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TransForce Inc. (TFI C\$11.04, TSX)

Key takeaways from conference call with Nulogx and 3Q10 earnings preview; maintaining Buy rating and C\$16 target

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TransForce Inc.

Rating	Buy–Average Risk
Target	C\$16.00
Symbol	TFI
Exchange	TSX
Sector	Transportation & Aerospace
Closing price	C\$11.04
Potential total return	49%
Dividend yield	3.6%
52-week range	C\$6.43–11.45
Shares O/S	95.3m basic, FD
Market cap	C\$1,052m
Year-end	Dec-31
Revenue 2009A	C\$1,847m
2010E	C\$2,006m
2011E	C\$2,162m
Adj EPS 2009A	C\$0.54
2010E	C\$0.88
2011E	C\$1.14
P/E 2009A	20.4x
2010E	12.5x
2011E	9.7x
Book value/sh	C\$5.87
LQ ROE	12.2%

Quarterly data

Adj EPS 3Q10E	Desjardins C\$0.27
	Consensus C\$0.22
Adj EPS 3Q09A	C\$0.18

Source: Desjardins Securities

Company description

TransForce has become the leader in the trucking and transportation logistics industry in Canada through successful growth by acquisition. The company has the largest fleet in Canada and is active in both the domestic and trans-border market (70% and 30% of 2009 revenues, respectively).

www.transforce.ca



The Desjardins Takeaway

We provide below the key takeaways from our conference call with Nulogx, a leading transportation management solutions provider. We also take the opportunity to preview TransForce's 3Q results, which are scheduled to be released on October 28. Overall, based on solid peer results and confirmation that pricing is increasing, we expect a good quarter for TransForce. We believe the stock is still undervalued and would recommend investors buy the shares ahead of the results. TransForce is rated Buy–Average Risk with a C\$16 target price.

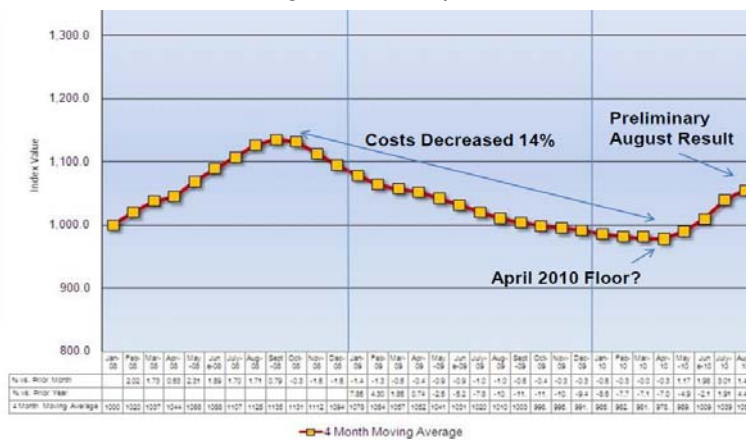
Event

We provide below the key takeaways from the conference call we held on October 21 with Doug Payne and Scott Irvine of Nulogx Inc., a leading transportation management solutions provider. We also take the opportunity to preview TransForce's 3Q10 results, which are scheduled to be released on October 28.

