



Consolidation in the liner industry

White paper

March 2016

Executive summary

Container shipping remains remarkably fragmented, with the top five operators accounting for less than half the global market. This presents considerable opportunity for further consolidation.

Until recently, the industry had experienced a 10-year lull of M&A activity following a flurry of takeovers in the early 2000s. Yet in the past 12 months four major deals have taken place involving several major shipping lines which have led people to question whether this presages a new trend of further industry consolidation.

The financial pressure on industry players, and in particular on weaker carriers, is intensifying daily as rates plumb new depths. Consolidation may be a route to survival for some, allowing lines to combine to create scale and to realise synergies.

As stronger carriers have shown, however, it is not the only route to scale. Both Maersk and Hapag-Lloyd have used acquisition as an engine of growth, whereas MSC has relied entirely on organic growth and prior to its acquisition of APL, CMA-CGM had complemented organic growth with a number of small acquisitions.

The benefit to the industry as a whole is considerably greater if lines pursue growth through acquisition rather than continuing to build new and larger tonnage, which the industry does not need. On the other hand, consolidation as a strategy for individual shipping lines entails considerable risk that the targeted benefits will not be achieved. Much depends on how effectively the task of consolidating the two businesses is managed.

Drewry identifies several key learning points for any shipping line considering consolidation with another carrier:

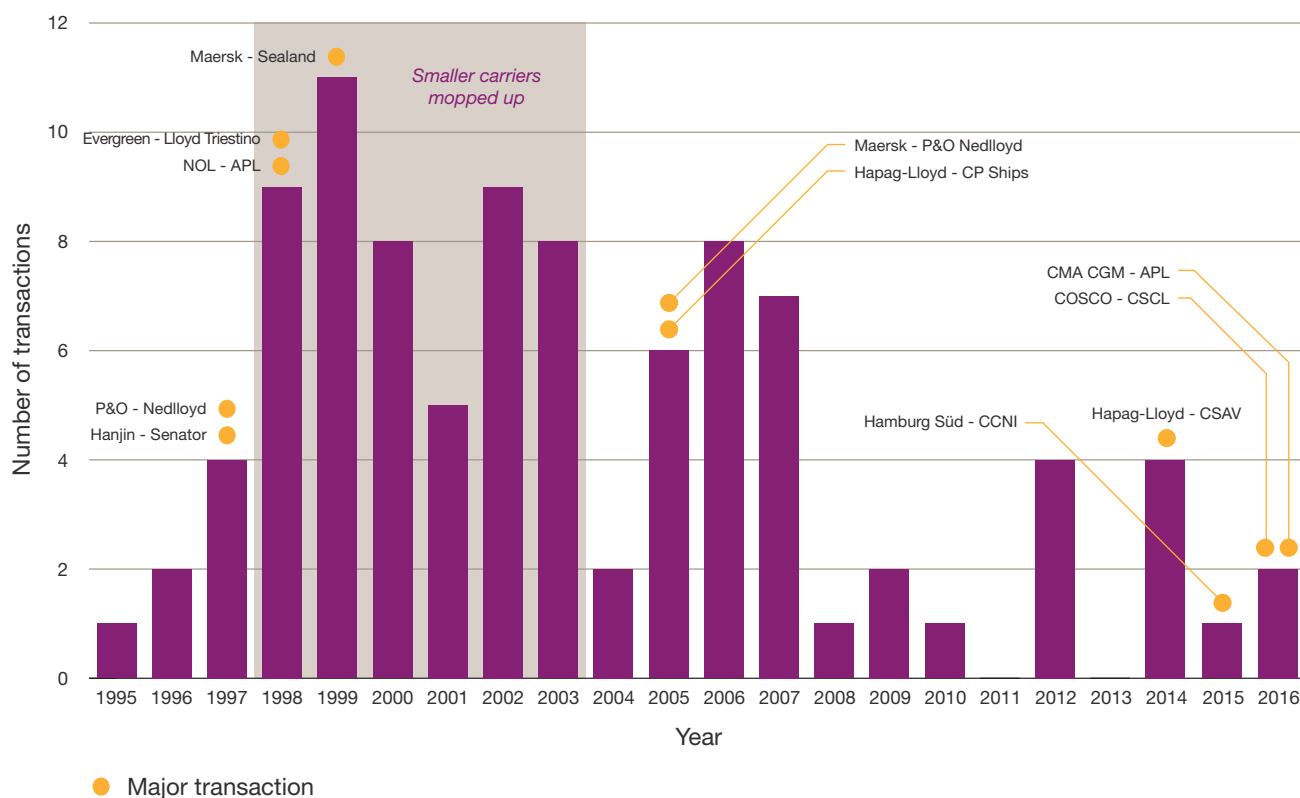
- Consolidation between two container shipping lines should achieve cost savings, through delivering synergies and longer term strategic advantage
- Consolidation yields greater benefit if the geographical footprint of the two companies is complementary, rather than resulting in additional volumes in the same trades
- The main cost savings come from economies of scale benefits as well as opportunities for smarter operations with increased volumes – e.g. improved network utilisation and lower container and imbalance costs
- While additional volumes can support employment of larger vessels, in many cases scale benefits in ship systems are already being achieved through Alliance membership
- A key objective during any consolidation must be to retain the customers of the two lines - loss of volumes or market share can cancel out the cost benefits obtained
- The challenge of merging two organisations with potentially different cultures and management styles should not be underestimated
- There will be significant one-off costs associated with combining the two businesses
- Planning and execution of mergers requires careful project management which can stretch resources - external expertise can alleviate this by providing additional skill sets
- People are critical to the transformation process and without a fully committed team there is a risk of customer attrition and project delay. It is essential to motivate both those chosen to remain in the future business together with those who are only needed through the transition phase
- Communication with all involved parties, including staff, customers, suppliers and partners, is vital throughout the process.

1 Mergers and Acquisitions – back on the agenda?

Back in the early 2000s, consolidation among major container shipping lines, whether merger or acquisition, was seen as the way to improve profitability and establish a more sustainable structure for the industry as a whole.

Yet, there was no significant M&A activity post-2005 until the merger of Hamburg-based Hapag-Lloyd and Chile's CSAV at the end of 2014. Now deals between Germany's Hamburg Süd and Chilean carrier CCNI, China's COSCO and CSCL, as well as France's CMA CGM with Singapore-based APL have followed in 2015, the latter two for completion in 2016.

Are major transactions back on the consolidation agenda?



This recent activity has led many to question whether it represents the start of a new phase of further M&A consolidation or whether they are one-off events.

2 Industry under financial pressure

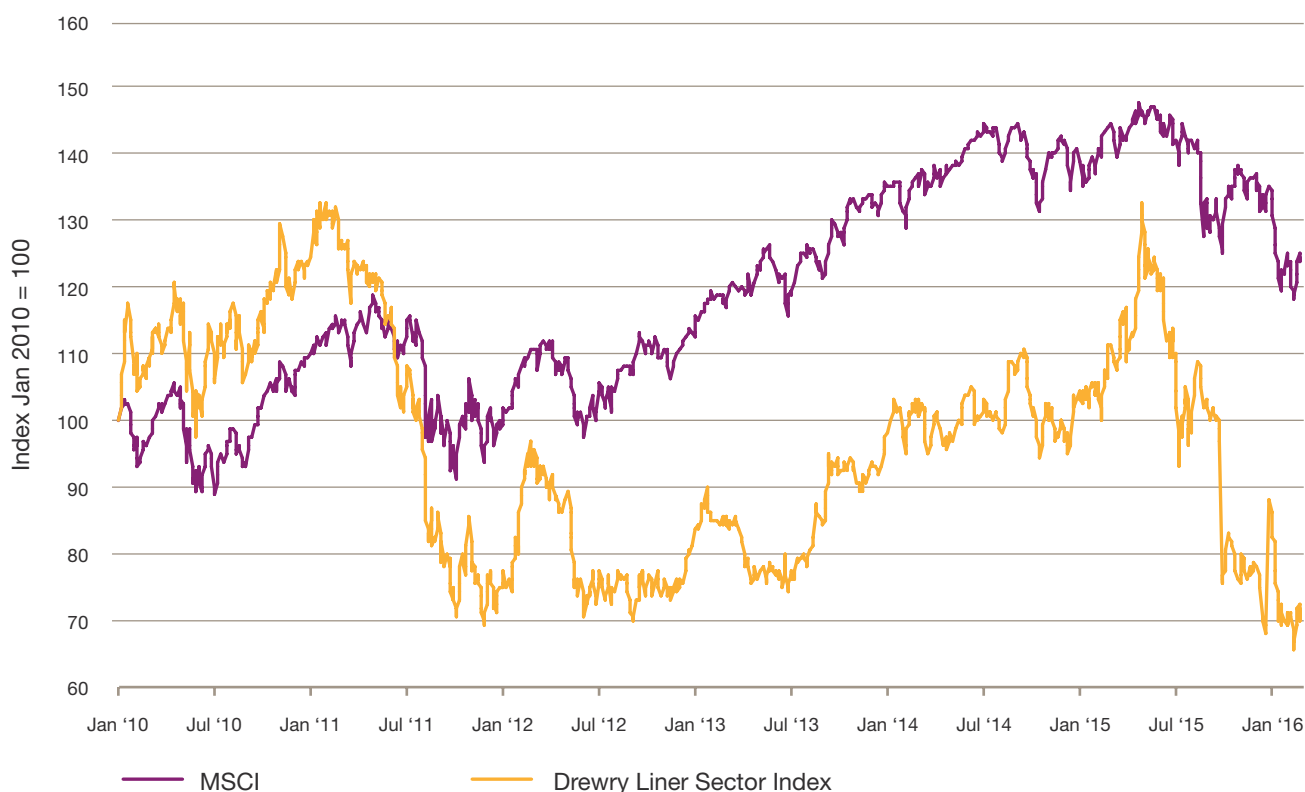
Container shipping continued its profit recovery into 2015 but total industry sales declined as growth stalled. Despite this lacklustre revenue performance fuel savings meant that carriers were able to cushion their average operating margin. Fuel costs fell faster than freight rates, enabling shipping lines to continue posting profits, albeit shrinking with each passing quarter.

