FREIGHTWAVES
PASSPORT RESEARCH
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Asset operators: insurance, fuel, equipment values

Overview

In this report focusing on operators of trucking assets, we examine three headwinds for carriers: rising insurance costs, a potentially narrower wholesale to retail diesel spread going forward, and falling equipment values.

Trucking carriers are the safest and most compliant they've been in several years, but still face rising insurance costs, both in absolute dollars and as a percentage of revenue. Accidents are lower; fatalities in November were the lowest in years; fewer inspections result in violations. In our view, insurance costs are being driven by a separate cycle: insurance carriers left the commercial vehicle market and now the remaining players, facing less competition, are taking price.

The spread between wholesale and retail diesel prices that allows trucking carriers to profit from fuel surcharges has widened to more than $1.10/gallon, but we expect the spread to compress going forward. Although commodity prices are weak, downstream retailers have held retail prices up—that can only go on for so long until retail prices correct downward.

Used truck markets are oversupplied and asset values are declining. Expect low used truck prices through the first half of 2020 until volumes grow, capacity tightens, prices rise, and carrier sentiment turns bullish again.

Safety statistics

November trucking fatalities	333
Violations/inspections ratio	1.48

Commodity prices

WTI crude oil	$55.55/b
DOE diesel retail	$3.03/g
Wholesale to retail diesel spread	$1.10/g

Used truck prices

Three year old models	$52,860
Four year old models	$48,233
Five year old models	$37,878

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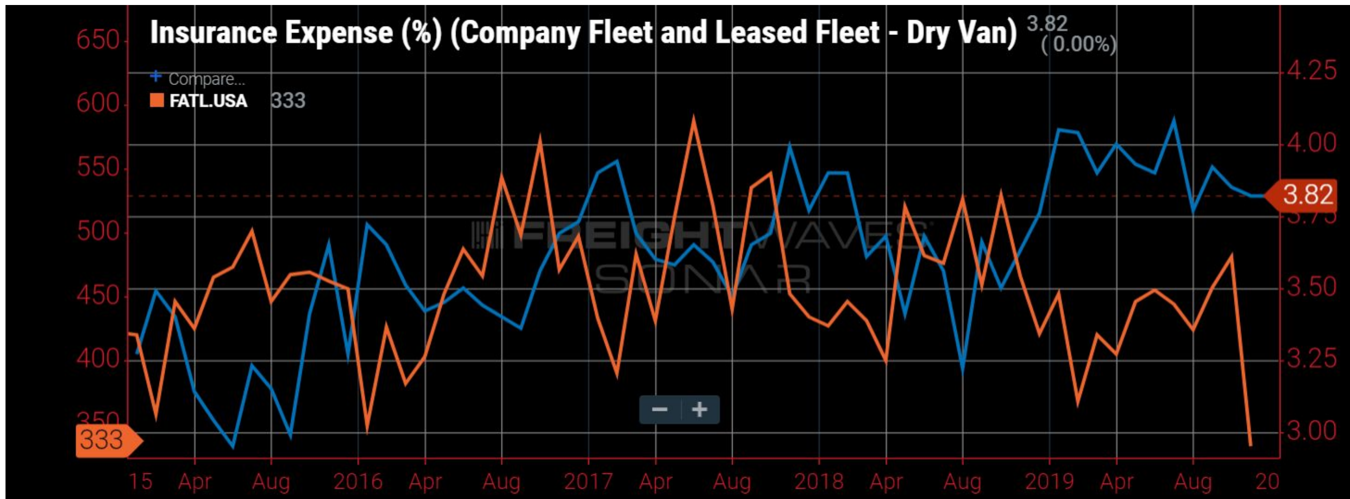
Accidents



FreightWaves SONAR

With regard to commercial vehicle fatalities, 2015-2017 was a very different picture than 2018-2019. Fatal accidents trended upward from 2015 through 2017 before reversing in 2018 and 2019. The last reported accidents number was the lowest monthly total in five years, great news for both truckers and motorists.

