AVIOR

2019 Industry Report

Trucking in Australia

An industry with opportunities and a key challenge

There are opportunities ahead for Australia's trucking operators, but also an important set of crossroads where key decisions affecting the sector will need to be made.

Trucking, or transport and logistics, is the lifeblood for a nation the size of Australia with its dispersed but concentrated population centres. In this geographic circumstance, manufacturers, producers and retailers depend on the trucking industry for the efficient movement of goods between locations that may be thousands of km apart.

But that is not all trucking does. In addition to normal every-day freight movement, transport plays an important role in capital expenditure and construction activity. Heavy duty trucks are called upon to assist with civil works of infrastructure projects, as well as move people, machinery and equipment to remote mine locations.

Transport businesses prospered during the mining boom in Western Australia and Queensland, and also during the housing expansion in Victoria and New South Wales. The sector is poised to benefit again during the next resources resurgence and as large infrastructure projects such as the Western Sydney International Airport and Melbourne's West Gate Tunnel take on lives of their own.

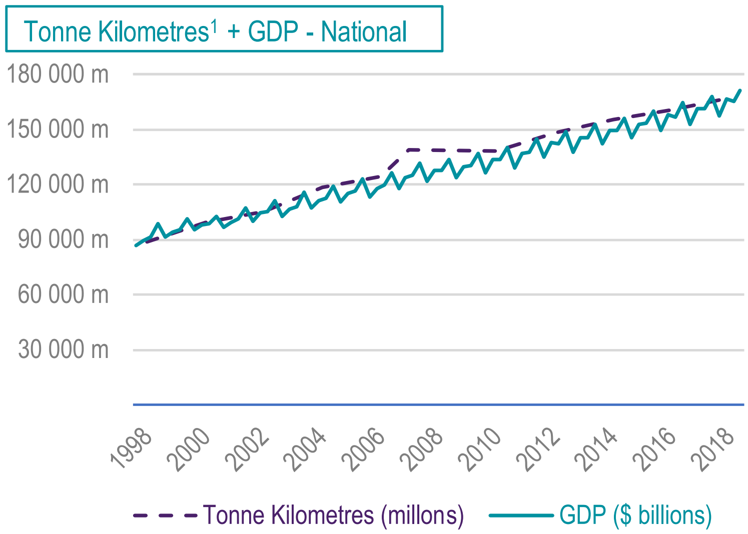
However, the sector is not without its difficulties. Indeed, the transport industry is confronted with a deep, structural challenge. It needs to change, significantly. Like any other disruptive period, opportunities will arise during this time and operators who seize them will be rewarded. Those who choose not to act will survive, but only for a time…

