

Where did all the trucks go?

The commercial truck scarcity predicted for the past two years is starting to become reality, forcing shippers to rethink how to keep their supply networks functioning smoothly.

U.S. truck capacity is so tight that analysts and trucking executives are warning of serious shortages at the slightest sign of improvement in the economy.

“Sometime in 2012 there is a reasonable probability of sporadic supply chain failures based on capacity,” freight industry economist Noël Perry recently said at the Council of Supply Chain Management Professionals’ annual conference in Philadelphia.

Transportation constraints, once isolated to certain long-distance truckload routes, are now widespread as demand increases for trucks to move goods to and from ports, distribution centers, farms and factories, according to industry experts.

The capacity crunch is a function of two variables — not enough equipment and drivers.

During the economic downturn, which started in 2007 for the trucking industry, motor carriers significantly reduced their fleets by selling used tractors at home or overseas and deferring purchases of replacement equipment. Thousands of trucking companies, most of them small outfits, went out of business. And investment in new vehicles remains difficult for many companies because of the high initial cost for trucks that carry clean emissions technology, higher maintenance costs and tight credit from banks.



The truckload industry lost about 20 percent of its capacity since late 2006, but shippers didn’t feel the impact because freight tonnage plunged about 30 percent. Supply and demand are almost in equilibrium now as the economy has rebounded from its depths in 2008. Tonnage is almost at the same level as in late 2006. That means motor carriers are busy keeping up with orders.

The shortage is most acute in the flatbed sector because it was the first to feel the impact of the freight recession that began five years ago and pulled back on equipment buys, experts say.

Meanwhile, more than 13 percent of the driver workforce left the industry during the past four years and there are fewer young people entering the market to replace an aging driver pool.

The trucking industry was short about 190,000 drivers during the middle of last decade, when the economy was strong. That figure is about 125,000 today because the recession and slow growth have temporarily suppressed the need for trucks, according to Perry.

Logistics professionals warn that pending federal safety regulations for trucking will exacerbate the capacity shortfall and raise motor carrier costs.

The Federal Motor Carrier Safety Administration’s new Compliance, Safety and

Accountability initiative has increased the level of motor carrier scrutiny by scoring and ranking companies based on more timely and accurate data from roadside inspections, state-reported crashes and periodic safety audits. The new system for the first time creates a mechanism to track violations of individual drivers, which will now be factored into a carrier's overall safety score. Carriers are becoming more particular about the drivers they choose because driving records will stay on their ledger even if an employee leaves the company and because shippers are selecting safe transportation providers to minimize any potential liability from an accident.

There is also trepidation about new hours-of-service rules that would reduce the driver's workday by an hour to 13 hours and set limits on the use of the 34-hour rest period that restarts the weekly duty clock. The agency is also considering reducing the daily duty period behind the wheel from 11 hours to 10 hours.

Shipper takeaways

- Consider moving product ahead of the peak shipping season, as many do in ocean transport to ensure space for their containers. There may be some extra storage costs, but at least the goods will be there in time for whatever season you are targeting. Putting retail goods on store display earlier than normal is also an option.
- Be carrier friendly. This can include making sure trucks don't have to wait for room at the loading dock or to be loaded/unloaded, paying transportation bills rather than using the entire 30- or 45-day accounts payable cycle, having ample parking for drop shipments, and not making drivers handle the freight.
- Try to be consistent in your shipping patterns and share demand forecasts with your carrier.

Trucking experts say CSA could weed out 5 to 10 percent of commercial drivers and that the on-duty rule-change would require motor carriers to hire more drivers (150,000 according to Perry) and deploy more trucks to move the same amount of freight as today. The pending mandate to require electronic onboard recorders to automatically measure driver hours is also expected to reduce productivity as drivers' ability to falsify paper logbooks is eliminated.

Industry officials say the driver

work rules that were implemented in 2004 have been successful and point to a 30 percent drop in the industry accident rate.

Old Dominion Freight Line, which has seen its accident frequency rate improve 40 percent since then, would have to hire 560 extra drivers and spend an extra \$50 million to maintain the status quo, not to mention another \$1.5 million in recruiting, training and other hiring expenses, CEO David Congdon told *American Shipper*.

The current shortfall is not as bad as the one experienced in 2004, but is enough to enable many truckload and less-than-truckload contract rates to increase more than 5 percent since 2009. Perry, principal owner of consulting firm Transport Fundamentals Inc. and managing director of freight forecaster FTR Associates, predicted that shippers will feel a trucking shortage equivalent to the shipping peak in 2004 by the end of next year.

The capacity crisis "is staring us right in the face," Mark Whittaker, vice president of transportation for Pepsico, said at the CSCMP conference.

