

THE STATE OF *THE AUTOMOTIVE* INDUSTRY



An analysis of the automotive industry through a survey of shippers.

In the early days of the COVID-19 pandemic, the automotive industry was reeling. After new vehicle sales notched an impressive 8.4% year-over-year gain in February, sales tumbled for the next two months. In April, new vehicle sales were down 46% from the same time last year. The short-term outlook was grim; more than 30 million Americans were receiving federal unemployment benefits and had likely been taken out of the auto market.

All non-essential jobs were put on hold, and that included the automotive plants. Factories in both the U.S. and Mexico were shut down for months and at different times. While the auto industry did not follow directly in the footsteps of the meatpacking industry, there were still many factories that had to deal with COVID outbreaks within their walls.

Then in May, as the Big 3 Detroit automakers lobbied to reopen both U.S. and Mexican operations, the Mexican government gave conflicting messaging multiple times about reopening procedures. When the economy reopened, consumers rushed back to dealerships at a much higher rate than expected, wiping out the already low inventories due to factory shutdowns.

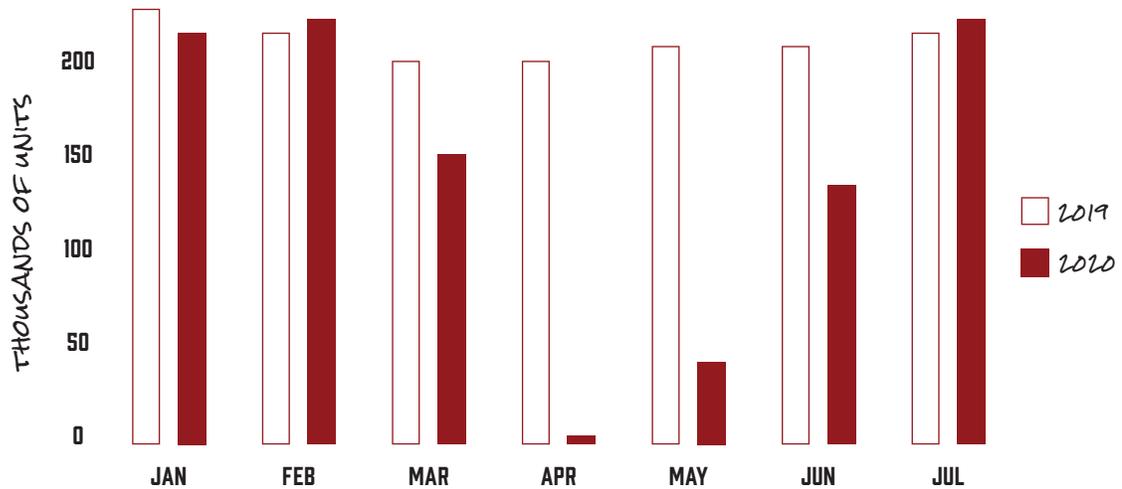
Soon after, the overall freight market shot spot rates into the stratosphere toward the end of the summer. These elevated rates are making cross-border moves unattractive and further exacerbating the capacity constraints from a lack of southbound volume and lack of northbound equipment.

What follows is an analysis of the automotive industry through a survey of shippers fielded during the third quarter of 2020. The findings provide a detailed view of the fluctuations in automotive demand, shifting dynamics in cross-border shipping, overall expectations around shipping costs moving forward and the role technology can play in helping to mitigate risk.

DEMAND

In April, the auto industry was bracing for disaster. As the corona virus spread, car sales plunged, and automakers shut down plants. In recent months, automakers and automotive logistics companies have been able to breathe a little easier. Automotive production has resumed, and factories are now back above production levels that prevailed pre-COVID.

