Opinion

FedEx's Great Timing on Watkins Deal

By Satish Jindel
President
SJ Consulting Group Inc.

In announcing the recent decision to purchase Watkins Motor Lines (see story, p. 1), FedEx Corp. supported getting into the longhaul less-than-truckload business with a statement that "growth is dependent on accelerated economic activity and competitor failures." In light of recent economic news about inflation, rising fuel prices and the like, mention of competitor failures is noteworthy.

The closing is scheduled for August 2006, about 18 months prior to the March 31, 2008, expiration of the National Master Freight Agreement that covers most hourly workers at four trucking companies within YRC Worldwide and at ABF Freight System. It is also timed to handle any longhaul freight diversion that might result from the UPS contract with Teamsters that expires July 31, 2008. Both YRC and UPS Inc. will enter these negotiations with "double breasting," or a mixture of union and nonunion employees.

The history of prior contract negotiations shows that shipment diversion can be significant. Even during the less challenging labor negotiation period of 1998, Yellow and Roadway experienced diversion of tonnage and shipments to nonunion carriers. Yellow reported loss of business in late 1997 and early 1998 due to customer concerns over the possibility of work stoppage linked to NMFA talks with the Teamsters. The company experienced a decrease in tonnage of 3.6%. With similar negative effects at other union LTL carriers, the total revenue diversion is estimated at $325 million.

The contract talks in 2003 were less disruptive, largely because of the closing of unionized Consolidated Freightways. The contract talks in 2008 have the potential to be more disruptive.

The Watkins acquisition gives FedEx Freight most of 2007 to integrate that operation into the FedEx family of operating companies from technology, marketing, branding and sales perspectives.

What are the potential benefits of this deal for FedEx Freight?

■ It will be positioned to be the preferred nonunion longhaul LTL carrier in case of any diversion of longhaul LTL shipments from union carriers in anticipation of challenging Teamsters negotiations.

■ It gives FedEx Freight a separate operating network optimized for longhaul service such that each network can focus on being the best in its market segment.

■ FedEx will gain capacity in terms of terminal facilities, drivers and experienced management — all of which are at a premium in the current tight market.

■ It will leverage FedEx's marketing, technology and portfolio of global transportation services for a bundled offering to include longhaul LTL service.

■ It creates the single largest branded LTL carrier in North America, with annual revenues of $4.5 billion — the next closest being Yellow Transportation at $3.2 billion.

■ It extends Watkins' longhaul service to smaller markets not presently serviced via its 139 terminal facilities by leveraging FedEx Freight's network of more than 330 terminals nationwide.

The implications of this deal will stretch far beyond FedEx Corp. It will result in continued changes in the LTL and broader transportation industry as follows:

■ Teamsters may view the expanded FedEx Freight as a bigger threat to loss of business by YRC and ABF companies. This could pressure union leaders to be cooperative for early dialogue and a more carrier-friendly NMFA contract with member carriers.

■ After the current NMFA expires in 2008, YRC may integrate Yellow and Roadway networks into one longhaul operation branded as YRC National and bring all regional operating units — i.e., USF Holland, Bestway, Reddaway and New Penn — under one operating company branded YRC Regional, for greater leverage of marketing and sales resources.

■ The few remaining LTL carriers with a national footprint, such as Con-way Freight, Estes Express, R&L Carriers and Old Dominion Freight Line, will find it more compelling to be acquired by global companies such as DHL International, Deutsche Bahn or TNT Express. Alternatively, these LTL carriers would seek to merge with other large carriers for density and market penetration to compete successfully with the more diversified services of FedEx and UPS.

■ UPS is likely to make another large LTL acquisition. The target carrier and timing would be influenced by the strategy or results of contract negotiations with the Teamsters in 2008.

■ Smaller LTL carriers, with less than $100 million in annual revenue, will find it difficult to support investment in technology, marketing, new equipment and employee recruiting and retention programs to meet customer, regulatory and internal needs of desired operating margins to stay in business. These carriers will need to be aggressive about looking to be acquired by larger carriers such as Vitran Express, Saia Motor Freight and ODFL that need to complete their national footprint.

■ While about 200 companies offer LTL service, 33 of those carriers have annual revenues below $5 million and 90 have annual revenues below $10 million. These carriers mainly operate in a metropolitan area or a single state. The 90 carriers collectively generate about $500 million in annual revenue and are too small to be acquisition targets or a competitive threat to the larger companies.

While the regional market has experienced considerable growth over the last several years, the shift has stabilized. Whether Watkins ends up being a good strategic fit or not, it offers great timing for faster penetration of the $9 billion longhaul LTL market.

SJ Consulting is based in Pittsburgh.