LOGISTICS & TRUCKING INDUSTRY REPORT

Q3-Q4 2019

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BR WILLIAMS

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Introduction and Market Recap

The past twenty-one months have seen significant influences and subsequent remarkable volatility in the truckload freight market. The enduring condition that contributes to the constant swinging of the market pendulum is as follows.

While it can take carriers over a year to respond to increased demand with correlating increases in capacity, shippers can stem demand with different buying decisions overnight and regulation can have sudden, harsh impact on capacity. This condition, whereby the supply of truckload capacity and the demand for it always move at different paces and sometimes in sudden “jolts”, contributes to the extreme surpluses and shortages so often present in, and exerting pressure on the truckload freight market.

The ELD (Electronic Logging Device) mandate effectively removed 4% of truck capacity in a relatively short period of time when there was insufficient excess capacity utilization to absorb the reduction. Through this process, the economy continued at a very healthy clip, which exacerbated the shortage. This caused fierce competition among shippers for the available capacity and a surge in freight rates across the board.

Introduction and Market Recap

The spot market exploded and leverage swung squarely to the carrier. Carriers negotiated substantial contract rate increases as a result. This was essential to truckload carriers that not only had endured multiple costly regulations in the recent past without organic market-based recompense, but had lost tremendous driver productivity via the direct effects of the ELD's.

Further, the driver shortage has caused a rapid increase in costs associated with recruiting and retaining drivers. These costs are expected to continue to rise, leaving very little room for carriers to absorb rate reductions while remaining profitable.

This stimulus caused several subsequent market influences that began pushing the pendulum in the opposite direction. Carriers began adding capacity to capture a greater share of the more profitable freight. Shippers began the process of making different buying decisions that would temper demand which had been on an upward trajectory.

Tractor and trailer OEM's were already behind on fulfilling their orders. The orders for equipment, at their peak, were up to twelve months for tractors, and sixteen months for trailers. Most of these contracts were and have been honored.

Therefore, even after the market arrived at equilibrium in August of 2018, where sufficient capacity had indeed been added to the truckload freight market, capacity continued to be injected into the market that desperately needed it to stop.

Instead, the deluge continued for nine more months. Year-over-year truckload demand was nearly static. Therefore, the issue was almost entirely one of oversupply.

Spot market rates began receding rapidly in August of 2018 and have remained in negative year-over-year growth since that time. Contract rates are no longer accelerating but have not lost ground. Capacity utilization has receded and the driver shortage has abated slightly.

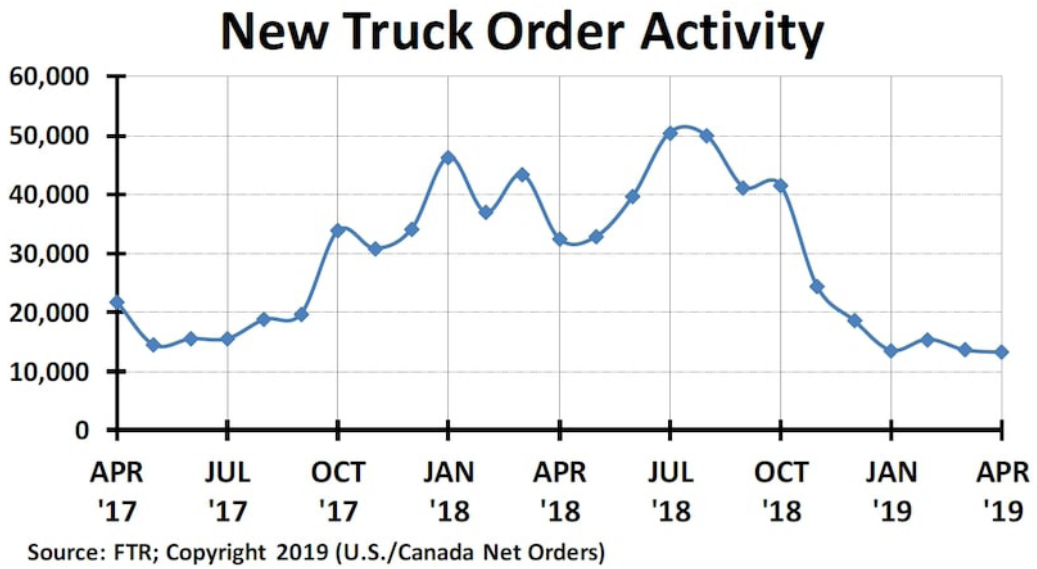
Q3-Q4 Market Outlook

The following is an examination of the truckload freight environment and the various factors that exert pressure within it. When a pendulum swings high in one direction, it will swing back in the opposite direction with nearly equal, reciprocal force.

