TheStreet

Do Emirates Cuts Threaten Orders at Boeing, a Company That Lately Can Do No Wrong?

Ted Reed Apr 21, 2017 1:44 PM EDT

TheStreet Video

It seems lately that **Boeing** (**BA**) can do no wrong.

Once a target of criticism by presidential candidate Donald Trump, Boeing has transformed itself into a presidential favorite. It contributed $1 million to the January inauguration. Weeks later, Trump visited Charleston, S.C., for the first 787-10 flight.

This month, he reversed himself to back the Export-Import Bank, which helps Boeing compete with **Airbus**.

Also in February, Boeing easily defeated a bid to unionize its Charleston plant, boosting its ability to play off South Carolina against Washington, where its plants are heavily unionized and where it has built airplanes for a century.

Boeing will report first-quarter earnings on Wednesday.

Of its $95 billion in 2016 revenue, Boeing Commercial Aircraft accounted for $65 billion while Boeing Defense Space & Security accounted for $29.5 billion. Demand for air travel is growing, while Trump has said he wants to spend more on defense.

No wonder Boeing shares closed Thursday at $179.30 or $6 below the all-time high. Among the 30 **Dow** stocks, Boeing is the third best 2017 performer, up 15% year to date. On Friday, the stock rose 0.5%.

Nevertheless, it cannot be viewed positively that on Wednesday, **Emirates** -- a key customer -- slashed its U.S. flying by 20%.

Let's acknowledge upfront that Boeing's commercial aircraft order backlog is 5,744 orders worth -- at list price, around $500 billion.

Emirates is the largest of the Middle East carriers that together account for 546 outstanding aircraft orders, about 10% of Boeing's total. The value percentage is higher because the Middle East order books tilt to widebodies, including 275 Boeing 777s and 134 Boeing 787s.

Emirates blamed the flying cutback on falling demand due to new security measures that ban laptops -- very peculiarly, only on flights from Middle East airports -- and on the Trump administration's continuing efforts to ban travelers from some Muslim-majority nations.

In truth, it has never been clear how much the growth of Emirates, **Etihad** and **Qatar** depends on demand, and how much it depends on government subsidies intended to grow the economies of the United Arab Emirates and Qatar.

"Their business model is based on growing their networks without regard to profitability in order to serve their governments' goals to dominate global aviation," said Jill Zuckman, spokeswoman for the Partnership for Open & Fair Skies, a coalition of U.S. airlines and labor unions who oppose the Gulf carrier's rapid U.S. expansion.

Still, "the growth needs to take a breather and allow the market to catch up," said aerospace consulting firm Air Insight in a recent report. "The concern should be how long this breather will be. For Airbus and Boeing, missing big orders from the ME3 will be a reality check -- the rest of the market is mature and buys much more carefully."

Similarly, a recent report by aerospace consultant Leeham Co. was titled, "Middle Eastern airline turmoil hits Boeing." It said Etihad, Emirates and Qatar "face over-capacity now compounded by electronic carry-on restrictions by the U.S. and U.K."

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Leeham also sees a potential threat to Boeing and Airbus in Asia, which has not had the sort of airline shakeout the U.S. has experienced.

The two manufacturers could face challenges from the 2016 creation of the Value Alliance of eight Asian low-fare carriers, including Singapore Airlines' Scoot and Tiger Airways; ANA's Vanilla Air; Tiger Airways Australia; Thailand's Nok Air and NokScoot, the Philippines' Cebu Pacific Air and Korea's Jeju Air, Leeham said.

"The ramifications of the coalescing of Value Alliance and its threats to AirAsia and even full-service carriers means that Airbus and Boeing-each with huge backlogs in the region, with the low-cost carriers and the full-service carriers -- may have to up their game on monitoring the health of the airlines once the Value Alliance is in full swing," the firm said.

For the near term, Wall Street analysts remain confident.

"We like Boeing's set-up into Q1 with low expectations," Cowen & Co. analyst Cai von Rumohr said in a recent report. "Light Q1 deliveries don't jeopardize full year 2017 EPS, while commercial & {defense} bookings were encouraging," he said.

"Combined with rising airline load factors, declining {Boeing Commercial Aircraft} headcount, and share award tax benefits, they bolster the 2017-19 outlook," he said. He rates the stock outperform.

CFRA Research analyst Jim Corridore has a buy rating and a price target of $191, 20 times his 2017 estimate. Boeing's five-year average P/E was about 20X.

"We see price appreciation over the next several years," Corridore wrote.

"Commercial aircraft demand remains strong," he said, and "while we remain concerned about a drag from defense, the operation's size relative to the commercial business and the recent election of Donald Trump argue for increases in defense in coming years."

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