



cutting through complexity

KPMG Transport Tracker

Global transport market trends
and views

August/September 2015

kpmg.com



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

Market fundamentals

Chinese economy weighs on the transport sector

Macroeconomic fundamentals have been on a downward trend over the first half of 2015 upon worries about the Chinese economy. Total Chinese trade for the first six months of the year fell by 7 percent, according to the General Administration of Customs, and Asia-Europe trade dropped by 3 percent. Yet the Chinese economy is reported to have grown at an annual rate of 7 percent in the second quarter of 2015, which is also the forecasted growth for the whole of 2015 (the weakest expansion in 25 years). China is now attempting to stimulate its economy by devaluing the yuan, which would ultimately affect transport companies through changing trade patterns (rising exports, and likely falling imports) and declining global commodity prices. In addition, the Chinese government recently announced to guide private capital into the logistics industry as part of wider efforts to stabilize economic growth^(a).

The indices for world trade and industrial production growth show a decline in the first half of 2015. Clarkson expects world seaborne trade to expand in a range of just 1.5 – 3.5 percent for the whole year, which is much lower than historic numbers. The United Nations now forecast global GDP to rise by 2.8 per cent in 2015 — a downward revision by 0.3 percentage points from the last forecast.

Global Purchase Manager Indices signal downward pressure on the manufacturing sector as well. While the US and European PMIs did increase over the last months, China's PMI stood at 50.2 in June, unchanged from the previous month and just above the 50-mark that separates growth from contraction. As a result, the Chartered Institute of Procurement and Supply has raised its global risk index to its highest level since 2013, partly reflecting the sluggish economic growth in China.

At the end of the first half of 2015, global fuel and oil prices ended up 40 – 45 percent below the prior year and are forecasted to remain below US\$70 a barrel over the next year^(b), which has a positive impact on the profitability of most transport companies. On the global capital markets, the airlines peer group outperformed the remaining transport subsectors and saw share prices rise by 33 percent over the last twelve months (as at the end of June 2015). Meanwhile, listed shipping and transport infrastructure companies saw share prices decline by 5 and 7 percent respectively compared to the prior year, which made them the worst performing groups among the transport subsectors. This reflects a healthier growth of global passenger transport markets compared to the freight transportation peer group, where the lackluster global economy has already been reflected in the recent share price movements.

At the same time, the depreciation of the yuan could reduce the earnings of China based airlines and has recently caused a sharp fall in share prices for the three big Chinese carriers (see chapter on Aviation). The weaker currency might also turn into a headache for some shipping companies (see chapter on Shipping). The short- and mid-term road ahead of transport companies will thus be bumpy amid growing economic uncertainty, especially for shipping and freight forwarding companies which are directly affected by any economic downturn and slower trade growth.

Note: (a) http://news.xinhuanet.com/english/2015-08/14/c_134513763.htm?mod=djemlogistics
(b) according to a Wall Street Journal survey: <http://www.wsj.com/articles/crude-prices-seen-staying-below-70-a-barrel-over-the-next-year-1439460867?mod=e2fb>

SHARE PRICES (end of June 2015 YOY):

15%

Freight forwarding
and logistics



-7%

Transport
infrastructure



33%

Airlines



19%

Public
transport



-5%

Shipping



Market fundamentals



Shipping and sea freight



Aviation



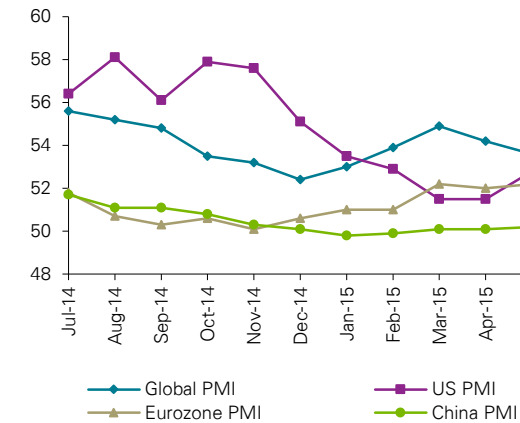
Express logistics



Case studies

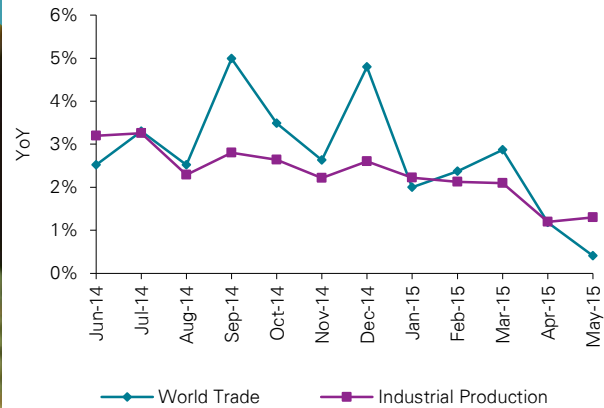


Global Purchasing Manager Indices (PMI)



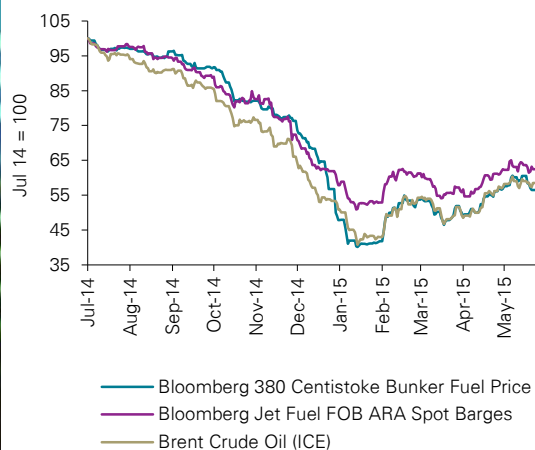
Note: Values above 50 indicate growth
Source: Institute for Supply Management (ISM), Markit, JP Morgan, China Federation of Logistics & Purchasing