The last twenty-one months have done exactly that. Many underestimated the degree to which capacity would oversupply the market over the last nine months. However, most economic indicators remain strong, as has the demand for truckload capacity over this period of time.

Further, the influencing factors behind oversupply appear to have tapered substantially, suggesting that the truckload freight market is entering a period of stability.

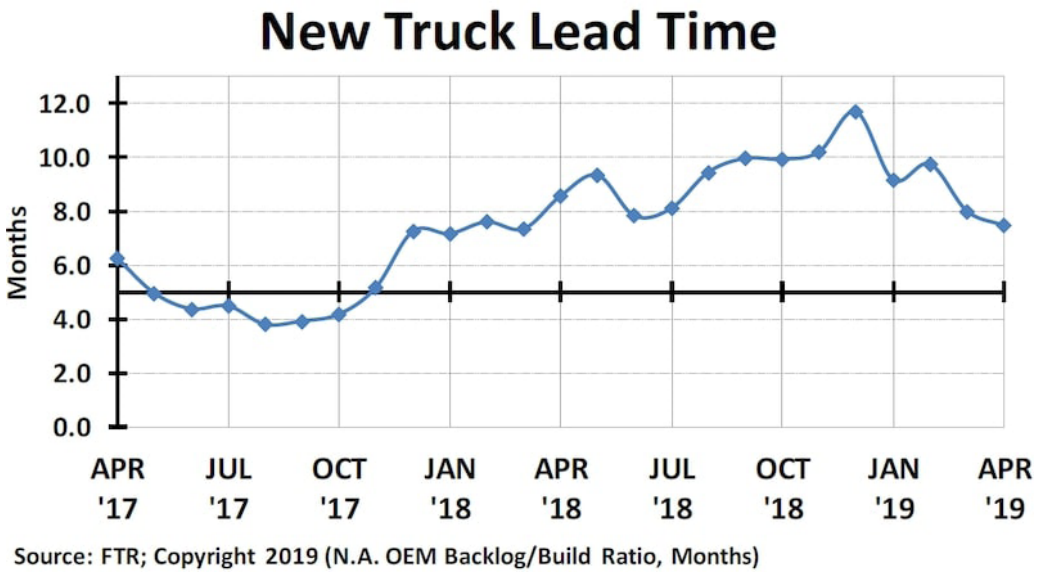
After a massive surge in new truck order activity, supply caught up with demand and truckload market conditions began to deteriorate. Subsequently, new orders plunged.



Q3-Q4 Market Outlook

However, the surge of orders vastly exceeded truck OEMs production capacity, causing the actual delivery of said equipment to lag far behind the orders. The sudden plunge of order activity, over the last nine months, has allowed OEMs to catch up with orders.

While lead time is still relatively and historically high, it has allowed the deluge of surplus capacity being added to the market to slow significantly.

