2009 Mid Year State of the Industry Review

Schneider Logistics, Inc.
Logistics Shared Services

July 27, 2009

TABLE OF CONTENTS

Domestic US State of the Industry

1. Economic Overview……………………..2
2. Fuel………………………………………3
3. Pricing Projections………..…………..5
4. Hot Topics………………………………6
5. Expedited Truckload……………………11
6. LTL………………………………………12
7. Intermodal………………………………13
8. Bulk………………………………………15
9. Flatbed…………………………………..15
10. Maritime/Domestic Water...……………17
11. Ocean/International……………………..18
12. Freight Forwarding……………………...19

NAFTA Update

1. Mexico……………………….………………... 20
2. Canada…………….…..……………………..23

Europe………………………………………………..25
China…………………………………………………26

Introduction

Thank you for taking the time to read our semi-annual assessment of the state of the logistics industry. Twice each year, logistics professionals from across the Schneider Enterprise in each of our operating geographies, offer their input on a particular area of functional expertise. Our procurement team bases their inputs on real-time experience across a multi-modal, $2 billion, international freight spend. Additionally, operators from our North America and Asia offices include their perspective on how legal, governmental and market forces are affecting each of their unique logistics environments. This effort, combined with available external reporting, culminate in this product which we distribute to our associates and customers as part of the value associated in working with a leading transportation and logistics provider. Many thanks are owed to the large group of contributors listed below without whom there would be no report.

Thank you to the following contributors:
Schneider Logistics (US) – George Middleton, Bob Parteka, Sarah Wilder, Chuck Fredrickson, Helge Tangen, Chris Renier, Rick Oettinger, Sara Schmidt, Tony Anderson, Shawn Zehms, Kathy Maas, Luis Ramos, David Bennett
Schneider de Mexico – Teresa Velasco
Schneider Canada – Cora McBride
Schneider Logistics China – Huabing, Ping Yuan
Schneider National, Inc – Dan Pierce

Additionally, should the reader have any question about specific Schneider capabilities, please refer queries to the following addresses:

N America - getconnected@schneider.com
China - wangjh@schneider.com

Finally, if there are any questions or concerns regarding the content of this report or if there is any other feedback, please don't hesitate to contact your Schneider representative or the editor at lowerj@schneider.com. Thanks again for reading.

Economic Overview

Description	QUARTER			ANNUAL		
	2009Q1	2009Q2	2009Q3	2008	2009	2010
Real GDP [1]	-5.7%	-2.1%	0.7%	1.1%	-2.7%	2.7%
Consumer Expenditures [1]	1.5%	-0.9%	1.2%	0.2%	-0.7%	2.6%
Industrial Production [1]	-19.0%	-12.5%	-3.9%	-2.2%	-12%	1.2%
Auto Sales, Millions [1]	9.5	9.9	10.3	13.1	10.1	12.7
Housing Starts, Millions [1]	0.53	0.55	0.51	0.90	0.53	0.55
Truckload Intermodal [2]	-3.6%	-5.1%	-4.0%	6.6%	-3.5%	3.5%
Heavy-Duty Truck Tonmiles [2]	-9.7%	-9.8%	-8.9%	-2.7%	-8.7%	0.4%
Dry Van Loads [2]	-10.9%	-10.8%	-10.1%	-3.8%	-9.6%	1.0%
Heavy-Duty Truck Utilization %	77.3%	76.8%	76.5%	82.7%	76.8%	78.4%

Notes:
[1] SAAR - Seasonally Adjusted Annual Rates; Seasonally Adjusted Quarter to Quarter Changes at Annual Rates.
[2] Y/Y %Change - Current period vs. same period one year ago.
Sources: Center for Econometric Model Research (CEMR), Indiana University; FTR Associates

The Shape of Recovery

Positive Q2 earnings reports seem to be spurring life back into the S&P 500 but it has not yet reached its previous high. News has generally been mixed. Jobless claims and continuing unemployment claims declined, but remain at high levels. Industrial production in June shrank by 0.4%, less than predicted by economists and smaller than the contraction in May. The Federal Reserve Bank of New York's manufacturing index declined by the lowest amount in over a year, but the Philadelphia Fed's index of business conditions showed a drop that was larger than predicted by economists and larger than the prior month. Housing starts rose to a seven-month high in June.

No discernable trends are apparent in income, production, sales or employment data. Unlike all other postwar recessions, this is not a recession associated with the adjustment of business inventories, but instead a product of a full-blown credit

contraction as both financial institutions and households repair their balance sheets. As a result, typical rules of thumb do not apply for determining the timing and strength of the economic recovery. Analysts believe that the recovery will be more muted, in that trend economic growth will be more volatile and significantly lower than the growth levels that the US has enjoyed in recent decades.

The health of the labor market continues to be a major concern as it could forestall a recovery. The unemployment rate, currently at 9.5%, continues to rise and the average workweek has shrunk to a record low. The U6 unemployment rate has risen to 16.5%, the highest level since records began. The U6 unemployment rate not only considered the unemployed, it also includes measures of those who have taken part-time jobs while seeking full-time jobs, as well as those who have stopped seeking full-time jobs, but want them. Companies are working hard to maintain, and in some cases, restore profitability. However, much of the improvement in profitability in the first quarter appeared to be the result of expense cutting via workforce reductions, as opposed to top line revenue growth. To increase earnings on a sustainable basis, sales need to pick up. [1]

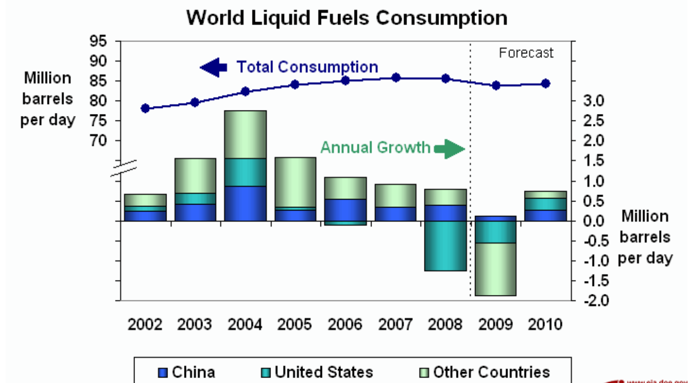
Prospects are improving for an end to the recession this year. After falling 5.5% in the first quarter, real GDP is on track to decline 2.1% in the second quarter and post a positive 0.7% rate in Q3 and a 2.8% increase in Q4. Behind this overly optimistic outlook (in our opinion) is evidence that a bottom is forming for housing, consumer spending has stabilized, and government spending is picking up. [2]

Historically, it is true that deep downturns are followed by more V-shaped recoveries, while shallow downturns are usually U-shaped. The early-1980s recession was a V-shaped recovery, that is, a deep downturn followed by strong recovery. This is because strong recoveries are usually led by the interest sensitive sectors, housing and auto. We expect this recover to look more like a "lopsided U". That is, somewhere between the "L" shaped recovery experienced by Japan's Nikkei and a true "U".
This type of delayed recovery is likely for several reasons. While housing and vehicle sales will increase from their current low levels, gains will be limited until excess housing inventory is nearly gone and pent-up vehicle demand revives. It would also be optimistic to expect the global economy to recover quickly. Finally, the credit crunch is likely to only lift slowly.

A slow, modest recovery is most likely. Real GDP is expected to fall 2.7% in 2009 before rising 2.7% in 2010 and 3.6% in 2011. There are risks. The recent rise in long-term rates, if sustained, could undermine any revival in home sales. In addition, there could be a delay in the recovery if the consumer, who is facing labor market weakness and declining home prices, decides to continue to conserve cash. The probability of a delay in the recovery is 20%.[3]

Diesel Fuel

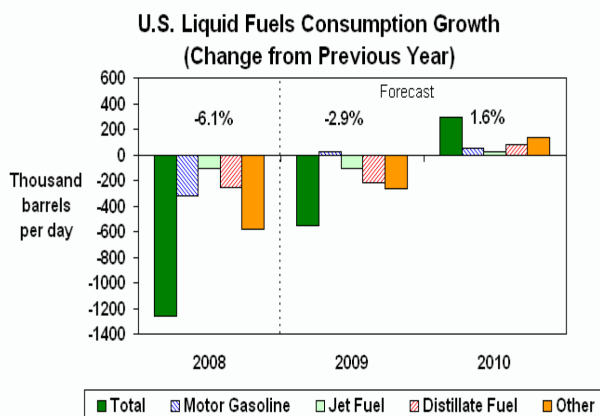
In the first twelve weeks of 2009, diesel prices continued the downward trend that began in July, 2008. Diesel reached an all-time high of $4.76 per gallon the week of July 14th, 2008. Over the next thirty-five weeks, the price of diesel dropped nearly $2.50 per gallon to settle at $2.02 per gallon the week of March 16th, 2009. Since March 16th, 2009, diesel has steadily climbed, reaching $2.62 per gallon in the third week of June. The increase in diesel prices over the past three months corresponds directly to the price of crude oil. Crude oil began the year at approximately $35 per barrel and has doubled over the past six months, trading at approximately $70 per barrel at the end of June, 2009[4].



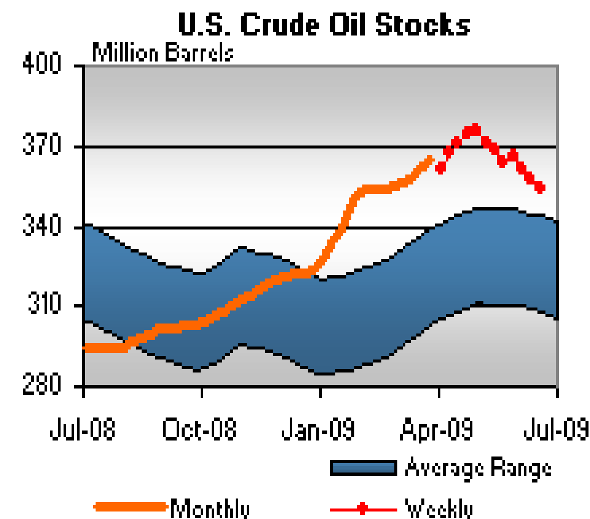
The dramatic drop in crude oil prices in the second half of 2008 was driven by the fundamental principle of supply and demand. As the slowing U.S. economy began

[1] Bernie Williams, USAA Federal Savings Bank
[2] FTR & Associates
[3] FTR, Economic and Freight Forecast, July 2009
[4] Energy, U.S. Department of. Energy Information Administration. June 2009

to contract in the third quarter of 2008, consumer confidence and spending dropped dramatically, thus lowering demand for fuel. The drop in consumer spending in the United States directly impacts China's export dependent economy. The slowing of the Chinese economy has greatly impacted the overall demand for crude oil, precipitating the dramatic drop in crude oil prices[5]. The current increase in crude oil prices is driven by speculators investing in commodities as a hedge against inflation. Investments in oil as a hedge against inflation are having an impact on the increased cost of oil in the second quarter of 2009. Investors are concerned that the U.S. government's current monetary and fiscal policies will lead to higher inflation. In addition, both China and Russia have been promoting the idea of a new global currency to be utilized in international trade, causing further weakening of the U.S. dollar and applying upward pressure on crude oil prices[6].



There is currently an abundant supply of crude oil. Member nations of the Organization for Economic Cooperation and Development, which includes the United States, have increased crude oil inventories by 46 million barrels during the first half of 2009, reaching 60 days of forward cover[7]. This is a historically high number for crude oil inventories. In addition, there are about 33 supertankers throughout the world storing an additional sixty-five million barrels of oil[8]. OPEC has failed to heed production quotas established in September, 2008, exceeding quotas by 800,000 barrels per day. At this time, OPEC does not plan any additional production cuts; instead members are being encouraged to meet already established production levels[9]. The US Department of Energy is predicting OPEC production to average 28.5 million barrels per day in 2009, increasing to 28.8 million barrels per day in 2010[10].



In the first quarter of 2009, global oil consumption continued to decline. Total year over year decrease in crude oil consumption dropped approximately 3.4 million barrels per day in the first half of 2009. The US Department of Energy anticipates the decline in oil consumption to slow the remainder of 2009, with global consumption rising by 700,000 barrels per day in 2010[11]. US crude oil consumption is estimated to decrease by 2.9% in 2009, with distillate consumption (diesel), decreasing by 6.9%[12]. It is estimated that overall fuel consumption will increase 1.6% in 2010 based on an anticipated economic recovery.

---

[5] Gress, Bruce. Pilot Travel Center Energy News for Customers. Weekly Energy Report. Knoxville: Pilot Travel Center LLC, 2009

[6] Xie, Oliver Biggadike and Ye. Bloomberg.com. 27 June 2009. 29 June 2009

[7] Energy, U.S. Department of. Energy Information Administration. June 2009

[8] Nightingale, Alaric. Hellenic Shipping News World Wide. 6 June 2009

[9] Press, Associated. msnbc. 25 May 2009. 29 June 2009

[10] Energy, U.S. Department of. Energy Information Administration. June 2009

[11] Energy, U.S. Department of Energy Information Administration. June 2009

[12] Ibid.

