Covenant Logistics Group 1st Quarter 2024 Conference Call

Mr. Grant – Good morning everyone and welcome to the Covenant Logistics Group first quarter 2024 conference call.

As a reminder:

> *This call will contain forward-looking statements under the Private Securities Litigation Reform Act, which are subject to risks and uncertainties that could cause actual results to differ materially. Please review our SEC filings and most recent risk factors. We undertake no obligation to publicly update or revise any forward-looking statements.*

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 today by David Parker and Paul Bunn.

We were pleased with our first quarter's operational results despite the lingering weakness in the overall freight environment and the severe weather that challenged us early in the quarter. Compared to a year ago, consolidated freight revenue increased by approximately $14.3 million or 6.1%. While each of our business segments grew freight revenue, the asset-based segments, consisting of Expedited and Dedicated, were the primary contributors with growth in the average tractor fleet and improved utilization compared to a year ago.

Adjusted operating income increased approximately $2.2 million or 17.3% compared to the prior year quarter. Our asset-light segments, consisting of Managed Freight and Warehousing, grew adjusted operating income by a combined $3.3 million, partially offset by $1.1 million of reduced adjusted operating income from our asset-based segments.

Compared to the prior year period, increased interest expense of $2.6 million and reduced pre-tax income from our equipment leasing company investment, TEL, of $2.3 million resulted in a decline in adjusted net income of approximately 9.7% to $11.6 million.

Key highlights include:

- All four of our reportable operating segments were successful in growing freight revenue compared to the prior year quarter.
- Our combined truckload segments navigated difficult weather conditions and improved utilization by 5.4% compared to a year ago, partially offsetting the impact of rate reductions of approximately 1.7%
- We successfully executed two new startups in our Dedicated fleet during the quarter and added to the pipeline of new customers in our Expedited fleet.
- Our net capital investment for revenue producing equipment was approximately $12 million for the quarter, consisting primarily of specialized equipment capex for poultry related growth.
- The average age of our fleet at March 31st improved to 21 months compared to 26 months a year ago.
- Within our combined truckload segments, compared to the prior year, operations and maintenance related expenses declined by 7 cents per total mile or 27%. Fixed equipment related costs, including leased revenue equipment expenses, depreciation, and gains on sale increased 9 cents per total mile or 25% as a result of operating newer, more costly equipment in a soft used equipment market.
- The sale of revenue equipment resulted in a $0.7 million loss in the quarter, compared to $1.1 million gain in the prior year.

- TEL produced $0.20 per diluted share, compared to $0.31 per diluted share versus the year ago period. TEL's contribution to pretax net earnings declined primarily as a result of the year over year softening in the used equipment market, suppressing gains on sale.
- Our net indebtedness as of March 31st was $252.1 million, yielding an adjusted leverage ratio of approximately 2.1x and debt-to-capital ratio of 38.2%,
- On an adjusted basis, return on average invested capital was 8.3% for the current quarter versus 14.8% in the prior year. The decline is attributable to reduced year-over-year trailing twelve-month operating income particularly from our asset-light Managed Freight segment and the increase in the average invested capital base associated with acquisitions, growth capex and reducing the average age of our fleet.

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

Thanks Tripp,

- Expedited performed well in a seasonally soft quarter compounded by severe inclement weather by yielding a 93.9% adjusted OR. In this segment, rates have declined by approximately 5% as a result of the rate reset in the second quarter of 2023, but utilization has improved approximately 7%. The improvement in utilization was principally attributable to more engineered routes and newer equipment in the fleet with less down time.

- Dedicated reflected another success story – yielding a 93.5% adjusted OR and successfully executing on two key customer startups during the quarter. Over the past three years, we have worked hard to improve the profitability within this segment by exiting unprofitable business and adding profitable business. This weed and feed approach has been uneven, but over time has served us well in deploying capital towards opportunities that meet our profitability and return requirements. We were pleased with the year over year improvement to adjusted margin and expect to continue to improve upon both this segment's size and profitability over the long term.

- Managed Freight experienced a 3% increase in freight revenue and a 102% increase in adjusted operating profit. The significant improvement adjusted operating profit was primarily the result of a large cargo related claim in 2023. The brokerage environment remains highly competitive with numerous brokers aggressively competing for volumes at the expense of margin. We anticipate continued margin pressure in this environment.

- Our Warehouse segment saw a 4% increase in freight revenue and a 795% increase of adjusted operating profit compared to the prior year, as a result of a stabilizing labor market, where employee retention has improved and the cost of labor is no longer outpacing the rate at which we can capture rate increases from the customer.

- Our minority investment in TEL contributed pre-tax net income of $3.7 million for the quarter, compared to $5.9 million in the prior year period. The decrease was largely due to continued deterioration in the equipment market, suppressing gains on sale of used equipment. TEL's revenue in the quarter declined 14% and pre-tax net income decreased by approximately 35% versus the first quarter of 2023. TEL decreased its truck fleet in the quarter versus year ago by 119 trucks to 2,082 and reduced its trailer fleet by 292 to 6,824.

Regarding our outlook for the future:

Despite the continuation of soft freight market conditions, we remain optimistic about our model as a result of the durability of our earnings for the past six quarters and the positive momentum we have taken with us into the second quarter in the form of a strong pipeline of new customers in our Expedited segment, fleet growth in our Dedicated segment, operational efficiencies that come with a young fleet and improved margins in our Warehousing segment. We anticipate adjusted operating income growth from our core operations to sequentially improve each quarter as we execute throughout the year. Although much of this growth will be offset by higher interest costs and reduced earnings contributions from TEL, we are excited about the direction of our company.

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