EVLI

FINNAIR

Transportation/Finland, February 27, 2019

Company update

Delivering on Asian strategy

Finnair's Asian strategy has proven successful and the remaining seven A350s deliveries in 2019-2022E support strategy execution and growth further. Evolution of competition in short-to-mid-term remains a key risk, in our view. We expect earnings to weaken slightly in 2019E and consider valuation as largely fair. We retain "Hold" rating.

A350 fleet carries from Asia to Europe via shortest route

Finnair's strategy is based on the geographic location of Helsinki hub, as the shortest route from (North-East) Asia to Europe goes over Helsinki. Finnair is able to serve most Asian routes in 24h rotations, which enables high utilization rate of planes and reduces the need for additional crew. New A350s, 12/19 of which were delivered by the end of 2018, are an essential part of the Asian strategy and form the cornerstone of cost management as they have higher seat capacity, lower maintenance cost and better fuel efficiency vs. the replaced A340s. The remaining seven A350s will be delivered in 2019-2022E, enabling further growth.

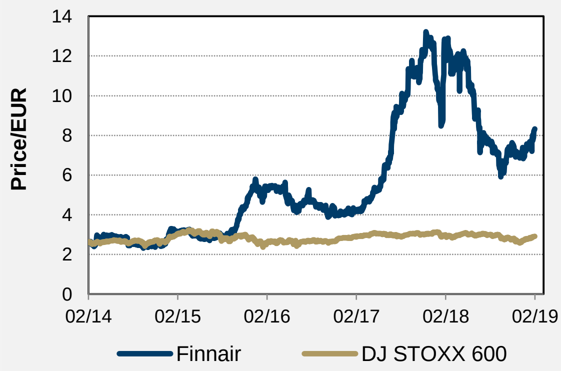
New A350s enable growth and balance capacity in 2019E

For 2019E Finnair guides 10% capacity growth (largely based on new A350s) and revenue growth slightly behind capacity. New capacity will be mostly put to Asian routes. This should enable further growth and improve weakened PLFs in European traffic, as a good part of capacity adds in 2018 was short-haul. Key risks for 2019E are demand and competition: demand could soften with economic growth, while competition is expected to increase in traffic between Europe and Asia and in intra-European traffic. Fuel is no longer at record levels, although hedged price should continue to edge up. At present we see adj. EBIT, excl. impact of IFRS 16, to weaken slightly in 2019E, assuming steady fuel.

Valuation appears fair – "Hold" reiterated

On our estimates Finnair's current P/E multiples are 10.8x for 2019E and 9.7x for 2020E, vs. the 3yr historical NTM average of 10.1x. On P/B Finnair trades 1.2-1.1x when the EUR 200m hybrid removed from equity, while generating ROCE of 8.8% in FY19E vs. our WACC of 8.9%. Overall, Finnair's current valuation appears largely fair to us. We hence retain "Hold" rating with an ex-div TP of EUR 8.0 (7.3). Our TP values Finnair close to par with Finnair's 3yr historical NTM P/E (10.1x) on our FY19E estimates.

Rating: HOLD



Share price, EUR (Last trading day's closing price)	8.33
Target price, EUR	8.0
Latest change in recommendation	13-Nov-17
Latest report on company	18-Feb-18
Research paid by issuer:	Yes
No. of shares outstanding, '000's	128,136
No. of shares fully diluted, '000's	128,136
Market cap, EURm	1,067
Free float, %	44.0
Exchange rate EUR/USD	1.138
Reuters code	FIA1S.HE
Bloomberg code	FIA1S FH
Average daily volume, EURm	na.
Next interim report	24-Apr-19
Web site	www.finnair.com

Analyst	Joonas Häyhä
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BUY HOLD SELL

KEY FIGURES

	Sales EURm	EBIT EURm	EBIT %	Ptx profit EURm	EPS EUR	P/E (x)	EV/Sales (x)	P/CF (x)	EV/EBIT (x)	DPS EUR
2017	2,568	170	6.6%	157	0.88	14.6	0.5	4.3	8.2	0.30
2018	2,835	169	6.0%	151	0.84	8.4	0.2	2.4	3.0	0.27
2019E	3,071	159	5.2%	140	0.77	10.8	0.2	3.6	4.7	0.30
2020E	3,211	177	5.5%	154	0.86	9.7	0.2	3.3	4.5	0.35
2021E	3,339	194	5.8%	169	1.05	7.9	0.2	3.0	4.2	0.40

Market cap, EURm	1,067	BV per share 2019E, EUR	8.5	CAGR EPS 2018-21, %	7.7
Net debt 2019E, EURm	-325	Price/book 2019E	1.0	CAGR sales 2018-21, %	5.6
Enterprise value, EURm	742	Dividend yield 2019E, %	3.6	ROE 2019E, %	9.4
Total assets 2019E, EURm	3,197	Tax rate 2019E, %	20.0	ROCE 2019E, %	8.8
Goodwill 2019E, EURm	0	Equity ratio 2019E, %	38.1	PEG, P/E 19/CAGR	0.8

All the important disclosures can be found on the last pages of this report.

Investment Summary

Finnair – from Asia to Europe

Finnair is a network airline focusing on traffic between Asia and Europe. Passenger traffic accounts for 79% of revenue, cargo traffic for 7%, travel services for 8% and ancillary sales for 6%. Asian and European traffic each contribute 40-45% of passenger revenue.

Competitive advantage based on location

Finnair's strategy focuses on the growing traffic between Asia and Europe. The strategy is based on the geographic location of the Helsinki hub: the shortest route from (North-East) Asia to Europe goes over Helsinki. Additionally, the distance between Helsinki and most Asian destinations is such that Finnair is able serve most routes in 24h rotations, which enables high utilization rate of planes and reduces the need for additional crew. The most direct route to Asia is enabled by having Russian overflight rights. Flights through the Siberian corridor from Asia to Europe via Helsinki save ca. 2h on flight time compared to one-stop flights via European hubs and ca. 4h compared to routes via the Middle East.

A350 fleet carries from Asia to Europe, enabling growth

Finnair's fleet renewal and expansion strategy form the cornerstones of its cost management as well as revenue growth. Initially Finnair ordered 19 new Airbus A350 planes to replace old A340 models and to expand its Asian long-haul capacity. At the end of 2018 Finnair had 12 A350s operational. Current delivery schedule for the remaining 7 planes is two planes per year in 2019-2021E and one plane in 2022E. During this period the older A330 wide-body planes are expected to remain operational, implying Finnair's long-haul capacity is set to grow from 20 planes at the end of 2018 to 27 planes in 2022E.

Asian traffic nearly doubled by 2018 vs. 2010

Finnair's strategic goals have included: 1) to double its Asian traffic by 2018 compared to 2010 base, 2) to nearly double ancillary revenues by 2020 compared to the 2016 base, and 3) to reach 20 million passengers by 2030, which implies 4% CAGR from 2017. Finnair largely reached its target of doubling its Asian traffic by 2018 compared to 2010 base. Finnair has not yet updated its financial targets to reflect IFRS 16, but even with a clear increase in net debt (IFRS 16 -gearing was approximately 70% in 2018) Finnair's balance sheet remains healthy, enabling further investments.

2019E – ASK to grow by 10% driven largely by new A350s

Finnair had a record year in 2017, but 2018 was two-fold. Still in H1 traffic grew close to or above capacity and lower hedged fuel price supported, but in H2 the earnings trend turned downwards driven by increased fuel price and weaker traffic due to tighter competition. For 2019E Finnair guides 10% capacity growth (largely based on new A350s) and revenue growth slightly behind capacity. New capacity will be mostly put to Asian routes This should enable further growth and improve weakened PLFs in European traffic, as a good part of capacity adds in 2018 was short-haul. Key risks for 2019E are demand and competition: demand could soften with economic growth, while competition is expected to increase in traffic between Europe and Asia and in intra-European traffic. Fuel is no longer at record levels, although hedged price should continue to edge up. At present we see adj. EBIT, excl. impact of IFRS 16, to weaken slightly in 2019E, assuming steady fuel.

Valuation looks fair – "Hold" reiterated

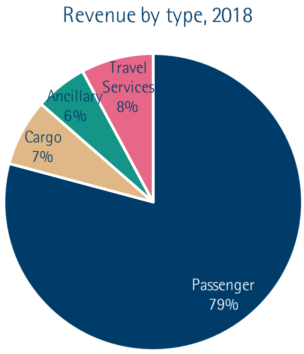
We approach Finnair's valuation primarily through valuation multiples. On our estimates Finnair's current P/E multiples are 10.8x for 2019E and 9.7x for 2020E. During the last 3 years, Finnair's 12m fwd P/E (on Factset consensus) has averaged 10.1x. On P/B Finnair trades 1.0x and 0.9x in FY19-20E, respectively, or 1.2-1.1x when the EUR 200m hybrid removed from equity, while generating ROCE of 8.8% in FY19-20E vs. our WACC of 8.9%. Overall, Finnair's current valuation appears largely fair to us. We hence reiterate "Hold" rating with an ex-div TP of EUR 8.0 (7.3). Our TP values the shares close to par with Finnair's 3yr historical NTM P/E (10.1x) on our FY19E estimates. Our 2019E adj. EBIT estimate is up by 5% since our latest update.

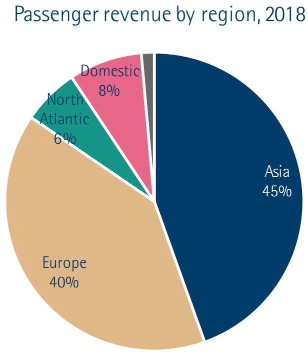
Company overview

Finnair – Finnish network airline

Finnair is a network airline focusing on traffic between Asia and Europe. Passenger traffic (ticket sales) accounts for 79% of revenue, cargo traffic for 7%, travel services (package tours) for 8% and ancillary sales (extra services) for %. Asian and European traffic each contribute 40-45% of passenger revenue with the rest coming from domestic, North American and other traffic. Structurally the legacy airline industry has been hit over the last decade by the rise of low cost carriers (LCCs), which have forced old network carriers to re-invent themselves. This development continues but with savings, fleet renewal and sharpened focus to Asian markets Finnair's results have improved notably in recent years.

Revenue by geography and product, 2018



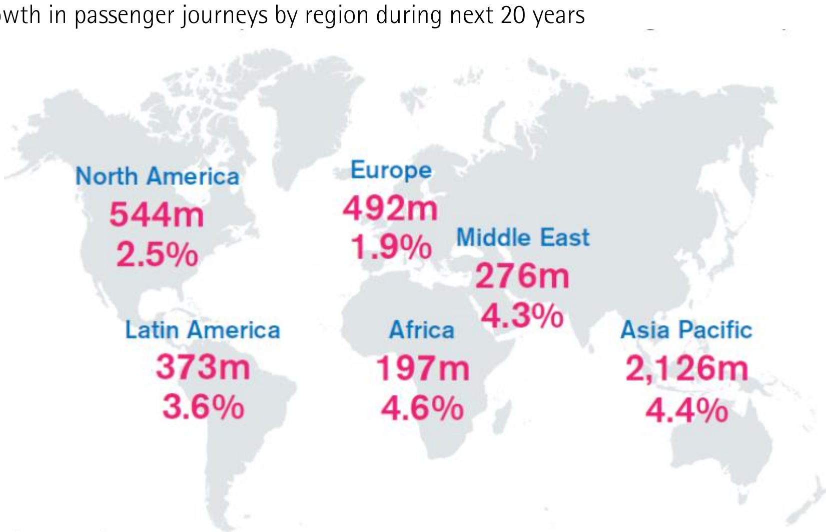


Source: Finnair

The global airline industry grows, with Asia as the biggest driver of demand

The global airline industry is growing: according to IATA, global passenger numbers are forecast to double to 8.2bn over the next 20 years (by 2037), which corresponds to 3.5% CAGR globally. Emerging middle class in developing countries is a key growth driver. Aviation's centre of gravity is shifting eastwards: China is expected to displace the U.S. as the largest air passenger market by 2025. The biggest driver of demand is expected to be the Asia-Pacific region, which will contribute more than half of new passengers over the next two decades. Currently the Asian market accounts for over 40% of Finnair's passenger revenues and the share is on the rise. Estimated market growth (passenger growth) is 4.4% p.a. in the Asia-Pacific region, which puts Asia-Pacific among the fastest growing markets. European market growth is estimated at 1.9%. Domestic market is likely to grow approximately in tandem with European market, but increasing winter tourism from Asia to Lapland could give an additional growth boost.

