

# Transportation and Logistics

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## EXECUTIVE OBSERVATIONS

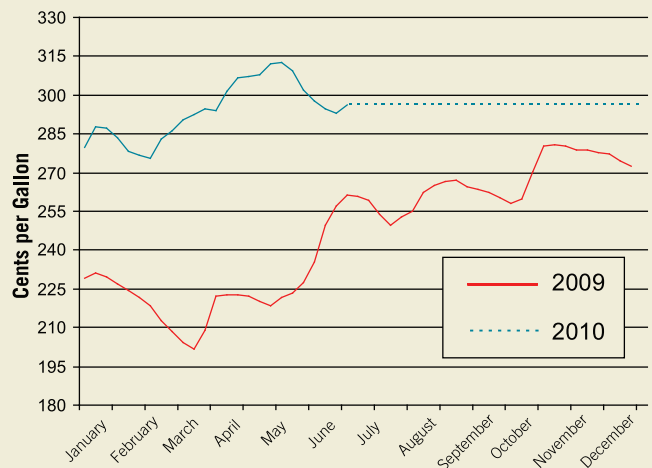
**D**uring the second quarter of 2010, Ariba experienced a slight downturn in sourcing activity as many modes of transport such as truckload and ocean freight started to show signs of tighter capacity. However, many shippers continued to examine their transportation spend to ensure they had competitive pricing in light of the market shift. The majority of project activity was centered on small parcel, freight forwarding, less than truckload, and European road freight. In addition to utilizing sourcing activities to source and secure new contracts, some shippers are using sourcing activities to gain market intelligence to optimize their current network and solidify their current contracts/relationships at market-competitive levels. As specific modes are starting to see rate increases, shippers are closely examining their current network to see if mode conversions such as ocean to air are able to produce savings at a time when resourcing within the same mode cannot.

There have been many signs that the industry is improving and is being backed by optimism that the worst times are in the past. Carriers continue to place new trailer orders to replace aging vehicles instead of reducing fleet sizes by removing the obsolete vehicles. New trailer orders were up three percent year over year in April and are 72 percent higher than the low point in 2009. While most of the new trailer orders are for fleet replacement, several carriers have stated the new orders are in response to increased demand. Dry van and refrigerated trailers account for most of the new orders, while flatbed orders continue to be stale since the flatbed industry hasn't seen the big rebounds it had expected in the housing and construction industry. It is important to note—purchasing new equipment is not a strategy unique to the trucking industry. Intermodal shipments increased nine percent quarter over quarter, with many intermodal

providers placing orders for new container orders to help with capacity issues. An additional sign that the transportation industry is improving can be found in small parcel, where daily shipping volumes are increasing and shippers are shipping higher package weights—both typically characteristic of a strong economy.

The U.S. Department of Energy (DOE) maintained its prediction for diesel fuel to average \$2.96 per gallon for 2010 despite raising their prediction to \$3.05 in May. Looking forward into 2011, the DOE is predicting that diesel will settle at \$3.11. The revised lower rates are based on lower crude oil prices, which are currently averaging \$70 per barrel compared to \$85 per barrel last quarter. While crude oil is expected to remain comparatively low, analysts are keeping a close eye on crude oil prices after the Gulf of Mexico oil spill.

### Weekly U.S. National Average Diesel Prices



Source: Energy Information Administration

So where do transportation shippers go from here as freight starts to pick up and capacity starts to tighten, albeit at different levels, across all modes? The market is predicted to peak during the traditional holiday shipping period and then level out or contract slightly as inventory levels reach their desired levels and uncertainty of the sustainability of the economic recovery continues to cloud the industry. Shippers should continue to monitor their contracts and use market intelligence to verify any rate increases requested by carriers.

