Transportation Sourcing Opportunities

Fuel Surcharge Deep Dive

February 2016

Cost & Capital

Executive Summary

- ***Fuel Surcharge Background–*** Fuel Surcharges provide a vital role in transportation agreements, protecting carriers and shippers from large swings in diesel prices. However, the importance of surcharge tables can often be overlooked during negotiations.
- ***Fuel Surcharge Index–*** Fuel Surcharge Agreements typically specify if the index is regional or national, with national agreements being common, which may cause shippers in advantaged areas to overpay.
- ***Regional Variations–*** Geography determines diesel pricing and should be reflected in regional contracts. Fleets in the Midwest, Gulf Coast and Southeast are consistently able to buy fuel at significantly less than the national average price.
- ***Fuel Surcharge Increments–*** Increments should be based on the fleet's MPG and can have a large impact on cost per mile, especially as diesel prices increase.
- ***Contract Review–*** Buying organizations should ensure their surcharges reflect their supply chain's regional footprint and their carriers' fleets' efficiency.
- ***Potential Impact–*** Shippers could achieve up to $0.09 per mile savings with diesel prices at $2.00 per gallon

Fuel Surcharge

Fuel Surcharges provide a vital role in transportation agreements, protecting carriers and customers from large swings in diesel prices.

Surcharge tables should reflect the fleet's efficiency and the supply chain footprint.

Fuel Surcharge Basics

- The fuel index's source should be clearly stated in the fuel surcharge agreement. A common example is the DOE National Average, but this should reflect the supply chain's footprint.
- Fuel surcharge agreements typically have a base and increase by $0.01 per mile for every $0.05-$0.08 increase in fuel price
  - The increments should be related to the fleet's mpg (e.g. 5 mpg translates to $0.01 per $0.05 increase in fuel price)
  - A rebate to the customer should be triggered if the on highway fuel price falls below the base level (e.g. $1.20 in the sample table)

Sample Fuel Surcharge Table

Fuel Price ($/ gal)		Surcharge ($/ Mile)
$ 1.200	$ 1.259	$ 0.010
$ 1.260	$ 1.319	$ 0.020
$ 1.320	$ 1.379	$ 0.030
$ 1.380	$ 1.439	$ 0.040
$ 1.440	$ 1.499	$ 0.050
$ 1.500	$ 1.559	$ 0.060
$ 1.560	$ 1.619	$ 0.070
$ 1.620	$ 1.679	$ 0.080
$ 1.680	$ 1.739	$ 0.090
$ 1.740	$ 1.799	$ 0.100
$ 1.800	$ 1.859	$ 0.110
$ 1.860	$ 1.919	$ 0.120
$ 1.920	$ 1.979	$ 0.130
$ 1.980	$ 2.039	$ 0.140
$ 2.040	$ 2.099	$ 0.150
$ 2.100	$ 2.159	$ 0.160
$ 2.160	$ 2.219	$ 0.170
$ 2.220	$ 2.279	$ 0.180
$ 2.280	$ 2.339	$ 0.190
$ 2.340	$ 2.399	$ 0.200
$ 2.400	$ 2.459	$ 0.210
$ 2.460	$ 2.519	$ 0.220
$ 2.520	$ 2.579	$ 0.230
$ 2.580	$ 2.639	$ 0.240
$ 2.640	$ 2.699	$ 0.250
$ 2.700	$ 2.759	$ 0.260
$ 2.760	$ 2.819	$ 0.270
$ 2.820	$ 2.879	$ 0.280
$ 2.880	$ 2.939	$ 0.290
$ 2.940	$ 2.999	$ 0.300
$ 3.000	$ 3.059	$ 0.310

Fuel Surcharge Index

Fuel Surcharge Agreements typically specify if the index is regional or national, with national agreements being common.

