Q4 2019 CARRIER OUTLOOK: AN END TO THE FREIGHT RECESSION?

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FREIGHTWAVES FREIGHTINTEL RESEARCH

Key Highlights:

- The outlook of small- and medium-sized carriers (fleets with 5 to 100 trucks) looks to have bottomed in the third quarter of 2019 and the outlook for load volumes and line-hauls rates posted significant gains in sentiment in the fourth quarter of 2019.

- 40% of carriers have a positive outlook on load volumes in the fourth quarter 2019 survey as compared to 30% in the third quarter survey.

- This should not be surprising as outbound tendered load volumes (OTVI.USA) performed well in the third quarter of 2019. Volumes moved above 2018 levels during the week of July 24 and have outperformed year-over-year ever since.

- Carriers' positivity on line-haul rates doubled from the third quarter to the fourth quarter. 43% are now positive about line-haul rates, while only one out of three are expecting line-haul rates to go lower in the next six months.

- It will be difficult for line-haul rates to go lower from here. The DAT Dry Van National Average (DATVF.VNU) is at $1.42, which is on the lower bounds of operating costs per mile for carriers.

- Outbound tender rejections (OTRI.USA) continue to languish under 5.5% as capacity refuses to leave the market.

- The only life seen in OTRI.USA during the third quarter was a short-lived spike to 6%, when 48,000 United Auto Workers (UAW) went on strike against General Motors in mid-September.

- Even with freight markets flooded with capacity, small- and medium-sized carriers are still looking to expand their fleets. Two out of five carriers plan to expand their fleets marginally, while almost half are expected to remain at the same size.

- This seems counterintuitive as 60% of small carriers believe the greatest risk to the trucking industry over the next six months is "depressed rates due to over-capacity," followed closely by "lower freight volumes" at 54%.

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An end to the freight recession of 2019?

The freight recession of 2019 may have ended on July 24, 2019 when 2019 tendered load volumes (OTVI.USA) surpassed 2018 volumes for the first time. OTVI.USA has not dipped below 2018 levels since and finished the third quarter up 7.14% year-over-year.

Figure 1 – Key Metrics for the 2019 Truckload Market

Metric	Q1 2019	Q2 2019	Q3 2019
Tendered Load Volumes (OTVI.USA) y/y	-0.5%	-5.7%	7.1%
Tender Rejections (OTRI.USA) y/y	-78%	-79%	-70%
DAT Spot Rates (DATVF.VNU) y/y	-22%	-28%	-18%
Carrier Sentiment for Load Volumes % Change	-22%	-5%	34%
Carrier Sentiment for Line-Haul Rates % Change	-23%	-21%	105%

*y/y is year-over-year

*Carrier Sentiment is % change from previous Quarter

Source: SONAR and FreightWaves Carrier Outlook Surveys – 2019

Figure 2 – Tender Load Volume Activity in the Third Quarter

SONAR: OTVI.USA – July 1, 2019 to September 30, 2019 (Blue) and OTVI.USA July 1, 2018 to September 30, 2018 (Green)

While load volumes have recovered quite nicely in the second half of 2019, over-capacity remains a serious issue in the freight markets. Capacity measures like outbound tender rejections (OTRI.USA) were stagnant in the third quarter, ranging from 3.78% to 6.02%, finishing the quarter at a paltry 5.2%.

Figure 3 – Outbound Tender Rejection Rates for the Past 12 Months

SONAR: OTRI.USA – September 30, 2018 to September 30, 2019

Over-capacity has created a drag on spot rates which has pulled down contract (or paper) rates. While shippers have been clawing back the rate increases given up during the capacity crunch of 2018, contract rates finally posted the first year-over-year negative growth numbers in September.

As seen in Figure 4 below, contract prices as measured by the Producer Price Index Long-Distance Truckload rates declined 2.73% in September. The primary driver for aggressive rebidding of contract rates in 2019 has been the plunge in spot rates measured by the DAT Dry Van National Average in green.

Spot rates spent most of the third quarter ranging from $1.40 to $1.45 per mile. While year-over-year comparisons have improved, it is still a dismal comparison for spot rates, down 18% compared to 2018.

