



STRATEGIC

Short Report



Sell Short Con-Way (CNW)

Cyclical, Capital Intensive (and Expensive) Trucking

VALUEx Vail 2012

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<http://strategicshortreport.agorafinancial.com/>

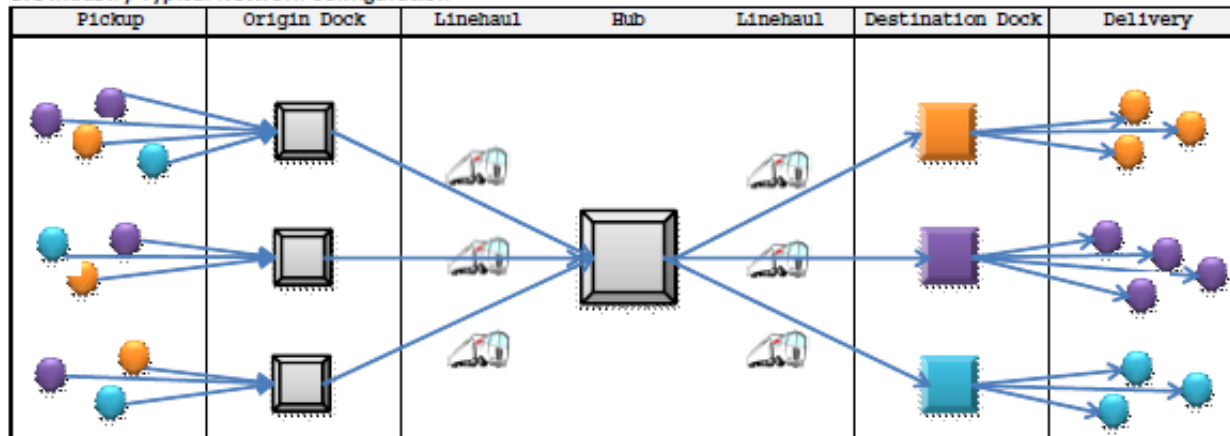
Core Long-Term Assumptions for Market Environment

- QE is addictive. Easy to start, hard to stop.
- No historical example of successful QE reversal (that I know of).
- U.S. economic indicators are rolling over, indicating a lag of Europe/China, rather than a “decoupling.”
- Reasonable assumption: P/E ratios for most stocks will remain low.
- **So...why are cyclical trucking stocks trading near peak multiples?**

Overview of “Less Than Truckload” (LTL) Industry

- LTL definition: the delivery of freight not requiring a full truckload (70% of LTL shipments are less than 1,000 pounds)
- Industry has consolidated, used IT to improve efficiency. But when volume slows, pricing is quick to follow, given need to cover high fixed costs and replenish capital base

LTL Industry Typical Network Configuration



Source: Raymond James & Associates.

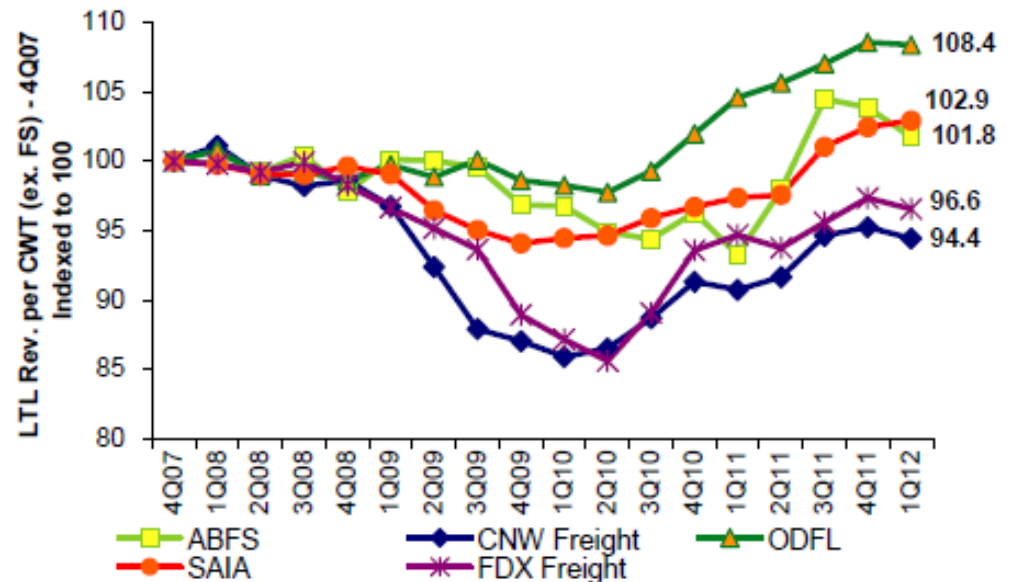
CARRIER	2009
YRC Worldwide	\$4,924
FedEx Freight	3,617
Con-Way Freight	2,712
UPS Freight	1,807
Arkansas Best	1,384
Old Dominion	1,245
Estes Express Lines	1,174
R+L Carriers	862
Saia Motor Freight	849
Averitt Express	800
Southeastern Freight Lines	628
Vitrans Express	519
AAA Cooper Transp.	418
Central Transport	342
Roadrunner Transportation	316
New England Motor Freight	311
Pitt-Ohio Express	255
Dayton Freight Lines	214
A. Duie Pyle	205
Central Freight Lines	162
Top 20 Revenues	22,746
Total LTL Industry Revenues ⁽¹⁾	25,474
Top 20 as % of Total	89%

