

Knight-Swift Transportation, Inc.
Q1 2022 Earnings Call Transcript
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04:30 PM ET

OPERATOR: This is Conference # 4899863

Operator: Good afternoon. My name is Christian, and I will be your conference operator today. At this time, I would like to welcome everyone to the Knight-Swift Transportation First Quarter 2022 Earnings Call. All lines have been placed on mute to prevent any background noise. Speakers for today's call will be Dave Jackson President and CEO and Adam Miller CFO. Mr. Miller, the meeting is now yours.

Adam Miller: Thank you Christian, I appreciate it. Good afternoon, everyone. Thank you for joining our call. I don't know what can I say, we enjoyed, I guess, the last near 4-year break from live conference calls, but I guess we're back now. We've decided to reinstitute the quarterly conference call and plan to hold a call on an ongoing basis, so you'd expect to see this every quarter now. We plan to touch on quite a few topics today and have slides today accompany this call. The slides are posted on our investor website which is investor.knight-swift.com/events.

David Jackson: Yes, Dave Jackson here. Glad to have you back. Adam and I are, we're excited. We're excited to spend the next hour with you. It's amazing to think that it has been 4 years since the last call, the way how things have changed. In addition to a global pandemic that none of us saw coming, our business has transformed rather significantly over that period of time.

I mean we have Swift Transportation who since, call it, second quarter of 2018, which was the last earnings call, arguably Swift is now the most profitable truckload carrier in the industry. We're in the LTL business with more than \$900 million of revenue. Free cash flow, on the last earnings call, we did was \$52 million. This quarter, it's \$352 million. Or maybe what another little fun fact is we were \$99.6 million of adjusted net income on the last call. This one, it's \$225 million for this quarter. So, all of this has been done while de-risking and diversifying our model, which we plan to talk about, we've got quite a bit pent up.

So hopefully, you'll bear with us as we walk through these slides and talk about our business.

Adam Miller: Okay. Thanks, Dave. So, our call is scheduled to go until 5:30 p.m. Eastern Time. During the call, we'll plan to discuss topics related to the results of the first quarter, provide an update on current market conditions, and update our full year 2022 guidance. Following our commentary, we'll answer as many questions as possible. In order to get to as many participants as possible, we're going to limit the questions to 1 per participant. And I know this is our first call back in a while, so please don't try to sneak a second question in as a follow-up question. We remember those tricks. So, if you have a second question, please feel free to get back in the queue. We'll answer as many as time allows. If we don't get to your question, you call (602) 606-6349, we'll try to connect that with you later today.

With that, I'll refer you to the disclosure slide, and note the following. This conference call and presentation may contain forward-looking statements made by the company that involve risks, assumptions and uncertainties that are difficult to predict. Investors are directed to the information contained in Item 1A Risk Factors or Part 1 of the company's annual report on Form 10-K filed with The United States SEC for a discussion of the risks that may affect the company's future operating results. Actual results may differ.

Now we'll move on to Slide 3. This compares our consolidated first quarter revenue and earnings results on a year-over-year basis. We continue to generate meaningful revenue and income growth, both organically and via acquisitions, and demonstrated the operating leverage of our business.

Each reportable segment improved both revenue and margin, which ultimately led to a 49.4% increase in revenue and an 82.7% increase in adjusted operating income on a consolidated basis. GAAP earnings per diluted share for the first quarter of 2022 were \$1.25, which represents a 62.3% improvement from the prior year, and our adjusted earnings per share came in at \$1.35. Both GAAP and the adjusted earnings per share include a \$13.1 million after-tax loss in other income or expense from an unrealized mark-to-market adjustment in our investment related to Embark Trucks. This loss reduced our adjusted earnings per share by \$0.08.

And now we'll move to the next slide. Slide 4 illustrates the revenue margin contributions for the first quarter and trailing 12 months in our segments. Chart on the right highlights the percentage of revenue during the first quarter of 2022 from each of our 4 segments as well as the percentage of revenue from our other services, which include our rapidly growing insurance, equipment and maintenance, equipment leasing, and warehousing services.

Our strategy is to continue to diversify our business while improving both margin and revenue in each segment. During the first quarter of 2022, our Truckload segment grew revenue 8.8% year-over-year, but as a percentage of total revenue moved from 77% in the first quarter of 2021 to 57% in 2022. This is the result of our continued focus on growing logistics, intermodal, and our recent investment in the LTL market.

Logistics revenue increased 142% year-over-year and as a percentage of the total moved from 10% last year to 17% this year. Revenue from Services group together in the other bucket grew 172% and as a percentage of revenue doubled from 3% to 6%. And with our recent acquisition of AAA Cooper in July of last year and MME in December, our LTL segment represents 13% of revenue.

The next few slides will discuss each segment's operating performance, starting with Truckload on Slide 5. On a year-over-year basis, our Truckload revenue, excluding fuel surcharge, grew nearly 8%, while our operating income grew near 30%. Our adjusted operating ratio of 78.2% was a 360-basis point improvement over the prior year. It was the first time we were below an 80% OR in the first quarter since the merger of Knight and Swift back in 2017. During the quarter, revenue per tractor grew 9.4%, driven by a 22.9% increase in revenue per loaded mile and a 9.6% decrease in miles per tractor. Intentional shift to a shorter length of haul partially contributed to the increase in revenue per loaded

mile and a decrease in miles per tractor. Miles per tractor also impacted by higher year-over-year unseated tractor count as well as COVID-related issues early in the quarter.

