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Inside the Numbers
with Lou Smyrlis

Publisher &
editorial director,
Transportation Media

IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

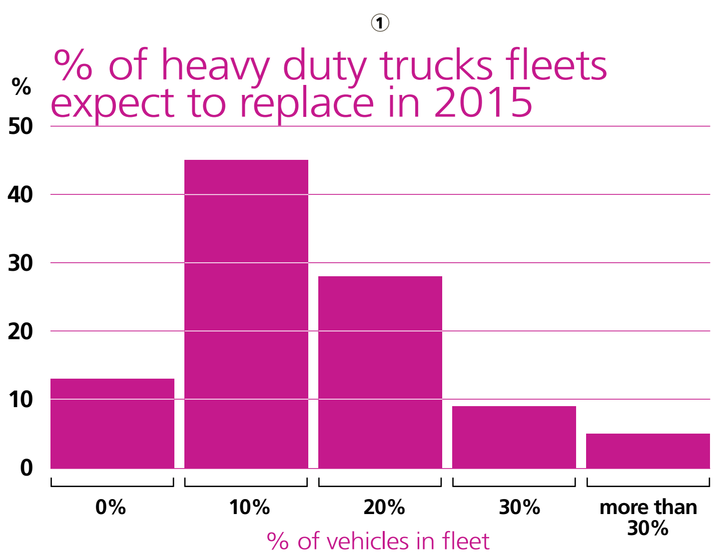
VOLUME 4, ISSUE 3

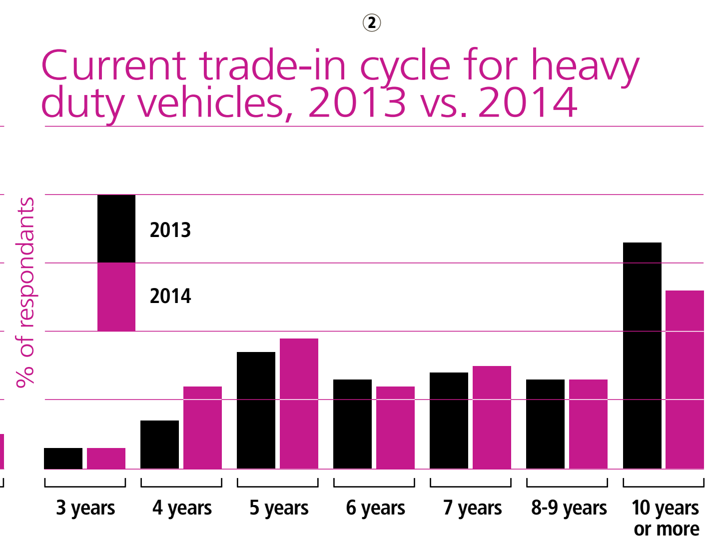
Large shift in thinking

Canada's smaller carriers finally ready to start upgrading their HD fleets

In my last Inside the Numbers newsletter and in my presentations at industry events across the country the last few months, I've been repeating that the market is starting to "feel right" for growth. Freight volumes are holding steady, carrier executives are the most optimistic I've seen them in years and industry suppliers are starting to wear the smiles I remembered from before the Great Recession.

But when it came to the Canadian market there was one thing that was still casting doubt on whether this recovery has finally gained traction: Class 8 truck sales were still not where they should be. In fact, not only were the YTD numbers not as good as they were in 2012 but they were even behind last year's less than stellar figures. How could fleet executives be feeling optimistic about the future and not be adding to their fleet? Heck, never mind enlarging their fleet, why weren't they more diligently working towards replacing their





existing trucks? We were, after all, hanging on to trucks longer than we had in recent memory and those maintenance costs sure start to climb after trucks hit the 500,000 mile mark.

Truth of course was that some fleets – primarily the large ones – were busy at replacing their older vehicles and perhaps even growing their fleet size a tad. It was the smaller fleets who were still not feeling optimistic enough about their future to partake more vigorously in fleet renewal. Our research was showing that almost two thirds of small fleets were on trade-in cycles for their heavy duty vehicles of more than 5 years. More than a third had a trade-in cycle of more than 10 years.

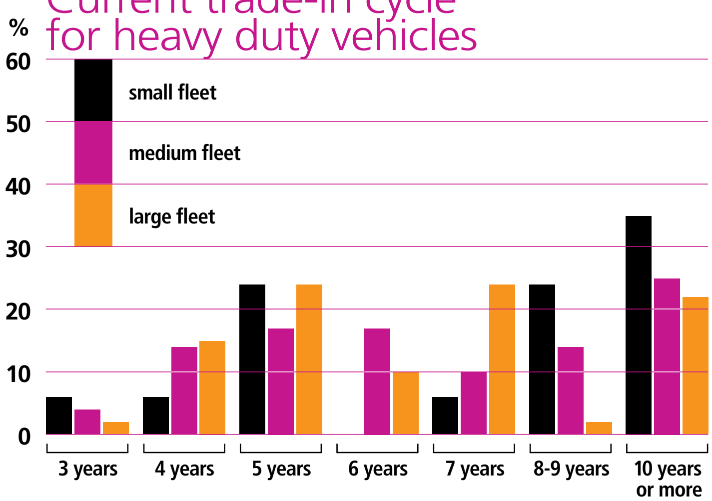
Our latest Equipment Buying Trends Survey (completed this summer) is showing an important and welcomed shift in how Canadian small fleets are approaching equipment renewal. More than half (53%) of small fleets (fewer than 10 trucks) indicated they would be replacing at least 10% of their heavy duty vehicles this year while 78% indicated plans to do likewise in 2015.

