$1/bbl
+/- fuel prices
~\$2.2B impact

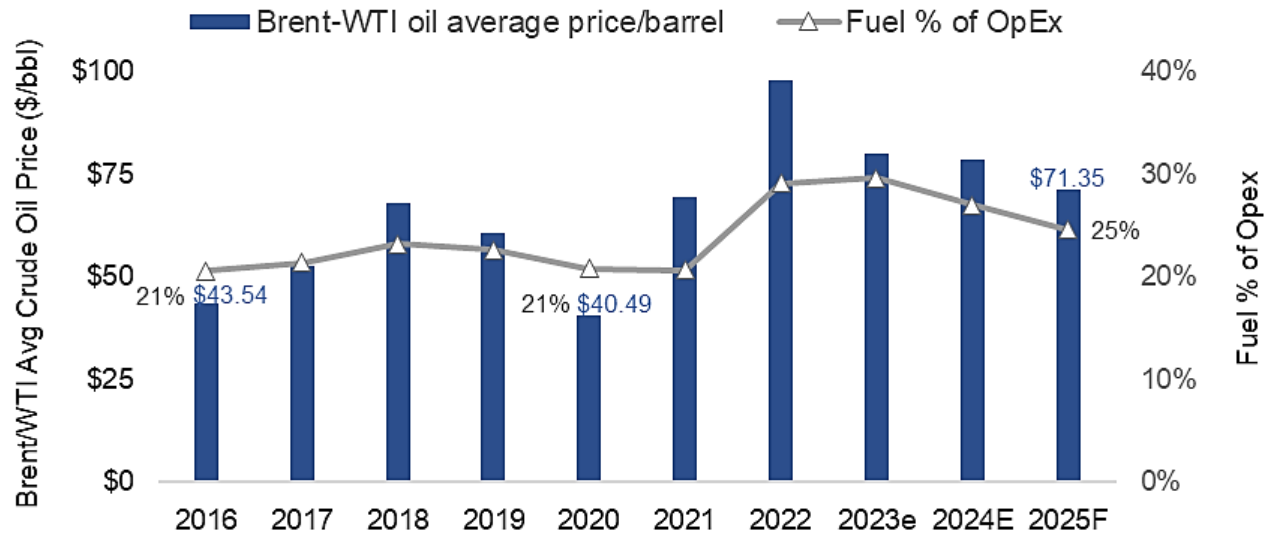
* IATA is the International Air Transport Association, based in Montreal and Geneva.

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Airline fuel context – fuel opex share, versus oil prices

**Aircraft fuel will average 24% of airline opex
in the 10 years 2016-2025 (nominal)**



Sources: AirTrav Inc., IATA Economics, U.S. Energy Information Administration.

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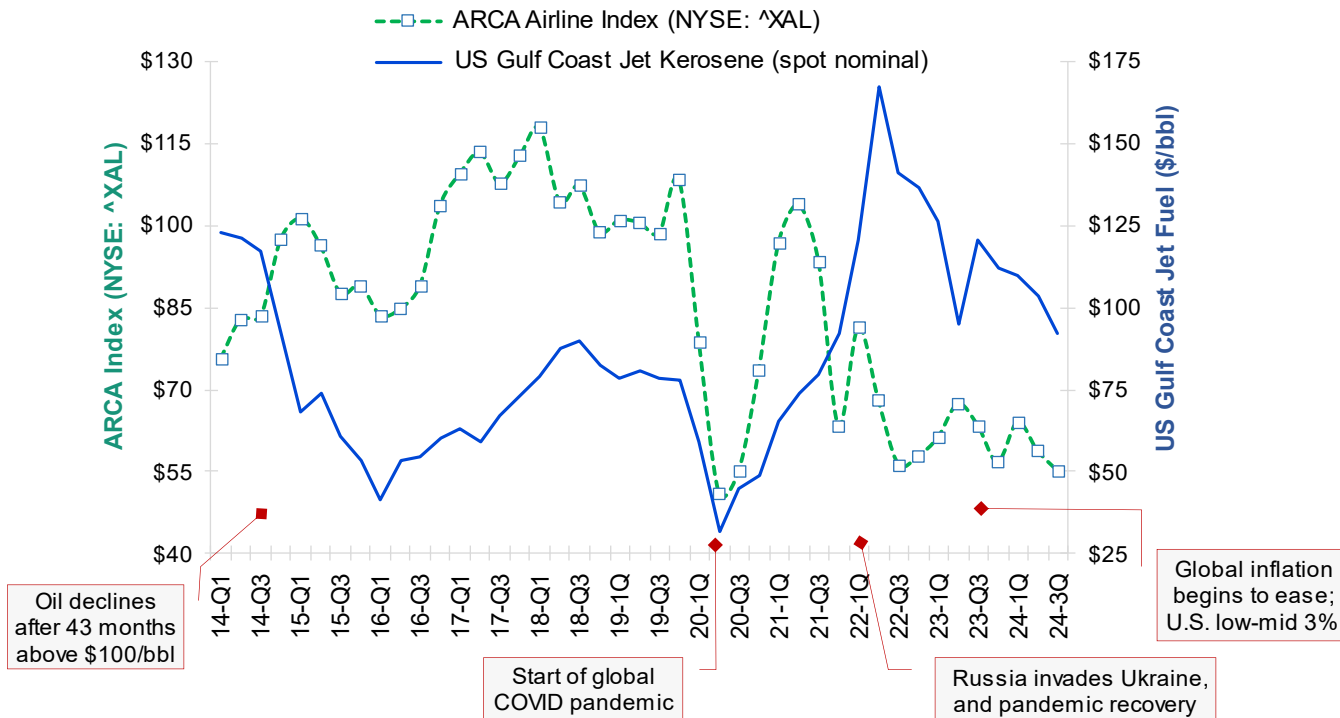
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Airline fuel context – correlation

Jet fuel price vs. airline stock prices: mixed bag correlation



Source: Market Watch; US Energy Information Administration.
Compiled by AirTrav Inc (Toronto).

