

# Transportation and Logistics

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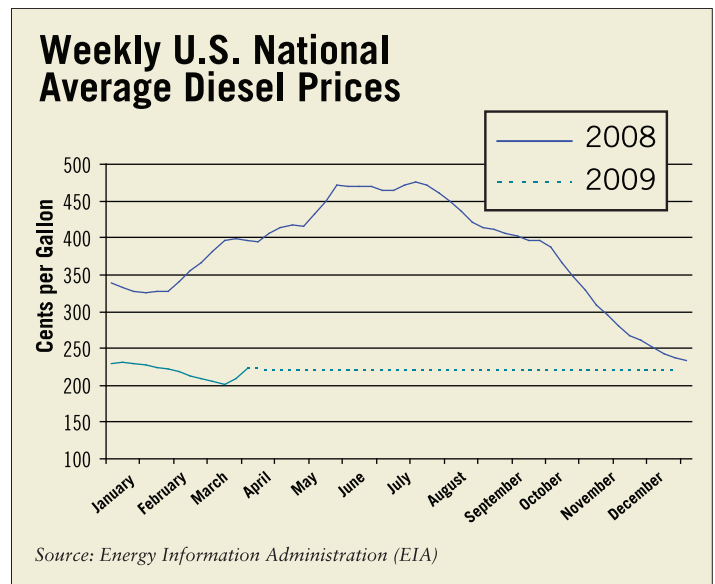
## EXECUTIVE OBSERVATIONS

**D**uring the first quarter, Ariba's project activities remained at a record high similar to the previous quarter with project activity focused on Less than Truckload, Truckload, Ocean Freight and Small Parcel. Savings levels remained very aggressive with average savings for all modes in the double digits. Carriers have been very eager to participate in sourcing events and have proven to be assertive with pricing in order to secure or increase freight levels.

Shippers have not only been able to achieve savings through sourcing activities but also through behavior changes such as mode optimization. In order to ensure one is shipping in the most cost-effective and time-efficient manner that adequately supports operations, shippers have also been very interested in optimizing their shipment profile. Shippers have been able to realize savings by limiting air shipments for those goods that are not time-sensitive and by examining shipment patterns to consolidate less-than-truckload shipments into truckload shipments.

Another thing that Ariba has observed is that companies are examining areas of spend that have previously been left untouched. Areas that had previously been deemed too difficult to source competitively such as freight bill auditing and payment are being examined to see if the cost of doing this activity in house outweighs the benefits and efficiency of outsourcing this area of spend to a third party provider.

Carriers and shippers alike continue to experience relief from high oil prices, which has brought lower diesel prices. The Energy Information Administration is predicting that highway diesel prices will average approximately \$2.30 per gallon through the rest of this year and will average approximately \$2.69 per gallon throughout 2010.



A great deal of attention has continuously been brought to taking advantage of market conditions and negotiating lower rates, but shippers should also take a step back and look to develop a contingency plan for the future during this recessionary period. What will happen if your primary carrier goes out of business? How will your freight move if your major trade lane is removed from the market? As the industry continues to worry about carrier consolidation and bankruptcy, shippers need to prequalify carriers now so they can quickly

move business if needed. Throughout the next few quarters, shippers should not be dependent on carriers to provide cost savings but they need to look inward and focus on ways to operate more efficiently. By developing a strategy that envelops rate negotiations, a carrier prequalification plan and an efficient operational strategy, shippers will position themselves in an ideal situation regardless of how the economy moves.

