The Mullen Group Limited

Second Quarter Earnings Conference Call Transcript

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Speakers:

Mr. Murray K. Mullen
Chairman, CEO & President

P. Stephen Clark
Chief Financial Officer

OPERATOR:

Welcome to the Mullen Group Limited Second Quarter Earnings Conference Call and Webcast. I would now like to turn the conference over to Murray K. Mullen, Chairman, CEO, and President. Please go ahead.

MURRAY K. MULLEN:

Thank you, and welcome to our quarterly conference call, all. We'll be discussing our second quarter financial results and our operating performance, and that will be followed by a review of what investors and shareholders can probably expect in the second half of 2021 from our Company, and, of course, we'll close the call with a Q&A session, so I would encourage all interested participants to ask follow-up questions.

Before I commence today's review, I'll remind everyone that our presentation contains forward-looking statements that are based on current expectations and are subject to a number of uncertainties and risks, and actual results may differ materially. Further information in identifying the risks, uncertainties, and assumptions can be found in the disclosure documents which are filed on SEDAR and at www.mullen-group.com.

With me this morning on the line, we're calling in from all over. I'm actually touring facilities of some of the new acquisitions we've done, and Stephen is on call, and Richard—Stephan Clark, our CFO; Richard Maloney, Joanna Scott, and Carlson Urlacher are calling in from corporate office, so that's who we have on the call with us this morning.

Let's start today's call with an overview of the highlights and accomplishments that we achieved last quarter, and I think the first thing I'm going to highlight is that—acquisitions has to be the first highlight.

For some time, I've been challenged, perhaps, rightly so, as to why we were holding so much cash on the balance sheet and had not actively pursued acquisitions. Well, the truth is we were always looking at acquisitions, but in saying this, our long-term shareholders know we do not chase growth. We identify strategic fits and opportunities, knowing full well that this is the only way to create real shareholder value. This quarter, everything just seemed to come together at the same time, meaning that our corporate office team, including those that I talked about earlier, was off the chart busy. Negotiating and finalizing five transactions in a quarter is both a highlight, and, I would say, is an accomplishment, so why five? Well, because these are good companies, and they're all aligned with our strategic thinking.

Now, we may have deployed a significant amount of our capital, I'd say $100—around $185 million, in fact, with this aggressive acquisition spree. However, we did so without putting the balance sheet at risk. Never have, never will. In fact, our overall debt ratios are well within our comfort zone at around approximately 2.5 to 1. The win from all of these transactions is that our shareholders are going to see many, many quarters, maybe years of solid growth commencing in Q3 of 2021 where the full benefit of all the transactions will be realized.

Now, in one year, we've completed seven acquisitions. We've added close to $400 million in new revenues. Now, this is not transitory. This is transformational, so our go-forward annualized revenues are now going to approach $1.6 billion, and puts us much closer to reaching our goal of annual revenues of $2 billion years ahead of plan.

Second highlight that I've got to talk about, and I'm sick of talking about it, but it's COVID-19. It remained a headline news, and perhaps this will be the last quarter we have to qualify our results with a health services disclaimer. COVID, obviously, will not disappear. However, the vaccination plan is working to contain much of the spread and harm, so countries that have high vaccination rates are in recovery mode, which is fantastic news on many levels. Canada now appears to have joined this exclusive club.

Number three, the consumer, through all—everything we've talked about, reign supreme. The evidence is compelling and it's widespread, and yes, COVID-19 has impacted all of our lives. It's a nightmare. It's a disaster from a healthcare perspective, but nothing seems to stop the insatiable appetite of the consumer, so even though in-store visit—the in-store visit has been disrupted, the ease with which consumers can buy online has transformed the shopping experience, and e-commerce has revolutionized how consumers spend, but this is also—I must tell you, this changed the supply chain dramatically. Today, consumer goods are shipped direct to the home from warehouses or fulfillment centres. It's usually in packages and boxes, which means the cardboard industry, as I've talked about before, is booming, but the trees are crying out in distress, so we'll see more deliveries, I suspect, smaller packages and lots of boxes that all need recycling.

To us, the consumer—this is now the safest, most convenient, and cheapest way to shop. Besides, if you don't like it, you send it back, and this emerging trend has not necessarily change the truckload industry. It has, however, kept freight demand, especially the van and container shipment industry, strong. Where the change has really occurred is that final mile component of the delivery process, and as I mentioned, more and smaller packages delivered to the home as compared to pallets delivered to the storefront, so in essence, a significant amount of consumer freight had to be diverted from the retail malls to warehouses, and this trend is the primary reason our LTL, our first and final mile business, is outperforming. In fact, I can tell you, I'm touring facilities, and our warehouses are packed. I can tell you first-hand on that.

Number four highlight trend that we've seen is freight demand, for virtually everything, appears to have hit the highest levels in several quarters, with June being the strongest, which corresponds nicely to a relaxation in government mandates and fewer business closures, so we saw a resurgent in customer activity, along with a more positive tone, indicating that business is beginning to restart the inventory and planning cycle. Now, this was, and will be, great news for our logistics, trucking, and our warehousing business units.

Number five highlight has got to be commodity prices. They've started to influence, finally, producers' investment and spending decisions, and we saw that start to emerge in the second quarter, so oil and gas drilling, natural gas drilling activity in western Canada was up significantly over the same period of last year, but I've got to qualify that with how could it not? Last year was a disaster. We have not seen a recovery to pre-pandemic levels, but I can tell you the tone is very encouraging.

Now, offsetting all of these positives, we had two numbers—two things that influenced our results, let me call them challenges, that influenced our second quarter performance. Last year, you'll recall, our Premay Pipeline group had a fantastic second quarter, as we expected, given the order backlog and given what we expected from the orders of pipe that were coming in for these two major projects, particularly, which is the Trans Mountain crude oil pipeline and the Coastal Gas project in Kitimat.

