BUSINESS EXPECTATIONS SURVEY

TRANSPORT CAPITAL
PARTNERS

Optimism for Volume and Rate Increases Continues to Grow, but Rates Remain Flat

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FOURTH QUARTER 2013

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Transport Capital Partners, LLC
Business Expectations Survey Results

Fourth Quarter 2013

Since the 2nd Quarter of 2008, Transport Capital Partners' (TCP) quarterly Business Expectations Survey (BES) has been a frequently quoted bellwether of the American trucking industry. By taking the pulse of trucking company executives across the country, the survey asks core questions every quarter on recent rate trends, future volume and rate expectations, and interest in buying or selling their firms in the future. Topical questions are also incorporated in each survey depending on current events, with previous topics including credit and financing, equipment issues and plans, drivers, new regulations, trade cycles, and other fleet sentiment opportunities and concerns. This is coupled with observations of TCP partners and associates engaged in advisory activities throughout the industry.

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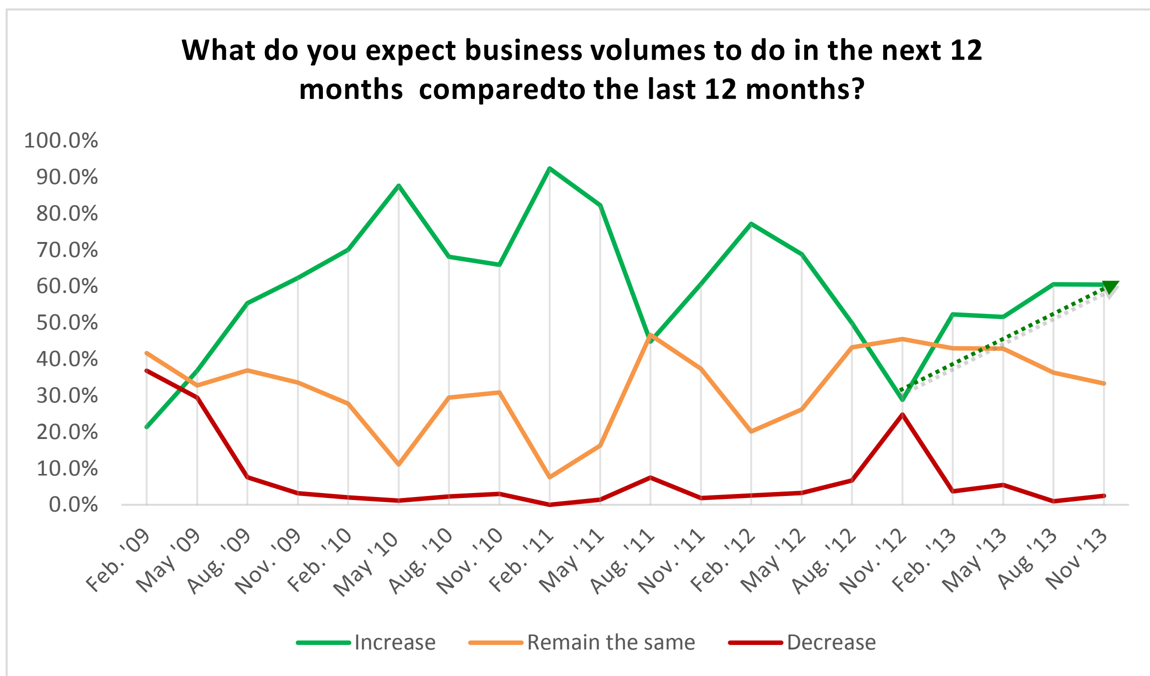
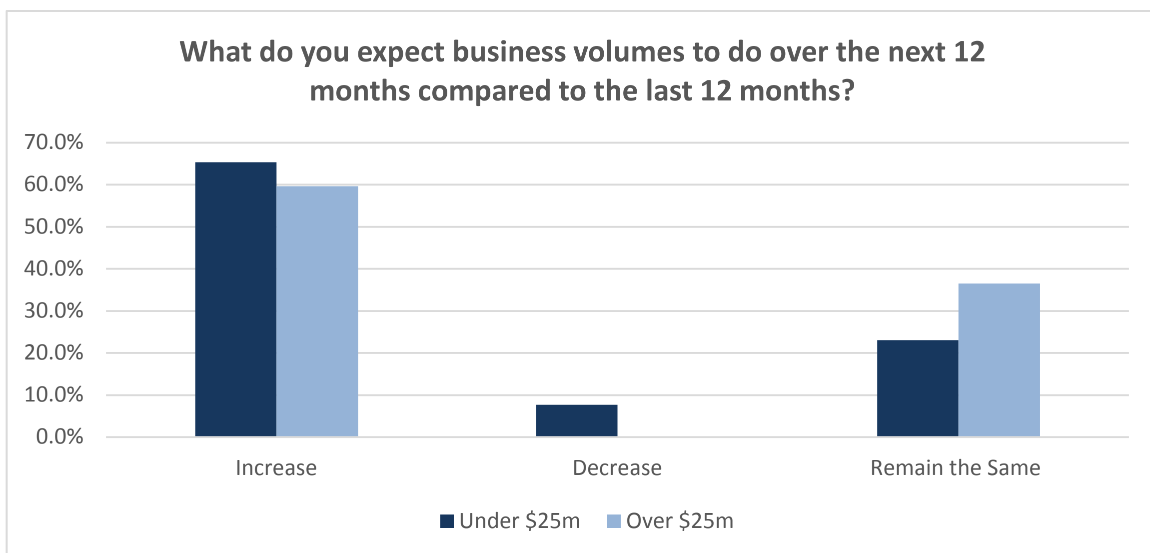
Optimism for Volume and Rate Increases Continues to Grow, but Rates Remain Flat

More carriers are now optimistic that volumes will increase over the next 12 months. The slow, but upward, growth in the economy has moved the freight market to a higher level. As a result, carriers in this survey, and in conversations with TCP, sense an improving marketplace. Since the Fourth Quarter last year, positive expectations have increased from 29% to 61%. Larger carriers (those grossing more than $25 million per year) are more likely to expect volumes to remain the same than smaller carriers – 37% vs. 23%





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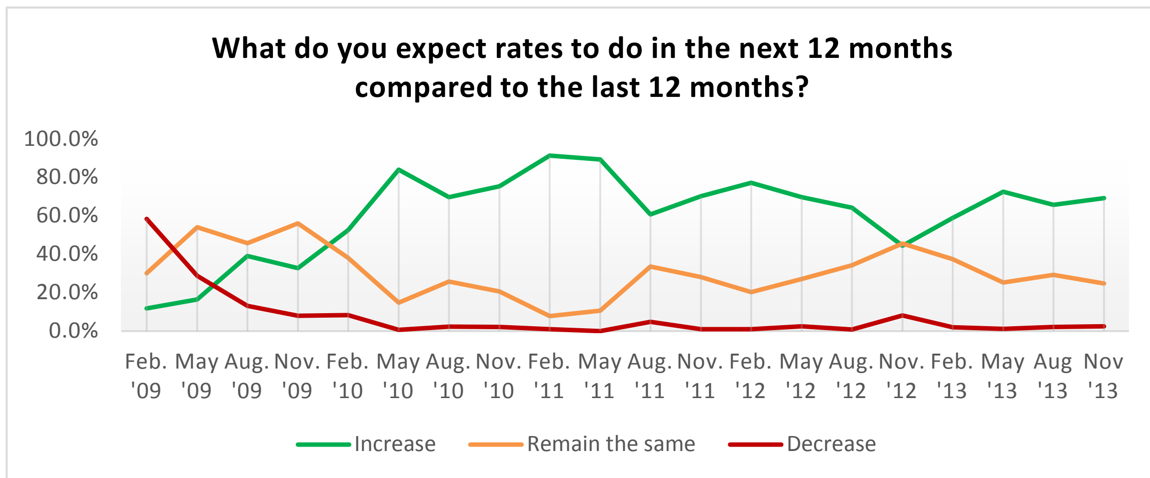
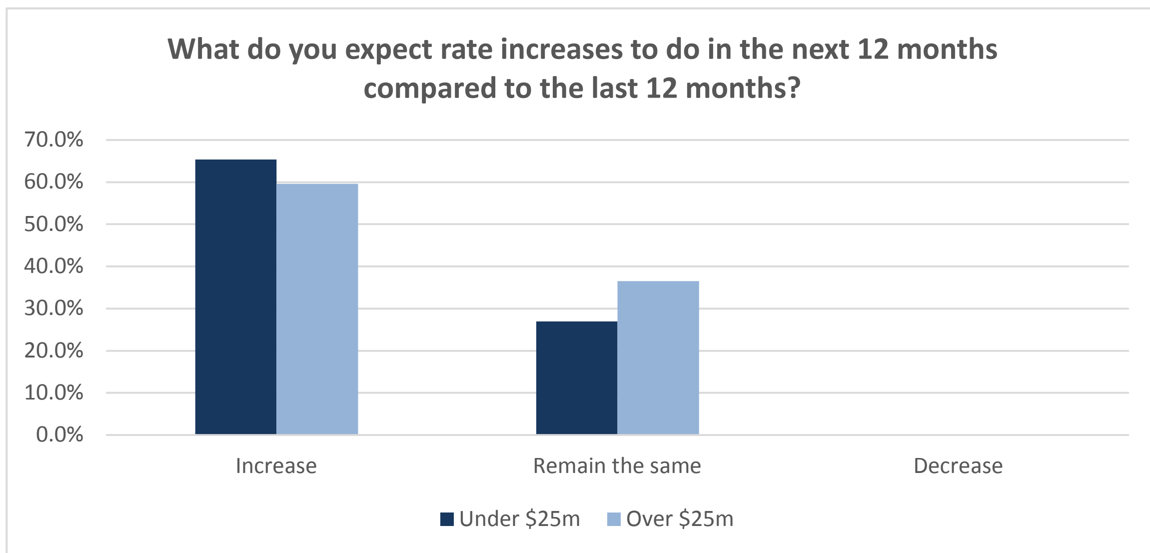
It follows from expectations of increased volumes that rates will also increase. Indeed, a majority of carriers in this survey do expect rates to increase over the next 12 months. Carriers optimistic about rate increases represented almost a 3:1 majority over pessimistic carriers (69% vs. 25%). Smaller carries expect rate increases slightly more than larger carriers (65% vs. 60%). Historically, smaller carriers have been the more optimistic about rate increases, despite their actual numbers not always reflecting those increases.





