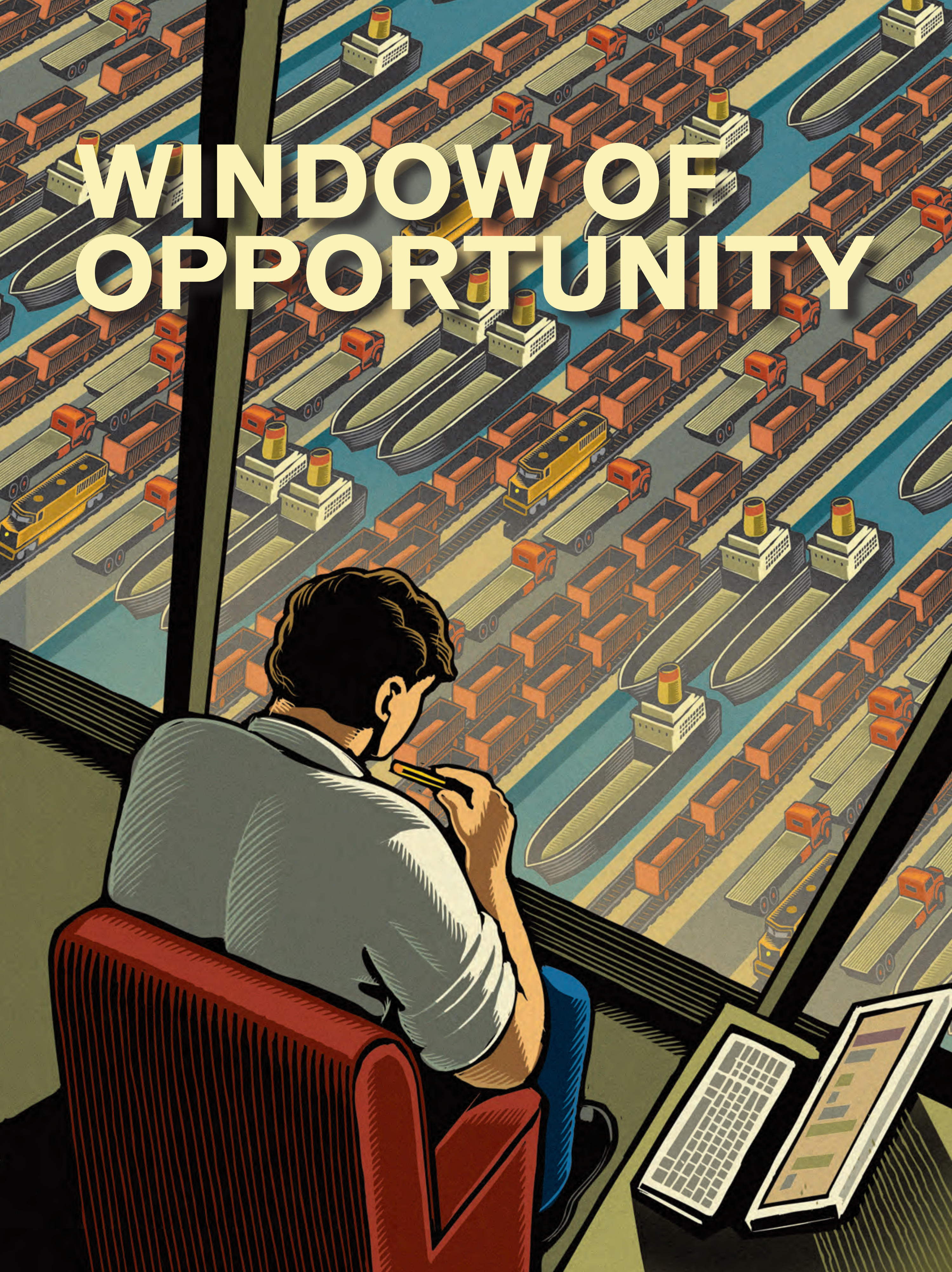
WINDOW OF OPPORTUNITY



2009 LOGISTICS RATE OUTLOOK

BY **JOHN PAUL QUINN,** CONTRIBUTING EDITOR

The confluence of global economic weakening and widespread carrier problems offers shippers a rare rate opportunity—but for how long?

