As we roll into 2017, it’s clear that the $36 billion less-than-truckload (LTL) sector is enjoying a financial renaissance as carriers continue their newfound pricing discipline and resist the urge to expand capacity beyond fulfilling immediate shipper needs.

“Overall, the first quarter of 2017 is looking upbeat from an economic standpoint,” says Wayne Spain, president and COO of Averitt Express, the nation’s 12th-largest LTL carrier. “We’re seeing many positive indicators, including comfortable growth in the months leading up to 2017 and the reaction of markets to the new presidential administration.”

Others close to the market can do nothing but agree with Spain’s positive sentiments. According to Satish Jindel, principal of SJ Consulting, an analyst firm that tracks the LTL sector, the new President’s “America First” promise could pay dividends in the LTL sector—eventually. “It won’t show up immediately, but the

While LTL executives are bullish on the new administration’s “America First” emphasis, shippers should expect rate increases in the 3% range amid a “rational” pricing landscape.

By John D. Schulz, Editor at Large
new administration’s focus on keeping more business in the United States should translate into more freight,” he projects. “There could be a time lag, but that should be a positive.”

Brad Jacobs, chairman and CEO of XPO Logistics, parent company of the nation’s 2nd-largest U.S. LTL carrier, says that he’s “actually encouraged” by the overall national economic picture, both in macro trends and internal industry supply data. “Both demand and yields have been good,” he says. “The pricing environment is rational and the industrial recession that had been kicking U.S. manufacturers in the stomach has been showing some signs of improvement.”

According to David Ross, trucking analyst for Stifel Inc., better times are ahead for the LTL industry due to lower taxes, reduced regulation, increased capital spending and the Trump administration’s stated focus on domestic jobs, infrastructure and manufacturing.

“In theory, these should all work to drive earnings higher for LTL carriers,” Ross notes, adding that more money invested in infrastructure projects will increase freight demand, but will also reduce the truck driver supply because the construction industry often taps into the same potential labor pool for drivers as the LTL sector.

“We believe that 2017 will be generally good for LTL stocks, but it may be a bumpy ride, as high expectations are tested before much improvement is evident,” adds Ross cautiously. And while much “educated speculation” is swirling around, let’s dive a little deeper into a few factors that could drive LTL shippers’ rates, capacity and negotiations over the course of 2017.
ELD effect
First and foremost, shippers need to keep in mind that electronic logging devices (ELDs) are supposed to be mandated this year. However, while those regulations are still moving forward, they are potentially subject to delay or elimination by the Trump administration.

Assuming that the rule takes effect as stated later this year, what will be the effect on LTL operations and pricing?

“ELDs should affect some capacity, and some drivers won’t be able to drive extra hours,” says Jindel. “Mind you, LTL carriers won’t go out of business, but some on the truckload [TL] side might. However, those reduced hours on the TL side should have some spillover effect that would benefit the LTL carriers.”

It’s important to remember that the LTL sector, as well as most of the large TL carriers, pushed for the ELD mandate to the dismay of owner-operators, who fought the measure in the courts. At this stage, many large LTL carriers already have their fleets outfitted with the devices.

“ELDs will have no impact on our operations at all,” says Chuck Hammel, president of Pitt Ohio, the nation’s 17th-largest LTL carrier. “We have been fully compliant for several years now, so the initial loss of productivity we experienced on day one is now much less. I suspect most carriers are fully compliant so I don’t expect much disruption at all.”

Indeed, that’s a compliment to the LTL sector, which outfitted most fleets long before the actual ELD rulemaking was made official.

“All of our trucks have been outfitted with ELDs,” says Averitt’s Spain says. “In many cases, new Averitt drivers are coming from carriers that have not implemented ELDs into their operations. There’s certainly a learning curve associated with those devices; however, our drivers go through in-depth training in order to make a smooth transition.”

Overall, Spain believes that ELDs will be beneficial to the industry. “They hold carriers more accountable with regards to safety on the roads, which is a benefit to everyone,” he says. “We live in an age of digital information and ELDs help us in planning more efficiently. There’s little doubt that the upfront costs will be offset by the inherent benefits.”

YRC gets some breathing room
YRC Worldwide, parent of YRC Freight, the 2nd-largest LTL carrier, and YRC Regional, three companies that collectively make the 7th-largest LTL group, is getting some sorely needed financial breathing room.

According to YRC, the company has launched an amendment to its term loan credit agreement, including an adjustment to the leverage ratio covenant from the first quarter of 2017 through the fourth quarter of 2018.

“Since 2011, we have made strides to strengthen our company, including significantly improving adjusted EBITDA and operating cash flow while reinvesting back into the business and reducing debt to the lowest level in more than a decade,” said YRC Worldwide CEO James Welch in a statement.

Over the past few years, Welch noted that the LTL sector has seen tonnage decline and lower fuel surcharge revenue from falling diesel prices. “We have remained in compliance with the leverage ratio covenant since the inception of the term loan, and we are launching the amendment to take uncertainty out of the market regarding our expected ongoing compliance” said Welch.

