Industrial Research
April 5, 2010

Transportation/Logistics

April Freight Flows

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Please refer to Appendix - Important Disclosures and Analyst Certification.

Action

Broad-based, above-seasonal demand in 1Q and improving supply dynamics have lifted investor expectation among transports. As a result, asset-based transport stocks generally outperformed in March and 1Q. However, 1Q EPS upside expectations largely contained to rails and airfreight (UPS, EXPD). Investors expecting broad-based earnings upside among truckers will likely be disappointed.

Our April Freight Flows contains a preview of our 1Q expectations by mode ahead of reporting.

Summary

- **March stock outperformance.** Above-seasonal demand and anecdotes of firming trucking rates helped drive improved investor sentiment, leading to transport stock outperformance in March. For the month, LTLs (+12%), Integrators and Rails (+10%), and TLs (+7%) outperformed the S&P 500 (+6%), with 3PLs (+3%) the lone underperforming segment.
- **Rails.** Volume growth should generally exceed 10% in 2010, compared to mid-single-digit consensus expectations. Better-than-expected volumes should result in better-than-expected operating leverage, which should lead to EPS upside.
- **Airfreight & Parcel.** Strong 1Q demand continued in both international airfreight and ocean freight. International trends in March were better than seasonally expected. Positive implications for UPS/FDX and EXPD/UTIW.
- **Truckload.** Firming demand and pricing fundamentals in 1Q bodes well for contractual and spot rates as 2010 progresses. However, we do not expect notable EPS upside until 2H10, which may disappoint investors in the near term. We would more aggressively commit new money into any resulting weakness.
- **LTLs.** 1Q an inflection point in rates following severe 4Q pressure. However, LTL rates continue to lag other modes given 15-20% excess industry capacity. We expect this to be a drag on sentiment for the asset-based LTL carriers.
- **3PLs are the laggard, but looking to get more constructive.** CHRW faces a tough 1Q given the yield squeeze, but we recommend that longer-term investors buy into weakness.
- **We recommend exposure to asset-based transports,** though recent rally has made us more selective. For large-caps, we continue to like the rails (CSX, UNP) and UPS. We would look for pullbacks to be more aggressive buyers of our top truckload and intermodal picks (KNX, HTLD, JBHT). For longer-term value investors, we like UTIW as a turnaround opportunity.

Details

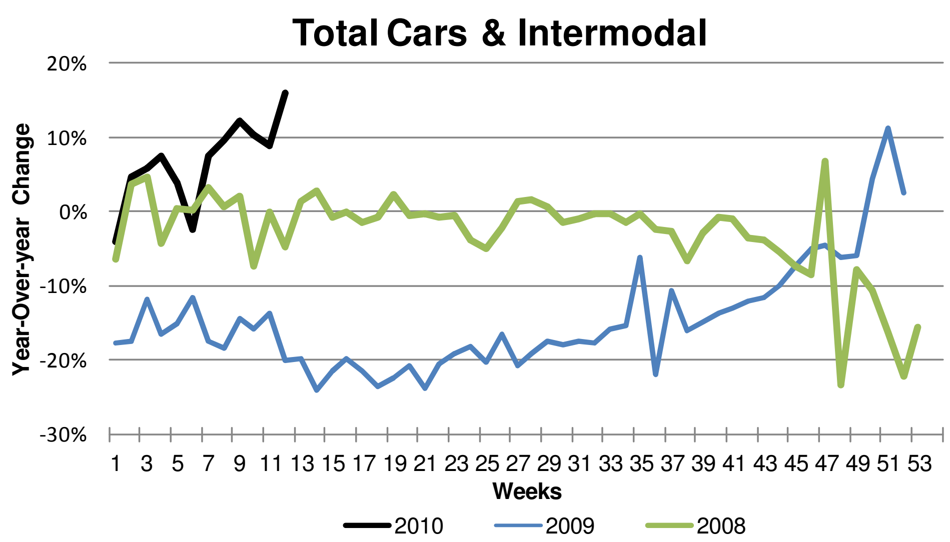
Better-than-seasonal supply/demand trends in 1Q have driven increased interest in the asset-based transport stocks. During March and throughout 2010, transports have largely outperformed the broader market as investors seek early cycle exposure and recognize the improved industry fundamentals. Investor expectations have risen given the assumption that improved industry fundamentals will accelerate carrier pricing power and drive meaningful earnings improvement in upcoming quarters.

