

# Intermodal logistics



*Hub Group's Phillip Yeager tells why assets should be controlled, not owned.*

BY ROBERT MOTTLEY

**H**ub Group Inc., a non-asset-based freight transportation management company that provides intermodal, truckload brokerage, logistics and distribution services, is having a very good year:

- The company has just paid off \$50 million of its debt after a successful stock sale.
- Second-quarter 2004 earnings vindicate a new business model.

- Hub exclusively controls 7,250 rail containers without the hassle of owning them.
- The industry in which Hub is a dominant player is thriving again in an ever-fractious market.

Yet Phillip C. Yeager, Hub Group's chairman and an intermodal marketing pioneer, noted in an interview that his company can take nothing for granted.

"Railroads tried over the years to eliminate shipper agents. However, today the railroads realize they need us more than ever before," said Yeager, who will be 77 this November.

In Yeager's view, the railroads' opposition dates to 1959, "when they tried to sell their



By the 1970s, the shipper agent process had become part of physical distribution, as logistics was called then.

**Assessing Prospects.** Yeager was born in Bellevue, Ky. He graduated from the University of Cincinnati, where he was on a football-basketball scholarship until “I found out that I wasn’t big enough to play football,” he recalled.

After college, he worked as a warehouse manager with the Pure Carbonic Co. in Cincinnati, and then for the Penn Central Railroad.

“We called intermodal ‘piggyback’ at that time and learned the process from the railroad’s side,” Yeager said. Piggybacking referred to putting truck trailers on rail flatcars, so the trailers would ride or actually ‘piggyback’ on the rail vehicle.

“I dealt with shipper agents while I was with Penn Central. I got to know a little about the business. I liked it — it was very entrepreneurial and had considerable flexibility,” he explained.

At that time, freight forwarders and truck lines were regulated, but shipper agents had a freer hand. “We had no regulation, which gave us the ability to be flexible and actually sell the railroad product to shippers,” he said.

In 1971, Yeager, then 43, was anxious to start his own shipper agency. “I had an idea that I thought would work, if I could survive a startup,” he said.

**Chicago Base.** Yeager and his wife, Joyce, moved from New York to Chicago “because we thought that city would work best as a center for our business,” he explained. The next year, they formed a company called Hub City Terminals Inc., with \$10,000.

“Fortunately, we had cash flow almost immediately from our early customers,” Yeager noted.

“At that time, there were only about 40 shipper agents in the entire country,” he said. “I had a number of contacts with railroads, individuals who liked me personally. That helped in developing our initial shipper business.”

Asked why shippers would avail themselves of the nascent Hub company, Yeager said, “the advantage I sold was really my 12 years of experience from having worked with a railroad.”

“We first had to convince shippers to use us. When they did, they gave us an order for a shipment, including its origin, the trucking firm needed to get the trailer and go to the railroad, and the railroad that was to move it. The shipper would also provide services at destination. We did the paperwork and the follow-through.

“We had no assets of our own, and that remains so to this day,” he said.

“There was still a lot of hostility between

railroads and shipper agents. The railroads were very uncooperative. I don’t want to brag about it but, with hindsight, I was certainly one of the people who first brought them together,” Yeager explained.

**Franchise Model.** The company the Yeagers had started found its feet with an unusual business model. “We decided to create a series of ‘Sub-S’ companies, named after a section of the tax code that made franchises an attractive way of starting a business,” he said.

“We had a young man with us in Chicago, and he and his wife went to Detroit to start our second office.

“We built the organization by opening offices we called ‘hubs’ around the country. Those people who ran the hubs invested and bought 25 percent of the stock. They had the title of ‘president’ within the sphere of their franchises,” Yeager said.

After Detroit came Milwaukee, New Haven, and Pittsburgh. “The network between those hubs was one of the strongest points for our company. Our competitors didn’t have it then and they don’t now,” he explained.

Other Hub ‘hubs’ followed, in Boston; Stamford, Conn.; Rochester, N.Y.; Philadelphia; Baltimore; Cleveland; Toledo, Ohio; Indianapolis; Kansas City, Kan.; St. Louis; Minneapolis; Atlanta; Memphis; Birmingham, Ala.; Jacksonville, Fla.; Dallas; Houston; San Antonio; New Orleans; Salt Lake City; Seattle; Portland, Ore.; Oakland, Calif.; and Los Angeles.

