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More LTL carriers may follow AAA Cooper to the altar, consultant says

LTL carriers are appealing acquisition candidates because their middle-mile networks are perfectly suited for e-commerce, Jindel says

Mark Solomon • Monday, July 19, 2021 6 minutes read

(Photo: SJ Consulting & Jim Allen/FreightWaves)

Five or 10 years ago, a truckload carrier would have looked askance at acquiring an LTL carrier. Truckload carriers were comfortable shipping directly from the shipper to the consignee at a minimal fixed cost, a model that runs counter to the multistop terminal networks of LTL carriers. The truckload-LTL relationship was mostly confined to truckload carriers handling shipments of overflow LTL freight weighing more than 8,000 pounds if LTL capacity was too tight to meet the demand.

However, e-commerce has profoundly transformed supply chains and, by extension, the trucking industry. Truckload networks designed to efficiently handle heavier volumes are not well suited to move the lighter-weighted shipments — 1,000 to 1,500 pounds in total — that are the bulwarks of e-commerce. That's especially true for the middle-mile portion of the delivery chain, where freight moves from a supplier's warehouse to a retail store or a distribution center before the final delivery to a residence or business. In a changing distribution landscape, truckload executives have come to value the LTL network design, and they are voting with their dollars.

In January, Canadian carrier TFI International Inc. (NYSE:TFI), which generates nearly half of its revenue from truckload, acquired LTL carrier UPS Freight from parent UPS Inc. (NYSE:UPS) for $800 million. Then two weeks ago, Knight-Swift Transportation Holdings Inc. (NYSE:KNX), the nation's largest truckload carrier, acquired privately held regional trucker AAA Cooper Transportation (ACT), the nation's 17th-largest LTL carrier, for $1.3 billion.

According to veteran consultant Satish Jindel (pictured), there will be increased interest in LTL carriers from truckload carriers and from carriers not now involved in either segment. Jindel, whose Pittsburgh-based firm, SJ Consulting, advised Knight-Swift on the transaction, spoke last week to Mark Solomon, senior writer at FreightWaves, about the sweet spot LTL carriers find themselves in, and why the good ones that may want to sell — there aren't that many of them — can essentially name their price.

Q: How do you size up the Knight-Swift-AAA Cooper deal?

A: "It's a milestone development. It's by far the biggest push by a major truckload carrier — and Knight-Swift is the largest — into the LTL industry.

Almost as important will be the extent to which Knight-Swift broadens ACT's geographic reach, how it cross-sells and what additional steps Knight-Swift takes to expand its presence in LTL. It has a lot of truckload customers that would be interested in leveraging ACT's capabilities."

Q: Can you explain the LTL carriers' appeal to truckload carriers?

A: "The traditional middle mile is typically a truckload move from a warehouse to a distribution center. There's still a lot of that. But e-commerce and omnichannel fulfillment are changing the transport and distribution landscape. Increasingly, deliveries from the supplier's facility are nonlinear, they move shorter distances, and they consist of several boxes on a few pallets instead of a truckload full of pallets. These changing characteristics are turning what was a truckload carrier's game into an LTL carrier's game.

"Truckload operators grasp the importance of e-commerce and the updated definition of the middle mile. They know that without a strong upstream game, the "downstream," or the last mile, won't matter much. However, they lack the know-how to replicate complex LTL networks. In addition, the resources required to grow a viable in-house LTL infrastructure, such as high-quality real estate, are in short supply. Due to barriers to entry in the LTL industry, which is evidenced by the fact that there have been only two asset-based LTL startups since 1980, the only option for truckload carriers to get into LTL is to buy one."

Q: LTL carriers have also gotten their financial houses in order following disastrous rate wars after the Great Recession?

A: "LTL carriers have exercised stellar pricing discipline over the past decade. They have shifted from what I call an "honor system" shipment-profile model to one that captures a shipment's actual weight and density and properly bills a customer based on those characteristics. LTL carriers also recognize the high barriers to entry due to the cost and complexity of their networks. It's a concentrated segment of trucking, and price increases tend to stick even through downturns in industrial production activity which has traditionally been LTL's core business. The huge role that LTL carriers are now playing in e-commerce only adds to their appeal."

