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Another rough year for shippers to manage bid process and carrier networks



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WHITE PAPER

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Meet the new year, same as the old year?

The factors driving the tight freight market seem to be sticking around forever, like your in-laws at Christmas. The labor shortage, the semiconductor shortage, the elevated consumer goods spending, and the congestion at the ports – none seem to be changing much. Improved railway fluidity is one of the few areas where transportation networks are improving, but even in that mode, terminal congestion remains rampant.

As we approach the end of the year, shippers are in the unenviable position of having to put freight out for bid in a carriers' market while budgeting for further-inflationary 2022 transportation costs on top of rampant inflation in virtually all of their other costs (labor, materials, packaging, energy, etc.) at the same time.

Meanwhile, shippers face the challenge of managing their day-to-day transportation networks during a period of unprecedented supply chain disruption.

Either one would be a challenge, but performing both at the same time presents additional challenges in a carriers' market. For instance, if shippers attempt to drive a hard bargain in a bid process, it may impair carriers' motivation to accept their tendered loads.

In preparation for next year's bid season, and for purposes of managing day-to-day carrier networks, we first recommend evaluating the performance of your current carriers.

To do that, we recommend using the the SONAR Supply Chain Intelligence tool to determine:

1) Whether your carriers are charging rates in line with the market. SONAR SCI can be used to benchmark your rates against what other shippers in your industry are paying in the same lanes.

2) Understand whether you are getting the service you are paying for. Use SONAR to see how often carriers are rejecting loads with similar characteristics to yours.

That analysis should help you to determine which carriers you want to solicit bids from.

From there, we recommend using a variety of data sets in SONAR to help quantify the degree of inflation or deflation in rates you should expect for the freight you are putting out to bid. Those SONAR data set include:

- National contract rate data
- Tender rejection rates by market
- Historical and predicted spot rates by lane

Lane and market scoring data that tells shippers how difficult a lane or market will be to cover

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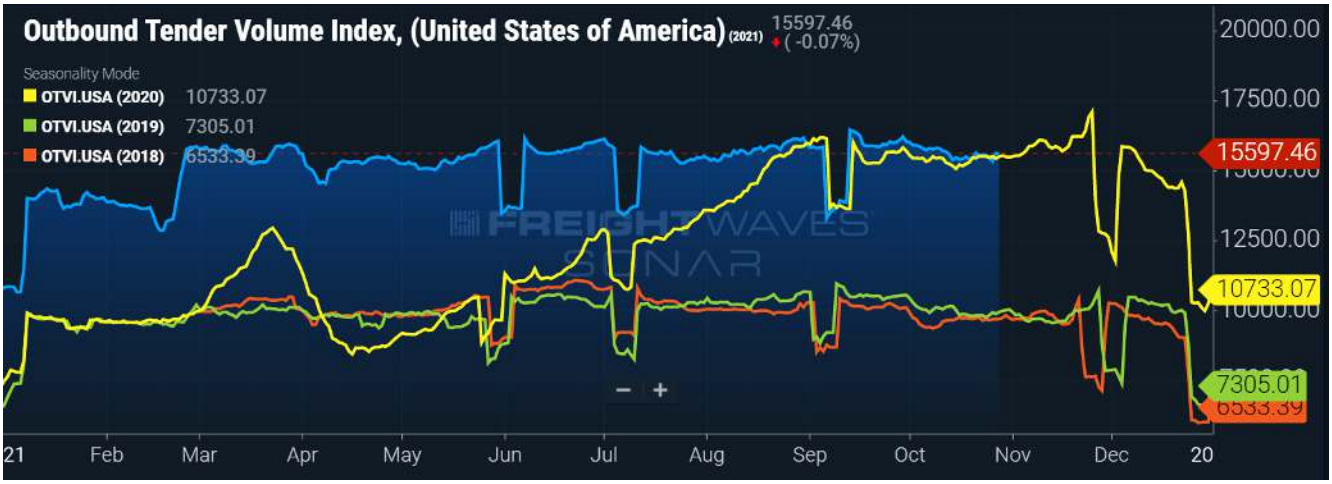
2022 may not bring the relief that shippers are hoping for.