World trade and industrial production index



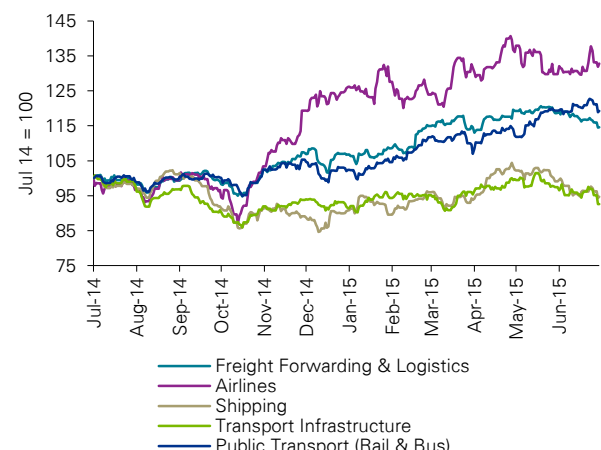
Source: CPB Netherlands Bureau for Economic Policy Analysis

Fuel and oil prices



Source: Bloomberg, ICE (Intercontinental Exchange)

Share prices of transport subsectors



Source: Bloomberg, KPMG Research

Shipping and sea freight

No calm sea in 2015

While a slowdown in fleet capacity growth and lower bunker prices had a positive impact on the earnings of shipping operators in the first half of 2015, another market indicator has now turned against the industry: world trade growth. The Container Throughput Index in May decreased to a level last seen in 2014 and slipped further in June, mostly due to declining port handling volumes in some Asian ports (see chapter on Market Fundamentals). In addition, the shipping industry is currently the most pessimistic in six years about its prospects, according to a survey by Norton Rose Fulbright, largely due to continuing concern of overcapacities. Despite heavy scrapping and fewer deliveries of new capacities, the world fleet is still estimated to be growing at the same rate as demand in the first half of 2015.

In container shipping, the slowdown in Chinese economic activity and subsequent falling demand for container trade resulted once again in sharply declining container freight rates in the second quarter of 2015 with freight rates at a six-year low, according to BIMCO. Just recently, the G6 Alliance, Maersk and MSC announced that they will be voiding several Asia-Europe sailings due to declining demand and slumping freight rates. Yet, with bunker prices down 45 percent over the prior year, average containerships earnings in the first half of 2015 still ended up 36 percent above the prior year's period, according to Clarkson estimates. As a result, the average operating margins of the largest container liners improved to 5.0 percent in the first quarter of 2015, compared to -1.3 percent in the same quarter of 2014^(a).

In contrast to freight rates, container time charter rates showed a strong upward trend in Q2, which indicates a slight relief for non-operating vessel owners. The global containership fleet increased by 6.7 percent over the past twelve months with the orderbook remaining largely flat at 17.5 percent of existing capacity.

The Baltic Dry Index struggled further in 2015, albeit on an upward trend towards the end of the second quarter. The late increase was partly caused by a subdued supply growth in dry bulk shipping, especially compared to the last couple of years. Total dry bulk capacity only increased by 2.9 percent over the last twelve months while the orderbook showed a clear downward trend in 2015. At the same time, the latest depreciation of the yuan might turn into another major issue for shipping companies, as it will increase USD commodity import prices for China which is the largest importer of iron ore and could thus ultimately dampen demand for bulk commodities. Chinese iron ore imports did in fact decline in the first half of 2015. At the same time, the lower Chinese demand for commodities as a result of weaker currency will also cause a fall in commodity prices which could partly offset the decline in purchasing power. The Bank of America has estimated that a 1.0 percent depreciation in the CNY against the USD will cause a 0.6 percent decline in commodity prices overall^(b).

The performance of the tanker segment has been the strongest of all shipping peer groups in 2015 so far, evident by growing freight rates and share prices. According to BIMCO, the first quarter of 2015 was the best since Q4-2008 for product tankers. The rather slow supply side growth was the key success factor for the comparably high freight rates of crude oil tankers in the first half of 2015. Lower oil prices also contributed to the positive market situation.

Note: (a) Alphaliner Weekly Newsletter, Volume 2015, Issue 20
(b) BofA Merrill Lynch, Global Energy Weekly, 6 August 2015