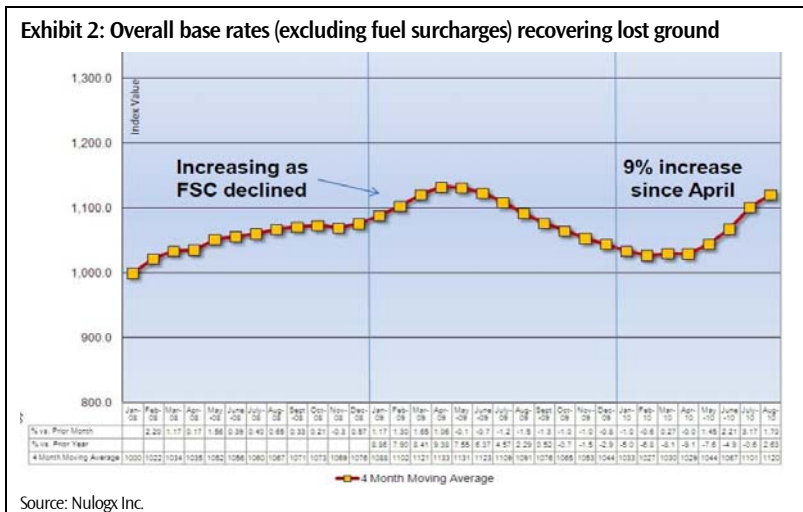
Implications

Canadian trucking rates are rising, according to Nulogx; positive preliminary data for August. According to Nulogx, trucking rates in Canada have increased 6.4% ytd after reaching a floor in April 2010. Preliminary data that was disclosed exclusively during the conference call indicated that pricing increased 1.5% yoy in August. In our view, TransForce stands to benefit from this improved pricing, given it generates ~70% of its business in Canada. Nulogx estimates that 75% of trucking shipments are shipped on long-term contracts, while the remaining 25% are on a spot basis.

Exhibit 1: Canadian General Freight Index...6.4% ytd increase



Source: Nulogx Inc.



TL is recovering fast while LTL is still lagging. One interesting conclusion from the call—which supports the data we have seen out of the US—is that the TL market is recovering faster than the LTL market. This is especially true in the domestic TL market, where rates have increased 14% from December 2009 to August 2010 as TL providers rationalized capacity. In comparison, pricing conditions in the LTL market are more difficult. Domestic LTL and cross-border LTL rates have risen 0.8% and declined 4.4%, respectively, from December 2009 to August 2010. We believe this is because competition remains intense in the sector, given that many players are chasing smaller volumes by offering price discounts. We also note that overcapacity remains an issue in the LTL market.

Exhibit 3: Average rate increases

	2008 ¹	2009 ²	1H10 ³
Domestic LTL	4.9	-7.2	0.8
Domestic TL	7.6	-5.3	14.0
Cross-border LTL	13.5	-22.1	-4.4
Cross-border TL	11.7	-12.1	-0.5
Overall	9.4	-9.4	6.4

¹ Dec-08 vs Jan-08; ² Dec-09 vs Dec-08; ³ 1H: Aug-10 vs Dec-09
Source: Nulogx Inc.

Domestic market appears more stable than cross-border market. As seen in Exhibit 3 above, the domestic market appears to be more vibrant than the cross-border market. According to Nulogx, this reflects the better economic conditions in Canada vs the US. Desjardins Economic Studies expects real GDP growth in Canada to be stronger than in the US in both 2011 and 2012 (3.1% vs 2.6% and 2.7% vs 2.4%). In this regard, we believe TFI is well positioned, given it derives 70% of its revenues domestically.

TransForce's LTL margins are decent despite pricing pressures. Despite the continued pricing pressures, TransForce's 2Q EBITDA margin of 12.4% was better than our estimate of 10.6% as the company continued with the strategic consolidation of its terminals. Going forward, we expect margins to improve as capacity is rationalized and demand increases. We forecast LTL EBITDA margins of 11.4% and 12.7% in 2010 and 2011, respectively.

Recent price increases at FedEx and UPS support our stance that pricing is recovering. Earlier this fall, FedEx announced that it would increase its shipping rates by a net average of 3.9% for US domestic and US export shipping starting in January 2011. Furthermore, FedEx announced that it would raise general rates by 6.9% at FedEx freight and FedEx national LTL. Interestingly, this applies to shipments between the US and Canada. Similar to FedEx, UPS announced a 5.9% general rate increase (applicable to non-contract freight only). Other LTL providers such as YRC and ABF Freight System have also announced similar rate hikes. Increases in non-contract prices bode well for future contractual rates as we expect carriers to ask for larger increases when freight contracts are renegotiated.

Six out of nine companies have beaten 3Q EPS consensus so far; TL companies note effect of slowing economy on volumes. As seen in Exhibit 4 below, six of the nine transportation companies we monitor that have reported 3Q results

to date have beaten consensus estimates. Results from the TL sector remain solid, although most companies noted that slower economic growth was starting to be reflected in their results. Volumes are slipping as the economy is slowing down. JB Hunt noted that “though freight volumes backed off from the torrid pace we saw in June, demand remained steady across all segments”, including intermodal and truckload. Further, the company stated that it expects to see a rebound in freight rates from the unsustainable lows seen during the recession. Meanwhile, Werner said that “freight market trends continued to be good in 3Q10. . . [although] they were not as strong as 2Q10”. Landstar expects moderate volume increases in 4Q10, but a strong pricing environment as capacity in the industry is restrained.

