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COVID-19 RESPONSE

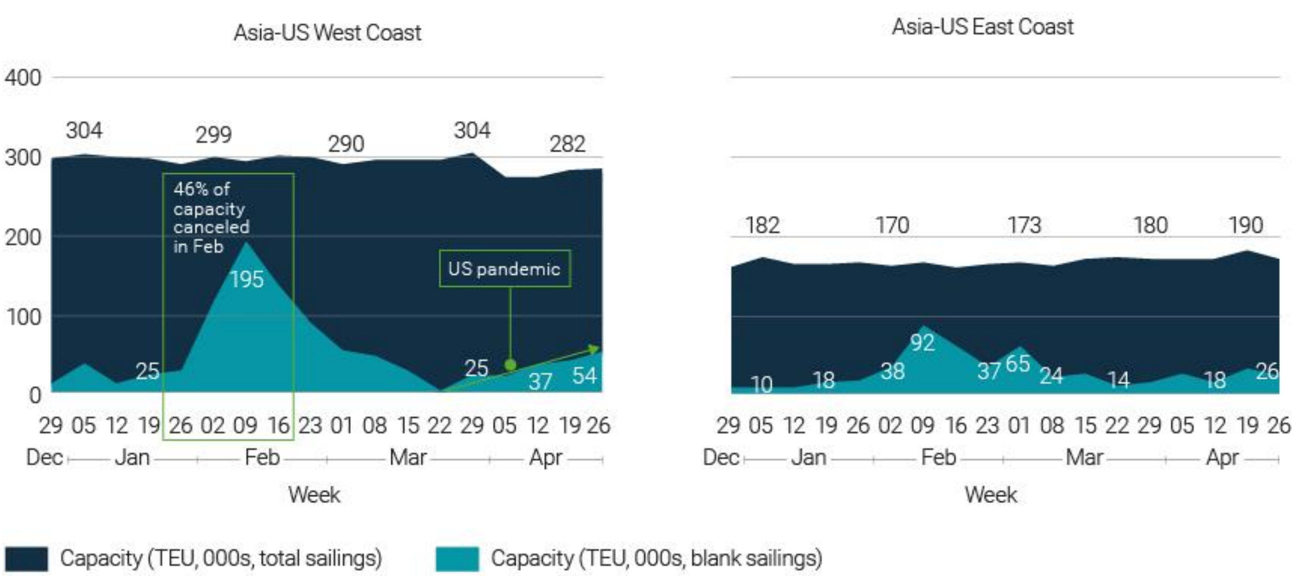
AlixPartners insights and advice: Intermodal Shipping Operations

June 2020

The COVID-19 crisis has sent US GDP into steep decline, and container volumes have plunged in turn amid a surge in retail purchase order cancellations and blank sailings. Prominent analysts have revised their 2020 GDP forecasts substantially downward to negative 5 to 6% annual GDP growth, with many economists predicting an even deeper decline. A recession is clearly under way, but there is considerable uncertainty about its depth and duration.

Facing what could be a deep and long-lasting downturn, it is imperative that terminal operators, drayage companies, intermodal players, and other components of the container-shipping ecosystem focus on protecting margin and cash flow. Companies can position themselves for short-term survival and long-term success by focusing their resources and management attention on core activities, effectively managing fixed costs, and taking other mitigating actions.

FIGURE 1: YEAR TO DATE: APRIL 2020 SAILING CAPACITY CANCELED FROM ASIA TO US (TEUs 000s)



