Inside the Numbers
with Lou Smyrlis

Editorial Director,
Transportation Media

IN DEPTH ANALYSIS OF THE FACTORS AFFECTING YOUR PROFITABILITY

VOLUME 2, ISSUE 4

THE ECONOMY:
Why it's not as bad as it may seem right now

Watch the nightly newscasts and their tendency to overemphasize the importance of the constant gyrations of the stock market and you would think that if the sky is not falling quite yet, it's almost certain that it soon will. While those who tend towards the glass is half empty approach see the recent economic slowdown as a certain harbinger of a return to recession, the economists I have been listening to over the past few weeks believe that many of the economic fundamentals remain sound.

There is no reason to press the panic button. There is reason to remain focused on your growth plans.

It's painfully true that normal post-recession GDP growth would come in at about 5% per year, and instead, the global economy is growing at a clip of just over 3% and North American GDP at 2%. As a result freight volumes have not shown the strength motor carrier executives would have expected this year.

But slow growth is still growth, and with the exception of Europe, the global economy and the North American economy, continue to plod along on the path to recovery. Let me share with you what some leading Canadian economists see as they look into 2013.

Carlos Gomes, a senior economist with Scotiabank, delivered an upbeat economic overview at our 2012 Surface Transportation Summit Oct. 17. The Summit, hosted by *Fleet Executive, our sister publication Canadian Transportation & Logistics* and Dan Goodwill & Associates brought together more than 200 leading shipper and carrier executives to discuss transportation issues. The event kicked off with the economic overview from Gomes.

"I do remain optimistic with respect to the outlook, notwithstanding the challenges we hear about on a regular basis," Gomes asserted.

The Euro-zone is the only region in the world that is still in recession, with a declining economy. But Gomes pointed out Europe accounts for only 15% of global GDP, "so we have 15% that's contracting and we have the remainder which is improving."

Dawn Desjardins, assistant chief economist at RBC, also had a positive economic outlook to counter the economic doomsayers when she addressed the Supply Chain & Logistics Association Canada breakfast seminar earlier in October.

The unanticipated slowing of the economy experienced this year, as economic risk factors mounted in Asia, Europe and the US, will reverse, Desjardins said, and the Canadian economy will move closer to its potential rate.

"As some of these risks to the global economy dissipate, our economy is going very close to its potential rate. Levels of growth in Canada came from Canadian consumers.. In Canadian households, conditions were quite good."

A highlight for North America, and automotive haulers, is that auto production is up 20% this year, giving a boost to overall manufacturing activity and, of course, transportation.

"Our view is the auto sector will continue to see improving sales and one of the main reasons is the fall-off in the US was so dramatic in 2008-2009, you now have an average age of the US fleet of 11 years," Gomes said of the auto industry. This pent-up demand for new vehicles is good news for the auto industry and the carriers that support it.

Gomes also spoke of an uptick in Canadian building permits, mostly driven by industrial activity.

This is not to say there aren't bumps in the road ahead. As I was writing this report, the latest RBC Canadian Manufac-

turing Purchasing Managers' Index hit my Inbox. I must admit, I wish the numbers looked better. The headline PMI -- a composite indicator designed to provide a single-figure snapshot of the health of the manufacturing sector -- showed that Canada's manufacturing sector grew only modestly in October, with the rate of expansion the weakest since January. At 51.4 (anything above 50.0 indicates growth) the level was a continuation of a trend in recent months towards only modest expansion and a fall from the 52.4 level posted in September.

The slowing performance shown by the RBC PMI for Canada is also in line with what is being shown by purchasing manager indices for manufacturing in China and much of the developed world. This is leading to declining business confidence worldwide which is being reflected at the transportation level through deferred orders, inventory liquidation and preference towards moving smaller shipments so as not to build up inventories.

Jim Ramsay, a vice president with UPS Supply Chain Solutions, noted during a panel I hosted at Halifax Port Days in late September, the economic stumbles we've seen this year are creating a level of uncertainty that leads to caution.

"That caution manifests itself in a couple of ways: One is companies are not willing to invest as much and secondly what they are really driving towards is being razor thin on inventory levels," Ramsay said. "The way that is impacting the transportation world is that we are seeing smaller orders. Often it's the same total volumes we've seen in recent years but broken up into smaller quantities. And that comes down to people not being willing to take the risk for the big order, not knowing how quickly they are going to be able to sell that through."

