Published on *JOC.com* (http://www.joc.com)

Do your homework

BY BILL MONGELLUZZO | Jun 25, 2006 8:00PM EDT

With the third-party logistics industry growing at double-digit rates, established 3PLs feel the urge to snap up a competitor before a large shipping line or equity investment company gets there first. After all, logistics is a 3PL's core competency, so how risky can it be to purchase another service provider when it looks like it will be a good fit?

Without the proper research, the risks are great, according to Jon DeCesare, a consultant who helps 3PLs perform due diligence on potential merger or takeover targets. Indeed, rushing into a deal can be disastrous, even in a high-growth market. "You don't go and buy a company because you have a gut feel about it. Those days are gone," said DeCesare, chief executive of World Class Logistics Consulting Inc. in Long Beach.

Logistics companies that cut the due-diligence process short often set themselves up for a series of problems that can spin out of control. The purchaser may find that the logistics provider has an inadequate warehouse management system, outdated business processes, insufficient warehouse space to handle growth and a corporate culture that is so radically different from its own that key professionals will leave rather than join the merged operation.

In the end, the purchaser may find that it paid too much for the logistics provider and is facing a large bill to re-engineer its operations and upgrade the information technology systems, both of which can be costly. That can lead to profits being less than anticipated, dissatisfaction among the board of directors and shareholders and low company morale.

Performing due diligence before finalizing the purchase of a logistics provider is a relatively quick process that takes eight to 10 weeks, DeCesare said. The parties can agree upon a financial arrangement pending completion of the due-diligence process. Upon completion, the purchaser may proceed with the deal as planned, end up lowering its offer because costly flaws were uncovered or even scuttling the deal because the problems will cost too much to correct.

Even if a logistics provider is a leader in its field, rushing into a purchase can be risky. Weber Distribution in June closed on a deal to purchase TaB Warehouse and Distribution Co., a leading 3PL in the confectionery warehousing field that handles some of the most recognizable names in chocolates.

"Things looked good. They were No. 1 in their core niche," said Scott Weiss, manager of business development at Weber. "But guess what? They were in financial trouble," he said.

To make the purchase profitable, Weber knew it would have to switch TaB's processes and warehouse management systems to meet Weber's productivity standards. Weber maintains detailed productivity figures down to the number of pallets handled per hour and the profit margin it realizes for each of its customers.

Still, TaB, like Weber, was a privately owned company with loyal employees, many of whom had worked with the company for 10 to 15 years. Since the corporate cultures were similar, Weber wanted TaB employees to stay with the merged company. Weber executives called meetings early in the process to give TaB employees peace of mind and tell them how they would fit into the merged company, Weiss said.

Mergers and acquisitions in the 3PL industry are a hot item, totaling more than $9 billion last year, DeCesare said. Several types of companies are engaged in the process. Existing 3PLs are purchasing competitors to expand their market share in a certain product category or geographical region or to expand quickly into areas where they do not have a presence.

The logistics subsidiaries of ocean carriers, large trucking companies and integrated carriers have large amounts of cash available to purchase other logistics providers and expand their global reach. Equity investment firms with no experience in the 3PL business are also flush with cash - and attracted to the industry because of its high growth rates and 8 to 12 percent margins.

Equity investment firms usually seek to purchase 3PLs that have high growth potential and can be resold in several years for a good profit. "They've seen the statistics and realize the opportunities, but they have to be educated about the 3PL business," DeCesare said.

Investors from outside the logistics industry should perform due diligence that goes beyond profit and loss statements. General due-diligence consultants can talk finances, but with no background in a specialized business such as logistics they usually lack a detailed knowledge of where the industry is headed and what constitutes best practices for 3PLs, DeCesare said.

DeCesare favors a team approach to due diligence in which experts in finance, 3PL processes, information technology, strategy and organization combine their talents to provide the client with a full picture of the logistics industry as well as a company's internal finances.

Benchmarking a logistics provider against best practices in the industry gives a truer picture of that company's potential worth than relying only upon an analysis of the finances. If a company's information system is rapidly becoming outdated or its existing warehouse and equipment assets are insufficient to accommodate new business in a market that is growing by double-digit rates, the purchasing company faces major investments once the deal is complete.

DeCesare favors a comprehensive strategy toward benchmarking. His company uses its own database in conjunction with university studies and best practices from other 3PLs.

Experienced 3PLs likewise turn to consultants for assistance in performing due diligence. Although they understand the industry, 3PLs may not have a large enough staff to perform due diligence them-selves, or they are looking for an objective analysis of how the other company's corporate culture will fit into its own.

Investors in the 3PL business also must decide if they want an asset-based or nonasset-based operation. Some Wall Street investors favor nonasset-based companies, and there are examples of highly successful 3PLs that do not own warehouses, trucks and lift equipment. The most successful non-asset-based 3PLs have invested heavily in information technology to seamlessly connect the warehousing, transportation and cargo-tracking functions of their vendors, DeCesare said.

Asset-based 3PLs are growing in popularity as shippers get out of the warehousing business and outsource their distribution and transportation functions so they can concentrate on their core business operations. Asset-based 3PL operations are capital-intensive, but they can often provide warehousing and distribution services at a competitive cost because of the economies of scale they realize by serving a number of customers.

"That's where the global 3PLs are in the marketplace. They offer the right solution at the right time," DeCesare said.

Purchasing an asset-based 3PL provides instant access to warehouse space, equipment and skilled warehouse and trucking employees in a tight market. The purchase of TaB brought Weber 1 million square feet of warehouse space, allowing Weber to move some of its business into unused space at the TaB facilities, Weiss said. Weber also acquired 200 trucks and drivers and 400 warehouse employees.

DeCesare and Weiss emphasized the importance of moving quickly to reassure employees and managers of the company that is being acquired that they will have a position in the merged operation. This is key to the "go forward" services that are part of the due-diligence package, DeCesare said.

Source URL: http://www.joc.com/do-your-homework_20060625.html