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Classifying something as the "best" often attracts debate. This is NOT the case with Old Dominion Freight Line. Whether you speak with investors, customers, or even their competitors (!) – ODFL is the best less-than-truckload (LTL) operator.

Our good friend David Kim (aka scuttleblurb) joined us to analyze how ODFL has achieved this reputation. We go through the strong family roots, the network philosophy and adjoining investment program, and just how good those metrics look next to peers.

**GLOSSARY**

Truckload (TL) – a truckload carrier moves full trailers or containers from the same shipper.

Less-Than-Truckload (LTL) – an LTL carrier moves freight for customers who don't require use of an entire container.

Pick-up and Delivery driver (P&D) – an LTL driver will have a route that includes both pickups and delivery during the day.


## Introduction

**Matt:** **David - thank you for our first "email back-and-forth" Breakdown! If this goes well, you will be etched into Colossus history. I picture your keyboard next to Jeff Gramm's microphone from Invest Like The Best Episode 1. And if this goes poorly, it will have scarcity value. A cult classic. We can't lose.**

**Scuttleblurb**: *Thanks Matt, love the podcast, it's an honor to do this.*

## The Trucking Industry

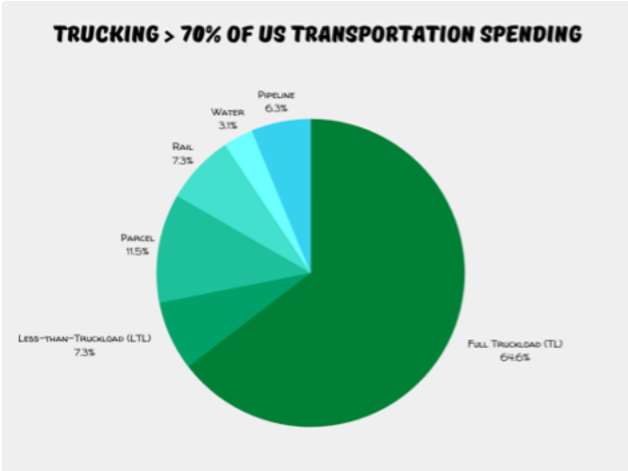
**Matt:** **Our topic today is a trucking business - Old Dominion Freight Line (ODFL). You once described ODFL's less-than-truckload (LTL) network this way:**

***"It's like an organic, self-nourishing complex in which each strategically placed service center node contributes to the health of every other."***

**Rare poetic words for a transportation business! Let's start with the trucking industry - what differentiates less-than-truckload (LTL) from truckload (TL)? Do they have similar physical networks? Market sizes? We can start with that overview and then get into ODFL specifically.**

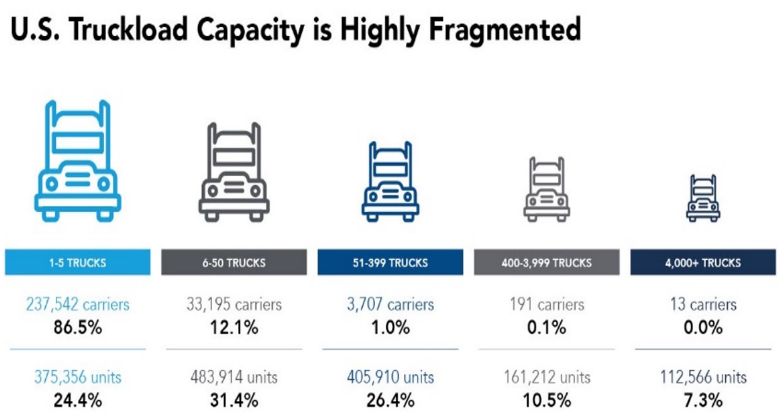
**Scuttleblurb:** In the US, surface freight transportation is a trillion-dollar industry. By far the largest piece of that, at around $800bn, is truckload transportation (TL).

Truckload transportation is incredibly fragmented. There are about 900k for-hire carriers, more than 90% of whom operate fewer than 6 trucks. Knight-Swift (KNX), the largest truckload carrier in the US, has less than 1% share. Even the aggregation layer on top of all that, which consists of brokers like CH Robinson (CHRW) and Uber Freight (UBER) that connect shippers to truck drivers, is very fragmented industry, with 17k players. The largest, CH Robinson, intermediates just 3% of the market.




*Source: Kearny, State of Logistics*

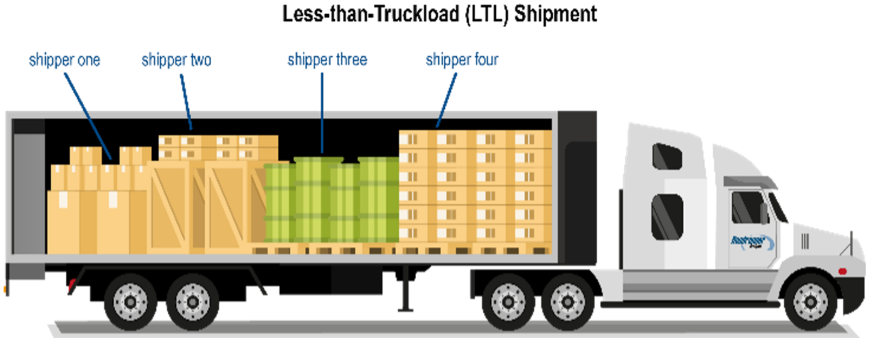
The truckload industry is fragmented because the entry barriers are low. It doesn't take much more than a commercial driver's license and a truck to get started. A carrier's job is tiring but simple: move a trailer full of parts from a single supplier over long distances, from Boston to Chicago or whatever.



