

AUGUST 2020

CARRIER RATE REPORT

FREIGHTWAVES FREIGHTINTEL RESEARCH





Executive Summary

The trucking market today is as healthy as it has been since 2017– early 2018, when a very robust backdrop for carriers prevailed. However, the trucking industry embarked on an 18-month downtrend in mid-2018 when the cycle peaked, as far too much capacity rushed in to take advantage of positive fundamentals.. This downturn, along with other issues, such as trucking bankruptcies, deeply negative new truck orders and dramatically rising insurance premiums, to name a few, —cleansed the market of a great deal of capacity. In contrast to the mid-2018 peak, we believe the strong fundamentals that are emerging now have staying power, and that we are on the cusp of a new multi-year upcycle for trucking.

With a backdrop of tightening capacity (as of Aug 2020), contracted truckload volumes are running up 27% year over year, and this is at a time when the market is typically in the midst of a seasonal slow down (post July 4). Instead, an acceleration in demand is occurring, and the strength is manifesting itself in the midst of the deepest recession since the Great Depression. The trucking industry is benefitting from a host of factors in our view, principally among them being the generous government stimulus and unemployment benefits that are keeping consumer spending intact; the fact that demand for goods is robust relative to services in light of COVID-19 (which is a positive tailwind for trucking); a resumption of imports to the West Coast U.S.; and finally, a broad rebuilding of inventory as the economy recovers.

In light of these bullish conditions (e.g., load volumes are currently running 28% above 2018, which was a banner year for trucking), our base-case forecast is that upcoming contract rate negotiations will see at least flat to positive low-single-digit increases for carriers. In addition to the tight capacity (as measured by tender rejections of above 20%), Truckstop.com national spot rates are currently running 25%+ above 2019 levels, with rising rates on almost all major lanes and rising spot market activity serving as further confirmation. This pushes the negotiating leverage to carriers in our view. Even if contracted load volumes decelerate and turn downward, it would take a nearly 30% collapse for them to go negative. Meanwhile, as noted, the rate picture is dramatically improving, which should allow carriers to drive meaningfully higher profits and cash flow from now into 2021.

We are mindful of the fact that the trucking industry is incredibly dynamic, and conditions can change rapidly, for better or worse. This characteristic could be exacerbated by the fact that the U.S. economy is on a delicate recovery trajectory. The latter is entirely dependent on renewed stimulus passing through Congress to buy enough time until a COVID-19 vaccine arrives. At the time of writing, Congress has taken a multi-week recess and Senator Pelosi said the two sides were “miles away” from passing another stimulus package. This could prove to be painful in the



last months of the year, but with the election forthcoming it seems logical both sides will want to get a deal passed.

All in all, we currently see no obvious red flags or warning signs that suggest an imminent slowdown, and therefore, our expectation is for conditions in the trucking industry to stay relatively strong and slowly improve as we head into 2021.



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First-Half 2020 Review of Truck Capacity

Tender rejections for the second quarter of 2020 (in blue; and Q1 2020 for that matter) resembled a U-shape from the late-March peak until the beginning of July. Since then, capacity has tightened significantly and carriers are rejecting contracted freight at a clip not seen since 2018.

In all, tender rejections averaged 7.47% in 2Q 2020, 258 basis points (bps) higher compared to the previous year.

Capacity has gone through a cleansing process since mid-to-late 2018 as severely depressed new truck orders, elevated carrier bankruptcies, insurance inflation and a deep freight recession (among other factors) all led to a reduction in capacity (relative to freight demand).

Figure 1: Outbound Tender Reject Index (2020 – blue, 2019 – orange, 2018 – green)



[SONAR: OTRI.USA](https://www.freightwaves.com/sonar/OTRI.USA)

