**Gross Exposure: Neutral**

* **Bullish Forces:**
  + Recent macro data supports the soft landing narrative, which continues to drive a broader rotation into early-cycle industries that should be supportive to transportation equities
  + Potential tariffs may lead to some NT upside (for most of the group) if Trump wins the presidency
  + Bouncing along the bottom of a 2-year long freight recession which will at some point turn
* **Bearish Forces:**
  + Still poor fundamentals overall – no NT line of sight to this changing
  + Earnings revision risk to both NT numbers and FY25 numbers
* **Staying Neutral:**
  + Bearish on fundamentals for the next couple of quarters but need to respect current risk-on sentiment of market right now
* **Key Gross Factor Exposures:**
  + Long Buybacks:
    - Buyback factor tends to outperform during Fed cutting cycles regardless of whether there is a recession
  + Long Valuation:
    - Tends to outperform during recession but perform in-line during a cutting cycle without a recession

**Net Long Rails (+$5m):**

**Sector Thesis:**

* **Can grow volumes at a great pace than other modes in the long-run**
  + Can win back volume share they lost during COVID by providing a better service product
    - Shippers and IMCs have unilaterally stated that rail service is the best its been
    - Service metrics have been steadily improving since the pandemic
    - Rails have been running higher headcount levels relative to volume to ensure service doesn’t suffer in the event of an cyclical upturn like it did during COVID
  + Can win truck conversions whenever that market firms up due to cost savings associated with rail transportation
    - Will be led by intermodal but also have a fair amount of growth opportunity in their higher yielding merchandise categories
  + In the long-run shippers will be forced to become more conscious of emissions which could lead to more freight being moved on rail
    - Much more fuel efficient/environmentally friendly
* **In a less supportive macro environment can still get consistent pricing increases, but still will see strong incremental margins during an upcycle**
  + Duopoly structure gives the rails pricing power
    - Have consistently priced ahead of cost inflation throughout history – no reason why this would change anytime soon
  + Front-loaded a lot of costs ahead of growth so have operating leverage
    - Most of that margin impact has already been realized
    - Many Class I’s now letting attrition drag down headcount as volume recovery has been pushed to the right (but still running elevated headcount levels)
* **Less demanding valuations that can expand if they achieve long-term volume growth**
  + Historically volume growth has driven multiple expansion
    - Lots of skepticism around the secular volume story so much of that upside not being baked into valuations
  + Relative valuations vs. the broader market at historical lows
    - Not pricing in the same hockey stick recovery as TLs/LTLs

**Factor Exposure:**

* **Long Buybacks + Dividends**
  + Most rails consistently return capital to shareholders over the long-run
* **Long (Large) Size**
  + All of the Class I’s are large cap equities with material institutional ownership
* **Long (Attractive) Valuation**
  + Relatively cheap compared to rest of sector and market
* **Long Profitability**
  + High margins compared to rest of the group

**Long CNI (+$12.5m)**

* **Looks cheap on a relative basis despite the quality of the network**
  + CNI has been the worst performing rail YTD
  + Only trade 0.9x the SPX
    - In-line with NSC, cheaper than UNP
  + Historically has traded at a premium to other rails due to less truck competitiveness (longer lengths of haul), more profitable/defensive mix, being the first movers on PSR
  + Was a consensus short for a while, but this is beginning to change
* **Potential management change can drive multiple expansion**
  + Lots of chatter that Tracy may get replaced due to the underperformance of the stock and the unrealistic guides she’s been putting out for the past few years
  + Not being baked into valuation so essentially get a call option on this when you buy the stock
* **Both FY24 and FY26 guides seem derisked after 3Q pre-announcement**
  + FY24 guide of LSD to MSD EPS growth now being baked into consensus
  + FY26 guide of MSD to HSD EPS growth now being baked into consensus
  + Guide revision largely driven by impact of work stoppage as well as Alberta wildfires
    - Impact of this will mostly be felt in 3Q with little lingering effects
    - Hard to see how this comes down more barring a macro recession

**Long CSX (+$12.5m):**

* **Cheapest rail by far even as a lot of the bear thesis has been materialized**
  + Relative valuation is near all-time lows
  + Now baking in a lot of the bear points following 3Q24 print – feels more derisked
    - Coal, fuel surcharge, hurricane, and labor inflation headwinds probably all being baked into models now as management talked down 4Q and the beginning of 2025
    - With a volume tailwind guidance could end up being conservative
* **November investor day could be an interesting NT catalyst**
  + Rails typically rally into investors days but fade after