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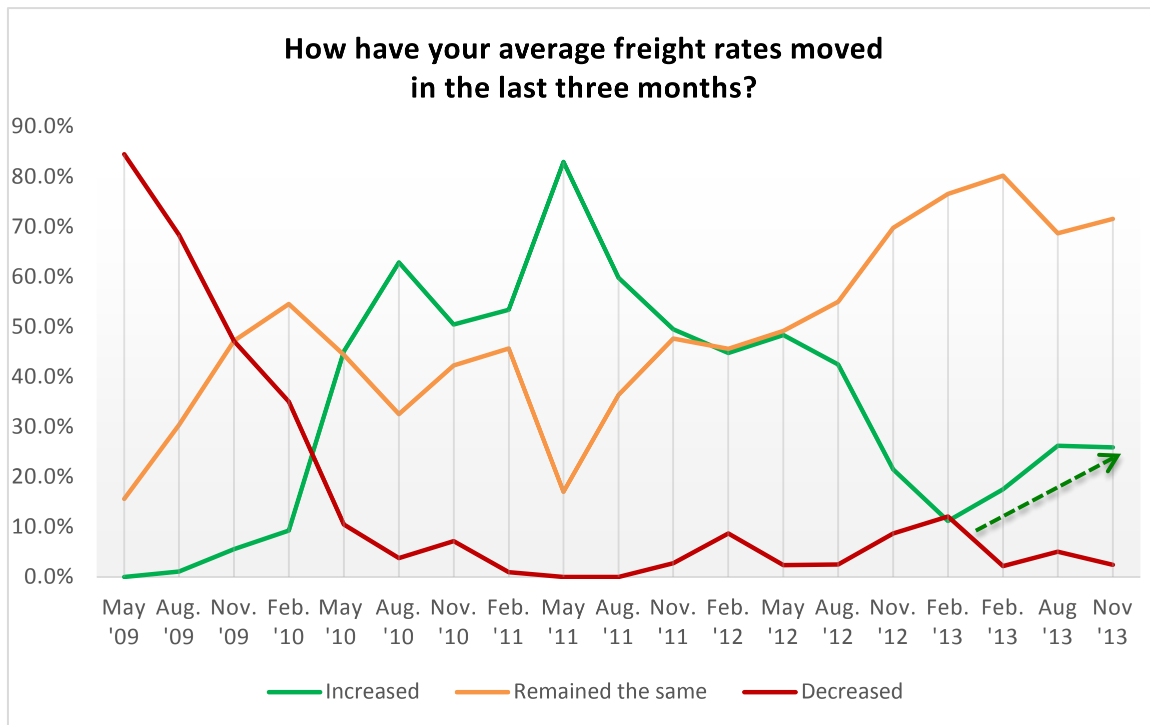
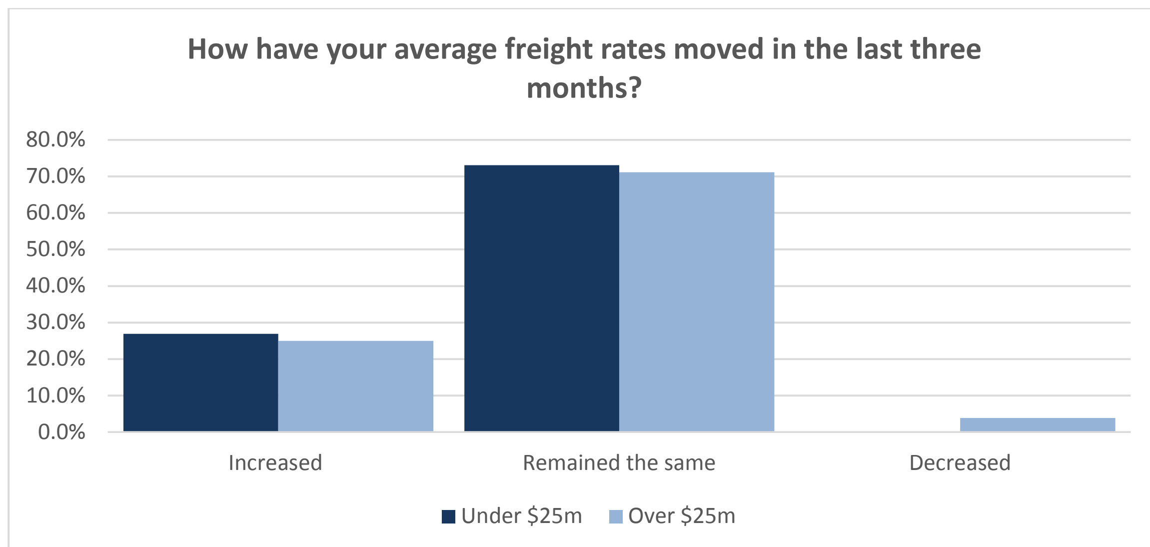
With 1- to 2-year economic growth projections staying in the low single digits, carriers are still not seeing their optimism on volumes and rates translate into rate reality. The exceptions to this are in construction, petroleum, and seasonal freight. Since February 2010 (16 quarters), more than 50% of carriers have expected rates to increase (see graph above). However, it is only since February 2013 that rates have actually risen, and even then, only for 26% of the respondents. That number is still far below two years ago when 50% of the carriers were seeing rate increases. Seventy-two percent of carriers saw rates remain the same for this quarter.





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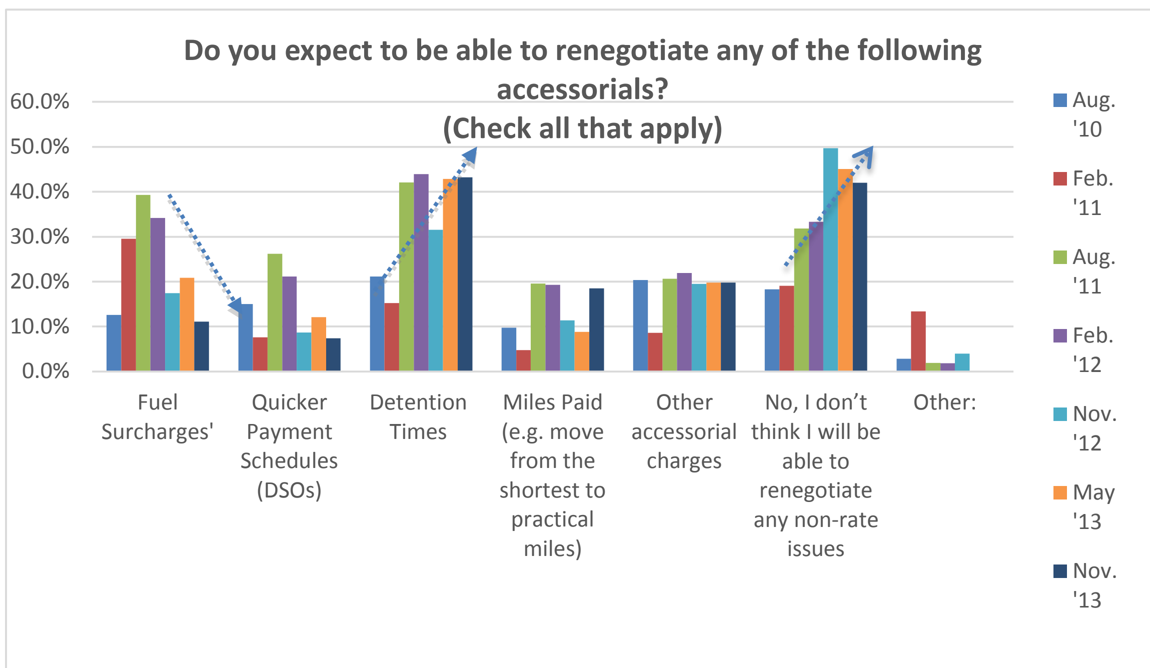
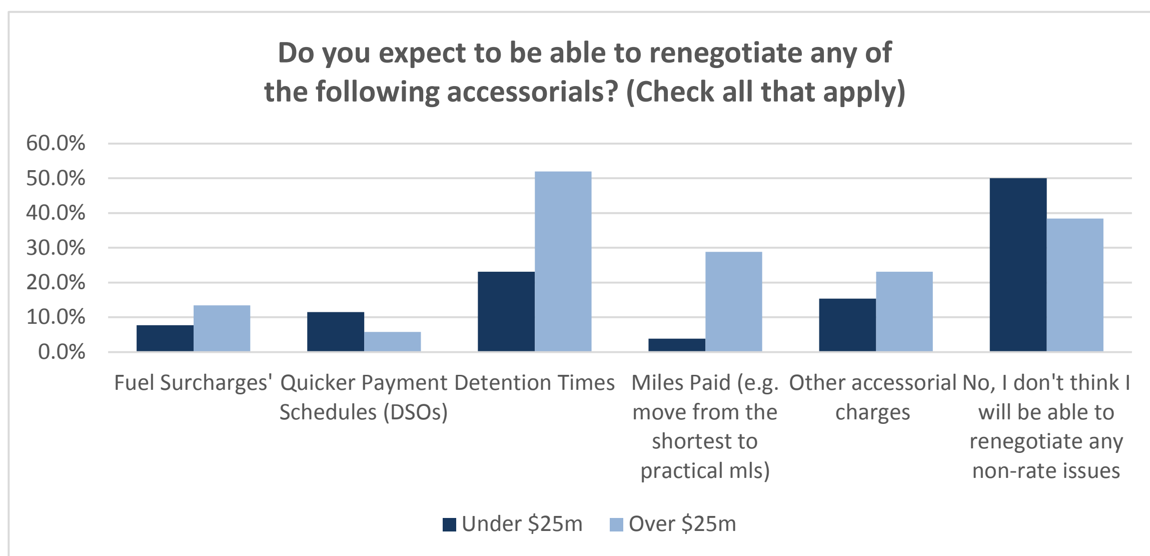
With the continued lack of rate increases in the industry, carriers may have looked to raise income through renegotiating accessorials. Unfortunately, 42% of carriers do not expect to be able to renegotiate. This is down slightly from the past two quarters.

