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MARGINS - OUCH!

Road transport operators' costs (excluding labour) increased 12.5% over the year to March while the prices they charged their customers increased by just 6.1%. That implies that margins have shrunk by 6.4%.

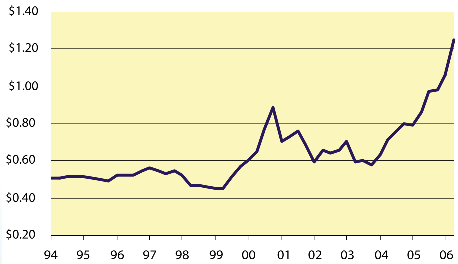
When we addressed the margin issue in our November article last year our expectations were for margins to tighten over the course of 2006 as softening domestic demand hindered operators' ability to pass rising wage and financing costs on to clients. The headline figures above suggest that on that score we have been proven largely correct.

Labour costs in the road freight industry have continued to rise, with the driver shortages pushing wages 5.5% higher over the year to March 2006 – almost double the 3.0% rise recorded for private sector wages in general. Cost pressures in this area can be expected to persist for as long as there remains a dearth of qualified staff.

Where we got it wrong in November, however, was in our prediction for diesel prices to fall. The opposite has occurred: a sharper than expected fall in the dollar combined with a series of geopolitical events (Iranian nuclear ambitions, disruptions to oil supply in Nigeria, and the current Israel, Lebanon situation) has resulted in the price of diesel rising sharply over the first half of this year.

We now expect the price of oil to settle back to between $US50-60/bl by 2008. With the dollar hovering just below $US0.60 during that period, diesel prices should ease from their current levels.

Up up and...
Diesel price $ per litre



The increase in costs over the first half of this year comes at time when demand for road freight services is weakening. Transport and storage GDP in the March quarter was 2.4% down on the same period in 2005, while very heavy vehicle RUC kilometre purchases over the three months to June were 1.5% lower than a year ago.

Operators appear to have responded to the tougher trading conditions by shelving truck replacement programmes. Year-to-date sales of heavy trucks are 20% down on 2005 levels, while medium trucks sales, after holding up over the March quarter, have also begun to fall.

With most freight customers (with the possible exceptions of construction and roading contractors) facing cost and demand pressures of their own, transport operators will find it difficult to increase freight charges. There will be real pressure on operators to look for productivity gains to cushion the squeeze on their margins. The amount of freight carried per trip and travelling times that maximise fuel efficiency will become imperatives rather than just sensible. Rationalisation within the industry also looks probable as increasing numbers of smaller operators find the going too tough.