Small 3PLs Make it Big

The logistics market's high growth and fragmentation evidences it is in the early stages of a massive wave of consolidation that will transform the industry. As logisticians and senior-level executives plan for the future it's more important than ever before that they're mindful of this fast-changing landscape. Here's an insightful overview of what lies ahead.

By Benjamin Gordon

THE LOGISTICS MARKET is experiencing a new pattern: the collapse of the middle.

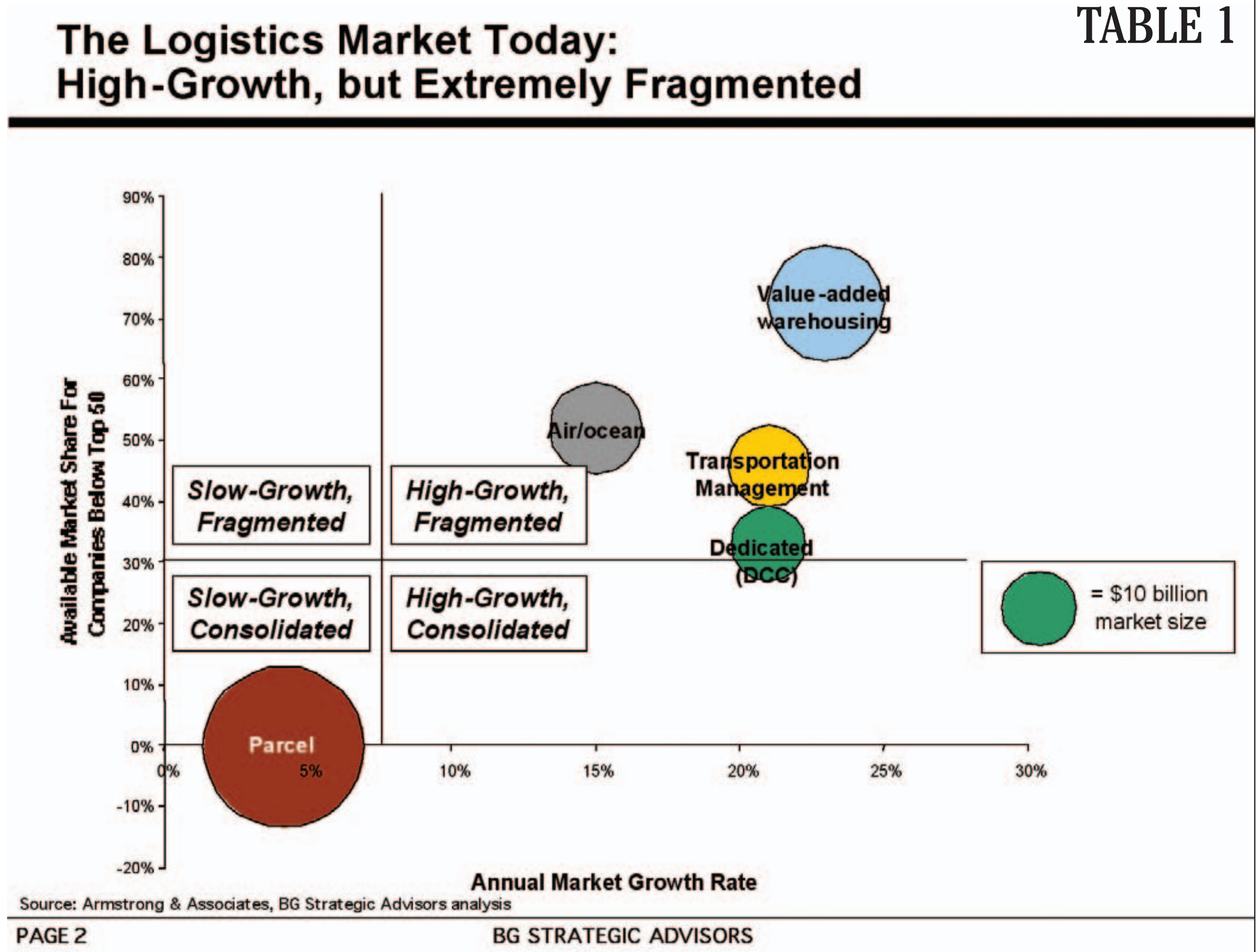
At one end of the spectrum, large logistics companies are getting larger. In the past three years, we have seen a wave of acquisitions: UTi acquired Standard Logistics. Kuehne & Nagel bought USCO. UPS purchased both Fritz and Mailboxes Etc. Not to be outdone, Deutsche Post bought AEI, Danzas and Airborne.