Those heavy duty truck replacement plans from Canada's small fleets may still pale in comparison to the truck replacement plans of the country 's largest fleets, 95% of which plan on replacing at least 10% of their vehicles next year, but it's the best we've seen from the small fleet sector since before the Great Recession.

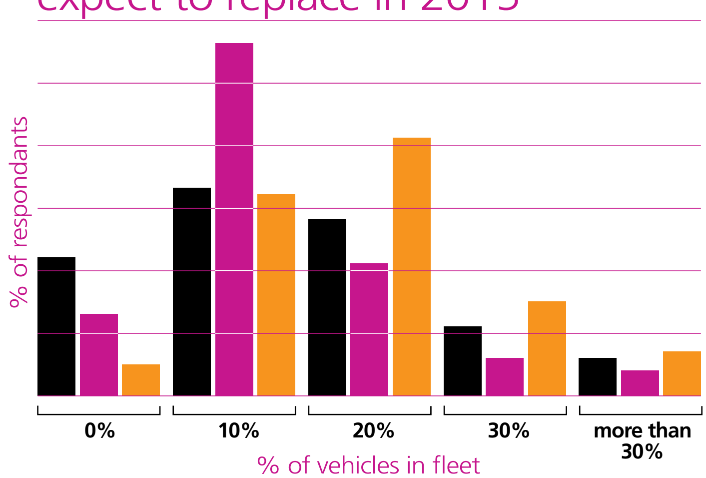
Overall Class 8 truck sales, as mentioned, were trailing behind last year's totals up to May. Then June's figures (the latest available from the Canadian Motor Vehicle Manufacturers Association) came in as fresh and welcomed as a summer breeze. June's totals soared above last year's and June 2014 went down as the fifth best month for Canadian Class 8 truck sales since 1999. (Volvo in particular showed significant improvement to their numbers over the past year while Freightliner, International and Kenworth also surpassed their previous year's numbers.) The June numbers were strong enough to push the YTD numbers past last year's as well and after rather disappointing January and February numbers, Class 8 sales have been growing steadily since March.

While I would like to see at least one more month of sales results, things are starting to "feel right" on this side of the business as well.

Current trade-in cycle for heavy duty vehicles



% of heavy duty trucks fleets expect to replace in 2015



M&A activity heats up in second quarter

Merger and acquisition (M&A) activity in the transportation and logistics industry has been heating up in the second quarter of 2014, with the total volume and value of deals increasing over the first quarter of 2014, as well as the second quarter last year, according to a PwC report.

Still, overall M&A activity in the sector year-to-date remains "subdued"compared to historical standards.

51 transportation and logistics transactions worth $50 million or more took place in the second quarter of 2014, totaling $20 billion, compared to 38 deals worth $16.2 billion in the first quarter of 2014.

Second quarter 2014 M&A activity also increased over the comparable period in 2013, which recorded 39 deals valued at $16.6 million.

Increased activity in the shipping and trucking sectors drove the deals, with an emphasis on addressing overcapacity, fragmentation and sourcing higher margin services.

"Looking ahead, we believe transportation and logistics M&A activity will increasingly focus on higher margin, ancillary operations, including assets that benefit supply chain economics and lead to improved operating efficiencies." said Jonathan Kletzel, US transportation and logistics leader for PwC.

2014 was on pace to be one of the weakest years for cross-border activity over the past decade, PwC reported.

According to Transport Intelligence senior analyst Cathy Roberson, North America has been the focus of nearly $2bn worth of mergers and acquisitions activity over the course of the first week in August.

"Deals like these have the potential to change the nature of the markets in which they take place and to transform the business environment in which companies operate," said the Ti report.

"This apparent uptick in mergers and acquisitions seem to be due to a number of factors including an improving economy, increasing regulations and shortage of drivers within the trucking market, a fragmented logistics market and the growth in specific vertical industry sectors," Roberson said.

Julia Kuzeljevich, Associate editor, Canadian Shipper
A 15-year veteran of our editorial team, Julia's work has garnered Truck Writers of North America Awards and Canadian Business Press writing awards.

The incredible shrinking Canadian freight carrier industry

For many years, industry experts have been predicting a consolidation in the Canadian freight industry. During and after the Great Recession, the decibel level of these warnings increased as most trucking companies faced the challenges of reduced freight volumes, sinking rates and the difficulty of managing a business during recessionary times. In fact, the industry did shrink by an estimated fifteen percent during the downturn, not through acquisition, but through companies closing their doors or parking equipment.

As one looks back over the past five years, the Canadian economy has been recovering, albeit painfully slowly. There has been some growth in GDP and in jobs, largely in the west. During this same period, the Canadian freight industry has been consolidating and continues to consolidate. This has been driven by a host of factors.