ARCA Index – Jet Fuel correlation

- ARCA: Top Americas airline equities
- ARCA ↔ Jet Fuel not always tight
- Correlation tightens when oil price velocity exceeds average
- Extended periods of high oil prices suppress earnings


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IATA forecast – traffic and P&L

2025F versus: 2024E & 2019					
(USD Billions, nominal)					
	2025F	2024E	% 2025/24	2019	% 2024/19
Change in:					
Capacity (ASKs)			+7.4%		+11.9%
Traffic (RPKs)			+8.0%		+13.0%
Pax load factor %			+0.4 pts		+0.8 pts
Op revenues	\$ 1,007	\$ 965	+4%	\$838	+20%
Op expenses	\$ 940	\$ 903	+4%	\$795	+18%
Operating profit	\$ 67.5	\$ 61.4	+10%	\$43.1	+57%
Net Profit	\$ 36.6	\$ 31.5	+16%	\$26.4	+39%
ROIC	6.8%	6.6%	+0.2 pts	+5.8%	+ 1 pt

Source: IATA Economics

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IATA forecast – fuel & other opex

2025F versus: 2024E & 2019

(USD Billions, nominal)

	2025F	2024E	% 2025/24	2019	% 2024/19
Jet fuel \$/barrel	\$87	\$99	(12%)	\$80	+9%
Fuel	\$248	\$261	(5%)	\$190	+31%
- % of revenues	25%	27%	(2 pts)	23%	+2 pts
Labor	\$253	\$235	+8%	\$180	+41%
All other opex	\$439	\$407	+8%	\$425	+3%
Total non-fuel opex	\$692	\$643	+19%	\$605	+7%

Source: IATA Economics

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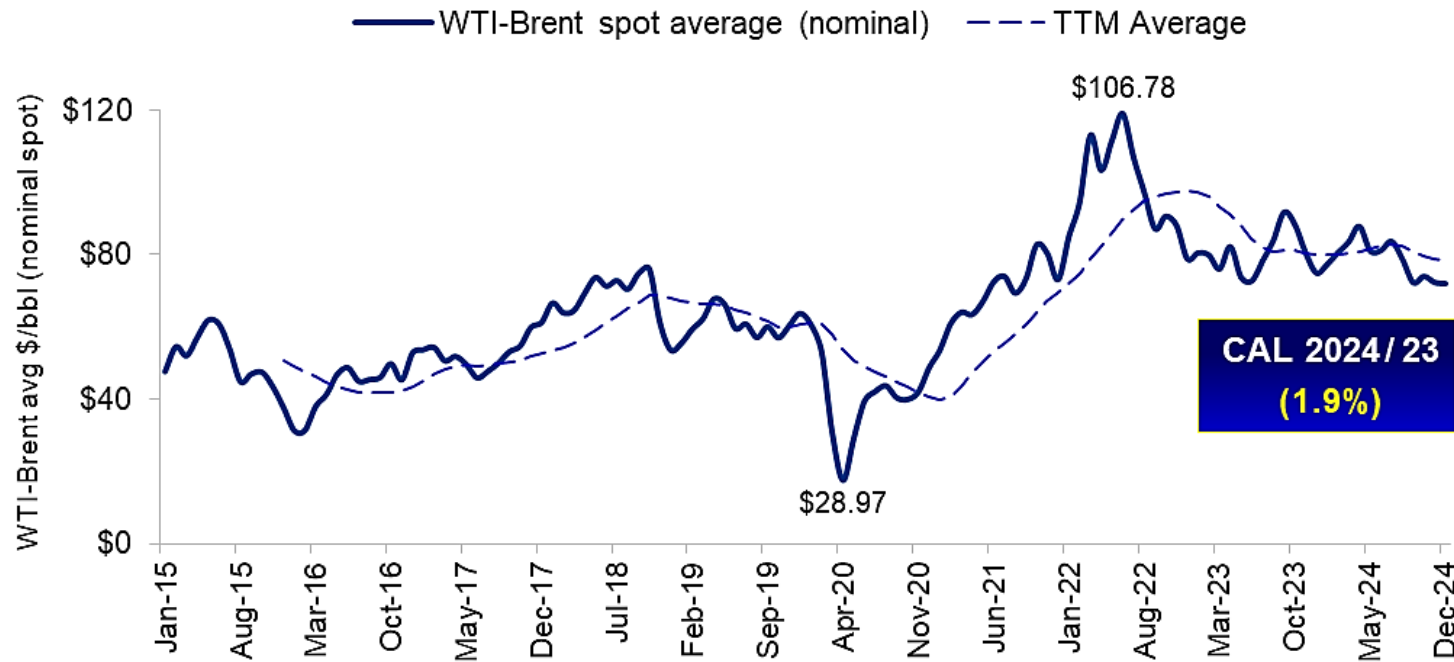
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Crude Oil prices – Y/Y trending down

10 Year WTI-Brent Oil Average
(nominal spot price, USD/bbl)



Source: U.S. Energy Information Administration.