**Short NSC (-$10m):**

* **2H24 OR guide at risk of being revised up**
  + Faces greater intermodal mix headwinds which could push 3Q OR towards the 65
    - 4Q OR will face additional headwinds from coal and fuel surcharges
  + CSX quantified hurricane impact to be $50m in 4Q that might extend into 1Q25
    - If NSC faces similar headwinds, this could take a chunk nearly 100bps out of 4Q OR
      * Headwinds could be even worse given that they are undergoing structural costs initiatives
* **Relatively more optimistic about NSC recently, especially following Alan Shaw’s exit**
  + Street modelling for OR to improve 3Q to 4Q, which appears unlikely now even with the continued improvements to the network management is making
* **Hedge to CSX**
  + Faces all of the same headwinds (coal, fuel surcharges, hurricane impact) but is more exposed to intermodal mix headwinds

**Short UNP (-10%):**

* **Hedge to CNI**
  + Trading on the valuation spread extreme between the two
* **Valuation has gotten relatively expensive when compared to conservative investor day guide**
  + 2nd most expensive rail (outside of CPKC) on a FY26 guide for MSD-HSD EPS CAGR
    - More than baking in a lot of the improvement brought upon by Vena as well as nearshoring tailwinds
* **Much discussed nearshoring tailwind may actually be a double edged sword**
  + Some risk that CP takes share in cross-border Mexico, which would limit the positive impact UNP gets from one of their key LT growth drivers
    - CPKC’s single-line service from Canada through deep into Mexico will be competitive with UNP’s existing offerings in Laredo and Brownsville
  + A potential trump presidency would be a (perceived) net negative to UNP in particular due to exposure to Mexico
  + Cross-border rail volumes have not really picked up at all even as cross-border truck volumes have continued to grow
    - Still a lot of facilities being built out (particularly in automotive) so this could change
      * But automotive is only a small part of their overall volume mix anyways
* **Artificially higher international intermodal mix likely to continue through 4Q due to prolonged ILA negotiations**
  + Shippers who moved more operations west in response to the ILA East Coast strike will likely stay there until there is more clarity on a labor agreement
  + Intermodal is necessary for LT growth path, but sudden spike in international combined with more muted merchandise performance will weigh on OR on the short-term
    - International is even lower yielding than domestic intermodal, the latter of which is really a sizeable portion of truck conversions translate towards

**Ramp Procedure:**

1. Construct models and measure normal seasonality via trend cycle analysis to compare to current results
2. Compare freight mix of the rails along with network footprint/key geographies and port connections
3. Consolidate weekly rail volume data, run correlations with key macro data and port volumes to get a better sense of end-market drivers, and measure typical seasonality to compare to current results
4. Consolidate weekly rail service data
5. Consolidate rail pricing data for nowcasting use (i.e. Intermodal PPI, Carload PPI, ATA Intermodal Rev/Load)
6. Consolidate data related to costs (e.g. STB rail employment, wages, fuel)
7. Consolidate border crossing volume data from CBP to better track progression of nearshoring tailwind for rails
8. Consolidate sell-side estimates along with recent revisions to compare to personal estimates and seasonality
9. Consolidate short interest, absolute/relative valuation (on consensus numbers), relative performance, earnings reactions (vs. beat/miss), and Reg SHO daily short volume data over time to get a better sense of flows/positioning
10. Build more automated pipeline for said data along with key industry news
11. Run through company transcripts/commentary to pick up on forward guidance and incrementals while also getting a better sense of management credibility
12. Speak with IR/industry experts to discuss company-specific initiatives
    1. If possible would want to visit the network
13. Speak with sell-side to get a better sense of positioning and market views on intermodal, volume growth, service, management, and company specific initiatives
14. Speak with industry experts/shippers to get their opinion on how service has (or has not) improved and the general willingness to use rail
15. Speak with industry experts/shippers on importance of sustainability in future decision making
16. Try to quantify cost savings of intermodal vs. truck over time
17. Quantify share recapture opportunity for rails in the long-run
18. Leverage factor models to better quantify factor exposure
19. Analyze stock performance during previous Fed cutting cycles and during previous freight cycles

