PROFITS

PETER HORVATH

While the world's airlines are posting an impressive revenue rebound, air cargo analysts claim that volatility caused by too little or too much capacity in the market has resulted in wide swings in rates and overall carrier performance.

By Karen E. Thuermer, Air Cargo Correspondent

While the height of the global recession in 2008-2009 saw the airline industry facing unprecedented declines, the dramatic upturn that began in the 4th Quarter of 2009—driven by shipper needs to restock depleted inventory—only draws more attention to the air freight market's volatility.

At first glance, the news appears positive for the carriers. International Air Transport Association (IATA) projects that for 2010, global demand for both passenger and cargo service will expand by 11 percent. IATA forecasts 2010 yields for cargo to grow 7.9 percent, sharply higher than the 4.5 percent previously projected. As of September, IATA now expects the airline industry worldwide to generate net profits of $8.9 billion in 2010, up from its previous forecast of $2.5 billion. Certainly, current airline revenue figures are

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impressive. In the United States alone, Delta Airlines posted a $467 million second quarter 2010 profit, part of the cumulative $1.45 billion profit reported by the top nine U.S. passenger airlines for that period—and a dramatic turnaround from their net loss of $556 million a year ago. However, the IATA maintains that this recovery is not sustainable and only reflects a post recession rebound; in the meantime, the organization does commend the industry for managing its assets with tight capacity over the past 12 months.

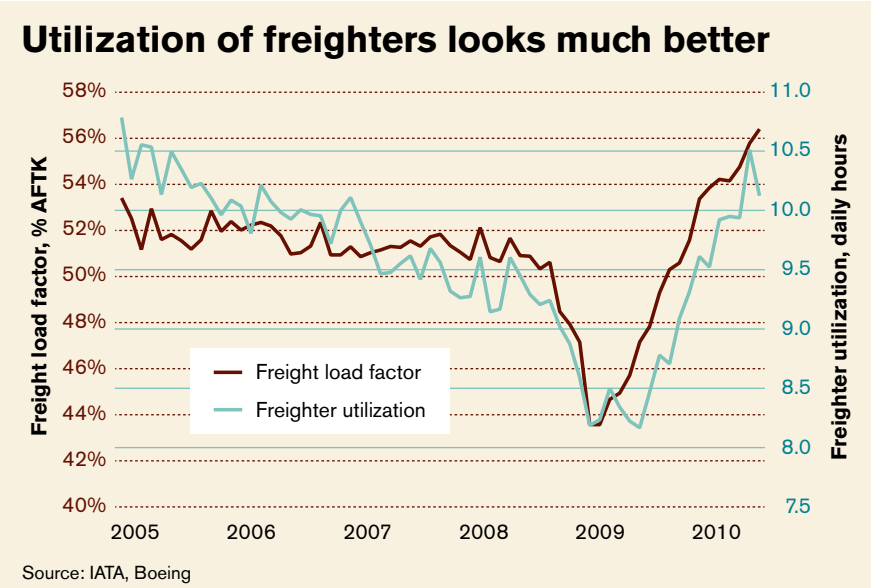
Any way you slice it, it's time for a reality check. The IATA warns that even with this year's improvement, yields are still 8 percent below the pre-crisis levels of 2008. In addition, doubts linger about how long this cyclical upturn will last. "This year is as good as it gets," says Giovanni Bisignani, IATA director general and CEO. "It will be the peak of the cycle and 2011 will be a much tougher year." Bisignani's reasoning for the slow down in the air is directly related to the forces that have kept the current rebound rather tepid: government stimulus monies are ending; new jobs haven't been created; and consumer confidence remains low. "Even if it is sustainable, the profit margins are so razor thin that even increasing profits 3.5 times only generates a 1.6 percent margin," he adds. This is below the 2.5 percent margin of the previous cycle peak in 2007 and far below what it would take just to cover the industry's capital costs."The bounce that we saw this year was to restock inventories," Bisignani adds. "Now consumer spending needs to support demand."

