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Using transactions to drive growth

Transportation industry strategies

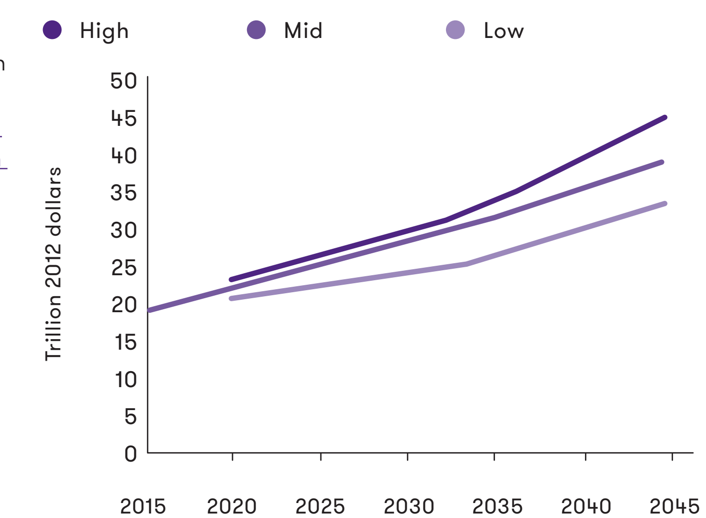
Grant Thornton and Raymond James

Contents

Transportation drives the American economy. Nearly every product we eat, wear or use is moved along the supply chain via transportation, logistics and distribution companies.

Not only is transportation central to the U.S. economy in its function, but also in its scale. Spending in the U.S. transportation and logistics industry is expected to keep growing, according to the U.S. Department of Transportation. By 2045, total freight for air, vessel, pipeline, rail and truck spending is projected to reach 25 billion tons, with a value of $37 trillion.[1]

Transactions are attractive in any growing industry, and transportation has the added benefit of being diversified. There are asset-intensive businesses (think: fleets or infrastructure) and nonasset or asset-light businesses (think: services such as brokerage and third-party logistics). Each has their own cyclical characteristics, making various businesses attractive during different economic times. And, despite its massive size, the transportation and logistics industry is highly fragmented, with only a few very large players. Opportunities for consolidation abound, which takes on added importance with the limited organic growth potential in this well-established market.



Source: U.S. Department of Transportation, Bureau of Transportation Statistics and Federal Highway Administration, Freight Analysis Framework, version 4.1 2016.

[1] United States Department of Transportation. "DOT Releases 30-Year Freight Projections," March 3, 2016.

Transportation investment

Buyers have circled the transportation sector for investment opportunities. Corporate buyers, buoyed by inexpensive borrowing and high levels of balance sheet cash that are generating little to no return, are competing with private equity acquirers on price. In addition, strategic buyers tend to have built-in synergies that may allow them to drive higher multiples. The end result is a highly competitive sellers' market, particularly for middle-market companies in the range of $5 million to $15 million in earnings before EBITDA.

What makes a transportation industry prospect attractive to buyers? As always, nonasset or asset-light businesses remain the most popular targets. But as competition has intensified, it's no longer just nonasset or asset-light companies that are being bought and sold. Infrastructure and asset-intensive companies are on the table, too, as investors seek attractive, stable, long-term returns, but find limited opportunities. Infrastructure-related deals, such as toll roads and ports, are gaining popularity among private equity firms and pension funds due to the steady, long-term returns and general absence of competition. Moreover, new toll roads are likely to be built in the U.S. in the near term, as the U.S. government turns to renewing its aging infrastructure.

To grow rapidly, meet targets and put cash to use.

Acquisition is more than an option — it is a necessity.

The transportation industry is large and broad enough that ample investment opportunities exist for savvy private equity buyers. There seems to be an asset for nearly every buyer and at every time in the economic cycle. "We do a lot of sell-side work for transportation companies," notes Paul Jones, managing director of investment advisory with Raymond James, which covers the logistics space. "We are seeing tons of private equity bids on those businesses. The strategic buyers are looking for a very particular fit with their businesses, but private equity is just looking for good businesses, and they are finding them in spades in the transportation industry. An increasing number of funds are showing interest."

Luke Jones, a principal in the Transaction Services practice at Grant Thornton, notes that buyers are currently taking a fairly broad view of the types of companies they'll consider. "Buyers are very selective about asset-intensive businesses, but it's gotten so hard to get deals done due to high valuations and competition that buyers are expanding their list of prospects to more asset-intensive businesses."

