

# Transportation and Logistics

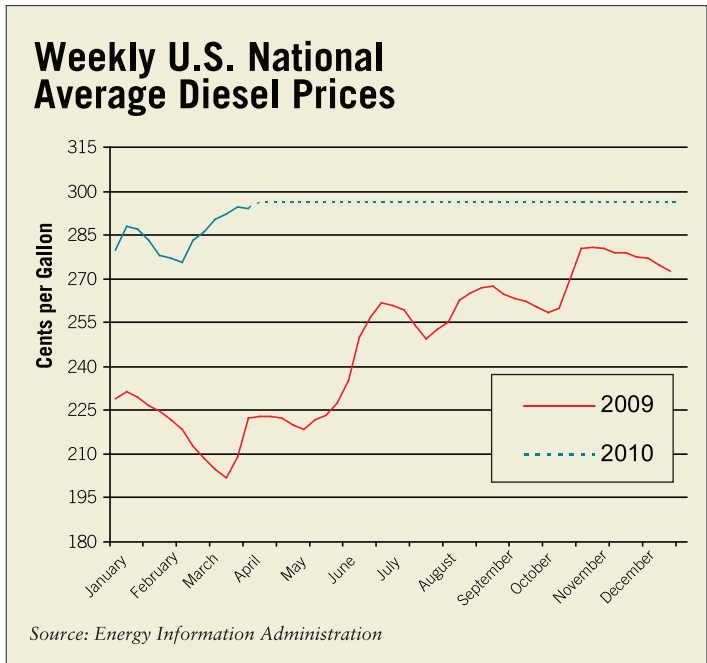
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## EXECUTIVE OBSERVATIONS

In the first quarter of 2010, Ariba saw a significant upturn in sourcing activity as many shippers decided to take advantage of continued softened market conditions in trucking and small parcel, and strategically resolved to validate price increases that are facing global freight markets such as ocean and air freight. Project interest was solid across all modes of transportation, as shippers cautiously prepared for improved business conditions over the next several months.

For the first time in 18 months, a majority of transporters feel the worst is behind the industry, and that positive signs of recovery can be seen in varying degrees across most modes. This leaves shippers to wonder if the market power pendulum is swinging back to the carriers. But it is important to evaluate each mode separately, as each mode is displaying different characteristics that will help predict how long their recovery will take. Ocean freight shippers are already facing cost containment issues, as capacity has been strategically removed in the Transpacific, while other regions are still offering attractive savings. Air freight is mimicking ocean freight with tightened capacity in parts of Europe and Latin America, yet savings opportunities exist in the rest of the world. Truckload, less than truckload, and small parcel are showing signs of improvement; however, all three modes will take significant time to fully recover. Looking back to the freight recession of 2000, the market slumped by an average of 10 percent, and took a solid year to recover back to pre-recessionary levels. When analyzing this freight recession, the market was depressed at times as much as 20 to 25 percent. Drawing a correlation between the two recessions, this recovery should take the majority of this year and potentially part of next year.

The U.S. Department of Energy (DOE) maintained its prediction for diesel fuel for 2010 to an average \$2.96 per gallon, and issued a prediction of \$3.14 per gallon for 2011. Current crude oil prices are above \$80 per barrel, exceeding the annual predictions of \$75 to \$80 per barrel. Many analysts feel that the high crude prices are being driven up by the perception that the economy is picking up, and prices will continue to rise slightly until additional market results come in.



Shippers should continue to focus on three things as the transportation market tries to jumpstart its recovery. First and foremost, understand the financial stability of your primary carriers. This not only helps shippers plan for continuity of service, but it also helps shippers understand what is driving

negotiation behaviors of their carriers. Second, shippers should examine the total rate decreases that their carriers have individually given them since the market began to slip in 2008. Understanding how much your carrier has moved since the market plunged is much more important than year-over-year savings. Lastly, shippers need to focus on their relationship with their carriers. It is much more important to have a carrier that provides you with impeccable services or helps you out in a pinch than having the lowest-cost carrier at all times.

