Q1 2020 CARRIER OUTLOOK

JANUARY2020

FREIGHTWAVES FREIGHTINTEL RESEARCH

Key Highlights

- With outbound tender load volumes posting two consecutive quarters of strong year-over-year growth, it looks like the freight recession is officially over.

Figure 1 - Year-over-year comparables for key freight market metrics

Metric FREIGHTWAVES	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Tendered Load Volumes (OTVI.USA) y/y	-0.5%	-5.7%	7.1%	10.6%
Tender Rejection Rate (OTRI.USA) y/y	-78.3%	-78.7%	-70.5%	-24.2%
DAT Spot Rates (DATVF.VNU) y/y	-22.4%	-27.5%	-17.6%	-7.6%
Carrier Sentiment for Load Volumes % Change	-22.0%	-5.0%	34.0%	-7.0%
Carrier Sentiment for Line-Haul Rates % Change	-23.0%	-21.0%	105.0%	-13.0%

*y/y is year-over-year
*Carrier Sentiment is % change from previous Quarter

Source: SONAR and FreightWaves Q1 2020 Carrier Outlook Survey

- This does not mean spot and contract rates are going to immediately see a positive impact. Overcapacity was an issue throughout 2019 and will likely continue to be an issue for at least the first half of 2020.

- Carriers have no clue where load volumes are heading in the first quarter of 2020. The outlook for load volumes is split evenly between higher, lower and sideways, with one-third of carriers choosing each.

- The same is true for line-haul rates. Carriers are not quite in a three-way tie whether rates will go up, down or sideways but close.

- Less than 30% of carriers think diesel prices are headed higher in the first quarter of 2020. This is surprising as IMO 2020 came online in full force on Jan. 1. Diesel prices have not moved, but this could change at any moment.

- Fewer fleets are planning to expand over the next 12 months as excess truck capacity is still driving trucking rates down. But only 15% expect to contract their fleet sizes.

- Speaking of excess capacity, operating ratios (OR) are in the high 90s. Dry van carriers are running the highest at 99.4 in the latest results from the TCA benchmarking program.

- ORs in the high 90s with 20% insurance premium increases should drive some of the excess truck capacity out of the market. Expect an acceleration in closures of trucking companies over the first half of 2020.

- The drug clearinghouse and random drug testing, IMO 2020, AB5 in California and of course ELDs are all major regulatory issues heading into 2020. The most interesting is the Drug & Alcohol Clearinghouse, which could put a serious dent in the pool of qualified drivers.

- New truck orders have run under replacement level (23,000 per month) since December 2018. Based on this data, we estimate truck capacity gets cut by 2% to 4% in 2020.

- On the demand side, watch consumers closely in 2020 as they powered the economy in 2019. Industrial and manufacturing numbers have plunged to contractionary levels, but unemployment still remains near historical lows.

- Spot rates should post positive year-over-year gains in the first half of 2020. This will not happen immediately though. The rebalancing between supply and demand can be slow as a snail, but it will happen at some point.

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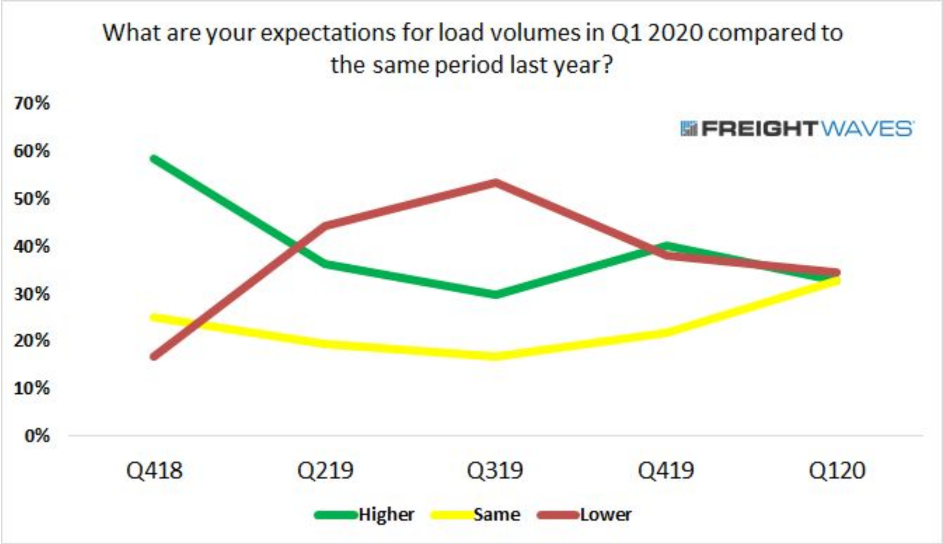
First quarter 2020 carrier outlook survey results

