

CARGO E-CHARTBOOK

Q2 2008

KEY POINTS

- Having performed relatively well in 2007, air cargo businesses have seen a modest slowdown in demand and yields in the past 3 months. Capacity has been held in line with demand, sustaining load factors.
- However, fuel costs have risen dramatically and forward-looking indicators for demand have turned sharply negative. Emerging market growth looks robust but confidence in future profitability has slumped.

HEADLINES BY SECTION

Economic Outlook (page 2)

- The US economy will be weak this year, close to recession, but emerging markets are forecast to continue growing strongly. Interest rates were cut further but banks inside and outside the US are limiting credit expansion as they repair balance sheets damaged from sub-prime mortgage losses.

Demand Environment (page 4)

- Forward-looking indicators for air freight demand have weakened sharply in recent months. Much weaker business confidence in manufacturing and a fall in shipments by the key semi-conductor industry points to a further deceleration of air freight volume growth in the next few months.

Costs (page 6)

- There has been an unprecedented rise in the cost of jet fuel during the first part of this year, with a virtual doubling of prices by late-May. At this level airlines face fuel costs taking up over 50% of operating costs, but this will be higher for cargo airlines for whom fuel is already a larger cost.

Competition (page 8)

- The ocean freight industry suffered a more severe downturn in the first quarter than air freight. Having risen late last year, ocean freight rates are now falling, under pressure from excess capacity. Ocean freight markets contracted with North America, slowed in Europe but accelerated in Asia.

Traffic Growth (page 3)

- Air freight volume growth has slowed during the first few months of 2008, but the slowdown has been much less than for the passenger business. A greater exposure to Asia and other emerging markets, which remain strong, is providing some offset to the weakness from the US economy.

Revenue and Yields (page 5)

- Air cargo yields started to rise at the end of last year, reflecting higher fuel costs. Fuel costs rose considerably further so far this year, but economic weakness in the US and increasing deliveries of new capacity led to a resumed decline in yields in the first quarter.

Capacity (page 7)

- So far this year freight capacity growth has been held in line with slower demand growth, sustaining freight load factors, in contrast to declining load factors in the passenger business. However, the significant increase in twin-aisle deliveries over the next couple of years will risk excess capacity.

Profitability (page 9)

- Profitability among cargo only airlines improved significantly during 2007, despite the rise in fuel costs. The industry is now faced with a sharp rise in fuel costs and markets that have weakened in the US. As a result confidence for profitability over the next 12 months has deteriorated sharply.

Economic Outlook

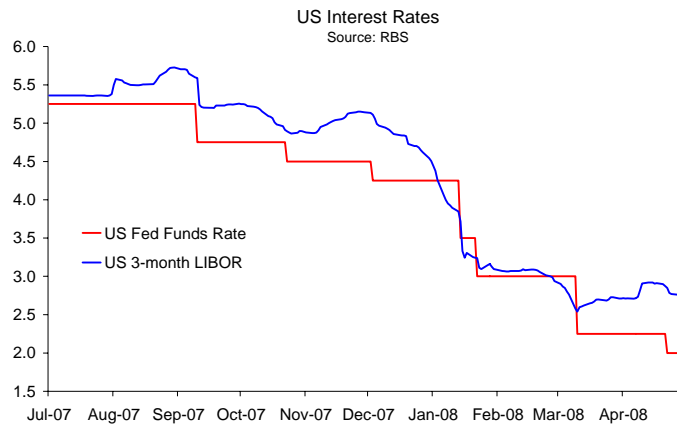
Key Issue:

- The US economy will be weak this year but emerging markets are forecast to continue growing strongly.

Expected implications for the air freight industry:

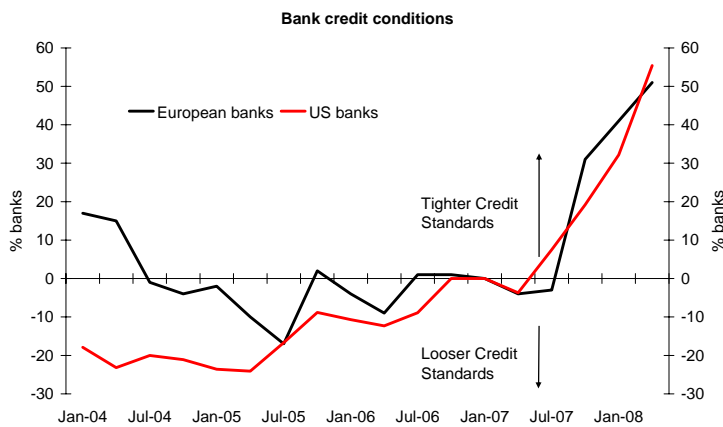
- Damage from the US will be limited by the greater importance of Asian markets for air freight.

