MERCER CAPITAL

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How to Value Your Trucking Company

WHEN YOU NEED TO KNOW WHAT YOUR BUSINESS IS WORTH

SELLING OUT?

In the most obvious case, someone planning to sell their business needs to know its worth. One of the hardest issues a business owner encounters is cashing-out their life's work. But beyond the myriad of emotional issues, there are the raw economics of how you will sell and for how much. Hundreds of issues may arise in a transaction that will ultimately affect the proceeds to the seller. A valuation of your business will allow you to know what you should expect and to evaluate whether or not an offer for your company is reasonable.

SELLING IN?

Transferring ownership to your children or management team requires you to have a complete understanding of what the transferred interests are worth. Depending on the circumstances, a small minority interest may be worth much less than a pro rata interest in the total value of the business. Ignoring this issue can cost you a lot of money and potentially result in inflated taxes being owed on the transfer.

BUY-SELL AGREEMENTS

If your business has other shareholders, there is likely a buy-sell agreement between these shareholders that describes how the business (or business interests) will be valued in the event of a shareholder dispute, death, or departure from the business (even on friendly terms). Many business owners fail to understand the valuation implications of buy-sell agreements. In our experience, buy-sell agreements almost never sufficiently describe the mechanism to be used to value the business. The process always looks simpler when the buy-sell agreement is drafted and a transaction is not actually on the table. But when the day comes that a buy-sell agreement is invoked, a clear process and accurate understanding of value will allow for a much smoother undertaking.

OTHER OWNERSHIP TRANSFER SCENARIOS

Some business owners use business valuation as a tool for creating ownership stability and assessing management performance. However, since business owners are often consumed with the day-to-day activities of running the business, many fail to acknowledge that life (and business) cycle events do happen to them, their partners, and their families. Events like these will require that their businesses be valued. Mercer Capital professionals have spoken for years about the "things that happen to you" and the "things you make happen." The key take-away is this: an understanding of the value of your business or business interest is critical in preparing yourself for any of these eventualities. The following table illustrates the range of potential events that might trigger an ownership change.

The Business Transfer Matrix	PARTIAL SALE/ TRANSFER	TOTAL SALE/ TRANSFER
THINGS YOU MAKE HAPPEN	ESOP Outside Investor(s) Sale to Insiders/Family Combination Merger/ Cash Out Going Public	Sale of Business Stock-for-Stock Exchange w/ Public co. Stock Cash Sale to Public Co. Installment Sale to Insiders/Family ESOP/Management Buyout
THINGS THAT HAPPEN TO YOU	Death Divorce Forced Restructuring Shareholder Disputes	Death Divorce Forced Restructuring Bankruptcy

VALUE MANAGEMENT

Even those not currently contemplating a transaction in their business have a reason to consider a business valuation. Why? Because knowing the value of your business can be a tremendously effective management tool. Ultimately, you will get two returns from your business – in the valuation community we call these “interim cash flows” and “terminal cash flows.” Interim cash flows include things like your salary, your benefits, and your dividends/distributions. You know what these are and what you can do to influence them. However, your greatest cash flow may be the terminal cash flow (i.e., the value when you sell your business). Are you managing your business in a way that increases its value or not? Do you know?

BASIC CONCEPTS THAT MUST BE DEFINED IN EVERY VALUATION

Before covering specific details of business value related to the trucking industry, we will first explore a few basic valuation concepts. Some business owners may be surprised to learn that their business does not have a single value, but rather, that its valuation is determined by numerous factors. Tax, legal, and other elements play important roles in defining value based upon the transfer circumstances. While there are significant nuances to each of the following topics, our purpose is to help you combine the economics of valuation with the relevant legal framework.

THE VALUATION DATE

Every valuation has an "as of" date, which is the date around which the analysis is focused. The date may be set by legal requirements related to a death or divorce, or it may be implicit, such as the closing date of a transaction.