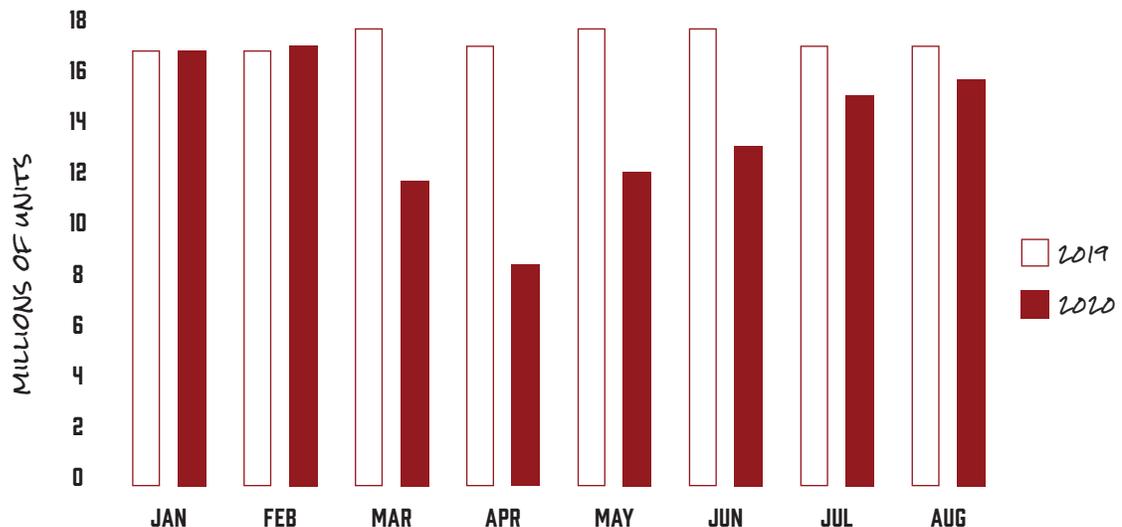
DOMESTIC AUTO PRODUCTION



Source: U.S. Bureau of Economic Analysis

More importantly, vehicle sales have picked up more quickly than many industry executives expected. Vehicle sales are expected to fall roughly 20% year-over-year in 2020 (Motor Intelligence). However, given the economic backdrop of 30 million Americans on unemployment benefits and a double-digit unemployment rate, that number is encouraging. Also, this demand has not come from rental car companies, who typically account for up to 20% of all new cars sold. Rental companies have been hit hard by the lack of travel and have all but stopped buying cars. Additionally, one of the nation's largest rental fleets, Hertz, filed for bankruptcy in May.

TOTAL VEHICLE SALES



Source: U.S. Bureau of Economic Analysis

With business travel restricted for many quarters ahead, it's unlikely that rental companies will be placing large orders anytime soon. Despite this, automakers and automotive logistics providers remain optimistic that the current rebound trend will continue. The rebound has occurred in part due to the pent-up demand from the high-flying pre-COVID consumer economy. Many were forced to put purchases on hold due to personal financial uncertainty while others simply couldn't find a dealership open or the model they desired. Fortunately, some have come back.

Automakers have lured potential buyers back to dealerships with generous financing options like longer-term loans. In fact, General Motors, Ford Motor and Fiat Chrysler were offering interest-free loans for 84 months on most or all their vehicles. While the majority of Americans who received a \$1,200 CARES Act check used it on food and essentials, automakers are certainly benefiting from the additional money in consumers pockets from both the CARES Act and the money saved during the economic lockdowns in the spring. The automotive industry isn't the only sector to benefit from a lack of services-induced demand surge. Other durable goods sectors such as home appliances, consumer electronics and home improvement have performed well throughout the pandemic. Families were forced to cancel vacations or go months without health and beauty services, and as a result, many replaced some of that spending with additional goods. This has possibly benefited the freight industry more than any other. In a time when much of the country was still under COVID related economic shutdowns, freight tenders kept rising.

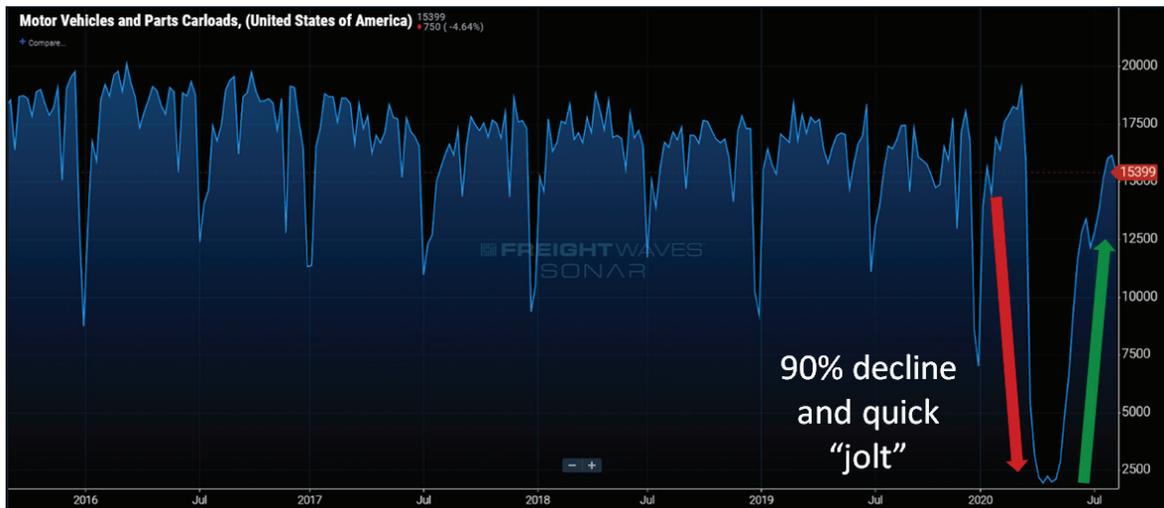
The recent surge in production above pre-COVID levels comes as a result of the rebound in sales. Inventories dwindled over the summer months because so few cars were produced in America. In April, while factories across the country were shut down, only 1,700 vehicles were produced compared to 204,000 during the same time last year. The data is even more staggering when aggregating all North American production: 4,840 vehicles were produced in April 2020 compared to 1.5 million during the same month in 2019.

The North American automotive industry is as intertwined between the three nations as any other industry. The fact that the U.S. and Mexico have been at different stages of their respective COVID-19 battles has proven challenging for the industry, not only when it comes to ramping up production, but also procurement and planning. In fact, Jordan Dewart, Managing Director for Redwood Mexico, believes the massive jolt that the automotive logistics industry has endured was due, in part, to the difficulty that automakers had in planning materials and parts movement.

