



Into The Abyss; New Cargo Airlines:

Fuel costs are skyrocketing. Cargo aircraft, even those thirty and forty year old relics once considered little better than candidates for the scrap heap like the old DC-10, now are in short supply. In the meantime, the list of new cargo airlines, particularly based in Asia, keeps getting longer and longer. Hypnotized primarily by the Chinese market and to a lesser degree by the growth of air cargo volume out of India, the number of new airlines vying for business is mind boggling. They include Jett Airlines Cargo, formed by a group of former Singapore Airline executives, My Air Cargo, Great Wall Airlines, Yangtze River Express and Jade Air Cargo.

These new airlines will be facing a host of well-established air cargo divisions of combination carriers or all cargo airlines. Apart from the incumbents including MASKargo, Cathay Pacific, Dragonair, Korean Air, Asiana, China Airlines, EVA Air, JAL and those two 600-lb. gorillas, FedEx and UPS just to name a few, there are the established Chinese carriers including China Southern, China Cargo Airlines and Air China Cargo. Where will all the new freight come from to fill all

those main decks and bellies? Chinese cargo growth is not infinite. And what about the backhaul? Cargo volume already is heavily imbalanced eastbound with very little flying in the opposite direction.

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I believe these new carriers will be flying blindly into bankruptcy. Some carriers are playing it smart, however. American Airlines for one. Starting non-stop service from Chicago into Shanghai, the airline will carry only belly freight. It has no plans to put freighters on the U.S.-China route. Cargo will be considered strictly incremental income to the airline's passenger revenues. Perhaps going back to the future is not such a bad idea, after all.

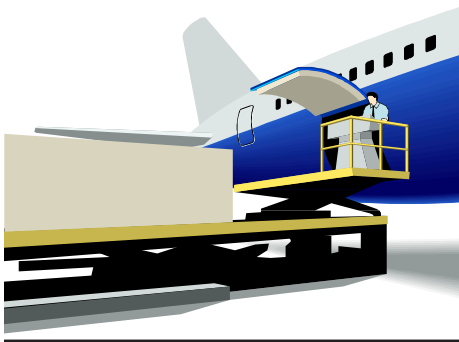
Announcements

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While new entries into the all-cargo business are eternally optimistic about their future, existing freight carriers are facing the present reality of rocketing fuel costs and low rates for their services. The latest all cargo carrier to hit the bankruptcy courts is Gemini Air Cargo, which has filed for Chapter 11. While the bankruptcy petition was voluntary and pre-negotiated, Gemini is another example of how tough it is to make money as an all cargo carrier.

Tortuous Toll Holdings-Patrick Negotiations Finally At End:



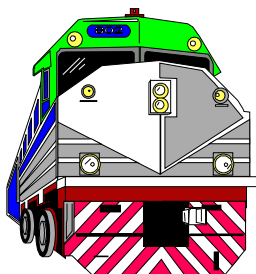
Down Australia way; an on-again, off-again battle for the past few years had been waging between two of that nation's largest logistic companies. Toll Holdings finally won control of Patrick Corp. for about (U.S.) \$4.5 billion. Patrick is Australia's largest shipping (air & sea) handler and also has majority control of Richard Branson's Virgin Blue, while Toll is engaged in a variety of logistics operations. The purchase is boosting Toll's ranking as the worlds

fourth largest mover of cargo behind UPS, FedEx and DHL. Like everyone else, Toll is fascinated by China. The primary purpose of the acquisition was to be a provider of integrated logistic services in Asia—primarily China. The U.S. market played almost no roll in Toll's desire to acquire Patrick. It demonstrates once again how the China market is obsessing companies throughout the world.

Railroads; Return Of The Dinosaurs:

Of the four major types of transportation; rail, truck air and ocean; guess who's doing the best in revenues and profitability? It's the railroads, until not too long ago considered the dinosaurs of the transportation business. It is interesting to recall that in the tech investment boom of the nineteen nineties, railroads were considered good for nothing more than providing rights of way along their tracks which broadband companies spent billions burying fiber optic lines. Back then, the smart money on Wall Street thought it ridiculous to invest in actual rail infrastructure. Tracks were abandoned, rolling stock kept getting older and older with little thought for replacing locomotives or freight cars while thousands of skilled railway men either were discharged or forced to take early retirement. What a difference a decade makes!

