The Mullen Group Limited

Second Quarter Earnings Conference Call Transcript

Date: Thursday, July 22nd, 2022

Time: 9:00 AM MT

Speakers:

Murray K. Mullen
Chair, Senior Executive Officer, and President

Carson Urlacher
Senior Accounting Officer

OPERATOR:
Welcome to the Mullen Group Limited Second Quarter Earnings Conference Call and Webcast.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there'll be an opportunity to ask questions.

I would now like to turn the conference over to Murray K. Mullen, Chair, Senior Executive Officer, and President. Please go ahead.

MURRAY K. MULLEN:
Thank you. Welcome to our quarterly conference call.

We'll provide shareholders and interested investors with an overview of the second quarter financial results, and in addition, we will discuss the main drivers impacting our operating performance, our expectations for the year, and we'll close with a Q&A session.

Before I commence today's review, I'll remind everyone that our presentation contains forward-looking statements that are based upon current expectations and are subject to a number of risks and uncertainties, and as such actual results may differ materially. Further information identifying the risks, the 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, I have our Executive Team. I have Joanna Scott, Senior Corporate Officer, and Carson Urlacher, our Senior Accounting Officer. Richard Maloney, our Senior Operating Officer, is on the line. I like to refer to Carson as our Senior Accounting Officer and some like to say the CFO, or Chief Financial Officer, but at the Mullen Group, we do not have chiefs, we have senior executives.

Let me pivot towards the next topic this morning and that is the discussing our Q2 2022 financial and operating performance. As I was preparing my comments, I came across an old saying that I believe pretty much sums up how the market has viewed our performance really for quite some time. It goes like this. If a tree falls in the forest, and there's no one there to hear it, does it make a sound? Or in our case, if we have a great quarter and there's no one there to acknowledge it, does it matter? At the end of the day people justify whatever they want, philosophy is philosophy, but what I do know is this and what I can say is we nailed it.

So, in this morning's call, I'll walk the listeners through the quarter, Carson Urlacher will provide additional commentary and analysis, and then we'll close with the outlook followed by a Q&A session.

So let's start with the obvious. The capital markets are in a tad of disarray and there appears to be some major stress points within the financial system after many years of cheap, easy money, or as I like to refer to it as money for all. Now there's no argument that stimulus was required in the early days of COVID, but all that cheap money didn't go into building infrastructure or adding to supply. All it did was fuel demand, and then because the powers to be didn't turn off the taps quick enough, a new generation of gambling mentality emerged.

Markets went crazy, everything goes up, up, and away until the central bank has finally said, “Enough is enough.” But that was only after they realized that inflation was not transitory. The result of the new central bank moves is troubling. A recent report by James Hodgkin of Cycle GMP highlights that world capital markets, equities, bonds, real estate, cryptos, etc. have seen over $50 trillion in perceived wealth evaporate since the start of 2020 and that's on a global perspective.

Now, pretty soon this could get serious. It might even impact overall demand. Unfortunately, for those of us that live in the real economy, there could be ramifications. So, we watch this very carefully because one really never knows.

So what about the real economy? By this, I mean the consumers, industry, business. Here's what we saw last quarter and what we know today. As for tomorrow, next year, and beyond, I’ll let those much smarter than me come to their own conclusions.

Actually, last quarter, the economy was pretty good. We didn't see a lot of growth. In fact, it's nearly impossible, I believe, given the inability to add capacity due to bottlenecks everywhere in historically tight labour markets, but there certainly were some pockets of strength.

For example, the consumer spend held in fairly well despite inflation. Capital spending by business was quite strong and would have been a lot stronger if it was not for those darn supply chain issues. This suggests to us that the capital spend cycle will be extended out for longer than previous cycles.

Furthermore, we have so much catching up to do in terms of capital replacement. It is difficult to see any meaningful drop in capital spending for quite some time. By way of example, we are on capital allocation for nearly every piece of new equipment way out into 2023. We all know you must invest to improve productivity or to get a handle on costs.

Now, one area of the economy that finally after years of underinvestment entered a recovery phase was in the oil and natural gas sector. It should be obvious to everyone by now that producers must add productive capacity. They must invest if we have any chance of bringing fuel costs down. Longer term, of course, maybe new sources of the energy complex will replace and displace crude oil and natural gas, but there's no way in the short term. This implies old fashioned drilling, I believe.

If I could be so bold as to suggest that Canadians really want to help our European allies get off of Russian dependence of crude oil and natural gas, then Canada needs additional infrastructure, new LNG facilities, and pipelines to Canada's East coast.

Now, let me digress for a moment to speak about the war because this will impact all of us at some point. The Ukrainian people are paying dearly for the invasion by the aggressor, Putin. The rest of Europe including Germany, the home of a manufacturing juggernaut, is suffering collateral damage because it needs energy to operate their economy to keep the factories open. Russia is limiting deliveries; it's fooling with deliveries. This is beyond serious and it is most certainly going to require real leadership and new thinking. Difficult decisions must be made and I'll just leave it at that. So, okay enough with my digression. Let's get back on track.

When you add up everything I discussed in terms of the economy, I can tell you that from our perspective, the economy did just fine, keeping the demand for all kinds of freight shipments, LTL truckload, specialized bulk, and e-commerce at very healthy levels. This was the backdrop that I'll speak to now and highlight as it relates to the quarter results or should I say record quarterly results.

How did we do it? Well, let's start with six quality acquisitions in ’21 and a couple of tuck ins so far this year that formed the basis of the growth.

Secondly, price increases. In response to inflationary pressures, we raised prices, quite significantly in many cases, but—and I will reiterate this very important point—we did not nor will we gouge our customers. With inflation running at a hot 8% to 9%, we had no choice but to raise prices and I am not sure we are done. Every lane, every customer has been critically analyzed to ensure we generate the appropriate returns.

