

European Logistics Markets

May 2003

A report on trends in the European logistics sector and their implications on property



Executive summary

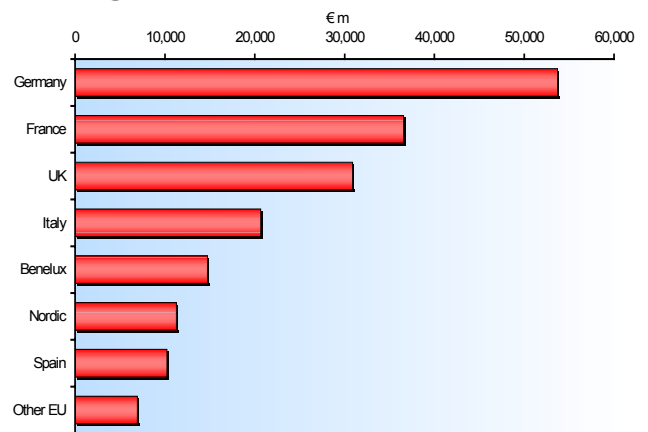
- The logistics market in Europe has grown strongly over the past several years and is expected to continue to experience growth in size by expenditure and employment.
- Key trends in the logistics sector over recent years have been industry consolidation and globalisation, and the outsourcing of logistics operations by businesses to logistics operators.
- Major logistics locations are characterised by close proximity to the largest markets and high levels of accessibility. The positioning of operations around these centres is expected to continue in established markets and progress in developing logistics markets.
- Logistics patterns are largely focused toward national distribution although regional and pan-European hub operations are located in key locations such as the Dutch-Belgian border.
- The demand for logistics services has been steady although is now slowing as businesses delay their decision to outsource, given the prevailing economic climate.
- The impact on logistics property markets is parallel to the deceleration of demand for logistics services. Occupational behaviour is also in line with the business environment, with flexibility of commitments and high quality/modern specification buildings being important to logistics operators.

Major logistics markets within the EU

For the purposes of this report, the logistics market is defined as the provision of services to ensure the prompt delivery of products to market. The value of the market can then be separated into in-house and outsourced operations. Thus market size is a combination of expenditure and sales. The paper also builds upon the findings of a survey of European logistics operators recently completed by DTZ Research.

The market is estimated at approximately €185 billion for 2002. The largest market is Germany, which represents almost 30% of the total. This by far eclipses the second and third largest markets - France at almost 20% of the total and UK at just under 17%. The relative sizes of the markets are indicative of the nature of logistics activities in different countries. For example, the UK market is highly developed in terms of the integration of supply chain services. In contrast, in Italy, the tendency is to operate separate parts of the supply chain – such as haulage and warehousing – individually through a number of different suppliers. Thus, the fragmented nature of the Italian market means that the market size for expenditure of more complex logistics operations is smaller than in the UK. This also implies that there is greater scope for development of this market in Italy.

