

Logistics – WTO Reforms Driving M&A and Foreign Expansion

MARKET OVERVIEW

China, the largest producer of goods in the world with a near 20% global market share, is opening up the logistics market to foreign ownership. In accordance with the terms of China's accession to the WTO, by the end of 2005, foreign firms will be able to operate independently in China without local partners in all logistics business lines through wholly foreign owned enterprises. Driven by deregulation and the government's commitment to improving the efficiency of the nation's logistics infrastructure, the China logistics market is expected to undergo rapid change and increased competition as both local and foreign firms compete for market share.

Logistics Market Opening Timetable		
Business	Current policies (Foreign ownership)	WTO agreement (Foreign ownership)
Freight forwarding	Up to 75%	100% by Dec-05
Int'l express	Minority	100% by Dec-05
Domestic express (mail and documents)	Zero	100% by Dec-05
Shipping agency	Minority	100% by Dec-05
Storage and warehousing	Majority	100% by Dec-05
Logistics consulting	Minority	100% by Dec-05

Source: Ministry of Commerce

This creates more opportunities for foreign logistics services providers. However, challenges remain for foreign firms who are planning to expand market share and operate independently of Chinese partners, including:

- **Regulation** – numerous regulatory inefficiencies;
- **Infrastructure** – highly fragmented logistics infrastructure and bottlenecks at the key coastal ports;
- **Local Requirements** – local customers/shippers have specific preferences based on local market and are relatively unsophisticated regarding their logistics needs and advanced supply chain solutions; and
- **Competition** – fierce price competition with local logistics services providers.

We expect foreign firms to move quickly in this competitive environment with investment and acquisition of local assets and firms to better manage service quality and expand capabilities. This will lead to a consolidation of the sector.

Industry Dynamics

China's logistics spending is projected to increase from about \$US300 billion in 2003 to US\$360 billion in 2005.ⁱ Total logistics spend in China is approximately 20% of GNP compared to 10% of GNP in developed countries.ⁱⁱ The high cost of logistics spending reflects China's fragmented transportation network, less developed infrastructure, untrained workers and market barriers to new competition.

All the ongoing changes are leading to a less fragmented and more sophisticated logistics sector. As firms expand their operations across geographies, the increasing complexity of logistics services will require more advanced IT systems and operational expertise. In addition, as more multinational corporations establish and grow their presence in China and local firms outsource more logistics services, the demand for sophisticated logistics services will also increase. Foreign integrated logistics services providers will spur technology transfer and emphasize service quality, leading to improved standards over time.

Consolidation in this sector is already occurring. Notable transactions include UPS' purchase of Sinotrans' express business for US\$100 million and TNT's plan to invest US\$260 million in China to expand express and logistics lines.ⁱⁱⁱ

Segmentation

- **Transport and Warehousing:** More than 500,000^{iv} logistics companies in China provide mostly basic transportation and warehousing services locally or regionally. These companies are highly price-competitive and operate on very thin margins.
- **Freight Forwarding:** There are over 3,000 licensed freight forwarders in China including both foreign and local freight forwarders. Sinotrans is the largest freight forwarder in China with about 10% market share in both sea and airfreight forwarding industries. Cosco Logistics and China Shipping are the other two major players in the sea freight forwarding industry with EAS another key player in the airfreight forwarding industry.^v
- **Domestic Express:** China's domestic express delivery market is highly fragmented. China Post's EMS is the major player with an extensive network. Other major players include China Air Express, China Railway Express, and Da Tian. The barrier to enter this market is low.
- **International Express:** China's international express delivery market is estimated to reach total revenue of approximately US\$1 billion in 2003 and the market will grow by 15% p.a. in the next few years. The market is highly concentrated and dominated by five big companies: DHL-Sinotrans, FedEx-Da Tian, UPS-Sinotrans, TNT-Marchplus, and China Post's EMS. These five companies jointly control over 95% of the market.^{vi}
- **Shipping Agency and General Logistics:** There are over 600 licensed shipping agencies in China.^{vii} Many of them are small local firms. They compete with the bigger companies via lower prices, because of their lower costs.

THIRD-PARTY LOGISTICS (3PL) MARKET

Overview

Estimates of the current size of the China 3PL market vary with some forecasts as high as US\$12 billion.^{viii} The 3PL market in China is in its very early stages and represents about 4% of the total Chinese logistics market compared with 14% and 25% in the U.S. and Europe, respectively.^{ix} The 3PL market is expected to grow rapidly with predictions of 25% per annum growth over the next five years. The market is highly fragmented and no one firm has a significant market share.