The robust results in the transportation sector are in addition to the solid results posted by railroads in 3Q.

Exhibit 4: 3Q10 results of trucking companies

	Company	Ticker	Sales (US\$m)		EPS (US\$)	
			Actual	Expected	Actual	Expected
TL	Heartland Express	HTLD	127	130	0.14	0.18
	JB Hunt	JBHT	986	986	0.43	0.44
	Knight Transportation	KNX	191	187	0.21	0.20
	Werner Enterprises	WERN	463	475	0.33	0.32
Other	CSX	CSX	2,700	2,662	1.08	1.04
	Hub Group	HUBG	478	486	0.33	0.34
	Landstar System	LSTR	645	623	0.49	0.49
	Ryder System	R	1,317	1,324	0.72	0.65
	Union Pacific	UNP	4,364	4,408	1.56	1.50
	UPS	UPS	12,192	12,361	0.93	0.88

Source: Desjardins Securities, Bloomberg

Preview of TFI's 3Q10 results. TransForce is scheduled to report on Thursday, October 28. We are looking for revenues of C\$508m (up 13% yoy) and adjusted EPS of C\$0.27 (vs consensus of C\$0.22). The company maintains its prudent outlook of EBITDA of C\$250–260m in 2010 on “better quality” revenue; we believe this guidance is quite conservative. We currently forecast EBITDA of C\$279m in 2010 and have not integrated some of the company's more recent acquisitions/contract wins (eg Enquest and government of Ontario), which we believe will further boost profitability. In our view, TFI could beat its guidance. CEO Alain Bédard has said in the past that TransForce has missed guidance only once in his 14 years at the helm, and we do not believe 2010 will be the second year that this will occur.

Exhibit 5: TransForce Inc. 3Q10 earnings preview

Year end Dec-31 (C\$m)	Desjardins est			Chg (%)	
	3Q10	2Q10	3Q09	Qoq	Yoy
Revenue	508	497	451	2	13
EBITDA	76	71	62	6	22
EBITDA margin (%)	14.9	14.4	13.7	4	8
Operating income	44	40	32	11	39
Operating ratio (%)	91.3	92.0	92.9	-1	-2
Net income	25.5	17.1	17.0	49	50
Net margin (%)	5.0	3.4	3.8	46	33
EPS (C\$)	0.27	0.18	0.19	50	42
Adjusted EPS (C\$)	0.27	0.23	0.18	17	50
Shares O/S average (m)	95.3	95.3	91.2	0	4
Segmented information					
Revenue by division					
Less-than-truckload (LTL)	136	138	129	-2	5
Package & courier	97	94	67	3	44
Truckload (TL)	173	164	160	5	8
Specialized services	117	114	106	2	10
Eliminations	-14	-14	-11	0	23
Total	508	497	451	2	13
EBITDA margin (%)					
Less-than-truckload (LTL)	12.8	12.4	10.8	3	19
Package & courier	17.6	17.4	17.9	1	-2
Truckload (TL)	12.3	11.6	10.7	6	15
Specialized services	17.5	17.4	15.1	1	16
Total	14.9	14.4	13.7	3	9
Other information					
Capex (C\$m)	6	28	19	-79	-69
FCF after dividends (C\$m)	65	10	35	529	85
Debt-to-capital ratio (%)	52	55	54	-5	-4
Net debt/LTM EBITDA (x)	2.43	2.84	2.88	-14	-16
ROIC (%)	21.5	20.8	17.2	3	25

Source: Desjardins Securities, company reports

Further earnings power down the road; normalized EBITDA provides potential EPS of C\$1.83 (we forecast C\$1.14 in 2011). During 2Q's conference call, management shared its view of the 'normalized' EBITDA margin for each division. As seen in the table below, operating leverage is significant for TransForce, and each segment's EBITDA margin has substantial upside. Assuming revenue growth of 9% in 2012 and using the midpoint of management's targets, we derive potential EPS of C\$1.83, which is significantly higher than most market participants expect. In comparison, peak EPS in the previous cycle was C\$1.26 (adjusted EPS in 2006 assuming a 30% tax rate). Although we would be cautious with regard to our potential EPS estimate, we believe it is attainable considering the cost-reduction initiatives implemented by the company, the shift in its revenue mix toward high-margin businesses and the acquisitions that have been realized over the last few years.

