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M&A trends in the maritime sector

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Current mergers and acquisition (M&A) activities in the shipping and ports sector tell us two different stories: Shipping liners are focusing more on alliances and resource sharing, instead of engaging in M&A. On the other hand, M&A activity is gaining momentum within the shipping terminals sector, as investors are focusing on strategic buying options.

Shipping liners focusing on alliances

Shipping carriers have been struggling with persistent overcapacity and low freight rates since the financial crisis in 2008–09.

As a result, shipping companies are focusing on attaining economies of scale by trading up to large ships, which not only lower operating costs but also provide access to the biggest trading lanes.[1] However, not all companies are capable of procuring big ships as most of them are struggling to fulfil their financing needs.

A major way to attain economies of scale is consolidation among players. Banks, the largest source of financing to the shipping sector, have been gradually reducing their exposure to shipping assets post-recession. Due to lack of capital, several companies would prefer a merger option if it provides them access to finances.[2]

- In a major merger in December 2014, Chile-based Cia. Sud Americana de Vapores SA (CSAV) combined its container shipping operations with Germany's Hapag-Lloyd AG, creating the fourth largest container line in the world. According to Oscar Hasbun, chief executive officer of CSAV, the tie-up is expected to lead to annual savings of US$300 million and to open up new trade routes for the company.[3]
- China's two largest shipping liners, China COSCO and China Shipping Container Lines (CSCL) are negotiating over a merger, for asset reorganization.[4]
- While, in Singapore, Temasek Holdings Pte. Ltd., which is the major shareholder of Neptune Orient Lines (NOL), is reportedly planning to sell off the liner.[5]

The container shipping industry had been fragmented until 2001, when the top 10 carriers held a market share of 37.3 percent. However, after 2001, a number of large mergers and acquisitions resulted in a less fragmented market. Today, the top 10 container carriers hold a 63 percent market share. However, this notable consolidation can be attributed largely to asset expansion, rather than mergers.[6]

In fact, merger or acquisition among companies operating over the arterial trade routes, is few and far between. Although, consolidation is a viable option, for gaining financial control, many factors such as family-owned interest and state interest, hamper larger M&A deals.[7]

Preference for alliances and an improved operating margin may hamper M&A activity

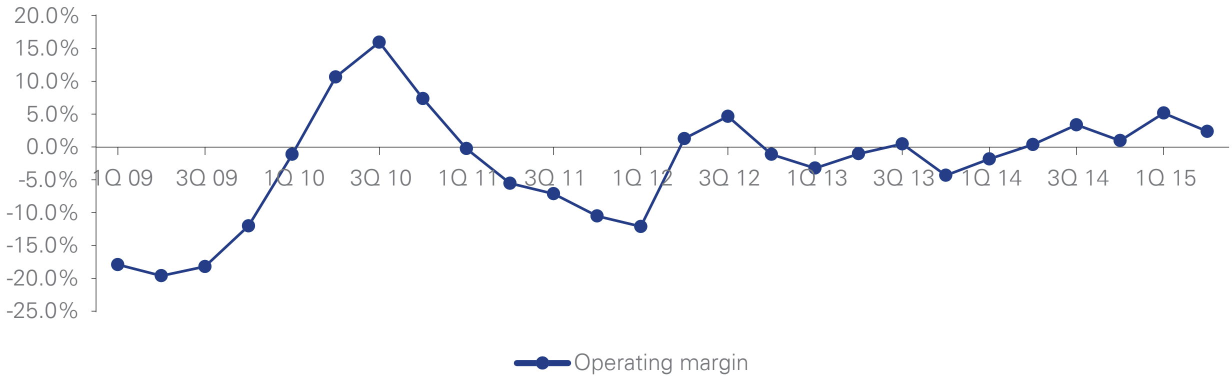
A major trend that has evolved over the past few years is that an increasing number of companies have become interested in creating alliances.

Currently, four major alliances dominate the global shipping industry: 2M, Ocean Three, G6 and CKYHE group.[8] Similar to code-sharing between airlines, shipping alliances help in reducing costs and increasing geographic reach by sharing ships and port facilities. Although, demand for alliances is driven by cost pressure, reluctance to lose control on the part of firms owned by families or sovereign wealth funds has further fuelled the need to form alliances.[9]

At the same time, creating alliances may not solve the challenges of overcapacity or high freight rates. Moreover, the efficiency of alliances has also become a matter of concern as complete cooperation between alliance partners is yet to be achieved

Low fuel prices have also cushioned the profitability of shipping liners. Even as revenue is declining, during H1 2015, carriers have been able to more than triple their operating margins over 2014 figures, due to rapidly falling fuel prices. In H1 2015, CMA CGM's fuel cost declined 33 percent, compared with that in H1 2014. Moreover, large and fuel-efficient ships are also lowering costs.[10] Figure 1 shows the gradual rise in operating margins of shipping liners.