Recruiting and retaining drivers continued to be a challenge, but we are seeing improvement sequentially and have made modest improvements in seating tractors, primarily as a result of our extensive training programs. Freight demand followed normal seasonal trends but was generally strong throughout the quarter. Contract rates continue to increase as customers work to increase committed capacity.

We are especially seeing greater demand from our customers to secure trailer pool capacity through our Truckload and Logistics segments. As we make more commitments, as we expect the large carriers are, we are seeing higher tender acceptance levels and fewer noncontract opportunities. As the bid season progresses, we are reducing our exposure to the spot market as high contract rates support greater commitments.

We continue to invest in our trailer network, which grew sequentially by 2,200 trailers to just over 71,000 trailer fleet wide. We believe our scale in trailers is a competitive advantage and provides our customers capabilities that are extremely difficult to replicate. Our Q1 results continue to reflect the structural and fundamental changes within our Swift brand that has created parity in margins between both Knight and Swift. We believe these changes are lasting and expect the margins for our Swift brand to continue to be in line with historical Knight margins over the coming quarters.

Now we'll move to Slide 6. This slide illustrates the results of our LTL operations, which now include a full quarter results of MME. For the quarter, revenue excluding fuel surcharge was \$215 million, adjusted operating income was \$30 million and our adjusted operating ratio was 85.9%, which was a 410-basis point improvement from the fourth quarter.

The sequential improvement in OR was driven by AAA Cooper's 5.2% increase in revenue per shipment and 2.4% increase in shipments per day. Improvements were also driven by the benefit from our ongoing synergy efforts and the full quarter results of MME. The teams from both AAA Cooper and MME have been working to harmonize network systems through AAA Cooper's footprint in the southeast and MME's footprint in the mid and northwest portions of the U.S. We believe that connecting these networks has begun to create additional revenue opportunities and improve margins. We are very encouraged by the collaboration of the MME and AAA Cooper teams and our conviction for synergy achievement continues to grow.

Customers are still seeking to secure capacity, and we continue to find revenue synergies from introducing our Truckload customers to our LTL service. In January and February, we saw some negative impact from more frequent weather events, but volume and margins finished strong in March, and that momentum has carried into the second quarter. We expect double-digit increases in pricing, coupled with realized cost synergies that will more than offset inflationary pressures and keep us ahead of our 3-year goal to achieve an 85 OR, while growing revenue in the high single digits.

Additionally, we continue to look for opportunities to build out our LTL network, primarily in the Southwest and the Northeast, and we are pleased to announce that during the first quarter, we acquired 5 facilities in Texas and 1 in Las Vegas to support organic growth. We continue to explore additional acquisitions and partnerships as we work to build out a nationwide network.

Now let's move to Slide 7. Our Logistics segment continues to grow at a rapid pace while expanding margins. Our power-only service continues to thrive, growing over 400% and helping to fuel Logistics year-over-year revenue growth of 142%, volume growth of 77% and revenue per load growth of 37%. Gross margin was 20.2% in the quarter compared to 14.4% last year, leading to an 85.7% adjusted operating ratio.

This revenue growth, combined with improvements in gross margin, led to more than a 400% improvement in operating income, which was nearly \$40 million for the quarter. We were able to grow volumes in both our traditional and power-only services. Our expansive trailer network gives our customers tremendous flexibility in how they run their operations, allows third-party carriers to participate in drop-and-hook freight they would not historically have access to, and gives us additional revenue opportunities by utilizing third-party carriers.

We continue to be excited about this business and have several projects ongoing that will improve the experience for our third-party carriers as well as provide more seamless information internally and to our customers that will lead to more opportunities to utilize our equipment.

So go to Slide 8 to talk about Intermodal. We've made some meaningful progress in expanding margins as we've monetized our underutilized containers while we were transitioning rail partners. We expect to pull these containers back into our operations during late second and third quarter leading to additional growth in load volumes. Our switch from the BNSF to the Union Pacific was completed early 2022, and we are pleased with our new partnership.

We did experience some customer disruption through the transition but have a strong pipeline of opportunities that we expect will lead to year-over-year load count growth in the back half of the year. During the quarter, volumes were negatively impacted by chassis allocations and some disruption in network fluidity from switching rail providers, but it appears these disruptions are behind us.

As we move through the bid season, we are seeing contract rate improvements in the high single to low digit range while improving committed volumes. Our current rail partnerships allow us to approach customers with creative multiyear solutions which has been received positively through the bid season. Additionally, we continue to make investments in the growth of this business, and we'll be adding 2,000 containers throughout the year. As this business scales, we expect our operating ratio to trend between the high 80s to low 90s.

We'll move to Slide 9. The non-reportable segment hasn't been a great focus for analysts or investors over the years but is now building as one of our fastest-growing culmination of businesses. We have seen significant growth in revenue and margin related to Iron Truck

Services, which provides third-party carriers insurance, equipment maintenance from our existing shops as well as discounts on fuel purchases.

The growth in these services, particularly insurance, has been exponential, and we believe will be sustainable regardless of the freight environment. We have seen tremendous demand from our customers to lease trailers for storage, seasonal projects, or typical operational use. With the shortage of trailing equipment being built, we believe demand will remain strong in this area. We've also performed well in our warehousing business, and we are currently looking for areas to expand these services.