But many of the economists I've listened to in recent weeks, including Patricia Mohr, a vice president with Scotiabank Group who spoke at Richard Lande's Cost Savings and Innovation Conference in October, expect to see "radically stronger" conditions going forward, in part because of the improvement in the US housing market.

Another reason for optimism is the health of consumers worldwide. The pace of employment around the world is holding up well, Gomes noted, with emerging nations leading the way in job creation. But what about American consumers and their out-of-control spending habits, coupled with rising gas prices? Is consumer spending at risk? Gomes said when you look at the percentage of household income eaten up by debt and energy payments, Americans have aggressively paid off debt and brought that indicator down from 20% pre-recession to 16% today.

"That is the lowest level in more than a decade, so Americans are in much better financial shape to withstand any hits from energy costs than they were in 2007-2008," Gomes said.

Canadians, on the other hand, continue to take on more debt, and see 13.6% of their disposable income spent on energy and debt payments, still below US levels but not trending downward as it is with our neighbours to the south.

Gomes predicted 3.5% global GDP growth next year, up from 3.1% this year. The North American economy will continue to grow at about 2% year-over-year, he added, and there should be some "stabilization" in Europe in the second half of 2013.

Scotiabank's Mohr projected 3.3% global GDP growth for 2013 with Canada at 1.8% and the US slightly outpacing the Canadian economy at 1.9 GDP growth.

Bob Costello, chief economist of the American Trucking Associations was forecast that US gross domestic product (GDP) will grow an average of just 1.5% through the rest of this year and on into next. He said GDP "won't get to 2% growth until the 3rd quarter of next year."

with files from James Menzies and Julia Kuzeljevich

Will the US go over a "fiscal cliff" and drag us along with them?

By James Menzies and Lou Smyrlis

One of the biggest sources of concern for 2013 is the so-called fiscal cliff facing the US, when $500-billion in tax increases and spending reductions are slated to take effect Jan. 1, 2013.

"Concern over the cliff is leading businesses to reduce hiring and [capital] investments," Bob Costello, chief economist of the American Trucking Associations, told a packed audience at the American Trucking Associations conference I attended in October in Las Vegas. Costello said even those businesses flush with cash are avoiding any "risk-taking" that normally would help boost the economy.

"Business investment is already plunging and that is coupled with sluggish hiring" causing GDP growth to suffer. He added that "we are not saying recession is imminent, but that we'll have less GDP growth than we could be having."

Unfortunately, Costello expects the lame-duck Congress that will return to work after the elections "will kick the can down the road" and it will be the job of the new Congress to deal with it, but that most likely won't happen until next summer. "That punt will delay the immediate consequences, but hurt the economy by continuing uncertainty (over its eventual impact)."

At our own Surface Transportation Summit held in mid October, Carlos Gomes, a senior economist with Scotia Bank, was more optimistic. Gomes said the situation is manageable and expects Democrats and Republicans to come together with a solution to postpone some of the tax increases and spending reductions.

"What we are saying is, there is time, we think there's going to be an agreement between the two parties because it would be irresponsible from everyone's perspective to allow that to happen," he said. "We think they're going to reach an agreement prior to Jan. 1, in order to not have a drastic effect on the economy. There are risks, but it's a political decision that can be dealt with… I'd keep my eye on that with the understanding that it's one of the biggest risks in the system, but there will likely be some agreement prior to the deadline."

Meanwhile, monetary policies around the world will continue to be geared towards reviving growth, Gomes predicted.

"Every central bank in the world is in easing mode," he said. "They're all on the same page, they want to ensure this recovery is sustainable and they're able to keep rates low because inflation has come down across most of the world.

To grow or not to grow

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Can equipment – specifically the inability of some carriers to invest in new tractors – fuel trucking's next consolidation phase?

American Trucking Association's chief economist Bob Costello believes it could and I agree with him.

The average age of a Class 8 truck in the US is now up to 7 years – the highest since such has data been collected. During the boom times of the previous decade, the average age was around 4-5 years. There aren't up-to-date stats for the Canadian market but we too are running the oldest fleet in recent memory.

