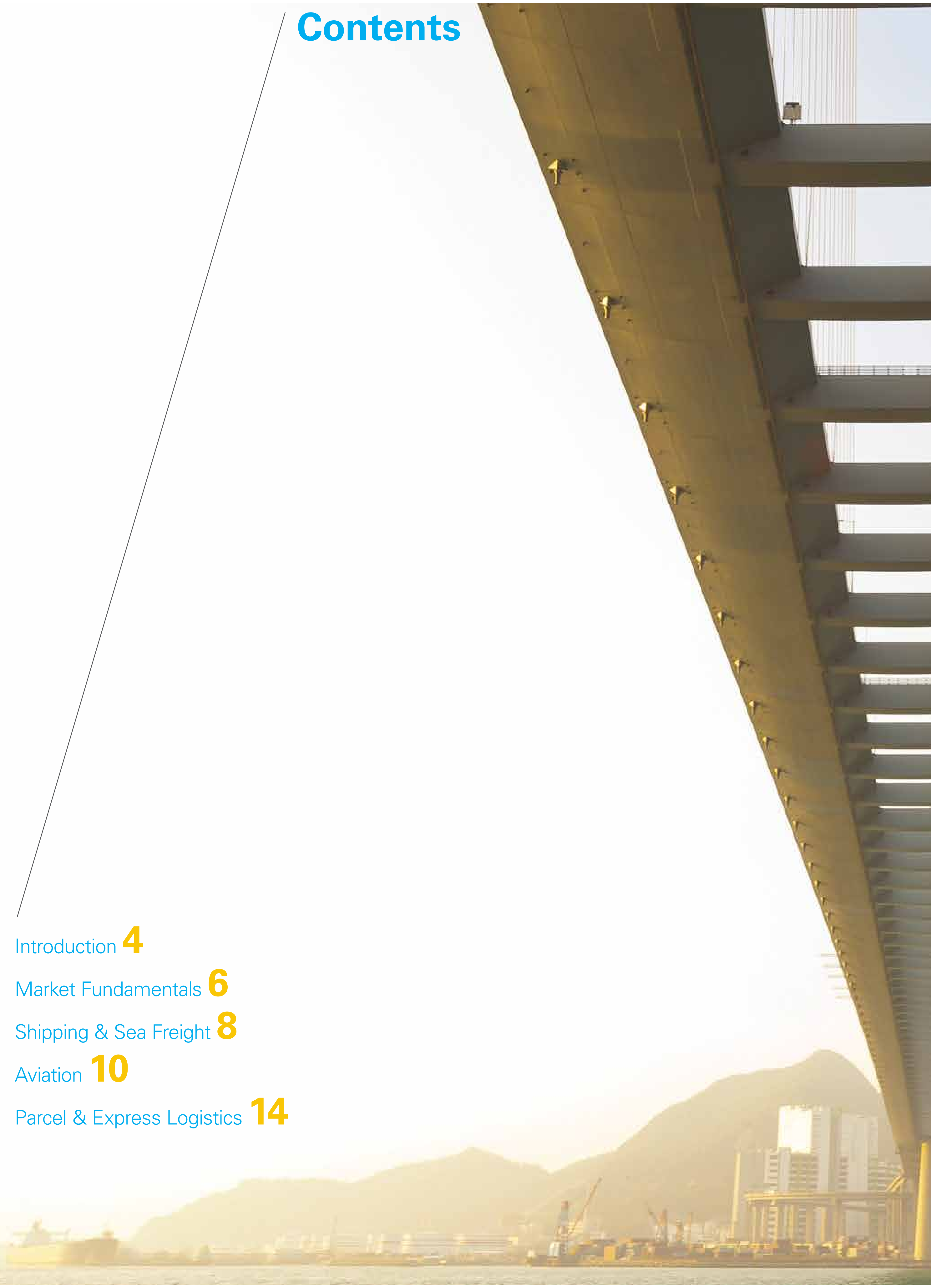
cutting through complexity

KPMG Transport Tracker

Global Transport Market Trends and Views

June 2014

kpmg.com



Contents

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Introduction

We are delighted to present the second edition of the KPMG Transport Tracker, our regular publication looking at the latest market indicators and trends in the global transport market.

This second edition will focus on the global aviation and shipping markets at the end of Q1 2014. In addition, we have added a new section looking at the latest developments in the parcel and express logistics market.

A number of key trends are affecting the transport sector at the beginning of 2014:

→ Seaborne trade volumes have continued to increase, reaching an all-time high in March 2014. However, freight rates have not kept pace due primarily to oversupply in most sectors. While the global economy begins to show signs of a sustained recovery, it may be some time before we see the necessary growth in demand to make inroads into the oversupply in the shipping sector.

