Inside the Numbers
with Lou Smyrlis

Editorial Director,
Transportation Media

IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

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VANILLA FORECASTING

You survived the Great Recession. Are you ready for the "GREAT OKAY"?

ACT Research president Kenneth Vieth may have summed up the US economic forecast best at ATA's All Eyes on the Economy session when he said "We came through the Great Recession and we are now in the Great Okay."

Vieth was referring to expectations for continued but less than spectacular growth in 2014 and 2015 for the US. Co-panelist Mark Vitner, managing director and senior economist at Wells Fargo, forecast GDP growth of 2.4% in 2014 and 2.7% for 2015.

A slow growing US economy, of course, is not good news for Canadian carriers. More than 70% of our exports are still reliant on the US market. But there may be reason for more optimism north of the border as our reliance on the US market continues to be progressively reduced. Though the United States will remain Canada's largest trading partner, the percentage of Canadian trade with the U.S. has dropped to 74% from nearly 90% in the past decade and is expected to decline another 10% by the end of this decade.

ATA vice president and senior economist Bob Costello was more optimistic about the future of the US market but conceded current freight growth is "very choppy." For example, while truck tonnage is up 5% year to date and intermodal tonnage is up 3.7%, rail carloads are down 0.9% and air freight is down as well.

Costello added that mostly because recovery in sectors such as energy and construction are outpacing the recovery in the general economy, heavy freight is driving the tonnage figures even though the number of loads is growing slower.

Flatbed freight is up 1.8% YTD, temperature control freight is up 2.7%, tank freight up 5.4%, yet dry van is down 0.1% but improving, according to Costello.

The economy is "moving in the right direction," Vitner said with homeownership expected to increase and home construction, which was held up by the wettest summer on record in the southern states, picking up the rest of the year. But to place current home construction in perspective, he pointed out about as many new homes are being built now as back in 1981 when mortgage rates were around 15%.

Vitner also warned that uneven distribution of economic gains means consumer confidence is growing slowly and retailers who cater to mid and low-income shoppers are experiencing slow growth as a result.

Vitner explained that rising stock prices are bolstering household finances at a time when incomes are growing slowly but those gains are being registered by just the top seven percent of US households. He did add he sees this situation improving in 2014 and 2015.

"More income is what we need, particularly among mid-income consumers, to get this economy growing," he said.

Vitner also didn't have strong expectations for the upcoming holiday season, which will be shorter than usual because the US Thanksgiving will be celebrated later this year.

It all led panel moderator Stuart Varney of Fox News to comment: "I have to say the new normal is not that attractive."

This side of the border, Carlos Gomes, senior economist with Scotiabank, and a speaker at our own Surface Transportation Summit, held in mid October, also described the forecast for Canada's economy in 2014 as a mixed bag.

"Coming out of the downturn, we had a significant improvement both in manufacturing shipments as well as building permits," Gomes said, noting growth has since moderated.

But Canada is also doing a better job in recent years in looking beyond the US market. The multi-billion dollar pact just agreed to by the European Union and Canada, integrating two of the world's largest economies, is a good example.

The deal makes Canada the only G8 country – and one of the only developed nations anywhere – to have preferential access to the world's two largest markets, the EU and the United States, home to a total of 800 million people. The deal is expected to increase bilateral trade in goods and services by a fifth to 25.7 billion euros ($35 billion) a year, according to the latest EU estimates. According to a federal report, CETA could boost the Canadian economy by at least C$12 billion annually. The EU is Canada's second-biggest trading partner, with goods and services exports totaling C$40 billion and imports totaling C$52 billion in 2011.

The agreement could come into effect from 2015, after EU governments, the European Parliament and the Canadian provinces give their blessing.

Traditionally strong North Atlantic, general cargo trading partners like Montreal and Halifax are well positioned, but so could other ports on the Great Lakes/St. Lawrence maritime corridor benefit from increased shipments across the Atlantic. Falling under the latter category would be such mainstream commodity ports as Quebec, Sept Iles, Port Cartier, and Hamilton.

Bob Armstrong, president of the Chartered Institute of Logistics & Transport North America and of ATLAS Trade & Logistics Advisory Services Inc states "there is no doubt " in his mind that imports and exports between Canada and the EU will grow, as has been experienced under the North American Free Trade Agreement (Nafta) for more than two decades.

