USA Truck

Fourth Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

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James Reed - *President and Chief Executive Officer*

Jason Bates - *EVP and Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to the USA Truck Fourth Quarter 2017 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 one on your telephone keypad. To withdraw your question, please press star then two. Please note that today's event is being recorded.

I would now like to turn the conference over to Jimmie Acklen, Financial Reporting Manager. Please go ahead.

Jimmie Acklen
Good morning, and welcome to USA Truck's Fourth Quarter Earnings Conference Call. Joining us this morning from the company are James Reed, President and Chief Executive Officer; and Jason Bates, Executive VP and Chief Financial Officer.

Please be reminded 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 are made pursuant to the provisions of 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 and consider the factors that may affect future results and other disclosures by the company in its press releases, annual report on Form 10-K and other filings with the Securities and Exchange Commission. Any forward-looking statement speaks only as of the date on which it is made.

Also on today's conference 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.

I'll now turn the call over to James.

James Reed
Thanks, Jimmie. I hope everyone had a chance to review our earnings release from last night. Just as the third quarter was important to show what our team could do in a short period of time, this quarter was critical for different reasons. It was an opportunity to prove our thesis has merit and has legs, that there is latent value in our network that has been untapped for years, and that this team knows how to manage in a way to access that value, keep our charts moving and grow our logistics business further. And let's not forget, this assembled management team has only been together for two full quarters.

I'd like to offer some historical perspective on our quarter. The fourth quarter represents the third highest adjusted EPS for USA Truck in the last ten years. Our base revenue per loaded mile in our trucking segment was up 20.1% year-over-year and 13.5% sequentially. This is the largest single quarter year-over-year or sequential price increase in our company's recent history. Consolidated operating revenue was up 19.5% year-over-year to $123.3 million and up 7.9% sequentially. This represents the highest quarterly operating revenue in more than two years on a smaller fleet basis, and we’re just getting started.

The quarter was not a spot market play, but rather an intentional and concerted acceptance of commitments with existing customers to meet their needs in the quarter. For the first time, due to our strategic network reengineering initiatives, we were well positioned to meaningfully participate in the retail surge. And while participation in the surge was a contributing factor to our best-in-class rate per loaded mile moves year-over-year, it was not the whole story. We saw significant improvement in our core network performance, in addition to the surge-related impacts. Thus far, our network has been a reflection of in-flight re-pricings, rationalization of the current network and the optimization of the hand we were dealt.

Moving forward, we expect our strategy to emerge, as our efforts to re-price and reorganize the network take effect in the first quarter of 2018 and beyond. We remain focused on closing the gap on the base revenue per loaded mile metric that USA Truck has historically had versus the competition. We are all happy for our employees, our shareholders and our community, they all deserve the rewards that come with being part of a winning team, but getting to a consolidated 95 OR in the fourth quarter does not constitute victory for us. We continue to see opportunity for growth, gaps to close with our peer group, and a business that is poised to continue on the path and plans just as we have laid out in the past. It would be a mistake to declare success at this early stage, and while we are proud of the outcomes we, quite frankly, feel we could have performed even better.

Let's now turn to slide 3 for a look at our consolidated results. Freight demand in the fourth quarter on a seasonally adjusted basis was strong when compared to the same period in prior years and sequentially. Indicative of the company's ongoing efforts, consolidated operating performance, as I said earlier, was strong. Operating revenues came in at $123.3 million for the quarter, a 19.5% increase year-over-year. Operating income was $5.5 million and net income was $14.8 million, or $1.84 per diluted share. Adjusted net income was $2.8 million, or $0.35 per diluted share, excluding the impact of the tax law reform.

Consolidated adjusted operating ratio for the quarter was 95%. This represents an overall improvement of 990 basis points year-over-year and 320 basis points sequentially. Trucking adjusted operating ratio for the quarter was 95.2% an improvement of 1,460 basis points year-over-year and 660 basis points sequentially. Finally, USAT Logistics adjusted operating ratio for the quarter was 94.6%, an improvement of 40 basis points year-over-year and a decrease of 310 basis points sequentially. Recall however, that the third quarter of 2017 was unusually robust in the wake of natural disasters.

Moving to slide 4. Base revenue per loaded mile in the trucking segment increased to $0.35.2 or 20.1% versus the fourth quarter 2016, and $0.25 or 13.5% versus the third quarter of 2017. Approximately $0.17 of the year-over-year increase in base revenue per loaded mile for the fourth quarter was driven by our increased participation in the retail surge. Historically, USA Truck has not been a significant player in this annual phenomenon. We expect this to be a recurring element of future fourth quarters, as these opportunities exist each year for the best carriers.

The change in surge strategy was accompanied by our continued efforts to retool our network, customer, market and lane strategies that are central to our trucking turnaround. These efforts resulted in approximately $0.18.2 of the year-over-year increase in base revenue per loaded mile for the fourth quarter. Said differently, we saw a network-driven increase in base revenue per loaded mile, excluding the surge, in the fourth quarter 2017 of approximately 10.4% year-over-year. To summarize the year-over-year increase in base revenue per loaded mile, just under half of the 20.1% increase was surge-related, while just over half was network-driven.

