The Mullen Group Limited
Third Quarter Earnings Conference Call Transcript

Date: **Thursday, October 20th, 2022**

Time: **9:00 AM MT**

Speakers: **Murray Mullen**
Chair, SEO & President

Carson Urlacher
Senior Accounting Officer

OPERATOR:
Welcome to the Mullen Group Limited Third 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 will be an opportunity to ask questions. To join the question queue, you may press star then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

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

MURRAY MULLEN:
Thank you. Welcome, everyone, to Mullen Group's quarterly conference call. We'll provide shareholders and interested investors with an overview of the third quarter financial results; in addition, we will discuss the main drivers impacting operating performance, our expectations for the balance of the year, and close with a Q&A session.

Before I commence today's review, I remind everyone that our presentation contains forward-looking statements that are based on our 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, 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 senior team. We'll have Richard Maloney, who is the Senior Operating Officer, Joanna Scott, Senior Corporate Officer, and Carson Urlacher, who is our Senior Accounting Officer.

As I start looking at Q3 2022 financial and operating performance, I'll start by using my recollection from a July investor call in that, based upon our strong Q2 results, I believe that we are on target to achieve annual revenues of around $2 billion and EBITDA of $300 million. But based upon our Q3 results, it's evident that I was only half-right. The revenue number looks to be on target; however, it now appears very likely that EBITDA will be higher than the $300 million that I had talked about in Q2.

Carson Urlacher will dig deeper into our quarterly results in a few moments, but what I can say is that Q3 was another great quarter for our organization. Our focus on yield, margin and profitability shows in results: strong revenues, great EBITDA, improving margins, and a cash flow that positions MTL for the very sound future.

Now for the details on the quarter, I'll turn it over to Carson Urlacher.

Carson, you're up.

CARSON URLACHER:
All right, well thank you, Murray, and good morning, everyone. I'll provide a bit more detail; however, our third quarter interim report fully explains our financial performance. As such, I will just speak to some of the highlights.

This is the second consecutive quarter where we've generated in excess of $500 million in revenue, and now on a trailing four-quarter basis we've generated over $1.9 billion in revenue along with $318 million in OIBDA and $1.25 in earnings per share. In the third quarter, we generated $518 million in revenue, a record compared to any previous third quarter. Revenue increased by approximately $86 million or 20% compared to the prior year, and was primarily due to three reasons: first, general rate increases along with steady demand resulted in a $40 million increase in revenue; secondly, fuel surcharge revenue increased by $37 million due to the 63% year-over-year increase the price of diesel fuel; and lastly, we recognized $9 million of incremental revenue from acquisitions.

In terms of adjusted OIBDA, we generated approximately $98 million, again a record compared to any previous third quarter and second to only previous quarter, being the first quarter of 2012 where we generated $99 million of adjusted OIBDA. Adjusted OIBDA increased by $33.7 million or 52% compared to the third quarter of 2021, with all three of our asset-based segments contributing to the increase. In terms of margin, our adjusted OIBDA margin improved by 4% to 18.9% in 2022 compared to 14.9% in 2021, and was mainly due to rate increases implemented in 2022 which more than offset inflationary costs. Sequentially, adjusted operating margin improved by almost a full point from the 18% generated in the second quarter of 2022.

Now let's take a quick look at how we performed by segment. Starting with our largest asset base segment, our LTL segment grew by $32.5 million to $201 million: $21 million of the increase was due to higher fuel surcharge, $9 million was due to acquisitions, while general rate increases and steady consumer demand added $2.4 million in segment revenue. Adjusted OIBDA increased by $14 million to $41 million in the quarter, which was largely due to rate increases implemented in the current year, while acquisitions accounted for $1.7 million of the increase. The continued strength in consumer spending held freight volumes steady while rate increases led to higher revenue and adjusted OIBDA. Adjusted operating margin increased by 4.5% to 20.4% as compared to 15.9% in 2021. The adjusted operating margin of 20.4% was relatively flat on a sequential basis.

Our second largest asset base segment is our L&W segment, which grew revenues by $34 million to $156 million compared to the prior year and was essentially flat on a sequential basis. Of the $34 million increase in revenue, $22 million was due to general rate increases and strong demand for freight services, while fuel surcharge accounted for the remaining $11.9 million increase in revenue. Adjusted OIBDA increased by $10 million to $32.7 million in the quarter and was mainly due to rate increases that led to the strong performance at virtually all of our business units. Adjusted operating margin increased to 20.9% in 2022 from 18.6% in 2021 as freight rates remained elevated and more than offset inflationary costs. On a sequential basis, adjusted operating margin improved by 1.4%.

Our third asset base segment is our S&I segment. Revenues in this segment were up $23 million to $108.8 million in the quarter, which was mainly due to rate increases and strong demand for specialized services, including dewatering, water management, pipeline hauling, oilfield activity and construction projects in northern Manitoba. Adjusted OIBDA increased by $9 million or 57% in the quarter compared to the prior year. Our adjusted operating margin increased by 4.4% to 22.6% compared to the prior year due to price increases, the strong performance at Canadian Dewatering, and greater oilfield activity levels. Sequentially, adjusted operating margins improved by 2.2% compared to our most recent quarter.

