Road Transport: Labor costs explain the large gap in profitability in Europe

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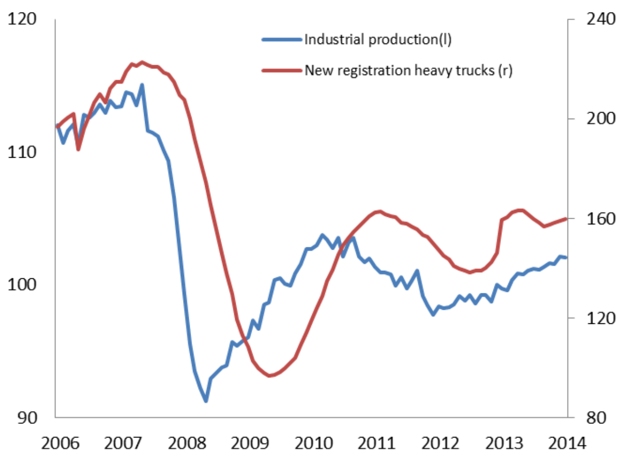
Executive Summary

- The European Road Transport sector is very fragmented and competitive, while growth is weak at +2/3% in 2014.
- Countries compete along four criteria: on one hand, the fuel bill (26% of total costs) and the accumulation of environmental standards (and therefore material costs that represent 12%) are consistent across Europe; on the other hand, the cabotage and variation in salaries (from 9 to 33 euros in hourly wages) explains the differences in competitiveness between countries.
- In the end, three countries emerge based on the net profitability of their actors. First off, Belgium, highly cabotaged, suffers. Next come Italy, France, Austria and Germany with weak profit margins (between 0.6% and 1.5%). Finally, the big winners are Poland, the Czech Republic, and Spain.

A highly fragmented sector, with weak growth prospects that intensify competition.

The Road Transport sector in Europe is largely dominated by a majority of small and medium companies. We estimate approximately 95% of EU firms with fewer than 10 employees, while the French INSEE counts 97% of companies with fewer than 50 employees. This extreme fragmentation currently finds itself in a low-growth environment. In fact, the performance of the road transport companies and consequently their investment in new vehicles is highly correlated to the industrial production. This sector, like new vehicle registrations, has yet to return to pre-crisis levels, but was able to show a slight positive growth at the end of 2013. We predict the volume of road transportation will grow by +2/3% in 2014. One thing to note: the rebound in the registration of heavyweight transportation at the end of 2013 was not in anticipation of strong growth, but rather caused by the expected implementation of the Euro 6 environmental standards at the start of 2014.

Chart 1: Variation in industrial production and heavyweight vehicle registrations over 17 tons in number of units in euro zone (basis 100: 2010)



Sources : IHS Global Insight, Euler Hermes

A quick look at cost breakdowns reveals three major determinants of differences in competitiveness in Europe, in addition to regulation.

The cost structure of road transport highlights two distinct categories of constraints. The first category includes costs affecting all countries such as fuel, which makes up 26% of the total, and materials, which are more restrictive than one might think (12%) and suffer from hyperinflation due to the buildup of environmental standards which raise vehicle prices. The second category encompasses the factors separating countries, including labor costs (28.5%), which have gained weight from the gradual opening of the European market, known as cabotage. By analyzing these 4 elements, it is possible to anticipate the potential growth and difficulties of road transportation in each country.