Miles per seated tractor per week decreased 2.9% versus the fourth quarter of 2016, down 58 miles per tractor per week year-over-year, but increased 0.4%, or eight miles per tractor per week sequentially. Our average unseated tractor percentage for the fourth quarter of 2017 was 5.5%, which represents a 380 basis point improvement year-over-year and a 100 basis point improvement sequentially. The average seated tractor count for the fourth quarter of 2017 was 1,588, which represented a 2.7% improvement over our fourth quarter of 2016 average of 1,547.

While the change in both unseated tractor percentage and total seated tractor count improved year-over-year on average for the quarter, each trended unfavorably throughout the quarter, as the driver and independent contractor markets continue to be challenging. This is as tough a driver market as any of us has ever seen. We have implemented a variety of initiatives designed to help mitigate this headwind, and this will remain a significant area of focus for our organization throughout 2018.

Base revenue per seated tractor per week, among our most critical measures, improved for the fifth consecutive quarter to $3,505, up $487 or 16.1% versus the fourth quarter of 2016, and up $378 or 12.1% versus the third quarter of 2017. As we stated last quarter, our trucking focus has been, and will remain, improving our safety, increasing rate through further densification of the network and disciplined pricing, and improving utilization. Our performance in tractor utilization lags the progress we have achieved in other key metrics, and thus remains a significant focus. We know that to truly compete, we must close the gap between ourselves and the industry on this measure.

I'll now turn the call over to Jason to give you an update on our Logistics business and financial position.

Jason Bates
Thank you, James. Turning to slide 5. As noted previously in the fourth quarter USAT Logistics generated revenues of $39.5 million, which is up 19% year-over-year and 4.5% sequentially. Gross margin came in at $7.1 million for the quarter, reflecting a $0.9 million increase, or 14.6% year-over-year improvement. Load count was down 5.5% year-over-year, which is reflective of tighter capacity in the market and gross margin decreased 70 basis points to 17.9% compared to 18.6% in the first quarter of 2016.

During the fourth quarter tighter capacity drove significant but anticipated increases in purchase transportation costs, which facilitated higher revenue per load but compressed margins when compared to the third quarter of 2017. Given the market conditions, USAT Logistics increased participation in spot market activity to counteract the sharp increase in purchase transportation costs and to respond to the spot market opportunities.

USAT Logistics will continue to focus on increasing market share by providing a transparent and value driven model to its customers. This model is designed to increase volume and normalize gross margin, while providing our customers with transparent and market based pricing, with the intention of building stronger customer loyalty and sustainable market share gains.

Turning to slide 6. As of December 31, 2017, our total debt and capital lease obligations, net of cash or net debt was $107.4 million. This represents a $13.3 million reduction in net debt sequentially during the quarter. Total stockholders' equity was $66.5 million, which marks an improvement of $15 million sequentially.

Net debt-to-adjusted EBITDA decreased sequentially to 3.9x compared with 5.8x as of the end of the third quarter. The company had approximately $61.8 million available to borrow under its credit facility as of December 31, 2017.

As previously discussed, we will be reinvesting in our fleet in 2018. We expect to replace approximately 300 to 400 tractors during the year, with an anticipated net capex between $40 million and $50 million. Any free cash flow after our capex requirements have been satisfied will be directed towards debt repayment. We made significant progress in reducing our leverage ratio during the quarter and expect this trend to continue throughout 2018, and we remain committed to achieving our previously communicated long term goal of 2.5x to 3x.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was signed into law, which reduced the federal corporate income tax rate from 35% to 21%. This change required the company to revalue its deferred tax liabilities as of December 31 and at the new corporate income tax rate, which resulted in a reduction of income tax expense by approximately $12 million, or $1.49 per diluted share.

With that, I'll go ahead and pass the call back to James.

James Reed
Thanks, Jason. We have previously provided a range of operating improvements that we expected would be accretive to results in 2017, and we wanted to review those with you. We've largely delivered on those commitments.

Slide 7 shows the focus areas we said were most critical to our success: raising rate and seating trucks. We said we would, by our pricing and network reengineering, raise base revenue per seated tractor per week by 3% to 5% by the end of the year. We accomplished that goal. For the full year average, base revenue per seated tractor per week was up just over 6% from $2,998 in 2016 to $3,179 in 2017. On an exit trajectory basis, in the fourth quarter of 2016 base revenue per seated tractor was $3,018, compared to $3,505 in the fourth quarter of 2017, a 16.1% increase.

