Con-way Inc.
Form 10-Q
November 02, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

___ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to___

Commission File Number: 1-05046

Con-way Inc.
(Exact name of registrant as specified in its charter)

Delaware	94-1444798
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2211 Old Earhart Road, Suite 100, Ann Arbor, MI	48105
(Address of principal executive offices)	(Zip code)

Registrant’s telephone number, including area code: (734) 994-6600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:
Large accelerated filer ý Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o   No ý

Number of shares of Common Stock, $0.625 par value,
outstanding as of October 31, 2012: 55,968,995

CON-WAY INC.
FORM 10-Q
Quarter Ended September 30, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CON-WAY INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

ASSETS	September 30, 2012 (Unaudited)	December 31, 2011
Current Assets		
Cash and cash equivalents	$442,021	$438,010
Marketable securities	3,200	13,255
Trade accounts receivable, net	629,370	577,522
Other accounts receivable	53,196	43,849
Operating supplies, at lower of average cost or market	25,674	22,822
Prepaid expenses	38,564	48,369
Deferred income taxes	17,069	46,563
Total Current Assets	1,209,094	1,190,390
Property, Plant and Equipment		
Land	189,319	194,078
Buildings and leasehold improvements	829,231	827,910
Revenue equipment	1,709,507	1,613,806
Other equipment	328,304	318,313
	3,056,361	2,954,107
Accumulated depreciation	(1,509,860)	(1,458,074)
Net Property, Plant and Equipment	1,546,501	1,496,033
Other Assets		
Deferred charges and other assets	34,957	36,743
Capitalized software, net	20,941	19,829
Marketable securities	—	5,354
Intangible assets, net	11,586	13,951
Goodwill	338,041	337,716
	405,525	413,593
Total Assets	$3,161,120	$3,100,016

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CON-WAY INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands except per share amounts)

LIABILITIES AND SHAREHOLDERS' EQUITY	September 30, 2012 (Unaudited)	December 31, 2011
Current Liabilities		
Accounts payable	$361,489	$345,489
Accrued liabilities	255,472	235,146
Self-insurance accruals	104,272	104,328
Short-term borrowings	10,639	14,481
Current maturities of long-term debt and capital leases	12,745	24,026
Total Current Liabilities	744,617	723,470
Long-Term Liabilities		
Long-term debt	718,983	718,336
Long-term obligations under capital leases	36,765	51,902
Self-insurance accruals	148,903	158,889
Employee benefits	555,070	610,850
Other liabilities and deferred credits	34,814	39,120
Deferred income taxes	71,581	38,195
Total Liabilities	2,310,733	2,340,762
Commitments and Contingencies (Note 8)		
Shareholders' Equity		
Common stock, $0.625 par value; authorized 100,000,000 shares; issued 63,550,965 and 63,065,931 shares, respectively	39,692	39,394
Additional paid-in capital, common stock	611,094	595,992
Retained earnings	955,141	884,758
Cost of repurchased common stock (7,581,970 and 7,468,869 shares, respectively)	(326,088)	(322,454)
Accumulated other comprehensive loss	(429,452)	(438,436)
Total Shareholders' Equity	850,387	759,254
Total Liabilities and Shareholders' Equity	$3,161,120	$3,100,016

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CON-WAY INC.
STATEMENTS OF CONSOLIDATED INCOME
(Unaudited)
(Dollars in thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	$1,404,113	$1,377,079	$4,216,370	$3,971,255
Costs and Expenses				
Salaries, wages and employee benefits	534,011	516,083	1,601,105	1,516,597
Purchased transportation	384,312	365,306	1,152,563	1,030,822
Other operating expenses	145,660	145,298	420,704	417,998
Fuel and fuel-related taxes	136,011	142,185	420,196	428,322
Depreciation and amortization	55,403	50,814	160,687	151,668
Maintenance	33,893	35,711	98,474	97,692
Rents and leases	29,654	30,423	86,596	86,944
Purchased labor	29,956	30,134	84,999	83,226
	1,348,900	1,315,954	4,025,324	3,813,269
Operating Income	55,213	61,125	191,046	157,986
Other Income (Expense)				
Investment income	204	163	648	712
Interest expense	(13,667)	(13,909)	(41,199)	(41,751)
Miscellaneous, net	(592)	227	(3,218)	(2,536)
	(14,055)	(13,519)	(43,769)	(43,575)
Income before Income Tax Provision	41,158	47,606	147,277	114,411
Income Tax Provision	15,854	18,478	54,527	48,939
Net Income	$25,304	$29,128	$92,750	$65,472
Weighted-Average Common Shares Outstanding				
Basic	55,906,636	55,535,074	55,806,937	55,331,170
Diluted	56,463,535	56,117,334	56,432,216	56,054,059
Earnings per Common Share				
Basic	$0.45	$0.52	$1.66	$1.18
Diluted	$0.45	$0.52	$1.64	$1.17