An Overview of “Less Than Truckload” (LTL) Industry

- During 2008 recession, different LTL carriers pursued different price/volume strategies...
- **More successful strategy:** Old Dominion held its pricing discipline, temporarily lost volume, but regained volume in recovery
- **Not so successful:** Con-way and FedEx Freight cut pricing to gain market share, but wound up with several quarters of unprofitable freight

Exhibit 1

Former Discounters FDX & CNW Have Most Upside To Prior-Peak Pricing



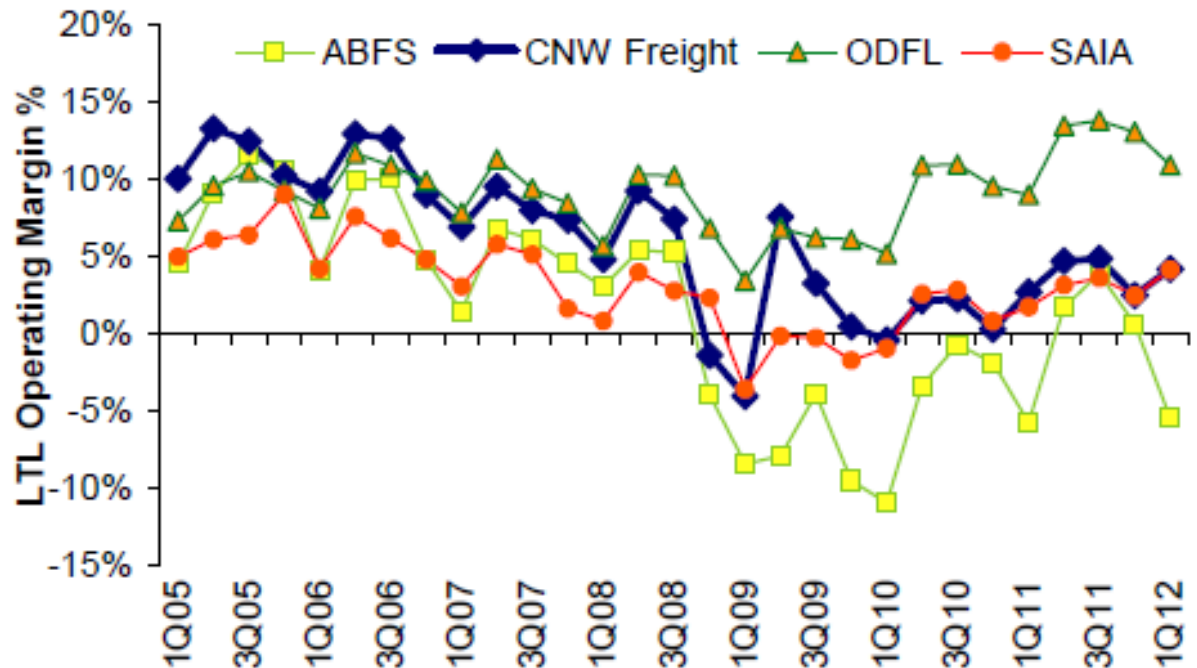
Source: Company Data, Morgan Stanley Research Estimates

An Overview of “Less Than Truckload” (LTL) Industry

- The consensus view: it’s only a matter of time before LTL industry reverts to peak margins...
- But...the market doesn’t appreciate the 9 lives of YRC Worldwide, which lowers returns for all LTL players...

