MFIF

Minutemen Fixed Income Fund

United Airlines, Inc. (NASDAQ: UAL)

Analyst: Jeff Formica

We recommend an overweight position on UAL's 4.875% 2025 senior notes. UAL is a legacy airline operating 4,900 flights/day on a hub-and-spoke model in which local airports (spokes) offer air transportation to central airports (hubs) where long-distance flights are available. Due to high anticipated capital expenditures in 2020 (~$7bn) and delays in the Boeing 737 MAX recertification, we do not believe that UAL's credit quality will improve until after year-end. That being said, we maintain a positive view of the company's credit in the long term. UAL's 25s have been impacted by several exogenous factors in the airline industry, chiefly the grounding of the 737 MAX plane and the recent impact of the Coronavirus. We believe that the price depreciation from the coronavirus (25s widened ~44bps) is unjustified, as jet fuel prices boost margins even if Asian Pacific revenue takes a hit. Furthermore, we believe that when the MAX returns to UAL schedules in September, the company will be able to make headway on gauge and CASM improvement plans that have been put on hold in the short term. For the above reasons, we expect UAL's 25s to tighten relative to industry peers.

Capitalization Table

United Airlines Capitalization Table					
Outstanding Debt Metrics and Leverage					
Type of Debt	**Rate**	**Debt Outstanding ($MM)**	**xLTM EBITDA**	**Price**	**YTW**
First Lien Loans					
UAL TL B 1L 4/1/24	3.442%	$1,474.00		N/A	3.401%
Total 1st Lien Secured Loans		**1,579.00**	**0.24x**		
1st Lien Secured Bonds					
UAL 4.15 4/11/24	4.150%	512.00		$106.61	2.474%
UAL 4.3 8/15/25	4.300%	524.00		109.05	2.564%
UAL 4 4/11/26	4.000%	553.00		107.67	2.676%
Total 1st Lien Secured Bonds		**7,675.29**	**1.38x**		
2nd Lien Secured Bonds					
UAL 3.45 7/7/28	3.450%	281.34		105.61	2.746%
Total 2nd Lien Secured Bonds		**1,665.97**	**1.63x**		
3rd Lien Secured Bonds					
UAL 3.65 1/7/26	3.650%	214.09		103.17	3.091%
Total 3rd Lien Secured Bonds		**617.22**	**1.72x**		
Senior Unsecured Bonds					
UAL 6 12/1/20	6.000%	300.00		102.87	2.328%
4.25 10/1/22	4.250%	400.00		104.25	2.593%
UAL 2/1/24	5.000%	300.00		107.44	3.066%
UAL 4.875 1/15/25	**4.875%**	**350.00**		**107.03**	**3.384%**
Total Senior Unsecured Bonds		**1,350.00**	**1.92x**		
Municipal Bonds					
13050RAA0 7/15/29	4.000%	249.90		$118.65	1.829%
Total Municipal Bonds		**2,675.33**			
Total Debt Outstanding		**15,562.81**	**2.32x**		
Market Capitalization		20,220.00			
Less: Cash		2,762.00			
Enterprise Value		**$33,020.81**	**4.92x**		

Bond Data

Bond Maturity: 01/15/25
Rating: Ba3/BB
Price: $107.029
YTW: 3.305%
Security Type: Bullet
Coupon: 4.875%
Rank: Senior Unsecured
Z-Spread: 199.5

Contents

Caveat: Credit Quality Improvements Delayed Until 2021 and Beyond

Although we are bullish on long term prospects for the company, UAL's credit quality will likely fail to improve in the short term. UAL management has guided high capital expenditures in 2020 at ~$7bn (compare with ~$5bn net CapEx in 2019) as the company invests heavily in their fleet. UAL plans to take delivery of 15 Boeing 787s and 2 777s, as well as some 737 MAX planes (which, if delayed further, will extend some of that $7bn figure into next year). This high CapEx figure limits cash generation and debt serviceability in the near term. Furthermore, gauge growth and profitability improvements are heavily tied to the return of the 737 MAX, which remains out of schedules until Q4 of this year. After year-end 2020, when UAL begins to reap the benefits of these investments, we expect that margin and profitability improvements will cause the 25s to tighten relative to industry peers like DAL. With these delays, it is difficult to foresee exactly when investors will begin to buy in to UAL's 25s, but given the current price depreciation associated with the Coronavirus, we maintain that now is a good buy in point.