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CON-WAY INC.
STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Income	$25,304	$29,128	$92,750	$65,472
Other Comprehensive Income (Loss):				
Foreign currency translation adjustment	674	(1,226)	(52)	477
Unrealized gain on available-for-sale security, net of deferred tax of $182, $7, $145 and $21, respectively	283	12	226	33
Employee benefit plans				
Amortization of actuarial loss included in expense, net of deferred tax of $1,872, $976, $5,633 and $2,928, respectively	2,928	1,527	8,810	4,581
	3,885	313	8,984	5,091
Comprehensive Income	$29,189	$29,441	$101,734	$70,563

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CON-WAY INC.
STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30, 2012	2011
Cash and Cash Equivalents, Beginning of Period	$438,010	$421,420
Operating Activities		
Net income	92,750	65,472
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net of accretion	159,936	150,905
Non-cash compensation and employee benefits	25,299	17,668
Increase in deferred income taxes	57,102	42,049
Provision for uncollectible accounts	3,267	4,973
Gain from sales of property, equipment and investment, net	(8,015)	(1,923)
Changes in assets and liabilities:		
Receivables	(54,586)	(104,658)
Prepaid expenses	9,805	16,350
Accounts payable	8,716	53,788
Accrued variable compensation	(4,742)	12,806
Accrued liabilities, excluding accrued variable compensation and employee benefits	25,153	15,172
Self-insurance accruals	(10,042)	(11,970)
Accrued income taxes	(8,949)	31,218
Employee benefits	(55,865)	(51,430)
Deferred charges and credits	(3,915)	1,508
Other	(6,211)	(5,878)
Net Cash Provided by Operating Activities	229,703	236,050
Investing Activities		
Capital expenditures	(213,217)	(176,677)
Software expenditures	(5,743)	(7,280)
Proceeds from sales of property and equipment	19,385	6,083
Purchases of marketable securities	(8,200)	(11,230)
Proceeds from sales of marketable securities	23,613	525
Net Cash Used in Investing Activities	(184,162)	(188,579)
Financing Activities		
Repayment of capital leases	(25,868)	(14,884)
Net repayments of short-term borrowings	(3,891)	(3,732)
Payment of debt issuance costs	—	(661)
Proceeds from exercise of stock options	3,357	5,374
Excess tax benefit from share-based compensation	1,632	713
Payments of common dividends	(16,760)	(16,617)
Net Cash Used in Financing Activities	(41,530)	(29,807)
Increase in Cash and Cash Equivalents	4,011	17,664
Cash and Cash Equivalents, End of Period	$442,021	$439,084
Supplemental Disclosure		

Cash paid (refunded) for income taxes, net	$7,260	$(28,005)
Cash paid for interest, net of amounts capitalized	$43,105	$43,765
Non-cash Investing and Financing Activities		
Revenue equipment acquired through partial non-monetary exchanges	$23,974	$25,708
Repurchased common stock issued under defined contribution plan	$—	$17,307

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

CON-WAY INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Principal Accounting Policies

Organization

Con-way Inc. and its consolidated subsidiaries ("Con-way") provide transportation, logistics and supply-chain management services for a wide range of manufacturing, industrial and retail customers. Con-way's business units operate in regional and transcontinental less-than-truckload and full-truckload freight transportation, contract logistics and supply-chain management, multimodal freight brokerage, and trailer manufacturing. As more fully discussed in Note 3, "Segment Reporting," for financial reporting purposes, Con-way is divided into four reporting segments: Freight, Logistics, Truckload and Other.