Today, Hub Group’s headquarters is in Downers Grove, Ill., a suburb of Chicago.

**Marital Teams.** One common thread ran through Hub Group. Husband-and-wife teams ran 15 of the company’s first 20 hubs, reflecting the Yeagers’ own business relationship.

Joyce Yeager remained vice president of the Hub Group until her death in 1992. “Joyce was cofounder of the company, and a tremendous asset. She had been a legal secretary, and was very detail-focused,” Yeager said. “We worked as equals, although she thought she was in charge.”

Through their long run, the Yeagers have valued loyalty. Tom Hardin, president of Hub Group, was their first employee.

Asked how Yeager and his wife picked their franchise presidents, Yeager said, “you sensed things early on about a person, if you wanted them in that role.

“Our confidence, by and large, was rewarded. We did have to send a couple of people to jail. That was sad, because you don’t expect anyone to abuse the authority you’ve given them,” he said.

“The original concept for our company was to bring in experienced people, all chiefs, no Indians. Everybody had to be able make

own services and couldn’t do it,” he said.

The railroads had put in very attractive ramp-to-ramp rates in an effort to stimulate intermodal shipments, “yet they didn’t know how to sell intermodal as a concept,” he said.

“They tried to compete with truck lines with the same service, supposedly, and rates, but people wouldn’t buy it.

“The railroads needed another party, a shipper agent-type — today, we’re called intermodal marketing companies — to make all of the arrangements on drayage, equipment — everything, he said. “That, at least, was the reasoning behind the origin of our industry.”

decisions,” Yeager said. “If you give your principal people that kind of responsibility, then you have to give them authority, too.”

“I knew most of our original owners or principals in each of the hubs. I frequently visited all of them,” he continued. “Each principal had a different level of intensity. If they lived, ate and breathed the company, they were successful.”

“We never had anyone who actually goofed around, but we had to make changes in several hubs and bring in new principals.”

“We actually had six of our hubs started by people who were 26 years old or younger. To own 25 percent of a company at that age was unheard of in the 1970s and 1980s,” he added. “That was a major incentive for our principals.”

The Yeagers brought all of their principals from the company’s hubs, both husbands and wives, together for an annual dinner. “We’d have a three-day meeting in Florida that was as much a celebration as a business gathering. It wasn’t just for the guys, but for the women, too,” Yeager said. “It was very helpful that the wives were so involved. They were vice presidents, and worked as hard as their husbands.”

**Sons And Daughter.** In the Yeagers’ own family, the company’s nature did not pass unremarked. Their sons, David and Mark, and their daughter, Deborah, had a constant earful of Hub lore.

Around the family table, “we discussed how the various hubs were doing. Why was one functioning better than another? Did we have the right people in place? If so, did we need to spend more time with them? Our children heard everything,” Yeager said.

“Mark was only 6 when we started the company and moved to Chicago,” he recalled. “Mark would come in and clean desks, and carry out the garbage on weekends. That’s how we worked him into the business.”

“All Mark heard at home was ‘Hub, Hub, Hub.’ Finally, he said one day, ‘why do we always have to talk about Hub?’ I said, ‘Some-day, Mark you will understand.’ When he was 16, he worked all of one summer for us. Before going back to school, he told his mother and me, ‘Now, I know why. My friends are telling me to stop talking about Hub.’”

“Mark’s brother, David, always said that he would never work for me because I was too mean,” Yeager recalled. “However, David changed his mind after college, and later opened two hubs for us.”

Joyce Yeager persuaded Mark to join the Hub Group after he had worked as a lawyer in Chicago for three years. “We needed an attorney, and he came over to us,” Phillip Yeager said.

Deborah, Yeager’s daughter, was vice

president of the Hub office in St Louis until she and her husband started a family.

Today, David P. Yeager, 51, is vice chairman and chief executive officer of Hub Group. Mark A. Yeager, 40, is president, field operations, as well as chief operating officer.

Neither David nor Mark has ever worked directly under Phillip. “They’ve had to make their own way,” their father said.

“In our company, the person who hires you will be the person who fires you, should it ever be necessary,” he said. “That has been true for my sons as much as for anyone else.”