→ The first quarter of the year is commonly a weak quarter in the airline industry and this year has been no different. Regionally, airlines have shown mixed results with Asia-Pacific carriers suffering from a weakened Chinese economy, to labour unrest and adverse currency fluctuations in Europe, to North America showing a few bright spots amid negative impact from severe weather conditions.

→ In express and parcel logistics, vast growth potential lies in the rise of e-commerce. Online grocery sales and same-day delivery seem to be new areas of opportunity for logistics companies. However, competition and cost pressure in this market is already intense. Adding to this competition, retailers are also expanding into the delivery business of online sales. At the same time, logistics companies are trying to gain a larger share of the e-commerce value chain by expanding into the online retailing market. We are thus witnessing a convergence of the retail, technology and logistics sectors.

We would be pleased to discuss the results of our analysis with you.

Dr Steffen Wagner
Global Chair, Transport

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Market Fundamentals

Fundamentals at the beginning of 2014 are encouraging but show worrisome signs

Market fundamentals for the transport and logistics sector at the beginning of 2014 continue to be positive. Industrial production grew by an average of **3.6%** year on year in the first quarter of the year. Growth of world trade showed some moderation at the beginning of the year but still remains positive at **2.4%**.

Global GDP growth in the first quarter was around **2.3%** according to Bloomberg consensus estimates, a slight decline to the **2.5%** growth of the prior quarter. GDP growth in Europe remains positive with **1.5%** in the first quarter.

Purchasing Manager Indices (PMIs) are all showing values above 50 in the first quarter of 2014, indicating expanding manufacturing activities in all major regions. Encouragingly, the PMI for the Eurozone remains robust, with positive numbers for each of the last nine months. Growth seems to have moderated in the United States though, where the manufacturing PMI has now converged down to the global average. More worryingly, the Chinese manufacturing PMI is still lagging behind global average and is only slightly above the 50 points growth line, pointing to a first-quarter slowdown of industrial expansion. In this context, Chinese GDP growth is estimated to be **7.4%** in the first quarter of 2014, down from **7.7%** in the last quarter of 2013.

Oil and fuel prices declined slightly to the prior year, with crude oil ending the first quarter **-2%** below the prior year, jet fuel prices **-4%** and bunker prices **-5%**. Though there has been a recent spike in oil prices amid recent violence in Iraq.

Share prices of freight forwarding and logistics are clearly outperforming the rest of the sector over the last twelve months, ending up **33%** above the prior year, followed by transport infrastructure (**+24%**), airlines (**+20%**), public transport (**+12%**) and shipping (**+10%**).

Share prices:

Freight forwarding and logistics **+33%**

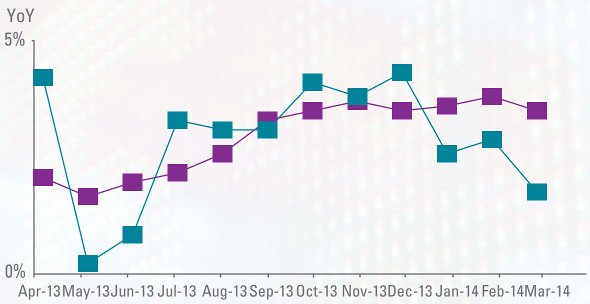
Transport infrastructure **+24%**

Airlines **+20%**

Public transport **+12%**

Shipping **+10%**

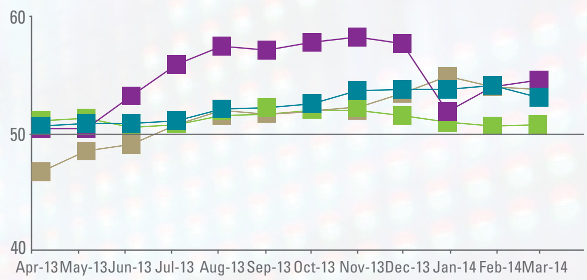
World trade and industrial production



- World Trade
- Industrial Production

Source: CPB Netherlands Bureau for Economic Policy Analysis

Global Purchasing Manager indices



- Global PMI
- Eurozone PMI
- USA PMI
- China PMI

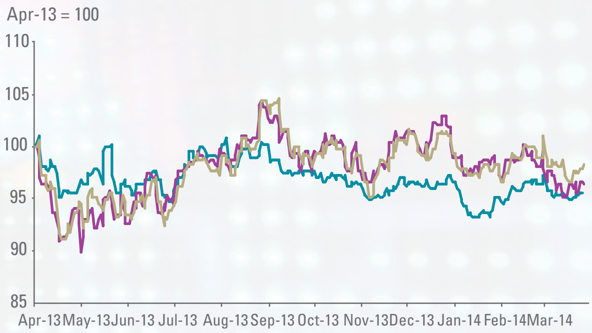
Note: Values above 50 indicate growth
Source: Institute for Supply Management (ISM), Markit, JP Morgan, China Federation of Logistics & Purchasing