We are believers in the industry pricing inflection across most modes (truckload, rail, parcel, international). But we are also realistic that the benefits of this inflection will take several quarters to play out. **For some sectors such as Rail and Parcel, strong volume growth should drive incremental leverage and near-term EPS upside.** But for other sectors, such as the asset-based truckers, the benefit of these trends should take time to play out. For example, **though industry truckload trends have firmed, we do not believe it is yet strong enough to support widespread 1Q EPS upside.**

Ahead of the 1Q reporting season: we would continue to commit new money to the rails and UPS given the EPS upside potential. We also believe EXPD represents an attractive short-term opportunity due to strong international airfreight throughout the quarter. While we remain constructive on the truckload and intermodal stock over the balance of the year, we are near-term cautious given the strong 1Q stock performance and potential lack of 1Q EPS upside. However, we would recommend investors buy into weakness in the truckload and intermodal sector.

Below we preview our 1Q expectations by mode.

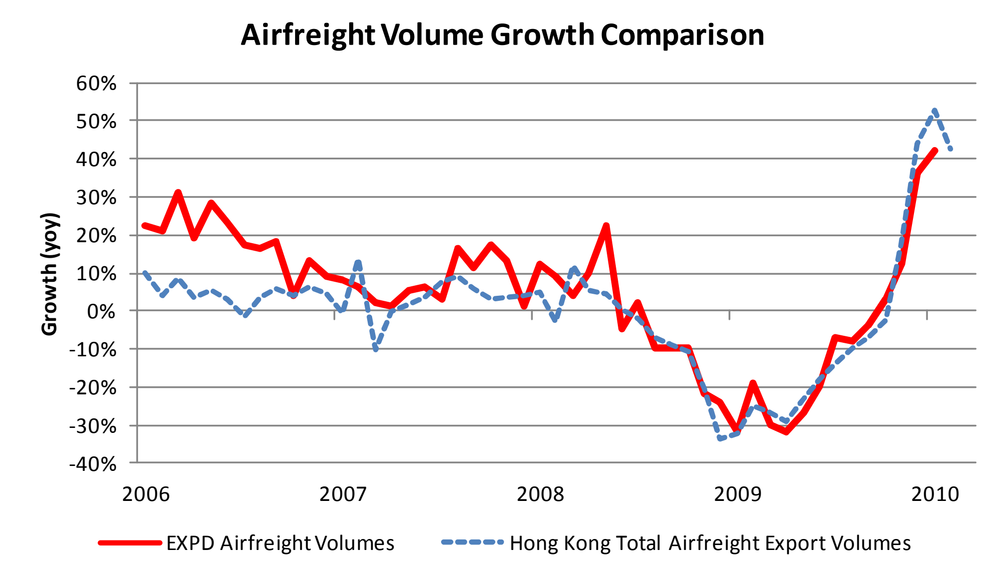
Rails: strong volumes and operating leverage ahead. As domestic trucking freight demand has firmed in 1Q10, rail volumes have trended above seasonal levels to begin 2010. On its current trajectory, rail volume growth could exceed 10% in 2010 (UNP, NSC), compared to our estimate of implied consensus volume growth in the mid-single-digits. **Better-than-expected volumes and better-than-expected operating leverage (costs lag volumes, particularly early in the cycle) should produce EPS upside for the rails.** The chart below highlights the recent strength to railroad industry volume growth.



