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Inside the Numbers with Lou Smyrlis

Editorial Director, *Transportation Media*

IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

VOLUME 3, ISSUE 5

Who has the better crystal ball?

The slow and uneven recovery is making for vastly different economic outlooks.

Place two economists in a room and you are bound to get three opinions. If not more. It's a joke that has been making the rounds at the numerous economic sessions I've been attending this fall at industry conferences and it's rather apt, particularly heading into next year. It seems that with the Canadian and US economies growing at below 3% GDP, there is enough volatility in the marketplace to cause economists to derive different meanings from the same set of statistics.

So what's best to do when trying to figure out how to prepare for 2014? Listen to both sides and keep in mind that any economy growing at less than 3% GDP does not provide that rising tide that lifts all ships. Which economic forecast will ring closer to "truth" for you will depend on the sectors you serve, the regions you operate in and your appetite for risk taking.

In the last issue of Inside the Numbers we looked at the mainly positive views of Carlos Gomes, senior economist with Scotiabank and the American Trucking Association's senior economist Bob Costello along with the lukewarm forecasts from ACT Research's Ken Vieth, and Wells Fargo's Mark Vitner. This issue we consider the outlook provided by David Newman, transportation market analyst with Cormark Securities, Noel Perry, managing director and senior consultant with industry forecaster FTR, and Emanuella Enenajor, economist, CIBC World Markets.

Being a glass is half full type of guy, I'll start with David Newman, an industry friend who exudes energy and whose transportation market advice has stood the test of time.

After five tough years, the global economic picture is starting to shape up for the better and Canada is well-positioned to take advantage of the new opportunities, according to Newman, who provided his mainly positive message at the CITT annual conference in Toronto.

Europe's economy is turning the corner at the same time as the US economy is improving and the Chinese economy is stabilizing at a lower but still robust growth level, Newman said. India is continuing to develop and Mexico is gaining momentum.

"What we are hoping is for all to align at once – synchronous global growth," he said, adding he is expecting global growth around 3% next year.

Canada stands to profit from such synchronous global growth, Newman said, because it has the base metals, energy products and agricultural products required to feed the demand of an expanding world economy.

"We have what the world wants and we stand to benefit," Newman said, pointing out Western Canada with its strong raw materials base is particularly well positioned.

The growth in manufacturing is good indication of what's to come. Manufacturing around the world expanded in October and US manufacturing is at its strongest in 2.5 years. US auto sales are almost at pre-recession highs. They were at 16 million in 2007 and are expected to hit 15.7 million in 2014 and 16.2 million by 2015.

US housing starts, although nowhere near their peak levels from prior to the recession, are nevertheless continuing to recover and unemployment is down to 7.2% from the 10% peak during the recession and US consumer confidence peaked in June.

In Canada there are concerns about a correction in the condo market but the single family house market should be safe.

"It's unlikely we will witness a US style meltdown. It's not going to happen," Newman said due to the much stricter Canadian lending rules.

Canadian unemployment is down to 6.9% from the peak of 8.7% back in August of 2009.

Newman forecasts GDP growth of 2.5% to 3.0% for the US and a more muted 2.2% in Canada for 2014.

"We are near recovery mode. Nowhere near the peaks of the past but we are on the right track," he said.

CIBC's Enenajor is less optimistic than Newman forecasting around 1.5% GDP growth for Canada in 2014, much of that tied to the US. Slow, flat growth, but growth, nonetheless. There's been a pickup in US manufacturing, she noted in her address to the Ontario Trucking Association's annual convention.