The vast majority of 3PL firms in China generate less than US\$25 million per year in revenue and the majority of this revenue is still generated by basic Storage and Warehousing services such as transport management and warehousing.

- Local firms are reluctant to outsource core logistics functions.
- Pricing pressure is extremely high as some local competitors under-price or gives discounts on their 3PL services as loss leaders.
- Local manufacturers often fail to recognize full value of 3PL and often prefer asset-based logistics service providers.

Competitive Landscape

Four distinct groups compete in the 3PL services landscape:

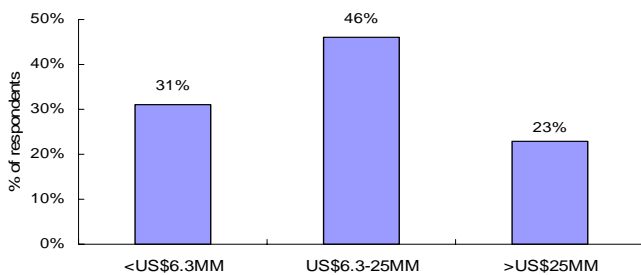
Competitive Landscape in China 3PL Market

Traditional Chinese Transportation Companies	Emerging Chinese Logistics Companies
<ul style="list-style-type: none"> • COSCO • Sinotrans • China Shipping • China Resources • China Materials Storage and Transportation Co. • China Post • CRML • CRE 	<ul style="list-style-type: none"> • EAS • St-Anda • PGL • Hurry Top • China Overseas Logistics • Jiuchuan Logistics
Internal Logistics Departments of Chinese Companies	Foreign Logistics Providers
<ul style="list-style-type: none"> • Annto Logistics • Haier Logistics • Attend Logistics • Ding Xin Logistics • Bright Dairy & Food • TCL • Konka 	<ul style="list-style-type: none"> • APL • HTB • Maersk • Panalpina • Exel • Danzas • TNT • Schenker • FedEx • UPS • DHL

Sources: Global Business Insight Research 2005

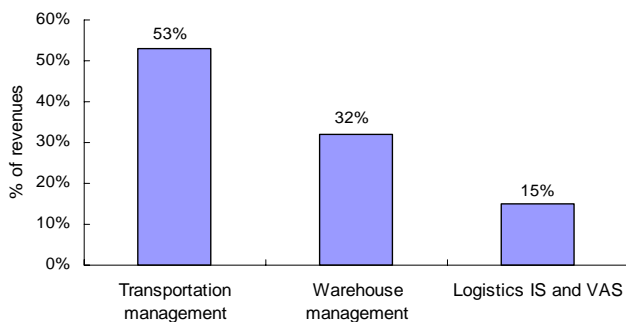
- **Traditional Chinese transportation companies** are strong in transportation and warehouse assets, have national networks, and normally maintain good relationships with central and provincial governments. Their weaknesses are overstaffing, a lack of customer orientation, and the need to improve service levels. Many are in the process of improving their efficiency. Some are enhancing their capabilities, particularly in IT systems.
- **Emerging Chinese logistics companies** are generally privately owned and tend to focus on one or two key industries. These firms have grown the fastest due to their light-asset nature and higher efficiency than the traditional companies. Their challenges are sufficient financial support, management talent, and organizational structures that will sustain their growth and profitability.

Gross Revenue



Sources: Mercer Management Consulting research, 2002.

Revenue Breakdown



Sources: Mercer Management Consulting research, 2002.

Customer surveys suggested that the future revenue driver will be demand for radio frequency ID (RFID) tracking and supplier management systems.

3PL services to multinational corporations (MNCs) are the most lucrative and are highly competitive, with foreign firms dominating this market based on existing relationships and their global reach. The challenges in providing 3PL services to local firms include:

China Logistics Sector Review

- **Internal logistics departments** of Chinese manufacturers and distributors mainly provide services to internal customers. Most of them have in-depth knowledge of the industries that they serve and reasonable network coverage, but they are weak in marketing. Some companies are planning to spin-off or sell these divisions.
- **Foreign logistics providers** typically enter China with their customers in an effort to serve those customers' global needs. Their advantages are advanced IT systems, operational expertise, and strong global networks. These companies are challenged by their higher cost structures as compared to their Chinese counterparts. Their lack of on-the-ground capabilities in China and their recent worldwide cost control efforts may put them at a disadvantage.

