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Road Transport: Caught in the headlights of the heavyweights

Australia's big trucking companies are enjoying a comfortable ride to prosperity on the back of an unprecedented economic boom, but not everyone is cruising in the fast lane. **George Georges and Brendan Richards** look at why some transport operators are having a bumpy ride.



In the midst of a record economic boom, you would expect every road transport company in the country to be enjoying unprecedented prosperity. Think about it: growth in economic activity leads to growth in freight. It is a simple formula and it demonstrates why the road transport industry is recognised as one of the most effective economic barometers.

Anyone familiar with the statistics will tell you that the numbers are impressive, too: road transport revenues grew 7.1% in real terms over 2004/2005 – significantly outpacing GDP growth of 2.3%. Look at the success of Toll Holdings – core revenue up 12% in 2005/2006 – it all sounds like great news for transport operators.

But the truth is that while the transport heavyweights are literally cruising down the highway, many smaller transport companies are bouncing along the road to adversity. Why? And what does that mean for the future of small-to-medium-sized transport operators?

What's driving the change?

Three key factors are driving the growth in road transport revenue:

- Sustained economic growth
- The resources boom
- Phantom revenue increases generated by fuel levies

Australia's ongoing economic growth is a direct driver of the organic growth in the national freight task.

While it may be tempting to attribute a large portion of the sector's revenue growth to the resources boom, the bulk mineral sector contributed to just 2.2% of total industry revenue growth.

So this explains some of the growth, but not all of it.

What is clear is that part of the apparent increase in revenue has actually been due to the impact of fuel levies, introduced in response to rapidly rising fuel prices. Because revenue growth statistics incorporate the impact of the levy, they overstate any real growth – leading to phantom revenue increases.

The issue for the transport industry is that this growth appears to be shared mostly among the industry heavyweights while many private operators are missing out.

Why are the majors winning?

The growing divide between the transport heavyweights and the welterweights is being driven by economies of scale. The likes of Toll and Linfox realised many years ago that complete supply chain solutions would act as a hedge against downturns in the trucking business.

Furthermore, the industry majors tend to have coverage in all significant trucking segments from liquid to beverage, food and retail, and have been able to capitalise on the boom in bulk mineral cartage. Businesses providing general freight cartage services alone, or an out-of-favour niche (such as livestock), have struggled.

Backs to the wall

The small-to-medium market operators have their backs to the wall, unable to compete with the biggest players on price without completely eroding their margin. And they are subject to significant wage pressure from driver shortages. Couple this with high fuel prices, often haphazard management styles and severe working capital shortages, and the position looks grim.

A national driver shortage is the most significant issue facing the industry. The inability to attract a new generation of young drivers is primarily a consequence of work-life balance issues and opportunities that exist in a low-unemployment economy. On the back of declining revenues and margins, it is almost impossible for smaller players to absorb wage increases.

Did you know...

- The top four players (Toll, Linfox, K&S and TNT) account for only 21% of total industry revenues.
- Owner drivers and small freight operators account for less than 12% of industry revenues but represent 66% of total operating businesses.
- The balance of industry revenues are contributed by the middle market and 2nd-tier players such as Transwest and Scott Group.
- The national freight task is anticipated to double in the next 20 years.

And that's just the beginning. The problems are compounded by ongoing inconsistencies in regulation between the states. Take the ridiculous anomaly that sees Victoria's roads being nearly 100 per cent open to B-double combinations but New South Wales roads being only 20% open to the same vehicles. Since the mid 1980s, Victorian transport companies have enjoyed a 30% decrease in running costs flowing from the transition to B-doubles, but this has yet to be fully realised in other states.

An additional issue is the cost of the relatively new Chain of Responsibility legislation that confers upon all parties relevant to goods cartage a legal liability for breaches under the various Road Safety Acts.

Chain of responsibility

- Confers a legal liability for Road Safety Act breaches on all parties (not just the driver and operator) subject to control in the transport of a product.
- If a breach of road transport law occurs due to your action or inaction, you could be legally accountable.
- Put simply: Control = responsibility = legal liability.

Common problems

Beyond these industry-wide issues we see a number of consistent problems at a micro level. These include:

- Poor operational expertise
- Insufficient fuel levies
- Inconsistent regulation
- Incorrect prime-mover selection

Foremost among these is the inability to properly calculate an appropriate load mix, combined with poor scheduling. Small-to-medium operators with poor operational expertise are often unable to determine whether a truck leaving the depot will make a profit or a loss.

Rising fuel prices and the ability to calculate an appropriate levy has become a significant issue in the last couple of years. Many operators continue to display technical deficiencies in calculating fuel levy matrices, and consequently are bearing a greater portion of the additional fuel cost burden than their competitors.

Inappropriate fleet selection can also catch out transport operators. Despite the 30% efficiency gains that can be achieved by running a B-double fleet, there are many instances of businesses operating single-trailer combinations rather than B-doubles in order to cater to roads that they rarely use.

Beyond this, many small operators fall victim to 'over-specing' prime-movers, resulting in financing costs disproportionate to the turnover of the business. Judicious selection of the right combination and prime-mover specifications can make the difference between a prosperous or faltering business.

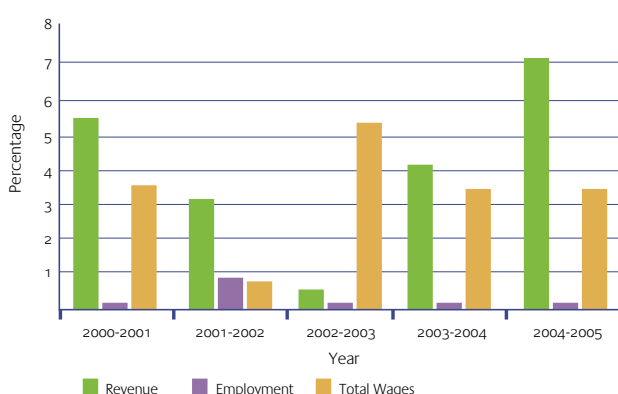
Is there a solution?

Transport operators in the small-to-middle market can prosper, but it requires discipline. Importantly, successful operators:

- 1 Identify and capitalise on a niche to minimise the margin pressures of being a generalist
- 2 Improve operational efficiency through the employment of an experienced operations manager capable of accurately and consistently pricing loads
- 3 Ensure fuel levies are properly tested to ensure increasing prices are fully compensated

Unfortunately for many smaller players, the ability to compete and display a point of difference is becoming more difficult. A number of operators have already taken the initiative to exit the industry.

Historical growth in the road transport industry
Source: IBISWorld



With the quantum of private equity funds available at present, opportunities are starting to emerge for a strategic exit that has the potential to provide a return to shareholders well beyond what could be achieved by continued ownership.

Private equity firms have the capacity to, through strategic acquisition, build a strong portfolio of similar or niche operators and capitalise on economies of scale. The synergistic benefits available can unlock significant value.

This is an emerging trend: ABN Amro Capital has already completed the acquisitions of Scott's Refrigerated, McColl's Geelong and ID Transport. More consolidation is inevitable.

While for some operators, a strategic exit – if achievable – is the best outcome, the alternative is something many are not willing to face.

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