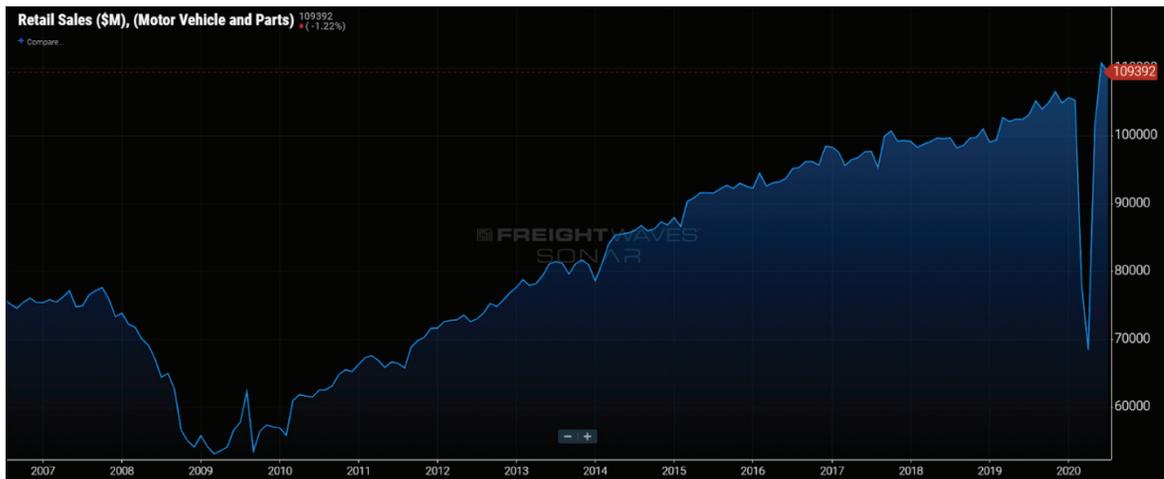
The Mexican plants shut down in April and did not come back fully until June. During this time, raw materials and parts kept flowing into Mexican plants, creating inventory surpluses that kept freight moving inbound even before demand recovered. While FreightWaves does not have truckload volumes broken down by commodity type, commoditized rail data can shed some light as a proxy.

DEMAND

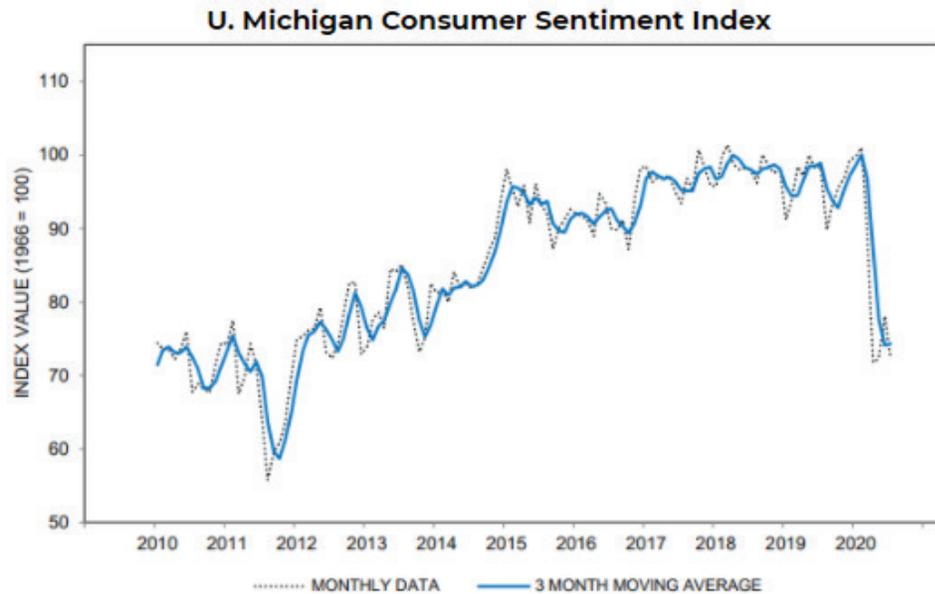
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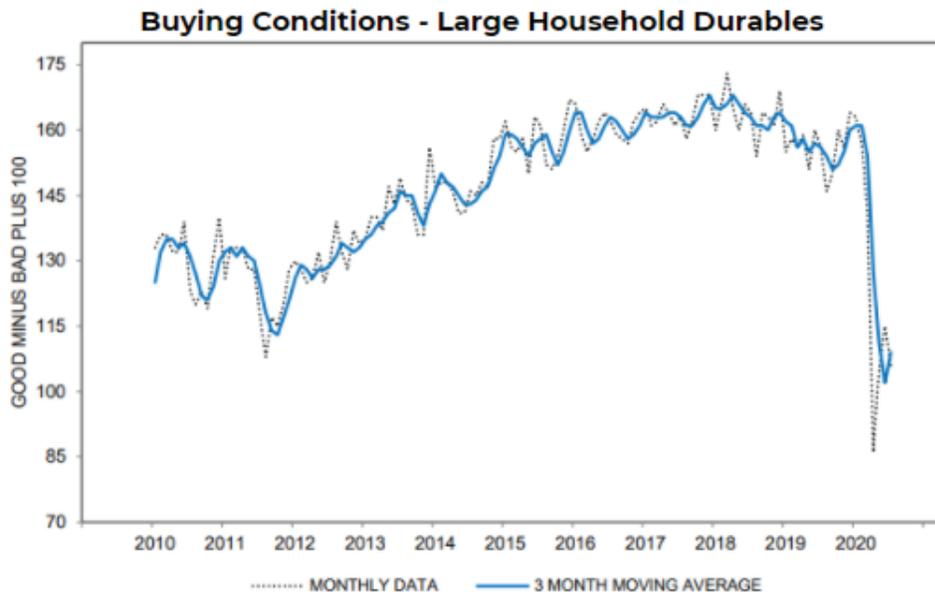
Unlike the rail demand for automotive parts and vehicles, Dewart believes that truckload volumes have rebounded to “more than surpass pre-COVID levels.” His belief is in line with retail sales of motor vehicles and parts from the Commerce Department. Dewart went on to say that the current environment is akin to a natural disaster, but unlike those hectic, short-term volume surges, this one has persisted for months and is likely to lead right into the holiday season. Both he and Olga Salinas, Senior Vice President, Mexico Business Development for Redwood Mexico, believe that the current demand environment will persist through the end of the year.



