Covenant Transportation Group 4th Quarter 2016 Conference Call

Mr. Cribbs – Good morning and welcome to our fourth quarter conference call. Joining me on the call remotely 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 7.3% to $147.7 million due to a 4.4% decrease in average tractors and a 3.2% decrease in average freight revenue per truck,
- Versus the year ago period average freight revenue per total mile was down $.106 per mile or 5.5% and our miles per truck were up 2.4%,
- Freight revenue per tractor at our Covenant Transport subsidiary experienced a decrease of 2.4% versus the prior year quarter, our refrigerated subsidiary, SRT, experienced a decrease of 7.8%, and our Star Transportation ("Star") subsidiary experienced a decrease of 1.1%,
- The asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.026 per mile compared to the year ago period. This was mainly attributable to higher capital costs, operations and maintenance expense, casualty insurance expense, and other fixed costs. These increases were partially offset by lower employee wages,
- We recognized a loss on disposal of equipment of $0.7 million in the fourth quarter of 2016 versus a gain of $0.3 million in the fourth quarter of 2015,
- The asset-based operating ratio was 93.4% in the fourth quarter of 2016, compared with 87.2% in the fourth quarter of 2015,
- Our Solutions logistics subsidiary decreased revenue by 18.9% versus the year ago quarter. Combined purchased transportation and other operating expenses increased as a percentage of revenue resulting in operating ratio

contraction to 90.4% from 87.7% in the year ago quarter, the result being a decrease of operating income contribution to $2.5 million in the current year quarter from $3.9 million in the prior year quarter,

- Our minority investment in Transport Enterprise Leasing contributed $0.6 million to pre-tax earnings or $.02 per share,
- Our effective income tax rate increased to 44.6% in the current period from 41.7% in the year ago period,
- The average age of our tractor fleet continues to be very young at 1.8 years as of the end of the quarter, up slightly from 1.7 years a year ago. As we are extending the trade cycle of our tractors, we expect the average age of our tractor fleet to increase over the next three or four quarters,
- While EPS declined significantly versus year ago, our operating cash flows increased to $19.6 million in the current period from $6.9 million in the year ago period as we improved on our average receivable days outstanding as compared to 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 $37.5 million to $226.7 million,
- At December 31, 2016, we have available borrowing capacity of $55.6 million under our revolving credit facility.

The main positives in the fourth quarter were 1) our tangible book value per basic share increased 16.1% to $12.95 from $11.15 a year ago, 2) a 4.3% sequential increase in revenue per truck at our SRT subsidiary, and 3) a 7.7% decrease 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 capital and casualty insurance costs, 2) a 2.4% decrease in revenue per truck compared to the prior year quarter at our Covenant Transport subsidiary, and 3) SRT operating at a loss for the fourth consecutive quarter.

Our fleet experienced a decrease to 2,535 trucks by the end of December, a 46 truck decrease from our reported fleet size of 2,581 trucks at the end of September. Our fleet of team-driven trucks averaged 1,032 teams in the fourth quarter of 2016, a 3.6% increase from 996 average teams in the third quarter of 2016.

Our fourth quarter freight was softest in October and improved in the last two months of the quarter. Our year-over-year October miles per truck was down 0.4%. Our year-over-year November miles per truck was up 3.1%. And, our year-over-year December miles per truck was up 4.8%.

For 2017, we are forecasting sequential improvement throughout the year. In the first half of 2017, we do not expect to match the earnings per share levels we generated for the first and second quarters of 2016. However, we believe the combination of an improving economy, growth of time-sensitive e-commerce freight, industry regulatory changes, retail inventory declines, year-over-year net fuel expense savings from our improved fuel hedge positions, and operational progress at SRT should deliver earnings improvement that result in higher earnings for the second half and potentially the full year of 2017. The largest variable we foresee is the pace and magnitude of improvement at SRT, which we believe could contribute up to $10.0 million of pre-tax income in improved results as compared with 2016. The pace and amount of change will depend, in large part, on our ability to enhance the freight network, which depends on internally re-engineering lanes and a stronger refrigerated freight market. Our success in turning around SRT is expected to determine whether our earnings per share in 2017 exceed our results for 2016. From a balance sheet perspective, with net capital expenditures scheduled to be below normal replacement cycle, along with positive operating cash flows, we expect to further reduce balance sheet and off-balance sheet debt over the course of fiscal 2017.

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