Inside the Numbers
with Lou Smyrlis

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IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

VOLUME 1, ISSUE 2

All eyes on the economy

Why there is good reason to invest in the future despite the daily stream of bad economic news

For Canadian trucking executives, it's all eyes focused on the economy right now. But the bigger decision is whether to have the foot hovering over the brake or the accelerator. Does the almost daily barrage of bad financial news clearly indicate we're headed towards the dreaded double-dip recession or is something else going on? Should motor carrier executives be boarding the windows to weather another storm or investing in the future? What's the risk in adopting the wrong strategy at this point?

Look beyond the "sky is falling" headlines in the mainstream media and you will see two economic realities existing side by side right now. In this issue of Inside the Numbers I would like to dig deeper into each reality.

NEGATIVE ECONOMIC INDICATORS

Let's start with the familiar, the severity of which can't be ignored. The daily stream of red numbers being reported is alarming. Stock markets are down by around 20% since mid year and that's the unofficial threshold for a bear market. Daily movements are particularly volatile and seem to require just the mention of any negative financial news to set them off. Commodity markets are also in turmoil and are hovering around 20% below their April peak. Bond markets are taking a hit and consumer confidence, particularly in the US, is once again on the wane.

As I've argued in my columns and blogs in recent months, however, the downturn in the economic indicators during the early part of the summer was reflecting a lot of "noise" from natural disasters such as the earthquake in Japan and flooding in the US, that disrupted supply chains. There was enough disruption that we could not build all the cars and other products that needed to be built, based on market demand. And that showed up in the various market indicators as a slowdown in the economy that spooked markets more than it should have.

But that was months ago. As Peter Hall, chief economist with Export Development Canada points out, shocks to the economy may linger but their effects on current growth tend to dissipate. What is still contributing to the economic weakness today? Hall believes tumbling financial indicators are not necessarily the economy's fault and that the undercurrent contributing to the present weakness is something that should also come as no surprise to any of us: the withdrawal of the fiscal stimulus programs initiated by OECD nations when the recession hit.

"Does fiscal withdrawal really matter? Given the extent of stimulus, absolutely. Recall that the average package for OECD nations added up to 3.9% of GDP. Collectively, this pile of cash made a huge impact coming in, and will likely make a showy exit, too," Hall argued in a recent blog.

Coordinated public stimulus of a magnitude we have never seen before pulled the economy back from the brink of the second Great Depression. The problem is that now that the stimulus is drawing to a close, business seems uncertain whether to believe in the recovery and invest in the future.

POSITIVE ECONOMIC INDICATORS

Is there good reason to invest in the future at this point? Let's take a look at some key economic indicators that run counter to all the dark headlines but have not been receiving the attention they deserve.

One particularly important one is orders received by business, or as economists refer to them: knocks on the door. Many countries, including Canada, track these orders as a gauge to coming production. Essentially, this serves as a good indicator of the pace of business in the coming months. Over the summer and into the early fall, orders received were showing positive gains in the least likely of places. Take the battered US economy, for example, after slowing down in the spring, the pace of orders regained strength over the summer and is up 15% at an annual rate. Europe is feared to be an economic basket case yet German orders are up 11% since the beginning of the year; Spain is up almost 20%; Italy up 18% and France is up nicely as well.

Stats released last month show Canadian business is also getting plenty of knocks on the door. New orders here are up 12% on an annualized basis since January and growth was particularly healthy in July and August. In fact, we are busy enough that businesses are being challenged to keep pace. Unfilled orders have surged by more than 30% which means manufacturers will be kept busy over the coming months simply trying to get to all the new business they've received.

Real GDP Forecasts					
	Q4F	Q1F	Q2F	Q3F	Q4F
TD Economics	1.3	2.0	2.2	2.7	2.8
RBC Economics	2.6	2.9	2.6	2.6	2.7
Scotia Bank Economics	1.4	1.6	2.0	2.4	2.4
CIBC Economics	2.1	1.9			
BMO Economics	1.5	1.8	2.0	2.3	2.5

The EDC's Peter Hall appears convinced these numbers bear watching. This is what he had to say in a blog last month: "Many economic indicators can be going in the wrong direction, but rising orders trump a lot of them. They are probably the best indication we have of production in the coming weeks and months, and they suggest we are in for decent growth,"

Here are a few more numbers that point to continued growth:

- Manufacturing sales have been on a steady rise from the bottom of the cliff they fell to in the spring of 2009. They are about halfway back to their pre-collapse level. The value of Canadian manufacturing sales grew 1.4% in August, to $47.6 billion, the highest monthly value in almost three years. As with any economy growing at less than 3%, the growth in sales is uneven. August growth was limited to 11 of the 21 manufacturing sectors but those 11 sectors represent 70% of the industry. Right now, transportation equipment (+7.0%), food products (+3.9%) and petroleum and coal products (+2.7%) are experiencing the most growth. By region, growth was more spread out as 8 provinces posted growth.