Unfortunately, insurance expense as a percentage of carriers' revenue has not followed the same downward slope. Even as the trucking industry suffers fewer catastrophic accidents, insurance carriers continue to raise rates.

Up until the beginning of 2019, both fatal accidents and insurance expense trended in the same direction. Accidents then continued to trend lower while insurance expense continued trending higher.

There are a few reasons behind the divergence in fatalities and insurance expense. First, insurance carriers are taking price. Several major insurance carriers have left the commercial vehicle insurance industry in the past few years, and reduced competition is finally allowing insurance carriers to raise premiums above claims. Secondly, trucking carrier revenues are down (so insurance costs, which are fixed, rise as a proportion of revenue).

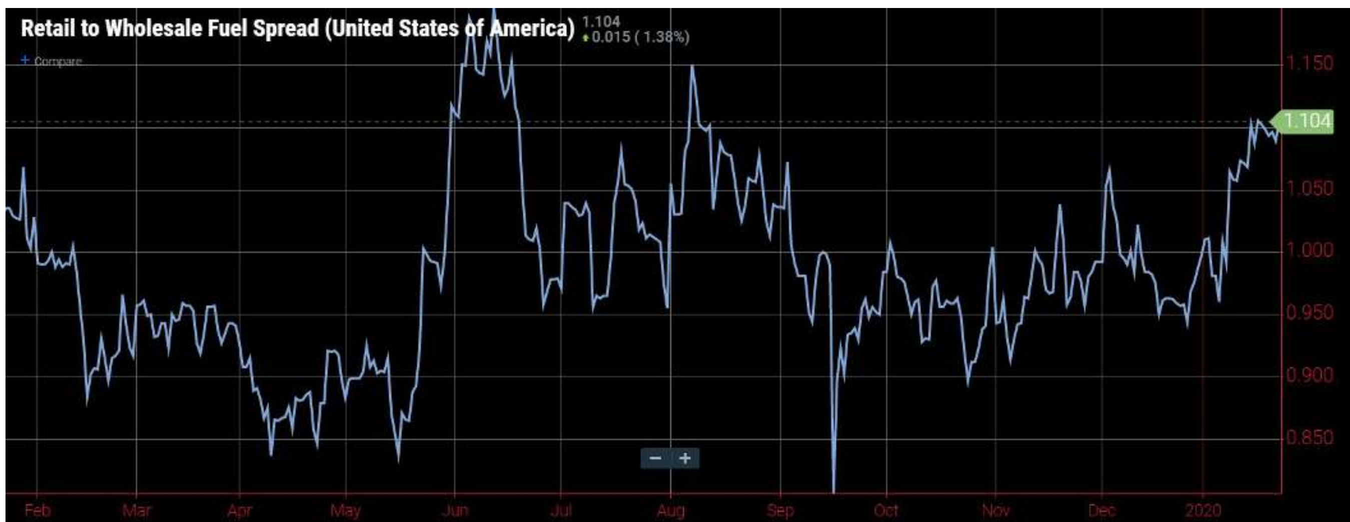
At least two trucking carriers who shut down last year specifically cited insurance costs as a reason for the company's failure. In late July 2019, Carney Trucking Company went out of business. Carney was founded in 1983 and had 25 drivers. A.L.A. Trucking also shut down in early June 2019, citing insurance costs.

Fuel

Trucking carriers large enough to negotiate truck stop fuel contracts and fuel surcharges with their customers know how important diesel spreads are to their business. If a carrier pays a price based on the wholesale or 'rack' price and is reimbursed by the shipper based on DOE's retail assessment, then the difference between the rack and retail prices have a material impact on its business.