US interest rates have been cut even further in response to the risk of a US recession



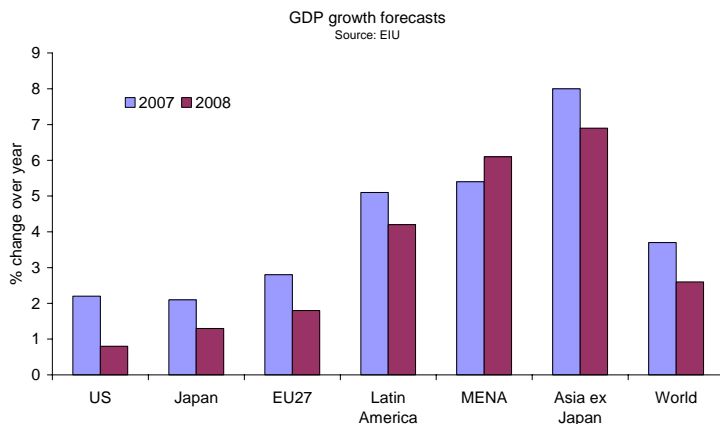
- In the past 3 months official interest rates have been cut a further 1% point to 2% in the US, in response to the increasing risk of recession.
- However, market interest rates did not fall reflecting perceptions of credit risk, so limiting the benefits of official cuts.
- Outside the US there is more concern over inflation and so interest rates have not been cut in Europe or Asia, strengthening exchange rates against the US dollar.

But banks have tightened credit conditions further in Europe as well as the US



- Not only have market interest rates not fallen but banks have tightened their credit conditions, making it much more difficult for firms and households to obtain credit.
- Credit conditions are tightening as banks try to repair balance sheets damaged by losses suffered as a result of the sub-prime mortgage crisis in the US.
- Banks outside the US also suffered losses so the impact on lending and investment is being felt in Europe too.

The US is seen as close to recession but emerging market growth remains strong



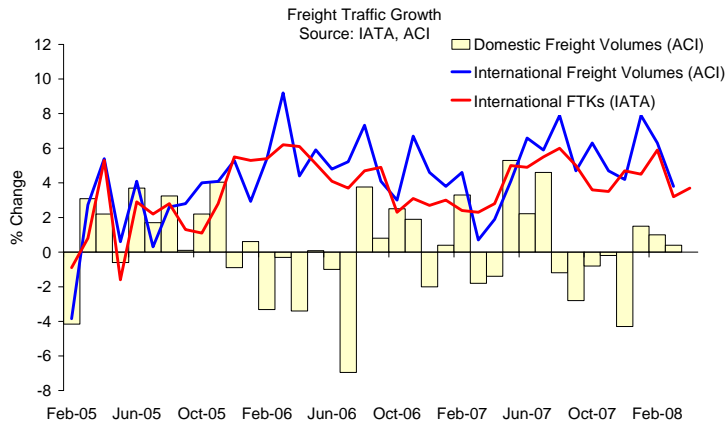
- Economic growth in the US will be very low this year, even if recession is avoided.
- The ripples from the US downturn are spreading and pulling down growth in Europe. Japan is also looking weak.
- However, economic growth in key markets for air cargo such as Asia, as well as regions such as Latin America and the Middle East are expected to continue to provide strong growth.

Traffic Growth

Key Changes in the data this quarter:

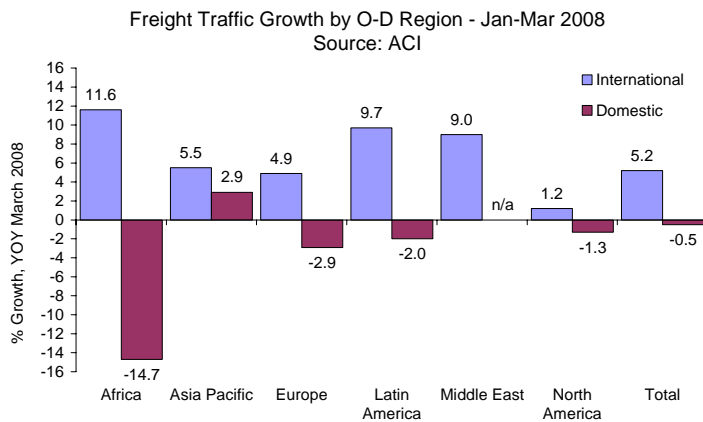
- Air freight volume growth has slowed during the first few months of 2008, but the slowdown has been much less than for the passenger business. A greater exposure to Asia and other emerging markets, which remain strong, is providing some offset to the weakness from the US economy.

Air freight volume growth slowing but remains close to recent trend



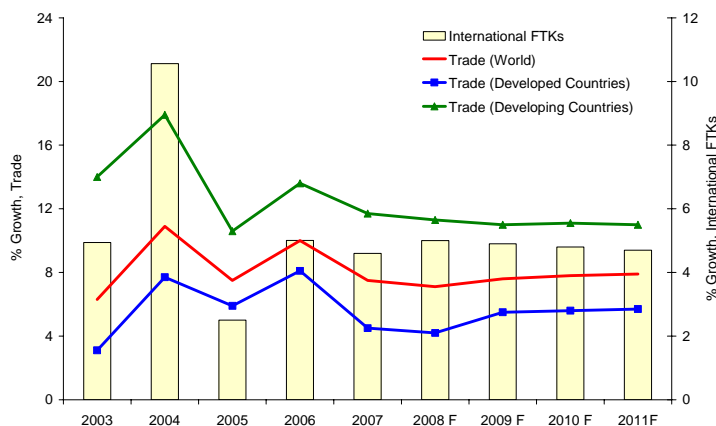
- Air freight volumes are slowing but not as fast as might be expected.
- February data were distorted by the extra day added by the leap-year. March and April saw a further slowdown in the growth of international air freight volumes.
- However, the slowdown has been modest in comparison with the passenger market. Air freight has a much larger exposure to the stronger Asian markets in comparison with the passenger business.