Recent China Logistics M&A Review

Consolidation in the China logistics market will be driven by both local and foreign firms seeking to improve their breadth and quality of logistics services. Domestically, the Chinese government is actively encouraging specialized logistics services through improved transport systems, IT, and infrastructure. Foreign firms are expected to invest substantially in China logistics. Acquisition activity will also be driven by a relaxation of ownership rules from WTO changes going into effect in December 2005.

Selected Recent China Logistics/Transport Deals

Date	Acquirer	Seller	Value (US\$)
Mar 05	Meridian IQ (Yell subsidiary)	GPS Logistics Group (Shanghai)	N/A
Feb 05	Temasek Holdings	Asia Container Terminals	\$243.6mn
Jan 05	COSCO Shipping Co., Ltd	Galaxy Shipping & Enterprise	\$6mn
Dec 04	CSX Corp	Asia Container Terminals	\$203mn
Dec 04	COSCO International	Yuantong Marine Services Co., Ltd	\$6.9mn
Dec 04	Dubai Ports International	CSX World Terminals LLC	\$1,142mn
Dec 04	United Parcel Service	Sinotrans Express Operations	\$100mn
Sep 04	Kerry Properties Ltd	Transportation Services COS	\$45.9mn
Sep 04	COSCO Corp Singapore Ltd	COSCO Shipyard Group Co	\$69.8mn
Sep 04	Guangdong Power Group	COSCO Shipping Co., Ltd	\$10.5mn
Aug 04	China Merchants Holdings	Ming Wah Universal	\$168mn
Jun 04	Singapore Airport Terminals	Asia Airfreight Terminal Co	\$44.6mn
Mar 04	Jinhui Shipping	Bulk Carrier	\$35.3mn

In general, mid-market logistics and transport deals in the U.S. have been completed at 5-8x EBITDA^x and generally at the higher end of the range for business with revenue over US\$25 million but below US\$100 million.

China deal terms are more difficult to obtain as compared to U.S. transactions and can vary substantially in terms and multiples paid based on the situation and strategic importance of the transaction. Recent deals include Meridian IQ, the global logistics management subsidiary of Yellow Roadway (YELL), acquiring the Shanghai based GPS Logistics Group for less than US\$10 million.

In the express delivery market, UPS will gradually take control of Sinotrans' agency business (UPS-Sinotrans JV with 70.4% stake held by Sinotrans). Sinotrans has been providing international express agent service to UPS under the UPS brand since 1998. UPS will gradually take direct control of Sinotrans' customers, 22 locations, customs brokerage and customer service by the end of 2005. UPS will pay US\$100 million to Sinotrans with installments of US\$40 million in January of 2005, US\$10 million in January 2006 and US\$50 million in January 2007. The multiple paid was reported to be 8.5x net earnings for the Sino-UPS venture or 12.2x net earnings to Sinotrans in 2003.^{xi}

In the freight forwarding market, Stonepath Group recently closed its acquisition of a 55% stake in Shanxi Sunshine Cargo Services (announced late 2003) at a price of up to US\$13 million with US\$5.5 million subject to earn-out. The first 10 months of 2003 net income was reported to be US\$2.3 million with revenue of US\$55 million. Pro-rating full year net income to US\$2.8 million, Stonepath paid approximately 8x 2003 net income or 5.9x expected net income of US\$4 million based on the earn-out provisions.

SUMMARY

China logistics companies are evolving from rudimentary transportation/warehouse providers to become broad supply chain solution providers. 3PL services providers will focus more on customer needs and continue to improve their technology abilities, thereby enhancing customer relationship. Outsourcing of transaction-based services to 3PL providers will also increase. The current expansion, acquisition, and consolidation activities in the China 3PL industry will continue.

