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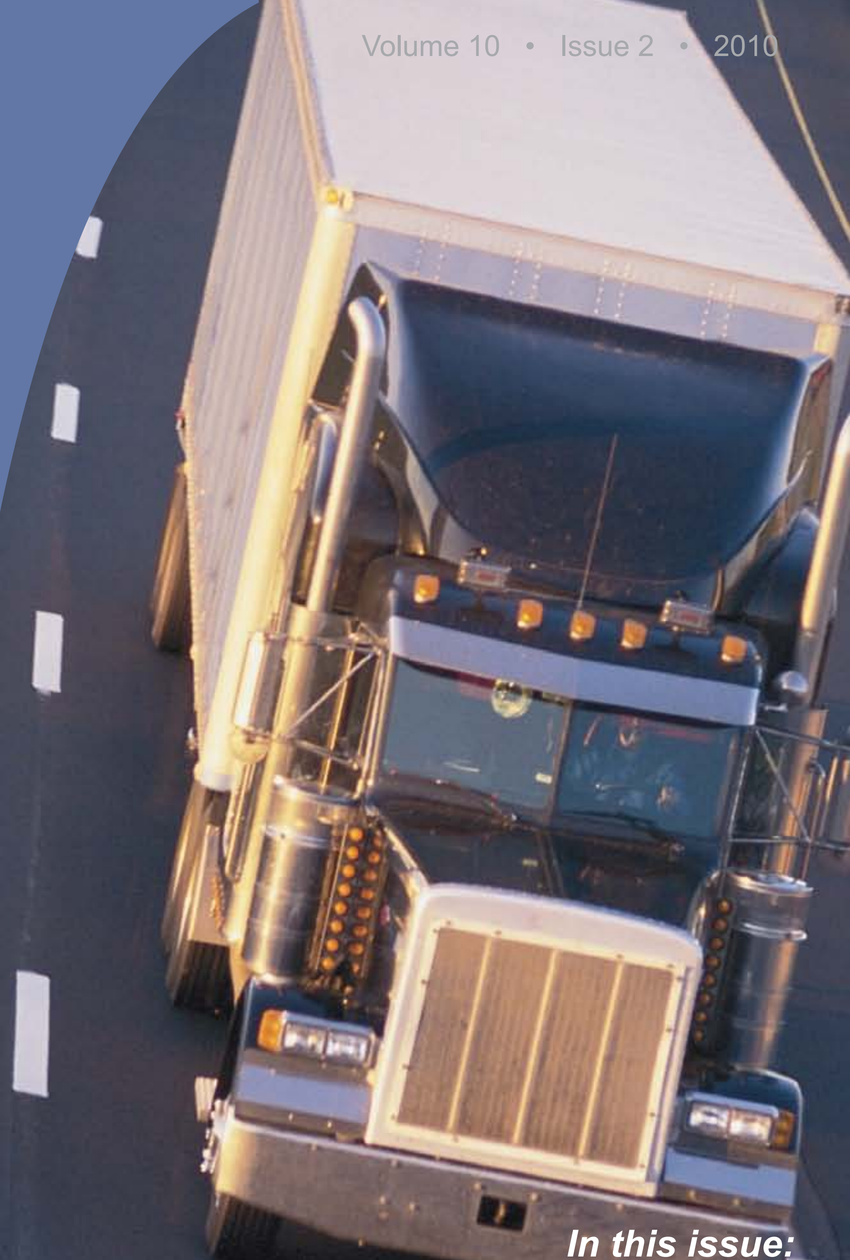
Katz, Sapper & Miller

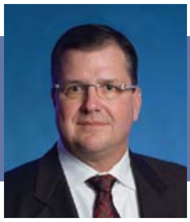
Truck Times

The Financial Side of the Trucking Industry



In this issue:

How Much is Your Book of Business Worth?