Growth in passenger journeys by region during next 20 years



Source: IATA/Tourism Economics

Strategy is based on the geographic location of the Helsinki hub

Geographic location and Russian overflight rights

Finnair's strategy focuses on the growing traffic between Asia and Europe. The strategy is based on the geographic location of the Helsinki hub: the shortest route from (North-East) Asia to Europe goes over Helsinki. Additionally, the distance between Helsinki and most Asian destinations is such that Finnair is able serve most routes in 24h rotations, which enables high utilization rate of planes and reduces the need for additional crew. The shortest route also saves fuel. The most direct route to Asia is enabled by having Russian overflight rights. Flights through the Siberian corridor from Asia to Europe via Helsinki save ca. 2h on flight time compared to one-stop flights via European hubs and ca. 4h compared to routes via the Middle East.

Strategic and financial targets

Finnair's strategic goals have included:

- to double its Asian traffic by 2018 compared to 2010 base
- to nearly double its ancillary revenues by 2020 compared to the 2016 base
- 20 million passengers by 2030E, which implies 4% CAGR from 2017.

Long-term financial goals have included (these do not include impact of IFRS 16):

- Comparable EBIT of at least 6% over the cycle
- Comparable EBITDAR of at least 17% over the cycle
- Adjusted gearing of less than 175%
- ROCE of at least 7%
- Dividend policy is to pay at least 1/3 of net earnings during an economic cycle, taking into account earnings, outlook, financial situation and capital needs.

Some targets met, some not

Finnair largely met its target of doubling its Asian traffic by 2018 compared to 2010 base. Ancillary sales have grown double-digit in 2017 and 2018 and for 2019 and 2020 10%+ growth rate is needed for the target to be reached. Growth in ancillary sales has been driven primarily by growth in passenger numbers, as average ancillary sales per passenger have been flattish at EUR 12 level since 2017 - Finnair targets to reach EUR 15 level. Finnair long lagged its EBITDAR and EBIT margin targets, but the EBIT margin target was met in 2017 and 2018. The ROCE target has been met in 2017 and 2018. The adjusted gearing target has been easily met in 2015-2018.

EBITDA, EBIT and net debt will increase with IFRS 16

Finnair's EBITDA and EBIT will increase with IFRS 16 from start of 2019. Finnair estimates that the 2018 adj. EBIT (EUR 169m) will improve by about 30% due to IFRS 16. On the balance sheet side Finnair estimates that its assets will increase by EUR 1.0bn due to recognition of right-of-use assets, and that its liabilities will increase in total by EUR 1.1bn due to the recognition of lease liabilities. The impact to equity will be EUR -0.1bn. Equity ratio is expected to decrease by more than 10 %-points, while gearing is expected to increase significantly by over 100 %-points to approximately 70%. Balance sheet will look healthy also with IFRS 16.

2018E Guidance – capacity to grow ~10%, revenue slightly less

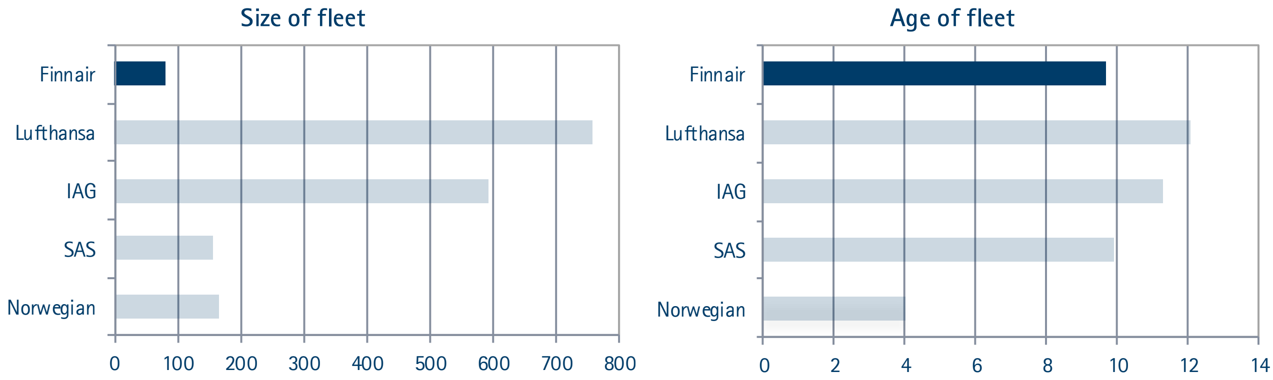
Finnair guides capacity to grow by about 10% in 2019E. Added capacity will be mostly put to Asian routes. Revenue is guided to grow slightly less than capacity. Guidance for adj. EBIT will be given with Q2 earnings, as usual. Finnair expects global airline traffic to continue growing and competition to increase due to capacity increases especially on routes between Europe and Asia as well as in intra-European traffic. Demand is also seen to be at risk of softening with slowdown in economic growth. However, Norwegian's planned capacity cuts may impact Finnair positively on some routes.

Fleet expansion: seven A350s to be delivered in 2019-2022E

Airbus A350 – cornerstone of the strategy

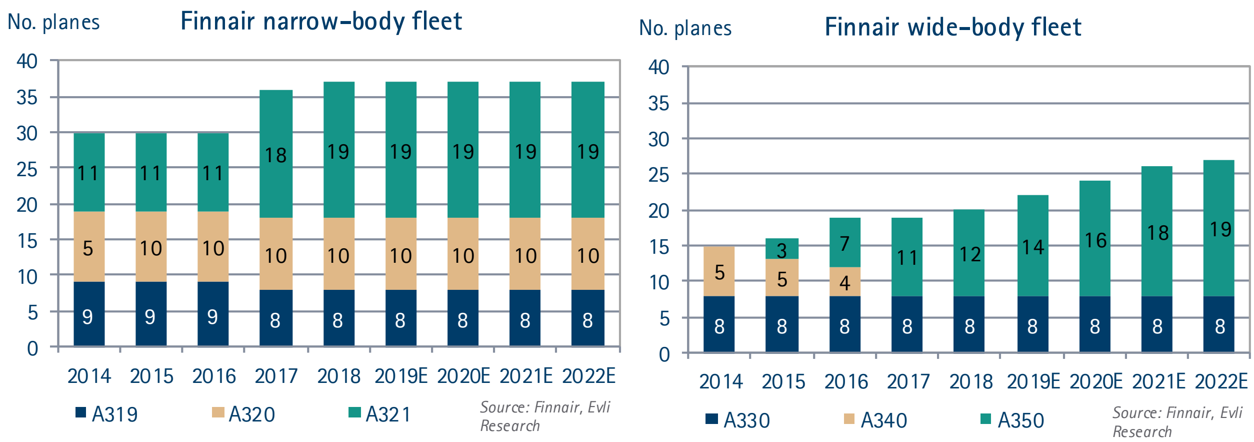
Finnair's fleet renewal and expansion strategy form the cornerstones of its cost management as well as revenue growth. Finnair states that A350 is up to 25% more fuel-efficient than the replaced A340s. Initially Finnair ordered 19 new Airbus A350 XWB to replace old A340 models and to expand its Asian long haul capacity. First three planes were delivered during Q2'15. At the end of 2018 Finnair had 12 A350s operational. Current delivery schedule for the remaining 7 planes is two planes per year in 2019-2021E and one plane in 2022E. During this period the older A330s wide body planes are expected to remain operational, implying Finnair's long-haul capacity is set to grow from 20 planes at the end of 2018 to 27 planes in 2022. On the short-haul side Finnair has not placed on order for new narrow-body planes, but capacity increases are possible via leasing - we have not currently assumed any new leases in our estimates, but we have assumed that the number of narrow body planes remains at 37 in 2019-2022E. Finnair ownership strategy regarding planes is intact: about half of planes are to be company-owned. At the end of 2018, 27/57 planes operated by Finnair were company-owned.

Fleet size and average age vs. peers



Source: Finnair, company information

Finnair fleet



Source: Finnair, Evli estimates

Competitive landscape

Competing with both LCCs and FSCs

Finnair's competitive landscape can be roughly divided into two parts; short haul point-to-point traffic in Europe and long-haul transfer traffic between Asia and Europe. In short haul point-to-point traffic, airlines with the lowest cost structures typically have the strongest competitive positions, and competition is mainly driven by price. In long-haul traffic, the significance of a comprehensive network, comfort of travel, customer service and smooth transfers are highlighted.

Key competitors in intra-European traffic: SAS, Norwegian and others

Regionally the number of competitors vary and is typically both direct (overlapping routes) and indirect (via stops and nearby airports). In domestic traffic Norwegian is a key competitor, offering flights regularly from Helsinki to Oulu and Rovaniemi and also to Kittilä and Ivalo during the winter season. In intra-European traffic competition is more scattered. SAS and Norwegian are key competitors in traffic within the Nordics. Additionally Norwegian serves tens of routes between Helsinki and Europe. Other competitors in traffic between Helsinki and Europe include (at least) Lufthansa, Air France-KLM, British Airways (IAG) and Air Baltic.

Competition comes from many directions in EU-Asia traffic

In long-haul routes between Europe and Asia, Finnair competes with European, Asian and Middle Eastern carriers. Among European carriers Lufthansa, British Airways and Air France-KLM are key competitors. Each offer certain direct routes between European and Asian megacities, and also a comprehensive network from their European hubs. The number of Asian competitors flying between Asia and Europe is higher, but their routes are typically direct point-to-point flights between Asian and European megacities, ie. they are not able to offer similar network connectivity to smaller European destinations. Of Nordic competitors, SAS is focused on serving Nordic customers and it currently has only three destinations in Asia. Norwegian has been interested in expanding in Asia, but for the time being it does not have overflight rights with Russia.

Competitive advantage based on location

The geographical location of the Helsinki hub gives Finnair a competitive advantage. Finnair is able serve most Asian routes in 24h rotations, which enables high utilization rate of planes, reduces the need for additional crew and saves fuel due to shorter distances. Additionally, flights through the Siberian corridor from Asia to Europe via Helsinki save ca. 2h on flight time compared to one-stop flights via European hubs and ca. 4h compared to routes via the Middle East. Finnair is currently the only European airline that operates most Asian destinations on a 24-hour aircraft rotation from Helsinki. Still, intense competition is expected to continue, especially with Asian airlines most likely further expanding operations to intercontinental flights. Further, low-cost and high-service government-backed Middle Eastern carriers may continue opening more routes to Europe and increasing competition; Qatar Airways started flying between Helsinki and Doha in fall 2016. However, Middle Eastern operators do not offer point-to-point services between Asia and Europe and they lose on flight duration.

Tight competition in Europe continues over medium term

According to CAPA, low-cost carriers (LCCs) have almost doubled their capacity in Europe over the past decade, which has led to overcapacity and deteriorated profits. LCCs have built strong positions on short haul intra-European routes and their market share has increased: OAG reported market share of LCCs at above 40% in 2017 in Western Europe. Consequently, European flag carriers have formed LCC subsidiaries that now function as growth engines for large legacy groups, like Lufthansa and IAG.

The European airline sector is fragmented compared to the U.S.

Overall, consolidation has been a global industry trend, but progress varies by region. In the U.S. market share of the three largest carriers is ca. 50-60%, while Europe lags behind at ca. 30%. The European airline sector is more fragmented and less profitable, with average sector EBIT margin at ~5-7% in recent years vs. North American airlines at ~10-14% in recent years, according to IATA. More consolidated North American market is often associated with stricter capacity discipline. The fragmented nature of the

European airline industry should present opportunities for more consolidation and collaboration, but political and regulatory barriers slow down progress. National carriers - like Finnair - seem to appeal to national interest.

European airlines: ROIC finally above WACC

According to IATA, profitability and ROIC of the European airline sector improved in 2015-2017: ROIC in Europe has exceeded 10% in 2015-2017 beating WACC, whereas in 2010-2014 ROIC in Europe was between 5-8%. Improved profitability in 2015-2017 was supported by a clear fall in jet (hedged) fuel price. Jet fuel spot bottomed in Q1'16 and rose throughout 2016 until late 2018. Profitability in Europe is expected to weaken somewhat in 2018E from the peak of 2017. Overall, intra-European competition is likely to continue to be driven by price and margins to remain tight. Finnair's growth strategy in Asia also requires increasing short-haul feeder traffic to Helsinki hub from Europe, where sustaining profitability will be challenging.