Widening from Coronavirus Creates Good Entry Point

Since Coronavirus headlines gained steam on 1/17/20, UAL's 25s have widened ~44bps in response to flight suspensions in the Asian-Pacific region (specifically from mainland China). UAL has the most exposure to the region in comparison to other major U.S. airlines, at 4% capacity exposure to China as compared to DAL's 3% exposure and AAL's 2%. That being said, UAL's widening was significantly greater than other legacy carriers (DAL's 24s remained flat and AAL's 22s widened 24bps). UAL suspended flights between the U.S. and Beijing, Shanghai, and Chengdu until 4/24 as well as Hong Kong until 2/20, creating Q1 2020 RASM headwinds. However, we believe that RASM declines will be at least offset by a corresponding fall in kerosene jet fuel prices triggered by the same event. kerosene jet fuel spot prices have fallen ~17.6% YTD from $1.93 to $1.59, and WTI Crude has fallen ~12.1% from $61.18 to $53.78. UAL estimates that based on 2019 fuel consumption, a $1 change in the price of crude would equate to a $102mm change in the company's fuel expense. Based on these changes in fuel prices, we estimate that the Coronavirus will have a stronger impact on the company's CASM than their RASM and the 44bp widening from the event is therefore unjustified.

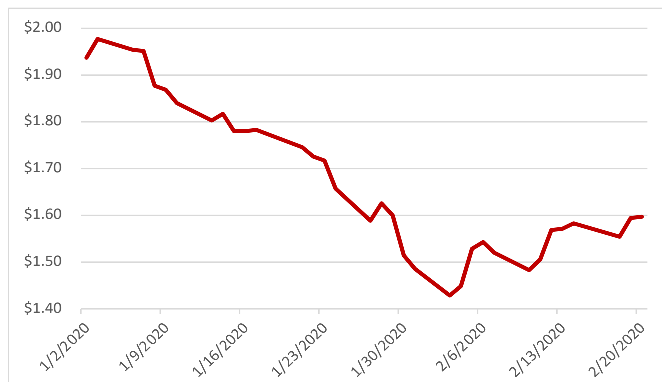
Risks

- UAL has outsized exposure to the Boeing 737 MAX as compared to legacy peers DAL and UAL
- MAX adoption by the airlines industry could create downward pressure on fares, causing greater than expected RASM headwinds.
- Coronavirus spreading outside of China could trigger flight suspensions to other destinations

Coronavirus Z-Spread Implications

Spread Widening Since 1/17			
UAL	DAL	LUV	AAL
44.40	3.47	5.99	44.32

YTD Kerosene Jet Fuel (/gal)



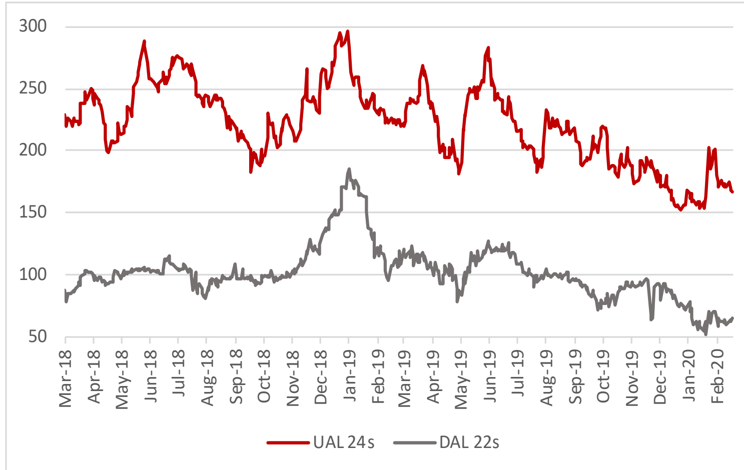
Comparable Company Metrics

	UAL 25s	DAL 24s	LUV 26s	AAL 22s
Revenue	43,259	47,000	22,426	45,768
Total Debt	15,562	17,225	3,996	33,444
EBITDA	6,715	9,199	4,350	6,023
Z-Spread (bps)	200	113	85	167
Rank	Sr. Unsec	Sr. Unsec	Sr. Unsec	Sr. Unsec
Rating	Ba3/BB	Baa3/BB+	A3/BBB-	B1/BB-
Debt/EBITDA	2.32x	1.87x	0.92x	5.55x
EBITDA/Interest	13.09x	33.93x	53.05x	5.19x
Spread/xLeverage	86.30	60.35	92.53	30.08