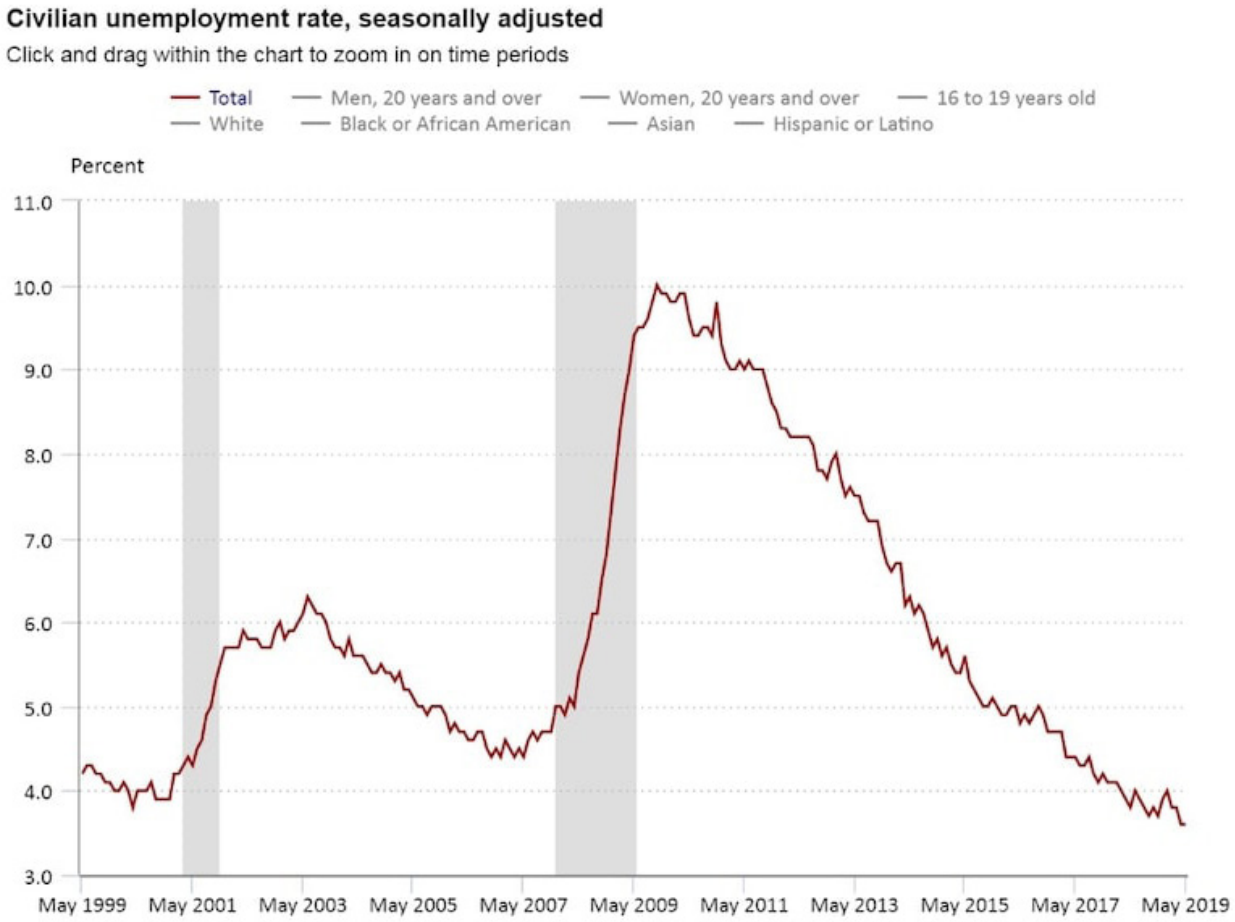


Since October of 2009, when the unemployment rate rose to a shocking 10%, it has fallen consistently over that nearly ten-year period. As of the most recent reading in May, the unemployment rate sits at 3.6%.

There are a few caveats to this good news. First, this does not include individuals that have, for whatever reason, left the job market and are no longer seeking employment. Therefore, unemployment must always be viewed through the context of the labor participation rate.

As a consequence of, among other things, women joining the labor force, the labor participation rate climbed from the early 1960's until its peak in 2000 at 67%, before

beginning to decline until 2014, when it leveled out and has remained at roughly 62.8%. Therefore, the decreasing unemployment that has occurred since 2014 has not been countered by a correlating loss in participation, and can be viewed as truly and almost entirely beneficial to the US Economy.