Third, fuel surcharges. Now, this is associated with the doubling of diesel costs year-over-year. This flow through expense to customers is an absolute necessity, but it generally does not contribute to margin because it is designed as a blow through. In saying this, there can be an arbitrage and fuel surcharge if your company-owned fleet achieves a very good fuel mileage because fuel surcharge is based upon a mean average of fuel consumption. In other words, if your fleet or truck is above the mean—in most cases, this is set around 5.5 miles per gallon, which many of our Company trucks are—then you can make margin on fuel surcharges.

Conversely, if your fuel mileage is below the mean, like many independent contractors, you will most likely go broke very quickly. This is a bifurcated situation where only those with good fuel mileage win and the last contributing factor to our outstanding results this quarter was the excellent efforts of each one of our business units.

They managed costs where they could, they grew market share in certain circumstances, and they handled very difficult situations. They negotiated hard to protect our margins, ensuring they did their part to keep the economy moving. In other words, they all did a fantastic job, all 38 of them.

Now, for some more details, I'll turn the call over to Carson Urlacher. So, Carson, you're up.

CARSON URLACHER:
All right. Thank you Murray and welcome everyone.

I'll provide a bit more detail. However, our second quarter interim report fully explains our financial performance. As such, I will provide you with some of the financial highlights.

For the quarter, we generated $521 million in revenue, a record compared to any previous quarterly period. Compared to the prior year, revenue increased by $209 million or 67%, with all four of our segments contributing to this increase.

In terms of adjusted OIBDA, we generated approximately $94 million, a record compared to any previous second quarter. In fact, this $94 million represented the second highest amount of adjusted OIBDA for any quarter in our history. There was only one quarter where we generated more and for that you need to go back 10 years to the first quarter of 2012, where we generated $99 million of adjusted OIBDA, only difference being in 2012, we were a much more capital-intensive Company as compared to our business model today.

Now, getting back to our second quarter results. Adjusted OIBDA, which excludes the impact of $6 million of CUEs (phonetic 10:18) in 2021, increased by $41 million or almost 80% compared to the second quarter of 2021, with all four segments again contributing to this increase.

In terms of margin, our adjusted operating margin improved by 1.2% to 18% in 2022 compared to 16.8% in 2021. Now, if you exclude the impact of the financial results of our non-asset based U.S. 3PL segment, our adjusted operating margins improved to just shy of 20%. So, to put it into perspective, adjusted operating margins improved by 3% from our traditional asset based business units from 16.8% in 2021 to 19.8% in 2022.

Now, let's take a look at our results by segment. Starting with our non-asset based U.S. 3PL segment, this segment added $57 million of incremental acquisition revenue in the quarter, along with $2.2 million of adjusted OIBDA, representing a margin of 3.8%. As you can see, this non-asset based segment has a detrimental impact to our consolidated operating margin. Operating margin on a net revenue basis was 43%. Since being acquired one year ago, the segment has added $8.2 million of adjusted OIBDA to our organization with virtually no CapEx requirements.

Now, let's take a look at how our traditional asset based operating segments were able to improve margins by 3% to 19.8%. Starting with our largest asset based segment, the LTL segment grew revenues by $84 million, of which $59 million was due to acquisitions, $18 million was due to higher fuel surcharge, and internal growth added $7 million of revenue.

Adjusted OIBDA increased by $19.4 million to $42 million in the quarter. Acquisitions accounted for $10 million of this increase, while internal growth added the remaining $9.4 million. The continued strength in consumer spending held freight volume steady, while rate increases implemented in March led to internal growth in both revenue and adjusted OIBDA.

Adjusted operating margin increased by almost a full two points to 20.1% as compared to 18.2% in 2021. This trend of higher margins started in March, which was the strongest month in the first quarter. Margins in April then exceeded the margin generated in March. Margins in May then exceeded the margin generated in April, and the month of June continued the trend by exceeding the margin generated in the month of May.

Our second largest asset based segment is our L&W segment, which grew revenues by $36 million to $156 million. Internal growth represented the largest component of this increase at $16.7 million, and it was mainly due to price increases implemented earlier in the year, coupled with greater freight demand as more infrastructure spending and capital projects commenced. Fuel surcharge increased by $12.6 million and incremental acquisition revenue of $6.8 million was also recognized.

Adjusted OIBDA increased by $7.8 million to $30 million in the quarter and was mainly due to internal growth being highlighted by the strong performance at virtually all of our business units. Adjusted operating margin increased to 19.5% in 2022 from 18.8% in 2021, as freight rates remained elevated and more than offset inflationary costs.

Last but not least, our third asset based segment is our S&I segment. Revenues in this segment were up $34 million to $100 million in the quarter, which was mainly due to internal growth as higher commodity prices led to a recovery in the oil and natural gas service sector, resulting in greater demand and price increases within the majority of our business units.

Demand continued to strengthen in all service offerings and was highlighted by the strong performance of Canadian Dewatering. Adjusted OIBDA increased by just under 100% or $10.2 million to $20.5 million in the quarter. Our adjusted operating margin increased by almost a full five points to 20.4% in 2022 from 15.5% in 2021 as greater demand price increases and the strong performance at Canadian Dewatering led to improved results in this segment.

Our net income was $42.7 million, or $0.46 cents per common share, both up roughly 100% compared to the prior year. We continued to buy back our own stock by repurchasing and canceling approximately 580,000 common shares at an average price of $12.47 in the quarter.

As a result of our strong performance, our return on equity improved to 19.1% in the quarter and 13.2% on a year-to-date basis, despite the fact that real estate is our largest asset class on our balance sheet.

Looking at some other notable items, we continued to generate cash in excess of our operating needs as net cash from operating activities for the period was $48.8 million compared to $55.9 million in 2021. This decrease of $7.1 million was due to our revenue growth, resulting in us financing our working capital requirements.

Our balance sheet remains strong. Our debt to operating cash flow covenant under our private debt agreement is down to 2.37:1 providing us with over one full turn of room available under this covenant. We have a total of $250 million of bank credit facilities available to us, of which we had $142 million drawn at the end of the quarter, leaving us with over $100 million of room available.