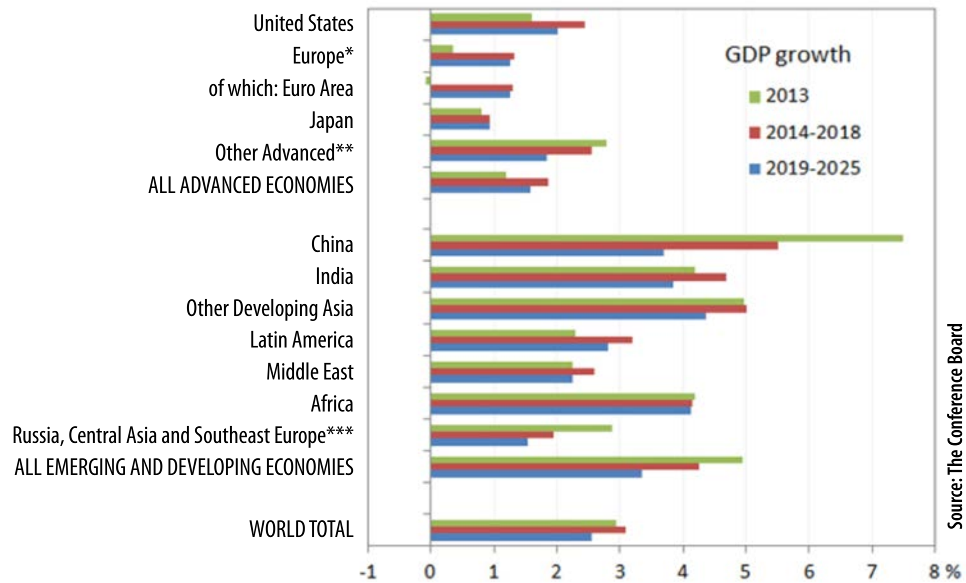
"In terms of what is the outlook, given that Canada is leveraged quite heavily to the US, our leverage to the US has actually been a very good thing recently, from the perspective of exports."

Canada's exports to the US have increased throughout the recovery, she noted. "We do see improvements," she said. "Canada's going to be piggybacking a little bit on the US in terms of our ability to export to the US. We really need external growth to boost domestic growth and we're likely going to see that in 2014 as we see US growth accelerate in the coming year."

Still, she doesn't expect much from Canada's manufacturing sector. "It's likely that manufacturing will be less and less an important part of the Canadian economy and resource extraction will increasingly be an important part – and when I say resource extraction, I mean primarily oil and gas."

Perry was definitely the most negative of the bunch. He even uttered the "R" word. (Hey Noel, think you could have held off on that till after the holidays?)

Global Outlook For Growth of GDP, 2013-2025



Potential for synchronous global growth could ignite demand for transportation, leading to improved carrier pricing, a recovery of profitability and potential for industry consolidation.

Motor carrier executives "should not have high expectations for the remainder of this recovery," was Perry's somber advice when addressing clients during a recent State of Freight webinar. While US GDP growth has been moderate through the first three quarters of 2013, Perry noted it's expected the government shutdown in October could reduce Q4 GDP by half a point. At the same time, the industrial sector and home sales in the US are leveling off, he believes.

Worse yet, Perry noted, "We are now at the point where historically, you would begin to expect a recession at some point in the next two to three years…History says recessions tend to occur in five- to seven-year increments and seven years from 2009 is 2016, so you should have in your scenario portfolio a recession in the next couple of years, regardless of whether we or anyone else forecasts it."

Even Perry's seemingly bleak forecast could get worse. He noted forecasts are built upon a "relatively calm world" and conditions could change in a hurry if consumers or investors overreact to negative quarterly indicators.

"This recovery has been unvolatile," Perry said. "Even though we've had disappointing growth, we've had stable conditions that makes it easy to invest and easy to manage a truck fleet because you're not trying to chase the market up or down. One of the critical variables over the next couple of years is, will this stability continue? History says it won't and therefore, my strong recommendation is that you keep your operations and your investment horizon flexible, because things can change rapidly."

So there you have it: Three different economists, three different outlooks for next year. Six months from now we'll know who had the better crystal ball into the future.

WANT TO LEARN MORE?

James Menzies and Jason Rhyno (yeah, he's doing work for us now) have full reports on the economic outlooks and other issues key to transportation for 2014 in all of Transportation Media's platforms: Motortruck Fleet Executive, Truck News, Truck West, trucknews.com and TMTV.

