

Expeditors International of Washington, Inc. EXPD [XNAS] | ★★★★★

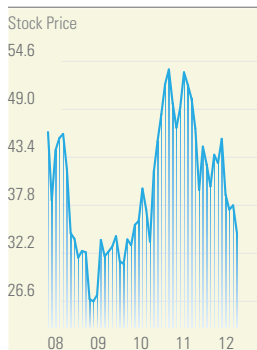
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
37.03 USD	51.00 USD	35.70 USD	68.85 USD	Medium	Wide	Exemplary		Integrated Shipping & Logistics

Airfreight Weakness Persists in Expeditors' Second Quarter

by Matthew Young, CFA
Equity Analyst
Analyst covering this company do not own its stock.

Pricing data through Aug 14, 2012.
Rating Updated as of Aug 14, 2012.

Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Aug. 07, 2012

Expeditors' EXPD second-quarter gross revenue fell 5% from the same period last year, below our forecast due in part to sluggish airfreight pricing and a moderation in customs brokerage growth. The revenue decline relative to last year was mostly driven by persistent weakness in airfreight demand, which more than offset modest gains in ocean freight activity and a slight 1% increase in customs brokerage. Airfreight tonnage fell 10%, similar to the 9% contraction posted in the first quarter. Overall, customers are moving smaller shipments as they manage inventories to uncertain demand and sluggish global economic conditions. Lower levels of special-project business and customers' down-shifting to (slower, but less costly) ocean freight also contributed. In each month of the quarter, the firm posted year-over-year airfreight volume declines of 17%, 7%, and 6%, respectively. Ocean volume was up 1% with improvement throughout the quarter--it fell 1% in April, but increased 1% in May and 3% in June.

Net revenue (gross revenue less purchased transportation) was down 4%, slightly less than the gross revenue decline due to 30 basis points of gross profit margin gains. That said, ocean yields fell more than 200 basis points as carriers are managing supply and raising rates in an attempt to reclaim profitability--it takes time for Expeditors to pass those increases along to customers. Total operating margin (off net revenue) fell 300 basis points to 29.2% partly because of lost leverage from softer shipment volume. Although the company operates a nonasset based model, it has a history of maintaining network service capabilities throughout difficult markets. During the 2009 freight recession, it avoided layoffs (despite pressure to cut costs) to ensure the network was positioned to gain share during an eventual recovery. That strategy paid off in 2010, and we would expect the same outcome when airfreight markets improve this time around.

We adjusted our model to reflect weaker-than-expected revenue trends during the second quarter, but we do not expect to make significant changes to our fair value estimate.

Thesis Jul. 19, 2012

Expeditors International ranks among the top-10 global freight forwarders in a fragmented industry, and the firm's track record of impressive financial performance leads the pack. It operates about 250 offices on six continents, with a core focus on Asia-North America trade lanes. As an international forwarder, the firm contracts with airlines and ocean carriers for cargo space then fills that capacity with customers' freight. Importantly, Expeditors' non-asset-based model mitigates margin pressure during periods of anemic freight demand--operating margins (off net revenue) contracted only 170 basis points in 2009 during the freight recession. It also holds a mountain of cash, owes no debt, and produces solid cash flows.

As with other third-party logistics (3PL) providers of scale in our coverage universe, we think Expeditors benefits from the network effect, which provides a wide economic moat capable of defending long-run profitability from the competition. Cargo airlines and ocean carriers benefit from its ability to act as a key source of freight demand, and shippers leverage its significant buying power, while outsourcing the complex tasks of international shipping (communicating in multiple languages, clearing customs, etc.). Furthermore, the firm's global office network becomes more valuable since each location now has a larger geographic reach with which to arrange trade.

Expeditors' geographic scope extends well beyond the U.S., but we think the North American 3PL landscape provides insight into global industry trends. While moderating economic growth and financial disruption in Europe are pressuring international air and ocean freight flows, we think long-term trends remain favorable. We estimate that the \$130 billion-plus North American outsourced 3PL market (including truck brokerage, international freight forwarding,

