June 9, 2011

FTR June 2011 Update

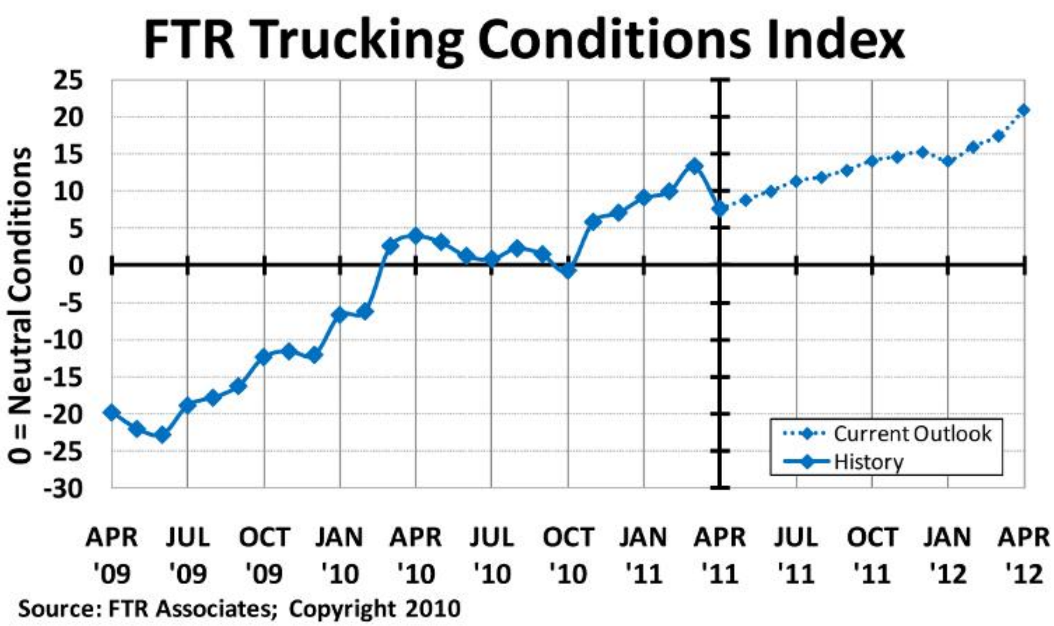
Over the last several weeks, many shippers have asked me what key indicators do we as a flatbed shipper look at to assess market demand and capacity. To this end, in my last weekly update I promised to provide more detailed information regarding the key economic indicators relative to flatbed demand. There is no one indicator and no single answer, so this week's update will be quite lengthy. I find it best to read and digest this type of data with a cold drink, a comfortable chair, and a lot of time!

When analyzing FLATBED ONLY demand indicators it is very important NOT to look only at top line numbers i.e. overall GDP, Unemployment, etc. as the markets & industries that drive flatbed freight are only a sub-segment of the overall GDP, etc. While the overall GDP or economic numbers may by trending downward (or upward), the flatbed segments may or may not be following GDP. FTR Freight Focus Trucking Update does a very good job of breaking out the key factors & indicators that drive each trucking sector (van, flatbed, bulk, etc), and I will summarize excerpts from their June 2011 report as it relates to flatbed only.

Trucking Update
www.FTRAssociates.com **| |** ***June 2011 |***
Part of the FTR Freight Focus Series

