STIFEL

September 10, 2013

Transportation

Less-Than-Truckload (LTL)

Industry Update

In 2Q13 Review, TL and LTL Pricing Gains Losing Steam

On pp. 2-5, we look back at 2Q13 for some key trends in TL and LTL operating statistics, but page 1 comments here are focused on LTL. While structurally, we believe the LTL industry is well positioned to increase pricing and margins in the midst of a slow-growth environment and claw back its lost margin, it appears the lack of carrier discipline is beginning to interfere with those efforts. We have seen a deterioration in public LTL yields since 3Q11, with 2Q13 average public carrier yields increasing only 0.5% y/y (the weakest since 1Q10). Excluding Roadrunner Transportation, whose results were influenced by acquisition-related mix changes, yields were up only 1.2%—again the weakest since 3Q10. Adjusting for changes to average shipment size, fuel surcharges, and length of haul, core pricing was up only 0.4% y/y (or 1% y/y excluding Roadrunner), in our estimate.

- August was OK, depending on which carrier we spoke with – basically, flat to up (still roughly in that 0%-2% growth range we've been writing about for a while; See **Exhibit 5**), even though the ISM Index and rail carloadings (up 4.4% y/y, excluding coal and grain in the most recent week) are indicating more strength. One carrier has seen significant y/y tonnage gains, but this is a private regional player who is mainly gaining share, in our view, from a struggling competitor who has lost a significant volume.
- Most interestingly, 2Q13 conference call comments about pricing did not foot with the numbers reported, in our opinion. Most management teams cited 3%-5% rate increases, but reported what we estimate to be price increases closer to 1% (See **Exhibit 6**). It is possible that while contract renewals were in the 3%-4% range, not all of the accounts approached for increases accepted the increase. In our view, national accounts remain an issue, as the pricing gap between the large national accounts and small regional accounts is not closing.
- LTL has yet to benefit from any capacity issues in or spillover freight from the truckload sector, as TL volumes have been weak (See **Exhibit 1**), which can be explained, in our view, by the weak summer retail season and resulting increased retail inventories public retailers recently reported.
- On the cost side, companies are trying to keep a lid on health care expense increases, which have been and continue to be significant. Safety is another area several carriers are targeting for cost savings, especially with most LTLs having significant deductibles per incident.
- Due to the sluggish freight market and decelerating pricing, we believe margin expansion may prove difficult near-term for most carriers aside from productivity improvements available to a select few stronger operators (See **Exhibit 8**).
- We are maintaining our Hold ratings on the public LTL carriers until we see ahead a reversal of the current pricing trend, stronger freight volumes, and a tighter supply/demand relationship in the TL sector. YRCW (Hold, $17.78) should remain volatile but may have the most near-term upside potential, in our view, as it continues to search for capital structure relief and could benefit from improving fall freight volumes, if its change of operations issues are truly in the rearview mirror. ABFS (Hold, $26.09) could have significant upside or downside from here, depending on the resolution of its two remaining outstanding supplemental agreements that are preventing the company from benefiting from its new labor contract.

Prices as of the close 9/9/2013

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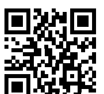

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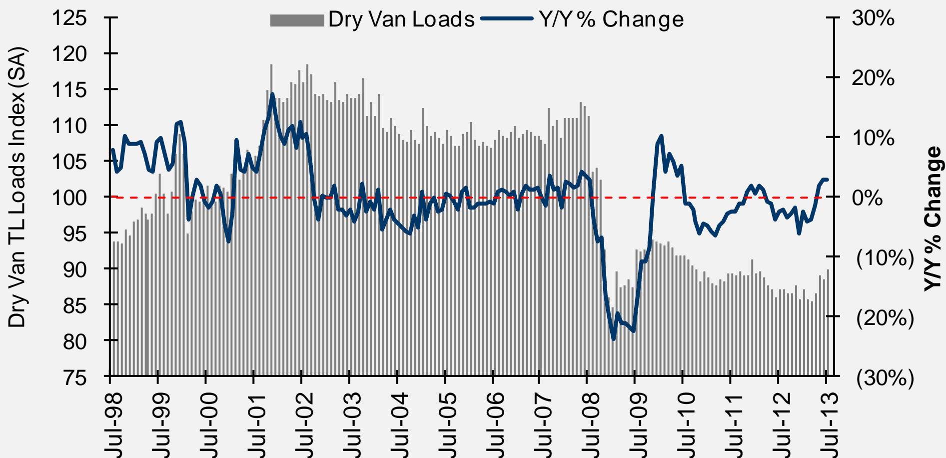
Truckload (TL) – 2Q13 public carrier overview