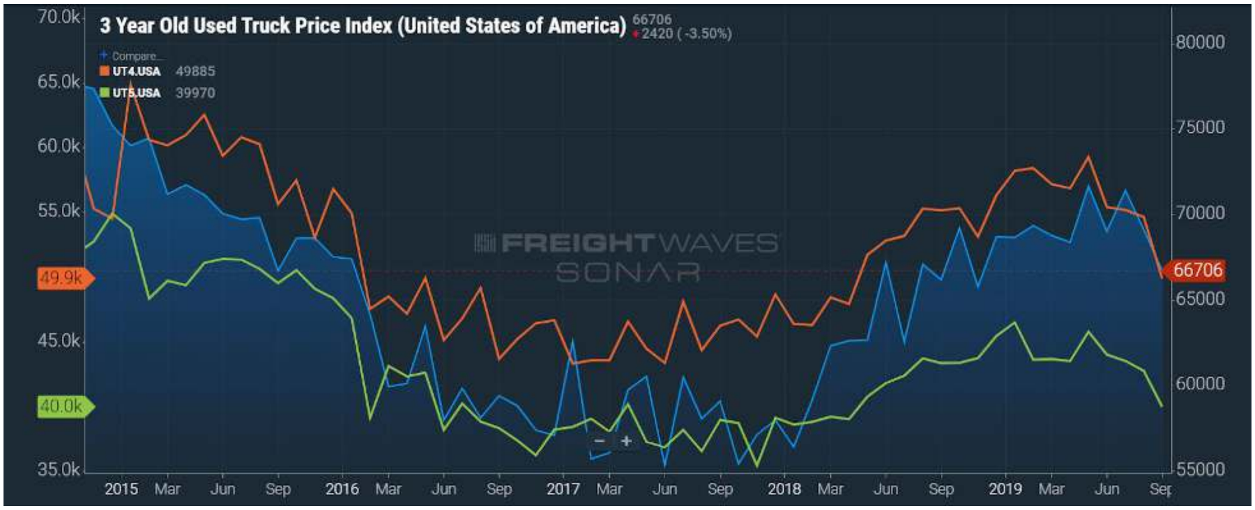
Figure 4 – Contract Rates Post First Year-Over-Year Declines in Growth

Source: PPI.LDTL (Blue) and DATVF.VNU (Green)

This trend has been emphasized by the large publicly traded freight brokerages' third quarter 2019 earnings and subsequent earnings calls. One of the largest publicly traded freight brokerages reported aggressively bidding down of contract renewal rates of -12.5%. Even with double digit decreases, price load volumes on these lanes were down -4% year-over-year.

If used truck values are any indication of capacity leaving the market, then it might be picking up some steam. Used truck values have posted two consecutive monthly declines. The year-over-year values of 3-year-old trucks are roughly flat, 4-year-old trucks are down 3.23%, and 5-year-old trucks have dipped 7.31%.

