



AIR FREIGHT FORWARDING GROWTH AND PROFITABILITY IN 2022

By Thomas Cullen, Senior Analyst, Ti



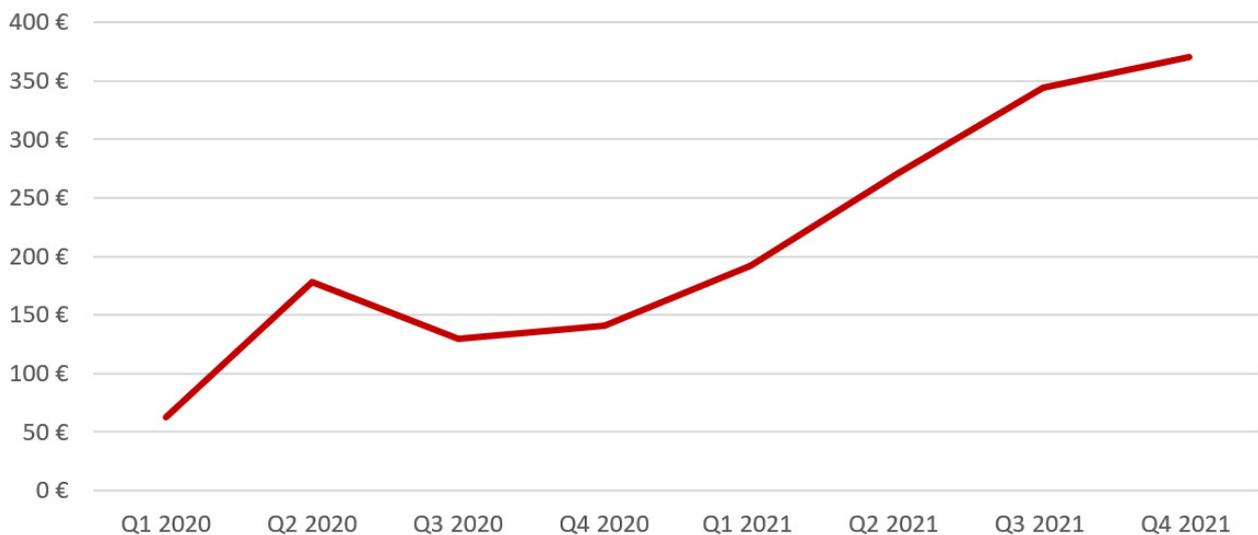
AIR FREIGHT FORWARDING GROWTH AND PROFITABILITY IN 2022

The performance of freight forwarders in this extraordinary market over 2020-2022 has been remarkable but easy to miscomprehend.

Their profitability has been significant. The larger forwarders invariably have forwarding businesses that combine sea and air freight forwarding at the business level and so it can be hard to disentangle the specific profitability of airfreight. However, the figure below is a reasonable illustration, with DHL Global Forwarding seeing Earnings Before Interest and Tax (EBIT) rising seven-fold.

However, how this profitability has been delivered has been complex. It has not been simply the case that forwarders have passed on higher air freight costs.

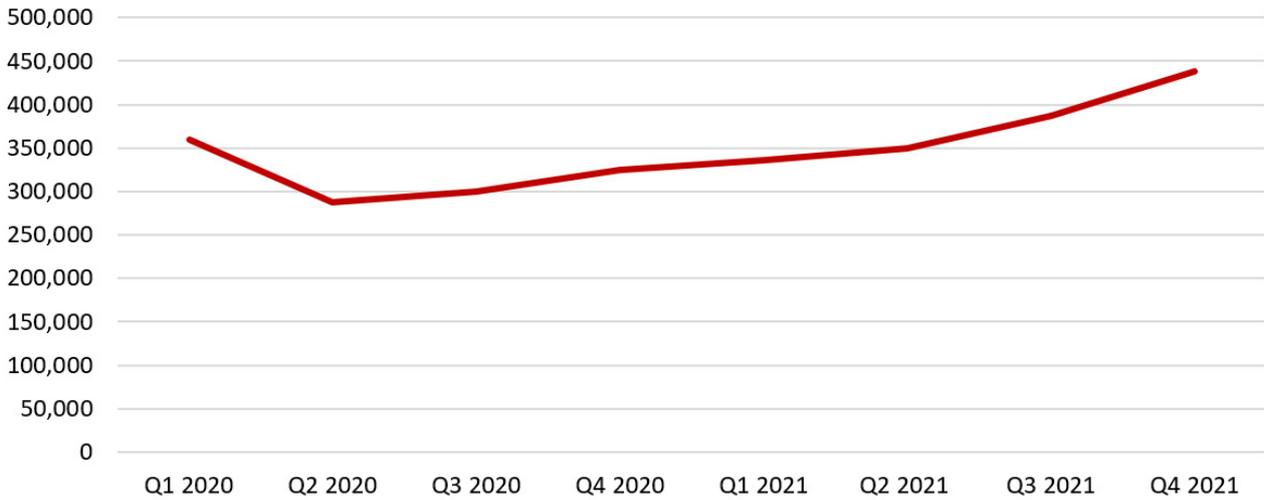
Figure 1: DHL Global Forwarding EBIT (€m)