Lastly, our non-asset based U.S. 3PL segment, revenue in this segment was down slightly to $54.7 million as freight demand in the United States for full truckload shipments softened in the third quarter and negatively impacted revenue in this segment. Adjusted operating margins were 2.7% on a gross basis, while operating margins on a net revenue basis were 28.8%. Margins were negatively impacted by higher than normal contractor expense and an increase in S&A costs as we continue to add talented IT staff to continue to build out our technology platform.

Our net income was $38 million or $0.41 per common share, both up over 100% compared to the prior year. When we look at net income and EPS on an adjusted basis, which really excludes the gain and loss generated from how we account for our U.S. dollar-denominated debt and our cross-currency swaps, which essentially provides a pure economic hedge on the principal repayment on such debt, we generated $47 million of adjusted net income or $0.51 on an adjusted EPS basis. Our adjusted EPS on a trailing four-quarter basis was $1.41 per common share.

We continued to buy back our stock by repurchasing and cancelling just over 206,000 common shares at an average price of $12.11 in the quarter. As a result of our strong performance, our return on equity improved to 16.6% in the quarter and 14.3% on a year-to-date basis.

Looking at some other notable items, we continue to generate cash in excess of our operating needs as net cash from operating activities in the period was $95.7 million compared to $37.3 million in 2021. This increase of $58 million was mainly due to two things, one being the $33.6 million increase in OIBDA, and the other was due to a $24 million year-over-year variance in changes from non-cash working capital items. This strong cash flow generation enabled us to reduce the amount being borrowed on our credit facilities by over $40 million in the third quarter alone.

Our balance sheet remains strong. Our debt to operating cash flow covenant under our private debt agreement is down to 1.98 to 1, which is the lowest level we've seen since 2014. We have a total of $250 million of bank credit facilities available to us, of which we had $98.7 million drawn at the end of the quarter, leaving us with approximately $150 million of room available. This trend of paying down debt on our credit facility has continued into the fourth quarter. The repayment amounts on our credit facilities over the last half of 2022, we believe, is just one of the highlights of our results so far this year and really provides us with increased flexibility to be able to adapt to market conditions as we head into 2023.

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

MURRAY MULLEN:
Well done, thank you, Carson.

As we shift gears now and we start looking at the outlook section, and I'll give a few comments and then we'll move right to the Q&A session, but it's pretty obvious that with three quarters that are now completed that we've generated some excellent results for this organization. Economic conditions have been favourable and we've really grown quite nicely with some very key good acquisitions.

But looking backwards doesn't always foretell the future and one must look at what could change, so investors, in fact all stakeholders, are continuously focused on what comes next. When it comes to predicting the future, we all have our thoughts, our opinions and our views, you have yours and I have mine, so I will use the next few minutes to provide my best analysis of what the balance of '22 looks like for the Mullen Group.

Now, it should be obvious to everyone on the call today that there is a fair amount of uncertainty these days, which really means that it is difficult to predict with any degree of conviction. Top of the list is financial stress caused by rising interest rates. Wars are ugly and damaging to way too many people, and a changing geopolitical landscape which will undoubtedly alter supply chains needs to be taken into consideration. Energy and those all-important computer chips are huge issues and will be front and centre as politicians migrate the supply concerns. With these topics in mind, I have a number of thoughts as to how our business should perform, and I'll break from the tradition and just use what I call bullet points, and let's call it my Twitter account, short and to the point.

Let's start with the economy. I don't see any growth. There's downside risks that are now elevated, but let's not listen to me, let's hear it from the experts. If we listen to politicians on both sides of the border, there will only be a slight downturn. If we listen to all of the economists, a material downturn is almost a certainty. Financial experts, they're warning of dire consequences if interest rates continue to be pushed higher. So, who do you believe? That's your choice. But what is pretty clear is that manufacturing, at least of critical components, is coming back to North America. There's an excellent read on how FedEx views these new conditions. And for reference, I suggest those interested should read the October 5, 2022 economic report that summarizes and really dovetails quite nicely with what our viewpoints are.

Now, what about the consumer? In the absence of significant job losses, I suggest the consumer will continue to spend, so this is the number one issue I focus on, because if the job market remains strong, consumption will remain steady. It will perhaps change, but it will still be okay, and we all must remember that we are a consumer-driven economy.

Another important element, capital investment. I'm still of the view that the key to bringing prices down to controlling inflation is adding supply. Capital projects, construction activity, oil and gas drilling; all of this is required. And oh, by the way, speaking of oil and gas drilling, did I just hear that our Minister of Finance is advocating that Canada must do more to help our European friends and allies with energy supplies and that the Federal Government will fast-track projects? Wow, I haven't heard anything like this since the days of the Harper Government.

How about number four, all things considered, how will we be impacted? From my perspective, no growth does not mean contraction. Our order book is still sound and, based upon everything we currently see, I still expect somewhere around $500 million in consolidated revenues in Q4, meaning that our $2 billion target for 2022 is achievable. At $500 million in revenue, we have the potential of generating in excess of $90 million in EBITDA next quarter, which means '22 will be a record year.

What about on the people side? Well, we're currently fully staffed at this time and people are now available, and we are still, here at Mullen Group, old school when it comes to recruiting new employees. This means we do the interviewing, not the employee. We ask what you bring to our team, and we will not lower our standards. Everyone must contribute and, I must say this, some really candidates have joined our winning team lately.

