

## JP Morgan CSA Transportation Report

CSA continues to be the hottest topic of conversation in the industry. Also, it is the most misunderstood topic in the industry today! Surprisingly, the best summary explanation of CSA and its impacts to carriers/customers that I have run across is from an investment analyst - not the FMCSA. The J.P. Morgan report dated December 13, 2010 does an excellent job explaining CSA in brief, understandable terms. The report also highlights a few surprises and makes predictions that, if correct, will impact us all. I have noted the key points of the report below and you can find full details in the attached report.

- **CSA safety ratings provide negative surprises for several large TL carriers.** We (JP Morgan) provide detailed data for the 16 largest TL carriers, which show that 7 of these 16 carriers exceeded the FMCSA's intervention threshold on at least one of the five metrics... **Check the report to find out who these carriers are and their detail ratings!**
- **Greater competition for safe drivers and rising driver pay.** .....will likely drive an increase in competition for drivers as well as pushing a certain portion (5%-9%) of drivers out of the market. The result will most likely be a significant rise in driver pay in 2011 and 2012. **All of the carriers with whom I have spoken in the last couple of months are in agreement that there is no doubt that many drivers will be pushed out of the market AND absolutely no doubt that carriers will have to pay the safer drivers much more in order to keep trucks manned. The only questions are a) how much will driver wages rise and b) how much will rates rise? After 18 - 24 months of rates being driven to break-even or below, carriers cannot absorb cost increases. Forward-thinking shippers realize they will have to pass much of the cost increases through to their customers and will prepare customers & upper management during the first quarter 2011 before the Spring/Summer busy season begins.**
- **Pressures on driver capacity are a potential net positive for TL.** A tightening driver market should support stronger TL pricing. **The law of supply and demand will put A-List shippers at a competitive advantage in the market place as their B & C-List competitor shippers will have difficulty securing dependable capacity.**
- **CSA 2010 Suggests Some Large Carriers have Performance Deficiencies.** Unsafe driving appears to be the most challenging category, and five of the 16 largest carriers were beyond the threshold in the Unsafe Driving category... We believe that carriers with scores beyond the CSA 2010 thresholds are more likely to face roadside inspections and potentially facility inspections. **Poor performing carriers who continue to operate will now likely have even more challenges picking up and delivering on time if their fleets are inspected more frequently than good-performing carriers. The new CSA ratings make poor performers much more visible to law enforcement and DOT officials.**
- **Impact of CSA 2010 on the Truckload Carriers. Rising Driver Costs, Tighter TL market, and Higher TL Rates.** ...greatest effect will be to push drivers with a poor safety record out of the market. There could also be an effect where there is a significant rise in competition for drivers with strong safety scores. Both of these effects would likely put upward pressure on driver pay. **Most GOOD major carriers who are reviewing their CSA scores already have corrective actions in process. The BETTER carriers have been recruiting to the new CSA criteria/standards for several months. The BEST carriers are also working hard in the background to revise compensation plans, driver wages, and customer/load/lane "driver friendliness" to attract top drivers.**

Thank you for working with Melton Truck Lines. We appreciate your business and look forward to a great year in 2011!

January 5, 2011

Best Regards,

A handwritten signature in cursive script that reads "Dan Taylor".

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The logo for Melton Truck Lines, Inc. features the word "Melton" in a large, bold, blue serif font with a red underline. Below it, the words "Truck Lines, Inc." are written in a smaller, blue, sans-serif font.

