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Inside the Numbers

with Lou Smyrlis

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Transportation Media

IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

VOLUME 4, ISSUE 4

Baby steps

Buying used is a viable option for new or small fleets looking to grow their operations. Are they buying into that strategy?

For new carriers trying to break into the industry or small carriers looking to expand their operations during a still volatile economic recovery, taking a cautious approach to fleet renewal is a smart strategy.

As Vik Gupta, general manager of Arrow Truck Sales in Mississauga, Ont, told us recently for our Spec Smart guide to new and used truck purchasing, "it's always a good idea to take a baby step."

"Before we run we need to walk. So trying something (as a new person to the trucking industry) with used trucks with an extended warranty, will at least give you a good feeling, and you can see if they can make money in this industry. After that, then you can buy new if you want," Gupta advises.

Makes sense considering a quality used truck usually goes for anywhere between $40,000-$60,000, whereas a new truck can run anywhere from $130,000 and above.

Do Canada's smaller carriers (5-25 trucks) consider buying used as a viable option? If they do, which factors affect their buying decisions? Our annual Equipment Buying Trends Survey includes a number of questions relating to used truck purchasing. I would like to share some of the key takeaways revealed by the national research, completed this summer.

After several years of sitting on the sidelines and allowing their Class 8 trucks to age, our research shows Canada's small fleets are once again looking to refresh their tired iron in 2015. Only 18% of those responding to our survey said they had no plans to replace at least 10% of their fleet next year. Most (39%) are looking to replace up to 20% of their heavy duty vehicles. Small fleets' reinvigorated desire to renew their Class 8 vehicles may be as much in response to the rising maintenance costs associated with aging vehicles as it to seizing opportunities in a growing economic market. But they face challenges when their purchasing plans call for purchasing new. With more than 40% of small fleets surveyed now trying to make do with 6-9 year trade-in cycles and almost a third being on 10+-year trade-in cycles, the trade-in value of their used vehicles is clearly depressed due to the increased age and mileage on these rigs. We've heard of small fleets having to turn in two and three of their older tractors to make the economics work for purchasing a new tractor.

The majority of Canada's smaller carriers are already familiar with buying used with 69% of our survey respondents indicating they have purchased a used truck before. One quarter of them have plans to purchase used trucks next year. While one third of them are looking to purchase used as a way to address business growth projections, the largest number (37%)are looking to purchase used to avoid new engine emissions technology they don't yet trust.

Interestingly, the newest engines are being touted by manufacturers for their considerable improvement in fuel performance and several of the larger fleets I've spoken with who have invested in this new engine technology see the resulting fuel savings as a competitive advantage.

What do they look for in a used truck? First, let's note that they are very confident in their ability to pick the right truck out of the used truck lot. Asked to rate their "knowledge and ability to properly spec a used truck" on a scale of 1 to 5, survey respondents gave themselves an average score of 4.19.

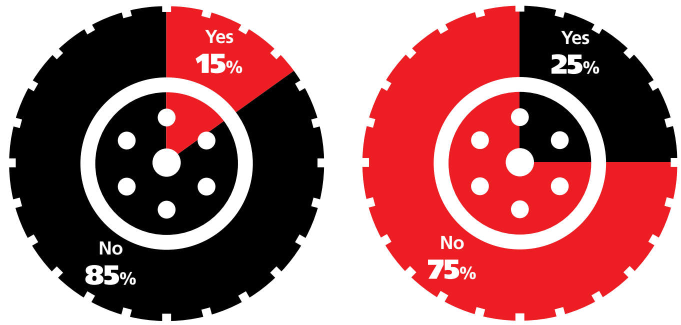
Gross vehicle weight, mileage on the truck, availability of parts. and transmission type are the four most important factors driving their used truck purchasing decision. All four of those factors were scored above 4 on a scale of importance from 1 to 5. Looking specifically at transmission preferences, the vast majority of small Canadian fleets (40%) prefer a manual 13-speed transmission when purchasing used trucks. The Eaton-Fuller brand is by far the most sought after. But automatic is the choice of transmission for 30% of our survey respondents, which shows how much the automatic transmission has grown in acceptance over the past decade.

A USEful option

What Canadian fleets look for when purchasing used trucks

With new truck prices much higher than they were during the previous economic growth spurt, buying used is an option many small Canadian fleets should consider. Our annual Transportation Buying Trends Survey reveals more than two thirds of small Canadian fleets have purchased used trucks in the past and one quarter are looking to repeat that strategy next year. Read on to find out what they will be looking for in a used truck purchase.

