

# Transportation and Logistics

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## EXECUTIVE OBSERVATIONS

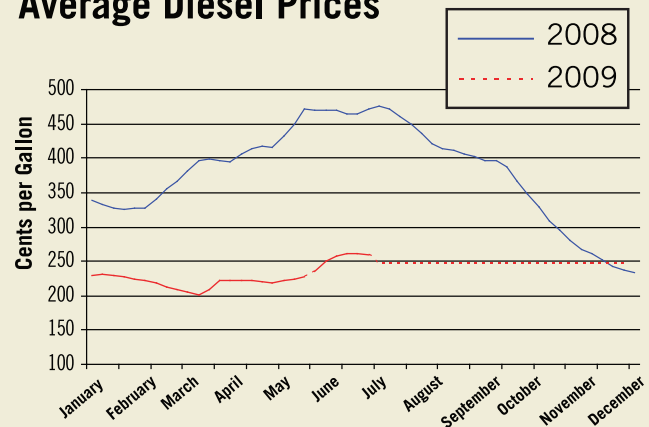
**T**hroughout the second quarter of 2009, Ariba's project activity remains at an all-time high for Transportation and Logistics. Sourcing projects were concentrated on the following modes: Truckload, Less than Truckload, Ocean Freight and Small Parcel. A change in bidding behavior was observed, which has produced an expedited timeline for the overall sourcing projects. Historically, it took several rounds of pricing to get the best pricing from carriers. However, carriers have recently been offering their best pricing immediately instead of holding back. In addition to the typical sourcing projects, Ariba assisted with carrier negotiations, contract reviews and market assessments. Within the market assessments, Ariba was able to provide a comprehensive summary that included supplier identification, benchmark pricing and service-level analysis.

While many analysts are predicting that the transportation industry has hit rock bottom and is starting to make a recovery, most do agree that the recovery will be a slow process and freight levels will not soon rebound to the record levels seen a few years ago. Relief is not expected to come from a fast and furious peak shipping season in the summer to fall months of 2009. Past freight recessions suggest the air freight industry is the leading indicator used to estimate a return of demand. Flat market trends for the current air freight market further illustrate the belief that the return of demand for the overall transportation industry will be slow.

Mid year, carriers and shippers are continuing to see relief from the high energy prices of 2008. While prices are still below the record levels of last summer, the industry has seen a slight increase in recent months. The Department of Energy is now predicting annual diesel fuel prices to average around \$2.46 for the rest of this year, which is an increase from the earlier prediction

of \$2.19 made during the first quarter of the year. Diesel fuel is also estimated to be \$2.79 per gallon in 2010, which is an increase from the previously predicted \$2.50 per gallon. As the world continues to anticipate an economic recovery, shippers will need to keep a close eye on oil as it has a direct impact on fuel types (diesel, jet fuel and bunker fuel).

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



Source: Energy Information Administration (EIA)

One positive note for carriers through this softened transportation market has been bulk ocean. The Baltic Dry Index has improved through most of this year and at one point in May increased for 11 straight days, during which time the index gained 43 percent and was up 228 percent year over year. The Baltic Index has historically been a measure of shipping rates; consequently the increase in the Baltic Dry Index is regarded by many analysts as an important indicator of an improving global economy.

Over the last year, the industry has faced a considerable amount of negative press and the industry is highly anticipating the day

that it starts to show signs of significant improvement. However, emphasis should now be placed on some of the positive trends taking place in the industry:

- Compared to one year ago, fuel is at a more manageable level
- Ports are operating with little to no congestion
- Driver turnover issues that have plagued the industry for years are all but eliminated
- Efficient networks are now seen through the industry as excess capacity has been removed

### Top Areas for Sourcing

1) **Small Parcel** – Mid year, the small parcel industry continues to be plagued by excess capacity, competitive pricing and legal challenges. The shift the industry experienced last summer was one of air shipments moving to the more-economical ground shipments to deal with rising fuel prices. Most people expected this trend to reverse itself as fuel settled to a more feasible level, but it seems this temporary trend has become permanent. While this shift is advantageous to shippers, it has had a detrimental impact on carriers' margins. Pricing remains extremely competitive amongst carriers as they look to rebuild network density and has recently produced savings of eight to 15 percent for shippers through competitive negotiations. Some carriers may feel incited to increase pricing in an effort to recover lost margins but many admit that it is often an unsuccessful strategy when there are feasible lower-priced substitutions in the market. While many shippers are seeing the benefits of the softened market conditions, it should be noted the average sourcing timeline has increased over the last two quarters from 12 weeks to 16 to 20 weeks. The extended timeline has been driven by carriers requiring more time to submit proposals as they examine margins closer. Changes to DHL continue to unfold as it was announced that their U.S. hub will be moved from Ohio to Kentucky. DHL also announced that all talks between UPS and DHL that would have UPS carrying DHL air freight have stopped.

