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Radiant Logistics
AMEX:RLGT
Last: $1.80

Summary:

- Non-asset-based 3PL provider with a focus on expedited freight
- 5 year revenue CAGR of 34%
- The 3PL industry has grown 10% annually for 15 years and is now starting to consolidate
- Vast consolidation opportunity means there is no end in sight to growth for RLGT and select peers
- Currently trades at 8x FCF and less than 6x EBITDA based on NTM guidance
- Peers trade at 10-15x EBITDA
- Stellar CEO owns 30% of company, recently bought shares in open market

The non-asset-based and asset-light 3PL industry consists primarily of intermediaries who organize the storage and transport of goods, both domestically and internationally. Most of them don't own transportation assets, just relationships with shipping customers and shippers. Driven by supply chain modernization and the globalization of trade, the 3PL industry has grown 15% per year for 15 years. The industry is extremely fragmented, with the largest U.S. 3PL, C.H. Robinson, having only a 2% domestic share.

The economics of the 3PL business are great at scale. The 3PLs that have focused on the right niches of the industry have grown their revenues at double-digit rates for a long, long time, and all of the large well-run 3PLs earn ROEs of at least 20% and generate a tons of cash. The market has rewarded them each with EBITDA multiples in the 11-12x range. The table on the next page gives an overview of most of the publicly-traded non-asset-based and asset-light 3PLs. I've inserted the break into list of companies to delineate the large 3PLs from what I will call the mid-sized 3PLs.

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	Share Price	Market Cap	EV	LTM Revenue	LTM EBITDA	NTM EBITDA	EBITDA Margin	ROE	EV/LTM EBITDA	EV/NTM EBITDA
SWX:KNIN	fr. 100.40	11,979	10,886	16,188	939	1,014	6%	21%	11.6x	10.7x
CHRW	$ 56.18	9,329	9,018	10,523	739	811	7%	36%	12.2x	11.1x
EXPD	$ 38.00	8,226	6,804	6,101	640	698	10%	19%	10.6x	9.8x
LSTR	$ 48.74	2,351	2,404	2,728	218	244	8%	40%	11.0x	9.8x
ECHO	$ 18.90	431	383	642	24	37	4%	11%	16.0x	10.2x
Coyote (Private)	NM	NM	NM	560	NM	NM	NM	NM	NM	NM
AUTO	$ 0.73	25	36	306	7	8	2%	16%	5.3x	4.5x
RLGT	$ 1.80	55	77	286	8	14	3%	27%	9.7x	5.5x
XPO	$ 16.38	300	138	180	(3)	(11)	-2%	-2%	NM	NM

But things are starting to change in the industry. In 2001 only 46% of Fortune 500 companies used 3PLs. Today, about 85% do. As a result, the adoption of 3PL services by large corporations is losing strength as a driver of growth. This is causing the top end of the industry to mature, as the big 3PLs rely most heavily on large corporations as customers.

The next step in the industry lifecycle is to consolidate. The 3PL industry is profoundly fragmented, consisting of thousands of companies, many of them little more than a few guys in an office arranging truckloads.

The industry's fragmentation has two causes. The first is that the trucking industry, which is the backbone of the U.S. transportation system, is itself extraordinarily fragmented—there are more than 1.2 million trucking companies in the U.S., and 90% of them operate six or fewer trucks.

The second cause of the extreme fragmentation at the smaller end of the 3PL industry is working capital. In freight brokerage, the largest subsector of the 3PL industry, the dollar value of accounts receivable is typically 1.5-2.0x the value of accounts payable, so 3PLs must front money to grow. A lot of the small ones don't have enough capital, which throttles growth and makes scale hard to achieve.

So there are a lot of very small 3PLs out there, and the small end of the industry is going to consolidate, which will be great for the consolidators. But there is one minor problem for the big guys like KNIN, CHRW, LSTR, and EXPD—they are too big. They all generate EBITDA in the hundreds of millions. Buying up 3PLs/freight brokers with EBITDA in the single-digit or low-double-digit millions won't move the needle. The return on time invested is not sufficient to justify the investment.