PLANS TO PURCHASE USED TRUCKS – SMALL FLEETS

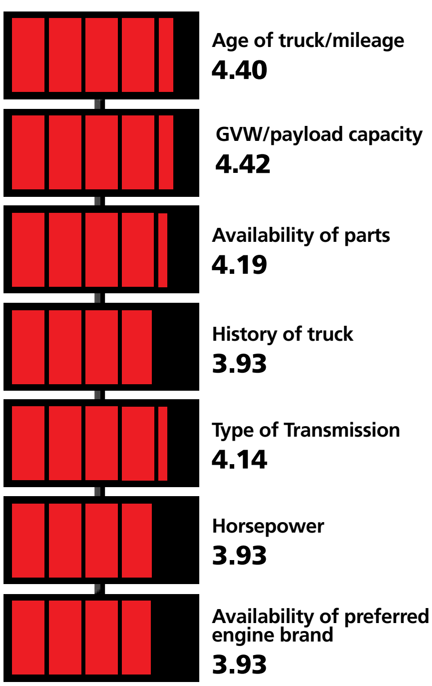


Remainder of 2014 — In 2015

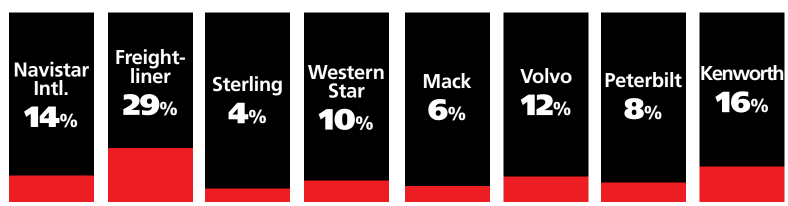
PURCHASED A USED TRUCK BEFORE – SMALL FLEETS

MOST IMPORTANT FACTORS IN USED TRUCK SELECTION SMALL FLEETS

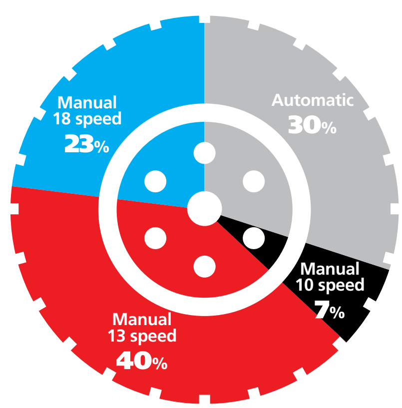
(ranked on a scale of 1 to 5 with 5 being the most important)



BRANDS CURRENTLY IN FLEET – SMALL FLEETS



TYPE OF TRANSMISSION PREFERRED



The "Fun" is Back in the LTL Freight Industry

BY DAN GOODWILL

As I look at LTL freight transportation today, it is hard to believe that just a few years ago, this was one of the most battered sectors of the freight industry. The LTL freight industry took a tremendous pounding during the Great Recession as business volumes contracted by about twenty-five percent. As operating margins shrunk, LTL carriers closed or consolidated terminals and cut staff in an effort to right size their businesses. Shippers took advantage of the situation by conducting multiple freight bids to leverage their volumes to extract rate concessions.

Seven years later, the industry has changed dramatically and the pendulum has swung back in the carriers' favour. As volumes return to pre-recession levels, LTL carriers are finding their networks full of freight. As the North American economy improves, manufacturing is on the rise. The near shoring movement is also bringing some manufacturing jobs back to America. In addition, the driver shortage is making it difficult to find drivers, particularly for long haul truckload routes. A clogged intermodal system is limiting the opportunities to divert over the road truckload freight to the rail system. The net result is that some of this freight is being diverted to large LTL shipments so it can move with an LTL carrier. In other words, this is creating traffic for an already full LTL system.