As 2008 came to a close, world markets were in slow-motion freefall, retail spending was off significantly, and overcapacity was the prevailing condition of virtually every transportation mode.

Rather than a perfect storm, this represents a perfect break in the weather for shippers who have been battered for months by heavy fuel surcharges and uncertainty as to what modal alternatives to consider. With oil dropping cataclysmically from $150 to $50 a barrel in just six months, and ships, trains, and trucks empty and idle, observers agree that the first half of 2009 should be the time for shippers to turn the situation to their own cost-saving advantage.

But how long this opportunity will last depends on the duration of the present economic doldrums. "The economy will continue to shrink into the middle of this year, and we don't expect to see growth again until 2010," says James Haughey, director of economics for RBI-US, *Logistics Management*'s parent company. "The worst period will probably be the next three to four months."

Haughey believes that oil prices will settle in the $60-$70 range while the global economy remains slack, so fuel-cost adjustment clauses will actually benefit shippers over this time.

"The concern for carriers of all types is when the upturn will happen," adds Paul Svindland of supply chain advisory firm AlixPartners. "Even if the new administration stimulates the economy and things start to fall into place in February or March, the effect may not hit the freight industry until the summer. So shippers should understand that even in a best case scenario, it may be as late as the third or fourth quarter before there is any improvement in the carrier position."

The critical takeaway is this: Now is the time to review all carrier contracts and strike while the iron is hot. Bargain hard while lower rates are available and work for agreements with as long duration as possible; but remember to exercise judgment in maintaining carrier relationships given the dangerous uncertainty of future market conditions. Here is a snapshot of what shippers can expect to encounter in the modes of transport they use.

RATES UNDER PRESSURE ON THE RAILS AND ROADS

While sources report that rail rates were down 8 percent for the last quarter of 2008, many rail contracts have already been negotiated for 2009. But for those shippers who have not yet committed themselves, there is wiggle room.

"Demand for rail line-haul operations will only turn around in mid-2009 at the earliest, so rates will be under intense pressure, and this is the best time to negotiate in this sector in years," says David Jacoby, president of Boston Strategies International, a supply chain strategy consultancy.

In terms of the intermodal situation, the leverage is even more in favor of the shipper. "Shippers should buy capacity between now and June," advises Brooks Bentz, partner, supply chain transportation at Accenture. "If a shipper is considering changing his network or shifting to intermodal, or going from LTL to TL, he should do it now. The opportunity won't get any better than in the first half of this year, so this is the time for the shipper to take care of business."

The urgency relates to a large extent, Bentz believes, on the precariously transitory nature of oil prices: "Anyone who thinks the fuel crisis is over is not living in the real world. Shippers have to be aware that fuel will inevitably come back as a major factor and be up in price and down in supply."

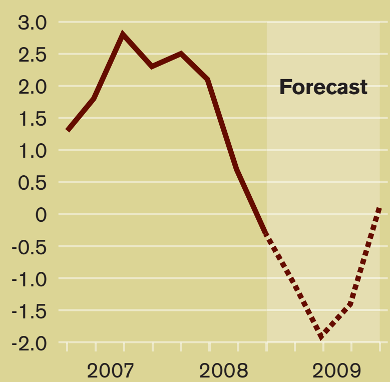
But cheap fuel and the resulting evaporation of surcharges aren't the only complications carriers face.

"For both rail and trucking carriers this is a brutal market, and there is no indication that volumes will pick up in the first half of 2009," says AlixPartners' Svindland. "So, from the shipper's side of the equation, with plenty of capacity available, trucking rates will be in their favor because it's a buyer's market with significant downward pressure on pricing."

The sharp drop in fuel pricing factors significantly in the shipper's negotiating position, according to Svindland. "Historically, shippers shift from truck to intermodal when fuel prices are high and capacity is tight," he notes. "But now with the major retail, construction and automotive markets all weak, both trucking and intermodal carriers are

GDP expected to register year over year growth of 0.7% in 2009–the smallest increase since 1954

(percent change* in real GDP)



* % change from prior quarter at annualized rate
Source: Blue Chip Economic Indicators (Dec. 2008)

hungry for business and aggressive in bargaining to get it. So, shippers may want to stay with going over-the-road, or if they are into long-haul traffic that is not crucially time-sensitive, this is an opportunity to consider the intermodal option."