**Net Long Parcels (+$5m):**

**Sector Thesis:**

* **Secular AMZN headwind, while a valid concern, has been somewhat blown out of proportion**
  + AMZN has been rapidly expanding its internal logistics capabilities ever since 2015, and yet parcel pricing has continued to increase every year
  + AMZN faces structural headwinds to winning more business outside of its own e-commerce network
    - Prioritization of its own packages during peak season makes major shippers less likely to work with them during that time
      * Not necessarily economical for AMZN to bring on additional capacity to address this since it would be sitting idle for the rest of the year
  + AMZN is behind on more profitable B2B where UPS and FDX thrive
  + Most of the volume headwinds from AMZN moving its e-commerce shipments to its own network have played out already
* **Pricing still seems rational despite investor concerns**
  + The price headwinds associated with UPS trying to win back business they lost from the Teamsters negotiation were very temporary and are in the reaview
  + Recent GRIs have been higher than long-term average – still getting good capture on those
  + UPS and FDX have both been expanding fuel surcharge tables to more zip codes
  + Perceived main threats to UPS and FDX pricing (AMZN + USPS) both are not competitive with FDX and UPS in many of their key end markets (B2B, Express B2C ex. AMZN business)
  + Much of the degradation in RPP recently has been related to a higher mix of deferred services, which, while punitive, will likely subside as inflation moderates
* **Trough multiples much lower than what they have been in past cycles despite large amount of operating leverage to an upswing and idiosyncratic cost initiatives**
  + Long-only’s and HFs both cautious/apathetic on the group which could change given cost initiatives across the industry, better understanding of AMZN threat, and the operating leverage they have to an upcycle right now

**Factor Exposure:**

* **Long Buybacks + Dividends**
  + FDX and UPS return capital to shareholders in the long run and have commitments to continue doing so
* **Long (Large) Size**
  + Two of the largest names in transports
* **Long (Attractive) Valuation**
  + Relatively cheaper compared to rest of sector and market
* **Long (Low) Profitability**
  + Low margins compared to rest of group

**Long FDX ($35m):**

* **LTL spin provides idiosyncratic call option**
  + Will likely happen in December – no reason why they wouldn’t do this
    - Makes more financial sense now as LTL multiples have expanded since they first announced their strategic review
    - If for some reason they don’t, its likely an activist will come in and long only shareholders will support them
  + LTL not being baked into current valuation at all
    - ODFL is half of FDX’s consolidated enterprise value even though FDX is actually the larger LTL network
    - $320-$350 stock depending on how conservative you are when valuing LTL
  + Could print another miss and still go up if this is announced
* **Less executional risk after 1Q25 earnings miss**
  + Buyside seems to be modelling for $17-$18 FY25 EPS (vs. $20-$21 guide)
  + FDX had already telegraphed that DRIVE savings would be back end loaded
  + A good portion of the recent miss was macro driven which sets up FDX mgmt to execute and deliver on DRIVE savings ahead of rerated expectations
* **Relative multiple vs. UPS can expand as its historically traded at discount vs. UPS due to**:
  + Structurally lower margin
    - Even if they don’t hit their guide FDX margin should improve more than UPS over the next year
      * Projecting more cost savings than UPS in the next year on a lower base
      * Has more operating leverage to an upcycle
  + Lower quality network
    - Network integration should over time give them a more comparable network and margin profile to UPS
      * A lot of redundancy can be removed by overlapping Express and Ground networks
  + Less credible mgmt
    - Executed on $1.8b of structural cost takeout (DRIVE) in FY24 without major setbacks and was able to raise/hold the guide throughout the year and achieve EPS growth despite macro headwinds
      * Can continue to build credibility with further execution especially following the 1Q25 miss
    - UPS now facing mgmt. problems of their own

**Short UPS (-$30m):**

* **Hedge against FDX to reduce long exposure to Parcel**
  + Most positive needle movers that UPS would disclose in their 3Q print would center around pricing, mix, and volumes would also be a net positive to FDX (and vice versa)
* **New surcharges on Chinese e-commerce business may lead to NT volume downside**
  + One of the only major sources of volume growth has been Asian e-commerce
  + Has been a mix headwind in the past but investors were more positive on new surcharges that were recently implemented that would offset this
  + But these e-commerce players may become more price sensitive which could cause them to divert volume elsewhere – not everyone appears to be considering this
* **Unlikely to hit FY24 or FY26 guides**
  + FY24 guide predicated on more normalized seasonal uplift in volumes and better yield performance than we have seen
    - Though this is more derisked at this point
  + FY26 guide predicated on an acceleration of volume growth to get closer to the levels seen during COVID
* **Positioning much less negative than it used to be**
  + Lots of HF’s flipping from short to long now after all being short throughout the year
  + Many thought they sounded better at Laguna