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
United Parcel Service Inc (UPS)	USD	73,014	53,817	6,222	3,883
FedEx Corporation	USD	27,728	42,680	3,186	2,032
Deutsche Post AG	EUR	18,843	53,386	2,498	1,371
UTi Worldwide, Inc.	USD	1,412	4,864	133	77

dedicated contract carriage, and warehousing) will expand at a multiple of GDP growth over the next five years. This follows impressive average annual growth of 10% between 1996 and 2009, according to data from Armstrong & Associates. The first year-over-year decline in outsourced logistics spending on record was in 2009 (down 16%), although the market recovered nicely in 2010 and 2011 (up 12% on average). The industry expands with international trade, global sourcing among manufacturers, and logistics outsourcing--especially as it relates to international freight forwarding. As the supply chain becomes more of a competitive differentiator (facilitating faster inventory turns and mode optimization), we think demand for outsourced 3PL solutions will persist. Importantly, North American 3PL providers still have a relatively small share of the market, capturing less than 10% of transportation and logistics spending; this number is closer to 8% on a global basis. Additionally, a recent study conducted by Capgemini suggest that two thirds of large shippers (or at least of those polled) are increasing their use of 3PLs, while half are consolidating the number of providers used--factors that bode well for top forwarders like Expeditors.

Expeditors enjoys a long history of consistent net revenue expansion (13% on average during the last decade) and industry-leading profitability, partly because of its emphasis on organic growth, which has enabled it to build a cohesive network and consistent culture. This is in contrast to many of its freight forwarding peers that have grown by acquisition. Given the firm's record of impressive execution and wide-moat positioning, we expect it to capitalize on favorable industry trends in the long run, despite cyclical fluctuations in freight demand and increasing competition. Additionally, we believe Expeditors will continue taking

market share from smaller, less capable providers as demand for sophisticated supply-chain technology and access to flexible capacity expands.

We think corporate culture is a key component of Expeditors' strong performance record. Salesforce compensation is predominantly commission based (with below-average base salaries), and managers' bonuses are tied to their branch's net revenue growth and operating profit, thus making for a profit-conscious setting. The firm's entrepreneurial culture does not drive our wide moat rating (since it can be replicated), but Expeditors leads its peers in terms of executing this strategy. We also like that executive management is fiercely independent, operating and expanding the firm as it deems best, rather than catering to short-term operating metrics or transitory market opinion. For example, the firm avoided layoffs throughout the 2008-09 freight recession despite pressure to cut costs, choosing instead to maintain its robust service capabilities and rely on natural attrition--it reaped record earnings in 2010 as the market recovered, thanks to its still intact network. Overall, Expeditors' impressive performance over time confirms the wisdom of its long-term strategy.

Valuation, Growth and Profitability

As we transition coverage to a new analyst, we have reduced our fair value estimate to \$51 per share (from \$61) partly to account for continued pressure on international air and ocean freight flows driven by slowing global economic growth and the debt crisis in Europe. Based on commentary from Expeditors' management and several of the firm's peers, we anticipate sluggish freight volume over the next year.

For 2012, we anticipate low-single-digit gross revenue expansion, as sluggish airfreight activity tempers modest growth in ocean shipments and customs brokerage. We model slightly less net revenue progression due to pressure on yields from rising carrier rates on ocean business--ocean liners are pushing rates up in an attempt to restore anemic profitability. We forecast 140 basis points of operating margin contraction (off of net revenue) in 2012 because of

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weak market conditions and the related drag on productivity. Looking out through 2016, we project 10% annual net revenue growth on average, supported by positive secular trends in third-party logistics outsourcing, and a recovery in airfreight conditions in later years. This is modestly below the 12% average annual net revenue expansion posted during the last decade, driven in part by the lack of a near-term catalyst for airfreight improvement. We are modeling operating margins near 34% by 2016, versus slightly less than 33% in 2011.

Risk

Cyclical declines in global trade reduce Expeditors' core airfreight and ocean-container volume, thereby decreasing revenue and profits. The firm's asset-light model provides the flexibility to better match expenses with demand, but also subjects Expeditors to variations in available carrier capacity (and fluctuations in gross profit margins). Exposure to currency exchange risk is inherent to international shipping. Additionally, current government-related investigations into alleged anticompetitive behavior in several freight-forwarding markets across the globe (including the U.S. and Europe) could compromise margins by way of additional penalties should the firm be found at fault. We note that earlier this year the European Commission fined Expeditors \$5.5 million for alleged anticompetitive behavior on "airfreight trade lanes between South China/Hong Kong and the European Economic Area."

Bulls Say

- Supply chains are increasing in complexity, in part because of the globalization of trade and foreign sourcing. Shippers are also paying more attention to supply-chain optimization as a competitive differentiator and source of cost savings. These factors are boosting demand for outsourced transportation and logistics solutions offered

by sophisticated 3PL providers with scale, like Expeditors.

