8 EXPECTED TRENDS IN TRANSPORTATION FOR 2016

The coming year will be a fascinating year for those in the transportation industry.

Third-party logistics (3PL) companies continue to penetrate and alter the market, the price of fuel has dropped dramatically, which has far reaching consequences, and the driver shortage gets worse by the month. Beyond these trends in transportation, what everyone should be paying attention to is the fact that transportation costs are set to rise in 2016.

Rising Transportation Costs

The cost of shipping will rise in 2016 and will continue to increase in the foreseeable future. For years, carriers have been hurt by inflated fuel prices and have had to operate on thin margins. And now, even in this temporary reprieve of low diesel prices, motor freight carriers must increase rates to make up for revenue that is continually lost due to several volatile trends in the industry.

Transportation costs are at the heart of expected trends in 2016. Carriers, shippers and 3PLs are all looking for better ways to manage expenses and meet customer expectations.

2016 Transportation Trends

1 REGULATIONS WILL HURT TRUCKING PRODUCTIVITY

The trucking industry is full of restrictive regulations that harm productivity, and more regulations will be implemented in 2016. One recent, controversial regulation that is anticipated is a national driver drug-testing information clearinghouse and hair follicle-based drug tests. Driver unions have mobilized against hair-follicle testing, saying it is unnecessary and inaccurate. If the Federal Motor Carrier Safety Administration (FMCSA) makes follicle testing the norm, the number of drivers disqualified by positive drug tests could skyrocket: J.B. Hunt was the first major carrier to adopt follicle-testing, and they saw their failed drug test go from 1 percent to 15 percent of all applicants.

Other regulation developments like the recently announced electronic logging device (ELD) mandate, carbon emissions regulations and regulations on the environmental impact of future equipment have caused a stir in the industry. Even more of these regulations are expected to be announced in 2016.

But by far the most controversial and biggest regulatory hurdle is the hours of service (HOS) regulation. A previous HOS rule mandated that truck drivers who are on the road for 70 hours a week must take at least 34 hours off duty, including two consecutive nights from 1 a.m. to 5 a.m. Safety advocates say it is a step in the right direction, but not far enough, and experienced truck drivers say it is overkill and does not help. It is estimated that this HOS rule, before suspension, cost carriers three or four percent in lost productivity. It is unclear whether the rule will be reinstated in 2016 or not, but if it is, it will hurt carrier productivity, which will drive up shipping costs.

2

DRIVER SHORTAGE WILL GET WORSE

The driver shortage will pick up momentum in 2016, and by as early as 2017, we may see severe shortages leading to highly inflated transportation costs. In 2016, though, more drivers will retire and leave the industry for good. If hair-follicle drug testing is implemented, it could potentially force out more drivers who aren't near the retirement age. Bill Graves, American Trucking Association (ATA) President and CEO, said that the driver shortage is not just one in which the numbers don't add up. On top of the existing problems, the quality of applicants rarely meets the industry's minimum standards. A recent study by the ATA revealed that 88 percent of carriers say most of their applicants are not qualified to drive a truck. Carriers have compromised by accepting a poorer quality candidate than they have in the past, but even with these additions, the number of drivers entering the industry is severely low. With a driver shortage this serious, the cost of shipping rises because shippers must compete for available capacity by paying more.

3

DRIVER PAY WILL INCREASE

Truck driver pay has been slowly increasing for a few years. The average yearly salary for an over-the-road (OTR) trucker is $51,000. The average annual salary for a private-fleet trucker is $73,000. These averages increase for more experienced drivers. Truck driver pay increased 12 percent in 2015 and 2016 will be no different. Carriers have to pay drivers more money because drivers have become a scarce commodity. Also, driver turnover has consistently been above 90 percent for the past 15 years, until 2015, when the turnover rate was around 87 percent. Even if turnover levels drop in 2016, they are still abnormally high. It takes money to recruit and retain drivers. Driver pay is now 34 percent of a carrier's total operating costs – the main reason shippers can expect higher transport rates.

4

TRUCK CAPACITY WILL REACH ITS THRESHOLD

Due to the driver shortage and an expected uptick in freight volume, truck capacity will reach its maximum threshold in 2016. In 2015, the industry saw much looser capacity than expected, which delayed price increases from carriers. Companies like FedEx and UPS have already raised their rates by 4.9 percent for 2016. Shippers are concerned with moving freight and finding capacity, so they're improving processes and taking steps to become a preferred shipper. Carriers will have to respond to having just enough capacity for demand, or possibly not enough, by increasing prices and being selective with who they work with. This is because driver pay, among other factors, is increasing operating costs for carriers – so they must increase prices significantly. Since carriers will be functioning at maximum capacity, they need trucks to operate smoothly, or else disruptions will lead to a carrier being labeled as a bad service provider. Carriers will prefer to work with shippers who boost the fleet's efficiency and keep drivers and equipment moving without delay.