Today, commodities that are measured in pound, tons and barrels which are carried in rail cars, are in a powerful and seemingly unstoppable upward price spiral. Everything that is measured in megabytes and carried on fiber lines is in deflation. Major railroads like Burlington-Santa Fe and Union Pacific are reporting record sales and earnings while hi-tech companies at best are reporting mixed results. One of the oldest forms of domestic transportation is flush with prosperity while our newest mode, air—particularly our domestic segment—is showing either no growth or an actual decline in volume. As a matter of fact, trains haul more freight in a single week than the entire domestic air cargo business moves in a year. Ironically, transportation dinosaurs seem to have the brightest future.



Are Mega Mergers Good For Anyone But Shareholders?

Air freight has not been immune to the merger mania sweeping global industry. AEI's absorption into Deutsche Post with the German post office than swallowing Exel. Geologistics now is a subsidiary of a Dubai transport conglomerate while BAX Global is under the control of the German Deutsche Ban. The latest, and perhaps most disastrous merger is Deutsche Post's absorption of DHL and Airborne Express. A question naturally arises; who benefits from these mega mergers? Those shareholders smart or lucky enough to hold stock in BAX Global or Airborne certainly benefited, but for everyone else it has been pure chaos. As one astute observer commented, "mega mergers are often like perfume."

"The heart of the transport business; the shipper, increasingly is getting lost as logistics providers struggle to integrate these multi-billion dollar mergers."

They may be delicious to smell but dangerous to taste." The heart of the transport business; the shipper, increasingly is getting lost as logistics providers struggle to integrate these multi-billion dollar mergers. Companies may think they have the manpower and financial resources to execute successfully a mega merger. But in the real world, particularly in the fast moving transportation business, the wish is most definitely not the father to the thought. Also, shippers increasingly are reluctant to put all their eggs into one multi-billion dollar cargo basket. They don't want to be tied to the fate of a single provider. Mergers simply haven't created a convincing value proposition to the shipper. During the past decade, assorted "experts" and pundits were predicting the demise of the mid-sized forwarder. How wrong they were! Even Fortune 500 companies are awarding their logistics business to smaller, more agile and high service consolidators. As the shortcomings of these mega mergers sink in, I predict a stalling of such activity.

French Students Say "Oui" To Jobs; "Non" To Entrepreneurship:

The recent strikes by French students, clamoring for lifetime jobs once they graduate from their elite schools like the Sorbonne, throws a harsh spotlight on the French economy and an entire society that reflects this economy. What were these well educated students striking for? Simply stated; lifetime employment either with the government or one of France's huge, state supported industries like the oil company, Total. What they definitely were not striking for was the opportunity to be an entrepreneur (ironically, a French word) and to make their mark as independent businessmen in a fluid and flexible society. Of all the hundreds of signs and placards waved by the students as they marched through Paris streets calling for lifetime employment, did any one read? "I want to be an entrepreneur." Of course not. To be an independent business man or woman, .

to be a starter of companies, to be an innovator and create new wealth outside of an admittedly rigid economic system seems to be totally beyond the comprehension or desire by the youth of France. Where is the French equivalent of American college kids working out of their dorms or garages to create new businesses? Unhappily for France, they do not exist.

Our industry has tasted French stubbornness and willingness to strike at a chapeau's notice. Before its amalgamation with KLM, Air France had a history of labor intransigence that was unequalled in the airline industry. Its workers would strike over petty issues that to other airline labor unions would be settled quickly around a conference table. Happily, the more sober Dutch have calmed down the excitable French.

Are Airlines Asking For Trouble Over Fuel Surcharges?