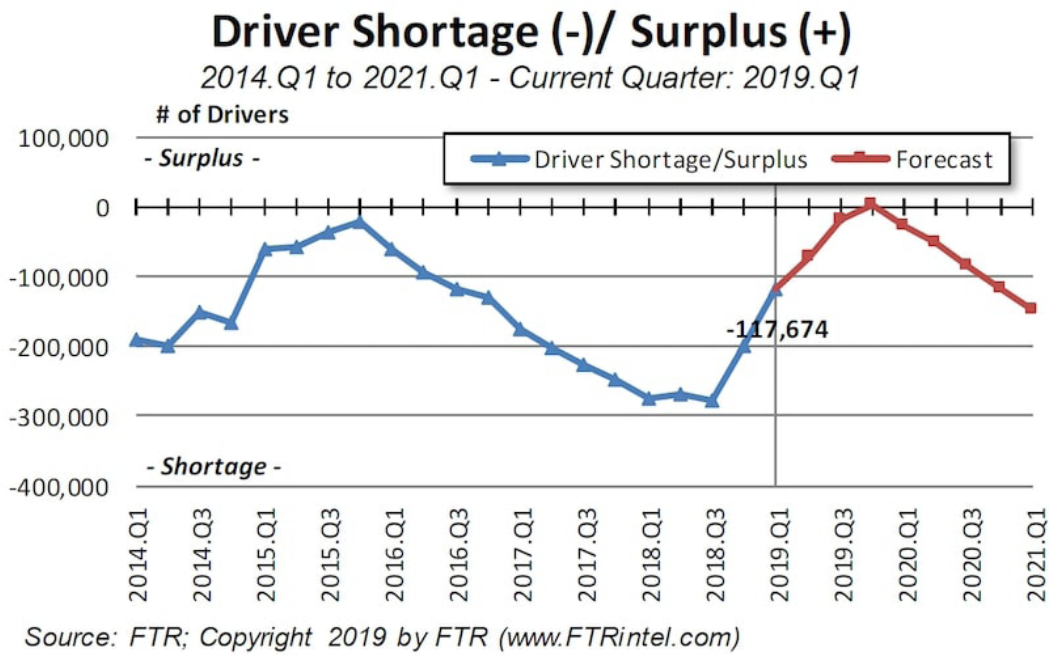
There is a downside to low employment, however. Economists view 4% unemployment as “full employment”. What that really means is “ideal employment”. The reason that this is considered the ideal instead of zero, for instance, is that the economy cannot grow without the ability to expand and contract within a pool of job seekers.

Q3-Q4 Market Outlook

This is particularly true in labor-intensive goods and services markets. The labor market for truck drivers is no exception.

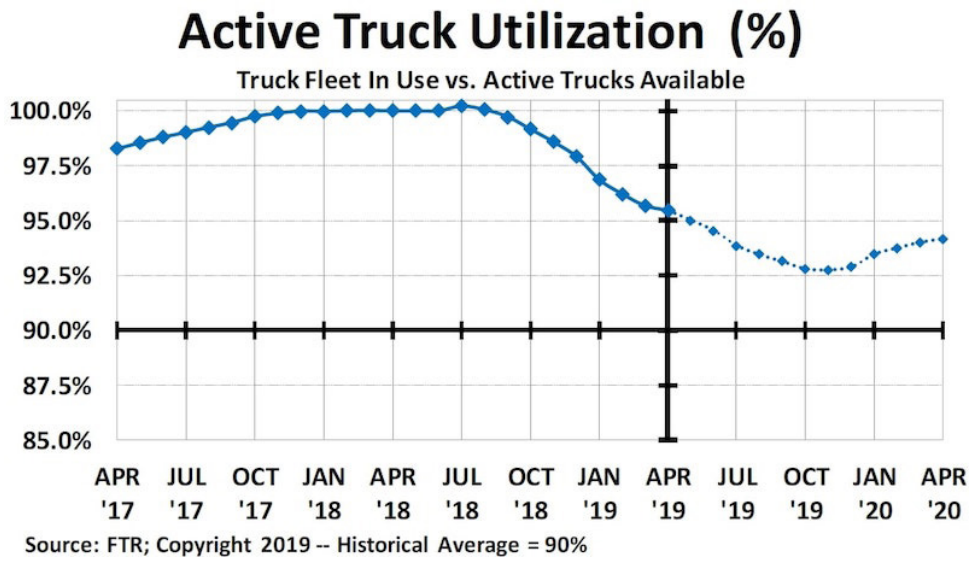
Not only is the supply of truck drivers constrained by the overall labor market, but the average age of drivers is rising rapidly and the percentage of young people choosing a career as a truck driver is a declining at a pace that will prove, without reversal of this trend, insufficient to replace the retiring baby boomers.

This is particularly true for OTR (over-the-road) truck drivers. While the driver shortage is expected to remain a challenge for those reasons, it has indeed temporarily abated as many carriers found some measure of success in their robust efforts to recruit and train new drivers.

