

Shaldor Case – Strategy for an Airline Company

The year is 2018. The El-Al airline is interested in executing a long-term strategic move in the following year. Out of the following strategic alternatives, determine which will maximize El-Al's profits in the following 5 years:

- a. Launching a direct flight to Dublin, Ireland
- b. Shifting advertising budget into digital channels. The move is expected reduce the company's advertising costs by 20% with no effects on the company's revenue

Instructions for the submitted response:

- Please explain each step of the solution clearly. The exam will be graded based on the logic of the overall methodology and steps, the rationale for each assumption made, and the clarity of the calculations. Please keep these elements in mind as you approach the problem.
- After you are done solving the question, summarize your recommendations regarding the different strategic alternatives in 1-2 pages and attach it to the rest of the materials.
- The final solution must include:
 - A quantitative examination of expected profit (or loss) in 2022 under each of the strategic alternatives
 - Additional factors taken into consideration when deciding the best alternative

Financial Data
From EI-AI's
2017 Annual Report

El-Al's financial results

Currency in Millions of US Dollars	Dec-31	Dec-31	Dec-31	Dec-31
	2014	2015	2016	2017
TOTAL REVENUES	2,081	2,054	2,038	2,097
Cost of Goods Sold	1,803	1,593	1,638	1,749
GROSS PROFIT	279	461	400	348
Selling General & Admin Expenses, Total	292	291	290	319
OPERATING INCOME	-13	170	110	29
NET INCOME	-28	107	81	6

Explanations of Financial Results

- **Cost of Goods Sold** – Expenses made in order to create revenues
- **Gross Profit** – Difference between Revenues and Costs of Goods Sold
- **Selling General & Admin Expenses:**
 - **Selling Expenses** – Salespersons salary, agent fees, packaging and delivery expenditures, advertisements etc.
 - **General & Admin Expenses** – Administration salary, rent, legal fees, office, mail and telephone expenses, etc...
- **Operating Income** – Difference between gross profit and Selling, General & Admin expenses
- **Net Income** – Operating income after tax deduction

El-AI Operational Data¹

	2017	2016	Δ change
Revenue Passengers (in thousands)	5,645	5,512	2.40%
RPK – Revenue Passenger Kilometers (in millions)	21,310	21,066	1.20%
ASK - Available Seat Kilometers (in millions)	25,167	25,072	0.40%
Passenger Load Factor	84.70%	84.00%	0.80%
Passengers Market Share	28.50%	32.60%	-12.50%
Revenue Cargo Tons (in thousands of tons)	92	91.2	0.90%
RTK – Revenue Ton Kilometers (in millions)	498.6	476.1	4.70%
Calculated flight hours (including leased aircrafts) in thousands of hours	178.8	180.7	1.10%
Workers – years of labor			
Permanent Workers	3,648	3,640	0%
Temporary Workers	2,571	2,362	8%
Overall	6,219	6,002	4%
Number of active aircrafts at the end of the period	43	43	-
Average age of aircraft fleet at the end of the period (years)	12.9	12.6	0.3

Terms Glossary:

Revenue Passenger – One-way ticket

RPK – Number of passengers multiplied by kilometers flown

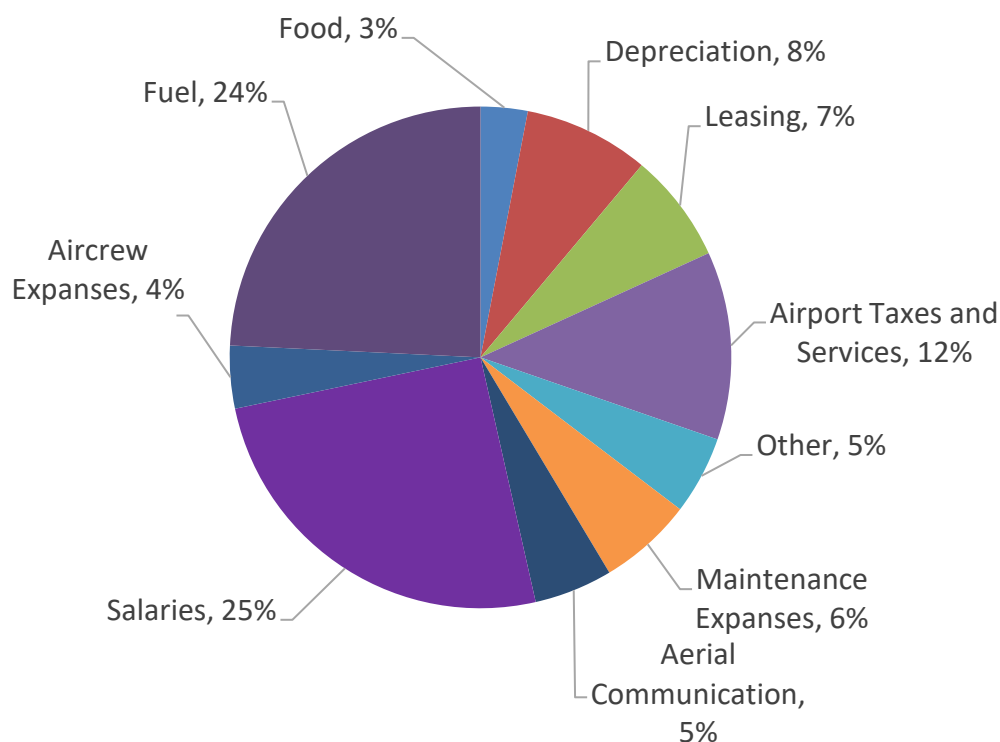
ASK – Number of seats available multiplied by kilometers flown

RTK – Weight of cargo multiplied by kilometers flown

Load Factor – RPK as percentage of ASK

¹ Operational Data relates to domestic and international operations

El Al Operational Expenses 2017



El Al Fleet (2017)

Type of Aircraft	Owned by El Al	Leased	Ordered and yet to be received	Average age (in years)	Average number of sits	Maximum range (Nautical Miles ²)
747-400	4	-	-	22.4	403	7,300
777-200ER	6	-	-	14.8	279	7,700
767-300ER	2	5	-	22.4	215	5,600
737-900ER	8	-	-	3.2	172	5,500
737-800	6	9	-	14.2	165	3,100
787-9	1	1	8 (5 of those in leasing)	0.3	282	7,600
787-8	-	-	5 (2 of those in leasing)	-	254	7,800
Overall	27	17	13	13.3	217	-

² 1 nautical mile = 1.85 km

Changes in the International Airline Industry (2017)

According to the International Air Transport Association (IATA), airlines' profits will keep on growing in 2018. The evaluation is based on growing passenger demand, streamlining processes of airlines and low interest rate payments to financial institutions. The improvement is expected despite anticipated growth in expenses in 2017, mainly due to rising prices of jet fuel and wages.

International Traffic segmented by region, changes between 2016 and 2017

Region	Passengers		
	RPK Annual change	ASK Annual change	PLF (2017)
Africa	7.50%	3.60%	70.30%
Asia	9.40%	7.90%	79.60%
Europe	8.20%	6.10%	84.40%
South America	9.30%	8.00%	82.10%
Middle East	6.60%	6.40%	74.70%
North America	4.80%	4.50%	81.70%
Overall	7.90%	6.40%	80.60%

As presented in the table above, all regions experienced growth in passenger traffic, and the largest growth accrued in Asian and South American airlines. From the data presented it is expected that airlines from all regions, except Africa, will experience growth in profits in 2018.

Passengers – Passenger traffic in 2018 is expected to grow by 6% from 2017 and will sum up to 4.3B. The growth in passenger traffic is expected to be larger than the growth in passenger capacity, therefore the average Passenger Load Factor is expected to reach an all time high of 81.4% in 2018. As a result of the expected growth in PLF, the average revenue per passenger is expected to grow by 3%. Airline revenues from passengers are expected to grow by 9.2% between 2017 and 2018 and will sum up to 581B\$.

