

LOGISTICS HELPS REDUCE 'CUSTO BRASIL'

SUMMARY

> **Brazil's thriving logistics industry** has grown rapidly since the mid-1990s, with farmers, manufacturers and other businesses desperate to reduce the costs they incur as a result of the country's deficient infrastructure.

> **The industry will grow** by at least twice the rate of GDP for the foreseeable future, but many bigger and more successful players will expand at a much faster rate.

> **The industry is still heavily fragmented**, with many small family-based and often informal operations, so there is a lot of room for consolidation to continue.



Hundreds of lorries wait to load and unload their freights at a ferry port terminal in Paranaguá

Historic underinvestment in Brazil's roads and ports has led to the growth of a thriving logistics sector helping businesses reduce costs and improve efficiency.

Images of lorries queuing for miles outside Brazilian ports or struggling through mud-clogged Amazonian roads have almost become a cliché. But the well-known deficiencies of Brazil's transport network also have a more positive side. Desperate to reduce costs and improve efficiency, manufacturers, farmers and other businesses have fed demand for a booming logistics industry. Last year, 130 companies generated revenues of R\$39bn (\$23bn, £15bn, €17bn). Although the original players were all from Europe and the US, a number of authentically Brazilian companies now lead the way. Many of the biggest and most successful players such as JSL (JSLG3:SAO) and América Latina Logística (ALLL3:SAO), along with smaller players such as Log-In (LOGN3:SAO), Santos Brasil (STBP3:SAO) and Wilson Sons (WSON3:SAO), have been

favourites among investors. Brazil Confidential believes this success is likely to continue. Our interviews with a cross section of executives and industry observers give grounds to suggest that annual double-digit growth is on the cards for the next few years.

Since the mid-1990s, both Brazilian and international companies have begun to contract specialist logistics operators to handle activities such as storage and cargo transport. These operators – who originally developed their businesses in Europe and the US – have used information technology to better manage these transport operations, helping to reduce the disadvantages stemming from weak infrastructure. "They started from practically zero and grew very fast," says Paulo Fleury, director of ILOS, the institute of logistics and supply chain.

Nowadays core activities for integrated Logistics service providers (LSPs) include transportation (full truck loads for a single customer), storage, port-to-distribution, shared transport (less-than-truck-loads, with a single truck carrying shared cargos for various customers), IT management, stock control, project development, integrated management of logistics operations, cross docking (unloading products from trucks or trailers straight onto other trucks to be immediately moved to

The heavy demand for new trucks last year is another sign that the expansion will continue

► destinations without needing intermediate storage), and logistics for international cross-border operations.

Mauro Henrique Pereira, board member of the **Brazilian Logistics Association (ASLOG)** and director of Kimera Consulting, says that logistics providers have seen average revenue growth of around 13.6% annually

for the last five years. Although this growth may ease due to signs of the worsening global economic situation, a slowdown could also generate opportunities as companies look to reduce their costs by outsourcing

activities or adding new technology or processes to become more efficient. "Expertise is often required to revise processes and restructure [during an economic crisis], in order to save costs," he adds.

The heavy demand for new trucks last year is another sign that the expansion will continue. During 2010, truck sales soared 52% compared to 2009 and, as over 60% of volumes are transported by road, this confirms the likely continuation of growth in the sector, Mr Pereira says.

The integrated logistics sector, which combines different types of operations such as providing inventories and storage, through to managing companies' assembly lines and packaging activities, is set to continue to grow. The sector is expected to expand because many companies are not yet using third-party logistics providers that typically organise warehouses, pick up and organise materials and distribute and transport them, while other companies intend to outsource additional activities. More complex logistics activities are also in demand such as warehouse management and IT, with an increase in build-to-suit warehouses in which the buildings are erected and managed by third parties.

Business intelligence tools as well as tracking and tracing systems are also in demand, while companies are also eyeing rail services. "There is plenty of room for growth and we envisage revenue growth on average of 15% this year," says Mr Fleury at ILOS, warning that this depends on the impact of the financial crisis. Also, while some larger companies that are organically expanding or hungry for acquisitions may grow at even faster rates of around 20%, the number of companies should broadly stabilise as smaller companies are snapped up and some new entrants target the market.

ILOS also undertakes annual performance ratings of the providers by interviewing some 330 logistics managed in nine major industrial sectors including chemicals, automotive, pulp and paper and metals. The researchers asked the interviewees to give their opinions of the top two companies for different categories such as general logistics, and related to specific sectors such as automotive or pharmaceuticals.