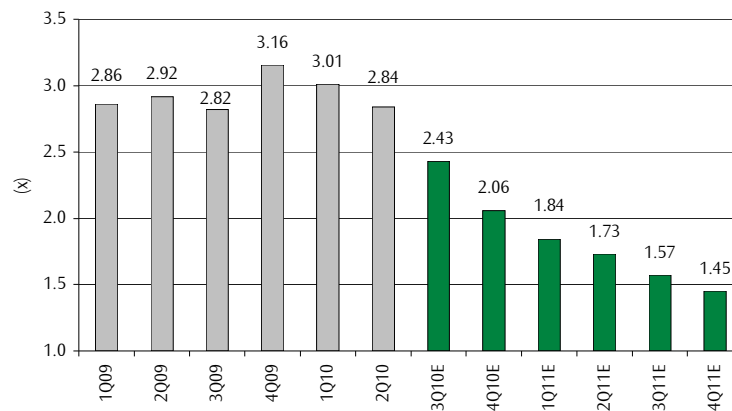
Exhibit 6: Normalized EBITDA margins provide significant upside to current estimates

Year-end Dec-31 (%)	2008	2009	1Q10	2Q10	2010E	2011E	Normalized
Less-than-truckload (LTL)	12.8	9.6	6.9	12.4	10.0	11.1	16.5
Package & courier	15.4	16.2	11.1	17.4	16.1	16.5	20.0-22.0
Truckload (TL)	10.3	9.3	7.2	11.6	9.8	10.3	14.0
Specialized services	16.6	13.9	18.9	14.4	16.6	17.4	20.0
Total	12.6	12.3	10.9	14.4	12.8	13.5	17.6

Source: Desjardins Securities, company reports

Financial concerns unwarranted as TransForce has positioned itself to further consolidate the industry. TransForce is confident that its financial position will improve within the next 12 months as it intends to pay down debt by about C\$100m (we forecast C\$120m) to reach a debt to EBITDA ratio of 2.0–2.5x (we forecast 2.1x at the end of 2010). Hence, we believe that concerns regarding the company's high debt levels are no longer warranted and expect that the company will soon be better positioned to further consolidate the market. The company appears on track to sell assets worth a combined C\$40–50m in 2010. Potential sale-leaseback transactions include a facility in BC and another facility located in Ontario or Québec. We expect the company to generate C\$173m of FCF in 2010, although this amount could come in below expectations in light of the Enquest acquisition and in the event that the sale-leaseback transactions do not materialize. For 2011, we assume FCF of C\$118m, as we do not assume any cash inflows from asset disposals.

Exhibit 7: Net debt/LTM EBITDA



Source: Desjardins Securities, company reports

Exhibit 8: Free cash flow

Year-end Dec-31 (C\$)	Annual debt repayments	FCF
2006	193	93
2007	53	84
2008	84	109
2009	112	137
2010E	120	173
2011E	0	118

Source: Desjardins Securities, company reports

Recommendation

Overall, we remain positive on TransForce and recommend that investors buy the stock ahead of the results. We continue to believe that the shares are undervalued and we expect 3Q results to provide momentum. In addition, we believe that investors are also underestimating the potential impact of the acquisitions made during the downturn. Moreover, TransForce's improved financial position provides more room for opportunistic acquisitions as the company continues to pay down debt.

Exhibit 9: Calculation of our target price

	(C\$)
(1) 15x P/E multiple on our 2011 adjusted EPS estimate	17.08
(2) 7.0x EV/EBITDA multiple on our 2011 EBITDA estimate	15.64
(3) DCF value	15.83
Average of implied values	16.18