The food and beverage giant operates the largest private fleet in North America, but could be impacted by the overall trucking situation because it utilizes some for-hire carriers to help meet its delivery needs.

Truckers face an avalanche of escalating costs and say they will only add capacity, or hire extra drivers, when shippers are willing to pay rates that allow them to make an adequate return on investment, not simply in anticipation of new business. Modern Class 8 tractors are 30 percent more expensive than ones being replaced (\$125,000 compared to \$85,000 10 years ago), diesel fuel costs have flirted with the \$4 per gallon mark most of the year, and labor is becoming more expensive.

Congestion due to inadequate road infrastructure investment by all levels of government also reduces asset utilization for carriers and their customers, and it is expected to worsen as the economy improves.

The regulatory environment and high capital requirements have created higher barriers for small business owners to enter the industry than in the past. Trucking companies that used to chase market share are now holding tight on capacity, and pricing service in accordance with their costs.

A more disciplined investment approach based on tangible demand and higher margins means there will be a lag between the time the general economy and the trucking industry begin to grow.

"We're seeing the first signs of a mature era of smart pricing in trucking" similar to how the railroads figured out how to price differently and become profitable in recent years, Perry said.

"So it's highly probable," he concluded, "that the shortages will last two to three years rather than one year the last time."

Industry observers and executives say that raising driver pay and getting truckers home more often are the only solutions to the driver shortage, but Perry said carriers won't do that until freight rates go up at least 10 to 15 percent.

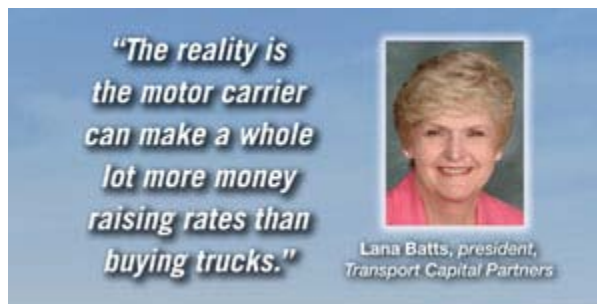
Scheduling long-haul drivers to be home every week instead of every other week adds \$30,000 to \$40,000 in annual cost per driver, he said.

Almost all new truck purchases are to swap out old equipment, according to trucking executives.

A recent survey of 125 motor carrier officers conducted by Transport Capital Partners, a strategic advisory firm specializing in trucking, found that 73 percent expected to add between zero and less than 5 percent capacity in the next 12 months, compared to only 60 percent who responded that way in May. And there was a 90 percent drop since May, from roughly 28 percent to 3 percent, in the number of companies that planned to augment their fleets by 16 percent or more.

Although new truck sales increased 71 percent in August from the prior year, the figure is deceiving, Transport Capital Partners President Lana Batts said on a conference call hosted by Stifel Nicolaus Capital Markets on Oct. 12. That's because about 12,000 trucks need to be produced each month just to maintain the industry's fleet at its current size and there have only been four months this year, as of August, in which truck production has exceeded that level.

"And the reality of it is that it's not a shortage that you can get over tomorrow. The



equipment manufacturers are running flat out just to do replacements but they're really reluctant to open any new facilities because of the cyclical nature of the industry," Batts said.

"So it's going to take a long time to work our way through five years of not producing 12,000 trucks a month," which means rates, accessorial charges and driver wages will go up in the near future, she added.



Many truckers say they can't justify reinvesting in equipment until they can get an adequate return, especially when a truck costs 40 percent higher than a few years ago and rates where they were in about 2006.

Rates will escalate by double digits, Batts predicted, whether or not volumes increase. "I think the shipping community is going to be very surprised at how high those prices are going to go. The reality is the motor carrier can make a whole lot more money raising rates than buying trucks," she said. "And understand, those rate increases are

going to go in the pocket of the driver first."

Batts said motor carriers are also holding off on investment because of the uncertainty surrounding the hours-of-service rule and a host of other proposed regulations.

Werner Enterprises won't expand its fleet until trucking margins are 11 percent and its return on assets is between 13 and 15 percent, Derek Leathers, the company's president and chief operating officer, said during a separate panel discussion at CSCMP.

The freight transportation provider raised its capital expenditure from \$140 million at the start of the year to \$240 million, but is keeping its fleet size flat.

"If I'm going to ask for more than a quarter billion dollars, I'm not going to do it at a 7.4 percent margin and I'm not going to do it when the industry average of the 11 publicly traded truckload carriers has a return on assets of below 5 percent. It's just not an acceptable return. It's not a business model that makes sense to reinvest in equipment right now," he said.

