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Activist makes strong case: Forward's management took company backward

Overview

Activist investor Ancora Holdings is circling Forward Air (FWRD), citing a laundry list of issues to fix that have caused the company to badly lag its LTL peers from a financial and shareholder performance standpoint.

FWRD is known for its core asset-light, expedited airport LTL service (accounting for two-thirds, or more, of profits), which has underperformed in recent years as the company embarked on a M&A-focused growth strategy, as opposed to focusing on its core business and optimizing its margins and returns. Ancora believes that the current management team has poorly executed, lost focus and destroyed shareholder capital on dilutive acquisitions.

Now the original co-founder, Scott Niswonger, as well as the company's former CFO, Andrew Clarke, have joined together with Ancora Advisors and nominated four board members. Given its long indirect history with the company, Ancora has intimate knowledge of the operations and has a detailed plan to fix the issues it deems most pressing, while potentially delivering big upside for shareholders in the process.

Essentially, Ancora wants FWRD to return to its old roots. The plan focuses on several pillars: returning focus to core LTL operations; selling off recent noncore and dilutive acquisitions; yield/pricing improvement; cost cuts; improved employee productivity; balance sheet optimization (higher leverage target); and front-loaded share buybacks.

FWRD as a stock has already run up a lot, likely due to investor excitement over future potential for improvements, but we think there is still plenty of long-term upside left should Ancora successfully execute on many (or even some) of its plans. We attempt to demonstrate this by providing a high-level analysis on the long-term upside potential in our sum-of-the-parts valuation.

LTL Operating Ratio (OR); Stock increase since 2007; Market Capitalization ($B) - per Ancora letter

Forward Air: 91.4%; 1.5 times; $2.3B
Old Dominion: 77.4%; 30 times; $24.1B
Saia: 90.1%; 22 times; $5.3B

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Forward Air: Brief history and overview

Forward Air's core expedited LTL primarily services airports, which is where the vast majority of its ~90 hubs are located (at or near). FWRD is asset-light in the sense that it does not own trucks or employ drivers. It does, however, employ lots of people at terminals for loading and unloading freight. FWRD works with freight-forwarding companies to handle the expedited ground deliveries of goods that arrive by air. This means FWRD's LTL business is more consumer driven as opposed to most LTL peers that are more leveraged to the industrial economy in the U.S.

FWRD employs a different operating model than its LTL peers and competitors, which are all asset heavy and own their own trucks and employ their own drivers. This means that FWRD operates like a LTL brokerage in that it has to procure transportation, which it does through a blend of purchasing capacity from owner-operators and third-party carriers. In recent years, this mix has trended toward 50/50 (from 70/30 in favor of owner-operators about a decade ago), which is one of Ancora's complaints, as we will touch on later. This results in less operating leverage for FWRD in a tight market and has been a harder model to execute recently given a recent scarcity of owner-operators to pull from. Nonetheless, FWRD was able to generate an operating ratio (OR) in line with its asset-heavy peers in the low 80% range despite these differences, so we do not view these differences as posing a structural barrier to improvement. In recent years, FWRD's OR has deteriorated by about 10 percentage points to the low 90s and well above best-in-class peers.

Also, over the last decade or so, and since the old management now staging an activist campaign had left the company, subsequent management has pursued a M&A-focused growth strategy and acquired meaningful exposure to intermodal/drayage, final mile and pool distribution (which has already been moved to discontinued operations and is actively for sale). This strategy has tacked on more revenue, but at a lower margin and return profile, as we discuss in depth later. As it stands today, the core, legacy expedited LTL business accounts for about 44% of revenue but closer to 66%+ of operating income (due to its higher margins), while the remainder is split between primarily intermodal/drayage, final mile and other subsegments of its Expedited segment, with a small percentage to pool distribution.