By David H. Roush
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Middle market trucking companies have traditionally been purchased based on an asset valuation. The valuation of assets such as equipment, shop inventory, office supplies and other hard assets is fairly straight forward. Likewise, the calculation of non-contingent liabilities is also fairly straight forward. But what about the blue sky, the biggest component of which is generally the freight…how is it valued?

Traditionally, most buyers of companies employ a variety of techniques from Anecdotal (listening to the seller's description of his customers and lanes); to Value Add (comparing the rates the buyer has in key lanes to the seller); to Analytical (performing complex analysis of the business in Excel or Access). All of these methods provide an indication of the value of freight and how it will enhance or detract from the acquiring company's freight network, and thereby profitability. However, none provide a definitive and quantifiable value or listing of what freight fits the network and what freight does not.

Some of the more sophisticated buyers quantify the value of the acquired book of business and model the impact of combining freight networks (or in the case of a stand alone purchase, the quality of the freight) by utilizing an optimization software program such as TMW System's Netwise®. Netwise allows carriers to layer freight networks to determine the accretive value of adding additional freight, and provides a definitive listing of what freight fits and what does not.

In Exhibit 1, Carrier A is contemplating acquiring Carrier B. Both carriers are of similar size and operate in a similar geographic area. When the two carriers are combined, as may be done in a traditional analysis, the metrics from the two freights' networks are summed and the results are shown in the Carrier A/B column; this is a simple mathematic combination. The loads, revenues and margins are simple addition, while the other metrics are weighted averages.

The Netwise analysis is in the OPT A/B column. This scenario optimizes the freight networks of both the carriers. In this analysis the actual trucks that hauled the loads are disregarded and the model utilizes an algorithm to minimize deadhead and maximize the rate per mile. Note that while the loads and revenue the model "desires" are less, the margin and rate per total mile ($PTM) are higher, while the deadhead (MT%) is considerably less. Clients that aggressively implement the strategy suggested by the model will generate results in the 30 to 60 percent range suggested in the OPT A/B scenario. For these two carriers, at 50 percent attainment, the "Netwise" margin increases $77,441 per month, or $929,292 per year, over Carrier A alone. In addition to this high-level view of optimization, Netwise provides a playbook that clearly shows what freight, of both the buyer and seller, fits the new combined and optimized network and what freight does not.

Exhibit 1

	Carrier A	Carrier B	Carrier A/B	OPT A/B
Loads	3,522	3,654	7,176	6,849
Total Revenue	3,345,204	3,155,567	6,500,771	6,210,119
Total Margin	1,312,015	1,187,417	2,499,432	2,654,314
Margin %	39.2%	37.6%	38.4%	42.7%
Margin / Load	$ 302	$ 303	$ 304	$ 305
$PTM	$ 1.494	$ 1.478	$ 1.486	$ 1.575
LOH	571	531	551	545
MT %	10.2%	9.0%	9.7%	5.3%
			Gross Margin Improvement	$ 154,882
			TRPTM Improvement	$ 0.088
			DH Improvement	-4.4%
			% Revenue Selected	95.5%
			% of Loads Selected	95.4%

For potential sellers, as the legendary boxer Jack Dempsey said, "The best defense is a good offense." Consider optimizing freight networks now as any work done prior to selling a company will result in a tighter, more profitable freight network that will bring a higher value at closing, as well as improve profitability in the interim.

Potential buyers should consider utilizing optimization in their due diligence and valuation processes. Hope is not a strategy. Utilizing optimization removes an element of the unknown (or "hope") and provides a real world evaluation and mathematically derived go forward strategy to improve profitability. •

Tax and Business Benefits of Using Auxiliary Power Units (APUs)