- RBC's Canadian Manufacturing Purchasing Manager's Index has performed exactly the way its analysts believed it would, slowing down in the second quarter in response to economic shocks and rebounding in the third quarter. Index readings above 50.0 signal expansion from the previous month, readings below 50.0 indicate contraction. By September the PMI had reached 55.0, the highest reading since April signaling a solid improvement in Canadian manufacturing sector business conditions.

- The global purchasing managers' index, although it has slowed, still remains above the key 50 mark indicating continued growth.

- Another positive sign: a relatively low level for the inventory-to-sales ratio. Manufacturers will need to order materials to keep up with their orders; they can't live off their inventories as they did during the recession.

- Canadian retail sales in September breezed past expectations, showing consumers may be wary but they are still spending. Retail sales rose by 1.1% during the month, the strongest rise since February.

Unlike the speculation going on in the markets, the indicators shown above provide a firm outlook of what to expect in the coming months and they do not show a return to recession but rather continued, albeit modest, growth.

As Bill Graves, head of the American Trucking Associations, mentioned in his recent state of the industry address: "We need to be careful not to become so obsessed with the challenges of the moment that we give up on the opportunity of the future."

Down but not out

The latest Ontario Trucking Association (OTA) quarterly survey of its members shows they are not as optimistic about their prospects as they were earlier in the year but that the majority are still experiencing growth.

Sixty-four percent are optimistic about the industry's overall prospects for the next three months. But that's an 8% drop from the 2Q survey. The number of carriers who reported they were unsure about the industry's prospects increased to 26% (up 5% from the previous quarter). Still, only 9% of carriers were pessimistic about the industry's prospects.

Forty-five percent indicated that loaded miles are increasing, the largest proportion of respondents to report this since OTA began surveying that data in 4Q08. Seventy-two percent reported that the average length of haul is staying the same, while 18% reported it is increasing (up 3% since last quarter's survey).

VOLUMES

67% said freight volumes had increased compared to a year ago. However, fewer respondents indicated that freight volumes have improved compared to three months ago.

62% indicated intra-Ontario freight volumes are about the same as volumes three months ago (up 22% from last quarter), while 32% indicated volumes had improved (down 21% from 2Q11).

49% indicated interprovincial freight volumes stayed the same (up 13% from last quarter) and 44% indicated volumes had improved (down 16% from last quarter).

31% said southbound US volumes had decreased compared to three months ago (up 14% from last quarter). Only 19% said volumes were improving (compared to 39% last quarter) and half the respondents said volumes were about the same.

51% said freight volumes were still improving in the northbound US market (down 10% from last quarter). And 37% said northbound volumes were about the same.

RATES & SURCHARGES

26% said that intra-Ontario freight rates were improving (up 4% from the second quarter) while 61% reported rates were about the same.

46% reported improving rates in the interprovincial market (up 7% from the previous quarter). It was the highest value reported since OTA began the survey in 3Q08.

14% reported rates were improving in the southbound US market (down 11% since last quarter) while 58% reported rates were about the same.

55% reported northbound US rates were improving (down 4% from last quarter). Forty-one percent indicated rates were about the same (up 6% from last quarter) and only 2% reported northbound US rates were decreasing.

85% reported customers are paying a reasonable fuel surcharge (up 7% from last quarter). The majority (70%) report that contract timeframes are not changing, although 21% reported customers are lengthening contract timeframes, locking in capacity.

CAPACITY

39% reported capacity stayed the same over the last quarter (up 11% from 2Q11). In addition, 29% reported capacity had decreased from last quarter. Carriers are split as to where capacity will go; 37% reported that capacity will increase, 29% believe it will decrease and 33% believe it will remain the same.

54% said they plan no new additions to their fleet of tractors. Similarly, 53% plan no net change in the number of trailers in their fleet.

51% said they plan to add more company drivers while 47% said they have no planned changes to the net number of drivers. Forty-nine percent said they plan to add more owner-operators. No respondents are planning on reducing the number of owner-operators over the next three months.

COSTS

38% reported fuel cost increases of between 15% and 20% over the past year, while 23% reported increases of greater than 20%.

98% reported an increase in maintenance costs. Sixty-four percent reported maintenance cost increases of 5-10%.

89% reported an increase in tire costs with 61% reporting tire cost increases of similar magnitude.

91% of carriers reported increases in driver wages -- 67% of which reported increases of between 5-10%.

62% reported increases in employee benefit costs over the year, 35% of which reported increases of between 5% and 10%.

Over 50 carriers participated in the survey which was conducted electronically between July 4th and 25th, 2011.

The more the uncertainty and variation, the more nimbleness counts.

With so much uncertainty about the economy in 2012, is it best to wait it out? Here are two reasons why that may prove a dangerous strategy.

1

REASON ONE: The average age of the North American Class 8 truck fleet has increased considerably over the past few years. The average age in the US is about 7 years. Only 20% of the heavy duty trucks owned by Canadian carriers are model year 2006 or newer.