In terms of pricing, rates are stabilizing, perhaps they might come down somewhat, but costs are remaining sticky high, like wages, facility costs, equipment costs. Prices will not go back to where they were in 2020; furthermore, any price declines will be short-lived, in my view, because low prices combined with high costs will crush those that price discount steeply.

Now, there's one exception in the marketplace that I think prices may still move higher, and that relates to oil and natural gas services activity. We still think prices must rise if drilling activity in Western Canada reaches that magical 250 active rigs working, and if that's the case, then prices will rise in this sector of the economy. Now, I don't want to dwell on the oil and natural gas sector, because so many investors shun the space, but it is becoming increasingly evident that the world still needs carbon, even as economies transition to the net zero world. Canada is blessed with some of the best natural resources in the world. The only question therefore is, do we share our plentiful bound, or not? Ask Europe and they may have the key to Canada's energy riddle.

Supply chain issues, pockets of disruption remain, although most issues are starting to be resolved. In saying this, there will always be some disruptions. This is a tight market. For example, let's look at our warehouse space. It is still very tight due to high inventory levels. Quite simply, we can only handle new volumes when existing inventory is sold or liquidated; in other words, one pallet in, one pallet out. How about equipment? Virtually everything is on allocation today. Even if we wanted to purchase more trucks, for example, we cannot get them, and we expect these challenges to persist into '23, '24. Secondly, the price of a new heavy-duty truck has virtually doubled since a few years ago. And to Canadian companies, this is partially due to the collapse of the Canadian dollar versus the U.S. dollar, but it's also due to inflation and changing truck design. So think about what this will mean. With the price of a truck doubling for Canadian truckers or independents that have old trucks, they have to increase their prices dramatically.

Competition, as I said, the trucking industry is dominated by independent contractors. They work hard, but many do not have the right equipment for today's market; in other words, it is old and not very fuel efficient. They will struggle, which means supply may shrink, and as I just mentioned, can they even afford a new truck? I could tell you this: not if they cut rates.

Fuel prices, this one's tricky, because I subscribe to the thesis that crude oil markets are close to being under-supplied. If you layer on top of tight crude oil markets, you've got to think about refining capacity issues. This, too, is very limited and it's due to years of chronic under-investing, meaning that if one thing goes wrong, and they usually do at some point, there will be a shortage of refined products. Under this scenario, I believe fuel prices will stay elevated. This is why having the right equipment specced to get good fuel mileage is a competitive advantage. Fuel prices are one of the largest input costs of the transportation sector, so it only makes sense that one should manage these costs very, very closely, and I can tell you at Mullen Group, we do.

What about acquisitions? Well, truthfully, we're being cautious these days, although we have deals thrown at us every week. We will continue to look at tuck-ins and smaller deals that strengthen our current market and competitive positions, and I can also comment that valuations are coming down.

Carson mentioned a little bit about the last topic, then I'll turn it over to the call—to the Q&A, and that's the balance sheet. You know, I really don't see any reason to leverage the balance sheet at this time, given the uncertainties of the moment. Time is on our side, so we have chosen a path of prudence and caution. With our decision to slow acquisition growth, that free cash flow we generate simply is allocated to debt repayment. It's quite conceivable, in fact, that we have no bank debt by year end, given the cash flow we project and the potential to monetize some non-core assets, so that will leave us with roughly $250 million to pursue growth when the time is right.

With that, enough of the Twitter talking points. Let's move right to the Q&A session. I'll turn it over to the Operator.

OPERATOR:
Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star then two. We will pause for a moment as callers join the queue.

Our first question comes from Kevin Chiang of CIBC. Please go ahead.

Kevin Chiang:
Hi, good morning. Thanks for taking my questions, and congrats on a good Q3 there.

Murray, maybe I could start with your outlook comment, you know, optimistic about 2022, but cognizant of the risks that could be facing the economy in 2023. Just wondering what does that mean in terms of how do you prepare for that, because it seems like you're kind of facing two extreme situations here, where you're resourcing for continued strength, which means do you over-resource in the event that there is a downturn in 2023? Like, how much flexibility do you think you can bring into the operating model in the event that we do enter into a mild recession or a deeper recession, as you mentioned in your prepared remarks?

Murray Mullen:
Are you specifically referencing '23, Kev?

Kevin Chiang:
Yes, just given how strong 2022 was, it feels like you're not going to be pulling resources now.

Murray Mullen:
Yes. You know, where we still have room, Kev—I think as you know, in the truckload business, which we're really not dominated in our business model with truckload business, we do some but not—that's just a transaction. That's just what does the market do, because you can't find yield in truckload. Where you find yield is in small package or LTL, so, you know, we'll focus on yield and management and process improvement that will help.

You know, I'm still optimistic we can improve in LTL a bit. We still have a lot of room there. Now, it was a lot of hard work to get yield management, but, you know, I still think there's some operating efficiencies we get in LTL.

Some of the trucking, the logistics warehousing side, now that's going to be a little tricky on yield, but I think that's going to hold in pretty sticky just due to the make-up of our business models that we have in there, you know, we've got warehousing. That's not changing. Can we drive margin yield next year off that one? Hmm, I think that would be a bit of a stretch, but we still have lots of levers to pull to protect margin, but maybe not improve margin in logistics and warehousing.

