KPMG

cutting through complexity

KPMG Transport Tracker

Global transport market trends and views

March/April 2015

kpmg.com

Contents

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

Market fundamentals

Falling oil prices on the economy and transport sector: is less always more?

Average world trade growth in 2014 was 3.3 percent according to the CPB index. A downward trend of the growth rates is visible towards the end of the year, in line with declining global Purchase Manager Indices ('PMIs') which point to slowing economic growth over the last months of the year. At the same time, the PMIs were above the 50 growth line in all regions for all months albeit at a narrow margin especially in China and the Eurozone where economic worries are clearly visible. The USA showed the strongest economic performance.

The International Monetary Fund ('IMF') now forecasts global GDP to grow by 3.5 percent in 2015 and 3.7 percent in 2016, revised down by 0.3 percent for both years. For the US, the IMF has adjusted the forecast significantly upwards to 3.6 percent, due to stronger private domestic demand. The Eurozone forecast has been revised down to 1.2 percent, while GDP growth in China has been marked down to below 7 percent[1].

Fuel and oil prices ended the year down 45 – 50 percent, largely driven by supply factors. While the impact on private consumption and the overall economy varies strongly by region (and its positive effect is also partly offset by the appreciation of the US Dollar), lower oil prices generally mean lower costs for transport companies and thus are often simply interpreted as a positive sign for the sector. However, significant volatility in oil prices (particularly the step-changes experienced towards the end of the year) lead to a pressure on freight rates and ticket prices as transport customers (passengers or shippers) push for a pass-through of those very visible savings. In addition, margin calls on out-of-the-money hedges can impact companies with weaker credit ratings/balance sheets.

In shipping, lower bunker prices have lead to question faster steaming, delayed decommissioning or even re-commissioning of older, less fuel-efficient vessels, which could ultimately offset the positive effect of the oil price decline. An oil price contago leads to increased floating storage of oil in tankers, soaking up supply and improving earnings. In the aviation sector, where airlines may be expected to be the biggest winners among all transport modes given the high ratio of fuel costs to total operating costs, we find that the impact of competition from carriers (who otherwise may have been reducing unviable capacity); hedging; and customer expectations of reduced ticket prices (whether implicit, or explicit via lower fuel surcharges) mean that less is not necessarily more.

In addition, volatility in the fuel price adds a further dimension of complexity to transport companies operations such as in capacity planning and fleet mix, network and route management, modal shifts and pricing. These factors, combined with remaining overcapacity in many transport sub-sectors, continued global economic uncertainty, and significant geo-political impacts on oil prices (which have, in recent times, dominated the longer-term upward demand led trend experienced over the last decade) mean that businesses will continue to require flexibility in their business models in order to adapt.

Share prices (end of 2014 YOY):

Freight forwarding and logistics **9%**

Transport infrastructure **5%**

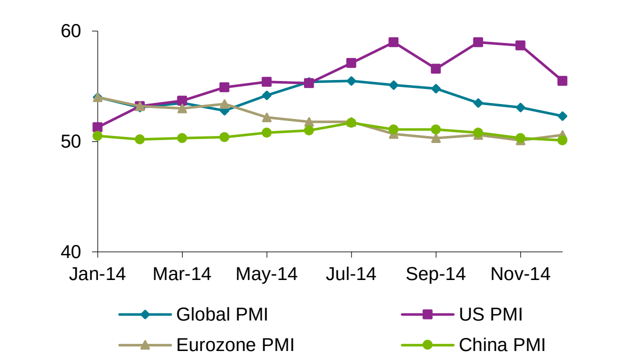
Airlines **41%**

Public transport **7%**

Shipping **-15%**

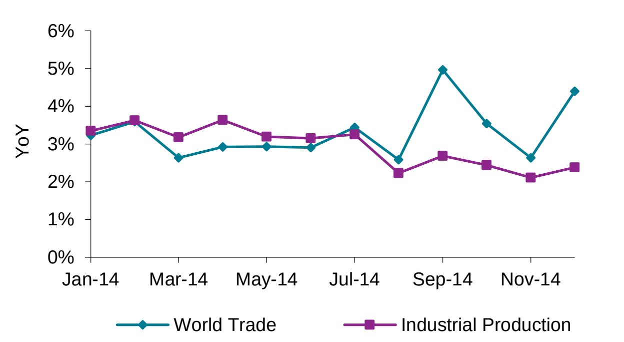
1. http://www.imf.org/external/pubs/ft/survey/so/2015/NEW012015A.htm

Global Purchasing Manager Indices (PMI)



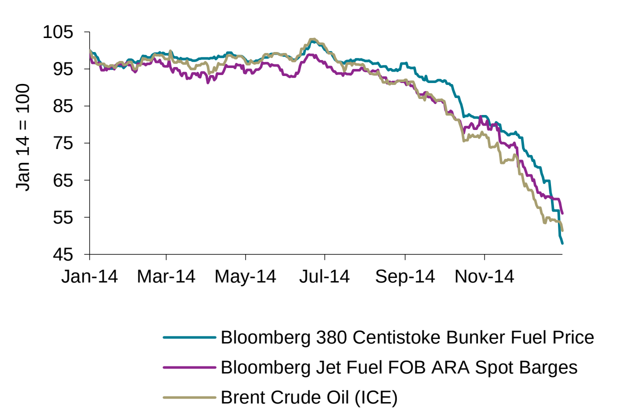
Note: Values above 50 indicate growth
Source: Institute for Supply Management (ISM), Markit, JP Morgan, China Federation of Logistics & Purchasing

World trade and industrial production



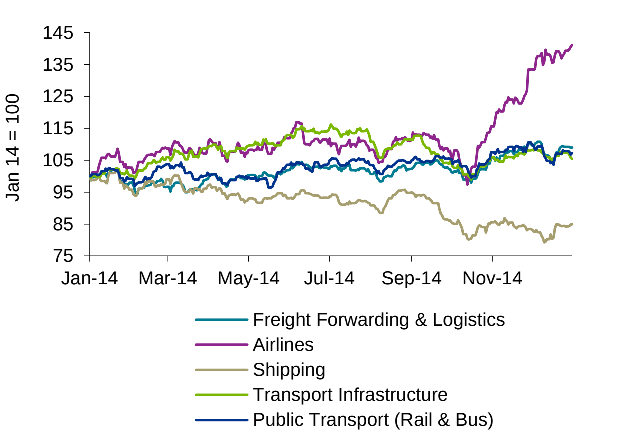
Source: CPB Netherlands Bureau for Economic Policy Analysis

Fuel and oil prices



Source: Bloomberg, ICE (Intercontinental Exchange)

