

**TransForce Inc.**

(TFI-TSX, \$9.00)

Stock Rating:

**HOLD**

12-Month Target:

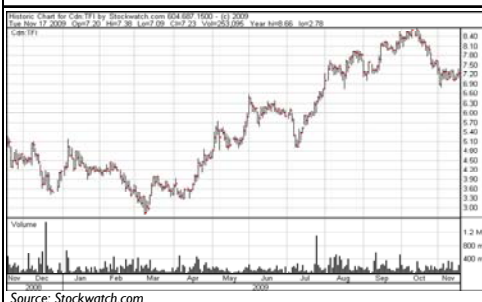
**\$8.00**

Estimates (C\$)	2008A	2009A	2010E	2011E
Revenue (mm)	\$2,261.9	\$1,846.5	\$1,974.2	\$2,101.2
change		\$24.0	-\$10.3	-\$119.1
EBITDA (mm)	\$280.0	\$226.5	\$248.6	\$290.8
change		-\$1.1	-\$17.3	-\$15.3
Margin	12.4%	12.3%	12.6%	13.8%
FD EPS	\$0.92	\$0.62	\$0.66	\$0.93
change		\$0.03	-\$0.09	-\$0.07
Operating Ratio	92.9%	94.2%	93.6%	92.3%
Dividend per Share		\$0.40	\$0.40	\$0.40

Quarterly Estimates (C\$)	Q1/10E	Q2/10E	Q3/10E	Q4/10E
Revenue (mm)	\$488.7	\$489.0	\$490.3	\$506.3
EBITDA (mm)	\$55.7	\$59.9	\$65.1	\$68.0

Valuation	2008A	2009A	2010E	2011E
EV/EBITDA	5.6x	6.9x	6.3x	5.4x
P/E	9.8x	14.5x	13.6x	9.7x

Stock Data	
Previous Close (C\$)	\$9.00
Dividend Yield	4.4%
Potential Total Return	-7%
52-Week High - Low	\$9.00 / \$2.78
Avg. Daily Vol. (3m)	144,430
Basic Shares Outstanding (millions)	95.3
FD Shares Outstanding (millions)	95.3
Major Shareholder: Jolina Capital, Inc.	16.8%
Float (millions)	74.7
Market Cap (C millions)	\$857.3
Net Debt (C millions)	\$714.8
Enterprise Value (C millions)	\$1,572.0
Fiscal Year End	31-Dec



**Company Profile**  
TransForce Inc., headquartered in Montreal, is the largest player in the Canadian road freight transportation and logistics industry serving both domestic and trans-border markets. TransForce, through a network of wholly-owned, operating subsidiaries, operates 4 segments: i) Less Than Truckload; ii) Package and Courier; iii) Specialized Services; and iv) Truckload.

**Not Yet Out Of the Woods**

**HIGHLIGHTS**

- Strong Revenues, Weak Margins** - While the Company beat our top line estimates, this was not the case for EBITDA due to weaker than expected margins. The weakness is pronounced in the LTL, TL and the Specialized Services segments due to a dramatic drop in prices and weakness in the energy service sector in the West.
- Weak Outlook** - Management stated they expect flat revenues in 2010 (vs. 2009) excluding the ATS acquisition, but an increase in EBITDA due to continuous cost cutting measures. This is surprising given that US peers are seeing an improvement in pricing and volume (although from a very low base). Structural problems in the TL segment, overcapacity, and weak natural gas drilling activity are to blame for this outlook. Management also mentioned that ATS, the recently acquired parcel company is having a rough start in 2010.
- Cutting Our Estimates And Price Target** - We are cutting our 2010 and 2011 EBITDA estimates by 6.5% and 5% respectively to factor the weaker outlook at ATS and other divisions both in term of volume and pricing. We are maintaining our valuation methodology of EV/EBITDA of 6x which results in our price target cut from \$9.50 to \$8.00 to reflect the lower EBITDA.
- Strong Free Cash Flow** - We expect the Company to generate free cash flow of \$94 million after dividend payment in 2010 which will be partly used to repay debts and make acquisitions. The Company will raise an additional \$80 million through the sale and leaseback of some of its properties to repay some debts.