This year, the institute ranks the country's main LSPs from one (lowest) to ten (highest), with the average score being 8.1 for the sector. This year, ILOS ranked **DHL** as the top performer, with top positions across various sectors such as food and beverage, automotives, retail, electron-

ics and chemicals. DHL was followed in the overall ranking by ALL, TNT, Rapidão Cometa, Luft, TNT Mercurio, Correios, CEVA, Aliança/Hamburg Süd Group and Vale.

JSL diversifies

Both large local companies and international players see attractive opportunities to expand. The infrastructure challenges that Brazil faces actually bring opportunities to logistics companies that specialise in finding solu- ►

Logistics costs highest for farmers

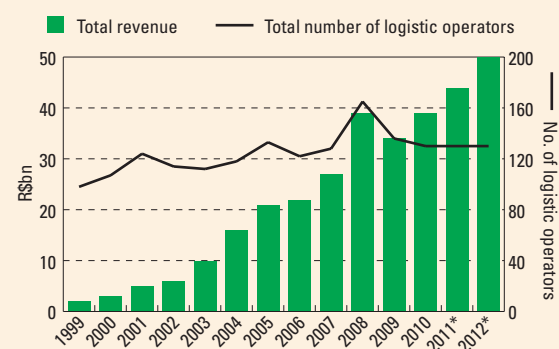
Logistics costs as share of total revenues by industry sector, 2011

Industry	Logistics cost as share of total revenues (%)
Agrobusiness	13.3
Beverages	12.1
Pulp and paper	11.0
Construction and decoration	10.6
Food	9.9
Retail	9.4
Chemical and petrochemical	8.3
Steel and metals	7.2
Hygiene, cleaning, cosmetics and pharmaceutical	7.0
Electronical	4.9
Automobiles and autoparts	3.0
Others	3.0

Source: ILOS

Rising revenues and consolidation

Total revenue and total number of logistics operators in Brazil, 1999-2012



*Forecast

Source: ILOS, Brazil Confidential

DHL takes gold

Ranking of "the best" logistic companies in Brazil, 2011

Ranking	Company	Ranking	Company
1	DHL	6	TNT Mercurio
2	JSL	7	Correios
3	ALL	8	CEVA
4	Rapidão Cometa	9	Aliança
5	Luft	10	Vale

Source: ILOS

► tions to navigate around obstacles and barriers, says Fernando Simões, president of JSL, one of the country's largest logistics companies. For instance, LSPs need to look for solutions such as transporting cargos at night when there is less traffic in big cities, he says.

As the economy expands, JSL expects revenues to grow 23-25% this year compared to last year due to new and existing contracts. JSL secured R\$1.2bn in gross revenues in 1H11, up 33% compared to the same period in

2010. The second half of the year is typically seasonally stronger.

JSL expects to grow 23-25% this year compared to last year due to new and existing contracts

Fernando's father, Julio Simões, a Portuguese immigrant, started business in 1956 with a single used truck to transport cargoes of fruit and vegetables from Mogi das Cruzes in the interior of São Paulo state to Rio de Janeiro. The company expanded to provide passenger transport and fleet outsourcing in the 1980s and dedicated services to customers' supply chains in the 1990s. Last year, JSL raised R\$478m in an IPO to fund its aggressive growth plans. JSL share price rose 15% during 2Q11 compared to a 9.9% dip on the Bovespa. Its shares soared 43.8% since its IPO up to June 30, versus a decline of 10.1% for the Bovespa in the same period.

JSL handles inbound logistics such as managing and operating deliveries of raw materials or undertaking milk runs (that deliver regular loads to plants or customers) with spare parts or equipment. It also operates warehousing and internal logistics as well as outbound deliveries of products from factories such as auto parts, consumer goods, pulp and paper and food to customers or dealers across the country.

To keep up with the growth, JSL is also making hefty investments to modernise and expand its fleet. The company invested R\$800m in 2010 and expects to plough another R\$710m this year into renewing and expanding its fleet by 20% from last year's 14,000 light vehicles (cars or vans), 4,200 trailers and 1,700 items of equipment and machinery such as diggers. The company's workforce of 14,000 employees across 121 branches is also expected to grow 20% by year-end. Last year, JSL reported R\$2.3bn in revenues, up 37% YoY, and net income of R\$93m, up 52% YoY. The company is among the largest road transport providers.

