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Realigning Intermodal

BY JOHN GALLAGHER

Hub Group ditches franchise model for 'network' approach to win back business

Trucking's inroads into the intermodal industry are driving changes at the nation's largest intermodal marketing company. Hub Group, the original retailer of intermodal freight, is making a wholesale organizational change to regain market share lost to trucks.

On Feb. 1, the intermodal marketing giant will move from a geography-based operation with separate profit and loss centers spread across the country to an operation based on a single profit and loss center. Sales managers at 18 local offices no longer will be rewarded based on how much freight they can book out of their location but on the amount of business they can bring to the company.

Decision making in four areas — sales, intermodal, highway and logistics — previously carried out at the local level, now will be handled at Hub Group headquarters in Lombard, Ill.

Hub Group says the new strategy will enable it to react to the intermodal market as a single network — a strategy that has created double-digit intermodal growth for over-the-road carriers Schneider National and J.B. Hunt while Hub's growth has remained stagnant.

"Large truckload carriers like Hunt and Schneider have been set up to operate from a network perspective and to maximize lane density for a long time," said Richard M. Rogan, Hub Group's executive vice president for Midwest regional sales. "It's been more difficult for us because of individual geographic interest that multiple profit and loss centers generated. This realignment is designed to remove those barriers and make good pricing decisions."

Hub's reorganization comes at a time when the company has started showing positive financial performance after three years of lackluster profits. Headcount reductions, a new pricing structure, and benefits from a more efficient IT system have raised earnings per share by 75 cents and reduced debt by $27 million during the first nine months of 2003.

"We see Hub in the early stages of a significant turnaround in the non asset-based intermodal marketing business," said Gary Yablon, an analyst with Credit Suisse First Boston, which initiated coverage of Hub Group on Dec. 5. "It is both cost and revenue driven and should allow the company to regain a degree of intermodal share lost in the 2000-2002 time frame." That turnaround, however, "has a long way to go," he said.

CSFB gave Hub an outperform rating and a 12-month target price of $30 per share. Hub Group's stock price jumped over 10 percent after CSFB initiated coverage. As of Dec. 10 the company was trading at $22 a share.

Hub Group, which will generate about $1.4 billion in revenue this year, says that a single-network sales approach — versus one that rewards each location as a stand-alone profit center — can lead to decisions that better manage and improve volume and density across the company's system.

"If you can price business to attract customers to use more than a single leg of your network, you can improve volume and density dramatically," said Rogan.

"The daily cost for having a container in the network is about $12 to $15 a day for us," said Hub Group CEO David P. Yeager. "If we figure out how to turn the equipment in one day rather than two, we can save on the delivered cost, which we can then pass down to our customers."

Schneider National is not surprised that Hub is realigning to better compete for intermodal business. "We feel the traditional model that the majority of IMCs operate in is obsolete and has a relatively short shelf life," said Schneider National's Bryan Bowers, vice president and general manager of intermodal services. "Customer expectations today require network solutions for intermodal capacity, and we use the same tools to manage the intermodal fleet as we do the highway, so when demand is projected in a given region we can proactively relocate capacity to meet that need," he said.

There have been several barriers to Hub Group's growth over the last several years. The company took a hit along with the rest of the intermodal industry when rail mergers caused nationwide service declines five years ago. But Hub had internal issues as well.

In 1998 it borrowed $100 million to begin buying out minority interests in its original "franchise" system of 30 hubs. Three years ago, as the railroads were easing out of their service declines, Hub invested $50 million in an information technology system designed to link the company's local officers to reduce network inefficiencies that only recently began showing results.

In January 2001 the Securities and Exchange Commission cited the company for accounting violations that resulted in a $10.5 million restatement of earnings due

to inflated financial results between 1999-2001. Throughout it all, the company continued to lose market share.

"We took our eye off the ball," said Yeager. "But with the current structure, which changes the responsibilities of the top executives, we're prepared to grow. The beauty of the change is that the vast majority of the company will be doing what they did before."

Only 15 percent of Hub Group's 1,250 employees will see their responsibilities change in the reorganization. Relationships between field sales managers and their customers will not change.

Besides arming its sales force with incentives to make pricing decisions that will help convert freight from the roads to the rails, Hub Group says its new network approach to securing freight will allow it to address equipment imbalances in traditional intermodal lanes.

"Historically, demand for equipment was greater moving westbound than eastbound, and railroad pricing has reflected that," Yeager said. "The balance has shifted in the last few years and, although the railroads' pricing has kept up a little, it has not yet reflected the magnitude of the demand shift."

To counter that, Yeager said, IMCs have to be more aggressive on their end in pricing equipment moving westbound to better reflect market demands.

Intermodal marketing consultant Rick Grandish says that it's important for IMCs like Hub to operate on a national, network-based level. "It's about ease of doing business," Grandish said. "If an IMC can make a contract with a major customer that guarantees service and equipment, you've eased that customer's daily workload and made their logistics that much more efficient."

But smaller IMCs don't feel threatened by competition heating up between the larger IMCs.

"The larger ones don't bother with smaller shippers," said Chet Biernat, president of Incon Container USA, based in West Palm Beach, Fla. "They either can't find the smaller shippers or they're not interested. A lot of times the J.B. Hunts and the larger IMCs don't stay with the smaller client when they convert from road to rail. We work to convert that customer and then keep him on the rails." ●