THE PURPOSE OF THE VALUATION

The purpose of the valuation is linked to the transfer event at hand (such as a sale, estate planning, or buy-sell agreement trigger). A valuation prepared for one purpose is not necessarily useful or applicable for another.

THE STANDARD OF VALUE

The standard of value is an important legal concept that must be addressed in every valuation assignment, as it influences the selection of valuation methods as well as the level of value. "Fair market value," most commonly used in tax matters, is the most familiar standard of value. Other important standards of value include "fair value" (financial reporting purposes under GAAP), "investment value" (purchase and sale transactions), "statutory fair value" (corporate reorganizations), and "intrinsic value" (public securities analysis). Using the proper standard of value is crucial in obtaining an accurate determination of value.

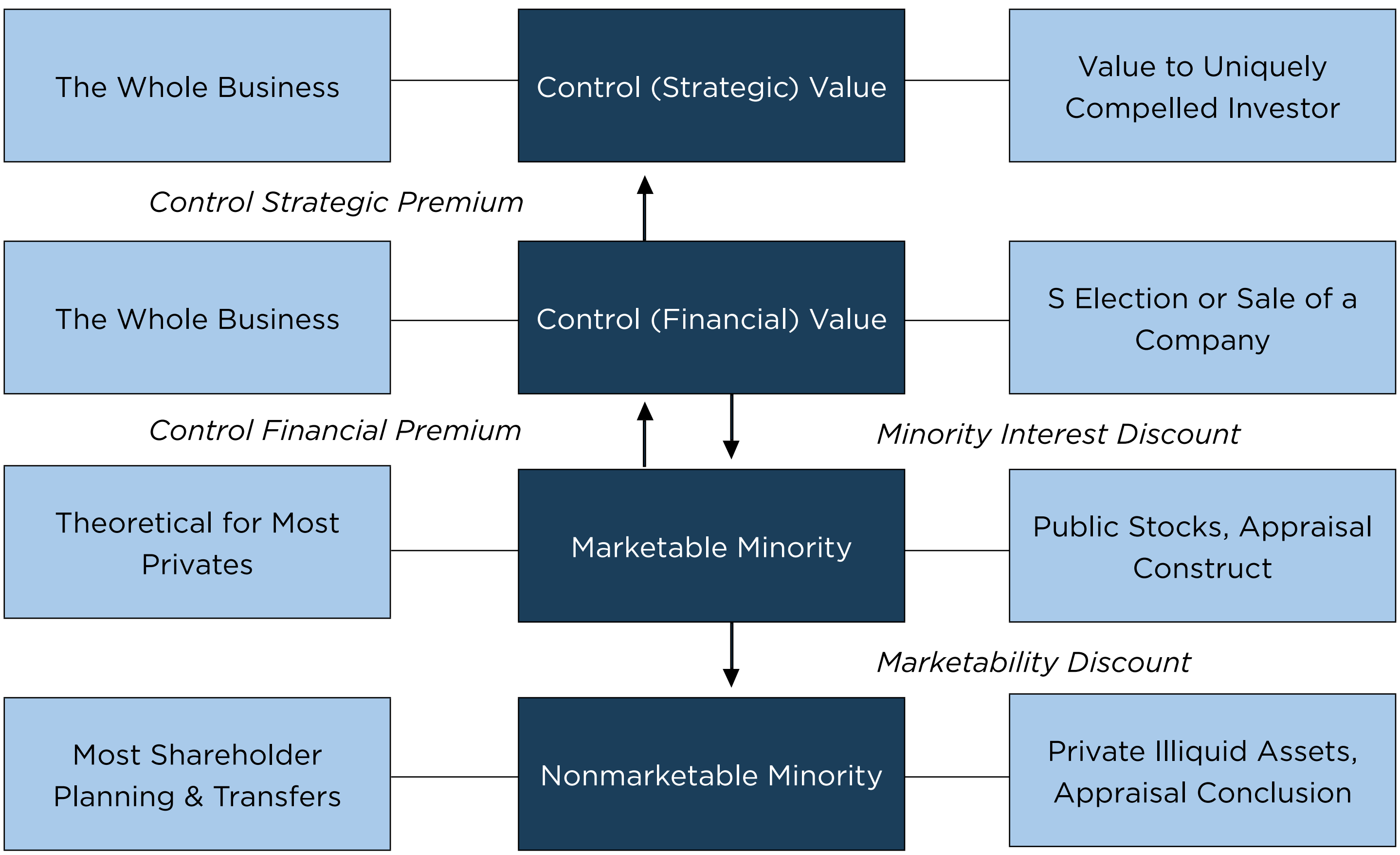
THE LEVELS (PREMISE) OF VALUE

Does it make a difference in value per share if you own 10% or 75% of a business? It absolutely does. A minority interest does not enjoy the same prerogatives of control that come with a majority holding. Minority owners are relegated to bearing witness to a process over which they have no control or discretion, and they, in effect, play the role of silent partners. Without the ability to control compensation, distributions, or to dictate the strategic direction of the business, the value per share of a minority partner is likely worth less than the shares of a 75% owner.

To add further insult to injury, a minority owner of a private business likely has no ready market in which to sell their interest. Minority ownership in a publicly traded company enjoys near instantaneous liquidity given that such interests can be traded on organized and regulated exchanges. The unique uncertainties related to the timing and favorability of converting a private, minority ownership interest to cash gives rise to a valuation discount (for lack of marketability) which further distances the minority owner's per share value from that of a controlling owner's value per share.

The following chart provides perspective of the various "levels of value." In most cases a valuation is developed at one level of value and then converted to another level of value by way of a discount or premium.

Levels of Value



APPROACHES

Again, it comes as a surprise to many owners to learn that there is not a single value for their business. Without offering a full dissertation on business valuation, you need to understand that there are three commonly accepted approaches to value: asset-based, market, and income. Approaches refer to the basis upon which value is measured. Each approach incorporates procedures that may enhance awareness about specific business attributes that may be relevant to determining the final value. Ultimately, the concluded valuation will reflect consideration of one or more of these approaches (and perhaps several underlying methods) as being most indicative of value for the interest under consideration.