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## Truckload

### More Naughty Than Nice: CSA Data Show More TL Carrier Safety Issues Than We Expected

- CSA safety ratings provide negative surprises for several large TL carriers.** On Sunday, December 12 the Federal Motor Carrier Safety Administration (FMCSA) provided the first public data on trucking company performance on five of seven metrics within its new system (CSA 2010) for measuring and assessing trucking company safety performance. While we expected a few surprises, our overall reaction is surprise regarding the number of poor ratings received by large carriers. We provide detailed data for the 16 largest TL carriers, which show that 7 of these 16 carriers exceeded the FMCSA's intervention threshold on at least one of five metrics, including Covenant, CRST, Dart, Knight, USA Truck, US Xpress, and Western Express.
- Data highlights likely greater competition for safe drivers and rising driver pay.** Given that most of the seven safety metrics are either directly a function of driver performance or at least indirectly affected by driver performance, we believe that the carriers with relatively weak scores will likely need to be more aggressive in their recruitment of drivers with strong safety track records. We suspect that the CSA 2010 program and now public data on carrier performance will likely drive an increase in competition for drivers as well as pushing a certain portion (4%-9%) of drivers out of the market. The result will most likely be a significant rise in driver pay in 2011 and 2012.
- LTL and small package company scores show little risk.** We also provide tables that show performance of the small package divisions of UPS and FDX and also the major LTL carriers (including the LTL units of UPS and FDX). While there are differences in performance across the carriers, the scores show little risk from CSA 2010 for the small package and LTL carriers as all the carriers we examined show good scores. UPS and FDX scores in their small package businesses are the strongest and most impressive scores.
- Easy read is that CSA 2010 is positive for intermodal.** The number of large carriers with scores (on certain metrics) that exceed the intervention threshold was surprisingly large. We read this as an indication that the impact of CSA 2010 could be greater than we had anticipated in terms of the magnitude of tightening in the driver market. We believe that the easiest read from the CSA 2010 data (and also from a likely reduction in truck hours of service) is that TL capacity challenges provide a benefit to the intermodal players. We expect the benefit to come in the form of modal share gain for intermodal vs. truck and also in terms of support for rising intermodal prices.
- Pressures on driver capacity are a potential net positive for TL.** A tightening driver market should support stronger TL pricing, and we believe that the weak CSA 2010 scores from a number of large TL carriers are likely to contribute to shipper fears about TL capacity. However, the TL carriers also face likely significant increases in driver pay with risk that the competition for safe drivers could sharply increase. Nevertheless, we expect a net positive effect as the impact from rising TL prices is greater than the impact from driver pay.

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## What is CSA 2010?

### Compliance Safety & Accountability (CSA) 2010

CSA 2010 is a new initiative from the Federal Motor Carrier Safety Administration (FMCSA), which is part of the U.S. Department of Transportation (DOT). The purpose of the program is to improve safety of commercial vehicles and reduce associated accidents and fatalities. Using monthly data from the Safety Measurement System (SMS), which is a rolling two-year historical safety record of drivers and carriers, safety issues are identified and targeted for resolution. Truckload performance is weighted so that more recent data is more significant than older data. Relative to the oldest data (from more than 12 months ago), the most recent 6 months of data has 3x greater weighting, while the data from 7-12 months ago is weighted only twice as much as the oldest data. This should allow for a more timely adjustment to the scores as improvements are made by the carriers. There are three steps to the CSA 2010 process: measurement, evaluation, and intervention summarized below.

#### *The CSA 2010 Process*

- *Measurement* - CSA 2010 quantifies driver and carrier safety performance in seven categories and rates the combined score on a scale of 0-100 (where 100 is the worst performer). Over time, it can be determined whether driver and carrier performance is improving or deteriorating. We summarize the seven measured BASICS (Behavioral Analysis and Safety Improvement Categories) below.
  1. Unsafe Driving: Operating a commercial motor vehicle (CMV) unsafely, e.g. speeding, reckless driving, improper lane change, inattention, etc. Performance threshold: 60%.
  2. Fatigued Driving (Hours of Service): Violations of or non-compliance with Hours of Service regulations, or driving while fatigued. Performance threshold: 60%.
  3. Driver Fitness: Drivers must have the proper medical qualifications, training, and experience to operate a vehicle safely. Performance threshold: 75%.
  4. Controlled Substances / Alcohol: Misuse of prescription or over the counter medication or impairment due to controlled substances. Performance threshold: 75%.
  5. Vehicle Maintenance: Failure to properly maintain vehicle (lights, brakes, required damage repairs). Performance threshold: 75%.
  6. Cargo-Related: Improperly securing loads, cargo retention, handling of hazardous materials. Carrier performance in this category has not been made public at this time. Performance threshold: 75%.
  7. Crash Indicator: Frequency and severity of crashes. Carrier performance in this category has not been made public at this time. Performance threshold: 60%.
- *Evaluation* - The safety evaluation process enables FMCSA to determine which carriers are poor operators and need some form of intervention. Ultimately, after following a series of steps FMCSA can suspend a carrier from operation.
- *Intervention* - As part of CSA 2010, there are three categories of intervention that FMCSA can employ. Early contact includes warning letters, carrier access to safety data, and targeted roadside inspection. More serious measures include