It would seem that small companies would have little hope of competing against such multi-billion-dollar behemoths. In fact, at the other end of the spectrum, a surprising trend has appeared. While many small companies have struggled, a few have emerged as big winners. This column is about the success stories of those smaller logistics companies, and the implications for others in the industry.

The Case for Consolidation

The logistics market is undergoing a sea change. We are in the early stages of

TABLE 1



a massive wave of consolidation that will transform the industry. This powerful change is rooted in the market's high growth and fragmentation.

As Table 1 shows, the logistics market comprises several categories: value-added warehousing, air/ocean freight forwarding, asset-light transportation management, and asset-based dedicated contract carriage. Each segment has grown at 15-25 percent annually over the past decade, and is likely to continue to do so. Furthermore, each segment is highly fragmented. In all cases, the market share available for small companies (defined as those which are not top-50 in their segments) is above 30 percent, and in the case of warehousing is over 75 percent.

As growth inevitably slows, the largest logistics companies are pursuing acquisitions. This is for three reasons. First, Fortune 1000 customers are increasingly seeking to reduce the number of logistics suppliers they use. Second, new technologies make it possible to manage companies' logistics needs more cost-effectively, as the Menlo-Vector and KN-Nortel examples show. Third, outside capital is serving as a force multiplier, accelerating the growth rate of new ideas.

The Mid-Market Opportunity

The bad news for small and mid-sized logistics companies is that larger companies are deploying their deep pockets to boost their market shares. The good news is that many of the most compelling growth opportunities lie in the mid-market.

As adoption levels approach saturation for the largest companies in the industry, the mid-market is emerging as a source of major growth potential. Table 2 shows that companies in the Fortune 100 are already fully-penetrated, with over 70 percent using outsourced logistics services. In contrast, companies in Fortune 401-500 are just over 20 percent penetrated. As a consequence, the Fortune 100 are only likely to see outsourced logistics spending growth of 8 percent, whereas outsourced logistics expenditures for companies in Fortune 401-500 are likely to grow at 20 percent annually.

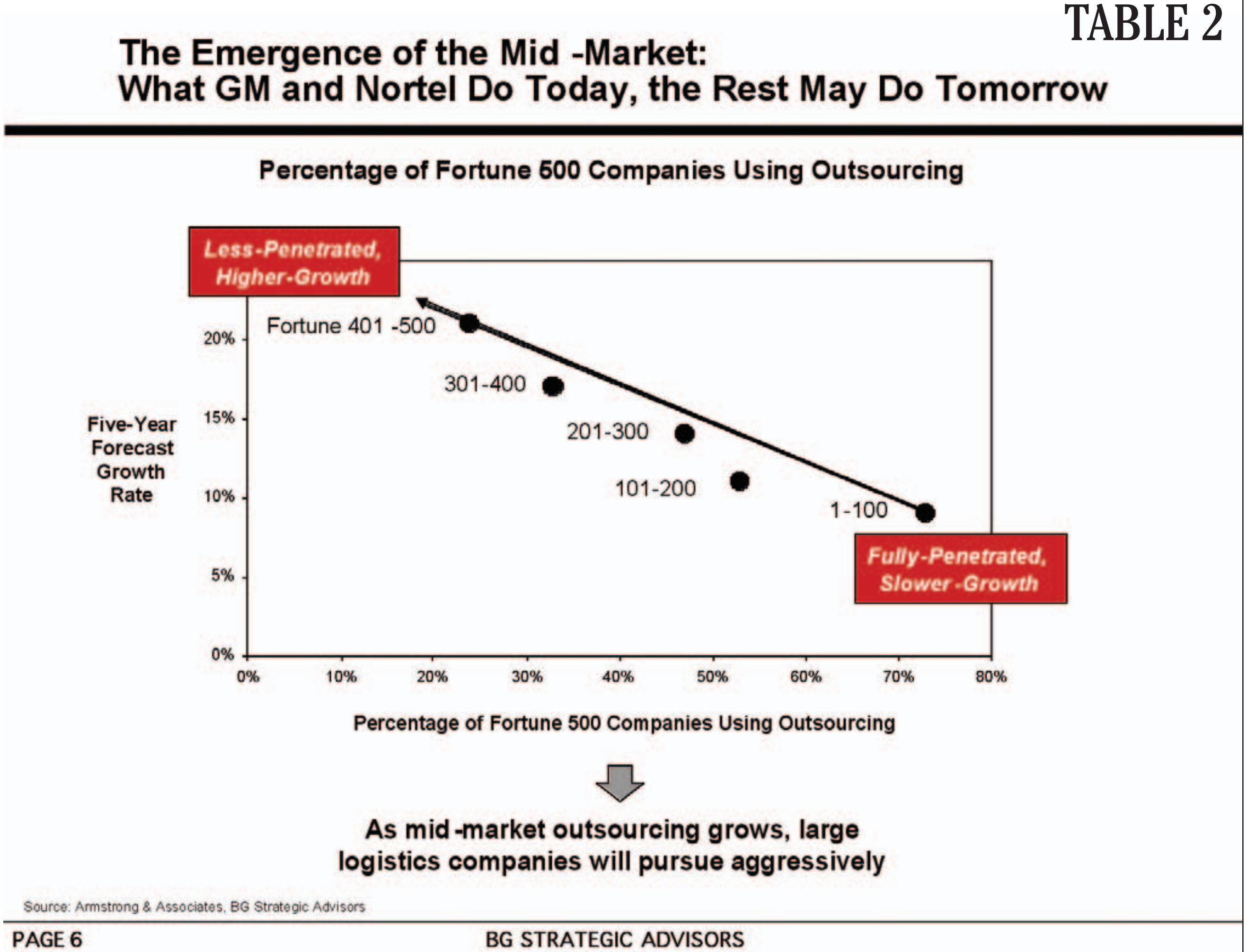
Consequently, the stage is set for 2004 as a year of growth for niche-oriented, mid-market-focused logistics firms.

