

TFI (T)	\$10.31
Stock Rating:	Outperform (Unchanged)
Target:	\$12.00 (Unchanged)
Risk Rating:	Above Average (Unchanged)

**Stock Data:**

52-week High-Low	\$10.43 - \$4.35
Bloomberg/Reuters: Canada	TFI CN / TFI.TO

(FY-End Dec. 31)	2009a	2010e	2011e
Revenue (mln)	\$1 847	\$2 056	\$2 177
EBITDA (mln)	\$227	\$265	\$300
FD EPS	\$0.58	\$0.74	\$1.09
Revenue Y/Y Chg.	-18.4%	11.4%	5.9%
Organic, Y/Y	-14.4%	2.9%	4.4%
EBITDA Y/Y Chg.	-20.3%	17.0%	13.3%
EPS Chg. Y/Y	-47.7%	27.8%	47.7%
EBITDA margin	12.3%	12.9%	13.8%
Operating Ratio	94.2%	93.4%	91.6%
P/E	17.7x	13.9x	9.4x
EV / EBITDA	7.4x	6.3x	5.6x
FFO/sh	\$2.12	\$2.06	\$2.36

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

**Key Data**

Shares Outstanding (mln)	95.5
Market Capitalization (mln)	\$981
Net Debt (Mar. 10)	700.5
Net Debt to Cap.	56.0%
Net Debt to TTM EBITDA	3.0x
Enterprise Value	\$1 682
Current Yield	3.9%

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.

### Q1 2010 Results Revisited

## Gears Up for Leverage to Rebound in Volumes Later in 2010 and 2011

### HIGHLIGHTS

- **Q1 Results Roughly In-line**

TransForce (TFI) reported an adj. EPS of \$0.09, up from an adj. \$0.03 last year, but a penny shy of our \$0.10 estimate (Street at \$0.06). EBITDA was up 14% y/y, as revenue increased 3% and operating costs increased 2%, and essentially in line with the Street at \$49.6 million, but below our \$54.1 million estimate.

- **Improving Volumes Complement Cost Initiatives**

Although TFI expects to witness relatively modest revenue growth in 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 to position the Company well, with substantial upside leverage to the eventual recovery, which we expect in H2 2010. TFI is increasingly appearing more confident about posting slightly better than targeted EBITDA of \$250 million in 2010, on the back of the aforementioned factors, offset by ongoing pricing and FX pressures, especially in the TL and LTL businesses. We are encouraged with TFI's ability to manage down its cost structure and maintain, or even improve, margins, which have a further upside potential given a recovering economy and its focus on long-term growth through strategic acquisitions.

- **Maintain Outperform, \$12.00 Target Price**

We are maintaining our 2010 EPS estimate of \$0.74, while slightly increasing our 2011 EPS estimate to \$1.09 (was \$1.07). Our \$12.00 target is based on 7.0x 2010e EBITDA. Outperform.

### Stock Performance



## Gears Up for Leverage to Rebound in Volumes Later in 2010 and 2011

Although TransForce (TFI) expects to witness relatively modest revenue growth in 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. TFI is increasingly appearing more confident about posting slightly better than targeted EBITDA of \$250 million in 2010, on the back of the aforementioned factors, offset by ongoing pricing and FX pressures, especially in the TL and LTL businesses. TFI's fundamental growth should be further augmented by the resilient waste management business and the strengthening of its relatively stable and high-margin Package & Courier business, which is benefiting from the addition of the Retail Solution Division of ATS Andlauer (ATS.un – T; Not Rated). In all, TFI's diverse service offering should continue to help offset weakness, to a great extent, in the relatively weaker segments, i.e. TL, LTL and energy. We are encouraged with TFI's ability to manage down its cost structure and maintain, or even improve, margins, which have a further upside potential given a recovering economy and its focus on long-term growth through strategic acquisitions.

**We are maintaining our 2010 EPS estimate of \$0.74, while slightly increasing our 2011 EPS estimate to \$1.09 (was \$1.07).**

TransForce Inc.: Estimates Summary						
Dec. 31 FYE	New Estimates			Old Estimates		
Cdn\$	Q2 10e	2010e	2011e	Q2 10e	2010e	2011e
Revenue (mln)	499	2 056	2 177	507	2 080	2 199
EBITDA (mln)	63	265	301	65	265	294
FD EPS	\$0.15	\$0.74	\$1.09	\$0.18	\$0.74	\$1.07

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) efforts to reign in costs and maintain/improve margins and operating ratio given dramatic declines in its revenue base; iii) strong FCF and debt reduction; iv) potential to gain through acquisitions; and v) position as the most liquid and diversified name in Canadian trucking.