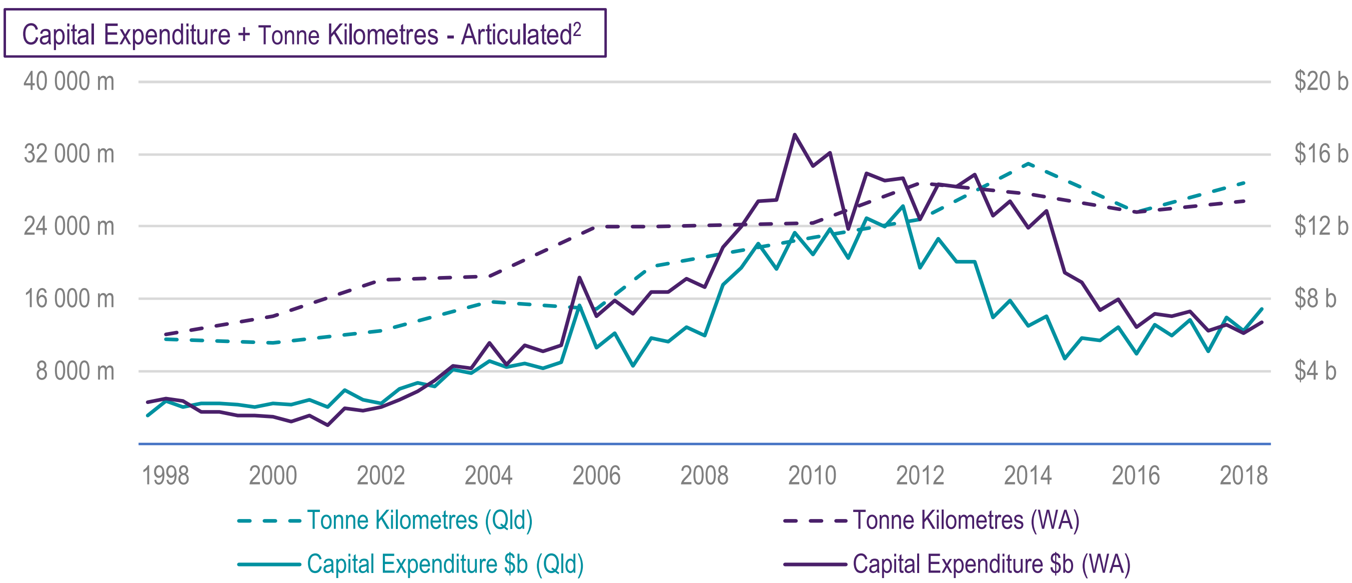
The trucking industry

75%
- Proportion of Australia's non-bulk freight movement provided by trucking
- Percentage of trucking businesses with 5 trucks or less
- Expected sector growth rate between 2011 - 2031

The industry's expected growth rate of 75% is not surprising given the high correlation between the level of trucking activity and the nation's economic output. This is demonstrated by comparing Australia's tonne-kilometres and GDP.

The sector also does well during periods of capital investment, as shown by the ramp up in freight movement in Western Australia and Queensland during the mining boom.





1 Measure representing the transport of one tonne of goods over one kilometre of road.
2 An articulated vehicle is a vehicle which has a permanent or semi-permanent pivot joint in its construction, allowing the vehicle to turn more sharply.

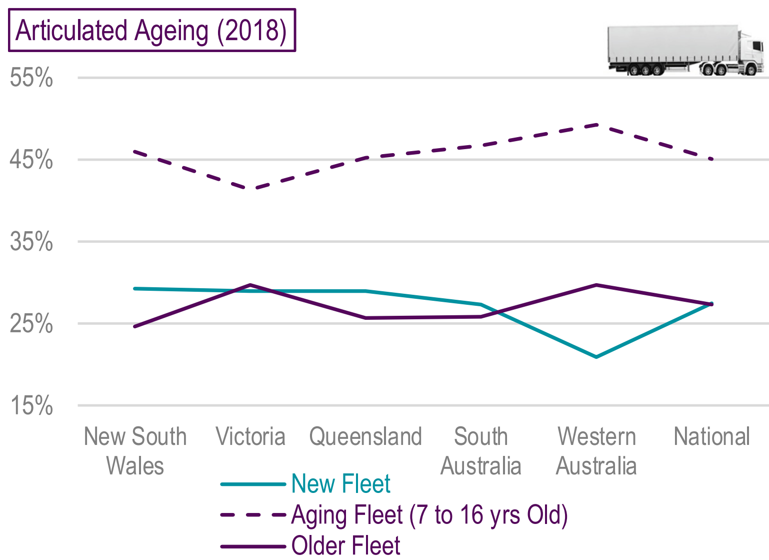
Economic indicators

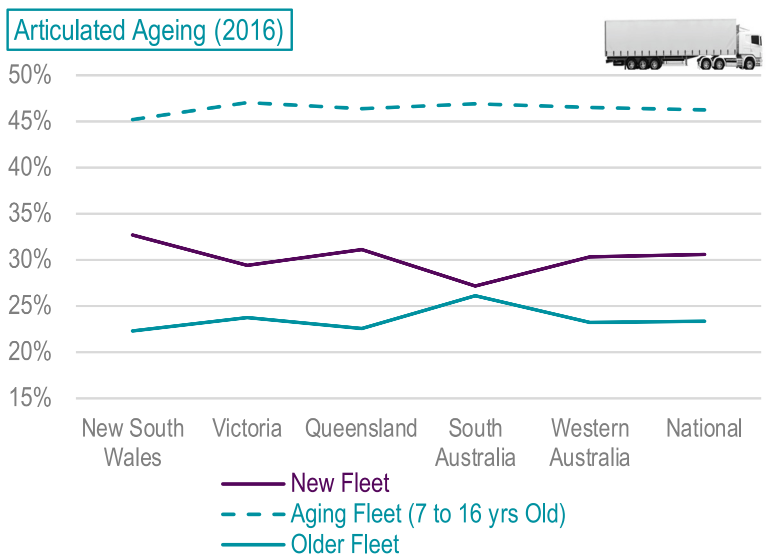
Australia's articulated fleet is, as a whole, getting older...

