

TFI (T)	\$9.00
Stock Rating:	Outperform (Unchanged)
Target:	\$12.00 (Unchanged)
Risk Rating:	Above Average (Unchanged)

#### Stock Data:

52-week High-Low	\$8.89 - \$2.78
Bloomberg/Reuters: Canada	TFI CN / TFI.TO

(FY-End Dec. 31)	2009a	2010e	2011e
Revenue (mln)	\$1 847	\$2 080	\$2 199
EBITDA (mln)	\$227	\$265	\$294
FD EPS	\$0.58	\$0.74	\$1.07
Revenue Y/Y Chg.	-18.4%	12.6%	5.8%
Organic, Y/Y	-14.4%	4.3%	4.5%
EBITDA Y/Y Chg.	-20.3%	17.0%	11.0%
EPS Chg. Y/Y	-47.7%	28.3%	43.8%
EBITDA margin	12.3%	12.7%	13.4%
Operating Ratio	94.2%	93.2%	91.6%
P/E	15.5x	12.1x	8.4x
EV / EBITDA	6.9x	5.9x	5.3x
FFO/sh	\$2.12	\$2.07	\$2.27

*Organic growth ex. fuel surcharge, major acq.*

#### Key Data

Shares Outstanding (mln)	95.3
Market Capitalization (mln)	\$857
Net Debt (Dec. 09)	714.8
Net Debt to Cap.	57.3%
Net Debt to TTM EBITDA	3.2x
Enterprise Value	\$1 572
Current Yield	4.4%

All figures in Cdn\$ unless otherwise noted.

**Industry Rating (Road & Rail): Overweight** (NBF Economics & Strategy Group)

#### Company Profile:

Dating back to the 1950s, Montreal-based TransForce has grown rapidly through acquisition and now stands as the largest trucking company in Canada. Operations span the spectrum of Canadian trucking from network-based LTL, parcel and waste management to truckload operations, including specialized TL. An income trust from late-2002, TFI converted back to a corporation in early-2008.

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## TransForce Inc.

### Q4 2009 Results Revisited

## Focussed on a Reduction in Costs and Debt as Volume Rebound Expected in H2 2010

### HIGHLIGHTS

#### ■ Q4 Results Beat on Earnings

TransForce (TFI) reported an adj. EPS of \$0.19, down from an adj. \$0.26 last year, but above our estimate and the Street consensus of \$0.15. While total revenue (-10% y/y) and operating costs (-9% y/y) came in above our expectations, the resulting EBITDA of \$60.3 million, down 18% y/y, was right in line with our \$60.8 million estimate and the Street consensus of \$60.3 million.

#### ■ Well-Positioned to Recover in 2010

Although we expect TFI to witness relatively modest revenue growth in H1 2010, reflecting the weak volume and pricing environment, albeit with signs of sequential top-line improvement, we highlight that TFI has held margins fairly well through this downturn by taking fairly dramatic steps to reduce costs, generate FCF, and reduce debt, with substantial upside leverage to the eventual recovery, which we expect in H2 2010. While TFI provided a relatively cautious outlook, we believe 2010 could be a year of modest recovery. We believe LTL will be more challenged on the pricing front than TL, which TFI highlighted on the call.

#### ■ Maintain Outperform, \$12.00 Target Price

With improving volume trends, TFI's continued focus on its cost structure and cost-cutting, FCF generation, and debt reduction, and its potential for growth through acquisitions, offset by ongoing pressures in the TL, LTL and energy businesses, we are increasing our 2010 EPS estimate to \$0.74 (was \$0.66) and introducing our 2011 EPS estimate of \$1.07. We are encouraged with TFI's ability to manage down its cost structure and maintain margins. Outperform.