While the industry is more optimistic than anticipated, there are still potential headwinds. The University of Michigan consumer sentiment index and the consumer confidence index from the Conference Board are both at 6-year lows. According to the University of Michigan, consumers provided no indication that they expect the recession to end anytime soon.



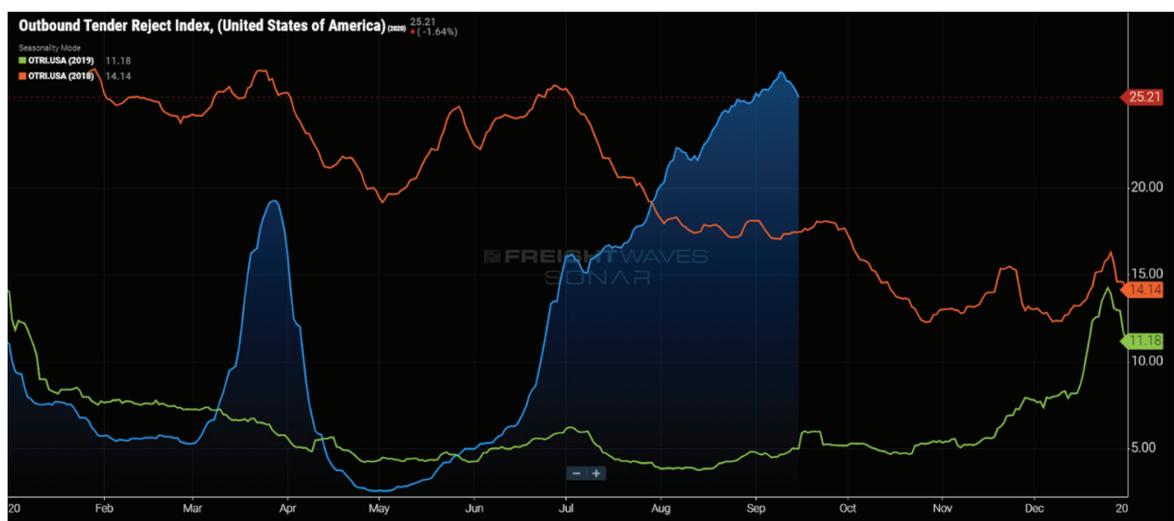
The third-quarter GDP was certainly an improvement, to say the least, from the record-setting second-quarter collapse. GDP increased a whopping 33% according to the "advance" estimate published by the Bureau of Economic Analysis. This surge in value can be largely attributed to the continual reopening of businesses across the country, and increases in personal consumption expenditures (PCE), where motor vehicles and parts led for goods sold. In addition, exports were also led by automotive vehicles, engines, and parts. Even with the bump in GDP, it is unlikely that consumers will feel the recession is anywhere near over. The CARES Act and Paycheck Protection Program (PPP) have prevented more substantial declines in consumer finances, partially shielding consumers from the unprecedented surge in job losses, reduced work hours and salary cuts. With that said, it has been reported that nearly 30 million Americans did not have enough to eat at the end of July. This is one reason why Americans are so skeptical about large durable goods purchases over the next 12 months. The durable good buying conditions index from the University of Michigan indicates only 6% (index = 106) more consumers feel good about their prospects of purchasing versus bad, compared to 56% (index = 156) for the same period a year ago.