In the U.S. 3PL side, that one is—that one, I don't have enough to know whether that one I can improve margin there or not. I don't think we will, because what we're going to do is really focus on building out the technology there. Even in this quarter, our margin was down a little bit, but that's just because we're investing for the future, and we don't capitalize our IT spend; we just expense it. But IT is the queue to—and development is the key to that business on a go-forward basis, and so we'll probably continue to invest in that one, so I don't see margin improvement. But we're going to build for the future, because markets come, markets go.

Then in the specialized and industrial side, potential margin improvement primarily for the reason I talked about: if the oil and gas sector is going to increase drilling activity at all, then prices will rise as activity increases, because that market is very, very tight right at the moment, so.

Maybe we can move margin, to summarize, in LTL a little bit; but truthfully, I think we'll really be focused on protecting margin next year more than coming out aggressively and saying, I can increase margin in a tougher economic environment, and that's what we think is going to happen, so we'll work hard on protecting rather than improving, but that means we've got to work hard. We're going to have to have some productivity gains next year, for sure.

KEVIN CHIANG:
That's great colour and a fair comment.

Your Q3 results were strong, but I'd like to—if you could provide us a monthly cadence of how that progressed, just because some of the U.S. carriers—and I know the business doesn't fully overlap with what you do, so the KPIs aren't the same, but a number of the companies that have reported, whether it's FedEx or (inaudible 0:24:51.0), seem to suggest that they saw a pretty material deceleration in demand in September, maybe more so than they would have anticipated, even back in August, and so you're kind of seeing that play through when they report Q3. What have you seen in your book of business? I know it's primarily Canada, but are you seeing something similar in Canada, or is that holding up better—

MURRAY MULLEN:
I don't see material deterioration, Kevin. Now, there's certain pockets that you might see material deterioration. If you were in the truckload business, you've seen material deterioration, because the inventory build-up scenario that we had from 2021, early '22 is over; now, they've got to liquidate those high inventories, so I'd expect that will be soft for most of '23. But, you know, the retailers will work through their inventory issues, and then they'll have to go back and replenish again sometime in '23, I'm pretty sure, unless you have material job losses, which I'm not predicting that. I just don't see that happening. So, so long as the consumer's strong, I don't see any material downturn in business activity.

I see no growth, and the only growth that we may see is maybe in the energy-related business, where you've got to add supply if you want to bring—if you want to keep prices from going through the roof. I don't see anything material.

Now, if you have business in Europe, which we do not, we might be talking a different story, so anybody that had business in Europe, and FedEx had a whole bunch, that's not a pretty place to be right now. But in North America, where would you rather be? I'd rather be in North America than anywhere, so I like our position.

KEVIN CHIANG:
No, that's great colour. Maybe just last one for me, I think on the Q1 call, maybe it was your Q4 call, you talked about just there's a lot of high cost capacity in the market, just people that have entered in during the pandemic and obviously they're signalling higher OpEx costs, higher driver costs, higher trucking costs, capital asset costs. Are you seeing some of that capacity exit the market as we've seen a little bit of softness in the freight world, or is that just something you think will eventually happen; or are you're actually starting to see that happen today?

MURRAY MULLEN:
Yes, I think that's a—you know, that's exactly what happened. We saw high costs in Q1, and the marketplace was kind of in a bit of disarray in Q1, and we were—our businesses were probably a little bit slow on the pricing side. And because we use so many subcontractors and independents, the independents move faster than we did. That's because we have the relationship with the customer and you had to be very careful not to get too far ahead of your customer. They have to kind of see that the things are changing before you go in and slap them with a big price increase.

But you saw what happened, post Q1, with all those price increases and all the productivity losses that have been built into the systems post COVID: prices went up, and then you saw what happened when we raised prices. That's why our EBITDA has gone up into the $90 million to $100 million range, just because of pricing increases.

The subcontractors are lowering prices now as the market slows down, and we took advantage in the last quarter, which was why we're up over second quarter a bit. They're very, very price-sensitive on the day to day, because they're all spot market, whereas a lot of our business is either through contract with customers, or it's with relationships, so you've got to be pretty careful how you manage that, in our view.

KEVIN CHIANG:
Excellent, great colour. Congrats on a good (multiple speakers 0:29:11.1).

MURRAY MULLEN:
But there is—look, there has been a lack of productivity in our business in the economy, post COVID. There is more vacation days, there is more leave days, there is lots of waiting, there's still bottlenecks. The rails, the warehouses, all of that leads to additional costs, and that has to be passed on in your price. That might normalize here over this next bit as it slows down, and maybe we can get back to getting productivity gains again and growing our business the old fashioned way, which is you earn it rather than just price it.

KEVIN CHIANG:
Perfect. Best of luck as you go through the year. Thank you.

MURRAY MULLEN:
Thanks, Kev.

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

KONARK GUPTA:
Thanks, Operator.

Good morning, everyone, and congrats on a good quarter. Great to see the margins expanding in a tough inflationary environment here.

I wanted to kind of dig in on the rate environment, Murray. You kind of mentioned obviously the subcontractors are lowering the rates right now. We all know what's happening in the spot markets these days, so it appears as the spot market will eventually transpire into the contract market. So, any insights you can provide on your LTL business? Do you think if inflation kind of slows down here and your demand slows down, do you see a risk where the LTL rate environment becomes negative; meaning rates, instead of being up high-single, low-double can then be down low single, mid-single kind of rates next year?