Q: If you look at the top 20 LTL carriers, which are attractive candidates for acquisition?

A: "Most of them are not prospects."

Q: Why not?

A: "Some are parts of larger companies. Pure-play publicly traded LTL carriers trade at high multiples. Many carriers are family-owned and -operated. They have been around for generations, and the current leaders have strong ties to their companies' legacies. They also know that the macro tailwinds are strong. Rob Estes [chairman and CEO of Estes Express Lines, which was founded by his grandfather in 1931] has many family members in the business and would have no interest in taking a call from a potential buyer. R&L Carriers is a $2 billion company and very private in all respects. They won't sell. Other LTL carriers like Southeastern Freight Lines and Averitt Express have already rejected attractive offers.

"AAA Cooper sold at a multiple of 9.64 times its 2021 EBITDA. That is very reasonable considering that Old Dominion Freight Line (NASDAQ:ODFL) trades at a 2021 multiple of 20 times its 2021 EBITDA, and Saia (NASDAQ: SAIA) trades at a 15.6 multiple. Keep in mind, though, that Con-way Inc., which had one of the largest LTL operations for years, was bought at six times EBITDA by XPO Logistics (NYSE:XPO) in 2015. But Con-way had a 95 operating ratio [the ratio of revenues to expenses] in 2015. ACT, by contrast, has a more favorable ratio of 90. In addition, today's e-commerce market is much more robust than in 2015."

Q: So who would be available at a reasonable price?

A: "There are companies out there, though I'm not at liberty to identify them. I will say that any truckload carrier looking at high-quality LTL companies needs to move fast or it will be left standing out there."

Q: Amazon.com (NASDAQ:AMZN) has 161 million square feet of fulfillment center space. It is largely driving the shift we are seeing in middle-mile configurations. Would Amazon be an acquirer?

A: "According to my sources, Amazon has reached out to some of the premium LTL carriers with buyout offers but has been turned away. Amazon is currently one of the largest, if not the largest, customers of many LTL carriers. The Knight-Swift-ACT deal could reenergize Amazon to return to the acquisition game.

"There's a reason for Amazon's interest in LTL. The company could provide two-day deliveries with just eight fulfillment centers. Each facility would have 20 million square feet, and Amazon could receive and stock merchandise in full truckload quantities. However, such huge fulfillment centers would pose too many other problems. The feasible alternative is to have 160 centers of 1 million square feet, which in turn requires Amazon to receive products in smaller LTL quantities and more frequently."

Q: How about in the other direction? Would LTL carriers be interested in acquiring truckload carriers to expand their portfolio?

A: "No. LTL carriers are already in the best competitive position. They don't need to dilute their balance sheets by acquiring a truckload carrier. LTL carriers would also not be interested in acquiring regional truckload carriers, because they already handle short-haul truckload shipments within their LTL networks."

Q: How do truckload carriers avoid making strategic and tactical missteps once they acquire LTL carriers?

A: "Provide the LTL operations with adequate capital for investments in the network and technology. Then, let its management leverage the customer relationships and the driver resources of the TL operation. LTL is a network-based business with much higher fixed costs and pricing complexity. Most of the people running these companies have been at it for decades. Knight-Swift is smart enough to know what it does not know. That's why it retained ACT's management and employees, and is allowing it to operate as a separate business."

Q: The word "convergence" has been used quite a bit recently to rationalize the cross-trucking consolidation concept. Do you buy into the idea that the two sectors are in fact converging?

A: "The synergies between truckload and LTL are very strong. They utilize similar equipment and drivers, and many shippers rely on both services. The synergies are amplified by the profound changes playing out in e-commerce. The focus will not be on whether freight moves truckload or LTL. It will instead be on what types of shipments are going to be carried and what the appropriate network should be designed and executed to carry them."

#AAA Cooper Transportation #Amazon #Averitt Express #Estes Express Lines #Knight-Swift #Old Dominion #R&L Carriers #Rob Estes #Saia #SJ Consulting #Southeastern Freight Lines #XPO Logistics

2 Comments