We said we would increase seated tractor count 5% to 7% versus the fourth quarter of 2016 average tractor count, and despite exiting the third quarter of 2017 5.2% over the baseline, we backslid in the fourth quarter, almost exclusively in our independent contractor count, and ended the year just 2.9% ahead of 2016 year-end seated tractor count. We noted this concern in our third quarter earnings discussion, and at that time we had identified new industry partners, who we believe are even better than the prior options. We did ramp the new partners in the fourth quarter and have just begun seeing the impact of those efforts in the last three weeks.

While the uptake on the programs has been slower than hoped, we are encouraged at the direction. During our last update, we indicated that our independent contractor count was approximately 17% of the fleet, and today it's just above 15%.

The final 2017 initiative we reported on throughout the year was the reduction of fixed controllable costs, which are down $4.1 million year-over-year, and in the high end of the $3 million to $4.5 million range we had initially indicated a year ago. We expect costs to remain core to our execution strategy going forward, and will offer periodic updates on our cost performance in the future.

Now moving to slide 8. We want to set the tone for our 2018 key focus areas. Just like in 2017, we consider these touchstones that we will return to quarterly to update investors and analysts on our progress. Safety remains our highest priority in the business, and to that end, we will have all of our tractors operating with both inwards and outward facing in-cab recording devices by the end of the first quarter of this year. We began this process in the middle of the third quarter of 2017, and I have been delighted with our professional drivers' response to this change and pleased with the management team's skill in navigating what could have been a tough issue. Our whole team has handled this professionally, and the value is beyond what I expected in terms of coaching and insights gained.

Additionally, with the replacement cycle of our tractors that Jason mentioned, we will have 51% of our company fleet equipped with forward collision mitigation systems by the end of the year.
Other key measures outlined on this slide that we will report on throughout the year will include the following. Continued improvement in base revenue per seated tractor per week, with the goal of an additional 5% to 7% over 2017 averages. Increase our seated tractor count 4% to 6% through the recovery and expansion of our independent contractor or owner-operator program. Maintaining our unseated tractor percentage at or below 5%, and a reduction of $3 million to $5 million in costs on a CPM comparative basis through a series of corporate initiatives.

I had intimated in prior calls that we were considering opening maintenance facilities to reduce our over the road repair costs, and I am happy to announce the reopening of the New Holland, Illinois maintenance facility in the first quarter of this year.

And finally, our goal to grow USAT Logistics year-over-year volume by 6% to 10%. We maintain our long term intent to get this business to 50% of consolidated revenues, but in 2018 are striving to get that back to 35%.

In summary, our Logistics business is a great news story that consistently is producing healthy margins and a growing base of business with limited invested capital required to run it. Our long term focus remains on running a well executing trucking business paired with this profitable logistics business. It is a powerful combination, and we believe we have the business, the people and the customers to deliver on that, as I've said before.

Our trucking segment experienced a truly transformative quarter, and now we will look for sustainable repeat performances. I like to modify the cliché, "A high tide raises all the boats in the harbor," to also add, "but it also hides all the rocks." Some of the rocks have been cleared in the last few quarters, but many still remain. One effort we are pursuing is to update our TMS system, beginning in 2018, to have better continuity in operations, 21st century optimization capability, and improved latency. Mine is mostly a tech background, and our CTO and I have undertaken this task before together, but it is a big task that outside observers should be aware of. We will periodically talk about this over the course of the effort, which could take until the middle of 2019 to complete.

While this is a time for our team to have some pride in signs of positive progress, we still see significant opportunity in each of our businesses. As we discussed earlier, we have got to get better at recruiting drivers and seating our trucks; we have got to do a better job of recruiting and growing our independent contractor fleet; we have no choice but to improve our utilization; and our Logistics business has got to gain market share if we are to reach our potential.

The widely reported market observations about this January are also true for USA Truck. There is more freight than trucks right now and more spot pressure on the Logistics business than we've seen in a long time. It is a unique January in all our collective experience, and the only thing keeping us from our potential is us. There have been some serious weather challenges in January, I was told there were 11 storms by our count, so execution will be key. In spite of the slower than expected seating of our trucks and overall fleet size, we still expect to improve our performance over prior first quarters of past years.

As I've said before, our intent is to measure our performance against the industry and close the performance gap in meaningful ways like has never been done at USA Truck before. Based on what we've seen, it's clear that the fourth quarter was a significant step in that direction, as our results speak for themselves. This is no accident, it is a result of bringing together a great team, unified in purpose, aligned on our goals and a fantastic group of professionals on the road and in our back offices for making this potential a reality.

Operator, we'll now open the call to questions. After the questions, I will wrap up with a summary.
QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time we will pause momentarily to assemble our roster.

Our first question comes from Brad Delco of Stephens Inc. Please go ahead.

Brad Delco
Good morning, James. Good morning, Jason.

James Reed
Hi, Brad.

Jason Bates
Hi, Brad.