As these businesses grow and develop, we will evaluate whether it makes sense to aggregate some of this business as a separate reportable segment in the future. We remain encouraged with the growth and diversification and contribution from the businesses that make up our non-reportable segment. And this will be my last slide before I turn it over to Dave. So, we're moving to Slide 10.

Ultimately, we remain focused on creating value to our shareholders. The improved performance of our segments over the years have led to not only strong returns but significant increases in the amount of free cash flow we have generated. This free cash flow has enabled us to invest in organic growth, aggressively pursue M&A opportunities, optimize our capital structure following the Knight-Swift merger, opportunistically buy back shares every year and consistently increase our dividend. We've been able to position our business for long-term growth and to navigate the different markets we may face along the way.

So, with that, I'll now turn it over to Dave Jackson.

David Jackson:

Thanks, Adam. I'm going to start here with Slide 11. Our objective has been to build a successful industrial growth company with consistent double-digit returns on tangible net assets. This requires multiple growth avenues that requires diversification of revenue streams to mitigate seasons and cycles. It requires massive network building to accumulate economies of scale, which we have done with over 200 facilities, representing approximately 3,000 acres in the right places with employees, equipment and execution for our customers that enables us to operate with industry-leading cost efficiency and create value for our customers that yields abundant revenue opportunities.

We've seen huge demand for our trailers that electronic logs have changed supply chains to using trailer pools as opposed to paying for detention when a driver can't immediately be loaded or unloaded upon arrival, which historically and prior to the regulation in 2018, that's largely gone uncharged to the supply chains from small carriers previous to that electronic log mandate.

Consequently, we've been able to provide our customers additional capacity, while still using trailer pools, when we hire the power-only from small carriers. The power is the truck and the driver moving our trailer. This has been hugely successful with more customers and small carrier demand that we can keep up with.

It has the potential to be a massive growth platform, one we've been designing and implementing technology along the way over the last couple of years to further remove friction and maximize the use of this platform, which in essence is our freight network of profitable loads combined with our trailers. We will continue to share more about this in coming quarters as additional technology is rolled out.

The significance of the trailer in our industry's largest trailer fleet of 71,000 truckload trailers, makes us a more resilient company. In 2019, when index spot rates between brokers and small carriers, was nearly cut in half, contract rates endured better than in any other negative cycle since deregulation.

Most contract business uses trailer pools on at least one end. Non-asset brokers offering one truck and one trailer to need to be immediately loaded or unloaded is no longer a viable alternative as it was in previous cycles, and it was exploited heavily in those cycles, whether that was 2008, 2009, 2010, or 2011, or 2012, or 2013, or 2016, or 2017.

Hence, traditional non-asset brokers have struggled to have more than single digit load volume growth in what has been the strongest freight demand in history. It's about value creation and electronic logs changed economics and large trailer fleets are finally being rewarded and can mitigate volatility for the additional value that we create to the supply chain.

Further evidence of this trend, and that the increased resilience in our truck load model is that over 90% of the truckloads that we move involve a trailer pool on at least one side if not both. It was never that high before this regulation took effect in early 2018. But we'll continue to speak to the other new growth verticals in coming quarters, particularly the organic LTL growth and the fast-growing services to third-party carriers through Iron Truck Services.

And in addition to steps that we've mentioned to mitigate the seasonality and cyclicity of our truckload business, our revenues come from more diverse sources than ever. Over 40% of revenue comes from non-truckload services, 14% of revenue is multiyear dedicated resulting in only 43% of our total revenues coming from the irregular route truckload service.

Next on to Slide #12, you can see how our changing revenue diversity is leading to a diversity of earnings as well. This chart on the left shows the percentage of adjusted operating income from each of our segments and our other non-reportable services since the Knight-Swift merger in 2017 through the first quarter of this year. We are pleased to report meaningful contributions in earnings from each of these areas. I'd also like to point out that in 2017 virtually 100% of our earnings were generated by our Truckload segment.

For the first quarter of 2022, this percentage of adjusted operating income has moved to 64%. Keep in mind that this reduction in our truckload earnings percentage has changed while at the same time we more than doubled our truckload earnings from a 2017 full-year combined pro forma Knight and Swift earnings of \$319 million to \$786 million for the full year of 2021. The chart on the right shows our rolling four quarter adjusted earnings per

share since the Knight and Swift merger. During this time, the EPS has moved from \$2.16 per share to \$5.24 per share.

Next on to Slide #13, it shows the scale of our network across our various brands and services throughout North America. The graphic highlights our locations by brand including major truckload locations at Knight-Swift, Abilene, Barr-Nunn, and our LTL locations of AAA Cooper, and Midwest Motor Express or MME, also our warehouse locations.

In total, as mentioned, we have over 200 sites across the U.S. and Mexico. The size and scale of our network allows us to provide end-to-end services to our customers, the opportunity to link various solutions to optimize each brand, and collectively afford a significant buying power. I don't want to say that our network can't be replicated. There's just nothing that rivals what we have and we're just beginning to leverage all that can be done with this network.

Next to Slide #14, just a glimpse into some of our ESG-related activities, sustainability and being good stewards to all stakeholders, including the community and the environment are important and a priority to us. We're making progress towards our multiple goals, including the near-term goal of a 5% reduction in CO2 grams per mile by 2025.

We've made major investments in safety-related technology and experienced a 37% decline in our combined DOT recordable crash rates since 2018. Supporting worthy community causes and supporting individuals seeking education and training to better themselves have long been part of our culture, now more so than ever.

