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Highway to Hell ?

Rough road ahead for trucking industry

The world has been travelling a rocky road during 2008. Oil is at record highs. Interest rates are up. Food prices are rising. All that is bad enough, but for those operating in Australia's road transport industry there are a handful of speed humps looming that will test even the most experienced operators.

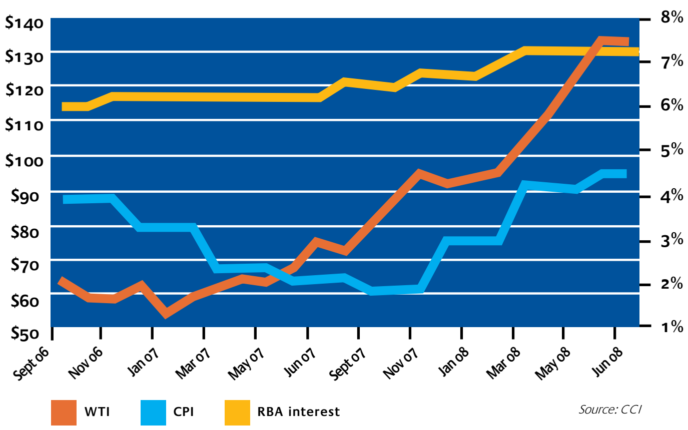
The skilled driver shortage and the introduction of legislation regarding carbon emissions trading and driver fatigue will all add to the existing pressures on road transport operators. Their ability to identify, quantify and pass on these costs will be a key factor in deciding which operators survive... and which end up broken down wrecks along the side of the road. Critically, the role of the Operations Manager will become more important than ever before as the arbiter of margins and profitability.

A key indicator for the future of the sector was Kenworth Trucks' announcement this week that it will sack more than 80 workers, blaming the slowing economy, high fuel prices and interest rates. The company has already cut 380 contractors since last year and production will drop from 23 trucks a day to just eight.

Fuel prices and the economy

Fuel prices affect everyone. Regardless of whether you drive a car or not, everyone has to eat – and all that food is transported to your local supermarket by petroleum-fuelled trucks. So if the trucking firms are feeling the pinch, you will too. Vehicle-running expenditure traditionally represents 31% of operating costs; so rising fuel prices will exert additional pressure on costs. At the same time, the big retailers are squeezing transport margins in an effort to eke out their own profits in a tough market.

West Texas Intermediate crude price / CPI / RBA interest rate



In September 2007, transport operators complained when oil reached a record US$81 per barrel. This year we have seen prices rise to over $140 per barrel. Increased fuel prices are now a reality and Australian industry needs to get used to the idea. With dwindling global fuel reserves, simple economics tells us that demand will outstrip supply and force prices even higher.

With retailers pushing to maintain their margins, trucking companies must hold firm when their rates are questioned. In a passionate editorial in a recent edition of *Prime Mover* magazine, Editor Peter Armstrong wrote about the need for trucking companies to learn how to say no.

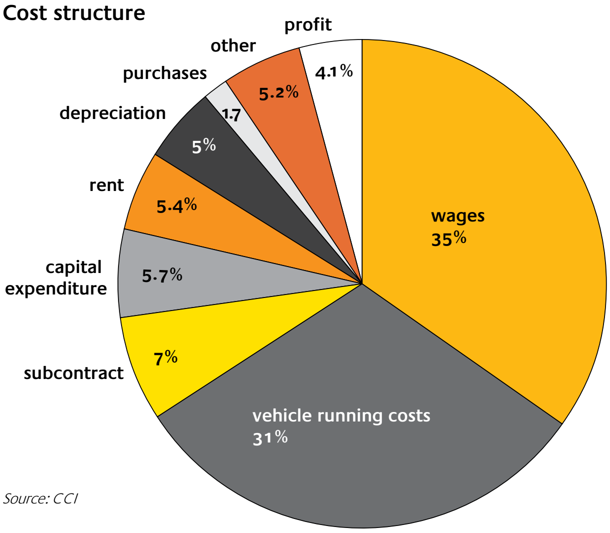
"Rising fuel prices have changed the whole trucking scene... spiralling operating costs are now a fact of life in trucking," Armstrong wrote. "The time is here to re-evaluate business practices and say no to customers demanding low freight rates."