Source: AAR

Commentary regarding pockets of capacity tightness in certain regions in the domestic intermodal market is consistent with the data points concerning tightening truckload capacity. This above-seasonal trend, coupled with instances of rails' raising rates on certain domestic intermodal lanes ahead of the 2010 bid season, should support domestic intermodal pricing beginning in 2H10. That said, we again do not expect the improved pricing dynamics to materialize in 1Q results, as the pressure of 2009's aggressive contracting period continues to pressure intermodal marketing company (i.e., JBHT, HUBG) margins.

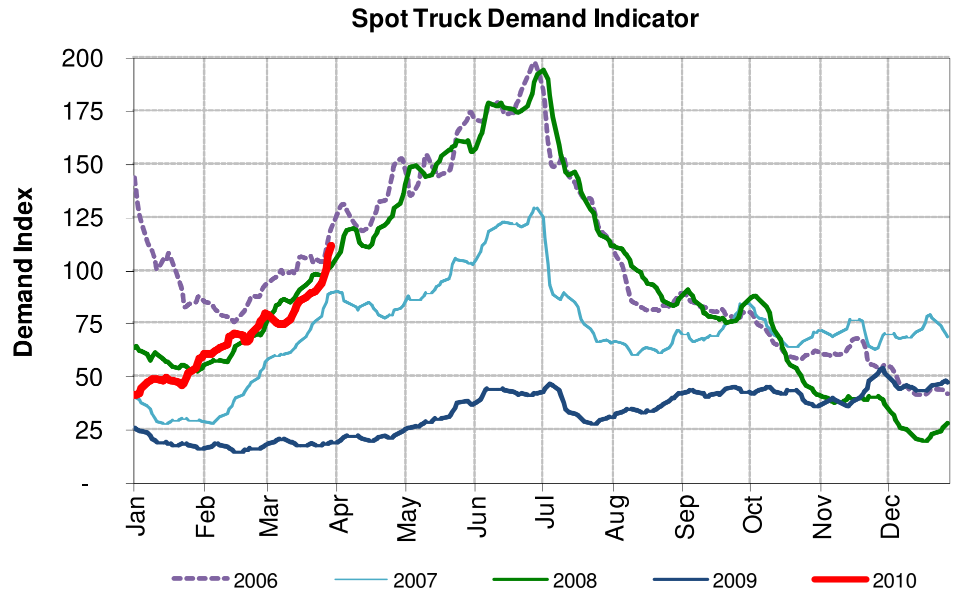
International trends remain strong. Consistent with domestic trends during 1Q, international volumes tracked better-than-seasonal trends to begin 2010, particularly out of Asia. Airfreight volumes out of Hong Kong have been notably strong, with a combined January/February total volume level 4% above prior all-time highs and 48% above 2009 levels. On the ocean freight side, our Baird Asian Port Index reading for January/February was only 4% below 2008's peak level, and was 14% above 2009. We believe these strong trends were driven by a return to more normal inventory order cycles and modest inventory restocking. Our industry sources suggest these strong trends continued in March, and we estimate airfreight volumes out of Hong Kong could be up 40-50% yoy in 1Q, with ocean freight volumes out of Asia up 10-15% yoy. **Such strong volume growth could be a positive catalyst for Neutral-rated EXPD (and for UTIW when they report in late May).** Upside potential exists for EXPD relative to consensus from the volume strength despite the partial offset from higher industry freight rates, which have pressured forwarding yields in recent quarters. The chart below highlights the recent correlation between EXPD's reported airfreight monthly volume growth and the total export volume growth from the Hong Kong Air Cargo Terminals Ltd. (HACTL).