"The marine industry," he says, "should be excited about the growth prospects of two-way trade as tariffs are reduced to zero and other barriers to trade are eliminated in the final drafting of this free trade agreement. Commodities from Canada such as iron ore and coal will have new markets in the EU and be a boon to marine operators."

Armstrong also believes CETA will offer an opportunity to increase Canadian exports of fish and seafood products via the marine mode. "And likewise, certain imports of agrifood products from the EU should increase as tariffs are reduced to zero."

Other sectors identified by Armstrong for increased business with Canada (and through Canada to the US) is production machinery, advanced equipment, project cargoes, and the like - especially from Germany.

Armstrong also asserts: "The EU will see Canada as a key stepping stone to the US and Mexico markets to complement our own market – thereby boosting cargo movements on the St. Lawrence-Great Lakes waterway."

And, of course, all that can only have positive spin-off effects for Canadian trucking companies.

Freight volumes strong, but overcapacity remains an issue: M-O's Munro

Freight volumes are higher than they've been in "many, many" years, but there remains excess capacity in the marketplace and continued downward pressure on rates.

Doug Munro, president of Maritime-Ontario Freight Lines, told a packed Surface Transportation Summit that strong freight demand isn't yet translating into stronger rates. In fact, he said it's quite the opposite, as there continues to be pressure to reduce trucking prices.

"There is a lot of overcapacity, so though there's been an improvement in freight volumes, it's very hard to get rate increases," Munro said. "Margins are under pressure. We see that on a lot of freight quotes."

Munro said many shippers are continuing to issue RFPs in a bid to reduce their transportation costs.

"It's very difficult to get rate increases in this environment," Munro said. "The volumes are there, but it's hard to get the margins on it."

Maritime-Ontario is taking advantage of low interest rates to refresh its fleet, but isn't adding capacity.

"We're using this time to get new equipment and fund it at very reasonable rates," he said.

Asked what signals Munro is looking for before adding capacity, he responded it would take real demand and healthy rates - not outlooks or forecasts - before shifting into growth mode.

"We respond to demand, rather than looking at outlooks that are hard to predict. We look at actual demand. If demand is growing, we add accordingly. Without demand, we don't add (trucks)," Munro said. "We would like to see continuing growth in freight volumes and freight rates to justify those capital expenditures."

Asked by moderator Lou Smyrlis what it would take to bring capacity back in line with demand, Munro said it could be a combination of mergers and acquisitions and insolvencies.

"But until now, we haven't seen a lot of M&A or insolvencies, so it's hard to say," he added.

Looking ahead to 2014, Munro remains cautious. He characterized the US financial situation as "very fragile" and worries about what will happen when the Federal Reserve begins weaning the economy off life support.

"I think things will work their way through, but we can see how it would be a difficult time for the next couple of years, especially if the US doesn't sort through these problems," he said.

Most economic indicators remain in positive territory

Despite all the negativity on the news, and the uncertainty involving the US debt ceiling, most trends are pointing to a steadily growing economy that bodes well for trucking's future.

That was the synopsis from leading economists and industry analysts speaking at the 2013 Surface Transportation Summit, put on by our Fleet Executive and Canadian Shipper publications in partnership with Dan Goodwill & Associates. Carlos Gomes, senior economist with Scotiabank, has earned a reputation for being more upbeat than many of his peers. He remained that way with his latest forecast.

"I generally have been very positive over the past several years and I still remain positive with respect to the outlook," Gomes said.

Globally, Gomes said the economy has been improving throughout the year, led by emerging markets in China, India and Brazil. "They have moderated as well, but they continue to grow in excess of 5%, while the global economy is closer to 3%," Gomes said of emerging markets.

Even Europe, which has been an economic anchor in recent years, returned to positive growth in the second quarter, Gomes noted.

China saw some moderation in economic growth last year, but it has enjoyed double-digit growth in late 2012 and into 2013, "which is telling us the slowdown in China that was expected to last several years is coming to an end."

Job growth is improving in the US, by about 2% year-over-year. That's a leading indicator Gomes watches closely.

"Employment growth went negative a full year before the recession began," he pointed out.

