

# CARGO E-CHARTBOOK

Q4 2009

## KEY POINTS

- This past quarter has begun to show more consistent signs of an improvement in the air freight business. Volumes and yields are now moving in the right direction – upwards – although there is still a long way to go before early 2008 levels are regained. Several years of growth have been lost in this extraordinary downturn. Moreover, the revival in economic growth is very uneven – with a strong rebound in Asia and parts of South America but weak growth in developed markets – and is expected to remain that way for some time. But world trade is now picking up adding to the impetus given to air freight by the inventory cycle and mode switching. However, better volumes are not the same as moving from loss to profit. Yields are starting to turn up, as load factors fully recover, but low aircraft utilisation and scheduled deliveries imply that capacity remains a threat to restoring profitability.

## HEADLINES BY SECTION

### Economic Outlook (page 2)

- Economic recovery is now underway as a result of massive stimulus packages. Emerging economies return to good growth but developed economies, burdened by debt, could see an extended period of weak growth.

### Demand Environment (page 4)

- The inventory overhang has diminished and purchasing managers in industries around the major economies are saying they will increase orders, further boosting air freight. However, growth seems narrowly based at the moment.

### Costs (page 6)

- Fuel prices remain a key risk, but in this economic environment – with rising unemployment and spare capacity in industry – non-fuel costs should be falling not rising. Economy wide wages are doing just this.

### Competition (page 8)

- Air freight increased its market share earlier this year but there are now signs of increased demand for both bulk commodity and containerised ocean transport. Ocean cargo yields are now rising sharply as the recovery in world trade broadens.

### Traffic Growth (page 3)

- Air freight volumes have risen 15% above their low point in a typical post-recession pattern, benefiting from a switch from other modes. World trade is now picking up but the geographical pattern remains very uneven.

### Revenue and Yields (page 5)

- Having fallen in 2009Q2 to levels 21% down on the previous year cargo yields started to turn up in Q3, as load factors returned to pre-recession levels. However, cargo revenues are likely to be down 25-30% this year.

### Capacity (page 7)

- Freight load factors on international markets are back to pre-recession levels, helping to turn yields up from their mid-year lows. Deliveries are being deferred but the fleet is still expanding and utilisation is low.

### Profitability (page 9)

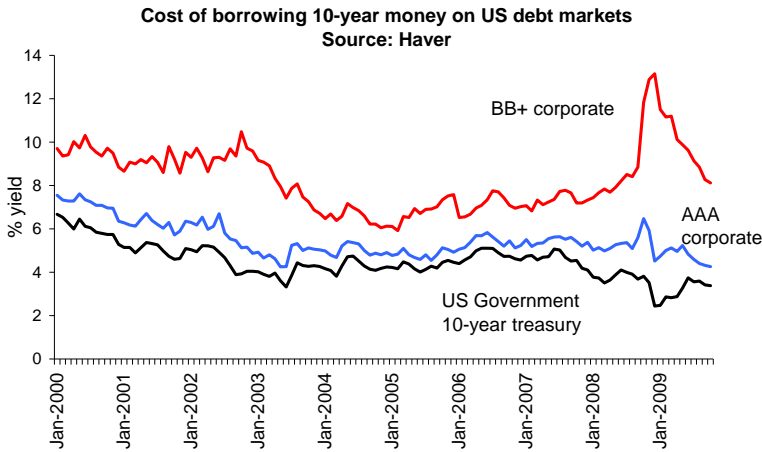
- The evidence we have for cargo financial performance shows deepening net losses in Q2. The October survey of heads of cargo showed a tough Q3 as well but confidence in the future has improved sharply.

## Economic Outlook

### Key Issue:

➤ Economic recovery is now underway as a result of massive stimulus packages. Emerging economies return to good growth but developed economies, burdened by debt, could see an extended period of weak growth.

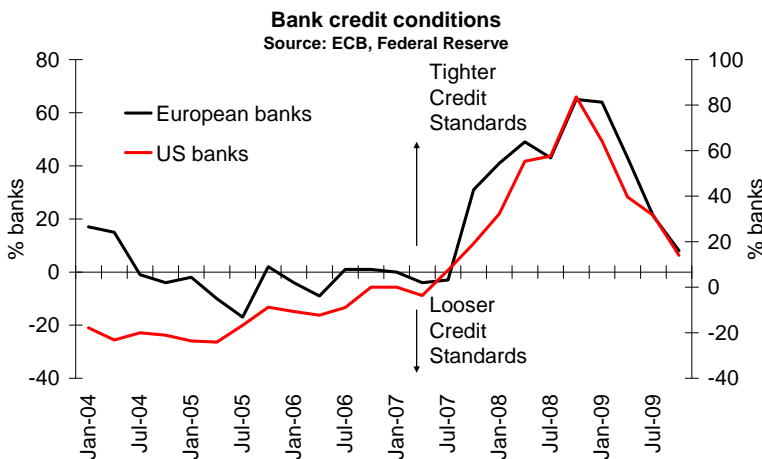
### Credit spreads are narrowing but debt remains expensive for most borrowers



➤ Near zero central bank interest rates are helping to restore the profitability of the banks but this does not reflect the borrowing costs of less-than-investment-grade companies. The BB+ borrower (most airlines) still has to pay more than 8% to issue 10-year debt in US markets.

➤ Central banks in Asia-Pacific are starting to withdraw the monetary stimulus, raising interest rates. This is not expected to happen soon in the US or Europe, where private balance sheets remain fragile.