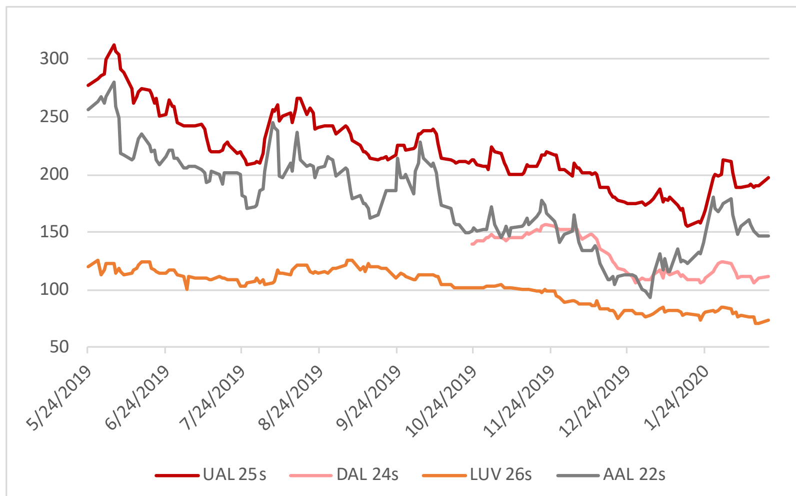
MAX Return to Drive Gauge Growth and CASM Improvements

The Boeing 737 MAX has been grounded since March 2019 after the jet's second fatal crash. Although the return of the jet has been delayed several times, we believe the current estimates of recertification by mid-2020 and a return to UAL schedules by 9/4 to be a reasonable timeline. UAL currently has 14 MAX jets and purchase agreements to integrate more of the aircraft into their fleet, as compared to UAL's main competitor, DAL, who does not fly the Boeing 737 MAX and has zero commitments to order the plane. We believe that the return of the MAX will provide significant CASM benefit for those airlines that fly it because the aircraft's larger size allows it to fit more passengers with comparatively small increases in the company's operating expenses. UAL in particular has the most to gain in this category because the company is so far behind in terms of gauge (UAL has approximately 13% fewer seats per departure compared to DAL), and the company announced a plan in January of 2018 to improve their gauge using the MAX plane. In our view, market prices of UAL's bonds do not reflect the potential CASM benefits, as the spread between UAL's 24s and DAL's 22s have only tightened ~20bps over the past two years since the plan was announced. We believe that when the MAX returns to service and UAL integrates this more cost-efficient plane into their fleet, UAL's 25s will tighten relative to DAL's notes.

UAL 24s and DAL 22s Z-Spread Comparison



Comparable Z-Spread



Relative Value

UAL's 25s are currently trading at ~200bps whereas their main competitor DAL's 24s are trading at roughly 113bps. Based on leverage alone, we UAL's yield more attractive (UAL has debt/EBITDA of ~2.3x vs. DAL's ~1.9x, implying ~86bps per turn of leverage for UAL and ~60bps for DAL). Furthermore, we find a more compelling story going forward with UAL, as the returning Boeing MAX plane will provide them with significant gauge and CASM improvements and we are anticipating a tightening of UAL's 25s as Coronavirus fears begin to fade.

Compared to AAL's 22s, UAL has a significantly stronger credit profile (AAL has ~5.6x debt/EBITDA and ~5.2x interest coverage, as compared to UAL's ~2.3x and ~13.1x. Even after adjusting for spread, UAL offers ~86bps per turn of leverage vs. AAL's ~30bps. That being said, AAL's notes mature 3 years earlier, providing less risk in that regard.

LUV is the safest investment out of these four carriers, with leverage of just ~0.9x and ~53x interest coverage. That being said, when adjusting for spread (LUV's 26s are trading at ~85bps), the company's bonds are roughly in line with UAL at ~92bps per turn of leverage. Based on UAL's business model (hub and spoke legacy carrier with strong mid-continent geographic positioning), we think that UAL has more pricing power in the event of diminishing fares with the industry adoption of the MAX, whereas LUV's low-cost carrier model is predicated almost entirely on price competition.

Summary Model

United Airlines (NASDAQ: UAL)