Emerging markets continue to generate rapid freight growth so far this year



- The weakness of the US economy can be seen clearly in the weakness of air freight originating in or destined for North America.
- Europe and Asia Pacific markets were still growing at a reasonable pace in the first quarter of this year.
- However, air freight growth in emerging markets such as Africa, Latin America and the Middle East continues to grow strongly in line with better economic performance in these economies.

Increased trade levels in developing economies is helping to drive future growth



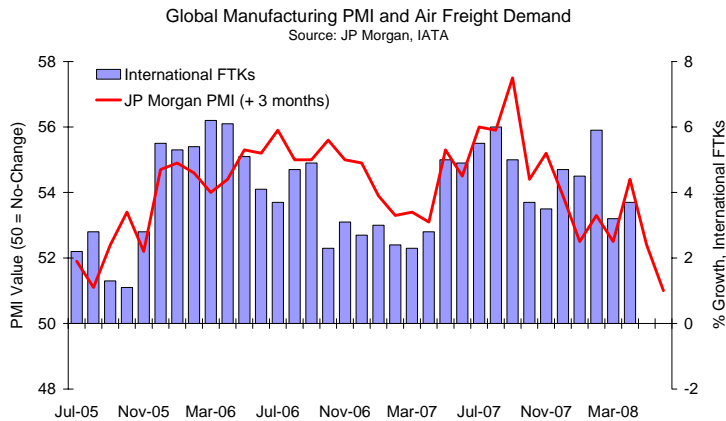
- Looking further ahead the fast growing air freight markets in developing countries are expected to play an increasingly important role in growth of the overall air freight market.
- Growth of trade in manufactured goods originating in the developed countries is expected to grow by only 4-5%
- But developing country trade in these goods is expected to continue growing at 10-12% a year, in line with recent growth of air freight in these regions.

Demand Environment

Key Changes in the data this quarter:

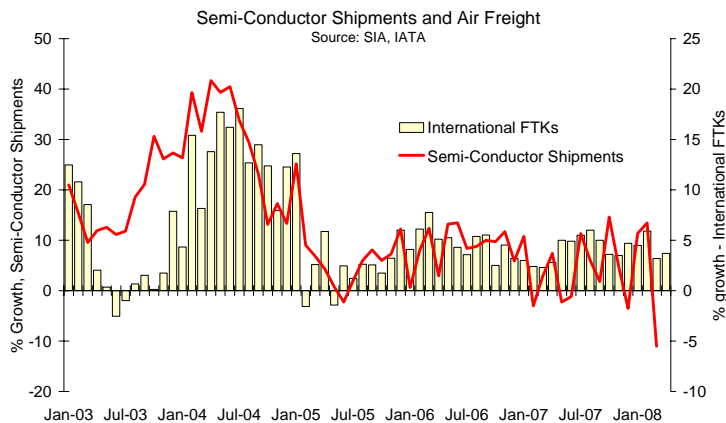
- Forward-looking indicators for air freight demand have weakened sharply in recent months. Much weaker business confidence in manufacturing and a fall in shipments by the key semi-conductor industry points to a further deceleration of air freight volume growth in the next few months.

PMI global manufacturing indicator is pointing towards sharply lower growth



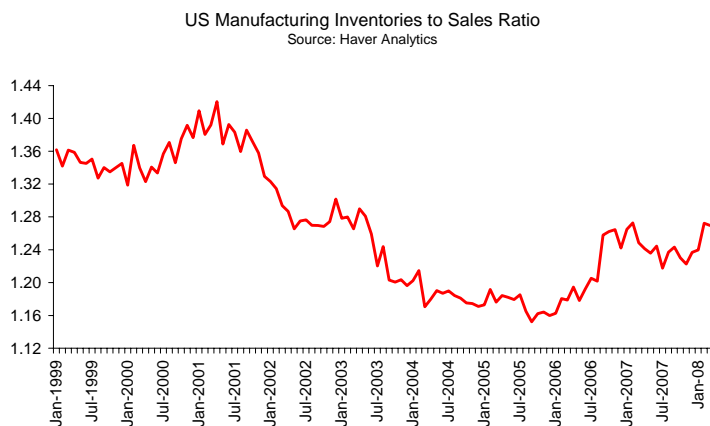
- Forward-looking indicators are pointing to a decline in air freight growth in the next few months.
- There has been a further sharp fall in the business confidence of purchasing managers in manufacturing world-wide.
- The slump in business confidence among the sector that ships most air freight is consistent with a halving of recent growth in air freight volumes.

Semi-conductor shipment growth has also fallen significantly in recent months



- The semi-conductor industry is one of the key sectors that ship their high-value low-volume goods by air freight.
- Growth in semi-conductor shipments has been relatively weak over the past 2 years and offers a major reason for the sluggishness of air freight growth, when compared with the much faster growth of trade in manufactured goods.
- At the end of the first quarter semi-conductor shipments declined sharply. Further declines are likely given the deterioration in US consumer demand.