By Ben Lyon, CPA
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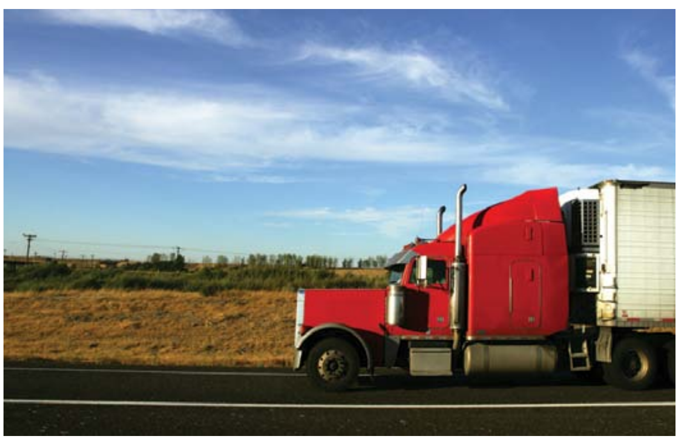
In the past few years the availability and use of Auxiliary Power Units (APUs) has become more and more widespread in the trucking industry. An APU is a power generator that runs off of a truck's diesel fuel to power the heating, air conditioning, cab electricity, and in some trucks, the refer cooling unit. When running the APU, the truck's main engine does not have to run, saving fuel used when idling. Besides the benefit of fuel cost savings, decreased engine maintenance and longer engine lives, there is also a potential tax savings through the credit for federal tax paid on fuels.



To determine the fuel savings of using an APU as opposed to simply idling the engine, the average fuel consumption of each can be compared. An APU on average consumes around .1 gallons of diesel fuel per hour while an average class 8 truck consumes around .7 gallons of diesel per hour while idling. If an average truck in a fleet idles 500 hours in a year, there would be a savings of 300 gallons of diesel fuel per year, per truck. Using a generic diesel cost of $2.75 per gallon, this totals a fuel savings of $825 per year, per truck that used an APU versus idling its engine.

To determine the potential tax credit available when APUs are utilized, a company needs to develop a methodology to calculate the number of gallons expended by the APUs during the year, or to actually track the hours each APU is used. Some companies have developed different formulas to calculate the number of gallons used – some directly track idle hours while using the APU, and others take the average idle hours per truck per month and calculate the hours using the APU based on that number. It is advisable, however, to have a definite formula that can be presented based on information that can be pulled directly from the system. The average APU fuel consumption generally seen across the industry is 12 ounces of diesel fuel burned for every hour an APU is used (varies by APU manufacturer). Once the total number of hours that APUs were run during the year is known, the total number of gallons of diesel used is calculated, and the tax

"When the natural cost savings of lower fuel use, longer engine lives and less maintenance on engines are combined with the potential tax savings, the numbers show that APUs can be a way to improve the bottom line and lower tax bills each year. "

credit is determined. The tax credit is currently $.243 cents per gallon used, so if a fleet burned 30,000 gallons of fuel during 2009 while running APUs, the company would receive a tax credit of $7,290. If the company is a C-corporation, this is a direct dollar for dollar tax savings, and if a company is an S-corporation or LLC, the tax credit flows through as a dollar for dollar tax credit to the owners of the company.

When the natural cost savings of lower fuel use, longer engine lives and less maintenance on engines are combined with the potential tax savings, the numbers show that APUs can be a way to improve the bottom line and lower tax bills each year. After the initial investment, these units will pay for themselves in a few years, and also lower the emissions of a fleet – making for a leaner, greener transportation company.

Revised Bulletin Provides Sales Tax Exemption Guidance

By Mark Flinchum, CPA
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Effective July 1, 2010, the Indiana Department of Revenue (IDOR) issued revised Sales Tax Information Bulletin #12 outlining the requirements transportation companies must meet in order to qualify for sales tax exemption afforded to transportation companies.

Independent transportation companies providing services for unrelated third parties have had little trouble in satisfying the requirements for the industry-favorable sales tax exemption. However, captive transportation companies providing services to primarily related parties who have enjoyed the sales tax exemption have recently been under scrutiny by the IDOR. The IDOR has argued that captive transportation companies have not operated as a separate company and/or at arms-length terms that are required to meet the factors necessary to be sales tax exempt.

The information bulletin provides factors that fall into two categories: critical and non-critical. At a minimum, trucking companies must meet every critical factor; however, a company's failure to meet non-critical factors can also result in the exemption being denied.

