

Industry Update March 22, 2011

Thom Albrecht, Managing Director of BB&T Capital Markets - Transportation Equity Research just released his industry update on March 14th. One of the aspects of Mr. Albrecht's market approach is that he spends a great deal of time and effort personally speaking with carriers and shippers across a broad spectrum of equipment types, industries, and commodities. He adds insight to statistics to provide what has historically been a very accurate assessment of the marketplace. Below are his summarized key points along with a few comments from my perspective. I have also provided Mr. Albrecht's direct contact information should you wish to receive his industry updates directly.

Trucking

Key Points

- "We recently visited with a number of shippers and trucking companies (mostly private) and this note highlights a number of things we heard including comments about freight supply and demand, drivers, shipper strategies, etc."

- "In general both carriers and shippers described an environment that has gotten noticeably tighter, with variances driven by geography, types of freight and shippers' treatment of carriers. One shipper told us that despite paying fleets in 15 days with no discount and with a majority of its loads being single-stop TL, that they are having difficulty securing capacity into the northeast, especially Pennsylvania and Massachusetts. Many shippers acknowledged that they are going deep into the route guide, turning to both secondary (back-up) carriers and even brokers to obtain capacity."

This is the first time in years that we have also seen any appreciable tightening in capacity in the northeast. Historically, carriers must make their money going in to the northeast because rates coming out of the northeast are so low. The reason for low rates outbound from the northeast has always been an excess of capacity. The northeast will be very interesting if things play out as predicted. I am hearing from many of my fellow carriers that they do NOT want to go to the northeast at almost any rate. Why?

First, the cost of fuel in the Northeast is much higher than the DOE national average, so most carriers fall even shorter on fuel surcharge reimbursements.

Second, the propensity for accidents and violations is greater in the northeast due to congestion, special routings, etc. - given the new CSA implications; carriers simply do not want to run any unnecessary risks of incurring a violation....and many drivers prefer not to go there. Freight is very plentiful throughout most of the rest of the U.S., so carriers have more preferable choices.

Third, the low rates and higher than average deadhead to get out of the northeast are unattractive to many carriers. If early indications hold true through the busy summer months, for the first time in years, shippers in the northeast will have to pay higher rates, adjust their fuel surcharges to adequately compensate for diesel costs in the NE, and make substantial efforts to improve loading and unloading times to assist carriers with productivity.

Some analysts and carriers are predicting rates in excess of \$3.25 per mile plus fuel to New England and only slightly less for the rest of the northeast. I also anticipate that finding trucks that will go to the boroughs of New York City will be very difficult and at an exceptional premium.

- "Houston, we have a problem--drivers! During 2010 carriers frequently mentioned that the recruitment and retention of drivers would re-emerge as an issue. The potential future problem

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is now at hand. *Numerous fleets told us that their unseated trucks have gone up 50% to 100% since early January.* Perhaps the most extreme example we heard was a fleet going from about 100 unseated trucks to over 300 in barely two months. One fleet told us that inbound calls from driver candidates dropped from 38,000 in 2009 to 25,000 last year (with minimal fleet shrinkage) and despite spending 20+% more on advertising, their inbound calls are expected to be down again in 2011. A few fleets are starting to raise pay in March, but our sense is that the bulk of "round 1" of pay increases will occur in May-August."

•**We heard that many bids are delayed or extended.** Typically, an inflection point is approaching in the cycle when bids are delayed, whether due to tightening capacity or loosening capacity. We heard three reasons why bids have been done in recent months, including: a) one last "hurrah" to see if rates can be reduced, b) to secure capacity, and c) to gather data to show non-traffic executives what is really happening with rates and capacity.

Comments to the points above regarding bids and RFPs:

a) **Shippers and 3PLs are probably not going to realize a return on effort in pursuing one last "hurrah" to result in reduced rates. As a major flatbed carrier, demand for our trucks is now exceeding capacity AND the traditional flatbed busy season has not hit full force yet. Carriers see what the demand is and what it will be. Smart carriers are not about to cut their rates when we see even higher rates on the horizon in a few months. Also, carriers are not going to expend much effort or resources completing lengthy, complicated RFPs or bids - especially for shippers/3PLs with whom they have no relationship or who have refused to work with them over the past 2-3 difficult years. In this market, we are very selective in which, if any, RFPs or Bids we are responding to. RFPs & Bids usually signal to a carrier that the shipper is primarily a price shopper, and in this market, carriers are not too interested in bidding rates down against ourselves. Most of us will take our chances with one-on-one negotiations with shippers rather spend many hours responding to RFPs.**

b) **Unless the Carrier & Shipper already have a very strong relationship, it is doubtful that RFPs or Bids will, in reality, "secure" capacity. The "rate agreements" and "load commitments" for the most part have no contractual obligation or penalties on either party. Therefore, to survive most carriers will likely allocate their trucks to shippers who pay the most, have reasonable fuel surcharges, load & unload quickly, have flexible hours of operation, etc. The majority of shippers have historically done the same from their perspective.**

c) **This late in the ball game, if shippers have to issue an RFP / Bid in order to prove to their non-traffic executives what is happening in the market place with rates and capacity - they have already missed the mark. Many carriers, including Melton Truck Lines, have been providing industry news, emerging transportation trends, informative articles, etc on these very issues to our shipper contacts for months. Carriers have no interest in filling out RFPs & Bids to provide "proof." We are busy analyzing profitability, productivity, and yield on customers, lanes, commodity sectors, etc. to determine where to assign our capacity.**

•**Rising fuel prices and cash flow pressures were a constant topic.** We heard of 3 carriers shutting down in recent days. Others are now at their credit limits and can't get the banks to raise the limits. As such, they need fuel prices to fall, a surge in cash flows, renewed cost reductions or asset sales to fund operations.

Dramatically rising fuel prices coupled with many Shipper fuel surcharges that fall short of allowing the carrier to break even will undoubtedly be the demise of many less financially strong carriers. Even the largest carriers must pay for fuel weekly, and mid to smaller carriers must pay at the pump as they fuel. The fuel surcharges, if any, being applied are already at least one week in arrears, so the fuel costs today are higher than carriers are being compensated for. Add the

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time of payment factor into the equation ...carriers are not paid for 30 - 40 days. The end effect is that many carriers do not have the cash to pay for diesel up front and wait for payment from shippers for weeks. Many are starting to factor receivables to accelerate cash flow - and this of course further reduces their profit margins and ability to cover other operating costs. Shippers who have been able to demand payment terms of 45 - 60 days in the past or who do not pay carriers promptly on time will be among the first to be denied trucks.

•As the environment tightens, what enforcement mechanisms or "teeth" do shippers have to hold carriers to their commitments? Generally, there are no volume guarantees, nor financial penalties, so essentially when load acceptance rates fall, a lot of yelling and hollering is what happens. The same occurs when loose capacity emerges.

•Carriers unsatisfied with their mix of business told us they are willing to "create" capacity for customers and industries they want to serve.

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Best regards,



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