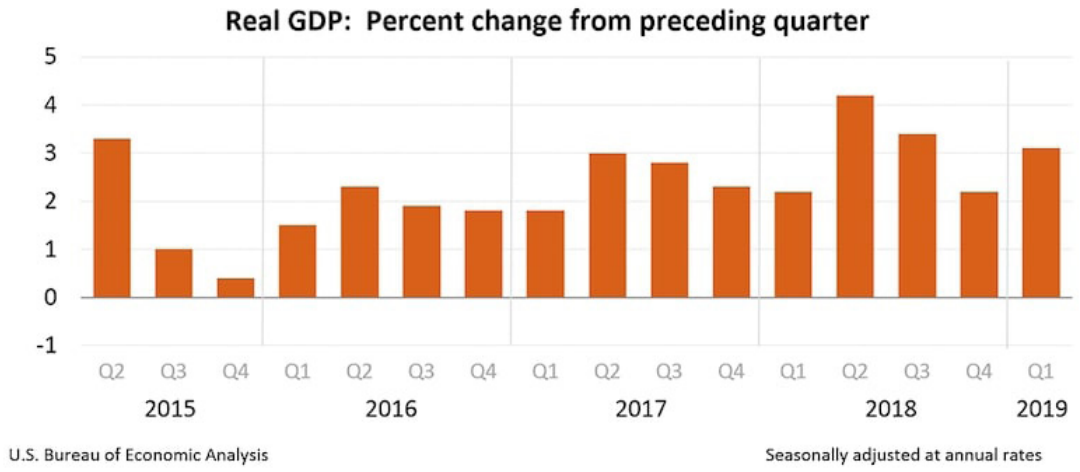


While the historical average of Active Truck Utilization is 90%, carriers have, under constant pressure from the shipping community to find profitability in increased efficiency rather than increased rates, used systems and technology to improve this average over

time. Any return to 90% would indicate very poor truckload freight market conditions. Active Truck Utilization has, however, remained and is projected to remain, historically high.