The last two years have seen the number of carriers able to raise fuel surcharges drop from 30% to 11%. Conversely, 43% now expect they can renegotiate detention times. While renegotiating detention times does not necessarily raise cash, it may make carriers' equipment more productive. Interestingly, about 30% of the larger carriers also think they can renegotiate miles paid (i.e., move from shortest route to practical route). Were this to materialize, the impact on revenues - even with steady rates - would be significant. Pessimism about accessorials is greater among the smaller carriers ranks than the larger carriers (50% vs. 38%).





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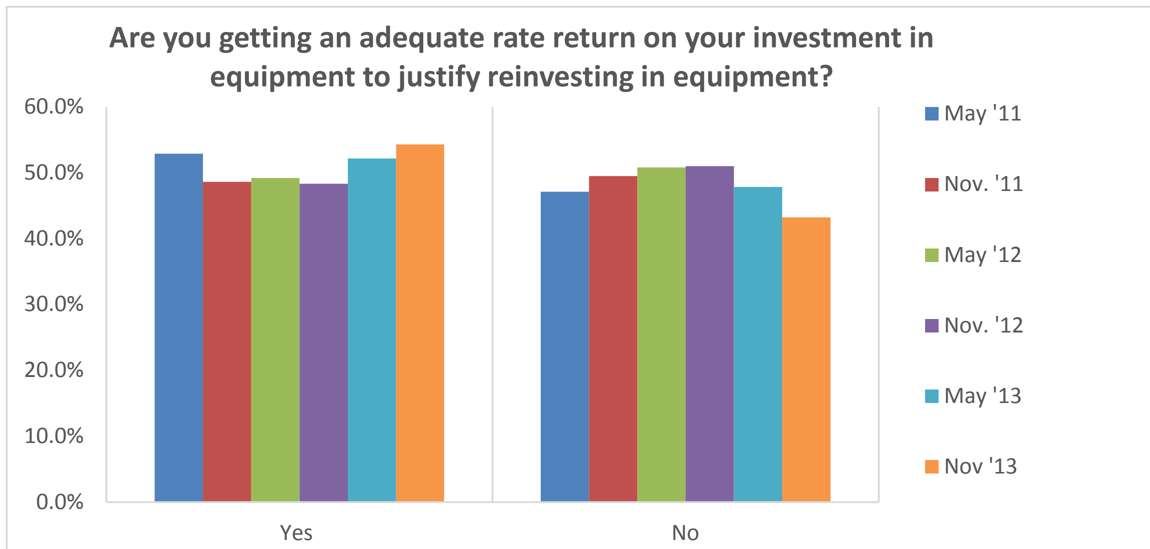
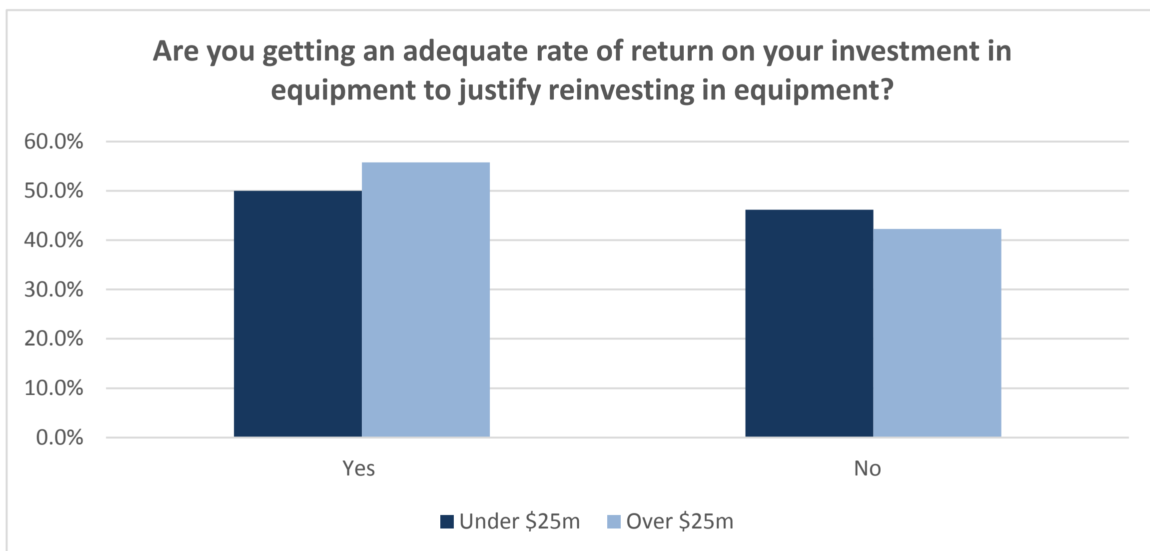
Even with the problems of increasing rates and static accessorials, slightly more than half (54%) of carriers indicated they were getting an adequate rate of return - the highest level yet for this survey. But this percentage is not entirely encouraging. Forty-three percent still believe they are *not* getting an adequate return. The issue may lie in how carriers define “an adequate rate of return”. What is “adequate” for one carrier may be “inadequate” for another. Larger carriers are slightly more likely to say “yes” than smaller carriers – 56% vs. 50%. For the industry to thrive, and not just survive, a large percentage of the carriers must be making adequate rates of return to afford the investment in equipment and support services required by modern supply chains.





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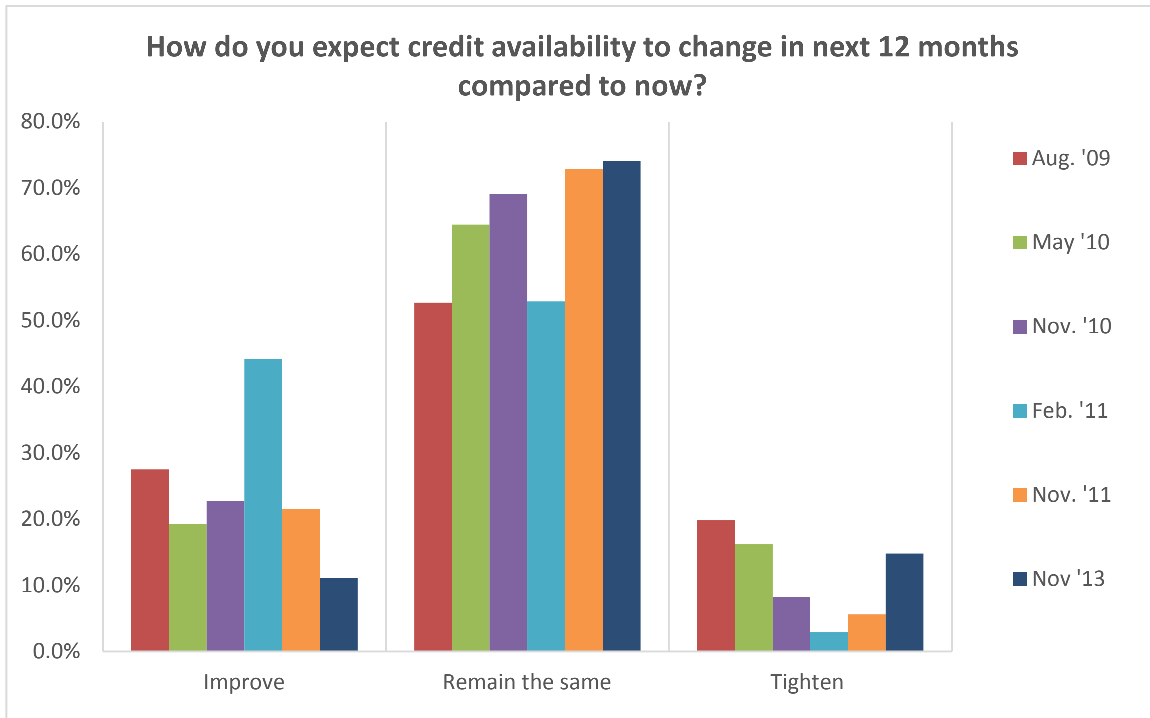
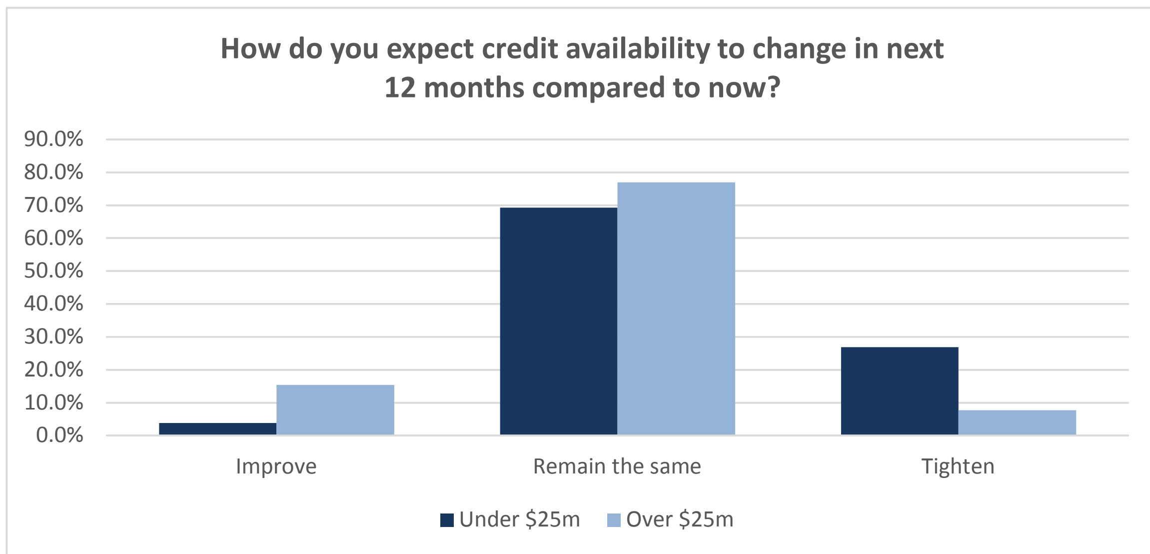
Carriers also do not see improvement in credit availability. Approximately 75% expect credit availability will remain the same – a similar number to one year ago. It appears carriers believe tighter requirements for credit is the new normal. Credit availability and carrier profitability go hand–in-hand, both are essential to replace aging fleet assets and to grow capacity. Carriers with stronger profitability and cash flows will find credit available and affordable and will be better positioned to gain market share.