**Ramp Procedure:**

1. Construct models and measure normal seasonality via trend cycle analysis to compare to current results
2. Compare mix between Ground/Air services and international vs. domestic services
3. Consolidate credit card data, air cargo volume data, Pitney Bowes shipping index data, and key macro data that correlates with volumes
4. Consolidate key data that relates to cost structure (i.e. fuel, wages)
5. Consolidate parcel pricing data for nowcasting use (i.e. AFS/TD Cowen Index, Courier PPI)
   1. Would be interesting to see if we can use webscrapping/automation to collect real-time data over time and run comparisons between carriers (including AMZN)
6. Consolidate border crossing volume data from CBP
7. Consolidate sell-side estimates along with recent revisions to compare to personal estimates and seasonality
8. Consolidate short interest, absolute/relative valuation (on consensus numbers), relative performance, earnings reactions (vs. beat/miss), and Reg SHO daily short volume data over time to get a better sense of flows/positioning
9. Build more automated pipeline for said data along with key industry news
10. Run through company transcripts/commentary to pick up on forward guidance and incrementals while also getting a better sense of management credibility
11. Speak with IR/industry experts to discuss company-specific initiatives
    1. Would want to visit facilities that FDX/UPS are working on to get a better sense of the structural changes being done if possibe
12. Speak with sell-side to get a better sense of positioning and market views on AMZN/USPS, management, volume growth, pricing, and company specific initiatives
13. Speak with industry experts/shippers to get opinions on USPS and AMZN service/pricing vs. FDX and UPS
14. Speak with current/former employees to get their opinions on structural changes
15. Leverage factor models to better quantify factor exposure
16. Analyze stock performance during previous Fed cutting cycles and during previous freight cycles

**Net Short TLs (-$5m):**

**Sector Thesis:**

* **No NT demand catalyst in sight, which won’t help TL rates in the NT**
  + Unlikely to be an inventory restocking event as some have hoped for
    - Retailer inventory/sales ratios have been flat/declining as retailers have rightsized their inventory levels following a massive destocking from COVID levels
    - Higher interest rates increase the opportunity cost of holding inventory so any significant “restocking decisions” will likely be made after we are already well into the Fed’s easing cycle
    - In the long-run inventory/sales declines as retailers more efficiently manage inventory via technology and supply chain improvement
  + Macro uncertainty, visibility into further rate cuts, and an election that may significantly impact international trade policy will likely keep manufacturing activity in limbo and reduce incentives to stock up in inventories as firms await for more clarity before making capital investments
    - Many investors underestimate the impact of manufacturing on the TL cycle
      * Manufacturing data has a much higher correlation with TL data than retail data
      * Retail-facing mix of larger publicly traded carriers with great relationships with retailers distorts view – government surveys indicate that industrial activity plays a significant role
      * A good amount of consumer goods still finalized in the U.S. as 25% of imports are intermediate goods
  + Volumes unlikely to deteriorate but all else held equal its hard to see rates improving without significant volume improvement
* **Industry overcapacity remains and there are no identifiable catalysts to facilitate more exits**
  + Still ~28,000 more trucking firms vs. the long-term capacity growth trend and the pace of exits has slowed as small carriers who made a ton of money during COVID unlikely to be willing to exit the business before peak season at the bottom of the cycle
    - Especially with visibility into rate cuts and potential tariff tailwind if Trump wins election
    - A decent amount of them probably parking their trucks temporarily to do other things while waiting for the cycle to turn
    - Public carriers have been calling the bottom for so long now which may be giving them some additional optimism
    - Cost inflation moderating which helps them stay afloat
  + Large carriers still hold a ton of excess capacity in preparation for an upturn
    - Employment still 2% higher than pre-pandemic levels even after the mass carrier exodus following the COVID freight boom
    - Average hours worked by payrolled trucking employees (who are mainly employed by larger firms) is lower than it was during the start of COVID and the DotCom bubble burst, indicating that large carriers are also holding lots of excess capacity
    - Carriers only recently started materially cutting capex guides
* **Face secular headwind from growing private fleet adoption**
  + Major retail shippers (WMT, HD, DG) all have grown their fleets since COVID amid the supply chain disruption they experienced then
    - WMT and DG are largest customers of KNX and WERN respectively
  + The number of private fleets registered with the DOT has been expanding since 2016, even during the mass carrier exodus following COVID and extremely low for-hire trucking rates
  + Likely this trend continues, especially amongst larger shippers who have the resources and scale to support private fleet infrastructure
* **Peak season appears like it will be slightly early, which means that rates may remain sub-seasonal for the rest of the year.**
  + 2Q and the early portion of 3Q saw more normalized seasonality, but August and Labor Day seasonality was very muted
  + Container imports and rates spiked in 1H24 as the Red Sea became obstructed by the Houthis
  + A decent amount of imports likely also related to goods impacted by Biden tariffs (solar panels and semiconductors) that don’t have as much to do with core end markets
* **Multiples are very elevated relative to history and FY25 estimates look too high. Both depend on the next cycle looking like the past two**
  + Multiple froth especially the case now as the stocks have traded up on macro narratives (Trump, rate cuts) despite fundamentals actually getting worse
  + But in the absence of a true catalyst, this cycle is more likely to look like a more moderate period (2014) vs. 2018 or 2020.
  + Need recovery to be sharp, counter-seasonal step up in 1Q, and better exit rate in 4Q to justify
  + A 2014 type recovery year implies St. ’25 numbers need to come down by roughly 20%