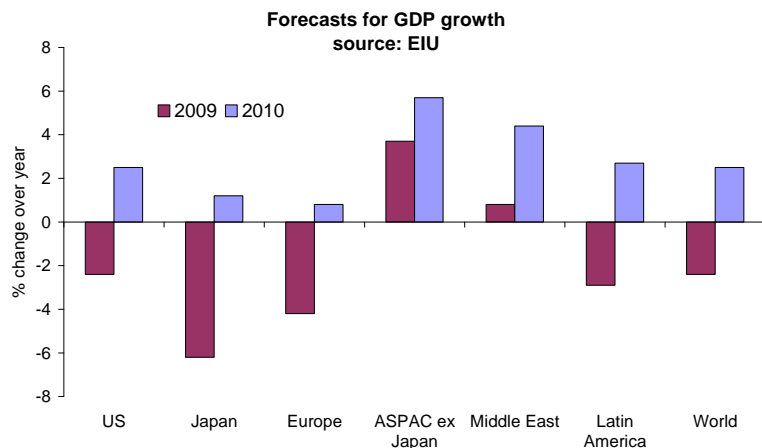
### The credit crunch is now starting to ease but bank credit remains tight



➤ The massive central bank support packages for the financial system together with substantial capital raising is starting to underpin the banks in Western economies. The proportion of banks still tightening credit conditions has almost fallen to zero.

➤ However, there are still some banks tightening credit conditions and banks in the US and Europe remain short of capital. As a result bank credit remains tight and a drag on the economic recovery in these economies.

### Upturn in economic growth through 2010 forecast to be geographically uneven



➤ Following the steepest fall in GDP experienced since the 1930s, economic growth is expected to return in 2010. However, growth is widely expected to vary dramatically between regions.

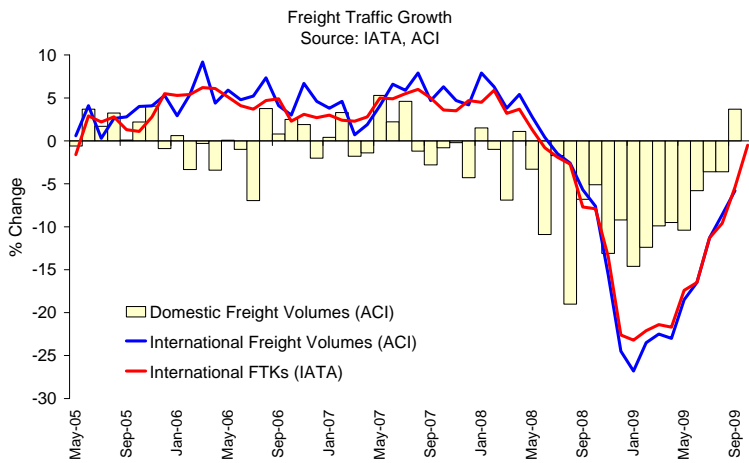
➤ Reasonably robust growth is forecast in the emerging economies. However, in the US, Europe and Japan growth will be held back for an extended period of time while problems of highly leveraged household and bank balance sheets are resolved.

## Traffic Growth

### Key Changes in the data this quarter:

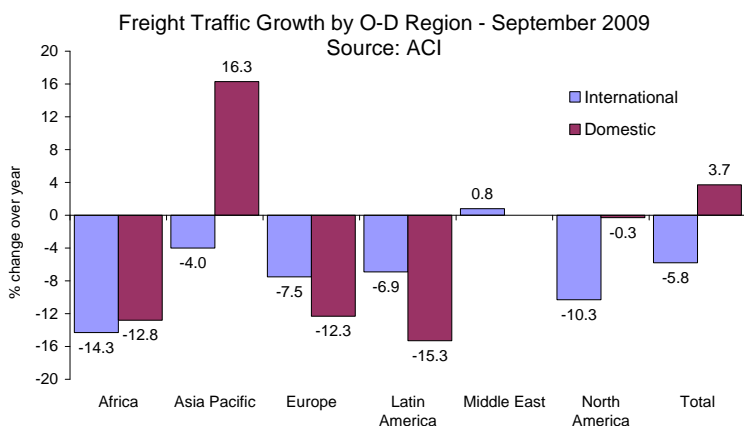
- Air freight volumes have risen 15% above their low point in a typical post-recession pattern, benefiting from a switch from other modes. World trade is picking up but the geographical pattern remains very uneven.

### Air freight volumes back to year ago levels but have only recovered half 2008 loss



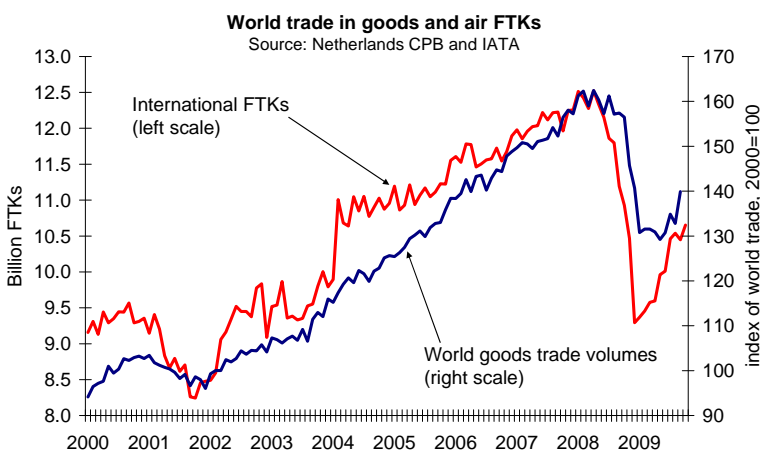
- By October air freight volumes on international markets had risen to a level just 0.5% below the same month the previous year. According to ACI data domestic freight rose above year earlier levels in September.
- Air freight has risen 15% from the low reached in December 2008. However, that takes the market only half way back towards the level seen at the beginning of 2008. There is some way to go before earlier levels in the market are recovered.

