



“Economic development worldwide is getting a significant boost from air transport. This wider economic benefit is being generated by increasing connections between cities - enabling the flow of goods, people, capital, technology and ideas - and falling air transport costs.

The number of unique city-pair connections is estimated to have exceeded 20,000 this year, more than double the connectivity by air twenty years ago. The price of air transport for users continues to fall, after adjusting for inflation. Compared to twenty years ago real transport costs have more than halved.”

(IATA, 2017 end-of-year review)

December 22, 2017

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The Global Aviation Industry

The aviation industry in 2017 was defined by two turning points. The election of Donald Trump as US President in November 2016 and the initiation of the Brexit scenario in June 2016 marked a new era which altered the landscape of the global aviation industry in 2017. According to the International Air Transport Association (IATA), the European Union is the single biggest destination market from the UK, grasping 49% of passengers and 54% of scheduled commercial flights. In turn, the UK is an important source of business and a traveling hot spot for all major European airlines. In the UK, preliminary estimates by the IATA suggest the number of UK air passengers may slip by 3 to 5% by 2020, and the UK will face the biggest trade-off: accessing the European Single Aviation Market, or having the policy freedom to set its own regulations.

In the Middle East (ME), the US foreign policy carried compounded challenges to the airlines industry in H1 2017. The Trump administration this year imposed the ban on US entry for people from seven Muslim-majority countries as well as an aircraft cabin ban on Personal Electronic Devices (PEDs) later in March 2017. The IATA estimated the PEDs ban impacted on average 333 flights per week from the Middle East and North Africa (MENA). The ban also inflicted travel plans, as 74% of business travelers explained that the need to check-in their devices while flying would affect how they plan business travel, while the other 15% indicated they would look to reduce the frequency of travel.

Middle East Airlines and the Aviation Industry: 2017 in Review

Regional Comparison: Airline Operating (EBIT) Margins

| (in % of total revenues) | 2015 | 2016 | 2016Q2 | 2017Q2 |
|--------------------------|------------|------------|-------------|------------|
| Industry Average | 8.5 | 8.8 | 10.2 | 9.5 |
| Africa & the Middle East | 2.2 | 2.0 | 10.2 | 8.6 |
| Europe | 5.4 | 6.1 | 4.5 | 8.6 |

Source: IATA, Sept. 2017

In H2 2017, the operations of the Middle Eastern airlines were more buoyant. In fact, as companies' profitability was eroded in the first six months of the year, ME carriers strived to boost efficiency across their networks in H2. The *Emirates* airlines, one of the big three of the ME, and its low-cost sister *Flydubai*, agreed to join forces and expand their codeshare to reach 240 destinations within the next 5 years, with 45 already in place.

Moreover, ME carriers implemented expansion strategies during the November 2017 Dubai Air Show. Despite the headwinds from fluctuating oil prices and geopolitical crises within the Middle East, three leading carriers struck substantial deals: *Emirates airlines* set an order with Boeing for 40 aircrafts of the model 787-10 Dreamliners, valued at \$15.1 billion (B), to fly to new destinations. Similarly, *Flydubai* ordered 225 airplanes of the model 737MAX at \$27B with Boeing, which made this the biggest deal by "number of aircrafts" in airlines' history.

In Focus: The Lebanese Middle East Airlines (MEA)

Middle East Airlines is an established airline business that prioritized sustainability and adaptability to the latest aviation trends in 2017. MEA is the sole national carrier of passengers. The company employed 4,787 employees in 2016. Some of the employees work at MEA's direct offices, while others are split between two affiliate entities: MASCO, dedicated for aircraft maintenance and MEAG specialized in group handling. Moreover, a major overhaul is at sight in terms of the company's ownership. Initially, Banque du Liban (BDL) owned 99% of MEA, but in November 2017 and in the attempt to keep up with the growth and direction of the international aviation industry, the central bank governor suggested the privatization of 25% of the company and its successive listing on the Beirut Stock Exchange (BSE).

