Covenant Transportation Group 2nd Quarter 2019 Conference Call

Mr. Cribbs – Good morning and welcome to our second 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, increased 4.2% to $151.2 million due primarily to a 486 (or 18.7%) average truck increase, partially offset by a 12.2% decrease in average freight revenue per truck in the 2019 period as compared to the 2018 period. Of the 486 increased average trucks, 467 trucks were contributed by the Landair acquisition as Landair contributed $20.6 million of freight revenue to combined truckload operations in the second quarter of 2019,
- Versus the year ago period average freight revenue per total mile was down $.018 per mile or 1.0% and our average miles per tractor were down 11.3%. The main factor impacting the decreased freight revenue per total mile was a higher percentage of lower rate dedicated freight revenue at the Covenant Transport, Southern Refrigerated Transport ("SRT"), and Star Transportation ("Star) subsidiaries, partially offset by the Landair dedicated fleet's higher average freight revenue per total mile. The main factors impacting the decreased utilization include the softer freight environment in our one-way truckload businesses and the impact of Landair operations on the combined truckload division, including an approximate 640 basis point decrease in the percentage of our total fleet comprised of team-driven trucks, partially offset by a lower average seated truck percentage. Landair's shorter average length of haul and dedicated contract, solo-driven truck operations generally produce higher revenue per total mile and fewer miles per tractor than our other truckload business units,
- Versus the prior year quarter, freight revenue per tractor at our Covenant Transport subsidiary experienced a decrease of 11.1%, the SRT subsidiary experienced a decrease of 7.8%, and our Star subsidiary experienced a decrease of 5.1%,

- The Truckload segment's operating costs per mile, net of surcharge revenue, were up approximately $.070 per mile compared to the year ago period. This was mainly attributable to higher professional driver wages, group health insurance claims costs, net fuel expense, operations and maintenance expense, and the impact of the Landair truckload operations' higher cost per mile model. These increases were partially offset by a reversal of $1.8 million in compensation expense related to certain equity grants accrued between January 2018 and March 2019, as reduced earnings have made performance vesting not probable for such restricted stock grants,
- Our Managed Freight segment's revenue, excluding fuel, increased 70.8% versus the year ago quarter to $43.7 million from $25.6 million. Of the $18.1 million of increased revenue, Landair contributed $21.2 million of revenue to combined Managed Freight operations in the second quarter of 2019, offset by a $3.1 million reduction in freight revenue from our brokerage subsidiary,
- Our minority investment in Transport Enterprise Leasing contributed $2.4 million to pre-tax earnings or $0.09 per diluted share in the second quarter of 2019, compared with a $1.8 million contribution to pre-tax earnings or $0.07 per diluted share in the prior year quarter,
- The average age of our tractor fleet continues to be young at 2.2 years as of the end of the quarter, slightly up from 2.1 years a year ago,
- Since December 31, 2018, total indebtedness, net of cash and including lease obligations has increased by approximately $39.9 million to $294.5 million. At June 30, 2019, our stockholders' equity was $351.7 million, for a ratio of net indebtedness to total capitalization of 45.6%, compared to a 42.6% ratio as of December 31, 2018. In addition, our leverage ratio has increased to 1.8x as of June 30, 2019 from 1.5x as of December 31, 2018.

The main positives in the second quarter were 1) improvement in the operating income at our Managed Freight segment, including successful integration of Landair's warehousing and transportation management service offerings, 2) improved year-over-year earnings contributed from our investment in Transport Enterprise Leasing, and 3) consistent demand and profitability from our growing dedicated businesses at Landair and Star. The main negatives in the quarter were 1) the operating margin declines of our expedited and solo refrigerated service offerings, 2) an approximate 10.6% decrease in average freight revenue per truck for our Truckload segment, excluding Landair's truckload operations versus the second quarter of 2018, and 3) increased Truckload operating costs on a per mile basis, primarily from increased professional driver wages, group health insurance, net fuel costs and operations and maintenance expense.

Our fleet size remained basically flat with 3,101 trucks at the end of June, a 2-truck decrease from our reported fleet size of 3,103 trucks at the end of March.

For the second half of the year, our focus will be on identifying opportunities to improve the performance of our one-way truckload service offerings and adding profitable contract logistics service customers with more predictable long-term contracts in our dedicated truckload, transportation management and warehousing service offerings.

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