

# AIRLINE FUEL HEDGING

Hedging relevance to asset financing

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

 AIRLINE ECONOMICS

# SINGAPORE

GROWTH FRONTIERS CONFERENCE

**4-6 NOVEMBER 2024**

THE RITZ-CARLTON, MILLENIA SINGAPORE

# Airline Fuel Hedging

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## Agenda



### Introduction to AirTrav

- Airline-fuel context
- Recent pricing and forecasts
- Hedging overview
- Hedging perspectives and guidance
- AirTrav “health check” reviews – hedging and fuel procurement



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



## 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 & MRO

Evaluations, inspections, and mandated aircraft search 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

- 32 years in aviation, fuel management, travel- distribution/-management/-tech
- Operational finance and fuel/carbon expert
- Experienced with network, regional, LCC, ULCC, and cargo airline businesses
- Acknowledged expert by A-list media: BBC, Bloomberg, CNBC, Financial Post, SKIES, WSJ
- Conference speaker globally





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## Introduction to AirTrav – fuel management practice



*Serving airlines, airports, governments, maritime and roadhaul operators, military, pipeline and trade associations*

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, ESG, SAF uptake agreements, hydrogen analytics, net zero


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# Airline fuel context

## Hedging relevance to asset financing

- Strengthen financial results
- Protect and improve cash flow
- Accelerate long-term debt repayment
- Support financing of PDP's and deposits
- Improve credit ratings & risk-based spreads





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## Airline fuel context – impact of price changes

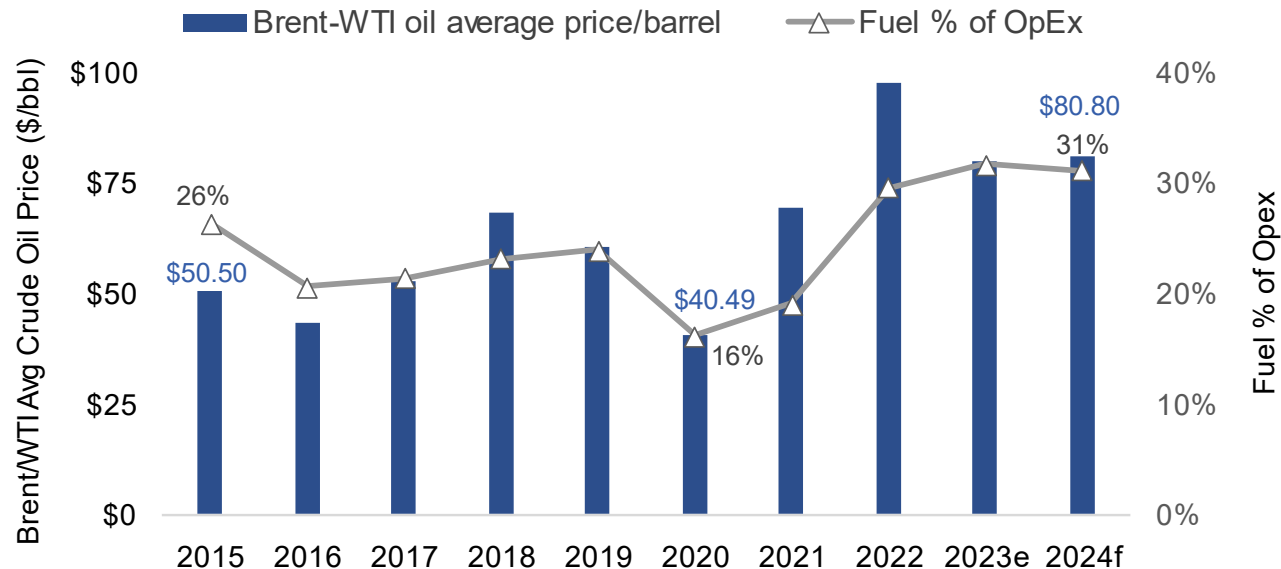
- International Air Transport Association (IATA)
  - 320 airline members in some 120 countries carry 83% of global airline traffic
  - In 2023, fuel accounted for ~**32%** percent of airline opex
  - Every **\$1/bbl change** in fuel prices impacts IATA members ~**\$2.2 billion** (greater if including non-IATA)



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**Aircraft fuel has averaged 24% of airline opex over the last 10 years (nominal)**



**AIRTRAV** INC.  
INTERNATIONAL AVIATION ADVISORY

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## Airline fuel context – IATA airlines, 2024 forecast

2024F versus 2019 (USD Billions, nominal)				
	2024f	2019	Change	% change
Revenues	\$996	\$838	\$158	+19%
Fuel*	\$271	\$190	\$81	+43%
- % of revenues	27%	23%		+4 pts
Non-Fuel opex	\$645	\$605	\$40	+7%
Operating profit	\$59.9	\$43.2	\$16.7	+39%
Net Profit	\$30.5	\$26.4	\$4.1	+16%
ROIC	5.7%	+5.8%		(0.1%)

\* 2024F adjusted by AirTrav per Oct24 vs. Jun24 change in U.S. EIA short-term jet fuel forecast