### Stock Performance



## Well-Positioned to Recover in 2010 with Better Cost Structure

Although we expect TransForce (TFI) to witness relatively modest revenue growth in H1 2010, reflecting the weak volume and pricing environment, albeit with signs of sequential top-line improvement, we highlight that TFI has held margins fairly well through this downturn by taking fairly dramatic steps to reduce costs, generate Free Cash Flow (FCF), and reduce debt to position the Company well, with substantial upside leverage to the eventual recovery, which we expect in H2 2010. In addition, TFI's diverse service offering, primarily the parcel and resilient waste management businesses, has helped partially offset weakness in the Truckload (TL) and Less-than-truckload (LTL) segments. Despite the tough current conditions, TFI has witnessed a modest recovery in some end markets, which should broaden out in line with economic recovery. With improving trends in volume (supported by our recent survey of shippers, discussions with industry players and various industry statistics we monitor), TFI's continued focus on its cost structure and cost-cutting, FCF generation, and debt reduction, its potential for growth through acquisitions, and further strengthening of its relatively stable and high-margin Package & Courier (P&C) business with the addition of the Retail Solution Division of ATS Andlauer (ATS.un – T; not rated), offset by ongoing pressures in the TL, LTL and energy businesses, especially out West, we are increasing our 2010 EPS estimate to \$0.74 (was \$0.66) and introducing our 2011 EPS estimate of \$1.07.

TransForce Inc.: Estimates Summary						
Dec. 31 FYE	New Estimates			Old Estimates		
Cdn\$	Q1 10e	2010e	2011e	Q1 10e	2010e	2011e
Revenue (mln)	477	2 080	2 199	493	2 052	
EBITDA (mln)	54	265	294	51	265	
FD EPS	\$0.10	\$0.74	\$1.07	\$0.04	\$0.66	

Source: NBF

**We continue to rate TFI Outperform with a \$12.00 target price.** We continue to like the long-term TFI story given its: i) leverage to an economic recovery; ii) position as the most liquid and diversified name in Canadian trucking; iii) efforts to reign in costs and maintain margins and operating ratio given dramatic declines in its revenue base; iv) potential to gain through acquisitions; and v) strong FCF and debt reduction. While freight demand remains weak, TFI does not anticipate a recovery until the fall, and despite some improvement, TFI remains one of the most leveraged names in the trucking industry (3.2x Net Debt to TTM EBITDA), we are encouraged with TFI's ability to quickly manage down its cost structure and maintain margins relatively flat, while initial debt reduction efforts are also a marked positive, as leverage has been our primary concern with the name.

## Q4 Results Beat on Earnings

**Yesterday, TFI reported an adjusted EPS of \$0.19, down from an adjusted \$0.26 last year, but above our estimate and the Street consensus of \$0.15,** with lower interest expense (\$0.01/sh delta), as a result of lower interest rates as well as TFI's efforts to lower debt levels, and lower effective tax rate (\$3.2 million or \$0.03/sh tax benefit due to a change in statutory rates) accounting for the beat. While total revenue (-10% y/y) and operating costs (-9% y/y) came in above our expectations, the resulting EBITDA of \$60.3 million, down 18% y/y, was right in line with our \$60.8 million estimate and the Street consensus of \$60.3 million. The Retail Solutions Division of ATS Andlauer (acquisition completed on November 19, 2009) also contributed to the top-line (\$23.2 million) and operating expenses in Q4 2009, producing an EBITDA margin in the mid-teens, in our view. Excluding fuel surcharge, all segments except P&C (+30% y/y) posted y/y revenue declines, including TL (down 11%), LTL (down 11%), and Specialized Services (down 20%). Of note, the P&C segment was able to bolster margins and grow EBITDA 37% y/y, aided by the addition of the Retail Solutions Division and perhaps as TFI's initiatives to improve operations at Canpar begin to bear fruit. Overall, TFI posted better than expected results in Q4 benefiting from lower interest expense, lower effective tax rate, headcount reductions, sub-contractor cost savings, lower fuel consumption, hiring and salary freeze, asset rationalization, and cost-cutting aimed at discretionary spending, offset by significantly weaker results from the energy business (down about 40-50% y/y) and very weak LTL yields, especially out West.