**Short WERN (-$20m):**

* **Management is relatively more optimistic on the cycle than they probably should be in the NT**
  + They are assuming they get normal seasonality for the rest of the year
* **Dedicated pipeline especially exposed to private fleet headwind and currently experiencing share losses**
  + Have been losing business throughout 1H and don’t see this picking up sharply again in the NT
  + DG, their largest customer, has committed to moving half of their goods via their own fleet
  + Its likely that whatever is left over for WERN is less profitable freight since more profitable business was likely more punitive to DG’s freight costs
* **Relative multiple is harder to justify given lack of leverage vs. KNX**
  + Greater skew towards dedicated services and contract freight vs. spot freight means they get less EPS torque in an upturn and will see changes in rev/mile at a slower rate
  + WERN trading only at a 1x discount to KNX
* **Factor Exposure:**
  + Short (Small) Size:
    - Small cap name vs rest of the group
  + Short (Expensive) Valuation:
    - Relatively high valuation vs rest of the group
  + Short (Low) Profitability:
    - Razor thin margins compared to rest of group

**Long KNX (+$15m):**

* **Hedge against WERN to manage exposure to TL short**
* **Has most immediate torque for whenever spot rates start rising**
  + Business is more spot exposed by nature
  + Stock typically reacts first to rate movements, while other TL’s closely follow suit
* **Gets additional leverage when the cycle turns due to USX integration**
  + Have been steadily improving operations/margins there but will need the macro to cooperate to realize further benefit
* **NT guide relatively more conservative**
  + Not underwriting any seasonal improvement in price or volume
  + Key to the guide assuming a muted macro backdrop will be cost management
* **Factor Exposure:**
  + Long (Small) Size:
    - Small cap name vs the rest of the group
  + Long (Expensive) Valuation:
    - Relatively high valuation vs rest of the group
  + Long (Low) Profitability:
    - Razor thin margins compared to rest of group

**Ramp Procedure:**

1. Construct models and measure normal seasonality via trend cycle analysis to compare to current results
2. Consolidate key pricing data sources (for both spot and contract rates) that correlate well with or lead Rev/Load
   1. Can use for nowcasting purposes
3. Consolidate key capacity data (i.e. FMCSA authorities, employment, Class 8 new orders, private fleet data)
4. Consolidate key alt/ macro data that relates to demand (i.e. retail sales/major retailer cc data, container imports, ISM, sell-side surveys, cass, DAT/FreightWaves data)
5. Consolidate key data that relates to cost structure (i.e. fuel, wages, insurance PPI)
6. Consolidate sell-side estimates along with recent revisions to compare to personal estimates and seasonality
7. Consolidate short interest, absolute/relative valuation (on consensus numbers), relative performance, earnings reactions (vs. beat/miss), and Reg SHO daily short volume data over time to get a better sense of flows/positioning
8. Build more automated pipeline to retrieve said data along with key news updates
9. Run through company transcripts/commentary to pick up on forward guidance and incrementals while also getting a better sense of management credibility
10. Speak with IR/industry experts to discuss company-specific initiatives
    1. Particularly with KNX
11. Speak with sell-side to get a better sense of positioning and market views on pricing, management, volumes, capacity, and company specific initiatives
12. Speak with industry participants/shippers about private fleet adoption vs. Dedicated services from for-hire carriers
13. Speak with small carriers about ability to stay afloat during current downturn
14. Do work on catalysts/drivers of prior trucking upcycles
15. Leverage factor models to better quantify factor exposure
16. Consolidate data showing manufacturing impact on TL industry/linkage to consumer goods
17. Leverage factor models to better quantify factor exposure
18. Analyze stock performance during previous Fed cutting cycles and during previous freight cycles

