

Trends for air travel in the Middle East-

A look at the long haul and regional market

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Agenda

- Headlines and new developments
- The Global Hub model and its sustainability
- The evolution of low cost airlines in the region
- Ancillary revenues – importance and structure
- How these trends might impact the consumers that you see on the planes and in the airports

Some good news...

There Have been some positive headlines:

Passenger Demand Strengthens

Geneva- 25 November 2010 - The International Air Transport Association announced international traffic results for October showing a 10.1% year-on-year increase in passenger demand.

Emirates quadruples first-half net profit

ATI - 01Nov10 Middle Eastern carrier Emirates has posted a net profit of Dhs3.4 billion (\$925 million) for the first half of the year, more than quadruple its previous interim figure.

But the underlying issues have not changed

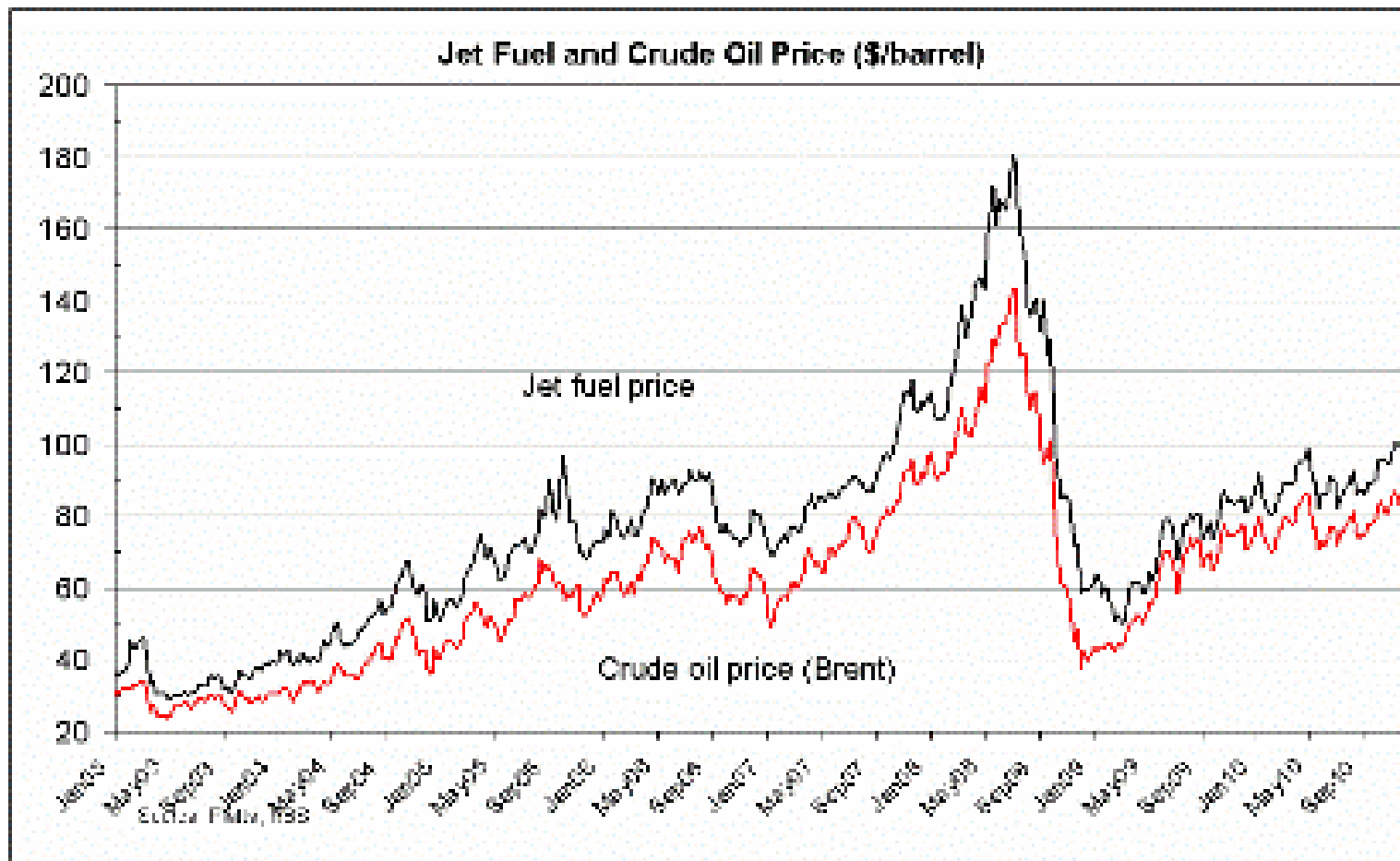
But we all still need to be cautious...

