Industrial Research
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Transportation/Logistics

February Freight Flows

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Please refer to Appendix - Important Disclosures and Analyst Certification.

Action

Concerns about the pace of an economic recovery and cautious near-term management outlooks drove transport stock underperformance in January and through 4Q reporting. However, our investment thesis remains unchanged. We continue to view 2010 as an inflection point for industry pricing, and recommend asset-based transport exposure ahead of improving fundamentals.

Our February Freight Flows discusses the dominant themes by transport mode following 4Q reporting, as well as recent stock performance.

Summary

- **Transport stocks generally underperform in January** and during last week's reporting. January performance by mode: LTLs -16%, Rails -6%, TLs -5%, 3PLs -4% and Integrators -2% versus a -4% S&P 500. Below we highlight the relevant themes emerging from 4Q reporting by mode:
- **Rails.** Mixed 4Q results, with more weakness among Eastern US rails. Industry pricing decelerated further in 4Q, consistent with our expectations. Near-term headwinds include slower pricing growth, increased regulatory uncertainty, and mix shift given coal volume weakness. However, 2010 pricing outlook is healthy (+4%); cost controls remain solid; and coal fundamentals are bottoming.
- **Truckload/Intermodal** posted generally in-line results. Demand seasonality through 2H09 and improving capacity imbalance supports our view that truckload pricing has bottomed. Early read on 1H10 bids indicate rates remain competitive, but many carriers cautiously optimistic on 2010 rates given capacity rationalization. TL rates appear at an inflection, and we recommend exposure to the group.
- **LTL.** Industry pricing remains pressured given excess capacity. We expect continued pressure on LTL stocks as investor appreciation for YRCW viability increases; recommend continuing to avoid the group, but would be more constructive on the broader group with pullbacks of 10% or more.
- **4Q reporting disappoints investors, but our core thesis remains intact.** Concerns about pace of improvement in fundamentals (i.e., no broad-based EPS beats) and cautious near-term management outlooks disappointed investors. However, fundamentals are firming; January freight trends were better than seasonal; and we continue to believe 2010 domestic pricing will inflect positively absent an economic deterioration. Pace and magnitude of growth determined by strength of economic recovery, with upside to expectations possible later in 2010 with a stronger industrial rebound.
- **Continue to recommend increased asset-based transport exposure** ahead of a domestic freight rate pricing cycle. Best ideas remain JBHT and UTIW; for truckload exposure, KNX and HTLD; for large caps, UPS and CSX. We are more positive on Neutral-rated HUBG, FDX, and R given recent pullbacks.

Details

A majority of our coverage list has reported 4Q results. Below, we outline the key takeaways by mode. Transport stocks underperformed the market throughout reporting, which we believe is a function of investor disappointment surrounding the pace of a freight recovery and the improvement in industry fundamentals as evidenced by the lack of consistent top-line driven EPS upside in 4Q results. Further, guarded management outlooks, which we expected, drove investor caution.

Our investment thesis remains unchanged. We believe ongoing capacity rationalization and stable demand trends should allow the industry to achieve supply/demand equilibrium during 2010, absent deterioration in economic conditions. As such, pricing, particularly truckload, should reach an inflection point in 2010, and we recommend investors to increase asset-based exposure ahead of a potential recovery in freight rates as early as 2H10.

Rail

Core industry pricing growth slowed in 4Q to +3-4% from +5-6% in recent quarters, as general economic conditions and competitive truckload pricing weigh on pricing growth. Though pricing deceleration was largely expected among investors, the slower (but positive) pricing growth is expected to persist through 2010.

Near term, coal volume trends will continue to lag other commodities. Coal volumes have lagged the recovery realized among other commodity types, given high utility stockpiles and low 2009 natural gas prices (coal substitute). This mix shift has had a greater-than-expected impact to margins, as coal is among the highest-margin commodities handled by the rails. Further, the Eastern rails' larger concentration (roughly 30% of revenue) to coal creates a headwind to profitability in 2010 until coal volumes recover. However, in our view coal fundamentals have bottomed given improved industrial production, higher natural gas prices, and colder-than-normal weather could return customer stockpiles to equilibrium by the end of 1H10.

Outperform-rated UNP and CSX continued to show cost variability to a weaker volume environment as expense declines outpaced volume declines. We remain optimistic in the rails' ability to control costs and further improve OR as volumes improve.