Unfortunately, for this year, as we start taking that pipe from stockpile location into stringing, we had a couple things that impacted all of that business, and that is, firstly, COVID-19 restrictions on workplace and work camp activity, but then, because of environmental concerns specifically related to hummingbird nesting. I'm not kidding. The projects were shut down, first and foremost, because of COVID, and then because of federal law that protects hummingbird nesting, so as a result, both projects were put on hold during the second quarter, and that would—that really impacted our quarter-over-quarter results, including our revenues in the second quarter by $12.6 million year-over-year, and even though this was a negative last quarter, I will tell you, the projects are not canceled. They've just been pushed out, so we expect Premay Pipeline to be back on the job this summer and pick those—pick up the pace on that. It might be pushed out, some of it, into 2022.

The second issue relates to CEWS. Now, that's that government-funded program that gave money to virtually every business negatively impacted by COVID-19. This quarter, we received last government support payments as business activity returned close to pre-pandemic levels. In fact, total CEWS in the quarter were $6.4 million versus $10.9 million last year during the same period. Now, the good news is business is nearing full recovery, and as such, we will not qualify for future CEWS funding, but here, I think, is the real story on CEWS. Mullen Group, we never needed the funding because we were well-capitalized going into March of last year. Many of our competitors, however, relied on these funds to stay afloat, so the federal government distributed billions and billions of dollars to keep the majority of Canadian companies, including many in the trucking industry, from failure. I'm left to surmise that there are no free markets in Canada, just fair markets, but it is what it is, and we haven't necessarily gained market share yet, but I can tell you that we've used these funds to invest in new assets, which positions our business units nicely for future growth, and I say this with a high degree of confidence, that we will eventually gain market share.

All in all, folks, a very busy quarter, a very positive quarter, and with all the details, I will now turn the call over to Stephen Clark. Steph?

P. STEPHEN CLARK:
Thank you, Murray, and good morning, fellow shareholders.

I'll get a little more granular. However, our interim report contains the details that fully explains our performance. As such, I will only provide some highlights and high-level commentary.

Year-over-year revenue increased by $55 million to $312.5 million, including $34.6 million of acquisition revenue and $8.6 million increase in fuel surcharge revenue on a same-store basis. Excluding the effect of acquisitions and fuel surcharge fluctuations, revenue include—increased by $11.8 million, or 4.8%, largely due to the strength of the LTL and our Logistics and Warehousing segments, being offset by the weakness in our Specialized and Industrial segment. Of course, in many respects, a comparison to the second quarter of 2020, when the North American economy experienced a sudden and sharp decline in economic activity due to the initial onset of COVID-19, is somewhat out of context. During the second quarter of 2020, revenue in the LTL, the Logistics and Warehousing, and Specialized and Industrial Services segments declined by 9.3%, 18.9%, and 30%, respectively.

Perhaps a comparison on a sequential basis is better, while those are also somewhat out of context due to the number of acquisitions we did. On a sequential basis, consolidated revenue increased by $22 million from $290.5 million achieved in Q1 '21 due to the acquisitions being partially offset by the slowdown in pipeline activity, so what has changed from a year ago? A lot. What has changed since the last quarter? Even more.

For those keeping track, our news release is set out in estimated revenue for each acquisition, and that series of news releases added up to $355 million of annualized revenue. Our second quarter MD&A speaks to $400 million of annualized revenue being added. It appears our timing couldn't have been better, and we have revised our estimates upwards from what our acquisitions did in the past 12 months prior to closing to what we now expect going forward; case in point, Bandstra. In the news release, we estimated that they would add $65 million of revenue on an annualized basis. Lo and behold, they added about $21 million of additional revenue for the first two-and-a-half months being under our umbrella. We acquired them mid-April, and then you would see that additive to the Logistics and Warehousing segment. Annualize that trend, a trend that is up both to the end of the COVID restrictions and to—and you get a much higher number than we first announced, so not $65 million, but maybe on trend for $80 million to $90 million. Perhaps we are all getting a bit more bullish now that COVID is behind us, but that is our current estimates, and Murray spoke to it earlier being more of a $400 million number rather than the $355 million.

Now, getting a bit more granular, revenue in the consumer-driven Less-Than-Truckload segment rose by $24.8 million, or 24.3%, to $126.7 million as compared to $101.9 million in

2020, in part, due to the acquisition of Pacific Coast Express. However, adjusting for this acquisition and the fluctuation of fuel surcharge revenue, which is generally a flow-through, revenue grew by 12.8% due to the strength of consumer spending and market share gains.

Aided by the acquisition of Bandstra, and other acquisitions as well, the Logistics and Warehousing segment rose by 45.7% year-over-year to $120.6 million as compared to $82.8 million in 2020. Adjusted for fuel surcharge fluctuation and acquisition revenue of $25 million, this segment grew by 13.1% year-over-year. Comparatively, this segment experienced an 18.9% decline in revenue in the second quarter of 2020, so as I spoke to earlier, we've got to be careful on the comparatives, but nonetheless, the trend is certainly very constructive, and as Murray had said, June was of much the differentiator and getting much stronger as the quarter progressed. On a sequential basis, excluding the Bandstra and Tri Point acquisitions, revenue in the segment grew by approximately 8%. I would say that's pretty good.

In the Specialized and Industrial Services segment, revenue declined by $7.1 million, or 9.7%, to $66.4 million as compared to $73.5 million in 2020. COVID still lingered and restricted many close-contact construction jobs. These restrictions negatively affected not only Premay Pipeline, but Smook and Canadian Dewatering as well. Thankfully, a surge in oil and gas prices created more demand for our other specialized services.

As for profitability, operating income before depreciation and amortization, commonly referred to as EBITDA, was $59 million, or 18.9% of revenue, as compared to $55 million, or 21.4% in 2020. Of course, that was a bit higher because of CEWS, and for the period, as Murray mentioned earlier, CEWS accounted for $6.4 million of subsidy versus $10.9 million, a decrease of $4.5 million year-over-year, so excluding CEWS, EBITDA increased by $8.5 million to $52.6 million, for an operating margin of 16.8%, fairly consistent with the 17.1% of operating margin achieved in 2020. The majority of the $8.5 million increase was due to the $7.9 million of incremental EBITDA generated by our acquisitions, so a little bit of a change there, but largely, the margin was the same, just down a little bit, and that was really because of the revenue mix and the loss of some higher margin Premay Pipeline work.