Basis of Presentation

These unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and Rule 10-01 of Regulation S-X, and should be read in conjunction with Con-way's 2011 Annual Report on Form 10-K. Accordingly, significant accounting policies and other disclosures normally provided have been reduced or omitted. In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments, necessary to present fairly Con-way's financial position, results of operations and cash flows for the periods presented. Results for the interim periods presented are not necessarily indicative of annual results.

Earnings per Share ("EPS")

Basic EPS is computed by dividing net income by the weighted-average common shares outstanding during the period. Diluted EPS is calculated as follows:

(Dollars in thousands except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income	$25,304	$29,128	$92,750	$65,472
Denominator:				
Weighted-average common shares outstanding	55,906,636	55,535,074	55,806,937	55,331,170
Stock options and nonvested stock	556,899	582,260	625,279	722,889
	56,463,535	56,117,334	56,432,216	56,054,059
Diluted Earnings per Share:	$0.45	$0.52	$1.64	$1.17
Anti-dilutive securities excluded from the computation of diluted EPS	1,818,992	2,070,672	1,779,609	1,838,289

New Accounting Standards

As of September 30, 2012, there are no material new accounting standards that have been issued but not yet adopted by Con-way.

2. Goodwill and Intangible Assets

Goodwill

The following table shows the changes in the gross carrying amounts of goodwill attributable to each applicable segment:

(Dollars in thousands)	Logistics	Truckload	Other	Total
Balance at December 31, 2010				
Goodwill	$55,374	$464,598	$727	$520,699
Accumulated impairment losses	(48,236)	(134,813)	—	(183,049)
	7,138	329,785	727	337,650
Change in foreign currency exchange rates	66	—	—	66
Balances at December 31, 2011				
Goodwill	55,440	464,598	727	520,765
Accumulated impairment losses	(48,236)	(134,813)	—	(183,049)
	7,204	329,785	727	337,716
Change in foreign currency exchange rates	325	—	—	325
Balances at September 30, 2012				
Goodwill	55,765	464,598	727	521,090
Accumulated impairment losses	(48,236)	(134,813)	—	(183,049)
	$7,529	$329,785	$727	$338,041

Intangible Assets

Definite-lived intangible assets are amortized on a straight-line basis over their estimated useful lives. In the third quarter and first nine months of 2012, amortization expense related to intangible assets was $0.8 million and $2.4 million, respectively, compared to $0.9 million and $2.5 million in the same periods of 2011.

Intangible assets consisted of the following:

	September 30, 2012		December 31, 2011	
(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer relationships	$23,098	$11,512	$27,570	$13,619

Estimated amortization expense for the next five years is presented in the following table:

(Dollars in thousands)

Year ending December 31:	
Remaining three months of 2012	$590
2013	2,356
2014	2,356
2015	2,356
2016	2,356

2017	1,571

3. Segment Reporting

Con-way discloses segment information in the manner in which the business units are organized for making operating decisions, assessing performance and allocating resources. For the periods presented, Con-way is divided into the following four reporting segments:

- Freight. The Freight segment consists of the operating results of the Con-way Freight business unit, which provides regional, inter-regional and transcontinental less-than-truckload freight services throughout North America.
- Logistics. The Logistics segment consists of the operating results of the Menlo Worldwide Logistics business unit, which develops contract-logistics solutions, including the management of complex distribution networks and supply-chain engineering and consulting, and also provides multimodal freight-brokerage services.
- Truckload. The Truckload segment consists of the operating results of the Con-way Truckload business unit, which provides asset-based full-truckload freight services throughout North America.
- Other. The Other reporting segment consists of the operating results of Road Systems, a trailer manufacturer, and certain corporate activities for which the related income or expense has not been allocated to other reporting segments.