Inventories may also act as a constraint on air freight growth



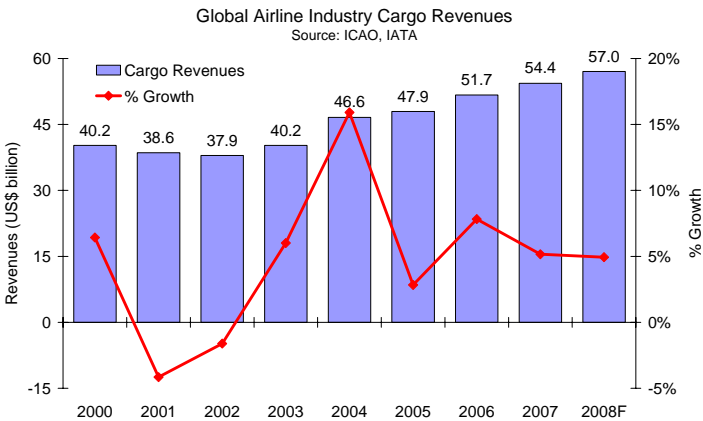
- Inventory levels in US manufacturing have risen recently, compared to sales, and are considerably higher than two years ago.
- Given the weak outlook in the US there is likely to be a move to source goods and components from inventories rather than new orders.
- The impact of this would be to lower shipment growth and air freight volumes, until inventory are lower.

Revenues and Yields

Key Changes in the data this quarter:

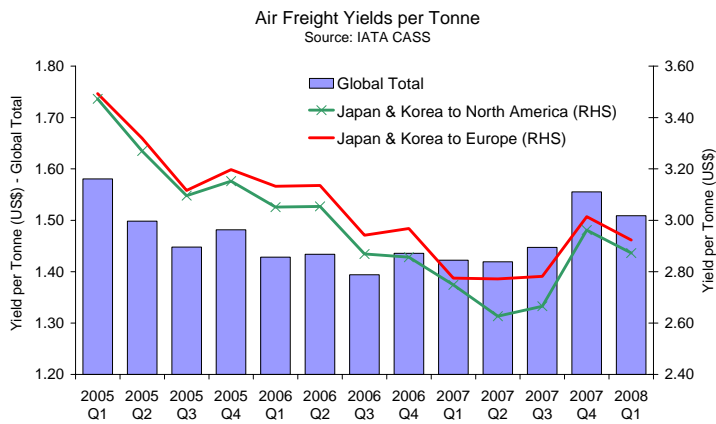
- Air cargo yields started to rise at the end of last year, reflecting the rise in fuel costs. Fuel costs rose considerably further so far this year, but economic weakness in the US and increasing deliveries of new capacity led to a resumed decline in yields in the first quarter.

Cargo revenue growth is forecast to grow, modestly, this year



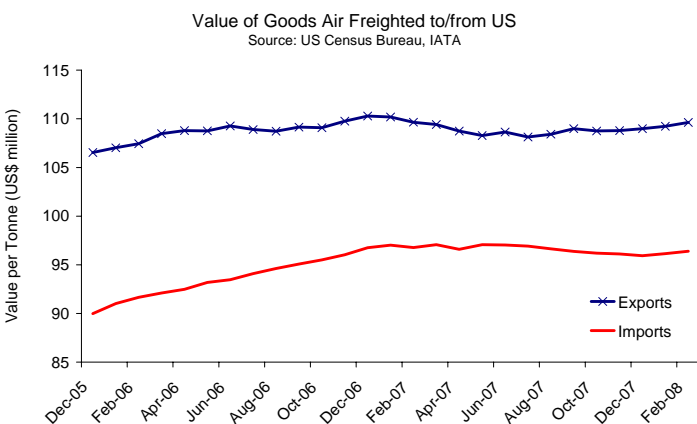
- Air cargo revenues are forecast to reach \$57 billion in 2008, but their growth will slow further given the very difficult economic environment.
- In the 12 months to May jet fuel prices had almost doubled, forcing increases in the price of air cargo.
- The negative impact of this on volumes will be felt more in 2009 than 2008, due to lags in contracts. During 2008 strong emerging markets are expected to sustain revenue growth of around 5%.

Yields under downward pressure again after year end rise



- Air freight yields had risen at the end of last year, reflecting the rise in fuel costs.
- However, the impact of the US slowdown was felt in the first quarter and yields began to fall once more.
- The huge rise in fuel costs will put further upward pressure on air cargo costs and yields. However, US economic weakness and rising deliveries of new capacity are increasing the pressures on yields in the opposite direction.