Looking at other notable items, net cash from operating activities for the period was a healthy $55.8 million. However, our cash balance changed materially in the quarter and after the quarter due to the series of acquisitions we made during the quarter. We are now borrowing about $70 million on our demand facility. It's been a long time since I've said that. However, our leverage ratio, calculated under a private placement agreement, was 2.54 to 1, without giving consideration to earnings from our newly-acquired businesses. If you included those earnings, and they're under a different framework and management, but our leverage ratio would be closer to 2 or 2.2 times rather than 2.5 times, so again, we feel very comfortable with the level of debt that we have.

Lastly, a quick word on ESG. I wouldn't only talk about profits and such, and cash generation, because profits and cash generation are good, but not if they come at the expense of our workers' safety or the environment. Our second quarter safety results continue to improve. I recently read a competitor's ESG report where they stated they endorsed the United Nations' sustainability goals, and goal 3.6 was to reduce vehicle accidents by half, or an effort to reduce the road accident fatality rate to 9.1 deaths per billion kilometres travelled versus the current 18.2 deaths per billion kilometres travelled. We know to achieve this goal we need better medicine, roads, auto design, but most importantly, as I know from my many years on city council, a safety culture and supportive attitude is most important.

Here at Mullen, we don't speak about United Nations' sustainability goals. We may not virtue signal, but we do have the right safety culture. In fact, if we accepted the United Nations' benchmark, we would be killing a worker each and every quarter, totally unacceptable. We don't accept that. We exited the quarter with a lost-time claims ratio that improved to 0.68, and our total recordable injury rate was 2.47, world-class stats. The competitor I speak of, their total injury frequency rate was 6.9 last year, so compare that to our 2.47. They also had 24,120 collisions per billion kilometres travelled, whereas we had about 4,000 collisions for every billion kilometers travelled. In short, actions speak louder than words, and our commitment to safety will never be compromised by profit, nor will we accept anything but world-class safety results. Our ESG score may be lower than our competitors, but clearly, our safety culture and results are better.

On the GHG front, Murray was talking very much about the evolution of packaging and how we're doing residential deliveries, and for us, that means we are now investing in hybrid Sprinter vans instead of diesel, and we've continued to make those investments through the first half of the year, and, in fact, we’ve purchased our first all-electric shunt truck for our yards, and we are trialing our first hydrogen truck this summer, so in my mind, that's good governance and good stewards of not only the environment, but as I say, promoting a great safety culture.

With that, Murray, I'll pass the conference back to you. Thanks.

MURRAY K. MULLEN:
Thanks, Steph.

As we wrap up the call this morning, let me give you a little bit of an outlook. The second quarter is behind us, so what's our plans, initiatives; maybe some thought about expectations, and clearly, the trends that I see for the near future.

As I was thinking about this and trying to describe our plans for the next while, I came up with this: we're going to tighten up and do tuck-ins, so that's the general theme that I think that we'll be focused on in the last half of the year, tighten up and do tuck-ins. What will be the—what will we be working on and concentrating on? Well, first and foremost, as I just mentioned, we're going to dedicate a significant amount of time and resources as we integrate the last five acquisitions into our organization. Pleased to report out touring facilities engaging with the people and collaborating with—putting the teams together, and how we can find those synergies that everyone talks about with acquisition, and we all know that it's the synergies that will drive shareholder value.

Now, since I'm on the topic of acquisitions, let me address this issue. Now, we have been very active. Obviously, we think we've bought all good companies. However, as I view the landscape in the markets, in general, the most likely outcome is we will only continue to consider tuck-in opportunities, but refrain from reaching for any additional platform companies. The markets just don't appear to be rewarding aggressive acquisition growth, so we'll just pivot into what I call harvest mode.

The exception's going to be if we find a suitable bolt-on target for our newest venture, QuadExpress, which is soon to be rebranded, and that's just in being certified right now, and we'll talk more about that as it comes up, but we'll be rebranding QuadExpress this quarter, but QuadExpress puts us squarely into the very large U.S. 3PL market, which really expands the opportunities for us on a go-forward basis.

The second trend that I see relates to the economy in the markets we serve. On this issue, I'd—I'll be honest with you, I don't know if I could be more confident. Clearly, there's concerns, but generally speaking, I'm quite positive, believing that the freight demand and economic activity will be robust. We know, for example, the monetary policy remains accommodative. It's providing ample liquidity and fuel to keep the fire going, and, of course, governments love spending and giving money away, so you have to love this new economic theory that's being advocated, which is essentially saying that debt doesn't matter, so let the good times roll until it stops, of course.

The third macro trend that everyone is now aware of is the supply chain remains tight, maybe borderline, I don't know if chaotic is the right word, but it certainly is under strain. It's driven by a combination of strong consumer demand and supply chain disruptions, so there's currently a reduction in manufacturing capacities. It's due to workplace issues, additional sickness, safety protocols, everything. Things have slowed down, and, as a result, bottlenecks are now occurring regularly, and that's placing tremendous strain on that age-old concept of just in time management. In fact, I personally believe—and some of you've heard me talk about this before, that I believe business must be prepared to pivot towards just in case inventory management, and this implies higher costs and forward planning and lots of warehousing, so I'm happy to report we have lots of warehousing capacity in our portfolio, our business units, although I would say it's getting pretty full. Difficult to see how we can add a whole bunch more when we're pretty full, so that's the good news there.

Finally, let's not forget about technology. It remains a dominant theme. We will continue to invest in our business to remain—make sure we invest best-in-class market leaders. We'll search for new and creative ways to meet society's changing narratives. Steph talked a little bit about electrification of our fleet. It's a given, and to this end, we're all pleased to report we'll be ordering new units, especially for the short-haul and in-city service units with battery-powered capabilities.

In summary, it is reasonable to expect some very solid results from our Company through the balance of the year. Acquisitions are going to supercharge our revenue growth relative to last year, folks. That's why we did them. The consumer portion of the economy is on solid footing. E-commerce and direct-to-consumer drive—continue to drive demand. Our Less-Than-Truckload and Logistics and Warehousing segments both will benefit from the strong economy, robust consumer demand, and changes in the supply chain, so there's growing optimism, even in the oil and natural gas service sector, so all in all, I have a pretty positive outlook of the segments that we serve.

