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Celadon: anatomy of a trucking failure

Overview

This week saw one of the largest, if not the largest, carrier failure in truckload history with Celadon's Chapter 11 filing on Monday, Dec. 9.

In this Special Topics report, we reconstruct the chronology of the Celadon shutdown, examine the root causes and analyze decisions made by both ownership and management.

One important finding is that it's hard to kill a trucker. Bad decisions made in the 2016 downturn didn't fully come home to roost until the trucking market collapsed again in 2019. It took a full cycle for the top 20 carrier to go under. In our view, legal issues — including a debilitating $42 million settlement with the SEC — as well as mounting cost pressures through the cycle contributed to Celadon's demise.

But the shutdown should not have been as chaotic as what transpired during the week of Dec. 2. Management and ownership went into the week operating under different assumptions. Eventually customers and media were informed about the shutdown, but employees and crucial vendors such as Comdata were not.

Ultimately assets that were to be sold as going concerns — Jaguar and Hyndman — were abruptly shut down in an unplanned way.

Trucking carrier failures in 2019 (y/y change)

Q1	225 (+80%)
Q2	415 (+730%)
Q3	160 (+146%)

Largest trucking failures in 2019 by drivers

Celadon	2,880
New England Motor Freight	1,472
Falcon Transport	585
Stevens Tanker Division	576
LME	424

Average market conditions (y/y change)

Dry van spot rate	$1.57/mile (-5.9%)
Tender reject rate	8.32% (-34.4%)
Diesel rack price	$2.01/gal (+6.30%)

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Chronology of the shutdown

There were many red flags prior to the Celadon bankruptcy filing. Below is a structured timeline of events leading up to the bankruptcy.

Dec. 2: Celadon starts the workweek with one week of cash on hand.
Dec. 4: Honda is warned about possible service disruptions.
Dec. 5: Celadon's lenders start repossessing equipment. Celadon's last-minute financing deal with creditors falls through. Two former executives are charged with securities fraud.
Dec. 6: Media contacts Celadon management regarding rumors about the company's future. Celadon notifies its top 20 customers of a potential shutdown. Customers start refusing to load Celadon trailers. Media starts reporting Celadon's impending bankruptcy late Friday night.
Dec. 7: Drivers exchange rumors on social media. Comdata shuts off Celadon's fuel cards and contracted maintenance services refuse to work on Celadon equipment. Customers unload Celadon drop trailers. Drivers start abandoning Celadon trucks while some managers tell drivers to carry on with "business as usual."
Dec. 8: Celadon investor Blue Torch Capital guarantees fuel card credit in order to get equipment returned. Freight is abandoned at customs brokerage facilities in Laredo, Texas.
Dec. 9: Celadon files Chapter 11, informs drivers of the shutdown and gives office employees 30 minutes to clear their desks. Celadon's Canadian subsidiary, Hyndman, closes down. Jaguar company officials tell FreightWaves it will continue operations.
Dec. 10: Tuesday morning Jaguar shuts down; drivers blockade gates to equipment yards and demand their pay.

Root causes: legal troubles and freight recession

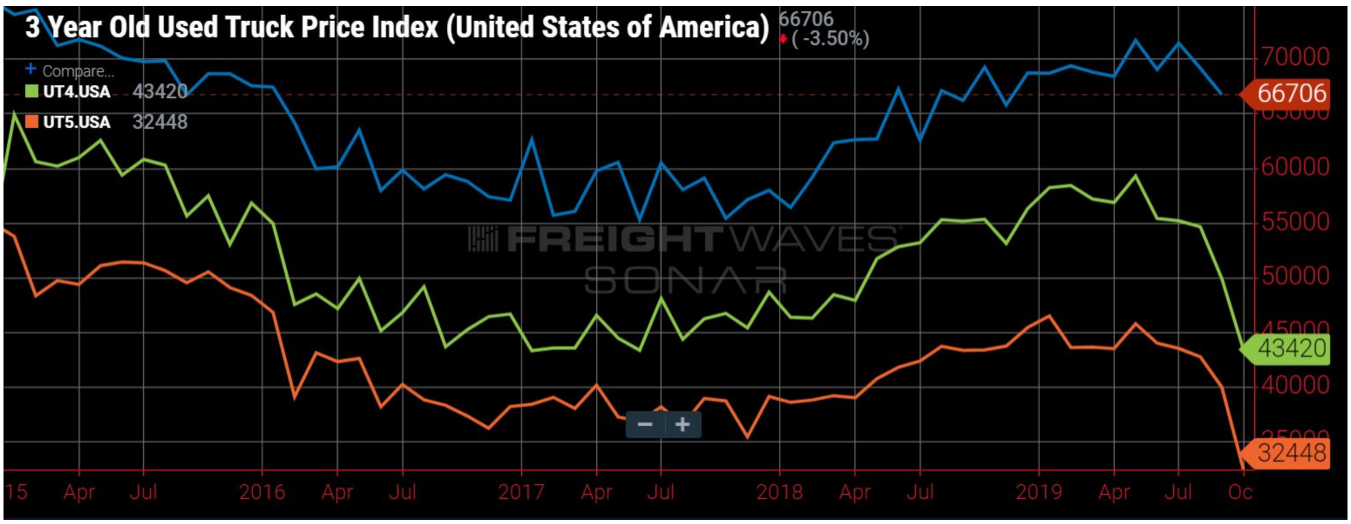
Celadon's collapse is a story that spans two troughs in the trucking market. Poor management decisions ultimately leading to criminal charges were made in the context of a very soft trucking market in 2016, but the fallout would not put Celadon under until the next downturn, in 2019.