On Slide #15 we will provide a bit of an outlook. We see the contract rates continued to be strong, which is pulling capacity from the spot market to be locked up and committed contractually. There's extraordinary demand for trailers right now. Different than 2021, we do expect to see and have seen some seasonality to 2022. Produce and beverage are typically the first seasonal upticks in the year. We typically don't see those until middle part of the second quarter which we would expect to see. Used equipment is scarce and at all-time high prices with very limited access to new trucks or new trailers, all of which is creating a very high barrier for any growth.

Fuel of course further discourages capacity additions at the moment speaking industry wide. We're seeing and expect strong LTL demand to continue throughout the year. Driver hiring continues to be difficult. The drug and alcohol clearinghouse continues to make the industry safer but does disqualify a meaningful amount of drivers each month. The cost of everything is on the rise, especially for those that don't have economies of scale, speaking particularly to small carriers that we might compete with.

Cost per mile has been irreversibly increased in many ways, in many areas. For perspective, the peak in rates in 2018 seems insufficient to cover small carrier costs today. So, the trough in rates this cycle could very well be higher than the 2018 peak in rates.

I'll now turn it over to Adam for guidance.

Adam Miller: Okay, so this will be our last slide and then we'll jump in to take calls. So, slide #16 outlines our guidance for the full year 2022. We now expect full year 2022 adjusted EPS to fall within the range of \$5.20 to \$5.40. This is an increase from our previous quarter guidance of \$5.10 to \$5.30.

During the first quarter, bid season was robust and we expect full year double digit contract rate increases with larger increases occurring earlier in the bid season and now moderating as the bid season progresses, and spot rates, we expect those to continue to moderate.

We expect tractor count to remain stable through the year with a modest sequential improvement in miles per tractor as we improve our seated truck count. Strong Intermodal margins in the first half of the year and then normalizing into the high 80s or low 90s by year end. And we expect load volumes will grow sequentially and expect to surpass year-over-year numbers in the second half. Logistics we expect that to grow by about 30% with margins in the high 80s to low 90s and with LTL we're expecting to grow through the year and improve our margins towards the mid-80 goal that we referred to.

We expect other revenue and income to grow when compared to the prior year as well. There's still going to be inflationary pressures from driver expenses, maintenance equipment, non-driver labor will continue to be inflationary, we're feeling pressure really everywhere in our business. Gain on sale was elevated in the first quarter, but we expect to see that still on a much higher level than in a normal year, but begin to moderate in the back half of the year. And then we expect our net cash CapEx for the full year to be in the range of \$550 to \$600 million with our tax rate to stay around 25% for the year.

So, these estimates represent management's best estimates based on current information available. Actual results may differ materially from these estimates. We refer you to the risk factors section of the company's annual report for a discussion of the risks that may affect results.

This now concludes our prepared remarks. We'd like to remind you that this call will end at 5:30 Eastern. We'll answer as many questions as time will allow. Please again, keep it to one question and if you can't get to your questions, you can dial 602-606-6349 and we'll do our best to follow up promptly.

We will now entertain questions, Christian.

Operator: Ladies and gentlemen, if you have a question at this time, please press Star and then the number One key on your touchtone telephone. Again, that is Star One to ask a question. Your first question is from Jack Atkins from Stephens.

Jack Atkins: Okay. Great. Good afternoon. Guys, thanks very much for taking my question.

David Jackson: Hi Jack.

Jack Atkins: So, I guess let me start with the one that's on probably the top of mind for most investors, and most analysts on the call. You guys did a great job I think laying out the steps you've

taken over the last several years to diversify the business and make it more resilient to cyclical upside or downside of the freight markets. I guess as we look forward, nobody has a crystal ball, but what do you think that translates into in terms of the potential risks to earnings if we were to go into a more challenging freight market?

And we think back to 2019, your earnings were down sort of mid-teens versus 2018, do you think the changes that you've made in the business use that somewhat as we kind of think about what could come next for the freight markets? I'll just hand it over to you and let you kind of talk about that.

David Jackson:

Yes, yes, well, I think the business profile has changed quite a bit. And I think in those prepared remarks, hopefully, they weren't too comprehensive, but we've covered quite a bit of that. But I think when you look at our business, and you look at the— just a kind of a recap here just to size up really how much we're talking about in terms of volatility, because this will support kind of my end statement, which is, we have trouble finding a trough EPS that doesn't start with a 4. That's ultimately where I'm headed with this, but that's quite a bit different than where we were in 2019, but the makeup again of the business is quite a bit different.

So if 43% call it of our business is really a regular route exposed and that's when you back away dedicated, you back away all the other businesses, recognizing that again 90% of that business is tied to trailer pools which makes it where there's a relatively small number of competitors that we have that can come in and bring thousands of trailers in a nationwide type of a bid to compete with, 24% of our revenue is variable and that would be logistics and the new arrangements we have with our rail partners provide some variability for us, so allowing us to be a little flexible in the market. And then of course, you've got 13% presently, and we have an appetite to continue to grow that both organically and through acquisition.

