Valitas Insights: Logistics & M&A – Adaptation and Transformation

Part 1. An Overview

Whether we realize it or not, the Logistics industry is a key component in our everyday lives. Our grocery stores always have food on the shelves. We rely on full gas pumps to keep our cars running. And when we order novelty products from China, they arrive promptly, right at our doorsteps. Without the Logistics industry, none of this would be possible. On top of this, the emergence of e-commerce and its transformation of the retail market is driving the Logistics industry to adapt to a new life of customized orders with many more end destinations.

This article serves as the first in our Logistics & M&A series. Part 1 provides an overview of the sector and historic M&A activity, and subsequent articles will discuss key industry trends. In writing this series, we benefit from the input of Martin Kelly and Keith Hart, industry veterans, who provided insights drawing on their wealth of Logistics experience.

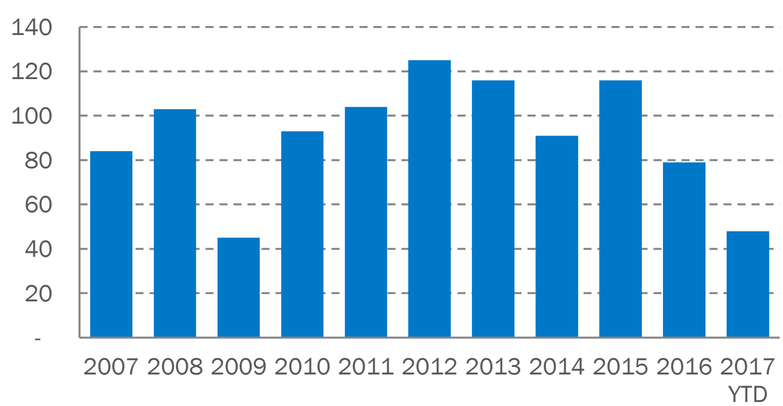
What is Logistics?

The Logistics industry includes the inbound and outbound flow of goods, warehousing, materials handling, and fleet management, all with the purpose of ensuring products move from point A to point B. The parties at points A and B might be two businesses, two consumers, or a combination of the two.[1] In addition, there is a move by Logistics companies to expand their traditional offerings, providing more of an "end-to-end integrated solution" that includes services like inventory management, packaging, labeling, and a myriad of value-added services.

Recent Industry Mergers and Acquisitions (M&A) in North America[2]

As an M&A advisory firm, we are interested in deal activity in the sector - understanding historic patterns, as well as identifying the trends that will drive Logistics M&A in the future. We'll start with the retrospective view.

Figure 1: M&A Deal Count



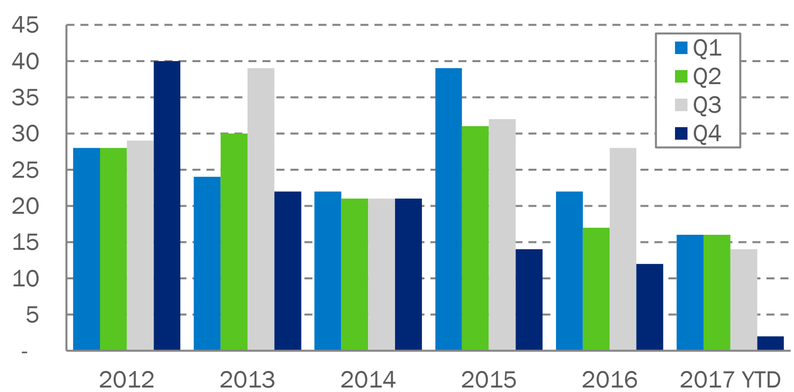
[1] *Understanding Supply Chain & Logistics Management: A Primer*, Martin Kelly

[2] All chart data from this article is sourced from Capital IQ, as of October 23rd, 2017

M&A activity in the North American Logistics sector was relatively stable from 2010-2015, reaching peak levels in 2012 with 125 closed deals (Figure 1). The number of closed deals has since softened, with 79 and 48 deals being closed in 2016 and 2017 year to date (YTD), respectively.

Keith Hart suggests that this slowdown may be attributable to the lull in Logistics sector activity that, in his view, often follows a period of active M&A. A further compelling explanation relates to recent and current trade-related political uncertainties, including the U.S. withdrawal from the TPP and the renegotiation and potential collapse of the North American Free Trade Agreement (NAFTA).[3] We don't see it as coincidental that the decline in deal activity (Figure 2) tracks with the election of a new U.S. administration with strong protectionist views.

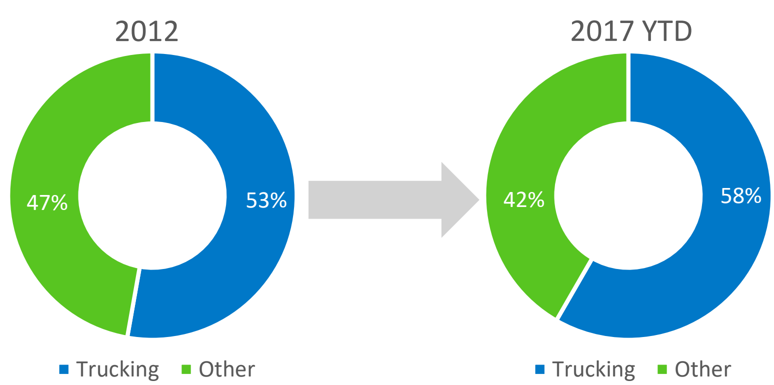
Figure 2: M&A Deal Count by Quarter



Segmented M&A Activity

The Trucking segment has consistently accounted for the most deal activity in the North American Logistics industry, averaging greater than 50% of total industry M&A for the past five years (Figure 3).

