



Transport services review

July 2008

Transport services output to continue to slow next year

• **Growth in output in the transport services sector in the UK is expected to slow from 4.1% this year to 2.7% in 2008. Air transport services is forecast to remain relatively robust at 6-6.5% in 2008 and 2009, but land transport, which includes rail, bus, taxi and road haulage, is forecast to slow from 3.9% this year to 1.6% in 2009.**

• **Airline efficiency gains and profits will be eroded by rising fuel costs and weaker consumer and corporate demand. We expect oil prices to fall back towards \$110 per barrel, but political tensions in the Middle East remain an upside risk.**

• **UK rail passenger numbers continued to rise last year, but capacity constraints mean higher prices and that significant further investment is needed in the industry to increase capacity in the long term. The road haulage sector will suffer from weaker economic growth, higher fuel prices and the possibility of further road-pricing schemes.**

• **Freight shipping is benefiting from rising demand for foreign-produced goods, especially from China, while sea passengers last year rose, possibly reflecting more price-conscious consumers. Weaker demand and rising oil prices are the key near-term risks for freight shipping.**

Air: The global industry's profit of \$5.6bn in 2007 is expected to swing to a loss of about \$6bn this year, according to the IATA, as a result of soaring oil prices and weakening demand, especially in the US. Our central view is for oil prices, currently around \$130 per barrel, to fall back to nearer \$110 by the end of the year. However, political tensions in the Middle East remain an upside risk to the oil price outlook. In the first five months of the year, global passenger traffic growth slowed to 3.3%, compared with over 7% growth for 2007 as a whole, with North America growth at only 0.5%, compared with 4% in Europe and Asia Pacific and 13.8% in the Middle East. Growth in freight has also eased. We expect US consumer spending to recover moderately next year, as unemployment starts to fall. In the UK, profitability will be squeezed, but we still expect growth in the air transport sector to expand by more than 6% pa this year and next. In the longer term, congestion in London's airports will be relieved by an extra runway at Heathrow, if it gets the go-ahead.

Land: UK rail passenger numbers continued to rise in 2007, up 7.8% to 1.2bn, according to the ATOC. Higher oil prices have raised operating costs, but are also helping to switch demand away from cars. Rail passenger growth, however, is likely to be constrained by lack of capacity, leading to higher fares, and therefore further substantial investment is needed in the industry to enable passenger volumes to continue to grow in the longer term. In the **road haulage sector**, activity will be weighed by weaker growth in the economy, as well as high fuel prices and the possibility of further road-pricing schemes.

Sea: The recent boom in the freight shipping industry has been driven by rising demand for goods manufactured abroad, mainly in China. Near-term risks include weaker UK demand and rising transportation costs, but the weaker pound will boost export growth. International sea passenger journeys have fallen by about one-third in the past decade, but rose 1% in 2007, which may reflect more price-conscious behaviour among consumers.

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Chart a: Air transport to outperform GDP

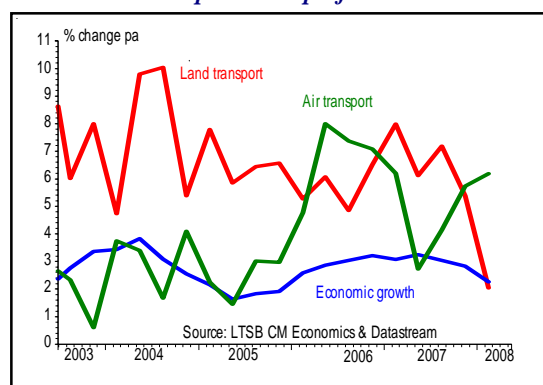
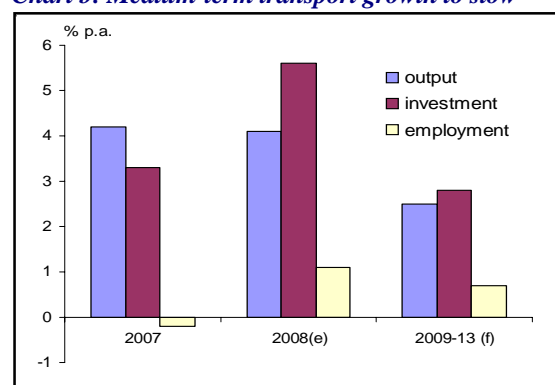


Chart b: Medium-term transport growth to slow



Comment on financial ratios

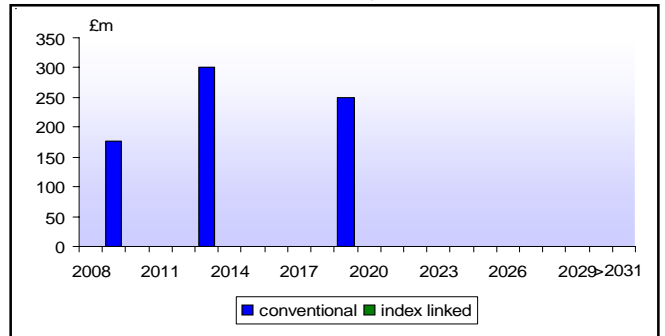
Pre-tax profit margins of FTSE All-Share index airline companies (BA and Easyjet) were at 10.4% in July, while road and sea transportation companies posted a profit margin of 6.5%. Rising fuel prices and slower demand are the key factors eroding airlines' profit margins, but a fallback in world oil prices will reduce costs, especially for airlines that have hedged only a small proportion of their fuel requirements. In the near term, the economic environment will increase the pressure on airlines to reduce capacity, in some cases possibly by merging.