Source: DP DHL

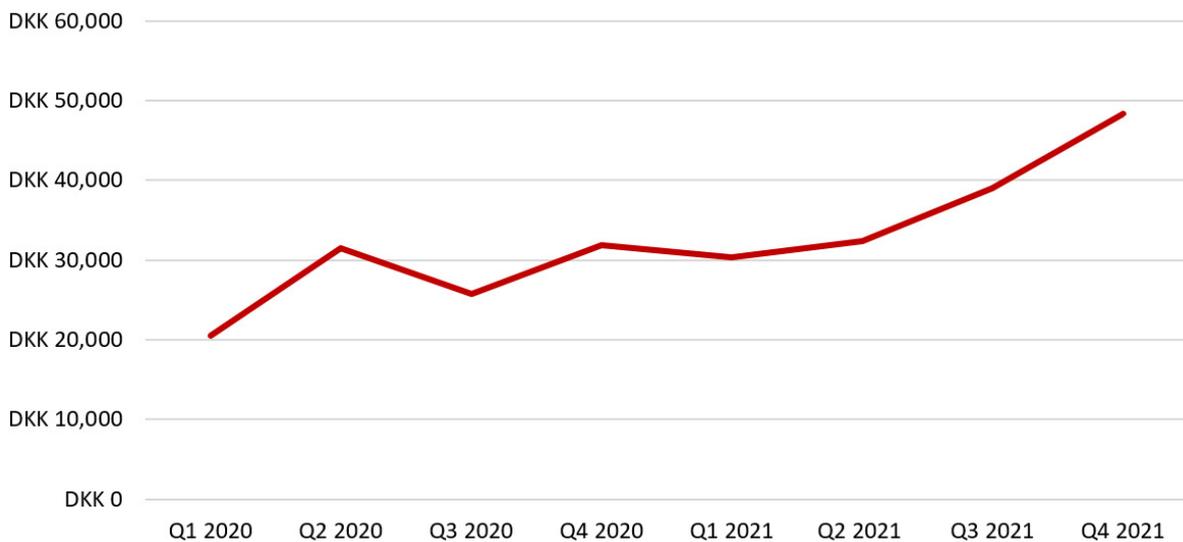
Note: This includes Sea freight as well as air freight forwarding, with sea freight being around 1/3 of revenue

Figure 2: DSV Airfreight Tonnes 2020-2021



Source: DSV

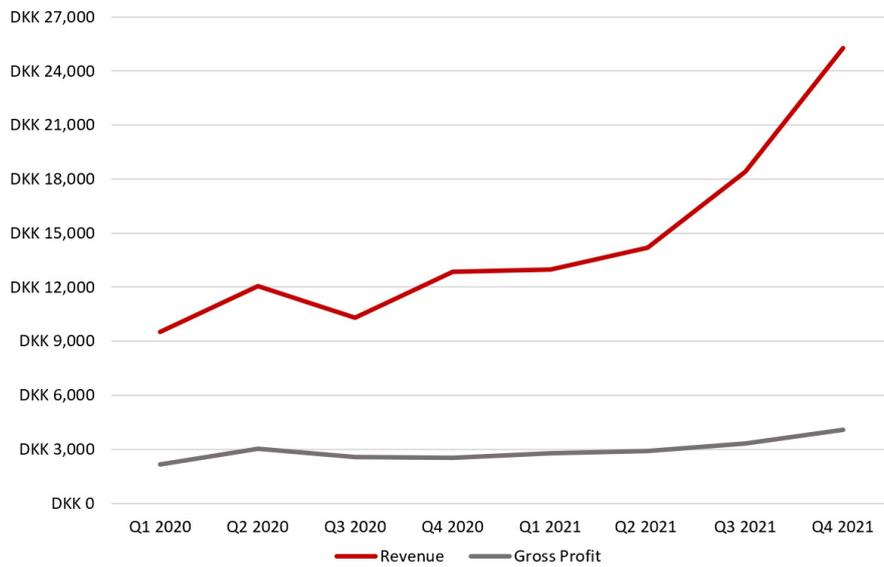
Figure 3: What DSV paid for airfreight per tonne



Source: DSV

The above figure (fig.3) provides a useful insight into the reality of airfreight pricing over the past two years. Essentially the price per tonne has increased two-and-a-half fold over the past two years. Surprisingly, this increase continued through the end of 2021. The Q1 2022 numbers reflect the volatility around both the situation in China and the Ukraine and rates appear to continue to be high.