- Expeditors non-asset-based operating model helps mitigate margin pressure during periods of anemic freight demand--it posted average returns on capital of 25% during the last five years.
- Expeditors' global footprint and vast network of shippers and carriers makes for a compelling value proposition--the firm can aggregate its buying power to reduce shippers' transportation costs, while providing carriers with an attractive source of freight opportunities.
- Because Expeditors has primarily focused on organic growth, its global IT platform is integrated and uniform, providing for greater operating efficiency than some of the firm's peers.

Bears Say

- We expect air cargo volume trends to remain sluggish through the second half of 2012, and rising ocean-carrier rates probably will temper gross profit margin improvement.
- Expeditors is subject to a variety of risks because of its reliance on international operations, including political (particularly litigation from governmental authorities) and currency risk.
- High returns on invested capital are attracting competition to the 3PL space, particularly the integrators' (namely FedEx and UPS) rising focus on outsourced supply-chain-related services. Additionally, domestic truck brokers, like C.H. Robinson, are increasingly offering international freight forwarding services to their clients.
- The firm holds cash reserves well above levels needed to conduct business. Interest income reflects a return on cash and short-term investments below capital returns from core operations.

Financial Overview

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Financial Health:Expeditors' balance sheet is in excellent shape, with no long-term debt and \$1.3 billion in cash—a sizable multiple of funds required for operations.

Company Overview

Profile: Expeditors International of Washington is a non-asset-based third-party logistics (3PL) firm, with a core focus on international freight forwarding. It employs sophisticated IT systems and contracts with airlines and steamship carriers to move customers' freight across the globe. The firm operates 185 full-service offices and 64 satellite locations worldwide. In 2011, Expeditors derived roughly 37% of consolidated net revenue from airfreight, 23% from ocean freight, and 40% from customs brokerage and other services.

Management: Expeditors' senior management team has delivered steady growth and profitability over the years, and several founders remain in the top ranks. Management wields compensation as a powerful tool, paying a relatively modest base salary to the salesforce, but offering a clear plan for substantial incentive pay. Employees have incentive to expand their branch's operating margins, so productivity and cost management are constantly in their sights. In line with the firm's emphasis on variable compensation, it paid 68-year-old CEO Peter Rose \$6.8 million in 2011 and \$6.6 million in 2010, after reducing his compensation by \$1.2 million to \$4.8 million in 2009 when business contracted. Rose's 2011 base salary was just \$110,000, while his nonequity incentive pay was \$6.7 million. Rose has served as a director and executive of the firm since 1981 and as CEO since 1988.

We appreciate that management provides clear financial reports, including publishing written responses to investor inquiries on a periodic basis. These 8-K filings often reveal

an independent, even irreverent attitude toward Wall Street. Overall, we consider management's unmitigated focus on long-term performance refreshing, and a healthy contrast to the more common preoccupation with short-term deviations. For example, counter to many of its peers, Expeditors resisted layoffs during the recession, choosing instead to preserve its network and strong service capabilities for an eventual recovery. Additionally, the firm's growth has been primarily organic, providing for a consistent entrepreneurial culture and unified IT infrastructure.

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Analyst Notes

Airfreight Weakness Persists in Expeditors' Second Quarter Aug. 07, 2012

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Net revenue (gross revenue less purchased transportation) was down 4%, slightly less than the gross revenue decline due to 30 basis points of gross profit margin gains. That said, ocean yields fell more than 200 basis points as carriers are managing supply and raising rates in an attempt to reclaim profitability--it takes time for Expeditors to pass those increases along to customers. Total operating margin (off net revenue) fell 300 basis points to 29.2% partly because of lost leverage from softer shipment volume. Although the company operates a nonasset based model, it has a history of maintaining network service capabilities throughout difficult markets. During the 2009 freight recession, it avoided layoffs (despite pressure to cut costs) to ensure the network was positioned to gain share during an eventual recovery. That strategy paid off in 2010, and we would

expect the same outcome when airfreight markets improve this time around.

We adjusted our model to reflect weaker-than-expected revenue trends during the second quarter, but we do not expect to make significant changes to our fair value estimate.