MURRAY MULLEN:
I don't really see that, Konark, so long as the consumer stays active. Now, the consumer's squeezed with inflation, we all know that, and they just adjust their spend, but they're still spending, and so—and that's really what drives LTL business, so we're okay on that side. As I said, we still can work on some productivity improvements and drive yield management, and we're looking at all creative things to make sure that we can do that in all of our businesses that are tied to the LTL side, so LTL looks pretty sticky. I don't see a lot of big change there.

Where we have seen the big change is in that truckload space, where the prices went skyrocket—well, they're coming back to earth and maybe below, but in the LTL they just went up steady. You can even look at our margin, we're up a couple points, but it's not a 10-point move, so there was no big gouging of customers or whatever. There was really good, solid demand with steady pricing increases, and I think what we're going to do is just work on high-grading some of our—you know, some of the freight that we're hauling to make sure that we get good yield management there.

I think LTL will stay pretty sticky. No growth. The only growth we'd get is if we do tuck-in acquisitions, but I think the pricing will stay pretty sticky and we'll probably get pricing increases in '23 something equal to what—labour costs will go up or something like that, and those kind of things, which, you know, from our perspective, inflation is coming down fast. We don't have the same pricing leverage in the marketplace that we had before. There's still inflation, but nowhere near at the same elevated level that it has been for the last 12 months or so.

KONARK GUPTA:
That's great colour. The last one from me before I turn it over, we talked about the priority being debt repayment right now, so I was just curious with respect to your capital priorities other than debt repayment, where do you see those, especially as the M&A slows down here. Again, talk

dividends, buybacks or capital (inaudible 0:33:36.2), especially in the Alberta market, if you can provide any colour. Thanks.

MURRAY MULLEN:
Yes, I don't think we'll—you know, we're just going to stay course here over the next bit. Carson?

CARSON URLACHER:
Yes, I would—I think what we're doing right now is being prudent with the balance sheet and managing for 2023. Just being cautious, just to ensure that either if things go sideways, we're in a debt structure that we'd be just fine; or if things turn and grow positive, well, then you've got that balance sheet that can go ahead and do acquisitions and continue the growth story. By prudently paying own our operating line, we're getting ready for either scenario going into 2023.

MURRAY MULLEN:
Konark, you know what? In terms of M&A, really, we take our cue from our shareholders, and right now when we speak to shareholders, they're more cautious. They're really not going to reward us for growth, so why would we pursue M&A unless shareholders reward us for that—for taking that risk?

It appears that shareholders are risk-adverse, so we'll just take our cue from them. And then any acquisition that we do, we're looking at whether we can see clear and obvious synergies so that we can drive margin out of that for our existing businesses.

KONARK GUPTA:
That's great colour. Thanks so much, guys.

MURRAY MULLEN:
Thank you.

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

DAVID OCAMPO:
Thanks, good morning, everyone.

MURRAY MULLEN:
Morning, David.

DAVID OCAMPO:
I wanted to focus a little bit on the S&I segment. You talked a little bit about rig counts moving up. What's it going to take for you guys to deploy more capital to that division? Is it significant rate increases, or more demand from your customers? What's it going to take for you guys (multiple speakers 0:35:38.6)?

MURRAY MULLEN:
Yes, commitment from the customers. I've always said to our customers, look, you can't ask for a commitment unless you give a commitment, so you give us a commitment, we'll go make—we'll go make the capital. But on the capital front, even if they gave us a commitment today, I can't get the capital anyhow. The market's too tight, so that would tell me, and any—it's just the market. The market's tight, so if they decide that they're going to spend a little bit more money because they want to add growth or whatever, that's—the prices are going to go up because it's just a very, very tight market right now, so. But we're not going to make big capital investments until we get a commitment from customers.

DAVID OCAMPO:
And does the margin profile need to be significantly higher, just given the volatility and the cyclicality of that division? I mean, you're doing 20-point margin, you're doing 20 points in your trucking assets, which is almost identical, but the risk profiles are different.

MURRAY MULLEN:
Yes, if you are going to go in the energy space, you're going to need a—if you're going to make a capital commitment, you're going to get a heck of a lot more than 20% margin. We won't even entertain anything at a 20-point margin. Now, we may make 20-point margins, David, in some of our—in some of ours, but that's because we use subcontractors, not because we make that capital—you know, we have a big capital commitment. But if we're going to have a big capital commitment, you're going to see north of 25-point margins, or else we're not even going to entertain it.

DAVID OCAMPO:
Got it, that makes a lot of sense. Then just going back to Kevin's initial question about your 2023 and how much you can flex the capacity there, if I go back to kind of the depths of the pandemic, revenues were down 20% in Q2, but your margins were relatively flat. What's it going to take for the margins to dip? Is it a 30-point drop in revenues and that's kind of when, you know, you can't pull on the levers that you have to keep margins at the same levels that they are today?

MURRAY MULLEN:
Well, honestly, I think for us to move that margin dramatically, you'd have to have pricing increases again, and that's really a market-driven thing. Like I said to you, I don't know if we're going to drive margin improvement in '23 unless there's pricing and pricing improvements. I don't think we can make it up on productivity massively.