Small 3PL Success Stories

Within this market, how can mid-sized logistics companies respond?

Based on our research, I would suggest that several companies are poised to take the stage, by virtue of their focus on high-growth mid-market segments. In particular, logistics firms which have achieved leadership within protected niche markets are likely to be especially successful. Three types of niches look

TABLE 2



particularly attractive: vertical solutions, cross-border services, and post office logistics.

Vertical Solutions

One example of a winning mid-market strategy revolves around vertical solutions. On the surface, this may appear counter-intuitive, since many companies focus on different vertical markets. However, the true giants of value creation in the logistics sector have developed pure-play, highly-differentiated offerings that are tailored uniquely to customer segments.

For instance, USCO Logistics was slightly better than break-even in profitability in 1996. When new CEO Bob Auray came on board the following year, he molded the business around the high-tech and telecom sectors, developing tailored technologies and business services for clients such as Sun and Nortel. Within four years, USCO shot up to close to $40 million in cash flow or EBITDA, before selling to Kuehne & Nagel for approximately ten times EBITDA. Similarly, CTI commanded a premium valuation of 14 times EBITDA when it sold to TPG, in large part because of its niche leadership within the automotive sector. As these examples demonstrate, vertical solutions can provide tremendous value to shareholders.

Today, PACAM is an example of a company focused on vertical solutions for the liquor industry. As the #1 logistics provider to this niche, PACAM has developed a set of customized services including Foreign Trade Zone designation, co-packing, value-added warehousing, and transportation for the liquor distribution market. Although a small company, PACAM has leveraged these capabilities to achieve over 20 percent annual growth for the past decade, competing successfully in head-to-head battles against multi-billion-dollar logistics companies.

Cross-Border Services

Another category poised for growth is cross-border services. Over the past decade, US exports to Canada have grown at 10 percent annually. Last year, over 10 million trucks crossed the US-Canada border, as the U.S. imported $211 billion from Canada and exported $161 billion. Similarly, truck crossings on the U.S.-Mexico border grew from 2.8 million in 1995 to 4.4 million in 2002, as both exports to and imports from Mexico more than doubled over the same time period. As U.S. companies continue to expand trade with NAFTA neighbors, and as security regulations create increased complexity in terms of compliance, cross-border services will provide expanding opportunities for innovative logistics companies.