Expeditors Issues Form 8-K to Respond to Selected Inquiries; April Airfreight Tonnage Down 17% Y/Y May. 23, 2012

Expeditors EXPD filed an 8-K Monday responding to selected investors' questions. The most material takeaway is the firm's indicating April airfreight tonnage declined 17% year over year--even steeper than the 13% drop in March. Ocean container volume improved 1% in April, in line with first-quarter results. The firm indicated no industry verticals were strong, but retail, some tech, and some health-care markets were stable. Also, as in the May 7 10-Q filing, the firm attributed its low volume comparisons not only to lower global market demand, but also to lower tonnage related to certain nonrecurring projects present in the 2011 period and absent this year. Management indicates the divergence in first-quarter airfreight shipment quantity (up) and tonnage (down) is due to less project business now than in the prior-year period and smaller, more cautious shipments as air shippers keep inventory tight because of uncertain demand. It has now been about a year since year-over-year airfreight tonnage comparisons went negative at the company; absent inflection in airfreight tonnage, we don't expect Expeditors' shares to improve much from the present low level.

Low share prices have not escaped management's gaze. We normally consider Expeditors' cash to be an inaccessible hoard deployed only to pay a modest dividend (currently yielding about 1.5%) and to repurchase shares to keep the

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Analyst Notes (continued)

share count flat. However, in the Q&A, management hinted at the possibility of escalating share repurchases, writing "...we're taking more than a casual interest in what [the] stock's closing price is each day." We consider the \$1.4 billion of cash on the balance sheet a multiple of what's required to run the business, and as the firm grows organically rather than via acquisitions, we believe repurchases would benefit shareholders at the current market price well below our fair value estimate.

As Previously Announced, Expeditors' Airfreight Remains Weak and Constrains First-Quarter Earnings

May. 02, 2012

Expeditors' EXPD first-quarter airfreight tonnage indeed was weak, as management guided in its April 19 press release. While the quantity of air shipments increased 5%, airfreight tonnage declined a steep 9% from the year-ago quarter, via a year-over-year 15% decline in January, 3% growth in February, and a 13% plunge in March. Ocean volume improved versus prior-year 20-foot equivalents by 1% in the quarter with year-over-year deltas of negative 6%, positive 15%, and negative 1% in the first three months of the year; the firm grew its customs brokerage gross revenue 5.7% from the year-ago quarter. The timing of Chinese New Year clouds the January and February comparisons (occurred in January this year, was Feb. 3 in 2011), but March is anemic without this complication. All in, Expeditors' gross revenue, net revenue, and EBIT decreased by respective 3%, 2%, and 15%, and earnings per share fell to \$0.36 from \$0.42 in the first quarter of 2011. This year's values include the \$5.5 million price-fixing fine by the European Commission.

Our opinion on Expeditors has not changed. We expect its share price recovery will be catalyzed by a turnaround in airfreight volume, which headed south in the second quarter of 2011. Following the announcement a few days ago, we

tempered our projections for full-year 2012 air and ocean gross revenue growth to flat and 5%, respectively. Our \$61 per share fair value estimate is unchanged.

We believe Expeditors' wide moat remains intact. The firm does not flinch during the economic cycle, but leaves its 30-years-in-the-making network in place to capture rents during recovery. In fact, Expeditors increased head count 4.8% from the prior-year period, and we think this will help the firm win revenue in coming quarters. The firm remains free cash flow positive (cash from operations less capital expenditures) and liquidity concerns are nil--the company ended the first quarter with \$1.4 billion of cash and investments (\$6.60 per diluted share) and owes no debt. We can't time the resumption of global trade to the present quarter or the next, but when trade does recover, we're confident Expeditors will arrange it while remaining cash-flow positive and poised for recovery all the while.

We're Decreasing the Uncertainty Ratings on Many Transportation Stocks Apr. 23, 2012

We have decreased the uncertainty ratings on Class I railroads, U.S. integrated shippers, international freight forwarders, and intermodal marketing companies. This reverses our uncertainty increase in October 2011, when we observed divergent movement among various modes of freight, with trucking, domestic intermodal, ground parcels, and most non-coal railroad commodities expanding, while international airfreight, express parcels, coal, and ocean either slipped or stagnated.

We now think trends are more clear, and accordingly have narrowed our cone of uncertainty surrounding our fair value estimates. By this we do not imply all markets have recovered (airfreight is still weak and coal is abysmal), but rather that we think segment demand directions are more

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Analyst Notes (continued)

clearly established. Accordingly, we now consider the following stocks to have fair values with medium uncertainty (down from high): Canadian National CNI, Canadian Pacific CP, CSX CSX, Norfolk Southern NSC, Union Pacific UNP, UPS UPS, FedEx FDX, Expeditors International of Washington EXPD, Hub Group HUBG, and UTi Worldwide UTIW. Pacer PACR is now high uncertainty (from very high).