Research shows there is a financial penalty associated with hanging on to older trucks. While maintenance costs average out to about 5 cents per mile for trucks with under 550,000 miles on them, maintenance costs rise to about 15 cents per mile once that 550,000 mile threshold is reached.

American Trucking Associations chief economist Bob Costello anticipates solid truck sales to renew aging fleets.

Our own research, conducted this summer, shows only 27% of Canadian for-hire carriers planning no fleet replacements in 2011 and only 18% not planning fleet replacements for 2012.

Cost will be a challenge, however. The average sticker price for a Class 8 truck in 2006 was $95,000. Today, it is around $125,000 – a $30,000 increase that somehow has to be absorbed during a weak economy. Thank goodness for a strong Loonie!

2

REASON TWO: The North American trucking industry, after deregulation, was rebuilt during an era of relative economic stability. After enduring four recessions from 1970 to 1982, the industry experienced only two from 1983 to 2007. Also important is the comparison between length of the recoveries during this period and prior to it. Consider the analysis provided by Noel Perry from FTR Associates in his influential report *The Challenge of Deep Economic Cycles*.

"The recoveries of the 1980s and 1990s lasted 25 and 28 quarters, respectively. The average for the rest of the recoveries was less than 10 quarters. We see then that the likely departure from the benign Reagan/Clinton era into an era of short cycles would cut by half the amount of time available for industry growth. Short recoveries are bad for transportation for a simple reason. The benefits from an upturn take about a year to come in. It takes six months or more for the average manager to realize there has been a turn; it takes another six months for that manager to take advantage. This is not a big deal with a long economic cycle. Four wasted quarters out of a 26-quarter recovery still leaves more than five years to prosper. Four lost quarters out of an 8- or 10-quarter cycle is a significant fraction, particularly if the subsequent recession is a deep one."

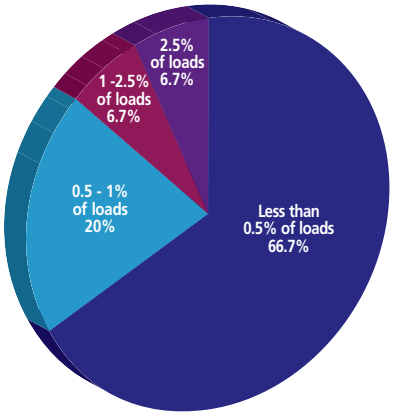
As Perry goes on to conclude, the best firms will recognize a change in market conditions earlier and respond faster because they have already thought through their options. The more the uncertainty and variation, the more nimbleness counts.

inside the numbers

74%

Is the percent of logistics and transportation firms who prefer to use off-the shelf advanced technology as their model of IT acquisition, when available.