Figure 5 – Used Truck Values Are on the Decline



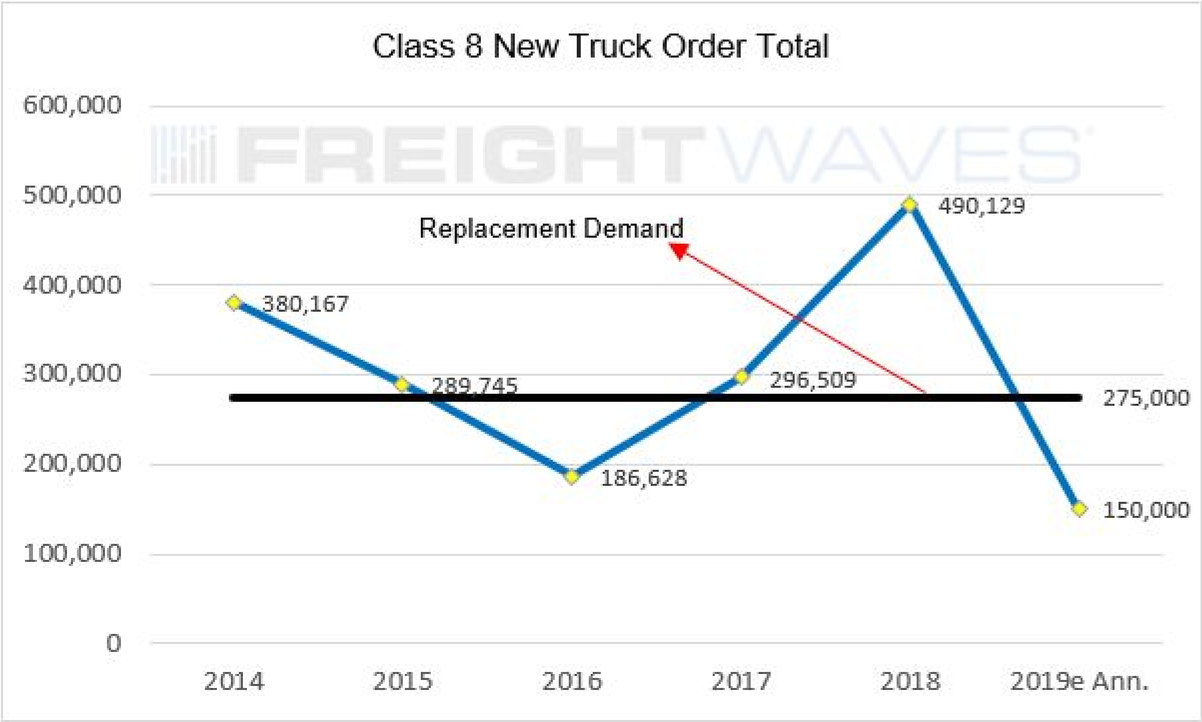
Source: SONAR - UT3.USA, UT4.USA, UT5.USA

After a record year for new truck orders in 2018, new orders in 2019 have dropped well below normal replacement levels.

In Figure 6 we have plotted annual run rates for new truck orders over the past five years. Our estimated replacement level for the North American trucking market is 275,000 new trucks. The run rate for 2019 will be close to 150,000 new truck orders. This suggests there will be fewer trucks in the market over the next few quarters as fleets trim fleet counts.

As long as over-capacity remains in the market, paper and spot rates will remain at depressed levels.

Figure 6 – 2019 New Truck Orders Compared to Replacement Rate for Trucking Fleets



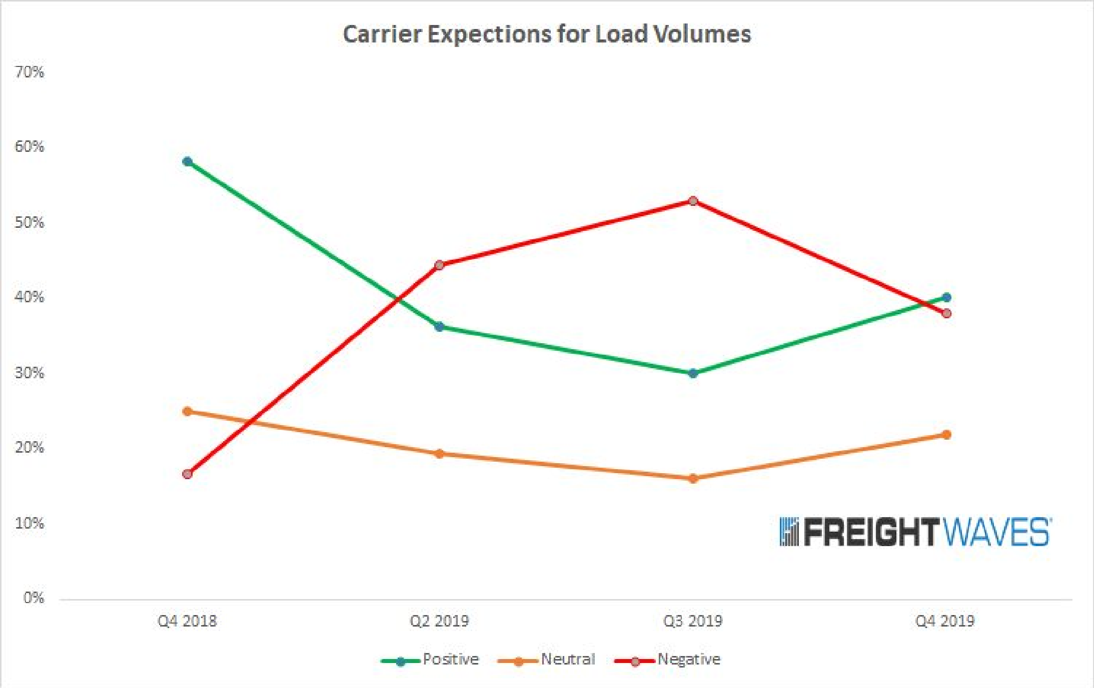
Source: FreightWaves analysis of ACT Research