The US Department of Energy is projecting that West Texas Intermediate crude is projected to average $58.70 per barrel in 2009 and $67.42 per barrel in 2010. Diesel is projected to average $2.40 per gallon in 2009 and $2.67 in 2010[13]. The Department of Energy states that these estimates are based on current production, consumption and economic recovery projections. They acknowledge that "energy price forecasts are highly uncertain"[14]. The increase in fuel costs in the second quarter of 2009 was driven by speculators seeking shelter from anticipated inflation, as well as an "anticipated economic recovery"[15]. The other factor in projecting future fuel costs is geopolitical concerns. Unrest in the Middle East, Iran and North Korea has the potential to impact fuel prices for the foreseeable future.

General Pricing Projections

At this time last year, we found ourselves slightly pessimistic on the notion that we may be in a shipper's market during surge and potentially into 1H09. At the time of publication, astronomical fuel costs and an unprecedented mass exodus of capacity from the market had our procurement teams bracing for a replay of the '04/'05 scenario. This led to relatively conservative projections about the pricing activity to be expected in 2H08.

Our projections were revised by the time the end of year review went to print, but a prevailing trend of cautious optimism about the economy, even at the end of 2008, left us slightly off the mark again for 1H09. What happened in reality was that consumer and industrial manufacturing indices, on the bubble at the end of 2008, fell through the floor. Even rapidly decreasing capacity could not keep pace with a massive downshift in demand. In the end, our procurement teams spent the better part of Q109 advising clients, who had not planned freight bids 6 months previously, to consider double digit decreases on 1 year old rates with moderation.

Climbing unemployment, wide-spread economic uncertainty and a host of trade publications advertising transactional market price/capacity dynamics resulted in new decision makers at major shippers eager to save a buck and provide for their own job security. We are happy to report that many of our customers who value the stability and predictability that comes with long term logistics agreements and strategic relationship management recognized that discretion is the better part of valor in this case and approached their award scenarios with restraint. Meanwhile, other clients with more tolerance in their business model for the peaks and valleys that come with an arm's length approach to their procurement went into their award phase with eyes wide open and focused on obtaining the maximum amount of savings possible.

Regardless of the individual philosophies, one thing is for certain; our bid season, which is typically centered in Q1, was longer and more intense than it has been in the last several years. By the end of June, Schneider Logistics had conducted 70 procurement events, 18 of which were fully managed bids facilitated through our Bidsmart™ software. This compares to 18 bids conducted during the entirety of 2008. The pre-sourcing value of these events totaled more than $800 million and yielded over 11%, on average, in savings. Additionally, we have 16 more bids currently scheduled representing a very broad set of industry verticals and modes.

Truckload – 5-7% Decrease; LTL - Flat

It is pure downside economics for carriers. Following the reduction of over 7% of US capacity in 2008, the situation is unlikely to improve. Our experience shows 25-30% less shipping activity across our industry verticals which translates to a weak pricing market and less than favorable operating ratios. We expect this to continue through the end of 2009 with some improvement in freight demand by the end of Q4 but little chance for carriers to improve margins through pricing activity.

Ocean – 6% Decrease

Rates for ocean carriers remain tight, although there have been some reports of increases. Rates have fallen about 50% from peak as declining global trade has caused carriers to respond by dropping ports of call and laying ships up. About 10% of containership capacity was laid up by the middle of April, which is down from a high of over 13% earlier in the year. Despite this, there is still an overcapacity in the industry that will most likely not correct itself until 2015. $750 billion has been spent on new ships in the last 5 years which is more than the previous 25 year combined. Between 2000 and 2012, the fleet is expected to grow by 154%. There are scattered reports of order cancellations but many are already

---

[13] Ibid.
[14] Ibid.
[15] Gress, Bruce. Pilot Travel Center Energy News for Customers. Weekly Energy Report. Knoxville: Pilot Travel Center LLC, 2009.

in progress and would be too costly to cancel. Even when the economy begins to rebound, do not expect to see rapid change in the containership sector. It probably has another 15-18 months of tough times. Laid up capacity will reenter gradually as operators look to maximize their load factor on vessels still in service to help with cost recovery. [16]

Small Package/Air – Flat

Air cargo rates may have hit bottom. The International Air Transport Association (IATA) revised its airline financial forecast for 2009 to a global loss of $9 billion in June, noting that it is nearly twice as high as the association's March estimate of a $4.7 billion loss. IATA's revised forecast sees revenues declining an unprecedented 15 percent ($80 billion) from $528 billion in 2008 to $448 billion in 2009. Air cargo demand is expected to decline by 17 percent by the end of the year. In 2009, airlines are forecast to carry 33.3 million tons of freight, compared to 40.1 million tons in 2008. The revenue impact of falling demand will be further exaggerated by large falls in yields—11 percent for cargo.[17]

Hot Topics

Cargo Theft

Theft trend reports coming from security watchdog groups such as Supply Chain Integrity and Freightwatch, along with regional cargo theft task forces indicate the cargo theft gangs are increasing in boldness and in their operating territory in the "down" economy of 2009. These organized theft gangs are now targeting warehouses and individual rigs loaded with high value or desirable freight that are left at truck stops or shipper/carrier yards. We have spoken with several carriers this year who are investing in several risk mitigation techniques.

Carriers report that the thieves are utilizing an elaborate web of internet surveillance of businesses and transportation patterns to understand where products they want are produced and stored before they move to distribution hubs. They then put teams on the ground to verify transportation lanes in order to pick off individual loads. One recent example involved a tractor stopped by police in Bolingbrook, IL. A legitimate tractor out of a company in Miami, FL was occupied by 2 males of Cuban descent carrying addresses and Google maps of electronics distribution centers across Northern Illinois – Romeoville, Carol Stream, Woodstock, Waukegan, Bolingbrook, and a distribution center in McDonough, GA.

What are the thieves after? – Consumer electronics, TV's, cell phones, pharmaceuticals, food, computers and lately, building materials. The high value products all make sense, but building materials like shingles, trusses, lumber? This makes sense when you plot the theft locations. They are occurring in Texas. Someone is clearly preparing for hurricane season with a damage renovation plan! The other high value commodities are being taken primarily for an export market out of Miami and into Central and South American black markets. At the center of this "trade", stolen from warehouses, truck stops and yards across the mid-South in Texas, Arkansas, Tennessee, Kentucky and Georgia are gangs or organized thieves focusing on full trailer load heists and operating out of Miami, FL. Trailers and containers stolen from all states mentioned above are nearly always found empty in the Miami, FL area.

In discussion with security personnel at our major carrier's ranging from Chief Security Officers to Loss Prevention Managers, we compiled the following thoughts which were consistent among them.

Drivers must be watchful and report any suspicious activity they see in and around distribution centers for the "preferred" commodities above. If a driver suspects a "tailing vehicle" or someone tries to get him/her to stop, or feels threatened in any way then the police should be notified immediately. Any stops at truck stops should be treated as a potential theft opportunity. All vehicles should be locked up and theft deterrents such as king pin locks, brake button locks and glad-hand locks should be employed by the driver even for a 10 minute rest break. No communication to any casual person about load contents, pickup location or destination should be made because these theft gangs have done their homework as to product sites and distribution networks. Protect the client's freight by always being on the alert for these theft groups.

Comprehensive Safety Analysis 2010

The Federal Motor Carrier Safety Administration (FMCSA) has developed a more effective way to monitor carriers' and drivers' safety. As a result, they have planned to launch a new program called the Comprehensive Safety Analysis (CSA). The goal of CSA 2010 is for the FMCSA, state partners and the transportation industry

[16] CSCMP
[17] Ibid.

to work collaboratively in an effort to reduce crashes, injuries and fatalities while improving the effectiveness of FMCSA's compliance and enforcement programs. Currently in the pilot stage, this program will go into effect in June of 2010 and is considered by some to be the most significant change in FMCSA's compliance and enforcement program since the inception of the compliance review. The concept for the new model began in 2004 with development taking 30 months and culminating in an operational test model by 2008. The original pilot included CO, GA, MO and NJ and was expanded in May of 2009 to include MN, MT and OR.

The case for change is that there are significantly more motor carriers than federal / state investigators. FMCSA regulates approximately 725,000 interstate and foreign based truck and bus companies but they are only able to reach < 2% (approximately 12,000) of this total carrier population annually. FMCSA believes that CSA 2010 will improve their enforcement efficiencies by extending their reach to more carriers and drivers thus improving their ability to save lives by identifying safety problems earlier.

Currently, SafeStat is organized into four Safety Evaluation Areas (SEA's).

- Accident SEA
- Driver SEA
- Vehicle SEA
- Safety Management SEA

The new Safety Measurement System (SMS) is organized into seven Behavioral Analysis Safety Improvement Categories (BASIC's)

- Unsafe Driving
- Fatigued Driving
- Driver Fitness
- Controlled Substances & Alcohol
- Vehicle Maintenance
- Improper Loading/Cargo Securement
- Crash/Incident Experience

Each BASIC is then assessed using the Safety Management Cycle

- Preventive Policies & Procedures
- Roles & Responsibilities
- Qualifications & Hiring
- Training & Communication
- Monitoring & Tracking
- Meaningful Action

The table below lists other major differences between SafeStat and SMS.

Today's Model – SafeStat	CSA 2010's SMS
Organized in general areas (4 SEAs)	**Organized by behaviors (7 BASICs)**
Identifies carriers for compliance review	**Identifies safety problems in the same structure that CSA 2010 fixes the problems**
Assesses carriers only	**Distinct systems assess carriers (CSMS) and individual driver (DSMS)**
No risk based violation weightings	**Risk based violation weightings**
Compliance review is resource and labor intensive	**More interventions, less resource intensive**
Safety Ratings: Satisfactory, Conditional & Unsatisfactory	**Safety Ratings: Continue to Operate, Marginal & Unfit**

To facilitate this new program, FMCSA has developed COMPASS, an agency wide initiative to leverage new technology solutions. Chief among them will be their Comprehensive Safety Information (CSI) portal which will allow carriers to access and manage their relevant safety data. FMCSA advertises that CSI will:

- Create a single source for safety data via single sign-on access
- Improve data quality to enable better, more informed decision making
- Provide actionable information as well as data

For an Introduction to Compass, visit:
www.fmcsa.dot.gov/compass

To Login, Register & Access Portal
https://portal.fmcsa.dot.gov

Stimulus Package[18]

The American Recovery and Reinvestment Act of 2009 (Recovery Act) was signed into law by President Obama on February 17, 2009. It is designed to jumpstart the Nation's economy, create or save millions of jobs and put a down payment on addressing long neglected challenges so our country can thrive in the 21st century. The Act includes measures to modernize our nation's infrastructure, enhance energy independence, expand educational opportunities, preserve and improve affordable health care, provide tax relief, and protect those in greatest need.
As it turns out, only about $45 billion of the stimulus package is for transportation, which will be like the feds doubling spending for one year.

Of the $45 billion freight will probably directly benefit from only about one half of what is spent, and that may even be generous. The stimulus bill will really not build a lot of new highways or light-rail lines. It won't address the long term infrastructure problems facing the freight. It does represent a well thought out way to address the investment needs of the freight transportation community. It is a start and does include the following:

- $27.5 billion for supplemental grants for highway investments. Specific earmarks include $105 million for Puerto Rico highways, $45 million for territorial highways,a $60 million set-aside for construction of ferry boats and ferry terminal facilities, and a $550 million set-aside for Indian reservations and Federal lands. Of the projects approved so far in this category, many will benefit freight in some way as grants are being used to fund separated rail highway grade crossings, perform bridge maintenance and repairs, and repair and repave aging roadways.
- $6.9 billion for Transit Capital Assistance grants—no freight benefits
- $1.5 billion for competitive grants to State and local governments for projects that will have a significant impact on the Nation, a metropolitan area, or a region. Grants capped at $300 million each, so five projects tops and it is likely to be highly competitive. Freight projects should be able to qualify easily enough, but the funding cap makes any of the most relevant ineligible.
- $9.3 billion for investments in rail transportation, including Amtrak, High Speed, and Intercity Rail—of which $450 million is to be used for capital security grants. This has some potential for freight because new track and sidings will need to be built to move freight trains out of the way of passenger trains. Money may also be spent to upgrade the speed of some existing track. It includes $8 billion allocated for intercity rail passenger capital improvements and projects and 1.3 billion for Amtrak, with a requirement that $450 million to be used for security improvements and that no more than $510 million be used on capital improvements for the Northeast Corridor.
- $300 million for transit and rail security, which is of minimal value to freight.
- $1.1 billion to the Federal Aviation Administration (FAA) for discretionary grants for airport investment, and $200 million for FAA facilities and equipment. While this one might seem on the surface that it has potential to benefit air freight, it will have far more benefit to passengers.
- $100 million in discretionary grants at the Federal Transit Administration for energy efficiency/greenhouse gas reduction. No direct freight benefit, but we all benefit from this one.
- $750 million for Fixed Guideway Infrastructure Investment that will be apportioned through the existing fixed guideway formulas—transit related.
- $750 Million for Capital Investment Grants (New Starts). Again transit related for capital investment grants in the stimulus for new commuter rail systems, under the New Starts and Small Starts programs, with priority given to projects already in construction or that are able to obligate the funds within 150 days.
- $300 million for capital expenditures and necessary expenses of acquiring motor vehicles with higher fuel economy, including hybrid vehicles, electric vehicles, and commercially-available plug-in hybrid vehicles. This is for the U.S. Environmental Protection Agency's (EPA) Diesel Emissions Reduction grant program and eliminates the state-matching requirement for the receipt of such funds.