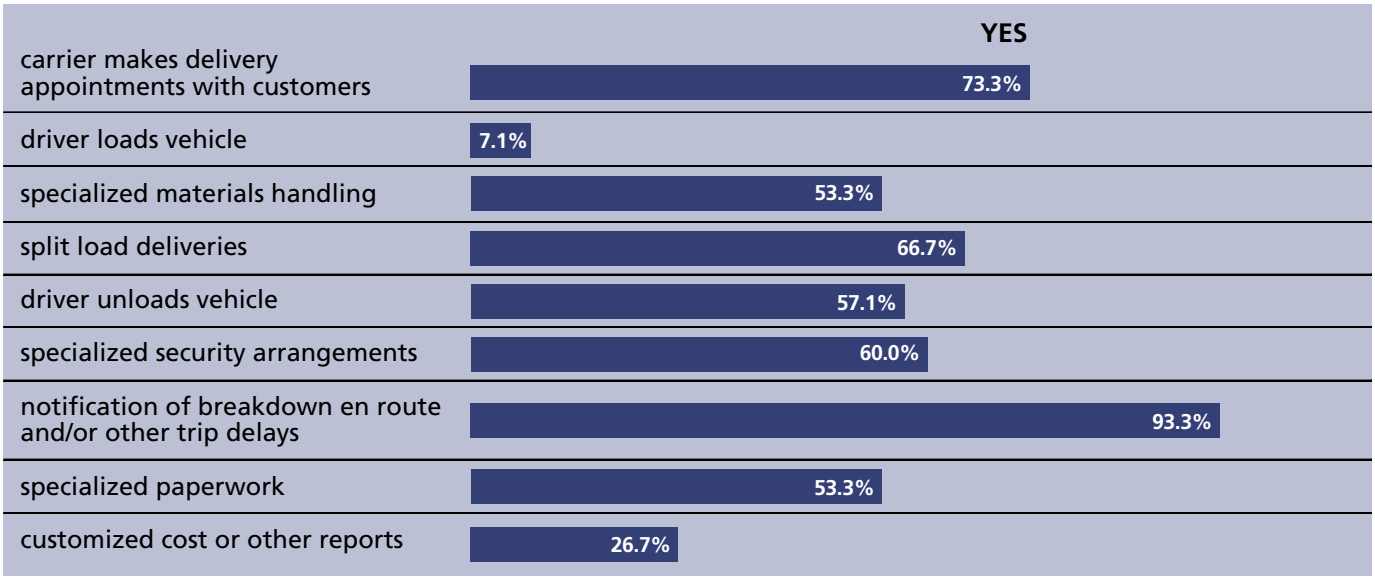
PERCENT OF TL LOADS THAT RESULT IN PRODUCT DAMAGE



TL SERVICE ASSESSMENT

	AGREE COMPLETELY	AGREE SOMEWHAT	NEITHER AGREE NOR DISAGREE	DISAGREE SOMEWHAT	DISAGREE COMPLETELY
My TL carrier operates effectively	33.3%	60.0%	6.7%	0%	0%
The customer service people are knowledgeable and helpful	20.0%	73.3%	6.7%	0%	0%
Administration is straightforward and effective	20.0%	66.7%	13.3%	0%	0%
They deal with my problems quickly and well	40.0%	46.7%	13.3%	0%	0%
Overall they are good to do business with	46.7%	46.7%	6.7%	0%	0%

TL VALUE-ADDED SERVICES



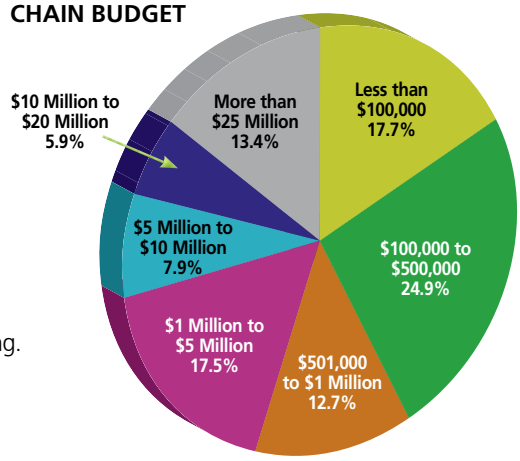
HOW SATISFIED ARE SHIPPERS WITH TRUCKLOAD SERVICES?

Our annual Shipper's Choice Survey shows that shippers expect more from their TL carriers on many fronts than from any other mode Further research shows how satisfied Canadian shippers are with their TL service providers. In the annual CITA Members Benchmarking Survey, authored Dr. Alan Saipe of Supply Chain Surveys Inc., and now conducted in coordination with RBC Capital Markets, there were several questions asked about the service TL carriers are providing the participants. The survey found that most would agree they get satisfactory to great service. About 93% of respondents "agreed somewhat" or "agreed completely" with the statement "my TL carrier operates effectively." No respondent disagreed with that statement. And almost 87% "agreed somewhat" or "agreed completely" with the statement "they deal with my problems quickly and well." The results are in contrast to how shippers felt about the service they are receiving from rail.The survey also looked at product damage with two-thirds of shippers reporting product damage to less than 0.5% of their loads.

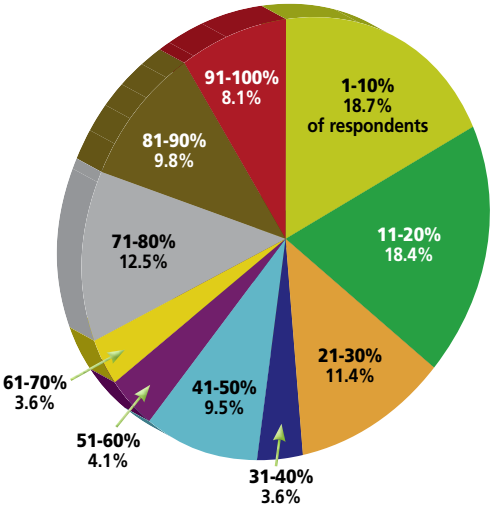
6.3%

That's the percentage of Canadian GDP accounted for by commercial transportation. More than one third of that is generated by trucking.

SIZE OF ANNUAL SUPPLY CHAIN BUDGET



PERCENT OF ANNUAL SUPPLY CHAIN BUDGET SPENT ON TRANSPORTATION



IMPORTANCE OF PERFORMANCE CRITERIA

Mode	On-Time Performance	Quality of Equipment & Operations	Information Technology	Competitive Pricing	Customer Service	Leadership in Problem Solving	Ability to Provide Value-Added Services	Sustainable Transportation Practices
LTL	4.738	4.229	3.981	4.659	4.662	4.327	3.443	4.073
TL	4.850	4.456	4.076	4.710	4.611	4.312	3.723	4.176
OCEAN CARRIERS	4.541	4.362	4.286	4.736	4.579	4.357	3.838	4.134
COURIERS	4.844	4.310	4.537	4.697	4.644	4.324	3.700	4.122
AIR CARRIERS	4.863	4.415	4.495	4.574	4.635	4.401	3.831	4.186
RAIL CARRIERS	4.498	4.259	4.174	4.658	4.487	4.204	3.618	4.099