## Focus on Costs and Debt as Volume Rebound Expected in H2 2010

According to Management, although the economic turnaround is pointing to an end to the recession, with the dark days of 2009 behind, activity levels in the transportation and logistics industry are not immediately realizing the benefits of the recovery, as overall volumes remain relatively low. As such, noting that the U.S. trucking industry is ahead of Canada on volumes and yields, although Canada remains a more stable market, TFI is expecting 2010 to be another challenging year at the outset, with flat first half and likely better second half, partially driven by parcel volumes, from a y/y volume improvement point of view. Also, pricing is expected to remain at low levels, especially due to weak LTL yields, offset by pricing discipline in other segments and perhaps price increases in the East. As a result, TFI is expecting revenues to remain flat in 2010, perhaps with modest upside, with a slow recovery in all sectors, while it is expecting EBITDA margins to expand modestly, as it continues to focus on further reductions in costs (especially fixed costs and discretionary spending) and debt levels, and free cash flow generation, while exercising pricing discipline, to a degree. In all, with a relatively flat top-line and improved margins, TFI expects an upside to its bottom-line in 2010. We believe with deeper cuts in its fixed costs, most of which are expected to be permanent in nature, TFI should be well-positioned to benefit from increased volumes that should flow from an eventual higher level of general economic activity in North America in H2 2010 and 2011, in our view.

TFI commented that activity levels have remained weak in January and February in 2010, perhaps pointing to another tough quarter (Q1 2010). On capacity, TFI has seen some smaller players leaving the market, but the more important factor is expected to be fleet rationalization efforts from the larger players such as TFI (tractors down 8% y/y in Q4), Contrans (CSS – T; Outperform; \$9.00) and others. **TFI forecasts flat y/y revenues in 2010, EBITDA in the \$250 million range, FCF around \$100 (not including potential \$80 million in sale/leaseback transactions), capex of \$50-\$60 million, and \$50-\$75 million in M&A related investments.**

While TFI provided a relatively cautious outlook, we believe 2010 could be a year of modest recovery, with volumes up in the mid single-digit range, in terms of organic growth, and freight rates recovering 1-2% or so for TL and LTL, on average. We believe LTL will be more challenged on the pricing front than TL, which TFI highlighted on its conference call. For a detailed outlook and various industry statistics we monitor, please refer to our Industry Note entitled "*Canadian Trucker Q4 Preview & Update: Bumpy Drive Up the Recovery Hill*" published on February 22, 2010.

### ■ Truckload (TL)

- Typically the most competitive of all truck markets, TL continues to remain under pressure (with business down 10-15% for TFI) until demand recovers, likely in H2 2010 and 2011, given fleet reductions (TL tractor count down 18% y/y in Q4), weak transborder volume, and strong FX. While the pricing environment is changing, as carriers are shrugging off excess capacity, volumes could remain soft in the near-term. That said, TFI noted that supply is getting close to demand, as it sees signs of bottoming in demand, which could lead to pricing increases in H2 2010.
- While customer bankruptcy fears continue to hinder recovery in this sector (another TFI customer went bankrupt after AbitibiBowater), TFI is starting to see some shippers getting nervous, instead of carriers, and asking for 2-3 year commitments, perhaps in anticipation of rate increases later this year and in 2011.
- We highlight that TL could be the first to recover, followed by the LTL business, although TL could permanently lose some business, especially given the strong Canadian dollar, which is undermining Canadian manufacturers' competitiveness.

### ■ Less-than-Truckload (LTL)

- Overall LTL volume and pricing remain pressured, with TFI's Western LTL operations getting impacted heavily, especially in Edmonton, with business down in the realm of 15-20%. In contrast, business in Calgary and Eastern markets is faring relatively better (volume and pricing remain fairly stable in the East). TFI expects 2010 to be another tough year for the Western business.
- Although TFI looks to consolidate facilities in some smaller locations to reduce

overhead costs, it opened a new terminal in Red Deer, and is looking to open more terminals in Ontario.

- We believe LTL volumes will likely remain depressed until H2 2010, but could grow at a mid single-digit rate in 2010. LTL will likely be more challenged on the pricing front than TL, given the importance of covering fixed network costs versus a more variable cost structure in TL.