Poor financial returns

Listed container shipping operators have delivered very poor shareholder returns over the past five years. Since the global financial crisis of 2008, liner stocks have performed poorly relative to other sectors. For instance, Drewry estimates that on an index basis average container shipping sector returns have been 30% lower than the MSCI Global Index in the five-year period since 2010 (see chart below).

Container shipping line equity values fell sharply following the end of the restocking-led recovery in late 2010, before recovering in early 2015 as fuel costs fell and speculators bought into Chinese listed players. However, these gains proved shortlived as the reality of weaker market fundamentals set in, confirmed by AP Moller Maersk's third quarter profits warning, as sector returns deteriorated.

DMER Container Shipping Index Vs MSCI, Indexed- Jan 2010

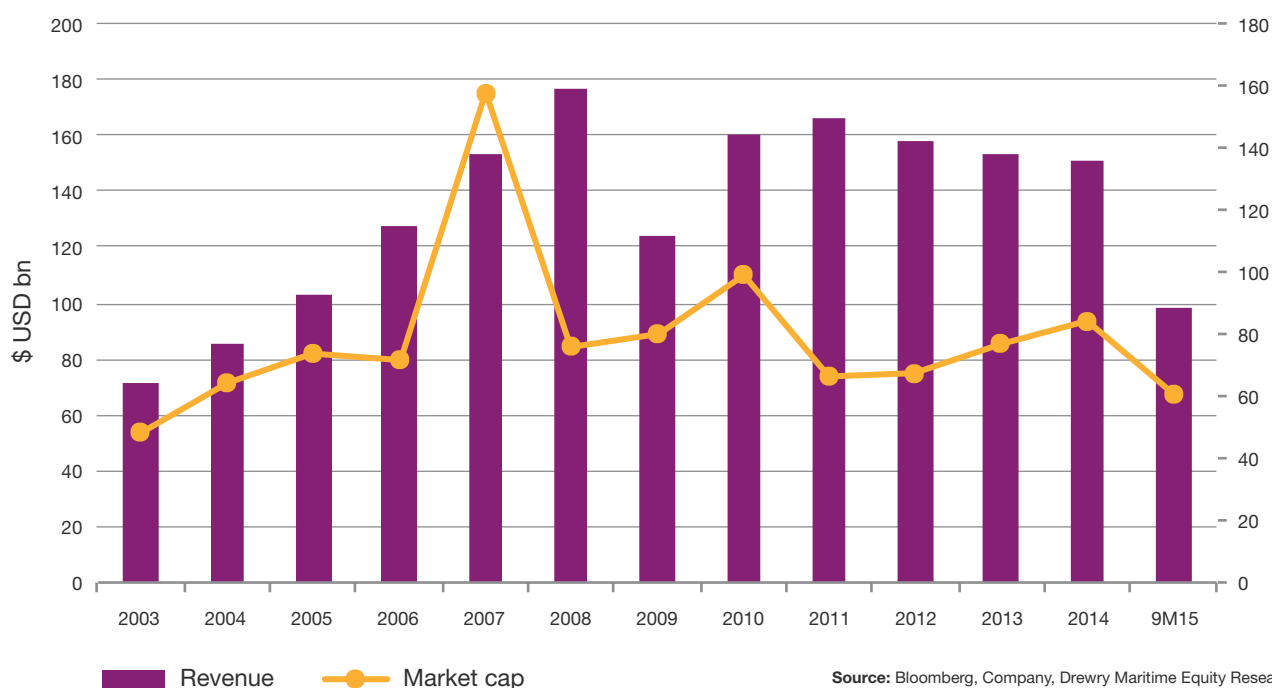


Source: Bloomberg, Drewry Maritime Equity Research

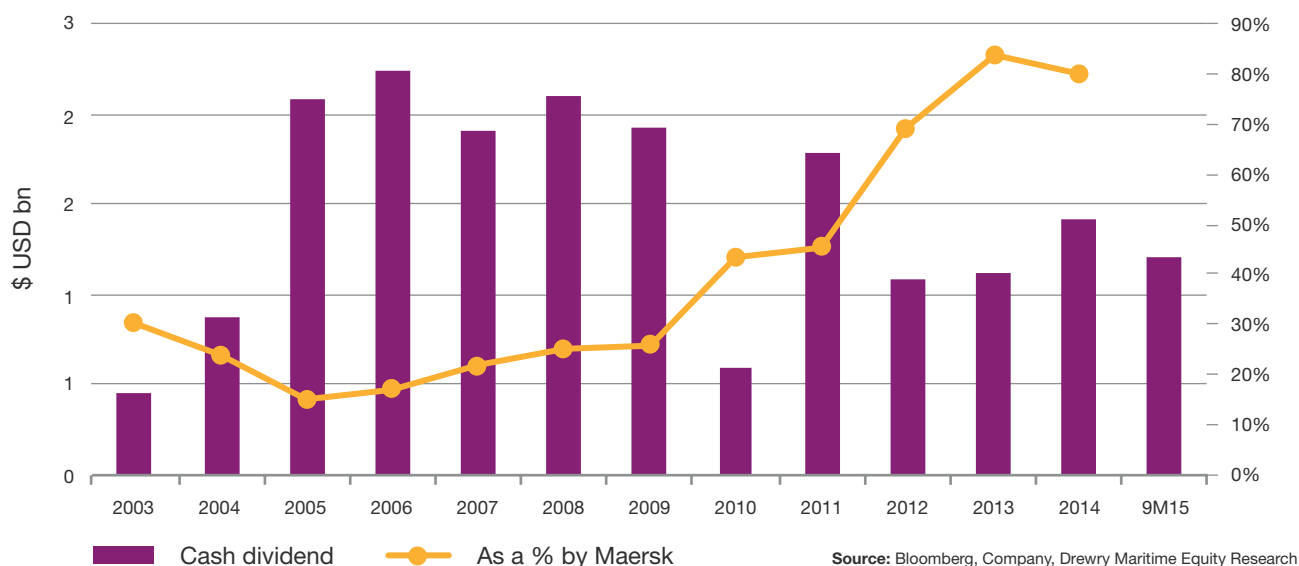
2 Industry under financial pressure *(continued)*

Industry revenues have recovered from their 2009 recession levels, but the absence of profits has eroded market capitalisation. The gap between revenue and market capitalisation is now at its widest since the depth of the financial crisis in 2008. Revenue recovery has been a result of volume increases, while weak freight rates and volatile bunker prices have depressed profitability. Operating margins remain under pressure resulting in poor returns for industry stakeholders.

Revenues stagnating and market capitalisation eroding



Dividends gone missing, barring few; most companies haven't restored any dividends



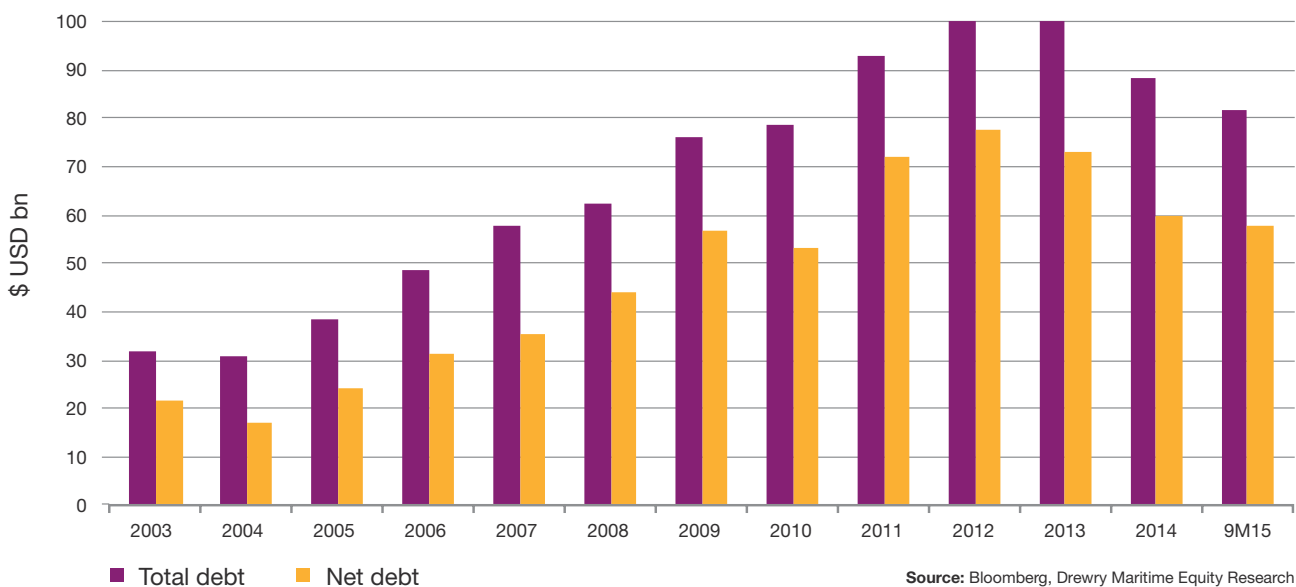
2 Industry under financial pressure *(continued)*