Lastly, I would just like to point out our highlights within our Q2 interim financial report to take a look at the chart under the summary of quarterly results. The chart on that page highlights our results over the trailing 12 months, whereby revenue is just shy of $1.9 billion, while our OIBDA is roughly $285 million. Our net income over the trailing 12 months is approximately $97 million, while basic earnings per share is $1.02 per common share over the last 12 months.

With that, Murray, I will pass the conference back to you.

MURRAY K. MULLEN:
Thanks, Carson.

As we talked about, it's always nice when you give good numbers like that. It always feels good, so, thanks for that. A very good report.

As I move to the next section, and we'll talk about the outlook, what do I see? How will the economy perform for the balance of the year? How will our business units perform? Let's be clear, my crystal ball is no better than anyone else. As such, I'll take a very pragmatic and practical approach when it comes to predicting future outcomes.

Now, I'll start with the obvious. We all know that risks are elevated as central bankers adjust monetary policy due to inflation caused by the way by central bankers flooding this monetary system with too much liquidity. So, now they start correcting their last mistakes. Hopefully, they will get it right this time.

When you layer on some very disruptive war, a very disruptive war, tight labour markets, stretched supply chains, system wide bottlenecks, high commodity prices, you have a pretty good recipe for inflationary pressures to remain uncomfortably high. So, slowing for sure but it's difficult to see inflation returning to the old norm of 2%. I don't see that but we do think that inflation starts to slow as the year progresses and into ‘23.

Now, of course, central bankers may play tough and take the job of taming inflation seriously but this will require a stiff resolve and governments to temper their spending habits. So, what does this mean? I'll focus on a few key metrics in determining the directional move we see for the economy and our business.

I'll start with jobs, number one. As long as the job market remains on solid ground, and I believe it will, then consumers have money. Government fiscal policy is also right there. I have not heard one policymaker politician talk austerity. As such, I conclude that governments will continue issuing checks for everything.

Capital flow is obviously crucial to the financial system but this one I am struggling with to be honest, because it's capital that is what is required to help us get out of the inflationary spiral we're experiencing.

Quite simply, I believe we need more supply, and supply is the fuel needed, and capital is the fuel needed for investment activity. So, yes, we need the capital markets to stabilize in order for the economy to move forward in any meaningful way.

With all of this as a backdrop, here's how I see the balance of the year unfolding. I'll start with the so-called freight recession investors have been spooked about. I don't see it. Consumer demand is not collapsing, although spending habits are changing. Slowing yes, but at the same time, there's less capacity to move available freight. So from my perspective, our business will do just fine.

I expect the LTL logistics and warehousing and U.S. 3PL segments all to have a good second half, perhaps not growing, but results should be just fine, especially with sticky freight rates. In the specialized and industrial services segment, however, I expect a very good second half in 2022, driven by increased investment activity by oil and natural gas producers. In particular, I anticipate drilling activity in Western Canada will reach capacity of 250 to 300 active drilling rigs by year-end, but this is only if the supply chain cooperates.

This means higher revenues and improved margins for our business units leveraged to the oil and natural gas industry. Also, many in our logistics and warehousing segment, because by the way, all those consumables must be moved by truck and we have one of Western Canada's best networks.

As for the housing market, higher interest rates are not good. New buyers will be boxed out of the market because of higher mortgage rates. Builders will slow home construction, which will only set up tomorrow's problems because if immigration remains a priority for the Canadian government, these people will all need accommodation, and a lot of other goods and services.

My expectation is that infrastructure spending and construction activity accelerates because as I indicated earlier, this is the key to adding capacity. Whether it's new roads, hospitals, airports expansions, freight terminals, warehouses, you name it, the economy needs it. Now, of course, this implies we need a robust labour force. This may be the single biggest impediment to future growth and productivity improvement. Without people, without a good work ethic, continuing inflation could be problematic.

So in summary, I fully expect 2022 to be an excellent year for our organization, just as I suggested on our April '22 to call when I said, and if I'm right, then many more solid quarters in our future, and I am sticking with my April outlook. We will generate record results. We will work on margins. We will continue to invest capital in new equipment when we can get it, new facilities when we can get approvals, but we slow acquisitions and the main reason is because the capital markets are in a state of flux, which implies that our growth rate slows.

We are monetizing some non-core assets and have already signed three letters of intent. Now the due diligence period for these LOIs expires this quarter. If all close as we expect, by year-end, we free up around $60 million of cash, proceeds we'll use to grow in areas of our strategic focus or we'll strengthen the balance sheet.

So in closing, I know inflation bites. It bites hardest on the working class but job losses hurt, so I suspect policymakers will only push so hard. Under this scenario, we do very well.

With that closing comment, let's open the lines to the Q&A session. Thank you.

OPERATOR:
We will now begin the question-and-answer session.

Our first question comes from Konark Gupta of Scotia Capital. Please go ahead.

KONARK GUPTA:
Good morning. Thanks, Operator. Morning, Murray.

MURRAY K. MULLEN:
Morning, Konark. How are you?

KONARK GUPTA:
Morning, Murray. How are you? Good, thanks.

I wanted to firstly appreciate three months ago, you mentioned we will probably see good deals at a lot of sellers and stores and that's happening right now. So, you kind of nailed the outlook in the short term for sure. So, I want to kind of pick your brains on how you see things evolving now as you go ahead. As you pointed out the previous session, everyone's kind of talking about.

With respect to your businesses, in Canada especially, have you noticed any significant changes in demand or pricing in the recent weeks as inflation and wage increases have started to slip through or impact consumer sentiment, at least, and maybe the spending habits are shifting. So what are you observing? Because it doesn't feel like—we don't have a clear direction from a lot of data points. We are getting a lot of mixed messages at this point.

So, yes, curious as to what do you think about where the economy is heading from your perspective.

MURRAY K. MULLEN:
Konark, from all of the discussions we have and with our peers, what we see with all of our business, and this is both sides of the border, everything, we have not seen any meaningful decline in demand yet. Right, Carson?