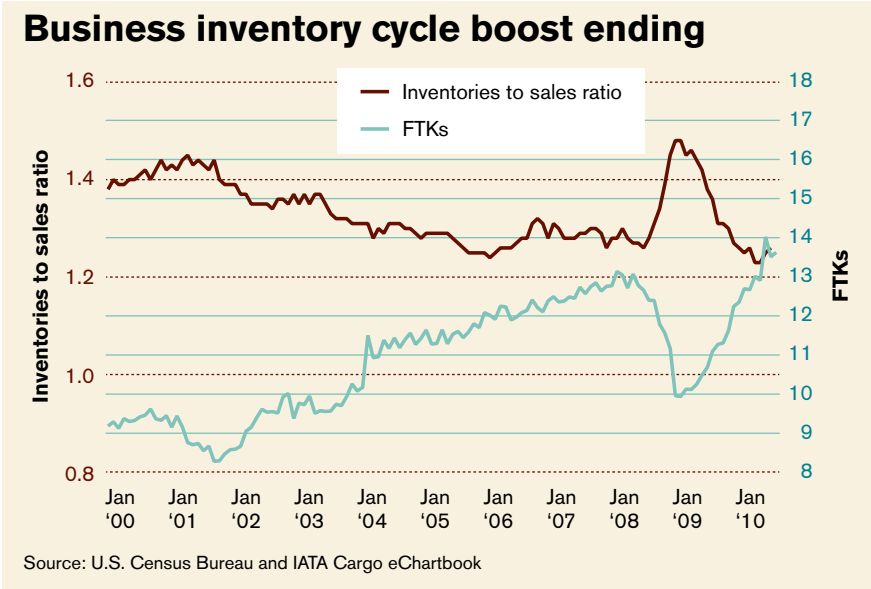
Volatility swings

Volatility caused by too little or too much capacity in the airfreight market has also resulted in wide swings in overall transportation costs, rates, and on-time performance.

Carriers, particularly those with expansive global footprints and integrated networks, are better able to manage capacity effectively from a cost and an on-time performance perspective. UPS, for example, has relationships with 300 carriers, an integrated network and freight forwarder operations, and alternate routings respond to capacity issues that leverage its dedicated transportation networks in North America and Europe.

"In addition, UPS continually monitors global





"This year bucked all past trends and the upturn continued... Consumer demand for Notebooks, iPads, plasma and LCD TVs, and mobile phones—which continues to be the mainstay of the traffic flow—was back with a vengeance."

—Pradeep Kumar, senior vice president of cargo, Emirates SkyCargo

transportation trends," says Scott Aubuchon, UPS marketing director of global air freight. "With global distribution and sourcing trends continually shifting to new and emerging markets, it is important to have timely, efficient, and cost-effective access to these markets."

Volatility in rates continues to be an issue, one that air carriers don't generally like to discuss. However, Pradeep Kumar, senior vice president of cargo at Emirates SkyCargo, sees rates nearly back to pre-crisis levels. He believes this has stabilized airline yields. "Volumes, too, are back to good levels," says Kumar. "Inventories had depleted, so companies were restocking right up until August, which is traditionally a very quiet month in our industry."

With all the replenishing of stock continuing, Kumar says that this August has been the best August Emirates has experienced in years. Beginning with the fourth quarter of 2009, Emirates witnessed an explosion in cargo demand from Asia, particularly to Europe and the United States, as well as to the Middle East and Africa. "This year bucked all past trends and the upturn continued," he says. "Consumer demand for Notebooks, iPads, plasma and LCD TVs, and mobile phones—which continues to be the mainstay of the traffic flow—was back with a vengeance."

Counter to the IATA forecast, Emirates SkyCargo's Kumar predicts a positive outlook for 2011. "With the cyclical nature of this business, we have witnessed that after a great period of volume growth, things slow down for a while before the markets pick up again," Kumar says.

Global factors

Currencies are another factor affecting the global air cargo business. The depreciation of the Eurozone currencies, coupled with the economic crises in Greece, Spain, and Portugal, will have an effect on imports into the traditionally large consumer market in Europe.

Meanwhile, airfreight has been experiencing higher growth rates in emerging markets than it has in traditional markets such as the United States and the countries in Europe. Asia-Pacific airlines have been the major beneficiary of the very sharp rebound in cargo markets and revenues. China is the key driver with a 9.9 percent GDP growth rate driving exports. "From our point of view, China will remain the main driver for air freight," says Michael Goentgens, Lufthansa Cargo spokesman. "This year we expect, again, a very strong

Air cargo security: Much ado about nothing?

This year anticipation of the new federal law to mandate 100 percent screening of cargo transported on passenger aircraft has been the 800 pound gorilla in the room for both air carriers and shippers. "It seemed as if no one in the industry could predict the full extent of the challenges the industry might experience," says Mark Mohr, manager of product development and specialty sales for Continental Airlines.

Carriers, in particular, made enormous investments in screening equipment.

Like Y2K, however, when the new rules went into effect on August 1, their impact became negligible.

