

## Industrial Research

March 20, 2014

# Global Freight Flows on the Mend

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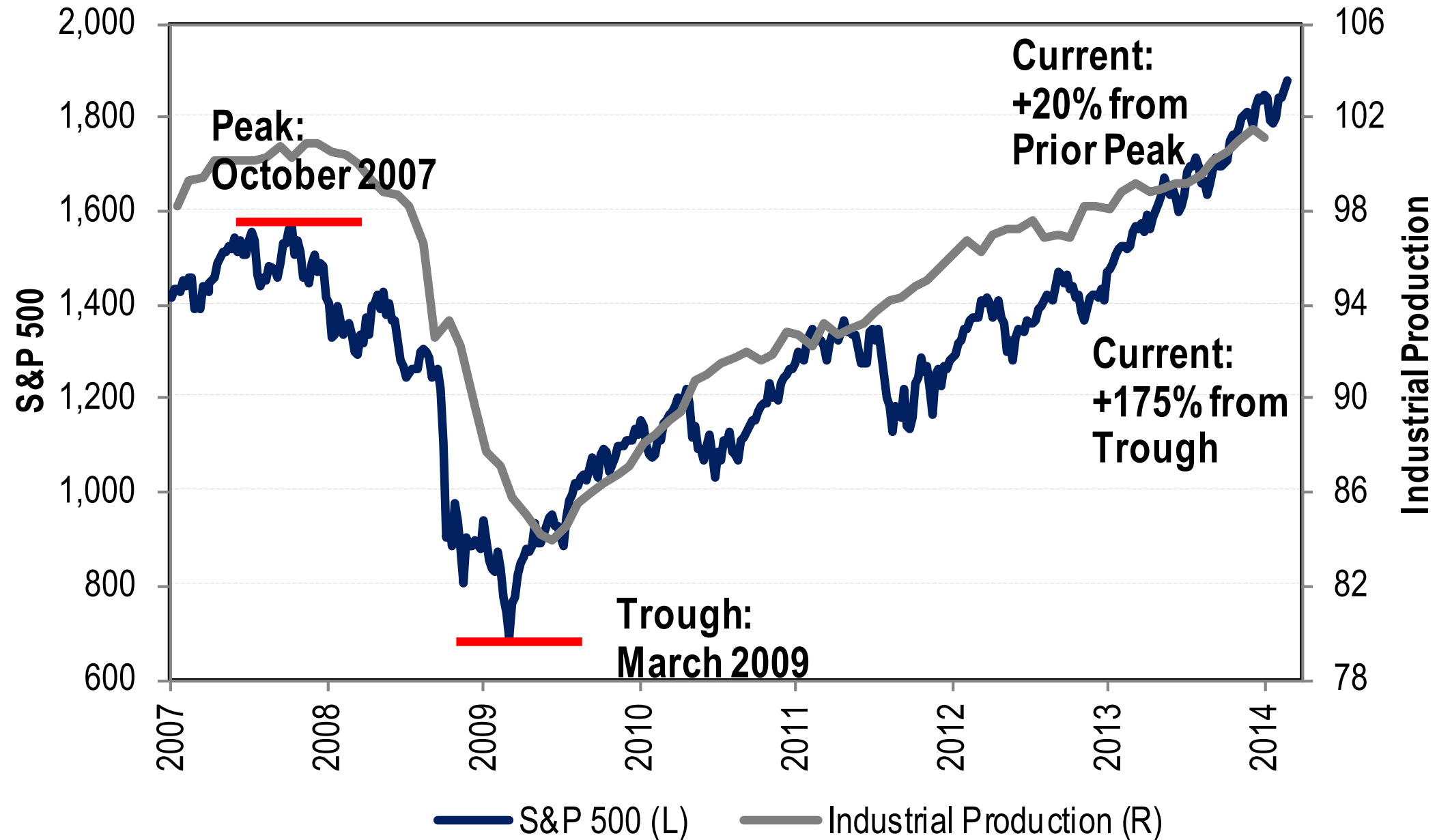


# Global Freight Flows On The Mend

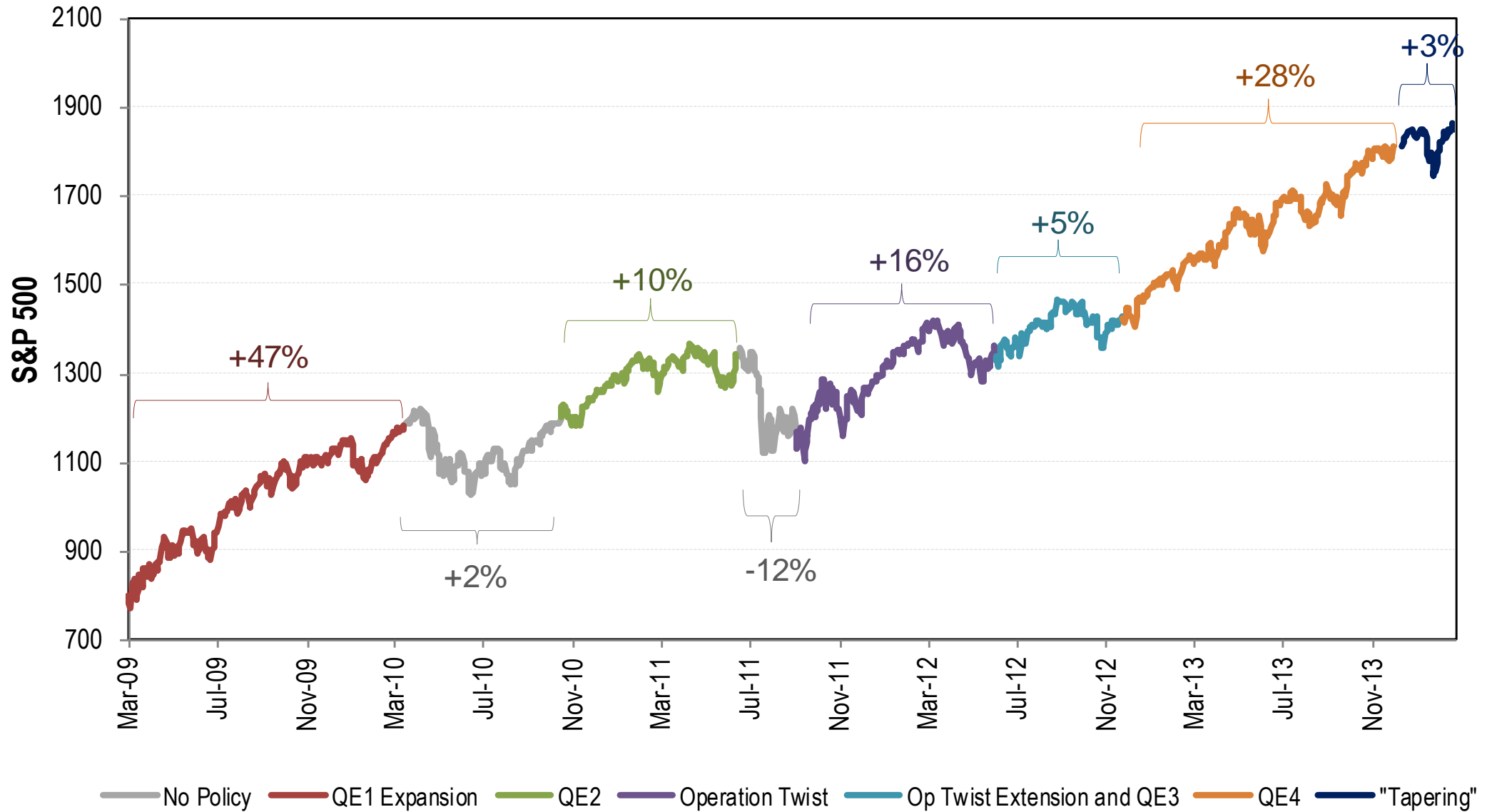
Focal points for 2014:

- We expect US and global growth to reaccelerate.
- US Industrial Production -- History suggests ~20% more upside this cycle.
- The US consumer is crucial to carrying the recovery. Demand remains soft, but some early signs of engagement are emerging.
- Bottom line: Federal Reserve actions have proven successful so far -- but the private sector must now carry the baton.

# A Look Back At This Cycle



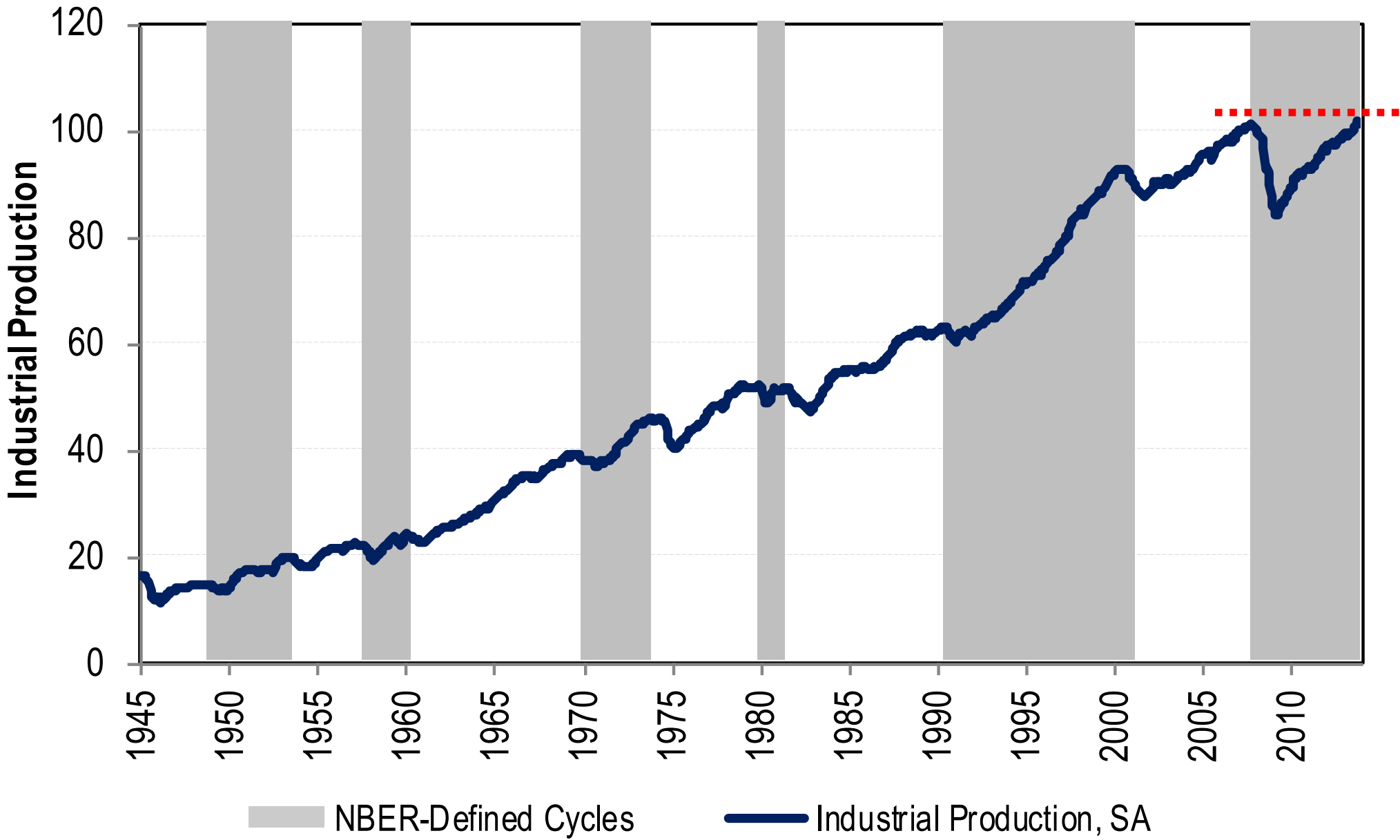
# S&P 500 Returns From March 2009 Lows Fueled By The Fed



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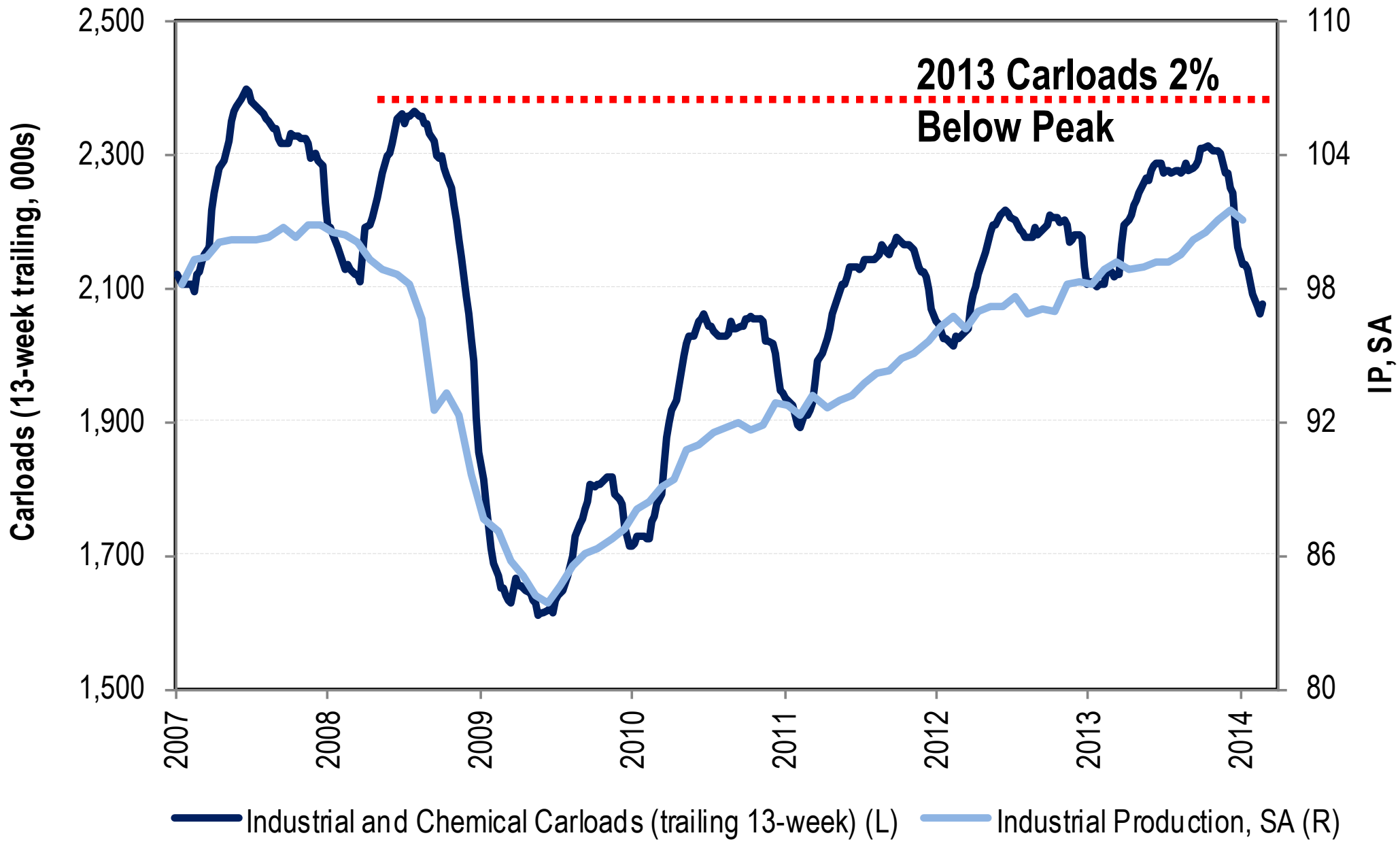