CARSON URLACHER:
Agreed, yes.

MURRAY K. MULLEN:
So, I know that the markets are anticipating the freight recession, and once social media gets a hold of it, then everybody thinks it will happen until new data comes out that challenges that, the new thesis. What we see as of today is we have seen no meaningful decline in demand across any of our business platforms. When I speak to my peers, it's the same thing.

Now, we don't see any growth. Let's be blunt, and we can't add growth because you can't get equipment and you can't get people and we've lost productivity. What we have seen, Konark, is it's remained tight and we've raised prices. Raising prices to protect our margin from rising inflationary costs, and along the way, we improved our margin.

Last quarter, we improved it by, depending on what number you want to look at, but just over 1% just on stated net results. If you back out our U.S. 3PL, if you back out CUEs from last year, which is a funny number, it's up by 3%, quarter-over-quarter on a year-over-year basis.

So, that's what we see today. Tomorrow, maybe the market's right. Maybe consumers are in trouble and maybe job losses will hit hard. If job hos losses hit hard, give me a call back and let's have a future—I'm not predicting it, but it's a prediction. I don't know but I don't see it as of right now. We're not anticipating it. I can tell you, we have no job losses here. We're still actively trying to recruit so that we can be as productive as we can. That's what we see right now.

KONARK GUPTA:
That's great. Thanks, Murray.

As a follow up, if I can ask you, what are sort of the obvious differences in your mind between the Canadian and the U.S. freight markets, if you have noticed anything in the recent times?

MURRAY K. MULLEN:
LTL has remained quite strong, which is really tied to the consumer. That's getting right through into the end part of the consumer. Where it has slowed down, particularly in the U.S., has been in the truckload side, but that's just because I think it was super juiced up last year because of the inventory rebuild by retailers and by manufacturers.

So, they've slowed the inventory, but it's not stopped. It's still a mess. The ports are plugged, and the rails can't get product moved, so the supply chain remains inefficient. It's still moving but it remains inefficient.

I don't know. I feel for the retailers, particularly the small ones, because their costs are up and the consumers are not happy with prices. So, they're pushing for price declines. I feel for those retailers, particularly the small ones right now but there's nothing we could do about the cost side. Our warehouses are plugged. I can't get rail service. We're losing trucking capacity because of high fuel prices. Good quality companies like ourselves are in good shape.

KONARK GUPTA:
That's great, Murray. Thanks.

Last thing for me on the M&A front, I think you mentioned, obviously, the rising interest rates and your prudence about balance sheet and the volatility in the capital markets. Everything is kind of making you cautious perhaps in the short term on M&A side of things. Now, my question on M&A is maybe given the environment we are in and the rates and inflation etc., it might push a few players over the edge in terms of opportunities. So, how do you look at your balance sheet where it stands today? What's the incremental opportunities that may come out because of the downturn?

MURRAY K. MULLEN:
Well, let me start with the M&A market. The M&A market, I must get—my in-basket is plugged. I've got to get two a day of opportunity, which is not normal. That tells you there's stress in the market. That tells you that maybe some of the sellers think they can catch the buyer asleep at the wheel.

Let me just tell our investors, you don't catch us asleep at the wheel. We were aggressive on acquisitions in 2021 when we felt if we got these acquisitions and then we saw pricing coming up that our shareholders and our investors would do exceptionally well when we got that book of business and then we raised prices. Our results reflect those decisions.

Today, I'm cautious. People show good numbers just like us but we're not biting. I'll just wait it out. I think there'll be a better day because I think some people have got them stretched. They've overspent. So, we'll just wait.

The second thing is, Konark, I read the tea leaves. If investors are not excited about the future, I'll take a cue card from that. I'm not going to stretch the balance sheet just to add some more growth, because I'll be blunt with you, it doesn't appear our shareholders and our investors give us any credit for it so why would I risk the balance sheet? Man, we got a big Company right now and we're just acing it. So, yes, we'll either strengthen the balance sheet or we'll give some more back to our current investors, but I'm not going fishing right now. I don't like it.

KONARK GUPTA:
That makes sense. Perfect. Thanks so much, Murray, and all the best.

MURRAY K. MULLEN:
Thank you.

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

DAVID OCAMPO:
Thanks. Good morning, Murray.

MURRAY K. MULLEN:
Good morning, David.

DAVID OCAMPO:
I just wanted to touch on the S&I division. You talked about continued strength, at least for the balance of the year, just given the strength in the commodity prices. Does that change your mid- or longer-term outlook on how much CapEx you spend on that division, because it's been relatively muted in recent years? Then, two, do you guys (inaudible 32:08) a lot of unused capacity where you can really grow off the current based on the top line?

MURRAY K. MULLEN:
David, we're going to have to have a—even internally that will be a major point of discussion with the senior execs and then, finally, with the Board, but let's just say we wanted to increase CapEx in the oilfield side because, man, we see things really taking off. David, we can't get it. The supply chain. We're out. You can't get a new truck till 2023 and we're on allocation in '23.

So, will new capital be required in that sector? Absolutely. Nobody's invested for years. Just like we didn't drill, so now they got to go back drilling. We need to see, first and foremost, the recovery. We need secondly, to see the commitment that the producers are going to make that they say I need you and then we'll go out and we'll consider. I said we'll consider adding capital into that sector, but in the meantime, I'm raising prices, because the capital we got is coveted. The people we have are outstanding. We stuck with them during the toughest times when everybody said get rid of that stuff. Now, it's our time to make a good profit and a return on those investments.

DAVID OCAMPO:
That makes a lot of sense.

Then on your trucking side, on the asset base there, you guys were guiding to $60 million of CapEx. Any risks that you guys don't hit that number just given all the supply chain issues that we're seeing today?

MURRAY K. MULLEN:
Carson, what do you think?