He wrote that many successful operators have divested non-profitable loading and reduced truck numbers in order to boost the bottom line. He is onto something. The ability of transport operators to identify unprofitable loading and set healthy freight rates is going to become vital to the future of every trucking business.

Industrial action of the type engaged in the UK and France will do little to curb the price of fuel, as the Federal Government sets its excise on a cents-per-litre basis, rather than a percentage of the total. As a result, no matter what the price, the tax on fuel for the transport industry remains the same. The underlying problem is the world price of oil.

While the Federal Government can help the industry through increased concessions on taxation, such as the expansion of the fuel credits scheme to include fuel used in bulldozers, cranes and backhoes, this will be offset by the underlying increase in the price of fuel (diesel has increased from about 134 cents per litre to 184 cents since October 2007). The bottom line is that playing with fuel taxes is not the solution.

Cost structure



Source: CCI

Skills shortage

The average age of Australian truck drivers is fast emerging as one of the major issues facing the industry. In 1997, only 37% of the transport and logistics workforce was over the age of 45, last year it was more than 45%.

Australian Trucking Association Chairman, Trevor Martyn, says the trucking industry will need an additional 10,000 drivers by 2012 as it responds to Australia's growing freight task. The Department of Workplace Relations states that there were 84,000 truck drivers in Australia in 2007. That means an additional 12% more drivers will need to be found in four years – and that excludes the need to replace those that will retire in that time.

A report by the Transport & Logistics Industry Skills Council ("TLISC") found the transport industry workforce is under pressure due to the need to replace an ageing workforce and the shift from unskilled roles to management responsibilities. However, a Department of Immigration and Citizenship report on the trucking industry found there is no skills shortage and that it expects only moderate growth in demand for drivers over the next five years. In response, the role of truck driver was removed from the 457 visa program that would have allowed the sponsoring of foreign workers into Australia.

The life of an interstate truck driver does not appeal to the average Generation-Y employee who is seeking a career offering greater work-life balance. The resources boom has attracted many Gen-Ys to lucrative mining positions. According to www.mycareer.com.au, the average mining wage is $128,751 compared to just $62,500 in the transport industry. This is a serious problem for the industry: wages represent the largest proportion of an operator's costs at approximately 35%.

Fatigue regulations

The National Transport Commission ("NTC") rolls out its new Heavy Vehicle Driver Fatigue legislation on September 29 in a bid to improve the safety of heavy vehicle drivers and reduce fatigue-related accidents. Key to the new legislation is the determination that a maximum of 12 hours can be worked in any 24-hour period under standard hours. Seven consecutive hours of rest must be taken in any 24-hour period. The legislation will make all parties in the supply chain legally responsible for preventing driver fatigue and introduce fines of up to $50,000.

Opponents of the scheme argue that Australia has an insufficient number of rest areas along its network, which will invariably lead to breaches of the legislation. There is also concern the Government will pursue this legislation as a means of raising revenue rather than improving safety conditions for drivers and other road users.

There is no question the new anti-fatigue legislation will increase costs for operators and put delivery times under pressure. Owner-drivers are likely to be hit hardest. VicRoads advises that the new legislation will ensure fewer crashes, resulting in less business disruption, lower insurance-premium costs and reduced workers' compensation. What is evident, however, is that if any savings are made, they will be in the medium term – costs to operators will be felt immediately.