Challenging market conditions could see debt levels rise again

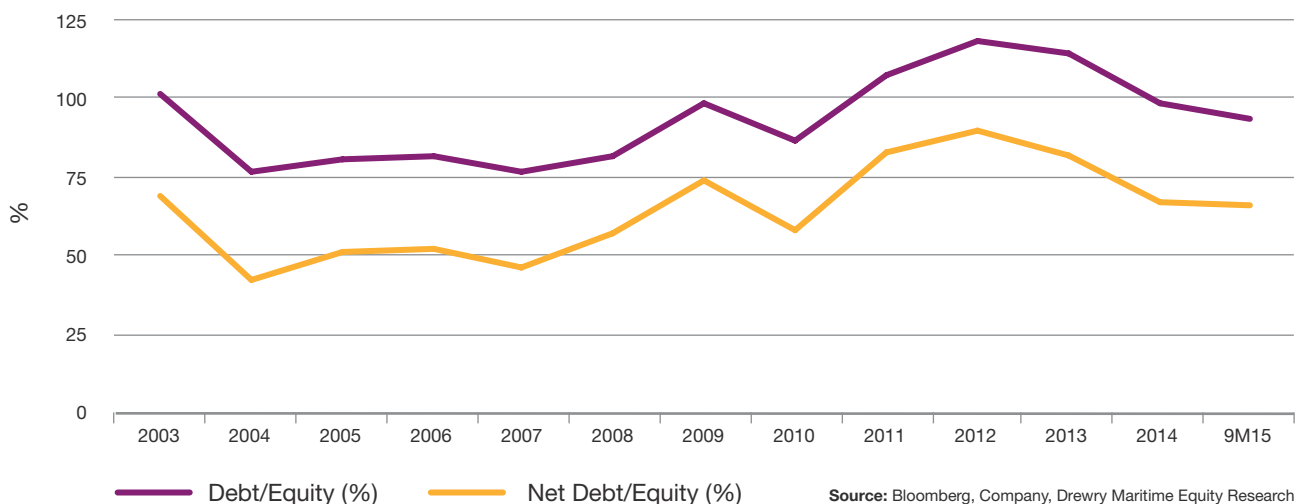
Balance sheets have recovered marginally and industry debt is declining, although it is still above \$ USD 85bn. Challenging market conditions could see debt levels rise again.

Liner shipping's financial health has improved over the past three years, with the exception of a few players who continue to be challenged by high debt and poor financial performance. Having seen their balance sheets deteriorate over the past five years with rising gearing, overall industry cash buffers have only slightly improved. In addition to the operational stress of challenging market conditions, ballooning debt and negative cash flows for an extended period of time will exert serious strain on carrier business viability.

Leverage receded from record levels, debt growth decelerating in past 5 years



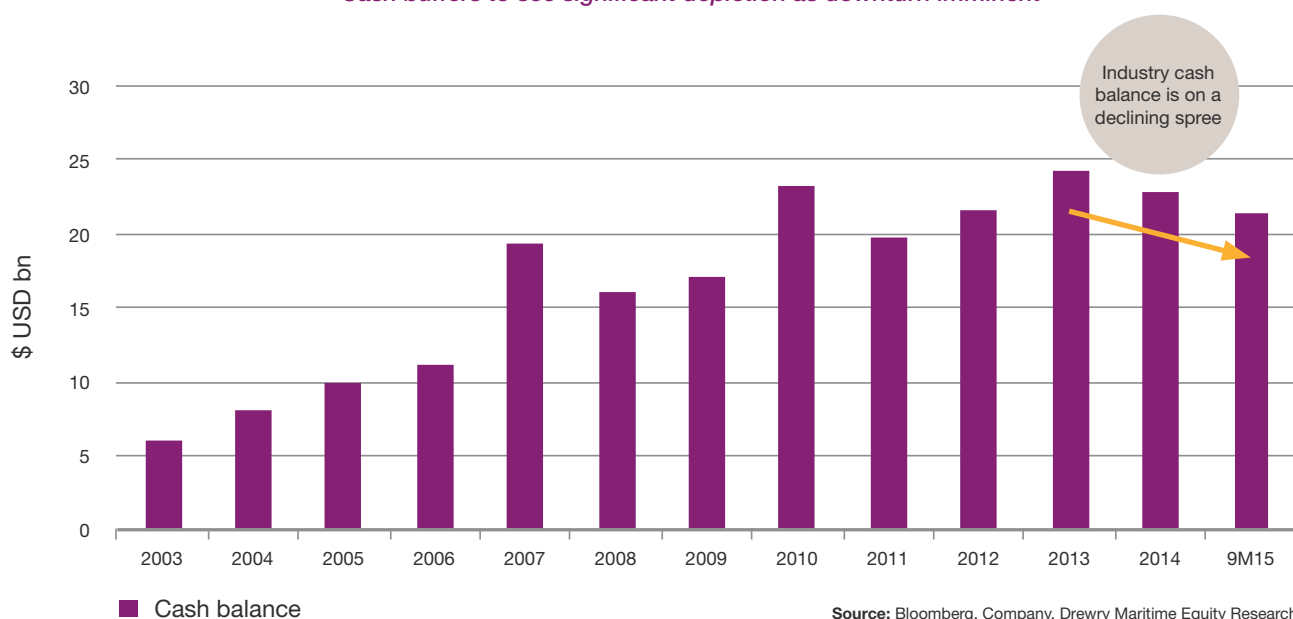
Industry debt-to-equity ratio at ~1x, but weaker medium term fundamentals could drive it up again



2 Industry under financial pressure *(continued)*

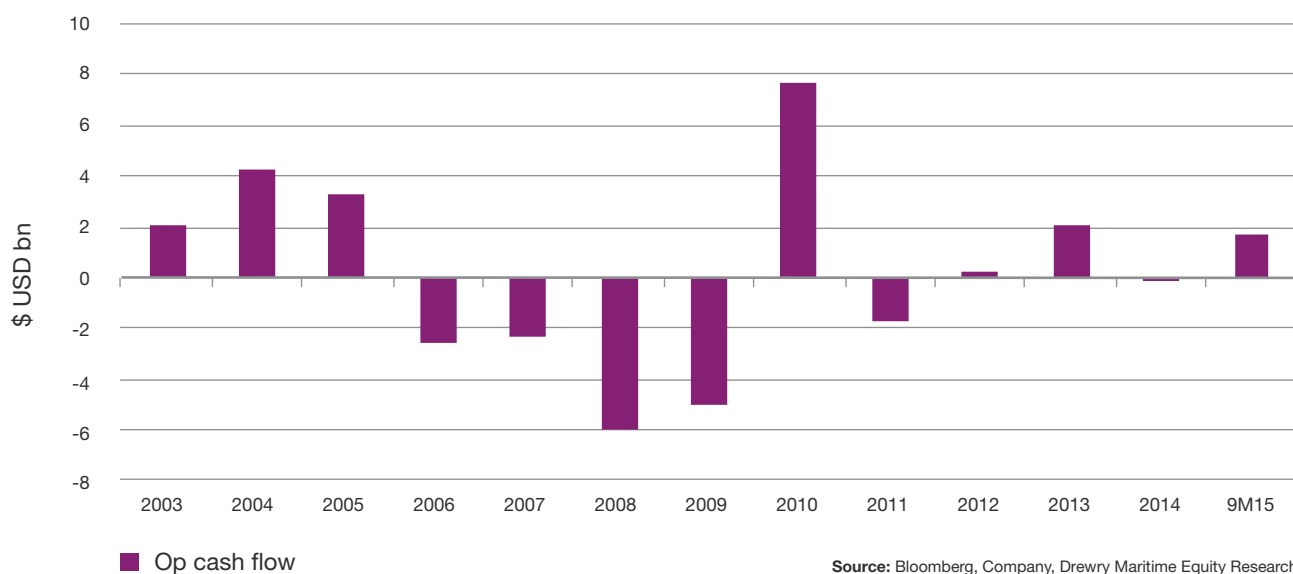
Despite a recovering global economy, the container shipping industry has remained afflicted with severe debt after investing heavily during the boom years and has failed to capitalise on cheap oil prices. Industry cash buffers have been built up over the past few years but these are likely to see significant depletion following a poor second half of 2015 and expectations of a weak 2016.

