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TRANSPORT & LOGISTICS

Adapt and evolve in times of crisis

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TRANSPORTATION POST-COVID-19: M&A OPPORTUNITIES TO FUEL GROWTH ON THE ROAD AHEAD

DON WIGGINS, PRINCIPAL, JACKSONVILLE
OAKLINS LOGISTICS TEAM LEAD

The global COVID-19 pandemic has rewritten the dynamics of international supply chains and domestic trade, impacting transportation industries across the board. There are several industries that have weathered the storm with more stability than others, though, and the forthcoming economic recovery presents plenty of opportunities for companies that are capable of capitalizing on the current environment.

Global lockdowns and restrictions on air travel delivered blows to passenger aircraft and shrunk air cargo capacity by 35%. On the other hand, trucking has suffered less severe dips in activity as many ground transportation fleets have turned their focus to last mile transportation in concentrated local markets.

In these conditions, national intermodal firms may see opportunities to broaden their market reach. Companies that have responded well to local demand trends are attractive prospects for larger firms looking to penetrate these markets. Air cargo and freight companies also have opportunities to consolidate before a full economic rebound and position themselves for future growth.

In both the trucking and air freight industries, the pandemic has highlighted the need for supply chain technology. The volatility in markets has fueled discounts in tech and logistics valuations, creating attractive bolt-on acquisition prospects for firms looking to broaden their tech infrastructure. As e-commerce continues to eclipse other venues for consumer sales, integrating technology to better serve this market will be a key motive for M&A.

The recovery presents chances for well-capitalized firms across the sector to expand their foothold in their respective industries, especially in the face of changing trade dynamics post-COVID. Difficult times often present unique opportunities, and many companies are slowly shifting their focus from survival to growth as the world overcomes this global pandemic.

DON WIGGINS

WILL CONSUMERS BE ABLE TO DRIVE THE AUTOMOTIVE INDUSTRY OUT OF THE RED ZONE?

MATTHEW J. MUELLER, MANAGING DIRECTOR, CLEVELAND

In March, COVID-19 caused the global automotive industry to endure a two-month halt in vehicle production. By mid-May, OEMs and suppliers reopened, but face an uncertain road ahead.

Consumers' desire and ability to purchase new vehicles will be key to the industry's recovery. As economies have begun to reopen, consumers have shown increased preference for vehicle ownership as a safer alternative to public transit or shared mobility. However, those facing uncertain employment or reduced pay may instead turn to the used vehicle market, limiting demand for new vehicles.

As suppliers start back to work, many are in a tenuous liquidity position. Cash for pre-shutdown work was collected in May and even with employee layoffs, companies incurred expenses during shutdown. Investments in testing, PPE and refined operations that adhere to social distancing guidelines were required. Suppliers are also operating at less profitable volume levels and with 45 or 60-day payment terms, may not start to collect significant cash until August.

The liquidity constraints faced in the coming quarters will expose poorly-capitalized suppliers who will need to undergo restructuring through bankruptcy or receivership processes.

However, there are also opportunities for companies to build for future success by considering transaction alternatives that include:

- Acquisitions that provide access to new customers, capabilities or access to higher growth segments of the industry
- Consolidating suppliers in high fixed-cost, slower-growth segments to leverage increase scale and operating efficiencies
- Divesting non-core business segments to consolidators or private equity and redeploying capital in businesses with long-term strategic advantages
- Raise junior capital in the form of mezzanine debt or minority equity that can be used to bridge a liquidity shortfall, or to pursue acquisition or organic growth plans

MATTHEW J. MUELLER

CERTAIN RAIL SEGMENTS GETTING BACK ON TRACK

FAUSTO LEVY, PRINCIPAL, MONTREAL

During these uncertain times, the railway industry has emerged as one of the most diversely affected. The freight rail segment was impacted by the drop in oil and gas volume, and by reduced Chinese imports of commodities. Additionally, intermodal transport activity was negatively impacted by decreased car sales. However, this segment was critical to transporting PPE and consumer staples early in the pandemic, while dealing with reductions in loadings, industrial production and supply chain disruptions.

The passenger rail segment (commuter and intercity) experienced a large reduction in activity due to the enforced lockdowns and closure of borders. Eligible passenger rail operators will benefit from various government initiatives. For example, the USA's US$2.2 trillion CARES Act contains US$25 billion in grants for public transit agencies, and more than US$1 billion in operating assistance for Amtrak to help the railroad recover revenue losses.