Key 4Q09 Railroad Operating Results

	YOY Change							YOY bps			EPS vs.
			Core		Fuel-adj						
	Rev	Vol	Price	RTM	Exp	EPS	OR	Chg	EPS	Cnss	Cnss
BNI	-16%	-12%	<2%	-7%	-9%	-27%	75.7%	-120	1.30	1.22	+7%
CSX	-13%	-7%	5.3%	-11%	-11%	-15%	74.9%	-80	0.77	0.76	+1%
NSC	-16%	-9%	2-3%	-10%	-7%	-32%	73.9%	-540	0.82	0.84	-2%
UNP	-12%	-5%	3.5%	-9%	-9%	-18%	73.3%	+10	1.08	1.04	+4%

Source: Company filings, Baird estimates

Truckload

We continue to believe pricing has reached an inflection point for the truckload industry. Though carriers remain guarded about 1H10 bid season prospects, we believe rates have stopped deteriorating. Ongoing capacity reductions, through below-replacement demand for new trucks and carrier failures, should return the market to equilibrium during 2010. Further, the state of disrepair among carrier balance sheets, coupled with bottoming industry fundamentals and used truck prices, could create acquisition opportunities for well-capitalized carriers such as KNX and HTLD. Volumes remained weak, but freight trends demonstrated seasonality through

2H09, which we view as evidence of an industry moving beyond the trough. Encouragingly, some carriers have noted positive yoy trends continue in January. Given the ongoing capacity rationalization, we believe any upside in demand could produce pockets of positive industry rate growth during 1H09, with a sustained recovery in rates possible as early as 2H09.

Key 4Q09 Truckload Operating Results

	YOY Change									
	Rev x-fuel	Vol	Rev/Load Mile	LOH	EPS	Margin x-fuel	YOY bps Chg	EPS	Cnss	EPS vs. Cnss
JBHT*	-7%	8%	-15%	13%	-23%	-1.1%	+290	0.32	0.32	+0%
WERN	0%	-6%	-2%	-13%	-4%	9.2%	+70	0.25	0.24	+4%
HTLD	-16%	-12%	-4%	na	-42%	16.0%	-830	0.12	0.15	-20%
KNX	0%	1%	-3%	-8%	-18%	14.6%	-420	0.16	0.16	+0%
MRTN	-11%	-10%	-1%	-14%	-30%	7.4%	-220	0.19	0.17	+12%
CGI	11%	19%	-7%	na	-38%	2.6%	-180	0.05	0.03	+67%
USAK	-8%	-10%	1%	-14%	NM	-3.4%	-618	(0.24)	(0.17)	NM
LSTR*	-9%	10%	-14%	na	-22%	6.3%	-40	0.37	0.41	-10%

JBHT operating metrics are from the Truck division

LSTR revenue "Total Truck", incl fuel; volume and pricing growth based on BCO statistics; margin includes fuel

Source: Company filings, Baird estimates

Less-than-truckload

LTL industry trends continue to lag other domestic modes, with excess capacity and aggressive competitor pricing driving further yield deterioration in 4Q. Though LTL yield growth will be muted in the near term absent a meaningful correction in capacity, we believe that with carrier acceptance in YRCW's near-term survival prospects and current yields at unsustainable levels, LTL yields will likely bottom in 1H10. However, excess capacity will continue to weigh on yield growth, both in 2010 and beyond, limiting LTL carrier profitability.

Volumes stabilized, demonstrating typical signs of seasonality in 4Q, with some strength appearing to favor freight with longer lengths of haul, a result of market share gains from YRCW during the quarter given uncertain surrounding its near-term survival prospects. We expect volumes to experience modest growth and lag the recovery realized in TL volumes, which is typical in the early stages of an economic recovery.

Key 4Q09 LTL Operating Results

	YOY Change							
	Rev	Daily Tons	Rev per CWT	Margin	YOY bps Chg	EPS	Cnss	EPS vs. Cnss
ABFS	-7%	-2%	-6.0%	-9.3%	-530	(0.88)	(0.30)	NM
FDX	-11%	3%	-12.1%	-1.1%	-380			
ODFL	-7%	-4%	-3.0%	6.1%	-70	0.26	0.23	+13%
SAIA	-12%	-4%	-8.7%	-1.8%	-410	(0.31)	(0.32)	NM

*FDX operating metrics reflects LTL division

Source: Company filings, Baird estimates

Transport Stocks Generally Underperform in January

Transport stocks generally underperformed in January, both for the full month and through last week's reporting. From worst to best, LTLs (-16%), Rails (-6%), and TLs (-5%) underperformed the market (S&P 500 -4%), with 3PLs in line and Integrators (-2%) the lone outperforming segment in January. Last week, only the Integrators matched the market (with both -2%), as the remaining modes underperformed. A complete chart of stock performance is shown below:

					Trading Performance					
Ticker	Name	Rating	01/29/10 Price	Price Target	1 wk	Jan	2009	2008	2007	2006
Integrator Index					**(2%)**	**(2%)**	**13%**	**(24%)**	**(10%)**	**2%**
UPS	United Parcel Service	O	57.77	$70	(2%)	1%	4%	(22%)	(6%)	(0%)
FDX	FedEx Corp	N	78.35	$93	(2%)	(6%)	30%	(28%)	(18%)	5%
Railroad Index					**(3%)**	**(6%)**	**35%**	**(20%)**	**19%**	**13%**
UNP	Union Pacific	O	60.50	$77	(5%)	(5%)	34%	(24%)	37%	14%
BNI	Burlington Northern	N	99.73	$100	1%	1%	30%	(9%)	13%	4%
NSC	Norfolk Southern	N	47.06	$56	(5%)	(10%)	11%	(7%)	0%	12%
CSX	CSX	O	42.86	$59	(3%)	(12%)	49%	(26%)	28%	36%
CNI	Canadian National	NR	49.93		(4%)	(8%)	48%	(22%)	9%	8%
CP	Canadian Pacific	NR	47.00		(7%)	(13%)	61%	(48%)	23%	26%
KSU	Kansas City Southern	NR	29.70		(4%)	(11%)	75%	(45%)	18%	19%
RA	RailAmerica	NR	12.64		(5%)	4%				
GWR	Genesee & Wyoming	NR	29.47		(2%)	(10%)	7%	26%	(8%)	5%
Third-Party Logistics Index					**(3%)**	**(4%)**	**6%**	**(12%)**	**12%**	**8%**
EXPD	Expeditors Intl	N	34.10	$34	(1%)	(2%)	5%	(26%)	10%	20%
CHRW	C.H. Robinson	N	56.63	$66	(1%)	(4%)	7%	2%	32%	10%
JBHT	J.B. Hunt Transportation	O	30.66	$41	(5%)	(5%)	23%	(5%)	33%	(8%)
LSTR	Landstar	N	36.29	$43	(5%)	(6%)	1%	(9%)	10%	(9%)
UTIW	UTi Worldwide	O	13.73	$20	(3%)	(4%)	(0%)	(27%)	(34%)	(3%)
HUBG	Hub Group	N	24.11	$30	(9%)	(10%)	1%	(0%)	(4%)	56%
FWRD	Forward Air Corp	N	23.63	$24	(5%)	(6%)	3%	(22%)	8%	(21%)
PACR	Pacer International	N	3.00	$3	(9%)	(5%)	(70%)	(29%)	(51%)	14%
ECHO	Echo Global Logistics	NR	12.07		(4%)	(5%)				
UACL	Universal Truckload	NR	16.84		(4%)	(7%)	28%	(26%)	(19%)	3%
Leasing										
R	Ryder	N	36.40	$45	(3%)	(12%)	6%	(18%)	(8%)	24%
TAL	TAL International Group	N	14.10	$14	1%	7%	(6%)	(38%)	(15%)	29%
Truckload Index					**(4%)**	**(5%)**	**10%**	**5%**	**(9%)**	**(3%)**
WERN	Werner Enterprises	N	19.78	$23	(4%)	(0%)	14%	2%	(3%)	(11%)
HTLD	Heartland Express	O	13.89	$19	(8%)	(9%)	(3%)	11%	(6%)	(1%)
KNX	Knight Transportation	O	18.10	$22	(4%)	(6%)	20%	9%	(13%)	(18%)
CGI	Celedon Group	NR	9.82		(1%)	(9%)	27%	(7%)	(45%)	31%
MRTN	Marten Transport	NR	17.61		3%	(2%)	(5%)	36%	(25%)	2%
USAK	USA Truck	NR	12.35		(0%)	(1%)	(9%)	(10%)	(4%)	(45%)
CVTI	Covenant Transportation	NR	3.60		(5%)	(14%)	111%	(70%)	(41%)	(18%)
Less-Than-Truckload Index					**(3%)**	**(16%)**	**11%**	**(34%)**	**(33%)**	**(16%)**
CNW	Con-way	N	28.62	$35	(3%)	(18%)	31%	(36%)	(6%)	(21%)
YRCW	YRC Worldwide	U	0.93	$0	0%	11%	(71%)	(83%)	(55%)	(15%)
ODFL	Old Dominion	N	27.50	$28	4%	(10%)	8%	23%	(4%)	(11%)
ABFS	Arkansas Best	U	22.54	$23	(14%)	(23%)	(2%)	37%	(39%)	(18%)
SAIA	Saia	NR	12.00		(2%)	(19%)	36%	(18%)	(43%)	9%
VTNC	Vitran Corporation	NR	8.99		2%	(17%)	74%	(56%)	(18%)	(12%)
SPX	**S&P 500**				**(2%)**	**(4%)**	**23%**	**(38%)**	**4%**	**14%**

** Indices are market-cap weighted.*

Source: FactSet, Baird estimates

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