# Airline Fuel Hedging

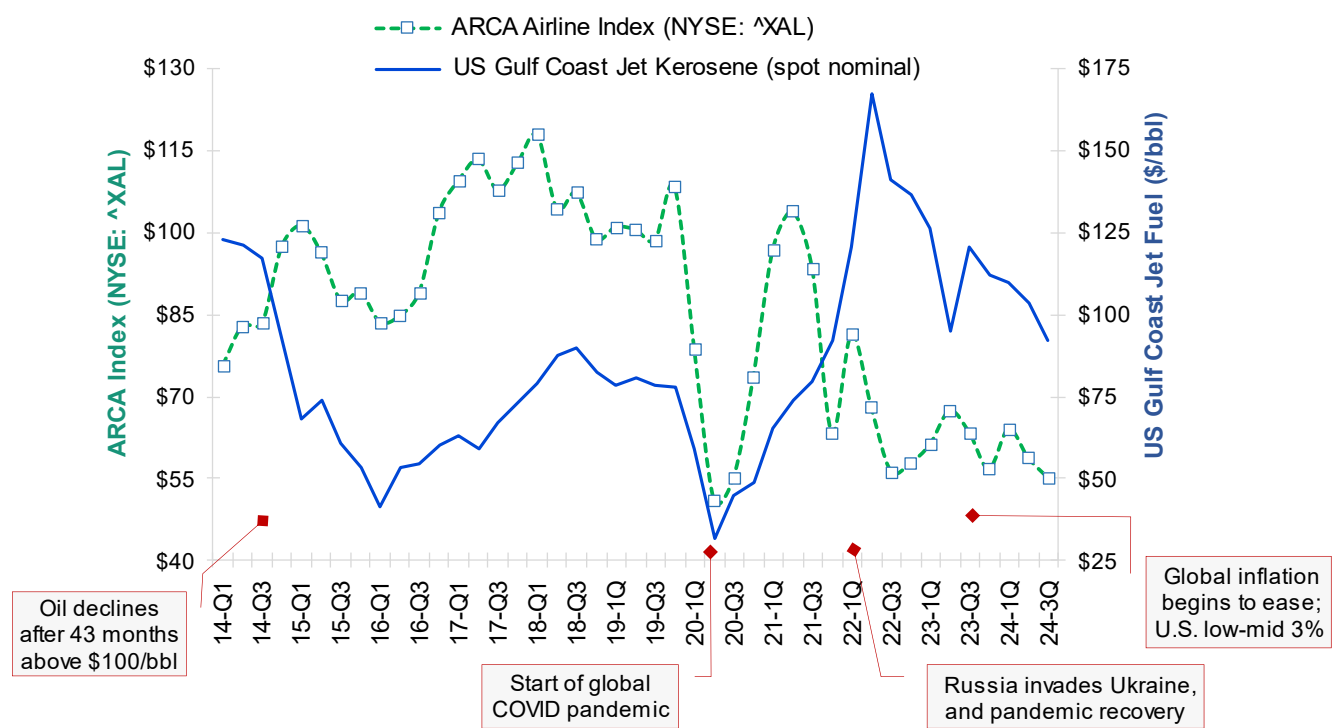
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## Airline fuel context – fuel prices vs. airline stocks – geopolitical shocks