Fleet executives are ready for a "pricing renaissance". But is the market?

Trucking "is in radical need of a pricing renaissance," according to Noel Perry of FTR Associates.

"The pricing culture in our industry is based on 50 years of falling costs. And therefore we didn't have to learn the art of price increase in this industry.," Perry said in his presentation at the recent Ontario Trucking Association annual convention. "Well, them days is over."

I'm sure it's a cry for change every fleet executive could rally around. But, assuming carrier executives are ready and willing to talk tough in contract negotiations, is the market right for such a change?

Just like the economic forecast for 2014, it depends whom you ask.

The potential for synchronous global growth could ignite demand for transportation, leading to higher carrier pricing, a recovery of profitability, and the potential for industry consolidation, according to David Newman, a transportation market analyst with Cormark Securities and the luncheon speaker at the recent CITT conference in Toronto.

Surface transportation volumes have actually been relatively sluggish with the railways realizing modest growth, although above GDP, and the TL and LTL trucking segments suffering declines. But motor carriers have done a "phenomenal job at cost and capacity management and their balance sheets are in excellent shape," Newman said.

There have been areas of strong performance in the niche/specialized markets, such as bulk/tank, heavy haul and oilfield services.

"And everyone is expecting the fourth quarter and into next year to start looking better," Newman added. "Truck tonnage and our tracking of various indices seem to point toward an emerging recovery in volumes."

Newman said a variety of factors could lead to above average growth for carriers in the years to come. Europe's economy is turning the corner at the same time as the US economy is improving and the Chinese economy is stabilizing at a lower but still robust growth level, Newman said. India is continuing to develop and Mexico is gaining momentum. He is expecting global growth around 3% next year.

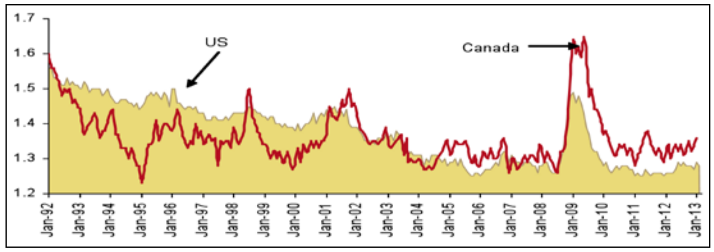
Canada stands to profit from such synchronous global growth, Newman said, because it has the base metals, energy products and agricultural products required to feed the demand of an expanding world economy.

The inventory to sales ratio is also in balance so if there is an increase in demand there should be an immediate impact on freight volumes.

"It won't be a dead cat bounce. It will be the real thing," Newman ensured.

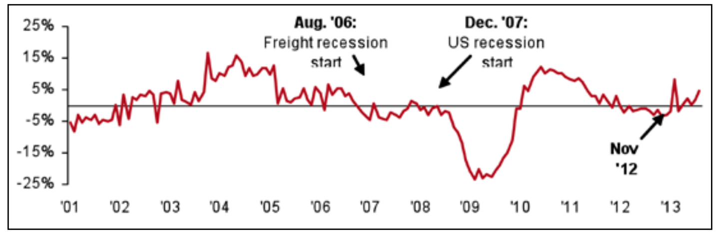
Canada's West Coast ports are also doing well, and considerably outpacing their US counterparts. Containerized traffic for the three largest US West Coast ports has grown just 2% YTD while Canada's West Coast ports are experiencing 18% growth YTD.

North American Inventory to Sales (I/S) Ratio



The inventory to sales ratio is in a relatively well balanced position

Cormark North American Freight Monitor



Truck tonnage and Cormark's tracking of various indices seem to point toward an emerging recovery in volumes. Given driver shortages, HOS rules, CSA 2010 and demographics, supply may be restrained, pointing toward a stronger potential pricing environment.