Source: Alphaliner

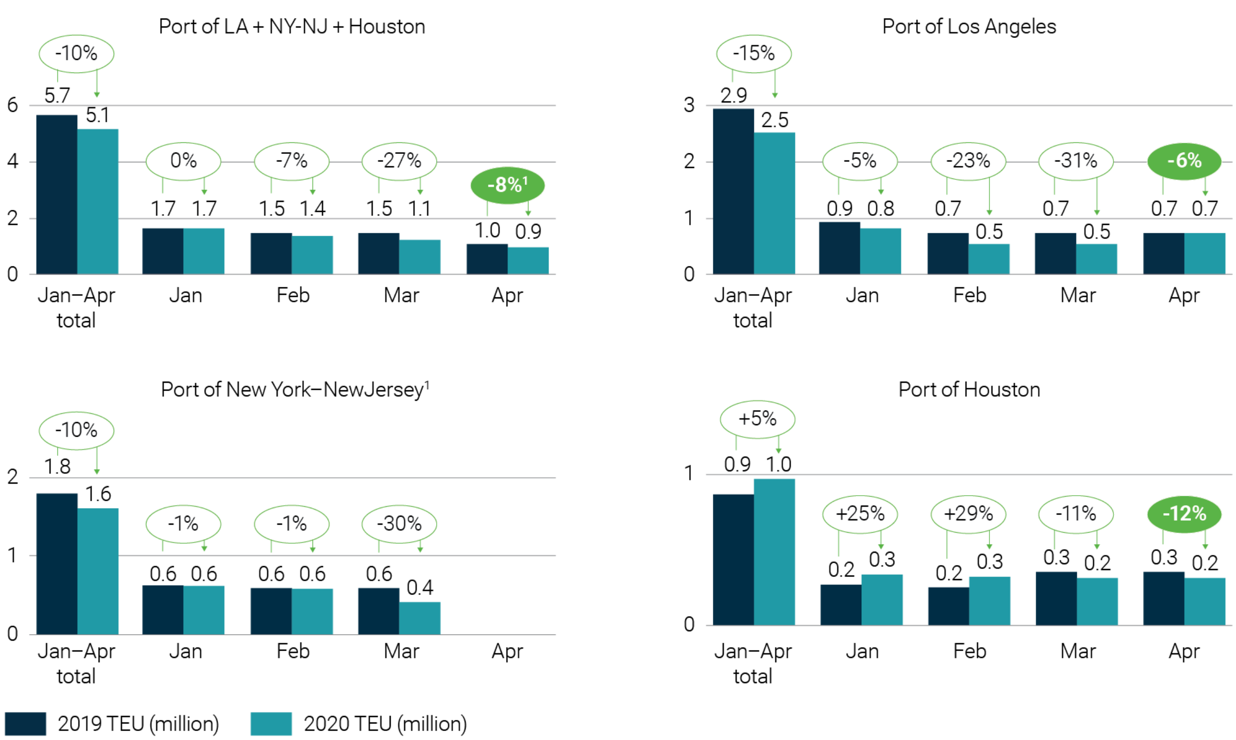
Situation

Because terminal operators and other container port players have high fixed costs, sticky variable costs, and complex relationships with port authorities and labor unions, those entities often struggle to adapt to sudden changes in volume. For example, when volume declines even, say, a relatively modest 5%, EBITDA can plunge 20 to 30% or more. And the struggle doesn't end when volume recovers: strong volume spikes can strain capacity and degrade productivity.

Firm control of both fixed and variable costs is the key to surviving a downturn and to preparing for eventual economic recovery. Variable costs, including direct labor and operating expenses, are especially challenging because there can be a lag between volume declines and declines in head count and equipment costs. Container-shipping players must force the pace by continually evaluating and optimizing labor and equipment productivity and adjusting staffing and usage levels as needed.

Fixed costs, including SG&A and facilities expenses, are spread across both core and noncore activities. The COVID-19 crisis gives terminal operators and others in the container port ecosystem the opportunity to simplify their SG&A functions and scale back non-personnel SG&A costs.

FIGURE 2: JANUARY TO APRIL CONTAINER VOLUME: TOTAL TEUs (IMPORT AND EXPORT, INCLUDING EMPTY)



1. NY-NJ data for April 2020 not yet available
Source: Port websites

Advice

Market dynamics are apt to change quickly in response to the progress of the pandemic, the amount of economic stimulus, the nature of the stimulus's recipients, and shifting trade policies. Container port players should plan for multiple macroeconomic scenarios and should pay particular attention to each scenario's impact on EBITDA.

1. Manage for cash

In addition to modeling your cash position under multiple macroeconomic scenarios, project your cash balances through early 2021. Prepare weekly cash forecasts for the next three months. To conserve cash, consider selectively deferring maintenance of capital equipment and postponing some capital projects as well as deliveries of capital equipment. Work with vendors to ease payment terms, watch receivables like a hawk, and review contracts for opportunities to levy appropriate surcharges and collect accessorial fees.

Analyze your procurement spend to identify opportunities to realize savings from vendors and manage demand that ensures you buy only what you need. Determine the services customers will need in the new environment, and charge for them accordingly. For example, terminal operators should make sure that storage-charges fees effectively reflect a potential rise in dwell times.

2. Rigorously control costs

Companies can't count on the natural reduction in variable costs that follows reduced volume to deliver the savings they need. Operators must scrutinize expense, with particular focus on fixed costs and variable costs that in fact may be only semivariable. Now is the time to identify and implement efficiency improvements in yard, gate, and crane operations. It's also advisable to model labor productivity scenarios at multiple levels of volume and to identify levers that would scale operations up and down with minimal friction and productivity loss.

The back office, too, can benefit from management attention. Analyze SG&A functions with an eye toward simplifying them sustainably and settling them on a lower cost base going forward. At the same time, seek ways to trim non-personnel SG&A expenses, such as aggressively managing marketing- and sales-related costs to make sure that such expenditures get effectively deployed to capture revenue opportunities.

3. Seek new revenue opportunities

The sharp decline in port traffic presents operators and other players in the port ecosystem with an opportunity to redeploy personnel toward service-related activities. Players that anticipate customer needs and tailor and deliver services to fulfil them will both retain more customers through the downturn and draw in new customers as conditions ease.

Our people

We deploy teams of highly experienced and qualified experts with profound situational and operational insight to support our clients in times of crisis.

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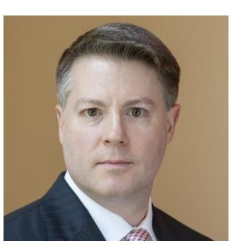

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