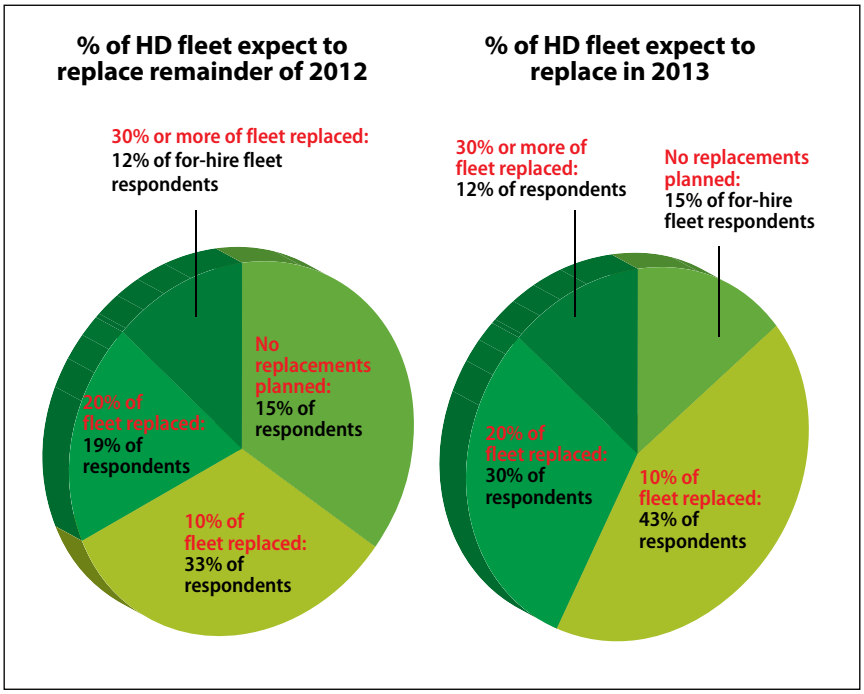
Carriers needing to update their fleets are finding themselves squeezed by a variety of factors.

1. The average price of a Class 8 truck today is about $125,000, thanks to the added cost of meeting the latest engine emissions regulations. That's a sizeable increase from the average $95,000 sticker price back in 2006.
2. At the same time, the average 7-year old tractor may have a resale value of just $20,000, compared to $50,000 had it been only 5 years old. That means carriers looking to update their fleets need to finance $105,000 of the sticker price for each truck whereas before the recession, with lower prices for new trucks and better prices for used, they would only have to finance $45,000. As a result, many small carriers are turning in two trucks to purchase one.
3. A slow growing and still volatile economic rebound is making carriers nervous about large investments in new iron.

At the start of the recovery many carrier executives believed that keeping capacity tight would help place upward pressure on rates. The slow economic recovery, however, has thwarted that hope. The Canadian General Freight Index shows base rates dropping over the summer months, not increasing. At the same time, aging tractors pose a number of problems for carriers, resulting in nothing but grief from their drivers, their customers and their own maintenance department:

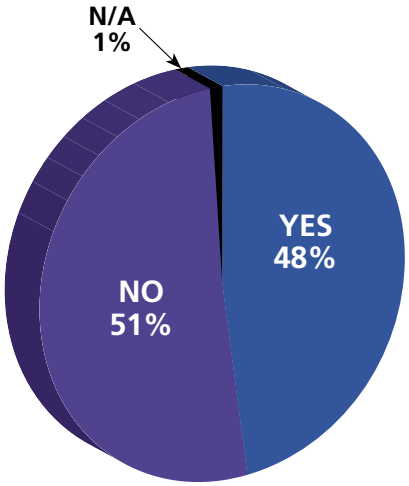
- Fleets unable to get out of their older trucks may have a hard time hanging on to their drivers as they get enticed by fleets able to put them in new iron.
- Our annual Shipper's Choice survey shows that shippers place a priority on quality of equipment when selecting carriers. A carrier's quality of equipment is rated higher in priority among shippers than its information technology capabilities, its problem solving abilities, its value-added services and its sustainable practices. It's a similar situation for LTL trucking. In fact, shippers set a higher standard for quality equipment for their TL carriers than for any other mode other than airfreight.
- Older trucks are much more costly to maintain. On average, before a truck hits the 550,000 mile mark, maintenance costs work out to about 5 cents/mile. But above the 550,000 mile mark, maintenance costs rise to 15 cents/mile.