Capacity – New Class 8 Truck Orders

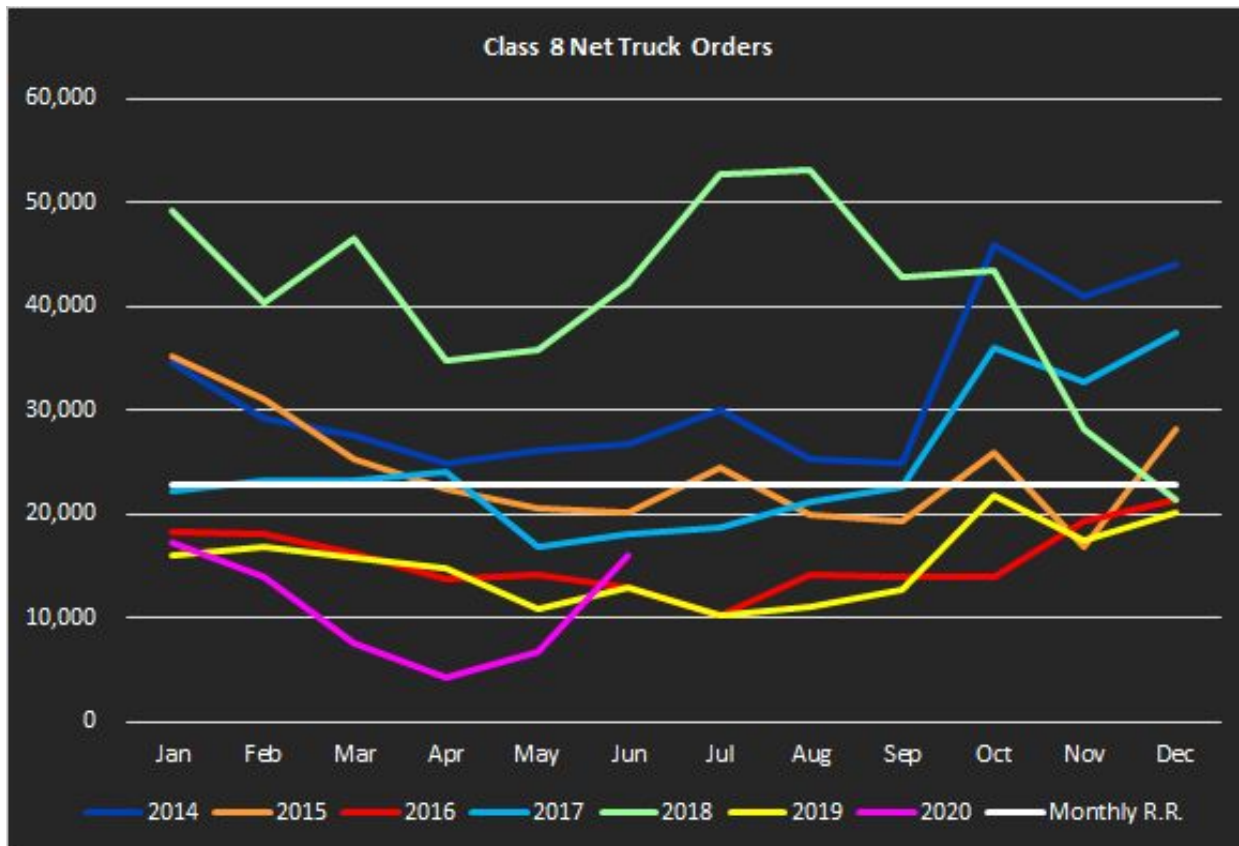
New truck orders showed signs of life in June, increasing by 23% year over year and 139% sequentially from May—a sharp contrast from the 20-month downtrend of severe negative year-over-year declines in place since November 2018.

However, new truck orders of 16,000 in June still sit approximately 30% below FreightWaves’ monthly estimate for replacement demand of 23,000.



Year-to-date new Class 8 truck orders are running -25% year-over-year through 1H 2020 (and at an annualized run rate of about 130,000), suggesting we will need to see a material acceleration from here to swamp demand should truckload volumes stay elevated.

Figure 2: New Class 8 Truck Orders in the U.S. (2014–2020; replacement rate in white)



Source: ACT Research, FreightWaves



Figure 3: New Class 8 Truck Orders in the U.S. – Monthly Absolute Values (2014-2020)

Class 8 Net Truck Orders							
	2014	2015	2016	2017	2018	2019	2020
Jan	34,584	35,283	18,297	22,188	49,136	16,105	17,204
Feb	29,225	31,158	18,078	23,245	40,271	16,854	14,060
Mar	27,487	25,293	16,233	23,215	46,593	15,783	7,610
Apr	24,831	22,458	13,676	24,007	34,735	14,859	4,275
May	26,115	20,533	14,224	16,940	35,721	10,886	6,687
Jun	26,729	20,229	12,955	18,104	42,213	12,979	16,000
Jul	30,073	24,557	10,358	18,726	52,618	10,298	
Aug	25,354	19,971	14,194	21,213	53,040	11,119	
Sep	24,851	19,421	13,880	22,573	42,781	12,692	
Oct	45,956	25,925	13,907	36,092	43,526	21,864	
Nov	40,925	16,772	19,440	32,637	28,114	17,483	
Dec	44,037	28,145	21,386	37,569	21,381	20,073	
Year Total	380,167	289,745	186,628	296,509	490,129	180,995	65,836
Y/Y Change	42%	-24%	-36%	59%	65%	-63%	-25%
Monthly Avg	31,681	24,145	15,552	24,709	40,844	15,083	10,973

Source: ACT Research, FreightWaves

Capacity – Used Truck Prices

Used truck prices have yet to find a bottom after a one-year slide, even as the trucking industry begins to recover. The three-year old cohort is the only exception - prices have fluctuated for the better half of a year now.