Brad Delco
Good results, guys, congratulations. James, you gave us a lot of great detail, and it seems like you have some good momentum. I think it is, given the low share count, pretty difficult to guesstimate where numbers can go. And I know you guys don't give guidance, but when you think about the portion of the rate that you got that essentially is network driven, not just spot or seasonal, where directionally should we take rates for first quarter? Because I know, at least in January, spot rates were up even greater than what they were in 4Q. So I'm just trying to kind of get a sense.

James Reed
Yes, that's a great question Brad. I appreciate you being on and asking it. It's interesting—I'll give you a little more color than just the first quarter. As you look at our 2017 Q1 and Q2, we had relatively easy comps, right? We had a low rate per loaded mile in the first half of 2017, especially at USA Truck and especially relative to the industry. My view of really the first two quarters is I'm expecting what I would call low double digits. But as the back half of the year goes, we're planning on that moderating to mid to high single digits, and we're going to obviously update you guys in future releases as we get more clarity about that. We're aware, obviously, of the momentum in the market and the speculation about what the back half will do, but we're kind of in a wait and see mode, and we'll see what actually happens.

So for now, overall it has been mid to high single digits for the year, with the first half having relatively easy comps, and I'd look for low double digit increases year-over-year Q1 and Q2.

Jason, do you want to add anything to that?

Jason Bates
No.

James Reed
I'm out of striking distance, by the way.

Jason Bates
He's across the table. I can't reach him. But I think the one thing is obviously when we were putting together our plan for 2018 we weren't anticipating these type of increases that James just alluded to. Obviously, the market has strengthened in that regard. Keep in mind, we are more contractual than spot in our trucking operation, and so while some of our peers may play more in the spot market and may have an easier time achieving those types of increases, our goal is to be more contractually oriented.
Again, that's something that we'll evaluate as we progress through the year.

But the other thing I want to make sure people catch on to is that in an environment like that, there's going to be inflationary costs as well, that we just need to make sure that we don't just flow through high single digit rate increases in the model and get ahead of ourselves. I know that's not what you would do, but I think that that is the kneejerk reaction and tendency for some people with models out there to do. We just encourage people to keep in mind that there will be inflationary costs, drivers, equipment, things like that, that we have to factor in as well.

Brad Delco
Well that's a perfect segue to question number two then, Jason, if you don't mind. I think the way to stabilize, or in your case grow the fleet, is obviously the need to attract drivers. You're bringing on new equipment, but you probably need to raise wages. Where do you think USA Truck wages are on a per company mile year-over-year for 2018?

James Reed
Yes, that's a great question Brad. We suffer a little bit of not being as vocal about our successes as we should be. You might recall that in the fourth quarter of 2016, we did a reset on driver pay, where we regionalized the pay, and the net impact of that was a penny and half on average for all of our drivers. Unlike many of our competitors, we did a pay increase in the fourth quarter of 2016.

Prior to that, we also changed our performance base quarterly per mile bonus opportunity that drivers had to a monthly payout, which also had a moderating effect on the entire fleet. We have not sat on the sidelines, as some others have intimated in the past, we've actually actively been managing driver pay. We asked this same question during the quarter, and we have an expressed strategy that we want to be in the bottom of the top third of driver pay, and we look at a quarterly driver pay survey, we benchmarked ourselves again this quarter, we're confident that we're right in the sweet spot where we need to be.

But we think we need to get better at being marketers about it, we just published a really nice glossy piece that's going to go out on our web site as well. We're re-advertising to our existing drivers and drivers that we're recruiting, that we have a great pay package that not only includes a very competitive base rate, but also includes bonus and loyalty opportunities that overall make us a very competitive strategy for anyone.

Now that said, we're also not silly. As things get going, I would expect as industry rates tend to rise, that about 25% of that makes its way back to drivers typically. So Jason?

Jason Bates
Yes. The only thing I would add to that, is I think we've talked openly in the past, and James alluded to in his prepared remarks, utilization is going to be a big area of focus for us in 2018. Unlike some of our

peers who are already running fairly stout utilization numbers, we openly admit that we have got opportunity to improve there. Obviously that has multiple effects, one of which is, we as a company run more miles and better utilize our assets, but the other is that drivers get more pay, their total take home improves, in terms of having the same amount of time away from home, they just make more money while they are doing it. I think that's something that many of them will start to see this year, as Werner and the ops teams drive that change in methodology and perspective throughout the organization, that that will have multiple benefits there.

James Reed
Yes, Brad; James again. We just love talking about the success of the company, right, that you can't talk about driver pay without talking about the network. The point that Jason just brought up, and it's a little bit of a Do loop, right, you've got to have the customers to have the networks, and you've got to have the networks to get to customers. But as we're tightening our network density we're starting to see ourselves get better at utilizing the equipment and, to Jason's point, I mean, we have many drivers that could give themselves a 10% pay increase, just because now we have a better network for them to run. We don't see these as independent variables, but actually quite opposite to that, we see them as highly and tightly linked.

