Covenant Transportation Group 1st Quarter 2020 Conference Call

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

> *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 Highway Services Truckload segment's revenue, excluding fuel, decreased 1.0% to $77.0 million due primarily to a 5.8% (or 80 tractors) average operating fleet reduction, partially offset by a 5.1% increase in average freight revenue per tractor in the 2020 period as compared to the 2019 period. Versus the year ago period, average freight revenue per total mile was down 7.3 cents or 3.7%, while average miles per tractor was up 9.1%. The main factors impacting the increased utilization were a 710 basis point increase in the percentage of our Highway Services' fleet comprised of team-driven tractors and an improved average seated tractor percentage, as only 3.1% of our Highway Services' tractor fleet lacked drivers compared with 7.7% during the prior year quarter,
- Our Dedicated Truckload segment's revenue, excluding fuel, decreased 2.5% to $69.9 million due primarily to a 3.1% (or 53 tractors) average operating fleet reduction, partially offset by a 0.6% increase in average freight revenue per tractor in the 2020 period as compared to the 2019 period. Versus the year ago period, average freight revenue per total mile was down 2.9 cents or 1.6%, while average miles per tractor was up 2.2%,
- The combined Truckload segment's operating cost per mile, net of surcharge revenue, increased just 0.4 cents compared to the year ago period. This was attributable to higher non-driver wages, group health, workers' compensation and casualty insurance claims' costs, basically offset by lower maintenance & repair, unloading, recruiting, net fuel, and capital costs,
- Our Managed Freight segment's operating revenue decreased 4.0% versus the year ago quarter to $42.7 million. This decrease was driven by a 10.4% decrease in freight brokerage operating revenue to $21.8 million, partially offset by a 3.7% increase in the combined operating revenues of TMS and Warehousing. Managed Freight operating income was $1.6 million for an operating ratio of 96.2%,

- Our Factoring segment's net fee revenue increased 48.2% versus the year ago quarter to $2.7 million. Factoring segment operating income was $2.2 million, compared with $1.5 million in the prior year quarter. The increase in net fee revenue and operating income is the result of new customers, as well as growth with prior existing customers,
- We recognized a $0.7 million pre-tax loss from our 49% equity investment in TEL, compared with pre-tax income of $3.0 million in the first quarter of 2019. Ongoing weakness in the truck sales and leasing market contributed to these results,
- The average age of our tractor fleet continues to be young at 1.8 years as of the end of the quarter, down from 2.3 years a year ago,
- During the first quarter, we took delivery of ≈ 250 new tractors and 65 new trailers, while disposing of ≈ 375 used tractors and 190 used trailers. We reduced our operational fleet size by 74 tractors, or 2.4%, to 2,947 tractors by the end of March from our reported operational fleet size of 3,021 tractors at the end of December.
- By the end of 2020, the size of our operational tractor fleet is expected to be down 12.0% to 14.0% compared to the end of 2019, allowing us to maximize the utilization of our operational fleet including culling out lower performing freight where some shippers are not willing to sufficiently compensate us during the immediate term before freight demand returns and truckload oversupply is corrected,
- Between December 31, 2019 and March 31, 2020, total indebtedness, net of cash increased by $32.2 million to $336.8 million. This sequential increase to net indebtedness included cash payments during the first quarter of 2020 totaling $17.5 million for the repurchase of over 1.4 million shares of our common stock prior to the suspension of our stock repurchase plan in late March and a $24.2 million increase to net funds employed in our factoring business to $106.6 million at March 31, 2020. Total indebtedness, net of cash decreased by $16.9 million for the month to $319.9 million at April 30, 2020,
- At March 31, 2020, we had cash and cash equivalents totaling $39.7 million, as well as available borrowing capacity of $35.6 million under our asset-based revolving credit ("ABL") facility for a total of $75.3 million in liquidity. The sole financial covenant under our ABL facility is a fixed charge coverage ratio covenant that is tested only when available borrowing capacity is below a certain threshold. Based on availability as of March 31, 2020, no testing was required, and we do not expect testing to be required in the foreseeable future. Liquidity increased $9.7 million for the month to $85.0 million at April 30, 2020.

The main positives in the first quarter were 1) realignment of our executive structure and organizing our talent to most effectively design and execute our strategic initiatives, 2) completion and initiation of certain elements of our plan to reduce our total capital employed while reducing leverage and prioritizing our higher margin and less volatile core service offerings, 3) cost control planning and ongoing execution to provide significant cost savings as we move through the fiscal year, 4) the swift and effective response to Covid-19 by our teammates, 5) year-over-year average freight revenue per tractor increases in each of the Highway Services and Dedicated Truckload segments, 6) Combined Truckload segment operating costs, net of fuel surcharges increased just 0.4 cents per mile compared to the first quarter of 2019,

even with an excessively adverse insurance and claims expense quarter, partially offset by the $1.7 million gain on the sale of our Orlando terminal and 7) growth and increased profitability from our Factoring segment. The main negatives in the quarter were 1) the revenue and related profitability lost while two of our large dedicated automotive customers shutdown operations in mid-March related to Covid-19 precautionary measures and are just now slowly stepping up production this week, 2) the pass-through loss from our investment in TEL, and 3) net indebtedness increasing $32.2 million from the end of 2019 as we made the decision to repurchase $17.5 million of our common stock and to grow our factoring segment significantly.

We are encouraged by the initial positive results of our strategic plan execution and structural advancements, as an improved business mix and our cost control efforts offset the impact of a challenging volume and pricing environment in April. However, we expect volatility from month to month over the remainder of the year due to external factors as well as gains and losses associated with our internal initiatives and changes in our revenue and cost structure. Accordingly, our prior outlook for 2020 is no longer applicable and we do not expect to provide earnings or similar expectations for the foreseeable future. In the near term, we are well-prepared in to support our partner-customers as their productivity, the economy and business levels return to normal. Over the longer term, we believe the influential structural improvements and strategic initiatives we are executing will strengthen our position in the U.S. logistics industry, de-risk our leverage profile, and concentrate our less-cyclical business model on more sustainable, higher margin sectors where we can add considerably greater value to our partner-customers and for our stakeholders.

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