Knight Transportation, Inc.

Moderator: Adam Miller
July 25, 2018
4:30 p.m. ET

Operator: Good afternoon. My name is Franz, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Knight-Swift Transportation's Second Quarter 2018 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; Kevin Knight, Executive Chairman; and Adam Miller, CFO.

Mr. Miller, the meeting is now yours.

Adam W. Miller: Thanks, Franz, and good afternoon, everyone, and thank you for joining the call. We have slides to accompany the call posted on our Investor website, which is investor.knight-swift.com/events.

Our call is scheduled to go until 5:30 p.m. Eastern Time and will be structured similarly to our calls in the past. Following our commentary, we hope to answer as many questions as time will allow. If we're not able to get your question due to time restrictions, you may call (602) 606-6349.

During this call, we plan to cover topics and any questions specific to the results of the second quarter, provide an update on the merger and provide guidance for the next 2 quarters.

The rules for questions remain the same as in the past. One question per participant. If you have a second question please feel free to get back into the queue to answer – to ask your question. We'll try to answer as many questions as time allows for.

To begin, I'll first refer you to the disclosures on Page 2 and 3 of the presentation. I'll also read 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.

I'll now move to Slide 4 to discuss the results of the second quarter. The table on Slide 4 compares second quarter revenue and earnings results on a year-over-year basis. An important item to note, however, is that due to the accounting requirements associated with the merger transaction, the 2017 figures represent only Knight Transportation's historically reported results.

GAAP earnings per diluted share for the second quarter of 2018 were $0.51. Our adjusted earnings per share were $0.56, excluding $10.7 million or $8.2 million after-tax of amortization expense, primarily related to the merger, representing a year-over-year improvement of 124 percent.

Effective tax rate in the quarter was 22.9 percent compared to 37.6 percent in the prior year, and it increased sequentially from 21.2 percent in the first quarter of 2018. On a go-forward basis, we expect a normalized tax rate of approximately 24 percent.

Now on to the next slide, Slide 5. We provide a 3-year comparison of revenue, excluding fuel surcharge, and adjusted operating income. And in the comparison, we've included the historical Swift results in gray, as we believe this provides a better year-over-year comparison.

Second quarter consolidated revenue, excluding fuel surcharge, was $1.2 billion. Revenue, excluding fuel surcharge, increased 2.1 percent from the prior year when we compare the second quarter of 2018 with the combination of what each entity separately reported in the second quarter of '17.

Total revenue was $1.3 billion, which represents a 5.2 percent increase, again, when we compare the second quarter of '18 with the combination of what each entity separately reported in the second quarter of '17.

The combined adjusted operating income was $135 million for the quarter, which is an improvement of 47 percent if we compare the second quarter of '18 with what each entity reported in the second quarter of '17.

Our year-over-year combined revenue growth was achieved despite shedding some underperforming business and implementing more stringent driver, driving the higher requirements at Swift. We believe our ability to convert increases in revenue per mile is a meaningful improvement in operating income, demonstrates the type of industry-leading operating leverage we continue to see in each of our segments.

We are pleased with the results our team produced in the second quarter and the progress we have made, rate improvement and operating income growth built throughout the quarter, and we believe this momentum will carry into the second half of the year as we remain focused on improving our productivity while expanding our margins.

Now I'll turn to Slide 6. We continue to deleverage the balance sheet as our net debt decreased to $744 million, a reduction of $150 million since the beginning of the year. This is even after the first quarter acquisition of Abilene Motor Express. We also continued to reduce our off-balance sheet debt at a similar pace.

Net CapEx was $121 million during the first 6 months of 2018. We are still expecting a range of $525 million to $575 million net CapEx for the full year of '18, which primarily represents the replacement of the tractors and trailers we intend to pull out of service during the year. This range assumes all CapEx will be funded with cash and on-balance sheet financing through our revolver.

Our operations remained strong, as demonstrated by our ability to generate $376 million in cash from operating activities during the first half of the year.

This, less the $121 million of net CapEx, has resulted in free cash flow of $255 million.

Unrestricted cash increased to $115 million and our total available liquidity was $770 million at the end of the quarter. This provides us the ability to continue to invest in our business organically as well as through acquisitions.

During the second quarter, our board authorized the share repurchase program of up to $250 million. We plan to monitor the price of our stock relative to our expectations and historical valuation levels and we'll be active where we see opportunities.

