Covenant Transportation Group 2nd Quarter 2017 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.

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 1.1% to $128.9 million due primarily to a 0.4% decrease in average tractors and a 0.2% decrease in average freight revenue per tractor,
- Versus the year ago period average freight revenue per total mile was up $.009 per mile or 0.5% and our miles per tractor per week were down 0.7%,
- Freight revenue per tractor at our Covenant Transport subsidiary experienced an increase of 2.7% versus the prior year quarter, while our refrigerated subsidiary, SRT, experienced a decrease of 1.6%, and our Star Transportation ("Star") subsidiary experienced a decrease of 6.5%,
- The asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.045 per mile compared to the year ago period. This was mainly attributable to higher employee wages, capital costs, and casualty insurance expense. These increases were partially offset by lower net fuel cost,
- We recognized a loss on disposal of equipment of $2.1 million in the second quarter of 2017 versus a gain of $0.6 million in the second quarter of 2016,
- The asset-based operating ratio was 98.2% in the second quarter of 2017, compared with 95.5% in the second quarter of 2016,
- Our Solutions logistics subsidiary increased revenue by 18.1% versus the year ago quarter. Purchased transportation decreased as a percentage of revenue, however other operating expenses increased greater as a percentage of revenue resulting in operating ratio deterioration to 90.5% from 89.5% in the year ago quarter. With the increased revenue, the result was an increase of operating income contribution to $1.6 million in the current year quarter from $1.5 million in the prior year quarter,

- Our minority investment in Transport Enterprise Leasing contributed $0.8 million to pre-tax earnings or $.03 per share,
- The average age of our tractor fleet continues to be young at 2.2 years as of the end of the quarter, although up from 1.7 years a year ago,
- Since December 31, 2016, total indebtedness, net of cash and including the present value of off-balance sheet lease obligations has decreased by approximately $22.3 million to $204.4 million.

The main positives in the second quarter were 1) sequential tractor utilization improvement throughout the quarter, 2) deleveraging with a $10.7 million decrease in our total net indebtedness, and 3) our tangible book value per basic share increased 7.5% to $12.97 from $12.07 a year ago. The main negatives in the quarter were 1) increased operating costs on a per mile basis, including unfavorable employee wages, capital, and casualty insurance costs, partially offset by lower net fuel cost, and 2) SRT operating at a loss for the sixth consecutive quarter.

Our fleet experienced an increase to 2,577 trucks by the end of June, a 7 truck increase from our reported fleet size of 2,570 trucks at the end of March. Our fleet of team-driven trucks averaged 1,012 teams in the second quarter of 2017, a 0.9% increase from 1,003 average teams in the first quarter of 2017.

Our second quarter freight improved sequentially on a monthly basis. April started off weak resulting in year-over-year April miles per tractor being down 2.8%. After replacing some of the freight we reduced in April, May miles per tractor finished even compared with the prior year. In June, capacity tightened resulting in a 0.5% year-over-year increase in average miles per tractor despite our Star subsidiary experiencing a 6% reduction due primarily to automotive plant shutdowns in its network.

For the third quarter of 2017, we expect a favorable year-over-year comparison in freight revenue per tractor. It is still too early in our continuing discussions with peak customers to provide guidance regarding freight yields for the fourth quarter of 2017. For the remaining half of the year, we expect year-over-year net fuel expense savings, and a flattening of the year-over-year impact of the changes to our depreciation policy adopted in the third quarter of 2016, somewhat offset by higher maintenance expense and professional driver wages. At SRT, we expect additional progress in the two remaining quarters of 2017 versus 2016. To the extent mandatory ELD implementation and resulting lower truck numbers or decreased daily driving time for newly-compliant carriers remove industry-wide freight transportation capacity, and economic growth spurs volumes, we expect the supply-demand environment to improve later in 2017 and into 2018. However, the timing and magnitude of these changes are difficult to predict and may be different in each of our markets. Our goal remains to deliver earnings improvement for the second half of 2017 as compared to the second half of 2016.

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