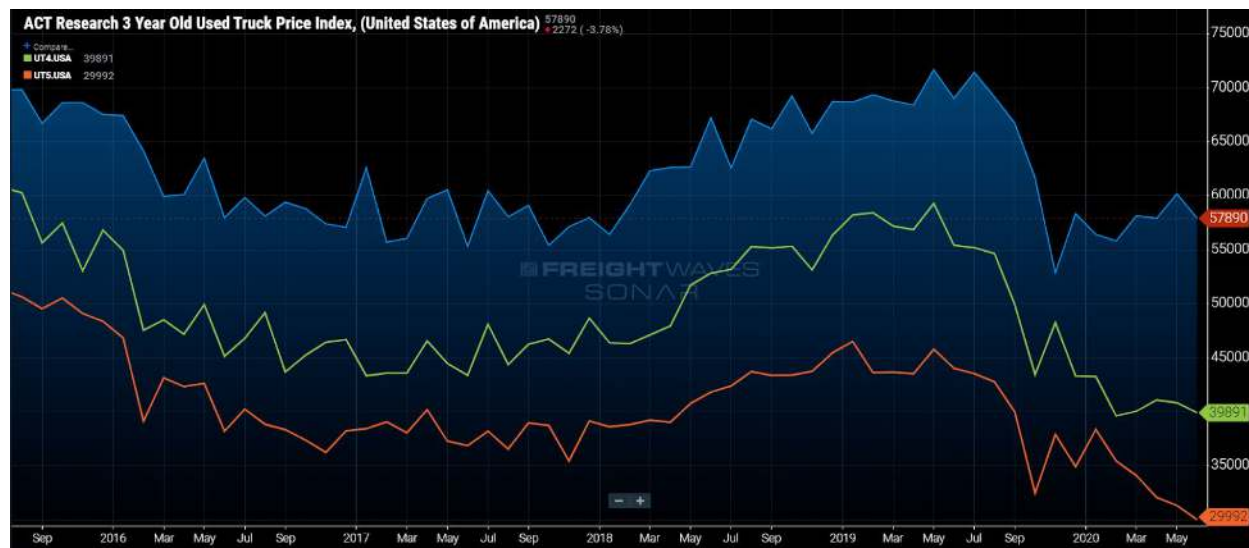
Used truck prices typically snap back early on in an economic recovery because, as trucking rates recover, new entrants and drivers conclude that they can retain more of the incremental upside from a rebound in rates if they buy a used truck for one-third of the price (roughly \$50,000 compared to a new truck for around \$150,000).

Interestingly, in 2018, this dynamic did not play out as much as expected, or is typical, because fleet owners increasingly used new trucks as recruiting tools to compete for a scarce pool of seated drivers.

With the current environment of strong volumes and upward pressure on spot rates, we could begin seeing used truck prices pick up steam moving into 2021. However, a [glut of inventory was a problem pre-covid](#), so demand will need to accelerate materially before prices firm up for all of the cohorts.



Figure 4: ACT Research Used Truck Prices (3-year-old – blue, 4-year-old – green, 5-year-old – orange)



[SONAR: UT3USA, UT4.USA, UT5.USA](#)

Trucking Failures

Carrier bankruptcies roughly quadrupled in 2019 from 2018, and though the pace has slowed recently as industry fundamentals improve, bankruptcies remain elevated as profitability is only now inflecting positively for most carriers. Should this trend continue (or even if trucking markets are unable to sustain a recovery), it appears more likely that we are closer to the beginning of a multi-year trucking upcycle rather than another freight recession.

Nuclear verdicts and rising insurance premiums continue to wreak havoc on truckload operating ratios (ORs) and profitability, particularly in smaller fleets lacking buying scale and an ability to self-insure.

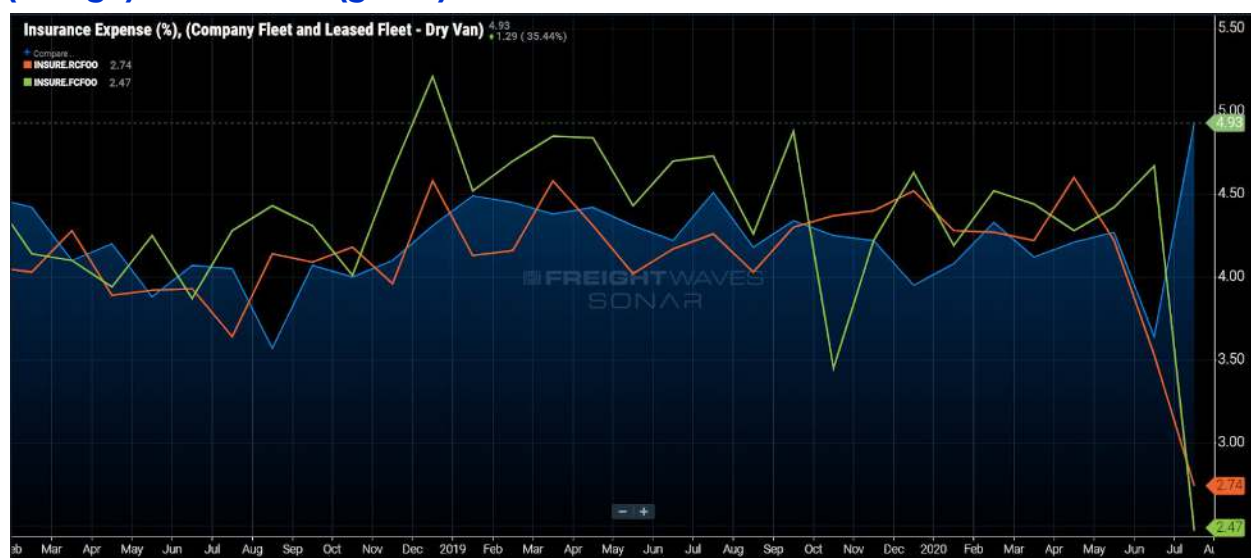


Figure 5: Operating Ratios for Dry Van (blue), Reefer (purple) and Flatbed (green)