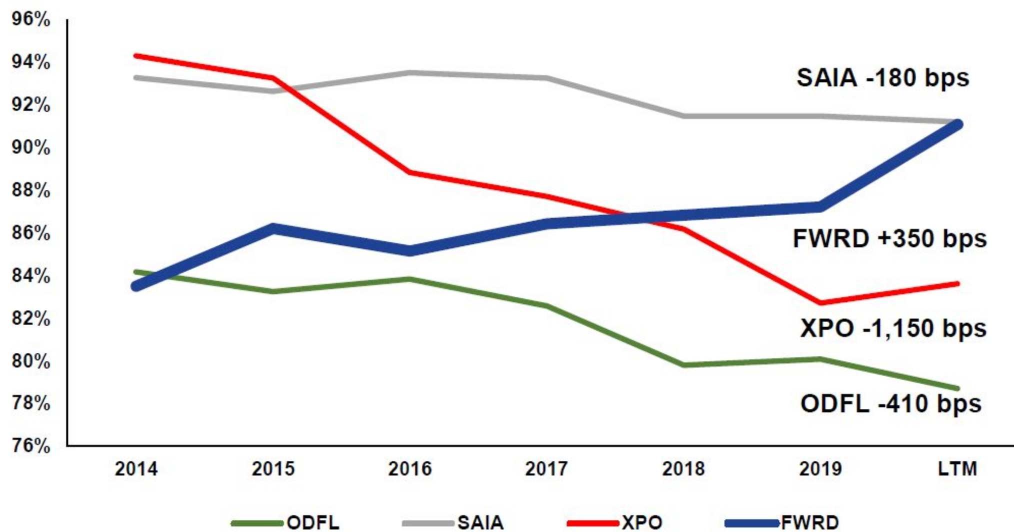
Why is Ancora taking an activist stake in FWRD?

Ancora indirectly has a long history with FWRD and intimate knowledge of its operations. If there were one word to describe why Ancora has targeted FWRD, it is probably "underperformance" — or relative underperformance, at least, compared to blue-chip LTL providers such as ODFL, SAIA and XPO.

Since former CFO Clarke left in 2006, there has been a steady and significant deterioration in all the metrics shareholders typically care deeply about, such as operating ratio (OR, a hallmark metric for transportation investors), margins and return on invested capital (ROIC). Due to this fact, FWRD's compounded shareholder value and returns over the past 10 to 15 years have badly lagged peers. Revenue growth, due to the acquisitive strategy that has been pursued over the past five to 10 years, has been far more on par (or superior) to peers. But it has come at a cost, as pricing and revenue have not kept pace with the cost to serve those customers, resulting in significant margin degradation.

Ancora also does not like the industry diversification strategy (i.e., intermodal/drayage, final mile, pool distribution) that FWRD has pursued with respect to its acquisitions. In Ancora's view, this has resulted in nearly a billion dollars of shareholder capital that has been squandered, with nothing to show for it except for a halving of ROIC and a badly lagging stock price that has barely appreciated in one of the biggest bull markets in U.S. history (post the credit crisis). In addition, Ancora asserts that it has been a golden age for nonunionized LTL carriers as the industry structure and pricing power have improved, leading to rapidly rising stock prices, margins and returns for FWRD's peers. According to Ancora, FRWD has been left behind as a result. But all is not lost in Ancora's view because the problems can be fixed through a host of operational and financial changes and implementing the right people to head the organization, as we discuss next.

LTL Peer Comparison – Operating Ratio (2014-2019, LTM)