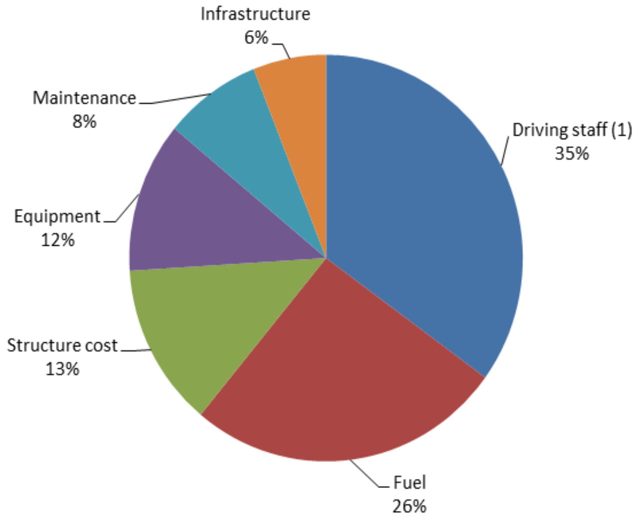
Determinant #1: The volatility of oil prices is currently not as damaging, but remains a point of concern for a sector with low profit margins

2012 and 2013 saw little variations in oil prices, at +1.75% on average per year (in euros per barrel). However, it should be noted that fuel prices increased by +7% per year on average of the 2007-2013 period, well above the inflation rate of +2.5% per year (EU-27). The rise in the volatility of oil is a fear across the sector which cannot be downplayed, especially in such a competitive environment with feeble growth. In theory, the solution lies in factoring the change in oil prices into transportation contracts. However, in reality this becomes much more difficult to implement.

Determinant #2: Investments in equipment are more and more expensive due to the accumulation of environmental standards aiming at improving air quality.

Ever since the 1990 Euro 0 standard, no less than 7 new environmental standards have been implemented, each more stringent than the last. While the goal of reducing harmful emissions is commendable, it generates additional costs for engines and in the installment of particle filters. For example, the implementation of the new Euro 6 standard on January 1st 2014 creates additional costs of approximately 6 000 to 10 000 euros for every new vehicle (tractors).

Chart 2: Breakdown of operating costs for long distance transport (40 tons) in France in 2011



(1) Labor cost (28.5%) and travelling cost (6.5%)

Sources: Survey long distance, French road national committee

Chart 3: Growth of oil prices (euros per barrel)

Sources : IHS Global Insight, Euler Hermes

Chart 4: European environmental standards

Standard	applicable	Nitrogen oxide (Nox)	Caron monoxide (CO)	Hydrocarbon (HC)	Particles
Euro 0	oct.-90	14.4	11.2	2.4	
Euro 1	oct.-93	9	4.9	1.23	0.36
Euro 2	oct.-96	7	4	1.1	0.15
Euro 3	oct.-01	5	2.1	0.66	0.13
Euro 4	oct.-06	3.5	1.5	0.46	0.02
Euro 5	oct.-09	2	1.5	0.46	0.02
Euro 6	jan.-14	0.4	1.5	0.13	0.01

Sources: European Commission, Euler Hermes

Determinant #3: The gradual opening of the European market, known as 'cabotage', is not complete.

Cabotage is the temporary right given to a European transporter based outside of France, which allows it to transport within the national territory through a communal license. In effect since 2009 for new member states, it was meant to become fully liberalized in 2014. However, in 2013 the decision was made to postpone the ruling in order to prevent the further increase of inequalities between countries and carriers. The inequalities are not limited to salaries, but also to annual driving time (from 1601 hours in France to 1980 hours in Eastern Germany, CNR 2011 numbers). This decision was also taken to prevent further damage to an already devastated sector in Western Europe.

Determinant #4: Labor costs, the main factor, create the largest gap.

In terms of hourly wages, three groups stand out.
1- Around 30 euros an hour, where a relative homogeneity exists between five countries categorized as previously industrialized: Belgium, France, Austria, Germany, and Italy. Between them, competition is healthy.
2- Around 20 euros an hour, only Spain separates itself, which is in direct competition with its previously mentioned neighbors.
3- Around 10 euros an hour, new member states Poland and the Czech Republic compete with the others mostly in terms of long distance activities and cabotage.
In the end, the ratios of 1 to 3.5 between countries create highly fragmented competition.