Cash buffers to see significant depletion as downturn imminent



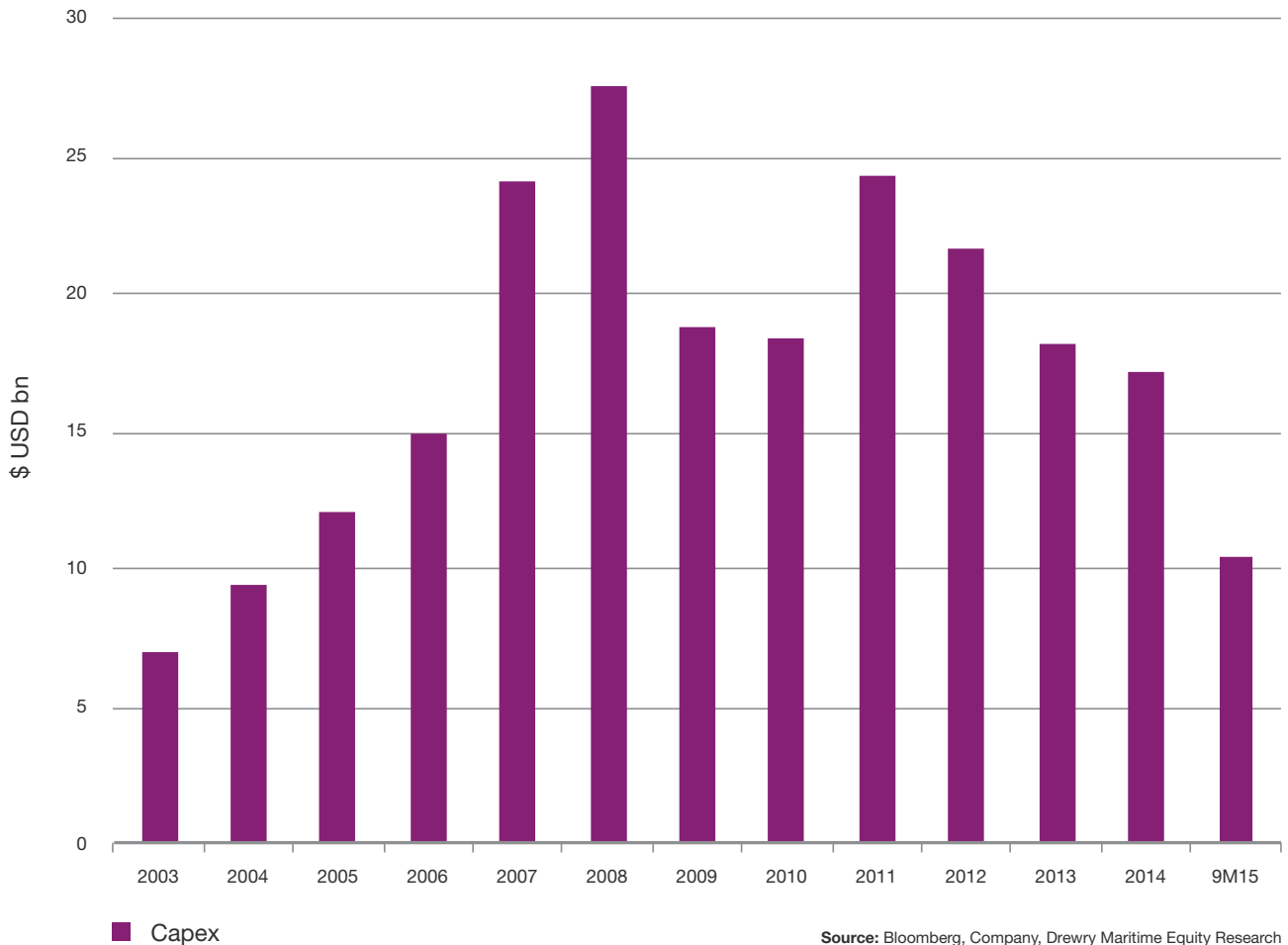
Cash strapped container lines have been shedding port assets around the world to concentrate more on their core business. Capital expenditure for larger, long-term projects in the industry declined to \$ USD 18bn in 2014, from \$ USD 19bn in 2013 and \$ USD 23bn in 2012.

Free cash flow barely positive, capex boom likely to end soon



2 Industry under financial pressure *(continued)*

Significant deceleration in Capex anticipated in coming years



Drewry expects that liner financial results will deteriorate materially in 2016-17 and diminishing carrier profitability makes further industry consolidation more likely. Carriers with weak financials will be forced to address their cost structures in the absence of growth.

Note: Sample consists of A.P. Moller-Maersk, China Cosco, CMA CGM, CSCL, Evergreen Marine Corp, Hanjin Shipping, Hapag-Lloyd, Hyundai Merchant Marine, K Line, MOL, NOL, RCL, Wan Hai, and Yang Ming.

3 Rationale for M&A

Economies of scale

The most often quoted reason for consolidation is the reduction in unit costs which can be obtained by an operator with a larger volume of business. The ways in which these reductions can be achieved in practice are discussed in more detail below.

Strategic advantage

Consolidation may put a shipping line in a better position to chart its future, with larger volumes and a greater control of its own destiny. For instance:

- CMA-CGM's acquisition of APL leaves it in third place among the carriers (measured by capacity operated) but advances it to a share much closer to MSC and Maersk – putting the top 3 carriers in a class of their own
- COSCO and CSCL's merger advances them to fourth place (previously sixth and seventh respectively) though around 4% points behind CMA-CGM.

Other carrier combinations could achieve comparable scale and there has been plenty of speculation around the case for shipping lines of the same nationality to merge. Any of the following combinations would create a Top five carrier:

- **Korea** – Hanjin & Hyundai moving them to fifth place (from eighth and 15th respectively)
- **Japan** – MOL, NYK & K Line moving them to fifth place (from ninth, 12th and 14th respectively)
- **Germany** – Hapag-Lloyd & Hamburg Süd moving them to fourth place (from fifth and seventh respectively).

Leaving aside whether the shareholders of these parties are likely to reach any such agreements, these would provide an opportunity to create another shipping line of the scale approaching that of the soon to be created Top Four.

Changes in global rankings - as at 31 December 2015

Old Rank	New Rank	Operator	Share (%)
1	1	APM-Maersk	14.7%
2	2	Mediterranean Shg Co	13.3%
3	3	CMA-CGM + APL	11.5%
-	4	COSCO + CSCL	7.6%
4	5	Hapag-Lloyd	4.6%
5	6	Evergreen Line	4.6%
6	-	COSCO	4.2%
7	-	CSCL	3.5%
8	7	Hamburg Süd Group	3.2%
9	8	Hanjin Shipping	3.1%
10	9	MOL	2.7%
11	10	OOCL	2.7%
12	11	Yang Ming Marine Transport Corp.	2.7%
13	-	APL	2.6%

3 Rationale for Consolidation *(continued)*

Complementary geographical coverage

It is often argued that the most ideal M&As are where the two shipping lines have complementary geographical strengths, whether regionally or in particular trade routes, rather than just 'doubling up' market share in the same trades.

This rationale has been behind several previous shipping acquisitions, where strong East-West trade presence of the acquirer has been matched with another carrier's greater focus on North-South routes. Maersk's acquisition of Safmarine and Hapag-Lloyd's of CP Ships are obvious examples, and more recently the merger of Hapag-Lloyd and CSAV looks a good 'fit' given the latter's strong position in Latin America.

But the latest M&A activity offers less in the way of such complementarity, other than CMA CGM's takeover of APL, where the former's main strength is in its Middle East trades, which will boost the French carrier's position in that area.

COSCO and CSCL have similar scale in most of the major trades and neither has significant shares in the north/south trades.

And looking at potential future consolidations, both a merger of the two Korean lines or the three Japanese carriers would serve to build scale in existing trades, rather than offer a broader trade base to the merged line.

Hamburg Süd is the only remaining line which has a strong North-South trade route base which would be attractive to an East-West trades focused carrier. A merger with Hapag-Lloyd was always seen as a good fit in this respect. And despite its recent acquisition of Chilean-based CSAV, Hamburg Süd would boost Hapag-Lloyd's position in both Australasia and South America.