[18] CSCMP

The Obama Administration is already calling the transportation stimulus package a success. Signs like those stating “Putting America to Work” are popping up all over the country as work is underway. In California, Obama recently proclaimed that the highway projects brought about with stimulus money have come in “ahead of schedule and under budget.” The program's early success probably owes more to the depth of the economic crisis than to any newfound efficiency in Washington. State DOT administrators are reporting that construction companies have seen their business plunge so far, so fast, that they rushed to submit unusually low bids for the federally funded projects—hoping to have at least some work in the summer construction season, and hoping to stay afloat. Bids on transportation projects paid for with federal stimulus money are coming in far below estimates, leaving the states with opportunities to fund more work than anticipated. But that has left some states in a difficult position because there are not enough projects that meet the federal requirements and are have been through the state’s approval processes.

In order to qualify for stimulus funds, the projects had to be “shovel ready”. States have been given 120 days to commit half of their allotment or they have to give it back. The planning horizon for most road building plans is typically three to eight years, so DOTs were able to go through their portfolios and pick projects that could be moved forward by accelerating engineering and environmental work. The result is that many small projects, valued at $20 million or less, are being started all over the country. While it is certain that most of these projects have merit, even on a statewide basis they do not represent a change in investment strategy with the big picture in mind. With the deadline for committing the sums looming, it is unclear what will be done with unspent money.

From the vantage point of getting workers back to work or keeping them there, the stimulus package will probably be viewed as a success, but it needs to be noted that it is only a drop in the bucket for transportation investment needed and even for labor recovery. For instance, the stimulus projects are expected to create or save 6,020 jobs in Arizona, but that does not come close to compensating for the 77,000 construction jobs lost in that state during the last two years.

In addition to the transportation infrastructure piece of the Stimulus Package, the Army Corps of Engineers received $4.6 billion dollars for the nation’s waterways. For transportation this includes ports, harbors, inland waterways, locks, dredging, etc. Also included in the total are flood control projects, wastewater facilities, and recreation projects. Two million dollars has been earmarked for new construction projects, and just over two million dollars for operations and maintenance and $375 million for Mississippi River and tributaries. Please note that included in these totals are significant funding for flood control projects, wastewater facilities, and recreation projects. The remaining $2.6 billion or so is for remedial programs and regulatory programs. Interestingly in his $3.6 trillion budget, Obama identified 121 programs that he wants to eliminate or reduce to save $17 billion. It included eliminating some Army Corps of Engineers programs. It appears that he specifically targeted $206.7 million earmarked for wastewater treatment projects and may not impact the announced freight infrastructure projects.

We still have a long way to go and effort needs to be concentrated on coming up with a nationwide plan. The American Society of Civil Engineers periodically does a study and issues a report card to help policymakers and stakeholders understand the magnitude of the problems to work to fix them. Listed below are the results of their most recent analysis:

Roads – D: Americans spend 4.2 billion hours a year stuck in traffic at a cost to the economy of $78.2 billion, or $710 per motorist. One-third of America’s major roads are in poor or mediocre condition and 45 percent of major urban highways are congested. Poor conditions cost motorists $67 billion a year in repairs and operating costs. It is estimated that $186 billion is needed annually for highway capital improvements to substantially improve conditions. Currently we spend about a third of that—$70.3 billion. Not investing in the nation’s highways and roads will lead to increased congestion and delays for motorists and the further deterioration of pavement conditions. Automobile vehicle miles traveled (VMT) increased 94 percent and truck VMT increased 105 percent, highway lane-miles grew by only 3.5 percent in the last 25 years. Additionally ton miles of freight moved by truck grew 33 percent and forecasts for the next 20 years show that doubling. The increase in freight traffic will cause added wear and tear on roadways, adversely impacting economic growth and will pose increased safety concerns. An overstressed infrastructure will also slow freight delivery, create unpredictability in supply chains, diminish the competitiveness of U.S. businesses, and increase the cost of consumer goods. Second, it is clear that the current funding model for the Highway Trust Fund (HTF) is failing. The Federal Highway

Trust Fund will need an estimated $5 billion to $7 billion to maintain existing construction projects this year and another $8 billion to $10 billion will be needed for 2010. Last year, Congress approved an emergency transfer of $8 billion in general treasury money to make up a projected shortfall in the fund—the first time in the program's history that had happened. We cannot continue to rely upon gasoline and diesel taxes to generate the HTF revenues, when national policy demands a reduction in both our reliance upon foreign sources of energy and our nation's carbon footprint. Reduced driving since 2007 has cut federal gas tax revenue, which is the primary source of highway fund money. An increase in the gas tax may be necessary in the short term, but our national policy must move toward a system that more directly aligns fees that a user is charged, with the benefits that the user derives. Finally, the legislation must encourage innovative thinking and solutions from all sectors: public, private, and academia.

Bridges – C: Usually built to last 50 years, the average bridge in our country is now 43 years old. One in four of the nation's bridges are either structurally deficient or functionally obsolete. While some progress has been made in recent years to reduce the number of deficient and obsolete bridges in rural areas, the number in urban areas is rising. A $17 billion annual investment is needed to substantially improve current bridge conditions. Currently, only about $10.5 billion is spent annually on the construction and maintenance of bridges.

Rail – C: A freight train is three times as fuel efficient as a truck. However, growth and changes in demand create bottlenecks that constrain traffic in critical areas. The Obama administration has embraced the concept of high speed rail and has earmarked stimulus money for its development. Freight and passenger rail generally share the same network, and a significant potential increase in passenger rail demand will add to the freight railroad capacity challenges. Demand for freight transportation is projected to nearly double by 2035—from 19.3 billion tons in 2007 to 37.2 billion tons in 2035. An estimated $148 billion in improvements will be needed to accommodate the projected rail freight demand in 2035. Class I freight railroads' share of this cost is estimated at $135 billion. The Class I railroads have embarked on an ambitious capital program for the last five years or so and have plans to continue to make the changes necessary to respond to demand.

Inland Waterways – D: The U.S. inland waterway system consists of 12,000 miles of navigable waterways in four systems—the Mississippi River, the Ohio River Basin, the Gulf Intercoastal Waterway, and the Pacific Coast systems—that connect with most states in the U.S.. Because of their ability to move large amounts of cargo, the nation's inland waterways are a strategic economic and military resource. The average tow barge can carry the equivalent of 870 tractor trailer loads. Of the 257 locks still in use on the nation's inland waterways, 30 were built in the 1800s and another 92 are more than 60 years old. The average age of all federally owned or operated locks is nearly 60 years, well past their planned design life of 50 years. The cost to replace the present system of locks is estimated at more than $125 billion. The stimulus funds that were earmarked for inland waterways, but they represent only a fraction of what is needed for maintenance, let alone replacement and modernization.

Ports and Harbors – Ungraded: Due to a lack of adequate data, the American Society of Civil Engineers (ASCE) was unable to assess the condition of, or assign a grade to, the infrastructure of the nation's more than 300 ports and harbors. In 2007, the American Association of Port Authorities (AAPA) — which represents ports in the US, Canada, and Mexico—reported that public ports in the US must invest $1.7 billion annually to update and modernize their facilities. Ports, which are owned and operated largely by state, local, and private entities, are not required to report on the condition of their infrastructure to the federal government. US ports connect to 1,000 federally maintained harbor channels and 12,000 miles of taxpayer funded inland waterways, and their landside port infrastructure facilities include terminals, wharves, rail yards, and roadways within the harbor districts. The US has fallen far behind Europe and Asia in its ports and this will impact the competitiveness of our economy in the future.

President Obama's choice of retiring Congressman Ray LaHood (R-IL) for Secretary of Transportation shows his commitment to working across party lines to make government work again. Mr. LaHood's record on transportation issues is neither long nor strong, but his reputation as a committed public servant could serve him well as Secretary. He has more opportunity to shape the economic future of our nation than any of his predecessors in recent memory. The DOT Secretary also can have substantial influence on the effort to restore our economy, create jobs and reduce our oil dependency through a major renewal of our national transportation program later this year. The current transportation law, SAFETEA-LU, expires this year and is due for major reform. Secretary LaHood must provide

vision and insight, not just in crafting a new approach, but in implementing it after it is adopted.

Expedited Truckload

We know of no significant, ground expedite carrier failures since our last report. Likewise, there have been no major acquisitions reported. That said, the economic headwinds for ground expeditors are the same as described in other parts of this report, with the notable addition that the expedite carriers are unusually exposed to the travails of the auto industry. FedEx displays their financial results in aggregate format so their Custom Critical business, the self described "largest time specific, critical shipment carrier," is not shown independently. Rather, it is included in the FedEx Freight segment of their corporate report. However, results for FedEx Freight are suggestive. For the quarter ending 2/28/09, the FedEx Freight segment reported a $59 million dollar loss, representing a $105 million dollar negative swing from the same quarter the previous year. Express 1, the only publicly traded ground expedite carrier, reported a $27,000 loss for its' Express 1 expedite division in the first quarter. This is down from a $960,000 profit for the same quarter in the previous year. The ground expedite carriers have been adversely affected by not only the declines in the general economy, but also by dramatic decreases in their core business – the automotive manufacturers and their suppliers. In response to deteriorating market conditions, Express 1 reports that they have had staff reductions, hours reductions, wage freezes, benefit eliminations and reductions in travel and entertainment expenses. Ground expedite carriers we talk to all report they are trying to diversify into other industries to reduce their reliance on the automotive industry.

Expedite freight goes by many names; premium freight, exception freight, deviation freight, etc. Whatever the name – management of the freight expense is essential. We believe that there will always be a need for expedites but that the costs can be intelligently managed with strategies and plans that are developed in advance of the need for the expedite service. Expedite freight is a much maligned mode of transportation. Expedites are usually tendered under some pressure, circumstances in which cost is relegated to a secondary factor. It's at the end of the month (hopefully), or the end of the year when accountings for expedite freight are required that the painful discussions are held about the high cost of expedites.

Recently, we have been involved in discussions about the cost of expedites at Schneider Logistics. We represent accounts that fall into three general categories in terms of expedite handling: 1. We have accounts that contract directly with expedite carriers. Usually the number of carriers is small, and represent the usual major expedite names. 2. Some accounts rely solely on Premium Freight Management Websites (PFMW). These are technology driven providers that contract directly with a broad base of expedite carriers. 3. Some accounts use a hybrid methodology, contracting with a handful of expedite carriers and using a PFMW. Expedite tenders go out to the contracted carriers and the PFMW simultaneously. Rate response comparisons are made on both before a tender determination is made.

As a purchasing group we continue to believe that the PFMW model represents the lowest total cost solution if a shipment must be treated as an expedite. We continue to maintain that the overarching goal should be to keep freight out of the premium expedite environment by a variety of alternative means. However, if a shipment requires expedited service, PFMW do have the following benefits:

- Standardized format for defining shipment requirements.
- Fast means for requesting quotes from a broad base of expedite carriers (Note: the PFMW model removes the need for direct contracting with the expedite carriers)
- Formatted responses in defined time parameters to allow the selection of the best carrier fit for the specific move, quickly.
- Simple tender process.
- Post tender monitoring by the PFMW provider.
- Detailed, account specific reporting on a monthly basis.

Our data, though incomplete, suggests that on the average, the PFMW model results in lower costs for moving specific shipments. In particular, we recently reviewed a data set from an account that uses the hybrid model and found that the PFMW was utilized 80% of the time over contracted expedite carriers. For the 20% of the cases that the contracted carriers were used, the saving was approximately $107 per shipment. Once administrative costs are considered for the additional labor associated with the directly contracted carriers, we believe that the net savings for the directly contracted carriers is neutral at best. We are continuing these investigations.

To sum up, paraphrasing an executive in the expedite industry, “premium freight is a strategic tool, not a (band-aid) for failed processes.”

LTL

The first topic of any LTL discussion focuses on the status of YRC, Inc. Status updates on their credit and labor issues are occurring weekly and add a sense of unpredictability to this difficult situation. While this is a forward looking document, these statements reflect what has been seen as of the date of this writing. Clearly there will be changes based on unforeseen market and banking forces.

The fortunes of the YRC companies have changed from that of a superstar transportation company in 2007 to a battered, billion dollar LTL giant trying to survive into 2010. YRC’s financial woes dominate the internal planning within the family of companies while management attempts to defend the organization’s reputation from the Wall Street analysts and their competition. YRC’s biggest allies are three partners few industry experts would have expected.

The Teamsters have actively engaged themselves in wage reductions and have pushed their independent pension boards to relax pension funding requirements of millions of dollars in exchange for real estate property of uncertain market value. The second group is the seventeen major financial institutions that continue to rework and lower debt covenants to the most minimal of levels. Under “normal” business levels, these institutions would have acted to assume YRC in its entirety. These institutions are presently facing their own crisis of toxic assets and the prospect of adding another toxic asset in the trucking sector is something they don’t want. The third partner would be competitors of YRC, like Estes Express. Estes Express is a family owned $1.5 billion national LTL carrier who is buying up YRC terminals to lease back to YRC. Without this funding, YRC would not have the capital to operate. The value to Estes is the ability to hand pick only the terminals they want and need for future developments, yet buying these select terminals at “fire sales” prices while having an immediate tenant (YRC on a lease back arrangement).