Expeditors Issues Guidance: Airfreight Still Weak, 1Q EPS Below Consensus Estimates Apr. 20, 2012

Expeditors International of Washington EXPD announced preliminary results Thursday that indicate first-quarter earnings per share are likely to be \$0.35-\$0.37, below current analysts' estimates of \$0.40-\$0.45 (all including the \$5.5 million fine levied by the European Commission at the end of March). Earnings will thus be slightly below the level of the first quarter of 2011. Sequential 2011 quarterly diluted earnings per share were \$0.42, \$0.44, \$0.50, and \$0.44. CEO Peter Rose cited the soft global economy and volume from existing ("particularly airfreight") customers that was lower than in the year-ago quarter. Had the \$5.5 million fine occurred in the prior-year period, earnings would have dropped about \$0.02 per share. The firm plans to report first-quarter results May 2.

While we think expectations of modest or no growth in near-term airfreight volume are already incorporated into Expeditors' share price, we wouldn't be surprised to see the stock suffer on this downward guidance--and this may provide a buying opportunity for those who share our time horizon longer than the next few quarters and our appreciation for this high-return-on-invested-capital name. As we've written several times, we expect the main catalyst for Expeditors' share price ascent will be inflection in the airfreight volume trajectory, which headed south in the second quarter of 2011, and some continuity in recent

slightly positive ocean unit comparisons.

From the announcement we conclude the positive airfreight comps are still at least a quarter distant. Accordingly, we have tempered our 2012 projections for air and ocean gross revenue growth to flat and 5%, respectively. The company ended the fourth quarter with \$1.3 billion of cash and investments (\$6.05 per diluted share) offset by no debt. We maintain our opinion that shares of well-managed, well-capitalized Expeditors are trading at recessionlike multiples and at a significant discount to our fair value estimate of \$61 per share, which remains unchanged.

Freight Forwarders Fined in EU for Alleged Anti-Competitive Behavior; We Foresee No Valuation Impact Mar. 30, 2012

Expeditors EXPD, UPS UPS, UTi Worldwide UTIW, and about a dozen other air freight forwarders were fined this week in Europe for alleged anti-competitive behavior six years ago. The European Commission fined Expeditors EUR 4.1 million, UPS EUR 9.8 million, and UTi Worldwide EUR 3.1 million for alleged unlawful price-fixing behavior. North America-domiciled firms were not the only firms fined: The commission fined two European forwarders (Kuehne+Nagel and Panalpina) the steepest amounts, (around EUR 50 million each), and fined EU operations of CEVA and Schenker as well.

Expeditors' fine pertains to peak season surcharges on the South China/Hong Kong to Europe route from September 2005 to June 2006. Expeditors assessed surcharges of less than \$1.5 million during that period. In an 8-K filing, Expeditors' CEO Pete Rose vigorously denied entering into any agreement that affected prices to customers and questioned the EC's motives, calling it "ironic" that the "world's largest freight forwarder [DHL, the EC's immunity

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applicant], who allegedly organized, orchestrated, and perpetuated these so-called 'Breakfast Club' meetings in Hong Kong [between competitor forwarders], has not been penalized at all for these actions. In our opinion, it's almost as if they've attempted to turn this into a competitive advantage."

We expect firms will accrue fines in first-quarter results, but the amounts are immaterial to operations as large and healthy as these companies. Some firms may appeal the findings, but at some point, legal expenses outweigh the benefit of contesting penalties regardless of the veracity of the ruling. In recent years, forwarders have faced allegations of anti-competitive behavior in many jurisdictions, including Australia, Brazil, Canada, New Zealand, Singapore, South Africa, and the U.S. In 2011 the U.S. DOJ fined 13 forwarders a total of \$100 million for price fixing. Given the relatively small magnitude of the penalties levied to date, we think details of the European fines may reduce investor uncertainty. These findings do not alter our investment theses on UPS or freight forwarders.

Weak Airfreight Demand Constrains Expeditors' Fourth Quarter; Full Year in Line With Expectations Feb. 21, 2012

Expeditors' EXPD fourth-quarter airfreight tonnage remained weak, but the freight forwarder grew ocean volume slightly over prior-year levels to expand quarterly net revenue and operating income by 5% and 4%, respectively. Quarterly gross sales contracted 5% year over year. For the full year, Expeditors grew gross and net revenue by a respective 3% and 12%, and the 13% annual EBIT growth exceeded our 10% projection. Actual full-year \$1.79 earnings per share were in line with our projected \$1.81. Annual results don't differ much from what we projected in our valuation model, but third- and fourth-quarter income growth slowed to

low-single-digit rates. Accordingly, we'll revisit our valuation assumptions for 2012, but expect to make no major adjustments to our model.

