

Flight plan for freighters

Short-term prospects improve even as pricing pressure and inadequate niche cargo cast a cloud on long-term prospects

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Dedicated freighters in India have minuscule share versus global peers

Shorter lead distances compared with global freighters, lack of significant niche cargo, and intense competition from airlines – which also carry cargo in aircraft belly – are expected to continue restricting growth of domestic dedicated freighters.

However, in the immediate term, a sudden drop in capacity expansion of airlines on account of grounding of Jet Airways will aid volumes and pricing for dedicated freighters.

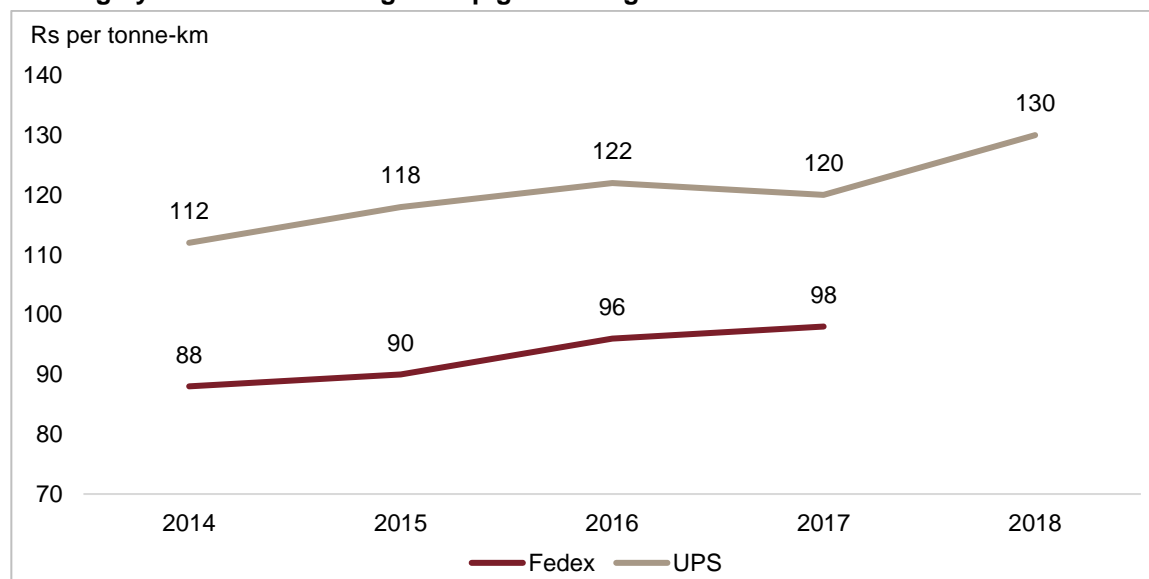
In the long term, increased freight concentration on select routes, integration with global freighters, and in-house logistics requirement will ensure growth.

The dedicated air freight market in India is estimated at Rs 6-7 billion currently.

In terms of revenue tonne kilometre, dedicated freighters have ~15% share of the air freight market in India, compared with 50-55% globally. This is because while their global peers move cargo across countries/ continents, those in India operate on shorter distances and lead times, leading to competition from other modes of transport.

Also, dedicated freighters command higher yields globally. UPS, for instance, earned Rs 130/ tonne km in calendar 2018, compared with Rs 51/ tonne km for Blue Dart in fiscal 2018. Yields for global freighters are based on end-to-end movement of express segment, whereas for domestic freighters it is airport-to-airport movement for the most part.

Air cargo yields remain strong for top global freighters



Note: (i) Converted to INR as per average exchange rates
 (ii) Calendar year for UPS, May 31 financial year for FedEx
 (iii) Yields based on end to end movement of express segment.
 Source: US DOT, Company reports

Also, somewhat tellingly, dedicated freighters in India command just 7 aircraft compared with ~680 in commercial aviation today (including Jet Airways). In comparison, as per Boeing data, the global freighter fleet stood at 1,870 aircraft as of 2017, compared with a commercial fleet of 24,400 aircraft – that’s almost 8 times the fleet share.