In December, FreightWaves surveyed 20,000 small to midsize carriers (fleets between five and 100 trucks) to gauge their outlook for the trucking market for the first quarter of 2020. The survey had 122 respondents, and the results are described in the section.

Figure 2 - Carriers think line-haul rates are going up, down and sideways

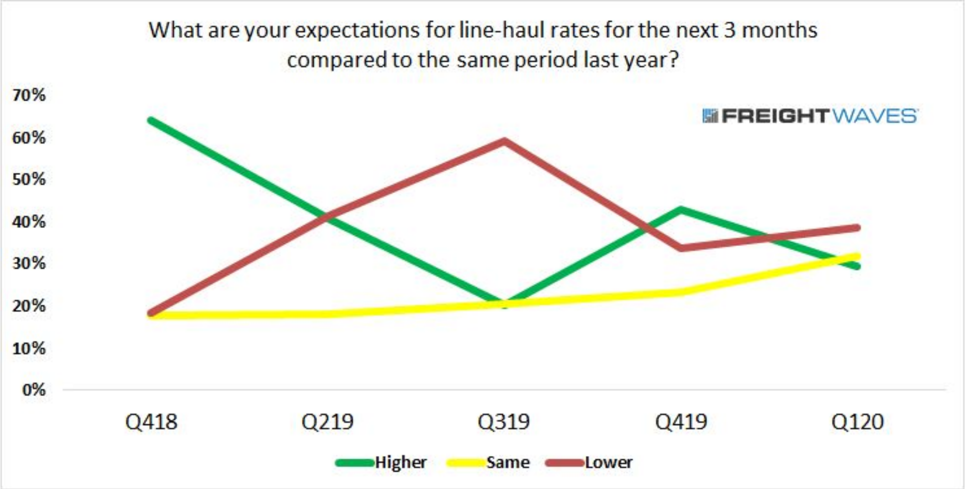


Source: FreightWaves Q1 2020 Carrier Outlook Survey

Carriers have no clue where loads and line-haul rates are heading in the first quarter of 2020. The outlook for load volumes is split evenly between higher, lower and sideways, with one-third of carriers choosing each.

The story is much the same for line-haul rates. While it is not a perfectly even split like on load volumes, it is close. One-third of carriers believe rates will be comparable to the first quarter of 2019, while 32% believe rates will be higher, followed by the 39% of carriers who are planning for rates to slide even farther.

Figure 3 - Where do carriers think rates are heading?

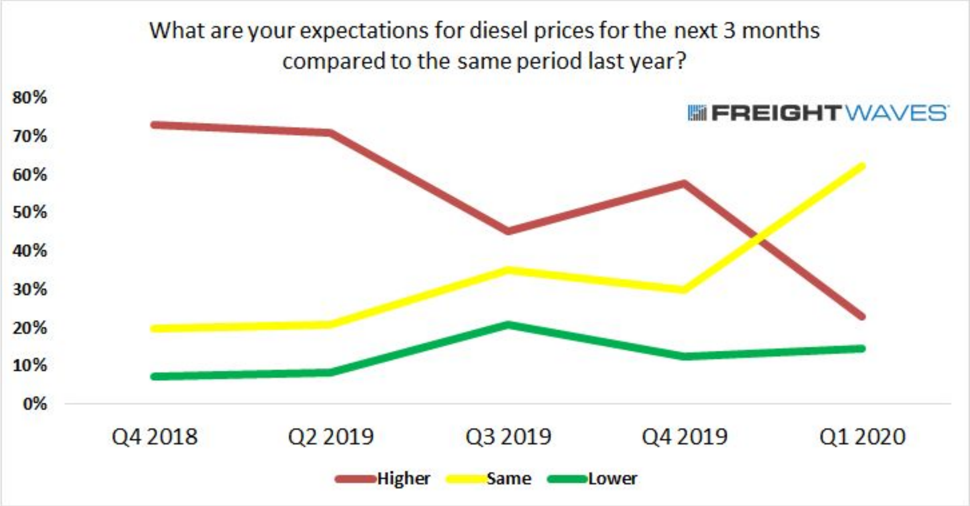


Source: FreightWaves Q1 2020 Carrier Outlook Survey

Carriers are most optimistic that diesel prices will be lower over the next three months compared to last year. Less than 30% think we are headed higher, while 40% are planning for diesel prices to head lower in the first quarter of 2020.