THE ASSET-BASED APPROACH

The asset-based approach can be applied in different ways, but in general it represents the market value of a company's assets minus the market value of its liabilities. While an asset value consideration can be a meaningful component of the overall valuation of a trucking company that owns tractors and trailers, it is the income generated by these assets that typically drives the value of a business. For this reason, the asset-based approach is typically not the sole (or even primary) indicator of value.

THE INCOME APPROACH

The income approach can be applied in several different ways. Generally, such an approach is applied through the development of an ongoing earnings or cash flow figure and the application of a multiple to those earnings based on market returns. The income approach allows for the consideration of characteristics specific to the subject business, such as its level of risk and its growth prospects relative to the market.

THE MARKET APPROACH

The market approach utilizes market data from comparable public companies or transactions of similar companies in developing an indication of value. In many ways, this approach goes straight to the heart of value: a company is worth what someone is willing to pay for it.

In many industries, there are ample comparable public companies that can be relied on to provide meaningful market-based indications of value. But comparing these large, diversified, global businesses to the typical private, independent trucking company can be problematic.

Data from industry acquisitions can also be utilized as a multiple on the subject company's performance measures. This can provide a meaningful indication of value as it typically takes into account industry factors (or at least the market participants' perception of these factors) far more directly than the asset-based approach or income-based approach.

FINANCIAL AND MARKET CONSIDERATIONS

The financial health and outlook of a trucking company should be assessed in the context of the overall trucking market. The trajectories of revenue and earnings have a lot to do with the timing in the business cycle for the industry and the state of the overall economy.

Industry factors such as technological developments, the relative cost of alternative transportation methods, and government regulation at the date of the appraisal can affect the potential for growth and the demand for trucking transportation.