A migration of YRC talent to family run LTL carriers has contributed to the continued cross-pollenization of new business concepts and practices across the industry. Most notably, Holland’s former president has taken over the controls at R+L Carriers and a YRC Senior Regional VP is now president of Milan Express. Of even greater importance is that many other YRC managers and sales staff have reappeared with regional or family based LTL carriers, bringing new ideas and different experiences with them to strengthen these carriers.

The short term future of the LTL industry will certainly revolve around YRC. While we don’t expect an immediate exit of YRC because of the reasons noted above, its departure from the LTL arena would fill capacity and drive pricing upward for the foreseeable future. YRC could also create challenges for customers in validation of their rates and freight payment as outside creditors seek to regain as much of YRC’s outstanding receivables as possible. Issues of cargo claims and missing freight will absorb the focus of 3PLs and customers alike.

This leads us to the present status of the other LTL carriers trying to survive in this market. Peer competition has always been aggressive but many of these carriers find themselves in a better financial position than YRC. We believe the company bit off more than it could chew and planned poorly for the integration of Yellow and Roadway. We want to avoid the appearance of being armchair quarterbacks but, hindsight being what it is, it appears that true integrations efforts came too little, too late. YRC simply grew too fast and lost their ability to compete on the street. In the 90’s, many big carriers, like YRC, migrated to large financial institutions who are now facing major problems of their own. Smaller trucking companies have maintained their banking relationships with local banks that have a significantly better balance sheet than their large counterparts. This gives more flexibility to these regional and family owned LTL carriers. Many of these carriers, because of their size and freedom from shareholder scrutiny, are more nimble in their decision making and have a better “hands on” relationship with the daily operational and administrative functions affording them better cost control.

We are also seeing a positive switch in management philosophy by many LTL carriers. Con-way has broken away from the old CF management style (CF founded Con-way). The closure of their regional headquarters and consolidation of senior management at a Michigan headquarters has enabled Con-way to be more proactive and keep themselves in front of the competition. This is reflected by Con-way regaining profitability in March (and forward), when others haven’t. Another example of Con-Way’s forward thinking was their closure of a limited number of terminals based on aligning workload and productivity. This change resulted in a better service product but was also a definite help in the financial

downturn. Con-way's new management structure has built better customer relationships and more realistic pricing and contract. Most notably, Con-way's new program to move truckload like volume at LTL pricing levels could have a significant effect on industry norms in freight flows and pricing methodology.

LTL carriers, as a group, have tried to "right size" their companies to accompany the 15.5% average tonnage decline. As a group they have seen their yields decline by 8%, pushing operating ratios over 105 for the group of publically held carriers. Of the group, two carriers seem to be the exception to these poor statistics. Con-way, as previously stated, has been proactive and innovative, leading to these positive results. Old Dominion took a different approach, quietly downsizing their labor force a year and half ago, driving better results.

It should be noted that many companies in the LTL industry are privately held and are not obligated to report their financial levels. Carriers, small and large fall into this segment. Estes (national), R+L (national), AAA Cooper (regional), Averitt (regional), Southeastern (regional), Wilson Freight (regional), Dayton Freight (regional), A Duie Pyle (regional), Ward (regional), Pitt Ohio (regional), DATS (regional), Oak Harbor (regional) and Peninsula (regional), reflect that a large segment of LTL carriers are privately held. When we have been compelled to delve into these carriers' financials, they have provided us with support reflecting that, on average, they are financially viable with the ability to weather the economic storm.

It must be noted that it would not be unexpected to have a failure in this group. However, it appears the carrier community as a whole has made the necessary operational, staffing, external banking and vendor changes to survive the existing market conditions. We see the emergence of a marketing strategy known as "bundling" by two carriers. FedEx and UPS have always paid lip service to this collaborative approach to their service offerings but have never cracked the code on selling customers on multiple services and modes under their one brand. We are seeing a spike in joint calls from these carriers combining sales presentations from their ground, small pack, LTL, truckload, air freight, international and supply chain services. While the branding and marketing work appears to be gaining traction, we believe both companies, but FedEx most specifically, have a way to go before truly streamlining their pricing practices across what may have been multiple regional operations previously. This strategy may eventually become successful but anecdotal evidence from sales representation as well as other shippers still shows some reluctance. If they can make it work, it is certain that both competitors would capitalize on their unique position in the LTL industry by leveraging their other mode strengths to solidify their LTL presence with a customer. Securing this position creates a "cost to change" for a customer that assures continuing dominance for either carrier within that customer's distribution network. This could signal stronger profits for UPS and FedEx in their freight divisions in the future.

Emerging from the economic recession, LTL carriers will have fine-tuned their operational network to its maximum efficiency. If the predictions of a jobless recovery are true, the LTL carriers will see an available work force of 700,000 available drivers to join their ranks. These positions will be desirable, Monday to Friday, day jobs. This will give the LTL carriers a better labor position than the truckload segment. Longer term, family owned carriers could also see opportunities to exit the LTL business. Carriers like Vitran, SAIA and many other super-regional LTL carriers will seek to expand. Smaller, private firms with select regional niches needed by these superregional carriers could view the economic recovery as a good time to maximize their returns and exit the business. This would create larger LTL carriers and further limit the competitive base in this business.

Intermodal/Rail

Volumes in the rail industry continued where they left off in the fourth quarter with volume declines reaching double digits in many of the commodity segments shipped across the country. While things had appeared to stabilize mid way through the first quarter, volumes took a turn for the worse beginning in late March and into April. Volume declines in the housing and automobile sectors hammered rail carloadings which dropped 13.7% year-over-year. This drop represented the tenth consecutive quarter of year-over-year declines primarily as a result of continued weakness in those sectors as well as the overall challenging economic environment. Average volumes for the US Class 1 railroads declined 17.6% year-over-year in the first quarter. Looking at the full year 2009, volumes will decline on average 17.6% in the second quarter, 11.2% in the third quarter, and 4.2% in the fourth quarter until turning positive in 2010.[19]

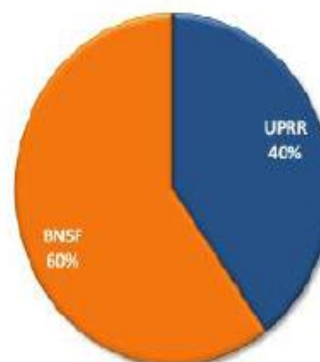
---

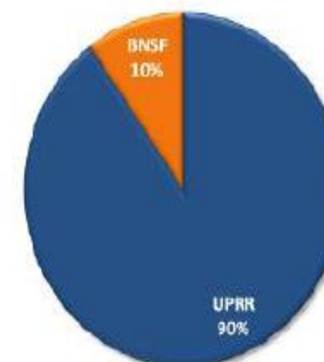
[19] Morgan Keegan & Co.

The efficiency and productivity improvements that have been a trademark of the railroad carriers over recent quarters continued into the first quarter of 2009 as the carriers had to find ways to cut costs and improve productivity measures during the worst freight recession in decades. These improvements, combined with substantially lower fuel costs, helped to partially offset declining volumes in an unstable freight environment. Productivity is best measured by velocity (average train speeds) and terminal dwell times.

Available capacity continues to be the story for the rail industry as huge numbers of freight cars sit idle on tracks across both the US and Canada. There is said to be an estimated 223,000 parked cars in storage that can very quickly and easily be absorbed back into the network once the economy starts to rebound. While storing this equipment can be difficult at times as to where to put them, this headache is more than offset by the fact that with fewer cars on the mainline it allows faster asset turns. The result is the overall North American network cycling 12% faster YTD versus the same period last year. This cyclical boost in asset turns is considered normal in recessions and acts as a partial offset to the financial damage done by lower volumes. As a percentage of cars on line, each rail has between 14-25% available capacity which should prove ample in anything but a strong "V" recovery.[20]

Intermodal provider Hub Group has elected to shift the majority of its western-U.S. box loads to the Union Pacific Railroad from the BNSF Railway. It is estimated that over the next three months Hub will shift approximately 8,400 boxes but leave about 1,400 with the BNSF to handle in strategic markets like the Pacific Northwest where the BNSF provides excellent service. It is thought that the switch should drive increased savings from only having to manage one rail provider. This current move is contrary to Hub's past strategy which has been one of flexing from rail to rail based on service performance and customer needs. It is speculated that Hub would gain better pricing with the Union Pacific by consolidating more volume there to reap incentives but Hub executives have denied that its existing economics with the UP or UP's rate discipline has changed.[21]





Railroad Legislation

Earlier this year, seven US senators led by Herb Kohl of Wisconsin introduced the topic of removing antitrust exemptions currently granted to the railroad industry. Their legislation, titled the Railroad Antitrust Enforcement Act, was touted as the bill that would bring the freight rail system under the nation's antitrust laws and provide needed protection to farmers, manufacturers, and electricity consumers. They also stated that the lack of railroad anti-trust compliance has caused rail customers to suffer from increased rates and decreased quality of service, which they contend is largely due to a lack of competition among freight railroad operators. The idea of promoting competition and protecting consumers were the prime motivating factors when Congress in 1980 passed the Staggers Act. The Staggers Act provided a government agency, now the Surface Transportation Board (STB), with the ability to prevent monopoly abuses of those shippers left captive to just one railroad, and to make sure that the railroads in competitive situations were able to operate in such a way in order to be profitable. Somewhere along the way the part of the STB mandate to protect shippers has been ignored or has become less important to the fact that the railroads need to be profitable.

[20] UBS Investment Research
[21] Journal of Commerce

In March of this year, Jay Rockefeller along with several of his colleagues introduced the Rail Competition bill. This bill is designed to:

- Ensure rail customer access to rail competition
- Ensure a workable rate challenge process at the STB for rail customers without access to transportation competition
- Unlike the Antitrust bill, this legislation would overhaul the STB and ensure a proactive STB
- Clarify and enforce the railroads' obligation to serve their customers
- And provide for an arbitration process allowing carrier and agricultural rail customers the opportunity to work out their differences without extensive litigation

The possibility that the Antitrust bill would be the only rail legislation that would make it to the Senate floor in 2009 caused both authors to withdraw their legislation from senate consideration and announce on June 2nd that they reached an agreement to include antitrust legislation in a different bill aimed at overhauling the STB. Both share the common goals of addressing the longstanding concerns of rail shippers and making the rail industry more competitive. The new joint legislation should be coming out in July or August.

Bulk

Recession Impact

January to April 2009 tank truck revenue was down just over 30% compared to the same period in 2008. Tumbling from a high in March of 2008, volumes are off by 30% as well. Volume has continued to drop, with March being the only month that did not exhibit a volume contraction over the last 7 months. Consumer and industrial goods are driving the slump. IHS Global Insight estimates general commodity truck traffic to increase 2.3% per year from 2009-2014. Bulk commodity truck traffic is forecast to increase only 1.9% per year over the same period.

Other News

Insurance: Results from the Transportation Insurance Pricing Survey (TIPS,) benchmarking Insurance availability and rates, was released by NIP Group for Q1 2009. "The trend toward rate increases was most noticeable in small accounts (those with premiums of $75,000 or less) and medium-size accounts (those with premiums between $75,000 and $250,000. This trend has even begun to manifest itself in large accounts (those with premiums of more than $250,000), which have not been similarly impacted in previous quarters. Several segments have reported flat rates or slight increases, including Trucking, Intermodal, Specialized, Riggers, Charter/Tour, and School Bus. Bulk and Airport Ground reports are mixed with some acknowledging decreases compared to the prior quarter and others reporting significant increases.[22]

Flatbed/Specialized

As we move into the second half of 2009, Open Equipment Carriers have struggled greatly. If there is a surprising nugget in all of this, it is that more capacity has not exited the marketplace. Discussions with carriers bring out a variety of underlying reasons for this. As fuel prices moderated late in the year, free cash flow improved for many carriers, allowing them to ride out the weak market longer. Many carriers anticipated the Downturn, and with the 2001 recession still in recent memory, many carriers acted earlier than normal to the weakened market. Banks do not want to own equipment, and in some cases are taking extraordinary steps to avoid repossessing equipment while limiting additional exposure.

The current market balance between flatbed capacity and demand in early June is at levels that traditionally are normal for early March, but is on an upward trend. Normally the market peaks in about a month and then falls steadily toward the low in December. 2003 was an anomaly in that trend with the market topping in July and remaining flat for the remainder of the year.[23] If 2009 follows that path, 2010 could be a repeat of the 2004 flatbed marketplace, which saw large imbalances of freight and capacity, with trucks in many cases either abandoning traditional customers in pursuit of higher priced freight, or threatening to do so if price increases (sometimes significant) were not forthcoming. For that scenario to play out, some additional capacity would have to exit the marketplace.