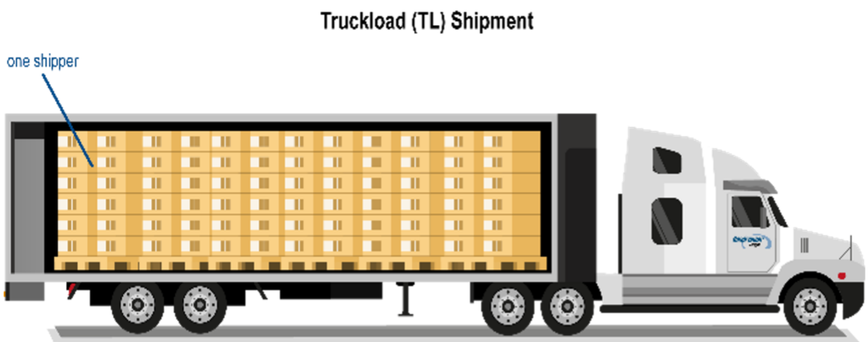

*Source: CH Robinson*

**Matt: And LTL?**

**Scuttleblurb**: Less-than-truckload, or LTL, works differently. In a just-in-time supply chain, manufacturers trying to limit days of inventory will want small batches delivered with higher frequency rather than a big batch delivered all at once. So instead of filling up an entire 53-foot trailer (a full "truckload") for a single customer, a supplier will break their freight up into several smaller shipments. They hire an LTL carrier, who will combine that small batch freight with the small batch freight of other shippers to fill up a trailer.




The trailer is filled up with pallets from individual shippers who are paying for space based on the dimesional space of their goods.




The entire trailer is filled with goods from the same shipper. Truckload shipping offers cost-savings when you have a significant amount of goods to ship and maximize space available on the full trailer.

*Source: Roadrunner transportation*

For reasons I can discuss later, this is a capital-intensive logistics problem that requires scale to profitably solve. So while the LTL market is small compared to Truckload, with about $80bn of revenue, it is far more consolidated. The top 5 players have 53% share, the top 10 have 75%.

Matt: **I think we can tap into that capital-intensive logistics problem now. How does the LTL network differ from other transportation networks (if at all)?**

Scuttleblurb: An LTL will have service centers strategically placed throughout the country or a region. Each of those service centers will employ pickup and delivery (P&D) drivers, who are assigned a specific territory - so a P&D driver employed by a service center in Boston might be responsible for pickups and deliveries in Cambridge, for instance. Those drivers will deliver freight in the morning, pick up freight throughout the day, and drop off their pickups at the service center at the end of the day.

Sticking with this example, at the Boston service center, dock workers will then combine Shipper A's (MATT'S AUTO PART COMPANY) pallets with those from 2 or 3 other shippers ([illegible]'S BIKE COMPANY and JANET'S GLASS COMPANY). The combined load is put on a trailer at one of, say, 100 loading bay doors in the case of a large service center. Then a line haul driver will take this truckload to another of the LTL's service centers in, say, Chicago, where the Shipper A's pallets are again combined with pallets from other customers brought in from other service centers. Those shipments are put on another linehaul truck headed to the LTL's service center in Los Angeles. From there, in the morning, a P&D driver will take Shipper A's freight to its final destination - a warehouse or a construction site in South LA. That's just one example. Not all shipments involve an intermediate service center. Some go from the origin terminal to the destination terminal but in all cases, with LTL you're talking about combining freight from multiple shippers at service centers.


*Source: Flock Freight*

So whereas a truckload operation can be as simple as a truck driver with a trailer full of goods from one shipper traveling from point A to B, an LTL operation has service centers where pallets of freight are aggregated; P&D drivers who pickup and the deliver freight in a local service area; dock employees at the service center who combine pallets; and linehaul drivers who transport freight from one service center to another. This is a capital intensive business with high fixed costs. LTLs need to acquire a fleet of tractors and trailers, they need to lease or, in Old Dominion's case, outright own service centers, and then also bear the costs of driver and dock worker wages.

The key to scaling these fixed costs is density and efficiency. You want P&D drivers making as many pickups as possible along a given route. You want the right kind of freight, with pallets holding goods that are tightly packed together, with geometries that maximize trailer space so you're not just moving air. You need dock workers who can unload and move pallets quickly without damaging freight. You need linehaul trailers maximally loaded with shipments. This is not the kind of thing that can be replicated all at once. It takes time to win credibility with shippers, to train dock workers to handle freight, and to build density in P&D routes and linehaul lanes. The barriers to entry are huge but so are the barriers to scale.

Matt: **The point-to-point simplicity of Truckload versus the network complexity of Less-Than-Truckload. And how would you compare the LTL network to a parcel network like UPS/FedEx?**

**Scuttleblurb**: Parcel delivery deals with small packages, typically less than 100 lbs compared to 1,000 to 2,000 lbs for an average LTL shipment. In parcel, a UPS of Fedex driver might pick up packages along a route and bring those packages to a hub. At the hub, those packages are placed label-up on conveyor belts where they are scanned and routed to a truck alongside packages from other shippers, all headed to the same zip code.

