

AHERN ADVISORY The Credit Crisis - Does it Impact Transportation?

I had planned on further discussions on how to create additional value when selling your business. However, that article will be postponed until next week because of the downgrade of US debt. **Since that's occurred;**

- **Numerous questions have been directed to me, in reference to my opinion on what this means for the transportation, and;**
- **Why could such a thing happen?**

I don't think that I'm qualified to comment on the political mess we're in; However, I'm qualified to explain why the S & P took the unprecedented step of lowering the US credit rating;

- **I believe it's going to have a substantial impact to the general public, long term, but;**
- **I believe that trucking will prosper through these most difficult times.**

To understand the credit crisis, you must first understand what S & P's did? The rating agency downgraded its rating on the Federal Government's long term debt one level from the top AAA grade to AA+. Long term debt includes notes and bonds that come due in more than one year. **They have terms ranging from 2 – 30 years. Short term debt includes Treasury Bills that have** terms ranging from a few days to 52 weeks. **The rating on the government's short term debt was not downgraded.** Of the \$9.4 billion in publicly traded government debt, 72% is long term.

What does the downgrade mean? In very simplistic terms; it's a warning to Buyers of bonds and other debt, the chance that they won't get their money back has increased, however slightly. **In theory, downgrades should lead to higher borrowing cost for the issuer** (the government) since investors demand a higher interest rate if they're taking a bigger risk.

Assuming that the downgrade will impact the stock market, which it has; do I believe that US interest rates will go up? Most analysts say; probably not. They believe, since a 10 year treasury note is considered the basis for all other interest rates, in which interest rates should not go up (immediately) but may increase over the long term.

To be quite honest, I'm not sure. If you look at the S & P's downgrade and forget about all the political positioning between the various parties, what S & P has stated is:

- **You didn't make a large enough effort to reduce the deficit.**
- **You can't keep printing money and borrow your way out of your problems;**
- **You can't tax people to death because of your incompetence, and;**
- **The unemployment rates are somewhat skewed since the largest employer is the Federal Government.**

MERGERS • ACQUISITIONS • DIVESTITURES • OPERATIONAL REVIEWS • MANAGEMENT CONSULTING

THE AHERN ADVISORY

in this issue

The Credit Crisis – Does it Impact Transportation?



Ahern & Associates, Ltd.

Accredited Member
National Bureau of Certified
Consultants Inc.

August 12, 2011

I doubt that interest rates will go up, short term, because recent reports suggest the economy is slowing to a near stall;

- The US domestic gross product grew at less than 1% in the first 6 months of 2011.
- Manufacturing slowed and so is consumer spending, and;
- After dropping more than 500 points, Thursday, the Dow industrial “seesawed” Friday, increased the following Tuesday and tanked on Wednesday.

The end result;

- The economy will continue to “sputter”.
- **The Federal Government is going to have to come up with a plan to stimulate the economy;**
- Most people’s 401K’s have cratered, and;
- People are tired of increasing taxes for no other reason than politicians can’t balance the budget.

What does that mean for trucking? Opportunity!

There was a trucking industry update from Stifle Nicholas Transportation & Logistics Research Group. Basically, their investment conclusion was that all the noise surrounding the debt ceiling and decelerating economic data; **truckload carrier fundamentals have held up remarkably well.**

What I found most interesting is, in their review, they indicated that;

- Industry rates continue to move up in the low single digit range – 2% - 3%.
- **Industry volumes were outstanding in the second quarter – particularly in May and June, and during July – tracked in line with the normal seasonal pattern.**
- Driver availability is the number one challenge for the industry.
- **Used equipment prices for both tractors and trailers continue to increase, thereby making it difficult for new owner operators to be created.**
- **Niche markets, such as the expedited team driver van market, and the flatbed market, are not experiencing the ebb and flows associated with the macro-economy as the van sector has been consistently strong.**
- **Companies that focus on;**
 - a) Leveraging their assets.
 - b) Controlling their fuel cost, and
 - c) Growing their fleet should do fairly well.

These statistics certainly don’t track with the economic indicators. There is no doubt that our economy is in a deep hole. The huge amount of deleveraging that is necessary after the housing bubble of the early 2000’s can only be accomplished over time.

If I was to look into my crystal ball, I would say that;

- Capacity issues will continue to work to truckings advantage.
- **Drivers will continue to be a scarce commodity, therefore causing creativity in the marketplace, and;**
- The companies that can solve driver issues and become creative, will do remarkably well in a very stagnant economy.

People forget that, during the Regan administration, in 1982, the unemployment rate hit 10.8%;

- Regan's immediate challenge was that inflation and interest rates were out of control, and;
- What Regan was able to do is;
 1. Reduce inflation and interest rates, dramatically, and;
 2. Follow a slow process of recovery from 1982 to the end of 1988 with an average growth rate of real GDP of 4.6% per year.

The administration focused on;

1. Implementing good economic policies.
2. Not blaming incompetent predecessors for the terrible economy, and;
3. Operating aggressively and creatively.

The loss of the US government's triple A rating is a great symbolic blow and one that's going to take a long time to overcome. The reality is that;

- Small trucking companies are going to find it increasingly more difficult to compete.
- Lenders are going to be very reluctant to provide the working capital for trucking companies that are marginally profitable, and;
- Companies that want to grow, not only have to build their operating platform, but also have to build their intellectual capital.

In closing, should you panic? No! Should you be upset? Yes! There is not one person that I, personally, know of who has not taken a beating in their retirement fund, due to the inability of the government to run the government as a business. The US downgrade basically stated;

- Look at your own house.
- Clean up your house.
- Look for additional sweeping cuts, and;
- Give us a plan that's concrete – not based on maybe's and hypotheticals.

Was it politically based? Probably! Was it well deserved? You tell me? You can't argue with statistics and statistics indicate that we failed miserably.

Next week, we will re-engage discussing selling a business and creating additional value.

QUOTE OF THE WEEK: **“If you're looking back, you're in trouble”** (Charlie McCclandon)