Covenant Transportation Group 1st Quarter 2017 Conference Call

Mr. Cribbs – Good morning and welcome to our first 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 3.1% to $127.0 million due primarily to a 2.4% decrease in average tractors,
- Versus the year ago period average freight revenue per total mile was up $.005 per mile or 0.3% and our miles per truck per week were up 0.6%,
- Freight revenue per tractor at our Covenant Transport subsidiary experienced an increase of 2.4% versus the prior year quarter, our Star Transportation ("Star") subsidiary experienced an increase of 0.4%, while our refrigerated subsidiary, SRT, experienced a decrease of 5.0%,
- The asset-based division's operating costs per mile, net of surcharge revenue, were up approximately $.069 per mile compared to the year ago period. This was mainly attributable to higher employee wages, capital costs, operations and maintenance expense, casualty insurance expense, and other fixed costs. These increases were partially offset by lower net fuel cost,
- We recognized a loss on disposal of equipment of $0.5 million in the first quarter of 2017 versus a loss of $0.3 million in the first quarter of 2016,
- The asset-based operating ratio was 100.2% in the first quarter of 2017, compared with 95.7% in the first quarter of 2016,
- Our Solutions logistics subsidiary decreased revenue by 3.4% versus the year ago quarter. Combined purchased transportation and other operating expenses increased as a percentage of revenue resulting in operating ratio deterioration to 89.0% from 86.6% in the year ago quarter, the result being a decrease of operating income contribution to $1.4 million in the current year quarter from $1.8 million in the prior year quarter,

- Our minority investment in Transport Enterprise Leasing contributed $1.0 million to pre-tax earnings or $.03 per share,
- The average age of our tractor fleet continues to be young at 2.0 years as of the end of the quarter, although up 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 two or three quarters,
- Since December 31, 2016, total indebtedness, net of cash and including the present value of off-balance sheet lease obligations has decreased by approximately $11.6 million to $215.2 million.

The main positives in the first quarter were 1) our tangible book value per basic share increased 13.4% to $12.91 from $11.38 a year ago, 2) deleveraging with a $11.6 million decrease in our total net indebtedness, and 3) a 12.5% year-over-year increase in the average tractor fleet at our Star Transportation subsidiary. The main negatives in the quarter were 1) increased operating costs on a per mile basis, including unfavorable employee wages, capital, maintenance and casualty insurance costs, partially offset by lower net fuel cost, and 2) SRT operating at a loss for the fifth consecutive quarter.

Our fleet experienced an increase to 2,570 trucks by the end of March, a 35 truck increase from our reported fleet size of 2,535 trucks at the end of December. Our fleet of team-driven trucks averaged 1,003 teams in the first quarter of 2017, a 2.8% decrease from 1,032 average teams in the fourth quarter of 2016.

Our first quarter freight varied from month to month. January started off strong, but weakened at the end of the month resulting in year-over-year January miles per truck being up 0.7%. February was weak for most of the month, resulting in year-over-year February miles per truck being down 4.7%, on one less calendar day. And March picked back up meeting seasonal expectations, with our year-over-year March miles per truck finishing up 2.2%.

For the remainder of 2017, our outlook is mixed. We expect the second quarter of 2017 to remain challenged by negative comparisons in freight revenue per tractor, accelerated depreciation, and higher maintenance expense and professional driver wages. These factors will be countered to some extent by year-over-year net fuel expense savings in all remaining quarters and a flattening of the negative year-over-year impact of depreciation in the second half of 2017. At SRT, we are seeing progress and have confidence in our plan and team, and we expect additional progress in the three remaining quarters of 2017 versus 2016. To the extent mandatory ELD implementation and lower truck numbers in our industry decrease effective 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. We are hopeful that these items will deliver earnings improvement for the second half of 2017 as compared to the second half of 2016. We expect operating cash flow in excess of net capital expenditures and to continue to pay down debt in 2017.

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