Share prices of transport subsectors



Source: Bloomberg, KPMG Research

Shipping and sea freight

Facing reality

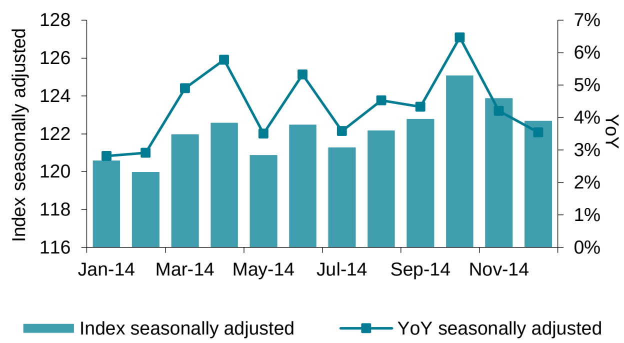
Supply growth again outpaced demand in most shipping segments in 2014 as economic growth and world trade remained comparatively sluggish. World trade growth was 3.4 percent in 2014 while the containership and bulk carrier fleet expanded by 5-6 percent according to Clarkson. ISL's Container Throughput Index increased by an average of 4.3 percent year-on-year.

On the positive side, the orderbook remained rather flat for all shipping segments and is highest for dry bulk vessels (22 percent). For containerships, the orderbook at the end of 2014 was the lowest it had been in 15 years according to Alphaliner (17 percent of the existing containership fleet). And yet, capacity expansion will still be significant in 2015, with the container ship fleet expected to expand by as much as 7.8 percent, particularly at the larger end.

Freight and charter rates again failed to recover to sustainable levels. Container time charter rates increased by 3.6 percent on historically low earnings for vessel owners while freight rates declined by 5 percent. The crude oil tanker fleet increased by 1.4 percent and freight rates declined by 13.5 percent, while the total fleet capacity of oil product tankers dropped by 7 percent causing the clean tanker rates to rise by 28 percent. The Baltic Dry Index ended up 65 percent below the prior year. Share prices remained depressed as well with general shipping stocks ending 15 percent below the prior year (dry bulk stocks performed worst, down 44 percent year-on-year).

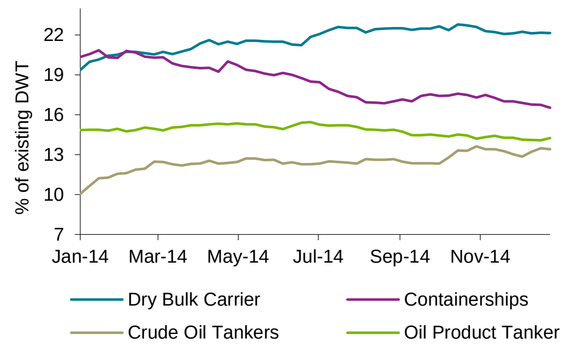
Falling oil prices provided some relief on the cost base of shipping companies, but could potentially cause a revision of the common strategy of slow steaming. In a type of prisoner dilemma, the first shipping company to substantially increase steaming speed could eventually cause a broader trend in the market that would intensify cascading effects and fuel consumption.

Container Throughput Index



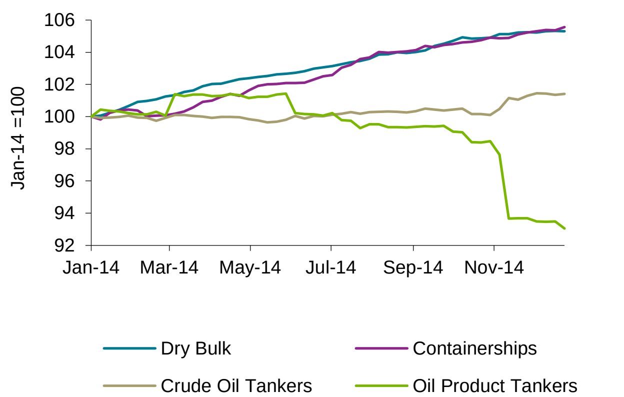
Note: Based on flash estimates of 73 ports, 2008 = 100
Source: Institute of Shipping Economics and Logistics (ISL)

Orderbook in % of capacity



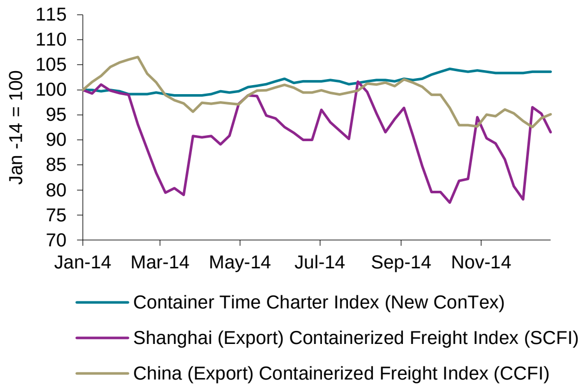
Source: Global Insight

Total fleet capacity (DWT)



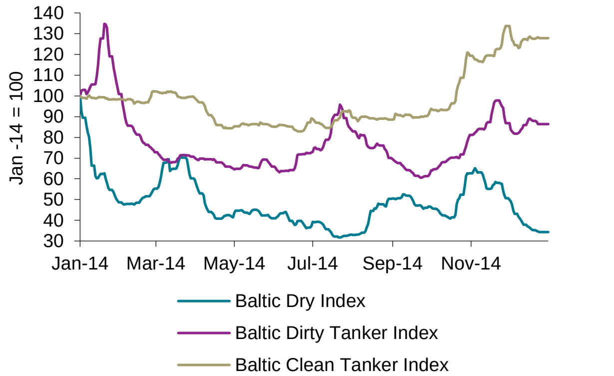
Source: Global Insight

Container freight and time charter rates



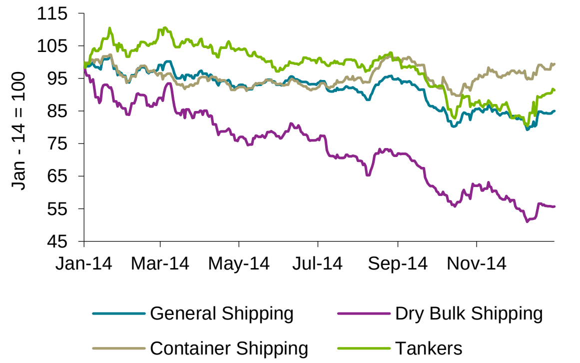
Source: Vereingung Hamburger Schiffsmakler und Schiffsagenten (VHSS), Shanghai Shipping Exchange

Baltic shipping indices



Source: Baltic Exchange

Share prices of shipping subsectors



Source: Bloomberg, KPMG Research

Shipping and sea freight (cont.)