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



XAL-Jet **correlation** not always tight

Correlation tightens when oil price velocity > average

Extended periods of high oil prices tend to suppress earnings

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




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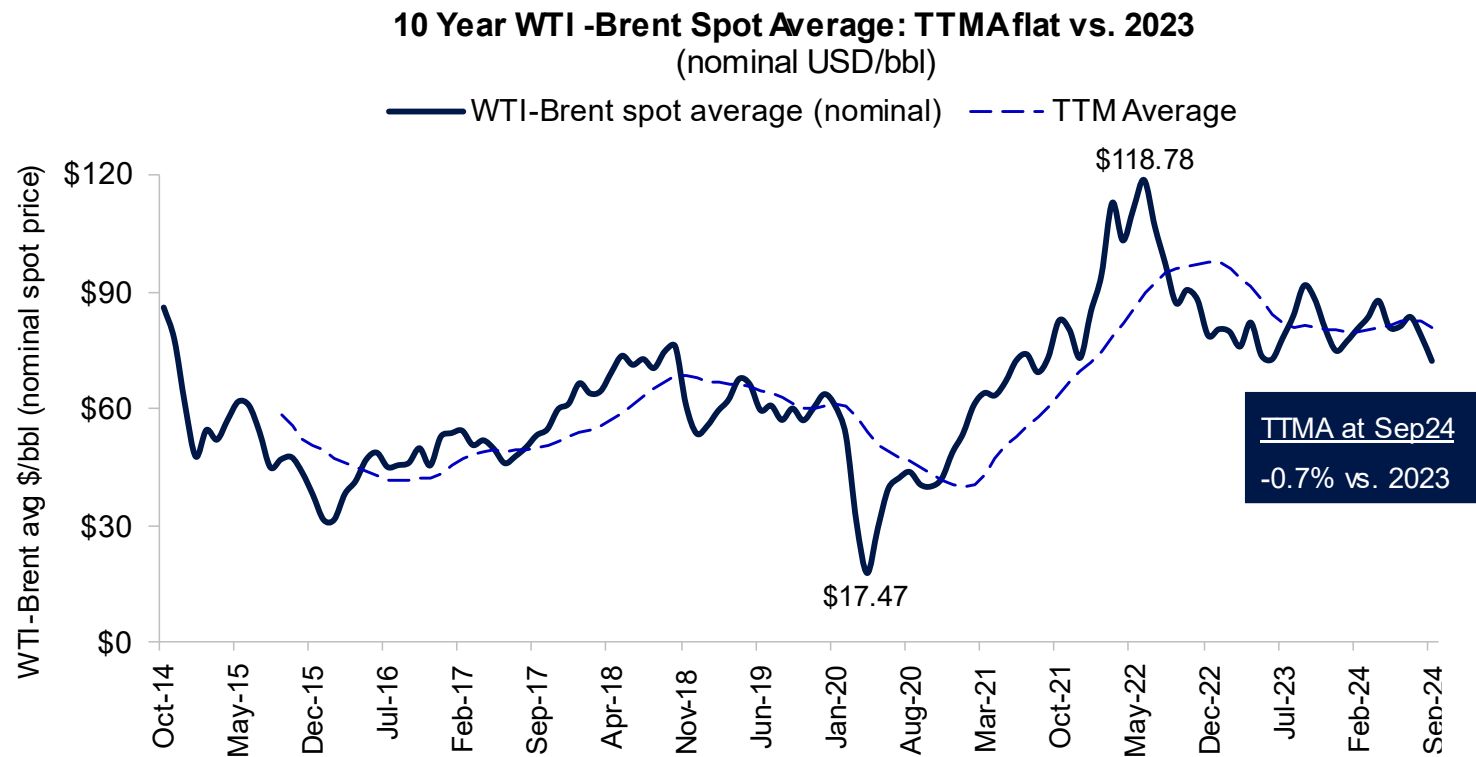
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## Crude oil TTMA Sep 2024: flat Y/Y



Source: U.S. Energy Information Administration.

### ! Middle East turmoil pushing up futures

- Brent surged 13% mid-Sept to mid-Oct, when conflict came to Lebanon
- Futures contracts will reflect degree of escalation between Israel and Iran

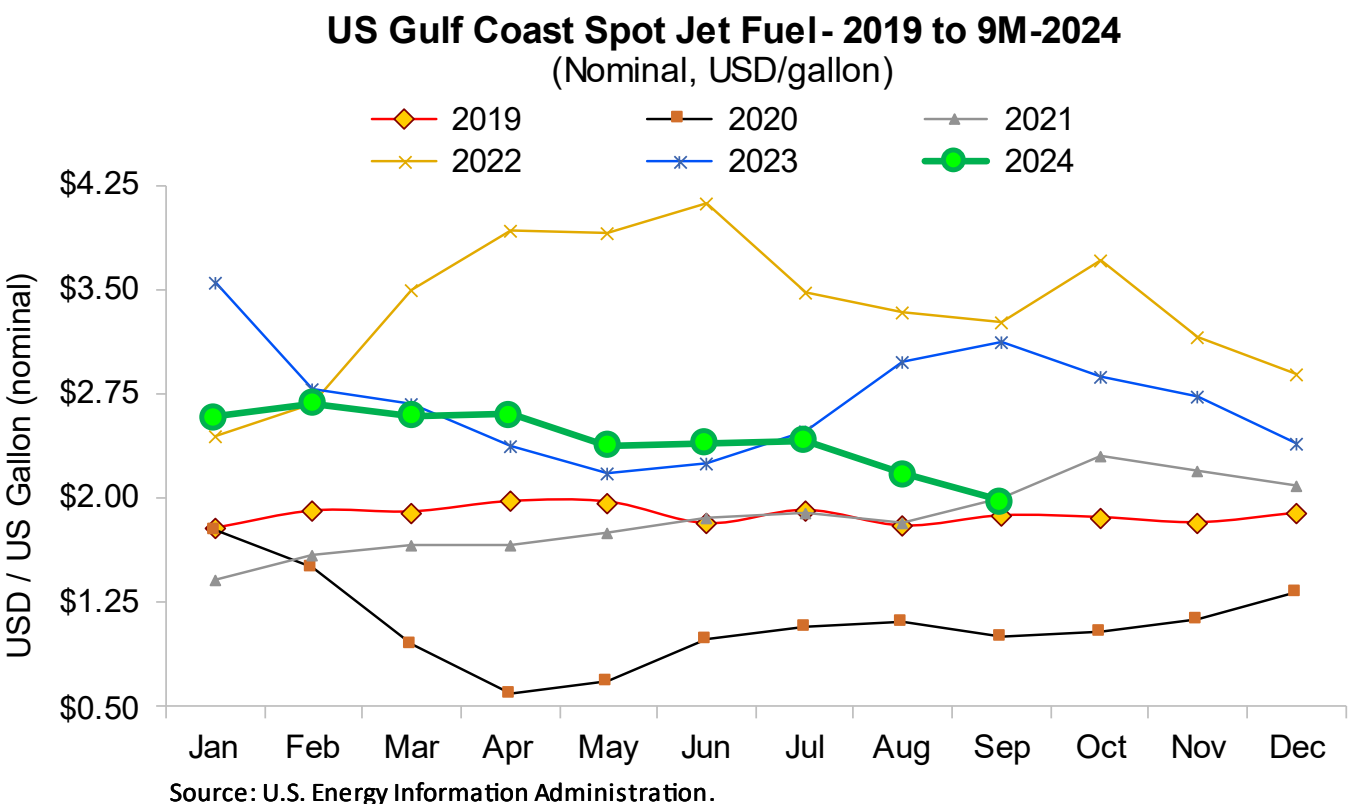
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## US Gulf Coast Jet Fuel: 2019 to Sep 2024