Selected China Logistics M&A Candidate Targets

Company	HQ	Warehouse Space (m ²)	Selected Clients	Comments
 Beijing Bailiwei Logistics Co., LTD	Beijing	80,000	Dzelec, RSD	<ul style="list-style-type: none"> • USD 12.5 MM investment in firm • Goal is to establish 40 transport centers across China
 Eternal Asia	Shenzhen	N/A	China Telecom, China Unicom, Haier, Cisco, Digital China, Eastcom, Ingram, Konka, Servgate Technologies, Siemens, Star, TCL, TsingHua Tongfang	<ul style="list-style-type: none"> • Subsidiaries in 8 major cities: Beijing, Chengdu, Guangzhou, Hong Kong, Shanghai, Shenzhen, Suzhou, Wuhan • 200+ cities network, 400+ clients
 GTG Logistics Co Ltd	Guangzhou	50,000	Gdxdy, Jianlibao, Kelon, Konka, Nippon Paint, P&G, Strongfood, Wrigley	<ul style="list-style-type: none"> • USD 1.25 MM in registered capital and 300 transport vehicles • 8 subsidiaries and 30+ branches primarily in southern china • Subsidiary of Guangdong Transportation group, a state-owned utility company
 GZ logistics	Guangzhou	210,000	Carrefour, China Unicom, FAW, JNJ, Mead Janson, Meiling Holdings, Panasonic, Shinco, Samsung, Unilever, Whirlpool	<ul style="list-style-type: none"> • USD 37.5 MM total asset • 150 branches and nationwide network, 150 vehicles
 Hezhong Logistics	Beijing	100,000	AkzonNobel, BMCC-National, Panasonic, GE, LG, National Panasonic, Shinco, Richo, Samsung	<ul style="list-style-type: none"> • Reports 56 distribution vehicles, 50 container trucks and 10 large transport vehicles. • Subsidiary of a state-owned entity, Hezhong Transportation Group
 Hua Nan Run1 Logistics Co	Changsha	N/A	Broad Air Condition, Puyuan Corp, Sany Heavy Industry Corp Ltd	<ul style="list-style-type: none"> • USD 75 MM total asset • 200 branches, 2,000 employees and 4,400 vehicles • Advanced management, EDI
 HurryTop	Shanghai	200,000	Electrolux, Kraft, P&G, Philips, Unilever	<ul style="list-style-type: none"> • 30+ branches • Logistic management systems, WMS, TMS and ERP • Serve 30+ Fortune 500 companies
 Jia Yu Logistics	Shanghai	N/A	Acer, APP, Canon, Colgate, Digital China, GE, Hedy, Ingersoll Rand, Lenovo, Lanxum, LG, Motorola, Pioneer, Siemens, Toshiba and Unilever	<ul style="list-style-type: none"> • USD 13+ MM assets in 2002 with 550 vehicles • USD 25 MM in sales (co. site) • 150 + branches across China, warehouses in 90 cities, 2100 employees • Logistics management, express delivery and privately owned
 JiaJie Express	Shanghai	N/A	ABB, Danone, Electrolux, Epson, Hedy, KFC, Koda, Levono, Medi, Netro, PCI, Philips, Richo, Star, UT Starcom	<ul style="list-style-type: none"> • USD 75.8 MM in registered capital and USD 52.5 MM in revenue in 2002 • 360 branches, 700 transport vehicles and 5,000 employees • 50 MM sq. m. operation area
 JiaYi Logistics	Jinan	60,000	Acer, Digital China, Foundertech, Hisense, Langcao, Lenovo, Panasonic China, Philips, Samsung, Sanyo	<ul style="list-style-type: none"> • 2,000+ clients, 510 employees • Distributed USD 1.5 billion+ goods in 2003
 Ningbo Zhong Tong Wu Liu	Ningbo	20,000	Changhong, Haier, Konka, Little Swan, TCL	<ul style="list-style-type: none"> • 80 vehicles and 120 branches • Nationwide road transportations service
 Qiancheng Logics	Shanghai	8500	Asus, Benq, Dell, Guangdong Fortune Colour Picture Tube Co. Ltd, Hualing Holding, Shanghai Stow Storage Equipment Ltd, 3M	<ul style="list-style-type: none"> • Focuses on IT logistics, 85 trucks
 Shenzhen Energy Logistics Company	Shenzhen	20,000	Accton, Casio, Hellmann, IBM, Kikari, KorChina, Maersk Logistics, Mitac, Nanfu, Panalpina, Ricoh, Samsung, Schenker, Sony, ST	<ul style="list-style-type: none"> • Subsidiary of a public co • About 100 transportation vehicles • SO9001. Logistic management, JIT

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- i “Case Stories: The third-party niche”, *Global Business Insights (GBI)*, January 31, 2005, <http://www.gb-insights.com/>
 - ii *Ibid*
 - iii *UBS Investment Research, Sinotrans Limited, “Industry-leading position challenged”, November 19, 2004*
 - iv “Case Stories: The third-party niche”, *Global Business Insights (GBI)*, January 31, 2005, <http://www.gb-insights.com/>
 - v *UBS Investment Research, Sinotrans Limited, “Industry-leading position challenged”, November 19, 2004*
 - vi *Ibid*
 - vii *Ibid*
 - viii “Case Stories: The third-party niche”, *Global Business Insights (GBI)*, January 31, 2005, <http://www.gb-insights.com/>
 - ix *Ibid*
 - x *Securities Data Corp, Thomson Financial, UBS Research*
 - xi *CICC Research, December 16, 2004*