### Top Areas for Sourcing

- 1) **Less than Truckload: Three to Seven Percent Savings** – During a traditionally slow shipping season, LTL carriers saw growth in freight with first quarter tonnage up by one percent compared to the fourth quarter of 2009. Major carriers such as Con-way, UPS, FedEx, Old Dominion, and Saia are all reporting increased tonnage, however YRC continues to see a decline in freight. Although there was an increase in tonnage, revenue per ton and total shipments continue to fluctuate. Revenue per ton for large LTL carriers decreased for the first time in five months by almost one percent yet revenue per ton for smaller LTL carriers increased by 5.5 percent—marking the seventh straight gain in revenue. According to the American Trucking Association (ATA), shipments activity also varied by size of carrier. For small LTL carriers, shipments increased by almost five percent in April, however larger LTL carriers saw a decline of half a percent. Shippers continue to report that capacity is not an issue with LTL like it is with Truckload, which indicates that supply still outweighs demand leaving the LTL industry as a shipper's market. LTL rates remain flat, indicating the industry has not yet completely recovered and several carriers continue to take a cautiously optimistic approach to the market and continue to look for ways to cut costs. ABF is a prime example of one of the carriers trying to cut costs to remain competitive. Although it was rejected, they recently asked their Teamsters union workers to take a 15 percent pay reduction to bring its pay package closer to their competitors.
- 2) **Small Parcel: Five to Nine Percent Savings** – For the first time in two years, parcel shippers are reporting positive year-over-year growth in domestic freight volumes. Although the less than one percent growth is small, the positive trend is clearly being driven by the improved economy. Much of the growth was driven by an increase in demand for ground services as shippers continue to look for the most economic way to ship a package. Revenue per piece also increased slightly for carriers, which was mainly driven by the increase in fuel surcharges. Ground fuel surcharges are approximately three percent higher now than last year and air fuel surcharges are approximately five percent higher during the same time period. International shipping continues to show significant freight increases. The Asia region is showing the strongest growth while Europe is showing the least amount of growth due to economic instability. Continuing the pattern that international shipments are showing stronger growth than domestic shipments, both UPS and FedEx are reporting that more than a quarter of their revenue is linked to international shipments. Unlike air freight, the small parcel carriers were hardly impacted by the Icelandic volcanic ash due to utilization of their ground networks where possible.
- 3) **Air Freight: Four to Eight Percent Savings** – The global air freight industry has begun to show signs of improvement, driven mainly by cargo in the Asia-Pacific region despite being impacted by the Iceland volcano. Freight demand was impacted far less than passenger traffic, however the industry did slip slightly as freight improved by 25.2 percent year over year in April, down slightly from March's improvement of 28.1 percent. Previously, the industry had been improving by approximately two percent per month. Despite the dip in demand, the IATA is predicting that by June the industry should be back to pre-recession traffic levels. However, growth levels may stabilize towards the end of this year as companies complete inventory

restocking efforts. European airlines continue to suffer the most compared to other regions due to weak regional economic growth and airspace closures due to the Iceland volcanic ash. On a global average, air freight rates are rising slightly although outbound and inbound European rates remain flat. Westbound transpacific rates continue to be strong with rates at peak season levels. Shippers should expect rates in the tight markets to continue to rise as the industry enters into the peak season before leveling out in October.

The air freight industry is seeing the first signs of additional capacity being added back into the market with 60 percent of the capacity expansion being attributed to new growth opportunities with the remainder due to the replacement of aging equipment. European load factors remain the lowest in the industry, averaging less than 50 percent on a year-to-date basis. IATA has upgraded its 2010 forecast to a small net profit of \$2.5 billion for the airline industry, up from the net loss of \$2.8 billion projected in an earlier forecast. The exception to this improved outlook is Europe, where the situation has deteriorated and predicted net losses are larger than previously expected. Economic uncertainty such as the Greek financial crisis and looming budget deficiencies in many countries may hinder future growth more significantly than predicted. The APAC region continues to be the strongest region and has been responsible for more than half of the freight improvements experienced by the industry in the last year.

- 4) **Third Party Logistic Services: Eight to 12 Percent Savings** – As the freight industry starts to tighten and it is harder to find savings than it was last year, many shippers are reaching out to third party logistic providers (3PLs) for market knowledge and in particular freight benchmarking information to gain leverage so they can get the best-possible shipping rates. Another activity 3PLs are commonly undertaking is carrier identification to help alleviate equipment shortages or premium rates on strategic lanes. According to a recent study by Eye for Transportation,

51 percent of 3PLs say they were greatly impacted by the recession, indicating that a significant amount of business was lost last year. Since 3PLs may be very eager to regain lost business, there is significant opportunity for contract negotiations on issues ranging from actual rates to type of contract such as paid for performance or variable rates. A majority of 3PLs feel their market will not truly improve until 2011, making this a prime category to source with significant savings.

