

## Transportation and Logistics



### Air Cargo Update

An October 2010 attempt by al Qaeda in the Arabian Peninsula to send bombs via the air cargo of United Parcel Services and FedEx has highlighted a long-standing policy debate about the screening of packages shipped via air carriers. Millions of packages move through the global air cargo shipping system every day, and it will remain a vital link in the supply chain for many businesses throughout the world. The packages, sent by al Qaeda in part on passenger flights, were designed to explode in flight and likely would have destroyed the planes if detonated.<sup>1</sup> The attempted attack brings to light the Transportation Security Administration's (TSA) mandate to move to 100 percent air freight screening for cargo transported on passenger aircrafts, effective August 2010.

In 2007, Congress passed the Implementing Recommendations of the 9/11 Commission Act (more commonly known as the 9/11 Act). The law mandates that all cargo transported on passenger aircraft must be screened for explosives. As a response to the September 11 terrorist attacks in New York, the security screening mandate was created with an initial target of 30 percent. In February 2009, the requirement increased to 50 percent and finally stepped up to 100 percent screening in August 2010. The latest increment requires that every shipment of cargo carried on passenger aircraft be screened, at piece level, prior to being transported on any passenger aircraft. In order to meet this requirement, pallets need to be taken apart, screened, and reconfigured. The 9/11 Act specifically identifies the types of screening allowed including physical inspection and various scanning technologies.<sup>2</sup>

To facilitate the transition to full screening, the TSA has developed the Certified Cargo Screening Program (CCSP) as a solution to assist the industry in reaching the 100 percent screening objective. Under the CCSP, the TSA will certify cargo screening facilities located throughout the United States that screen cargo prior to providing it to airlines for shipment on passenger flights. Participation in the program is voluntary and designed to enable vetted, validated and certified supply chain facilities to meet the 100 percent screening requirement.<sup>2</sup>

The TSA is encouraging air freight forwarders and other vendors to handle most of the screening duties. The TSA will certify private sector companies as being capable of screening air freight shipments. Companies certified by the TSA will be trusted, vetted, and audited.<sup>3</sup> Among others, shippers that do not want to become a Certified Cargo Screener but wish to avoid potential delays or damage to their shipments due to the screening process can use freight forwarder's Indirect Air Carrier (IAC) services, or use an Independent Cargo Screening Facility (ICSF).<sup>2</sup>

IACs include entities within the United States that engage indirectly in the air transportation of property and uses for all or any part of such transportation the services of a passenger air carrier, but who are not in possession of a Federal Aviation Administration air carrier operating certificate.<sup>2</sup> Specific locations of many IACs have been approved by the TSA to screen as well as transport CCSP air cargo. ICSFs are independent cargo screening facilities that are authorized by the TSA to screen cargo that will

be transported by a passenger air carrier. Most ICSFs are not freight forwarders.<sup>2</sup>

In the short term, the mandate has generated broad criticism that 100 percent screening is not only inefficient but also that the program poses serious logistical and theft concerns. The air-freight industry has argued that because air-cargo packages are wrapped together with dozens of other items on large frames, or pallets, screening will be impossible without a huge investment of time and manpower that would create delays and raise costs significantly. Implementing the screening program will require large facilities to handle multiple unpacked shipments. Critics also cite the lack of TSA-certified screening technology to inspect large air cargo shipments. Technological restraints coupled with hefty costs will force logistics providers and regulators to strike a balance between practical security measures and the need to facilitate commerce.<sup>3</sup>

Furthermore, the law does not address screening on cargo airplanes. Several members of Congress have vowed to address this perceived deficiency in the law as written. Lawmakers are also urging for increased scrutiny of cargo airplanes from dangerous points of origin. Some have proposed a list of "countries of interest" that would include, but not necessarily be limited to, those same nations for which the TSA ordered enhanced screening techniques for passengers bound for the United States in previous failed attacks.<sup>4</sup>

### Implications for the T&L Industry

The 100 percent screening mandate has spurred industry participants to assess potential strategic opportunities as a result of the TSA screening mandate. Producers of products as well as the shipping industry have prepared for the increased requirements. For example, Pfizer Inc., a global pharmaceutical company, is obtaining TSA certification for its own facilities in order to handle security for sensitive cargo in house. Other businesses may choose to shift to freight operators, which have different screening rules than passenger aircraft, or forwarders with approved screening programs.

<sup>1</sup> *Washington Times*, "Cargo Screening on the Radar after Scare," November 2, 2010.

<sup>2</sup> Transportation Security Administration, Air Cargo Programs and Initiatives. 100 Percent Screening Requirement, December 9, 2010.

<sup>3</sup> *The Journal of Commerce Online*, Mongelluzzo, Bill. "Cargo Screening Offers Profits, Risks; Private Sector to Screen Most Airfreight," April 23, 2009.

<sup>4</sup> *HSToday*, McCarter, Mickey. "DHS Steps Up Cargo Screening," November 4, 2010.

