

U.S. Airlines

AMR v.8.0 - AAMRQ re-initiated at Overweight, with \$6.50 price target; LCC upgraded and PT also raised

The dynamics of claims recovery associated with the proposed LCC-AMR merger suggest that holders of AAMRQ (old AMR equity) could witness outsized potential gains under fairly plausible scenarios, in our view. Put differently, AAMRQ is best viewed as an attractive “option” (albeit a short-dated one) on LCC. Given the modest post-merger correction in LCC and increase of our 2013 PT from \$18 to \$18.50, return potential now warrants an upgrade to Overweight. However, should LCC sustain our price target during the 120-day distribution of new equity, we estimate AAMRQ equity could more than double in value from current levels. We are re-initiating with an OW-rating on AAMRQ with a \$6.50 price target.

- **We'll start with the simple stuff** – Last month, we downgraded LCC from OW to Neutral, believing shares adequately reflected a pending merger with LCC's value portion not expected to top 27%. Two things have happened since: LCC's value portion emerged at 28% and shares sold off modestly (-12% from the recent 8-Jan-13 peak vs. S&P 500 +3.9%) as some chose to short LCC as a hedge on AMR credit. While there are no changes to our model, the blend of 28% value, 5.2x stand-alone EV/EBITDAR and 7x P/E nudges our price target from \$18 to \$18.50 and our rating rises to Overweight.
- **Here's where it gets interesting** – AAMRQ is best viewed as effectively an attractive “option” on LCC. For example, should LCC achieve our \$18.50 target during the 120-day distribution period of AA Group Common Stock, we estimate AAMRQ value of \$6.71 per share, a 167% increase from today's close. Our analysis is predicated on regulatory approval, an autumnal effective date of the plan of reorganization, and a final (120th day) distribution occurring in 1Q14. Note that there are four distributions at day 30/60/90/120, and our analysis is predicated on LCC achieving the requisite VWAP (Volume Weighted Adjusted Price) over each preceding five-day period.
- **Here's how it works** – We estimate the adjusted AMR claims pool, inclusive of labor's portion and adjusted for dividends, is approximately \$7.565 billion (we no longer expect an OPEB claim, which is one reason why our pool may be smaller than other estimates). If LCC trades at \$14.99 during the distribution of new equity (let's round to \$15), creditors will be made whole (receiving par + accrued) and AAMRQ will be worth an estimated \$1.15/share. However, any additional value created by LCC above \$15.00 flows directly to AAMRQ. For example, at \$16.00 for LCC, we estimate \$2.75 for AAMRQ (~10% above their current price). At \$17.50 for LCC, AAMRQ reaches \$5.13. And at our \$18.50 price target, AAMRQ reaches \$6.71.

Equity Ratings and Price Targets

Company	Symbol	Mkt Cap (\$ mn)	Price (\$)	Rating		Price Target	
				Cur	Prev	Cur	Prev
AMR Corp.	AAMRQ	840.85	2.51	OW	NR	6.50	—
US Airways Group, Inc.	LCC	2,734.18	13.33	OW	N	18.50	18.00

Source: Company data, Bloomberg, J.P. Morgan estimates. n/c = no change. All prices as of 20 Feb 13.

See page 10 for analyst certification and important disclosures.

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- **We are harmonizing our views on LCC and AAMRQ equity** — If one is bullish on LCC (due to the merger, better GDP, lower fuel, sector re-rating...it doesn't particularly matter for purposes of this analysis) and believes that shares could sustainably trade above \$16 between Autumn and early 1Q14, we believe AAMRQ offers an attractive way to lever up one's potential return. We are re-initiating with an Overweight rating on AAMRQ with \$6.50 year-end price target, wholly consistent with our Overweight rating/\$18.50 year-end target for LCC.

Investment Theses

Table 1: If LCC rallies beyond \$16.00, we estimate significant upside in AAMRQ.