If such an imbalance occurs again, customers who do not have excellent relationships with their carriers should expect a loss of capacity, higher rates, and perhaps even punitive pricing as carriers will again have the upper hand in negotiations. Many carriers will look at the increased prices as a way to fix

---

[22] Bulk Transporter, June 2009

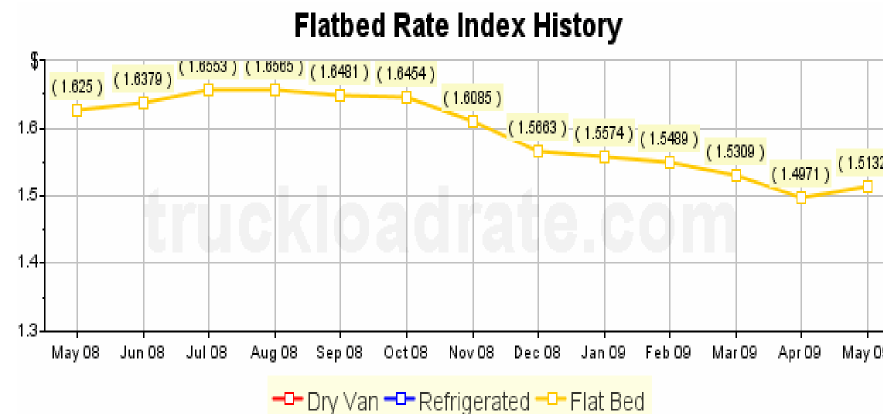
[23] Morgan Stanley Truckload Freight Index Update 6/14/09

recession damaged balanced sheets and recapitalize equipment after 2 or 3 lackluster years. In 2004 when this happened, some carriers irreparably damaged relationships with some of their shippers with repercussions in the current downturn. Carriers see some shippers doing the same sorts or things as everyone scrambles for savings and puts further pressure on rates.

The ATA (American Trucking Associations) reported that March flatbed freight volumes were the lowest in 10 years, and that was followed by an April report showing the largest year-over-year decline since they started tracking the data. In addition, the rates appear to have caught up to the lack of demand, as seasonally adjusted revenue was down almost 36% year over year.[24]

As Federal Stimulus dollars still have not made their way into the economy in any significant way, the efforts made in "Infrastructure Spending" are not yet having a positive impact on the open equipment sector of the Industry. Small Carriers that are dependent on a single shipper for the majority of their revenue are particularly hard hit. If the shipper has closed the site(s), the carrier is now left without a stable, regular income source. If the shipper is also under financial pressure, they are likely to be allowing and even encouraging a race to the bottom from a rates perspective. Finally, if the shipper's volumes are merely down, the carrier is left with little choice but to reduce the number of trucks they are running. If those units are financed, it leaves the carrier with a much higher burden of fixed costs against a reduced revenue base.

Regarding rates, there appears to be at least a 7% decline in line haul rates year over year in the Flatbed market depending on your source. This decline is greater from a percentage basis than that seen in the Dry-Van truckload market (estimated 6%) and is compounded by the fact that most flatbed carriers operate at a lower ratio of billed to empty miles than do most van carriers.[25] The phenomenon of chasing freight for flatbed carriers is alive and well. If there is a positive note to the chart below from a carrier perspective, it is that the average rate paid in May appears to be higher than that paid in April. That said, there may be outside factors at play as well, as there may have been regional differences or a shrinking length of haul on an overall basis that could be skewing the numbers.



If the Length of Haul is driving the average rate up, it has negative implications for carriers attempting to maintain or improve their billed ratio.

Another source paints an even more unpleasant picture for the survivability of carriers with a 30% decrease in Flatbed rates year over year. Again they show that Flatbed carriers are taking it harder than van carriers in this economy as Van rate decreases are over 20% but less than 30%. The rate decrease is not linear with regard to demand decrease, as their market intelligence shows that demand is down 14% year over year.[26]

The question remains – will the economy recover enough to allow for continued survival of the majority of current Flatbed carriers. If the answer is yes, then the capacity demand balance for the majority of shippers will be tolerable as the economy recovers. If the answer is no, then shippers who have protected their carriers and truly enjoy good long term relations with them should be able to reap the benefits as rates increase and capacity shortfalls become commonplace.

[24] American Trucking Associations Trucking Activity Report 6/17/09
[25] Truckloadrate.com

[26] Cleveland Research Monthly Surveys

Maritime/Domestic Water

As a part of the December 2007 Energy Independence Act, the Secretary of Transportation was directed to establish marine transportation programs to mitigate ground transportation congestion on America's highways. The department within transportation that is responsible for promoting marine highways is the Maritime Administration, commonly known as MARAD.

Under the Act, MARAD is required to report to Congress the progress they are making in promoting and establishing marine highway activity. Marine Highway activity is nothing new. In the 40's and 50' the Detroit automakers moved automobiles across the Great Lakes on large ferries to connect with railroads in Eastern Wisconsin to move automobiles west. The impetus was to avoid the severe rail congestion in the Chicago yards.
The cornerstone of the current argument for marine transportation is the familiar slide we've seen depicting truck congestion on America's interstate system like the one shown here. The scene of cars and trucks tied up for hours in metropolitan traffic is very familiar to anyone who travels on a regular basis.

The proponents of domestic marine transportation point out that over 40 states are accessible by water: The Atlantic and Pacific oceans, the Gulf of Mexico, Great Lakes, and navigable waterways. The entire push for marine highways is to take trucks and containers off the highways and move them, for at least a portion of their journey, on water.

Advocates not only argue the benefits of physically removing trucks from the highways to remove congestion, but also point out the substantial "Green" benefits from moving trucks from highways to water. Towed barges are estimated to produce 28% less CO2 per million ton miles than trains and a whopping 73% less than trucks. One barge capable of handling 1,500 tons could handle the equivalent of 58 trucks. A fifteen barge tow capable of handling 22,500 tons is the equivalent of 870 trucks.

So, it seems as though all the right reasons exist to move some trucks off the roads and onto the water. What are the obstacles? There many obstacles but the largest is economics. At the present time it does not make sense economically to move trailers and containers on the water domestically for long distances around the contiguous 48 states. We know of a major Jones Act carrier that moves 53 foot trailers on self propelled vessels that has studied the costs of marine service on the east coast between Jacksonville and Newark. The study showed that service between these two ports would be 3 ½ days and that they would have to capture 65% of the existing truck traffic on this eastern seaboard lane to be economically viable. This is viewed as a virtual impossibility since a large portion of this traffic is made up of 1 or 2 vehicle truck owner operators. The target price for barges to compete with trucks is about $1400 per load. A major factor that has worked against water service is the rapid decline in diesel prices. Studies have shown that water becomes more economical as length of haul increases and fuel prices rise.

Additionally, marine transport has many more moving parts than simply driving a truck between two points; somewhat comparable to intermodal service but with more stakeholders. Stakeholders include: shippers, longshoremen, stevedores, multiple state jurisdictions, port authorities, truckers and dray operators, U.S Maritime Administration, various law enforcement agencies, tug and barge

operators and maintenance vendors, to name a few. Other obstacles are Jones Act requirements regarding vessel construction and crews and federal harbor tax rules.

Despite the obstacles, there are startup barge operations working today. Eco-Transport has started a container-on-barge service from Oakland, CA to retail distribution centers located in the San Joaquin Valley and Stockton, CA. The atmosphere in the San Joaquin Valley is ranked among the worst in the country for particulate matter and ozone. Eco-Transport's stated mission is to convert one million truck trips to Marine Highway.

The James River Barge Line, called the "64 Express," established container-on-barge service from Norfolk, Va. to Richmond, VA., in December 2008. The company's stated goal is "… (To) provide the most cost effective, reliable, and environmentally-friendly mode of transport." Columbia Coastal has reinstituted a container-on barge service from Portland, ME to New York. The primary customer on this venture is a Maine pulp mill that is exporting product overseas.
Despite these commendable start-ups we believe that a viable long distance container/ trailer-on-water service is still some years away.

Ocean/International

Market conditions have remained relatively soft as we enter into what is typically considered the peak season of summer and the early fall months. Rate levels on the key head haul lanes from Asia to North America remain under tremendous stress that are not sustainable without serious consequences to the trade. During a recent interview with Bloomberg News, Maersk Line CEO Eivind Kolding predicted 2009 will be a year of substantial loss and 2010 will be equally difficult. "Freight rates are down to 1990 levels pushing operating margins to record lows".

However, there are some positive signs to report as we enter into the 2nd half of 2009 which may lead to signs of a slight recovery in the 3rd and 4th quarters. The number of vessels idled peaked in March of 2009 when there were 241 ships representing approximately 1.04 Million twenty foot equivalent units (TEU) of capacity laid up out of service.[27] The net result of this excess capacity in the market was continued pressure on the freight rates which hit the floor in April when Hong Kong to Long Beach rates were as low as $750 per forty foot equivalent unit (FEU) all in. Long Beach to Hong Kong rates for wastepaper and plastic scrap, the base export commodities from the region bottomed at $250 per 40 std all in. As of late May, 199 vessels representing 790,000 TEU of capacity remained idle, so gradually capacity was being placed back into service to meet demand. Rate levels have increased as well to the $1000 per FEU, but this is still very low and cannot be sustained over the long haul without severe consequences. New vessel deployment schedules are beginning to take shape, routing cargo on an "all-water" course from Asia through the Suez before calling on the US East Coast ports. Analysts have noted that the falling value of the dollar also contributed to this pattern, as traders realized the obvious benefit of off-loading some goods in the EU before reaching US destinations at New York, Charleston, and Savannah.

The Panama Canal has experienced a resurgence of traffic, bringing more cargo to Houston and other US Gulf ports. The Canal's expansion project will build a new lane of traffic along the Panama Canal through the construction of a new set of locks, which will double capacity and allow for increased traffic and wider ships. The construction of the two locks -- one at the waterway's Caribbean entrance, the other on the Pacific -- will cost $5.25 billion, take five years to complete and require 5,000 construction workers. The Panama Canal Authority recently made a public statement that, despite the financial crisis, expansion plans remain on schedule for 2014 which is the 100th anniversary of the canal's original construction. This alternative will prove to be even more attractive to operators of the newest post-Panamax vessels — quarter-mile-long ships carrying 14,000 cargo containers, compared with maximum 4,500-container ships that now transit the 50-mile waterway.

The canal authority maintains that the expanded canal will make Panama an even more important transit hub by attracting a bigger share of Asian container freight destined for the eastern United States. Currently, 70% of that cargo is offloaded at Los Angeles, Long Beach and other North American ports and moved by rail or truck across the country. Nearly half a million jobs in Southern California depend on international trade. The implication here is that the ports of Los Angeles and

[27] Journal of Commerce, AXZ - Alphaliner

Long Beach, as well as the major rail lines could potentially see a huge drop in volume as shippers are able to reach alternative ports.[28]
The canal expansion project is already having a ripple effect in Southern California. The Los Angeles and Long Beach ports have each launched expansion and streamlining projects valued at hundreds of millions of dollars to improve their competitiveness with an expanded Panama Canal. Los Angeles' plans include the expansion of three terminals and improved wharf access for Union Pacific and Burlington Northern Santa Fe rail lines while Long Beach has put in motion a 10-year plan to invest $1.6 billion in upgrades of piers and rail access.[29] Similarly, US ports on the Eastern Seaboard may need to make changes to accommodate the biggest ships. Ports including Savannah, GA, Charleston, SC, and Miami are too shallow, and access to the Newark, NJ, port is blocked by the Bayonne Bridge.

Global shipping companies are wary of the rising tolls the canal is charging to fund the expansion. The average toll will be doubled over a 20-year period that began in 2006. The expanded canal may divert some US freight away from US West Coast ports, but how much will depend on transit times and the effect of the canal's toll hikes.[30]

As a defensive measure, Maersk and other shipping lines serving the Asia-to-eastern US routes are taking a close look at westward routes through the Suez Canal in Egypt. Although Maersk is not yet diverting traffic from Panama, it plans to open a Suez route for post-Panamax ships in the near future, Kristiansen said.

Freight Forwarding

In recent months, oil prices have gradually increased hovering around the $70 per barrel range as we enter the summer. As oil prices rise and demand for services gradually increases, we expect to see more pressures on rates during the 3rd quarter. Most experts feel that ocean rates to the West Coast ports of Long Beach, Los Angeles, Seattle, and Tacoma will remain relatively low over the next twelve months. Combined with a softer than anticipated truckload and intermodal market, shippers are favoring the increased routing flexibility afforded by transload/warehouse operations. We also see this trend becoming more attractive in the East Coast gateways of Savannah, Charleston and Norfolk as transit times to these ports have improved tremendously from South China.

Charter rates for bulk ships hit bottom in the first half of 2009 and as China has become to import raw materials again, demand and rates have increased significantly. As a result, some commodities such as grain that was moving via break bulk services will once again shift back to containers creating more opportunities to street turn empty containers in regions such as Chicago.

Legislative Issues

Legislative mandates continue to impact the cost of moving goods through the key Long Beach and Los Angeles gateway. The controversial Clean Truck Program is before the Federal Court in California however, the $35 TEU fee is being collected until the courts determine the legality of the mandate. The Port of Oakland and other ports are watching this case carefully as they have similar plans that will go into effect based on the outcome of this controversial program. It should be noted that development of strong environmental policies such as utilization of trucks that run on alternative fuels like liquefied natural gas (LNG) is not the basis of the debate on the Clean Truck Program as the industry is committed to taking steps that are environmentally responsible. The primary issue is whether or not a port has the authority to mandate a driver to give up ownership under the Independent Owner Operator model in order to conduct business within the port facilities. Once this case is settled in the Federal Courts, we anticipate the other port facilities will move forward with similar programs that will be restructured to meet the court requirements. In the long term, the port of LA/Long Beach may be seen as progressive and on the leading edge of port reform but, in the short term, programs like this make this vital gateway more expensive than its counterparts on the East Coast and, as a result, we see volumes growing at the Port of Georgia in Savannah and the Port of Virginia in Norfolk.