## Select Transportation and Logistics M&A Transactions

- March 7, 2011—**Arcus Infrastructure Partners LLP**, a principal investment firm, acquired **Forth Ports plc** (LSE: FPT), a provider of port, cargo handling, towage, and related services and facilities in the United Kingdom, for US\$1.3 billion. The transaction implies a valuation multiple of 5.6x revenue and 16.3x EBITDA based on LTM August 2010 results.
- March 3, 2011—**Kuehne & Nagel International AG** (SWX:KNIN), a provider of logistic services, acquired **Hapag-Lloyd AG**, which offers vessels for the transport of various goods, such as cargo with oversized dimensions and dangerous goods, and general, noncontainerized, temperature-controlled cargo, for US\$488 million.
- March 1, 2011—**JSC Passenger Port**, which provides marine transportation and organizes tours and entertaining trips on owned and rented boats, acquired **North Western Shipping Company** (MICEX: SZPR), a river and sea shipping company, for US\$33 million. The transaction implies a valuation multiple of 0.9x revenue based on LTM November 2010 results.
- February 24, 2011—Private equity firms **Warburg Pincus LLC** and **Vestar Capital Partners** acquired **Triton Container International Limited**, which operates and leases marine inter modal cargo container fleets for the ocean carriers and international trade firms, for an undisclosed amount.
- February 21, 2011—**Trancom Co. Ltd.** (TSE:9058), a provider of logistic management and logistic information services in Japan, acquired **Tradia Corp.**, which engages in the harbor transportation business that includes custom clearance, warehousing, freight transportation, and international freight forwarding in Japan, for US\$3 million. The transaction implies a valuation multiple of 0.4x revenue and 19.0x EBITDA based on LTM February 2011 results.
- February 15, 2011—**The Hertz Corporation**, which provides the rental and leasing of cars, trucks, and equipment, acquired **Ace Rental Cars, Ltd.**, which operates as a car rental company, for an undisclosed amount.
- February 8, 2011—**Odyssey Logistics & Technology Corporation**, a provider of logistics management and transportation services for the chemical and process manufacturing industries, acquired **Chemical Marketing Concepts, Inc.**, a provider of outsourced sample fulfillment and logistics services, for an undisclosed amount.
- February 3, 2011—**Roadrunner Transportation Systems, Inc.** (NYSE: RRTS), a provider of customized and expedited less-than-truckload, truckload and intermodal brokerage, and domestic and international air services, acquired **Morgan Southern, Inc.**, a provider of transportation services for the intermodal and shipping community, for US\$20 million. The transaction implies a valuation multiple of 0.4x revenue and 5.0x EBITDA based on LTM December 2010 results.
- February 1, 2011—**Kirby Corporation** (NYSE: KEX), a provider of marine transportation and diesel engine services to the marine and power generation markets in the United States, acquired **Enterprise Marine Services LLC, Ship Bunkering Operations**, which comprises 21 inland and offshore tank barges and 15 inland towboats and offshore tugboats, for US\$53 million.
- January 30, 2011—**International Truckload Services Inc.**, which operates as an investment and management company in the Philippines, acquired **CSI Logistics, Inc.**, a provider of truckload services, warehousing, and distribution services, for an undisclosed amount.
- January 20, 2011—**Air New Zealand Limited** (NZSE: AIR), an air passenger and cargo transportation services provider based in New Zealand, acquired **Virgin Blue Holdings Ltd.** (ASX:VBA), a provider of domestic and international airline services in Australia, for \$144 million. The transaction implies a valuation multiple of 0.6x revenue and 6.6x EBITDA based on LTM February 2011 results.
- January 14, 2011—**Advent International Corporation**, a private equity firm, acquired **Terminal De Conteneres De Paranaguá S/A**, an operator of the Paranagu port, handles various cargo products, storage, dock, and logistics services, for \$497 million.
- January 12, 2011—**Karden Israel Ltd.** (TASE: KRIS), an importer and marketer of motor vehicles, motor vehicle spare parts, and accessories in Israel, acquired **Dan Vehicle & Transportation D.V.T. Ltd.** (TASE: DVT), a provider of car rental services, for US\$94 million.
- January 5, 2011—**Victory Park Capital Advisors, LCC**, a private equity firm, acquired **Gulfstream International Group Inc.** (OTCPK: GIGI.Q), an operator of a scheduled airline, flight training academy for licensed commercial pilots, and provider of on-demand charter services, for US\$9 million. The transaction implies a valuation multiple of 0.1x revenue based on LTM June 2010 results.