While most companies likely adhere to many of the factors listed in the bulletin in their normal course of business, there may be a small number of both critical and non-critical factors some companies are not currently following. For example, one critical requirement is any transportation company that is organized as a single member LLC must file a schedule of intercompany eliminations with their federal tax return. This factor is imposing a requirement not even required by the Internal Revenue Service (IRS). However, while the IDOR may be imposing requirements that could be challenged if litigated, a business that fails to observe these guidelines runs the risk the IDOR will attempt to revoke their sales tax exemption during an audit.

Lastly, for trucking companies that share employees whereby the employee works for both the captive transportation company and the operating entity, the IDOR provides guidance on what documentation will be required in these instances.

The critical factors included in the bulletin are as follows:

- The transportation company must transport the persons or property of another.
- The transportation company must receive compensation for the services it provides.
- The transportation company must hold and pay for appropriate public transportation insurance.

"...a business that fails to observe these guidelines runs the risk the IDOR will attempt to revoke their sales tax exemption during an audit."

- The transportation company must be fully and independently authorized by federal and/or state authorities to provide public transportation services.
- Shared employees must be properly accounted for and detailed records maintained.
- Contributions of vehicles to a transportation company from a parent must be properly titled in the transportation company.
- Transactions between the parent company and the trucking company must be evidenced by actual invoicing and payments for all transactions.
- The parent company and the transportation company must segregate and account for each entity's purchases and expenses.
- The parent company and trucking company must file appropriate schedules with their federal tax return reflecting intercompany eliminations.

The non-critical factors included in the bulletin are as follows:

- The transportation company and the parent company must maintain separate books and records, including separate charts of accounts.
- Transactions between the parent company and the trucking company must evidence a commercially reasonable, arms-length relationship.

Continued on page 7. See "*Bulletin.*"

Window of Opportunity

By Bruce W. Jones
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After battling the Great Recession for several years to a standstill, the last thing on many owners' list of priorities for the remainder of 2010 is selling their business. Exhaustion associated with survival, battered balance sheets and anemic income statements make the feasibility of selling during the next few months at a reasonable price seem like a Disney fantasy.

Certainly, it would be difficult to find an experienced investment banker who would suggest this is a robust market for mergers and acquisitions (M&A); however, a strong case can be made that the next six months may represent the best window of opportunity to buy/sell a trucking entity.

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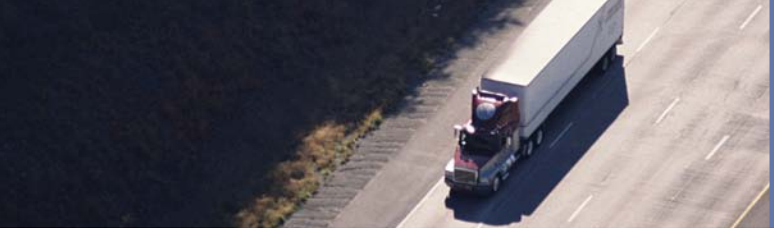
Below are the top 10 reasons why now may be the best time to buy/sell a trucking entity:

- There are qualified buyers actively looking for transactions.
- The capital gains tax rate may increase dramatically from 15 to 20 percent at the beginning of 2011.
- Public trucking multiples that support private carrier valuations are at record levels, but these levels will fall if the economic recovery is less than expected, as some predict.
- Rising freight rates permit buyers/sellers to use projections of future earnings instead of 2009 losses to value businesses.
- Strategic buyers are experiencing driver shortages and looking to acquire more.
- Many buyers would like to find low mileage used fleets to avoid buying 2010 engines.
- Higher used truck values are helping buyers find acquisition financing.
- Middle market carriers are increasingly competing with large carriers, making long-term survival less certain.
- New government regulations will challenge carrier management into the future.
- Banks are becoming less tolerant of underperforming carriers.