What I think we can do is protect margin. I think that's going to be our number one focus. If we can improve it, I'll do handstands and backflips, but I'm not going to predict that. It's a slowing—we all know it's got to slow. I mean, that's how you're going to tame inflation. You either tame inflation by slowing demand, or increasing supply, but you can't add supply fast, so they're going to slow it for a little bit. I get it, so we're just going to stay in our lane and add to cash. We generate a ton of cash, and that will position us as to when we want to really accelerate our growth one more time through acquisitions, and then we'll look for companies that we can find good synergies that can drive margin improvement.

DAVID OCAMPO:
That's fair. Let me ask it another way: if you see a 10-point drop in your top line, do you think you can still defend your margins?

MURRAY MULLEN:
I think we can. A good chunk of our business is with independent contractors, so we just manage the spread. Right? If business comes down, well, that means on the spot market, the prices come down, so that really doesn't change a whole bunch. It didn't change on the way up, and it didn't change on the way down. You will—we could lose a little bit of margin if you lose 10%, but that would be a huge drop. I mean, we're not going there, that I see any scenario of 10% drop in business, but it depends, I guess, as to how aggressive the Fed is going to be. If they want to take interest rates up and you have job losses, anything is on the table.

We've got multiple scenarios, David. I'll leave it to you to which scenario you think it's going to go, and then you can go pick your poison from there. But if we lost 10% of revenue, I doubt if we could maintain margin. I think it's got to be—you've got a pretty tough environment there, so. I'm just telling you, I'm not predicting that, but you may. That's your call.

DAVID OCAMPO:
That makes a lot of sense. Thanks a lot, guys.

MURRAY MULLEN:
Okay.

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

MATTHEW WEEKES:
Good morning. Thanks for taking my questions.

MURRAY MULLEN:
Hi, Matt, yes.

MATTHEW WEEKES:
My first question is just clarifying an earlier comment. Did you say during the opening remarks that you have the potential to exceed $90 million in EBITDA next quarter?

MURRAY MULLEN:
Yes, if we're doing $500 million, I think it's conceivable that we could do $90 million, and that's what I said: it's conceivable. I don't see a big change in the demand for the fourth quarter, so we have the potential to do it. I'm not—and if we did $500 million, we'll probably do $90 million.

We'll do $90 million if we do $500 million, so, you know, that's where we're at. Yes, that's kind of what we think we could do, so that—.

Will it be that? I don't know. You know, this is a pretty fluid market right now; but based upon what we see right now, I think we're still on target for roughly $500 million for the fourth quarter.

MATTHEW WEEKES:
Yes, that makes sense, and I appreciate the clarification on that.

Then just one, and thinking about demand and maybe different pockets of demand, I'm just wondering if you can sort of roughly break down exposure on the consumer side of the business. How much of the shipments would generally be discretionary goods, say, non-discretionary?

MURRAY MULLEN:
Oh, you know what? I don't have that at my fingertips. That's—I don't have that number.

CARSON URLACHER:
Yes, we don't track that.

MURRAY MULLEN:
We don't track it that way, but I think if you—if you looked at the overall economy, and you can look at it and look it up as to what's discretionary and non-discretionary, you could probably accurately predict that we're somewhere around there. All we do is service the consumer, basically, with LTL. But I don't have it at my fingertips.

MATTHEW WEEKES:
No, that's okay. Thanks. I figured I'd ask.

My last question is just on oilfield services. It seems like there's kind of a lot of structural tightness in that market driving a lot of the high prices. With those likely to kind of persist, I imagine you've sort of been spending—you know, investing less in that business over the recent years. I was just wondering if you could comment on what the returns on capital might be like in that area of the business compared to recent years, and maybe even compared to sort of pre-2016 years, and what sort of returns you might be earning at this point.

MURRAY MULLEN:
Well, geez, I don't have that. It's an asset-based business. Let me just comment on the oilfield service for a second before I try and get into that granular stuff you're asking. Number one is oilfield services, we think, will remain tighter than the overall economy for the reasons that we've talked about, is that there's a chronic under-shortage, under—the market's under-supplied for energy, so that market will stay tighter than the overall economy, in our view. That means prices will stay up, stay elevated, or maybe go up.

On our returns on capital employed, I think we'd have to go through that. And before I comment on that, we'd have to do that offline, I think, Matthew. I don't have that right here on each one.

Our businesses are different. Some of our oil patch, we use subcontractors. Some is—you know, we've got a lot of capital employed. In the old days, we used to make 25, 30 points on capital employed. Over the last bit, that's been way, way down; but in the future, if we're going to put new capital to work, we're going to make 25 to 30 points, or we're not making the capital investment. It's that simple.

MATTHEW WEEKES:
No, that makes sense. I appreciate the commentary. Apologies if the questions were a little bit granular. I think that's it for me, so I'll turn the call back. Thanks.

MURRAY MULLEN:
Yes, okay, very good. Just give Carson a call and maybe we can work through that specific one, but we don't have that right in front of us here on that question.

MATTHEW WEEKES:
No, no problem. Maybe we can touch base after the call, but, yes. Thanks.

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

WALTER SPRACKLIN:
Yes, thanks very much. I've already—good morning, everyone.

MURRAY MULLEN:
Hi, Walter.

