Core Category Detail

Transportation and Logistics

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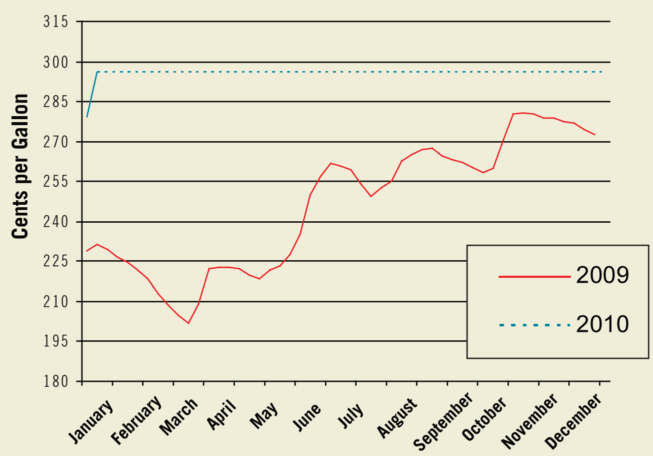
EXECUTIVE OBSERVATIONS

After glimmers of hope that the transportation industry had bottomed out in the third quarter, the industry continued to take steps in the right direction, with several modes of transportation showing increases in tonnage and freight levels during the fourth quarter. Activities that typically reflect the health of the transportation industry continue to indicate that we are moving in the right direction; both retail sales and manufacturing output are exhibiting moderate upward trends that should benefit freight markets. Despite signs of demand improvement, the market has a long way to go before it adversely impacts the favorable environment for buyers.

In the fourth quarter of 2009, Ariba continued to experience robust demand for transportation sourcing projects, with a significant amount of traction in small parcel, truckload and freight forwarding. Ariba also saw an increase in category assessments that involved multiple modes of transportation, which enabled shippers to gain visibility and understand if their organization was effectively optimizing their freight patterns and carrier base to support their operations. Ariba continued to assist several customers in face-to-face negotiations with carriers critical to operations, along with efforts to outsource to third party logistics providers.

Diesel fuel finished the year at an average of $2.46 per gallon, despite seeing significant increases in the last quarter in which diesel fuel averaged $2.74 per gallon. The U.S. Department of Energy (DOE) revised its predictions for diesel fuel for 2010 to $2.96, up two cents from an earlier prediction. Crude oil is predicted to average between $75 and $80 per barrel this year, which is an increase from an early prediction of $60 per barrel. While the revised predictions do not match the highs experienced in the past, the price of oil should be closely monitored throughout 2010, as this has a direct effect on all types of transportation fuel, especially bunker and jet fuel.

Weekly U.S. National Average Diesel Prices



Source: Energy Information Administration

While many analysts and carriers remain hopeful that this year will bring improvements to the transportation industry, the industry needs to be braced for small improvements, as the market will remain “shipper friendly” for some time to come. Reflecting back on the last year, it is important to realize that while the losses have started to minimize, there still is a significant road ahead to a complete recovery. Modes such as truckload and less than truckload should recover faster than others, but even those modes are not predicted to realize true supply and

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demand equilibrium until 2011. Other modes such as ocean and air are not predicted to experience a steady state until 2013 or 2014. The theme of this year will be one of reliability, sustainability, customer service and strength of relationships. Shippers will continue to look to the carriers that can maintain high levels of customer service and grow their relationship, while carriers must continue to examine their cost model to ensure their sustainability.

Top Areas for Sourcing

1) **Less than Truckload: Six to 11 Percent Savings –** The LTL industry continues to operate in a state of flux, with many waiting to see which carriers will survive the downturn in the freight market. Analysts feel that the industry currently is over capacity by approximately 25 percent; however that number will drastically change if YRC files for bankruptcy. Pricing remains low, which many feel is being driven by two main factors. Some speculate that the low rates are a potential competitive pricing strategy by other carriers to test YRC's financial sustainability. The other challenge to LTL pricing is competition from other modes. As truckload rates remain depressed, some shippers are seeing additional price benefits by optimizing modes and shifting freight from LTL to truckload. According to the American Trucking Association, both tonnage and shipments continue to slide. Year-over-year, LTL tonnage is down 23.2 percent, and shipments are down 22.4 percent. One area that is receiving less attention now is fuel surcharges. When fuel was at an all-time high last year, surcharges averaged almost 33 percent, but now they stand at an average of 14 percent. With the volatility taken out of pricing, carriers and shippers alike can focus on building and maintaining relationships that allow for both parties to grow. Looking ahead to this year, the LTL industry is expected to stabilize, and either remain flat or see modest growth levels of one to two percent. Shippers who saw significant price decreases in 2009 might not see the same savings levels in 2010 contract renewals; however, the attractive pricing achieved last year should be sustainable.