Moreover, asset-intensive and infrastructure investments are increasingly demonstrating that they can offer an exit plan for investors. New York-based Fortress Transportation and Infrastructure Investors, which owns and acquires infrastructure and equipment such as airplanes, shipping containers, railroads, port facilities and oil refineries, had a successful IPO in May 2015, raising $340 million.

Transportation sector trends

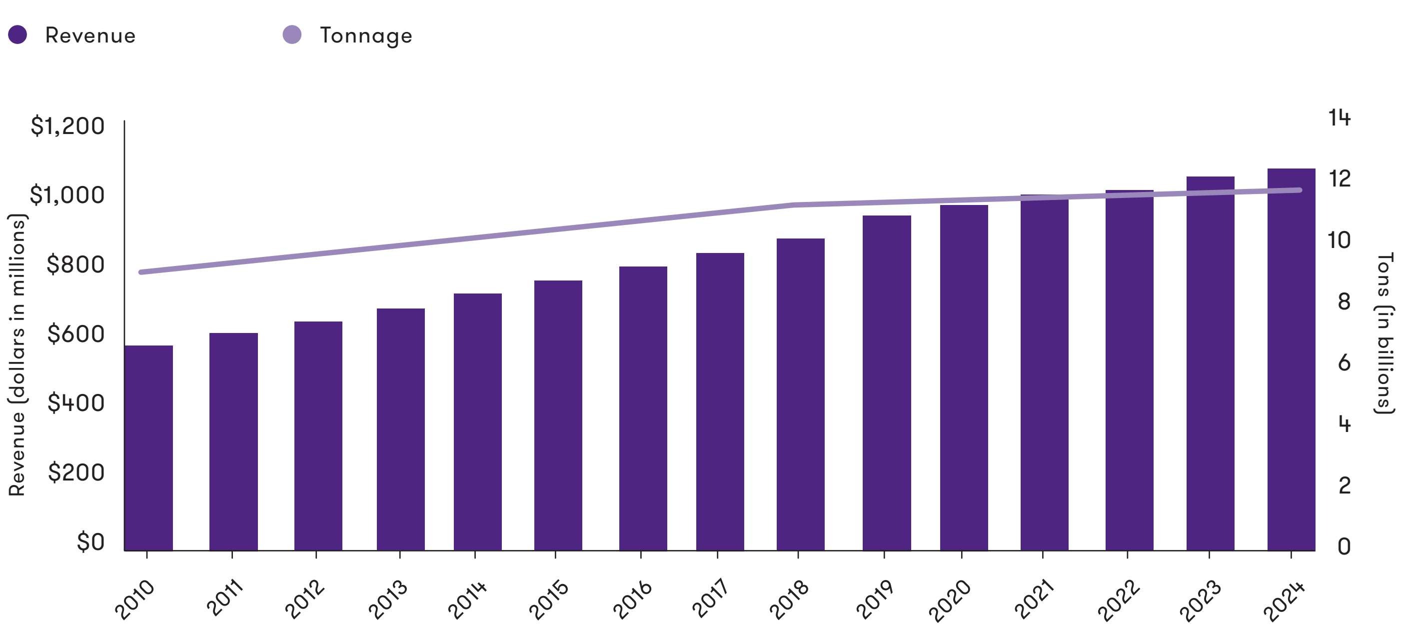
Where are conditions strong for deal activity in the transportation industry? A number of sectors are ripe for investment, while others remain harder to penetrate.

Trucking

Trucking has long been the dominant mode of freight transportation in the United States. In 2015, trucks moved 69% of the value of all domestic freight in the U.S. and 64% of its tonnage — moving 18.1 billion tons of goods, worth about $19.2 trillion, according to a report by the U.S. Department of Transportation's Bureau of Transportation Statistics and Federal Highway Administration.[2]

Like other transportation sectors, trucking is a large and extremely fragmented market, which is unlikely to change anytime soon (as shown in the graph below).[3] While there is increasing consolidation among the larger players since margins are relatively low and the industry is substantial, the sector will likely continue to have many small carriers. Price competition for deals is likely to remain intense, too.

U.S. revenue and tonnage growth for trucking



Consolidation doesn't look likely to slow or threaten to narrow to a handful of large players any time soon. "We expect to continue to see some level of growth via acquisition from large players," says Paul Jones.

With freight volumes climbing, trucking companies that had held off on replacing equipment during the recession returned to spending, replacing older fleets and equipment. Lower fuel prices, combined with these more efficient fleets, improved margins for truckload carriers. While freight volumes are up, there is continued tight capacity and a driver shortage affecting the sector. In fact, carriers have been forced to offer competitive wages and benefits to draw in and retain the best employees, which is increasingly challenging. Even with pay raises, limitations to capacity brought on by the driver shortage are a major problem for trucking companies.