Customs Issues

New customs regulations will have a dramatic impact on the flow of goods in the coming months. The introduction of the 10+2 regulations represent a new set of data elements that must be provided to US Customs in advance of the cargo loading the vessel. This regulation has far reaching implications within the supply chain. The carrier, importer, surety and broker all face penalties and sanctions if the Importer Security Filing is not filed within the required time period.

[28] Drewry Shipping Consultants, Ltd.
[29] Los Angeles Times
[30] Maersk

In October 2006, U.S. Customs and Border Patrol (CBP) signed into law the Security and Accountability for Every Port Act (SAFE Port). The SAFE Port Act sets forth requirements to enhance the capability of CBP's Automated Targeting System (ATS). The required elements will allow CBP to further screen cargo for risks prior to it entering the US Currently, the Importer Security Filing ruling only applies to ocean shipments that call a US port directly. Initially, shipments moving through a Canadian or Mexican port and trucked to a final US destination would not be affected.

The passage of the Lacey Act promises to make the importation of wood and wood products more information intensive. The Lacey Act requires that the entries for certain plant based products be accompanied by a "Plant Product Declaration." The declaration specifies the genus of the plant product as well as the actual supplier. This is another regulation which requires that the importer be familiar with their imported products on a "manufacturers" level and will be held accountable to report this information to US Customs and the USDA.

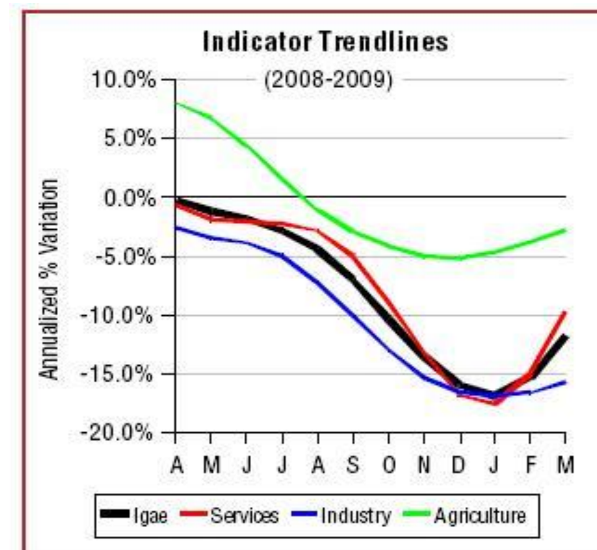
CBP has made tremendous strides in the development of strong outreach programs for both the trade and importers with regards to C-TPAT. Due to a much higher level of awareness, C-TPAT validated 3,011 supply chains, representing a 27% increase since2006. Of the 3,011 validations conducted, 601, or 20%, were revalidations. This was the first year that C-TPAT began re-verifying supply chains. The resounding message CPB is sending out to the trade is to make sure you know your product and who you are doing business with. Failure to know your product and your vendor will result in costly penalties. We will continue to see this trend of CBP requiring more and more information about vendors, manufacturers and middlemen.

Looking towards the 2nd half of 2009, we anticipate improving market conditions, but it will be gradual as the complexities of the global recession created such a sharp and rapid decline in the industry. Ocean carriers have taken drastic steps to control cost such and many experts feel it will be at least 2 years before carriers return to profitability.

North American Free Trade

Mexico

One full year of mounting economic losses, starting with -2.3 percent in Q308 and -9.8 percent in Q408, and now -5.9 percent confirmed for Q109, has wiped out years of growth and progress. Some industries have been set back a decade in terms of physical output and employment.



In March, GDP began to exhibit signs of stabilization as well. The monthly GDP proxy, the **Igae**, was still spitting out negative annual trend lines, but the pace of decline had clearly slowed. Then in April the **A/H1N1** swine influenza contingency hit. Mexico City schools, restaurants, and bars closed, at least partially, and roughly a quarter of the public decided their best option was to simply self-quarantine at home.

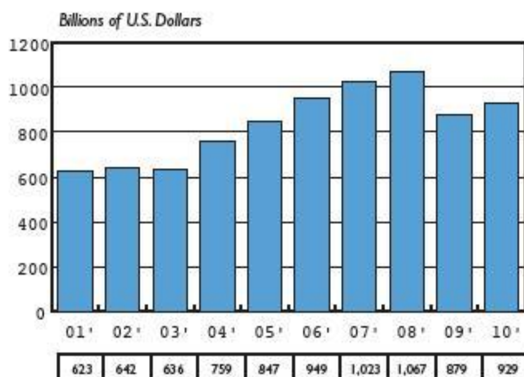
On a seasonally adjusted basis, urban joblessness soared to 7.01 percent of the workforce in April (those actively seeking who could not find even one hour of employment, paid or unpaid, during the reference week), up from 5.70 percent in March. The last time the urban rate hit that level was in 1996, during the jobless recovery from the 1995 recession.

Already, trade was suffering harshly. Total exports dipped by 1.7% (seasonally adjusted and annualized) to $17.82 billion in April. However, stripping out the effect of higher oil prices, non-petroleum exports tumbled 17.3% to $15.84 billion and overseas sales of manufactured goods dropped 23.3% to $14.98 billion. Imports, meanwhile, plunged 35.8% to $18.06 billion. All three import divisions posted losses. Intermediate goods for use in manufacturing dropped 35.6% to $12.99 billion, a definite sign that the factory sector continues to suffer. Imports of capital

goods, a proxy for business investment, sank by 40.3% to $2.48 billion. Consumer goods imports were off 22.3% down to $2.51 billion.

Mexico Gains Four Pegs In The 2009 World Competitiveness Yearbook

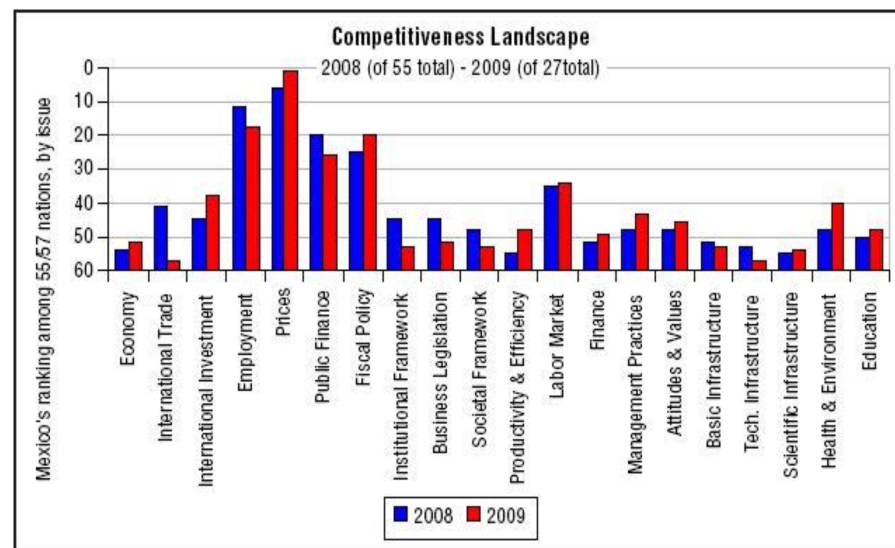
In the 2009 WCY, Mexico placed 46th out of 57 nations. Moreover, the two new countries added to the ranking topped Mexico, meaning that against last year's sample, Mexico would have hit 44th out of 55 – a sizeable leap.



WCY ranks and analyzes how a nation's environment creates and sustains the competitiveness of enterprises using 331 criteria. It divides competitiveness into four basic pillars: Economic Performance, Government Efficiency, Business Efficiency, and Infrastructure. Each category is further broken down into five sub-indicators which highlight every facet of the areas analyzed – thus there are 20 sub-indicators, built in turn by the 331 criteria. Two-thirds of these are hard data, such as GDP growth or number of Internet users. The remaining come from surveys of executives, academics, and other professionals within the countries.

Economic Performance

Once again, Mexico has its best category-wide ranking in Economic Performance at 28th place among the 57 nations, arguably the most important competitiveness category. The positive WCY assessment captures many of the contradictions inherent in the Mexican economy that makes it at once compelling and unnerving for foreign investors and ordinary residents alike. Overall economic output is huge, but not on a per capita basis. Mexico is a powerhouse for exporting manufacturing goods, but has too many eggs in too few baskets

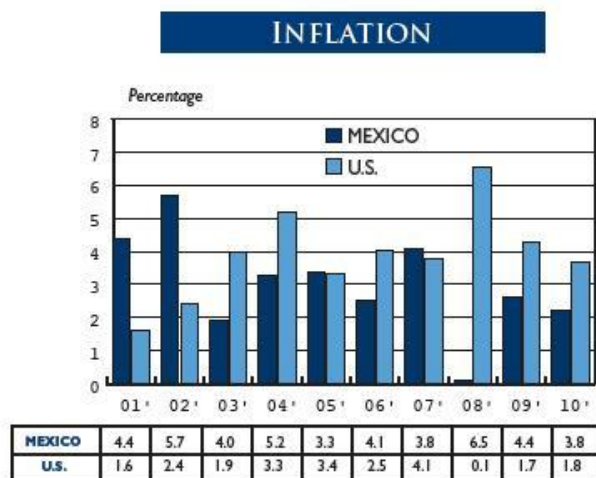


The economy contracted sharply in the first quarter of 2009: gross domestic product (GDP, the measure of the size of the economy) plunged 8.2% compared to the first quarter of 2008 — its largest contraction since the second quarter of 1995. *AMCHAM* expects the economy to "bottom out" in the second quarter but that does not mean that GDP will grow on a year over year basis, which is how growth is reported in Mexico. Measured against the same quarter of the previous year, the economy will contract each quarter of 2009.

The rate at which it contracts will slow in the second half of the year. Measured against the fourth quarter, the economy contracted 5.6% in the first three months of 2009.

In 2005 and 2007, consumer price inflation (CPI) in Mexico was less than in the U.S. It has proved impossible to sustain. Mexico's annual inflation rate should not hit the 3% target this year or next. Nonetheless, the CPI should decline this year for two reasons. One is the sharp drop in economic activity. The other is the government's pricing policy: in the first 18 weeks of 2009, administered prices (prices set by the government) had contracted 9.1%.

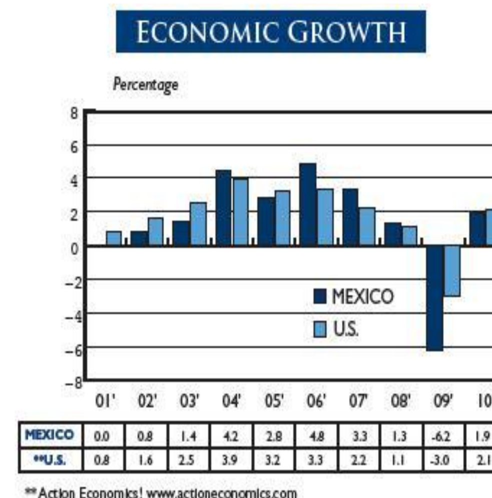
Underlying inflation (the Mexican homologue of the US core inflation rate) climbed 2% in the first nineteen weeks of 2009. The underlying inflation rate excludes agricultural prices and administered and controlled prices from the calculation of inflation. By this measure, inflation has been going in the wrong direction for over 2 ½ years: in the first half of June 2006, the twelve-month underlying inflation rate bottomed out at 3.46%. It subsequently rose, reaching 5.95% in the second half of March before dipping to 5.61% in the first half of May 2009. *Banxico* again modified its projections of the trajectory of inflation but only for this year. In its quarterly *Report on Inflation (January-March 2009),* published on April 29, *Banxico* raised its projected inflation ranges for the second, third and fourth quarters of 2009 by a quarter of a percentage point each quarter. The projected ranges for 2010 were not altered. If *Banxico*'s projections are correct, inflation will average 3.0%-3.5% in the fourth quarter of 2010. That is a full percentage point less than *Banxico* is projecting for the fourth quarter of 2009 and 2.5 percentage points less than it is projecting for the second quarter of 2009.



In the first four months of 2009, Mexico's trade deficit was 38.6% less than in the same period of 2008. Surpluses in March and April kept the trade account deficit to US$1.68 billion through April.

The reason for the shrinkage is simply that the plunge in imports is even larger than the drop in exports: the import bill was 30.7% smaller in the first four months of this year than in the same period of last year, while export revenues were down 30.5%.

Oil revenues were a bit more than three-fifths of their level in the first four months of 2008. Both lower prices and a reduction in volume contributed to the reduction in average revenues, from US$4.98 billion/month in the first eight months of 2008 to US$1.85 billion/month in the first four months of 2009. In each of the first four months of this year, Mexico exported an average of 1,253 mbd at an average price of US$40.79. Last year, Mexico exported an average of 1,403 mbd each month at an average price of US$84.35.



The US recession has battered Mexico manufactured exports, which were 25.3% less in the first four months of this year (83.7% of total export revenues) than in the same period of 2008. Non-oil exports to the rest of the world fared no better than those to the US, plummeting 24.0%, (- 24.3% to the U.S.). Mexico's non-oil exports are inextricably linked to the fate of the automotive sector. Automotive exports to the US, which accounted for 15.9% of Mexico's non-oil exports in the first four months of 2009, dropped 38.0%. Automotive exports to the rest of the world, another 3.2% of Mexico's non-oil exports, plummeted 45.9%.