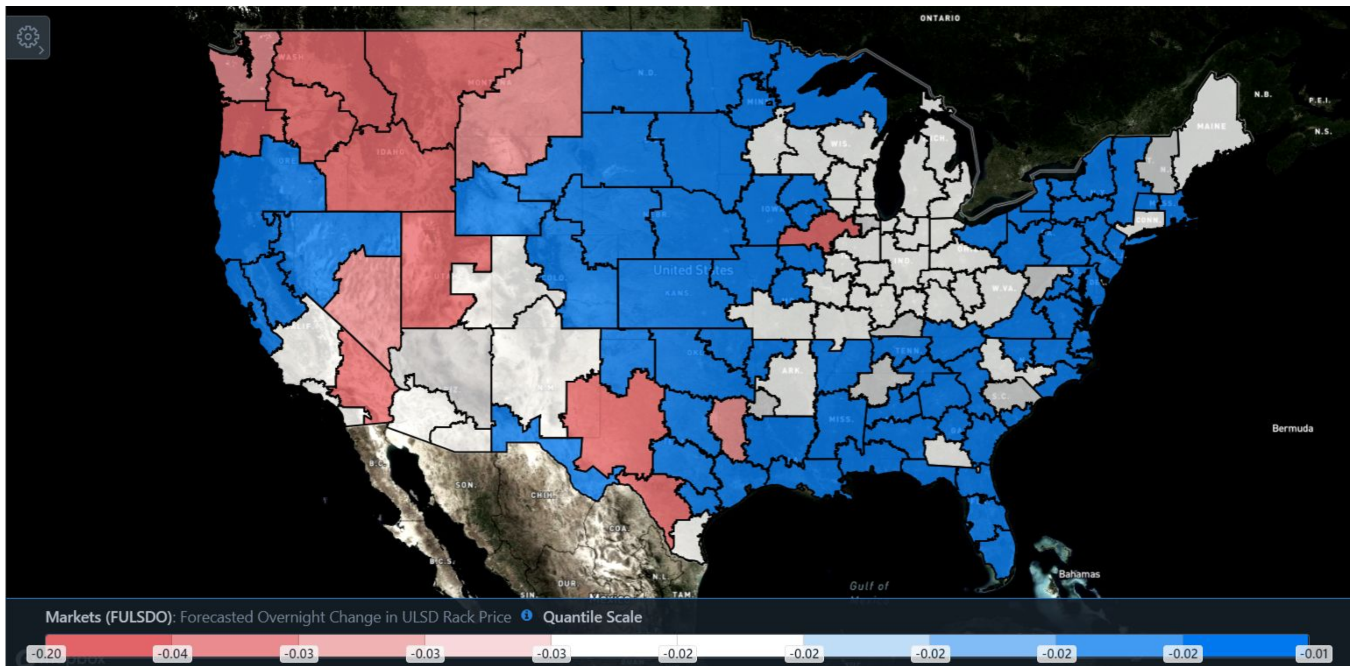
Rack prices are more volatile than retail prices because they move overnight based on crude oil futures markets, U.S. distillate inventories, and refinery capacity. And, of course, truck stops and gas stations hold retail prices steady as long as they can when rack prices drop to capture the spread themselves and avoid passing savings along to the retail customer.

This year, the rack to retail spread has widened to more than $1.10/gallon, creating an unearned windfall for trucking carriers. Growing U.S. oil production and weaker global economic growth have certainly been factors contributing to soft wholesale diesel prices, and we expect that macro backdrop to hold true for the foreseeable future. In a global oil market that has already shaken off attacks on Saudi production, the brouhaha in Iran/Iraq, and the loss of Libyan production, it's hard to envision a sequence of events that would move commodity prices substantially higher.



(FreightWaves SONAR: Retail to "Rack" Spread remains elevated)

However, we are bearish on the rack to retail spread going forward; we think that retail prices will eventually correct downward toward the wholesale price. That means that less cash from carriers' fuel surcharges will ultimately drop to the bottom line.