CARSON URLACHER:
I would say that's going to be difficult to hit. You take a look at our results in six months, year-to-date, we're net CapEx at $24 million. So, you look at the next six months out for 2022, hitting $60 million is going to be tough, especially with the delay in getting our orders in. The product's ordered; it's just a matter of timing as to when we can get this stuff.

I'm going to say we don't hit the $60 million mark by the end of the year. Is it off by 10%? Maybe. I could see a $50 million mark for net CapEx by end of the year. Again, this is contingent upon us not closing any of those non-core asset sales that we're looking at.

MURRAY K. MULLEN:
David, what we do know is this is that the requests from our business units are significantly higher than our ability to get capital delivered. So, what you see is what we spent. That wasn't what was requested by our business units.

CARSON URLACHER:
Correct.

MURRAY K. MULLEN:
In fact, what we articulated earlier was we were going to have a higher CapEx spend this year than what we're on target for, so that tells you the supply chain is tight. I don't see that loosening up. We're already on allocation, David, for '23.

DAVID OCAMPO:
Do you guys have a sense on how much that is weighing on margins if you guys are running older equipment? Is it 100 basis points, 50 basis points?

CARSON URLACHER:
That would be very difficult for us to calculate, David.

DAVID OCAMPO:
No, I completely understand.

MURRAY K. MULLEN:
Yes, I think what it is, we've always maintained a steady CapEx program throughout time. That's why we kept investing in that. What we have is, David, I think that we'll continue to do that, replace capital, so we've always got the most efficient equipment but you can't add to what you've got. You cannot grow our fleet right now because we cannot get it. We're trying to always improve, always have a better fuel mileage, always do our part for the environment, always grow our repairs and maintenance costs.

We continue to do that but we can't add incremental to it. There's not enough capacity in the system for us to add more Company trucks. By the way, there's no drivers anyhow, so it doesn't matter.

DAVID OCAMPO:
Those are my questions. I'll hop back in queue. Thanks a lot, guys.

MURRAY K. MULLEN:
Thanks.

OPERATOR:
Our next question comes from Tim James of TD securities. Please go ahead.

TIM JAMES:
Thank you. Good morning. Congratulations on the great results. Great results.

MURRAY K. MULLEN:
Good morning.

TIM JAMES:
My first question, I'm just wondering if you could kind of update us on Mullen's exposure to the spot market pricing in LTL and logistics, more specifically and if you're seeing customers—I mean, you mentioned you've been able to raise prices and there may be more of that to come. Are you seeing customers move towards wanting or locking into sort of contractual pricing maybe some longer-term pricing? What trend are you seeing in that side of the business?

MURRAY K. MULLEN:
That's a really good observation, Tim.

So, spot market pricing has definitely softened. That tells me that the customer is starting to push back. There was a time when they'd just get it, "I just want it" because they were caught short, but today people are pushing back saying, "No, no. I'm not going to pay a stupid number." So, we've seen that.

Now, a lot of our pricing in the spot market, we would have also had spot market pricing from our contractors. So, we just managed the spread on that between how that worked out, but the spot market has definitely softened.

Now, you'd say, "Okay, are customers wanting to go more to the contract market?" No, I don't see it. I've got to be blunt, everybody talks about contract pricings. Tim, they all got a 30-day cancellation clause on both sides so let's not pretend that you're locking into a three-year fixed price, no adjustment clause contract. We don't have any of those. Maybe somebody else has, but we don't do that.

So, customers definitely when they've made commitments to their carriers, they're going into the contract pricing rather than the spot market. So, demand has softened a bit; that's softened the spot market pricing. Contract pricing, we haven't seen any significant pushback. Although, I would tell you, it feels like customers, we all want to get inflation under control. All of us do.

The problem that you got if customers overcook, and they want to really reduce pricing, unless fuel prices really come down significantly, all you're going to do is push more of the independent contractors into bankruptcy. We're already seeing too many contractors fold the tent, not be around, and that's where I talked about the supply side is really at risk in my view, because the contractors don't get great fuel mileage, and that's your single biggest cost by two right now.

The other thing about the independent contractors are at real risk is availability of parts. That is not that easy to get right now. So, if you're an independent contractor, and your truck goes down because your clutch went out or you had to get new brakes or whatever, you could be down for quite a while. That's 100% of your fleet. If 20% of our fleet is down at any given time because we can't get parts, that's 20%, but if they go down, it's 100%. That is not sustainable. You can't just go in and get service quickly today.

So, I suspect the supply side is going to keep the market and pricing up pretty firm with all of the major carriers. I don't see us really dropping contract rates too much to be honest with you. I don't see it.

TIM JAMES:
Okay, that's helpful.

Maybe just to elaborate on that a bit. So, your contractors that you use, you're maybe benefiting a little bit from the softness in the spot market, I assume there, but from your transportation equipment that's generating revenue, you've talked about being able to raise prices, and maybe some more upside there. Could you just kind of talk about your ability to do that in the face of this softening spot market? Is that just because of sort of the regions you're in? What gives you the ability to do that, despite a softening spot market, I guess, is my question?

MURRAY K. MULLEN:
We operate in every region, the United States, right across Canada, nearly every sector of the economy. There's no doubt there's been a cooling off of the freight surge that happened in ‘21, as I talked about, but not on the contract side. Those are staying firm. I don't hear anybody really capitulating and saying—because you can't get any drivers, I can't get anybody to go to work. They’ve either got the sniffles or they don't want to go to work. Golly, we got a lot of people retiring in the transportation sector. The demographics is not working in our favor at the moment so we're not dropping prices. It's that simple.

I don't know if we're going to increase prices. We certainly won't be at the same rate as we have, but inflation is up 8% to 9%. Clearly, we had to get that. What's inflation tomorrow? It's not going to be 8% and 9%, I don't believe that. It's going to fall back into line. Is it going to be 2% as I talked about? I doubt it very much but I don't think it's going to be 8% or 9% either.