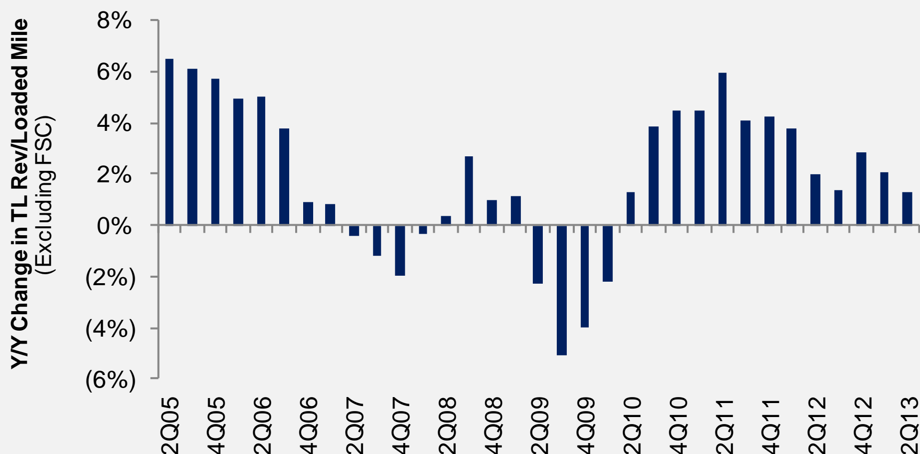
Exhibit 1: Absolute TL loads remain weak relative to pre-recession peaks



Source: American Trucking Associations, Stifel format

Year-over-year truckload volume comps have been disappointing for the last several years, as underlying core economic growth has been sluggish. Absolute loads have yet to recover to pre-recession levels, and would require a meaningful housing recovery, in our view, to do so.

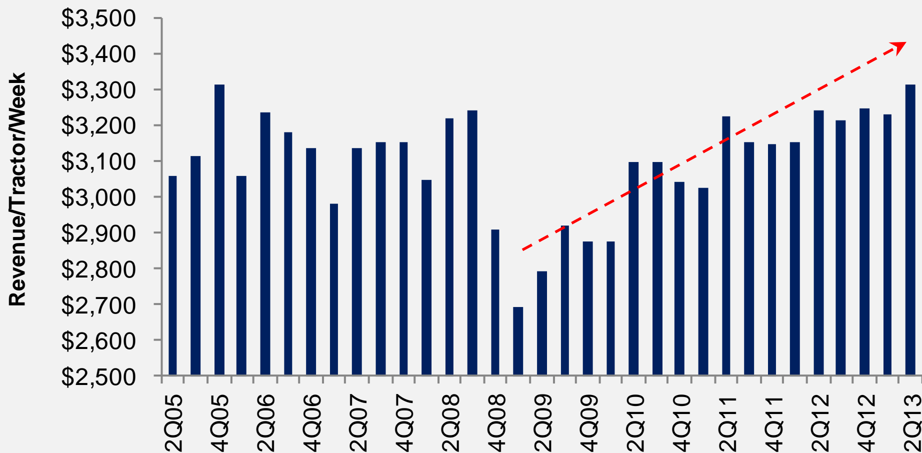
Exhibit 2: Truckload yields (ex. fuel) have been decelerating since their 2Q11 peak



Source: Company data, Stifel format

Truckload yields have been positive for the past 14 quarters, but growth has decelerated steadily since their 2Q11 peak to a very modest 1.3% y/y in 2Q13. These results exclude fuel surcharges, so the trend reflects a degradation in core pricing momentum, as volume trends have stagnated.