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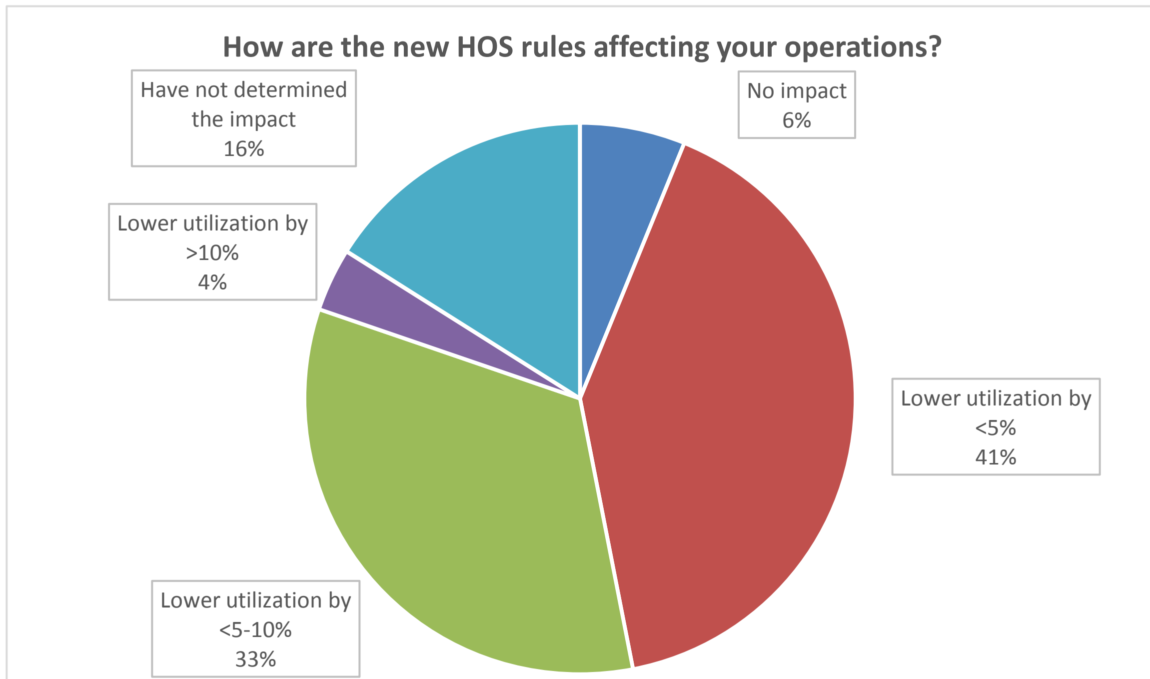
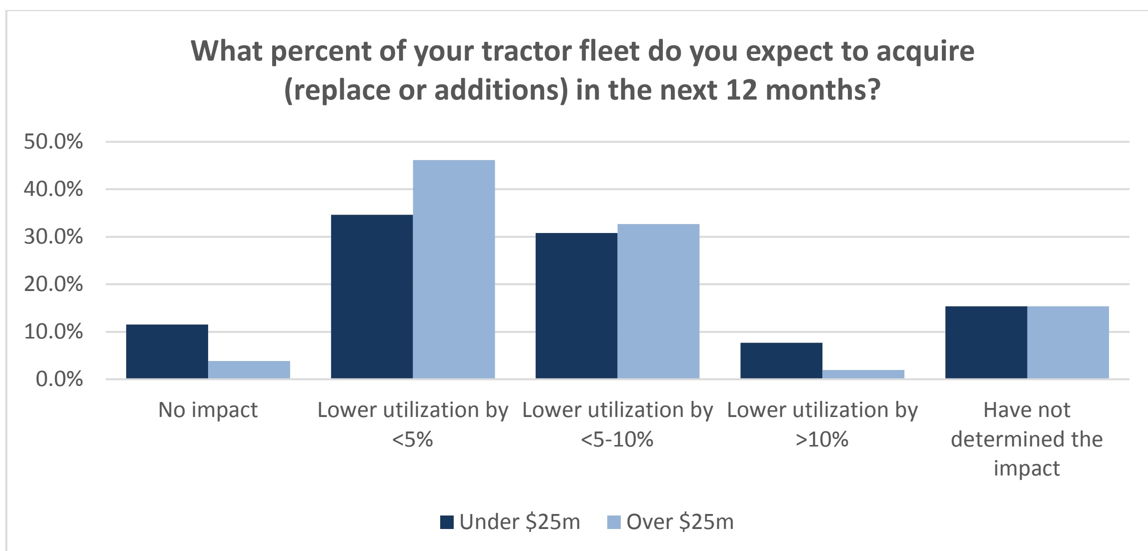
Without rate increases or improved assessorials, carriers will need to boost productivity if they are to improve the bottom line. However, the new Hours of Service regulations appear to have cut off that avenue. Seventy-eight percent report some impact on productivity. Forty-one percent expect the impact will be less than 5%. But an almost equal number (37%) say the new regulations will have more than a 5% impact. Amazingly, almost six months after the changes were implemented, 16% still have not determined the impact.





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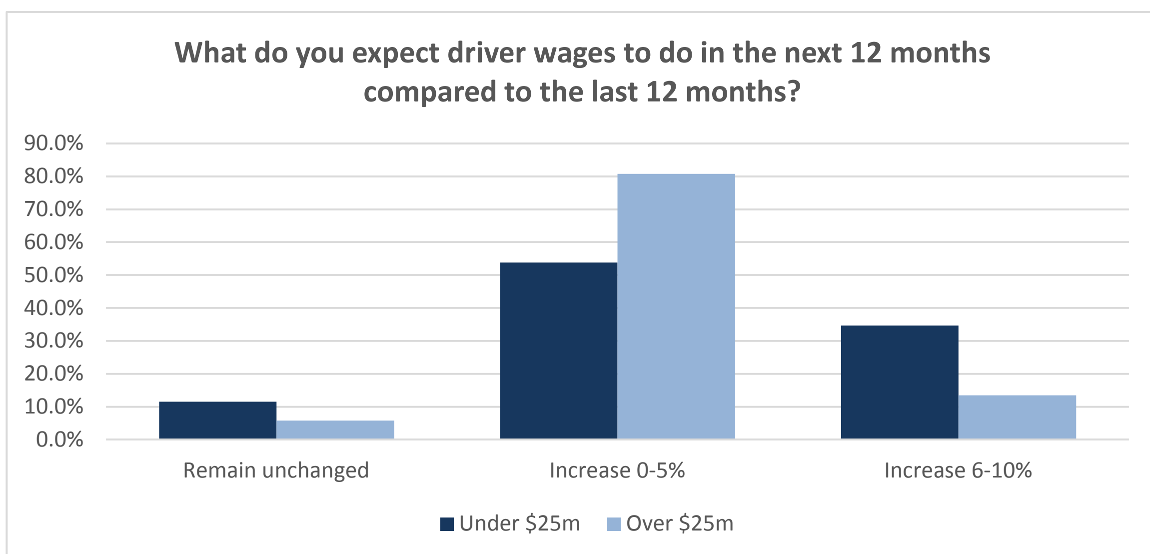
If carriers are going to lose productivity (i.e., miles) under the new Hours of Service, then *ipso facto*, driver wages will be cut. Given loss in productivity and the need to find more drivers, carriers must raise wages just to keep drivers "whole". In the current environment of static rates, do carriers believe they can raise driver wages? The answer, according to this survey, is "yes". Seventy-two percent of carriers expect to raise wages, albeit modestly from 1-5%. The expectations are not even across the board: 81% of larger carriers think wages will increase 1-5% compared to only 50% of smaller carriers. Thirty-five percent of smaller carriers think wages will increase 6-10% compared with only 14% of larger carriers. We surmise the pressure of unseated trucks and higher turnover levels may be driving some carriers to higher pay increases.



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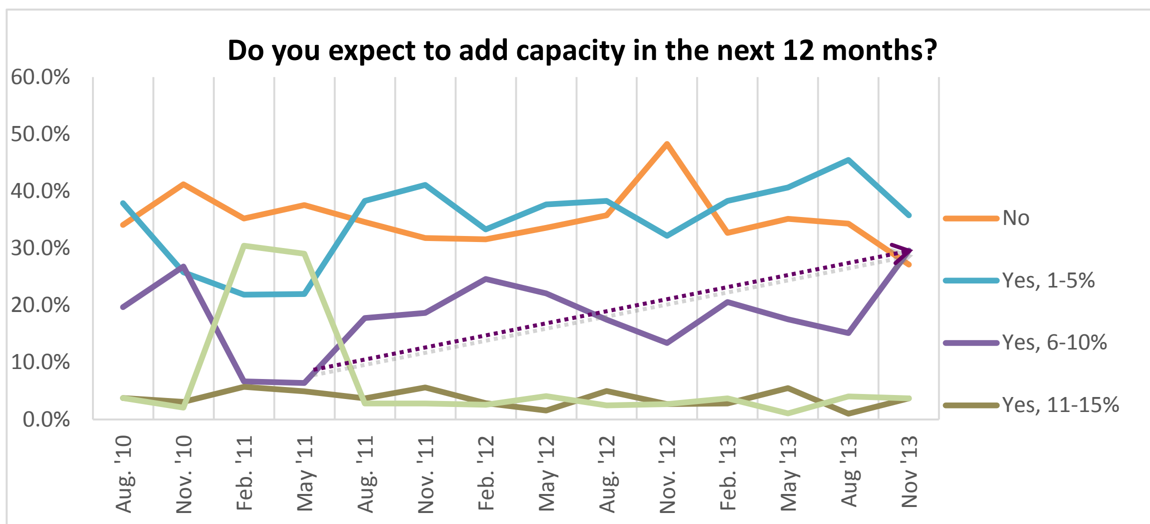
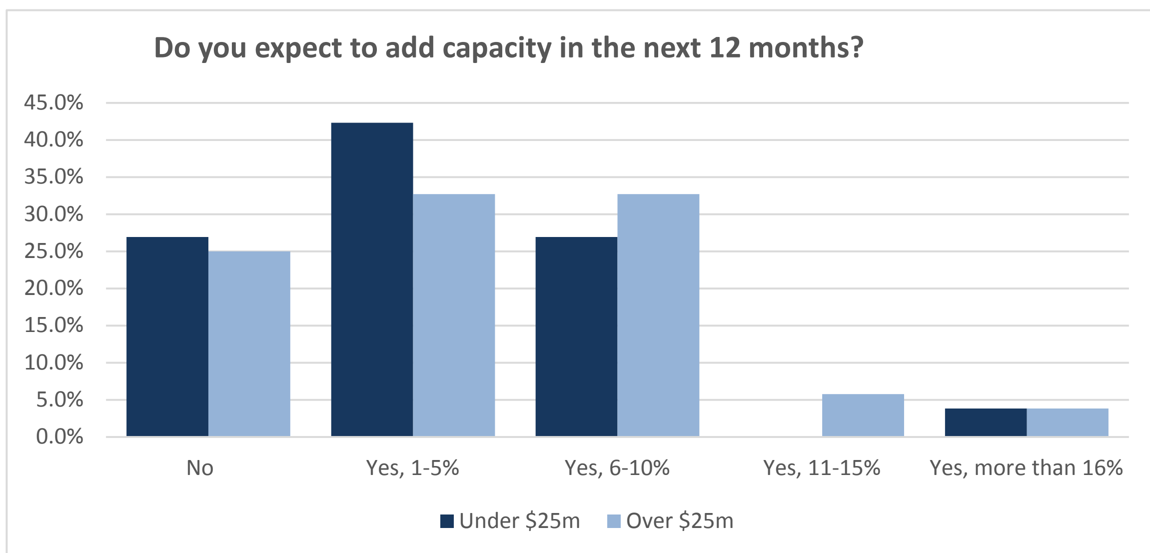
With fewer hours per day utilization of equipment, carriers will have to increase capacity in addition to increasing driver pay. Thus, the number of carriers indicating they are not going to add capacity has been trending down, now to its lowest level yet (27%). Over time, the most common estimate of adding capacity over time - by around 35% of the carriers - has been of 1-5% growth. For the first time ever, 30% of carriers expect to add between 6-10% capacity. These results are not surprising given that 78% of the carriers indicate they have lost productivity due to hours of service. Larger carriers are planning to be more aggressive in adding equipment than smaller carriers. Thirty-nine percent of larger carriers expect to add between 5-15% compared with only 27% of smaller carriers.