During the quarter, air kilos declined 10%, but ocean forty-foot equivalent units (FEUs) increased 3%. On a monthly basis, volume changes year over year in October, November, and December for air kilos were all negative, by 14%, 6%, and 9%, respectively, and all positive for ocean FEUs: 2%, 1%, and 7%. In the previous (third) quarter, year-over-year volume changes in July, August, and September for air kilos were negative 8%, negative 2%, and negative 5%; ocean FEUs were negative 4%, negative 2%, and flat. From these results it appears Expeditors' ocean demand has turned positive versus the prior-year levels, but airfreight continues to sink.

Expeditors again demonstrated it can grow EBIT, albeit by a modest increment, in a mixed-volume scenario. We think expectations of modest or no growth in near-term volume are already incorporated into Expeditors' share price, thus we expect no steep plummet following this earnings report. We maintain our opinion that shares of well-managed, well-capitalized Expeditors are trading at recessionlike multiples and at a significant discount to our fair value estimate of \$61 per share.

While we expect that the main catalyst for share price ascent will be inflection in the airfreight volume trajectory and some continuity in positive ocean unit comparisons, we expect Expeditors to convert whatever volume is available into cash. During 2011, the firm produced \$379 million of annual cash from operations less net capital expenditures--an impressive 20% of net revenue. The company ended the year with \$1.3 billion of cash and investments (\$6.05 per diluted share) offset by no debt. Of

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criticized for hoarding cash, the firm increased its dividend per share in 2011 by 25% to \$0.50 annually (still only around a 1% yield, but a 25% increase is significant). While we suspect this amount of cash is not needed to run the business, management has indicated that a significant cash reserve enables the firm to preserve its model during freight recessions, so we would be surprised by an announcement of a special dividend. At today's share prices, however, timely repurchases would be accretive to our valuation. Still, we think investors should probably consider cash on the balance sheet to be firmly in reserve, based on the company's attitude toward cash in the past. Expeditors finished the year with 13,692 employees, marking a 6.4% increase from the end of 2010, and demonstrating the firm's long-term growth and customer-service focus.

Expeditors International of Washington, Inc. EXPD

Sales USD Mil 6,325
Mkt Cap USD Mil 7,775
Industry Integrated Shipping & Logistics
Sector Industrials

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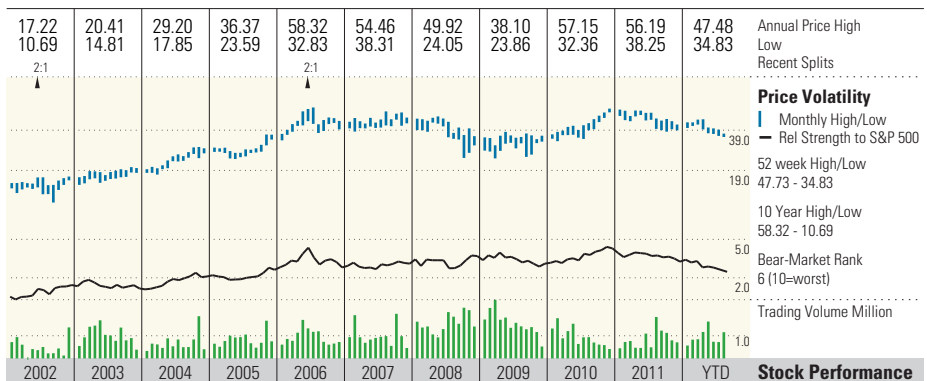
Growth Rates Compound Annual					
Grade: C	1 Yr	3 Yr	5 Yr	10 Yr	
Revenue %	3.1	3.0	5.9	14.0	
Operating Income %	13.0	9.3	10.5	15.5	
Earnings/Share %	12.6	9.3	11.1	15.0	
Dividends %	25.0	16.0	17.8	25.9	
Book Value/Share %	15.1	13.6	13.5	16.8	
Stock Total Return %	-15.5	5.2	-4.0	10.0	
+/- Industry	-26.5	-6.7	-4.5	4.8	
+/- Market	-40.9	-6.6	-3.3	7.9	