Air Road Logistics is an example of a specialist logistics firm, focused on US-Mexico logistics services for automotive, consumer electronics, retail and industrial companies. Air Road was recently acquired by Reliant Equity Investors, in partnership with former Wal-Mart logistics executive Steve Robinson. They were excited about Air Road's niche leadership, and saw an opportunity to expand the company's services into new geographies (NAFTA-wide, including Canada) and services (including dedicated, brokerage, and inventory management (VMI)). This asset based company really gets supply chain and is uniquely qualified to deliver outsourced services in support of NAFTA driven logistics operations.

Unicity Integrated Logistics is an example of another type of cross-border specialist, serving as a Canadian platform for U.S.-based Fortune 500 companies. Unicity provides Fortune 500 companies with a Canadian supply chain and logistics platform, either for (a) outsourcing their manufacturing operations to Canada, or (b) distributing their products into the Canadian marketplace. The company has grown at over 20 percent annually and should continue to be a leader in this category.

Post Office Logistics

The United States Postal Service is the nation's largest transportation entity. It delivers to a mind-boggling 130 million addresses per day. The USPS designed a Work-Share Initiative in the mid-1990s to better manage the high volume densities received from direct mailers. It sought partners who would shoulder the responsibility of handling linehaul transportation of mail freight, thereby enabling the USPS to focus on its core competency of "final mile delivery." This outsourcing shift created an enormous market opportunity for creative transportation companies who took the time to understand the magnitude of the post office logistics operations.

SmartMail Services responded with an innovative business model that has grown rapidly since its inception in 1996. Maximizing the strength and efficiencies of the USPS, SmartMail offers delivery services for catalogs, flat-size mail pieces, and parcel packages. The company built 16 processing centers nationwide and designed each facility to quickly and efficiently process mail pieces in a highly secure environment. Delivery options include expedited air and budget ground. Service features such as on-line tracking and reporting, address verification, ZIP code correction and selective routing offer mailers greater control over their deliveries. According to CEO Jim Martell, "The broad range of services we offer high volume mailers and shippers give them delivery options they didn't have ten years ago. The density we achieve in our processing centers allows mailers to shave millions off of their shipping costs without compromising delivery times." Since its founding in 1996, SmartMail has grown to over 1,200 customers and $200 million in revenues, and is likely to continue to expand.

Ultimately, the smartest small companies are pursuing one of two paths: (1) scale up through niche market leadership, invest in technology, and execute a differentiated strategy, or (2) sell to one of the many motivated buyers that currently exist in the logistics marketplace. Companies can succeed in either scenario. The key is to make a clear decision as to which path to pursue.

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Providing Logistics CEOs with the Tools to Maximize Value

In a consolidating market, what should you do to ensure your company's success? Acquire a competitor? Raise capital? Launch a new business? Or sell?

BG Strategic Advisors can help. Our firm specializes in providing CEOs in the transportation, warehousing and logistics industry with the tools to maximize value. We draw on deep market expertise, a trusted reputation for high-quality advice to top-tier supply chain companies, and a track record of integrity and success. Here are a few examples of past engagements:

AIR-ROAD

NFI
How Business is One

Nations Express
Expediting & Logistics

Air-Road Express, a leading U.S.-Mexico automotive logistics company, wanted to explore a potential sale of the business. Air Road hired BG Strategic Advisors to evaluate their options. Our firm developed a strategy for positioning the company, wrote an informational memorandum highlighting its unique strengths, and identified an ideal buyer. Within 60 days, our client signed an agreement for the sale of the company to Reliant Equity Investors. The deal was completed in August 2003.

NFI Industries, a $500 million multi-service transportation, warehousing and logistics company, wanted to develop an integrated growth strategy for its "business silos." NFI chose BG Strategic Advisors to identify the best opportunities. We profiled competitors, interviewed customers, and outlined a new business design. As a result, NFI re-positioned as an integrated supply chain solutions leader, and achieved record revenues and profits in 2003.

Nations Express, a $30 million expedited transportation company, selected BG Strategic Advisors to conduct a Logistics Leaders Session with the Board. We analyzed the market, profiled success stories of top innovators, and led a fact-based brainstorming session. To maximize its differentiation, Nations Express launched a major technology initiative, in partnership with us. The company is on track for record revenues, productivity and profits in 2004.

If you are considering an acquisition, capital raise, strategy initiative, or sale of a business, talk to BG Strategic Advisors first. We would be glad to provide a free, confidential consultation.

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