Covenant Transportation Group 1st Quarter 2018 Conference Call

Mr. Cribbs – Good morning and welcome to our first quarter conference call. Joining me on the call this morning are David Parker and Joey Hogan.

This conference call will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Please review our disclosures in filings with the Securities Exchange Commission, including, without limitation, the Risk factors section in our most recent Form 10-K. We undertake no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

A copy of our prepared comments and additional financial information is available on our website at www.covenanttransport.com/investors. Our prepared comments will be brief and then we will open up the call for questions.

In summary, the key highlights of the quarter were:

- Our asset-based divisions' revenue, excluding fuel, increased 3.5% to $131.4 million due primarily to a 6.3% increase in average freight revenue per tractor, partially offset by a $3.2 million year-over-year reduction in intermodal revenues
- Versus the year ago period average freight revenue per total mile was up $.154 per mile or 9.5% and our average miles per tractor were down 2.9%,
- Versus the prior year quarter, freight revenue per tractor at our Covenant Transport subsidiary experienced an increase of 6.5%, and our Southern Refrigerated Transport ("SRT") subsidiary experienced an increase of 9.2%, while our Star Transportation ("Star") subsidiary experienced a decrease of 1.1%,
- The asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.026 per mile compared to the year ago period. This was mainly attributable to higher employee wages. These increases were partially offset by lower net fuel costs,
- We recognized a loss on disposal of equipment of $1.1 million in the first quarter of 2018 versus a loss of $0.4 million in the first quarter of 2017,
- The asset-based operating ratio was 95.9% in the first quarter of 2018, compared with 100.9% in the first quarter of 2017,
- Our Solutions logistics subsidiary increased revenue by 45.0% versus the year ago quarter. Purchased transportation increased as a percentage of revenue, while other operating expenses decreased as a percentage of revenue resulting in operating ratio contraction to 94.4% from 89.0% in the year ago quarter. The result was a

decrease of operating income contribution to $1.1 million in the current year quarter from $1.4 million in the prior year quarter,

- Our minority investment in Transport Enterprise Leasing contributed $1.5 million to pre-tax earnings or $.06 per share,
- The average age of our tractor fleet continues to be young at 2.1 years as of the end of the quarter, although up from 2.0 years a year ago,
- Since December 31, 2017, total indebtedness, net of cash and including the present value of off-balance sheet lease obligations has decreased by approximately $24.9 million to $195.2 million.

The main positives in the first quarter were 1) significant improvement in the operating profitability at each of our three asset-based truckload subsidiaries, 2) a 6.3% increase in average freight revenue per truck versus the same quarter of 2017, 3) deleveraging with a $24.9 million decrease in our total net indebtedness, 4) improved year-over-year earnings from our investment in Transport Enterprise Leasing, and 5) our tangible book value per basic share increased 27.5% to $16.46 from $12.91 a year ago. The main negatives in the quarter were 1) the operating income decline from our Solutions subsidiary, and 2) increased truckload operating costs on a per mile basis, including unfavorable employee wages, partially offset by lower net fuel costs.

Our fleet experienced an increase to 2,576 trucks by the end of March, a 17 truck increase from our reported fleet size of 2,559 trucks at the end of December. Our fleet of team-driven trucks averaged 894 teams in the first quarter of 2018, a 2.0% decrease from 912 average teams in the fourth quarter of 2017.

From a financial perspective, we are forecasting sequential operating income improvement in each of the remaining quarters of 2018. Based on our expectation of a continuation of recent U.S. economic growth, as well as continued regulatory and demographic capacity constraints on driver availability, we expect year-over-year average freight revenue per total mile to be positive over the remainder of the year by a high single digit percentage. The percentage may be greatest in the second quarter, when a large portion of our annual contractual rate revisions are scheduled and the comparison to last year's quarter is most favorable. The expected increase in yield will be offset in part by higher employee wages, the potential for miles per tractor to remain lower than last year, and inflationary factors. All in all, we expect meaningful year-over-year improvements in earnings per share each quarter of 2018.

In terms of strategic and operating considerations, we remain focused on positioning our service offerings for extended success in their respective markets and continuing to develop and grow our professional driver employee base. A key initiative for our business in 2018 is becoming closer to our customers. As we allocate our capacity in the currently robust freight market, we are seeking to partner with customers that will integrate us deeper into their supply chains, offer operationally friendly and seasonally manageable volumes, and respect our drivers’ time and value. We expect to increase our capital allocation toward dedicated, 3PL, and other managed freight solutions to become the go-to partner for our customers' most critical transportation and logistics needs. In this regard, we believe our diverse service offerings provide a valuable asset that we can leverage to achieve this goal, while our enterprise-wide sales effort will make it easier to do business with us. We continue to expect significant earnings contribution from peak shipments in November-December of each year; however, the focus on these other services is intended to reduce the seasonal volatility we have experienced in previous years. As we pursue our goals, we expect the professional driver environment to continue to offer significant challenges as well as the opportunity to differentiate the Covenant group of companies as the carrier of choice for many drivers. Many small competitors face the prospect of network disruption and substantially lower paid miles for their drivers due to the enforcement of mandatory electronic log requirements. Our network has been built on years of electronic log compliance, and we are actively working with our customers to maximize the efficiency and utility of our drivers' hours of service. We expect to continue to reward our drivers with pay increases to maintain or improve our seated truck percentage. In addition, we will continue to be highly focused on all aspects of our drivers' experience, giving them the resources they need to enjoy their time with us, spend more time with their families, provide excellent customer service, and view us as a safe and rewarding home.

Thank you for your time and we will now open up the call for any questions.