Profitability Analysis				
Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	18.4	20.9	24.2	22.8
Return on Assets %	12.3	13.4	9.5	9.3
Fixed Asset Turns	11.3	10.9	3.4	7.7
Inventory Turns	—	—	28.6	17.0
Revenue/Employee USD K	443.3	418.9*	—	1055.7
Gross Margin %	31.0	29.8	61.0	39.7
Operating Margin %	9.6	9.0	10.2	16.6
Net Margin %	6.0	5.7	5.7	11.1
Free Cash Flow/Rev %	6.2	6.0	6.2	0.1
R&D/Rev %	—	—	—	9.5

Financial Position		
Grade: A	12-11 USD Mil	06-12 USD Mil
Cash	1294	1364
Inventories	—	—
Receivables	935	983
Current Assets	2287	2405
Fixed Assets	539	547
Intangibles	11	10
Total Assets	2867	2992
Payables	627	699
Short-Term Debt	—	—
Current Liabilities	796	883
Long-Term Debt	—	—
Total Liabilities	863	949
Total Equity	2004	2043

Valuation Analysis				
	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	21.9	30.1	17.3	—
Forward P/E	17.6	—	—	13.2
Price/Cash Flow	17.9	24.4	8.9	—
Price/Free Cash Flow	21.1	29.5	16.8	—
Dividend Yield %	1.4	—	2.1	2.0
Price/Book	3.8	5.8	4.3	—
Price/Sales	1.3	1.7	1.0	—
PEG Ratio	2.4	—	—	0.3

Morningstar Rating — **Last Price** 36.93 **Fair Value** — **Uncertainty** — **Economic Moat™** — **Stewardship** —
 per share prices in USD



Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
15.1	15.8	49.0	21.4	20.6	13.7	-26.6	5.7	58.2	-24.1	-9.2	Total Return %	
38.5	-10.6	40.0	18.4	7.0	10.2	11.9	-17.7	45.4	-24.1	-21.0	+/- Market	
1.3	-5.1	23.6	23.6	16.6	18.2	-6.5	-6.5	30.1	-20.1	-11.7	+/- Industry	
0.4	0.4	0.4	0.4	0.5	0.6	1.0	1.1	0.7	1.2	1.4	Dividend Yield %	
3398	3954	5955	7199	8633	9750	7055	7372	11578	8685	7775	Market Cap USD Mil	

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials
2297	2625	3318	3902	4626	5235	5634	4092	5968	6151	6025	Revenue USD Mil	
25.0	24.1	23.4	34.7	27.7	27.8	28.5	33.8	28.4	30.8	31.0	Gross Margin %	
171	187	241	305	375	423	473	385	547	618	577	Oper Income USD Mil	
7.4	7.1	7.3	7.8	8.1	8.1	8.4	9.4	9.2	10.1	9.6	Operating Margin %	
113	122	156	219	235	269	301	240	344	386	360	Net Income USD Mil	
0.52	0.56	0.71	0.98	1.06	1.21	1.37	1.11	1.59	1.79	1.68	Earnings Per Share USD	
0.06	0.08	0.11	0.15	0.22	0.28	0.32	0.38	0.40	0.50	0.53	Dividends USD	
218	218	222	223	222	222	219	217	216	215	214	Shares Mil	
2.52	3.07	3.79	4.28	5.02	5.76	6.44	7.32	8.21	9.45	9.71	Book Value Per Share USD	
116	114	193	280	333	313	409	331	396	457	441	Oper Cash Flow USD Mil	
-81	-21	-66	-91	-141	-83	-60	-35	-42	-78	-67	Cap Spending USD Mil	
35	94	126	189	192	230	349	296	353	379	375	Free Cash Flow USD Mil	

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
14.4	12.7	13.0	14.9	13.9	13.8	14.4	10.9	13.8	13.9	12.3	Return on Assets %	
24.0	20.9	21.5	25.4	23.7	23.4	23.2	16.5	20.9	20.6	18.4	Return on Equity %	
4.9	4.6	4.7	5.6	5.1	5.1	5.3	5.9	5.8	6.3	6.0	Net Margin %	
2.93	2.73	2.76	2.66	2.73	2.69	2.70	1.85	2.39	2.22	2.05	Asset Turnover	
1.7	1.6	1.7	1.7	1.7	1.7	1.5	1.5	1.5	1.4	1.5	Financial Leverage	

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	06-12	Financial Health
249	370	522	589	633	765	903	1079	1278	1491	1523	Working Capital USD Mil	
—	—	—	—	—	—	—	—	—	—	—	Long-Term Debt USD Mil	
524	646	807	914	1070	1227	1366	1553	1741	2004	2043	Total Equity USD Mil	
—	—	—	—	—	—	—	—	—	—	—	Debt/Equity	