### Top Areas for Sourcing

- 1) **Air Freight** – The air freight industry continues to face a drastic decline in freight volumes despite finally seeing relief from the high jet fuel prices. Recent sourcing activities have reflected the decline in freight as carriers offered savings ranging from six to 10 percent. The International Air Transport Association (IATA) recently stated that freight volumes saw a 23 percent year-over-year decrease in January and a similar year-over-year decline in February of 22 percent. Overall, all regions have been hit by the downturn in freight, however the Asian regions have been hit the hardest, mainly driven by a harsh decline in Japanese exports. With freight levels at such a dramatic low, analysts are left to wonder if freight levels have bottomed out. Erring on the optimistic side, analysts are predicting the air freight industry is on the road to recovery, a very slow recovery, as freight levels cannot get much worse. As carriers balance capacity with demand, shippers should not utilize contract negotiations to solely drive down rates but should also aim to establish a contingency plan that will provide coverage if a major trade lane is removed from the market and identify a core carrier list that will enable one to quickly switch business between carriers if necessary.
- 2) **Ocean Freight** – Facing a global trade that has been duped “the worst since WWII”, the ocean freight industry and its carriers are struggling to find ways to reduce its losses. Recently several carriers, Hanjin Shipping, Maersk Line,

Mediterranean Shipping Co, APL and CMA CGM, issued rate increases effective April 1 to combat rate levels that the carriers felt were unsustainable for the rest of 2009. Even with these rate increases, pricing levels remain low with recent rate negotiations showing savings of five to 12 percent. Rates between Asia and Europe are down almost 70 percent year over year. Ariba has also seen carriers become extremely cost conscious and creative in order to minimize losses. “Slow streaming” is now a common practice. Carriers are cruising at half their normal speeds in order to be as fuel efficient as possible, saving as much as \$5,000 per hour in fuel costs. With demand on Europe to Asia lanes so low that it is hard to fill an entire ship, and bunker fuel costing only a third of what it did last year, some carriers have decided that they are comfortable with the longer transit times and routes to avoid the fees at the Suez Canal. The Suez Canal Authority has stated that traffic is down 20 percent this year, indicating that many carriers are deciding to avoid the canal in specific routes to help save costs. For those carriers that have decided to remove capacity from the market in order to limit losses, carriers are searching for the cheapest place to park vessels. Analysts have stated that more than 1,000 vessels are currently laid up due to a lack of freight and if the economy does not improve, they expect this number will increase accordingly. In order to park a vessel at a port, carriers pay by the deadweight ton and if a ship weights 150,000 deadweight tons, with the average parking fee at a port at \$0.17 per deadweight ton, those costs are going to add up quickly. The vessel parking business has been so profitable that some ports have been able to offset any losses that they may have suffered from the drop in freight handling fees.

Ultimately the industry needs to see cargo increase in order to stop the continuous losses felt by carriers. Cargo volumes released by National Retail Federation and HIS

Global Insight indicate that the industry might be moving in that exact direction. In January, U.S. ports handled 1.05 million twenty foot equivalent units (TEUs), down slightly from December and down 14.6 percent year over year. February's traffic has been estimated at one million TEUs, down 17.7 percent year over year, however February is historically the slowest month of the year for ocean freight. March is predicted to be at 1.07 million TEUs, up from February and down only 7.4 percent from last year. March is the beginning of the climb to peak season. The industry should not expect a drastic increase over the next few months leading into peak season as past peak seasons have demonstrated, but instead very slow but gradual growth. On a positive note, the lower freight levels have left all ports with little to no congestion, enabling freight to move inland quicker than in the past.

3) **Truckload** – This past quarter, the American Trucking Association's (ATA) Advanced Seasonally Adjusted for Hire Truck Tonnage Index has slightly increased, three percent in January and an additional 1.8 percent in February. However, the month-over-month increase is not enough to eradicate the drastic drop of 7.8 percent that occurred in December of last year. Tonnage is still down 9.2 percent compared to last year. ATA has stated that the past five consecutive months where tonnage is down year over year is a clear indication of how weak the industry is. Carrier rate negotiations have provided aggressive savings of eight to 13 percent, which is another indication of how weak the market is. March is typically the mark of the beginning of peak season with a strong seasonal upturn, but freight remains flat as consumers continue to be pessimistic over the economy, spending remains low and unemployment hits record highs each month. Shippers and carriers should expect the truckload industry to remain flat through the rest of this year if the economy remains the same. If freight

levels continue to decline at the pace in which they are, shippers should expect to see continued carrier consolidation within the market. With demand declining and rates falling, the small to mid-sized carriers are having a hard time surviving. Many carriers have stated that they are considering liquidating in the next year if freight levels stay at the level in which they are currently.

