

CARGO E-CHARTBOOK

Q1 2008

KEY POINTS

- The economic outlook has deteriorated with the US economy now close to, or already in, recession. At the same time fuel prices have hit new record highs. There may be some decline in fuel prices, as growth softens, but both these developments will put air cargo profitability under pressure over the next year.
- Cargo is less exposed than the passenger business to the impact of a US recession this year, given that a larger proportion of air freight flows are linked with the still buoyant Asian markets. However, increased liberalisation and aircraft deliveries look set to increase competitive pressures on yields.

HEADLINES BY SECTION

Economic Outlook (page 2)

- US interest rates have been slashed in response to the risk of a US recession.
- Banks are tightening credit conditions in Europe as well as the US.
- The US is seen as close to recession but growth hot-spots expected to remain.

Demand Environment (page 4)

- PMI indicator is pointing towards slower growth.
- Semi-conductor shipment growth has also slowed in recent months.
- The decline in inventories may also have acted as a constraint on air freight growth.

Costs (page 6)

- Oil and jet fuel prices rise sharply to new record highs in Q4.
- But the depreciation of the dollar has offset some of the increase for other currencies.
- Unit labour costs face upward pressure, especially where skills are in short supply.

Competition (page 8)

- Container shipping capacity is growing rapidly.
- Container freight rates have increased since Q2, largely due to pass-on of high fuel costs.
- Growth in container demand remained robust in Q4, especially in Asia and the Middle East.

Traffic Growth (page 3)

- Air freight volume growth slowed through to the end of last year.
- Emerging markets continued to generate rapid freight growth last year.
- Increased trade levels in developed economies is helping to drive future growth.

Revenue and Yields (page 5)

- Cargo revenue growth slowed in 2007 and not much rebound expected this year.
- Strong competition continuing to push yields down, but pressure eased at year-end.
- The value of goods transported by air rising.

Capacity (page 7)

- Freight capacity rising faster than demand in 2007.
- The rate of new widebody aircraft deliveries will rise sharply in the next 3 years, particularly in Asia.
- There is a higher risk of excess capacity if less than 25% of new deliveries are for replacement.

Profitability (page 9)

- Underlying cargo profitability now falling.
- Average airline returns are below the cost of capital, but with some enjoying high returns.
- Airline business confidence has fallen since October, but remains relatively positive.

Economic Outlook

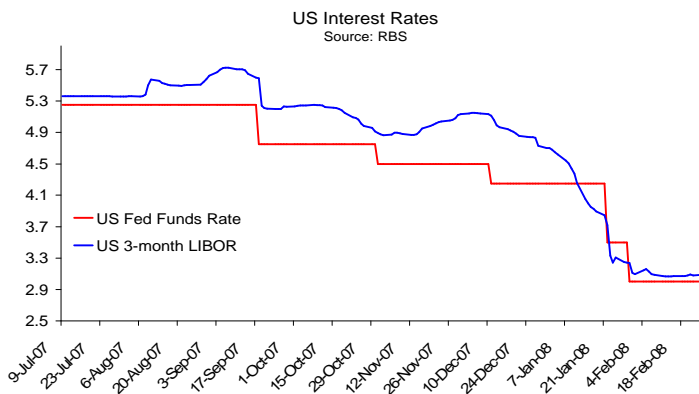
Key Issue:

- The US economy now looks as though it may already be in recession. The key issue is for how long and what impact will this have on other economies around the world. Current market expectations are that Asia and the Middle East will remain buoyant, Europe sluggish, with Japan looking rather weaker.

Expected implications for the air freight industry:

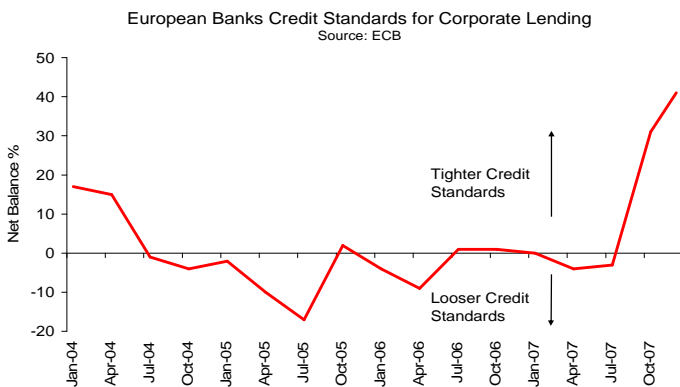
- The bursting of the US housing and the credit market bubbles are now having a more serious demand-side impact on the outlook for the air cargo industry. However, freight should be less seriously affected than the passenger business. N American airports see 27% of the market by tonnage, whereas Asia Pacific now accounts for over 40%. Lower interest rates help but tougher credit conditions will make financing difficult.