So, it'll start trending downward. That means we will get pricing increases in the future and contract rates to cover inflation but I don't think much more than that. All of the margin improvement that we will get in the future is because of productivity improvements, that we have better equipment than somebody else, and that we've made better decisions. We'll continue to work, and we always work on that, Tim. We'll continue to work on it.

TIM JAMES:
My second question, just looking at EBITDA margins, is it possible just to discuss a little bit the trajectory of margins kind of through the balance of the year that gets you to your EBITDA target for the year? I think, historically, and granted with the new presentation we don't have a lot of history, but Q4, there's typically a bit of a step down in the margin percentage in LTL and maybe specialized, but could you just give us—again, obviously, I'm sure you don't want to get into real specifics—but what we should expect in terms of the trajectory of margins for the segments for the balance of the year?

MURRAY K. MULLEN:
Well, let's start with how we did this year vis-à-vis last year, and you should expect that we should have the same increases year-over-year for the balance of the year.

TIM JAMES:
Okay. So, the year-over-year changes that we've seen kind of through the first part of the year should be sustainable through the second half? Am I interpreting that correctly?

MURRAY K. MULLEN:
That's what we think and which is why I said I think we're on target for $300 million of EBITDA this year.

TIM JAMES:
Okay, great.

Then my final question, you'd mentioned just more of a confirmation or you'd mentioned about non-core asset sales. I may have missed the number, but did I hear $60 million, potentially, in terms of the three LOIs that you've got? Would the completion of those sales in 2022 change that kind of let's call it $50 million sort of gross CapEx number that Carson mentioned earlier? Or should we just think about that, if that comes through, that's simply extra cash that sits on the balance sheet; it wouldn't be redeployed this year?

MURRAY K. MULLEN:
We can't redeploy it in new capital. Forget it. Now, we might redeploy it in acquisitions, perhaps, but not in new capital because we can't get new capital. So, we're already behind the curve on our 2022 CapEx, but we might deploy it into growth CapEx, just repositioning that capital. Or we might just strengthen the balance sheet and just pay down debt and we'll just play it by ear over the balance of the year as to whether capital markets are in a total flux, as I call them, and they're going to have a hissy fit for how long. I have no idea.

All I know is this, the capital markets didn't have a hissy fit at the start of the year, but now they do. So, I don't know what the markets are going to be like at the end of the year, but at least we have options. If I think that the markets are in a bit of disarray, well, we'll strengthen the balance sheet. If things normalize, and whatever, and we freed up $60 million, we'll go to acquisitions and growth. So, that's a great thing about our business model. We got flexibility galore.

TIM JAMES:
Those non-core assets, are they in a particular segment or are they spread across the businesses?

MURRAY K. MULLEN:
You know what? We're in a quiet period on our LOI, so I'm just highlighting to everybody that you know what, we're looking at monetizing non-core assets that really aren't adding us a lot of EBITDA. So, we're just freeing it up, okay?

TIM JAMES:
Okay. Fair enough. Great. Thank you very much.

MURRAY K. MULLEN:
You bet. Thanks.

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

WALTER SPRACKLIN:
Thanks very much. Hi, everyone. How are things? Good?

MURRAY K. MULLEN:
Today they are, Walter, yes.

WALTER SPRACKLIN:
It's a very good day. These are great results. Congratulations.

I want to touch on that. One of the things that when I look at your guidance, and I compare it to what you've commented on on a business segment perspective, I came into this call wondering if—and I couldn't gauge by the press release that there was anything one time in the second quarter that was not a trend.

So, when I look at the segment, and I see you say that less than truckload second half will be equal to or better than the first half, when you say logistics and warehousing will continue to produce strong results, and specialized industrial should be better than in the first half, when I reflect all that in on a segmented basis, I'm coming up with north of $315 million and that's assuming, you might have a little bit of conservatism in those segmented commentary, which would mean it might be above $315 million.

Am I reading something wrong into it? Is there some corporate elimination or something like that that is going to offset the segmented commentary that you provided? Or is the guidance that you provided just have a nice dose of conservatism even if you add up the commentary on the segmented basis as you provided it?

MURRAY K. MULLEN:
How do I say this? I probably wouldn't say we could do $300 million if I thought we weren't going to do $300 million. So, we always under commit and try and over perform. So, I think you have a pretty good analysis, a pretty good take on it, what you said. If it plays out as we think it might, you could be spot on in your analysis. I'll leave that to you to kind of make your best guess. I've given you our best take on what we see and how we see it.

Clearly, we're on target for a good end of the year, so long as there's no job losses, unless there's no major capitulation in the real economy, which I'm not predicting. I think, Carson, we've talked about, I think last year, our Q3 was our best quarter.

CARSON URLACHER:
Yes, typically, traditionally, our third quarter is now our strongest quarter. Then, Q4, obviously falls off because you lose half of the month of December with holidays and that sort of thing.

WALTER SPRACKLIN:
Okay. That's great colour.

MURRAY K. MULLEN:
So, it's plausible, Walter although I'm reluctant. It's a very fluid market, but it's plausible the third quarter could be our best quarter, and then the fourth quarter falls off, typically but if I'm right that the drilling rig count is going to hit that cyclical high of 250 to 300, then our S&I segment's going to have a good fourth quarter. So, yes, the stars are lining up pretty good for this business model right here. Yes, we feel pretty good about it.

WALTER SPRACKLIN:
All right. Then on the non-core assets, you're in a quiet period, but I want to ask whether that sale is an indication of what you might do…

MURRAY K. MULLEN:
It's not that sale, it's sales.

WALTER SPRACKLIN:
Sorry, say again?

MURRAY K. MULLEN:
Sales, more than one. It's not just one.

WALTER SPRACKLIN:
Yes. Is this an indication of a broader strategy because you own a lot of your land. Are you looking to monetize more of your balance sheet and your holdings? Is this an indication of a strategic shift in that regard?