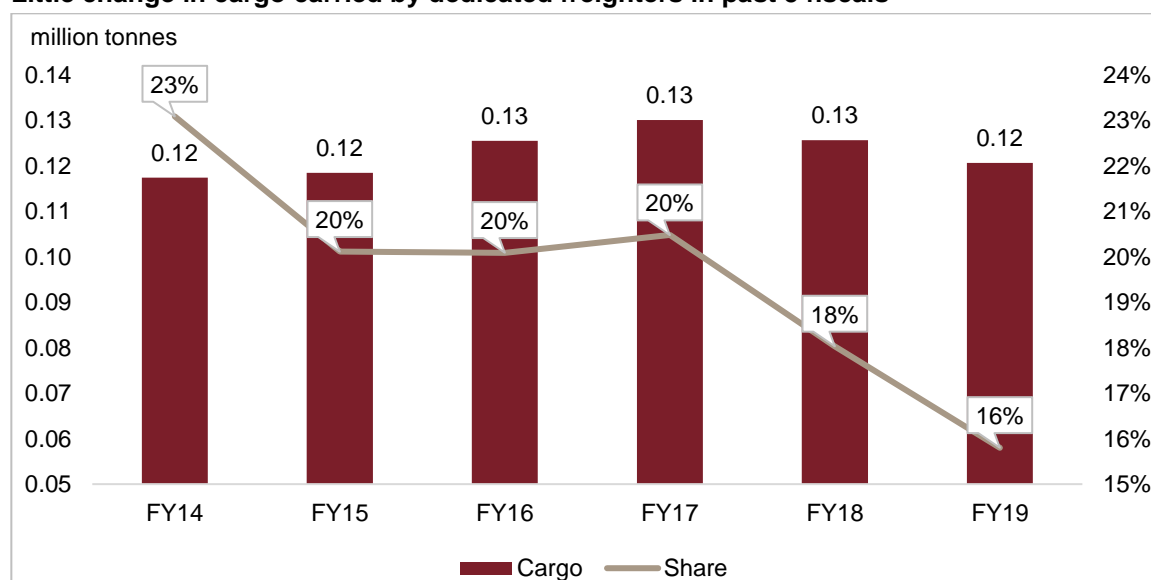
Just what is holding back growth of the segment in India? We take a closer look in this report.

Indian dedicated freighters have lost share in last five years

In the five fiscals through 2019, domestic air freight demand in India logged a compound annual growth rate (CAGR) of 8% to 0.8 million tonne, according to the Directorate General of Civil Aviation. Majority of the cargo during this period was transported in ‘aircraft belly’. A 14% CAGR spurt in domestic airline capacity provided adequate room to support this growth.

However, the quantum of cargo moved by dedicated freighters hardly increased, bringing down their share of the pie from 23% in fiscal 2014 to 16% in fiscal 2019.

Little change in cargo carried by dedicated freighters in past 5 fiscals



Source: DGCA

The reasons are not far to seek.