US interest rates have been slashed in response to the risk of a US recession



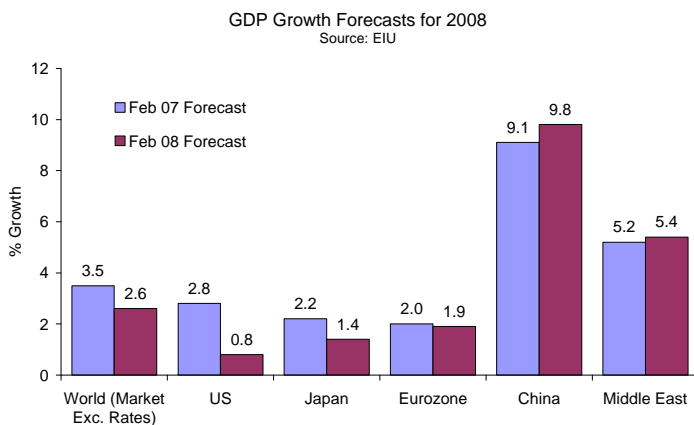
- The US Federal Reserve has now slashed interest rates by 225 basis points since the sub-prime mortgage crisis emerged six months ago.
- The bursting of the housing and credit bubbles in the US now looks to have dragged the economy into recession.
- Central banks outside the US and UK have not cut interest rates, reflecting a greater concern about inflation.

Banks are tightening credit conditions in Europe as well as the US



- The US Fed may have cut the cost of obtaining funds for banks, but it cannot force them to lend. Banks in the US and in Europe are continuing to tighten conditions for credit.
- This raises the cost of credit for sub-investment grade borrowers, in the US and in Europe.
- The effectiveness of monetary policy is reduced raising the risk of an extended US recession and low EU growth.

The US is seen as close to recession but growth hot-spots expected to remain



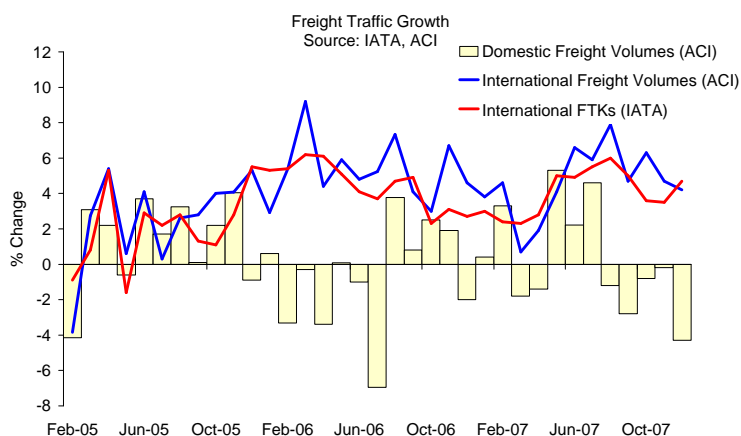
- The outlook has worsened with the US economy possibly already in recession, and the outlook for Japan and Europe weaker than three months ago.
- However, prospects for strong growth in China and the Middle East remain which should limit the reduction in economic growth world-wide.
- Central banks have cut interest rates but financial institutions are reluctant to lend, until balance sheets are repaired.

Traffic Growth

Key Changes in the data this quarter:

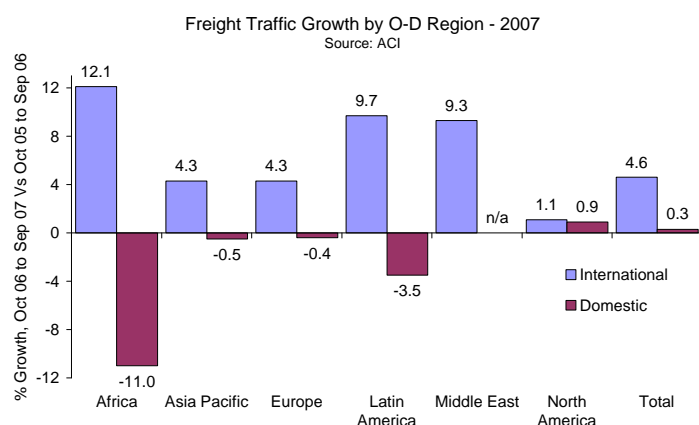
- Air freight volume growth slowed in the fourth quarter, with absolute falls on domestic markets. On international markets this slowdown takes market growth back to the range seen in the past two years. This is reasonable but still below the 7-8% growth seen in manufactured goods trade.
- Slower end-year growth in air freight is also consistent with changes in the wider economy. Even in the US economic growth was still expanding at a reasonable pace during the fourth quarter. However, the outlook for the US has turned sharply for the worse in the first quarter of this year.

Air freight volume growth slowed through to the end of last year



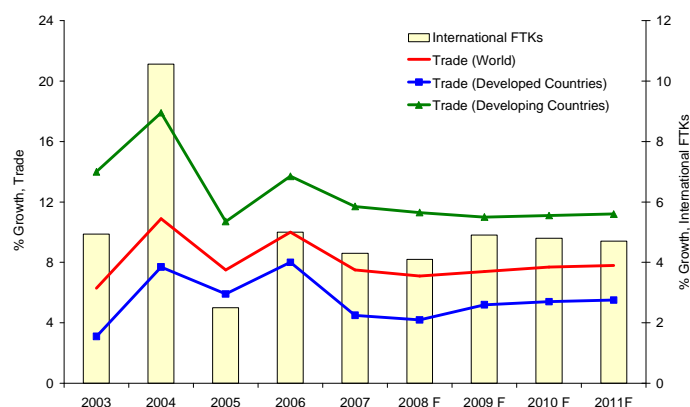
- Air freight volumes slowed during the second half and final quarter of last year, domestic air freight falling in absolute terms.
- The end year rise in IATA's airline registration based freight growth may be data volatility, since airport-based data continued to slow.
- However, air freight growth seemed to hold up in January, particularly compared to a weak passenger market.