Share prices of transport subsectors

- Freight Forwarding & Logistics
- Airlines
- Shipping
- Transport Infrastructure
- Public Transport (Rail & Bus)

Source: Bloomberg, KPMG Research

Fuel and oil prices



- Bloomberg 380 Centistoke Bunker Fuel Price
- Bloomberg Jet Fuel FOB ARA Spot Barges
- Brent Crude (ICE)

Source: Bloomberg, ICE (Intercontinental Exchange)

Shipping and Sea Freight

Even as demand firms, oversupply remains the dominant issue

As the global economy begins to show signs of a sustained recovery, international seaborne trade volumes continue to increase. Bulk cargo imports are up **3%** year on year with a broad spread across oil, gas and dry bulk. It is the developing markets of Asia, Africa and Latin America fuelling the growth. Container imports are up **5%** again with the strongest growth coming from Asia and Africa. Many expect the slow growth of the last two years to improve slightly. The container throughput chart here backs this up by hitting an all time high in March.

So if the demand for seaborne freight is well and truly on the mend, what has happened to rates? Sadly for ship owners the recovery of recent months has not been sustained. Tanker earnings were down over **20%** on the quarter and dry bulk almost **10%**. Only gas carriers were doing well as the US LPG exports increase and capacity in the segment was relatively constrained.

At least most segments are still back in the black at the operating cash flow level. However for those owners who were already struggling, this position may represent some respite but it will not repair damaged balance sheets without further improvement.

As insipid demand begins to firm across the world, the driver of freight rates is simply over supply in most sectors. The world continues to order and build too many new ships. Of course this has slowed somewhat – Clarksons indicates **16%** fall in global contracting and a **6%** fall in deliveries. However the tonnage of the global fleet still increased by over **1%**, assisted by a slowdown in scrapping.

Order books at the end of March 2014 stand at **21%** for dry bulk, **19.6%** for container ships, **12.3%** for crude oil and **15.2%** for oil product tanker, the last one showing a clear expansionary trend at the end of the first quarter 2014.

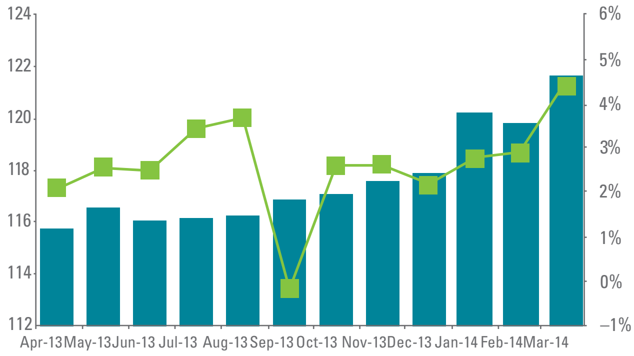
Low vessel prices, the lure of competitive advantage derived from bigger, more fuel efficient ships and the entrance of non-traditional financial investors to shipping together with a general loosening of the capital constraints may further boost supply in 2014 and beyond.

So, with another mini-surge in deliveries anticipated from 2016/17 and many operators already slow steaming, it will take some time for this rate of growth in demand to make inroads into the oversupply and provide sustained relief for embattled owners.

John Luke
Global Head of Shipping

Container throughput index

Index seasonally adjusted

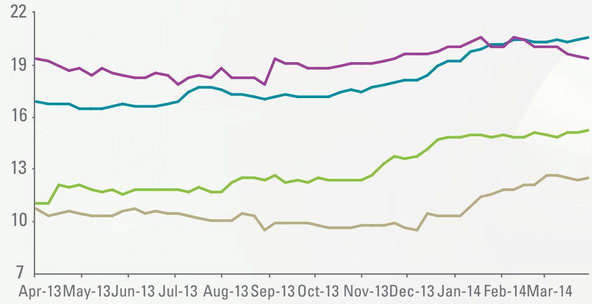


- Index seasonally adjusted
- YoY seasonally adjusted

Note: Based on flash estimates of 73 ports, 2008 = 100
Source: Institute of Shipping Economics and Logistics (ISL)