Source: HACTL, Company data, Baird estimates

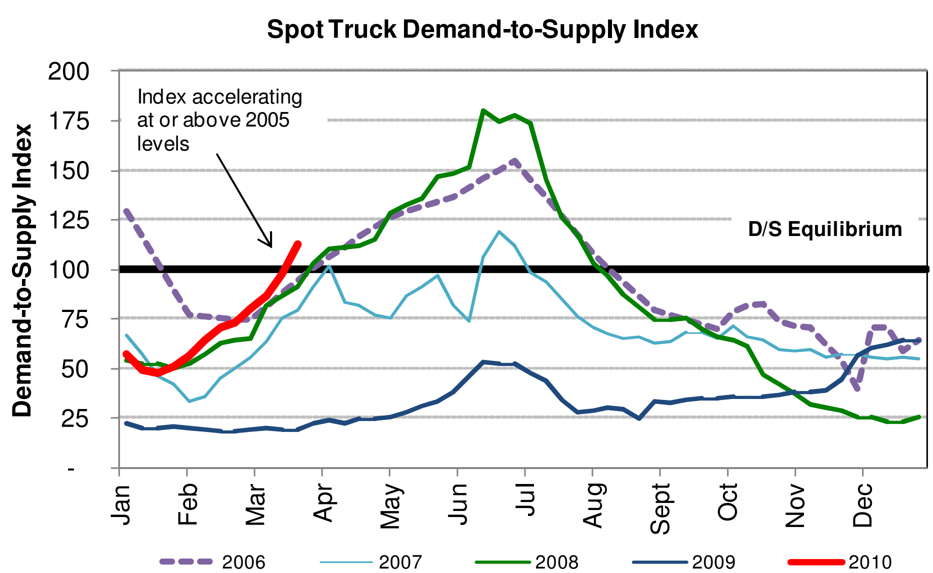
Parcel providers well positioned on near-term volumes and intermediate-term pricing backdrop. Strong international airfreight demand and very strong parcel volumes reported by FDX in March bode well for UPS. 1Q UPS guidance appears conservative. Additionally, over the intermediate term, the industry pricing inflection could be meaningful to the earnings power of FDX and UPS. During our recently hosted FDX meetings with investors, management repeatedly emphasized the importance and commitment to more industry pricing discipline, which will be a positive for both FDX and UPS if their actions are consistent with their strategy.

Truckload: Freight Pricing Renaissance on the horizon. Truckload fundamentals have firmed to begin 2010. Our Spot Truck Demand Indicator is tracking at or above 2008 and 2006 levels, both of which were healthy freight periods. The improved reading is consistent with industry anecdotes.



Source: Industry data, Baird estimates

More importantly, our Supply/Demand truckload index has improved beyond the levels experienced in the past four year years and is at or above 2005 levels for this time of year. This bodes very well for both contractual rate increases and spot rates as the year progresses.



Source: Industry data, Baird estimates

That said, we do not expect widespread 1Q EPS upside from truckload stocks, which may be a letdown for investors expecting near-term upside. Because this recovery appears to be driven by what is more of a supply-constrained recovery against a very depressed rate environment, the initial benefits of firming price are more notable with the fringe carriers (i.e., the carriers pricing for cash flow). However, we expect these benefits to quickly translate to stronger pricing for the larger carriers as the year progresses.

Given the gradual rise in freight rates during 1Q, we see modest risk to Neutral-rated CHRW ahead of 1Q reporting. We recognize that CHRW is facing one or two challenging quarters as above-market volume growth is unlikely to offset the rise in truckload capacity rates. This margin pressure could produce an EPS miss relative to consensus expectations; however, we would look to become more aggressive buyers on the stock on pullbacks created by the margin pressure, which we view as a temporary and normal issue within the model.

Less-than-truckload. LTL demand is generally healthy, and LTL rates have stabilized in 1Q10 following intense pressure during 4Q09 as YRCW's survival remained an overhang. However, LTL pricing gains remain very limited given the 15-20% excess industry capacity. **Absent a meaningful capacity rationalization, LTL rate growth will lag broader modes and pressure full-cycle margin potential for LTL carriers, which leaves us cautious on asset-based LTL carriers.** Near term, we see no positive catalysts for these asset-based stocks given the valuations.