2) **Truckload** – The Truckload market has seen little change to the market in the past few quarters. The industry is still facing a situation of over-capacity, low volumes and aggressively low rates, however many analysts feel the worst declines are over and the market will remain flat until mid 2010. It is estimated that an additional one percent of capacity was removed from the market in the last quarter, but the removal of an additional five to six percent would be needed to have a meaningful impact.

According to the American Trucking Association's (ATA) For Hire Truck Tonnage Index, tonnage increased for the first time in May by 3.2 percent. However this increase was not enough to recoup the cumulative loss of 6.7 percent experienced in March and April. Year-over-year tonnage is down 11 percent, but this is a slight improvement from April's negative 13.2 percent. Despite the improvement in tonnage, overall shipments have not fared as well. ATA reported a four percent drop in their seasonally adjusted load index, dropping the index to its lowest level since November 1997. Recent dynamic events have produced aggressive savings in the range of eight to 14 percent.

3) **Less than Truckload** – The Less than Truckload industry continues to face the same market conditions as previous quarters, limited demand and over-capacity. Analysts are predicting rates will continue to drop through the remainder of 2009 with little hope for an upturn in freight demand. Savings results through competitive bidding reflect the low rates with results on average of eight to 12 percent. One noticeable trend is the continued interest by carriers to get very creative in order to attract and secure freight. Con-way Freight recently announced "True LTL Pricing" service, which caps the carrier's LTL rates below typical truckload shipment costs. Con-way discovered that for larger, heavier LTL shipments, they were losing potential freight business as customers found it was cheaper to utilize a truckload provider.

The industry is facing the predicament of removing capacity to meet freight demand while remaining poised to immediately capitalize on freight improvements. While many analysts state pricing will remain down until additional capacity is removed from the market, other analysts are concerned that carriers will not be able to rescale to meet rising freight demand later if too much capacity is removed now. While there is hope that the industry will start to improve in 2010, the rebound will be a long drawn-out process as freight volume is only expected to improve by a few percentage points in the next year. According to the ATA, the industry has not seen much net improvement, as illustrated by conflicting April statistics of an improvement of overall LTL shipments by 0.3 percent while tonnage fell 0.5 percent.

4) **Ocean Freight** – Following similar trends as last quarter, demand continues to slump for containerized freight—resulting in unprecedented low rates. The Port Tracker report by IHS Global Insight and the National Retail Federation state that freight levels in the U.S. remain down in April, making it the third-slowest month in the last five years. While April's volume was higher than the first quarter of this year, it remained below the one million container level at 990,632 Twenty Foot Equivalent Units (TEUs). Through April, U.S. port containerized imports are down 22.6 percent but analysts are indicating that the worst may be over. Trans-Pacific trade has been continuous, increasing since February when the U.S. West Coast Ports hit rock bottom and only handled 483,833 TEUs. Subsequent volumes have consistently increased—reaching 622,329 TEUs and 624,638 TEUs in March and April, respectively.

Shippers continue to take advantage of the softened market conditions as sourcing activity continues year-round instead of the normal November to April sourcing season. Negotiations this quarter reflected savings of five to 12 percent. Reports indicate rates are down 50 to 60 percent despite the fact that many carriers are issuing rate increases across the board to help minimize losses. Carriers are not the only one being affected by the softened market condition as channel partners

are also feeling a trickle-down effect. In May, the Panama Canal Authority announced a temporary rate reduction for ships utilizing the canal. Container ships carrying less than 30 percent capacity will pay the reduced rate that is normally offered to empty ships.

While the industry faces record-low freight levels, some international ports are still crippled with port congestion. Ports in the Middle East such as Jeddah Islamic Port in Saudi Arabia, which is one of the largest ports in the region, have historically faced dramatic port congestion levels. In order to alleviate the congestion, there are plans under way to create a new container terminal by October, the Red Sea Gateway Terminal, which will expand capacity in the region by 45 percent.