JSL is diversifying. It has ramped up its activities in steel and mining, capital goods, electric energy and agriculture in 2Q11. It also recently began using a new inter-model terminal at Itaquaquecetuba on the busy São Paulo-Rio de Janeiro axis for urban distribution. Meanwhile, it is renting agricultural equipment hoping to benefit from laws prohibiting sugarcane burning and the need for mechanisation. "Logistics is one of the sectors that the economy needs to function – whether there's a downturn or not – and the sector supports growth," Mr Simões says.

This strong track record and diversification should stand JSL in good stead as pulp and paper, its largest sector, only accounts for 16.5% of income in 2Q11 and the company has further diversified into areas such as agri-

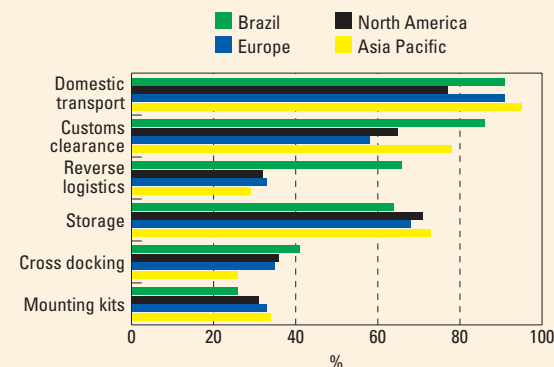
culture and domestic consumer goods. Having reported a 27% compound annual growth rate (CAGR) over the last ten years and revenue growth of 33% in 1H11, the company should be able to meet its 2011 revenue target growth. Without considering a downturn in the Brazilian and global economy, JSL should eye around 20% revenue growth in 2012 based on existing contracts and a strong position across a broad range of domestic sectors that will continue to need logistics services.

Another major logistics player listed on the Bovespa is **América Latina Logística (ALL)**, which is the only listed rail operator and the country's lowest-cost operator. The Curitiba-based company reported consolidated gross revenue rising 13% to R\$2.9bn last year compared to 2009, while net earnings reached R\$240m, up 590% YoY. The company's ebitda grew 21.6% last year to R\$1.34bn, with margins up 3.5pp to 48.6%. ALL operates 21,300 km of rail tracks, 1,095 locomotives, 31,650 rail cars, and 650 highway vehicles to serve customers in sectors from agriculture to metals.

ALL's revenues YoY should rise 11-13% this year and next year helped by a record soy crop. ALL should ►

Brazil, an international leader in logistics

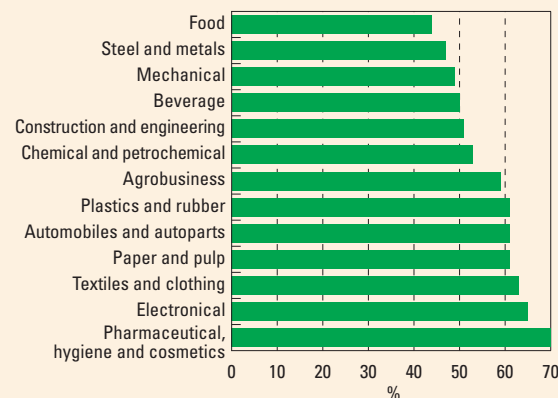
Share of activity that is outsourced, Brazil vs global regions, 2009



Source: Coppead and ILOS

Pharmaceuticals outsources logistics most

Share of logistics activity outsourced by industry, 2009



Source: ILOS

▶ also see total loads rise by double-digit figures in 2011 versus 2010 as a result of its partnership with Rumo Logística, the logistics arm of the sugar company Cosan (CSNA3:SAO). This focus on agriculture (66% of revenues last year) can be seen as defensive as people will always need to eat, but soft commodity prices such as soybeans could always fall during a global economic downturn hurting ALL's major agricultural customers.

Tegma Gestão Logística (TGMA3:SAO), which specialises in road transportation especially for the automotive sector, is also listed on the Bovespa. The company reported R\$1.16bn in revenues in 2010, up 9% YoY, and net income of R\$112m, up 47% YoY. It also reported R\$847m in gross revenues in 1H11, up 27.8% YoY, and transported 607,000 vehicles in the same period, up 9% YoY, for an average distance of 985 km. The company works for Fiat (FI:MIL), Claro, Unilever (ULVR:LSE) and CSA. Tegma has 78 units across the country, 2m sq m of open patios and 125,000 sq m of covered patios.