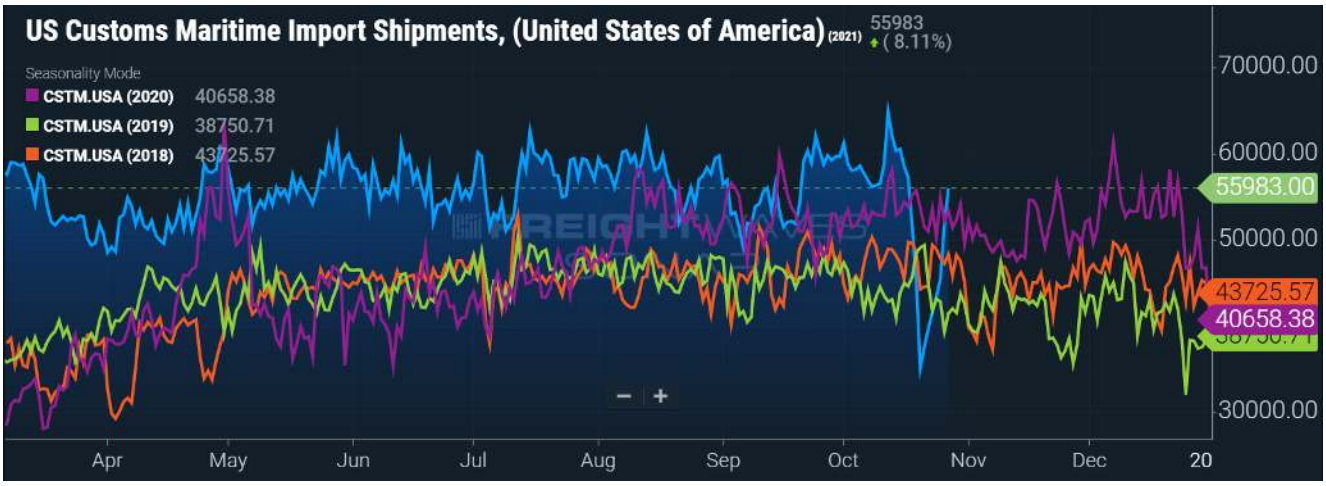
To put it lightly, 2021 has been a rough year for shippers. So as we flip the calendar onto the penultimate month of said year, shippers should feel some sense of relief, right? Maybe not so much. The strong carrier market fundamentals that have emerged likely have staying power, and the backdrop of high rates and tight capacity can last well into 2022, or maybe beyond next year.

Truckload demand remains elevated and shows no immediate signs of easing.



Load volumes should present little to no surprises when we begin 2022, as the primary catalysts of demand show no indication of cooling down. We can assume that consumer spending will continue to remain robust next year, driven by individual earnings and government-provided stimulus, including the new child care tax credit. The past two years have shown that consumers are more than willing to spend their stimulus payments (or use them as an excuse to quit a job or gamble on cryptocurrency). The return to spending on services has done little to diminish elevated goods spending. As we move to 2022, heightened levels of consumer demand will likely keep inventory levels low, especially across the retail sector. Thin inventories will call upon replenishment demand from both foreign and domestic supply bases, sustaining historic import levels and assisting the industrial economy's expansionary momentum (both of which support load volumes). Inventory restocking will likely be the driving force behind load volumes next year, buoyed heavily by the continuously rapid acceleration of e-commerce.

After a short-lived dip in October, maritime import shipments are again up year-over-year.

