USA Truck, Inc.

Fourth Quarter 2016 Earnings Conference Call

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CORPORATE PARTICIPANTS

James Reed - *President and Chief Executive Officer*

Jim Craig - *Executive Vice President and Chief Commercial Officer*

Martin Tewari - *President, Trucking*

Joe Kaiser -*Vice President and Principal Financial Officer*

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PRESENTATION

Operator
Good day and welcome to the USA Truck Fourth Quarter 2016 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Jody Burfening. Please go ahead.

Jody Burfening
Thank you, Allison. Good morning, everyone, and welcome to USA Truck's Fourth Quarter Earnings Conference Call. Joining us this morning from the company are James Reed, President and CEO; Jim Craig, Executive Vice President and Chief Commercial Officer; Martin Tewari, President, Trucking; and Joe Kaiser, Vice President and Principal Financial Officer.

Before beginning the call, I would like to remind everyone that this call will contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and such statements are subject to the safe harbor created by those sections and the Private Securities Litigation Reform Act of 1995, as amended. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Please review our disclosures in our filings with the Securities and Exchange Commission.

Also on today's call, management will be referring to certain non-GAAP financial measures in its analysis of the results that supplement the GAAP financial statements. A reconciliation of these non-GAAP measures to GAAP is provided in the tables at the end of the slide presentation accompanying today's conference call.

With that introduction, I would now like to turn the call over to James. Good morning, James.

James Reed
Good morning, Jody. Thank you very much. Thanks, everyone, for joining us this morning. Our focus on this call is fourth quarter earnings, but I want to begin by acknowledging our recent change in leadership with my appointment to CEO and Jim's to Chief Commercial Officer. We each have experience driving rapid and aggressive change in organizations requiring significant operational improvements, and we'll do the same here at USA Truck. Both of us and the rest of the USA Truck management team understand that we must execute and accelerate the pace of change at the company. Our results have been unacceptable, and we are looking forward to leading USA Truck into the future on a much faster path.

I'd like to draw your attention to Slide 3 to clarify what this change means to USA Truck and what you can expect from us in the future. This quote from Andy Grove sums up how I feel about the last several years in our company. He said, "Most companies don't die because they are wrong. Most die because they don't commit themselves. The greatest danger is in standing still." We will not stand still. Our strategy is sound. Our execution and pace have not been, and that now has changed. Our execution and pace of change have already accelerated and will continue to do so. You've seen professional managers from within the industry, and there's no doubt that many of them are exceptional, but we bring an intensity and immediacy to the table that I can say with certainty has not existed at USA Truck. We expect to improve, we expect excellence, we expect engagement, and we demand maximum effort and fast results.

This approach is already yielding early returns. Our operational results were encouraging enough in January that I will share two key results from the month with you. The first is productivity per seated truck per week in January was up 8.3 percent versus January of 2016. Improving per-truck productivity over 150 miles per truck in this environment is a testament to our team and their focus on results, despite what everybody knows was a slow start due to the weather in January countrywide.

Our first quarter freight awards that are going into effect this quarter, which account for over $40 million of our annual revenue portfolio, are at rates more than 5 percent higher than they were in 2016, and we think that's an encouraging trend. Jim's new role is all about maximizing synergies between our truckload and logistics businesses. There are many latent opportunities for revenue generation at the lane, customer, and broader geography level that are missed by artificial siloing of the business, and Jim is uniquely positioned to bring that together. Just this week he led the effort that launched a trucking and logistics load board desk that will now allow us to consider and quickly commit to incremental loads from shippers looking for immediate capacity commitments between our two businesses. We are moving quickly.

With that introduction, let's turn to Slide 4 for a look at our consolidated results. The overall freight environment in our business was just okay in the fourth quarter as we saw slightly lower volumes than expected, particularly in October. We also saw a shorter seasonal window than we have historically experienced. However, upward price pressure was evident during the peak of the quarter as tightening capacity became more of an issue in our sector than it was in 2015. We wrestled with higher-than-expected unseated tractors, which limited our ability to fully take advantage of the improving conditions.