Size of logistics markets – 2002e

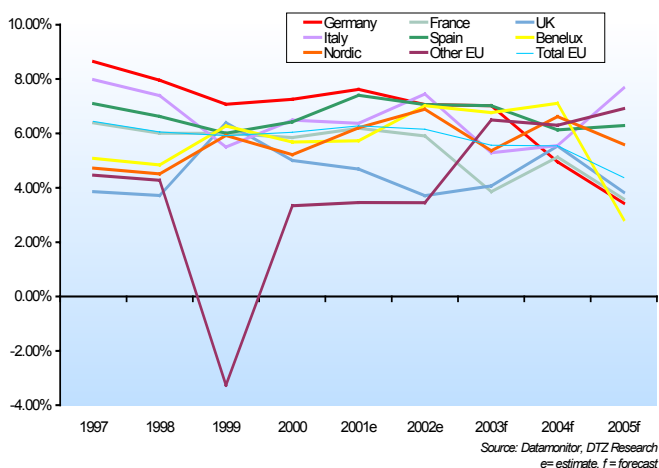


Source: Datamonitor, DTZ Research
e = estimate

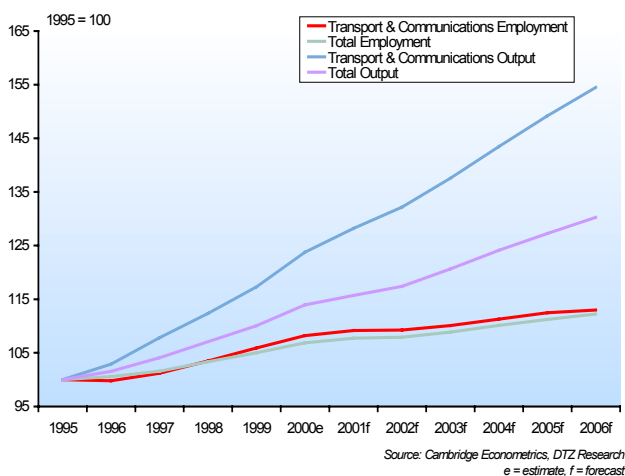
Average annual growth between 1996-2001 was over 6% for the EU. However, rates of increase in the individual countries varied: in Germany, the market increased by an average of almost 8% over the period, whilst in the UK, the rate was under 5%.

During the period 1995-2001, both employment growth and output growth in logistics-related activities have outperformed total employment growth and total output growth. Across the EU, the number of people employed in transport and communications (T&C) activities increased by over 9% from 1995-2001 whilst total employment rose by just under 8%. Whilst total economic output has grown by 16% from 1995-2001, output from T&C activities has grown by over 28%.

Growth of logistics markets – 1996-2005f



Economic output and employment growth in the EU – 1995-2006f



The size of the logistics market is expected to continue to grow, although not as strongly as in recent years. At over 5%, the average growth rate for the EU between 2001-2005 is about half a percentage point below the growth for 1996-2001. Spanish and Italian markets are anticipated to lead growth during 2001-2005 with over 6% average annual growth forecast for each market. Those more developed markets – such as the UK and France – are expected to experience slower growth with just over 4% and under 5% respectively.

Overall growth of employment in logistics-related activities is expected to be marginally ahead of total employment, whilst T&C output growth will significantly outpace the growth in total economic output.

Sector trends

Key trends in the European logistics sector have been industry consolidation and globalisation and the outsourcing of logistics operations by businesses.

The European logistics market has been characterised in recent years by significant consolidation activity as major players seek to establish “one-stop shops” for integrated logistics services and geographic coverage. Entry into a number of European markets – such as the highly fragmented Italian market – has typically been through the acquisition of local operators. The planned deregulation of postal markets has also encouraged traditional mail operators to expand their focus both in terms of operations and geography.

Acquisition has boosted the impressive growth of some of the largest players in the European markets. Large companies from Germany and the UK have led consolidation activity. Deutsche Post in particular has been exceptionally active, acquiring key European logistics operator Danzas and express parcel service provider DHL as well as other operations across Europe. In October 2002, Deutsche Bahn, the state-owned rail operator, completed the purchase of Stinnes AG, a key German service provider.

In the UK, Exel plc, market leader and one of the key operators in Europe, was formed through the merger of NFC Plc and Ocean Group in 2000. In January 2003, UK competition authorities approved the purchase of P&O Trans European by Wincanton, another leading UK firm. The announcement in March 2003 that UK operator Hays is planning to shed its logistics unit has led to speculation about potential purchasers. Major operators such as Deutsche Post and TPG have been mooted as possible buyers, although Exel and Tibbett & Britten are reportedly no longer interested in making an offer. Hays have commented that the company is in “no rush to sell” and may take up to three years complete the disposal.