5) **Air Freight** – After many quarters of reporting continuous downward slides, the air freight industry appears to have hit the bottom. Since December of 2008, the industry has seen five consecutive months resulting in a decline in demand by more than 20 percent. The International Air Transport Association (IATA) admits that freight levels are still at a shockingly low level, but the consecutive months of similar decline may be an indication that the worst is behind the industry. Although freight levels for April are down 21.8 percent year over year, the corresponding May values show an improved 17.4 percent decline. All regions have seen considerable declines, with Middle Eastern carriers performing the best in April with a 3.7 percent decline and Latin American carriers showing the worst decline of 21 percent. Recent sourcing activities have reflected the decline in freight as carriers offered savings ranging from six to 10 percent. Despite freight declines bottoming out, IATA did recently increase its June forecast to \$9 billion, up from its \$4.7 billion forecast for June that was made in March. The industry should expect a very long and slow comeback as the industry tries to rebound to previous demand levels. Some analysts feel it may be three or four years before the industry reaches a comfortable level. In an effort to hasten the recovery period, carriers have been aggressively removing capacity from the market to better match freight demand.

## Additional Active Categories

Category	Avg. Savings	Comments
3PL Services	3 - 8 percent	As companies continue to focus on core competencies and try to minimize internal resources, supply chain organizations are seeing increased outsourcing or reduced headcount. Many third party providers (3PL) are reporting significant pipelines of new and existing customers.
Roll-On Roll-Off (Ro-Ro) Ocean Freight	5 - 9 percent	As new vehicle sales have slowed, the routine deliveries of automobiles via Ro-Ro have started to see declines. Some ports have reported seeing nine to 16 percent drops in Ro-Ro shipments. The decline in demand has even caused some shipping companies to defer deliveries of new Ro-Ro vessels.
Warehousing	2 - 5 percent	In alignment with the global recession and a faltering transportation industry, the warehousing market has continued the struggle. According to Colliers International, a leading global real estate services firm, the national industrial vacancy rate increased from 8.9 percent at the end of last year to 9.57 percent at the beginning of the year. The introduction of new storage space has slowed considerably in correlation with the decline of the construction market.

## Market Buzz and Trends to Watch

### UPS vs. FedEx – Union vs. Non Union

UPS and FedEx are currently in a head-to-head battle, but this time not over freight. The argument at hand surrounds FedEx's labor laws. FedEx currently falls under the Railway Labor Act (RLA), which makes labor organization more difficult. FedEx cannot be unionized on a location by location basis; it must be done through a company-wide vote. Unlike FedEx, UPS is governed by the National Labor Relations Act, which allows for unionization at the local level. Provisions to change Fedex's status were included in the FAA Reauthorization Act, which was recently passed by the House of Representative and waiting to be voted on by the Senate.

*Ariba's Take:* It does seem fair that companies that are performing similar operations receive the same treatment, in this case the

same government designation. However, since the U.S. small parcel market is currently structured as a duopoly, the fear exists that the union could easily affect price and service in the form of work interruptions. It will be interesting to see the outcome of the Senate vote as similar bills have died in the Senate in the past. However with new administration in office, many feel that there is a very high likelihood that this one will pass.

### Yellow's Uncertain Future

Like many trucking companies, YRC Worldwide has been struggling with low freight volumes. However, as the largest trucking company in the United States, YRC's woes have gained much more publicity than their competitors. Over the last few months, the industry has watched YRC try to reorganize and recover. Recently they received approval from their pension fund to use some property as collateral instead of cash payments. The company also announced plans to ask for \$1 billion in bailout money from the Troubled Asset Relief Program to help the company cover pension obligations. YRC also entered into labor modification talks with the Teamsters to help reduce its overall cost structure, preserve cash flow and prevent bankruptcy. A tentative deal is said to have been reached, however details will not be released until information is provided to union members.

*Ariba's Take:* YRC Worldwide has changed leadership, closed facilities, reduced jobs and announced pay cuts, yet it still does not seem to be enough to give the trucking company sufficient breathing room. In the midst of implementing major company integration, YRC's freight is down 30 percent in the first quarter of this year alone. Unfortunately, it seems like the cards are stacked against YRC and the hole that they are in is still too deep for them to get out of unscathed. Many analysts feel they cannot avoid some form of bankruptcy restructuring. When the trucking industry starts to show signs of constant improvement, there is little doubt YRC will still be in existence, however there is little certainty regarding the resulting form and fashion of the company.