- **Manufacturing Output.** Domestic manufacturing activity is a large source of demand for freight transportation services.
- **Competitive Landscape**. Competition includes other modes of transportation, such as rail, ocean, and air in addition to direct competitors within the trucking industry.
- **Fuel Prices**. Fluctuations in fuel prices are often addressed through surcharges. However, companies may not be able to fully pass along the increase in fuel input costs.
- **Government Regulation**. The transportation industry is highly regulated, with legislation covering environmental aspects, labor, and infrastructure. Regulations may have a bigger effect on smaller companies.
- **Demand for Trucking**. Often measured by truck tonnage movement, the demand for road transportation brings together all of the above factors and can affect the growth outlook for an industry as well as determine the desire (or need) for consolidation activity.

A word on industry segments: The above factors can affect industry segments differently. The trucking industry can be sliced in many different ways: by truckload or less-than-truckload, distance carried, cargo type, and service specialty just to name a few. These individual segments of the industry are influenced by a multitude of niche factors, as well. Take commodity haulers for example and the effect of spot market prices on their business. It's important to understand how both broad industry factors and niche segment factors affect your company.

THERE ARE DIFFERENCES BETWEEN PUBLIC AND PRIVATE TRUCKING COMPANIES

THE GUIDELINE PUBLIC COMPANY METHOD

Solely comparing private trucking companies to public companies for valuation purposes is problematic. To know why, let's first take a look at the public companies. The five largest trucking companies traded on the U.S. exchanges as of the date of publication are as follows:

Old Dominion Freight Line, Inc. (ODFL)

Old Dominion Freight Line, Inc.			
Enterprise Value ($M)	**LTM Revenue ($M)**	**EBITDA Margin**	**Employees**
28,870	4,577	31%	19,779

Old Dominion provides LTL services on the regional, inter-regional, and national levels. Founded in 1934 and based in Thomasville, NC, it operates over 9,200 tractors.

J.B. Hunt Transportation Services, Inc. (JBHT)

J.B. Hunt Transportation Services, Inc			
Enterprise Value ($M)	**LTM Revenue ($M)**	**EBITDA Margin**	**Employees**
18,104	10,737	13%	30,309

J.B. Hunt Transport Services, Inc. was incorporated in 1960 and is headquartered in Lowell, Arkansas. The company provides surface transportation services in the continental U.S., Canada, and Mexico. It consists of four segments: Intermodal (JBI), Dedicated Contract Services (DCS), Integrated Capacity Solutions (ICS), and Truckload (JBT). JBI deals in intermodal transportation, and owns over 5,000 tractors. DCS is J.B. Hunt's supply chain support segment, which owns over 9,500 trucks. ICS deals in traditional freight brokerage, as well as engaging with LTL, flatbed, and refrigerated solutions. It operates 44 remote sales branches. JBT offers full-load and dry-van freight services, and operates over 1,100 tractors.

Ryder System, Inc. (R)

Ryder System, Inc.			
Enterprise Value ($M)	LTM Revenue ($M)	EBITDA Margin	Employees
10,545	8,967	28%	39,000

Ryder System, Inc. is a worldwide supply chain and transportation solution provider. It was founded in 1933 in Miami, FL. Ryder operates in three segments: Fleet Management Solutions (FMS), Dedicated Transportation Solutions (DTS), and Supply Chain Solutions (SCS). FMS offers full service leasing as well as maintenance services and supplies, while also selling used vehicles through 53 retail sales centers. DTS offers equipment, maintenance, routing and scheduling, and other support services. SCS provides primarily value-added services, such as coordinating the flow of goods from receiving to shipping functions and handling import and export for international shipments.