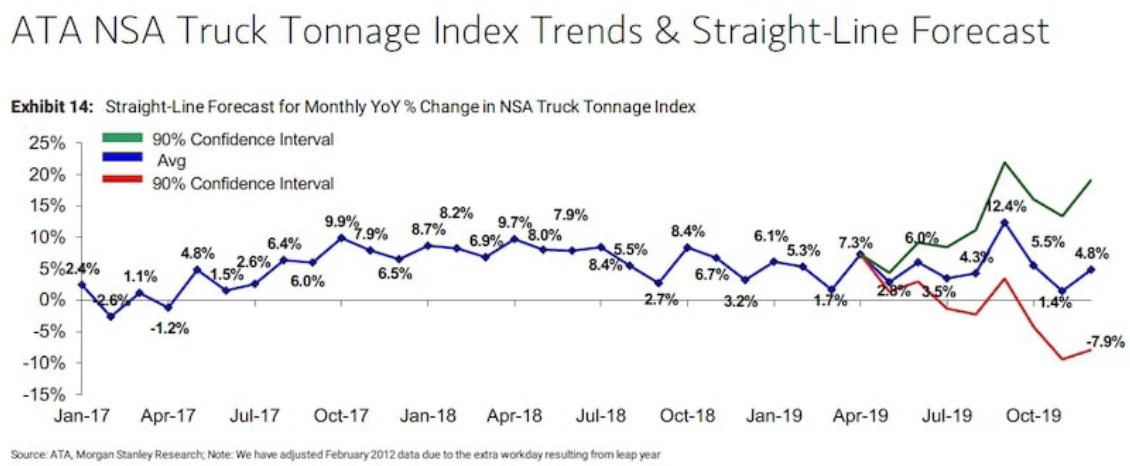


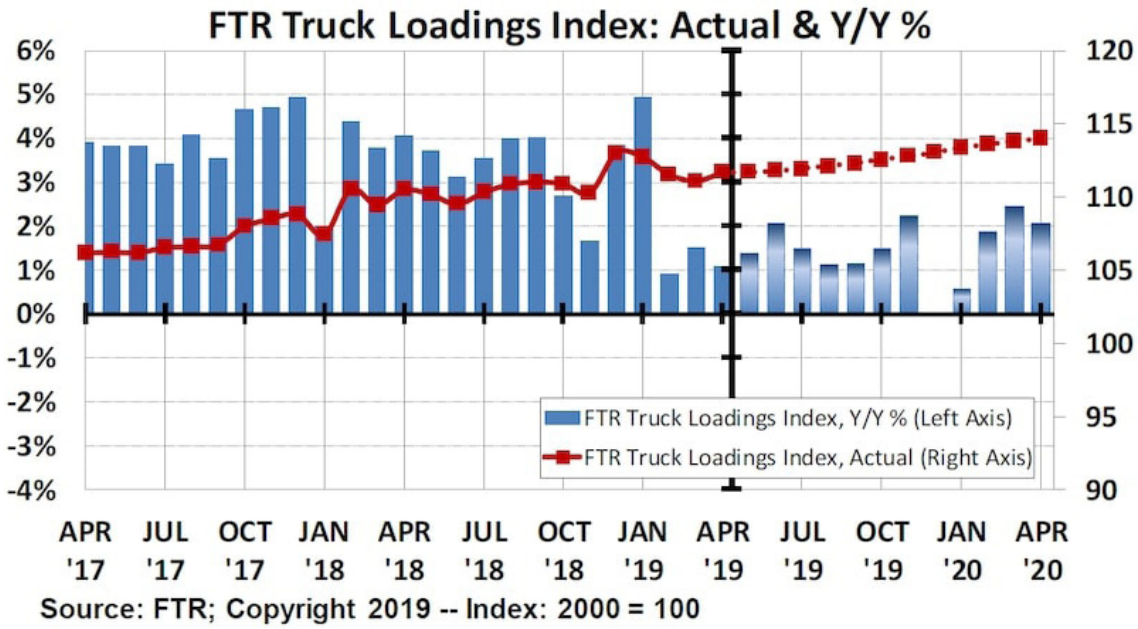
General Economic data remains strong with the GDP growth exceeding 3% year-over-year growth in the first quarter of 2019.



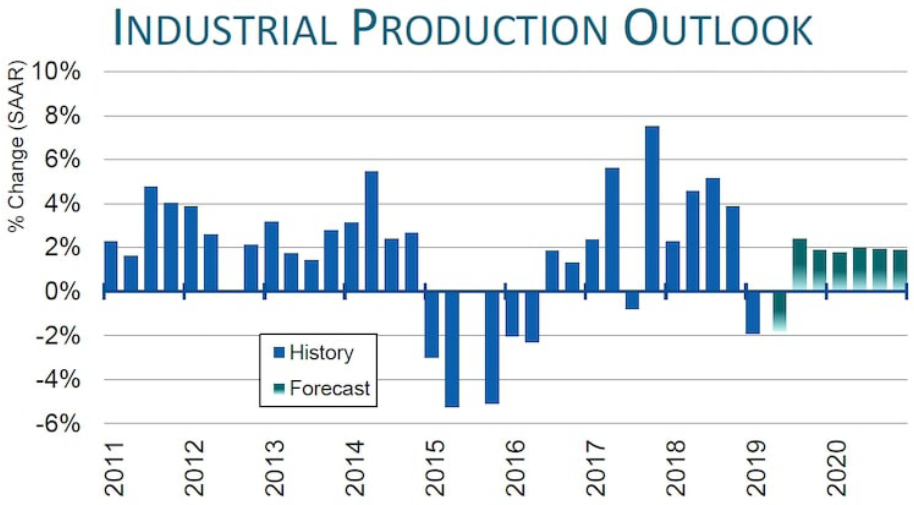
Q3-Q4 Market Outlook

Freight volumes have been and are projected to remain, steady and with moderate growth.