WALTER SPRACKLIN:
I guess I'm a little surprised, Murray, by your comment on acquisitions, because you mention it was based on what investors and the market is valuing, and I always look at your commentary in the past and your acquisition strategy as being something more long-term oriented, that you're focusing less on what your stock's doing day to day and more on getting good businesses that can reinforce your business model going forward.

You mention valuations are coming down and you have a prime balance sheet, so I would have thought that this would be the time you would start looking to ramp up acquisitions opportunistically, kind of regardless of what the market is doing day to day, if it can improve your business. I would have thought you'd be dedicating more capital toward it, so just curious to flesh out why you're indicating you're going to step on the sidelines here on the acquisition side.

MURRAY MULLEN:
Well, I think the number one reason is that I think shareholders and equity markets are going to be—have changed. We've now got a higher interest rate environment, and growth at all costs is not a focus anymore of the markets. Profitability, returns, running a great business, those are things that are probably more valued, and that's what I'm hearing from investors. But when I look at the markets, growth is not rewarded today as it once was in a very low interest rate environment. If interest rates are going to be up or stay elevated for a period of time, growth is going to be difficult.

If you think the market's going to get tough next year, why would I buy somebody today if valuations are coming down? That doesn't make any sense to me.

WALTER SPRACKLIN:
Okay, fair enough. That actually is a good segue into my next question for next year. Are you still planning on giving guidance in the same framework that you gave in the last—in prior years, and if so, how do you approach giving guidance for next year? Are you going to assume a slowdown? You mentioned it can be anything from modest, to really severe. What's going to be the approach that you take when you sit down and put pen to paper and give guidance for next year? Just curious.

MURRAY MULLEN:
Boy, that's an excellent question, one that we've debated here. I think, given all the cross-currents that we see, it's really difficult to predict what will happen in '23 right now. We're waiting—I guess I'm like the Fed and the central bankers and everybody else. I'm looking for more data points.

I think we'll be in a better position to say, what's '23 going to look like, after we get through Q4. Thus far, I've said I think we can maintain $500 million and still be very profitable in the fourth quarter, but I'm not ready to—what I said is I thought that the slowdown that is going to come is a '23, it's going to happen in '23, so I want to see how Q4 really shakes out and see how my competitors respond and all those kind of things before I really start talking about '23, Walter. I don't know if we'll come out in December with a '23—if we have comfort that we know what's happening, I'll come out and say, here's what we're going to do and this is how we think it will shake out. Otherwise, we might wait until we get Q4 out before I get too aggressive on trying to predict what the heck's going to happen next year. I'm trying to predict what will happen this quarter, and I hedge my bets on that, so.

I don't know. I'll be getting economic reports and listen to central bankers and listen to our customers. That's the big thing. We listen to our customers and we're watching what consumers do. Those are the things we're really watching, along with really paying attention to how our competitors are handling this situation. We're in a way better position than most of our competitors, so we might have to—we're just going to be cautious for the next bit. I think that's the right thing, and that's the message that we're telling to our shareholders. We're going to be prudent, we're going to be cautious, and don't worry. This market will go—if it slows down, it's only going to slow down for a bit, and then we'll pick our spots when we do acquisitions. We are not going to force growth and leverage the balance sheet. I'd rather protect the balance sheet and wait for another day.

WALTER SPRACKLIN:
That's great. My last question kind of relates to something you mentioned there about listening to your customers Which customers do you think give you the best lead time for where the economy is going, where demand is going? What particular—not the specific customer name, but perhaps what segment of your customer base do you kind of really pay attention to when you look to gauge the tea leaves for how demand is developing over the foreseeable future?

MURRAY MULLEN:
Yes, well, as you know, we just don't have one customer base. We're in nearly every vertical in terms of logistics that the Canadian economy covers, so. We don't have just one. We look at all of them: what's happening in the auto sector, what's happening with consumer spend, what's happening on the retail side, what's happening with our big industrial customers, like Finning, what are they seeing, what are the big oil and gas companies saying, what are they seeing? We listen to all of them and then we package it all together, and that's what we do.

I don't have just one we listen to. I watch one data point for a lot of cues—clues, and that is the employment statistics. If employment stays strong, we don't have to worry that much. If you start having job losses, we're going to have to have a re-think as to what's going to happen. There will be a lot of people in a lot of trouble, and I'm not predicting that, I'm just saying that's the one I watch the most, is employment data.

WALTER SPRACKLIN:
Okay, that makes sense. Thanks very much for the time, as always, Murray.

MURRAY MULLEN:
Thanks, Walt.

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

TIM JAMES:
Thanks. Congratulations on a great quarter here.

MURRAY MULLEN:
Thanks, Tim.

TIM JAMES:
I guess my first question, I'm going to return once again to this M&A theme, and there's two parts to this. One, maybe, Murray, can you reflect back in your experience, if you had to look forward to sort of past or at the right time when M&A starts to make sense again, can you

foresee any particular regions or characteristics of targets that may appear for you in segments of your business, or maybe it's regionally? Maybe just talk about what are most likely the kinds of opportunities that you'll eventually see.

Then secondly, as more of a confirmation, do you feel that if you kind of want to look on the bright side, the tougher next year is, while it may obviously impact you next year, it might actually create even better opportunities from an M&A perspective, which over the long term will actually put you even further ahead?