Emerging markets continued to generate rapid freight growth last year



- Domestic air freight volumes – one third of the market – barely expanded last year but many international markets saw rapid growth.
- Emerging international markets linked to Africa, Latin America and the Middle East all saw growth around 10%.
- North American markets were already soft last year, while European markets were slow. Asia Pacific combines a weak Japan but strong Chinese market.

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



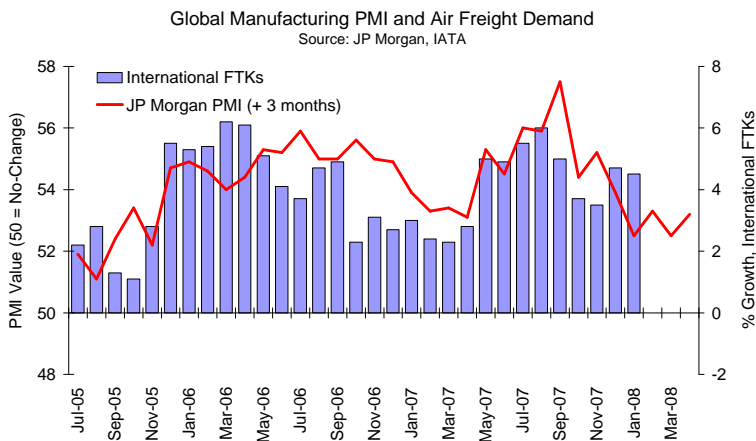
- IATA forecasts an average annual growth rate of 4.8% in international freight tonnes between 2007 and 2011.
- The EIU expect global trade growth to remain at 6.5-8% per annum over the same period, led by double-digit trade growth in developing economies.
- China (10.8%), India (8.3%), Korea (8.2%), Turkey (7.5%) and Vietnam (7.5%) are forecast to have the highest air freight growth rates.

Demand Environment

Key Changes in the data this quarter:

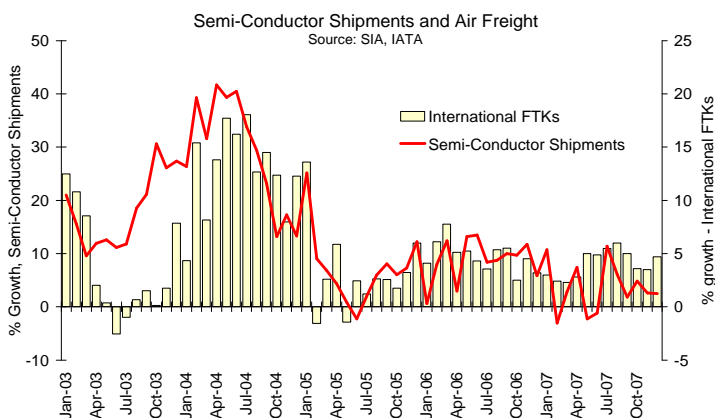
- Most leading key indicators – such as the global manufacturing purchasing managers index (PMI) – have weakened in Q4, reflecting the increased likelihood of a US recession and pointing to slower growth in air freight traffic in Q1. However, while inbound freight to the US is likely to weaken, the fall in the US dollar is boosting exports and outbound air freight. Moreover, Asian markets look set to remain strong.

PMI global manufacturing indicator is pointing towards slower growth



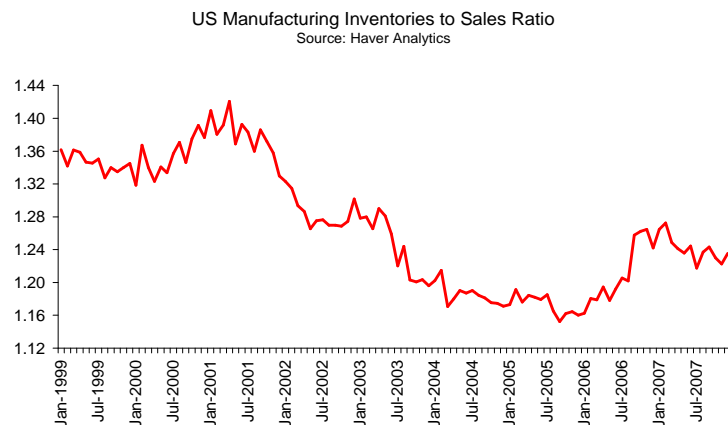
- The JP Morgan global manufacturing PMI is a useful leading indicator for air freight demand.
- The monthly PMI level has a close correlation with international freight growth three month's later.
- This suggests that the modest growth rebound in IATA's airline registration-based data in December and January may be short-lived.
- Slower growth in the region of 3-4% looks likely in the next three months.

Semi-conductor shipment growth has also slowed in recent months



- The level of global semi-conductor shipment is a key indicator of conditions in the wider IT sector (a key air freight customer).
- The growth in shipments has also slowed in Q4, reflecting the general economic uncertainty and a reduction in inventories in parts of the IT sector.
- US consumer retrenchment will damage the outlook for this sector, but Asian strength provides some offset.