### Regional data on air freight flows reflects the uneven pattern of the economic upturn



- Regional air freight data, from the ACI, illustrates how uneven the pattern of economic growth is at present. By September international flows in and out of the Middle East and Asia Pacific were strongest. Domestic freight is particularly strong in Asia-Pacific reflecting the robust rebound in economic growth.
- European and N American international freight flows remain very weak, largely due to the moderate recovery in these economies so far.

### World trade upturn now gathering strength boosting air freight on top of modal shift



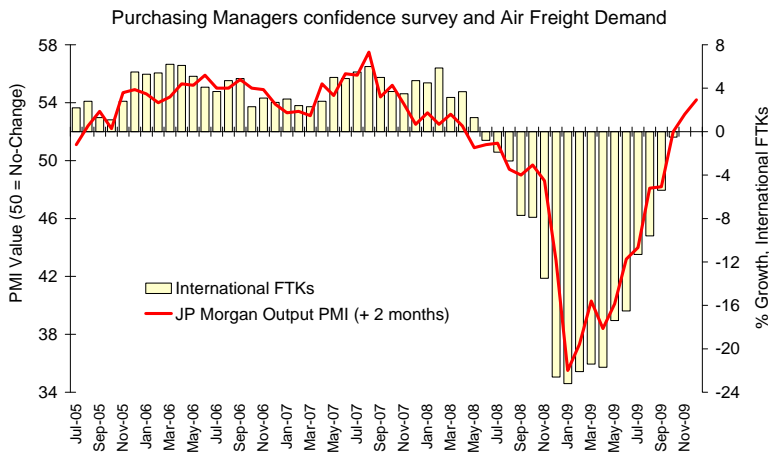
- Air freight is now 15% above the low and started rising well before overall world trade in goods as, in a typical post-recession pattern, shippers wanted to restock and switch mode to air freight in order to minimise working capital.
- In the past few months this inventory cycle appears to have led to a stronger rise in overall world trade. Once the inventory cycle is complete further recovery in air freight depends in a broader and sustained growth in world trade.

## Demand Environment

### Key Changes in the data this quarter:

- ↗ The inventory overhang has diminished and purchasing managers in industries around the major economies are saying they will increase orders, further boosting air freight. However, growth seems narrowly based.

### Purchasing managers confidence points to further gains in air freight volumes



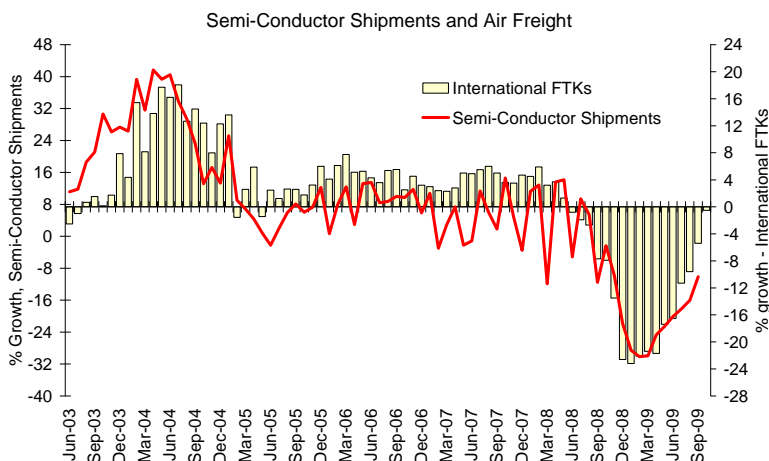
- ↗ Survey data on the confidence of purchasing managers in manufacturing industries around the major economies has proved to be a good leading indicator for the growth in air freight.
- ↗ Purchasing managers are as confident about orders in the near term as they were back in 2007, consistent with air freight growth of a little less than 5%. However, it is notable that this indicator is not consistent with the pace of month-to-month expansion continuing into next year.

### De-stocking by manufacturers is now reducing the inventory overhang



- ↗ The inventory to sales ratio in major economies is almost the mirror image of air freight volumes. As a massive inventory overhang developed, when recession hit sales at the end of last year, air freight collapsed. When warehouses are full, shipments of components and final goods stop.
- ↗ As destocking started to empty warehouses through 2009, increased shipments were needed to maintain renewed production levels. Air freight has been the beneficiary.

### Semi-conductors are turning up but clearly have not driven the recent rise in air freight



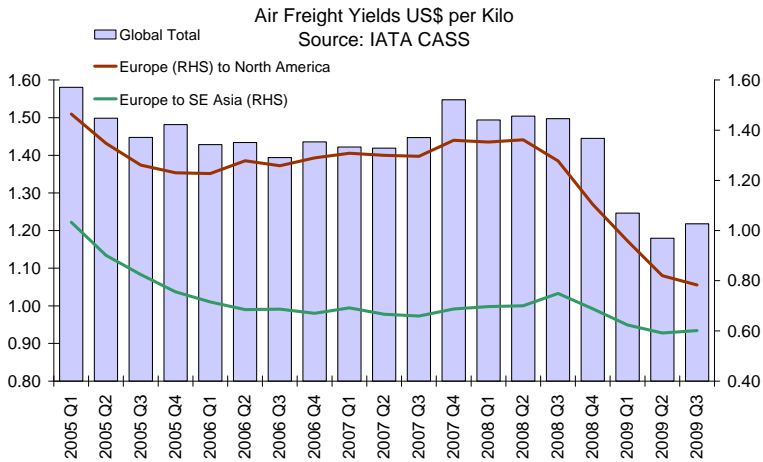
- ↗ Usually semi-conductor shipments are a very good coincident indicator of air freight, since these low-weight, high-value goods are an important part of the air freight product mix.
- ↗ They have risen this year but only by half the extent of air freight. Clearly other products have driven the rise in air freight in recent months. This may indicate the fragile nature of the upturn so far, since the lack of semi-conductor recovery shows consumers are not confident enough to return to buying consumer durables in any scale as yet.