**Net Short LTLs (-$5m):**

**Sector Thesis:**

* **Core industrial demand will continue to be a headwind for the rest of 2024 at least, and a recovery will likely not be a hockey stick as some are baking in**
  + Visibility into further rate cuts as well as the upcoming election put capital spending decisions in limbo
    - Shippers want to wait until cost of capital is lower to make major purchases
    - Shippers want more clarity on international trade policy (tariffs)
  + TL taking some share from LTLs due to how cheap prices are there
    - ODFL and CHRW both think this
  + Most intra-quarter operational updates have shown Y/Y volume declines and more muted seasonality which points to a more challenging 4Q starting point
  + In the absence of a clear catalyst, the next upcycle is more likely to look steadier than 2018 and 2020 (think 2014)
    - Trump tariffs in 2018 and COVID in 2020 exacerbated the pace of volume growth in the two most recent cycles
    - Historically early cycle tonnage growth is roughly 2-3% in a “normal” upcycle, in-line with industrial production
* **Yield momentum should decelerate in the NT**
  + Lapping impact from YELL bankruptcy
    - Tougher Y/Y comps
    - Less momentum than immediately after YELL as a lot of the business that was taken by other carriers was already repriced from the low pricing they had with YELL
  + Lack of industrial recovery negatively impacting mix – Retail freight is lower yielding
    - As long as industrial economy remains weak, there will be lighter and less profitable freight in the networks
  + Much of the capacity that left the industry still hasn’t returned yet
    - Employment near trough 2020 levels now
    - Still over 100 unsold YELL terminals
      * Not all will come back but still a lot of purchased terminals that need to be opened and YELL will sell more locations in January
  + Fuel declines another headwind
    - LTLs make a margin on fuel so will have impact on OR
* **Trough multiples especially demanding and require everything to go right for the group**
  + Forward P/E’s all at high end of historical ranges on both absolute and relative basis
  + Baking in both a sharp industrial freight recovery and a continuation of current pricing momentum

**Short SAIA (-$15m):**

* **Major earnings risk into 3Q print due to ramifications of new terminal openings**
  + Estimates coming higher after August operational update showed volumes coming in way ahead of peers/seasonality
  + But these volume wins likely come at the expense of yield/mix as they tap 3PLs to fill new terminals with lower quality (probably a lot of retail) freight
  + Costs should also be a headwind as they opened 11 terminals in the quarter and didn’t get a lot of benefit from them
    - 4.1% wage inflation on a much higher employee base could end up being much more punitive than many are modeling for
  + Similar setup to 2Q
  + These types of headwinds may extend into 4Q as they continue to open the rest of the terminals they bought fromYELL
* **Some degree of execution risk in FY25 numbers**
  + Current estimates rely on SAIA to maintain the rapid volume growth they have been seeing this year (which requires them to maintain service levels during the next upcycle) and also for yield growth to return to being at least in-line with the industry
* **Factor Exposure:**
  + Short (Expensive) Valuation:
    - One of the more expensive names in transports
  + Short (Small) Size:
    - Smaller cap name compared to ODFL
  + Short Growth:
    - SAIA has a LT secular growth opportunity