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
31.8	33.7	39.7	34.5	38.2	37.9	24.3	31.4	34.4	22.9	21.9	Price/Earnings	
—	—	—	—	—	—	—	—	—	1.3	—	P/E vs. Market	
1.6	1.6	1.9	1.9	2.0	1.9	1.3	1.8	2.0	1.4	1.3	Price/Sales	
6.5	6.1	7.4	7.9	8.1	8.0	5.2	4.8	6.7	4.3	3.8	Price/Book	
30.5	35.8	32.1	26.9	27.1	32.5	17.8	22.8	29.9	19.3	17.9	Price/Cash Flow	

Quarterly Results							
Revenue USD Mil	Sep 11	Dec 11	Mar 12	Jun 12			
Most Recent Period	1606.4	1501.9	1411.4	1505.0			
Prior Year Period	1667.6	1582.1	1460.8	1581.4			
Rev Growth %	Sep 11	Dec 11	Mar 12	Jun 12			
Most Recent Period	-3.7	-5.1	-3.4	-4.8			
Prior Year Period	60.8	26.9	21.6	4.3			
Earnings Per Share USD	Sep 11	Dec 11	Mar 12	Jun 12			
Most Recent Period	0.50	0.43	0.36	0.39			
Prior Year Period	0.44	0.45	0.42	0.44			

Industry Peers by Market Cap				
	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Expeditors Internati	7775	6025	21.9	18.4
United Parcel Serv	72985	53817	19.2	48.9
FedEx Corporation	27788	42680	13.7	13.6

Major Fund Holders		% of shares
		—
		—
		—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- ▶ Economic Moat™ Rating
- ▶ Discounted Cash Flow
- ▶ Discount Rate
- ▶ Fair Value
- ▶ Uncertainty
- ▶ Margin of Safety
- ▶ Consider Buying/Consider Selling
- ▶ Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based

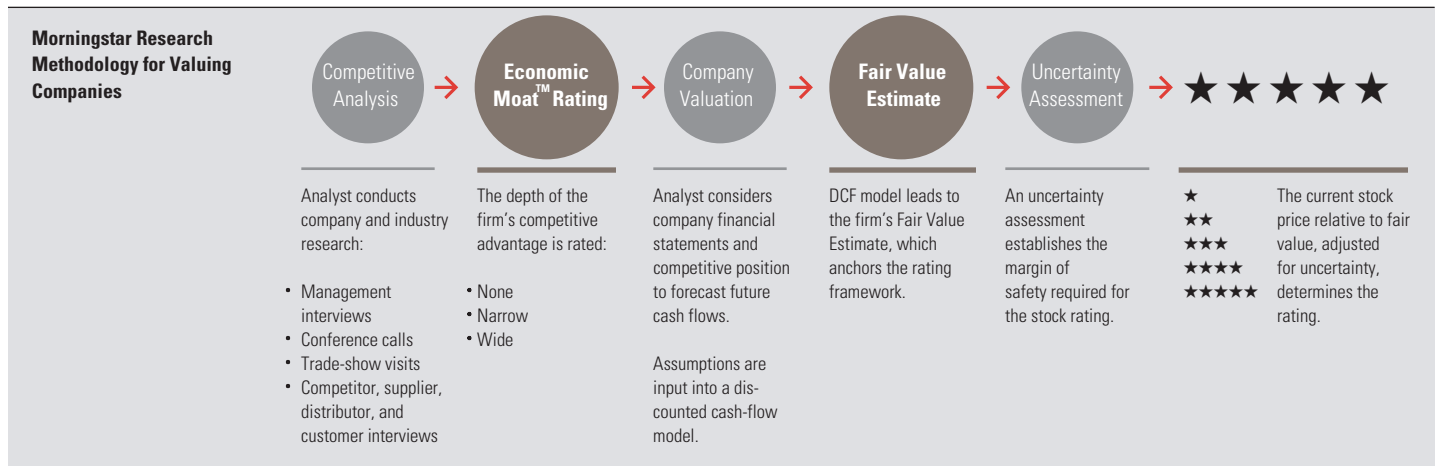
just on movement in the share price. If we think a stock's fair value is \$50, and the shares decline to \$40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at \$40 than they were at \$50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



Morningstar's Approach to Rating Stocks (continued)

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High,

Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth. The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.