If freight volumes don't bounce back strong in 2013 – and the projections for continued slow economic growth don't suggest that they will – then carriers hanging on to older equipment will have to take a leap of faith. Those who won't, or can't, may find themselves in dire straits.



inside the numbers

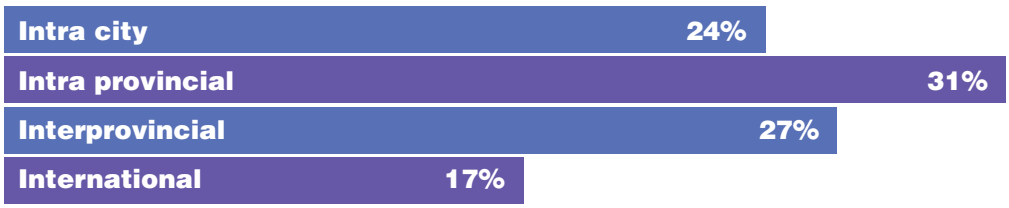
Private fleet performs for-hire activities



76%

That's the percentage of private fleet managers who consider "attracting qualified employees" to be the key challenge facing their operation

Scope of Canadian private fleet operations



Private fleet equipment owned vs. leased – tractors

Private fleet equipment owned vs. leased – trailers

UNDERSTANDING CANADA'S QUIET GIANT: PRIVATE FLEETS

Private fleets are a critical part of Canadian supply chains. Private fleet, or "own-account" transportation as Statistics Canada refers to it, is estimated to account for 2.5% of Canadian GDP. Truck and delivery van services dominate private fleet transportation, accounting for nearly 89% of the total. (The remaining 11% consists of small proportions of air, rail, water, bus and other ground transportation.) The size of the Canadian private truck fleet (when costs are measured) is estimated to be worth about $35 billion, which is slightly larger than the value of the Canadian for-hire fleet. Wholesale trade, retail trade and construction are large users of transportation services in value terms and most reliant on own-account transportation. While own-account truck fleets can be found in large companies such as The Hudson's Bay and Molson's, most private fleets are small operations.

With the last comprehensive study of private fleets published by the Canadian government more than 15 years ago, however, finding accurate data on this sector has been difficult. Seeking to remedy this situation, *Transportation Media* collaborated with the Private Motor Truck Council to publish the *Canadian Private Fleet Practices Benchmark Study*. The data shown above is from that study.

inside the numbers

TOP 10 INTERPROVINCIAL TRADE ROUTES	
Provincial Trade Route	$ (millions)
1. Quebec-Ontario	$38,317
2. Ontario-Alberta	$23,668
3. Alberta-British Columbia	$15,401
4. Ontario-British Columbia	$9,902
5. Saskatchewan-Alberta	$9,819
6. Quebec-Alberta	$7,824
7. Ontario-Saskatchewan	$7,627
8. Ontario-Manitoba	$5,541
9. Manitoba-Alberta	$5,044
10. Quebec-British Columbia	$5,004

10 BUSIEST CANADA-US BORDER CROSSINGS	
Border Crossing	$ (millions)
1. Windsor-Ambassador, Ontario	$86,001
2. Fort Erie/Niagara Falls, Ontario	$49,870
3. Sarnia, Ontario	$42,416
4. Lacolle, Quebec	$20,284
5. Emerson, Manitoba	$15,355
6. Pacific Highway, British Columbia	$13,320
7. Lansdowne, Ontario	$12,540
8. Coutts, Alberta	$11,914
9. North Portal, Saskatchewan	$8,674
10. Philipsburg, Quebec	$4,654

4.2%

That's the percentage of Canadian GDP represented by the transportation services sector, totalling $53 billion

TOTAL CANADA-US TRADE SHARE BY MODE 2001 VS. 2011

MODE	2001	2011
Road	63.7%	56.5%
Rail	16.6%	16.9%
Marine	2.3	5.8%
Air	7.5%	5.0%
Other	9.8%	15.8%

WINNERS AND LOSERS IN CANADA'S TRANSPORTATION INFRASTRUCTURE

Our country, and our $1.8 trillion economy, is shaped to a great degree by our challenging geography and demographics. And that, in turn, shapes our transportation infrastructure and practices. The 10-million-square-kilometre land mass we call Canada is home to just 34 million inhabitants. We have the longest land border in the world, shared with the world's most wealthy country. The challenge for Canadian transportation is to be efficient and cost-effective enough to move products large distances across provincial and international borders. Canada's export-oriented international trade activity remains largely dependent on the health of the US economy. In 2011, Canada's total merchandise trade with the US was $551 billion and represented 62% of Canada's total trade activities, according to the annual Transportation in Canada report published late this summer. The charts above show which regions are capturing the largest percentage of trade-related traffic and revenues.