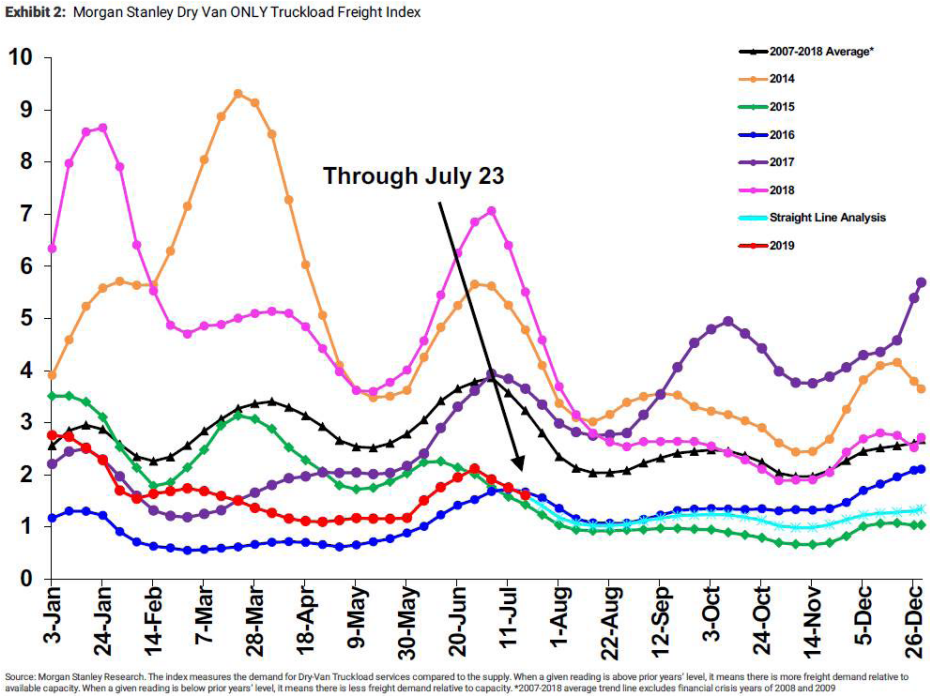




Q3-Q4 Market Outlook



Aggregated truckload data shows clearly that the market volatility of the previous twenty-one months is behind us. While there is a surplus of capacity, the market factors that drove that outcome have receded significantly. Therefore, the forecast is one of continued stability.



Regulatory Environment

Under 21 Driving Age Pilot Programs

As we reported in our previous Logistics Industry Report, the FMCSA is moving forward with its proposed pilot program to allow 18, 19 and 20 year old non-military drivers to operate CMV's (Commercial Motor Vehicles), in interstate commerce.

On May 15, the FMCSA issued a notice requesting comments until July 15, 2019 regarding this pilot program. Expect proponents and opponents to be on both sides of this issue, however, we expect that input regarding this will result in some type of pilot program being allowed to move forward, that could impact the future source of professional drivers in our industry.

Currently 48 states and the District of Columbia already allow 18, 19, and 20 year old CDL holders to operate CMV's in intrastate commerce. The pilot program would extend this practice into interstate commerce. Current proposals contain rigorous training standards along with vehicles being mandated for these drivers that incorporate "safety performance enhancing features technology" that could result in markedly improved safety operating environment for pilot participants.

FMCSA is already moving forward with the Under 21 Military CDL Pilot Program. On June 3, 2019, FMCSA began accepting what they hope will be at least 200 participants of these Under 21 drivers that currently maintain a military equivalent Commercial Driver's License. The safety records of these participants will be compared to a control group of drivers, monitoring the success or failure of this program.

Technology and Automated Vehicles

On May 28, 2019, both the National Highway Traffic Safety Administrations and the Federal Motor Carrier Safety Administration published Advanced Notice of Proposed Rulemakings looking to identify and address "unnecessary regulatory barriers to the safe introduction of automated driving system vehicles in the United State."

These organizations are looking for public comment on topics including requirements of human drivers, hours of service rules, medical qualifications, safe driving, distracted driving and cybersecurity. This comment period is open for 60 days.

As technology in this area continues to get better and more dependable, the regulatory agencies appear to want to move forward with preparing for a regulatory environment to support such technology in the future if it becomes viable and more public acceptance.

Again, compare the airline industry safety record and progress with the auto pilot acceptance and capabilities understanding this technology will eventually come to market as well, however it would be impossible to predict the timeline in this area.

Driver Detention Time

On June 10, 2019, the FMCSA published a “Request for Information (RFI)”, concerning commercial motor vehicle driver detention time during loading and unloading.FMCSA is requesting public comments on:

1. Current available data or potential sources of data to better understand driver detention time and the potential impact of road safety
2. The technology available to record and delineate prompt loading and unloading times
3. Estimates of what is considered reasonable loading/unloading time
4. Actions that FMCSA could take, within its current statutory authority, to reduce loading, unloading and delay times

Shippers should continue to monitor the progress of this while continuing to work to remove inefficiencies from their loading/unloading processes. The regulatory agencies had the courage to move forward in leveling the playing field for operations in compliance with Hours of Service for Safety across the industry, therefore, we expect a similar response in working to remove inefficiencies in detention times throughout the industry as well.