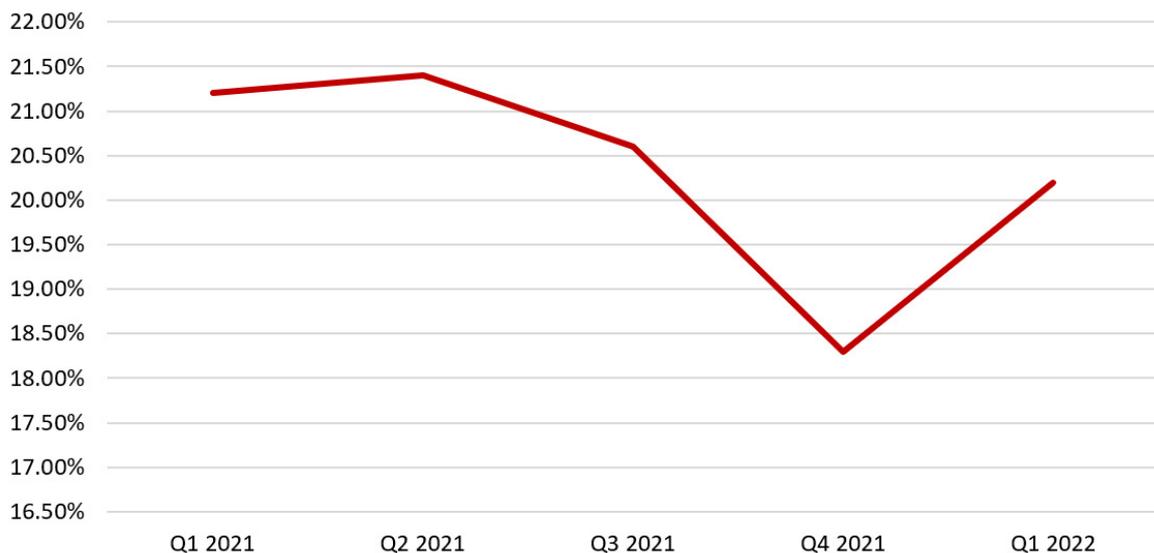
Figure 4: DSV Air Freight Forwarding Revenue 2020 – 2021 as compared with Gross Profit (DKK m)



Source: DSV

The forwarders’ response to this has been complex. In theory, there ought to be a linear response to increases in airfreight. A key aspect of the freight forwarding business model is the ability to pass on cost increases to customers. Here, gross revenue is key. ‘Gross Profit’ is the revenue of the forwarder with the cost of the purchased services (i.e. airfreight) subtracted. Gross profit includes the services which the forwarder does in house, such as certain types of handling, possibly customs clearance, order processing and, of course, profit. The dynamic of gross revenue is key to understanding any forwarder’s business.