2) **Ocean Freight: Six to 12 Percent Savings –** After experiencing a slow peak season, the ocean freight industry is eager to put last year behind and move forward. The industry is hoping for growth in 2010 of approximately three to eight percent, depending on the overall strength of the global economic recovery. According to the National Retail Federation (NRF), changes in volume may be possible, but there is insufficient data to predict growth with complete confidence. Import volume at U.S. ports continued to decline, and according to the Port Tracker published by IHS Global and the NRF, container volumes have been down year-over-year for 27 consecutive months through September. Major international ports are also experiencing declines in freight; the Hong Kong Census and Statistics Department stated that Hong Kong's container traffic in the third quarter decreased 17 percent year-over-year. In line with the declines in freight, some carriers have stated that rates fell almost 30 percent last year. In many cases, pricing fell to a level that is not sustainable. In response, many top tier carriers have issued and continue to issue price increases to bring prices to a more-manageable level. Overall, shippers should remember that freight remains flat and the industry is entering into a traditionally slow shipping season during the first quarter. Shippers should continue to monitor the market to verify price increases and maintain competitive pricing.

3) **Small Parcel: Five to Nine Percent Savings –** Just like at the start of any other year, FedEx and UPS have issued their annual rate increases. FedEx's base rates have increased 5.9 percent and UPS has increased their base rates by 6.9 percent; both have decreased their fuel surcharges by two percent. Accessorial charges have also increased. The rate increases are intended to help improve revenues after seeing a decline year-over-year last year. In 2009, the U.S. domestic parcel revenue was off 14 percent to $52.65 billion, compared to $61 billion in 2008. International shipments continue to reflect strong growth, and recently U.S. domestic shipments

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have started to show signs of improvement. Sourcing efforts continue to achieve strong savings for shippers; however, overall timelines have started to lengthen as carriers closely examine all pricing proposals to verify that pricing can be sustained.

4) **Air Freight: Seven to Nine Percent Savings –** Similar to other modes of transportation, global air freight has started to show signs of improvement, as demand for freight is only at 0.5 percent below 2008, and load factors are averaging over 50 percent. While demand is showing signs of recovery, the main factor influencing the load factors is the reduction in capacity. Carriers have been aggressively removing aircrafts from the market, with some carriers reporting that they have removed as much as 20 percent in the last quarter alone. Globally the industry is gaining strength across all regions with month-over-month growth reported from September to October. However, particular regions are outperforming others year-over-year. According to the International Air Transport Association (IATA), Middle Eastern and Latin American carriers reflected an 18.4 percent and 6.7 percent year-over-year growth in October, respectively, while European carriers are seeing the biggest drop with an 11 percent decline. The IATA is predicting that cargo demand will grow by seven percent in 2010 due mainly to inventory rebuilding efforts; this follows an estimated 13 percent decline in freight in 2009. Once inventory levels are right-sized, growth is expected to mirror the overall growth in world trade. Despite predicting significant growth in the industry, the IATA is still forecasting that the industry will lose $5.6 billion dollars this year. This comes after the industry is expected to lose $11 billion in 2009. Shippers should continue to see aggressive savings within this market, as carriers look to recover lost revenues from the past two years.

5) **Truckload: Five to 10 Percent Savings –** The truckload industry continues to show signs of recovery. According to the American Trucking Association, October was the first month that saw a slight decline in shipments after three consecutive months of gains. Signs of shipment growth are expected to have continued in November due to holiday shopping restocking efforts. Tonnage also continued to show a healthy recovery as tonnage levels are now only 3.5 percent below 2008. The consistent gains now place freight levels only nine percent below the previous year. Despite the positive signs of growth, many are remaining realistic on how fast capacity will begin to tighten up. Carriers can take two different approaches in tightening up capacity; some are taking a strategic look at their fleet and either removing equipment or choosing not to replace aging vehicles, while other carriers are becoming aggressive in their pricing in order to secure freight and utilize capacity. Regardless of what strategy