Exhibit 4

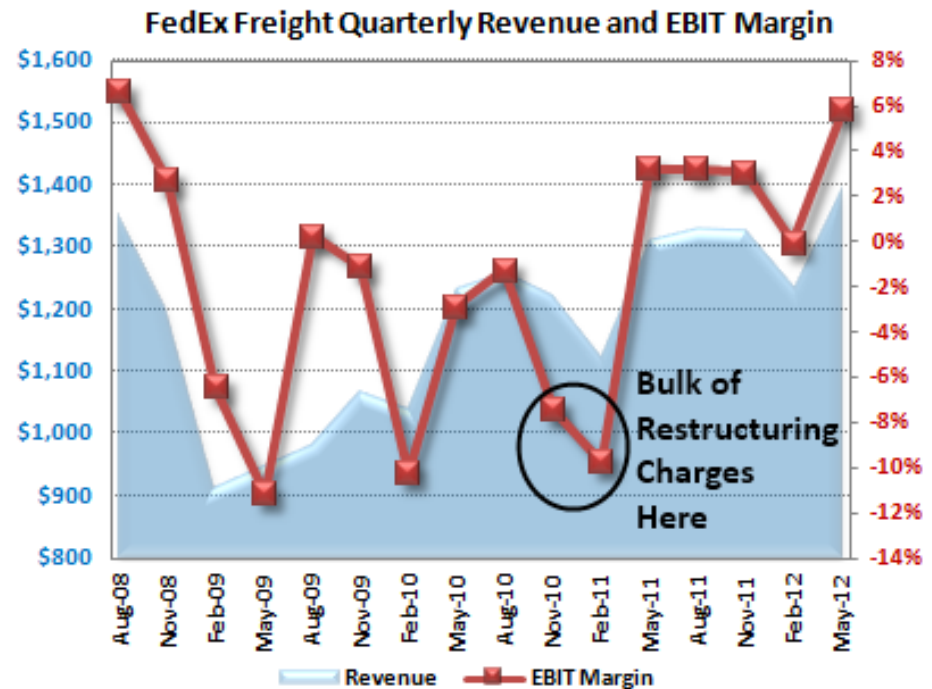
CNW Freight Operating Margins Remain Below “Normalized” Levels



Source: Company Data, Morgan Stanley Research

An Overview of “Less Than Truckload” (LTL) Industry

- ...And FedEx Freight restructured 18 months ago, and is now poised to gain share in LTL.
- June 19 FedEx conference call: *“One of the advantages of our revenue management committee where our sales and marketing team works with the operating companies on a weekly basis is we can actually fine tune the strategy as we go through the quarter and the year. So there will be some periods where we have a little bit more volume focus and there will be some periods where we have a little more yield focus.”* -- Mike Glenn, CEO of FedEx Services



source: FedEx Investor Relations Statistical Book

Short Idea: Con-way, Inc. (CNW: NYSE)

- Three segments:
 - Con-Way Freight (LTL)
 - \$3.2 billion revenue
 - \$120 million EBIT
 - Menlo Logistics
 - \$1.6 billion revenue
 - \$55 million EBIT
 - Con-way Truckload (overpaid for Contract Freighters, for \$752 million in August 2007)
 - \$615 million revenue
 - \$35 million EBIT
- Full-cycle average ROA: 3%; ROE: 9%

Data provided by [Capital IQ](#), except where noted.