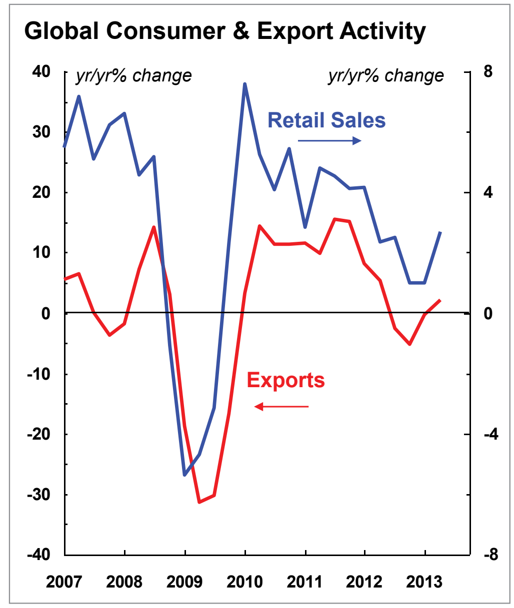
Here in Canada, Gomes characterized the economic picture as "more mixed."

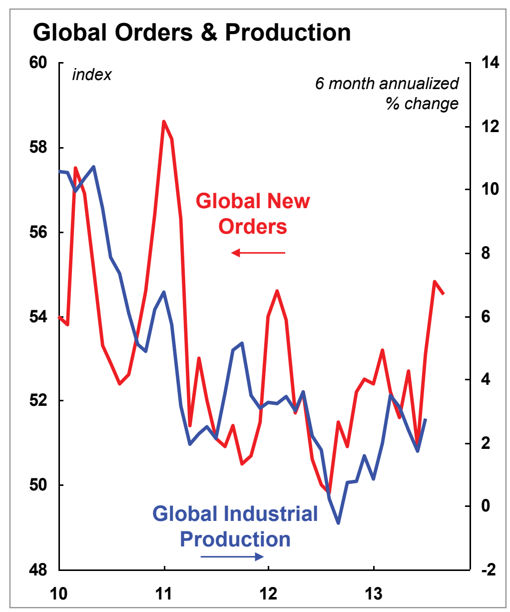
"Coming out of the downturn, we had a significant improvement both in manufacturing shipments as well as building permits," Gomes said, noting growth has since moderated. Canada still relies heavily on the US for 70% of its exports.

Gomes acknowledged Canadian household debt is a valid concern, but that it may not be as dire as it seems. Canadians now carry a debt-to-household income ratio of nearly 160%, which is higher than in the US today, and about equal to where US debt loads sat before the recession.

However, thanks to low interest rates, debt charges account for just 7% of disposable income in Canada, a figure that was in excess of 9% in 2008 and as high as 12% in the 1990s. Interest rates would have to climb by 100 basis points to bring the debt charges as a percentage of disposable income to its average rate of 8.5%. So while Canadian household debt is high, Gomes said it's manageable as long as interest rates remain low.

Focusing on transportation Charles Clowdis Jr., managing director, North American markets with IHS Global Insights, said he's seeing evidence of near-shoring, with as much as 5% of manufacturing that was moved to Asia, returning to North America, usually to Mexico. This bodes well for trucking and rail providers, he noted.





Source: Bloomberg, Statistics Canada, Scotiabank Economics.

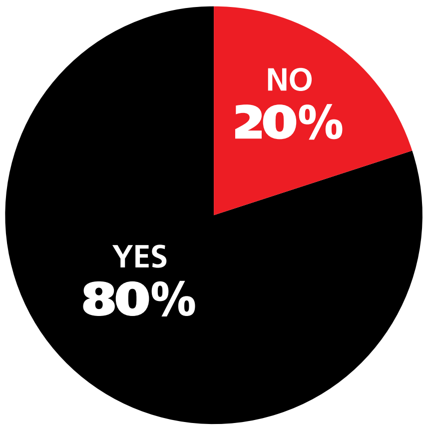
INSIDE THE NUMBERS

CAN YOU GET USED TO IT?

