

By William B. Cassidy

SWIFT ROLLS ON WALL STREET

Truckload giant's Moyes is banking on a bullish trucking market to deliver a \$700 million IPO

TRUCKING MAGNATE JERRY Moyes is driving \$2.6 billion Swift Transportation back to Wall Street with plans to raise \$700 million in an initial public offering.

The Swift IPO would be the largest in trucking since Union Pacific spun off Overnite Transportation — now UPS Freight — in a \$610 million offering in 2003.

It also would be the second time on the stock exchange for Swift, the nation's third-largest truckload carrier on the JOC's ranking of Top 50 trucking companies for

2009 (http://www.joc.com/joc_inc/pdf/truckings_hard_brake.pdf). The company first went public in 1990, raising \$22 million. Moyes, who founded the company with one truck in 1966, repurchased the business in a \$2.5 billion acquisition in 2007 — just as trucking slid into a downturn.

The company didn't set a share price or deadline for the offering.

Moyes isn't known as a big fan of Wall Street. Taking Swift private in 2007 allowed him to refocus on rebuilding the company's business, "and not worry about kissing Wall Street's butt," he said at the time. But he needs investors' money.

He's banking on an economic recovery — even a weak one — that is bringing profit to struggling truck operators and boosting the

stock prices of motor carriers from thriving J.B. Hunt Transport Services to struggling YRC Worldwide.

"We expect to benefit from the improving supply-demand environment as our existing asset base, relatively young fleet, and extensive terminal network position us to gain new customers, increase our overall freight volumes, and realize improved pricing," the company said in a registration statement with the federal Securities and Exchange Commission on July 21.

"We intend to further penetrate our existing customer base, cross-sell our services, and pursue new customer opportunities."

A portion of the proceeds from the IPO would pay down the \$2.3 billion debt remaining from the 2007 buyout, and some would fuel expansion.

The debt from the acquisition proved an albatross for Swift as freight volume deteriorated and the general economy collapsed into recession. From 2007 through 2009, Swift paid \$666.9 million in interest and related expenses, according to data the company filed with the SEC.

That filing gave Wall Street — and Swift's customers and competitors — insight into how the company has performed financially since the Moyes-led buyout.

The company, which had net income of \$141.1 million in 2006, lost \$96.2 million in 2007, \$146.6 million in 2008 and \$435.6 million in 2009.

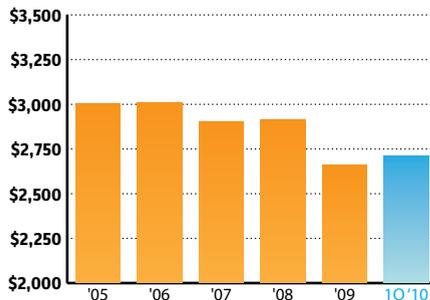


SWIFTER CHANGE

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SWIFT EFFICIENCY

■ Average annual revenue per tractor.



Source: Company reports

Without the interest burden, Swift probably would have been profitable in 2007 and 2008, although tax issues cloud the picture. Swift received a \$230.2 million bottom-line tax benefit in 2007 when it became a subchapter S corporation. As an S corporation, Swift didn't have to pay income taxes, which lightened what would have been a much deeper net loss for that year. Last year Swift switched back to a subchapter C corporation, paying \$324.8 million in deferred income taxes.

In the first quarter of 2010, Swift had a net loss of \$53 million on \$654.8 million in revenue. Interest and related expenses cost the company \$88.5 million.

By one of its own internal yardsticks, adjusted operating ratio, Swift is doing better than the income and loss columns indicate. Its adjusted operating ratio measures total operating expenses excluding fuel surcharges and other excludable costs as a percentage of total revenue, minus fuel surcharges. In 2009, the adjusted operating ratio was 93.9.

"It's a balance sheet issue, and that's what they're trying to correct by going public," said Satish Jindel, president of SJ Con-

Swift Transportation pulls up to Wall Street a different company than the one that left the stock exchange in 2007. Swift isn't just smaller, it's more intermodal.

Rail intermodal accounted for 6.2 percent of Swift's business in 2009, compared with 2.9 percent in 2006, and the company is set to ratchet up that percentage.

Swift will place an additional 1,000 containers into service starting this month and running through next June, the company said in its July 21 filing with the Securities and Exchange Commission. That will bring its total container count to about 5,500.

Deep cuts in the truck fleet and an internal shift in capacity are changing its core truckload business, as well.

Since 2007, Swift has cut its company-based tractor fleet 22 percent to about 12,500 tractors. However, it expanded its use of owner-operators 27 percent, contracting with about 3,700 independent drivers last year.

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SWIFT'S REVENUE SLOWDOWN

■ Year-over-year percentage change in annual trucking revenue at Swift.



*Reflects consolidated results of Swift Corp. and predecessor company.