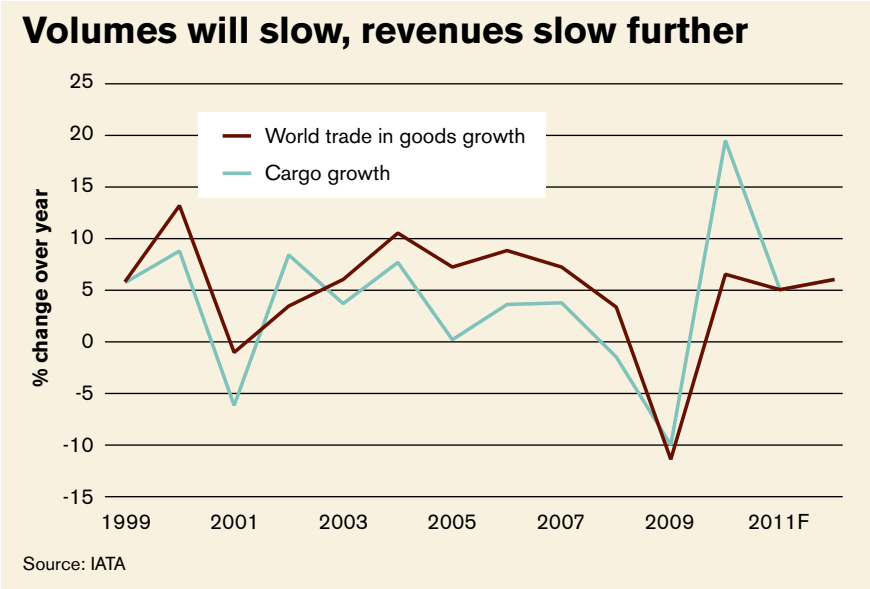
"Our investment in large aperture x-ray screening equipment at our Newark (EWR) and Houston (IAH) hubs made all the difference in ensuring a smooth cargo flow for our customers as well as our operations," says Mohr.

Particularly helping, however, was the TSA Certified Cargo Screening Program (CCSP) that allows the private sector to meet the 100 percent requirement without significant disruptions to the supply chain. Under CCSP, screening can occur at the shippers' or freight forwarders' premises, where the cargo can be screened at the piece level as the TSA requires.

The Airforwarders Association (AfA) warns, however, that major challenges may still lie ahead. These include the lack of approved pallet screening technology, ongoing financial barriers to participation, and the future of air cargo security policy in general.

peak season around Christmas on an even higher level than last year." According to Goentgens, Lufthansa Cargo is making certain it will offer its customers the capacity they need. "This will also include a significant number of charter flights that we organize together with Lufthansa Cargo Charter GmbH," he says.

Carriers around the globe are also responding to South America's rise in growth, although this market has always been important to U.S. passenger carriers American Airlines (AA) and Delta. "Our Latin American division is our largest revenue generating division in our system," says Carmen Taylor, director of cargo sales for Miami, the Caribbean, and Latin America for AACargo. "This includes our southbound and northbound business."



Like most airlines, AA has suffered from shrinking capacity due to the global economic slowdown. Some of its flights to the Caribbean, Central America, and the northern rim of South America ceased when the carrier retired 32 Airbus aircraft. "We have replaced those with 767-300 aircraft, and have also been adding aircraft," says Taylor.

Manufacturers in North America and Europe are taking a cautionary approach to business inventory rebuilding. With continued high unemployment, consumer spending at a stalemate, coupled with an end to government fiscal stimulus packages, they see the economy slowing again and the need for fewer goods. Manufacturers in other producing countries such as China are also taking more caution in ordering their production volumes. These concerns, as well as other financial factors, are contributing to a shortening of supply chains around the world.

Meanwhile, North American shippers who turned to ocean freight to save costs during the height of the economic slowdown are now using air to reduce possible overstocking. While this might be good news for companies operating main deck freighter aircraft, combination carrier airlines that haul cargo in the belly hold of their aircraft are still reluctant to add additional capacity. "Most of those decisions are based on passenger loads versus cargo needs," comments Mark Mohr, manager of product development and specialty sales for Continental Airlines Cargo. What's more, air freighter operators are reluctant to add capacity to avoid market oversupply, a move that would result in lower yields and the prospect of having to again mothball aircraft just taken out of storage. "Until consumers loosen their purse strings, the industry will adopt a wait-and-see approach," Mohr warns.