The decline in inventories may also have acted as a constraint on air freight growth



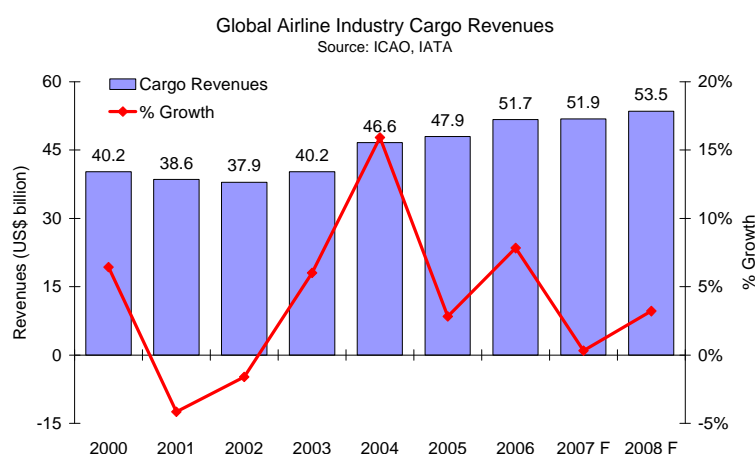
- There are signs of a general reduction in inventory levels during 2007. The 2006 recovery in the US inventory to sales ratio has been partly reversed.
- This can act as a constraint on air freight growth, as customer demand is met from inventories rather than new shipments.
- Given the weakness in the US outlook there will be further pressure to reduce inventories. This could soften demand for shipments by air during Q1.

Revenues and Yields

Key Changes in the data this quarter:

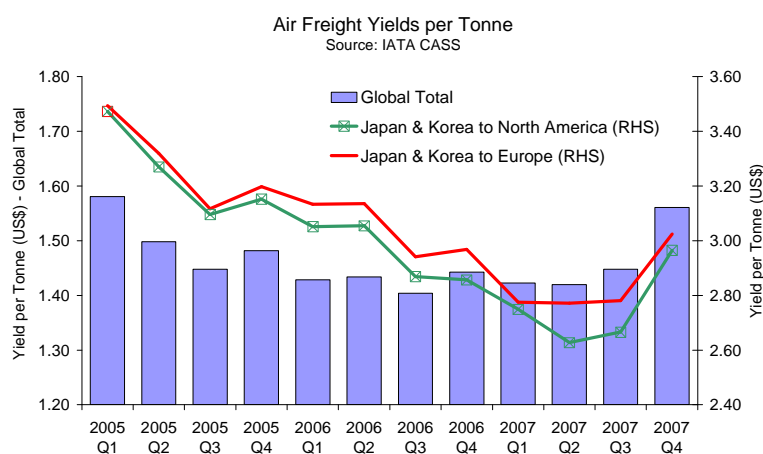
- Revenue growth picked up during Q4 last year as a partial recovery in US\$ denominated yields offset softer volume growth. However, much of the move in yields was either the effect of the slump in the US dollar or a reaction to the surge in the cost of jet fuel during the quarter.
- A weaker US economic outlook and increasing competition suggests downward pressure on yields remains.

Cargo revenue growth slowed in 2007 and not much rebound expected this year



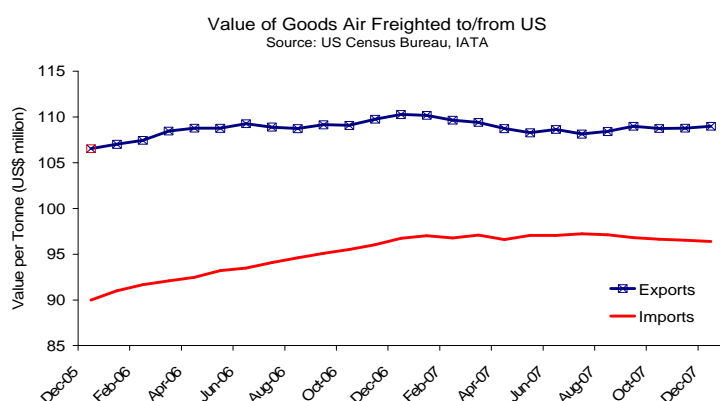
- IATA's Dec 07 financial forecast expects that, at a global level, the growth in air cargo revenues will slow from 7.8% in 2006 to 0.3% in 2007, picking-up slightly to 3.2% in 2008.
- Industry wide cargo volumes are forecast to slow to 4.3% this year, following growth of 4.5% in 2007.
- Moreover, US\$ denominated yields (per FTK) are expected to fall by 1% this year, due to weaker pricing power.

Strong competition continuing to push yields down but pressure eased at year end



- Within the IATA CASS figures, global yields per tonne rose significantly during Q4 of last year. This looks to be partly the translation effect of the large Q4 fall in the US dollar. In addition it reflects the impact of higher fuel costs and surcharges, rather than any change in the downward trend of underlying yields.
- At a route level, yields per tonne are highest on routes out of Asia. Long-haul outbound rates can be up to 3 times higher than inbound rates to Asia.

The value of goods transported by air has increased during 2007



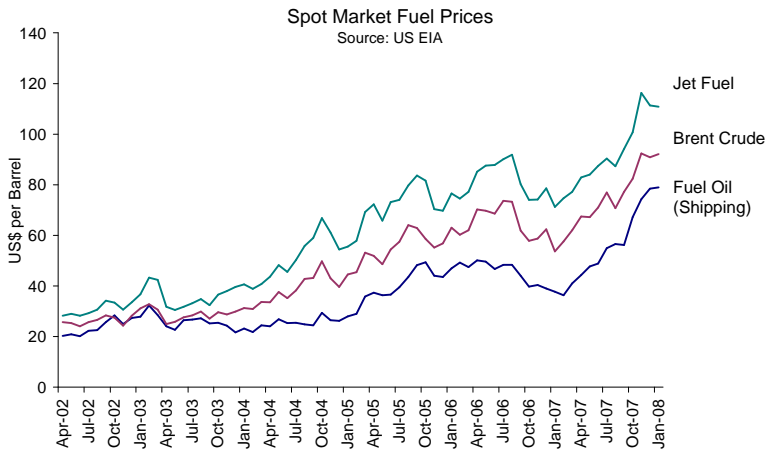
- US customs data shows the value per tonne of the goods exported by air has been relatively stable over the last 18 months.
- However, the \$ value per tonne of goods imported by air has risen by over 5% since early 2006. This reflects both higher-value goods and \$ depreciation.
- Though less than 1% of trade by weight, air freight represented 25% of US trade by value in 2007.