MURRAY MULLEN:
Well, that's a—so here's our strategy on acquisitions. Number one is, every acquisition we do has to fit our strategy. We don't do it—and growth is not the strategy, it's about whether it fits in the markets that we see the future of logistics and transportation going. We'll always make long-term investments if the right opportunity comes along. But number two is, you love to do acquisitions when you see some change in the markets, and we hit some really well in '21 when we saw markets tightening and potential for getting pricing increases, and therefore not only do you grow, but you get margin improvement, which means the valuation metrics that you paid on, you look really smart with that.

You don't want to be, conversely, buying a—doing an acquisition and paying and then you've had margin deterioration, so based upon what you're saying and everything analyst that I heard this morning, and nobody knows what's going to happen, why would we take a guess on what's going to happen with the margins next year when I don't know what—I know we're going to have to work hard to protect margin, so you never want to do an acquisition and then margins go down.

I think the third one is, can we find synergy, can I find a way that we get market penetration, that we get yield management, and that we can reduce costs to drive margin? It's not about growth, it's about margin, and in saying that I should also say, of course, that it's also about return on capital. Some of the businesses we acquire are non-asset businesses.

CARSON URLACHER:
Correct.

MURRAY MULLEN:
So, they may have a lower margin, but they've got a great return on capital employed.

TIM JAMES:
Right, okay. That's helpful. My second question, when you talk about what you see right now, how far out is your visibility now? And I'm kind of thinking purely short term here, obviously you've got a good sense for what October holds, and I suppose less for November and then December. But do you have good visibility on the pricing side as you look through the rest of the quarter, and it's maybe more a volume question that gives more uncertainty? Maybe kind of talk through what your visibility time frame looks like.

MURRAY MULLEN:
Well, I don't have any visibility. I'll be blunt with you on that. You know what? That's why we're in touch with all of our businesses every week and we get—we have regular updates from them, what's happening in the marketplace right now, because all the other stuff is just—you know, the markets move so fast today and they'll move on anything, so.

We don't have great visibility. What we have is basic assumptions, and we've said I feel better about—you know, I think volumes will hold in pretty steady, because there's backlogs and we've still got to move stuff. I haven't seen—there's no real crack in pricing on the contract side. It's getting tougher, but I don't see the cracks. Where there is cracks in pricing is on the spot market. If you're relying upon the spot market, there's a big delta in that, for sure, right now, but we haven't seen too much on the contract side yet we're entering into with some of our major clients. But those are getting to be tougher conversations. I'll be blunt on that. That's why I say it's absolutely important that we work on productivity improvements to mitigate the challenges that might arise in the market on the pricing—getting pricing, and that's healthy for the economy long term, that we start focusing on productivity again, not just getting pricing increases. That's good for everyone, and that really fits in our bailiwick because that's going to put pressure on our competitors that don't take that long-term view that we do.

OPERATOR:
Once again, if you have a question, please press star then one.

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

MICHAEL ROBERTSON:
Hi, good morning all. Congrats on another really solid quarter here, and thanks for taking my call.

Most of the things I wanted to touch on have been covered already. I was just wondering, I noted in the MD&A you guys highlighted that of the three non-core or potential non-core asset divestitures you noted on the Q2 call, with the LOIs, one of them had expired without closing, the other two were sort of still ongoing, I guess. Just wondering, A, if you'd expect that to be a Q4 event, how that was progressing, and also what sort of EBITDA loss you guys would expect with that potential divestment.

MURRAY MULLEN:
Yes, so, you're right, the one expired, the other two are still—we expect to close, but this—I think if they don't close, that's really a foretelling that the financial markets have—something's happened in the financial markets. It's not the business side. I think that really happened on the first one where they just couldn't come up with the financing, so. I think a lot of it will do with how the financial markets respond over the next bit, as to whether those other two close in the fourth quarter, which we expect—that is our expectation right at the moment, they will close. It will have minimal impact on our EBITDA, I think, Carson, in terms of that—

CARSON URLACHER:
Yes, that's right.

MURRAY MULLEN:
You know, really what the storyline on that will be is that we just bring in a lot of cash, and that's why I say we could be at net zero in terms of bank debt by the end of the year if we close these two transactions and with the cash flow that we're going to generate from operations in Q4. Even right now, our bank debt is below where we were at the end of the quarter…

CARSON URLACHER:
Yes, it is.

MURRAY MULLEN:
…end of Q3, so. We keep paying off debt quite nicely, which you want to do as interest rates are going to go up again, so we want to have less debt in a high interest rate environment, and we'll see whether those other two close. I'm optimistic, I'm hopeful, but I don't—we've got to get through the rest of the due diligence into closing dates.

CARSON URLACHER:
We'll know by the end of the year.

MURRAY MULLEN:
Yes, we'll know in Q4, in December, as we come out.

MICHAEL ROBERTSON:
All right, that's great colour, I appreciate it. I'll turn it back.

MURRAY MULLEN:
Thank you very much.

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 MULLEN:
Thanks for joining us, folks. I think that covers it all. Really strong quarter for us again, and we look forward to another strong quarter, this one coming up. Hopefully we can deliver the same quality results that we've delivered for the last while, so until then, we're going to be very, very prudent with our investors' capital. Thank you very much, and have a great day.

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