In the first downturn, 2016's industrial recession, Celadon's post-Russell management team came under pressure. The trucking market was collapsing — volumes and rates were down. Meanwhile, Celadon had aggressively expanded its Quality truck leasing business from 750 to more than 11,000 trucks.

The problem was that many of the trucks in Celadon's leased fleet were 2012 International ProStars with MaxxForce engines, trucks that had significant mechanical issues and were sharply devalued in the used truck market. Celadon's executives made the decision to execute fraudulent trades of their trucks with a dealer in order to avoid marking down their assets in the third quarter of 2016, near the trough of the trucking market.

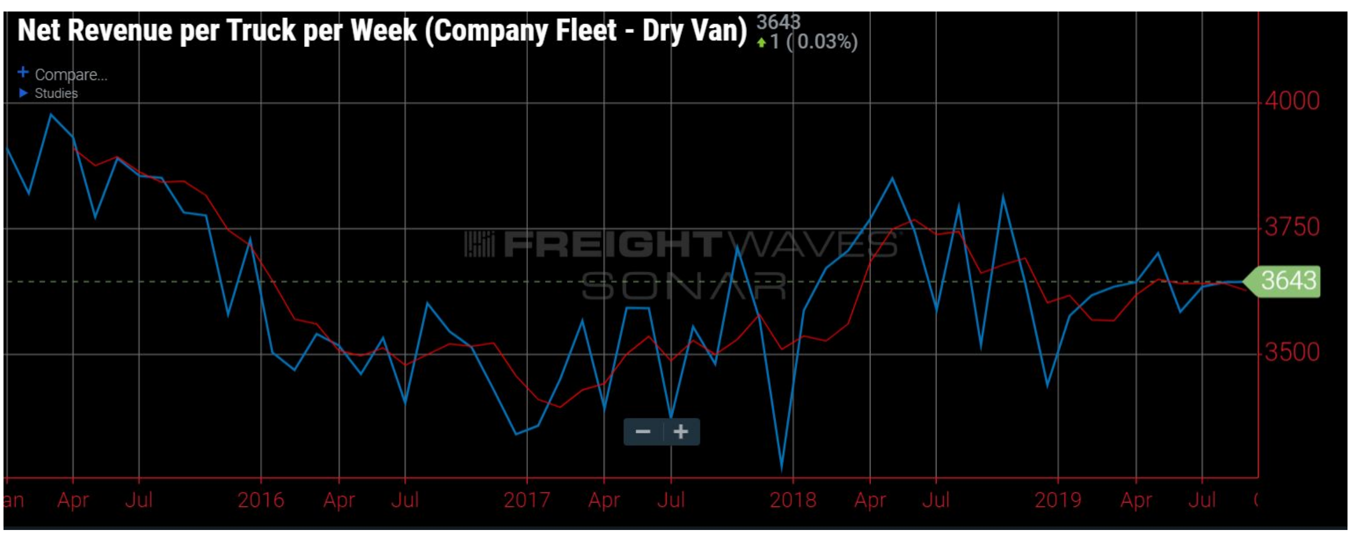
Eventually Celadon faced SEC sanctions, settling for $42 million. Meanwhile, it spent $12 million on legal fees, but ultimately couldn't save COO William Meek, CFO Bobby Peavler and Quality President Danny Williams from criminal charges. A historic bull run from the second quarter of 2017 through the end of 2018 bought the new management team some time, but Celadon couldn't get ahead of the market. Most of the proceeds from asset sales went to creditors.