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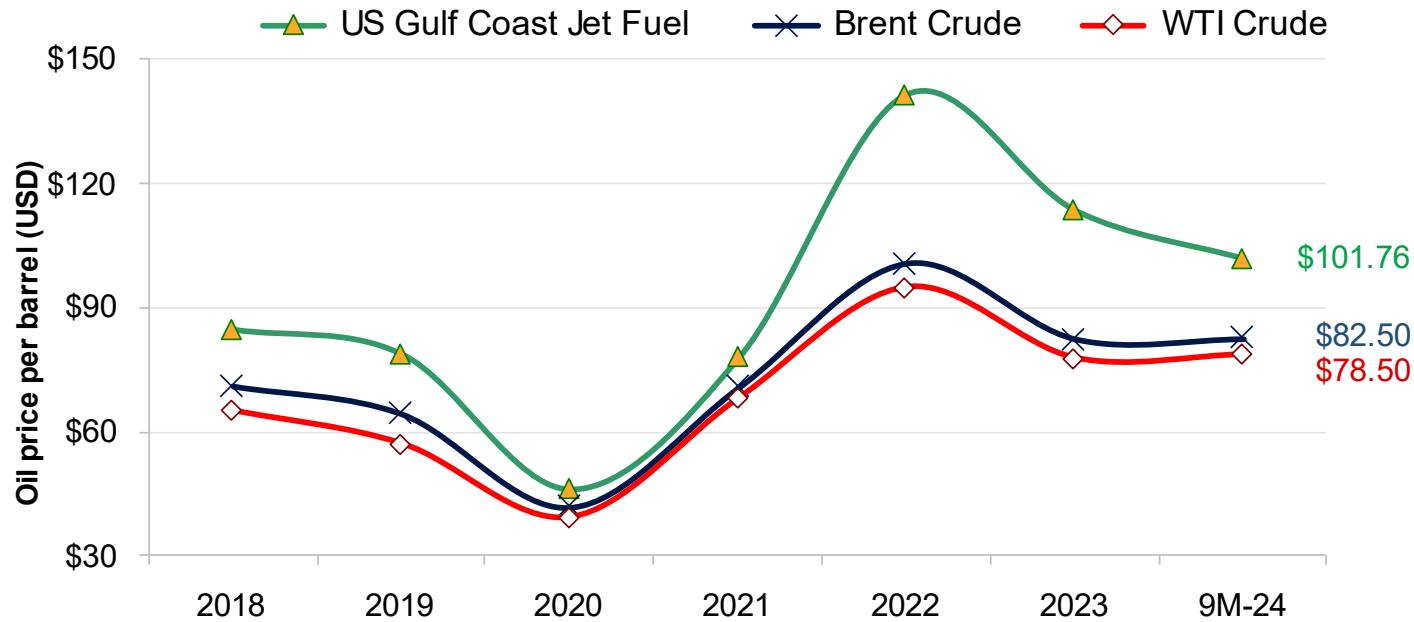
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## Correlation: jet fuel versus crude oil

Jet Fuel versus Crude Oil, 20181Q24  
(nominal spot USD/bbl)



Source: U.S. Energy Information Administration.

**Crack spreads\*** tighten and widen with changing market dynamics

WTI and Brent are closely correlated, though WTI trades at a discount to Brent

Changes in the WTI-Brent relationship can pose challenges to Jet-WTI hedging

\* Crack spreads also known as the *refinery margin*

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## U.S. EIA: **Year 2025** forecast at 08-Oct-2024

! Expectations for falling spot prices in 2025

CAL 2025	Spot USD per barrel	2025/24
USGC Jet Kero	\$90.25	(8.9%)
WTI Crude Oil	\$73.13	(4.9%)
Brent Crude Oil	\$77.59	(4.1%)
US jet-oil crack	\$17.12	(22.7%)