The 13% is LTL, which historically is incredibly durable. And then we've got another 6% of other revenues that's growing rapidly, that is not really tied to freight rate. So that's why when we look at our model, and we look at, okay, giving up as much as comparing to where we just performed with our truckload business in the first quarter, giving up as much as 9 or 10 OR points, we still can see our way to the EPS annual number that starts with a 4, that's significantly different than any other cycle we've been part of as we can— as we think about a crystal ball and just look out for a moment. The reality is, equipment is very scarce, and has a limited useful life. And we've not as an industry supplied the industry with enough trucks to really accommodate the aging, useful life of equipment. The OEMs aren't taking any more orders this year for trucks. They have not opened up the order book for 2023 yet. They are having difficulty delivering on time and trucks from last year have been pushed into this year and we suspect the same will happen as they have difficulty. Their dealers are on allocation right now and in previous cycles, where there hasn't been discipline and there's been an oversupply, what we've seen is, we've seen that the dealers are complicit in that, as they speculate. The finance companies, even the banks get a little aggressive in the financing side of this and so those are not those are not happening now.

Another impact that I'm not sure has been fully recognized, is that the large fleets like us, we're not trading our small trucks. We're not selling those at the normal pace that we're accustomed to because we can't replace them with new trucks. And so, it's presenting us

introducing affordable four year old call it, four to five year old is what the typical large fleet would trade out on a trade cycle.

We're not supplying or enabling small carriers to affordably come in and add capacity. And the limited number of used trucks we are selling, in some cases, we're selling these for as much or close to what we paid for them brand new before we put 450,000 or 500,000 miles on the trucks. And so, what sets up a whole new problem if the economy is headed for a little soft patch, and the banks decide to not be so aggressive in the financing. And so, I would say that watching what's happening with equipment is maybe the most valuable thing we can look at for the crystal ball for full truckload.

Now, we know that demand has been incredibly high, but part of that demand has been because of urgency. And you've had -- normally there's six months or sophisticated supply chains are buying products that they import nine months in advance. And so, things have been more hand to mouth and more urgent in the supply chain. And so, because you could look at inventory to sales ratios and the reality is, there's been a little bit of a dead cat bounce off the bottom, but it's still I think the last number was 1.13, which is well below the 1.4 historical average.

And so, I think when we look at what's happened most recently in freight rates and the reports of the death of the freight market, which have been greatly exaggerated, I think that what we're seeing a little bit of is seasonality. And there isn't the kind of urgency that there has been in the last that we saw last year or really that we've seen for almost a year and a half nonstop. And so, there isn't a lot of urgency. There's not a holiday with a deadline that's driving a lot of this, and it will be interesting to see what seasonality looks like when beverage and produce season come into play. But I suspect that we're back to a world where we'll see the seasonality the ebbs and flows and so some of what we've seen here in the first quarter was likely some of the least efficient freight. This was live load, live unload, and I'm speaking to what we saw happen in the index, which is or the indices that are out there, which is smallest carrier getting a load from a broker and so it's live load, live unload, it's stuff that didn't have commitments and it paid at ridiculously high rates and of course, that's going to be the first step to go away. So, I think it's a little early to try and call the defeat in the overall market given what I shared about equipment. But that being said, our business is prepared, and it's been years in the making to whether whatever cycles might come our way in the future. Adam, anything to -- ?

Adam Miller:

Yes. Again, I think talking about the used equipment market, those that have ventured in to grow their truck count from a small carrier perspective, their cost structure is very different to where it has ever been. And so, they can only afford to drop rates to a certain level before they exit our space, because they're buying equipment that probably three to four times what they would have purchased it in the previous cycle. So that's one thing to watch really closely. And as Dave mentioned, there's less urgency, but there's still a firm market up there. There's still quite a bit of demand to secure trailer pool capacity. Even looking at some of the indices, although they're off their record highs, they're still very elevated when you compared to other prior years or even averages over a period of time.

Dave Jackson: So, Jack that was two answers for one question.

Jack Atkins: Well, Dave and Adam thanks very much for that. I really appreciate the time. I'll hand it over.

David Jackson: Thanks, Jack.

Adam Miller: Thanks, Jack.

Operator: Your next question is from Bert Subin from Stifel.

Bert Subin: Hey guys, good afternoon and thanks for the time.

David Jackson: You bet, Bert.

Bert Subin: So, Adam, you said you expect spot rates to continue to moderate, but ex-fuel rates are already down roughly 20% from the peak. What makes you think they'll continue, that trend will continue to persist? And how does that make you assess when you guys get to that four handle?

Adam Miller: Well, when we were thinking about spot rates, we're thinking about what we do in our business. I think what you see in some of the indices is really more of a broker to small carrier transaction. Anything that we do spot right now is going to be at a premium to where our contract rates are. And as we improve our contract rates, we make more commitments, we'll probably see less exposure to spot and probably see those rates come a little bit tighter in to where our contract rates are and there's maybe less urgency to move goods. But I think what we do on the contract side, which now represents closer to 85% of our load count on our regular route trucking that I think it puts us in we can offset any impact from the fewer spot loads that we're able to haul.

Bert Subin: So not a follow up, just a clarification, you weren't making any sort of prognostication about spot rates from here. You're just talking about sort of how you guys are switching to contract?

Adam Miller: Yes. I think we're just thinking about the progression of the market and how we would navigate through it and how it would impact our business in the back half of the year.

David Jackson: Yes. Yes, so Bert, that comment is not tied to what we think will happen with DAT rates or Internet Truckstop sourced or any other derivatives of those on that relationship between small carriers and brokers. We don't participate. We don't get those kind of spot rates through brokers. And so, in that world, we think that you'll see some seasonality, which is part of what we've seen already. And so yes, I think the comment that we talk about moderating is we have been -- we've had the throttle a little bit more opened in terms of a percentage of our revenue that is more in that spot basket. And that is -- we are seeing very strong contractual renewals. And I would even dare say stronger than we would have

expected. And that is naturally pulling some of that spot at very high spot into a longer-term, more durable contract arrangement. So, they are two different things. So please don't take that as an industry-wide prognostication.