The peso pulled out of its nosedive in March. After hitting $15.35 on March 9, the fix exchange rate rapidly ceded ground; a month later, a dollar cost two pesos less. In spite of the AH1N1-induced bump at the end of April, April's average monthly exchange rate average was 8.4% stronger than in March. In the first 25 days of May, the fix exchange rate averaged $13.16, a 2.1% appreciation from April. .

Truckin' South

Chicago's Navistar International is mulling the move of some or all of its Canadian heavy-duty truck production to its booming Escobedo plant in Nuevo Leon. "Many

of our suppliers have moved from the Midwest down into the Southwest and even into Mexico and that poses a challenge to our cost structure" in Ontario, said CEO Daniel Ustian, during a conference call with analysts. "The logistics can cost as much or more than putting the vehicles together." In September, Navistar said it would pump $8 million into its Escobedo lines to adapt them to manufacture its ProStar truck, an advanced model touted as the most aerodynamic and fuel-efficient Class 8 truck available. The Ontario plant also makes the ProStar. Several years ago, Navistar announced it would close the Ontario plant and move its operations to Escobedo but agreed to stick it out there after the union agreed to $31 million in cost reductions at the plant. It also received more than $40 million in federal and provincial government money for worker training.

Farewell FAW

Grupo Salinas Motors, the automotive division of Ricardo Salinas Pliego's business empire originally created to build and market cars with China's FAW in Mexico, is pulling out of that project, the company said, blaming the current economic downturn. GS Motors and FAW claimed last March to have broken ground on a new $150-million factory in Michoacan that will have a capacity for 50,000 units in 2010, when the first phase was completed. What the future holds and how much has been invested is unclear but GS Motors will convert its nationwide network of two dozen dealerships, hundreds of Elektra stores, and downmarket bank Banco Azteca to finance and sell used cars. GS Motors began importing and selling FAW vehicles (over 5,000 cars and light trucks to date) after pledging to build the Michoacan facility. With the project on hold, Chinese auto imports will carry a 50-percent duty, thus the decision to switch to the used car market.

Border Region

The Mexican American border region has been feeling the same pain as the US, with volumes continuing to move downward, as a large part of the movement between borders is related to the automotive industry. US and Mexico transportation trade totaled $18.1 billion in February 09, which is down 25.7% from the same period in 2008, and the value of exports carried by truck was 15.4% lower than the previous year as well. Texas led all states in trade with $6.1 billion, followed by California ($3 billion) and Michigan ($1.3 billion). [31]

The decrease in trade across all modes between the US and Mexico has led to a lot of temporary shutdowns in the "twin plants" along the border, as they try to stay open and profitable by running their plants only when they know for sure they are producing based on actual customers orders. These temporary shutdowns, together with the Swine Flu have affected not only the Mexican border region, but all of Mexico.

After being extended past its initial one year pilot timeframe, the open border pilot program that began in 2007 was recently shutdown by the Senate and President Obama. This has caused some angry reactions from the Mexican trucking industry which is now in the process of suing the United States for about $6 billion. CANACAR, the Mexican equivalent of the American Trucking Association (ATA), is behind the lawsuit and pushing hard for the program to be re-established and expanded, hoping this time more Mexican companies decide to take advantage of it. Proponents of the program believe that US opposition to the program was driven by pressure from unions who fear competition and safety advocates concerned over the quality of Mexican equipment. Despite the setback, Transportation Secretary Lahood continues to lobby his congressional peers for cross border truck program that would satisfy our NAFTA obligations.[32]

Canada

The Canadian economy entered 2009 expecting a challenge and, at the mid way point of the year, this has proven to be an understatement. The impacts of the financial market crisis and global recession saw the Canadian economy post its largest single-quarter contraction since 1991. A decline in the first quarter of 2009 by 5.4% has left a steep hill to climb if the economy is to show a positive growth rate for the year. The Canadian government has implemented a stimulus package intended to create jobs and entice spending through large scale infrastructure investment. Combined with record low interest rates and a stable financial sector, this plan should provide some opportunity for improvement. Forecasts indicate that Canada should see a moderate economic recovery in 2010.

---

[31] Bureau of Transportation Statistics
[32] Logistics Management

Declines in manufacturing and the automotive industry impacted the logistics sector significantly. Changes in the rate of merchandise trade were dramatic. Year over year exports into the US in April dropped by a staggering 43.7%. Month over month trends paint a brighter future showing a much smaller March 09 to April 09 decrease of 2.4%.[33] While the Canadian economy has fared better than its southern neighbor, its heavy reliance on cross border trade with the U.S. has left it vulnerable. True recovery for trade will be based on how quickly the U.S. economy recovers.

Truck transportation lost 3,300 jobs in April. This is more jobs than all but two other segments of the Canadian economy, according to the latest figures from Statistics Canada. This loss indicates that the industry continues to maintain excess capacity. Low, stable diesel costs have allowed many providers to continue to survive in this volatile economy and slow down the reduction in the overall available capacity. Until capacity levels are at the right size to match current freight levels, price will not increase. Many carriers have decided to change their long term strategies to better handle volatile market conditions. Canadian carriers are seeking out markets that have growth and potential. Regional operations, intra Canada, expedited and 3rd party movements seem to be the current focus. Carriers are attempting to match their capacity where they feel demand opportunities exist. Finding the most profitable and stable opportunities for their assets while keeping a strong and diversified customer base will be key to surviving the upcoming months.

Expectations from customers continue to put pressure on an already depressed industry. Their basic needs include low freight costs, high service, ensuring security and providing green options. Customers generally have become savvier in the marketplace. They are opting to conduct multiple rounds of bids and tendering freight numerous times throughout the year, hoping to minimize their transportation costs. Other clients are opting to utilize the spot market, again taking advantage of desperately low rates. Seeing rates in the .70-.80 cent range has become all too common. For most service providers this rate barely covers costs. The customer's ability to leverage the abundance of capacity and lowered freight volumes has continued to put downward pressure on price during the first half of the year. A ray of hope did show up during the last few weeks of June as price seemed to stabilize slightly, an indication that prices may have hit bottom and will start to stabilize or even increase slowly in the upcoming months.

Economic pressures were not the only issue for logistics providers in Canada for the first half of the year. One of the biggest events for cross-border providers in 2009 was the Western Hemisphere Travel Initiative (WHTI). A major United States security initiative, WHTI came into effect on June 1st. The new law requires that all land travelers, including both US and Canadian citizens, present a valid passport or other approved secure document when entering the United States from within the western hemisphere. Before the new rules went into effect, land and sea-based travelers were only required to show a birth certificate plus a form of government-issued photo ID such as a driver's license. This initiative forced many transportation providers to spend considerable time and money to ensure that their capacity could meet the new requirements. Hiring and keeping drivers who qualify to cross the border will add complexity and cost for employers, as demand for such qualified drivers will increase. The glut of capacity in the market will temporarily keep these issues at a minimum. However, costs to hire and retain these drivers will certainly increase when capacity tightens. All providers will need to create plans to ensure they have a fleet capable of crossing legally and without issue/delay.

Despite predictions of delays during the initial WHTI implementation on June 1st, very few issues were reported. US Homeland Security has allowed for a grace period of two months following implementation, but has stated that currently very few issues have occurred. Although we are early in the initiative, we have seen no significant problems which could impact the flow of goods. This is a positive outcome for logistics providers who need speed and ease of doing business across the border.

The volatility of the market, dramatic drop in freight volumes, and the resulting lower prices have created a very difficult business environment. Further, increased customer expectations and added complexity in border crossing requirements has severely challenged freight carriers who continue to struggle to control costs. Providers who can set themselves up to navigate through this volatility will be positioned well when the market finally stabilizes.

[33] Bureau of Transportation Statistics, TransBorder Freight Data

Canada requiring speed limiters on CMV's
New laws in Ontario and Quebec require that all trucks 1995 and newer grossing at least 26,000 pounds have a computerized speed limiter activated at or below the maximum of 105 kilometers per hour, or 65 mph. The law affects trucks from the rest of Canada and from the U.S. that travel in Ontario or Quebec.

Ontario and Quebec will begin handing out fines to truckers who do not have a speed limiter activated on their vehicles. The minimum fine according to the Ontario Ministry of Transportation is $250 for a truck found not to have a working speed limiter or if the “anti-tampering” provision has been violated. Maximum fines can reach $20,000. Implementation took effect on January 1, 2009 with a six-month grace period to educate truckers and the public.[34]

Europe

Europe is experiencing a steeper fall than the United States, probably representing the worst point in the economic history of Europe. Analysts think that the recession is likely to continue for at least several more months and that steep rises in unemployment are still likely. The economy in every major European country has fallen this year. While many analysts see signs that Europe is beginning to emerge from its fall, it is still facing a rough ride back because even if growth resumes near the end of the year, it is likely to be modest.

A return to growth is unlikely to ease unemployment. The European Union recently forecast a jobless rate of 9.5% by year’s end, and 11.5% through 2010. The rate hit 8.9% in April. Germany, the largest European economy, led the way down with a 3.8% decline in the first quarter. Current forecasts suggest German output could decline by 6% this year, making for the worst performance by far since World War II. The pain reflects the country’s heavy reliance on exports and the fact that it receives little counterbalancing help from consumer spending. The French economy shrank for the fourth consecutive quarter, with GDP falling 1.2% from the fourth quarter of 2008.[35] And in Italy, the economy contracted 2.4% from the previous quarter, the largest decline since 1980.[36] Spain, the other big euro-zone economy, reported 1.8% shrinkage in the first quarter.

Although consumer spends are low, this is not to say that consumer spend has collapsed (apart from in 'big ticket' sectors such as automotive). It is a case of supply and demand becoming decoupled. Where consumers have continued to spend at similar rates to last year, many logistics companies (especially contract logistics players) operating in the downstream supply chain have continued to do reasonably well. This is borne out by the latest retail sales figures. In Europe, in May 2009, food, drinks and tobacco sales fell by just 1.6% in the EU27 compared with May 2008.

Logistics
Global 3PL revenues are down 8.8% for 2009, impacted mainly by the depressed automotive and retail markets.[37] Expeditors, CH Robinson, Kuehne + Nagel and other major transportation managers reported net revenues have already decreased by between 3% and 10%, and are expected to drop another 5% this year. The automotive and retail industries were the main drags on 3PL market growth for 2009, with projected revenues down 32% and 23% respectively. 2009 will be the first recorded negative year in 3PL gross revenue growth since 1996.[38]

In addition to the aforementioned declining revenue streams within the logistics industry, the risk of increasing fuel prices has also returned. Oil prices are on a high level again. The recent rise comes on the heels of a renewed sense of optimism about the state of the global economy as traders believe that increasing economic activity will boost demand.

Finally, volumes have slumped over the past year, with many logistic companies seeing a fall of 25-30%. Logistics companies have been struggling with their working capital as they try to survive in the current economic environment. Very few 3PLs have been able to reduce costs in line with a fall in revenues. Increasing fuel costs will add to the difficult situation some logistics companies are facing today.

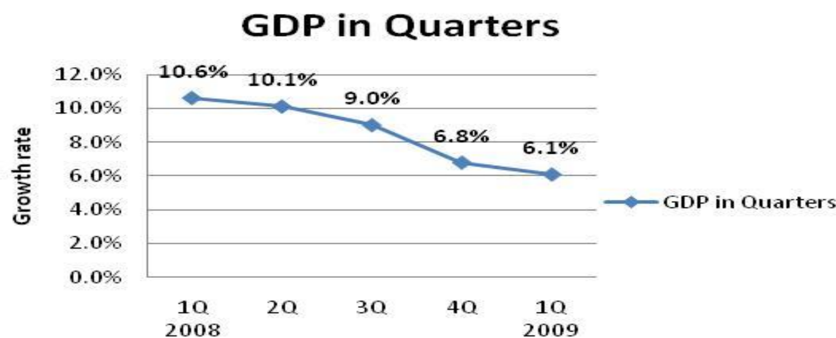
---

[34] http://www.mto.gov.on.ca/english/trucks/trucklimits.shtml
[35] Insee
[36] Istsat
[37] Armstrong & Associates
[38] Ibid.

China

Executive Summary

The financial crisis that broke out last September has led to a global crisis. China's economy is closely integrated with those of its trading partners, so its economic activities have also decelerated since the last quarter of 2008. With the impact from the global economic crisis deepening, analysts believe that 2009 may be the toughest year for logistics in China in the past 30 years.



However, the government injected a RMB 4 trillion investment for infrastructure-oriented projects, which led to 6.1% increase in GDP (over the same period last year) in the first quarter of 2009. With less global demand and declining export growth, China needs more growth from domestic demand. Its government stimulus package lists ten key industries for direct investment; its logistics infrastructure will see immediate benefits resulting from many substantial projects moving forward.

We are experiencing an uptick in carrier pricing attributed to increased fuel and administrative costs but the overall logistics spend growth is still slowing due to overall lower demand. While strong headwinds remain for the international trade segment, it appears the domestic market is poised to continue its growth in the coming quarters. The changing focus from international trade to domestic logistics will keep downward price pressure on the market. However, growth in China's domestic economy and the eventual recovery of import/export trade will lead to pricing stability in the medium and longer term.

