MERCER CAPITAL

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# Understand the Value of Your Logistics Company

# WHEN YOU NEED TO KNOW WHAT YOUR BUSINESS IS WORTH

## SELLING OUT?

In the most obvious case, someone planning to sell their business needs to know its worth. One of the hardest issues a business owner encounters is cashing-out their life's work. But beyond the myriad of emotional issues, there are the raw economics of how you will sell and for how much. Hundreds of issues may arise in a transaction that will ultimately affect the proceeds to the seller. A valuation of your business will allow you to know what you should expect and to evaluate whether or not an offer for your company is reasonable.

## SELLING IN?

Transferring ownership to your children or management team requires you to have a complete understanding of what the transferred interests are worth. Depending on the circumstances, a small minority interest may be worth much less than a pro rata interest in the total value of the business. Ignoring this issue can cost you a lot of money and potentially result in inflated taxes being owed on the transfer.

## BUY-SELL AGREEMENTS

If your business has other shareholders, there is likely a buy-sell agreement between these shareholders that describes how the business (or business interests) will be valued in the event of a shareholder dispute, death, or departure from the business (even on friendly terms). Many business owners fail to understand the valuation implications of buy-sell agreements. In our experience, buy-sell agreements almost never sufficiently describe the mechanism to be used to value the business. The process always looks simpler when the buy-sell agreement is drafted and a transaction is not actually on the table. But when the day comes that a buy-sell agreement is invoked, a clear process and accurate understanding of value will allow for a much smoother undertaking.

## OTHER OWNERSHIP TRANSFER SCENARIOS

Some business owners use business valuation as a tool for creating ownership stability and assessing management performance. However, since business owners are often consumed with the day-to-day activities of running the business, many fail to acknowledge that life (and business) cycle events do happen to them, their partners, and their families. Events like these will require that their businesses be valued. Mercer Capital professionals have spoken for years about the "things that happen to you" and the "things you make happen." The key take-away is this: an understanding of the value of your business or business interest is critical in preparing yourself for any of these eventualities. The following table illustrates the range of potential events that might trigger an ownership change.

| The Business Transfer Matrix | PARTIAL SALE/ TRANSFER | TOTAL SALE/ TRANSFER |
|---|---|---|
| **THINGS YOU MAKE HAPPEN** | ESOP<br>Outside Investor(s)<br>Sale to Insiders/Family<br>Combination Merger/ Cash Out<br>Going Public | Sale of Business<br>Stock-for-Stock Exchange w/ Public co.<br>Stock Cash Sale to Public Co.<br>Installment Sale to Insiders/Family<br>ESOP/Management Buyout |
| **THINGS THAT HAPPEN TO YOU** | Death<br>Divorce<br>Forced Restructuring<br>Shareholder Disputes | Death<br>Divorce<br>Forced Restructuring<br>Bankruptcy |

## VALUE MANAGEMENT

Even those not currently contemplating a transaction in their business have a reason to consider a business valuation. Why? Because knowing the value of your business can be a tremendously effective management tool. Ultimately, you will get two returns from your business – in the valuation community we call these “interim cash flows” and “terminal cash flows.” Interim cash flows include things like your salary, your benefits, and your dividends/distributions. You know what these are and what you can do to influence them. However, your greatest cash flow may be the terminal cash flow (i.e., the value when you sell your business). Are you managing your business in a way that increases its value or not? Do you know?

# BASIC CONCEPTS THAT MUST BE DEFINED IN EVERY VALUATION

Before covering specific details of business value related to the logistics industry, we will first explore a few basic valuation concepts. Some business owners may be surprised to learn that their business does not have a single value, but rather, that its valuation is determined by numerous factors. Tax, legal, and other elements play important roles in defining value based upon the transfer circumstances. While there are significant nuances to each of the following topics, our purpose is to help you combine the economics of valuation with the relevant legal framework.