# US Industrial Production Has Returned To Pre-Recessionary Levels...

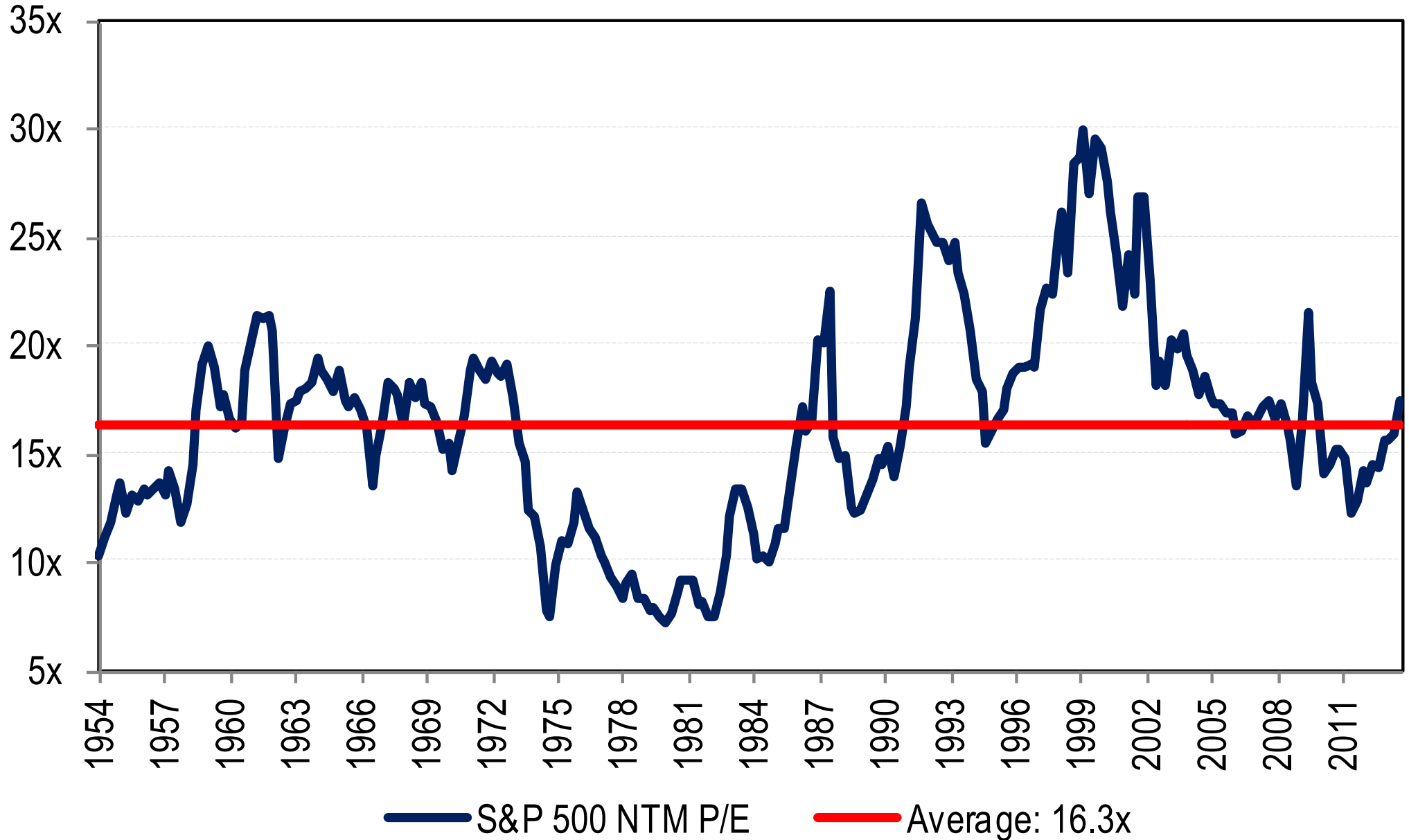


■ NBER-Defined Cycles      — Industrial Production, SA

# ...While Industrial Rail Carloads Are Nearing Prior Peak



# Market Multiples Remain Reasonable

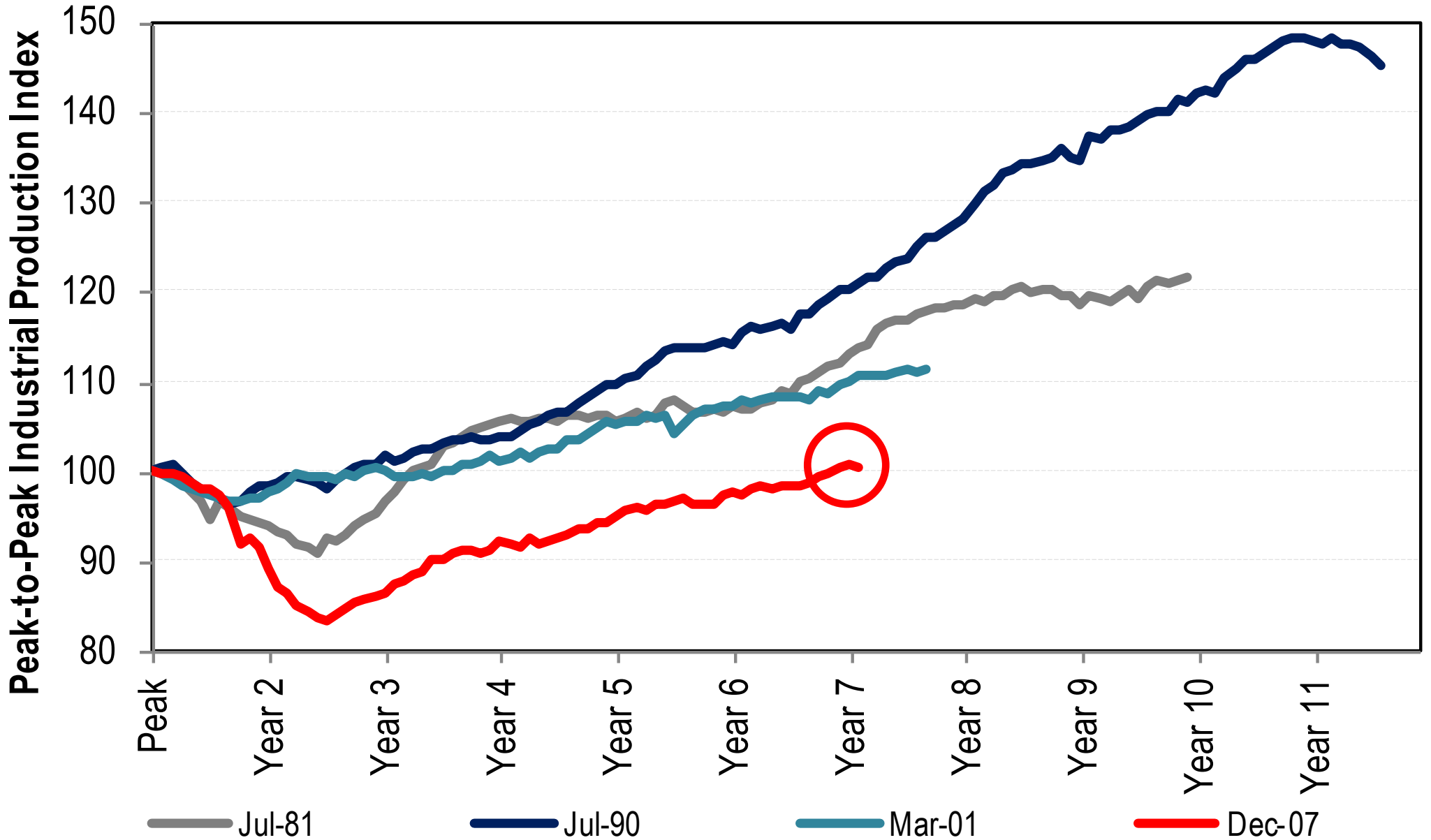




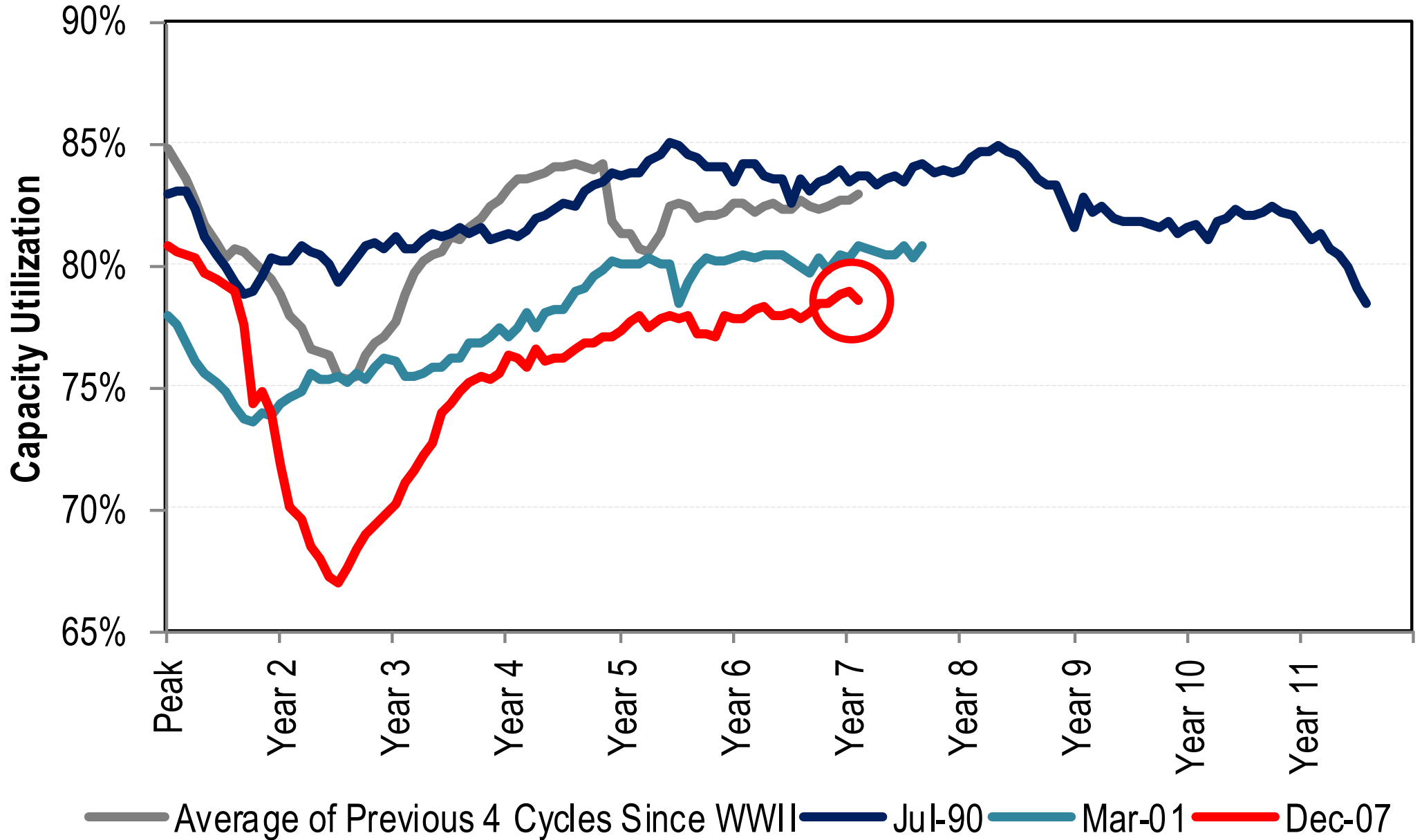
# And Historical Cycles Suggest 20% More Growth

Peak	Trough	Peak-to-Peak Duration (months)	Peak-to-Peak Growth
February-45	October-45	45	-10%
November-48	October-49	56	36%
July-53	May-54	49	11%
August-57	April-58	32	8%
April-60	February-61	116	65%
December-69	November-70	47	18%
November-73	March-75	74	12%
January-80	July-80	18	-1%
July-81	November-82	108	21%
July-90	March-91	128	45%
March-01	November-01	81	11%
Average		69	20%
December-07	June-09	73	0%