## Q1 Results Roughly In-line

On April 23, TFI reported its seasonally weakest quarter, posting slightly lower EBITDA than we expected, although in line with the Street, primarily due to slightly lower organic revenues (higher volumes, but lower pricing), and relatively modest gains with the previous ATS acquisition considered. The ATS Retail Solutions Division contributed \$25.4 million to the top-line, while adding \$17.8 million to operating costs and \$6.1 million to fixed and G&A expenses, resulting in a weaker margin than expected for this business (vs. roughly 16% in Q4 2009), which is a function of seasonality (January and February are typically not good months for the Retail Solutions Division, with a pick-up witnessed in March and April). Overall, TFI's margins improved y/y, resulting from its concerted effort to reduce fixed costs and G&A expenses. Excluding significant acquisitions, operating costs decreased y/y due to cost-cutting initiatives including workforce and sub-contractor reductions, branch and terminal consolidations, reductions in the leased premises and related expenses, and conversion of company-owned tractors to owner-operators, as well as savings from fixed costs and G&A through a hiring and salary freeze, and discretionary spending cuts.

### ■ Adj. EPS

Adjusted EPS of \$0.09, up from an adjusted \$0.03 last year, was a penny shy of our \$0.10 estimate, but higher than the Street at \$0.06, on the back of slightly lower organic revenues (higher volumes but lower pricing), and relatively modest gains with the previous ATS acquisition considered. We adjusted the GAAP EPS of \$0.28 for the gains on fair value adjustments related to interest rate swaps (\$3.2 million) and the acquisition of Lafèche Environmental Inc. (\$16.3 million).

## ■ Revenue

TFI reported revenue, excluding fuel surcharge, of \$429 million, up 2%, but slightly below our \$438 million estimate. The y/y increase primarily resulted from the acquisition of the ATS Retail Solutions Division (acquired in Q4 2009), as well as increase in volumes, offset by FX and pricing. Including fuel surcharge, TFI reported revenue of \$466 million, slightly below our \$477 million estimate and the Street at \$475 million.

## ■ EBITDA

EBITDA of \$50.7 million was up 14% y/y, and essentially in line with the Street at \$49.6 million, but below our \$54.1 million estimate. The EBITDA margin of 10.9% was up from 9.8% last year, and roughly in line with our 11.3% estimate, as operating costs increased 2% y/y (primarily due to the significant acquisitions), in line with the 2% increase in revenue ex surcharge.

TFI: Financial Highlights				
3 Months Ending Mar. 31	2010	2009	Y/Y Chg.	NBF Est.
Revenue	429.2	422.2	2%	438.4
Fuel Surcharge	36.9	30.1	22%	38.1
<b>Total Revenue</b>	<b>466.1</b>	<b>452.4</b>	<b>3%</b>	<b>476.6</b>
Operating costs	330.4	322.6	2%	345.5
Fixed cost, G&A	85.0	85.3	0%	76.2
Incentive & other	-	-	na	0.8
Total OpEx	415.4	407.9	2%	422.5
<b>EBITDA</b>	<b>50.7</b>	<b>44.5</b>	<b>14%</b>	<b>54.1</b>
D&A	31.1	30.9	1%	32.7
Gain on disposals	(0.7)	(0.3)	nmf	(0.5)
EBIT	20.2	13.9	46%	21.8
Interest Expense	8.4	9.9	-15%	8.2
EBT	11.8	4.0	197%	13.6
Income taxes (rec)	4.7	1.2	306%	4.1
Unusual items	(19.4)	(0.3)	nmf	-
Net Income	26.6	3.1	754%	9.6
<b>Adj. Net Income</b>	<b>8.1</b>	<b>2.9</b>	<b>179%</b>	<b>9.6</b>
Rpt. EPS, FD	\$0.28	\$0.04	678%	\$0.10
<b>Adj. EPS, FD</b>	<b>\$0.09</b>	<b>\$0.03</b>	<b>150%</b>	<b>\$0.10</b>
<b>Margins</b>				
<b>EBITDA Margin</b>	<b>10.9%</b>	<b>9.8%</b>	1.0 pps	<b>11.3%</b>
Operating Ratio	95.7%	96.9%	-1.3 pps	95.4%
Effective Tax Rate	39.6%	29.0%		29.9%

Source: Company reports, NBF Estimates & Analysis.