Market fundamentals



Shipping and sea freight



Aviation



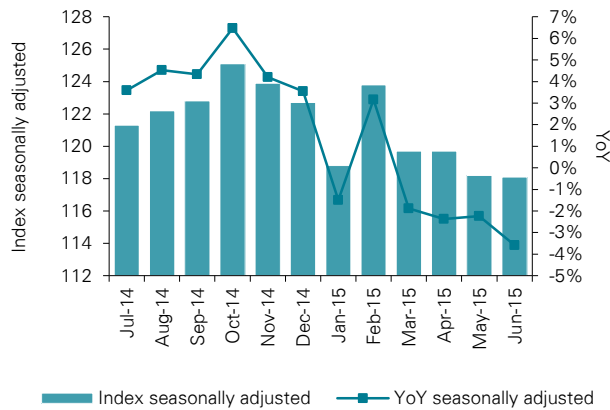
Express logistics



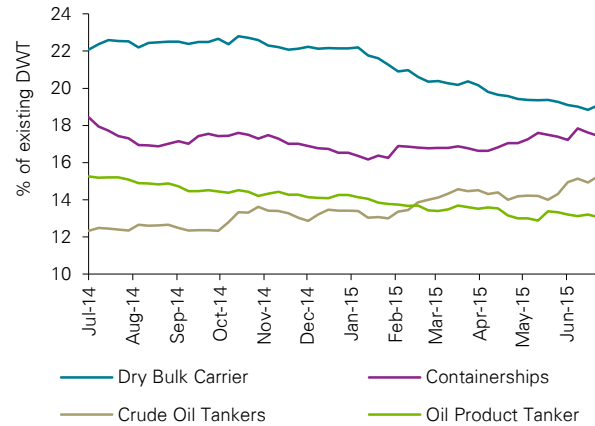
Case studies



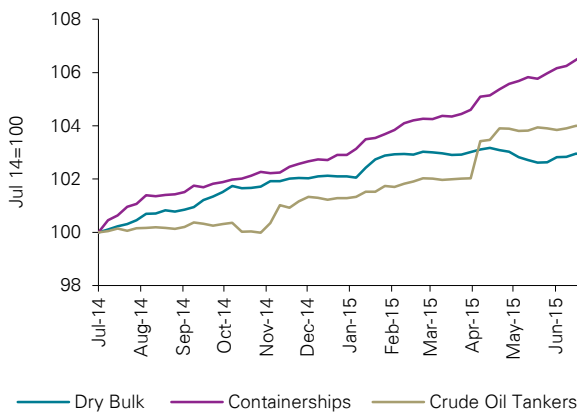
Container Throughput Index



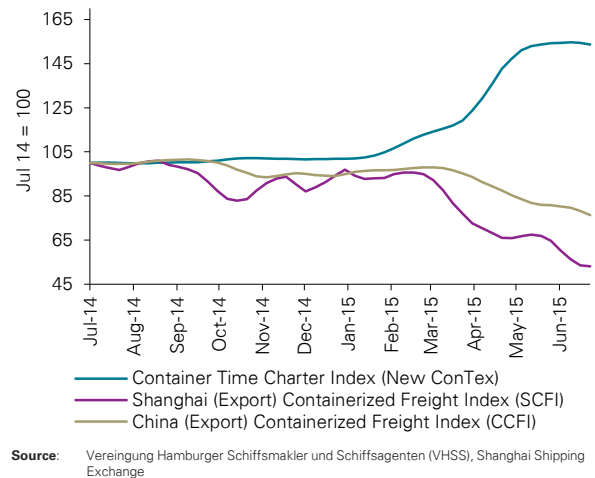
Orderbook in % of capacity



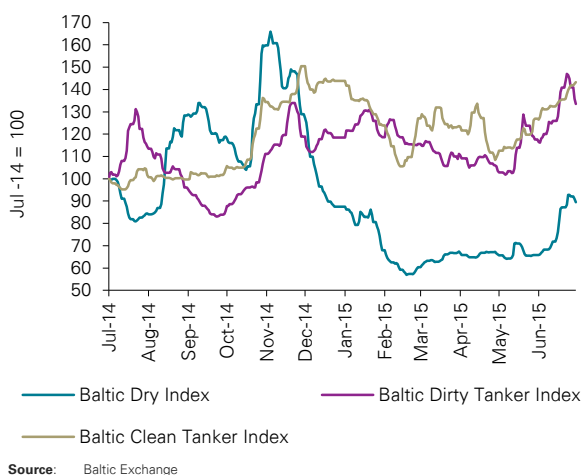
Total fleet capacity (DWT)



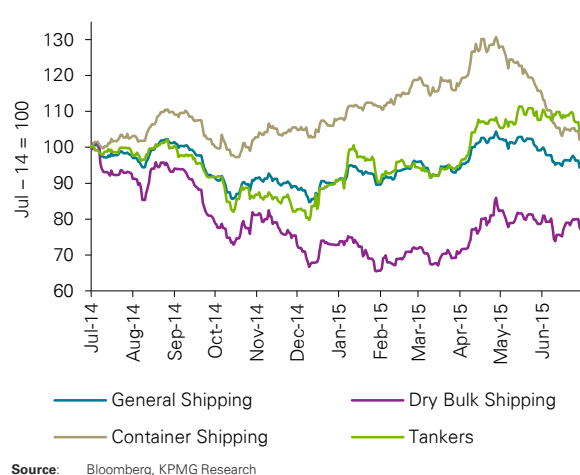
Container freight and time charter rates



Baltic shipping indices



Share prices of shipping subsectors



Shipping and sea freight (cont.)



John Luke
Global Head of Shipping

No calm sea in 2015 (cont.)

In summary, the first quarter of 2015 saw a mixture of encouraging signs on the back of lower bunker prices and comparably slow supply growth, however sluggish world trade has now become a worrisome indicator for the shipping industry outlook in the near future. This, in turn, may have a negative short-term impact on the currently active M&A pipeline in the shipping industry and could thus further delay the necessary consolidation. Still, China Ocean Shipping Group (Cosco) and China Shipping Group are reported to plan a merger that would create the world's fourth-biggest container line, although antitrust rules in different operational jurisdiction would need to be monitored closely^(c).

Note: (c) <http://www.scmp.com/business/companies/article/1847580/cosco-china-shipping-merger-talks?mod=djemlogistics>



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John Luke
Global Head of Shipping

**Another market indicator has
now turned against the shipping
industry: world trade growth.**



Aviation

Passenger growth remains strong, driven by the Middle East and LATAM

The global aviation passenger market continues its strong growth track in 2015, with total passenger traffic expanding by 6.3 percent in the first half of 2015 (compared to the prior year period). This was slightly ahead of the 5.9 percent growth in passenger traffic capacity, resulting in average global load factors above the 79 percent mark in the first half of 2015, which is usually known for weaker load factors due to seasonal factors.