Unlike the truckload sector where even the largest players control only a small (single digit) percent of the total truckload sector, the LTL industry is highly concentrated among a core group of companies. The top 9 LTL carriers in the United States (e.g. FedEx Freight, Con-way, YRC, UPS Freight, Old Dominion, Estes, USF Holland, Reddaway and New Penn, ABF, R & L Carriers and Saia) control almost seventy percent of the LTL market. In Canada, the major players, TransForce (e.g. TST Overland, Canadian Freightways, Kingsway, QuikX, Quiktrax, Clarke Transport and Vitran), the Day and Ross Group and Manitoulin would also control a major share of the LTL market. With limited capacity and pricing discipline, this gives this group of companies considerable pricing power. With high quality costing models, these companies can now seek meaningful rate increases or de-market poor paying accounts. In other words, the "fun" is back in this business.

To further improve yields, FedEx Freight and UPS Freight are introducing density based or dimensional or cube-based pricing. I wrote about the potential of this trend years ago (http://www.dantranscon.com/images/downloads/mtr%20sep_oct%202009.pdf) and it is finally starting to take hold. Just as airlines charge for "bums in seats" and adjust their plane sizes to each route and the potential passenger traffic, LTL freight carriers are going to become much more diligent about charging shippers for the cubic space occupied on their trailers. Shippers with poor packaging, who don't nest their products effectively or don't design their products well or load them smartly, will face a nasty surprise. With so much industry consolidation, it won't take long before dimensional pricing becomes more standard across the industry.

Another reason why LTL carriers are having more "fun" is in their attitudes toward logistics service providers. A few years ago, 3PLs were viewed as the enemy. They were seen as trying to poach LTL customers and replace their carriers by taking control of the direct customer interface. Times have changed. LTL carriers are increasingly viewing 3PLs as business partners. They are forming alliances with companies that have common objectives and customer profiles so they can collectively bring value to the customer. The large LTL carriers are going a step further by creating their own internal logistics or at least freight brokerage arms.

The terminal networks of the large and even medium-sized LTL carriers serve as barriers to entry. As a result, it is not easy to establish an LTL freight business as it is a truckload business. This is producing some new models of LTL carriers. In addition to marketing alliances between regional LTL carriers (to expand market coverage) such as the Reliance Network, we are also seeing the creation of asset lite or even non-asset based (technology driven) LTL players. Roadrunner Transportation Systems and FreightQuote are just two of the companies now targeting this sector using these new models.

The thrill was gone in 2007 and 2008 but the fun is back in 2014.

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.

Continued economic strength ahead, senior Scotiabank economist predicts

Now's the time to fix what's broken in your business, Kriska's Seymour advises

Leading economic indicators are pointing towards continued economic growth and favourable conditions for motor carriers.

That was the upbeat message from Carlos Gomes, senior economist with Scotiabank, when providing an economic outlook at the sold-out Surface Transportation Summit.

"Despite all the events in the equity markets, we continue to be optimistic with respect to our outlook," Gomes told nearly 400 motor carrier and shipper executives.

Gomes said global economic growth is expected to accelerate over the next year.

New order activity, which tends to lead industrial activity, has been on the rise globally.

"When we look at the global economy, most regions are on an upward trend, especially the US," Gomes said.

The European economy has returned to growth mode, albeit at a modest pace. China's economic growth is expected to remain around 7% per year.

While household debt in the US and Canada is high, Gomes said he isn't alarmed because interest rates are low and household finances are actually healthier than in the past.

"In both the US and Canada, the key thing that's important is that household balance sheets have improved significantly," Gomes said.

In 2007, about 20% of disposable income went to paying debt, interest and energy costs. Today it's about 15%.

"While debt is high, the fact rates are low and energy prices are actually declining as we speak, means it's not consuming a significant amount of household income," Gomes said. "It leaves significant disposable income for other purchases."

This is good news for the auto sector, which has seen demand for new vehicles return to pre-recession levels while the average age of the fleet remains at a record high.

"The financial conditions of households are very healthy and the average age of the fleet in the US is about 11.5 years. About 40% of all vehicles in the US are more than 12 years old. That tells you if they're not going to be replaced this year or next year, they'll definitely have to be replaced one to three years down the road, so that gives me confidence we're going to have a decent cycle for an extended period of time," Gomes said.

Gomes sees Canadian exports growing 6% in 2015 and is bullish on the US economy, where consumers are financially stable and manufacturing activity is up.

Asked if he has any concerns, Gomes said economic conditions in Europe and China still bear watching, as do interest rates in the US and Canada, though indications are that they'll be kept low for the immediate future.