Knight-Swift Transportation Holdings, Inc. (KNX)

Knight-Swift Transportation Holdings, Inc.			
Enterprise Value ($M)	LTM Revenue ($M)	EBITDA Margin	Employees
8,267	5,027	24%	22,900

Knight-Swift Transportation Holdings Inc. provides truckload transportation services in the United States, Mexico, and Canada. The company operates through six segments: Knight Trucking, Knight Logistics, Swift Truckload, Swift Dedicated, Swift Refrigerated, and Swift Intermodal. It offers a wide variety of services, including dry van, refrigerated, flatbed, and cross-border, among others. Its total tractor base is almost 20,000 vehicles. It was founded in 1989, and is headquartered in Phoenix, AZ.

Landstar System, Inc. (LSTR)

Landstar System, Inc			
Enterprise Value ($M)	LTM Revenue ($M)	EBITDA Margin	Employees
5,977	5,243	8%	1,320

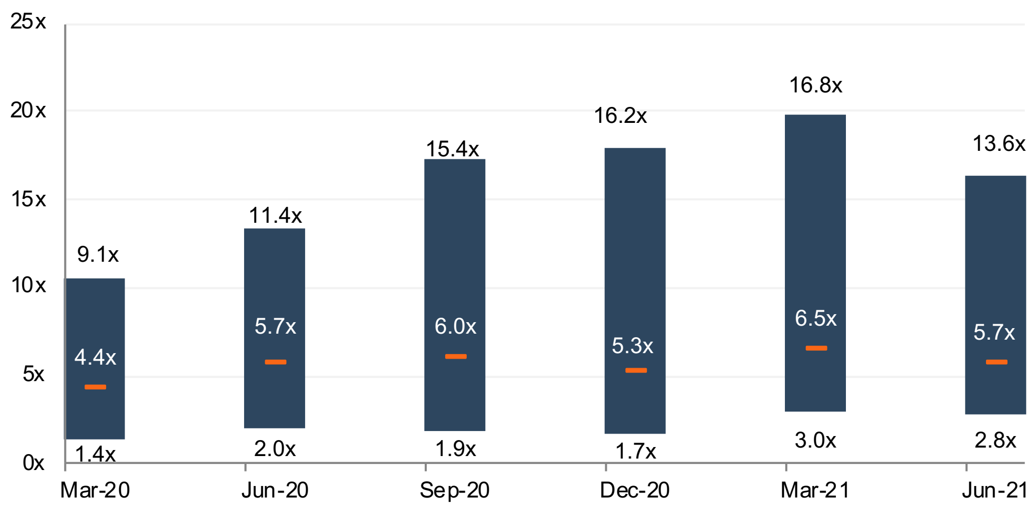
Landstar System, Inc. is a company that provides transportation management solutions in the U.S., Mexico, and Canada. Landstar operates in two segments: Transportation Logistics and Insurance. The Transportation Logistics segment offers a wide variety of transportation solutions in the truckload, LTL, and intermodal transportation, among others. The Insurance segment reinsures the risks of Landstar's independent contractors. Founded in 1968, Landstar is headquartered in Jacksonville, FL.

THE DIFFERENCES BETWEEN PUBLIC AND PRIVATE COMPANIES

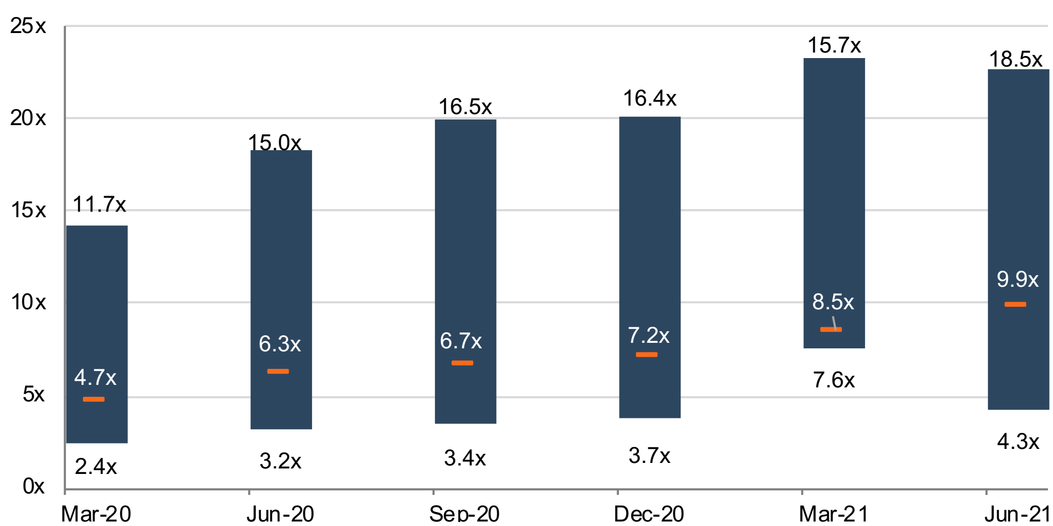
Size, Diversification, and Location Impact Valuation