# This Recovery Doesn't Appear To Be Over

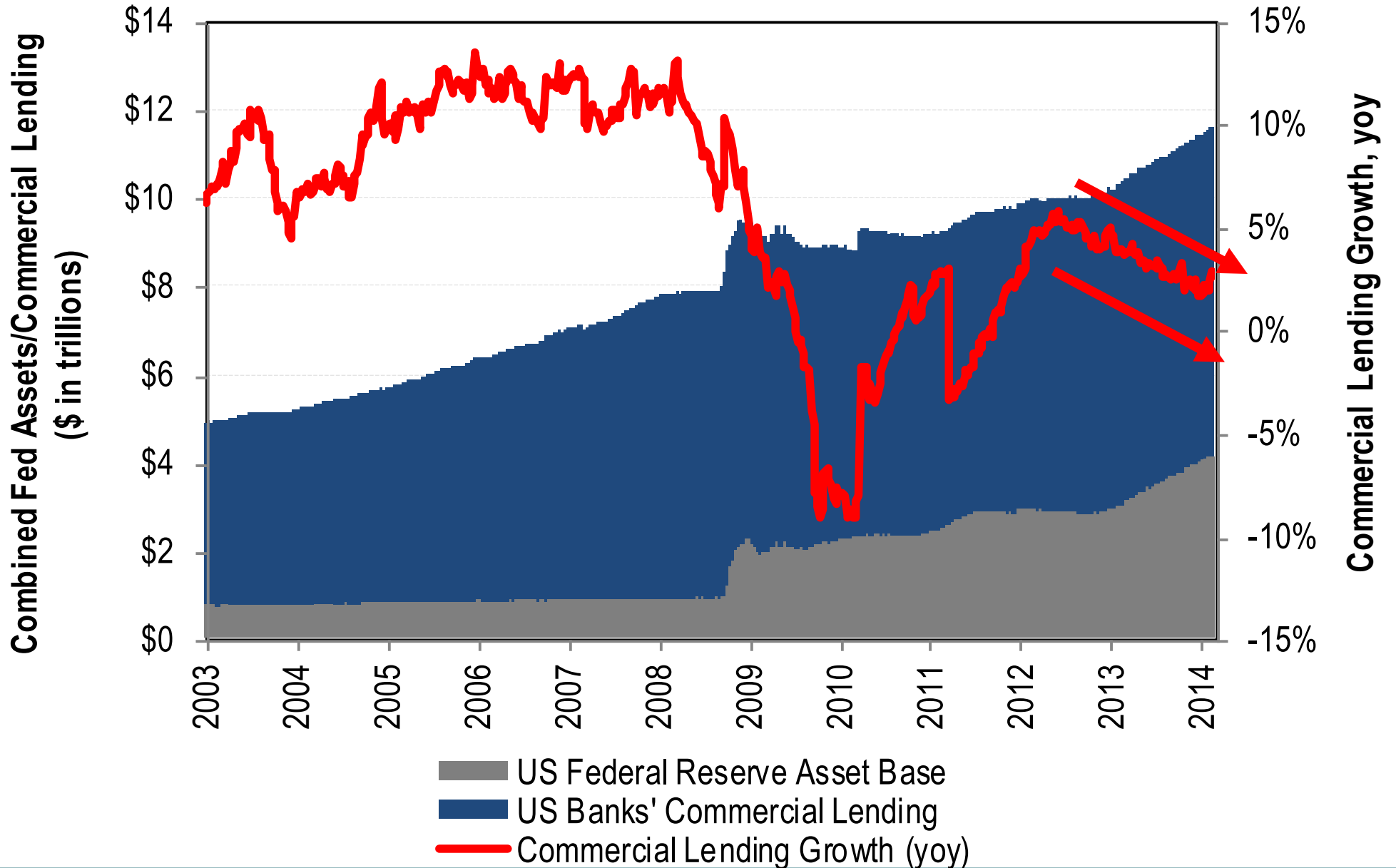


# Headwinds Remain: 1) Capacity Utilization Levels Remain Weak

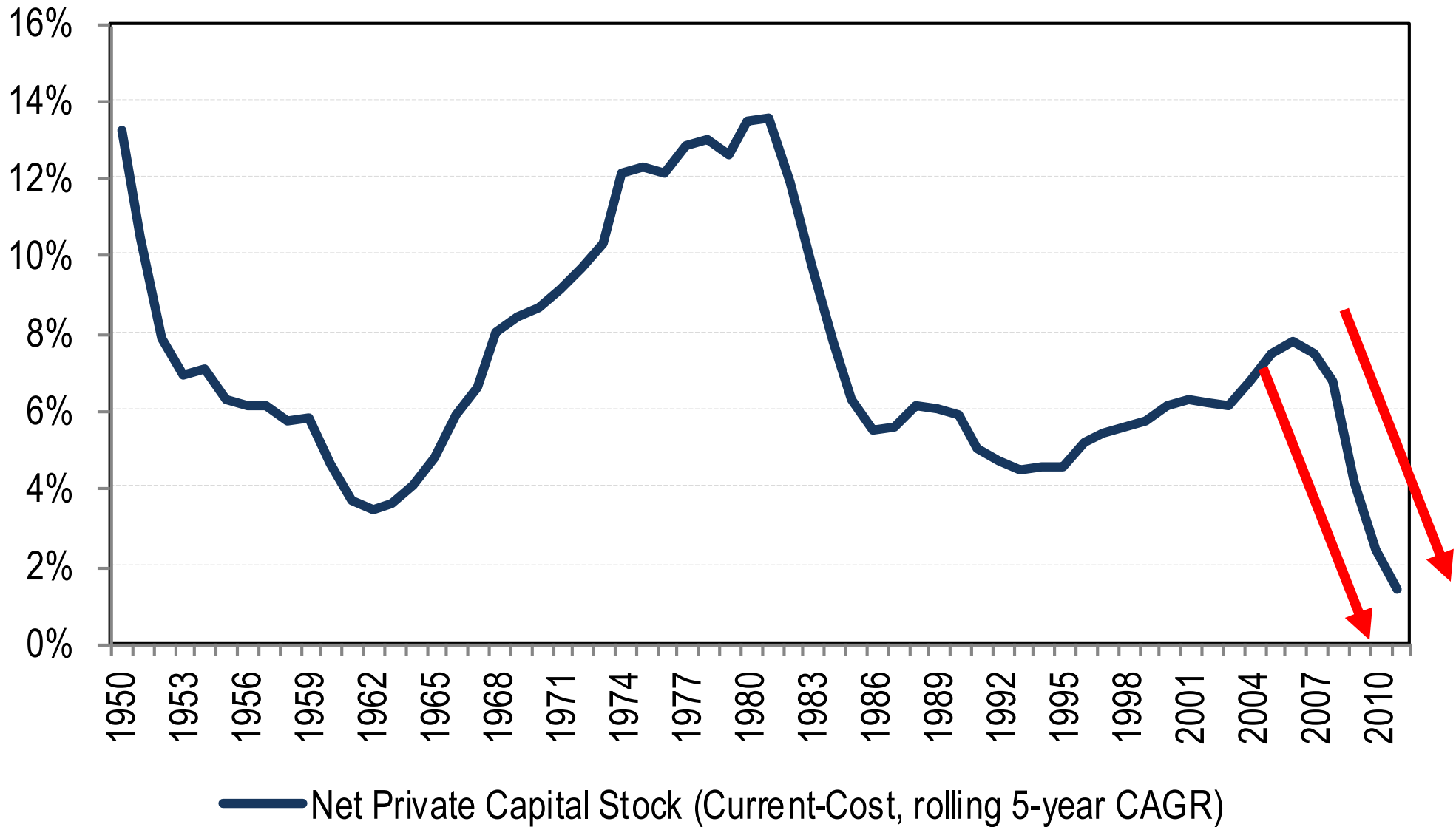


# Headwinds Remain:

## 2) Commercial Lending Growth Is Slowing

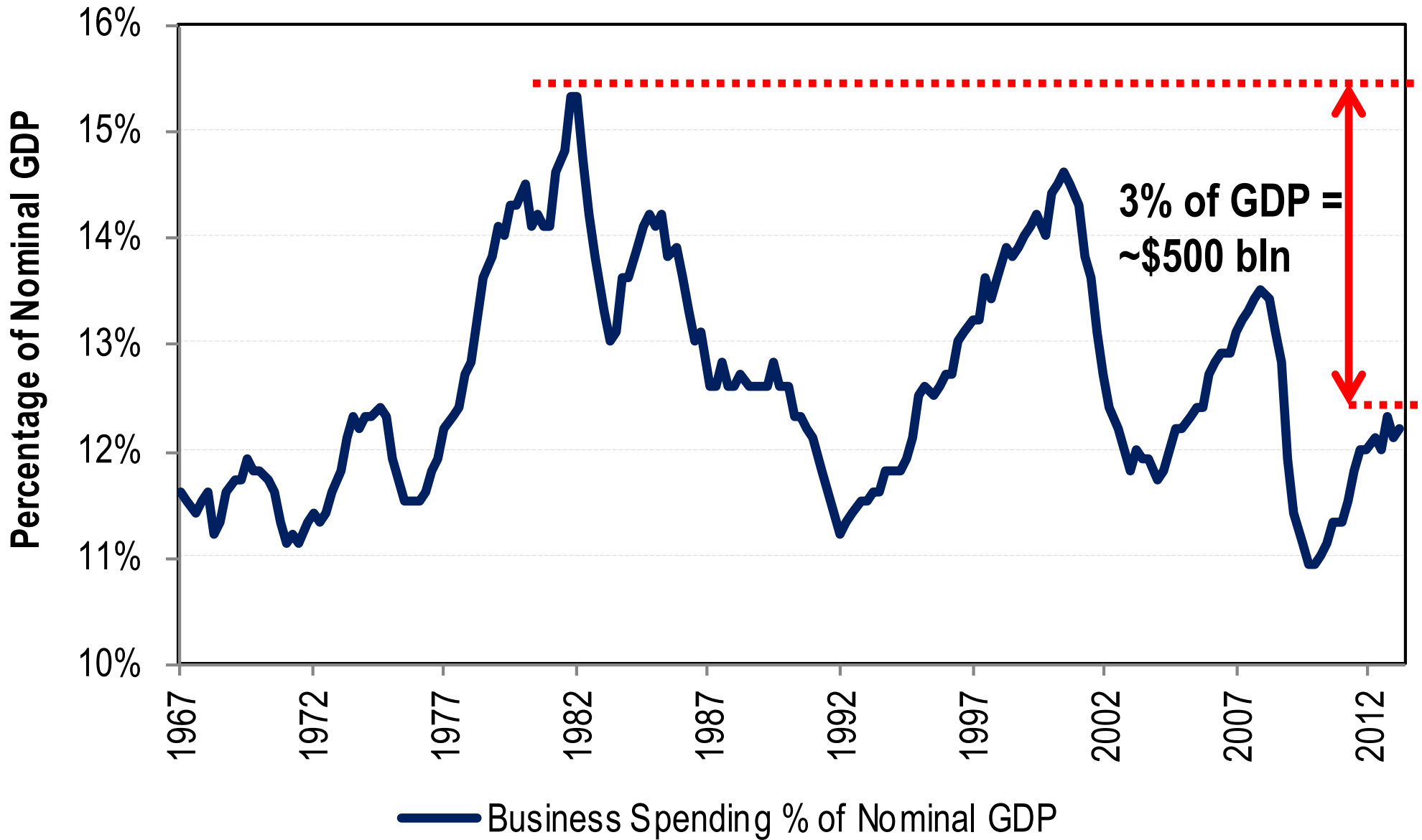


# But Headwinds Remain: 3) As Is Net Private Capital Stock Investment Growth

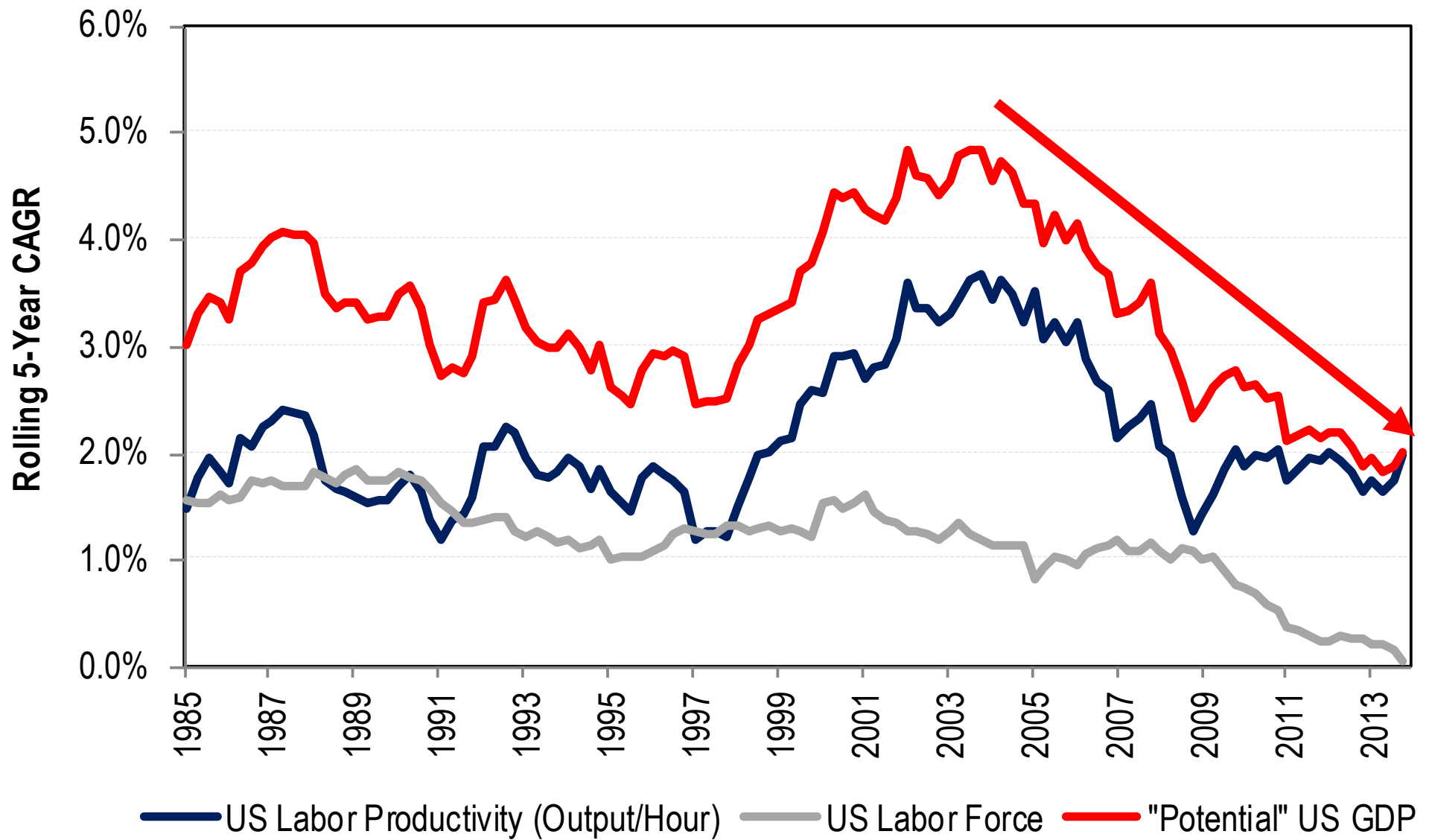


# Headwinds Remain:

## 4) Business Spending Remains Well Below Prior Peaks

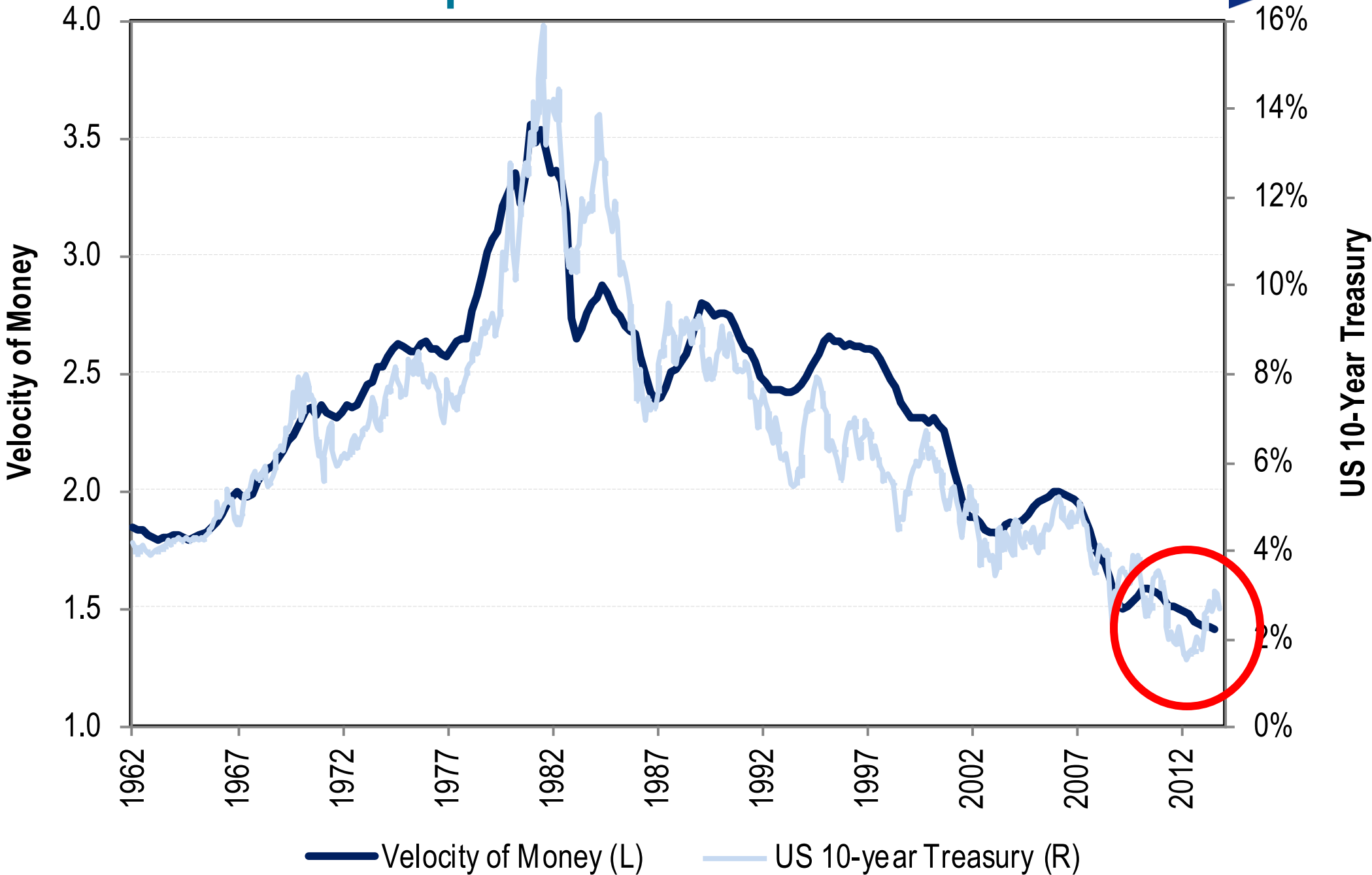


# But Headwinds Remain: 5) And Slowing US Productivity & Employment Growth Limit "Potential" US GDP Growth



# So Continue To Expect An Accommodative Fed

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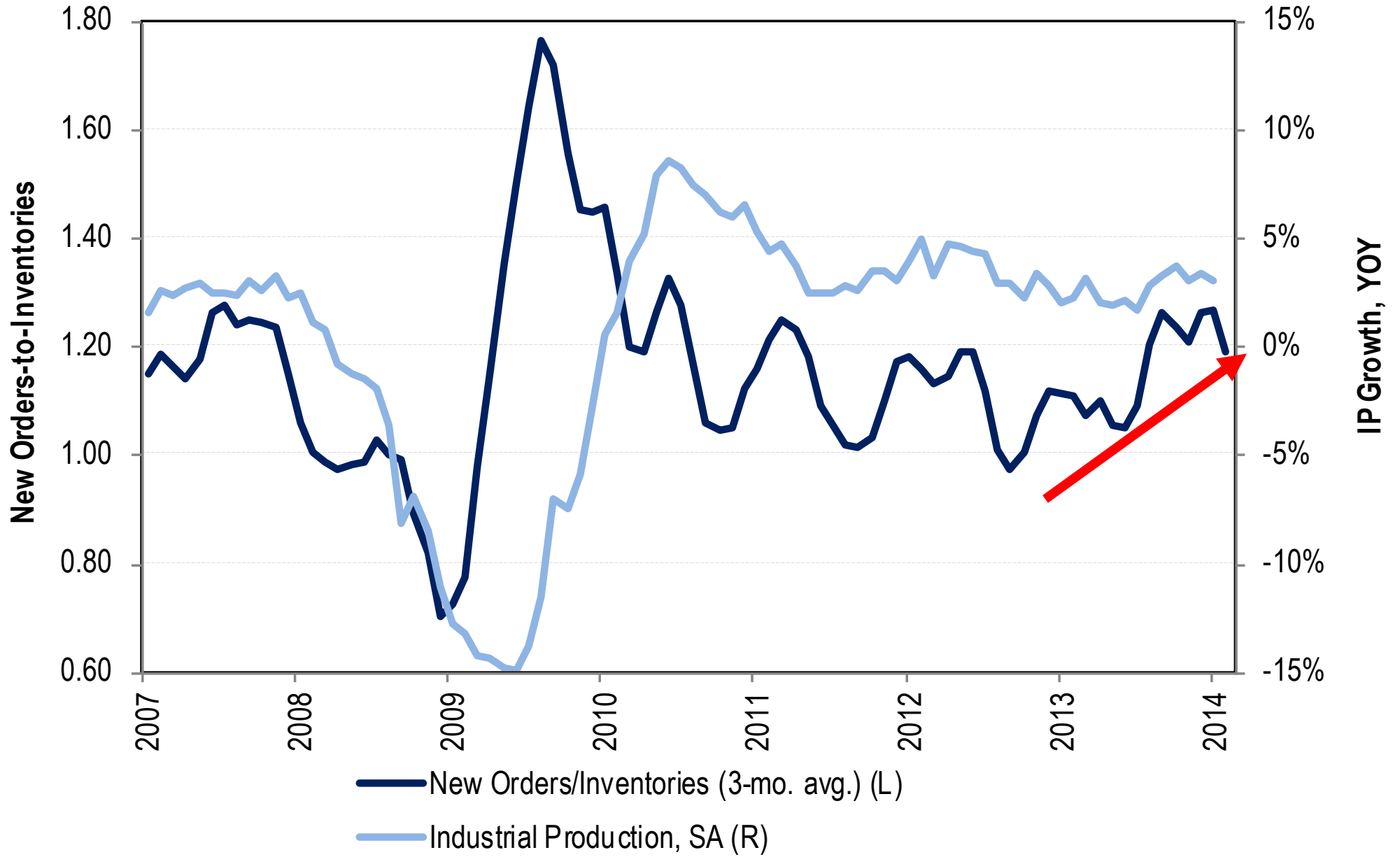




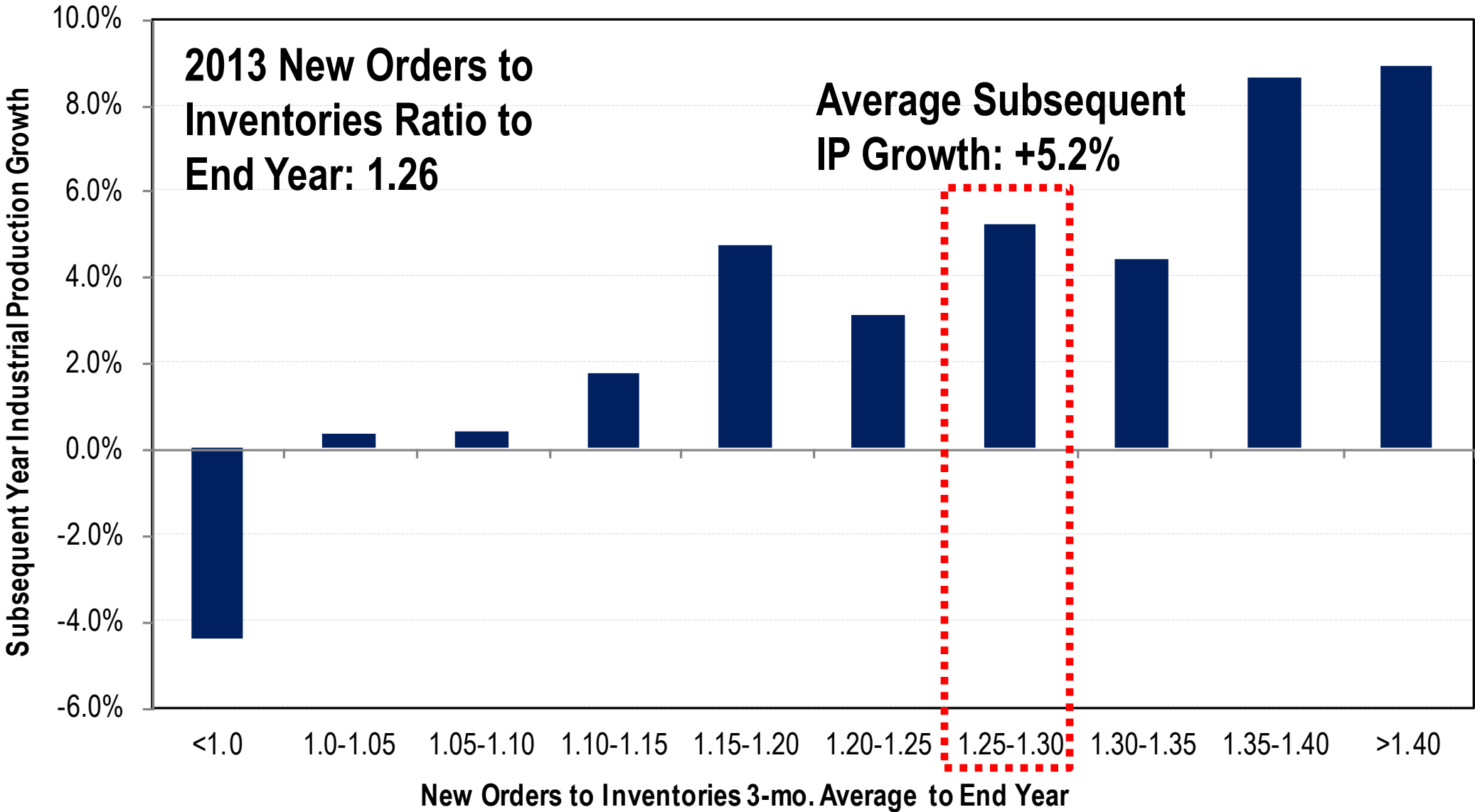
# Watch The 10-Year



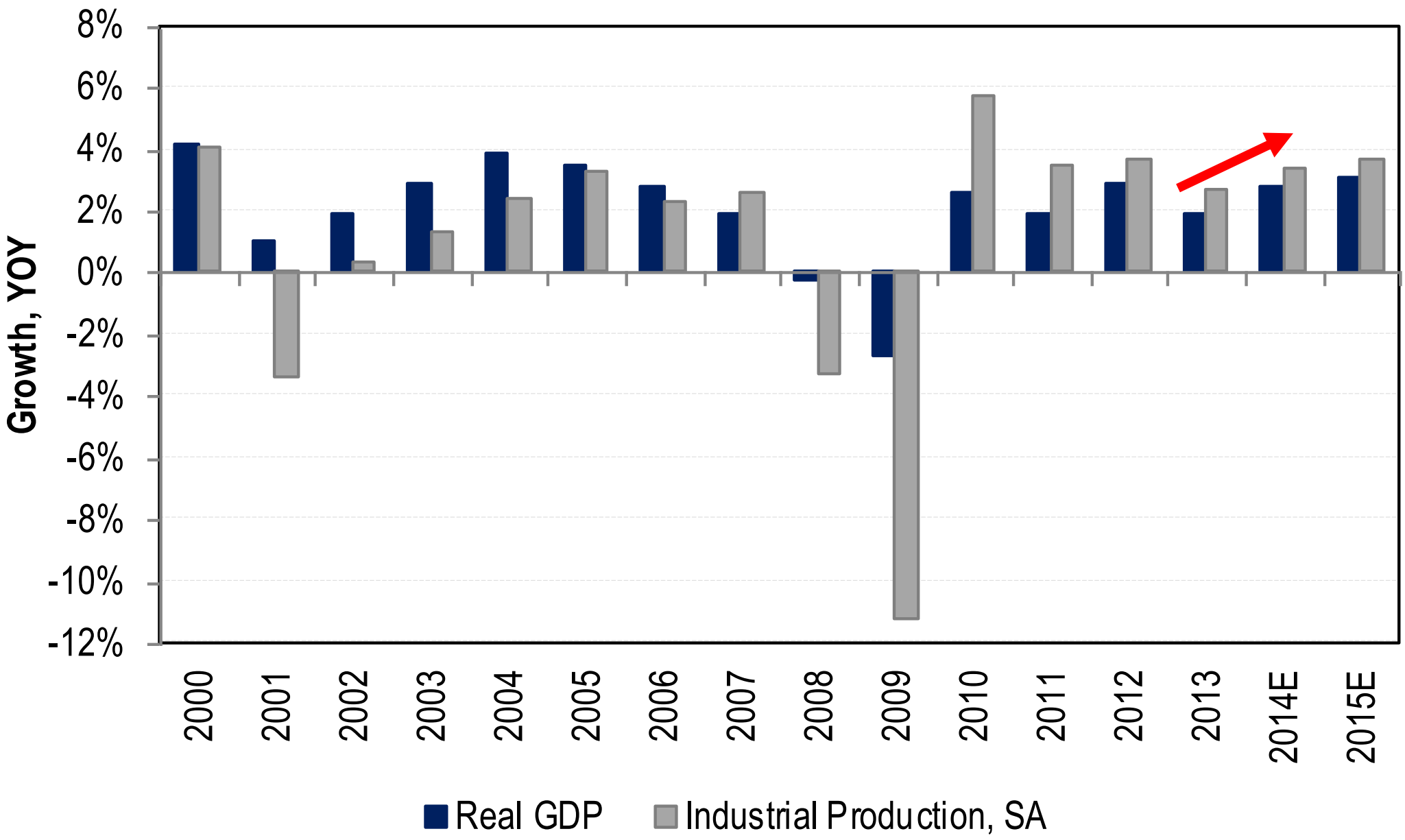
# But, Recent Industrial Order Data Suggest A Strengthening Recovery



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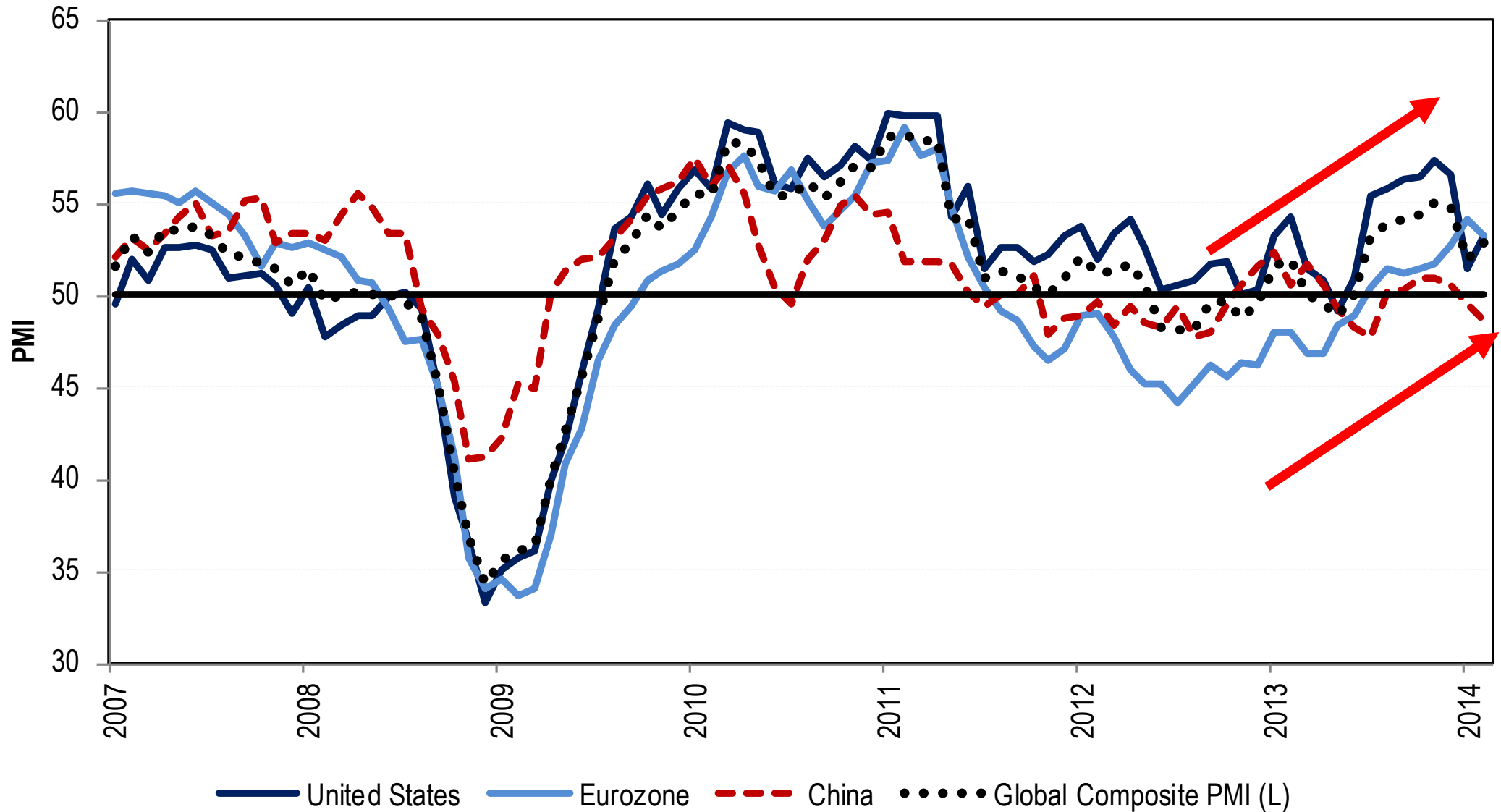


# Growth Expected To Reaccelerate In 2014

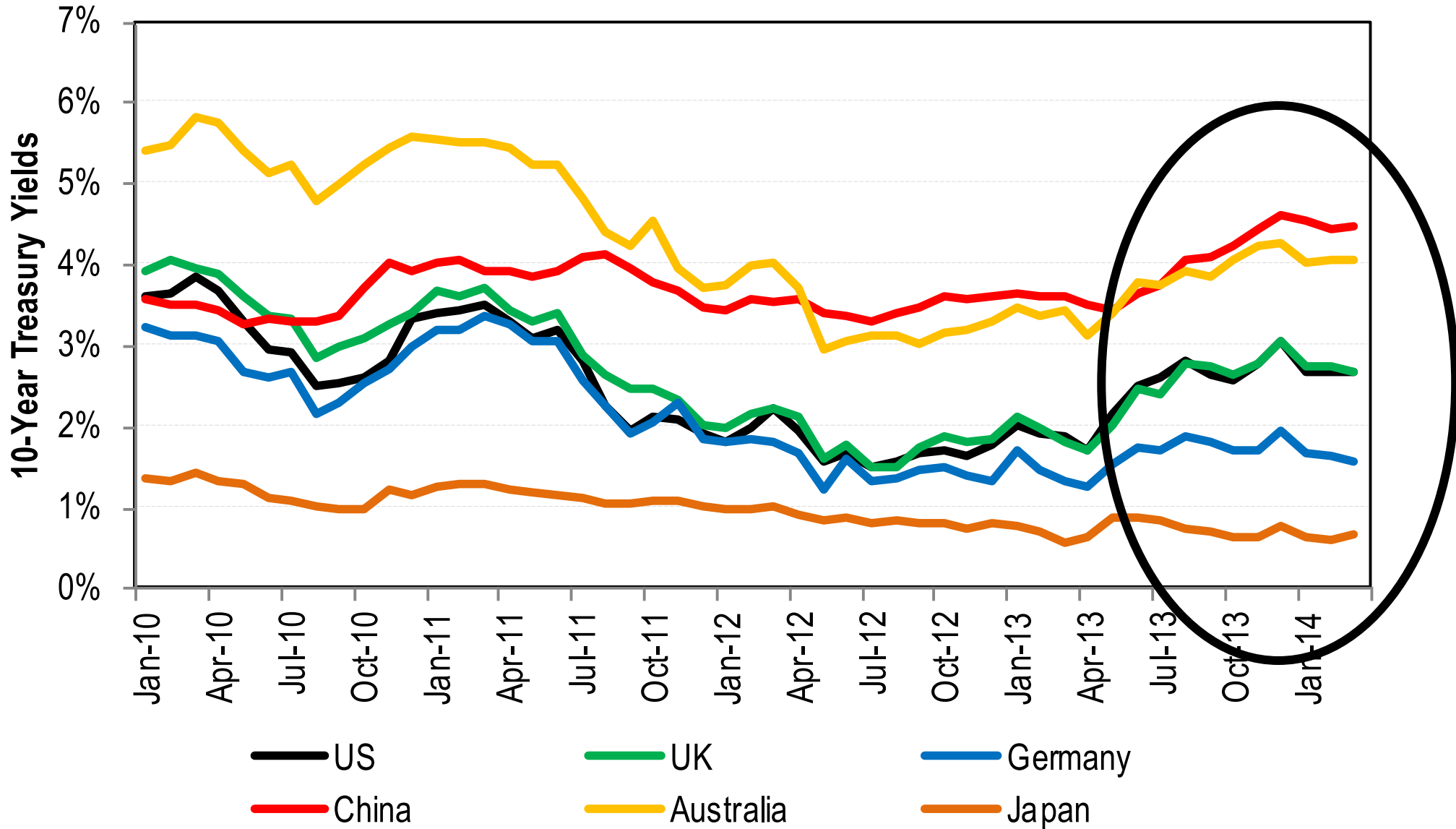


Source: Federal Reserve, BEA

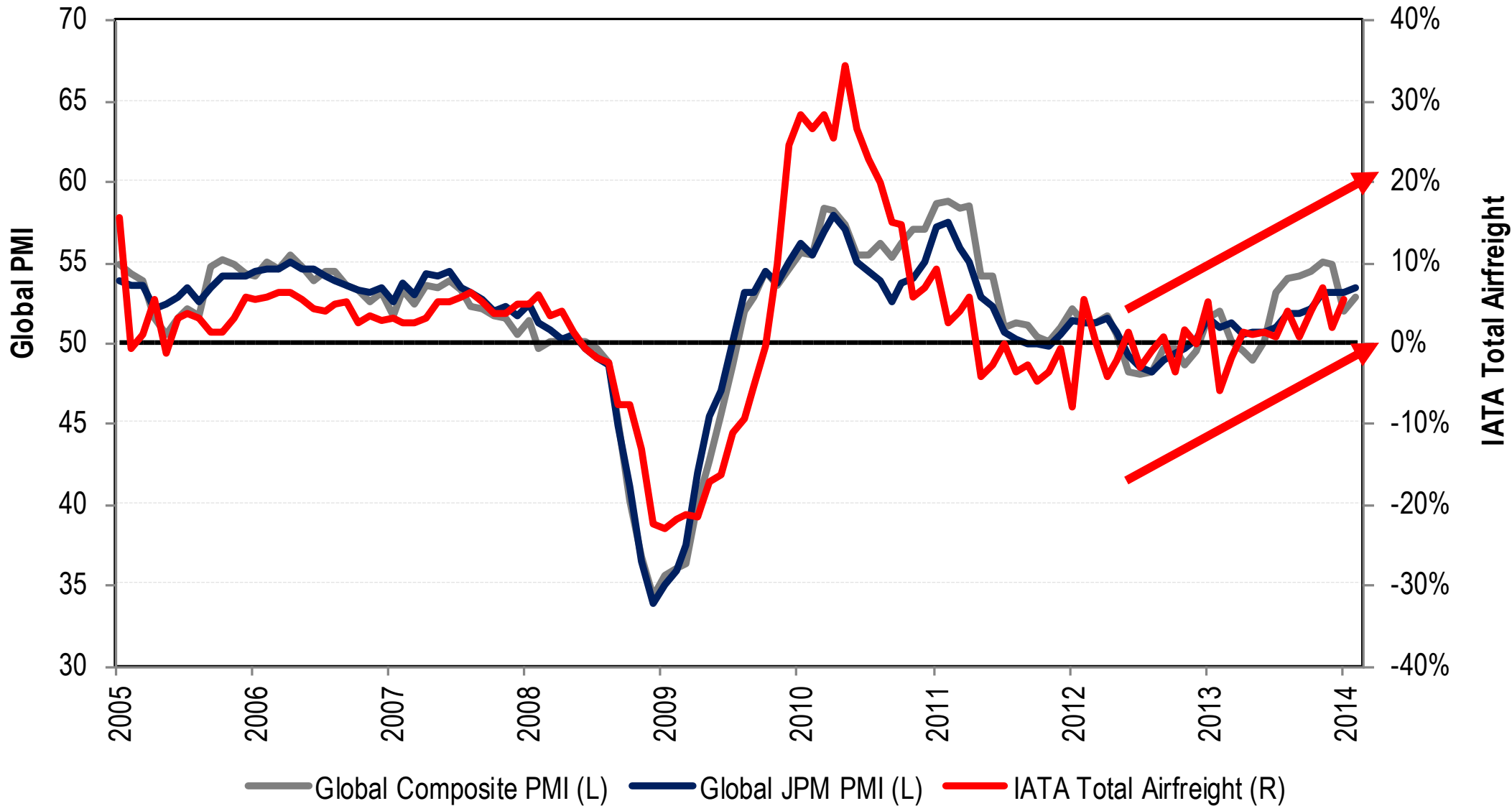
# Global Data Suggests Similarly Strengthening Demand, Though China Has Softened