## THE VALUATION DATE

Every valuation has an “as of” date, which is the date around which the analysis is focused. The date may be set by legal requirements related to a death or divorce, or it may be implicit, such as the closing date of a transaction..

## THE PURPOSE OF THE VALUATION

The purpose of the valuation is linked to the transfer event at hand (such as a sale, estate planning, or buy-sell agreement trigger). A valuation prepared for one purpose is not necessarily useful or applicable for another.

## THE STANDARD OF VALUE

The standard of value is an important legal concept that must be addressed in every valuation assignment, as it influences the selection of valuation methods as well as the level of value. “Fair market value,” most commonly used in tax matters, is the most familiar standard of value. Other important standards of value include “fair value” (financial reporting purposes under GAAP), “investment value” (purchase and sale transactions), “statutory fair value” (corporate reorganizations), and “intrinsic value” (public securities analysis). Using the proper standard of value is crucial in obtaining an accurate determination of value.

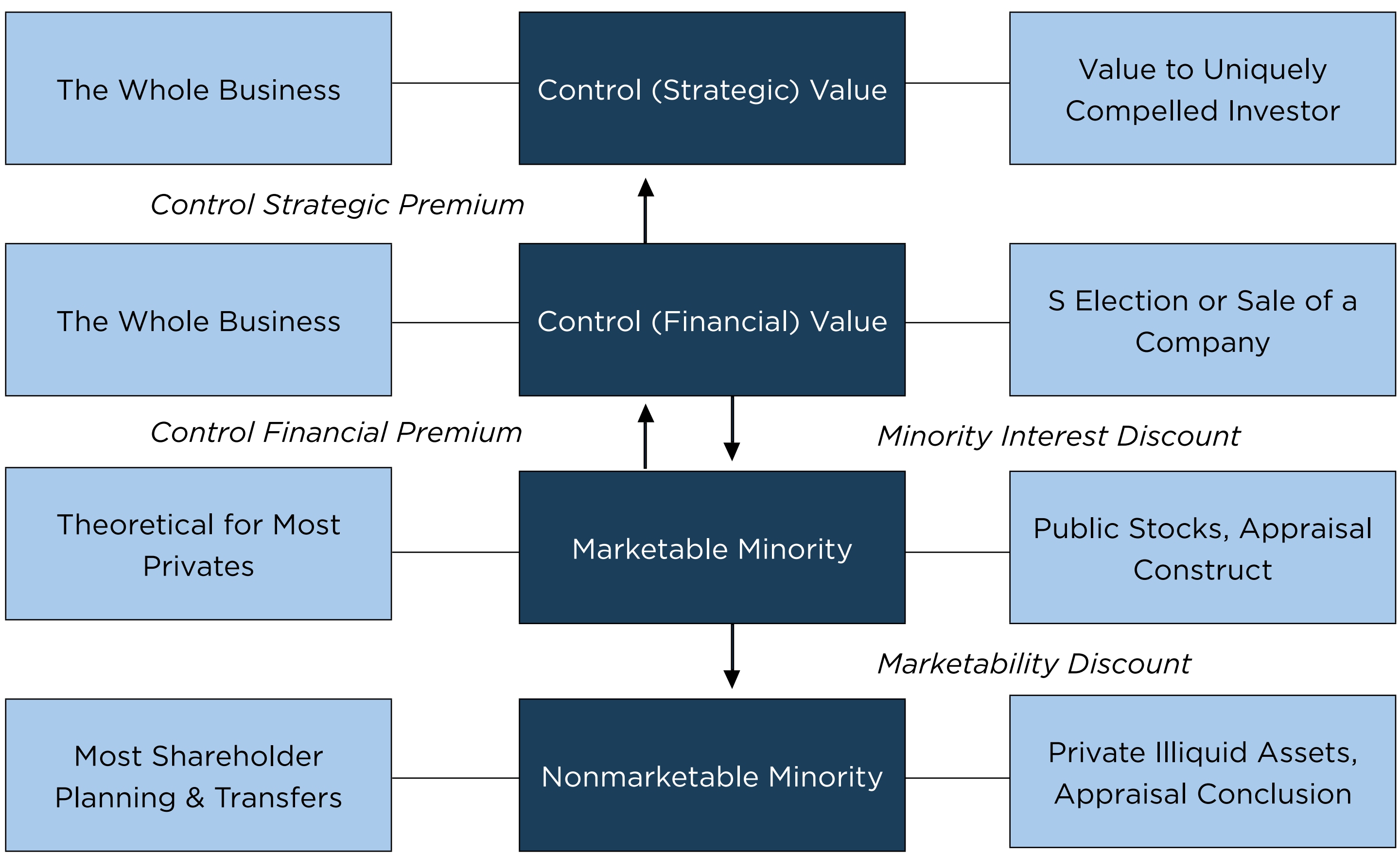
## THE LEVELS (PREMISE) OF VALUE

Does it make a difference in value per share if you own 10% or 75% of a business? It absolutely does. A minority interest does not enjoy the same prerogatives of control that come with a majority holding. Minority owners are relegated to bearing witness to a process over which they have no control or discretion, and they, in effect, play the role of silent partners. Without the ability to control compensation, distributions, or to dictate the strategic direction of the business, the value per share of a minority partner is likely worth less than the shares of a 75% owner.

To add further insult to injury, a minority owner of a private business likely has no ready market in which to sell their interest. Minority ownership in a publicly traded company enjoys near instantaneous liquidity given that such interests can be traded on organized and regulated exchanges. The unique uncertainties related to the timing and favorability of converting a private, minority ownership interest to cash gives rise to a valuation discount (for lack of marketability) which further distances the minority owner's per share value from that of a controlling owner's value per share.

The following chart provides perspective of the various "levels of value." In most cases a valuation is developed at one level of value and then converted to another level of value by way of a discount or premium.

