Covenant Transportation Group 1st Quarter 2019 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 Truckload segment's revenue, excluding fuel, increased 13.7% to $149.4 million due primarily to a 560 (or 21.9%) average truck increase, partially offset by a 6.7% decrease in average freight revenue per truck in the 2019 period as compared to the 2018 period. Of the 560 increased average trucks, 435 average trucks were contributed by the Landair acquisition as Landair contributed $20.0 million of freight revenue to combined truckload operations in the first quarter of 2019,
- Versus the year ago period average freight revenue per total mile was up $.116 per mile or 6.6% and our average miles per tractor were down 12.5%. Truckload rates were impacted favorably and utilization was impacted unfavorably by the impact of the Landair operations on the combined truckload segment. 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 8.0%, our Southern Refrigerated Transport ("SRT") subsidiary experienced a decrease of 1.5%, and our Star Transportation ("Star") subsidiary experienced a decrease of 0.7%,
- The Truckload segment's operating costs per mile, net of surcharge revenue, were up approximately $.172 per mile compared to the year ago period. This was mainly attributable to higher employee wages, casualty insurance claims costs, and the impact of the Landair truckload operations' higher cost per mile model. These increases were partially offset by lower net fuel costs and net depreciation expense as we recognized a gain on disposal of equipment totaling $0.1 million in the first quarter of 2019 versus a loss of $1.1 million in the first quarter of 2018,

- The Truckload segment's adjusted operating ratio was 98.8% in the first quarter of 2019, compared with 95.9% in the first quarter of 2018,
- Our Managed Freight segment's revenue, excluding fuel, increased 143.7% versus the year ago quarter to $46.4 million from $19.0 million. Of the $27.4 million of increased revenue, Landair contributed $20.2 million of revenue to combined Managed Freight operations in the first quarter of 2019. The Managed Freight segment's adjusted operating ratio was 90.4% in the first quarter of 2019, compared with 94.4% in the first quarter of 2018. The result was an increase of Managed Freight adjusted operating income contribution to $4.4 million in the current year quarter from $1.1 million in the prior year quarter,
- Our minority investment in Transport Enterprise Leasing contributed $3.0 million to pre-tax earnings or $.12 per diluted share in the first quarter of 2019, compared with a $1.5 million contribution to pre-tax earnings or $0.06 per diluted share in the prior year quarter,
- The average age of our tractor fleet continues to be young at 2.3 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 operating lease liabilities has increased by approximately $24.4 million to $279.0 million. At March 31, 2019, our stockholders' equity was $347.7 million, for a ratio of net indebtedness to total capitalization of 44.5%, compared to a 42.6% ratio as of December 31, 2018. In addition, our leverage ratio has increased to 1.7x as of March 31, 2019 from 1.5x as of December 31, 2018.

The main positives in the first quarter were 1) improvement in the operating income and operating margin at our Managed Freight segment, including successful integration of Landair's warehousing and transportation management service offerings, 2) the organic growth of our freight brokerage service offering as compared to the first quarter of 2018, and 3) improved year-over-year earnings contributed from our investment in Transport Enterprise Leasing. The main negatives in the quarter were 1) the operating margin declines of our expedited and solo refrigerated service offerings, 2) an approximate 6.1% decrease in average freight revenue per truck for our Truckload segment, excluding Landair's truckload operations versus the first quarter of 2018, 3) increased Truckload operating costs on a per mile basis, most notably the unfavorable employee wages and casualty insurance claims costs, partially offset by improved net depreciation expense, and 4) the $24.4 million quarterly increase in our total net indebtedness primarily related to the growth of receivables purchased by our factoring division during the first quarter of 2019.

Our fleet experienced a decrease to 3,103 trucks by the end of March, a 51-truck decrease from our reported fleet size of 3,154 trucks at the end of December. This decrease was primarily driven by a reduction of trucks from our solo-driven one-way fleets. This was partially offset by 24-truck increase to 1,677 dedicated fleet trucks at March 31, 2019.

We intend to continue executing our strategic plan of becoming increasingly embedded in our customers' supply chains by growing our Managed Freight segment and the portions of our Truckload segment with more predictable long-term contracts. Based on the current freight market and normal seasonal patterns, we expect second quarter 2019 adjusted earnings per diluted share to be fairly consistent with the prior year quarter, based on the favorable impact of earnings contribution from Landair's service offerings, partially offset by the unfavorable impact of the slower freight market in general.

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