IATA indicates that since late last year, capacity has come back to the market at about the same pace as demand growth. Consequently, to meet demand, Cathay Pacific has reinstated its fleet of five 747-400 freight-

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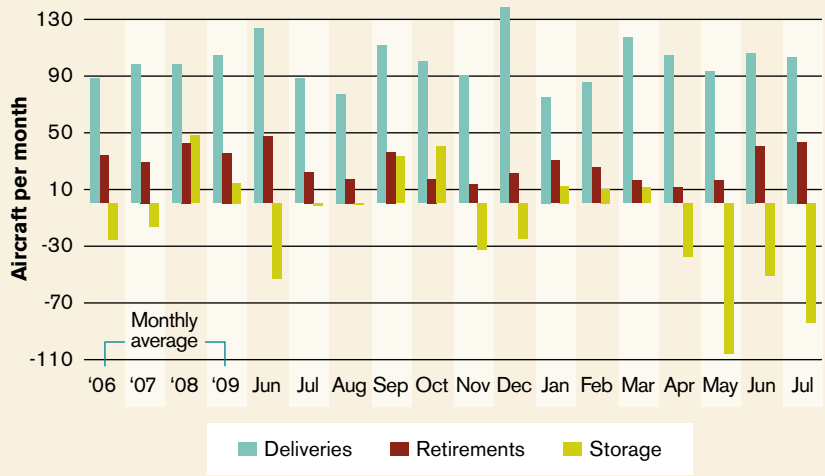
—Steve Gunning, managing director, BAWC

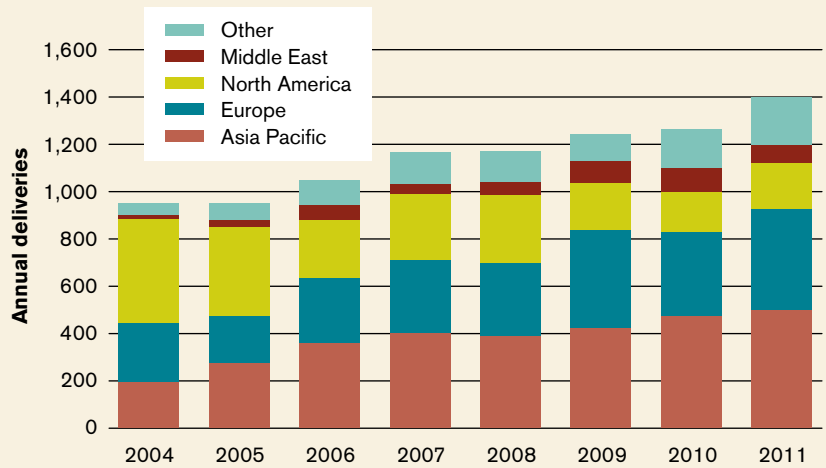
ers it stored in California for 12 months. Lufthansa Cargo pulled the last of four aircraft it parked in California in mid-September. "Two of the airplanes are already back in operation, and one (an MD-11) is currently in for scheduled maintenance in Xiamen, China," comments Goentgens. Another MD-11 will be integrated into Lufthansa Cargo's schedule in November after it completes its maintenance check. British Airways is recalling a 747-400 from desert storage for flights to Dallas for its winter schedule starting October. The airline is also freeing up a Boeing 777 to increase service from six to seven per day between London to JFK. Meanwhile, British Airways World Cargo (BAWC) is getting ready to deploy Boeing's new and very efficient B747-8f freighters, due for delivery at the beginning of 2011. "The three new Boeing 747-8f aircraft will operate to our existing schedule, maintaining regular services through Stansted, Hong Kong, Frankfurt, Pudong (Shanghai), Chicago, Delhi, among others," says Steve Gunning, managing director of BAWC. BAWC officials see the long-haul freighters as providing flexibility and capacity on resilient and growing lanes. The aircraft will be operated via a five-year wet lease agreement with Global Supply Systems (GSS). Emirates, meanwhile, did not park any aircraft during the economic crisis nor cancel routes. It did, however, rationalize capacity, slowed its expansion, and embarked on a stringent cost containment program."As such, when loads picked up we were already there with our existing services to carry them," Kumar says. "When any capacity becomes available, we are able to deploy it on charter operations, such as the many relief flights to Islamabad we have operated." Now, adds Kumar, Emirates is back to its aggressive expansion. This year it launched services to Tokyo, Amsterdam, Prague, Madrid, and Dakar on the passenger side and added Almaty in Kazakhstan, and Kabul in Afghanistan to its existing freighter network. Given Emirates' new routes and additional capacity on existing routes, the carrier is expecting an increase in volumes at the end of the year of about 20 percent over 2009. □

Capacity now coming out of storage



Source: Ascend

Delivery of new capacity set to rise



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