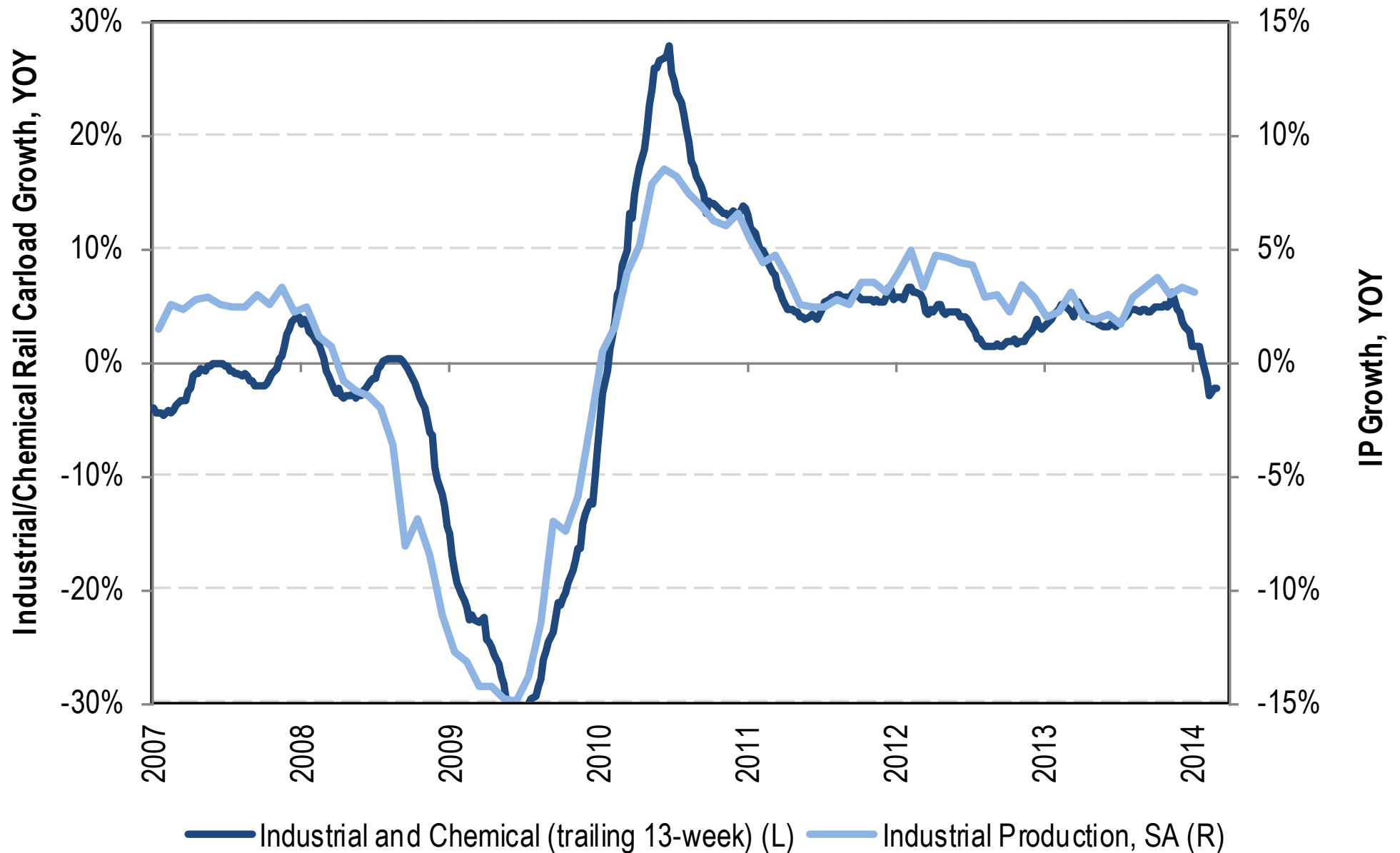
# While Rising Yields In Developed Nations Suggest Signs Of Reflation Expectations



# But Stabilizing Global Growth Puts A Floor Beneath AF Volume Growth

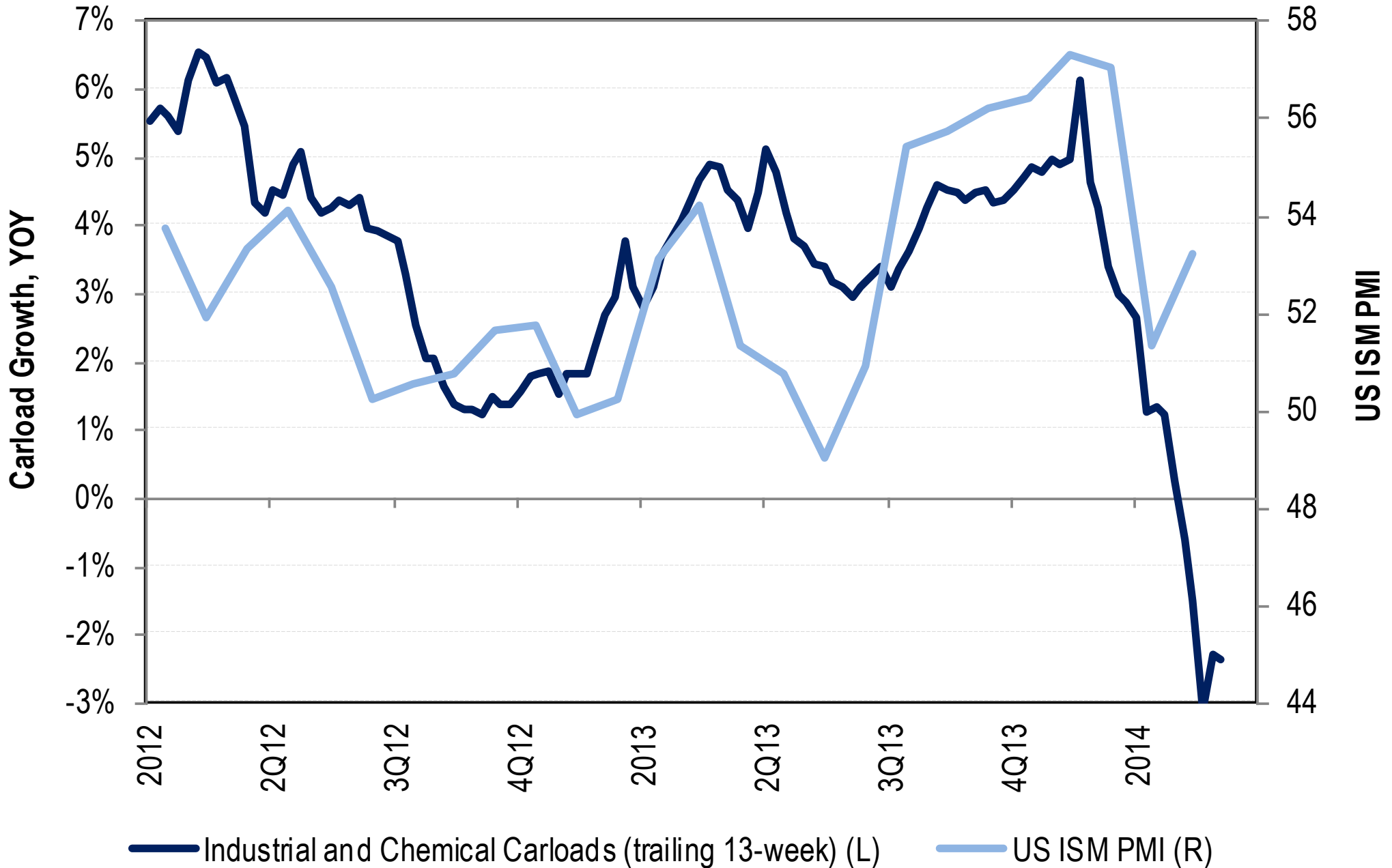


# Accelerating US Industrial Production Should Support Accelerating Industrial Freight Growth (Logically...)

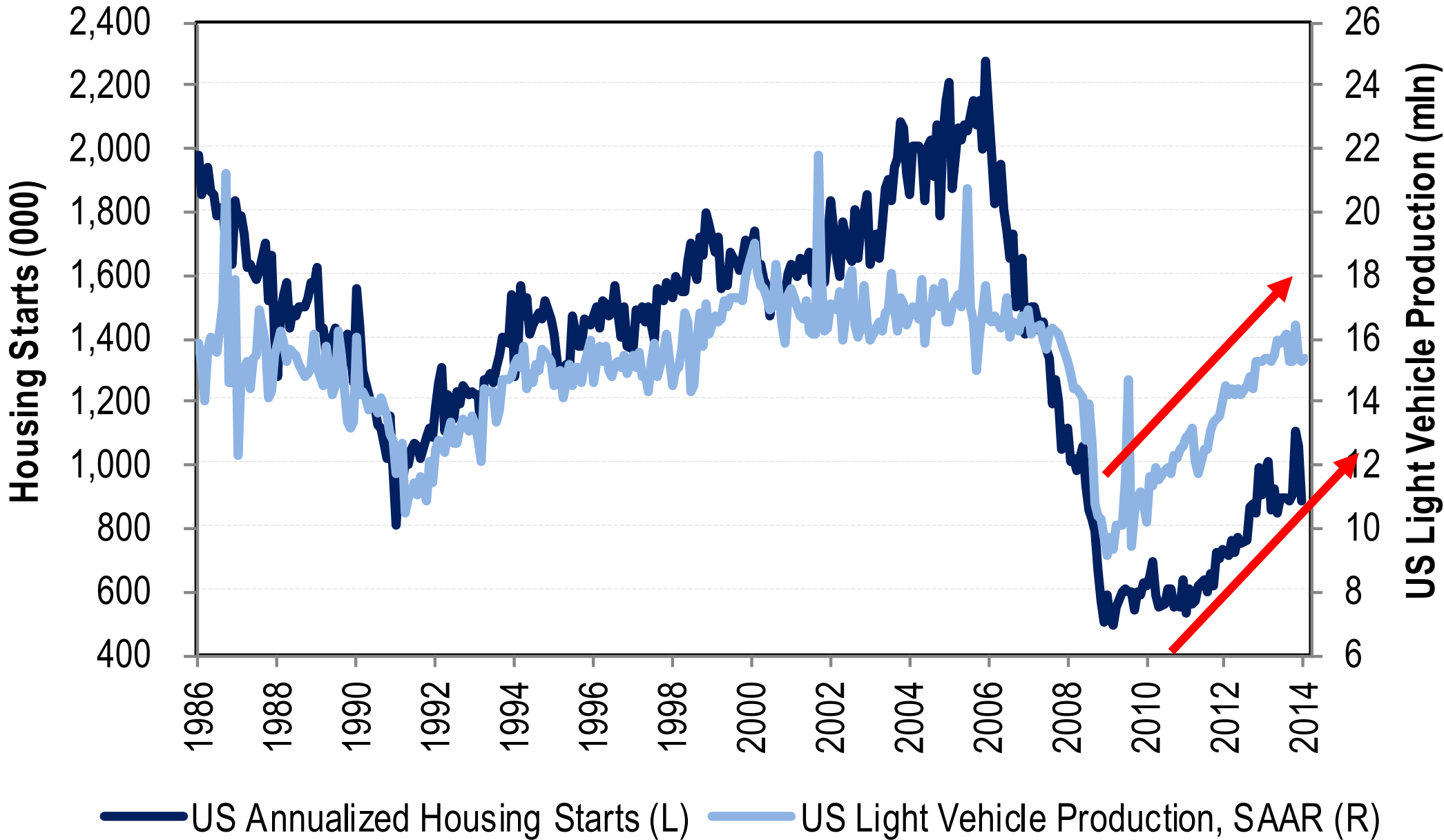




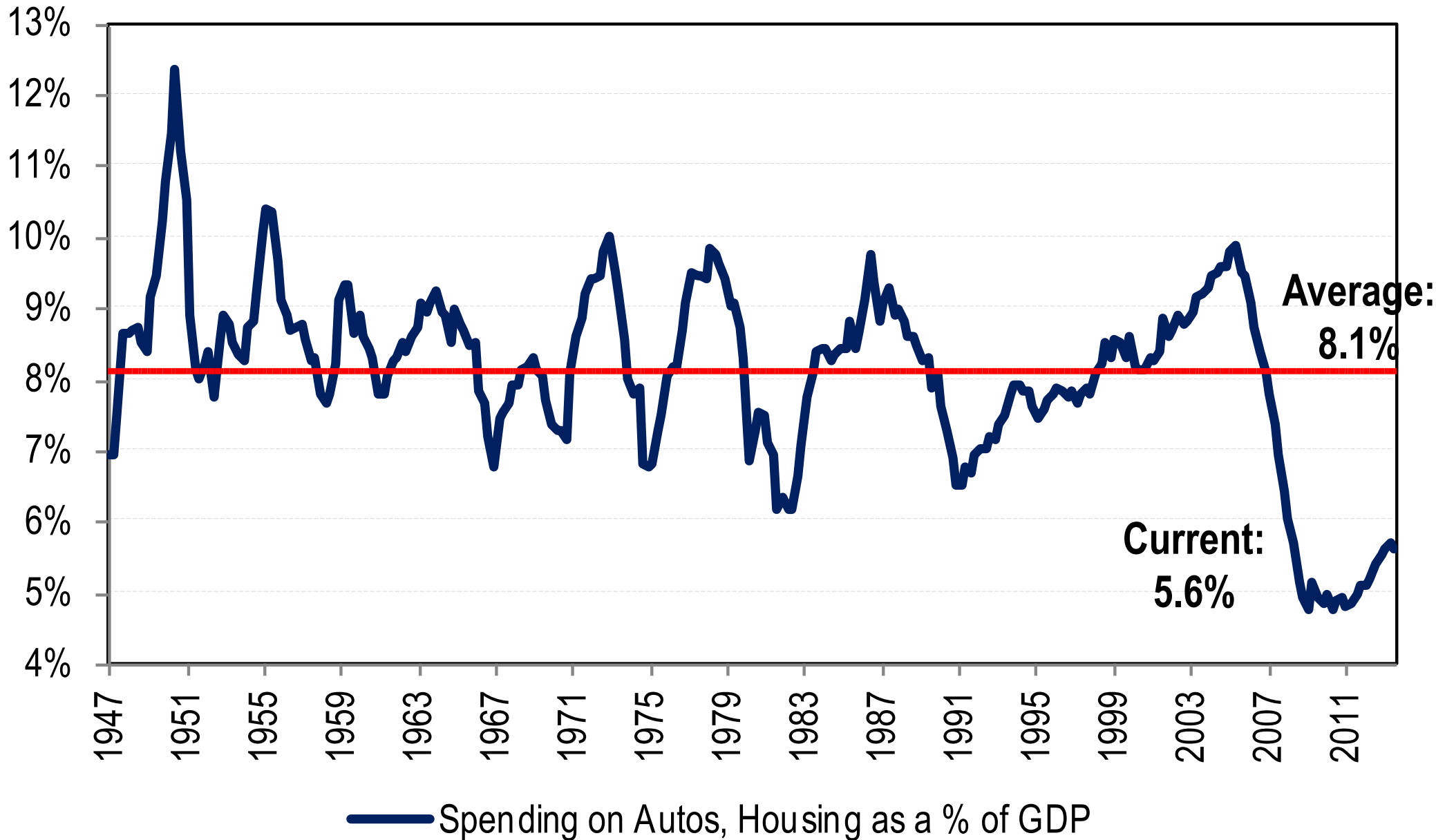
# The Recovery Is Still Tenuous



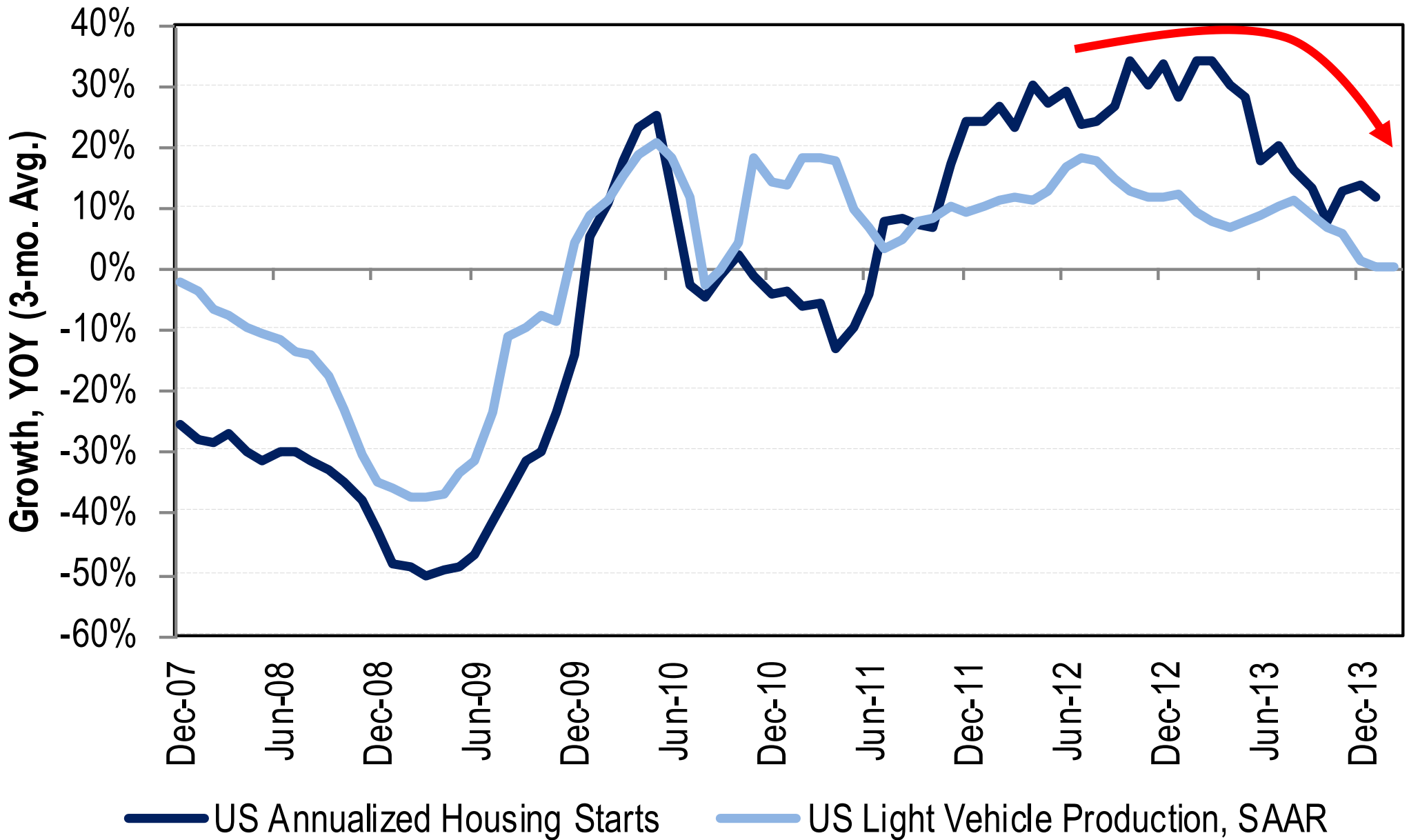
# Auto & Housing's Recovery Have Had Leadership This Cycle...



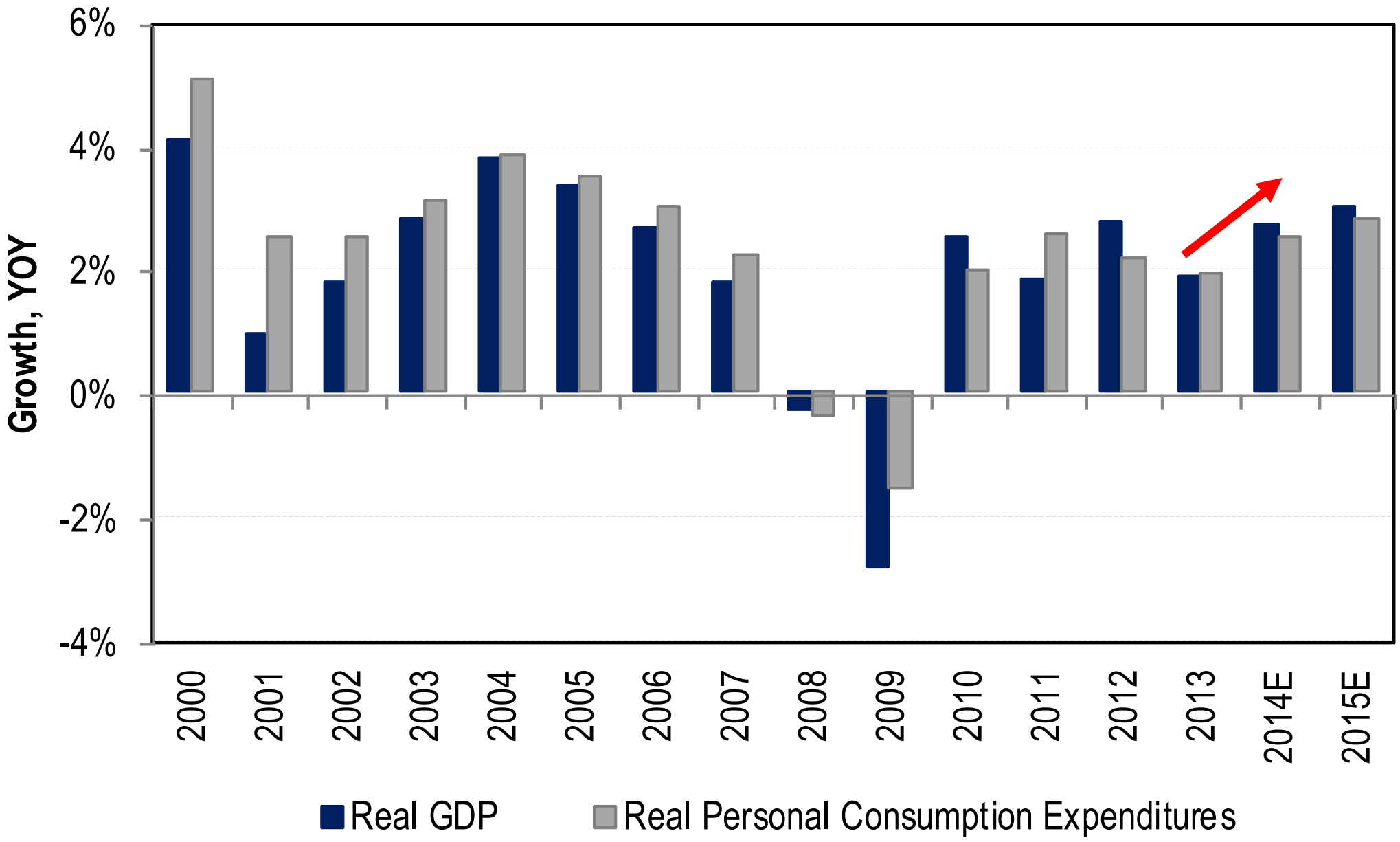
# ...And Their Contribution To US GDP Remains Below Trend...