## Revenues and Yields

### Key Changes in the data this quarter:

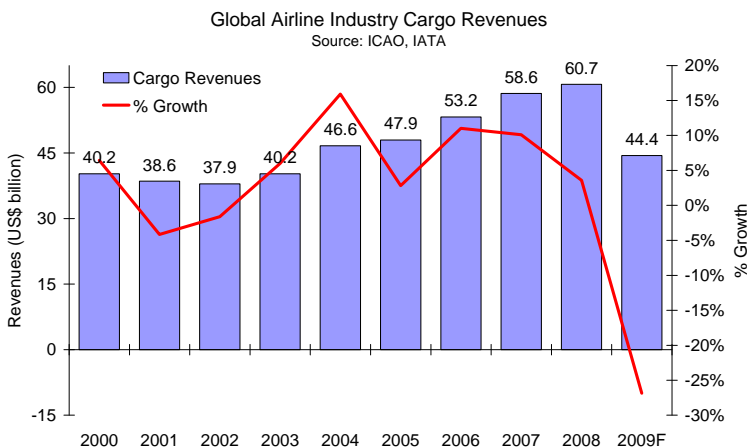
- Having fallen in 2009Q2 to levels 21% down on the previous year cargo yields started to turn up in Q3, as load factors returned to pre-recession levels. However, cargo revenues likely to be down 25-30% this year.

### Cargo yields start to turn up in Q3 as load factors recover pre-recession levels



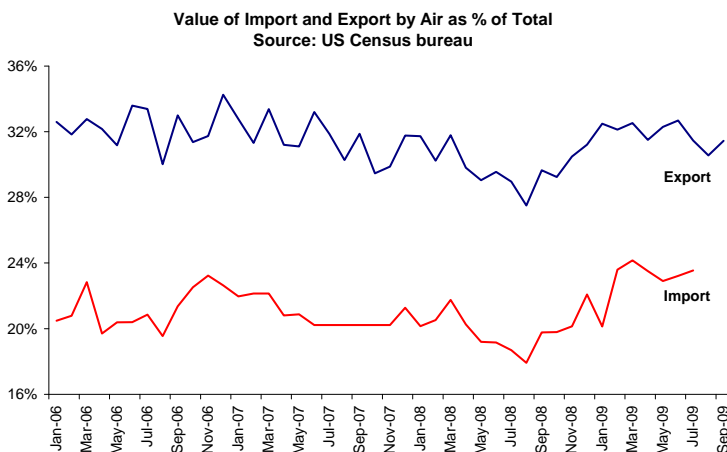
- Having fallen to levels 21% down on the previous year in Q2, there were signs of an upturn in air freight yields in the third quarter. As can be seen on p7 load factors are back up to pre-recession levels, tightening supply-demand conditions in freight markets.
- During Q3 average yields rose 3% to a level still 19% below the same quarter last year. By market the picture is very mixed with yield increases on many Asian and South American markets but further falls elsewhere.

### Cargo revenues were down 40% in 2009H1 moderating to -25% in Q3



- Although both freight volumes and yields are now turning up, they are both rising from a deep hole into which they fell at the start of the year. First half revenues were down around 40%.
- By the third quarter volumes were rising strongly and yields had begun to turn up. However, yields in particular were still a long way from where they were a year earlier. Q3 cargo revenues were down an estimated 25%. For 2009 as a whole a fall of 25-30% is expected.

### Air freight regains lost market share at the start of an upturn in economic activity



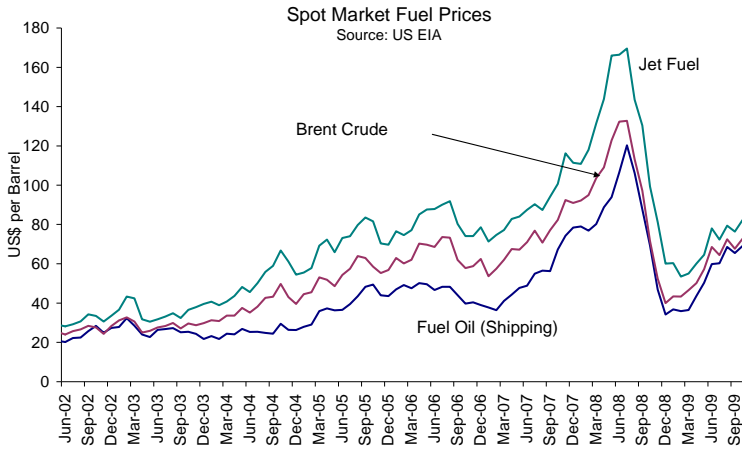
- The share of air freight by value in US exports and import has risen significantly through 2009 to around 32% for exports and 24% for imports.
- The dip in value share in the middle of last year was driven more by the impact of the oil price spike on energy imports and exports. Some of the rise in air freight share since has been due to falling oil prices but, since the start of this year, there has also been a cyclical switch from ocean to air.

## Costs

### Key Changes in the data this quarter:

➤ Fuel prices remain a key risk, but in this economic environment – with rising unemployment and spare capacity in industry – non-fuel costs should be falling not rising. Economy wide wages are doing just this.