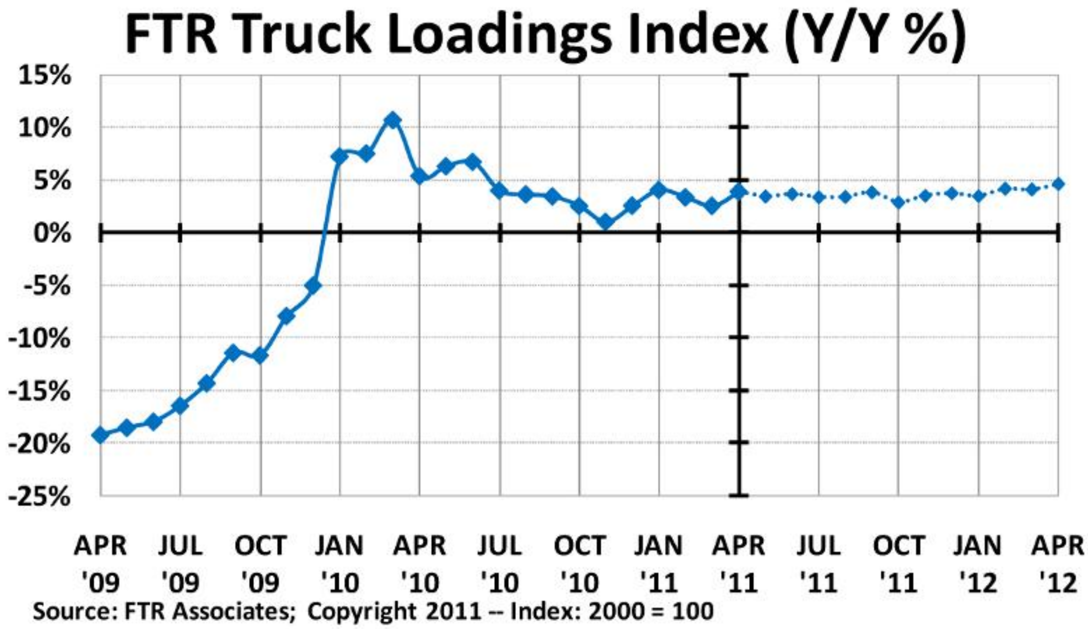
TRUCKING ENVIRONMENT

FTR Trucking Conditions Index



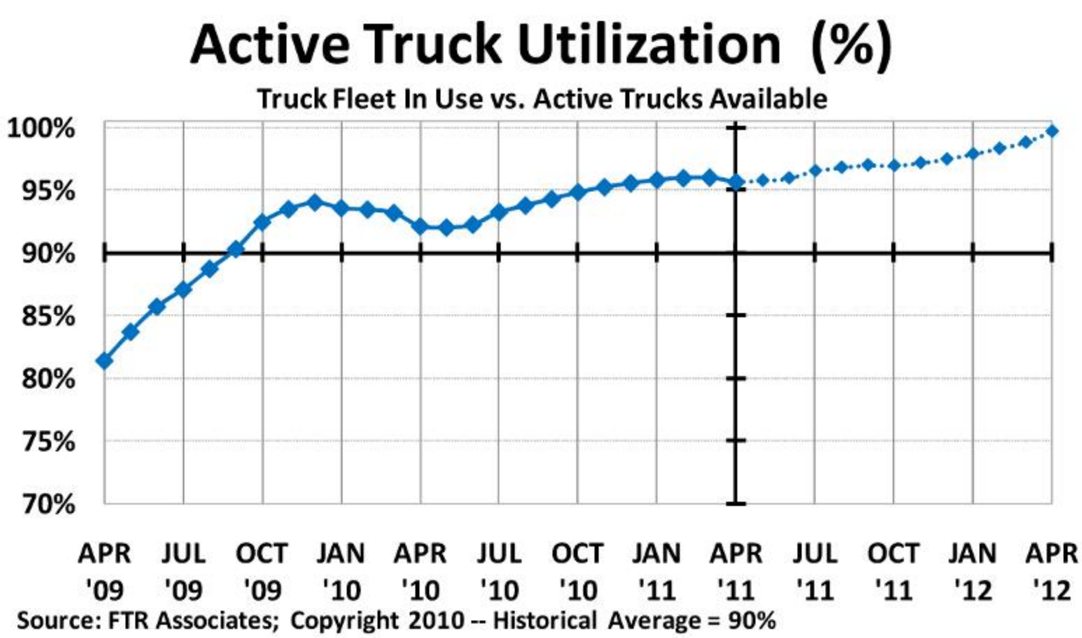
■ The Trucking Conditions Index remains firmly in positive territory.
■ Tightness in driver hiring is enough to keep pricing firm until the economy reaccelerates.

FTR Truck Loadings Index (Y/Y %)