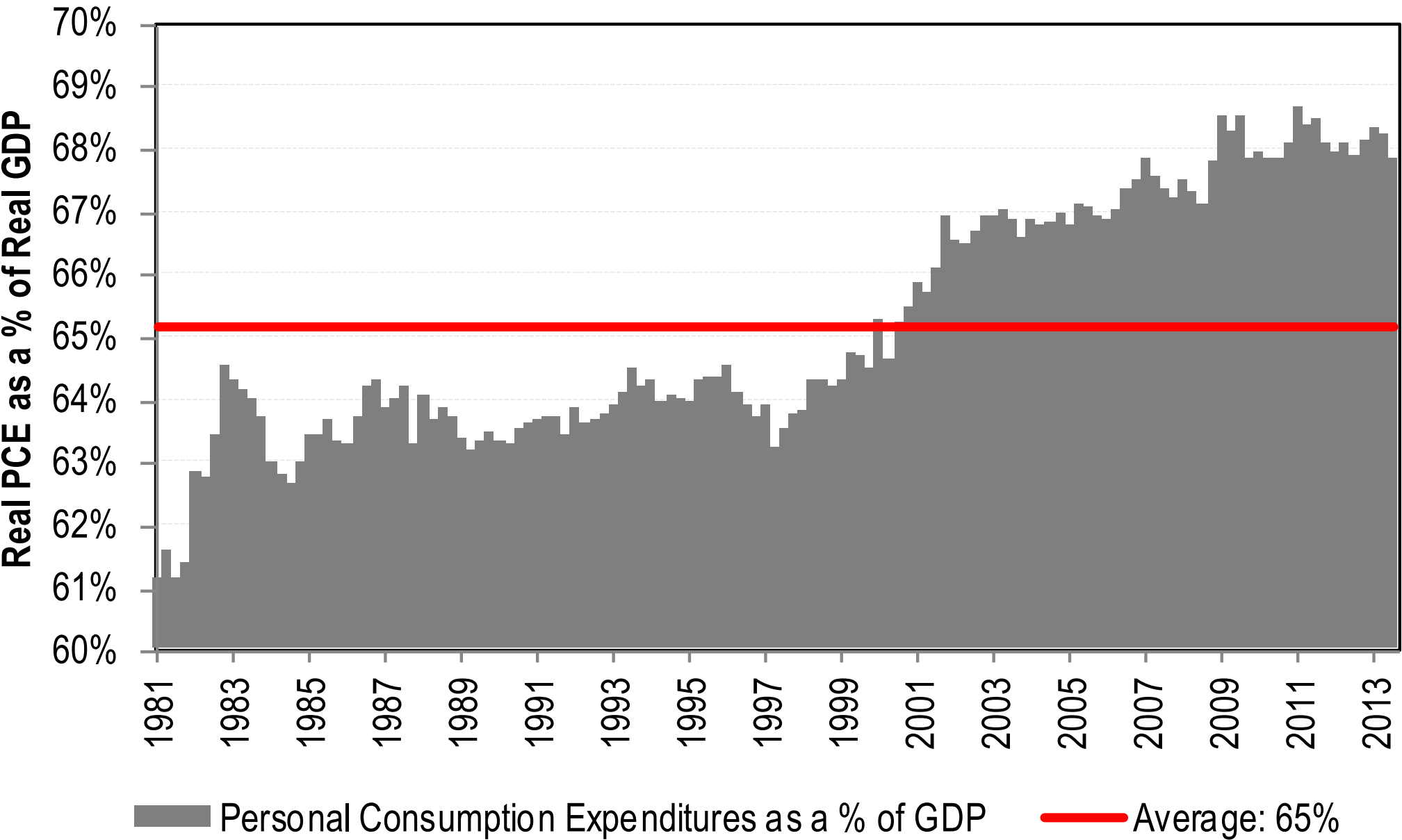
# ...But Growth Is Slowing



# What Drives The Next Leg Of Expansion? The Recovery Needs Engagement From The Consumer

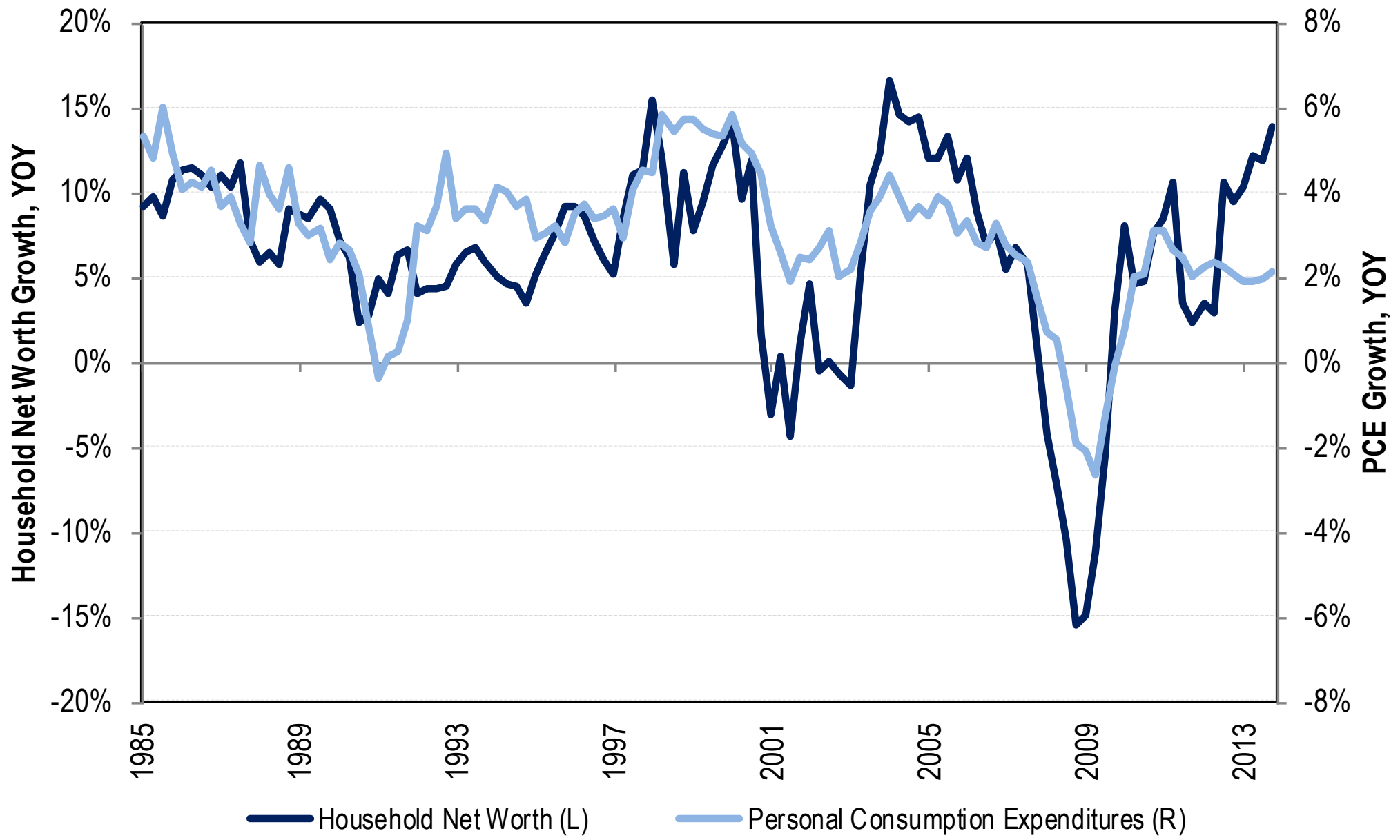


# Consumption Still Drives US GDP Growth

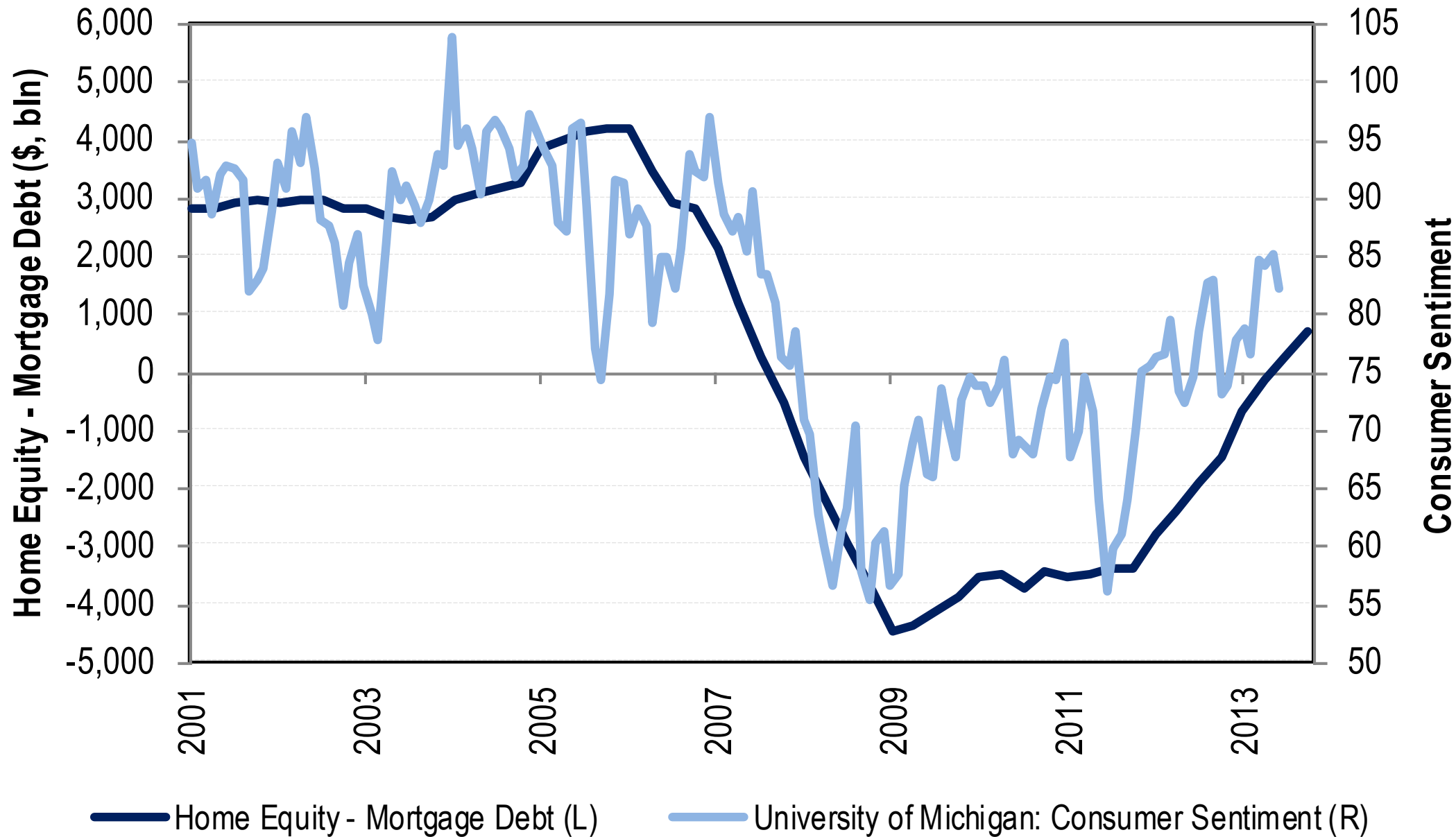


Source: BEA

# The Housing/Equity Market Recovery Should Support Improved Consumer Demand

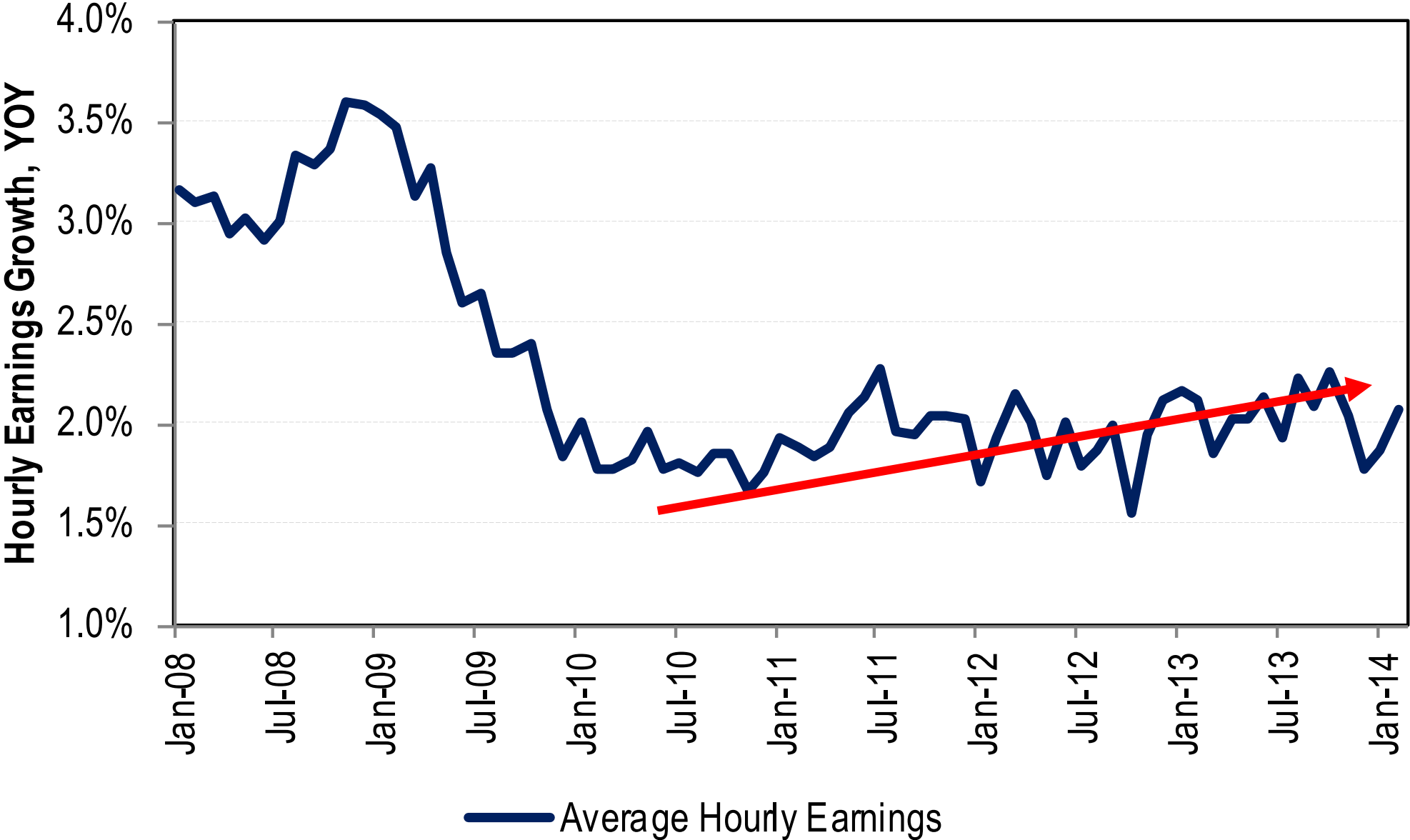


# Some Indication Of An Improving Consumer

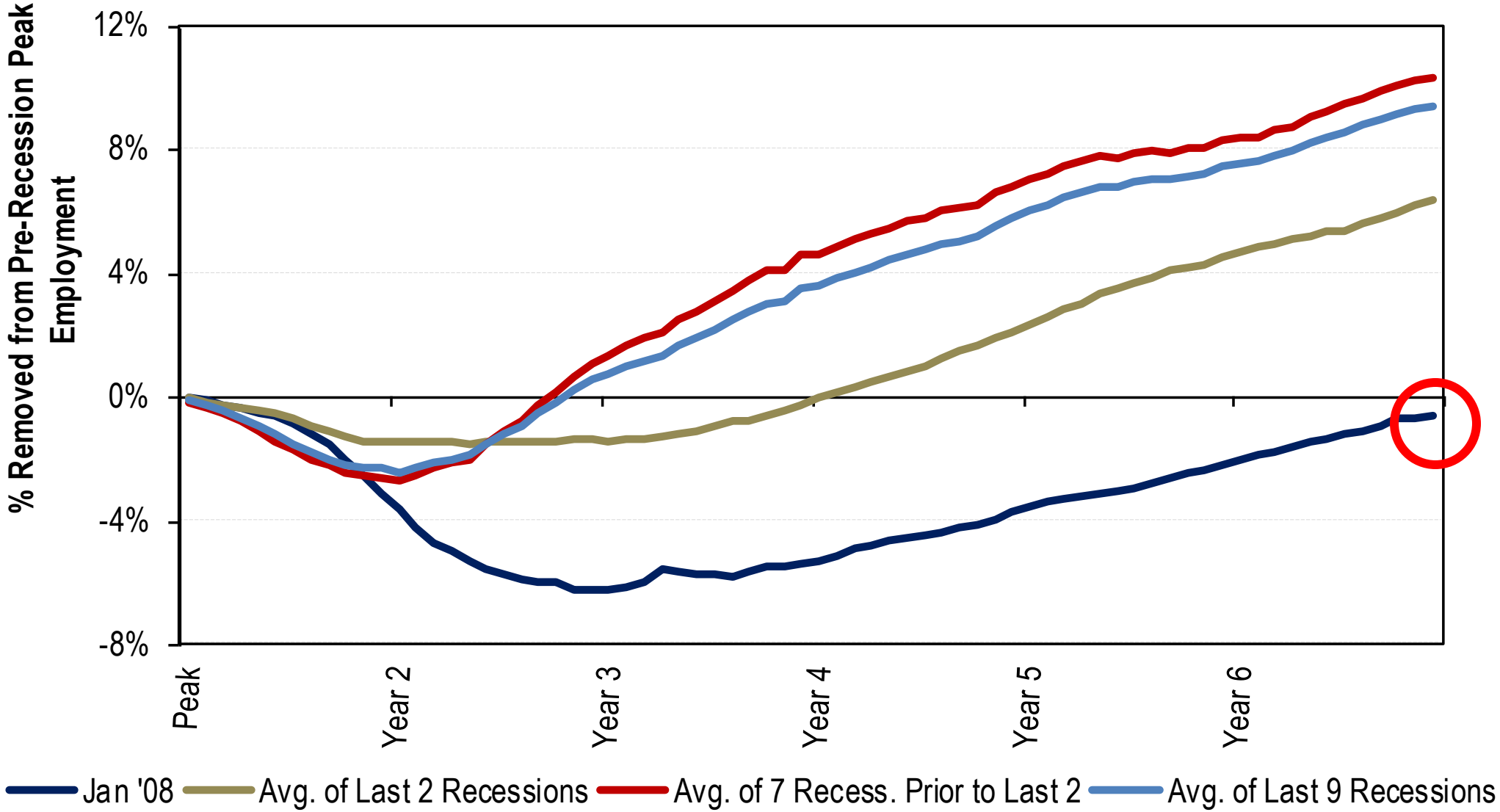




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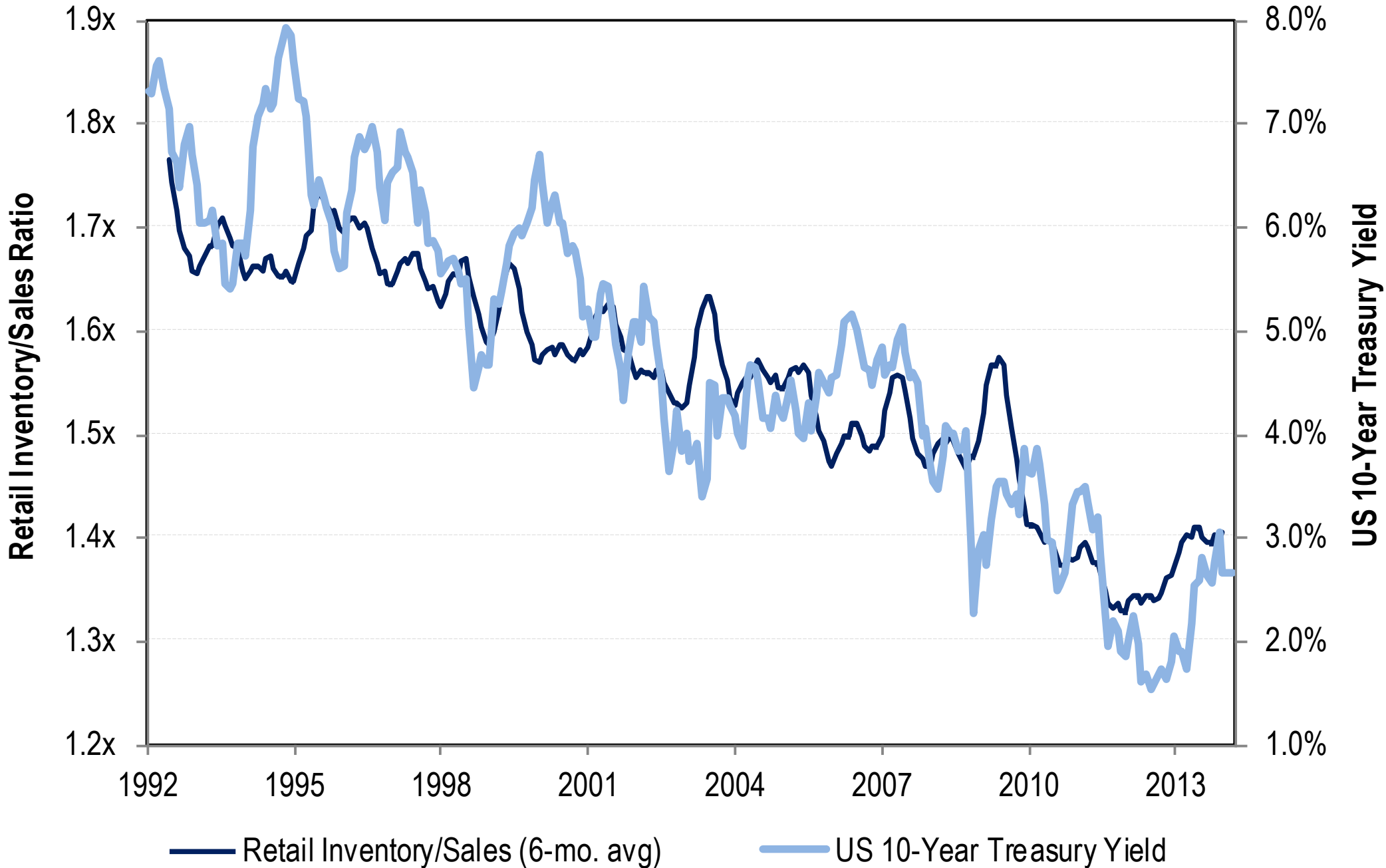