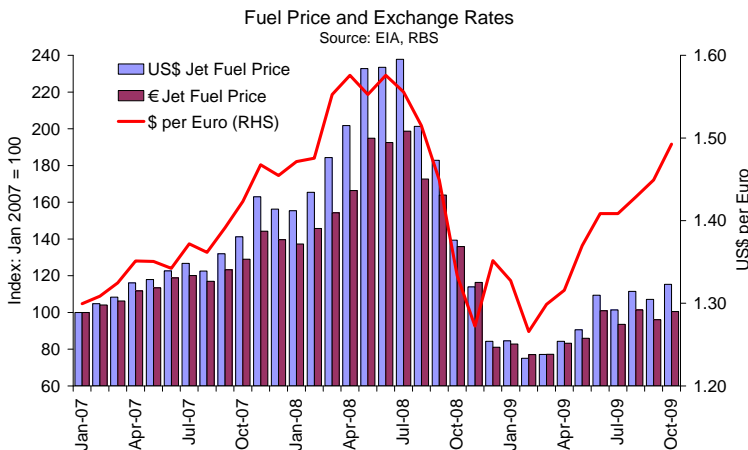
### Jet fuel price, pushed higher by oil prices, rises back over \$80 a barrel



➤ Oil prices have doubled since the start of this year, though remain well below the peak of 2008. This has pushed jet prices back over US\$80 a barrel, squeezing cash flows.

➤ Unlike the 2003-2008 period, when air freight lost market share to ocean shipping, fuel oil prices are now trading much closer to jet. Looking ahead the market is uncertain with most forecasts relatively flat. Oil inventories are high but financial investors have lots of cash looking for an asset in which to invest.

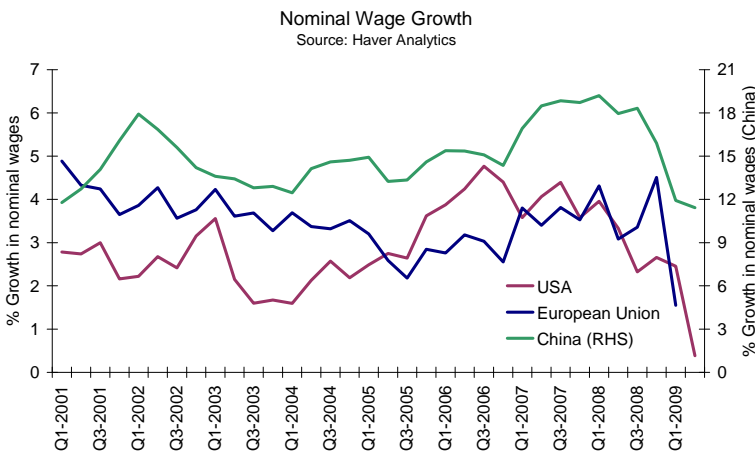
### US dollar weakness this year provides a moderate offset to jet fuel price rises for some



➤ The US dollar has almost lost all of the ground it gained against the Euro in late 2008 – a gain generated by the recession-induced rush into supposedly safer US asset classes. Now that economies are recovering and risk appetite is returning the US dollar has suffered.

➤ This 15% currency move has provided some limited offset for non-US dollar airlines against the rise in the US\$ price of oil and jet fuel.

### Looser labour markets are reducing wage pressures in most regions



➤ Inflation is not a major risk in this economic environment, despite the huge injections of central bank cash. The cash is finding its way into asset markets rather than demand for goods or labour.

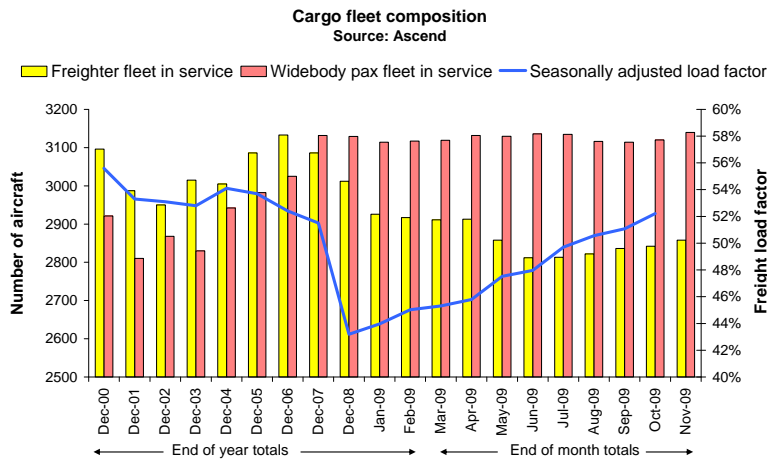
➤ High and still rising unemployment will mean that labour's bargaining power remains weak for some time, reducing the growth in wage costs. Of course some scarce and skilled employee groups, such as pilots, retain bargaining power but generally non-fuel costs should be falling rather than increasing.

## Capacity

### Key Changes in the data this quarter:

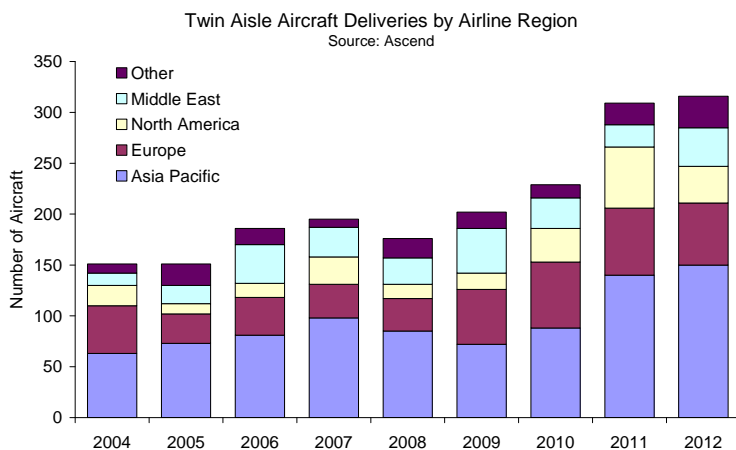
- Freight load factors on international markets are back to pre-recession levels, helping to turn yields up from their mid-year lows. Deliveries are being deferred but the fleet is still expanding and utilisation is low.