**Levels of Value**



# APPROACHES

Again, it comes as a surprise to many owners to learn that there is not a single value for their business. Without offering a full dissertation on business valuation, you need to understand that there are three commonly accepted approaches to value: asset-based, market, and income. Approaches refer to the basis upon which value is measured. Each approach incorporates procedures that may enhance awareness about specific business attributes that may be relevant to determining the final value. Ultimately, the concluded valuation will reflect consideration of one or more of these approaches (and perhaps several underlying methods) as being most indicative of value for the interest under consideration.

## THE ASSET-BASED APPROACH

The asset-based approach can be applied in different ways, but in general it represents the market value of a company's assets minus the market value of its liabilities. Asset valuations are typically not a meaningful part of the overall valuation of a third-party logistics company, as it is the income generated by the assets that typically drives the value of these businesses. For this reason, the asset-based approach is typically not the sole (or even primary) indicator of value.

## THE INCOME APPROACH

The income approach can be applied in several different ways. Generally, such an approach is applied through the development of an ongoing earnings or cash flow figure and the application of a multiple to those earnings based on market returns. The income approach allows for the consideration of characteristics specific to the subject business, such as its level of risk and its growth prospects relative to the market.

## THE MARKET APPROACH

The market approach utilizes market data from comparable public companies or transactions of similar companies in developing an indication of value. In many ways, this approach goes straight to the heart of value: a company is worth what someone is willing to pay for it.

In many industries, there are ample comparable public companies that can be relied on to provide meaningful market-based indications of value. But comparing these large, diversified, global businesses to the typical private, independent third-party logistics company can be problematic.

Data from industry acquisitions can also be utilized as a multiple on the subject company's performance measures. This can provide a meaningful indication of value as it typically takes into account industry factors (or at least the market participants' perception of these factors) far more directly than the asset-based approach or income-based approach.