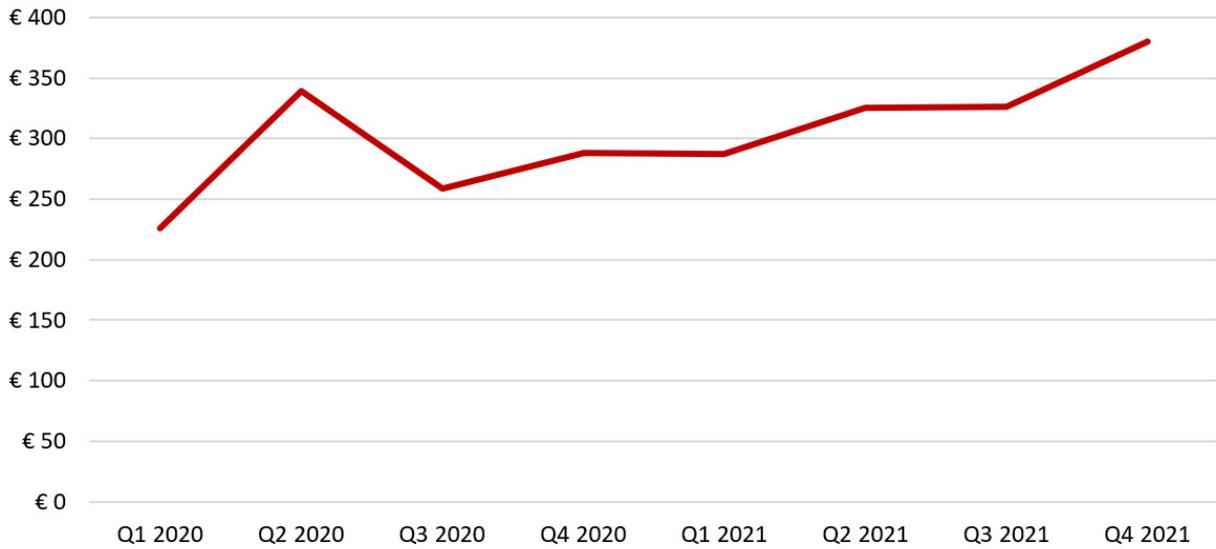
Figure 5: DHL GFF Gross Profit Margin %



Source: DP DHL

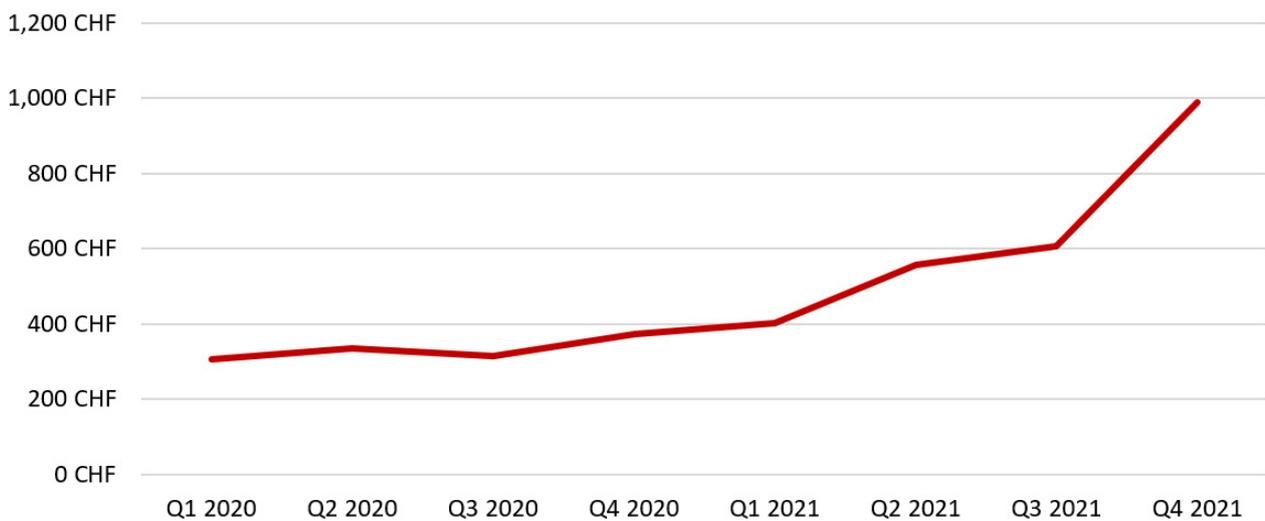
What we have seen over the past two years is that gross profit has risen, but not as much as the cost of airfreight itself. Gross profit as a proportion of revenue has fallen, as can be seen above, however, it has risen in absolute terms as the price of air forwarding has risen in absolute terms. This trend can also be seen in K+N and DHL Global Forwarding's numbers.

Figure 6: DHL Airfreight Gross Profit 2020 – 2021 (€m)



Source: DP DHL

Figure 7: K+N Airfreight Forwarding Gross Profit 2020 2021 (CHFm)



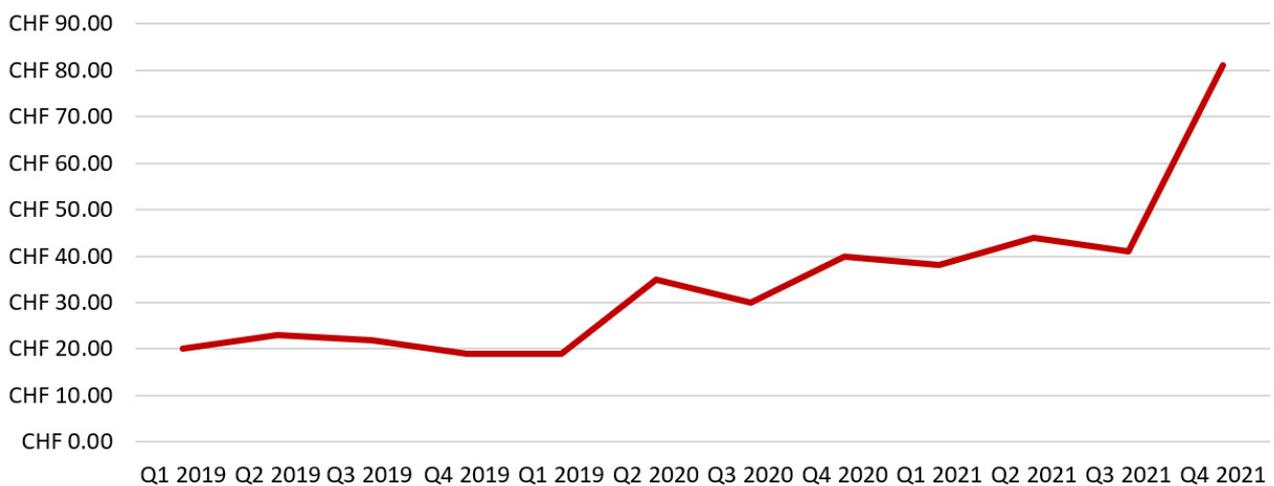
Source: Kuehne + Nagel

It should be strongly noted, however, that there is more to the gross profit and profit (i.e. EBIT, EBITDA) figures than the increase in air freight rates. Indeed, such has been the dysfunction in the market that unusual new opportunities opened up for forwarders. These were:

- The arrangement of 'charter flights'. The nature of these is rarely made clear by the forwarders, however, these generally took the form of forwarders leasing cargo aircraft and then selling the capacity to existing customers on a shared-user, or occasionally, a dedicated basis. This appears to have been lucrative for both the aircraft operator and the forwarder.
- The shortage of belly freight created exceptional market conditions. Freight forwarders were better placed to understand the market than their customers and exploit the high prices the shortage created.
- The ability to exploit the exceptional demand for healthcare-related products in 2020 which invoked such panic buying amongst a certain group of shippers that forwarders were able to exploit effectively due to their better understanding of the market.

