

# TRUCKING'S MIXED BAG

By Michael D. Scheid

The trucking industry was quick to rebound in 2010 after a major falloff in revenue and profit during 2008 and 2009. The rebound is continuing this year as trucking companies increase rates and push profits higher. Although profit margins have increased, however, there's room for improvement among many carriers.

Some carriers produced record profits in the second quarter, and others got close. Old Dominion Freight Line, for example, reported an operating margin of 13.5 percent, the largest quarterly margin in the company's history and nearly 2 percentage points higher than its previous best.

ODFL's margin was more than two times better than any other public less-than-truckload carrier and came while the company was competing with more than 20 large carriers in a fragmented market. Even some private and smaller LTL carriers posted double-digit margins in the quarter.

Among public truckload carriers, only Heartland Express had a better operating result than ODFL, producing a 23.8 percent margin during the quarter, its best result in six years. Heartland's segment-leading operating margin is due in part to its low fleet age and its concentration of freight in profitable, regional lanes. The company's young fleet, although reducing maintenance costs and limiting tractor downtime, doesn't generate a high operating margin alone. Consider that Covenant Transportation's average tractor age was 1.7 years at the end of the quarter, the same as Heartland's, but Covenant had an operating margin of 4.2 percent.

Heartland's average length of haul has declined less than 5 percent since 2005. Other truckload carriers have decreased their length of haul by as much as 30 percent during the same period as companies shifted to regional lanes because of increasing competition from intermodal and changes in shippers' supply chain practices.

Heartland also routes its trucks to stay within the same region, limiting empty miles and reducing operating expenses. One result is an industry-low empty mile percentage.

Parcel carriers also have been successful in increasing first half margins. FedEx Ground's fiscal fourth quarter 2011 margin of 18.4 percent was the best in the company's history and 2.1 percent better than a year earlier. UPS's operating margin of 12.5 percent for its domestic business also was more than 2 percent better than its 10.3 percent margin a year earlier.

Increasing demand and pricing enabled other companies to make significant strides in improving their second quarter profitability. ABF returned to profitability for the first time since the third quarter of 2008, Celadon had its highest margin in four years, and Werner reported its best operating margin since the fourth quarter of 2005. Despite the improvement by most carriers, the weighted average operating ratio for the public LTLs is still less than 5 percent, and the average margin for the truckload carriers is less than 10 percent.

Some carriers have cited tightening driver availability as an explanation for a lower operating margin. But in 2005, when the driver shortage was at its peak, the combined operating margin of the public truckload and LTL carriers was approximately 9 percent.

Furthermore, the unavailability of drivers affects revenue growth more than margin, provided the carriers don't have many empty trucks parked in the yard. The 2 cents-per-mile wage increases by several truckload carriers only affects about 35 percent of total operating expenses, while the higher rate increases that can be achieved when capacity is tight are taken on total revenue.

Rising diesel prices also is a common culprit cited by analysts for pressuring operating margins. But this isn't a new phenomenon (remember 2008?) and can't bear the responsibility for lower profits. Companies have had three years to prepare for another quick rise in fuel prices by restructuring poor fuel surcharge mechanisms.

Between truckload and LTL, the LTL carriers still have the most room for margin expansion. After margins of 8.5 percent in 2005 and 2006, the average margin for public LTLs was negative in 2008, 2009 and 2010. The second quarter 2011 weighted average margin of 3.9 percent is certainly an improvement compared to the last three years of losses, but is still down 4.6 percent from its peak five years ago.

LTL carriers are making strides toward a return to peak margins through better pricing methods. Recently announced rate increases on tariff-rate customers should drive higher margins as long as carriers refrain from raising discounts. Although this will improve profitability on about one-third of revenue typically covered by base tariffs, bigger gains are waiting in the form of eliminating cross-subsidies between shippers that exist through extensive use of freight-all-kinds pricing, lack of charges on labor-intensive accessorials services and failure to charge for the correct weight of the shipment.

Because truckload carriers felt less margin pressure in prior years, 2010 margins were less than 2 percent below their mid-2000s peak. Margins inched closer to peak levels in the first half of the year, but there is still opportunity to raise profitability. No public truckload carrier came within 10 percent of Heartland's second quarter operating margin, evidence there is room for more than one carrier to achieve an operating margin in the high teens.

Increasing operating margins will generate cash LTL carriers need to upgrade their aging fleets. Consider ABF's average road tractor is twice as old as it was four years ago and even ODFL's tractors are 50 percent older on average than in 2005.

With economic uncertainty and one pending regulation that could be detrimental to nearly all carriers, the operating outlook isn't rosy. Increasing operating margins now will help carriers avoid indigestion from the roller-coaster ride in equity markets and consumer sentiment driven by the U.S. and European financial crisis that is sure to persist until early 2013. **JOC**



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