### Freighters and widebodies now rising but load factors back to pre-recession levels



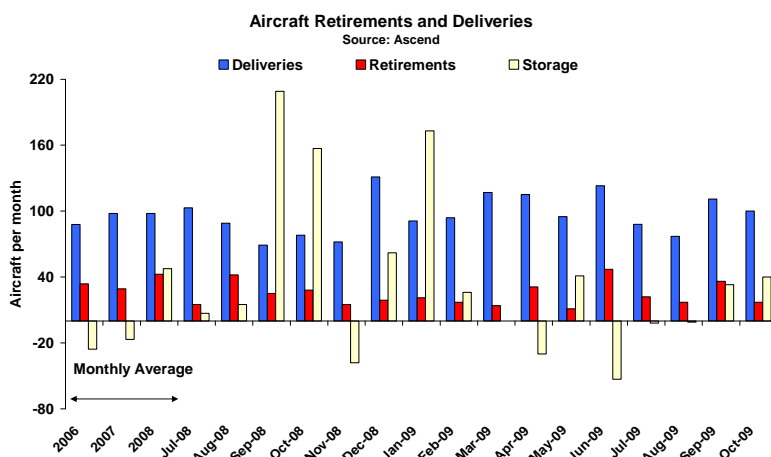
- Freight load factors on international markets are now back to pre-recession levels, above 52%. These tighter supply-demand conditions have started to turn cargo yields up, albeit slowly, as seen in Q3.
- However, while the in-service freighter fleet was cut by 200 aircraft between January and June, since then the fleet has risen by almost 50 new aircraft. The widebody passenger fleet is also up. Capacity has been cut by reducing aircraft utilisation – not good for profits.

### New aircraft deliveries increasingly being deferred into later years



- Just looking at new belly capacity due to be delivered in widebody passenger aircraft, the good news is that an increasing number of planned deliveries have been deferred into later years. Indeed planned 2010 deliveries are down 30% from those expected in January.
- Nonetheless, the 229 delivered current planned for 2010 still represent a 7% addition to the fleet. Together with low aircraft utilisation, the threat to yields over the coming year remains.

### Twin and single aisle fleet expanding as deliveries continue to exceed parking



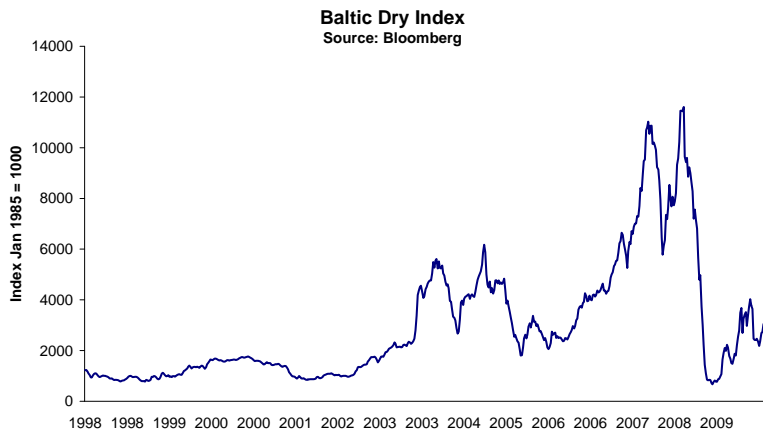
- Aircraft may not be in the air as much as before but they are still not being taken out of the in-service fleet in the numbers seen at the end of 2008. In October around 40 were put in storage, with a number around half that retired. However, new aircraft deliveries were up at 100 during the month.
- As a result the aircraft fleet is up around 2% in size from the start of the year. With low utilisation of the existing fleet it might be increasingly difficult to keep a lid on capacity growth.

## Competition

### Key Changes in the data this quarter:

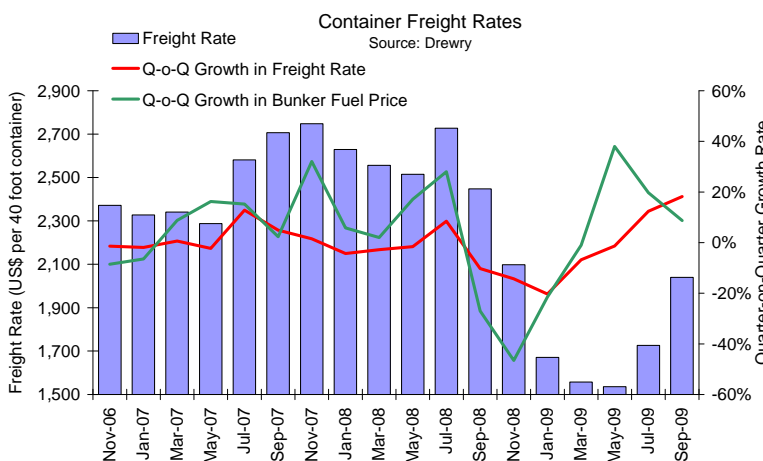
- Air freight increased its market share earlier this year but there are now signs of increased demand for both bulk commodity and containerised ocean transport. Ocean cargo yields are now rising sharply.