Privatizing the carrier may partly help MEA raise funds for future growth and regional investments. Fresh capital can help boost the lifespan of the business. The privatization may also contribute to the corporation's credibility and transparency vis-à-vis the public, as listing of MEA shares on the BSE can support the carrier's reputation, encourage, and expose the airline's consistent quality service. Yet, for the time being, the process of MEA going public is pending the completion of the privatization of BSE first.

MEA also has plans to beef up its fleet by 2019 and render its operations more environmentally-friendly. By 2016, MEA's fleet consisted of 20 aircrafts with average life of 5.45 years. To maintain its competency, the carrier is always renewing the fleet, partly through expansion and partly by replacing old aircrafts with new ones, like is the case this year. In December, MEA chairman Mohammad Hout

Middle East Airlines and the Aviation Industry: 2017 in Review

announced that the national carrier will receive five new Airbus 321 jets in the summer of 2019, expected to reduce the company's environmental imprint and improve the efficiency of the network.

The MEA company operates under Lebanon's "open skies policy". Assessing the air transport in Lebanon, the market is open for all foreign airline companies to fly their travelers into and out of Lebanon; yet, sometimes when for example relations with Saudi Arabia and/or the UAE are giddy, MEA is not granted free access to these markets, under the pretext that there are no slots available at their airports. In fact, some key statistics prove that the open skies policy is applied and competition exists. For instance in 2016, the MEA operated approximately 39% of the total flights of Beirut International Airport, and the carrier's share of the total number of seats comprised 35% (equivalent to approximately 3.5M seats) of total seats available.

MEA's existing and newly-signed alliance agreements in 2017 could capture a new base of clientele. Besides the carrier's 2012 *SkyTeam Alliance*, which basically grants passengers access to more than 1,100 destinations in 177 countries, and more than 600 lounges at international airports, "code sharing" can further enhance flights to more destinations.

In 2016, the MEA offered direct connections between Beirut and 30 destinations:

| | |
|---------------------|---|
| Europe: | Brussels, Larnaca, Paris, London, Frankfurt, Rome, Milan, Athens, Geneva, Dusseldorf, Nice, Copenhagen. |
| Gulf: | Jeddah, Riyadh, Dubai, Abu Dhabi, Dammam, Kuwait, Doha, or Madinah. |
| Middle East: | Amman, Al Najaf, Basra, Baghdad, Cairo, Erbil, Istanbul, Sharm el Sheikh, Yerevan. |
| Africa: | Abidjan, Lagos, and Accra. |

Nonetheless, according to a managerial source at the company, the national airline signed two code sharing agreements this May 2017 with *Etihad Airways* and the Turkish Airlines, which promise to broaden the commercial partnership between the companies and their respective countries. The new code sharings alongside the existing agreements between MEA and each of the Royal Jordanian, Air France, Tunis, Qatar Airways, and Air Canada will offer passengers more flexibility and travel options.

Timeline of MEA's Net Profits (in US\$ millions)

