Beating the Odds

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The trucking industry has been clamoring about impending doom from industry regulations and the persistent shortage of qualified drivers since the end of the economic recession in 2010. Inability to add capacity and skyrocketing operating expenses are the two most often cited outcomes resulting from these industry changes. Although the long-term impact of these developments is yet to be determined, however, carriers' second-quarter earnings show the gloomy scenarios aren't affecting the bottom lines of the largest carriers.

In 2014, carriers displayed strong growth as they capitalized on increasing volume and rates. Among the largest companies, as represented by SJ Consulting's top carrier lists, seven, including Dayton Freight, Western Express and Prime (refrigerated), increased top-line revenue by more than 15 percent without the aid of an acquisition. Although the rate of growth in volumes has slowed this year, the pricing momentum has continued and indicates carriers' ability to manage capacity.

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The first half of 2015 presented a tepid economic environment, with the U.S. Bureau of Economic Analysis reporting real first-quarter GDP growth of just 0.6 percent, followed by a small bump of 2.3 percent in the second quarter. Demand for less-than-truckload and truckload services was similarly weak during the most recent quarter, as volume growth for both sectors was flat.

Even with the weak demand during the first half of 2015, carriers have kept their profit engines running. Margin expansion was supported by carriers' prowess in securing significant rate increases from their customers, despite soft demand. In the second quarter, the two dozen or so public truckload and LTL companies collectively expanded their operating income by 14 percent year-over-year, to more than $1 billion.

Of the publicly traded trucking companies, only three registered year-over-year declines in second-quarter operating income. Another — Swift Transportation — experienced lower operating income in its truckload division, but it was offset by growth in the company's dedicated and refrigerated segments.

Growth in second-quarter operating income resulted in margin expansion for the LTL and truckload sectors. Margins for the major LTL carriers expanded to an average of 8.1 percent — the best quarterly mark in nearly a decade — keeping the LTL industry on pace for a 10 percent margin by the end of 2016. This profit increase was driven by yield growth of more than 6 percent. Adjusted for changes in average weight per shipment and freight mix, real pricing grew about 4 percent.

Pricing for truckload carriers grew by an amount similar to their LTL counterparts and helped the group earn a near-record double-digit margin. Although capacity was seemingly looser year-over-year in the quarter, it was exceeded by demand and enabled carriers to obtain strong price increases.

The favorable profits for trucking companies come even after major regulatory burdens were implemented, namely the Compliance, Safety, Accountability, or CSA, program and hours-of-service changes. Carriers have displayed an ability to combat these government-imposed challenges, as well as those presented by an aging driver population. Assuming demand continues to exceed available capacity, trucking companies can keep the same approach to sustain future profits.

With top-line growth surpassing recent cost increases, large carriers have proved they are well-positioned to mitigate the negative impact from any new regulations. Major issues that loom include electronic logging devices and a national clearinghouse for drug test results. The majority of the largest trucking companies, including owner-operators, already have logging devices equipped and hiring and drug testing standards.

Another potential cost pressure is a mandatory increase in the minimum insurance requirement. The largest carriers, however, already have insurance coverage above the current minimum, and although the regulatory change could increase rates for all trucking companies, the large carriers are better able to recoup these costs through higher rate increases.

Future regulatory changes are slated to reduce capacity across all trucking modes as the potential for smaller operators to leave the market intensifies. Despite the additional expenses these changes might add, however, the decline in available capacity should enable the largest carriers to continue to earn rate increases that can expand bottom lines.

Although large carriers may be worried about the potential of increasing fleet sizes, they should embrace the tight capacity and the pricing and profit growth it supports. Despite the seemingly heavy cloud weighing over the trucking industry, current market dynamics, with disciplined pricing because of difficulties with adding capacity, suggests bottom-line growth for the largest trucking companies will continue through the second half of 2015 and beyond. JOC

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