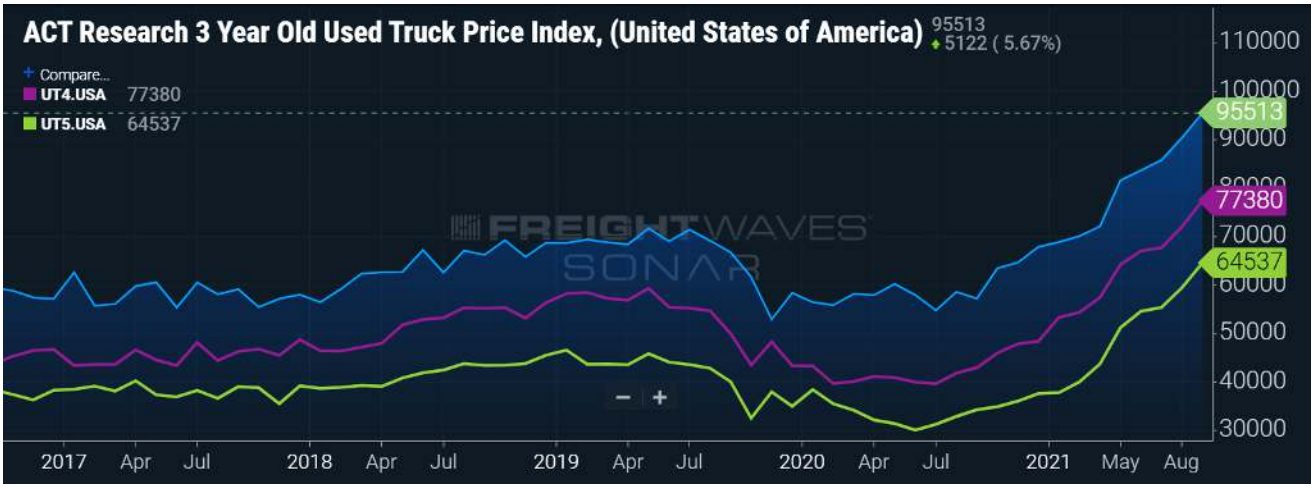


Sustained and historic levels of U.S. import volumes have bombarded stateside ports since last August, continuously outpacing both ocean and land-based capacity. Overwhelmed ports, transloading facilities, warehouses and equipment pools have plagued network fluidity in both truckload and rail intermodal, increasing costs and transit times for shippers. Despite government intervention and initiatives, labor shortages, data gaps and lack of coordination between players in the global supply chain will likely keep congestion prevalent through at least mid-2022.

Supply side constraints and bottlenecks will keep capacity tight, if not tighter than 2021.

Shippers have struggled with carrier compliance this year and have often had to resort to using the spot market; until last week, the national tender rejection rate remained above 20%. Supply constraints may persist next year as carriers find it more difficult to increase/modernize their fleets and seat them with available drivers. Despite new Class 8 truck orders well in excess of replacement demand (~20,000 per month), production constraints due to the global semiconductor shortage have limited order fulfillment and pushed out lead times. As a result, even well-capitalized carriers are struggling to expand or replace their aging fleets – limiting the number of power units that fall onto the used truck market.

Used equipment prices continue to rise, highlighting a lack of available equipment.



The lack of power units being sold by carriers has drastically inflated the used truck market, with the cost of a 3-year old truck appreciating 41% to $95,513, just this year. Such high used tractor costs

prevent small owner-operator fleets from expanding and build a larger barrier to entry for new operators, keeping even more capacity off the roads.

On top of equipment scarcity, seating tractors continues to be difficult. Competition with other industries and attrition continue to take from the already-diminished pool of available drivers. Compounding the driver shortage, the Biden administration's vaccine mandate, if put into effect, would likely lead to an even larger exodus of seated drivers.

An even greater impact is felt on shippers that operate in the booming energy sector. As oil and natural gas demand continues to rise, tank truck carriers that haul this specialized freight have already experienced a 42% reduction in qualified drivers over the past two years, as the workforce grows older and age requirements limit new drivers.