As of June 30, 2021, the enterprise values for these public companies ranged from $6.0 billion to $18.1 billion. The charts below show the range of implied Enterprise Value to EBITDA multiples for the publicly-traded truckload and less-than-truckload sectors over the last six quarters (prior to publication of this paper). Many private companies utilize the valuation multiples of public companies to estimate private company value.

Truckload



Less Than Truckload



As their business descriptions indicate, the operations of these five publicly traded companies are diverse and international. The companies have 1,273 to 36,000 employees and annual revenue between $4.5 billion and $10.7 billion. When utilizing these public companies as a valuation benchmark, keep in mind the above descriptive analysis when comparing your private trucking operations and adjust for the differences.

WHAT VALUATION APPROACHES MAKE SENSE FOR TRUCKING COMPANIES?

Guideline Public Company Method Can Be Helpful But Not as a Stand-Alone Method

Making the judgment that the guideline public company method is appropriate or not appropriate can be simple or quite complex. While using publicly traded companies to assess the value of a trucking company can provide a general context for private company valuation, this process should not begin and end at public company valuation multiples applied to private company performance levels. To put it bluntly, the above five publicly traded companies are not directly comparable to most trucking companies. As such utilizing public transportation companies to value privately held ones requires various adjustments to be made. It is not an "apples to apples" comparison. To explain further, let's consider a couple of major differences.

Size. The five largest trucking companies in both Truckload and LTL have annual revenues over $4.0 billion. When comparing public companies to private companies, there is a general "rule of 10," which says if a subject company is 10x larger or smaller than the public company compared to it, the growth and risk factors are so different that it is very difficult to adjust and reconcile these differences. According to this "rule of 10," any trucking company with revenues of less than $400 million violates the general comparability rule in reference to any of the five largest companies in its category. While this is just a general rule and not an absolute, it is important to keep in mind, especially in light of the next difference: diversification.

Diversification. Each of the above public companies generate revenues from multiple sources of services, customers, industries, and multiple locations (many internationally). Every business owner understands that diversification minimizes risk and promotes growth; both are value enhancers for a business. However, many local and regional fleets are tied to a certain area or region. In addition, smaller fleets may have significant customer associated with one or two large accounts due to lack of diversification. This fact pattern changes the risk profile significantly, making comparison between smaller, private trucking companies to the publics unsupportable. Additionally, for companies of larger and more diversified business models, the cost of debt and equity capital is significantly cheaper. Larger, seemingly less risky businesses have access to more sources of capital compared to smaller, more risky businesses (all other things being equal).

Both of these differences (and more) must be considered in performing a valuation utilizing public companies.

The Market Transaction Approach

Market transactions of privately held companies in the same or similar business may also provide a reasonable basis for valuation of the subject company. Such companies provide controlling interest valuation data. Market transactions are used to develop valuation indications under the presumption that a similar market exists for the subject company and the comparable companies.

Ideal guideline companies are in the same business as the company being valued. However, if there is insufficient transaction evidence, it may be necessary to consider companies with an underlying similarity of relevant investment characteristics such as market, products, growth, cyclical variability, and other relevant factors.