Source: Company reports

sulting Group in Pittsburgh. In fact, Swift sees opportunities to make major gains as a publicly owned carrier with reduced and refinanced debt. "Because of our size and operating leverage, even small improvements in our asset productivity and yield can have a significant impact on our operating results," the company said.

If it could get miles per tractor back to 2005 levels, keeping its reduced fleet size (and a resultant 14.9 percent gain in efficiency), "operating revenue would increase by an estimated \$425 million." **joc**

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WAREHOUSING BUILDS BUFFER ZONE

Low industrial real estate prices make for warehouse 'bargains,' site selection firm says

DISTRIBUTION CENTERS WILL crop up in unlikely places as transportation corridors shift and energy demands bring new markets to light, a location consultant says.

"Many of the projects we're involved with are in the deep Southwest, along the 'Canamex' corridor" from Nogales, Ariz., through Nevada and along I-15 to Canada, said John Boyd Jr., a principal with The Boyd Co. in Princeton, N.J.

Those projects could be in Tucson or Phoenix or Kingman, Ariz., Las Vegas or St. George, Utah, where Wal-Mart has a 1.2 million-square-foot distribution center and two supercenter stores. "St. George is emerging as a major distribution center in the Southwest," Boyd said. "Any markets along I-15 are being looked at right now."

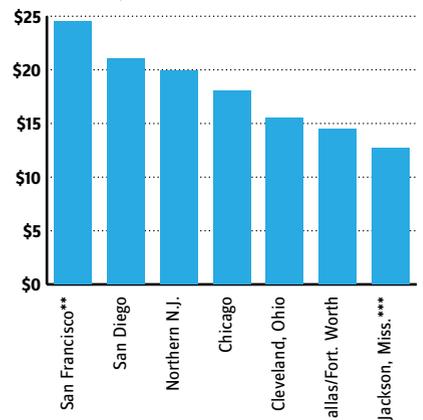
That's partly because those areas would benefit from any diversion of imports from Asia to Mexican ports, and partly because they're cheap compared to larger West Coast cities, said Boyd, whose company provides site selection consulting to companies and organizations that include AT&T, PepsiCo, Pratt & Whitney, Hewlett-Packard and the World Bank.

"We're seeing an increase in planning for next year," he said. "The cost of industrial space is at an all-time low, and the big trend is buffer acreage. Companies and third-parties are buying more acres than they actually need because there are real bargains out



WAREHOUSING COST

■ Annual operating costs for 450,000-square-foot distribution center in select markets, in millions of dollars.*



*Totals reflect a new construction assumption.

**Highest cost market.

***Lowest cost market.

Source: BizCosts.com, The Boyd Co.

there” that enable future expansion.

Access to dependable water and energy sources is an increasingly important factor in site selection, he said. “Water has become a very valuable commodity, and, with pending energy legislation, access to hydroelectric power,” Boyd said. “In the West, we’re seeing activity on Native American reservations that have priority water rights. We’re looking at some sites on reservations right now based solely on their ability to draw water from the Colorado River.”

Boyd spoke with The Journal of Commerce July 13 after releasing an annual report on distribution center operating costs for BizCosts.com, which produces comparative cost of doing business studies based on data Boyd gathers.

The 2010 report found the San Francisco metropolitan area is the most expensive place in the U.S. to operate a distribution center, followed by San Diego, Calif., the northern New Jersey-New York metropolitan area and Chicago. “There hasn’t been a dramatic change in the ranking” in recent years.

The report examined several cost factors, including labor, utilities, taxes, construction, leasing and shipping, and scaled costs to a hypothetical 450,000-square-foot distribution center employing 150 workers and shipping in truckloads.

“The cost of power is becoming a major concern among our clients,” Boyd said. “We’ve had inflationary cost pressures in terms of electric power costs among the cities. It can range from 3 or 4 cents a kilowatt in places like Washington state, which has good access to hydropower, to 16, 17 or 18 cents in the Northeast.”

At \$24.5 million, the cost of operating a distribution center in San Francisco was 92 percent higher than the \$12.7 million for the lowest cost city, Jackson, Miss.

Labor costs alone were 41 percent higher in San Francisco than in Jackson, Miss., according to the report. Weighted average hourly warehouse earnings in San Francisco were \$18.20, compared with \$12.84 in Jackson.

Although labor costs are a major factor in distribution site selection, the recession made

them less of a factor last year, Boyd said. “We have areas where wage increases were kept to under 2 percent, under 1 percent in some and in others flat. That’s one of the most telling phenomena in this year’s study.”

But Boyd said warehouse labor costs are rising over the longer term as distribution centers demand more technical skills from workers. “The warehouse in 2010 has some very good high-paying jobs, more than a prevailing manufacturing wage in a right-to-work state,” Boyd said. And despite the loss of manufacturing jobs to outsourcing, “good jobs are washing back ashore each year as we handle more imports,” he said.