- Profitability has yet to return to levels seen before the Global Financial Crisis.
- While we are in an upswing, there is nothing to suggest that the industry has broken away from long term chronic cyclicalilty.
- Airlines continue to be subject to 'Constant Crisis Syndrome'
- The Icelandic Volcano was a shock, but then again so was Swine Flu, \$150/BBL Oil, Lehman Brothers, SARS etc...
- Security Issues (and the need of governments to be perceived as addressing those issues) will continue to make life challenging.

Airline issues

- Is it a straight line to the top of the next cycle?
 - Structural opportunity versus only cyclical recovery
 - The impact of changing customer demands
 - Short haul - Will it only be low fares and no-frills?
 - Long haul – Will it only be “more for less” for the passenger?
 - Consolidation
 - It may be inevitable but in what form, with what benefits and for whom?
 - Factors for success
 - Network, profit, cash generation
 - Access to “affordable capital”.... or what?
-

The constant issue that impacts all carriers



Regulation is still the main barrier to growth

- Pricing and rights approvals have been effective in slowing the growth of both the Flag Carriers and the LCC's in certain market.
- A number of government are putting forth policies that prioritise flag carriers interests over consumers
 - Canada
 - France and Germany
 - Iran, the KSA and even here in North Africa

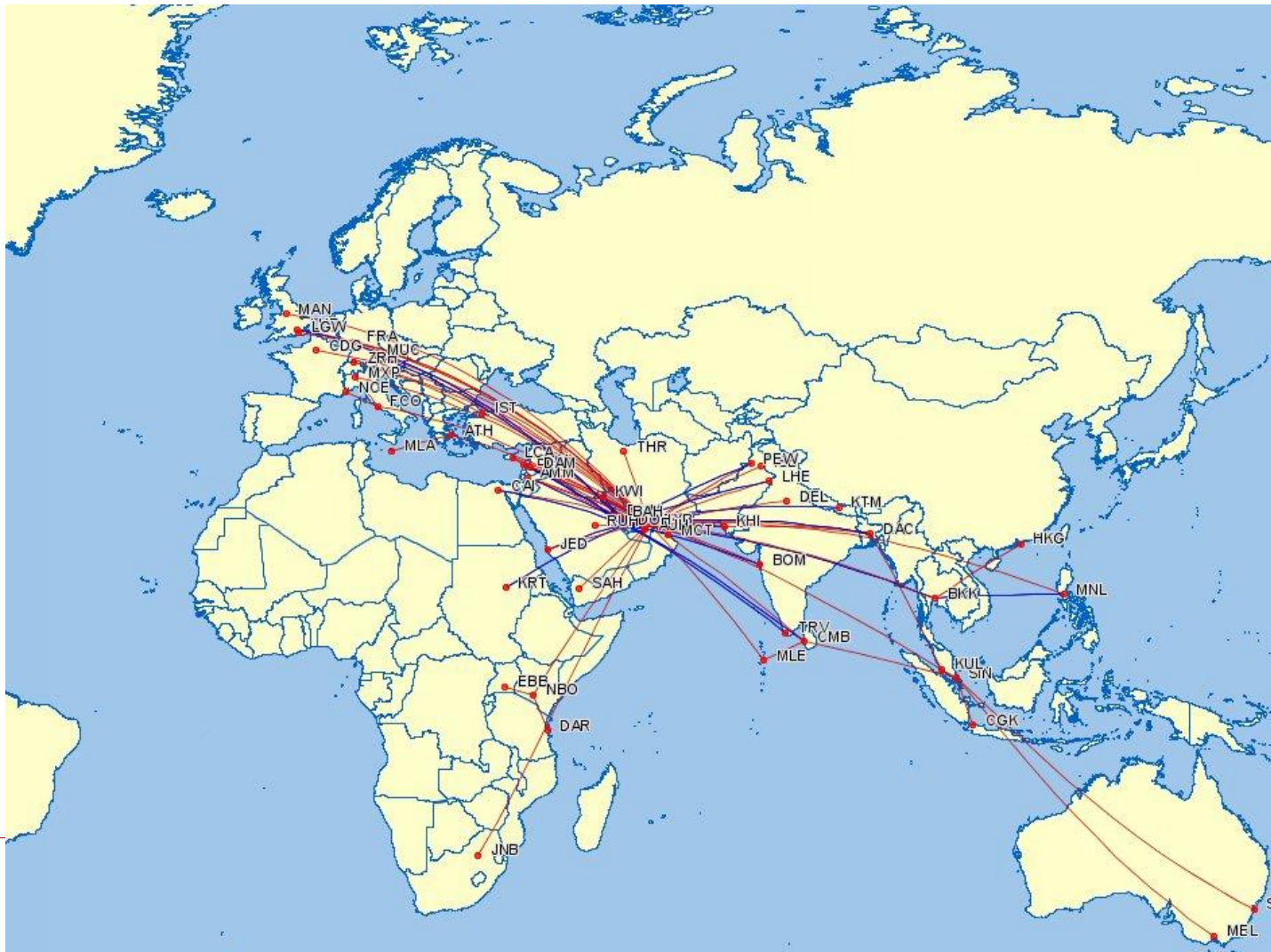
The export subsidy question

- The present skirmishes on export subsidies will not substantially alter the equation.
- Financial support of any kind distorts markets and this is no different – it may just be more even handed.
- Even if it is addressed, in the long term, it is not consequential.
- Flag Carriers like Aircraft Manufacturers throughout the world will need to constantly evolve to compete, or depend on the national treasury for life support.

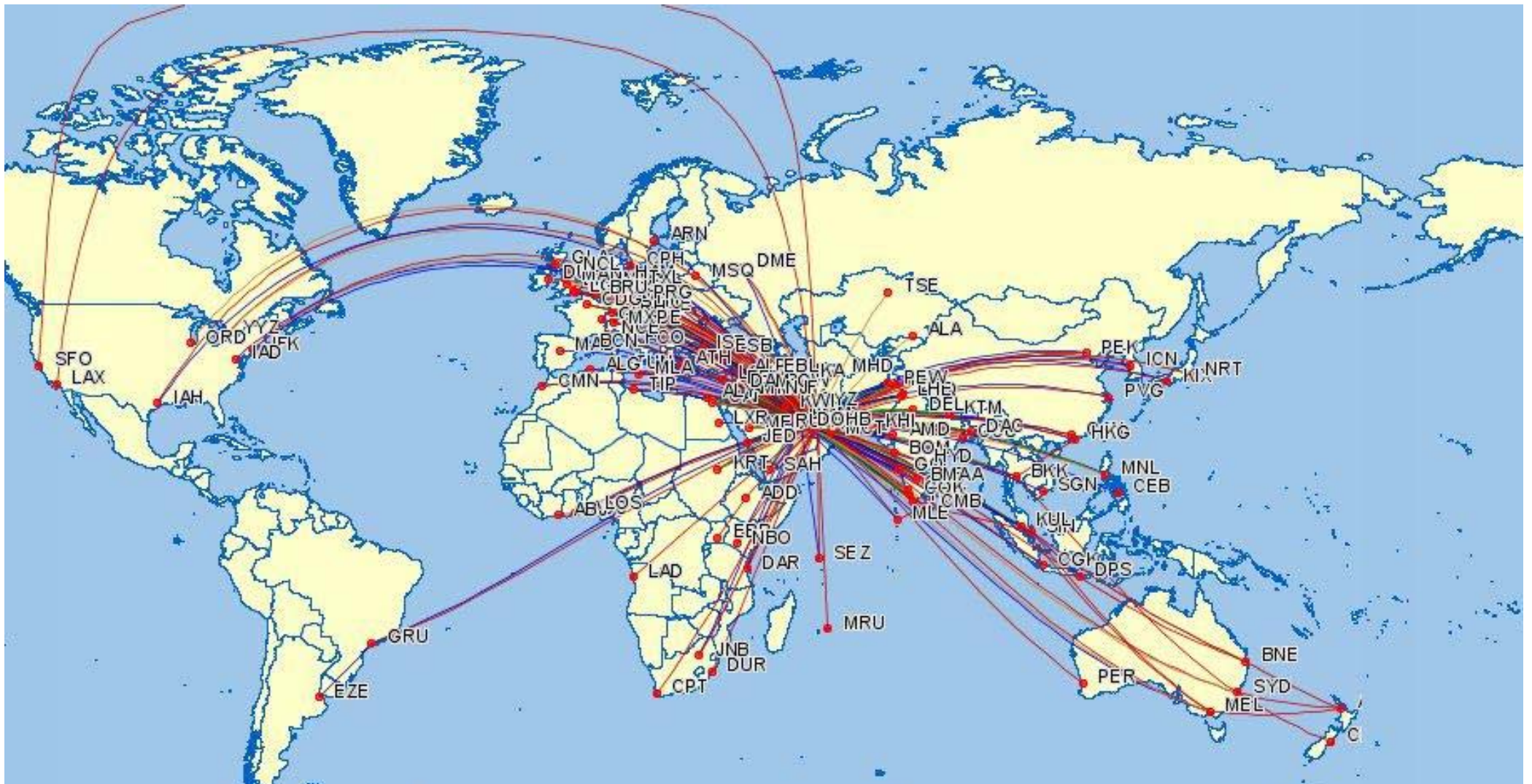
What constitutes the product and which are “must haves”?