Fourth Quarter Carrier Outlook Survey Results

In October 2019 FreightWaves surveyed over 10,000 small- and medium-sized carriers (fleets with 5 to 100 trucks) to gauge their current sentiment on a number of market conditions compared to those experienced in 2018. The survey had 137 respondents.

This survey is a continuation of quarterly carrier outlook survey FreightWaves has conducted since the fourth quarter of 2018. The results are presented below to provide a historical look at carrier sentiment.

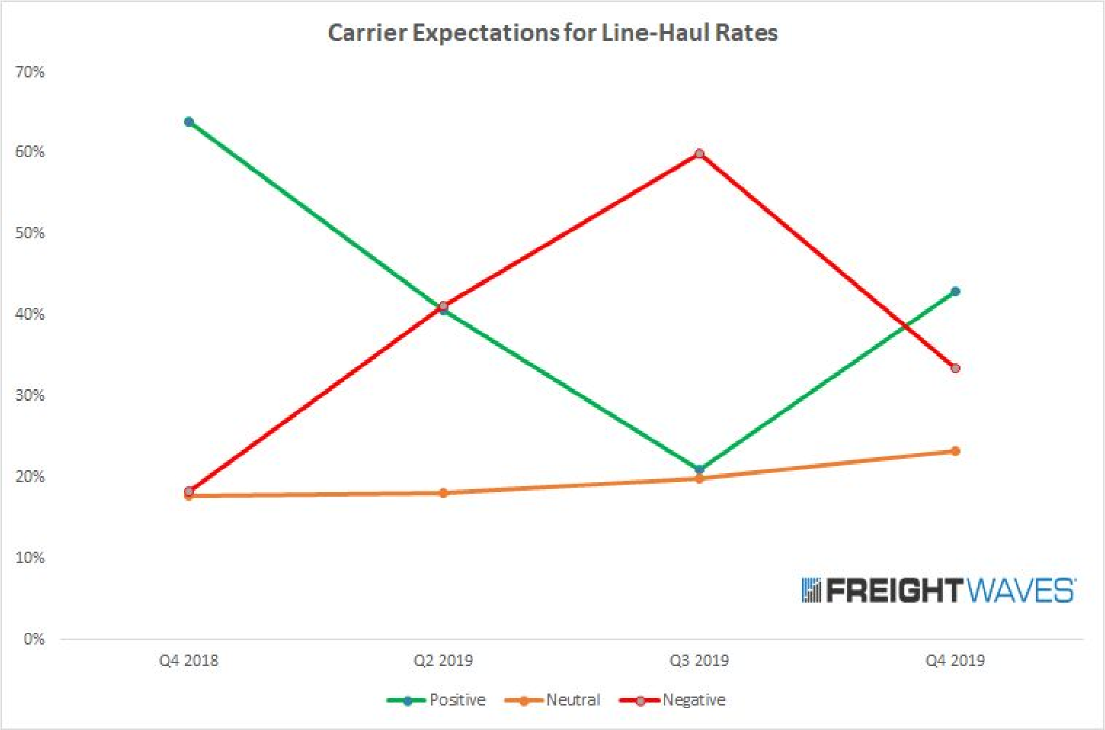
Figure 7 – Carrier Outlook for Loads Rebounds



Source: FreightWaves Carrier Outlook Surveys – Q4 2018, Q2-Q4 2019

- Carrier sentiment seems to have reached its trough in the third quarter of 2019, when only 30% were optimistic on load volumes.
- This should not be a major surprise as OTVI.USA first surpassed 2018 volumes on July 24, 2019 and closed the third quarter up 7.1% year-over-year.
- However, the market is split on whether load volumes will move up or down over the next six months. Both positive and negative sentiment hovers within a margin of error at 40%.