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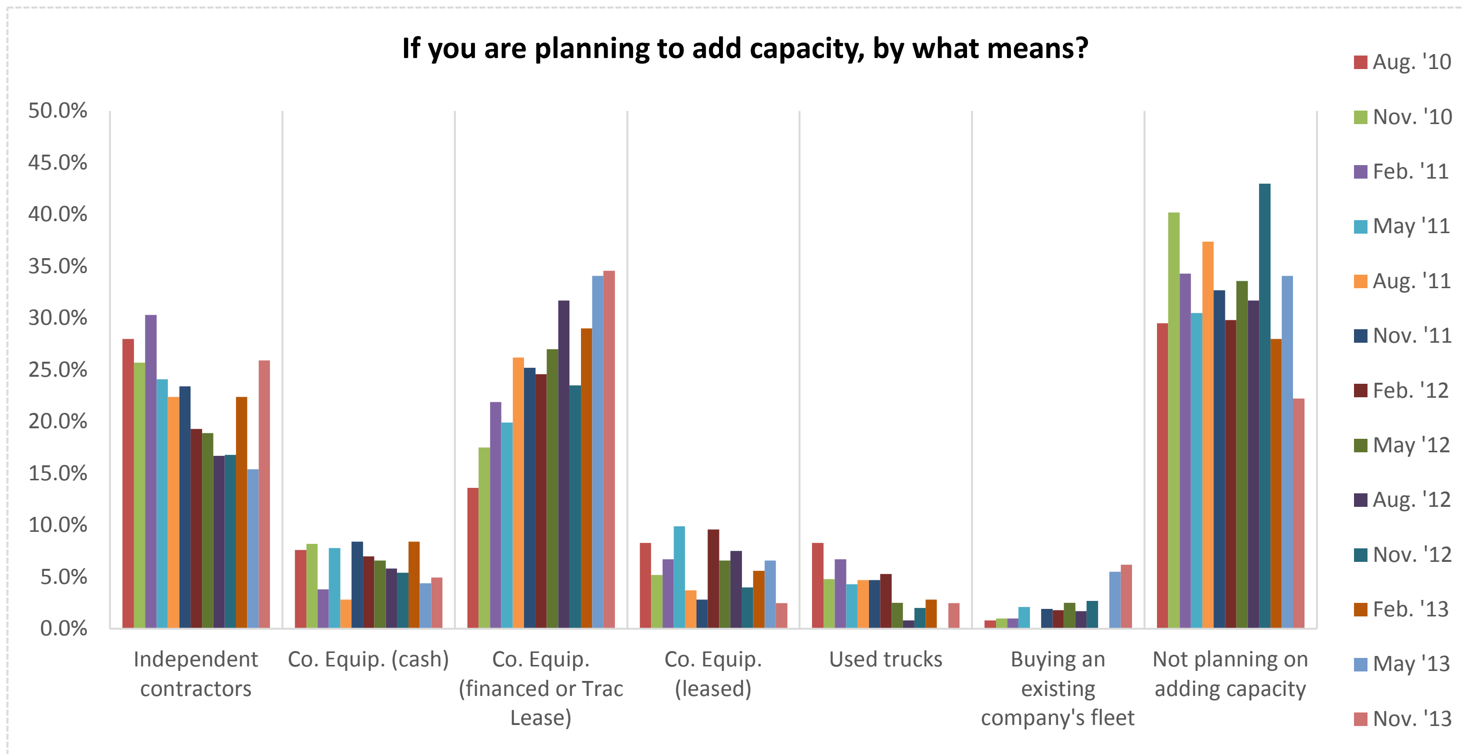
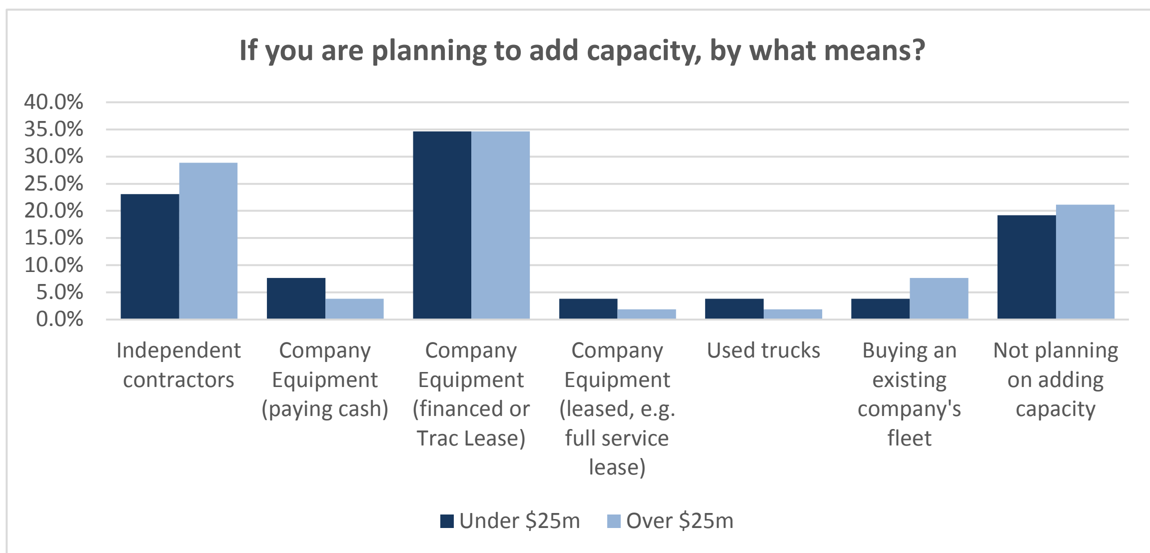
Among those intending to add capacity, the percentage of carriers planning to add capacity through the use of independent contractors has jumped 63% (from 16% to 26%). The most commonly reported method for adding capacity is through company equipment that is either financed or purchased on a Trac Lease - 35%, up from 26% last quarter. Carriers adding capacity by purchasing other carriers has increased from 0% three quarters ago to 6%. There are no major differences in the buying patterns of larger versus smaller carriers.