U.S. On-Highway Diesel Fuel Prices* (dollars per gallon) full history

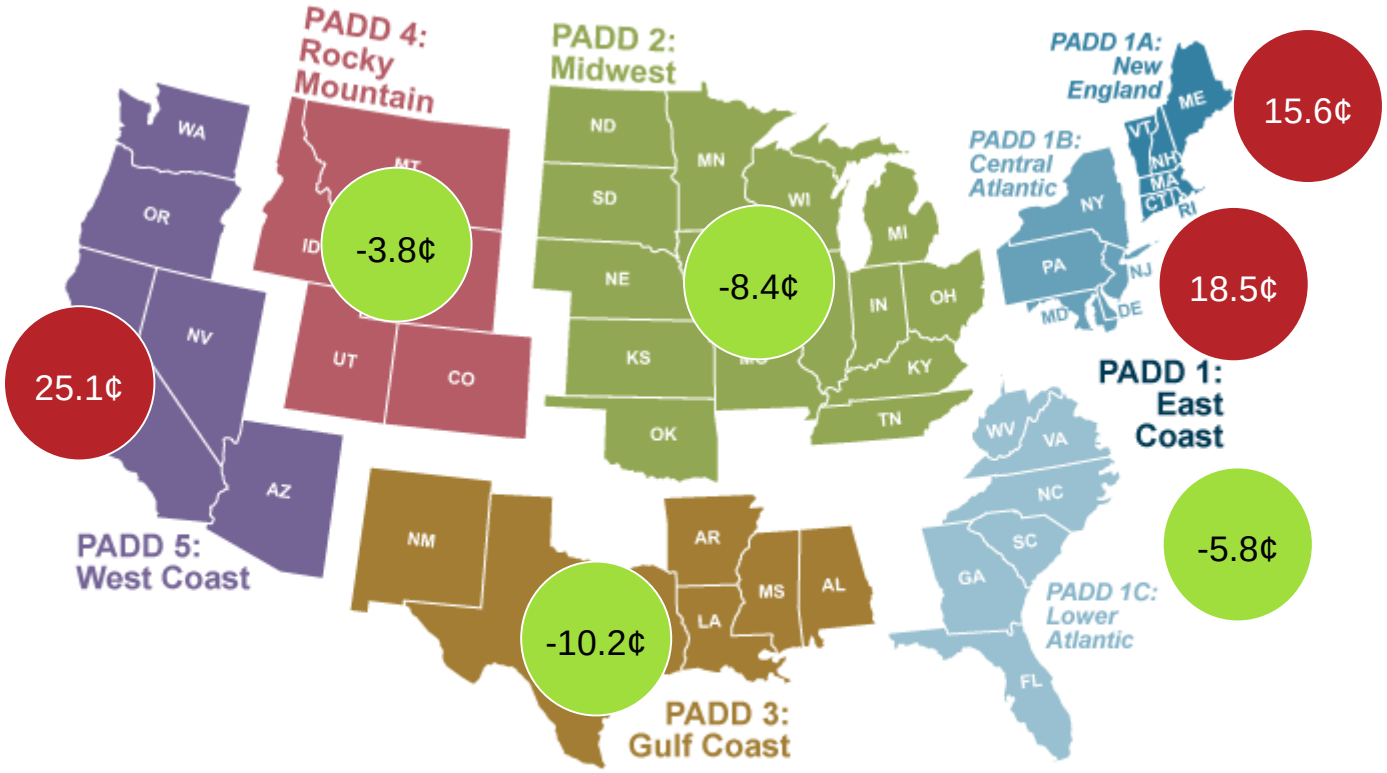
				Change from	
	02/08/16	02/15/16	02/22/16	week ago	year ago
U.S.	2.008	1.980	1.983	↑ 0.003	↓ -0.917
East Coast (PADD1)	2.087	2.069	2.059	↓ -0.010	↓ -0.946
New England (PADD1A)	2.201	2.183	2.160	↓ -0.023	↓ -1.013
Central Atlantic (PADD1B)	2.224	2.197	2.184	↓ -0.013	↓ -0.976
Lower Atlantic (PADD1C)	1.959	1.947	1.944	↓ -0.003	↓ -0.909
Midwest (PADD2)	1.929	1.908	1.921	↑ 0.013	↓ -0.905
Gulf Coast (PADD3)	1.896	1.858	1.873	↑ 0.015	↓ -0.922
Rocky Mountain (PADD4)	1.914	1.866	1.861	↓ -0.005	↓ -0.901
West Coast (PADD5)	2.236	2.194	2.181	↓ -0.013	↓ -0.884
West Coast less California	2.073	2.043	2.050	↑ 0.007	↓ -0.839
California	2.369	2.316	2.288	↓ -0.028	↓ -0.920

prices include all taxes

Source: EIA

On Highway Diesel Price Variation by Region

Geography determines pricing and should be reflected in regional contracts.