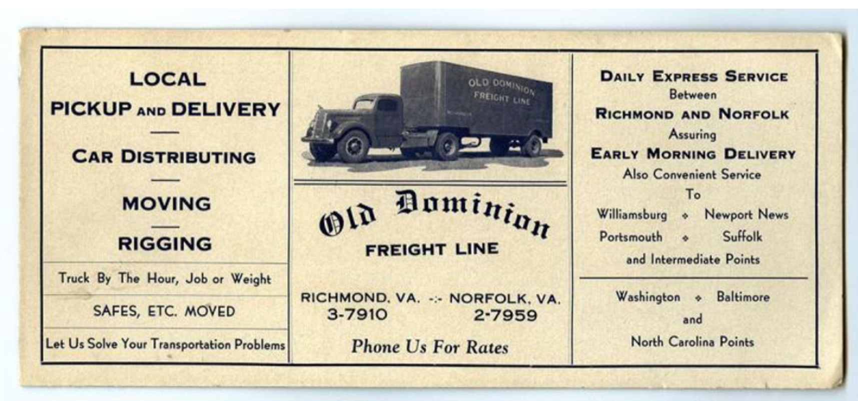
So the general workflow of sorting and re-combining packages is similar and certainly scale economies and route density are important to both LTL and parcel. But LTL is further upstream from parcel, it handles pallet-sized shipments rather than small packages, and delivers to warehouses, factories, and other commercial establishments rather than residences. Except in certain rare cases, you won't see an Old Dominion truck roaming around your neighborhood. For the most part, LTL is a B2B business, with most of the industry's volumes come from the industrial sector. Though interestingly, for Fedex LTL also acts as a complement to parcel delivery. Fedex actually runs the largest LTL in the US and they use it to support ground and express delivery operations.

Matt: **Earlier you attached LTL to just-in-time inventory management. Does the history of LTL coincide with the just-in-time movement (which I tend to align with Toyota and the 1970s)? I'm curious to know how much that market has been growing or shrinking relative to Transportation as a whole.**

**Scuttleblurb**: The LTL industry precedes just-in-time. Many of the major LTLs - like Old Dominion, ArcBest, Estes Express, Yellow, Roadway (which is part of Yellow) - were founded in 1920s and '30s. They didn't live up to their potential for a long time because the trucking industry was heavily regulated until the Motor Carrier Act of 1980. Before then, carriers were limited in what they could ship, where they could ship, and the prices they could charge. Freight trucking was expensive and inefficient.

Interstate and intrastate regulations were peeled away in the '80s and '90s, ushering in more price competition and better customer service. Many players went under during this time. There were 528 LTL carriers in 1976 and just 159 carriers in 1989. Of the 60 largest LTLs in 1980, only 8 were still around by 2003. The ones who survived did so by building lane density, operating efficiently, pricing adequately, and providing superior service.

Since 2003, trucking revenue has grown by around 1.5%-2% a year. In LTL, which is a subset of trucking, revenue has expanded by just over 3% a year. But it's a bit tricky to disentangle LTL from Truckload revenue because historically, LTL would absorb spillover volume from Truckload - excess volumes would flow into LTL when Truckload capacity was tight and then come flowing out of LTL and back into Truckload when Truckload capacity was loose. So the two segments were tied together to some degree and the highly cyclical dynamics of the Truckload industry therefore infected LTL. This spillover effect still happens but to a lesser extent I think compared to 10 years ago.




*Source: ODFL*

Matt: **It's noteworthy that 1980s regulation was a gamechanger for Rails as well. Both subsectors saw serious consolidation of operators.**

**When you see these trucks on the highway (LTL and TL) they all look the same. But the differentiation really comes when they are not on the road. That loading/unloading ... nt which is capital intensive and operationally challenging – but also a major barrier to entry for competition. I'm just repeating what you've already said but I think it's i... sting how often sub-industries are hard to perfectly measure.**

**I find it noteworthy that FedEx is the market share leader in LTL. Is that a one-off or is the market-share table dominated by diversified operators? And when it comes to the customers – how do you think about the benefit of a LTL/parcel bundle versus ODFL's pureplay LTL offering?**

**Scuttleblurb**: The top 5 LTLs in the US by revenue are Fedex Freight, Old Dominion, XPO Logistics, Estes Express, and UPS Freight. So the two largest parcel companies in the US also both happen to be top 5 LTLs. Other than that though, within the top 10, each of the rest are for the most part pure LTLs.

There isn't much evidence to suggest that bundling parcel has spillover benefits for LTL. UPS took a large impairment charge on LTL a few years ago, then sold the business to TFI International last year for a beat down revenue multiple. Fedex Freight has historically had operating margins in middle of the LTL pack. And the best operator in the space, Old Dominion, is a pure play LTL. LTL was only about 3% of UPS' revenue, more like 10% for Fedex. It's dwarfed by what those companies realize in ground and express, which makes you wonder how much they're focused on optimizing LTL on a standalone basis.