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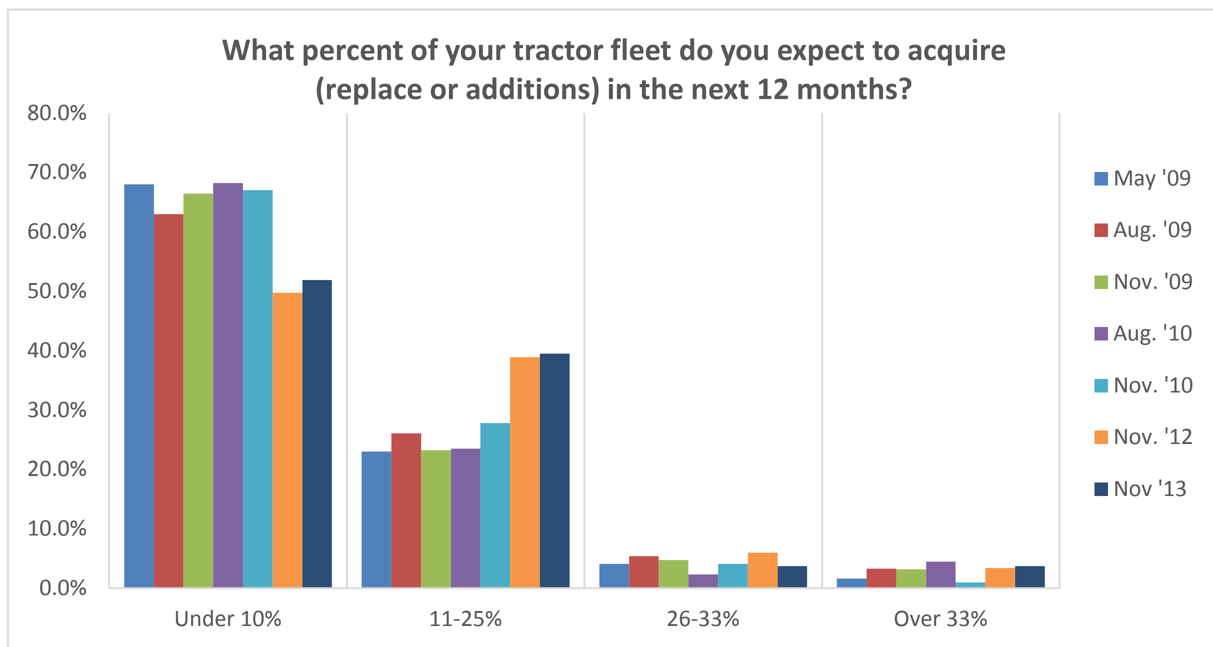
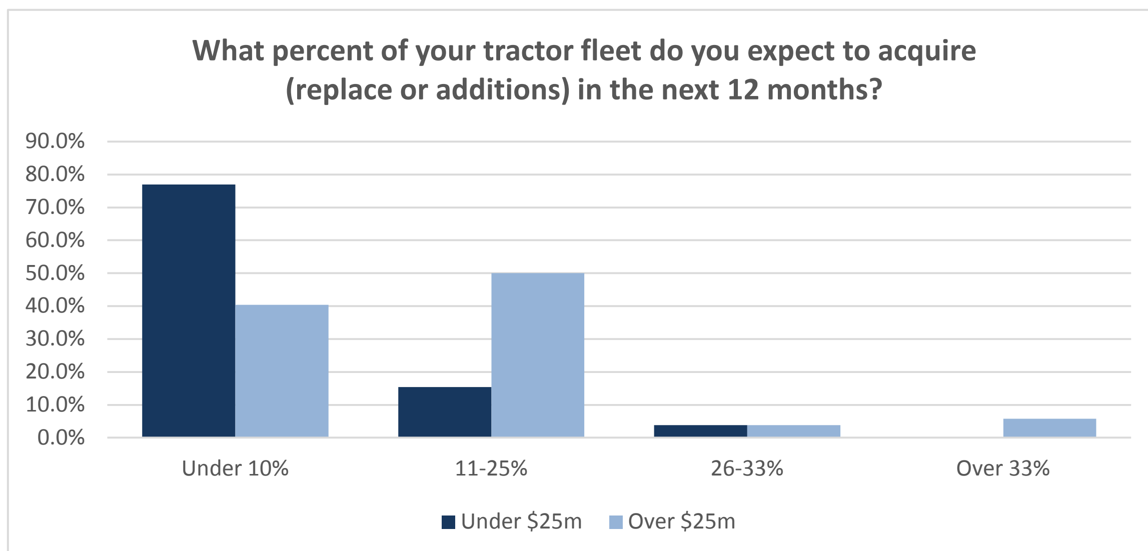
Carriers, as mentioned above, are expecting to add capacity. Not surprisingly, they are also interested in replacing their older tractors. While no one can predict what the "new normal" will be for trade cycles, almost 40% expect to replace 11-25% of their fleet this year, about the same number as last year. Only 4 percent expect to trade over 33% of their fleet. We suspect that all the 2007 pre-buy tractors are being traded out.

The difference between smaller and larger carriers is striking: by an almost 2:1 ratio, 77% of smaller carriers plan to replace less than 10% of their fleet compared with 40% of larger carriers (still a large number). Almost three times as many larger carriers expect to add 11-25% (50% vs. 15%). If smaller carriers are not able to replace older, less fuel-efficient equipment (and their higher maintenance costs), smaller carriers will not be well positioned to benefit from looming good times.





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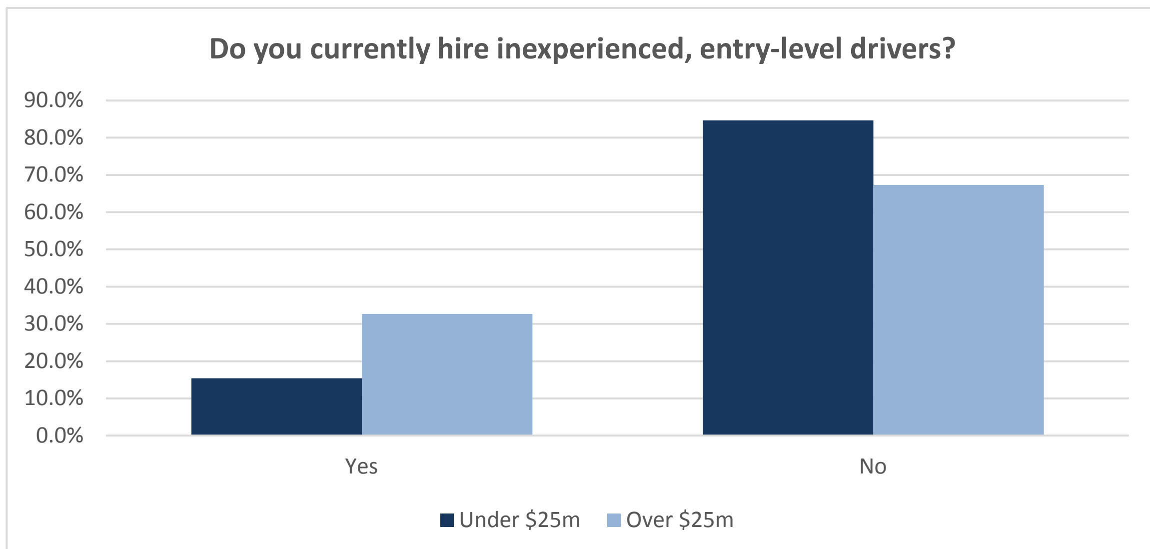
With the many changes taking place in the regulatory and economic environment, carriers are also reviewing their labor policies. Currently, less than 30% of carriers hire inexperienced entry-level drivers. But the larger carriers are twice as inclined to spend the time, money, and effort to develop entry-level drivers than are smaller carriers (33% vs. 15%).



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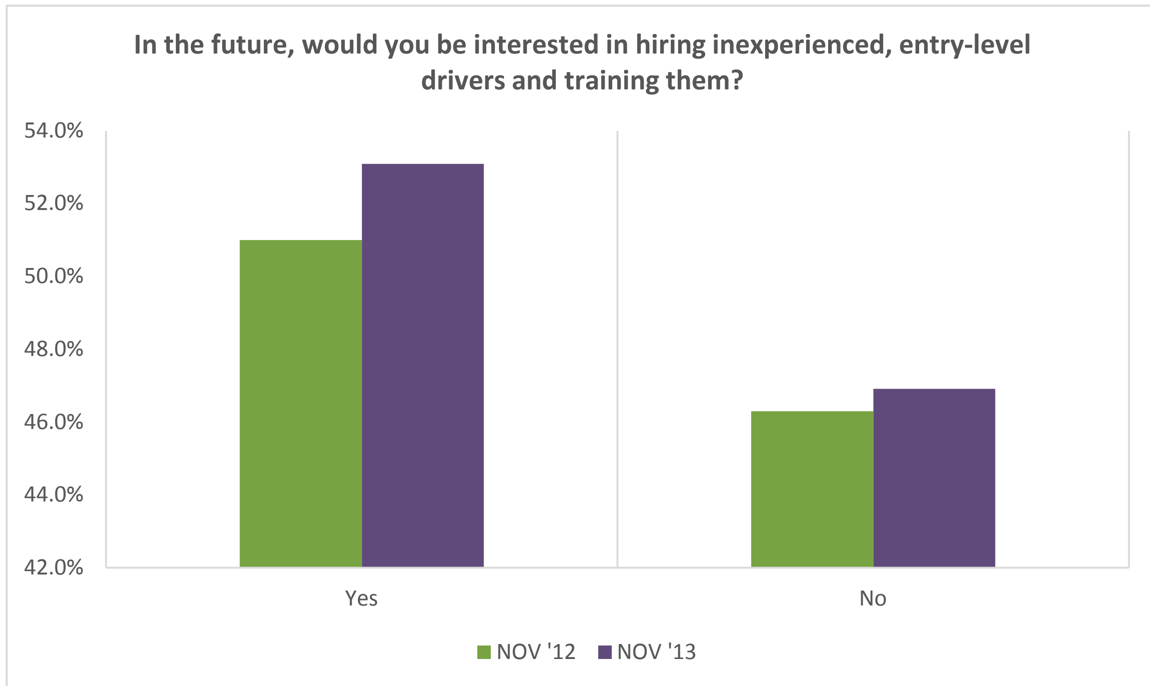
Only a third of carriers presently use entry-level drivers. In the future, that number will grow - slightly over half of all carriers expect to soon be training and utilzing inexperienced, entry-level drivers. Larger carriers see this option at a rate of over 2:1 to smaller carriers (64% vs. 25%).