- There is a bundle of attributes that passengers value (differently) which may comprise:
 - The flight itself
 - Frequency
 - FFP/Mileage
 - Free allowances/”benefits”
 - Airport attractiveness including access
 - Timing
 - Ticket flexibility
 - On board service
 - On ground service
- There are significant behavioural change on the part of short haul passengers over the last decade reinforcing supply side changes
 - Growth of the “destination indifferent passenger”
 - Growth in middle class VFR (Visiting Friends and Relatives)
- Clear evidence of passengers getting “more for less” in long haul

Combined Network of the Major Gulf Carriers 2000



Combined Network of the Major Gulf Carriers 2010



This is not as new as it appears

Its an evolution of a long established strategy

- The Gulf Hubs have emerged from two continuing developments in the airline industry:

The increasing range of modern aircraft

combined with

**The realignment of the traffic and demographics
that determine the optimum hub location**

Hubs are an old idea – but this is new twist

- The strategy we see today is, at its core, based on the same principals that made US Cities like Dallas, Denver, Atlanta and Chicago more significant domestic air hubs than their larger coastal counterparts
 - Airlines as diverse as Icelandair, Ethiopian, Hawaiian and Singapore Airlines have used the hub as the backbone of their strategy to overcome limited local markets
 - It's why we also see carriers like Turkish emerging today as potentially the next formidable force in the region.
 - India could do the same if infrastructural, market distortion and regulatory issues could be overcome.
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From the other end of the spectrum...

An LCC - Is it that simple?

- Eliminate free catering
 - All one class
 - Offer cheap seats (be an LFC-Low Fare Carrier)
 - Squeeze on as many people as possible.
- But much of that is already happening now.

Yet the 'CASK'* demonstrates the difference:

Air Asia	3.52	US¢ /ASK**
Air Arabia	4.43	
vs.		
Air France	12.05	
British Airways	8.88	
Singapore Airlines	8.92	



*CASK Cost per Available Seat Kilometer

**Source: CAPA, Nov. 2010 - figures are from early 2010 and subject to exchange rate fluctuations

What is an LCC?

- Many carriers have made the mistaken assumption that Low Cost Carriers won't work in their market.
- LCC's globally trace their origins back to Southwest Airlines which started a new way of flying in the 1970's.
- The model has evolved and spread throughout the globe.
- There is no exact definition today – many are hybrids and some are pretenders.
- There are some core values that are universal among all successful LCC's

Efficient Distribution

Lean Operations

Optimum Utilisation/ Quick Turns

High Density Seating

Product Unbundling & Ancillaries

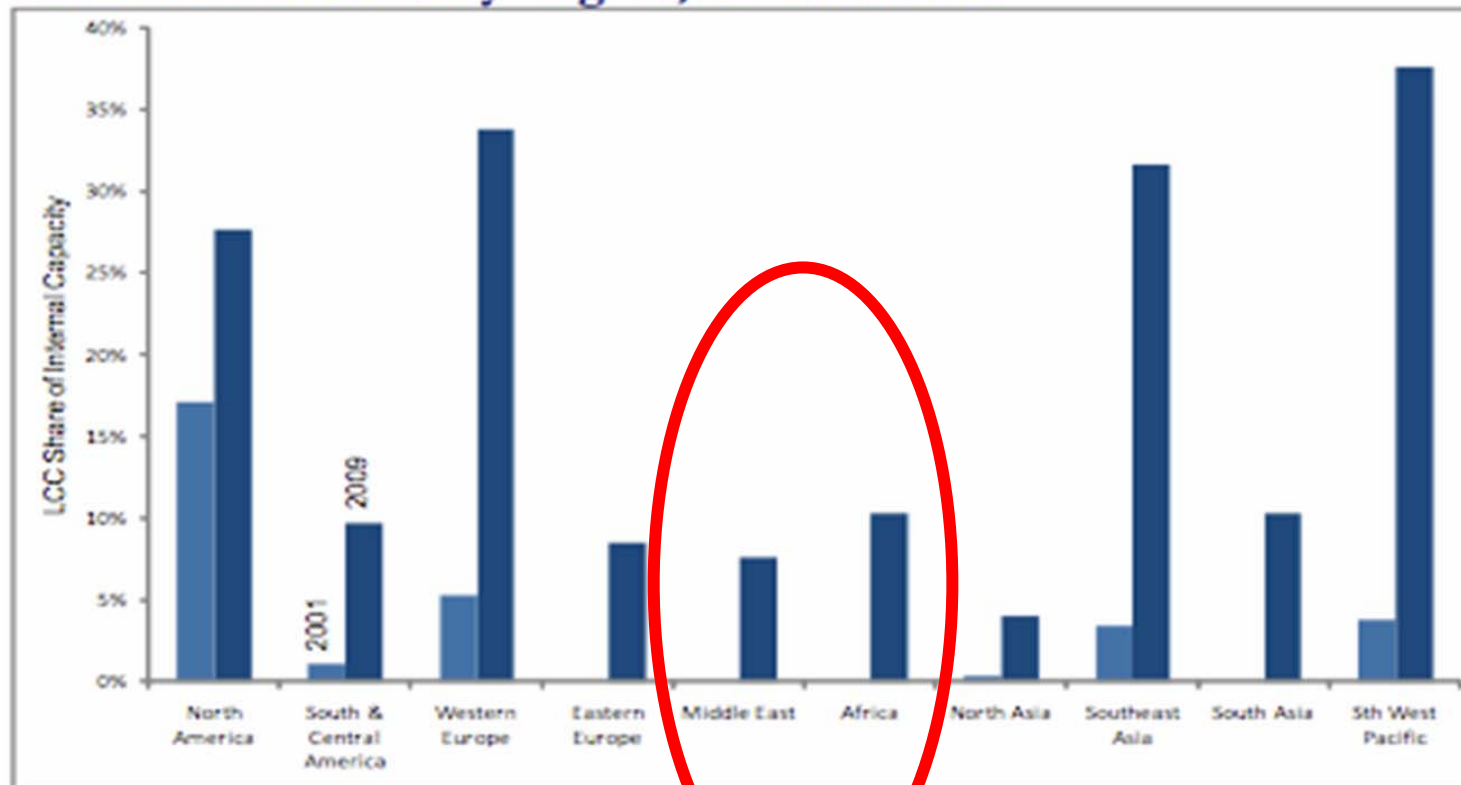
Nothing is Sacred (except safety!)