US economic weakness restraining imports but exports boosted by weak US dollar



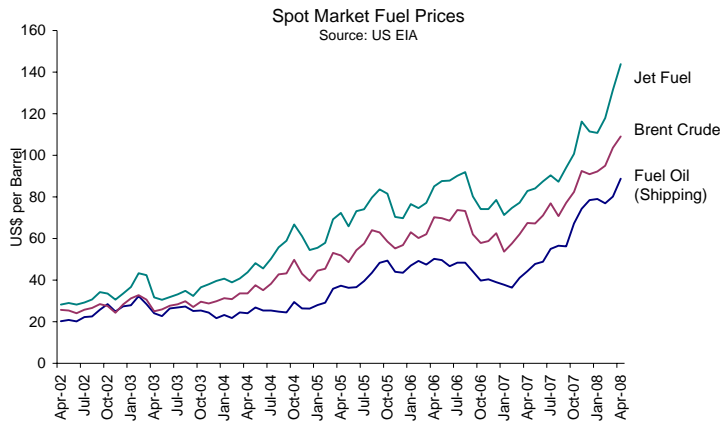
- The impact of the decline in the US economy close to recession is being seen in the weakness of US imports.
- However, US exports are rising significantly. Volumes are up far more than the value figures shown in this chart.
- The weak US dollar and relatively strong overseas markets has put US firms in a strong competitive position and air freight will benefit from strong outbound goods flows from the US.

Costs

Key Changes in the data this quarter:

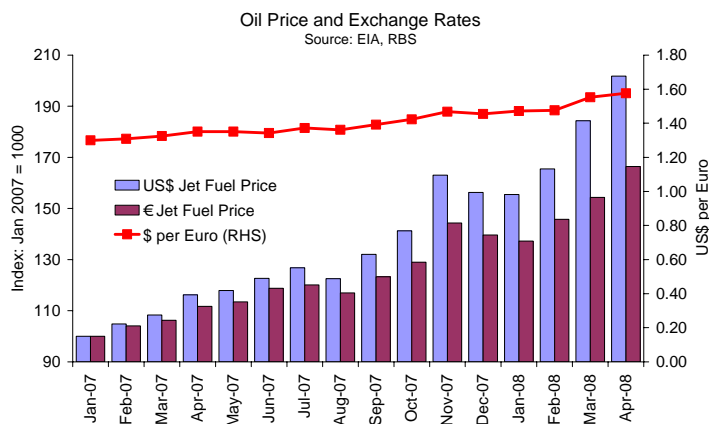
- There has been an unprecedented rise in the cost of jet fuel during the first part of this year, with a virtual doubling of prices by late-May. At this level airlines world-wide face fuel costs taking up over 50% of operating costs, but this will be higher for cargo airlines for whom fuel is already a larger cost.

Oil and jet fuel prices rise sharply to new record highs in Q2



- By late May jet fuel prices had doubled from where they were a year earlier and exceeded \$171 a barrel. The refinery margin over crude rose from around \$6 a barrel in 2003 to over \$40 a barrel by May.
- The chart shows data to April and indicates the speed of the most recent spike in fuel costs, with a rise of around \$70 a barrel or over 40% since the start of this year.
- Residual fuel oil, for shipping, continues to sell at a discount to crude.

But the depreciation of the dollar has offset some of the increase for other currencies



- In the past year interest rate cuts and economic weakness have caused the US dollar to fall almost 20% against the Euro and other currencies.
- For airlines operating in non US\$ linked currencies this has offset part of the rise in the price of jet fuel.
- However, such has been the rise of jet fuel that the weak dollar has only turned a 75% rise in dollar prices in the 12 months to April into a 50% rise for Euro-based airlines.

Wage cost pressure easing in US but rising elsewhere with shortage of skilled labour



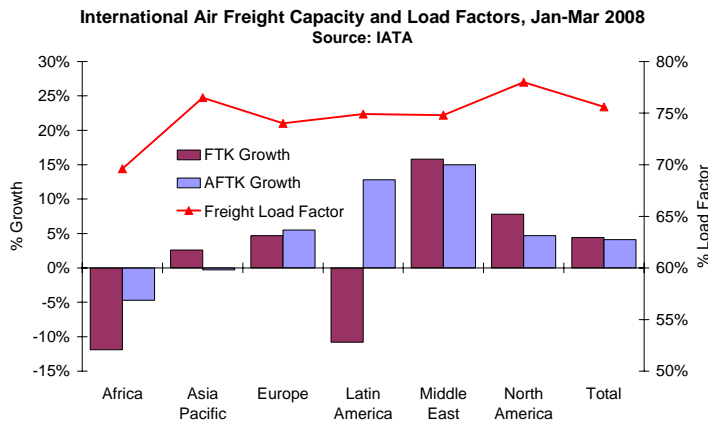
- US economic weakness is now being reflected in a softening of labour market pressures and a decline in wage inflation.
- This does not resolve the growing issue of supply shortages of pilots and engineers. However, it does mean that the pressure for wage increases is diminishing in the US.
- This is not so in Europe and Asia where wage rises are accelerating, potentially adding to the cost pressures facing cargo airlines.