Order book in % existing capacity

% of existing DWT

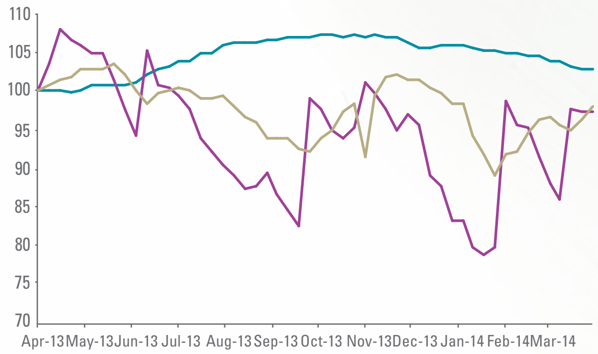


- Dry Bulk
- Crude Oil Tankers
- Containerships
- Oil Product Tankers

Source: Global Insight

Container freight and time charter rates

Apr-13 = 100

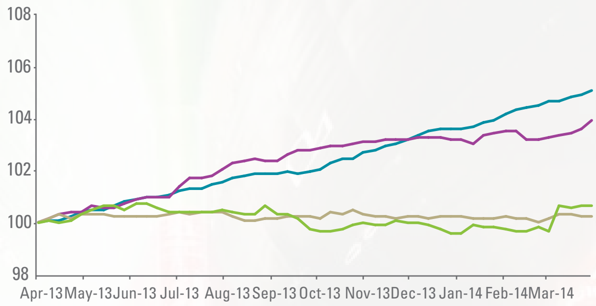


- Container Time Charter Index (New ConTex)
- Shanghai (Export) Containerized Freight Index (SCFI)
- China (Export) Containerized Freight Index (CCFI)

Source: Vereingung Hamburger Schiffsmakler und Schiffsagenten (VHSS), Shanghai Shipping Exchange

Total fleet capacity (DWT)

Apr-13 = 100

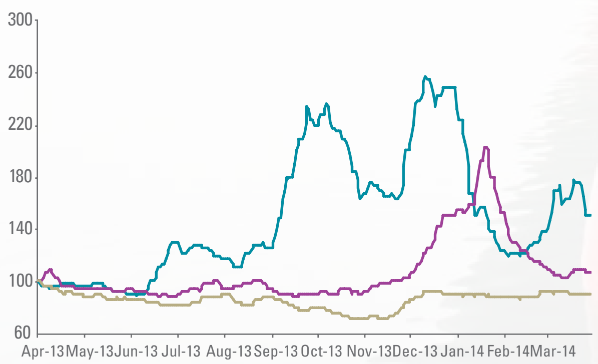


- Dry Bulk
- Crude Oil Tankers
- Containerships
- Oil Product Tankers

Source: Global Insight

Baltic shipping indices

Apr-13 = 100



- Baltic Dry Index
- Baltic Clean Tanker Index
- Baltic Dirty Tanker Index

Source: Baltic Exchange

Share prices of shipping subsectors

Apr-13 = 100

- General Shipping
- Container Shipping
- Dry Bulk Shipping
- Tankers

Source: Bloomberg, KPMG Research

Aviation

Storm turbulence

Economic clouds in China and an Arctic vortex in the USA impacted on what is already commonly a weak quarter in the airline industry.

IATA revised down their forecast for 2014 profits by US$0.7 billion (to US$18 billion) citing concerns about the Chinese economy, and the costs imposed by governments (tax, regulation, and air traffic inefficiencies), along with rising infrastructure costs.

Despite this, passenger traffic in the first quarter of 2014 increased **5.6%**, which still represents a slight improvement over the **5.2%** overall growth achieved in the same period in 2013.

Regionally airlines highlighted mixed fortunes:

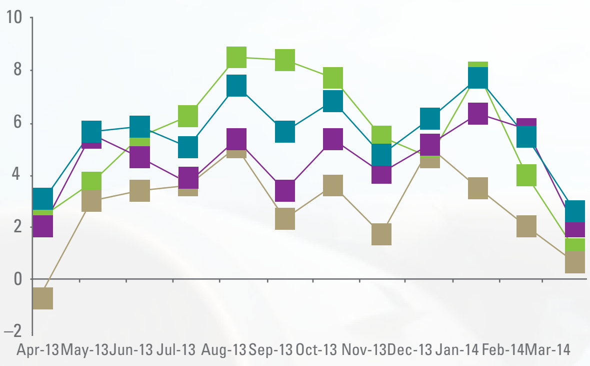
- Asia Pacific carriers suffered from a weakness of Chinese economy at the beginning of the year, with some of the larger carriers (including Singapore Airlines and Cathay Pacific) referring to lower yields in an attempt to fill capacity;
- In North America, severe weather had an impact on all major carriers, with Delta alone suffering 17,000 flight cancellations. United attributed **1.5** percentage points (of an overall **2** percentage point decrease) in unit revenues to the severe storms. However, American Airlines reported record Q1 profits (based on volume improvements and fuel driven unit cost decreases), as their re-launch gathers momentum, and Delta reported higher unit revenues and operating margins;
- European carriers had results distorted by the timing of Easter (a traditional point of holiday travel and travel booking), in what is commonly a weak quarter. IAG noted that the consolidation of Vueling amplified this issue (although we would expect this to drop out of next years comparisons); Lufthansa (LH) was impacted by strikes and adverse currency movements; and Air France-KLM suffered from enforced network changes caused by currency depreciation in Venezuela. However both IAG and LH reported benefits from restructuring. LCC's continue to operate in a very competitive market with high levels of capacity, and we expect to update on the LCC market in Q2.