Brad Delco
Got you. To summarize that, if your rates are up, let's say for the year high single digits, low double digits, whatever the math works out to be, just to put some more context around, Jason, your concern about us not taking into account inflationary costs, salaries, wages and benefits you think are up a similar percent year-over-year?

Jason Bates
Yes. I think from a modeling perspective, if we're talking about high single digit rate increases, I think it's fair to assume, like James said, 25% depending on the hike the driver market gets could flow through. Depending on what you're assuming for driver pay, yes, I mean it could be similar in terms of the growth there.

Brad Delco
Okay. And a real quick last question, I don't remember if it was in the release or not, but expected tax rate on a go forward basis?

Jason Bates
Yes. Obviously, we all would expect to see roughly a 14% improvement on that corporate tax rate from where we've been. We are at an inflection point as a company, where we're moving from not having profits and then being subject to the minimum stake and per diem taxes that cause that tax rate to be a little bit higher and now as we move into having gained income and taxes that we space ourselves from that. If you looked in the first half of the year we were in the low 40s, whereas, in the fourth quarter on an adjusted basis it was in more like a 37% tax rate, that was for 2017, and then obviously the tax reform will move everyone down next year. Our hope would be that it moves us down similarly.

Brad Delco
Okay. All right, guys. I'll get back in queue. Thanks for the time.

Jason Bates
Thank you, Brad.

Operator
Our next question comes from Jason Seidl of Cowen. Please go ahead.

Jason Seidl
Thanks, operator. James, Jason and team, good morning. I wanted to drill down a bit on your efforts to sort of re-price and sort of change your book of business, which has been ongoing since you guys took over. Clearly, the efforts showed up in the quarter. If I recall, on your second quarter call you said the back half of 2017 you re-priced roughly two-thirds of your business. Could you talk a little bit about the re-pricing cadence that you saw on a contractual basis, what you guys were getting as you moved through the quarter, and what you're seeing here in 1Q?

James Reed
Yes, absolutely. It's a good question and it's good to hear your voice, Jason. Thanks for being on. As we went through the third and fourth quarter, these things aren't exactly synchronous, third quarter bids don't always go in in first quarter and fourth quarter bids don't always go in in second quarter, we have a little bit of third quarter and fourth quarter bids that are going into effect this quarter right now. I mentioned before, and we checked the math again this morning, we expect our rates on that business, apples-to-apples, to go up 6% to 7%, it's a pretty tight range, we're pretty comfortable with where that is. That's hard to bake into your models, because you don't know exactly what percentage of our total business is, and I'm not going to tell you that, but we're seeing 6% to 7% on those bids that went out in the third quarter and fourth quarter that are being implemented right now.

I'm just going to anticipate your next question to say, as the market is changing, our customers are also changing their bid sequence. One very large customer that most people know has pulled their bid in and made it a one year bid for all of their business, that's going through right now, and the results of that bid go in effect in the third quarter. Our cadence, what it looks like right now, I have the bar chart right in front of me, is we expect about 30% of our business to be bid in Q1, about 20% in Q2. And in the back half of the year I guess there would be about 49%, call it-50-50, so 50 in the first half of the year and 50% in the back half of the year, and the first half is split 30-20.

Jason Seidl
That's great color. If you guys were getting about 6% to 7% in the third and fourth quarter, everyone is going to assume that in this market right now and 1Q being a very unusually strong January, that you probably have the ability, depending upon obviously who the customer is, on average to get above those totals?

James Reed
That would sound like a rational position to take. I mean certainly that's what our intent is, right? But I also want to kind of give you guys some unique insight into the dialogue that goes on inside our four walls. We're very mindful, as you look back at the history of this company, 2014, we were super opportunistic when capacity got tight, and as a result customers remembered that in 2016 and it hurt the company immensely. We have a lot of conversations about let's not alienate our customers, let's make sure we're investing in the relationship, let's make sure this is long term.

The other thing that I would add is a nuance that I don't know how you model it is there's also an important network effect. I literally had a conversation with my pricing team two weeks ago, where we were looking at a customer, and we actually went down in price on one of their critical lanes because taking that lane out, they had a more competitive bid from another carrier, taking that out of our bid would have had a disproportionately deleterious effect on our network. And we now, like never before, understand the combined effect of network pricing balance in managing our business, and we were able to economically demonstrate that that was the right decision.

I don't mean to put kind of a fly in the ointment, but, yes, we're pushing for higher prices, we're trying to do so sustainably and responsibly, and in some cases we pick network over price.

Jason Bates
Yes, and just to add to James' point there. I mean, when you talk about the 6% to 7%, and he talked about high single digit and low double digit in the front half of the year, I mean, the network optimization and the mix component is what covers that gap.

James Reed
It makes it so hard to compare, too.

Jason Bates
Obviously as we continue to refine the network and we start being more consistent with regard to the type of freight that we're hauling, the comparables will be easier. But it's not unlikely to see USA Truck be disproportionately higher than others in the market who already have a defined network this year.