David Newman, equity research analyst, Cormark Securities, agreed with Gomes that economic indicators are strong and so too are conditions facing trucking providers. Newman noted about 20% of US trucking capacity was removed due to the recession, a tougher regulatory environment and the driver shortage. Trucking rates are going up, Newman said, and active truck utilization has reached 99%, giving carriers some pricing power.

Newman pointed out the US economy should remain strong, even if there is turmoil in Europe and China, since 80% of US corporate profits are domestic.

The Canadian Purchasing Managers' Index recently hit a nine-month high, which is another indicator of freight volume strength.

Cormark's own North American Freight Monitor points "toward a healthy freight volume environment" as well as pricing increases, Newman said. Canadian ports are "booming," he added, thanks to the diversion of containers from the ports of L.A. and Long Beach, which experienced labour issues over the summer.

The Canadian spot market has seen volumes rise 42% year-over-year and rates have been increasing, which is now cascading over into contract rates, Newman said.

Providing a fleet perspective, Mark Seymour, president of Kriska Holdings, said carriers need to take advantage of current conditions and a healthy rate environment to fix what's broken within their organizations.

"We've had a good run the last three to four years," Seymour admitted. "It has been a good run but there's lots of work to do around our drivers and wages and the way we treat them. Those are the areas we are working on the most right now."

Seymour also advised carriers to take advantage of the opportunity to re-assess how they run their businesses now that freight volumes and rates are strong. And this will require working with shippers.

"There are lots of opportunities right now to work on the issues within our business as it relates to profitability and discipline"

MARK SEYMOUR

"There are lots of opportunities right now to work on the issues within our business as it relates to profitability and discipline," Seymour explained. "We can take this opportunity to fix things that are broken. There has never been a better time to do that; to tighten our network, charge for things we haven't been able to charge for in the past, to adjust short-term pricing strategies and not lock down into a three-year pricing model because our costs are going up too quickly. We are never able to engineer solutions and get waste out of the system if we're forever going back (to customers) year after year, wondering if we're going to be able to keep the business in certain lanes and certain markets."

The Americans are coming

And other reasons industry consolidation will continue

More consolidation within the Canadian trucking industry is coming, including the likely arrival of some major US players, according to experts speaking at our sold-out Surface Transportation Summit held in mid October at the Mississauga Convention Centre.

"I think the Americans are coming," warned Mark Seymour, president of Kriska Holdings. "They'll buy their way into Canada or find their way in some other way. Building mass and building scale puts us in a better position to defend against what it is they are likely to do."

Ongoing domestic consolidation and the potential arrival of new competitors from south of the border were a couple of the reasons Kriska chose recently to align with Mullen Group.

"Big customers are looking for capacity right now," Seymour said. "There are more discussions with shippers around capacity now than price."

Seymour said Kriska has tried growing organically for the past three to five years but has been unable to add capacity.

David Newman, equity research analyst with Cormark Securities, agreed that US fleets could be looking for a piece of the Canadian market as the owners of small- to mid-sized Canadian carriers look to sell.

"Smaller carriers face a whole host of challenges and it's going to get tougher," Newman said, citing a tightening regulatory environment and the driver shortage. "You've got US carriers kicking tires."

He cited Celadon's purchase of Yanke and Kenan Advantage Group's purchase of RTL Westcan's bulk division as two recent examples.

Newman said he wouldn't be surprised if TransForce is broken up into several divisions and listed in the US or sold, potentially to American firms. But Newman also said there could be more Canadian trucking companies going public as well.

Patrick Cain, vice-president of business development with Cain Express and Titanium Transportation Group, also addressed the appeal of consolidation, having recently sold his family business to Titanium.

"Growth creates challenges for organizations," he said. "Certainly for a company the size of Cain Express, as we continued to grow we put stress on our people, stress on our processes and systems and stress on our equipment and financing."

Both Cain and Seymour concluded their respective businesses were too small to compete with the big players on their own.

"If we didn't have a significant role with a customer, we were relatively easy to replace," Cain admitted. "Bringing scale to your customers gives you a better relationship."

But while a merger or acquisition may look good on paper, Seymour acknowledged that how the corporate cultures of the organizations involved will mesh is another consideration. For this reason, Kriska and Mill Creek – the Mullen-owned van carrier included in the joint venture – will continue to be run separately.