On a related note, there are other examples of LTL carriers bundling services to provide "end-to-end" service for customers. Conway, in addition to LTL, also ran a multi-modal freight brokerage, contract warehousing, and truckload. And before they were acquired by XPO, they were losing revenue share and had mediocre margins. ArcBest also runs a truckload brokerage and other asset light logistics services. They've also lost some share over the last 6-7 years and have worse operating margins than most of their publicly traded peers. XPO started out as a capital light truckload brokerage rollup, then acquired their way into intermodal and last mile logistics. They got asset-heavy with their acquisition of Norbert, a contract logistics company, and then Conway, an LTL, with this grand vision of providing comprehensive supply chain logistics to shippers all around the world. But they then unwound the whole thing. They spun off contract logistics business as GXO Logistics, they sold intermodal, and now they're spinning off truckload brokerage, the business they started with. And today they're a pureplay LTL.

So you'd think there'd be some synergies across these logistics modes but for whatever reason it doesn't seem to have played out that way.

**Matt: Oh there will be an XPO Breakdown someday. Brad Jacobs is the James Cameron of CEOs. Once a decade he enters a new industry, and leaves you with Terminator, Titantic, or Avatar in the form of billion-dollar businesses. Quite the allocator.**

**Scuttleblurb**: The James Cameron comparison is a good one. XPO did a great job with Conway. They bought the company at a terrific price in 2015 and have since doubled the margins. United Rentals, another Brad Jacobs production, is also an interesting company that's created lots of value.

## Why ODFL is Objectively the Best

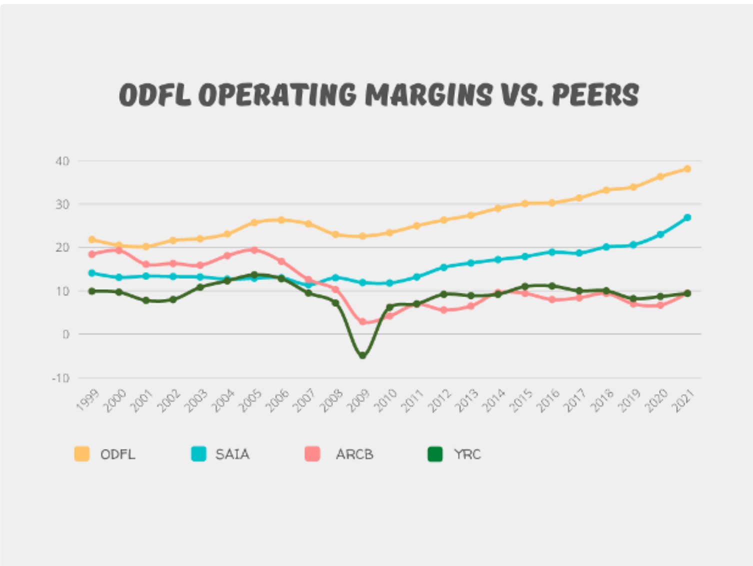
**Matt: You earlier referenced ODFL as "the best operator in the space". Can you quantify that? And maybe elaborate on what "the best" means for this industry?**

**Scuttleblurb**: I'm not the only one declaring Old Dominion the best operator in the space. SAIA has also called them the best run LTL. You know you're doing something right when a close competitor explicitly calls you out on their earnings call as an aspirational benchmark.

Quantitatively, pick a metric, any metric. They have the highest on time performance and the lowest claims ratio (the claims ratio being the percent of shipments with claimed damages). They've taken more share than anyone else over the last decade and command the highest operating margins by far. Last year, their service centers on average did 60% more profits of the next most profitable public peer, Fedex.

In freight transportation there's a metric called operating ratio, which is just operating expenses divided into revenue - you talked about this in your excellent breakdown of Union Pacific - it's basically a measure of operating efficiency, the lower the better. Old Dominion has an OR of just 72% on a trailing 12 months basis. The next most efficient peers, Fedex and SAIA, are in the low-to-mid 80s. If you rewind to 2007, among the publicly traded LTLs, operating ratios were bunched together in the low-to-mid 90s. Everyone has gotten better since then, but Old Dominion has shown the most dramatic improvement by a mile.

This has translated into stunning returns on capital. In the decade through 2021, they've grown EBITDA by $1.3bn against an additional $3.5bn of gross capital, implying 35-40% pre-tax returns on incremental capital.




*Source: Company Reports*

**Matt: And what is ODFL doing differently to achieve this?**

**Scuttleblurb**: I think a good point of comparison is Yellow, formerly known as YRC. Yellow is on the other end of the operating spectrum. In the early-to-mid 2000s, they spent billions acquiring two other LTL carriers, got into asset light brokerages, and were exploring JVs in China, trying to do the end-to-end logistics thing.

Instead, they found themselves with overlapping terminals, duplicate routes, and too much management overhead. Service levels were terrible. It also doesn't help that they have a unionized workforce, which puts restrictions on how they operate and keeps them distracted with adversarial labor negotiations. Their former CEO retook the reins in 2011 to turn things around but didn't make much progress relative to peers by the time he left in 2018. Yellow is still very much at the bottom of the heap. Whereas Old Dominion is doing close to 30% operating margins, Yellow was doing low-single digits. They were close to bankruptcy twice and were rescued by the government both times, kept afloat by TARP rescue fund during the GFC and a $700mn pandemic relief loan in 2020. They've been in perpetual restructuring mode for more than a decade. EBITDA add-backs up the wazoo and a carousel wheel of new management. It's been a mess.