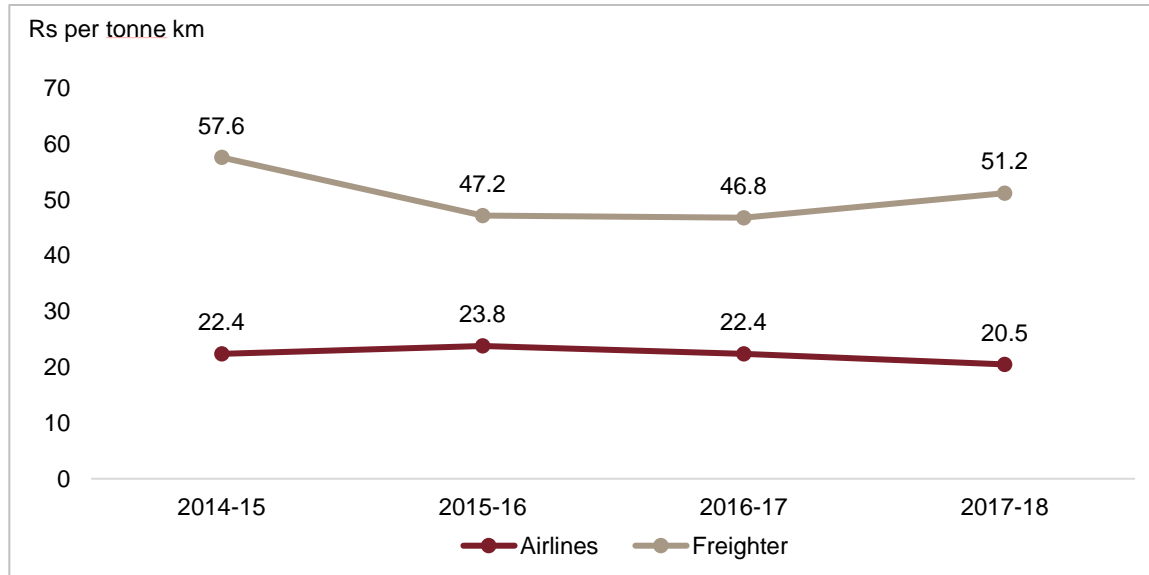
Globally, dedicated freighters benefit from higher share of over dimensional cargo (ODC), hazardous cargo, and express shipments (which have low competition from airlines) compared with Indian market. Besides, significant demand for export/ import of high-value commodities such as electronics, machinery and equipment and jewellery across long distances – and quickly – ensures adequate cargo for dedicated freighters to attain viability. This is especially visible on major trade routes such as Europe-Asia and North America-Asia.

In India, the situation is different due to minuscule volumes of ODC and hazardous cargo, which cannot be accommodated in airlines due to constraints of dimension or passenger safety – and which provides a firm base for dedicated freighters. Even the express segment is in a nascent stage in India, leading to very less product differentiation in the service levels offered by freighters compared with airlines. On top of this, airlines transport cargo at half the price of dedicated freighters (given that airlines are not dependent on cargo and only operate it as an ancillary business), leading to inclination of logistic firms towards airlines.

Over the past several years, players such as QuikJet Cargo, Deccan 360, and Air India had commenced operations in the market with an eye on the stable traffic and lucrative yields. However, they have failed to sustain on account of competition from airlines, resulting in lower load factors and yields.

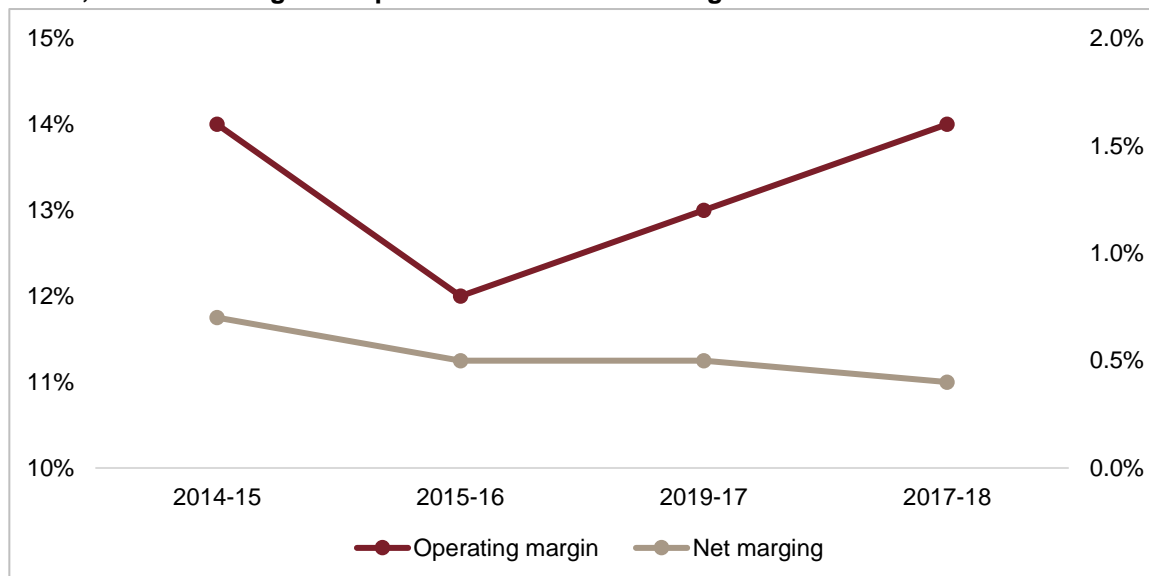
While the dominance of airlines over dedicated freighters in the domestic market is expected to continue in the long term, grounding of operations by Jet Airways is expected to benefit dedicated freighter operators in the immediate term by supporting volumes and pricing. Jet Airways, which has a market share of 17% (in terms of revenue tonne km) in domestic freight, has grounded all operations from April 17, 2019. This is expected to improve utilisations for airlines and dedicated freighters alike, even as some of it spills over to other modes of transport such as roads over pricing differential.