"Between 1995 and 2008, Kriska made about seven acquisitions, all of which ended up being tuck-ins," Seymour said. "Each time we had a rude awakening about how powerful culture was at the company we tried to tuck in. Over time, we learned from our mistakes. In this case we will not be putting Kriska and Mill Creek together for that very reason. Mill Creek by itself has significant scale, it's very profitable, safe and disciplined so there's no advantage to try to put them together but there's a tremendous amount of risk to try to do that."

Cain added differences in corporate culture are not necessarily a bad thing – as long as both organizations adopt the best that their new partner brings to the table.

"In some cases, differences (in culture) will be for the better," he said. "Hopefully you can bring something to the table that helps them with their business."

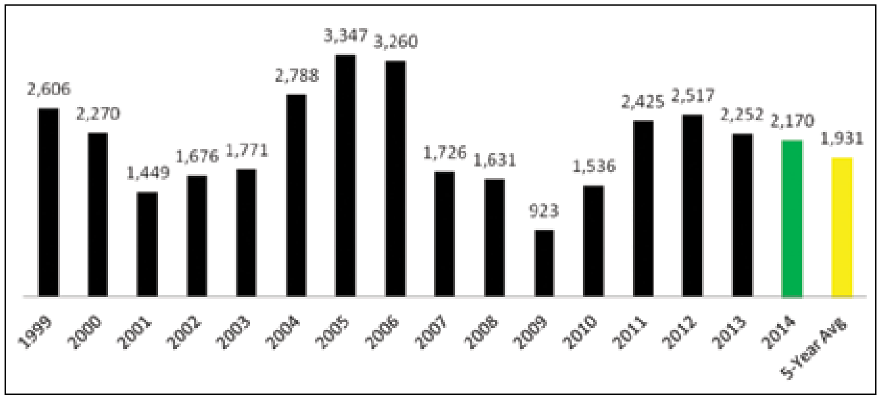
The Surface Transportation Summit, organized by Fleet Executive, Canadian Shipper and Dan Goodwill & Associates, brings together industry-leading shippers, carriers, equipment providers and analysts to discuss emerging issues and trends. Look for more coverage on www.trucknews.com and in all Transportation Media publications.

CLASS 8 Truck Sales Trends

Monthly Class 8 Sales – Aug 14

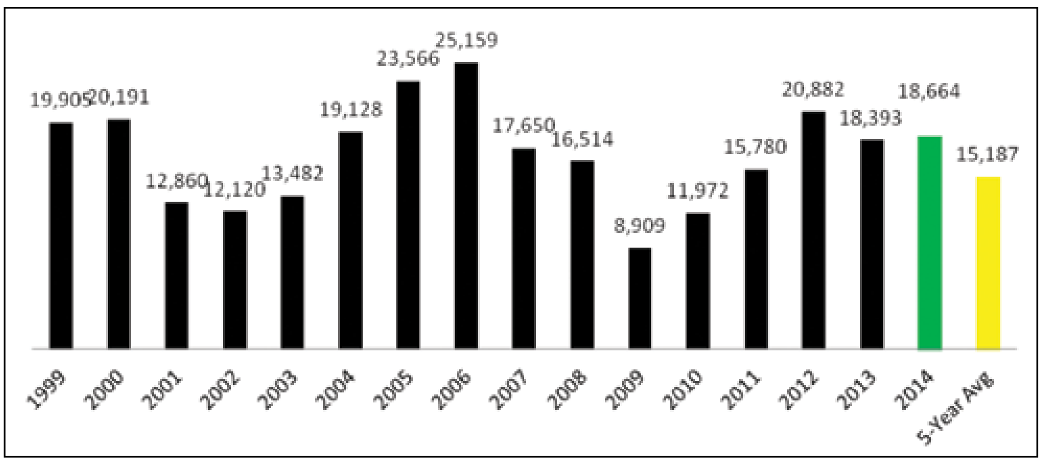
OEM	This Month	Last Year
Freightliner	540	502
International	221	308
Kenworth	416	395
Mack	166	179
Peterbilt	308	366
Volvo	328	351
Western Star	191	151
TOTALS	2170	2252

Historical Comparison – Aug 14 Sales



August Class 8 sales, although above 2,000, are a disappointment. The momentum shown in June and July was not maintained and sales dropped behind last year's monthly total. In fact the 2,170 Class 8 trucks sold made for the weakest August since 2010. Freightliner, Kenworth and Western Star posted gains compared to the previous year but all the other truck manufacturers sold fewer trucks this August than in August of 2013.