Con-way Truckload is trading out older vehicles as rapidly as possible and moving to get back on a three-year replacement cycle so that all its trucks are covered under the manufacturer's four-year bumper-to-bumper warranty after postponing purchases to conserve cash during the recession, Pete Montano, vice president of sales, said in an interview.

Having a modern fleet helps with recruiting because drivers don't want trucks that break down and prevent them from hitting the mileage targets upon which their pay is based,

he said.

Perry predicted that if the supply of trucks becomes scarce and rates go up, motor carriers that capped fleet speeds at 60 to 65 mph to save fuel will drive faster to get more business.

Supply and Demand. There are mixed signs about whether available capacity is tightening further or loosening.

The American Trucking Associations reported that seasonally adjusted truck tonnage grew 5.2 percent in August from a year prior, based on a survey of its members. In July, the ATA's tonnage index was 4.5 percent above a year earlier.

On a month-over-month seasonally adjusted basis, truck tonnage declined 0.2 percent (to 114.4), the fifth straight month of relatively flat growth after 20 consecutive months of sequential growth. Not accounting for seasonal shipping patterns, actual tonnage hauled by trucks grew 10.9 percent in August from July.

The news suggests the truckload market has stabilized.

The ATA data dovetails with Morgan Stanley's Truckload Freight Index, which has shown incremental improvement since mid-August. The seasonal strength of the Truckload Index is a positive sign for the industry given the relative weakness of the overall economy. Morgan Stanley stock analyst William Greene predicted in a client note that if the trend continues year-over-year tonnage is likely to accelerate in the coming months.

The Transport Capital Partners survey, however, showed a dampening outlook for volumes and rates. There was a dramatic decrease in optimism between February and August that business will grow during the next 12 months — with almost half saying they expected volumes to stay the same. Another 7.5 percent now think volumes will decrease compared to 0 percent of respondents in February.

Trucking executives surveyed also indicated that rate increases were slowing down after more than a year of moving up. In the quarter ending in August, 60 percent reported they were able to win rate increases versus 83 percent in the prior quarter. Forty-seven percent of carriers had their rates increase by 5 percent, down from 57 percent last quarter, and 36 percent said rates remained flat compared to 17 percent last quarter.

Larger carriers saw more rate movement than smaller carriers, 7 to 8 percent of which actually experienced rate decreases in the summer.

Only 60 percent of respondents expect rates to increase in the next year compared to 90 percent who felt that way in the previous quarter. Those who expected rates to stay flat increased to 33 percent from 10 percent, while 5 percent expected rates to decrease compared to none in the prior survey.

Meanwhile, the turnover rate for over-the-road truck drivers rose to 79 percent in the second quarter, according to the ATA's latest Trucking Activity Report, marking the third

quarter in a row of increased churn in the driver market.

Trucking companies historically have had difficulty keeping drivers either because they leave the industry or jump to other companies. The data means carriers lost an average of 79 drivers for every 100 drivers employed, the highest point since the second quarter of 2008.

The survey of large truckload carriers showed a turnover rate of 75 percent in the first quarter. Last year driver turnover was 39 percent. Thom Albrecht, managing director for transportation at BB&T Capital Markets, forecast that driver churn will reach 90 percent in the third quarter.

“Even though the increase was small, we still believe the market for quality drivers is getting extremely tight and fleets are aggressively recruiting to fill their openings,” ATA Chief Economist Bob Costello said in a statement. “The slowdown of the economic recovery has affected the turnover rate, but if the economy continues to improve we’ll see further tightening in the driver market and a renewed risk of a severe driver shortage.”

Many trucking executives are perplexed that drivers are difficult to find when the nation’s unemployment rate remains stuck above 9 percent. Some suggest that potential drivers have an incentive not to work because unemployment benefits now stretch for almost two years. The construction industry has experienced an uptick in hiring along with spending on non-residential construction and is expected to begin drawing again from the same labor pool that supplies truck drivers, according to Albrecht.

The Transport Capital Partners survey reported that 75 percent of respondents believe driver wages will need to reach \$50,000 to \$70,000 per year to attract and retain drivers, compared to the current average of \$47,000 for an over-the-road driver. The challenging operating environment is speeding up the trend of nationwide carriers migrating away from long-haul business, shifting that freight to intermodal rail and focusing on regional runs and, in some cases, container-shuttle service to and from ports or railheads.

The change is underscored by the fact that the industry’s average length of haul has been decreasing for several years.

Increasingly, coast-to-coast or irregular routes are becoming a niche business because of the low margins and difficulty finding drivers willing to stay away from home for two weeks or more at a time. In a regional configuration, turnover goes down because drivers are home at least every other night. Driver retention is even greater with drayage operations that allow drivers to go home every day.