Debt interest payments as a share of earnings in the UK sector amount to around 20%. IBES earnings estimates are encouraging for the sector as a whole and could help reduce the debt burden going forward. The road and sea transportation companies have a slightly longer debt maturity distribution than the airlines industry. The Bank of England compiles bank lending data for the sector together with the communications sector, see charts below.

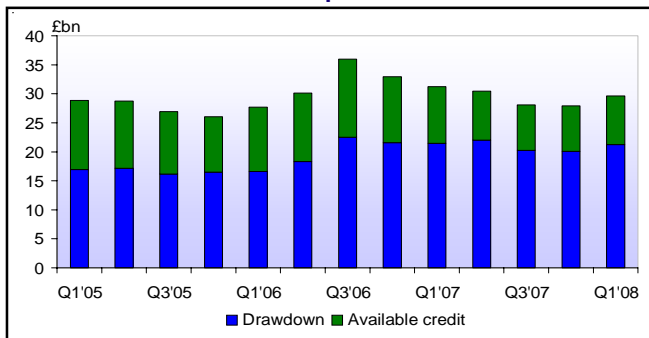
Financial ratios - July 2008

	Airlines	Transportation
Market value £bn	3.6	9.2
IBES long-term earnings estimate %	14.2	8.0
Pre-tax profit margin %	10.4	6.5
ROCE%	13.1	12.2
Debt ratio %	57.3	61.0
Interest expense cover	5.9	4.3
Interest % of earnings	17.1	23.0

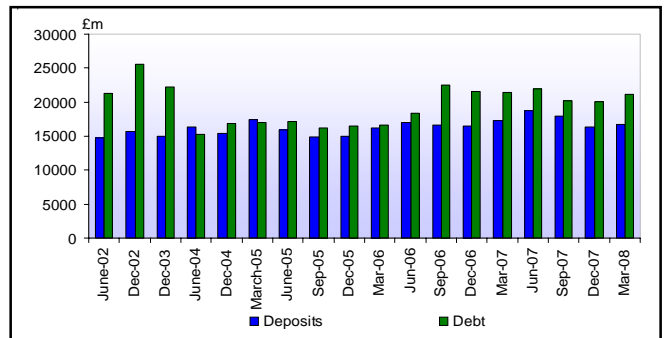
Bond debt distribution - maturity profile - Transportation



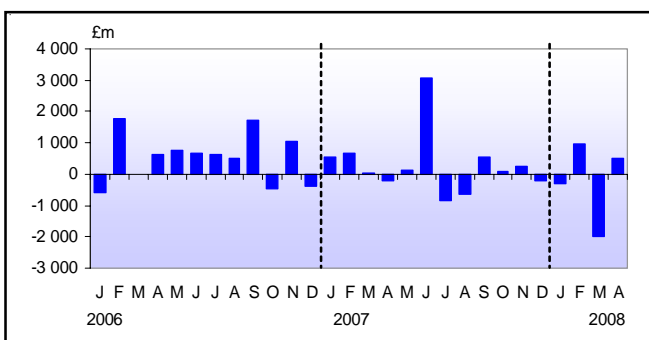
Bank credit facilities - Transport & communications



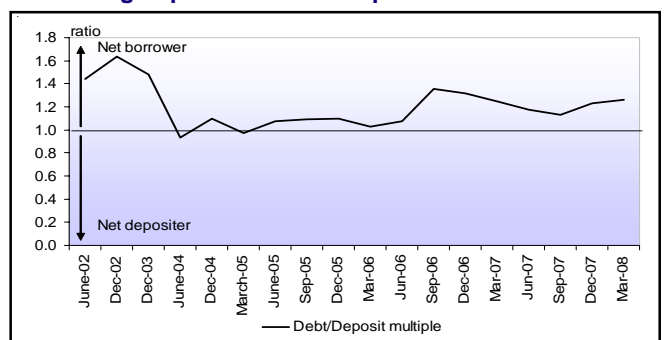
Debt/Deposit trends - Transport & communications



Net capital issuance, inc bonds, shares and commercial paper



Borrowing/deposit ratio - Transport & communications



* All charts sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, Bank of England and Thomson Datastream

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