Costs

Key Changes in the data this quarter:

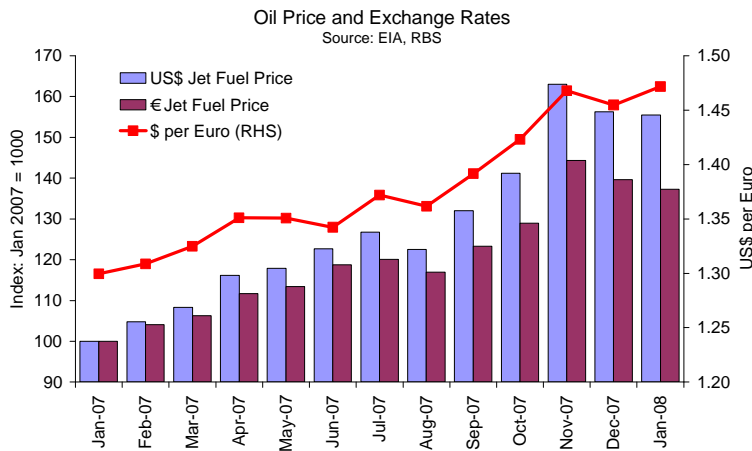
Oil and jet fuel prices reached new record highs in the fourth quarter of last year, as OPEC maintained firm limits to supply while OECD inventories started to fall. In spite of a likely US recession fuel prices hit new high in February this year. Meanwhile emerging skills shortages put upward pressure on wages, though there are signs that labour markets may be easing in the US.

Oil and jet fuel prices rise sharply to new record highs in Q4



- Oil prices rose sharply in Q4, driven largely by OPEC supply constraints and lower than expected US oil inventory levels.
- The Jet Fuel price has increased to over \$110 per barrel, due to increases in crude oil and a slight widening of the refining margin.
- Fuel oil for shipping rose by more than jet fuel during the last few months of 2007, helping to improve the competitiveness of air freight.

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



- A depreciation of almost 10% in the dollar against the euro in Q4 2007 offset part of the rise in fuel prices in euro terms.
- Dollar fuel prices have risen by over 55% in the 12 months to January, but by 37% in euro terms.
- However, the weaker dollar in itself has been adding to upward pressure on the oil price, as oil exporters seek to maintain the purchasing power value of \$ denominated oil.

Unit labour costs face upward pressure, especially where skills are in short supply



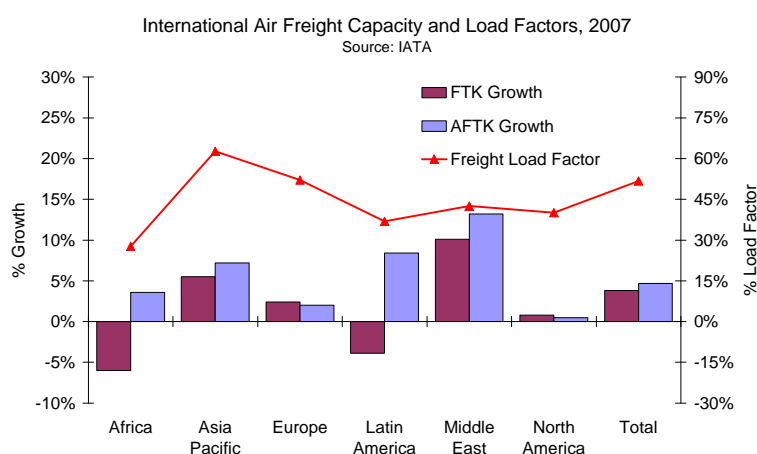
- Strong global economic growth over the last five years has reduced spare capacity in many labour markets, with unemployment falling to historically low levels.
- Consequently, lower unemployment and potential skills shortages places upward pressure on unit wage costs.
- Nominal wage growth has increased sharply in China in 2007, a little less so in Europe. In the US there are signs that labour market pressures may ease.

Capacity

Key Changes in the data this quarter:

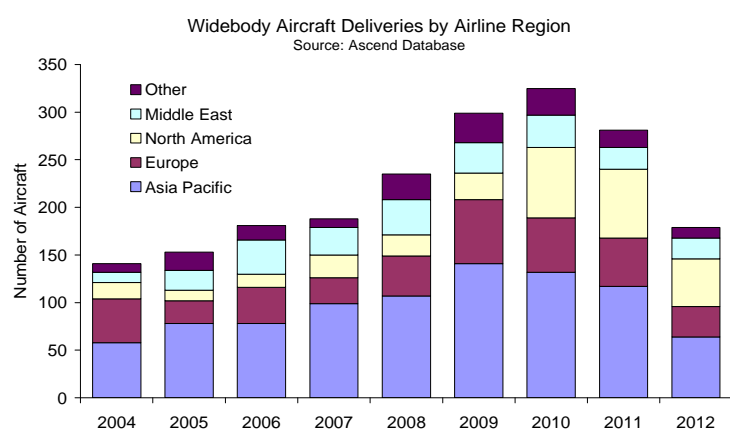
- Available Freight Tonne Kilometres (AFTKs) continued to grow at a faster rate than traffic demand in Q4. Load factors slipped as a result, reducing the benefit from better (Q4) yields on unit revenues.
- With the rate of new aircraft deliveries set to increase significantly over the next 3 years, there is a risk of excess capacity emerging unless more than 25% of new deliveries are for replacement of older aircraft.