Capacity

Key Changes in the data this quarter:

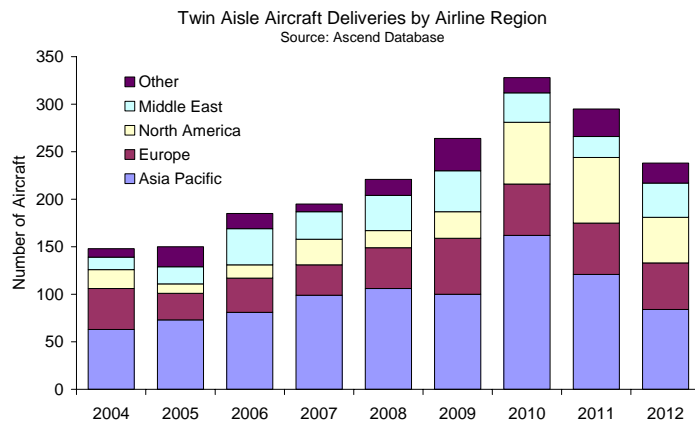
- So far this year freight capacity growth has been held in line with slower demand growth, sustaining freight load factors, in contrast to declining load factors in the passenger business. However, the significant increase in twin-aisle deliveries over the next couple of years will risk excess capacity.

Freight capacity growth in line with demand so far in 2008



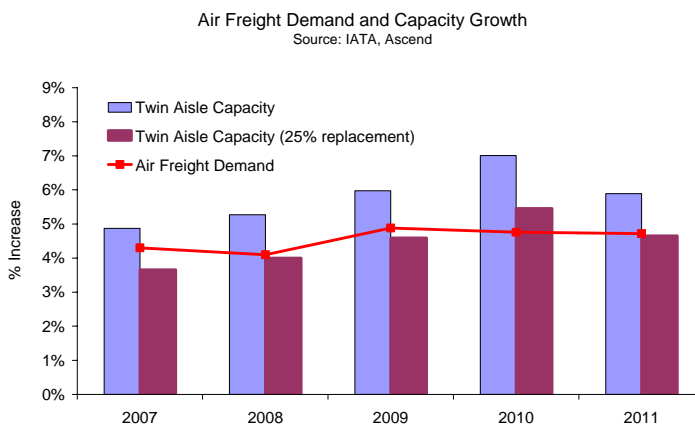
- So far this year air freight capacity has been held in line with slower demand growth. Load factors were unchanged over the year.
- Passenger load factors have been falling significantly in recent months, suggesting that unit revenues have held up more in the cargo business.
- There is much regional variation in the data based on the region of registration of the airline. Airlines in Africa and Latin America in particular have suffered losses in market share.

But a lot of new capacity is due to be delivered in the next couple of years



- This success in restraining capacity growth in line with demand looks set to be challenged during the rest of this year and next.
- New aircraft are needed to improve fuel efficiency, given current prices, and expand service to growing emerging markets.
- However, overall rising deliveries at a time of slowing demand will lead to excess capacity on some markets.

Leading to excess capacity if less than 25% of new deliveries are for replacement



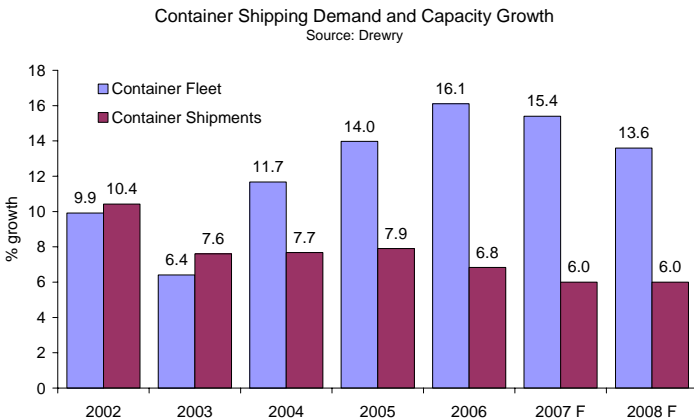
- With fuel prices at current levels there will be a substantial increase in the number of aircraft retired from the current fleet because they are just not fuel efficient enough.
- However, it would need around one-quarter of new aircraft deliveries to be matched by an older aircraft being retired from the fleet to bring supply growth more in line with demand.
- This is not completely unrealistic given fuel prices. However, excess capacity on some markets is likely.

Competition

Key Changes in the data this quarter:

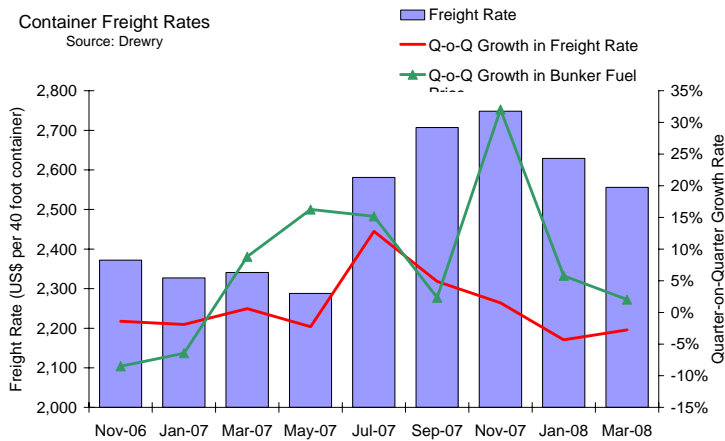
- The ocean freight industry suffered a more severe downturn in the first quarter than air freight. Having risen in the second half of last year, ocean freight rates are now falling, under pressure from excess capacity. Ocean freight markets contracted with North America, slowed in Europe but accelerated in Asia.