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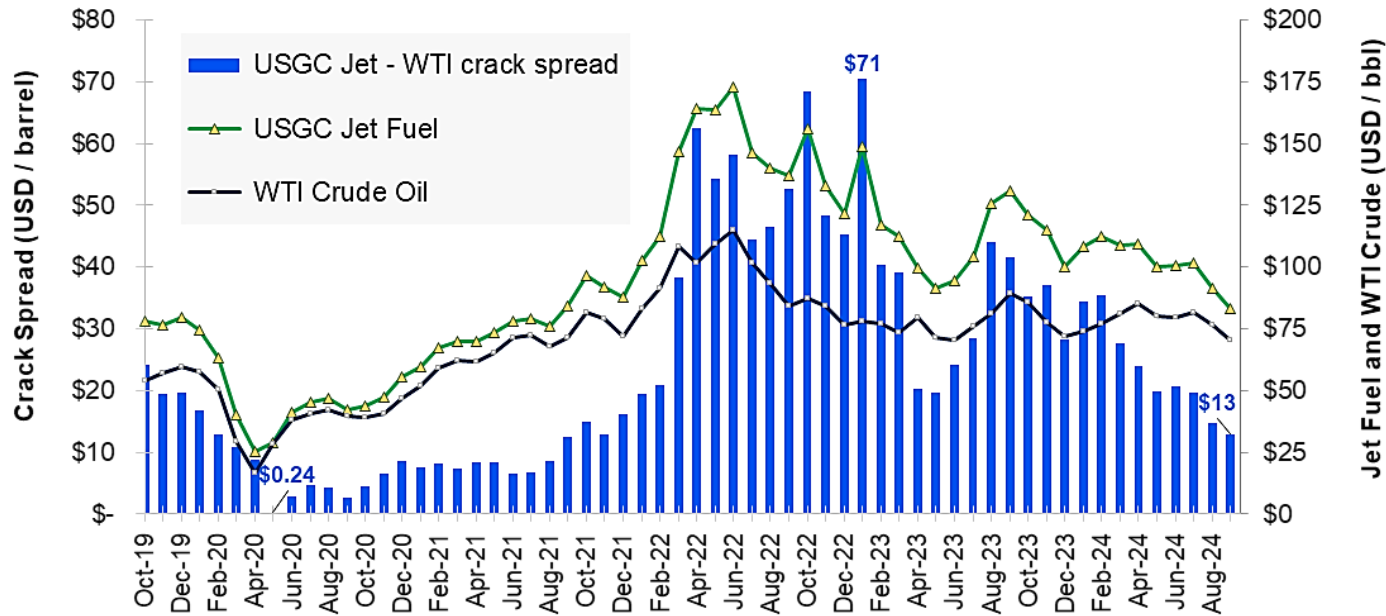


## Narrowing *crack spreads* that widened in early 2022

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



Source: U.S. Energy Information Administration.

Hedging is challenged by price volatility, wider cracks, and other market fundamentals

Some airlines **stopped hedging\*** due to:

- (1) Poor results, or (2) Market conditions, or
- (3) Program mgt cost, or (4) Fiscal capacity, or
- (5) IFRS hedge accounting, or (6) All the above

\* i.e., Alaska Airlines stopped fuel hedging 02/24



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## Hedging overview – Asia-Pacific jet fuel/kerosene news\*

### “Asia jet fuel remains King of the Barrel” : Versus Dubai swaps, jet swap cracks valued > gasoil swap cracks

- Tightness in the Asian jet fuel/kerosene complex pushed the product to remain the king of the barrel, as the FOB Singapore jet fuel/kerosene swap crack against front-month Dubai swaps maintained its lead over that of co-distillate 10ppm sulfur gasoil for eight consecutive trading sessions.
  - Platts assessed the FOB Singapore jet fuel swap crack against front-month Dubai swaps – a measure of the product's relative strength to the crude it was refined from – at \$14.29/bbl at the Asian close Oct. 23.
  - In comparison, the ultra-low sulfur gasoil swap crack versus front-month Dubai Swaps was \$13.74/bbl since Oct. 14
- This reflects tightness in the Northeast Asia net fuel market.
- Regional demand remains strong on the back of buying interest from North Asia, further bolstering prices.
- Jet fuel price strength may not last as cargoes arrive from India and the Middle East, amid poor arbitrage economics to send barrels to the West, and this will likely disincentivize refiners from tilting the production of gasoil to jet fuel.