With no immediate solution available for the underlying supply/demand imbalance at U.S. ports and across domestic markets, shippers are likely to see higher freight rates in 2022 and will likely again experience sub-par service levels due to persistent capacity limitations. Higher freight rates are almost a given; the main question seems to be whether freight rates will again rise in double-digit percentages next year.

Shippers need to ensure carriers aren't price-gouging on lanes, and therefore blowing out transportation budgets.

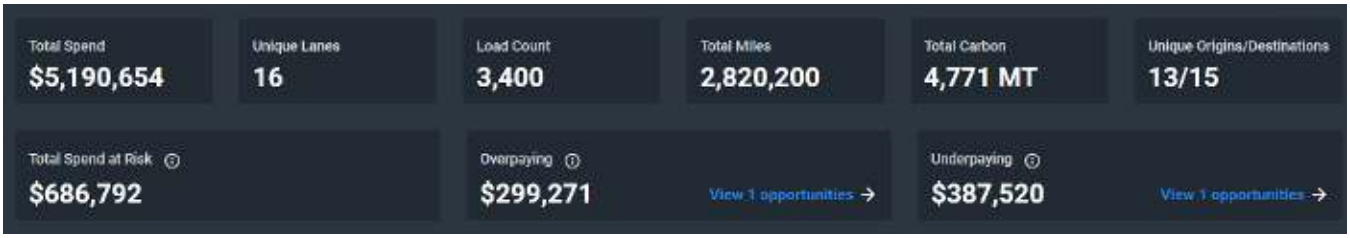
Managing a bid amid the severe volatility of the freight markets is quite difficult, especially when carriers hold most of the pricing power in the market. Through the entire bid cycle, shippers must hold carriers accountable for fair prices and adequate service levels, while also maintaining valuable customer relationships.

In the current environment, carriers hold most of the pricing power as evident by the rapid rise in prices, both contract and spot. The average initially reported contract rate, which is just the base linehaul rate, has increased by over 20% in the past year to $2.70/mile. The national average spot rate according to Truckstop.com, which includes fuel surcharges, is also up about 20%, currently sitting at $3.43/mi.

With FreightWaves' SONAR and SCI platforms, shippers are able to target low-hanging fruit, strengthen customer relationships and have discussions with carriers about prices with appropriate service levels. Joel Rosenblatt, FreightWaves Customer Success Manager, describes the benefits of SONAR SCI as "shippers are now able to hedge themselves in this market by running constant dynamic benchmarks, forecasts and market condition diagnostics checks. This allows them to keep a true pulse on their budget and keep all necessary stakeholders (both internal and external) looped in proactively, leading to a better experience for their end consumers."

In the examples below a hypothetical shipper, Shipper X, is going through a bid cycle and identifying areas that could be improved, even though the market is quite volatile. The summary provided by FreightWaves SCI shows exactly what spend is at risk of both underpaying and overpaying.

Overpaying on lanes may seem like low-hanging fruit, but could actually be advantageous to ensure service levels are maintained in a volatile market.



FreightWaves SCI. Shipper X is significantly overpaying on one lane over the past year, resulting in nearly $300,000 at risk.

Shipper X is only overpaying along a single lane of the 16 that the company is putting out to bid, but the overpayment is nearly 6% of the total spend on the lane.

The one lane where Shipper X is significantly overpaying is Houston to Los Angeles; its carriers are charging Shipper X more than $1 per mile over the market rate. This lane as a whole is relatively desirable for carriers, given the typical ease of getting loads out of Los Angeles, as the Lane Score indicates (69 is the third-highest score of the 16 lanes Shipper X is reviewing). The fact that Shipper X is overpaying in this lane is likely a result of stale rates; in the past year, as the West Coast ports have broken import records, rates on westbound lanes to the West Coast have not appreciated as fast as national average freight rates.