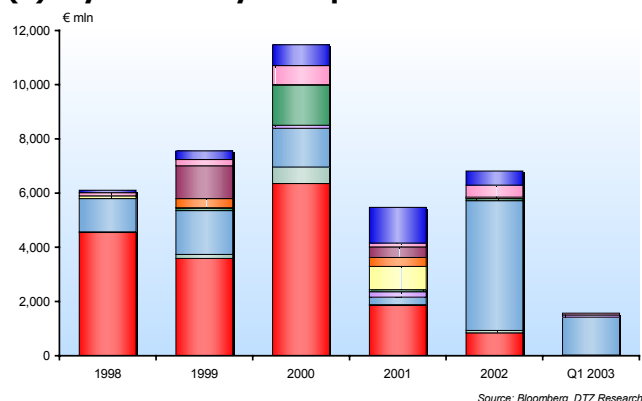
Operators active in Europe continue to seek out opportunities to provide integrated global supply chain networks in line with growing demand from clients. It is an increasing trend that clients will

look for logistics partners across regions rather than individual operators in each country and as such, the major operators are seeking to better position themselves to meet the demand. Hence, many mergers and acquisitions have been motivated by this need to increase and improve total coverage by provider networks.

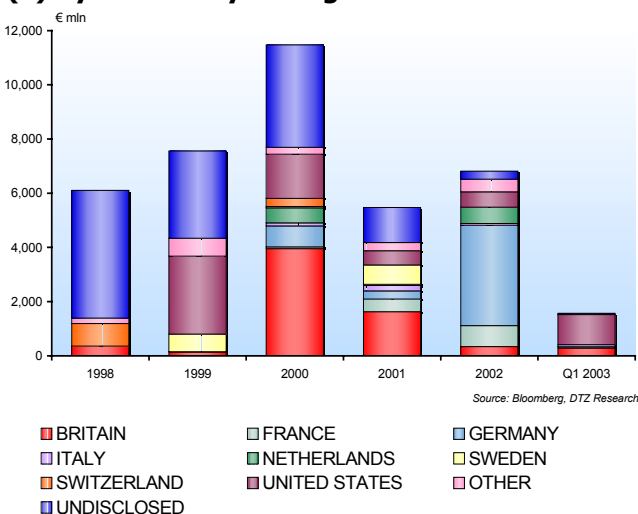
Consequently, European operators have started to turn their attention to developing European markets, particularly in Central and Eastern Europe (CEE), seeking to capitalise on the imminent accession of many CEE states to the EU and the impact of EU enlargement on the European business landscape. A number of operators have also been seeking to expand into the US market: Deutsche Post announced the purchase of airline operator Airborne in March 2003, although the deal is facing some opposition from competitors. Exel plc recently purchased the US and UK operations of Power Packaging Inc, provider of logistics and packaging services, in an effort to strengthen their position.

European transport services merger and acquisition activity – 1996-Q1 2003

(a) By nationality of acquirer



(b) By nationality of target

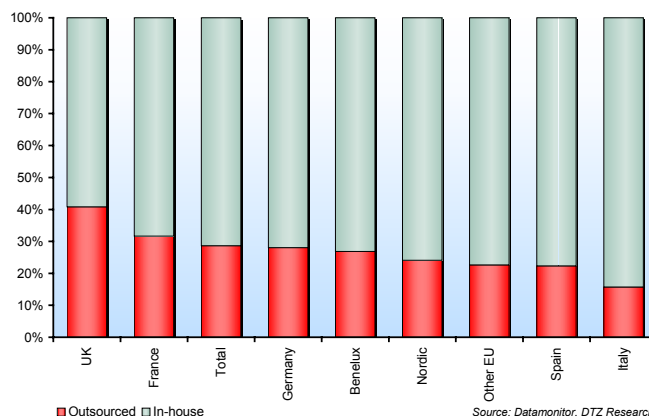


NB: Announced deals with disclosed transaction value – 9% of transactions by value pending.

Over recent years, a key development in European logistics markets has been the outsourcing of logistics services by businesses to third-party logistics operators. Rather than managing logistics operations in-house, companies are turning to dedicated firms to provide these services, allowing the firm to re-concentrate efforts on their core business activities, whilst enjoying the expertise and efficiency third-party providers can bring.

Although outsourcing has deeply penetrated the European logistics landscape with an estimated 29% of operations being dealt with externally in 2002, the proportions of outsourced to in-house vary significantly across countries. The UK is the most highly outsourced market in the EU with over 40% of the market contracted out. At the other end of the spectrum is Italy with a share of only 16%. The low proportion of outsourcing in Italy is attributed to a lack of enthusiasm for externalising logistics operations from manufacturers and retailers, due largely to their unwillingness to relinquish control of what is seen to be a key area of competitive advantage in Italian markets.