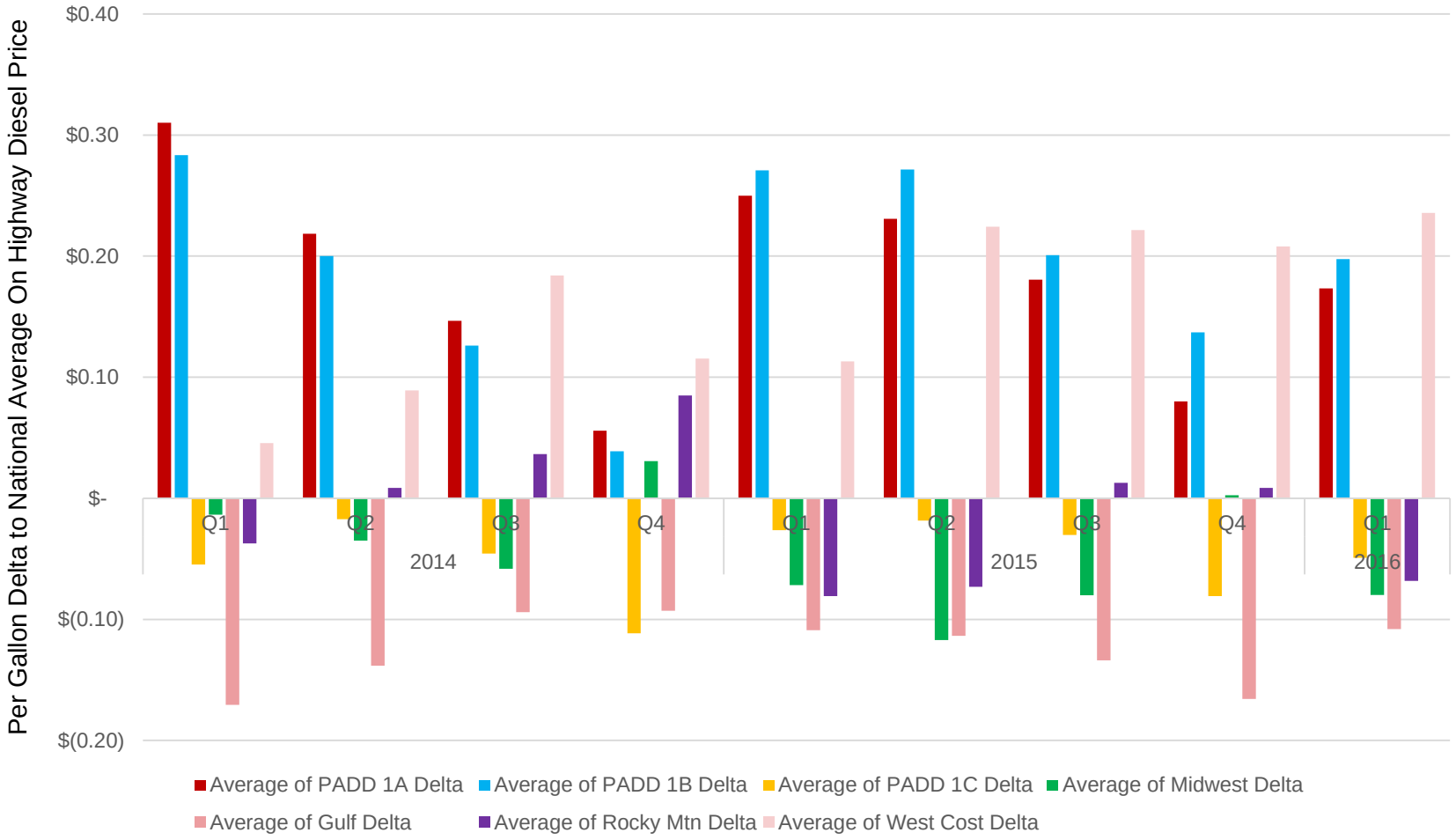


12.9 ¢ January 2016 PADD Regional $ / gal difference to average US On Highway Diesel Price

Source: EIA

Variation by Region

The Gulf Coast, Midwest and Southeast are the most cost advantaged regions.