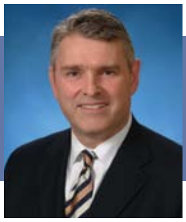
The economy is at an inflection point that is best characterized by uncertainty. Daily, there is an array of conflicting information regarding the future. Some see a long-lived "V-shaped" recovery for trucking because of diminishing capacity, while others see the inability to sustain recent improvements due to increasing government regulations and troubling worldwide macroeconomics. Optimism is coexisting with pessimism.

This uncertainty is creating an unusual dynamic within the industry – simultaneously motivated buyers and sellers. Within a subset of owners there are buyers with resources interested in preparing for the future, and sellers wanting to cap their losses while some of their business equity remains. Increasingly, a number of owners feel a strategy of waiting for confirmation of the future may be riskier than acting on the uncertainty of today.

Our federal government's changing propensity for business oversight and taxes has effectively added a time element, or window, to these potential strategies, tempting some to explore the feasibility of an M&A transaction. Is now a good time to buy or sell a trucking company? Will those who view the current situation as a window of opportunity be lucky or learn the lesson of a Las Vegas junket? Time will tell of course, but a quote from Tom Peters may provide some perspective: "If a window of opportunity appears, don't pull down the shade."



Improve Profitability By Building Strong Leaders



By Tim Almack, CPA
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A company needs strong leaders to be successful, but many people misunderstand what qualities are essential. Leadership is especially important now, when the business environment is changing so rapidly. Why? Leaders strive to meet tomorrow's needs, not just today's. They are visionaries who turn problems into opportunities and improve their firms' profitability levels.

To build a strong company, more is needed than people with the capabilities and inspiration to perform the work. Companies need strong leadership. Individuals may seek leadership positions for power, wealth and acclaim, but a successful leader's motivation is the need to fulfill the potential in others. People with misguided motivations are destined to fail, hurting the company in the process.

If everything in the company is for the benefit of the leader alone, what motivates the employees to work to keep it strong? People are keenly aware of directions that will not benefit the entire organization, and this affects their commitment to working toward the leader's vision.

Leadership Logic

Businesses will benefit by actively seeking and building leaders within their ranks, and should look for people who acknowledge and understand their leadership intentions. The ability and desire to help others grow and achieve ensures their success. Leaders must also be able to communicate their visions to their teams. This is the cornerstone of a long-standing and successful company.

Reasons for moving people into leadership positions should be examined. Often the reasons have less to do with their leadership ability than their seniority, technical skills, ability to bring in customers or money, or tireless self-promotion; but people placed in leadership positions for the wrong reasons, or because of the wrong motives, tend to be ineffective.

"Leadership is especially important now, when the business environment is changing so rapidly."

Finding and Building Successful Leaders

Identify natural leaders who will easily step into their roles, create strategic plans, get everyone involved and motivate them to perform to the best of their abilities.

These last two points are perhaps the most important. Without the strength of everyone in the company, whatever strategic plans that are implemented will fail. A building will not stand without a firm foundation, and a leader cannot exist without followers.

How are natural leaders identified? Look for people who:

- Understand the trends and opportunities in the marketplace;
- Are risk takers;
- Have a passion that inspires others;
- Are good listeners;
- Focus on achieving company goals, not just acquiring personal power;
- Have the highest levels of integrity and trustworthiness;
- Share information willingly;
- Admit mistakes and forgive the mistakes of others;
- Make tough decisions;
- Understand how individuals with different strengths, skills and talents all make valuable contributions to the company, and
- Build group cohesiveness.

Once selections have been made, take steps to nurture those people and help them grow, and consider implementing a training program. Here are a few ideas:

- Use a coach (preferably from outside the firm) to work one-on-one with seasoned and emerging leaders;
- Conduct an internal assessment where each participant evaluates his own leadership skills, and peers and subordinates also evaluate those skills;
- Hold or attend a seminar concerning leadership skills;
- Consider creating a mini-library of leadership development materials.