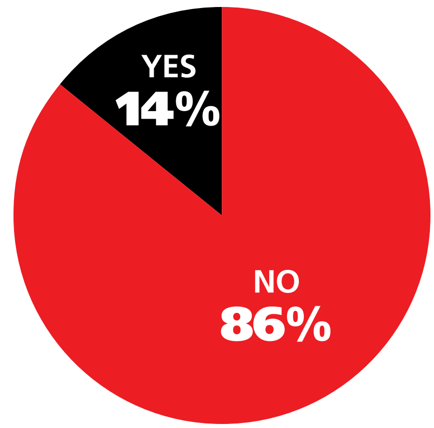
Probing for-hire carrier appetites for used iron

Small fleets are hard pressed to purchase new trucks due to high purchase pricing. Is buying used a viable alternative? Eight in 10 Canadian for-hire carriers have purchased used trucks before, so it's a common practice industry wide, our annual Equipment Buying Trends Survey indicates. Differences in used truck purchasing strategies, however, are revealed when we examine for-hire fleets by size. While less than three quarters of large for-hire carriers have purchased used trucks in the past, 100% of small carriers responding to our survey have done so and 18% expect to add some used iron to their fleet before the year is out.

PURCHASED USED TRUCKS BEFORE

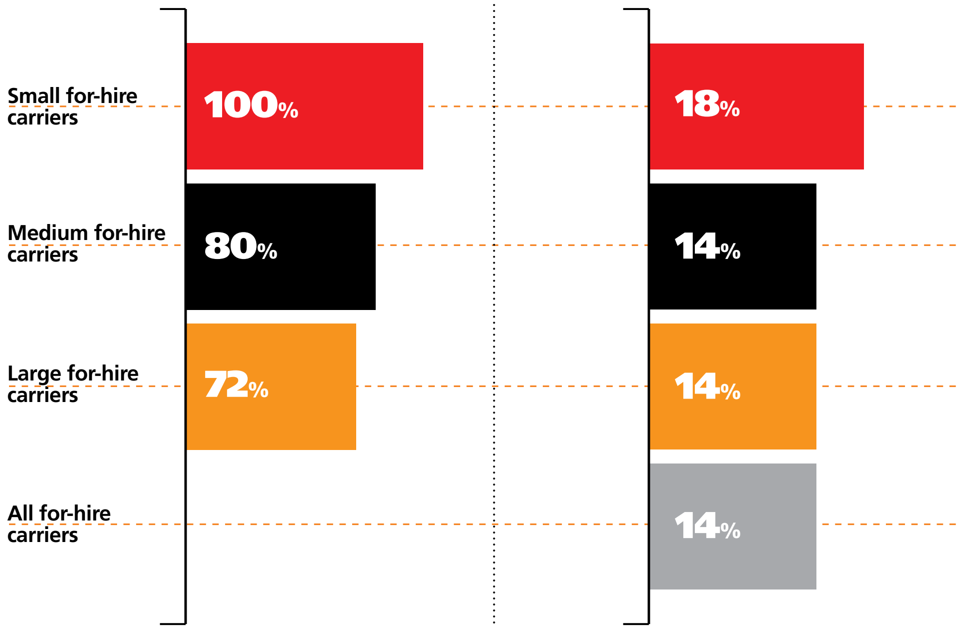


PURCHASING USED TRUCK(S) REMAINDER OF YEAR

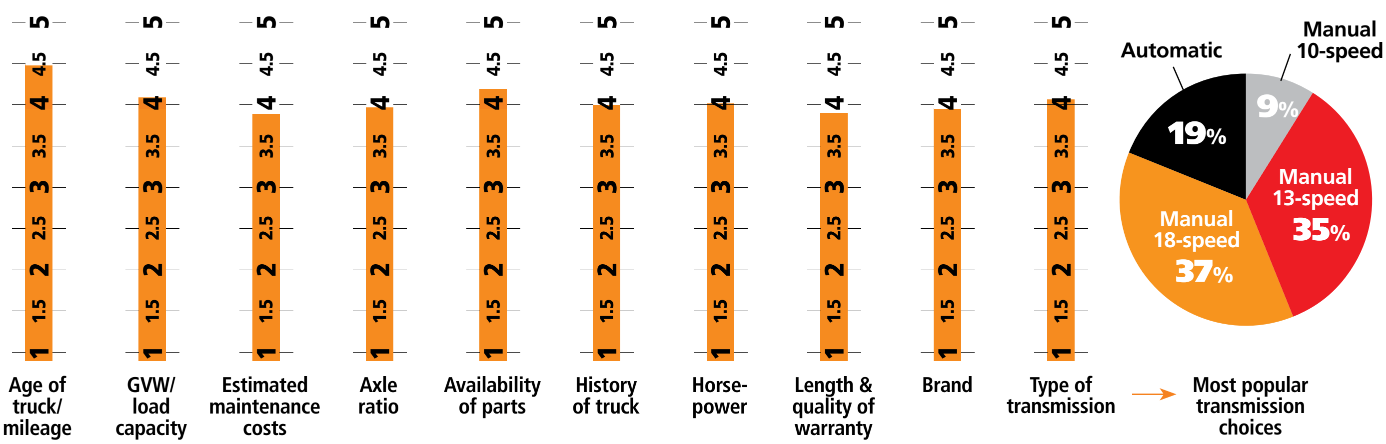


PURCHASED USED TRUCKS BEFORE BY SIZE OF CARRIER