Freight capacity has risen faster than demand so far in 2007



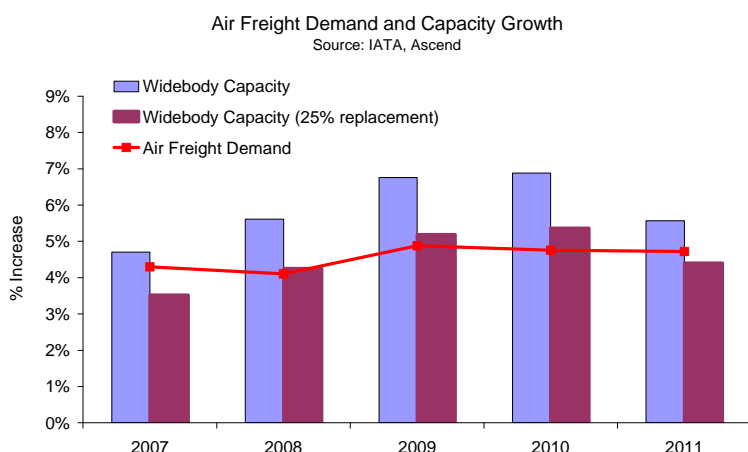
- AFTKs grew by 4.7% during 2007 compared with a growth in FTKs of 4.5%.
- AFTKs have grown at a faster rate than FTKs in all regions except Europe and North America. As such, freight load factors by weight have declined, averaging just under 52% in 2007.
- Load factors are highest in Asia Pacific, reflecting strong outbound flows from the region. The Middle East has, by far, the fastest rate of growth.

The rate of new widebody aircraft deliveries will rise sharply in the next 3 years



- The rate of new widebody aircraft deliveries is set to increase significantly over the next 3 years.
- Deliveries are set to increase from 188 in 2007 to 235 in 2008, 299 in 2009 and 325 in 2010.
- Airlines in Asia Pacific will account for around 40-45% of new deliveries. However, the Middle East is also set to see a large increase, relative to its current share of freight traffic.

A risk of excess capacity if less than 25% of new deliveries are for replacement



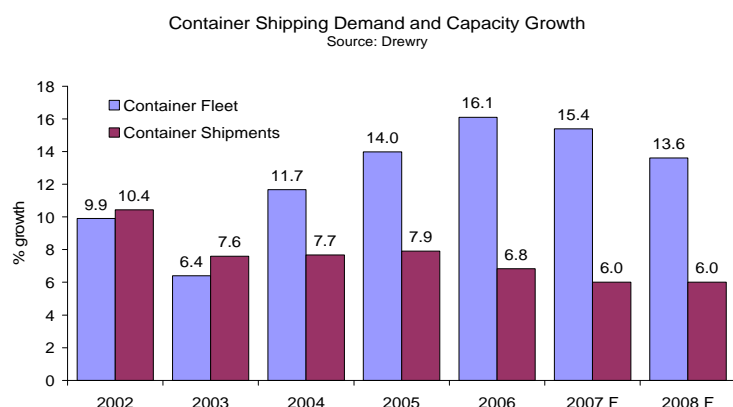
- New aircraft deliveries will be for expansion as well as for the replacement of older, fuel inefficient aircraft.
- If all deliveries were additions to the global fleet, capacity growth would be over 2 % points higher than demand growth in 2009 and 2010, increasing the risk of excess capacity.
- However, if around 25% of deliveries are replacement, demand and supply growth will be more in balance.

Competition

Key Changes in the data this quarter:

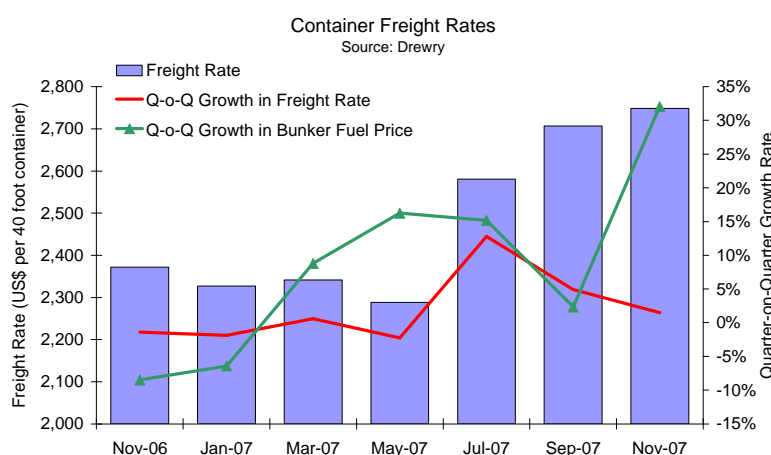
- Container freight rates have increased by nearly 20% since May, partly reversing an historic longer-term decline in rates and providing a helpful competitive boost for air freight at the end of last year.
- A stronger shipping demand environment, especially in Asia and the Middle East, and higher fuel input costs have led to a concerted effort to increase ocean freight rates. Bunker fuel costs rose sharply in Q4.