There were and still are willing sellers. Many trucking company owners, particularly those in the baby boomer generation, without a succession plan, or with poor prospects for survival, saw the sale of their business as the most logical business option. For some, the challenge of hanging on during the Great Recession, took some of the appeal out of the business. That coupled with the option of creating a retirement fund was a desirable route to follow.

The post-recession business climate brought a host of challenges. Just as trucking company owners are getting older, so are truck drivers. Young men and women are not interested in becoming long haul truck drivers, dealing with crossing the Canada – US border, spending weeks away from their families, for $40,000 to $50,000 per year. The driver shortage, coupled with rising costs of fuel and equipment, low margins, increasing technological sophistication and regulatory changes, have made life much more difficult, particularly for small fleets with limited access to capital.

In addition, there were and still are willing buyers. Some of the larger trucking companies and conglomerates have been active buyers. Take a look at the websites of the large truckers to see the list of companies that have been acquired. The larger fleets have seized the opportunity to increase market share, to enter new markets, and/or to acquire new drivers, equipment and management talent. With TransForce's acquisition of Contrans, we are now seeing a very large conglomerate devour a large conglomerate. What does this all mean for the Canadian freight industry?

The owners of the fleets being acquired are receiving some sort of retirement nest egg depending on the value of their businesses. It is questionable if some of these companies would have survived if they hadn't been acquired. While some people are often released during or after an acquisition, many people were able to retain their jobs within a financially more viable structure. That is certainly a good thing. As we have also seen, companies making acquisitions can mix and match the pieces of the puzzle in creative ways to drive more synergy and value.

Of course, a very high percentage of mergers and acquisitions fail. These can be visible or invisible to the shipping public. If you look back at the list of companies acquired over the past five to ten years, you will find some names that are missing, either because they have been merged with another entity, or they simply failed due to incompatible cultures, the loss of key employees, weak business models, or a host of other reasons. In other words, there are pluses and minuses with all of this merger and acquisition activity. Some acquisitions work, many don't.

What are the implications for shippers? Again, there are positive and negative aspects. The big players have gotten much bigger and stronger. Some performers, strong and weak, have been merged or realigned with stronger players to make them more viable, from both a financial and service perspective. The consequences of these M & A activities vary from segment to segment. While there has been consolidation in the truckload sector, and there will be more, this market is large and very diverse. There are thousands of truckload carriers, ranging from very small fleets to the major players. Even the biggest truckload carriers control a small segment of the market.

However, for the reasons outlined above, it is becoming increasingly difficult for the smaller fleets to survive. In addition to driver and capital issues, there is the matter of economies of scale. It is a challenge for small fleets to meet the capacity needs of large shippers. It is likely that we will continue to see more consolidation. This may result in fewer options and higher rates. To make this business more attractive for entrepreneurs, the regulatory and economic climate may have to change. Whether this will happen is questionable.

The LTL market is quite different. To properly serve this market, viable players must have terminal networks. Less than ten companies control this market in Canada. The same is true in the United States. TransForce's recent acquisition of Clarke Transport, Vitran's Canadian operations and QuikX/QuikTrax, within a very short time, has certainly changed the dynamics of this specific (east-west intermodal) market. It will be interesting to watch if the three western Canada (intermodal) businesses are integrated into one consolidated business.

The point is that for national LTL freight distribution and major regional LTL shipping as well, the number of options is quite limited. If any of the large LTL carriers (e.g. Day & Ross, Manitoulin, TransForce's stable of LTL carriers) were to contemplate a merger with each other, one would have to wonder if this would be a tipping point for Canada's Competition Bureau.

The courier market is similar to the LTL market. To effectively serve this market requires sorting and processing facilities. There are a limited number of national and regional players. Any further consolidation (e.g. the sale of Purolator to another big player) would certainly raise issues of competitive service options in Canada.

Where do we go from here?

We can expect to see more M & A activity in the days ahead. While many players have come out of the market, there are still many left to buy and there continue to be willing sellers. If you look at the sheer number of trucking companies that have been purchased over the past five years, we are witnessing a consolidating industry. As this continues, hopefully market and regulatory forces, if required, will ensure we maintain a competitive trucking industry in Canada.

Dan Goodwill, president of Dan Goodwill and Associates has more than 20 years of experience in the logistics and transportation industries in both Canada and the US. He has held several executive level positions in the industry. He can be reached at dan@dantranscon.com.

Why I'm taking a wait and see approach to the Transforce-Contrans mega deal

BY LOU SMYRLIS

Ever since the end of the Great Recession, industry executives have been talking about the need to consolidate the industry as a way to soak up excess capacity, provide top shippers with the large scale transportation network they desire, and act as protection against downward pressure on rates. For just as long we in the media have been speculating about when that blockbuster deal would happen or if it would.

Well, it just did with the announcement that Canada's largest trucking firm, TransForce, has made a friendly, board-approved takeover bid for Contrans, another of Canada's largest, publicly traded trucking firms, as reported first on our website www.trucknews.com. Until now we had seen markedly smaller deals. Executives from large fleets may have desired growth by acquisition, and there may have been numerous acquisition targets as the Baby Boomers who started many of our industry's small and medium-sized enterprises approached retirement age, but most top company decision makers seemed more comfortable with less risky bolt-on type acquisitions.