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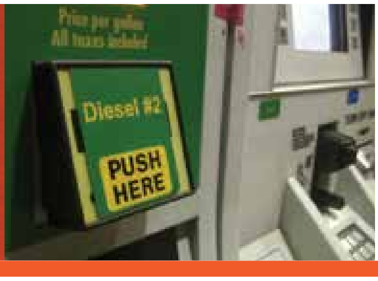
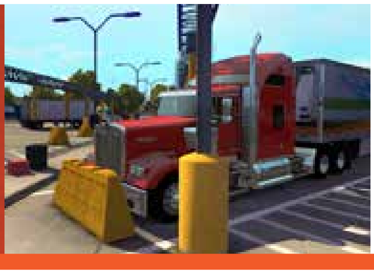


LOW DIESEL PRICES

The Energy Information Administration says that fuel prices will remain low throughout 2016, and possibly for years after that. The price of diesel fuel was $2.42/gallon in December 2015, after a year of almost continuously falling diesel prices. In 2016, there will be a slight jump in price to about $3.12/gallon. A large reason for falling oil prices has been the boom in production from shale gas drilling. Shale gas production is expected to decrease somewhat in 2016, which is why the expected diesel prices will be slightly higher in 2016. Despite generally low fuel prices, carriers will not decrease fuel surcharges, in fact, FedEx implemented two fuel surcharge increases in 2015, and is expected to reveal more in 2016. Carriers have always used fuel surcharges as a source of revenue. As operating costs continue to rise for carriers, they need to generate revenue off of fuel to keep steady profits. The slight increase in fuel price, combined with many other factors that increase operating costs for carriers, will cause trucking companies to further increase rates.

6 INCREASED FREIGHT TONNAGE AND E-COMMERCE ACTIVITY



Since the recession in 2008, there has been a slow recovery led by the industrial sector. This is highly unusual, as economic recovery has always been led by consumer activity. Many economists are unsure of what to expect, but two things are clear: In 2016, industrial activity is expected to decline and the continuation of economic recovery depends on consumer activity. Consumer spending has been weak since 2008. Low fuel prices and rising employment in 2016 are expected to lead to consumer confidence, which translates into more frequent purchases from consumers. Consumer spending online will continue to grow. The rise of e-commerce has been demanding on carriers and is partly responsible for the general rate increases (GRIs) that FedEx and UPS have implemented on LTL and parcel freight. It is more difficult to provide quality service due to the complexity of the logistics involved with e-commerce, and this will be another driving force behind rate increases.

7 CLOSER INDUSTRY COLLABORATION

In 2016, third-party logistics companies will continue to be a popular source of transportation management. Although a recent study showed a 3.5 percent decline in 3PL-satisfaction from shippers, many of these companies plan to switch 3PLs, rather than try to manage transportation in-house. Some verticals, such as the pharmaceutical, food and beverage industries, have increased their reliance on logistics companies because they've found their partnerships successful in the past. Either way, companies will be looking for closer collaboration with 3PLs in 2016. Barry Blake, Vice President of Research for SCM World, says, "By sticking with a single provider model, some companies are getting the best bottom line results without worrying about short-term results or the annual retendering cycle." Shippers want to work with one 3PL because the 3PL can come to truly learn the shipper's business, create custom solutions based on a their particular needs, and provide in-depth data to what's going on in its logistics and supply chain processes. A long-term focus on outsourcing success is needed to go this route in transportation management as a 3PL needs time and experience with a certain shipper's processes and industry. The expectation of increased collaboration is directly in response to the expectation of rising shipping costs in the future.

8

3PLS WILL CUT TRANSPORTATION COSTS

With transportation rates predicted to rise, and expectations of closer industry collaboration, 3PLs will step in and help reduce transportation spend for shippers.

A 3PL helps a shipper obtain reliable capacity, implement expensive technology, and mine complicated data for insights into the supply chain. With a 3PL, technology-driven results are found through a centralized transportation management system (TMS). A TMS provides powerful insight into logistics processes for the sake of optimization. No other tool provides this type of visibility into transportation. In 2016, TMS adoption will continue to increase in popularity, especially for small and medium-sized businesses. New, cloud-based TMS software makes these systems affordable for shippers with lower volumes of freight, but still provides quality data and analytics into shipping procedures. Mining and analyzing transportation data continues to gain importance in the industry. 3PLs have the technology and expertise to give shippers a competitive advantage in today's marketplace and in 2016 3PLs will continue to gain market share in the transportation industry. Shippers' main goal for 3PLs in 2016, as it has always been, is to cut transportation spend.

Conclusion

Increased driver salaries, less capacity and more freight tonnage are expected to lead to rising transportation costs in 2016. Higher rates will be at the top of shippers' minds as they work more closely with 3PLs and implement technology-enabled solutions. Cutting transportation spend will become a competitive advantage and 3PLs will step up and be the ones to find savings in freight spend.

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