Specialty trucking has become an area of increasing consolidation. Niche areas such as last-mile delivery, oilfield services, specialty chemicals, and oversized items have generated growing interest and, with it, deals. For instance, there is very strong demand among chemical companies for trucking carriers to handle current large-scale petrochemical plant expansion and construction.

"Carriers with niche specialties that generate higher margins are almost always attractive to investors," says Randolph Smith, Transportation practice leader with Grant Thornton. "Unique carriers that can deliver higher margins are getting acquired. The key metric to focus on is the operating ratio (the cost of operations per dollar of sales). This is closely related to the ratio of operating profit to net sales. The lower the operating ratio is, the higher the margins."

Warehouse/fulfillment

Warehousing companies provide facilities to store goods and are a growing sector in the transportation space. While many of these companies started out as old-school warehousing operations, they have increasingly branched out into full-service supply chain management, providing a range of services involved in the distribution of goods, including order fulfillment.

Demands in the warehousing and fulfillment sector have skyrocketed over the past several years due to the massive growth in e-commerce. Companies increasingly expect fast, automated tracking and storage systems that can source and deliver their products to customers. Many online retailers are looking to expand their drop-ship capabilities, which would only increase warehousing demand. In the past, warehouses stored and sent full pallets to retail stores, but now due to just-in-time inventory management, they frequently ship smaller amounts via UPS and less-than-truckload carriers. As these changes have taken root, warehousing and fulfillment companies have jockeyed for position by broadening their capabilities into full-service logistics providers.

Despite rapid growth in the third-party logistics (3PL) sector over the past few years, there are a number of areas of opportunity in this sector, including e-commerce, logistics IT and omni-channel retailing (e.g., channels including retail, online or mobile stores, mobile apps, telephone sales). IT is particularly an area where 3PLs are gaining traction — or could be.

[2] *Ibid.*
[3] Armstrong & Associates, Inc. *U.S. 3PL Market Size Estimates*, 2016.

Industry challenges

Brokerage/intermodal/freight forwarding

Brokerage, intermodal and freight-forwarding services are areas of continued growth for the transportation industry. Companies in this sector essentially function as matchmakers between asset owners and shippers who deliver products via ship, rail, air, truck or some combination thereof. A growing number of manufacturers and retailers are outsourcing this function, fueling growth in the industry.

The brokerage sector is highly fragmented, driving increased competition through price and efficiency. Smaller players face stiff competition from market leaders like UPS and DB Schenker. Large operators can offer lower costs and predictable schedules, given their abilities to aggregate shipments, resulting in lower carrier rates.

Airfreight has been seeing increased traffic, boosted in part by port congestion, particularly on the West Coast, due to a protracted labor dispute. More shippers are utilizing airfreight as a way to mitigate the slowdown from port congestion and backlog, including retailers and auto manufacturers. Those companies will likely continue to use air cargo to move goods into the U.S. from overseas, particularly as low fuel costs make these air freight operations more profitable. Another key factor in the growth of brokerage is capacity constraint caused by multiple factors, not the least being the driver shortage plaguing the trucking industry. With tight trucking capacity, shippers rely more heavily on brokerage services to make sure goods get where they need to go, when they need to be there.

Intermodal transport has become increasingly popular over the past two decades and is expected to grow in the coming years. The careful handling of goods between modes of transport (e.g., ship to truck, rail to truck) reduces the risk of goods being damaged and enables operators to transport goods efficiently. While reliability of the rails has been a long-standing barrier to growth and a source of ongoing challenges to intermodal, rail operators have begun measures to increase efficiency. A continuation of this trend should lead to improved service and consequently additional growth in intermodal demand.

Rail

The rail industry moves large amounts of heavy cargo and products via the U.S. rail tracking network. This includes 70% of U.S. coal, 58% of U.S. raw metal ores and approximately 30% of U.S. grain. According to the Association of American Railroads, coal remains the most widely transported commodity in the United States, accounting for 38.8% of all freight tonnage.[4] However, as the U.S. moves away from coal-generated power, it is likely that the rail industry will take a hit.

But there is a bright spot in that rail transport is environmentally friendly. As companies look to boost sustainability, more are turning to rail transport since it is an energy-efficient and cost-effective way to move goods and freight. Another positive trend for rail is involvement in transportation for the energy industry. As shale oil production has boomed in the U.S., energy companies have increasingly turned to rail to transport their oil, especially as the pipeline networks were unable to keep up with production.