USD, Millions	FY 2016	FY 2017	FY 2018	FY 2019	Q1 2020E	Q2 2020E	Q3 2020E	Q4 2020 E	FY 2020E	FY 2021E	FY 2022E	FY 2023E
Income Statement												
Passenger Revenue	**$31,457.00**	**$32,404.00**	**$37,706.00**	**$39,625.00**	**$ 9,075.53**	**$10,907.28**	**$10,954.74**	**$10,381.97**	**$41,319.51**	**$43,051.98**	**$44,326.32**	**$45,418.97**
Cargo	876.00	1,035.00	1,237.00	1,179.00	285.22	342.79	344.28	326.28	1,298.57	1,353.02	1,393.07	1,427.41
Other Operating Revenue	4,223.00	4,297.00	2,360.00	2,455.00	567.93	682.56	685.53	649.69	2,585.71	2,694.12	2,773.87	2,842.24
Total Revenue	**36,556.00**	**37,736.00**	**41,303.00**	**43,259.00**	**9,928.68**	**11,932.62**	**11,984.55**	**11,357.94**	**45,203.79**	**47,099.13**	**48,493.26**	**49,688.62**
% Growth		*3.23%*	*9.45%*	*4.74%*	*3.54%*	*4.65%*	*5.31%*	*4.32%*	*4.50%*	*4.19%*	*2.96%*	*2.47%*
Operating Expenses:												
Salaries and Related Costs	10,275.00	11,045.00	11,458.00	12,071.00	2,771.90	3,331.36	3,345.86	3,170.92	12,620.05	12,491.73	12,861.49	13,178.52
Aircraft Fuel	5,813.00	6,913.00	9,307.00	8,953.00	1,930.59	2,320.24	2,459.80	2,404.81	9,115.45	9,870.51	10,162.68	10,413.19
Landing Fees and Other Rent	2,165.00	2,240.00	2,359.00	2,543.00	576.83	693.25	696.27	659.86	2,626.21	2,654.24	2,732.80	2,800.16
Regional Capacity Purchase	2,197.00	2,232.00	2,601.00	2,849.00								
Depreciation and Amortization	1,977.00	2,149.00	2,240.00	2,288.00	533.85	641.60	644.39	610.70	2,430.55	2,532.46	2,607.42	2,671.70
Other Operating Expenses	11,988.00	11,891.00	12,647.00	13,103.00	3,033.60	3,645.89	3,661.75	3,470.30	13,811.54	13,671.11	14,223.94	14,650.47
Total Operating Expenses	**32,218.00**	**34,238.00**	**38,011.00**	**38,958.00**	**8,846.77**	**10,632.35**	**10,808.08**	**10,316.60**	**40,603.81**	**41,220.06**	**42,588.34**	**43,714.05**
Operating Income	**4,338.00**	**3,498.00**	**3,292.00**	**4,301.00**	**1,081.91**	**1,300.27**	**1,176.47**	**1,041.34**	**4,599.99**	**5,879.07**	**5,904.92**	**5,974.57**
Operating Margin	*11.87%*	*9.27%*	*7.97%*	*9.94%*	*10.90%*	*10.90%*	*9.82%*	*9.17%*	*10.18%*	*12.48%*	*12.18%*	*12.02%*
Non Operating Expenses:												
Interest Expense, Capitalized, and Income	(500.00)	(502.00)	(558.00)	(513.00)	(141.35)	(146.21)	(146.21)	(151.06)	(584.83)	(625.63)	(625.63)	(625.63)
Miscellaneous	(19.00)	3.00	(76.00)	126.00	44.81	53.86	54.09	51.26	204.02	212.57	218.86	224.26
Total Non-Operating Expenses	**(519.00)**	**(499.00)**	**(634.00)**	**(387.00)**	**(96.54)**	**(92.35)**	**(92.12)**	**(99.80)**	**(380.81)**	**(413.06)**	**(406.77)**	**(401.37)**
Pretax Income	**3,819.00**	**2,999.00**	**2,658.00**	**3,914.00**	**985.37**	**1,207.92**	**1,084.35**	**941.54**	**4,219.18**	**5,466.01**	**5,498.16**	**5,573.20**
Income Tax Expense	1,556.00	868.00	529.00	905.00	208.74	255.89	229.71	199.45	893.79	1,157.92	1,164.72	1,180.62
Net Income	**2,263.00**	**2,131.00**	**2,129.00**	**3,009.00**	776.63	952.04	854.64	742.08	3,325.39	4,308.09	4,333.43	4,392.58
EBITDA	**$ 6,296.00**	**$ 5,650.00**	**$ 5,456.00**	**$ 6,715.00**	**$ 1,660.57**	**$ 1,995.73**	**$ 1,874.95**	**$ 1,703.30**	**$ 7,234.56**	**$ 8,624.10**	**$ 8,731.21**	**$ 8,870.53**