Figure 3: Segment Breakdown



[3] *Freight and Logistics M&A Landscape: June 2017*, Duff & Phelps

With the proliferation of e-commerce in the retail markets, many in key segments of the trucking industry are expanding their focus from business to business (B2B) to include business to consumer (B2C).[4] As a result, shipping routes and inventory management are becoming more complex, with more end destinations in this segment requiring lower quantities and more customized products. The increased focus on B2C—and the inventory complexities associated with this segment—is creating an impetus for more trucking companies to acquire both technology-focused companies and local trucking companies to help manage costs and inventory, plan routes, and acquire local customers.

Trends

There are several trends that, while not necessarily unique to the Logistics sector, are drivers of Logistics strategy and, by extension, M&A activity. We will elaborate on these trends in subsequent articles.

1. **E-Commerce Proliferation**
   As discussed previously, the Logistics industry is transitioning to adapt to more demand from B2C, entailing more localized shipping. According to Martin Kelly, warehousing plays an important role in this transition. Companies are transforming their brick and mortar stores to local distribution centres for e-commerce customers, and e-commerce-focused companies are actively acquiring warehousing spaces as their operations expand. Amazon, a leading example, has expanded its warehousing rental space from nine million square feet in 2009 to an estimated 114 million square feet by year's end.[5] This includes the lease of a 600,000 square foot warehouse in Alberta in late October.[6] The e-commerce driven transformation of the retail market is pushing Logistics companies to focus on how to optimally achieving 'last-mile delivery' to the B2C segment.

2. **Expanding service offering**
   According to Keith Hart, more businesses view Logistics companies as being in "the program management business." Mr. Hart tells us that many companies prefer to tender all of the physical distribution requirements of a particular geographic operation, business unit, or product line, instead of contracting piecemeal across a broad range of providers. This acceleration towards centralized distribution has created an impetus for Logistics companies to expand their service offerings, including data analytics, labelling, and packaging. We expect this trend to impact M&A activity, as Logistics companies target technology-focused businesses to diversify their offerings and distinguish themselves from their competitors.

3. **Outsourcing & Globalization**
   Mr. Hart and Mr. Kelly agree that there is a competitive advantage inherent in a global presence. Businesses with global operations prefer to outsource logistics to companies with sophisticated solutions and a global presence. This preference provides incentive for Logistics companies to pursue acquisitions in other geographies to accommodate their customers' demands.

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[4] *Accelerating into Uncertainty*, A.T. Kearney
[5] https://www.nytimes.com/2017/10/24/business/amazon-ecommerce-warehouse-demand.html
[6] https://globalnews.ca/news/3826519/new-amazon-warehouse-facility-to-open-in-southern-alberta/

4. **Technology and Automation**
   Pressures to optimize the value chain and implement data management software will serve as a natural transition to automation in the industry.[7] In the summer of 2016, Uber completed its acquisition of Otto, an autonomous truck driving company.[8] Tesla is also developing their own technology to develop self-driving trucks.[9] The availability of technology to generate efficiencies and automation is likely to drive deal activity between Logistics and technology companies.

5. **Excess Capacity in Container Shipping**
   A low interest rate environment and positive economic outlook stimulated a wave of optimistic investment in cargo ships with extra capacity. However, slower growth and political uncertainty have dampened demand for this extra cargo space, with the result that older vessels are sitting idle. As Keith Hart points out, given the state of this sub-sector, it makes sense for companies to consolidate and operate from a position of strength in what is currently a challenging environment for ocean carriers

As current political uncertainties are resolved, we expect to see an uptick in Logistics deal activity. We believe that the trucking segment is particularly well-positioned to maintain or increase its share of Logistics M&A, as companies use acquisition strategies to adapt to the proliferation of e-commerce. In addition, we expect the trends highlighted above to drive M&A across the whole sector, and will embark on a more detailed discussion in the next instalment of our Logistics and M&A series.

Martin Kelly has more than 40 years of leadership experience in the supply chain / logistics industry. His experience spans industries, including retail, electronics, third party logistics (3PL) and freight transportation. Mr. Kelly held significant roles with Wheels International over more than eighteen years, during a period of unprecedented growth for the company and its industry. He is a Senior Advisor at Valitas Capital, specializing in the logistics sector, holds CCLP and P.Log. designations, and is a past President of the Toronto Chapter of the Council of Supply Chain Mgmt Professionals.

Keith Hart has extensive experience in global logistics management along with customs and trade compliance. He was previously Vice-President – Americas Trade Area for DB Schenker, the logistics arm of German multinational Deutsche Bahn. Mr. Hart is a Senior Advisor at Valitas CapItal specializing in the logistics sector and is the founding Partner at Tradelink an Advisory and Agency business, founded in 2002. He holds a P.Log designation and is a licensed customs broker (Canada).

[7] https://www.pwc.com/gx/en/industries/transportation-logistics/transport-tomorrow.html
[8] https://techcrunch.com/2016/08/18/uber-acquires-otto-to-lead-ubers-self-driving-car-effort-report-says/
[9] https://www.reuters.com/article/us-tesla-truck-autonomous/exclusive-tesla-developing-self-driving-tech-for-semi-truck-wants-to-test-in-nevada-idUSKBN1AP2GD