Industry Research Update
Truck Transportation

Key Developments
- According to the “advance” estimate from the U.S. Commerce Department, annualized GDP growth during the 3rd quarter of 2015 grew at a modest rate of 1.5%; down significantly from robust growth of 3.9% during the 2nd quarter and well below the 4.3% growth in the year earlier quarter.
- XPO Logistics is buying Con-way for $3 billion, the highest price ever paid for a U.S. trucking company. Con-way is listed as the 4th largest domestic general freight carrier according to CCJ’s 2015 rankings.
- Despite multi-year lows in fuel prices, a growing number of carriers are planning increases in non-contractual freight rates. Notable recent announcements include Con-way, UPS Freight and FedEx Freight all with average increases of 4.9%.
- Navistar and GM agreed to jointly develop and manufacture class 4-5 medium duty trucks that are planned to reach the market in 2018.
- According to the American Trucking Associations (ATA), annualized driver turnover within large truckload fleets rose from a four-year low of 84% during the 1st quarter to 87% in the 2nd quarter. Meanwhile, annualized turnover at smaller TL fleets fell 7 percentage points to a two year low of 76%.

Industry Fundamentals
Despite significant volatility in the financial markets that rattled consumer confidence, the freight environment exhibited modest signs of improvement during the 3rd quarter of 2015. The tailwinds of post recession highs for residential construction activity and light vehicle sales were just enough to offset lackluster retail sales as well as severe weakness in energy and commodity production. Nonetheless, the heavy duty equipment cycle is clearly past its peak with the pace of new equipment orders recently experiencing a swift correction. Large numbers of recent new truck deliveries have easily outpaced freight growth resulting in reduced capacity utilization and a softening rate environment. Not coincidently, several large carriers announced 3rd quarter earnings that were below expectations despite multi-year low fuel costs.

Industrial Production Index (Seasonally Adjusted)

The Industrial Production Index reflects a clear slowing of economic growth during the 3rd quarter. The September reading represented the lowest year-over-year growth of 2015 and the 7th month out of the previous 9 where the index had declined month-over-month.

Reflecting slackening production, capacity utilization for the industrial sector decreased by 0.3 percentage points in September to 77.5 percent. This is 1 percentage point below the level of a year earlier and 2.6 percentage points below the long-run (1972-2014) average of 80.1 percent.
Macroeconomic Indicators

ISM Purchasing Managers Index

The Purchasing Managers’ Index (PMI), which is a measure of near-term business conditions in the manufacturing sector, has fallen to a 2-year low and is on the cusp of falling into contraction territory. The September PMI of 50.2 represented a 3rd consecutive month-over-month decline and is down significantly from the 56.1 reading a year earlier. Nonetheless, the average YTD PMI and the past relationship between the PMI and GDP suggests annualized GDP growth of 2.9%. In addition, if September’s PMI is annualized, it would equate to tepid GDP growth of 2.2%.

Retail Sales & Food Services (Seasonally Adjusted $Bn)

Retail Sales and Food Services during September reached a new all-time high. That being said, year-over-year growth has been locked in an underwhelming range of 1.5%-2.5% for most of the year. Year-to-date through September, retail sales were up 2.2% compared to the same period a year earlier, which represents a noticeably slower pace than the 3.9% rate of growth during all of 2014.

Truck Transportation Employment (Seasonally Adjusted 000s)

Truck transportation employment in September retreated modestly from an all-time high in July while the rate of growth has been decelerating throughout the year. On a seasonally adjusted basis, industry employment at the end of September was down 0.3% from August but grew 2.1% compared to a year earlier.
Through September, the freight environment began to show improvement from weakness during the Spring and early Summer. Despite the headwinds of lackluster industrial production and retail sales, most freight indicators exhibited positive year-over-year growth throughout the 3rd quarter. Heading into the final quarter of the year, the tailwind of strong residential construction trends will be challenged by relatively high levels of retail inventory coupled with ongoing weak conditions in the energy and commodities sectors.

**Tonnage Indicators**

The September ATA advanced seasonally adjusted For-Hire Truck Tonnage Index improved 0.7% from August and year-to-date was up 3.3% compared to the same timeframe a year earlier.

The FTR Truck Tonnage Index exhibited accelerating improvement during the 3rd quarter with year-over-year growth reaching an impressive 5.3% during September.

The Cass Freight Shipment Index saw sequential improvement during September but remains 1.5% lower than a year earlier.

The TSI Freight Index exhibited modest improvement in the 3rd quarter and reached a new all time high in August.

Despite large numbers of new trucks entering the market, Class 8 Capacity Utilization has held steady at relatively high levels albeit below the peak seen at the end of 2014.
Revenue And Expense Indicators

The Cass Truckload Linehaul Index has shown steady year-over-year growth in the range of 3-4% since April and has increased month-over-month for four consecutive months through September. Looking ahead, strength in linehaul rates may taper as a sluggish freight environment conspires with a steady flow of new trucks hitting the road.

At the end of October, the average price of on-highway diesel fuel remained near multi-year lows. The average retail price of $2.52 per gallon during October was the 2nd lowest monthly average since 2009. That being said, energy prices are expected to stabilize and thereafter increase heading into next year. As of October, the EIA forecasted on-highway diesel prices to average $2.72 per gallon in 2015 (vs. $3.83 in 2014) and $2.77 per gallon in 2016.