[SONAR: OPRAT.VCF, OPRAT.RCF, OPRAT.FCF](#)

Figure 6: Insurance Expense (as a % of revenue) for Dry Van (blue), Reefer (orange) and Flatbed (green)



[SONAR: INSURE.VCFOO, INSURE.RCFOO, INSURE.FCFOO](#)

Regulatory Issues

The U.S. House of Representatives recently voted to more than double the minimum amount of insurance required for carriers from \$750,000 to \$2 million. While the bill must ultimately pass the Senate and its resolution remains uncertain, its passage would almost certainly result in a big blow to smaller carriers and lead to many exiting the industry or facing bankruptcy.



This bill favors larger carriers and represents a medium- to long-term risk for shippers as it would likely lead to lower normalized capacity and greater pricing power for the remaining carriers in the future.

First-Half 2020 Review of Load Volumes

Contracted truckload volumes in the second quarter of 2020 were weak early on as they plunged in April following a panic-buying-induced moonshot in March, followed by a steady upward appreciation throughout the remainder of the quarter.

Contract volumes averaged 6.8% higher year over year in the second quarter 2020 compared to the previous year. Since the beginning of the third quarter, the volume faucet has been flowing in an unprecedented manner. Currently, OTVI sits roughly 30% above 2018 (which was a very strong year for freight). It must be noted that our OTVI includes some percentage of rejected tenders at a time like this. It is a measure of national outbound tenders, not just accepted tenders. That being said, the freight volumes are at a multi-year high, but are more likely closer to 12 - 18% up year-over-year. In any case, carriers are benefitting from the influx of freight demand.

Volumes by subsector could be characterized as weak across the board through April (aside from certain well-insulated categories such as grocery, CPG, online retail and home improvement). Starting in May and carrying over into June and July, most categories of consumer spending, housing and manufacturing all began to experience a broad-based sharp recovery (but not quite back to pre-COVID peak levels).

Figure 7: Outbound Tender Volume Index (2020 – blue, 2019 – orange, 2018 – green)





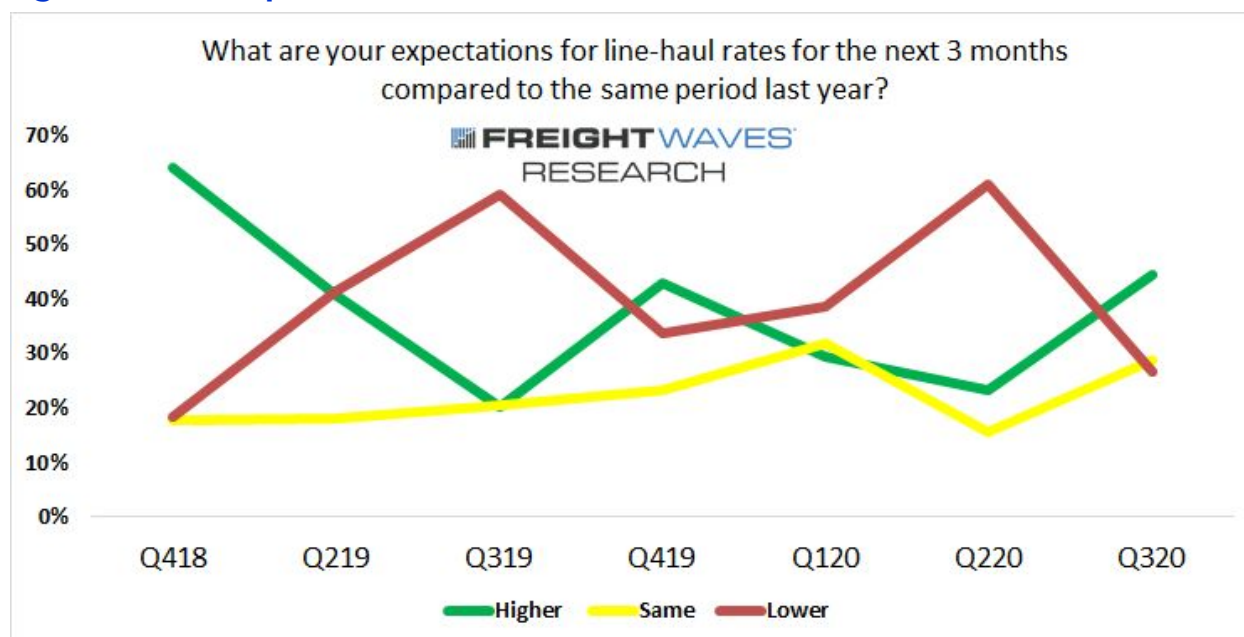
[SONAR: OTVI.USA](https://www.freightwaves.com/sonar/OTVI.USA)

First-Half 2020 Review of Trucking Rates

Spot rates in the second quarter of 2020 (in blue) were weak early on as they plunged in April following a panic-buying induced moonshot in March, followed by a steady upward appreciation throughout the remainder of the quarter.