Outlook

Whilst there will be individual segment bright spots and occasional peaky rate volatility, persisting structural imbalances in shipping supply and demand as well as economic headwinds will make a sustainable recovery in 2015 unlikely for the sector as a whole. Trends such as re- and near-shoring of production and increasing intra-regional trades, especially within Asia, have already lead to a new consensus estimate of future shipping demand in the mid-single digit range.

The recovery has been consistently postponed in each of the years after the financial crisis. Although the situation on the supply side has to a certain extent improved in more recent years, there is a new reality of sluggish and volatile demand growth which will again delay the recovery (for this year at least). The numbers back this up:

- Dry bulk shipping can be expected to be negatively affected by slowing economic growth in China this year (with Chinese demand for iron ore being the biggest driver of dry bulk volume growth). BIMCO expects demand growth to slow to 4-5 percent in 2015. We are seeing examples of dry bulkers being converted to tankers and previous orders switching out of the dry bulk sector.
- For container liners, growth of the container ship fleet (7-8 percent) is expected to outpace world trade (3.5 percent) and container demand growth (5.5 percent) this year, hence excess capacity will again last through 2015. The major lines are growing their mega-carrier capacity and smaller tonnage cascades from the mainlanes to other trades. But there may still be brighter spots for investors in smaller tonnage where oversupply is not so prevalent.
- World oil demand is expected to increase by 1.2 percent in 2015, leading to a 3-4 percent growth in tanker demand. Combined with an increase in tonne miles and demand for floating storage, this could outpace supply growth and is already driving an increase in tanker rates. As we write VLCCs are earning more than US$ 50,000 per day for storage against breakeven of around US$ 15,000.

John Luke
Global Head of Shipping

John Luke
Global Head of Shipping

> **"Trends such as re- and near-shoring of production and increasing intra-regional trades, have lead to a new consensus estimate of future shipping demand"**

Aviation

Unit cost and capacity discipline delivers results

In the year of 2014 passenger traffic demand (RPKs) increased 5.9 percent compared to 2013 according to IATA numbers. All regions saw healthy demand growth in 2014, although traffic in the Middle East again outpaced the rest of the world (traffic growth was 13.0 percent for Middle East carries, compared to 5.8 percent of Asia Pacific, 5.7 percent of European and 3.1 percent of North America carriers).

Global capacity rose by a slightly lower 5.6 percent, resulting in load factors climbing to 79.7 percent. Capacity in North America increased by 4.6 percent, dropping load factor slightly to 81.7 percent (which is, however, still the highest among all regions). Middle East airlines were also leading capacity expansion, increasing ASKs by 11.9 percent in 2014. This astonishing growth in capacity was actually below traffic growth, pushing up load factors to 78.1 percent.

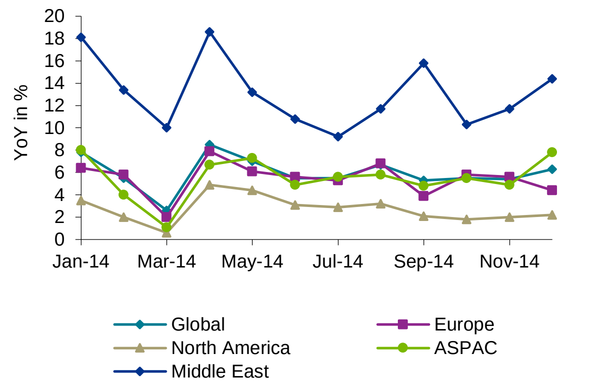
Increases in share prices across all regions were apparent particularly towards the end of the year. Global airlines share prices outperformed all other transport sector peer groups and ended up 41 percent above the prior year. On the financial side, results of certain key global legacy carriers showed the reason for this optimism, as a better economy and continued close attention to controllable unit-costs led to some notable results:

- → Qantas announced H1 (to 31 December 2014) underlying PBIT of A$ 367mn, compared to a loss of A$ 252mn in the same period of the prior year, citing over A$ 374mn of transformation program benefits (driving a 4.8% improvement in CASK);
- → IAG reported revenues of EUR 20.2bn for the year, up 8 percent and operating profit before exceptional items of EUR 1.4bn, up 81 percent on 2013;
- → Delta Airlines' pre-tax income, excluding special items, was US$ 4.5bn in 2014, an increase of 70 percent over 2013; and
- → China Southern Airlines revenue of US$ 17.7bn was up 10 percent and operating profit of US$ 772mn was up 214 percent in 2014.

However, set against this, the imperative for change and reform of cost base meant that strike costs again featured heavily in the 2014 results announcements:

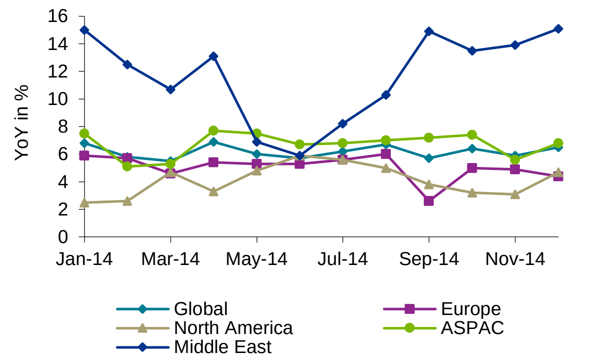
- → Air France-KLM reported 2014 total revenues of EUR 24.9bn, down 2.4 percent on 2013 but stable like-for-like. Activity was affected by a fourteen-day pilot strike, which had an estimated negative impact of EUR 425mn on the operating result. EBITDA was down 14 percent but up 9 percent excluding strike effects.
- → Lufthansa reported a net income of EUR 55mn (down 82% from 2013), which was impacted by EUR 232mn due to 15 days of strike action, and offset EUR 385mn of fuel price gains.

Passenger traffic growth (RPK)



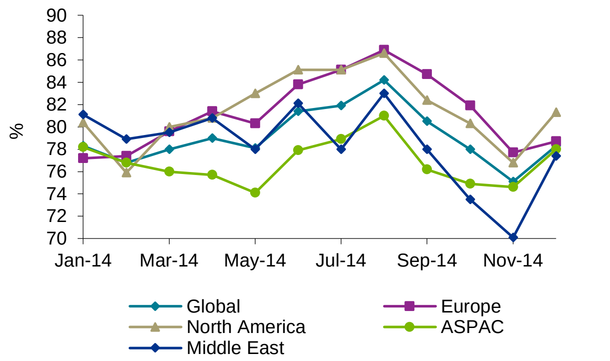
Source: International Air Transport Association (IATA)

Passenger capacity growth (ASK)



Source: International Air Transport Association (IATA)

Passenger load factor



Source: International Air Transport Association (IATA) Source

Aviation (cont.)