For the quarter, operating revenue was down 12.6 percent, and we had an operating loss of $4.6 million, and our operating ratio was 104.5, well below our results for the same period in 2015. In this year's fourth quarter, we recognized a $2.8 million pre-tax, or 23 cents per share, impairment charge on assets held for sale that was included in per-share earnings.

The 2015 quarter included a $200,000 benefit from lower costs associated with facility closures, and that was adjusted out at the time in the per-share earnings for comparative reasons as you look at those two.

In trucking, we had an operating loss of $6.2 million, driven by lower base revenue per loaded mile, a smaller fleet, an increase in insurance and claims expense, less gain on sale of assets, and higher fixed costs. In logistics, we had operating income of $1.5 million, down compared to last year's period due to soft demand and an increase in revenue—a decrease, excuse me, in revenue per invoice. I want to emphasize that while I believe the company's strategy is solid, we have real work to do to execute and return to the levels of performance we expect, including a profitable first half of 2017 and beyond.

Before we talk about next steps, let's move to Slide 5 for a closer look at trucking's fourth quarter results. The good news in trucking was that the base rate per loaded mile improved almost 3 cents, or 1.7 percent sequentially, reflecting improvements in our customer service, which has been a focus for the last 15 months as well as stronger pricing trends. On average, bids that became effective in the fourth quarter were up 2 percent over 2015's period, and we're continuing to see that trend in 2017. Another bright spot was the sequential increase in base revenue per seated tractor per week that averaged $3,018, the highest quarterly average of the year. We had a lower seated tractor count throughout the year as we eliminated high-cost tractors, but we also experienced some challenges with driver retention in the fourth quarter. We're addressing that situation now with steps like a more effective onboarding process, an improved monthly bonus program, and a highly successful driver relation model that's given us some really good early returns.

Moving to Slide 6, where we've summarized trucking's operating metrics, I'll call out a few notable items. Average miles per seated tractor improved by 4.9 percent versus the fourth quarter of 2015, even as empty miles percentage improved 20 basis points. The fourth quarter was the first full quarter of insourcing our road assistance program and retiring certain high-cost tractors and trailers, which contributed to a $1.7 million improvement in our operations and maintenance expense compared with the fourth quarter of 2015.

We also reduced non-driver head count and corporate overhead during the quarter by approximately $1 million annualized, and we've taken additional organizational steps in this year's first quarter to decrease ongoing fixed costs. That's noted in the release, and that's about $800,000 on an annualized basis. Insurance and claims costs continue to be a burden on a CPM basis but will have a lesser impact as our truck productivity metrics continue to improve.

Let's now move to Slide 7. Although financial results for USAT Logistics in the fourth quarter were down year-over-year due to ongoing market softness and revenue per invoice declines versus 2015, they did improve as the quarter progressed. November and December both showed encouraging load, revenue, and margin performance exceeding our internal expectations. During the fourth quarter, we continued to take steps to cut non-productive overhead, reconfiguring our Seattle and Buffalo offices to satellite sales offices under regional centers in Sacramento and Chicago, respectively. Along with reconfiguring our intermodal leadership, we reduced annual salary and benefits expense by $600,000.

Now I'll turn it over to Joe Kaiser to discuss our balance sheet and liquidity. Joe?

Joe Kaiser

Thank you, James. Given that James has already provided color around operating results, I'll walk through some of our other financial metrics. As of December 31, 2016, our net debt was $152.3 million. Total availability under our credit facility as of December 31, 2016, was $45.9 million. Additionally, we are in compliance with all bank covenants as of December 31, 2016.

Our focus in 2017 will be on enhancing cash flow from operations and reducing our leverage ratio toward our long-term goal of less than 2½ times adjusted EBITDA. We believe we will increase our 2017 cash provided by operating activities beyond our 2015 levels. With reduced capex requirements in 2017, we expect to let our tractor age increase during 2017 to approximately 2.7 years, from 2.1 years as of December 31, 2016. This strategy should increase free-cash flow in 2017 compared to 2016 in addition to improved operational performance in both of our segments.