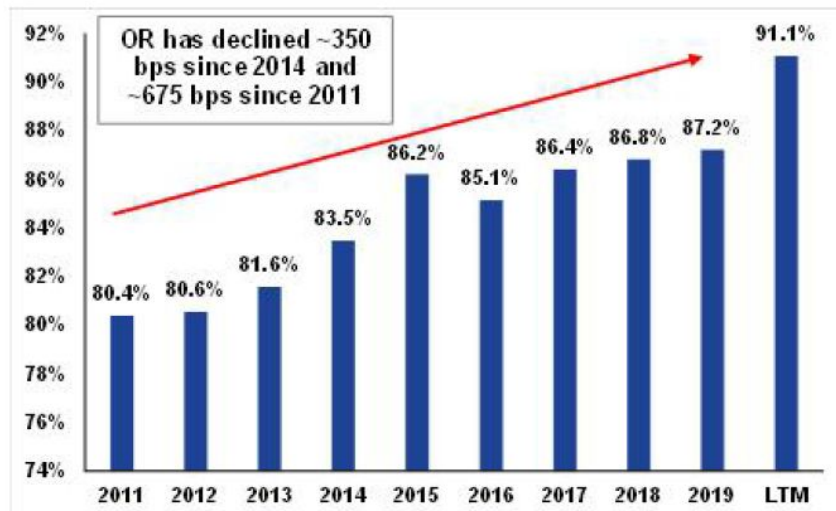


Source: Company Filings and Ancora Estimates. XPO reflects only the LTL business within XPO. LTM as of 9/30/2020.

(Source: Company filings, Ancora Advisors)

Ancora's plans to increase shareholder value

Ancora made it well known in the letter that Forward has struggled with operating ratios expanding while other nonunionized LTL providers have improved their operating ratios during the same period. Ancora pointed out in the letter that the operating ratio for the core business, Expedited LTL, has grown by ~675 basis points since 2011 and ~350 basis points since 2014 while other operators have improved OR during the same period.



(Source: Company filings, Ancora Advisors)

Ancora believes that with the correct pricing strategy and the right customer list, Forward's Expedited LTL OR should be in the mid to low 80s. Ancora notes that Forward's OR in the mid-2000s prior to the financial crisis operated in the low 80s and even had quarters that were sub-80. A laser focus on operating the LTL segment of the company would greatly improve operating margins, as cost control had fallen by the wayside since 2011 as cost per LTL ton had grown by roughly 35%.

Ancora stated that it has already identified greater than 1,000 basis points (bps) of margin improvement in the core Expedited LTL business. This belief rests upon reduced operating reliance on third-party carriers, headcount reductions and a focus on premium pricing. The percentage of owner-operators that Forward has used is down to 52% from 71% in 2009.

While operating margins have narrowed to single digits, return on invested capital (ROIC) has been cut in half as acquisitions outside of the core business haven't been accretive. Since 2007, Forward has completed 19 total acquisitions, including the acquisition of Pool Distribution, which was marked as discontinued or held for sale in early 2020. Only one of the 19 acquisitions was within the core expedited LTL business.

The company has deployed nearly $1 billion in capital through acquisitions and as well as capex since 2007. The results have not returned to levels prior to the acquisition frenzy — ROIC in 2007 was ~30%, roughly double today's level of 15%.

Ancora believes that management's deployment of capital strategy is too widespread to lead to shareholder value creation; through capex, acquisitions and share repurchases/dividends, the focus on the core business has been lost.

Ancora believes that divesting the intermodal segment of the company will generate $300 million or more in capital immediately and wants to deliver that value to shareholders through stock buybacks.

Ancora also believes that the chairman of the board and CEO positions should be separated so the board has oversight over management and can hold management accountable for suboptimal performance.

Ancora, within its letter to shareholders, announced the intentions to name Clarke as chairman (with the initial title of executive chairman). Clarke, the former CFO of Forward Air and C.H. Robinson and former CEO of Panther, has experience in operating the asset-light LTL provider.

In addition to the focus on the Expedited LTL segment and making Clarke the chairman of the board, Ancora talked about potential divestiture of noncore businesses. The segment noted in the letter was the intermodal and pool distribution, which would result in at least $300 million that could be used for share repurchases.

Forward Air's valuation has appreciated greatly since the activist's involvement began.

With the latest share price of $85.58, up from less than $70 before the activist involvement was made public, FWRD is currently trading at FY2021 (Dec.) EV/Revenue, EV/EBITDA and p/e multiples of 1.8x, 16.0x and 29.0x, respectively. At these levels, FWRD is trading well above its five-year average forward multiples that are closer to 1.3x EV/Revenue, 10-11x EV/EBITDA and 21x p/e.