Matt: **Mistakes in capital intensive businesses can be particularly painful. Those two (ODFL and YRC) are certainly a tale of two cities…**

Scuttleblurb: Old Dominion is the complete opposite. They have a clean balance sheet. They haven't been distracted by huge, transformative acquisitions. They have a union-free workforce and an aligned management team. I spoke to a few of their sales guys 6 or 7 years ago and if I recall both had nearly all their 401k's in Old Dominion stock. And ownership seems widespread among the rank-and-file. Almost 40% of Old Dominion's 401(k) retirement plan investments was parked in Old Dominion stock at the end of last year.

Unlike Yellow, Old Dominion also enjoys institutional continuity. The Congdon family has continuously operated Old Dominion since its founding in 1934 and owns 18% of the stock. The founder's son, Earl Congdon Jr. ran the company for 45 years. Earl Jr.'s son then took over as CEO for 11 years and now Chairs the Board. The current CEO, Greg Gantt, has been with the company since 1994.

That senior management longevity and alignment, along with financial incentives down the ranks, has preserved a very disciplined way doing things. They have strict profitability targets for every account and are selective about the kind of freight that they're willing to accept. The bonuses that service center managers earn are in large part tied to profitability and service levels.

During the last financial crisis, Old Dominion was one of the few players who refused to engage in destructive rate cuts. They lost some customers by staying firm on price, but many of them returned because other carriers couldn't offer the same level of service. One of the things Old Dominion gets better than most is that at the end of the day, this is a service business and you can't offer great service unless you have the cash flows to maintain it. Old Dominion isn't the cheapest service provider but they offer the best value. They have a deep understanding of their costs and price at levels that ensure healthy profits. They then recycle those profits into service centers, tractors, and trailers to better serve customers. If you look at their capex as a % of revenue, it's averaged about 13% of revenue since 2003 compared to around 2% for Yellow and ArcBest, and 8% for SAIA. By consistently investing in capacity to provide top notch on time service to customers they've take share from competitors, driving lane density and operating leverage, resulting in more cash flows which are then reinvested in capacity, leading to more share gains. Classic flywheel stuff.

Matt: **Everyone knows "flywheel" can be overused – but seeing 10+ years of this playbook, high investment driving higher margins, really solidifies the point.**

Scuttleblurb: And they're unique in this respect. Hamilton Helmer popularized the idea of counter-positioning on strategy. Well, I think Old Dominion is an example of a company that counter-positions on culture. It's hokey to talk about culture, but it's a legitimate moat if it translates into differentiated behavior. And you see that in Old Dominion. These guys are thinking in decades when most are playing for quarters. They were the only one of public LTLs who opened service centers through the last recession and were rewarded with share gains during the recovery. The number of LTL service centers for the industry as a whole has contracted over the last decade while Old Dominion has grown its service center footprint by 16% and its door count by 50%. Even today, when everyone is freaking out about recession and inflation, they continue to invest in growth because that's the right thing to do for the long-term health of the business and there's a long lead time for new capacity.

Consistency in service commitment is paramount because there are feedback loops to [illegible]. You can imagine an LTL that takes short cuts - rather than invest in trucks and trailers and employ their own drivers, they start to rely on third party carriers, they don't invest ahead of demand but try to maximize their margins instead. So then service deteriorates, customers take their shipments elsewhere, the LTL de-leverages their fixed costs, doesn't have the cash flow necessary to build capacity, morale deteriorates, the unions come knocking. Once you find yourself in that position, it's very hard to come back, especially when competing against someone like Old Dominion who's compounding its scale advantage by doing the exact opposite.

## History of the Firm

Matt: **You mentioned the cultural challenges presented by union negotiations. What has allowed ODFL to avoid unionized labor? And does that present a long-term threat?**

Scuttleblurb: Old Dominion has had several sordid and even violent run-ins with the Teamsters that goes all the way back to the 1940s. They acquired a company called Bottoms-Fiske that operated as a separate subsidiary and that voted to be unionized in 1959. Management rejected the labor contract and things got ugly. Drivers were shot at. Their family members were threatened. Drunk picketers harassed employees. This went on for more than a year but eventually people wanted to get back to work and the strikes broke. There's a coffee table book about Old Dominion's corporate history called Helping the World Keep Its Promises that gets into some of this.

A bunch of unionized carriers went out of business after deregulation. They just couldn't compete. In tough times, a non-unionized carrier like Old Dominion can assign a linehaul driver to P&D or to handle freight on the dock, depending on need. Unionized LTLs don't have that kind of flexibility. In 1994, the Teamsters organized a huge strike and non-unionized carriers like Old Dominion were big beneficiaries of that.

We can argue about the chicken-and-egg effects of unionization: does poor performance lure unions or do unions cause poor performance? But the fact that Yellow and ArcBest are two most unionized public LTLs and also the two least efficient and slowest growing LTLs is probably no coincidence. Unionization is an ever-present threat but what I'd say is that the best way to avoid unions is to win. People want to work for winning companies and winning companies take care of their employees and are in a better financial position to take care of them too.

