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Rating Methods by Sector

Land Transportation

1. Business base

With progress in deregulation, competition is increasingly intense in the land transportation industry (which in this report excludes railway transportation). As a result, attracting and retaining business with superior customers have become prerequisites for survival. Meanwhile, the demands of customers for more efficient logistics have also been increasing, and the ability to make high-quality proposals and reduce costs are essential for ensuring profit. JCR focuses on the customer bases of land transportation companies and their ability to meet the needs of customers.

(1) Characteristics of the industry

(i) Market overview

Land transportation is basically a domestic demand-oriented industry and is often linked to domestic business conditions. At the level of individual companies, meanwhile, some companies have the attributes of customers themselves, and some are dependent on major customers. As the first step in rating, therefore, JCR learns the characteristics of the industry to which major customers belong and follows the trends of that industry together with macroeconomic developments.

The industry was once heavily regulated for the purpose of adjusting supply and demand. Since the enactment of the two logistics laws of 1990 (the Trucking Business Law and Freight Forwarding Business Law), however, the industry has been increasingly deregulated in operational terms. Changes have also been evident in the needs of customers. For special loading motor truck transportation operators (“special loading operators”), companies who can stably offer high transportation quality, in addition to reasonable fee structure, are increasingly preferred. As part of efforts for customers’ logistics efficiency improvement, needs for third-party logistics (“3PL”), which handles comprehensive logistics operations for customers, are also robust. For companies offering 3PL operations as their main business, high-level operation knowhow for yard operation, among others, and advantages in systems including inventory management would be important. The market for door-to-door delivery operators has been expanding, but as with special loading operators, high transportation quality should be maintained.

(ii) Competitive situation

Currently, the number of operators exceeds 60,000, many of which are small and medium enterprises with 10 trucks or less. For this reason, direct competition with each of large operators with a nation-wide logistics network subject to the rating is limited.

For the above-mentioned 3PL, operators tend to maintain stable long-term business relations with specific customers, creating a relatively high entry barrier. That said, some customers replace operators if their cost competitiveness or service structure look unfavorable compared with others. JCR therefore focuses on acquisition of new customers and entry of other companies to existing customers' business.

(iii) Cost structure

Major costs and expenses include personnel expenses, the cost of hiring trucks, and fuel expenses, of which the latter two are variable costs.

For personnel expenses, balancing them with acquisition of drivers is a challenge. All large companies are faced with the aging of drivers and difficulty in recruiting young replacements. Since ensuring an appropriate number of quality drivers naturally entails decent costs, progress in shifting increases in the costs to customers, in addition to improvement in operation efficiency, is the key. The cost of hiring trucks increasingly has the nature of a fixed cost as peak transportation capacity must be maintained even during the off-season with excess capacity. Fuel expenses squeeze profits when fuel prices surge. A pass-through to transportation charges through, for instance, a surcharge system, would be favorable, but this can be difficult depending on customer relations and competition. JCR constantly updates actual responses and effectiveness.

Some companies invest in facilities such as a logistics center in order to develop logistics networks or serve specific customer needs. JCR continuously and over the medium term observes whether the investment generates results initially expected and whether the investment is likely to be recovered without problem.

(2) Important factors in market position and competitiveness

(i) Market position

Each of large special loading operators has a nation-wide logistics network to maintain and improve its high transportation quality. There are roughly two types of operators: those who own their own logistics networks and those who cover most of the networks via operation partnerships. They overall seem to maintain a certain level of transportation quality. They are thus ensuring strong competitive advantage over small and medium operators, in JCR's view.

The door-to-door delivery market is dominated by three large companies. Taking into account brand loyalty as well, market shares are almost considered to be the companies' competitiveness. The trend in market shares is thus one of the most important indicators to monitor.

