USA Truck, Inc.

Fourth Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Chad Lang, Assistant Treasurer

James Reed, *President and Chief Executive Officer*

Jason Bates*, Executive Vice President and Chief Financial Officer*

PRESENTATION

Operator
Hello and welcome to the USA Truck Fourth Quarter 2018 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 touchtone phone. To withdraw your question, please press star, then two. Please note this event is being recorded.

I would now like to turn the conference over to Chad Lang. Please go ahead, sir.

Chad Lang
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 Vice President 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 Jason.

Jason Bates
Great. Thank you, Chad. We want to thank everyone for joining us on the call today, and we appreciate your interest in and support of our company. As you may have noticed, in the fourth quarter, we issued a press release announcing a rebranding initiative for our company. From a marketing and sales perspective, we will utilize the new name, USAT Capacity Solutions. However, from a legal entity perspective, we are still USA Truck. On this call, we will use these terms interchangeably.

We hope you all had an opportunity to review our earnings release from last night. We are pleased to report that our team has delivered a sixth consecutive quarter of consolidated profitability. We are encouraged by the dedication and hard work exhibited by our entire team this quarter in spite of its challenges.

If you'll please turn with me to Slide #3 for a review of our financial results. Consolidated operating revenues came in at $141.1 million for the quarter, which represents a 14.5 percent increase year over year. Net income was $5.3 million. Consolidated adjusted operating ratio for the quarter was 92.8 percent, which represents an improvement of 220 basis points year over year. The fourth quarter of 2018 generated the highest quarterly adjusted earnings per diluted share in our company's history, at 68 cents. The full-year 2018 adjusted earnings per diluted share of $1.56 was the third highest in company history. This is also only the second time in 12 years we have posted positive adjusted EPS in all four quarters. This is a trend we intend to build upon.

Turning to Slide #4, you will note that our trucking segment generated $7.4 million of operating income in the fourth quarter of 2018. This represents a $3.9 million improvement year over year. Our adjusted operating ratio for the quarter was 91.1 percent, an improvement of 410 basis points year over year. It was the best OR for trucking since the second quarter of 2006. Base revenue per available tractor per week increased $30, or .9 percent, year over year for the fourth quarter. The year-over-year increase in revenue per truck per week, our most critical measure, is a continuation of our methodical network and yield management initiatives. Base revenue per loaded mile increased 25.5 cents, or 12.1 percent, when compared to the fourth quarter of 2017. Loaded miles per available tractor per week decreased 162 miles, or 10 percent, year over year, while dead-head percentage for the fourth quarter of 2018 increased 170 basis points year over year. The dilution in our utilization and dead-head metrics was related to the inclusion of the Davis Transfer acquisition, the year-over-year growth in our dedicated operations, and our participation in seasonal surge business. However, in spite of being dilutive to these metrics, each of these business opportunities were accretive to our financial performance.

Our average available unseated tractor percentage for the fourth quarter of 2018, was 6.3 percent, which increased approximately 370 basis points year over year. This was largely a function of the influx of new tractors, resulting from the OEM delays we have referenced on previous calls. At this point, we have taken delivery of almost all the 2019 model-year tractors we had ordered. This catch-up of new equipment, combined with the challenging driver- recruiting market, were the key contributing factors to our unseated tractor percentage. Our average tractor age is now 2.7 years as of year-end 2018 versus a peak of 3.3 years earlier in the year. The average available tractor count for the fourth quarter of 2018 was 1,883, which is a 15.6 percent increase when compared to the fourth quarter of 2017 average of 16.29. This is largely a function of the Davis acquisition.

Turning to Slide #5, we will review the results of our USA key logistics segment. Operating revenue increased 9.3 percent, or $3.7 million, year over year, to $43.2 million for the fourth quarter of 2018. However, operating income was $1.3 million, a decrease of $.7 million, or 35 percent, year over year. Adjusted operating ratio was 96.7 percent in the fourth quarter of 2018 compared to 94.6 percent for the comparable 2017 period. Both revenue and costs continue to rise, resulting in margin compression in our logistics business. We remain focused on providing quality service, while striving to manage costs.

Gross margin dollars decreased 8 percent, or $600,000, year over year to $6.5 million for the fourth quarter of 2018. This was a byproduct of compression on gross margin percent, slightly offset by increased volumes as previously discussed. Gross margin percentage for the fourth quarter of 2018 decreased to 15 percent, from 17.9 percent, when compared to the same quarter in 2017, due to excess capacity in the market driving down average revenue per load. Revenue per load decreased 2.9 percent, or $47 per load, year over year.

If you'll turn with me to Slide #6, we will highlight some key balance sheet and liquidity measures. As of December 31, 2018, total debt and capital lease obligations was $160.5 million. Total net debt, net of cash, was $159.5 million, and total stockholders' equity was $80.5 million. Net debt to adjusted EBITDA for the trailing 12-months ended December 31, 2018, was 2.7 times, using actual USAT and proforma financial information from our Davis acquisition. The company had approximately $50.8 million available to borrow under its credit facility as of December 31, 2018, up from $44.3 million at the Davis acquisition closing on October 18, 2018.

As previously announced, on January 31, 2019, we entered into an amended and restated credit facility. At a high level, this is a renewal of our current credit facility with Bank of America entered into in February of 2015. Some of the most important updated terms include an increased facility size to $225 million, with a $75 million accordion; an improved pricing grid; a maturity extension, from February 2020 to January 2024; financial and other covenants consistent with our current facility; and improvements in various baskets and thresholds throughout the document due to improved company performance.

Now, I'll turn the call over to James for a discussion of the business and go-forward strategies.