**Business Expansions.** A basic change in the Hub Group occurred in 1996 “when we became a public company. The reasoning for that was very personal,” Yeager said. “All of our own funds were tied up in the company. Many of our principals were in the same position. Some of them had reached the point in life when they needed a way to retire. They couldn’t sell the company for anything by themselves, so we had to do it as a whole company.”

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Hub’s business model also changed dramatically. “We had been 95 percent intermodal and 5 percent trucking. After we hired Dick Rogan, who brought us trucking expertise, our over-the-road trucking business really took off,” Yeager said.

Another successful venture was Hub’s intermodal boxcar program, which began in 1997 in Hub’s Boston office. By 1999, the program had become a Hub initiative nationally.

Today, Hub’s boxcar program works in this way: The company contracts with warehouse operators to handle transloading from truck to rail car. The vehicles used come from Hub’s network of local truckers, who provide pick up and delivery services. The umbrella over it all is the company’s arrangements and relationships with Union Pacific, CSX-Transportation, and Burlington Northern Santa Fe, among other rail carriers.

That truck-and-rail combination gives Hub’s carload customers access to a rail infrastructure without the need to have a

rail siding. Customers with rail sidings of their own can use the program without any trucks being involved.

**Work For Diageo.** Hub Group’s intermodal program has worked especially well in the wine and beer business, where the conventional wisdom had been that rail service couldn’t guarantee that temperatures wouldn’t fluctuate, and breakage was always a factor.

In Hub’s shipments, cases of wine are palletized and shrink-wrapped, packed so tightly they don’t shift inside a rail car.

Diageo PLC, a shipper of Guinness beer and a Hub customer, has cited only one damaged case per 5,180, a rate so low it’s no longer tracked as a performance indicator. To control temperature, each boxcar has a disposable thermograph.

For Guinness in North America, Hub sources equipment, arranges interline agreements between Class 1 railroads and short lines, and provides training for the proper loading of boxcars. Hub also secures boxcars for shipments between breweries and distribution centers.

A full boxcar can hold 3,600 cases, which means that Hub’s customers can fit up to three and one-half truckloads onto every rail car. Although rail transit times are longer than transit times by truck, customers say that financial returns significantly outweigh additional inventory carrying costs.

“Boxcars are cheaper than over-the-road hauls by 15 to 20 percent,” Yeager said. The longer the haul, the greater the savings.

Railroads are still wary of third parties moving in on their domain, but “we have shown that we can increase the railroads’ sales and market reach,” Yeager said.

**Two Setbacks.** Yeager’s company has had its share of knocks. An opportunity to manage trailers in the United States for Cho Yang, a South Korean ocean carrier, worked well for a while, until “we were hung with a large bankruptcy. Cho Yang stopped its business and tanked us for about \$4.7 million,” Yeager said.

Today, Hub Group repositions trailers for several carefully selected steamship lines.

Another issue occurred in February 2002, when Hub reported to the Securities Exchange Commission (SEC) that it had overstated earnings between 1999 and 2001 by \$3 million to \$4 million, due to accounting errors within Hub Group Distribution Services.

Hub Group dismissed Arthur Anderson as its accountant, and hired Ernst & Young. Overall, the company spent about \$1 million to restore its financial order.

**Bettors Times.** Hub Group reported net income of \$4.1 million for the second

quarter of 2004, compared to \$1.5 million for the second quarter of 2003.

Hub's total second-quarter revenue was \$349 million, a 5.2-percent increase over the \$331.7 million reported for the second quarter of 2003.

"All three main businesses are growing again," said David Yeager. Hub Group's transportation business is divided into intermodal, truckload brokerage and logistics units.

Intermodal revenue for the second quarter increased 5.7 percent to \$242.3 million. Truckload brokerage revenue rose 7.3 percent to \$56.8 million, and logistics revenue increased 17.1 percent to \$39.4 million.

Total transportation-related revenue from all three units was \$338.5 million up 7.2 percent.

Revenue from Hub Group Distribution Services dropped 34 percent to \$10.5 million from \$15.9 million, "due primarily to lower installation business," the company said in a statement.

Hub Group's recent public offering of Class A common stock priced at \$33 a share closed July 2. The company's \$56.1 million in net proceeds from the sale of 1.8 million shares were used to repay \$50 million of debt.