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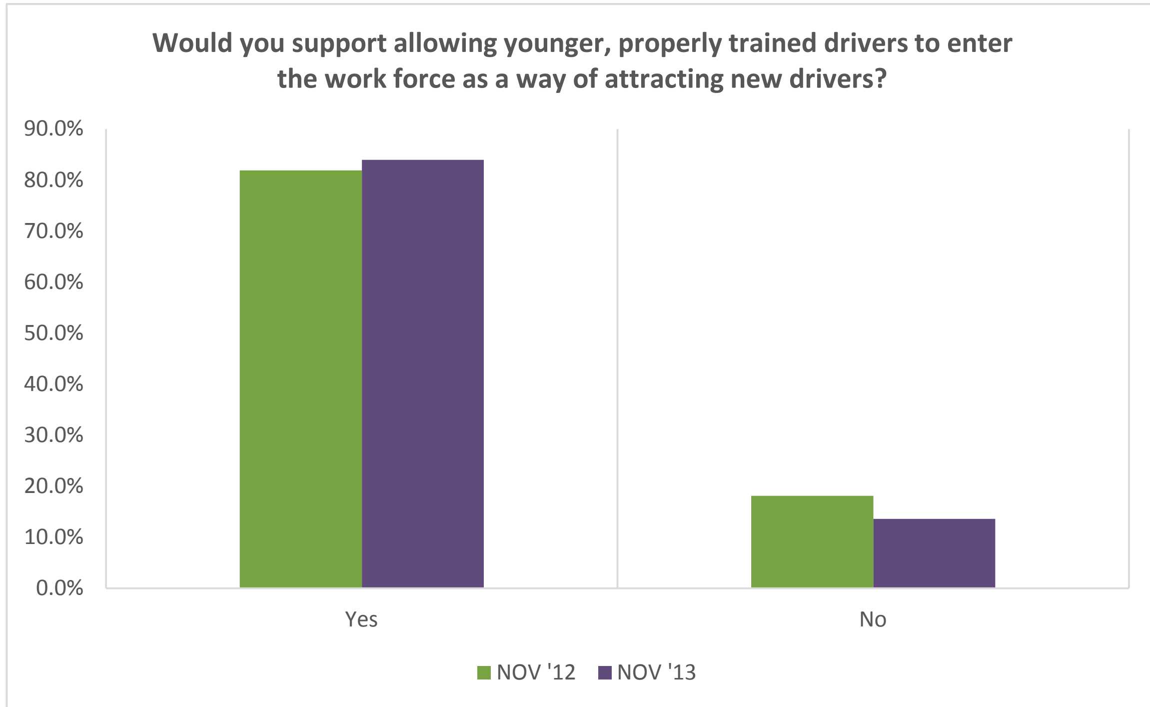
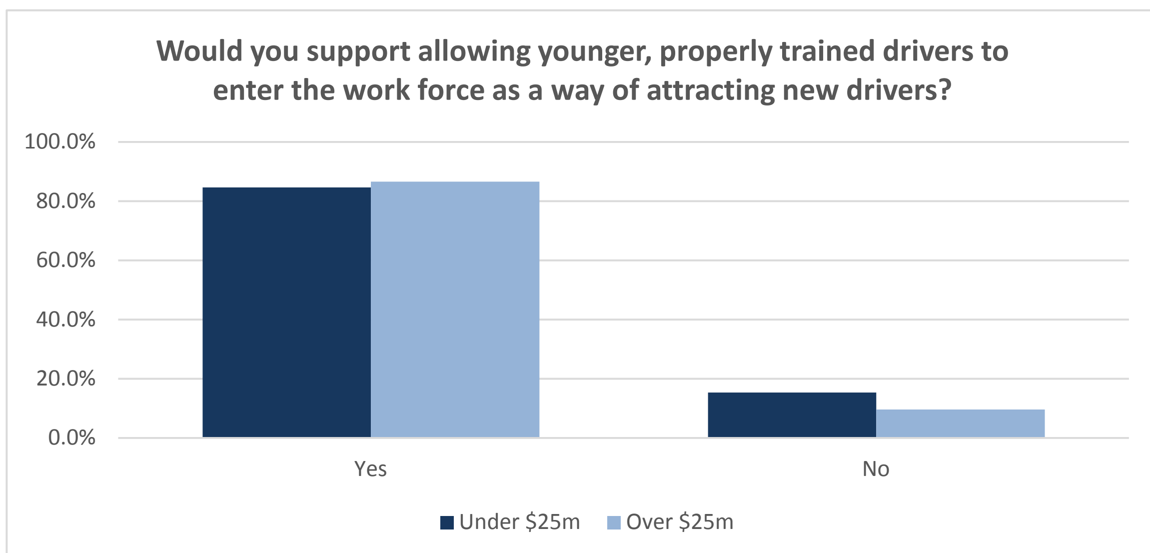
While a slight majoity of carriers are interested in utilizing entry-level drivers, a stunning 84% of carriers are willing to support allowing younger, properly trained drivers to enter the driving pool. We believe this means they support *other* carriers hiring and training younger driver so that they can then poach them. There is virtually no difference in support for younger drivers between carrier sizes.





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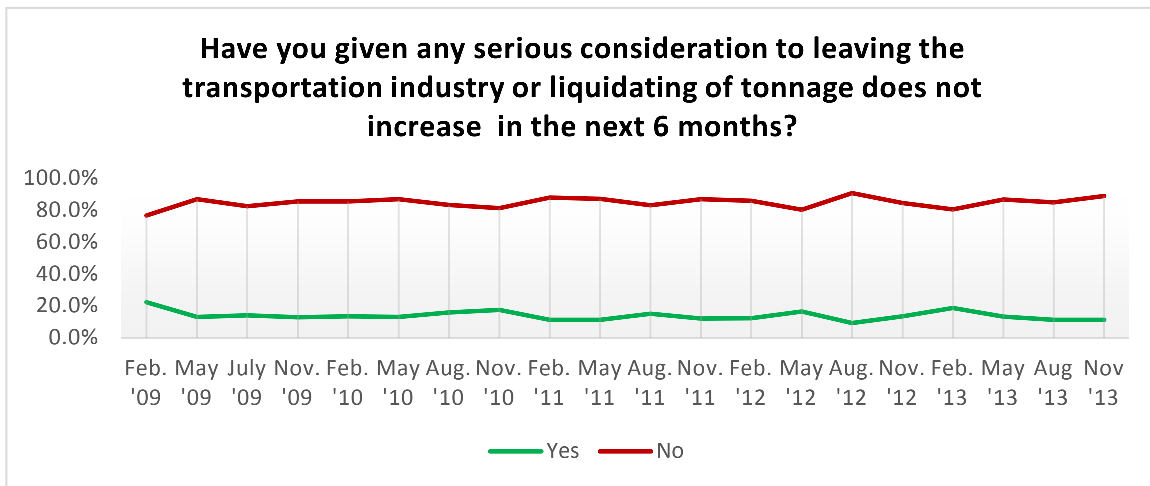
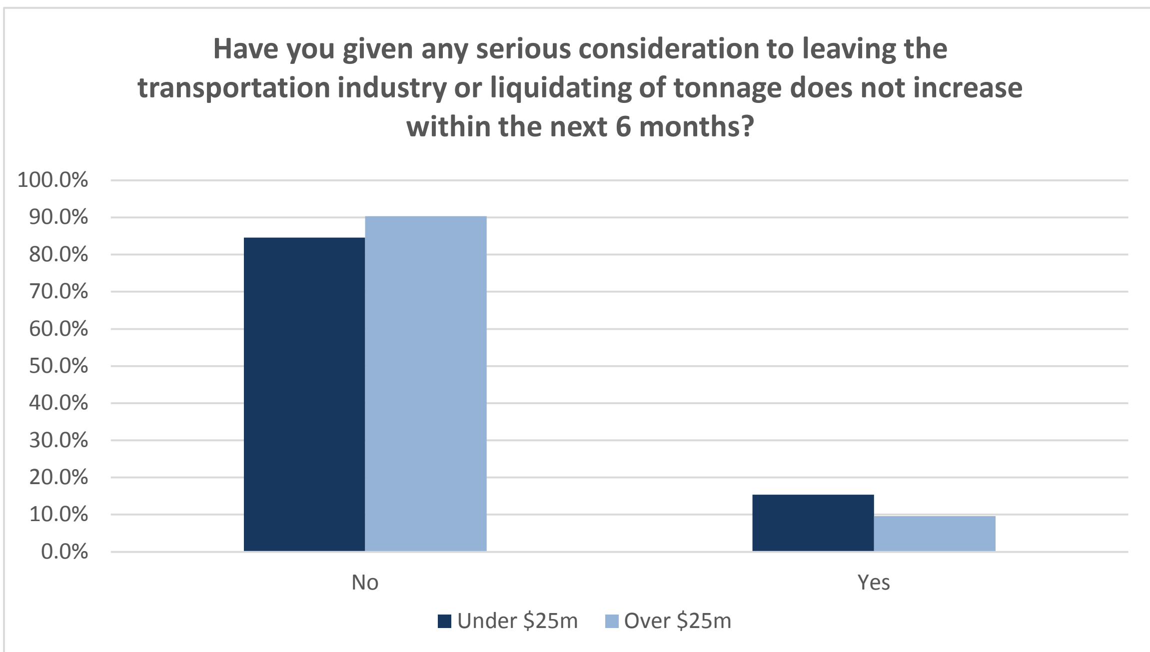
Carriers indicating they wish to exit the industry in the next six months remained at 11%, the same as last quarter but down slightly from 13% a year ago. However, 15% of smaller carriers are thinking about exiting the industry in the next six months, if revenues do not improve. This number contrasts with 10% of larger carriers. Those carriers wishing to sell their company in the next 18 months dropped to 11% - the lowest it has ever been. More smaller carriers want to sell than large carriers (19% vs. 8%). Even with all the reports of carrier acquisitions this quarter, the overall number of carriers wishing to buy a company in the next 12 months dropped slighted from 47% to 42%, with buyers concentrated among the larger carriers at 50% vs. 27%. TCP experience shows pricing continues to be a focal point, with buyers remaining conservative and hesitant to pay "blue sky" except for carriers with excellent operations or significant strategic benefits.





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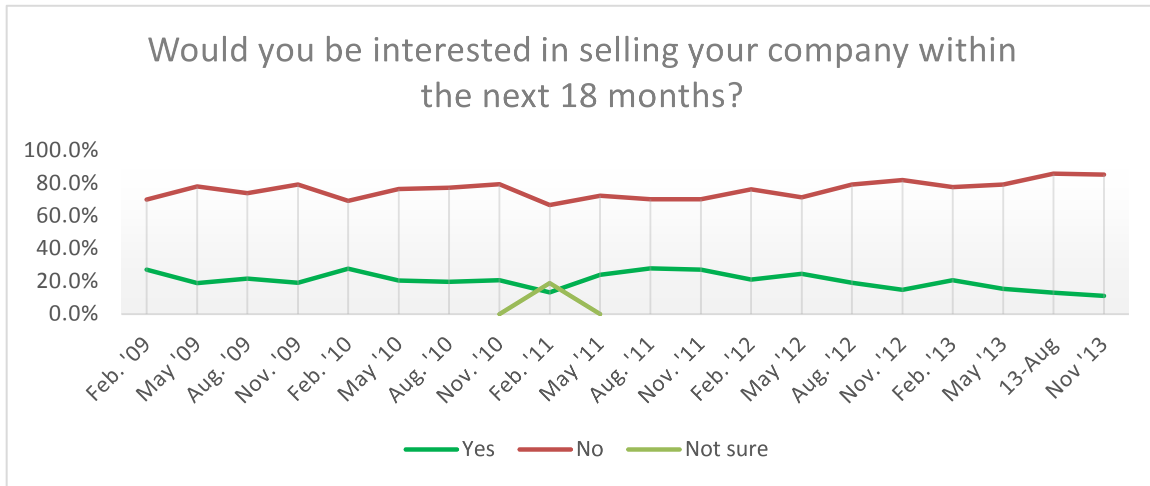