Average prices of new heavy duty trucks sold by Rush Enterprises during the 3rd quarter decreased 2% from the 2nd quarter and by a similar 2.1% compared to the year earlier quarter. Slowing sales to the energy complex, which typically carry higher prices, and higher sales to large over-the-road fleets, kept a lid on the mix of overall average selling prices.

Average prices of all used trucks sold by Rush Enterprises saw a fairly steep correction during the 3rd quarter. The average retail price of a used truck sold by Rush Enterprises decreased 7.7% compared to the 2nd quarter but were down less than 1% compared to the year earlier 3rd quarter.
Following a breakout finish to 2014, U.S. Class 8 net new truck orders saw a sharp deceleration through the first 3 quarters of 2015. Net orders during the 3rd quarter grew 2% from the 2nd quarter but were 16% lower than the year earlier quarter. YTD through September, net orders were down 8% compared to same period of 2014. Net orders during the month of September were down 3% compared to August and 19% compared to the same month a year earlier.

Following a seasonally weak 1st half, U.S. Class 5-7 Net Truck Orders mirrored strength in residential construction and rebounded during the 3rd quarter. Net orders during the 3rd quarter increased 7% compared to the 2nd quarter and were also 5% higher than the year earlier quarter. YTD through September, net orders were up 4% compared to the same timeframe in 2014. Net orders during the month of September were up 23% compared to August and up nearly 19% compared to the same month a year earlier.

U.S. Net Trailer Orders have followed a volatile yet somewhat predictable seasonal order pattern over the past few years with Fall/Winter the usual timeframe for fresh capital commitments. True to form, net trailer orders saw a strong sequential uptick during the 3rd quarter. Net trailer orders increased 30% compared to the 2nd quarter while also increasing 7% compared to the year earlier quarter. However, due to pronounced weakness during the February-May timeframe, YTD net orders through September were down 6% compared to 2014.
Other Business Indicators

U.S. Class 8 Trucks Sold In The Past 3 Years Compared To The Past 7 Years (3/7 Ratio)

Following a robust 19% increase in retail sales during 2014, retail sales of heavy duty trucks remained strong through the first three quarters of 2015 (+20% YTD) and in aggregate have accelerated over the past 3 years. As such, the percentage of trucks sold within the past 3 years compared to all trucks sold over the past 7 years remains solidly above the “theoretical” level where normal equipment replacement transitions into fleet expansion.

The heavy duty backlog-to-build ratio has trended sharply lower throughout 2015 as a modest deceleration in builds did not keep pace with a sharper correction in orders. During the 3rd quarter, the industry backlog decreased significantly as the number of monthly builds averaged nearly 5,400 more than the average number of net new orders. The heavy duty inventory-to-sales ratio trended sharply higher during the 3rd quarter as three consecutive decreases in monthly retail sales outpaced a more modest deceleration in builds. At the end of September, inventories represented 2 ½ times the level of sales during September, which is a high watermark for 2015.

Sales and builds of new heavy duty trucks decelerated throughout the 3rd quarter. During the 3rd quarter, HD sales decreased 2% compared to the 2nd quarter but were up 13% compared to the same quarter a year earlier. Similarly, builds during the 3rd quarter were down 8% compared to the 2nd quarter but were up 7% compared to the same quarter a year earlier.
Other Business Indicators

U.S. Housing Starts (Seasonally Adjusted, Annualized Rate)

Housing Starts in the U.S., which are a strong influencing factor in the overall direction of freight tonnage, were at multi-year highs through September. Despite choppiness induced by the potential of rising interest rates, the monthly average annualized rate of 1.163 million units during the 3rd quarter of 2015 was more than 13% ahead of the pace in the year earlier quarter. Following an abysmal winter where the rate of starts was lower year-over-year during January and February, annualized starts during September were 18% higher than a year earlier.

U.S. Light Vehicle Sales (Seasonally Adjusted, Annualized Rate)

Light vehicle sales in the U.S. are also an indicator of the overall direction of freight tonnage. Similar to housing starts, annualized sales of light vehicles have shown significant improvement throughout 2011-2015. Annualized sales reached a new cycle peak of 18.1 million units during September, which was the highest rate since 2006 and the 9th highest monthly reading in the past 40 years.

U.S. Class 8 Order Cancellations

While mirroring the significant increase in backlog since 2014, Class 8 cancellations in absolute terms have understandably trended higher. While eye catching, the spikes in August and September appear to be following a familiar seasonal pattern of OEM orderbook “clean-up” in advance of a new model year. Nonetheless, given the dramatic 50% drop in monthly gross orders since a peak in October 2014, the recent spike in the cancellation rate (as a % of backlog) also reflects a broader and fairly rapid reset of expectations for new capacity requirements.
Due to the combination of low fuel costs and a steady rate environment, net income for public carriers during the 2nd quarter of 2015 was stronger than typical historical seasonal trends. The combined net income of a composite of public trucking companies during the 2nd quarter increased 9% compared to the year-earlier quarter and 27% for the entire 1st half of the year. The benefits of a 7% increase in operating revenue coupled with a 30% decrease in fuel costs more than offset a 27% decrease in fuel surcharge revenue and a 3% increase in other non-fuel operating costs. As a result, the average operating expense ratio during the 2nd quarter decreased to 90.3%, down from 91.1% in the year ago 2nd quarter.