### Cost of shipping bulk commodities pulled up by iron ore demand from China



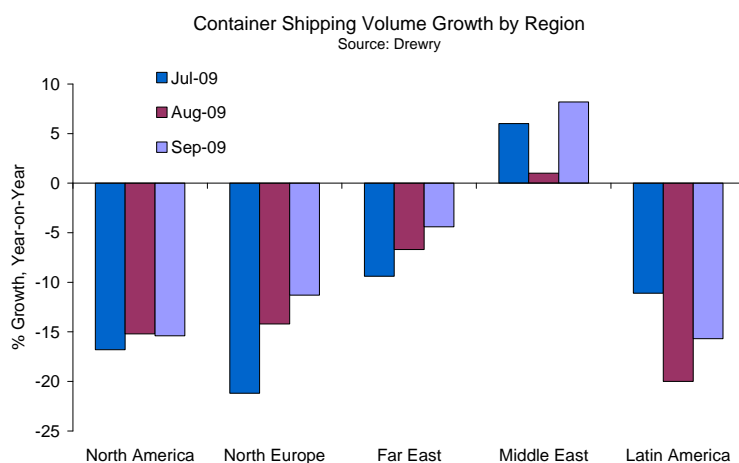
- Strong Chinese demand for Brazilian iron ore pushed up the cost of bulk ocean transport at the start of this year, boosting the Baltic Dry Index from its end-2008 low.
- An influx of new shipping capacity pushed the index down but renewed strength in recent months does seem to reflect a broader rise in world trade. Overall world trade volumes rose 5% in August over the previous month, which is encouraging.

### Container freight rates rise significantly from mid-year



- A further sign that world trade markets are strengthening is visible in the rise of container freight rates from July, now up 33% from that low.
- Part of that rise reflects rising residual fuel oil costs, but is it certainly a sign that the market is strong enough to take it. There is still 25% to go before container shipping freight rates have recovered the levels of late 2007 or mid-2008.

### Container demand rise lagging air freight but is showing signs of strengthening



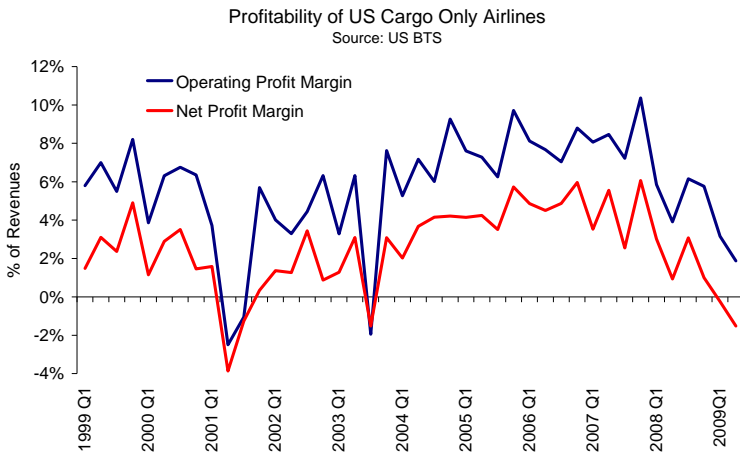
- Demand for containerised shipments of goods – a close competitor to air freight – was falling during the first half of this year, in contrast to rising demand for air freight. This switch of modes is typical in the early stages of economic recovery as the need to reduce time and working capital offset the higher cost of air freight. However, in August and September there were signs that ocean freight was also benefiting from the world trade upturn.
- This upturn was most visible in and out of the Far and the Middle East, reflecting the relative strength of the economic revival in non-Japan Asia.

## Profitability

### Key Changes in the data this quarter:

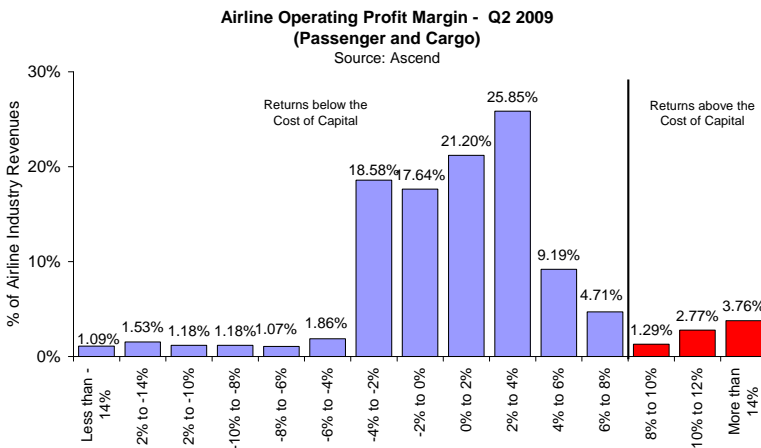
- The evidence we have for cargo financial performance shows deepening net losses in Q2. The October survey of heads of cargo showed a tough Q3 as well but confidence in the future has improved sharply.

### All-cargo airlines loss deepens in the second quarter of 2009



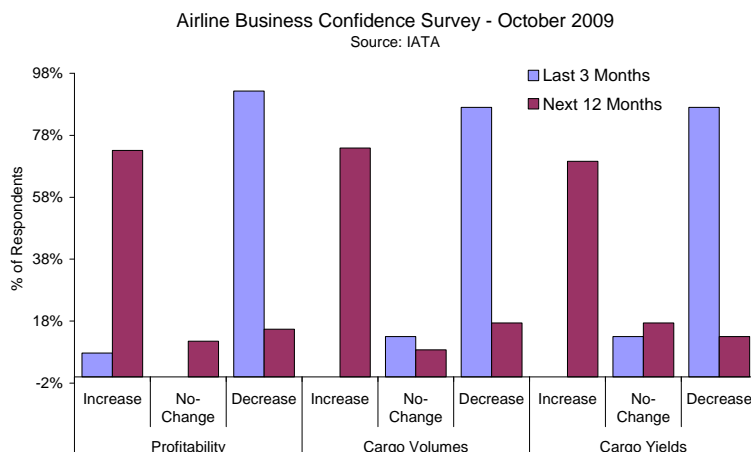
- Passenger airlines are showing signs of a moderate improvement in profitability in Q3. However, all-cargo airlines in the US have yet to all report on Q3. Certainly losses were deepening into the second quarter of this year, as freight yields hit lows and the rise in freight volumes was just gathering pace.
- The volume improvement in Q3 and the start of a turn up in yields will go some way to offsetting the impact of higher fuel prices on Q3 profitability.