AAMRQ analysis			
AAMRQ share price		\$2.51	
LCC share price		\$13.33	
Est. AMR claims pool, \$bb, trued up for implied labor claim*	\$7.565	<--VWAP discount adjusted JPM estimate, includes approximately \$1.7b for labor.	
Est. LCC hurdle price, for claims to receive par + accrued	\$14.99	<--Let's call it \$15 rounded	
Proforma shares outstanding (mm)	736.8		
Shares allocated to AAMRQ (3.5% of total)	25.8		
Remaining shares to be allocated to AMR (72% of deal value)	504.7	<--to be distributed in four equal installments, at 30, 60, 90 & 120 days after plan confirmation	
Total consideration to AAMRQ @ \$15.00 LCC share price (\$mm)	\$386.8		
AAMRQ share count (mm)	335.3		
AAMRQ value per share, @ \$15.00 LCC share price	\$1.15	<--what AAMRQ holders receive, if LCC trades at \$15.00 during 120-day distribution period.	
*Based on double dip & single dip claims, adjusted for VWAP and preferred dividends, and inclusive of implied labor claim			
Share price analysis			
LCC Equity		AAMRQ Equity	
Price	up/down	Price	up/down
\$11.00	-17%	\$0.85	-66%
\$11.50	-14%	\$0.88	-65%
\$12.00	-10%	\$0.92	-63%
\$12.50	-6%	\$0.96	-62%
\$13.00	-2%	\$1.00	-60%
approximate LCC current price -->	\$13.50	1%	\$1.04 -59%
\$14.00	5%	\$1.08	-57%
\$14.50	9%	\$1.12	-56%
\$15.00	13%	\$1.15	-54%
\$15.50	16%	\$1.96	-22%
\$16.00	20%	\$2.75	10%
			<--approximate AAMRQ current price
\$16.50	24%	\$3.55	41%
\$17.00	28%	\$4.34	73%
\$17.50	31%	\$5.13	104%
\$18.00	35%	\$5.92	136%
JPM LCC price targets -->	\$18.50	39%	\$6.71 167%
\$19.00	43%	\$7.50	199%
\$19.50	46%	\$8.29	230%
\$20.00	50%	\$9.08	262%

Source: J.P. Morgan Equity & Credit Research estimates, AMR & LCC filings.

If you're bullish on LCC, keep reading.

We believe AAMRQ equity (old AMR) represents a largely overlooked means by which to significantly lever up potential returns in LCC between now and early next year. We'll start with the usual caveats. Ours is a thesis that is specifically predicated on LCC sustaining *at least* a \$16.00 share price for each of the four planned equity distributions over a 120-day period, which we expect to commence in Autumn (and culminate in early 1Q14), in order to break even on AAMRQ. Second, while the reasons for one's LCC bullishness are largely irrelevant, our analysis supporting the AAMRQ recommendation is predicated on regulatory approval of the LCC-AMR merger and an Autumnal effective date of the plan of reorganization. Lastly, we are not planning for any potential formation of an equity committee that could somehow disrupt the process with an argument that AAMRQ holders are entitled to even more value (indeed, this seems like a low-probability outcome in light of the analysis, in our view, but it has been known to happen).

Both our LCC rating and equity price target are nudged upward.

Our bullishness for LCC equity began to wane by mid-January, culminating in a downgrade to Neutral on January 15th. At the time, we felt that shares were adequately discounting what we believed to be an imminent merger announcement (given how broadly LCC & AMR's courtship had been telegraphed) and that LCC shareholders were unlikely to garner no more than 27% of the deal's potential value. Since that time, two notable things occurred. First, 28% emerged as LCC's portion of deal value. Second, LCC shares lost roughly 12% of their value from the recent, pre-deal peak (vs. S&P 500 +3.9%), reflecting both profit taking and short selling by those looking to hedge their exposure to AMR credit. While our stand-alone earnings model is unchanged, the incorporation of slightly greater deal value blended with unchanged 5.2x EV/EBITDAR and 7x P/E target multiples (with a 75/25% weighting between the two) pushes our earlier \$18 price target to \$18.50. Given a calculated potential return of 39%, we once again can justify an Overweight rating.