James Reed
Great. Thanks, Jason. As everyone can imagine, we're very proud of our team putting up the best EPS result in our company's history and the best trucking OR in nearly 13 years. It was a great quarter by most measures, and our logistics business, while experiencing some expected margin compression, posted revenue growth yet again. What a difference a couple of years makes.

We outlined a plan when we started this journey together in mid-2017, that we expected to see 300 to 400 basis points of adjusted trucking OR improvement annually for the next several years. 2018 resulted in a 730-basis point adjusted trucking OR improvement over 2017, we feel like we're ahead of our plan, but we want more.

Our exceptional story is one influenced by our capable management team, but the real notables in the equation are our drivers, our fleet management team, our logistics team, our technicians, and our driver-support teams. The unsung heroes of USA Truck are all those people who have endured what I've come to call the lost decade. These folks lived through multiple leadership teams, multiple business cycles and strategies, and never-ending changes in direction. I want to personally thank every one of our teams who believed in our current team enough to execute the strategy that we outlined together. Our message has not changed in the last couple of years. This is a commoditized market. There is no reason USA Truck cannot compete. We are focused on a turnaround that moves results more toward our peers over time through appropriate pricing, consistent seating of trucks, and putting more and more revenue on our trucks and through our logistics regional offices. All this has to be done while being absolutely hawkish on costs. USA Truck has proven to be, and remains, a self-help story. The market has helped, but these are not market-only improvements. They are permanent changes in execution and strategy.

Before we get into our segment discussion, I want to address the market dynamics. The fourth quarter started strong and that carried through November, and when we heard concern about a softer market in December, our data just doesn't reflect that. December was seasonally soft but historically in line with expectations. Revenues by month in each segment were up year over year, and while the logistics business did see dropping spot pricing, please recall that we are not highly dependent on the spot market.

The first quarter of this year started off seasonally slower than expected, but the last half of January was strong, so much so that in the last week of January, we saw load counts and demand nearly back to pre-holiday levels. These recent trends cause us to feel encouraged by the current state of the market. Add in the consumer confidence, while down a bit, is still at historically high levels, unemployment is at the lowest point in my lifetime, and GDP indications, while muted versus recent results, are still expected to exceed both the 10- and 20-year averages in the U.S., and we think we have a pretty good market.

Let's briefly now recap our trucking results. As Jason noted on Slide #4, our revenue per tractor per week was up $30 year over year. That could feel underwhelming until one considers that our trucking segment includes the Davis Transfer business and our dedicated business, both of which have lower-revenue-per-tractor profiles but better cost structures that contributed positively to the consolidated results. Also keep in mind that the $30 year-over-year improvement in revenue per tractor per week was achieved on 10 percent less utilization or loaded miles per truck per week. This was a strategic decision towards a more profitable model. Higher revenues on lower miles and thus lower cost translates to higher profits.

Base rate per loaded mile continued to increase on a pace that reflects the market and our own story, up 12.1 percent versus the fourth quarter of 2017 and 10.8 percent sequentially. 2018 ended up on a rate-per-loaded-mile basis 17½ percent and was up over 20 percent in three of the four quarters in the year. This was our first order of business in our turnaround, and the team has made great progress on this front.

Unseated tractors remain a difficult part of the business as we certainly have not solved the driver-recruiting challenges; however, we are confident in the continued attention and recruitment measures we are taking to fill the trucks. Our marketing strategy has now been in place for just two quarters, our driver-referral programs are gaining momentum, and our training fleets have been growing. All these things will contribute to improved results as we execute on them. I might add parenthetically that, as Jason mentioned in his comments about getting a little bit behind the eight ball on new truck deliveries in 2018, were also a headwind for us, that we don't foresee in the near future.

We made progress in reducing our average age of fleets to 2.7 years in the quarter, reflecting our great execution in working through some of the truck issues we had discussed last year and last quarter. Our procurement, maintenance, and industry partners made this happen, and, while our maintenance costs have not yet moved to where they need to be, we expect progress on that front in 2019 as we begin to see the full benefit of the new trucks in our fleet and the lower average age of fleet. Our fleet grew 15.6 percent year over year to 1,883 available trucks in the quarter. The addition of Davis to the results was clearly the most impactful contributor to this growth.

Speaking of Davis, we are pleased with the progress in the business. Financially, Davis exceeded our expectations in the quarter, even as they completed the required audit of their historical financials and dealt with the normal growing pains associated with any level of integration. As a reminder, Davis will remain branded as Davis Transfer, has retained its leadership, customers, and drivers, and is only being integrated in the sense that there are back office and cost synergies that will serve to enhance the business without changing it. We bought them for a reason and are committed to our own version of the truckers' Hippocratic Oath to do no harm to the business. We are excited to see what Todd and the team can accomplish when they get to just run their business without the distraction of normal integration activities that had to be done.

Finally, the area where we made the most progress in the quarter is in our service performance. While we don't disclose our exact service numbers externally, we improved in the quarter by roughly 10 percent. Q4 is understandably the toughest quarter to deliver service in, and we made remarkable progress in this most critical area, and our customers took notice. As we look at bid awards completed and set to be implemented in the first quarter, on average, our bid awards are up well over 20 percent in volume and continue to reflect upward moves and contracted rates in the range of 5 to 7 percent. Our network redesign is now in the second year, and these critical wins with our customers will allow us to further densify the network, positively affect our overall rate-per-loaded mile and provide better network solutions to our drivers. This is an opportunity to upgrade and diversify our network.