Lower oil costs – surely a good thing?

Because fuel costs are the largest operating cost of most airlines (with industry averages of about one third of total costs represented by fuel), then surely lower prices must always be good news? IATA forecasts the highest profit margins in more than five years for airlines in 2015. But things are not quite that simple. For a start, sharp changes in oil price require airlines to review current hedging and pricing strategies compared to their competitors. Un-hedged airlines may either have not hedged out of choice (and can claim stellar judgment), or by virtue of not being able to post collateral.

Both may be at a significant competitive advantage to their peers. Both are, arguably, not equally good. In addition, investors must also try and see through the significant distortion to reported (compared to "normalized") results, and understand the impact of increased restricted cash postings to hedge counterparties. To give a sense of the scale of the impact, Delta announced the following for Q4 2014:

- → The impact of mark-to-market adjustments on fuel hedges (on contracts with maturity dates outside the quarter) added US$ 2bn to reported pre-tax costs. On an adjusted basis, the cost per gallon decreases by 39% from US$ 4.70 to US$ 2.87/gallon[2];
- → Results for Q4 include US$ 180mn of settled hedge losses, however Delta still expected US$ 2bn of fuel price savings in 2015 (net of hedges) at current prices[3];
- → From a restricted cash perspective, cash postings to hedge counterparties had increased to US$ 925mn (US$ nil as at 31 December 2013).

Disclosure of this high level of clarity is not universal, and this makes comparison of performance challenging. From a passenger perspective, it remains to be seen if airlines reduce fuel surcharges and pass on the benefit of lower fuel to passenger. On this topic:

- → Delta's CEO noted in response to analyst questions that the "…first order of use [for a fuel windfall] is going to continue to reduce our net debt. And the second order of use is going to be higher cash returns for our owners"[4];
- → Qantas stated[5] that it will restructure its international tariffs so that fuel surcharges are absorbed into base fares, but that "overall fares will not change", noting that while global fuel prices have fallen, and that international air-fares are significantly lower than when surcharges were first introduced 10 years ago.

Overall, IATA note that they estimate net profit per passenger to increase by US$ 1 (to US$ 7) in 2015 after factoring in fuel price benefits. In this context, it seems likely that airlines will take the chance to invest in new fleet, routes, customer experience, and balance sheet strengthening in order to make themselves viable over the longer term, rather than engaging in price cutting. However (and somewhat perversely), lower fuel prices may be positive for airlines that may otherwise have struggled as a result of weaker balance sheets and/or older fleet. As such, the relief on the cost base caused by falling fuel prices might ultimately postpone further – inevitable – s consolidation of the aviation industry through mergers, divestments, and failures; and allow lower-priced capacity that might otherwise have been withdrawn to continue in the medium term.

But, longer term, this will not sustainably improve the competitive position of sub-scale legacy carriers especially with regards to the persistent comparable cost disadvantages to low cost carriers, gulf airlines, and those with mega-carriers scale.

2. Calculated based on consolidated Group results. Mainline only results show an average adjusted fuel price for the quarter of $2.62.
3. At the date of the Q4 earnings release
4. CEO comments as recorded in the Q4 2014 Earnings Call transcript, 20 Jan 2015.
5. Qantas press release, 26th January 2015

James Stamp
Global Head of Aviation

> “Sharp changes in oil price require airlines to review current hedging and pricing strategies”

Aviation (cont.)

Fuel prices and port congestion providing tailwind for air freight volumes

Air freight markets continued to recover in 2014, with air cargo traffic demand (FTKs) up 4.5 percent compared to 2013. Growth was noticeable in all regions except Latin America but strongest in the Middle East (11 percent) and ASPAC (5.4 percent). Overall, the ASPAC and Middle East regions contributed to 46 percent and 29 percent of the expansion in air cargo traffic. North American airlines increased cargo traffic by 2.4 percent while Europe still recorded a plus of 2 percent on the back of a slow and fragile market recovery.

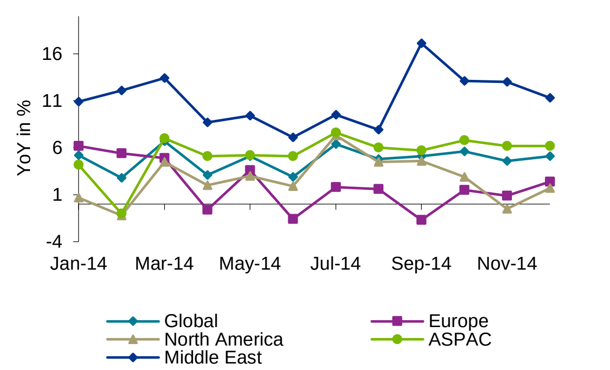
Issues with port congestion at US container ports provided some tailwind for the growth of air freight volumes at the end of 2014 and the market is expected to return to solid growth rates in the near future. Global air freight demand is expected to grow by 4.5 percent in 2015 and by a CAGR of 4.1 percent over the next five years according to IATA. The latest Stiefel Logistics Confidence Index (February 2015) reports decelerating, but still positive growth in air freight markets and a favourable six-month outlook for all lanes.

Yet, overall yields remain depressed. The average growth of Drewry's air freight price index in the twelve months of 2014 was 2.8 percent but did decline by 2 percent in the last month of the year, clearly showing that the market recovery is still shaky and imbalances on demand and capacities remain. In addition, the decline in jet-fuel prices will eventually be passed on in the form of lower fuel surcharges from airlines.

New alliances and joint ventures may evolve as a new trend for air cargo carriers to capture global opportunities in a challenging market. In this regard, German Lufthansa Cargo (LHC) and Japan-based ANA Cargo announced the first worldwide cargo joint venture in December 2014 to deepen bilateral relationship.