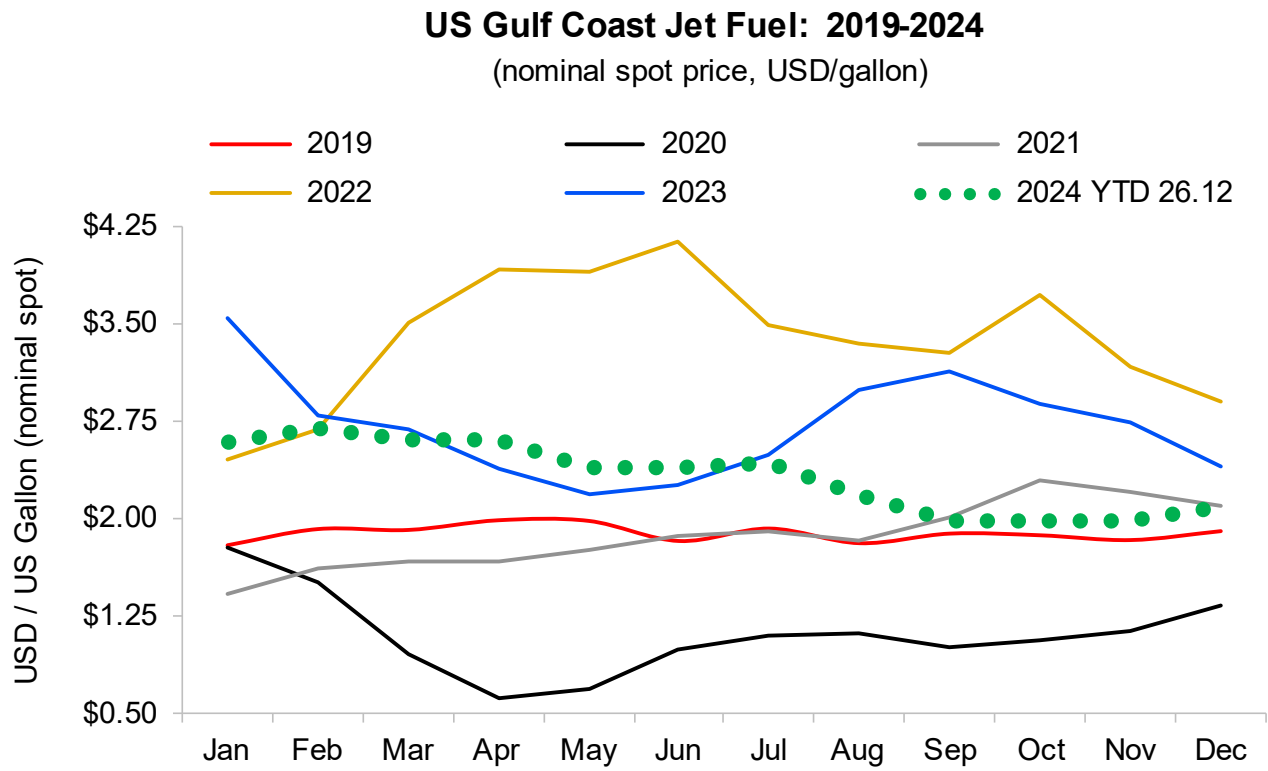
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Jet Fuel price – 2024 below 2023 after mid-year



Source: U.S. Energy Information Administration.

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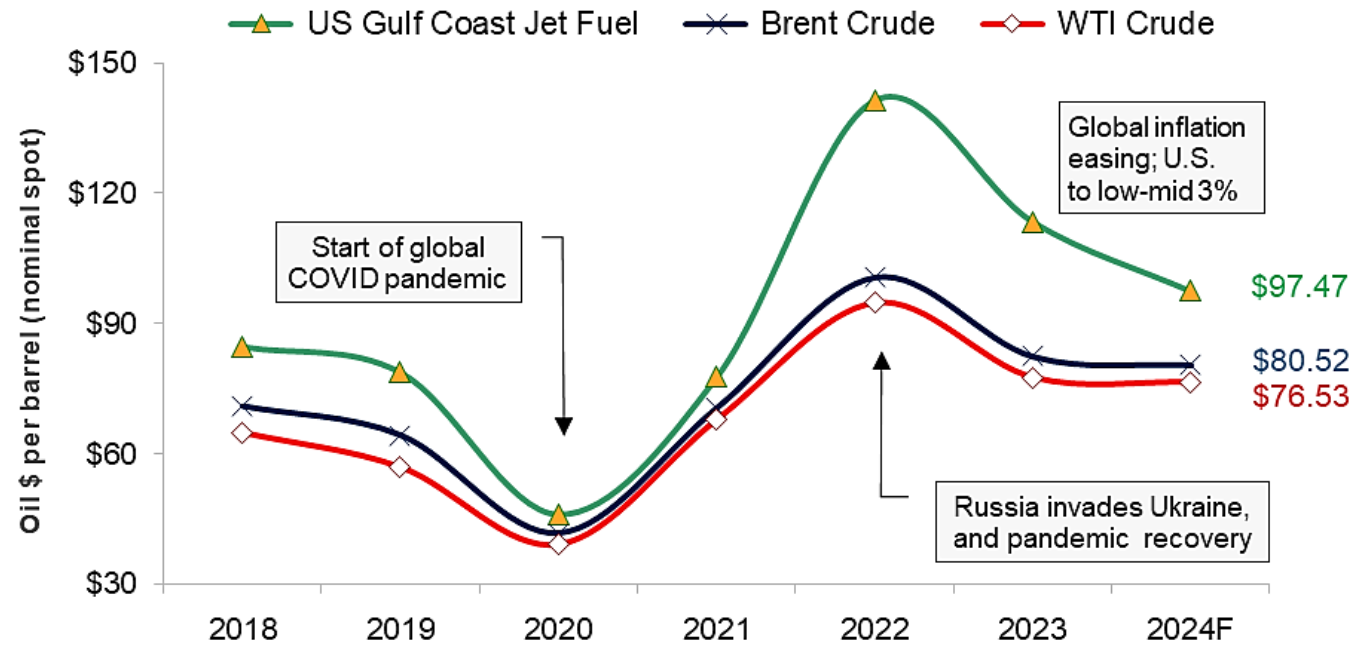
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Correlation – jet fuel *versus* crude oil