**Short ODFL (-$15m):**

* **No idiosyncratic story + spare capacity strategy = even more exposure to NT macro headwinds**
  + OR will continue to be challenged NT as they stick with their strategy of maintaining spare capacity for an upturn
  + Volumes will continue to face greater pressure relative to others as they have not been gaining as much share since YELL
    - Hard to improve service when you are already best-in-class
    - Took almost no YELL freight as it didn’t fit their network
* **Competitive moat at risk as other LTL’s look to copy ODFL’s (winning) framework**
  + Carriers that used to chase volume at the expense of price have been talking much more about price discipline this year, seemingly learning from ODFL’s strategy
  + More competitors using the opportunity provided by YELL to improve service or expand their networks, which may make ODFL’s offering less competitive
    - Many of the terminals KNX and XPO bought are meant to improve network density and service
    - SAIA will eventually have a more comparable national network and can price appropriately if they even just maintain current service performance
* **Multiple premium vs. other carriers can contract as LT EPS growth likely to lag competitors**
  + Much harder to improve a 70% OR vs. a 90% OR without impacting service
  + More supported by long-only’s who could reduce exposure and move it elsewhere if they underperform
    - Though almost every hedge fund is short so incremental seller (for now) has to be long-only’s due to a murkier LT outlook
* **Factor Exposure:**
  + Short (Large) Size:
    - Large cap name in the SPX with lots of institutional ownership
  + Short (Expensive) Valuation:
    - One of the more expensive names in the group
  + Short Profitability:
    - Has best margins of all the LTLs (and pretty good compared to rest of transports)

**Long XPO (+$25m):**

* **Hedge against LTL short exposure**
  + Always reports after SAIA and ODFL
* **Most likely to outperform on yield in 3Q and beyond**
  + Providing better service than before (lower claims ratio) which provides them more opportunities to reprice their book of business appropriately
  + 26/28 of purchased terminals are in existing geographies
    - Not taking the SAIA approach so won’t face the same kind of mix headwinds as they won’t need to rapidly try and fill the terminals
    - Makes network denser, improving service
* **Has other cost and efficiency levers to pull to improve OR including efforts to insource linehaul miles that have started bearing fruit**
  + Management says they have been ahead of schedule in reducing PT as a % of revenue
  + Since most terminal openings are duplicative to the network there is less of an upfront cost headwind as they can fill them more quickly
* **Have been walking investors down on volumes so more derisked on that front**
  + Stock was punished after August operational update
  + Have lowered their estimate of 3Q “normal seasonality” progressively throughout the quarter
  + Have some buffer to volumes from winning share through a better service product that could provide some incremental upside
* **Europe spin could be a positive NT catalyst**
  + No specific timeline on this yet but will happen eventually
  + Will help them further delever balance sheet and focus on core LTL offering while offloading an underperforming asset that weighs on EPS growth
* **Factor Exposure:**
  + Long Leverage:
    - XPO is one of the few transportation names with a more levered balance sheet (from its past as a highly levered conglomerate)
  + Long Growth:
    - XPO has a LT secular growth story
  + Long (Small) Size:
    - Smaller cap name compared to ODFL
  + Long (Expensive) Valuation:
    - One of the more expensive names in transports
  + Long (Low) Profitability:
    - Lower margins compared to toher LTLs

**Ramp Procedure:**

1. Construct models and measure normal seasonality via trend cycle analysis to compare to current results
2. Consolidate key pricing data that correlates well with Rev/CWT for use in nowcasting model (i.e. ATA LTL Rev/Ton, LTL PPI)
3. Consolidate key macro data that relates to demand (i.e. ISM, sell-side surveys, industrial production, cass)
4. Consolidate key data that relates to cost structure (i.e. wages, fuel, insurance PPI)
5. Consolidate info on terminal opening schedules along with LTL employment data to get a better sense of capacity ramp
6. Consolidate sell-side estimates along with recent revisions to compare to personal estimates and seasonality
7. Consolidate short interest, absolute/relative valuation (on consensus numbers), relative performance, earnings reactions (vs. beat/miss), and Reg SHO daily short volume data over time to get a better sense of flows/positioning
8. Build more automated pipeline to retrieve said data along with key news updates
9. Run through company transcripts/commentary to pick up on forward guidance and incrementals while also getting a better sense of management credibility
10. Speak with IR/industry experts to learn more about company specific initiatives
    1. Particularly for SAIA and XPO
11. Speak with sell-side to get a better sense of positioning and market views on pricing, volumes, capacity, management, and company specific initiatives
    1. Particularly for Long Onlys who are generally overweight ODFL
12. Speak with industry participants/shippers about relocating freight from LTL to TL due to cost savings
13. Speak with industry participants/shippers about current LTL service changes/improvements (for SAIA and XPO vs. ODFL)
14. Leverage factor models to better quantify factor exposure
15. Analyze stock performance during previous Fed cutting cycles and during previous freight cycles