Moving to USAT logistics, the team was able to grow another 9.3 percent year over year in the fourth quarter, but in so doing, reduced margin percentage and margin dollars. The imperative in logistics was to grow in 2018, and our approach was to accept some margin compression while growing load count enough to be accretive on a gross margin dollars basis. We did not grow our load count enough in the quarter to accomplish our purposes when comparing to the unusually strong market that we experienced in the fourth quarter of 2017 for comparison. However, on a full-year basis, USAT logistics revenue was up 29 percent in 2018, and topline revenue nearly eclipsed all-time highs in annual revenues for the segment. Logistics is on a revenue upswing as we are finding many opportunities to provide capacity solutions to customers. We've grown the team 22 percent year over year, and our sales and logistics leadership teams are aligned on landing even more opportunities. This business is critical to our long-term success as our customers value the opportunity to have access to an asset provider via a brokerage solution that can meet their broader needs. Even though the business has remained approximately 35 percent of revenues for two years now, it remains our intent to grow this segment, and that's why we continue to make investments in people and technology that lead to longer-term growth in this segment. USAT logistics will continue to maintain roughly 50 percent of its business as contract based, minimizing excessive exposure to the spot market volatility. We believe this leads to more sustainable and predictable results over time.

Moving now to Slide #7, what we are showing here is a list on the left of our 2019 company objectives. These are intentionally directional but all backed up with a number of very specific initiatives to accomplish the objective. While we won't share all of our initiatives, there are a few that we would like to update everyone on throughout the year. You should notice that these initiatives are much less survival mode in nature than in the past and more forward looking as the business now is on a slightly better footing than it was when we started this process in 2017. USA Truck will continue to improve our safety. Our collisions-per-million miles has improved 20 percent in the last two years as our technology investments, our management focus, and, most importantly, the commitment of our team has been on improving this critical measure. We expect to improve at least another 5 percent on a crash — collisions-per-million miles throughout the year. This is a tough goal to compare between carriers because of the many qualifiers and liberties people take in their reporting, but, by our own measure, we expect improvements.

As we noted earlier, service has truly become a differentiator for us. We don't really believe that service leads to long-term sustained pricing differentiation in a highly commoditized market, but we do believe that the best service providers retain volumes most effectively in downturns, and downturns will come. And so our goal of being in the top one-third of our top-ten customers' scorecards gives us something to shoot for. Right now we clear that bar on half of our top-ten customers.

Technology investments have been a focus in the last 18 months. A large contributor to our momentum in logistics has been attributable to the team driving a common TMS across the finish line so that 95 percent of our transactions occur in one system. Our executive team recently spent two days of technology strategy sessions to help calibrate our future endeavors on this front, but before we do anything disruptive or transformative, we have to update our trucking TMS, implement a more sustainable telematic solution, and begin optimizing our freight planning.

These are all things our well-run competitors do today and translate to relatively quick opportunities as we execute on them. Everything is for naught if it does not translate commercially and profitably. To that end, we will continue to grow our logistics business as a percent of total revenue. It's been fairly consistent in the last couple of years at around 35 percent as I said earlier, and revenue per truck should improve to be more in line with industry norms.

On the cost reduction front, we utilize a strategic partner named Ahree [phonetic] to assist us in identifying, implementing, and realizing many of these cost saving initiatives. In calendar year 2018, they helped us implement annualized cost savings of $2.4 million, and we are targeting $3 [million] to $4 million in 2019.

Finally, USA Truck has struggled with account acquisition and retention in the past, and while we have worked diligently to hire the best, train our teams on core business and process discipline and execution, we still want more for our people. To that end, we have started a leadership academy program to invest in our people, with the goal of growing some of our best future leaders in-house. Although I don't intend to talk too much about the details of this initiative in future quarters, I will say we should expect the future leaders of USA Truck to come from within as we continue to make investments on this front.

We've now delivered six consecutive quarters of profitability by doing exactly what we said we would do. Our team remains focused on our priorities of competitive pricing, seating trucks, and putting revenue on those assets while growing our logistics share of the market. We have outlined in the past that we have many opportunities to improve our cost structure and execution by eliminating structural deficiencies. Our operations recently shifted to a more regionally focused design that allows us to better cater to the needs of our drivers, service freight more consistently, and address our issues related to driver domiciles outside our network.

We have historically had issues with our lack of sufficient maintenance locations within our network as well. The addition of Davis directly addressed that in the Southeast, and we're making great progress on further expanding our facility footprint in 2019.

Next, our past equipment management processes resulted in a high average fleet age, expensive replacement cycles, higher maintenance costs, and dissatisfied drivers. We have addressed this issue head on, and due to disciplined fleet investments over the past year, we now have a 2.7-year-old age of fleet, and we expect the cost reductions, especially on the maintenance front, to follow.

Each of these actions will help us reduce unnecessary operational-related waste, while supporting our improving network with all the corresponding results that come from that effort. The future is bright at USA Truck. We remain committed to our commercial improvement and feel we have unique opportunities to improve our cost execution with the investments we've made over the last two years. Our team views this opportunity as a unique chance to return this company to sustained profitability and make a difference to our shareholders, coworkers, communities, and industry partners. A self-help story in a commodity-like business is the best kind. All we have to do now is continue to execute, and we think we're off to a pretty good start.

So with that, Keith, I'll turn it back over to you for questions. Thanks.

QUESTIONS AND ANSWERS

Operator
Yes, thank you. 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 are 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.

And the first question comes from David Ross with Stifel.

David Ross
Good morning.

James Reed
Hey, Dave.

Jason Bates
Hey, Dave.