PURCHASING USED TRUCKS REMAINDER OF YEAR BY SIZE OF CARRIER



KEY FACTORS CONSIDERED WHEN PURCHASING USED TRUCKS

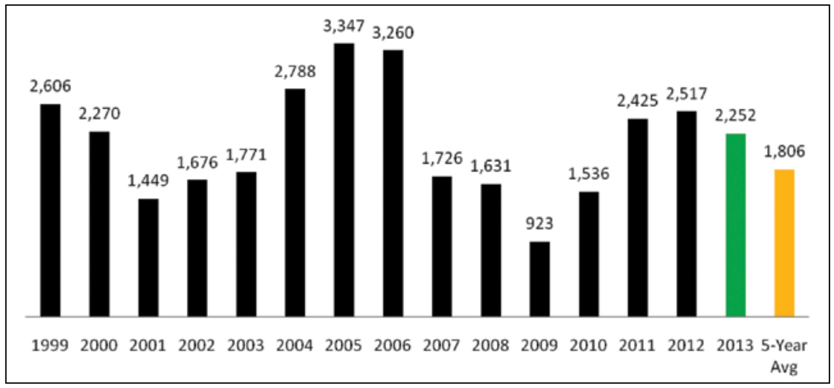


CLASS 8
Truck Sales Trends

Monthly Class 8 Sales – Aug 13

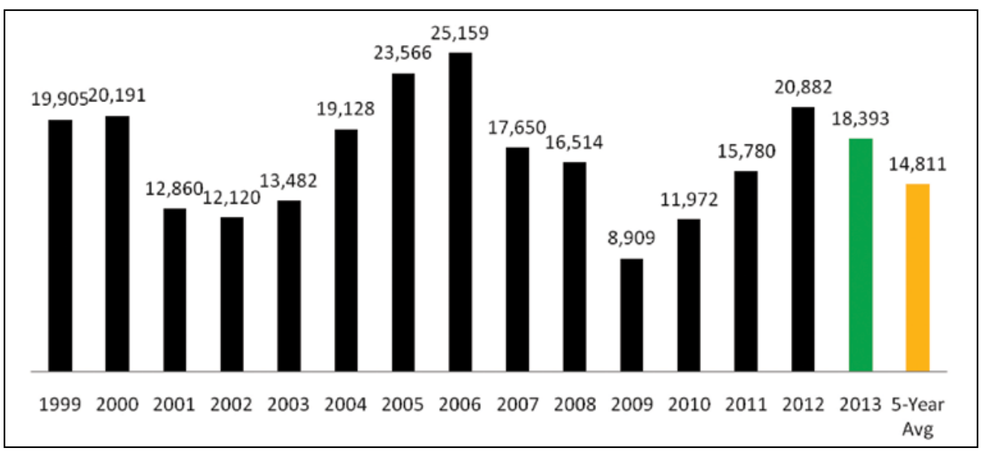
OEM	This Month	Last Year
Freightliner	502	675
International	308	394
Kenworth	395	428
Mack	179	209
Peterbilt	366	335
Volvo	351	271
Western Star	151	205
TOTALS	2252	2517

Historical Comparison – Aug 13 Sales



The 2,252 trucks sold in August, although a strong total, were more than 250 behind last year's pace. That has been the trend for the entire year so far: good, but not as good as the previous year or on pace with the best years in truck sales. Every OEM, with the exception of Peterbilt and Volvo, posted lower figures than the previous year. Going back to 1999, there were only 7 years with better sales results in June. The sales total for the month is also more than 400 above the five-year average.