CAPACITY

As mentioned before, the freight industry may be the biggest beneficiary of service spending declines. The industry has also benefited greatly from the acceleration of e-commerce. These factors, along with historically low new truck sales over the past 18 months, have created an environment in which demand is far outstripping capacity across the entire continent. This was not always the case, though, as Dewart believes the market was “lulled into thinking there would be no peak season due to COVID in May and June.” But as the economy reopened, it became apparent that this was not true. Freight volumes rose off the May bottom and have not yet slowed. Typically, Independence Day marks the beginning of a summer freight slump, but this year, holidays have passed, and volumes have risen. There has been no seasonality to this freight market, and all signs point to that pattern continuing.

Dewart believes that many carriers who were exposed to a particularly soft 2019 with depressed rates throughout are “coming back with a vengeance,” with many carriers holding capacity until the end of the day and selling it to the highest bidder. The unprecedented volume throughput has given carriers the ability to be particularly selective when choosing freight, and this selectivity has pushed the Outbound Tender Reject Index (OTRI) upward of 25%.



This is historically a very high value as the OTRI has only been above 25% twice in its three-year history, with both events occurring in early 2018. A value of 25% indicates that carriers are rejecting 1 in 4 contracted loads across all commodities and trailer types across the country.

To understand the drastic equipment shortages occurring at the border, one must look at the U.S. freight industry as a whole. When rates and volumes become so attractive domestically, truckers don't have to send their equipment into Mexico and can make their money north of the border. Why risk losing a trailer for a week or more and being caught up in cross-border delays when you can get more than \$3/mile in one of many domestic lanes? The ability to avoid the Mexican border has further exacerbated the capacity constraint.

There is currently an imbalance of freight equipment that is forcing shippers to pay widespread repositioning costs. Shippers and brokers are finding little capacity headed southbound due to the options carriers have domestically. This has created a cycle of capacity shortages in both the U.S. and Mexican sides of the border. The lack of southbound equipment has left Mexican operators with the same problem. Additionally, automakers are having difficulty finding drivers to be at the border to pick up loads. This has induced widespread repositioning costs over the past few months. Dewart noted that in July, shippers were paying repositioning costs from the border, but in August that expanded up through San Antonio, Houston and Dallas.

One metric that shippers and brokers analyze when searching for capacity is load-to-truck ratios, which provide a broad sense of the supply-demand dynamic. Both Dewart and Salinas say these are some of the highest load-to truck ratios they have seen in their 20-plus years managing cross-border operations. Load-to-truck ratios have exceeded 50:1 throughout the summer months and have not come down in recent weeks. Dewart is hoping the holiday season will provide some relief as American-made goods are shipped into Mexico, but he is not confident that the environment will change before the end of the year.

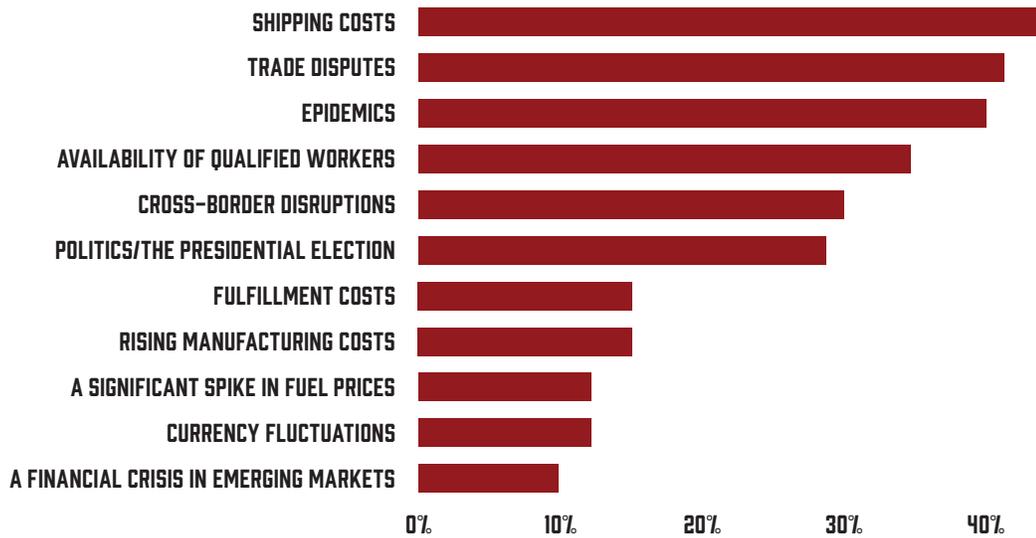
It is important to note that the lack of southbound volumes alone is not creating a capacity constraint, but rather that lack of volume combined with a massive increase in overall domestic freight tenders.