Passenger traffic demand growth was strongest for Middle Eastern airlines (11.3 percent) although this was still significantly below the unprecedented capacity growth (15.2 percent) in the first half of 2015. This resulted in lower load factors compared to the other regions, and highlights the growth ambition of Middle Eastern carriers in the global aviation market. Despite deceleration in Brazil and Argentina, both demand and capacity show strong growth in LATAM in comparison to the rest of the world. Load factors were again highest for US airlines who continue to experience lower demand, but also lower capacity growth than the global average and benefit from higher utilization and productivity as a result of the past consolidation.

Share prices of airlines worldwide reflect the upward market trend in 2015 as airlines outperformed other transport peer groups and ended up 33 percent above the prior year.

Low oil continues to have an impact – but not necessarily universally positive

Continued low oil and jet fuel prices – lately impacted by expectations of supply increases from Iran – have so far broadly benefitted airlines in 2015. A sample of 81 airlines from IATA shows that the industry financial performance in the first quarter improved significantly (on prior year), largely driven by the strong performance of North American airlines and the return to positive operating and net profit at the beginning of the year. European airlines remain the only ones to record negative operating profit in Q1 2015 which highlights the strong competitive pressure in this region, seasonal factors, and low oil acting to keep “unproductive” capacity in the market.

Concerns over growth in China impacts regional expectations

Most recently, ASPAC airlines have been impacted by the devaluation of the yuan, which according to analysts may reduce earnings for the biggest Chinese airlines by as much as a half over the full year due to foreign-debt exposure^(a).

Impact of regulation on the competitive environment

Globally, airline markets remain extremely competitive, but there are marked differences by region.

Region	Number of airlines holding 80% of the market ^(b)
North America	9
Europe	45
Latam	20
ASPAC	53
MESA	22

Source: CAPA Centre for Aviation

Note: (a) The Wall Street Journal, August 14 2015

(b) Measured by the number of seats flown by airlines from the region to all global destinations in the week of 17 August 2015 to 23 August 2015.

Market fundamentals



Shipping and sea freight



Aviation



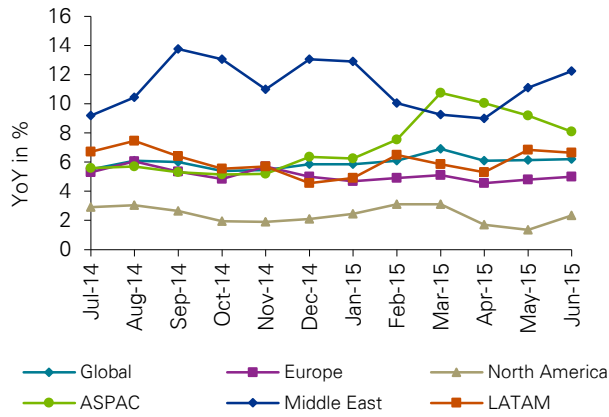
Express logistics



Case studies

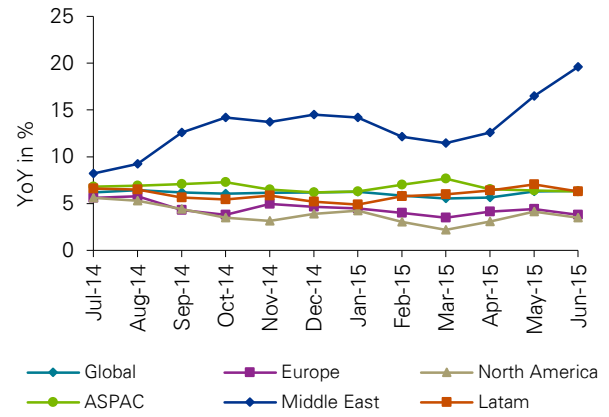


Passenger traffic growth (RPK)



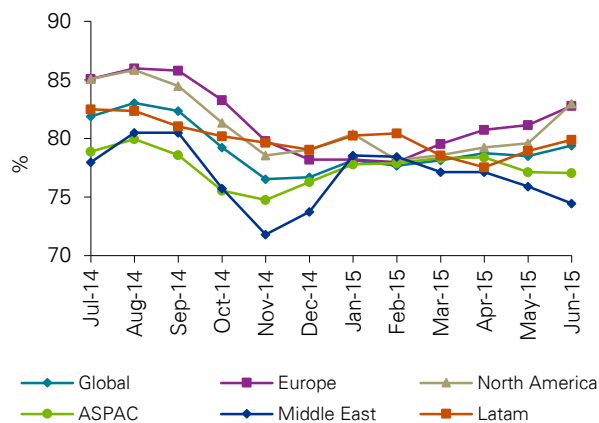
Note: Two months rolling average
Source: International Air Transport Association (IATA)

Passenger capacity growth (ASK)



Note: Two months rolling average
Source: International Air Transport Association (IATA)

Passenger load factor



Note: Two months rolling average
Source: International Air Transport Association (IATA)

Aviation (cont.)