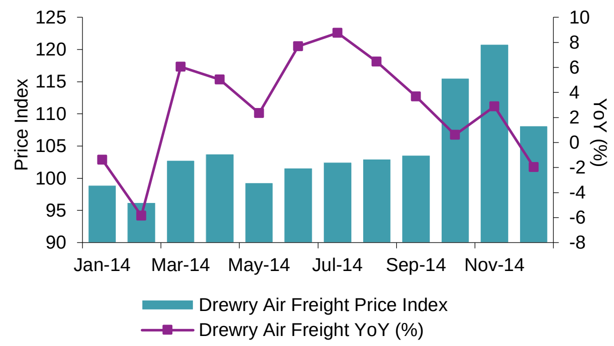
James Stamp
Global Head of Aviation

Freight traffic growth (FTK)



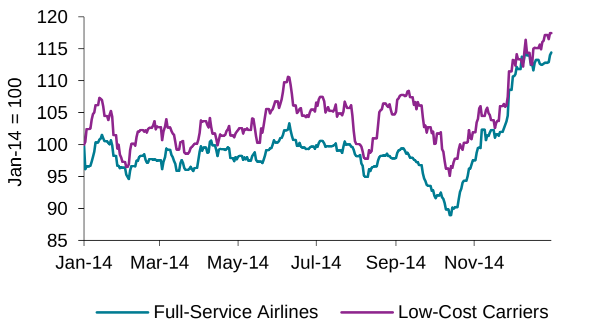
Source: International Air Transport Association (IATA)

Air freight price index



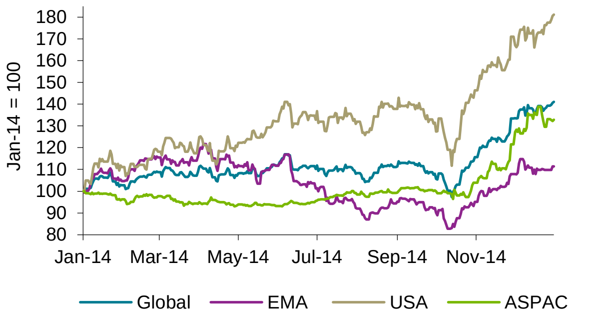
Source: Drewry

Share prices by business model



Source: Bloomberg, KPMG Research

Share prices by region



Source: Bloomberg, KPMG Research

Express logistics

Record peak season in online shopping brings joy and pain for global express logistics

As ever-growing e-commerce is causing record peak seasons for express logistics companies over the Christmas period in almost all major (western) markets, the task of delivering all those packages becomes more challenging. In fact, the last quarter of 2014 has shown that the peak season is not only getting higher, it is also getting shorter and the problems it causes for logistics companies is getting even bigger. Just a few record numbers to highlight this trend:

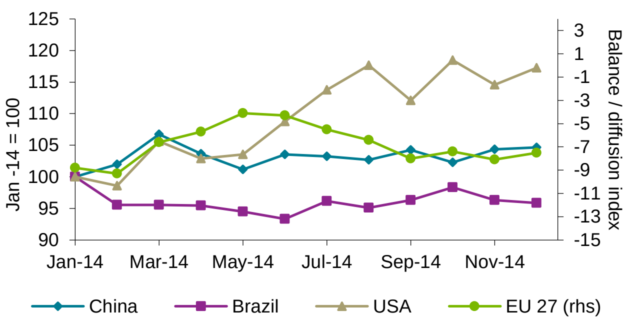
Record numbers during the last Christmas peak season[6]

- For its members, International Post Corporation's monitoring systems show an increase in volumes of 15 percent for the month of December as compared to the prior year;
- German online sales grew by 15 percent year-on-year over the 2014 Christmas season to reach revenues of EUR 10bn;
- The French e-commerce market grew by 13 percent over the Christmas period, with e-commerce revenues reaching over EUR 11 billion;
- E-retail delivery volumes in the UK showed a year-on-year growth of 11.6 percent growth in December 2014;
- In the United States, USPS exceeded its holiday delivery projections this season, delivering 18 percent more packages than in 2013. UPS delivered 1.3bn packages during the fourth quarter, an increase of 8.1 percent over the same period last year;
- In Singapore, SingPost has seen revenue and profits growing by more than 7 percent in its latest quarter. The company said the 'steady' growth was driven by its logistics operations and e-commerce-related businesses, which offset the decline in traditional mail revenue.

And yet, these record numbers are not pure joy for everybody. In fact, a number of logistics companies are struggling to cope with the peak volumes. In its latest quarterly results, UPS' US domestic business, operating profit fell by 5.3 percent year-on-year, driven-down by higher costs 'primarily due to higher than anticipated peak related costs'. This clearly shows that logistics companies continue to struggle to balance fixed and variable capacity and have to rely on additional workers and subcontracted transport providers to cope with peak Christmas demand, which of course is costly. Transport Intelligence states that 'these sorts of results reflects the fact that logistics costs in e-commerce home delivery are high and that a market which is frequently based on the concept of 'free delivery' is probably not sustainable in the long-run'[7].

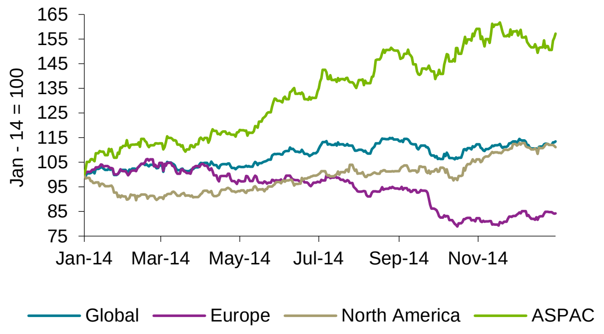
6. Numbers sourced from the International Post Corporation's Markt Flash, http://www.ipc.be/
7. http://www.transportintelligence.com/briefs/ups-seeks-to-cope-with-high-demand-with-home-delivery-surcharges/3066/

Consumer confidence indices



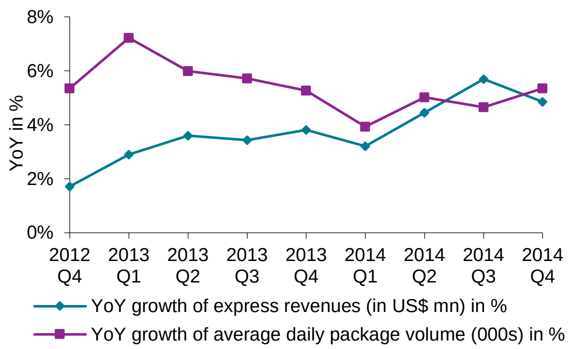
Source: National Bureau of Statistics of China, CNI (Confederacao Nacional das Industrias, Conference Board, European Commission)

Express logistics share prices



Source: Bloomberg, KPMG Research

Quarterly express delivery revenues and volumes



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

Express logistics (cont.)

At the same time, a clear trend on how to deal logistically with the record package volumes in a profitable, sustainable and customer pleasing way is still missing. UPS went ahead announcing it will impose peak season surcharges and tighten up on costs in the USA this year after its excessive spending on additional capacity. While others may follow this example, it will not solve the much bigger underlying problem:

Record volume of packages means record volume of data – but what to do with it?