Valuation Measures	
Market Cap (intraday) ⁵ :	2.15B
Enterprise Value (Jun 19, 2012) ³ :	2.40B
Trailing P/E (ttm, intraday):	20.06
Forward P/E (fye Dec 31, 2013) ¹ :	13.45
PEG Ratio (5 yr expected) ¹ :	0.34
Price/Sales (ttm):	0.37
Price/Book (mrq):	2.57
Enterprise Value/Revenue (ttm) ³ :	0.44
Enterprise Value/EBITDA (ttm) ⁶ :	5.91



CNW's Low Positive Leverage to Tonnage Growth

- May 2, 2012: Beat 1Q12 estimates by a dime, posting \$0.45 EPS
- But...cost headwinds will lower contribution margin from higher yields/tonnage
 - April 2012 wage increase is an additional \$11 million per quarter headwind going forward
 - Since 2005, Con-Way's labor expense + purchased transportation consumed 67%-71% of revenue

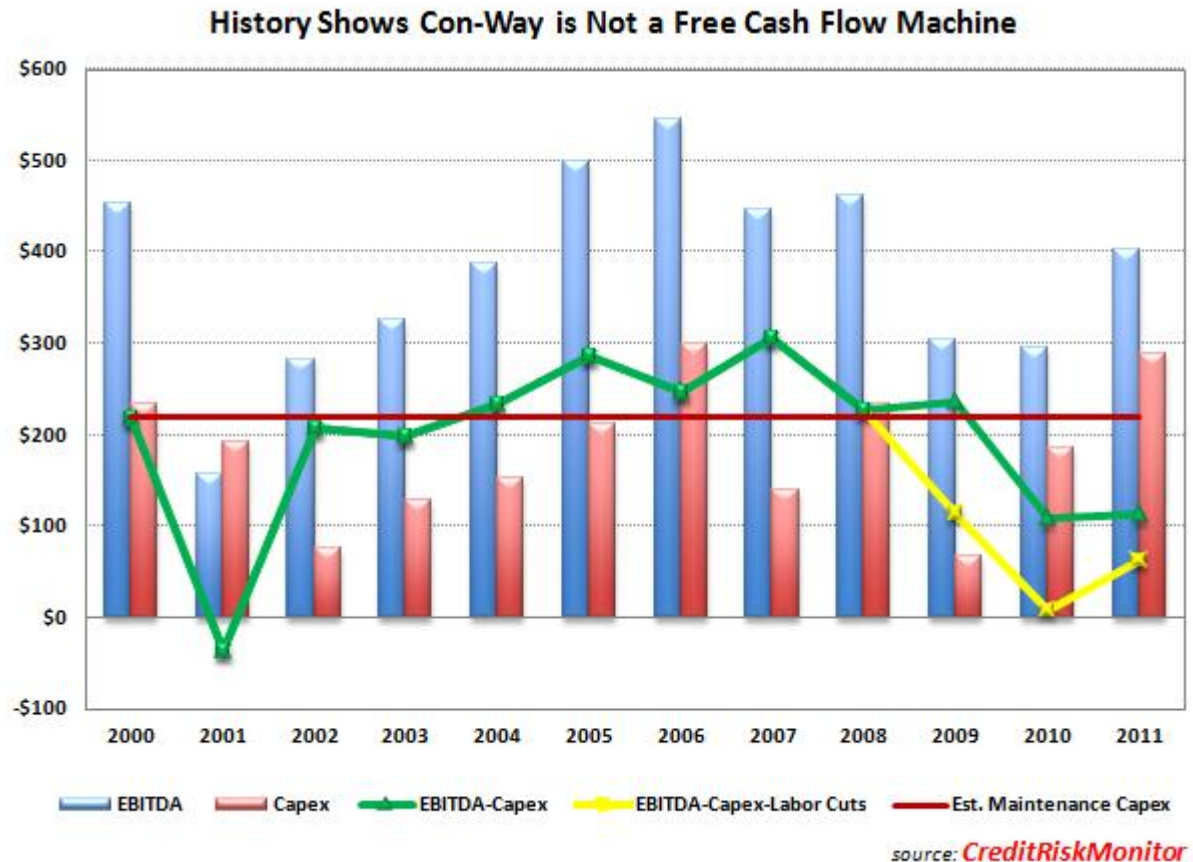
Historical Labor Cost Savings from 10-K:

<i>(Dollars in millions)</i>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Salaries and wages	\$—	\$ 29	\$ 41
Compensated absences	—	15	47
Defined contribution plan			
Matching	34	34	22
Basic and transition	17	22	12
Total estimated cost savings	<u>\$ 51</u>	<u>\$100</u>	<u>\$122</u>