We expect to finance approximately $15 million to $20 million of new revenue equipment, primarily consisting of trailers with operating leases during 2017. Depreciation and amortization expense is expected to be in the range of $30 million to $32 million for 2017, as we have determined that our depreciation policy is in line with the current market conditions for the used tractors and trailers. However, we expect our equipment rent expense to be in the range of $9 million to $10 million for 2017, up from $7.4 million as of December 31, 2016.

I'll now pass the call back to James.

James Reed
Great. Thanks, Joe. If we now look at Slide 9, you'll see the strategic action plan that we laid out for trucking in our third quarter call with you, on the left side of the screen. It outlined a number of initiatives critical to 2017's success, and we wanted to offer an update on progress to those goals, which are on track.

First, increasing the rates. As I mentioned earlier, we're making steady progress on this front, and we're managing this aggressively.

Second, improving maintenance costs. We're planning for continued progress on maintenance cost reductions, and you see that in our results.

Third, optimizing our network. Our network management is progressing nicely as we noted in the January highlight that I mentioned at the onset of the call.

And, finally, increasing the percent of independent contractors. We didn't make it to the 20 percent goal we'd set for the end of 2016, but we did end the year with an increase over 2015. We remain committed to this outcome and have exciting programmatic changes in the works that we hope to reveal in future quarters.

The two new performance targets we've set for 2017 that are outcomes of the strategic action plan are shown on the right side of the screen. The first is to increase base revenue per seated tractor per week by 3 to 5 percent over the 2016 average of 2,998. And the second is to increase seated truck count by 5 to 7 percent over the fourth quarter 2016 average of 1,547. We'll report to you quarterly on how these efforts are going. Martin is on the call and will be available in the Q&A for more detail on these initiatives and other questions you might have regarding the trucking business.

I'll now turn it over to Jim Craig to discuss the logistics business. Jim?

Jim Craig
Thanks, James. Turning now to Slide 10, we were very pleased with the traction of our business development initiatives as the fourth quarter progressed. We grew our Plus Power Fleet sequentially by approximately 15 percent. And with our accelerated recruiting efforts, we are targeting the addition of 10 to 15 trucks a month each month in 2017. Customer interest and support is solid, and this capacity complements rather than competes with our asset needs.

Our sales agent initiative has been progressing steadily. We're now at 21 sales agents and have been continuing those recruiting efforts as well. Our primary focus now is on training the new agents on USAT Logistics' service offerings and systems utilization. As I said on last quarter's call, ultimately not all agents will make the cut, as our standards and expectations will be high, but continuous recruiting will keep us north of 20 agents in growing the roster count throughout 2017.

In the fourth quarter, our realigned and re-energized national sales team demonstrated a renewed and measurable focus in identifying and pursuing opportunities for both active and prospect accounts. In addition, we are pleased to announce today the creation of USAT Logistics to México and the opening of an office in Central Mexico. We have been working on this initiative for the past eight months and are launching this location, effectively a ninth regional center for USAT Logistics, with a fully staffed office, with pre-existing, in-depth market knowledge in both customer and carrier relationships already in place. We expect that new office to generate meaningful revenue and to be operating profitably before the end of 2017.

Our initiative to reintroduce company trailers and CLC service has been well received, and we are seeing traction in regular contribution over a specific and limited service network. We continue to hire into market-facing roles, while assessing those resources in the first quarter and reinvesting where appropriate. The combination of these initiatives will help us reach our goal of generating approximately 45 percent of the company's consolidated revenue from USAT Logistics by the end of 2017.

Now I'm going to turn the call back to James for his closing remarks.

James Reed
Thanks a lot, Jim. As a recap, and this is our final slide, I'd like to highlight some of the comments that we've made in this and prior releases. The first is continued fixed cost reductions. Last quarter we targeted $3 million to $4½ million in fixed cost reductions, and we made a lot of progress on that. We have about $1 million to $2 million remaining through the remainder of 2017.