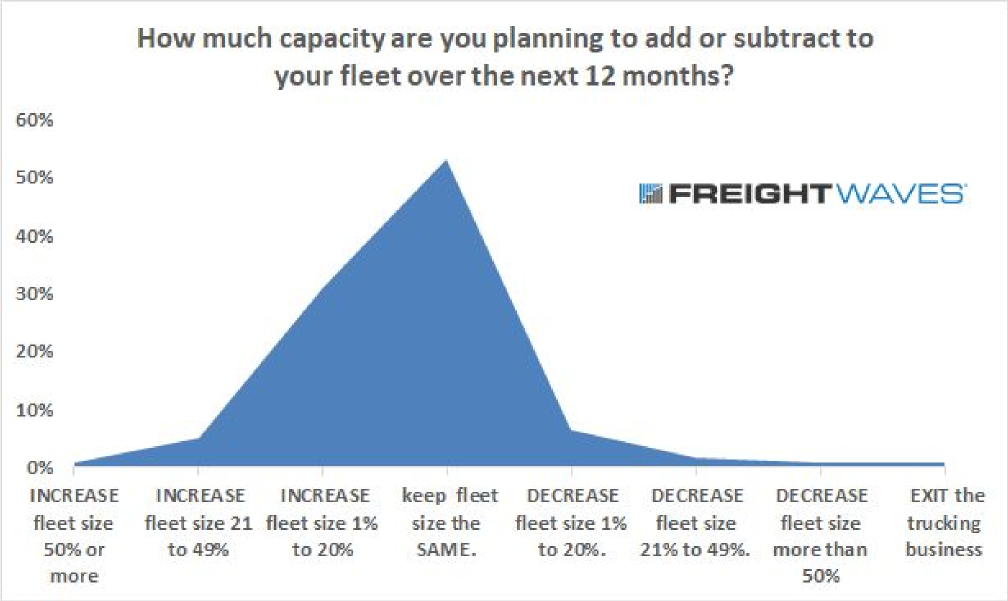
This is somewhat surprising with the threat that IMO 2020 could push diesel prices higher after going live on Jan. 1. To be fair, hints of higher diesel prices from ocean vessels switching to lower-sulfur fuels have not materialized in real-time diesel prices or the futures market — although it could happen at any time as the switch over to low-sulfur fuels starts happening with ocean vessels at scale.

Figure 4 - Diesel prices are expected to go lower



Source: FreightWaves Q1 2020 Carrier Outlook Survey

Figure 5 - More than one-third of carriers are still planning to expand their fleets