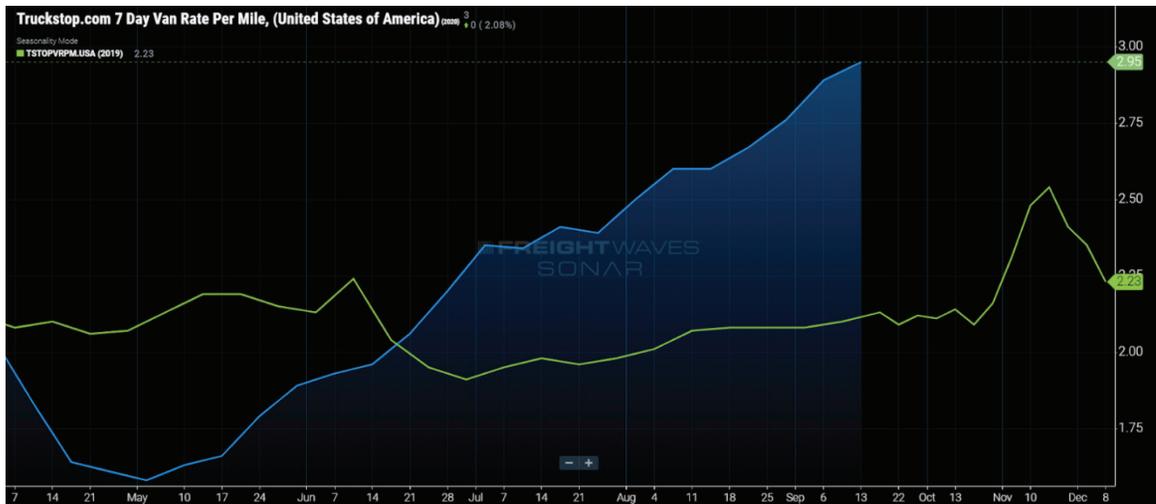
RATES

Shipping costs are on the top of automotive shippers' minds. This is the second time we have posed this question to shippers since the beginning of April. Unsurprisingly, shipping costs have jumped two spots since the beginning of the pandemic and are now the most significant risk to automotive supply chains for the rest of the year.

WHAT ARE THE MOST SIGNIFICANT RISKS FOR YOUR SUPPLY CHAIN IN 2020?



And for good reason—spot rates have surged off of the early-May bottom to reach \$2.95/mile on a national level. As Dewart mentioned, carriers can essentially auction capacity at this point. National spot rates are running up nearly 30% year-over-year, and 46 of the 100 lane pairings from Truckstop.com in SONAR have rates upward of \$3/mile.

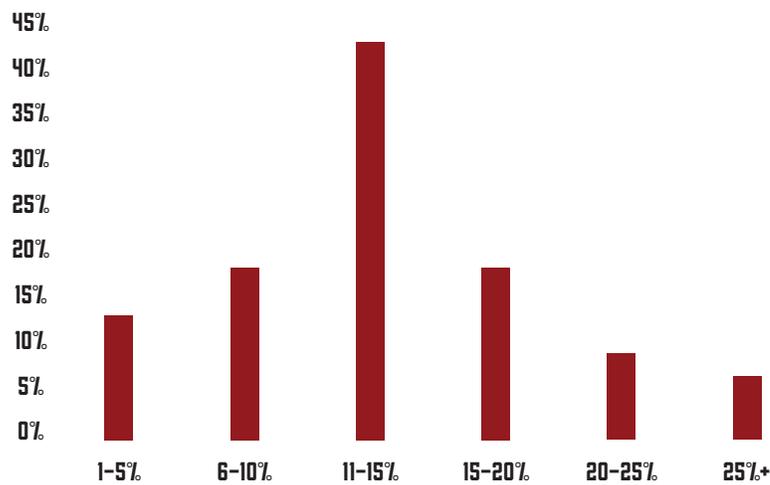


RATES

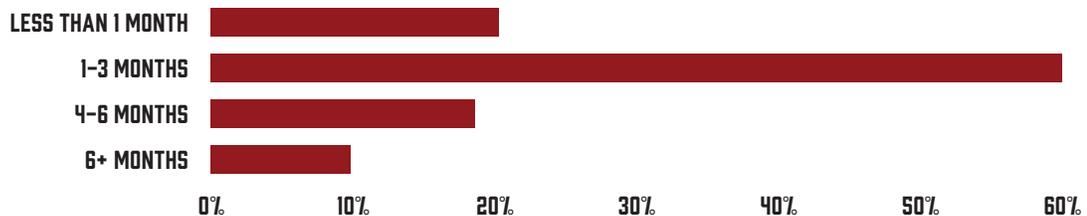
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In the fall of 2019, FreightWaves' Freight Intel Team surveyed shippers to get a better understanding of the timing of carriers renegotiating contracted rates. We found that spot rates typically exceed contract rates by 10–15% for one to three months before carriers start rejecting and rebidding freight at scale. When asked if the market had reached that point, Dewart said, "If there's a tipping point where [carriers begin rebidding], it has come and passed."

SHIPPERS—ON THE FLIP SIDE, HOW FAR DO SPOT RATES NEED TO CLIMB ABOVE CONTRACT RATES BEFORE YOU START SEEING DIFFICULTIES FINDING CAPACITY AT YOUR CONTRACT RATES?



SHIPPERS—HOW LONG DO SPOT MARKET RATES NEED TO STAY AT OR ABOVE THE LEVEL YOU SELECTED BEFORE YOU ARE FORCED TO MOVE SOME OF YOUR LOADS INTO THE SPOT MARKET TO FIND CAPACITY?



This will be a historically difficult negotiation season for many industry segments, but particularly for the automotive industry due to its tightly woven supply chain across all three North American countries. The hope is that holiday demand will relieve some of the equipment constraints at the border and on the Mexican side, but this is not guaranteed. We feel as though the variables creating the constraints and pushing up the rates will persist through the end of the year.