**Strategic Partnering.** Hub Group, which has been active in Mexico for more than 20 years, is partnering with TMM Logistics (TMML), part of GRUPO TMM, a major logistics and transportation company in Latin America. TMML assumes control and responsibility for shipments within Mexico, while Hub Group covers transit in the United States and Canada.

"There are significant equipment shortages in Mexico," Phillip Yeager explained. "We're getting business going southbound to fulfill our equipment needs. We have the system to recruit those shipments to Mexico."

**Market Pressures.** In the fall of 2004, Hub Group's relationship with railroads is analogous to that of a non-vessel-operating common carrier with steamship companies.

"We're now the second-largest mover of U.S. intermodal shipments — UPS is larger," Yeager said.

As an example of the leverage Hub Group has, "we've worked out an agreement with the Burlington Northern Santa Fe and Norfolk Southern in which there are 7,200 53-foot and 48-foot containers that we control completely," Yeager said.

As the containers controlled by Hub Group move about from one regional hub to another, "we monitor them so we know they are going to places where they will be used," he explained.

Asked what effect the pull of goods from

Asia, especially through the ports of Los Angeles and Long Beach, has had on Hub's domestic business, Yeager said, "it definitely has affected the drive to get westbound equipment into that southern California area.

"We direct our sales efforts in order to perform with equipment going to those points.

"We have thousands of rail containers moving in our system each day. The bottom line is that we help the railroads achieve better utilization of their equipment," Yeager said.

"The tremendous current flow of goods through Los Angeles in particular really causes problems," he said. "The Union Pacific is struggling with serious delays due to congestion. The railroads are telling us that the present situation isn't going to improve this year, which is unfortunate.

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"As an ex-railroad man, I have strong feelings for them. I want them to do well. But I represent shippers, and I always will," he said.

"There's no denying that shippers had bad experiences with railroads. We found in 1997 that so many people had bitter feelings toward the railroads that they were doing everything possible not to go back to using them. Some of the big accounts we lost then we've never gotten back," he said.

"Having said that, in fairness I have to say that, in normal times, the railroads give darn good service," he added.

Asked to name the most efficient U.S. railroad, Yeager replied "BNSF." That was not exactly a surprise, given Hub Group's controlled container pool with BNSF.

Yeager acknowledged there's irony in the fact that Hub Group, formed as a Midwest company to move goods out of the Midwest to U.S. West and East coasts, now must adjust to the suction from Asia that is flooding goods into the Midwest.

**Not For Sale.** Looking back over 33 years, Yeager said he was proudest of the fact Hub Group is nearly debt-free and that, among the company's 1,200 employees, "literarily hundreds have 15 to 20 years experience."

He is pleased, too, that certain perceptions have changed in the media, and in trade circles influenced by the media.

During a period of difficulties, "several years ago, one journalist — not from your magazine — said in an article that Hub was for sale," Yeager recalled. "I don't where that reporter obtained his information, but in the six months that followed, we had half a dozen offers. They were all from U.S. sources that wanted to buy us on the cheap because we were going through a rough time."

The story is different today. In much stronger shape, "Hub Group is not for sale," Yeager said. Nor does his company have immediate plans to acquire a 3PL subsidiary, as some rumors have had it.

Yeager is also quietly but unmistakably pleased about a change in his private life.

"After Joyce died of cancer, I had seven years as a bachelor," said Yeager. "That was a lonely time for me, and I'm blessed to be married again." His second wife, Anne, worked for Hub Group but has now retired.

**Tight Margins,** Short Memories. Asked how Hub Group's relations with shippers have changed over the years, Yeager replied, "today, shippers are much savvier. Information technology has sharpened up everyone. In fact, the old guard in the intermodal industry has somewhat reluctantly come to see IT as an actual ally.

"That means more is known about our business, a fact I welcome. There's never been a veil over what we do," he said.

"When the economy slows down, customers look to intermodal because, if nothing else, we're cost-effective. But margins are always tight in this business, and shippers have short memories.

"All of the current screaming about how railroads are raising their rates just isn't justified, if you take the long view," Yeager said.

"Many shippers don't understand that, in 1980, the rates charged by railroads were higher than they are today.

"Shippers must come to understand that if railroads can't make money with their freight, the railroads cannot invest additional hundreds of millions of dollars to expand their capacity," he said.

"We have the best transportation system in the world, and must make sure we maintain that huge economic advantage," Yeager said. ■