Financial Data

Management evaluates segment performance primarily based on revenue and operating income (loss). Accordingly, investment income, interest expense, and other non-operating items are not reported in segment results. Corporate expenses are generally allocated based on measurable services provided to each segment, or for general corporate expenses, based on segment revenue. Inter-segment revenue and related operating income (loss) have been eliminated to reconcile to consolidated revenue and operating income. Transactions between segments are generally based on negotiated prices.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues before Inter-segment Eliminations				
Freight	$858,276	$843,300	$2,567,847	$2,450,870
Logistics	427,790	417,142	1,294,965	1,181,129
Truckload	160,094	158,705	480,337	459,371
Other	15,229	12,160	44,156	36,454
Inter-segment Revenue Eliminations	(57,276)	(54,228)	(170,935)	(156,569)
	$1,404,113	$1,377,079	$4,216,370	$3,971,255
Inter-segment Revenue Eliminations				
Freight	$11,996	$13,205	$37,868	$36,931
Logistics	12,625	9,411	34,792	24,216
Truckload	18,502	20,921	57,273	63,291
Other	14,153	10,691	41,002	32,131
	$57,276	$54,228	$170,935	$156,569
Revenues from External Customers				
Freight	$846,280	$830,095	$2,529,979	$2,413,939
Logistics	415,165	407,731	1,260,173	1,156,913
Truckload	141,592	137,784	423,064	396,080
Other	1,076	1,469	3,154	4,323
	$1,404,113	$1,377,079	$4,216,370	$3,971,255
Operating Income (Loss)				
Freight	$34,441	$40,721	$122,372	$100,220
Logistics	10,990	12,679	35,972	33,420
Truckload	11,273	7,867	36,442	25,273
Other	(1,491)	(142)	(3,740)	(927)
	$55,213	$61,125	$191,046	$157,986

4. Fair-Value Measurements

Assets and liabilities reported at fair value are classified in one of the following three levels within the fair-value hierarchy:

Level 1: Quoted market prices in active markets for identical assets or liabilities
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data
Level 3: Unobservable inputs that are not corroborated by market data

Financial Assets Measured at Fair Value on a Recurring Basis

The following table summarizes the valuation of financial instruments within the fair-value hierarchy:

	September 30, 2012			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Cash equivalents	$398,496	$84,082	$314,414	$—
Current marketable securities	3,200	—	3,200	—
	December 31, 2011			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Cash equivalents	$398,450	$84,872	$313,578	$—

Current marketable securities	13,255	—	13,255	—
Other marketable securities	5,354	—	—	5,354

Cash equivalents consist of short-term interest-bearing instruments (primarily commercial paper, certificates of deposit and money-market funds) with maturities of three months or less at the date of purchase. Current marketable securities consist of variable-rate demand notes.

Money-market funds reflect their published net asset value and are classified as Level 1 instruments. Commercial paper, certificates of deposit and variable-rate demand notes are generally valued using published interest rates for instruments with similar terms and maturities, and accordingly, are classified as Level 2 instruments. At September 30, 2012, the weighted-average remaining maturity of the cash equivalents was less than one month. Based on their short maturities, the carrying amount of the cash equivalents approximates their fair value.

Level 3 investments consisted of one auction-rate security at December 31, 2010 and December 31, 2011, which was valued with an income approach that utilized a discounted cash flow model. This investment was sold during the three months ended September 30, 2012. The following table summarizes the change in fair value of Con-way's auction-rate security, which was valued using Level 3 inputs:

(Dollars in thousands)	Auction-rate security
Balance at December 31, 2010	$6,039
Loss included in other comprehensive income	(10)
Settlements	(675)
Balance at December 31, 2011	$5,354
Gains (Losses)	
Included in earnings	(367)
Included in other comprehensive income	371
Settlements and Sales	
Settlements	(75)
Sales	(5,283)
Balance at September 30, 2012	$—

5. Employee Benefit Plans

In the periods presented, employees of Con-way and its subsidiaries in the U.S. were covered under several retirement benefit plans, including defined benefit pension plans, defined contribution retirement plans and a postretirement medical plan. See Note 10, "Employee Benefit Plans," of Item 8, "Financial Statements and Supplementary Data," in Con-way's 2011 Annual Report on Form 10-K for additional information concerning its employee benefit plans, including changes to its defined contribution retirement plans.