Now, of course, we must be mindful that trouble could be growing, especially as it relates to, let's call it, inflationary pressures. I would also say the labour shortage, which is either real or perceived, don't know which one you want to call it, but I will tell you finding quality people all of a sudden is real challenge, and then, of course, we've got supply chain bottlenecks, so that's going to put a cap on how much new business companies can take in.

All of these trends that I talk about, our business units are all informed about them, and we're going to manage our business accordingly, so I think that to the extent that you can't get people, that there's lots of freight. I think what you're going to see is inflation is really on the cusp of hitting home to a lot of businesses.

Lastly, and I'll remind our shareholders and listeners of my prediction for 2021. I said we'd be slow out of the gate and with a strong finish, so we're on target not just to meet our 2021 goals, but to exceed them, and we'll continue to repurchase our own stock from the free cash flow our business generates, as long as the investment community under-appreciates the true value of one of Canada's largest logistics companies.

With this background, I'll now turn the call over to the Operator and we'll go directly to the Q&A session. Operator, over to you.

OPERATOR:
Our first question comes from David Ocampo of Cormark Securities. Please go ahead.

DAVID OCAMPO:
Good morning.

MURRAY K. MULLEN:
Morning, David.

David Ocampo:

My first question is on the U.S. logistics business, and you guys mentioned in your remarks that you could potentially do a bolt-on transaction to continue to build out that platform, but is this something that you could also do organically? When I look at one of your competitors in Canada, they're building out their brokerage business, basically all up from organics. Is that a logical solution, or is it not possible with the technology that you guys have?

Murray K. Mullen:

Clearly, you want to grow organically if you can, and I think that's the big thing that we see in this platform. They have a really nice technology platform called SilverExpress, and we think that's the enabler. Technology, along with this—with logistics is what becomes scalable, so we should be able to grow internally. Now, we've got to—the first part is we've got to get the integration done, and we've got to get this—the transition agreement done, and all those kinds of things, so next quarter will be a little choppy for us, because we've got to get that all migrated over into our new name, and those kind of things, but I see plenty of opportunity from both sides. I see it from leveraging off of that technology platform that they've got.

That, obviously, is a good technology platform, because they're doing a fair amount of business, and they've got a lot of customers using it, so they've already got some stickiness there, and then what we're going to do is we're just going to put that technology platform on steroids. We're going to invest in it like crazy because we see that as the key to future growth. Along the way, I think you can also look at some acquisitions that might fit, and I'm really impressed with the senior team that we've got down there. They can grow this thing. They know what they're doing, and with us wanting to invest in this business and build it out, I think there's some good opportunities on both fronts.

3PL, that's the business we like. It's one of the key strategies that we talk about. We like 3PL, but I would tell you, it's 3PL with technology. Otherwise, it's just freight brokerage, and we're—I'm not interested in freight brokerage. We're interested in the value-add, which is 3PL with technology platform. You know we love LTL, because that's the consumer, and logistics and warehousing is a key part of the supply chain, so this is a new market for us and new opportunity. I like the management team, like the technology, so I'm pretty optimistic about that—where we can take that in the future, another new growth platform for our Company, for sure.

DAVID OCAMPO:
I know it's only been a few weeks since you've had Quad under your belt, but do you guys have a finer point on the margin profile, especially with it becoming its own division next quarter?

MURRAY K. MULLEN:
No, you've got to be careful on that side because you're talking—it's just the spread you've got to look at, and so we're—we haven't narrowed it down yet because we're just in the middle of that, but typically 3PL, you're talking 10% gross margin, something like that, and then you've got to take off from there, so I think you're looking at 5% margins, but that on a return on capital is pretty significant, so—and then on a net basis, it's not 5%. The net being the spread between what the revenue is and what you pay the subcontractor, the net spread is going to be—is the thing that we look at, and it's pretty attractive.

I think the other thing about this, David, is I'm not really worried about margins in the short term because I'll be honest with you, we're building out the technology and we're building out a platform here that's going to be a marketplace. This is just another add-on to our—the investments that we've made in our moving online platform and holistic, and I just see a great opportunity to build this out down south, because the reason is they have the loads, and the loads is what attracts the carriers, and so we think that's where we're going to go in this.

We're planning for the future with this one, so I'm not going to get too stressed out about what the margin is on this because I'm only worried about building out the platform and getting more and more content. After I get the content, then we can monetize, for sure, and the content in 3PL is loads. We've got to get the shippers on. That's why I really like SilverExpress because it has a shipper-centric focus, and we'll report it all separately so that it's totally visible to everybody, but this will be, can we add new agents, can we add new business, and are we getting more carriers on the platform?

DAVID OCAMPO:
Yes, that's helpful, and then maybe switching gears for my last question here. With rate claiming (phonetic 32:22) season coming up in the next few months, I was just curious if you've had any initial discussions with any of the shippers about a potential rate increase in Canada, especially

since the market has been largely flat over the last year, and you compare that to the U.S., which seems to be doing quite well with them having reopened a lot sooner than us.

MURRAY K. MULLEN:

Yes. We're in early stages of that, David. I can tell you we've started that just recently. If this market keeps going the way it's going, rate increases are nearly a given, and when I said that there were certain trends that I saw; demand staying strong, supply chain tight, and it's really difficult—it's really going to be really difficult to get more drivers, to get more workers for all of us. There's lots of Canadians—hard working Canadians that are working now, but I don't know if there's a whole bunch more. There's lots of people available, but increasingly, what we hear from that new—from that labour force that hasn't been working for a bit is, well, I'm not sure. What's my time up? We can't run a business on that, so I suspect if freight demand is going to stay as strong as it is, that pricing is inevitable, and that will be the storyline for the next bit. We'll catch up to what the U.S. is doing. We're just going to be a little bit behind the U.S., I suspect.

DAVID OCAMPO:

A quick follow-up to that, if you do see rate increases, would that be—would that lead to margin expansion? Would it offset all the inflated operating costs that you guys are seeing with higher driver pay?