Compared to two years ago, the articulated fleet[3] has aged. The proportion of Australia's articulated trucks more than 16 years old has increased to 27% as compared to 23% two years earlier. Western Australia experienced a particularly large shift, going from 23% to 29%.

This outcome is not surprising given the decline in the fleet's productive efficiency (ref. p 8). The trucks are not carrying loads often enough to financially justify new investment.

The implications are that depreciation charges have likely fallen whilst maintenance costs have likely increased. The bad news is that only the latter impacts cash flow and not in a good way.





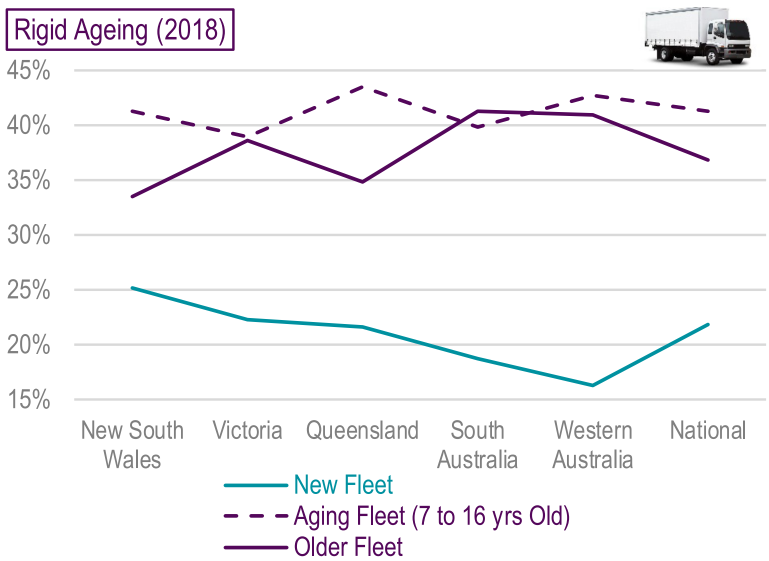
3 Articulated trucks, or heavy vehicles, were responsible for 72% of Australia's tonne-kilometres in 2018.

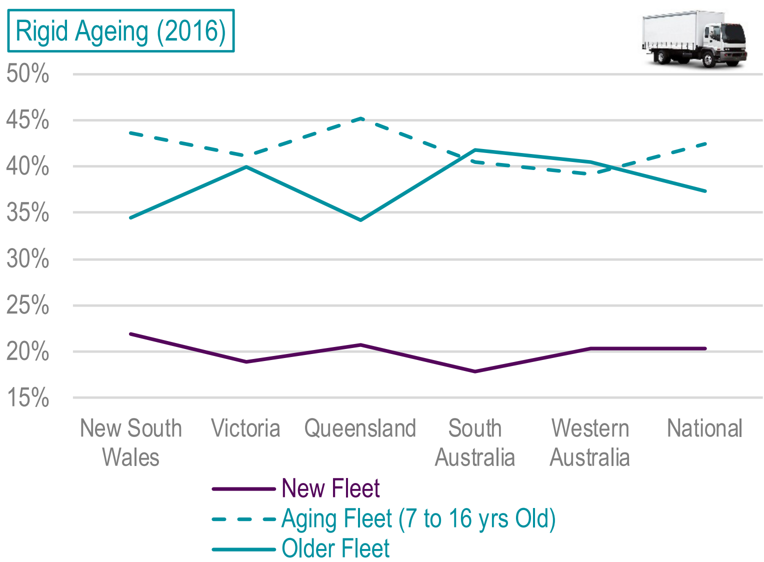
Economic indicators

...Whereas the rigid fleet has stayed the same.