TFI: Segment Highlights			
3 Months Ending Mar. 31	2010	2009	Y/Y Chg.
<b>Segment Revenue</b>			
LTL	112.3	116.1	-3%
Package & Courier	82.9	62.1	34%
Specialized Services	109.3	114.4	-4%
TL	136.9	142.8	-4%
<b>Net Revenue</b>	<b>441.4</b>	<b>435.4</b>	<b>1%</b>
Fuel Surcharge	36.9	30.1	22%
FSC % Rev.	8.4%	6.9%	21%
Corp. Eliminations	(12.2)	(13.2)	-7%
<b>Total Revenue</b>	<b>466.1</b>	<b>452.4</b>	<b>3%</b>
<b>Segment EBITDA</b>			
LTL	8.8	10.7	-18%
Package & Courier	9.9	6.8	45%
Specialized Services	20.8	18.4	13%
TL	10.9	11.3	-4%
Corp. Eliminations	0.2	(2.7)	-109%
<b>Total EBITDA</b>	<b>50.7</b>	<b>44.5</b>	<b>14%</b>
<b>Segment EBITDA Margins</b>			
LTL	7.8%	9.2%	-1.4 pps
Package & Courier	12.0%	11.0%	0.9 pps
Specialized Services	19.1%	16.0%	3.0 pps
TL	8.0%	7.9%	0.0 pps
<b>Total</b>	<b>10.9%</b>	<b>9.8%</b>	<b>1.0 pps</b>

Note: Segment margins ex. FSC, total margin includes FSC

## Remains on Track to Meet its Target Margin in 2010

According to Management, although TFI witnessed some positive signs in terms of level of activity in the first quarter of 2010, the quality of its revenues (as measured by pricing and high-margin business, in our view) has still to recover from the economic slowdown of 2009. As a result, TFI still believes 2010 could be a challenging year with some potential for improvement in H2 2010, as volumes are expected to continue to improve. We believe pricing should remain at low levels, especially due to weak LTL yields and FX, offset by pricing discipline in other segments, albeit TFI noted that base rates are stabilizing. With a y/y increase in diesel prices, TFI remains disciplined with its fuel surcharge recovery program, instead of chasing business utilizing irrational pricing.

TFI remains focused on controlling costs while exercising pricing discipline, to a degree, given the current weak environment, thereby maintaining or improving its EBITDA margins, which should also benefit from the addition of the ATS Retail Solutions Division in subsequent quarters. As one of the more levered names in the trucking industry, 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.

TFI intends to continue to pay down debt in 2010 through free cash flow generation and sale-leasebacks (targeting a property in Vancouver and potentially Montreal), as well as remains committed to its long-term strategy of growth through acquisitions, which meet its strict criteria.

**With more comfort level on margins, due primarily to its cost saving initiatives, TFI anticipates meeting or exceeding its EBITDA target of \$250 million in 2010. Other than EBITDA, it continues to expect almost flat y/y revenues, FCF of around \$100 million (not including potential sale/leaseback transactions), capex of \$50-\$55 million (net of disposals), and debt reduction of around \$100 million in 2010.** We continue to 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, offset by a negative impact of FX. We believe LTL will be more challenged on the pricing front than TL, which TFI highlighted on its conference call.

■ **Truckload (TL)**

- Typically the most competitive of all truck markets, TL continues to remain under pressure especially out West, as well as in the East, where business is mostly related to forestry, which is not out of the woods yet, albeit better than last year as U.S. housing market stabilizes. However, flatbed is faring much better y/y than other areas.
- In comparison to the improving U.S. TL market, which is heavily domestic in nature, Canadian TL market appears to have hit the bottom, as domestic business is performing better than the international business, which continues to suffer due to stronger Canadian dollar.
- While the pricing environment is changing, as carriers are shrugging off excess capacity, volumes could remain soft in the near-term.
- We reiterate 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 could undermine Canadian manufacturers' and truckers' competitiveness.