Historical Comparison – YTD Aug 13



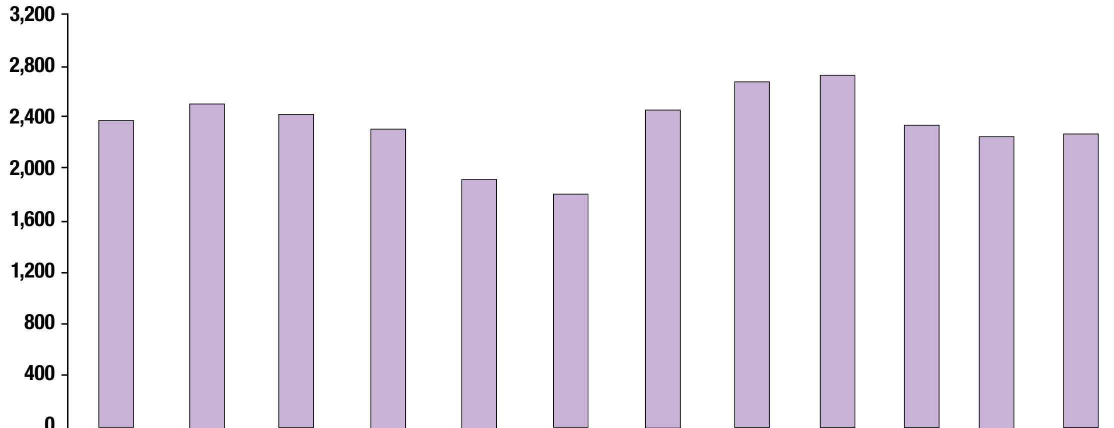
Class 8 Sales (YTD Aug 13) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	292	471	103	193	1,641	620	185	60	5	13	3,583
Kenworth	458	903	232	52	381	459	67	0	0	0	2,552
Mack	86	187	85	41	398	183	42	42	0	6	1,070
International	76	364	32	75	827	433	66	27	16	21	1,937
Peterbilt	292	664	143	132	283	319	82	39	0	0	1,954
Volvo	177	109	84	110	658	367	73	37	0	3	1,618
Western Star	178	380	40	28	217	236	29	60	4	16	1,188
TOTALS	1,559	3,078	719	631	4,405	2,617	544	265	25	59	13,902

YTD Class 8 sales of 18,393 units places 2013 more than 2,000 trucks behind last year's pace but also more than 3,500 above the five-year average. So far this is the 7th best year in sales going back to 1999 but slippage is occurring. We don't expect a particularly strong second half of the year. Our revised estimate is for Class 8 sales to come in around 28,500 vehicles in 2013.

CLASS 8
Truck Sales Trends

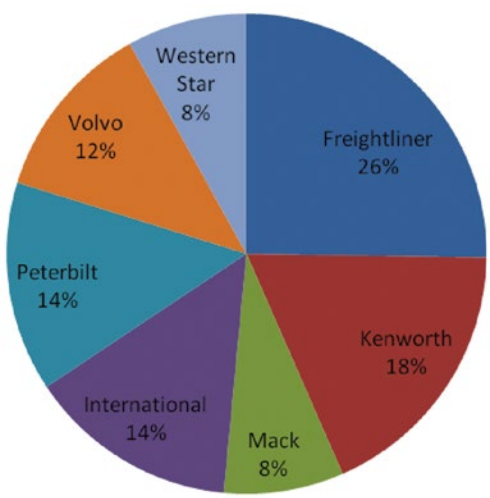
12-Month Sales Trends



	September	October	November	December	January	February	March	April	May	June	July	August
SALES	**2,392**	**2,575**	**2,411**	**2,326**	**1,916**	**1,808**	**2,442**	**2,669**	**2,721**	**2,346**	**2.239**	**2,252**

Class 8 sales have come in above 2,000, reminiscent of the industry's capacity boom years of 2005 to 2007, for six straight months now. The three-month trend towards increased sales figures month over month came to an end in July but August showed improvement again. The big question was whether sales would hold up over the summer months and they have. Next question now is how they will hold up the rest of 2013.

Market Share Class 8 – Aug 13 YTD



Freightliner, last year's Canadian market leader, is solidly in control of the market share lead with more than a quarter of Canadian Class 8 truck sales. Kenworth finished 2012 in the number two spot for market share and there it still sits with an 18% market share. Navistar International finished the year with 15% market share and is now in a dead heat with Peterbilt with a 14% share of the Canadian Class 8 market. Volvo is the only other OE with a market share above 10%.

Source: Canadian Motor Vehicle Manufacturers Association