AAMRQ represents a higher octane play on the same thesis.

AAMRQ is best viewed as an attractive "option" on LCC. Based on our analysis, should LCC sustain our \$18.50 target during the 120-day distribution period of AA Group Common Stock, we estimate AAMRQ value of \$6.71, a 167% increase from today's close. The dynamics of claims recovery is the catalyst.

We estimate the adjusted AMR claims pool to be approximately \$7.565 billion. It is important to note that ours is an adjusted pool, inclusive of both labor's portion and, in the case of double dip and single dip claims, adjusted for dividends (and the 3.5% VWAP discount). We also don't include an OPEB claim, which might explain why our pool is lower than some Street estimates. Remember our "pensionomics" call and the positive impact on valuation from the freeze rather than rejection of the DB plans? Well let us introduce you to "OPEBonomics". It simply doesn't make sense, in our opinion, to reject OPEB and create a \$1bn+ claim at a 90%+ recovery when the carrying cost is likely <\$100mm or a drag of no more than \$500mm on the EV at current <5x multiples.

Moving on, our claims pool estimate is then divided by 504.7m, the expected number of remaining shares to be distributed after AAMRQ holders receive their stake of 3.5%/25.8m shares. By dividing \$7.565 billion by 504.7m, one arrives at a \$14.99 LCC share price (we round to \$15.00). This \$15.00 is therefore the "hurdle price" at which creditors receive par + accrued, and AAMRQ holders receive an estimated \$1.15/share.

Note that equity distribution is expected to begin as of the effective date of the plan of reorganization, which we estimate to be early Autumn. Distribution will occur in four equal installments, the 30th, 60th, 90th and 120th day after the effective date.

But here's the kicker. Should LCC's share price be sustained above \$15.00 for the duration of distribution, incremental deal value flows disproportionately to holders of AAMRQ, for the simple reason that conventional creditors can't receive more than par + accrued. Please note, LCC's share price (in turn determining the value that accrues to AAMRQ) will be based on the VWAP over the five days leading up to each distribution. (Hence our frequent use of the term "sustained", as LCC's VWAP will be measured on each of the four distribution dates).

As shown in Table 1, upside could prove significant. At a \$16.00 LCC share price, the added \$1 of LCC value times the 504.7 million shares creates \$504.7 million of surplus value, which in turn is distributed amongst the 335 million AAMRQ shares - \$1.51 of additional value beyond the \$1.15 AAMRQ holders could expect at an LCC share price of \$15.00 (plus 6.7% appreciation on the initial 3.5% slug given the move from \$15 to \$16), for a total of \$2.75 per AAMRQ. We note that AAMRQ is currently trading slightly below this level, therefore a \$16.00 LCC share price is best thought of as a good break-even proxy for AAMRQ.

Similarly, at LCC equity values of \$17.50 or \$18.50 at each of the four distribution windows, we estimate AAMRQ value per share of \$5.13 and \$6.71, respectively, representing potential upside of 104% and 167% from today's close. Given a year-end LCC equity price target of \$18.50, we believe it only makes sense to harmonize our views in regard to AAMRQ equity. Accordingly, we are re-initiating with an Overweight rating on AAMRQ and establishing a \$6.50 price target, which is consistent with our revised \$18.50 target for LCC.

Valuation

We are raising our December year-end price target for LCC from \$18 to \$18.50. Our price target is initially predicated on our forward EV/EBITDAR company-specific curve and a P/E multiple. Looking at the historical LCC EV/EBITDAR curve, we see that our level of forecast profitability has historically resulted in a ~5.5x multiple. For LCC, we have ascribed a 75% weighting to our EBITDAR methodology and a 25% weighting to a 7x P/E given limited historical profitability hence the lower reliability of the P/E metric. We also blend in a calculation of potential merger-related value, which at 28% for LCC exceeded our earlier 27% estimate. Given recent 10% decline in LCC equity from the recent pre-deal peak, upside potential to our \$18.50 now exceeds 30%, and as a result we are upgrading our equity rating from Neutral to Overweight.