#### ■ **Specialized Services (Logistics, Energy Services and Waste Management)**

- The oilfield services business (part of the Energy sub-segment) remains the weakest performer, driven mainly by declines in drilling activity in Canada following low natural gas prices and weak pricing (discounts running at 25-30%), reflecting the drop in activity as well as TFI's non-leadership position in that niche market (TFI is #3 behind Mullen (MTL – T; Sector Perform; \$17.50 target price) and Flint Energy (FES – T; Outperform; \$17.50 target price)). Consequently, TFI recorded a goodwill impairment charge of \$45 million in the oilfield services group in Q4 2009. TFI noted that while drilling activity could modestly increase in 2010, pricing remains very low.
- In contrast, the oilsand services business (~18% of Specialized Services, also part of the Energy sub-segment) continues to perform well, as it recently won a contract from Imperial Oil's (IMO – T; Sector Perform; \$48.00 target price) Kearl oil sands project in Alberta.
- TFI's U.S. energy business (~15% of TFI's oilpatch work), which is relatively small compared to Canada, with a presence in two states, is faring relatively better than Canada, offset by strong Canadian dollar. TFI is looking to expand its U.S. operations, perhaps by servicing another state that has a shale gas drilling activity.
- The resilient Waste Management business remains very strong.

#### ■ **Package & Courier (P&C)**

- Package & Courier has remained relatively resilient, with volatility not as extreme as in the LTL and TL business, largely because a baseline level of activity still has to be conducted, in our view.
- The ATS Andlauer Retail Solutions Division, which was acquired on November 19, 2009, should augment TFI's organic growth prospects, including winning business from its competitors. Although it has very good gross margins, closer to TFI's ICS business, as it is mostly owner-operated, TFI expects to take some extra costs out of the business to make it more profitable on EBITDA. The existing EBITDA margins of around 10-12%, according to TFI, could rise to 18-20%, in our view, post cost-cutting and perhaps as the operations merge, to a certain degree, with TFI's Canpar and ICS.
- TFI noted on the call that although the Retail Solutions Division has had a rough start in 2010 on volumes, it is expected to contribute \$100-\$120 million to the top-line in 2010.

#### ■ **Cost Reduction**

While TFI took various cost-cutting measures during 2009, including headcount reductions, sub-contractor cost savings, and fixed cost reductions (terminal consolidation, hiring and salary freeze, and discretionary cost cuts), it noted that it still has further scope for cost-cutting in P&C (Canpar and Retail Solutions Division), LTL (terminal consolidation in the East), etc. Continuing its focus to reduce its fixed cost base, it expects to convert more (likely 10-20) employee trucks at ICS Courier to owner-operated in 2010, in addition to 34 trucks converted in 2009.

#### ■ **Debt Reduction**

After repaying around \$100 million in debt in 2009, TFI is expecting to repay a similar, if not greater, amount in 2010, which would increase TFI's enterprise value by at least \$1.00/share. It is looking to renegotiate credit lines (seeking \$600 million) but expects interest expense to go up in 2010 as the interest rate is expected to increase by 200 bps, which is compelling TFI to further reduce debt levels in 2010. The net debt to capital ratio decreased to 57% at 2009-end vs. 62% at 2008-end. TFI's current debt of \$400 million will come due in October 2010.

■ **Free Cash Flow (FCF)**

TFI expects to generate \$100 million in FCF in 2010 (vs. \$137 million in 2009), as well as another \$80 million or so in cash flow from sale-leaseback of properties, including \$32 million in Calgary (entered into an agreement in January 2010) and Vancouver and possibly Montréal or Toronto (\$50 million). We are projecting FCF of \$121 million in 2010, slightly higher than TFI's \$100 million guidance. The Company guided to \$50-\$60 million in 2010 capex, net of disposals.

■ **Acquisitions**

After an accretive acquisition of ATS Andlauer Retail Solutions Division in 2009, TFI remains focused on its long-term growth strategy and expects to emerge from the economic slowdown in a better position as an industry consolidator through acquisitions. It expects to spend \$50-\$75 million on M&A, with a focus on waste management (most profitable segment for TFI), P&C or small LTL carriers in Ontario or Alberta, but nothing is expected on the TL front.

### Valuation & Recommendation

Our \$12.00 target is based on a combination of 6.7x 2010e EBITDA and 15.0x 2010e EPS, equating to a target yield of over 3%. TFI is currently trading at 5.9x 2010e EBITDA versus its peer group (U.S. TL & LTL) at 7.3x (ex. outliers). While TFI continues to trade at a discount versus its U.S. peers, compared to an average premium of 1.0x historically, we believe with a recovery underway, TFI's leverage should allow it to outperform its peers, closing the gap to historical levels.

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