Rail companies don't want to see the movement of oil cease. A number of Class 1 rail companies have recently adopted a new pricing structure for crude shipments: dynamic pricing. This enables Class 1 rail carriers to lock in a base price and for the remainder of the cost to float higher or lower depending on crude oil prices. The new pricing structure is designed to ensure that oil continues moving when spreads/prices are not as advantageous, as well as to provide some cost relief to the customer.

Strong historical industry revenue growth for rail has made the sector attractive to private equity and strategic buyers, and although growth may stagnate in the near term, longer-term growth prospects appear achievable. Moreover, larger railroad companies are expected to grow through acquisitions, and small regional railroads are likely targets for purchase. As such, consolidation should continue to drive investment.

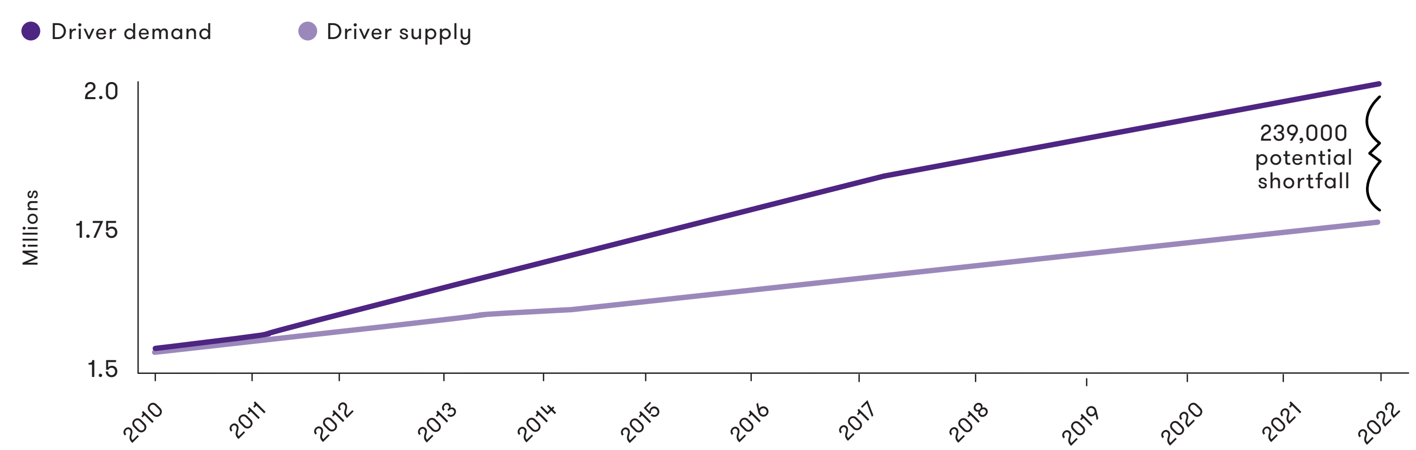
[4] IBISWorld. *Rail Transportation in the U.S.: Market Research Report* (Industry Report 48211), November 2016.

Driver shortage may have long-term effects

The transportation industry is facing a major driver shortage that is limiting capacity. This will only intensify as older drivers retire without a strong pipeline of younger talent entering the driving workforce. Moreover, this retirement is coming relatively soon since the average age of a commercial driver in the U.S. is 55, according to the Bureau of Labor Statistics. The American Trucking Association reports that the current shortfall is about 35,000 truck drivers. Moreover, the industry supply/demand dynamics are set to produce a deficit and need of nearly 240,000 additional drivers by 2022, according to the 2015 3PL study.[5]

New regulations that limit productivity — albeit while boosting safety, an important priority — such as the hours-of-service rules are reducing capacity and spiking needs for additional drivers at a time when driver retention and recruitment are difficult. Other regulations have made it more difficult for drivers to get into or stay in the industry, such as requirements that drivers be 21 and pass periodic drug tests. These rules, taken together, have eaten away at the independence of the job — traditionally one of long-haul trucking's appeals.

Projected driver shortage



Source: 2015 3PL Study

[5] Third-Party Logistics Study. *2015 Third-Party Logistics Study. The State of Logistics Outsourcing*, 2015.

Competition for drivers is particularly stiff when the economy is strong. Would-be truck drivers can often earn more working construction, being able to sleep at home every night. Fracking is another industry that is hiring away potential drivers. "We see transportation companies working together to get more drivers in the pool and recruit drivers," says Grant Thornton's Randolph Smith. The challenge, however, is that there aren't quick fixes. "Companies with relatively low margins can only raise pay so high before the business model becomes untenable."