Local politics and regulation make a key difference, and we observe that where consolidation has been allowed to occur (as in the US), it very often has. In H1 this year, thoughts have turned once again to European consolidation:

- The CEO of the European Airline Association noted that there needs to be more consolidation in the European market, but that “everyone is running into a wall of regulatory impediments”.^(c)
- Finnair’s chairman asked “how good airline connections in Finland could be secured in this consolidating world”. We note that in this context, the Finnish government owns a 55.8 percent share in the airline.^(d)
- Lufthansa’s CEO stated that they expect consolidation – “if [consolidation] comes about, Lufthansa needs to be part of that and Eurowings is our tool for that”.^(e)

But while Governments and regulators in Europe are being asked to consider relaxing restrictions to aid consolidation across the Atlantic, submission of a 55 page dossier to the US government (compiled on behalf of the largest US based airlines) urged Washington to re-examine its open skies policy with Qatar and the UAE, claiming that subsidies of US\$42bn (since 2004) have created an unfair playing field. The subsidies were claimed in areas such as fuel, artificially low airport charges, labor, and capital injections.^(f)

Back in Europe, at a meeting of EU finance ministers on 13 March, Paris and Berlin asked the European Commission to put an end to “unfair competitive practices”.

A Gulf apart in views

Unsurprisingly, the Gulf carriers have a different view. Speaking on behalf of Ethihad, their CEO James Hogan accused the EU and US of attempting to “pull the ladder up” after receiving similar subsidies themselves. The Gulf carriers point to significantly increased customer choice as a market stimulating factor. In other words: “They [the US and EU airlines] are getting a smaller slice, it is true. But it is a slice of a bigger cake”.

Might Latin America see the next wave of Gulf interest?

In Latin America, the impact of the Gulf carriers has so far been relatively modest. However, global traffic flows between Latin America and Asia are predicted to increase significantly by 2033. According to Airbus, RPK’s on South America – ASPAC routes will increase by 6.4 percent to be the 2nd fastest growing traffic flow to/from South America (following South America – Middle East traffic growth of 7.4 percent), even though intra-regional, North America and Europe traffic flows will remain biggest in absolute terms. This drives speculation that the Gulf carriers may seek to form deeper alliances with carriers based in convenient “stop-off” points between Asia and South America. However, if foreign ownership restrictions were relaxed, a wave of M&A may be more attractive than alliances – with the formation of truly global companies in their own right.

Note:

- (c) CAPA Aviation News, March 27 2015
- (d) Finnair investor Relations website, March 25 2015
- (e) Reuters, March 12 2015
- (f) The Economist, March 6 2015

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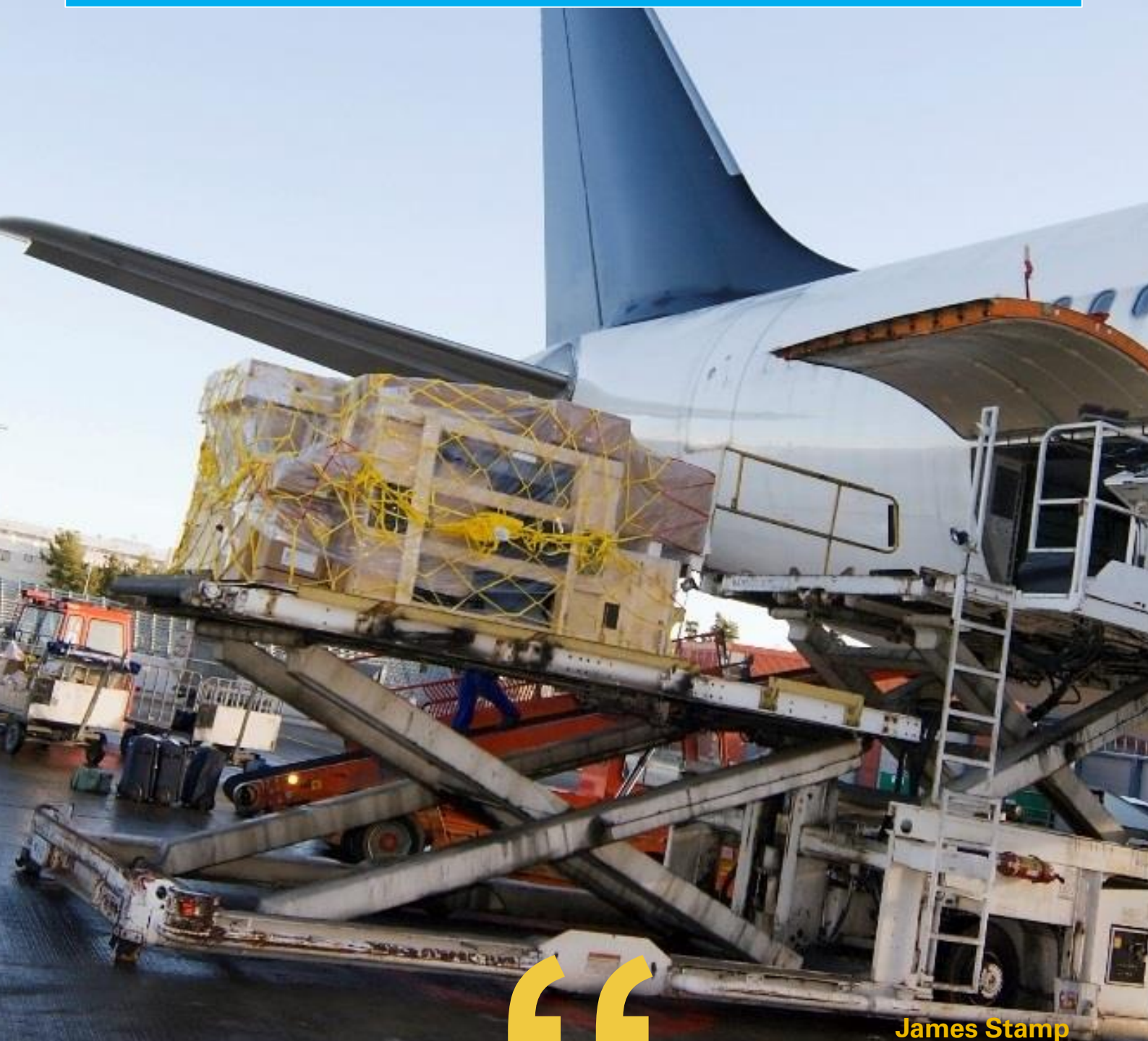
Aviation



Express logistics



Case studies



“

James Stamp
Global Head of Aviation

If foreign ownership restrictions were relaxed, a wave of M&A may be more attractive than alliances – with the formation of truly global companies in their own right.