Relentless pursuit of costs & simplicity

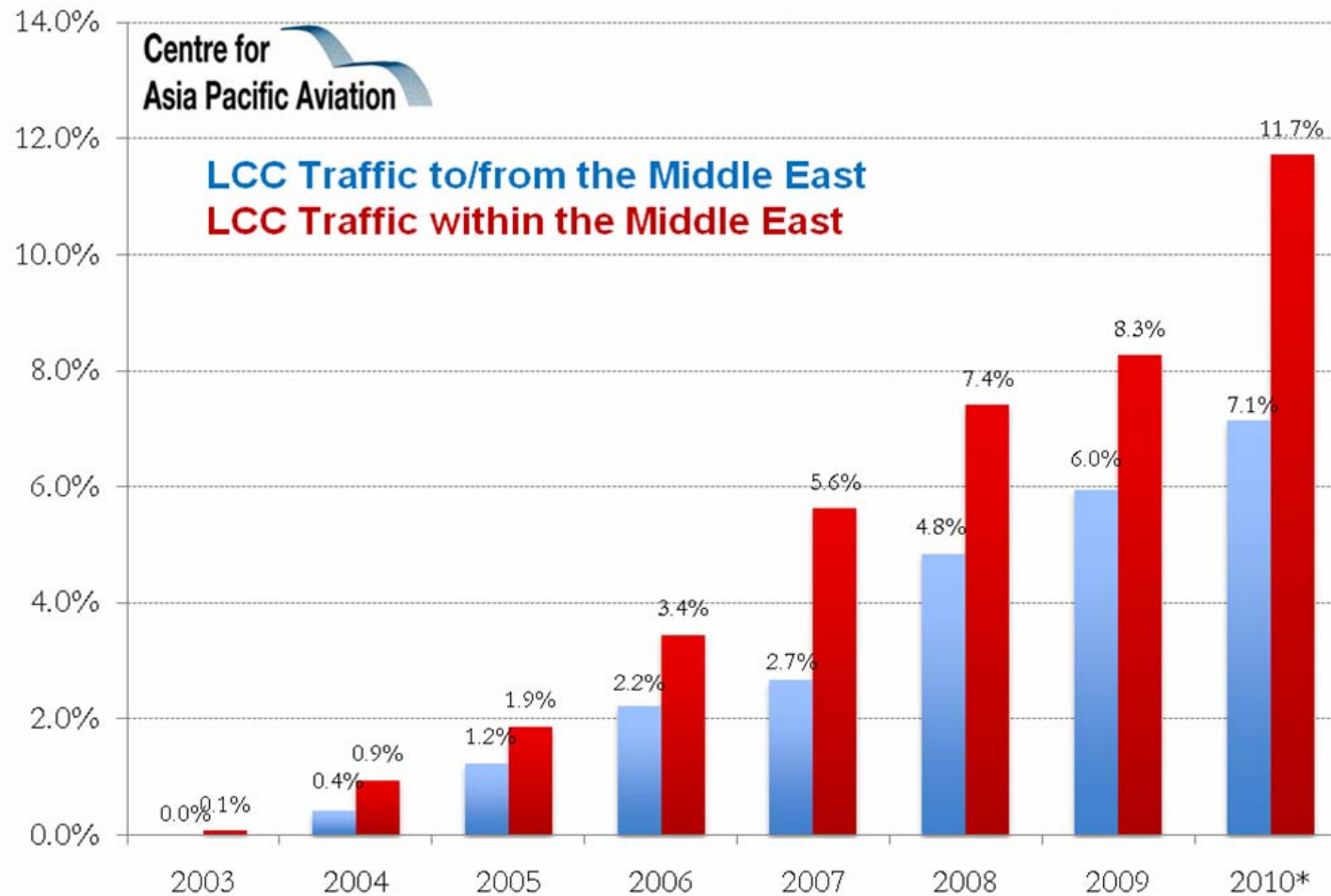
There is still upside in existing markets

