# CALM BEFORE THE STORM

**THE U.S. TRUCKING** market entered 2016 quietly, unlike in 2015 when the West Coast port slowdown was in full force and the price of oil was dropping precipitously. The first few months of 2016 resemble the last few of 2015, with no real change in demand.

Although 2015 wasn't a bust like the years of the Great Recession, it wasn't anything to write home about, either Companies didn't have to scramble to find freight to put on empty trucks, but they weren't overwhelmed by volumes. Margins improved, mainly because of gains made in the first half of the year as tight capacity remnants from 2014 allowed companies to secure significant rate increases.

On the less-than-truckload side, demand decreased about 1 percent in 2015, but base rate increases enabled carriers to increase margins by a collective 50 basis points. Had it not been for the drop in fuel prices and resulting decline in fuel surcharge revenue that cut into bottom lines, the LTL industry could have expanded its margin by another 100 basis points.

Truckload demand was choppy throughout the year, but as in LTL, carriers were able to secure rate increases. Unlike in LTL, where fallin gfuel prices hurt margins, the truckload industry benefited from the reduced fuel cost and allowed the publicly traded truckload carriers to improve their margins by 200 basis points from 2014.

Despite the calm market in early 2016, a storm is forming. New regulations coming in the next several months and the increasing influence of a major retailer are poised to cause significant turbulence in the U.S. trucking market.

Electronic logging devices are expected to be the single largest disruptor of industry capacity. Many of the nation's largest LTL and truckload carriers already have compliant devices in their equipment and thus already have suffered the negative productivity setbacks these units cause. As such, these companies are well-positioned to prosper from the tightening of truck capacity that will result from the implementation of other, smaller companies. Fleets operating fewer than 20 trucks currently make up about one-third of industry capacity, and most don't have ELDs installed.

Although some drivers will leave the industry voluntarily, the bulk of the capacity reduction caused by ELD implementation is likely to be from the lower truck utilization the devices allow. With ELDs, drivers will be forced to comply more strictly with safety-driven regulations that will reduce the daily number of miles a driver can legally travel. The potential upside of the rule is that carriers will be involved in fewer accidents while on the road.

Lower utilization will result in fewer truck miles over the road, effectively shrinking industry capacity. Fewer daily miles also will result in smaller paychecks for some drivers, at least in the short term, forcing some out of the industry and further reducing the available driver pool. This capacity tightening caused by ELD implementation industrywide is likely to benefit the large carriers by supporting stronger pricing and thus bottom-line growth, boosting the performance of these companies and paying dividends to their shareholders.

Consider that in late 2014 and early 2015, tight capacity enabled the large truckload carriers to produce collective yield growth exceeding 5 percent, excluding fuel. With the expansion in yields came considerable margin gains, including an average improvement of more than 200 basis points in the fourth quarter of 2014 and first quarter of 2015. Once industry capacity tightens again, large truckload carriers should be able to increase their margins and reinvest in their businesses.

On the demand side, Amazon's growing presence and evolving supply chain practices could impact the trucking industry greatly during the next few years. Aside from the company insourcing some final-mile deliveries or investing in its own private trailer fleet, the company is impacting the way goods move nationwide.

With its ever-expanding distribution center network, shipments that once moved by truckload are now split into several LTL shipments. Likewise, the increasing demand of consumers for speedier delivery is increasing the need for truckload carriers providing team driver or premium services.

Amazon's influence over the U.S. trucking industry has become so large that nearly every one of the 25 largest LTL carriers, as well as many of the nation's largest truckload carriers and intermodal marketing companies, does business directly with the company or for one of its suppliers. This is reflected in 2015 results as the growth of some Top 25 LTL carriers was likely fueled by the increasing transportation spend of the e-commerce titan. With such market penetration, any abrupt shift in Amazon's transportation strategy, and its more than $8 billion in domestic transportation spend, could cause ripples throughout trucking industry.

As with any storm, those about to be hit by the tumultuous weather should prepare. Freight volumes are seemingly stable in early 2016 and pricing is still rational, so the current calm is the ideal environment for carriers to ready themselves for major industry changes. JOC

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