% of outsourced to in-house logistics services – 2002e



Outsourcing of logistics services to third-party logistics providers continues but logistics operators have noted a slowing of demand as difficult economic conditions persist. Firms are delaying their decision to outsource in an effort to minimise disruption to business and customer unease. However, outsourcing is set to continue as businesses look for further efficiencies and cost savings.

E-commerce is influencing logistics markets in Europe although the development of e-logistics is considered a longer-term trend. Advanced technology is being applied to operations to increase efficiency and scope and bring down costs, driven principally by business client

demand for higher level services, notably better quality communications. A degree of advanced technology is now considered necessary for providers to compete whereas only recently it was regarded as a means of differentiating a provider from its competitors.

Major logistics locations

The major logistics locations throughout Europe tend to be situated according to all-important proximity to significant markets. Accessibility is also key, with close proximity to transport infrastructure vital. Thus main locations tend to be major cities and their close neighbours. The map below shows key logistics locations across Europe as well as a number of locations with high accessibility due to proximity to transport

infrastructure. Key locations are particularly Paris, London, Madrid, Barcelona, Milan, the Dutch-Belgian border and north-western Germany.

Of importance to logistics operators is also proximity to manufacturing clients' locations but with easy access to the key markets. Another consideration for distribution – particularly from express parcel delivery operators – is time. Thus central locations are particularly important, as they allow distribution to the greatest number of locations at the required speed. However, the "weighted average" nature of businesses means that much distribution is to larger cities and so location tends to be skewed towards these "centres of gravity."

Major European logistics locations



DTZ Research - <http://www.dtzresearch.com>
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Source: DTZ Research

- The locations named in blue on the above map are those that have been identified as key logistics locations throughout Western Europe. The locations named in black are major logistics locations in Eastern Europe which are less developed than those mapped in the west, but are key for the region.
- The unnamed points are those identified as minor logistics locations as well as those that rank highly on the DTZ Pieda Accessibility Index which measures accessibility based on proximity to transport infrastructure nodes and density of transport infrastructure networks.
- Locations highlighted within the shaded areas represent areas of agglomeration of logistics centres – Paris, Lyon, Barcelona, Milan and the Dutch-Belgian border and north-western Germany.

Despite the increasing trend in demand for global services, distribution points within countries are still largely focused toward national distribution rather than regional or pan-European. However, different products demand different distribution patterns: those designed for a national market, such as some fast-moving consumer goods, demand a national distribution network whilst products identical across borders, such as electronics, tend to be distributed on a regional/international level.

The Dutch-Belgian border area has become a location for pan-European and international distribution as it is critically located to benefit from significant population and wealth proximity as well as accessibility. Logistics operators have also commented on the establishment of hubs to service regions such as Scandinavia, Iberia and the central West European nations of Germany, Switzerland and Austria.

Conversely, some markets are more fragmented than others and as such, also require regional operations. In Spain, some logistics providers note that regional centres are necessary as well as hubs in Madrid and Barcelona. Similarly, in Germany, logistics facilities are required across the country in various manufacturing locations, reflecting the country's diverse economic geography.

Outside the EU

Operators are becoming increasingly interested in CEE countries, referred to by some as "gold rush" nations. Significant economic growth, spurred on by the imminent accession of many of the CEE countries to the EU in 2004, has encouraged development of embryonic integrated logistics markets and this is set to continue. Accession to the EU and ultimately inclusion in the single market are expected to encourage improvement in infrastructure and development of trade, whilst increased economic activity should also stimulate domestic demand.