**Conclusion and Recommendation**

We are concerned about the Company's lower margins especially when revenues increased sequentially. With a weak outlook and lack of catalysts in the near term, we are downgrading our recommendation to a **HOLD** (from BUY) to reflect our new price target of **\$8.00** from \$9.50 previously.

**CLARUS SECURITIES INC.**

- Exchange Tower, 130 King Street, W. Suite 3640, P.O. Box 38 Toronto, ON M5X 1A9 ■ Ph (416) 343-2777 ■ Fax (416) 343-2799
- First Canadian Centre, 350 7th Avenue S.W. Suite 3200, Calgary, AB T2P 3N9 ■ Ph (403) 269-5900 ■ Fax (403) 269-8900
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**Strong Revenues, Weak Margins**

TransForce reported its Q4/09 results yesterday. Revenues were \$488.6 million, an increase of 8.2% quarter-over-quarter and compared with our estimated \$464.6 million. EBITDA was down 3% QoQ to \$60.3 million which is below our estimates of \$61.3 million. Lower EBITDA margins are noted in particular in the LTL, TL and the Specialized Services segments due to the dramatic drop in prices and the weakness in the energy service sector in the West.

**Exhibit 1. Segment Results**

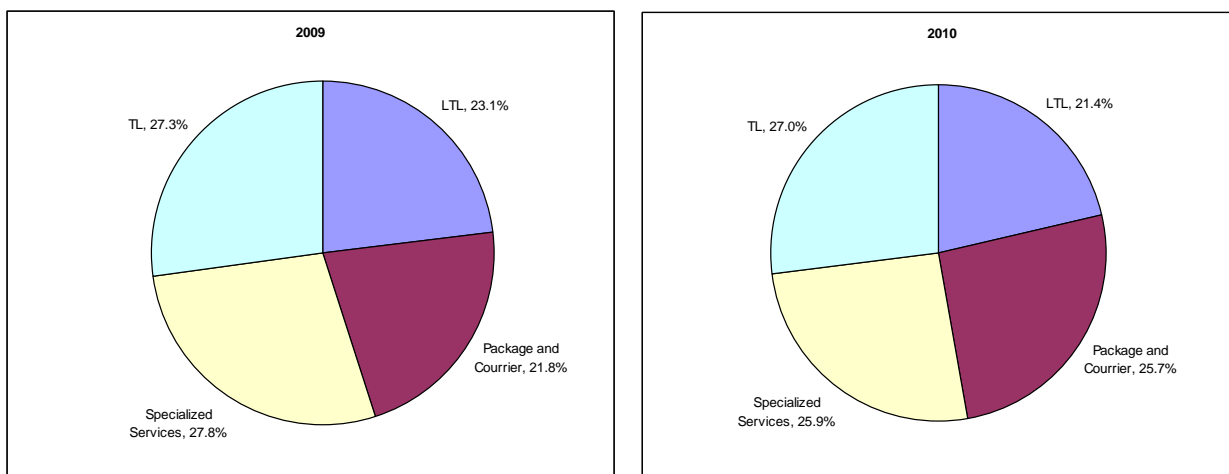
	Q4/09E	Q4/09A	Diff	Comment
<b>LTL</b>				
Revenues (C\$MM)	115.7	131.6	13.7%	Weak western energy sector, economy
EBITDA Margin	11.0%	7.3%	-33.9%	Lower yield, pricing pressure
EBITDA (C\$MM)	12.7	9.6	-24.9%	Lower margin
<b>Package and Courier</b>				
Revenues (C\$MM)	84.0	93.9	11.8%	Resilient business, ATS acquisition impact
EBITDA Margin	18.1%	17.4%	-3.8%	Impact of ATS acquisition
EBITDA (C\$MM)	14.2	16.3	14.8%	Coconsolidation of ATS
<b>Specialized Services</b>				
Revenues (C\$MM)	107.7	111.9	3.9%	Waste division offset weak energy sector
EBITDA Margin	15.5%	12.5%	-19.2%	Price destruction especially in the energy segment
EBITDA (C\$MM)	16.7	14.0	-16.0%	Lower margin
<b>TL</b>				
Revenues (C\$MM)	156.7	164.4	4.9%	Strong Ontario TL offset volume decline
EBITDA Margin	11.3%	9.8%	-12.9%	Pricing pressure
EBITDA (C\$MM)	17.7	16.2	-8.7%	Lower margin
<b>Total Revenues (C\$MM)</b>	<b>464.6</b>	<b>488.6</b>	<b>5.2%</b>	
EBITDA Margin	13.2%	12.3%	-6.6%	
<b>EBITDA (C\$MM)</b>	<b>61.3</b>	<b>60.3</b>	<b>-1.7%</b>	
<b>Operating Ratio</b>	<b>93.5%</b>	<b>93.8%</b>	<b>0.4%</b>	Lower margin
FD EPS (C\$) *	0.16	0.19	21.3%	Lower taxes