David Ross
I wanted a few — I guess start if off just talking a little bit about the trucking business and the trends. Yield does not equal price, and you commented that the contractual new rules [sic] are coming in that 5 to 7 percent range, but if we're thinking about the next few quarters post-Davis here, is that 12 percent-revenue-per-loaded mile and a 10 percent drop in utilization a good thing to think about as the next few quarters as we go out?

James Reed
Yeah, I'll give my thoughts, and then Jason will give the right answer. We haven't typically gotten into a discussion really about yields. I would say that what we saw in the quarter was a little exceptional in terms of what we expect on the rate front going into 2019. We do expect it to be a little more muted for sure than it was in 2018. As it relates to yields, I'm hesitant, Dave, to give too much direction about that, because we just think there's a massive opportunity there. We've talked about some of the waste that exists in our business, and it's really about utilizing our assets better to get more revenue on those, and I don't think it would be extraordinary to deliver that kind of yield improvement in 2019, but it's going to take a combination of our improved utilization efforts combined with the rate improvement. I don't mean to dodge your question. It's just not something that we feel comfortable giving a lot of direction on, but maybe even more nebulous is to say we look at what our industry competitors are doing, and we think the bar is pretty high, and we have a long ways to go to get there. And so, Jason, what —

Jason Bates
Yeah, I think you summarized it well. I think different people talk about yields in different ways. If you're talking about yields from a rate perspective, Dave, James threw out that 5 to 7 percent, that's on new business that we're entering into, but let's not lose sight of the fact that last year we had 20-plus percent rate increases in the first three quarters, and 12 percent in the fourth quarter, some of that inherently is going to carry through into 2019 on top of what we're getting on new business. That's one aspect on the rate side.

But in terms of what we really focused on, which is revenue-per-truck-per week, which is what James was addressing, we have some work to do on the utilization front, and not to use it as an excuse, but it was a hindrance in the fourth quarter when we had all these new trucks coming in.

It did create a little bit of a utilization headwind for us, which I don't expect to recur in future periods, because we've worked with the OEMs to streamline that process, we don't get a glut of trucks in November and December like we ended up taking this last year.

David Ross
Yeah, that makes sense. And was there anything peculiar about the fourth quarter from a seasonality perspective on the margin? Some companies just have a much better fourth quarter than the other three quarters due to their customer exposure. Is that the case at USA Truck, or is this something that you see as more sustainable going forward, from a seasonality standpoint? Obviously, first quarter's not going to be as good as fourth quarter, but is it [inaudible]?

Jason Bates
Yeah, we actually said this a year ago when we participated in what we called the retail surge in the fourth quarter. That's something that USA Truck had not done historically, and I really appreciate the question, because it gives us a chance to reiterate that we did that again in 2018, and, 2017 results were dramatically better than 2016. We said that that would be part of our ongoing strategy. We executed on that again and still got another 12.1 percent increase in our rate, and I think on a seasonal basis, as you compare Q4's to Q4's, the last two Q4's are pretty typical, and what you should expect from us seasonally going forward.

James Reed
Yeah, both in terms of the change between Q3 and Q4 as well as the Q4 to Q1 slowdown that you referred to.

Jason Bates
Correct.

David Ross
And then you talked about being ahead of plan, which is always good to hear, in where you want to be, so that's it not all for naught, right? But when you look at '19 and '20, is that 300- or 400-basis point annual OR improvement still the cadence that you're shooting for, or as a result of being ahead of plan, is that a smaller number that you're looking for?

James Reed
Yeah, as you talk about our trucking business, we're here to talk about Q4, but it's helpful perspective to look at it on an annualized basis. Our trucking business is still running at a 96 OR for the year. We still see some opportunities there, but not to kick the can down the road, but just a little teaser. I'd ask you to tune in for my closing comments, because I'm going to address that specifically — well, generically but with some specific direction.

David Ross
Okay.

Jason Bates
Great.

David Ross
And the last question is just any comments on the used truck market, any changes there?

James Reed
Yeah, go ahead, Jason.

Jason Bates
Yeah, I would just say —real quick, as a follow-up to what James said, to be clear, we're not backing off our 300 to 400 target, but keep in mind we set that target a year ago, we've exceeded that and we're still holding ourselves accountable, but the goal — when we were doing that math, we were at 100, 102 OR in our trucking operation, we said 300 to 400 a year over a three-year period is going to get you down to the low 90s. We're still targeting during that three-year horizon to getting to the low 90s. The trajectory and how quickly we get there and how much is in each period, more to come. But James will talk a little bit about that in the closing remarks as we talk about our strategy going forward.

But now, directly addressing your question about the used truck market, we made a strategic decision early in 2018, to hold onto some trucks longer than we had initially anticipated keeping them. Now, that was dilutive from a maintenance expense perspective, but the reason we did it was because we wanted to try to minimize any losses on the sale of that equipment. And that worked out for us, and in the third and fourth quarter, that strategy paid dividends as we saw that we were able to get out of those trucks, breaking even or even with gains. I think it's safe to say from where we were in Q1, Q2, where the used truck market was in Q1, Q2 versus where it was in the back half of the year, it was definitely improved. Now, is it as strong and robust as it was? I would say two years ago, no, but it's better than it was in the first half of last year.

David Ross
Excellent. Thank you very much.

James Reed
It's our pleasure. Thank you.

Jason Bates
Thank you, David.

Operator
Thank you. And the next question comes from Jason Seidl with Cowan & Company.

Jason Seidl
Good morning, gentlemen. How are you?

James Reed
Good. How are you, Jason?