Figure 8 – What are carrier thoughts on rates?

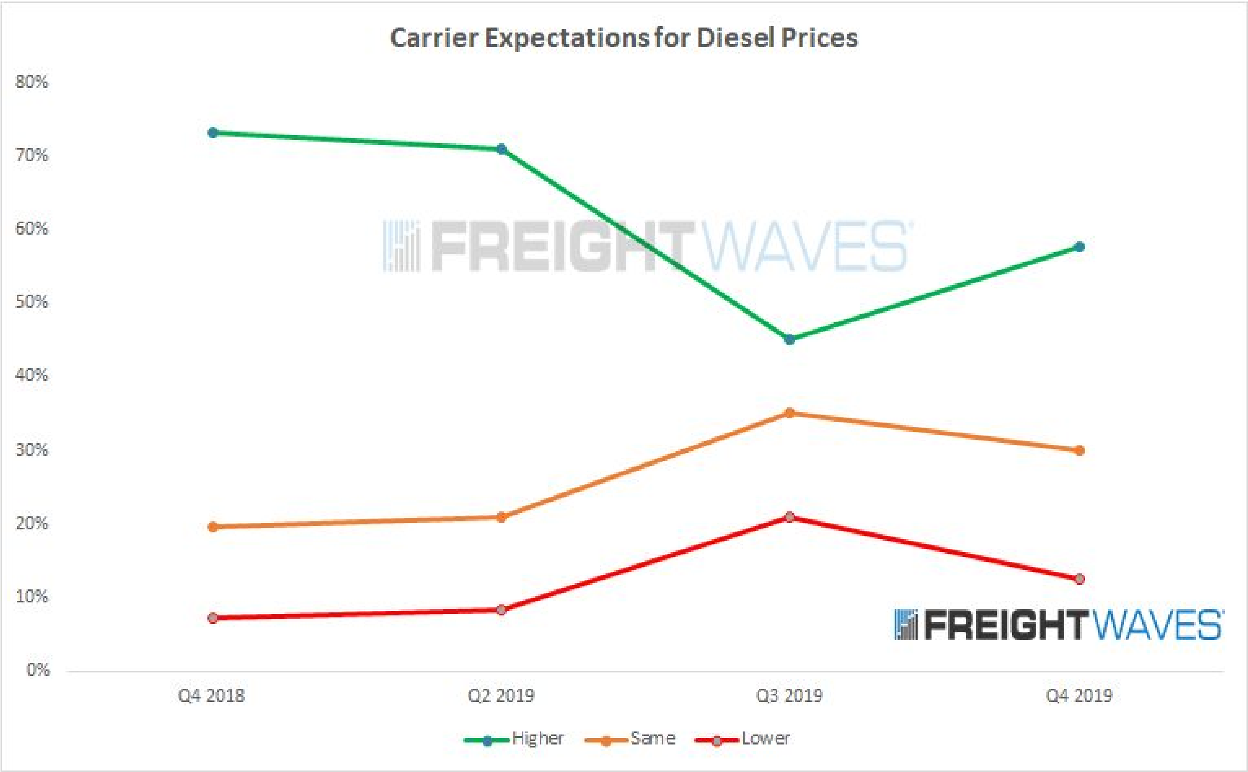


Source: FreightWaves Carrier Outlook Surveys – Q4 2018, Q2-Q4 2019

- The outlook for rates is where the big move happened this quarter. Almost two-thirds of carriers had a negative outlook for rates in the third quarter of 2019.
- With spot rates at operating cost levels, contract rates adjusting down to match spot, and capacity everywhere, there is not much to be positive about. And it showed, as only one in five carriers had a positive outlook on rates in the prior quarter's survey.
- This quarter, sentiment about rates surged, more than doubling. Even with the same dynamics in contract and spot rates, over 40% of carriers now believe line-haul rates will be moving up over the six months.
- Most respondents aren't overly optimistic though; most believing rates will only increase slightly over the next six months. Trucking is cyclical and it is hard to imagine line-haul rates going lower from here for a long period of time.