## Additional Active Categories

Category	Avg. Savings	Comments
Ocean Freight	Cost Avoidance - 3%	Ocean freight continues to show the strongest recovery of all freight markets. Trans-Pacific eastbound freight continues to be a very tight market as freight returns to pre-recession levels and is expected to show the strongest growth this year compared to all other regions. Trans-Atlantic volume continues to show signs of weakness due to the economic uncertainty in Europe. Westbound Trans-Atlantic volume shows slightly stronger levels of freight, however a significant shift in either direction is not expected before 2012. Although Transatlantic freight demand has not shown great growth, rate increases have been applied by most major ocean carriers. On average, the increases have been \$300-\$400 for a 20-ft. container and \$400-\$550 for a 40-ft. container. As the industry enters into the summer months and the beginning of peak season shipping, shippers should expect that carriers will be implementing high peak season surcharges; acceptance of this surcharge will help ensure freight is not bumped.
Truckload	Cost Avoidance - 4%	The trucking industry exited the second quarter of 2010 with a strong rebound as freight indicates a strong economic recovery. According to the American Trucking Association (ATA), tonnage increased nearly 10 percent year over year in April, the strongest increase in five years and is now at the highest level since September 2008. According to the ATA, shipment activities continue to fluctuate month to month with dry van showing the smallest fluctuations and refrigerated and flat bed shipments showing the largest variability. With new equipment orders tripling, it will be important for the industry to increase capacity to meet demand as to avoid another supply imbalance. Relationships with carriers continue to play a huge part in the industry with some shippers saying they have seen their freight rates increase dramatically to over \$2 per mile while some shippers report that their carrier base has asked for minimal rate increases. Spot rates continue to rise dramatically compared to contractual rates and are higher than levels seen in 2003 through 2005.

### Market Buzz and Trends to Watch

#### Will Driver Turnover Become an Issue Again?

Over the last 18 months, the trucking industry has lost more than 150,000 drivers and driver turnover went from being a hot topic to a non-existent discussion point. Now with freight showing drastic signs of improvement, the shortage of drivers is now back in the forefront of everyone's minds. Some are predicting that due to the increase in freight and the optimism that is backing the trucking industry, up to 200,000 additional drivers will be needed by the end of this year alone and another 200,000 by the end of 2011. Driving the need for drivers is not only the increase in freight, but the increasing age of drivers and tougher safety regulations designed to identify and rid the industry of unsafe drivers.

***Ariba's Take:** Over the last few quarters, Ariba has highlighted several major companies that have laid off thousands of workers, so to see the industry talk about job openings is a welcomed change. With unemployment rates still relatively high at above nine percent, it would seem that driver turnover would not be a major issue with many people still out of work. However, it seems that individuals are weighing the quality of a job over simply having a job. One factor that is helping to diminish the massive spike in driver turnover is the subdued growth in freight levels. In previous years, post-recessionary freight levels increased more than 10 percent yet per year, but this year freight is only predicted to improve by four or six percent.*

#### Financial Backing of Transportation Companies Improving

Bank lending to trucking companies, especially smaller firms, continued to increase in the first quarter of 2010, up almost six percent from the same time period last year. There had been signs that the financial backing of trucking companies had been improving. The third quarter of 2009 was down 28 percent compared to the third quarter of 2008 yet the fourth quarter was only down eight percent. According to PayNet, a company who tracks the financial backing of industries, one third less companies will default on loans in 2010 than in 2009.

***Ariba's Take:** Since the trucking industry is among the top industries that defaults most frequently on loans, the increase in loan activity has brought concern to some since analysts are not convinced the industry has truly recovered. However, since trucking equipment is typically purchased based on true demand and not on future growth potential, it seems there is freight available to fill the trucks which in turn is creating revenue that will help pay off loans. It is also evident that trucking companies are taking a cautious approach to the freight recovery since the increase in loans is not in double or triple digits. Until the industry truly sees how fast the freight will pick up, slow and steady is the right way to approach expansion.*