# US Unemployment At/Near Prior Peak Levels

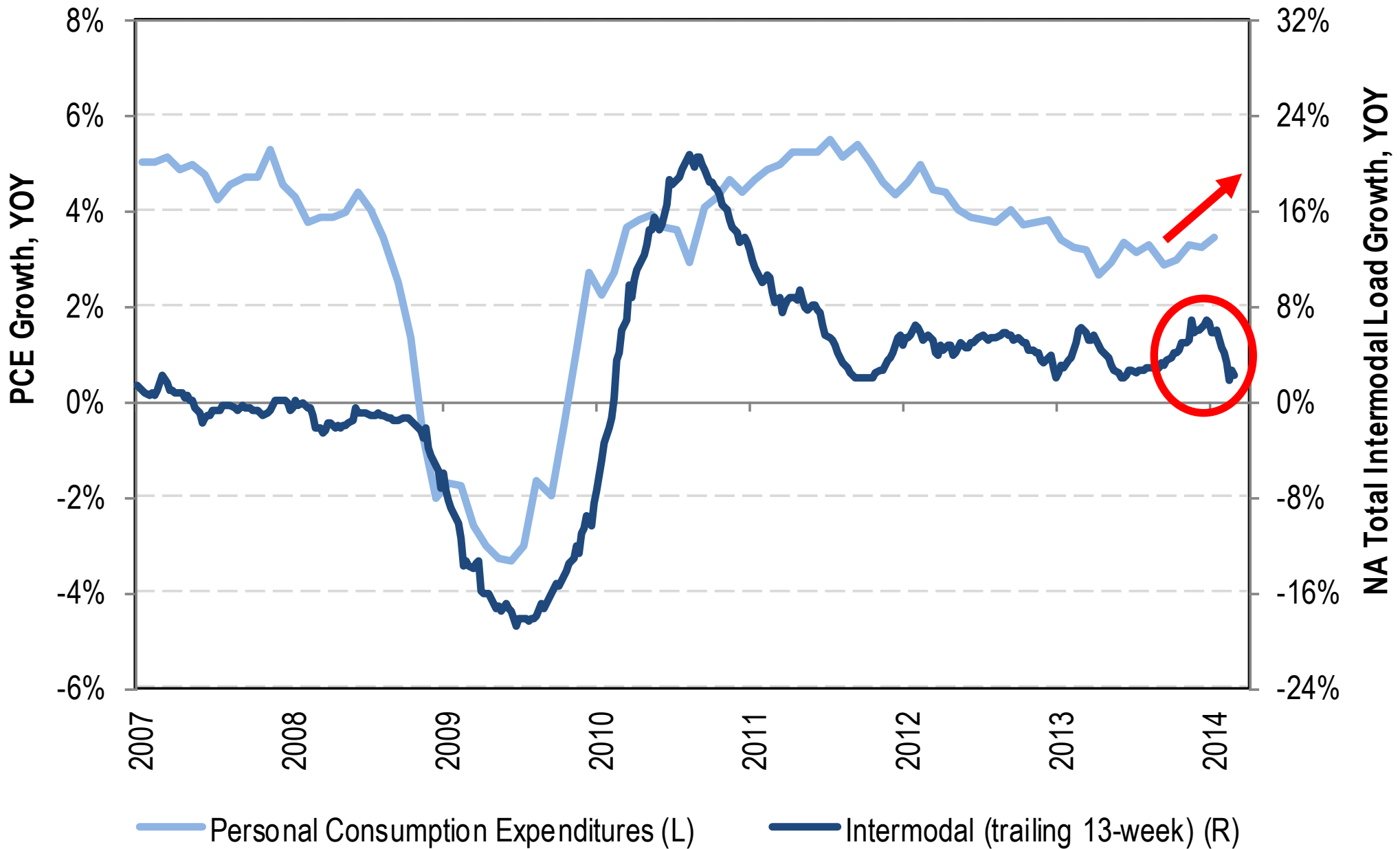


# A Restock, Or Weaker-Than-Expected Demand?

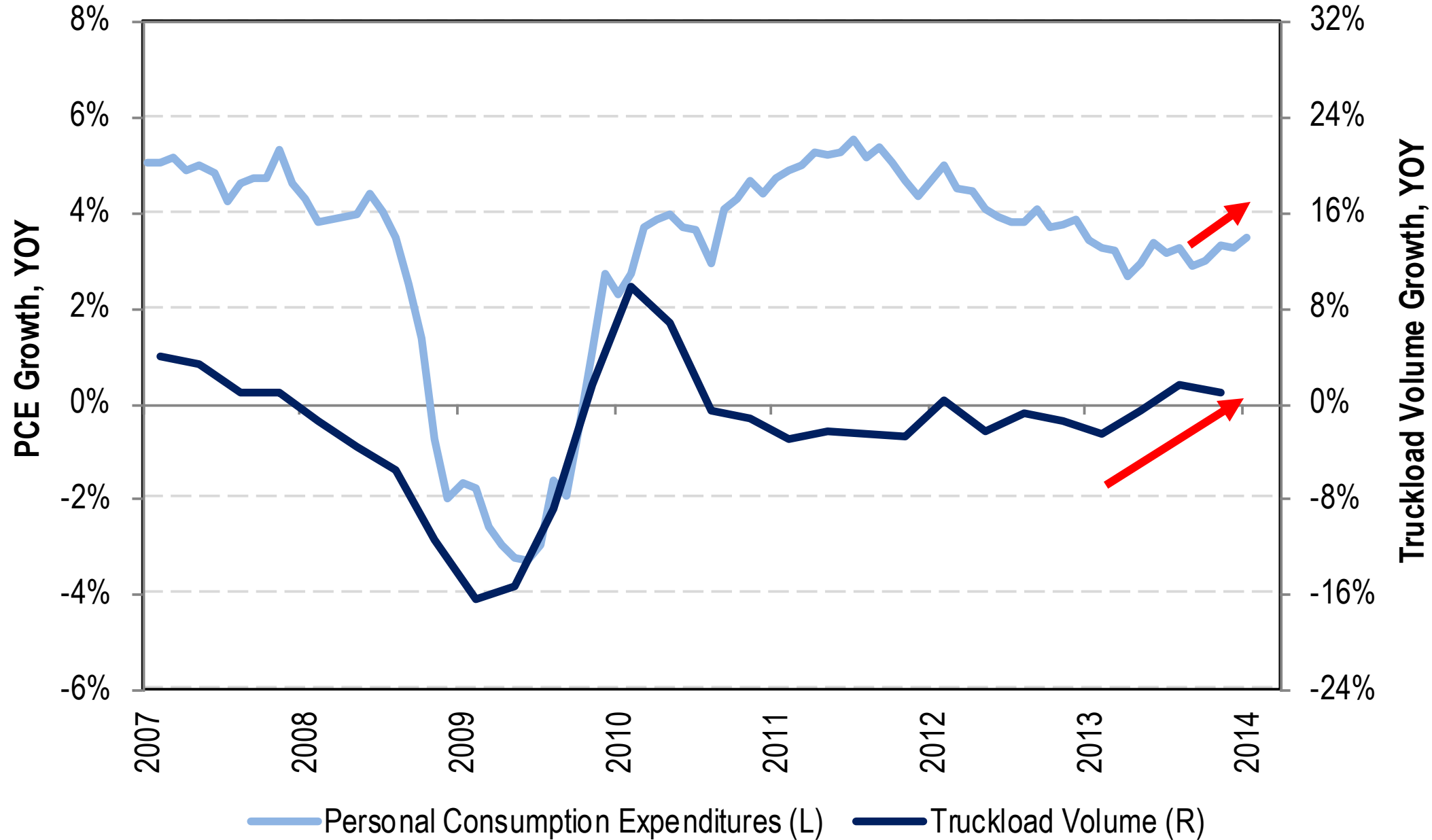
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# Consumer Spending Matters...To Intermodal Volume Growth

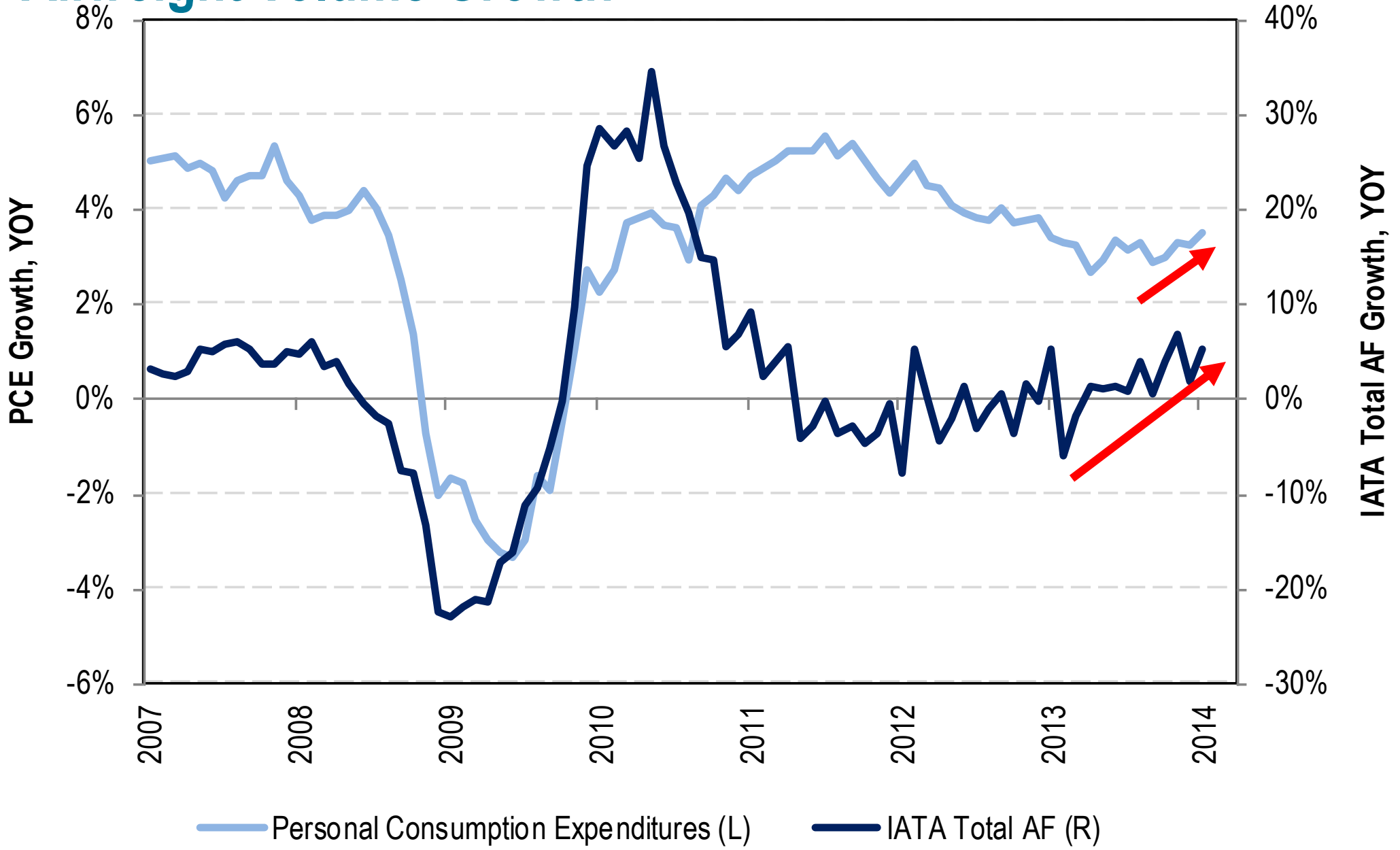


# Consumer Spending Matters...To Truckload Volume Growth



Source: BEA, Company data

# Consumer Spending Matters...To Airfreight Volume Growth



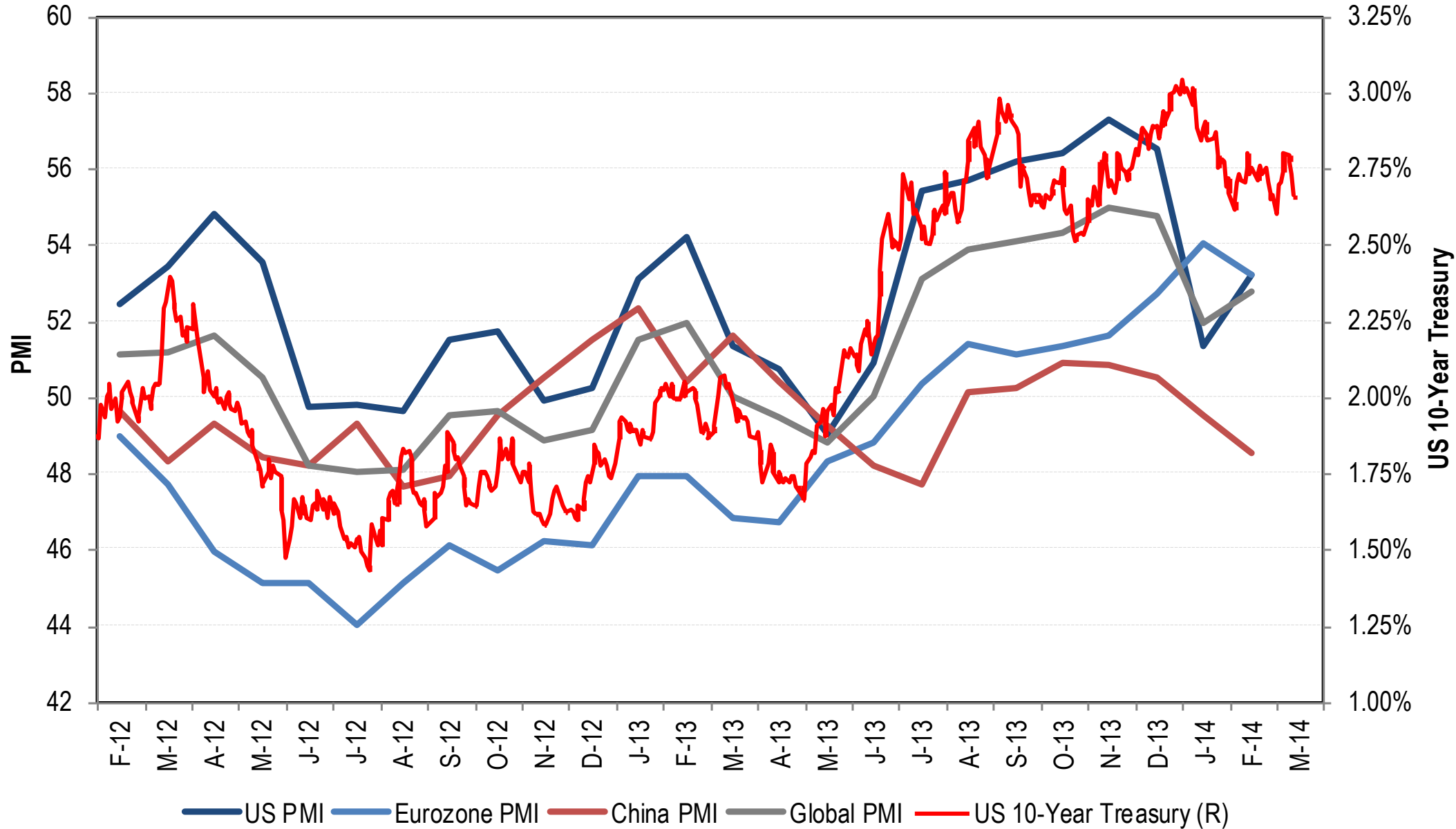
Source: BEA, IATA

# We're All Tired Of Talking About The Weather

...But it will remain a topic among transports well into 2Q14. Some early 2014 themes that build off of the severe winter weather:

- 1) Asset-based transports across modes (Integrators, Rails, LTLs, TLs) have acknowledged both elevated operating expenses and negative network utilization due to this year's severe winter weather.
- 2) 2014 core pricing growth ahead of expectations given 1Q capacity shortages.
- 3) Below-seasonal retail demand in January presents a potential above-seasonal tailwind in March and into 2Q14.

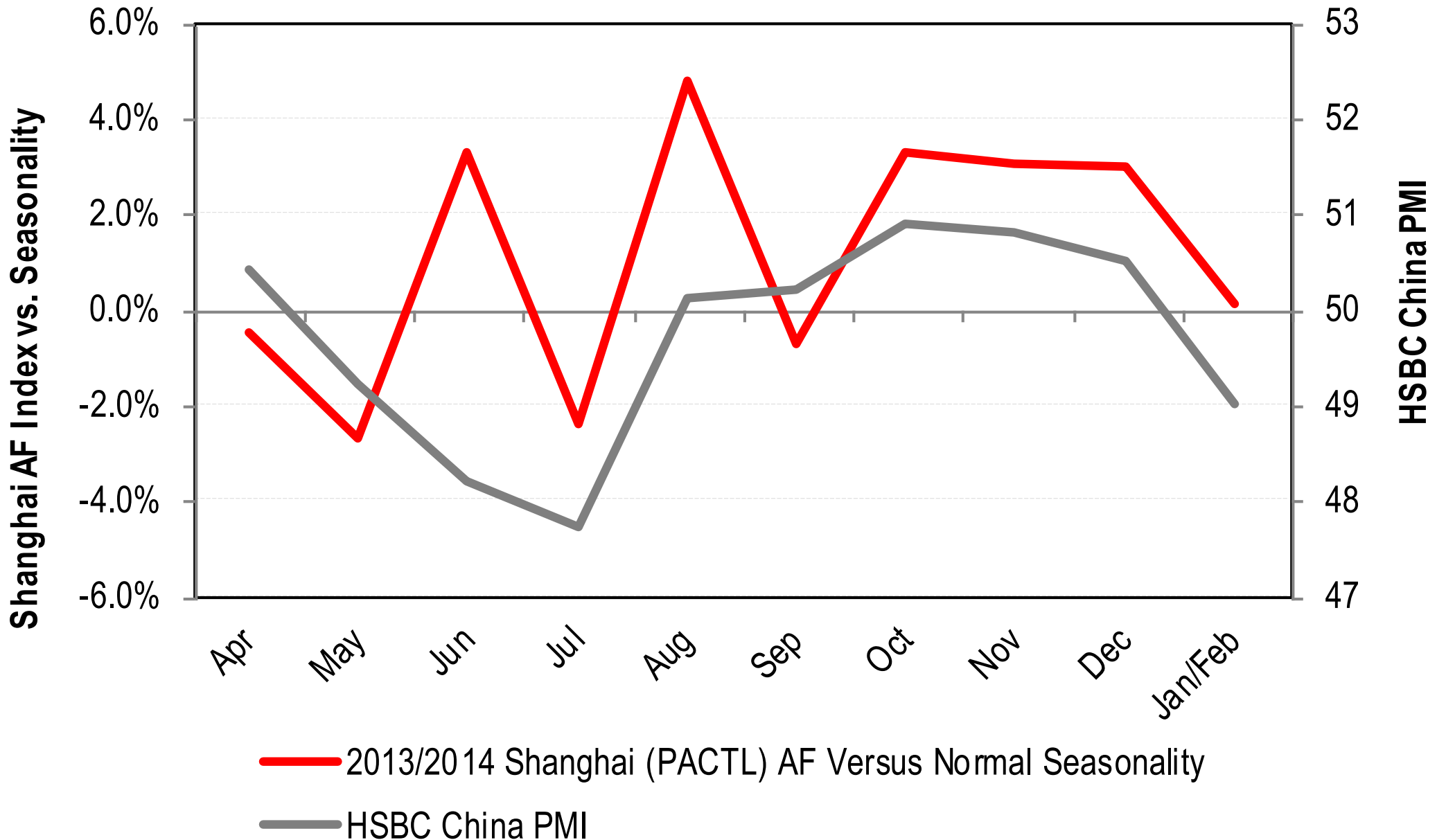
# US 10-Year Yield Closely Tracking US & Global PMI Readings



Source: FactSet, Institute for Supply Management, Markit

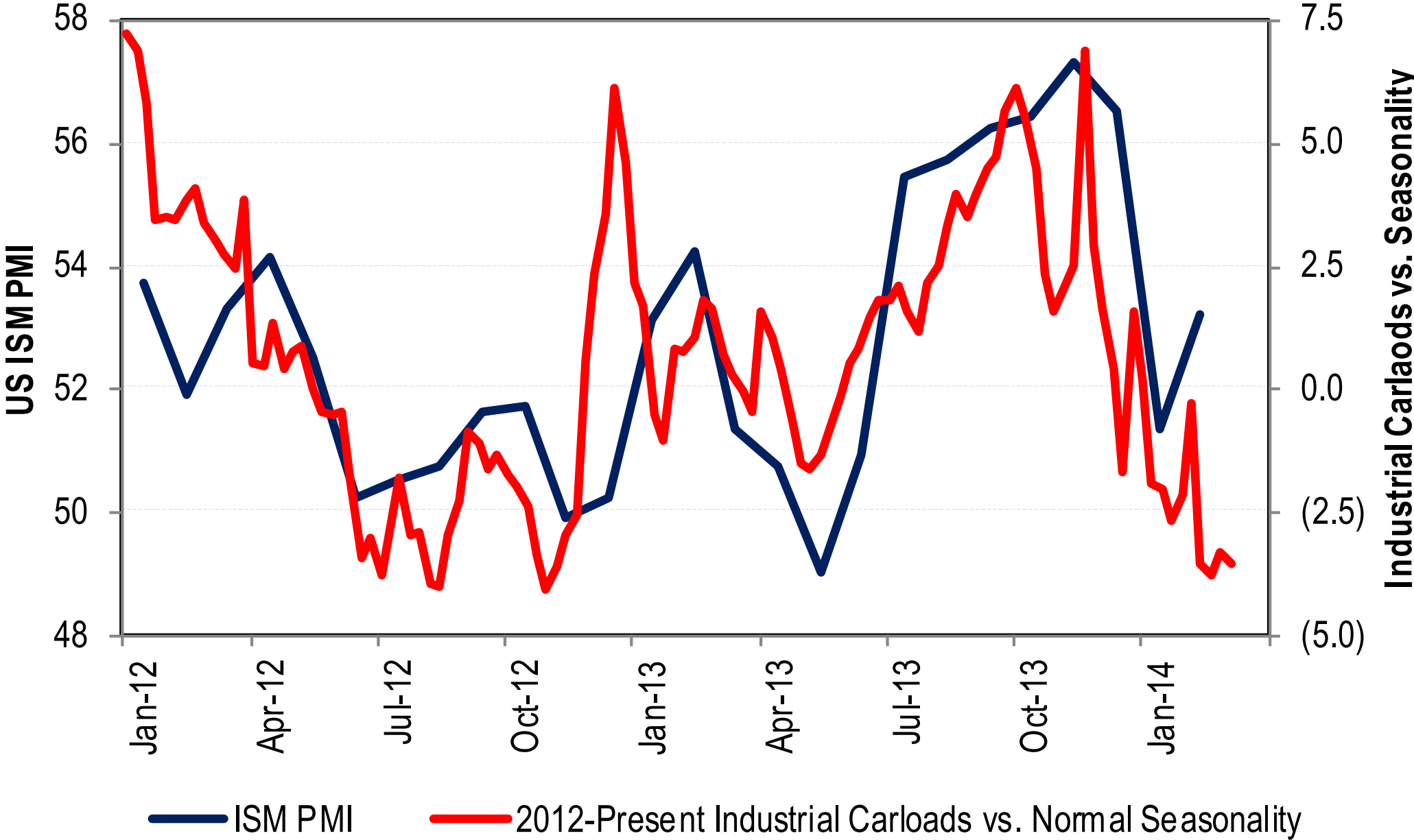


# Asian Airfreight Trends Softening In 2014 Into Weaker China Data



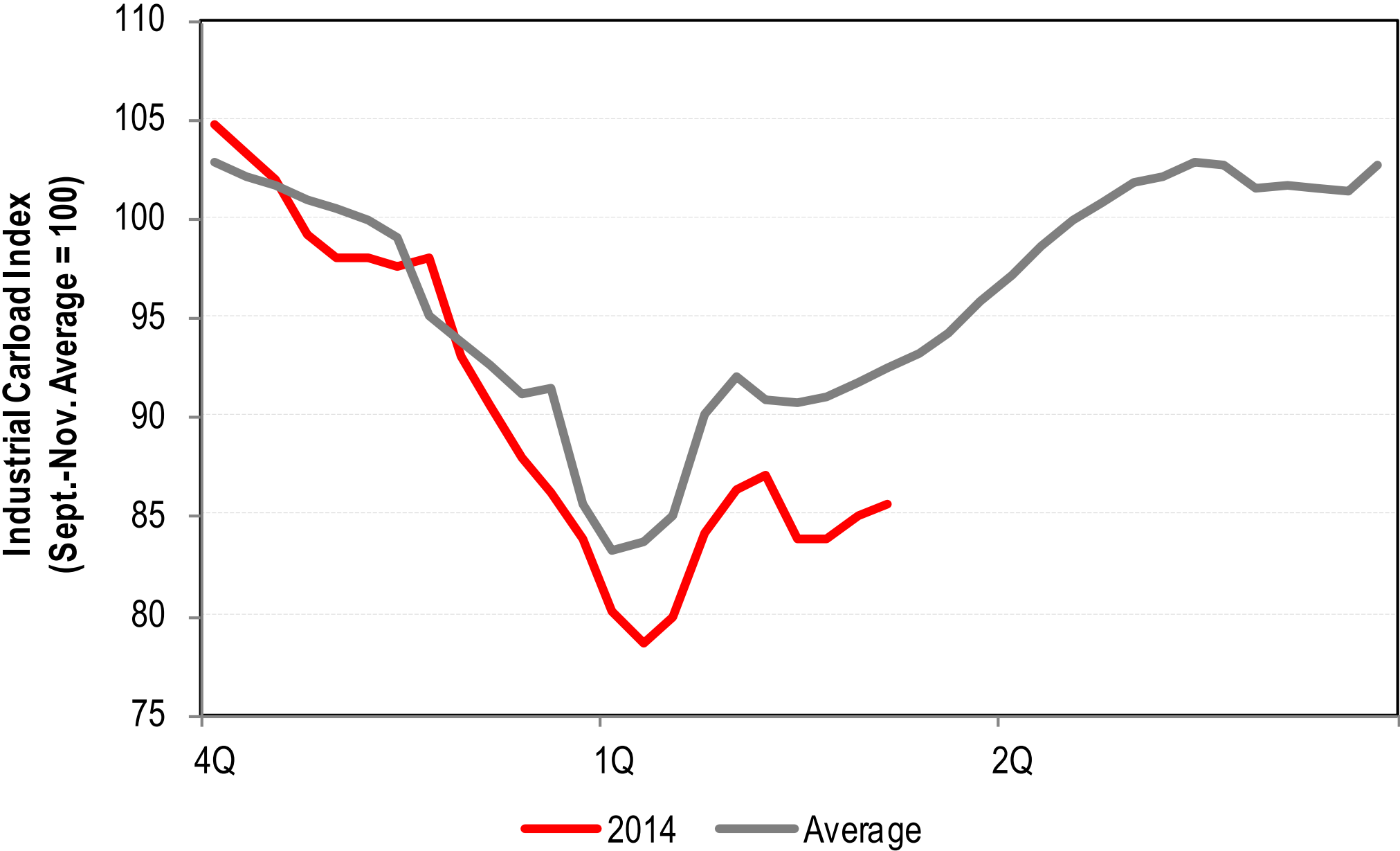
— 2013/2014 Shanghai (PACTL) AF Versus Normal Seasonality  
— HSBC China PMI