Spot rates averaged 2.8% higher year over year in Q2 2020 compared to the previous year, but after the upward pressure to begin Q3 now sit at \$2.00/mile linehaul (ex-fuel), well above operating cost per mile (ex-fuel) in the \$1.40 range. This allows carriers to increasingly generate profits and significant cash flow. Should this continue, normal industry dynamics would dictate that the number of trucks in market and seated driver capacity should increase alongside spot rates.

Figure 8: Rate Expectations



Spot rates are on pace to break through 2018 record levels if the volume pace can remain. In our survey of shippers in 2019, shippers noted that spot rates need to stay above contract rates for 3 months before they start to see carriers rebidding contract rates upward - we are nearing that point.



Figure 9: DAT National Spot Rates Linehaul Ex-Fuel (2020 – blue, 2019 – purple, 2018 – green)



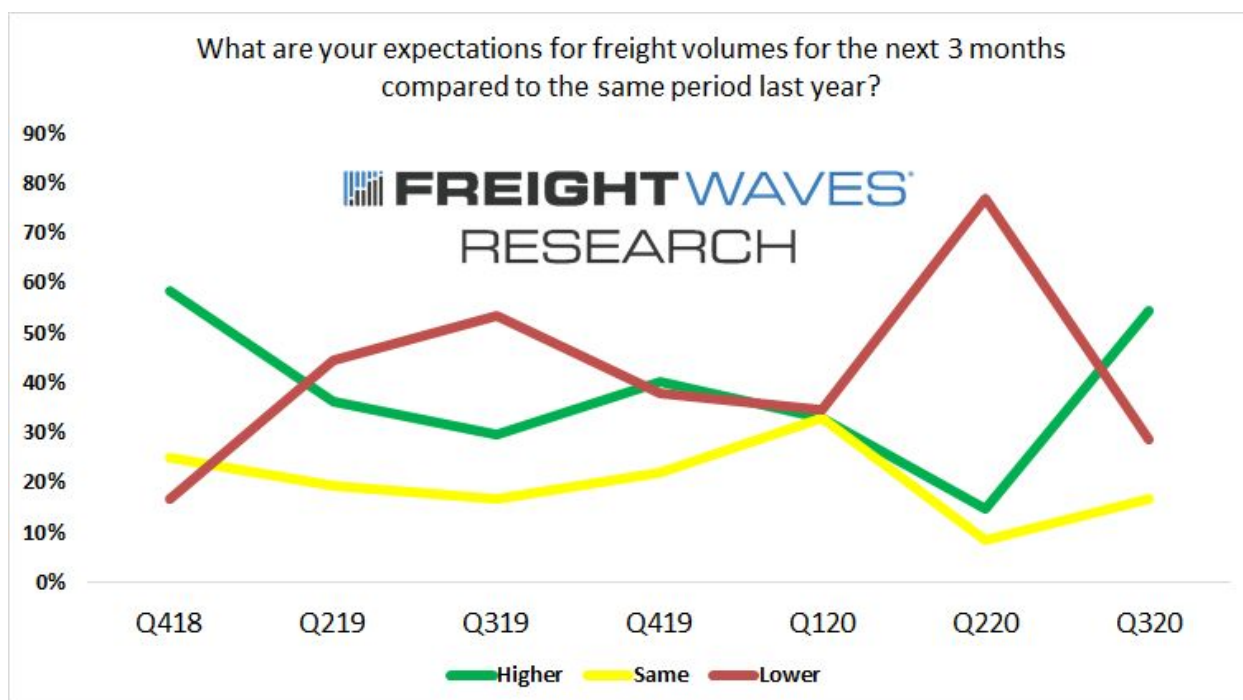
[SONAR: DATVF.VNU](#)

Trucking Forecast for the Second Half of 2020

The U.S. economic backdrop as of August 2020 is extremely fluid and dynamic and is even harder than usual to forecast given the numerous variables that must be handicapped (e.g., vaccines, politics, geopolitics, stimulus, etc.). In light of this, we approach a forecast for the second half of 2020 with a probabilistic mindset.



Figure 10: Volume Expectations



Seasonality Considerations:

Capacity appears tight for now and has exhibited no signs of seasonality thus far. Typically, the market naturally eases in July and into August before picking back up in September into the fourth quarter (up until the Christmas peak) should normal seasonality hold. That has not been the case this year as volumes have actually acted contrary to what we usually see.

The Base Case (a U-Shaped Recovery) – Carriers Will Likely Play Aggressively if the Status Quo Prevails; High Probability (40%):

The strongest variable for carriers is that volumes have continued to push higher when we typically see a slow down. Post-Independence Day volumes typically recede, but volumes have kept capacity tight. There is material inflation in spot rates that will likely spill over and put upward pressure on contract re-bids. This appears to be the most likely path if the status quo is maintained and the COVID resurgence in the Sunbelt does not lead to surging deaths and broad, nationwide lockdowns.

Load volumes are likely to sustain positive on a year-over-year basis through the end of 2020, with tight capacity leading to spot rates higher than 2019/2018 and moderate upward pressure on contract rate re-bids (positive low single-digits year



over year). This environment would be consistent with a high single-digit/low double-digit tender rejection rate nationally.