”

Aviation (Freight)

Pressure remains on Air Freight

The story of global aviation markets remains divided into two separate ones, with strongly growing passenger traffic, but struggling air cargo markets. While air freight traffic growth had appeared to have recovered over the end of 2014, IATA numbers show that growth continued to slow down to 1.2 percent in June, the slowest rate this year, which was significantly outpaced by capacity expansion of over 5 percent. On a year-to-date basis, freight volumes are up 3.5 percent in the first half of 2015.

Middle Eastern and Asia-Pacific airlines contributed most to this growth while there was evident struggle in North and Latin America and Europe. All three regions reported declining traffic for the first half of 2015, with most notable drop of -6.9 percent for Latin American airlines, partly due to continued weakness in Brazil and Argentina. The market continues to suffer from significant over-capacity, and at the same time faces challenges around time-sensitive cargo (where connection times must be minimized). Remaining overcapacities of air cargo supply resulted in freight load factors that were reported to be the lowest since mid-2009 (on a seasonally adjusted basis) according to IATA. As a result, freight prices declined sharply over 2015, both on a month-on-month and year-on-year basis. The overall decline in freight prices averaged -6 percent in the first months of 2015, highlighting the continued struggle and volatility of air cargo.

In Asia, Thai announced its withdrawal from the cargo market in the face of stiff competition. The key markets of North America and Europe are difficult to serve with a limited freighter fleet. Thai operated two dedicated 747 freighters, compared to 22 for Cathay Pacific, and 18 for China Airlines^(g). Equally, FedEx Express is going ahead with its fleet modernization programme with 50 more Boeing 767-300 freighters on order, and options for 50 further ones, highlighting that scale is key to maintaining a competitive position in the aviation freight market.

While freight traffic traditionally serves as an early sentiment indicator of global trade and thus points to continued sluggishness and uncertainty, there is an underlying structural weakness of air cargo which goes beyond its traditional correlation and dependency on world trade. Air cargo and its diverse stakeholders (carriers, forwarders and handlers) need to adapt to the current trends in the global logistics markets such as digitization of business processes, use of data analytics for operational excellence and stronger demand for flexible and tailor-made solutions from customers in order to justify the higher costs and position air freight as a value-added service to shippers.



James Stamp
Global Head of Aviation

Note: (g) CAPA Aviation News, March 26 2015

Market fundamentals



Shipping and sea freight



Aviation



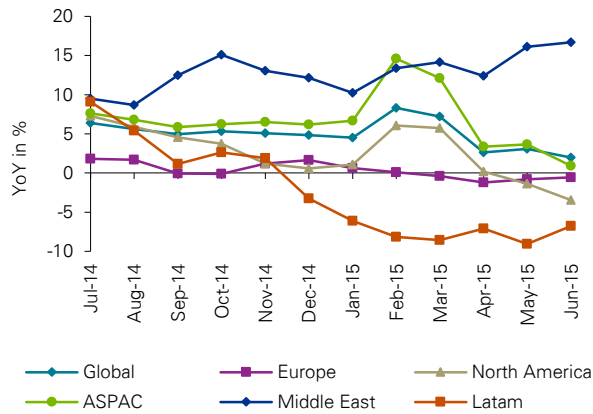
Express logistics



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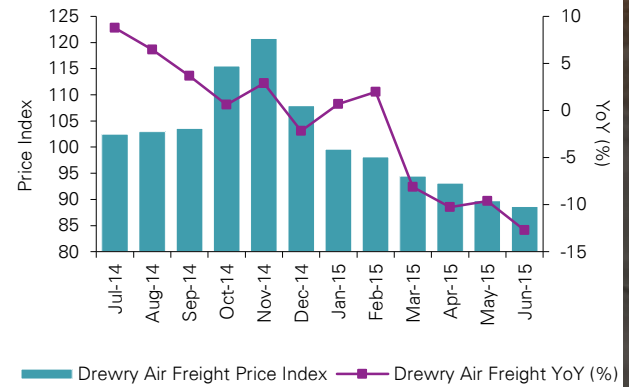


Freight traffic growth (FTK)



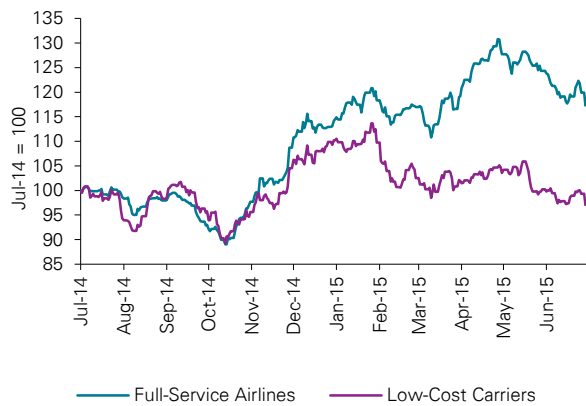
Note: Two months rolling average
Source: International Air Transport Association (IATA)