Add to this the fact that a number of TL companies have gone out of business, others are downsizing their fleets, owner-operated trucks are being repossessed, and the likelihood is that the rate situation will most probably stay stalled—since the drop in capacity has been matched by a drop in shipper volume and fuel surcharges are no longer an issue.

But on the LTL side, things might become more competitive due to the labor and volume problems of Yellow Transportation, the largest player in this sector. "LTL rates could be down 1 to 4 percent for early 2009," says John Larkin of investment advisory Stifel, Nicolaus & Co. "They would only rebound dramatically depending on what happens to the largest carrier in the field. If Yellow has to continue to consolidate internally and shed traffic, this would tighten up capacity and there would be more freight than the industry could carry."

Larkin also warns that the current reduction in fuel surcharges is a temporary respite, and he suggests that shippers who are heavily into LTL consider options such as intermodal, more TL, and to look for ways to interface TL with regional LTL to achieve the distribution they require.

PLENTY OF SPACE AT SEA AND IN THE AIR

Nowhere is the capacity glut more apparent than in the air and ocean freight sectors; in fact, ocean rates slipped by as much as 30 percent last year due to a combination of factors.

"Until mid-2008, with the weakened dollar, there was a boom in U.S. export traffic, but when the currency situation reversed in the latter half of the year, both imports and exports were down," notes Jacoby at Boston Strategies. "So ocean carriers had to absorb a lot of costs, and at the same time they had commissioned the expansion of their fleets by some 10-12 percent. So for the shipper there is an imperative to act now, because he could lose six months of rate gains if he doesn't renegotiate."

And the carriers are suffering, no matter what sea lanes they work. "The Europe-Asia market has cratered, and the state of trans-Pacific to U.S. traffic is atrocious," states Mike Regan, CEO of freight payment specialist Tranzact Technologies. "Containers that shippers paid $2,000 for a year ago…they now pay $700 for, and it may go lower."

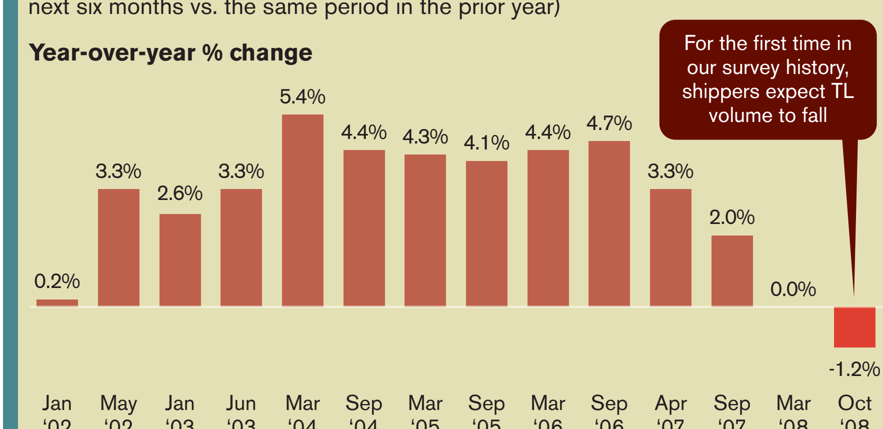
And for carriers it's worse up in the air. As an example, Air Japan has canceled

> **"Even in a best case scenario, it may be as late as the third or fourth quarter before there is any improvement in the carrier position."**
>
> – Paul Svindland, AlixPartners

> **"Anyone who thinks the fuel crisis is over is not living in the real world. Shippers have to be aware that fuel will inevitably come back as a major factor and be up in price and down in supply."**
>
> – Brooks Bentz, Accenture