Jason Seidl
Okay. That's great. I wanted to talk a little bit about costs. I guess, since brought it up, you mentioned the TMS system coming in 2018, what's the financial impact of it on the P&L? What should we expect?

James Reed
Yes. That's such a hard question to answer. Obviously, there's a project management and implementation cost to that. Hopefully, you picked up on some of my cynicism in my comments when I said 21st century technology, coming from a tech background I have a board member who says USA Truck is the company that time forgot. I think the industry is that way a little bit, to be honest with you, there's massive opportunities for improvement. These projects—Jason, I'm not comfortable throwing a specific project cost out, because frankly we're still scoping the work, but I would expect long term the P&L impact to be positive because it would show up in our utilization numbers and our efficiency, and really our efficiency with people and resources.

But, Jason is my cost champion, and he can address that.

Jason Bates
Yes. But I think it's an astute observation, Jason, and one of the things that I was subtly alluding to about cost inflation this year, there are some things that we're going to be doing as a management team in terms of investing for the future, where it will have a negative effect in the current year. While we don't, to James' point, feel comfortable putting a hard number out there, it is something that we would highlight for you to think about as you're modeling.

James Reed
And it's going to take a lot of our attention, a lot of the team's attention.

Jason Seidl
Yes, any time in my history as an analyst that people put in very new, big systems, it always tends to cost a little bit more than they thought, and there's always some unforeseen problem that it does cause. There are some minefields, and I was just trying to figure out where I should look in terms of trying to model that out. But maybe as you guys sort of dive in deeper in the coming quarters, any updates that you can give us, I think it will be helpful. James, remember, when I started in the trucking industry the big technology that we had were beepers to get a hold of the driver, I'm dating myself now.

James Reed
Well, Jason, having gotten to know you a little bit, I often joke; guys, how hard can it be, they used to do this with index cards?

Jason Seidl
Yes, exactly.

James Reed
It's not there, but yes. Sorry, any other questions, Jason?

Jason Seidl
Yes one last one, and I'll turn it over. You talked about driver pay a little bit, and two questions. What percentage of your salaries, wages and benefits is driver pay now? You mentioned you could give back 25% of the rate increases you put through to your driver base, that's typical, given the tightness of the driver market, sort of the tightest it's ever been, do you think it can go beyond that 25%? Then I'll just turn it over to somebody else after you answer these.

Jason Bates
Yes. I was just going to jump in real quick, James is writing something down. I think the short answer is yes, it could go beyond that. Our hope is that through driving incremental utilization and through some of the initiatives that we have put into place over the last year and a half for drivers, will help mitigate that and make it not be as big of an issue.

But addressing your first part of your question about what percentage is salaries, wages and benefits, I mean, we don't break that out. I'm familiar with the sell-side models out there, and I think we have looked through yours as well and I have obviously dealt with you in a prior life, you've probably got an assumed driver wage cost per mile in your buildup and you look at your miles, and I would tell you that we're not far off of the industry number that's typically thrown around out there. From a modeling perspective, if you're trying to run those numbers through, and again I would be happy to talk with you a little more about it offline, but it's just not something that we disclose with regard to the exact amount.

Jason Seidl
Okay. Gentlemen, thank you for the time. I'm looking forward to seeing you next week.

Jason Bates
Thanks, Jason.

Operator
Again, if you have a question please press star then one. Our next question comes from Barry Haimes of Sage Asset Management. Please go ahead.

Barry Haimes
Hi, guys. Thanks. Great quarter. I had a couple of questions, I'll try to go through them quickly here. One is, just on your network density, what inning would you characterize where you guys are, in terms of getting it where you want? Just a feel.

James Reed
Yes. It's a great question. We're certainly in the first third, right? I'll actually say this in my closing comments.

Jason Bates
You're stealing his closing comments.

James Reed
I literally say we're in the bottom of the second, early third. I mean, what we have said very consistently, is we think it takes our team two full bid cycles to make this our network, and we're just now implementing the first bids this quarter that we did in Q3 and Q4 that reflect our new network strategies. 2018 will be the first year of a fully deployed network strategy, and 2019 will be reforming that and transforming that, and I think exiting 2019 we have no excuses but to say, this is what we've built and it's ours.

Barry Haimes
Got it. That makes sense. Secondly, Jason, following up on the tax rate question, when everything shakes out, are we talking a tax rate in the mid-20s, just give us a range of what the right tax rate is to think about.

Jason Bates
I would say, probably more like the high 20s, maybe even low 30s depending on how—per diem is something that we're really trying to encourage drivers to take advantage of because, that was one of the things that changed with this tax reform is the ability for drivers to deduct expenses. And so per diem is really the only mechanism that they have to be able to help them from a tax basis, on their personal income taxes, and that's something we're going to push. Then obviously that has an impact for the company as well in terms of our tax rate, right, and the way you think about that.