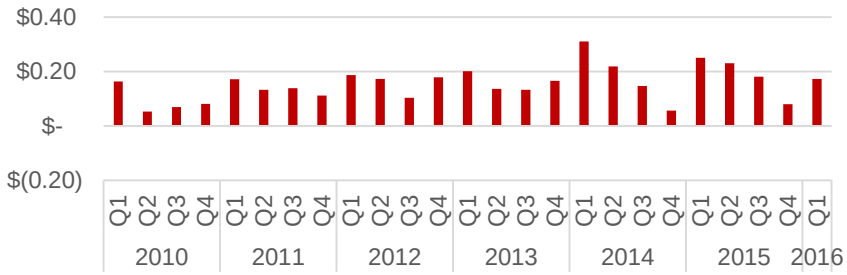


Source: EIA

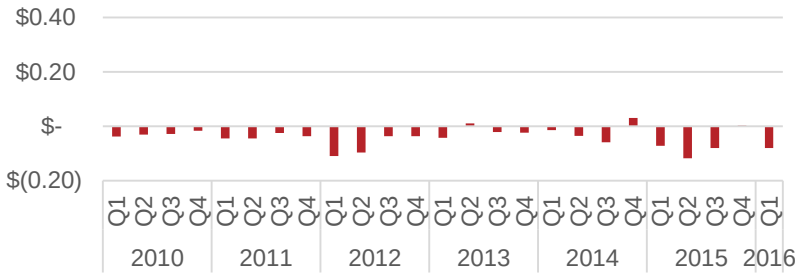
Variation by Region

The Gulf Coast and Midwest are the most cost advantaged regions for diesel.

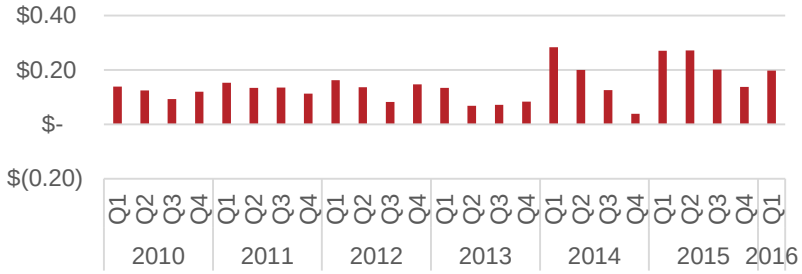
PADD 1A (New England) Delta to National Average



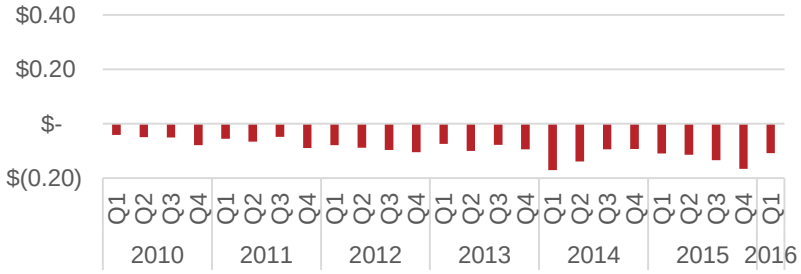
Midwest Delta to National Average



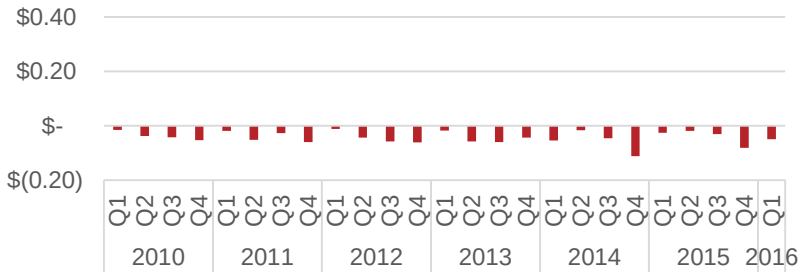
PADD 1B (Central Atlantic) Delta to National Average