Nationally, rigid trucks[4] have fared better, with the fleet being slightly newer as compared to 2016. The experience has not been uniform, however. New South Wales and Victoria experienced a 10% increase in their newer vintage trucks. Western Australia, due to its poorer economic climate during that period, experienced a 20% decline.

In terms of freight movement capacity, Austraila is using increasingly older equipment to transport an expanding freight load. This creates a drag on the economy in that, at best, operating costs per net tonne kilometre have stayed the same, but are more likely increasing.



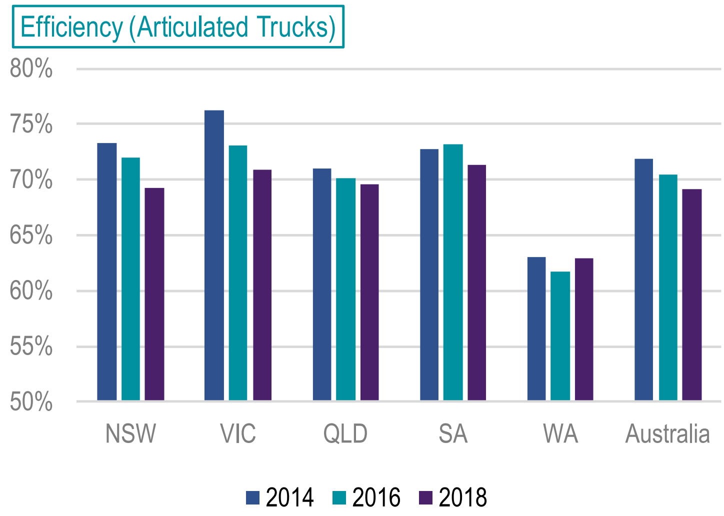


4 Rigid trucks contributed 23% of the country's tonne-kilometres in 2018.

Economic indicators

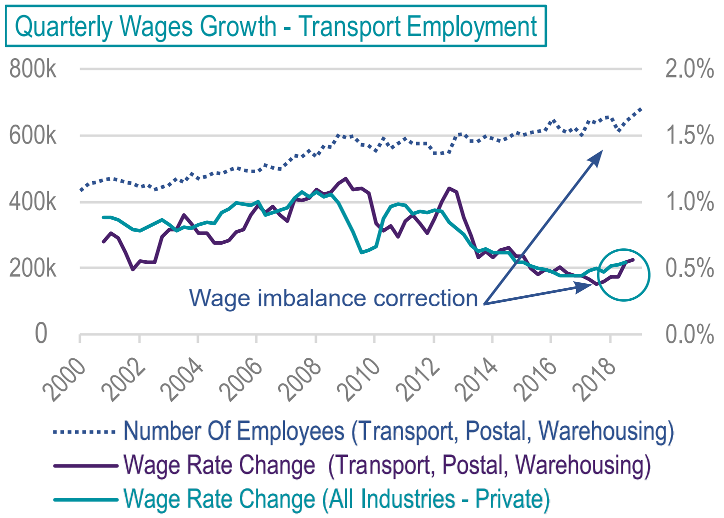
Efficiency

The efficiency of a trucking asset is measured as the ratio of the number of kilometres it travels loaded (laden km) to the number of kilometres it travels in total. The efficiency of Australia's articulated vehicles has declined since 2014. The exception is Western Australia. Although WA has bucked the trend downward, its relatively larger number of vehicles compared to the other States means that its efficiency is structurally 10% lower. WA's larger number of vehicles is attributed to its high resource exposure.