(ii) Customer base

Many land transportation companies maintain stable ties with major customers, which in turn provide the core of their earnings. JCR checks the leading customers and the status of business with them, their contribution to earnings, and other factors. JCR focuses on their customer portfolios, including, more specifically, industry structure, geographical composition, diversification, and other factors. Based on these, JCR identifies trends in earnings and the pattern of fluctuations of the companies being rated.

The acquisition of new customers and the status of dealings with existing owners are also important. JCR also takes the profitability of these activities into consideration. For existing customers, in particular, JCR focuses on measures for unprofitable customers (including negotiations to increase prices) and the results.

Meeting the needs of customers is essential to expanding and maintaining the customer base of land transportation companies, and this becomes a key factor in competitiveness.

(iii) Transportation quality

Transportation quality primarily serves the needs of customers, including punctuality, cargo security, flexible responses to the nature and amount of goods, and other factors. Believing that maintaining of high transportation quality would promise a competitive edge over industry peers and a benefit in fee revisions, large companies should have reasonable abilities through their experience and through development of systems. Whether they can maintain their abilities amid a trend towards more diversified and complex needs among customers, such as overseas expansion, becomes a challenge over the medium term.

(iv) Infrastructure

The infrastructure of each company is directly linked to its competitiveness. Infrastructure broadly consists of a logistics network (a logistics base and transportation and delivery routes) and an information system. The acquisition of drivers noted above is also included in infrastructure in the broad sense.

The logistics network requires comprehensiveness and efficiency, namely the optimization of the number of bases. Not all infrastructure needs to be funded by the company itself; cooperation with other companies in the same industry operating in different districts is effective in some cases.

The information system enables and develops transportation expertise to balance transportation quality, as noted, and provides efficiency and knowledge of the efficient operation of logistics facilities. This is essential also in 3PL, in which competition involving players from other industries is intensifying.

More than ever, land transportation companies are faced with the need to strengthen systems that support high transportation quality and improvement in customers’ logistics efficiency. The importance of infrastructure is therefore growing. JCR pays attention to how each company effectively uses infrastructure to deal with the seemingly contradictory needs of customers for more efficient logistics cost and the dispersion of logistics centers.

(v) Cost competitiveness

On top of improvement in operation efficiency, shifting increases in costs to customers through improvement in transportation quality is the key. Reduction in personnel expenses and the cost of hiring trucks is difficult, and efforts to work to absorb cost increases by raising operation efficiency are important. Observing enhancement in collaboration with peers such as joint delivery and joint operation in trunk transport, JCR confirms results of the effort.

2. Financial base

(1) Earnings strength

As noted, JCR emphasizes net sales is as an indicator of the strength of customer bases.

Profit, also as noted earlier, tends to be under pressure from both revenue and costs. JCR focuses on future durability and cost cutting. If earnings power is lower, JCR checks the cause, revenue level, and the likelihood of a future recovery. Conversely, companies enjoying stable or increasing profit under such business environment are analyzed in detail to determine the causes.

Key financial indicators:

- ■ Net sales
- ■ Operating income
- ■ Operating margin

(2) Cash flow

Responding to the needs of customers, in some cases, requires the construction of an exclusive logistics center. M&A also takes place for the expansion of business areas and the development of surrounding businesses. These strategic activities are supported by cash flow, and JCR monitors the level and trends of these activities in each company.

Key financial indicators:

- ■ Cash flow from operating activities
- ■ Free cash flow
- ■ EBITDA
- ■ Ratio of interest-bearing debt to EBITDA

(3) Safety

Meeting the needs of customers sometimes creates a financial burden, resulting in a considerable impact on a company’s financial structure. Although business volatility is not necessarily high, there is increasingly severe competition for a limited market with new entrants from other industries, which suggests a need of substantial financial durability. Land transportation companies overall maintain favorable financial structure. If their spending on logistics center construction and system investments are growing, JCR would pay attention to the level and trends of their financial structure, in addition to their policies on financial discipline.

Key financial indicators:

- Interest-bearing debt
- Shareholders' equity
- Debt equity ratio
- Equity ratio

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