The Bull Case (a V-Shaped Recovery) – Moderate Probability (30%):

Ed Hyman (a top Wall Street strategist at Evercore ISI) believes that the U.S. could return to peak GDP by the first quarter of 2021. If this occurs, given the fragile and arguably low supply of trucking capacity should even the status quo prevail, the melt-up in spot rates is likely to continue through the end of 2020 if the greater economic throughput spills over into load volumes. Hyman's math for GDP to return to peak (on a quarter-over-quarter SAAR basis) is roughly -30% in 2Q20, 20% in 3Q20 and 4Q20, and 5% in 1Q21.

Load volumes in such a scenario are likely sustained at 5-10%+ in the second half of 2020, and there is likely to be material upward pressure on contract rates in the next round of re-bids (positive low-single-digit to mid-single-digit range; 3%+ annual inflation year over year). This environment would be consistent with a mid-to-high double-digit tender rejection rate nationally.

The Bear Case (a Double-Dip Recession) – Moderately Low Probability (20%)

Should the COVID-19 case and death count surge nationwide lead to more lockdowns and overruns of hospitals' ICU capacities, or Capital Hill is unable to pass a second stimulus, the U.S. economy would likely go into a double-dip recession in the second half of 2020.

In this environment, load volumes are likely to contract on a year-over-year basis in the second half (from flat to down 10% as contracted load volumes troughed at roughly -10% during the height of the 2019 freight recession), with loose capacity leading to sub-2019/2018 spot rates (closer to or slightly below operating cost per mile) and moderate downward pressure on contract rate rebids (negative low-single-digit to mid-single-digits year over year). This environment would be consistent with a tender rejection rate of less than 5% nationally.

In the downside scenario, reefer is likely to outperform, dry van is likely to fare moderately poorly, and flatbed is likely to be in a severe recessionary backdrop.

Therefore, the weighted average (and most likely) scenario in FreightWaves' view is to expect positive load volumes year over year in the second half of 2020 (in the mid-to-high single digit range) and moderate upward pressure on spot (normalized for the traditional seasonal ramp in Q4) and contract rates (flat to up low single-digits year-over-year in renegotiations). It is important to note that this base-case forecast would represent a major deceleration from current conditions in these same key metrics as of late August 2020, which embeds an element of



conservatism (although dynamics in the trucking industry can change extremely rapidly).

The capacity (supply) side likely sets up fairly well for the carriers (or at least is vulnerable to lower downside risk than in a typical freight recession) even in a double-dip recession scenario because the industry has gone through an 18-month cleansing of supply.

Warning Signs That Could Derail Carrier Momentum and Tip the Balance in Favor of Shippers

Consumer spending has rebounded in a V-shape from the -40% trough in late March and early April but has stalled out in the -5% range, with risk to the downside particularly in categories such as travel, leisure, hospitality, entertainment, restaurants and bars, and brick-and-mortar retail.

With that being said, given trucking's exposure only to consumer goods (instead of to services), trucking is likely positioned favorably on a relative basis should the economy reverse and accelerate to the downside (as we saw in March, for example). A severe, sustained downturn and double-digit unemployment over a six-month or longer timeframe would likely take down the trucking market with it, but at a lag.