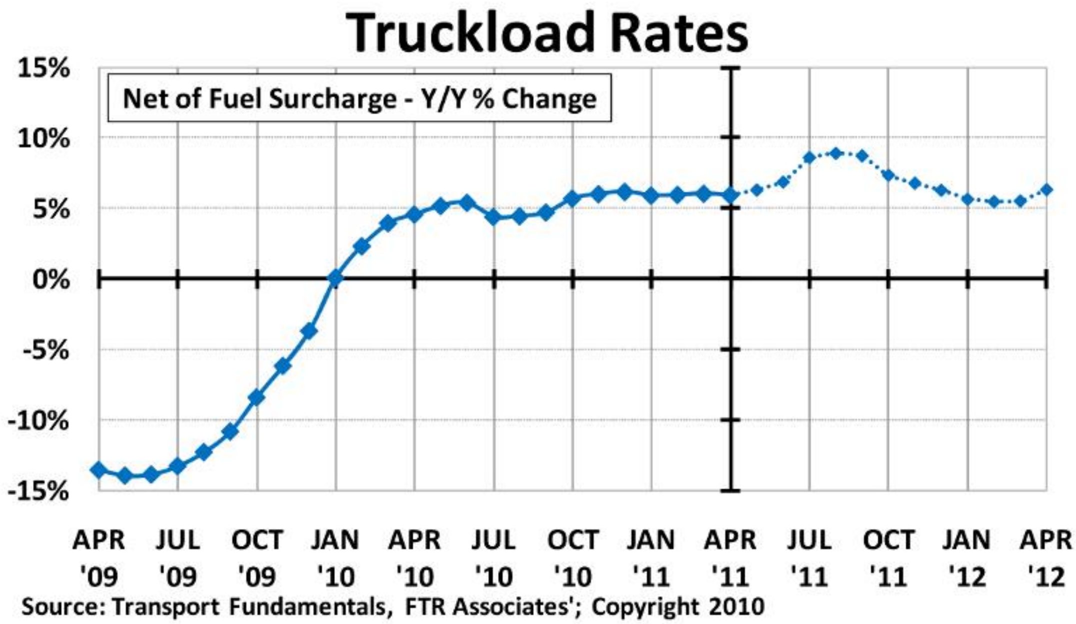
■ This index may also take a slight dip this spring, if the economy remains weak.
■ We expect it to remain positive because of the strength in the manufacturing sector. **(KEY FLATBED INDICATOR)**
■ Should it take a dip, that fall should be offset by **stronger- than-forecast growth in the second half of 2011.**

Active Truck Utilization (%)



■ The **driver shortage will keep this metric high regardless of any softening in freight.**
■ We expect the peak in capacity utilization to be pushed back into 2012 because the FMCSA has been slow to implement its new safety regulations

Truckload Rates (Note that stats are for <u>all</u> truckload sectors (flatbed, van, bulk, etc)



■ Field reports show **modest softening in spot rates with contract rates remaining firm**.
■ Rising costs will add pressure on rates (and margins) as the year matures.
■ Shippers, worried about impending capacity shortages, are more willing to accept rate increases in exchange for capacity commitments

Overview
■ The news right now is a **weakening of growth reflecting the weaker economy**. This development is a **<u>normal part of recoveries and should reverse during the second half.</u>**
■ Note that **manufacturing is still growing faster than GDP** - a very good thing for trucking.
■ The data also show that, even with steady growth since early 2009, the absolute level of freight is more than 10% below its record 2006 level.

Platform (Flatbed) Truck Loadings
■ Platform (flatbed) has surprisingly prospered this upturn due to its close connection with business capital spending. **The expiring depreciation tax break will keep machinery orders strong through the rest of the year.**

Fleet Costs Overview
■ Industry trade magazines are full of ads promoting 10%+ increases in driver pay. **Labor costs, which have been stable so far this upturn are on their way up**.
■ There will also be a bump in equipment costs as fleets take possession of new trucks at 20-30% higher costs than the one's they are replacing.

Labor Environment

■ When coupled with the slimmed down driver recruiting pipeline and regulatory drag, this development assures us of a tight labor market even with the early 2011 growth slowdown.
■ Note, again, that regulatory drag will occur later this cycle than originally forecast. **The full impact won't be felt until mid-2012, at the earliest.**

Bankruptcies

■ 2011Q1 bankruptcies were on par with what was seen during the prior three quarters with 295 fleets failing during the quarter. Only 5,420 trucks were removed in the first quarter. This is the lowest number since 2007Q1.
■ **NOTE: <u>Fuel pricing is a wildcard at the moment. Strong surges in oil price could affect a sizable number of operations</u>.**

ECONOMIC ENVIRONMENT

Economic indicators were less robust in April. Fortunately, oil prices have fallen recently and weather disruptions will soon dissipate. Look for a sluggish start to the summer before an improving environment this fall.