Tegma eased concerns about being heavily focused on the automotive and especially the finished vehicle transport market last year by acquiring Direct Express, which undertakes distribution for e-commerce companies. Nonetheless, the company with over 70% of its second quarter revenues from its auto and spare parts segments, may keep its eye out for other acquisitions to further diversify. The company should also improve its margins after its recent expansion, but there could be some idle capacity in the coming quarters. The company is expected to see low double-digit revenue growth YoY in 2011 and 2012.

Other players with a heavy presence of logistics activities include **Log-In**, which was spun-off from mining giant Vale in 2006. The company undertakes transportation of containers, rail transport, port activities and logistics management. The company secured R\$621m in consolidated net revenues in 2010, up 45.6% YoY, and net income of R\$18.8m, against a loss of R\$7m in 2009. The company plans to invest R\$1bn and build seven vessels by 2013 that will help improve its margins and lower costs by avoiding paying for leases. São Paulo-based Fator Corretora estimates its net revenues at R\$662m in 2011, R\$780m in 2012 and R\$916m in 2013.

Based in the north-east, **Wilson Sons'** main businesses last year were port terminals and towage, complemented by logistics, which counted for 17% of its revenues. The company co-operates two of the principal container terminals in Brazil, located in Rio Grande do Sul and Bahia, as well as supply chain solutions including road transportation, storage and distribution. The company achieved R\$959m in net revenues in 2010 compared to R\$832m in 2009. The company paid R\$9bn last year to secure 100% control of Brasco, which controls the largest terminal dedicated to oil rigs and handles logistics. This should further position the company to benefit from oil giant Petrobras' (PETR4:SAO) expansion of oil and gas exploration. Last year, the company also established a joint venture with Ultratug that should

buoy its offshore business.

Port terminal operator **Santos Brasil**, which runs TECON1, the largest container terminal in Latin America, recorded gross revenue of R\$165.5m last year, up 24.7% compared to 2009, giving compound annual growth of 20.3% over the last three years. Its net income of R\$865.5m in 2010 rose 31% compared to 2009. Santos Brasil, which is responsible for some 25% of the containers in the country, began offering large-scale logistics services in 2008 and in November expanded its operations with the inauguration of a distribution centre of 105,000 sq m in São Bernardo do Campo. The company forecasts investments of R\$138m for the expansion works in Imbituba, and the acquisition of new port equipment to operate in Santos, that should help to continue growth on import and export traffic.

Rail operator **MRS Logística** generated R\$2.48bn in sales and net income of R\$439,000 in 2010. The company has made R\$707m investments in permanent lines as well as locomotives and wagons. The company has 1,643 km of rail in the industrial south-east region. Elsewhere, **Aliança Navegação e Logística Ltda** reported sales of R\$2.17bn in 2010. The company operated some 28 container ships with some 69,000 containers of 20-foot equivalent units (TEUs) in 2010. To support operations in the Amazon region, Aliança has a distribution terminal in Manaus, with 10,000 sq m of open-air and 2,000 sq m of covered storage space.

International players roll on

JSL and other local logistics companies are not alone in visions of aggressive growth. Dutch-based **CEVA**, which has 950 customers in Brazil, is focusing on strategic sectors, especially automotive and tyres, technology, consumer goods, retail and energy, for example. Brett Bissell, CEVA's executive vice president for Latin America, says that in Latin America the logistics market is expected to grow twice as fast as GDP in the coming years. In Brazil, Bissell expects the company's business to grow by over 10% in the next three years.

Moreover, Mr Bissell says CEVA intends to aggressively grow customs brokerage, ground transportation, as well as ocean services. Additionally, CEVA has created a team focused on account management for its largest customers, which handles the top accounts, identifying new opportunities, cross-selling opportunities and helping customers.

US LSP **Penske** is also banking on growth for the sector. Paulo Sarti, Penske's managing director in Brazil, says the logistics market will keep up with the economic growth of the country. Industries are focusing on expanding their production and, as a consequence, they are increasing their needs for warehousing and transport, he says.

Penske predicts an increase in revenues of more than 30% in 2011 compared to last year, based on current and new accounts. Penske currently employs 2,000 workers and manages 340,000 sq m of warehouse space for customers at sites in Cajamar in São Paulo state, ▶

***ALL's revenues YoY
should rise 11-13% this
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breaking soy crop***

📍 Jaboatão dos Guararapes in Pernambuco and Camaçari in Bahia.

Other international companies are positive about the opportunities to grow, especially outside of the country's industrialised south-east region. Germany's DHL, which handles 260,000 shipments related to sectors such as auto, IT and manufacturing, expects its freight forwarding to grow in volume by 40% a year outside of São Paulo until the end of 2012.