Newman said the driver shortage, the new US hours or service, and demographics could also lead to higher pricing in the trucking sector as capacity is curtailed.

Perry agrees that a capacity crisis may provide the market opportunity where truckers will re-frame the way they price but concedes that right now "they are shy."

"Price has been near zero for the last year and a half," he points out. "Most of the publicly traded guys either lost margin in the last quarter or came in below expectations. It's because they have not been able to take advantage of this market opportunity, despite the fact that this market opportunity has been making their costs higher. So there's a big issue here."

The last time the trucking industry saw large-scale success in pricing was after the hours-of-service (HOS) changes in 2004.

Doug Payne, president and COO of Nulogx, knows more about truck pricing than most folks. His company's Canadian General Freight Index tracks pricing on a monthly basis and the index shows that from 2008 to August 2013, pricing has only increased marginally.

"And if I look at a year ago, we are still three points behind where pricing was a year ago. We are getting the same trends and I do think those opportunities are there for the tide to change."

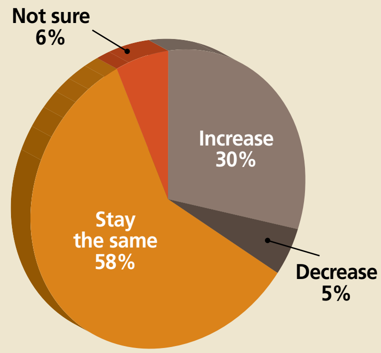
Trucking, LTL in particular, struggled with excess capacity during the recession and the start of the recovery. Estimates are that at least 15% of capacity was removed from the market since then. Perry believes trucking is now enjoying strong capacity utilization but to achieve that, it has shaken out its "excess surge capacity," meaning a sudden spike in demand for trucking services would likely result in a strong pricing increase.

And that may provide carrier executives with the leverage they need to get more aggressive on pricing.

Inside the numbers
TRANSPORTATION BUYING TRENDS SURVEY

TL freight shippers

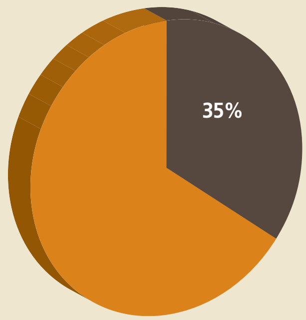
Changes in use of mode 2014

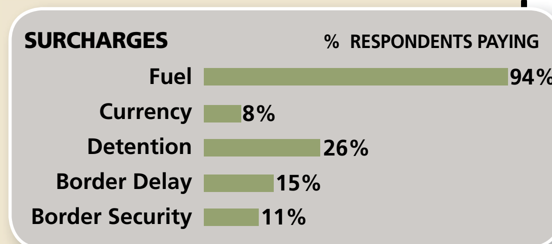


EXPECTED RATE INCREASES 2014

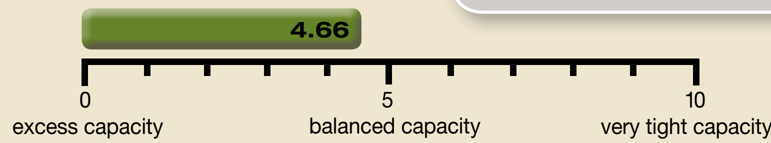
Size of Increase	% of Respondents
Down 5%+	1%
Down 2-5%	1%
Down 0-2%	3%
Flat	22%
Up 0-2%	29%
Up 2-5%	26%
Up 5%+	12%
Not sure	12%