Following the run-up in Forward's share price, those multiples are in the neighborhood of the public multiples of the best-in-class carriers that Ancora utilized in its open letter (i.e., Old Dominion Freight Line, XPO Logistics and Saia Inc., which trade at next 12 months forward P/E multiples of 29x, 32x and 30x, respectively). It is worth pointing out, as is often the case, that Forward Air does not have any "perfect comps" because it is the only publicly traded asset-light LTL carrier (Echo participates in the LTL industry as a pure broker) and is the only publicly traded company that grew up serving an airport-to-airport network. However, while the best-in-class carriers used in Ancora's report compared Forward Air to some of the industry's best companies, we also do not believe the publicly traded LTL carriers that the company did not use (i.e., YRC Worldwide and ArcBest) would have not been relevant comps since they are unionized and asset heavy, both factors that bring down a transportation company's multiples.

After the run in shares, p/e multiples have appreciated to levels of best-in-class competitors; here is what the current valuation imples for multiples of the individual segments:

Forward Air SOTP - LTM Earnings												
	LTM Revenue	LTM Op. Profit	Op Margin	Interest	Stand Alone PBT	Tax Rate	Net Income	Diluted S/O	2020 EPS	Comp P/E Multiple	Equity Value	Equity Value per Share
Expedited Segment												
Network	629.2	59.8	9.5%	1.8	58.0	24.6%	43.7	27.7	$ 1.58	39.0x	1,704.3	$ 61.53
Truckload	179.6	7.2	4.0%	0.5	6.7	24.6%	5.0	27.7	$ 0.18	35.0x	175.9	$ 6.35
Final Mile	192.5	7.7	4.0%	0.6	7.1	24.6%	5.4	27.7	$ 0.19	30.0x	161.6	$ 5.83
Other	26.3	0.6	2.4%	0.1	0.6	24.6%	0.4	27.7	$ 0.02	25.0x	10.7	$ 0.39
Expedited Freight Segment Total	**1,027.6**	**75.3**	**7.3%**	**3.0**	**72.3**	**24.6%**	**54.5**	**27.7**	**$ 1.97**	**37.6x**	**2,052.5**	**$ 74.10**
Intermodal	202.5	18.3	9.0%	0.6	17.7	24.6%	13.4	27.7	$ 0.48	25.0x	333.9	$ 12.06
Pool/Eliminations/other	204.0	(3.6)	-1.7%	0.6	(4.2)	24.6%	(3.1)	27.7	$ (0.11)	5.0x	(15.6)	$ (0.56)
TOTAL	**1,434.1**	**90.0**	**6.3%**	**4.1**	**85.9**	**24.6%**	**64.8**	**27.7**	**$ 2.34**	36.6x	**2,370.8**	**$ 85.59**

$ in million, except per share figures
Intra-segment operating profit within the Expedited Freight segment are assumptions since the company does not break out profitability within Expedited sub-segments
The Pool Distribution segment is combined with eliminations/other because it is considered a discontinued operation; the segment had a 3.5% operating margin in FY19
LTM for period ending 9/30/20
Source: company data and FreightWaves

The table below is our speculation of what Forward Air's income statement and valuation might look like after four of the key actions that were outlined in Ancora's open letter are implemented.

The adjustments we made from the above table are: (1) improving margins, (2) selling the intermodal segment for in excess of $300 million, (3) increasing leverage and (4) using proceeds from the sale of the intermodal segment and the higher leverage to repurchase shares. That is not a comprehensive list of changes that a potential new management team might make; for example, Ancora made it clear other segments and other recent acquisitions are also candidates for divestment. In short, we see why the activist involvement has investors excited even after the dramatic run-up in the share price since last fall.