One main issue with the peaks in parcel deliveries is its current unpredictability. Aside from Christmas and Black Friday, e-retailers are nowadays able to create a peak within 24 hours which makes capacity planning impossible for logistics companies. While later cut-offs, pick-up and multichannel services are first solutions, they are equally increasing the operating model's complexity for logistics companies. There is still an overarching requirement to increase current capacity utilization in express logistics on a day to day basis, while meeting higher and shorter peak demand.

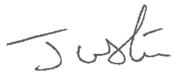
There is one main asset that express logistics are currently not yet exploiting to its full potential and this is the amount of data that comes with all those record volumes of packages. While methodologies in data & analytics are progressing on a fast track, logistics companies have not yet figured out what to do with the data they are collecting. In addition, data & analytic tools are currently predominantly used to analyze historic patterns, but there is no best practice yet to use the data for predictive shipping and capacity planning. Besides getting more sophisticated with data and tools, there is currently little stakeholder collaboration in data sharing and understanding of value and incorporating it into pricing and negotiations between retailers and logistics companies.

Next to data & analytics, further collaboration (within the transport sector as well as between different sectors) will be a way to better deal with unexpected peak seasons and capacity constraints in the future. There is a clear need for logistics companies to shake off the sector focused view and collaborate not only with subcontracted transport companies but also with e-retailers, IT companies and telecommunication service providers in order to optimize route and capacity planning.

Crowdsourcing in logistics showcases solutions on a micro level

While established logistics companies are still trying to figure out the best way to establish collaboration among their peers and e-retailers to ensure proper last mile delivery solutions, IT start-ups are leading the example on how this can be done on a micro-level via crowdsourcing.

Uber, which is seen as having disrupted taxi businesses around the world, is now eyeing the delivery sector with a new UberCargo service in Hong Kong. The new service is using private persons as drivers in the same way as with its existing taxi services for the delivery of packets and parcels.



Justin Zatouroff
Global Head of Post and Express

Justin Zatouroff
Global Head of Post & Express

“Next to data & analytics, further collaboration will be a way to better deal with unexpected peak seasons and capacity constraints in the future”

M&A review

M&A activities to remain high with changing patterns clearly visible

General Overview

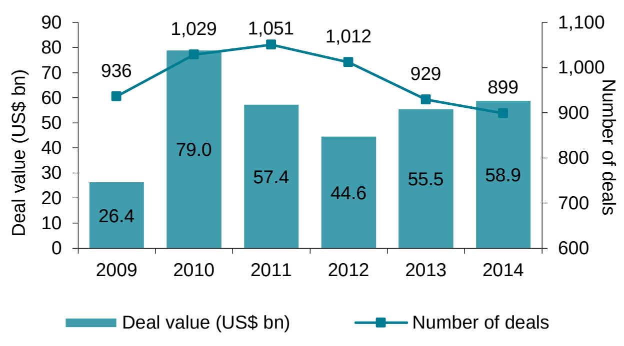
Total deal values of transport & logistics transactions in 2014 amounted to US$ 58.9bn, an increase of 6 percent to 2014. At the same time, the total numbers of transactions declined to 900 which points to a growing average size of transactions in 2014. In fact, this trend of rising values and declining volumes is now visible for three straight years already and shows an increasing number of strategic transactions in contrast to the large amount of distressed M&A what we have witnessed in the past. 2014 was the year with the highest transaction values since 2008, if the US$ 34bn acquisition of Burlington Northern Railroad by Berkshire Hathaway in 2010 is excluded as one–off large transaction.

North America was most active in terms of deal values in 2014, with transactions amounting to US$ 17.1bn after US$ 8.9bn in 2013. ASPAC was the second largest region for transport & logistics M&A in 2014 with total deal values of US$ 16.7bn. In EMA, total transactions values declined from US$ 26.5bn in 2013 to 13.5bn in 2014, partly due to a smaller number of large scale transactions in the infrastructure subsector. At the same time, deal values in Latin America accelerated sharply, reaching US$ 11.6bn in 2014, which is 10bn more than the year before. This rise was to a great extend caused by some large transactions in the infrastructure subsector in Brazil, as investors are increasingly looking to the emerging markets for transport infrastructure investments, given the great need of those countries to keep their infrastructure up to GDP growth rates. More than the half of deal values in this region can be attributed to the transaction of Aeroporto Internacional Tom Jobim (US$ 4.3bn) and MMX Porto Sudeste Ltda (US$ 2.3bn) to investor groups.

Rising M&A activity in logistics and shipping

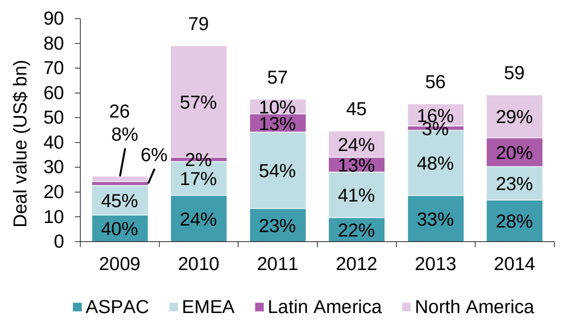
The transport & logistics subsector shows the highest share of total transaction values (US$ 25.2bn or 43 percent) in 2014. This in an increase of 135 percent in terms of transaction values as compared to the prior year and clearly shows a renewed interest of strategic and financials investors in this subsector - last year's M&A activities dominantly focused on infrastructure investments. The two largest deals in this subsector in 2014 were the transaction of Iowa China Offshore Holdings with US$ 2.4bn and the aerospace business line of logistics company KLX Inc with US$ 2.2bn.

Total transport transactions values & volumes



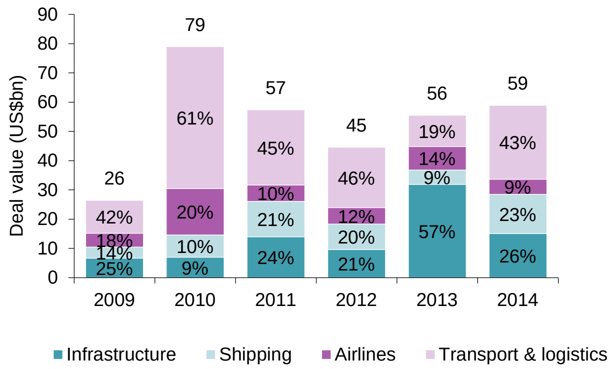
Source: Thomson ONE, KPMG

Transaction values by region



Source: Thomson ONE, KPMG

Transaction values by subsector



Source: Thomson ONE, KPMG

M&A review (cont.)