Analyst David Ross of Stifel Inc., which has a “buy” rating on YRC, noted that YRC’s improved financial picture allowed the change in the financial amendment. YRC stock zoomed nearly 12% the day the announcement was made.

In 2019, YRC has its five-year labor agreement expiring with the Teamsters union. “Fortunately for the company, we continue to believe that the industry tailwinds should be favorable this year and into next,” said Ross in explaining his “buy” rating.

—John D. Schulz, contributing editor
Capacity situation

One area where LTL carriers have always held a profitability edge over their TL counterparts is capacity, and that’s because the LTL sector has significant barriers to entry. Unlike point-to-point TL carriers that have few if any terminals, most large LTLs operate a complex hub-and-spoke network of hundreds of terminals. It’s difficult—if not financially impossible—to replicate such a network today.

The result has been few, if any, additions to LTL capacity over the past two decades. For example, back in the 1990s FedEx Freight was the last large LTL carrier to add significant capacity in the congested Northeast region.

This simple fact has translated into unusual pricing power for the carriers. In turn, the top 10 LTL carriers control about 75% of the domestic LTL market. Recently, however, there have been whispers that perhaps two or three large LTL carriers are looking to add capacity through buying more terminals in the Northeast.

The Great Recession of 2008-2009 took as much as 20% of the capacity out of the LTL sector; and since that time, the remaining LTLs have benefited from tight capacity in the industry. That’s resulted in what XPO’s Jacobs and others call “rational” pricing in the market place. However, any new large entrants into a region could test that rationality, LTL executives believe.

“I hope that if carriers expand markets they focus on service that shippers aren’t getting currently, not by offering a lower price,” says Jindel. What worries Jindel is that some carriers may get aggressive with discounting when entering a new region. “That doesn’t help that new entrant in the market place or the industry,” he says.

Still, in sobering news for shippers, Jindel says that pricing should be positive for carriers due to the increased use of dimensional pricing in addition to traditional rates based on weight and distance. He adds that LTL carriers are doing a better job pricing on the actual size and dimensions of freight—not on “the honor system” of the past when carriers largely took a shipper’s word for the actual size and weight of shipments.

“That should result in better pricing,” Jindel predicts. “Now, that doesn’t mean higher pricing—just more accurate pricing.”

Jindel estimates that currently 95% of all LTL shipments are weighed for pricing, while billing accuracy is now 97%—far higher than the 85% billing accuracy of ocean freight. He adds that about half of bills of lading have errors either in weight or shipments descriptions. With far more LTL shipments being verified by weight and class of freight, often shippers receive a correct invoice, but because of past oversights, they perceive it as a rate increase.

According to analyst Ross, LTL freight demand levels, which were flat in the fourth quarter of 2016, should grow again over the course of 2017. Stifel’s internal estimates are for 2% tonnage growth, “and that’s likely to pick up through the year.”

However, freight levels are wildly unpredictable. For example, the truck tonnage index maintained by the American Trucking Associations, fell 6.2% in December—an unusually steep decline. And that followed a 5.7% increase in November, again an usually wild upward swing.

“One of this uncertainty, we think the risk is to the upside on tonnage in 2017,” adds Ross. “Inventories should turn from a drag in 2016 to neutral in 2017, but 2018 is the wild card with significant potential upside for carriers.”
**Future pricing picture**

By all accounts, LTL pricing is firming as carriers are more optimistic after the election and more willing to hold the line than just a couple months ago. Revenue per hundredweight—yield, not pure price—rose by an average 1.9% in third quarter of 2016.

As of this reporting, most analysts and carrier executives are predicting revenue per hundredweight yields to be slightly more than 2% this year, with overall rate increases perhaps 3% to 4%. Of course, fuel price surcharges could affect those rate increases as well; so, shippers should expect their contract pricing increases to be up modestly, with fuel surcharges rising modestly—absent any shock to global oil supplies.

“Demand is steady at the moment and pricing, while not great, is still positive,” says Pitt Ohio’s Hammel. However, he adds that carriers are still under cost pressure from their suppliers on everything from new trucks to insurance to health care costs. “We still need more in the way of rate increases as our costs—all of them—continue to outpace our ability to raise rates.”

Still, Hammel, along with the analysts we interviewed, firmly believe that the overall business environment is positive for most LTL carriers. “We currently have a lot of new business opportunities on the table, having already on-boarded more than eight new accounts this year.”

But the biggest wild card for the economy is how the new Trump administration will handle the threats to world trade. Already, FedEx chairman Fred Smith labeled Trump’s move to pull out of the Trans-Pacific Partnership “unfortunate.” Smith added that Trump’s threat to withdraw from the North American Free Trade Agreement would have “massive economic repercussions.”

Others agree. “Without a doubt, what the Trump administration does is the biggest factor affecting freight,” adds XPO’s Jacobs. “If it’s a stimulus that gives a pop to the economy, that will help freight. If trade barriers go up that lead to geopolitical instability, those will hurt us.”

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