The simple answer is, yes. Ever since jet fuel prices have spiked, airline fuel surcharges have become a fixture on the cargo scene. In my view, based on thirty five years in the transport business, airlines are doing exactly what the shipping companies have done for years. A “bunker surcharge” or commonly known as BAF is what they call it. There would be a temporary BAF based upon the increase in cost and if it appeared the cost would not be reduced, shipping lines incorporated BAF into the freight charge. BAF was not a blanket surcharge but varied according to the shipping lanes.

Those morons who run the airlines almost never have been able to charge rates that were profitable based on costs. Most didn't even know their freight costs because most carriers look at cargo as incremental income. After years of declining rates, carriers saw an opening in the skyrocketing price of oil. Here was their “god send” excuse to rake in some more money from forwarders and shippers. As the price of oil reached \$50,

then \$60 and now more than \$70 per barrel, the airlines piled it on. Surcharges went up and some carriers now are charging \$0.65/kg irrespective of the distance cargo travels. In some cases, the surcharge is more than the actual freight rate and in particularly weak markets, it is the only rate!

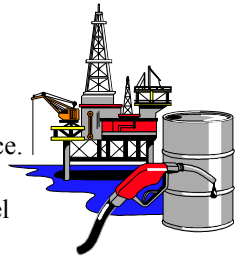
The obvious flaw in their methods inevitably drew the attention of the European Economic Commission. Shippers were complaining to high heaven. These complaints now have spread to the U.S. Unlike shipping companies who were far more sophisticated in applying different rates along different lanes, airlines were stupid enough to “common rate” the

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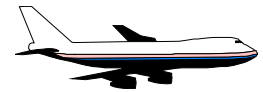
surcharge, no matter how long the distance.

Of course, they colluded in fixing fuel surcharges. If they had been smart enough to incorporate the increasing fuel surcharge into their regular rates as the price of jet fuel rose, they would not be in the trouble they are today. The authorities are looking for scapegoats and the airlines are in their gun sights. I believe the carriers are in real trouble and major litigation is just around the corner. Just what the airlines need!

The sad part of all this is that if the airlines are not bleeding red ink, profitability is marginal. Airline management almost never has the intestinal fortitude (perhaps because cargo people at combination carriers are way down the chain of command) to apply rates that would return a decent profit. Volume always has been the name of the game. Until we see airline management who know what they are doing and can communicate effectively, our industry will remain in chaos.



Boeing Is Winning The Airplane Race; At Least For Now:



At the beginning of this decade, the nation's biggest plane maker and U.S. exporter, Boeing, was in serious trouble. Its then current line of aircraft were considered behind the times and not competitive against Airbus' array of new planes. Management was rocked by government and sex scandals. Grumbling among the work force was getting louder as management made its unpopular decision to move corporate headquarters to Chicago after having called the Pacific Northwest home for almost 100 years. How fortunes have changed in just six years! Boeing today stands at the pinnacle of the commercial and military aircraft industry. The company's stock is at an all time high. It has pushed Airbus into an also ran position with its 787 “dream” aircraft, the company's long range triple 7 and amazingly enough, the rebirth of one of its oldest aircraft, the 747 as a cargo carrier. In the meantime, Airbus has stumbled badly. It now seems certain

that the Toulouse-based aircraft maker made a horrible mistake in designing and building the mammoth, 600-seater 380. This airplane is in the wrong place at the wrong time. After an initial spate of orders, there hasn't been one placed in Airbus' order book in almost a year. Interestingly, the few orders that have trickled in have been placed by cargo carriers. Perhaps an even greater threat to Airbus is the poor design and engineering of the airplane maker's 350 model which was created basically to compete against Boeing's 787. In a rare display of public censure, a number of purchasers of this aircraft have declared their dissatisfaction with the airline's fuel consumption and range. Airbus is caught between a rock and a hard place with its 350. Accede to customers' demands and the change in design will cost between \$5 and \$10 billion—wiping out any possible profits for the company during the next five years. Ignore its core customers and they

may pull out, despite very large cancellation penalties.

Yes, Boeing is on top now. But the aviation business is fickle. The American giant shouldn't rest on its laurels. Airbus management is smart and tenacious. They have the financial resources of Britain and France behind it. Don't count them out just yet.

Sincerely,

Julian A. Keeling