Already many trucking companies have their own in-house, company-sponsored commercial driver's license training programs to help attract potential drivers. Many of these trucking schools are free, although a few expect drivers to pay back tuition costs once they begin working.

The driver shortage is a problem shared by all trucking companies, even the industry's top performers. Some companies have begun offering signing bonuses topping $5,000 and free bus tickets to drivers willing to switch employers. Others are offering new amenities, such as satellite TVs.

Volatile fuel prices plague shippers, though less so for carriers

Fuel prices remain low, reflecting a protracted drop globally. Many analysts expect the market will remain oversupplied with crude oil, particularly because the global economy is growing at a relatively weak pace. When oil prices are low, the fuel surcharge in domestic trucking rates tends to go down, decreasing overall shipping costs. This, in turn, drives freight volumes. On the other hand, when prices rise, trucking operators typically add surcharges to offset their cost increases. These rising prices pose challenges for shippers, causing demand for trucking services to decline.

Another byproduct of higher fuel prices is that rail tends to get more use due to its relative fuel efficiency compared to trucking. Trains can move one ton of freight coast to coast on seven gallons of fuel. By contrast, road transportation uses 27 gallons to move the same ton the same distance.[6]

Nearly every trucking company of size is open to acquisitions in order to build capacity and expand reach.

[6] IBISWorld. *Rail Transportation in the U.S.: Market Research Report* (Industry Report 48211), November 2016.

Changing regulations

Transportation is besieged by new regulations, which are largely unpopular among long-established carriers but demand compliance despite the frustrations. These regulations tend to pose bigger challenges to smaller companies due to the costs, time and complexity of implementation, which are more easily shouldered by larger carriers.

Among the new rules are speed limiters on heavy trucks, and new drug and alcohol procedures that require a clearinghouse to track drug tests for commercial driver's license holders. The Compliance, Safety and Accountability rules, also known as hours-of-service rules, took effect in July 2013. These rules stipulate driver service hours per day and week. They have cut fleet productivity and require companies to use additional drivers to move the same amount of freight. The rules require additional breaks on overnight journeys and trips over eight hours, and limit when drivers can restart their workweeks.

Electronic logging device (ELD) mandates were finalized in 2015, requiring interstate commercial trucks and buses to install ELDs by Dec. 18, 2017 (or Dec. 16, 2019, for companies using automatic onboard recording devices). ELD rules are intended to help enforce hours-of-service rules. Many of the largest fleets have already adopted ELDs or are in the process of doing so, but many smaller fleets express concerns about the costs of the devices and invasion of privacy. Moreover, since ELDs log adherence to the hours-of-service rules, capacity and productivity are expected to decline because the mandate will require 100% implementation in the next two years.

"The little guys are sweating ELDs becoming mandatory," says Randolph Smith. "The cost of the technology is expensive, and they can't afford it. Worse, their drivers are not happy with the fact that there will be electronic logs on their tractors, and simply will not want to work with the carriers anymore. The drivers perceive it as a Big Brother environment in which they will be watched all the time. E-log and other regulations are driving carriers to sell, particularly those that cannot afford the technology," says Smith.

Trucking companies' ELD adoption may be an issue for financial and strategic buyers, too. While larger trucking companies have converted from paper to ELDs, the shift is not always easy since it demands a cultural and operational change from drivers and dispatchers. It also will reduce driver productivity, revenue per tractor and company profitability. Many buyers are loath to acquire smaller companies that are still operating on paper logs, with the concern that the shift to ELDs will increase deal risks and reduce profitability. Other regulatory challenges include escalating fuel economy standards (that reduce greenhouse gas emissions), and the federal requirement that an interstate commercial driver's license holder must be at least 21. This creates a three-year gap after high school that may prevent young people from considering a career in trucking at a time when the industry desperately needs new and young drivers due to an ongoing and worsening driver shortage.

The Trump administration promises reduced regulation, so some of these rules may be relaxed in the coming years.