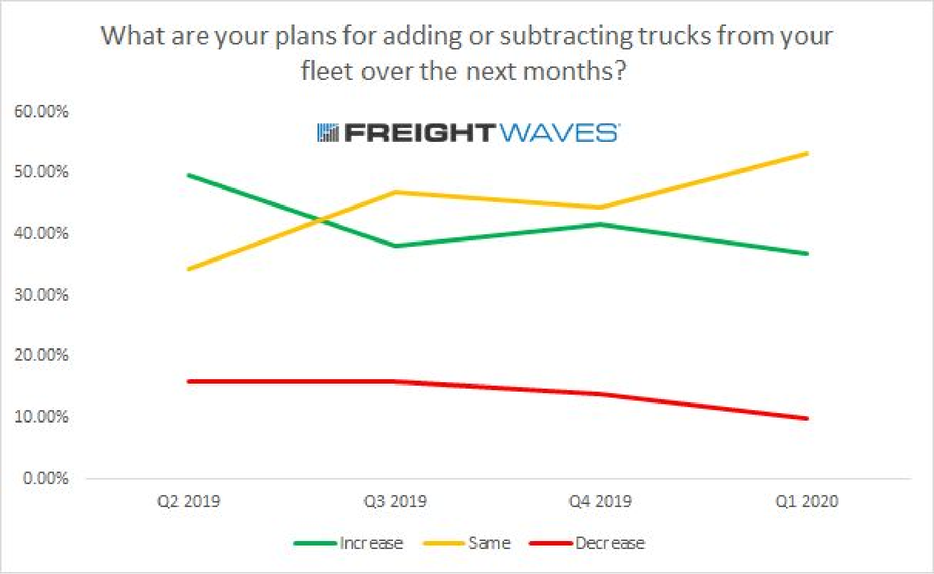


Source: FreightWaves Q1 2020 Carrier Outlook Survey

Even with the overcapacity of trucks chasing freight, 38% of carriers are still planning to expand their fleets over the next 12 months, which lines up with the number of carriers optimistic about load volumes and rates. A little more than half, though, say they will keep their fleets the same size, with less than 15% planning on reducing truck counts.

The expansion plans of carriers continued to fall over the past 12 to 15 months (Figure 6). The fourth quarter 2018 survey found that half of carriers were planning to expand. This number has continually dropped to 38% in the most recent survey. The percentage of carriers planning to keep their fleet sizes the same has moved almost inversely, while the number of carriers planning to trim their fleets has fallen just slightly from its already low level.

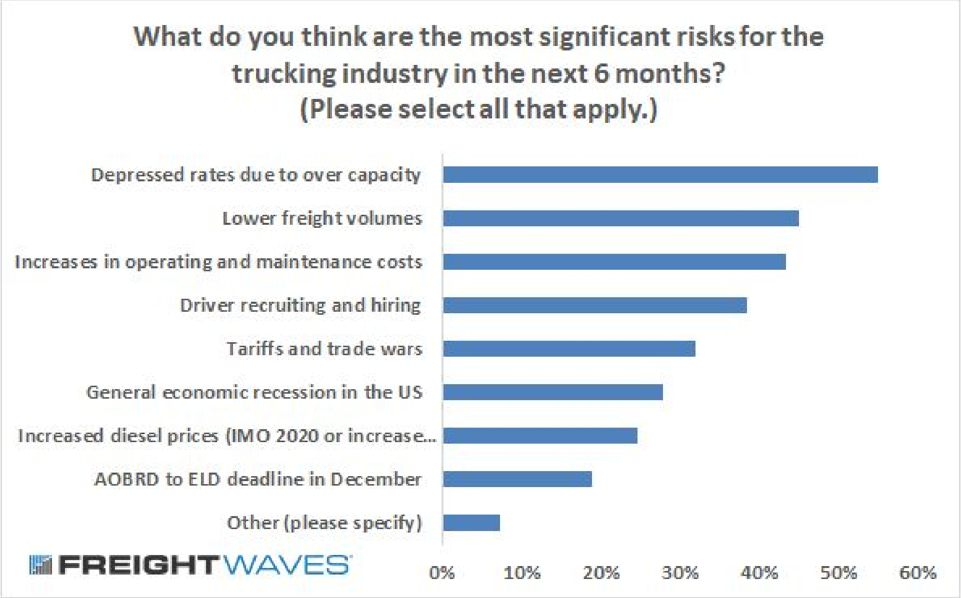
Figure 6 - Carriers' expansion plans are trending down though



Source: FreightWaves Q1 2020 Carrier Outlook Survey

Revenue is on carriers' minds as most believe rates and volumes are still the greatest risks to the trucking industry over the next six months. This is followed closely by the cost side of the equation as increases in operating, maintenance and hiring expenses rank third and fourth. Most of the other risks are out of the trucking industry's control, like trade wars and IMO 2020.

Figure 7 - The greatest risk to trucking remains overcapacity



Source: FreightWaves Q1 2020 Carrier Outlook Survey

Freight Intel Group's first quarter 2020 forecast

While carrier sentiment going into the first quarter of 2020 is guarded, market conditions are favorable for a rebound from the sluggish 2019 market. Supply and demand fundamentals should correct enough for line-haul rates to see a modest year-over-year improvement.

In this section we examine the major trends the Freight Intel Group has identified for supply and demand in 2020.