Bert Subin: Thanks, Dave. Thanks, Adam.

Operator: Your next question is from Ravi Shanker from Morgan Stanley.

Ravi Shanker: Thanks. First of all, gentlemen thank you so much for bringing the conference call back and I genuinely mean that. You won't regret it. Let's go to the next question. But I just wanted to focus a little bit on power-only. Your commentary there was incredibly powerful as it has been the last several quarters. Do you see a long-term shift in the – what would have been a traditional "brokerage market" away from the asset-light brokers towards the asset-heavy carriers because of power-only, what does this look like and what does the long-term margin in that business look like?

David Jackson: Yes, Ravi. Thanks for the question. Yes, we've seen a shift. I mean this is the first time where you've had such strong freight demand. And truthfully, the non-asset broker has been somewhat on the sideline, if not marginalized in this. And we kind of have this new term we referred to, which is traditional brokerage. So, within our own Logistics business, we kind of have the traditional brokerage, which we, to some degree, are running to stand still like some of the other large ones where it's hard to get above the single-digit load volume growth.

Meanwhile, we have our power-only business that represents, give or take, 40% of our Logistics revenue. And we saw load count improvement year-over-year in the first quarter of 166%. And so, now collectively, our Logistics business was up about 77% or 76.9%. So that gives you a sense at what the pace is. And keep in mind, this is at a time where small carriers have opportunities, other opportunities to haul loads and so they're choosing to come in. You saw that our gross margin for our Logistics business was 20.2%. I can tell you that the power-only margin was higher. It pulled that average up. The average for the traditional brokerage was much lower. And so, this isn't a case where we are artificially propping up or we're in some way cannibalizing our business to make this work. And so, there's no doubt that there is demand from both sides, from small carriers to participate in freight that they used to be part of, but no longer are because of shipper preference and demand to use trailer pools. So, they have two days to unload a load as opposed to two hours to unload a load. And so, there's no doubt that those forces exist. The question is how do you efficiently facilitate a platform that can serve both of their needs, while at the same time, serving our need to get a return. And that's what we're doing and that's where we have technology that we've been developing, that we've been acquiring that will help us to facilitate this.

And so, the difference for us is we don't have ex number of trailers that we've allocated to this. We have, as we've mentioned about five times so far in the call, we have 71,000 trailers. We're going to keep talking about that. If all goes well this year, we're going to add more than 10% to our trailer fleet that we should receive that based on what we think schedules will allow. And so, it's going to continue to grow. And so, if we have this kind of demand

in this strong environment, we feel like there are ways we can transition and make that even more appetizing and appealing in an even more difficult environment. So it is very much a different offering. To your point, it is very much a different offering. It is a Tale of Two Cities in terms of, one the traditional old school live load, live unload way that is struggling to grow versus this that we almost can't slow it down, so.

Adam Miller: And Ravi, just talking to customers, the value proposition is so different than a traditional broker who isn't bringing equipment and some customers limit how much of their business they will allow to actually go to brokers because they want people with assets. And we come with a logistics sell that involves trailers, that is not put into the brokerage bucket. They allow for as much growth in many cases as they can get from that service because it allows for them to keep the fluidity of that network, which has become so much more important to supply chain than it really ever has been.

Ravi Shanker: And you are confident that this is not just a quirk last cycle, I mean this is here to stay, right?

David Jackson: This is -- we believe this is here to stay because this is a function of a regulatory change that took effect technically, December 18, 2017, when electronic logs were mandated. Enforcement, I don't think started until like April of 2018. But on that day in December, in our brokerage, we had the smallest of carriers demanding to be paid or unloaded within two hours. And all of a sudden, the industry began to charge detention. The truth is that regulation should -- that change should have happened January 4, 2004, when the hours-of-service rules were changed. That's when we saw it. And if you look at most carriers, when you're just comparing a solo driver and a truck, we saw somewhere between 8% and 10% of miles per truck of productivity just disappear to the fleets that had ways to audit against the logs and we didn't have ELDs in the trucks, they hadn't been developed to the level that they eventually were. But we're just trying to live up to that hours-of-service change where you can't stop the clock, the big guys, we felt it, we felt the impact. And we saw our detention go up, and we saw it become much more difficult to compete, frankly, since 2004 until 2018 because we were largely competing with, in some cases, large brokers or 3PLs, that we're dealing with small carriers that perhaps had more flexibility. We'll just call it that.

With the logbook, then what those of us that were living by the 2004 rule. And so now the 2004 rule is finally being enforced, and it's dramatically changed the economics of trucking because this is a penny business. And on many backhaul lanes, if you charge an extra \$60 on a 350-mile length of haul-backhaul load, you're talking about a 50% increase because it took you three hours to unload instead of two hours. And so historically, that small carrier was kind of the rubber band, and the customer didn't have to pay for that kind of inefficiency, and they just weren't built for it. And they probably didn't even realize how much -- how inefficient it was.

And so, of course, in 2018, we had immediate overnight tightness because you had these carriers having to drive last miles, perhaps 8% to 10%, just like we had seen back in 2004. And so, this is not a fluke of the pandemic. In fact, if you look at the 2019, look at what happened to spot rates and contract rates in 2019. Spot rates were off about 50%. Contract rates were off about 5%. It's never been that wide of a gap between those two.