# FINANCIAL AND MARKET CONSIDERATIONS

The financial health and outlook of a 3PL company should be assessed in the context of the overall logistics market. The trajectories of revenue and earnings have a lot to do with the timing in the business cycle for the industry and the state of the overall economy.

Industry factors such as overall industrial production, consumer spending levels, and the freight transportation landscape at the date of the appraisal can affect the potential for growth and the demand for third party logistics firms.

- **Industrial Production Output.** Domestic industrial activity is a large source of demand for 3PL firms. As more industrial output occurs, more logistical coordination is needed.
- **Competitive Landscape.** Generally speaking, third-party logistics companies face high levels of competition which limits participant pricing power. While there are strong demand tailwinds, there are many small firms active in the industry. An unspecialized firm that tries to assert pricing power will almost certainly be undercut by one of its competitors. This margin pressure has led many 3PL firms to shift focus towards niches that give them more pricing power.
- **E-Commerce Sales.** 3PL firms have benefitted greatly from the ongoing shift in consumer preferences towards e-commerce. As customers continue to grow accustomed to same- or next-day delivery, many companies have learned to rely on local distributors to maximize logistical efficiency.
- **Overall Consumer Spending.** While the five years to 2020 saw a strong increase in consumer spending, the COVID-19 pandemic caused demand for logistics services to shrink by as much as 9.7% in a single year. Despite this disruption, the economic recovery from the early days of the pandemic has been encouraging to industry participants. Logistics companies of all kinds will likely benefit as consumers resume their typical spending levels.
- **Freight Transportation Landscape.** Third-party logistics companies often sit at the intersection of rail, road, marine, and air shipping. Factors influencing demand and supply for different freight services can have a strong impact on 3PL companies.
- **A word on industry segments:** The above factors can affect industry segments differently. As the logistics industry continues to increasingly focus on niche operations to gain pricing power, company-specific factors will gain more relevance. For example, a company that focuses on an industry vertical will naturally gain headwinds and tailwinds related to the industry they operate adjacent to. The same principle applies to 3PL companies that focus on operating within a given geographic area. It's important to understand how both broad industry factors and niche segment factors affect your company.

# THERE ARE DIFFERENCES BETWEEN PUBLIC AND PRIVATE THIRD-PARTY LOGISTICS COMPANIES

## THE GUIDELINE PUBLIC COMPANY METHOD

Solely comparing private logistics companies to public companies for valuation purposes is problematic. To know why, let's first take a look at the public companies. The five largest logistics companies traded on the U.S. exchanges as of the date of publication are as follows:

### United Parcel Service, Inc. (UPS)

| United Parcel Service, Inc. | | | |
|---|---|---|---|
| **Enterprise Value ($M)** | **LTM Revenue ($M)** | **EBITDA Margin** | **Employees** |
| 174,876 | 94,412 | 12% | 543,000 |

United Parcel Service, Inc. provides package delivery, transportation, logistics, and financial services. It operates in both domestic and international markets, where it provides time-definite delivery services through air freight, ocean freight, and ground services. While perhaps best known for their consumer letter and package delivery services, UPS is also involved in supply chain solutions for the healthcare and life sciences industry. It was founded in 1907 and is headquartered in Atlanta, Georgia.

### FedEx Corporation (FDX)

| FedEx Corporation | | | |
|---|---|---|---|
| **Enterprise Value ($M)** | **LTM Revenue ($M)** | **EBITDA Margin** | **Employees** |
| 87,725 | 78,752 | 11% | 600,000 |

FedEx Corporation provides transportation and business services in domestic and international markets. In addition to its package delivery business units, FedEx also has segments focusing on less-than-truckload freight transportation and supply chain management solutions. It was founded in 1971 and is headquartered in Memphis, Tennessee.

