Covenant Transportation Group 2nd Quarter 2016 Conference Call

Mr. Cribbs – Good morning and welcome to our second quarter conference call. Joining me on the call this morning are David Parker and Joey Hogan, along with various members of our management team.

> *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, decreased 6.6% to $130.3 million due to a 4.1% decrease in average tractors and a 3.2% decrease in average freight revenue per truck, partially offset by an increase in our refrigerated intermodal freight revenue,
- Versus the year ago period average freight revenue per loaded mile was up $.009 per mile or 0.5% and our miles per truck were down 3.3%,
- Freight revenue per tractor at our Covenant Transport subsidiary experienced a decrease of 0.7% versus the prior year quarter, while our refrigerated subsidiary, SRT, experienced a decrease of 7.6%, and our Star Transportation subsidiary experienced a decrease of 2.1%,
- Excluding the second quarter 2015 favorable impact totaling approximately $3.5 million pretax (or $.041 per total mile) of previously expensed casualty insurance premium for an insurance commutation, the asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.112 per mile compared to the year ago period. This was mainly attributable to higher net fuel cost, capital costs, employee wages, and other fixed costs related to worse fixed cost absorption. These increases were partially offset by lower casualty insurance expense,
- We recognized a gain on disposal of equipment of $0.6 million in the second quarter of 2016 versus a gain of $0.2 million in the second quarter of 2015,
- Excluding the impact of the aforementioned 2nd quarter 2015 insurance commutation, the asset-based operating ratio was 95.5% in the second quarter of 2016, compared with 89.5% in the second quarter of 2015. The 2016

period included a $1.5 million increase in fuel hedging losses compared with the 2015 quarter. Adjusting for that item, our operating margin contraction was approximately 480 basis points,

- Our Solutions logistics subsidiary increased revenue by 11.7% versus the year ago quarter. Combined purchased transportation and other operating expenses decreased as a percentage of revenue resulting in operating ratio expansion to 89.5% from 95.4% in the year ago quarter, the result being an increase of operating income contribution to $1.5 million in the current year quarter from $0.6 million in the prior year quarter,
- Our minority investment in Transport Enterprise Leasing contributed $1.2 million to pre-tax earnings or $.04 per share,
- The average age of our tractor fleet continues to be very young at 1.7 years as of the end of the quarter, down slightly from 1.8 years a year ago,
- Since December 31, 2015, total indebtedness, net of cash and including the present value of off-balance sheet lease obligations has decreased by approximately $46.4 million to $217.7 million,
- At June 30, 2016, we have available borrowing capacity of $54.9 million under our revolving credit facility.

The main positives in the second quarter were 1) revenue growth and improved operating profitability from our Solutions subsidiary, 2) growing our team truck percentage sequentially to 39.0% from 37.3% averaged in the first quarter, and 3) our safety efforts helped produce a greater than 10% reduction in Department of Transportation ("DOT") reportable accidents compared to the prior year quarter. The main negatives in the quarter were 1) increased operating costs on a per mile basis, including unfavorable salary, net fuel and capital costs, 2) a 3.3% reduction in average miles per tractor, and 3) sequential deterioration in quarterly operating profitability at our SRT subsidiary, resulting in two consecutive quarters operating at a loss.

Our fleet experienced a decrease to 2,589 trucks by the end of June, an 18 truck decrease from our reported fleet size of 2,607 trucks at the end of March. Our fleet of team-driven trucks averaged 1,007 teams in the second quarter of 2016, a 2.9% increase from 979 average teams in the first quarter of 2016.

Our second quarter freight was softest in April and improved some in the last two months of the quarter. However, May and June utilization finished short of prior year, as well. Our year-over-year April miles per truck was down 6.1%. Our year-over-year May miles per truck was down only 0.7%. And, our year-over-year June miles per truck was down 3.3%.

One of our key initiatives for the remainder of the year will be laying the groundwork to improve the performance of SRT. To assist with these efforts, we have engaged Herb Schmidt as a consultant to work directly with SRT's Texarkana leadership personnel on a routine basis over the second half of 2016. Mr. Schmidt, who previously served as CEO of Conway Truckload and Contract Freighters, Inc., has a broad mandate to assist SRT's management in improving SRT's performance. Mr. Schmidt will also remain a director of CTG. The turnaround of SRT is expected to take several quarters and should not be considered a near-term project.

Our second half focus will also include gaining commitments for the peak season from our key customers, and increasing the percentage of our trucks with professional drivers. Due to these large moving items, we are not affording earnings guidance for the second half of 2016. However, we do not expect the second half of 2016 to be as profitable as the second half of 2015. In this environment, we intend to increase freight revenue per tractor, intensely manage our costs and capital deployed, and manage down the size of our solo-driven fleet, while increasing the size and percentage of our team-driven fleet to best take advantage of the relatively stronger expedited freight market.

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