Defined Benefit Pension Plans

As a result of plan amendments in previous years, no additional benefits accrue under these plans and already-accrued benefits will not be adjusted for future increases in compensation. The following table summarizes the components of net periodic benefit expense (income) for Con-way's domestic defined benefit pension plans:

	Qualified Pension Plans			
	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2012	2011	2012	2011
Interest cost on benefit obligation	$17,542	$17,827	$52,626	$53,482
Expected return on plan assets	(21,102)	(21,483)	(63,308)	(64,451)
Amortization of net loss	4,862	2,636	14,585	7,909
Net periodic benefit expense (income)	$1,302	$(1,020)	$3,903	$(3,060)

	Non-Qualified Pension Plans			
	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2012	2011	2012	2011
Interest cost on benefit obligation	$860	$946	$2,579	$2,840
Amortization of net loss	240	170	763	509
Net periodic benefit expense	$1,100	$1,116	$3,342	$3,349

Con-way has made $51.4 million in contributions to its Qualified Pension Plans in 2012, including $8.4 million contributed in October 2012. Con-way does not anticipate making any further contributions to the plans in 2012.

Defined Contribution Retirement Plans

Con-way's expense for defined contribution retirement plans was $12.0 million and $37.6 million in the third quarter and first nine months of 2012, respectively, compared to $8.4 million and $26.2 million in the same periods of 2011. In the periods presented, Con-way's contributions included cash and Con-way common stock. From January 2009 through June 2011, the common stock contributions were made with repurchased common stock (also referred to as treasury stock). In 2011, Con-way used 461,151 shares of treasury stock to fund $17.3 million of contributions.

Postretirement Medical Plan

The following table summarizes the components of net periodic benefit expense for the postretirement medical plan:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2012	2011	2012	2011
Service cost	$419	$360	$1,259	$1,081
Interest cost on benefit obligation	1,080	1,123	3,239	3,369
Amortization of prior service credit	(302)	(303)	(905)	(909)
Net periodic benefit expense	$1,197	$1,180	$3,593	$3,541

6. Share-Based Compensation

Under terms of its share-based compensation plans, Con-way grants various types of share-based compensation awards to employees and directors. In addition to the awards described in Note 11, “Share-Based Compensation,” of Item 8, “Financial Statements and Supplementary Data,” in Con-way’s 2011 Annual Report on Form 10-K, the plans also provide for awards in the form of performance-share plan units ("PSPUs"). The PSPUs vest three years from the grant date if certain performance criteria are achieved. The number of shares the award recipients ultimately receive depends upon the achievement of certain performance criteria and can range from 0% to 200% of the grant target. PSPUs are subject to forfeiture if an award recipient ceases to be an active full-time employee prior to the end of the three-year period, subject in some cases to early vesting upon specified events, including death or disability of the award recipient, or termination of employment following a change in control of Con-way. The PSPUs are valued at the market price of Con-way's common stock at the date of the award, reduced by the present value of the dividends not received during the three-year vesting period. The amount of expense recorded each period is based on Con-way's current estimate of the number of shares that will ultimately vest.

At September 30, 2012 and December 31, 2011, Con-way had recognized accrued liabilities for cash-settled Stock Appreciation Rights ("SARs") of $3.6 million and $3.1 million, respectively, using a weighted-average fair value per SAR of $7.91 and $10.85, respectively.

The following expense was recognized for share-based compensation:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2012	2011	2012	2011
Salaries, wages and employee benefits	$1,542	$316	$11,371	$9,485
Deferred income tax benefit	(596)	(89)	(4,414)	(3,665)
Net share-based compensation expense	$946	$227	$6,957	$5,820

7. Income Taxes

Con-way's third-quarter and year-to-date effective tax rates in 2012 were 38.5% and 37.0%, respectively. In the third quarter
and first nine months of 2011, the effective tax rates were 38.8% and 42.8%, respectively. The year-to-date 2012 tax provision reflects a $2.5 million benefit for discrete adjustments, including $4.2 million of benefit in the second quarter for the release of reserves due to the expiration of the statute of limitations on uncertain tax positions, partially offset by a $2.5 million second-quarter charge for a proposed Internal Revenue Service ("IRS") audit adjustment. The 2011 year-to-date tax provision reflects $6.0 million of charges for discrete adjustments, including a $5.9 million

first-quarter charge due to the matter discussed below under “Audit Settlement.” Excluding the effect of various discrete tax adjustments, the third-quarter and year-to-date 2012 effective tax rates were 38.4% and 38.7%, respectively. In the third quarter and first nine months of 2011, the effective tax rates, excluding discrete adjustments, were 37.4% and 37.5%, respectively. The rates in 2012 increased from 2011 primarily due to a 2011 benefit associated with a now-expired fuel-related tax credit.