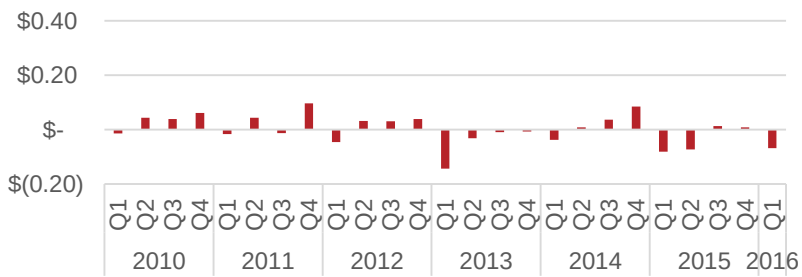
Gulf Delta to National Average



PADD 1C (Lower Atlantic) Delta to National Average



Rocky Mountain Delta to National Average



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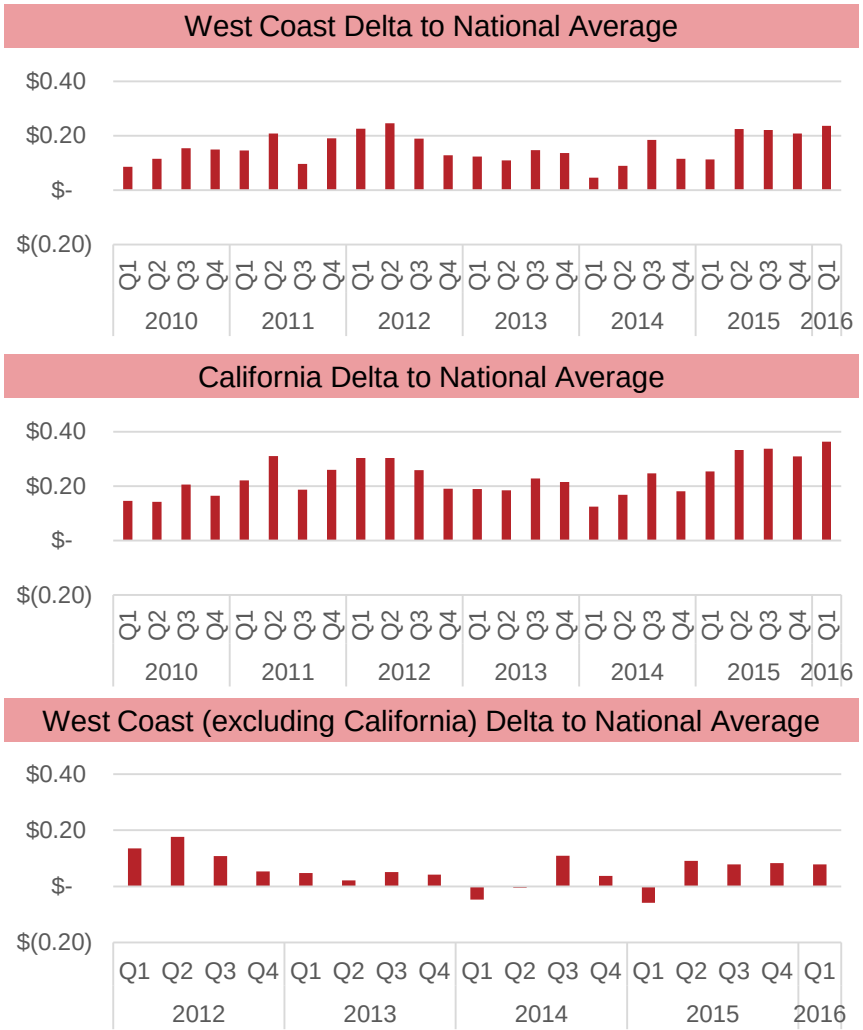
Source: EIA

