

12 Things I Think About Freight in 2012

I have a great deal of respect for the opinions and forecasts of Thom Albrecht, Managing Director with BB&T Capital Markets. In the article below, Thom points out his thoughts on 2012 – an insight all shippers should consider when looking forward in 2012.



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12 THINGS I THINK I THINK ABOUT FREIGHT IN 2012

- 1) Where is supply and demand in the truckload sector? Obviously, in January and February, there is excess capacity, but relative to the first half of 2012 we believe there is a slight shortage of supply that will manifest itself in March and then in May through about July 4. Over the balance of 1H'12 we believe there will be an asset shortage of perhaps 2% with specialized sectors in greater imbalance than van carriers.
- 2) What will be the top story in 2012? The driver challenge, in our opinion. Recruitment, retention, rising turnover, the whole shebang is likely to be on display. Two years ago driver turnover was an afterthought, last year it moved onto the back burner and in 2012 it may be the headline story.
- 3) Why is driver turnover becoming an issue even though the official unemployment rate is still close to 9%? Numerous factors have contributed to the TL turnover rate rising to 89% in Q3'11 from under 40% in early 2010 including CSA (raised the standard for an acceptable driver); extended unemployment benefits (hits low and mid-wage industries harder than high wage sectors); newfound stability in the construction market; and other factors.
- 4) Why have freight rates not gone up more, especially TL rates? First, not all sectors are equally created. Flatbed, tank and reefer all saw average base rates (excludes FSC) rise more than 5% during 2011, while long-haul dry van (close to a 5% increase) did much better than regional van (about 3%-3.5%). LTL rose over 5%. Second, preliminary 2011 figures show that overall van rates rose 4% to 4.5% in 2011, above "year one" of the last cycle, when rates rose 3.2% during 2003. We blame some of the disappointed expectations on

overly aggressive sellside commentary the past two years as rates didn't even stop declining until summer 2010.

5) What levers might shippers pull as capacity tightens? While each network is different, we envision at least 6 levers that shippers can pull. These include: a) more intermodal; b) increased level of dedicated capacity; c) expansion of brokerage partners; d) starting or increasing an in-house private fleet; e) expanding the core carrier base; and f) more shipper collaboration on selected lanes and territories. Currently, the environment contains a lot of mini-bids, but few national bids.

6) What do we worry about? Obviously the European debt crisis remains in play as does the slow pace of the U.S. economic recovery. And political rancor promises to be "interesting" this year. That said, our singular freight worry is gas prices. Our analysis shows that when gas prices represent about 4.3% to 4.5% of disposable income, then truck tonnage and consumer spending are likely to slow. Currently, gas prices are about 4% of disposable income. The alltime high was just under 5% in mid-2008.

7) What do we expect for freight to start 2012? We expect January freight volumes to be fairly okay due to gift card shopping, retail inventory replenishment and an early Chinese New Year (January 23 versus February 3, 2011). 2011 was an odd year with the S&P 500 about flat on the year, but that belies the tremendous volatility that the capital markets and freight markets experienced last year. Our sense is that GDP growth remains in a bandwidth between 1% and about 2.5%, with selected quarters slightly better or worse. 2012 holds the promise of slightly higher economic growth, but that is no guarantee. Less volatility would be a major feel good accomplishment, if nothing else.

8) So what will happen to freight rates, especially truckload, during 2012? Our sense is that some shippers believe they can hold van rate increases to 2% to 3%, but we also have heard from several concerned about increases of 4% to 5%. And those requiring a lot of specialized equipment are concerned about even larger increases. The reality is that rates are established by supply and demand and not carrier cost pressures or other factors. Should load acceptance rates deteriorate and service failures rise, then rates will go up more. Forecasting rates in the winter months is a futile drill. What seems clear to us is that every 6 months or so capacity seems to get a little tighter, call it by "half a turn" if capacity were a screw. Economic activity hasn't been strong enough for long enough periods to really tighten the screws, but the freight part of the economy is growing and drivers are getting more difficult to recruit and retain. If GDP growth is about 2.4% in 2012 versus about 1.9% in 2011 and the driver situation continues to tighten, then we believe supply and demand will be tighter in summer 2012 compared to summer 2011.

9) Service, in general, has been deteriorating for the better part of 9-10 months for large numbers of shippers. What used to be 99% on-time delivery performance has slipped to 95% to 96% in many cases. We do not expect service to improve as the cumulative impact of CSA and EOBRs (electronic on-board recorders) is contributing to deteriorating service.

10) Is HOS (hours of service) really the non-event that Wall Street and the media portray it to be? Setting aside for a moment the possibility of litigation, a closer examination suggests that the impact could be greater than many initially surmised. The FMCSA estimated that consecutive 1 a.m. to 5 a.m. off periods during the restart period would only impact about 5% of trucks. Yet that figure is misleading. For some operations, the HOS changes could impact as much as 20% of trucks, especially those accustomed to making food deliveries in the middle of the night and/or selected dedicated operations that utilize a full 6 days a week.

11) Could there be any pleasant surprises in the economy this year? Modestly positive things are percolating in some sectors including lower household debt; the fact that non-residential construction spending has been positive for 6 consecutive months after 3 years of declines; and expected growth in auto production (about 14M units in 2012 versus 13.5M in 2011; sales are slightly lower); and something of a bottom being put in on housing starts. Housing starts approximated 628,000 units in 2011 and while single-family starts remain weak, condos, apartments and townhouses are all on the rise, which means more freight. Several sources we examined expect housing starts to come close to 700,000 units, which would represent growth of 10% to 12%. This means more freight even if the absolute numbers remain below healthy levels.

12) What is happening with trucking Mergers and Acquisitions and overall carrier failures? While failures remain low, we do not believe that tells the entire story. Many fleets are selling two trucks for every new truck they buy or some ratio, maybe 4 for every 3, etc. The cost of new equipment remains prohibitive for fleets and the population of late model, low mileage used equipment remains very low. So while failures remain low, many fleets continue down a slow path of contraction in order to survive and reinvest in the fleet. And M&A activity, while up a bit yr/yr, remains below levels many have expected by now. Many fleets are so old that the buyers are confronted with the need to replace/replenish the entire fleet in a year or less just to keep operations competitive. In the "old days" such capex could be undertaken over two to three years. As such, acquisitions are generally not happening at the pace expected at this point in the economic cycle.

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