Several bankruptcies have been seen in Europe in 2017-2018

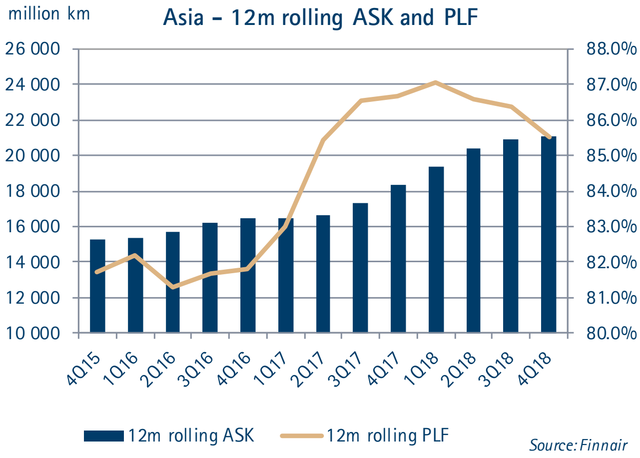
Several bankruptcies have been seen in Europe in 2017-2018. In 2017 Alitalia, Air Berlin and Monarch went bankrupt. Competitors bid for several of their assets. In 2018 smaller airlines including SkyWork, VLM, Cobalt Air, Small Planet Airlines Germany, Primera Air, Spparow Aviation and NextJet went out of business. Consolidation is healthy for the fragmented European industry, but we believe this is still far from sufficient to boost margins to US levels. M&A was at the table during 2018, with IAG pursuing Norwegian and Icenlandair wanting to buy Wow Air. Finnair has also been rumoured to be a takeover target a few years ago, with IAG-owned British Airways interested.

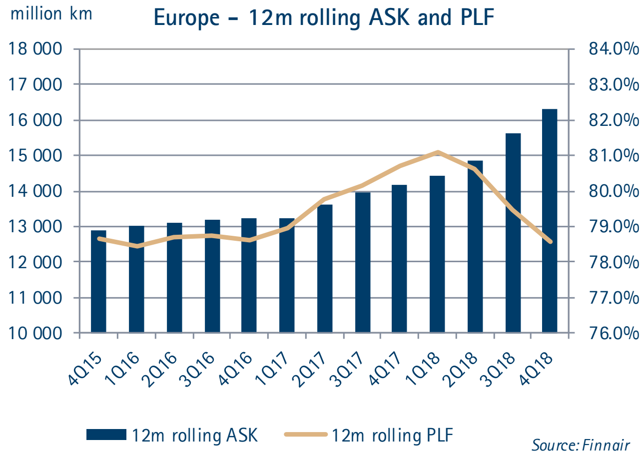
Traffic performance

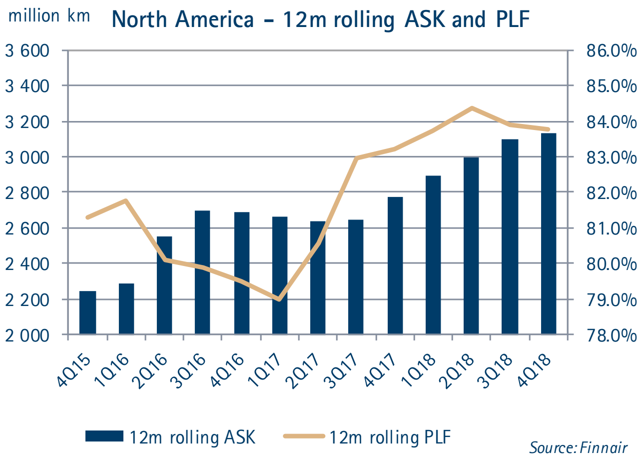
Traffic grew more than capacity in 2017, but trend turned in 2018

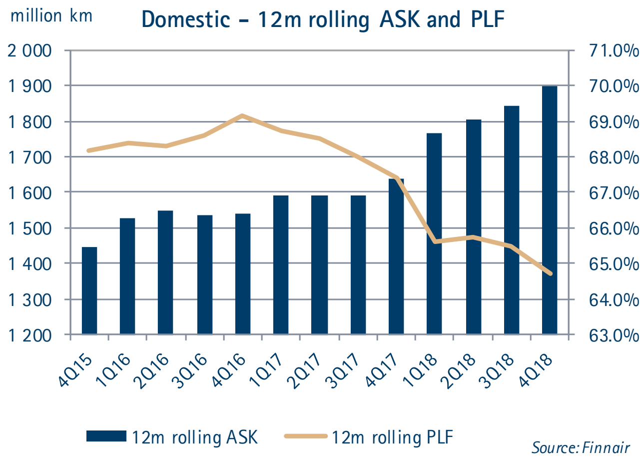
Finnair capacity has grown in all markets in 2017-2018. Passenger load factors (PLF) improved in most markets in 2017 despite a fairly rapid 9% ASK growth, but PLFs were generally in decline in 2018, impacted in part by capacity growth accelerating to 15%. Load factor development in the short-term is typically impacted by capacity growth: when capacity grows fast load factor typically declines as not all new seats are filled immediately. An additional negative contributor to weakening PLFs is competition: with Q3'18 earnings and related EBIT guidance downgrade Finnair flagged that competition had increased, especially in the Nordics. In 2019E Finnair's capacity will grow by about 10%, as per guidance. Added capacity will be put mostly on Asian routes in 209E.

Finnair's capacity (ASK) and passenger load factor (PLF) by region



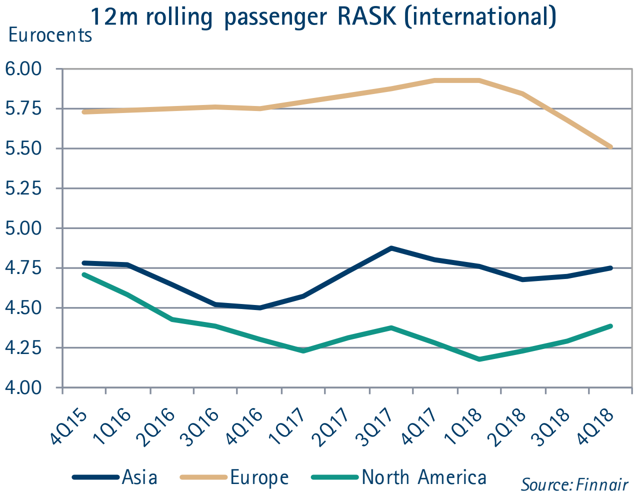


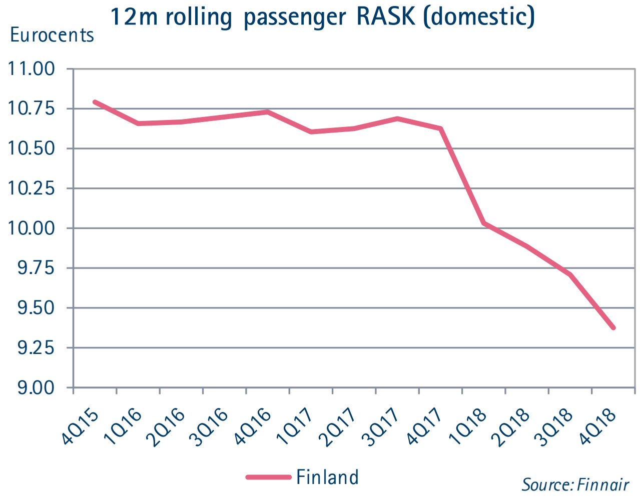


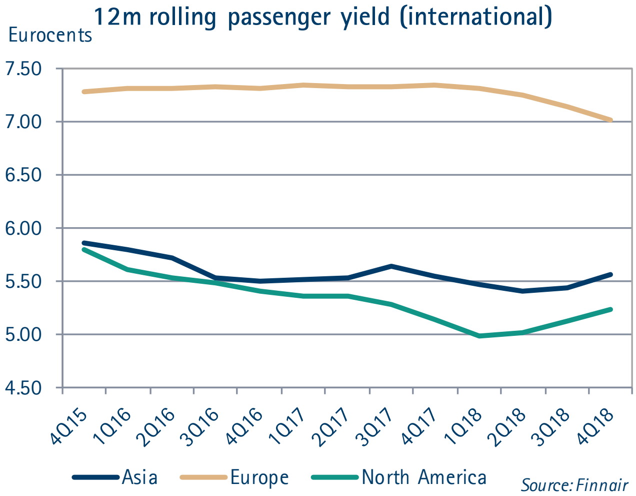


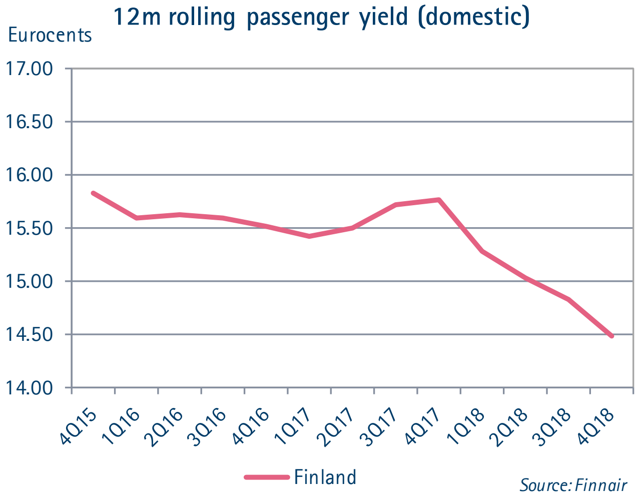
Softer traffic in 2018, especially in Europe

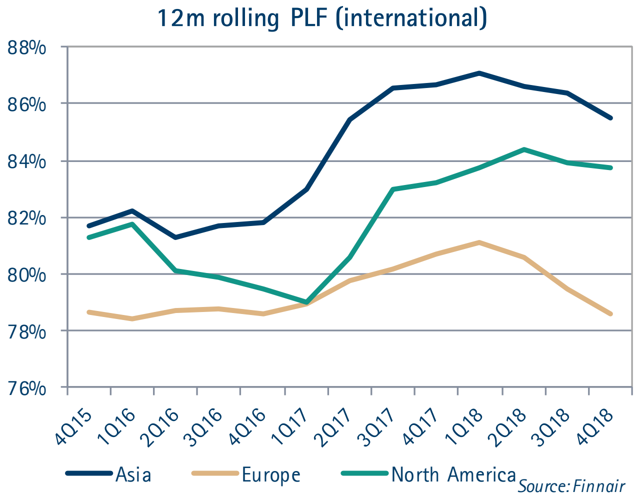
Finnair's passenger RASKs (passenger revenue/ASK) are determined by passenger yields (passenger revenue/RPK) and passenger load factors (PLF). Passenger yields reflect average fares per passenger (per km). In 2017 yield development was flattish in most markets. PLF improvements drove slight RASK improvements in Asian and European traffic in 2017. In 2018 PLFs generally declined especially after Q2. While Asian and North American yields were fairly stable in 2018, European and domestic yields declined. In European and domestic traffic both PLF and yield declined in 2018, resulting in weaker RASKs.

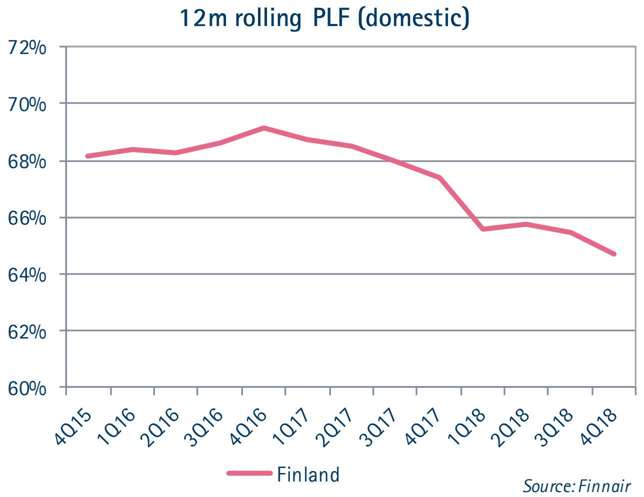

12m rolling passenger RASK (international)
Eurocents
6.00
5.75
5.50
5.25
5.00
4.75
4.50
4.25
4.00
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Asia
Europe
North America
Source: Finnair


12m rolling passenger RASK (domestic)
Eurocents
11.00
10.75
10.50
10.25
10.00
9.75
9.50
9.25
9.00
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Finland
Source: Finnair


12m rolling passenger yield (international)
Eurocents
7.50
7.00
6.50
6.00
5.50
5.00
4.50
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Asia
Europe
North America
Source: Finnair


12m rolling passenger yield (domestic)
Eurocents
17.00
16.50
16.00
15.50
15.00
14.50
14.00
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Finland
Source: Finnair


12m rolling PLF (international)
88%
86%
84%
82%
80%
78%
76%
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Asia
Europe
North America
Source: Finnair


12m rolling PLF (domestic)
72%
70%
68%
66%
64%
62%
60%
4Q15 1Q16 2Q16 3Q16 4Q16 1Q17 2Q17 3Q17 4Q17 1Q18 2Q18 3Q18 4Q18
Finland
Source: Finnair