A common theme globally is the continuing impact of unit cost containment in what remains a highly competitive market. The imperative to contain costs is illustrated by IATA's stark warning that forecast airline margins, at **2.4%**, represent only $6 per passenger.

Meanwhile, in a show of longer term optimism, the fleet order books of airlines remain at high levels at the end of the first quarter, with ratio of **36%** aircraft on order compared to aircraft in service. This represents high levels of longer term confidence. The ratio is significantly higher for low-cost carriers (**88%**) as compared to full service airlines (**41%**). The total aircraft order book increased by a further **0.4%** compared to prior quarter, again with a stronger expansion orders made by low cost carriers. This suggests that capacity is still expected to grow in the medium to long term.

James Stamp
Global Head of Aviation

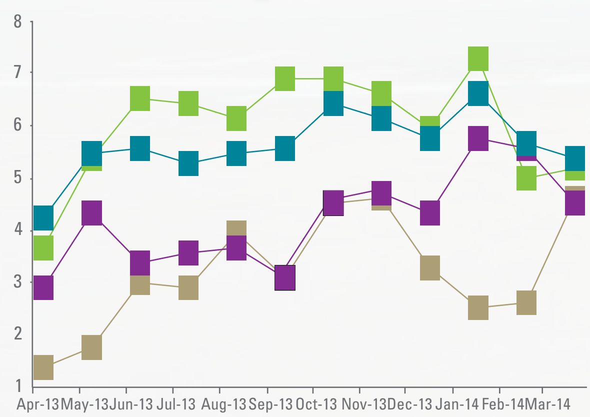
Passenger traffic growth (RPK)



- Global
- North America
- Europe
- ASPAC

Source: International Air Transport Association (IATA)

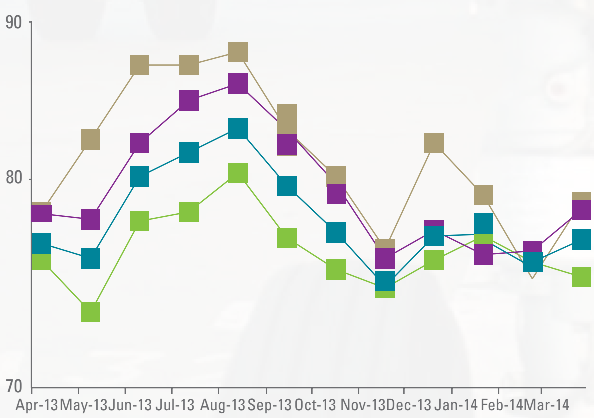
Passenger capacity growth (ASK)



- Global
- North America
- Europe
- ASPAC

Source: International Air Transport Association (IATA)

Passenger Load Factor



- Global
- North America
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Source: International Air Transport Association (IATA)

James Stamp
Global Head of Aviation

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The total aircraft order book increased by a further 0.4% compared to prior quarter, again with a stronger expansion orders made by low cost carriers.

Aviation (cont.)

Air freight remains tough

The air freight price index showed growth for the first time since October 2013, although the market remained soft.

Asia-Pacific carriers freight traffic grew by an average of **3.4%** in the first quarter of 2014 reflecting a rebound of business activity after the break for the New Year, however Cathay Pacific, a key regional player, noted that over capacity continues to put pressure on freight rates.

European airlines cargo traffic increased by an average of **5.5%** in the first quarter on growing business and manufacturing activity. However, Air France-KLM noted that cargo continues to be problematic, and announced a restructuring focused on their freighter fleet.

North American carriers freight traffic grew by **1.3%** in the first three months of 2014. UAL announced a first quarter revenue decline of **7.9%**.

James Stamp
Global Head of Aviation

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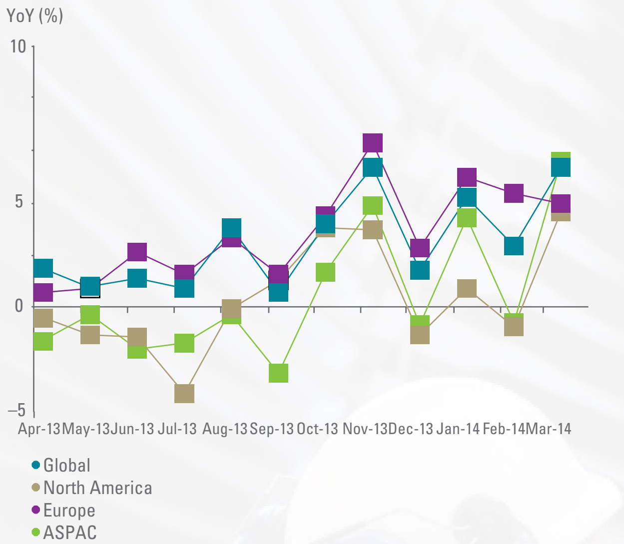
European airlines cargo traffic increased by an average of 5.5% in the first quarter on growing business and manufacturing activity.