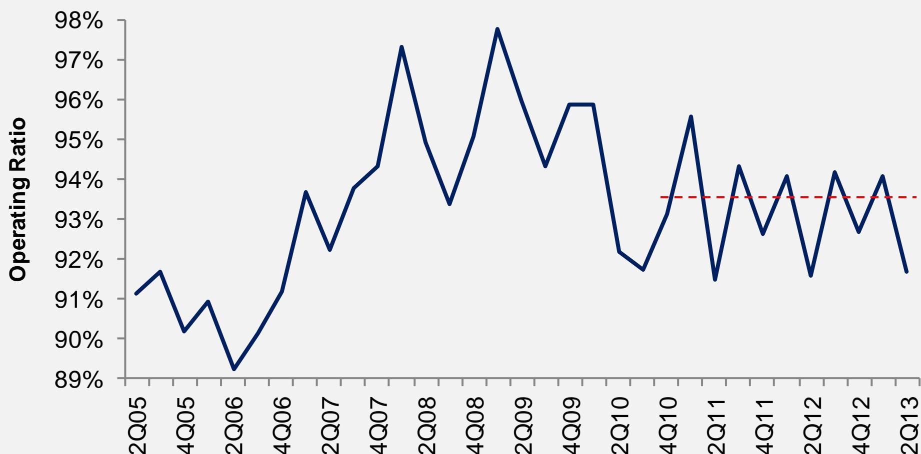
Exhibit 3: Revenue per tractor per week has improved steadily since 1Q09



Source: Company data, Stifel format

Better utilization and capacity discipline, especially among the larger, more well-capitalized carriers has helped breed an improving trend in revenue per tractor per week, our favorite TL metric.

Exhibit 4: Tepid freight and softening yields equate to hard-won margin gains

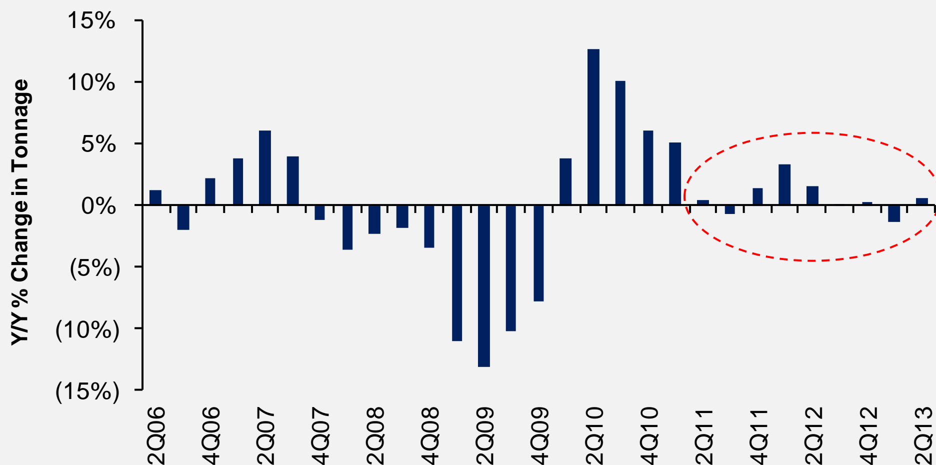


Source: Company data, Stifel format

Ultimately, slow recovery in the core economy has produced a sluggish freight climate, which has hindered traction on the yield side, making it difficult for the industry to improve its operating ratio. So, even as revenue per tractor per week has improved, so too has the cost of TL operations increased.

Less-Than-Truckload (LTL)– 2Q13 public carrier overview

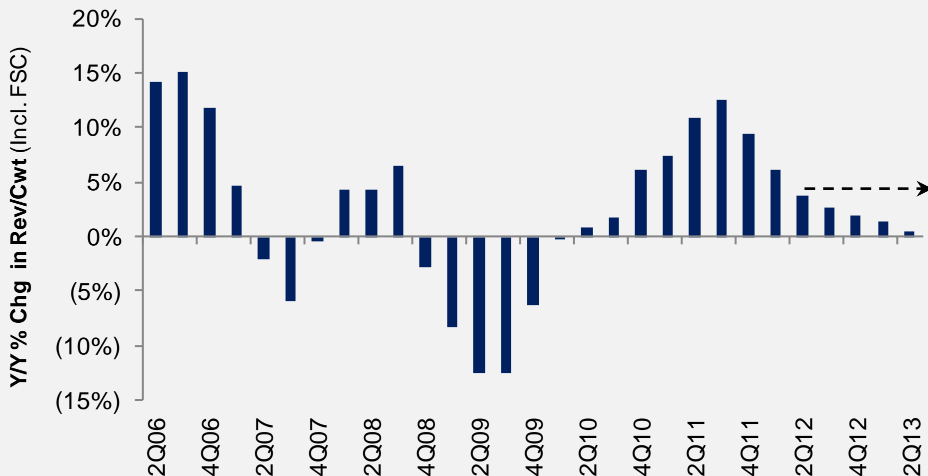
Exhibit 5: LTL y/y tonnage comps unimpressive for most of the last 2 years



Source: Company data, Stifel format

Less-than-truckload (LTL) volumes have been uninspired for the majority of the last two years, which, in our view, has helped carriers stay disciplined with respect to pricing and capacity additions.