- Another earnings/cash flow headwind: pension/healthcare underfunded by \$520 million
 - 8% expected rate of return on \$1.1 billion portfolio (60/40 stocks/bonds)

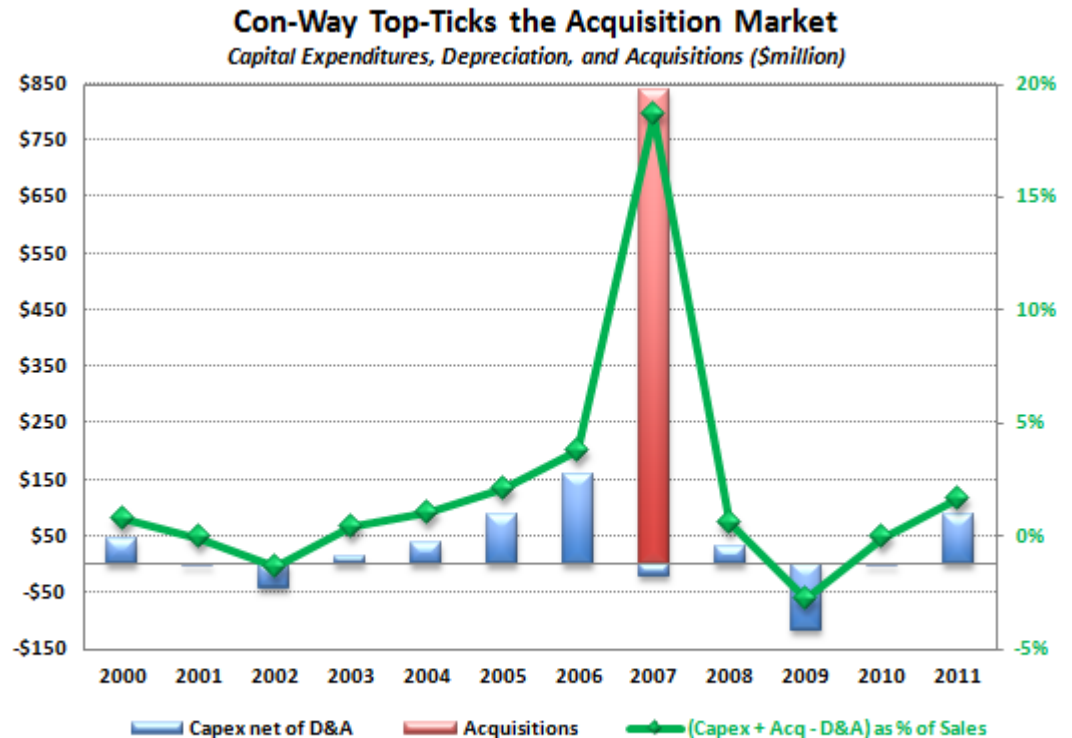
14x EV Multiple on Full-Cycle EBITDA-Capex

- Enterprise value at \$36/share: \$2.4 billion
- Average EBITDA-Capex since 2000: \$173mm
- **14x EV multiple of 12-year avg. EBITDA-Capex**
(adding back temporary labor cuts, write-downs)
- That was looking at past, but what about future EBITDA-Capex?



The Future: Low ROA and Capex Catch-Up

- In August 2007, CNW acquired Contract Freighters (CFI), for \$752 million to grow its truckload business
 - CNW paid 6.5x trailing EBITDA, 1.75x revenue; wrote off 30% of \$470 million of CFI goodwill in 2009
- \$88mm spent on Cougar Logistics and Chic Logistics in 2007 to expand Menlo into Singapore & China
- Huge chunk of 2010-2012 capex was refreshing tractor fleet in Con-Way Truckload. Still appears to be deferred capex for LTL operations -- forklifts, dollies to move pallets, etc.



source: **CreditRiskMonitor**

CNW Short Exit Strategy

- Cover short position immediately if bankers throw in the towel on YRC Worldwide, and it files bankruptcy
- **Cover short in low-\$20s**
- EV/EBITDA currently 6x
 - Historical average: 4.5x
 - Recession troughs: 3x
- Also...EBITDA faces headwinds
 - Labor expense growth matching tonnage growth
 - Aged tractor fleet and LTL facility equipment
 - Already well into freight recovery cycle



Thank You!