Freight traffic growth (FTK)

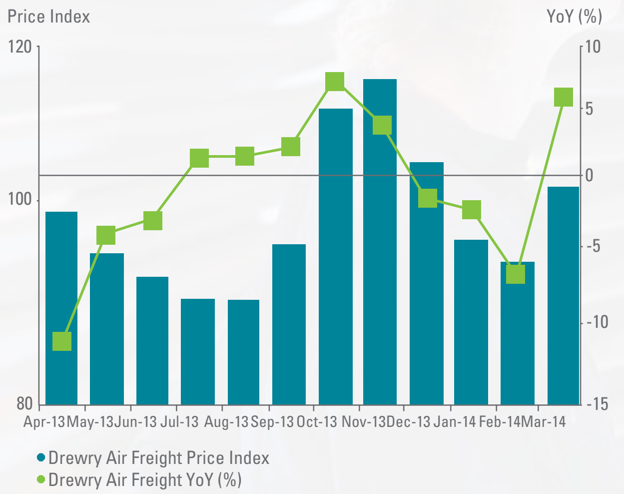


Source: International Air Transport Association (IATA)

Airlines share prices by business model

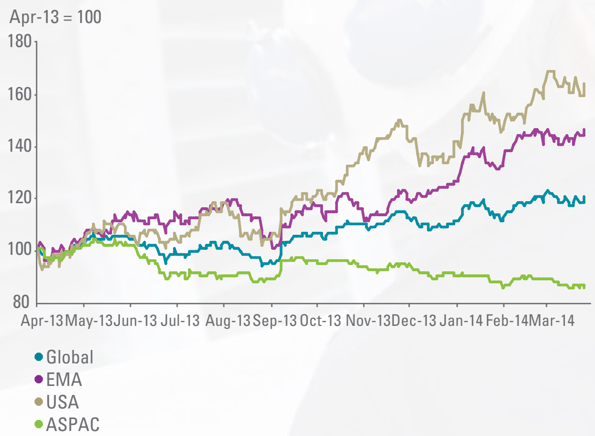
Source: Bloomberg, KPMG Research

Air freight price index



Source: Drewry

Airlines share price by region



Source: Bloomberg, KPMG Research

Parcel and Express Logistics

B2C e-commerce driving parcel deliveries

For a number of years, global express companies focused on high volume international parcel business targeting primarily B2B customers. This trend has changed drastically with the rise of B2C e-commerce. Global online retail sales have increased by a CAGR of **17%** 2007, according to Euromonitor and will further increase by **20%** in 2014 to reach US$1.5 trillion according to eMarketer.

Expanding online and mobile user bases in emerging markets, increases in m-commerce sales and new logistics solutions are expected to be the main driver of this trend. Currently, only around **8%** of European consumers have bought products by mobile phone but that is set to rise according to Forrester. Asia will be the strongest growing region to 2017, making it the largest regional market.

Online grocery offers major opportunities

Online grocery sales could be another big opportunity for logistics companies with a global market potential of US$100 billion by 2018. Online grocery sales will pass the €9bn mark in the UK by 2016 according to Forrester, making this by far the biggest market for online groceries in Europe. Growth is also expected to be strong in other European markets, as retailers in other countries try to adapt similar solutions to those currently found in the UK.

Securing a reliable and cost-efficient supply chain will be the main challenge for retailers and logistics companies that try to operate in this growing but challenging market. The challenge for logistics companies is developing operating models in this new multi-channel world (click-and-collect, home deliver, drop boxes etc.) to achieve profitable growth.

Same-day, crowd-logistics: new solutions to meet rising demand amid high cost pressure

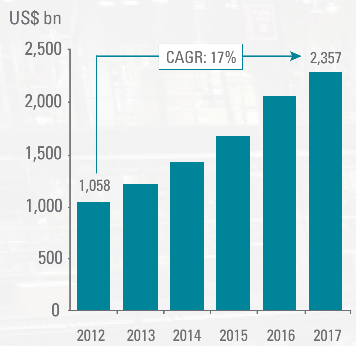
Competition for the B2C delivery market is blurring the lines between traditional retailers, online solution providers and traditional logistics companies. New services and alternative delivery options have evolved over the past few years. However, consumers are often not willing to pay delivery fees necessary to cover the last-mile cost in some regions, thus exerting cost pressure on retailers and delivery companies trying to defend market share and retain the satisfaction of online shoppers.

Competition between online retailers and logistics companies for the e-commerce delivery market is continually increasing. And it is not exclusive to traditional logistics companies: Google, Amazon, eBay, and Shutl are all testing e-commerce delivery concepts based around providing a marketplace for consumers, retailers and asset providers.

Same-day delivery is increasingly moving up the agenda despite high costs and capital demand to build regional networks. Amazon's planned roll out of its own private fleet of trucks to make more same-day deliveries could potentially threaten the growth of logistics companies if online retailers are re-insourcing their package deliveries.