Source: S&P Global Commodity Insights, 24 Oct 2024

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Coverage ratios differ between airlines that hedge fuel: below survey taken on 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)

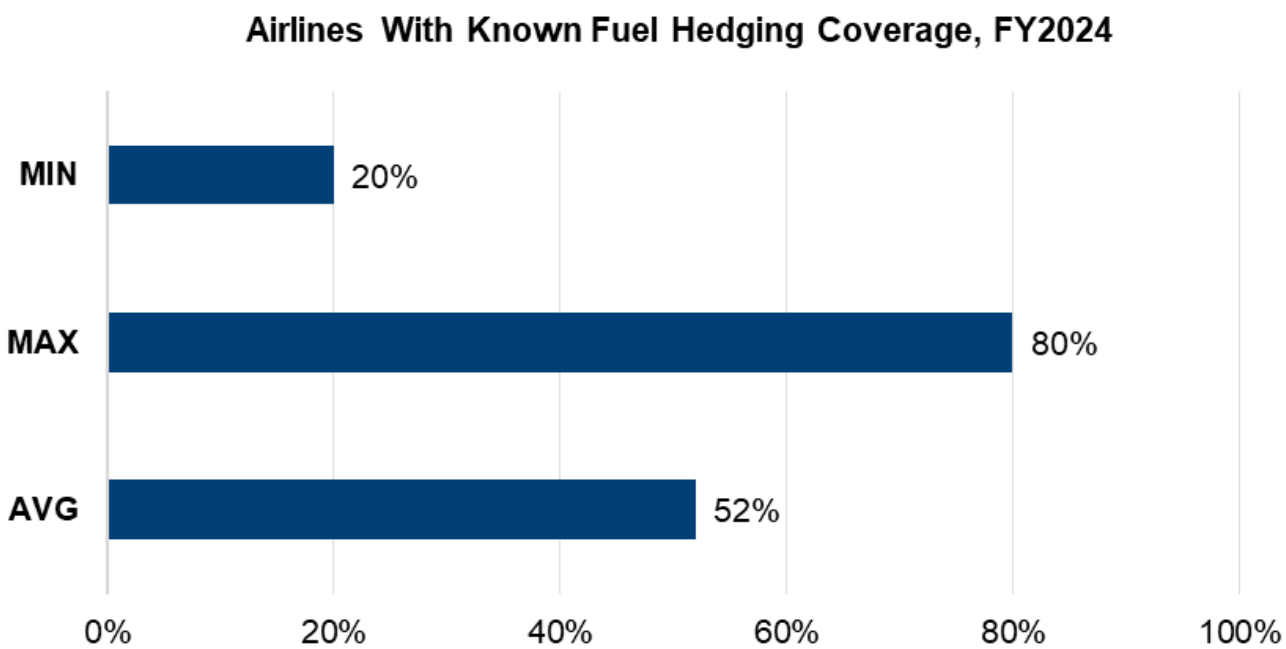
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## Survey – 2024 airline fuel hedging ratios (taken on 11 May 2024)



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 perspectives and guidance
  - AirTrav “health check” reviews – hedging and fuel procurement

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## Hedging overview – what is hedging?

- **Derivatives** – contracts that derives value from performance of an underlying entity, such as a commodity (i.e., crude oil), foreign exchange, or interest rate
- Derivatives can be used to **insure against price movements** – otherwise known as hedging
- Airline fuel hedging can **reduce exposure** to fuel price escalation and volatility
- Derivatives can be contracted and traded **over-the counter (OTC)** or **exchange-traded**

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## Hedging overview – key basic instruments – options and caps

Derivative	Examples	Benefits	Costs
Options	Calls, puts	Full upside/downside protection	Walk away – pay sunk cost premium
	Collared options	Range protection (call & put)	If falling prices breach floor
Caps	Forwards, swaps	Full upside protection	Strike price caps downside participation (pay counterparty)
Futures	Exchange traded	Full upside price protection, longer tenor, transparency, liquidity, standardized contracts, less counterparty risk; fulfillment guaranteed	Strike price caps downside participation, fees and margin maintenance, credit exposure due Replacement Risk Factor on mark-to-market (MTM) instruments



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## Hedging overview – options

Buyers pay a sunk-cost premium, which is received by the seller. Two vanilla types:

- **Call option** – gives buyers the option, but not obligation, to buy a commodity at a certain price before expiry
  - The call option seller must sell the commodity if the buyer exercises the call
  - Premium costs could be lower than the cost of fixed rate swaps
- **Put option** – gives buyers the option, but not obligation, to sell the commodity at a certain price before expiry
  - The put option seller must buy the commodity if the buyer exercises the call
- American and European options have different settlement characteristics

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## Hedging overview – options

- AirTrav advises airlines to hold a few “**catastrophic call**” options
- These far OTM\* options are expensive
- Bullish oil options were being traded at a record pace in the lead up to Israel’s April 19th attack on Iran
  - Calls at \$100 and \$110 were the most held options contracts in next 12 months for Brent crude (source: ICE Futures Europe)
  - Israel’s limited response meant that oil did not spike as expected – option premiums were peace-of-mind insurance

\* 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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## Hedging overview – options

### Collared “costless” options

- Provide range protection – airline purchases a call (ceiling) and sells a put (floor)
- Premium paid for the call offset by premium received for selling the put
- Not always “costless”, if rapidly dropping prices break through the floor (i.e., 2008-09 GFC)



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## Hedging overview – options

### Higher complexity 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
  - 3-way and 4-way collars 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 spread options