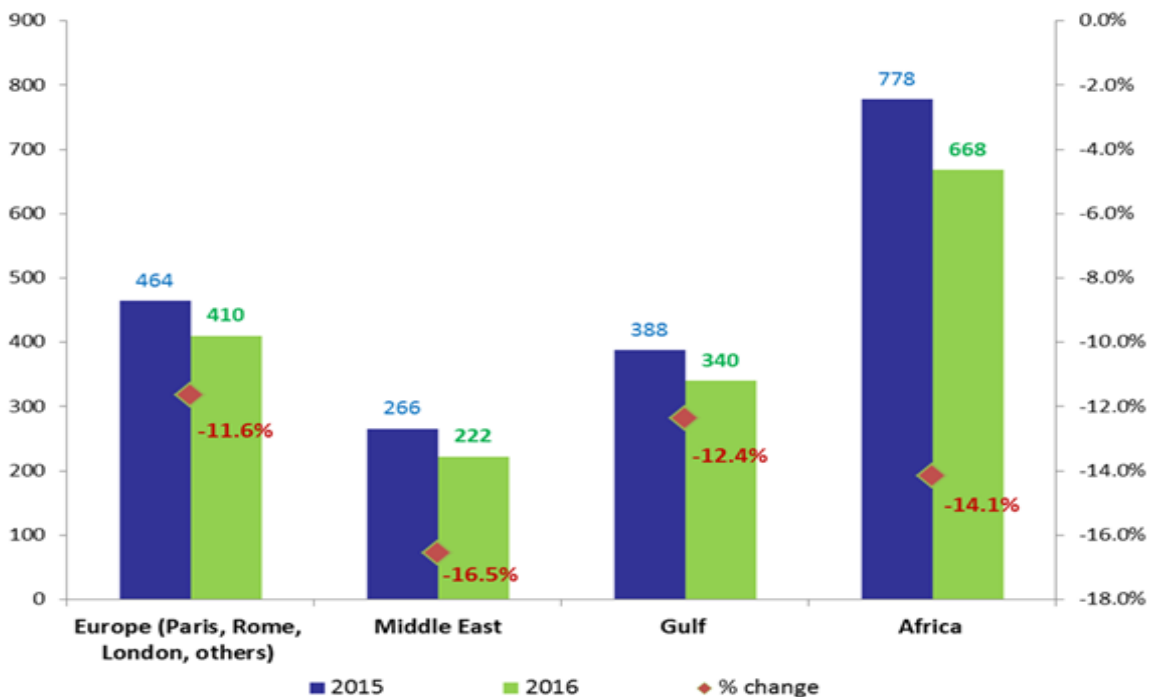


Source: MEA 2016 Board of Directors Report, released July 2017

MEA was harshly criticized for its elevated fares, yet for some passengers these may be justified by the carrier's competitive advantages. Pricing has been the airline's toughest challenge for years now. The criticism regarding the "unfair" or overpriced tickets intensified in the recent months, especially resounding from Lebanese expatriates, whose frequent traveling to and from the KSA and the UAE to visit family and friends becomes expensive.

In fact, MEA's yearly average prices to the carrier's main destinations dropped in 2016. In July 2017, MEA published for the first time in its 2016 Board of Directors Report, the airline's average prices for round trip tickets to defend its pricing strategy. In details, the prices below include the fuel surcharge and exclude governmental taxes.

Average Price of Roundtrip Travel Ticket to MEA's Destinations



Middle East Airlines and the Aviation Industry: 2017 in Review

Source: Blom Invest Bank; MEA 2016 Board of Directors Report, released July 2017

Moreover, a phone interview with a managerial source at the company explains that MEA's competitive edge lies in the carrier's:

- Prime hospitality (also referred to as MEA's "mankind touch")
- Trilingual cabin crew (Arabic, English, and French are requirements)
- Punctuality of flights in take-off and landing in 90% to 95% of the flights. Moreover, the 2016 BOD report supports the above, showing MEA's fleet punctuality attained 86.5% in 2016.
- High caliber maintenance and engineering teams who promptly adapt to delays or aircraft substitutions if/when needed.
- MEA has the best "business class" compared to that of Arab airlines', Lufthansa's and British Airways'.

A new trend has emerged several years ago consisting of operating low cost airlines to reduce prices for travelers. Price Waterhouse and Cooper's (PWC) 2017 report on modern trends in commercial aviation describes smaller aircrafts or Low Cost Carriers (LCCs) as the key to unlock the future potential in aviation. Several Gulf States had already tapped into the LCCs market this year to serve budget-conscious passengers. For instance, the KSA launched its second low-cost carrier, *Flyadeal*, in Sept. 2017 operating with one Airbus 320 and expecting seven additional aircrafts in 2018. More than 10,000 seats were sold in 24 hours according to Arabian Business, and *Flyadeal's* CEO Con Corfiatis explains that "low fares" and the option to "customize" journeys attract the travelers. Meanwhile Kuwait's *Wataniya* ordered 25 new Airbus A320s, and *Jazeera Airways* launched new routes this year.