Jet Fuel versus Crude Oil, 2018-2024F
(nominal spot USD/bbl)



Source: U.S. Energy Information Administration.

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U.S. EIA* – short-term forecast @ 10.DEC.2024

! Falling prices forecast in 2025, but Crack Spread UP

CAL 2025	Spot USD per barrel	% 2025/24
USGC Jet Kero	\$94.87	(5.0%)
WTI Crude Oil	\$69.12	(9.7%)
Brent Crude Oil	\$73.58	(8.6%)
Jet-avg Oil crack	\$17.12	+9.9%

* EIA is the United States Energy Information Administration and is part of the U.S. Department of Energy. In the early part of each month, the EIA publishes a short-term outlook of consumption, demand, and prices across all energy types for the current year and past three years, and a forecast for the next year.

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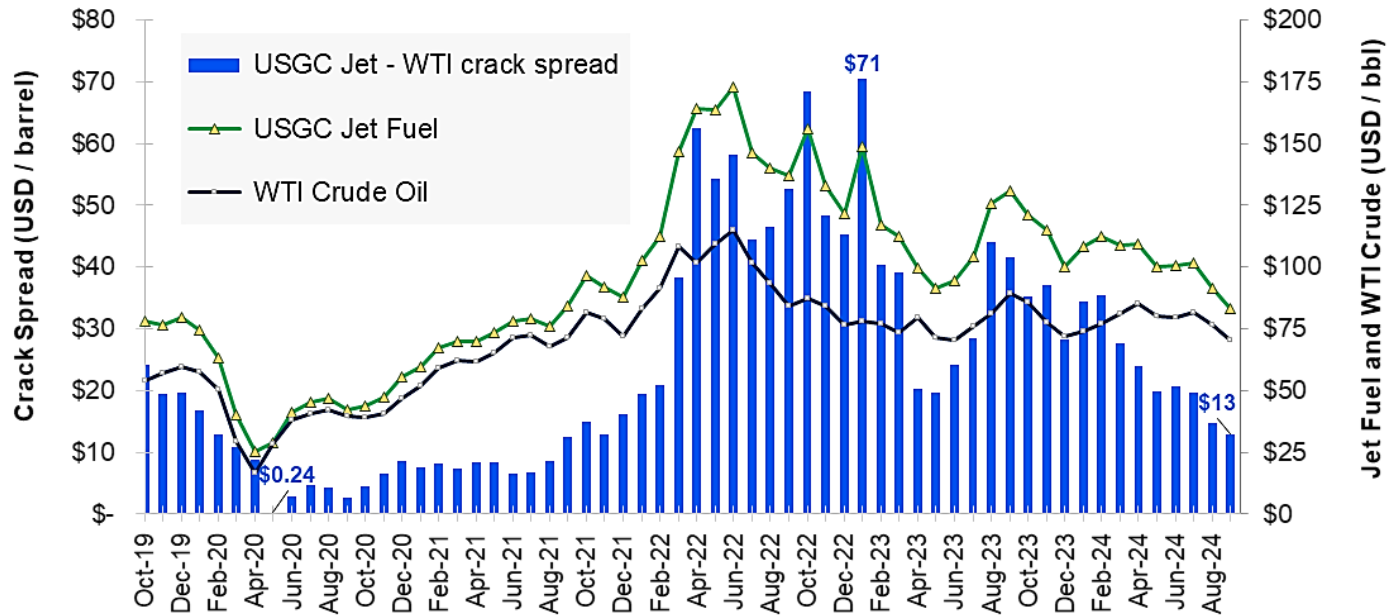


Crack spreads – widened in 2022, narrowing now

U.S. Jet-Crude Crack Spreads, Oct19-Sep24 (nominal spot, USD/bbl)

Back to and below to historic range following COVID volatility

Pre-Covid, Jan10-Dec19, crack average = \$20/bbl



Crack spreads

- Refinery margins: oil vs. refined products
- Jet-Oil crack varies with market dynamics
- WTI vs. Brent: usually close correlation, with WTI trading at a discount to Brent
- Changes in the WTI-Brent relationship can challenge Jet-WTI hedging

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Airline fuel context : effective risk management supports asset finance