Source: Capital IQ and Company Filings, March 7, 2011

The added complexity as a result of the new laws creates a growth opportunity for the logistics industry. David Wilt, global supply chain security manager for Xerox Corporation, commented on the mandate, "You're going to see a lot of shippers relying on their logistics providers."<sup>5</sup>

Some companies are already taking advantage of the opportunities. ADT Security Services teamed with URS Corporation and Andy Frain Services to offer a certified cargo screening solution to bid for TSA cargo screening pilot programs. As the prime contractor, URS provides a range of planning, engineering, architectural design, construction, and management services. Together, the three firms provide a complete solution package including construction, design and engineering services, access controls and facility security, training, and screening personnel.<sup>6</sup>

More recently, Homeland Security Secretary Janet Napolitano spoke directly with international shipping companies, including DHS, FedEx, TNT,

and UPS, to discuss methods of strengthening the screening of cargo on their planes in the wake of the explosives sent to U.S. destinations. Napolitano also reached out to the International Air Transport Association (IATA), to talk about ways of working with the private sector and international allies to protect the global supply chain from terrorist threats. The secretary stressed the need to coordinate activities at the TSA with private businesses to run background checks on personnel who handle cargo, to train employees, and to set cargo screening procedures.<sup>7</sup>

As the TSA continues to implement the Certified Cargo Screening Program, it will utilize a multilayered approach including allowing only known and established shippers to offer cargo to passenger airlines for shipment, randomly screening a significant percentage of all cargo, deploying explosive detection canine teams at high-volume cargo airports, and conducting cover tests and no-notice inspections of cargo operations.<sup>8</sup>

Almost all of the changes will require an investment in equipment, personnel, and training. In order to fulfill these requirements, analysts predict a wave of acquisitions and joint ventures as a means to quickly acquire capabilities or share in the investment. As the program matures, forward-thinking transportation and logistics companies will procure the greatest share of the expanded security screening market.

<sup>5</sup> *PRNewswire*, "Shippers Brace for Impending 100% Air Cargo Screening Requirement," July 12, 2010.

<sup>6</sup> *Aviation Today*, "Air Cargo Screening Moves Ahead," July 13, 2009.

<sup>7</sup> *HSToday*, McCarter, Mickey. "DHS Steps Up Cargo Screening," November 4, 2010.

<sup>8</sup> *PRNewswire*, "Shippers Brace for Impending 100% Air Cargo Screening Requirement," July 12, 2010.

Market Snapshot										
Company	Market Cap <sup>1,2</sup>	Share Price <sup>2</sup>	52-Week Low	52-Week High	Price % Change 1 Mo	Price % Change 1 Yr	Debt to TC	Price to BV	EV <sup>3</sup> /Sales	EV <sup>3</sup> /EBITDA <sup>4</sup>
<b>Logistics and Transportation</b>										
CH Robinson Worldwide Inc.	11,992.6	72.2	53.0	82.1	29.3%	19.7%	0.0%	10.0	1.2	17.8
Con-way Inc.	1,907.3	34.6	26.2	40.3	-1.4%	-10.8%	50.4%	2.3	0.5	8.2
Expeditors International of Washington Inc.	10,115.5	47.7	33.7	57.2	29.1%	17.1%	0.0%	5.8	1.5	15.4
FedEx Corporation	27,803.8	88.3	69.8	98.5	-5.5%	-1.9%	11.6%	1.9	0.7	6.5
Forward Air Corp.	852.9	29.3	22.4	32.3	11.3%	4.5%	16.7%	3.3	1.7	11.4
Hub Group Inc.	1,308.5	34.9	25.5	37.8	24.8%	9.1%	0.0%	3.5	0.7	15.2
JB Hunt Transport Services Inc.	5,096.7	42.0	31.5	43.9	17.1%	14.1%	53.3%	8.9	1.5	10.5
Landstar System Inc.	2,089.4	43.7	35.1	46.2	4.0%	-1.3%	36.9%	8.3	0.9	13.1
Pacer International Inc.	185.7	5.3	4.9	9.5	-11.6%	-19.9%	14.0%	1.9	0.1	10.0
Ryder System, Inc.	2,409.3	47.0	35.5	53.6	21.3%	1.1%	66.2%	1.7	1.0	4.5
United Parcel Service, Inc.	70,875.1	71.8	56.5	77.0	11.5%	3.8%	57.5%	8.9	1.6	10.2
UTiWorldwide Inc.	1,962.4	19.3	12.3	22.7	25.8%	21.7%	29.0%	2.2	0.5	11.3
YRC Worldwide Inc.	108.4	2.3	2.0	20.0	-83.2%	-83.7%	109.9%	NM	0.2	NM
<b>Logistics and Transportation Mean</b>					<b>5.6%</b>	<b>-2.0%</b>	<b>34.3%</b>	<b>4.9</b>	<b>0.9</b>	<b>11.2</b>
<b>Logistics and Transportation Median</b>					<b>11.5%</b>	<b>3.8%</b>	<b>29.0%</b>	<b>3.4</b>	<b>0.9</b>	<b>10.9</b>

Source: *Capital IQ* and company filings, March 7, 2011

<sup>1</sup> Market Capitalization amounts are in millions, based on closing share prices as of March 7, 2011.

<sup>2</sup> Market Capitalization and Share Prices are based on foreign exchange listed securities and converted to \$USD.

<sup>3</sup> Enterprise Value (EV) equals Market Capitalization plus Debt, Preferred Equity, and Minority Interest, minus Cash and Cash Equivalents.

<sup>4</sup> EBITDA equals Earnings Before Interest, Taxes, Depreciation, and Amortization.

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