We are establishing a December year-end price target for AAMRQ of \$6.50. Our price target is highly correlated to the performance of LCC equity during this period. Specifically, we estimate that at an LCC share price of \$18.50, an additional \$5.56 of value will accrue to AAMRQ equity, above the \$1.15 they are initially entitled to receive at a \$15.00 LCC equity value. Put differently, as LCC's share price potentially rises above an estimated \$15.00/share, the "surplus value" that is created above and beyond that required to pay creditors at par + accrued disproportionately cascades to holders of AAMRQ.

Risks to Ratings and Price Targets

We believe LCC (OW) remains highly leveraged to even the slightest fluctuations in demand for air travel. Should the US economy strengthen less than currently expected, our earnings and financial projections could be negatively affected. Furthermore, results are subject to variations in energy prices and labor-related job actions and explicitly assume no airline-related acts of terrorism. In a scenario in which less capacity exits the industry than currently expected, our thesis on airlines may be negatively impacted. Additionally, any move by US regulators to block the

proposed LCC-AMR merger could negatively affect our view, as could the formation of an equity committee that could potentially drag out the expected closure of the transaction. Lastly, any material integration hurdles or revisions to the proposed merger could cause us to revisit our rating on LCC.

Our rating on AAMRQ (OW) piggy-backs off our prevailing view on LCC; in this sense, AAMRQ is perhaps best thought of an option. Should LCC share price fail to achieve a sustained \$16.00 price during the anticipated distribution period of shares in AA Group Common stock, AAMRQ holders would likely receive less value than yesterday's close. Furthermore, any delay in achieving regulatory approval and/or the formation of an equity committee on behalf of AAMRQ holders could materially alter the timing of our analysis, causing us to revisit our thesis.

Overweight

Company Data	
Price (\$)	2.51
Date Of Price	20 Feb 13
52-week Range (\$)	2.94 - 0.36
Mkt Cap (\$ mn)	840.85
Fiscal Year End	Dec
Shares O/S (mn)	335
Price Target (\$)	6.50
Price Target End Date	31-Dec-13

AMR Corp. (AAMRQ;AAMRQ US)

FYE Dec	2011A	2012A
EPS (\$)		
Q1 (Mar)	(1.21)	(0.74)
Q2 (Jun)	(0.85)	0.28
Q3 (Sep)	(0.48)	0.35
Q4 (Dec)	(0.75)	(0.26)
FY	(3.30)	(0.39)
Bloomberg EPS FY (\$)	(3.50)	(0.80)

Source: Company data, Bloomberg, J.P. Morgan estimates. 'Bloomberg' above denotes Bloomberg consensus estimates.

Overweight

Company Data	
Price (\$)	13.33
Date Of Price	20 Feb 13
52-week Range (\$)	15.64 - 6.78
Mkt Cap (\$ mn)	2,734.18
Fiscal Year End	Dec
Shares O/S (mn)	205
Price Target (\$)	18.50
Price Target End Date	31 Dec 13

US Airways Group, Inc. (LCC;LCC US)

FYE Dec	2012A	2013E	2014E
EPS (\$)			
Q1 (Mar)	(0.13)	0.17	-
Q2 (Jun)	1.61	1.63	-
Q3 (Sep)	0.98	0.66	-
Q4 (Dec)	0.26	0.27	-
FY	2.79	2.71	2.55
Bloomberg EPS FY (\$)	2.70	3.03	3.08

Source: Company data, Bloomberg, J.P. Morgan estimates. Estimates reflect the dilutive impact of stock-based compensation required by FAS 123(R). 'Bloomberg' above denotes Bloomberg consensus estimates.