Container shipping supply growth is rising at a much faster pace than demand growth



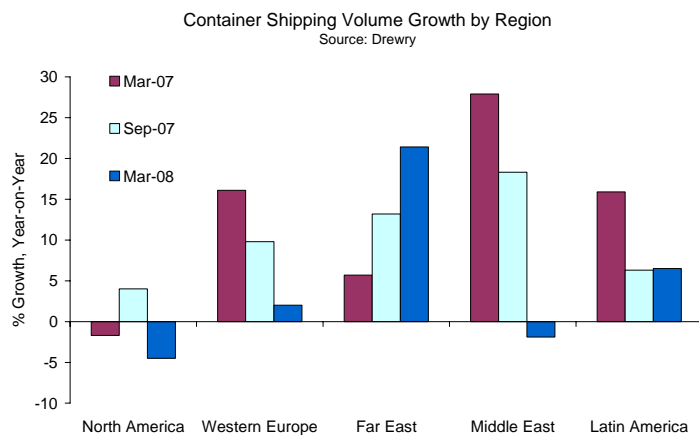
- On particular routes ocean container freight companies are rapidly adjusting capacity to demand. However, the overall picture is one of increasing excess capacity.
- This forecast from Drewry is getting a little out of date but long lead times on fleet capacity mean the analysis is still a realistic assessment of ocean going freight capacity expanding faster than demand.

Container freight rates have risen fallen back after end-2007 rise



- After a long period of decline ocean container freight rates followed a similar pattern to air freight yields, with a rise at the end of last year reflecting rising residual fuel prices.
- Since the start of this year ocean container freight rates have fallen 7%, compared to the 3% fall in air freight yields.
- The significance is that both ocean and air freight yields seem to be affected by similar competitive forces at present.

Growth in container demand has weakened this year, except in Asia



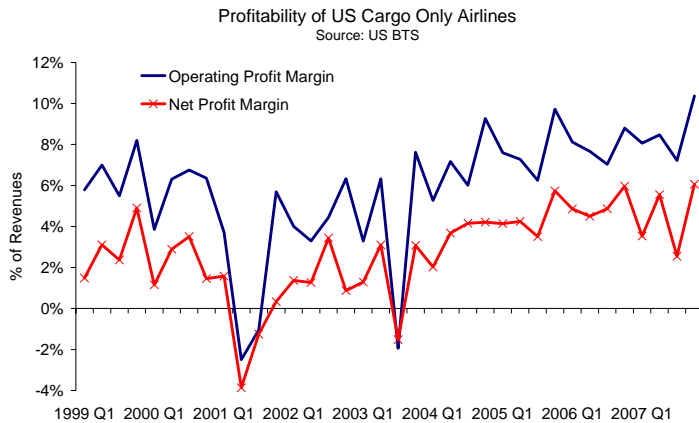
- In fact ocean freight growth appears to have fallen much more sharply than air freight in the last quarter.
- Only in Asia has there been any significant expansion in ocean freight during the past quarter, boosted by booming economies outside Japan.
- North American ocean freight is in decline, no doubt reflecting the economic downturn. Growth from Western Europe has slowed sharply too reflecting trade across the Atlantic.

Profitability

Key Changes in the data this quarter:

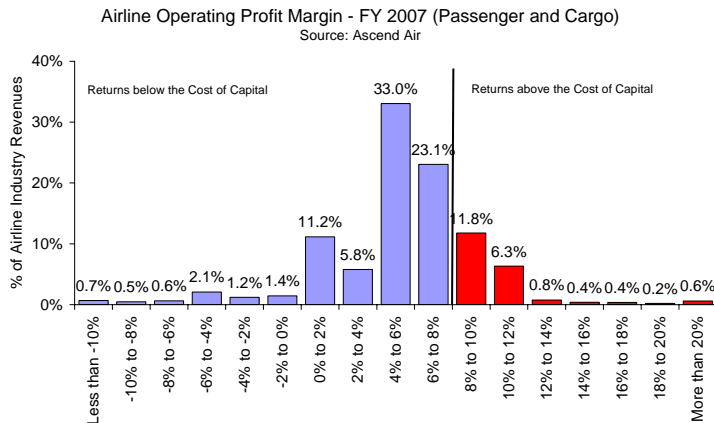
- Profitability among cargo only and other airlines improved significantly during 2007, despite the rise in fuel costs. However, the industry is now faced with a sharp rise in fuel costs and markets that have weakened in the US. As a result confidence for profitability over the next 12 months has deteriorated sharply.

Improved cargo profitability in 2007 is no guide to the outlook this year



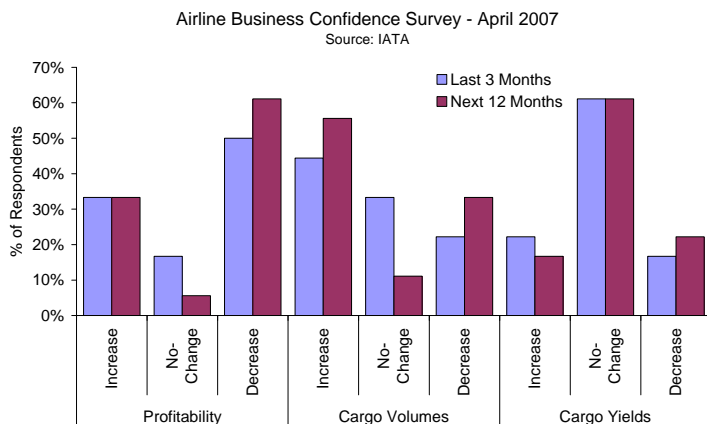
- Last year saw profitability rise on average, at least for cargo only airlines in the US.
- Fuel costs rose substantially but efficiency improvements helped offset some of this and still-strong economic growth in 2007 generated good revenues and load factors.
- Outside the US the data on cargo profitability is harder to identify, particular with the combination airlines.