Overshadowing the low freight levels has been issues surrounding the Mexican trucking program and concerns over the U.S.'s violation over the North American Free Trade Agreement. In early March, the U.S. decided to close its border to the pilot Mexican trucking program amongst pressure from Teamsters and other unions over competition levels despite a pilot period that proved Mexican long-haul carriers can operate safely with the U.S. When Congress ordered the shut down of the pilot program, Mexico responded by imposing almost \$2.4 billion worth of tariffs on U.S. products ranging from sunglasses and deodorant to fresh produce and Christmas trees. Since the cost of U.S. imports will now cost more, Mexico will likely look to find substitutes from Europe, Canada and Latin America. The Department of Transportation is working with legislators to develop a new plan that will reopen the borders while addressing all parties' concerns. Any new plan is highly anticipated during a time when freight is already at an all-time low and proactively decreasing demand has been questioned through the industry.

4) **Less than Truckload** – The outlook for the Less than Truckload (LTL) sector continues to be less than optimistic with carriers facing freight levels that are at a low that has not been seen since 2004. The American Trucking Association announced that the less-than-truckload seasonally adjusted shipments declined for the tenth

consecutive period in January. Freight decreased almost one percent in January, which brought the overall 10-month decline to 16.5 percent. Sourcing results have recently produced savings results on average of eight to 12 percent with some projects achieving even-higher savings upwards of 17 percent. Recent announcements within the industry reflect the hard times carriers are facing. Mid-State Express, an LTL carrier based in Illinois, has announced it closed its operations in March due to financial and credit-related issues. If freight levels continue at the level in which they are at now, the industry should expect to see additional carriers cease operations—especially the smaller regional carriers. In addition to carriers going out of business, the industry has seen several carriers announcing cut backs in pay, workforce and reduction in operations. Saia has stated that it will reduce executive pay by 10 percent and hourly, line haul, and salaried employees by five percent in order to cope with the economy. On the other hand, some carriers are thriving in this economy and expanding their service offerings to their customer base. Averitt Express is expanding services into Maryland and West Virginia and announced operational improvements in Virginia. Southeastern Freight Lines also announced improved service levels this past quarter. Southeastern has expanded its direct service offering to the entire state of Alabama—eliminating the need to partner with carriers to reach portions of the state. Overall, analysts are not predicting that the LTL market will begin to improve at all this year and when going through sourcing activities, a shipper needs to be wary of a carrier offering unsustainable rates. Instead, a shipper should look to find a carrier that is operationally efficient and financially stable in order to be in a better position regardless of which way the economy turns.

- 5) **Third Party Logistics Services** – In today’s tough economy, companies are looking for more ways to save

money, operate more efficiently and gain an advantage over their competition and often turn to a 3PL to achieve their goals. In a recent survey, many third party logistic providers (3PLs) have stated that revenues have been decreasing—especially those 3PLs that tend to specialize on the automotive, retail and consumer goods industries. The future of the 3PL will be a function of the economy and until the world sees an economic improvement, 3PLs will be aggressively seeking new business. For those 3PLs that are focused on the automotive industry, the next few quarters will be even more critical to operations as the