■ **Less-than-Truckload (LTL)**

- Although LTL still remains under pressure, TFI is witnessing widespread improvement in its LTL business, on the back of increasing volumes, offset by weak pricing, given excess capacity, and unfavourable FX.
- The LTL market is shrinking in Canada as some non-LTL operators are performing LTL activities, which is stealing away the business from pure-play LTL operators. As a result, the industry could consolidate further as more players will likely disappear, according to TFI.
- We believe LTL volumes will likely remain depressed until H2 2010, but could grow overall 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)**

- TFI is expecting energy and waste management segments to do better than expected in 2010, given improvements in drilling activity in Canada, led by increased oil drilling vs. gas drilling, and inherent stability in the resilient waste management business.
- As volumes are coming back to oilfield services (part of the energy sub-segment), TFI is witnessing modest pricing improvements, with discounting not as steep as it was in 2009. In March, TFI reduced its discounting by 5-10 points and anticipates it to remain the same throughout 2010, which is roughly similar to 2008 level. That said, we believe discounting should continue to exist in the near-term, given TFI's non-leadership position in the niche market (TFI is #3 behind Mullen (MTL – T; Sector Perform; \$18.50 target price) and Flint Energy (FES – T; Outperform; \$18.00 target price)).
- In waste management, TFI expects the recently acquired 50% interest in Lafèche to generate \$7.0 million in revenues in 2010.

#### ■ **Package & Courier (P&C)**

- TFI is calling for a relatively stronger performance at P&C in 2010, largely due to the acquisition of the Retail Solutions Division of ATS Andlauer in Q4 2009.
- Although TFI believes the acquired company (ATS) should do better than it has historically, generating \$120 million in annual revenues, TransForce highlighted that the ATS business is currently not as high-margin as it originally anticipated, albeit closer to TFI's ICS business, as it is mostly owner-operated.
- TFI expects to take some extra costs out of the P&C business to make it more profitable on EBITDA. The existing EBITDA margins of around 10-12%, according to TFI, could rise to mid-teens or even higher, in our view, post cost-cutting and perhaps as the operations merge, to a certain degree, with TFI's Canpar and ICS.
- TFI intends to run the ATS business on a stand-alone basis for at least one year, before looking for other potential M&A opportunities, meeting TFI's strict criteria.

#### ■ **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), we expect further cost-cutting to come from P&C (Canpar and the ATS Retail Solutions Division), LTL (terminal consolidation), etc. TFI anticipates taking out an additional \$5-\$15 million from fixed and G&A costs in 2010, and more cost improvement from network consolidation in all its regions.

#### ■ **Free Cash Flow**

TFI originally expected to generate \$100 million in FCF in 2010 (vs. \$137 million in 2009), as well as another \$60-\$80 million in cash flow from sale-leaseback of properties, likely including Calgary, Vancouver, Montréal or Toronto. We are projecting FCF of \$145 million in 2010. The Company guided to \$50-\$55 million in 2010 capex, net of disposals. TFI expects to make earn-out payments of about \$3-\$4 million every year through 2014 related to the ATS acquisition.

#### ■ **Debt Reduction**

In 2010, TFI continues to expect to repay about \$100 million in debt (similar to 2009 level), to eventually obtain a net debt to EBITDA ratio below 2.5x, and save on additional interest expense due to a possible hike in interest rates this year. TFI intends to renegotiate credit lines and is in active discussions with financial institutions to renew its four-year \$370 million revolving facility, due in October 2010, as well as replace the \$100 million unsecured loan from FSTQ, due in October 2013, with a secured loan. Net debt at the end of Q1 was \$700 million, equating to 3.0x trailing EBITDA (vs. 3.2x at Dec. 09). As at March 31, 2010, TFI was in compliance with its bank covenants and believes it will remain so throughout 2010.

#### ■ **Acquisitions**

After an accretive acquisition of the Retail Solutions Division in 2009 and the other 50% interest in Lafèche in Q1 2010, TFI remains focused on its long-term growth strategy through acquisitions. However, given uncertainty facing the trucking industry, and its efforts to reduce above average debt levels, TFI will not likely focus on M&A in 2010.

### **Maintaining Outperform and \$12.00 Target Price**

Our \$12.00 target is based on 7.0x 2010e EBITDA, equating to a target yield of over 3.3%. TFI is currently trading at 6.4x 2010e EBITDA versus its peer group (U.S. TL & LTL) at 8.5x (ex. outliers), pointing to upside. While TFI continues to trade at a discount versus its U.S. peers, we believe with a recovery underway, TFI's leverage should allow it to outperform its peers, closing the gap to a degree.

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