All of these factors must have had an impact. Assessing the scale of that impact is very hard, indeed the forwarders have a strong incentive to disguise the impact that such services have on their profitability. However, the underlying issue of the forwarders' superior market understanding should not be underestimated. It is very probably this competitive advantage that has under-pinned the ability of forwarders to profit so effectively in the unusual market of 2020-2021.

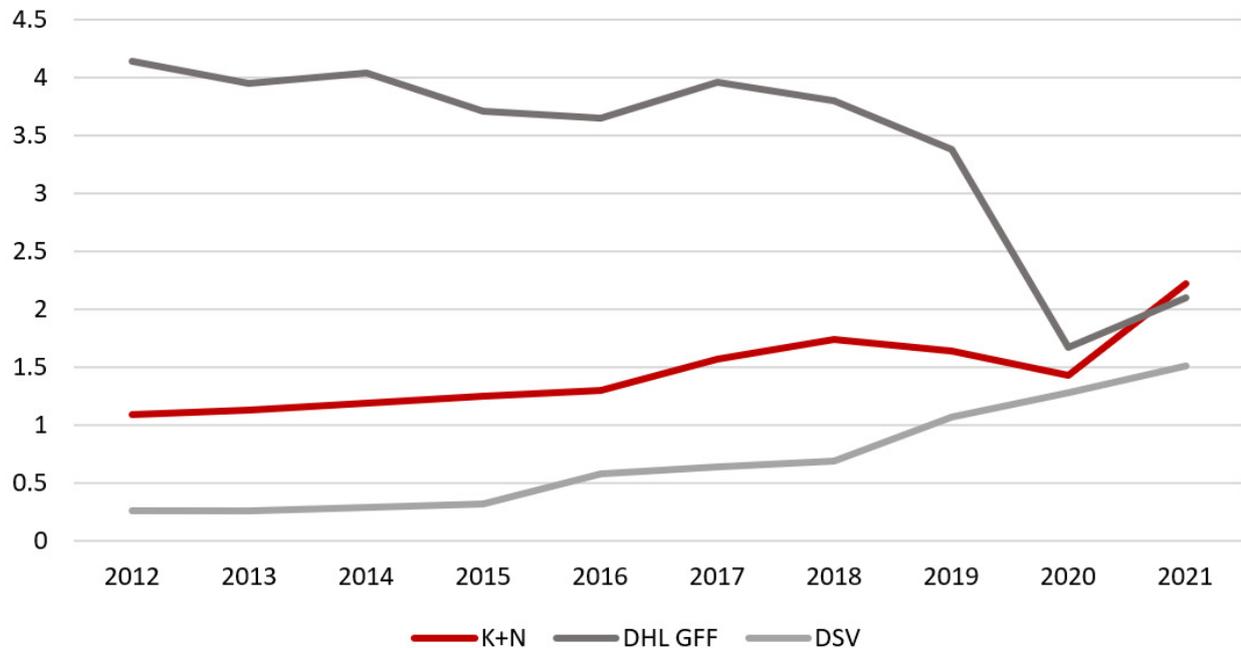
Figure 8: Kuehne + Nagel Gross Profit, Cost and Profit per 1000 Kg (CHF)



Source: Kuehne + Nagel

COMPETITION BETWEEN FREIGHT FORWARDERS

Figure 9: Annual air freight forwarded volumes (Tonnes m)



Source: K+N, DP DHL, DSV

With such an unusual market it might be expected that there would be violent differences between forwarders in terms of performance. Slightly surprisingly, this has not been the case. It appears that the unusual market conditions have lifted all of the major forwarders to a roughly equal extent, or rather more equal than their varying performance might suggest (fig.9).

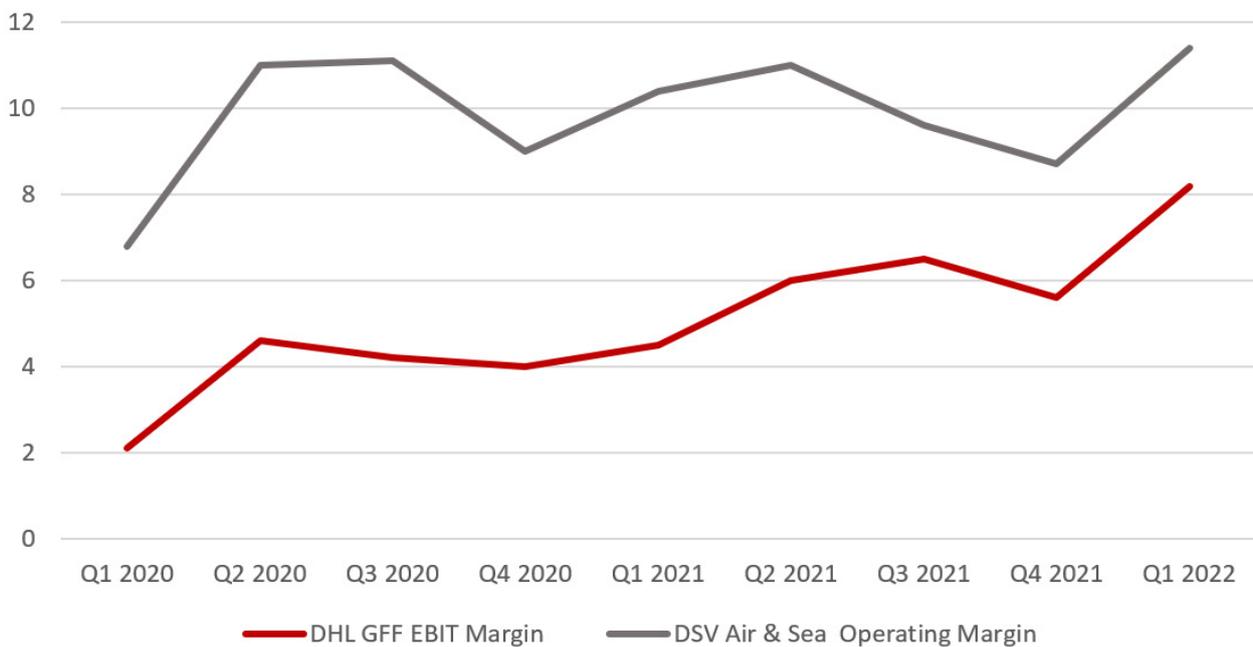
When measuring the market in terms of tonnage two trends jump out.