- 
- Protects and improves cash flow
 - Frees up cash for debt repayment
 - Strengthens financial results
 - Improves asset financing terms with lower cost of capital
 - Enhances credit ratings & risk spreads
 - Supports financing of PDP's and deposits

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Airline coverage ratios differ – AirTrav fuel hedging survey, 11 May 2024

Region	Airlines	Fuel Hedge Ratio	Period	FY Ending	Region	Airlines	Fuel Hedge Ratio	Period	FY Ending	Region	Airlines	Fuel Hedge Ratio	Period	FY Ending
EUROPE					AMERICAS					ASIA-PACIFIC				
	Air France-KLM	67%	FY24	31-Dec		Air Canada	30%	3Q23	31-Dec		Air Asia	0%		31-Dec
		22%	FY25			Transat - up to:	75%	FY24	31-Dec		Air New Zealand	75%	2H24	30-Jun
	easyJet	69%	2H24	30-Sep		LATAM	34%	2Q-4Q24	31-Dec			40%	1H25	
		43%	1H25			Southwest	58%	FY24	31-Dec		Cathay Pacific	38%	FY23	31-Dec
	IAG - network carriers, up to	60%	First 12 mths	31-Dec			47%	FY25			EVA Air	0%		31-Dec
	IAG - LCC, up to:	75%	First 12 mths	31-Dec			26%	FY26			Japan Airlines	35%	FY24	31-Dec
	Icelandair	46%	2Q-4Q24	31-Dec		Other US airlines	0%		31-Dec			20%	FY25	
		13%	FY25								Qantas	80%	2H24	30-Jun
	Lufthansa Group	80%	FY24	31-Dec	MIDDLE EAST / ARABIAN GULF					INDIAN SUBCONTINENT				
	Ryanair	65%	FY25	31-Mar		Emirates	N/A				Air India	20%		31-Mar
	SAS	0%	FY24	31-Oct		Etihad	N/A				IndiGo	0%		31-Mar
	Turkish Airlines	20%	4Q23	31-Dec		Gulf Air	N/A				Pakistan Airways	0%		31-Dec
	Wizz Air	62%	4Q23	31-Mar		Qatar Airways	N/A							
		37%	FY25			Royal Jordanian	N/A							

Sources: Airline investor relations & newswire reports. Compiled by AirTrav Inc. (Toronto)

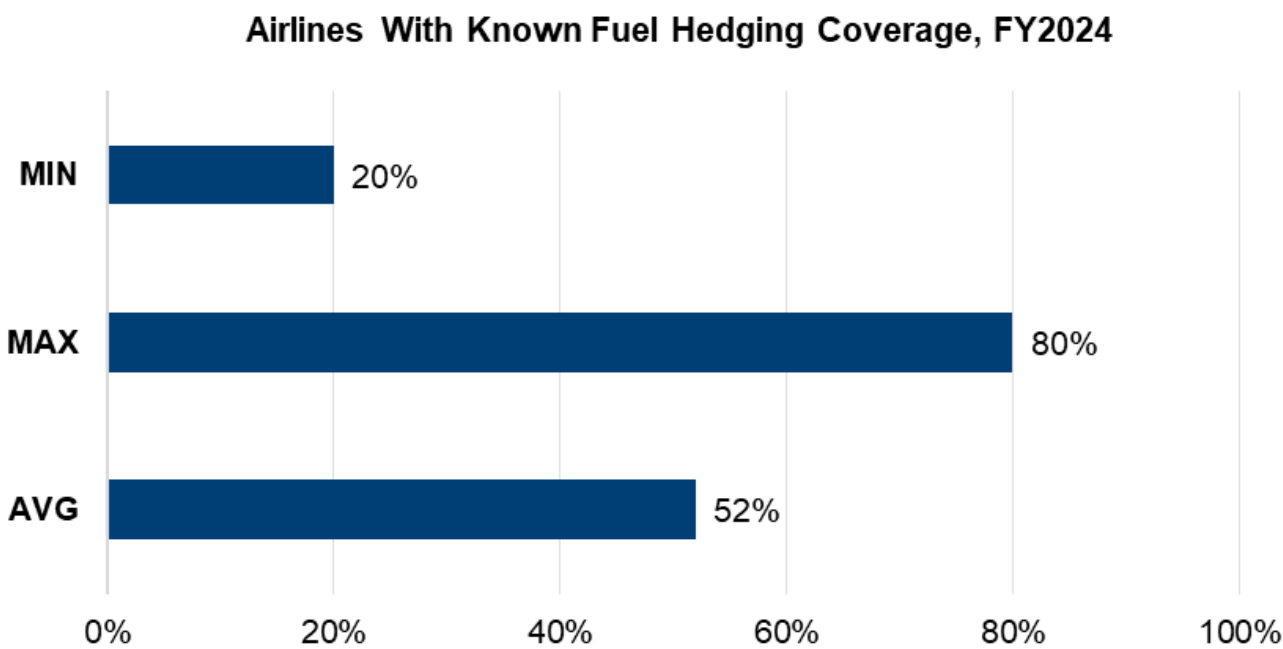
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Composite coverage – AirTrav fuel hedging survey, 11 May 2024



Source: Airline investor relations and newswire reports. Compiled by AirTrav Inc. (Toronto).
Excludes airlines where only guidance levels are published (i.e., min-mandatory and max-up to/discretionary).

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Hedging overview – what are hedging and derivatives?