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"The summit was very well done! A great learning and networking experience for someone like myself who is new to the industry."

Steve Magirias, General Manager, Anderson Haulage

"Congratulations on a well run Summit yesterday. I found it most informative and it was a most enjoyable event. Well done and thank you."

Norm Sneyd, V.P. Business Development, Bison Transport

"It was a very good conference. I noticed most people were actually listening and not playing on their phones. I think these days that is a way to determine the quality of a presentation."

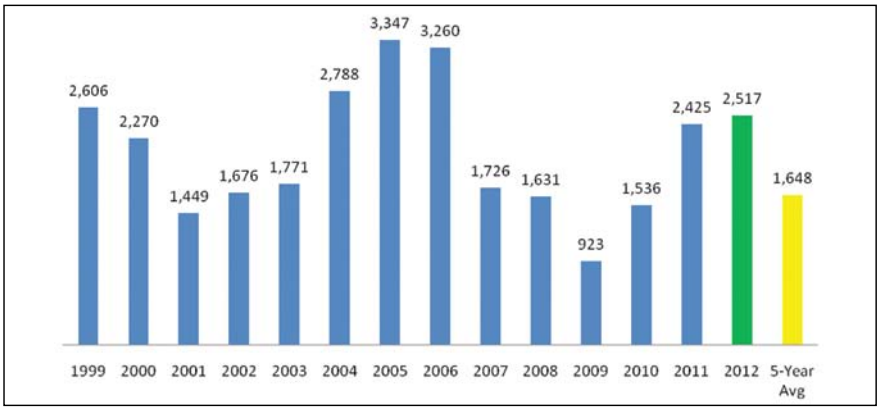
Mark Laine, Marketing Mgr., Mack Trucks Canada

CLASS 8
Truck Sales Trends

Monthly Class 8 Sales – Aug 12

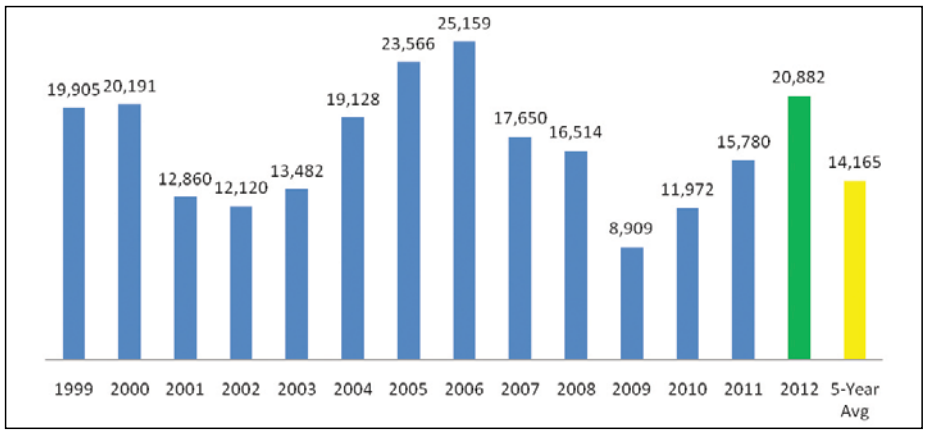
OEM	This Month	Last Year
Freightliner	675	550
International	394	620
Kenworth	428	595
Mack	209	110
Peterbilt	336	260
Volvo	271	193
Western Star	205	197
TOTALS	2517	2425

Historical Comparison – Aug 12 Sales



Class 8 truck sales in August once again topped the previous year's tally but this time the year-over-year increase was not as pronounced as in previous months. The 2,517 Class 8 trucks sold into the Canadian market in August was a little less than 100 units better than last year's performance. That made for the fifth best August since 1999 but was almost 900 units better than the 5-year average. Still, the slower sales growth in August may be indicative of a slowdown in truck purchases for the rest of 2012.