Ancillary income and cargo support earnings

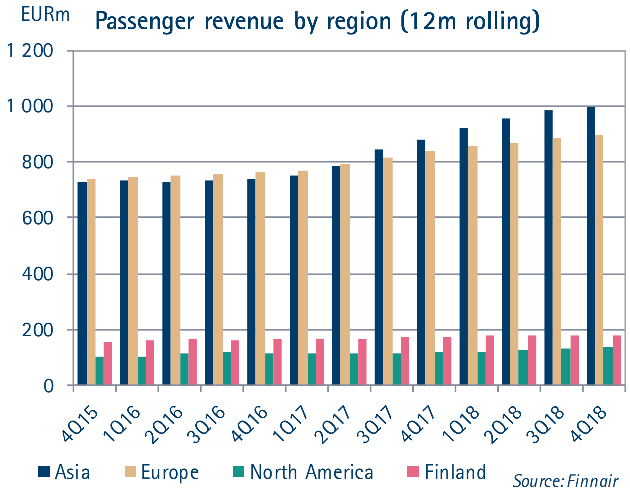
Ancillary income supports margins

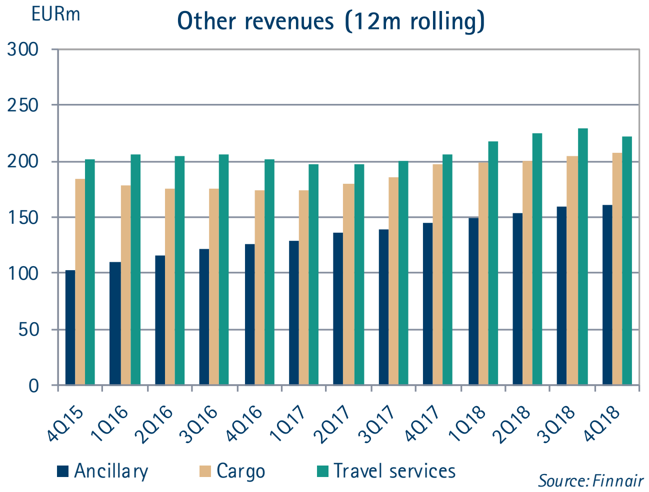
Worldwide, airlines are seeking new ancillary revenue sources to complement traditional baggage and seat fees with last minute upgrades, extra legroom seats, empty seat options, onboard Wi-Fi and other services offering new revenue streams. Increasing high-margin ancillary sales will be one main profit drivers in the industry. Finnair's ancillary sales per passenger improved in 2016-2017 from EUR 11 level to EUR 12 level, but in 2018 progress stalled with delays in bringing certain services live. Finnair is targeting EUR 15 level per passenger. Margins in many ancillary categories are high and boost overall EBIT-margin.

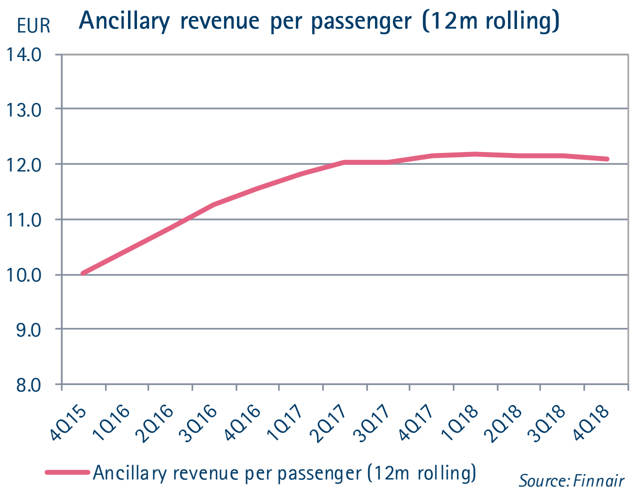
Cargo – new EUR 80m cargo terminal live from early 2018 onwards

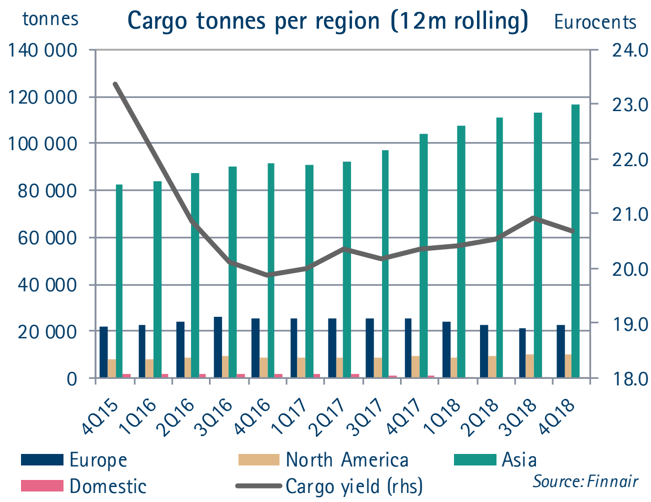
Cargo revenue is another important revenue source for Finnair. Finnair Cargo is specialized in air cargo traffic between Europe and Asia. Key products are pharma and perishables such as fish and seafood. Shift away from bulk to specialty cargo is a key margin driver. Growth in Cargo revenue is supported by increased capacity both on the air and on the ground: The new A350s will bring up to 50% more cargo capacity by year 2020, while Finnair's new EUR 80m COOL Nordic Cargo Terminal, which was brought live in early 2018, has been built to meet that load increase and is stated to be one of the world's most modern air cargo terminals with high automation and a leader in temperature-controlled logistics. The new terminal can be enlarged further if needed.

Revenue by source, cargo volumes per region and ancillary per passenger



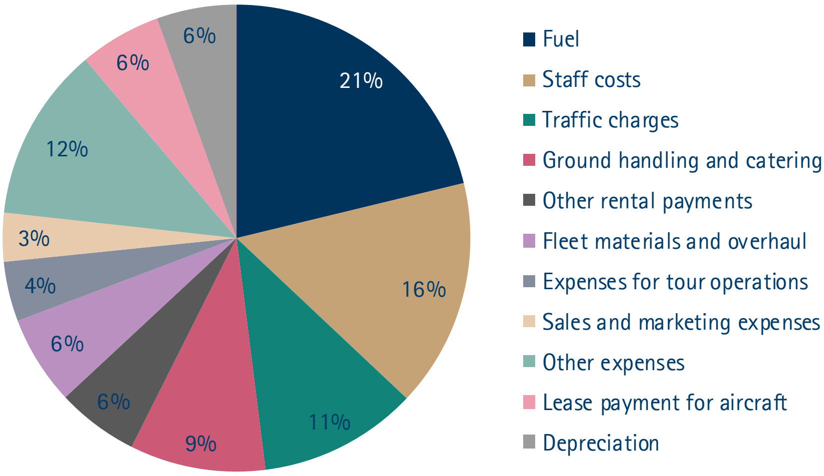






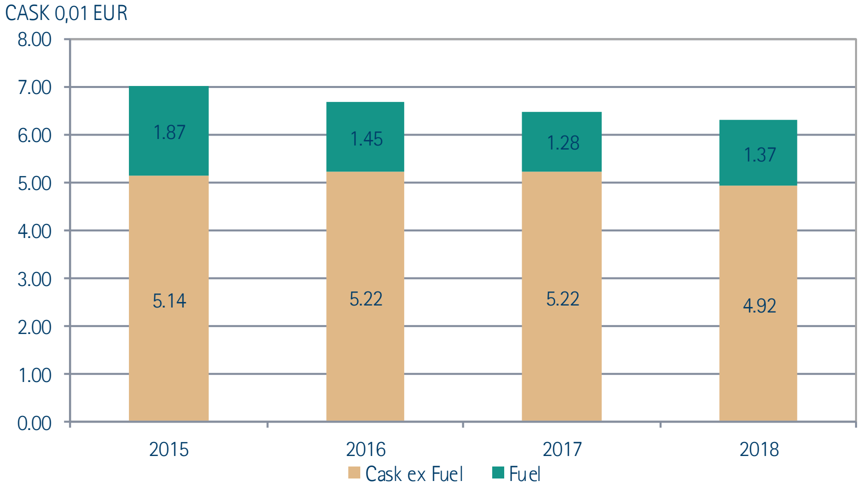
Cost Structure – Fuel and personnel

Finnair's cost structure in 2018 (before IFRS 16)



Source: Finnair

Cost move largely in line with ASK, except fuel



Source: Finnair

Fuel remains as key cost item

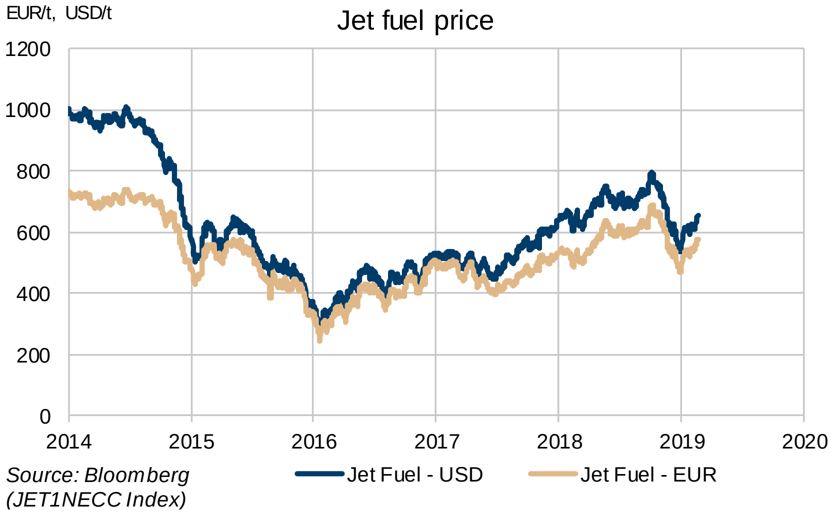
Jet fuel is the single largest cost item to Finnair. In 2018 fuel costs, EUR 581m accounted for 21% of group's operating expenses. Fuel is also the most volatile item. According to company, 10% change in fuel price translates into EUR 25m in yearly EBIT, taking hedging into account. Jet fuel principally tracks crude prices. Forecasting of price development is challenging, as OPEC-led production changes and political events can change the landscape rapidly. The spot price of jet fuel has increased since 2016 and the upward curve continued until turning in late 2018. Finnair hedges its fuel purchases for the next 24 months on a rolling basis, and therefore changes in fuel price show up in cost figures with a delay. Weakening of USD is positive for Finnair as it reduces jet fuel prices in euro. Changes in fuel price should eventually be reflected in passenger RASK (traffic revenue per available seat kilometre), ie. fuel price changes should pass through to ticket fares – however competition pricing dynamics, potentially preventing this from happening at least in the short term.

Fleet renewal improves fuel efficiency

Fleet renewal also impacts fuel costs. According to Finnair the A350 is up to 25% more fuel-efficient than the replaced A340. 2016 was the first full year when A350 impacted fuel efficiency measures. Effect of A350 on fuel consumption looks promising: in 2016-2018 consumption per ASK decreased 2-3%. A 2.5%-point enhancement in fuel efficiency should correspond to ca. 25,000 tonnes of fuel, which should translate into EUR 13-15m cost savings.

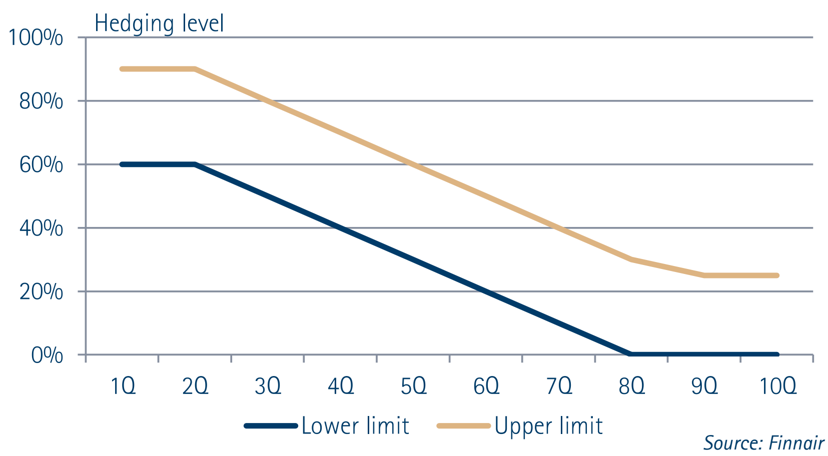
Fuel price eased towards the end of 2018 improving the outlook for 2019E, but has been increasing again in Jan-Feb 2019

Jet fuel spot prices increased since 2016, but turned in late 2018



Finnair hedges its fuel purchases for 24 months forward on a rolling basis, with the degree of hedging decreasing towards the end of the hedging period. The higher and lower limits of the degree of hedging are 90% and 60% for the following six months.

