Transportation Perspective 2004

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Perspective:

1. ***The balance of supply and demand has shifted in favor of demand***
2. ***Resurgent demand for shipping plus stripped-down capacity will push prices up***
3. ***Carriers in all modes stand ready to hike rates***

Rationale:

The movement of product in 2004 will be more interesting than ever. A convergence of factors should make 2004 a very interesting year for negotiating with your carriers. These factors should shift transportation purchasing to a sellers market. For instance, some experts are predicting that truckload rates will increase between 4% and 7%. Additionally, accessorial charges are predicted to double or triple for additional stops and for time to load and unload.

These factors include:

- An improving economy
- A capacity shortfall
- Carriers thin margins and inability to improve them through price increases
- Uncontrollable carrier operating cost increases
- And HOS - new hours of service rules.

Positive economic outlook should create greater demand carrier services.

- Thomas L. Finkbiner hasn't seen the trucking business look this good in five years. As president of Tampa-based Quality Distribution Inc. the nation's largest bulk trucking hauler, he's turning away 30 jobs a day. "It's a feeding frenzy out there," he says. Same story at United Parcel Service Inc. Compared to last year, "we're moving 200,000 more parcels a day," says CFO D. Scott Davis. (Source: Business Week, 01/12/204).
- A survey of the top 50 forecasters in the November 2003 issue of Kansas City, Mo. Based Blue Chip Economic Indicators, the US gross domestic product (GDP) will grow by 4.2% in 2004.

- Non-residential fixed investment will rise by 9.3% to 10.7% depending on whose prediction you use.
- It is also predicted that business inventories will grow in 2003.

All the above suggests an increase in demand for the existing transportation capacity.

Capacity Shortfall

- During the last few years capacity has been stripped-down -- because of low demand and the increasing cost new equipment has not been added to many fleets.
- No meaningful additions to capacity have been made in the last few years.
- Growing costs have put hundreds of independents out of business for good, says James Corridore, a transportation analyst at Standard & Poor's. And bankruptcies remain high -- which means fewer options for customers and higher prices all around. (Source: Business Week, 01/12/204). As Robert V. Delaney, vice president of Cass Information Systems, noted in his latest annual “State of Logistics” report, 2,345 motor carriers went out of business in 2002 and 3,990 in 2001. The actual figure is probably in the tens of thousands, because small owner-operators are generally not tracked.
- “If you talk to shippers, most are already having a hard time finding capacity in some instances,” says Adrian Gonzalez, director of the Logistics Executive Council at ARC Advisory Group, Dedham, Mass. (Source: Better Economy, Tighter Capacity May Shift Trucking To Sellers' Market, GLSCS, January, 2004)

Steady or improving demand on limited capacity will shore up carrier requests for higher rates. This also suggests that capacity might be very tight for the future.

Carriers thin margins and inability to improve them through price increases

- Transportation has always been a thin-margin business, average margin is 2%
- Operating costs have skyrocketed in recent years
- While a poor economy and excess capacity made it harder than ever for carriers to make rate increases stick.

Uncontrollable carrier operating cost increases

- Corporate transportation managers cannot look externally to carriers for motor freight cost containment or continued margin concessions. Driver, vehicle, fuel, and insurance costs are, at the micro-economic level, largely uncontrollable.
- Driver wages are being increased to minimize the effect of the driver shortage.
- Over the past two years, the price of diesel fuel has risen dramatically and carriers have been able to recover only a portion of this increase in the form of fuel surcharges. In addition, since the terrorist attacks on 9/11/01, liability insurance costs have soared and new security requirements have added more costs. A perennial driver shortage means higher recruitment, training and retention costs.
- New engine emission rules that went into effect in 2002 – and that will toughen again in 2007 – are raising the cost of acquiring and operating equipment. Incorporating these new engines,

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which cost about 20% more than the last generation of engines and are between 3% and 20% less fuel-efficient, depending on the load — say about five miles a gallon instead of six — is also going to add more costs to the trucking business.

And HOS - new hours of service rules.

- Depending on the type of operation, the negative impact on productivity ranges from a 4% decline to 10% or more. The government estimates this change will add $1.3 billion a year to trucking companies' costs. Shippers who have modeled the new rules and their impact on productivity report losses could range from a 3.85% decrease in productivity for one consumer packaged goods company to a decrease of 7.2% for a national retailer using “driver count.” A grocer with “high touch” freight claims the new rules will cause a 14.1% drop in productivity.
- The numbers swirling around the revision are staggering:
  - Wal-Mart, for example, estimates that 275 drivers and 300 new trucks will have to be added to its fleet operation to deliver and handle the same amount of cargo. It also estimates it will spend $24 million on new trucks just to maintain its private fleet's current capacity;
  - Industry analyst Robert Delaney projects that carriers will need to hire 84,000 additional drivers;
  - And the Federal Motor Carrier Safety Administration (FMCSA) threatens to level $11,000 penalties for each violation.
- Some trucking industry executives say that the lower levels of productivity could lead the industry to have to hire 40,000 or more — and some say many more than that — drivers. And they anticipate that the rule change could lead to increases in shipping costs of at least 4%.
- Many observers expect the hours-of-service rules will cause increased demand for drivers, probably driving up wages and benefits.
- The new regulations, which went into effect on Jan. 5, 2004, have attracted a great deal of concern within the trucking business. Under the new rule, truckers will need to rest two more hours between shifts — 10 hours instead of the current eight.
- The new rule permits 11 hours of driving out of a 14-hour on-duty period, following 10 consecutive hours off. Drivers are also limited to 60 hours on duty over seven consecutive days, or 70 hours over eight consecutive days. A new cycle may begin after a driver has been off duty for at least 34 consecutive hours.
- One of the key provisions of the rule is the end of the distinction between driving time and waiting time. For shippers, much of the added cost will stem from changes in the calculation of drivers' working hours. Under the old rules, time spent waiting had been considered off duty. But the new hours-of service clock doesn't stop once it's started, so every hour spent waiting to load or unload counts against a driver's daily limit. Any holdup, then, could run out a driver's time clock and leave a shipment stranded.
- What shippers should know:
  - Reducing hours of service (HOS) could lower productivity and equipment utilization rates. Result: higher transportation costs.
  - HOS changes could affect load planning and routing of freight, impacting on customer service levels.
  - The number of trucks on the road could increase by 15% to compensate for lost productivity.

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- Drivers will make fewer deliveries, negating service advantages and cost efficiencies of multistop route planning.
- Shippers will need to take responsibility for driver productivity.

What this means:

Carriers in all modes stand ready to hike rates and will use the forgoing for justification. Estimated at 4 to 7%, with some "high touch" freight estimated at 6 to 9%.

The message from large influential carriers, is that they are going to look to the types of freight that are most profitable, look to customers that are easier to work with and more collaborative, and prioritize who gets the capacity they have.

Drivers do a lot of waiting. Shippers, ports, intermodal terminals that delay/detain drivers may pay for the delay in a number of ways -- increased detention costs, business rejected and/or non-preferential treatment in the allocation of assets.

Working in a collaborative manner with carriers (improving dock productivity, integrating inbound and outbound activities with carriers, scheduling carriers to help reduce empty miles, working with customers to reduce dewell time, document generation or elimination, freight payment, etc.) can help to reduce or eliminate the need for rate hikes.

For most companies, transportation costs are approximately 40 percent of their total logistics costs. The opportunity to avoid all or part of a 6- to 9-percent increase in transportation costs could convert to a 1- to 2-percent increase in gross profit margin.

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