Strategic and Financial Analysis of International Airlines Group

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Sources Of Finance

Finance has been readily available to most airlines despite a worsening record of profitability when compared to other industries and the cyclic nature of earnings, primarily driven by seasonal travel patterns of customers. Unlike other industries, most airlines are owned either solely or partially by the respective governments and, as such, tend to receive funds from the government or have loans guaranteed by the government. (International Air Transport Association, 2024)

Besides, airlines primarily look for funding to purchase aircraft, which is an asset that most financial institutions have been funding at 80 to 90% of total expenses on a medium or long-term basis. Therefore, borrowings will be evident in most Airline financial statements. However, it is important for airlines to consider factors such as time and repayment period of financing, economic factors such as expected changes to lending and interest rates, fuel pricing and currency rate fluctuations. These factors could introduce financial risks for an airline.

Based on the 2016 Balance sheet of IAG-BA – the company's total assets account for a total of Euro 27,373m. Multiple options for acquiring land and building worth 20% of Net assets will be presented in the following sections for the chosen organization IAG-BA. The formula being used will be ((Total assets – Total Liabilities) * 20%]

Euro

Description	Amount
Total Assets	27,373,000,000
Total Liabilities	21,709,000,000
Difference	5,664,000,000
@ 20%	1,133,000,000

IAG decreased its capacity to Africa, the Middle East and South Asia due to weaker demand resulting from geopolitical issues. Flying was reduced this year to Angola, Nigeria, Morocco, Tunisia and Uganda. Other decreases resulted from the full-year impact of reductions made last year to Entebbe, Senegal and Gambia. Additional capacity was deployed to South Africa with Iberia reintroducing Johannesburg and British Airways launching a Cape Town route from London Gatwick. The passenger load factor improved by 0.9 points.

In Asia Pacific, the capacity increase was driven by the full-year impact of the network and aircraft changes made by British Airways last year in Kuala Lumpur, Singapore and Haneda. In 2016, Iberia launched its new service to Tokyo and Shanghai. Passenger load factors increased to 82.5 percent, one of the highest regions on the IAG network.

Acquisitions

The 2016 Group performance includes Aer Lingus for the full year. Aer Lingus was acquired on August 18, 2015. Therefore, the Group's 2015 comparator performance only includes Aer Lingus since the acquisition date. Metrics reported on a like-for-like basis include Aer Lingus for the full year in the base. (http://www.iairgroup.com/phoenix.zhtml?c=240949&p=irol-newsArticle&id=2249128, 2016) (EUROCONTROL, 2024)

In 2016, IAG- carried more than 100 million passengers – double the number British Airways and Iberia carried in 2010, a year before IAG was created."It is committed to providing a sustainable dividend for its shareholders and is pleased to confirm that the Board is proposing a final dividend of 12.5 euro cents per share. This brings the full-year dividend to 23.5 euro cents per share, subject to shareholder approval at our AGM in June. (International Airlines Group, 2025)

"Also announced that it intends to carry out a share buyback of €500 million during the course of 2017, which may be implemented through one or more share buyback programs. It has great confidence in IAG's future prospects and is increasing cash returns to its shareholders."

Trading Outlook

At current fuel prices and exchange rates, IAG expects its operating profit for 2017 to show an improvement year-on-year.

This announcement contains inside information and is disclosed in accordance with the Company's obligations under the Market Abuse Regulation (EU) No 596/2014. (http://www.iairgroup.com/phoenix.zhtml?c=240949&p=irol-newsArticle&id=2249128, 2017)

Internal Sources Of Finance

Option 1: Current Assets

In the event IAG-BA was to get the cash from its current assets, then its resulting impact on the current ratio also needs to be examined.

As per the balance sheet of 2016, the following details can be derived.

Description	Before acquiring land and buildings	After acquiring land and buildings
Current Assets	9,785,000,000	8,652,000,000
Current Liabilities	9,336,000,000	9,336,000,000
Current Ratio	1.05	0.93

Using this option will decrease the current ratio by 0.12 and reduce the ratio to below 1, suggesting that the company will be unable to honor its obligations should they become due at that point in time. The ideal current ratio preferred by banks is 1.33:1. While the ideal level as per the industry benchmark is 2:1. A higher current ratio depicts the company's capability to pay off its short-term liabilities.

Option 2: Retained Earnings And Cash Equivalents

A part of net income that is retained by the company and/or cash equivalents can be a source for internal funding.

Based on the Balance sheet of IAG-BA:

Retained earnings are Euro 952,000,000 (p104, Annual report 2016) as of 31st December 2016.

Cash and Cash equivalents are Euro 3,337,000,000 (p102, Annual report 2016) as of 31st December 2016.

The contribution from Retained earnings will not impact the liquidity ratio (current ratio) of the company, while a reduced contribution from the cash and cash equivalents would still protect the liquidity ratio (i.e., current ratio).

The above scenario looks to be favorable for IAG-BA should they choose to adopt this approach.

Option 3: Fixed Assets

In option 2, the consideration of current assets enables the company to convert such items to cash within a short period of time. While, in the case of fixed assets, the conversion to cash would take a longer time. However, IAG-BA has some fixed assets that could be converted in a shorter period of time but would not be normally considered for short-term access to finance.

The Euro 73,000,000 from available-for-sale financial assets could form part of the required funds and thus contribute to the capital of the company.

External Sources Of Finance

Option 1: Increase Capital Via Increased Borrowings

IAG-BA has an adjusted net debt of Euro 8,159,000,000, of which interest-bearing long-term borrowings are Euro 7,589,000,000, and the net debt is Euro 2,087,000,000 (a reduction of Euro 687,000,000 in the year due to stronger cash position). IAG -BA, being a strong aviation group of companies, continues to have good access to a range of financing solutions. In 2016, it raised secured debt from a broad range of financial institutions. The group's high cash balances and committed financing facilities mitigate the risk of short-term interruptions to the aircraft financing market. The same approach could be adopted to either partially or fully fund the purchase of the proposed land buildings worth Euro 1,133,000,000.

Option 2: Share Capital

As of 31st December 2016, IAG-BA has a share capital of Euro 1,066,494,371.50. in the stock exchange. (European Union Aviation Safety Agency, 2025)

Inspection of the Gearing ratio is also critical to the evaluation of the company's financial structure and bankruptcy risk.

Gearing Ratio IAG-BA			Gearing Ratio JAL		
Description	2016	2015	Description	2016	2015

Adjusted net debt	8,159,000,000	8,510,000,000	Net debt	2,938,000,000	2,590,000,000
Adjusted net debt + Adjusted equity	15,900,000,000	15,838,000,000	Capital Employed	6,745,000,000	6,212,000,000
Current Gearing Ratio	51%	54%			
	-1,133,000,000				
	14,767,000,000				
New Gearing ratio	55%		Gearing ratio	44%	42%

The overall capital of IAG-BA is in relation to its operations and volume of entities and business transactions. Even though it is easy for the company to raise additional capital, funding for the additional land and property from the capital funds will increase its gearing ratio by 4%, putting it further at risk against its competitor, JAL.

References

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