

Covenant Transportation Group 3rd Quarter 2019 Conference Call

Mr. Cribbs – Good morning and welcome to our third 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 and our current year Form 10-Qs. 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 the call for questions.

In summary, the key highlights of the quarter were:

- Our Truckload segment's revenue, excluding fuel, decreased 9.7% to \$152.0 million due primarily to a 9.5% decrease in average freight revenue per truck, along with a small 9 (or 0.3%) average truck decrease in the 2019 period as compared to the 2018 period,
- Versus the year ago period average freight revenue per total mile was down \$.109 per mile or 5.5% and our average miles per tractor were down 4.2%. The main factor impacting the decreased freight revenue per total mile was the much weaker freight environment in the current year quarter. The main factors impacting the decreased utilization was an approximate 160 basis point decrease in the percentage of our total fleet comprised of team-driven trucks and a lower freight demand in relation to industry-wide trucking capacity,
- Versus the prior year quarter, freight revenue per tractor at our Covenant Transport subsidiary experienced a decrease of 8.9%, the SRT subsidiary experienced a decrease of 12.9%, our Star subsidiary experienced a decrease of 4.4%, and the Truckload division at Landair experienced a decrease of 1.0%,
- The Truckload segment's operating costs per mile, net of surcharge revenue, were up approximately \$.10 per mile compared to the year ago period. This was mainly attributable to higher group health, workers' compensation and casualty insurance claims costs, net fuel expense, and capital costs, partially offset by reduced non-driver wages and operations and maintenance expense,
- Our Managed Freight segment's revenue, excluding fuel, increased 3.4% versus the year ago quarter to \$47.8 million from \$46.3 million,
- Our minority investment in Transport Enterprise Leasing contributed \$2.1 million to pre-tax earnings or \$0.08 per diluted share in the third quarter of 2019, equal to the prior year quarter,

- The average age of our tractor fleet continues to be young at 2.0 years as of the end of the quarter, down from 2.3 years a year ago,
- During the third quarter, we took delivery of 485 new tractors and disposed of 182 used tractors, with the large influx causing a temporary increase in excess tractor units that impacted our capital costs and total indebtedness; we expect to dispose of most of the excess tractor units in the fourth quarter of 2019,
- Since December 31, 2018, total indebtedness, net of cash and including lease obligations has increased by approximately \$74.3 million to \$328.8 million. At September 30, 2019, our stockholders' equity was \$348.4 million, for a ratio of net indebtedness to total capitalization of 48.5%, compared to a 42.6% ratio as of December 31, 2018. In addition, our leverage ratio has increased to 2.3x as of September 30, 2019 from 1.5x as of December 31, 2018.

The main positives in the third quarter were 1) consistent demand and profitability from our Landair dedicated and managed freight businesses in a difficult freight economy, 2) steady earnings contributed from our investment in Transport Enterprise Leasing, and 3) increasing our percentage of operating trucks with automatic transmissions to over 95%. The main negatives in the quarter were 1) the operating margin declines of our expedited and solo refrigerated service offerings, 2) an approximate 9.5% year-over-year decrease in average freight revenue per truck for our Truckload segment, 3) increased Truckload operating costs on a per mile basis, most notably from unfavorable group health, workers' compensation and casualty insurance expense, net fuel costs, and capital costs, and 4) the \$34.3 million quarterly increase in our total net indebtedness primarily related to the delay of proceeds from disposals of used revenue equipment to adequately offset the expenditures for a large portion of our annual new tractor deliveries during the quarter.

Our operational fleet size experienced a decrease to 3,008 by the end of September, a 93-truck decrease from our reported fleet size of 3,101 trucks at the end of June. This decrease was primarily driven by a reduction of trucks from our solo-driven one-way fleets. This was partially offset by an increase to our dedicated fleet.

For the fourth quarter of 2019, we expect to remain an important provider in our customers' peak season supply chains. However, given the current imbalance of capacity and demand, we expect pricing and volume levels to remain subdued compared with the last several holiday peak seasons. Our focus will be on identifying opportunities to improve the performance of our one-way truckload service offerings and adding more predictable long-term contracts in our dedicated truckload, transportation management and warehousing service offerings. Barring unforeseen circumstances, we expect our combined insurance and capital costs to decrease sequentially as compared to the third quarter of 2019 and anticipate our consolidated adjusted net income to improve sequentially to a profitable level in the fourth quarter of 2019.

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