3 macro trends affecting transportation investments

Macro trend No. 1: E-commerce spurs demand, services

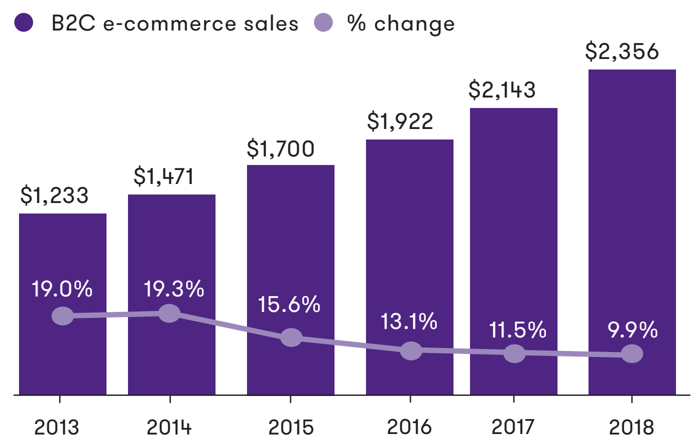
In addition to the shifting of the regulatory environment, e-commerce is having a significant impact on the transportation industry. During the recession, declining consumer spending resulted in a substantial drop in retail activity, and the transportation industry saw a decreased demand for its services. But as the economy has recovered, so too has consumer spending and with it, domestic freight volumes. As economic growth accelerates, consumer spending is forecast to increase, driving higher retail and industrial output. Freight volumes are anticipated to climb as retailers and manufacturers transport their goods between their facilities, markets and customers.

In fact, e-commerce sales have been one of the fastest-growing drivers of demand for transportation services. The ability to buy online and ever-shortening delivery windows have increased demand for courier services and substantially increased the volumes of smaller packages.[7]

"The rapid pace of change within retail is driving larger e-commerce initiatives for both traditional brick-and-mortar retailers, which are transforming into omni-channel retailers, and pure e-commerce retailers," says Jennifer Neill, senior manager of Transaction Services at Grant Thornton.

Paul Jones adds, "Companies want to be able to provide all of the retailers' transportation needs, and are adding value in a number of ways to do so, which is driving continued consolidation. At the same time, advancements in technology are enabling greater efficiency and less human touch on each individual shipment."

B2C e-commerce sales worldwide, 2013-2018
Trillions and % of change



Note: CAGR (2013-2018) = 13.8%; includes products and services ordered and leisure and unmanaged business travel sales booked using the internet via any device, regardless of the method of payment or fulfillment.

Source: eMarketer.com, July 2014

As e-commerce sites and online auctions have grown, warehousing has become a critical and expanding part of the industry since e-commerce companies require facilities from which to store and ship their products. Warehouse providers that can offer fast delivery and seamless tracking are increasingly gaining market share.

[7] *Ibid.*

Macro trend No. 2: Companies broaden offerings beyond traditional roles

The once-clear lines between various segments in the transportation industry have blurred as companies continue to expand and integrate their service offerings in order to differentiate themselves and win market share. Many transportation services companies have begun to offer value-added services like logistics consultation and supply chain management, casting the roles of brokers, freight forwarders and 3PLs into flux. Many brokers that used to strictly link shippers with truck and ocean transport, now offer intermodal services, while others own and operate their own trucks or warehouses. There is a growing trend toward offering integrated logistics services that provide door-to-door delivery.

Investors are drawn to the growth rates and asset-light business model of these 3PLs, and also to the expanding level of services offered. The trend toward integration of services has increased M&A, while low barrier to entry for these types of businesses has encouraged new competitors to enter the market. Larger industry players have had success with this approach because their resources have allowed them to more easily branch into other businesses or acquire competitors that offer synergistic services.[8]

Randolph Smith notes: "Many carriers have or are adding brokerage to their business. It's lower margin but it gives carriers more control. It adds diversification within the industry, so the old days when a carrier was in one subsegment are gone. For example, XPO has purchased asset-based companies and there are plentiful examples of different subsectors moving into other sectors to diversify their holdings."

Paul Jones of Raymond James adds, "Shippers have begun to use 3PLs as an intermediary between their companies and the carriers and pre-buying freight to help ensure they have capacity to move goods at certain times of year, while carriers work with 3PLs because it enables them to have more control over freight shipments."

Macro trend No. 3: Technology wins, especially big data

As the transportation industry adopts newer and better technologies — from GPS tracking to electronic logging and fuel management devices — these technologies offer clear information about where goods and resources are in the supply chain. Shipping data has become more accurate, and the speed of information sharing has vastly improved. These new technologies have enabled distributors to reduce the amount of on-hand inventory needed for operations.

Certainly, technologies such as electronic transaction services, online status updates and electronic bills have become standard among midsized and larger industry players, although many small transportation providers haven't had the resources to offer these and have continued to operate in a fairly manual environment.

Transportation management systems (TMS) have become increasingly common, providing shippers with visibility into decision-making, efficient execution and business intelligence data. These integrated systems provide shippers or carriers a link to their enterprise resource planning systems, and automate decision-making, shipment planning and execution, and tracking and payment. These systems have also enabled high-level optimization functions. The software-as-a-service model has resulted in a number of new TMS providers offering affordable, subscription-based systems without significant capital investments.