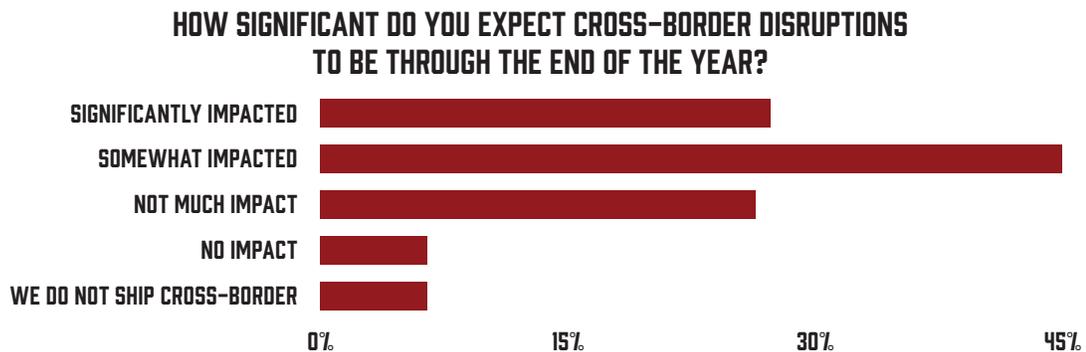
CROSS-BORDER DISRUPTIONS

Something else we expect to persist through the end of 2020 are disruptions at the border. Many interrelated issues are creating havoc at the border, and several of these are unique to 2020. COVID-19 has caused entire nations to shut down for considerable lengths of time, completely halting production for multiple months. Also, it is an election year, so political posturing has occurred and is expected to continue. Combine all of this with a historically hot domestic freight market, a lack of southbound volumes and a lack of northbound equipment, and 2020 has the freight industry in an extremely unique position.

Salinas stated that she was not surprised to see shipping costs as the top risk as it is the most immediate and tangible impact to the supply chain right now. It is also a financial risk that negatively impacts companies in the short and long term. She added, "Shippers are already running into transportation budget overruns [in September]."

She went on to say, "While we see cross-border disruptions every year, this is the worst I've seen in my 26+ years managing cross-border operations." The challenges are highlighted by extreme load-to-truck ratios at border crossings, as well as the widespread payment of repositioning costs by shippers to secure capacity near the border.

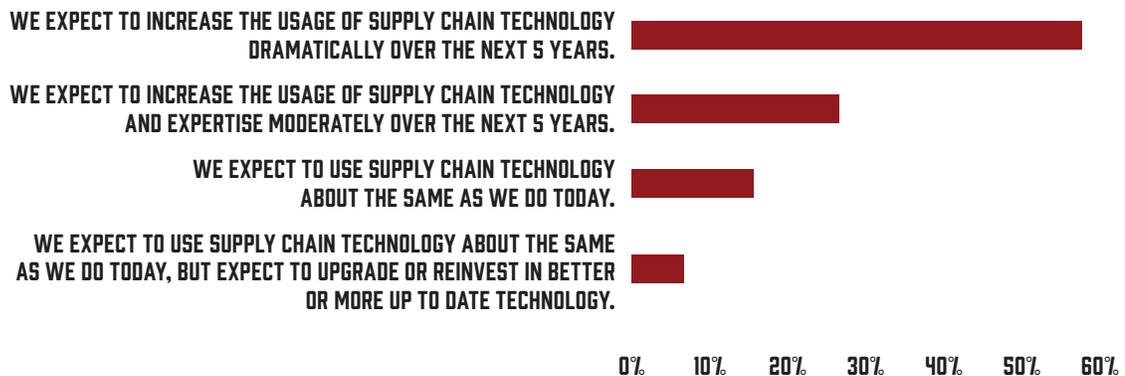
Dewart says the continuous disruptions at the southern border have led to an increased demand for transloading (both traditional transloading in which goods are switched between modes and transloading from trailer to trailer at the border). Both practices may increase costs but do also make larger capacity networks available.



CROSS-BORDER DISRUPTIONS

Supply chain risk management has become even more of a priority due to COVID. Due to the current uncertainty and unpredictability, identifying, assessing and controlling supply chain risks has become much more difficult this year. In order to mitigate these risks, shippers are looking to technology and outsourced logistics for answers. Salinas believes that “most large shippers manage their transportation through a transportation management system (TMS),” and these systems have become more important than ever, especially for global supply chains like the automotive industry.

WHAT IS THE OUTLOOK ON YOUR USE OF SUPPLY CHAIN TECHNOLOGY (TMS, WMS) OVER THE NEXT 5 YEARS?