offsite and onsite investigations (which can be focused on specific safety deficiencies or comprehensive for the entire carrier). Lastly, follow-on intervention includes a voluntary comprehensive safety plan, a formal notice of violation, a notice of claim, or as a last resort, an operations out-of-service order (OOS), which shuts down the motor carrier.

#### *CSA 2010 Will Be Rolled Out in Stages*

The field test for CSA 2010 began in February 2008 with Colorado, Georgia, Missouri, and New Jersey and expanded in 2009 to include Delaware, Kansas, Maryland, Minnesota, and Montana. Beginning in mid April 2010, motor carriers were given access to their safety scores using the BASIC methodology outlined above. In August 2010, carriers were provided access to their violations based on the Carrier Safety Management System (CSMS), and a significant portion of this data was made public on December 12. Also in fall/winter 2010, FMCSA will begin to send out warning letters to carriers with safety deficiencies, and roadside inspectors will target carriers for inspection. In 2011, a notice of proposed rulemaking is expected to outline how FMCSA will determine safety fitness. New enforcement personnel will be trained as states roll out the CSA 2010 operating model.

### **A First Look at CSA 2010 Results for Major TL Carriers**

In Table 1 below, we summarize and compare the CSA 2010 results of 16 major truckload carriers. The scores below reflect the carrier's performance percentile where a lower score is better (e.g. a measure of 25% translates to the carrier being in the top 25% of the industry). Cells that are highlighted in red in the following table indicate the performance of that carrier exceeded the threshold for a given BASIC category, and the carrier may be prioritized for an intervention action and roadside inspection, while orange indicates that serious violations were cited within the last 12 months from an investigation, although the score may not have exceeded the threshold for the respective category.

#### **CSA 2010 Suggests Some Large Carriers Have Performance Deficiencies**

The data summarized in the following table shows that some of the major truckload carriers (Swift, Schneider, J.B. Hunt, Heartland, Celadon, Crete, and NFI) have strong performance results across the available BASICs. However, we were surprised at the number of large carriers that are at or beyond the threshold for inspection on one or more metrics. This group with deficiencies in their CSA 2010 scores includes Covenant, CRST, Dart, Knight, USA Truck, US Xpress, and Western Express. Unsafe driving appears to be the most challenging category, and five of the 16 largest carriers were beyond the threshold in this category. Although Knight Transportation is just over the threshold in the Unsafe Driving category, we note that they are not far away from breaching the threshold in Driver Fitness. Knight Refrigerated, which has its own scores, is above the threshold on the Fatigued Driving and Driver Fitness categories. Western Express was above the threshold on three categories, including Unsafe Driving, Fatigued Driving, and Driver Fitness. We believe that carriers with scores beyond the CSA 2010 thresholds are more likely to face roadside inspections and potentially facility inspections.