"If you have good technology, it can make a big difference, particularly because good technology makes customers stickier," says Paul Jones. He adds: "If that technology can pull and slice and dice data and provide metrics, it can make a big difference in the price paid to acquire a business." On the other hand, companies for sale that have underinvested in technology are likely to see that reflected in purchase price, he says.

[8] IBISWorld. *Freight Forwarding Brokerages and Agencies in the U.S.: Market Research Report* (Industry Report 48851), April 2016.

Says Randolph Smith, “Technology is moving extremely fast. If transportation companies don’t invest in technology, they won’t survive. We’re seeing that in the U.S. currently. Expectations of customer and regulatory mandates have forced these guys to focus on technology, and I think it will continue to be that way for the foreseeable future. Better-capitalized companies are more easily able to adopt new technologies. Smaller, less sophisticated carriers may not be able to effectively deal with it.”

The challenge for private equity firms lies in assessing how good the seller’s technology actually is. “Everybody says they have great technology. But a lot of companies purposely underinvest in technology to buffer EBITDA. It is hard to verify,” Paul Jones cautions.

Strategies for successful deals

Given the complexities, stiff competition and high multiples for transportation deals, acquirers need to manage two fundamental challenges. First, they need to mitigate risks. Second, they need to maximize value in the transaction. What follows are tips for achieving these two critical elements.

Strategy No. 1: Mitigate risks

Consider tax and transaction structure of the entity.
Plan ahead for tax implications and anticipate the optimal tax entity. It is important to determine the entity’s tax structure before entering the sale market. Certain tax entities, particularly pass-through entities such as S-corporations or limited liability companies, provide ample flexibility for both buyer and seller.

Transactions can be structured as immediately taxable or tax-deferred, depending on the buyer or seller’s needs. Private equity owners selling a portfolio company may want to defer all or part of the gain on the sale by maintaining some equity interest with the company after the deal. Buyers acquiring a carrier almost always want the benefit of a tax step-up from a transaction characterized as an asset purchase. “When companies can acquire an asset with a step-up in basis, they’re able to amortize intangible assets for tax purposes to offset future income,” explains Russ Daniel, partner in M&A Tax Services at Grant Thornton. “The higher the valuation, the more important that is since you’re paying a premium for goodwill or other intangibles. If you haven’t structured the deal properly, then you can’t take advantage of the tax shield.”

Sellers may prefer a transaction characterized as a stock purchase so as to maximize the benefit of lower capital gain tax rates. Stock purchase/merger transaction structures often afford numerous efficiencies to motor carrier transactions, such as equipment titling and plates, permits and beneficial seller tax treatment. On the other hand, some private equity buyers prefer asset purchase transactions since the structure provides buyers with greater protection against seller liabilities, especially in the case of financially troubled sellers.

The tax structure of the entity is an issue sellers should address before entering the marketplace. “Sellers sometimes have very inefficient tax structures that create problems when they want to sell. Even if buyers are interested, the buyer sometimes can’t afford to sell at the offered price because the structure is so inefficient,” notes Randolph Smith.

Another consideration is the debt versus equity mix, says Daniel. “Private equity deals always have a fair amount of debt involved, and how you structure the debt can impact your ability to use the interest-expense deductions. If you don’t set it up correctly, you can’t use the deduction,” he explains.

Minimize deal risk with comprehensive due diligence.
Given the competitive environment, due diligence has never been more important to mitigate deal risks. Be prepared to understand and address three main areas as part of this process:

- The quality of EBITDA and working capital. However, for certain transactions, EBIT (excluding depreciation and amortization) or EBITDAR (including rent) may provide a better indication of the earnings quality.
- The quality and availability of data. Preparing data is critical to closing the transaction in an efficient and timely manner with minimal disruptions for management.
- The potential strengths or weaknesses that could affect value, such as customer concentration, related-party transactions, commitments and contingencies, customer and vendor arrangements, key employee agreements, and seasonality and equipment replacement for asset-intensive businesses.

Due diligence should also cover successor liabilities, which often are not sufficiently a focus of transaction due diligence and documentation. "Liabilities can be significant, particularly in the acquisition of a financially troubled or unsophisticated seller," notes Smith. "Don't overpay without knowing it," cautions Grant Thornton's Luke Jones. "Good due diligence upfront means you fully understand what you are getting into, so that you can make a conscious and informed value judgment. As buyers are paying increasing multiples, the impact of missed due diligence increases, too," says Jones.