When the trucking market collapsed in 2019, the margin of error narrowed further. A new wave of indictments in the week preceding the Celadon's bankruptcy filing — and the prospect of further legal fees — may have given Luminus and Blue Torch, Celadon's investors, cold feet when it came time to inject more capital into the business.



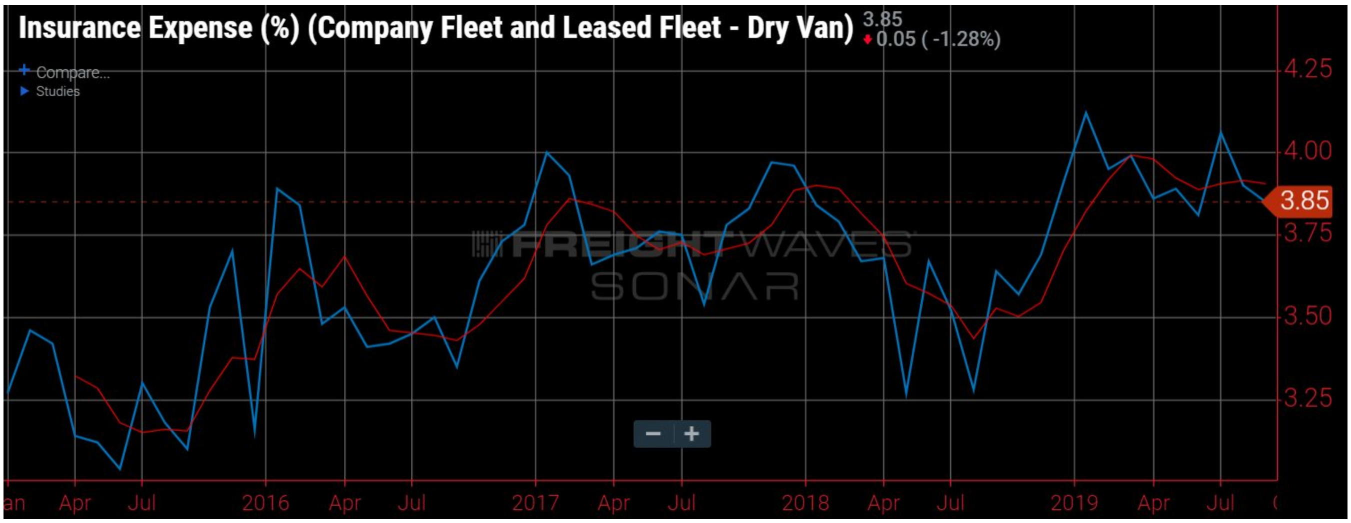
(Chart: FreightWaves SONAR. Used truck prices fell through 2016, when the initial fraud occurred)

The particular model of truck that Celadon was heavily exposed to, the 2012 ProStars, underperformed the rest of the used trucking market and was particularly disfavored by other fleets and owner-operators due to reportedly well-known mechanical issues. The issues with that truck model put Celadon's leased fleet further out of the money when it came time to sell.