## Expeditors International of Washington, Inc. (EXPD)

| Expeditors International of Washington, Inc. | | | |
|---|---|---|---|
| **Enterprise Value ($M)** | **LTM Revenue ($M)** | **EBITDA Margin** | **Employees** |
| 19,020 | 14,640 | 11% | 17,480 |

Expeditors International of Washington, Inc. is a logistics company with operations throughout the world. EXPD provides air and ocean freight, intra-continental ground transportation, warehousing and distribution services, and other supply-chain-related solutions. It was founded in 1979 and is headquartered in Seattle, Washington.

## XPO Logistics, Inc. (XPO)

| XPO Logistics, Inc. | | | |
|---|---|---|---|
| **Enterprise Value ($M)** | **LTM Revenue ($M)** | **EBITDA Margin** | **Employees** |
| 16,329 | 18,436 | 9% | 100,000 |

XPO Logistics, Inc. is a supply chain services provider which operates internationally. Its services are split into two units: Transportation and Logistics. The Transportation unit includes less-than-truckload services, freight brokerages services, and truck brokerage services, among many others. The Logistics unit includes operations such as supply chain optimization, warehousing and distribution, and cold chain-logistics. XPO was founded in 2000 and is based in Greenwich, Connecticut.

## C.H. Robinson Worldwide, Inc. (CHRW)

| C.H. Robinson Worldwide, Inc. | | | |
|---|---|---|---|
| **Enterprise Value ($M)** | **LTM Revenue ($M)** | **EBITDA Margin** | **Employees** |
| 12,968 | 21,150 | 5% | 14,888 |

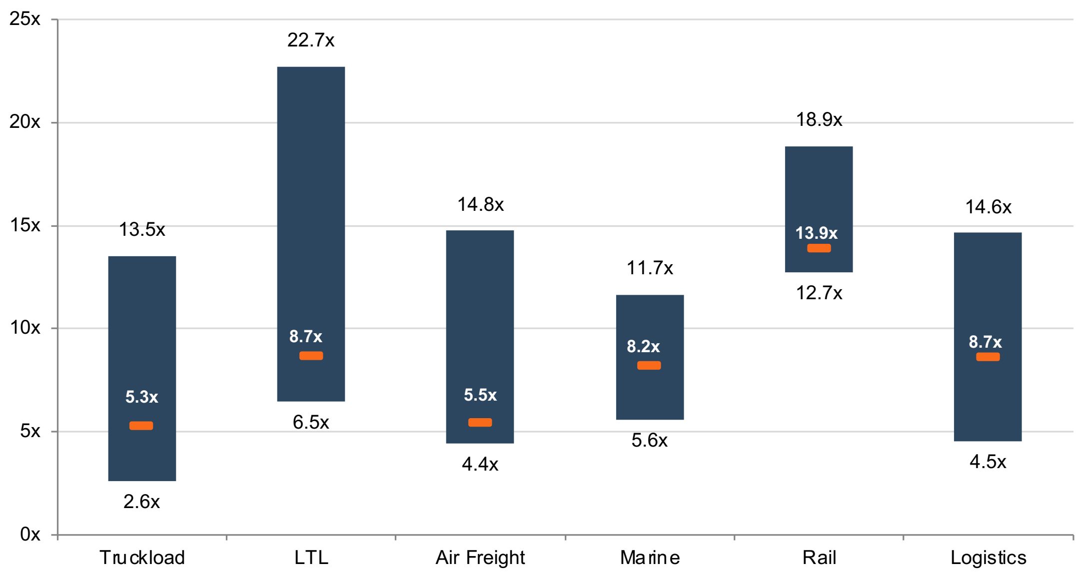
C.H. Robinson Worldwide, Inc. provides freight transportation and logistics services around the world. Their operations include truckload and less-than-truckload freight, intermodal transportation, warehousing, and more. C.H. Robinson was founded in 1905 and is headquartered in Eden Prairie, Minnesota.