New challenges

Yet, although LSPs see attractive growth ahead, the rapid pace of development is also causing new barriers. With record-low unemployment at around 6%, companies are struggling to recruit skilled employees. "Human resources is the main challenge due to the lack of qualified professionals," says Penske's Mr Sarti. The LSP has developed training centres and has made an agreement with the mayor in Cajamar in order to attract, select and train people for its operation. Penske has hired 600 new employees since 2010. As more jobs become available in the market, it is increasingly difficult to find truck drivers: many people prefer to opt for jobs that are located in one place, rather than needing to drive across the country, Mr Fleury says.

Another obstacle is to find space to allocate distribution centres capable of handling the burgeoning logistics demand of the country. The whole sector was impacted by increased rental costs of industrial sheds in the past few years. But, slowly, this situation is beginning to stabilise, particularly due to the large number of sheds being built, Mr Fleury says.

Penske is always looking for solutions to infrastructure problems. For example, one of Penske's distribution centres needed to work with a diesel power generator and without a phone line. "But we never stopped operations because of that," Mr Sarti says.

Consolidation perspectives

Brazil has a wide range of local and international logistics providers, with most of the international companies already having a foothold in the market. The trucking sector is highly fragmented with thousands of small companies, while the rail infrastructure is often dominated by large commodity producers such as Vale, with little available space beyond its own demand.

With the market still fragmented, several consolidation trends are apparent. Some companies are moving to become more specialised, achieving the benefits of economies of scale within a limited market niche. By contrast, others are looking to integrate services, merging or creating alliances that can offer storage, transport and distribution both locally and across borders.

There is plenty of room for consolidation. The expectation is that the sector will continue to see family-owned companies professionalising to maintain their market share, while international players have already entered the market via mergers and acquisitions, says Professor Manoel Reis, a specialist in logistics at 📍



The government PAC programme invests largely in the road network

INSIGHT INDUSTRY BOSSES HOPEFUL FOR PROGRESS

Scepticism about the government's programme to improve infrastructure may be widespread, but logistics industry bosses are hopeful of progress.

"There are lots of ideas, but often people talk too much, and do too little," warns Professor Manoel Reis, a specialist in logistics at business school Fundação Getulio Vargas in São Paulo. Business and media pressure has intensified as the concern of a potential "logistics blackout" has gained growing attention. These plans should enable more cargo to be moved more effectively and more cheaply, but it will take many years before the ongoing projects are completed, he says.

Yet executives in the logistics industry are less pessimistic. Ferdinand Kurt, Kuehne & Nagel's regional manager in South America, says that the federal government's Programme for Growth Acceleration (PAC) is positive. Highlighting government data, Mr Kurt says that 9% of projects financed by PAC (including transport as well as energy,

electricity and sanitation) have been completed and that 76% are on schedule, he says. The programme invests largely in the road network and as such will help the logistics sector and industry to create more cost-effective supply chains, he adds.

According to Brett Bissell, LSP CEVA's executive vice president for Latin America, the PAC has an important role in solving logistics challenges, independent of the big sporting events that Brazil will host in the next few years. With many public works projects underway, these should benefit logistics operators and the population in general, he says.

Other gains are also appearing. Mr Bissell says that customs process improvements that have occurred over the last few years, such as the introduction of industry standards Blue Line and RECOF, have helped. These schemes encourage electronic manufacturers, especially computer makers, to allow their imports to clear customs automatically into their in-bond warehouses helping to quicken the release of goods. In the past, customs clearance would take over a week, but nowadays it is down to a couple of days, sometimes even hours, he says.

► business school Fundação Getulio Vargas in São Paulo.

A recent example in July was global logistics company **Kuehne & Nagel's** (K&N) acquisition of family-owned, Port Alegre-based firm Grupo Eichenberg, with 700 employees across 14 locations, for an undisclosed value. Ferdinand Kurt, K&N's regional manager in South America, explains that through the acquisition of Eichenberg, which has a strong footprint especially in road logistics and domestic airfreight, K&N can now provide integrated door-to-door solutions. At the same time, it can increase activities in the domestic distribution of raw material and finished goods, Mr Kurt says.

ALL established a partnership last year with sugar and ethanol giant Cosan (CZZ:NYSE) to create Rumo Logística and in July established another partnership with transport and fleet outsourcing group Ouro Verde to create Ritmo Logística. On July 20, ALL also secured the approval of the Brazilian antitrust authority, Cade, to create Brado Logística, specialising in transporting containers. ALL aims to triple its size by 2020.