We'll manage any repurchase activity in light of the leverage levels and growth opportunities, both organic and inorganic. We believe our current balance sheet positions us to have the flexibility to be buyers of our stock, while maintaining the liquidity for future growth opportunities.

I'll now turn it over to Dave Jackson.

David A. Jackson: Thanks, Adam, and hello, everyone. I'm going to start with Slide 7, hopefully, to provide a bit of strategic context now that we are Knight-Swift Transportation Holdings Inc., which combines the largest and most efficient truckload carrier network with a proven model for industry-leading profitability.

Our approach to improving returns and growing net income has been leveraged to every previous acquisition, including, for example, Fayard/Fastway Systems, Edwards Brothers, Roads West, Barr-Nunn, and the most recently, Abilene.

The Knight-Swift merger has likewise recognized significantly improved returns in net income through the first 3 quarters since the transaction. The accountability created through the organizational alignment, the visibility created through the internal financial reporting and the use of proprietary technology to evaluate rates, lanes and commitments have led to significant, and most importantly, long-term sustainable returns and income improvements.

The network created by Swift is unmatched in several ways. It's taken over 50 years to build and create. Knight is 28 years in progress, with a similar decentralized network, and is the most recent company to do so. These types of decentralized heavily transactional terminals and service centers are not easily replicated, and few, if any, have even tried in the last 2 decades.

The irregular route truckload transportation is – consists of the largest portion of all truckload transportation in the country. It also is the most difficult to operate. It's by far the most in-demand and creates the most value to the supply chain. We love irregular route and the competitive barriers that it creates due to its complexity and operational demands. We've seen dramatic improvements in this segment for each company and expect to see Swift results align more closely to Knights' over time.

The dedicated truckload marketplace was very competitive throughout the downturn, in part due to many carriers leaving the more complex irregular route segment for the more consistent, dedicated space. The dedicated marketplace can most often be served by a relatively small group of larger fleets and the pricing is beginning to more closely align with the value provided. We offer dedicated services in many shapes and sizes.

The decentralized operations naturally lend themselves well to acquiring carriers and helping to improve their performance. As mentioned, Knight has a history of this. Knight's ability to continue to perform with industry-leading margins over the last 3 quarters, while Swift makes significant operating income improvement since the merger, continues to give us confidence in this approach. We remained returns-focused and expect future growth through our M&A activities as we continue to grow the largest and most profitable truckload franchise.

Next on to Slide 8. We look at the operating performance for Knight. This was really a remarkable quarter for Knight Transportation with a 77.7 percent operating ratio in the trucking business. Included in that number would be the first full quarter of Abilene Motor Express, who performed at an 82.4 percent operating ratio.

We're happy to have them as part of that, and hope that they'll continue to make progress, even from where that is. We're grateful for the Jones family and the wonderful business that they've built that we now find ourselves stewards of.

When we look at this quarter, this is arguably the best quarter in Knight Transportation's history, given that it was done with a fuel headwind due to rising fuel prices. It was achieved with rates being up, with miles per tractor being up meaningfully, with even the fleet size growing. Our driver turnover in the Knight Transportation business is at record lows right now.

Then we look at the market, Knight historically has done a good job with being agile in a strong market and typically holding on to rate longer in the weaker markets. This go around for the second quarter, we saw revenue per loaded mile improved 20.9 percent. That was made up of, of course, positive spot environment; but also, the most significant, obviously, percentage of the freight, was contractual freight that was hauled that saw meaningful improvement.

As we begin the third quarter, approximately 85 percent of all contractual rates have been revised within the last 6 months. And so it gives you a sense for how far the implementation has gone with new contractual rates as we move towards the back half of the year. And of course, different in this cycle than in previous cycles, this late in the fifth season, it's not normal or typical to still see the kind of freight available and the rates available in the spot market, which suggests the strength that we're experiencing.

So we – our outlook and expectation is that the Knight Transportation business will continue to operate in the 70s, from an operating ratio perspective in the trucking business, trucking segment, in the third and in the fourth quarter and continue into next year into 2019.

We would expect to see – continue to see very strong logistics growth, both in top line and hopefully continuing to improve the operating ratio, as was done in the second quarter.

I will now turn the time over to Kevin Knight to talk about Swift's operating performance.

Kevin P. Knight: Thanks, Dave. Appreciate everybody being on the call with us today. I remember back, prior to the merger, my biggest concern was how would Knight perform when so many investors over, helping the good folks at Swift reach their profit potential. And I feel an enormous amount of gratitude for the good work that is being done at Knight.