MURRAY K. MULLEN:
No, I don't think it's strategic from that. It's just the opportunity came up, and the opportunities that came up were just too compelling for us not to consider on behalf of our shareholders. Then it's just as I said, if they come to fruition, everybody—we were always in LOIs on acquisitions. In this case, we're in LOIs of divestitures. You never know how they'll play out; you got to go through due diligence and you got to come up with funding and all these kinds of things.

So, I'm just highlighting is that if it comes to fruition, that's a game changer for our balance sheet. Then we'll figure out whether we just reduce debt by $60 million or whether we use it to grow in 2023, which is further acquisitions. I can tell you, we got good options on both sides.

WALTER SPRACKLIN:
Yes. That was the next part of my question is let's just say it comes to fruition, and you're generating a lot of good free cash. You're holding back on acquisitions right now. You've got the option of shareholder return but I didn't hear you say much about that in the form of dividend or even buyback, so it sounds like you want to maybe reduce debt, knowing you can always scale it back up, reduce leverage, effectively park that dry powder and keep it on hand for either a bigger CapEx spend next year, if the opportunities present themselves, or acquisitions. Am I reading that right?

MURRAY K. MULLEN:
Yes. We've got four good uses of cash, but I'm just totally steadfast that I'm not going to go try and grow this Company and leverage the balance sheet, given the uneasiness in the capital markets. That is gambling and we do not gamble with our shareholders' money. It's too risky.

WALTER SPRACKLIN:
Fair enough.

MURRAY K. MULLEN:
So, we'll just take a prudent look at it. Clearly, we're not going to issue out stock. Investors don't believe that—in our business model, I guess, that's why our stock price is where it's at and I'm not going to leverage the balance sheet, so we'll just do it one step at a time.

There's not many other ways to do it, Walter. Acquisitions are damn expensive and they don't pay themselves off in one year. It's a long-term investment and I don't see where the investors or the debt markets want to make long-term commitment today, so why in the hell would we?

We'll just manage our business. We got a great business. It's twice what we were when we entered COVID. Twice. And our stock price is not up. I rest my case. There was nobody in the forest to hear the trees fall.

WALTER SPRACKLIN:
Okay. Thanks again. Appreciate the time.

MURRAY K. MULLEN:
Thank you.

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

KEVIN CHIANG:
Thanks for taking my question. Congrats on a very strong set of results there, Murray and team.

MURRAY K. MULLEN:
Yes, we had a pretty good one. We hit it out of the park. Every analyst missed it. What was the average, like 66? I think the one thing that nearly everybody missed, Kev. Everybody got kind of the top line right except for one thing. Nobody believed that we were going to get the pricing increases, and pricing increases have increased by 10% on $450 million. That's $45 million of incremental revenue, and we maintained margin. Actually, we grew it.

I think that's where most everybody missed. They thought we were going to do the same as last year, which is where the $66 million came in. Maybe beat it by a little bit. So, yes, I felt pretty good about our quarter, for sure.

KEVIN CHIANG:
No, no, you definitely hit it out of the park there.

Maybe if I could ask Walter's question differently because it does feel like you saw accelerated pricing growth in Q2, and maybe less so in Q1, which was also impacted by Omicron to start the year. If I just look at the $94 million of EBITDA—and it sounds like again, this is outside of some sort of economic slowdown, so maintain the status quo, which looks pretty good for you, it's hard to see how your normalized earnings on an annualized basis isn't something like $350 million or something north of that.

I know you'll give us a business update sometime in December this year but is there anything off about just taking what you did in Q2, applying what could be normal seasonality for your business, and assuming again kind of the economy status quo, that you're not like a mid-$300 million EBITDA company? Or am I off in my very simplistic math?

MURRAY K. MULLEN:
Yes, it sure feels like it. If prices remain sticky, which I'm predicting they will, then we've made a major step change in the revenue side with the acquisitions. Then in the pricing side, we've done that, our business units. It was really difficult for all of your businesses that have lived in a non-inflationary environment for 20 years to adjust on a dime to the rising inflation.

We talked to them about it, but it was really difficult for them to have those discussions with customers until it became so painfully obvious that inflation was running rampant that we had to raise the prices. Those were tough discussions we had with our business units. In March, they finally had the wherewithal to go and implement them. You can see the end result of that.

Not only did we cover off the inflationary pressures, but we actually added to margin. I suspect that I don't want to go back. I don't think they want to go back. Unless the market forces us to go back and I don't think it will, then we're not going back.

KEVIN CHIANG:
Just on the pricing, if I kind of look at it from a yield perspective, so you mentioned pricing of 10%, was there any tailwinds related to mix because I have to think, and tell me if I'm wrong, I have to think that Q2, you probably saw maybe a better recovery in B2B volumes, just as things reopened. I kind of think of that as being heavier and that's generally a positive mix shift when I think of yield. Was that something that also helped in terms of the broader unit revenue trends, or is that something that wasn't material in the quarter?

MURRAY K. MULLEN:
I don't think so, Kevin. Carson?

CARSON URLACHER:
I didn't see any one-off type changes that really impacted the quarter there, Kevin.

MURRAY K. MULLEN:
Kevin, the one-off change was pricing increases. That is not something we've seen. Now, we used to see that when the oil and gas sector was booming, and so that means we haven't seen it in over a decade in our Company, but in the general economy, I haven't seen it in two decades. So, yes, I would say the one-off change was pricing increases, but no, we're not going to have another 10% rate increase in Q3 over Q2, but you have Q3 pricing increases will be 10% above Q3 of 2021.

KEVIN CHIANG:
Yes, that makes a ton of sense.

Just last one for me. I've noticed port congestion, the West Coast ports here in Canada, and the rail dwell times have been kind of picking up here. Just wondering what you're seeing within your intermodal franchise. Anything concerning or anything that you're worried about as you kind of think about fluidity in the back half of the year, and as you kind of progress to

$300million+ of EBITDA? How much of a risk is this? Is it something that seems manageable, or is it is it something that's concerning in your eyes?

MURRAY K. MULLEN:
That's a really good observation, Kev. We monitor this daily.