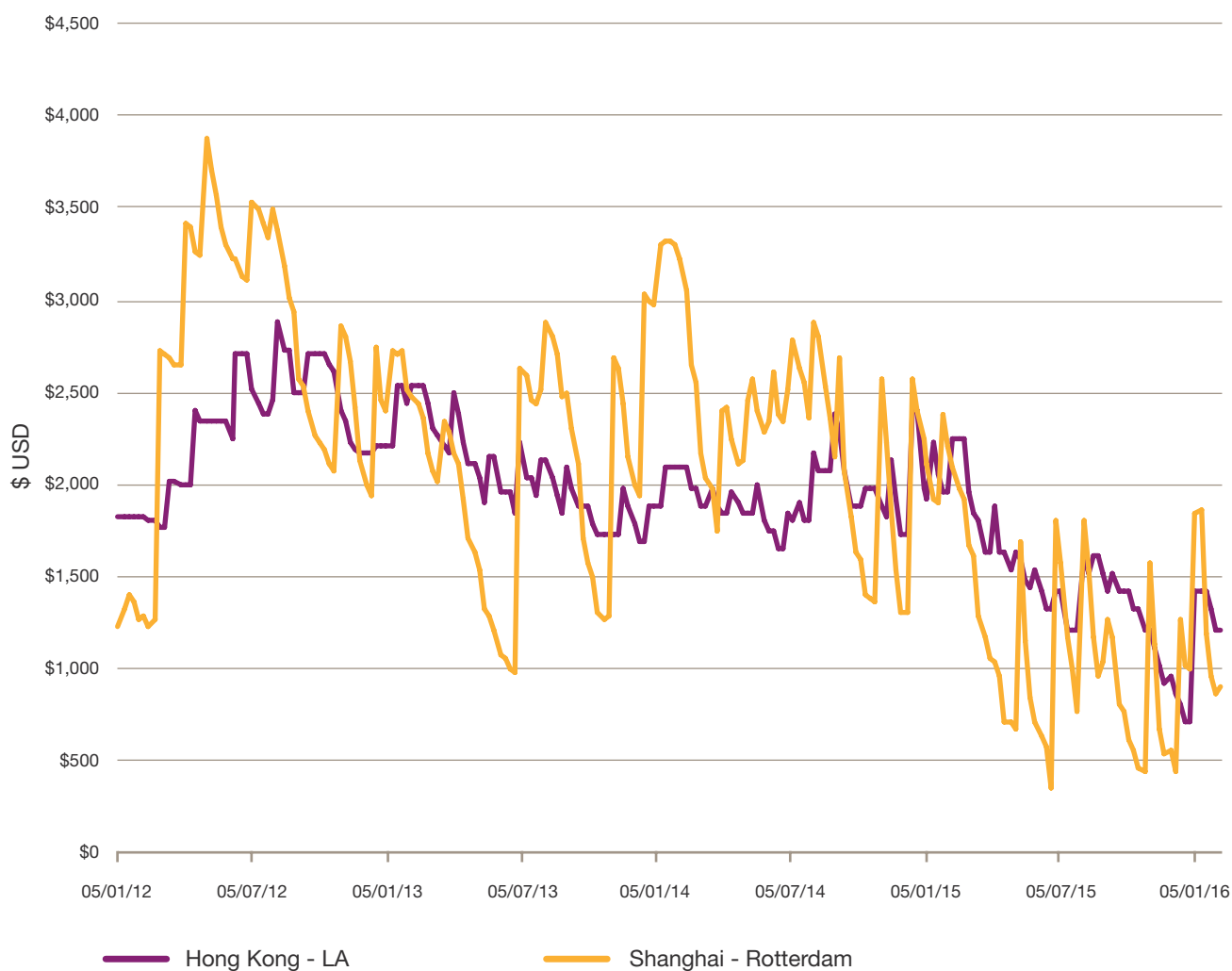
The other area of potential interest to a global deep sea shipping line might be the acquisition of a specialist Intra-Asia operator. Both Wan Hai and PIL could be attractive for this reason.

Market power

In the past it has been argued that with fewer larger shipping lines there would be greater price stability and that larger lines would be able to exercise market leadership in pricing. There has been no evidence of this having been achieved over the past 20 years and the industry remains fragmented. Even Maersk as the largest player appears to have had no success in influencing market prices from its own actions. The chart below illustrates the decline in spot container freight rates on the main headhaul East-West trades in recent years. Lines are therefore well advised to discount any pricing or unit revenue benefits arising from consolidation.

3 Rationale for Consolidation *(continued)*

Spot container freight rates have been volatile & falling on Asia origin trades into US & Europe



Sources: Drewry's Container Freight Rate Insight (www.drewry.co.uk/cfri) and World Container Index (www.worldcontainerindex.com)

4 Cost Benefits of M&A

Acquisitions are often justified on the basis of cost synergies arising from the consolidation of two businesses into one. These estimated cost savings are usually built into the price paid for the target company.

The following are identified as the main areas of potential cost saving. These will need to be evaluated and quantified case by case.

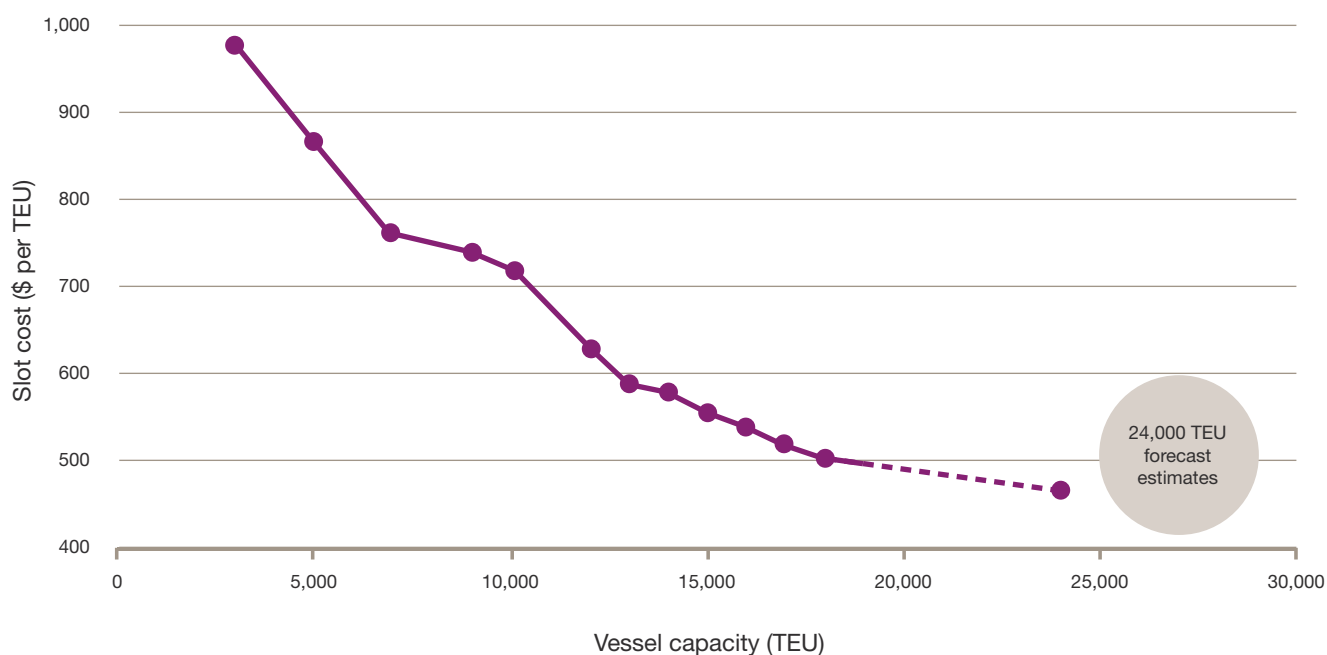
Procurement benefits – greater purchasing power

Higher volumes should enable the shipping line to obtain better terms from suppliers. Comparing present contractual terms between the two carriers will reveal opportunities to renegotiate contracts

Larger vessels?

Larger ships bring lower unit costs for the vessel network (ships, bunkers, port and canal transit costs) as demonstrated in the below chart.

Ship System Cost (\$ per TEU) Asia/N Europe service (round trip)



However, this advantage is being challenged by the evolution of mega alliances and vessel sharing agreements (VSAs) which have already enabled many carriers to deploy the largest possible vessels onto particular trade routes. Hence, the case that consolidation will improve scale economies needs to be approached with some caution and each case evaluated on its merits. For instance, it is expected that there will be individual trades and perhaps feeder services where immediate cost savings can be made from combining ship networks with larger vessels.

But M&A consolidation may provide scale economy benefits that cannot realistically be achieved through just alliances or VSAs. In particular, a combined business may be in a better position to justify ordering larger vessels in the future as its own scale may provide greater leverage and less reliance on alliance or VSA partners.

4 Cost Benefits of M&A *(continued)*

Ship networks – can improvements be made?

While direct scale savings in ship system costs may be limited in the short term, there is a strong argument that global scale enables a line to organise its whole network more efficiently and so reduce the cost per loaded container carried.

Maersk Line has shown, and commented in annual reports, that it is possible to reduce network costs without reducing volumes, by adjusting its network to use services and capacity more effectively.

When two lines consolidate there may be some ‘quick wins’ when the networks are put together, but otherwise this will be an ongoing exercise to optimise the network for the combined business.

Smarter operations

As well as looking at ship network savings, there will be other operational areas, where larger volumes open up opportunities to reduce unit costs through smarter operations with sophisticated planning systems.

One example is the potential to reduce container provision and imbalance costs. A larger business should be able to improve container productivity and reduce imbalances through the synergies of the combined fleet.

Overhead savings

There will be opportunities to reduce overheads by the removal of duplicate management and support structures, such as IT systems.

Costs can be reduced, for example, by having only one agent or owned office in each country. But care needs to be taken to separate fixed from the variable costs as many agency costs are linked directly to cargo volume. Many carriers have already centralised support services so synergies may be limited when combining the respective carriers’ service centres.

One-off costs

There will be a number of costs which have to be incurred before the benefits of consolidation can be realised, for example:

- Transferring vessels between services/networks
- Terminating and transferring contracts – e.g. property, container leases, charters, agency agreements, etc.
- Redundancy and related payments for staff no longer required
- Short term business dislocation and associated risk of some business attrition
- Financial costs of the transaction – including advisers’ fees.

5 Changing Drivers of M&A

The consolidation that took place in container shipping pre-2008 was driven by a desire for growth. Now M&A activity is all about survival, to address such factors as balance sheet restructuring, poor investor returns and adaptation to a low growth environment.

When AP Moeller-Maersk offered DKK 17 billion in cash to buy Anglo-Dutch rival P&O Nedlloyd in 2005, the primary objective was to make it history's biggest container line. "There are two ways to grow: organically or via acquisitions," A.P. Moeller-Maersk CEO Jess Soederberg told Reuters. "With the current lack of ship capacity we would not be able to grow organically within the next three to four years."