Maybe I'll walk you back in history just a little bit, if I could. When we went public, Alex. Brown took us public and John Larkin and (Rob Irwin) are the guys that took us public at Alex. Brown.

And I remember, at the time, we were 250 trucks, give or take. And the #1 question that I got on a roadshow was, "OK, you guys can do this when you're at 250 trucks. What are you going to do when you've got 500 trucks?", or "What are you going to do when you've got 1,000 trucks? How are you going to operate it in 80 percent OR with that much equipment because all your competitors are telling us that the reason you're able to do it is because you're so small?"

And I simply answered, "I don't know why we wouldn't. I don't know how we couldn't." And so I just – I can't help but reflect back on how that was. I remember when we were on that roadshow, John and Rob said, "Hey, what we do with our folks that we take around is we keep track of how many 10 percent orders you get.

And so we're going to give you a batting average." And I said, "Hey, that's way too easy." I said, "I'd much rather we go free-throw percentage because free-throw percentage is much higher than a batting average." So I just want you all to know that we were confident then and we're confident now. So anyway, hey, grateful for the Knight team and all the good work that's being accomplished.

Let's talk about Swift. So we're at Swift. Several of us at near full-time, some full-time. We've actually got a few Swift people at night near full-time.

We're finding the places in the business where each of us are the best. And there's multiple opportunities on – from both brands.

But here's what I am seeing. I'm seeing very much we are improving our market execution at Swift. I've always felt like Swift was an industry leader in size and I felt like it's – that Swift should be industry leader in market execution. And I can tell you that, with our line haul rates up 14.7 percent year-over-year, I'm pleased with the progress that we've made so far. I really see more momentum at Swift in that area.

Many of our contract truckload customers have just now gone through rate increases. We saw very good momentum in the quarter from April to May and from May to June. And we expect to continue to see good strong rate improvement as we progress into the back half of the year. And many of our large customers' rates will only become effective in May, June, July and even we've got rates becoming effective in August also.

I think we're doing a really good job of improving the profit-minded culture that's really started to help improve the margins in each of our businesses, with the exception of refrigerated business. And that's a unique business, the way Swift has it set up, but I can honestly tell you that we've got our arms around it and that we're in the process of now taking the steps and the actions that we need to take in order to get the refrigerated business performing at a very good return on invested capital. But it's just going to take a little bit longer than some of the other Swift businesses.

In our refrigerated OTR business, which is a smaller part of our overall refrigerated business, we saw rates improved 14 percent. So we're also seeing extremely good market execution in that part of our business.

Our driver retention is better, both sequentially and year-over-year. Our challenge has been on the recruiting front. And we've made it tougher on ourselves. We raised the bar on the quality of drivers we are bringing on, but we are investing heavily in our recruiting and our training efforts. And I feel really good about our progress. And I feel like our operational truck count is nearing stabilization at Swift, and we'll definitely see it stabilize in the back half of the year. So I'm very pleased.

It's important to understand how good we are at Swift in developing and training drivers. And now that we've intensified the standards, we're starting to really see our safety improve.

And our driver counts are continuing to climb from immediately post-merger to where we are today. And as you know, summer months are more difficult to recruit. And as Adam mentioned, many of our truck losses tie back as much to exiting business that was underperforming as the driver market. So quite honestly, I'm optimistic about where we stand from a driver perspective.

Going to the next slide, our merger update, I would just say that any time you have the capabilities that Knight has in terms of your operating performance to merge with somebody 3 to 4x your size and be in a position to control the outcomes of that 3 to 4x your size and basically you merge on near par value, it's an outstanding opportunity for us and our long-term shareholders.

We've been diligently creating a stronger foundation at Swift, as I mentioned, with our higher-quality driving associates and our improved safety program and our enhanced market intelligence. And as I mentioned earlier, we've been addressing our role performing business and developing a more profit-minded culture. I just want to tell you, these are foundational changes. Foundational changes actually make my job more difficult. They don't make it easier, they make it more difficult.

So as you are trying to just work and do all those things that you need to do every day to run a safe, profitable, irregular route truckload business, when you have to make foundational changes and you have the intestinal fortitude to actually make those changes, in spite of the fact that they're going to make your life and your short-term look not quite so handsome, that's what our culture is all about.

And that's what we've chosen to do. And I'm grateful that we've done that because we are seeing improvement. In June, for instance, or since the merger, we had our best performing safety month in a long time for Swift. And so we're starting to see all those things take place.