### Top Areas for Sourcing

- 1) **Less than Truckload: Four to Nine Percent Savings** – Should carriers focus on gaining market share through aggressive competitive pricing, or focus on profitability by increasing rates? Those are the two conflicting strategies facing the less-than-truckload market, which is not surprising when realizing that LTL market revenue dropped 24.4 percent from 2008 to 2009, according to a recent study published by the Journal of Commerce. Of the top 25 carriers within the market, every single carrier had a significant drop in revenue year-over-year, ranging from 47 percent by Central Freight, to a 10 percent loss by New England Motor Freight. In addition to trying to balance the mixed messages from different carriers in the market, shippers continued to show signs of uneasiness around the YRC financial situation. Despite being the largest LTL carrier in the market, their overall market share dropped 22.5 percent last year. YRC's market share has been gobbled up by various carriers, with two major carriers capturing the majority of YRC's lost market share. FedEx Freight and Con-way have increased their market share by 4.9 percent and 4.7 percent, respectively. The major carriers issuing recent rate increases are UPS, Old Dominion, ABF, FedEx Freight, and FedEx National, with the overall rate increase averaging five percent. Despite hearing of rate increases from those major carriers, other carriers are still very competitive with rate reductions and are structuring contracts in innovative ways to retain and
- gain business. Some carriers have gone as far as locking in long-term rates to ensure they retain important shippers, and are aggressively waiving accessorial charges. Current demand patterns imply that shippers will see more carriers offer aggressive rates instead of issuing rate increases over the next few months.
- 2) **Small Parcel: Five to Nine Percent Savings** – A recent healthy increase in both domestic and international freight demand has given small parcel express carriers a reason to feel fairly upbeat as they move into the traditionally robust shipping season. International business remains slightly stronger than domestic shipments; however, much of the international demand is being driven by growth in the Asia-Pacific region and by restocking efforts of many companies. FedEx recently announced that its strongest demand over the last three months (ending February) came in international express, where the shipments increased by 18 percent, tonnage soared by 62 percent, and freight revenue grew 49 percent. FedEx and UPS have issued major press releases, with UPS tripling their operating profit and FedEx posting a 146 percent increase in quarterly income. Both UPS and FedEx are examining pricing proposals much closer recently to ensure that the pricing discounts being offered to shippers are sustainable, leading to much-longer sourcing and negotiating timelines. Shippers should keep this in mind when planning for negotiations before contracts expire. Despite the duopolistic nature of this market, and promises to walk away from unprofitable accounts, UPS and FedEx both know that the competition will eagerly snap up any business that they let slip away, creating a competitive market for shippers.
- 3) **Truckload: Four to Eight Percent Savings** – Compared to less than truckload, the truckload industry continues to show slightly stronger signs of recovery, as capacity tightens due to small-yet-steady increases in demand. According to the American Trucking Association (ATA), January saw a

1.9 percent increase in tonnage. February saw a slight decrease of 0.5 percent, but many feel that February's numbers were skewed by the heavy snow storms along the East Coast. According to the ATA, total volume increased throughout the end of 2009, with 6.4 and 2.2 percent increases in November and December respectively. These types of increases should be reflected when 2010 shipment numbers are released, as carriers anecdotally talk about increased shipments from customers. Carriers are anxious to push rate increases across the board, but uncertainty remains regarding the overall pricing environment. While there have been some improvements in capacity, the overall market still has excess capacity, which will prevent any meaningful price increases from impacting the market. Because of that the market will remain defined as a "shipper's" market. As the year continues, shippers should expect to see a change in freight patterns as erratic fluctuations in freight stabilize, and unfortunately, an increased number of companies may fail as "lender leniency" begins to tighten.

4) **Warehousing: Two to Eight Percent Savings** – As we are starting to observe certain areas within the transportation industry rebound or at a minimum remain flat, the warehousing industry continues to sag. Overall demand for warehousing remains weak, and low occupancy rates continue to plague the industry. Analysts expect it to take several years to recover to pre-recessionary levels. Just over 12 million square feet of new warehousing space was added to the market in the fourth quarter of 2009; however, most of that space was preleased. Another 12 million square feet is expected to be added to the market this year, but most of the new developments are built to suit projects, of which a majority are already preleased. The sublease vacancy rate did remain steady quarter-over-quarter at 10 percent, with Florida and California having the highest vacancy space available. Warehousing sales also took a huge hit last year with a 70 percent decline from 2008. Recovery within this market will vary by geographic region; the areas with

major logistics hubs are already showing small signs of recovery as import/export shipments increase and domestic freight strengthens. Buyers should try to leverage demand across locations where possible to present higher attractive spend numbers to leasing companies, and closely examine the leasing or sale offers that landlords are offering. Since the market remains so soft, landlords are being very competitive with lease rates and offering valuable incentives to enable renters to get more for less.