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



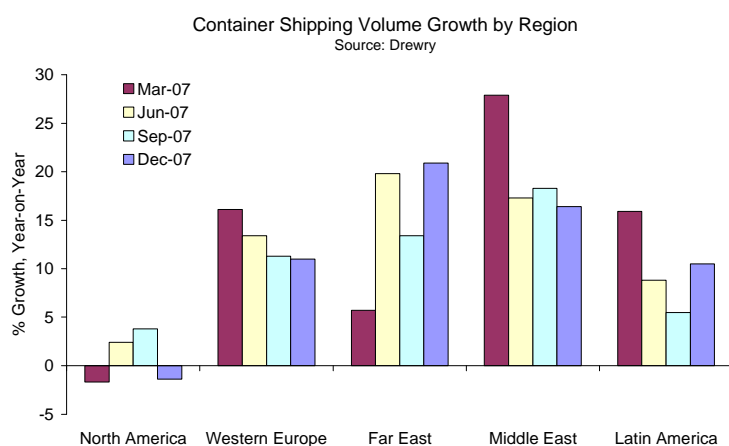
- Container shipping capacity is expected to increase by over 13% this year, as the large number of orders placed in the early 2000s continues to be delivered.
- The imbalance between container ship supply and demand growth continues to widen, with capacity growing by 2-2.5 times as fast as demand.
- The demand-supply balance is expected to place downward pressure on future ocean freight rates.

Container freight rates have risen during Q2-Q4 though largely due to higher fuel costs



- However, spot market ocean freight rates have actually increased by 20% since May.
- This increase is also partly influenced by the depreciation in the dollar on \$ denominated rates.
- However, it is largely driven by a concerted attempt by container ship operators to pass on a large part of the increase in bunker fuel costs to customers. A big Q4 rise in bunker fuel costs has yet to be reflected in rates.

Growth in container demand remained robust in Q4, especially in Asia



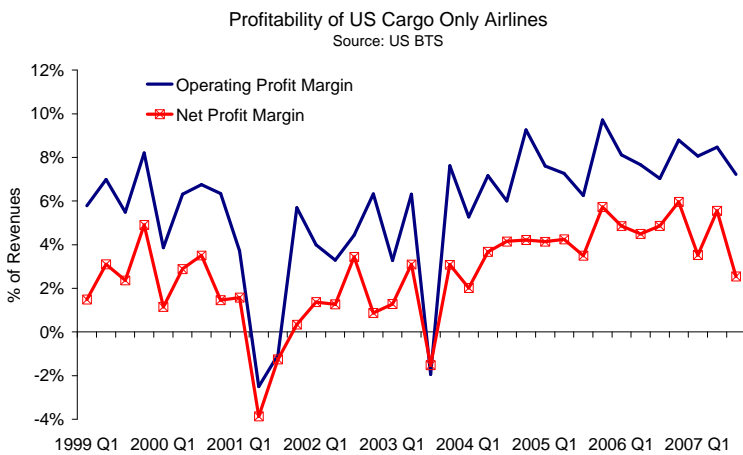
- Container ship operators have been relatively successful in increasing freight rates in the last 6 months due to a stronger demand environment.
- In particular, shipping volume growth picked up significantly in Q4 in ports in Asia and Latin America.
- Volumes fell in N America and slowed in Western Europe, but continued to grow at a strong pace in ports in the Middle East.

Profitability

Key Changes in the data this quarter:

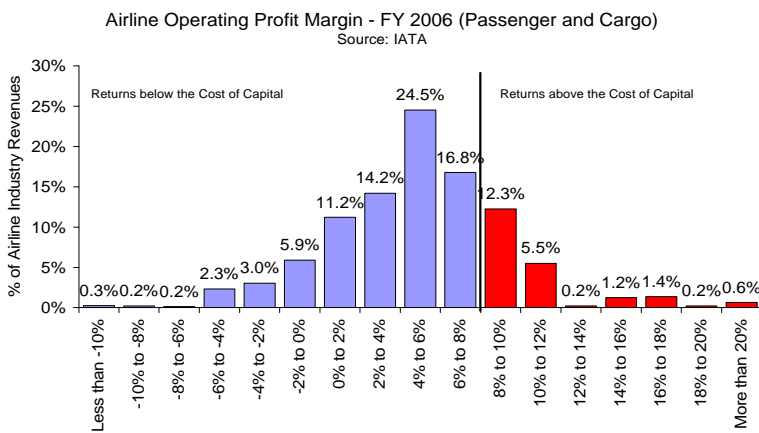
- US cargo airline operating and net profit margins fell significantly in Q3. It now looks as though cargo profitability peaked at the end of 2006. A further fall in Q4 is expected due to a sharp rise in fuel costs.
- Airlines still remain reasonably confident of an improvement in profits in 2008, but less so than in October and driven by volume rather than yield growth.