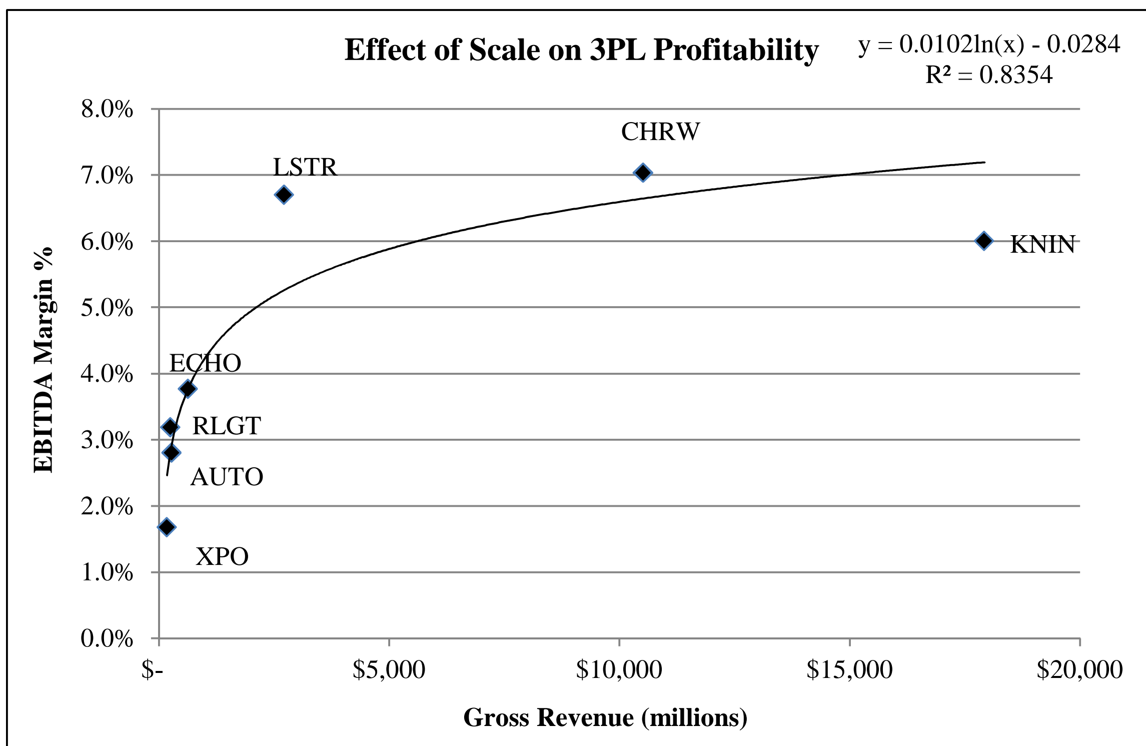
So the mid-sized 3PLs (and smart PE and VC firms) are doing it. They are happy to oblige, because the tiny 3PLs available for purchase are not indefinitely sustainable on a standalone basis, so their purchase prices are a pittance—typically 2-2.5x EBITDA in cash up front, and an additional 2-2.5x EBITDA in the form of a multi-year earn-out. Sometimes there is actually no price paid at all—a lot of the consolidation that goes on in the industry consists of attracting new sales agents from competitors and out of college with the allure of a larger shipping network to offer customers, as well as better IT and back office systems. Since the good 3PLs trade at 10x+

EBITDA, there is an obvious and enormous opportunity for value creation through consolidation.

Since consolidation has started, the mid-sized 3PLs doing the consolidating have grown at staggering rates. ECHO's five-year revenue CAGR is 79%. Coyote Logistics, a private VC-funded 3PL, has posted a 73% CAGR. XPO's number is 32%. RLGT's is 34%. AUTO's is 28%. The table below shows how the industry's maturation and consolidation have shifted growth from the large 3PLs to the smaller ones.

	5 Yr Rev CAGR as of 2005	5 Yr Rev CAGR as of today
SWX:KNIN	12%	1%
CHRW	15%	10%
EXPD	15%	5%
LSTR	12%	2%
ECHO		79%
Coyote		73%
AUTO		28%
RLGT		34%
XPO		32%

And because corporate costs can be scaled, EBITDA has been growing even faster. The incremental EBITDA margin on new sales is 6-8% depending on the mix of business, but the mid-sized 3PLs only earn 3-4% EBITDA margins, because they haven't achieved full scale yet.