Furthermore, the cost of labor cancels out a majority of the value added

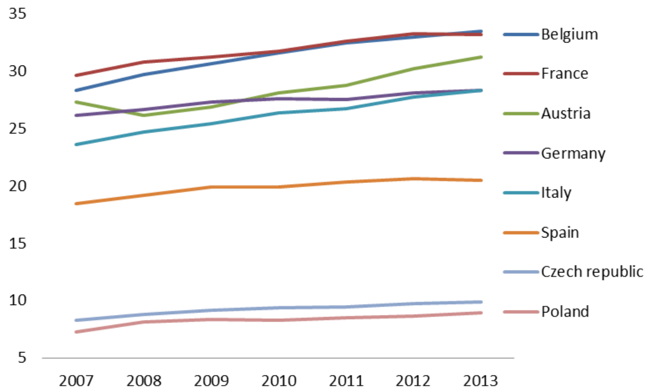
The countries with the highest hourly wages see their personnel costs absorb the largest amount of value added. This is especially true for France and Belgium, as both countries see their personnel costs make up over 80% of their value added, 20 points higher than their Spanish or Czech competitors. Between these extremes, an intermediate group of Germany, Italy, Austria and even Poland display a ratio of personnel costs to value added ranging from 70 to 75%, which seems to be the point of reference for average profitability. The case of Poland is unique, as it still records an average ratio despite its low hourly wages, due to the fact that its companies focus on mass transport with a low value added. This also cements its place as the #1 "caboteur" in the European Union.

Chart 5: Date of accession of the new member states into the European Union and French cabotage

Pays	Accord cabotage en France
Cyprus	2004
Malta	2004
Slovenia	2004
Estonia	2009
Latvia	2009
Lithuania	2009
Czech republic	2009
Slovakia	2009
Hungary	2009
Poland	2009
Bulgaria	2012
Romania	2012

Sources: European Commission, Euler Hermes

Chart 6: Hourly labor costs in major European countries (euros)



Sources: Eurostat, labor cost for transport and communication sector, Euler Hermes

Chart 7: Ratio of cost of labor to value added

Labor of cost/ VA (%)	2007	2008	2009	2010	2011	2012
Belgium	79.7	82.6	85.5	84.5	84.3	83.8
France	77.4	79.2	78.6	79.8	80.7	80.5
Italy	75.6	70.7	71.8	67.3	69.7	74.8
Germany	74.6	70.7	77.6	75.6	76.9	74.1
Austria	67.0	67.7	71.5	69.3	70.4	71.5
Poland	68.9	81.4	75.6	71.3	67.2	70.6
Spain	68.5	70.3	70.4	70.8	68.9	63.3
Czech republic	66.4	70.2	63.5	60.9	58.9	57.3

Sources: BACH database, Euler Hermes

In conclusion, net profitability is weak or even insufficient in Western Europe, except in Spain.

The European Road Transport sector remains consistently hampered by low profitability. Among them, the Belgian situation is the most concerning, with a negative to non-existent net profitability. Over 2008-2012, the Belgian industry lost -18% in national and -44% in international transportation (in t-km). Belgium has the highest cabotage in Europe in terms of rate of penetration. Over the same period, the French sector lost -14% nationally and -35% on the international level. Conversely, three countries have outperformed the rest: Poland, the Czech Republic and Spain, confirming the importance of the cost of labor in the net profitability of actors.

Chart 8: Ratio of net profit to revenues

Net profit/ revenues %	2007	2008	2009	2010	2011	2012
Belgium	1.5	0.1	-2.1	-1.3	-2.5	0.1
France	2.9	2.1	1.5	1.4	0.1	1.1
Italy	1.0	1.7	1.8	2.6	2.6	0.6
Germany	0.9	2.1	-0.5	-0.3	1.5	1.5
Austria	2.8	0.2	0.2	1.3	1.4	1.4
Poland	3.8	-0.1	0.1	1.8	3.4	2.9
Spain	2.6	0.7	1.8	2.0	0.3	5.0
Czech republic	5.1	4.7	3.6	4.8	5.0	4.4

Sources: BACH database, Euler Hermes

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