Shipping was also a very active subsector in 2014 with deal values rising to US$ 13.4bn from US$ 4.9bn in 2013. There were three transactions with a value around US$ 3.0bn including the acquisition of Prestige Cruises International by Norwegian Cruise, the investment of Jaccar Holdings into Bourbon SA and the transaction of stakes in Eagle Bulk Shipping to creditors. As an effect of a slowly progressing consolidation within this crisis plagued industry, overall M&A activity can be expected to pick up as liner companies are finally starting to merge on equity basis as opposed to the looser forms of collaborations and alliances we have seen in the past. One prominent example is the acquisition of CSAV by Hapag-Lloyd that has been announced and confirmed in 2014. At the same time, Private Equity houses that invested heavily into shipping after the financial crisis have been facing hard times with timely and profitable exits from the sector in 2014. As the market recovery has again been postponed for one year, so has the prospectus of many PE investors in exiting the market this year. In 2014 alone, EV/EBITDA valuation multiples of listed shipping companies have declined by another 12 percent, while the average valuation level of all companies in the transport sector has remained broadly stagnant over 2014. Another feature has been the sustained exit of major European lenders from the sector through a mixture of in house restructuring, bilateral and portfolio loan sales, most notably by Lloyds and Commerzbank.

Transport infrastructure transactions (ports, airports, road operations) amounted to a total value of US$ 15.1bn in 2014, which is only half of the prior year values but still the second highest value of the past seven years.

Transactions of airlines accounted for only 9 percent of total deal values in the sector in 2014. In the absence of larger transactions in 2014, some activity was visible in Europe around Etihad’s new strategy of acquiring stakes in European airlines to build up a regional network to feed its growing aviation hub in the Middle East. In late January 2015, Qatar Airways acquired around 10 percent of International Airlines Group (IAG), the owner of British Airways, making it the group's leading shareholder. In air cargo, Japan’s All Nippon Airways (ANA) and Lufthansa Cargo AG have launched an air cargo joint venture on Japan-Europe routes.

Transaction multiples rising

Valuation multiples of listed transport companies remained rather flat over 2014. The average increase of trading multiples for all subsectors was just 2 percent, which was in large part negatively affected by the declining valuation levels of listed shipping companies (multiples for shipping companies declined by 12 percent over 2014). At the end of the year, shipping companies were still trading with the highest average EV/EBITDA multiple of all subsectors, followed by transport infrastructure.

In contrast, transaction multiples did increase as compared to the prior year. The average transaction EV/EBITDA multiple for all transport companies in 2014 increased to 11.9x in 2014, after 9.0x in 2013. This shows a growing lack of available acquisition targets which is pushing up prices for target companies in the transport sector, predominately in the subsectors of transport & logistics, shipping and transport infrastructure.

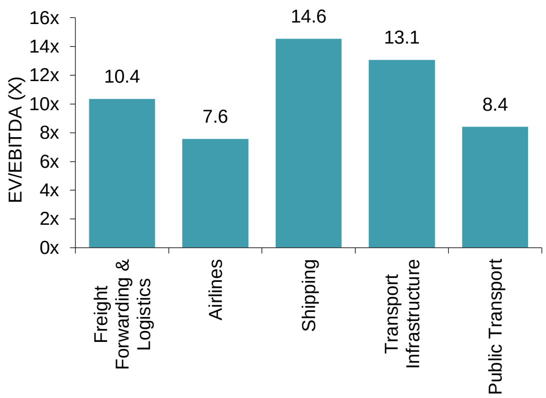
M&A review (cont.)

Outlook: Technology and IT driven M&A patterns in logistics increasingly visible

In 2015 and the near future, we expect M&A activity in the sector to remain on a high level, comparable or higher to the level we have seen in 2014. The first quarter of 2015 has already seen completed global transactions worth US$ 10.0bn, and further acquisitions valued at US$ 13.6bn have already been announced. There are several reasons for this expected trend, partly continuing historical patterns but also partly caused by new emerging trends due to overall market dynamics:

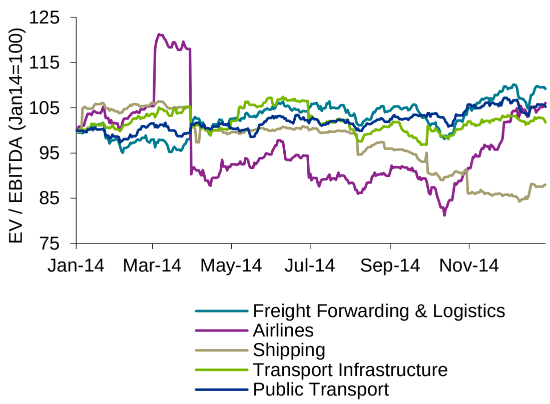
1. Consolidation, geographical expansion and vertical specialization remain the predominant reasons for transactions in the transport sector. At the beginning of 2015 there have been two landmark transactions in logistics already, the first one being the sale of Neptune Orient Lines' (NOL) logistics business APL to Japan's Kintetsu World Express (KWE) for US$ 1.2bn. This transaction will strengthen the financial position of the NOL Group, including repaying its borrowings, while KWE will substantially increase its geographic reach in contract logistics, especially in the US. The second transformative deal took place in the ASPAC region as well, where Japan Post announced a US$ 5.1bn takeover bid for Australia's Toll. This transaction will transform Japan Post business model towards a global logistics integrator and will place it in a similar position as Deutsche Post after the acquisition of DHL, ahead of the envisioned IPO later this year. As an example of vertical specialization through acquisitions, UPS announced the acquisition of Polish firm Poltraf, a provider of healthcare logistics services in Europe to strengthen its position in the vertical healthcare logistics market.
2. The need for investments into transport infrastructure remains high, both in emerging and mature markets. This is caused by a lack of public funding for transportation and further growing world trade, outpacing capacities of the transport infrastructure. As the infrastructure needs to keep up with the level of rising traffic, Governments will need to open up national infrastructure to private investors who are at the same time looking for stable investment opportunities and steady cash-flows.

Trading multiples by subsector



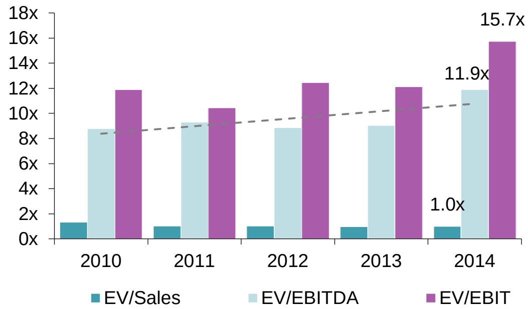
Source: Bloomberg, KPMG

Development of trading multiples



Source: Bloomberg, KPMG

Development of transaction multiples



Source: Thomson ONE, KPMG

M&A Review (cont.)