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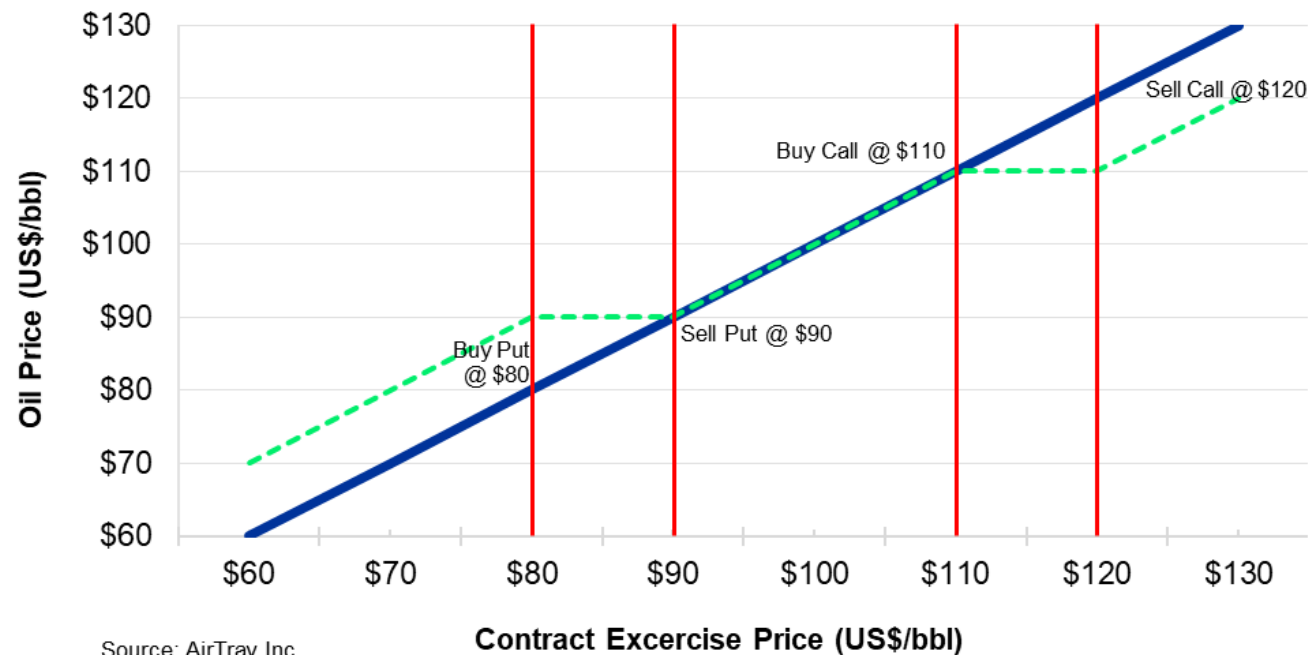
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## Hedging overview – options

Sample Four-Way Collar Option Instrument - Airline Perspective



### ! More complex than vanilla

- 4-way and 3-way collared options can be effective instruments.
- But they introduce risk that must be well understood and managed.

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## Hedging overview – swaps and forwards

### Swaps and forwards – alternatives to options

- A **swap** contract is like a forward contract, involving a series of future payments
- A **forward** has only a single payment at maturity
- Full protection provided against price escalation, but there are risks:
  - Trade potential downside enjoyment for fixed price security | Risk of counterparty default



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## Hedging overview – futures

### Exchange-traded futures (i.e., CME, DME, ICE, NYMEX)

#### ○ Benefits

- Protect against price escalation, like swaps and forwards
- Deep markets, longer tenor, narrow bid-ask spreads, price transparency, higher liquidity
- Standardized contracts and less counterparty risk; fulfillment guaranteed via options clearing corp (OCC)

#### ○ Drawbacks

- Strike price caps participation in downside price movement
- Clearing fees and margin maintenance accounts
- Incur credit exposure due Replacement Risk Factor 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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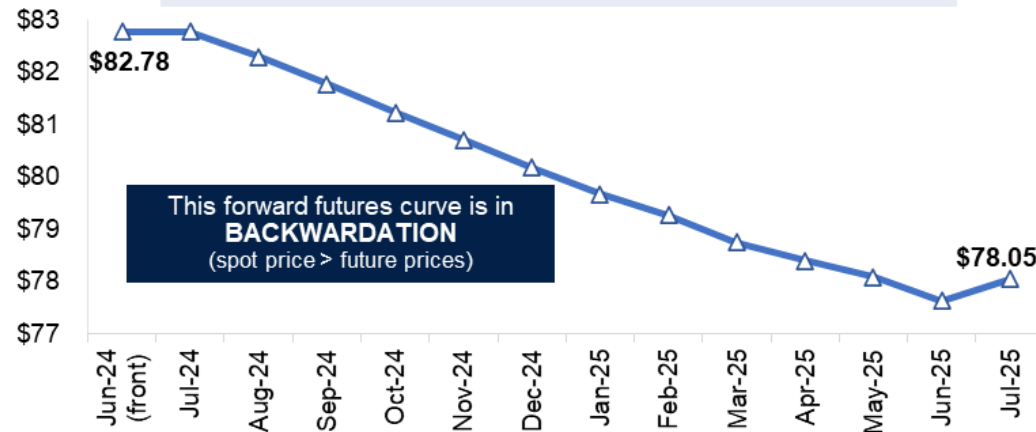