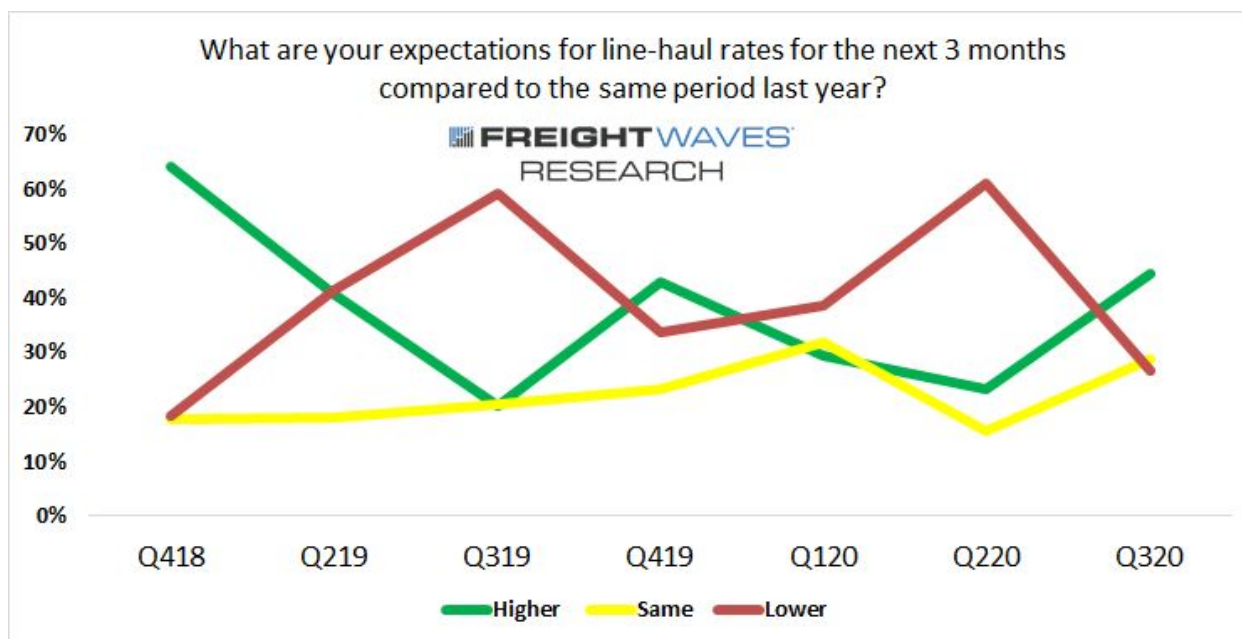
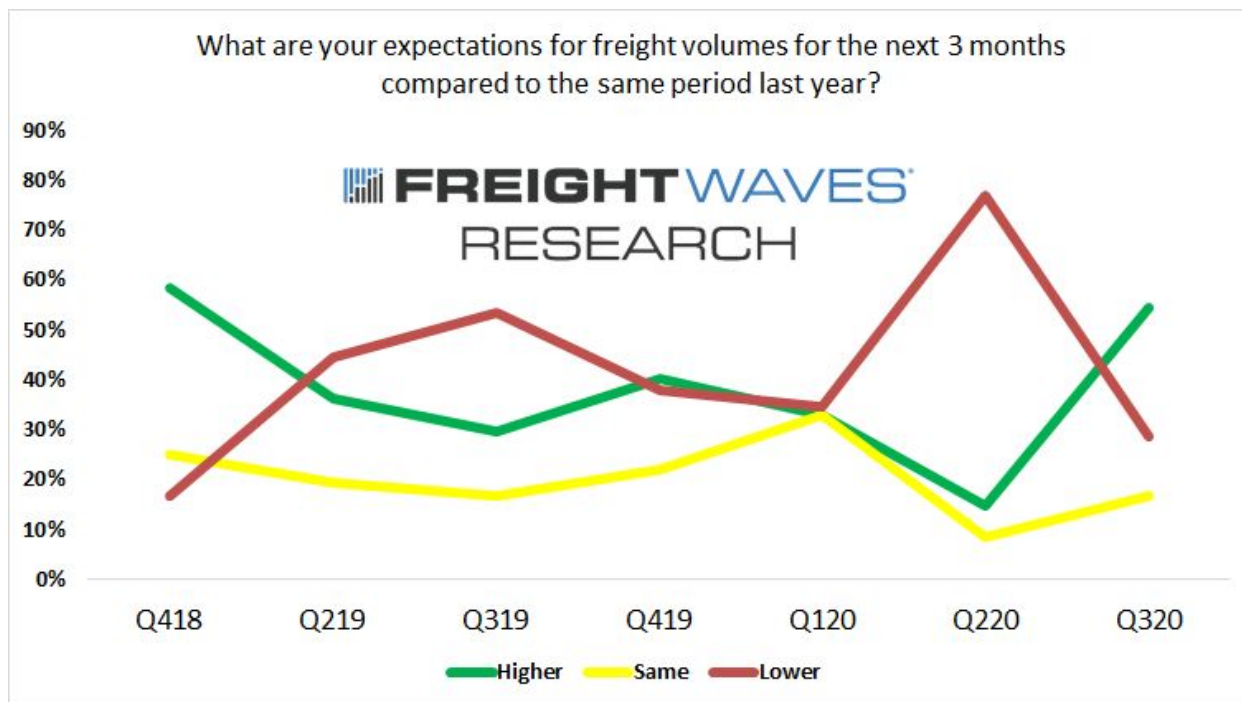
Generous unemployment insurance and stimulus must be extended after the July expiration to maintain consumer spending in the event that there is a slow ramp and re-hiring of furloughed workers. There is talk of extensions ongoing in Washington, D.C., but the gap between Democratic and Republican wishes is wide, and compromise will be needed.