Make a plan for regulations.
Dealing with a host of new and changing regulations is difficult, but it shouldn't be a surprise to buyers. The timing of regulations gives companies plenty of advance warning to know what's coming, which private equity buyers should use to plan for managing the new rules. Moreover, new regulations don't have to simply be a compliance burden — they are also an opportunity. In many cases, new regulations have encouraged the transportation industry to innovate, leading to new growth and even new ventures for companies that are proactive.

This is particularly true for existing industry supply companies with strong R&D functions. For example, technologies for ELD have proliferated. New rules passed in 2013 by the Federal Motor Carrier Safety Administration that require truck drivers to be screened for sleep apnea have spawned innovative solutions such as on-the-go diagnostic sleep studies specifically designed for truckers. (A pre-rule to collect data on obstructive sleep apnea and the impact it has on the trucking industry was published on March 10, 2016.)

Develop a strategy to attract and keep drivers.
The perfect storm for a driver shortage is coming. Many drivers are reaching retirement age; few young people are entering the talent pool; cumbersome regulations are impinging on drivers' autonomy; there is diminished capacity due to hours-of-service and speed rules. At the same time, demand is surging worldwide. Companies need a strategy for keeping the drivers they currently have and attracting a replenishing pool of new drivers. Higher pay always helps, but with the small margins earned by most carriers, it isn't enough. Addressing the driver shortage will take careful attention and creative solutions.

Strategy No. 2: Maximize value

Identify an operating partner in the transportation space.
It can be extremely beneficial for buyers to identify an experienced operating executive who is steeped in the transportation industry and partner with him or her to watch for good deals in the industry. Typically, this individual will have significant experience and perspective, and be able to distinguish a good deal from a troubled one. Occasionally, this operating executive has sold his or her own transportation company and is looking for an equity investment in a new firm. Further, that operating executive and partner will sometimes step in as CEO or a board member of the company once it has been acquired. Introductions can be made to these partners through industry contacts, investment bankers, law firms or consultants.

Consider add-on acquisitions.
"If you have a healthy company, add-on acquisitions for lower prices make sense every time. These pay off when you're ready to sell, and in the interim, you're improving those businesses," says Paul Jones. "When you buy a bigger company with a better management team, you pay a high price for that. But then you can buy smaller companies to add capabilities and customers, and usually you can do those smaller deals for a lower price," explains Jones. The only time that it's not a good idea, he cautions, is when purchasing a turnaround, which requires substantial attention and resources.

Perform buy- and sell-side due diligence.
Due diligence is not simply for buyers; it applies equally to sellers. Too often, sellers come to the transaction table wishing they were better prepared for the scrutiny that comes with the buyer's due diligence. Conducting an analysis of key risk areas ahead of a transaction is time and money well spent, since these areas will inevitably come to light and likely be negotiated as part of the sale. "Performing sell-side diligence helps sellers maximize the value and quality of the deal, while putting the seller in control of process. It typically accelerates the time to close and improves the quality of the deal, while ensuring money is not left on the table. In a deal market with relatively high multiples, ensuring you, as a seller, present EBITDA to its true potential is important," says Luke Jones.

Russ Daniel cautions companies to make sure that their due diligence is thorough — every time. "You never know what you're going to find. If owners have been greedy on their taxes, I often find substantial issues." Red flags that make Daniel raise an eyebrow include companies with a lot of related-party transactions or special purpose entities. "These aren't necessarily bad, but they should raise the antenna that there could be tax issues there. Companies may have misused related parties or special purpose entities in order to shelter taxes," cautions Daniel.

Develop a strategy for systems improvements.
Technology is a differentiator — particular technologies can produce data to guide strategic decision-making. Information systems that can enable owners to manage the business more effectively offer a distinct advantage. "This is extremely valuable because companies with good information systems can target the areas that are most profitable for growth, and shrink the unprofitable areas," says Paul Jones. Yet, in small to medium-sized founder-owned businesses in the fragmented transportation industry, the odds are that technology and operating systems may be less than cutting edge. It's critical for buyers to have a clear strategy that considers system upgrades, if necessary, in order to determine profitability by service line and customer, among others.

Know your value.
It's easy to lose focus when acquiring and integrating new businesses that offer a wide and sometimes new range of services. In some cases, accessing these services is the key strategic reason for the acquisition. But in other cases, particularly for private equity, keeping every service can erode focus on the core business. "Figure out the key reason that someone hires you instead of your competitor. Then, try to be the best at it rather than trying to be everything to everybody," concludes Paul Jones.

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