- Line-haul rates could remain in a narrow trough for a long period of time though. Especially if the economy stumbled into a recession in the first half of 2020.

Figure 9 – Where is Diesel Heading Over the Next 6 Months?



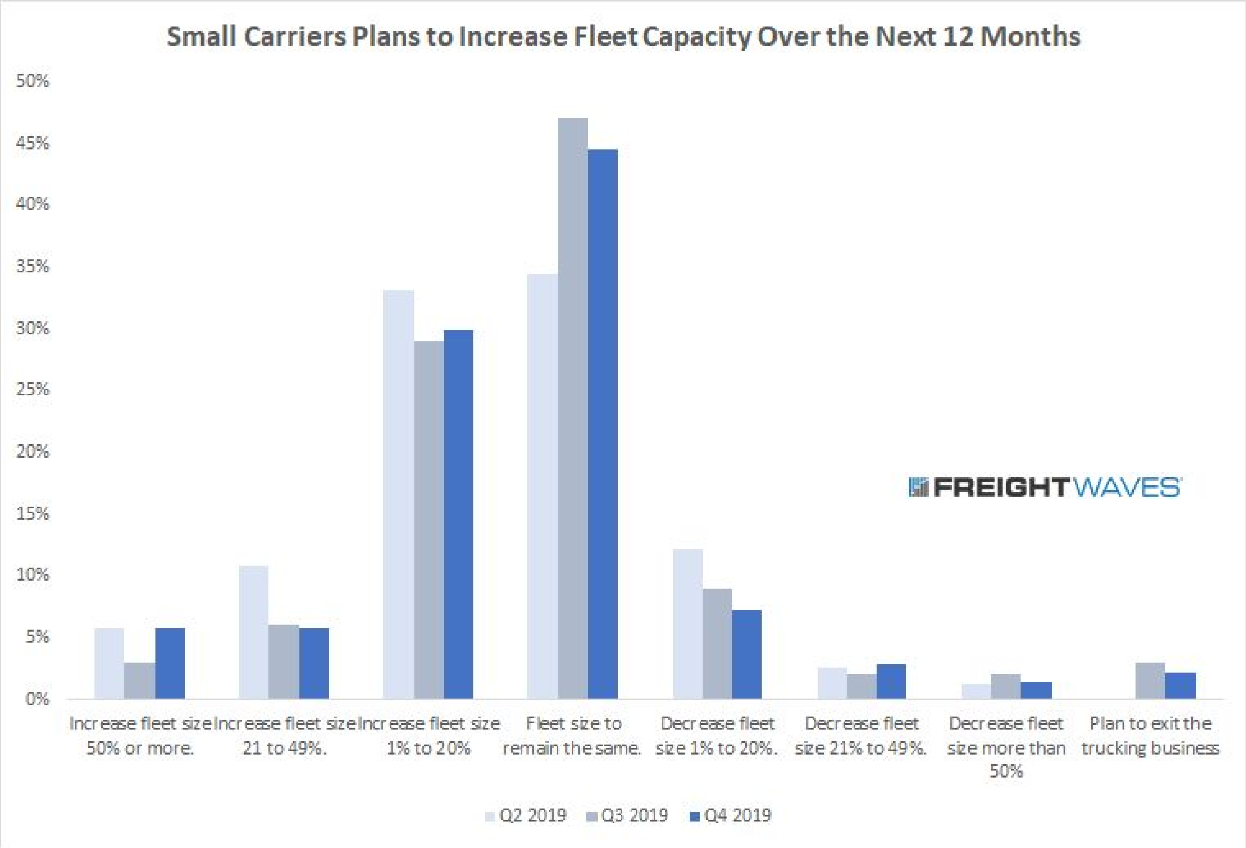
Source: FreightWaves Carrier Outlook Surveys – Q4 2018, Q2-Q4 2019

- Carriers are a pessimistic lot when it comes to diesel, however. The expectations are for diesel prices to always move higher from the present day.