Air freight price index



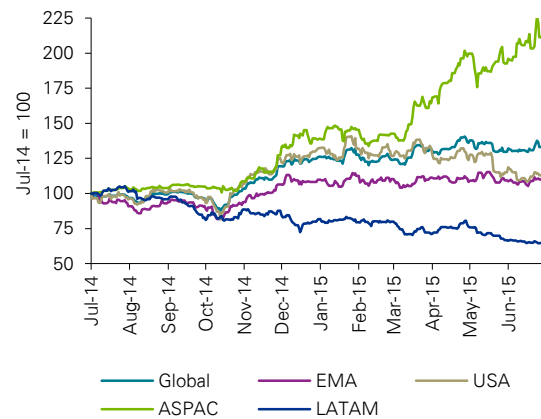
Source: Drewry

Share prices by business model



Source: Bloomberg, KPMG Research

Share prices by region



Source: Bloomberg, KPMG Research

Express logistics

Rising M&A activity in 2015 highlights market attractiveness and changing dynamics

A lot has been happening in the dynamic express logistics sector lately. A number of the key players have undertaken a range of actions from forming alliances and joint ventures, to strategic investments into new technologies and business models and, of course, mergers & acquisition (M&A). In the first half of 2015, a total of 400 transactions with a combined value of US\$27bn have been announced in the forwarding, logistics and express sector, which was almost as much as in the whole year of 2014 (US\$30bn on a total number of 750 announced transactions)⁽¹⁾. The rise in transaction values was driven by the high number of US\$1+bn deals in the first half of 2015.

The highlights this year so far include:

- **Japan Post's** acquisition of Australia's Toll Group for US\$5.1bn;
- **Alibaba's** US\$4.5bn acquisition of a 20 percent stake in Suning Commerce Group, which includes Suning's nationwide logistics network and last mile delivery stations;
- **FedEx'** envisioned US\$4.8bn acquisition of TNT Express and the completed takeover of GENCO for S\$1.4bn;
- **XPO Logistics'** series of acquisitions including France's Norbert Dentressangle for US\$3.5bn, targeting revenues of US\$2bn by 2019, more than tripling its US\$9bn revenue in mid-2015;
- **Global Logistic Properties'** US\$4.5bn acquisition of Industrial Income Trust, a U.S. industrial real estate investment trust (in addition to setting up a US\$7bn China-based logistics infrastructure fund to benefit from rising demand for warehouse space in China);
- **UPS'** rumored US\$1.8bn acquisition of US-based Coyote Logistics; and
- **Kintetsu World Express'** acquisition of Singapore's APL Logistics for U\$1.2bn.

One striking fact when looking at the transactions is the obvious cross-border focus of strategic investors in the pursuit of their inorganic growth strategies. This is not only caused by the strong dollar and a subsequent favorable pricing for US companies looking for targets in Europe, but rather a proof of how logistics markets are increasingly globalizing as an effect of rising cross-border e-commerce and related market opportunities.

Additionally, the M&A activities in the first half of 2015 also demonstrate how a number of different markets participants are now all investing into transportation and logistics capacities. Key players acquiring transportation targets range from post companies (Japan Post, Singpost), global integrators (FedEx, UPS), freight forwarders (Kintetsu World Express, Geodis) as well as eRetailers such as Alibaba who are equally expanding transportation and logistics capacities through acquisitions.

Note: (a) KPMG analysis based on numbers sourced from Thomson ONE

Market fundamentals



Shipping and sea freight



Aviation



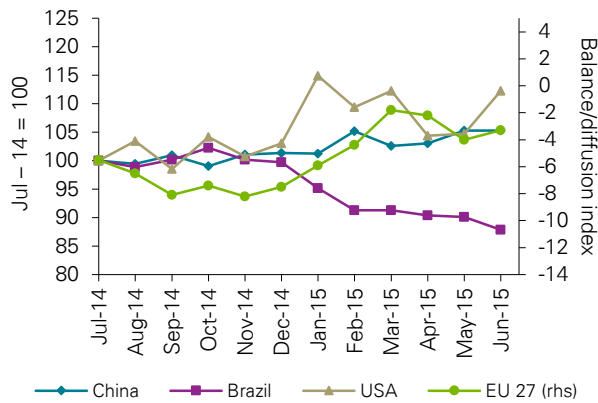
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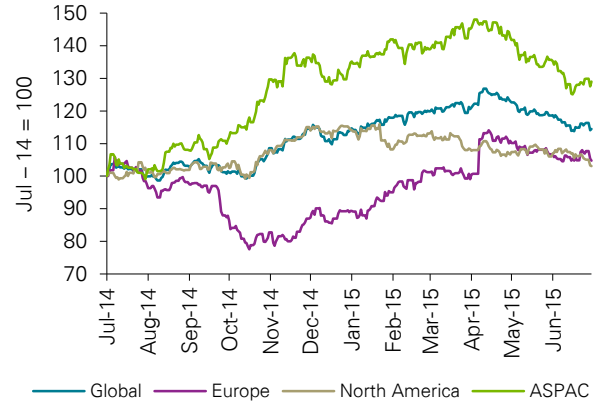


Consumer confidence indices



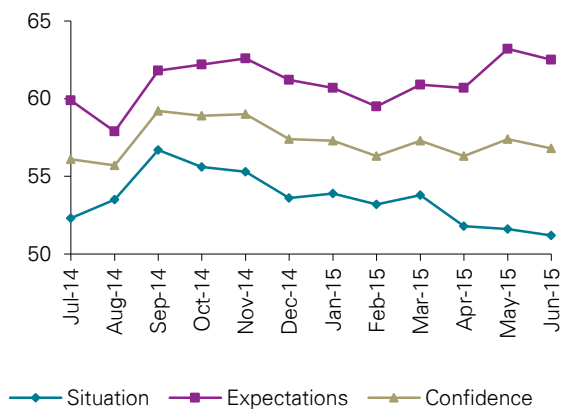
Source: National Bureau of Statistics of China, CNI (Confederacao Nacional das Industrias, Conference Board, European Commission)

Express logistics share prices



Source: Bloomberg, KPMG Research

Logistics Confidence Index



Note: Above 50 indicates higher volumes, below 50 indicates lower volumes*
Source: Stifel, Transport Intelligence

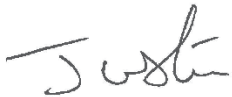
Express logistics (cont.)