Figure 1: Quarterly operating margin for shipping liners, Q1 2009 – Q2 2015



Source: Alphaliner

However, in the long run, the effects of fuel prices, freight rates and ship sizes may not always be favorable. Smaller liners, particularly, will face challenges in attracting favorable freight rates since they are in direct competition with big liners for business. "Continuing low freight rates will eventually persuade some, either of their own volition or coerced by the banks, to find pooling partners to maximize the potential of their vessels," according to Justin Archard, Managing Director, Asia Pacific & Oceania at SAL Heavy Lift Singapore Pte Ltd.[11]

M&A activity in ports increasing

Investment in the transport sector has increased significantly, as many countries are focusing on creating better and integrated infrastructure. Increasing the efficiency of ports is particularly important, as approximately 90 percent of global trade is conducted via ships. As shipping companies are focusing on getting larger ships, demand for upgraded or new ports is increasing. Port congestion, due to larger ships and an increase in shipping alliances, has become a major issue, and is affecting terminal businesses particularly in the US.

As bank financing is limited, particularly in Europe, terminal operators are focusing on equity financing options to expand port infrastructure. These options include M&A, share issues and sale of portfolio. Further, terminal operators are seeking investment from sovereign funds and governments.[12] Figure 2 shows that M&A activity in shipping terminals, has gradually increased during 2014–15.

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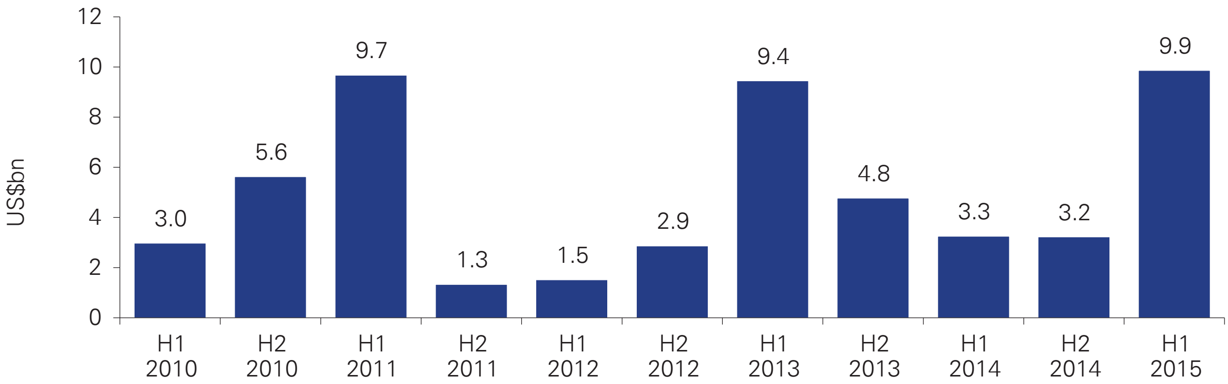
Figure 2: Shipping terminals, deal values, in US$ billion (as per announcement date)



Source: Thomson One Banker, as on October 19, 2015

Growing South East Asian trade aiding M&A activity

Among the global shipping trade lanes, South East Asian trade routes have seen increased trade activities, due to increased demand. Shipping terminals, in this region, are facing challenges of not only accommodating larger ships, but also extending value-added services such as providing logistical support to shipments. This in turn, is forcing the terminals to explore options of consolidation. Further, state investments funds, with access to capital, are also exploring ways to expand their reach globally, by acquiring strategic assets.

- Malaysian port operator Westports Holdings, which reported net profit of US$39 million in 2014, is actively looking for M&A targets in the region.[13]
- In September 2015, China's COSCO teamed up with China Merchants Group and China Investment Corp (CIC) to buy a US$950 million stake in Turkey's largest private port.
- COSCO is also a front-runner to acquire a 51 percent stake in Greece's Piraeus Port Authority (PPA)[14].

M&A activity in China is influenced by the country's plans for the Silk Road Economic Belt, which will link China's Yangtze River Delta, Pearl River Delta and Bohai Sea economic zones with the European economy.[15]

Low prices and privatization plans in mature markets

M&A activity is increasing not only in developing economies, but also in developed economies. In 2014, several high-profile deals took place in the US, including the sale of APM Terminals' Norfolk, Virginia terminal.[16] Further, shipping liners are selling their terminal assets as they are focusing on reducing costs by improving their core activities.

"The sector's strong financial performance and accelerating growth is encouraging new market entrants and renewed merger and acquisition activity in the container ports sector. Financial investors are particularly active at present, attracted by typical EBITDA margins of between 20% and 45%," said Neil Davidson, senior analyst in Drewry Maritime Research's ports and terminals practice.[17]

The increase in M&A activity is also due to relatively lower acquisition prices — about 8–12 times the EBITDA of companies.

Additionally, the attractiveness of US terminals have increased mostly due to terminals' focus on automation, thereby reducing labor costs. Thus, US terminals will be major M&A targets, and the number of deals in the region might further increase.

Focus on privatization by some governments is also leading to an increase in deal activity among terminals. While the Greek government mulled over the privatization of ports and rail companies, the Russian government in 2014 approved plans to privatize more than 400 companies. Among these companies, the Novorossiysk Commercial Sea Port, was one of the valuable assets the state had put up for sale.[18,19]

Conclusion

In 2014, listed shipping companies reported a decline in EV/EBITDA valuation multiples, making them accessible targets for acquisition. So far, alliances, instead of M&A, have proven to be ideal cost-saving models for shipping liners. On the other hand, ocean carriers are selling their terminal assets; and financial investors, who invested heavily during the mid-2000s, are seeking to exit the market. Therefore, we believe that M&A activity in the shipping sector, particularly within terminals, will increase in the coming years.

Source

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