### Operating losses persist in Q2 but not as severe as in the first quarter



- With full Q3 data not yet available we focus here on the distribution of financial performance in Q2, now that we have a large sample. Of the sample of major airlines in this sample the median airline was just back into positive operating profit. However, almost 50% reported an operating loss.
- Nonetheless, this is an improvement from Q1 when only 18% of the airlines reported a positive operating profit. Note that this sample is passenger as well as cargo airlines.

### Business confidence over future cargo revenues improves sharply in October survey



- The confidence of heads of cargo surveyed in October appeared to be markedly better than in July. However, they did report a difficult Q3 – with the vast majority reporting falling cargo volumes and yields, as well as losses.
- For the next 12 months the mood has swung to expectations of higher volumes, yields and profitability. Note however, that the profitability question is relative and at present consistent with smaller losses rather than positive net profits.

## Air Freight Routes and Direction

## International Freight Volume Growth by Route Area (Source: IATA ODS statistics)

Route Area	% Growth in Freight Tonnes, year-on-year					
	Apr 2009	May 2009	Jun 2009	Jul 2009	Aug 2009	Sep 2009
Africa - Middle East	-5.6%	-1.9%	6.3%	-3.4%	0.0%	-7.4%
Europe - Far East (Except Polar)	-26.1%	-22.3%	-22.3%	-17.5%	-16.5%	-12.3%
Europe - Middle East	-8.3%	-8.5%	-12.0%	-4.2%	-1.0%	-5.3%
Within Far East	-20.5%	-15.0%	-10.8%	-5.5%	-3.5%	3.1%
Within Middle East	1.1%	0.8%	-3.1%	3.4%	11.7%	-13.1%
Within South America	-23.7%	-21.9%	-21.0%	-14.8%	-4.9%	-4.0%
Mid Atlantic	-14.6%	-15.6%	-17.4%	-10.0%	-7.5%	-0.7%
Middle East - Far East	-3.2%	-2.3%	-3.8%	4.0%	6.1%	1.0%
North Atlantic	-26.5%	-20.6%	-19.9%	-16.2%	-13.5%	-9.8%
North America-Central America	-28.0%	-29.8%	-16.0%	-2.1%	-4.4%	-2.5%
Europe - Africa	-10.9%	-1.3%	0.3%	-1.3%	-7.0%	-7.6%
North America - South America	-32.1%	-23.2%	-19.5%	6.1%	10.1%	14.4%
Far East - Southwest Pacific	-11.1%	-12.1%	-11.8%	-3.6%	-2.0%	3.0%
North and Mid Pacific	-29.1%	-23.3%	-18.7%	-11.7%	-13.1%	-3.2%
South Atlantic	-28.1%	-19.7%	-22.4%	-12.0%	-3.9%	-2.6%
Within Europe	-20.4%	-12.7%	-17.0%	-10.9%	-19.1%	-17.7%

## Outbound CASS Market Revenues

Origin Region	US\$m Q3 2009	% Growth in Air Freight Revenues, year-on-year					
		Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Africa	31.5	9.4	5.9	2.2	-8.0	-18.2	-18.4
Caribbean	4.3	8.9	7.3	-6.8	-7.3	-4.2	-11.3
Central America	43.4	9.1	9.2	-19.9	-15.8	-17.5	-8.5
Europe	986.4	9.2	-1.1	-23.9	-37.0	-39.9	-30.4
Japan & Korea	608.4	-4.1	-23.5	-41.6	-55.6	-39.5	-12.9
Middle East	51.6	15.2	26.7	23.2	49.4	19.4	-1.5
North America	537.5	13.8	7.3	-15.1	-23.7	-32.2	-25.2
South America	147.3	12.8	11.0	-6.1	-20.8	-30.0	-20.1
South East Asia	772.6	27.2	27.2	-2.3	-27.2	-30.3	-22.3
South West Pacific	119.4	10.8	-0.3	-27.2	-30.0	-29.9	-13.1

## Inbound CASS Market Revenues

Destination Region	US\$m Q3 2009	% Growth in Air Freight Revenues, year-on-year					
		Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Africa	258.6	17.2	10.8	-5.9	-12.5	-19.5	-13.5
Caribbean	25.0	11.2	6.3	-10.2	-27.9	-22.1	-22.9
Central America	63.7	14.7	-6.2	-25.4	-37.1	-42.3	-34.0
Europe	889.4	8.4	2.3	-17.3	-33.6	-35.8	-25.6
Japan & Korea	185.8	-2.0	-13.2	-31.8	-41.2	-35.3	-23.9
Middle East	260.7	17.8	18.7	-2.4	-12.3	-16.3	-13.3
North America	593.7	2.2	-7.9	-31.0	-45.6	-43.9	-28.7
South America	264.3	28.7	24.7	-14.1	-33.9	-38.7	-29.8
South Asia	117.5	30.2	18.4	-3.9	-16.0	-23.6	-11.5
South East Asia	454.3	6.8	-5.5	-26.7	-42.4	-33.5	-15.0
South West Pacific	189.2	26.2	4.9	-25.1	-34.9	-39.4	-24.7

IATA Economics  
December 2009