% expect this mode to have highest pricing power 2014





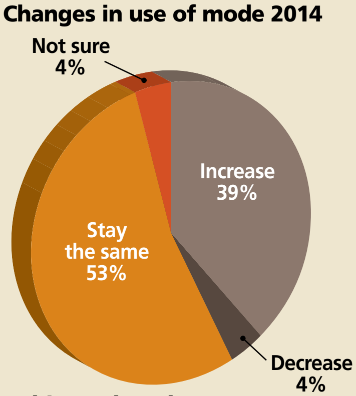
CAPACITY CONCERN



Inside the numbers
TRANSPORTATION BUYING TRENDS SURVEY

LTL freight shippers

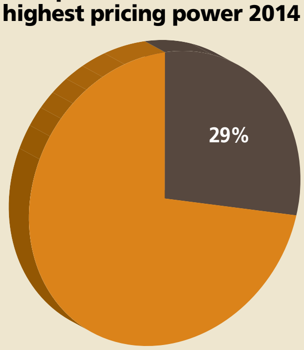
Changes in use of mode 2014

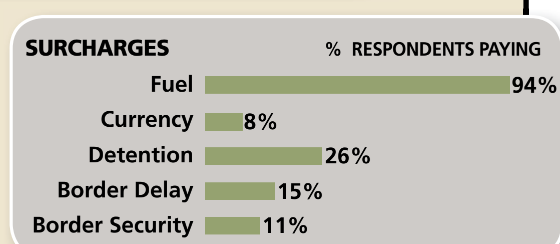


EXPECTED RATE INCREASES 2014

Size of Increase	% of Respondents
Down 5%+	3%
Down 2-5%	1%
Down 0-2%	4%
Flat	18%
Up 0-2%	30%
Up 2-5%	28%
Up 5%+	7%
Not sure	8%

% expect this mode to have highest pricing power 2014





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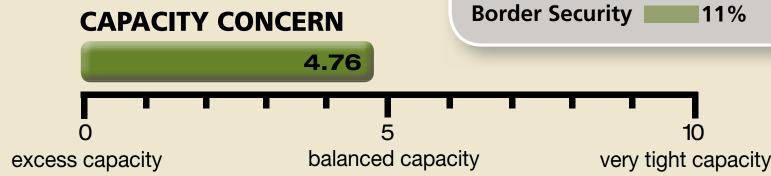

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LEADERS

Michelle Arseneau, managing partner, GX Transportation Solutions, on freight bids

Q. How many bid requests would you receive annually and how do you go about deciding whether you are going to quote on a bid?

Arseneau: We are in our 17th year of operation and we are an LTL carrier with a road service, dedicated service and an intermodal service. We are always happy to have the opportunity to quote on new business – it's part of the sales process and it means, generally, we are one step closer to securing more freight. That being said, we are not fans of the bid process that has been rolling out over the past 5 to 10 years. It seems to us that it's very price driven.

There are shippers out there who are doing it in a proactive way that is managed well but there is a whole lot of other shippers who are making it very difficult for carriers to participate effectively in the process. They are rolling out the bid process to multiple carriers who are not necessarily all qualified to be handling that business. The shippers are looking at sending the RFP to as many carriers as possible, hoping to scale down from there. As a carrier, when we get those massive tenders, even if everything is the way we want to see it in terms of matching our business model, we are still competing with 40 or 50 other carriers and we don't know the customer first hand and don't have the opportunity to ask questions. That boggles my mind. How can a carrier be expected to submit a quote but not be allowed to ask questions? So when we get these bids we consider: Is it just a benchmarking exercise for the shipper who is tendering the business or is it actually a means to an end? Is there actually a chance that we will secure this business or are we just going to blow our resources on completing the RFP?

When you look at the LTL business, you have a half dozen weight levels for every single location you are shipping to. If someone is putting out a national tender, it can involve thousands of rates that need to be worked out. Even with today's technology, it's still a time consuming process to go through that exercise. In the last couple of years there have been some interesting tenders that have come about where the pricing part of the process is hours and hours and all the preliminary stuff that you need to do is practically a full time job – supplying insurance documents, operating authorities and all that which should be done in advance and included in pre-qualifying carriers rather than being part of the tender process It is such a large and time consuming process that when it's thrown out to a whole slew of carriers and generalized, it makes it less attractive for the carriers to participate. Our chances of securing that freight are close to nil unless we have the opportunity to really sit down and present our company while meeting with their people and giving them a tour of our facility so they can see what we are doing and whether we actually have the proper processes in place. There are a lot of companies who will submit a bid but don't have all the processes in place.