Matt: **Well said. We've seen examples where businesses with union labor succeed (Rails and to a lesser extent, UPS)… but when performance drops off, union labor businesses have a way of spiraling.**

**You also mentioned they have largely built organically - is there any history of acquisitions?**

Scuttleblurb: Yes, there's a history of acquisitions, they've done maybe a few dozen over their lifetime, but not the big splashy sort. These have been small tuck-ins and asset purchases. Since 1990, I think the biggest acquisition they did relative to their size at the time was Goggin in 1998. That was a $58mn revenue company and at the time Old Dominion was doing close to $400mn in revenue. Wichita Southeast Kansas was bigger in absolute terms, that brought $68mn in revenue, but Old Dominion was doing over $800mn by then. Some of these purchases were opportunistic. For example, they were able to pick up a lot of terminals in the Midwest from Consolidated Freightways at very favorable prices when that company went under in 2002.

In the 80s, they did some truckload acquisitions but they either liquidated or divested the truckload operations such that by the time they went public in 1991 they were almost entirely focused on LTL. And the 10 or 11 tuck-ins they did after the IPO were LTLs as well. I don't think they've done any acquisitions since 2008.

Matt: **We won't say correlation is causation – but it's worth point outing that so much of the compounding (from $7/share to over $250/share) has come after 2008. You've**

**referenced the Congdon's a few times now. They are well known by the Transportation community but lesser known to public market investors. What were their defining characteristics?**

**Scuttleblurb**: Old Dominion does about $6bn in revenue with 255 service centers and 10k trucks. But this significant enterprise started in 1934 with a single truck and one route from Norfolk to Richmond, funded $1,700 of seed money from Lillian Congdon, wife of Earl Congdon Sr. They used their home as a "service center", then leased space from a local grocery store. In the ensuing 88 years, they've grown the business profitably despite all sorts of challenges related to unions, deregulation, intense competition, and economic cycles.

Earl & Lillian Congdon

*Source: ODFL*

There can be a tendency to explain business success in a simplistic, reductionist way when in fact lots of things had to go right, but having said that a common theme throughout the Old Dominion story is how a lot of the things that the company's done right have been downstream of a close-knit family culture. I don't want to overplay this hand - the Congdon's no longer control the company and it's a bit silly to talk about an organization with 24k employees as a family. I just mean to say that far more so than other LTL carriers, the founding family has managed to instill a sense of pride and ownership in the reputation and legacy of this company, and in what the Old Dominion name represents. The family has built an organization around the value of exceptional service. That core value has been preserved and transmitted through the longevity of this management team and the continued involvement of Congdon family.

Offering great service requires a cohesive workforce that will take care of customers knowing that Old Dominion will take care of them in turn, as well as the ability to act long-term even when it's hard. Old Dominion didn't cut wages and benefits during last recession when most others did. They stayed disciplined on pricing when everyone else was cutting rates to acquire volume. In doing so they maintained their high service levels and were the only public LTL that remained profitable in 2009….and while they lost customers by refusing to engage in price competition, they were able to reinvest their profits in more capacity and take share in the recovery. They were early to invest in driver safety technology, training programs, freight handling systems…things that yield long term service benefits but consume time and money upfront. And success breeds success. A workforce that rallies under a shared value produces great outcomes for customers and there's nothing better for morale, cohesiveness, and compensation than playing for an elite, championship team.

## Economics of the Business

**Matt: Another chicken-and-egg dynamic – but I think most that have experienced "strong culture" would defend its merits.**

**We can switch a bit to the economics of the business. How do you think about the unit economics or earnings equation for ODFL. I assume this is somewhat of a GDP+ type revenue line. How do you think about price and volume relative to GDP And inflation? And are there key areas that would allow for the margin profile to materially change? I assume fuel is a pass-through? Have they been able to offset wage inflation?**

**Scuttleblurb**: It's PxQ. How many tons are you moving through the system and how are you pricing for those tons.

Pricing is critical here. For every 1% reduction in price, they've got to grow volumes by 4%-5% just to maintain earnings and by 8%-10% just to keep their operating ratio flat.

**Matt: Operating leverage works both ways, eh?**

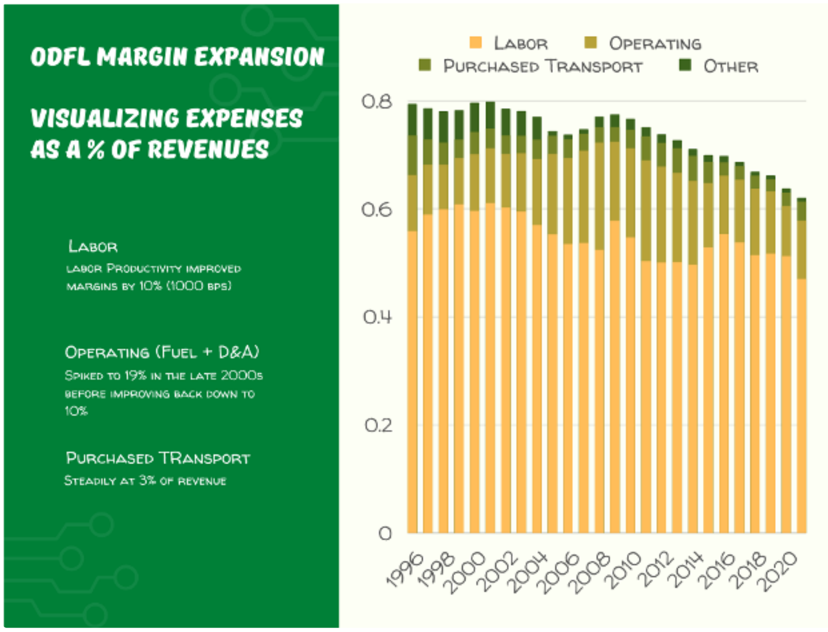
**Scuttleblurb**: That's why management is so adamant about staying disciplined on price. Below the revenue line, the biggest cash costs are salaries and wages, which is about half of revenue, and operating supplies and expense, the largest component of which is fuel expenses, and that's anywhere between 10% to 15% of revenue.