- While the third quarter witnessed the most carriers who thought diesel prices would move lower for the remainder of the year, this number has rebounded into the majority again.

- IMO 2020 is still right around the corner and from what we've seen and heard small- and medium-sized fleets could still be underestimating a spike in diesel prices as we move into the first quarter of 2020.

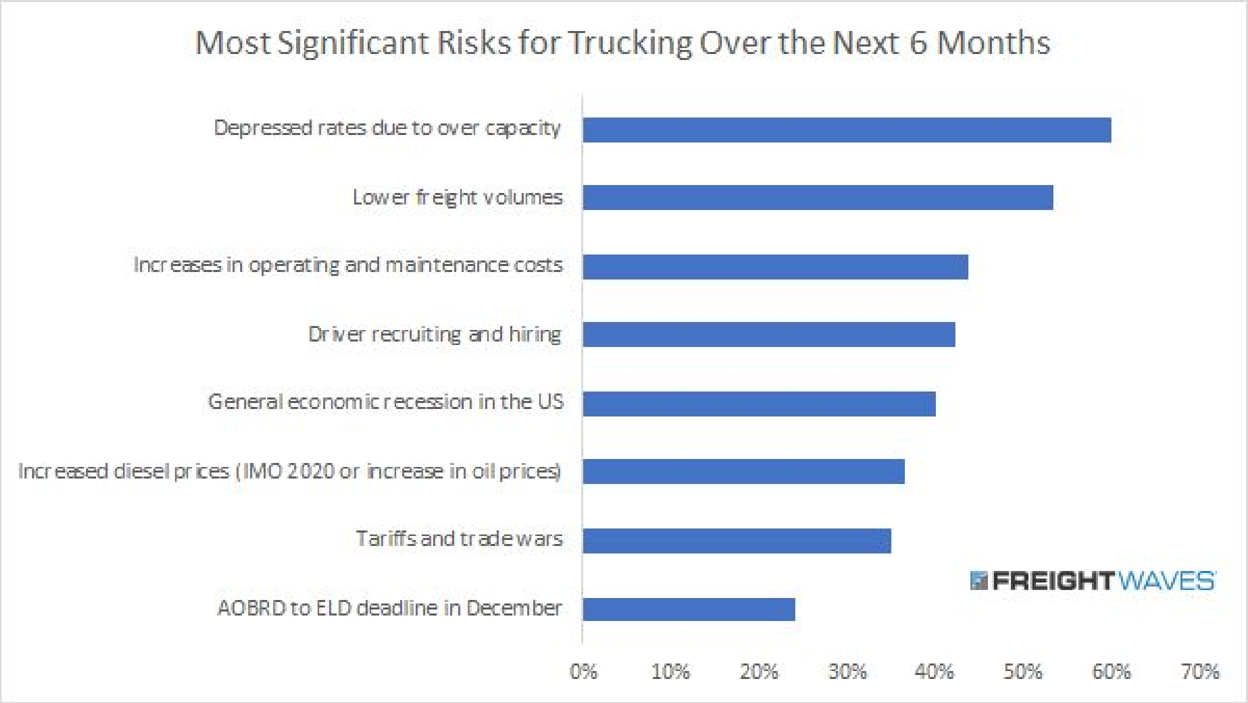
Figure 10 – Expanding or Contracting Trucks in the Fleet?



Source: FreightWaves Carrier Outlook Surveys – Q2-Q4 2019

- Small- and medium-sized carriers always seem to have an optimistic view when it comes to expanding their fleets, no matter what their opinion of the freight markets.
- Even when pessimistic about volumes and line-haul rates, carriers were planning to increase their fleets. This trend has continued throughout the trough in sentiment.
- Almost half of carriers are planning to keep their fleet size constant, while almost 30% are planning to increase the number of trucks by up to 20%.
- While it is good to be optimistic, carriers also believe reduced load volumes and over-capacity are the biggest risks to the trucking industry during the next six months (Figure 11).