## Additional Active Categories

Category	Avg. Savings	Comments
Small Parcel	8-15 percent	Similar to other modes of transportation, small parcel freight has been trending down in accordance with the economy. Even the exit of DHL from the U.S. market has not helped offset the effects of weakened global demand. Air freight demand has been impacted more than ground transportation by the recession since many shippers are looking at ways to cut costs and utilizing a more cost-effective mode such as ground is an effective strategy.
Flatbed Trucking	2-12 percent	Flatbed trucking continues to be hit the hardest by the downturn in the economy. The American Trucking Association (ATA) recently released freight levels that indicated that flatbed loads have fallen for seven consecutive months for a total decline of 28.7 percent—leaving freight levels at its lowest level since August of 1998.
Bulk Trucking	3-8 percent	The American Trucking Association (ATA) stated that bulk freight levels have decreased consistently over the course of the last four months, for a total decline of 18.9 percent. This is the lowest level bulk trucking has been at since March of 2003.

automotive industry continues to cut costs for ancillary services such as 3PL services and fight for survival. The 3PL industry has been enjoying double-digit growth over the past year, but that growth is expected to slow down in 2009. Slow growth will mean lower prices and now is the time to act if you think your organization could benefit from 3PL services.

### Market Buzz and Trends to Watch

#### LTL Carrier Experiences Integration Growing Pains

The integration plan for YRC Worldwide (YRCW) and all of its subsidiaries has not been as smooth as the company initially had planned. Last quarter the company heralded the start of the much-anticipated integration of Yellow Transportation and Roadway. The goal was to have one sales team, one management team, one network and one set of routes. YRCW announced the integration was completed this March and expects to save \$200 million this year through the integration while laying off approximately 2,000 workers because of duplicate efforts. Through this integration, some customers have complained of service disruptions. USF Holland, a subsidiary of YRCW, announced in March that it will close 11 regional service centers by the end of the first quarter in an effort to support the operational efficiency the company is seeking. An additional 350 employees will be laid off through the closure of these facilities. YRCW hopes to clear up any confusion that shippers have stated over which terminal to use.

*Ariba's Take: YRC Worldwide has taken great strides in integrating all of its subsidiaries into not just one company in namesake but into one operationally integrated company. There have been bumps in the road along the way and some shippers have chosen to move business to other carriers. While many analysts doubt YRCW will be able to efficiently and effectively complete their network*

*integration during a weakened freight market, for those shippers that stick with YRCW through its integration, they will be able to take advantage of the largest LTL network available with the most comprehensive service offerings. It will be interesting to see if YRCW survives and if they do not survive, how the reduction in capacity will affect rates and which carrier will take their place as having the largest network.*

#### Will a Major Ocean Carrier Go Bust?

The transportation industry has become immune to being surprised when a carrier ceases its operations, particularly in the North American Trucking industry. However the transportation industry has not seen an ocean freight carrier close its doors yet. With the World Trade Organization predicting that global trade will fall another nine percent this year alone, many analysts are not guessing if an ocean freight carrier will go out of business, they're guessing which one. Since the ocean freight industry was ramping up capacity as the demand drastically declined, many ocean freight carriers have not been able to react quickly enough with meaningful impact on their operations. We have seen that more carriers are removing capacity from the market in order to limit losses; for example, on an Asia to North American route, capacity has decreased by 13 percent. Carriers are not only being forced to make the difficult decision to either remove capacity, they also have to decide if they park the vessel as a "hot lay up" or "cold lay up". A "hot lay up" is when you maintain the crew on the vessel and you feel you are only going to take the vessel out of commission for less than 12 months. A "cold lay up" is when you do not maintain the ship's crew and it will be taken out of the lines for several years.

*Ariba's Take: It will be interesting to see if the analysts' predictions come true and how the industry reacts. Since ocean freight supply is very inelastic; there was, on*

## Core Category Detail

*average, a three-year lag between orders of additional supply (when demand was at an all-time high) and delivery of the new vessels (when demand took a drastic downturn). Even in a reactionary mode to lower demand, when a carrier removes capacity from the market, there are high fixed costs*

*that still need to be met that lower demand is not covering. The last time the industry started to park vessels, they remained idle for almost 10 years (1975 to 1984). If history does repeat itself as it tends to do, the prediction is not which carrier goes out of business but which ones are left standing.*