Freight yields for dedicated freighters are 2-2.5x higher than for airlines...



Note: Yields for airport to airport movement only
Source: Company, DGCA, CRISIL Research

...still, dedicated freighters operate with wafer-thin margins

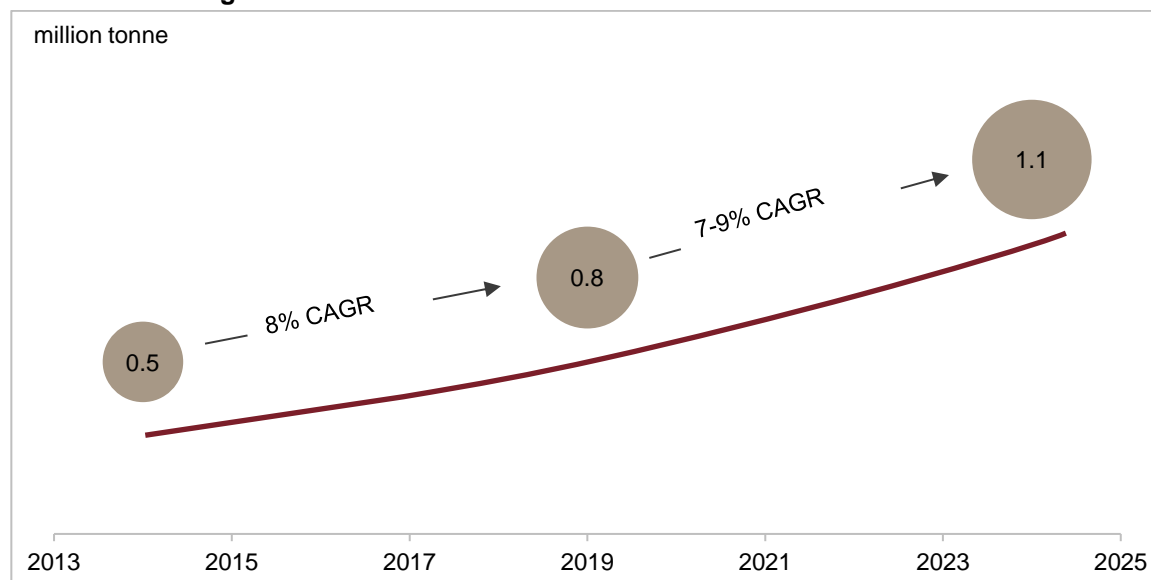


Note: Yields for airport-to-airport movement only
Source: Company, DGCA, CRISIL Research

Trend unlikely to change much in next five years...

In the next five fiscals, CRISIL Research expects domestic air freight demand to touch 1.1 million tonne, cruising at 7-9% CAGR.

Domestic air freight traffic on stable course



Source: DGCA, CRISIL Research

This growth would ride on a rise in e-commerce activity, increasing freight capacity, improving airline connectivity to Tier-II/III cities and competition on freight yields.