Finnair hedges jet fuel purchases on a 24 month rolling basis



Fuel consumption per ASK has decreased by 2-3% in 2016-2018 with A350s

Finnair's fuel efficiency has improved with A350s

Fuel efficiency	2013	2014	2015	2016	2017	2018
Fuel g/RPK	32.8	32.6	32.6	32.3	30.0	29.7
chg-%		-0.6%	0.0%	-0.9%	-7.1%	-1.0%
Fuel g/ASK	26.3	26.4	26.2	25.8	25.0	24.3
chg-%		0.4%	-0.8%	-1.5%	-3.1%	-2.8%
Fuel g/RTK	273.5	270.7	271.2	265.3	247.6	251.3
chg-%		-1.0%	0.2%	-2.2%	-6.7%	1.5%
Fuel g/ATK	180.0	180.9	180.1	174.1	167.0	165.4
chg-%		0.5%	-0.4%	-3.3%	-4.1%	-1.0%

Note: RPK and ASK describe passenger traffic performance, while RTK and ATK describe performance according to payload capacity (passengers+cargo). Finnair monitors the fuel efficiency of its flights primarily by the payload indicator (RTK), which accounts for passenger load factor, volume of cargo transported and distance between the origin and destination.

Source: Finnair

Personnel increasing with new capacity, but at lower wages

Staff costs are Finnair's second largest single expense, being 16% of total costs in 2018. Staff costs increased in 2017 as catering operations were transferred back to Finnair from LSG Sky Chefs; due to other recruitments; due to extensive training of flight crew; due to provisions made for incentive schemes and a EUR 6.7m, profit-based contribution to the personnel fund; and due to a EUR 13m extra reward to personnel. In 2018 staff costs increased by only 2.4%, as the comparison figure included a EUR 13m reservation for employee bonuses and also a EUR 11m reservation for pilots' share-linked incentive scheme, which was reversed in 2018. Comparable staff costs increased by 8% in 2018.

Most other cost grow in line with volume

Traffic charges account for roughly 11% of total costs. Development in traffic charges is driven by the passenger volume and regular index adjustments by the airport authorities. Moreover, the charges are denominated in USD and thus, as a cost item, exposed to a currency risk. Ground handling and catering operations, 9% of total costs, were both outsourced in 2016 but catering was insourced in spring of 2017. These costs are linked to volume. Majority of the technical services operations including engine services, maintenance, warehouse services have been outsourced. Also these costs develop in line with volume. Depreciations, aircraft lease payments and maintenance costs increase with fleet.

Financial performance and outlook

2015 – First A350s, fall in oil price, M&A speculation

Finnair generated an operating loss in 2014, but going to 2015 outlook was improving. In autumn of 2015 Finnair received first three Airbus A350 aircraft, paving the way for the Asian strategy. Expectation was that the company would reach black figures for good, positive momentum being driven by drop in jet fuel price, introduction of new Asian routes and fleet renewal. Growing capacity should start to elevate revenues and new fleet generate cost savings. However, Paris terrorist attacks in November 2015 and continuous concerns over Russian development diluted prospects. Also M&A speculations increased: state control was on the table and merger rumours with BA flourished.

2016 – More A350s, growth pains

Oil price bottomed in Q1 2016. Finnish government announced that it will retain majority ownership in Finnair and muted M&A speculation. Q1 disappointed with growth pains and a cost saving plan of EUR 20m to be reached by summer 2017 was launched. In Q2-Q3 Finnair received 3 new A350s but the company was not able to fill all new seats and a negative earnings impact followed. There were delays in A350 delivery schedule and expensive wet leases increased costs by EUR 20m in 2016. Ticket prices turned out to be quite sensitive to changes in jet fuel price, and margins remained tight, especially in Europe. SMT was divested in November 2016. Finnair posted comparable EBIT of EUR 55m (24m) on sales of EUR 2,317m (2,254m) for 2016. Unit revenue (RASK) decreased by 3.5% year-on-year and amounted to 6.83 eurocents. ASK grew by 6.5% and RPK by 5.8%. Finnair added 4 A350s in 2016 of which one was sold and leased back.

2017 – a record year for Finnair

2017 marked a record year for Finnair. In May 2017 Finnish government agreed with Russia over continuation of trans-Siberian overflight rights. New treaty allows Finnair to expand its Asian capacity by ca. 15% and open 10 new routes. Four new A350 planes were delivered in Q2-Q3 and with this all A340s had been replaced. While wide-body plane count did not grow in 2017, higher number of seats in A350s vs. the preplaced A340s and 6 new narrow-body planes increased ASK by 9.6% for the full 2017. Despite a fairly rapid capacity increase, Finnair's traffic increased more than capacity in 2017: passenger numbers grew by 11.3% while RPK grew by as much as 13.6%. Passenger load factors improved in all markets expect domestic traffic. Finnair upgraded its revenue guidance in Q2 and guided adj. EBIT to broadly double from EUR 55m in 2016. Guidance was upgraded again in September 2017 for adj. EBIT, which was now seen at EUR 135-155m. A third guidance upgrade came in November: revenue was now seen growing faster than capacity and adj. EBIT exceeding EUR 155m. With strong traffic performance, continued decrease of fuel costs and finalization of the EUR 20m cost savings program initiated in 2016, Finnair ended the year with a record adj. EBIT of EUR 170m and met its 6% EBIT margin target.

2018 – strong performance softened towards H2

The start of 2018 was promising: the load factor improvement seen in 2017 continued in Q1 despite strong 19% capacity growth in Q1. In Q2 capacity growth remained strong at 18%, but load factor now turned to -1.2pp decline. A disappointing guidance for adj. EBIT was provided with Q2 earnings: with a clear increase in jet fuel prices Finnair saw 2018E adj. EBIT remaining broadly at last year's level of EUR 170m. In Q3 traffic disappointed and fuel moved up further, reaching multi-year high at the end of Q3. With weaker traffic and increased fuel Finnair's 12m rolling adj. EBIT trend weakened for the first time in Q3'18 after 15 straight quarters of improvement. Guidance was also downgraded with Q3 earnings: adj. EBIT was now expected to somewhat weaken vs. be flat previously, reflecting increased competition especially in the Nordics (ie. European traffic) and higher fuel. In Q4 traffic again disappointed, as passenger load factor continued to weaken notably (-3.4pp) with increased competitive pressures. However, despite disappointing Q4 traffic revenue and earnings surprised on the positive side in Q4: fuel and yield were behind the earnings beat and Finnair ended the year broadly at adj. EBIT level of the previous year. Fuel costs were EUR 10m less than we expected in Q4, while on the revenue side yield surprisingly grew by 3.5% while we expected a decline to continue as increased competition had been flagged during H2. Yields improved in Asian and North American traffic (10-12% y/y) in Q4 and Finnair attributed this to the introduction of a new revenue management tool (during 2018) and to better demand/supply balance in Asia than in EU and domestic traffic. Management noted that the new revenue management tool puts more emphasis on optimising profitability of the whole network rather than individual routes. This may have potentially had a negative impact on PLF, but positive impact on yield.

2019E – ASK to grow by 10% driven largely by new A350s

2019E started with soft traffic data in January as PLF continued to decline (-3.1pp). The guidance given with Q4 earnings in February indicates 10% ASK growth for 2019E and revenue growth slightly behind capacity growth. The 10% capacity growth is largely based on three A350s: Finnair will receive both of its 2019-delivered new A350s during H1 (Feb and Apr), on top of which the Dec 2018 -delivered A350 will contribute to ASK growth. New capacity will be mostly put to Asian routes. Increased long-haul capacity should improve capacity balance in 2019E: additions in 2018 were mostly short-haul and in 2019E new long-haul additions will support the intra- European feeder traffic better. However, at the same time competition is expected to increase further with capacity increases in the industry, especially on routes between Europe and Asia and in intra-European traffic, even though Norwegian's planned capacity cuts may impact Finnair positively on some routes. Demand is also seen to be at risk of softening with slowdown in economic growth. Increasing competition and potentially softer demand keep visibility short. Fuel price eased towards the end of 2018 improving the outlook for 2019E, but has been increasing again Jan-Feb 2019.

2020-2022E – the remaining A350s to be delivered

In 2020-2022E Finnair is scheduled to receive the remaining A350s: two planes in 2020E and 2021E and one plane in 2022E. This allows Finnair to move ahead with its Asian strategy. In addition to unpredictable fuel, competition remains a key issue: Potential entry of low cost (Asian) carriers to the EU-Asia traffic will remain a threat. Tight competition also supports the case for consolidation in Europe, although for Finnair national interest can be a restrictive factor.

Operating model

Our estimates do not yet reflect IFRS 16. Finnair will provide restated comparison figures in March 2019. We have increased our FY2019E adj. EBIT estimate by 5% from our latest report.

FINNAIR EURm	2015 FY	2016 FY	2017 FY	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2018 FY	2019E Q1	2019E Q2	2019E Q3	2019E Q4	2019E FY
Passenger transportation													
Passenger revenue	1766	1816	2021	485	577	652	531	2244	524	628	719	573	2443
y/y change	*7.7 %*	*2.8 %*	*11.3 %*	*14.6 %*	*13.4 %*	*9.1 %*	*8.0 %*	*11.1 %*	*8.1 %*	*8.7 %*	*10.3 %*	*7.9 %*	*8.9 %*
Passengers (thousands)	10294	10866	11905	3018	3456	3653	3155	13281	3282	3797	3991	3451	14521
y/y change	*7%*	*6%*	*10%*	*16%*	*13%*	*12%*	*7%*	*12%*	*9%*	*10%*	*9%*	*9%*	*9%*
ASK (mkm)	31 836	33 914	36 922	9 666	10 718	11 528	10 473	42 386	10 707	11 989	12 597	11 457	46 749
y/y change	*3%*	*7%*	*9%*	*19%*	*18%*	*14%*	*9%*	*15%*	*11%*	*12%*	*9%*	*9%*	*10%*
RPK (mkm)	25 592	27 065	30 749	8 016	8 847	9 743	8 055	34 660	8 579	9 733	10 642	8 884	37 838
y/y change	*3%*	*6%*	*14%*	*21%*	*16%*	*11%*	*4%*	*13%*	*7%*	*10%*	*9%*	*10%*	*9%*
Load factor (RPK/ASK), PLF	80.4 %	79.8 %	83.3 %	82.9%	82.5%	84.5%	76.9%	81.8 %	80.1%	81.2%	84.5%	77.5%	80.9 %
y/y change	*0.2%-p*	*-0.6%-p*	*3.5%-p*	*1.5%-p*	*-1.2%-p*	*-2.7%-p*	*-3.4%-p*	*-1.5%-p*	*-2.8%-p*	*-1.4%-p*	*0.0%-p*	*0.6%-p*	*-0.8%-p*
RASK (total revenue / ASK), cents	7.08	6.83	6.96	6.57	6.67	6.95	6.52	6.69	6.34	6.46	6.98	6.44	6.57
y/y change	*13.7 %*	*-3.5 %*	*1.8 %*	*-3.6 %*	*-4.2 %*	*-4.6 %*	*-2.9 %*	*-3.9 %*	*-3.5 %*	*-3.1 %*	*0.5 %*	*-1.2 %*	*-1.8 %*
Yield (Traffic revenue / RPK), cents	6.90	6.71	6.57	6.05	6.52	6.69	6.59	6.48	6.11	6.45	6.76	6.45	6.46
y/y change	*4%*	*-3%*	*-2%*	*-5%*	*-2%*	*-2%*	*3%*	*-1%*	*1%*	*-1%*	*1%*	*-2%*	*0%*
CASK (cents)	7.01	6.67	6.49	6.53	6.22	6.01	6.43	6.29	6.46	6.09	5.97	6.44	6.23
y/y change	*10%*	*-5%*	*-3%*	*-6%*	*-5%*	*-2%*	*-1%*	*-3%*	*-1%*	*-2%*	*-1%*	*0%*	*-1%*
CASK ex-fuel (cents)	5.14	5.22	5.22	5.21	4.87	4.60	5.05	4.92	5.02	4.66	4.51	5.00	4.79
y/y change	*19%*	*2%*	*0%*	*-6%*	*-8%*	*-6%*	*-3%*	*-6%*	*-4%*	*-4%*	*-2%*	*-1%*	*-3%*
Ancillary and retail													
Revenue	103	126	145	39	41	42	39	161	43	46	48	45	183
Revenue growth	*30.5 %*	*21.6 %*	*15.3 %*	*15.7 %*	*11.9 %*	*12.3 %*	*5.1 %*	*11.1 %*	*10.9 %*	*13.7 %*	*14.7 %*	*14.9 %*	*13.6 %*
Cargo													
Revenue	184	174	197	41	52	55	60	207	43	55	59	64	221
Revenue growth	*-20.6 %*	*-5.4 %*	*13.5 %*	*3.3 %*	*4.5 %*	*6.4 %*	*4.9 %*	*4.9 %*	*7.0 %*	*7.0 %*	*7.0 %*	*7.0 %*	*7.0 %*
Travel services													
Revenue	207	201	206	71	46	53	53	223	68	46	54	56	224
Revenue growth	*-3.2 %*	*-2.7 %*	*2.1 %*	*21.1 %*	*18.4 %*	*7.8 %*	*-10.7 %*	*8.2 %*	*-4.0 %*	*1.0 %*	*2.0 %*	*5.6 %*	*0.7 %*
Passenger revenue													
Asia	730	740	882	217	243	311	228	999	248	286	361	262	1157
Europe	738	761	839	182	245	259	212	898	193	261	274	227	956
North Atlantic	106	116	119	25	36	46	31	138	29	39	50	32	149
Domestic	156	165	174	55	41	33	49	178	54	42	34	51	181
Total revenue	**2255**	**2317**	**2569**	**635**	**715**	**801**	**683**	**2835**	**679**	**775**	**879**	**738**	**3071**
YoY change	***-1%***	***3%***	***11%***	***15%***	***13%***	***9%***	***6%***	***10%***	***7%***	***8%***	***10%***	***8%***	***8%***
Other income	85	76	77	20	18	18	19	74	18	18	18	18	72
Staff costs	**-353**	**-363**	**-423**	**-106**	**-116**	**-109**	**-102**	**-433**	**-109**	**-121**	**-115**	**-118**	**-463**
y/y change	*2%*	*3%*	*17%*	*17%*	*8%*	*-3%*	*-9%*	*2%*	*2%*	*5%*	*5%*	*16%*	*7%*
% of revenue	*16%*	*16%*	*16%*	*17%*	*16%*	*14%*	*15%*	*15%*	*16%*	*16%*	*13%*	*16%*	*15%*
Fuel	**-596**	**-492**	**-472**	**-127**	**-145**	**-163**	**-145**	**-581**	**-154**	**-171**	**-184**	**-165**	**-674**
y/y change	*-10%*	*-17%*	*-4%*	*14%*	*27%*	*31%*	*19%*	*23%*	*21%*	*18%*	*13%*	*13%*	*16%*
% of revenue	*26%*	*21%*	*18%*	*20%*	*20%*	*20%*	*21%*	*20%*	*23%*	*22%*	*21%*	*22%*	*22%*
Other OPEX	**-1160**	**-1268**	**-1314**	**-343**	**-349**	**-363**	**-364**	**-1419**	**-364**	**-372**	**-388**	**-388**	**-1512**
y/y change	*3%*	*9%*	*4%*	*6%*	*6%*	*11%*	*8%*	*8%*	*6%*	*7%*	*7%*	*7%*	*7%*
% of revenue	*51%*	*55%*	*51%*	*54%*	*49%*	*45%*	*53%*	*50%*	*54%*	*48%*	*44%*	*53%*	*49%*
Comparable EBIT	**24**	**55**	**171**	**4**	**48**	**108**	**9**	**169**	**-13**	**44**	**127**	**0**	**159**
Comp. EBIT-%	***1.0 %***	***2.4 %***	***6.6 %***	***0.6 %***	***6.7 %***	***13.5 %***	***1.3 %***	***6.0 %***	***-1.9 %***	***5.7 %***	***14.5 %***	***0.0 %***	***5.2 %***
IAC & fair value changes	98	61	54	2	-8	-3	47	38	0	0	0	0	0
EBIT	122	116	225	6	40	106	56	208	-13	44	127	0	159