## Additional Active Categories

Category	Avg. Savings	Comments
Ocean Freight	Cost Avoidance - 3%	Average container rates sank almost 26 percent last year, and due to the un-sustainability of those rates, container pricing saw a major increase towards the end of 2009. Rates are expected to continue to rise through the first half of 2010 before stabilizing. Savings potential varies by region with the Transpacific market showing the tightest capacity and hence the largest price increases. Outbound European and Out/Inbound Latin American markets have proven to be much more stable and are still offering moderate savings. Due to the imbalance between imports and exports (imports outweigh exports) in the U.S., westbound transpacific lanes are offering attractive savings as carriers look to fill ships that bring cargo into the United States.
Air Freight	Cost Avoidance - 6%	The global air freight industry has started to show signs of improvement, mainly driven by cargo in the Asia-Pacific region, which has been responsible for over half of the freight improvements experienced by the industry in the last year. The improvement in demand coupled with the drastic reduction in capacity that the industry experienced last year to help minimize losses will reduce savings opportunities. Savings potential will vary by region, with the tightest regions being Asia-Pacific and Latin America.

## Market Buzz and Trends to Watch

### Employment Hasn't Stabilized Yet in the Transportation Industry

With unemployment over 10 percent, the transportation industry has not been immune to the loss of jobs. Despite showing signs of recovery, many transportation companies

are moving forward with a “cautiously optimistic” attitude and continue to look for ways to position themselves better. In addition to reducing operating costs through layoffs, many companies are looking at extended leaves of absences, freezes in salary, and suspension in benefits such as 401k matching. According to the U.S. Labor Department, despite the optimistic outlook, transportation employment continued to decrease; this continues a steady decline in employment since late 2008. The Labor Department reported that in the month of February, 8,200 jobs were lost in trucking alone, with additional small decreases felt in rail and air. UPS is just one of the latest companies to announce that it is eliminating 1,800 management and administrative positions across the U.S., and they are currently involved in talks with their pilots union to find ways to avoid as many as 300 furloughs. YRC Worldwide has laid off more than 4,000 workers in the last year, including an additional 200 individuals at their headquarters in Kansas and a campus in Ohio. ABF Freight Systems recently began talks with the Teamsters Union in an effort to mitigate additional losses after being hit with a \$127.5 Million loss last year. The talks could result in changes to wages and health and pension plans.

***Ariba's Take:** While some of the changes in employment have been directly caused by a loss of business, such as with YRC and ABF, other changes—such as UPS's moves—are proving to be more forward-looking and strategic. In the fourth quarter of 2009, UPS reported an operating profit that was nearly triple the profit from a year ago, yet the company's labor reductions have made headlines through this quarter. This has proven that while many are optimistic that the worst is behind the industry,*

*companies still need to think strategically of how they are streamlining their operations, not only for survival, but to retain their competitive advantage in order to thrive in the long term.*

**Labor Classification Continues to Hover over UPS and FedEx**  
Over the last several quarters, the express delivery business has been involved in a heated debate over the labor-related differences between UPS and FedEx. After making its way through the House of Representatives, the Federal Aviation Administration Reauthorization Act was finally voted on and passed by the Senate in late March. The bill secures \$34.5 billion in funding for the Federal Aviation Administration through September 2011, but it did not include the provision proposed by the House of Representatives that would potentially change the labor status of FedEx workers to fall under the National Labor Relations Act instead of the Railway Labor Act.

***Ariba's Take:** The two companies continue to be entrenched with a public relations battle over The Federal Aviation Administration Reauthorization Act. One side contends that the Act is a lobbyist-backed bailout plan for their competition, while the other side argues that it is simply time for equal treatment for both companies. Regardless of what was driving the bill, the Senate decided to focus on the essential part of the bill, which is dedicated towards modernizing the air travel system through enhancements in safety and training programs. The air travel system is a larger issue currently plaguing the United States. Perhaps the transportation industry should take a cue from the Senate and focus more on core issues such as softened market conditions and employment instability.*