Michelle Arseneau was part of a shipper-carrier panel debating the value of the RFP process and ways to improve it at our recent Surface Transportation Summit at the Mississauga Convention Centre. Her fellow panelists included:

Grace Tomaszun, manager, North America transportation sourcing. **McCormick & Company**.
Mike Owens, vice president of physical logistics, **Nestle Canada Ltd.**
Bruce Jantzi, senior vice president, operations, **Erb International**.

To read more about the insightful discussion, sponsored once again by Shaw Tracking, look for your next issue of Motortruck Fleet Executive and also upcoming episodes of TMTV.

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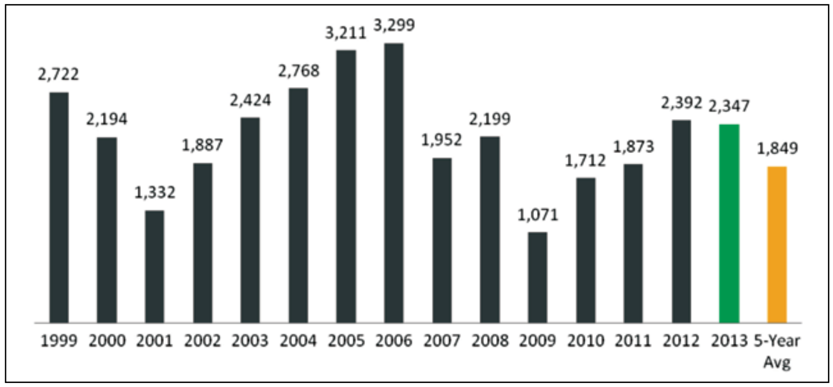
CLASS 8
Truck Sales Trends

Monthly Class 8 Sales – Sep 13

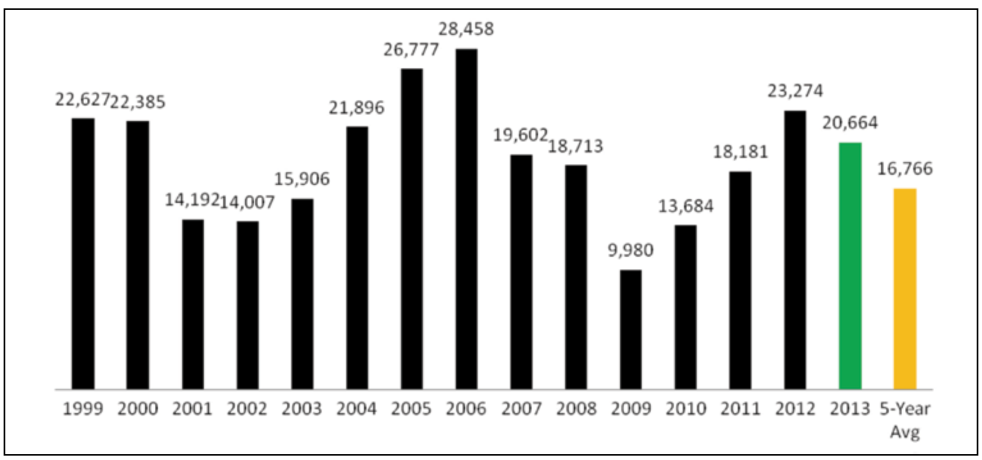
OEM	This Month	Last Year
Freightliner	617	604
International	343	283
Kenworth	417	404
Mack	170	204
Peterbilt	278	384
Volvo	281	312
Western Star	241	201
TOTALS	2347	2392

Historical Comparison – Sep 13 Sales



The 2,347 trucks sold in September were just slightly behind last year's pace. This continues the trend we've seen with Class 8 sales for the first three quarters: good, but not as good as the previous year or on pace with the best years in truck sales. Freightliner, International, Kenworth, and Western Star posted slightly higher figures than the previous year. Going back to 1999, there were only 6 years with better sales results in June. The sales total for the month is also more than 500 above the five-year average.