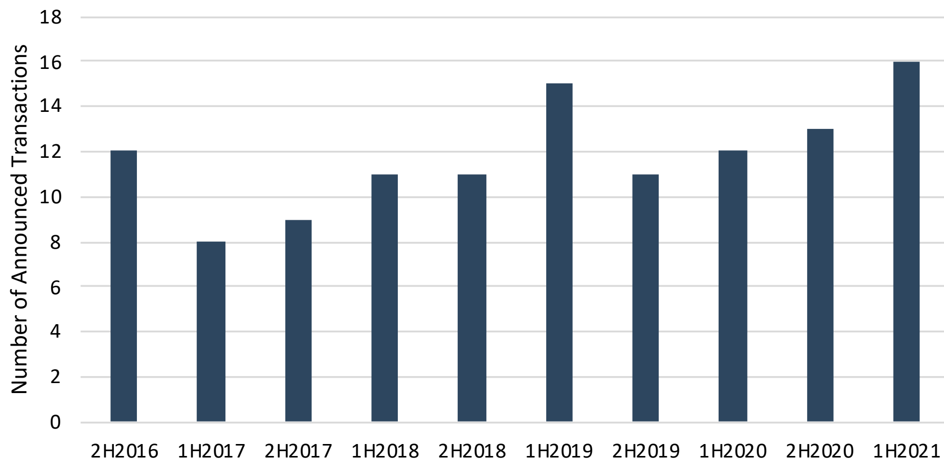
When considering the available transaction data for trucking companies, the Knight-Swift (NYSE: KNX) merger has been arguably the most significant in recent history. This acquisition created Knight-Swift Transportation, the fourth largest trucking company traded North American exchanges at the date of publication a company with an Enterprise Value of over $6 billion. The combination of two major public players in the truckload space was notable for its $3 billion price tag and 24x EBITDA multiple.

Knight-Swift Merger		
Acquirer		**Transaction Date**
Knight Transportation		4/10/17
Target		**Close Date**
Swift Transportation		9/8/17
Value ($M)	**Revenue**	**Implied EV / EBITDA**
$2,971	4.3x	24.1x

While it is tempting to turn to the biggest headline acquisitions as a means of comparison, it can be far more valuable to identify the industry appetite for smaller, more comparable businesses. The availability of relevant market transaction multiples may be limited, however, as smaller trucking company targets are often privately held and rarely report transaction multiples, while public M&A activity involves larger, diversified players like Knight-Swift.

Clearly, the more comparable the transactions are, the more meaningful the indication of value will be, but caution must be exercised when utilizing data from market transactions since the circumstances surrounding each sale are often unknown.

Trucking Industry M&A



CONCLUSION

Mercer Capital has long promoted the concept of managing your business as if it were being prepared to sell. In this fashion, you promote the efficiencies, goals, and disciplines that will maximize your value. Despite attempts to homogenize value through the use of simplistic rules of thumb, our experience is that each valuation is truly unique given the purpose for the valuation and the circumstances of the business.

Mercer Capital has valued businesses in various segments of the transportation and logistics industry over the years. We hope this information, which admittedly only scratches the surface, helps you better understand some of the valuation considerations that apply in the insurance industry.

We encourage you to extend your business planning dialogue to include valuation, because sooner or later, a valuation is going to happen. Proactive planning can alleviate the potential for a negative surprise that could complicate an already stressful time in your personal and business life.

For more information or to discuss a valuation or transaction issue in confidence, do not hesitate to contact us.

Transportation & Logistics Industry Services

Mercer Capital provides valuation and transaction advisory services to the transportation & logistics industry.

Industry Segments

Mercer Capital serves the following industry segments:

- Trucking
- Air Freight
- Marine
- Railroads
- Logistics & Intermodal

Services Provided

- Valuation of transportation and logistics companies
- Transaction advisory for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

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