AMR Corp.: Summary of Financials

Income Statement - Annual	FY11A	FY12A	FY13E	FY14E	Income Statement - Quarterly	1Q13E	2Q13E	3Q13E	4Q13E
RPMs (M)	126,491	126,406	-	-	RPKs (km)	-	-	-	-
ASMs (M)	154,322	152,628	-	-	ASKs (km)	-	-	-	-
Load factor	82.0%	82.8%	-	-	Load factor	-	-	-	-
Yield	14.19	14.83	-	-	Yield	-	-	-	-
RASM	11.63	12.28	-	-	RASK	-	-	-	-
CASM	13.82	14.23	-	-	CASK	-	-	-	-
CASM ex-fuel	9.04	9.18	-	-	CASK ex-fuel	-	-	-	-
Fuel cost/gal	3.01	3.20	-	-	Fuel cost/liter	-	-	-	-
Passenger revenues	17,947	18,743	-	-	Passenger revenues	-	-	-	-
Total revenues	23,979	24,855	-	-	Total revenues	-	-	-	-
Operating income	(298)	494	-	-	Operating income	-	-	-	-
Net income	(1,105)	(130)	-	-	Net income	-	-	-	-
EBITDA	788	1,510	-	-	EBITDA	-	-	-	-
EBITDAR	1,450	2,060	-	-	EBITDAR	-	-	-	-
EPS	(3.30)	(0.39)	-	-	EPS	-	-	-	-
Balance Sheet and Cash Flow Data	FY11A	FY12A	FY13E	FY14E	Ratio Analysis	FY11A	FY12A	FY13E	FY14E
Total debt	8,220	8,535	-	-	RPK growth	0.8%	(0.1%)	-	-
Cash and cash equivalents	4,739	4,742	-	-	ASK growth	0.7%	(1.1%)	-	-
Net debt	3,481	3,793	-	-	Yield growth	6.2%	4.5%	-	-
Operating leases	4,634	3,850	-	-	RASK growth	6.3%	5.6%	-	-
Minority interest	-	-	-	-	CASK growth	9.9%	3.0%	-	-
Preferred stock	-	-	-	-	CASK ex-fuel growth	2.5%	1.5%	-	-
Convert adjustment	0.00	0.00	-	-	Total revenue growth	8.2%	3.7%	-	-
Enterprise value	9,056	8,584	-	-	EBIT margin	(1.2%)	2.0%	-	-
Book value	(3,945)	(7,974)	-	-	EV/revenue	0.4	0.3	-	-
Capex	1,610	1,800	-	-	EV/EBITDAR	6.2	4.2	-	-
Free cash flow	(822)	(290)	-	-	EV/EBITDA	11.5	5.7	-	-
Free cash flow yield	(9.1%)	(3.4%)	-	-	BV/share	(11.78)	(23.80)	-	-
					Debt/capital	144.3%	280.8%	-	-

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share and fuel cost data). Fiscal year ends Dec