The TransForce-Contrans deal is on a much different scale, totaling an equity purchase price of about $495 million. Does it carry within it the seeds for future success? The industry analysts we spoke to think so.

Doug Nix of Corporate Finance Associates, a speaker at our Surface Transportation Summit last year, felt it was a strong strategic fit. Contrans' strategy has been to build a specialty carrier operation, but without looking south to the USA, it would have been hard to grow beyond where they were. So unless Contrans executives Stan (Dunford) and Greg (Rumble) were going to change strategy, selling was the best option, Nix believes.

RBC Capital Markets, in a report issued by analyst Walter Spracklin, also found the deal to be a good one. "In our view, this deal is compelling from a strategic perspective as we consider (Contrans) to be a best-in-class truckload operator with a strong position in niche markets. Accordingly, we believe TFI stands to gain a competitive edge in TL markets across Canada. From an operating point of view, this transaction offers density and scale in the North America truckload market."

Both of our own columnists who comment on such issues, Mike McCarron, who heads Wheels Group's M&A, and Mark Borkowski, president of Mercantile Mergers and Acquisitions, believe Transforce's bid for Contrans is proof a major transportation consolidation is taking place in the North American market and that the deals will get bigger and more numerous. The market has become so competitive that only the big will thrive and survive, they believe.

Personally, I'm going to take a wait and see approach to this one. Contrans, according to every analyst I've spoken with over the years, is indeed a well-managed company. Transforce has built a reputation over the years for choosing relatively well-run companies and letting them do their thing, at least initially. But, as mentioned from the outset, this is a big deal for the Canadian market. There is a great deal of resources that will have to come into play to ensure it's a smooth transition into the new reality for both companies involved. Often mergers of this scale run into difficulties not because they don't make sense on paper but because of cultural differences between the organizations. I still recall my conversation with Yellow Transportation president and CEO James L. Welch as his company was merging with Roadway in the blockbuster deal that hit the industry south of the border about a decade ago.

Welch was quick to point out "the road has been littered with nothing but disasters when companies try to merge" but argued the difference between what Yellow-Roadway were doing and what happened before is that in the past it was usually a healthy company acquiring or merging with an unhealthy company. Their situation was "very different" he assured me, adding "You have two very healthy companies that are very well respected in the marketplace and are doing things to make their companies successful. What we want to try and do is grow both companies."

I remember Welch as a very likeable gentleman. But we all know how that deal worked out.

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INSURANCE TELEMATICS: How they will reshape your insurance policy.

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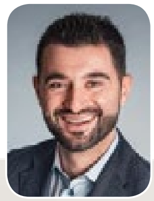
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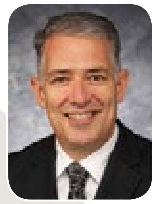
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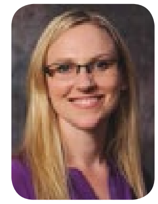
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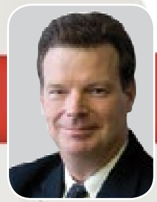
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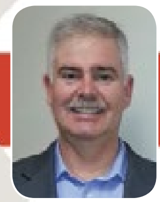
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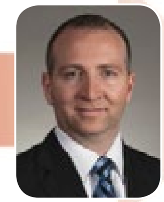
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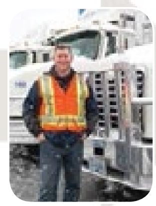
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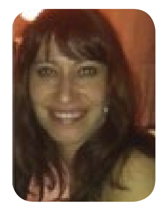
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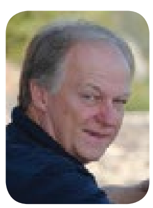
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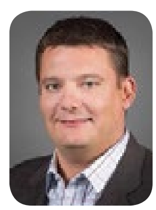
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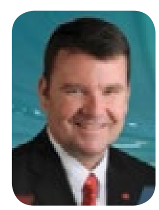
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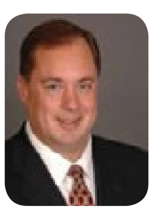
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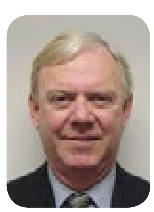
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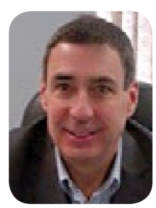
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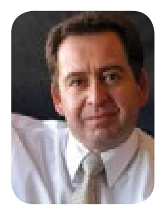
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Hurdles and goals

Executives from Bison Transport and Armour Transportation Systems – both members of the prestigious list of Canada's Best Managed Companies – weigh in on the priorities and challenges ahead.


PRIES


ARMOUR

Jeff Pries, senior vice president, sales & marketing, Bison Transport: Our top priority right now is to capitalize on our investments. Over the past 12 months we made significant investments in a lot of different areas. We grew our staff to ensure that we were properly resourced and that we could provide the best service to our customers. We invested in new tractors and trailers. We grew our fleet by about 100 trucks. And we also invested in terminal facilities across Canada. We have significant terminal facilities in just about every major city in Canada. So we've made some big investments and now is the time to capitalize on them.