Operating within a 500-mile region allows truckers to transport at least three loads compared to a single long-haul load over three days, effectively tripling a carrier’s capacity, David Howland, vice president of land transport services for APL Logistics, said on the sidelines of the CSCMP conference.

“The problem is that if you’re a very small carrier it’s difficult to do because it requires a lot of density in your traffic. Which means that the large carriers will get larger because the bigger you can get than the easier it is to plan to get those drivers home more often,” Batts said.

LTL. The less-than-truckload sector is also facing capacity constraints.

There are about 540 fewer terminals operated by the top 40 LTL companies since the industry peak of 2006 and 2007 — a 15 percent decline from 3,600 facilities, Congdon said.

The fleet of tractors less than eight years old is down 12 percent, since then. Tractors less than 15 years old are off 16 percent from the peak and there are 13 percent fewer 28-foot pup trailers in the system. As a whole, LTL vehicle capacity is down about 13 to 14 percent, while demand this year is only 7 percent less than in the second quarter of 2007, putting a strain on capacity, he said.

Old Dominion, which operates about 6,000 tractors, will add capacity at under the rate of projected demand, Congdon said. The company will increase its fleet size by 7 to 8 percent if tonnage is expected to grow 10 percent. And when the carrier buys new tractors as part of the replacement cycle it will hold off trading in old equipment until December or January to help get through the peak shipping season in the fall, he added.

LTL carriers face less of a driver shortage than their truckload counterparts because it’s easier to attract workers to drive short-haul and local delivery-routes that have them at home almost every night on a normal weekday schedule, according to logistics professionals. Turnover at less-than-truckload fleets actually fell in the second quarter, dropping to 6 percent from 8 percent, according to the ATA.

Thomasville, N.C.-based Old Dominion only churns through 10 percent of its drivers, half of whom quit and half of whom are terminated for cause, Congdon said. About 20 percent of its line-haul drivers make overnight trips and after six dispatches the company lets them take 48 hours off after they return to their home base.

Old Dominion, which projects \$1.9 billion in sales this year compared to \$1.5 billion in 2010, reduced its workforce by almost 18 percent during the economic downturn, but will hire 1,150 drivers in 2011. About 350 of them previously worked for the company on the loading docks, Congdon said.

The tables could be turned as far as unmet demand if there is a strong recovery because cross-dock facilities for consolidating partial shipments represent fixed infrastructure that cannot be quickly expanded. Truckload carriers do not need a network of facilities to resort cargo — they simply pick up and deliver point-to-point.

Shippers Respond. Astute shippers have been strengthening their relationships with core carriers the past couple of years in anticipation of capacity problems. The idea is to

give consistent business to certain carriers, accept fair rates and reduce dock-wait times so that a shipper is rewarded when decisions have to be made about which customer to serve first during busy times.

Creating more regular routes reduces ambiguity for carriers and lets them plan how to use their assets more effectively.

Batts said she recently has heard of shippers that are using the spot market to order trucks a week or more in advance and guarantee the load and the carrier's rate.

"I was talking with one motor carrier who said that for the first time in his entire life he got paid for eight loads he never moved," she told the Stifel Nicolaus audience.

Carriers are gravitating to the spot market more because they can get better rates than pre-set contract rates, which means shippers with contracts may still be hunting for availability unless their loads are profitable.

"I think in the end we'll get better productivity when carriers can plan where those trucks should be so they can start matching trucks to loads or loads to trucks as opposed to this 'you call, we haul' method. If the shipper can figure out what the inbound is they ought to be able to plan for the outbound," Batts said.

Retailers and manufacturers, in an effort to create more transportation stability, are also expanding their use of private fleets and dedicated contract carriage in which a carrier sets aside a certain number of vehicles and drivers to transport cargo for a customer on a regular route. Most dedicated contracts have surge protection for the shipper to accommodate spikes in volume, Larry Menaker, who heads his own eponymous consulting firm, said on a separate Stifel call.

Some private fleets have created extra capacity in recent years by selling empty space in their trailers on return trips to others needing transportation to the same general destination.

Kraft Food has also increased its business with truck brokers to gain more flexibility obtaining transportation for last-minute orders or deliveries to new customers out of the normal network, Michael Cole, the company's senior director of transportation and customs for North America, said.

Shippers can further redesign their supply chains to reduce their transportation costs and attract carriers by adjusting production schedules to produce loads when motor carriers have room and shipping in off-peak months when trucks are more plentiful, Perry said. There is about a 15 percent swing in available capacity between the highest and lowest volume months of the year, he noted.