I think from a modeling perspective, sorry if I went into too much detail there, but I think the short answer is high 20s, low 30s. We'll keep you apprised as we move throughout the year because obviously depending on the acceptance and adoption of drivers of the per diem program, it may cause that number to be slightly higher or lower.

Barry Haimes
Great. I had a question surrounding ELDs, and you guys maybe have some pretty good visibility within your brokerage unit in terms of carriers that weren't compliant. Have you found that they've gotten compliant, or are you seeing some of them quit and drop out, are some of them taking the tack that they're going to drive until they get caught? Just curious if, anecdotally you have any color, or is everybody just sort of waiting until April 1st? Any feel would be great.

James Reed
Yes. Great question. We've done a couple of surveys of our broker capacity, independent guys, just to understand where they are. One of things that's probably most noteworthy is that between our first survey, which was middle of summer, to our second survey, which we completed in November, there was a discernible change in their expectations and their willingness, a lot of defiance in the first survey, and a lot more acceptance.

Now that said, on December 18th, part of what drove the spot market we think and part of what made it challenging to cover freight, especially in the brokerage business, and you'll see that in our numbers in terms of volume, is there are a lot of guys that—and it's amazing to us—that are involved in the industry, but there are a lot of guys that genuinely thought this wasn't going to come to pass, right up until kind of triple witching hour. As we've gone through those surveys, we think it's a big number, it's call it, mid-20% that say, hey I'm walking away from the industry, I'm not going to do this. I think once they get home and their spouse says, how you are going to pay the electric bill, that may change a little bit.

And I wouldn't say I've always had a contrarian view, but I've just had a mathematically based view. Depending on whose survey you look at, if you assume 50% of the trucks on the road didn't have ELDs and 25% of that 50% are walking away, you start to get yourself in a math range where you think you could have, I'd say it's on the high end, but you could have up to 10% of people that are walking away, that's what we're seeing in our logistics business as we survey these guys. We think in the hot rate environment cooler minds will prevail and some of those folks will stay in, I mean, they're capitalists, don't forget.

Barry Haimes
Exactly. Essentially the freight has to move, the market has to balance sooner or later.

James Reed
We have that discussion all the time, Barry. That's a great point.

Barry Haimes
But then my final last question is, you certainly mentioned the difficulty of tracking drivers, and it's an industry-wide problem, that you guys were focused on that. Without giving away the story to the competition, anything you can share in terms of what you're trying to do to mitigate that? Thanks.

James Reed
Yes, that's a great question. It's interesting, we all talk about driver turnover and we talk about driver recruitment, but Werner Hugo, who leads our operations group, I was just talking to him yesterday, and one of the things I said to him is, one of the main reasons he got the job is because of his unique perspective, I'm talking about retention rather than turnover. Without kind of giving away the store, I'll just say we think we have, and I said this on our last call, some really insightful analysis that helps us identify the risks. We use this great internally developed logistic regression to help us understand who's at the highest risk. We have a program that we use that involves all kinds of, what I'd call normal customer retention type things, and I've got in front of me actually a five step program, I'm not going to disclose all the details of it, but we have a program that we use to help retain our drivers.

I just can't talk about this without reiterating what Jason said earlier, Werner knows, and his team knows, the best thing we can do to retain drivers is get them more miles and keep them busy in their trucks. Sorry for such a meandering and wandering answer, but that's really what we're doing.

Barry Haimes
Great. Appreciate all the insights. Thanks, guys.

James Reed
Thanks, Barry.

Operator
Again, if you have a question, please press star then one. Our next question comes from Mike Vermut of Newland Capital. Please go ahead.

Mike Vermut
Hi, guys. Great job here. Kind of expanding on that last question there, you say you need two bid cycles really to get the company where you want it to be. When we're looking to model this, would it be a reasonable assumption to say 2019, 2020, we get us to maybe an industry average OR on the company, maybe upper 80s by 2020? And what are the big buckets that you see that get us there, and that have been keeping us behind?

James Reed
That's a great question, Mike, and I'm not going to answer it. No, I'm just kidding you. Thanks for

asking it. It's funny, nobody asked us but I'm just going to volunteer it, I'm going to be really candid with you, I think we're six months ahead of our schedule. I really think that the network guys and the trucking guys, and let's not forget the logistics guys, put up a really great number for, really for them the third consecutive quarter.

It's a hard question to answer, because we're just kind of coming to grips with the results, but as I look at the competitive landscape, I'm now going to your big buckets question, from a rate per loaded mile basis we were out of fed a year ago. And if you look at us, and I'll let you do your own homework, but by our math, we think we're second only to one company in terms of rate per loaded mile right now coming out of the quarter. That is a Lazarus-like recovery, and we've focused on that and we've done that, and we're going to continue to focus on it. Price is clearly a big bucket.

Another big bucket is clearly drivers, we've got to get drivers in seat trucks. Assets without drivers are useless to us. And finally, utilization. I don't mean to oversimplify the business, but to us that's what we think about. I also should talk about safety, and I'm going to talk about that a little bit more, in that we've made some big investments to reduce the exposure on the safety front, and that's really, frankly our biggest cost "issue," I'm using air quotes here. Those are the buckets, safety, utilization, drivers and price.