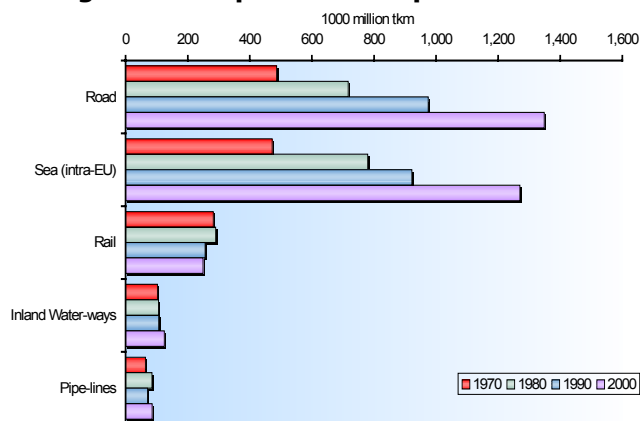
Key logistics locations in CEE have developed around major cities. Prague, Warsaw and Budapest have attracted most activity whilst there have been developments in regional locations – such as Poznan, Lodz, Silesia and Wroclaw – in Poland, given the larger size of this country. Although as yet there are no modern, speculatively-developed logistics centres, Bratislava has attracted significant interest, partly due to its proximity to both Vienna and Budapest. Logistics operators have also noted interest in Russia and the Ukraine, Romania, Bulgaria,

Croatia and Turkey as areas of development in the future and are looking to place themselves strategically at this early stage.

Modes of transport

The dominant mode of transport in Europe is road. In the EU, over 43% of the goods transported are moved by road. Sea shipping is also particularly important with a further 41% of goods moved intra-EU transported by sea.

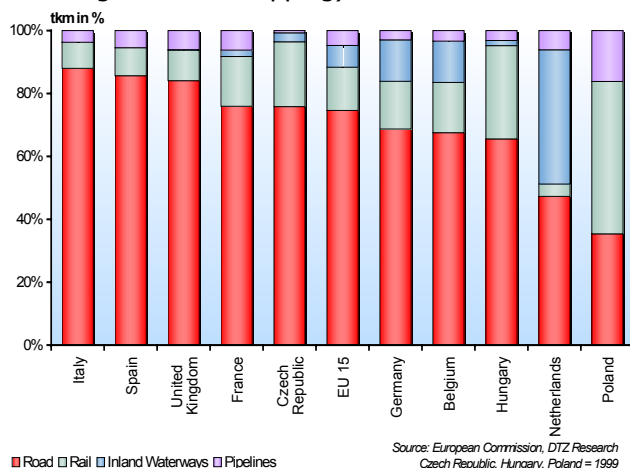
EU15 goods transport: modal split



Source: European Commission, DTZ Research
tkm: tonne-kilometre (unit of measure: 1 tonne transported a distance of 1 kilometre)

Although the amount of goods transported by rail has declined over the past thirty years, it is still an important form of transport, particularly in CEE countries where road networks are less developed. Inland waterways are of particular importance in the Netherlands where this mode accounts for a significant proportion of goods transport compared with other countries.

Goods transport: modal split by country (excluding short-sea shipping) – 2000



Source: European Commission, DTZ Research
Czech Republic, Hungary, Poland = 1999

The amount of goods and mail transported by air is much smaller. Only 11 million tonnes of cargo and mail were loaded and unloaded at the 25

major EU airports in 2000 compared with over 1500 million tonnes through the 25 major sea ports.

Demand for logistics operations

Logistics operators have noted steady demand for services from businesses although there is evidence to suggest that there is a general deceleration in logistics requirements in line with continuing difficult economic conditions. For example, as consumer spending weakens in France, there is a reduction in logistics requirements from the retail and consumer goods markets.

For logistics operators, the retail and consumer markets are the main drivers of demand for services and manufacturers and retailers are key clients. Manufacturers of electronics and telecommunications, high technology, pharmaceuticals and healthcare, and automotive products have been key sources of demand in Europe. More recently, however, manufacturing in the high tech sector has been particularly hard hit by the continuing business difficulties, as demand for their products has weakened. Consequently, their reduced need for logistics services has affected those providers exposed to the sector. The technology sector continues to be depressed. Some logistics operators have noted strong demand for logistics services from pharmaceuticals and healthcare companies.