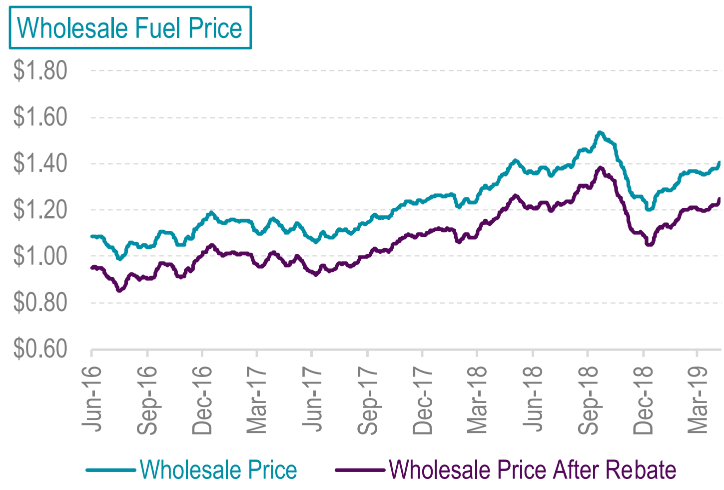
Employment + Wage Rates

Employment in the sector is at an historical high after declining in late 2017. The increase in numbers was achieved by correcting a pay imbalance relative to other jobs in the private sector. As discussed later in this update, we expect wage pressures in the trucking industry to continue.



Fuel Prices

After a welcomed correction from the highs of September 2018, fuel prices are again marching upwards. The vigilance of ensuring haulage rates reflect current diesel costs has therefore returned.



Outlook

2019-2020 is shaping up to be a good year for trucking operators.

Operators in Western Australia and Queensland will begin to benefit as purse strings for announced resource projects in those states are loosened. WA's outlook is particularly promising with its State government predicting GSP (gross state product) growth of 3.5%.

For New South Wales and Victoria, their large infrastructure budgets will underpin the ongoing revenue demand for transport and freight in those states.

At press time for this update, the RBA was predicting GDP growth of 2.75% for the year, not quite making the 3% target, and citing concerns over low inflation. An interest rate cut of 25 basis points was confirmed on June 4th 2019 by the RBA, which brings the cash rate down to 1.25%. This policy change will make trucks and ancillary equipment more affordable. On balance then, the year ahead should be a solid one for trucking businesses.

Who will drive the trucks?

The central issue facing the industry: not enough drivers

Survey commissioned by Volvo Group Australia[5]		
52% Respondents having issues attracting the quantity of drivers needed.	82% Respondents having issues attracting the quality of drivers needed.	46% Respondents currently experiencing a shortage of available drivers.

The current pool of drivers is also getting older, having an average age of 53. (The median age for Australian workers is 39.) Furthermore, only 15% of drivers are under 30. With freight demand likely to exceed GDP in the near term, we see this supply shortage worsening.

The problem is a tricky one as the remedy does not appear to be simply paying drivers more, although higher pay is likely to be a necessary outcome. The profession suffers from an image problem. When someone says ‘truck driver’, many of us still picture a bloke in a blue singlet and shorts, wearing an old mesh baseball cap. The stigma is so bad that a recent survey commissioned by Volvo Group Australia identified that many drivers felt uncomfortable talking about what they did for a living.

The fact is the profession has changed. Society just hasn't recognised this yet. Most drivers now wear uniforms, are very safety conscious and are also involved in customer relations. Professionalism has therefore increased. Replacing the earlier stereotype is taking time, however, and these improvements have not been grasped by young people entering the workforce.

To make the career more appealing, consideration is being given to introducing a formal trade accreditation program for heavy vehicle drivers. People currently driving the road trains obtained their Multi Combination (MC) vehicle licence by graduating through the lower licence levels and meeting minimum driving experience requirements. The trade designation is expected to add to a driver’s knowledge base by studying topics such as load restraint, axle weights, carrying capacity, etc. Aligning truck driving with other recognised trades like electricians and plumbers is expected to give the vocation more respectability.

5 Volvo Group Australia, May 2016, Professional Truck Driver Shortage: How driver availability impacts the transport industry & Australian society. Available from: trucks.volvotrucks.com.au/professionaltruckdrivershortage

Ageing equipment not helping

Newer trucks are a drawcard.