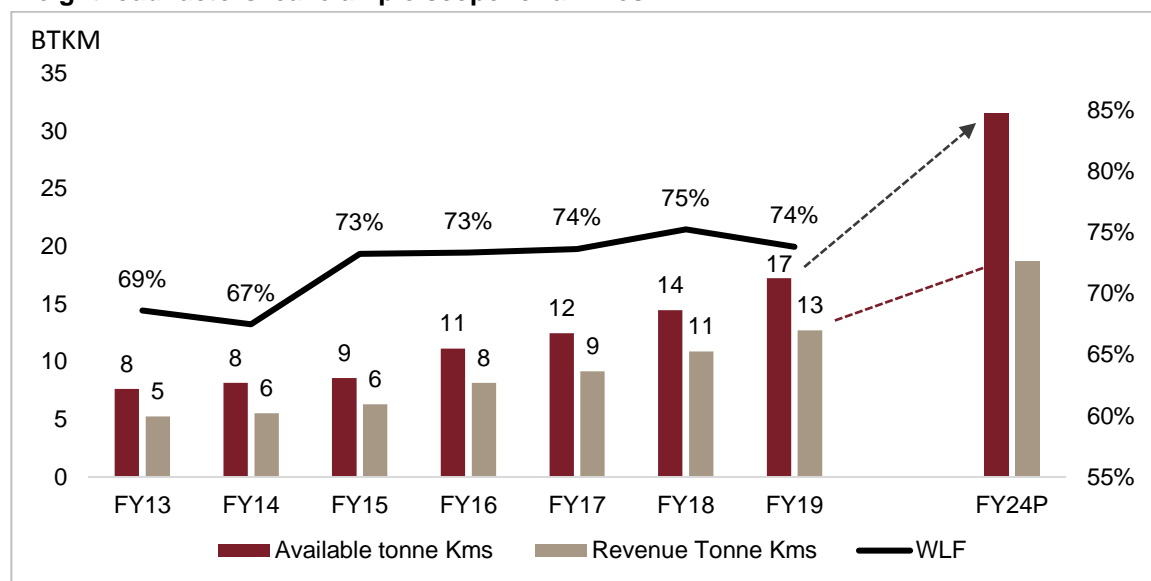
However, cargo capacity of airlines is expected to grow faster, at 13-15% CAGR, given the impending fleet expansions. This will further shift the market towards airlines. The fleet expansion factors resumption of Jet Airways with 30-40% (of fiscal 2019) capacity in fiscal 2020 and a gradual expansion over the next four years.

That said, dedicated freighters will continue to attract players and traffic, and grow at an organic pace.

...but route and cargo dynamics can turn favourable

For dedicated freighters, the biggest spur comes from the fact that route and cargo dynamics demand their presence despite the fact that the current cargo capacity utilisation of airlines, at 70-80%, is sufficient to meet the domestic air cargo demand.

Weight load factors leave ample scope for airlines



Note: Revenue tonne km include both passenger and freight carried in the aircraft

Source: DGCA

Capacity constraints between metro airports are a huge spur. For instance, while air cargo traffic between Delhi, Mumbai, Chennai, Kolkata, Bangalore and Hyderabad is dense and accounts for 50-55% of the domestic air cargo traffic, only 30-35% of the airline capacity is deployed on these routes. Thus, cargo evacuation requires dedicated freighter operations.

Inadequate cargo hold capacity of airlines on these routes is mainly due to wide dispersion, considering these cater to passenger traffic at more than 70 airports. In comparison, dedicated freighters serve only 7-8 domestic airports.

Infrastructure constraints at the metro airports limit the ability of airlines to add significant capacity there in the medium term. That allows room for dedicated freighters operating on these routes. Slot constraints at metro airports arise for airlines and not for dedicated freighters because freight operations by airlines are dispersed across the day, quite contrary to dedicated freighters.

Additional spur comes from feeder traffic through tie-ups with global freighters, and express shipments.

But more than anything, for dedicated freighters, success hinges on their ability to achieve adequate cargo aggregation in both directions. This is made more challenging by the fact that air freight typically costs 6-10 times that of road transportation, which limits demand to select high-value segments such as jewellery, pharmaceuticals, electric and electronic equipment, textile, machinery and perishable products.

In the long term, to improve their return metrics, dedicated freighters need to look at better integration of networks through airlines' belly-hold capacity, ground network and global freighters.

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