Now going back to your original question, and I've said this publicly before, our goal has been to kind of catch up in 2019. We believe that we can get close to the industry average. Now at the time that we said that, we were thinking 92. The industry with the tailwinds is kind of running away from us a little bit, even though we're closing the gap. I think we could have a debate about what industry average is over the long term, but, yes, I think 2019, 2020 is I think pretty consistent with what we think.

Sometimes I make comments like and it makes Jason nervous. He doesn't look nervous right now, I'd like him to chime in and see what he has to say.

Jason Bates
I mean, yes, I would agree, from a bucketization perspective, with the things that James talked about. We've got a lot of opportunity, we've got a really good, stable logistics business and we've got an environment where we have the opportunity to grow it. But it's funny, Jim Craig, who heads up our Logistics division, we were kind of giving him a hard time the other day about we want logistics to be 50% of total revenue, and he was like, well Werner and the trucking team are running away from us.

We have lots of different levers that we can pull, and we've got them all going in the right direction right now. But we're not naïve to the fact that, listen, we've still got a long way to go and there's a lot of things. Every single day, Mike, we stumble across things that we're just like, are you kidding me, we're doing that, or we're spending money on that or we're not looking or paying attention to this? There's a lot of opportunity, and it just comes through slow, methodical, daily, going to the gym, lifting weights, and eventually you turn around and you are what you want to be. That we have that vision of what we want to be, but it's going to take some time for us to get there. It is a couple year project to get to industry leading levels, but I have every confidence that we're going to get there.

James Reed
And a point that Jason made that I'd like to just make sure everybody is thinking about is, as the logistics business becomes more and more a percentage of our total revenues, don't lose sight of the fact that's kind of a 95 OR business, right, so that's going to have a proportionate weighted impact overall.

We clearly want to look at consolidated results. Clearly, the Logistics business is complementary to trucking, and trucking is complementary to logistics. But logistics is what it is, in terms of what the margin opportunity is there, so just when you're holding up the accountable long term, yes, there's a chance we could be at 90 on trucking and a 95 on logistics, and that puts us at a 92.5 when we're 50-50 weight. Just make sure you're thinking through the model the right way.

Jason Bates
But from an ROIC perspective, that's a no-brainer.

James Reed
That's a home run.

Mike Vermut
Excellent. Thanks, guys and fantastic job.

Jason Bates
Thank you, Mike.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to James Reed for any closing remarks.

James Reed
Thanks, Andrea, and thank you, everybody, for participating on our call this morning. Consistency and focus have been important factors in our efforts at USA Truck, I'll close by saying exactly what I did in the last two quarters. Company-wide, we have been consistent and steady and are focused on execution and accountability. Safety, accountability and execution have been the hallmarks of the new USA Truck, and while we strive every day to meet our potential, there are times when we slip up. But on balance, we have done a great job as a team in meeting that aspiration.

Bill Parcells famously borrowed and changed the quote from Vince Lombardi; you are what the scoreboard says you are. I would characterize our new leadership team's track record on the scoreboard so far as pretty good. I'm sure we're 2-0, but we are showing our ability to close the gap with our public competitors like never before. We're still very—it's like you read my script—in the bottom of the second inning or the top of the third of our transformation. We think it will take us two full bid seasons to get our network to be "our network."

My greatest concern is which USA Truck will show up in the middle innings of this mighty change. We are proud of our results for sure, but it is our job as a team to make sure that these greatly improved results become the new standard of our business, and that the prior episodes of consistently inconsistent performance are a thing of the past. That's what our goal is, and that's why we brought this team here, to bring this company to a place of competitive prominence consistently over a long period of time.

We have shared snippets of our company vision in the past, but I'd like to share the part that more strongly speaks to me: that we aim to be a company that improves the lives of team members, customers, industry partners and our communities. We recognize that improved results have a discernible impact on each of those constituents and that the investment community is one of our most vital customers. Further to that point, improving and ultimately acceptable financial returns will be the most critical measure by which we measure our own success.

Our team here at USA Truck deserves all the accolades for this result; from our drivers, to operations, to the back office, sales, maintenance, logistics, and everyone in between, everyone is pulling in the same direction, and as we do so, I expect our best days are ahead. What a privilege it is to be part of a team with so many professionals getting better at what they do every day. We are so proud of them. Our company slogan in 2017 was, “We win together,” and in 2018 we’ll build on that with our new mantra, which we think says it all, “USA is back.”

Jason and I will be in New York for an industry conference next week and in Miami the following week. You can find the details in our recent advisory announcement. We look forward to meeting you and discussing our plans further for the business at that time.

Thanks again for your attendance today. We’re still just getting started, and I hope you’ll continue to be part of this story. Thank you.

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