And the big difference was contract rates are largely, nearly all today, but back then, were largely trailer pool connected. And so, Ravi, if you look at we talked about Iron Truck Services, and we see that kind of growth in the other reportable, we're now a couple of years into developing, for example, the maintenance network, where we're doing maintenance out of 29-or-so shops or we're underwriting insurance for thousands of carriers now, and we're really addressing the pain points for these small carriers because the nature of our relationship with third-party carriers is evolving and changing.

It's becoming less transactional, as it normally was in a non-asset broker world where you take a margin off of desperation when a small carrier needs to move a load. And that's not a 100% of how brokerage works, but that's a lot of the broker loads. That's how that works. And so, we are finding ways to create more of a win-win and dare I say consolidation and that's where this is headed. It's -- and so we're able to help them. We're able to leverage our size and scale to bring some of these benefits to them that, ultimately, we believe, can lead us to more competitive pricing, which can be more enduring in up and down cycles and give us the kind of variability that we're looking for.

So, what you see now, I hope, is these things are not unrelated. Ultimately, efficiency wins the day, which is why trailer pools are in such high demand from the supply chain. It is so much more efficient. And so, we are bringing other efficiencies to these small carriers because, in the end, we think it will allow us to be even more efficient, the kind of pricing we can offer long-term and grow.

Ravi Shanker: Great, thanks Dave and Adam.

David Jackson: Thanks, Ravi.

Operator: Your next question is from Todd Fowler from KeyBanc Capital Markets.

Male Speaker: Hey good afternoon. This is Zach on for Todd. Sorry, it's Zach, but a question on LTL. So solid growth in terminals during the quarter. I guess, how do you guys think about your ability to continue to grow that business organically through the year and is that through leveraging existing locations or maybe just additional terminal adds? And if that's the case, is there a cadence we should be thinking about in terms of those adds quarterly? And then conversely, just kind of your general thoughts on the M&A environment in LTL? Thanks.

David Jackson: Yes. Well, thanks for the question. We -- as we noted, we picked up six new facilities, and these are existing LTL terminals. They've been LTL terminals in the past and so there's a little bit of work we'll do to get these things ready to go and embrace those. And so, we'll have a couple of those. Hopefully, we'll get rolling with them but before the end of the second quarter. And then between Q3 and Q4, we'll continue to add some more, and there may be a terminal or two that don't really come into full life until maybe even early next year. And so, we saw an opportunity to pick those up, which we did.

Adam in his remarks mentioned about how connecting just the AAA Cooper and the MME network is leading to revenue opportunities, we're seeing that. I mean we -- this was by far the -- our best performance in our limited time so far in our nine months that we've been in

the LTL business. And if you were to break it down, January and February, particularly in the Southeast, suffered quite a bit of inclement weather. And so, there were at least five weeks between in January and February, where we were not where we would have normally been. And March was perhaps the best in history, and we brought that momentum into the second quarter. So, when you look at that mid-80s OR, March helped significantly there. So, we're starting to see the impact of these -- of working together. We're starting to see the impact of some customer introductions and increasing just organically the volume, and we're seeing improvement in the rates. The way to think about this is we're going from two regional businesses to -- you could maybe say we now have a super-regional LTL presence, and we're on our way to a national presence. And it appears that the pricing when you can be super regional, there's pricing opportunities with that. When you can be national, there's even more pricing opportunity that can come with that. And so, we're just getting going and exploring that and so Adam, anything else to about growth cadence throughout the year?

Adam Miller: Yes. As I mentioned earlier, we're finding customer synergies, and we look at the customer base of our Truckload business, those are very large shippers. And many of them were not in the AAA or MME portfolio. So, as we make those introductions, onboard freight, those are big wins, big opportunities to grow and diversify the freight mix in those businesses. And we've seen several of those wins that have started to scale, and we'll see more and more of those as the quarters progress. And so, we're excited about that.

And then we're bringing the MME team onto the AAA system. So, we have better connectivity to the customer, more fluidity through the network. There's a lot that could be done that wasn't connected versus two separate systems. So, we're excited about that. And I think what's the most encouraging is that the MME team and the AAA team are on the same page. And they're working hand-in-hand to find the best way to develop the most fluid, cost-efficient, effective LTL network. And as we bring on other LTL providers, which are -- that's our desire, that's our plan, we have now a road map to be able to do that and to know how that could work.

Zach: Great. I appreciate it. Thanks.

Operator: Your next question is from Amit Mehrotra from Deutsche Bank. Your line is open.

David Jackson: Hi, Amit.

Amit Mehrotra: Thanks operator. Hi Dave. Hey Dave. Hey Adam. So, I just wanted to ask you, I guess, a couple of quick hit questions, if I could. First one, the operating ratio last year, high 70s, even mid-70s at some point last year, obviously you showed the power of the model, the power of the Swift integration and a really, really good market. What does that look like at the other end of the spectrum in a really bad market? I'm not calling for that and you guys aren't calling for that, but clearly, I think that's an important question in the context of the conversations today.

And then the second related to that, Adam, you talked about rejections coming down due to higher contract rates. That makes entirely good sense from a carrier's perspective. But what I'm wondering is, have shippers tendered less volume because of what's happening in

the spot market? Does it appear that way because of the drop in hook or the trailer pools? But if you can just talk about at what point do you think -- have you seen any indication of the shippers moving away from tendering volumes that they've committed to because of what's happening in the spot market?