With the information provided by SCI, Shipper X can approach the carrier with data-backed information and have discussions to determine why the carrier is overcharging and if service levels have been adequate. If the carrier-shipper relationship on this lane is vital to Shipper X's network, the discussion should revolve around ensuring that prices are fair in the market and working toward a happy medium, even when the market turns on its head. If the relationship is less important to the overall network, it may make more sense to cut ties with the carrier along this lane and form a new relationship or offer the lane to a carrier that has provided adequate service at fair prices in other parts of the network.

An example of where Shipper X has exceptional carrier compliance in a key lane that would normally be quite difficult to cover is Dallas to Little Rock, Arkansas.

Pinpointing lanes where carriers have lived up to service expectations without price gouging can be just as important as identifying the low-hanging fruit.



(FreightWaves SCI: Benchmark Lane profile for Dallas, TX to Little Rock, AR. Outlining lane level spend, score and carbon footprint)

By employing FreightWaves' SONAR SCI platform, Shipper X can quickly deduce that its Dallas to Little Rock dry van lane was more difficult to cover than most, judging by a below average lane score of 40. Over the last quarter, hypothetical Shipper X has received reliable contract compliance along this lane from its primary carrier, limiting its exposure to the inflated spot market. Despite being in line with peer rates, Shipper X's primary carrier is running at $0.04 below the market rate, a level that most shippers would expect to see an increased risk of compliance failures on this difficult-to-manage lane.

So while a carrier on the Los Angeles to Houston lane is overcharging significantly on a relatively easy lane to cover, another carrier is providing quality service on a difficult lane without vastly overcharging the market rate.

So while markets within the networks are extremely volatile, especially in the current environment, carriers and shippers can still work together to come up with equitable solutions.

In this instance, through the demonstration of providing quality service at reasonable prices along a difficult lane to cover, Shipper X can enter discussions with the carrier to extend further volume to the carrier, whether it is along this lane or another lane. Additionally, if it is compatible, Shipper X could even extend to the carrier more desirable freight in the network, like the Los Angeles to Houston lane.

Ultimately, the shipper-carrier relationship management is vital throughout the entire bid cycle, especially in volatile periods. The ability to strengthen those relationships, or foster new ones, amid the volatility is a win-win for both carriers and shippers.

SONAR helps shippers quantify where rates are likely to be next year.

For a shipper's bid process to be most effective and for shippers to budget freight costs for the upcoming year, it is important to forecast rates to a quasi-accurate level. Clearly, there is no freight rate forecast that will be perfectly accurate, but several data points will help shippers understand whether carriers' bids on the freight packages that shippers put out to bid are reasonable. When evaluating bids, we recommend that shippers consider the bids in the context of the latest applicable contract and spot rates and their recent trajectories as well as tender and ocean data, which we consider to be forward-looking.

Dry van contract rates have risen 20% on average in the past 12 months.



(Chart: FreightWaves SONAR. Average initial reporting of dry van contract rates, not including fuel surcharges.)

When budgeting freight costs for the upcoming year, we recommend that shippers compare their rates and recent inflation (or deflation) to relevant comparables. For shippers that move freight via dry van contracts, one place to start is the national average dry van contract rate in late October of $2.70/mile before fuel surcharges. That rate is up 20% year-over-year with rates that took steps up roughly once per quarter of 5%, on average.