Additional Active Categories

Category	Avg. Savings	Comments
Third Party Logistics	3 - 8%	Due to the prevailing uncertainty with economic conditions, many 3PL providers have reported that while business losses have started to minimize, no significant gains in margins or new business are expected during the next few quarters. A modest global recovery is predicted for the 3PL industry, specifically in Europe. Any announced plans for physical expansion will happen at a much-slower-than-expected pace, as many 3PLs start to focus on alliances with other 3PLs to expand their global footprint and competencies.
Freight Bill Audit and Payment	5 - 14%	As companies continue to focus on minimizing costs, the freight bill audit and payment (FBAP) segment is one of the few areas of logistics that is experiencing growth. While operating with smaller staff levels, many are leveraging an FBAP's efficiency while capitalizing on their cost savings.
Warehousing	2 - 6%	After experiencing a year of low inventory levels, the warehousing industry expects to see growth in 2010 as companies start to increase their stocking levels. However, the industry is still facing a steep uphill climb, as revenue levels have fallen significantly enough to wipe out any gains achieved over the last three years.

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is being employed, noticeable changes in capacity are not expected until at least the end of the third quarter of this year, and shippers should continue to benefit in the meantime.

Market Buzz and Trends to Watch

Changing Landscape in Trucking Continues

The turbulent times in the trucking industry continued through the remainder of 2009, with additional carriers going out of business and the YRC restructuring plans continuing to unfold. Flatbed carrier Arrow Trucking of Oklahoma suddenly closed its doors on December 22, suspending all operations and laying off all 1,600 employees. The company was ranked No. 99 on the Transport Topics 100 list of the largest U.S. and Canadian for-hire carriers. While a formal statement has not been issued by the company yet, the CEO did release a brief statement that indicated the company was negotiating with its principal lender. In another step to realign its business model, YRC Worldwide sold the dedicated contract carriage division of YRC Logistics to Greatwide Logistics Services for $34 million. YRC Logistics' dedicated contract carriage business accounts for approximately 15 percent of YRC Logistics' revenue, and about one percent of YRC's total revenue. YRC also completed its debt-for-equity exchange offer in an ongoing attempt to reach a more-stable financial standing. The $536.8 million exchange offer enables YRC to defer approximately $19 million in interest and fees to creditors.

Ariba's Take: *Over the course of the last 18 months, the industry has seen its landscape change with several major carriers closing their doors, and others reporting significant quarter-over-quarter losses. While it hasn't been determined if Arrow's closure is a permanent or a temporary one, it is clear that some carriers are surviving on a day-to-day basis, and credit issues are becoming even-more critical. YRC completed its debt-to-equity exchange one week before an interest payment was due that could have pushed them into bankruptcy. In the past, the industry had always predicted who would be the top carriers at the end of the year, but now analysts are only looking ahead months at a time. With the usual slow months of the first quarter ahead, it will be interesting to see who is left standing. Buyers are advised to continue to monitor the market closely and maintain a number of active carrier relationships to mitigate any market fallout from financially troubled providers.*

Despite Declines, Railroad Industry Continues to Be a Safe Bet

The Association of American Railroads stated that mid-December intermodal traffic continues to be down year-over-year, but seems to be stabilizing. Intermodal container volume was up 3.6 percent year-over-year, but down 7.7 percent compared to 2007. Intermodal trailer volume decreased 24.5 percent year-over-year and is 35.2 percent less than 2007. Despite the declines, the industry did receive a boost of confidence when investor Warren Buffet's investment company, Berkshire Hathaway, proposed to acquire Burlington Northern Santa Fe, the nation's second largest railroad company. The proposal is set to be approved early in 2010.

Ariba's Take: *Much attention has been given to many of the other modes of transportation (besides rail) during the recession because of the grand nature of some of the news stories such as DHL's exit or YRC's financial trouble. Yet the railroads are an excellent barometer for the health of the U.S. economy, and are in a position to rebound faster than other modes, since rail transports goods for a wide variety of industries. Shippers should keep an eye on activity in this industry, particularly since it serves as an effective leading indicator for the health of the U.S. economy and overall transportation industry. Warren Buffet's investment in Burlington Northern Santa Fe signals market confidence that the rail industry's financial health is stronger than other modes of transportation. Many railroads have been able to remain profitable despite the recession, and have become even-more efficient through technology enhancements.*

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