Historical Comparison – YTD Aug 14



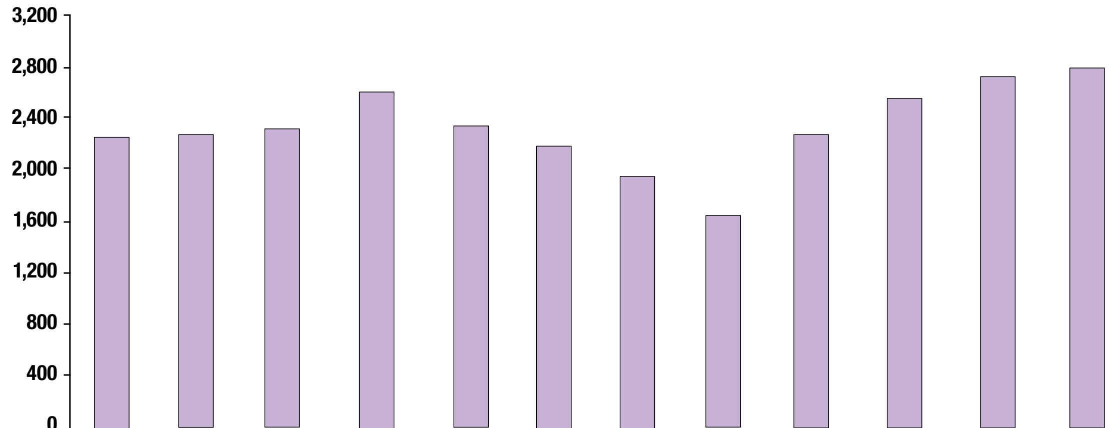
Class 8 Sales (YTD Aug 14) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	382	683	172	211	1,947	694	221	84	4	23	4,421
Kenworth	427	1,233	284	1	543	547	57	0	0	0	3,092
Mack	103	268	120	73	773	174	23	44	5	18	1,601
International	106	390	52	108	1,267	403	107	38	8	28	2,507
Peterbilt	324	986	224	133	456	302	107	11	0	0	2,543
Volvo	354	407	92	193	1,301	442	117	60	0	6	2,972
Western Star	233	546	49	84	293	231	34	47	3	8	1,528
TOTALS	1,929	4,513	993	803	6,580	2,793	666	284	20	83	18,664

Despite a weaker than hoped for August, optimism for an improvement in Class 8 truck sales this year has not lost steam. Our research shows small carriers are more willing to purchase new trucks than they have been in years and both carriers and truck manufacturers are feeling more optimistic about the industry for the rest of the year. So far 2014 is shaping up to be the seventh best year in Class 8 truck sales since 1999.

CLASS 8 Truck Sales Trends

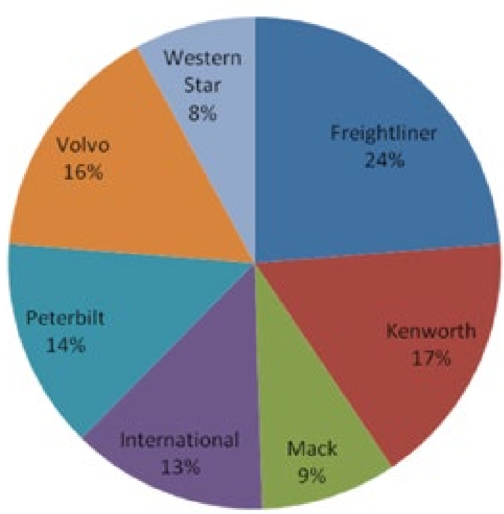
12-Month Sales Trends



	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

Monthly totals have been on a three-month drop after the high mark of 2,800 set in June. However, the Canadian market has enjoyed 6 straight months now of sales above 2,000 after suffering through two months of sales below that figure to start the year. Prior to that the market had posted 10 straight months of sales coming in above the 2,000 mark, reminiscent of the industry's capacity boom years of 2005 to 2007.

Market Share Class 8 –Aug 14 YTD



Freightliner remains the market leader with a 24% share of the market while Kenworth's market share stands at 17%. Volvo, which has shown the most growth this year after leapfrogging past Peterbilt, is holding on to a 16% market share. Peterbilt and Navistar are at 14% and 13% respectively. Mack remains slightly ahead of Western Star with a 9% share compared to 8% for Western Star.

Source: Canadian Motor Vehicle Manufacturers Association