Follow the Path to Profitability

In the early stages of a business, its leader accepts personal responsibility for achieving positive results, but as the company and the people who work in it grow and mature, this person must trust others to accomplish goals. Mistakes become learning experiences that will ultimately strengthen the organization. As employees successfully assume more duties, the leader should take pride in their personal growth. It takes great courage for a person to follow this course, but the effect on the business's profitability is enormous.

Successful leaders have broad visions. When they look at their reflections, they see not only themselves, but also those who support them and who are part of the team. Only the ability to work together, as equals, will bring quality and meaning to the merchandise, service or other end product of a company's effort.

Client Spotlight: Big G Express Forms 100% ESOP

Big G Express, Inc. announced December 22, 2009 the company had sold 100 percent of the operations to the employees through an Employee Stock Ownership Plan (ESOP). Founded in 1995 by brothers Pat and Jack Marsh and later joined by Patty Corley and David Nolan, the dry van carrier has grown to 375 tractors and 850 trailers. Headquartered in Shelbyville, TN, the company also provides warehousing and distribution.

While over the last couple of years Big G Express had been contacted by several outside interested buyers, the owners decided to reward the employees who had helped build the company. Chief Financial Officer David Nolan commented, "Under an ESOP, our eligible employees will participate in a retirement plan that invests in the stock of the company. Doing business with an ESOP company makes good business sense because every employee is an owner and has incentive to do their job well. A lot of companies talk about taking care of their employees. At Big G, we don't just talk about it, we do it."

Katz, Sapper & Miller (KSM) provided services in tax structuring and financial modeling of the ESOP transaction. In addition, KSM facilitated the transaction by coordinating the services of the trustee, attorneys, valuation experts and financial institutions. KSM, also a 100 percent ESOP company, has extensive experience and expertise related to ESOP feasibility, formation, valuation, ongoing compliance, tax structure and accounting matters.

For more information, contact any member of our Valuation Services Group at 317.580.2000.

Bulletin *(Continued from page 4)*

- The parent company and trucking company must maintain separate bank accounts.
- The parent company and trucking company must issue separate Form W-2s to their employees.
- The parent company and trucking company must maintain separate federal depreciation schedules pursuant to generally accepted accounting standards.
- Any income earned by the transportation company for transporting for a third party is to be recognized by the transportation company.

If the parent company owns and holds titles to the vehicles, the parent company may lease those vehicles to the transportation company; however, the lease must be documented as a commercially reasonable, arms-length transaction. In addition, the lease must be evidenced by actual payments to the parent company. If the transportation company owns the vehicles, titles to the vehicles must be held by the transportation company.

The parent company and trucking company must have separate employees, or if the transportation company leases it employees from the parent company, there must be a meaningful, arms-length charge for the leased employee.

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Here and There in the Trucking Industry

Katz, Sapper & Miller has joined the Mid-West Truckers Association.

TMW Systems, Inc. (TMW), the leading business software provider to the transportation services industry, has announced a strategic alliance with KSM Transport Advisors, LLC (KSMTA). The alliance is built on TMW's long-standing relationship with David Roush, newly appointed Vice President for KSMTA. Roush will continue to use the industry-leading TMW Netwise® software at KSMTA as he did prior to joining KSMTA. In addition, he will utilize Netwise to evaluate and model mergers and acquisitions.

Tim Almack presented "Truckers Need an Attitude, a Profit Attitude" at the American Trucking Associations' Leadership Meeting in Washington, DC and the Montana Trucking Association's Annual Convention in Billings, Montana.

Bruce Jones and Jason Miller presented at the Kentucky Motor Transport Association Leadership and Management Conference in Covington, KY.

KSM's Committment to the Trucking Industry:

- Alabama Trucking Association
- American Trucking Associations
- Illinois Trucking Association
- Indiana Motor Truck Association
- Kentucky Motor Transport Association
- Mid-West Truckers Association
- National Tank Truck Carriers
- Ohio Trucking Association
- Truckload Carriers Association
- Tennessee Trucking Association

For more information about Katz, Sapper & Miller, please visit www.ksmcpa.com.

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