I want to call out our equipment and maintenance team. Our equipment and maintenance expense was higher at Swift than it was at night, but we met with that group as recently as either yesterday or the day before, I can't remember, but the progress that we are seeing made by that group is absolutely unbelievable. And we have some really open-minded folks working there.

And really, I could go on and on, whether you're talking about our sales team or our operations team or our finance team, everybody is working hard on what I call the right things that are going to make us a better company.

I don't know if this has been mentioned, but 80 percent of our trucking business between both companies, which represents about 15,300 trucks, is performing well.

Now not as well as I would like to see, certainly some parts of it are performing as well as I would like to see, but when you look at 15,300 trucks and it comes out to an adjusted OR of 83.8 percent, I mean, that isn't bad. Now it isn't good enough, but I'm just telling you it isn't bad.

I want you to know on the refrigerated business, I just want to emphasize one more time. We are making significant progress on certain parts of that business, but we have identified the other parts of the business and the steps that have to be taken in order to improve it. And I feel like we have really good customer support in order to do the things that we need to do in order to get the returns on that business solidify.

When we first merged, the most questions that I got was on our intermodal franchise. And everybody said, "Now you're going to get that thing sold right of the bat, aren't you?" And we even had suitors calling us. And when you think of the truckload franchise that we have, to not have an intermodal piece that's part of that would have been very short sighted. Now I've got to tell you, we're not the best at intermodal yet. But I will tell you, we are getting a lot better.

And what I've noticed is when we talk about – when I talk about being profit-minded, our intermodal group, in my opinion, for the first time, is making profit-minded. And we are doing a great job for many of our customers to help them reduce their costs by being able to serve the intermodal space.

Now, hey, are we happy with a 95 percent or 96 percent OR? Absolutely not. And I'm grateful for companies like J.B. Hunt and Schneider that give us something to target, because you can rest assured that we will not rest until we are performing at or better than both of those brands in that part of our business.

And I know many of you are saying that maybe J.B. Hunt has an advantage. Well, they probably do. But at the end of the day, we don't make excuses and we're going to give them a run for their money. So – but hey, we're grateful for them and the example that they are.

We haven't said much about our logistics business. I will tell you that the logistics business is really good at Knight, and I will tell you it's going to be really good at Swift. We're now on the same platform, we now think the same way. And it really hasn't done much yet for Swift in terms of revenues and earnings, but I promise you it's going to end. And I really like the pace of improvement that we see there.

So basically, that's how I see it, maybe a little long-winded for some of you, but I wanted to give you a bird's-eye view from my chair.

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

Adam W. Miller: Thank you, Kevin. So we move on to Slide 11, so we've decided to revert back to the – to our similar past practices and we're now introducing guidance for the next 2 quarters.

So based on the current truckload market and recent trends, our expected ranges for the third quarter of '18 is $0.56 to $0.60 of adjusted EPS. Our expected range for adjusted EPS in the fourth quarter of '18 is $0.68 to $0.72. I'll lay out some of the assumptions made by management to come up with these estimates.

We expect rates to continue to improve sequentially for both our OTR and dedicated fleets, in both Knight and Swift. We expect sequential adjusted operating ratio improvement in each of the Swift segments.

We expect the Knight trucking segment adjusted operating ratio to remain in the high 70s, as Dave previously noted.

We expect truck count to stabilize in the back half for Swift and to remain essentially flat from the second quarter truck count at Knight.

We set both company driver wages and owner-operator expenses to remain inflationary.

We expect logistics to continue to grow profitably and we expect gains on sale to trend down slightly during the back half of the year.

And again, as I previously noted, our tax rate, we assumed that to be around 24 percent for the back half of the year.

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

So this concludes our prepared remarks. And like – again, we'd like to remind you this call will end at 5:30 Eastern Time. We'll answer as many questions as time will allow. If we don't get to your question, feel free to call (602) 606-6349. We'll do our best to follow up promptly.

And we'll now turn it over for questions.

Operator: At this time, I would like to remind everyone in order to ask a question press star then the number one on your telephone keypad. Again, that is star one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Ken Hoexter from Bank of America.

Kenneth Scott Hoexter: Great. Thank you for the outlook, Adam, and for the details there, but maybe if we can dig into kind of what went wrong at part of Swift, and I mean, particularly within their refrigerated side, just given the focus that management has had on the operational turn.