\* Adjusted for special one-time items

Source: Company Reports, Clarus Securities Inc.

The Package and Courier business remains the best performer and the least affected by the current slowdown. Its contribution to the total revenue will increase to 26% in 2010 from 22% in 2009 due to the consolidation of ATS.

**Exhibit 2. EBITDA Breakdown**



Source: Company Reports, Clarus Securities Inc.

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## Weak Outlook

Management stated they expect flat revenues in 2010 (excluding the ATS acquisition) with a slight improvement to start in 2H/10. This is in contrast to what US peers have been telling the market, where they are seeing improvement in volume and pricing although gradual. This could be related to the lower base comparison in the US vs. Canada. Nevertheless, we were surprised by this outlook despite the improvement in the economy. This is also despite that management maintained their previous guidance of \$250 million in EBITDA for 2010. We believe this is related to the following:

- 1) Overcapacity of trucks and service providers remain an issue that continue to depress prices. This is true in both the LTL and TL businesses especially in the West. According to management, the TL segment is facing structural problems which can be only addressed by a significant cut in industry capacity.
- 2) Weak energy segment (which is mainly part of the specialized service segment). Among the regions, the West Coast in particular continues to show the worst performance. This is due to low natural gas prices which depressed both prices and volume due to the lack of drilling activities. Also, the weaker economy there has affected operations.
- 3) ATS started the year on a rough note with volume falling in January despite the low base of last year. Management now expects revenue contribution from the ATS division to be in the range of \$100-\$120 compared to \$120 million previously. We are looking for \$105 million (new estimates vs. \$120 million previously for 2010).

Management mentioned that the EBITDA improvement will come mainly from cost cutting (apart from the ATS contribution) which the Company embarked on last year. We highlight a few items:

1. Cutting truck capacity and SG&A expenses in the TL operations;
2. Improve network efficiency and reduce operating costs via potential consolidation/acquisition on the LTL front;
3. Improve operating efficiency at the Package and Courier division – The Company will continue headcount reduction and IT system implementation, in addition to realizing cost synergies and cost improvement from the integration of the recently announced acquisition of ATS Andlauer retail service;

## Cutting Our Estimates And Price Target

As a result, we are cutting our 2010 and 2011 EBITDA estimates by 6.5% and 5% previously to factor mainly:

- 1) Lower prices and volume increase in most divisions
- 2) Lower contribution from the ATS division
- 3) Lower margin assumptions in line with the pricing pressure although we assume margins will stabilize in 2011 due to the benefits of additional cost cutting measures and a more stable pricing environment

We detail our new estimates in Exhibit 3.