SHIPPER SATISFACTION RATINGS BY MODE

Mode	On-Time Performance	Quality of Equipment & Operations	Information Technology	Competitive Pricing	Customer Service	Leadership in Problem Solving	Ability to Provide Value-Added Services	Sustainable Transportation Practices	TOTAL SATISFACTION SCORE
LTL	20.11	17.44	15.44	19.36	19.54	16.91	13.30	16.23	138.326
TL	21.31	19.13	15.83	19.97	19.86	17.58	14.42	17.05	145.135
OCEAN CARRIERS	18.70	17.87	16.94	19.14	18.47	16.59	13.90	15.71	137.309
COURIERS	20.44	17.87	18.57	18.75	17.95	15.64	13.27	15.91	138.399
AIR CARRIERS	20.82	18.86	17.97	18.49	18.82	17.08	14.14	16.49	142.674
RAIL CARRIERS	15.57	15.82	15.43	16.83	14.66	12.89	11.53	14.86	117.598

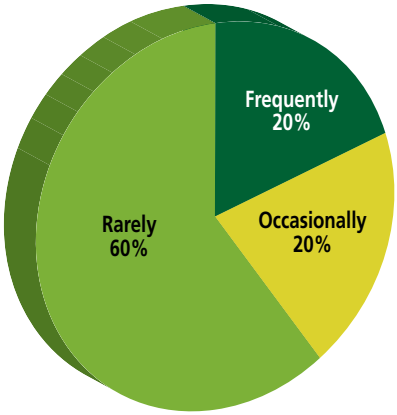
ARE YOU GIVING CUSTOMERS WHAT THEY WANT MOST?

The importance of competitive pricing is evident in our annual Shipper's Choice Awards research, which asks more than 2,000 shippers across Canada to rate the importance of eight Key Performance Indicators when it comes to selecting one carrier over another. The "Importance of Performance Criteria" chart above shows the value shippers place on each of the eight KPIs on a scale of 1 to 5 and provides a comparison for all modes. While on-time performance remains the top priority when it comes to selecting both LTL and TL carriers, competitive pricing is the second highest consideration when shippers select a TL carrier and the third most important when selecting an LTL carrier. The "Shipper Satisfaction Ratings By Mode" chart shows that motor carriers are doing better than other modes in satisfying shipper needs for competitive pricing. However, just providing low rates does not ensure success among shippers. Our research also shows that customer service is also highly valued among shippers, followed by quality of equipment and sustainable transportation practices.

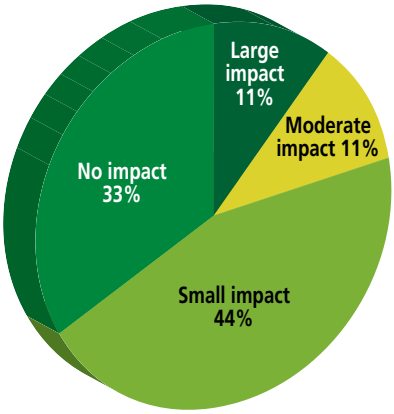
74%

That's the percentage of logistics and transportation firms which prefer to use off-the-shelf, advanced technology as their model of IT acquisition, when available.

Waiting longer than normal for rail pickups? (% of replies)



Impact of rail work stoppage (% of replies)



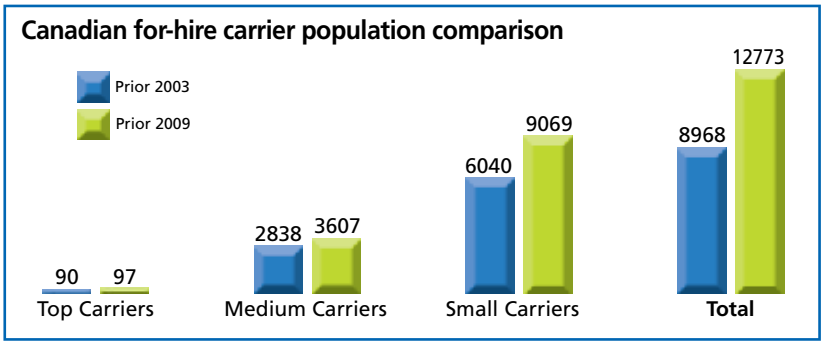
Rail service assessment

	Agree completely	Agree somewhat	Neither agree nor disagree	Disagree somewhat	Disagree completely
My rail carrier operates effectively	0%	55.6%	11.1%	33.3%	0.0%
The customer service people are knowledgeable and helpful	0%	66.7%	22.2%	11.1%	0.0%
Administration is straightforward and effective	0%	44.4%	22.2%	11.1%	22.2%
They deal with my problems quickly and well	0%	33.3%	22.2%	44.4%	0.0%
Overall they are good to do business with	0%	22.2%	66.7%	0.0%	11.1%

HOW SATISFIED ARE SHIPPERS WITH RAIL SERVICES?