I think the supply chain is still subject to some real bottlenecks. I think now the bottleneck is now starting at our warehouses. So, our warehouses, Kevin, I can tell you, they're jam-packed, so that means we can't get any more inventory in but there's inventory in the water, there's inventory on the trains. So, you can't bring the container to us because I can't handle it. So, then if you can't bring it to us, it can't get out of the railway station. If it can't get out of the railway station, they can't…

There's always a bottleneck and it appears that the freight is not moving out of the warehouses at a fast enough clip to let new freight in. So, that that's why I say to you, I really feel for the retailer right now because they're in a bit of disarray.

The railways, they're good friends of ours, we use them a lot but, man, it's a mess. Now, you've got particularly issues down in California. That could morph into other parts, which is labour disruption. You've heard about AB5. The independent contractors are striking in California because the state of California has ruled that independent contractors can't be independent contractors, and they're fighting mad.

The port union workers in Oakland will not cross the picket lines. Freight is not moving until this gets resolved. So, it's a Mexican standoff; it's a shootout at the OK Corral. I don't care what the hell you want to call it. It is going to bottleneck the supply chain. That means you can't offload the ships.

KEVIN CHIANG:
Right. That makes sense. That makes sense. I'll leave it there. Murray. Congrats again on the good Q2. I'll say we all heard the tree fall on this quarter. Thank you.

MURRAY K. MULLEN:
Thanks, Kev. Look forward to chatting again. Take care now.

OPERATOR:
Our next question comes from Matthew Weekes of iA Capital Markets. Please go ahead.

MATTHEW WEEKES:
Good morning. Thanks for taking my question. Congrats on the good quarter. I think most of mine have been answered at this point.

I just want to ask, and you talked about sort of the different dynamics you're seeing between spot and contracts rate a little bit recently here, I'm just wondering if you could provide any kind of commentary or colour on how much your business would you say roughly is exposed to spot market versus how much is typically contract?

MURRAY K. MULLEN:
I would say nearly all LTL business is contract rate. It's either book rate, contract rate, whatever. So, LTL is very sticky in terms of whatever the rate is what the rate is. In the logistics and warehousing business, so the long-haul business, the spot market, a lot goes on load boards and it's posted. The trucks post the trucks and the freight brokers would post what their freight is, and that kind of sets what the market is for the spot market. That's soft, but still, it's the independent contractors that are taking it on the chin in the spot market, not bigger companies because we typically don't play in the spot market.

Our logistics business plays the spot market, but as I said to you, we just manage the spread between what the market pays and what we can buy a contractor on the market for. So, we still manage the spread. Our spread hasn't changed, I don't think, has it, Carson?

CARSON URLACHER:
No.

MURRAY K. MULLEN:
The price of the contract just went up; we raised the bus to the customers. If the spot market changes, we don't get as much from the customer, the trucker doesn't get as much. It's the independent contractor that's at risk here as the spot market adjusts to whatever the economy is at that day, whereas the larger carriers, we typically don't play the spot market that much with our Company equipment.

CARSON URLACHER:
Yes, our margins in the L&W segment actually improved here in the last quarter, year-over-year.

MATTHEW WEEKES:
Okay, thanks. I appreciate the commentary on that. I'll turn the call back. Thanks.

MURRAY K. MULLEN:
Thank you.

OPERATOR:
Our next question comes from Michael Robertson of National Bank Financial. Please go ahead.

MICHAEL ROBERTSON:
Hi. Good morning, all. Great quarter. I’m cognizant of the time here so I'll just have a quick follow up, I guess.

Just wanted to touch on your updated guidance for the year. If I look at those numbers and back out what you've done in the first half of the year, it looks like you're pointing to margins going down from what we saw in Q2 and I guess in H1 as a whole. I was just wondering if you're seeing some specific drivers behind that, that you could speak to, or if maybe that's just as you noted earlier erring a bit on the conservative side?

MURRAY K. MULLEN:
Well, I'm always conservative, Michael. I'm not a promoter. We tell people this is our best analysis. I can tell you that I don't ever want to underperform what we tell the market. So, I would say to, I would think that I would not say $300 million if I didn't think it was baked in the cake.

MICHAEL ROBERTSON:
Got it. So you don't see—I was just wondering if maybe there was like a cost creep or something that you saw catching up in the back half of the year that might put pressure on those margins relative to what you've seen.

MURRAY K. MULLEN:
I don't see that because I think that the prices are sticky for the reasons I've explained. I don't think that freight volumes are increasing. Yes, freight volumes are increasing and demand is increasing in the specialized industrial side. There's no doubt about that, and that's because the drilling rig count is going up. In fact, we're seeing the rig count is going up like 10 a week right now. So, we'll hit that $250 million-$300 million and that's kind of the peak where I think that industry settles out at. We've raised the prices, we'll have good margins, and a good second half for our S&I side.

In the rest of our business, we're going to bust our butts here to make sure the margins that we had in the second quarter are maintained throughout the balance of the year, but the whole market softens a little bit as we go into fourth quarter with the consumer spend. So, take what we do in the fourth quarter of last year and our logistics and warehousing and our LTL side and say, well, we still should improve it by 1%, Carson.

We improved in this last quarter and that's with our 3PL in there, but if you take the 3PL out, we'll have a nice increase. That's our expectation. It'll be up by at least 1% or 2%, the margin, over last year. Not over the second quarter. Over last year. We're talking about the rate of change, year-over-year.

MICHAEL ROBERTSON:
Got it. Appreciate the colour as always. Great quarter. Thanks.

MURRAY K. MULLEN:
Thanks, Mike. Appreciate that. Take care.

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:
I just want to wrap up and say thanks, folks. Early start to the day. We got the numbers out. We're already focused on Q3 and the other stuff we got working on. We got a lot of work ahead of us but we feel pretty good about the last half of the year, but we watch carefully. We've got a keen eye on the capital markets just in case the capital markets are right and the world is coming to an end. So, we watch it carefully, but we don't predict it. Take care. Have a great summer and stay safe.

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