# Recent Softening in US ISM PMI Consistent With Industrial Carloads

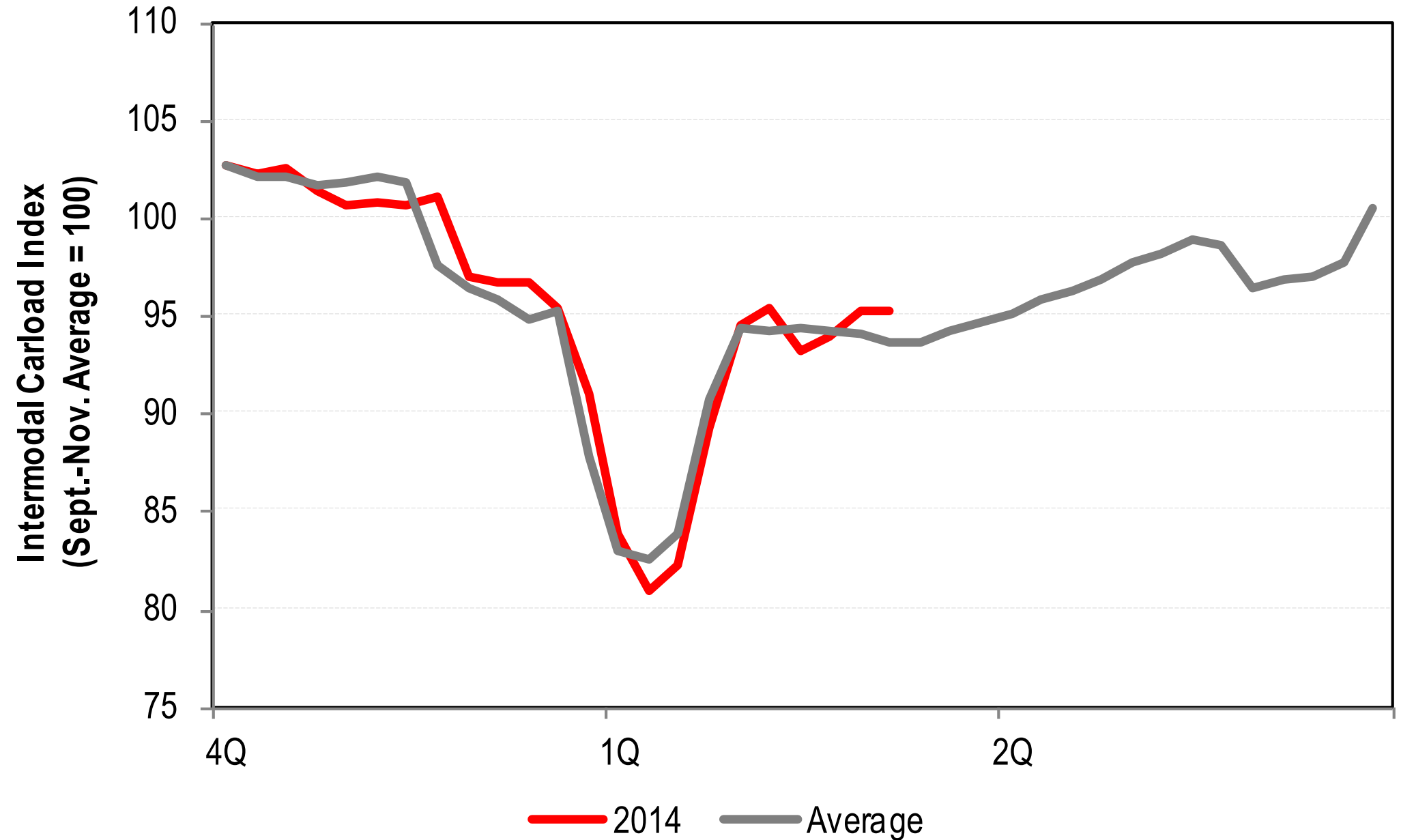


Source: Institute for Supply Management, AAR

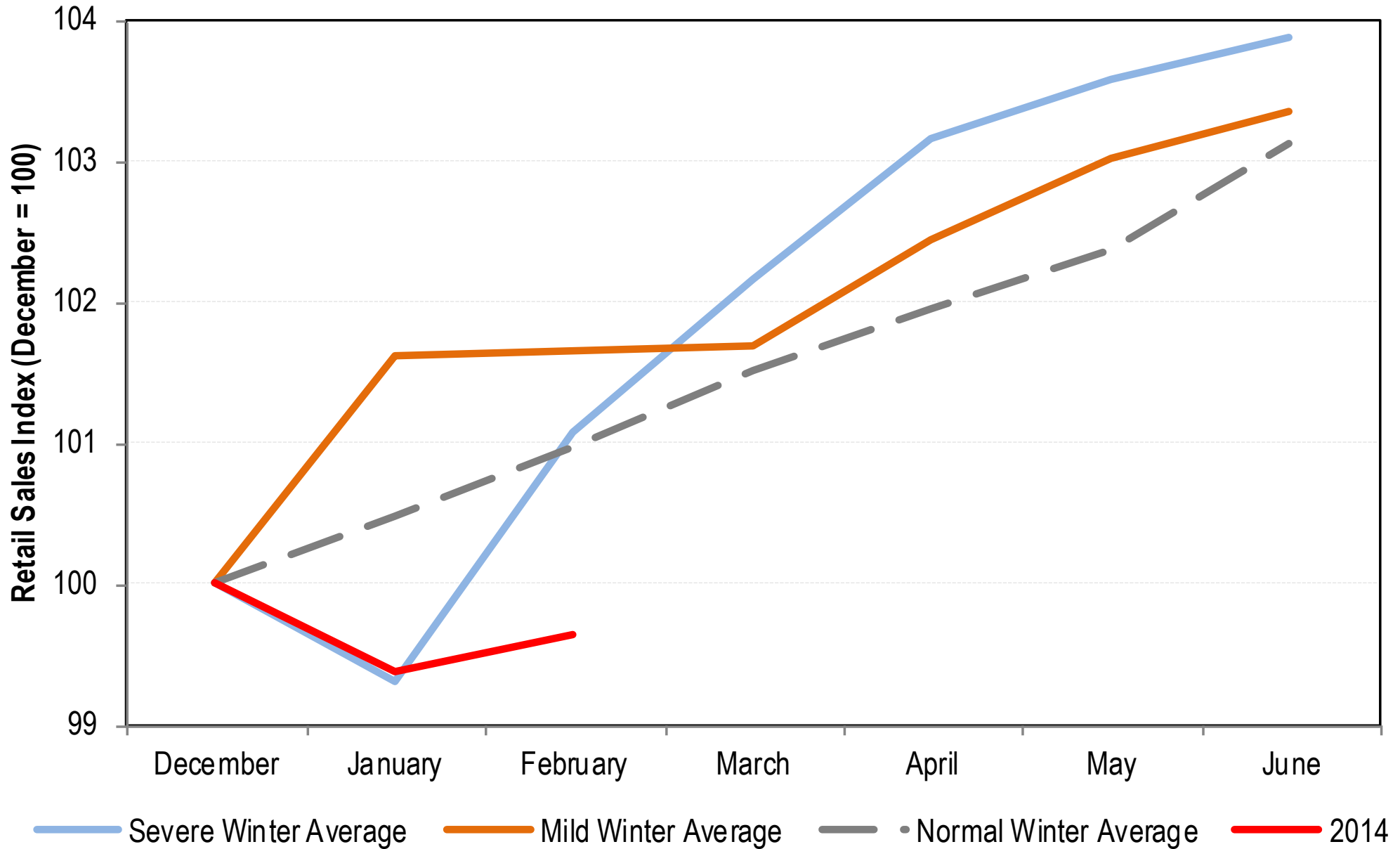
# Industrial Rail Carloads Below Seasonal To Begin 2014



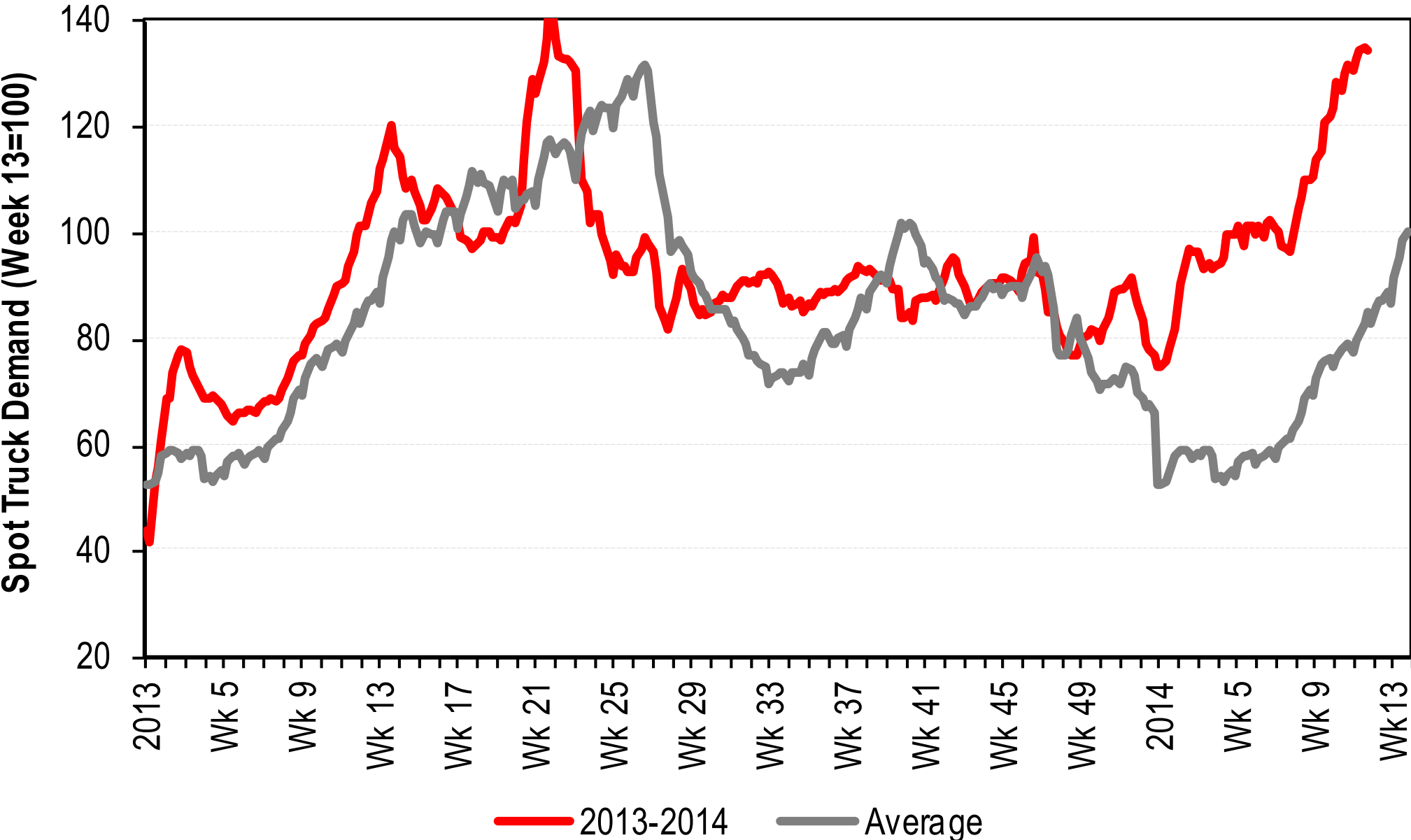
# Stable Intermodal Volumes YTD Despite Hampered Rail Service



# A Cold Winter Could Drive Cabin-Fever-Induced Retail Strength In 2Q14



# Weather Has Driven Above-Seasonal Spot Demand Trends YTD

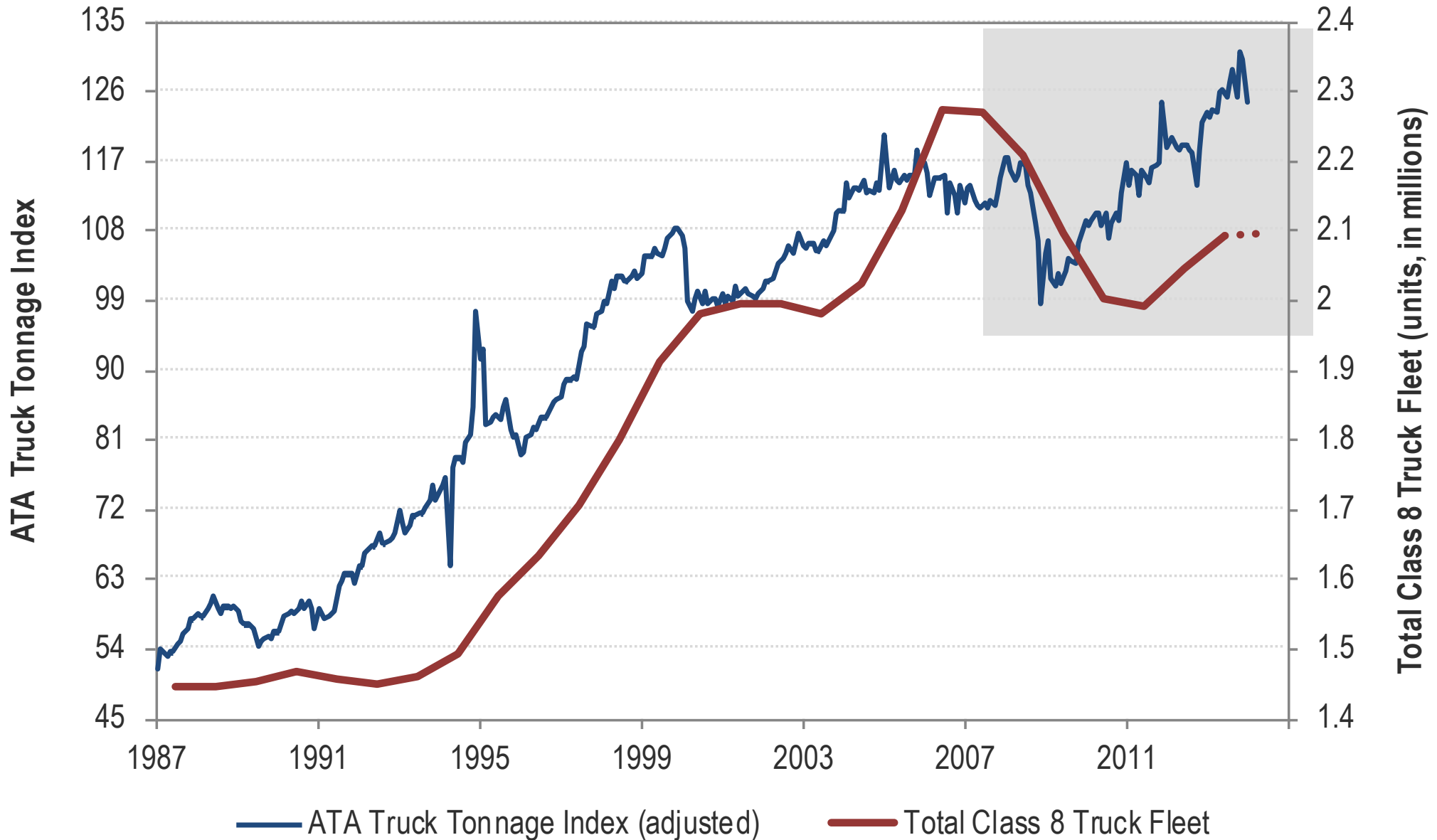


Source: Industry data, Baird estimates

# Three Emerging Concepts This Cycle...

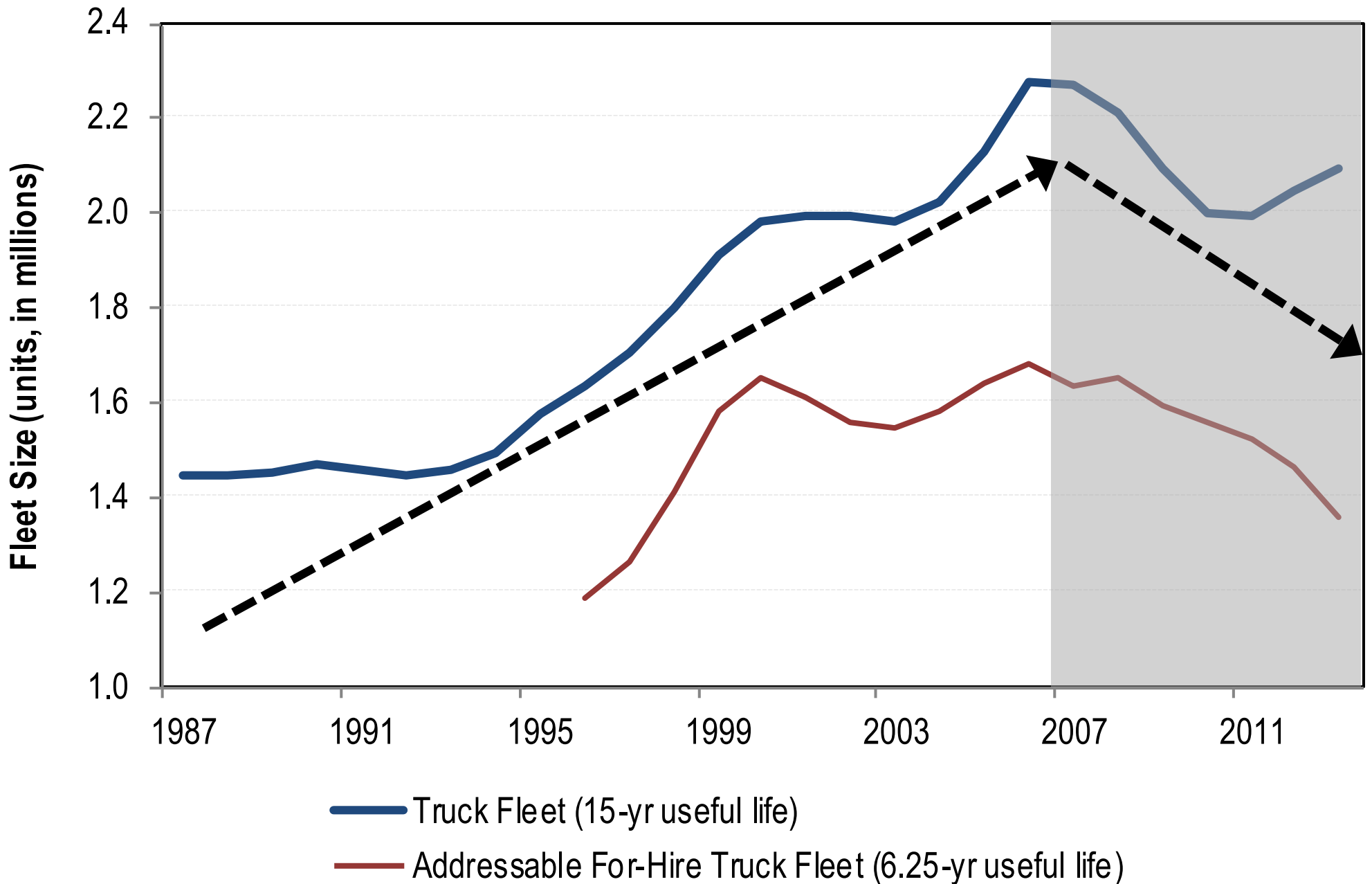
- 1) Pricing power is shifting to the capacity providers given changes to capacity management behavior
- 2) Transport models are converging
- 3) Supply chains and freight flows are changing