US Airways Group, Inc.: Summary of Financials

Income Statement - Annual	FY11A	FY12A	FY13E	FY14E	Income Statement - Quarterly	1Q13E	2Q13E	3Q13E	4Q13E
RPMs (M)	60,779	62,434	64,942	65,327	RPKs (km)	14,418	17,000	17,544	15,980
ASMs (M)	72,603	74,211	77,000	77,770	ASKs (km)	17,800	20,000	20,400	18,800
Load factor	83.7%	84.1%	84.3%	84.0%	Load factor	81.0%	85.0%	86.0%	85.0%
Yield	13.99	14.38	14.84	15.05	Yield	15.20	15.30	14.40	14.49
RASM	11.71	12.10	12.51	12.64	RASK	12.31	13.01	12.38	12.32
CASM	13.05	13.18	13.42	13.52	CASK	13.80	13.39	13.11	13.44
CASM ex-fuel	8.35	8.39	8.39	8.47	CASK ex-fuel	8.97	8.25	8.03	8.38
Fuel cost/gal	3.11	3.16	3.38	3.35	Fuel cost/liter	3.30	3.40	3.40	3.40
Passenger revenues	8,501	8,980	9,634	9,831	Passenger revenues	2,192	2,601	2,526	2,316
Total revenues	13,055	13,831	14,670	14,986	Total revenues	3,362	3,958	3,816	3,534
Operating income	451	894	1,053	1,133	Operating income	114	466	304	169
Net income	111	537	535	500	Net income	29	329	129	47
EBITDA	688	1,139	1,297	1,383	EBITDA	175	527	365	230
EBITDAR	1,334	1,781	1,937	2,033	EBITDAR	335	687	525	390
EPS	0.68	2.79	2.71	2.55	EPS	0.17	1.63	0.66	0.27
Balance Sheet and Cash Flow Data	FY11A	FY12A	FY13E	FY14E	Ratio Analysis	FY11A	FY12A	FY13E	FY14E
Total debt	4,566	4,793	4,376	3,905	RPK growth	3.1%	2.7%	4.0%	0.6%
Cash and cash equivalents	2,312	2,712	2,953	3,600	ASK growth	1.4%	2.2%	3.8%	1.0%
Net debt	2,254	2,081	1,423	305	Yield growth	7.9%	2.8%	3.1%	1.4%
Operating leases	4,522	4,494	4,480	4,550	RASK growth	9.6%	3.3%	3.4%	1.0%
Minority interest	-	-	-	-	CASK growth	11.3%	0.9%	1.9%	0.7%
Preferred stock	-	-	-	-	CASK ex-fuel growth	0.6%	0.5%	(0.0%)	1.0%
Convert adjustment	0.00	0.00	-	-					
Enterprise value	9,701	9,500	8,828	7,780	Total revenue growth	9.6%	5.9%	6.1%	2.2%
					EBIT margin	3.5%	6.5%	7.2%	7.6%
Book value	150	790	1,495	2,329					
Capex	593	283	462	298	EV/revenue	0.7	0.7	-	-
Free cash flow	95	856	835	1,085	EV/EBITDAR	7.3	5.3	4.6	3.8
Free cash flow yield	1.0%	9.0%	-	-	EV/EBITDA	14.1	8.3	6.8	5.6
					BV/share	0.92	3.87	7.21	11.23
					Debt/capital	98.4%	92.2%	85.6%	78.4%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share and fuel cost data). Fiscal year ends Dec

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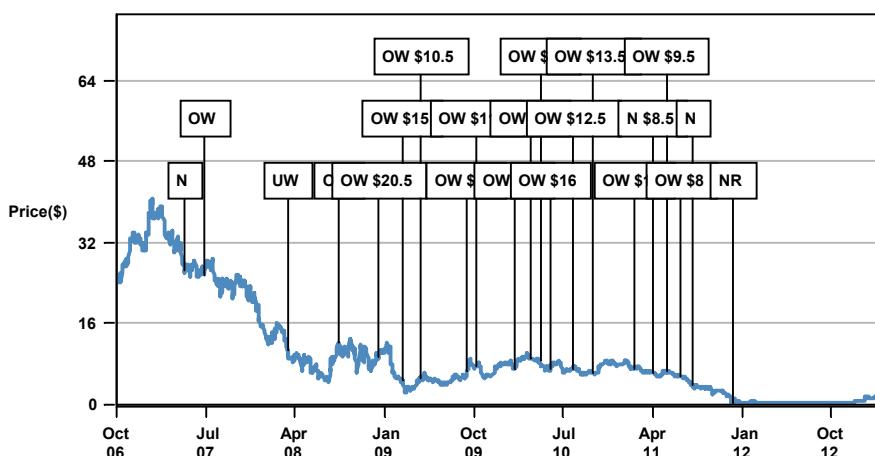
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AMR Corp. (AAMRQ, AAMRQ US) Price Chart