Jason Seidl
I can't complain. I want to kick off talking a little bit about 1Q and how we should look at it. When I look at your last two first quarters in the trucking business, you didn't post a profit. I'm assuming, given the trends that we've been seeing from you and the nice progression that you've shown, that 1Q '19 should be a profitable quarter for the trucking business?

James Reed
Yeah. You're trying to get me to share things that I don't want to disclose here, Jason. Yeah, the answer is —

Jason Seidl
Who, me?

James Reed
Yeah, right. The answer is yes. Yeah, I mean, our internal plan, which we never disclose our internal plans, but I'll just say directionally —

Jason Seidl
you can just email me, that's fine.
James Reed
Yeah, exactly. But it is to be profitable in the trucking business. That's clearly the next hurdle for us to clear. As I said a moment ago, trucking OR is 96-1 for the year. There's just a lot of room for improvement there. So I —pursuant to the question we received from Dave earlier, and Jason did a great job clarifying this — we still think there's 300 to 400 basis points to go for a couple years down there. Q1, that started off really slow for a couple weeks, and then the last few weeks, and even as recently as yesterday's business and this morning's revenue trend, have made a pretty roaring comeback, we're pretty bullish on that.

Jason Seidl
Yeah, that's me knocking on wood there. Some questions just in terms of — with some of the trends we saw in the fourth quarter with Davis. Obviously, there's a lot of moving parts in 4Q. How should we think about the following two items for modeling purposes: your total miles now with Davis in and also the deadhead? Because I'm assuming some of that just increased because, you acquired Davis, and everything was new and then you might be smoothing that out as we go on the next couple quarters.

James Reed
I'll let Jason hit on the total miles vector. Miles are going to go up from an overall standpoint over time, obviously, because we've added a significant number of trucks, pursuant to that acquisition.

Deadhead, I'll just say a couple things. Remember from the announcement, what we did say publicly about Davis, it's a quasi-dedicated business, and, as a result, those businesses often will run deadhead, but it will be paid deadhead miles. We're going to incur higher deadhead in a more dedicated business, but I promise you it's a more profitable way to run the business, and I don't know what you'd say about total miles, Jason.

Jason Bates
Just a reminder, when you look at the fourth quarter, what's included in our reported numbers is just October 18th through December 31st. That's one thing I just want to remind everyone about, the stub period. You don't even have a full quarter effect in those numbers but obviously fourth quarter is seasonally stronger than the rest, than Q1 would be.

Jason Seidl
Correct.

Jason Bates
You want to factor that in as well, but, James touched on it. The Davis model is a lean cost structure with candidly, lower utilization, slightly higher deadhead, and pretty good rates, but the net financial return is very accretive to our business model, and the team down at Davis is going to continue to work hard to drive more miles, lower deadhead, and there are some synergies that we will be able to realize between our two businesses to help minimize some of that unnecessary deadhead. We're working on those and communicating on those, but those are things that we'll realize over time, and, candidly, that's just icing on the cake as it relates to this acquisition for us.

Jason Seidl
All right. Thanks, that's good color. I want to jump back on the truck market, for example. You said you basically have taken delivery of all the OEM tie-up trucks that you had last year. Does that mean that you're going to have more for sale in 2019, or did you dispose of those before year-end?

James Reed
We either got rid of them or had them getting ready to be sold right at the end of the year. Where we're sitting today, most of them are gone. I would tell you that keep in mind, though, that USA Trucks had kind of underinvested for a couple of years, and last year was a big investment year, but now we've got to get on a regular cadence. We're going to be bringing in 300 to 350 more trucks this year, starting here in the first quarter, and we will be continuing to get rid of the old trucks and bring in the new ones.

Jason was a little vague about this earlier in the call, but, I want everybody to understand that our operating model is to receive those trucks, preferably in the first half, certainly in the first three quarters of the year. It is not our operating norm going forward to be receiving masses of trucks in the fourth quarter. That was unusual, and we're going to do everything we can to prevent that. Early signs from the OEMs, by the way, are no problem. They're meeting their delivery schedules right now, even as we're only a month and a week into the year, but they are hitting delivery schedules as planned. That's very promising compared to what we experienced last year.

Jason Seidl
Good to hear that. The last one, and I'll turn it over to somebody else. Other opportunities out there like Davis for USA Truck?

James Reed
I'll take that one. I think we signaled to the market what our intentions are with the Davis acquisition. Again, just as we said to Dave, I don't want to diminish my closing comments, but we're planning — let me address that a little bit in my closing comments. We're going to clarify our market position over the next couple months, and we're going to do that in a forum that makes sense for everybody, but we're not going to do it on this call.

Jason Seidl
All right. I'll go grab the popcorn and wait for the remarks.

James Reed
Okay. All right.

Jason Seidl
Take care, guys. Thanks.

Operator
Thank you, and the next question comes from Scott Schoenhaus with Stephens.

Brad Delco
Hey, guys, it's Brad Delco in for Scott.

James Reed
Oh, wow. Surprise visit.

Brad Delco
I got booed off the stage pretty quickly, so I got in on the call.

James Reed
Hope you didn't take my comments about the State of the Union too personally. We're glad you're here.

Brad Delco
No, it's all good. Glad to be here. I wanted to follow up — I know you guys have talked about ways to leverage the Davis acquisition, and I think you tied in some comments about where your freight was versus where your drivers were domiciled, and I was just curious, has there been any change in that or any updates, and how do you think that could impact your P&L in '19, or is that too soon to start seeing some of the impact?