# Carriers Now Managing Capacity To The Trough, Not The Peak

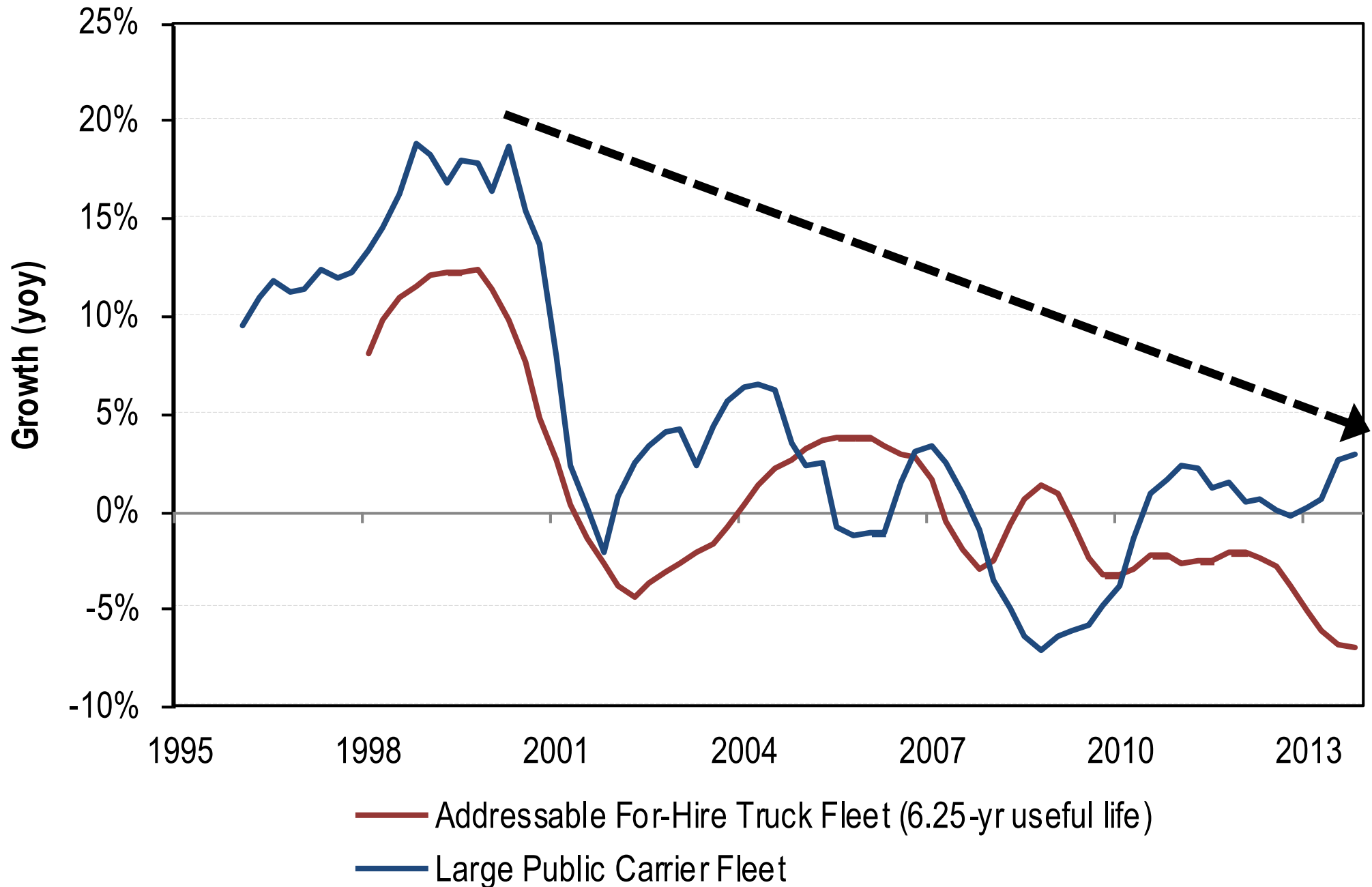




# Truckload Capacity Trends Have Inflected This Cycle



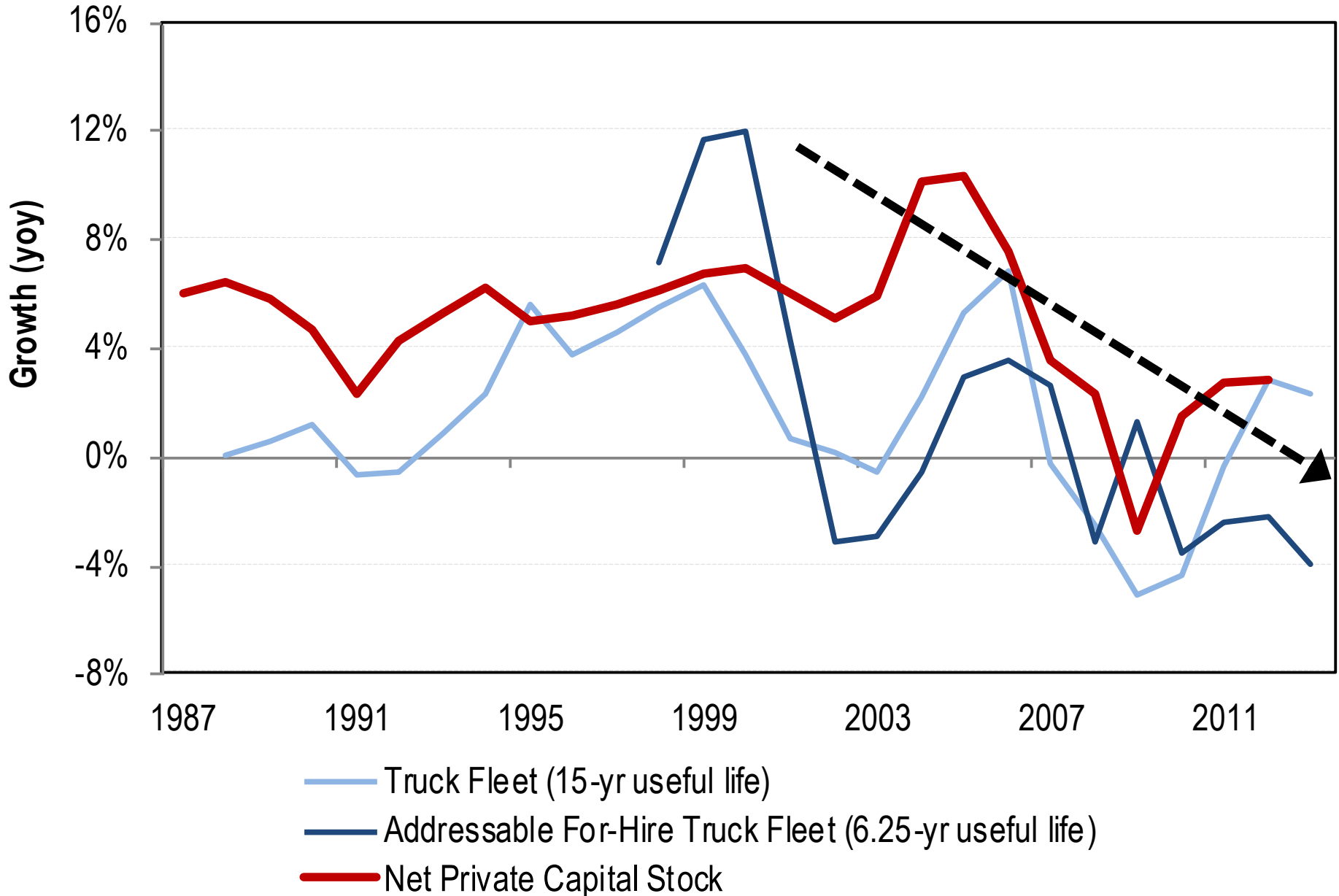
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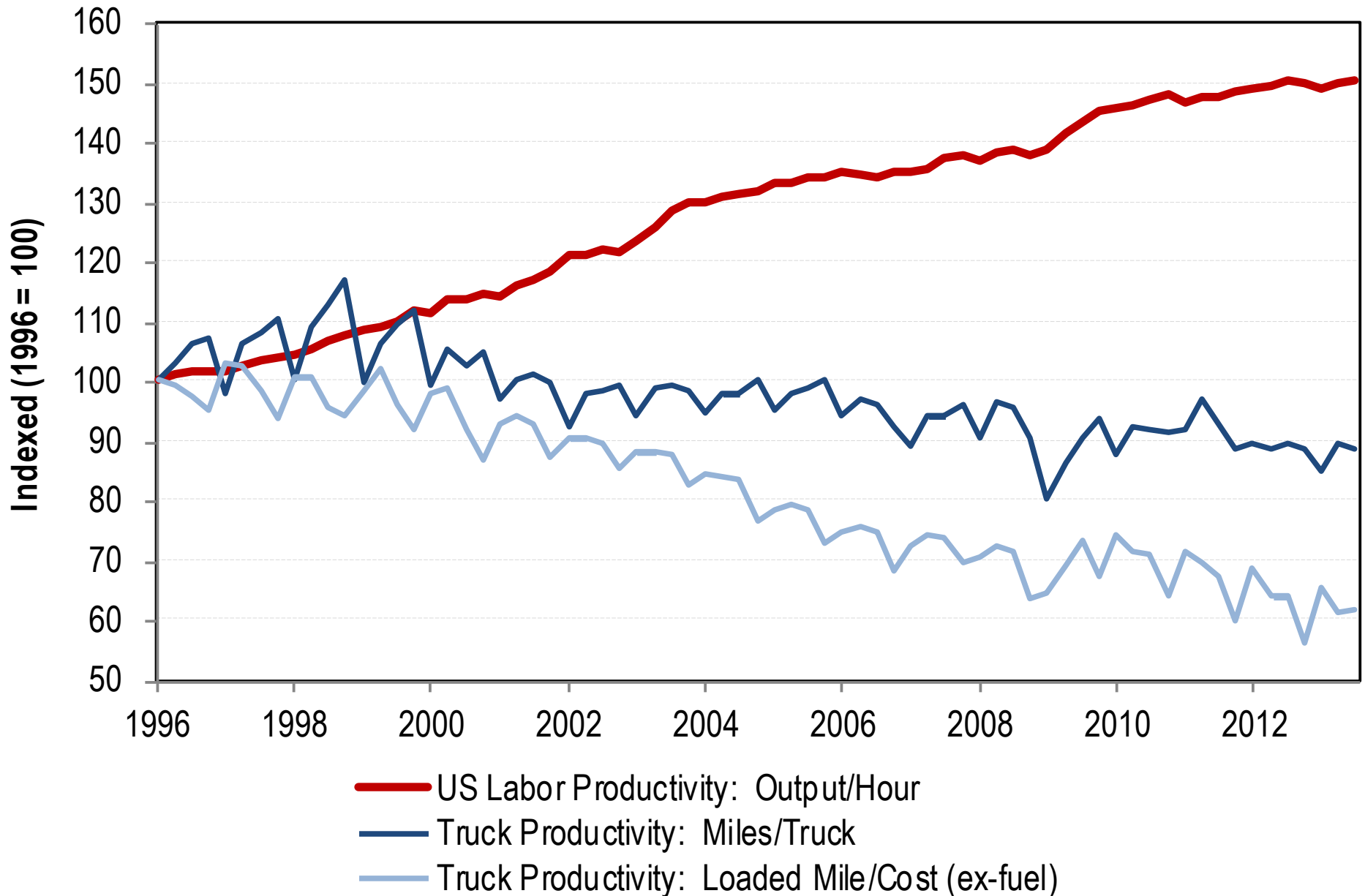
Source: ACT Research, Company data, Baird estimates

\*Large Public Carrier Fleet includes: CGI, CVTI, HTLD, JBHT, KNX, MS Carriers, SWFT, USAK, WERN

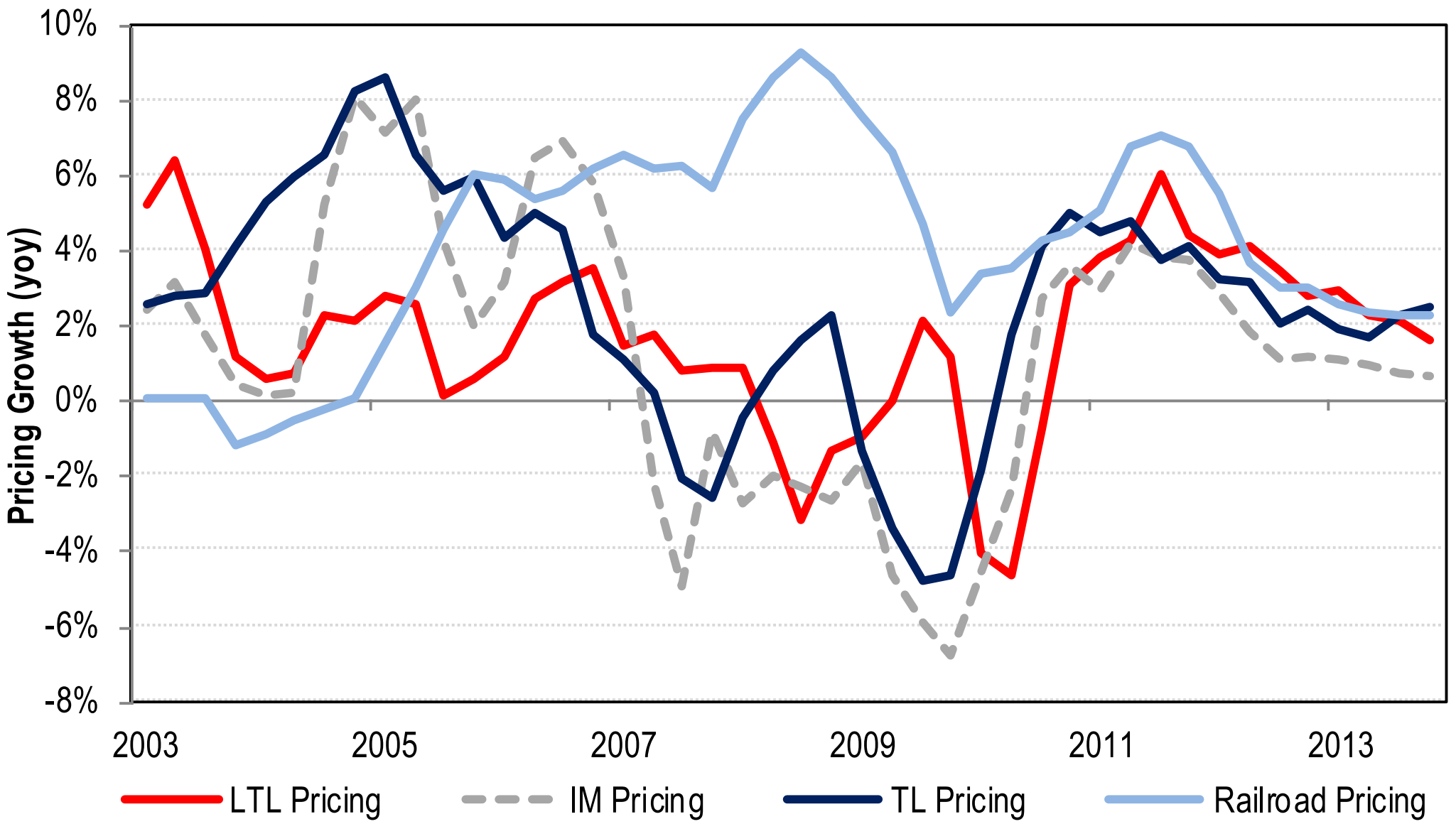
# Truckload Capacity and Productivity Trends Relative To The Broader US Economy



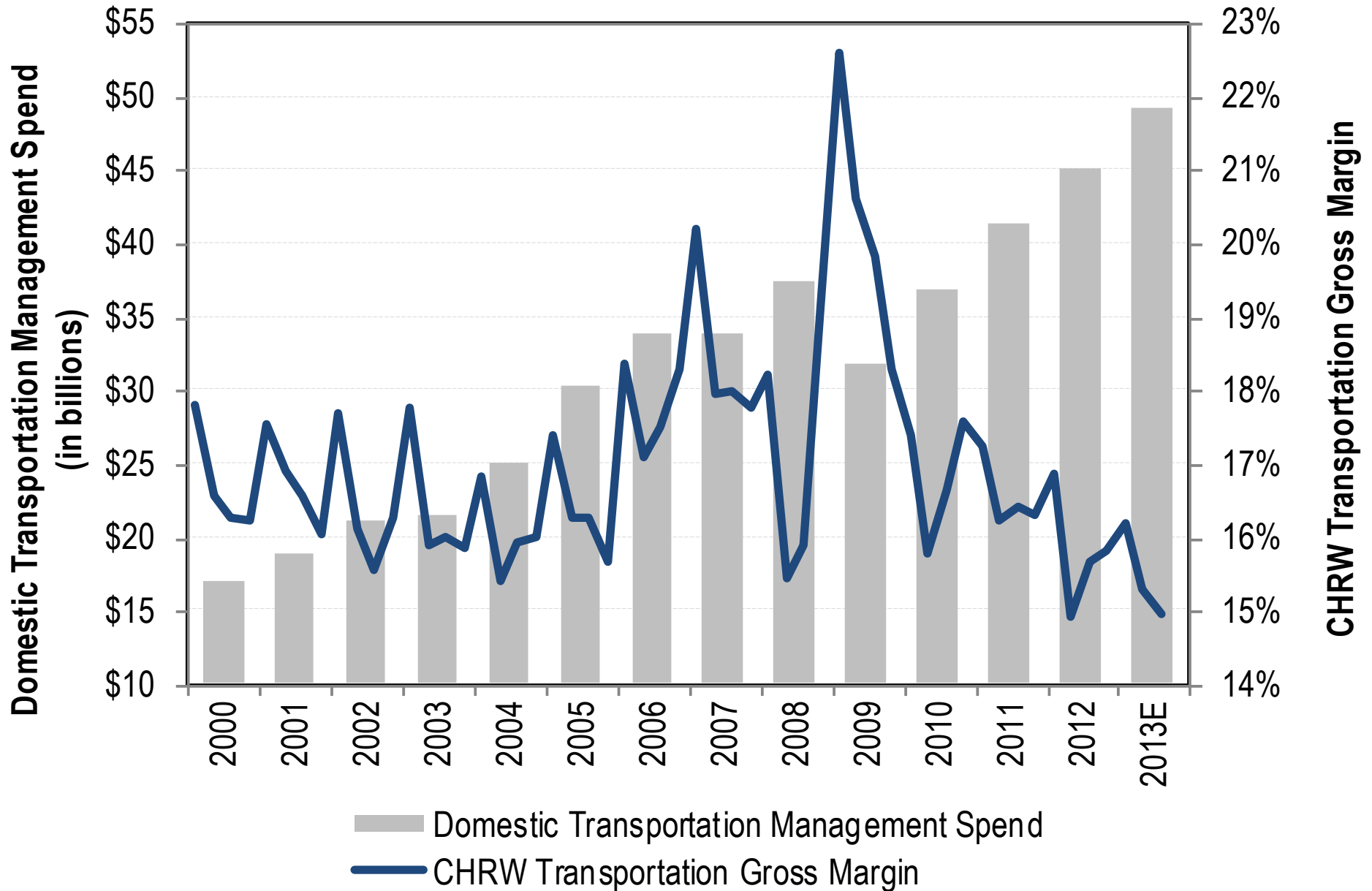
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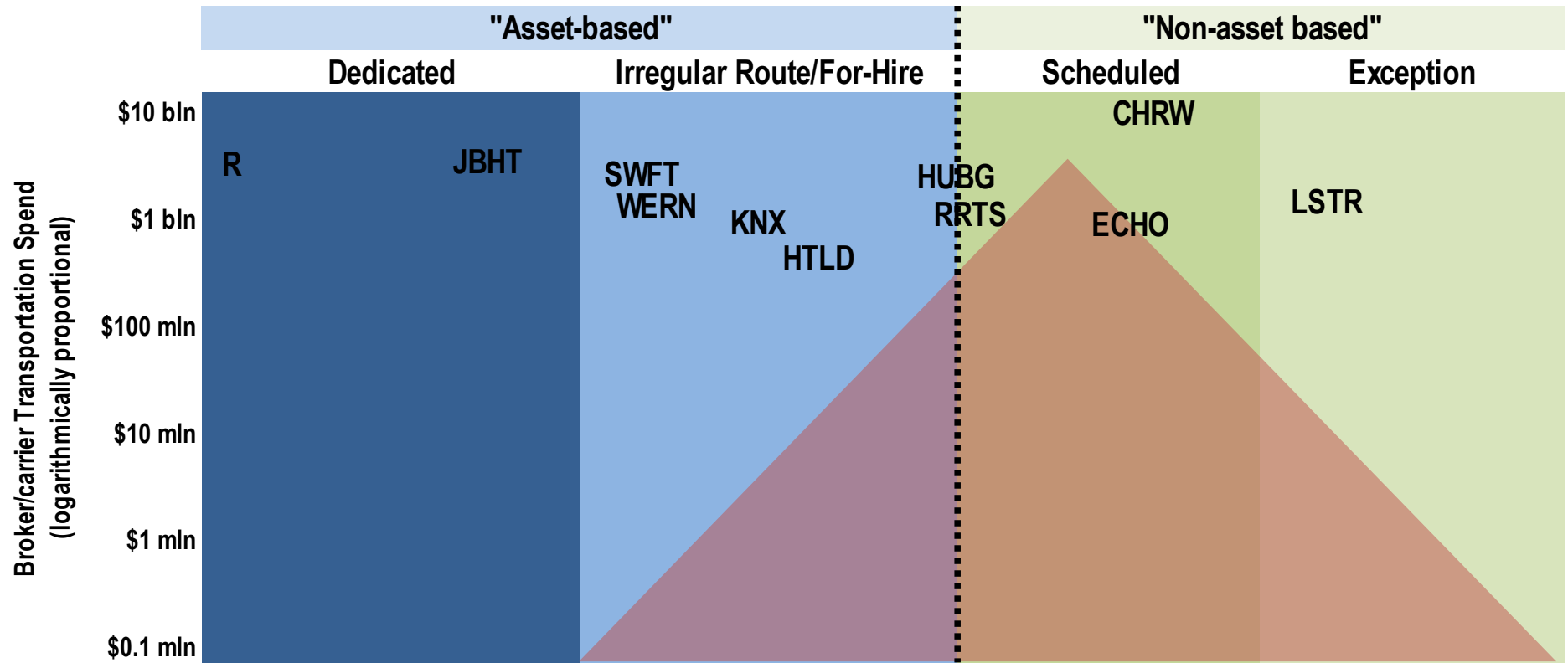
# Pricing Growth Has Slowed This Cycle; 2014 Presenting An Inflection



# Changing Dynamics Pressuring Freight Brokers' Gross Margins



# Continuum of Domestic Freight Capacity Needs And The “Pyramid of Pressure” This Cycle



	Dedicated	Irregular Route/For-Hire	Scheduled	Exception
<b>Dynamics this cycle</b>	<p>*Pressures to shippers operating private fleets (rising equipment costs, capital scarcity, driver regulations) leading to elevated inquiries about outsourcing management to dedicated fleet operators</p>	<p>*Core carrier concept among shippers highlights credible concerns about access to reliable capacity</p> <p>*Carriers with scale strategically positioned to protect margins and expand service offering</p> <p>*Small carriers/individual owner-operators facing numerous headwinds, limiting</p>	<p>*Pressures to small carriers/owner-operators (~80% of TL market) limit available capacity base</p> <p>*Coupled with slower end-market growth and increasing competition, expect gross margin pressure for brokers lacking</p>	<p>*Constraints to capacity base similarly pressures gross margins</p> <p>*But, brokers filling need (exception/emergency freight) or niche (specialized equipment) in position to deliver value, particularly among small/medium-</p>

# Global Freight Flows On The Mend

**2014 headed toward more "normalized" growth, both in the US and globally.**

## **Positive sources of growth:**

- Structural gains from energy (both crude and petrochemical), domestic intermodal
- Changing sourcing patterns (i.e., B2C) an opportunity for some
- Agricultural volumes should recover following 2012's drought
- Reindustrialization of US/North America should support continued growth in US Industrial Production this cycle
- The US consumer is healing; and US business investment has yet to fully engage this cycle
- Rising consumption in emerging global markets (Asia, South America, Eastern Europe, Africa)

## **Risks and headwinds to growth:**

- Regulatory changes
- Structural declines in certain industries (coal, paper)
- Freight growth impediments from digitalization
- Geopolitical risks and macro shocks



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