Source: Desjardins Securities

Exhibit 10: Comparative valuation

Company (US\$)	Ticker	Mkt Share		1y chg	EBITDA mgn	Net mgn	P/E ² (x)			EV/EBITDA ² (x)			TTM sales (\$m)	P/S FY2 (x)	P/B (x)	Dt/ cap (x)
		cap	price				TTM	FY1	FY2	TTM	FY1	FY2				
Canadian trucking																
Contrans Group ¹	CSS	290	8.46	12.1	12.1	5.2	10.7	13.7	12.2	7.0	7.1	6.3	393	0.7	1.6	33.4
Mullen Group ¹	MTL	1,190	15.12	-7.6	19.1	-2.9	20.2	20.5	13.8	8.6	7.9	6.5	938	1.0	1.1	32.4
Trimac Income Fund ¹	TMA.UN	58	4.61	8.5	NA	NA	20.1	10.4	11.7	NA	1.7	1.6	327	0.2	0.6	0.0
Vitran ³	VTN	180	11.06	26.4	3.6	1.0	NM	34.5	11.2	13.4	8.3	5.5	676	0.2	1.3	39.5
Average				9.8	11.6	1.1	17.0	19.8	12.2	9.7	6.2	5.0		0.5	1.1	26.3
Median				10.3	12.1	1.0	20.1	17.1	11.9	8.6	7.5	5.9		0.4	1.2	32.9
Truckload																
Celadon Group	CGI	300	13.43	14.7	8.1	2.0	61.0	18.5	13.1	8.3	5.4	4.3	523	0.5	2.1	19.0
Covenant Transport	CVTI	89	7.30	49.0	10.5	1.7	NM	19.0	10.3	4.8	3.9	3.6	632	0.1	1.1	70.0
Heartland Express	HTLD	1,357	14.96	8.8	27.1	14.4	23.7	22.1	18.6	8.8	7.6	6.9	484	2.5	4.2	0.0
JB Hunt	JBHT	4,456	36.14	8.0	14.2	5.3	25.1	23.1	18.0	9.4	9.2	7.7	3,650	1.1	7.5	52.2
Knight Transportation	KNX	1,523	18.22	4.2	23.0	8.7	26.0	24.8	19.3	9.4	8.3	7.0	710	1.9	2.7	0.0
Marten Transport	MRTN	469	21.39	18.2	16.7	4.3	24.9	23.1	16.7	6.3	5.7	4.9	509	0.8	1.6	8.7
Quality Distribution	QLTY	148	6.88	77.3	9.7	1.2	15.6	18.7	10.5	7.0	7.8	6.8	653	0.2	-1.1	168.2
USA Truck	USAK	153	14.61	19.0	11.1	0.5	NM	NM	33.5	5.3	4.8	3.8	438	0.3	1.1	42.4
Werner Enterprises	WERN	1,513	20.83	9.4	15.4	5.2	20.4	19.3	15.8	5.1	5.0	4.5	1,791	0.8	2.0	0.0
Average				23.2	15.1	4.8	28.1	21.1	17.3	7.1	6.4	5.5		0.9	2.4	40.1
Median				14.7	14.2	4.3	24.9	20.7	16.7	7.0	5.7	4.9		0.8	2.0	19.0
Less-than-truckload																
Arkansas Best	ABFS	645	25.48	-9.1	-5.5	-1.8	NM	NM	50.9	NA	34.5	5.7	1,542	0.4	1.4	7.8
Con-Way	CNW	1,721	31.62	-10.7	6.2	1.1	NM	41.0	17.0	6.8	6.6	5.0	4,718	0.3	2.0	49.0
Old Dominion Freight Line	ODFL	1,473	26.33	39.5	14.0	5.8	29.7	20.2	15.7	8.7	8.2	6.9	1,320	0.9	2.4	31.7
SAIA	SAIA	218	13.72	-8.0	5.2	0.9	NM	NM	14.4	6.9	5.6	4.0	868	0.2	1.1	30.8
YRC Worldwide	YRCW	202	4.27	-95.2	-5.2	-0.9	NM	NM	NM	NA	NM	6.4	4,634	0.0	-2.6	107.1
Average				-16.7	2.9	1.0	29.7	30.6	24.5	7.5	13.7	5.6		0.4	0.8	45.3
Median				-9.1	5.2	0.9	29.7	30.6	16.4	6.9	7.4	5.7		0.3	1.4	31.7
Specialized services (logistics & waste management)																
CH Robinson Worldwide	CHRW	12,028	72.52	22.9	7.3	4.0	33.0	31.4	26.8	14.5	18.3	15.7	8,492	1.1	10.9	0.0
Casella Waste Systems	CWST	125	4.96	72.8	22.6	-2.1	NM	NM	NM	5.6	5.8	5.6	530	0.2	2.7	92.1
Dynamex	DDMX	206	21.08	7.2	5.1	2.7	19.2	16.4	14.9	5.0	7.8	6.8	406	0.4	1.9	0.0
Expeditors Intl Wash	EXPD	10,518	49.57	44.0	9.7	6.0	37.6	32.4	28.3	13.1	16.8	14.6	5,002	1.5	6.5	0.0
Forward Air Corporation	FWRD	784	27.02	11.7	14.4	7.3	29.4	25.1	19.9	11.0	10.4	9.0	469	1.5	3.2	17.5
HUB Group	HUBG	1,210	32.68	22.8	4.2	2.6	29.7	28.1	21.3	13.1	14.6	11.3	1,762	0.6	3.4	0.0
IESI-BFC	BIN	2,640	23.88	71.4	27.9	5.8	34.1	27.1	22.5	8.3	8.4	6.6	1,094	1.5	2.5	39.0
Landstar System	LSTR	1,878	37.69	2.0	6.6	3.5	23.0	21.1	17.4	12.6	11.3	9.6	2,360	0.7	6.7	35.1
Republic Services	RSG	11,762	30.71	10.8	29.4	7.7	30.7	17.9	15.2	7.9	7.4	7.0	8,097	1.4	1.6	48.1
Universal Truckload Svcs	UACL	236	14.79	-12.7	3.9	3.0	23.1	25.3	16.1	9.4	8.6	6.4	562	0.3	1.5	0.0
UTI Worldwide	UTIW	1,924	18.90	35.0	3.9	1.6	38.6	25.7	18.9	9.5	11.1	8.9	4,165	0.4	2.3	34.6
Waste Connections	WCN	3,131	40.79	29.3	31.7	11.9	26.0	22.3	19.2	9.5	9.5	8.8	1,294	2.2	2.3	38.1
Waste Management	WM	17,565	36.79	16.9	25.7	7.8	17.6	17.5	15.6	7.6	7.8	7.3	12,122	1.3	2.9	59.9
Average				25.7	14.8	4.8	28.5	24.2	19.7	9.8	10.6	9.0		1.0	3.7	28.0
Median				22.8	9.7	4.0	29.5	25.2	19.0	9.5	9.5	8.8		1.1	2.7	34.6
Package & courier																
FedEx	FDX	27,959	88.86	12.5	11.8	4.0	20.2	17.1	14.2	5.8	6.0	5.2	36,182	0.7	2.0	11.9
United Parcel Service	UPS	50,628	69.83	22.3	NA	8.1	22.2	19.9	17.0	NA	10.1	8.9	48,501	0.9	8.8	NA
Average				17.4	11.8	6.1	21.2	18.5	15.6	5.8	8.0	7.0		0.8	5.4	11.9
Median				17.4	11.8	6.1	21.2	18.5	15.6	5.8	8.0	7.0		0.8	5.4	11.9
TransForce¹	TFI	1,052	11.04	37.0	14.4	3.4	17.0	12.5	9.7	6.7	6.2	5.5	1,903	0.5	1.9	55.0