The North American economic outlook is solidying but I think that the fundamentals are still the same. The fundamentals that a shipper is looking for are service and capacity at a competitive price. We are seeing from our customers and prospects an interest towards innovative solutions that are sustainable; an interest in not just getting the job done but how the job is getting done. I'm also seeing customers interested in logistics solutions from asset based providers. The Fortune 500 companies are looking for solutions from players who are "in the game", so to speak, and who have the ability to stretch their capacity and have multiple ways to move freight through different modes.

Wes Armour, president and CEO Armour Transportation Systems: Shifting demographics is a challenge I believe many companies are facing today, particularly in Atlantic Canada. With one of the lowest birth rates in the country, coupled with low net immigration, the working age population is declining in our region.

We continue to invest more resources in attracting and retaining our people. One of the major challenges facing carriers continues to be attracting and retaining qualified people in all areas of transportation including technicians, dispatchers, administration, safety personnel and transport operators. While transportation, as you know, is an exciting, dynamic and ever-changing industry to work in, it is also a 24 hour/day, 7 day a week operation.

The hours of operation create major challenges for attracting qualified people, so as a company we are addressing these work-life balance issues by offering for example 4 days on, 4 days off. This is not new to many industries, but to the drivers it is a new concept. The driver works for 4 days reaching his allowable hours each day and then the truck goes to another driver who works for 4 days. This concept allows the drivers to share 4 days off for every 8 days and yet our tractor is working 365 days per year except time off for maintenance. In our industry, it is not normal that a driver would consistently get 4 days off and then work for 4 days and still earn a good wage. We are also doing the same thing with our dispatch, which is a 24 hour, 7 day a week operation. So the issue really isn't all about wages, which are very competitive in this industry, but the working hours themselves.

The driver shortage continues to worsen and there really isn't a "silver bullet" to solve the driver problem. While many carriers have pulled out all of the stops to attract drivers, the reality is that many carriers can barely keep their heads above water, with respect to capacity additions. The average driver age continues to increase and fewer young people have an interest in driving as a career.

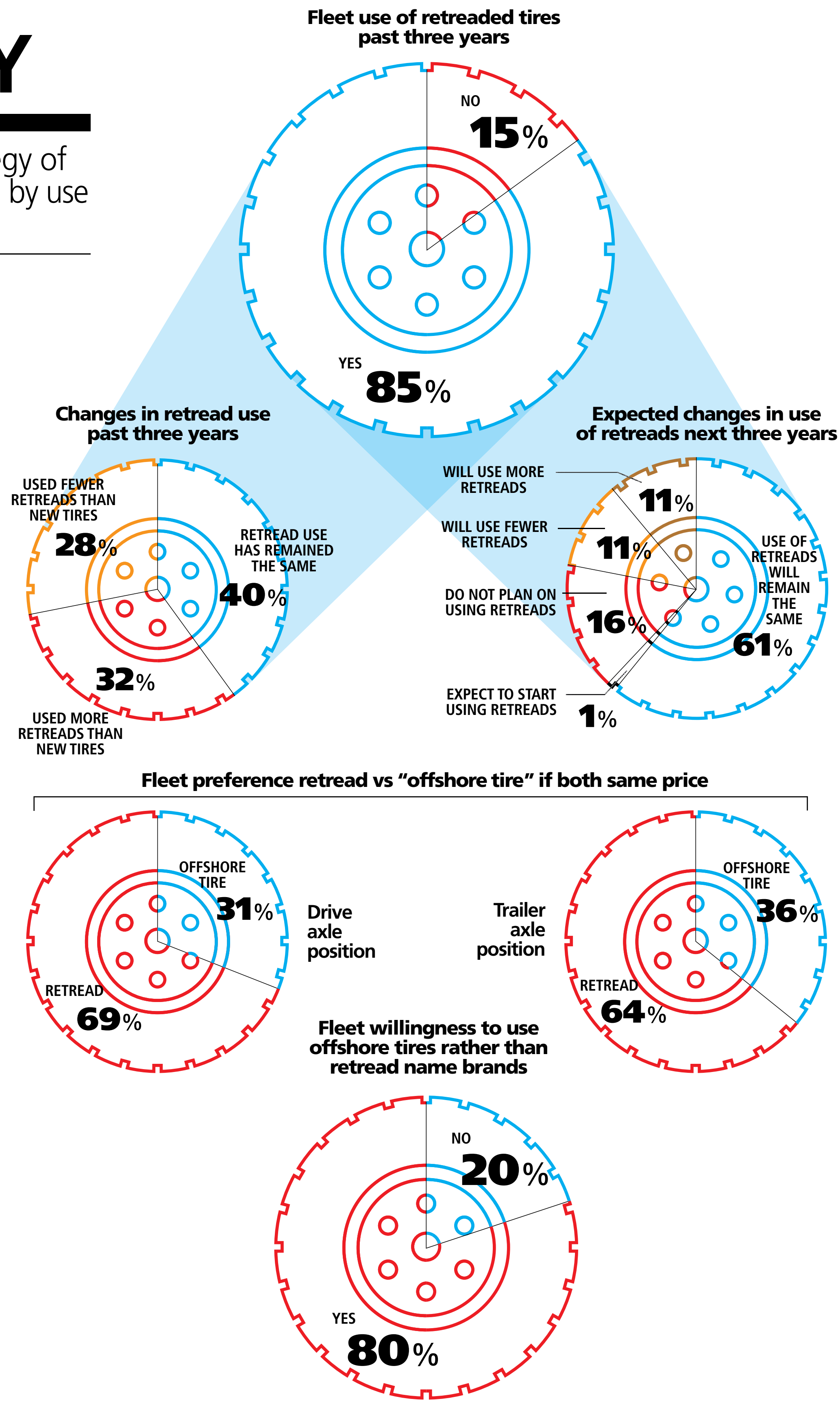
As a result, each and every year, we invest more resources in attracting and retaining people and I see this challenge continuing in the future. We are very pleased to say our turnover rate is significantly less than the industry average.