○ Hedging

- For airlines it **mitigates exposure to rising/volatile fuel prices** (or other: forex, interest rates)
- Protect budgets/cash flow and smooths earnings
- Contracts involve **taking an opposite position** to that of a counterparty or investment
- **Derivatives** are a big part of hedging contracts

○ Derivatives

- Instruments whose **value is based on the price of an underlying entity**, such as a commodity (i.e., crude oil), foreign exchange, interest rate, or security
- Contract examples include **options, futures, swaps, and forwards**
- Can be contracted and **traded over-the counter (OTC)** or **exchange-traded**

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Hedging overview – two broad groups of derivatives

1. **Non-risk** derivatives :
 - Premium cost
 - Upside protection, downside participation
 - ✓ **Options**
2. **At-risk** derivatives :
 - Low or no premium cost
 - Upside protection, no downside participation
 - ✓ **Range protection (collars)**
 - ✓ **Caps (forwards, swaps and futures)**



Hedging overview – options

Approach	Examples	Description / Examples	Benefits	Drawbacks
Options	Calls	<ul style="list-style-type: none">- Gives buyers the option, but not obligation, to BUY a commodity at a certain price before option expiry- Call option sellers must sell the commodity if buyers exercises the Call	Upside protection	Pay (or receive) sunk cost premium
	Puts	<ul style="list-style-type: none">- Gives buyers the option, but not obligation, to SELL the commodity at a certain price before option expiry- Put option sellers must buy the commodity if buyers exercises the Put	Downside protection	Pay (or receive) sunk cost premium
	Collared options	Airline buys a call, sells a floor	Range protection via Call ceiling and Put floor Premiums paid and received mostly offset	If falling prices breach floor

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Hedging overview – options

Higher complexity vs. “vanilla” structures

- 3- and 4-ways

- Sell a further OTM **call** option to reduce the premium cost of the purchased call option
- Alternately, buy a further OTM **put** option to protect against rapid price drop in the underlying
- These are not without risk, but may make sense in certain market conditions

- Call/Put spreads – options with knock-outs, knock-ins, extendable dates, etc.

- Calendar spreads

- Crack spreads

- “Catastrophic” Calls – expensive as they are far OTM*, but useful in certain market conditions)

! Higher complexity options introduce risk that must be well understood and managed

* OTM stands for *Out-of-the-Money* options contract that only contains extrinsic (time) value, and little to no intrinsic (profitable) value. In contrast, options may be ITM, or *In-the-Money*.

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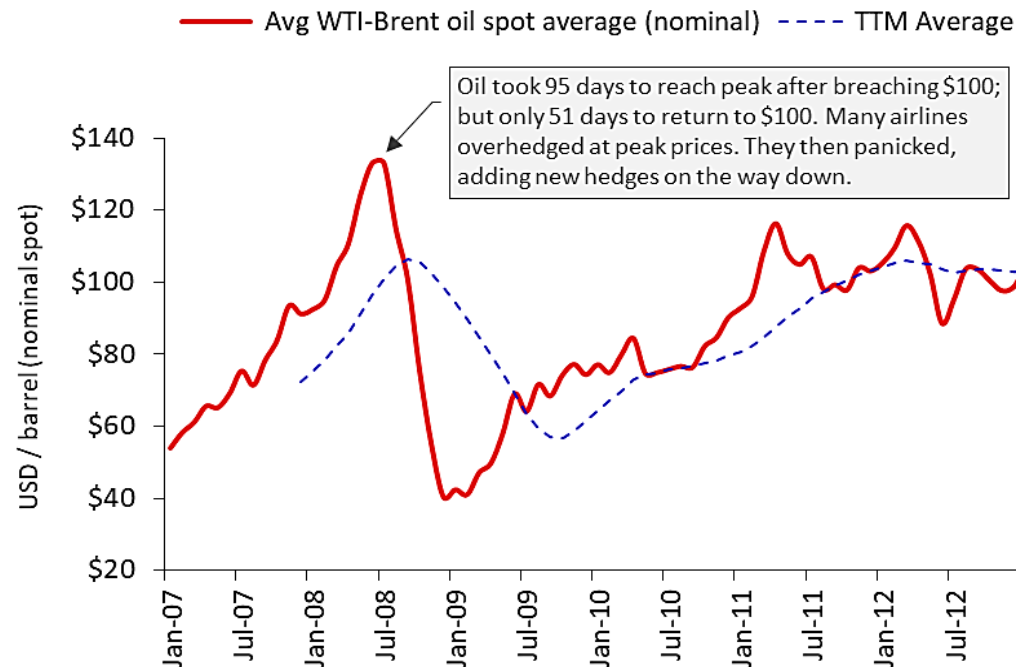
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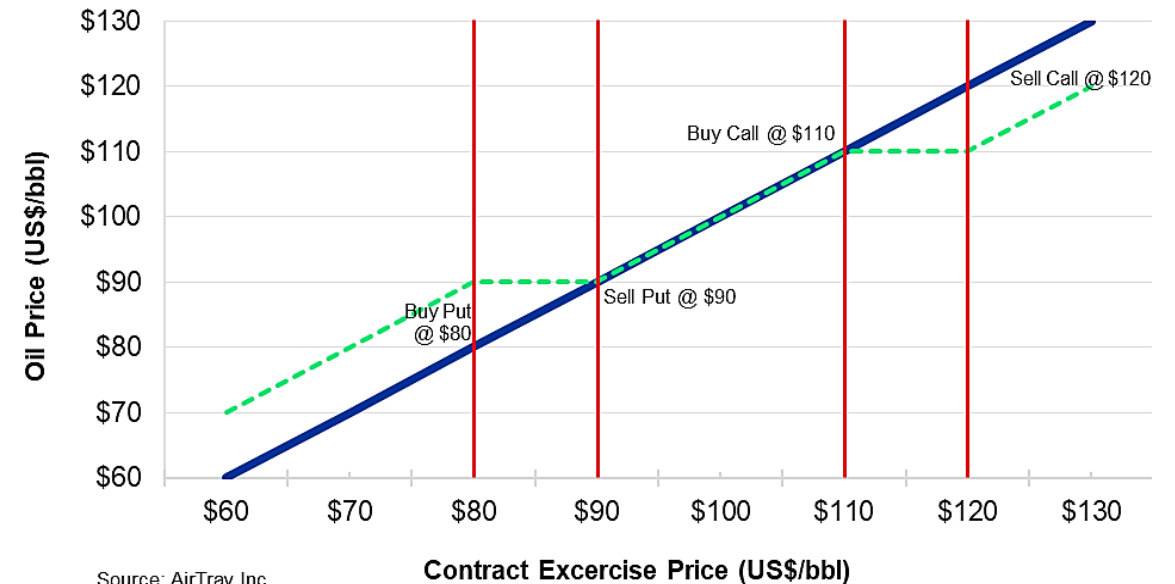