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**Exhibit 3. Estimates Revisions**

	2010E			2011E		
	Prior	New	Change	Prior	New	Change
<b>LTL</b>						
Revenues (C\$MM)	520.4	537.1	3.2%	579.7	570.0	-1.7%
EBITDA Margin	11.2%	10.0%	-11.0%	12.0%	12.0%	0.0%
EBITDA (C\$MM)	58.5	53.7	-8.2%	69.6	68.4	-1.7%
<b>Package and Courier</b>						
Revenues (C\$MM)	410.3	385.0	-6.2%	457.0	408.5	-10.6%
EBITDA Margin	16.5%	16.7%	1.5%	17.1%	17.3%	1.1%
EBITDA (C\$MM)	67.5	64.4	-4.7%	78.0	70.5	-9.6%
<b>Specialized Services</b>						
Revenues (C\$MM)	460.2	451.3	-1.9%	547.5	478.9	-12.5%
EBITDA Margin	15.6%	14.4%	-7.9%	15.6%	16.0%	2.6%
EBITDA (C\$MM)	71.8	64.9	-9.7%	85.4	76.6	-10.3%
<b>TL</b>						
Revenues (C\$MM)	593.7	600.8	1.2%	636.1	643.7	1.2%
EBITDA Margin	11.8%	11.3%	-4.5%	11.8%	12.0%	1.7%
EBITDA (C\$MM)	70.1	67.7	-3.4%	75.1	77.2	2.9%
<b>Total Revenues (C\$MM)</b>	<b>1,984.5</b>	<b>1,974.2</b>	<b>-0.5%</b>	<b>2,220.3</b>	<b>2,101.2</b>	<b>-5.4%</b>
EBITDA Margin	13.4%	12.6%	-6.0%	13.8%	13.8%	0.4%
<b>EBITDA (C\$MM)</b>	<b>265.9</b>	<b>248.6</b>	<b>-6.5%</b>	<b>306.1</b>	<b>290.8</b>	<b>-5.0%</b>
<b>Operating Ratio</b>	<b>93.2%</b>	<b>93.6%</b>	<b>0.4%</b>	<b>92.6%</b>	<b>92.3%</b>	<b>-0.3%</b>
FD EPS (C\$)	0.75	0.66	-12.0%	1.00	0.93	-7.3%

Source: Clarus Securities Inc.

**New Target Price**

Our new target price decreases to \$8.00 (from \$9.50 previously) to factor in the lower 2010 EBITDA. Our target price is based on a 2010 EV/EBITDA multiple of 6.0x, which remains unchanged and in line with its historical average.

**Exhibit 4. Deriving Our Price Target**

<b>Target EV/EBITDA</b>	<b>6.0x</b>
2010 EBITDA (C\$mm)	248.6
Implied EV (C\$mm)	1,491.8
Implied Market Cap (C\$mm)	777.0
Total Shares Outstanding (mm)	95.3
<b>Price Target</b>	<b>\$ 8.00</b>

\*Avg of logistics, waste mgmt and oilfield services

Source: Clarus Securities Inc.

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## Strong Free Cash Flow

As a result of the ATS acquisition, leverage increased to approximately \$710 million at the end of 2009 from \$678 million at the end of Q3 which is in line with our expectations. We estimate the number to fall to approximately \$595 million in 2010 (the Company target is to reduce its debts by \$100 million which is similar to 2009). This is due to the following reasons:

- 1) We expect TransForce to generate \$94 million in free cash flow (after dividends) hence it will use some of this free cash flow to repay its debts.
- 2) The Company is also embarking on a sale and lease buyback of some of its properties in Alberta, BC and Toronto which should generate \$80 million in cash.

We also highlight that TransForce's \$515 million 4 year revolving facility (with \$378.1 million drawn at the end of Q4/09) comes due in October 2010. During the conference call, management stated it is negotiating its banking syndicate for renewal which includes the revolver mentioned above and another \$160 million term loan which will mature in 2013. TransForce would likely require \$100 million less capacity and negotiate better structured covenants but may also ending paying 200 basis points above the current rates. We have factored these items into our new estimates effective Q3/2010 including the repayment of \$100 million in debts.