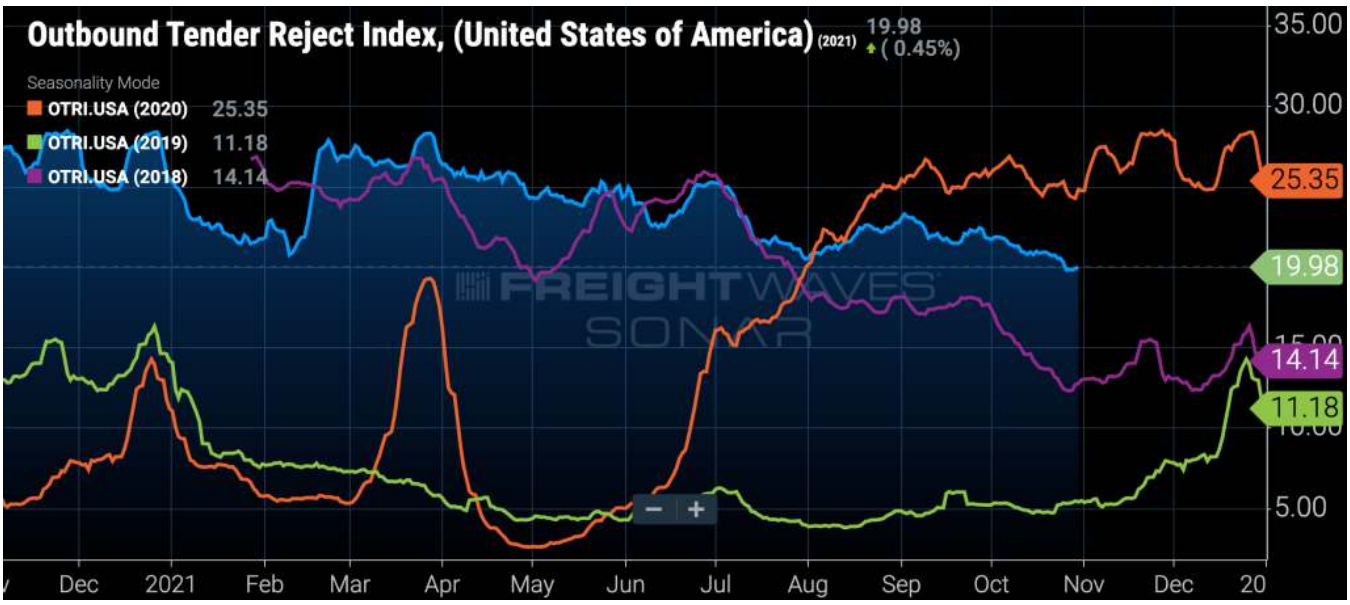
That trajectory indicates to us that shippers that have not had their freight rates repriced since early 2021 will have to budget larger increases that may exceed 20%, whereas shippers that repriced their freight frequently throughout 2021 will likely experience more moderate rate increases next year since their current rates were already closer to the current market rate.

Due to routing and service specifics of a shipper's freight, its freight rates may be consistently higher or lower than industry averages, such as the dry van average shown in the chart above. Therefore, most shippers will have to adjust their expected rates, and even if $2.70/mile before fuel is highly inconsistent with the rate shippers are actually paying, we believe understanding the recent average contract rate trajectory is relevant as a starting point.

Tender rejection rates indicate that freight rates remain inflationary.

The national tender rejection rate has trended downward in recent months to just under 20% after reaching its 2021 peak of 28.3% in April. We do not interpret that increase in carrier compliance to be the result of a meaningful loosening in the truckload market. Instead, we believe it was a result of the double-digit contract rate increases, which created less incentive for carriers to reject tenders to pursue higher-rated spot loads. In addition, we have heard anecdotes to suggest that shippers accepted much higher rates in exchange for an understanding with carriers that they would be much more compliant under those new, and more highly-rated contracts. In addition, a tender rejection rate near 20% remains high by historical levels and we consider tender rejection rates above roughly the 7%-10% range to be inflationary. Recall that 2018 was a tight year for truckload capacity; tender rejection rates that year were in the 12%-16% range during the final two months of the year, which suggests to us that shippers will likely experience more inflation in early 2022 than in early 2019.