# THE DIFFERENCES BETWEEN PUBLIC AND PRIVATE COMPANIES

## SIZE, DIVERSIFICATION, AND LOCATION IMPACT VALUATION

As of September 30, 2021, the enterprise values for these public companies ranged from $13.0 billion to $174.9 billion. The charts below show the range of implied Enterprise Value to EBITDA multiples for the publicly-traded marine, rail, and logistics sectors over the last six quarters (prior to September 30, 2021). Many private companies utilize the valuation multiples of public companies to estimate private company value.

**TEV/EBITDA Multiples**




*Source: S&P Global Market Intelligence* *Data as of September 30, 2021, excludes outliers*

As their business descriptions indicate, the operations of these five publicly traded companies are diverse and international. The companies have 14,800 to 543,000 employees and annual revenue between $21.2 billion and $94.4 billion. When utilizing these public companies as a valuation benchmark, keep in mind the above descriptive analysis when comparing your private logistics company and adjust for the differences.

# WHAT VALUATION APPROACHES MAKE SENSE FOR TRUCKING COMPANIES?

## GUIDELINE PUBLIC COMPANY METHOD CAN BE HELPFUL BUT NOT AS A STAND-ALONE METHOD

Making the judgment that the guideline public company method is appropriate or not appropriate can be simple or quite complex. While using publicly traded companies to assess the value of a 3PL company can provide a general context for private company valuation, this process should not begin and end at public company valuation multiples applied to private company performance levels. To put it bluntly, the above five publicly traded companies are not directly comparable to most logistics companies. As such utilizing public transportation companies to value privately held ones requires various adjustments to be made. It is not an “apples to apples” comparison. To explain further, let’s consider a couple of major differences.

**Size.** The five largest publicly traded logistics companies have annual revenues over $21.2 billion. When comparing public companies to private companies, there is a general “rule of 10,” which says if a subject company is 10x larger or smaller than the public company compared to it, the growth and risk factors are so different that it is very difficult to adjust and reconcile these differences. According to this “rule of 10,” any logistics company with revenues of less than $2.1 billion violates the general comparability rule in reference to any of the five largest companies in its category. While this is just a general rule and not an absolute, it is important to keep in mind, especially in light of the next difference: diversification.

**Diversification.** Each of the above public companies generate revenues from multiple sources of services, customers, industries, and multiple locations (many internationally). Every business owner understands that diversification minimizes risk and promotes growth; both are value enhancers for a business. However, many smaller or niche operators are tied to a certain area or region. In addition, smaller 3PL companies may rely almost exclusively on a small set of one or two main customers. This fact pattern changes the risk profile significantly, making comparison between smaller, private logistics companies to the publics unsupportable. Additionally, for companies of larger and more diversified business models, the cost of debt and equity capital is significantly cheaper. Larger, seemingly less risky businesses have access to more sources of capital compared to smaller, more risky businesses (all other things being equal).

Each of these differences (and more) must be considered in performing a valuation utilizing public companies.

## THE MARKET TRANSACTION APPROACH

Market transactions of privately held companies in the same or similar business may also provide a reasonable basis for valuation of the subject company. Such companies provide controlling interest valuation data. Market transactions are used to develop valuation indications under the presumption that a similar market exists for the subject company and the comparable companies.