Environmental considerations

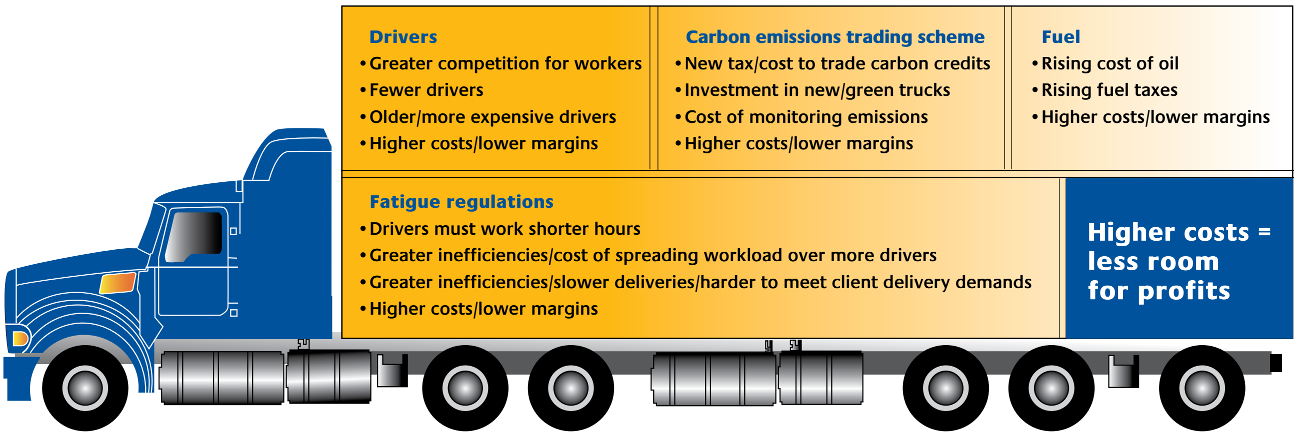
Together with fuel prices, climate change will become a major factor in the trucking industry, with the Federal Government's determination to introduce a Carbon Pollution Reduction Scheme ("CPRS") and emissions trading. Carbon pollution permits – required for every tonne of greenhouse gas emitted – will be sold via auction, but for some firms it will be cheaper to reduce emissions than buy permits.

The National Emissions Trading Taskforce has not identified trucking as an industry eligible for exclusion from the scheme or for assistance as an emissions-intensive, trade-exposed industry. The CPRS Green Paper in July 2008 stated: "The Government does not believe that excluding transport from the Carbon Pollution Reduction Scheme is, over the long term, economically responsible."

The scheme is only likely to directly affect the very largest firms in the industry. Those unable to procure carbon permits will be forced to purchase more environmentally responsible vehicles, placing additional pressure on costs and freight rates.

There will be some relief for the industry in the short term. For heavy vehicle road users, fuel taxes will be cut on a cent-for-cent basis to offset the initial price impact on fuel associated with the impact of the CPRS. The Government will review this measure after one year. The job of calculating the cost of emissions

Truckload of profit killers



to incorporate into freight rates is a task that will fall to the Operations Managers. They will also be responsible for monitoring the fleet's carbon emissions. Whilst Treasury is still modelling the scheme's pricing structure, the legislation – if passed – will see carbon trading become reality for the trucking industry from 2010.

Conclusion

Firms that have not already done so should consider investment in freight-rate calculation software, which is likely to become invaluable. Stakeholders will need to ensure operators do not chase shortcuts on the issues of fleet maintenance, taxation and employee entitlements. Operators will need to be vigilant about changes to legislation as well as being brutal in the costing of jobs and the focus on margins.

A key change in all this will be the new onus on the Operations Manager ("OM"), who is going to become the most important person in the business. Against a backdrop of constantly changing market conditions, OMs will be required to give instant load analyses to ensure vehicles do not go on the road unless there is margin in it.

The OM role will become more complex – far more than simply juggling dwindling driver numbers, higher wages and an understanding of the formula for passing on rising fuel costs, these people will require a thorough knowledge of carbon emission regulations and the company's obligations under fatigue-prevention regulations.

Even more challenging, the industry needs to ensure that it has the staff capable of undertaking these roles. This in itself represents another problem needing a solution.

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