James Reed
Great question, actually. In my prepared comments, I only briefly mentioned that we've undergone a recent change to a more regionalized model here at USA Truck, and so there's a nuance in the way that we've run our business, that we've essentially had fleets that ran our entire operating area, and literally, Brad, within the last few weeks, we have split up the operating area into discernible regions, and I will call it a domicile-driven region model. Sorry if I'm getting too detailed, but that was a direct result of the Davis acquisition, Davis gave us the first kind of de facto Southeast regional operation. We then took the rest of our business and split it into regions. One of the questions we think is pretty obvious, but we think it might be thoughtful when compared to our peers, is we've talked to other people that have had acquisitions in their history — is we're trying to avoid what I will call lane conflict. We have gotten together, identified all of our drivers that live in the region that Davis serves so well. We've actually had some cross pollenization where we've moved some USA Truck drivers — I don't want to give the wrong impression — it's not a lot, but it's more than ten — USA Truck drivers from USA Trucks' network into the Davis network, and they're working now driving trucks in the Davis network, because it was a better fit for them. We also have USA Truck drivers who drive in the rest of our network who live at domiciles in the Davis operating area. We've worked with the data; the facts; the profitability measures: by lane, by driver, by customer to understand where it makes sense to have those drivers driving the USA Truck fleet versus the Davis fleet, and sorry to be so longwinded, but you can tell I'm pretty excited about this change. We're making sure that we don't have lane conflicts where we're competing against ourselves with specific customers on given lanes. A really longwinded answer but a fantastic question. Yes, the Davis acquisition promise of better regionalization has come home to roost. It's working exactly as we had hoped, and, yes, I won't give you a number, but I would expect it to help our 2019 results, for sure.

Jason Bates
As James alluded to, the goal now is to replicate that in other parts of the country.

Brad Delco
This is another way of me asking what your add-a-route [phonetic] miles are. I guess I still can't get that answer?

James Reed
That's a great question that we will never answer, but as we did, I don't mean to be so silly, but last quarter we alluded to the fact that we have high add-a-route miles compared to our competitors. I can tell you that year to date in the first quarter, we've already seen a pretty

significant improvement in that measure alone. It's a direct result of all the factors that I just explained to you. If you start figuring out how much a percentage of add-a-route miles need to accompany, we didn't disclose the exact number, but we did say that we were 10 percent higher than everybody else, given what we think an operating norm is. It's a real big opportunity for us.

Brad Delco
Great. Jason, I think we're all trying to figure out the impact of Davis on the blended metrics, and I know you mentioned utilization was negatively impacted by the company taking delivery of equipment. Can you maybe provide us some context? Was it 200 basis points? Do you have any idea of what that did to utilization in the fourth quarter?

Jason Bates
We actually have it broken down between Davis, unseated trucks, dedicated growth. We're just not comfortable providing that level of detail at this time in terms of breaking it out. I can think through that and see if there's a way for us to give you guys some guidance in terms of how to model that, but given that those aren't segments that we report, it's hard to break that out.

James Reed
Nor are they mutually exclusive, because we manage those assets in the place where they give us the highest returns, we're swapping assets all the time between those three internal operating entities. What I think — and this probably doesn't help you with the level of specificity in your modeling that you would like; and Jason can work with the sales side to make sure everybody's on the same page here and get this information to the market in a thoughtful and smart way, but Davis, what we said was a mid- to high-80s OR business, and we would reiterate that today. That takes you past all the natural assumptions down to, they got a couple hundred trucks and they operate in the mid-80s, that should be able to help you with your modeling, and, Jason's right. We don't want to get to that level of specificity, but hopefully that keeps you on track.

Brad Delco
No, that's great. And then a last question, Jason, for you, in terms of the balance sheet. I think you're at 2.7 times debt to EBITDA. Where are you comfortable with that being after this year, and I would assume best uses of capital, invest in the business, but are you focused on deleveraging? And I apologize if you guys already discussed this, but I jumped on late.

Jason Bates
Great question. You're right. When you include proforma financials for Davis, we're at about 2.7 times now. We've been saying, ever since James and I got here, that we're comfortable between 2 and 3 times. Obviously, you have to pay attention also, though, to the market environment, right? We felt comfortable levering up a little bit for this acquisition, but as you can see, we already are paying down debt since that acquisition.

We believe even with a meaningful investment this year in assets, continuing to replenish our assets, that by the end of the year, we'll be below 2½ times, and that's with a pretty hefty investment in fleet. We're comfortable at those levels. Now, if we looked at other opportunities and there was a great Davis-like opportunity out there, we would evaluate it, and we would look at the market factors and forces and make sure. What we don't want to do is excessively lever up into, a downturn, just because from my history, having been at Swift and having had lots of leverage in a really rough market, it can create unnecessary strain from an investor and bankers' perspective, we want to be mindful of that, but we also want to be opportunistic, and if there are good deals to be had out there, we're going to take a hard look at them.

Brad Delco
Okay. Well, great. Well, guys, thanks for fitting us in.

James Reed
Our pleasure. Thanks, Brad.

Operator
Thank you, and the next question comes from Jeff Kaufman with Loop Capital Markets.

Jeff Kaufman
Thank you very much. Hey, congratulations, guys, good morning.

James Reed
Thanks. Good morning.

Jason Bates
Good morning, Jeff. Thanks.

Jeff Kaufman
Good morning. I just wanted to follow up a couple questions here. First of all, modeling truck count, I know the Davis numbers were in for most of the fourth quarter in your average truck count numbers, but, full-year, year-end truck count's probably a little different?

Jason Bates
Yeah. Go ahead and give him that.

James Reed
I'll just put this out here so that we've all got the numbers. As of the end of the year, we were at 1,937 — is that the December average?