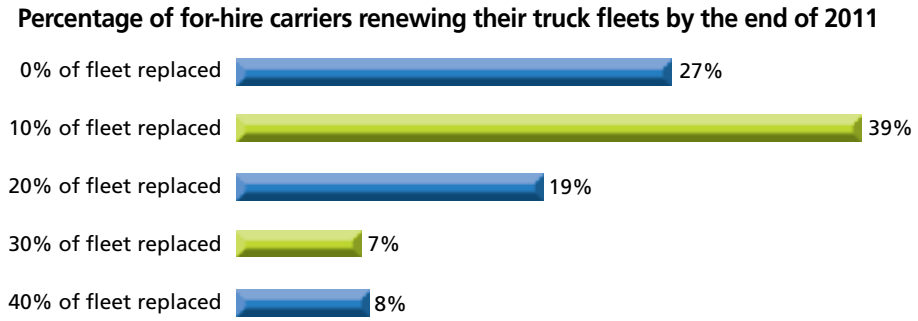
The use of rail services has been growing in recent years as shippers have been more interested in cost-effective service offerings and railways have expanded their networks and portfolios. In the annual CITA Members Benchmarking Survey, authored Dr. Alan Saipe of Supply Chain Surveys Inc., and now conducted in coordination with RBC Capital Markets, there were several questions asked about the service railroads are providing the participants. The survey found that some get good service and are reasonably satisfied with it, while others are much less satisfied because the service they receive is relatively poor. About 56% of respondents "agreed somewhat" with the statement, "My rail carrier operates effectively." No respondent "agreed completely" with that statement. And only 33% "agreed somewhat" with the statement, "They deal with my problems quickly and well." On the good news side, 71% reported that less than 0.5% of loads result in product damage. The survey also probed participants about empty railcars. The normal elapsed time to get empties from the railway ranges from two days to seven to 10 days. When asked how often the wait for empties is longer than normal, 67% said "occasionally" and 17% said "frequently." The longest wait times experienced were as much as two weeks beyond normal wait times.

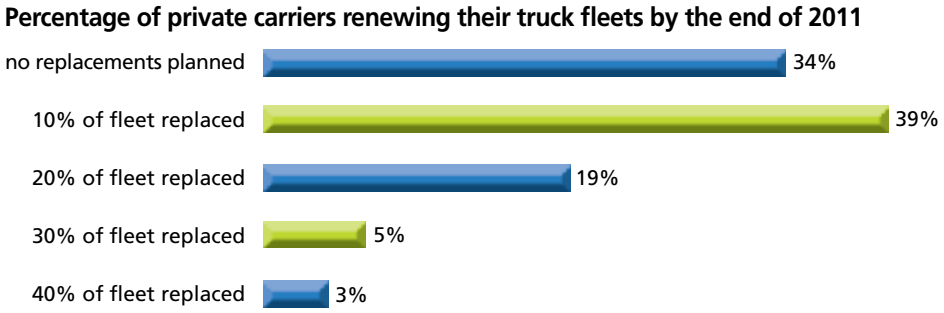
inside the numbers

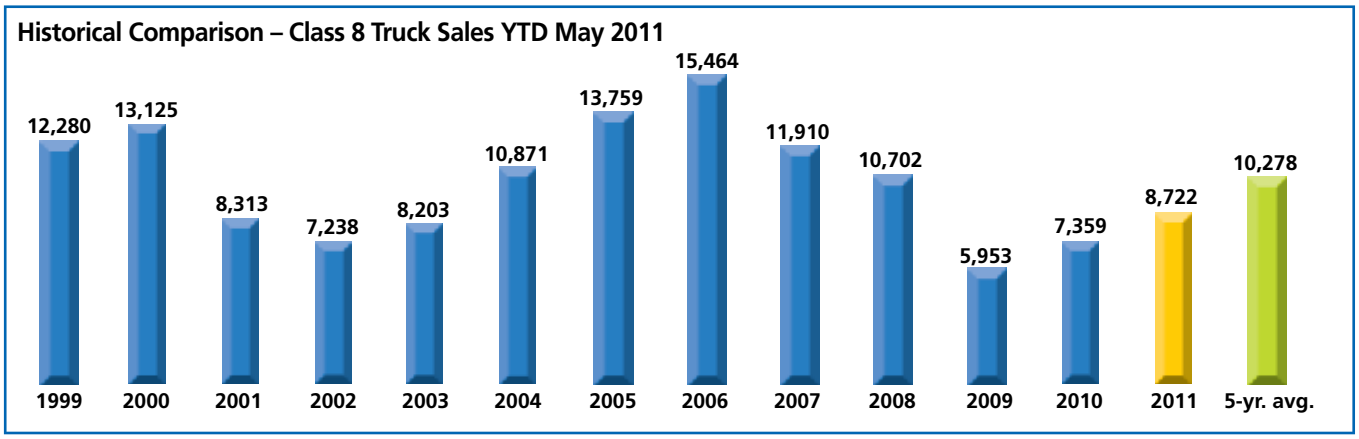


8.3%

That's the percent of the nominal Gross Domestic Product (GDP) taken up by logistics costs in the US in 2010, according to CSCMP's annual State of Logistics Report.