MURRAY K. MULLEN:

Definitely, you're going to have to raise rates because you're going to have to protect your workforce. We are seeing higher fuel prices. We're seeing higher cost across the board; maintenance costs, tires, equipment, parts, everything, so there's inflationary pressures, but we're not going to do it to stay even. I would expect that when we get pricing leverage, that we'll get some margin expansion. That's what we're going to be focused on. That's what I'm telling people. If I can't hire more people to all of our business—like I said, if you can't hire good people, take the freight that pays more money and put your good people on that, and that should lead to margin expansion, and then we can pay our people more.

DAVID OCAMPO:

That's great. I'll hand the call over.

MURRAY K. MULLEN:

Thank you.

OPERATOR:

Our next question comes from Konark Gupta of Scotiabank. Please go ahead.

KONARK GUPTA:

Good morning, and thanks for taking my questions.

MURRAY K. MULLEN:

Good morning.

KONARK GUPTA:

Good morning. Maybe I can start with Murray, I don't think I heard on the call what's your new 2021 revenue and EBITDA targets are with all these acquisitions, and can you also help us understand, you mentioned the annualized revenue run rate is now 1.6%. What seems to be a good margin for that or a good EBITDA proxy for that run rate?

MURRAY K. MULLEN:

Yes. Steph, I don't think we put in a number that said what 2021 was going to be. I think what I said, Konark, is that we're going to be a heck of a lot above the 1.2% that we had originally—had put out as our plan. I said that was our goal, and then I said the annualized is now about 1.6%, so I think you can do the math, so okay, if we got all these acquisitions for six months, it'll be a hybrid of—in between that is what I would suggest.

Margin is, I expect it's going to hold about flat until we start seeing some pricing leverage, and as I just spoke with David about, I think margin—the pricing leverage is coming in the Canadian marketplace, and that will be somewhat accretive to margins. I don't know particularly how it's going to do. The worst case is we're going to stay the same with margin. The best is we have margin improvement, but it's a little early to predict when we get that, because you got to let the market catch up to itself. If you move too early, you're going to run into trouble.

The thing we are seeing, Konark, is the customers really have nowhere else to go because everybody's maxed out right now. You can't put more freight on our dock, as an example, so now I'm just working with the business units to say, okay, what freight goes on our dock, so that's what we'll be working on with our business teams over this last half of the year, which is what I said I'd do, and if I'm right, then maybe margin improvement goes up. That would be the goal, but I don't have a specific number for you. I think that's a—it's—that'd be a little too presumptuous of us, but I suspect we'll do—I think we'll do just fine.

KONARK GUPTA:
Understood. That's good colour. Thank you, Murray.

Then you mentioned, I think, in the MD&A as well on the call, June seemed to be a pretty good month or solid month all across the business lines, virtually. Just wanted to get more context behind that, so what was your normal June like pre-COVID, and what was it this year, and then is it a good proxy for revenue run rate organically, and then I can add maybe the apps and the other two acquisitions, Quad, Harris for July, or was there something one-off in June, you were catching up on some backlog or something that benefited a lot?

MURRAY K. MULLEN:
Steph, I think that's the granular question, so if I defer over to you that you're so good at, but does it not appear that June—I think we were back June—same-store sales, let's call it that. I think June was actually even a little bit above June of '19, if I'm not mistaken.

P. STEPHEN CLARK:
Yes. It was essentially flat, but it depends on what segments you were looking at. The Oil Services segment, or what we used to call Oilfield Services segment, now is the S&I segment, was still below '19, as the rig count is still below the five-year average or historical trends despite the fact that oil's quite healthy, and more importantly, natural gas prices are very healthy. If you go back to 2019, you were about $2.50, now you're about $4, so we're starting to see that trend change, but it hasn't quite translated. I think our customers are still rebuilding balance sheets.

When you look at the LTL market, clearly, the consumer has improved since 2019, and it's clearly above trend, and everything we do for apps and Pacific Coast is additive to those historic trends.

The Logistics and Warehouse segment, if we look at it on a historic basis, it's still down, and I spoke to earlier L&W being down about 18%, 19% last year from 2019, and then rebounding about 13% ex-acquisition, so it's one where it's still down a little bit. The Canadian economy lags a little bit behind the U.S., which appears to be more on fire than—is probably the way to describe it, so it's a little bit to get granular.

It's a little bit different in every segment, but we certainly see the trend for June, again, still coming much, much stronger, and that shouldn't come as a surprise as the supply chain is beginning to repair. Certainly, consumer demand is there, and the government is propping up, whether it's in the States with their trillion dollars of stimulus or in Canada where we still are running $100 billion deficits that are estimated for 20——the next fiscal year, so it's after coming off, I don't know, $300 billion deficit, so deficit financing, governments are still playing a role. The consumer’s still spending. The economy is repairing itself, and in fact, I'm sure you follow the GDP stats just like I do, it's back to pre-COVID level, so we're back to December of 2019 levels in April of 2021.

It took us a long time to get back to where we were, and of course, there's a few more Canadians. Our population has grown, so we're still a ways in run room to go, and there's still some slack in the economy and about 8% unemployment, so there's still room to run, but it's—certainly for us, we saw a lot of improvement in June. We saw a lot of the COVID restrictions come off, and for the most part, it's still that Specialized and Industrial Services segment that's lagging for the most part. LTL is well above, and Logistics and Warehouse is still almost down par, but still a little bit behind pre-COVID levels.

KONARK GUPTA:
That’s great colour. Thank you so much.

MURRAY K. MULLEN:
Konark, I don't think that, as we head into third quarter, that our Logistics and Warehousing business will be behind 2019. There's too much demand right now, and it really just started to come in, in June, so I would think that the last half of the year will be above 2019. I'd be very surprised, to be honest with you.

KONARK GUPTA:

Yes. That makes sense, Murray. Thanks, and Stephen, thank you for that, and then this one recent issue, and when you spoke about supply chain, I think the one major issue weighing on a lot of transportation companies and their customers was the BC wildfires, which still continue. Just curious, Wales had a pretty huge backlog off-work there, and BC, especially between Kamloops and Boston Bar going to Vancouver. Did you guys see any benefit or any kind of negative impact of those rail supply chain issues at all in July?