Jason Bates
Yeah, the December average was 1,937, and that would have had all of the Davis trucks in there as well.

Jeff Kaufman

Okay, and then —

James Reed

[Inaudible]

Jeff Kaufman

Go ahead.

James Reed
They're having to deal with a stub period there that's thrown off that average.

Jeff Kaufman

Okay, thank you. That was helpful. And then between the unseated truck levels and a lot of the late deliveries, as I think about truck capex, you mentioned about 350 more trucks in 2019, how should I think about capex '19 relative to capex '18 with the number of unseated vehicles out there?

Jason Bates
We have some unseated trucks today, but a lot of that has to do with getting drivers in and out of old trucks, into new trucks and having received a lot of them in December, which is historically a difficult month to be recruiting drivers, we're aggressively working to seat those trucks, and we're fairly confident that we'll be able to do so, but that doesn't change our goal to stay on top of refreshing our fleet. We're intending, like I said, to buy roughly 350 trucks this year. That's for both Davis and USA Truck, because we're going to be replenishing the fleet on both sides there. We're also looking at some trailers, and James talked a little bit about technology and some of the investments that we're going to be making this year on that front, but we're going to be targeting, depending on which things we end up pulling the trigger on, somewhere between $50 [million] and $55 million of net capex this year.

Jeff Kaufman
Okay, which brings me to the telematics question. Whose telematics system are you putting into the fleet, and can you talk about some of the benefits that you're looking to get out of a telematics network across your fleet? And do the telematics plans include the data suite?

James Reed
A really good question. A couple ways to answer that. First, let me start with Davis, and I'm not going to turn this into an advertisement for vendors at this point, although I did talk to one vendor during the call, but, Davis is on an ELD solution that's fantastic and compliant and all those things. USA Truck, and we mentioned this before, is on an LBR solution, which has until December 16th, 2019, before you have to be fully compliant on ELB. I want to make sure everybody understands. We're compliant with the ELD regs, fully compliant, and we have been since they went into place, we've been ahead of that for years. That said, we have to make a change this year, either upgrading with our current provider or looking at another provider. We haven't made that decision yet about exactly who we're going to use. We've done some pilots with both our existing provider and some new providers. I will tell you there's some super cool technologies out there in the form of what I'd call a puck [phonetic] solution that allows you to use an iPad-type device or some kind of tablet device that allows you levels of customization to manage your fleet to communicate with your fleet, to deliver training that's not available on the current technology. We're actually in the middle of our second proof of concept, coming very close to the end of that, and we'll be targeting a final decision and implementation starting in April. That's as far as I'm willing to go with that question, but it's a great question.

Jeff Kaufman
Okay, and beyond the ELD's, telematics is a much broader product, can you talk about some of the benefits that you're looking to accrue as you roll out telematics across the fleet?

James Reed
I'll talk about them very broadly. In my prepared comments, I mentioned that we had done a two-day technology strategy offsite. My background — I've been in trucking for eight years, and Jason's been in trucking for 16 years, but prior to that, I was a tech guy, everybody knows my background, Intel, EMC, T-Mobile, [WaMoo [ph].com. Our team brings a level of imagination to the playing field that maybe doesn't exist elsewhere. We brought in a professor who's an expert

in artificial intelligence, and we brought in an outside vendor, actually from one of my former employers, to talk to us about advanced business analytics.

We've got a vision for using the data that's available from those devices to help improve the lives of our drivers, provide them more meaningful feedback, and, frankly, at the end of the day, I always say we're capitalist pigs. We're here to make money for our shareholders. We think we can run the business more profitably, and you can start to imagine things like, everybody in the industry talks about optimizing their route recommendations to a driver based on profitability, but have you ever thought about whether individual drivers have individual profit profiles, and an individual might be better capable to run a specific route based on their own history using artificial intelligence to predict how they're going to do on a given dispatch?

There's stuff like that that's intentionally vague, because we do think we have a little bit of secret sauce here. To be clear, and this is more for our employees that are on the call than for our investors that are on the call, we have to execute on the basics first. We've got an antiquated TMS system that has to be overhauled, and that's actually implementing in the next eight weeks. We have to start optimizing with the technologies that are available, and we have to get our telematics deployed. We have a great imagination about these things, but let's be honest, we're still at 96 OR in our trucking business. We don't have permission to get super creative until we get into market-level performance on those measures. An area I'm super passionate about. I hope, Jeff, that gives you some color about where our head is and some of the things we're thinking about.

Jeff Kaufman
To your point, there's some pretty cool stuff out there, but, you can have all the data in the world, but if you're not managing it properly, it doesn't make a big difference, but it sounds exciting, thank you for your answer.

James Reed
Thanks. Thank you, Jeff.

Operator
Thank you. And, once again, please press star, then one if you'd like to ask a question.

And the next question comes from Barry Haimes with Sage Asset Management.

Barry Haimes
Good morning, guys. Great quarter. Just a couple follow-up questions. One is on the capex. You mentioned the number for '19, 50 to 55. What was it in '18, just to get the comparison?

Jason Bates
Our target for the year was 40 to 45. We ended up getting some really favorable leasing options and opportunities towards the end of the year that caused us to not end up having to utilize the full extent of that range, and then we had Davis, that came into the picture too that muddied the waters a little bit. You can see at 50 to 55, we are expecting to be slightly higher, but that's because of the investment in Davis next year as well.

Barry Haimes
Got it. And then just to get a feel for the character, [unintelligible] the end of the year in terms of representative fleet was automatic transmission. How does that compare to the start of the year,

and when you take the new deliveries of '19, when you get to the end of '19, where will that metric be? I don't need an exact number but just to get a flavor of the progression.