Sources: Finnair, Evli estimates

Valuation – "Hold" with target price of EUR 8.0 (7.3)

We approach Finnair's valuation primarily through valuation multiples

We consider the visibility into Finnair's earnings development to be relatively short with intense competition and volatile fuel. We approach Finnair's valuation primarily through valuation multiples and compare them to Finnair's own historical multiples and to peer multiples. It is noteworthy that with IFRS 16 EV-based multiples (EV/EBITDA, EV/EBIT) change for both Finnair and its peers, which at present makes comparisons more challenging depending on the pace with which estimates reflect IFRS 16. Estimates for net debt may also differ for other reasons (treatment of hybrids, for example). However, market cap-based multiples P/E and P/B should be less affected and better comparable.

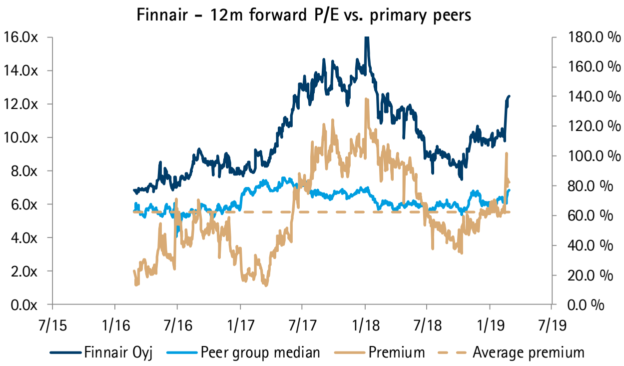
Valuation declined to more moderate levels in 2018

Finnair's valuation increased substantially during the record year 2017, but after reaching peak in 2018 valuation has now declined to more moderate levels. On our estimates Finnair's current P/E multiples are 10.8x for 2019E and 9.7x for 2020E. During the last 3 years, Finnair's 12m fwd P/E (on Factset consensus) has averaged 10.1x, ie. at present Finnair trades at 7% premium vs. own historical level with 2019E P/E. Finnair's 2019E P/E multiple, based on our estimates, is currently at some ~55% premium to the primary peer group, but this has been the case before as the P/E premium has averaged 62% during the past 3 years. On our estimates Finnair's P/B multiples are 1.0x and 0.9x in FY19-20E, respectively, or 1.2-1.1x when the EUR 200m hybrid removed from equity. At the same time, our estimates suggest Finnair generates ROCE of 8.8% in FY19-20E, in line with our WACC of 8.9%. Finnair's P/B multiples, based on our estimates, are currently at ~20-30% discount to primary peers in FY19-20E, but that also is broadly in line with the average discount of 24% during the last 3 years.

We consider the shares to be quite fairly valued – "Hold".

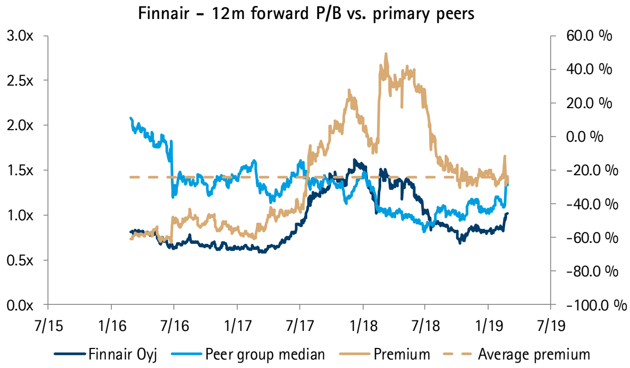
Overall, Finnair's current valuation appears largely fair to us - we retain "Hold" rating with TP of EUR 8.0 (7.3). Our TP values the shares close to par with Finnair's 3yr historical NTM P/E (10.1x) on our FY19E estimates.

P/E and P/B multiples vs. peers and own historical levels



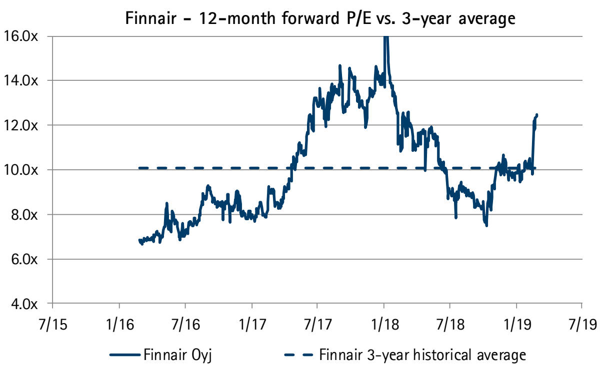
Source: Factset

Primary peers include SAS, Norwegian, IAG, Lufthansa and Air France-KLM

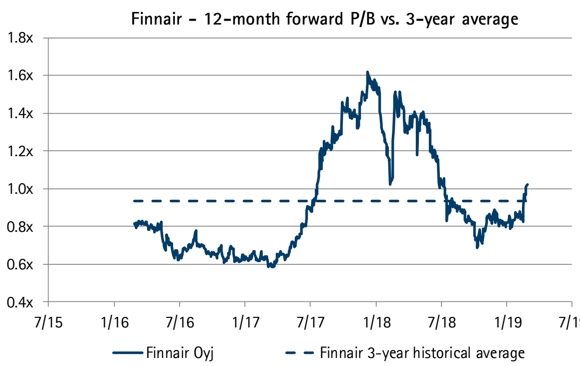


Source: Factset

Primary peers include SAS, Norwegian, IAG, Lufthansa and Air France-KLM



Source: Factset



Source: Factset

Peer group

Our model treats Finnair's EUR 200m hybrid bond as 100% equity. Our estimates exclude IAC and fair value changes, but include hybrid interest. If the EUR 200m hybrid bond is removed from equity, Finnair's P/B is 1.2-1.1x in FY19-20E. At the same time, our estimates suggest Finnair generates ROCE of 8.8% in FY19-20E, in line with our WACC of 8.9%.

It is noteworthy that with IFRS 16 EV-based multiples (EV/EBITDA, EV/EBIT) change for both Finnair and its peers, which at present makes comparisons more challenging depending on the pace with which estimates reflect IFRS 16. Estimates for net debt may also differ for other reasons. This warrants caution when looking at relative valuation with EV-based measures. On EV/EBITDA and EV/EBIT, Finnair trades below peers on our estimates, but closer to peers on consensus estimates - the difference seems to be driven mostly by different estimates for net debt. However, earnings- and market cap-based multiples P/E and P/B should be less affected. Our estimates do not yet reflect IFRS 16.

FINNAIR PEER GROUP	MCAP local FX	EV/EBITDA 19	EV/EBITDA 20	EV/EBITDA 21	EV/EBIT 19	EV/EBIT 20	EV/EBIT 21	P/E 19	P/E 20	P/E 21	P/B 19	P/B 20	P/B 21
Primary European peers													
SAS AB	9037	4.8x	4.3x	4.1x	9.5x	8.7x	7.2x	9.4x	6.8x	5.8x	1.2x	1.0x	0.8x
International Consolidated Airlines Group	12237	3.0x	3.0x	2.5x	4.3x	4.3x	3.7x	6.0x	5.5x	4.8x	1.4x	1.2x	1.1x
Air France-KLM SA	5442	2.7x	2.4x	2.2x	8.5x	7.1x	6.3x	8.0x	6.8x	6.2x	1.5x	1.3x	1.2x
Deutsche Lufthansa AG	11172	2.9x	2.6x	2.1x	5.1x	4.4x	3.6x	5.4x	5.0x	4.6x	0.9x	0.7x	0.6x
Norwegian Air Shuttle ASA	8111	17.1x	12.1x	8.4x	138.5x	31.6x	17.6x		54.0x	5.4x	1.7x	1.7x	1.9x
Other European peers													
Aegean Airlines SA	563	3.0x	2.8x		3.7x	3.3x		9.0x	8.0x		1.9x	1.7x	
easyJet plc	5333	6.5x	6.2x	5.6x	9.3x	9.0x	8.0x	11.8x	11.0x	9.6x	1.5x	1.4x	1.3x
Flybe Group PLC	3												
Ryanair Holdings Plc	14043	7.6x	6.3x	5.0x	11.7x	9.5x	7.4x	12.9x	10.4x	8.6x	2.4x	2.0x	
Wizz Air Holdings Plc	2307	3.0x	2.3x	1.2x	4.3x	3.3x	2.9x	13.2x	10.7x	9.9x	2.1x	1.7x	1.8x
North American peers													
American Airlines Group, Inc.	16278	6.2x	5.9x	5.5x	8.9x	8.6x	8.2x	5.9x	5.7x	5.2x	7.7x	4.0x	2.1x
Delta Air Lines, Inc.	34708	4.7x	4.4x	4.2x	6.6x	6.3x	5.9x	7.8x	7.3x	6.7x	2.0x	1.6x	1.3x
JetBlue Airways Corporation	5266	4.3x	3.9x	3.5x	6.7x	6.0x	5.2x	8.3x	7.2x	6.1x	0.9x	0.8x	0.7x
Southwest Airlines Co.	29674	5.8x	5.4x	5.1x	7.9x	7.4x	7.0x	10.5x	9.7x	8.8x	2.3x	2.0x	1.6x
Spirit Airlines, Inc.	4169	6.3x	5.9x	5.1x	8.3x	7.9x	6.9x	9.3x	8.7x	8.1x	1.8x	1.5x	1.3x
United Continental Holdings, Inc.	24394	5.1x	4.8x	4.4x	7.8x	7.4x	6.7x	7.8x	7.3x	6.4x	1.9x	1.6x	1.3x
WestJet	2393	4.8x	4.3x	2.8x	11.9x	9.8x	6.1x	12.2x	9.7x	7.6x	1.0x	0.9x	0.8x
Primary European peers median		**3.0x**	**3.0x**	**2.5x**	**8.5x**	**7.1x**	**6.3x**	**7.0x**	**6.8x**	**5.4x**	**1.4x**	**1.2x**	**1.1x**
Finnair (Evli est)*		**2.2x**	**2.2x**	**2.1x**	**4.7x**	**4.5x**	**4.2x**	**10.8x**	**9.7x**	**7.9x**	**1.0x**	**0.9x**	**0.9x**
*Finnair discount/premium to primary peer group median**		*-26%*	*-26%*	*-18%*	*-45%*	*-37%*	*-33%*	*54%*	*42%*	*46%*	*-28%*	*-21%*	*-19%*