As evident from management comments at the time of these acquisitions, growth or scale was the primary objective to undertake M&A. The industry was still in growth phase, globalisation was still evolving and manufacturers shifting sourcing to Asia.

However, recent acquisitions have been driven by the potential for synergies from cost saving, economies of scale, competitive position and protection against weak industry fundamentals.

In the case of Hapag-Lloyd and CSAV, financial distress plagued the latter and its owners were forced to look for alternative sources of fresh capital at the time of merger. The Luksic family which controlled CSAV with a 46% stake had invested more than \$1 billion in the company in two years after it lost a record \$1.25 billion in 2011. The company hadn't recorded a profit since 2010 and continued reporting losses.

The financial distress and lack of capital to effectively compete in a low growth environment was even more pronounced in NOL's sale to CMA CGM. NOL's liner division APL was on course to record a five-year cumulative operational loss of over \$1.1 billion. Mounting losses from container shipping led NOL to sell its non-core assets such as office buildings and profitable logistics business. However, even after a 2009 rights issue and the sale of APL Logistics, NOL's debt was unsustainable. Drewry estimates that the company would have needed a further capital injection from its main shareholder Temasek in subsequent quarters as operating cash flow was shrinking fast so fast.

In a joint press conference, CMA CGM and NOL revealed the rationale for the merger. The management stated: "With the outlook for the global container shipping industry remaining grim, joining forces is key to riding out the storm," said Mr Rodolphe Saadé, vice chairman of CMA CGM. "Joining forces will enable us to grow [as] our industry faces new challenges ... We believe that scale is more critical than ever to sustainable growth."

NOL group president and chief executive also acknowledged the current protracted weakness in freight rates is a key driver of the deal.

Drewry believes that M&A can be an effective means for resolving financial distress as highlighted in the cases of NOL and CSAV above, with the objectives of:

- Providing an opportunity to recapitalise the business and obtain new sources of funding
- Achieving additional economies of scale to give the new business cost efficiencies which are close to those of the top shipping lines
- Creating a business of sufficient scale to focus on growing with the market, which is not forced to depress its yields through continually looking to outgrow the market

However, there are important risks that need to be recognised, such as potential customer attrition, among others.

6 Risks and challenges

While the longer term advantages of consolidation may seem clear, there are a number of hurdles to overcome.

Alliance and VSA memberships

One of the biggest challenges may arise if the two lines are members of different Alliances and VSAs. Typically this involves an upheaval of alliance membership for all members, not just the consolidating shipping lines, as happened with P&O/Nedlloyd and NOL/APL in the 1990s.

CMA-CGM has already announced that APL's volumes will be consolidated with Ocean 3 in due course, with G6 losing out as a result. No announcement has yet been made as to which alliance will benefit from the merger of COSCO, currently with CKYHE, and CSCL who are with Ocean 3.

Should there be a merger of the Korean or Japanese lines, these would also disrupt current alliance membership structures.

Implications for Alliance membership of current/potential consolidation

ALLIANCE MEMBERS			
2M	G6	CKYHE	Ocean 3
Maersk	APL	COSCO	CMA-CGM
MSC	Hapag-Lloyd	Evergreen	CSCL
	Hyundai	Hanjin	UASC
	MOL	K Line	
	NYK	Yang Ming	
	OOCL		

- Acquisition by CMA-CGM of APL (APL's share moves to Ocean 3)
- Merger of COSCO/CSCL (outcome unknown)
- Potential consolidation of Korean Lines
- Potential consolidation of Japanese Lines

It will take several months to unwind these complex alliance structures following M&A transactions and the newly combined shipping line may have to continue to work in two parallel alliance or VSA arrangements for some time.

Notice periods, change of control clauses, relative market shares, compatibility of tonnage, specific terminal interests will all play a part in seeking a 'new' Alliance structure and membership which suits the newly combined carrier. A particular outcome cannot be guaranteed when other parties are involved.

Keeping the customers

Cost saving benefits from consolidation can be rapidly eroded if the enlarged line is not able to keep the market shares and customers of the two constituent carriers. This can be a major challenge, since customers may experience significant change in the service provided, for example:

- Alliance/VSA services may change, or one 'set' of services lost
- Loss of familiar staff in agency offices
- Changes to IT systems - e.g. customer facing e-commerce systems
- Loss of external focus, as the line's staff become more concerned with what is happening within the business, rather than looking after their customers.

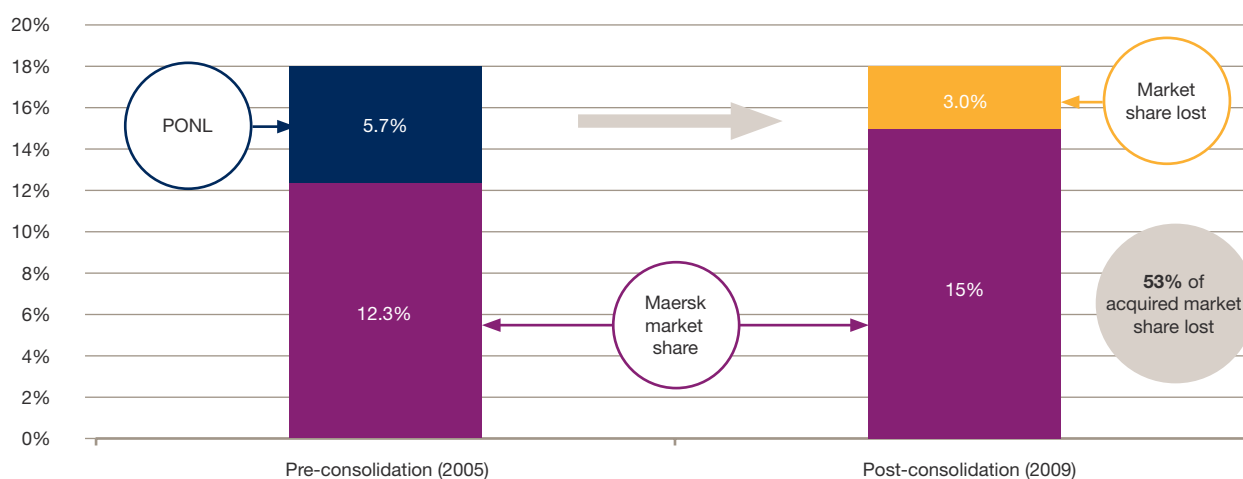
6 Risks and challenges *(continued)*

As mentioned earlier this may be less problematic if the two lines operate largely in different trades, so there will be less change to networks and to the customer service personnel.

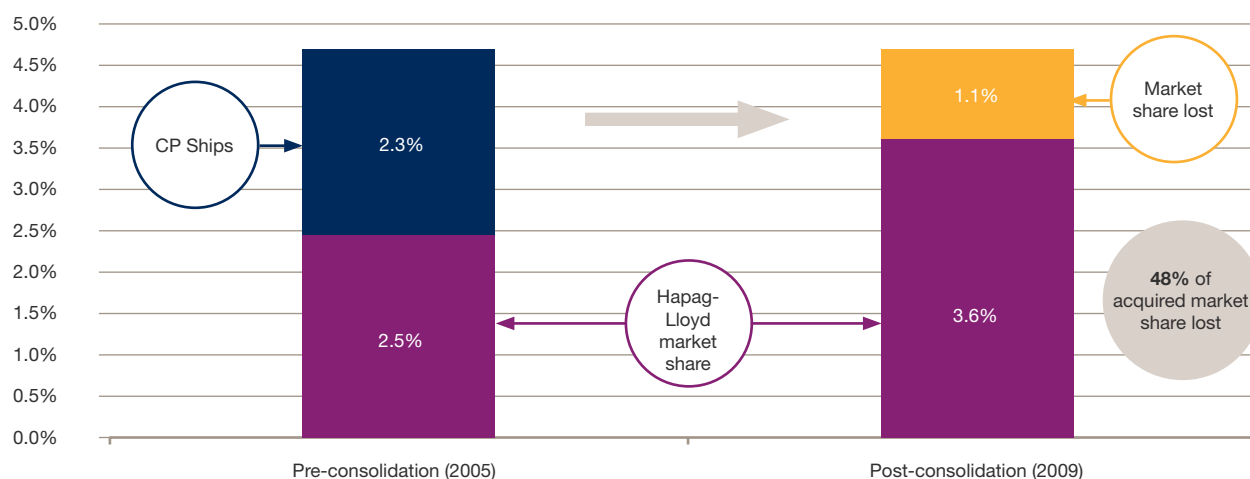
A further challenge arises when the customer has been sharing cargo between the consolidating lines. In these circumstances it may be difficult for the merged entity to retain its market share of that customer.

A review of the success achieved in retaining share acquired in the last few major consolidations does not paint a particularly positive picture:

Maersk Line



Hapag-Lloyd



Using the measure of operated capacity to estimate market share, this suggests that Maersk and Hapag-Lloyd retained only half of the market shares acquired from P&O Nedlloyd and CP Ships respectively. Therefore, if one of the objectives of consolidation is to gain economies of scale, these transactions appear less than successful.

6 Risks and challenges *(continued)*

IT Systems for the new organisation

Successful IT systems selection and integration is critical to M&A success. Both carriers will have systems with different strengths and weaknesses, so the temptation will be to take the best from both systems. Such an approach is close to impossible, as IT systems tend to be heavily integrated.