It seems like you've taken a bit of a step back on the refrigerated side. You noted that there are some things you're working on, maybe you can kind of discuss in a little bit greater detail to understand how to fix it and the time frame to get there.

Adam W. Miller: Yes. So maybe I'll touch a little bit on the Swift results and we'll dive into refrigerated. And Kevin, feel free to jump in if you have any additional comments. Look, we're not looking at Swift as, "Hey, something went wrong with Swift."

I mean, if we look at all of our segments other than refrigerated, we made some meaningful improvements in our operating ratio. We are able to convert the rate improvement that we made to improvements in the operating ratio and did so at levels that most in our space, those who have reported thus far, hadn't been able to do.

We may have lost a few more trucks than we would have liked, but as Kevin noted, we're evaluating our business and we're building a stronger foundation with our driver base. And we feel confident that we're able to stabilize that in the back half of the year.

In refrigerated, we did a deeper dive into that business. There's different chunks on how that's made up and there's one piece that clearly hasn't been working. And we've got a team around the table that is highly engaged with our customers.

We've had a clear path of what we want to achieve and we're around the table with them on a regular basis to develop a pathway to be able to implement some of those changes in the coming quarters, which we expect to improve the results in that business.

Kevin P. Knight: Yes. And Ken, I would just add, I think we are very clear from the beginning that we expected that our work at Swift, to get Swift where we want to get Swift and where the people at Swift want to get Swift, will take 2 or 3 years. And the fact of the matter is we got off to a very good start in the fourth quarter of last year because we had a very strong market, but we wouldn't be really addressing any of the foundational issues yet.

And so – but we had a plan that once we come into the first part of the year, we've got to address these foundational issues to make sure that Swift can see its way to the promised land. So that's basically what we've done. And there's – as far as I'm concerned, there's nothing going wrong at Swift.

So everything that I'm involved with, I feel like we're making very good progress on. And I believe that our people are extremely engaged and basically have a good, clear understanding of what our expectations are from a return on invested capital perspective, from an OR perspective, and really what we need to do in order to get there. So you might see it as though maybe there's something wrong, but I sure I said no.

Adam W. Miller: Right. And just to add to that. I mean, I think it was encouraging to see the sequential improvement that we saw from April to May and then from May to June. And again to reiterate, we expect that momentum to continue into the third quarter.

Kenneth Scott Hoexter: Perhaps I – maybe I wasn't clear enough. I wasn't talking about Swift overall, Kevin and Adam. I'm more specific to your refrigerated segment, where you had a 98 percent OR, up from 94.7 percent. I'm just trying to understand, you mentioned there were a couple of things you were working on to fix it. It seems like you were admitting that even that OR was not on track.

Kevin P. Knight: Yes. Well, I would say that OR is not on track. But in my mind, all ORs weren't ever going to be on track. And there would be setbacks along the way. So yes, I'm absolutely with you, Ken. That OR, refrigerated, is not on track, but we're doing everything we need to do to make sure that we get to returns on that business where we need to get them.

Operator: Your next question comes from the line of Ravi Shanker.

Ravi Shanker: Can I just follow up on that a little bit more, because I think this is important to kind of try and get a sense of what those initiatives are in the refrigerated business and kind of just for us to understand how long it will take to fix that remaining 20 percent of the business, if you will, that you highlighted as kind of not running at full strength?

So can you give us any color on what exactly is wrong and kind of what are the steps you are taking and kind of is this a matter of a few months, a few quarters, a few years, kind of just how structural those changes are?

Kevin P. Knight: Yes. First off, Ravi, we won't discuss the specifics, but what I will say is that, basically, we have identified the areas that need support in that business and we know the things that we need to do in order to get that business where it needs to get. So literally, if we do really well, we'll get it where it needs to be in 2 to 3 or 4 quarters.

If it takes us a little bit longer, it might take us a year or 2, but I don't expect that it will. But we're just – these are very important customers of ours. We're very good in that segment of our business. We've improved the operating ratio in our refrigerated business by over 300 basis points, with the exception of this specific section of the business that I'm talking about. And so we just got – you just got to hang in there. I mean, you just got to bear with us as we continue to do our work.

Ravi Shanker: OK, and this is a follow-up. Can you just talk about, again, overall, given the current environment and kind of where rates are right now and the strength of the market right now, can you just talk about what you're seeing kind of heading into peak season, while at the same time having just a bit of overhang on tariffs, kind of how would you characterize the overall pricing and volume environment kind of as we go into peak season here?