Hedging overview – options

Mid-2008 GFC and Oil Crash: Big Hedging Losses



Later Response: 4-way Collared Options



Source: AirTrav Inc.

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Hedging overview – swaps, forwards, and futures

Approach	Examples	Description / Examples	Benefits	Drawbacks
Caps	Swaps, forwards	Swap and forward contracts are similar with payments to a counterparties; however: <ul style="list-style-type: none">- Swaps: a series of future payments- Forwards: only one payment at maturity	Full protection against price escalation Customizable (date and amount)	Strike price removes downside participation (pay counterparty) Risk of counterparty default
Futures	Crude oil or gasoil contracts	Exchange traded contracts <ul style="list-style-type: none">- CME, DME, ICE, NYMEX Agreement to buy or sell at a set price and date in the future; cash settled or deliverable	Full upside price protection, longer tenor, liquidity, transparency, standardized contracts, less counterparty risk; fulfillment guaranteed	Strike price caps downside participation, initial + maintenance margin requirements, clearing fees, Replacement Risk Factor credit exposure on mark-to-market (MTM) instruments

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Hedging overview – forward curves

Backwardation (or “positive basis”)

- A contract is trading below the expected spot price at contract maturity (current spot price > futures price)
- Occurs when the difference between the forward price and the spot price is less than the cost of carry

Contango (or “negative basis”)

- The price of a forward or futures contract is trading above the expected spot price at contract maturity

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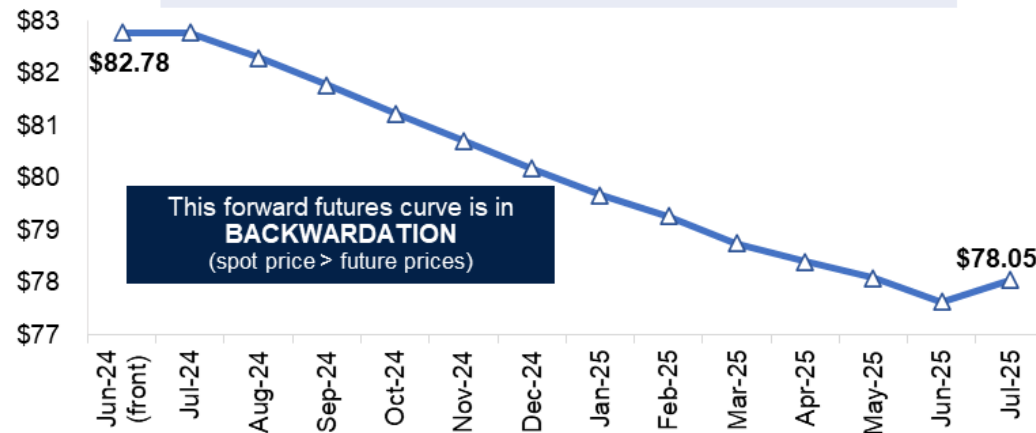


Hedging overview – Brent forward curve example

ICE Brent Crude Futures

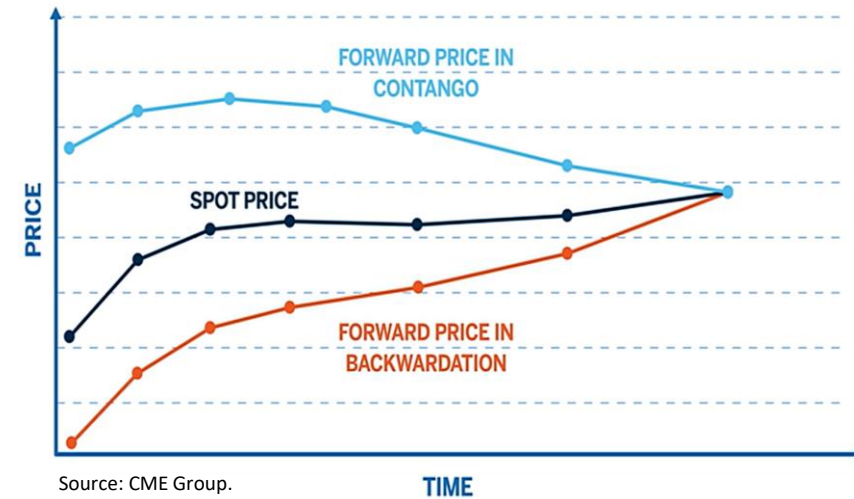
Closing day contract prices at of 10.May.2024 (US\$/bbl)

The ICE Brent Crude futures contract is a deliverable contract based on EFP delivery with an option to cash settle against the ICE Brent Index price for the last trading day of the futures contract. Contract size is 1,000 barrels.