Underlying cargo profitability now coming under downward pressure



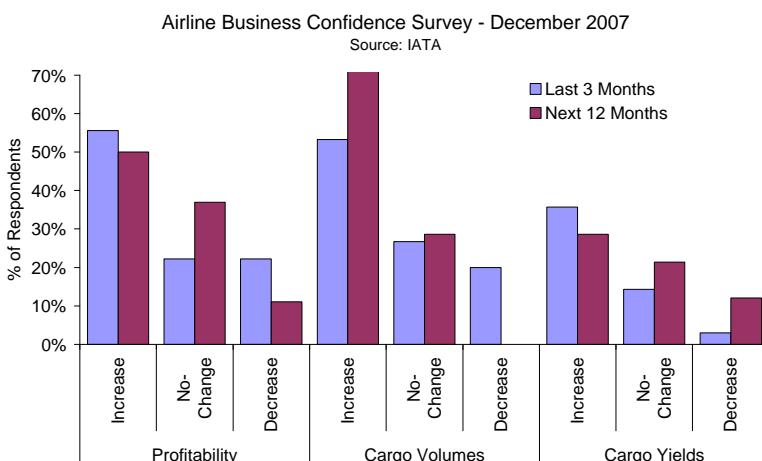
- Specific airline cargo profitability figures are often not reported. However, an historic series of profit levels of cargo only airlines is available in the US, albeit with a slight delay.
- For these US airlines, profitability fell in Q3, as fuel costs increased and revenues slowed.
- The sharp rise in fuel costs will be offset somewhat by stronger yields in Q4, but it looks likely that profitability slipped further at the end of last year.

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



- For all major global airlines there is a wide distribution in terms of operating profit margin in 2006.
- On average, the global airline industry still fails to achieve a return on capital equal to its cost of capital.
- Nevertheless, in a sample of over 90 major airlines, around 20-25% did earn a return higher than their cost of capital, including some cargo-only carriers.

Business confidence remains positive, but is less optimistic than it was



- IATA's airline business confidence survey provides a leading indicator of airline expectations for market conditions over the next 12 months.
- The percentage of airlines expecting profitability to increase over the next year fell from 70% of respondents in October to less than 50% in December.
- Perhaps reflecting the end year rebound, expectations are more positive about volumes than yields.

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					
	Jul 2007	Aug 2007	Sep 2007	Oct 2007	Nov 2007	Dec 2007
Within Far East	11.9	13.9	12.3	9.2	14.2	6.7
Europe – Far East	10.3	13.6	9.0	3.9	6.0	0.2
North Atlantic	-0.4	2.0	0.1	-1.3	-0.1	1.5
North and Mid Pacific	1.2	3.6	4.7	8.3	8.9	-20.3
Europe – Middle East	1.2	-0.1	7.8	-6.2	2.3	12.5
Within Europe	-0.9	0.2	0.9	-5.4	-0.7	-0.5
Europe – N Africa	-1.2	3.6	2.6	-11.5	-5.5	-11.9
Middle East – Far East	3.1	10.3	12.1	-1.4	-1.1	7.7
N America – S America	3.8	10.4	7.5	0.2	10.5	15.4
South Atlantic	16.5	13.2	17.1	18.7	23.8	22.5
Far East – SW Pacific	6.7	0.8	-2.3	-14.2	0.6	1.1
Within Middle East	-6.7	-5.7	15.9	34.0	-11.7	2.9
Mid Atlantic	3.9	4.2	7.9	-4.2	5.7	2.1
Africa – Middle East	-13.6	-16.2	-14.1	-2.8	-15.8	-16.8
Within S America	10.2	20.6	10.8	24.1	14.2	18.8
N America – C America	-19.6	-14.6	-12.0	-13.7	-5.0	-9.2

Outbound CASS Market Revenues

Origin Region	US\$m Q4 2007	% Growth in Air Freight Revenues, year-on-year					
		Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007
Africa	41.2	5.2	10.2	4.8	22.5	32.8	24.3
Caribbean	4.3	19.0	1.6	-9.4	-7.9	3.8	4.8
Central America	46.4	14.2	11.2	7.7	3.4	3.9	2.9
Europe	1,597.5	3.6	7.8	11.4	10.2	11.3	12.9
Japan & Korea	1,098.8	-10.1	-13.7	-13.6	-16.0	-8.7	8.4
Middle East	44.5	324.4	146.6	46.8	114.8	-5.2	3.6
North America	689.1	8.8	5.0	9.8	13.4	16.4	16.4
South America	206.7	12.9	13.6	9.3	4.6	-3.7	-7.7
South East Asia	925.1	188.5	22.4	116.1	130.9	135.6	149.4
South West Pacific	146.9	-0.9	7.6	13.6	20.4	16.5	12.3

Inbound CASS Market Revenues

Destination Region	US\$m Q4 2007	% Growth in Air Freight Revenues, year-on-year					
		Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007
Africa	303.2	14.7	19.1	18.2	17.3	21.0	21.2
Caribbean	37.3	14.9	1.7	7.2	3.5	6.1	11.2
Central America	105.9	14.5	14.9	13.3	11.3	25.0	16.0
Europe	1,395.6	16.3	2.7	15.5	19.7	32.5	34.1
Japan & Korea	316.9	-9.0	-12.4	4.3	6.7	8.9	14.6
Middle East	270.5	4.9	13.8	19.0	21.0	19.8	15.3
North America	1,057.5	2.6	2.4	10.2	7.6	12.4	19.5
South America	333.8	28.0	20.6	17.4	23.1	30.4	33.6
South Asia	119.2	7.8	-2.8	9.4	13.5	21.1	28.0
South East Asia	596.0	-1.7	-7.4	5.9	4.9	9.6	16.5
South West Pacific	267.0	14.7	9.2	13.9	17.4	19.8	29.9