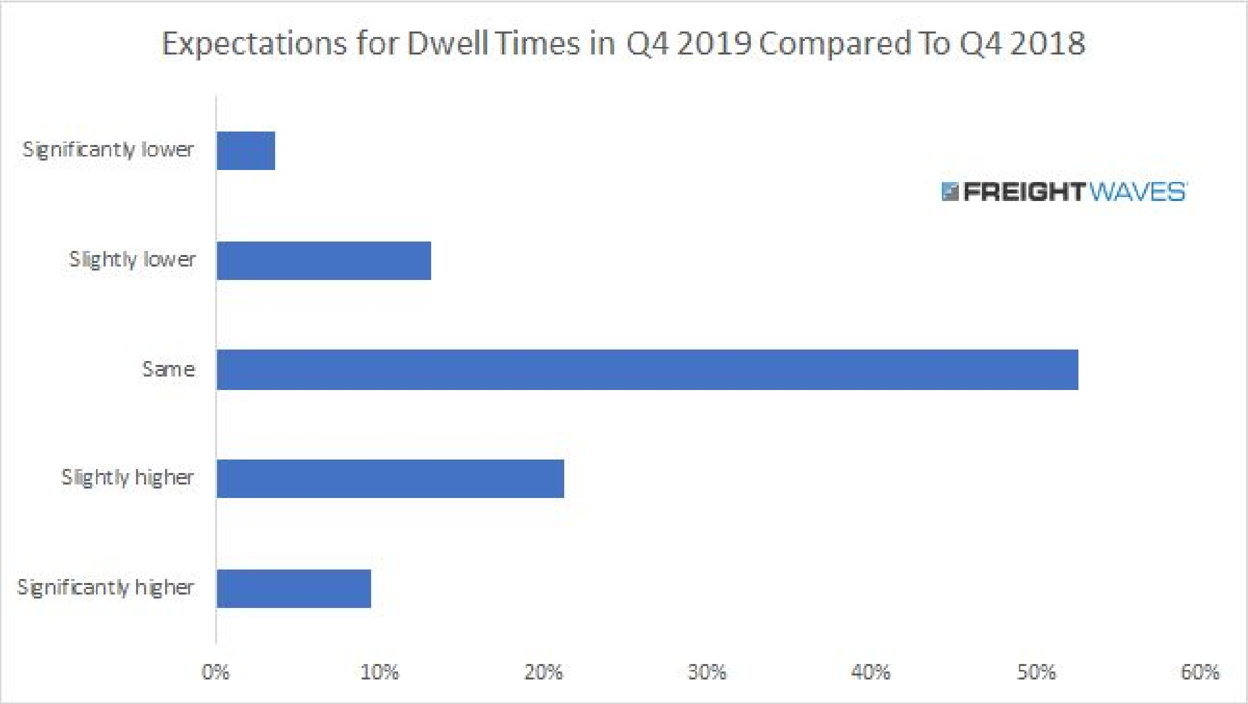
Figure 11 – Where is the Risk to a Trucking Recovery?



Source: FreightWaves Carrier Outlook Surveys – Q4 2019

- As mentioned above, carriers believe the greatest risks to any freight market recovery is over-capacity and/or a drop in load volumes.
- Costs have been going up in 2019, even as rates fall. Some of this is baked into driver compensation, which increased significantly in 2018, along with maintenance costs.
- Speaking of increased costs, IMO 2020 is cited by only one-third of carriers as a concern. While the true effects of the new maritime rule cannot be determined yet, we believe it does hold significant dangers to carriers' operating ratios.
- Only one in four carriers cite the final ELD conversion as posing a risk. FreightWaves has done significant research on this conversion and believes it carries minimal risk, as over 95% of carriers have made the switch to ELDs.

Figure 12 – Detention Time Forecast for Q4 2019



Source: FreightWaves Carrier Outlook Surveys – Q4 2019

- Status quo is the forecast for dwell times over the next six months.
- Less than one in four carriers believe dwell times will improve, while one out of three believe wait times will lengthen over the next six months.
- This aligns with the national average for wait time data (WAIT.USA) in SONAR, which has ranged from 143 to 154 minutes year-to-date in 2019.
- For a more in-depth look at the latest trends in detention, stay on the lookout for our upcoming detention survey that will be published in November 2019.