Transport Stocks Outperformed in March

Given anecdotes of firming domestic fundamentals during the month, transport stocks generally outperformed in March. From best to worst, LTLs (+12%), Integrators and Rails (+10%), and TLs (+7%) outperformed the market (S&P 500 +6%), with 3PLs (+3%) the lone underperforming segment in March. For 1Q10, TLs (+13%), Integrators (+12%), and Rails (+9%) outperformed the S&P (+5%), driven by potential for positive operating leverage to firming fundamentals. 3PLs (+3%) and LTLs (-3%) underperformed the market. A complete chart of stock performance is shown below:

				Trading Performance			
Ticker	**Name**	**Rating**	**03/31/10 Price**	**Mar**	**1Q**	**2009**	**2008**
Integrator Index				**10%**	**12%**	**13%**	**(24%)**
UPS	United Parcel Service	O	64.41	10%	12%	4%	(22%)
FDX	FedEx Corp	N	93.40	10%	12%	30%	(28%)
Railroad Index				**10%**	**9%**	**35%**	**(20%)**
UNP	Union Pacific	O	73.30	9%	15%	34%	(24%)
NSC	Norfolk Southern	N	55.89	9%	7%	11%	(7%)
CSX	CSX	O	50.90	7%	5%	49%	(26%)
CNI	Canadian National	NR	60.59	15%	11%	48%	(22%)
CP	Canadian Pacific	NR	56.24	17%	4%	61%	(48%)
KSU	Kansas City Southern	NR	36.17	5%	9%	75%	(45%)
RA	RailAmerica	NR	11.80	(0%)	(3%)		
GWR	Genesee & Wyoming	NR	34.12	7%	5%	7%	26%
Third-Party Logistics Index				**3%**	**3%**	**6%**	**(12%)**
EXPD	Expeditors Intl	N	36.92	1%	6%	5%	(26%)
CHRW	C.H. Robinson	N	55.85	5%	(5%)	7%	2%
JBHT	J.B. Hunt Transportation	O	35.88	1%	11%	23%	(5%)
LSTR	Landstar	N	41.98	5%	8%	1%	(9%)
UTIW	UTi Worldwide	O	15.32	3%	7%	(0%)	(27%)
HUBG	Hub Group	O	27.98	4%	4%	1%	(0%)
FWRD	Forward Air Corp	N	26.30	8%	5%	3%	(22%)
PACR	Pacer International	N	6.02	25%	91%	(70%)	(29%)
ECHO	Echo Global Logistics	NR	12.91	14%	2%		
UACL	Universal Truckload	NR	17.58	(1%)	(3%)	28%	(26%)
Leasing							
R	Ryder	N	38.76	10%	(6%)	6%	(18%)
TAL	TAL International Group	N	19.98	10%	51%	(6%)	(38%)
Truckload Index				**7%**	**13%**	**10%**	**5%**
WERN	Werner Enterprises	N	23.17	4%	17%	14%	2%
HTLD	Heartland Express	O	16.50	8%	8%	(3%)	11%
KNX	Knight Transportation	O	21.09	7%	9%	20%	9%
CGI	Celedon Group	NR	13.94	14%	28%	27%	(7%)
MRTN	Marten Transport	NR	19.71	5%	10%	(5%)	36%
USAK	USA Truck	NR	16.16	22%	29%	(9%)	(10%)
CVTI	Covenant Transportation	NR	6.03	31%	43%	111%	(70%)
LTL Index				**12%**	**(3%)**	**17%**	**(26%)**
CNW	Con-way	N	35.12	8%	1%	31%	(36%)
YRCW	YRC Worldwide	U	0.54	18%	(35%)	(71%)	(83%)
ODFL	Old Dominion	N	33.39	9%	9%	8%	23%
ABFS	Arkansas Best	U	29.88	14%	2%	(2%)	37%
SAIA	Saia	NR	13.88	10%	(6%)	36%	(18%)
VTNC	Vitran Corporation	NR	12.08	26%	11%	74%	(56%)
SPX	**S&P 500**			**6%**	**5%**	**23%**	**(38%)**

** Indices are market-cap weighted.*

Source: FactSet, Baird estimates

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Performance of transportation and logistics companies is subject to a variety of risks including, but not limited to: economic sensitivity, highly competitive markets, government regulation, and exposure to foreign markets. Inability to navigate these and other challenges could negatively impact operating results and/or the long-term value of the company.

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