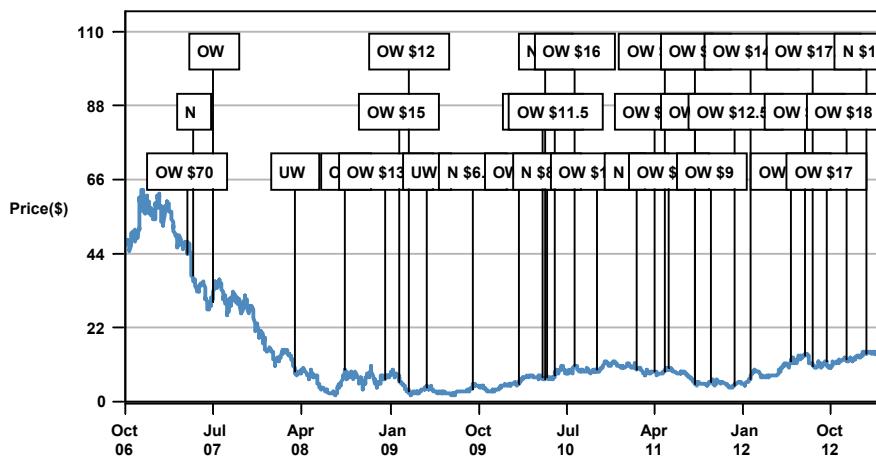


Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Apr 27, 2007 - Jun 28, 2007.

Date	Rating	Share Price (\$)	Price Target (\$)
27-Apr-07	N	26.35	--
28-Jun-07	OW	25.85	--
12-Mar-08	UW	10.67	--
12-Aug-08	OW	12.18	--
12-Dec-08	OW	9.53	20.50
27-Feb-09	OW	4.60	15.00
22-Apr-09	OW	5.31	10.50
10-Sep-09	OW	6.69	12.00
09-Oct-09	OW	7.57	11.50
04-Feb-10	OW	6.92	16.00
22-Mar-10	OW	9.08	15.00
21-Apr-10	OW	8.56	14.00
25-May-10	OW	7.14	16.00
29-Jul-10	OW	7.08	12.50
01-Oct-10	OW	6.27	13.50
04-Feb-11	OW	7.18	11.00
01-Apr-11	N	6.39	8.50
16-May-11	OW	6.69	9.50
28-Jun-11	OW	5.64	8.00

03-Aug-11	N	3.85	--
30-Nov-11	NR	0.32	--
Date	Rating	Share Price (\$)	Price Target (\$)
12-Apr-07	OW	44.12	70.00
27-Apr-07	N	37.18	--
28-Jun-07	OW	29.67	--
12-Mar-08	UW	9.02	--
12-Aug-08	OW	9.39	--
12-Dec-08	OW	6.68	13.50
30-Jan-09	OW	5.67	15.00
27-Feb-09	OW	2.85	12.00
22-Apr-09	UW	4.36	--
10-Sep-09	N	3.58	6.50
04-Feb-10	OW	5.49	9.00
19-Apr-10	OW	7.15	11.00
22-Apr-10	N	6.76	8.00
28-Apr-10	N	7.32	8.50
25-May-10	OW	7.81	11.50
29-Jul-10	OW	10.66	16.00
01-Oct-10	OW	9.29	16.50
04-Feb-11	N	9.24	12.00
01-Apr-11	OW	8.71	12.00
29-Apr-11	OW	8.77	13.50
16-May-11	OW	9.94	18.00
03-Aug-11	OW	5.90	9.00
04-Aug-11	OW	5.52	8.00
23-Sep-11	OW	6.13	9.00
01-Dec-11	OW	4.94	12.50
25-Jan-12	OW	6.41	14.50
24-May-12	OW	12.16	17.00
05-Jul-12	OW	13.47	19.00
01-Aug-12	OW	10.83	17.50
12-Sep-12	OW	11.82	17.00
13-Nov-12	OW	12.29	18.00
15-Jan-13	N	14.31	18.00

US Airways Group, Inc. (LCC, LCC US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Apr 27, 2007 - Jun 28, 2007.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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