Forward Air SOTP After: (1) Improving Margins, (2) Selling Intermodal, (3) Adding Leverage and (4) Buying Back Shares												
	LTM Revenue	LTM Op. Profit	Op Margin	Interest	Stand Alone PBT	Tax Rate	Net Income	Diluted S/O	2020 EPS	Comp P/E Multiple	Equity Value	Equity Value per Share
Expedited Segment												
Network	629.2	125.8	20.0%	8.5	117.4	24.6%	88.5	20.5	$ 4.32	22.0x	1,947.2	$ 94.98
Truckload	179.6	21.5	12.0%	2.4	19.1	24.6%	14.4	20.5	$ 0.70	25.0x	360.7	$ 17.59
Final Mile	192.5	28.9	15.0%	2.6	26.3	24.6%	19.8	20.5	$ 0.97	20.0x	396.4	$ 19.34
Other	26.3	2.6	10.0%	0.4	2.3	24.6%	1.7	20.5	$ 0.08	20.0x	34.3	$ 1.67
Expedited Freight Segment Total	**1,027.6**	**178.9**	**17.4%**	**13.8**	**165.1**	**24.6%**	**124.5**	**20.5**	**$ 6.07**	**22.0x**	**2,738.6**	**$ 133.59**
Intermodal	Sold	Sold	Sold	Sold	Sold	Sold	Sold	Sold	Sold			
Pool/Eliminations/other	204.0	(3.6)	-1.7%	2.7	(6.3)	24.6%	(4.8)	20.5	$ (0.23)	5.0x	(23.8)	$ (1.16)
TOTAL	**1,231.6**	**175.3**	**14.2%**	**16.6**	**158.8**	**24.6%**	**119.7**	**20.5**	**$ 5.84**	**22.7x**	**2,714.8**	**$ 132.43**

$ in million, except per share figures
Intra-segment operating profit within the Expedited Freight segment are assumptions since the company does not break out profitability within Expedited sub-segments
The Pool Distribution segment is combined with eliminations/other because it is considered a discontinued operation; the segment had a 3.5% operating margin in FY19
Assumes selling the Intermodal segment for $333 million and using proceeds to repurchase shares
Assumes quadrupling current debt balance and using proceeds to repurchase shares
Assuming margin improvement from cost controls and operational discipline, including getting core network Expedited segment back to 20% operating margins
LTM for period ending 9/30/20
Source: company data and FreightWaves

Forward Air responds to Ancora

On Wednesday, the current FWRD board and management team responded to Ancora's letter and confirmed receipt of Ancora's director nominations.

The company acknowledged merit to some of Ancora's proposals and vowed to be receptive to and work with Ancora. The company defended its board structure, citing a need for deep industry knowledge accounting for the dual chairman and CEO role.

Forward Air confirmed that it has been in active discussions with Ancora over the past several months and has already put in motion some of its suggestions, with additional plans to implement others. The company was clear and fairly adamant, however, that it believes in the company's current strategic direction and is not changing course.

Finally, the company cited a few examples whereby it had attempted to work with Ancora — such as offering to grant two Ancora-appointed board members and a mutually agreed upon third. The overall response was fairly vague though in terms of specifics or rebuttals to Ancora's chief complaints in its 18-page letter.

Do shareholders want new board members and new management?

They should in our view. While some of Ancora's activist letter could perhaps be construed as aggressive and one-sided, on the whole, we felt it was mostly factual and hard to argue with. We think Ancora's plan is sound. The response in the stock price thus far since Ancora first began accumulating a stake in October 2020 suggests the market thinks Ancora's plan has significant potential. Time will tell whether they do.

We think it is likely that Ancora has already been in contact and gained verbal approval from at least some of the larger shareholders, opening up a path to a successful nomination of its four proposed board members at the upcoming annual shareholder meeting (usually in May but it has not yet been announced).

The current management of FWRD appears to have already started to try to make inroads on some of Ancora's complaints (e.g., underpricing, bloated cost structure, etc.). We would not be surprised if the current management team organizes an event of some kind to try to tell its side of the story in more detail. Absent that, Ancora's prospects for getting its wishes granted appear likely in our opinion.

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