Shippers must form partnerships with their carrier as we will see a shortage of capacity and a shortage of drivers. Many carriers will not have the ability to keep up with new business growth and will be much more loyal to customers who have treated them fairly over the years and who they have created fair partnerships with, but will be limited to increase their volumes. This is already happening south of the border with truckload carriers and I see this trend happening in Canada in the near future.

LOSING LOYALTY

The time-tested strategy of retreading threatened by use of offshore tire brands

Retreading tire casings is one of the most effective tire management strategies. It is, however, coming under threat from increased use of offshore tire brands, made in countries such as China and India and sold at considerably lower cost albeit with sometimes questionable quality. Transportation Media Research has been tracking this development annually since 2006. While 8 in 10 Canadian fleets responding to our Tire Buying Trends Survey indicate they retread their tires, more than a quarter plan to either use fewer retreads or not use retreads at all in the future. One fifth of carriers report they're willing to purchase offshore tires rather than retread the established name brands. Almost a third say they prefer to use offshore brands versus retreads in the drive axle position while more than a third say the same about the trailer position.

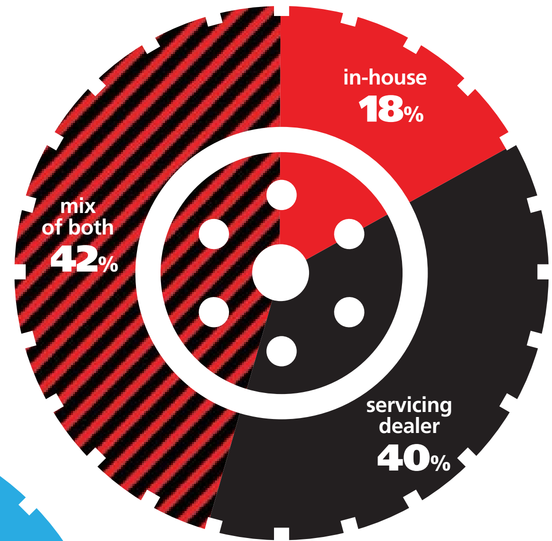


KEEPING IT IN THE HOUSE

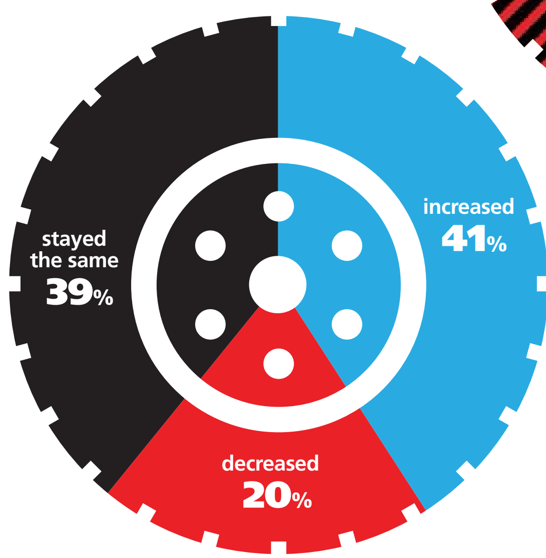
Why more Canadian fleets are choosing to handle their own tire work

The right tire maintenance strategy can provide considerable cost savings and improve vehicle downtime. Transportation Media Research has been tracking the evolution of tire maintenance strategies annually for almost a decade. Our latest research shows that only 18% of fleets handle tire maintenance completely in-house, with the majority choosing to use both in-house facilities and dealer facilities to service their tires. The amount of tire work done in-house, however, has been on the increase and 45% of fleets report having dedicated tire staff. Lower cost and ease of access to vehicles and scheduling are the primary reasons for performing tire work in-house. Pressure checks, rotation and mounting/dismounting of tires are the services most likely to be performed in-house. More complicated procedures, such as wheel assembly balancing and alignment are more likely to be done at the dealer facilities.