Table 1: Summary of CSA 2010 Results for Major Truckload Carriers

	Power Units	Drivers	Unsafe Driving	Fatigued Driving (Hours of Service)	Driver Fitness	Controlled Substances and Alcohol	Vehicle Maintenance
<b>Performance Threshold:</b>			<b>60%</b>	<b>60%</b>	<b>75%</b>	<b>75%</b>	<b>75%</b>
Swift	16,048	17,812	34.7%	40.3%	58.5%	18.8%	42.2%
Schneider	10,620	12,053	21.9%	27.4%	30.1%	9.4%	65.5%
J.B. Hunt	10,512	10,096	16.0%	34.9%	57.1%	0.0%	31.2%
Werner	8,819	10,663	49.1%	9.0%	48.5%	20.7%	72.1%
Landstar	6,848	7,511	40.1%	55.7%	27.8%	1.8%	61.5%
US Xpress	5,721	6,638	62.0%	60.0%	56.6%	13.2%	56.9%
Crete	5,545	5,016	25.1%	26.8%	35.5%	16.9%	35.4%
Knight Transportation	3,644	3,300	60.4%	48.0%	73.2%	37.7%	54.6%
Knight Refrigerated	630	589	49.7%	69.6%	78.6%	N/A	46.0%
Celadon	3,300	2,635	44.9%	48.2%	63.5%	52.8%	47.8%
Heartland Express	2,886	2,886	19.2%	39.4%	26.3%	0.0%	18.6%
Con-way Truckload	2,753	3,165	36.8%	46.1%	47.9%	Inconclusive	32.5%
Dart	2,658	2,597	46.5%	48.8%	48.9%	0.0%	82.2%
Western Express	2,590	2,450	63.6%	87.5%	92.2%	58.4%	57.1%
USA Truck	2,356	2,519	39.0%	57.8%	59.3%	33.9%	77.1%
Covenant	1,833	3,000	81.2%	50.6%	56.3%	11.3%	45.7%
CRST	1,733	3,486	89.3%	47.2%	57.8%	15.0%	27.6%
NFI	1,113	1,306	25.6%	54.1%	13.7%	0.0%	43.3%

Source: Federal Motor Carrier Safety Administration. Data made available December 12, 2012 and reflects safety performance through November 19, 2010.

Red indicates that this carrier exceeds the FMCSA established intervention threshold relative to its safety event grouping and/or has been cited with one or more serious violations within the past 12 months. Therefore, this carrier may be prioritized for an intervention action and roadside inspection.

Orange indicates that serious violations were cited within last 12 months from an investigation.

### Small Package and LTL Results

In the table below we show the CSA 2010 results for a group of seven LTL carriers (for YRC we show the three YRC regional units as well as the national unit) and also for the small package businesses of UPS and FDX. The scores for both the LTL and small package companies show little risk regarding safety performance as all of the carriers are below the threshold level on each of the five categories. The LTL and small package companies score particularly well in the Unsafe Driving, Fatigued Driving, and Controlled Substances categories. The scores for UPS and FDX in their small package businesses are generally better than the scores of the LTL companies.

Table 2: Summary of CSA 2010 Results for LTL and Small Package Carriers

	Power Units	Drivers	Unsafe Driving	Fatigued Driving (Hours of Service)	Driver Fitness	Controlled Substances and Alcohol	Vehicle Maintenance
Performance Threshold			60%	60%	75%	75%	75%
<b>LTL</b>							
Arkansas Best	3,632	6,730	8.0%	19.3%	17.8%	0.0%	38.8%
Old Dominion	5,855	6,061	5.3%	28.0%	36.9%	0.0%	39.2%
Estes Express	4,952	4,230	14.4%	23.7%	40.9%	Inconclusive	50.2%
Con-way	9,212	14,439	7.4%	22.2%	28.9%	0.0%	35.6%
YRC Inc.	12,381	21,800	3.2%	25.5%	34.4%	4.0%	61.7%
New Penn	879	1,534	3.9%	12.2%	46.3%	0.0%	15.0%
Holland	3,948	4,876	17.1%	24.8%	11.1%	3.8%	48.3%
Reddaway	1,671	1,436	0.3%	9.2%	4.2%	0.0%	23.4%
Fedex Freight	11,208	14,474	1.0%	11.9%	22.3%	0.1%	32.1%
UPS Ground Freight	5,940	8,465	13.3%	32.1%	30.4%	8.0%	62.0%
<b>Small Package</b>							
Fedex	30,643	47,799	1.5%	7.6%	37.2%	0.7%	14.8%
UPS	97,370	91,065	3.0%	4.6%	43.2%	0.0%	10.2%

Source: Federal Motor Carrier Safety Administration. Data made available December 12, 2012 and reflects safety performance through November 19, 2010.