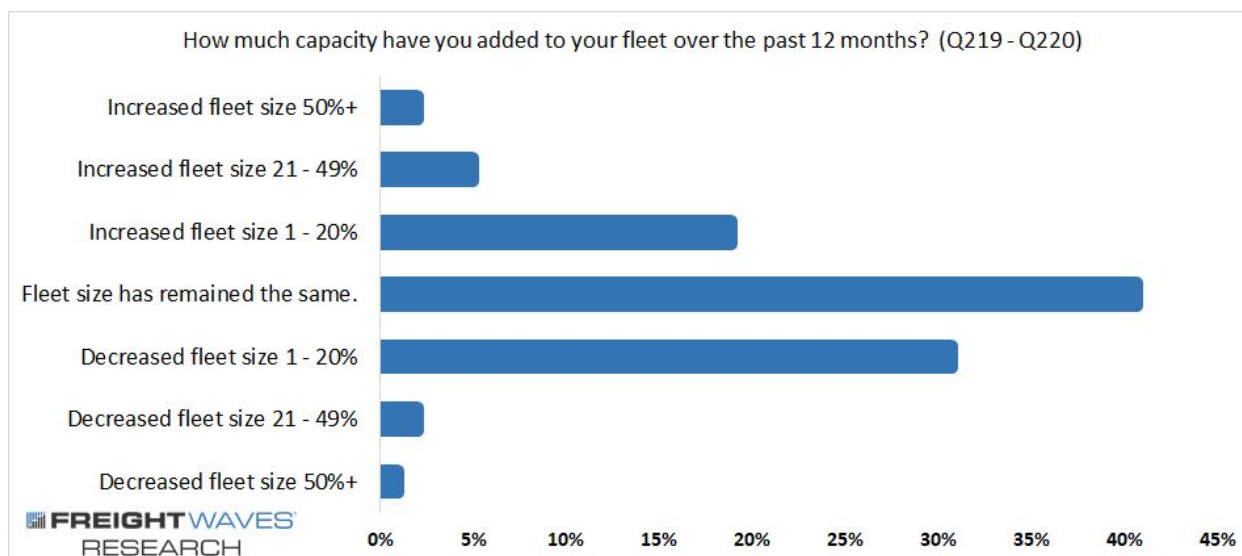
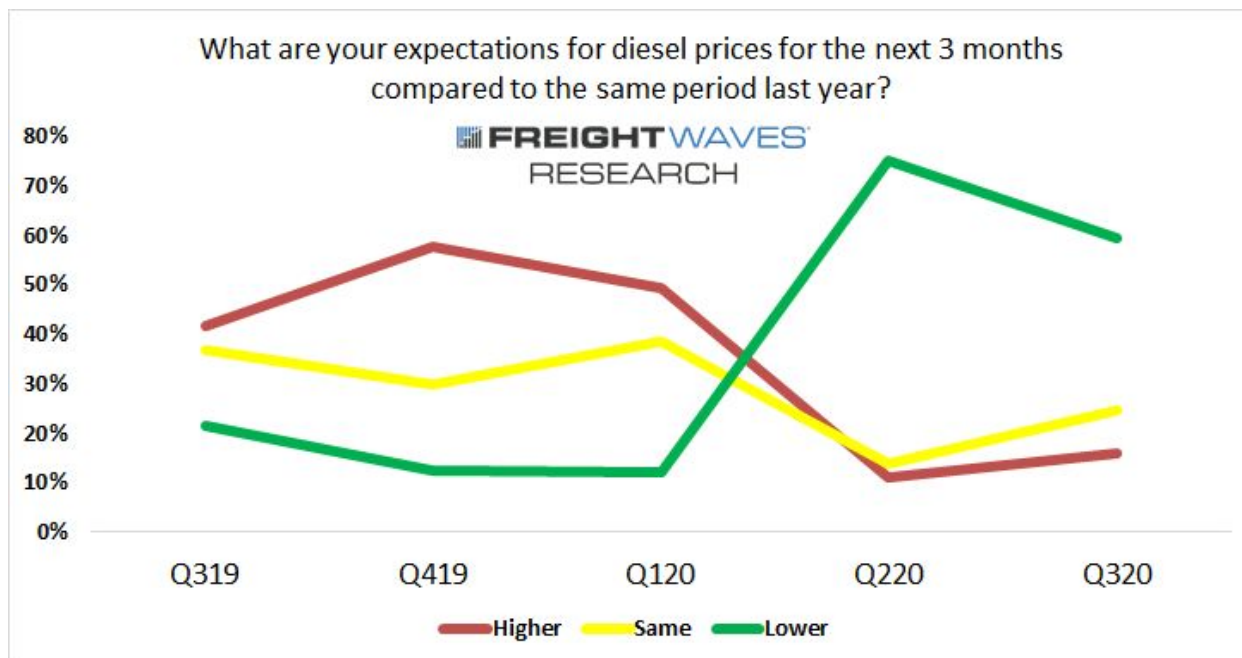
Will there be a meaningful back to school (BTS) season as usual? BTS is about a \$100 billion event, according to the National Retail Federation. This means BTS represents 7%+ of overall retail spending in the third quarter by our estimates. Therefore, if most U.S. schools go all online for the 2020–2021 school year (a distinct possibility), there is potentially significant downside risk to this number (although it certainly will not go to zero) and to associated truckload and intermodal volumes as a result.

The November presidential election is also a risk to freight volumes in the second half of 2020. Should Joe Biden win (as polls now suggest), there will be a rollback of the Trump tax cuts, which could pose a significant risk to the stock market and the economy by way of reduced consumer sentiment/spending and lower hiring and capital expenditures by corporations and small businesses (which account for 50% of employment in the U.S. and are already in shambles).



Q3 CARRIER SURVEY RESULTS







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' team of 150 full-time captures, models, and interprets near-time data from more than one thousand sources to provide participants with 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 datasets that can help them optimize their routing, pricing, and planning decisions.

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FreightWaves Freight Intel Contacts

Kevin Hill, Director of Research
(646) 731-4735, khill@freightwaves.com

Seth Holm, Senior Research Analyst
(404) 840-2064, sholm@freightwaves.com

Andrew Cox, Research Analyst
(615) 495-4507, acox@freightwaves.com