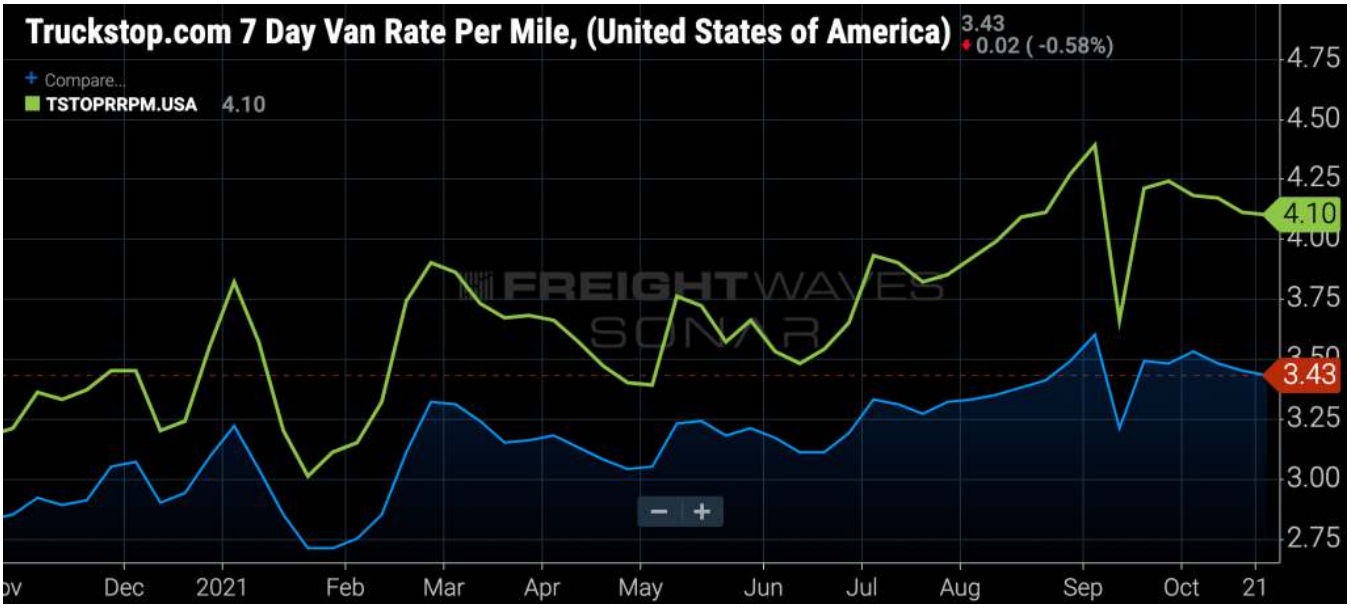
Tender rejection rates remain at levels indicative of further freight rate inflation.



(Chart: FreightWaves SONAR. Tender rejection rates for 2018, 2019, 2020 and 2021 shown in purple, green, orange and blue, respectively.)

The chart below illustrates a major reason why we do not believe that the decline in tender rejection rates reflects any meaningful loosening in truckload capacity: dry van and reefer spot rates have risen throughout the year before declining (which we expect to be temporary) early in the fourth quarter. Usually, spot rates move in a trend that nearly mirrors tender rejections with tender rejections serving as a leading indicator. The generally rising truckload spot rates (and the rising contract rates shown above) suggest to us that transportation capacity continues to get more expensive despite the declining tender rejection rates (to a still-high level).

Spot rates are about 20% higher than they were one year ago.



(Chart: FreightWaves SONAR. Dry van and reefer spot rates are shown in blue and green, respectively.)

We recommend that shippers apply the granularity available in SONAR to their own networks. Of course, the paragraphs above pertain to the market as a whole. The granularity provided in SONAR allows shippers to view the tender data, contract rates and spot rates in the lanes and with the equipment types that closely reflect the freight that shippers are putting out to bid. In addition, SONAR SCI allows shippers to compare their contract rates to contract rates that are being paid by shippers in the same industry on the same lanes. All of those data sets should help shippers navigate what appears to be another challenging year in 2022.

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