Forecast for truck capacity (supply)

Tight capacity and high rates in early 2018 encouraged both large and small trucking fleets to expand their fleets to capture this "new normal" that many thought would last for years. This did not happen, of course. Instead, a glut of new capacity hit the market as year-over-year GDP growth rates began to shrink.

The hangover from the 2018 boom has now lasted for 12 to 15 months and will continue for at least another three to six months. The correction is painful to go through but is needed to restrict capacity and lift up line-haul rates.

Listed below are the three major themes to watch for to gauge how capacity will move in 2020.

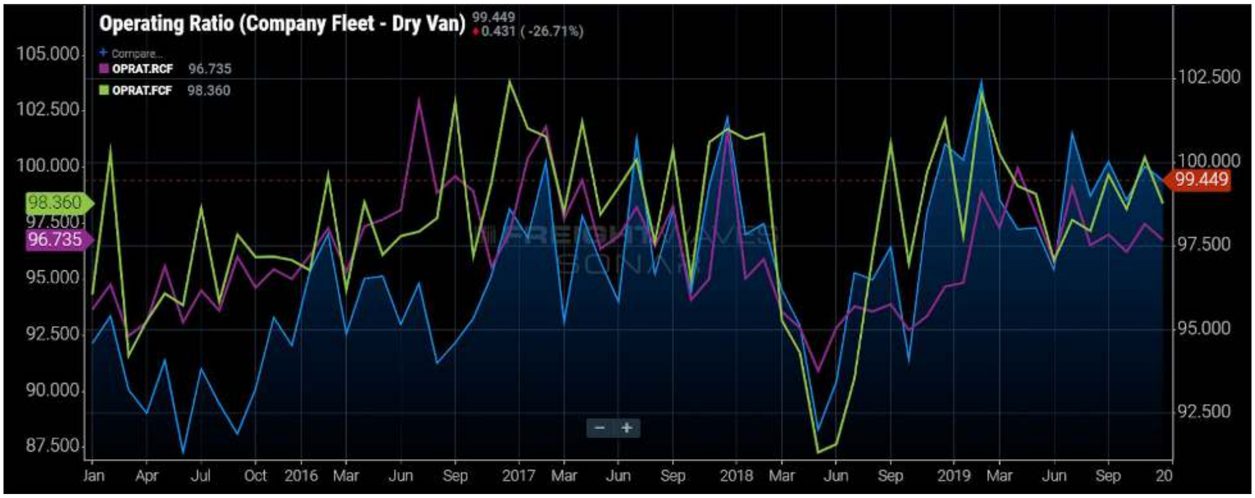
Trucking failures

News of bankrupt carriers dominated the headlines in 2019. Celadon and Falcon garnered the most attention, but there were also hundreds that were too small to be noticed by the market.

One of the reasons trucking company failures will accelerate in the first half of 2020 is found in Figures 2 and 3. The operating ratio (OR) of fleets is hovering near 100. For dry van fleets, operating ratios are 99.4. Refrigerated and flatbed fleets are not too far behind with ORs of 96.7 and 98.36, respectively.

First quarter 2020 operating ratios are typically the highest as load demand is the softest. Based on first quarter 2019 comparables, the odds of an acceleration of trucking company bankruptcies are high.

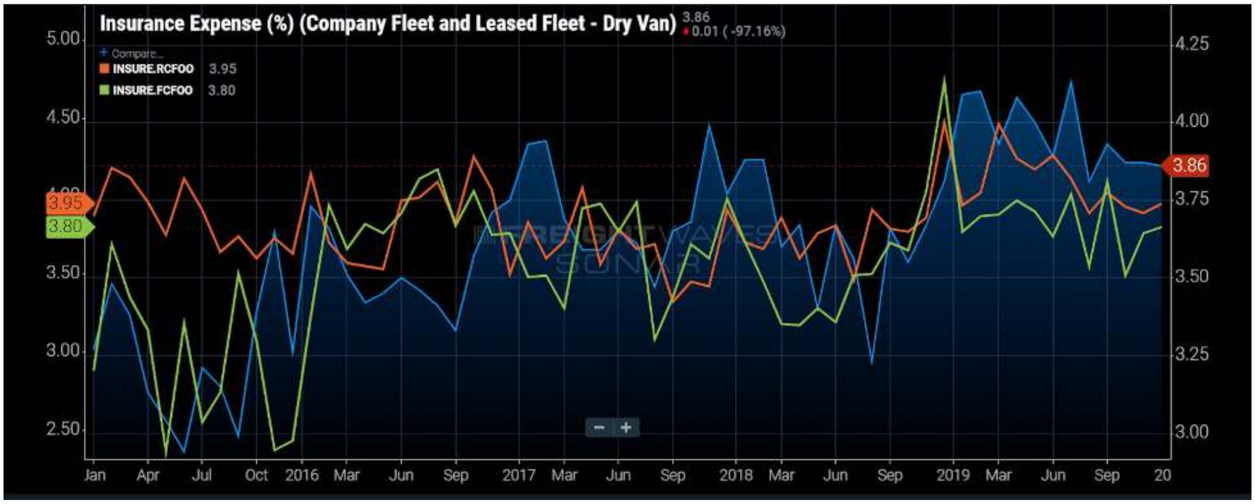
Figure 8 - Operating ratios indicate 2019 was a year without profits