Source: Centre for Asia Pacific Aviation (Sydney)

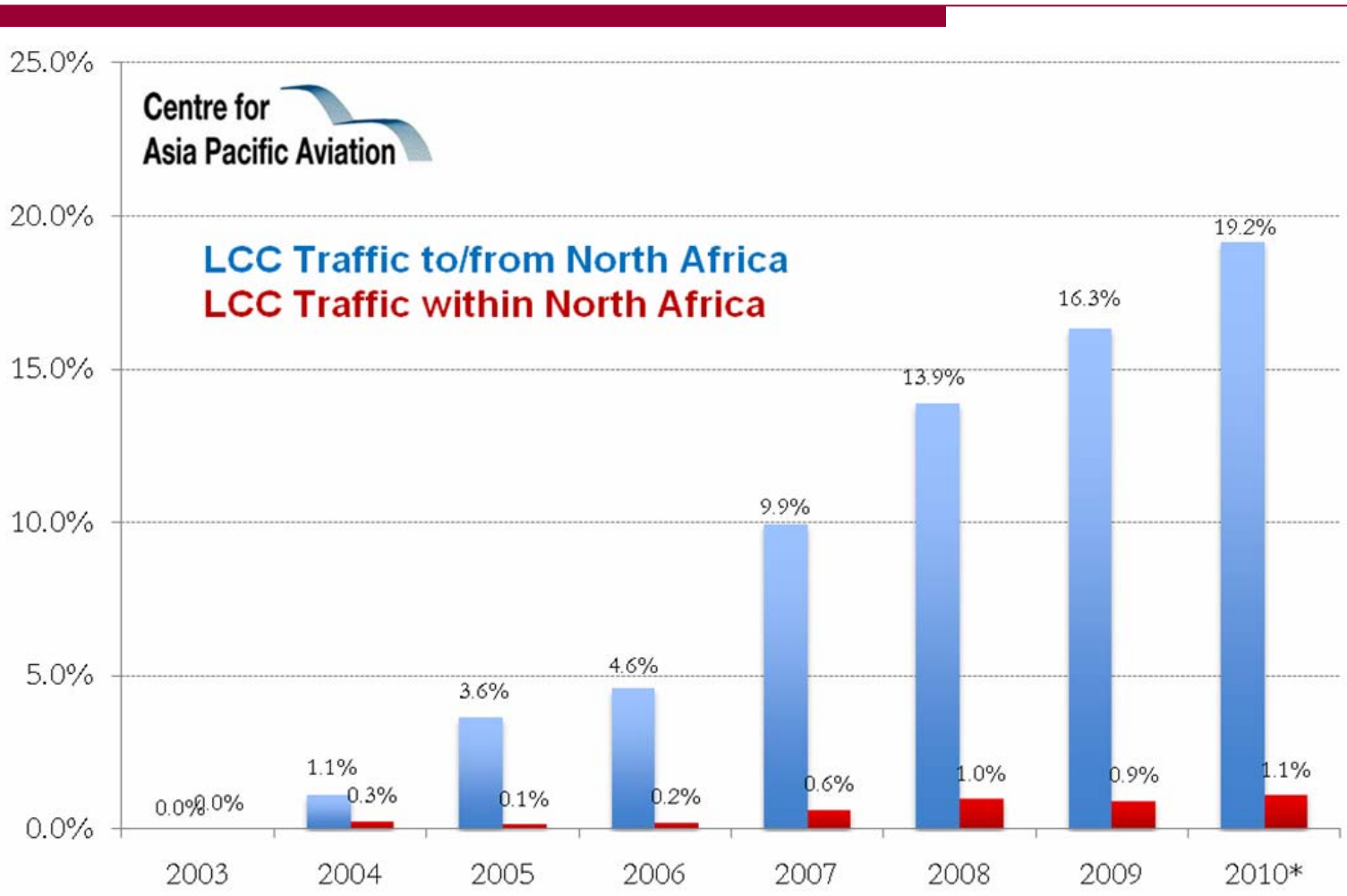
LCC Market Shares by Region, 2001 and 2009