IS A MOTOR CARRIER CAPACITY SQUEEZE IMMINENT?

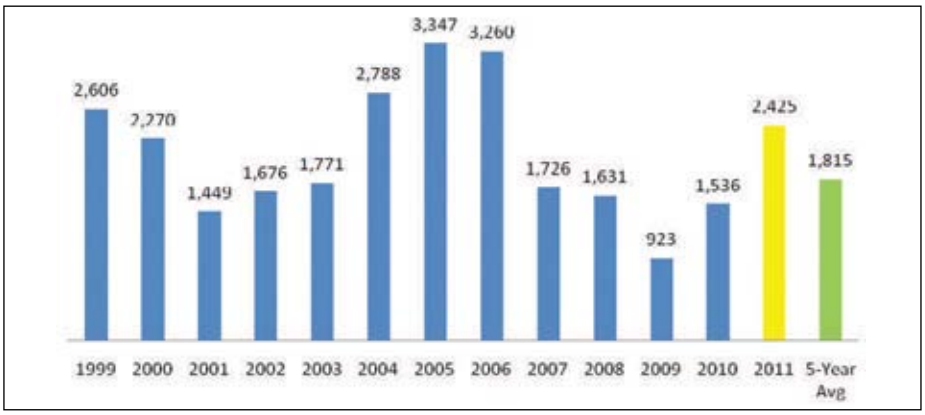
For much of this year, transportation analysts have warned about a capacity squeeze in trucking that will place considerable upward pressure on pricing. Yet an examination of monthly trucking market indices on both sides of the border does not support that prediction – not yet anyway. Transport Canada data shows that the for-hire motor carrier sector grew considerably during the economic boom time between 2003 and 2009. Where there were 8,968 for-hire motor carriers serving the Canadian market prior to 2003, by the start of the recession, new entrants had ballooned that number to 12,773. There was considerable growth in the number of small carriers (earning less than $1 million annually and running 10 trucks or fewer) in particular. Our estimates are that capacity shrank by 10-15% as a result of the recession. The question is how quickly it will come back. Our just-completed annual equipment buying intentions survey of the nation's for-hire carriers shows that more than a quarter have no intentions to replenish their aging fleets this year. The vast majority (nearly 40%) plan to replace up to a tenth of their fleet. Private carriers appear even more reluctant to put new trucks on the road, with more than a third saying they have no plans to replenish their fleets this year. Motor Vehicle Manufacturers Association numbers show 2011 is proving to be better than the previous two years as well as the slow years at the start of the previous decade in terms of sales of new Class 8 trucks. But sales totals are still far below the record truck purchasing experience from 2004 to 2008. Were it not for the economic slowdown from the second quarter, we might already be feeling the impact of a capacity squeeze.

CLASS 8
Truck Sales Trends

Monthly Class 8 Sales – Aug 11

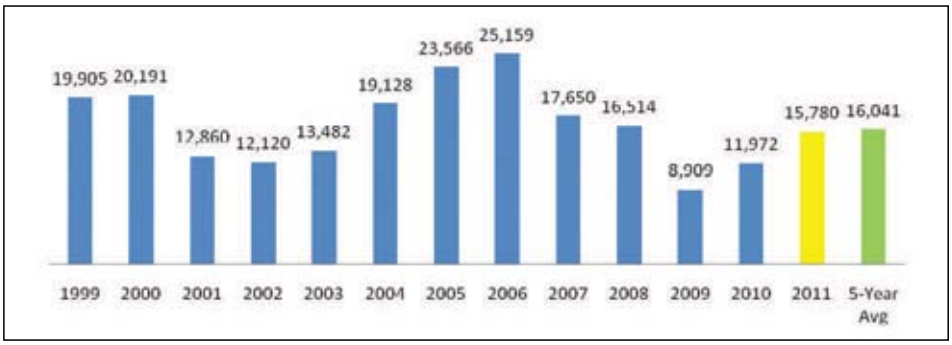
OEM	This Month	Last Year
Freightliner	550	369
International	520	314
Kenworth	595	327
Mack	110	99
Peterbilt	260	167
Sterling	0	0
Volvo	193	172
Western Star	197	88
TOTALS	2425	1536

Historical Comparison – Aug 11 Sales



This was one of the best Augusts the Canadian Class 8 market has experienced over the past decade. The 2,425 Class 8 trucks sold in August far surpassed the monthly totals from last year as well as 2007 to 2009 and from 2000 to 2003. The month's sales tally also surpassed the five-year average for the month by more than 600 units, the third straight month this has happened.