Source: CME Group.

Over time, as the futures contract approaches maturity, the futures price will converge with the spot price.



Source: CME Group.

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Hedging perspectives and guidance – notable headlines, fuel price impacts

BAD

- “Asia Pacific airlines **hit** by \$3.2 billion **fuel hedging losses**”
EuroFinance, 26.01.2021
- “Airline **Stocks Tumble** Into Bear Market on **Soaring Oil** Prices”
Bloomberg, 15.09.2023
- “United Air Forecasts **Profit Miss** on **High Fuel** Costs, Israeli War”
BNN Bloomberg, 17.10.2023
- “**Rising jet** fuel costs could **cloud bumper earnings** of European airlines”
Reuters, 26.10.2023
- “Airline SAS posts Q4 **loss** as weak krona and **fuel costs bite**”
Reuters, 30.11.2023
- “Singapore Airlines **Shares Fall** After Quarterly Profit Miss Due **Higher Fuel** Costs”
Morningstar, 20.02.2024
- “American Airlines **Stock Falls** After **Jet Fuel Prices Increase**”
Forbes, 12.04.2024
- “**Fuel costs** might eat into Air Canada **earnings**”
The Motley Fool, 29.04.2024

GOOD

- “British Airways and Aer Lingus owner IAG sees **profits soar** as fuel costs cool”
Yahoo! Finance, 10.05.2024
- “**Low oil** prices **give airlines hope** for 2025”
Bangkok Post, 31.10.2024
- “Global Outlook for Air Transport: A **World with Lower Oil Prices?**”
IATA Economics, 19.12.2024

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Hedging perspectives and guidance – some airline actions during oil spikes & crashes

- Repeated past market mistakes
- Coverage was too high, or too low
- Tried to time the market, or stop/start a hedging program
- Over-use of long dated instruments
- Over reliance on *at-risk* instruments – range protection (collars) and caps (swaps and futures)
- Over complexity of program
- Rush to restructure portfolios – including reduction, suspension, or cancellation of hedging

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Hedging perspectives and guidance – some airlines reduce or stop hedging

- Poor results
- Market conditions
- Program cost (i.e., option premiums)
- Fiscal capacity
- Over-complexity
- Management attention
- IFRS hedge accounting
- All the above

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Hedging perspectives and guidance – every airline has different capabilities

- Financial health (risk capacity, including premium budget)
- Risk appetite (Board governance, competitor matching)
- Cash flow & financing needs (i.e., PDPs, LT Debt payments)
- SME (knowledge, experience and sophistication)

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Hedging perspectives and guidance – every airline has different objectives

- Smooth earnings and cash flow volatilities
- Improve budgeting and forecasting accuracy
- Build in cost certainty and lower fuel expense
- Handle double exposure of fuel & forex (non-US carriers)
- Strengthen credit rating
- Other

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Hedging perspectives and guidance

Pre-requisites for success



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Hedging perspectives and guidance – pre-requisites for success

1. **Accept :** Hedging is not speculative, treat it like insurance – sunk cost, no free lunch
2. **Balance :** Risk vs Return
 - The *riskier* the techniques – lower hedging program cost
 - The more *conservative* the techniques – higher hedging program cost
3. **Optimize :** Coverage – as the forward curve and market conditions
4. **Adapt :** Portfolio structure – be patient and keep Risk Mgt policy focused, but be nimble enough to vary instruments, tenor, and hedge ratio as market conditions change

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Hedging perspectives and guidance

- “If we don’t hedge jet fuel price risk, we are speculating ...
It is our fiduciary duty to try and hedge this risk.”

(S. Topping, former VP & Treasurer, Southwest Airlines / former CFO Hawaiian Airlines)

- “To not hedge your airline’s top operating expense ...
is like taking the ultimate short view of the market ...
that prices will either be staying the same or decreasing.”

(R. Kokonis, President & Managing Director, AirTrav)




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Airline hedging programs: **AirTrav 10-step “Health Check”**

1. Risk appetite – question and quantify
2. Fiscal capacity & financial health – review financials and forecasts
3. Risk management committee – staff capabilities, complexity handling
4. Risk management policy – budget, accounting, instruments, underlying, tenor, hedge ratio, basis risk, automation
5. Synchronize policies – fuel and forex hedging
6. Corporate governance – program oversight and limits
7. Counterparties – sufficiency and diversification
8. Benchmark – current or potential program versus peers
9. Enterprise risk management – how do fuel/forex hedging fit in?
10. Post-visit report – structured recommendations and strategies

! Our Philosophy

No transactional “skin in the game”
Unbiased/neutral third-party view

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Thank you

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