We believe this pandemic could accelerate the shift of passengers from air to rail, which will allow for the high-speed rail segment to grow faster than any other. Due to the layout of passenger wagons, the adaptation of safety measures will be fast and efficient. Rail will be able to provide safe, independent compartments in which a small number of passengers will be able to travel and apply social distancing measures.

Whilst industry M&A activity has been impacted, the latest trends are carried out by resilient buyers actively seeking to expand their rail presence by acquiring international targets, companies holding the right intellectual properties and generating sustainable cash flows.

We believe that the current crisis will focus financial buyers' attention towards rolling stock companies operating within the essential services segments.

FAUSTO LEVY

DISRUPTION AND ACCELERATED M&A OPPORTUNITY IN AUSTRALIA

SCOTT MCINNES, MANAGING DIRECTOR, MELBOURNE

The advent of COVID-19 has challenged and accelerated opportunities in the transport and logistics industry globally, and Australia is no exception. Thinking ahead for Australia, there are two key trends likely to shape M&A in the sector:

1. Market duopoly structure driving industry consolidation

Like many small, developed markets, Australian transport and logistics lends itself to monopoly characteristics, in this case, a duopoly between Toll Group and Linfox. These large logistics businesses can consistently out-invest smaller competitors in areas such as technology, IT, capital expenditure and human capital. However, customers are aware of this increasing concentration of market power and are actively supporting other logistics providers to drive competition.

2. Rise of e-commerce disrupting traditional logistics practices

In Australia, revenue in the e-commerce market is projected to reach US$32 billion (AU$47 billion) billion by 2024 (5.8% CAGR). COVID-19 is driving consumer behavior increasingly online and accelerating the shift to online fulfilment. Challenges to the industry include managing annual demand peaks and servicing consumer fulfilment expectations. Additionally, the opportunity of e-commerce is not evenly spread, as seen by Amazon's recent proposal to construct a 'mega' Sydney warehouse to meet this surging demand.

What do these trends mean for M&A?

- Increasing drivers for consolidation in the market to achieve a 'third-pillar', creating the scale and capability to both invest and compete with the dominant players.
- Mid-tier players are likely to be on the lookout for acquisition opportunities to drive scale or become acquisition targets themselves. We've seen this reflected in transactions such as Chalmers sale to Qube Holdings and Anchorage Capital's acquisition of AHG's cold-chain logistics business.
- On a global scale, there's scope for Australian logistics companies to explore international joint ventures and partnerships to smooth international commerce and better serve their customers.


SCOTT MCINNES

COVID-19 PROVIDES ROOM FOR PE-BACKED BUY-AND-BUILD PLATFORMS IN LOGISTICS

ARJEN KOSTELIJK, PARTNER, AMSTERDAM

We are following the European logistics services market closely and what we see is that while many businesses in the sector have taken a big hit, they are now recovering strongly due to the reopening of borders and increasing sea and air activity.

When we look at road transport, we see that businesses still need to cope with the governmental measures that have been put in place. Delays are still being experienced at some European borders and at collection and delivery addresses due to health and safety measures, as well as other COVID-19-related safety checks. Air freight capacity has plummeted due to canceled business and holiday flights. Cargo carriers have been widely used to ship medical supplies and other necessities. As cargo space can now be used for normal goods, tariffs are moving towards normal levels again. Sea freight is down considerably, but the situation has become more stable and predictable, and the effects of COVID-19 are decreasing from week to week. Equipment availability, space and blanked vessel sailings are continuing to have an impact on the overall situation.

How logistics services companies perform also depends heavily on the vertical in which they are active. Those companies that focus on medical supplies, e-commerce and food & beverage are still doing well. Volumes and transport rates are high, resulting in higher revenues and profits. However, businesses that are active in fashion, oil & gas and automotive logistics, for example, face more difficult times ahead as demand has fallen sharply.

In the M&A market, we see a clear distinction between large European consolidators and PE-backed buy-and-build platforms. Large consolidators such as Kuehne + Nagel and DSV have not been active this year and are actually selling non-core assets to regain focus and enhance liquidity at the same time. This provides a clear track for M&A for PE-backed buy-and-build platforms such as Global Transport Solutions (backed by Waterland) and SLS Group (backed by Auctus). They are continuing with their active M&A strategy and are using this time to further build their portfolio without competing with the large consolidators.


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