Economic crisis expected to weigh on TL volumes

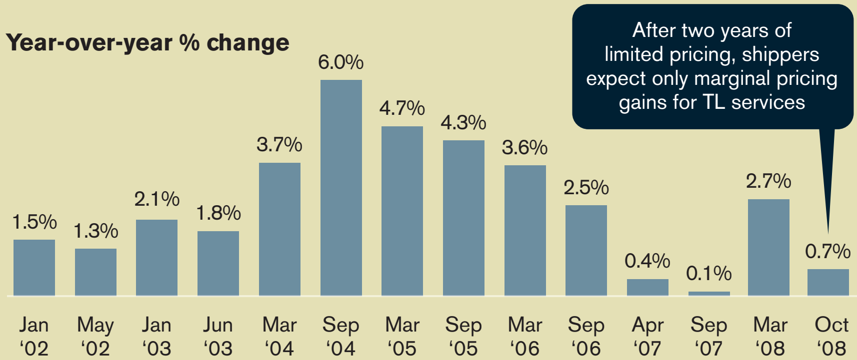
(Shippers' expectations for changes in TL volumes over the next six months vs. the same period in the prior year)



Source: Morgan Stanley Freight Pulse survey (October 2008)

Shippers see marginally higher TL rates over the next 6 months

(Shippers expect TL rates to rise, but well below cost inflation. Given expectations for shrinking fleets and carrier bankruptcies, shippers generally feel capacity will grow tighter in the future which would put upward pressure on rates)



Source: Morgan Stanley Freight Pulse survey (October 2008)

its freight service from the Orient to New York, and will fly into Chicago and link with the East Coast by road. "There just isn't enough freight density to keep the planes flying because the volumes aren't there," notes Bentz at Accenture. "Again, it's a question of renegotiating now if you have to ship by ocean or by air."

PARCEL SLUGFEST

The most significant development in the parcel sector has been the virtual exit of DHL from the U.S. marketplace, especially since the company was the acknowledged low-cost provider for price-sensitive shippers (See Patrick Burnson's Parcel Express Roundtable on page 33).

Most likely, former customers of DHL, which was the low-cost provider, will continue to be price-conscious and migrate to USPS, UPS, and then FedEx, according to observers. But this apparent tightening of capacity isn't necessarily a threat for shippers.

"Increasingly, fewer customers actually pay book rates," says Ted Scherck at The Colography Group, an advisory firm for parcel shippers. "When the major parcel carriers announce 6 percent rate increases they will not get anywhere near that in a competitive marketplace. Historically, in a recessionary period, if they get two-thirds of what they ask for they're lucky."

According to Scherck, shippers should respond by bargaining for lower rates, or consider changing the timeframe and thus the mode by which they move their product. Over the latter part of 2008, the trend was from overnight to deferred air or to ground parcel and ultimately to LTL.

"If a shipper is considering changing his network or shifting to intermodal, or going from LTL to TL, he should do it now. The opportunity won't get any better than in the first half of this year, so this is the time for the shipper to take care of business."

– Brooks Bentz, Accenture

What is most critical for shippers in the parcel sector, says our sources, is to do your homework on what the rate structures of UPS, USPS, and FedEx are before bargaining with an existing carrier or switching to another. "When there are only three major players, pricing dynamics come into play," warns Jerry Hempstead at parcel advisory Hempstead Consulting. "This can get complicated, because USPS has only been deregulated for a year and is going through a learning curve on their pricing latitude."

Meanwhile, with DHL gone from the U.S., Hempstead adds that UPS and FedEx can be expected to boost their base rates to take advantage of shippers who don't realize they can renegotiate. "When a carrier has excess capacity and a fixed network, and there are declining volumes in the marketplace...if you have any kind of volume, you are now in the position to demand a better price," he adds.

IT'S NOW OR NEVER

Virtually every industry observer in every sector agrees that the first half of 2009 will be an almost unique period of bargaining strength for the shipper.

And their counsel is consistent: negotiate, renegotiate, and renegotiate again. Be sure you know the new rules and realities of each modal sector. Try to lock in conditions of contract for as long as possible, especially as relates to the fuel situation.

Finally, shippers need to remember that prognosticating transport industry conditions has proven to be both risky and virtually impossible. Six months ago anyone predicting that oil would drop below $50 a barrel by year's end would have been considered as having open capacity in the I.Q. department. Market tracking models and benchmarks in many cases last no longer than days or weeks, and everything has to be rethought and renegotiated–now.

Because what the rate outlook will be by the middle of 2009 is literally anybody's guess.

John Paul Quinn is a Contributing Editor to Logistics Management