FINNAIR PEER GROUP	Ticker	Div yield 19	Div yield 20	Div yield 21	EBIT-% 19	EBIT-% 20	EBIT-% 21	ROCE-% 19	ROCE-% 20	ROCE-% 21	ROE-% 19	ROE-% 20	ROE-% 21
Primary European peers													
SAS AB	SAS-SE	0.0%	0.0%	0.0%	3.7%	5.1%	5.3%	7.7%	9.8%	9.7%	12.3%	14.2%	14.6%
International Consolidated Airlines Group	IAG-GB	4.5%	4.8%	5.1%	12.3%	12.3%	13.0%	16.0%	15.6%	15.2%	22.9%	21.2%	21.8%
Air France-KLM SA	AF-FR	0.3%	0.7%	0.6%	4.9%	5.3%	5.5%	7.2%	7.7%	8.6%	19.3%	18.6%	19.9%
Deutsche Lufthansa AG	LHA-DE	3.9%	4.2%	4.1%	7.6%	7.9%	8.0%	11.1%	11.3%	10.7%	15.8%	14.9%	13.4%
Norwegian Air Shuttle ASA	NAS-NO	0.0%	0.1%	0.5%	1.0%	4.3%	7.5%	0.8%	3.6%	6.7%	-26.3%	3.1%	34.8%
Other European peers													
Aegean Airlines SA	AEGN-GR	6.0%	6.5%		7.2%	7.9%		23.9%	22.8%		21.1%	21.2%	
easyJet plc	EZJ-GB	4.3%	4.6%	5.1%	8.9%	8.9%	9.5%	10.5%	10.3%	10.8%	13.0%	12.9%	13.4%
Flybe Group PLC	FLYB-GB												
Ryanair Holdings Plc	RY4C-IE	0.2%	0.2%	0.0%	14.8%	16.4%	18.0%	13.0%	14.5%	15.0%	18.6%	19.3%	
Wizz Air Holdings Plc	WIZZ-GB	0.0%	0.0%		14.4%	15.2%	13.4%	18.3%	20.4%		16.1%	16.0%	17.7%
North American peers													
American Airlines Group, Inc.	AAL-US	1.1%	1.1%	1.1%	9.5%	9.0%	8.6%	10.3%	9.9%	10.2%	130.3%	70.2%	41.0%
Delta Air Lines, Inc.	DAL-US	2.8%	3.1%	3.4%	13.4%	12.9%	12.9%	14.3%	13.7%	14.1%	25.6%	22.0%	19.4%
JetBlue Airways Corporation	JBLU-US	0.0%	5.8%	0.0%	11.4%	11.8%	12.7%	10.9%	11.1%	12.1%	11.0%	11.0%	11.1%
Southwest Airlines Co.	LUV-US	1.3%	1.5%	2.0%	15.6%	15.1%	14.7%	19.1%	18.6%	20.2%	21.6%	20.2%	18.2%
Spirit Airlines, Inc.	SAVE-US	0.0%	1.6%	0.0%	16.3%	15.2%	14.7%	13.1%	12.0%	11.2%	19.2%	17.2%	15.7%
United Continental Holdings, Inc.	UAL-US	0.0%	0.0%	0.0%	10.4%	10.0%	10.2%	12.5%	11.7%	12.2%	24.2%	21.2%	20.4%
WestJet	WJA-CA	2.7%	2.7%	2.7%	6.0%	6.9%	7.7%	6.6%	7.8%		8.0%	9.3%	11.1%
Primary European peers median		**0.3%**	**0.7%**	**0.6%**	**4.9%**	**5.3%**	**7.5%**	**7.7 %**	**9.8 %**	**9.7 %**	**15.8%**	**14.9%**	**19.9%**
Finnair (Evli est)*	FIA1S-FI	**3.6%**	**4.2%**	**4.8%**	**5.2%**	**5.5%**	**5.8%**	**8.8 %**	**8.8 %**	**8.9 %**	**9.4%**	**9.9%**	**11.2%**

Source: Factset, Evli Research

Note: Our model treats Finnair's EUR 200m hybrid bond as 100% equity. Our estimates exclude IAC and fair value changes, but include hybrid interest.

VALUATION RESULTS		BASE CASE DETAILS		VALUATION ASSUMPTIONS		ASSUMPTIONS FOR WACC	
Current share price	8.33	PV of Free Cash Flow	521	Long-term growth, %	2.0	Risk-free interest rate, %	2.25
DCF share value	11.84	PV of Horizon value	598	WACC, %	8.9	Market risk premium, %	5.8
Share price potential, %	42.1	Unconsolidated equity	0	Spread, %	0.5	Debt risk premium, %	2.8
Maximum value	12.5	Marketable securities	1,067	Minimum WACC, %	8.4	Equity beta coefficient	1.20
Minimum value	11.2	Debt - dividend	-669	Maximum WACC, %	9.4	Target debt ratio, %	20
Horizon value, %	53.4	Value of stock	1,516	Nr of shares, Mn	128.1	Effective tax rate, %	25

DCF valuation, EURm	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	Horizon
Net sales	2,835	3,071	3,211	3,339	3,456	3,525	3,596	3,668	3,741	3,816	3,892	3,970
Sales growth, %	*10.4*	*8.4*	*4.6*	*4.0*	*3.5*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*
Operating income (EBIT)	169	159	177	194	207	176	180	183	150	153	156	159
EBIT margin, %	*6.0*	*5.2*	*5.5*	*5.8*	*6.0*	*5.0*	*5.0*	*5.0*	*4.0*	*4.0*	*4.0*	*4.0*
+ Depreciation+amort.	151	172	183	197	209	208	209	210	212	215	218	
- Income taxes	-34	-32	-35	-39	-41	-35	-36	-37	-30	-31	-31	
- Change in NWC	50	2	1	1	1	0	0	0	0	0	0	
NWC / Sales, %	*-26.3*	*-24.3*	*-23.3*	*-22.4*	*-21.6*	*-21.2*	*-20.8*	*-20.4*	*-20.0*	*-19.7*	*-19.3*	
+ Change in other liabs	-91	0	0	0	0	0	0	0	0	0	0	
- Capital Expenditure	-102	-310	-310	-310	-200	-210	-220	-230	-240	-240	-250	-255
Investments / Sales, %	*3.6*	*10.1*	*9.7*	*9.3*	*5.8*	*6.0*	*6.1*	*6.3*	*6.4*	*6.3*	*6.4*	*6.4*
- Other items	34	-13	-13	0	0	0	0	0	0	0	0	
= Unlevered Free CF (FCF)	177	-22	3	43	176	140	133	127	92	98	93	1,380
= Discounted FCF (DFCF)		-20	2	34	127	93	81	71	47	46	40	598

= DFCF min WACC	-21	2	34	129	95	83	73	49	48	42	674
= DFCF max WACC	-20	2	33	125	91	79	69	46	44	38	533

INTERIM FIGURES

EVLI ESTIMATES, EURm	2018Q1	2018Q2	2018Q3	2018Q4	2018	2019Q1E	2019Q2E	2019Q3E	2019Q4E	2019E	2020E	2021E
Net sales	635	715	801	683	2,835	679	775	879	738	3,071	3,211	3,339
EBITDA	40	84	146	52	320	30	87	170	43	331	360	391
EBITDA margin (%)	*6.2*	*11.7*	*18.2*	*7.5*	*11.3*	*4.4*	*11.3*	*19.4*	*5.9*	*10.8*	*11.2*	*11.7*
EBIT	4	48	108	9	169	-13	44	127	0	159	177	194
EBIT margin (%)	*0.6*	*6.7*	*13.5*	*1.3*	*6.0*	*-1.9*	*5.7*	*14.5*	*0.0*	*5.2*	*5.5*	*5.8*
Net financial items	-4	-5	-5	-4	-18	-5	-5	-5	-5	-19	-23	-25
Pre-tax profit	0	43	103	5	151	-18	40	123	-5	140	154	169
Tax	0	-9	-21	-1	-30	4	-8	-25	1	-28	-31	-34
Tax rate (%)	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*
Net profit	-3	31	79	1	108	-18	29	95	-7	99	111	135
EPS	-0.03	0.24	0.62	0.01	0.84	-0.14	0.22	0.74	-0.05	0.77	0.86	1.05
EPS adjusted (diluted no. of shares)	-0.03	0.24	0.62	0.01	0.84	-0.14	0.22	0.74	-0.05	0.77	0.86	1.05
Dividend per share	0.00	0.00	0.00	0.00	0.27	0.00	0.00	0.00	0.00	0.30	0.35	0.40
SALES, EURm												
Group total	635	715	801	683	2,835	679	775	879	738	3,071	3,211	3,339
Total	635	715	801	683	2,835	679	775	879	738	3,071	3,211	3,339
SALES GROWTH, Y/Y %												
Group total	*14.6*	*12.9*	*8.9*	*5.8*	*10.4*	*6.9*	*8.4*	*9.8*	*8.0*	*8.4*	*4.6*	*4.0*
Total	*14.6*	*12.9*	*8.9*	*5.8*	*10.4*	*6.9*	*8.4*	*9.8*	*8.0*	*8.4*	*4.6*	*4.0*
EBIT, EURm												
Group total	4	48	108	9	169	-13	44	127	0	159	177	194
Total	4	48	108	9	169	-13	44	127	0	159	177	194
EBIT margin, %												
Group total	*0.6*	*6.7*	*13.5*	*1.3*	*6.0*	*-1.9*	*5.7*	*14.5*	*0.0*	*5.2*	*5.5*	*5.8*
Total	*0.6*	*6.7*	*13.5*	*1.3*	*6.0*	*-1.9*	*5.7*	*14.5*	*0.0*	*5.2*	*5.5*	*5.8*

INCOME STATEMENT, EURm	2014	2015	2016	2017	2018	2019E	2020E	2021E
Sales	2,285	2,255	2,317	2,568	2,835	3,071	3,211	3,339
Sales growth (%)	*-4.8*	*-1.3*	*2.8*	*10.9*	*10.4*	*8.4*	*4.6*	*4.0*
Costs	-2,187	-2,123	-2,156	-2,269	-2,514	-2,740	-2,852	-2,949
Reported EBITDA	98	132	161	300	320	331	360	391
Extraordinary items in EBITDA	0	0	0	0	0	0	0	0
EBITDA margin (%)	*4.3*	*5.8*	*6.9*	*11.7*	*11.3*	*10.8*	*11.2*	*11.7*
Depreciation	-134	-108	-106	-129	-151	-172	-183	-197
EBITA	-36	24	55	170	169	159	177	194
Goodwill amortization / writedown	0	0	0	0	0	0	0	0
Reported EBIT	-36	24	55	170	169	159	177	194
EBIT margin (%)	*-1.6*	*1.1*	*2.4*	*6.6*	*6.0*	*5.2*	*5.5*	*5.8*
Net financials	-27	-8	-10	-14	-18	-19	-23	-25
Pre-tax profit	-63	15	45	157	151	140	154	169
Extraordinary items	0	-11	-1	-1	0	0	0	0
Taxes	13	-3	-9	-31	-30	-28	-31	-34
Minority shares	0	0	0	0	0	0	0	0
Net profit	-51	-18	19	112	108	99	111	135
BALANCE SHEET, EURm								
Assets								
Fixed assets	1,053	957	1,189	1,446	1,555	1,693	1,819	1,932
% of sales	*46*	*42*	*51*	*56*	*55*	*55*	*57*	*58*
Goodwill	0	0	0	0	0	0	0	0
% of sales	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Inventory	15	12	15	17	25	27	28	30
% of sales	*1*	*1*	*1*	*1*	*1*	*1*	*1*	*1*
Receivables	358	364	512	460	300	320	332	343
% of sales	*16*	*16*	*22*	*18*	*11*	*10*	*10*	*10*
Liquid funds	426	708	814	965	1,067	1,156	1,209	1,257
% of sales	*19*	*31*	*35*	*38*	*38*	*38*	*38*	*38*
Total assets	1,885	2,050	2,529	2,887	2,947	3,197	3,389	3,563
Liabilities								
Equity	514	727	857	1,016	1,022	1,086	1,158	1,248
% of sales	*23*	*32*	*37*	*40*	*36*	*35*	*36*	*37*
Deferred taxes	0	0	33	74	74	74	74	74
% of sales	*0*	*0*	*1*	*3*	*3*	*2*	*2*	*2*
Interest bearing debt	428	346	718	719	669	831	938	1,008
% of sales	*19*	*15*	*31*	*28*	*24*	*27*	*29*	*30*
Non-interest bearing current liabilities	601	682	519	566	285	309	323	336
% of sales	*26*	*30*	*22*	*22*	*10*	*10*	*10*	*10*
Other interest free debt	246	201	339	428	806	806	806	806
% of sales	*11*	*9*	*15*	*17*	*28*	*26*	*25*	*24*
Total liabilities	1,885	2,050	2,529	2,887	2,947	3,197	3,389	3,563
CASH FLOW, EURm								
+ EBITDA	98	132	161	300	320	331	360	391
- Net financial items	-27	-8	-10	-14	-18	-19	-23	-25
- Taxes	0	0	33	-1	-31	-28	-31	-34
- Increase in Net Working Capital	-33	43	56	57	50	2	1	1
+/- Other	-15	5	-19	40	62	-13	-13	0
= Cash flow from operations	23	171	220	382	383	273	295	333
- Capex	-146	-81	-486	-394	-316	-310	-310	-310
- Acquisitions	0	0	0	0	0	0	0	0
+ Divestments	268	448	153	157	214	0	0	0
= Net cash flow	144	538	-113	146	281	-37	-15	23
+/- Change in interest-bearing debt	-165	-81	372	1	-49	162	107	70
+/- New issues/buybacks	143	231	110	60	-64	0	0	0
- Paid dividend	0	0	0	-13	-38	-35	-38	-45
+/- Change in loan receivables	-107	-291	-167	79	-91	0	0	0
Change in cash	15	397	202	273	39	89	53	48