The 3PL business is cyclical, but with a few counter-cyclical features. During recessions excess transport capacity increases, which brings down the cost of shipping, thereby making shipping more economical than it was during the good times. In addition, companies looking to cut costs become more incentivized to outsource, which can bring additional work to 3PLs.

For the mid-sized 3PLs, economic cycles are even less of an issue because there are plenty of 3PLs out there for purchase, boom or bust. The deregulation of the U.S. trucking industry in 1980 basically gave birth to the 3PL industry, and the entrepreneurs who started 3PLs at age 30 in 1980 are now approaching 65 and looking for financial exits. In the dark days of 2009 the large 3PLs all saw healthy revenue declines, but most of the mid-sized consolidators actually grew, albeit with the help of acquisitions.

	2009 Revenue Growth
SWX:KNIN	-18%
CHRW	-12%
EXPD	-27%
LSTR	-24%
ECHO	28%
Coyote	12%
AUTO	2%
RLGT	7%
XPO	-9%

Why invest in RLGT *specifically*?

You can't invest in Coyote because it's private. ECHO is public but it trades at a big EBITDA multiple and its founders have a history of using very aggressive accounting. XPO too trades at an extreme price, because its CEO and largest owner, Brad Jacobs, has a long history of success rolling up fragmented industries. And AUTO is miniscule, with a $7.5M float. RLGT is all that's left.

Luckily RLGT is not exactly a bad date to be stuck with. The company was founded in 2005 with $5M of equity capital by Bohn Crain. Today RLGT's market cap is $60M, and its intrinsic value is easily in excess of $100M (and growing quickly). Mr. Crain was formerly a financial executive with CSX, Schneider Logistics, and a few other companies. He still owns 30% of RLGT, and has purchased shares in the open market on multiple occasions, including a purchase a few weeks ago. Substantially all of his net worth is invested in RLGT, and his salary is modest. He is an excellent manager, something you can learn by listening to RLGT's conference calls. There are plenty of companies out there that are five times RLGT's size but would be lucky to have Mr. Crain at the helm.

Why buy RLGT *now*? In a word, DBA.

DBA, or Distribution By Air, is a an expedited freight broker based in New Jersey. RLGT bought DBA in March of last year for $12M, making DBA Radiant's largest acquisition yet. Unfortunately, to get the deal done RLGT broke one of its own cardinal rules and agreed to a

deal without an earn-out. Not long after the acquisition closed, one of DBA's owners left and went into competition with RLGT. RLGT sued, believing this constituted a breach of the noncompetition clause (it seems likely that it did, and that RLGT will receive monetary compensation in return).

The bad results at DBA as a result of the previous owner's actions broke a string of otherwise-consistent margin improvement and profit results for RLGT. Radiant's management has been adamant that DBA will be fixed, however, and has released June 2013 guidance to substantiate that claim. The guidance calls for $13.5M of EBITDA, which puts the stock at under 6x EBITDA at the current price, and 8x cash earnings. Thanks to operational improvements at DBA, RLGT should actually post improving results over the next 12 months even as the economy falters.

A few weeks ago, when the stock was below $1.80, Mr. Crain and a board member each bought $50k worth of stock. $50K is not a huge dollar amount on its own, but I view it as meaningful given that A) Mr. Crain is already up to his neck in RLGT exposure, and B) Mr. Crain made $450k in cash compensation in 2011, meaning that after taxes and living expenses his $50k purchase probably represented a decent portion of his discretionary income for the year.

Based on a simple 12x peer EBITDA multiple, RLGT should be a $4 stock. Looking out five years, EBITDA could easily be three or four or five times what it is now, and RLGT could easily be a $10-15 stock.

How many chances do you get to pay 8x FCF for a great business growing 30% a year, in strong financial shape, with a huge growth runway ahead of it, run by an excellent CEO who has everything on the line?

June 2013 Guidance		**Cash EPS Reconciliation (Mine)**	
Revenue	330.0	EBITDA	13.6
EBITDA	13.6	less: Interest	-2.0
DA	3.1	less: Taxes	-3.2
EBIT	10.5	less: CapEx	-0.5
Interest	2.0	less: Minority Interest	-0.2
PTI	8.5	Cash Earnings	7.7
Income Tax	3.2		
Net Income	5.3	Shares	35
CapEx	-0.5		
Minority Interest	-0.2	Cash Earnings/Share	$0.22