Next, we expect a 1 to 3 percent increase in company-owned tractors in 2017 pursuant to the capital that Joe discussed earlier and a 15 to 25 percent in independent contractors as well.

We expect USAT Logistics, as Jim shared, to generate 45 percent of our consolidated revenues by the end of 2017. Our net-debt-to-adjusted EBITDA between 2½ to 3 times by December 31, 2017 — our goal is 2½ times.

And, finally, a return to profitability in the first half of the year and beyond. There's no magic bullet or silver—there's no magic formula—excuse me—or silver bullet to deliver on these items. It's just pick-and-shovel work, and we have a team that enjoys and is experienced at that kind of effort.

At this point, Allison, we'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now being the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. At this time, we will pause for a moment to assemble our roster.

The first question will come from Brad Delco of Stephens. Please go ahead.

James Reed
Brad, are you there?

Operator
Mr. Delco, your line may be muted?

James Reed
I think what—

Male Speaker
[Inaudible at 17:03] was not.

Brad Delco
Hi, guys, can you hear me?

James Reed
Yes, we just—congratulations, Brad, we had just assumed that maybe the trip width had taken a toll on your sleep.

Brad Delco
Well, they definitely have, but I do appreciate that. I don't know what was going on. I had to switch lines. So I appreciate all the details you guys gave with the plan. My first question on—really ties to reducing fixed costs relative to the size of the fleet, and you made a comment that you have $1 million to $2 million of reductions to make. Now, is that based on where the fleet is today, or is that based on needing to grow it 5 to 7? And I guess the question really is: if you're not able to grow the fleet 5 to 7 percent, is there additional fixed costs that need to come out of the business?

James Reed
Yes, that's a good question. That's based on where the fleet is today, Brad. We're not going to pursue an if-you-build-it, they-will come management strategy, so we don't disclose the numbers, but we manage very closely our trucks per non-driver head count in the business, and I'm confident to tell you that right now we're where we need to be. But we will not pursue an if-you-build-it, they-will come head count and fixed cost strategy. I don't know if that answers your question, but—

Brad Delco
It does.

Joe Kaiser
Hey, Brad, this—yes, real quick this is Joe Kaiser real quick. I just wanted to iterate that we're anticipating to grow the company on tractor fleet by 1 to 3 percent.

Brad Delco
Yes, but with independent contractors, it gets to 5 to 7, right?

James Reed
Correct.

Joe Kaiser
Yes.

Brad Delco

The—and then, I guess, maybe you answered the second part of that question, James. I think, generally speaking, most best-in-breed truckload carriers operate six drivers to every one non-driver personnel. You're not going to give us any idea where you are today versus where you want to be?

James Reed
Not at this time, other than to say that we manage it aggressively, and we're always seeking to improve it. I mean, one of the things that our management team has in spades is a continuous improvement background, and there's no doubt that we can get better, but I can tell you that we're competitive with other carriers, maybe not best-in-class, but certainly competitive.

Brad Delco
And then the one concern I would have is, well, it seems like you want to upgrade your existing driver base, and that generally comes at the expense of increased pay. What are you prepared to do with driver pay this year, and what's basically in the budget that has you returning to profitability in the first half of '17?

James Reed
So with respect to drivers, we constantly are looking at the competitive environment. We're mindful of the fact that we want to pay drivers a fair wage, and we have some initiatives that are looking at ways to do that. But the best way we can give drivers pay increases is by being more efficient with our network. And maybe I could turn that over to Martin for just a second to kind of tell you what we're doing in the first half, first quarter to address some of those productivity enhancements. Martin, you want to take that?

Martin Tewari
Hi, Brad, good morning. How are you?

Brad Delco
Great, Martin, thanks.

Martin Tewari
On the driver-pay side, the first part of your question, we just implemented a monthly bonus program for them, where a driver can make up to 5 cents per mile per month, and with that, with improved productivity that we're seeing on our fleet, we believe our drivers will be pleased with the—you know, with their new compensation and help us grow our fleet.