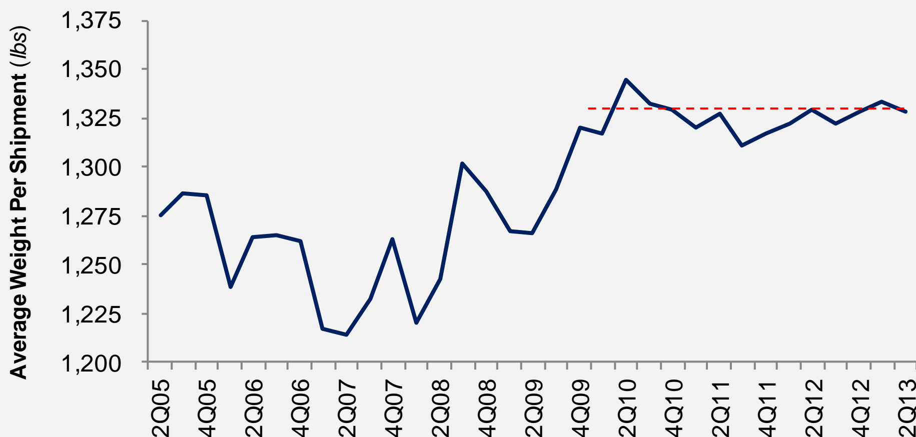
Exhibit 6: LTL y/y pricing comps have decelerated, but remain positive ex. FSC



Source: Company data, Stifel format

LTL yields (as measured by revenue per hundredweight, including fuel surcharge) have been positive for the past three years, but have been decelerating. We would not be surprised if further margin improvement is challenged near-term with pricing and volume growth barely positive.

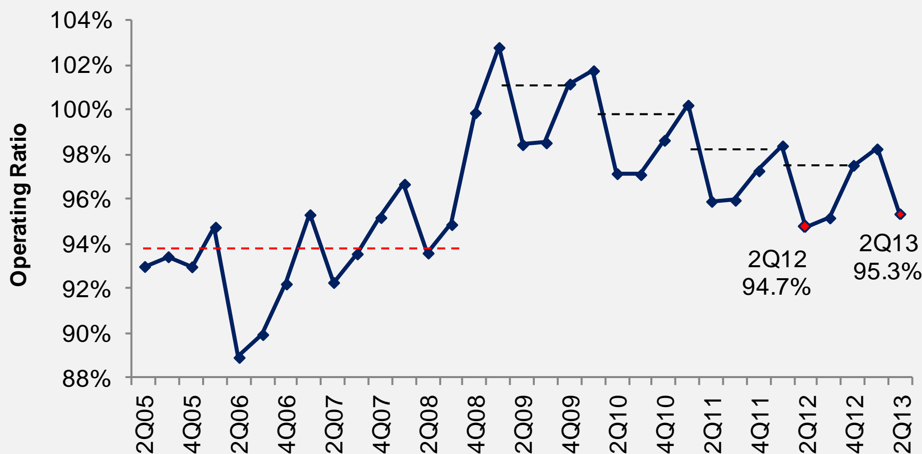
<u>Exhibit 7</u>: Average weight per shipment has leveled off over the last 3 years



Source: Company data, Stifel format

Average weight per shipment increases have stalled due to the slow recovery and have generally not been a significant factor in y/y yield changes.

<u>Exhibit 8</u>: 2Q13 y/y OR deteriorated by 60bp; still off from pre-recession average



Source: Company data, Stifel format

It's been a mixed bag, as carriers like Saia and Old Dominion have made significant strides in their margins, whereas others, like Vitran, ABF, and YRC Freight, are still fighting to get up to industry average margins or even to just get back to profitability.

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