### Exhibit 5. Looking At Leverage

Leverage	2009A	Q1/10E	Q2/10E	Q3/10E	Q4/10E	2010E	2011E
Total Debt (C\$MM)	714.8	703.1	700.7	598.2	595.8	595.8	478.2
Debt to EBITDA	3.16	2.96	2.95	2.48	2.40	2.40	1.64
Debt/Capital	0.57	0.57	0.56	0.52	0.52	0.52	0.44
<b>Covenants</b>							
Adjusted Debt / EBITDAR (<3.50x)	3.17						
EBITDAR / fixed cost (>2.75x)	3.13	3.32	3.36	3.34	3.37	3.37	3.92

Source: Clarus Securities Inc.

### Exhibit 6. Free Cash Flow Analysis

(C\$ millions)	2008A	2009A	Q1/10E	Q2/10E	Q3/10E	Q4/10E	2010E	2011E
EBITDA	280.0	226.5	55.7	59.9	65.1	68.0	248.6	290.8
Less Tax	19.5	21.4	5.3	6.5	7.8	8.8	28.4	39.8
	260.5	205.1	50.4	53.4	57.3	59.2	220.2	251.0
Add Change in Working Capital	(25.0)	24.9	10.7	(2.1)	(2.1)	(3.1)	3.4	(4.5)
Others	18.7	14.7	0.9	0.9	0.9	0.9	3.6	3.6
<b>Op. Cash Flow (before interest)</b>	<b>254.2</b>	<b>244.8</b>	<b>62.0</b>	<b>52.2</b>	<b>56.1</b>	<b>56.9</b>	<b>227.2</b>	<b>250.1</b>
Net Interest	46.6	35.0	8.0	7.9	9.8	9.1	34.9	33.0
<b>Operating Cash Flow</b>	<b>207.6</b>	<b>209.8</b>	<b>54.0</b>	<b>44.2</b>	<b>46.3</b>	<b>47.8</b>	<b>192.4</b>	<b>217.1</b>
Net Capex	(78.4)	(37.3)	(15.0)	(15.0)	(15.0)	(15.0)	(60.0)	(70.0)
<b>FCF (before acquisition)</b>	<b>129.2</b>	<b>172.5</b>	<b>39.0</b>	<b>29.2</b>	<b>31.3</b>	<b>32.8</b>	<b>132.4</b>	<b>147.1</b>
Acquisition	(93.8)	(67.1)	-	-	-	-	-	-
<b>Free Cash Flow</b>	<b>35.4</b>	<b>105.4</b>	<b>39.0</b>	<b>29.2</b>	<b>31.3</b>	<b>32.8</b>	<b>132.4</b>	<b>147.1</b>
Dividend Payment	(73.4)	(36.1)	(9.5)	(9.5)	(9.5)	(9.5)	(38.1)	(38.1)
<b>FCF (Excl. Acquisition) After Dividends</b>	<b>55.8</b>	<b>136.4</b>	<b>29.5</b>	<b>19.7</b>	<b>21.8</b>	<b>23.3</b>	<b>94.3</b>	<b>109.0</b>
<b>Free Cash Flow After Dividends</b>	<b>(38.0)</b>	<b>69.3</b>	<b>29.5</b>	<b>19.7</b>	<b>21.8</b>	<b>23.3</b>	<b>94.3</b>	<b>109.0</b>
Borrowing (Debts Repayment)	38.0	(116.9)	(13.4)	(2.4)	(102.4)	(2.4)	(120.8)	(117.5)
Equity Financing	-	47.6	-	-	-	-	-	-
Sales and leasback financing			32.0	-	48.0	-	80.0	-
Available Cash (financing requirements)	0.0	-	48.1	65.3	32.6	53.5	53.5	44.9

Source: Clarus Securities Inc.

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## **Conclusion and Recommendation**

We are concerned about the Company's lower margins especially when revenues increased sequentially. With a weak outlook and lack of catalysts in the near term, we are downgrading our recommendation to a **HOLD** (from BUY) to reflect our new price target of **\$8.00** from \$9.50 previously.

Target price calculation: We use EV/EBITDA of 6x to derive our price target which is in line with its historical average

Key Risk to Target Price: Please refer to the risks disclosed in the initiating report dated July 10, 2009.

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