MURRAY K. MULLEN:

It just backs everything up. I'm sitting in Toronto, and we have those containers that come in, and now those containers are—so we don't have as many backed up—lined to come in because they're not coming into that same steady pace, but that flood is about to come in, so when my guys are giving me the update here right now, they're handling containers coming in, but there's a massive amount of backlog that's going to hit, and then that's going to cause a bottle—the bottleneck will go from the ports to the rails to the warehouses to the truck. It's going to just back up for a while, and it appears that there's always something. There's always this, there's always that, so I said to you, the supply chain is very, very tight. The demand is there, but the supply chain is not as efficient as it once was, so that creates ebbs and flows and difficult to manage, but that's what we have to do, and—but you're right, it's backed everything up, and it creates these surges that come in.

We know that the ports are plugged. We know that Union Pacific put an embargo on freight traffic going into Chicago. Why? Because they couldn't take any shipment, they couldn't take any boxes, intermodal containers. It was plugged, so they just kept it at the port, or they kept it on the ships in the port, so it's not just Canada. It's North America-wide and maybe even beyond North America right now.

KONARK GUPTA:

Yes. That's great, and then last one for me before I turn it over. CapEx, we probably did not touch on that lately after all the acquisitions, so I understand, obviously, there's some asset-light businesses there that we got, but what about the CapEx requirements for these acquisitions in aggregate? Where would you see your kind of this year's budget or next year's budget—we'll probably have to wait, but where does CapEx go after these acquisitions? What kind of requirement out there?

MURRAY K. MULLEN:

Yes. Typically, when we do acquisitions, we would update our CapEx. We had said we came out with a $50 million CapEx plan for this year, ex of facilities, ex of some other things, but requiring basically $50 million of sustainable CapEx. We're actually behind the curve on that, because the supply chain is so messed up that we're not actually going to hit the $50 million this year. Everything is pushed out to 2022, so we know that these companies are going to need some CapEx. Our CapEx will go up next year. First blush, let's call it, $70 million from $50 million, but we can't get the product in this year, so our CapEx for this year will probably—if we're fortunate, we'll hit $50 million, and that means the assets have arrived, but for example, trailers, they're pushed out to late 2022 now, so it doesn't matter if you put the order in. It's a long ways off before it comes in, so no increase for this year, not because we wouldn't, because we can't get it, and then next year, first blush, we'll update it at the end of the year, but I would say, Steph, $70 million is a reasonable CapEx expectation going forward.

P. STEPHEN CLARK:

Yes, agreed.

KONARK GUPTA:

That’s it for me. Thank you so much, guys.

MURRAY K. MULLEN:

Thanks, Konark.

OPERATOR:

Our next question comes from Walter Spracklin of RBC Capital Markets. Please go ahead.

JAMES MCGARRAGLE:

This is James McGarragle. I'm on for Walter this afternoon. How’s everyone doing?

MURRAY K. MULLEN:

Good, James. Welcome.

JAMES MCGARRAGLE:

Thank you. I just have a question on…

MURRAY K. MULLEN:

I've got to tell you, you're behind, because Walter's always first, so I'm going to have a talk with Walter, so you're already starting behind. I was waiting for your call, James.

JAMES MCGARRAGLE:

I appreciate it. I just had a question on the M&A and some of the recent Canadian acquisitions. Is there anything to highlight in the first few months of working with any of these businesses, just specifically around using your technology or any organic opportunities that you might not have seen initially when you acquired the businesses, and then looking at the U.S. acquisition of QuadExpress in a similar vein, any of the information that you've got by using their technology that you think might open up some opportunities in the U.S. you're looking into 2022?

MURRAY K. MULLEN:

I don't think anything's changed from what we expected when we negotiated the deal—these deals. What we do know is, is that the markets are quite robust right now, so that lends to what Stephen had said, that our timing—it appears our timing is pretty good on those acquisitions, so they'll probably be perform at or above expectations is what I suspect, so nothing material there. These were good companies. We got good management teams. I can tell you, as I tour the facilities now finally, is that I'm very impressed, even more than when I—when we did our virtual due diligence, or our actual due diligence now. Very impressed with the teams, the workforce, the people, all that, so I'm really happy with that side, and so that covers that off.

In the U.S., we've got a little bit more work to do there because we're in a transition of carving out, if you will, this platform of QuadExpress from Quad Corporate, and QuadGraphics has refocused their business away from print to digital—to a digital platform, so this wasn't a core business to them, so we took it on, but we've got to carve it out from them. We've got a transition agreement. We're working with them, etc. That's going to be messy for the first quarter. That's just what—we knew that going in, but great, solid team. They're on every issue, and they work with us to streamline and get that transition done as fast as possible. Then what we're going to do is turn our attention towards the growth side, and we're in the right space. I can tell you that. That's where capital is going. That's where everybody from Uber Freight—everybody's talking about what this—a company like Quad does. They're talking about building an app, about building a technology. Guess what? We acquired one. We got a good one, and what we're going to do is just make it better. That's all. That's going to be our secret sauce.

JAMES MCGARRAGLE:
Appreciate that, and that's it for me. Thank you.

MURRAY K. MULLEN:
Thank you.

OPERATOR:
Our next question comes from Kevin Chiang of CIBC. Please go ahead.

KEVIN CHIANG:
Hi. Good morning, Mullen team.

Maybe if I could just turn to your S&I segment, pretty optimistic outlook that you provided in your disclosure. If I look at pre-pandemic and just looking where oil prices are now, you're doing, let's call it, about $100 million a quarter in revenue. Do you think that's something you could hit in the back half of the year just given what you're seeing today, or do you think it's still a ways away before we kind of make up the gap from where you're running today versus maybe where you were running back in 2019?