- DHL GFF (note Global Forwarding Freight or, just the forwarding division is Global Forwarding) has lost market share over the past two years.
- DSV (which has acquired Panalpina) and K+N (which has acquired smaller forwarders) have increased volumes, including through the past two years of disruption.

Comparing DHL GF with other large forwarders can be misleading. DHL Global Forwarding passed through a crisis in 2018-2019 as the result of a failed IT project. This cost the group considerable losses but also led to the rationalisation of Global Forwarding's customer base, resulting in a fairly savage loss of market leadership. It should be added that DHL GF's profitability has recovered aggressively.

However, in contrast, K+N and DSV continued their gradual rise until the outbreak of the COVID-19 crisis in Q1 2020. The following year saw a rapid rise in volumes, but again as suggested above, it is probably dangerous to extrapolate from these trends displayed in this period due to the extraordinary nature of the market.

Figure 10: Operational/EBIT Margins (%)



Source: Ti/DSV/DP DHL

Looking at the performance of the two freight forwarders which are part of the major shipping-line based logistics operations; CEVA, part of CMA CGM and Maersk formerly Damco, a similar pattern can be seen. This is despite the apparent success of the 'integrated' model that both Maersk and CMA CGM have implemented over the past two years. CEVA has seen a sustained fall in volumes since 2016 and this has only been reversed partially in the past two years. Maersk/Damco has also seen less growth than one might expect. What has boosted the revenues and the profits of these two forwarders is the exceptional conditions of the market.

LARGE, MEDIUM AND SMALL

A good question is the relative performance of forwarders of different sizes. The leading forwarders described above have a distinctly different business model from medium-sized forwarder, who might be strong on certain routes but lacks a global presence as well as smaller forwarders who will lack most of the physical added value services that large forwarders offer. In particular, were medium and small forwarders able to charter aircraft in the way that the large forwarders clearly did? For most smaller and medium forwarders the answer is very likely to be no. This weakness is also likely to be seen in other areas, such as the ability to offer alternative routes around congestion. It is not that smaller forwarders are incapable of doing these things, it is that the resources of the large forwarders make it so much easier to respond to the sort of systematic issues seen over the past two years.

This highlights that the leading forwarders have a distinctly different business model than both smaller and medium forwarders.