INDUSTRIAL PRODUCTION	Jan	Feb	Mar	Apr	Impact	Y/Y Chg.	Comments
Total Industrial Production	0.1%	-0.3%	0.7%	0.0%	●	5.0%	Weakness was broad-based, but concentrated in autos.
Total Manufacturing [1]	0.7%	0.2%	0.6%	-0.5%	●	5.0%	First m/m decline since June 2009. Largely auto related.
Automobile and Light Duty Motor Vehicle Production	4.8%	7.5%	5.2%	-13.5%	▼	12.2%	The supply disruptions finally hit in April. Indications are that production will be impacted through June.
BUSINESS INDICATORS							
Unemployment Rate	9.0%	8.9%	8.8%	9.0%	●	-80 bp	A modest reversal of the recent trend. Not a concern.
Job Creation (Payroll Employment)	68k	235k	221k	244k	▲	1,313k	Best month since Census-induced gains in early 2010.
ISM Manufacturing Index	60.8	61.4	61.2	60.4	▲	0 bp	Another modest retreat. Still at a high level.
CONSUMER INDICATORS							
Consumer Confidence (Conference Board)	65.6	72.0	63.8	65.4	▼	7.7 pts	Confidence has yet to improve from its March decline.
Housing Starts	20.9%	-18.6%	12.9%	-10.6%	▼	-23.0%	Housing remains dismal. Stuck in record low territory.
Retail Sales	0.8%	1.3%	0.9%	0.5%	▲	6.4%	Sales are modestly slowing. Worth keeping an eye on.
Consumer Price Index	0.4%	0.5%	0.5%	0.4%	●	3.1%	Food and energy prices moderated. Core prices are stable.
OIL AND FUEL							
National Avg. Diesel/Gal.	3.388	3.585	3.905	4.064	▼	32.9%	Price looks to have peaked. Currently just below $4/gal.
W. Texas Int. Crude Oil ($Bbl.)	89.42	89.58	102.94	110.04	▼	30.3%	Price has fallen significantly recently. Currently under $100.

Economic Overview

■ **Economic fundamentals are improving**, but the economy lost some momentum in the first quarter. Lower gasoline prices are providing support. The economy will expand just above potential in the forecast period.
■ Total IP was unchanged in April, **while the manufacturing component fell 0.4%, held back by a decline in auto output emanating from Japan. The trend is still quite positive going forward.**
■ The ISM manufacturing survey fell slightly to 60.4 in April from 61.2 in March. **The index has been above the 60 mark for four consecutive months, suggesting healthy activity.**

Economic Forecast

■ Real GDP is forecast to increase at potential in 2011 and just above potential in 2012-13. **Manufacturing is an important source of freight-movements. Industrial production is forecast to increase 5.0% in 2011, 5.8% in 2012 and 4.6% in 2013.**
■ **The goods producing sector is an aggregate of all the freight generating components of the economy. The goods producing sector is forecast to increase 6.1% in both 2011 and 2012 and increase 5.5% in 2013.**

June 9, 2011

The official numbers for 2011 first quarter GDP are now out: 1.8% growth, well below what we thought it would be several months ago. At the same time economists are revising their forecasts down for the second quarter. FTR has it at 2.6%; we wouldn't be surprised if it goes lower. **Does this mean that this recovery that looked so promising in December is over? Nope! Here's why.**

First, the weight of history says, "no." Since the Great Depression, the shortest recovery on record was the 1976-1979 event. Most have been longer. So if you believe this one will stop at two years you need a pretty strong reason.

Second, history also tells us that recoveries are subject to random, temporary interruptions (and accelerations). This kind of thing happens every recovery, sometimes earlier, sometimes later. Again, history tells us not to lose our nerve over a couple of bad quarters.

Finally, we have a good idea what is going on this time, and that the forces that have depressed demand will reverse. There are four explanations:

1) It starts with the **Tohoku earthquake**. We know that such events initially depress manufacturing, and then stimulate it. Experts think the stimulation will begin by the third quarter.
2) The next explanation is **energy**. Oil prices spiked on the Libyan fears in the first quarter. They have stabilized, and will probably fall as conservation and slower economic growth kick in. We should get a boost from that during the second half of 2011.
3) Moving on, 2011Q1 had a big **decrease in governmental spending that economists think was a data anomaly**. Even though we won't be getting the big stimulus spending of 2010, we will get more Federal spending during the rest of the year.
4) Finally, **we expect a big surge in capital spending to take advantage of a tax break that expires on December 31.**

All in all, there are <u>lots of reasons to expect a good second half.</u> While the economy is not in perfect sync, key elements that drive flatbed trucking freight continue to improve ahead of the general economy. In summary, when checking key economic indicators that indicate flatbed demand, we heavily weight the following indices.

- **<u>INDUSTRIAL PRODUCTION</u>**
  - **Total Industrial Production**
  - **Total Manufacturing**
  - **Primary Metal**
  - **Fabricated Metal Product**

- **<u>BUSINESS INDICATORS</u>**
  - **ISM Manufacturing Index**
  - **Chicago Fed National Activity Index**

Overall, the outlook for the second half of 2011 going through 2012 remains very, very strong for the flatbed sector. We at Melton Truck Lines appreciate your business and look forward to continued growth with our valued customers. If you have any questions or need additional information, please do not hesitate to contact your Melton Regional Sales Representative or me.

June 9, 2011

Best regards,

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