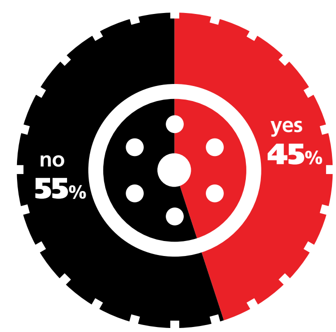
LOCATION TIRE SERVICE IS PERFORMED



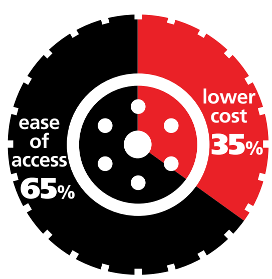
TREND IN AMOUNT OF TIRE WORK PERFORMED IN-HOUSE LAST 5 YEARS



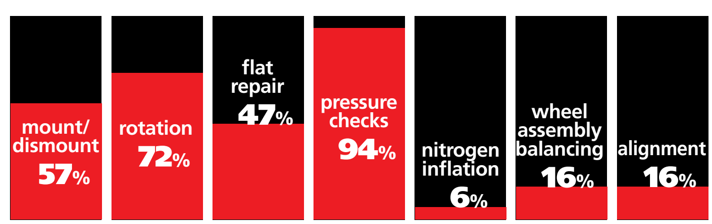
CANADIAN FLEETS WITH DEDICATED TIRE STAFF



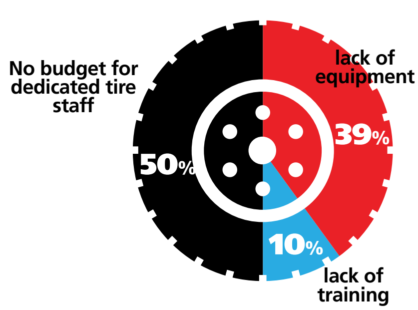
MAIN REASON FOR DOING TIRE WORK IN-HOUSE



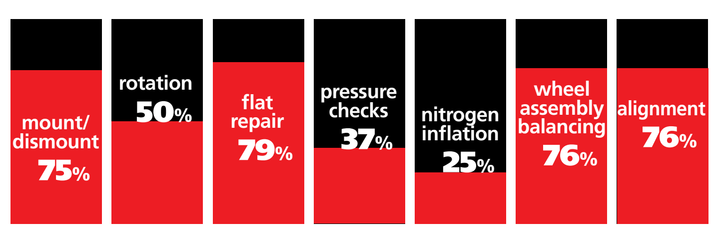
SERVICES PERFORMED IN-HOUSE



MAIN REASON FOR SERVICING DEALER DOING TIRE WORK



SERVICES PROVIDED BY DEALER

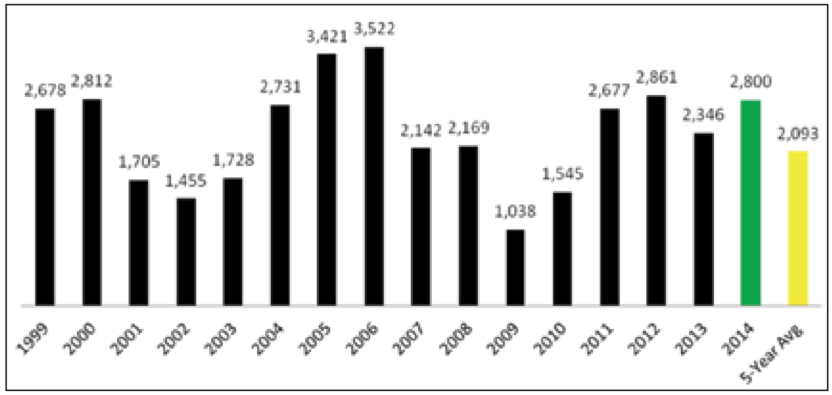


CLASS 8 Truck Sales Trends

Monthly Class 8 Sales – June 14

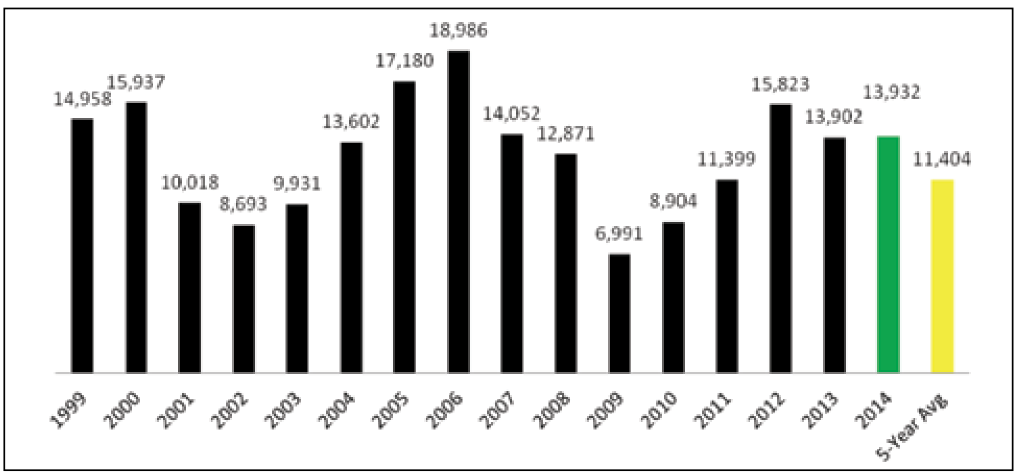
OEM	This Month	Last Year
Freightliner	686	588
International	382	300
Kenworth	407	368
Mack	217	234
Peterbilt	304	337
Volvo	576	277
Western Star	228	242
TOTALS	2800	2346

Historical Comparison – June 14 Sales



June was a breath of fresh air for Canadian Class 8 truck sales. After dipping below the previous year's pace for four straight months, June's sales totals soared above last year's. The month's sales totals were the fifth best June totals dating back to 1999. Volvo in particular showed significant improvement to their numbers over the past year while Freightliner, International and Kenworth also surpassed their previous year's numbers.