James Reed
That's a good question, Barry, because, that relates to your ability to recruit new drivers that are entering the industry who almost all have automatic — or, qualifiers on their CDLs. At the end of 2017, we were at 74 percent of our fleet. That was manual transmission. Every truck that we've bought is an automatic transmission. Every Davis truck is an automatic transmission, we're at roughly half the fleet now that's automatic transmissions, and by the end of 2019, it will be three-quarters of the fleet.

Barry Haimes
Great. And just maybe one question back on the contract pricing and what you're seeing so far. That's a great metric you talked about of 20 percent with some of the core customers' 5 to 7 percent rate, but as we know, as we went through the first quarter and went through the year last year, the rates got stronger, January to March, March to May and June, let's say. When you compare that rate you're getting now of 5 to 7, which I'm presuming is — somebody's negotiated earlier last year, and then you compare to that rate per mile, if you will, a similar type [lane] to somebody who renegotiated in May or June and got a bigger increase, is that rate looking up a little, down a little, flattish? If you get the gist of my question, I'm trying to get a flavor of — because the 5 to 7, as we go through more months, you would think would go down if rates stayed the same, I'm just trying to get a flavor for that.

James Reed
I'm going to give another one of my longer answers, because there's a lot of color for what you just asked. The first thing is a point that Jason made, and I just want to make sure everybody gets. The rates that were rebid, and maybe this answers your question, Barry, in the third and fourth quarter, were up 20 and 12 percent. That's what manifested itself in our performance. Q3 was up 20 percent year over year, and Q4 was up 12 percent year over year. Of course, our rate negotiations that are inherent in those quarters. Those rate wins that went in in those quarter, to your point, they're usually on about a year [fuse], they rebid those in a year's time. There's a lot of carryover effect from that.

The other point to make that you nibbled at the edges, but our commercial guy I was talking to the other day confirmed for me that the bid season is actually accelerated. A lot of bids are moving forward this year, because people have to remember, and I know that you know this, contract bid awards are slightly more valuable than the paper they're written on, because contract awards are not a guarantee to do business. They're more a reflection of the customer's intention about how much of their business they're going to throw your way as a provider. As we look at the 5 to 7 percent number that we gave you, that considers the calculus of the year. We have some pretty strong rates in the first half of the year. We're going to have tougher accounts in the back half of the year, but we feel pretty good that 5 to 7 is the number for the full year, and that contemplates the dynamic that you explained.

Barry Haimes
Got it. Thanks. That's helpful. Appreciate it. Thanks, guys.

James Reed
Thanks, Barry.

Jason Bates

Thanks, Barry.

Operator
Thank you, and the next question is a follow-up from David Ross with Stifel.

David Ross
Thanks for having me back on again. Just a quick question related to the refinancing last week. You mentioned it helped the interest expense outlook, if you did $1.2 million interest expense in the fourth quarter, should it be a little bit lower as we look at the 2019 quarters?

Jason Bates
It was roughly a 25-basis point improvement, because, what LIBOR does, and what the Fed does is going to affect what interest expense might be, but simplistically, that's the improvement there. When you think about the fourth quarter, there was a lot of things that got muddied up from the data transaction as well, but when you're modeling out our debt and what we've got on the balance sheet as debt and you look at what we had previously, you would want to look at that and say there's going to be a 25-basis point improvement going forward.

And keep in mind, as we paid down debt in the fourth quarter, the goal will be to be paying down debt in the first quarter and throughout the year, those are things that factor in when you're looking at how you model that.

David Ross
And were there any changes to covenants with the new agreement?

Jason Bates
Only favorable improvements A lot of people have said that there were a lot of things that former leadership at USA Truck didn't do well over the last five to ten years. Well, I can tell you, the one thing they did really well was negotiate this credit agreement back in 2015. They got a great facility with minimal covenants, nice baskets, and our banking syndicate has been very, very good to work with and very supportive. We've effectively maintained the same structure, with slight improvements to pricing, small changes to some baskets and other things like that, which we've outlined in the 8-K that was published or put out on the 1st.

David Ross
Okay. Thank you very much. I'm going to stop there, because I can't wait to hear James' closing remarks.

James Reed
It's not that great. It's not that big.

David Ross
All right. Thank you.

Operator
Thank you. And as that was the last question, I would like to return the floor to James Reed for any closing comments.

CONCLUSION

James Reed
Thanks, Keith. As we shared before, our motto in 2018 was, "USA is Back." For 2019, the slogan will shift to "Tradition with a New Vision." We're happy to report that our recent performance is ahead of the schedule we committed to you and in line with the questions you guys had.

The challenge is that we aren't satisfied with just being average. We want to be best-in-class, and in order to accomplish that, we need to keep executing and improving on our operational and financial results such that USA Truck continues to move upward and to the right in our future performance. Yes, our remaining commercial and cost opportunities that lead to continued, albeit slower paced, improvements, but we are not content with this result. It is not a final destination; we need to update our direction to accomplish our goals.

With this in mind, we look forward to hosting an Investor Day in New York City on May 8, 2019. The details and the venue and time will be forthcoming, but we look forward to sharing more of our future vision, expounding on our growth opportunities, and giving more insight to our costs and commercial opportunities. We think this is needed, given our accelerated performance vis-à-vis what we previously communicated, and now it's time to talk about what's next.

Jason and I will be in New York this week, and we'll be in Florida next week for some sale-side conferences. We look forward to seeing you there, and, as always, we appreciate the support. Thanks.

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