Justin Zatouroff
Global Head of Logistics & Post

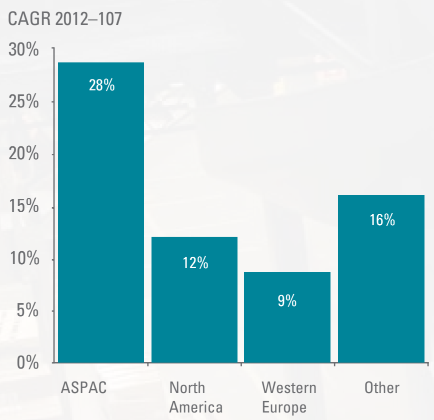
Global B2C e-commerce revenue forecast



Source: eMarketer

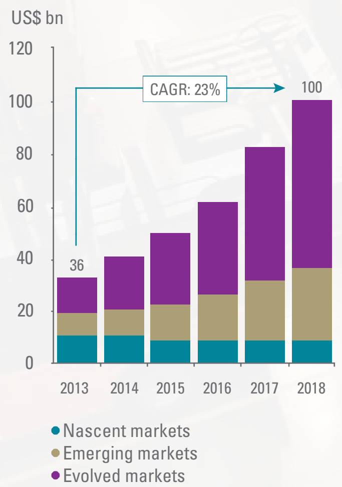
e-commerce sales growth by region

e-commerce sales growth by region



Source: eMarketer

Online grocery market revenue forecast



Source: Boston Consulting Group

Parcel and Express Logistics (cont.)

The convergence of retailing and logistics is also pushed forward by transport companies expanding into e-commerce retailing through acquisitions and vice versa. In this context, Deutsche Post recently acquired a majority stake in allyouneed.com, a German online shop which is DHL's first acquisition in an online platform directly linked to e-commerce. Conversely Alibaba has recently announced a significant investment in Singapore Post, and the two groups are also discussing a joint venture for international e-commerce logistics.

Latest market signs show ongoing growth

The start of 2014 showed further signs of robust parcel delivery growth with average express and courier revenues of major integrators growing by **3.2%** in Q1 2014 and average daily package volumes by **3.9%** compared to the prior year.

Latest consumer sentiment indicators show rising confidence in Europe and North America, supported by an ongoing economic recovery in both markets. While stronger consumer confidence is supporting B2C growth, growing manufacturing PMIs (see Market Fundamentals section) are expected to also lead to rising B2B volumes.

Consumer confidence in the emerging markets of China and Brazil is rather stagnant. However, China is showing clear signs of acceleration at the beginning of 2014 and continues to grow ahead of global averages.

Regional picture is varied

Share prices of European parcel and express logistics companies have shown strong performance over the last twelve months, backed by rising consumer and business confidence and a gradual economic recovery.

A number of postal operators have successfully listed reflecting the opportunity in the e-commerce and logistics market in the face of declining letter volumes for example, Royal Mail Group in the UK, Correios de Portugal (CTT) and the joint venture between investment firm LDC and Netherlands' Post NL.

North American integrators share prices declined in Q1 2014, partly due to the harsh winter and the following disruptions in transport and logistics networks at the beginning of the year.

Asian share prices of parcel and express companies accelerated sharply at the beginning of 2014, recovering the rather sluggish performance over the previous nine months.

Justin Zatouroff
Global Head of Logistics & Post

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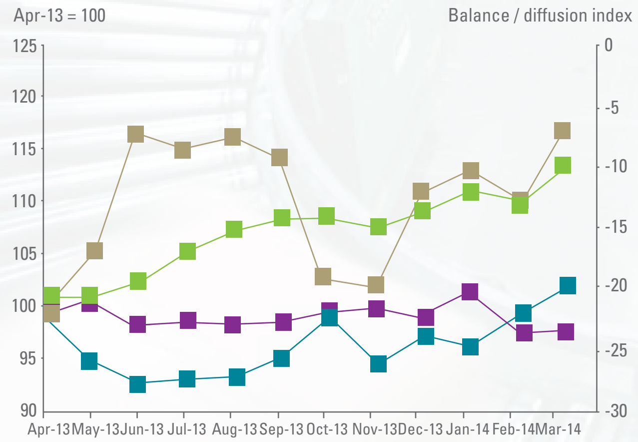
The convergence of retailing and logistics is also pushed forward by transport companies expanding into e-commerce retailing through acquisitions and vice versa.