David A. Jackson: Ravi, I'll just – I'll jump in there. I mean, we continue to see things very strong. I mean, the – in the broader economy, things continue to move very quickly. We haven't seen impact from tariffs, at least in our business, in a way that we can correlate changes that are anything other than what you seasonally would see. So far every season, since the fourth quarter – since early in the fourth quarter, has been much stronger than the normal seasonality.

So on the demand side, it hasn't looked this good in a long, long time over a decade. I mean, you have to go back to the last time that we saw economic expansion, which was over 10 years ago. So that outlook looks really good.

I think when you talk about – when we talk about 80 percent of our business that is really exceeding expectation, represents the largest group of trucks in the whole country and really is a multiple of the next closest, and for that to perform at the low 80s, for us to be sitting here a year later with more – 5 percent more total revenue and 47 percent more net income or operating income than what we would have had a year ago and for a firm 25 percent the size of the largest player to come in and do this, boy, there's a lot of very exciting positive things.

We expected on April 10, 2017, when we had the announcement, we expected to make meaningful progress over a 3-year time frame. We had 3 quarters and we've arguably done at least 2 years' worth of progress, maybe more in 3 quarters.

And the good news is we could have never expected the kind of positive freight demand, the positive larger macro economy on top of all the scarcity and barriers that have been created on the supply side. And so the outlook continues to be very positive.

You have to remember that on September 8, when we closed the deal, we found Swift already overcommitted, arguably committed to more loads that have had trucks possible to fulfill. And so some of those were more of the 1-year persuasion and others were over a longer period of time. And so the refrigerated business has more than its fair share of more complex arrangements and agreements.

And so we'll continue to address that. And the good news, it gives us even more confidence than just the fact that, where experiences in our wheelhouse, we know how to do this. What gives us even more confidence is the fact that we're in an environment that we've maybe never seen this good.

Kevin P. Knight: Yes, and I would just add, Ravi, from Swift's perspective, I think our momentum is really good on the rate front and we don't see anything that is going to change that. I think we just feel very positive about what's going to happen from a market perspective at Swift over the next couple of quarters as we work our way through peak.

Operator: Your next question comes from the line of Brad Delco from Stephens.

Albert Brad Delco: Yes. Dave, I just kind of want to ask the obvious question here. When we see multiples contract, it's essentially perception of earnings risk. And I think one of the unique things about Knight is that it has a pretty high variable cost structure and we haven't really seen a lot of earnings declines, even in, like, the economic recessions we saw in 2008 and '09.

I believe the market is saying that they think if things were to slowdown that we would see a lot of earnings risks at Swift, which is now a little more than half of your operating income. So maybe could you or Kevin or both comment on what the variable versus fixed costs are at Knight and Swift? And then, how quickly can we get Swift to resemble what we've seen historically with Knight?

David A. Jackson: You've got a few questions in there, Brad. So I'll answer the ones that I heard and maybe Kevin can clean up the rest. I think that, over time, Knight has enjoyed a premium multiple to earnings. And I think that's largely been predicated on the fact that it had return on invested capital that was typically double digits and exceeded the weighted average cost of capital.

Swift historically has not exceeded its weighted average cost of capital. And so looking at a forward P/E there, over the last 10 or 15 years, Swift has been more like 13x of forward P/E and Knight's been closer to 21x. The stock seems to right now favor the Swift valuation.

Now I will tell you that Swift valuation looking – when you look at return on invested capital, looks like net income after tax, that ROIC would have been closer to a 39 percent to 40 percent historic tax rate, whereas now it's a 24 percent to 25 percent. So arguably, the ROIC profile of even the previous earnings should merit maybe even more of a multiple.

But that being said, I think we understand it's – I don't think it's justified, but I think we understand that there might be some uncertainty or even risk that some individuals might feel with a deal of the size that did. Hopefully, every quarter gives people a little bit of confidence that the trajectory of this business is much more in line with the kind of returns that have been historically aligned with Knight Transportation and not with Swift.

And so when you see – we heard the issues, and Kevin gave the great anecdote earlier, but we heard the issues before. This is Knight. It's just going to become mediocre from the returns, and it's been nothing close to that. And I think that, that speaks to the strong foundation that has – that's been created at Knight. And so it is with that same experience and that same outlook that we're working through things over at Swift.