## Hedging overview – Brent forward curve example

### ICE Brent Crude Futures

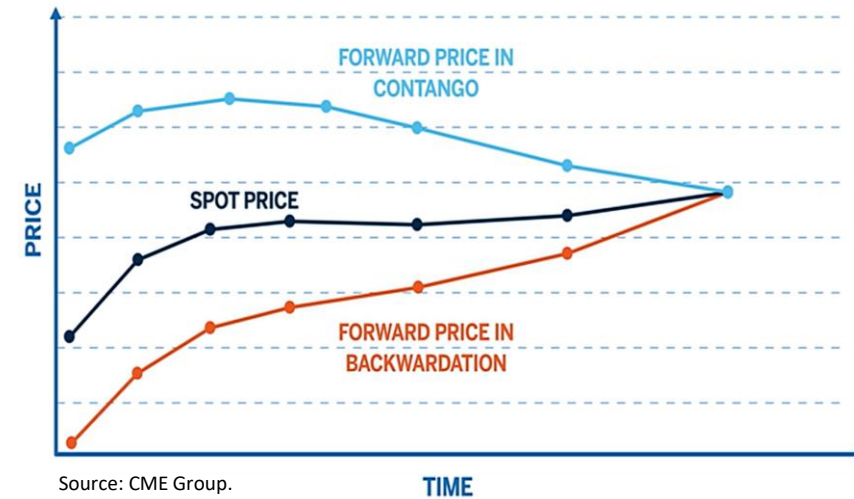
Closing day contract prices at of 10.May.2024 (US\$/bbl)

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

The Bad

- “Asia Pacific airlines **hit** by \$3.2 billion **fuel hedging losses**”
- “Airline Stocks **Tumble** Into Bear Market on Soaring Oil Prices”
- “United Air Forecasts Profit Miss on **High Fuel** Costs, Israeli War”
- “**Rising jet** fuel costs could cloud European airlines' bumper earnings”
- “Airline SAS posts Q4 loss as **fuel costs**, weak crown bite”
- “Singapore Airlines Shares Fall After Quarterly Profit Miss Due **Higher Fuel** Costs”
- “Australia’s Qantas flags **higher** 2023-24 jet **fuel costs**”
- “American Airlines Stock Falls After **Jet Fuel** Prices **Increase**”
- “**Fuel costs** might eat into Air Canada **earnings**”

*EuroFinance, 26.01.2021*

*Bloomberg, 15.09.2023*

*BNN Bloomberg, 17.10.2023*

*Reuters, 26.10.2023*

*Reuters, 30.11.2023*

*Morningstar, 20.02.2024*

*Argus, 21.02.2024*

*Forbes, 12.04.2024*

*The Motley Fool, 29.04.2024*

The Good

- “British Airways owner IAG sees **profits soar** as fuel costs cool”
- “**Low oil** prices **give airlines hope** for 2025”

*Yahoo! Finance, 10.05.2024*

*Bangkok Post, 31.10.2024*

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## Hedging perspectives and guidance

### Example of hedging actions during prior crises oil price spikes and crashes

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

Hedging is challenged by price volatility, wider cracks, and other market fundamentals

Some airlines **stopped hedging\*** due to:

- (1) Poor results, or (2) Market conditions, or
- (3) Program mgt cost, or (4) Fiscal capacity, or
- (5) IFRS hedge accounting, or (6) All the above

\* i.e., Alaska Airlines stopped fuel hedging 02/24



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## Hedging perspectives and guidance

### Reasons why some airlines reduce or stop hedging

1. Poor results
2. Market conditions
3. Over-complexity
4. Program management attention
5. Premium costs
6. Fiscal capacity
7. IFRS hedge accounting
8. Or all the above

Example: Alaska Airlines stopped fuel hedging 02/24

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1.02	British Pound	1.02
1.05	US Dollar	1.05
1.36	Euro	1.36
1.00	Japanese Yen	1.00
7.12	Chinese Yuan	7.12

## Hedging perspectives and guidance

### Every airline has different **capabilities**

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

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## Hedging perspectives and guidance

**Every airline has different objectives** – these should vary with market conditions

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



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## Hedging perspectives and guidance

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 evolves
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
2. Fiscal capacity & financial health
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

# Airline Fuel Hedging

AIRLINE ECONOMICS. GROWTH FRONTIERS

05 Nov 2024 ■ The Ritz Carlton Millenia, Singapore



Thank you

**Robert J. Kokonis**

President & Managing Director, AirTrav Inc.

Affiliate Canada, ICF Aviation

B +1 289-346-0071 | M +1 416-726-0722 | [rkokonis@airtrav.com](mailto:rkokonis@airtrav.com)

181 Bay Street, PO 30025, Toronto, ON M5J 0A5 CANADA

[airtrav.com](http://airtrav.com) | [icf.com/work/transportation/aviation](http://icf.com/work/transportation/aviation)