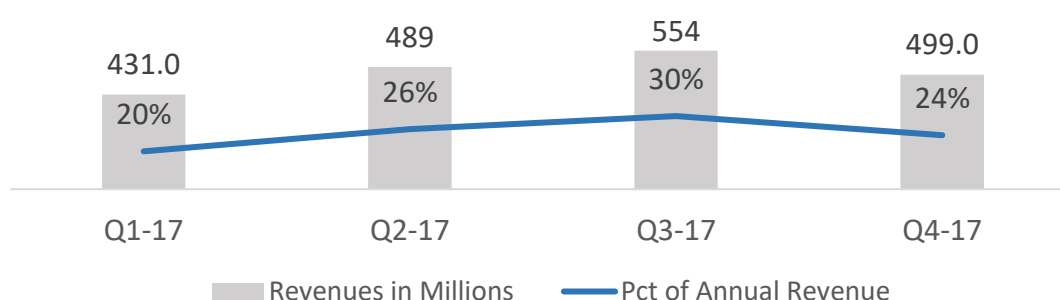
Cargo - Cargo traffic is expected to grow by 4.5% from 2017 to 2018. Part of the reasons for the growth is the rise in online commerce. Additionally, it is expected that revenue per ton will grow by 4% from 2017 to 2018. Airline revenues from cargo shipping (including cargo shipping in passenger aircrafts) is expected to grow by 8.6% and reach 2.59B\$ in 2018.

El Al Activities in 2017

Seasonality

El Al's activity is seasonal and is focused on peak seasons. A major traffic peak of Israeli passengers happens mainly during the summer and around Jewish Holidays. Peak traffic of foreign tourists to Israel takes place mainly during the summer, during Jewish and Christian holidays, and during other holidays in various countries. The activity peak for the airline takes place on the 3rd quarter. Revenues from the 2017 3rd quarter amounted to 29.5% of the annual revenues, in 2016 it was 31.3%.

Revenue segmentation by quarters and its share of the annual revenues (2017, in millions of Dollars):



Statements of Cash Flows

	2017 USD thousands	2016 USD thousands	Change USD Thousands
Net cash generated from operating activities	283,970	242,840	41,130
Net cash used in investing activities	(208,185)	(112,877)	(95,308)
Cash used in financing activities	(20,856)	(61,095)	40,239
Effect of exchange rate fluctuations on cash balances held in foreign currency	3,662	-780	4,442
Increase (decrease) in cash and cash equivalents	58,591	67,088	-9,497

Operating Activities:

The growth in cash generated from operating activities, despite the decreased gross profit, is mainly the result of growth in company's financial commitments such as commitments for airport's tax, growth in employee benefits commitments, allocating funds for maintenance expenses and growth in supplier balance.

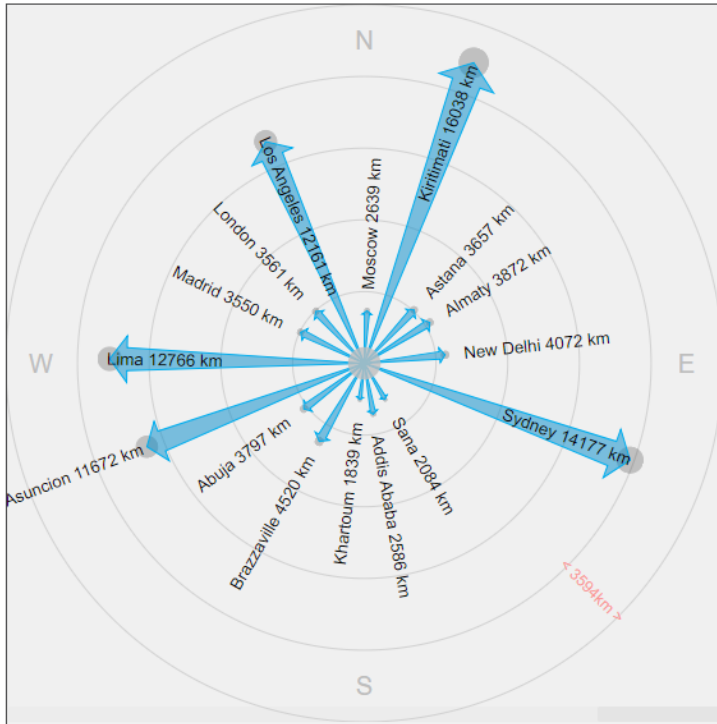
Investment Activities:

Investment in tangible and intangible assets amounted to 195M\$ (mainly advanced payments for the 787 planes and their parts). Additionally, the company invested 18M\$ in short term investment funds. The company also gained revenues from selling tangible assets for 5M\$.

Data from Articles, and Relevant Papers

Flight Distance from Tel Aviv to Various Destinations

Graph showing distances and directions to other locations. Click arrows to see the route on a map. [Learn more about the distance graph.](#)



Locations around this latitude

- Shanghai, Shanghai Municipality, China
- Amman, Jordan
- Dallas, Texas, USA
- Jerusalem, Israel
- Lahore, Pakistan

Locations around this longitude

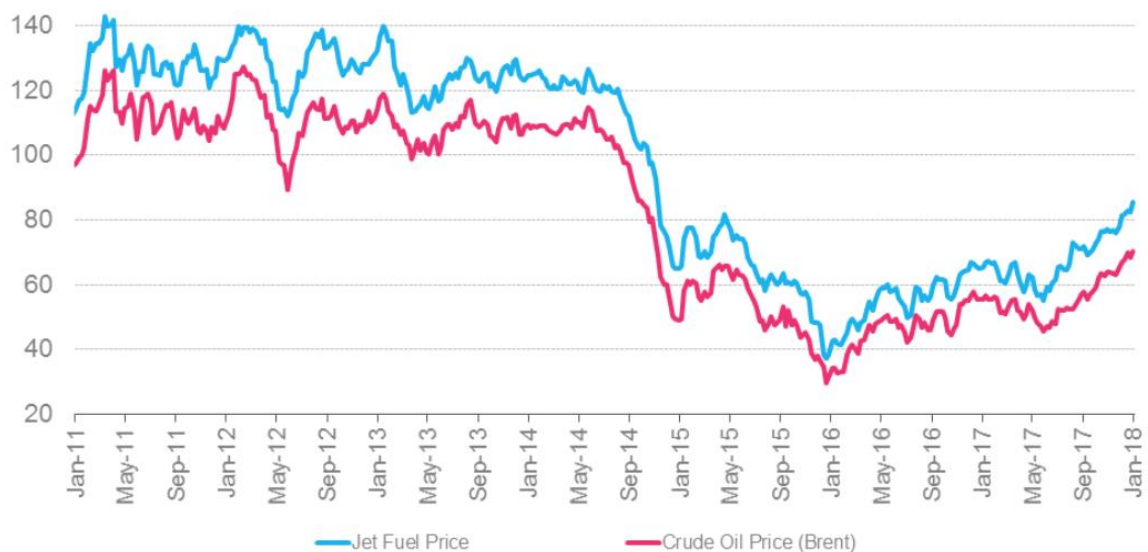
- Beirut, Lebanon
- Jerusalem, Israel
- Dodoma, Tanzania
- Dnipro, Dnipropetrovsk, Ukraine
- Bethlehem, West Bank, Palestinian Territories

Locations farthest away from Tel Aviv

- Gambier Islands, French Polynesia, 18,601 km
- Adamstown, Pitcairn Islands, 18,355 km
- Papeete, Tahiti, French Polynesia, 18,336 km
- Vaitape (Bora Bora), Tahiti, French Polynesia, 18,160 km
- Rarotonga, Cook Islands, 18,140 km

Source: Timesanddate.com

Price of Jet Fuel (Dollar/ Barrel³) since 2011



Source: Platts, Onada

³ Barrel = 159 litres

Tech Giants Want Direct Flights Between Tel Aviv and Dublin

Direct flights would position Dublin as a gateway to the U.S., as well as providing pre-clearance of U.S. customs for Israeli travelers.