MURRAY K. MULLEN:
It's going to be interesting, Kevin, on that side, because even though it's much stronger—I think the rig count's now up about—in Western Canada, let's call it, 150, 160. That's substantially above 2020. Let's forget about 2020, that's a write off, but it's much closer to 2021, but not—we're still behind 2021. I think the big issue that we've got to watch and see what happens is there any workers left to go into the oil patch, so there may be some limits as to how many rigs can actually go to work, and it's not commodity price. It may be availability of skilled workforce. They've all left, so I can't—it's early stages. Maybe we can attract them back. Maybe the industry can. We're going to have to see what happens in the last half of this year. I can tell you, you either got to attract more people back to the industry, or I can tell you, I suspect that prices in the oil patch are going to go up dramatically, even though activity levels may not go up dramatically, because there will be demand for that limited rig moving equipment, that limited

service offering that you have, so one of two things has to crack, because the commodity prices—I don't know what's going to derail that right now.

Natural gas prices are through—are exponentially higher than they have been, and western Canada is still a natural gas basin. It's not an oil basin. It's an oil sands basin and it's a natural gas basin, so the key to me is that I watch is natural gas price, not oil price. Oil price would be for Suncor and Syncrude and those kind of things, but the others, like the natural gas players, like a Tourmaline and Peyto and all of them, that's natural gas, and there's a lot of positive momentum on natural gas right at the moment, so I think it's way more constructive.

I talk to our groups now, and the trend that happened in June continues on and gains momentum, but we may be bumping up against how much we can really do. It's no different than when I'm touring the warehouses. They're full. I can't take much more freight, so all you're going to do is just triage it and manage your—you're just going to price accordingly, but there'll be no more deals. There's no more cheap pricing. I don't know if that's going to be—I don't know if we're going to get the top line back—it can't—for the reasons I just explained, but I'm pretty sure we're going to get the bottom line back.

KEVIN CHIANG:

Right. No, that makes a ton of sense, and then just maybe turning to your LTL segment. I think historically, we've seen LTL in Canada underperform on a yield perspective versus the U.S, and I think people have talked about the U.S. having more industrial exposure. The industry is more fragmented in Canada, but as you sit here today, Murray, the consumer economy's ripping and roaring. It seems like the market is tighter, and it might be more structural now. Do you see an opportunity here where yields in Canada can really start to converge on what you're seeing in the U.S., and maybe you start outpacing the pricing growth you may be seeing from some of the U.S. LTL carriers?

MURRAY K. MULLEN:

I can tell you we've got pockets. We've got some of our business units that have—that are in the LTL business that have margins the same as the best-in-class U.S. I said certain parts of our business. That's not universal yet, but that's my expectation, is that the LTL business is—it's a good—it's a great business to be in. I'm happy to report we've got one of the largest platforms of LTL in Canada, and we're going to make sure that we continue to drive towards margin improvement. Some of it's yield management, some of it's—our facilities are full now, so I said we're just going to triage the freight and customers. You have to pay more, because I've got to pay more for people and those kind of things, so we're going to drive towards continued margin improvement in our LTL business. That's what we're going to strive towards, and part of that's just running a better business, part of it is pricing, and part of it is yield management by the mix of freight, so we will be aggressively pursuing higher-margin freight. Yes.

KEVIN CHIANG:
That's helpful. Thanks for the colour, and that's it for me. Congrats on a good quarter.

MURRAY K. MULLEN:
Thank you so much.

OPERATOR:
Our next question comes from Elias Foscolos of IA Capital Markets. Please go ahead.

MURRAY K. MULLEN:
Good morning, Elias.

ELIAS FOSCOLOS:
Good morning, Murray, and good morning to all the team. I've got a few questions.

First of all, Murray, I want to thank you for your macro view, and Stephen, thanks for the granular commentary. They were both helpful as we were scratching our heads on run rate revenue numbers from acquisition.

Murray, I'm going to focus a bit on acquisitions. Historically, you've made equity investments in companies. A couple of highlights I can think of, PCX involved, and you also talked last year about making some acquisitions into Canadian companies. I'm wondering, because that's been the seeds of some growth in the past, is that a strategy that you're going to continue, or just hasn't shown up, or things along that line?

MURRAY K. MULLEN:

Yes. We'll probably continue it, and why have we bought—made minority investments in certain companies? Well, it's because the whole company wasn't available, but I still like the company, so then we wait until the whole company's available, so we'll look at some minority interest, but the market has changed so dramatically and there's so many acquisition opportunities now that we'll just have to pivot, I think, a little bit on that and focus on where we think we can get the biggest bang for our shareholders, I think, really now in the short term.

The longer-term play that I've got that I'm focused on now is the U.S. market, because I think longer term, we have to be there for our shareholders and for our Company. We need another growth platform outside of the Canadian marketplace. The Canadian marketplace is going to be good, but eventually, it's not going to be a growth platform, and we needed to have another opportunity to move, so we planted some trees down there now, and we'll get bigger down there over time. That's our plan, and—but in Canada, we'll continue, probably, Elias, just doing tuck-ins, because that's where we can get a good workforce. That's where we can get—because you can't put an ad in the paper and get a workforce today, folks. It doesn't work that way. We'll get a good workforce, and then what we'll do is we'll just make sure that we look after our highest paying customers that pay us the most, and that's where we're going to get margin improvement, the more we can give to make sure that our employees are paid properly, so we're going to focus on that side.

I don't know about more platform—as I said, about more platform acquisition and growth opportunities. I just don't know if the investment community is—they certainly don't appear to be rewarding us for it, so we're just going to go and harvest and make as much money as we can and run a great business and pay our people more money, and we'll make more money for shareholders. That's what we're going to do.

ELIAS FOSCOLOS:

Okay. I appreciate that.

Maybe a question that might be more directed to Stephen, and again, thanks very much for the granularity on where your debt-to-EBITDA, call it debt ratio, would be pro forma acquisitions. It seems to me you have room for more debt, and specifically, I'm thinking of private placement debt. Number one, do you have room? Are you looking at that, and two, what level would you feel comfortable given that the business is quite a bit different today than when you wrote the covenants in 2014?

