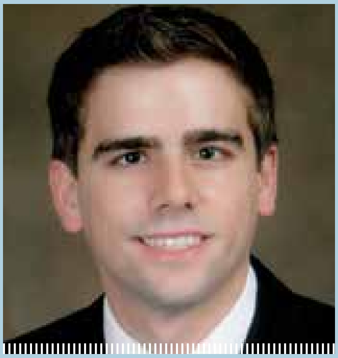
A BRIGHTER LTL OUTLOOK

FEW TRUCKING COMPANIES, it's safe to say, were sad to see 2013 end. The year was filled with turbulence as companies dealt with regulatory changes, weak freight demand and lengthy labor negotiations. This instability is reflected in the revenue growth and profitability of the top LTL and truckload carriers. Top-line growth decelerated for the largest trucking companies, and improvement in operating margins was stagnant.



■ Michael D. Scheid

Indications of an improved freight market emerged in late 2013, however, and the outlook is rosier this year despite a stormy first quarter.

Public LTL carriers reported an average operating margin of 4.7 percent for 2013, a slight improvement over 2012's 4.4 percent. Clear leaders in terms of profitability, including Old Dominion Freight Line and Saia, again registered meaningful margin growth in 2013, while carriers that struggled to increase profits, namely FedEx Freight, Con-way Freight and UPS Freight, disappointed as operating margins declined over the year.

In the truckload market, carriers kept a lid on capacity to maximize pricing. The number of trucks operated by public truckload carriers was steady at 62,000 between 2012 and 2013, and carriers were rewarded with average yields that increased 1.9 percent during the year. Lower truck utilization caused by stricter hours of service regulations offset the benefit of higher yields, however.

Some carriers had substantial margin declines for their truckload operations, including Werner Enterprises (down 1.7 percent) and J.B. Hunt Transport Services (down 3.8 percent). Overall, the average operating margin for public truckload carriers was flat at 7 percent in 2012 and 2013.

Along with increasing yields in the truckload market, tight truckload capacity aids LTL carriers by shifting heavyweight LTL freight from truckload fleets into LTL networks. The minimal 0.3 percent increase in weight per shipment for LTL carriers indicates this did not occur in 2013. With truck capacity tightening in 2014, however, LTL companies could see some heavier shipments come their way. A tight truckload market also gives LTL carriers the opportunity to increase their own rates.

Although the overall LTL market benefits from tight truckload capacity, the higher rates charged by truckload companies can negatively impact some LTL carriers that rely heavily on purchased truckload capacity for line-haul moves. Con-way Freight spends 17.1 percent of its revenue on purchased transportation and is one of the carriers to see a negative impact from tight truckload capacity.

LTL carriers that rely less on outside truckload companies to supply trucks and trailers for line-haul moves are better positioned to benefit from the segment's tight capacity. They include ODFL and Saia, which spend 4.5 and 6.4 percent of revenue on purchased transportation, respectively, as well as some profitable regional carriers such as Pitt Ohio and Dayton Freight Lines.

Likewise, companies that rely on rail for long-haul moves, including ABF Freight and YRC Freight, are better hedged against an increase in truckload rates.

Tonnage growth also is trending upward and should support LTL rate increases in 2014. Tonnage at public LTL carriers grew 3 percent year-over-year in the third quarter of 2013 and nearly 5 percent in the fourth quarter, the best consecutive quarters in nearly three years. Growth has continued into the first quarter as carriers report underlying demand strength despite the severe weather. This accelerating tonnage growth should help LTL carriers increase yields faster than the marginal 1.3 percent improvement in 2013, provided companies don't revert to aggressive pricing tactics.

Along with increasing demand, other factors will contribute to higher yields this year, notably Central Transport's acquisition of Vitran's U.S. LTL business. Vitran maintained one of the lowest yields in the industry, a large factor in the company's financial struggles, so any shipper that diverts from Central Transport is likely to see higher rates from their new carrier. Vitran's struggles also give further evidence to other carriers that maintaining bottom-level pricing isn't a sustainable business model.

Also impacting rates in 2014 will be new labor agreements for ABF Freight and YRC Freight. ABF has had a challenging relationship with the Teamsters recently, and although the company was able to secure concessions from its union work force in the new agreement, discounting away the cost savings through lower pricing would damage the carrier's relationship with employees and their union. ABF demonstrated its focus on pricing in the fourth quarter, increasing yield 2.3 percent year-over-year, faster than any other LTL carrier.

YRC Freight also secured a union contract extension as well as new financing that give the company more long-term viability. YRC Freight was the only public LTL carrier to lose money in 2013 and has the greatest urgency to increase pricing and profitability.

Pricing and tonnage growth result in top-line revenue expansion, but companies still will need to manage operating costs to drive profit margin expansion in 2014. With at least two public LTL carriers and several private companies with operating ratios in the high 80s and low 90s, there is no reason for the other carriers not to improve their margins. LTL carriers that have performed well during the last few years are likely to continue to outperform, but it remains to be seen if management at other carriers will be able to capitalize on improving conditions to increase profits. JOC

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