Kevin P. Knight: Maybe I could add, Dave. Brad, you talked about the variable cost structure of the business. And really, most of what we're going to see and improving our cost models at Swift, it just takes time. When you're – when you've got driver higher costs that are significantly higher than at Knight, it takes time to improve on that.

When you have less efficiency in your headcount, it takes time to improve on that. When you talk about transforming the quality of your driver ranks, that takes time to improve on that. When you talk about all of the cost savings that we've put into effect, well, many of those costs play out over a 4-year period, which is our equipment trade cycle.

Those things take a little bit of time. So basically, with the things we have in place right now, we are going to continue to see costs in very difficult areas to achieve cost savings, support that lower variable cost model that we have. And just from my perspective, before the analyst community determined what our earnings estimate should be, if – when we did this merger, if you would have told me we were going to make $0.44 in the first quarter and $0.56 in the second quarter, I'd have signed up.

But you guys just got a little ahead of yourselves. I don't know how else to explain it. You've got way ahead of me. I know that. So – but hey, Brad, it's – we're doing the right things, we're addressing the right issues. And hey, for those of you who have been with us for the last 28 years, I think your confidence level should be really high.

Operator: Your next question comes from the line of Tom Wadewitz from UBS.

Thomas Richard Wadewitz: Hey, Kevin, Dave, Adam, I appreciate the time. I wanted to see – I think one of the things is just attrition and drivers at Swift Truckload. I think at the end of the first quarter, you kind of said that it was stabilizing and then there was some further attrition in the second quarter.

Can you give us some numbers that would just give us a little more visibility to the progression, perhaps like a driver count at the end of May, June, at the present, something like that?

Kevin P. Knight: Yes. Let me just – I'm not going to give what you asked for, but I'll give you something. And first off, Tom, the first conference call we had, we had some attrition and everybody said there was concern. And I said, "Hey, guys you've got to give us 2 or 3 quarters."

Now I don't know what I said last conference call for sure, but my thought has always been it's going to take 2 to 3 quarters to do this. Now through that process, as we started that foundational improvement that I've talked about in terms of our market dynamics, of course, we found pieces of business that just weren't working. And if we didn't get a certain amount of rate, they weren't going to work.

And so what we chose to do is we chose to present that rate. And what happened is the customer chose to say, "Hey, I'd rather take my chances on

The Street." So that certainly contributed to what you saw this quarter. To put it in perspective, we exited several large dedicated buildings. And those exits are complete now. And so basically, that should give you just a little bit of comfort.

But the most important number to me is, in the last 6 weeks, the number of potential drivers coming into our system versus exiting our system is 0. We've had as many people come in as we've had come out. That is a first for Swift in many years. And that even includes the number of our drivers that are transferring into our independent contractor programs.

So considering we're in the summer doldrums and considering this is usually a difficult time of the year as far as drivers are concerned, we're very optimistic. Now I've got to tell you, we are working around the clock.

If you have a list of every driver development schools in the nation, I would be very surprised if someone in our organization hasn't visited them in the last 90 days. And so what you guys have to understand is we are working around the clock. And not only are we working to develop our relationships with those guys, but we're also working to intensify the operation of our academy.

Swift Academy is used to produce twice as many drivers as they do today. And at the end of the day, we got a little lazy there, in my opinion. And so when I look at the potential of us building up our academies, we have – we are going to be able to build our academies. And so I feel very confident that between third-party schools and between academies, we're – we've made lots of good progress and we are not stopping.

As a matter fact, we're putting our foot on the freaking throttle. Now as far as experienced drivers, we also are doing a much better job in terms of experienced hires between both companies. And the thing about Swift is, as we get the rates up, we can pay our drivers more. And that's an important part of the quotient.

So Tom, I probably didn't give it to you exactly the way you would have hoped to have gotten it in terms of anything, maybe specifically, statistical, but the momentum is definitely in the right direction.

Thomas Richard Wadewitz: Yes. Well, that's helpful. I appreciate it. I hope you don't mind if I ask one follow-on. You had mentioned, Kevin, your comment on The Street expectations that were – got a bit out of hand. So it sounds like you do have a pretty good idea of what the forward-look might be.

When you look at 2019, I think The Street, $2.78, it could be that things are slower this year but you still get there. I don't know if this is probably an unfair question, but do you think that people are ahead to where you're going to be in '19? Or do you think that's been the realm of possibilities that you could kind of get to, bearing in mind that maybe it's a little slower second half this year than we have been modeling?