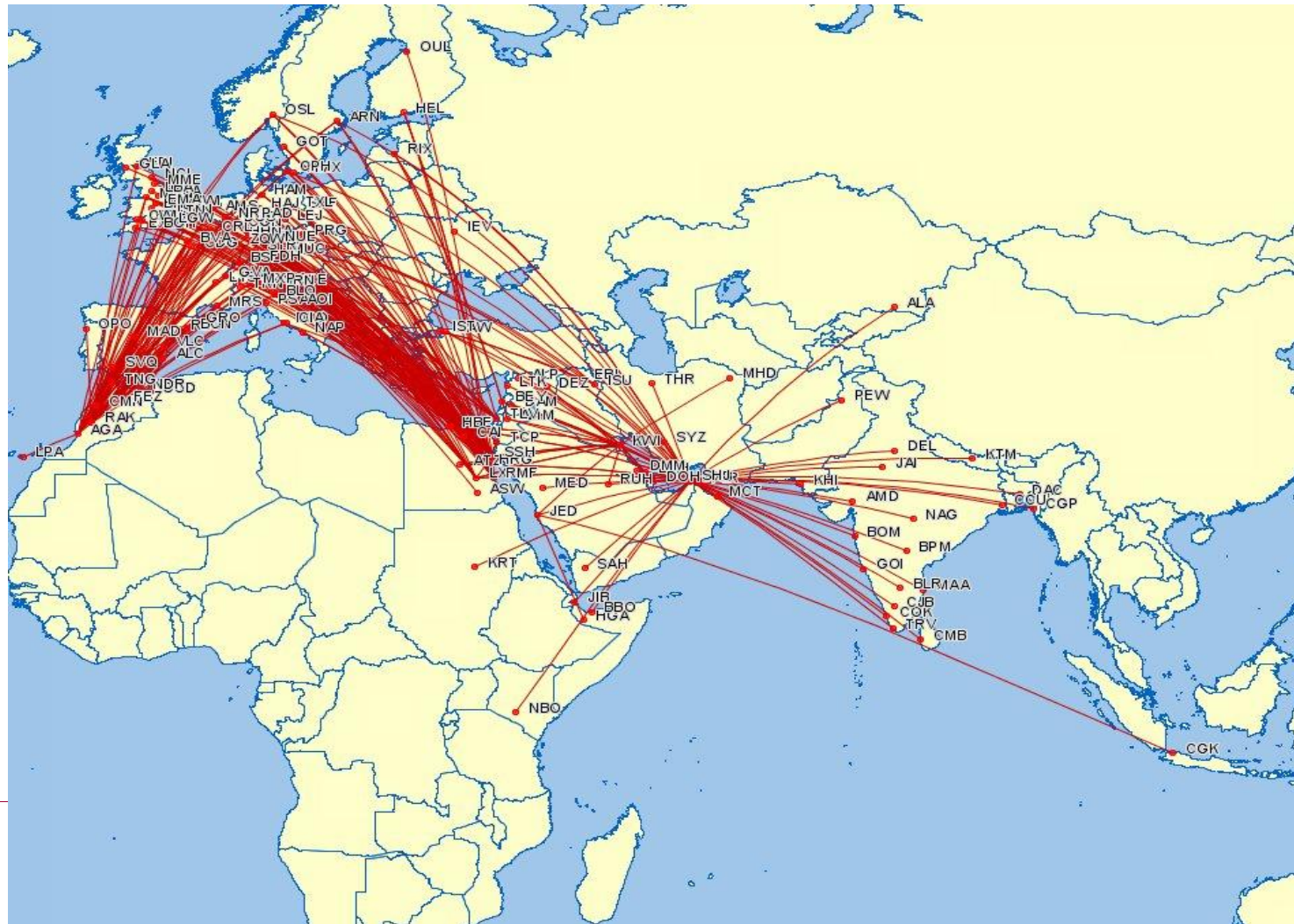
LCC Growth in the Middle East- Reflecting Historical Global Trends



LCC Growth in the North Africa- Open Skies vs. Regulation



All of this in less than a decade...



“Legacy” short haul segment responses

- Need to apply “Best Practice” (including from LCC’s)
 - Fare structure simplification with better demand curve pricing.
 - Development of ancillary revenue streams.
 - Easier internet booking process and reduction of commission payments.
 - Creating an awareness of product differences and value.
- How should incumbent airlines respond ?
 - Set up a new airline?
 - Make changes to their existing model?