Balance Sheet												
Cash	$ 2,179.00	$ 1,482.00	$ 1,694.00	$ 2,762.00	$ 3,073.25	$ 3,436.24	$ 2,978.23	$ 832.63	$ 832.63	$ 1,238.38	$ 2,223.15	$ 3,511.85
Total Debt	**10,767.00**	**13,268.00**	**13,445.00**	**14,552.00**	**14,552.00**	**15,052.00**	**15,052.00**	**15,552.00**	**15,552.00**	**16,302.00**	**16,302.00**	**16,302.00**
Net Debt	$ 8,588.00	$ 11,786.00	$ 11,751.00	$ 11,790.00	$ 11,478.75	$ 11,615.76	$ 12,073.77	$ 14,719.37	$ 14,719.37	$ 15,063.62	$ 14,078.85	$ 12,790.15
Statement of Cash Flows												
Cash From Operating Activities	**$ 5,542.00**	**$ 3,413.00**	**$ 6,181.00**	**$ 6,909.00**	**$ 1,643.95**	**$ 1,975.75**	**$ 1,856.18**	**$ 1,686.25**	**$ 6,511.10**	**$ 7,761.69**	**$ 7,858.09**	**$ 7,983.47**
Capital Expenditures	(3,223.00)	(3,998.00)	(4,177.00)	(4,528.00)	(1,050.00)	(1,050.00)	(1,750.00)	(3,150.00)	(7,000.00)	(5,750.00)	(5,250.00)	(5,000.00)
Cash From Investing Activities	**(3,238.00)**	**(3,930.00)**	**(4,563.00)**	**(4,560.00)**	**(997.75)**	**(997.75)**	**(1,697.75)**	**(3,097.75)**	**(6,791.00)**	**(5,658.75)**	**(5,158.75)**	**(4,908.75)**
Payments of LT Debt	(1,215.00)	(901.00)	(1,235.00)	(1,240.00)	(326.23)	(337.43)	(337.43)	(348.64)	(1,349.74)	(1,397.75)	(1,411.07)	(1,424.38)
Proceeds from Issuance of LT Debt	808.00	2,765.00	1,740.00	1,847.00	469.50	485.63	485.63	501.76	1,942.52	1,793.50	1,883.18	1,977.33
Repurchases of Common Stock	(2,614.00)	(1,844.00)	(1,727.00)	(1,645.00)	(421.50)	(712.75)	(705.94)	(812.41)	(2,652.59)	(2,008.20)	(2,101.93)	(2,254.24)
Other	(198.00)	(217.00)	(188.00)	(242.00)	(56.72)	(50.46)	(58.71)	(74.82)	(240.70)	(84.74)	(84.74)	(84.74)
Cash From Financing Activities	**(3,213.00)**	**(195.00)**	**(1,410.00)**	**(1,280.00)**	**(334.95)**	**(615.01)**	**(616.45)**	**(734.11)**	**(2,300.52)**	**(1,697.19)**	**(1,714.56)**	**(1,786.02)**
Net Change in Cash	**(909.00)**	**(712.00)**	**208.00**	**1,069.00**	**311.25**	**362.99**	**(458.01)**	**(2,145.60)**	**(2,580.42)**	**405.75**	**984.78**	**1,288.70**
Free Cash Flow	**$ 2,319.00**	**$ (585.00)**	**$ 2,004.00**	**$ 2,381.00**	**$ 593.95**	**$ 925.75**	**$ 106.18**	**$ (1,463.75)**	**$ (488.90)**	**$ 2,011.69**	**$ 2,608.09**	**$ 2,983.47**
Credit Ratios												
Debt/LTM EBITDA	**1.71x**	**2.35x**	**2.46x**	**2.17x**	**1.99x**	**2.07x**	**2.12x**	**2.15x**	**2.15x**	**1.89x**	**1.87x**	**1.84x**
Net Debt/EBITDA	1.36x	2.09x	2.15x	1.76x	1.57x	1.60x	1.70x	2.03x	2.03x	1.75x	1.61x	1.44x
EBITDA/Interest	12.59x	11.25x	9.78x	13.09x	11.75x	13.65x	12.82x	11.28x	12.37x	13.78x	13.96x	14.18x
Industry Metrics												
RPM (millions)	186,181	193,444	230,155	239,360	54,955	65,191	67,226	60,951	248,975	262,046	272,528	282,067
ASM (millions)	224,692	234,576	275,262	284,999	67,943	75,803	78,079	73,880	296,399	311,219	323,668	334,996
Load Factor	82.9%	82.5%	83.6%	84.0%	80.9%	86.0%	86.1%	82.5%	84.0%	84.2%	84.2%	84.2%
PRASM (cents)	14.00	13.81	13.70	13.90	13.36	14.39	14.03	14.05	13.97	13.83	13.70	13.56
CASM (cents)	14.34	14.60	13.81	13.67	13.02	14.03	13.84	13.96	13.70	13.24	13.16	13.05