Source: SONAR - Operating ratios for dry van (OPRAT.VCF) in blue, refrigerated (OPRAT.RCF) in purple and flatbed carriers (OPRAT.FCF) in green.

Adding to profitability issues are the continual increases in insurance expenses as insurers price in the increasing threats of nuclear verdicts. Insurance premiums have increased by more than 40% since 2016 and are likely to continue climbing from here without an end in sight.

Figure 9 - Insurance premiums add to the misery



Source: SONAR - Insurance expenses as a percentage of revenue for dry van (INSURE.VCFOO) in blue, refrigerated (INSURE.RCFOO) in orange and flatbed carriers (INSURE.FCFOO) in green.

Regulatory issues

The drug clearinghouse and random testing, IMO 2020, AB5 in California and of course ELDs are all major regulatory issues heading into 2020.

Each has the power to restrict capacity enough to move the freight market. The most interesting is the Drug & Alcohol Clearinghouse, along with the recent announcement that the [Federal Motor Carrier Safety Administration (FMCSA) will double the rate of random drug testing of drivers from 25% to 50% in 2020].

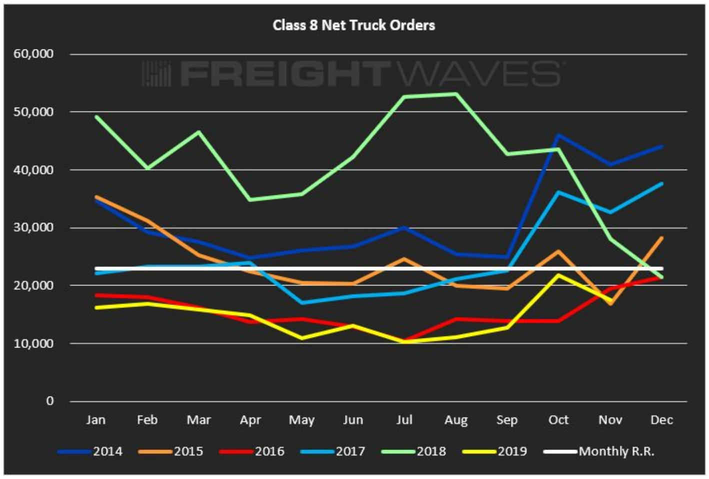
This recent development in random drug testing will accelerate the creation of the Drug & Alcohol Clearinghouse that is set to go into effect on Jan. 6. [The clearinghouse is a national database that will give authorities real-time access to CDL drivers who fail a drug test]. Before this announcement, industry estimates were that it would remove 3% to 10% of drivers from the qualified driver pool within the next six to 12 months. Doubling random drug testing will accelerate this time frame considerably.

New truck orders

Monthly orders for new Class 8 tractors have been below the replacement level of 23,000 units per month for 12 months straight now. This was expected after a record-breaking year for new truck orders in 2018.

The estimate for new truck orders in 2020 is 150,000. Based on the run rate of new truck orders, we estimate it will reduce truck capacity by 3% to 5% in 2020.

Figure 10 - New truck orders have been well below replacement in 2019



Source: FreightWaves analysis of ACT Research monthly truck order data. The white bar represents replacement level orders.