P. STEPHEN CLARK:

Yes, and I think we'd look at all alternatives. We look at whether we get something with a syndicated bank line or something more structured rather than just a demand facility, although the demand facility for us has been pretty good, and I say that because we're notoriously cheap and we don't like paying fees and standby fees, and all these sorts of things, and quite frankly, RBC has been very good to us, giving us a demand facility without fees, knowing that we never really stretch out our debt, and when we did the debt, or historically earlier in 2014 and such, we were really an oilfield services company with a lot of beta in our numbers. We've really gotten rid of a lot of that beta, so when you think about how much we're tied to the drill bit, it's not as much as we were a decade ago, so then we were comfortable with getting or having leverage of about 2 to 2.5 times. I remember going to New York and seeing—talking to those folks and saying, I want to be 2.25 times. We might expand that at times if we see a really good acquisition and we feel comfortable, but I don't think that philosophy has really changed, although the Company has changed. The debate is not there. The earnings are a lot more stable.

The largest part of the Canadian or North American economy is stable, so we could, in theory, increase our debt leverage and feel, still, very comfortable, but that's just not us. That's not our nature. We're not really high leverage stock promoting guys. We're more conservative, thoughtful, and we do these very deliberately, and we don't stretch out and go to 4 times like some other trucking competitors may do. Although I would tell you, going to 4 times is not unusual in our—within our peer set would feel comfortable doing that within North America, so long answer to tell you that we're very comfortable where we're at.

Are we going to do the next round of acquisitions or next round of growth? Is it going to be private placement debt? Perhaps. Is it going to be bank debt? Perhaps. I think what's out of market right now, and you just have to look at the cost of borrowing, equity doing another round for equity right now with the yield and the way that the share price is currently, it just isn't very attractive to us, and I know every shareholder, every CEO thinks their shares are undervalued, but again, we really feel that, and evidenced by our share buyback that we continue to do and invest back into a pretty premier great Company in Canada.

Long story short, when we buy EBITDA, we can get up a little bit more debt. We bought a lot of EBITDA here in the last quarter and we've reduced our leverage, so—because we're—although we're buying it 5 times, it's just the way that the whole momentum and the synergies and everything works that we're coming out of this virtually at the same debt leverage as we came into it into the quarter, and we're going to exit the year as you see the annualization, as you see these acquisitions start coming into that formal calculation, that it'll be reduced, and so I don't know what to tell you, Elias, other than we're comfortable where it is, more than comfortable from where it is, and the next financing round is yet to be determined, but we have lots of opportunities out there to do all of the above; private placement debt, equity, converts. The money will be there. We have a great track record of finding good acquisitions and exceeding that cost of capital materially.

MURRAY K. MULLEN:
Let me take that and simplify it even more. We're not issuing on equity at these levels. Forget it. All our shareholders, forget that.

Number two is, do we want to put on more debt? Yes, we'll put on more debt. We'll put on more debt to acquire really, really good companies that are strategic fits, but if we didn't do anything, I can tell you with the cash flow we generate, we'll have no bank debt next year, so we're going to generate a lot of cash, and then we'll just figure out whether we're going to continue to do tuck-ins and grow or whether we're going to—once we pay off the debt, whether we're going to—what we do next for the shareholders, but really, I think, Elias, it depends on the opportunity coming in, but new equity and the debt—and the other thing about our debt, we've acquired a lot of great real estate over the—since we did this long-term debt, so we feel pretty good about the position that we're at—that we're in with that, to be honest with you, so—but for now…

ELIAS FOSCOLOS:
I appreciate that, Murray.

MURRAY K. MULLEN:
For now, we're coming up for air after doing five acquisitions, and we'll look at tuck-ins where we could amalgamate things into these 36—I think we've got 36 business units now, and I've been so busy, maybe I've lost track here, but we've got a lot of great management teams out there that can—we can do tuck-ins of those 36. Will we have 37? Don't know about that sid…

ELIAS FOSCOLOS:

Okay.

MURRAY K. MULLEN:

…and it's a strong market. It's a strong market. If you do acquisitions now, you're kind of looking at—you're getting a good workforce, and then you're just—truthfully, you're just allocating the workforce to where you—because you need it and you've got higher margin business over the year, you don't want to turn down.

ELIAS FOSCOLOS:

Okay. I have more questions, but maybe I'll leave it with one. Murray, you mentioned $2 billion of revenue. If I do some very simple math, because it's probably all I'm capable of, I can see you reaching that number within two to four years. Would you...

MURRAY K. MULLEN:

Yes, we would originally sit out when we talked about that, well, in the next five to 10 years, we can get up to $2 billion. We'll acquire all the great companies that we want in Canada, and we'll continue to do that, and oh, heck, I didn't know we were going to get all of them done here and so fast, but the market changed. We moved quickly. We were well positioned. We had the money, and we've got a great reputation of doing acquisitions, so we'll continue to do some more acquisitions in Canada, but be selective, but we had to enter the U.S. market so that we had another growth platform for our shareholders, and that one will emerge and it'll evolve, but we're in that market now, and I'm excited about it.

ELIAS FOSCOLOS:

Sorry, I have to make a follow-up with that, Murray. With the U.S, on top of revenue, do you think the U.S. is actually a multiple—is a multiple factor too?

MURRAY K. MULLEN:

Multiple of…

ELIAS FOSCOLOS:

In other words, I look at Mullen in 2014, Mullen today, more stable business and yet, the multiple's a lot lower. Would you get a better multiple for having assets in the U.S.?

MURRAY K. MULLEN:

You know what, Elias, I'm going to defer this over to you to go talk to the shareholders and those kind of things. I have given up trying to figure out what Mr., and Mrs. Market are thinking. All I can report to everybody is what we've done, how we position the Company, and what we have, and on those three fronts, we check a lot of boxes. Number four is, I'll leave it to the shareholders to figure out how they want to value us, but meanwhile, we're just going to run a great business. We've got a great team and we've got great operating teams that know what the heck they're doing, and so that gives us a great chance to continue to build on a great Company.

ELIAS FOSCOLOS:

Appreciate the colour. Thanks very much.

MURRAY K. MULLEN:

Thank you.

OPERATOR:

This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Mullen for any closing remarks.

MURRAY K. MULLEN:

No closing remarks, folks. Thank you very much. Everybody is busy. It's a little over an hour here that we've been on the line. Appreciate everything, and we look forward to chatting with you and giving you an update on—in October, so thank you very much. Enjoy the rest of your summer. Take care.

OPERATOR:

This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.