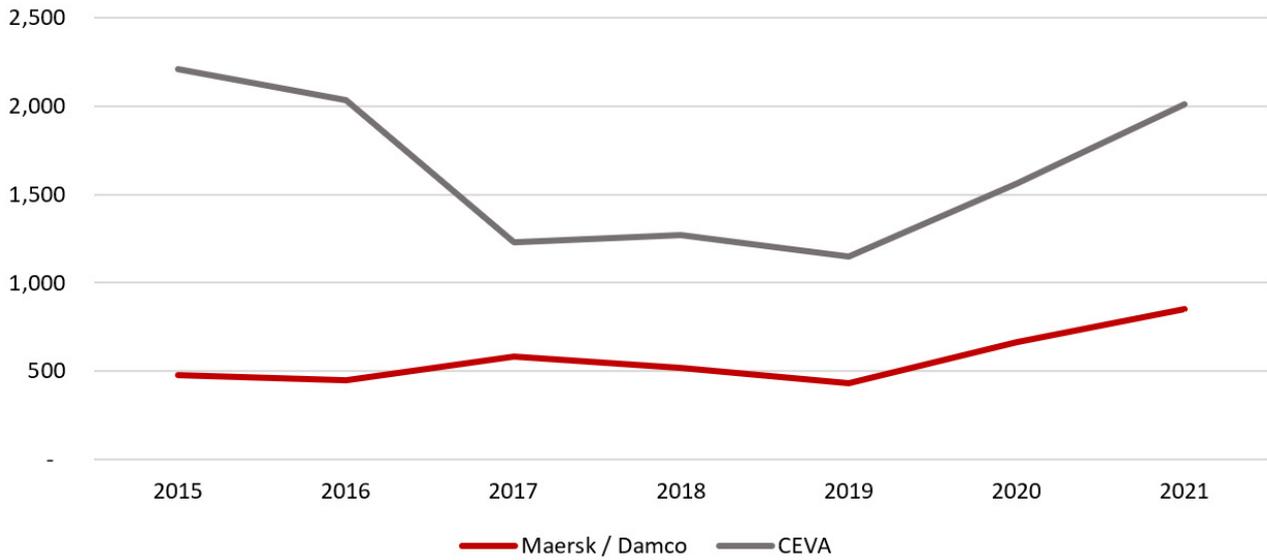
NEW PHYSICAL ASSET-BASED INTEGRATED CARRIERS

Another salient development in the air freight forwarding market is the entry of companies that started as shipping lines and have developed not only into forwarders but owners and operators of physical assets such as freighter aircraft.

The two most prominent are Maersk and CMA CGM, although MSC may be moving in this direction as well.

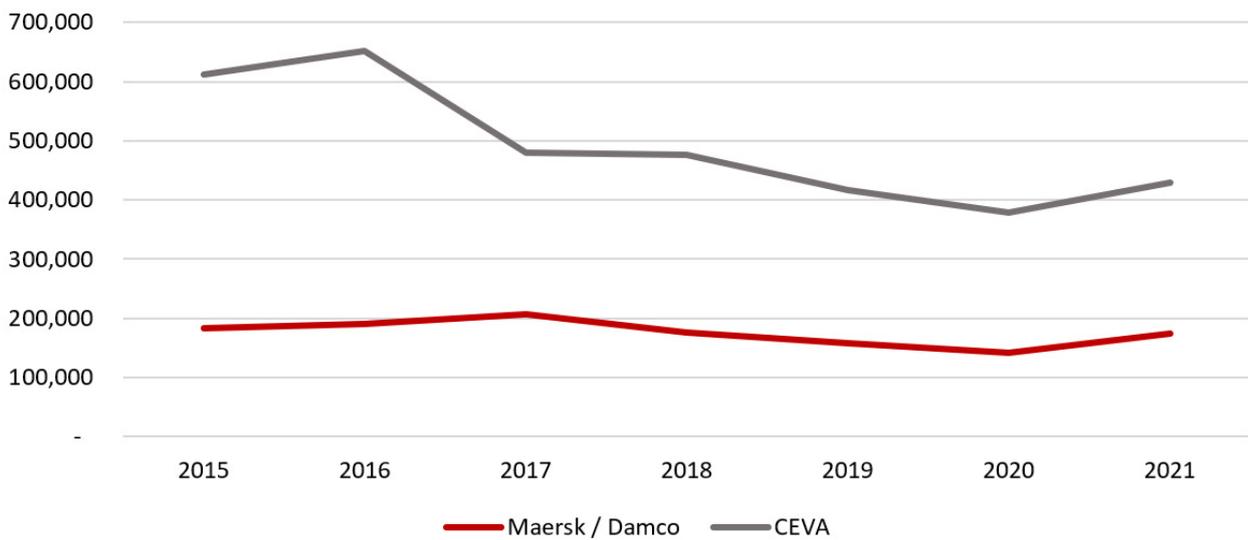
Looking at the performance (fig. below) of the two freight forwarders which are part of the major shipping-line based logistics operations; CEVA, part of CMA CGM and Maersk formerly Damco, a similar pattern to the rest of the market can be seen. This is despite the apparent success of the 'integrated' model that both Maersk and CMA CGM have implemented over the past two years. CEVA has seen a sustained fall in volumes since 2016 and this has only been reversed partially in the past two years. Maersk/Damco has also seen less growth than one might expect. What has boosted the revenues and the profits of these two forwarders is the exceptional conditions of the market.

Figure 11: CEVA and Maersk Air forwarding revenue (\$m)



Source: CEVA/Maersk

Figure 12: CEVA and Maersk Air Forwarding Volumes (tonnes)



Source: CEVA/Maersk

Central to this development is the issue of the value of physical assets. Maersk and CMA CGM have both invested heavily in freighter aircraft. Maersk's position on this is complex, with it already owning a freighter fleet division which was peripheral to the company's core logistics services. However, it has now earmarked a proportion of what is a 'share-user' fleet for its in-house purposes and will use these aircraft to support approximately half of its air freight services needs. Such is the scale of this, that it is questionable whether Maersk ought to be described as a 'forwarder' in the sense of being a non-asset owning common carrier. To a lesser extent, this is also becoming true for CMA CGM. It has increased its present fleet from four freighters to six, with another four on order to be delivered in 2025. It has also applied for an airline licence.

The reason why these companies have done this is important. Admittedly both are used to managing highly capitalised assets, however, the ownership or operation of container ships has not always been so profitable. The operation of aircraft does offer diversification out of ship-owning, although both Maersk and CMA CGM have embarked on this process through the development of other logistics services.

Will the ownership of aircraft strengthen the competitiveness of the two companies' freight forwarding, or rather what more accurately might be called 'air freight management services'? One of the core reasons for buying these aircraft is to exploit:

- Vertical integration benefits
- Yield on physical assets.

