Covenant Logistics Group 2nd Quarter 2024 Conference Call

Mr. Grant – Good morning everyone and welcome to the Covenant Logistics Group second 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.

Our core business performed well in the second quarter, overcoming lingering weakness in the overall freight environment. Compared to a year ago, consolidated freight revenue increased by approximately $12.8 million, or 5.3%, to $256.5 million and adjusted operating income increased by $2.4 million, or 15.0%, to $18.7 million.

The year over year increase in freight revenue was primarily derived from growth in average tractor counts within our asset-based truckload segments, consisting of Expedited and Dedicated. The growth in adjusted operating income was principally derived from our asset-based Dedicated segment and both of our asset-light segments, consisting of Managed Freight and Warehousing.

Adjusted net income of $14.5 million for the current quarter was essentially flat with the second quarter of 2023 primarily because higher adjusted operating income was offset by a $1.7 million increase in pre-tax interest expense and a $1.3 million reduction in pre-tax earnings from our equipment leasing company investment, TEL.

Key highlights include:

- Our combined truckload segments grew the average total tractor count by 191 units, or 9.1%, and improved freight revenue per tractor by approximately 0.8% compared to a year ago.
- Our Dedicated fleet achieved the lowest adjusted operating ratio in company history with a 90.9 and grew its average tractor count by 136 units or 10.9% compared to the prior year.
- Within our combined truckload segments, compared to the prior year, operations and maintenance related expenses declined by 2 cents per total mile or 10%. Fixed equipment related costs, including leased revenue equipment expenses, depreciation, and net gain/loss on sale increased 3 cents per total mile, or 8%, as a result of operating newer, more costly equipment in a soft used equipment market.
- Insurance and claims expense increased 8 cents per total mile, or 56%, compared to the prior year as a result of increases in new current period claims expense and the development and settlement of one large prior period claim.
- Our net capital investment for revenue producing equipment was approximately $43 million for the quarter, consisting of both specialized equipment capex for growth and maintenance capex.
- The average age of our fleet at June 30th improved to 21 months compared to 26 months a year ago.
- The sale of revenue equipment resulted in a $0.9 million loss in the quarter, compared to $2.0 million gain in the prior year.
- TEL produced $0.23 per diluted share, compared to $0.29 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 and increased interest expense.

- Our net indebtedness as of June 30th was $273.3 million, yielding an adjusted leverage ratio of approximately 2.0x and debt-to-capital ratio of 39.5%,
- On an adjusted basis, return on average invested capital was 8.0% for the current quarter versus 13.0% 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 was successful in growing freight revenue by approximately $3.0 million, or 3.4%, but experienced a 330-basis point deterioration in profitability compared to the prior year with an adjusted operating ratio of 94.0. Although our average tractor count grew 6.4%, profitability fell short of our expectations primarily as a result of cost headwinds from significant casualty claims and year over year declines in both rate and utilization.

- Dedicated was successful in growing both freight revenue and operating income, while yielding the best adjusted operating ratio in company history with a 90.9, representing a 170-basis point improvement compared to the prior year. During the current quarter, the team successfully executed its second large start up for the year, increasing the fleet's average tractor count by 10.9% year over year.

- Managed Freight experienced a 4.6% reduction in freight revenue and a 73.6% increase in adjusted operating profit compared to the prior year, reporting an adjusted operating ratio of 94.0. The significant improvement to adjusted operating profit was primarily the result of the combination of improved purchased transportation costs, the year over year impact of the Sims Transport acquisition, and reduced cargo related claims compared to the prior year quarter.

- Our Warehouse segment saw a 0.7% increase in freight revenue and a 104.7% increase of adjusted operating profit compared to the prior year, reporting an adjusted operating ratio of 91.0. We are pleased with the improvement in profitability within this segment, which struggled to produce adequate returns during the prior two years when the business was rapidly growing and labor inflation outpaced our ability to obtain rate increases from customers.

- Our minority investment in TEL contributed pre-tax net income of $4.1 million for the quarter, compared to $5.4 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 by 4.1% and pre-tax net income decreased by approximately 24% versus the second quarter of 2023. TEL decreased its truck fleet in the quarter versus year ago by 77 trucks to 2,206 and reduced its trailer fleet by 17 to 7,014.

Regarding our outlook for the future:

As we enter the third quarter of the year, we believe freight fundamentals are continuing to improve by excess carrier capacity slowly exiting a market with unsustainable conditions. Absent an outside catalyst to facilitate improved demand, we remain uncertain about the pace at which general freight conditions will meaningfully improve. Despite these challenges, we remain optimistic about our business model as evidenced by the durability and growth of our core operations over the last twelve months. In the third quarter, we believe that we have the momentum necessary to continue to grow operating income throughout the remainder of 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.

Lastly, it is with sad news that we recognize the passing of Doug Carmichael, founder and CEO of TEL. Doug was a true partner to Covenant and friend to all who worked with him. Known for his entrepreneurial spirit, quick wit and deep generosity, Doug will be missed dearly by all who were fortunate enough to know him. Although we will miss Doug, he leaves behind the most talented management team TEL has ever had. We look forward to working with them more closely to honor Doug’s legacy and ensuring the continued success of the business.

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