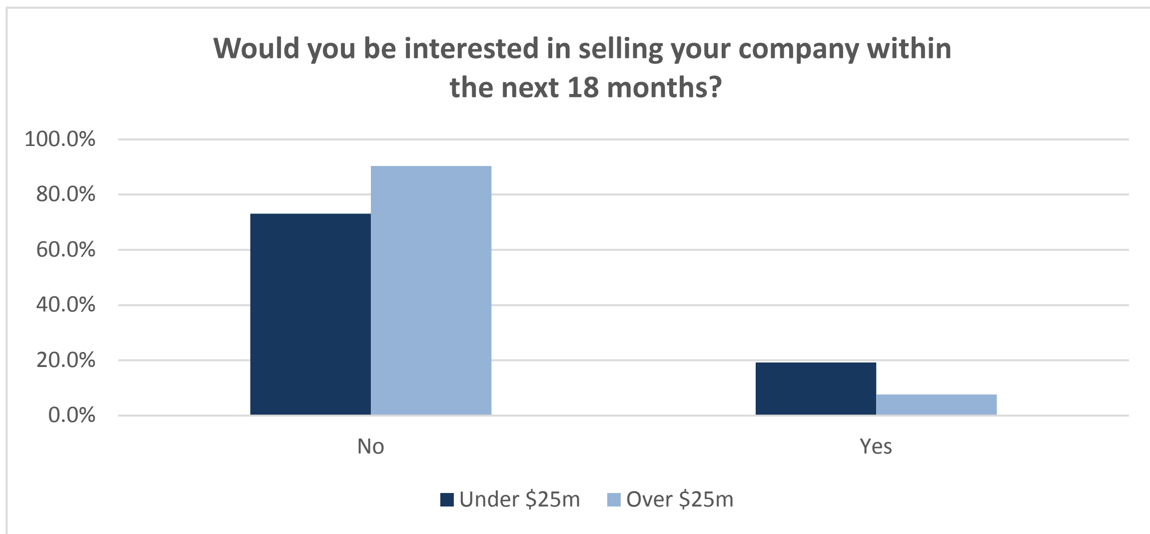

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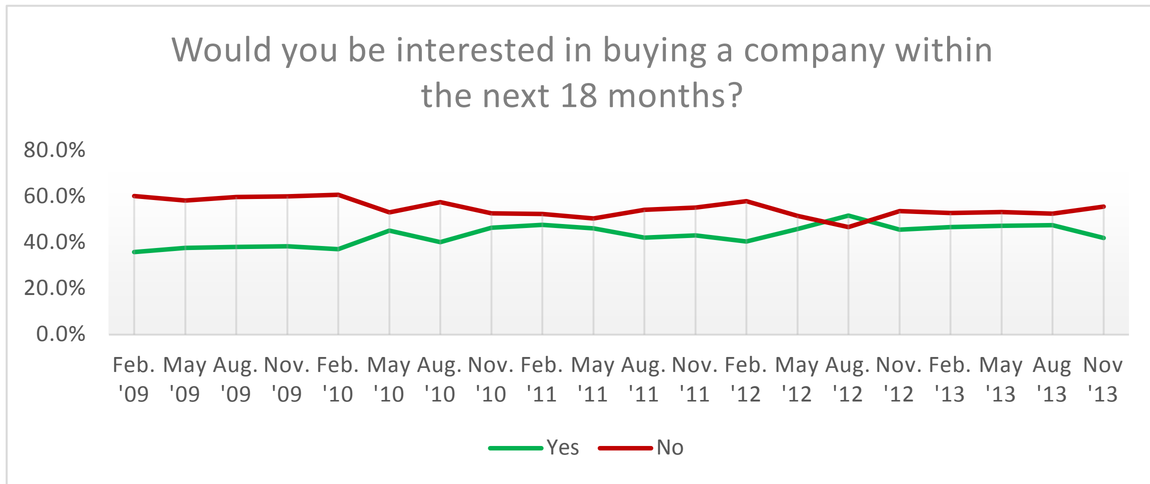

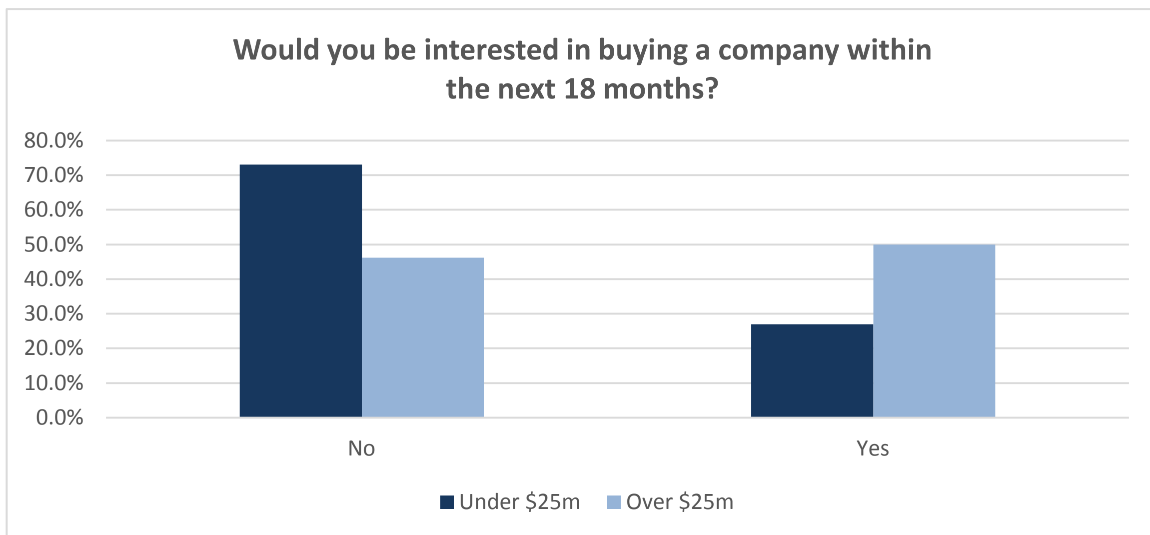

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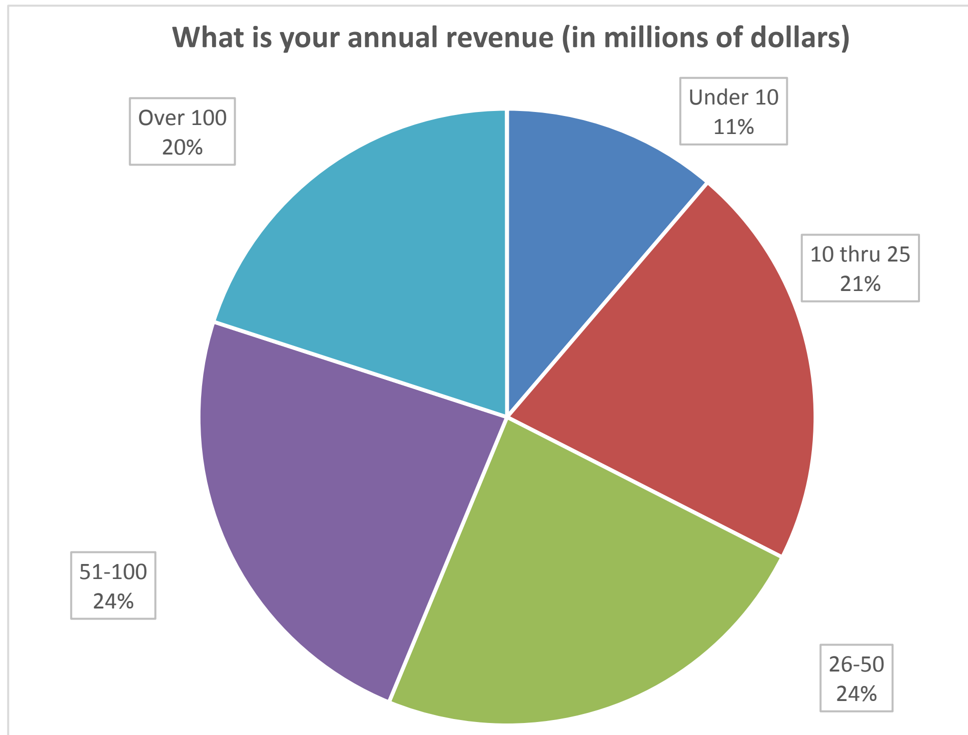
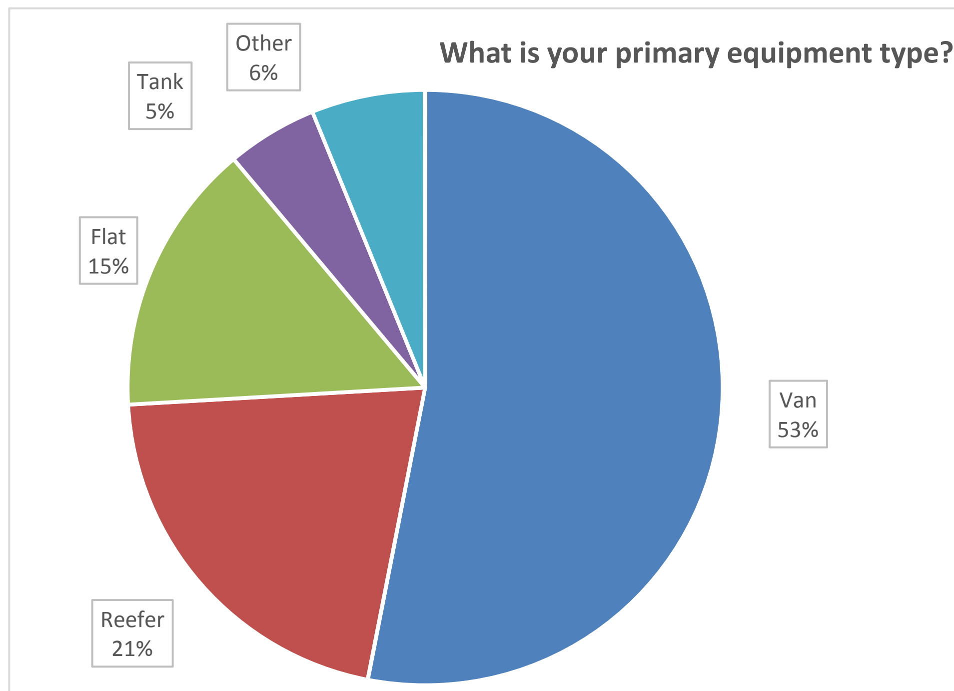

What is your annual revenue (in millions of dollars)
Under 10
11%
10 thru 25
21%
26-50
24%
51-100
24%
Over 100
20%


What is your primary equipment type?
Van
53%
Reefer
21%
Flat
15%
Tank
5%
Other
6%