Historical Comparison – YTD Sep 13



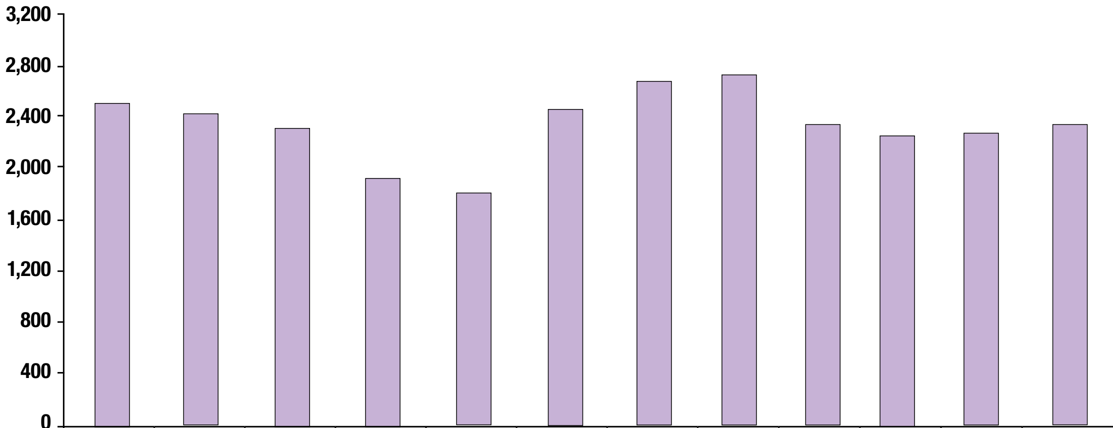
Class 8 Sales (YTD Sep 13) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	442	609	164	290	2,390	873	284	94	21	23	5,190
Kenworth	606	1,331	385	97	623	653	86	0	0	0	3,781
Mack	122	256	150	53	639	291	63	58	0	14	1,646
International	130	521	61	130	1,286	580	93	43	17	27	2,888
Peterbilt	407	980	235	178	459	411	136	48	0	0	2,854
Volvo	280	177	101	158	1,044	587	111	46	0	7	2,511
Western Star	274	561	60	55	344	358	40	79	4	19	1,794
TOTALS	2,261	4,435	1,156	961	6,785	3,753	813	368	42	90	20,664

YTD Class 8 sales of 20,664 units places 2013 more than 2,600 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

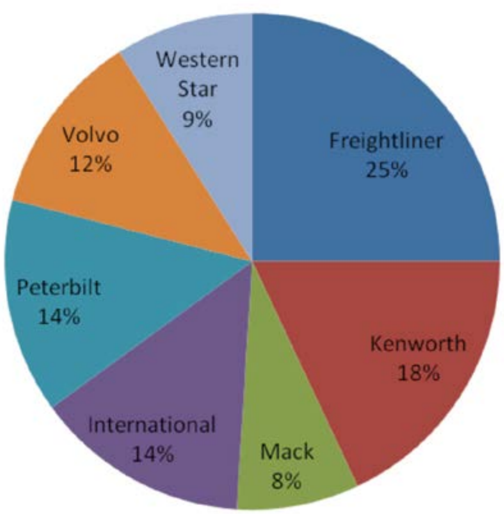
12-Month Sales Trends



	October	November	December	January	February	March	April	May	June	July	August	September
SALES	**2,575**	**2,411**	**2,326**	**1,916**	**1,808**	**2,442**	**2,669**	**2,721**	**2,346**	**2.239**	**2,252**	**2,347**

Class 8 sales have come in above 2,000, reminiscent of the industry's capacity boom years of 2005 to 2007, for seven 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 as did September. 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 final quarter 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 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