Historical Comparison – YTD June 14



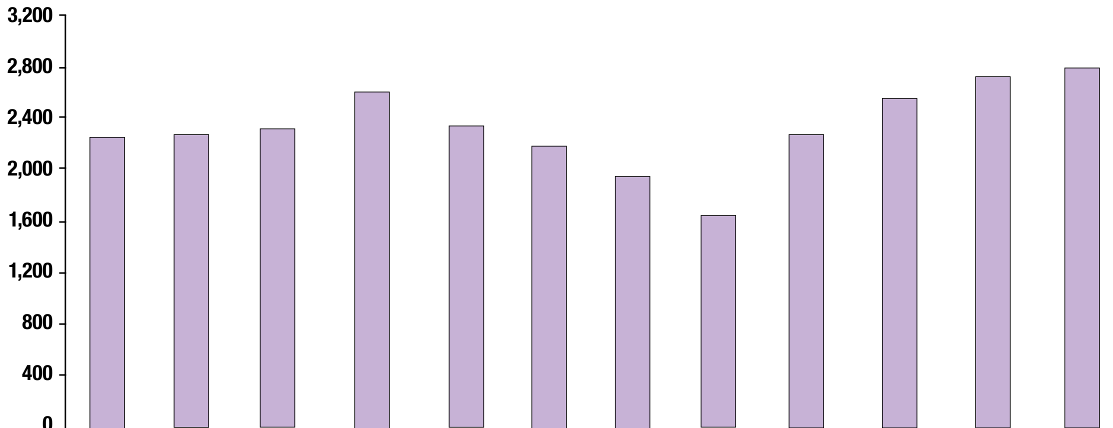
Class 8 Sales (YTD June 14) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	307	505	115	162	1,425	526	147	63	1	21	3,272
Kenworth	303	936	215	1	363	397	42	0	0	0	2,257
Mack	77	193	86	67	583	140	14	23	5	13	1,201
International	72	292	38	74	932	332	78	29	5	21	1,873
Peterbilt	255	687	162	105	360	236	75	11	0	0	1,891
Volvo	276	297	59	171	1,013	331	105	53	0	1	2,306
Western Star	163	422	41	65	190	182	28	34	3	4	1,132
TOTALS	1,453	3,332	716	645	4,866	2,144	489	213	14	60	13,932

The optimism for an improvement in Class 8 truck sales in 2014 after 2013 proved a disappointing year was quickly fading, despite improving fortunes for trucking companies. Then the June sales figures came in, blowing past last year's totals. YTD numbers are still nowhere close to those of 2012, the best year since the recession for Class 8 sales, but they are now ahead of last year's results. With small carriers more willing to purchase new trucks than they have been in years, according to our latest research, and all carriers feeling more optimistic, could the second half of 2014 be a memorable one?

CLASS 8 Truck Sales Trends

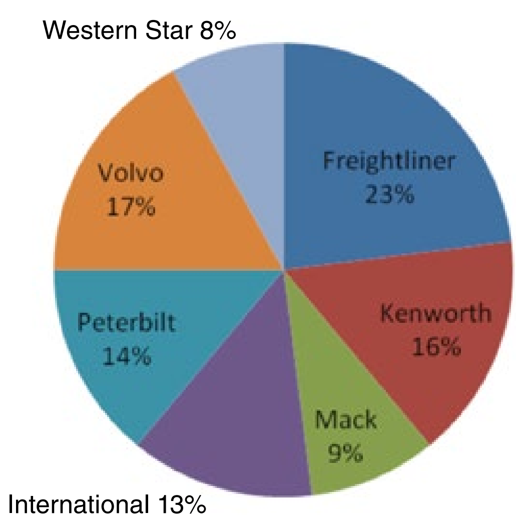
12-Month Sales Trends



	July	August	September	October	November	December	January	February	March	April	May	June
SALES	2.239	2,252	2,347	2,618	2,361	2,168	1,941	1,641	2,244	2587	2711	2,800

June has proved the best sales month of the past year. After 10 straight months of sales coming in above the 2,000 mark, reminiscent of the industry's capacity boom years of 2005 to 2007, they dropped slightly below 2,000 in January and considerably further in February. Good news is that they bounced back in March and April, topping the 2,000 mark both months. May showed further improvement and June was a welcomed surprise and shows a steady improvement in sales numbers the last four months.

Market Share Class 8 – June 14 YTD



Volvo's star continues to rise with Canadian Class 8 truck purchasers. Last month we reported that Volvo had surged to capture 16% of the Canadian market, leap frogging past Peterbilt, which was down to 14% market share. This month Volvo has slipped past the other Paccar company, Kenworth, to grab the number two spot. Volvo now enjoys a 17% share of Canadian Class 8 truck sales. Freightliner remains the market leader with a 23% share.

Source: Canadian Motor Vehicle Manufacturers Association