Other accounts receivable in the consolidated balance sheets include income tax receivables of $13.3 million and $4.8 million at September 30, 2012 and December 31, 2011, respectively.

Audit Settlement

In 2011, Con-way settled a disputed issue with the IRS that arose in the 2005 to 2007 audit cycle. This issue primarily related to the treatment and character of certain payments Con-way made to retirees and former employees of Menlo Worldwide Forwarding, Inc. and its subsidiaries ("MWF") since the 2004 sale of MWF to United Parcel Service, Inc. Con-way and the IRS agreed in the settlement to re-characterize a portion of these payments as capital losses. The re-characterized portion may not be deducted and may be used only to offset capital gains.

8. Commitments and Contingencies

Purchase Obligations

In connection with its outsourcing initiative, Con-way entered into agreements with third-party service providers in the first quarter of 2010. Payments to the third-party providers are estimated to be $232 million between 2012 and 2016, when the agreements are expected to expire. The payments under the terms of the agreements are subject to change depending on the quantities and types of services consumed. The estimated payments reflect amounts based on projections of services expected to be consumed. The contracts also contain provisions that allow Con-way to terminate the contract at any time; however, Con-way would be required to pay additional fees if termination is for causes other than the failure of the service providers to perform. If Con-way had elected, for convenience, to terminate the contract for the outsourced information-technology services at December 31, 2011, the termination fee would have been approximately $34 million, compared to approximately $28 million if Con-way elects to terminate the contract on December 31, 2012.

Legal Matters

Con-way is a defendant in various legal matters incidental to its businesses. It is the opinion of management that the ultimate outcome of these actions will not have a material effect on Con-way's financial position, results of operations or cash flows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Management's Discussion and Analysis of Financial Condition and Results of Operations (referred to as "Management's Discussion and Analysis") is intended to assist in a historical and prospective understanding of Con-way's financial condition, results of operations and cash flows, including a discussion and analysis of the following:

- Overview of Business
- Results of Operations
- Liquidity and Capital Resources
- Critical Accounting Policies and Estimates
- Forward-Looking Statements

Overview of Business

Con-way provides transportation, logistics and supply-chain management services for a wide range of manufacturing, industrial and retail customers through three primary business units: Con-way Freight, Menlo Worldwide Logistics and Con-way Truckload. These business units operate in regional and transcontinental less-than-truckload and full-truckload freight transportation, contract logistics and supply-chain management, and multimodal freight brokerage. For financial reporting purposes, Con-way is divided into four reporting segments:

- Freight. The Freight segment consists of the operating results of the Con-way Freight business unit, which provides regional, inter-regional and transcontinental less-than-truckload freight services throughout North America.
- Logistics. The Logistics segment consists of the operating results of the Menlo Worldwide Logistics business unit, which develops contract-logistics solutions, including the management of complex distribution networks and supply-chain engineering and consulting, and also provides multimodal freight-brokerage services.
- Truckload. The Truckload segment consists of the operating results of the Con-way Truckload business unit, which provides asset-based full-truckload freight services throughout North America.
- Other. The Other reporting segment consists of the operating results of Road Systems, a trailer manufacturer, and certain corporate activities for which the related income or expense has not been allocated to other reporting segments.

Con-way Freight primarily transports shipments utilizing a network of freight service centers combined with a fleet of company-operated line-haul and pickup-and-delivery tractors and trailers. Menlo Worldwide Logistics manages the logistics functions of its customers and primarily utilizes third-party transportation providers for the movement of customer shipments. Con-way Truckload primarily transports shipments using a fleet of company-operated long-haul tractors and trailers.

Con-way's primary business-unit results generally depend on the number, weight and distance of shipments transported, the prices received on those shipments or services and the mix of services provided to customers, as well as the fixed and variable costs incurred by Con-way in providing the services and the ability to manage those costs under changing circumstances. Due to Con-way Freight's cost structure, sudden or severe changes in shipment volumes can have a negative impact on management's ability to manage costs.

Con-way's primary business units are affected by the timing and degree of fluctuations in fuel prices and their ability to recover incremental fuel costs through fuel-surcharge programs and/or cost-recovery mechanisms, as more fully discussed in Item 3, "Quantitative and Qualitative Disclosures About Market Risk – Fuel."

