IN PERSPECTIVE

# Weak Demand Derails 3PL Growth

2015 was a historical year for the third-party logistics industry, not in terms of industry revenue, because lower fuel surcharges brought top-line dollars down from their record highs in 2014, but in terms of industry consolidation. The 3PL industry witnessed a record number of mergers and acquisitions among the segment's largest players over the last 12 months.

BY MICHAEL SCHEID

Favorable financial markets are enabling large companies to secure the money necessary to make sizable acquisitions that translate into top- and bottom-line growth. Prolonged record low interest rates are providing little return on the cash saved in company coffers, but they're also allowing companies to borrow cheaply to fund growth. Likewise, stagnant demand is making it difficult for large companies to expand their existing business, further giving preference to acquisitions that quickly provide a bump to sales.

Over the last year, the total spent on acquisitions involving the 50 largest global 3PLs was more than $21 billion. This is more than the revenue of DB Schenker Logistics, the third-largest global 3PL. Half of the world's 50 largest 3PLs either acquired a competitor or was bought out. In addition, seven of the top 50 3PLs were acquired by another top 50 company, redistributing approximately $16 billion in revenue within the list. The deals involving two top 50 players included UTi Worldwide by DSV (deal expected to close in the first quarter), Norbert Dentressangle and Menlo by XPO, Coyote Logistics by UPS, APL Logistics by Kintetsu, Genco by FedEx, and OHL by Geodis.

The deals involved strategic purchases of industry leaders (Norbert Dentressangle and Coyote, for example) and companies struggling with profitability but with attractive valuation and considerable upside potential (UTi). Likewise, some acquirers made purchases to gain access to new business segments (FedEx and Genco, UPS and Coyote), while others enhanced existing service offerings (Kintetsu and APL Logistics, C.H. Robinson and Freightquote, Echo and Command).

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The potential for significant deals still exists in 2016 even among the largest 3PLs. Companies that could see an ownership change include Hub Group, which remains a prime acquisition target for a global 3PL without a strong intermodal service offering. Other companies still under private ownership, including Schneider and TQL, have the potential to change hands via a public stock offering or private equity deal. Likewise, some companies, such as Yusen Logistics, are the part of much larger corporations with the potential to be sold or spun off.

Meaningful volume growth in 2015 was difficult without the aid of acquisitions, and the prospect for this changing in 2016 is fairly dim. In 2016, GDP growth for the world's advanced economies is expected to hover around 2 percent, significantly lower than the average 3 percent rate of growth in the 10 years prior to 2008. In addition, annual output is expected to decline in China, the world's

second-largest economy, for the third consecutive year.

There is good news for some companies, namely those serving the Asia-to-U.S. and Europe-to-U.S. markets, as the dollar continues to strengthen against other foreign currencies. The dollar is at an eight-year high versus the yen and a 12-year high compared to the euro. As the value of the dollar grows and the U.S. imports more goods, 3PLs in this space should benefit. Fuel prices also should remain low for the foreseeable future, allowing 3PLs to obtain higher margins.

In the U.S. trucking market, brokers were able to drive profit margins higher in 2015 as they benefited from decreasing fuel costs and slightly looser truck capacity. Demand growth tapered off from 2014's robust level and fleet additions by some asset-based truckload carriers resulted in a supply-demand shift back to brokers' advantage. As evidence of truckload capacity growth, consider that the major public truckload carriers increased capacity by about 5 percent in 2015, excluding fleet acquisitions.

With 2016's demand outlook looking much like 2015, truck brokers should continue to benefit from the desirable market conditions. This is the year for truck brokers to reap as much profit as possible before truck capacity becomes meaningfully tighter in 2017 as new industry regulations take effect. Once truck capacity tightens materially, it may be harder for brokers to find ways to keep expanding margins.

Like the rest of the 3PL industry, acquisitions in the U.S. truck brokerage market were significant in 2015. Five of the 50 largest global 3PLs made a major acquisition of a freight broker in 2015, including some with lofty valuations. Kuehne & Nagel and UPS entered the market via purchases of established competitors, and other large brokers, including C.H. Robinson and Echo, enhanced their service offerings with strategic purchases of sizable players. Because there is still an abundance of available targets, brokerage acquisitions likely will continue at their rapid pace in 2016.

In the U.S. intermodal market, volume growth slowed from that of recent years. Intermodal loads handled by the Class I North American railroads grew less than 2 percent in 2015, down from 5 percent growth in 2014. Continued service improvements and future truck capacity limitations, however, make the future outlook bright for major companies in this segment, such as J.B. Hunt.

Current market dynamics present opportunities for 3PLs to increase margins, but volume growth likely will be hard to secure again in 2016. Because logistics moves the world, the outlook for the 3PL industry should reflect that of the global economy: droopy. JOC

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