Unfortunately, Australia's economy has not been robust enough to make the business case for meaningful investment in new vehicles. As highlighted earlier in our update, Australia's fleet of articulated vehicles has aged over the last two years. Rigid trucks are generally (somewhat) newer, however, they only move 23% of the nation's freight. With newer, technologically up-to-date vehicles naturally commanding greater interest among drivers, operators with older equipment would be struggling to attract and retain drivers. The next resources cycle and large infrastructure projects may be the catalysts that will enable operators to justify increasing / updating their fleets.

Pay more to attract more

Are raises affordable?

In the absence of making truck driving a recognised trade and/or offering the newest vehicles, the final drawcard for attracting drivers is pay. This is the lever that trucking businesses have most control over. So, in response to the drivers shortage, our expectation is that wage rates will continue to rise.

Given that 75% of operators are small businesses, the initial presumption is that they would be unable to afford a wage raise. In terms of haulage rates, they are price takers not price setters, so the prospect of funding the raise with a price increase is low.

The solution, however, may lie in improving productivity. Additional revenues from utilising surplus capacity, as indicated by declining load efficiency, in the system will help fund the wage increase. Once the surplus capacity is used up, however, further increases in pay rates will cause profits to erode.

Our guidance

A time to sell, a time to buy.

Moderate to robust economic conditions mean that transport businesses can look to the year ahead with optimism, but with growing concern as to whether drivers will be present to keep their trucks on the road. Human nature being what it is, operators will likely muddle through as they are and keep going. But that is not what they should do.

If you've had thoughts of selling, revisit that strategy. You will be selling into an upmarket – valuations will be more in your favour. The threat of wage increases will be partly and perhaps fully mitigated by higher revenues obtained from efficiency improvements - i.e. carrying loads more often.

In choosing to sell, there is preparation work to be done. Truck logbooks, maintenance records, customer contract details, employee files, permits and licences, equipment listings and up-to-date financial statements. This information and the systems in place for compiling them needs to be assembled and organised to help buyers conduct due diligence quickly. Avior has substantial expertise in conducting business sales using a proven methodology and rigorous execution. Moulding to your requirements, we can manage the entire process: sale preparation, data room set-up, marketing, negotiation and transaction structuring in accordance with legal and tax advice. We will keep you updated with all developments whilst you maintain the business. What's more, the depth of our significant networks will be trolled to identify transaction partners.

Similarly, if your appetite is to grow, now is the time to get bigger, pursue the efficiency gains of a larger fleet and make the business eligible for larger contracts. Acquiring other trucking businesses should be an integral part of that strategy. Efficiencies gained through consolidation will fund wage increases and enhance the ability to demand higher haulage rates. Avior can bring the same expertise to bear in advising on the acquisition process: target identification, approach, term sheet preparation, due diligence, final negotiations and settlement.

Our guidance is to take action. If selling is a consideration, seek advice and begin preparations. If you're wanting to stay in business, and stay in trucking, then pursue growth.

Sources include Avior analysis of the following:

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Australian Bureau of Statistics, Catalogue 5625.0 - Private New Capital Expenditure and Expected Expenditure – Table 8a and 10a.

Australian Bureau of Statistics, Catalogue 6291.0.55.003 - Labour Force – Table 5.

Australian Bureau of Statistics, Catalogue 6345.0 - Wage Price Index – Table 9b.

Australian Bureau of Statistics, Catalogue 9208.0 - Survey of Motor Vehicle Use 2014 to 2018 – Table 9 and 21.

Australian Bureau of Statistics, Catalogue 9208.0 - Survey of Motor Vehicle Use 2012 – Table 5 and 16.

Australian Bureau of Statistics, Catalogue 9210.0.55.001 - Survey of Motor Vehicle Use 1998 to 2010 – Table 5 and 16.

Australian Bureau of Statistics, Catalogue 9309.0 - Motor Vehicle Census 2016 and 2018 – Table 9.

Australian Government Department of Jobs and Small Business, 2019, Industry Information. Available from: lmip.gov.au/default.aspx?LMIP/IndustryInformation

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