CII

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EXTRA!!! The Times EXTRA!!!

News & Views

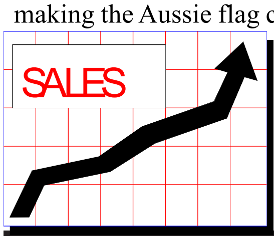
Aussie & Kiwi Land Booming:

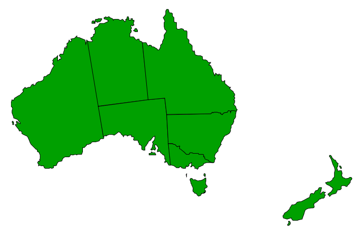
I have just returned from a two week sales and good will trip to Australia and New Zealand. Every call I made down under reflected the optimism of these two South Pacific nations. Forwarders are enjoying a great run. Rates are climbing and customers at long last are accepting the rise in tariffs. Of course, the strong air cargo market reflects the economic boom times in both nations.

Australia, still CII's principal market, is enjoying unprecedented good times. Its people never had it so good. National GDP is at an all time high; unemployment at an all time low. Aussies are buying everything that is not nailed down and like it is going out of style; from cars to teddy bears. The country is preparing for an even greater trade boom with the U.S. created by "AUSFTA" (Australia United States Free Trade Agreement). The country has every confidence that boom times will continue, with little fear of inflation or a rise in interest rates.

The New Zealand economy also is booming although there are a few clouds on the horizon. The country still is predominantly agricultural and the Kiwis are worried their meat, wool and fish will not be able to compete in world markets due to record highs in the nation's currency. Imports are at a record high and continue to climb. Unemployment is at a record low of 3%, the lowest of all OECD countries.

The two nations' airlines reflect these good times. Qantas announced a profit of more than one billion dollars (Australian), making the Aussie flag carrier one of the most profitable airlines in the world. Air NZ, after being bailed out by the government than three years ago, is about to declare a dividend (an unknown word for U.S. carriers) to its shareholders.





Up until 2004, the South Pacific market for U.S. exporters was flat. During the past six months, a complete reversal has occurred. Aided by two positive factors; the declining value of the U.S. dollar and the elimination of tariffs on manufactured goods between the two nations, American exports have risen sharply. Australia also is witnessing a boom in its manufactured goods to Asia, despite the strong Aussie currency.

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Although January and February were somewhat soft, Air NZ believes it is just a small hiccup. The airline already has announced an increase in cargo rates of 5-10% to take effect at the end of March.

To this old timer in the South Pacific cargo market, I see only blue skies ahead and a return to the great days of the nineteen eighties. Then, profits for our industry were high and there was no lack of freight to be flown "down under."

Announcements

Inside This Issue:

What About Customer Mergers?

Forwarders always are gossiping about, and the transportation press regularly reports about actual and potential mergers and acquisitions in our industry. The big swallowing up the small; the strong gobbling up the weak fascinates our industry. Yet, a far more significant development is occurring on the customer side. Companies who ship regularly both by air and sea are merging and acquiring each other at a huge pace. The financial press is reporting that M&A activity in 2005 will at least equal and perhaps surpass the frenetic pace of the late nineties—boom years for companies and their Wall Street bankers and investment advisors. In the retail field, K-Mart acquired Sears and it is expected that May Department Stores will be acquired by Federated. In telecommunications; the swallowing up of AT&T by SBC and the expected acquisition of MCI by Verizon is taking place with unknown consequences.

What About Customer Mergers? -cont-

What do all these mergers and acquisitions mean to the forwarding industry?

For each M&A, two customers will become one. A new, single entity will stretch its buying power across larger and longer supply chains. Will the new K-Mart-Sears combination really require the same number of vendors to move its products? Will the disappearance of AT&T and MCI, who spend hundreds of millions of dollars in transportation, also mean the disappearance of their hard working and loyal transport vendors? The prognosis is not bright. Perhaps the single most important reason for every merger or acquisition is the cutting of costs. Slashing payrolls, reducing purchases and eliminating duplication of vendors is the top priority of surviving management. Bids come under close scrutiny; rates are examined under a microscope—all nasty results of two companies becoming one.

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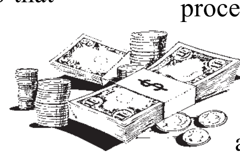
Are there any defensive measures forwarders can take? There are a few. Keep your ears attuned to any unusual talk among your customers. Are they discussing possible sale of their companies, or on the other hand, purchasing another? Review your arrangements with them. Are they genuine contracts or as Producer Sam Goldwyn used to say, "not worth the paper they are written on." Make sure your service standards remain top grade and that personal relationships with customers continue to be strong and cordial. If any vendors have to be eliminated, do your best to ensure that it is someone else. Don't become another victim of a M&A.

Supply Chain Management; It's The Money, Stupid:

When elaborate theories are propounded for outsourcing "supply chain" operations, or in simpler terms moving cargo from Point A to Point B, the principal idea was to remove large amounts of inventory from the supply chain and using outsiders or "third parties" to accomplish that goal. Elaborate theories were propounded so that shippers could reduce processes and people. Lean, agile and streamlined operations would be the result.



That was the myth. What is the reality? The reality is that supply chain management has emphasized reducing prices for freight, warehousing, logistics services and supplier products to the exclusion of every other consideration. Cost reduction has become the first and only priority. When manufacturers and shippers call in third party logistics people, or 3PLs, the only marching orders given are "reduce costs or we'll find someone else." No nonsense about improving efficiency, integrating supply management functions to make the whole process better, or even moving cargo faster and on schedule. Just achieve lower costs.