As you say, this is a GDP+ business. There isn't some huge secular tailwind lifting all boats. Old Dominion outpaces the industry over time by taking share and they take share by providing superior service, and they're able to provide superior service by refurbishing the equipment and investing in capacity, which they do by generating healthy profits, which comes from remaining disciplined on price and knowing their costs.

Everyone passes through fuel. Whether they can pass through other forms of cost inflation is a function of supply/demand dynamics at the time, as well as industry discipline. Old Dominion prices at a premium to peers because they offer better service and they've historically priced about 1-1.5% ahead of its cost inflation, but it's a step too far to say they have pricing power in the sense that they can keep raising prices every year like clockwork and keep all their volumes.

Through the business cycle, margin improvement comes from productivity gains and fixed cost leverage but otherwise these cost items as a percent of revenue can fluctuate quite a bit depending on the macro and how disciplined other carriers are.

Salaries and wages over the last 10 years have gone from 55% of revenue to 45%, but it's hardly been a straight line. It went from 55% in 2010 to 50% in 2015 back up to 55% in the mini industrial recession of 2016 before going all the way down to 45%. We happen to be in a very tight freight environment over the last year, the LTL industry has been running at close to full capacity, so carriers have been able to push through rather significant rate increases.




*Source: Company Reports*

There's a metric called "revenue per hundredweight excluding fuel surcharges" that is often used as a proxy for price - it's not perfect because there are mix issues and length of haul nuances that muddy the picture a bit - but for Old Dominion, XPO, and SAIA, it's up anywhere between high single digits and mid-teens over the last year or so.

But make no mistake, this is a cyclical business so it's important not to get too carried away and extrapolate out too far. In the past, OD's operating ratios have fluctuated around quite a bit. In the early 70s they were just below 90; in 1986 it was close to 100 (meaning they barely broke even). They jacked up pricing and got smarter about double checking freight weight, got their OR back down to the low 90s by the time they went public, then they lost ground again in 2009….anyway you get the idea.

Over the last 10 years, besides a few soft spots in 2016 and 2019, OD's OR has been basically a straight line down and the whole industry has seen dramatic OR improvements as well. But times have been good. The industry hasn't been tested in over a decade. COVID came and went like a far in the wind. It's easy to stay firm on price when demand is strong. The industry is more consolidated and appears more price disciplined than it has in the past, so maybe industry profitability looks like an upward sloping sine wave with shallower peak-to-troughs but we'll see.

Matt: **And how are rates/pricing determined? Are these long-term shipping contracts? Are they moving freight with a spot rate?**

Scuttleblurb: Somewhere around 75% of Old Dominion's business is contracted, typically under 1-to-2 year terms I believe. The remainder, and this applies to smaller customers who don't have the volumes to enter into contracts, are priced off a matrix called a tariff that lays out rates for different combinations of origin and destination zip codes, weight and freight types. Those schedules are subject to what's called a general rate increase (GRI) that is imposed once a year, sometimes more than once depending on the environment.

Matt: **I think there's an easy understanding of demand risk or macro risk here. You also have a risk that they lose their culture or have some self-inflicted wounds. But how do you think about the risk of competition?**

**Would you worry most about incumbents like SAIA? Is there potential for more businesses to bring the supply chain in-house? Is the big-bad Amazon a looming threat?**

Scuttleblurb: Amazon currently partners with third party LTL carriers for heavy shipments, sellers can use these LTLs to get their inventory to Amazon fulfillment centers. Of course because they're Amazon they get favorable pricing from those carriers. Now they're starting to handle logistics for non-Amazon sellers as well, so it wouldn't surprise me if they in-house LTL just as they've in-housed parcel.

For Old Dominion, retail is about 25% of their business, that's up from 15% 5 or 6 years ago. E-commerce has been a tailwind for them, as it has for many other LTLs. But 60% of Old Dominion's business is industrial and Amazon, as big as they are, is still just around 10% of US retail, so in the event that Amazon gets into LTL, the impact on Old Dominion should be somewhat muted. But then again, they might be willing to loss lead on LTL and they're now providing logistics as a service, so it's something to keep an eye on. You can never discount Amazon. The boundaries of that company are hard to define and always expanding.

