Covenant Transportation Group 3rd Quarter 2017 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 Form 10-Q. 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.ctgcompanies.com/investor-relations. 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 1.2% to $133.9 million due primarily to a 4.1% increase in average freight revenue per tractor, partially offset by a 2.6% decrease in average tractors,
- Versus the year ago period average freight revenue per total mile was up $.070 per mile or 4.4% and our miles per tractor per week were down 0.3%,
- Freight revenue per tractor at our Covenant Transport subsidiary experienced an increase of 4.5% versus the prior year quarter, and our refrigerated subsidiary, SRT, experienced an increase of 7.2%, while our Star Transportation ("Star") subsidiary experienced a decrease of 6.6%,
- The asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.031 per mile compared to the year ago period. This was mainly attributable to higher employee wages and maintenance expenses. These increases were partially offset by lower net fuel and capital costs,
- We recognized a loss on disposal of equipment of $0.7 million in the third quarter of 2017 versus a loss of $0.4 million in the third quarter of 2016,
- The asset-based operating ratio was 95.1% in the third quarter of 2017, compared with 97.3% in the third quarter of 2016,
- Our Solutions logistics subsidiary increased revenue by 60.8% 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 deterioration to 90.3% from 88.5% in the year ago quarter. With the increased revenue, the result was an increase of operating income contribution to $2.5 million in the current year quarter from $1.8 million in the prior year quarter,

- Our minority investment in Transport Enterprise Leasing contributed $0.8 million to pre-tax earnings or $.03 per share,
- The average age of our tractor fleet continues to be young at 2.2 years as of the end of the quarter, although up from 1.7 years a year ago,
- Since December 31, 2016, total indebtedness, net of cash and including the present value of off-balance sheet lease obligations has decreased by approximately $0.8 million to $225.9 million. For the fourth quarter, with positive cash flow from operations and a capital plan of 35 new tractor deliveries against 300 tractors scheduled for disposal, we expect total net indebtedness to decrease.

The main positives in the third quarter were 1) a 4.1% increase in average freight revenue per truck versus the same quarter of 2016, 2) excluding unallocated corporate overhead expenses, year-over-year quarterly operating income improvement of $2.6 million from our SRT subsidiary, 3) year-over-year revenue and operating income growth from our Solutions subsidiary, and 4) our tangible book value per basic share increased 7.9% to $13.36 from $12.38 a year ago. The main negatives in the quarter were increased operating costs on a per mile basis, including unfavorable employee wages, and maintenance expense, partially offset by lower net fuel expense and capital costs. The increases in wages and maintenance expense were consistent with our expectations based on the labor market and our targeted fleet age.

Our fleet experienced a decrease to 2,550 trucks by the end of September, a 27 truck decrease from our reported fleet size of 2,577 trucks at the end of June. Our fleet of team-driven trucks averaged 967 teams in the third quarter of 2017, a 4.4% decrease from 1,012 average teams in the second quarter of 2017.

There was significant noise in our quarterly productivity resulting from the devastating hurricanes experienced in the Southwest and Southeast regions of the United States. Following a slower Independence Day holiday week, July strengthened resulting in year-over-year July miles per tractor being up 0.4%. Supply/demand dynamics continued to tighten further as August miles per tractor finished up 3.1% compared with the prior year, even with the unfavorable impact in the last week of August resulting from Hurricane Harvey in the Southwest. In September, we continued to feel extreme tightness in the freight market, however significant productivity was lost in the Southeast during the middle of the month related to Hurricane Irma, resulting in a 4.5% year-over-year decrease in average miles per tractor.

Our outlook for the fourth quarter of 2017 is positive. Our goal remains to deliver earnings improvement for the fourth quarter of 2017 as compared to the fourth quarter of 2016. We expect strong customer demand to continue throughout the fourth quarter in all of our service offerings, as well as tightening of truckload supply as the mandatory ELD implementation date approaches. However, the timing and magnitude of these changes are difficult to predict and may be different in each of our markets. We expect year-over-year net fuel expense savings, and a flattening of the year-over-year impact of the changes to our depreciation policy adopted in the third quarter of 2016, somewhat offset by higher maintenance expense and professional driver wages. At SRT, we expect additional progress in the remaining quarter of 2017 versus 2016.

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