Brad Delco
Okay, and then maybe the final question, James. The comment to return to profitability in the first half of '17, to me, that seems to be quite a lofty goal. I know you've provided some color about the productivity trends in trucking. I think I have an 8.3 percent in January. Do you see enough evidence in January results that returning to profitability—maybe first quarter, I understand, is probably the toughest quarter to get there, but do you have enough confidence in January's results that you can return to profitability at least by second quarter?

James Reed
Absolutely. We set an aggressive plan this year, and we're not going to get in the habit of kind of pre-announcing financials, and you didn't ask me to do that, but we are close enough on track with that plan coming out of January, from an operational standpoint, that we're confident in that forward-leaning projection..

Brad Delco
Okay. Maybe—I'm sorry, this is the last question for Joe. The goal is 2½ to 3 times debt-to-EBITDA, and I'm assuming—I mean, I know you're extending the average age of the equipment, so cash flow should improve, but that's primarily going to be driven by growing into the capital structure versus debt pay down. Am I thinking about that the right way?

Joe Kaiser
No, we're anticipating to pay down a significant portion of debt this year as well as growing the operations on both sides of the business in logistics and trucking.

Brad Delco
Any way you can give us a range of what you would like to pay down with cash flow?

Joe Kaiser
Thirty million to $40 million of debt.

Brad Delco
Okay. All right, gentlemen. That's all for me. Thank you so much for the time.

James Reed
Great. Thanks, Brad.

Operator
Again, if you would like to ask a question, please press star, then 1. Our next question will come from Donald Broughton of Avondale Partners. Please go ahead.

Donald Broughton
Good morning, gentlemen.

James Reed
Hi, Donald, how are you?

Male Speaker
Good morning.

Donald Broughton
I'm doing well. I'm doing well. Congratulations on your new role, James, and I appreciate you reaching out to all of us in the last week to get better acquainted. A couple — just a little bit of housekeeping first of all. What was the beginning and ending company truck count, and what was the average number of owner/operators in the quarter?

Male Speaker
Average number of owner/operators for the quarter was 286, and the company-owned fleet was —ended December 31, at 1,415 tractors.

Donald Broughton
It's difficult to plug and play with the model. To make sure I heard this right, your average age of your trucks right now is 2.1, and you're—

James Reed
Correct.

Donald Broughton
—going to let that go to 2.7? Did you say 7?

James Reed
Yes, certainly, our goal long term for the investment piece is to keep it below 2½. Our focus this year is on generating cash and paying down debt while [inaudible at 24:21] —

Donald Broughton
So are you going to buy any—?

James Reed
[inaudible].

Donald Broughton
I understand. Understand. I'm sorry to interrupt.

James Reed
No, go ahead.

Donald Broughton
Are you going to buy any trucks this year?

Male Speaker
Yes, we do have some trucks that we'll lease with—we'll finance with operating leases. They will be smaller than the 310 that we purchased this year.

Donald Broughton
So what are you—how many—do you plan on getting—bringing the company —I'm assuming you'll be rotating out trucks. Are you selling the ones you held for sale, and you're going to trade how many trucks?

James Reed
In the current year?

Donald Broughton
Yes.

James Reed
So in the current year—

Donald Broughton
[Inaudible at 24:59]—

James Reed
—where I too —

Donald Broughton

[inaudible] essentially projected capex, even though you're going to finance it with operating leases, obviously, it sounds like.

James Reed
Right. So we're expecting to take delivery of about 40 to 50 trucks this year.

Donald Broughton
Forty to 50 trucks. What about the trailer side?

James Reed
Trailers, we're expecting 450 to 500.

Donald Broughton
Four hundred fifty to 500, and will you operating lease those as well?

James Reed
That's correct. That's what our expectation is.

Donald Broughton
And your current trailer count or your trailer count at the end of the quarter?

James Reed
We've got it here.