¹ Data in Canadian dollars; ² Ratios greater than 70x are considered to be not meaningful; ³ US\$ except for share price
 Source: Desjardins Securities, Bloomberg, I/B/E/S, FirstCall

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Rating category	Desjardins rating	Desjardins coverage universe (# of stocks)	% distribution	Desjardins Investment Banking (# of stocks)	% distribution
Buy	Top Pick/Buy	108	73	37	76
Hold	Hold	39	26	12	24
Sell	Sell	1	1	0	0
Total		148	100	49	100

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STOCK RATING SYSTEM

Top Pick

Desjardins' best investment ideas – stocks that offer the best risk/reward ratio and that are expected to significantly outperform their respective peer group* over a 12-month period

Buy

Stocks that are expected to outperform their respective peer group* over a 12-month period

Hold

Stocks that are expected to perform in line with their respective peer group* over a 12-month period

Sell

Stocks that are expected to underperform their respective peer group* over a 12-month period

Not Rated

Stock is being covered exclusively on an informational basis

RISK QUALIFIERS

Average Risk

Risk represented by the stock is in line with its peer group* in terms of volatility, liquidity and earnings predictability

Above-average Risk

Risk represented by the stock is greater than that of its peer group* in terms of volatility, liquidity and earnings predictability

Speculative

High degree of risk represented by the stock, marked by an exceptionally low level of predictability

* Peer group refers to all of the companies that an analyst has under coverage and does not necessarily correspond to what would typically be considered an industry group. Where an analyst's coverage universe is such that 'relative' performance against a 'peer group' is not meaningful, the analyst will benchmark the rating against the most appropriate market index

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