Vertical integration may offer benefits in terms of guaranteed access to air cargo capacity, although presumably, this will only be relevant in times of shortage. It may also have the ability to ensure superior yield on aircraft assets through high utilisation. In addition, Maersk and CMA CGM may gain market insights on pricing that can be deployed by the 'forwarding' element of the business. There is also the possibility of profits from the asset itself. Over the past two years, freighter aircraft have become very profitable. Previous the freighter market was known for its poor returns.

It should also be noted that other forwarders, notably Kuehne and Nagel, seem to be moving towards greater exposure to air freight physical assets. DP-DHL is a different case as it already owns a huge air fleet through its DHL Express business.

What can be said is that the possession- whether in terms of leases or direct ownership- of aircraft will have changed the risk profile of both Maersk and CMA CGM. Although at present both companies have reversed their previously troubled financial positions and can fund asset acquisitions without recourse to debt, the asset balance of the companies is still loaded with either expensive fixed assets or long leases. This will have implications for either liquidity and/or returns on capital employed.

FORWARDERS AND E-COMMERCE

Another salient development of the air freight market over the past two years has been the rise and partial fall, of e-commerce. Forwarders are not central to this, it being the provenance of Express networks, especially at the international and intercontinental level. The picture is complex as although e-commerce did boom through 2020 and 2021, there was a near corresponding fall in 'business-to-business' traffic which negatively balanced much of the available air freight capacity.

What might have been expected to happen is for these Express networks- and it is quite specific to the three leading providers of DHL, UPS and FedEx- to expand into the market 'space' of forwarders due to their ability to access the largest pool of freighters. Strangely this has not really happened. Undoubtedly both the Express and forwarding divisions of DHL and UPS, in particular, have played an important role in areas such as health-care freight, although this is likely to be more on the higher value freight such as vaccines than the volatile, low-value cargoes that were such a characteristic of 2020. What the picture of volumes moved and of prices paid suggest is that they have not moved into the traditional airfreight forwarding market. However, one should be cautious, as the 'traditional freight forwarding market' was so transformed over 2020 and 2021 that it is dangerous to make any hard conclusions. Nonetheless, it is hard not to think that the world's largest freighter fleets were "the dog that did not bark" over the past two years.

At present in Q2 2020, with the market gradually moving back to some form of normality, it seems that the gap between the express networks markets in e-commerce and the forwarders' more miscellaneous markets remains.

CONCLUSION

The air freight market of the present and the immediate past is very probably not a guide to the medium-term future. It is too atypical, characterised by a collapse of belly freight and peculiar trade patterns.

The position of freight forwarders in this market is unusual due to:

- The 90% reduction of their main commodity, belly freight, during much of 2020 and 2021
- The amplification of freight forwarders' main competitive advantage, asymmetric market knowledge during a period of dramatic market restructuring
- Huge increase in prices
- The emergence of charters as a major part of the market
- For periods – especially in Q2-Q3 2020 – selling to unusually price-insensitive customers.

There are other market characteristics, notably the growth of e-commerce, although this was of lesser importance for freight forwarders.

All of this resulted in an extraordinary 'uplift' in the profitability of freight forwarders. Will this be sustained? It seems unlikely if the air freight market returns to something resembling the status quo ante of 2019. Surely, despite the gyrations in China, the air transport sector will see a violent resumption of passenger traffic through 2022 and into 2023. There may well be higher prices for air services as a result

of a reduction in capacity in areas such as pilots, airport services and the financial robustness of airlines, however, these are likely to be temporary. One of the characteristics of the air transport sector has been a willingness to over-invest. Even though certain regions such as the US have consolidated capacity in the airline sector, other regions such as South East Asia, the Middle East, China and even Europe, have not. The likelihood is that there will be an oversupply of belly freight just as there was in 2019.

In addition, the air freight market has seen a significant increase in freighters. Outside the air express providers, freighters were in danger of becoming an endangered species, at least in many parts of the world. Even freight-heavy routes such as China-Europe saw significant consolidation and reduction in capacity from around 2010 onwards. It appears that this is being reversed. Moreover, the injection of additional capacity is directly into the part of the market most relevant to freight forwarders, with large forwarders developing their own fleets of freighters.

Therefore, the implications for air freight forwarders in the medium-term may be:

- A return to the levels of profitability seen before 2020
- Some sort of division in the market between those who have aircraft fleets and those who do not
- A collapse in the air charter market.

A further question is the volume of the air freight forwarding market. Investors in freighters seem to believe that the market for air freight will be robust enough to justify their investment. This may be the case, however, it ought to be noted that cost pressures in the short-to-medium term will be substantial including

- Fuel costs, which already have more than trebled from their lows in 2020
- Aircraft operating costs, including employees.

What is very uncertain in the future is both consumer demand, with the possibility of much of the world entering a recession in Q3-Q4 2022 and the nature of supply chains and thus the structural level of demand for air freight.

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- Ti's 2022 Digital Freight Forwarding & Global Freight Procurement survey findings.
- Examination of M&A activity within the market.
- Analysis of the state, and future of air freight.
- Comparative profiles of the largest freight forwarding companies.
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