"With all the focus on cost reduction, actually creating some value in these convoluted supply chain systems is completely abandoned."

With all the focus on cost reduction, actually creating some value in these convoluted supply chain systems is completely abandoned. Shippers concentrate on costs to the exclusion of everything else—rather than value. That is why all the fancy academic theories about supply chain management falls short. Shippers are not interested in theory. With the shipper, reducing costs is the Holy Grail. Nothing else really matters in the real world of the shipper-forwarder relationship. Consolidators must recognize this reality and respond to the customers true interest—money and not his public posturing.

Perhaps An Easing Of Lift Across The South Pacific:

With the goods news about the strong South Pacific economies, may come some more pleasant tidings. A constraint in serving the down under market is the current lack of lift. In an earlier Newsletter, I discussed this situation. This now inadequate capacity may be eased if current high level negotiations between the government of Australia and Singapore are successful. Singapore is turning up the pressure to enter into an open skies agreement that will open the door for Singapore Airlines to take up the South Pacific route to the U.S.

Shippers and forwarders need the additional lift. As discussed elsewhere in the Newsletter, the economy down under is strong with all signs pointing to even greater growth. One of the key stimulants is the new U.S.-Australian free trade agreement which went into effect in January of this year. Those Singapore Airline 747-400 freighters with their non stop range, would add significant lift to a cargo market that currently is sadly under served.

Are The Chinese Ready To Adopt Western Ways?

We all have heard and read about the Chinese economic "miracle." But there are plenty of holes in that miracle balloon. On a recent trip to China, I was made acutely aware of those cracks in the Chinese "miracle" facade. Transportation is one of the widest cracks.

For all the announcements by western car makers that they are pouring money into facilities and people to build autos in China, the most popular mode of transport in that nation still remains the bicycle. And it appears that the Chinese will be peddling to and from work for a long time to come.

Are The Chinese Ready To Adopt Western Ways? -cont-

China's large cities now resemble huge parking lots. They have not been able to adopt their roads and parking facilities to accommodate the automobile. Already, traffic jams exist in cities such as Shanghai and Beijing that outstrip even the most traffic burdened cities in the U.S. California traffic zips along compared to the paralysis in Chinese cities and the surrounding countryside.

Banks have stopped lending money for cars and people have decided "sticker shock" is not for them. Car dealers now are discounting vehicles below cost to move them out of showrooms. Not even below cost pricing is attracting buyers. Unlike most western countries, China does not consider a car as a necessity. Why own a car when gasoline prices are high, roads are poor, traffic jams a constant reality plus no place to park at destination? Also, even upwardly mobile Chinese have not lost the nation's habit of frugality. This means that Ford, GM, Toyota, Volkswagon and others have major problems with their investments in China. They will bleed red ink for years to come and in all probability, will have no chance of making a dime in the foreseeable future. Mercedes and BMW probably will pull out of the China market as there is simply no demand for high end, "status" vehicles.

My opinion is based on first hand evidence in China. The country is not ready for a change in lifestyles. Two centuries ago, Americans talked of hiding their savings under a mattress. They had no faith in banks. Fast forward to the 21st Century. That is how most Chinese still behave. I just cannot see China embracing Western culture and enjoying its lifestyle for many years to come. A lifestyle that Americans take for granted.

Maybe a far-sighted company should take a hard look at that battery driven bike Lee Iococca was promoting a few years back. If they could sell it profitably for, say, fifty bucks in China, that lucky corporation could overtake Exxon as the most profitable business on earth! With 1.2 billion pairs of legs, a couple of million of bikes could be sold!

Look Who's Trying To Go Public?

Perhaps the industry's least respected large freight forwarder, GeoLogistics, is attempting to go public. A prospectus has been written and the company hopes to be traded on NASDAQ with the symbol GEOL. How is that for gall? A company that has amassed hundreds of millions of dollars in losses during the past decade. An organization that has acted as a revolving door for executives, most of whom were incompetent. A forwarder who has treated its generally loyal middle management staff with contempt and derision. And whose operations both in the domestic and international fields have been compared to the antics of Animal House.

Questor Corporation, the New York based investment firm, which has sunk $67 million into GeoLogistics and watched helplessly as that money vanished into thin air, is hoping to recapture those funds plus a profit by fobbing off stock to the public. Cynical investment houses expect to unload the stock on gullible investors. IPOs have been coming fast and furious during the past year and a half but in fairness to Wall Street, many of these new issues have genuine sales and earnings. Unlike IPOs during the dot-com craze. If there is one exception to this healthy trend, it is GeoLogistics. A company that in its LEP days was bought by an investment company controlled by the late William Simon, Secretary of the Treasury under Presidents Nixon and Ford. It was then dropped like a hot potato by his son who ran unsuccessfully for governor of California. A company that was close to bankruptcy not once but a number of times.

If the investment public buys this investment "dog," it will buy anything!

Rates On The Rise Again:

CII just has received a letter from Air New Zealand advising us that at the end of March, the airline will be raising rates between "five and ten per cent." I have no doubt other carriers will follow suit.

A prudent forwarder should work hard at keeping his customers constantly aware of the times we live in. Your customers should not really complain. Their products never have been so competitively priced. A few nickels here and there in increased freight costs per kilo will not stop the momentum of increased trade. The American manufacturer has the first real chance in decades to conquer world markets.

At this writing, oil is hovering in the $50 per barrel range. It will be interesting to see if airlines simply raise their rates and forego fuel and security surcharges. With Iraq still in turmoil and with the general volatility prevailing in the Middle East, the Exxons and Chevrons of the world have a great excuse to keep oil prices high.

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Sincerely,

Julian A. Keeling