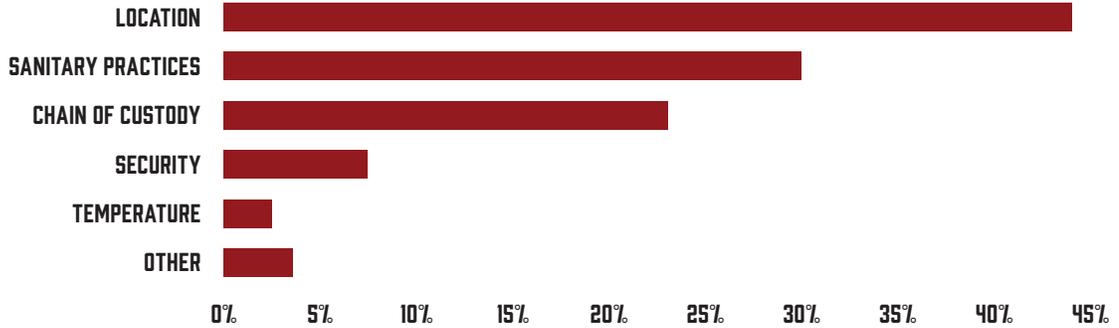
More than 50% of respondents say they expect to increase their usage of supply chain technology dramatically over the next five years while less than 20% say their usage will stay about the same. As Salinas noted, technology has become a requirement to operate in today’s world, especially in a COVID or post-COVID world that is more technologically connected and involves less human contact.

Some of the COVID-related disruptions have brought into light some of the pain points that shippers should address to ensure they are getting the most return from their TMS. More specifically, integration, connectivity and accessibility of data have proven to be challenging for shippers during COVID-19. In a recent survey of shippers, the Freight Intel Team found that location tracking was the most important visibility data for freight in 2020. Salinas stated, “The supply chain was not prepared for [disruptions from COVID] due to the lack of visibility.”

Along with technology utilization and integration, shippers have begun evaluating how to improve process efficiency within their supply chain network. Many continue to adopt strategic partnerships and re-engineer internal business units to optimize operations that allow for scalability and flexibility in any market conditions.

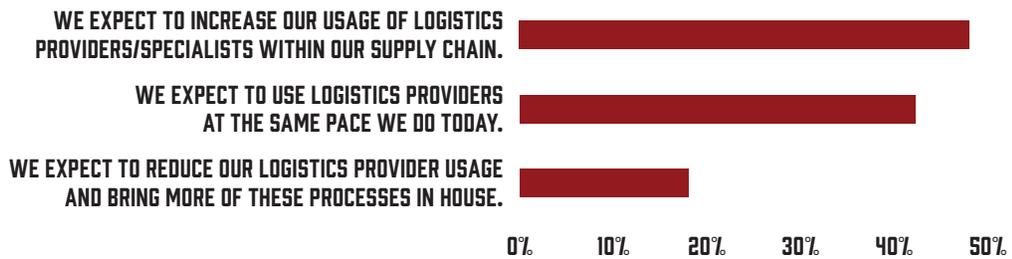
CROSS-BORDER DISRUPTIONS

WHAT HAS BEEN THE MOST IMPORTANT DATA FOR VISIBILITY OF YOUR FREIGHT SO FAR IN 2020 AS A RESULT OF ALL RECENT EVENTS (INCLUDING COVID-19 AND OTHER ECONOMIC FACTORS)?



Nearly half of automotive shipper respondents expect to increase their use of outsourced logistics in the next five years while 40% believe their use will stay the same, and less than 20% believe their usage will decrease. The reputation of a company depends in large part on how effectively they can deliver their products; thus, it depends on the reliability of their transportation providers. Therefore, Salinas believes shippers should search for category masters that are “highly competent in the specific service area you need” rather than a jack of all trades. Hundreds of companies ship cross-border, but how many have domain expertise in the product, mode or lane in which you operate?

WHAT ROLE WILL OUTSOURCED LOGISTICS PLAY IN YOUR SUPPLY CHAIN OVER THE NEXT 5 YEARS?





CONCLUSION

As Salinas noted, supply chain risk management has never been more challenging nor more important. COVID-19 and 2020 have presented a plethora of unique challenges to the market including demand fluctuations, supply disruptions, capacity shortages and elevated rates. The industry has endured everything from the most violent demand swings in history to load-to-truck ratios north of 50:1 at the border and COVID outbreaks. All considered, the industry is holding up better than expected. Many consumer durable segments have benefited from a lack of service availability, and the automotive industry is no different, but the increased demand comes with a caveat of spot prices running up 30% year-over-year.

We expect the environment to continue being very difficult for shippers and brokers in this segment through the end of the year. There is not much data pointing toward a material slowdown in demand, and there is nothing that lends us to believe capacity will loosen, especially at the border. The hope for capacity is that holiday demand of U.S. goods into Mexico could rebalance the network, but nothing is guaranteed. And the headwind for demand is poor consumer sentiment, but unconfident consumers have led the rebound thus far.

Given all these factors and the uncertainty that the entire industry is currently experiencing, it is incumbent upon shippers to seek out tools and partners that can help them alleviate these challenges and more successfully and effectively plan for the future. By partnering with solutions providers who have expertise in the logistics space and gaining the visibility they need to plan ahead using the right technologies, shippers will be better positioned to mitigate risk and prepare for what lies ahead.

CONTACT

REDWOOD®

1765 North Elston Avenue
Suite 216
Chicago, IL 60642

844.467.3396
hello@redwoodlogistics.com
redwoodlogistics.com