Outlook

Refining logistics networks – both by outsourcing and restructuring internal processes – can derive efficiencies and cost savings. Businesses, however, are delaying outsourcing logistics operations whilst difficult economic conditions persist in an effort to minimise business disruption. As a result, demand for third-party logistics services is expected to be steady with slight softening being experienced over the next 12-24 months in Western Europe. Indeed, some operators have felt a slowdown in recent growth in outsourcing, although they anticipate that outsourcing will continue as a trend across Europe. It is expected that as the economic environment improves, production and outsourcing activity will accelerate.

In terms of sectors of growth, it is generally felt that the consumer goods market has potential for development. For instance, manufacturers of technical and electronic goods and other products such as clothing and textiles are lagging in terms of outsourcing their logistics operations

and this is considered an area that will grow. However, in other segments of the consumer goods market, such as grocery retailing, businesses have more fully outsourced logistics operations to third parties and thus there is limited growth potential in this market.

It is also expected that the trends of consolidation and globalisation will continue as key European players seek to diversify and strengthen their business scope and geographic coverage.

As CEE economies grow, we anticipate logistics operations to become more active in that region. Sectors of development are considered to be manufacturing and assembly in the medium term but as different countries are experiencing growth in different sectors, development of logistics services in any sector will be dependent on the success of these industries in the region. The further opening of markets in CEE could also mean a drift of business in some areas – such as manufacturing and assembly – away from Western Europe due to the much lower costs of operation in the CEE countries. This would lead to significant logistics activity moving eastward. As a result, this could potentially mean a shift in pan-European distribution hubs away from the Dutch-Belgian border area toward Germany and the CEE frontier, which will be more central to distribution across Western Europe and CEE. In CEE, it is expected that logistics operations will continue to develop around the major economic centres of Prague, Budapest and Warsaw and provincial logistics centres in Poland. Bratislava has yet to be developed as a logistics location but the potential and interest are both there for this location.

Implications for logistics property markets

Logistics operators generally expect that property demand over the next 12-24 months will be in line with business development – that is, slowing to steady demand. It is the general practice of logistics operators to match property commitments to business commitments in terms of type and size of property and length of commitment – “back-to-back”. Many operators generally will not commit to space unless a specific contract demands it, as matching client specification to property commitment is critical. Operators often will take individual properties for individual clients – that is, each property would be selected on a client-need basis and would most likely be used for one client only.

In terms of length of commitment, as matching property commitment to business contract length is ideal, logistics companies have shown a preference toward leasehold property. Operators have also commented that leasehold allows greater flexibility and enables changes to be made more easily and swiftly to better meet requirements. Where ownership of property is considered particularly important to the client, the logistics operator may be asked to run the facility whilst not actually purchasing the property.

Although client needs dictate the location of commitment by logistics providers, the trend for locating operations near hub locations is expected to continue. The growth in the number of logistics operations in markets where outsourced logistics is yet to grow – such as Italy, Spain and CEE – is expected to be stronger.

Demand for larger properties is expected to continue as businesses and logistics operators centralise logistics operations at hub locations. For instance, although there is generally a preference for one client per property, some larger facilities are being used to service more than one client. This not only maximises the utilisation of operators' property but potentially reduces costs for clients. However, it has also been noted that, as logistics outsourcing contracts become more complex for individual clients, logistics operators have shown an interest in smaller facilities where services provided are more specialised or where flexibility is more valued.

An implication of further consolidation in the market is delay in property decisions. Company integration takes time and thus business and property commitment changes could be delayed.

Modern logistics activity requires a high standard of building to meet operational needs. New and good quality secondhand are the most appropriate types of property to meet modern logistics requirements. Property with these characteristics is in limited supply in the less developed CEE locations. However, development may be encouraged by the expected growth in the logistics sector as these economies strengthen. It is also worth noting that the definition of "modern specification" differs from country to country. Standardisation of definitions is required to enable ease of transactions, particularly with the growing globalisation of logistics operators and brands.

Once the global economy begins to improve, the trend for outsourcing logistics activities is expected to pick up again. In CEE, this should also be assisted by the further opening of these markets with the accession of many of CEE countries to the EU. The European logistics property markets will similarly evolve as businesses increasingly seek logistics solutions from providers who aim to best match business and property commitments.

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May 2003

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