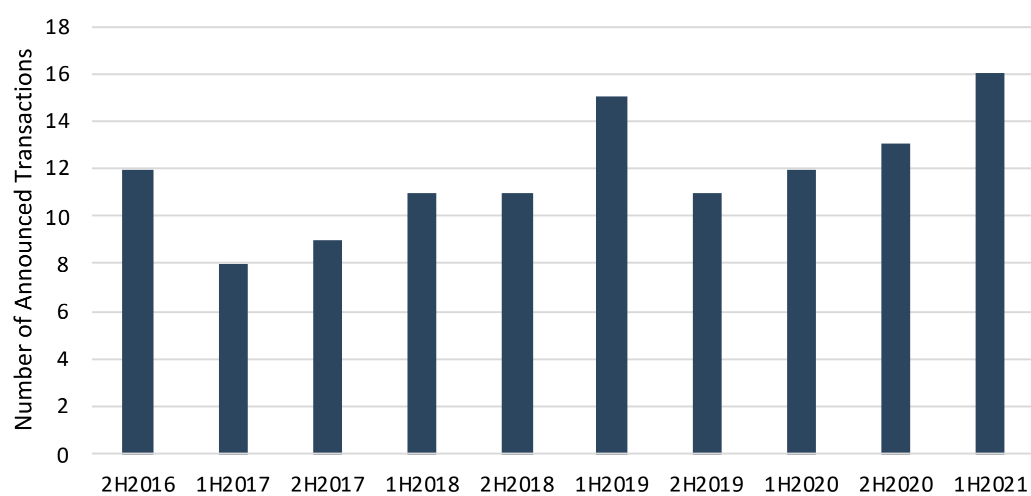
IIdeal guideline companies are in the same business as the company being valued. However, if there is insufficient transaction evidence, it may be necessary to consider companies with an underlying similarity of relevant investment characteristics such as market, products, growth, cyclical variability, and other relevant factors.

One of the most significant points of transaction data in the recent past is the acquisition of Echo Global Logistics (NASDAQ: ECHO) by The Jordan Company, L.P., a private equity firm. Echo was among the leader providers in technology-assisted supply chain management and transportation operations. The Jordan Company paid total consideration of $1.4 billion, implying an Enterprise Value to Revenue multiple 0f 0.44x, and an EBITDA multiple of 12.8x.

| Echo Global Logistics Acquisition | | |
|---|---|---|
| **Acquirer** | | **Announced Date** |
| The Jordan Company, L.P. | | 9/10/21 |
| **Target** | | **Close Date** |
| Echo Global Logistics, Inc. | | 11/23/21 |
| **Enterprise Value ($M)** | **Implied EV / Revenue** | **Implied EV / EBITDA** |
| 1,400 | 0.44 | 15.84 |

While it is tempting to turn to the biggest headline acquisitions as a means of comparison, it can be far more valuable to identify the industry appetite for smaller, more comparable businesses. The availability of relevant market transaction multiples may be limited, however, as smaller logistics company targets are often privately held and rarely report transaction multiples, while public M&A activity involves larger, diversified players like Echo.

**Trucking Industry M&A**



Clearly, the more comparable the transactions are, the more meaningful the indication of value will be, but caution must be exercised when utilizing data from market transactions since the circumstances surrounding each sale are often unknown

## CONCLUSION

Mercer Capital has long promoted the concept of managing your business as if it were being prepared to sell. In this fashion, you promote the efficiencies, goals, and disciplines that will maximize your value. Despite attempts to homogenize value through the use of simplistic rules of thumb, our experience is that each valuation is truly unique given the purpose for the valuation and the circumstances of the business.

Mercer Capital has valued businesses in various segments of the transportation and logistics industry over the years. We hope this information, which admittedly only scratches the surface, helps you better understand some of the valuation considerations that apply in the insurance industry.

We encourage you to extend your business planning dialogue to include valuation, because sooner or later, a valuation is going to happen. Proactive planning can alleviate the potential for a negative surprise that could complicate an already stressful time in your personal and business life.

For more information or to discuss a valuation or transaction issue in confidence, do not hesitate to contact us.

# Transportation & Logistics Industry Services

Mercer Capital provides valuation and transaction advisory services to the transportation & logistics industry.

### Industry Segments

Mercer Capital serves the following industry segments:

- Trucking
- Air Freight
- Marine
- Railroads
- Logistics & Intermodal

### Services Provided

- Valuation of transportation and logistics companies
- Transaction advisory for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

**Contact a Mercer Capital professional to discuss your needs in confidence.**

## Contact Us

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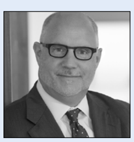

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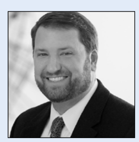

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