Results of Operations

The overview below provides a high-level summary of Con-way's results of operations for the periods presented and is intended to provide context for the remainder of the discussion on reporting segments. Refer to "Reporting Segment Review" below for more complete and detailed discussion and analysis.

(Dollars in thousands except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	$1,404,113	$1,377,079	$4,216,370	$3,971,255
Operating expenses	1,348,900	1,315,954	4,025,324	3,813,269
Operating income	55,213	61,125	191,046	157,986
Other non-operating expense	14,055	13,519	43,769	43,575
Income before income tax provision	41,158	47,606	147,277	114,411
Income tax provision	15,854	18,478	54,527	48,939
Net income	$25,304	$29,128	$92,750	$65,472
Diluted earnings per share	$0.45	$0.52	$1.64	$1.17

Overview

Con-way's third-quarter consolidated revenue increased 2.0% in 2012 compared with 2011, and consolidated revenue on a year-to-date basis increased 6.2% from 2011 to 2012. The increases in consolidated revenue for both periods reflect higher revenue at all segments.

Con-way's consolidated operating income for the third quarter decreased 9.7% to $55.2 million in 2012 from $61.1 million in 2011, the result of declines in the Freight, Logistics and Other segments. The declines at Freight and Logistics were the result of reduced operating margins, while the decline in Other was due to reinsurance activities. In the year-to-date periods, operating income increased 20.9% to $191.0 million in 2012 from $158.0 million in 2011, primarily due to increases at the Freight and Truckload segments.

Con-way's third-quarter and year-to-date effective tax rates in 2012 were 38.5% and 37.0%, respectively. In the third quarter and first nine months of 2011, the effective tax rates were 38.8% and 42.8%, respectively. Both years included discrete tax adjustments that affected the effective tax rate, as more fully discussed in Note 7, "Income Taxes," of Item 1, "Financial Statements." Excluding the discrete tax adjustments, the third-quarter and year-to-date effective tax rates in 2012 were 38.4% and 38.7%, respectively, compared to 37.4% and 37.5%, respectively, in 2011. The rates in 2012 increased from 2011 primarily due to a 2011 benefit associated with a now-expired fuel-related tax credit.

Cost-Reduction Actions

In response to economic conditions, in March 2009, Con-way announced several employee-related measures to reduce costs and conserve cash, as detailed in Item 7, "Management's Discussion and Analysis - Results of Operations - Overview," in Conway's 2011 Annual Report on Form 10-K. For the periods presented, Con-way's comparative expenses were affected by the reinstatement of certain employer contributions to the defined contribution retirement plan in the fourth quarter of 2011. One of the suspended benefits, matching contributions to the defined contribution retirement plan, has not been reinstated. Any potential reinstatement of Con-way's matching contributions is based on a number of considerations.

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Reporting Segment Review

For the discussion and analysis of segment operating results, management utilizes revenue before inter-segment eliminations. Management believes that revenue before inter-segment eliminations, combined with the detailed operating expense information, provides the most meaningful analysis of segment results. Revenue before inter-segment eliminations is reconciled to revenue from external customers in Note 3, “Segment Reporting,” of Item 1, “Financial Statements.”

Freight

The following table compares operating results, operating margins, and the percentage change in selected operating statistics of the Freight reporting segment:

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue before inter-segment eliminations	$858,276	$843,300	$2,567,847	$2,450,870
Salaries, wages and employee benefits	393,509	382,545	1,170,174	1,120,203
Purchased transportation	149,655	138,520	436,917	396,761
Other operating expenses	113,153	113,294	334,048	336,789
Fuel and fuel-related taxes	91,239	96,549	285,501	293,003
Depreciation and amortization	31,576	27,562	92,624	82,729
Maintenance	24,868	25,546	72,709	70,779
Rents and leases	13,119	12,460	37,229	35,235
Purchased labor	6,716	6,103	16,273	15,151
Total operating expenses	823,835	802,579	2,445,475	2,350,650
Operating income	$34,441	$40,721	$122,372	$100,220
Operating margin	4.0 %	4.8 %	4.8 %	4.1 %
	2012 vs. 2011			