Average returns are below the cost of capital, but with some enjoying high margins



- Average post-tax operating profits from the US cargo-only airlines above would have delivered returns just in excess of the cost of capital, creating investor value.
- This chart shows 2007 EBIT margins for the major airlines. Compared with 2006 returns are less spread out but there is no change in the result that most airlines are making sub-8% margins and so will not be making returns sufficient to cover their cost of capital.

Business confidence deteriorated in the April survey



- There was a sharp fall in the confidence of airline CFOs in IATA's April survey. For the first time profits were expected to fall significantly over the next twelve months.
- Another major change was that expectations about the next 12 months were worse than the experience of the past 3 months. Earlier surveys had shown the opposite.
- Consistent with the other analysis in this eChartbook, CFOs expect the next 12 months to be extremely challenging.

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					
	Oct 2007	Nov 2007	Dec 2007	Jan 2008	Feb 2008	Mar 2008
Within Far East	9.2%	14.2%	6.7%	17.2%	9.4%	4.3%
Europe – Far East	3.9%	6.0%	0.2%	6.4%	6.0%	2.4%
North Atlantic	-1.3%	-0.1%	1.5%	1.6%	7.0%	6.5%
North and Mid Pacific	8.3%	8.9%	-20.3%	8.8%	4.6%	5.0%
Europe – Middle East	-6.2%	2.3%	12.5%	4.0%	4.4%	3.6%
Within Europe	-5.4%	-0.7%	-0.5%	-5.5%	2.0%	-5.5%
Europe – N Africa	-11.5%	-5.5%	-11.9%	-3.6%	-0.3%	-10.8%
Middle East – Far East	-1.4%	-1.1%	7.7%	6.7%	4.0%	6.8%
N America – S America	0.2%	10.5%	15.4%	-6.9%	5.8%	-33.5%
South Atlantic	18.7%	23.8%	22.5%	12.1%	17.0%	6.7%
Far East – SW Pacific	-14.2%	0.6%	1.1%	3.2%	9.2%	0.5%
Within Middle East	34.0%	-11.7%	2.9%	8.5%	12.0%	14.7%
Mid Atlantic	-4.2%	5.7%	2.1%	7.9%	13.3%	-2.3%
Africa – Middle East	-2.8%	-15.8%	-16.8%	16.3%	9.3%	14.5%
Within S America	24.1%	14.2%	18.8%	-8.8%	1.2%	-39.8%
N America – C America	-13.7%	-5.0%	-9.2%	-13.8%	-10.4%	-9.7%

Outbound CASS Market Revenues

Origin Region	US\$m Q1 2008	% Growth in Air Freight Revenues, year-on-year					
		Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Africa	36.4	10.3	4.9	22.5	32.7	25.4	10.3
Caribbean	4.9	2.2	-9.2	-7.8	3.2	8.4	17.8
Central America	46.3	11.2	7.8	3.5	2.7	6.3	8.4
Europe	1427.5	8.0	11.4	10.1	11.2	11.7	6.6
Japan & Korea	936.7	-13.7	-13.5	-16.0	-3.9	6.3	6.2
Middle East	46.2	50.3	45.9	114.6	137.8	77.8	63.1
North America	671.3	5.1	9.8	13.3	15.1	17.7	14.6
South America	211.9	13.6	9.3	4.6	0.3	7.5	7.3
South East Asia	770.1	23.2	116.1	131.0	153.3	151.9	30.2
South West Pacific	146.6	7.6	13.7	20.4	16.7	15.8	10.4

Inbound CASS Market Revenues

Destination Region	US\$m Q1 2008	% Growth in Air Freight Revenues, year-on-year					
		Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
Africa	268.2	19.0	18.2	17.3	21.4	22.2	14.3
Caribbean	34.5	1.8	7.2	3.5	6.2	12.2	9.2
Central America	92.1	15.0	13.3	11.2	25.0	17.1	8.3
Europe	92.1	15.0	13.3	11.2	25.0	17.1	8.3
Japan & Korea	282.9	-12.1	4.4	6.7	9.0	15.0	0.2
Middle East	269.2	12.4	19.0	20.9	21.7	18.2	17.0
North America	881.7	1.5	10.2	7.6	14.8	21.2	2.9
South America	298.7	20.6	17.3	23.0	30.3	33.1	29.1
South Asia	123.1	-2.6	9.5	13.5	21.4	30.2	20.6
South East Asia	569.8	-7.3	5.9	4.8	9.5	16.6	8.1
South West Pacific	241.0	9.2	13.9	17.3	19.8	30.3	28.1