In Lebanon, MEA is clearly aware of the latest LCC trend but is cautiously studying the market. In December 2017, Mr. Mohamad Al Hout, Chairman of the MEA shared the possibility of starting a low-cost airline; however, running a low-cost airline means deviating from MEA's prime hospitality and quality services. Offering a budget flight comprises of providing a "lower level" of service, starting from a smaller aircraft, to more cramped seating, no food served, to rare or no multimedia services on board. The lack of these amenities may save travelers money, but the opportunity costs which include lower passenger comfort and quality of service may weigh down particularly on Arab travelers who have an affiliation for high quality flights and who usually travel in business class. No further details are available to date from MEA, but it is certain that the demand for low cost airlines must be scrutinized, along with the preferences of MEA's target audience.

2018 Outlook: MEA Christmas Specials, Airport Expansion, More Flights

Overall, the Middle East (ME) is a travel hub connecting east to west. In the past two decades, the Middle East has invested substantially in its airlines operations to position the region as a growing aviation hub that transits traffic from east to west. However, the negative impact of the last three-year oil slump and internationally-subdued growth constituted a major drawback for the industry. Nonetheless, Boeing's 2017 Current Market Outlook revealed that the Middle East region alone will need 3,350 new airplanes worth \$730 billion by 2036. Moreover, the demand for commercial airline pilots, technicians, and cabin crew is expected to grow to account for 10% of the total global need for pilots and technicians and 12% of total crew.

In Lebanon, MEA Chairman Hout reassured the market this December 2017. The MEA Chairman confirmed that the impacts of the Syrian crisis, as well as the potential effects of regional geopolitical

Middle East Airlines and the Aviation Industry: 2017 in Review

tensions among the Gulf States are limited and the airline's operations and profitability remained almost intact. The carrier has actually weathered more difficult times during Lebanon's civil war, then in 2002, 2005, and 2006.

In addition, Hout recently announced that MEA plans to offer a direct flight to Madrid -Spain before the 2018 summer season, based on the local demand for the trip.

Hotels may also act as a barometer for the health of tourism and thus the number of travelers via Beirut International Airport. Lebanese hotel owners expect more tourists to spend the end-of year holidays in Lebanon this 2017, and so they estimate the total number of tourists will stand at 1.9M by the end of the festive season. As such, the Secretary General of the Hotel Owners' Association, Wadih Kanaan, added that *"Lebanon's national carrier [...] was set to operate 70 additional flights to destinations including Doha, Cairo, Jeddah, Riyadh, Larnaca, and Abidjan between Dec. 20, 2017 and Jan. 11, 2018"*. Moreover, flights arriving from the Gulf States on Dec. 22 and 23 are fully booked, according to Kanaan, while planes arriving between Dec. 19 and 26, 2017 from various African countries are also fully booked.

The 2017 holiday vibe seems optimistic vis-à-vis the Middle East Airlines' flight traffic. In parallel, Prime Minister Saad Hariri recently announced the expansion plan of Beirut International Airport to fit 12M passengers instead of 6M. Also, the MEA this year has re-considered launching a low-cost arm of the airlines *"at the right time"* though as per Hout, knowing that on a global scale, the future potential in the aviation industry lies largely in low cost carriers and most of the Gulf airlines are already ahead in the game. Nonetheless, more security, political and economic stability in Lebanon will surely encourage larger investments, more expansions, and better quality of services, of which the new advanced aviation training center was inaugurated in October to provide top notch training to pilots, cabin crew and students/interns.

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