Variation by Region

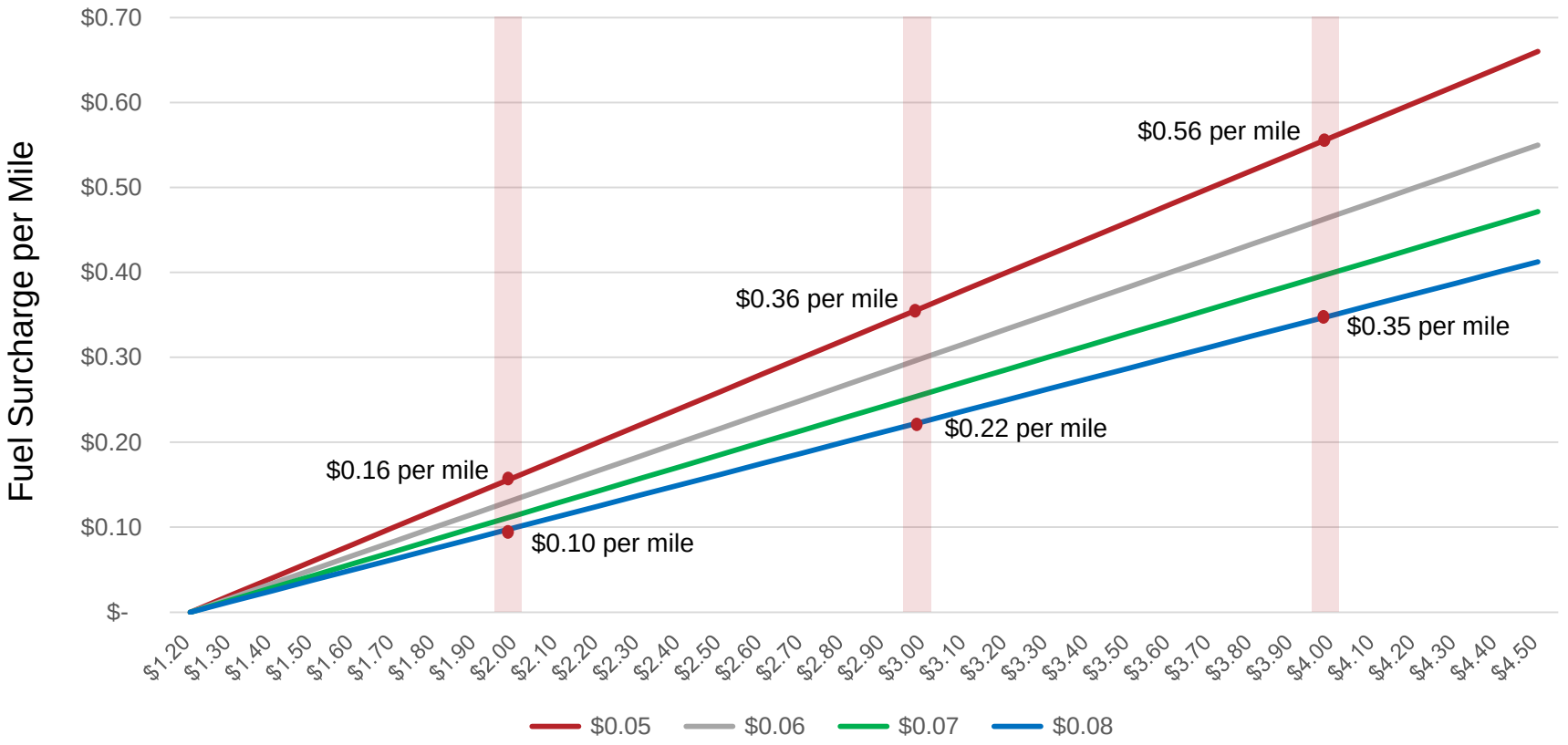
The West Coast is consistently disadvantaged.



Source: EIA

Fuel Surcharge Increments

Increments should be based on the fleet's MPG and can have a large impact on fuel surcharge cost per mile, especially as diesel prices increase.



Case Study: Potential Impact

Shippers with supply chains in the Southeast, Midwest, and Gulf Coast have a $0.01 – $0.09 per mile savings opportunity when diesel is $2.00 per gallon.

Per Mile Delta to Best Practice
(Diesel $2.00 per gallon)

Contract Increments	Southeast	Midwest	Gulf Coast
$0.05	$(0.07)	$(0.08)	$(0.09)
$0.06	$(0.04)	$(0.05)	$(0.05)
$0.07	$(0.02)	$(0.03)	$(0.03)
$0.08	$(0.01)	$(0.01)	$(0.02)

Per Mile Delta to Best Practice
(Diesel $3.00 per gallon)

Contract Increments	Southeast	Midwest	Gulf Coast
$0.05	$(0.15)	$(0.16)	$(0.17)
$0.06	$(0.09)	$(0.10)	$(0.10)
$0.07	$(0.04)	$(0.05)	$(0.05)
$0.08	$(0.01)	$(0.01)	$(0.02)

- Savings values indicate opportunity if index moves from national average to regional PADD price and increment moves to $0.08
- Contract Increments indicate amount diesel price needs to increase to increase surcharge by $0.01 per mile
- January/ February 2016 PADD average advantage vs. national average price for Southeast, Midwest and Gulf Coast was $0.05, $0.08 and $0.11 per gallon respectively.