Matt: **Amen. You can never discount Amazon.**

Scuttleblurb: The more salient issue though is that the LTL industry as a whole has upped its game over the last decade. Everyone has a more granular understanding of their unit costs. They're taking freight dimensions as well as weight into account in pricing decisions and after living through horrific experience of the last recession, everyone is very much focused on staying price disciplined and earning their cost of capital. Under Brad Jacobs' leadership, XPO has put in dynamic pricing technology and is now charging special fees to customers who ship awkwardly sized freight and hold up their trucks at pickup and delivery. TFI is re-pricing UPS' contracts towards their goal of getting to a 90 OR in the next 2 years. Knight Swift is now a top 20 LTL after acquiring AAA Cooper and MME, and they're pricing for mid-80s OR.

SAIA is a particularly interesting competitor. They expanded rapidly in the early 2000s but didn't have a good grasp on their costs and suffered losses during the last recession. Coming out of the recession, they halted growth and focused on profitability. In 2014, with their margins surpassing pre-crisis levels, they began investing in growth again. These days, they sound very much like Old Dominion. Their message now is excellent service at fair prices. And so as LTL carriers repair their operating ratios, they're going to start reinvesting in growth because that's a key component of offering great service. XPO is taking their capex from 5% of revenue to around 8-9%. SAIA is now actually opening more service centers per year than Old Dominion.And if you look at tonnage growth from 2016 to 2021, SAIA has grown by about 9%/year compared to 5% for Old Dominion. So as the industry becomes more profitable and invests in more capacity, you wonder what that added capacity could mean for pricing when demand falls off as it inevitably will.

So industry discipline is kind of a double edged sword for Old Dominion given how far ahead of the peer group they are. Everyone is more price disciplined and I think that is good for the industry as a whole but it also narrows the competitive gap between Old Dominion and the others. It's probably fair to say that the service gap will narrow to some extent as other players get their act together. Old Dominion has 99% on time delivery, that's up from 88% in 1989. They report claims ratio in basis points not percentage points and their OR is now a touch below 70 now. They're doing low-30s after-tax unlevered returns on capital. I can't think of anyone in freight logistics industry putting up those kind of returns. Old Dominion will keep getting better of course but they're probably closer to hitting a plateau than others just given how exceptional they already are.

Matt: **That "relative" plateau often explains why not all great businesses end up being great stocks.**

**With that lens - I'm curious how you'd think about valuing a business like this? You don't have to take a view on the stock - just curious if you have a method for valuing this cyclical business that seems to outperform its cyclical peers...**

Scuttleblurb: The standard way of valuing cyclicals is as a multiple of mid-cycle earnings but the LTL industry is a little weird in that:

1. it's not a pure commodity, customers will pay up for service and

2. you have a mix of structural winners and structural losers who have different experiences in a recession.

It's not a homogenous peer set. I think the union-free players, Old Dominion and SAIA, will continue to take share from unionized companies like Yellow and ArcBest. The latter two still have 17% market share, so share gains should help prop up Old Dominion's volumes to some degree irrespective of the macro. So the way I see it, the LTL industry is still cyclical but less cyclical than it's been in the past and less cyclical than full truckload; and then within the LTL space, because of share gains and productivity gains Old Dominion is somewhat less cyclical than the LTL sector overall.

When I look at cyclical compounders like Old Dominion, rather than being precise about valuation, I just try to avoid the extremes. Whether we are at an extreme today is a valid concern in my opinion. LTL profits have surged higher over the last 2.5 years. Old Dominion's profits have doubled over that time and its stock is trading at a near peak 26x multiple on those peak earnings, so it seems expensive to me on an absolute basis and even more expensive relative to other opportunities.

Now, Old Dominion has always traded at a premium valuation and you could have paid 25x earnings for Old Dominion in 2012 and still compounded by 20%. Except it's not 2012 is it? It's 2022. We're not in the early stages of recovery. Old Dominion's margins aren't 13%, they're 30%. Its returns on capital have doubled to levels that are unprecedented in the transportation sector. Meanwhile, LTL peers have gotten smarter and are working hard on closing the competitive gap. In short, Old Dominion trades like the exceptional company that it is.

Matt: **This has been great as both an overview on trucking and on a best-in-class business.**

**We close out these conversations with "lessons" – what are the major lessons you've taken away from evaluating Old Dominion? Higher level takeaways that you might apply when looking at other investments?**

Scuttleblurb: Yea when investors talk about compounders most of the time that's just code for "I'm looking for stocks that go up 15%-20% a year consistently with low variance". But the real compounding takes place way beneath the surface, it's not from guys like me buying and selling the stock, it comes from people in these organizations consistently getting better and more efficient at serving customers. You can try to predict the weather or you can make sure your house is built on solid ground, and that the people living in that house are reinforcing the foundations every day. Stocks will do what they do and the cycles will come and go.

Old Dominion is certainly not immune to the industrial cycle and has seen its profits fluctuate from one year to the next as a result. But underneath all that is an invariant commitment to superior service and doing all the things that entails - understanding your u[illegible]osts, pricing responsibly, taking care of your people, investing in capacity even in hard t[illegible]. The financial outcomes from those decision can be swamped by the macro in any gi[illegible] year or two but they don't go away, the compound to enormous value creation over t[illegible]

Matt: **Thank you so much David. ODFL is clearly a business worth studying.**

Scuttleblurb: Thanks Matt. This was great.