THE GAP BETWEEN LTL AND TRUCKLOAD IS A RELATIVELY NEW TREND.

By Michael D. Scheid

REBOUNDING MARGINS

PUBLIC LESS-THAN-TRUCKLOAD CARRIERS posted a slight operating profit in 2011 after three years of operating losses. Their combined operating margin of 2 percent was a rebound from their minus-1.3 percent margin in 2010. This 3.3 percent improvement was better than the 0.6 percent gain for truckload carriers and the 1 percent increase in ground parcel margins.

Despite the swing in profits, public LTL margins still lag truckload operators' 7.5 percent margin and the ground parcel divisions of UPS and FedEx (13 percent).

Parcel carriers historically have generated higher operating margins than the LTL industry, but the gap between LTL and truckload is a relatively new trend. In 2005 and 2006, average margins for LTL and truckload carriers were around 8.5 percent each. From 2005 to 2007, the difference in the average margins of the two segments was less than 0.5 percent.

This gap ballooned to 5.5 percent in 2008 and 10.9 percent in 2009 as predatory pricing and freight diversion to competing modes resulted in large LTL operating losses. The margin difference has subsided since, but average LTL margins were still 5.7 percent lower than truckload in 2011.

Private LTL carriers tell a different story than their public competitors, improving their margins 2 percent on average to about 5 percent last year. Private LTL carriers maintain margins that exceed their public counterparts by having a long-term focus on operations through disciplined pricing. Consider that of the top 25 LTL carriers, the private companies control only 25 percent of revenue, but account for nearly half of operating income.

Margin expansion in the LTL segment in 2011 resulted from a 5 percent increase in base yields on top of 2 percent growth in tonnage. Despite this uptick in yields, however, pricing is still below 2008 levels and is part of the reason LTL profits lag other trucking segments. With mediocre economic improvement in the short term, 2012 looks to be another year where LTL carriers will need strong price increases and operational changes to offset escalating expenses and drive margin growth.

One pricing area for LTL carriers to focus on is fuel surcharge caps. Unlike truckload, where fuel surcharge revenues typically recover less than 75 percent of fuel expenses, LTL carriers historically have recouped more than 80 percent of fuel costs through fuel surcharge mechanisms. Increasing use of fuel surcharge caps, however, reduces the potential revenue a carrier can collect and creates cross-subsidies that also impact operating profits.

In 2011, Con-way Freight's actual fuel surcharge percentage (reported fuel surcharge revenue as a percentage of base revenue) was 67.5 percent of the published rate; in 2007, it was 77 percent. For Old Dominion Freight Lines, the actual fuel surcharge was 73 percent of published in 2007 and 67 percent in 2011. If Con-way had maintained the 77 percent retention rate in 2011, the carrier's operating margin would have been 5.8 percent, compared with the 3.7 percent margin the company actually earned. With diesel costs rising in 2012 and the foreseeable future, more fuel surcharge caps will be hit and profits will continue to be constrained.

Another area of potential margin improvement deals with minimum charges. The average weight of an LTL shipment is about 1,300 pounds, but the median weight is closer to 600 pounds, because carriers handle a large volume of shipments weighing less than 500 pounds. The majority of this lighter freight incurs minimum charges.

As a result, about 40 percent of a carrier's shipments are priced at a minimum. Although carriers cannot easily raise minimum charges without risking further freight loss to other modes and competitors, they can make operational changes to increase the profitability of these shipments. Right-sizing pickup and delivery equipment will lead to higher margins on lightweight shipments.

Other factors are in place that on their own will keep costs from increasing and result in short-term margin relief for the LTL industry. The warm winter and a limited number of snowstorms compared to last winter will lead to cost savings in the first quarter. The leap year also will increase profits in February as the carriers benefit from an extra revenue day.

Another factor benefiting LTLs is the tightness in the truckload sector that is leading to heavier LTL shipment weights. The fixed costs associated with pickup and delivery mean heavier shipments are typically more profitable than lighter ones, and carriers typically welcome an increase in shipment weight. As truckload capacity tightens, shippers become less likely to tender their heavier LTL loads to truckload carriers, so these shipments shift back to LTL operators.

LTL shipment weights started rising in the fourth quarter, increasing an average of 0.6 percent year-over-year, compared with the minus-0.4 percent decline in the third quarter and the flat year-over-year change in the second quarter. This upward trend should continue as demand for truckload moves remains steady and truckload carriers keep a lid on capacity additions.

The LTL segment has the ability to mitigate impending cost pressures and improve profits in 2012, provided carriers focus on increasing rates, removing fuel surcharge caps and recapturing freight lost to competing modes without increasing capacity. JOC

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