An objective assessment of the two shipping lines' systems is needed and one of them chosen. The system selected must be easily scalable for the combined volumes. This decision needs to be made early in the process, so that resources can be devoted so planning how to transfer the other carrier's business to the chosen system.

Integration of the organisations

In order to both manage the new business effectively and achieve the expected cost savings, the two organisations have to be amalgamated, from head office down to country level. As well as offices, hardware and infrastructure this critically involves the staff in both organisations.

The right employees need to be chosen to continue in the new organisation and at the same time staff who will be leaving have to be motivated to continue to work through the process of transitioning the business to the new organisation.

Failure to correctly and sensitively manage the 'people' side of the merger can expose the combined business to considerable risk during the integration process.

There will be differences between how the two lines previously managed their business and staff, for example:

- Different organisational structures and splits of responsibilities between departments
- Different first languages and cultures
- Different management styles
- Different remuneration structures (e.g. bonuses).

All these will need to be resolved in order to create a unified team which can create a new business and focus on achieving the improvements on which the business case will have been based.

In addition to these issues, there may be struggles for personal power that distort and disrupt the process of integration.

7 Managing the integration

Whether or not the expected benefits from consolidation are achieved will depend critically on how the process of consolidation is managed.

Be ready to start

There is inevitably a period between the deal being agreed and financial closure, when no actual steps to amalgamate the businesses can be taken, but much useful work can be undertaken to ensure readiness.

Key actions which can be taken include:

- Provide reassurance to both staff and customers – ensure it is ‘business as usual’
- Decide on a new organisation structure for the combined line
- Identify senior managers for key positions
- Prepare a project plan for integration – including the resourcing of integration management
- Set up expert groups to examine key areas - e.g. ship networks, alliances, VSAs, container equipment fleet, IT and terminal selection
- Define processes for selecting staff for the new organisation and the exit terms for those not staying.

Timing the transfer of the business

A vital decision is when to move businesses over to the new organisation. There will be pressure to make the transfer quickly, to realise the identified benefits and prevent attrition of customers to competitors.

However, unless the new organisation and the associated IT systems are ready to effectively manage the combined business activity the merged company risks disappointing customers and losing business.

Some factors will not be in the carrier’s control, for example how long it may take to integrate ship networks given the constraints of alliance and VSA agreements.

Gaining ‘quick wins’

Some actions can be taken quickly, to deliver immediate cost savings in areas which do not impact customer service and support. For example, combining some operational activity and renegotiating contracts can start as soon as the deal is finalised.

A transparent project plan – clear objectives and financial targets

To be able to achieve all of the above, a clear project plan is required, with identified:

- Activities
- Responsibilities
- Resourcing
- Required outcomes (both financial and non-financial).

7 Managing the integration (*continued*)

Resourcing

Resourcing can be a problem during the transition period. Both carrier businesses need to be maintained until integrated, while at the same time staff have to be freed up to discuss, plan and take key decisions which will determine how the new business is organised.

Careful people management and appropriate packages will be needed to keep staff departing staff motivated who are needed through the transition period but not thereafter.

External resources with expertise in managing consolidation, particularly in the liner industry, may be useful to help with project management to ensure that the plan does not drift off target. External expertise may also help to provide dispassionate analysis and guidance over the choices which need to be made for the new business.

Hard decisions will need to be made, particularly if a merger is involved, as there is a risk that unsatisfactory compromises will be made to satisfy both parties, rather than to do what is best for the new business. A neutral party may be able to provide input to guide objective decision making.

Communications

The 'glue' that holds all this activity together is a plan for clear, regular and pro-active communications.

At times of uncertainty, staff, customers, contractors and partners will all want reassurance on how the consolidation will impact them.

While it will not always be possible to give precise answers, particularly in the initial stages before financial closure, it is vital to have a communications plan to let stakeholders know as much as possible. If you tell people nothing, they will fear the worst.

8 Future for M&A

Will the current round of M&A succeed?

It is too early to judge the success of the Hapag-Lloyd/CSAV merger. This consolidation had the advantage that the businesses were to an extent complementary, given CSAV's strong position in the South American trades and its exclusion from any formal East-West alliance arrangements. If the German carrier is able to convince CSAV's South American customers to remain with the new business, then the economies of scale cost benefits should be achievable.

CMA CGM has a track record of acquiring and integrating other carriers – its quarry includes ANL, McAndrews, Delmas and Cheng Lie. It has been successful in preserving the value of the acquired businesses, a number of which still operate as separate brands. However, APL is significantly larger than any of its previous acquisitions and presents the additional challenge of migrating the Singapore-based liner to a different East-West alliance. And this is happening at a time when the future shape of the Ocean 3 Alliance is itself uncertain depending on what the new COSCO decides for its own alliance plans.

The COSCO-CSCL merger is more a step into the unknown. COSCO, as the acquirer, has no history of integrating other liner businesses and while both are Chinese companies, there are considerable cultural differences between the two. Whatever they decide on future Alliance membership, their customers will face changes in services and account support organisations. It will therefore be a challenge to retain volumes from both the businesses in the merged entity.

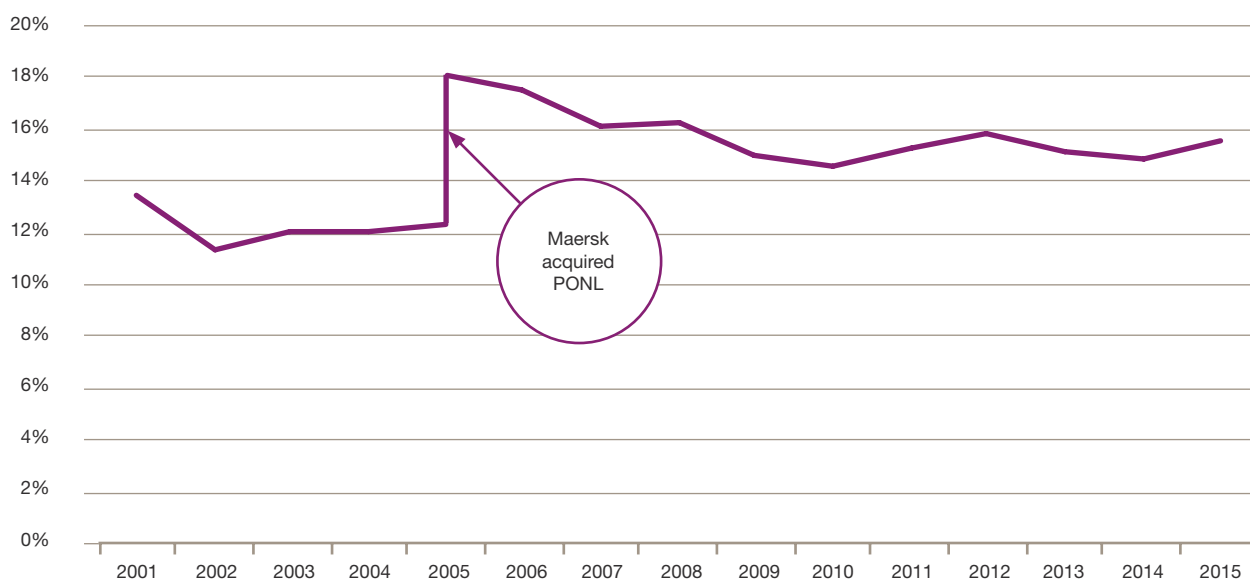
What are the alternatives for the future?

Where the focus is on achieving scale, it should be remembered that organic growth presents an alternative to consolidation.

The charts below show the relative market shares of the top four container shipping lines over recent years. Both Maersk and Hapag-Lloyd have used acquisition as an engine of growth, whereas MSC has relied entirely on organic growth and CMA CGM has complemented organic growth with a number of small acquisitions.

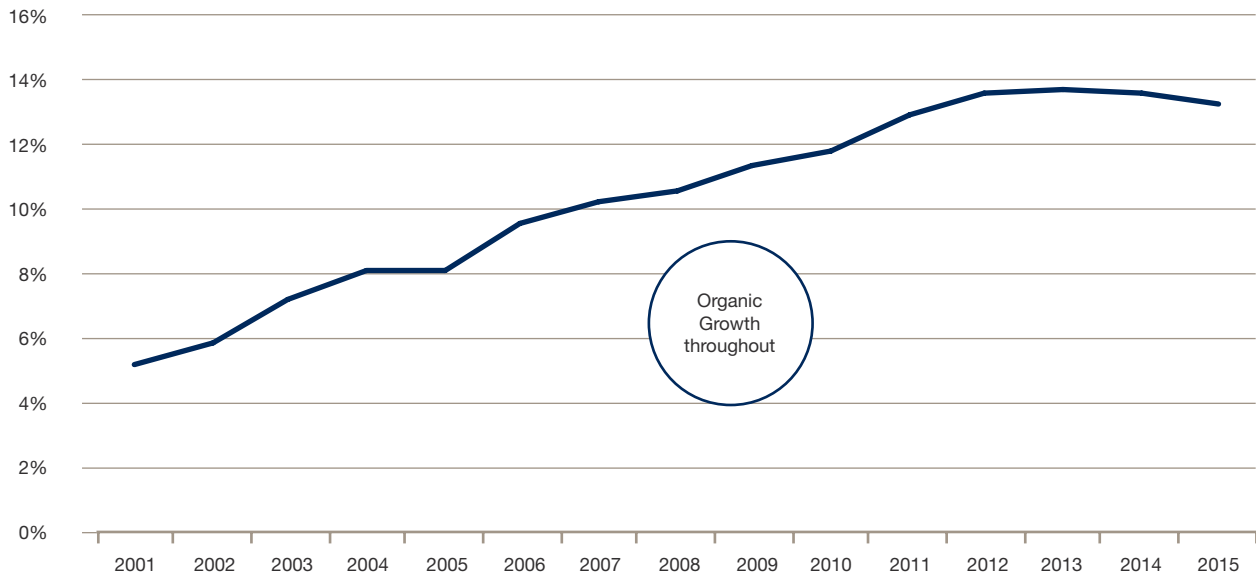
Market Share Growth – organic vs acquisition