Some of the world's leading high-tech companies have reportedly signed a petition calling for direct flights between Tel Aviv and Dublin, the capital of Ireland, according to the website of the Irish Independent newspaper.

"Direct flights would encourage more collaboration between tech companies to join forces and target customers in bigger economies, such as the U.S. and China," said Clyde Hutchinson, CEO of the Ireland-Israel Business Network, which is sponsoring the petition.

LinkedIn, Facebook, Intel, eBay and Salesforce are among the companies that have signed the petition, Hutchinson said. The European headquarters of many of the world's tech giants are located in Dublin.

Currently, travelers from Tel Aviv must catch a five-hour flight to London followed by a separate connection to Dublin. A direct route would reduce travel time to just over five hours.

In addition, Dublin has United States pre-clearance facilities, meaning that travelers can pass through U.S. customs in Dublin, a boon for the travelling businessperson.

"Many multinationals have their Israeli desks based in Dublin, so not having a direct flight is a huge inconvenience," said Hutchinson. "Executives and workers of these companies are constantly moving back and forth for meetings and events."

Hutchinson estimated that a Dublin-Tel Aviv route would cater to some 40,000 annually, a number that would require additional connecting flights between Dublin and North America.

"Tel Aviv is the second largest startup ecosystem in the world, yet is not connected enough to other ecosystems," said Hutchinson. "Ireland's unique connectivity with the US and the ability to clear US customs is a huge selling point for entrepreneurs."

Source: Haaretz, 2016

Ireland – Useful Information for the Israeli Tourist



How to fly to Dublin?

There are direct charter flights from Tel Aviv to Dublin between July and September. It makes sense to assume that as Ireland is growing in popularity among Israeli tourists, we will see more flights to Dublin in the future. Besides those charter flights, you can find different flights to Ireland with foreign airlines such as British Airways, Lufthansa, Turkish Airways and Air France. Most of them require a connection.

Landing in Ireland

Flights from Israel to Ireland land mostly in Dublin Airport, the largest airport in the country. The airport is located 12 km from Dublin the capital, and most visitors to Ireland visit Dublin as well. Dublin can be reached from the airport by bus. Public transportation in Ireland is considered very cheap and effective, and it will take you to Dublin quickly. Another way to get to Dublin from the airport is to take a taxi, even though their price is pretty high.

Visas:

Israelis don't need to obtain a visa in advance when they enter EU members. You need to make sure that your passport is valid for at least 6 months from the day of your planned return to Israel.

Additional information:

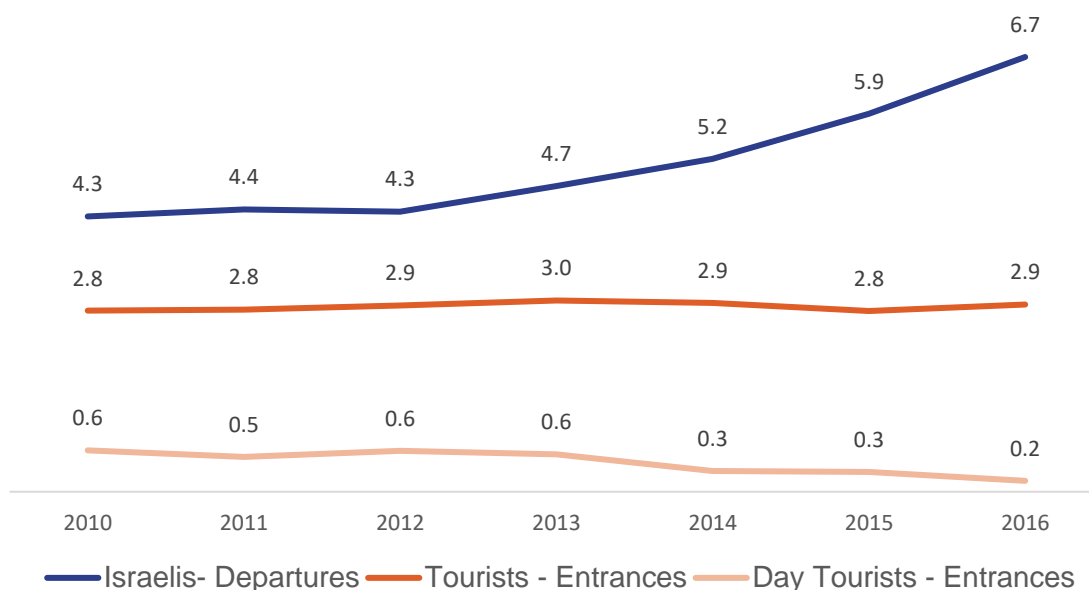
Currency – Euro

Electricity – type F wall sockets

Internet – most hotels and restaurants have Wi-fi (sometimes for additional cost)

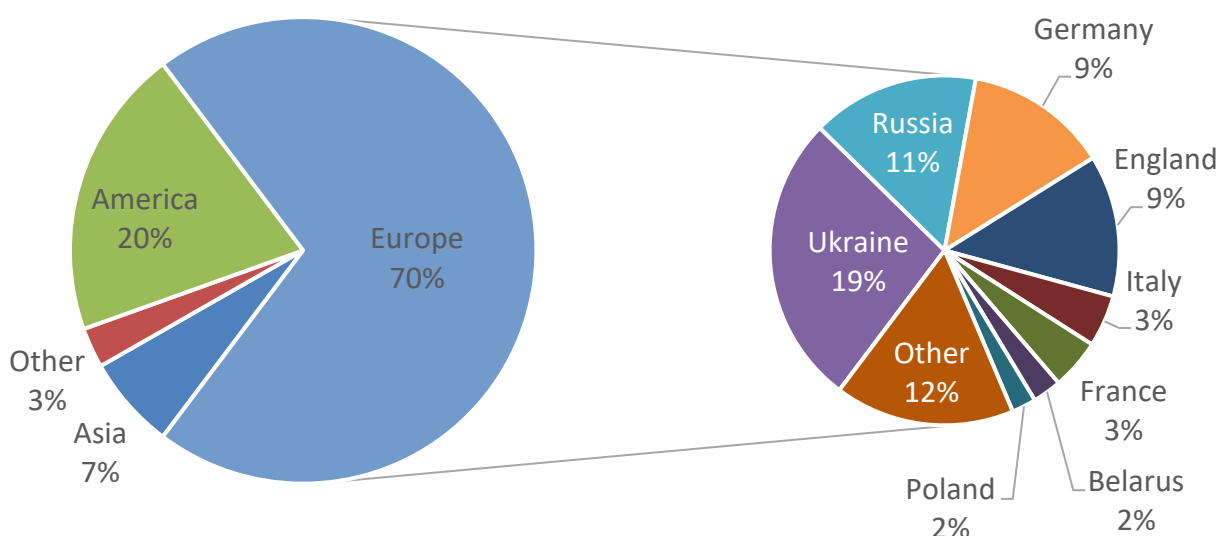
Source: TayarutEurope 2018

Entrances and Departures of Foreign Tourists and Israelis, 2010-2016, in millions



Source: Israeli Bureau of Statistics

Tourists Entrance to Israel by Nationality (2016)



Source: Israeli Bureau of Statistics