Transition from Automatic On Board Recording Devices (AOBRD) to Electronic Logging Devices (ELD)

Carriers currently using a grandfathered Automatic On-Board Recording Device have until December 16, 2019 to become compliant with the ELD rule.

After this date, all drivers subject to the ELD rule will be required to utilize an ELD that is self-certified with the FMCSA. Enforcement of the Electronic Logging in December 2017, while many thought that extensions of that enforcement date would be forthcoming, in reality created a scramble for many carriers for compliance while also marking the date many older professional drivers decided to exit the industry, thereby creating the temporary spike in the driver shortage that existed throughout 2018.

As this second enforcement date approaches for fully compliant Electronic Logging Devices, there should be no presumption this time around from any carriers that the final regulations enforcement date might be delayed.

Conclusion

The degree to which equipment purchase contracts were honored was surprising. Surplus capacity was still being added to the market a full nine months after market equilibrium was achieved. This precipitated a deeper than expected decline in spot rates.

However, the market has indeed stabilized. The volatility of the past twenty-two months is behind us. Historically, contract rates have followed the spot rates pattern on a six-to-nine-month delay. However, given the increased costs incurred by carriers dealing with an ever-changing regulatory environment and a driver shortage, the rates are highly unlikely to snap back to early 2017 levels.

The second half of 2019, as well as early 2020, should bring about an exodus of capacity. Carriers will reduce fleet size to mitigate losses and many small carriers will shutter operations, while truck loadings are predicted to continue to increase. This will begin to, yet again, constrain capacity. We are clearly in a freight recession and have been since September of 2018.

Other than those driven by a general economic recession, no freight recession has lasted more than eighteen months and this is not expected to be any different. In the absence of a general economic recession, by no later than end of 1st Quarter of 2020, the freight market should be in full recovery, with the pendulum again swinging back.

Recommendations

The following are some recommendations that BR Williams has for its shipper partners:

- The spot market is friendly. Some of the measures taken to avoid the spot market in 2018 could perhaps do with some relaxing

- The rising costs absorbed by carriers has not relented. The expectation should not be to claw back 100% of increases taken as much of those increases were by virtue of increased costs that are still increasing. The carriers' abilities to hire drivers 35 and younger will remain to be challenging, as drivers on the upper age brackets continue to retire.

- A mix of asset-based carriers and 3PL's reveals the lanes where each has the competitive advantage. For instance, a 3PL will most often be able to offer better rates from the Southeast to the West Coast, while an asset-based carrier will most often be able to offer better rates from the Midwest to the Northeast.

- A shipper with volume and favorable characteristics and terms, always has the competitive edge over other shippers. Therefore, strategies of "shippers of choice" generate better service, more stability, and lower cost (although perhaps, not always lower rates). Some of those strategies are:

    - Create strategies to reduce detention
    - Find ways to provide more advanced notice
    - Make sure that your facilities are accommodating to visiting drivers as you might be to other visiting vendors or partners
    - Carriers and drivers are more connected than ever before and often avoid shippers with a poor reputation in some of the aforementioned areas. Whereas many carriers would be willing to make concessions elsewhere in order to do business with a "shipper of choice"

ABOUT BR WILLIAMS TRUCKING, INC.

With humble beginnings back in 1958, BR Williams has grown into an award-winning supply chain management company servicing all 48 contiguous states and Canada. With facilities in Mobile AL; Piedmont, AL; Tallahassee, FL; Anniston, AL (two facilities); Eastaboga, AL; and Oxford, AL, B.R. Williams' distribution network supports over 50 customers and another 2,550 in the Trucking and Logistics divisions. Industries served include the following: automotive, defense, home improvement, education, food raw materials, textiles, chemical, industrial packaging, metals (finished goods), highway safety and more.

To discuss your Distribution, Logistics, or Transportation Services options, please contact sales@brwilliams.com or (800)-523-7963.

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