Other mergers and acquisitions have rippled across the highly fragmented sector. JSL acquired Lubiani in 2007 and Transportadora Grande ABC in 2008; while Tegma and Boni Gatx merged in 2007, and Tegma also took control of local distributor Direct Express Logística Integrada last year. Dutch company TNT Express also took over São Paulo-based Mercurio in 2007 and Expresso Araçatuba in 2009. Last year, Log-In announced a joint venture with shipping company TBS to ship cargoes of agricultural products for export.

Smaller players will need to be nimble and clearly client-focused to survive, says Mr Reis. These companies will need to simultaneously invest in niche segments that the big companies aren't targeting, while really understanding the needs of their clients and using technology from storage management through to tracking and tracing to offer services that the big players are missing, while keeping costs attractive, he says. "It's certainly not easy, and many more [small logistics companies] will disappear," he adds.

Although JSL is keeping an eye out for new acquisitions, the company's priority is to expand organically, says Mr Simões. Despite the many infrastructure challenges as Brazilian companies expand further from the country's ports and big cities, logistics players are becoming ever-more specialised and able to provide national coverage. This gives LSPs the chance to benefit from the country's growth. "As Brazil is a developing country, it needs more food, needs to build more, and needs to adapt to the expanding conditions," he says. "Brazil is therefore constantly growing and we intend to grow with it."

Government investment

Brazil has suffered from decades of underinvestment in infrastructure. Although the country saw spending on transport at 1.8% of GDP in 1975, it invested only

around 0.2% by 1990, and was still hovering around only 0.7% by 2008. ILOS says that 0.8% of GDP should be invested in transport 2011, and this should reach around 1% in 2012 and 2% in 2013, as long as a global downturn doesn't hit the economy. There has been a major deficit in spending in recent decades and 2% is the minimum needed, says Mr Fleury.

In recent years, the federal government has been increasing investments in major infrastructure projects. In 2007 it launched its so-called Programme for Growth Acceleration (PAC1), which has been interwoven with a large-scale transport infrastructure plan, National Plan for Logistics and Transport, (PNLT), which has a total budget of R\$291bn for 2008-2023 of which R\$109bn is to be invested by the end of 2011.

While chief of staff under her predecessor, the former President Luiz Inácio Lula da Silva, current President Dilma Rousseff oversaw this effort to boost infrastructure. Since taking office as president, Ms Rousseff has maintained logistics spending as a priority. The PNLT provides a framework for public and private initiatives to improve and expand all forms of transport and infrastructure. The plan includes expanding waterways, highways, ports and railways. The entire PNLT includes R\$150bn for rail projects, R\$13bn related to airports, R\$15bn for waterways, R\$38bn for ports and R\$69.7bn for highways and roads.

The key rail expansion includes an expansion of the north-south railway (Ferrovia Norte-Sul) that will pass from Belém across the country to the industrial south-east. The east-west (Ferrovia Integração Oeste-Leste) will connect the north-south railway to the north-eastern coast. Heading inland, the centre-west railway (Ferrovia de Integração Centro-Oeste) connects with the north-south railway with agricultural producers in the centre-west grain belt. The Transnordestina is also being built from the north-south railway to the north-east.

Building the infrastructure projects has been slower than expected as often the government has come up against unexpected challenges related to environmental licences and permission to gain right-of-way access over land. The government often hit obstacles such as the unexpected discovery of endangered species in areas targeted for development that blocked environmental licences, says Mr Fleury.

Gil Castello Branco, secretary general of NGO Contas Abertas in Brasília, adds that projects have been dogged by various factors. Mr Castello Branco agrees that licenses have often taken longer than expected to acquire. But another major barrier was that the new administration is still paying for PAC1 projects from periods as far back as 2007. Despite the political declarations, few PAC2 projects are underway, he says. Other issues contributing to the delays include a lack of experience and also the corruption scandal in the Ministry of Transport. "All this contributed to delays," he says. ■

Since taking office as president, Ms Rousseff has maintained logistics spending as a priority

ACTION POINTS

01 Large logistics service providers such as ALL and JSL have provided attractive financial results and continue to provide good investment opportunities and also should benefit from a consolidating sector.

02 Smaller companies such as Log-In, Santos Brasil or Wilson Sons that provide specialised services or port activities may also provide alternative investment opportunities. Wilson Sons could see opportunities related to future offshore oil and gas exploration, while Log-In is expected to benefit from investments in new vessels.