More technology-related jobs are heading to distribution. “For some time, our clients have been moving customer service management and administrative offices into the warehousing space,” he said. “The next frontier is the data security and storage field. We look to see more data storage activity in the warehouse.” **joc**

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By John D. Boyd

RAIL'S SPLIT PERSONALITY

Intermodal and some other cargoes are strong, but weakness still comes in carloads

THE FREIGHT RAIL business is looking more like two markets than one, a fast-paced intermodal segment marked by equipment tightness and other business segments marked by uncertainty about the economic recovery.

That split personality is revealed in remarks by officials at several companies that play to differing parts of the rail industry. "We do think that we're going to continue to see a tremendous amount of demand in the market," said David P. Yeager, chairman and CEO of intermodal specialist Hub Group.

That company experienced a surge in second quarter demand that used up all its available capacity, and it sees no sign of a letup. "The first few weeks in July we have seen just as strong as where June ended up," Yeager said in a July 21 earnings conference call. "That's rather extraordinary . . . that's not normal for July."

Yet at GATX, one of the premier North American suppliers of leased railcars and locomotives, demand across a much broader range of cargo markets is far less robust. "We continue to see some signs of improvement, although they are inconsistent," Chairman, President and CEO Brian Kenney told analysts on July 22.

While pricing on railcar leases have recovered somewhat from their recession lows, Kenney said lease renewal rates are still "well below expiring rates" in the second quarter.

Union Pacific Railroad, like other major carriers, is enjoying a surge in profit as it keeps equipment and work force capacity tight enough to keep pushing productivity and freight rates higher.

Yet UP, North America's largest rail freight hauler, also sees a slow economic recovery continuing to split its cargo markets, with intermodal, automobiles and

some other categories doing well, but other cargoes weak from a long slump in construction of housing, commercial buildings and highways.

"And it doesn't look like the slow improvement trajectory is going to change much over the last half" of this year, said John Koraleski, UP's executive vice president for marketing and sales.

James R. Young, UP chairman, president and CEO, told analysts, "We're cautious in terms of our outlook." He said if one adds up the pluses and minuses of the volume outlook for different cargoes, "they lean a little more on the positive side in volume than the negative."

The companies turned in strong earnings for the quarter.

UP's profit jumped 53 percent from a year earlier — which was the low point of the recession for freight haulers. Its net income of \$711 million was 17 percent of its \$4.2 billion in sales.

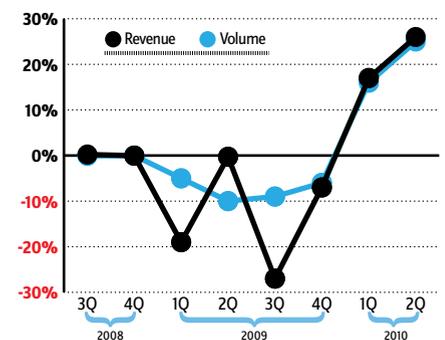
Revenue carloads rose 18 percent, including a 24 percent surge for intermodal loadings. Its automotive business, flattened at that point in 2009, soared 71 percent and in turn pulled up related shipments of metals and ores. And, because pricing power and efficiency gains lifted average unit revenue by 8 percent, UP's total revenue rose 27 percent.

UP, other railroads and rail shippers still have a vast fleet of idled railcars across the continent, so they are ordering few specialty cars and are slow to activate new leases.

That sluggishness in the largest business line for GATX trimmed the lessor's rail segment revenue by about \$10 million, and cut its rail profit 34 percent or nearly \$15 million. Gains from its Great Lakes bulk shipping line, American Steamship, and some specialty business pushed GATX's overall profit up 69 percent to \$21.5 million, but left

HUB'S GROWTH

■ Quarterly year-over-year percent change in intermodal revenue and volume at Hub Group.



Source: Company reports, Baird Equity Research

it wondering when it can count on a revived rail sector.

"It still feels like a downturn to us," Kenney said.

Hub was in the sweet spot of a sizzling intermodal market, where demand and pricing are up so much that marketers are ordering new containers and still expecting tight capacity.

Hub also has a sizable truck brokerage business, and admits it was caught off guard when demand revved up so much this past spring that truckers quickly hiked their rates to Hub or just opted not to carry loads. The result was "serious compression" in the profit margin on brokerage, Yeager said, and "it's going to take some time to dig out of that hole."

Outside of intermodal, one area of strength in rail loadings has been metals and ores, largely to supply a revived auto manufacturing industry as well as steel supports for stimulus projects around the U.S.

But recent rail data suggests metals demand could be cooling. GATX is also cautious about ore loadings for its Great Lakes ships, amid concerns some steelmaking furnaces may curtail production in coming months. "We could see some softening in demand for ore in the second half," Kenney said. **jc**

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