

Covenant Logistics Group 2nd Quarter 2022 Conference Call

Mr. Hogan – Welcome to the Covenant Logistics Group second quarter 2022 conference call.

As a reminder:

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 publicly update or revise any forward-looking statements to reflect subsequent events or circumstances.

A copy of the prepared comments and additional financial information is available on our website at www.covenantlogistics.com/investors. I am joined on the call by David Parker, Paul Bunn, and Tripp Grant.

We are grateful to our teammates for again producing record earnings per share for any quarter in our history. The transformation of the company that we have been working on for the past 5 years continues to build our confidence in our direction and leadership team. Our asset-based truckload operations lead the charge in the second quarter improving its operating income 76% despite a significant headwind in operating costs, primarily insurance claims expense and less gain on sale (the combined increased cost is \$.20 per share). Additionally, the small acquisition we made in the first quarter, plus the continued pursuit of investing in our undervalued company stock contributed nicely to the improved results versus year ago. Despite the murky economic outlook, we are bullish on Covenant.

In summary, the key highlights of the quarter were:

- Freight revenue grew 15% to \$267 million compared to the 2021 quarter,
- Adjusted earnings per share increased 70% to \$1.63 per share from the year ago quarter,
- Our asset-based truckload's freight revenue grew 16% versus the second quarter of 2021 with 80 fewer trucks,
- Our less asset intensive ("asset light") managed freight and warehouse segments combined grew 14% compared to the second quarter of 2021,
- On the safety side, DOT rate was 2% higher than a strong quarter last year, but development of a small number of prior period claims contributed to almost \$.06 per mile increase in insurance expense,
- Gain on sale was only \$400 thousand compared to \$1.9 million in the year ago quarter,
- Our TEL leasing company investment produced another record quarter, contributing \$0.33 per diluted share, or an additional \$0.17 per share versus the year ago period,
- Due to the strong cash flow in the quarter, our net indebtedness increased only \$10 million after utilizing \$28.5 million of cash on share repurchases,
- We finished the quarter with a leverage ratio of .43x, debt to equity ratio of 14.6%, and return on invested capital of 15.7%.

Now Paul will provide a little more color on the items affecting the business units:

- For the quarter, our **Asset light** businesses (comprised of managed freight and warehouse) were 37% of total freight revenue and 34% of consolidated adjusted operating profit. As we have discussed in the past few quarters, the managed freight revenue growth versus year ago is beginning to cool as the market softens and the surge demand recedes. However, the net revenue margin continues to be strong and we have an active pipeline for new business. By the end of the third quarter, our warehouse team will have

stood up 3 startups for the year, primarily in the second quarter. We will focus the remainder of the year on maximizing the revenue and margin opportunities to grow income again in this small unit. The asset light group remains a priority for growth, focusing on talent acquisition and technology enhancements.

- The **Expedited** division was 35% of consolidated freight revenue and 55% of adjusted operating profit in the quarter. It grew its revenue 23% versus the year ago quarter due to strong revenue per truck improvements and growth of 40 trucks. The first quarter acquisition contributed to revenue growth nicely. Expedited produced a record 83 adjusted OR, a 310 basis point improvement over the second quarter last year. Our freight network is not overbooked but remains balanced. Maintenance, insurance costs and less gain were a major headwind in the quarter, but we feel driver pay is in good shape at the present time. Our expedited leadership team is doing a great job of managing through this economic transition.
- The **Dedicated** division was 28% of consolidated freight revenue and 11% of adjusted operating profit in the quarter. This division continued its steady improvements with adjusted OR improving slightly versus the first quarter and 360 points from the year ago quarter. Revenue per truck grew 17% versus the year ago quarter while cost increases in maintenance and insurance and lower gain on sale also consumed some of the margin improvements. The “weed and feed” process continues with another 122 trucks planned to be upgraded in third quarter through either replacement and/or revenue per truck pricing improvements. Based on what we see today, we feel good about our goal of a 200 basis point sequential OR improvement in the third quarter. The pipeline for the remainder of year remains robust, supporting our expectation that margin improvement will continue.
- Our minority investment in **TEL** continues to produce strong, positive results. TEL’s revenue in the quarter grew 33% and pre-tax operating profit increased by 123% both versus the second quarter of 2021. TEL decreased its truck fleet in the quarter by 60 trucks to 2,013 and grew its trailer fleet by 117 to 6,869. Our investment in TEL, included in Other Assets in our consolidated balance sheet, grew \$7.1 million during the quarter to \$58.1 million. TEL focuses on a) managing lease purchase programs for clients, b) leasing trucks and trailers to small fleets or shippers and c) aiding clients in the procurement and disposition of their equipment through a robust equipment buy and sell program. TEL contributed a total of \$.33 per share to our overall results or an additional \$.17 versus the year ago quarter. Due to the business model, gains and losses on sale of equipment is a normal part of the business and can cause earnings to fluctuate from quarter to quarter. TEL’s future is very bright!

Regarding our outlook for the future:

As we said in the release, we expect the second half of 2022 to exceed the adjusted earnings per share of 2021 bringing the year to a minimum of \$5.00 per share. We do believe there will be market headwinds from continued inflationary pressures and softening freight demand but based on company specific factors – the investments we have made in the sales team, the small acquisition, share repurchases and returning insurance casualty costs to more normalized levels, we are very confident in the second half and planning for 2023. Over the last 5 years, our customer base has been intentionally moved to less cyclical industries through our full service logistics focus. We said last quarter that 2023 will be a breakout year for Covenant, and we remain firm on that statement and confident that we will continue to produce cash to maximize opportunities for our shareholders.

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