KEY FIGURES	2015	2016	2017	2018	2019E	2020E	2021E
M-cap	694	516	1,643	908	1,067	1,067	1,067
Net debt	-362	-96	-246	-398	-325	-272	-250
Enterprise value	332	420	1,397	510	742	796	818
Sales	2,255	2,317	2,568	2,835	3,071	3,211	3,339
EBITDA	132	161	300	320	331	360	391
EBIT	24	55	170	169	159	177	194
Pre-tax	15	45	157	151	140	154	169
Earnings	-6	21	113	108	99	111	135
Book value	727	857	1,016	1,022	1,086	1,158	1,248
Valuation multiples							
EV/sales	0.1	0.2	0.5	0.2	0.2	0.2	0.2
EV/EBITDA	2.5	2.6	4.7	1.6	2.2	2.2	2.1
EV/EBITA	14.0	7.6	8.2	3.0	4.7	4.5	4.2
EV/EBIT	14.0	7.6	8.2	3.0	4.7	4.5	4.2
EV/operating cash flow	1.9	1.9	3.7	1.3	2.5	2.4	2.3
EV/cash earnings	2.3	2.3	4.7	1.9	2.6	2.6	2.5
P/E	-107.2	24.9	14.6	8.4	10.8	9.7	7.9
P/E excl. goodwill	-107.2	24.9	14.6	8.4	10.8	9.7	7.9
P/B	1.0	0.6	1.6	0.9	1.0	0.9	0.9
P/sales	0.3	0.2	0.6	0.3	0.3	0.3	0.3
P/CF	4.1	2.4	4.3	2.4	3.6	3.3	3.0
Target EV/EBIT	*0.0*	*0.0*	*0.0*	*0.0*	*4.4*	*4.3*	*4.0*
Target P/E	*0.0*	*0.0*	*0.0*	*0.0*	*10.3*	*9.3*	*7.6*
Target P/B	*0.0*	*0.0*	*0.0*	*0.0*	*0.9*	*0.9*	*0.8*
Per share measures							
Number of shares	128,136	128,136	128,136	128,136	128,136	128,136	128,136
Number of shares (diluted)	128,136	128,136	128,136	128,136	128,136	128,136	128,136
EPS	-0.05	0.16	0.88	0.84	0.77	0.86	1.05
EPS excl. goodwill	-0.05	0.16	0.88	0.84	0.77	0.86	1.05
Cash EPS	1.13	1.43	2.31	2.12	2.21	2.39	2.59
Operating cash flow per share	1.33	1.71	2.98	2.99	2.35	2.54	2.75
Capital employed per share	2.83	5.92	5.99	4.84	5.91	6.89	7.77
Book value per share	5.68	6.69	7.93	7.97	8.47	9.04	9.74
Book value excl. goodwill	5.68	6.69	7.93	7.97	8.47	9.04	9.74
Dividend per share	0.00	0.10	0.30	0.27	0.30	0.35	0.40
Dividend payout ratio, %	0.0	61.7	34.1	32.5	38.8	40.6	38.0
Dividend yield, %	0.0	2.5	2.3	3.3	3.6	4.2	4.8
Efficiency measures							
ROE	-1.0	2.6	12.0	10.6	9.4	9.9	11.2
ROCE	2.4	4.2	10.3	9.9	8.8	8.8	8.9
Financial ratios							
Capex/sales, %	-16.3	14.4	9.2	3.6	10.1	9.7	9.3
Capex/depreciation excl. goodwill,%	-339.6	314.7	183.2	67.8	180.2	169.3	157.3
Net debt/EBITDA, book-weighted	-2.7	-0.6	-0.8	-1.2	-1.0	-0.8	-0.6
Debt/equity, market-weighted	0.5	1.4	0.4	0.7	0.8	0.9	0.9
Equity ratio, book-weighted	40.6	37.8	39.1	38.9	38.1	38.3	39.2
Gearing	-0.50	-0.11	-0.24	-0.39	-0.30	-0.23	-0.20
Number of employees, average	0	0	0	0	0	0	0
Sales per employee, EUR	0	0	0	0	0	0	0
EBIT per employee, EUR	0	0	0	0	0	0	0

COMPANY DESCRIPTION: Finnair is the Finnish flag carrier airline.

INVESTMENT CASE: Finnair has clearly improved its profitability in 2016-2017. Strategy relies on traffic between Asia and Europe with new A350 fleet.

OWNERSHIP STRUCTURE	SHARES	EURm	%
Prime Minister´s Office	71,515,426	595.723	55.8%
The Local Government Pensions Institution	6,250,875	52.070	4.9%
Tiiviste-Group Oy	2,150,000	17.909	1.7%
Ilmarinen Mutual Pension Insurance Company	1,945,000	16.202	1.5%
The State Pension Fund	1,700,000	14.161	1.3%
Oy Etra Invest Ab	1,000,000	8.330	0.8%
Veritas Pension Insurance Company Ltd.	849,991	7.080	0.7%
Finnair Oyj	797,008	6.639	0.6%
Laakkonen Mikko Kalervo	740,000	6.164	0.6%
Finnairin Henkilöstörahasto Hr.	466,400	3.885	0.4%
Ten largest	87,414,700	728.164	68%
Residual	40,721,415	339.209	32%
Total	128,136,115	1,067.374	100%

EARNINGS CALENDAR	
April 24, 2019	Q1 report
July 17, 2019	Q2 report
October 22, 2019	Q3 report
OTHER EVENTS	
March 20, 2018	AGM

COMPANY MISCELLANEOUS	
CEO: Topi Manner	Tietotie 9, 01053 FINNAIR (VANTAA AIRPORT)
CFO: Pekka Vähähyyppä	Tel: +358 9 818 2780
IR: Mari Reponen	

DEFINITIONS

P/E $\frac{\text{Price per share}}{\text{Earnings per share}}$	EPS $\frac{\text{Profit before extraordinary items and taxes} - \text{income taxes} + \text{minority interest}}{\text{Number of shares}}$
P/Sales $\frac{\text{Market cap}}{\text{Sales}}$	DPS Dividend for the financial period per share
P/BV $\frac{\text{Price per share}}{\text{Shareholders' equity} + \text{taxed provisions per share}}$	CEPS $\frac{\text{Gross cash flow from operations}}{\text{Number of shares}}$
P/CF $\frac{\text{Price per share}}{\text{Operating cash flow per share}}$	EV/Share $\frac{\text{Enterprise value}}{\text{Number of shares}}$
EV (Enterprise value) Market cap + net debt + minority interest at market value – share of associated companies at market value	Sales/Share $\frac{\text{Sales}}{\text{Number of shares}}$
Net debt Interest bearing debt – financial assets	EBITDA/Share $\frac{\text{Earnings before interest, tax, depreciation and amortisation}}{\text{Number of shares}}$
EV/Sales $\frac{\text{Enterprise value}}{\text{Sales}}$	EBIT/Share $\frac{\text{Operating profit}}{\text{Number of shares}}$
EV/EBITDA $\frac{\text{Enterprise value}}{\text{Earnings before interest, tax, depreciation and amortisation}}$	EAFI/Share $\frac{\text{Pretax profit}}{\text{Number of shares}}$
EV/EBIT $\frac{\text{Enterprise value}}{\text{Operating profit}}$	Capital employed/Share $\frac{\text{Total assets} - \text{non interest bearing debt}}{\text{Number of shares}}$
Div yield, % $\frac{\text{Dividend per share}}{\text{Price per share}}$	Total assets Balance sheet total
Payout ratio, % $\frac{\text{Total dividends}}{\text{Earnings before extraordinary items and taxes} - \text{income taxes} + \text{minority interest}}$	Interest coverage (x) $\frac{\text{Operating profit}}{\text{Financial items}}$
Net cash/Share $\frac{\text{Financial assets} - \text{interest bearing debt}}{\text{Number of shares}}$	Asset turnover (x) $\frac{\text{Turnover}}{\text{Balance sheet total (average)}}$
ROA, % $\frac{\text{Operating profit} + \text{financial income} + \text{extraordinary items}}{\text{Balance sheet total} - \text{interest free short term debt} - \text{long term advances received and accounts payable (average)}}$	Debt/Equity, % $\frac{\text{Interest bearing debt}}{\text{Shareholders' equity} + \text{minority interest} + \text{taxed provisions}}$
ROCE, % $\frac{\text{Profit before extraordinary items} + \text{interest expenses} + \text{other financial costs}}{\text{Balance sheet total} - \text{non interest bearing debt (average)}}$	Equity ratio, % $\frac{\text{Shareholders' equity} + \text{minority interest} + \text{taxed provisions}}{\text{Total assets} - \text{interest free loans}}$
ROE, % $\frac{\text{Profit before extraordinary items and taxes} - \text{income taxes}}{\text{Shareholders' equity} + \text{minority interest} + \text{taxed provisions (average)}}$	CAGR, % Cumulative annual growth rate = Average growth per year

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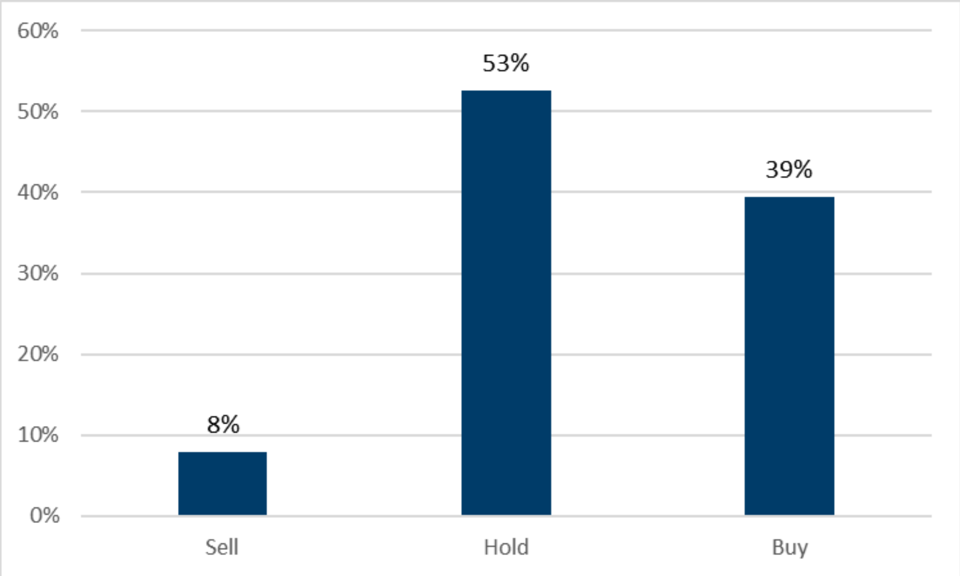
Investment recommendations are defined as follows:

Target price compared to share price	Recommendation
< -10 %	SELL
-10 – (+10) %	HOLD
> 10 %	BUY

ERP's investment recommendation of the analyzed company is updated at least 2 timer per year.



The graph above shows the distribution of ERP's recommendations of companies under coverage in 1st of February 2019. If recommendation is not given, it is not mentioned here.

Name(s) of the analyst(s): Häyhä

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