Quarterly express delivery revenues and volumes

- CEP Revenue (in US$ mn)
- Average Daily Package Volume (000s)

Note: Based on quarterly company filing of UPS, FedEx and TNT Express
Source: KPMG Research, Bloomberg

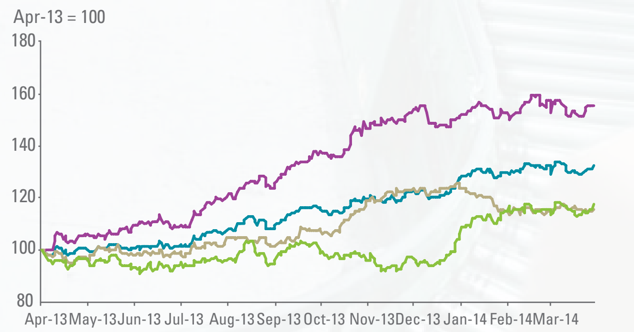
Consumer confidence indices in major express markets



- China
- Brazil
- USA
- EU 27 (rhs)

Source: National Bureau of Statistics of China, CNI (Confederacao Nacional das Industrias, Conference Board, European Commission)

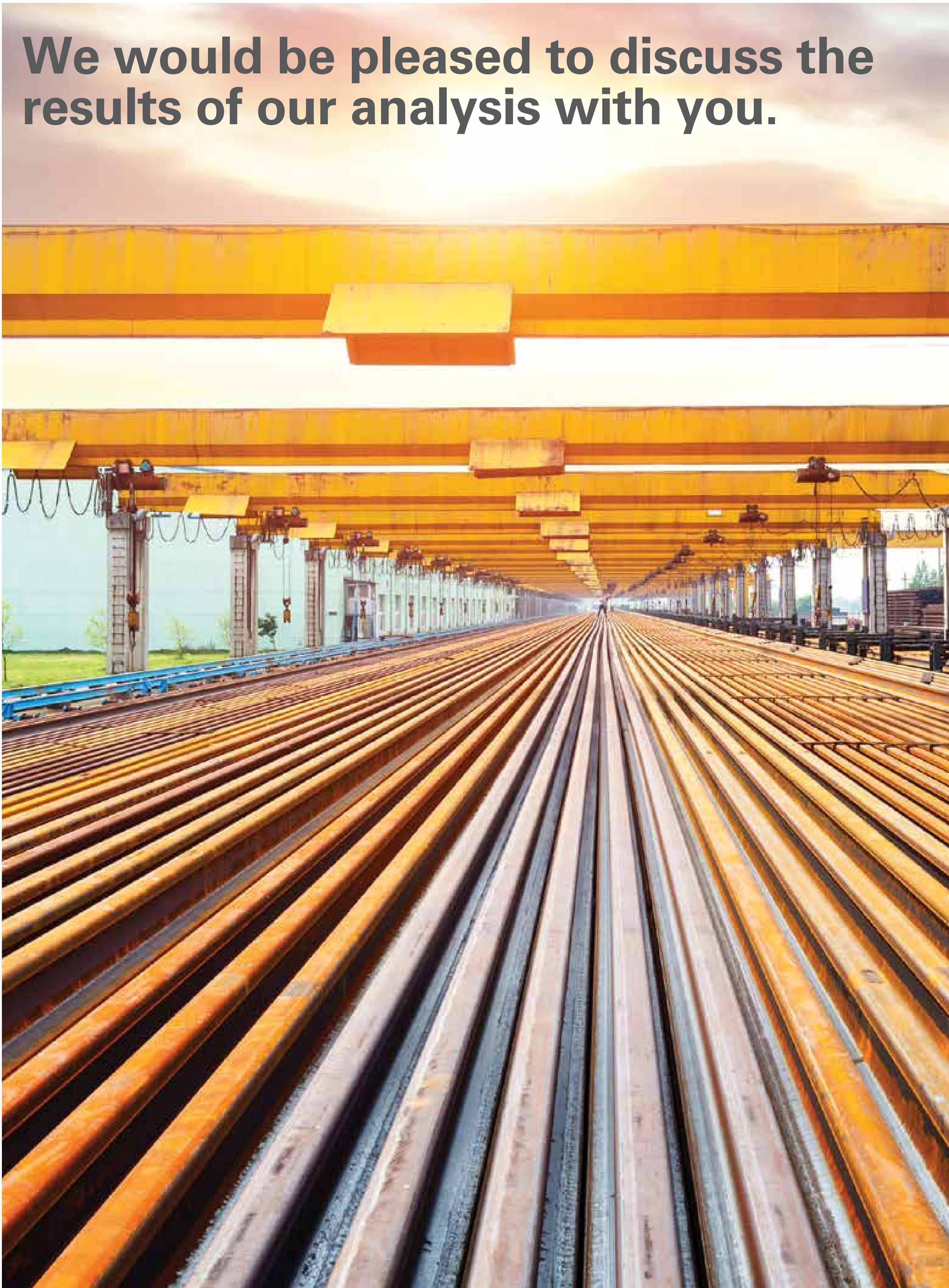
Parcel and express companies share prices by region



- Global
- EMA
- USA
- ASPAC

Source: Bloomberg, KPMG Research

We would be pleased to discuss the results of our analysis with you.

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