Although legacy airlines may be able to compete, can they make the changes necessary to prosper and should they operate short sector flights that do not primarily feed the network?

A hub by any other name...

Do not assume there is no connecting LCC traffic

- Every day hundreds of passengers on easyJet, Ryanair, Air Arabia and others (who do not sell connections) still 'connect' at unofficial 'hubs'.
- They do this by picking up their bags, marching upstairs & checking in a second time.



What drives ancillary revenues - Ryanair

Year to March 31st	2006	2007	2008	2009	2010
	€m	€m	€m	€m	€m
Non Flight Scheduled	166.8	242.0	334.6	425.8	463.6
Car Rental	19.8	23.0	25.3	32.2	29.9
Inflight Sales	45.3	60.1	73.3	83.2	86.5
Internet-related	27.3	37.1	55.0	56.9	83.6
	259.2	362.2	488.1	598.1	663.6
Booked passengers (m)	34.77	42.5	50.9	58.6	66.5
Estimated flown (m)	32.18	39.3	47.1	54.2	61.5
Per booked passenger (€)					
Non Flight Scheduled	4.80	5.69	6.57	7.27	6.97
Car Rental	0.57	0.54	0.50	0.55	0.45
→ Inflight Sales	1.30	1.41	1.44	1.42	1.30
Internet-related	0.79	0.87	1.08	0.97	1.26
Total	7.45	8.52	9.58	10.21	9.98
Average fare per booked passenger (€)	41.23	44.10	43.70	40.02	34.95
Ancillary as % of average booked fare (%)	18.08	19.32	21.93	25.52	28.55

Source: Nyras from Ryanair Form 20F FY 2007-2010

The good news

There is a bit of upside in these changes..

- Regulatory Protectionism is slowly being eroded.
 - Open Skies between the EU and Jordan (similar to Morocco).
 - Air Arabia gets approval for Casablanca-Tunis.
- Increased terminal “dwell time”
 - Due to security.
 - Informal Connectors with long layovers
(but by nature this tends to be price sensitive traffic).
- More takeaway food and drinks sold in terminal as free airline meals disappear.
- Arrivals Duty Free/Preorder are still an option (Not ideal, but better than nothing).

...and the bad news

The Downside risks are perhaps greater

- There are still a number of markets where regulatory blockages are holding firm
- Both the fuel and the efficiency equation works against in-flight sales
- Security issues (along with security theatre) are unlikely to get better while restrictions abroad will continue to ripple back to purchases here
- Airline baggage restrictions, have a knock on effect on carry on
 - Then carry on baggage restrictions will follow
 - Today's LCC's rules will be quietly followed (in part) by the majors over time
 - Non Flag Carrier Airline Risks
 - A higher chance of redeployment if things do not work
 - Some airports that focus on LCC traffic can easily become dependent on it

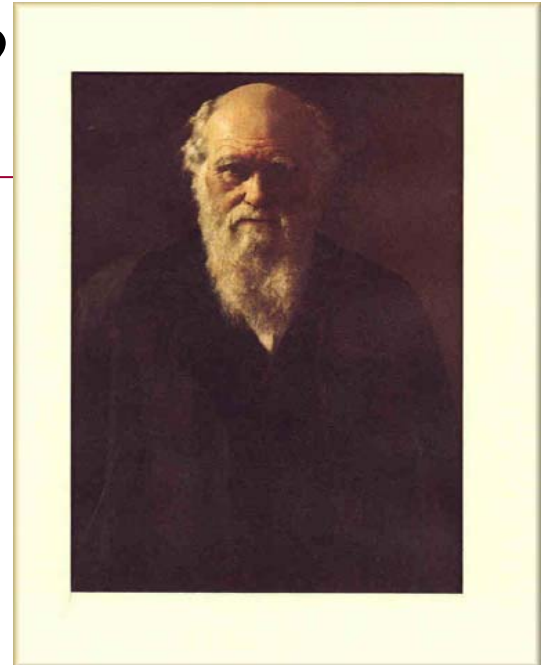
Difficulties ahead or Opportunities?

Ticketless Travel, Online check in and other IT developments are changing the airport experience

Security is turning the airports upside down, often having a notable impact on master plans

All parties are having to adapt – the airports themselves, ground handlers and airport retail

No one is immune from these changes – its just a question how one addresses the 'evolving' industry



An early visionary in
Aviation Strategy

Thank You

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Disclaimer - This document is intended for background research purposes and to enable discussion only. It does not constitute investment advice under the UK Financial Services and Markets Act 2000 and should not be relied upon by any person in relation to any investment-related decision or activity.

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