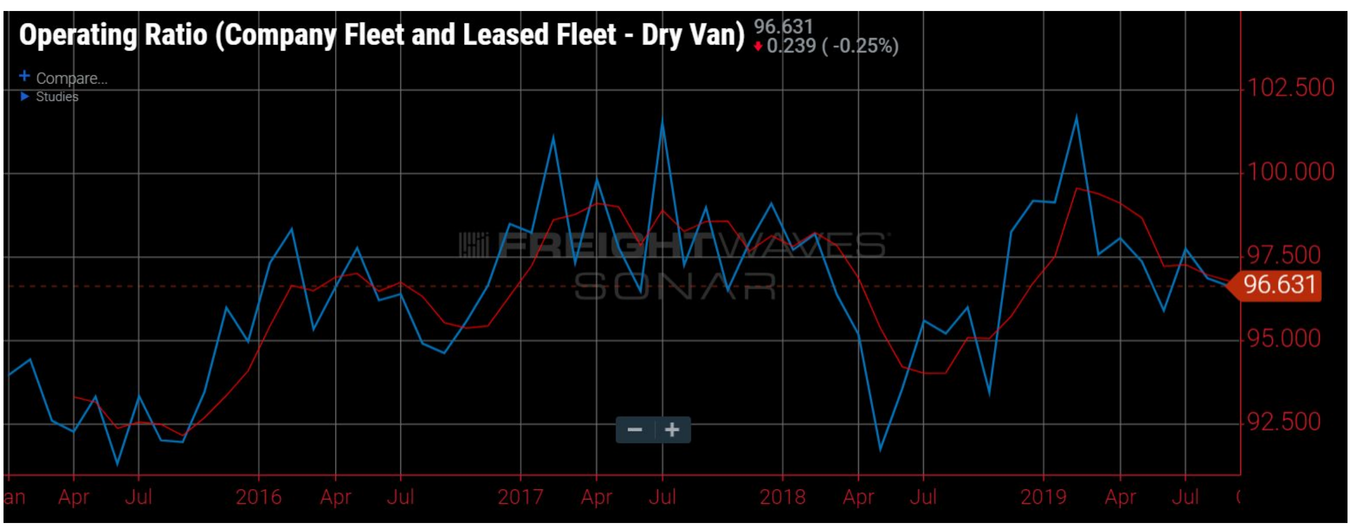
(Chart: FreightWaves SONAR. A broad sample of truckload fleets have still not reached 2015 levels)

The freight market then proceeded to go on a bull run in 2017 through 2018. In 2017 and 2018, the net revenue per truck per week was increasing at such a rate that it was tough for a trucking company to fail. Trucks were running loaded as volumes and trucking spot rates remained at highs, showing the top of the trucking cycle. Trucking companies were seeing their empty miles increasing throughout 2018 as companies could afford to run empty because the rates were high and they could chase the more desirable freight as opposed to what is happening in 2019, when the freight market is so weak that companies are taking any freight that they can get their hands on and can't afford to run empty.



(Chart: FreightWaves SONAR. Insurance expense as a percentage of revenue across a sample of truckload carriers)

Overall truckload insurance expenses have seen an increase throughout both cycles while truckload industry average operating ratios have stayed in the upper 90s.



(Chart: FreightWaves SONAR. Cost pressures keep ORs high across a sample of carriers)

For trucking companies, any penny that they can save means that their operating ratio will fall, making them look better for investors. In a weak freight market, like 2019, increasing insurance expenses combined with low rates and volumes lead to an increase in operating ratio and ultimately it leads to an increase in trucking company failures.

For Celadon, they just happened to be the product of two really bad freight cycles. The first one led to executives committing securities fraud. The second one ultimately led them to bankruptcy.

Management and owner decisions

Celadon management entered the week prior to the bankruptcy knowing they had a week's worth of cash left. We do not know how long negotiations about additional capital had been conducted, but clearly management did not have enough time to pivot to a new lender once the talks before Luminus and Blue Torch broke down. It appears, first, that management misjudged the willingness of its investors to fund Celadon Group as a going concern.

We do not fault Blue Torch for being unwilling to throw good money after bad. But to the extent that management was operating under a false sense of security going into the week of Dec. 2, some of the blame falls on the investors for not making their intentions clear.

The decision to inform Honda, Celadon Group's largest customer (the automotive industry, including both finished goods and parts, accounted for approximately 20% of Celadon's revenue), of a possible service disruption was made with good intentions. Automotive freight is complex, often just-in-time, and finding alternative providers is time-consuming and expensive. Still, Celadon executives apparently believed that they could selectively warn Celadon's largest customers and continue to manage any subsequent shutdown in an orderly way.

Instead, events cascaded and quickly spun out of Celadon's control. Lenders began repossessing trucks at truck stops across the country. Customers began refusing to load Celadon trailers, alerting the drivers to grave problems with Celadon operations.

On Friday, Dec. 6, media were able to confirm with internal Celadon sources that a bankruptcy filing was planned for the following week. The decision to disclose that information transformed rumor into publishable news and accelerated the shutdown. Comdata shut down fuel cards, drivers abandoned equipment and finger-pointing began.

In the end, some of the assets that Celadon intended to keep running and auction in an orderly, statutory way in the Chapter 11 process — namely Jaguar and Hyndman — were shut down in a chaotic, unplanned way.

It's hard to know whether Jaguar and Hyndman could have been salvaged, but it's also the case that the way the shutdown was handled — with information dribbled out to customers and the press — may have ended up costing Celadon's creditors money.