Forecast for load volumes (demand)

Outbound tender load volumes (OTVI.USA) was the bright spot in the market over the second half of 2019. The index has consistently posted year-over-year gains week in and week out. A strong peak season finished out 2019 and all eyes are now focused on the first quarter of 2020, which is typically the weakest quarter of the year.

The consumer powered the economy and load volumes through the second half of 2019. The industrial/manufacturing sectors have been in recessionary territory, construction has been tepid at best and low energy prices have continued to weaken activity in the oil patch.

On a positive note, international trade is looking brighter in 2020 as phase one of a U.S.-China trade deal is on the horizon. Also nearing passage is the United States–Mexico–Canada Agreement (USMCA), which replaces the North American Free Trade Agreement (NAFTA).

Figure 11 - Outbound tender volumes ended 2019 on a strong note

Source: SONAR - 2019 outbound tender volumes (OTVI.USA) in blue, 2018 OTVI.USA in green.

Figure 12 shows the growth in retail sales as compared to the year-over-year growth rates in U.S. gross domestic production (GDP). Even with a deceleration in GDP growth rates beginning in the second half of 2019, retail sales, which account for roughly 70% of GDP, have continued to chug along.

Figure 12 - A strong consumer drives retail sales higher as GDP growth slows

Source: SONAR - U.S. retail sales (RESL.USA) in blue, year-over-year real GDP growth rate (RDGPY.USA) in orange.

The industrial economy was a different story in 2019. The ISM Manufacturing Purchasing Managers Index, which measures industrial and manufacturing activity in the U.S., has been crashing since the fourth quarter of 2018. Figure X below shows even though the ISM index (blue) has been falling for more than a year now, unemployment continues to remain at historically low levels.

Figure 13 - A steep fall in manufacturing has not impacted employment numbers

Source: SONAR - ISM Purchasing Managers Index (ISM.PMI) in blue, U-3 unemployment rate (UEMP.USA) in green.

Forecast for trucking rates

The DHL Supply Chain Pricing Power Index finished the year with five straight weeks on rising power for carriers, though shippers still have the upper hand. The peak holiday season brought the Pricing Power Index up from a strong shipper reading of 15 in early November to finish at 45 — not quite a balanced market (50) but close.

Figure 14 - Pricing power finished 2019 almost balanced, but all eyes are on Q1 2020

Source: DHL Supply Chain/FreightWaves Pricing Power Index

With that said, peak season is now over and all eyes are focused on pricing power for the first quarter of 2020.

Figure 15 lists how contract rates (blue) and spot rates (green) are moving. In 2019 it was generally down for both. While both rates peaked in early 2019, contract rates lagged well behind, posting their first negative year-over-year numbers in July.

Figure 15 - Contract and spot rates slide down throughout 2019

Source: SONAR - Producer price index for long-distance truckload (PPI.LDTL) blue, DAT national dry van spot rates (DATVF.VNU) in green.

It's a new year and the good news is the same as the bad news. Spot rates were at a natural floor for most of 2019. This natural floor is between $1.40 and $1.50 per mile excluding fuel. Trucking rates below this range are unstainable as this is the average per-mile cost of running a truck.

Since trucking is cyclical, bad news in the present sets the table for good news in the future.

Barring a recession, we expect spot rates to begin posting positive year-over-year gains of 5% to 10% by the end of the first quarter of 2020. Load volumes should continue to remain strong year over year, and the issues with overcapacity will improve throughout 2020 slowly but surely as trucking capacity resets to a more normal freight environment.

FreightWaves

FreightWaves is one of the fastest-growing enterprise software-as-a-service (SaaS) companies in the world. In less than three years, FreightWaves has become the leading provider of data and analytics for the global freight market. FreightWaves' 150 full-time team members capture, model and interpret near-time data from more than 1,000 sources to provide the fastest insights into the global freight market. The company offers the fastest data in the industry and the most complete view across all modes of freight transportation. SONAR, the company's SaaS offering, is a market dashboard that provides companies involved in transportation with access to data sets that can help them optimize their routing, pricing and planning decisions.

FreightWaves is also the largest publisher of freight news and data in the world. FreightWaves.com publishes more than 40 news articles per day, providing commentary and analysis for freight transportation, while FreightWaves TV is the first and only streaming TV network for the transport and logistics industry.

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