Macro Economy

The executive meeting of China's State Council in June concluded that China's economy is at a critical moment in its recovery. The government will continue its proactive fiscal policy and moderately loosened monetary policy. The economy is showing some positive changes in investment and consumption growth and performed better than expected since the government announced a series of measures to boost the economy. These measures included a RMB 4 trillion (USD 586 billion) stimulus package along with plans to revitalize ten key industries. China's GDP reached RMB 6.57 trillion (USD 963 billion) in the first quarter, up 6.1% year over year. The growth rate 4.5 percentage points less than a year ago but only 0.7 percentage points less than the previous quarter.

Even though the 6.1% GDP growth rate in the first quarter hit a ten-year low, the growth rate of fixed assets investment did not show the same pattern. Total investment in fixed assets of the country stood at RMB 2,812.9 billion (USD 411.8 billion) in the first quarter, a year-on-year rise of 28.8% and 4.2 percentage points higher than the growth in the same period last year. [39] Meanwhile, China's retail sales of consumer goods increased 15% year over year to RMB 4.9 trillion (USD 717 billion) from January to May. Even though China's economic growth slowed significantly since last summer, retail sales of consumer goods only shrank slightly. Consumption has become more and more important for the country's economic growth.

GDP Forecast by World Bank

On June 18, 2009, The World Bank's latest forecast for China's 2009 GDP growth was estimated at 7.2%, as compared with the previous estimate of 6.5%, made in March. In its overview, The World Bank stated that even though China's economy has continued to feel the brunt of the global crisis, growth in China should remain respectable this year and the next as, China starts to adopt very expansionary fiscal and monetary policies, and the RMB 4 trillion (USD 586 billion) stimulus package triggers record loans and surging investment.

---

[39] National Bureau of Statistics of China

CPI & PPI

The Consumer Price Index (CPI) fell 1.4% in May from the previous year. The Producer Price Index (PPI) for manufacturing goods, which monitors factory-gate price changes, dropped 7.2% year over year while purchase prices for raw material, fuel and power fell 10.4%. Although both the CPI and PPI remain negative, analysts affirm that the threat of deflation is not as high as it had been at the end of last year, and that both of the indices are likely to register positive growth in the second half of the year.[40]

Foreign Trade

China's total trade activity was USD 763.49 billion during the January through May 2009 timeframe, down 24.7% from the same period of last year. Total export revenue was USD 426.14 billion, down 21.8%, and total import value came in at USD 337.35 billion, down 28%. The total trade surplus was USD 88.79 billion, up 15.7% from the same period last year, and posting a net increase of USD 12.05 billion. The import-export values with China's top three trade partners (the EU, US and Japan) were declining at 22.1%, 17.1% and 24.6% respectively from January to May.[41] Analysts believe that China's negative trade growth in the first half of 2009 is already a sure thing, and that the situation will remain gloomy throughout the second half of 2009.

Total trade in May was USD 164.13 billion, down 25.9% from the same period last year. China's export revenue was USD 88.76 billion, down 26.4% year over year and its import value was USD 75.37 billion, down 25.2% from last May. Compared with April, total trade, export and import figures were down 3.9%, 3.4% and 4.4% respectively.

Stimulus Plan

In February 2009, the State Council approved plans to stimulate growth in ten industries; steel, automobile, shipbuilding, petrochemical, textile, light industry, nonferrous metals, equipment manufacturing, electronics and information, and logistics. The central government has poured in a combined RMB 230 billion (USD 33.7 billion) to the 4 trillion Yuan stimulus package that it announced last November to bolster the slowing economy - RMB 100 billion (USD 14.6 billion) in the fourth quarter of 2008 and RMB 130 billion (USD 19 billion) in the first quarter of 2009.

Promotion of logistics industry growth in China is a major component of the stimulus package for the ten named industries. The planning period for logistics revitalization is 3 years, spanning from 2009 to 2011. The goal in 2009 is to resolve a number of major operational problems faced by logistics companies, and to maintain a stable growth rate within the logistics sector. By 2011, a group of large-scale integrated logistics companies will be built, which are expected to be competitive on an international level, and a modern logistics service system will be established characterizing rational network, sophisticated IT support, energy saving and environment protection, efficiency and safety.

According to the plan, the government will work towards the completion of nine key projects, namely developing an intermodal transportation infrastructure, building comprehensive logistics parks, streamlining urban delivery, developing logistics solutions oriented toward transporting bulk commodities and agricultural products, promoting logistics outsourcing for the manufacturing sector, promoting professional logistics standards and technologies, setting up public logistics information platforms, upgrading logistics technologies and establishing emergency logistics systems.

The plan also proposed the acceleration of mergers and acquisitions among logistics companies to foster a group of large-scale players, speed up the development of international and customs-bonded logistics, and optimize regional logistics networks by giving priority to the development of 9 major logistics regions, 10 logistics channels connecting the different regions, 21 national logistics gateway cities and 17 regional logistics gateway cities.

Second Tier Road Toll Fees

On the heels of its January 1, 2009 fuel tax reform, the Ministry of Transportation (MOT) made a May 5, 2009 announcement that 12 provinces have abolished toll fees for second-tier roads built by the governments on loans with a total distance of 70,800 kilometers. 1,263 toll-collection stations have been removed; these stations account for 65% of the total toll stations nationwide. Second-tier roads are those with a designated speed limit of 60 to 80 km per hour and without a divider or a center line to separate vehicles travelling in both directions. The second-tier toll roads account for more than 60% of all toll roads in the country.

[40] Ibid.

[41] General Administration of Customs

According to the MOT, the 12 provinces essentially cover all eastern and middle regions, with the exception of the three provinces of Guangdong, Shanxi and Zhejiang. These three provinces will lift the second-tier road toll fees in phases by the end of 2012.

Taxation Proposals by CFLP

Earlier this year, China's Federation for Logistics and Purchasing (CFLP) proposed ten pieces of taxation improvement for the logistics industry that are currently under review by the Ministry of Finance and State Administration of Taxation (NDRC). The proposals represent the CFLPs work with various industries across China. The key proposals include:

- Favorable taxation support for logistics companies during the 3-year logistics stimulus plan of 2009-2011, including a 50% business tax reduction for logistics companies (to help them weather the economic crisis)
- Tax rebates for corporate income tax
- Tariff reductions and exemptions for large-scale imported logistics equipment
- A unified business tax rate of 3% across the entire logistics industry. (Current taxes for logistics services are levied in two categories: 3% for transportation, loading, unloading, and moving; 5% for warehousing, delivery and brokerage. In practice, however, the above processes are connected closely in operations. The current taxation system hinders the integration of logistics operations and is not beneficial for tax collection or management. The proposals call for uniform declaration and payment of corporate income tax to be allowed for logistics companies that combine headquarters and branches into one entity. The prepayment of income tax at both headquarters and branches levels would be abolished in light of the integrated operation of logistics network.)
- Adoption of a unified invoice for the logistics industry nationwide. (The current invoices for logistics services are varied with different formats, usage scopes and requirements that may cause overlapping tax burdens for logistics companies and cause difficulty during collection.)

Gasoline and Diesel Prices Raised

Crude oil prices jumped 30% in May, the largest monthly rise since March 1999, bolstered by expectations of a global economic recovery later this year. Retail prices in China fluctuated more frequently this year, from the slight decrease in January to the three consecutive increases in March and June. The most recent increase in gasoline and diesel benchmark retail prices was just announced by NDRC on June 30, 2009. Retail prices increased by RMB 600 (USD 87.9) per ton equating to an 8% increase for gasoline and a 9% increase for diesel.

The increase was in response to rising international crude prices and was determined by the country's new fuel pricing mechanism, according to the NDRC. Under the new mechanism, China's domestic prices are "indirectly linked" to global crude prices "in a controlled manner". China adjusted its domestic fuel prices when global crude prices reported a daily fluctuation band of more than 4% for 22 working days in a row. The NDRC explained the "indirect link" as "based upon average global crude prices, while taking into account domestic production costs, taxation, and appropriate profits for oil refiners".

MOT Restructuring

In March, the State Council approved an internal MOT restructuring plan just one year after the new MOT was formed. The former Highway Administration Department was replaced by the Highway Administration Bureau, which does not assume the same functions as the former Department and will not deal with logistics business any more. It will manage all matters related to highway infrastructure once construction has been completed, including highway management and maintenance, toll collection, and drafting of highway technical standard. The former Waterway Administration Department was replaced with the Waterway Administration Bureau. Its organization and function remain basically the same as before.

Two new departments were set up; the Department of Road Transportation and the Department of Safety Supervision. The department of Road Transportation took over the function of transportation management from the former Highway Administration Department and added a number of new functions including administration of city bus, subway, and taxi and administration of the logistics sector. The new Department of Safety Supervision is responsible for supervising transportation safety, a function that had been managed separately by the safety divisions of waterway, highway and ocean departments before.

Export Tax Rebate

Though China has been trying hard to boost domestic consumption and demand, stabilizing export activity has always been one of the government's targets as exports account for approximately 40% of China's GDP. The Ministry of Finance announced on June 8, 2009, that tax rebates were increased anywhere from 5 to 17% on export products, including ethanol, toys and sewing machines, effective June 1, 2009. The export tax rebate scheme allows companies to recover part or all of the money they have paid in value-added tax, (up to 17%), for items that have gone into the production of export goods. This is the seventh time that the government has raised tax rebates for exporters since August 2008, when overseas demand began to retract sharply due to the global financial crisis.

Shrinking external demand remains the biggest difficulty facing the economy, and the government has promised to offer incentives, including tax breaks and credit support, to prop the sector. The government has also extended more than RMB 6 trillion (USD 878 billion) in loans in the recent half of the year, part of which was to intended to aid small- and medium-sized companies in expansion into the international markets and in establishment of distribution channels for emerging markets.

Modal Traffic

Road freight transportation was less affected by the recession, still keeping a growing momentum while the other three modes of railway, waterway and air suffered in different degrees from the international and domestic economic downturn, and maintained negative growth in Q1 2009.

Export container throughput was seriously affected by the downturn in international trade. Only the ports of Qingdao and Tianjin kept moderate growth rate of 2.4% and 2.9%, while the other six ports maintained negative growth rates ranging from Dalian's -2.3% to Shenzhen's -20.9%. The overall container market is still in the sluggish stage with weakening transportation demands and declining market prices.

China's air freight industry bore the brunt of the financial crisis as it linked closely with the domestic and international economies and trade. Also, the outbreak and spread of the H1N1 virus brought about rising costs and negatively impacted international flights during the first half of 2009.

Cargo transportation in domestic flights was less affected by the economic crisis than cargo transportation in international flights. There have been some signs of recovery for international flight transportation in recent months, but the pace of recovery remains a bit slow. Overall, we expect the operational performance and cargo volumes on international flights to continue facing uncertainties in the second half 2009.

The express business kept a slower growth pace in the first quarter of 2009. The total express shipment volume was 380 million items, up 12.8% over the same period last year, and the total express revenue was RMB 10 billion (USD 1.5 billion), up 3.4%.[42] Domestic express business maintained a relatively fast growth trend but the international business dropped substantially due to the shrinking international trade caused by the global financial crisis.

Revised Postal Law Passed

Top Chinese legislators gave their final approval to the revised Postal Law on April 24, 200 amid concerns that it may hamper foreign firms' and private couriers' access to the lucrative market. The law, due to take effect on Oct 1, 2009, bans foreign companies from delivering express letters in China, which means they can only deliver express packages domestically and send express letters internationally.

The adoption of the law means years of lobbying by major global express-delivery companies in China to lift such a restriction have amounted to nothing. Express delivery is a big business in China, accounting for 43% of the postal system's revenue of RMB 96 billion (USD 14 billion) last year, according to figures from the State Post Bureau.

Apart from the restrictions on foreign business, the new law also requires China's privately-owned express-delivery companies to acquire a permit from the government. Legislators said the market access system aims to regulate the rapidly growing sector. However, insiders claim it helped to maintain the state-owned postal service's market monopoly.

---

[42] State Post Bureau

Conclusion

In the past, China's economic growth was mainly driven by global demand and export, which brought about the '30 year miracle' in China's development. China must now make a structural shift in economic development from excessive dependence on global demand to expansion of domestic demand, and move forward from the low added-value manufacturing to the upper stream of industry chain. Certainly, China will continue on as a manufacturing base for the world since the infrastructure and macro economics cannot be easily replicated in other markets.

In 2009, it is estimated that over 60% of Chinese logistics companies will have realized negative growth over the previous year, with many facing financial losses that could lead to the closure of some companies and consolidation of others. Due to the highly fragmented market and relatively low costs of entry, it will be difficult to determine the exact impact to the market place.

With government stimulus taking hold and domestic demand picking up, any uptick of the import/export trade will lead to a more 'normal' growth pattern 10% or more for the industry in the coming years.

2009 may also be a good time for logistics companies to make internal adjustment and undergo restructuring efforts to cope with the fallout from the economic slowdown, and to secure their market positions. For a long-term strategy, the logistics providers must offer tailored services and expanded network coverage to meet customers' changing requirements. They must implement sustainable and systematic measures for cost optimization and operational improvement. Meanwhile, capable logistics companies must also adopt investment strategies to carry out mergers and acquisitions as a means of achieving their long-term goals.