Historical Comparison – YTD Aug 11



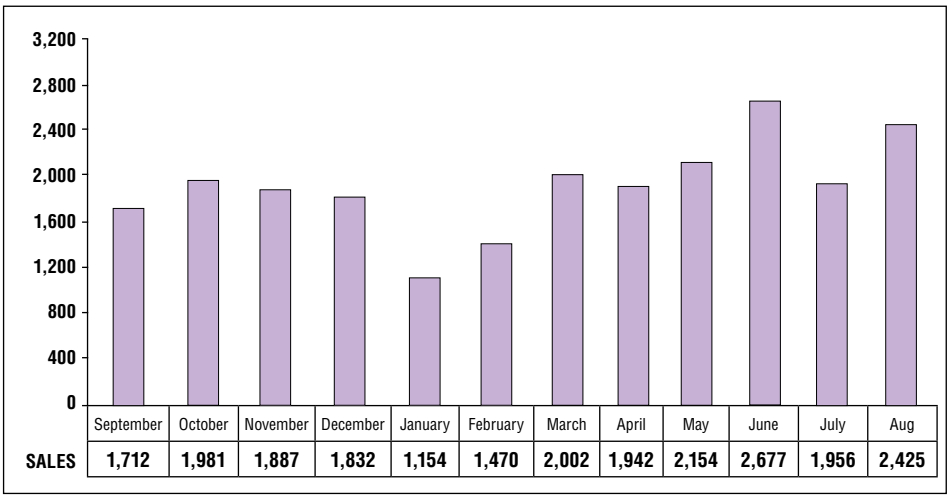
Class 8 Sales (YTD Aug 11) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	236	406	105	228	2,179	647	197	72	11	24	4,105
Kenworth	295	1,202	226	99	573	715	88	0	0	0	3,198
Mack	46	150	76	54	501	156	30	23	0	11	1,047
International	226	505	60	204	1,090	730	182	93	9	48	3,147
Peterbilt	200	533	146	125	353	234	91	19	0	0	1,701
Volvo	97	105	40	185	644	304	85	38	0	4	1,502
Western Star	213	333	52	26	172	184	43	48	1	8	1,080
TOTALS	**1,313**	**3,234**	**705**	**921**	**5,512**	**2,970**	**716**	**293**	**21**	**95**	**15,780**

So far, the YTD sales totals are significantly better than the sales figures posted in both 2009 and 2010 and also better than the results after the first half of 2001, 2002 and 2003. The YTD totals are also now less than 300 units off the five-year average and showing continuing improvement with the last three months running above the five-year average. The improvement in truck sales may be an indication that the economy is doing better than the public perceives, however with trucks ordered months in advance one has to wonder what the impact will be on future sales from the current spate of bad news stirred up by nervous stock markets.

CLASS 8
Truck Sales Trends

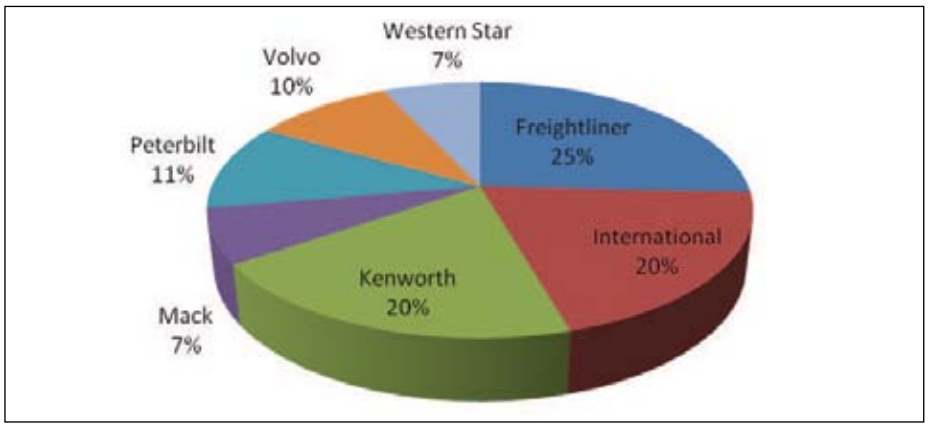
12 - Month Sales Trend



	September	October	November	December	January	February	March	April	May	June	July	Aug
SALES	1,712	1,981	1,887	1,832	1,154	1,470	2,002	1,942	2,154	2,677	1,956	2,425

The 2,425 trucks sold in August made it the second strongest sales month of the past 12-month period, just slightly behind June when sales climbed above 2,600 Class 8 trucks. So far, sales have climbed above the 2,000 mark for four of the first eight months of 2011 and came within less than 60 of achieving that mark on two more months.

Market Share Class 8 – Aug 11 YTD



Freightliner jumped out to an early lead at the start of the year with 28% market share and continues to hang on to that lead, although its share has declined. International, a former market leader who has adopted different engine emissions technology than the rest of the OEs, is battling it out with Kenworth for second place. Peterbilt and Volvo are the only other two manufacturers enjoying a 10% or greater share of the Canadian Class 8 market.

Source: Canadian Motor Vehicle Manufacturers Association

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