The M&A activity recently demonstrates that transportation & logistics will be a key playing field to capture growth opportunities arising from growing cross-border e-commerce in the near future. There are four main issues to consider:

- Pricing is currently good for US companies;
- Margins are higher in international flows;
- Organic growth is very hard to achieve and the economies of scale make M&A worthwhile;
- Getting the supply chain right is the critical mission for e-commerce – whether it is controlling costs or the customer experience on the door step. This means that we will continue to see e-tailers acquiring logistics expertise.

M&A also shows that the market remains attractive for a number of different companies. The mid- and long-term outlook for the sector is also positive and underlying market fundamentals remain intact, albeit there are concerns on the current state of the global economy (see chapter on Market fundamentals). The Stifel Logistics Confidence Index and express logistics share prices have lately also been pointing to a more challenging market environment.

At the same time, the recent decline in world trade growth signals a persistent convergence of trade and GDP growth (whereas in the past, trade had been growing above GDP rates). This is a sign of warning for logistics companies as economic growth does not impact the volume in supply chains as much as world trade, which directly reflects the current state of globalization. On the latter, the current indicators show that shorter supply chains as an effect of re- and onshoring are becoming a fact rather than a trend.



Justin Zatouroff
Global Head of Post and
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Justin Zatouroff
Global Head of Post and Express

Getting the supply chain right is the critical mission for e-commerce – whether it is controlling costs or the customer experience on the door step. This means that we will continue to see e-tailers acquiring logistics expertise.



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.

Quantifying costs to the airline industry of operations involving capacity constrained airports

Client challenge

At a growing number of airports worldwide, the growth in demand for air travel has placed pressure on airport capacity. Currently there are 167 airports around the world which require airlines to possess slots so as to operate air services. These slots can restrict the ability of an airline to provide services to customers, and can result in costs to airlines.

KPMG was engaged by International Air Transport Association ("IATA") to assess the costs incurred by airlines globally associated with the slot arrangement at capacity constrained airports.

KPMG response

- KPMG spoke with senior management of around 35 global leading airlines including major Asia Pacific carriers such as Cathay Pacific, Thai Airways and Qantas – to understand the direct, indirect and revenue foregone associated with slot capacity constraints at capacity constrained airports.
- Based on our consultations with airlines, KPMG has identified the major factors and costs of capacity constraint.
- KPMG further utilized econometric modeling tool to quantify the direct, indirect and revenue foregone identified, where possible.

Benefit to client

IATA was presented with the costs to airlines associated with operations in capacity constrained airports in terms of direct, indirect and revenue foregone. The results will be used by the aviation industry to advocate to governments, regulators and airport operators to convince timely investment to address demand needs.

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Global case studies in transport & logistics (cont.)

KPMG helps railway operator to calculate its True Value

Client challenge

NS Group (Dutch Railways) is the largest public transport operator in the Netherlands, responsible for passenger transport, rolling stock maintenance and commercial development of more than 400 Dutch railway stations. The organization is conscious of the value it creates for society by providing mobility, but is also aware that it has some negative effects, for example through greenhouse gas emissions.

Its long-term vision is to increase the value it creates for society while reducing its negative impacts and delivering healthy financial returns. NS has recognized that an important step in achieving this ambition must be to quantify the value it creates for society in order to better understand and manage it. With these goals in mind, the company looked for suitable quantification methodologies.

KPMG response

NS engaged KPMG to apply the KPMG True Value approach to calculate the socio-economic value, as well as the environmental value, that the company creates.


The project team included multi-disciplinary professionals from NS and KPMG with backgrounds in corporate finance, sustainability, operations and other functions.

- The first step in KPMG's True Value methodology was to identify the organization's material externalities and classify them as either positive or negative.
- The initial result was a 'long list' of externalities and issues that are important to stakeholders. A shortlist was then produced using the Global Reporting Initiative (GRI) G4 materiality guidelines and the principles of Integrated Reporting.
- The shortlist was then assessed further to determine where sufficient data and metrics were available to quantify these externalities in financial terms.
- KPMG professionals quantified these externalities and applied a financial value to them using expert input and the best available academic data sources.

Benefit to client

KPMG's True Value methodology has helped NS to articulate its economic, environmental and social impacts much more clearly and to explain how these impacts interact. This will help to improve the client's dialogue with stakeholders and help its passengers make better informed decisions about their own mobility.

NS plans to continue its work in this area, with the intention that its first steps will inspire other companies to consider how they measure, manage and report the value they create and reduce for society.

A photograph of two men in a warehouse setting. The man on the left is wearing a black polo shirt with orange accents, black trousers, safety glasses, and grey gloves. He is holding a clipboard with a document. The man on the right is wearing a white button-down shirt, black trousers, and safety glasses. He is holding a tablet computer. They are standing in front of tall orange metal shelving units filled with wooden pallets. Some pallets have labels like 'X61106NP' and 'X61111NP'. The background shows more of the warehouse structure.

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



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