Kevin P. Knight: Yes – no, I'm going to answer, Tom, because you asked me the question, but I'm going to ask Adam to make sure I didn't say something I shouldn't have said. But no, I don't think the expectations for '19 are outside the realm of possibilities. So no, I think – I think we're OK, Adam?

Adam W. Miller: Yes. I mean, obviously, we're not giving any guidance out. We've given our guidance for the back half of the year, but we certainly look at where The Street has us for '19. And basically where it's at, we don't think it's unreasonable.

Now certainly we'll provide an update on that and we'll start to give guidance into the first quarter than next quarter. But hey, we feel like we have really good momentum. We like where we're at from a synergy perspective. We've got our businesses that are making year-over-year improvement. We have one segment, the refrigerated segment, where we will feel like there's a lot of opportunity and we have a good pathway to improve that business. And we think there's a lot of upside from where we're at.

Operator: Your next question comes from the line of Amit Mehrotra from Deutsche Bank.

Amit Singh Mehrotra: So just I understand the commentary around the 80 percent of the business is performing well. But when we look at truckload specifically for Swift – sorry, Swift Truckload, the OR of 87.4 percent is actually higher than what

Swift is able to do on a stand-alone basis in the second quarters of each year of '13, '14 and '15. So fully appreciate that year-on-year you're improving. That's great.

But given all the changes you made with respect to pricing and the reorganization of the sales force in terms of how they report, plus the underlying demand and pricing environment, just would have been nice to see something even better given the seasonal tailwind. So if you could just help us with that. And ultimately, when you look at 2019, that 87.4 percent OR, I mean, where do you see that trending to on a sustainable basis? Would be helpful as well.

Kevin P. Knight: Yes. First off for me, what you got to understand in '13 and '14 is you had fuel prices headed south. You had a gain on sale headed north like we had never seen. And so at the end of the day, you can go back and look at numbers 4 or 5 years old, but it's just a different day, it's a different environment.

What we do is we look forward and we look at where we are today. And for us, the day of dawning was where Swift was in – on September 8, 2017, and so that's basically how we look at it. So in terms of from what we inherited to where – to the progress that we're making, we feel like it's good progress. And we feel like we're on course and we feel like we'll continue to make more progress. So Adam, you look like you have something you want to talk about.

Adam W. Miller: No, just in terms of just truckload. If we look at our operating income on a year-over-year basis, that's improved 48 percent, even on the smaller fleet that was mentioned earlier.

And Kevin noted we didn't merge with Swift from '13, '14 and '15, we merged with the Swift that had a different set of commitments, a difficult driver market and a different cost structure that they had then, and we've gone through a very extensive process to make improvements in that business, and we have good momentum. And we expect that to continue to improve like we saw the second quarter play out with incremental improvements throughout the year.

Kevin P. Knight: Yes. And Amit, I would just add, we wouldn't have got Swift on par value. You understand what I'm saying – or close to par value in 2013 or 2014. So we've got what we've got.

Amit Singh Mehrotra: Yes. And the 87.4 percent OR, does that trend down to the low 80s as we look at next year, I mean?

Kevin P. Knight: (It sure is, also).

Adam W. Miller: Yes. And Amit, if you look at the trends swift had seen historically from a second quarter to a third quarter, typically ORs increase. And so they deteriorated from second to third. We expect to improve the cadence of that earnings. We expect to see the operating ratio to continue to improve from second to third quarter.

David A. Jackson: So Amit, I'm feeling left out of this. So let me jump in here. That 87.4 percent that you quote was an improvement year-over-year of 560 basis points. Of the truckload companies that have released, at least prior to today because some may have already snuck out here at the same time ours did, but there's only one company that improved their OR better than the entire industry. And it was Knight Transportation that improved just shy of 700 basis points on the OR.

So what you're seeing, in fact, what we saw in that truckload space is we saw the Swift business actually dropping more to the bottom line from an OR from their rate improvement than even Knight did. And so we're – when you look at those fundamentals, I mean, there are some very strong things that are happening within the business. So we appreciate...

Amit Singh Mehrotra: All right, let me stop there because I think there's a minute before – (I'll get one more question in), so I'll hop off. Thank you for answering my questions.

David A. Jackson: OK. So we – unfortunately, we have additional people in the queue that we have run out of time as it is now 5:30 Eastern Time. We appreciate those of you that have joined our call today and your interest in our company. Have a wonderful evening.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

END