Sourcing Approach

A detailed review of the current situation enables dynamic scenario modeling and identification of savings opportunities.

Situation Analysis & Contract Review

- Situation Analysis
  - Spend & supplier footprint analysis
  - Historical pricing by region (e.g. PADD 2, PADD 3, PADD 5)
  - Supplier interviews and research to determine fleet MPG
- Contract Review
  - Volume commitments, exclusivity clauses, penalties
  - Benchmark (e.g. baseline, increments, index, rebates)
  - Payment terms
  - Index (e.g. DOE) and region discount to index

Value Chain Analysis

- Identify current supplier and customer footprint
- Review ordering process
- Review likely fuel footprint
- Identify cost for current and alternate value chain steps

Strategy Development

- Determine fair baseline, increment, and index by supplier
- Develop baseline cost model
  - Monthly volume by location
  - Volume by fuel region
  - Current cost per value chain step
- Develop dynamic savings model

RFQ and/or Negotiations

- Utilize model to determine savings opportunity and target
- Develop RFQ
  - Volume
  - Payment terms
  - Desired index
  - Baseline
  - increments
- Distribute RFQ
- Evaluate responses
- Supplier negotiations
- Define next steps and implementation roadmap
- Monitor impact on other pricing components (e.g. base rates, accessorial fees)

Cost & Capital Freight Experience

Cost & Capital has extensive freight experience

Cost & Capital Experience

- Cost & Capital has extensive face-to-face negotiation experience with the largest freight forwarders in the industry
- On several engagements, Cost & Capital has developed target methodologies and achieved significant savings
- Cost & Capital never applies a one size fits all solution but tailors the approach to each client's needs

Face to Face Negotiations

Expeditors® You'd be surprised how far we'll go for you.

KUEHNE+NAGEL

DHL GLOBAL FORWARDING

PANALPINA on 6 continents

DB SCHENKER

NIPPON EXPRESS

UPS Supply Chain Solutions

CEVA

Selected Reference Case

Cost Reduction

Ocean & Air Freight – Industrial Manufacturing

Origin Documentation Charges	Door to Port (OD to OP) Container Haulage Charges	Door to Port (OD to OP) Container Fix Fees (per container)	Origin Customs Clearance Fee - per shipment	Port to Port Charges (OP to DP)	BAF	Destination Documentation Charges
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$
$	$	$	$	$	Per Rate Card	$

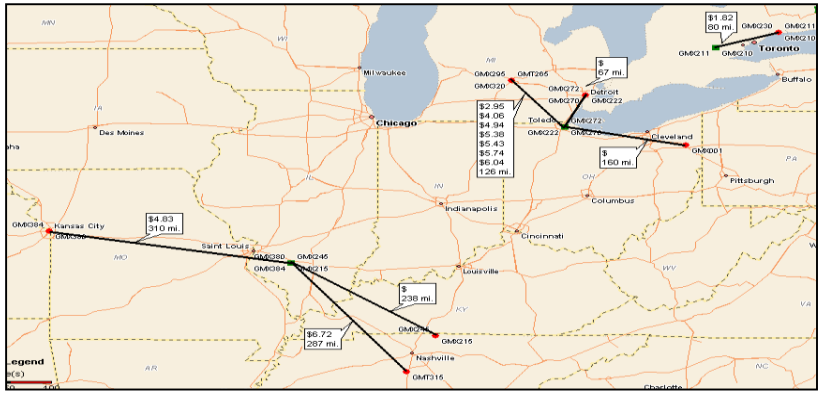
Engagement Overview

- After several acquisitions, the client's ocean & air spend was fragmented and visibility was limited
- The team worked to identify core elements, identified major routes and developed RFP template
- Targets were set based on best-in-class prices, current rates, and quotes to set expectations
- After several RFP rounds and negotiations, the team achieved 25% in savings and reduced the supply base to one primary and one secondary supplier by mode of transportation

Selected Reference Case

Cost Reduction

Truckload Cost Benchmarking – Automotive Components



Engagement Overview

- Inconsistent truckload costs were identified through benchmarking and quote analysis
- The team worked to identify core elements of the truck freight and identified multiple contracts with varying degrees of cost efficiency
- Targets were set based on best-in-class prices to set expectations
- Visibility into the spend resulted in 14% savings on truck freight prices

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