1. Maersk

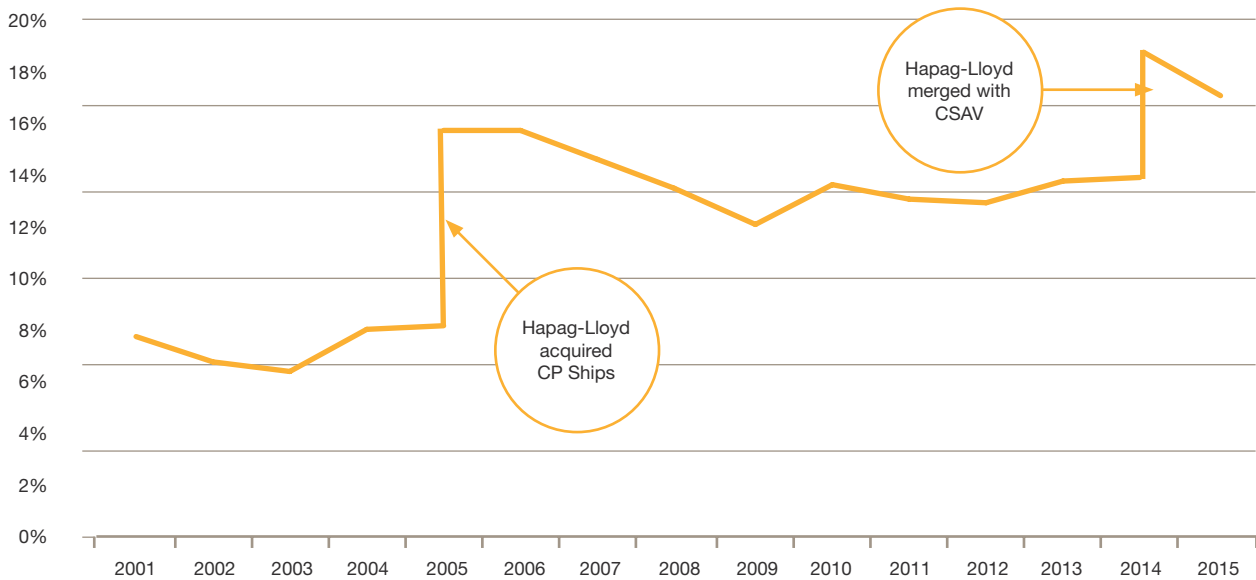


8 Future for M&A (continued)

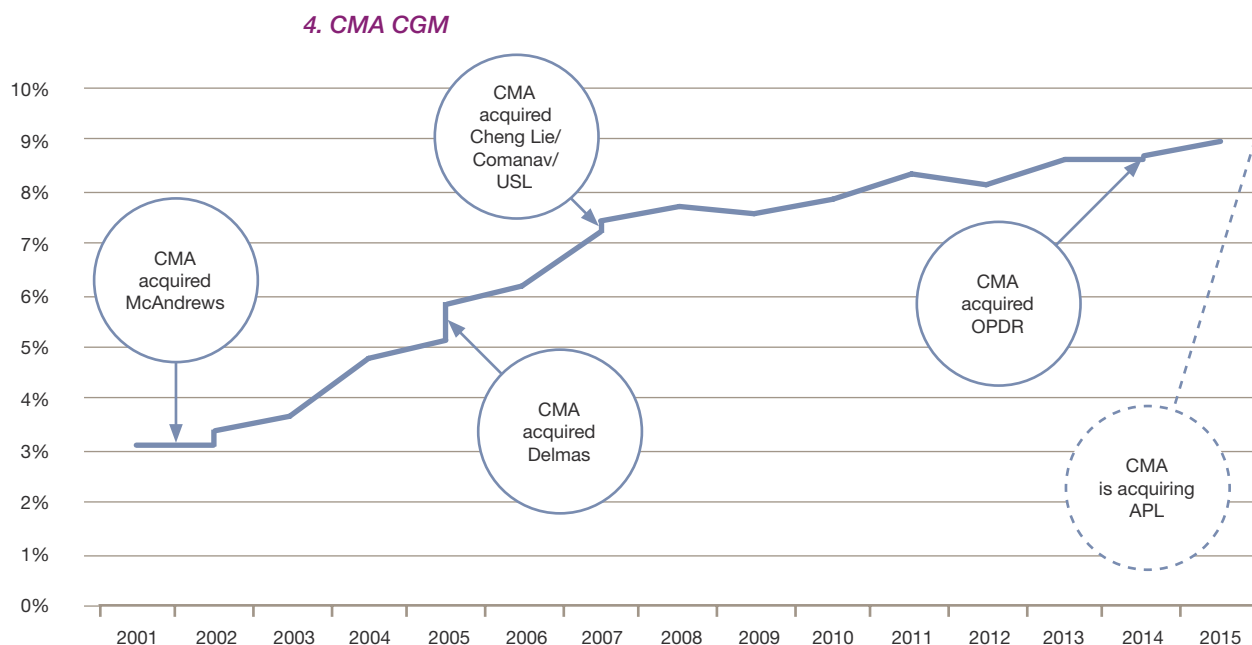
2. MSC



3. Hapag-Lloyd



8 Future for M&A (*continued*)



On the face of it, if all the lines in this chart have been seeking the benefits of economies of scale, those focussed on organic growth have been considerably more successful.

The benefit to the industry as a whole is considerably greater if lines pursue growth through acquisition rather than continuing to build new and larger tonnage, which the industry does not need. On the other hand, consolidation as a strategy for individual shipping lines entails considerable risk that the targeted benefits will not be achieved. Much depends on how effectively the task of consolidating the two businesses is managed.

Despite these challenges, Drewry expects further consolidation in container shipping as carriers seek to build scale to compete more effectively in an oversupplied market.

9 Consolidation - mergers and acquisitions – Key Learnings

- Consolidation between two liner companies should achieve cost savings – through achieving synergies in combining the business, and longer term strategic advantage
- Consolidation where the geographical footprint of the two companies are complementary may yield greater benefit than when the result is additional volumes in the same trades
- The main cost savings come from scale benefits, and opportunities for smarter operations with increased volumes, for example, improved network utilisations, and lower container and imbalance costs
- While additional volumes can support employment of larger vessels, in many cases – particularly the E/W trades – scale benefits in ship systems are already being achieved through Alliance membership
- A key objective during any consolidation must be to keep the customers of the two lines; loss of volumes/market share can cancel out the cost benefits obtained
- The challenge of merging two organisations, potentially with different cultures and management styles, should not be underestimated
- There will be significant one off costs of combining the two businesses
- Planning and execution of the consolidation will require careful project management. This will stretch resources (on top of running two existing businesses), and some external expertise may also provide additional skill sets
- People are critical to the transformation process, and without a team fully focused on the objectives, business will be lost and delays will occur in the critical first six months. It is essential to motivate both those chosen for the future business, together with those who are only needed through the transition phase
- Communication with all involved parties – staff, customers, suppliers, partners is vital throughout the process.

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About Drewry Maritime Advisors

Our Maritime Advisors offer a wealth of experience across the maritime sectors and lead the industry in their respective areas of specialisation. Our sector expertise covers; ports, bulk shipping, liner shipping, shipyards, ferry and RoRo, technical ship management. Our combination of deep sector understanding, technical expertise and market leading insight enables us to be confident in our actions and ability to deliver the right results for our clients.

Services and areas of expertise include:

- Strategic planning and analysis
- Operational assessments
- Commercial due diligence
- Financial modelling and analysis
- Investment and divestment appraisals
- Market studies and forecasting
- Vessel acquisition strategies
- Vessel valuations.

About Drewry

Drewry is a leading international provider of research and consulting services to the maritime and shipping industry. From its origins in 1970 London to a 21st century maritime and shipping consultancy, Drewry has established itself as one of the most widely used and respected sources of impartial market insight, industry analysis and advice. Offering a unique combination of sector knowledge, rich market insight and commercial awareness Drewry is able to consistently deliver the performance, profitability and competitive advantage its clients seek.

Drewry serves its clients through four business units: Drewry Maritime Research, publishing market-leading research on every key maritime sector; Drewry Maritime Advisors, supporting the needs of shipping and financial institutions; Drewry Supply Chain Advisors, providing seafreight procurement support to retailers and manufacturers; and Drewry Maritime Equity Research, delivering an Investment Research Service on listed companies operating in the industry. Drewry has a truly global perspective of the maritime sectors and areas of expertise it covers and employs over 100 professionals across an international network of offices in London, Delhi, Singapore and Shanghai.

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