**Relative Crash Performance Is Not Available, But Some Crash Statistics for the TL Carriers Provide Initial Insight into Crash Performance**

Although the Crash Indicator BASIC scores are not yet public, the FMCSA has provided some crash statistics that we believe help to provide insight into the relative performance of the TL carriers. As summarized below, we list the actual count of total crashes, crashes where equipment had to be towed away, and the number of injuries or fatalities. To compare the carriers (which are all different sizes), we compute a crash ratio on a per-driver and on a per-truck basis. Given that the CSA 2010 metrics are primarily focused on driver safety and performance, we believe the per-driver metric is more relevant. We note that the best performers are NFI, CRST, Landstar, and J.B. Hunt with ratios ranging from 0.03-0.07. This is notably better than the worst performers (Western Express and USA Truck), which were 0.14 and 0.13, respectively. The remaining carriers were between 0.08 and 0.09 with the exception of Werner's score of 0.11. In our view, the crash performance of most of these carriers would be considered below the threshold needed for intervention or roadside inspections, but Western Express and USA Truck might be at risk in this category.

Table 3: Crash Data for the TL Carriers

	Crash Data			Crash Ratios	
	Tow-Aways	Injuries or Fatalities	Total	Per-Driver	Per-Truck
Swift	1,364	462	1,430	0.08	0.09
Schneider	906	365	963	0.08	0.09
<b>J.B. Hunt</b>	650	249	684	<b>0.07</b>	0.07
Werner	1,112	401	1,157	0.11	0.13
<b>Landstar</b>	386	149	410	<b>0.05</b>	0.06
US Xpress	517	165	541	0.08	0.09
Crete	386	143	401	0.08	0.07
Knight Transportation	281	101	293	0.09	0.08
Knight Refrigerated	54	10	54	0.09	0.09
Celadon	220	93	233	0.09	0.07
Heartland Express	223	110	240	0.08	0.08
Dart	202	67	209	0.08	0.08
<b>Western Express</b>	316	130	336	<b>0.14</b>	0.13
<b>USA Truck</b>	309	100	324	<b>0.13</b>	0.14
Covenant	259	107	277	0.09	0.15
<b>CRST</b>	214	87	221	<b>0.06</b>	0.13
<b>NFI</b>	40	23	43	<b>0.03</b>	0.04

Source: Federal Motor Carrier Safety Administration. Data made available December 12, 2012 and reflects safety performance through November 19, 2010. Note: Total crashes may not equal the sum of tow-away accidents and injuries and fatalities because the categories are not mutually exclusive. Lower crash ratios are better.

## Impact of CSA 2010 on the Truckload Carriers

### *Rising Driver Costs, Tighter TL Market, and Higher TL Rates*

The most likely outcome, in our view, is an increase in driver wages over time. While a number of unsafe motor carriers could be shut down over time, we believe that the larger carriers we mention in this note are likely to have the resources to be able to address their CSA 2010 scores and performance issues over time. In our view, the greatest effect will be to push drivers with a poor safety record out of the market. There could also be an effect where there is a significant rise in competition for drivers with strong safety scores. Both of these effects would likely put upward pressure on driver pay. Our sense is that truckload driver pay is likely to rise 3-5% in 2011, but there could be greater upward pressure than we expect and the trend is likely to continue in 2012. We believe that there is currently tightness in driver availability in some regions, and we suspect that CSA 2010 will result in considerable tightening, which should support higher wages over the next few years. On a more positive note, a tighter driver market should translate directly to a tighter truckload market and higher truckload rates. We believe that the CSA 2010 initial data are likely to contribute to concern among shippers regarding truckload capacity availability in 2011 and 2012.

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