Historical Comparison – YTD Aug 12



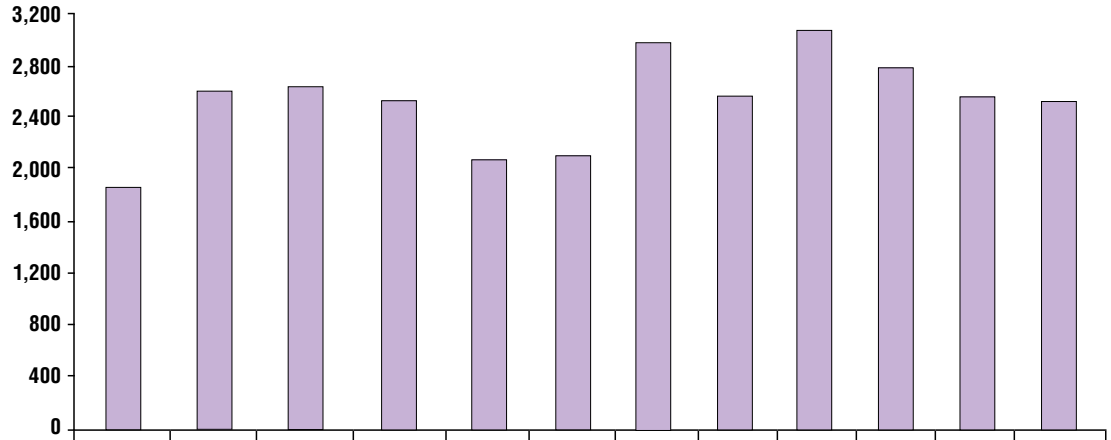
Class 8 Sales (YTD Aug 12) by Province and OEM

OEM	BC	ALTA	SASK	MAN	ONT	QUE	NB	NS	PEI	NF	CDA
Freightliner	411	517	166	417	2,406	861	241	100	24	10	5,153
Kenworth	447	1,815	275	162	744	727	88	0	0	0	4,258
Mack	70	286	146	88	616	282	49	25	0	10	1,572
International	116	539	57	196	1,433	647	119	60	24	45	3,236
Peterbilt	264	921	213	393	467	395	109	15	0	0	2,777
Volvo	163	208	84	184	1,125	461	79	54	0	5	2,353
Western Star	263	552	66	31	196	266	58	89	3	9	1,533
TOTALS	**1,724**	**4,838**	**1,007**	**1,471**	**6,987**	**3,639**	**743**	**343**	**51**	**79**	**20,882**

The Canadian and US economies may have slowed, particularly in manufacturing, but the economic recovery continues. Many industry experts believe the economic softening will impact Class 8 truck sales for the remainder of 2012. But so far, aside from slower growth in August, Canadian Class 8 sales remain strong. The 20,882 trucks sold after the first eight months in the Canadian market are more than 6,000 better than the 5-year average. To date, 2012 is the third best year for truck sales dating back to 1999.

CLASS 8
Truck Sales Trends

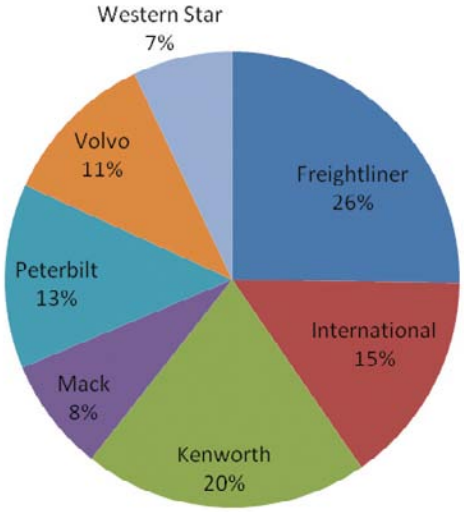
12-Month Sales Trends



	September	October	November	December	January	February	March	April	May	June	July	August
SALES	1,873	2,606	2,663	2,511	2,113	2,151	2,937	2,597	3,166	2,861	2,542	2,517

For the eleventh straight month, sales climbed above the 2,000 mark, reminiscent of the industry's capacity boom years of 2005 to 2007. The 2,517 trucks sold in August do reflect the third consecutive monthly decrease since the highpoint of 3,166 trucks sold in May but they are still considerably above the 2,000 mark. Our Transportation Buying Trends Survey found that 46% of Canadian carriers expect to purchase new Class 8 trucks in 2012. Question is if most carriers are looking to simply replace older equipment rather than add capacity, how long will the buying spree continue?

Market Share Class 8 – Aug 12 YTD



Two thirds of the way into the year, Freightliner, last year's Canadian market leader, is having a banner year, commanding a 26% share of Class 8 sales. Kenworth is in the number two spot for marketshare and enjoying the fact that its strong western network is able to tap into the stronger western economy. Troubled Navistar International is at 15% share of the market after announcing a change in direction with its engine technology and changes to its management team.

Source: Canadian Motor Vehicle Manufacturers Association