Adam Miller: Well, so real quick, I think Dave touched on a little bit on the potential downside, particularly on the Truckload side. The way we look at that is we expect the full Truckload segment, which includes the Swift business and the Knight business, in a difficult market to operate in that mid-80s operating ratio consolidated, including our dedicated.

In a more normalized environment, maybe that 80 to low 80s. In a good environment, like we're in, you're operating in the 70s. I think that's been consistent with how we performed in the Knight business through cycles. When we think about tenders, again, as Dave alluded to, there's less probably urgency in the system. And so, a lot of times, the rejections we see and others will see are the same load. They're tendering to as many people as they can until they can get someone to accept it. And so now as customers have been willing to make concessions on contract rates, more commitments are being loaded in the systems for these carriers and they're accepting more loads. And so, there's no longer the waterfall that these loads have to go through and get tendered out to multiple carriers to see who has capacity to pick it up. So, I do think that has the greater number of commitments being made has helped that.

David Jackson: Yes, and I would say, Amit, we watch really closely kind of what the response and behavior and demand is from our customers. And we've already seen where some of those that started the bid season late last year and finally got through to tender the awards in the first quarter, which those would be the earlier ones. We've already seen where it appears that those bids that they didn't get as many commitments as they would have hoped because we immediately see a mini bid following the normal bid that in essence was seeking commitments on what had just gone through the system. And of course, that second round typically comes with much higher rates because they were already increases in the first one, but that mini-bid follow-on typically is even higher. And so we're still seeing that, and we've been seeing that. We saw that all through 2021. We saw that through the back half of 2020. But really the bid season of 2021, which was a year ago, I mean, that was the norm and so we're still seeing that today.

So, I just think it speaks to the fact that they're just the kind of capacity that they need in their supply chains, they're just, it's become scarce. And if you look at irregular route capacity, particularly on a larger scale, which would include having access to trucks and trailers in about every market, even the large guys, the large guys are the ones who can really provide that. But the large truckload players have been moving away from an irregular route full truckload and have been moving maybe into the arms of dedicated a little bit more or something else. And so there just isn't as much of that. Now that's our bread and butter. I mean we love that. We're very comfortable with that. And it arguably is the most valuable to the customer. And so, I think that's what we continue to see. So, I think one has to be careful in extrapolating too much on data that comes from a load board, when the high-quality capacity and the kind of capacity that the majority of the shippers in this country look for, we're not on load boards looking for loads, so.

Amit Mehrotra: Great. Okay, very good. Thank you very much.

Operator: Your last question is from Tom Wadewitz. Please state your company affiliation and your line is open.

Tom Wadewitz: Yes, hey Dave, hey Adam. Thanks for the question.

David Jackson: It's Tom from UBS.

Tom Wadewitz: It's Tom from UBS. You got it. Thank you and thanks for doing the call. It's great to hear you guys live, and so I appreciate it. I wanted to just get your thoughts on use of cash. You generated a lot of cash in the quarter. I think, clearly, there's an intention to expand these non-irregular route truckload businesses more aggressively. How do we think about the most likely uses of cash? I know when you do M&A, it's hard to forecast when that happens. But are you optimistic on doing LTL deals this year? Are you thinking there are other types of deals or just what's your kind of lay the land and most likely uses of the pretty significant free cash you have on balance sheet capacity?

David Jackson: Yes. Well, thanks, Tom. Yes, the cash flow creation is astounding. And probably I don't know, dare I say, underappreciated a little bit. I mean when you look at over \$900 million of free cash flow generated last year or in the first quarter of \$352 million, it's significant. And if you look at where our debt is, our debt is at the low end, if not slightly below what our target capital structure would have us at. So, we're definitely poised to continue to make investments. We would love to grow in LTL, but we will only grow as fast as reasonable opportunities present themselves. And so, we're going to continue to execute. We're really -- we did two deals in six months. And so, we've been digesting those. And I think one of the most compelling things that we have for future LTL deals is success with the current partners that we have right now and proving out that this can work.

Reid Dove who's the CEO at AAA Cooper, he gives a great example talking about how the loads that get picked up in Birmingham, Alabama are picked up by AAA Cooper and just as they would have expected. And those loads might be delivered in Bismarck, North Dakota, and the loads delivered by MME, which is exactly who they expected to deliver it. And behind the scenes, we're there, connecting networks and making it all happen behind the scenes. And very few people have ever done it quite that way. Certainly, nobody's done it that way on a nationwide scale using those different brands. And those MME drivers, they enjoy driving for MME, likewise for AAA Cooper. And so, the fact that we're having success, the fact that we just posted an 85.9% OR with continued revenue growth, that's powerful for other families or individuals that own these other LTL regional LTL businesses, they put their heart and soul into it. And the fact that they can look and see what we're doing, we think, stands as powerful evidence.

So, we're going to continue to do that. Hopefully, put some money to work in LTL and continue to look for other deals that connect and help us diversify and become a stronger industrial growth company. Now along the way, when our stock price gets attractive, you can expect that we'll take advantage of an opportunity to buy back some shares at very -- but feel like very discounted PE multiples, so bought back almost \$150 million worth of

stock here in the first quarter. And at some point, it could be that we just generate so much cash that we continue to look at the dividend as well. But the priority is investing in our current business and making acquisitions.

Thanks, Tom, for the question. Everybody else, boy, we appreciate you joining our call this afternoon, and everybody, be safe.

Operator: Ladies and gentlemen, this does conclude today's conference call. Thank you for participating and have a great evening.