(FreightWaves SONAR: Map shows expected changes in diesel prices overnight for Friday, Jan. 24)

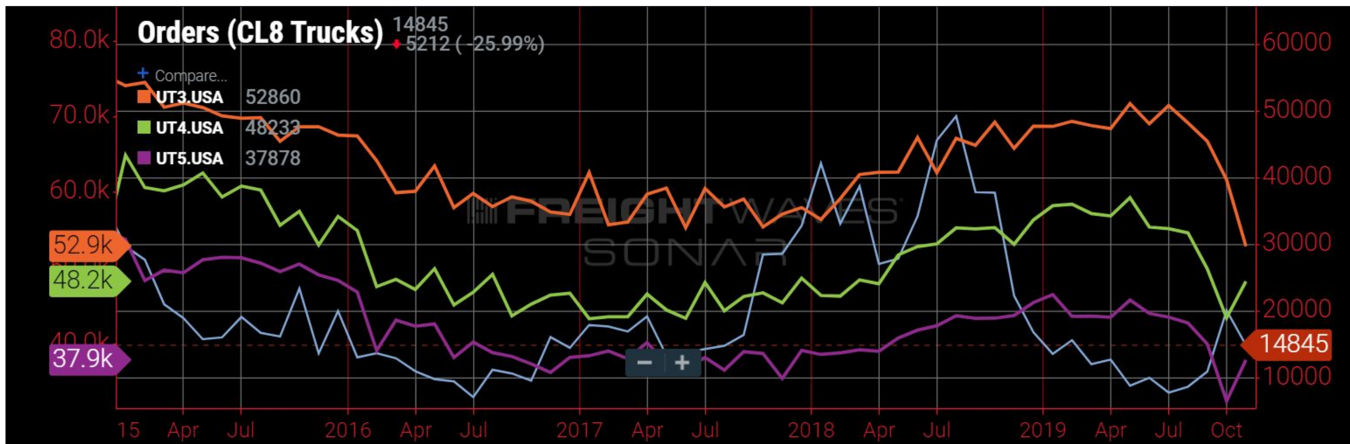
Where trucks decide to fuel up could be the difference in a few cents per gallon. Some fleets run optimizers to minimize fuel costs, but some don't.

We've built a forecasting tool in our data platform, SONAR, that predicts the overnight change in ULSD rack prices, which can help carriers decide where along their lanes to fill up. Rack prices are falling across the country (note that deep blue markets will see a one cent overnight drop, while the darkest red color is a 20 cent drop).

Equipment values

Overall, 2019 was a tough year for equipment values after a solid 2018. Trucking carriers took advantage of a hot trucking market in 2018 to order new Class 8 trucks well above the replacement rate. In 2019, new truck orders dipped as fewer companies had the cash or positive forward sentiment to justify replenishing or growing their fleets.

Large carriers typically replace their trucks with new orders every three years. But OEMs don't build new production capacity in response to an influx in orders; instead they lengthen their backlogs. In cycles like what was experienced in the back half of 2018, it typically takes between 6 and 10 months for the new Class 8 trucks to enter the market.



(FreightWaves SONAR: New Class 8 orders compared with Used Truck prices)

As the new trucks replenish fleets, enterprise carriers shift their 3 year old used trucks into the used market. The used market is now over-supplied with 3 year old models, driving the price for used trucks down near 4 year old truck prices. As that spread tightens, the market encourages buyers to purchase three year old trucks and sell them the following year for little to no depreciation.

This same cycle happened in 2016. New trucking orders spiked at the end of 2014 through early 2015. Once the new trucks hit the market in early 2016, new trucking orders dipped and used truck prices fell off the map.

As the trucking market looks to rebound in the first half of 2020, new truck orders should remain depressed as companies just replaced trucks within the last year and a half, but comps should ease throughout 2020. Look for 3 year old used truck prices to stabilize six to 10 months after the collapse of new truck orders.