Male Speaker
Just under 5,600.

James Reed
Give us a second, and we'll give you a real—yes.

Male Speaker
I mean —

Donald Broughton
Yes.

James Reed
It was 5,605 as of December 31.

Male Speaker
Yes.

Donald Broughton
Perfect. Perfect. Okay. So let me understand this. I understand what you're doing with the balance sheet. That, on one hand, makes sense. You're going to not really buy that many trucks, and what trucks you are going to buy, you're going to lease so you can use that incremental cash to pay down debt. But if the average age of your truck fleet goes from 2.1 to 2.7, how do you accomplish the goal of bringing down maintenance costs?

James Reed
That's a great—

Donald Broughton
How do you accomplish the goal of keeping the truck fleet fully seated without a really hefty driver pay increase? How do you accomplish the goal of increasing the rate you're going to get because you're on-time service is going to deteriorate?

James Reed
Yes, absolutely. Those are all things that we considered, and I think we have a good handle on. I'll take a swing at answering the questions, and then I'll ask Martin and Joe to chime in.

From a driver satisfaction standpoint, having a fleet that's around 2½ years, a little north of that, isn't a huge problem, right? It's still a fairly new fleet, and we'll keep the—we keep the miles at an appropriate level to maintain our costs. You're right on the CPM. We have to remain rigorous in our discipline about maintaining those tractors on their planned kind of maintenance intervals.

We've done a great job of bringing stuff in-house and being more effective in maintaining those. Martin and I were just talking yesterday about some of the in-house continuous improvement opportunities we have to get even better there. The short answer is a relentless and somewhat maniacal focus on the costs will be the way that we manage that.

Now, in terms of on-time delivery, again, our service numbers—everybody's service numbers are a little bit nebulous, but I can tell you our service numbers are as good as anybody's in the industry, and Martin's been focused on that for the last 15 months, and I think it's more a reflection of our operating thesis than it is a truck maintenance issue. Now, you're right to bring it up as a potential risk, but if we're mindful of that risk, which we are, we can manage it. So do you want to say anything more about that, Martin?

Martin Tewari
Hi, Donald. As far as managing some of those older trucks in our fleet, what we'll do from a maintenance perspective is we'll always have a certain percentage of the fleet that are unseated, and our best strategy there is obviously to keep our oldest trucks unseated versus—and keep the newer ones seated, so we're actively making sure anything that's unseated—we're seating our newest trucks with new drivers as they come in and keep those older ones when we have unseated trucks. Those are the ones that will be parked and will help us both on our maintenance cost perspective, and obviously driver satisfaction perspective as well.

Donald Broughton
Okay, but obviously a truck count ought to be what, 2 percent, 3 percent? You're running—you've got 11 percent of the fleet sitting on the fence right now.

James Reed
Yes, you're right. So we have a bunch of initiatives that we talked about in the discussion, the prepared comments, that are in flight that are actually having a really discernible impact on our unseated trucks. A well-run fleet, we think, should be at about 5 percent unseated, and that's what we're managing to, and we will be there within the first quarter.

Donald Broughton
All right, gentlemen. Good luck, and I'll let someone else ask a question.

James Reed
Great. Thanks, Donald.

Operator
Ladies and gentlemen, having no further questions, this will conclude our question-and-answer session. I would like to turn the conference back over to James for any closing remarks.

CONCLUSION

James Reed
Great. Thanks, Allison. Thank you all for participating in our call this morning. I'd like to sum up by saying that company-wide, we have a relentless focus on execution throughout the organization, and we are committed, as we discussed, to returning to profitability by the first half of 2017. We think we have a clear—it's a challenge, but we think we have a clear flight path to there.

We'll be in New York and Florida for industry conferences in the next two weeks. You'll see details in the advisory announcement that we issued yesterday. We'll also be available for one-on-ones, and I know quite a few of you have already requested time slots for those meetings. We look forward to meeting you and discussing our plans for strengthening our business in both the short and the long term. Thanks a lot.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.