3. A new trend of M&A strategies in transport & logistics has emerged over the past years, partly caused by the effect of rising e-commerce and the digitalization of logistics business processes. As an effect, we are witnessing a growing number of IT and technology driven transactions. New market participants like tech start-ups and mobile-app based software solutions are increasingly challenging the position of express logistics firms and global integrators as retailers and shoppers go directly to the delivery driver for last mile solutions. To stay in the game, many logistics companies are in turn investing strongly by acquiring new delivery solutions or merging with e-commerce start-ups. For instance, FedEx has just announced its acquisition of Bongo International, a provider of cross-border e-commerce IT solutions, only a day after it agreed to buy logistics provider Genco, which specializes in processing returned items. UPS too, announced in October last year its acquisition of i-Parcel to consolidate its strength in the fast-growing global e-commerce market. In Europe, Deutsche Post DHL acquired StreetScooter, a former start-up that is committed to the mission of developing affordable electric vehicles. This trend is now even visible in the more traditional subsectors like shipping: just recently, CMA CGM increased its investment in startup TRAXENS, which develops containers monitoring, geolocation and multimodal coordination systems through big data analysis.

We expect all three trends outlined above to continue over the next years, thus causing M&A activities in the transport to remain on top of the agenda. The beginning of 2015 has already seen a number of large transactions which will be a recurring theme over the course of this year.

> "As an effect of rising e-commerce and the digitalization of logistics business processes, we are witnessing a growing number of IT and technology driven transactions."

Global case studies in transport & logistics

KPMG member firms advise transport companies worldwide on an array of commercial and financial projects. We also work with Government policymakers and regulators and infrastructure companies. Our Global Transport Network works closely together to bring sector-specific advice to clients, wherever they may be.

This section of the Transport Tracker presents a selection of KPMG member firms' recent work in helping clients from across the transport sector.

Transport for London: ticketing risk and control framework

Client challenge

The Oyster Pay-as-you- Go ('PAYG') system was extended onto National Rail in January 2010, necessitating a new means of calculating the amount of ticketing revenue being apportioned between Transport for London ('TfL') and Train Operating Companies ('TOC's') accepting PAYG. Not only did the TOC's require assurance that the revenue collected by Transport for London was being completely and accurately apportioned to them but TfL was contractually obliged to the TOC's service provider, the Rail Settlement Plan ('RSP') to provide an annual independent assurance report over the controls in operation within PAYG environment.

KPMG response

In a first phase, KPMG worked with TfL to document process maps detailing the end- to-end processing in the PAYG environment from Card Readers and Ticket Vending Machines through data collation to back office processing, revenue apportionment and settlement. In doing so KPMG determined what controls were already in place in the PAYG environment, the nature of the control and the control owner. KPMG then ran a Risk Workshop with key TfL and RSP staff to determine and document risks to the completeness and accuracy of processing in the PAYG environment. Having done so, existing controls were mapped against the risks to determine if any risks remained that were not adequately mitigated and, for these, KPMG advised TfL to design appropriate controls. The output of this phase of work was a defined Risk and Control Framework for the PAYG environment, documenting risks and controls operating to mitigate those risks including classification of the controls as key or non-key dependent on their nature.

Phase 2 went on to test whether key controls in the control framework were adequately designed and had been operating effectively during a defined reporting period (of one year). KPMG provided a formal opinion over the adequacy of design and effectiveness of the control environment.

In a third phase, KPMG is currently supporting TfL by providing critical review of their end-to-end process, risk and control documentation relating to their new contactless payment card (CPC) ticketing system.

Benefit to client

As a result of the work completed TfL was able to identify and address areas where improvements could be made to mitigate key operational and financial risks. It is also able to represent the effectiveness of its control environment to all TOC's who offer PAYG services and fulfil its contractual requirements with an annual, independent, opinion being provided over this control environment. Furthermore, TfL now has an internal Risk and Controls framework with which it can continually monitor and assess the effectiveness of its control over risks, for example through the use of Internal Audit.

The Risk and Control framework also provides a baseline for the PAYG environment and benchmark for controls when future upgrades and changes are made.

Global case studies in transport & logistics (cont.)

Business process outsourcing for a leading global airline

Client challenge

Our client, a leading global airline had decided to implement BPO solutions for the procurement of indirect materials and for revenue accounting as part of a group-wide operational excellence and cost reduction program. Given the criticality of the program, the client was asking KPMG to support the entire sourcing process up to contract signature and the following transformation and transition process.

KPMG response

- KPMG deployed a senior advisory team with broad expertise in BPO, procurement and revenue accounting. In a first project phase, an intense review of the clients readiness was conducted, focusing on key risk areas and utilizing the extensive sourcing expertise across KPMG's global network.
- In a second phase a focused data gathering and analysis exercise facilitated the preparation of a highly professional RFP for both BPO projects. This included detailed category reviews, procurement systems and processes analysis, initial solution workshops and business case reviews.
- The following RFP process was leveraging the market expertise and industry insights of KPMG to help ensure the selection of capable providers, focused and clear communications, quality responses and maximum provider attention.
- For the review of responses and initial downselected providers, KPMG provided tested methodologies including assessment criteria matrices, solution workshops and decision-preparation support.
- Based on best-and-final-offers from downselected providers, the Due Diligence process (inbound DD, outbound DD) was coordinated and results used to identify the provider of choice for the following, exclusive contracting phase. Here, KPMG provided intensive negotiation support based on deep and pragmatic knowledge on industry best terms and conditions for BPO agreements.
- After contract signatures for both BPOs, KPMG transition managers supported the transformation and transition phase over a 4-month period.

Benefit to client

The client was able to achieve a highly professional BPO sourcing process with preferred service agreements, achieved in time and on budget. The client was also put in a position to select the most capable provider among highly attractive terms combined with strong risk mitigation effects.

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

Contact us

Dr Steffen Wagner
Global Chair, Transport
T: + 49 69 9587 1507
E: steffenwagner@kpmg.com

John Luke
Global Head of Shipping
T: + 44 20 7311 6461
E: john.luke@kpmg.co.uk

James Stamp
Global Head of Aviation
T: + 44 20 7311 4418
E: james.stamp@kpmg.co.uk

Justin Zatouroff
Global Head of Post and Express
T: +44 20 7311 8415
E: justin.zatouroff@kpmg.co.uk

www.kpmg.com

Produced by CREATE Graphics | CRT3545 | March 2015